Edelweiss Wealth Research

Home First Finance Company India Ltd

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Date: September 16, 2021

Long Term Recommendation
Home First Finance Company India

Financing homes for India's middle class

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- **Home First Finance India Company (HFFC) is a technology driven affordable housing financier focused on salaried customers (74% of total AUM) and home loans (92% of total AUM) with strong presence in markets like Gujarat and Maharashtra (57% of total AUM).**
- **HFFC delivered robust 49% AUM CAGR over FY17-FY21 despite FY21 being majorly impacted by the Covid-19 pandemic. While asset quality was impacted in FY21 due to the pandemic, it is expected to improve (with the exception of a third wave) as its early deliquencies in terms of 1dpd+ remains best in class.**
- **With AUM growth expectations of ~26% CAGR over the medium term, technology usage ensuring further optimisation of operating costs and normalisation of credit costs, we expect HFFC to deliver RoA/RoE of 3.4%/12.7% by FY24E with both operating and financial leverage kicking in.**
- **We initiate coverage with a 'BUY' recommendation, valuing the company at ~4x FY23E ABV of INR191, resulting in a target price of INR763, implying 33% upside from current levels.**

CMP INR: 573
Rating: BUY
Target Price INR: 763
Upside: 33%

Bloomberg:	HOMEFIRS IN
52-week range (INR):	640 / 441
Share in issue (cr):	9
M cap (INR cr):	5,011
Promoter Holding (%)	33.7

Stable spreads and improvement in opex/credit costs to drive RoA expansion

HFFC has managed to maintain yields near 13% (in line with peers) despite having higher proportion of salaried customers and higher mix of home loans (v/s peers). Further, HFFC is planning to increase its LAP mix from current 6% of AUM to 15% of AUM over the medium term which is likely to support yields. Cost of Funds (CoF) for the company has been declining due to rating upgrades (from BBB- in 2013 to A+ currently), which should ensure spreads between 4.8-5%. We expect RoA to expand to 3.4% in FY24 (v/s 2.5% in FY21) owing to moderation in opex/credit costs on the back of improvement in scale/asset quality, respectively.

Productivity ahead of peers driven by focus on technology

With a smaller branch network (v/s peers) and comparable employee strength, HFFC had the highest AUM/branch (INR59cr) in FY21. Employee productivity is also aided by adoption of technology with centralized underwriting, integrated CRM and cloud-based loan processing system (91% of loans were approved within 48 hours in Q1FY22).

Asset quality – impacted due to Covid, but should normalise FY23 onwards

Post Covid, HFFC's asset quality was in line with peers with GS-3 increasing to 1.9% in Q1FY22 (v/s 0.9% in FY20) and 1dpd+ at 8.9%. Credit cost is expected to be ~60-80 bps in FY22 due to impact of the second wave; however, it should normalise to 0.3-0.4% FY23 onwards. Management has also guided for 30bps reduction in GS-3 every quarter as the situation normalises.

Expect RoA expansion coupled with improving asset quality; Initiate with 'BUY'

We believe HFFC is well placed to capitalise on the high growth yet underpenetrated affordable housing market (projected to register ~20-25% CAGR over the medium term). Operating efficiencies and lower credit costs should ensure both RoA/RoE expand to 3.3%-3.4%/12-13%, respectively. Also, we expect asset quality to improve and the early delinquency numbers in terms 1dpd+ should provide comfort on the underwriting mechanism. We initiate with a 'BUY' recommendation and a target price of INR763, valuing the company at 4x FY23E P/ABV of INR191.

	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues (INR cr)	228	273	323	394	506
Net Profit (INR Cr)	79	100	124	170	227
Diluted EPS (INR)	10.6	12.2	14.2	19.4	26.0
P/E (x)		46.9	40.3	29.5	22.1
Adj. book value per share	118.5	156.6	171.6	190.8	216.6
P/ABV (x)		3.7	3.3	3.0	2.6
RoA	2.7	2.5	2.7	3.2	3.4

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Story in Nutshell

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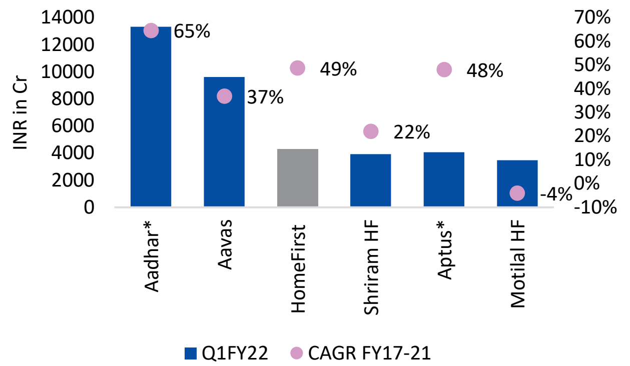
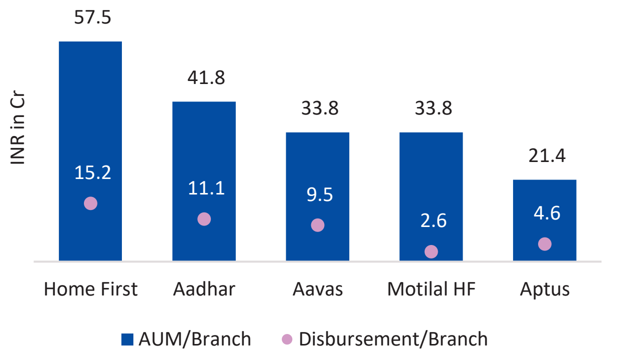


Exhibit 2: …with highest branch productivity among its peers



*Data as on FY21 and Growth rate higher due to merger of DHFL book

Exhibit 3: HFFC focuses on majorly on the home loans as compared to peers which also have LAP and other products

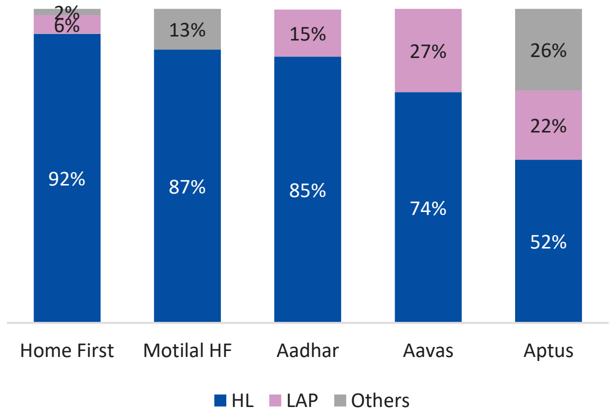


Exhibit 4: ..with higher share to salaried class (incl. informal class) compared to peers

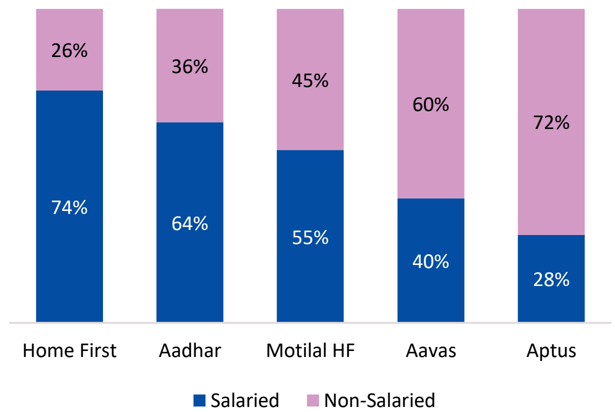


Exhibit 5: HFFC's yields and spread are comparable to peers despite higher share to HL and salaried contribution in AUM

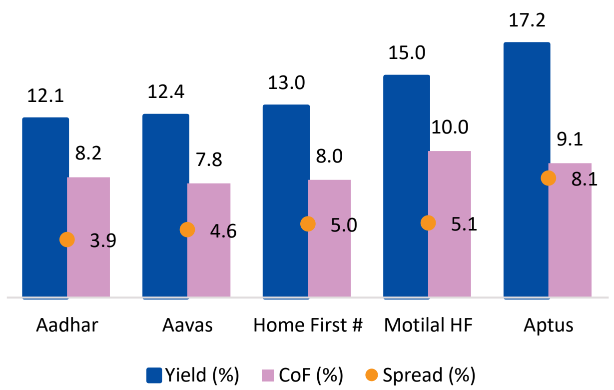
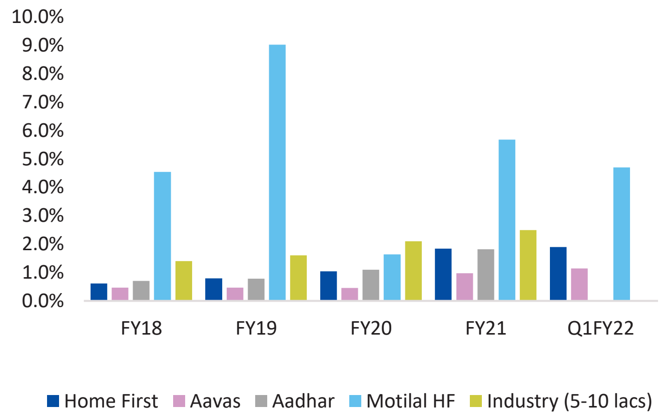


Exhibit 6: Focus on HL and salaried class has ensured GS-3 below sub 1% pre-Covid and lower than peers barring Aavas



#Except HFFC, DA income (net of expenses) for all other players are included in the interest income

Source: Edelweiss Wealth Research

Exhibit 7: High employee productivity due to optimum use of technology…

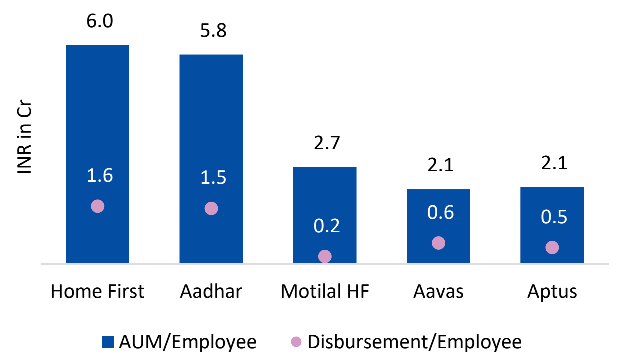


Exhibit 8: …resulting in comparable OPEX/AUM among peers despite being much smaller in size

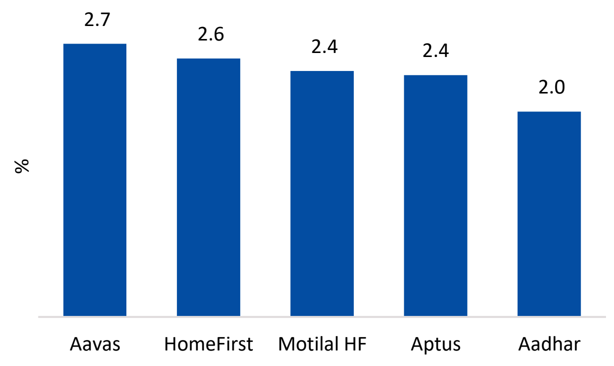


Exhibit 9: Asset quality has worsened due to Covid-19 but expected to improve going ahead

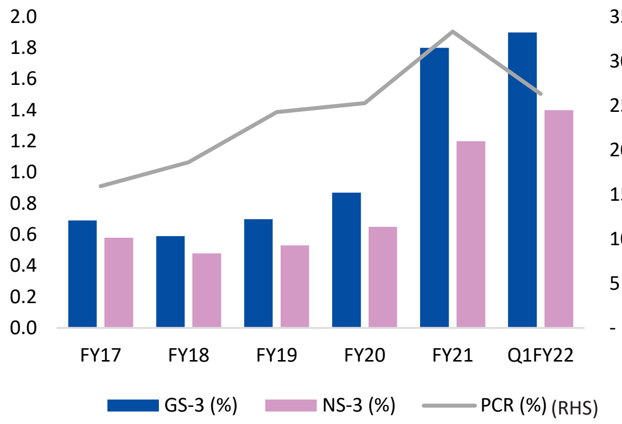


Exhibit 10: HFFC's 1+dpd has been in-line with Aavas in the past and better than Aavas in Q1FY22

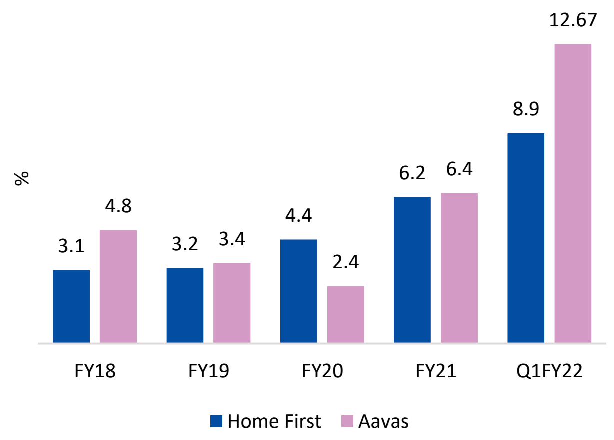


Exhibit 11: Returns ratio to surpass pre covid level by FY24 with improved leverage

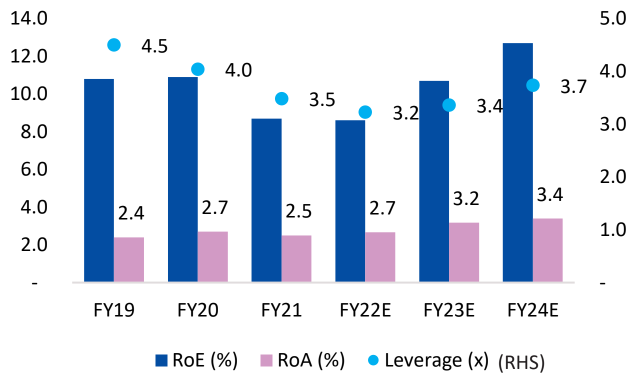
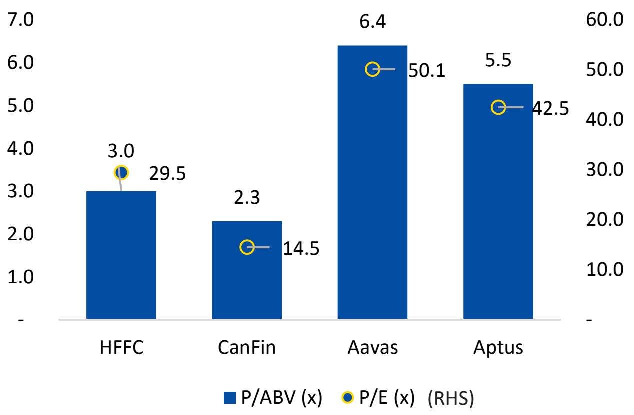


Exhibit 12: HFFC available at discount compared to affordable housing peers which is expected to close as RoA improves



Source: Edelweiss Wealth Research

We expect HFFC to register ~23% CAGR in net revenue and ~31% CAGR in PAT over FY21-24E driven by:

- Massive opportunity size of ~INR50tn in the Economically Weaker Section (EWS) and Low Income Group (LIG) categories with relatively lower competition from banks,
- Pickup in growth as the impact of Covid-19's second wave wanes,
- Centralised underwriting, integrated CRM and cloud-based platform loan processing system, which should ensure faster TAT and significant improvement in opex costs with building up of scale,
- Expectations of normalisation in credit costs with GS-3/NS-3 expected at 0.7%/ 0.4% by FY24, and
- AUM growth of >25%, lower opex and credit costs, and higher levererage, which should lead to RoA/RoE expansion of 90bps/ 405bps over FY21-24E to 3.4%/12.7% by FY24E.

Further, HFFC meets all our investment criteria such as:

- It is a technology driven affordable housing financier with strong track record of delivering ~49% CAGR over FY17-21.
- The company has best-in-class productivity parameters, which are expected to improve further with benefits of economies of scale (as observed in case of large HFCs),
- Significant presence in key affordable housing markets like Gujarat, Maharashtra, Tamil Nadu and Karnataka
- The stock being available at reasonable valuations considering its growth prospects and accretion in return ratios.

Thus, we initiate coverage on HFFC with a 'BUY' rating and target price of INR763/share, valuing it at 4.0x FY23E ABV of INR191.

Revenue/PPOP/PAT expected to grow at 23%/ 25% / 31% over FY21-24E

INR In Cr	FY21	FY22E	FY23E	FY24E
NII	219	236	285	365
Net Revenue	273	323	394	506
PPOP	166	197	248	324
PAT	100	124	170	227

RoA/RoE expected to return to 3.4%/12.7% by end-FY24E

	FY21	FY22E	FY23E	FY24E
RoAA	2.5	2.7	3.2	3.4
RoAE	8.7	8.6	10.7	12.7

We value the company at 4.0x FY23E ABV given the high RoA and growth prospects over the medium term

	FY24E	CMP/Target
4.0x	191	573/763

At current market price, the stock is trading at FY23E P/B of 3.0x

+

Expected RoA/RoE to increase from 2.5%/8.7% in FY21 to 3.4%/12.7% by FY24E

+

At target price, FY23E P/B is 4.0x

Upside of 33%

Business Value Drivers

Business value drivers		
	Nature of industry	The affordable housing finance industry (AHF) seen as loans with ticket size of <2.5mn in India's individual mortgage market is estimated at ~INR9.9tn as at FY21. The small ticket housing loan market defined as loans sub 1 mn ticket size is estimated to be around INR2.4 tn. In the overall mortgage market, banks are leading with ~61% market share, while market share of HFCs stands at ~35%. However, HFCs have a higher market share in the low-income small ticket housing space (0.5-1mn ticket size) at around 43% with very little presence of private banks in the space.
	Opportunity size	The mortgage market in India delivered ~11% CAGR over FY15-21. India's mortgage-to-GDP penetration stands at 11% currently (v/s 9% in 2018) with per-capita income expected to grow at 7.8% CAGR over FY20-25E. China has shown a similar co-relation – China's mortgage-to-GDP penetration grew to 31% in 2019 (v/s 8% in 2008) with per-capita income CAGR of 8.2% over the same period. India too is expected to demonstrate similar growth trajectory as shown by China.
	Predictability	HFFC delivered robust 49% CAGR over FY17-21; however, loan disbursements declined in FY21 due to the pandemic. As unlocking has started in the country and considering the consequent pent-up demand, we expect HFFC to deliever 26% AUM CAGR over FY21-24E.
	Sustainability	Due to HFFC's strong promoter group (True North and GIC), capital infusion by Warburg Pincus and its IPO issue, the company has strong CRAR ratio. This gives us enough comfort on HFFC's sustainability.
	Business strategy and planned initiatives	HFFC has robust underwriting process spread across three levels – (a) evaluation at branch level, (b) validation against digital databases, (c) centralised underwriting at the head office level at the time of loan approval and centralised validation of all previous processes at the time of loan disbursal. This, combined with advanced technology based underwriting makes the company stand out amongst peers. To further fuel growth, management intends to increase geographical diversification and reduce concentration in the top-3 states (Gujarat, Maharashtra and Tamil Nadu).
	Near-term visibility	Management aims to add 20 branches to its branch network over the next two years. It has also identified 50 different locations for digital expansion. This would allow the company to grow its business at a lower cost and increase profitability.
	Long-term visibility	Mini HFCs with asset size less than INR5,000cr have outperformed large HFCs by a whopping 35% CAGR over FY16-20. This outperformance can be largely attributed to the focus on LIG. Also, demand for housing is rising due to growing urbanisation, nuclearisation, increasing working population and higher per-capita income.
	Near-term risk	Covid-19's second wave impacted Q1FY22 and the possibility of a third wave could impact HFFC's profitability and future growth, leading to deterioration in asset quality. This in turn will impact the company's valuation.
	Long-term risk	Risks pertaining to credit, market, liquidity, interest rate, operations, IT and asset liability management. Though the company has a well established risk management framework, periodical monitoring will remain our key focus.

Mortgage market significantly under penetrated with enough headroom for growth post the recent head winds of RERA, IL&FS default and covid pandemic

I (A). Mortgage market still in infancy stage with long runway for growth

India's overall individual mortgage market delivered 12% CAGR over FY15-21 and is estimated to be ~INR23tn as at FY21. The sector's growth was severely impacted post the IL&FS crisis, which affected several large HFCs – growth stood at >15% over FY15-19 (pre-IL&FS), which decelerated to 5% over FY19-21 (post-IL&FS). Further, implementation of the RERA Act also resulted in considerable slowdown in the real estate sector.

Affordability at best level for decades coupled with low interest rates to act as catalysts for growth

On the flipside, the IL&FS crisis, RERA implementation and the slowdown in the economy followed by the Covid-19 pandemic resulted in the property market remaining stagnant for five years, which led to marginal decline in property prices over FY15-20 (slight uptick in FY21). However, annual income has steadily risen over the same period, pushing affordability (defined as property price/annual income) to its best levels in two decades at just over 3x.

We believe the mortgage market will resume its upward trend post normalisation of the economy with low interest rates acting as an additional growth kicker. We expect the individual mortgage market to register ~10% CAGR over FY21-25E.

Exhibit 13: Individual mortgage market's growth impacted post IL&FS crisis

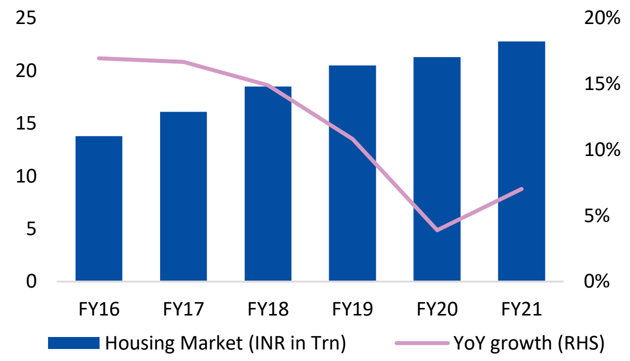
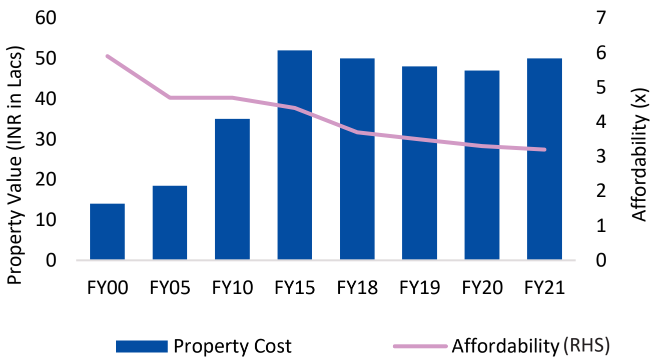


Exhibit 14: Affordability (Price/Annual Income) at best level in two decades



Source: HDFC, Edelweiss Wealth Research

Structurally, India's mortgage market is still largely underpenetrated. Mortgage as percentage of nominal GDP is abysmally low at 11% (v/s other emerging and developed countries), which implies huge scope for growth.

Exhibit 15: Mortgage as % of GDP growing in India...

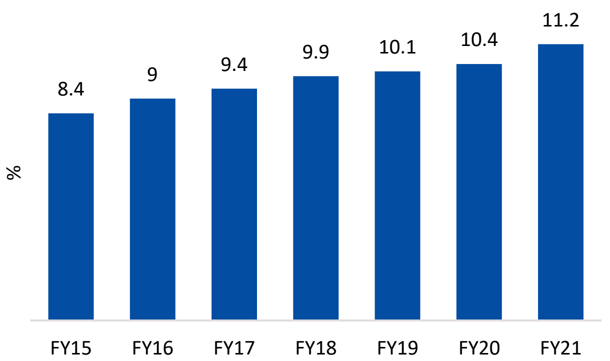
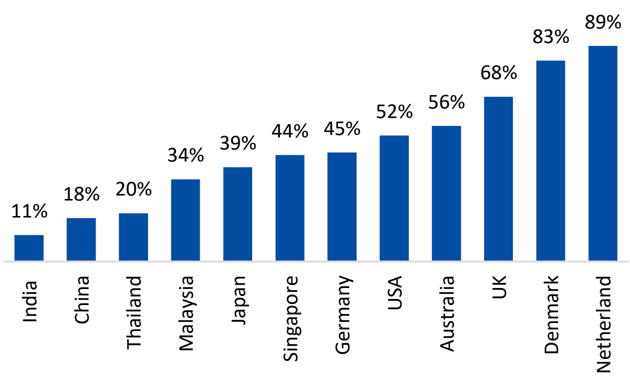


Exhibit 16: ...but remains much lower than peer countries



Source: HDFC, Edelweiss Wealth Research

95% of the housing shortage is in the EWS and LIG segments which presents an opportunity size of INR 50tn

I (B). HFCs dominate the small ticket size housing loan market

Affordable housing finance (AHF) is broadly defined as housing loans up to a ticket size of INR25lakhs. AHF accounts for ~80% of volumes and ~43% of value within the overall mortgage market. While this share has been declining over the years, AHF still forms a sizable chunk of the overall market. Moreover, as per a CRISIL report, the current shortage in housing units is ~10cr units. Of this, 95% shortage is in the EWS and LIG segments, thus, presenting massive un-tapped opportunity of ~INR50tn in the segment.

Exhibit 17: AHF loans accounts for 43% of value…

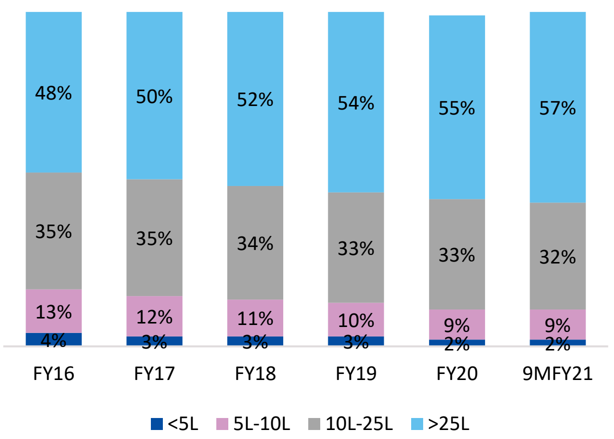
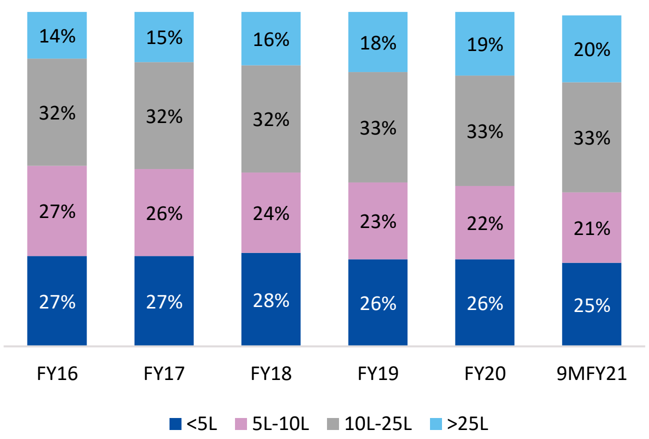


Exhibit 18: …and ~80% of volumes in individual mortgage market



Source: HDFC, Edelweiss Wealth Research

HFCs have established a niche in the sub-10 lakhs home loan segment

While banks dominate the overall mortgage market with ~61% share, HFCs share is a near 35%. Nevertheless, HFCs have a higher market share in the low-income housing space. Focus on self-employed/informal salaried customers, surrogate income, cash flow-based assessments, cash collections and low-ticket sizes makes the low-income housing space unattractive for banks. Thus, niche HFCs with a deeper understanding of micro markets have managed to gain a foothold in this segment.

Exhibit 19: Banks have gained market share in overall pie post IL&FS crisis

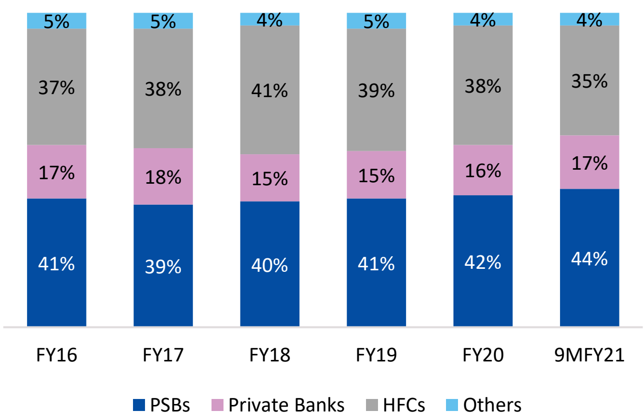
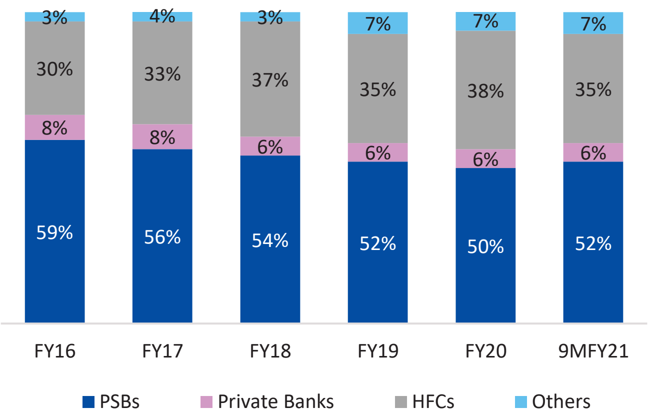


Exhibit 20: HFCs are increasing market share in low income housing space (loans up to INR 10lakhs)



Source: CRISIL, Edelweiss Wealth Research

Small/mini HFCs have outpaced large/medium HFCs in terms of growth leading to market share gain in the low income housing market

I (C). Growth divergent across the HFC universe

AUM growth of HFCs has been sharply divergent over FY16-20, with growth increasing sharply as the AUM size gets smaller. Mini HFCs with asset size less than INR5,000cr and focus on LIG have outperformed large HFCs by a whopping 35% CAGR over FY16-20. This outperformance has also resulted in market share gains for mini HFCs in low-income housing segment to 13% in 9MFY21 (v/s 3% in FY16).

Exhibit 21: Small/mini HFCs have outpaced large/medium HFCs in terms of growth (FY16-20 CAGR)*…

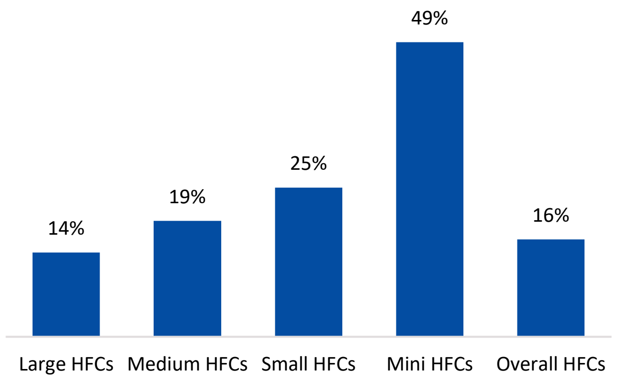
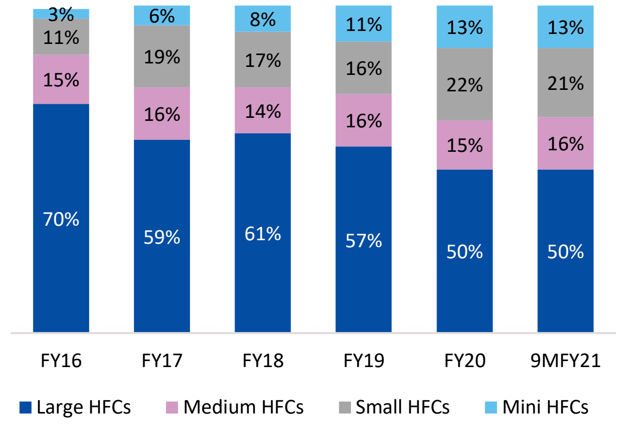


Exhibit 22: …leading to increased market share in low-income housing segment



Source: Edelweiss Wealth Research

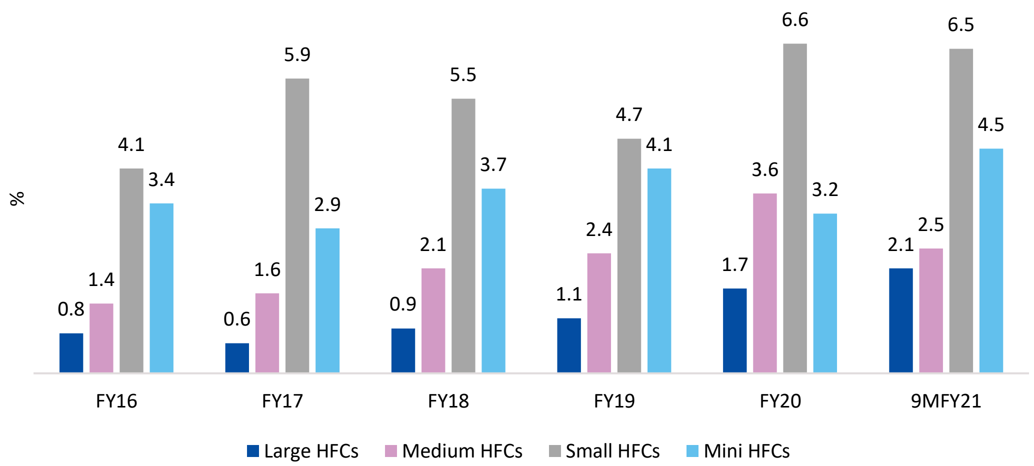
*AUM range for HFCs: Mini HFC – below INR5k cr, Small HFC – INR5k-15k cr, Medium HFC – 15-30k cr, Large – Above 30k cr

Asset quality worsens as the size of the HFC decreases as small and mini HFCs lend mainly to self-employed and informal salaried segment making

Assessment of cash flows and prudent underwriting ability are critical for these HFCs to maintain asset quality

Asset quality is markedly different for all four HFC groups – GNPA is the lowest for large HFCs, higher for medium HFCs, much higher for small HFCs. Historically, mini HFCs' asset quality is in between small/medium HFCs, which highlights importance of the underwriting process in this segment.

Exhibit 23: Asset quality markedly increasing as size of HFC decreases (barring mini HFCs)



Source: CRISIL, Edelweiss Wealth Research

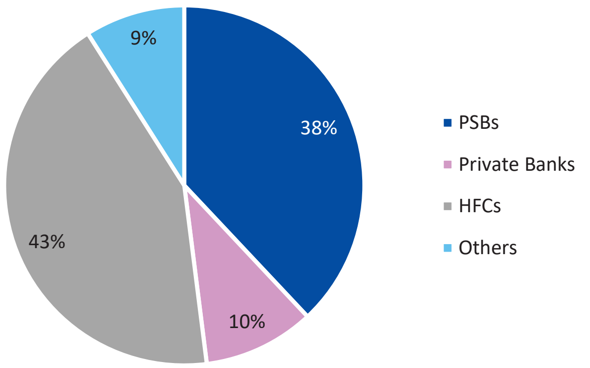
Mortgage loans with INR5-10lakh ticket size are dominated by HFCs, which have 43% market share, followed by PSBs

I (D). Banks facing tough competition from lower ticket HFC players

As at 9MFY21, HFCs with ticket size up to INR10lakhs (i.e., LIG) had an AUM of INR2.4tn. This translates to 11% value market share of such players in the housing finance market; however, market share in volume terms was significant at 46%.

Within this segment, mortgage loans with INR5-10lakh ticket size are dominated by HFCs, which have 43% market share, followed by PSBs. Private banks have miniscule presence in this segment.

Exhibit 24: HFCs lead INR5-10lakh ticket segment

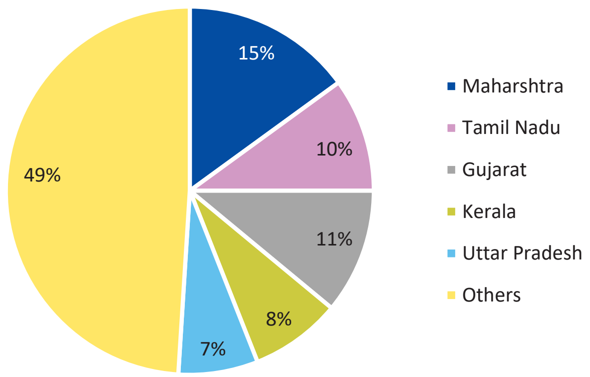


Source: Edelweiss Wealth Research

Even geographically, the housing loan market between INR5-10lakhs is fairly concentrated in five Indian states (Maharashtra, Tamil Nadu, Gujarat, Kerala, and Uttar Pradesh), which together account for ~51% of this market.

The market for housing loans between INR5-10lakhs is concentrated in five states which account for 51% of the overall market

Exhibit 25: Five states contribute ~51% of loans in INR5-10lakhs ticket segment



Source: Edelweiss Wealth Research

HFFC is a technology driven small ticket housing financier focused on salaried customers and the has exhibited the highest organic growth between FY17-21 among peers

II (A). HFFC – a tech driven HFC focused on LIG with strong track record

HFFC is a technology driven small ticket housing financier focused on salaried customers (both formal and informal) with robust ~49% AUM CAGR over FY17-21 (highest organic growth amongst peers). Aadhar (backed by Blackstone Group) have seen the highest overall growth amongst peers with 65% CAGR over the same period due to merger with DHFL Vysya in Nov-17. Growth moderated over FY20-21 due to the pandemic; however, we expect the company to register ~25% growth as the economy recovers with informal/semi-formal sectors coming back on track.

Exhibit 26: Robust AUM CAGR of ~49% over FY17-21

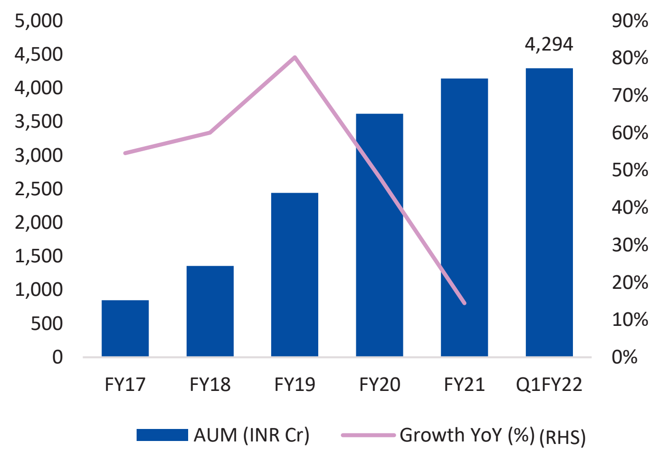
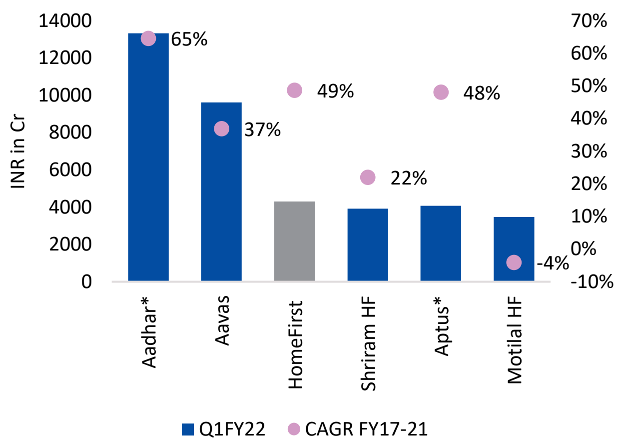


Exhibit 27: HFFC's growth robust amongst peers post adjustment of Aadhar's AUM



*Data as on FY21 and Growth rate higher due to merger of DHFL book

Source: Edelweiss Wealth Research

HFFC has continued to diversify its geographical exposure over the past four years

Approximately ~68% of HFFC's FY21 AUM exposure is in states that are major markets for low ticket housing loans (in the range of INR5-10lakhs). The company has also diversified its geographical presence and increased exposure in other states to 22% in FY21 (v/s 12% in FY17). Affordable/low ticket size HFCs generally have a core market in which they start operations and eventually diversify into adjoining states, which provides them with deeper understanding of customers' credit behaviour. Thus, all low ticket HFCs have significant exposure to one core state and HFFC is no exception with Gujarat accounting for 38% of its AUM.

Exhibit 28: HFFC has significant exposure in three states but diversification/ expansion is afoot in other states

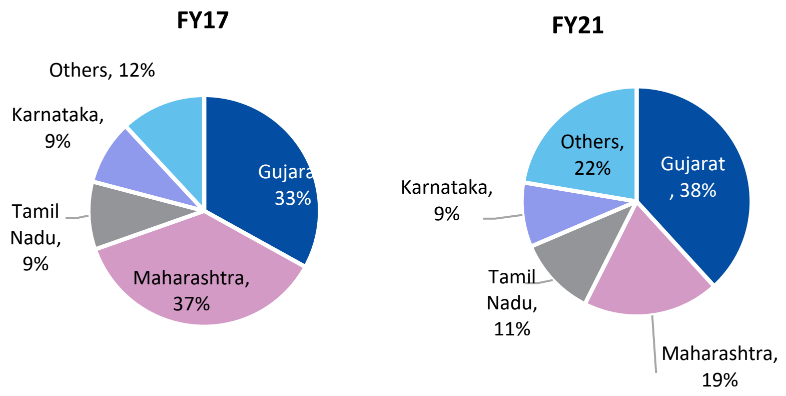


Exhibit 29: AHFCs generally have a core state in which they have major exposure

Companies	States	% of FY21 AUM
Aadhar	UP & MP	31%
Aavas	Rajasthan	43%
Aptus	Tamil Nadu	54%
Home First	Gujarat	38%
Motilal HF	Maharashtra	66%

Source: Edelweiss Wealth Research

HFFC has the highest exposure to housing loans in its AUM mix compared to its peers at 92% of the AUM

II (B). Primarily focused on housing loans and salaried customer base unlike peers

HFFC's main customer base comprises of low-to-mid income salaried borrowers in urban and semi-urban geographies. The company is primarily focused on housing loans (92% of AUM) and to some extent loan against property (LAP; 6% of AUM), which is unlike its peers that have a large chunk of LAP and other loans like construction finance in their portfolios. Management intends to gradually increase proportion of LAP in its loan book to ~15% over the medium term (4-5 years), which would support its yields.

Exhibit 30: Housing Loan (HL) share highest for HFFC amongst peers (as at FY21)

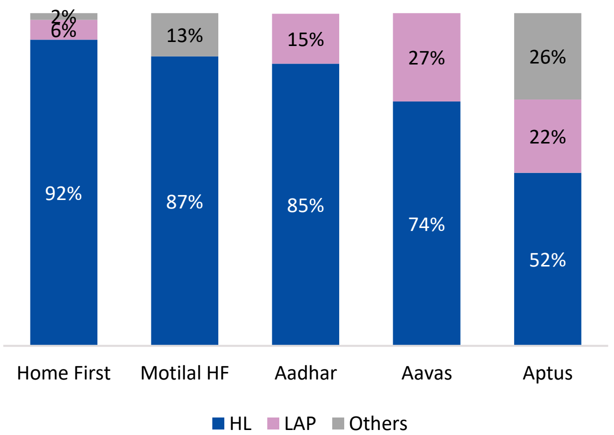
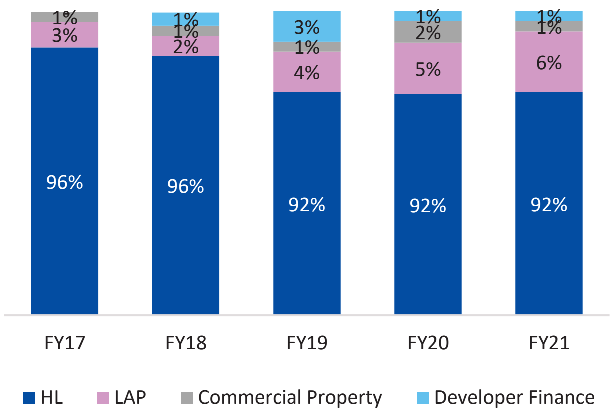


Exhibit 31: Share of HL above 90%; LAP portfolio rising gradually



Source: Edelweiss Wealth Research

HFFC also has the highest proportion of salaried customers compared to its peers

Share of salaried (including informal salaried) customers is amongst the highest for HFFC at 74%. The company's salaried customers comprise of employees working for small firms or at junior positions in larger companies, while self-employed customers are small business owners. This again is in sharp contrast to its peers, which have substantial portion of self-employed customers as part of their loan mix.

Exhibit 32: HFFC has largest exposure to salaried class (incl. informal salaried) as at FY21

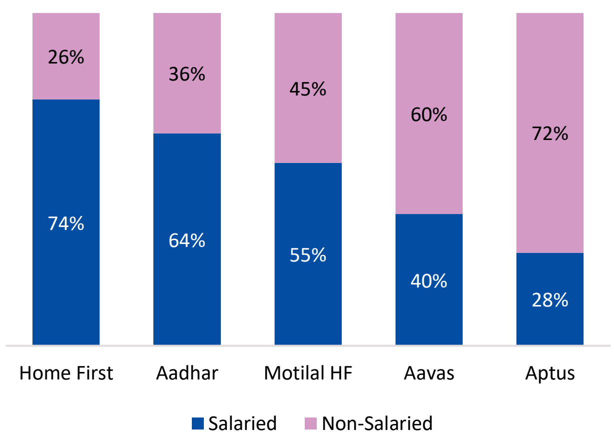
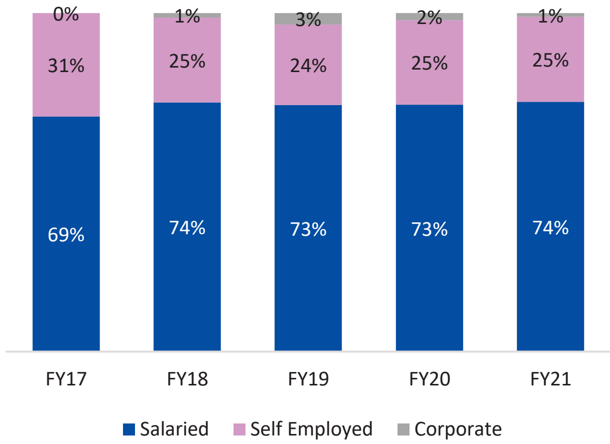


Exhibit 33: Share of salaried class has increased since FY17



Source: Edelweiss Wealth Research

HFFC's yields have remained sticky near 12-13%

III (A). Yields remain sticky despite lower borrowing cost

Declining CoF due to rating upgrades have led to a continuous decline in CoF leading to improving spreads

HFFC's yield on AUM is comparable with peers despite the company having higher share in the salaried segment. In comparison, Aptus has significantly higher yields – share in home loans (52%), LAP (21%), and working capital/small business loans (27%) – with target customers belonging to the self-employed category (78%). HFFC's yield on loan book has remained sticky in the range of 12-13% with cost of funds (CoF) declining continuously and improvement in its credit rating. Increased sourcing from NHB borrowing and use of direct assignment has also pushed HFFC's CoF lower, which has resulted in spreads improving continuously. Although lending rates are expected to moderate, we believe management's endeavour to increase the proportion of LAP (has ~200bps higher yield v/s home loans) in the AUM mix should allow HFFC to maintain yields near current levels.

Exhibit 34: Comparable yield on AUM (FY21) amongst peers

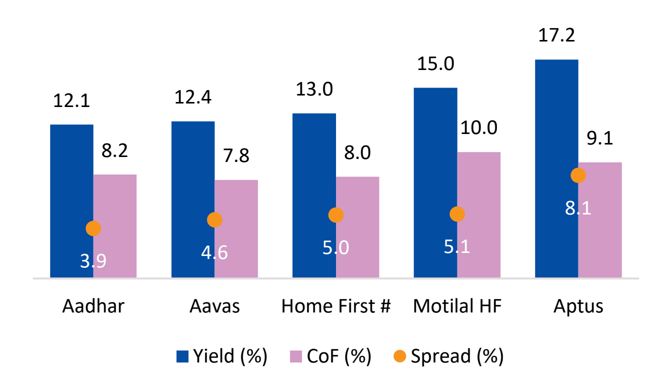
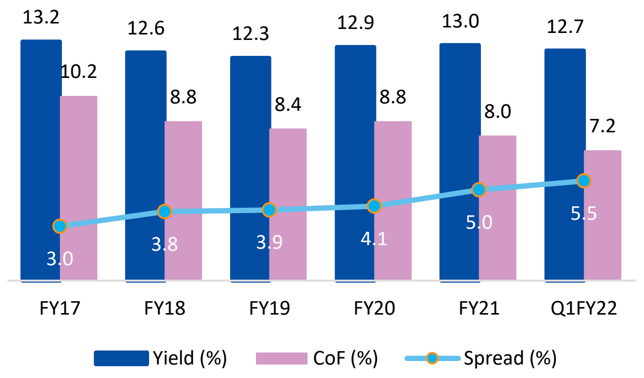


Exhibit 35: Lower CoF supporting spread improvement



#Except HFFC, DA income (net of expenses) for all other players are included in the interest income

Source: Edelweiss Wealth Research

HFFC's CoF is in line with Aavas despite having a lower rating. Rating improvement can lead to further decline in CoF

Aavas has the lowest CoF due to its diversified borrowing mix and AA-rating with stable outlook, whereas HFFC has approximately half of its borrowings from banks and A+ rating among small ticket HFCs. HFFC's CoF is in line with Aavas due to high exposure in NHB refinance where the borrowing rate is in the range of ~4-6%. Rating improvement can offset any changes in the borrowing mix and a general increase in interest rates. Moreover, 90% of the company's AUM is at floating interest rates, which significantly lowers its interest rate risk.

Exhibit 36: Shift to diversified borrowing mix

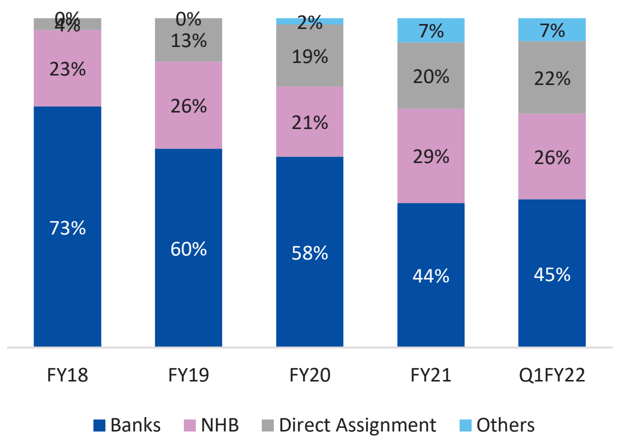
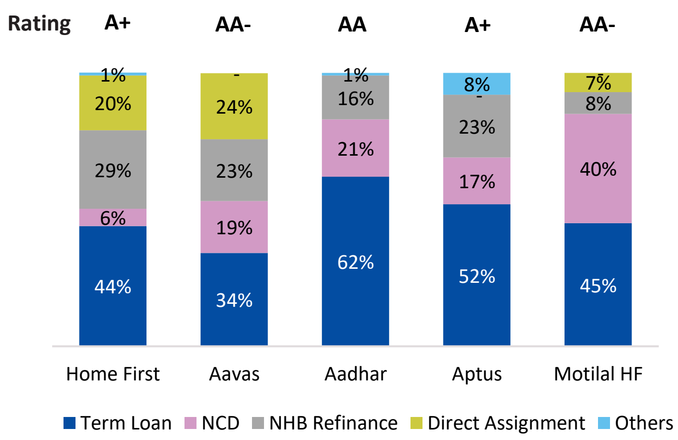


Exhibit 37: Aadhar and Aptus have the highest share in bank borrowing (as at FY21)



Source: Edelweiss Wealth Research

HFFC NIMs remain largely in line with peers near 7%

III (B). Margin in line with peers

Post the liquidity crisis in FY19 and recent capital infusions, most affordable housing companies are currently carrying high liquidity and capital adequacy to comfort their lenders. Due to this excess equity on books, NIMs of some small ticket HFCs are better than peers. HFFC registered NIMs of 6.8% in FY21 (in line with peers having comparable capital). Aptus' NIMs are the highest due to high equity on its books.

Exhibit 38: High Capital Adequacy is leading to higher NIMs (as at FY21)

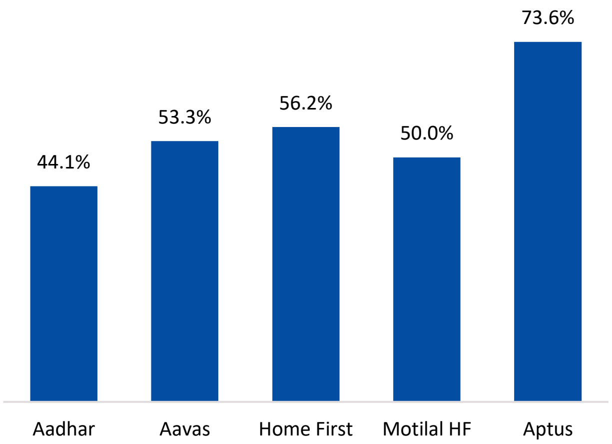
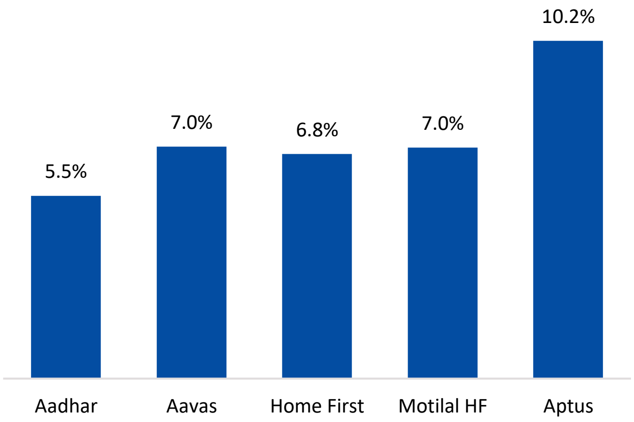


Exhibit 39: Aptus/Aavas' NIMS are higher than others due to higher spreads while HFFC is benefiting from higher CAR



Source: Edelweiss Wealth Research

HFFC has the best productivity metrics compared to its peers given the tech based centralized underwriting and lower proportion of in-house sourcing which ensures opex remains lower compared to peerset

IV (A). Tech-based centralized underwriting and low in-house sourcing ensuring higher productivity

HFFC has the lowest number of branches among its peer group – as at FY21, ~62% sourcing of new loans or the company fructified through connectors (individuals such as insurance agents, tax practitioners and local shopkeepers who are paid when loans are disbursed and do not participate in loan processing) and in-house efforts. These connectors only generate leads on the HFFC app and are paid anywhere between 30-40bps commission when the loan gets disbursed. However, sourcing mix for HFFC's peers is largely concentrated in-house with the direct sales team accounting for 70%, followed by direct selling agents (20%), branch walk-ins and others (10%).

Exhibit 40: HFFC has the lowest number of branches (as at FY21)

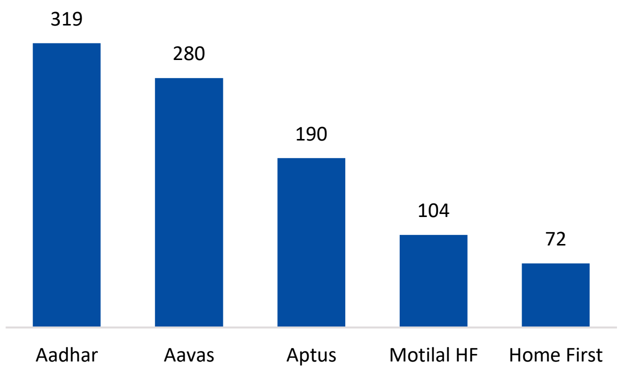
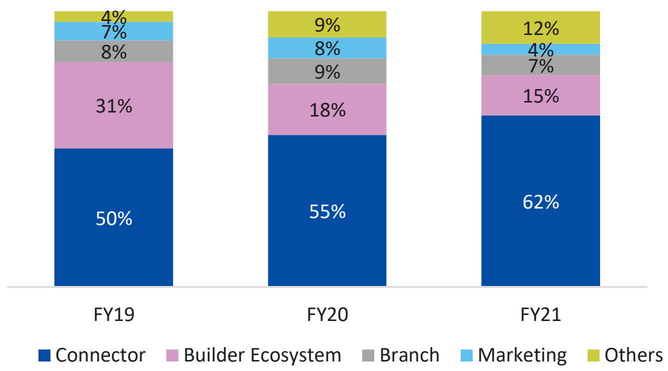


Exhibit 41: Sourcing is split in 60:40 ratio (connector: in-house efforts) for loan sanction



Source: Edelweiss Wealth Research

HFFC is focused on higher usage of technology for capturing and processing data with employees uploading documents or field images real time. It has a centralised underwriting, integrated CRM, and cloud-based platform for loan processing (91% of loans were processed within 48 hours as at Q1FY22). Amongst its peer set, HFFC had the highest AUM per employee and disbursement per employee in FY21. High employee productivity is boosting the company's overall branch productivity, which will get enhanced further as the business scales up.

Exhibit 42: High employee productivity due to optimum use of technology…

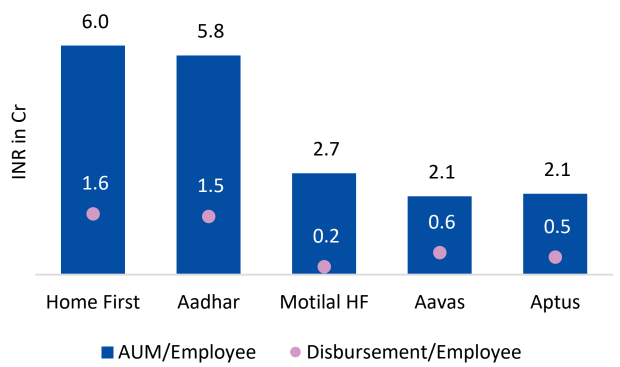
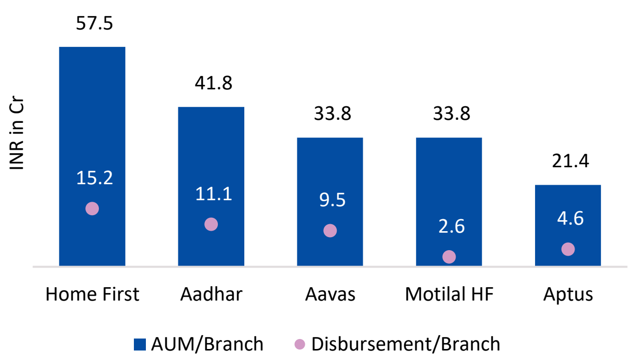


Exhibit 43: …driving overall branch productivity



Source: Edelweiss Wealth Research

HFFC's C/I ratio is currently close to most large peers given its technology focus and higher productivity

IV (B). C/I ratio comparable to peers, which will improve further as AUM gathers scale

HFFC's C/I ratio is currently close to most large peers given its technology focus and higher productivity. The company plans to increase its branch count by ~20 over the next two years. The company's branch expansion strategy is to open a branch in any location if the AUM (in the said location) crosses INR5cr. Prior to achieving this AUM, the company operated in such locations where there was demand only digitally. In Q1FY22, HFFC started operations in 33 potential branch locations (contributed 14% of incremental business) with digital presence in 32 locations (contributed 6% of incremental business). We believe this strategy of building digital presence prior to putting in a physical branch will majorly offset costs incurred in branch expansion.

Exhibit 44: Current C/I ratio near median range (as at FY21)

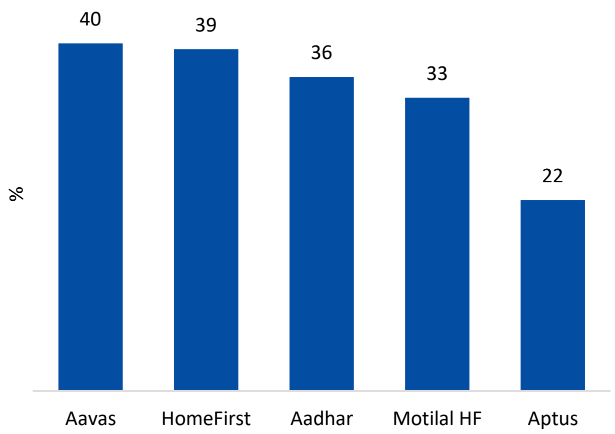
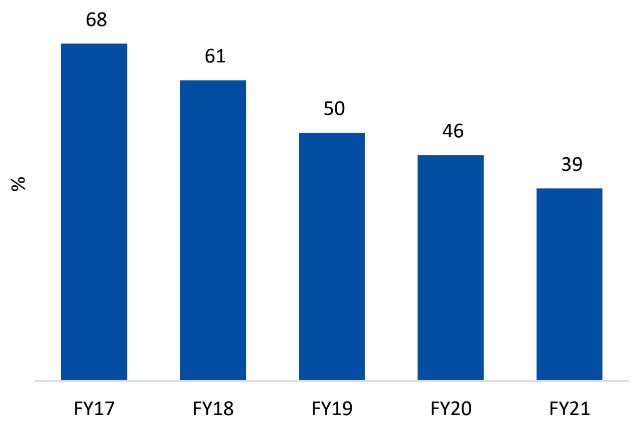


Exhibit 45: C/I ratio moderating for HFFC



Source: Edelweiss Wealth Research

The trend of C/I ratio is also visible in HFFC's opex/AUM ratio, which is also currently near larger industry peers like Aadhar. Given the company's lending to the informal sections of the economy is likely to be around 40% on an ongoing basis where the underwriting is mainly cash flow-based, it would be difficult for HFFC to achieve opex/AUM ratio levels seen in large HFCs. However, given management's focus on centralized underwriting, we believe some more cost benefits could accrue in the medium to long term.

Exhibit 46: HFFC's opex/AUM ratio comparable with peers

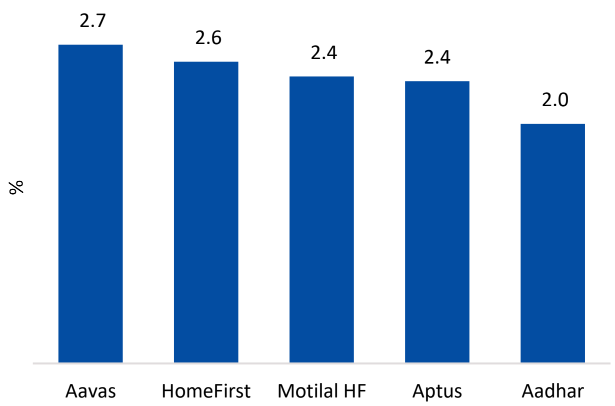
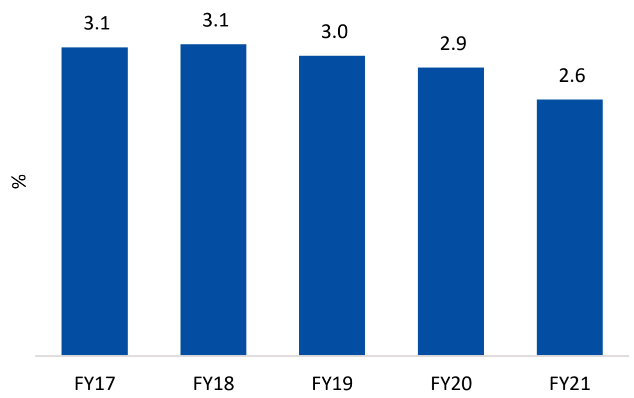


Exhibit 47: HFFC's opex/AUM ratio on a downtrend since FY18



Source: Edelweiss Wealth Research

HFFC has exhibited best in class asset quality in terms of 1+ dpd and expects to improve GS-3 by 10 bps every month till the end of FY22

V (A). Asset quality better than most peers; Provisioning most aggressive among peers

Asset quality for HFFC in terms GS-3 assets was sub 1% prior to the impact of the pandemic, which caused it to rise to ~1.9% in Q1FY22. However, this is the case with majority of affordable HFCs (barring Aavas, which has seen GS-3 rise to just above 1% in Q1FY22). Management is confident of rolling back asset quality with a target of reducing GS-3 by 10bps every month to end FY22 at ~1%.

Exhibit 48: Asset quality has worsened due to Covid-19

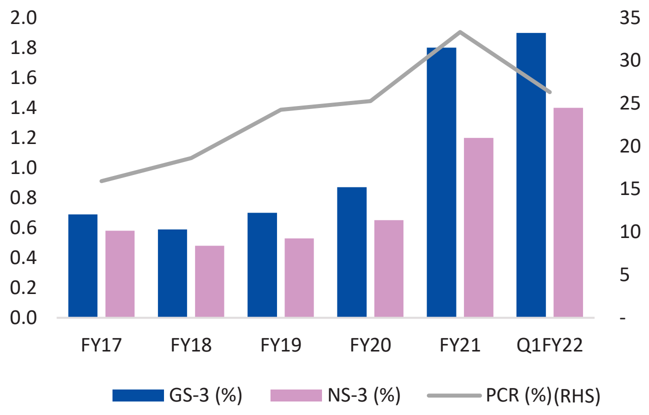
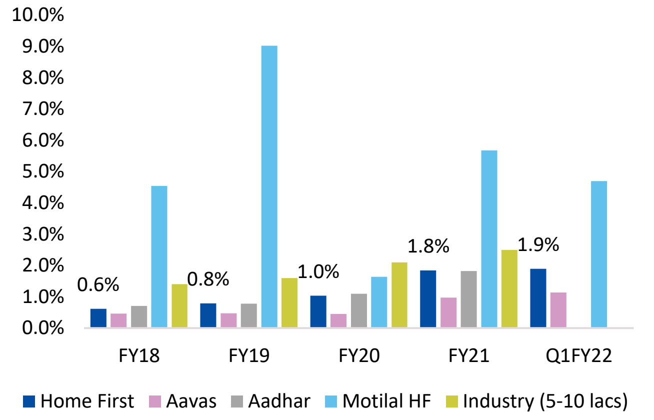


Exhibit 49: Covid has impacted asset quality for most AHFC players (barring Aavas)



Source: Edelweiss Wealth Research

Asset quality impact can also be gauged from the substantial increase in Stage-2 and Stage-3 assets of all players in FY21 (v/s historical trends). The increase in Stage-2 assets for HFFC was one of the lowest amongst peers.

Comparing HFFC's 1dpd+ with its nearest peer Aavas, the metric has been fairly similar for both players over the same period; however, the increase in 1dpd+ for Aavas was significantly higher than that for HFFC in Q1FY22. Even when compared to restructured assets, Aavas has reported ~1.2% of the books as restructuring whereas HFFC has only reported 0.6% of the books in Q1FY22 and also has no ECLGS lending in its books.

Exhibit 50: Stage-2 has increased for most players

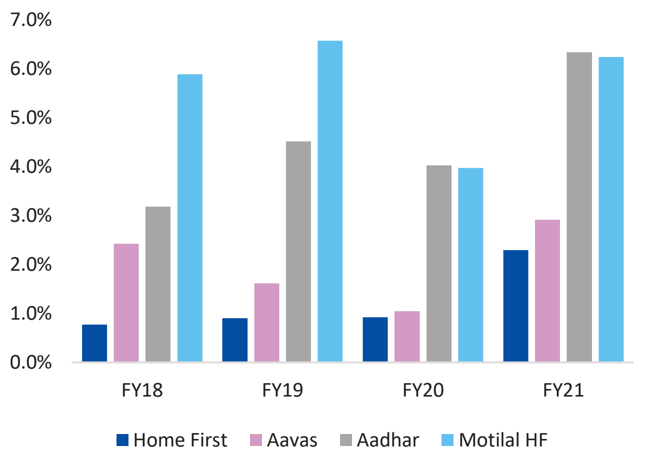
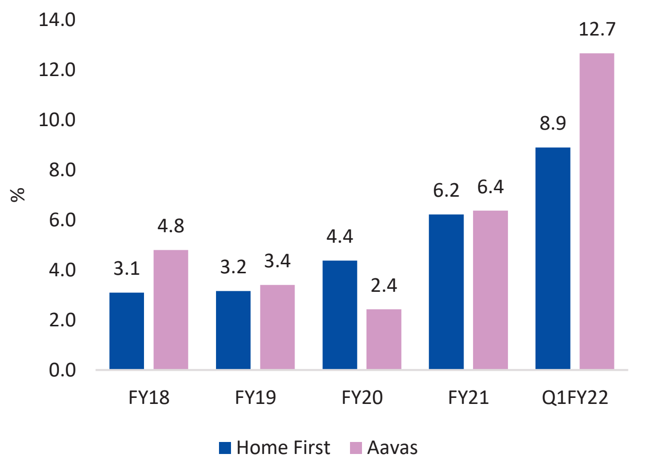


Exhibit 51: HFFC's 1+dpd better than Aavas in Q1FY22



Source: Edelweiss Wealth Research

The impact of the pandemic was also reflected in credit costs, which were higher for all players in FY21/Q1FY22, as most companies made incremental provisions for the stress.

Exhibit 52: Credit cost has increased substantially due to Covid for HFFC…

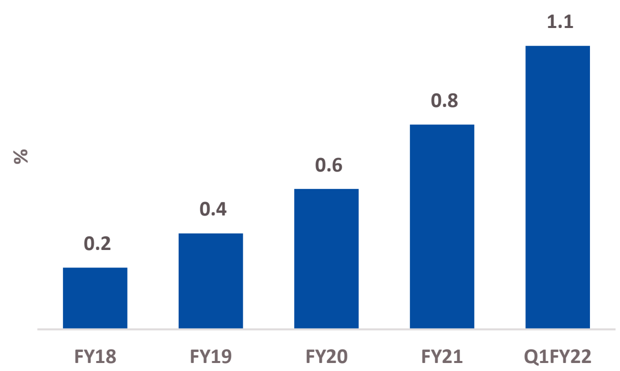
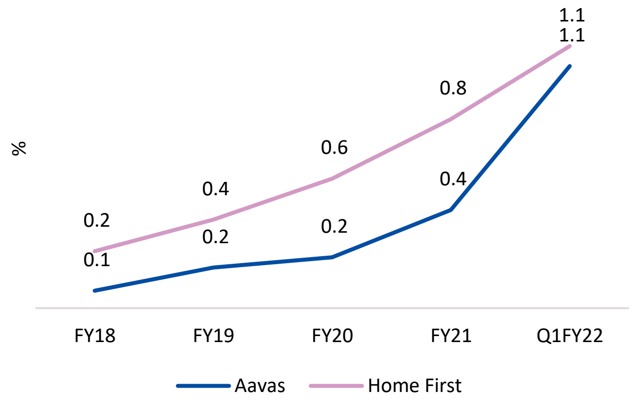


Exhibit 53: …and also for its peers

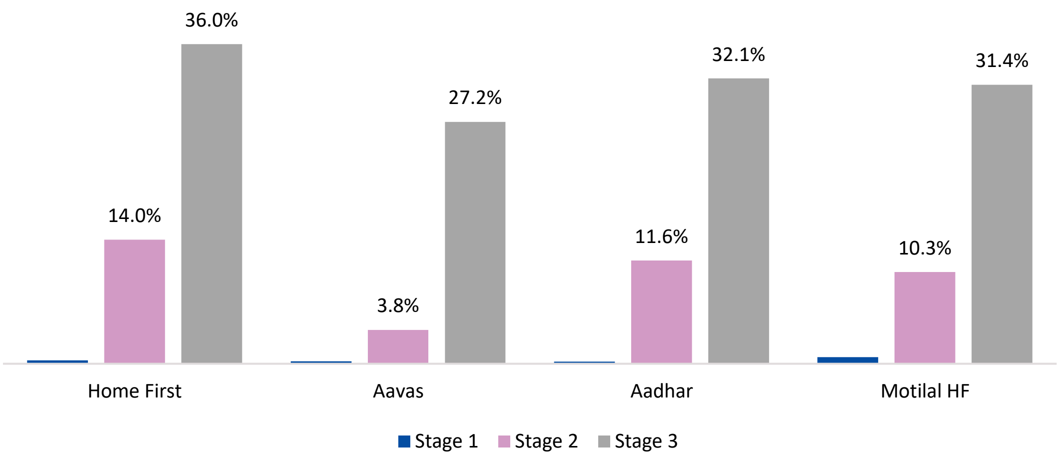


Source: Edelweiss Wealth Research

Stage-2 PCR is the highest for HFFC amongst its peers

The increase in HFFC's credit costs was not only to provide for NPAs but to also build buffers for the impending stress seen in Stage-2 assets. Thus, HFFC's aggressive provisioning stance is reflected in higher provisions for Stage-2 assets (v/s most peers).

Exhibit 54: HFFC's Stage-2 and Stage-3 PCR higher than most peers (as at FY21)



Source: Edelweiss Wealth Research

VI. Near-term ratios impacted by the pandemic

While RoAs are high across the affordable housing finance industry, RoEs are lower due to high capital in the books of most players, which also includes HFFC. Post the capital infusion in FY21 by Warburg Pincus, followed by the IPO, HFFC's leverage reduced to 3.5x in FY21 (v/s 4.5x in FY19). While this elevated HFFC's NIMs, RoE remained under pressure despite the increase in RoA. However, due to the pandemic, we expect the company to continue maintaining high capital in the medium term.

Exhibit 55: Lower RoE due to high capital despite decent RoA

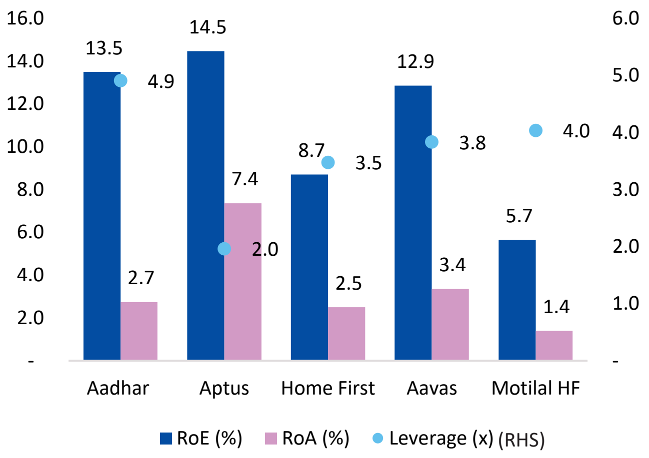
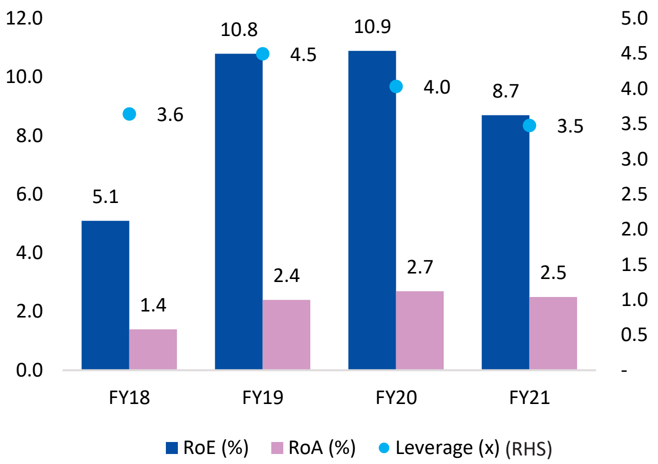


Exhibit 56: RoE and leverage declined post infusion of capital



Source: Edelweiss Wealth Research

Disbursement / AUM growth to come back in FY22 as the economy reopens which also will be aided by branch expansion

VII. Financial Projection

Overall, India's mortgage market is expected to register double-digit CAGR over FY21-25E (especially in the case of affordable housing financers). We expect HFFC's growth to return to pre-pandemic levels with disbursement growth of 43% CAGR over FY21-24E, which should result in 26% AUM growth over the same period.

Exhibit 57: Disbursement growth expected to return with opening of branches and higher productivity

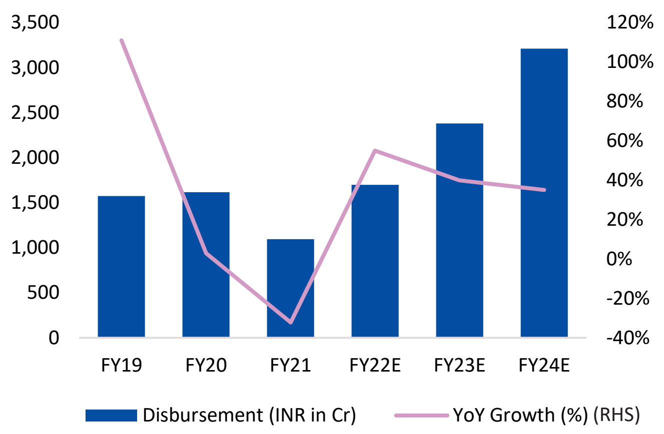
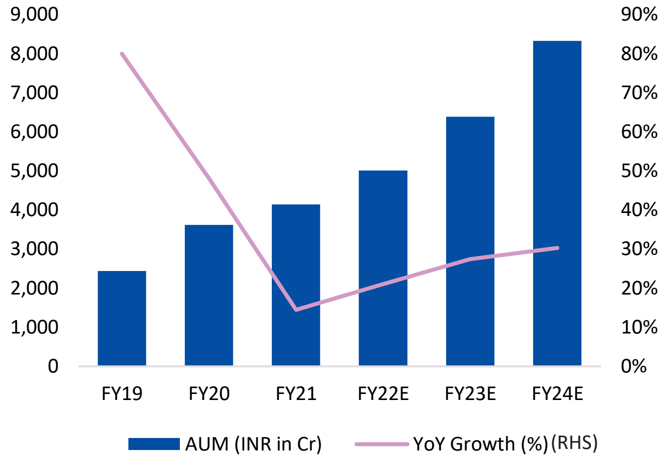


Exhibit 58: As disbursement grows, AUM is likely to scale up



Source: Edelweiss Wealth Research

We expect AUM growth to reflect in net revenue growth, which is expected at 23% CAGR over FY21-24E. Spreads should sustain between 4.8-5% given the stable outlook on yields CoF over FY21-24E. As impact of the pandemic wanes, capital adequacy ratio is expected to reduce slightly, and hence, we can see slight compression in NIMs.

Exhibit 59: Net revenue to grow largely in line with AUM growth

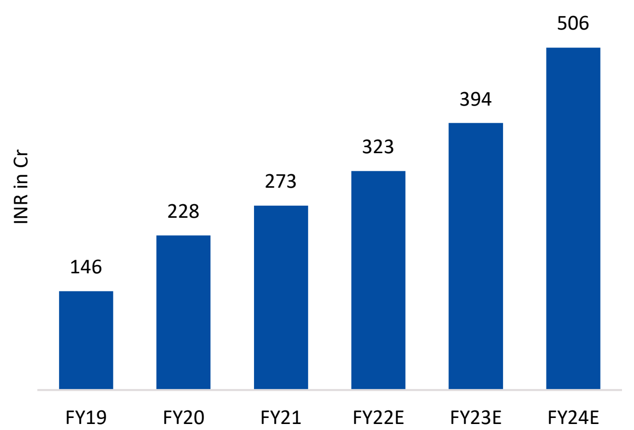
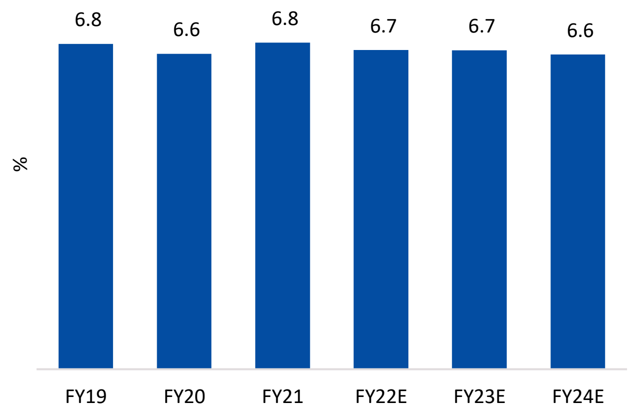


Exhibit 60: NIMs expected to moderate by FY24E (post FY22)



Source: Edelweiss Wealth Research

Stable NIMs and declining opex and credit costs to lead to PAT doubling from FY21 levels in FY24

Considering HFFC's plan to increase its branches, we expect operating expenses to stay elevated. However, this should get offset by higher income generation, both from new and matured branches. Hence, we expected C/I ratio to moderate over the next 2-3 years. Moderation in C/I ratio and lower credit cost is likely to lead to 31% PAT CAGR over FY21-24E.

Exhibit 61: C/I ratio expected to moderate

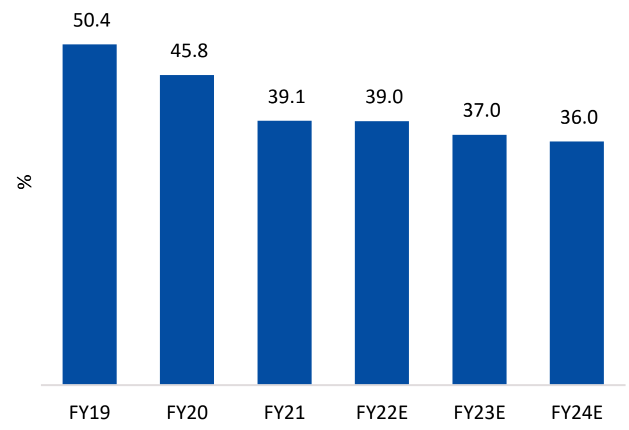
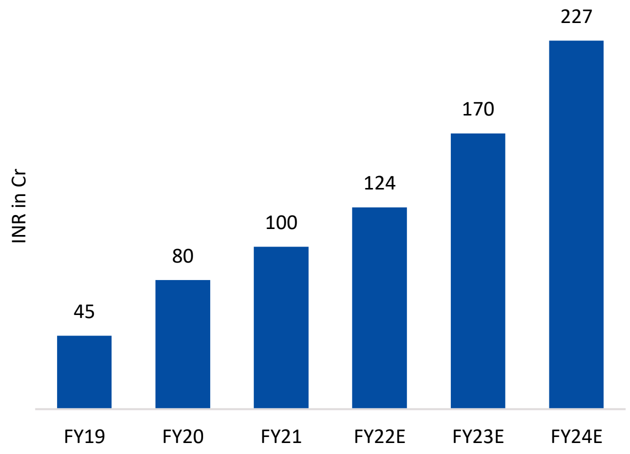


Exhibit 62: PAT expected to double in FY24 (v/s FY21 level)



Source: Edelweiss Wealth Research

ROA/ROE to reach 3.4%/12.7% in FY24 while asset quality to improve with GS-3 dropping to below 1% in FY24

As impact of the pandemic subsides and leverage increases, we expect RoA/RoE for the company to return to pre-Covid levels. We expect credit cost to normalise post FY22 as the economy opens up after the second wave and possibly the third wave (expected in Q2FY22). Given most of the provision would be adjusted in FY21-22E, we expect credit cost to return to pre-Covid level at ~30bps by FY24E.

Exhibit 63: Return ratios to surpass pre-Covid level by FY24E with improved leverage

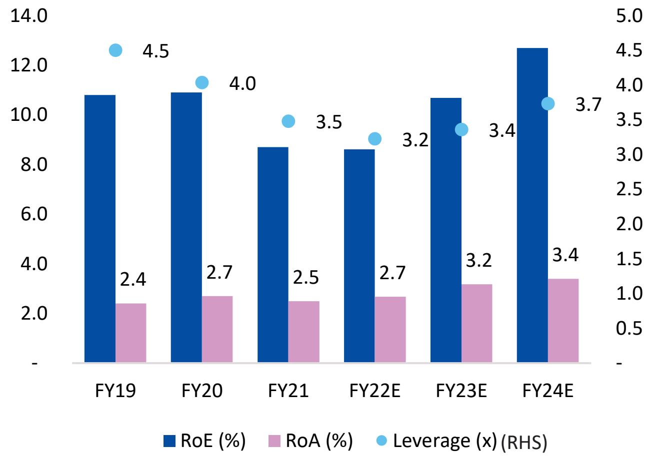
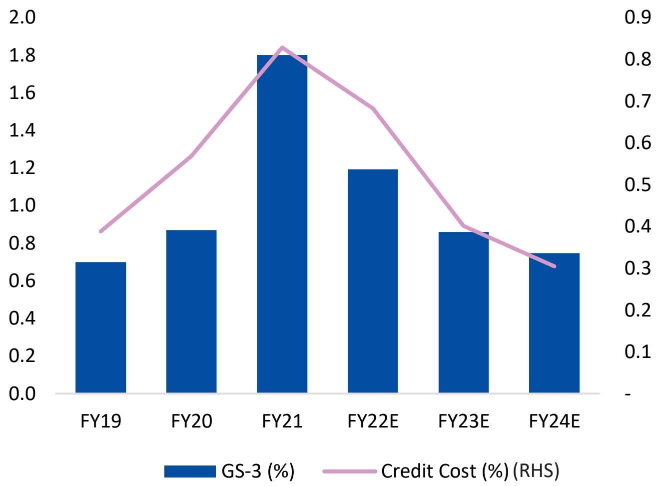


Exhibit 64: Asset quality expected to normalise by FY24E



Source: Edelweiss Wealth Research

Initiating coverage with 'BUY' recommendation and target price of INR763/share

HFFC's business model is different than its peers – the company's disbursements are speedy with less processing time owing to technology driven centralised processing system while also ensuring asset quality near the top quartile of its peers. Moreover, the company's presence largely in the salaried and home loan segment provide additional comfort. We expect the company to post near ~26% AUM growth over the medium term. Asset quality is expected to stabilise near 1% by end-FY22. Strong AUM growth coupled with normalisation of both operating and credit costs should lead to RoA/RoE of 3.4%/12.7% by FY24E. **Initiate with a 'BUY' recommendation and target price of INR763, valuing the company at ~4x FY23E ABV of INR 191.**

Exhibit 65: P/ABV (x) of HFFC

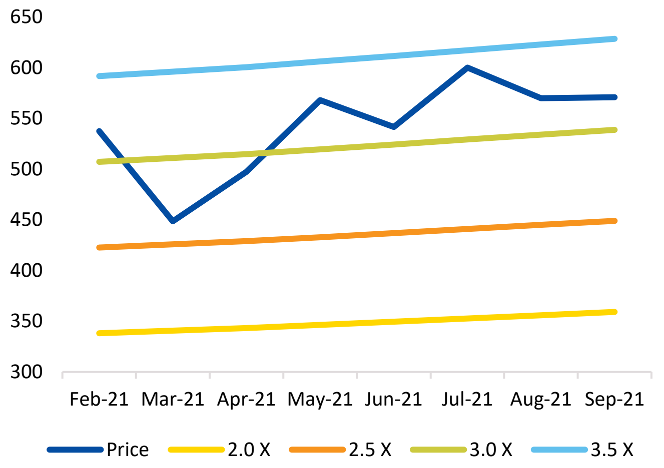
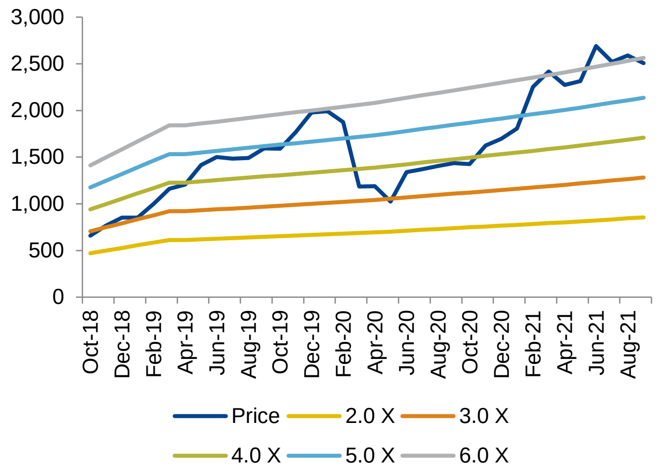


Exhibit 66: P/ABV (x) of Aavas



Source: Edelweiss Wealth Research

Peer comparison - Valuations

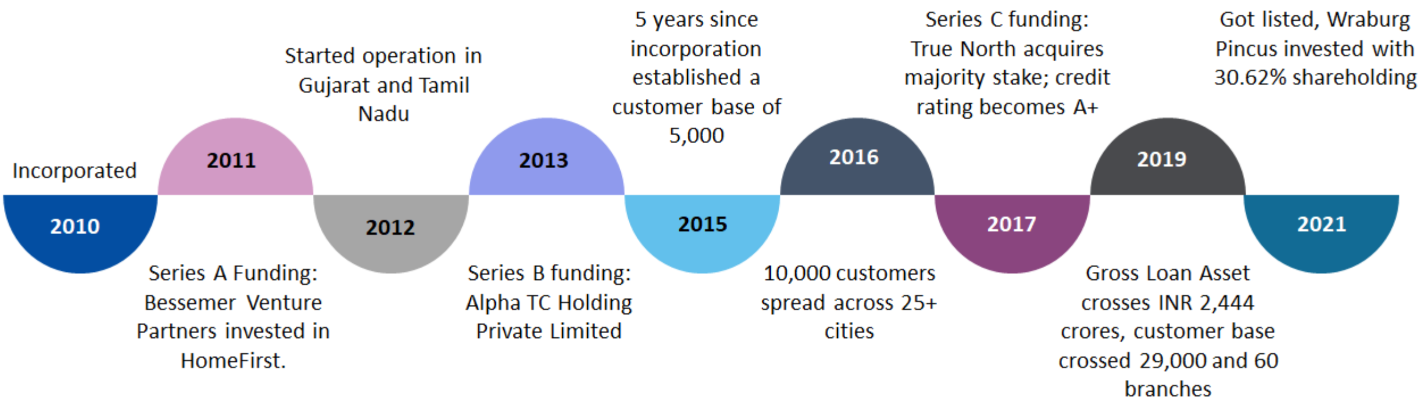
Company (INR Cr)	CMP*	P/ABV		P/E (x)		RoAE (%)		RoA (%)		NIM (%)		C/I(x)		GNPA (%)	
		FY21	FY23E	FY21	FY23E	FY21	FY23E	FY21	FY23E	FY21	FY23E	FY21	FY23E	FY21	FY23E
HFFC	573	3.7	3.0	46.9	29.5	8.7	10.7	2.5	3.2	6.8	6.7	39.1	37.0	1.8	0.9
CanFin	627	3.2	2.3	18.3	14.5	19.2	17.1	2.1	2.1	3.7	3.4	15.3	14.6	0.9	0.8
Aavas	2537	8.3	6.4	68.8	50.1	12.9	13.8	3.5	3.4	7.0	7.0	39.7	38.0	1.0	0.7
Aptus	361	8.7	5.5	64.2	42.5	14.5	13.8	6.1	6.5	10.2	10.6	21.8	22.0	0.7	1.1

**CMP as on September 15, 2021*

Name	Designation	Profile
Deepak Satwalekar	*Chairman & Independent Director*	Mr. Satwalekar is the Chairman and Independent Director of HFFC. He holds a bachelor's degree in Mechanical Engineering from Indian Institute of Technology (IIT), Mumbai, and a master's degree in Business Administration from American University. Previously, he was associated with HDFC Ltd as a Director and HDFC Standard Life Insurance Company Ltd as the MD and CEO. He has also been recognised as a distinguished alumnus by the IIT, Mumbai.
Manoj Viswanathan	*MD & CEO*	Mr. Viswanathan is the Managing Director and CEO of HFFC. He holds a bachelor's degree in Electrical & Electronics Engineering from Birla Institute of Technology and Science, Pilani, and a post-graduate diploma in Business Management from XLRI, Jamshedpur. He has over 23 years of experience in consumer lending. Previously, he was associated with Computer Garage Private Ltd, Asian Paints India Ltd, Citibank and Citi Financial Consumer Finance India Ltd.
Nutan Gaba Patwari	*CFO*	Ms. Patwari is the CFO of HFFC since Jan'19. She is a qualified Chartered Accountant and has over 14 years of experience in Finance. In her last stint, she was Vice President – Finance with True North and was responsible for strategy implementation of the Financial Services Portfolio. In her professional journey, she has worked with Hindustan Unilever Ltd, ITC Ltd, and Philip Morris Asia Ltd across Business Finance, Supply Chain and Distribution Finance and Corporate Finance. She leads the Accounts, Tax, Finance and Treasury, Secretarial, Investor relations and FP&A functions of the company.
Ajay Khetan	*Chief Business Officer*	Mr. Khetan is the Chief Business Officer of HFFC since Mar'12. He is a Mechanical Engineer with a post-graduate diploma in Management from Xavier Institute of Management, Bhubaneswar. He has over 21 years of experience in Consumer Finance, Operations and Risk Management. Prior to joining HFFC, he was associated with Macquarie Finance (India) Private Ltd, Hewlett Packard Financial Services (India) Private Ltd, CitiFinancial Consumer Finance India Private Ltd, MIRC Electronics Ltd and Tata Engineering and Locomotive Company Ltd.
Gaurav Mohta	*Chief Marketing Officer*	Mr. Mohta is the Chief Marketing Officer of HFFC since Mar'11. He is a Mechanical Engineer with a post-graduate diploma in Business Administration from ICFAI Business School, Hyderabad. He has over 17 years of experience in Consumer Finance, Marketing and Product Management. At HFFC, he has been instrumental in setting up sales distribution and evolving the brand identity of the company. Previously, he has worked with Kotak Mahindra Bank Ltd, CitiFinancial Consumer Finance India Private Ltd and Foodworld Supermarkets Private Ltd.
Vilasini Subramaniam	*Head – Strategic Alliances*	Ms. Subramaniam is the Head - Strategic Alliances of HFFC since Aug'14. She is a Chartered Accountant with over 18 years of experience in Consumer Finance and Credit. Prior to joining HFFC, she was associated with Citibank India, Janalakshmi Financial Services and Micro Housing Finance Corporation Ltd, where she handled Credit Underwriting, Product Development, Analytics and Business Strategy.

Source: Company, Edelweiss Wealth Research

Timeline


Incorporated
2010
2011
Series A Funding: Bessemer Venture Partners invested in HomeFirst.
Started operation in Gujarat and Tamil Nadu
2012
2013
Series B funding: Alpha TC Holding Private Limited
5 years since incorporation established a customer base of 5,000
2015
2016
10,000 customers spread across 25+ cities
Series C funding: True North acquires majority stake; credit rating becomes A+
2017
2019
Gross Loan Asset crosses INR 2,444 crores, customer base crossed 29,000 and 60 branches
Got listed, Wraburg Pincus invested with 30.62% shareholding
2021

Income statement

(INR Cr)

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Interest income	355	436	480	572	726
Interest charges	191	217	243	286	361
Net interest income	164	219	236	285	365
Fee & other income	65	53	87	109	141
Net revenues	**228**	**273**	**323**	**394**	**506**
Operating expense	105	106	126	146	182
- Employee exp	61	66	78	91	113
- Other opex	44	40	48	55	69
Preprovision profit	**124**	**166**	**197**	**248**	**324**
Provisions	17	32	31	21	20
PBT	107	134	166	227	304
Taxes	28	34	42	58	77
PAT	**80**	**100**	**124**	**170**	**227**
Extraordinaries	35%	37%	38%	43%	45%
Reported PAT	80	100	125	170	228
Basic number of shares (Crs)	8	9	9	9	9
Basic EPS (INR)	10.2	11.4	14.2	19.4	26.0
Diluted number of shares (Crs)	8	8	9	9	9
Diluted EPS (INR)	10.6	12.2	14.2	19.4	26.0

Balance Sheet

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Paid Capital	16	17	17	17	17
Reserve & Surplus	918	1,363	1,487	1,657	1,884
Shareholder's Fund	934	1,381	1,505	1,675	1,902
Total Borrowings	2,494	3,054	3,271	4,074	5,182
Other Liabilities	52	76	25	131	388
Total Liabilities	**3,480**	**4,510**	**4,800**	**5,879**	**7,472**
Cash & Bank Balance	222	680	639	623	687
Investment	146	375	301	335	375
Loan & Advances	3,014	3,327	3,760	4,792	6,243
Net Fixed Assets	21	17	19	24	31
Other assets	77	113	82	104	136
Total Assets	**3,480**	**4,510**	**4,800**	**5,879**	**7,472**
Total AUM	**3,618**	**4,141**	**5,013**	**6,390**	**8,324**

Growth ratios (%)

Year to March	FY20	FY21	FY22E	FY23E	FY24E
NII growth	52.8	34.0	7.9	20.6	27.9
Net revenues growth	56.4	19.3	18.7	21.9	28.3
Opex growth	42.3	1.7	18.5	15.7	24.8
PPP growth	70.8	34.1	18.8	25.9	30.3
Provisions growth	125.7	94.8	(3.6)	(32.3)	(5.2)
PAT growth	76.0	25.8	24.2	36.8	33.6

Operating ratios (%)

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Yield on advances	12.9	13.0	12.7	12.7	12.6
Cost of funds	8.8	8.0	7.7	7.8	7.8
Spread	4.1	5.0	5.0	4.9	4.8
Net interest margins	6.4	6.9	6.7	6.7	6.6
Cost-to-income	45.8	39.1	39.0	37.0	36.0
Tax rate	25.9	25.3	25.3	25.3	25.3

Balance sheet ratios (%)

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Loan growth	41.2	10.4	13.0	27.5	30.3
EA growth	39.2	29.6	7.3	22.4	27.0
Gross NPA ratio	0.9	1.8	1.2	0.9	0.7
Net NPA ratio	0.7	1.2	0.7	0.5	0.4
Provision coverage	25.3	33.3	42.7	43.0	40.8

RoE decomposition (%)

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Net interest income/Assets	4.8	5.0	5.0	5.0	5.0
Other Income/Assets	1.9	1.2	1.9	1.9	1.9
Net revenues/Assets	6.8	6.2	6.9	6.9	6.9
Operating expense/Assets	3.1	2.4	2.7	2.5	2.5
Provisions/Assets	0.5	0.7	0.7	0.4	0.3
Taxes/Assets	0.8	0.8	0.9	1.0	1.1
Total costs/Assets	4.4	3.9	4.2	3.9	3.8
ROA	2.7	2.5	2.7	3.2	3.4
Equity/Assets	24.4	29.0	31.0	29.8	26.8
ROAE	10.9	8.7	8.6	10.7	12.7

Valuation metrics

Year to March	FY20	FY21	FY22E	FY23E	FY24E
Diluted EPS (INR)	10.6	12.2	14.2	19.4	26.0
EPS growth (%)	42.4	12.7	24.2	36.8	33.6
Adjusted BV per share	118.5	156.6	171.6	190.8	216.6
Diluted P/E (x)		46.9	40.3	29.5	22.1
Price/Adj. Book Value(x)		3.7	3.3	3.0	2.6

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Digitally signed by VINAY KHATTAR
Date: 2021.09.17 18:13:51 +05'30'

Rating	Expected to
BUY	appreciate more than 15% over a 12-month period
HOLD	appreciate between 5-15% over a 12-month period
REDUCE	return below 5% over a 12-month period

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