

# Affordable Housing Finance

NBFC | Initiating Coverage

April 17, 2024

## Homing in on affordable housing

### Key Points

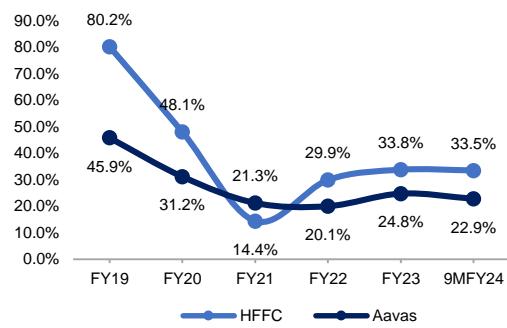
- Significant housing shortage and low mortgage penetration in India indicate huge scope for growth; outlook for Affordable HFCs remains positive driven by rising urbanisation/ per capita income and government focus.
- AHFCs with a geographically diversified portfolio, deep distribution focus, niche customer segment and granular underwriting model are best-positioned to capture the opportunity; prefer Aavas and Home First Finance (HFFC) as top picks in the space.
- Rising competitive intensity, near-term compression of spreads and elevated opex remain key challenges for AHFCs; in addition, the sector has seen a de-rating due to supply overhang (stake sale by PE funds).
- We remain optimistic on the ability of AHFCs to deliver long-term growth; Initiate with a BUY on HFFC (TP Rs1,150, 3.6x FY26E P/ABV) and reiterate BUY on Aavas (TP Rs1,775, 3x Dec FY26E P/ABV).

**Multi-year growth opportunity for Affordable HFCs:** India's significant housing shortage (100mn units housing demand), low mortgage penetration (12.3% of GDP as of FY23), rising per capita income and affordability indicate huge scope for growth over a multi-year horizon. Post a slowdown in the past few years, the affordable housing finance segment has rebounded strongly and is set to increase its share in the overall mortgage pie (loans below Rs 1.5mn form 15% of the overall housing finance market). Moreover, government impetus on "Housing for All" along-with multiple initiatives to drive home ownership mean a conducive growth environment for Affordable HFCs (AHFCs).

**Focusing on a differentiated customer profile:** We delve deeper into the operating metrics of low-income housing finance players. AHFCs have built robust business models over the years (average ticket size of ~Rs 1 mn) with a focus on salaried/ self-employed customers, living in rural areas/ urban peripheries. Deep distribution, niche customer segment, in-house underwriting and improving productivity are key success factors for affordable HFCs. Despite an unfavourable borrowing profile and high perceived risk in the customer segment, return ratios of these entities remain strong.

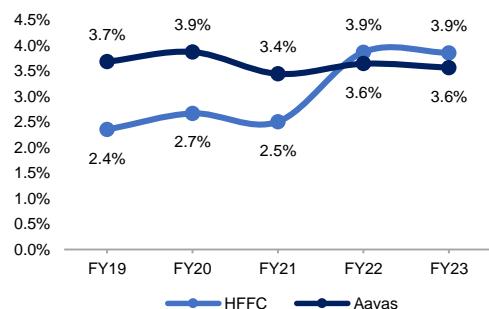
**Valuations have seen a de-rating; remain POSITIVE:** Despite healthy growth trajectory and return ratios, listed affordable HFCs have seen a sharp de-rating in recent months. Apart from top management attrition (Aavas), stake sales by large PE funds have led to the underperformance. We remain positive on the ability of AHFCs to deliver long-term growth, while maintaining a decent asset quality profile, factoring in a gradual decline in operating costs as they build scale. We expect earnings CAGR of 19%-28% for these companies over FY23-26E led by continued growth momentum, geographical expansion and stable asset quality metrics. We initiate with a BUY rating on Home First Finance (HFFC) and reiterate our BUY recommendation on Aavas.

### AUM YoY Growth (%) over FY19-9MFY24



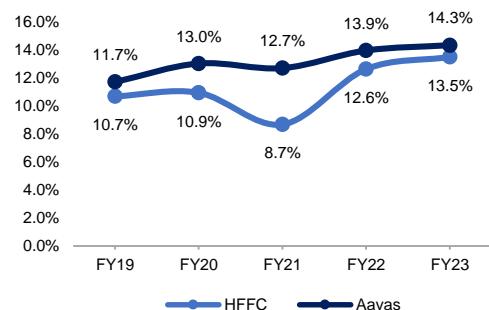
Source: Company, Nirmal Bang Institutional Equities Research

### RoA profile over the last 5 years (%)



Source: Company, Nirmal Bang Institutional Equities Research

### RoE profile over the last 5 years (%)



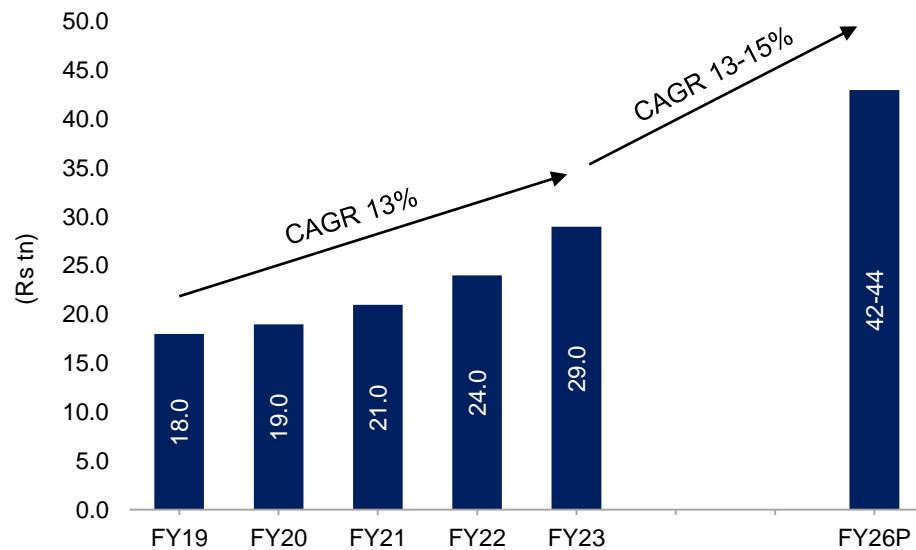
Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

## Industry Overview

The Indian Home Loan market has expanded at a healthy ~13% CAGR (growth in loan outstanding) over FY19-FY23 to Rs 29 trn on the back of rising disposable income, healthy demand from smaller cities, attractive interest rates and government's impetus on housing. Of the total Housing market in FY23, Public Sector Banks (PSBs) dominated with a 40% market share followed by HFCs (34%), Private Banks (20%), Others (4%) and NBFCs (2%).

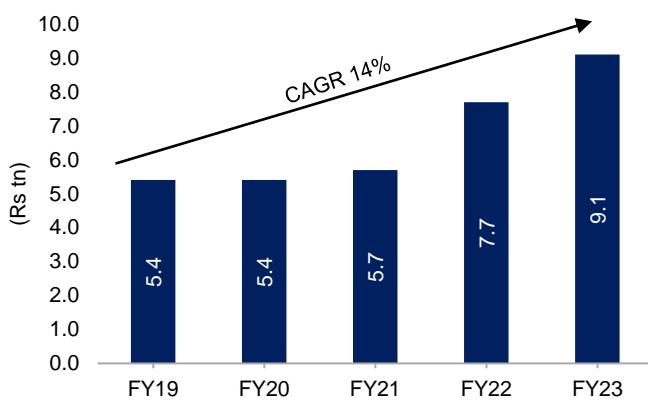
### Exhibit 1: Home Loans outstanding projected to grow at 13-15% over FY23-FY26 (Rs trn)



Note: P- Projected, Data includes only Housing loan excluding PMAY

Source: CRIF Highmark, CRISIL MI&A

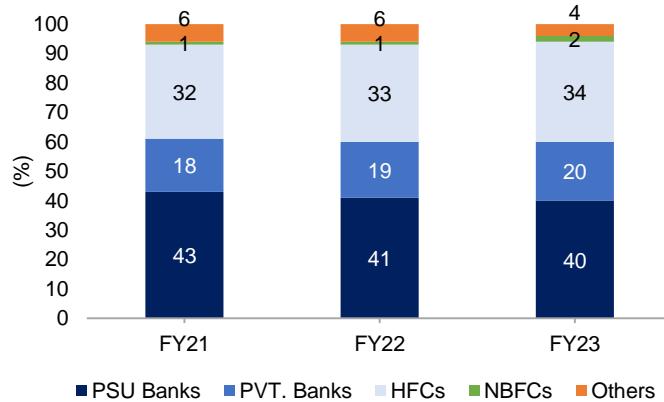
### Exhibit 2: Home loans disbursements grew at ~14% CAGR over FY19-FY23



Note: Sanctioned amount has been taken for gauging disbursement trend for all the Financial Years (excludes PMAY)

Source: CRIF Highmark, CRISIL MI&A

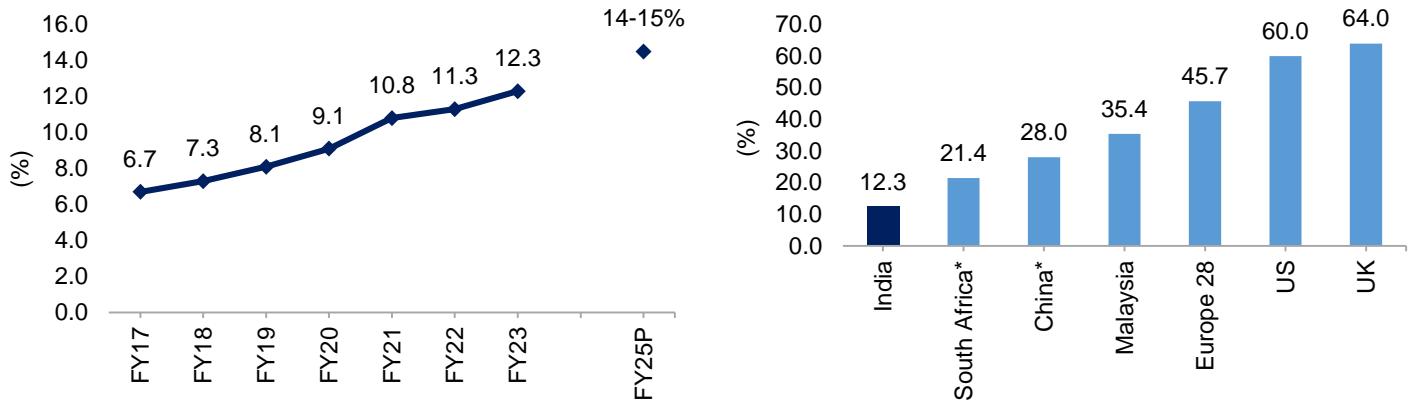
### Exhibit 3: HFCs had 2<sup>nd</sup> highest market share in Home Loans in FY23



Note: Numbers are rounded off to show the market share

Source: CRIF Highmark, CRISIL MI&A

While AUM growth for HFCs (ex-HDFC) was marginally lower at 10% in FY23, we expect disbursements to remain healthy on the back of improving affordability, growing urbanisation and expansion beyond Tier-I locations. While home loan affordability has improved over the past few years, led by sustained growth in incomes, we expect lower interest rates in 2HFY25 to reduce the EMI burden for households. Moreover, India has very low penetration in terms of housing finance (low Mortgage-to-GDP ratio) compared to peers, which shows increased potential for Indian HFCs to expand. Given the expected steady-state growth from FY23, CRISIL MI&A projects the ratio to be at 14-15% by FY25-end.

**Exhibit 4: Lower Mortgage-to-GDP ratio of India vs. other EMs**


Note: P – Projected, Data for mortgage to GDP for India includes both Housing loans outstanding over constant GDP for India

Source – NHB, World Bank, CRISIL MI&A Estimates

"Note: (\*) – As of CY17, Indian mortgage to GDP is for Financial Year 2023 – 12.3%; Europe 28 includes the 28 European Union Member states as of December 2018"

Source: HOFINET, European Mortgage Federation, NHB, CRISIL MI&A

**Estimated shortage of ~100mn houses in India in 2022**

As per RBI's report (Committee on the development of housing finance securitization market- September 2019), the housing shortage in India was estimated to increase to ~100mn units by 2022 with majority coming from the Lower Income Group (LIG) and Economically Weaker Sections (EWS). Total incremental demand required to address the shortage is estimated at ~Rs50-60trn. Meanwhile, the overall Home Loans outstanding (excluding Pradhan Mantri Awas Yojana- PMAY loans) as of March'23 was ~Rs31.1trn. This indicates the immense potential of the market to address the shortage of houses in India. The total value of units required to fulfil the entire shortage is estimated at ~Rs149trn, out of which Rs58trn is estimated to be the aggregate loan demand for housing.

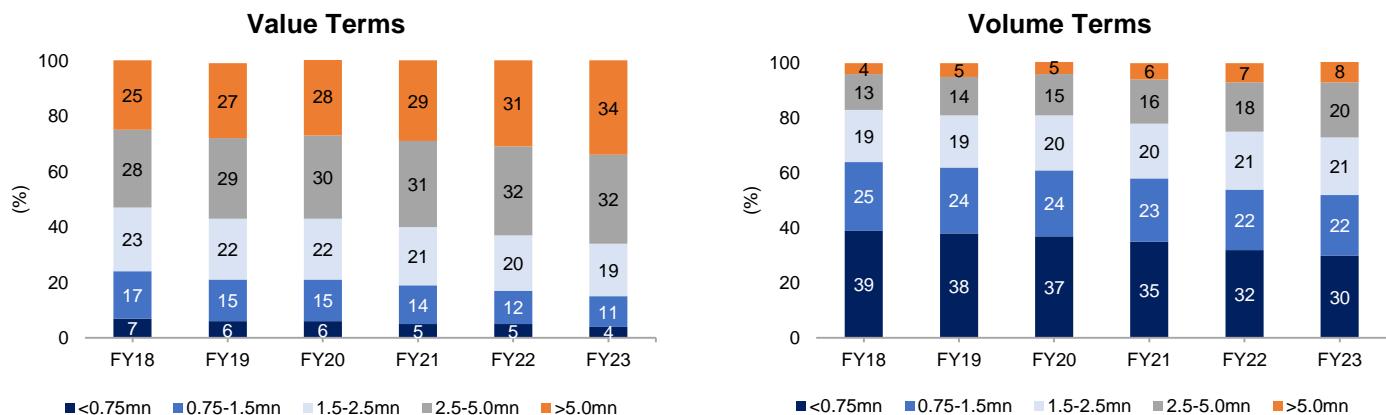
**Exhibit 5: Shortage of ~100mn houses in India by 2022**

Income Segment	Housing Shortage (in million)	Average ticket size (in ₹ million)	Value of Units (in ₹ trillion)	LTV	Credit Penetration	Aggregate loans demand (in ₹ trillion)
EWS	45	0.75	34	40%	40%	5
LIG	50	1.5	75	50%	80%	30
MIG & above	5	8	40	65%	85%	22
<b>Total</b>	<b>100</b>		<b>149</b>			<b>58</b>

Source: RBI Committee Discussion (Sept 2019), CRISIL MI&A

**Majority of the housing market in volume is dominated by lower ticket size loans**

The Home Loan market grew at ~13% CAGR during FY18-FY23, spurred by growth in the higher ticket size segment, i.e., over Rs1.5mn. The share of higher ticket loans increased from 76% as of March'18 to 85% as of March'23 in terms of value due to the impact of economic slowdown and elevated cost of construction compared to pre-Covid levels. However, majority of the Home Loan pie in terms of volume is still dominated by the lower ticket size segment (less than Rs1.5mn, which accounted for 52% of Home Loans outstanding as of March'23). In lower ticket size loan segments (up to Rs0.75mn and Rs0.75-1.5mn), PSBs have been witnessing strong competition from HFCs.

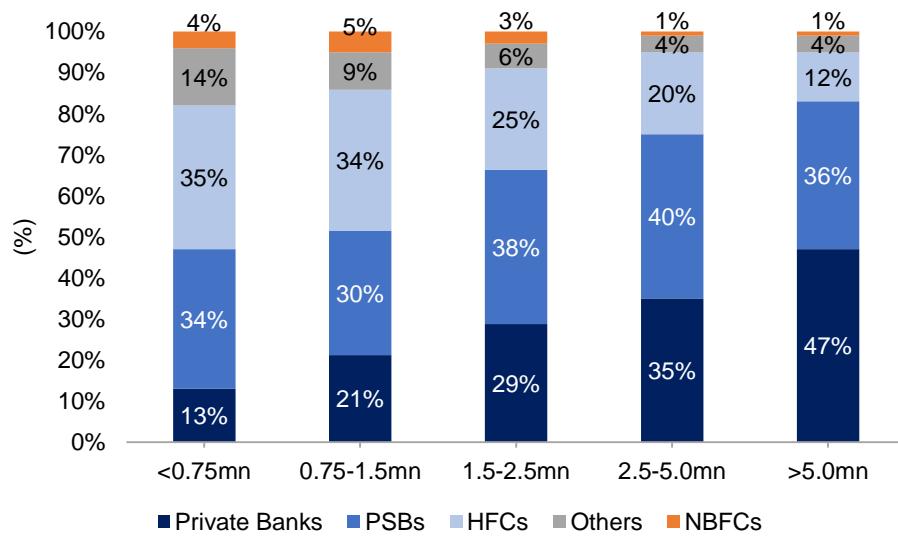
**Exhibit 6: High-ticket loans' share rises in value; but, below Rs1.5mn ticket size dominates in volume**


Note: Data excludes PMAY loans

Source: CRIF Highmark, CRISIL MI&A

Note: Data excludes PMAY loans

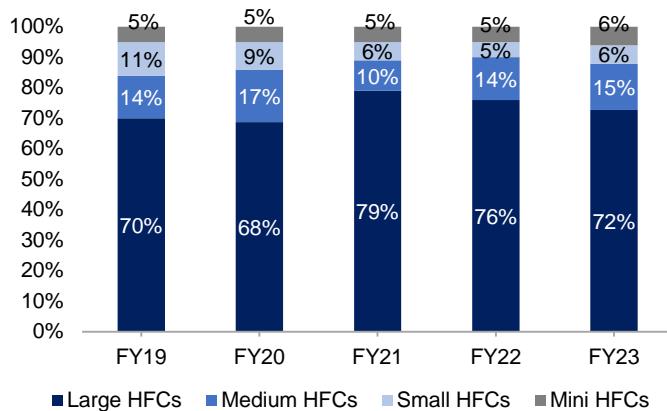
Source: CRIF Highmark, CRISIL MI&A

**Exhibit 7: In lower ticket size disbursements (up to Rs1.5mn), PSBs are seeing competition from HFCs**


Note: NBFCs include Fintech NBFCs, Others includes multi-national corporations ("MNCs") and small finance banks. The above classification of player groups is done based on data reported by respective entities to CIBIL.

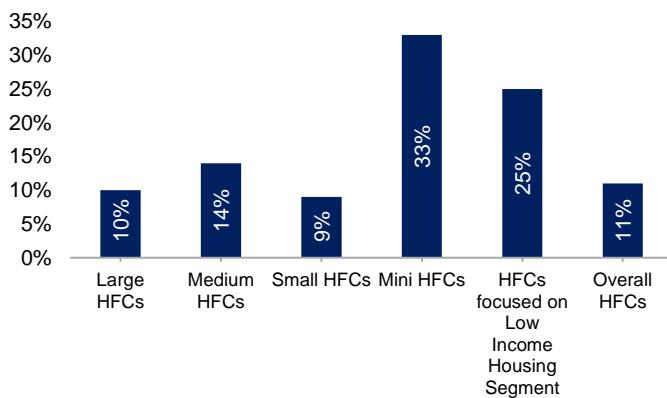
Source: CIBIL, CRISIL MI&A

Large HFCs continue to have a dominant share of the housing finance market, but their share has been falling in credit outstanding as several new HFCs (focused on Affordable Housing) have emerged. As of March'23, large HFCs had a market share of ~78% in Home Loan outstanding. The share of Mini HFCs in Home Loans outstanding has increased from 2% as of FY18 to 4% as of FY23. Moreover, the credit outstanding of Mini HFCs and HFCs focused on Affordable Housing grew at the fastest pace of 33% and 25% CAGR, respectively during FY18-FY23. As economic growth picks up, CRISIL MI&A expects revival in demand from the Affordable Housing segment to give a boost to mini, small and mid-sized HFCs.

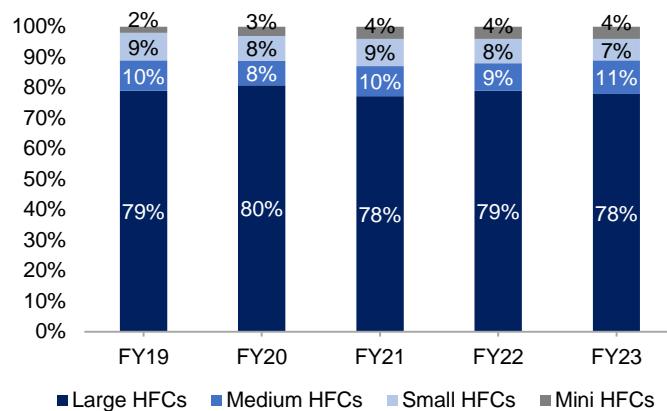
**Exhibit 8: While large HFCs continue to have a dominant share in disbursements...**


Note: GNPA considered as portfolio greater than 90 days excluding write-offs.

Source: CRIF Highmark, CRISIL MI&A

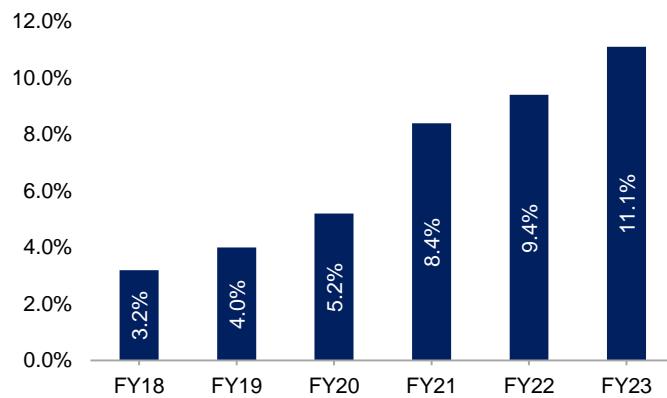
**Exhibit 10: Mini HFCs/HFCs focused on Affordable Housing have grown at 33% / 25% over FY18-FY23...**


Source: Source: CIBIL, CRISIL MI&A

**Exhibit 9: ... mini, small and mid-sized HFCs are increasing share in credit outstanding**


Note: GNPA considered as portfolio greater than 90 days excluding write-offs, Others include foreign banks and other players

Source: CRIF Highmark, CRISIL MI&A

**Exhibit 11: ...with rise in market share of Affordable Housing focused HFCs in overall Home Loans outstanding**


Source: CIBIL, CRISIL MI&A

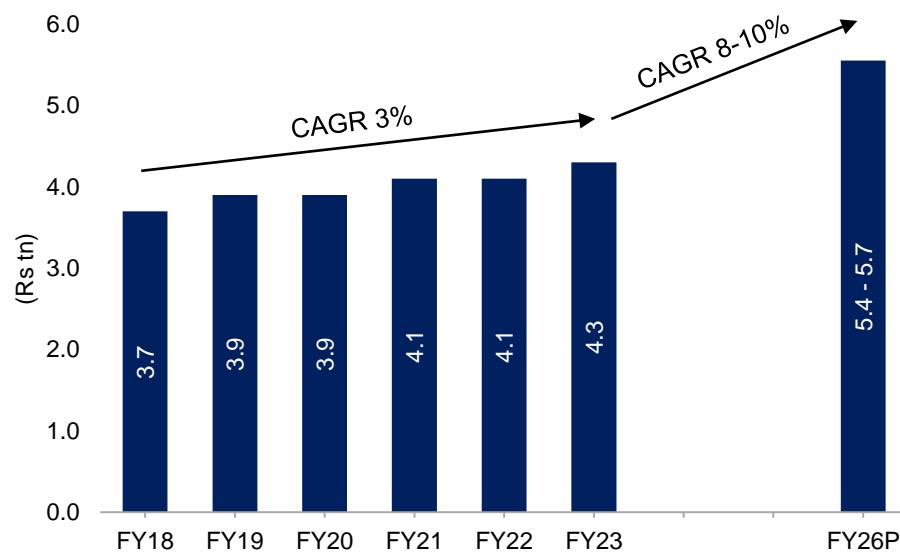
## What constitutes “Affordable Housing?”

India's mortgage market can broadly be divided into two segments - loans with ticket size of more than Rs1.5mn (normal mortgage market) and loans with ticket size of Rs1.5mn & below (Affordable Housing). As per RBI's report, the housing market in India is estimated to have a shortage of 45mn houses in the EWS segment and 50mn houses in the LIG segment (exhibit 5), accounting for 95% of the estimated housing shortage in India.

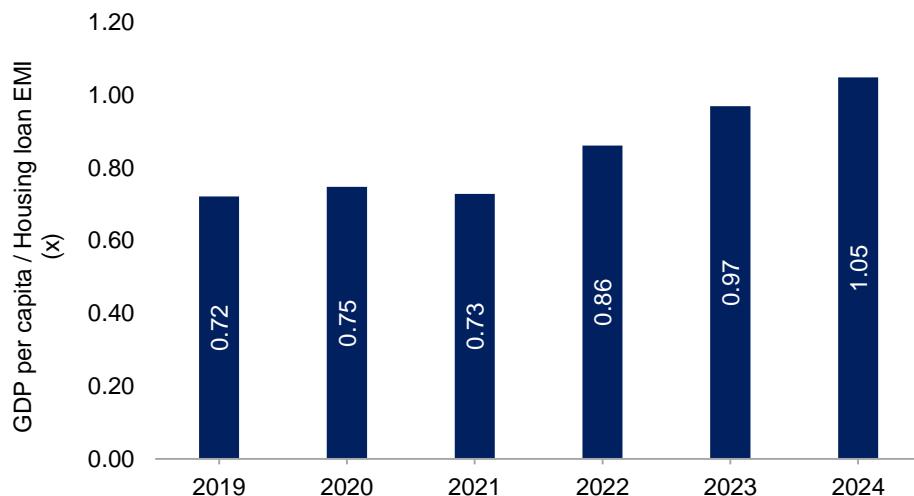
Affordable Housing focused loans in India were ~Rs4.3trn as of March'23, constituting ~15% of the overall housing finance market, as per CIBIL data. With outstanding loans of Rs1.8trn as of March'23, PSBs have the highest market share of 41% in the Affordable Housing market. HFCs accounted for 28% of the market (outstanding loans of Rs1.2trn as of March'23) followed by Private Banks, which had a market share of 21% (outstanding loans of Rs0.9trn as of March'23). All other groups (MNCs and SFBs) had a cumulative market share of 7% in Affordable Housing loans.

While the market has grown at a tepid pace over the past three years, CRISIL MI&A expects the industry to pick up steam gradually with a 8-10% CAGR over FY23-FY26 to reach Rs5.4-5.7trn by March'26. We believe the low-income housing market has seen multiple shocks over the past few years with demonetization, GST implementation and Covid-19 due to which growth has been weak. A rise in per capita income especially for the lower income class (exhibit 13) and increasing mortgage penetration along with moderating inflation will lead to a revival in demand for the affordable housing segment.

### Exhibit 12: Expect healthy growth of 8-10% in the Affordable Housing segment



Source: CRISIL MI&A, Nirmal Bang Institutional Equities Research

**Exhibit 13: Improving affordability for housing loans – GDP per capita/ annual housing loan EMI**


*Note: Assumed housing loan ticket size of Rs 1 mn for a tenure of 8 years with interest rates reported by HFFC Source: CRISIL MI&A, Nirmal Bang Institutional Equities Research*

**Exhibit 14: Regulatory initiatives to support growth**
**Government Initiatives**

- **PMAY-U (2015):** The scheme aims to fill the supply-demand gap in the housing sector.
- **PMAY-G (2016):** The scheme is for the rural population, which doesn't have their own houses. It provides financial assistance and interest rate subsidy.
- **Special financing window:** This window is expected to help revive stalled housing projects which require last-mile funding to reach completion.
- **Relaxation of ECB guidelines (2019):** The relaxed ECB guidelines will enable easier access to overseas funds and stimulate the sector.
- **Tax incentives:** Provides various tax benefits to home loan borrowers and developers.
- **Real estate regulatory authority (RERA) (2016):** The law was introduced in order to make the sector transparent.
- **Goods and Service Tax (GST) (2017):** The GST rate for Affordable Housing projects was cut.
- **Employees Provident Fund (EPF) corpus withdrawal:** Permission to withdraw 90% of the EPF corpus enables prospective home buyers to make the down-payment and pay their home loan EMIs.

**Regulator Initiatives**

- Risk weight rationalisation on housing loans to improve sentiment for the Real Estate sector.
- **Regulatory authority of HFCs shifted from NHB to RBI (2019):** The Budget 2020 proposed a change in regulatory oversight and supervision of HFCs from the NHB to the RBI. This shift led to more streamlined regulations and better risk management framework for HFCs.
- **SARFAESI Act (2002):** Bringing HFCs under the ambit of the SARFAESI Act has helped them accelerate recoveries.
- **NHB refinance:** The NHB refinancing schemes help HFCs lower their borrowing costs.
- **Priority sector lending (PSL) guidelines revised:** The RBI increased the threshold limit for home loans to be classified as PSL in order to promote PMAY.

**Other factors**

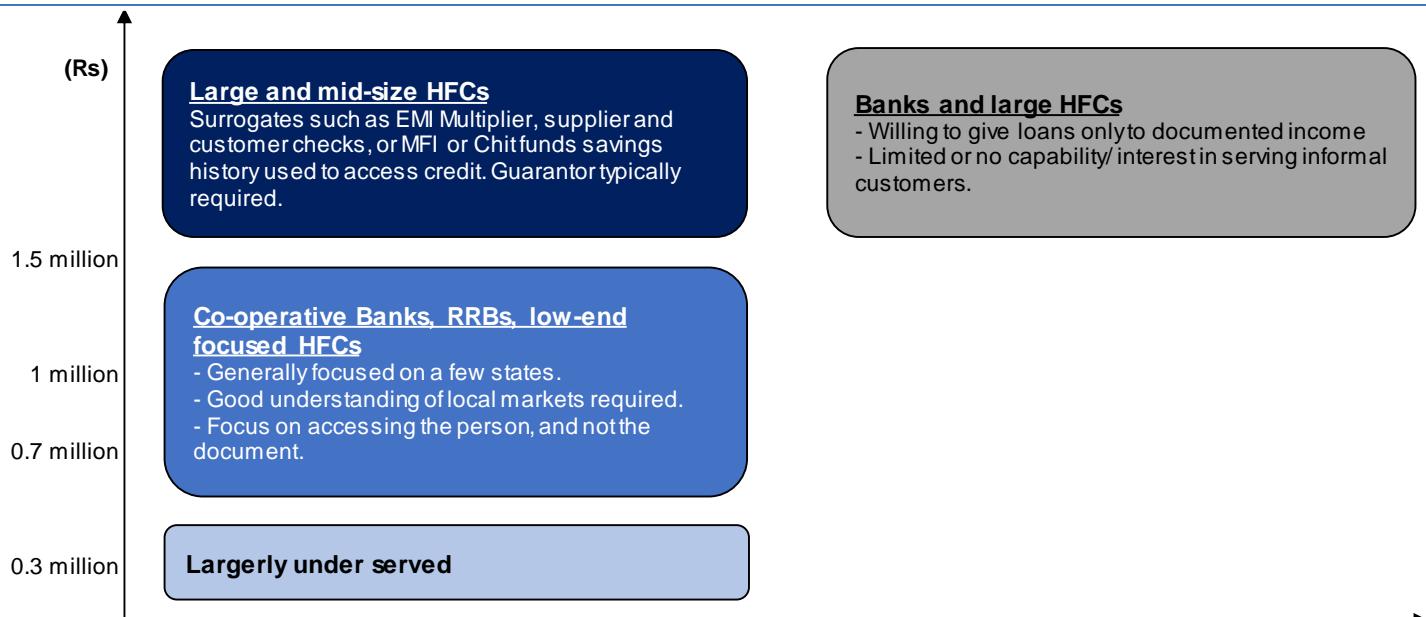
- **Low mortgage penetration.**
- **Growing urbanisation and nuclearisation:** Decreasing average household size and rising level of urban population create more housing demand.
- **Rising income levels:** Rising income levels help improve the affordability of houses.
- **Rising independent housing demand:** Increase in the share of independent houses helps housing finance market grow in the long term.

### Exploring Affordable Housing (<Rs1.5mn) segment

Housing financiers focused on the Affordable Housing segment typically serve the under-served category of low-income or mid-income customers who may be salaried, working in the informal sector or self-employed running a small business. An HFC targeting this segment of customers usually has a 'hub & spoke' model where retail branches of the HFC operate as 'hubs' in urban areas while small kiosks are set up near areas close to the construction activity to source customers. Financiers also spread awareness about their products in rural areas by setting up kiosks at 'gram sabhas' and arranging 'loan melas' for potential customers. Some players also rely on customers in need of credit for self-construction of their houses in tier-2 and tier-3 cities.

Usually, ~70% of the overall business of HFCs focused on Affordable Housing is sourced through direct sales teams. Moreover, all critical functions like origination, verification and credit appraisal are performed in-house while certain non-core activities like loan documentation and document processing may be outsourced. This allows HFCs operating in the segment to focus on vital aspects of lending such as verification, credit appraisal and credit assessment.

### Exhibit 15: Who caters to the Affordable Housing (<Rs1.5mn) segment?



#### Informal

Earns in Cash	Salaried or Self Employed
No Formal Income document	Significant proportion of undisclosed income
No Formal residence or identity documents	Some residence / identity documents

#### Formal

Salaried with pay-slip
Income tax documents/ Residence documents
Identity documents/ Bank documents

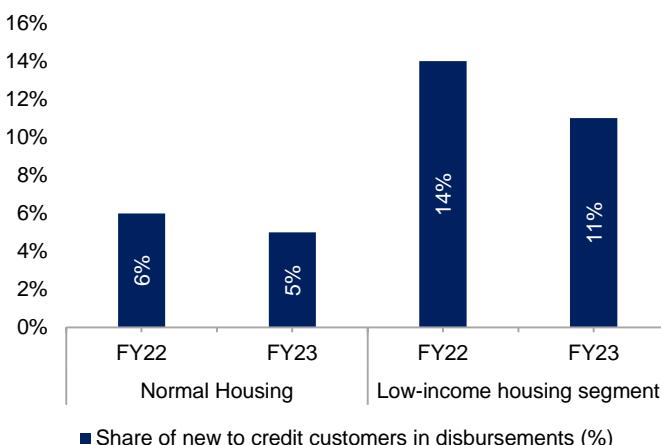
Source: CRISIL Mi&A, Nirmal Bang Institutional Equities Research

**Exhibit 16: Key differences between HFCs focused on Affordable Housing vs. other HFCs**

Sr. No. Parameters	HFCs focused on Affordable Housing	Normal housing finance players
1 Borrower profile	Mostly self-employed customers and customers having weaker income documents; some HFCs though focus on salaried but low-income customers	Majorly focus on customers having proper income documents
2 Surrogate usage	High surrogate usage to derive the income of borrowers	Very minimal usage of surrogates
3 Geographical focus	Mainly focus on smaller towns, semi-urbans areas and outskirts of larger cities	Mainly present in major locations and Tier 1 cities
4 Credit appraisal	Credit appraisal process involves high level of subjectivity to derive income and cash flow patterns	Credit appraisal process is based on pre-defined income and eligibility policies
5 Collection	Relatively lower share of repayment through electronic clearing service (ECS) / national automated clearing house (NACH) leading to higher operating expenses	Higher proportion of ECS and NACH in EMI payment leading to higher collection efficiency
6 Cost and sources of funds	Higher reliance on bank borrowings leading to relatively higher cost of funds	Higher reliance on capital markets leading to cheaper funds

Source: CRISIL MI&amp;A, Nirmal Bang Institutional Equities Research

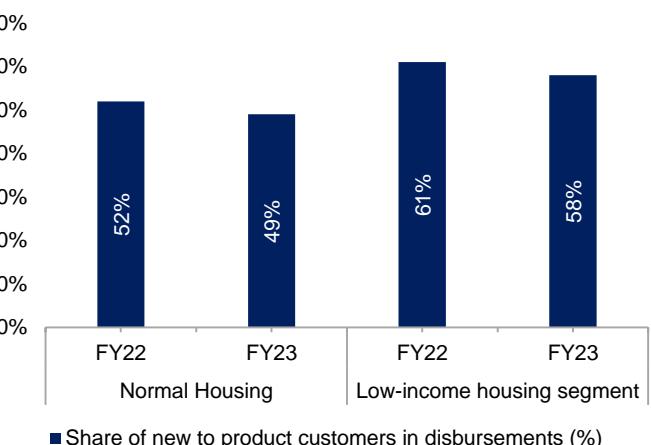
In FY23, the share of New-to-Credit (NTC) customers in housing finance focused on Affordable Housing was more than double that of normal housing segment (ticket size of more than Rs1.5mn). Moreover, as of FY23, first-time home loan customers accounted for 58% of home loan disbursements within the Affordable Housing segment vs. a share of ~49% in home loan disbursements above Rs1.5mn ticket size.

**Exhibit 17: Share of NTC customers higher (in value)...**


Note: Share of new to credit is derived as disbursement to new to credit customers divided by total disbursement to new to credit and known to credit customers.

New to credit customers are defined as customers with no credit history at the time of loan sanction

Source: CIBIL, CRISIL MI&amp;A, Nirmal Bang Institutional Equities Research

**Exhibit 18: Majority new to home loans (in value) as well**


Note: Share of new to product is derived as disbursement to new to product customers divided by total disbursement to new to product and known to product customers.

New to product customers are defined as customers with no credit history for home loans at the time of loan sanction

Source: CIBIL, CRISIL MI&amp;A, Nirmal Bang Institutional Equities Research

HFCs had 34% market share in housing finance disbursements and 28% market share in terms of outstanding focused on Affordable Housing in FY23. They have been able to build a strong market position in this segment on account of their strong focus on their target segment (i.e., housing loans lower than Rs1.5n ticket size to low-income customers), deep understanding of the micro-markets they operate in and relatively lower focus on other products such as Loans Against Property (LAP) and developer loans. In addition, they largely rely on their own direct sales teams to source home loans as opposed to market intermediaries such as DSAs. According to CRISIL MI&A estimates, direct sales teams as a sourcing channel accounts for 65-70% of loans of these HFCs.

**Exhibit 19: HFCs use 4Cs to succeed in Affordable Housing**


Source: CRISIL MI&A, Nirmal Bang Institutional Equities Research

**Exhibit 20: Operational parameters of AHFCs vs. normal HFCs**

Sr. No.	Parameters	Affordable Housing Finance Players	Normal Housing Finance Players
1	Sourcing mix	DSTs: 70%, DSAs: 20%, Branch walk-ins & others: 10%	DSTs: 60%, DSAs: 30%, Branch walk-ins & others: 10%
2	Average TAT	8-10 working days	9-11 working days
3	Loan to value	Average: 68%	Average: 75%
4	Customer profile mix	Salaried: 45-50%, Self-employed: 50-55%	Salaried: 50-60%, Self-employed: 40-50%
5	Portfolio Composition	Portfolio majorly dominated by Housing Loans followed by Loan Against Property (LAP)	Major composition of portfolio is housing loans also have significant share of other loan types (Project Loans, Construction Loans, etc.)
6	Loan Seeker Occupation	Majorly dominated by Self Occupied Individuals (Avg: 70%)	Majorly dominated by Salaried Individuals (Avg: 75%+)
7	Collection Efficiency	Average collection efficiency of 100% at par with Generic Housing Finance companies	Average collection efficiency of 100%

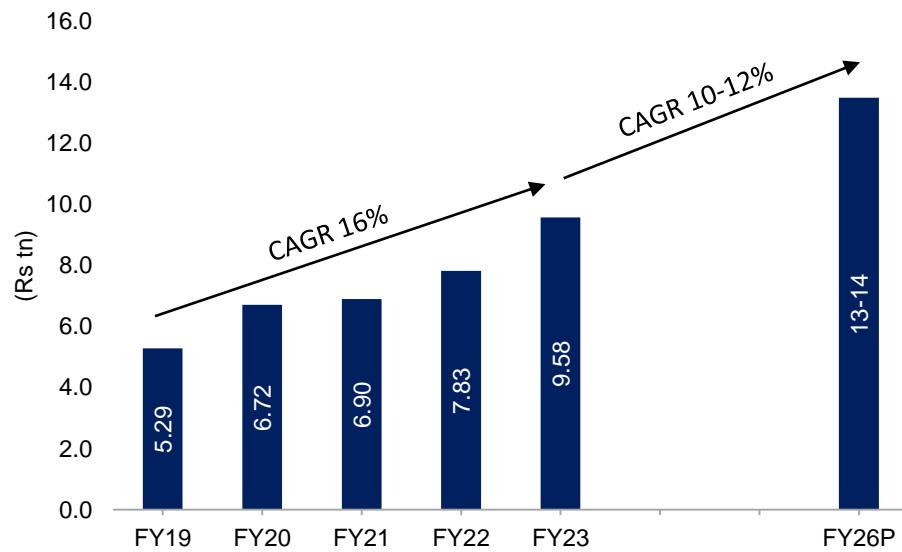
Note: DSTs: Direct Sales Teams, DSAs: Direct Selling Agents

Source: Industry, CRISIL MI&A

## LAP to grow at 10-12% CAGR during FY23-FY26

LAP has become popular among borrowers in recent years with an expansion in market size from Rs5.29trn in FY19 to Rs9.58trn in FY23. CRISIL MI&A expects overall LAP portfolio to grow at 10-12% CAGR during FY23-FY26, aided by increasing lender focus and penetration of such loans, growing lender comfort, enhanced use of technology, entry of new players and continued government support.

### Exhibit 21: LAP portfolio to grow at 10-12% CAGR during FY23-FY26



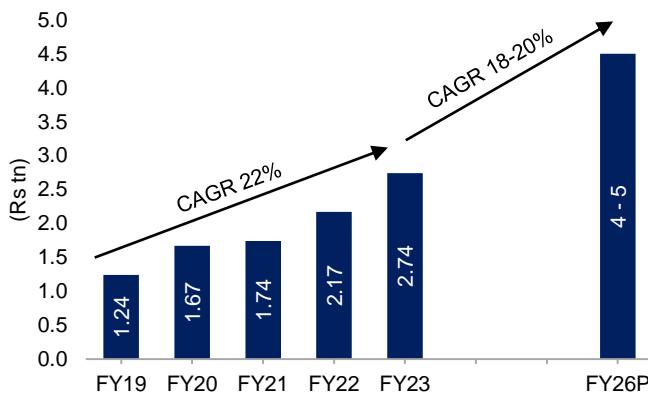
Note: P:Projected

Source: CRIF Highmark, CRISIL MI&A

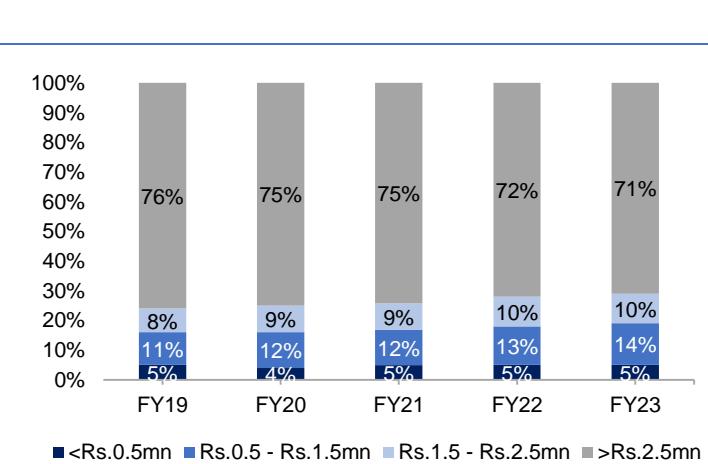
## LAP portfolio (<Rs2.5mn) to grow at a higher pace of 18-20% over FY23-FY26

LAP portfolio (<Rs2.5mn) has grown at a CAGR of 22% during FY19-FY23 and its share has increased from 23% in FY19 to ~29% in FY23. Within groups, HFCs are expected to register strong growth in this segment due to their higher market share, deeper penetration in tier 2 & 3 cities and adequate liquidity support. CRISIL MI&A projects LAP portfolio (<Rs2.5mn) to grow at 18-20% CAGR during FY23-FY26 vs. 10-12% growth for the overall LAP portfolio.

### Exhibit 22: LAP portfolio (<Rs2.5mn) clocked a CAGR of 22% during FY19-FY23...



### Exhibit 23: ...and constitutes ~29% of the market



Note: Numbers are rounded off to show the market share

Source: CRIF Highmark, CRISIL MI&A

Note: Others includes SFBs, foreign banks, regional rural banks, and co-operative banks

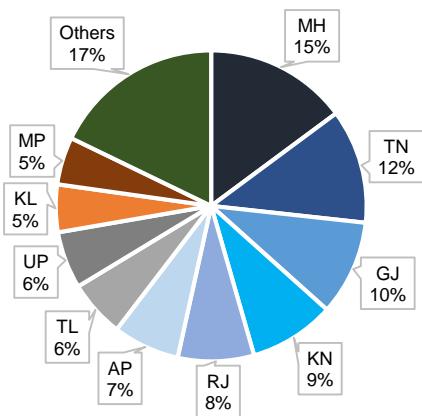
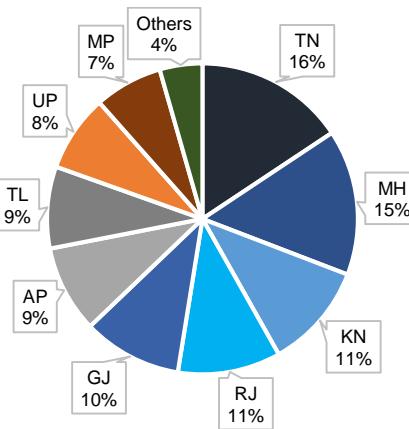
Source: CRIF Highmark, CRISIL MI&A

**Exhibit 24: Key factors driving competitiveness of HFCs in the LAP portfolio (<Rs2.5mn)**

HFCs had the highest market share among all players in the <Rs2.5mn LAP segment in FY23 and have been able to maintain this share due to various metrics:

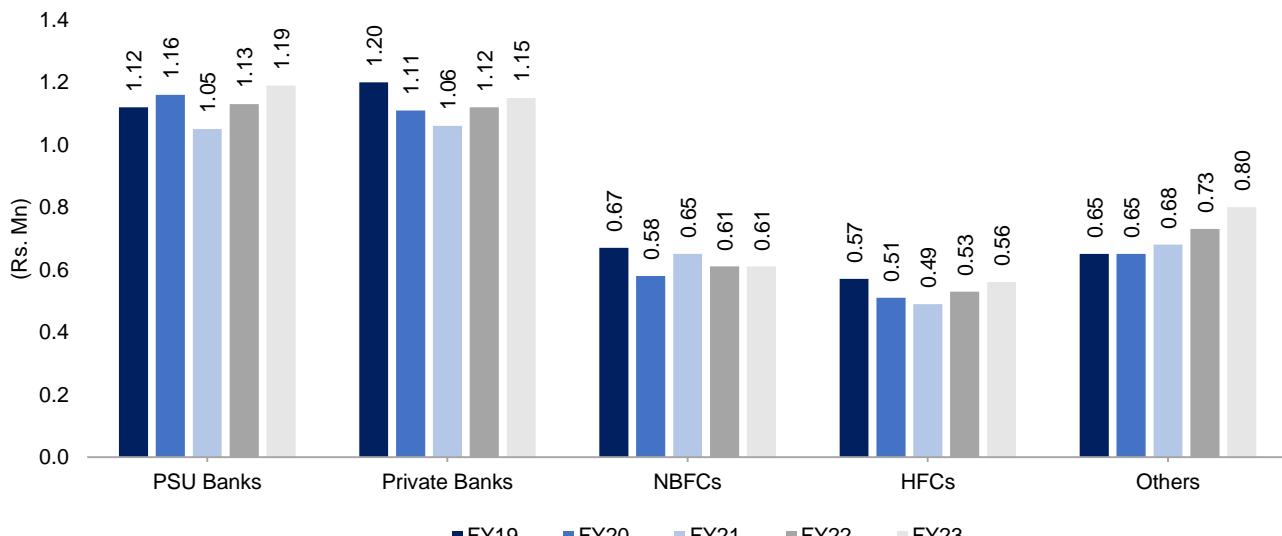
- Faster processing time, lower turnaround times in loans vs. peers
- HFCs offer flexible repayment terms on LAPs compared to other players
- HFCs have higher on-ground knowledge and a better understanding of the Real Estate market, giving them a competitive edge
- HFCs also have better expertise in underwriting loans in the informal segment along with borrowers with no or limited credit information
- Completely digitized processes along with 24\*7 disbursements to borrowers

Source: CRIF Highmark, CRISIL MI&A

**Exhibit 25: While Maharashtra has the highest share in overall LAP portfolio (<Rs2.5mn)...**

**Exhibit 26: ...TN leads with the highest disbursements in FY23**


Note: P: Projected

Source: CRIF Highmark, CRISIL MI&A

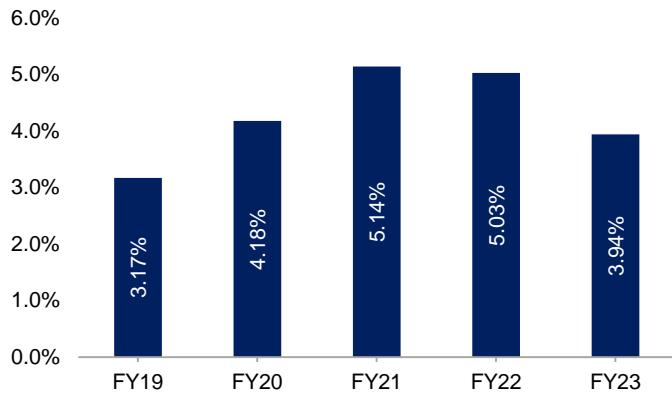
**Exhibit 27: HFCs have lower average ticket size vs. other lenders in LAP portfolio (<Rs2.5mn)**


Note: Others include foreign banks and other players

Source: CRIF Highmark, CRISIL MI&A

Asset quality in the LAP segment deteriorated in FY21 on account of the Covid-19 pandemic and we saw an elevated GNPA ratio of 5.03% in FY22 (vs. 3.17% in FY19). However, it improved to 3.94% in FY23 with economic revival resulting in an improvement in CE. HFCs in particular witnessed a significant improvement in asset quality in the LAP portfolio (< Rs2.5mn) in FY23 due to their expertise in the product and we expect the trend to continue with an improvement in economic activity, better CE and faster credit growth.

**Exhibit 28: Asset quality in LAP portfolio saw an improvement in FY23...**

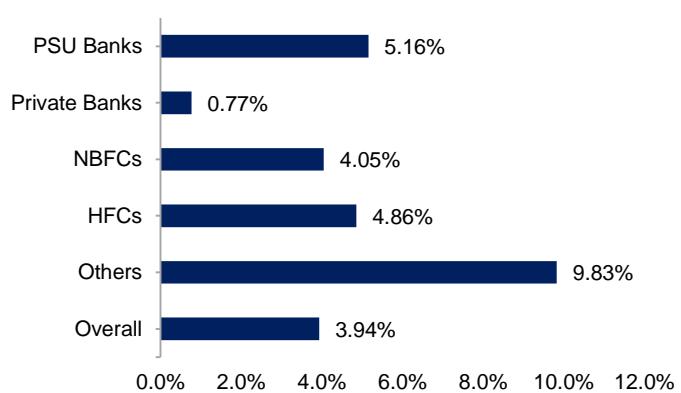


Note: GNPA considered as portfolio greater than 90 days excluding write-offs.

Source: CRIF Highmark, CRISIL MI&A

Source: ICRA, Nirmal Bang Institutional Equities Research

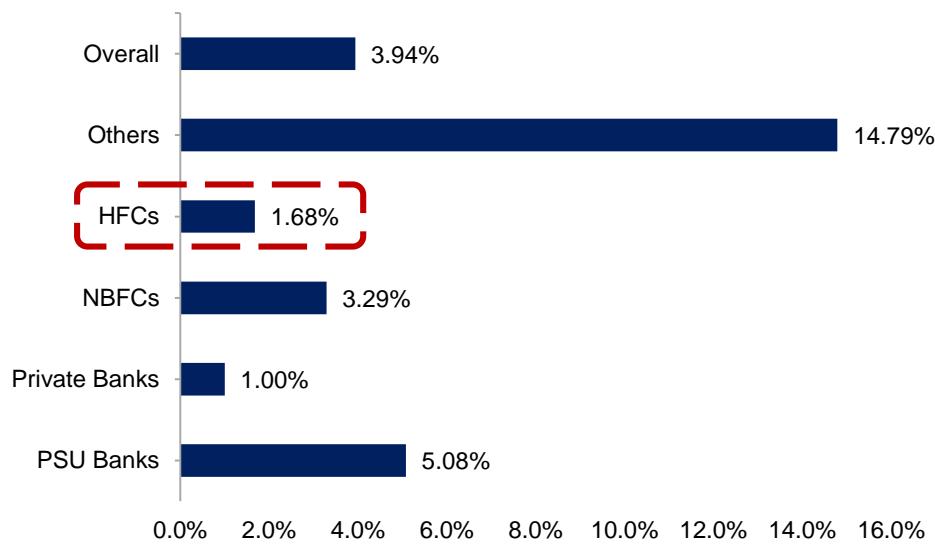
**Exhibit 29: ...with an improvement across all player groups (FY23)**



Note: GNPA considered as portfolio greater than 90 days excluding write-offs, Others include foreign banks and other players

Source: CRIF Highmark, CRISIL MI&A

**Exhibit 30: HFCs have superior asset quality among other lender types in the LAP portfolio (<Rs2.5mn) – FY23**



Source: ICRA, Nirmal Bang Institutional Equities Research

NBFCs in the LAP segment operate with yield of ~15-18% on an average. With average cost of funds being ~10-11%, NIMs in this segment are typically ~5-7%. We have seen an improvement in profitability for this segment from FY23 onwards owing to lower credit costs.

## AHFCs have a lucrative model

AHFCs have emerged as high-growth, high-RoA businesses. We have observed that the yield profile of AHFCs is strong across products and asset quality cycles. High RoAs of HFCs focused on Affordable Housing segment (~3% in FY23) can be attributed to the relatively higher yields they enjoy despite a higher cost of funds. The sector attracts higher yields as the customer segment is more vulnerable to economic shocks, adding to the risk premium for lenders. Moreover, AHFCs cater to a set of customers who are not very sensitive to interest rate changes, unlike large HFCs, and do not find it difficult to pass on the rate hikes to customers.

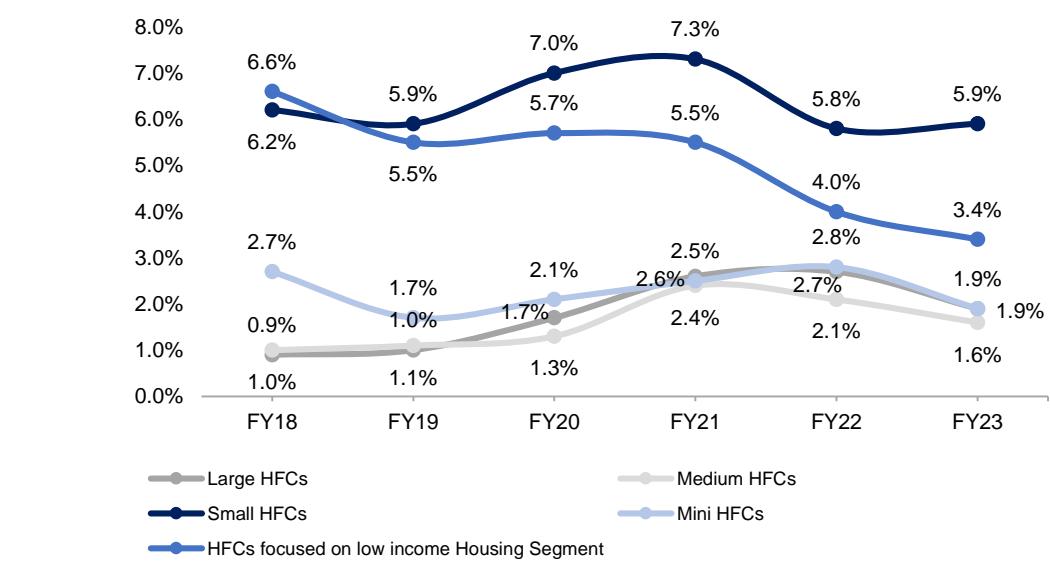
However, there is a significant variation in asset quality across players. In the Affordable Housing segment, the GNPA ratio for large and medium HFCs stood at 1.9%/1.6% as of March'23 while Small HFCs had the highest GNPA ratio of 5.9%. As the Indian economy revives, CRISIL MI&A expects delinquencies to normalize, resulting in a decrease in credit costs for HFCs. Additionally, for Affordable Housing players, operating expenses are expected to moderate, with the benefits of scale and digitalization kicking in.

### Exhibit 31: Despite high borrowing and opex costs, AHFCs earn RoAs of 3.5-4%

Parameter	2019-20	2020-21	2021-22	2022-23
NIMs	5.2%	5.6%	5.7%	6.0%
Yield on advances	14.4%	12.9%	13.4%	13.6%
Cost of borrowings	8.9%	8.9%	7.3%	7.7%
Opex	3.5%	3.2%	3.3%	3.6%
Credit Costs	0.4%	1.0%	0.4%	0.3%
RoE	12.3%	11.1%	12.4%	13.1%
RoA	4.0%	3.4%	3.9%	4.0%

Source: ICRA, Nirmal Bang Institutional Equities Research

### Exhibit 32: Small HFCs have seen higher asset quality stress - GNPA ratio (90dpd) of HFC groups in the Affordable Housing segment



Source: CIBIL, CRISIL MI&A

## Peer benchmarking

	Aavas			Aptus			HFFC		
	FY22	FY23	9MFY24	FY22	FY23	9MFY24	FY22	FY23	9MFY24
AUM (Rs bn)	113.5	141.7	160.8	51.8	67.4	80.7	53.8	72.0	90.1
AUM growth CAGR (FY19-23)		24.3%			31.6%			31.0%	
Disbursements (Rs bn)	36.0	50.2	36.9	16.4	23.9	21.6	20.3	30.1	28.6
Disbursement growth CAGR (FY19-23)		17.1%			19.3%			17.6%	
<b>AUM Mix (%)</b>									
Home Loans (%)	72.1%	69.9%	69.3%	67.0%	65.0%	69.0%	91.0%	88.0%	86.0%
LAP (%)	27.9%	30.1%	30.7%	0.0%	0.0%	0.0%	1.0%	1.0%	1.0%
Others (%)	0.0%	0.0%	0.0%	33.0%	35.0%	31.0%	8.0%	11.0%	13.0%
Salaried	40.0%	39.9%	40.2%	28.0%	29.0%	28.0%	72.0%	70.0%	68.0%
Self-Employed	60.0%	60.1%	59.8%	72.0%	71.0%	72.0%	28.0%	30.0%	32.0%
<b>Operational Metrics (%)</b>									
Yields (%)	12.65%	13.12%	13.07%	16.89%	17.00%	17.23%	12.80%	13.10%	13.50%
CoF (%)	6.88%	7.61%	7.95%	7.74%	8.10%	8.45%	7.20%	7.40%	8.20%
Spreads (%)	5.77%	5.51%	5.12%	9.15%	8.90%	8.78%	5.60%	5.70%	5.30%
NIMs (%)	8.23%	8.28%	7.94%	11.24%	10.88%	9.49%	5.70%	6.40%	6.20%
Opex/ AUM Ratio (%)	3.5%	3.7%	3.5%	2.3%	2.6%	2.7%	2.7%	2.8%	2.8%
Cost to Income Ratio (%)	41.9%	44.6%	46.1%	18.7%	19.8%	19.3%	33.9%	35.5%	35.9%
<b>Productivity</b>									
AUM/ Branch (Rs mn)	361.5	409.4	458.1	249.0	291.7	308.1	672.5	648.5	732.8
AUM/ Employee (Rs mn)	21.7	23.5	26.8	22.8	28.0	28.8	63.2	72.5	72.9
Disbursement/ Branch (Rs mn)	114.7	145.2	105.1	78.9	103.6	82.4	253.8	271.4	232.6
Disbursement/ Employee (Rs mn)	6.9	8.3	6.1	7.2	10.0	7.7	23.9	30.3	23.2
<b>Branches</b>	314	346	351	208	231	262	80	111	123
<b>Districts</b>	480	480	480	213	231	262	98	119	126
<b>Avg Ticket Size (Rs mn)</b>	0.86	0.89	0.92	1.00	1.00	1.00	1.05	1.11	1.14
<b>Asset Quality (%)</b>									
GNPA (%)	0.99%	0.92%	1.09%	1.19%	1.15%	1.19%	2.30%	1.60%	1.70%
NNPA (%)	0.77%	0.68%	0.79%	0.89%	0.86%	0.89%	1.80%	1.10%	1.20%
PCR (%)	23.1%	26.9%	27.5%	25.0%	25.0%	25.0%	24.9%	34.0%	29.9%
<b>Return Ratios (%)</b>									
RoA (%)	3.6%	3.5%	3.2%	8.0%	8.4%	8.1%	3.6%	3.9%	3.7%
RoE (%)	13.7%	14.1%	13.5%	14.5%	16.3%	17.1%	11.8%	13.5%	15.8%
<b>Geographic Dist (% of AUM)</b>									
Top 5 states (%)	NA	NA	NA	100.0%	100.0%	100.0%	79.9%	77.1%	75.2%
<b>Capital Adequacy</b>									
Tier 1 Ratio (%)	50.7%	46.5%	48.0%	85.4%	76.6%	NA	58.0%	48.9%	40.5%
Capital Adequacy Ratio (%)	51.4%	46.9%	46.0%	85.6%	77.4%	70.5%	58.6%	49.4%	40.9%
<b>Borrowing mix (%)</b>									
Term Loans	37.9%	45.0%	47.0%	50.0%	60.0%	63.0%	47.0%	60.0%	58.0%
NHB	21.5%	20.8%	18.8%	32.0%	26.0%	23.0%	27.0%	15.0%	22.0%
NCD	17.7%	12.2%	10.1%	14.0%	10.0%	6.0%	4.0%	6.0%	3.0%
Others	22.9%	22.0%	24.2%	4.0%	4.0%	8.0%	23.0%	19.0%	17.0%

Source: Company, Nirmal Bang Institutional Equities Research

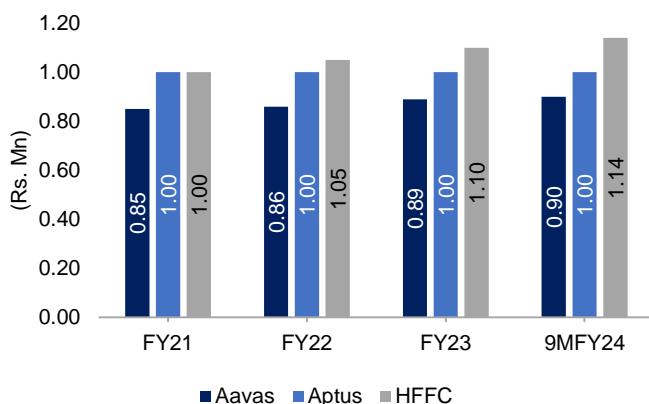
## Underwriting the right kind of customer

We take a look at the different customer cohorts targeted by AHFCs in the segment:

Home First Finance Company (HFFC) targets mostly formal, salaried borrowers in large affordable housing markets. These markets already have multiple lenders and hence the company has 'second-mover advantage' in these markets, picking up from the know-how of incumbent lenders (banks/ large NBFCs). This model is scalable, but is less defensible because there is significant competition from banks in these markets and most customers have pre-existing (deposit) relationships with them.

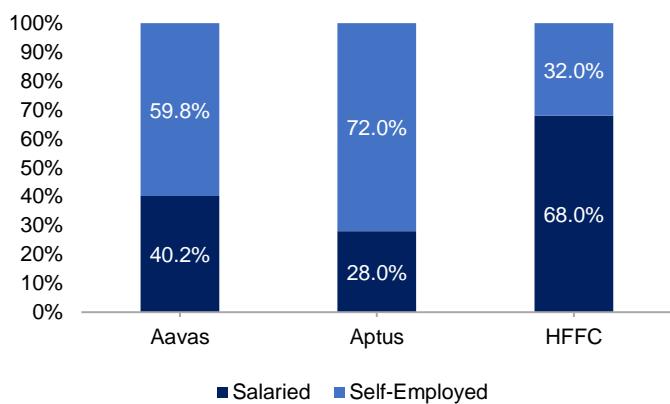
Aavas/Aptus are focused on serving deeper geographies with majority branches in tier 2 & 3 markets vs. HFFC. Moreover, self-employed customers account for 60%/72% of AUM for Aavas/Aptus vs. 32% for HFFC (Dec'23). While all three companies cater to a similar ticket size, Aptus and Aavas offer loans to the lowest end of the spectrum. The Average Ticket Size (ATS) of HFFC was Rs1.1mn in FY23 vs. Rs1.0mn/Rs0.9mn for Aptus/Aavas. We believe that exposure to small-ticket loans from a large self-employed customer base in tier 2 & 3 markets ensures a longer runway of growth.

**Exhibit 33: Aavas/Aptus offer smaller-ticket housing loans vs. HFFC**



Source: Company, Nirmal Bang Institutional Equities Research

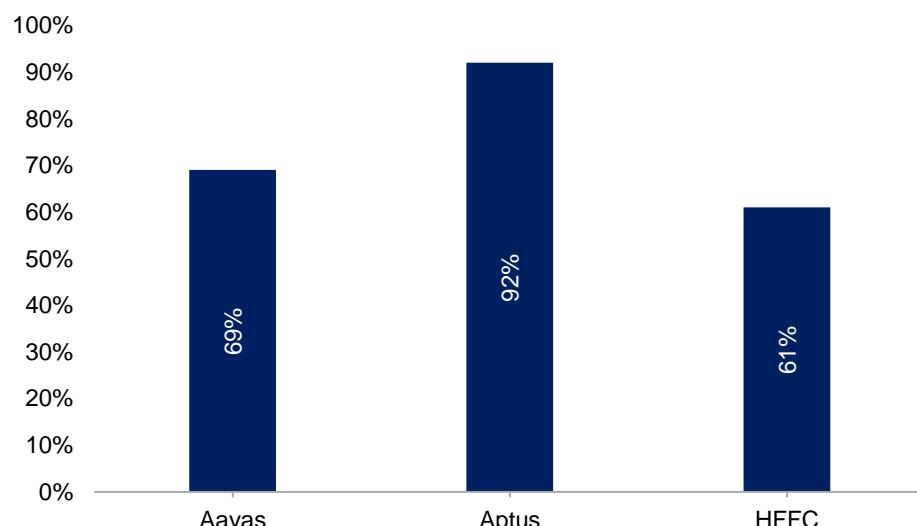
**Exhibit 34: Self-employed customers comprise 60%/72% for Aavas/Aptus vs. 32% for HFFC (Dec'23)**



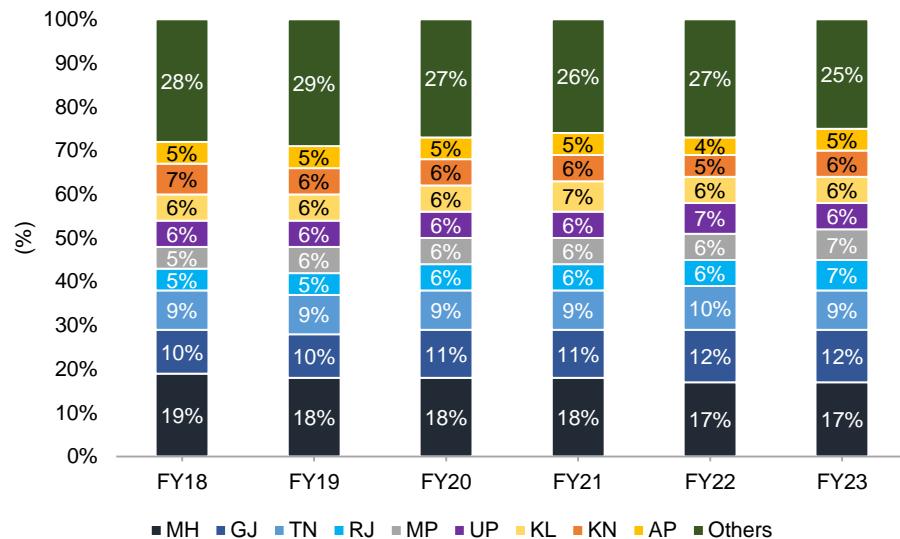
Source: Company, Nirmal Bang Institutional Equities Research

AHFCs also have concentrated operations with 61%/69%/92% of AUM in top 3 states for HFFC/Aavas/Aptus (as of FY23). Geographical expansion, driven by a scale-up in new branch openings will help in diversifying their portfolios.

**Exhibit 35: Aavas/ HFFC/Aptus have high exposure to top 3 states (FY23)**



Source: Company, Nirmal Bang Institutional Equities Research

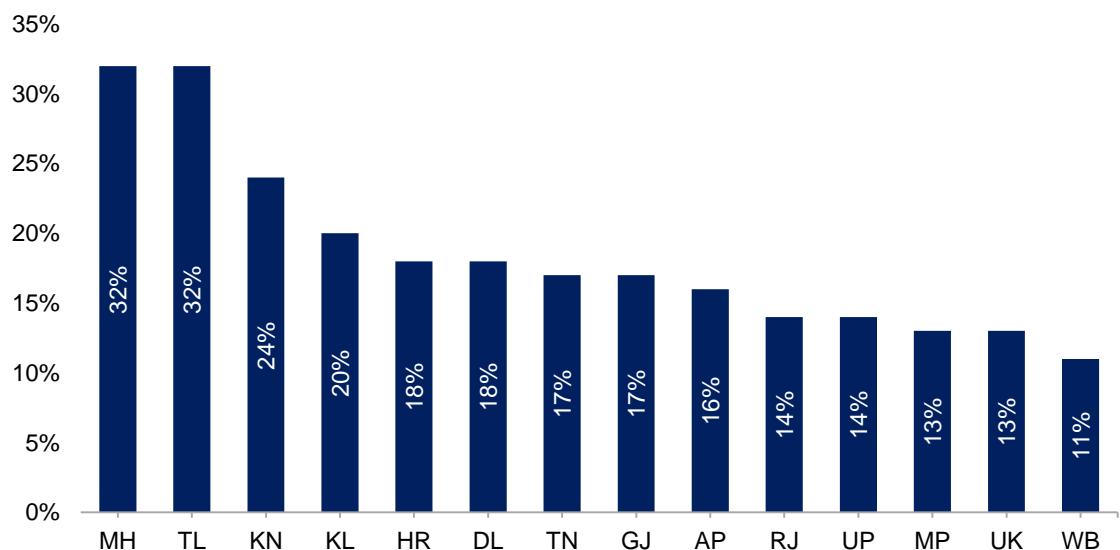
**Exhibit 36: West/ South dominate the Affordable Housing market**


Note: States/UT which have less than 1.5% share of housing finance focused on low income housing segment are- Bihar, Odisha, Uttarakhand, Assam, Himachal Pradesh, Jharkhand, Chandigarh, Jammu and Kashmir, Goa, Tripura, Pondicherry, Sikkim, Mizoram, Dadra & Nagar Haveli, Manipur, Meghalaya, Daman & Diu, Andaman & Nicobar islands, Nagaland, Arunachal Pradesh and Lakshadweep

Source: CIBIL, CRISIL MI&

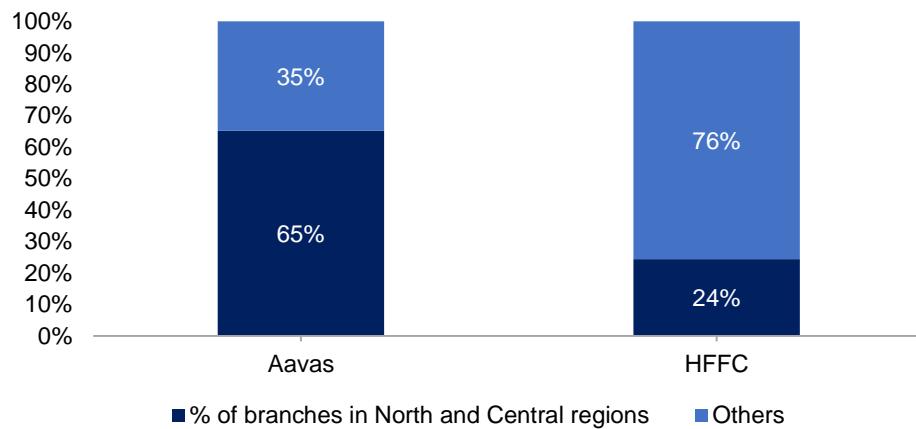
Traditionally, Western/Southern states have dominated the HF industry due to higher per capita incomes. Based on home loans outstanding in the Affordable Housing segment, Maharashtra has the highest share at 17% followed by Gujarat (12%), Tamil Nadu (9%), Rajasthan (7%) and Madhya Pradesh (6.5%).

Home loan penetration levels in the Western/Southern regions have also been higher (32% - 20%) vs. the national average (12%). We believe that North/Central regions have better growth prospects given a larger population size and significant under-penetration. 65% of branches for Aavas are in the North/Central regions vs. 24% for HFFC (Dec'23) while Aptus has negligible presence in these regions.

**Exhibit 37: North/Central regions have higher scope for further home loan penetration**


Note: Housing loan penetration calculated as Housing loan outstanding over state GSDP (at constant prices) as of Fiscal 2023; GDP taken as GSDP at constant prices, Base Year: 2011-12., \* GDSP taken for Fiscal 2022.

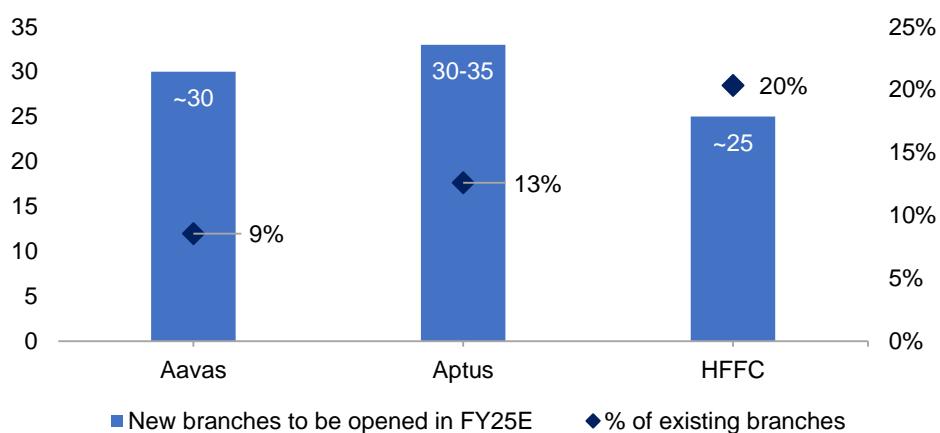
Source: CIBIL, RBI, MOSPI, CRISIL MI&A, Nirmal Bang Institutional Equities Research

**Exhibit 38: Aavas has a larger presence in North/ Central regions**


Source: Swiss Re, *Closing Asia's mortality protection gap 2020*, Nirmal Bang Institutional Equities Research

**Focus on deep distribution with an in-house sourcing model**

AHFCs have been able to maintain an edge in distribution by following a branch-heavy strategy to increase presence in tier 2 & 3 locations. Moreover, each of them have laid out aggressive plans in terms of new branch openings over the medium term.

**Exhibit 39: No. of branches to be opened in FY25**


\*Note: % of branches is as of 9MFY24; Source: Company, Nirmal Bang Institutional Equities Research

**Almost 100% of leads sourced are in-house**

Unlike traditional counterparts (Banks and HFCs), most of the sourcing for AHFCs is done in-house, led by existing employees and branches. While this allows them to maintain high underwriting standards, it is an opex-heavy strategy. While Aavas and Aptus have a completely in-house sourcing model, HFFC has built a unique model by sourcing leads through connectors. Connectors are individuals such as builders, hardware store owners, accountants/ lawyers etc. who help an individual in the purchase/ construction of a house while charging a small fee. To scale up, we believe that AHFCs will need to diversify their distribution mix by moving towards a hybrid sourcing model. While HFFC's distribution mix is more diversified, we expect Aavas and Aptus also to add DSAs/Connectors as an external channel to boost growth.

**In-house model of underwriting**

Both Aavas and Aptus follow a completely in-house model of lending from originations to collections. While this strategy is opex-heavy, it results in better quality underwriting. Since majority of these customers are self-employed with informal proof of income, underwriting these loans requires a high degree of subjective assessment. Investments in manpower and infrastructure are needed to manage operations.

**Exhibit 40: Key aspects of the underwriting model for AHFCs**

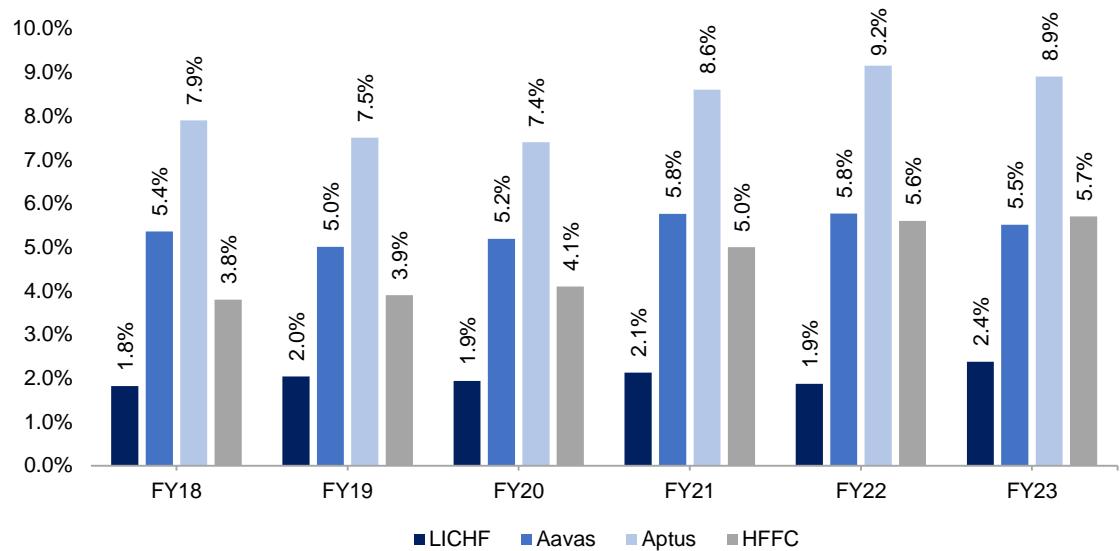
Function	Aavas	Aptus	HFFC
Lead generation	RMs directly source OTP-verified leads via referrals	Leads are generated through local advertisements, referrals, CRM team	Leads are generated mainly through connectors
	Alternate channels such as kiosk centres (e-Mitra), builder ecosystem, tie-ups with Approved Project Finance builders		Other sources such as builder ecosystem, referrals, marketing activities, micro-connectors, digital marketing, construction community etc.
Initial screening	In-house (KYC/ credit bureau scores/ third party or account aggregator information) done by RM	In-house (KYC/ credit bureau scores/ third party or account aggregator information) done by RM	In-house (KYC/ credit bureau scores/ third party or account aggregator information)
	Home/ workplace visits done by Credit Officers	Home/ workplace visits done by Credit Officers	Home/ workplace visits done by Sales RM
Underwriting	Decentralised Underwriting model	Centralised Underwriting model	Centralized underwriting team assisted by data science backed customer-scoring model to evaluate a customer's ability to repay the loan
	Credit Officers visit customers to understand their business, revenue streams, expenses and based on income validations, determine their loan eligibility and then prepare a credit appraisal memorandum/cash flow analysis	Credit officers assess customers' income and expenses by direct field visits, verification of income documents and other revenue streams, conducting reference checks and responding to queries from the Central Office	Technology platform enables it to digitally capture over 100 data points of a customer; third-party databases help obtain additional customer data points
	More than 60 templates of customer profiles with risk assessment measures for each geography	Review financial and other documents such as bank statements, salary slips and educational/technical qualifications	CRM and Loan Management System, which serves as a single platform for all internal and external customer related interactions integrated with third-party databases
	For salaried customers, the Credit Officer conducts telephonic discussions to prepare the credit appraisal memorandum	Assessed income is verified with surrogates such as recently created assets, including vehicles, residential lifestyle and education of family members	Proprietary ML credit scoring models to assist with credit assessment process; the model bifurcates customers into different categories based on the level of risk, which is then reviewed by underwriters to make a final decision
Legal/ Technical Assessment	In-house team of lawyers and engineers for verification of documents and technical evaluation/ periodical review of construction projects	In-house team of lawyers and civil engineers for inspection of collateral	Legal and technical assessment through third party vendors to verify the authenticity of the technical documents, legal title to the collateral property and its market value
Collections	Four-tier collections infrastructure comprising tele-calling, field collection, legal recovery and settlement	All borrowers register for an automated debit facility and payment reminders are given through text messages and automated calls	All borrowers register for an automated debit facility and they track the status of installments collected on a real time basis through a collections module
	Focus on early warning signals in accounts that are from 1dpd with localized teams	Between 1-29 dpd, Aptus sends customers letters and calls them to remind them of their overdue payments	At 1 dpd, front-end field teams call customers and at 30 dpd, company sends a default/ loan recall notice
	Specialized collections team to manage cases where collections are overdue for a certain period	Between 30 and 89 dpd, it conducts field visits to a customer's place of business or residence	At 60 dpd, company sends a pre-SARFAESI notice and employees increase the visit frequency and reiterate the repercussions of loan default
	Separate team to focus on the resolution of cases through SARFAESI	For loans over 90 dpd, it initiates legal action through SARFAESI/arbitration proceedings	At 90 dpd, company initiates legal action through SARFAESI
	Developed a statistical algorithm to predict the probability of default and conduct real time tracking of collections personnel		Use proprietary machine learning model to predict probability of bounce and initiate pre-emptive reminder calls
			Significant portion of employee incentives are dependent on collections

Source: Swiss Re, Closing Asia's mortality protection gap 2020, Nirmal Bang Institutional Equities Research

## Higher spreads are not here to stay

AHFCs have created a niche by focusing on self-employed, informal income customers in tier 2/3 locations. This is clearly reflected in their spreads, which are ~3x of large HFCs such as LICHF. However, with banks becoming more active in secured lending (Housing and Gold Loans), we believe that the market has become increasingly competitive. Moreover, even within AHFCs, we are starting to see signs of regional saturation.

### Exhibit 41: Spreads for AHFCs have been higher vs. LICHF



Source: IRDAI Annual Report, Nirmal Bang Institutional Equities Research

### Pre-payments/ BT-out pressures likely to be seen in FY25

Our interactions with AHFCs suggest that rate cuts by large banks such as SBI/HDFC in the past has led to higher pre-payments and Balance Transfer (BT) -out activity. While BT-outs are currently stable, we expect rate cuts (from H2FY25 onwards) to hamper growth for AHFCs. For instance, a rate cut of 100bps would result in interest savings of 8% if the loan is re-priced. We expect price competition, especially with banks planning to intensify their efforts in FY24, resulting in higher repayment and BT-out pressures for AHFCs.

### Exhibit 42: Estimated savings if a home loan is re-priced by 100bps due to a rate cut after 24 months

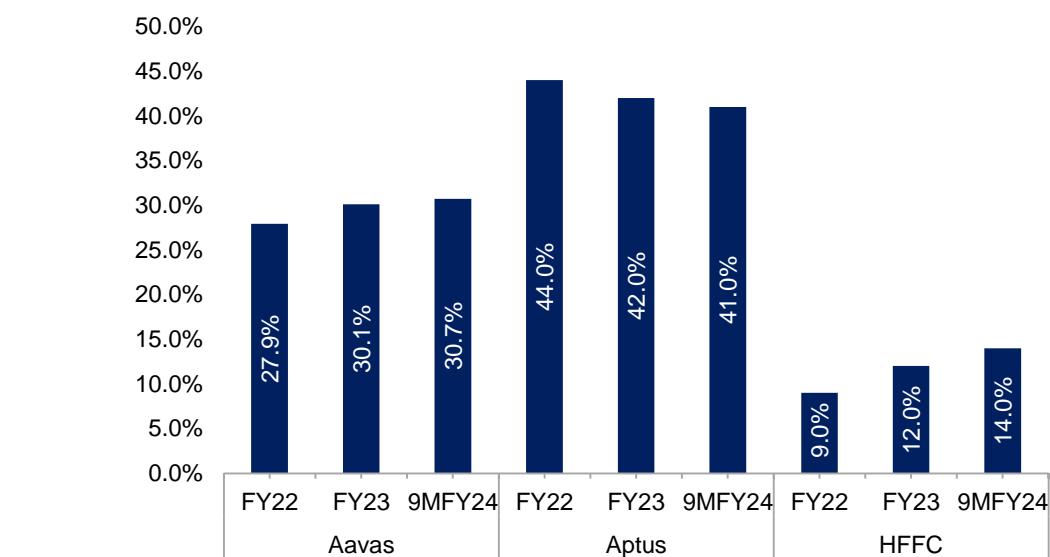
Assuming that loan is transferred 24 months after origination and re-priced 100 bps lower	
Total interest paid on loan original loan at 11%	508,009
Total interest paid assuming BT-out after 24 months	452,448
Processing charges due to BT-out	15,000
Savings (% of original interest)	8%

Source: IRDAI Annual Report, Nirmal Bang Institutional Equities Research Note: Assuming a principal loan amount of Rs 1 mn at 11% original rate of interest with a tenure of 8 years

Over the long term, as AHFCs grow in size, we expect spreads to decline. We have seen this in case of matured HFCs such as HDFC/LICHF where spreads have seen a declining trend due to rising competition.

### Focus on LAP/ MSME loans to provide support to spreads

While long-term compression in spreads might be inevitable, AHFCs are gradually increasing their share of Non-housing loans (Developer/MSME loans) to maintain profitability. While these loans are high-yielding and likely to help in sustaining margins, they are also riskier. Past experience for lenders in the segment has also asset quality issues. While we remain skeptical about the segment, AHFCs have been able to keep asset quality stress under control, making it a viable segment to build growth.

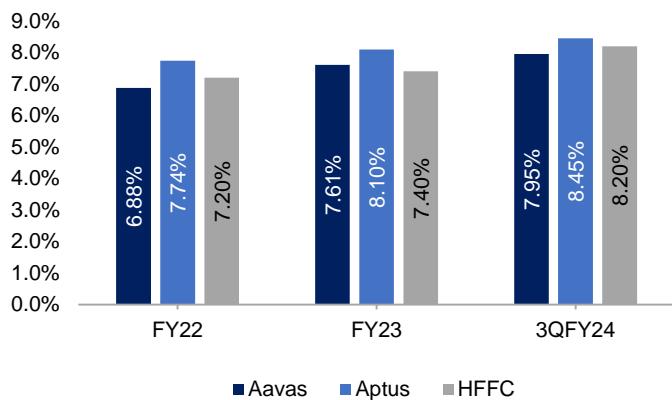
**Exhibit 43: Share of LAP/MSME loan portfolio has been growing**


Source: IRDAI Annual Report, Nirmal Bang Institutional Equities Research

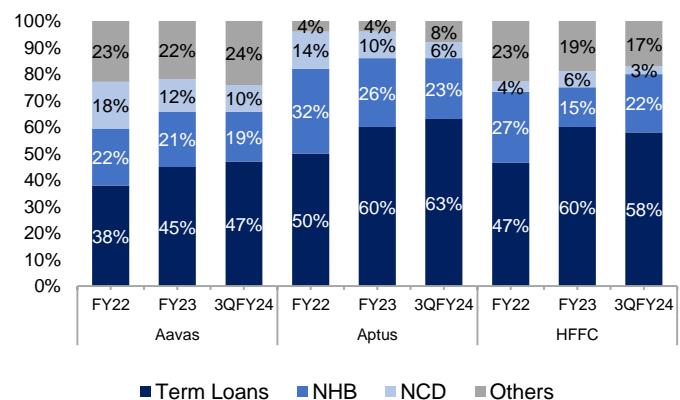
## Using available levers to control cost of borrowings

AHFCs with a geographic/customer segment niche have grown at a brisk pace over the past few years despite an unfavorable borrowing profile. The borrowing mix for AHFCs suggests a high dependence on term loans from banks, resulting in a higher cost of funds vs. large HFCs. Moreover, a higher share of NCD in the mix is likely to result in higher costs. To offset this, AHFCs can make use of NHB refinancing, which can help them to control CoF compared to other sources. Apart from NHB sanctions, Co-lending/Direct Assignment also help AHFCs maintain liquidity. HFFC has 14% of borrowings from direct assignment and 3% from co-lending with a negligible share of NCDs (3% as of Dec-23).

**Exhibit 44: Cost of funds (%) for AHFCs has been unfavorable ...**



**Exhibit 45: ... due to high dependence on term loans/NCDs**



Source: Company, Nirmal Bang Institutional Equities Research

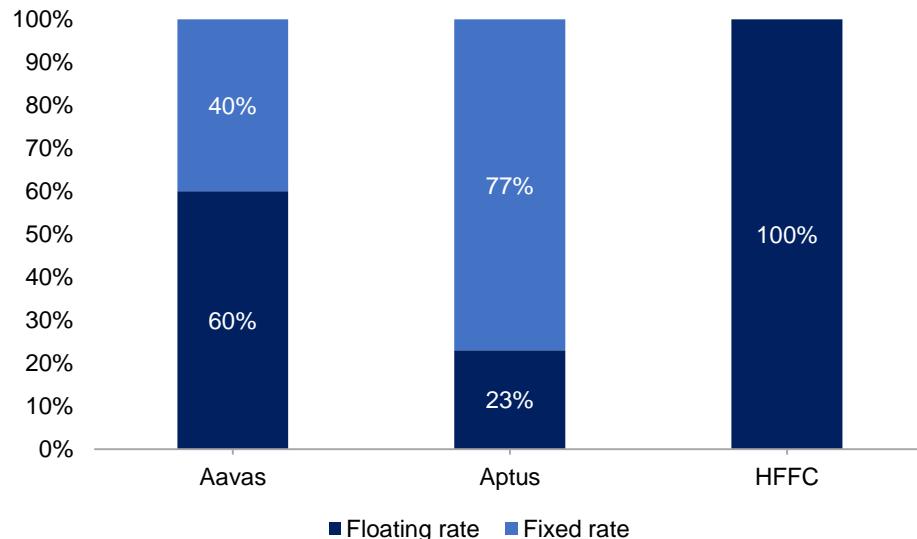
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 46: NHB sanctions drawn by AHFCs over the past few quarters**

Company	Already drawn in 9MFY24 (Rs bn)	To be drawn in Q4 (Rs bn)
Aavas	5.6	7.0
HFFC	4.5	2.5
Aptus	-	3.0

Source: IRDAI Annual Report, Nirmal Bang Institutional Equities Research

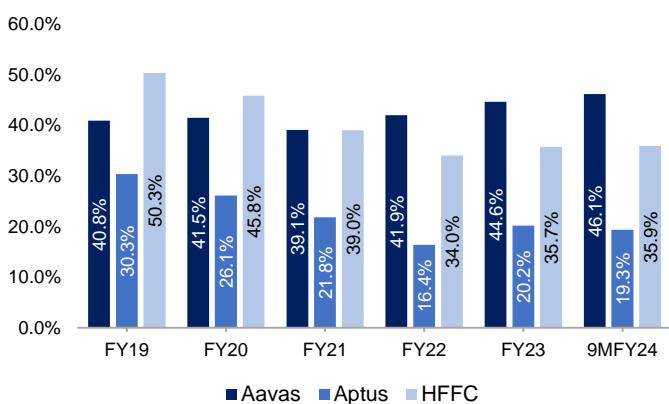
Floating rate loans comprise majority of HFFC's total financial liabilities as of FY23. Any increase in the cost of funds is likely to lead to a reduction in spreads or requires corresponding increase in incremental yield to maintain NIMs. However, a sharp rise in the interest rate increases the risk of pre-payments. Exhibit 47 shows that floating rate loans are prevalent in the industry.

**Exhibit 47: HFFC has highest share of floating-rate loans vs peers (AUM mix as of FY23)**


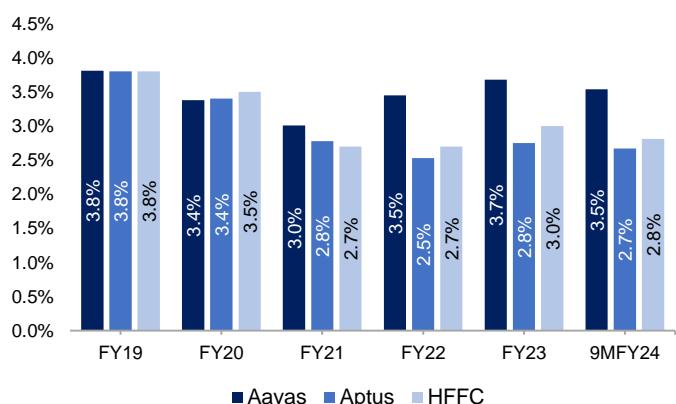
Source: IRDAI Annual Report, Nirmal Bang Institutional Equities Research

### Improving productivity is key

Given the nature of the customer segment (semi-formal income, rural & self-employed) and requirement of a relatively higher degree of physical presence, the AHFC model is relatively operation-intensive. 100% in-house sourcing and focus on small-ticket loans has led to high investments in branch expansion and manpower. This is reflected in the historical trend of high Opex/AUM ratios for AHFCs. As AHFCs scale up in size and deepen their distribution reach, their spreads will decline. To offset this impact, AHFCs will have to focus on improving productivity. In our view, this can be done by: (1) increasing AUM per branch (2) increasing the no. of loans disbursed per branch. Increasing the share of external sourcing (DSA/s connectors) is likely to help as well.

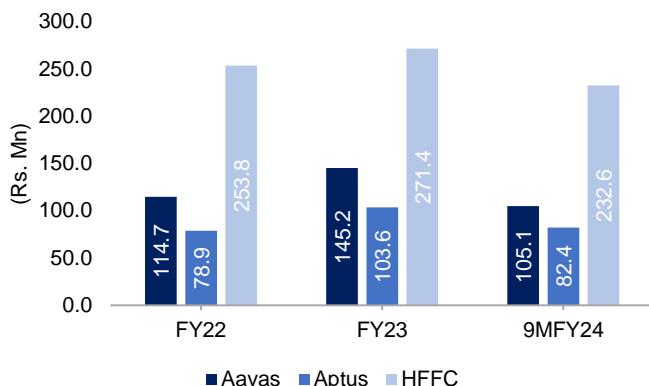
**Exhibit 48: AHFCs have seen higher Cost/Income ratios...      Exhibit 49: ...resulting in elevated Opex/AUM ratio**


Source: Company, Nirmal Bang Institutional Equities Research

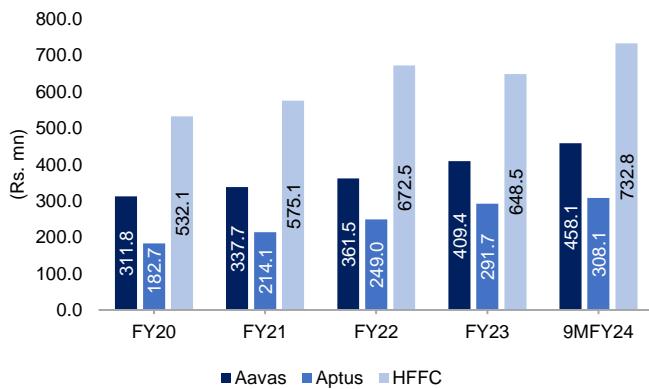


Source: Company, Nirmal Bang Institutional Equities Research

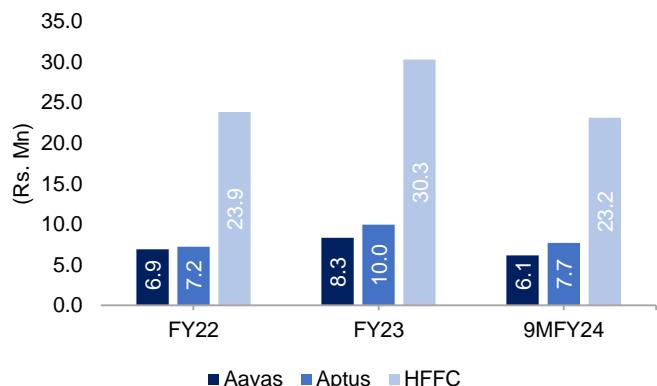
HFFC maintains the most productive distribution franchise with the highest no. of loans disbursed and AUM per branch. Moreover, it is also the most diversified in terms of sourcing loans via connectors. Aavas, on the other hand, has seen a decline in productivity over the past few years, indicated by a lower no. of loans disbursed per branch/ AUM per branch.

**Exhibit 50: HFFC has the highest disbursements per branch ...**


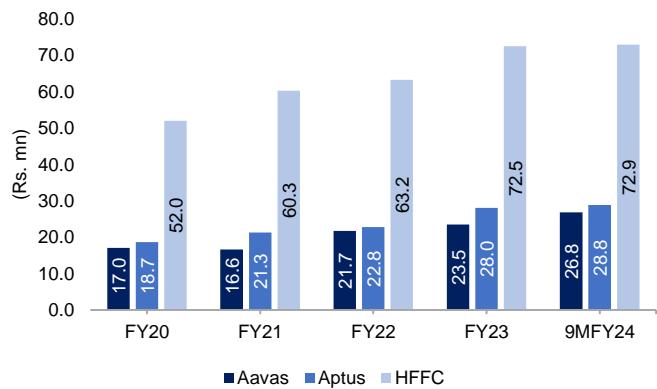
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 52: AUM per branch is also the highest for HFFC...**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 51: ... and disbursements per employee**


Source: Company, Nirmal Bang Institutional Equities Research

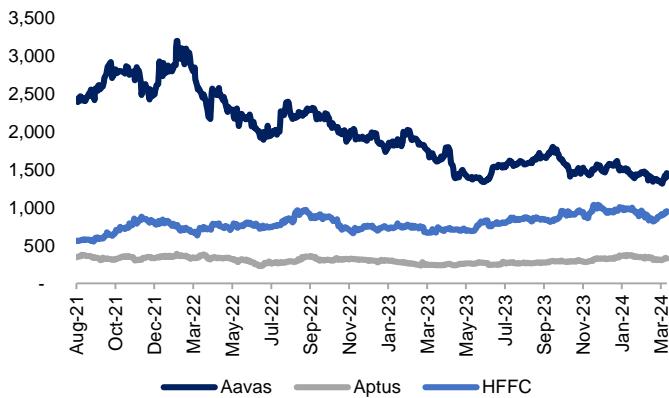
**Exhibit 53: ... along with the highest AUM per employee (Rs. Mn)**


Source: Company, Nirmal Bang Institutional Equities Research

## Sector has de-rated; but we remain positive

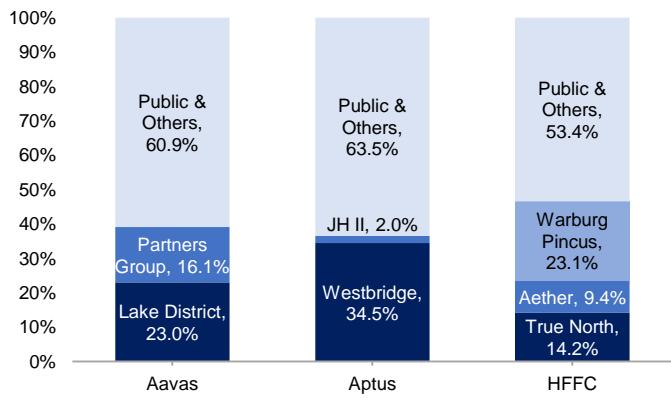
Listed AHFCs have seen a de-rating in recent months despite a strong growth trajectory and return ratios. Apart from the change in management of Aavas, which led to a sharp stock price movement, stake sales by large PE funds have likely put pressure on the stock performance.

**Exhibit 54: Stock price movement for Aptus, Aavas and HFFC over the past 3 years**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 55: Private equity funds hold 36%-47% of listed AHFCs**



Source: Company, Nirmal Bang Institutional Equities Research

Identifying a long runway for growth, we remain positive on the ability of AHFCs to deliver consistent growth while maintaining a decent asset quality profile, factoring in a gradual decline in operating costs as they build scale. We expect earnings CAGR of 19%-28% for these companies over FY23-26E led by continued growth momentum, geographical expansion and stable asset quality metrics. We initiate with a BUY rating on HFFC and reiterate our BUY recommendation on Aavas.

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# Home First Finance Company (HOMEFIRS)

NBFC | Initiating Coverage

**BUY**

**CMP: Rs886 | Target Price (TP): Rs1,150 | Upside: 30%**

**April 17, 2024**

## A tech-first play on housing finance

### Key Points

- HFFC has demonstrated robust AUM growth; we expect the trajectory to continue aided by deeper geographic expansion
- Investments in technology, connector-model of sourcing and centralized control over underwriting underpin scalability of the business model and justify premium valuation vs. peers.
- While rising competition and higher risk of BT-outs/ repayments is likely to put pressure on spreads, we believe the intensity of the pressures has bottomed out and expect spreads to be in the range of 5%- 5.25%
- Initiate coverage on Home First Finance (HFFC) with a BUY rating and a target price of Rs1,150 at 3.6x FY26E P/ABV (below +1 SD and in-line with 3-year trading average for the stock).

Est Change	-
TP Change	-
Rating Change	-

### Company Data and Valuation Summary

Reuters	HOME.BO
Bloomberg	HOMEFIRS IN
Mkt Cap (Rsbn/US\$mn)	78.5 / 941.6
52 Wk H / L (Rs)	1,061 / 686
ADTV-3M (mn) (Rs/US\$)	202.9 / 2.4
Stock performance (%) 1M/6M/1yr	7.7 / (2.5) / 23.7
Nifty 50 performance (%) 1M/6M/1yr	(0.8) / 0.5 / 25.4

Shareholding	2QFY24	3QFY24	4QFY24
Promoters	30.2	23.6	23.6
DILs	10.0	11.8	11.9
FII	17.0	24.8	25.1
Others	42.8	39.8	39.5
Pro pledge	0.0	0.0	0.0

### Financial and Valuation Summary

Particulars (Rsmn)	FY23	FY24E	FY25E	FY26E
NII	4,179	5,258	6,739	8,856
% growth	41.2	25.8	28.2	31.4
NIM %	6.6	6.2	6.0	6.1
Cost/Income Ratio	35.5	36.6	39.6	38.6
Operating Profit	3,167	4,133	5,017	6,604
% growth	26.0	30.5	21.4	31.6
Adjusted PAT	2,283	2,943	3,594	4,781
% growth	22.7	28.9	22.1	33.0
ABVPS	199.2	227.6	264.9	318.1
P/ABV	4.5	3.9	3.4	2.8
RoA (%)	3.9	3.6	3.2	3.3
Leverage (x)	3.5	4.2	4.9	5.4
RoE (%)	13.5	15.0	15.7	17.7

Source: Bloomberg, Company, Nirmal Bang Institutional Equities Research

**Key Links:** [Annual Report FY23](#) | [3QFY24 Result](#) | [3QFY24 Investor Presentation](#)

*Please refer to the disclaimer towards the end of the document.*

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## Company background

Founded in 2010, Home First Finance Company (HFFC) is a non-deposit taking housing finance company (HFC) focused on lending to home buyers belonging to salaried and self-employed segments with income less than Rs50k per month. As of Dec'23, the company had an AUM of Rs90.1bn, 86% of which comprises pure housing loans, 13% LAP and 1% commercial/shop loans. It is majorly a technology-driven lender with end-to-end loan process being handled digitally.

### Exhibit 1: Key milestones

<b>2010</b>	Incorporation of the company
<b>2011</b>	Primary investment of Rs100mn
<b>2012</b>	Started operations in Gujarat & Tamil Nadu in Ahmedabad and Chennai
<b>2013</b>	Tata Capital (Alpha TC Holdings Pte Ltd) primary investment of Rs470mn
<b>2014</b>	Home First turns profitable
<b>2015</b>	Customer base crosses 5,000
<b>2016</b>	AUM crosses Rs5bn with 10,000+ customers and reach spanning 25+ cities
<b>2017</b>	True North acquires majority stake; GIC Co-investment with True Nort
<b>2018</b>	Networth crosses Rs5bn with 15,000+ customers and 10 lenders
<b>2019</b>	Home First now has 30,000+ customers across 11 States + 1 UT
<b>2020</b>	AUM crosses Rs36bn
<b>2021</b>	Listed on NSE and BSE; Warburg Pincus invests in the company; 60,000+ sanctions
<b>2022</b>	India Ratings assigns long term credit facilities rating of AA- Stable
<b>2023</b>	ICRA & CARE rating upgraded to AA- Stable; Crossed 100 physical branches; 1,00,000+ customers served

Source: Company, Nirmal Bang Institutional Equities Research

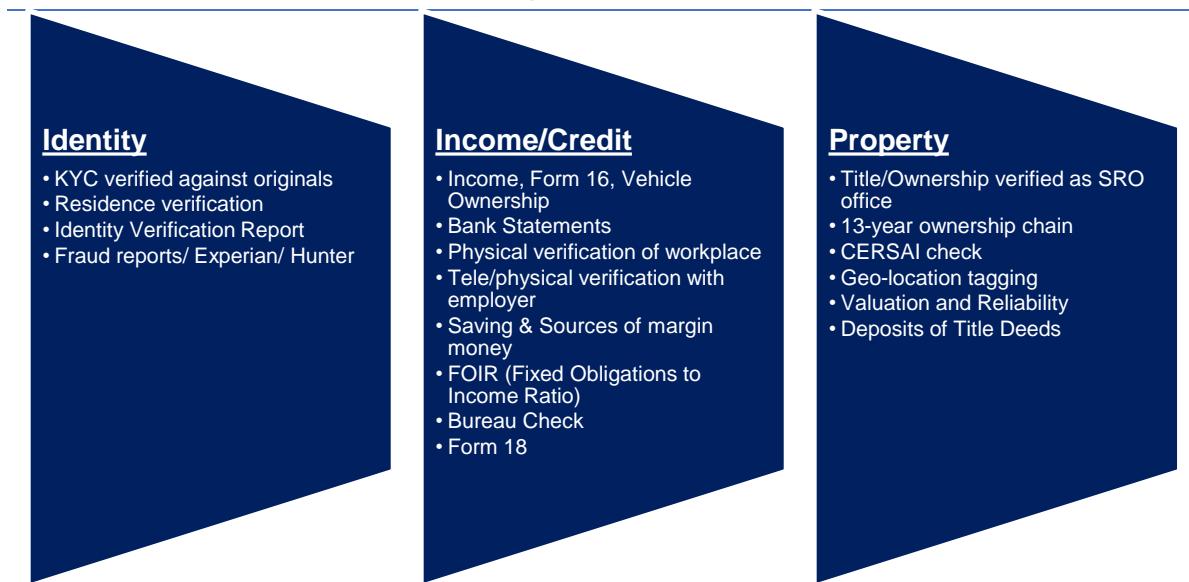
### Underwriting model - Salient features

- **Differentiated origination strategy:** HFFC analyses data from the Bureau/ Experian to identify high-velocity pin-codes/districts/markets in India. Generally, the company uses loan origination data of Banks/HFCs/Competitors to identify areas from where loans have been sourced/properties located. It also uses data for 2W/Car purchases and fast-food retail outlets as proxies for income when deciding where to set up a branch.
- **Ground-study with connectors:** Once the company has identified high-performing regions to set up a branch, it conducts a ground study with connectors in the area. The main purpose is to analyse customer behavior in terms of ticket sizes, sensitivity to pricing, delinquency trends etc. Sometimes, HFFC may set up a satellite branch where a RM from the nearest branch is relocated to disburse loans along with the help of connectors in the region. Once this satellite arm reaches an AUM of Rs 100mn, the company sets up a physical branch. This process might typically take 9-12 months.
- **Using connectors to generate leads:** Once a branch has been set up, RMs from the branch depend largely on connectors to source leads. HFFC has identified the following types of connectors:
  1. **Builders**
  2. **Financial connectors:** Chartered Accountants, lawyers, real-estate brokers, insurance agents etc.
  3. **Construction connectors:** masons, plumbers, cement dealers, hardware store owners
  4. **Micro-connectors:** kirana store owners
- HFFC has 2,900+ active connectors and it usually pays a commission of ~40bps on disbursal. Connectors have 3-4 financial partners, but usually prefer HFFC due to its lower TAT (~48 hours for credit underwriting). Apart from connectors, the company also sources leads from referrals, digital partnership and marketing efforts.
- **Field check by RMs:** Once the lead has been sourced, the RM has all the basic customer information (PAN, Aadhar, e-KYC). The RM then does a field check by visiting the home/ workplace of the customer to cross-verify documents of identity, property/asset/vehicle ownership etc. He/she also takes photos/videos of the field visits/property as proof along with documents such as GST data, sample bills, LPG/utility bills etc. All this data helps in creating a detailed profile of the customer to present to the central credit underwriting team.
- **Comprehensive credit underwriting:** The centralized credit team goes through the profile generated by the RM. The team evaluates documents such as basic/KYC details, CIBIL score, bank statements, salary slips, asset ownership/insurance documents and other bills to assess the borrower's income generation capacity. It also has fraud check tools in place to verify identity/ownership of the borrower and uses algorithms to attach a probability of default for each case. The credit algorithm used by the team has access to 100+ data points of the customer provided by third-party vendors (including account aggregator data from banks, Hunter, Perfios etc.). Based on this, the credit underwriting team decides whether to lend to the customer and applies a risk-based pricing mechanism (depending on the customer profile, type of loan) to arrive at interest rate, ticket size and LTV. This function of credit underwriting typically takes ~48 hours for most cases.
- **Technical valuation and legal verification:** Once the credit underwriting team has given approval, the technical and legal teams assess the property while reviewing all legal documents. This function is outsourced by HFFC to an outside vendor.
- **Strong collections mechanism:** RMs at branches are responsible for collections and ~50% of their incentives are linked to collection activity.

**Exhibit 2: Stages of underwriting**

Function	Description
Initial Screening and Pre-Sanction Check	Fresh customer leads are logged into the system by RMs. All customer interactions and review of customer documents is done by an in-house team of RMs. Each lead is checked against KYC, credit bureau and other third-party databases to establish customer credentials. RMs conduct home and workplace visits to verify living conditions, employment and income of potential customers.
Credit Underwriting	The completed digital loan application is submitted by RMs along with their commentary on residence & workplace visits and personal discussion with the customer. This is cross checked by underwriting and operations team for a number of factors, including completeness of application form, KYC, eligibility, fraud check, credit bureau, income assessment, loan-to-value, value of collateral, bank statements, debt burden and third-party databases for income and asset ownership.
Property Underwriting	The company uses a centralized underwriting mode assisted by data science backed customer-scoring models to evaluate a customer's ability to repay the loan. It utilizes proprietary machine learning credit scoring models to seek help with the credit assessment process which bifurcates customers into different categories based on the level of risk. HFFC has an integrated customer relationship management and loan management system, which serves as a single platform for all internal and external customer related interactions. Its technology platform captures 100+ data points of a customer and also maintains integrated systems with third-party databases to obtain additional customer data points.
Collections	HFFC conducts a legal and technical assessment through third-party vendors to verify the authenticity of technical documents, legal title to the collateral property and its market value. HFFC also uses an application for geo tagging of properties and a proprietary machine learning backed property price predictor to determine the value of the collateral property and LTV ratio.
	All borrowers register for an automated debit facility and the company tracks the status of installments collected on a real-time basis through a collections module. HFFC employs a structured collection process to remind customers of their payment schedules through text messages and automated calls. It also uses a proprietary machine learning model to predict probability of bounce, which helps in initiating action such as pre-emptive reminder calls made by branch teams. HFFC's collection process is completely managed by branch teams and a significant portion of employee incentives are dependent on collections.
	At 1 DPD, the company's front-end field teams call customers and initiate visits to understand reasons for default and recovery of the dues. At 30 DPD, it sends a default/loan recall notice depending upon the severity of the case. At 60 DPD, it sends a pre-SARFAESI notice and employees increase the visit frequency to reiterate the repercussions of default to the customer. At 90 DPD, HFFC initiates legal action through SARFAESI.

Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 3: Documents used in each stage**


Source: Company; Nirmal Bang Institutional Equities Research

Compared to peers, HFFC sources majority of leads from connectors. Moreover, it has a distinct model, backed by a centralized underwriting team, which helps in processing files faster (TAT of 48 hours). It outsources functions such as legal/technical analysis to third-party vendors while others perform these in-house. All these aspects, with the support of efficient tech operations, help HFFC in staying nimble vs. peers and expanding quickly into new geographies.

**Exhibit 4: HFFC's underwriting model has a distinct competitive advantage vs. peers**

	Aavas	Aptus	HFFC
<b>Lead generation</b>	In-house (via referrals)	In-house (via referrals)	Mostly outsourced (via connectors)
<b>Initial screening</b>	In-house (KYC/ credit bureau scores/ third party or account aggregator information) done by RMs	In-house (KYC/ credit bureau scores/ third party or account aggregator information) done by RMs	In-house (KYC/ credit bureau scores/ third party or account aggregator information)
	Home/ workplace visits done by Credit Officers	Home/ workplace visits done by Credit Officers	Home/ workplace visits done by Sales RM
<b>Underwriting</b>	De-centralised	Centralised	Centralised
<b>Separation of Sales and Credit Underwriting</b>	Yes	Yes	Yes
<b>Legal/ Technical Assessment</b>	In-house team of lawyers/ engineers/ valuers	In-house team of lawyers/ engineers/ valuers	External/ third party vendors
<b>Collections</b>	In-house (done by Field Officers)	In-house	In-house (done by RMs)

Source: Company; Nirmal Bang Institutional Equities Research

## Investment Arguments

### (a) Using tech as a core differentiator

HFFC has leveraged tech across functions such as app-based lead generation, proprietary ML used in credit underwriting and bounce prediction. Majority of its operations are handled digitally with a credit underwriting TAT of ~48 hours.

- It has three separate apps in place to streamline the underwriting process by making it more transparent for all stakeholders: (1) HF Connect (for connectors) (2) RM Pro (for RMs/Sales) and (3) HF Customer Portal (for customers).
- Its credit algorithm uses customer scoring models/Machine Learning tools in underwriting and captures 100+ data points for all customers with all documents, photographs and videos available on a single cloud-based system.
- It has also put in place an internally developed omni-channel lead management system (Kaisys) and uses software such as Tableau visualization within SalesForce.
- It also has an in-built property price predictor and uses bounce prediction models to identify early delinquencies.

### Exhibit 5: Apps used by HFFC stakeholders

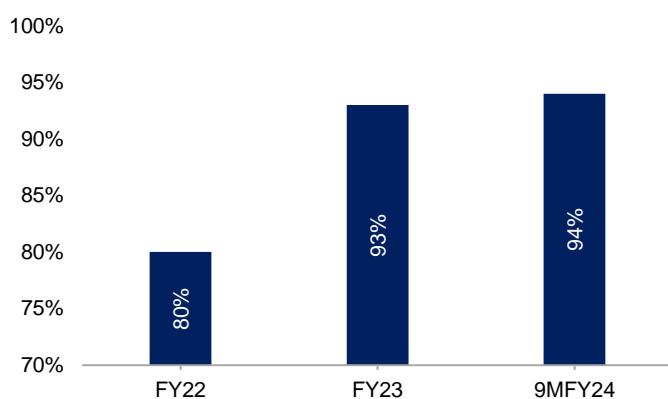
App	Description
<u><b>Home First Connect</b></u>	<ul style="list-style-type: none"> <li>• Helps connectors in tracking customer leads and includes:           <ol style="list-style-type: none"> <li>1. EMI Calculator</li> <li>2. Prepayment Calculator</li> <li>3. Eligibility Calculator</li> <li>4. Training modules</li> </ol> </li> <li>• The App is available for use in 6 languages.</li> <li>• Contest messages are automatically sent to connectors, showing current progress and pending amount of loans.</li> </ul>
<u><b>RM Pro</b></u>	<ul style="list-style-type: none"> <li>• Used by RMs to upload loan details, basic/ KYC details, CIBIL score, bank statements</li> <li>• Has APIs/ tie-ups with government agencies (Drivers' License, Voter ID), Karza</li> <li>• Multiple data points are captured to verify whether RMs completed their visits.</li> </ul>
<u><b>Home First Customer Portal</b></u>	<ul style="list-style-type: none"> <li>• App to engage with the customer and help with loan account information, part payments, service requests, monthly dues etc.</li> <li>• Customers can upload construction images and download interest certificate</li> <li>• Customers can also apply for top-up loans</li> </ul>

Source: Company; Nirmal Bang Institutional Equities Research

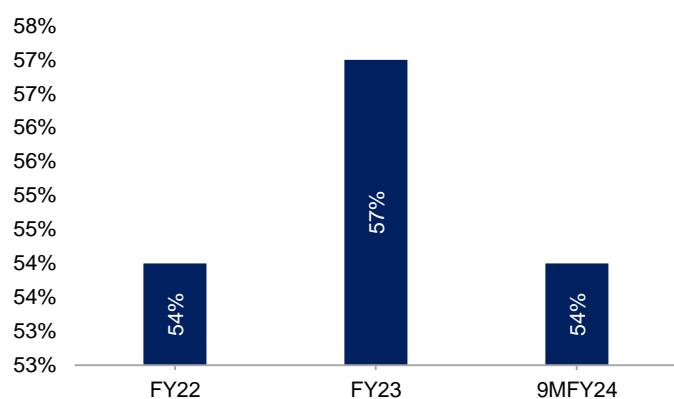
**Exhibit 6: Scalable operating model built on holistic technology usage**

Mobility	Digital Marketing	Data Analytics	Tech-Infra
<ul style="list-style-type: none"> <li>Home First App for all stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>Digital marketing on major online media</li> </ul>	<ul style="list-style-type: none"> <li>API Integration with third party databases</li> </ul>	<ul style="list-style-type: none"> <li>Data on Cloud</li> </ul>
<ul style="list-style-type: none"> <li>360° view of customers for employees.</li> </ul>	<ul style="list-style-type: none"> <li>Alliances with digital players</li> </ul>	<ul style="list-style-type: none"> <li>Proprietary property price predictor</li> </ul>	<ul style="list-style-type: none"> <li>Integrated CRM and loan management System</li> </ul>
<ul style="list-style-type: none"> <li>Electronic payments</li> </ul>	<ul style="list-style-type: none"> <li>10,000+ leads generated every month</li> </ul>	<ul style="list-style-type: none"> <li>Machine learning models to assist underwriting</li> </ul>	<ul style="list-style-type: none"> <li>Legal and Technical Portal</li> </ul>
<ul style="list-style-type: none"> <li>Income module for easy assessment of customers' income</li> </ul>	<ul style="list-style-type: none"> <li>Kaisys: Internally developed lead management system with omnichannel communication</li> </ul>	<ul style="list-style-type: none"> <li>E-Signature</li> </ul>	<ul style="list-style-type: none"> <li>Payment automation via Bharat Bill Pay Services and Fino Payments Bank</li> </ul>
		<ul style="list-style-type: none"> <li>Tableau Server for easy visualization</li> </ul>	<ul style="list-style-type: none"> <li>Digital Document Management</li> </ul>

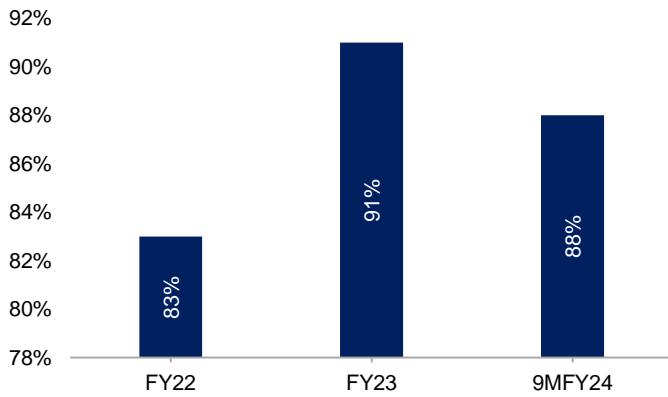
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 7: % customers registered on App**


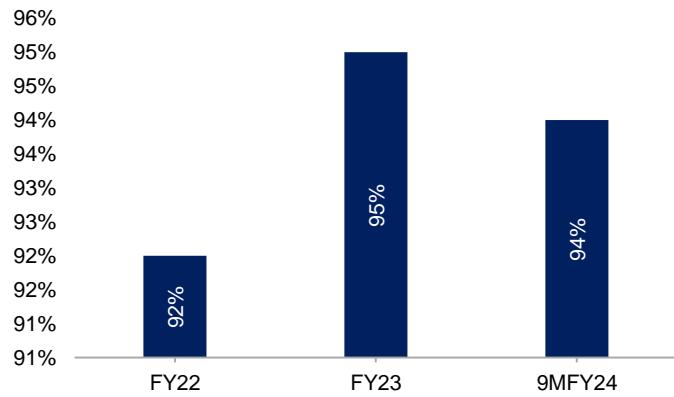
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 8: Unique user logins as % of active customers**


Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 9: % of service requests raised on app**


Source: Company; Nirmal Bang Institutional Equities Research

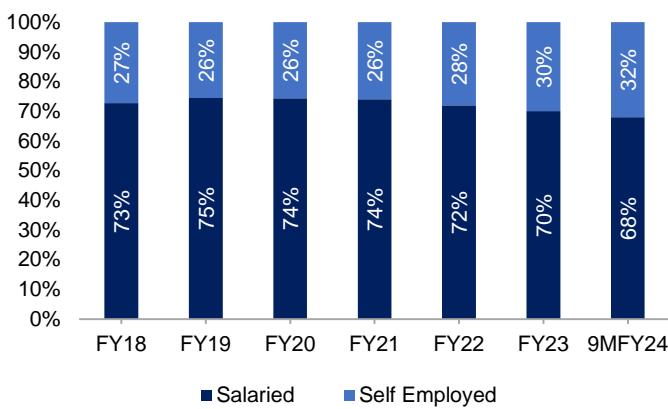
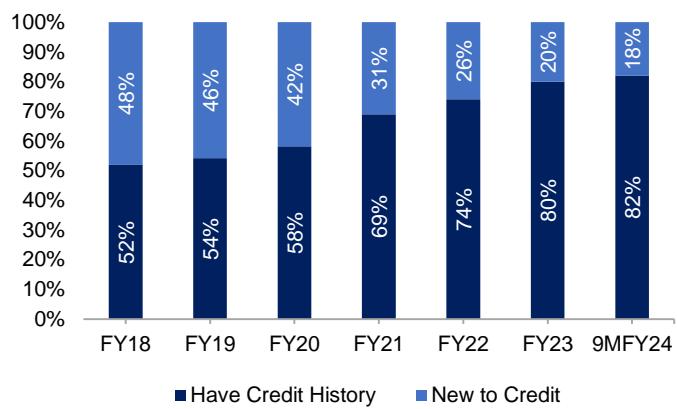
**Exhibit 10: % Non-cash collections**


Source: Company; Nirmal Bang Institutional Equities Research

**(b) Underwriting a niche customer within Affordable Housing**

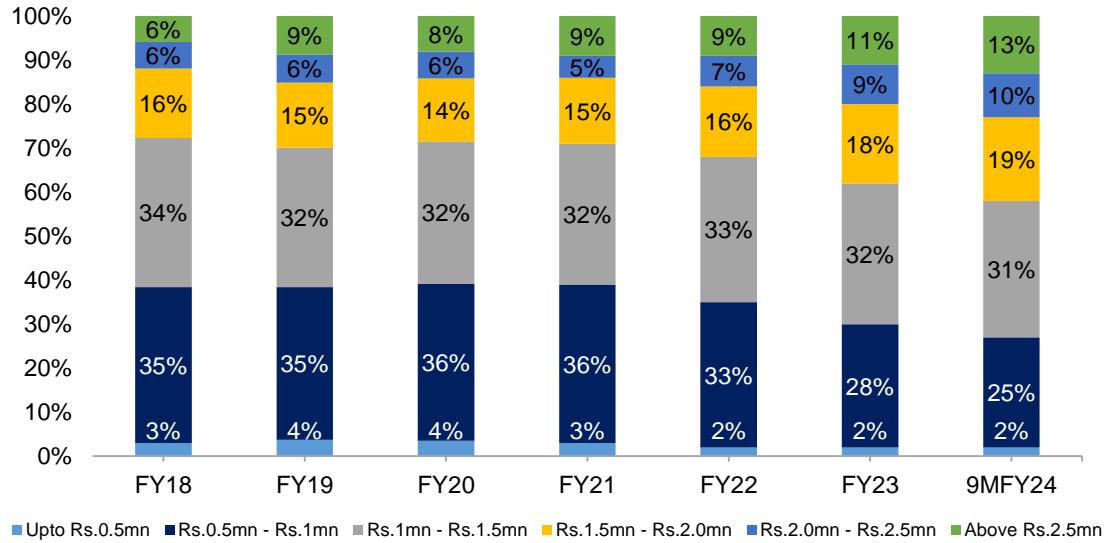
HFFC underwrites a distinct category within Affordable Housing - largely salaried home loan customers living in the peripheries of urban cities and usually having an established credit score/track record. 68% of its customers are salaried, 82% have prior credit history with an average credit bureau score of 744 (3QFY24). Focus is on urban centers (tier 1/2 locations) with dense populations, leading to high volume/transactions. By deepening distribution in existing pin-codes and expanding into new territories, we believe there is scope for HFFC to replicate the growth trajectory seen in established markets (GJ/MH).

HFFC has an overall market share of ~2.5% in existing states, with scope to penetrate more pockets/pin-codes. It plans to increase market share to ~3% in states where it has a market share of 1-1.5% (Maharashtra) and ~5% in states where it has a current market share of 3-4% (Gujarat). Apart from that, it is also focusing on new markets (Rajasthan, UP & MP) to boost growth.

**Exhibit 11: Majority of HFFC customers are salaried**

**Exhibit 12: Majority have an established track record**


Source: Company; Nirmal Bang Institutional Equities Research

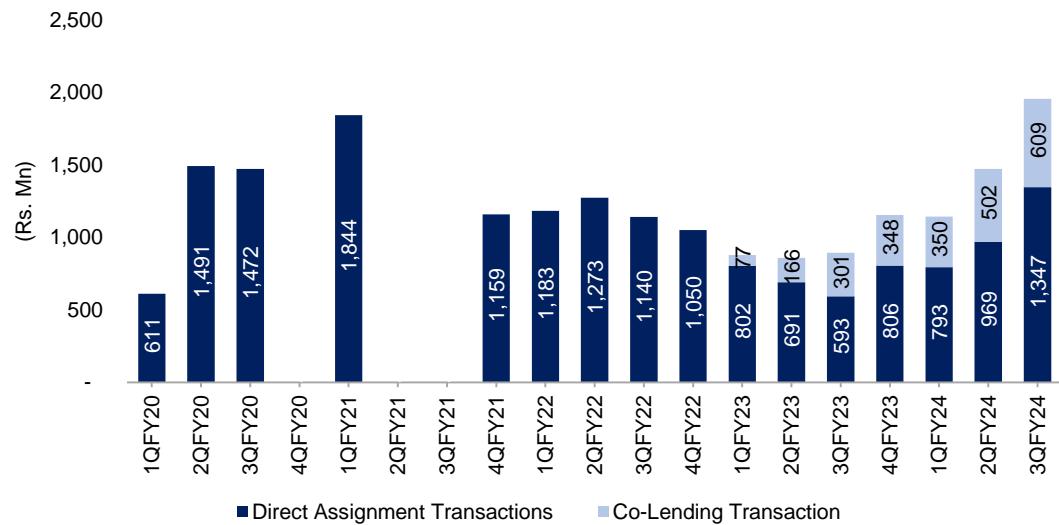
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 13: HFFC is focusing more on the Rs 1mn+ ticket size**


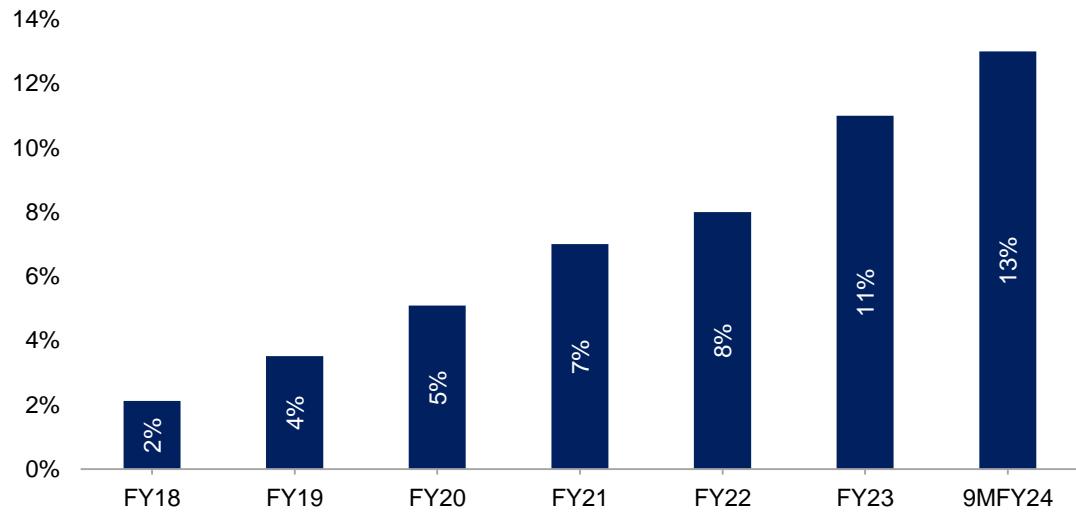
Source: Company; Nirmal Bang Institutional Equities Research

In terms of ticket sizes, 27% of HFFC's AUM is up to Rs1mn, 50% is ~Rs1-2mn and 23% is above Rs2mn. With rising inflation, high competitive intensity and elevated opex costs, the company is increasingly focusing on the ~Rs1mn+ ticket size. It is seeing a gradual shift with ticket sizes in the Rs1-1.5mn (31% of 3QFY24 AUM) and Rs1.5- 2mn category (19% of 3QFY24 AUM) growing faster than smaller buckets. Moreover, it plans to increase co-lending (with banks such as Central Bank of India and Union Bank of India) to ~10% of disbursements (currently ~6%).

The ticket sizes in this portfolio are typically higher (Rs2.5-3.5mn) and a rise in its share will give an additional boost to overall ticket sizes. Apart from that, the company has remained conservative in its LAP portfolio (~15% share of disbursal and 13% of AUM as of 3QFY24) while maintaining strong credit quality. We believe that it has scope to explore this category further, increasing the overall ticket sizes.

**Exhibit 14: Co-lending/DA transactions done by HFFC over the past few quarters**


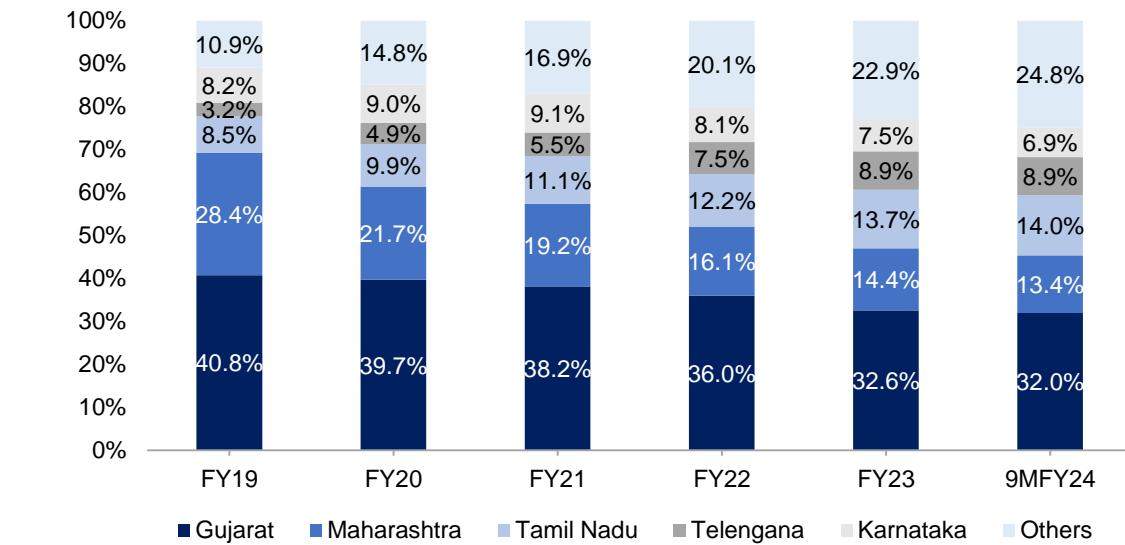
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 15: Rising share of LAP in the overall portfolio**


Source: Company; Nirmal Bang Institutional Equities Research

**(c) Diversified geographic mix with a focus on high-velocity states**

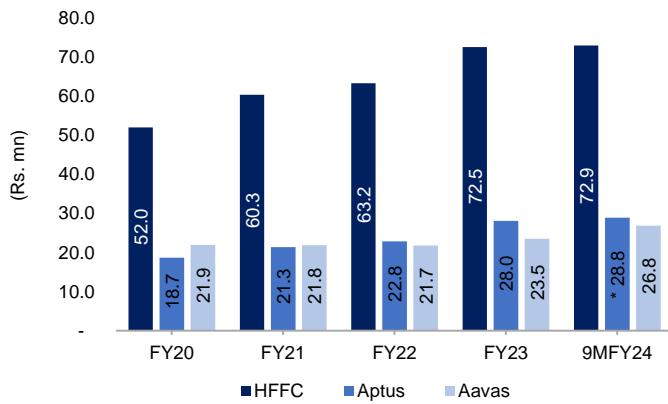
HFFC has established a pan-India presence with 123 branches and 305 touch-points across 126 districts. Gujarat / Tamil Nadu / Maharashtra/ Telangana/ Karnataka are the top 5 states contributing 32.0%/ 14.0%/ 13.4%/ 8.9%/ 6.9% to loan book (Dec'23). The company plans to increase market share to ~5% in established markets (Gujarat) and ~3% in crowded states (Maharashtra). Apart from these, it has identified Rajasthan, UP and MP as key focus markets and it is taking steps to strengthen its existing presence and deepen distribution in these states. It plans to reach 500 touch points over the next three years by expanding its presence in existing states and targeting new markets (opening 25 new branches every year). We believe that HFFC's top-down approach of identifying volume-driven markets and creating a presence in such markets is likely to drive rapid growth over FY24-FY26E. This, coupled with its opex-light strategy of setting up a satellite branch and then converting it into a physical branch once AUM reaches the Rs100mn threshold, is likely to sustain the growth momentum.

**Exhibit 16: Top 5 states constitute ~75% of AUM**


Source: Company; Nirmal Bang Institutional Equities Research

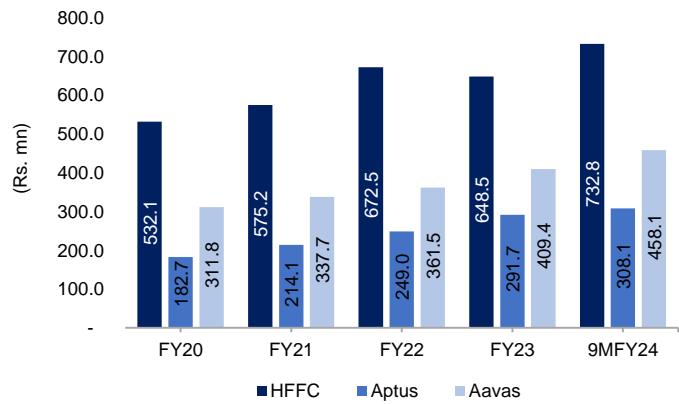
**(d) Distribution-light approach boosts productivity; however opex benefits played out**

HFFC follows a centralized model of underwriting, supported by superior front-end/ back-end tech capabilities. A single RM at HFFC performs multiple functions (sales, data verification, collections), resulting in a lean operating model. The use of tech along with the connector-model of sourcing leads and digitised processes ensures higher efficiency in operations (TAT of 48 hours for approval). Thus, HFFC's investments in its branch network is lower vs. peers while still maintaining the best AUM/Employee and AUM/Branch.

**Exhibit 17: AUM/Employee is the highest for HFFC**
**Exhibit 18: AUM/Branch is also better vs. peers**


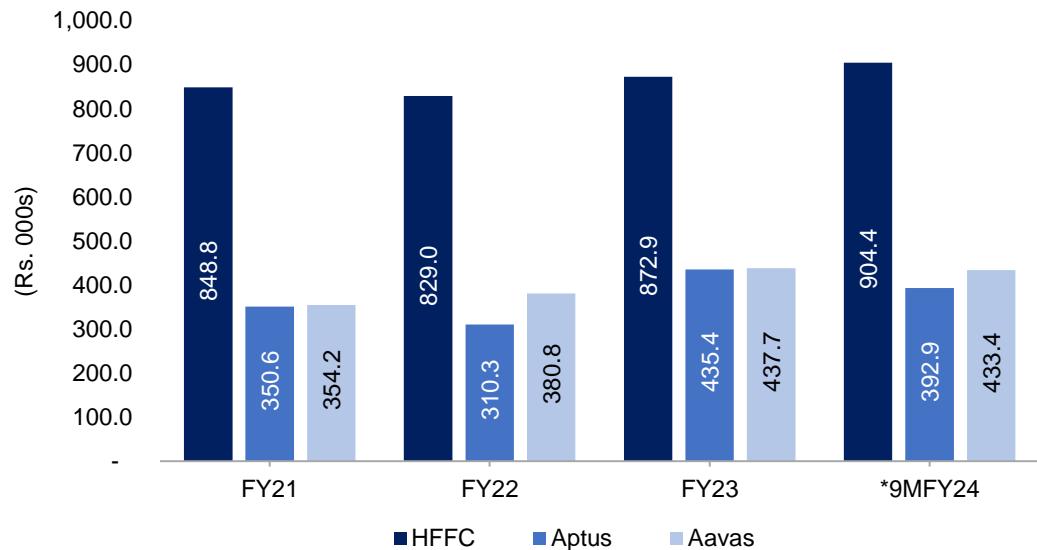
\*Note: No. of employees for Aptus is taken as on 1HFY24.

Source: Company; Nirmal Bang Institutional Equities Research



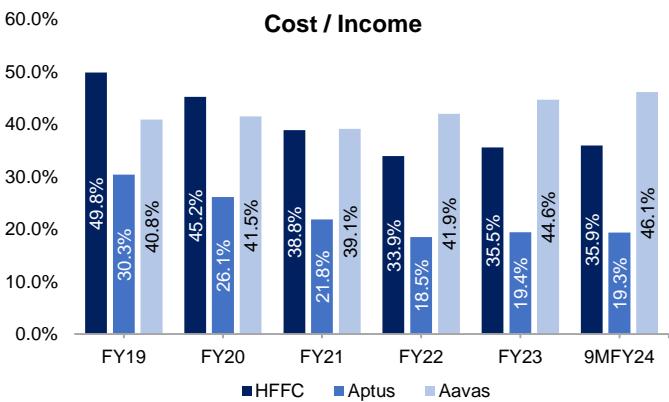
Source: Company; Nirmal Bang Institutional Equities Research

Despite relying on connectors and virtual branches, HFFC historically has seen adverse cost ratios. While Opex/AUM ratio has declined from 3.9% in FY18 to 2.8% in FY23 due to productivity gains, it is still higher than peers operating in the segment. We attribute this to higher rentals (operating in urban regions) and higher salaries (hiring MBA graduates as RMs). Further, being in high-growth mode, we expect opex costs to increase as the company expands into new geographies and continues to invest in technology. We expect Opex/AUM ratio of ~3% over the next two years, factoring in planned branch expansion and higher rentals/salaries. Post that, we expect operating costs to gradually reduce as the benefits of scale kick in with new branches becoming more productive.

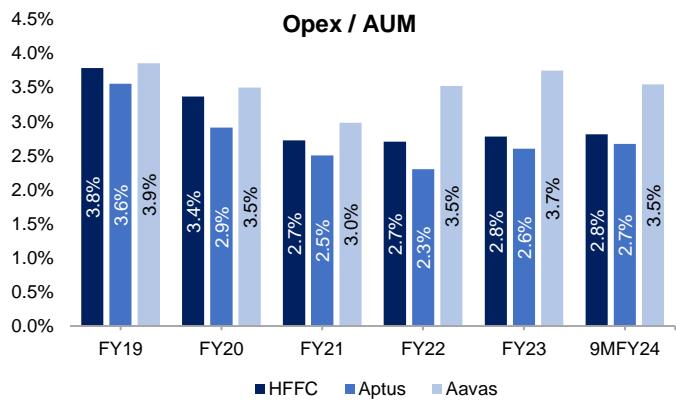
**Exhibit 19: Higher salary per employee for HFFC vs. peers**


*\*Note: Total Emp Costs have been taken for 9MFY23 while Wages and Salaries have been taken for the rest since companies provide a breakup of Employee Costs only in their Annual Report. No. of employees for Aptus is taken as on 1HFY24.*

Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 20: While opex ratios have improved from historical levels...**


Source: Company; Nirmal Bang Institutional Equities Research

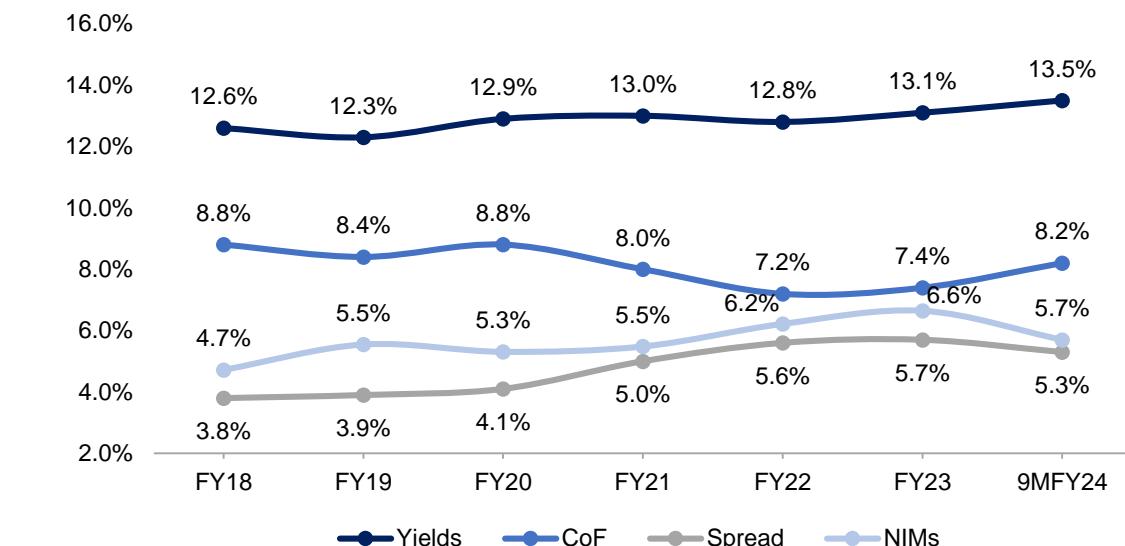
**Exhibit 21: ...HFFC still has scope for improvement vs. peers**


Source: Company; Nirmal Bang Institutional Equities Research

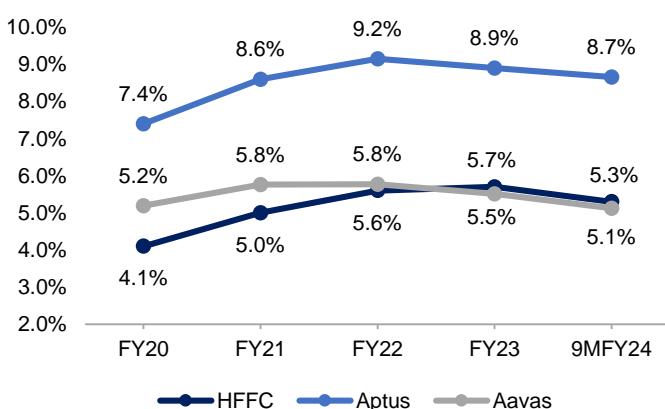
**(e) Strong liability franchise and steady yields have helped maintain spreads**

HFFC's focus on urban markets implies higher competition. On a relative basis, HFFC earns a lower spread vs. Aavas/Aptus due to higher competitive intensity in the customer segment/markets it operates in (mostly salaried customer in urban locations). However, spreads are still higher than Banks/Large HFCs, reflecting a segment which is under-serviced by large lenders.

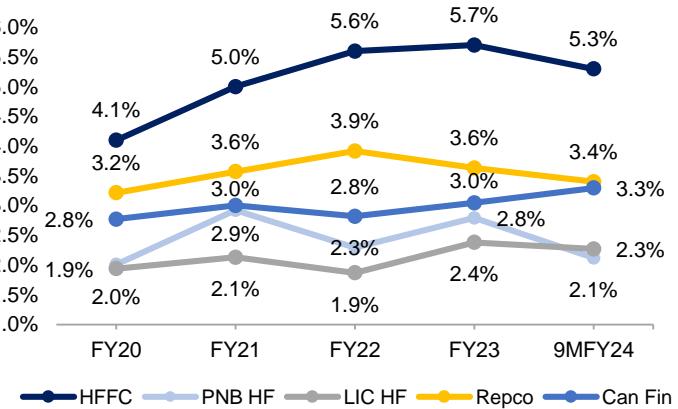
Historically, we have seen a reduction in spreads for players operating in these markets due to competition from Banks/NBFCs/AHFCs. This is also reflected in higher BT-out rates of 7.5%/8.6% (annualized) seen by the company in 3QFY24/2QFY24 due to a rise in EMI burden for customers.

**Exhibit 22: Yield, CoF and spread trajectory for HFFC over the past few years**


Source: Company; Nirmal Bang Institutional Equities Research

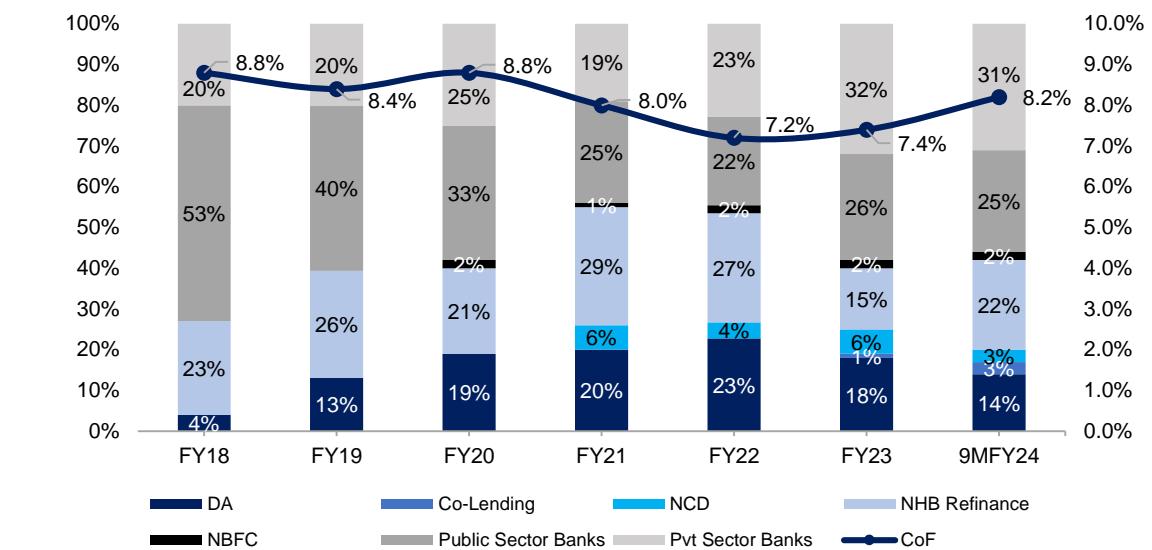
**Exhibit 23: HFFC has maintained spreads with Aavas/Aptus...**


Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 24: ...and the same is higher than other large lenders**


Source: Company; Nirmal Bang Institutional Equities Research

A diversified borrowing mix with zero borrowing through Commercial Papers (CP) and a healthy long-term credit rating (AA- Stable from ICRA/CARE) lend support to HFFC's liability franchise. 56% of its total borrowings is sourced from banks, 17% is from co-lending/direct assignment, 22% is re-financed from NHB at subsidized rates and 5% is from NBFCs/NCDs (Dec'23). Despite maintaining a favourable borrowing profile, the company has seen a steady increase in the cost of borrowings over the past 15 months due to rising interest rates. Its cost of borrowing increased to 8.2% in 3QFY24 vs. 7.4% in 3QFY23. To combat the rise in borrowing costs, it has drawn Rs10.5bn over 9MFY24 from NHB at subsidized rates and has available sanctions of Rs2.5bn likely to be drawn in 4QFY24. However, the marginal cost of borrowings stood at 8.4% in 3QFY24 and we expect ~10bps rise in 4QFY24, factoring in the impact of MCLR reset. Post 4QFY24, we expect borrowing costs to remain stable and start moderating in FY25, with the expectation of system-wide rate cuts by RBI. Moreover, the company plans to increase the proportion of its co-lending book (currently comprising 3% of borrowings in Dec'23), which would further reduce the cost of borrowings.

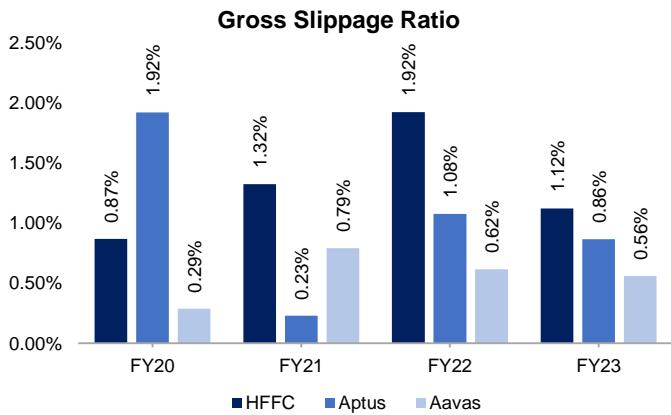
**Exhibit 25: ~39% of total borrowings is sourced from NHB/DA and Co-lending**


Source: Company; Nirmal Bang Institutional Equities Research

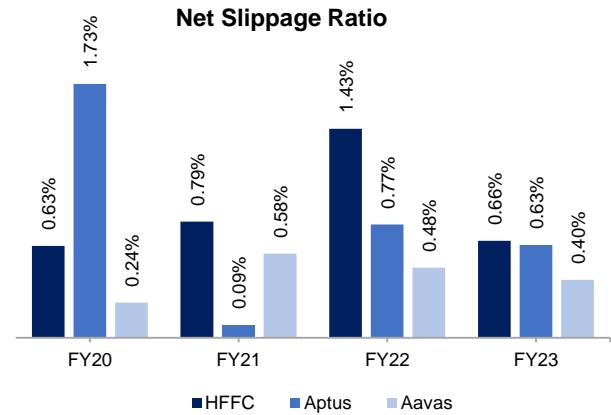
While HFFC has re-priced loans (taken 125bps of rate hike over July'22-Apr'23) to offset the impact of rising borrowing costs, spreads moderated to 5.3% in 3QFY24 (vs. 5.7%/5.6% for FY23/FY22). We expect the company to maintain spreads in the range of 5% -5.25%, with any subsequent reduction in the cost of borrowings to be passed on to customers.

**(f) Asset quality performance relatively weaker; expect higher credit costs vs. peers**

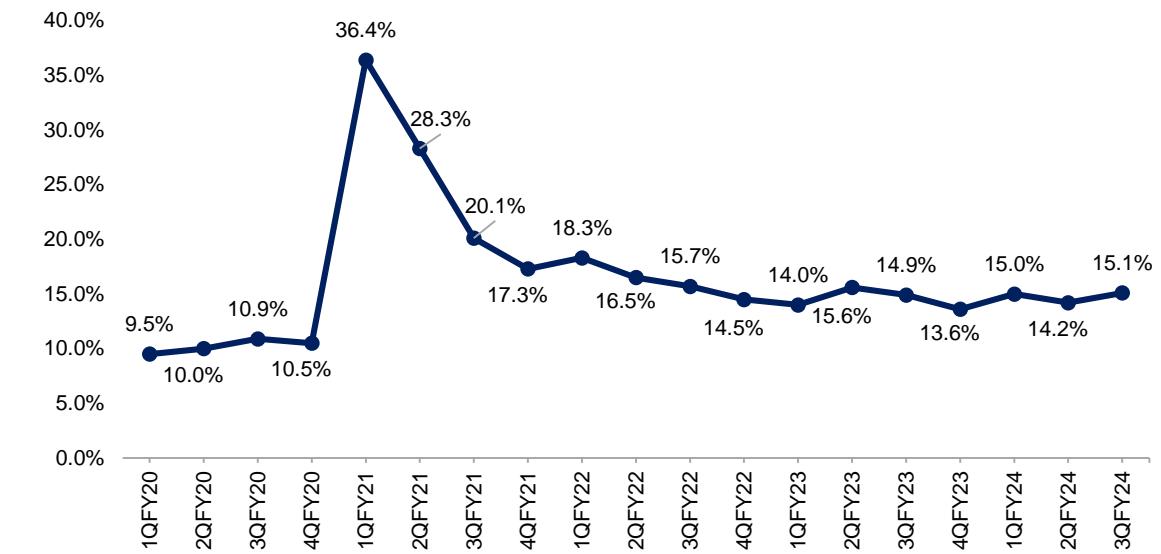
As highlighted earlier, HFFC's credit underwriting is backed by data science. Its proprietary models divide the customers into different risk buckets to predict bounce rates for each category. Despite that, the company saw higher stress vs. peers during the pandemic, leading to higher slippages and credit costs (average of 63bps) during the period (FY20-FY22). While bounce rates have reverted to pre-pandemic levels, its 2-year lagged GNPA ratio has been higher vs. peers during the period.

**Exhibit 26: HFFC has seen a spike in gross slippages...**
**Exhibit 27: ...and net slippages vs. peers during the pandemic**


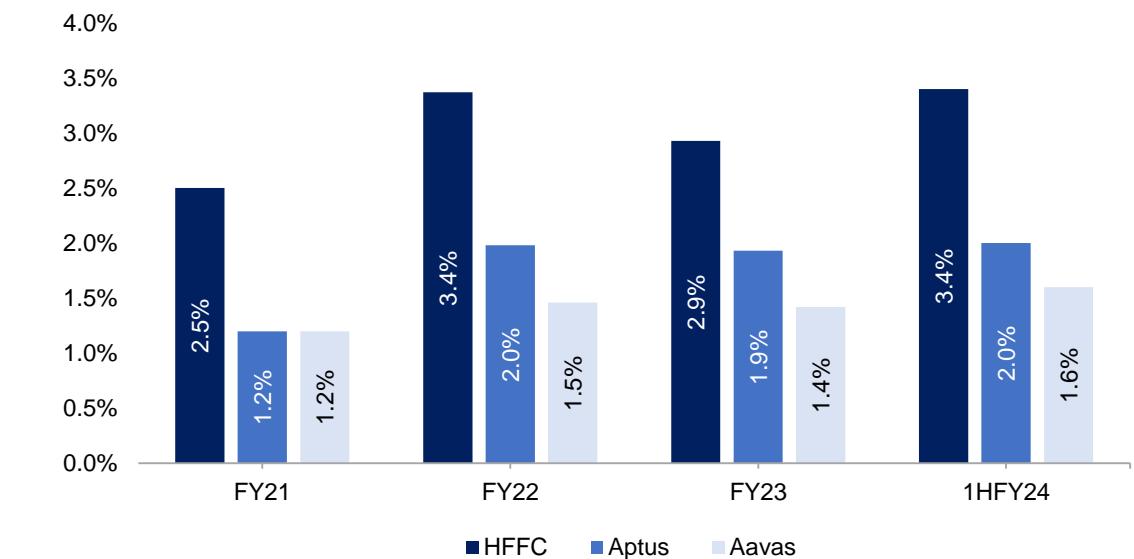
Source: Company; Nirmal Bang Institutional Equities Research



Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 28: While bounce rates have reverted to pre-pandemic levels...**


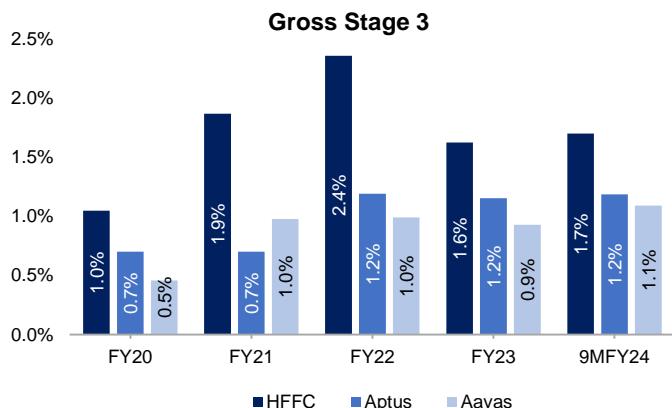
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 29: ...2-year lagged NPAs remain higher vs. peers**


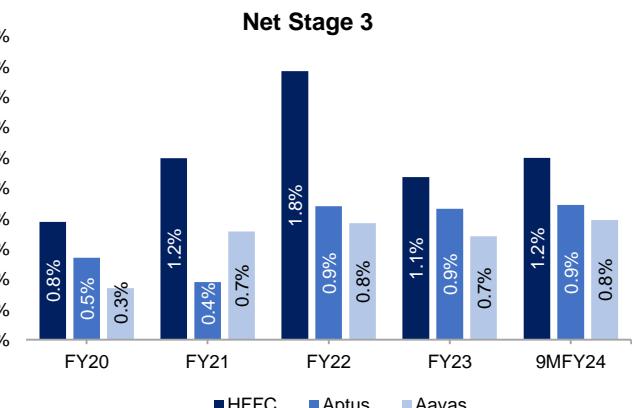
Source: Company; Nirmal Bang Institutional Equities Research

Moreover, HFFC's underwriting model assigns the responsibility of sales and collections to the same person (RM). While this helps in maintaining a lean operating model, it could dilute RM focus on both activities, resulting in poor collections. In our view, a disproportionate focus on sales is likely to impact collections activity, especially during the current high-growth phase of HFFC.

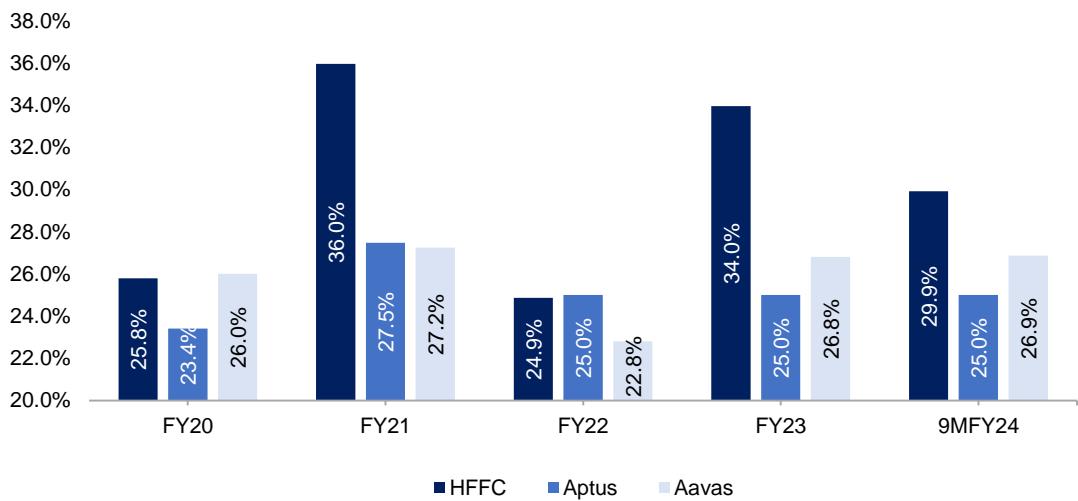
In terms of asset quality trend, HFFC has seen an improvement in Gross Stage 3 levels over FY20-9MFY24, moderating to 1.7% from peak of 2.3% in FY22. While bounce rates were higher during the pandemic, they have stabilized at ~14-15% levels over the past few quarters. The company maintains a PCR of 29.9% (Dec'23), which we believe to be sufficient for a highly secured business. Credit cost (peak of 0.8% in FY21) is down to 38bps in 9MFY24. While we do not expect any major asset quality challenges over the medium term, we are factoring in higher credit costs (~32bps) based on historical trend/difference in operations.

**Exhibit 30: Gross Stage 3 ratio is seeing an improvement post Covid-19 vs. peers...**


Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 31: ...and the same can be seen in Net Stage 3 levels**


Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 32: HFFC has maintained a higher PCR vs. peers**


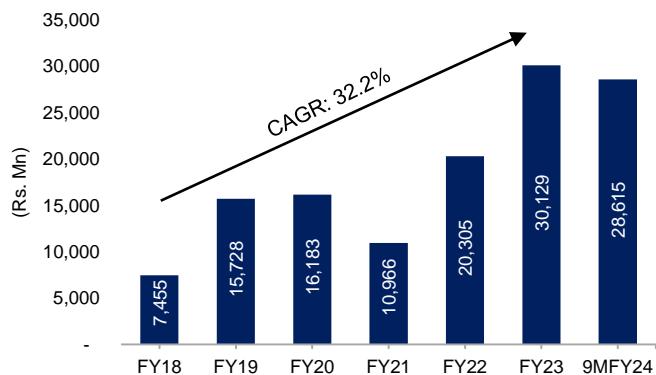
Source: Company; Nirmal Bang Institutional Equities Research

## Valuation and View

### Deeper expansion to drive AUM growth

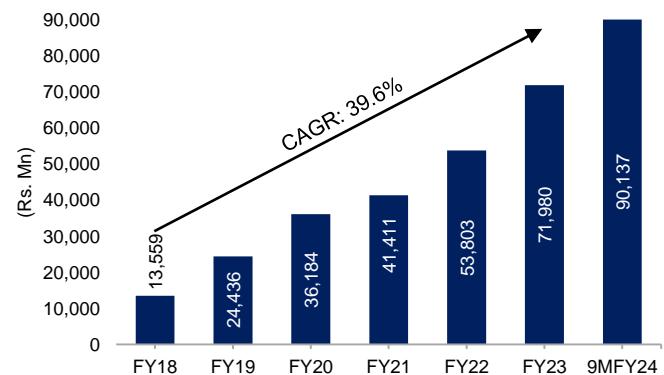
Over the past five years, HFFC has seen a rapid growth, delivering 39.6% AUM CAGR vs 28-37% for peers. The top 5 states contribute 73% to its AUM and the product mix is well-diversified, with home loans contributing 86% and LAP contributing 13% to AUM as on 3QFY24.

**Exhibit 33: Strong disbursement growth of 32.2% over FY18-FY23...**



Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 34: ...leading to AUM growth of 39.6%**

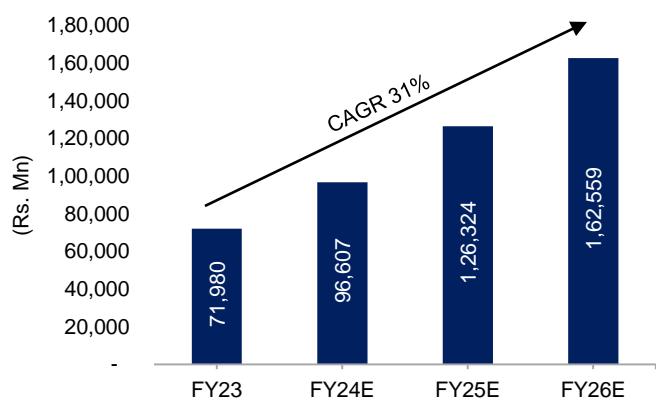


Source: Company; Nirmal Bang Institutional Equities Research

We expect HFFC to deliver 31% AUM CAGR over FY23-FY26E, with 26% CAGR in disbursements. We find two levers of growth for HFFC - (1) Deeper penetration into existing states (GJ & MH) and (2) Expansion into the new states (UP, MP & RJ). We expect HFFC to add ~25 branches per year over the next three years to expand its footprint. The focus will remain on large Affordable Housing finance markets across the regions it operates in.

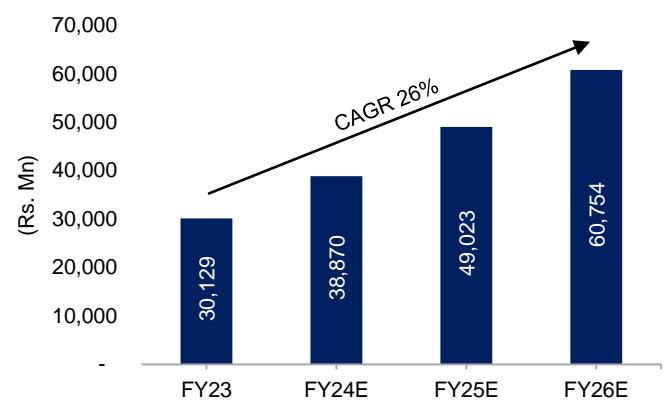
Repayment rates have moderated to 17% in 3QFY24 vs. 19% in 2QFY24 (19.4% in 3QFY23). We expect repayment rates to remain elevated in FY25E due to higher competitive intensity for the sector. While BT-outs moderated sequentially to 7.5% in 3QFY24 from 8.6% in 2QFY24, it remains higher than ~5-6% reported during FY22-FY23.

**Exhibit 35: We expect a robust AUM CAGR of 31% over FY23-26E...**



Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 36: ...driven by a strong disbursement trajectory (CAGR of 26% over FY23-26E)**



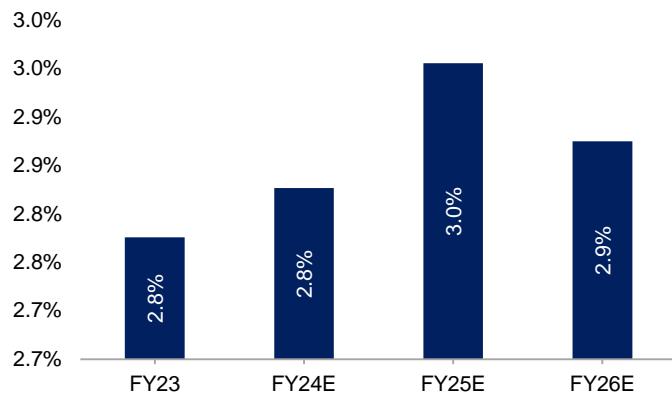
Source: Company; Nirmal Bang Institutional Equities Research

### Expect a compression in spreads over the near term

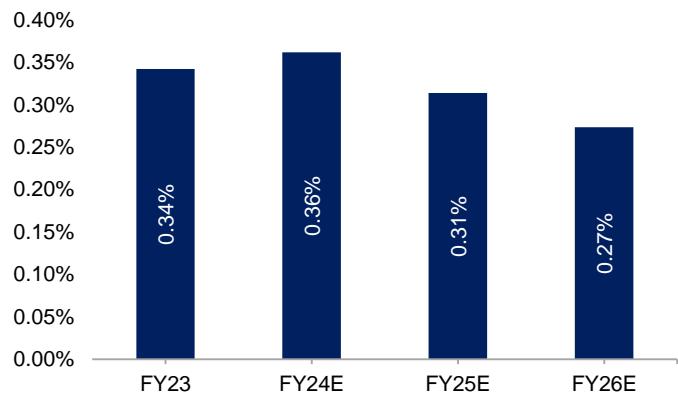
We expect a further rise of ~10bps in the cost of borrowings due to MCLR re-pricing, leading to an elevated cost of borrowings at 8.0% for FY24E. HFFC has available NHB sanction of Rs2.5bn, likely to be drawn in 4QFY24. While this will help offset the rise in the cost of borrowing, it will also lead to a moderation in yields in 4QFY24. We expect the company to maintain spreads in the range of ~5-5.25% over the medium term (currently at 5.3% as on Dec'23) with any subsequent reduction in the cost of borrowings to be passed on to customers.

**Opex costs elevated; Credit costs to remain moderate**

We expect Opex/AUM ratio of ~3% over the next two years, factoring in planned branch expansion and higher rentals/salaries. Post that, we expect operating costs to gradually reduce as the benefits of scale kick in with new branches becoming more productive. HFFC has contained credit costs at ~40bps in 9MFY24 on lower provisions and write-offs. We expect credit costs to remain in the same range (32bps) over the medium term, led by a benign asset quality environment.

**Exhibit 37: We expect opex costs to be elevated over FY25/26E...**


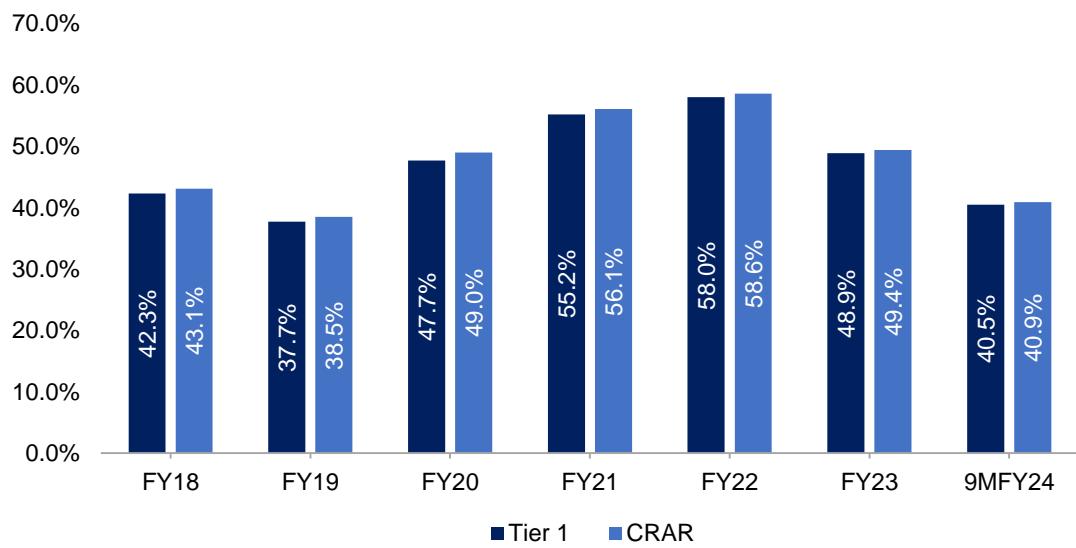
Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 38: ...while credit costs are expected to remain moderate**


Source: Company; Nirmal Bang Institutional Equities Research

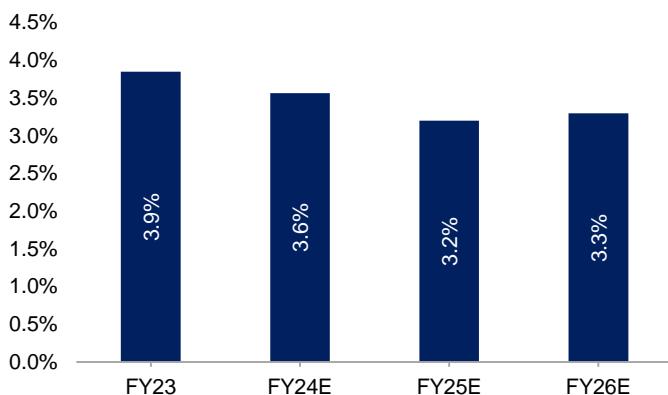
**Sufficiently capitalized to fuel growth**

HFFC has a Tier 1 ratio/CAR of 40.5%/40.9% as of Dec'23, which makes it sufficiently capitalized to support growth ambitions. However, due to high levels of capital, RoE ratios have been subdued. We expect a moderation in CAR to ~34% by FY26E as the company utilizes capital to sustain growth.

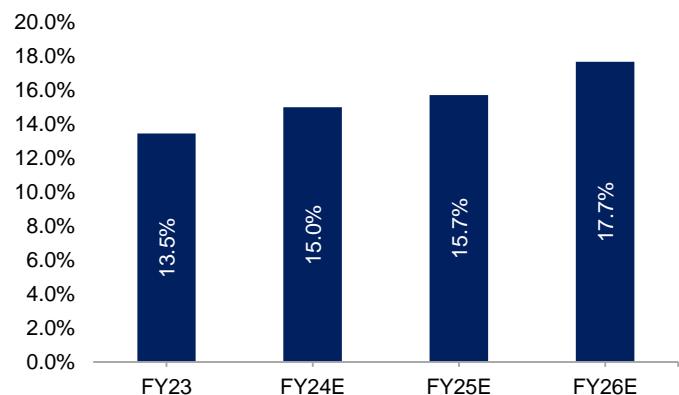
**Exhibit 39: Tier 1/Capital adequacy ratio remains robust**


Source: Company; Nirmal Bang Institutional Equities Research

We initiate coverage on HFFC with a BUY rating and TP of Rs1,150 (3.6x FY26E P/ABV). Rapid geographic expansion, lean operations and controlled credit costs should help sustain HFFC's strong return profile, delivering an RoA of 3.2%/ 3.3% in FY25E/ FY26E. While near term RoE is suppressed due to high capital adequacy (40.5% Tier 1 ratio), we expect it to expand to ~18% by FY26E with an earnings CAGR of 28% over FY23-26E.

**Exhibit 40: We expect an RoA return of 3.2%/3.3% in FY25E/FY26E...**


Source: Company; Nirmal Bang Institutional Equities Research

**Exhibit 41: ...with RoEs expanding to ~18% by FY26E**


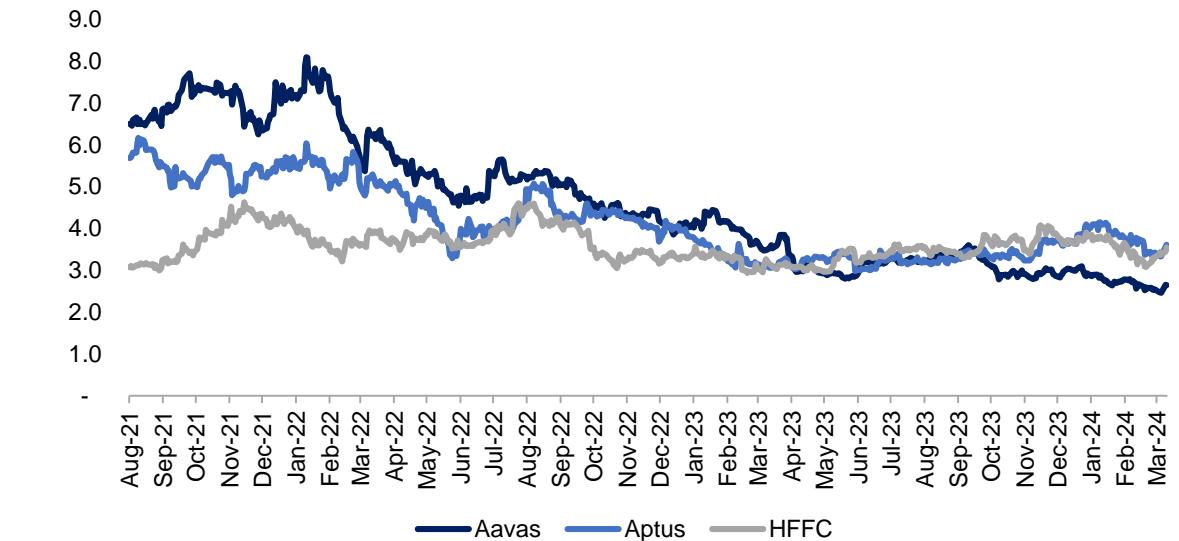
Source: Company; Nirmal Bang Institutional Equities Research

### Sector has de-rated; HFFC valued at a premium

Listed AHFCs have seen a de-rating in recent months despite strong growth trajectory and return ratios. Apart from the change in management of Aavas, which led to a sharp stock price movement, stake sales by large PE funds have likely put pressure on stock performance. HFFC is trading at a valuation of 2.8x FY26E P/ABV and on an average, it has traded at a multiple of 3.5x over the past three years. We believe our TP of Rs 1,150 at 3.6x FY26E P/ABV is in line with average historically traded multiples. Despite premium valuations (Aavas valued at 3x FY26E P/ABV), we maintain a positive stance on HFFC as one of the best Affordable Housing finance plays in India. Its unique technology based model, lean operations and distribution-light franchise grant a 20% premium over Aavas. Moreover, HFFC is a more diversified franchise and is quickly expanding into high-growth markets (RJ, UP, MP), while maintaining controlled opex and credit costs. For these reasons, we believe that HFFC commands a premium over Aavas.

**Exhibit 42: HFFC is trading at 2.8x FY26E P/ABV**


Source: Bloomberg, Nirmal Bang Institutional Equities Research

**Exhibit 43: ...at a premium vs. peers which we believe is justified (P/ABV multiple)**


Source: Bloomberg, Nirmal Bang Institutional Equities Research

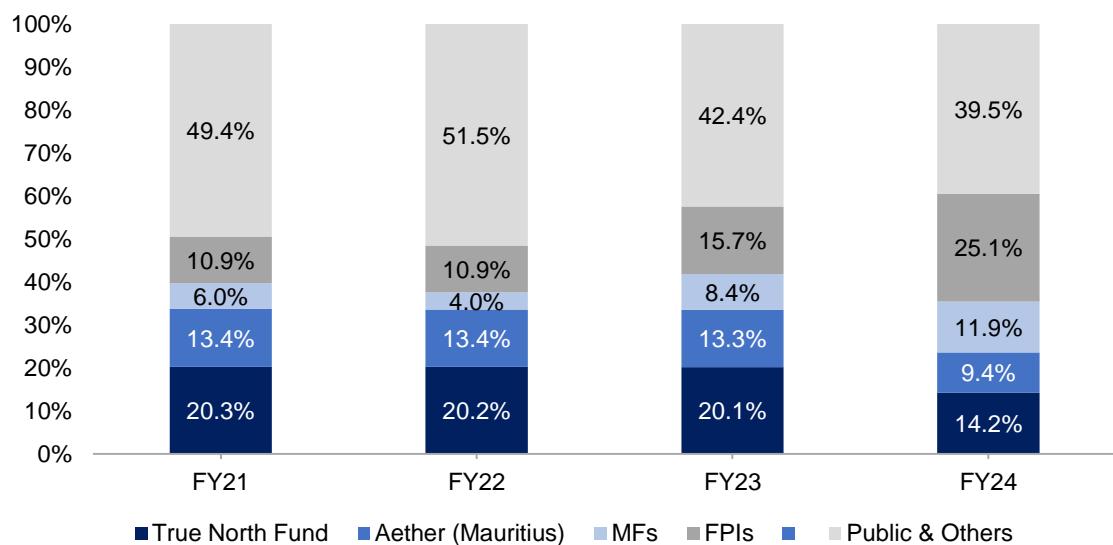
## Risks

- High concentration risk:** While HFFC operates in 13 states in India, top 3 states (GJ, MH and TN) comprise 59.4% of business (as of Dec'23). Furthermore, 71 out of 123 branches are also located in these states. Any significant social, political or economic disruption/natural calamities in these states could disrupt operations. While that remains a risk, HFFC is rapidly diversifying its portfolio by expanding in focus states (RJ, UP & MP).
- Execution risk for new geographies:** HFFC has actively expanded its branch network over the years and aims to further expand its presence in existing/new geographies. However, it operates in a highly competitive segment where Banks/SFBs are increasingly becoming active. Difference in business environment in new states vs. existing geographies could result in slower growth for HFFC. However, with a lean operating model and centralized model of underwriting supported by connectors, we believe HFFC is well-placed to deliver growth in new states.
- Risk of spreads erosion due to competition:** HFFC is most susceptible to competition from banks/ large lenders as it targets mostly formal/ salaried customers. Higher BT-outs/ repayments due to high competitive intensity is likely to result in slower growth. However, despite a recent rise in interest rates, HFFC has been able to keep BT-outs under control (7.5% in 3QFY24 vs. ~5-6% for peers).
- Asset quality stress is likely higher:** HFFC has seen higher slippages/GNPA ratios over the past few years, indicating higher stress vs. peers. However, it has managed to keep credit costs under control and maintains the highest PCR of 30% among peers (Dec'23). While we do not expect any asset quality challenges in the medium term for the sector, we have accounted for higher credit costs vs. peers in our estimates.

## Shareholding Pattern

The promoters, True North LLP and Aether (Mauritius) Limited own 23.6% in total. Warburg Pincus owns 23.1% while the rest is owned by MFs, FPIs and public shareholders.

**Exhibit 44: Shareholding Pattern (%)**



Source: Company, BSE, Nirmal Bang Institutional Equities Research

**Exhibit 45: Top 10 Shareholders as of FY24 (%)**

Name of Shareholder	% of Shareholding
Warburg Pincus	23.1%
True North	14.2%
Aether	9.4%
Govt. Pension Fund Global	3.3%
Invesco MF	3.2%
Small Cap World Fund	2.7%
Goldman Sachs	2.2%
Universal Trustees	1.5%
Aditya Birla Sun Life MF	1.3%
Kuwait Investment Authority	1.3%

Source: Company, BSE, Nirmal Bang Institutional Equities Research

## Management Team

### Exhibit 46: Brief profile of key managerial personnel

Name	Designation	Profile
Mr. Manoj Viswanathan	Managing Director and CEO	He holds a bachelor's degree in electrical and electronics engineering from the Birla Institute of Technology and Science, Pilani and a post graduate diploma in business management from XLRI, Jamshedpur. His expertise lies in the areas of finance, consumer behavior, sales & marketing, business operations, risk management, digital platform and strategic thinking.
Mr. Ajay Khetan	Chief Business Officer	He is a Mechanical Engineer and has done his post graduate diploma in management from Xavier Institute of Management, Bhubaneswar. He has over 23 years of experience in Consumer finance, Operations and Risk Management. He has previously worked with Macquarie Finance (India), HP Financial Services (India), CitiFinancial Consumer Finance, etc.
Mr. Gaurav Mohta	Chief Marketing Officer	He is a mechanical engineer and has done his post graduate diploma in business administration from ICFAI Business School, Hyderabad. He has over 20 years of experience in consumer finance, marketing and product management. He has previously worked with Kotak Mahindra Bank, CitiFinancial Consumer Finance and Foodworld Supermarkets.
Ms. Vilasini Subramaniam	Head – Strategic Alliances	In her current role she is working on building a new distribution channel through alliance partnerships and enhanced digital process flows. She is a commerce graduate and a Chartered accountant and has over 20 years of experience in consumer finance and credit. He has previously worked with MHFC, Janalakshmi Financial Services, Citibank India.
Ms. Nutan Gaba Patwari	Chief Financial Officer	She leads the Accounts, Tax, Finance and Treasury, Secretarial, Investor relations and FP&A functions of the Company. She has over 16 years of experience in finance. She has previously worked with True North, HUL, ITC, Philip Morris Asia.
Mr. Ashishkumar Darji	Chief Risk Officer	He is a risk management professional with an experience of 18 years in the Banking and Financial Services sector. His experience spans regulatory compliance, risk management and risk modelling. He has previously worked with KPMG, SBI, Kotak Securities and Clearing Corporation of India Limited.
Mr. Ramakrishna Vyamajala	Chief Human Resource Officer	He has done post graduate diploma in management from T.A. Pai Management Institute. He has over 17 years of experience in human resources, rewards and recognition, compensation and benefits. He has previously worked with Sterlite Technologies and IDFC Bank.
Mr. Abhijeet Jamkhindikar	Business Head – Maharashtra	He holds a bachelor's degree in civil engineering from Nagpur University. He has 20 years of experience in construction finance (for developers), finance, valuations, technical appraisals and business development. He has previously worked with C-Net Solutions India, HDFC.
Mr. Arunchandra Jupalli	Business Head - South	He is a commerce graduate and holds a master's degree in business studies from Bharati Vidyapeeth. He has over 21 years of experience in consumer lending business handling various products like Consumer Durable Finance, PL, Insurance, GL and LAP. He has previously worked with Atlantic Duncans International, India Office Solutions, Citigroup, Net Ambit Value First, Karvy Financial Services and Small Business FinCredit India.

Source: Company, Nirmal Bang Institutional Equities Research

## Financials

### Exhibit 47: Income statement

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	5,117	7,222	10,191	13,349	17,107
Interest expense	2,157	3,043	4,933	6,609	8,251
<b>Net interest income</b>	<b>2,960</b>	<b>4,179</b>	<b>5,258</b>	<b>6,739</b>	<b>8,856</b>
Non-interest income	840	734	1,257	1,572	1,901
<b>Net Revenue</b>	<b>3,800</b>	<b>4,913</b>	<b>6,516</b>	<b>8,311</b>	<b>10,756</b>
Operating Expense	1,287	1,746	2,383	3,294	4,153
<b>Operating profit</b>	<b>2,513</b>	<b>3,167</b>	<b>4,133</b>	<b>5,017</b>	<b>6,604</b>
Provisions	250	215	305	350	395
<b>PBT</b>	<b>2,263</b>	<b>2,952</b>	<b>3,828</b>	<b>4,667</b>	<b>6,209</b>
Taxes	402	669	885	1,073	1,428
<b>PAT</b>	<b>1,861</b>	<b>2,283</b>	<b>2,943</b>	<b>3,594</b>	<b>4,781</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 48: Balance sheet

Y/E March (Rsmn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	175	176	176	176	176
Reserves & surplus	15,562	17,997	20,862	24,456	29,237
<b>Networth</b>	<b>15,737</b>	<b>18,173</b>	<b>21,039</b>	<b>24,632</b>	<b>29,413</b>
Borrowings	34,668	48,135	75,309	100,568	131,825
Other liability & provisions	764	1,062	1,324	1,609	1,956
<b>Total liabilities</b>	<b>51,169</b>	<b>67,370</b>	<b>97,671</b>	<b>126,810</b>	<b>163,194</b>
Cash	6,678	2,984	6,644	9,039	13,172
Investments	0	2,808	7,814	8,877	9,792
Loans	43,049	59,957	81,150	106,112	136,550
Fixed & Other assets	1,442	1,621	2,064	2,782	3,681
<b>Total assets</b>	<b>51,169</b>	<b>67,370</b>	<b>97,671</b>	<b>126,810</b>	<b>163,194</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 49: Key ratios

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
<b>Growth (%)</b>					
Net Interest Income	39.2	41.2	25.8	28.2	31.4
Operating Profit	51.2	26.0	30.5	21.4	31.6
Profit After Tax	85.8	22.7	28.9	22.1	33.0
Loans	29.4	39.3	35.3	30.8	28.7
<b>Spreads (%)</b>					
Yield on loans	13.4	14.0	14.4	14.3	14.1
Cost of Borrowings	6.6	7.3	8.0	7.5	7.1
NIMs	6.2	6.6	6.2	6.0	6.1
<b>Operational Efficiency (%)</b>					
Cost to Income	33.9	35.5	36.6	39.6	38.6
Opex to AUM	2.7	2.8	2.8	3.0	2.9
<b>CRAR (%)</b>					
Total CRAR	58.6	49.4	40.2	36.3	33.8
<b>Asset Quality (%)</b>					
Gross NPA	2.4	1.6	1.6	1.4	1.3
Net NPA	1.8	1.1	1.2	1.2	1.0
Provision Coverage	24.9	34.0	35.0	35.0	35.0
Credit Cost	0.5	0.3	0.4	0.3	0.3
<b>Return Ratio (%)</b>					
ROE	12.6	13.5	15.0	15.7	17.7
ROA	3.9	3.9	3.6	3.2	3.3
<b>Per Share (%)</b>					
EPS	21.2	25.9	33.4	40.8	54.2
BV	179.6	206.5	238.6	279.4	333.6
ABV	170.9	199.2	227.6	264.9	318.1
<b>Valuation (x)</b>					
P/E	41.7	34.1	26.5	21.7	16.3
P/BV	4.9	4.3	3.7	3.2	2.7
P/ABV	5.2	4.4	3.9	3.3	2.8

Source: Company, Nirmal Bang Institutional Equities Research

## DISCLOSURES

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### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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