Consumer Finance
HFCs: Stay Selective; Initiate on PNB Housing and Repco

Key Takeaway

We initiate on PNB Housing at Buy and Repco Home Finance at Hold. We are positive on HFCs medium term, but we see near-term headwinds due to RERA and pressure on spreads. Valuations could diverge. Hence, we stay selective. Within HFCs, we prefer PNBHFL given its strong growth outlook. For LICHF, while spreads could fall further in 2Q, this may represent a bottom. We see growth and spread concerns at Repco, but post the sharp correction, downside may be limited.

Housing push medium-term positive; RERA could affect growth near term: Housing finance companies (HFCs) should gain from the government's affordable housing thrust, but supply of affordable housing units is a key constraint. Despite signs of improving developer interest, benefits would likely be back-ended. Near term, RERA implementation could affect loan growth, though this may vary across regions. Overall feedback is that growth in west (Gujarat, Maharashtra) is good; north is stabilizing but south is subdued.

Yields under pressure; funding cost levers could cushion spreads: With competition from banks intensifying, yields should be under pressure across most segments (home loan, LAP, developer). Salaried (LICHF), higher ticket LAP segment may see higher competition. HFCs with funding cost/ liability mix levers may be able to preserve spreads.

Diversified mix, niche segment, low-cost HFCs better positioned: HFCs with a diversified book (salaried, non-salaried) with stable asset quality (PNBHFL) and low funding cost (HDFC, PNBHFL) could be better positioned. Competition in niche small ticket, non-salaried segment (Repco, Gruh) should be lower, but elevated spreads seen by HFCs like Repco in the past could moderate.

Valuation multiples could diverge: Optimism around strong growth in housing, led by policy incentives and hopes of structural uplift in loan and earnings growth medium term, could keep multiples elevated at HFCs reporting strong growth, stable asset quality; HFCs reporting earning slowdown, asset quality issues could trade at lower valuations (LICHF, Repco).

Initiate on PNB Housing (PNBHFL) with Buy, PT Rs1,740: We believe loans should grow 34% CAGR over FY17-20E, led by branch additions, focus on a mix of housing, non-housing loans and competitive pricing. We expect strong loan growth and operating leverage gains to offset modest NIM compression and drive 35% profit CAGR over FY17-20E. GNPA, though lower vs most peers, should edge higher as its portfolio seasons. Valuations at 3.6x FY19E BV (peer avg. 3.2x) is admittedly at a premium, but this likely reflects its stronger profit growth outlook. We think these valuation premiums may sustain unless either earning growth (loan growth, NIMs) or asset quality slips, which we do not expect at this stage .

Initiate on Repco Home Finance with Hold, PT Rs585: We expect Tamil Nadu registration issue (62% of loans), rising prepayments and shift towards lower ticket LAP to weigh on loan growth. Repco has focused on niche, small-ticket, non- salaried home loans, resulting in higher spreads vs peers, but we believe spreads could moderate given competition and pressure on yields. We expect EPS growth to slow to 15% CAGR over FY17-20E (21% CAGR FY15-17). However, post sharp correction, valuations at 2.6x FY19E BV (historic avg 3.3x FY19E BV ex post) could limit downside potential.

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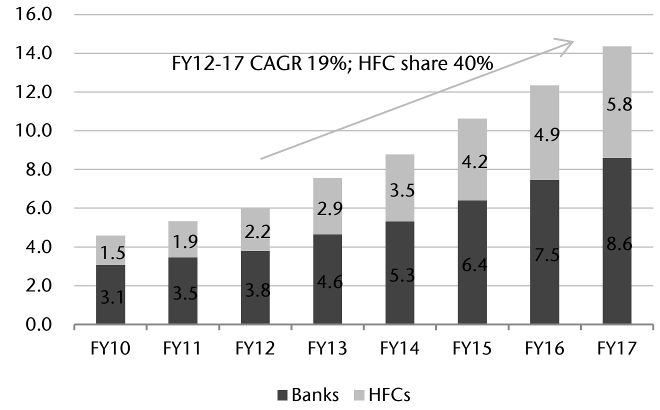
^Prior trading day's closing price unless otherwise noted.

Company Name	Ticker	Mkt. Cap (MM)	Rating	Price^	Price Target	Cons. Next FY	Current EPS Estimates 2017	2018	2019	Valuation (P/E) 2018	2019
LIC Housing	LICHF IN	INR316.6BN	HOLD	INR627.35	INR690.00	--	INR32.91	INR38.26	INR43.41	16.4x	14.5x
PNB Housing	PNBHOUSI IN	INR245.4BN	BUY	INR1,482.00	INR1,740.00	--	INR36.14	INR44.63	INR58.76	33.2x	25.2x
Repco	REPCO IN	NM	HOLD	INR628.95	INR585.00	--	INR29.23	INR31.47	INR37.58	20.0x	16.7x

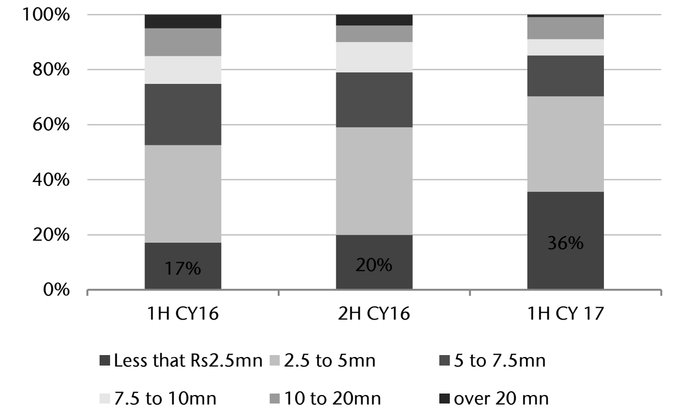
Key Charts

Exhibit 1: Housing loan market (Rs trn): HFCs to benefit from government push towards housing



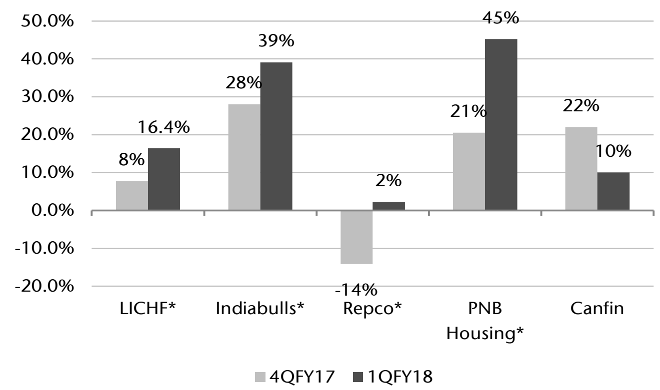
Source: CRISIL, DHFL, Jefferies, company data

Exhibit 2: Supply side is a constraint, but mix of new launches* in low- to mid-ticket segment is improving



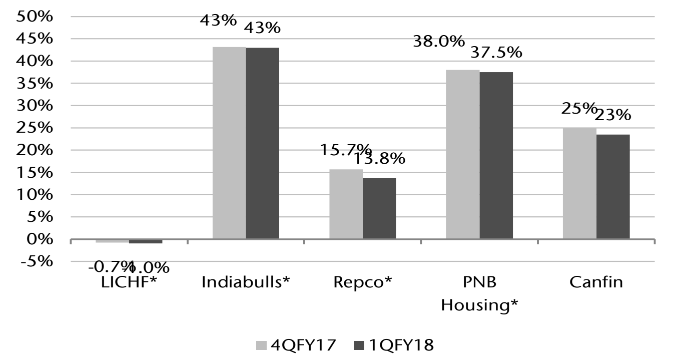
Source: Knight Frank, Jefferies *=top 8 cities

Exhibit 3: Disbursal growth (YoY) has improved in June Q...



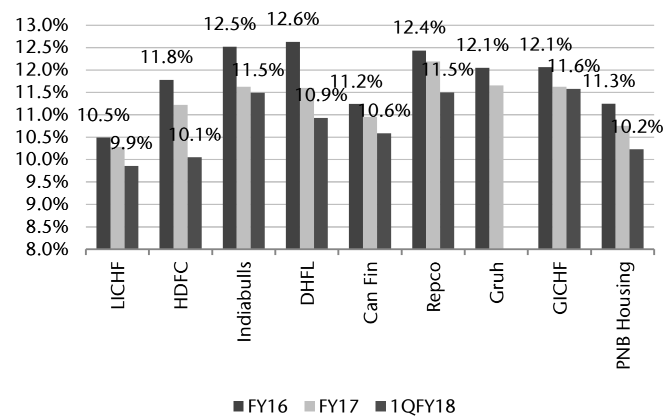
Source: Jefferies, company data

Exhibit 4: ... but AUM growth (YoY) was mixed due to balance transfers



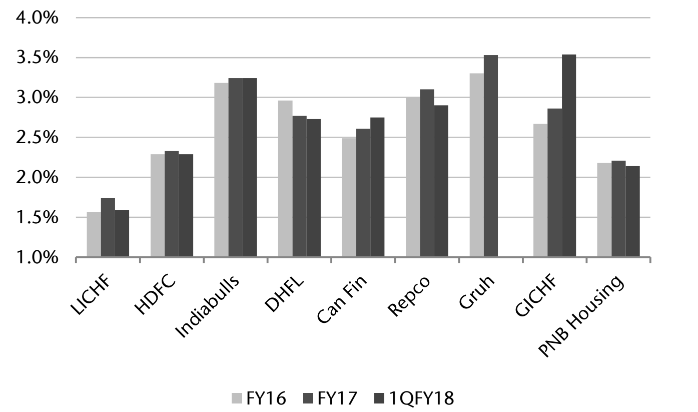
Source: Jefferies, company data

Exhibit 5: Yields have softened on lower interest rates and rising competition



Source: Jefferies, company data

Exhibit 6: Spreads have moderated in June Q



Source: Jefferies, company data

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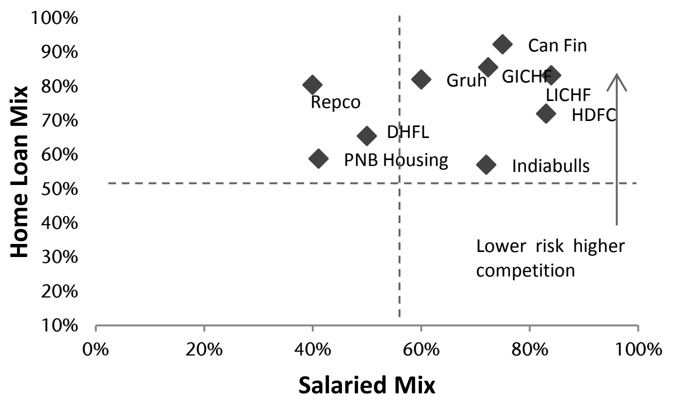
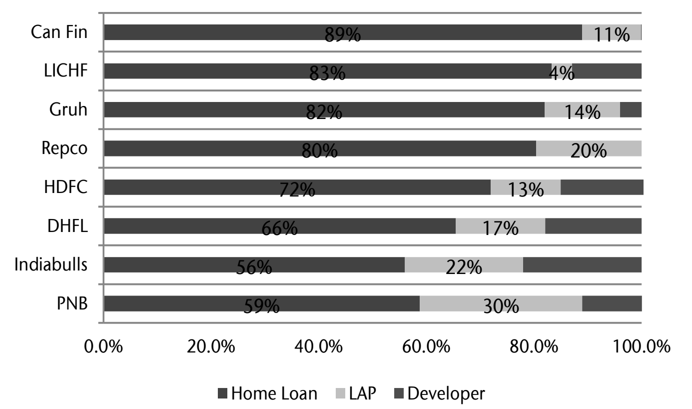
Exhibit 7: Higher home loan, higher salaried segment (FY17) may see higher competition



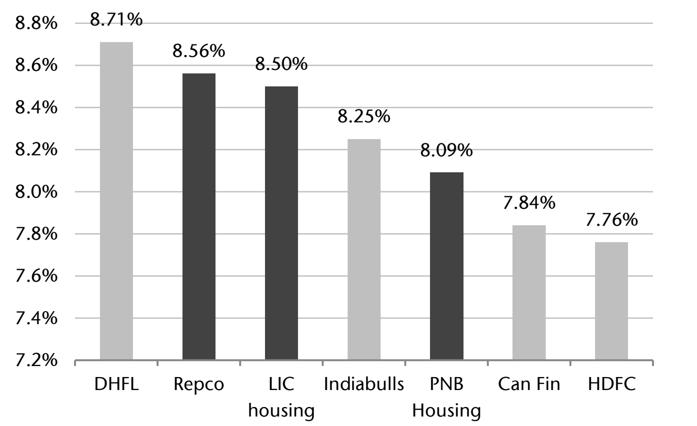
Source: Jefferies, company data

Exhibit 8: HFCs with diversified book may be better placed provided asset quality remains stable



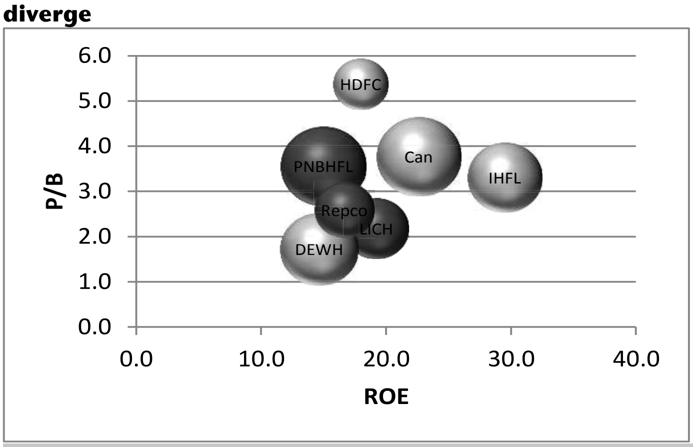
Source: Jefferies, company data

Exhibit 9: HFCs with liability mix levers or lower funding costs could be better placed



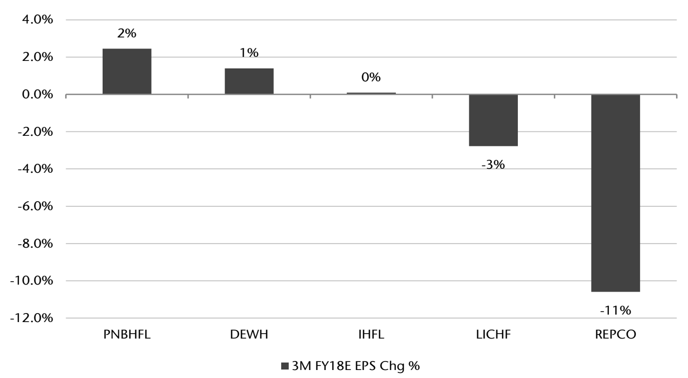
Source: Jefferies, company data

Exhibit 10: P/B (FY19E ex post): Valuation multiples* could diverge



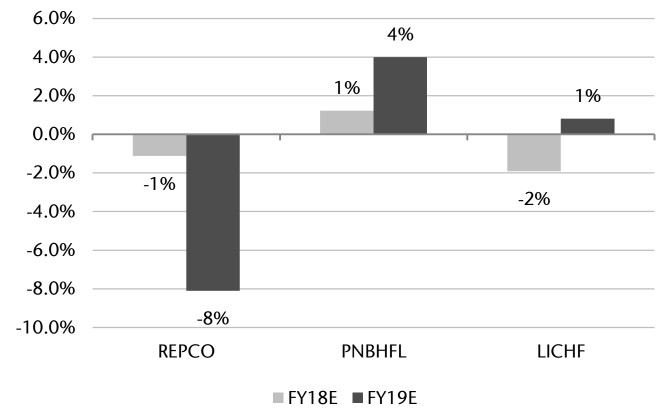
Source: Jefferies estimates, company data * size of bubble represents EPS CAGR over FY17-20E EPS (consensus est for of NC)

Exhibit 11: Consensus FY18E EPS: Valuation premiums have sustained at HFCs with stable/positive EPS revision; HFCs with negative EPS momentum could trade at lower multiple



Source: Bloomberg, Jefferies, company data

Exhibit 12: HFC Coverage: Our PNHFL est. are ahead of consensus, while that of Repco is below consensus



Source: Jefferies estimates, company data

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Repco Home Finance

We initiate on Repco Home Finance (Repco) with a Hold rating and PT of Rs585. Repco has faced multiple headwinds (Tamil Nadu registration ban, rising prepayments and asset quality issues) in recent quarters. While registration ban has been lifted, we expect slower loan growth over FY17-20E. This coupled with softer spreads could lead EPS growth to slow to 15% CAGR over FY17-20E (21% CAGR FY15-17). Asset quality issues have likely peaked, but it may stay elevated near term. Post sharp correction, valuations at 2.6x FY19BV appear reasonable and could limit downside potential.

Expect slower loan growth over FY17-19E: While the Madras High Court has relaxed ban on property registrations in Tamil Nadu (62% of loan book), full resolution could take longer. We expect loan growth at Repco to slow to 18% CAGR over FY17-20E (26% CAGR over FY14-17) as a) new property registrations in Tamil Nadu (62% of loan book) may take longer; affecting disbursal in self-construction segment (45% of loan book); b) existing properties in unapproved layouts will have to be regularised; c) repayment rates could increase due to rising competition and d) Repco has stopped disbursing high ticket LAP loans over Rs7.5mn (76% of LAP disbursal were above Rs5mn ticket size).

Moderation in spreads: Focus on underpenetrated small ticket non-salaried segment (60% of book) in tier 2 and 3 cities has helped Repco sustain higher yields vs. peers. However, rising competition from banks, repricing of its high yielding back book and efforts to focus on salaried home loan segment (due to rising asset quality issues in non-salaried segment) and moderation in LAP loan growth could lead to moderation in its yields. Fall in funding costs could cushion impact on spreads. We expect spreads to moderate to 2.93% over FY17-19E (3.1% in FY17).

Earnings growth to decelerate; ROAs to moderate: We believe slower loan growth, moderation in spreads and elevated credit costs should drive 15% EPS CAGR over FY17-20E (18% EPS CAGR over FY14-17). Repco has delivered average ROA of 2.2% over last three years, higher vs. most HFC peers due to focus on niche non salaried segment, but lower spreads should lead ROAs to moderate to around 2% over FY17-20E.

Asset quality issues have likely peaked: Repco's asset quality was broadly stable in the past due to strong underwriting process but GNPA rose sharply to 4% in 1Q FY18 owing to slippages in non-salaried home loans, higher ticket LAP loans due to a) demonetisation and b) as several LAP borrowers had exposure to real estate sector and were impacted by registration ban issues. Management indicated that recoveries are improving and expects sequential improvement over the next few quarters.

Valuations pricing in concerns largely: While we see near-term headwinds, valuations at 2.6x FY19E BV (vs the average 3.4x FY1 ex post) appear to be pricing in the concerns to large extent and may limit downside potential. Our PT of Rs585 based on RI model implies P/B of 2.4x FY19E. Risks: slower loan growth, further pressure on NIMs, deterioration in asset quality.

Exhibit 88: : Financial Summary

INR in Mn	**FY17**	**FY18E**	**FY19E**	**FY20E**
Net Interest Income	3,678	4,051	4,690	5,561
Pre provision operating profit		3,676	4,272	5,073
Profit after tax	1,823	1,962	2,343	2,779
EPS	**29.2**	**31.5**	**37.6**	**44.6**
EPS growth	22%	8%	19%	19%
ROA	2.17%	2.01%	2.05%	2.03%
RoE	17.4%	16.1%	16.7%	17.0%
Valuation				
P/E	21.6	20.0	16.8	14.1
P/BV	3.45	3.02	2.60	2.23

Source: Jefferies estimates, company data

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Presence in niche non-salaried home loan segment

Repco Home Finance (REPCO), promoted by Repco Bank, is a housing finance company (HFC) with strong concentration in south India, especially Tamil Nadu. Repco's loan book (Rs89.9bn) has grown at a CAGR of 26% over the past five years, led by focus on relatively higher yielding and under serviced non-salaried segment in tier II and tier III cities, where in competition is relatively lower. Repco has enjoyed higher spreads vs peers, which has offset higher credit costs and supported ROAs of 2.3% and ROE of 17% in last 5 years.

Repco has faced multiple headwinds in the past 12 months as Madras High Court Ban on property registration (63% of loan book), demonetisation impacted loan growth/ asset quality at Repco. The stock has corrected sharply in the past two months due to following factors:

- Disbursal growth was muted in June Q despite Madras High Court relaxing the ban in May, due to some confusion around the High Court Order.
- Repco has seen rising prepayment pressure in large ticket LAP segment and salaried home loan segment.
- GNPA has increased sharply in June Q. Besides tail effects of demonetisation, Repco has seen rising slippages in its LAP segment, especially in high ticket segment (over Rs7.5mn). Several borrowers in the LAP segment have presence in the real estate sector and their cash flows were affected due to ban on property registration as per Management.

With ban on property registration now lifted, property registration related issues should slowly fade. However, full resolution could take some time, in our view.

Focus on non-salaried home loans in tier 2, 3 cities

Repco targets the niche, non-salaried home loan segment, which represents 50% of its home loan portfolio and 60% of its overall portfolio (including loan against property). Its target segment comprises lower income borrowers like school teacher, small shop keepers, pawn brokers, small traders in tier 2, tier 3 cities and in outskirts of tier 1 cities. Around 20% of non-salaried borrowers are professionals like doctors, chartered accountants.

- Home loan ticket size is small at Rs1.1mn (salaried Rs0.9mn, self-employed Rs1.2mn), which falls in the affordable housing loan category. Around 45% of housing loans are in the self-construction segment.
- Yields are higher than peers given higher risk and relatively lower competition in this segment.
- Loan against Property (LAP) account for 19.6% of its home loan book. LAP book has a mix of small ticket LAP and lumpy large mortgage loans. Average ticket size of its LAP book is around Rs2mn, but its median ticket is low at Rs0.8-0.9mn.
- The branch manager is responsible for doing the initial checks and preliminary assessment of the credit worthiness of the customer and is also responsible for disbursing loans and monitoring loan repayments/ collections. In case of other geographies like Maharashtra, it also depends on DSAs for loan origination.

Strong Tamil Nadu concentration an issue; diversifying geographically

South India accounts for 89% of Repco's loan book. Tamil Nadu represents almost 62% of its loan book. Presence outside South is mainly in West Bengal, Odisha, Maharashtra, Gujarat, Madhya Pradesh and Jharkhand.

Repco intends to diversify its footprint to non-southern states. It plans to reduce its exposure to Tamil Nadu to around 50% in the medium term. In FY18, it is targeting 10 new branches across Maharashtra, Gujarat, Andhra Pradesh and Tamil Nadu.

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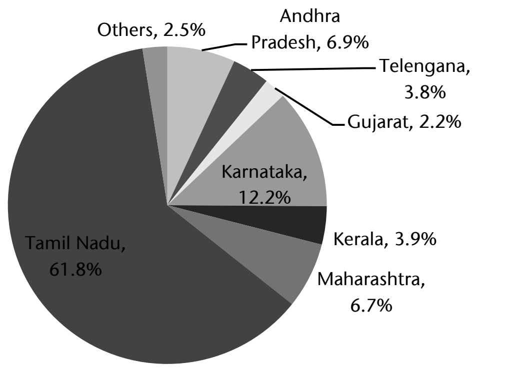
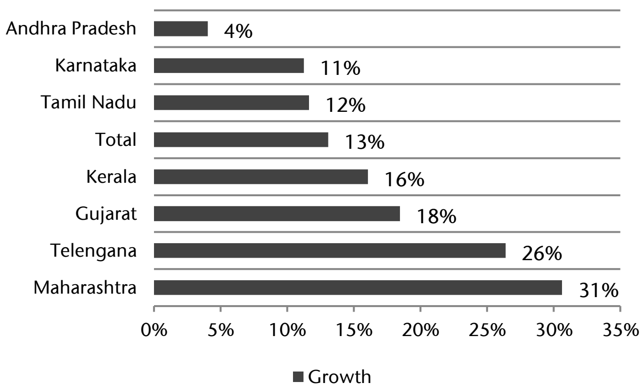
Exhibit 89: : Tamil Nadu accounts for 62% of the loan book



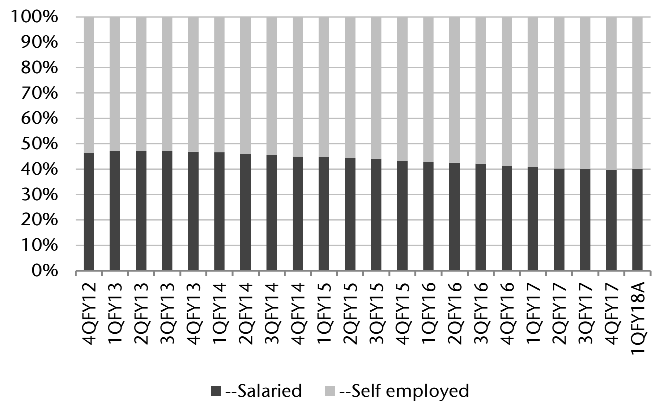
Source: Jefferies estimates, company data

Exhibit 90: : Repco is trying to diversify its geographic mix



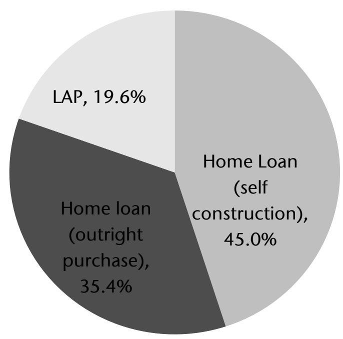
Source: Jefferies estimates, company data

Exhibit 91: : Loan mix: 40% of its loan book comprises salaried borrowers



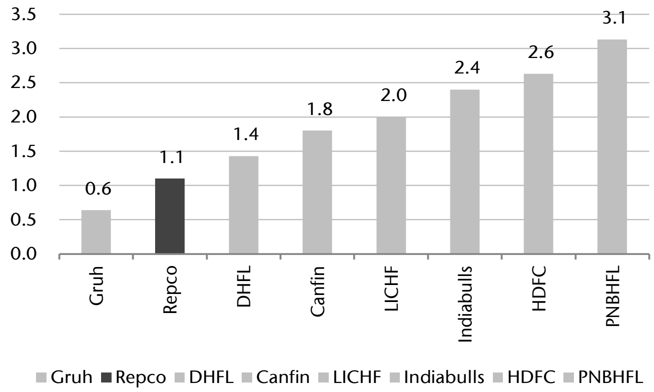
Source: Jefferies estimates, company data

Exhibit 92: : Repco: Around 80% of loan book is home loans, including 45% self-construction home loans



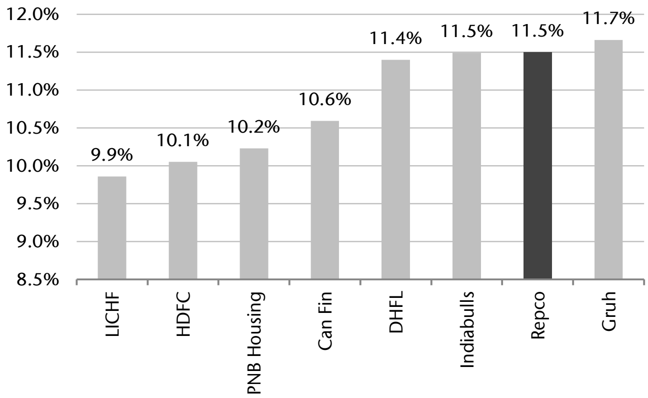
Source: Jefferies estimates, company data

Exhibit 93: : Repco average ticket size for home loan is Rs1.1mn lower end of home loan ticket size spectrum



Source: Jefferies estimates, company data

Exhibit 94: : Yields are better due to focus on under served small ticket, self-employed segment



Source: Jefferies estimates, company data

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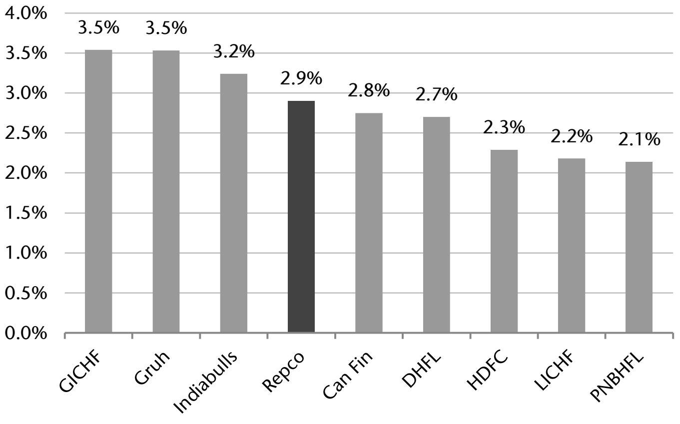
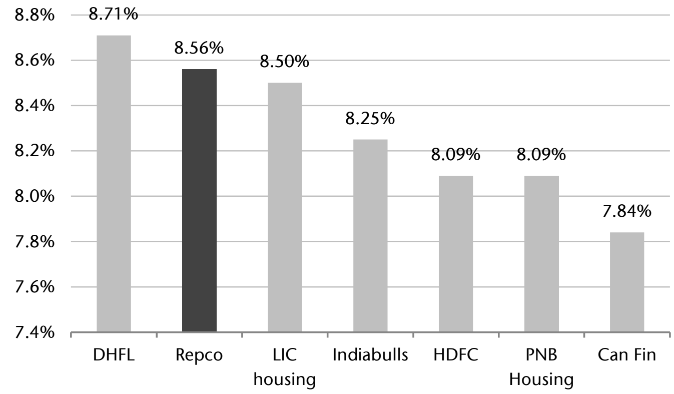
Exhibit 95: : Spreads are higher vs. peers



Source: Jefferies estimates, company data

Exhibit 96: : …. despite higher cost of borrowing



Source: Jefferies estimates, company data

Loan camps remain the main driver of customer origination

Repco mainly depends on loan camps for around 60% of its loan origination. Branch managers conduct loan camps once in two months. Customer documents are assessed at a broader level and an in principle sanction is given. Subsequently, customers are required to approach the branch for further processing of the loan.

Exhibit 97: Indicative Yields in June Q: large variance between incremental yield and backbook : higher re pricing risk

	Portfolio	Incremental
Salaried	11.1%	
Non Salaried	11.7%	
Home Loans	11.4%	10.5%
LAP	14.5%	12.5%

Source: Jefferies estimates, company data

Slower loan growth over FY17-19E

Repco's loan book grew at a 26% CAGR in the past five years, led by 24% CAGR growth in home loan book and 36% CAGR in loan against property book.

In FY17, disbursal declined 7% YoY, led by a confluence of factors a) elections in Tamil Nadu in 1Q; b) ban on registration of plots in unapproved housing lay outs in 2H FY17 imposed by Madras High Court and c) demonetisation impact, especially given exposure to self-employed segment. In June Q, prepayment rates jumped in June Q impacting book growth in June Q. Also, sand availability issues in Tamil Nadu, impacted growth in Repco's self-construction book (45% of loan book).

While factors (elections, demonetisation, sand availability issues and registration ban) that impacted loan growth in FY17 are steadily easing and worst is likely over in terms of negative news flow, loan growth may remain soft, in the near term. We expect loan growth at Repco to slow to 18% CAGR over FY17-20E (26% CAGR over FY14-17) as

- **Madras High Court Ban relaxed; full resolution could take longer:** Madras High Court has now relaxed the ban on re-registration of properties already registered before Oct 2016. However, new property registrations in Tamil Nadu (62% of loan book) may take longer. This would impact disbursal in self-construction segment (45% of loan book). Existing properties in unapproved layouts will have to be regularised, which could take time in our view.

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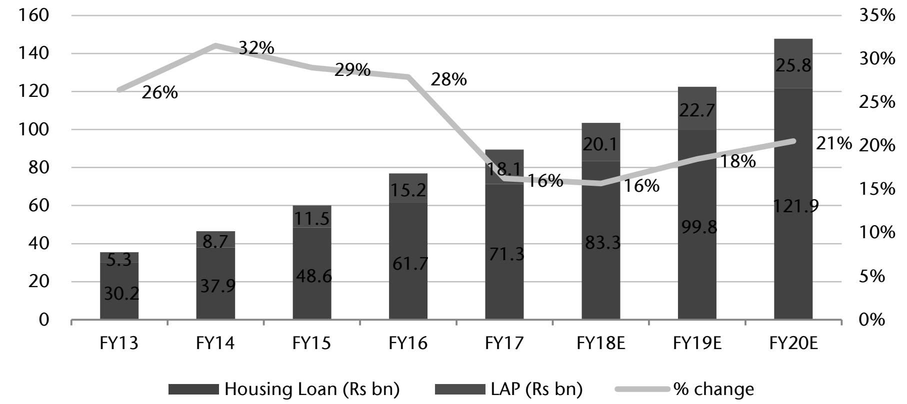
- **Salaried home loans seeing greater competition; non salaried segment still resilient:** Repco's yields are higher than peers as it lends to riskier under serviced non salaried segment in tier II and tier III cities. However, high spreads are likely to attract competition. Repco has seen higher balance transfers in last quarter especially in salaried segment and high ticket LAP segment.

- **Shift away from high ticket LAP to affect disbursal:** Repco has stopped disbursing high ticket loans (above Rs7mn) in loan against property segment. While average ticket size of LAP book is Rs2mn; loans over Rs5mn accounted for over 76% of disbursal in FY17.

Exhibit 98: Repco: Loans to grow at 18%CAGR over FY17-20E vs24% CAGR over last three years



Source: Jefferies estimates, company data

Tamil Nadu (62% of Loan Book): Ban on Property registration has eased

Loan growth in Tamil Nadu was impacted by ban on property registration in Tamil Nadu ordered by Madras High Court in September 2016.

- On 9 September 2016, Madras High Court ordered an interim blanket ban on registering plots and houses in unapproved housing layouts in Tamil Nadu. It also banned conversion of agricultural land for non-agricultural use in Tamil Nadu. The order was aimed at curbing development of unauthorised layouts and conversion of agricultural areas for non-agricultural use in an unplanned manner.

- The ban resulted in authorities not registering even normal residential properties that have been in existence for long. This impacted property sales transaction and also hurt loan disbursals in 2H FY17.

- In May 2017, Madras High Court allowed registration of sale deed related to unauthorised plots, after state government notified a regularisation scheme for un-approved housing sites. However, property transactions remained muted as sub registrars did not commence registration as it awaited directions from the state government. However, in June office of inspector general of registration granted sub registrars permission to re-register unapproved plots which were registered as "house sites" before Oct 2016.

- Madras High Court has recently passed an interim order, stating that while applications for ***regularisation of unauthorised buildings*** in the state may be entertained, no final decision can be taken without the court's permission.

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Exhibit 99: Tamil Nadu: Property Registration Ban: Key Events

Time line	Events
9-Sep-16	- Madras High Court bans registration of unauthorised plots
28-Sep-16	- Plea by associations asking for lifting of the ban
1-Nov-16	- Directed Petitioners and State Govt to file ,modified comprehensive categorisation of land
31-Jan-17	- Ban extended to Union Territory of Puducherry
29-Mar-17	- High Court allows resale and registration of unapproved plots already sold and registered
21-Apr-17	- Madras High restrains/ re registering plts that are part of unapproved plot
8-May-17	- TN Govt submits scheme for regularisation of unapproved plots
12-May-17	- HC clarified plots in unapproved layouts already registered before Oct 2016 may be allowed to be sold
Jun-17	- Inspector general of registration grants sub registrars permission to register unapproved plots which were registered Oct 2016
Sep-17	- Madras HC says regularisation of unauthorised buildings cannot take place without HC permission

Source: Media reports, Hindu, Housing.com, Jefferies, company data

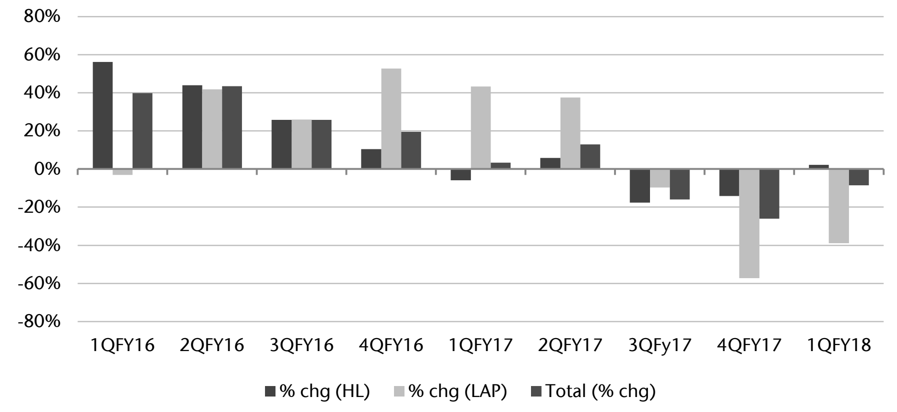
Full resolution could take time: Near-term disbursal could stay soft

While Madras High Court has relaxed ban on registration, full normalisation could take some time.

- **Need to regularise existing projects where approvals are not in place:** Existing projects in unapproved layout, that were already registered before Oct 2016 would need to be regularised as per a scheme announced by the State Government. Thus, transactions in such projects could be slow till regularisation is completed. This could take time, especially given limited progress, so far. The process would take time, in our view. Management indicated that there was a recent order by the state government as per which regularisation could be done at the local government level, which is an incremental positive.

- **New project approval lead times could be longer:** Self-construction segment accounts for 45% of loan book. While land registration for new projects in tier 2 and tier 3 cities were earlier given by local panchayats, this would now have to be approved by the Directorate of Town Planning (DTP) at Chennai. DTP would have to assess and ascertain whether developmental regulations have been complied with. This could increase cycle time for approvals.

Exhibit 100: 2HFY17 disbursal was hit by TN property registration ban and demonetisation; with ban lifted, home loans disbursal rose slightly in 1Q



Source: Jefferies estimates, company data; * HL= Home Loan, LAP = Loan against Property

Well positioned to benefit from affordable housing push

Repco's average ticket home loan ticket size of around Rs1.1mn (salaried Rs1.0mn, self-employed Rs1.2-1.3mn) makes it a natural beneficiary of government's thrust towards the affordable housing sector.

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Management has indicated that around 70-80% of Repco's loan book would fall in the affordable housing segment and could potentially qualify for government's interest subsidy scheme. However, other criteria (area, first time buyer) would also have to be met for borrowers to be eligible for the subsidy. Effectively, around 50% of its home loan disbursal would likely meet all the eligibility conditions as per management.

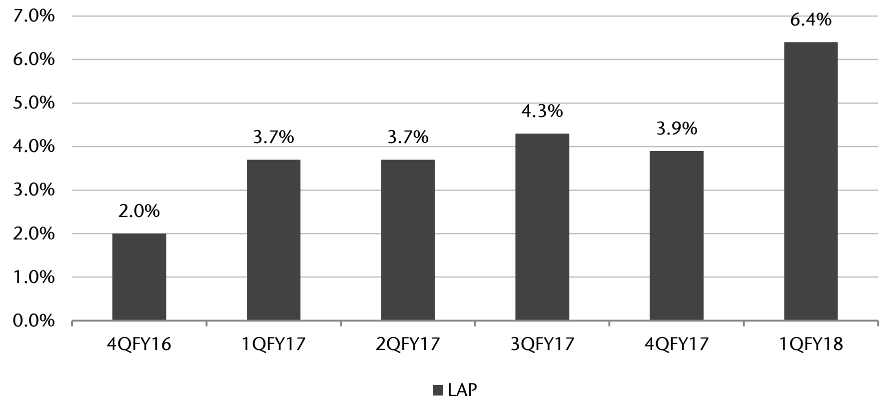
Growth in LAP segment to moderate

Repco plans to reduce its exposure to large ticket loan against property (LAP) given a) sharp rise in delinquencies in this segment; b) rising competition and higher balance transfers in this segment. Around 76% of LAP disbursal in FY17 (17% of total disbursal) were loans with over Rs5mn ticket size.

With Repco now focussing on lower ticket LAP, overall LAP loan growth would likely moderate. We forecast LAP loan book to grow at 13% CAGR over FY17-20E.

- Loan against property (LAP) accounts for 20% of Repco's loan book. Average ticket size of its loan against property book is Rs2.0mn and its yields are around 14.5% (on book, 12.5% incremental).
- Almost 20% of its loan against property portfolio has average ticket size of over Rs7.5mn. Median LAP ticket size is around Rs0.8mn.
- NPA in this segment has jumped sharply in the past few quarters to 6.4% (4Q FY18 3.9%). Large ticket LAP borrowers also include customers in the real estate segment, who have been hit by the Tamil Nadu registration ban issue as their cash flows were impacted due to the registration ban.
- Moreover, balance transfers, especially due to strong competition from banks, have led to sharp spike in repayment rates in LAP book, impacting growth in LAP book.

Exhibit 101: LAP GNPA has jumped in 1QFY18 led by slippages in high ticket accounts



Source: Jefferies estimates, company data

Spreads could moderate

Competition from banks has increased pressure on yields, especially in salaried and high ticket LAP segment. Focus on higher yielding/ less competitive non salaried segment (60% of book) has helped Repco sustain much higher spreads relative to peers. However, this is unlikely to sustain given rising competition.

Large yield differential vs incremental home loans has led to prepayments rising in the last few quarters. Repco has now revised it new home loan rates lower, which should weigh on yields. Funding costs should fall as benefits of lower MCLR flows thru P&L. This could

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cushion the impact on spreads in our view. We expect spreads to moderate to ~2.9% over FY17-19E levels (3.1% over FY15-17).

Higher focus towards salaried segment could be yield dilutive
Repco has traditionally focussed on the niche non-salaried segment, especially in tier 2 and tier 3 cities, which has allowed it to realise higher yields on its loans. This is mainly because a) credit risk is higher; b) banks/ HFCs usually target less risky salaried home loan markets, as assessing credit is an issue.

Yields on non-salaried home loans are around 75 bps higher vs. salaried segment. Higher exposure to LAP segment has also supported stronger yields. While Repco does not enjoy funding cost advantage that many of its peer have (linkage to stronger parent), its spreads are higher than most HFCs.

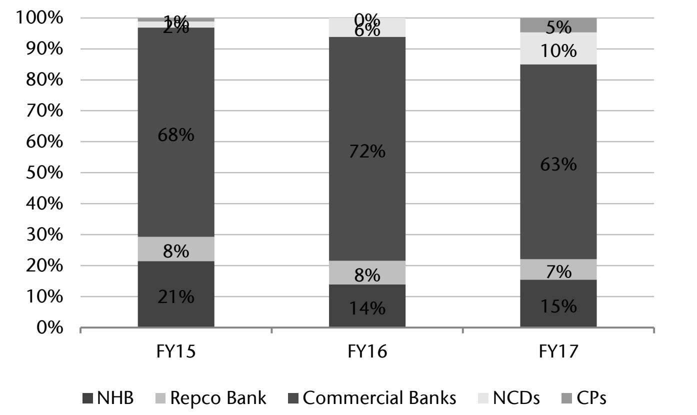
With asset quality issues rising in the non-salaried segment in last few quarters, Repco has indicated that it wants to increase its focus on salaried segment. Increase in mix of salaried home loans could be yield dilutive in the medium term. However, management does not expect a major shift in mix of salaried and non-salaried home loans in next few years.

Funding costs to fall as benefits of MCLR cuts come thru
Repco sources around 66% of its funds from banks and 14% from NHB. NCDs and CPs account for only 20% of its borrowings.

Repco's credit rating is AA, lower than other HFC peers like HDFC, LIC Housing, Can Fin Homes which benefit from stronger parentage. Moreover, Repco's GNPA is higher vs peers given exposure to riskier non-salaried home loan segment. Despite this, its cost of funding is competitive vs. peers.

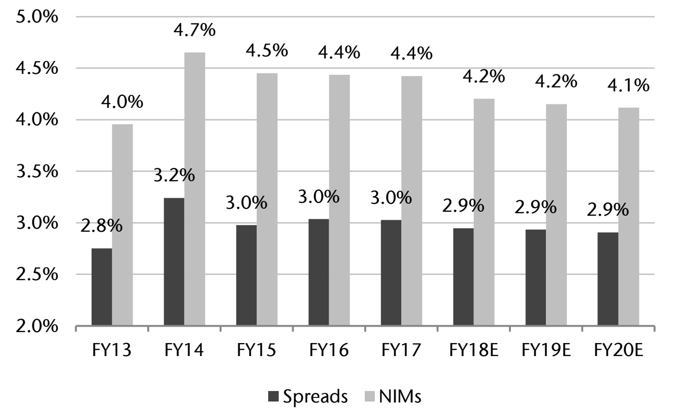
Cost of funding has declined ~70bps YoY in the last one year. Repco has managed to negotiate lower spreads over MCLR rate during base rate to MCLR conversion. It has also seen partial benefit of MCLR rate cut and would see cost of fund falling further (potentially by 20-25bps as per management) as full impact of MCLR cuts are reflected in its borrowing cost.

Exhibit 102 : Banks account for around 70% of borrowings; funding costs may decline as full impact of MCLR cuts come thru



Source: Jefferies estimates, company data

Exhibit 103: Spreads to soften



Source: Jefferies estimates, company data

Asset quality issues have likely peaked

Asset quality in the past has been stable

Repco's asset quality has been stable in the past despite its focus on riskier non salaried segment. With around 60% of loan book comprising non salaried borrowers, asset quality tends to be volatile as cash flows of these borrowers are lumpy. However, broader asset quality has been stable.

- Repco follows a structured credit appraisal process where in preliminary credit risk is assessed by the branch at the time of loan origination. This is revalidated at the corporate office level before sanction.
- For salaried home loans, credit appraisal is largely centralised. However, in case of non-salaried home loans, the branch undertakes a thorough scrutiny of the loan documents.
- The credit officers in the branch level visits the borrowers premise in order to assess income levels and cash flows of the non-salaried borrowers. This is further validated by feedback from local money lenders. The credit worthiness is further appraised at the corporate office level wherein each borrower is rate on a dynamic credit rating model.

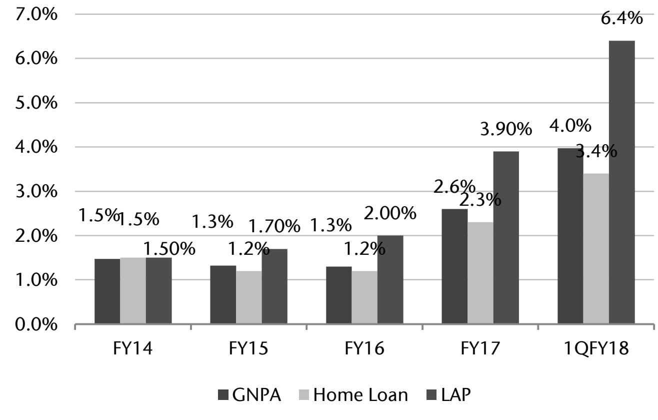
GNPA has increased sharply in the past few quarters

GNPA levels have, however, increased in the last few quarters due to following factors.

- Rise in GNPA in high ticket LAP segment as cash flows of non-salaried borrowers were hit by demonetisation.
- Several LAP borrowers had exposure to the real estate sector in Tamil Nadu. These borrowers were hit due to High Court imposed ban on property registration, which led to transactions stalling in the past few quarters.
- There were 17-18 accounts in high ticket size LAP segment that accounted for around Rs350-375mn of GNPA (10-11% of GNPA).

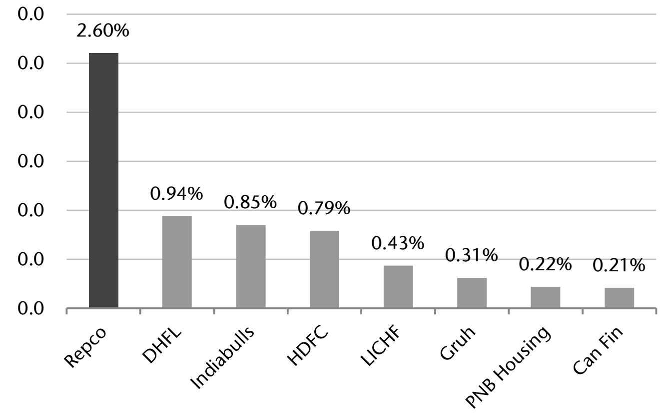
Demonetisation impact is fading and with Madras High Court now allowing reregistration of properties in unapproved lay out , property transactions should commence. This may ease some of the asset quality pressures seen in recent quarters.

Exhibit 104: : GNPA has been stable despite focus on riskier non salaried segment, but has jumped in 2H FY17/ 1QFY18



Source: Jefferies estimates, company data

Exhibit 105: Repco's GNPA is higher than other housing finance peers



Source: Jefferies estimates, company data

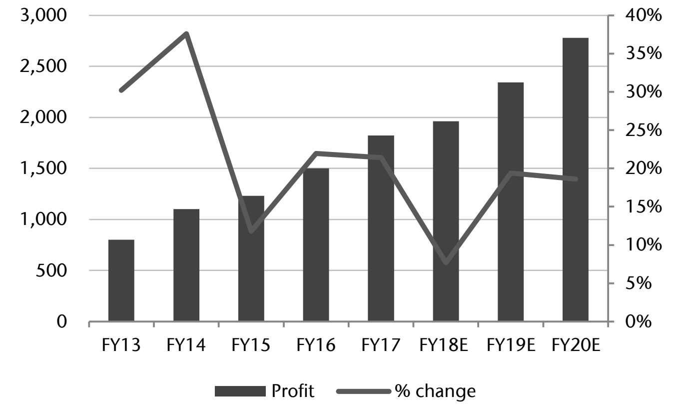
Management has indicated that recoveries are improving. Management expects asset quality to improve sequentially in the next few quarters. It expects GNPA to fall to 1.5% by March 2018.

We believe recoveries should improve steadily. We expect credit costs to rise to 0.7% (0.62% FY17) in FY18 and expect this to moderate to 0.6% in FY19. Note provision coverage has dipped to ~35% in June Q. Repco may raise provisions to raise provision coverage ratio which could be a risk to our earnings.

Earnings growth to decelerate

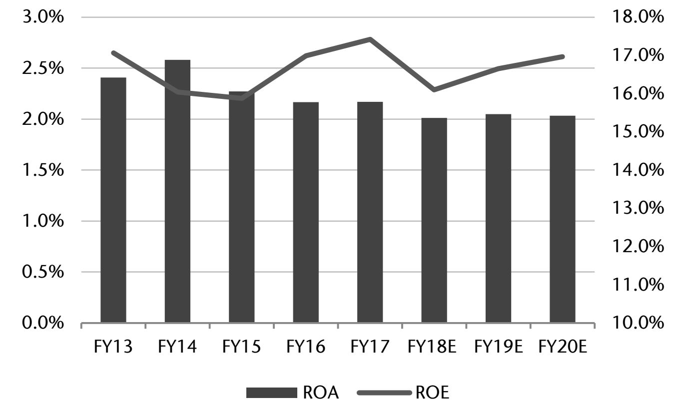
We believe slower loan growth, moderation in spreads and elevated credit costs should drive 15% EPS CAGR over FY17-20 (18% EPS CAGR over FY14-17). Repco has delivered an average ROA of 2.2% over last three years, higher vs. most HFC peers due to focus on niche non salaried segment, but lower spreads should lead ROAs to moderate to around 2% over FY17-20EE.

Exhibit 106: Expect slower earnings growth over FY17-20E



Source: Jefferies estimates, company data

Exhibit 107: ROA to moderate by 20bps to 2%



Source: Jefferies estimates, company data

Valuations

In the last 3 months, Repco has corrected 24% vs. NIFTY up 3%. Repco is trading at 2.6x FY19E BV at a discount to housing finance peer average (3.2x) and its historical average (3.4x).

Repco has traded at a premium historically given its high margins, focus on high yielding niche small ticket non salaried segment and maintaining low GNPA despite targeting a riskier segment. With rise in GNPA, pressure on spreads and slower loan growth, valuations may trade at a discount to a historic average.

Our PT of Rs585 is based on Dec 17E residual income (RI) valuation. Our RI model is based on cost of equity of 13.2% and a terminal growth of 5.5%. Our RI model is based on explicit forecasts until FY27E. At our price target, Repco would trade at 2.4x FY19E BV.

Table 1: Valuation Summary

AUM CAGR : FY17-20E	**18%**
AUM CAGR : FY20-27E	20%
Avg. NIM FY17-20E	4.2%
Avg NIM FY20-27E	4.0%
ROE FY16-19E	17%
ROE FY19-27E	18%
Cost of Equity	13.2%
Terminal growth	5.5%

Source: Jefferies estimates, company data

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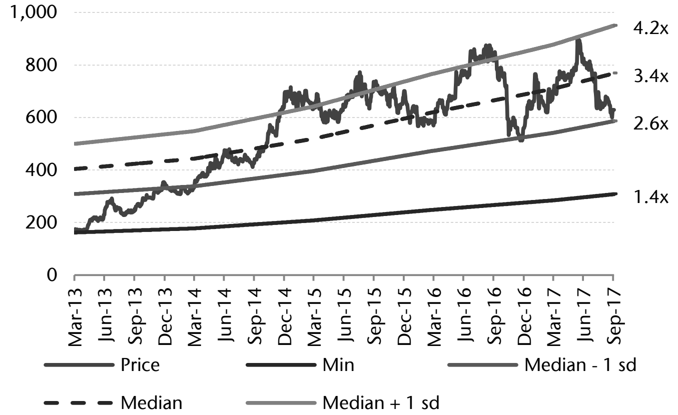
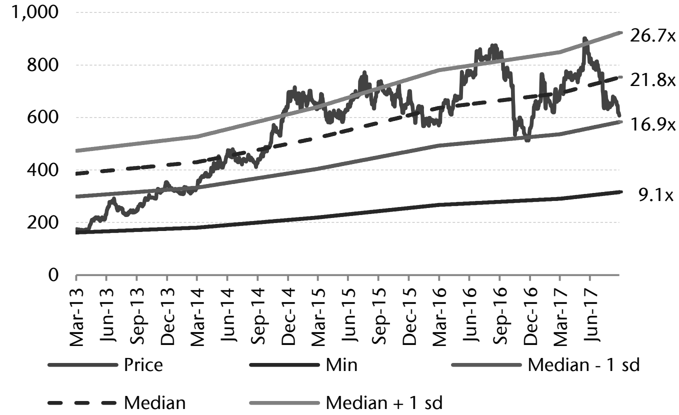
Exhibit 108: P/BV : Stock has derated fact oring part of concerns; further correction possible



Source: Jefferies estimates, company data

Exhibit 109: Repco is trading below its historic avg P/ E valuation, while most HFCs are at a premium



Source: Jefferies estimates, company data

Exhibit 110: : Key Management

Mr. R Varadarajan	Managing Director	• MD of Repco Home Finance, since Oct 2010. Also MD of Repatriates Cooperative Finance and Development Bank (Repco Bank) since Nov 2010. • Around 35 years of work experience in banking industry. Prior to joining Repco, he worked in Syndicate Bank.

Source: Jefferies, company data

Key risks to our estimates and PT

- Slower-than-expected loan growth due to delay in resolution of the Tamil Nadu registration issue.
- NIM pressure due repricing of its high yielding back book and pressure on incremental yields due to competition. Repco's elevated spreads trend towards spreads seen by other HFC peers.
- Asset quality issues deteriorate further.

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Financials

Exhibit 111: Repco: Summary Profit and Loss Summary

INR in Mn	FY17	FY18E	FY19E	FY20E
Interest Income	10,141	10,851	12,476	14,789
Interest Expense	6,463	6,799	7,786	9,228
Net Interest Income	**3,678**	**4,051**	**4,690**	**5,561**
NIM (% of on book AUM)		4.20%	4.15%	4.12%
Fees and Other Income	301	328	411	514
Other Non interest Income		17	19	21
Gross Revenue	**3,996**	**4,397**	**5,119**	**6,096**
Operating Expenses				
Employee Costs	431	460	532	636
Other Operating Expenses		261	315	387
Total Operating Expense	**676**	**721**	**847**	**1,023**
Cost to Income Ratio	16.9%	16.4%	16.5%	16.8%
Pre Provision Op. Profit	**3,320**	**3,676**	**4,272**	**5,073**
Provision	519	675	678	811
Credit cost	0.62%	0.70%	0.60%	0.60%
Profit before Tax	**2,802**	**3,001**	**3,594**	**4,263**
Tax	979	1038	1251	1483
Profit after Tax	**1,823**	**1,962**	**2,343**	**2,779**
% Change	38%	8%	19%	19%
EPS	**29.2**	**31.5**	**37.6**	**44.6**
% Change	22%	8%	19%	19%

Source: Jefferies estimates, company data

Exhibit 112: Repco: Summary Balance Sheet

INR in Mn	FY17	FY18E	FY19E	FY20E
Assets				
Fixed Assets	91	108	116	125
Investments	156	180	214	258
Loans and Advances	89,399	103,421	122,550	147,715
Other current assets	562	650	725	874
Cash and Bank Balance	225	260	368	443
Total Assets	**90,433**	**104,620**	**123,973**	**149,415**
Liabilities				
Current Liabilities	2,673	2,733	3,922	5,022
Non-Current Liabilities	784	784	929	1,120
Bank Borrowings	75,604	88,093	103,995	125,633
Equity	11,372	13,009	15,128	17,640
Total Liabilities	**90,433**	**104,620**	**123,973**	**149,415**

Source: Jefferies estimates, company data

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Exhibit 113: Key Assumption and Forecasts

INR in Mn	**FY17**	**FY18E**	**FY19E**	**FY20E**
Loans (Rs Mn)	**89399**	**103421**	**122550**	**147715**
% Change	16.2%	15.7%	18.5%	20.5%
Yield on On book AUM	12.19%	11.25%	11.05%	11.00%
Cost of Funds	9.17%	8.31%	8.11%	8.04%
Interest spread	3.03%	2.95%	2.94%	2.97%
NIM on AUM	4.42%	4.20%	4.16%	4.18%
Cost to Income Ratio	16.9%	16.4%	16.5%	16.6%
Return Ratios				
Return on Assets	2.17%	2.01%	2.06%	2.07%
Return on Avg Equity	17.4%	16.1%	16.7%	17.3%
Asset Quality Metrics				
Credit cost	62bps	70bps	60bps	60bps
GNPA	0.00%	3.34%	2.06%	1.51%
Net NPA	0.00%	1.79%	1.09%	0.76%
Book Value/share	182	209	243	284
Adjusted Book Value	155	171	200	244
Capital Adequacy				
Tier I Ratio	21.3%	21.1%	20.7%	20.1%
Tier II Ratio	0.0%	0.0%	0.0%	0.0%
CAR	21%	21%	21%	20%

Source: Jefferies estimates, company data

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Please see important disclosure information on pages 52 - 55 of this report.