INDIA RESEARCH
SECTOR UPDATE
NBFC

21 March 2016

ANTIQUE

Housing Finance
Small is the next big

Digant Haria
+91 22 4031 3422
digant.haria@antiquelimited.com

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+91 22 4031 3422
digant.haria@antiquelimited.com

SECTOR UPDATE

Housing Finance

Small is the next big

Repco Home Finance

Current Reco	:	BUY
Previous Reco	:	BUY
CMP	:	INR580
Target Price	:	INR838
Potential Return	:	44%

GRUH Finance

Current Reco	:	BUY
Previous Reco	:	BUY
CMP	:	INR235
Target Price	:	INR286
Potential Return	:	22%

A close look at the housing ecosystem brings to light a glaring contrast - On one side, the stock of unsold real estate inventory in top seven cities is at an all time high, new launches in these cities are at an all time low and volume off-take reported by large building material companies like Kajaria & Centuary Ply has been rather subdued. On the other side, there are small housing finance companies (HFCs) that are reporting loan growth in excess of 25%.

While there could be multiple explanations for this phenomenon, the writing on the wall is rather clear - large ticket housing is slowing down while small ticket housing continues to do well. We would go further to say that small ticket housing would be the big theme for next five years given the huge latent demand and the measures taken by the Government and the Regulator to fulfill it. HFCs that are able to capitalize on this impending boom in small ticket housing will continue to report strong performance. Gruh Finance and Repco Home Finance are well placed to benefit from this and continue to remain our favorite bets in the housing space.

Coordinated action by the Government and the regulator across housing ecosystem

Availability of land in vicinity of cities and availability of finance have been the biggest impediments to affordable housing. These issues are being tackled by the Central Government through incentivizing State Governments to provide land on one hand and doling out regulatory relaxations to HFCs on the other. Within a year of announcing the Pradhan Mantri Awas Yojana (PMAY) - Housing for All scheme, the Centre has been able to get more than eight State Governments on board. These State Governments have recently announced projects involving construction of 135,900 houses in affordable housing segment and the Central Government has sanctioned an assistance of INR20.3bn for the same.

At the same time, the regulator has made life easy for the housing finance companies by reducing the risk weights on small ticket loans and increasing the spread cap under the RHF scheme. Real estate developers are being incentivized by measure such as 100% income deduction to entities developing affordable houses. Buyers are being motivated by sops such as no stamp duty and service tax on 'affordable house', credit at subsidized rate through CLSS, etc.

Small HFCs to be at the fore front of this affordable housing boom

Disproportionate focus on urban salaried segment by banks and large HFCs has left the non-salaried market open to anyone who has the capabilities to operate in that segment. Smaller HFCs such as Gruh Finance, Repco Home, etc have operated profitably in this segment for many years through their carefully crafted appraisal techniques and low cost operating model. We believe that they will be the primary beneficiaries of the boom in affordable housing.

Valuations

				EPS		BV		RoE	
	Reco	CMP	Target	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Gruh	BUY	235	289	8.4	10.6	29.4	36.3	31.7	32.3
Repco	BUY	580	838	32.7	40.2	179.4	212.6	19.7	20.5

Source: Company, Antique

Central Government giving shape to its mega plans in affordable housing space

The Central Government announced its vision for Housing for All by 2022 soon after the election victory in May'14. It took them about twelve months to formulate the final policy, which is more than an aggregation of past policies, and issue operational guidelines in July'15. Once this was done, the Central Government started discussions with the state governments for them to come on board. Simultaneously, the regulator announced benign changes for housing finance companies (HFCs) and the government doled out goodies for developers and buyers of affordable housing. The Juggernaut has started and affordable housing on mass scale could soon be a reality.

Pradhan Mantri Awas Yojana (PMAY) - Housing for All by 2022

Objective: Construction of 3m houses per year for the urban poor

During the 10 years of Jawaharlal Nehru National Urban Renewal Mission (JNNURM) only 0.9m houses were constructed for the urban poor. Housing for all by CY22 aims to construct 3m houses per year over the next seven years for the urban poor. Initial focus will be on 500 class one cities, which will be extended to 4,041 statuary towns.

Scheme details: Four components to target demand & supply-side

The scheme has two components for incentivizing the supply side in affordable housing and two components for incentivizing the demand side. Any EWS or LIG beneficiary can take advantage under one component only. The details of the components are -

Demand side component 1: Credit Linked Subsidy Scheme (CLSS)

- Credit linked subsidy would be available for housing loans availed for new construction, addition of rooms, kitchen, toilet, etc to existing dwellings. The carpet area of houses being constructed should be up to 30 sq. meters and 60 sq. meters for EWS and LIG respectively.
- An interest subsidy of 6.5% will be offered to eligible beneficiaries belonging to the EWS and LIG group on bank loan up to Rs600,000.
- Discounted NPV of Rs230,000 would be paid upfront to beneficiaries, which will reduce the principal outstanding and hence the EMIs
- HUDCO and NHB have been identified as Central Nodal Agencies to channelize the subsidy to lending institutions. More than 69 HFCs have already signed MOUs with the nodal agencies to avail the CLSS

Demand side component 2: Beneficiary led individual house construction (BLC)

- Families belonging to EWS categories may avail central assistance of Rs1.5lac for construction of new house

Supply side component 1: "In Situ" slum redevelopment (SRD)

- The key objective of this component is to utilize the land under slum
- Center will provide slum rehabilitation grant of Rs.100,000 per house to the state government

Supply side component 2: Affordable Housing in Partnership (AHP)

- Central assistance at the rate of Rs150,000 per EWS house.
- States are free to implement affordable housing project through its agencies or in partnership with private sector

Encouraging response from States to Pradhan Mantri Awas Yojana (PMAY)

Post the announcement of PMAY scheme in later half of 2014, state governments were asked to conduct state levels surveys to assess the housing shortage in EWS and LIG category. Once that was complete, they are being incentivized to use the incentives under the PMAY and come out with housing projects for the EWS and LIG segments of the society.

- As an illustration, State Government of Tamil Nadu has projected a demand of 1.2 million housing units over the next seven years and has already announced projects that will witness construction of 24,000 units. In return, the Central Government has sanctioned amount of INR 3500 million as assistance to the state government.
- Similarly, State Government of Madhya Pradesh has projects a demand of 0.7 million housing units over the next seven years and announced projects to construct 19,000 units. In return, the Central Government has sanctioned assistance to the tune of INR 2880 million to the state government.

The activity has actually picked up pace since Oct'15 and is under full swing now. Below is the list of projects announced by the state governments and the related assistance agreed by the Central Government.

Announcements under PMAY till date

State	Category	Scheme component	Projects	No. of houses	Central assistance (INRm)
Mizoram	EWS	BLC	6	8,922	1,338
West Bengal	EWS	BLC	38	27,830	4,170
Jharkhand	EWS	BLC	24	4,093	614
Rajasthan	EWS	AHP	10	6,052	908
Telangana	EWS	AHP	31	15,941	2,391
Telangana	EWS	AHP	14	6,876	1,031
Bihar	EWS	BLC	40	13,315	1,997
Tamil Nadu	EWS	AHP	11	7,204	1,080
Tamil Nadu	EWS	BLC	166	16,820	2,440
Gujarat	EWS	AHP	6	9,606	1,441
Madhya Pradesh	EWS	AHP	17	19,241	2,886
Total			**363**	**135,900**	**20,296**

Source: MHUPA
Note: EWS = Economically Weaker Section BLC = Beneficiary led house construction AHP = Affordable Housing in Partnership

Regulatory sweetener for HFCs to ensure easy availability of finance

Given that availability of housing finance is one of the cornerstones of success of any affordable housing scheme, the regulator too has responded to the Central Government's ambitious plans in the housing sector. In the past twelve months, the regulator has lowered the risk weights on housing loans and made the NHB refinance scheme more attractive. Both these measures will enable housing finance companies to target the under-served segments without compromising on their profitability.

Reduction in risk weights (Oct'15): The regulator announced reduction in risk weights on individual home loans up to INR 7.5 million. Below are the details of the changes announced by the regulator. This will lower the capital requirement on home loans by almost 30%, leaving huge room for additional growth. The additional leverage which HFCs can enjoy due to this reduction in risk weights will result in additional RoEs, some of which could be passed on to the end borrower.

		Risk weight	
Individual Loans	**LTV**	**Old**	**New**
Loans up to INR 3 million	<80%	50%	35%
	>80%	50%	50%
Loans above INR 3 million and below 7.5 million	<75%	50%	35%
Loans above 75Lacs	>75%	50%	50%
Commercial Real Estate - Residential Housing	N.A	75%	75%
Commercial Real Estate	N.A	100%	100%

Source: MHUPA

Relaxation in re-finance criterion (Jan'16): Low cost borrowings from NHB, especially under its Rural Housing Fund (RHF) scheme, formed an integral part of liability profile for small housing finance companies like Repco Home Finance, Gruh Finance and Can Fin Homes. However, this changed in early 2014 as NHB introduced a spread cap of 2% on the usage of funds drawn under RHF. Given the high operating costs and the higher credit risks involved in servicing low-ticket borrowers, 2% spread was inadequate and HFCs discontinued borrowing from this scheme. Budgetary allocations to RHF remained un-utilized to a great extent in FY15 and large part of FY16, prompting NHB to revise the spreads to 3.5% in Jan'16.

	Allocation (FY16)	Interest rate	On lending cap	Spread
Rural Housing Fund (RHF)	INR80bn	6.12%	9.62%	3.50%
Urban Housing Fund (UHF)	INR40bn	6.87%	10.37%	3.50%

Source: Company, Antique

With the revised RHF scheme, HFCs can lend to their customers at 9.6% and yet enjoy a spread of 3.5%. Thus there is adequate incentive for HFCs to pursue affordable housing and at the same time, allow the customer to enjoy the benefit of lower borrowing rates.

Budgetary measures further incentivize affordable housing

The government is leaving no stone un-turned in the entire affordable housing eco-system - the state governments, the developers, the customers and the financiers. While it has incentivized the state governments and financiers through the Pradhan Mantri Awas Yojana (PMAY) and regulatory reforms, it is incentivizing the developer and the buyer through budget reforms too. Below is the list of measures announced in the budget for FY17.

- 100% deduction in profits for entities undertaking a housing project for flats up to 30 sq. mt in four metro cities and 60 sq. mt in other cities. However, MAT will be applicable. Also, service tax will be exempt on construction of affordable houses up to 60 sq. mt under any scheme of the Central or State Government.
- For the 'first - home buyers', a deduction for additional interest of INR50,000 per annum for loans up to INR3.5 million sanctioned during FY17, provided the value of the house does not exceed INR5.0 million.

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COMPANY UPDATE

Repco Home Finance Limited

Prepared for the Marathon

It's almost 3 years since Repco Home Finance (Repco) debuted on the stock exchanges and the company has been going from strength to strength ever since. From being largely dependent on the state of Tamil Nadu, it has diversified into ten more states and has a loan book of INR26bn in these states. This book has grown at 32% CAGR over the past five years in contrast to 26% CAGR witnessed in Tamil Nadu. Repco continues to invest for the next phase of growth through opening new branches across states, hiring & training suitable staff and experimenting with indirect sourcing models. All this while, it has continued to maintain its focus on self-employed segment, which contributes to 55% of the overall loan book.

On the liabilities front, its credit rating has improved two notches since its listing. Repco has slowly diversified into low cost market instruments like CPs and NCDs, which now contribute to 13% of its overall borrowings. The decline in NHB borrowings is set to reverse now that spread cap on RHF scheme has increased. In the light of its strong and consistent financial performance, it is only a matter of time that the credit ratings will improve further and liabilities will get further diversified. Maintain BUY

Scope for further growth in Tamil Nadu despite strong presence

Repco is present it 25 of the 32 districts in Tamil Nadu. Of those 25 districts, the top 3 districts of Chennai, Comibatore and Thanjavur have a combined loan book of INR15.5bn or 35% of the Tamil Nadu book. The average loan outstanding in the remaining 22 districts is mere INR1.3bn. Also, Repco has just one branch in each of these 22 talukas and few of them have satellite centers, indicating future scope.

Huge potential in states outside Tamil Nadu

Outside of Tamil Nadu, Repco has established its presence in ten more states through ~40 branches. The fact that it is present in only 9 / 40 districts in Maharashtra, 11 / 36 districts in Karnataka indicates huge potential for penetration driven growth for many years. We estimate Repco's non-Tamil Nadu business to grow at CARG of 30%+ in the coming years.

Strong capabilities to assess the self employed borrower

Continued reliance on its employees to generate business, credit appraisal involves multiple field visits, thorough profile check, and a double review by branch manager and the central credit team has helped Repco to curtail NPAs around 1.5% and credit costs in the range of 10bps. These skills will enable it to capture the opportunities that will be thrown by the progress in affordable housing space.

Market data

Sensex	:	24,953
Sector	:	NBFC
Market Cap (INRbn)	:	36.5
Market Cap (USDbn)	:	0.548
O/S Shares (m)	:	62.5
52-wk HI/LO (INR)	:	785/551
Avg Daily Vol ('000)	:	73
Bloomberg	:	REPCO IN

Source: Bloomberg

Valuation

	FY16e	FY17e	FY18e
EPS (INR)	26.9	32.7	40.2
P/E (x)	21.6	17.7	14.4
P/BV (x)	3.8	3.2	2.7
RoA (%)	2.4	2.3	2.3
RoE (%)	19.0	19.7	20.5

Source: Bloomberg

Returns (%)

	1m	3m	6m	12m
Absolute	(2)	(8)	(12)	(11)
Relative	(7)	(6)	(7)	2

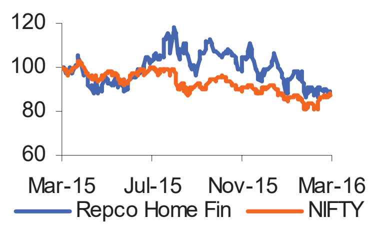
Source: Bloomberg

Shareholding pattern

Promoters	:	37%
Public	:	63%
Others	:	0%

Source: Bloomberg

Price performance *vs* Nifty



Source: Bloomberg, Indexed to 100

Key financials

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Net interest income (INRm)	1,908	2,373	3,010	3,703	4,556
Net Profit (INRm)	1,101	1,231	1,677	2,041	2,509
% growth	37.6	11.8	36.3	21.7	22.9
EPS (INR)	17.7	19.7	26.9	32.7	40.2
BV (INR)	119.2	130.2	152.4	179.4	212.6
P/E	32.7	29.4	21.6	17.7	14.4
P/BV	4.9	4.5	3.8	3.2	2.7
RoA (%)	2.6	2.3	2.4	2.3	2.3
RoE (%)	16.0	15.8	19.0	19.7	20.5

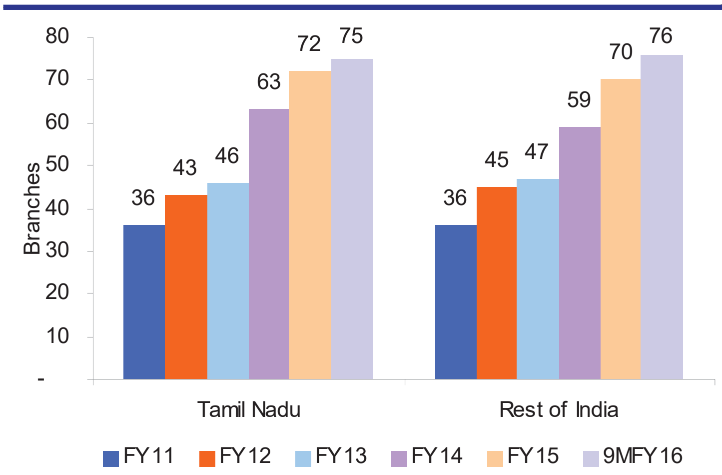
Source: Company, Antique

Strong in Tamil Nadu (TN), successful diversification in other states

While Repco has branch presence in 25 of the 32 districts in Tamil Nadu, it is yet to reach full penetration within most of districts. The top 3 districts in Tamil Nadu account for 35% of its Tamil Nadu loan book, implying that average loan per other 22 districts is mere INR1.3bn. Also, Repco has only one branch per district in these 22 districts (some branches are supported by satellite centers). Given the huge potential in the state, Repco expects TN to contribute ~60% of its loan book in foreseeable future and will continue to add branches in the state.

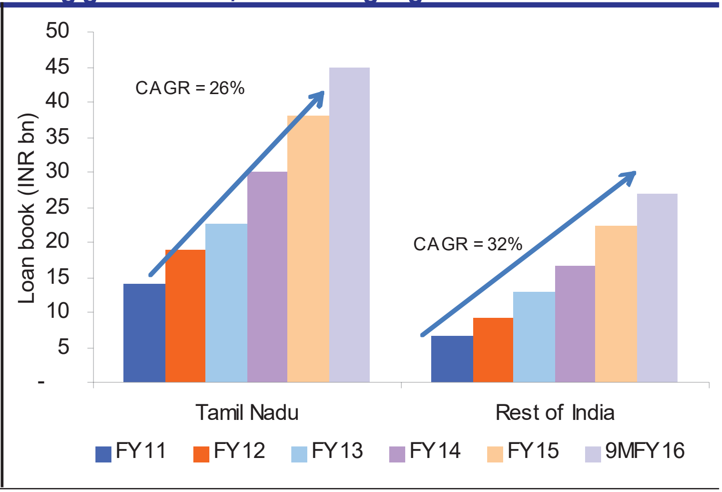
One of the investor concerns has been Repco's ability to do business outside the state of Tamil Nadu, given the fact that it's a relatively unknown brand. This concern has been put to rest through its careful diversification strategy. Repco is now present in 10 states apart from TN and business in growing strong. Progress in states like Maharashtra is especially noteworthy.

Similar branch additions in & outside TN



Source: Company, Antique

Strong growth in TN, even stronger growth outside of TN



Source: Company, Antique

Another point to note is that there is a huge potential for penetration driven growth in the states outside Tamil Nadu. In the larger states like Maharashtra and Karnataka, Repco has barely scratched the surface. Its penetration levels in these states are less than 35%. As an illustration, Repco has garnered a book of INR2.4bn in just two districts of Maharashtra where it started operations in 2011. Owing to the above reasons, we believe that loan book growth for Repco will continue to remain above 25% for FY16-18e despite the general slowdown in the Indian economy.

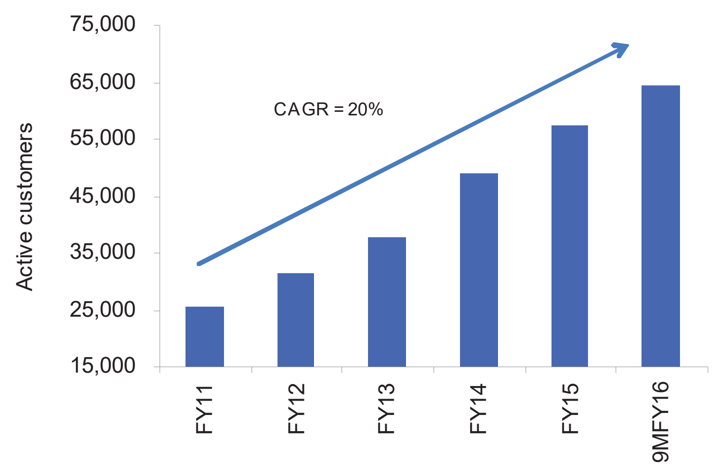
	Total Districts	Repco's presence	Penetration levels
Tamil Nadu	32	25	78%
Maharashtra	35	9	26%
Karnataka	30	11	37%
Kerala	14	5	36%

Source: Company, Antique

Maintaining its small ticket character all the while

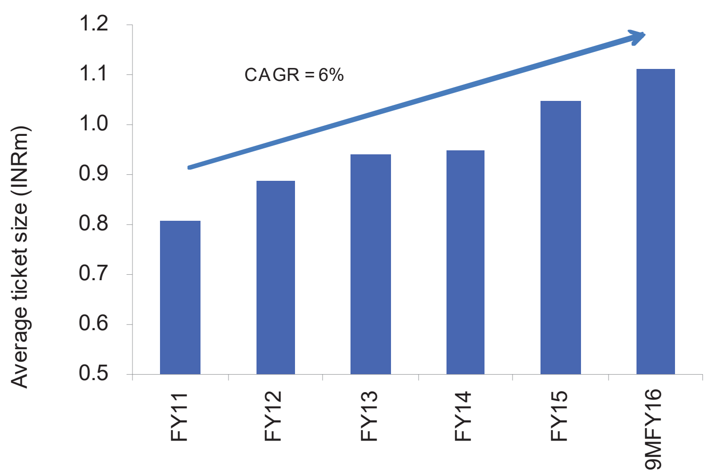
While growth for many of the large housing finance companies has emanated out of rising ticket sizes, Repco has stuck to its niche in the small ticket space. A large part of its growth has come through reaching out to new customers and only a small part has come through increase in ticket sizes. Active clients have grown at CAGR of 20% while its average ticket size has grown at CARG of 6% over FY11-16. An important outcome of this continued focus on small ticket size is stability in it margins at 4%+ levels.

Growth backed by strong customer addition



Source: Company, Antique

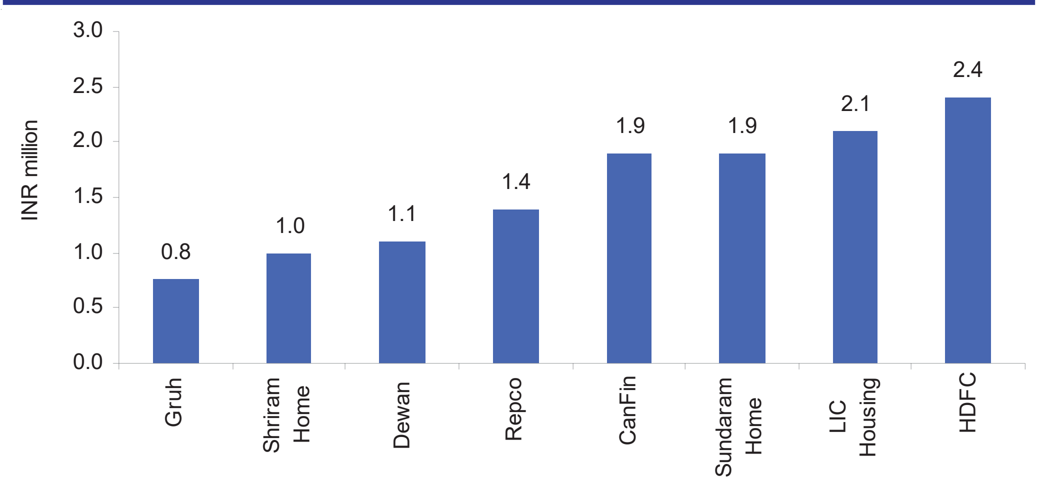
Ticket size keeping pace with inflation



Source: Company, Antique

Even on an incremental ticket size basis, Repco has still not crossed the INR1.5m mark. This will ensure that Repco remains eligible to the low cost re-financing under the RHF scheme as well as the GJRHS of the NHB. Many of its competitors have incremental ticket sizes above INR1.5m, making them ineligible for NHB refinance. This will enable Repco to maintain margins above 4% levels despite rising competition in the affordable housing space.

Incremental ticket sizes for various players in the housing finance space

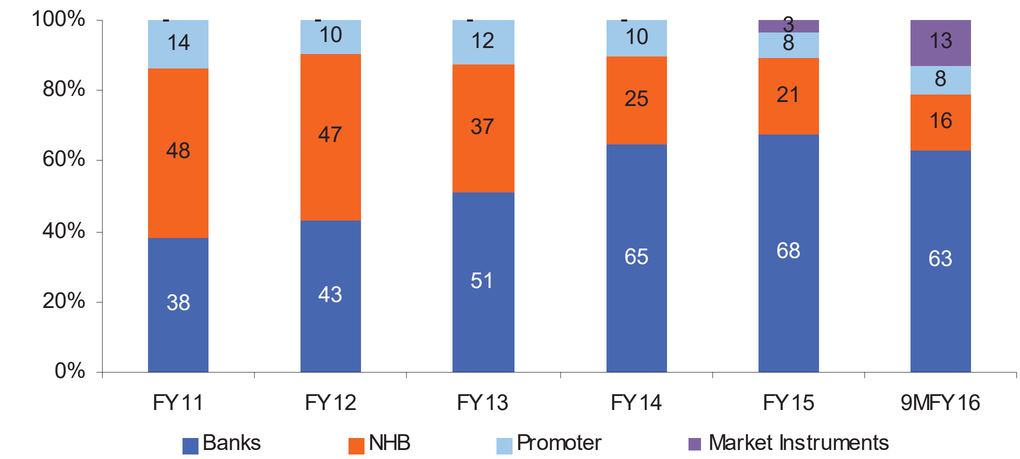


Source: Company, Antique

Proportion of low cost funding from NHB to improve

Proportion of low cost NHB borrowing declined sharply post FY13 due to the spread cap of 2% imposed on Rural Housing Fund (RHF) scheme. This is set to change as the spread cap has been revised to 3.5% from Jan'16. Also, NHB has lowered base rates for the first time in two years. Both these measures will result in 20bps reduction in overall cost of borrowings for Repco, which can be passed on to customers.

Decline in proportion of low cost NHB borrowings



Source: Company, Antique

Credit rating has further scope for improvement

Despite two notches improvement in Repco's credit rating after its stock market listing, it is still the lowest among small HFCs because of its small size and 'not-so-well-known' parent. However, we believe that consistent financial performance will ensure further improvement in credit ratings and ability to raise funding through market instruments.

Credit ratings - small housing finance companies

Company	Instrument	Rating	Agency
Repco	NCDs	AA-	ICRA
Gruh Finance	NCDs	AA+	ICRA
CanFin Homes	NCDs	AAA	ICRA
GIC Housing	NCDs	AA+	ICRA

Source: Company, Antique

Financials

Income statement (INRm)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Interest income	**5,156**	**6,691**	**8,339**	**10,544**	**13,226**
Interest expenses	3,248	4,318	5,329	6,841	8,670
NII	**1,908**	**2,373**	**3,010**	**3,703**	**4,556**
Other income	198	239	287	344	413
Total income	2,106	2,613	3,297	4,047	4,969
Operating expenses	388	547	692	809	994
PPP	**1,718**	**2,065**	**2,604**	**3,238**	**3,975**
Provisions	227	203	101	191	231
Pre tax profit	**1,491**	**1,862**	**2,503**	**3,047**	**3,744**
Tax expense	390	631	826	1,005	1,236
PAT	**1,101**	**1,231**	**1,677**	**2,041**	**2,509**

Balance sheet (INRm)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Share capital	622	624	624	624	624
Reserves & Surplus	6,789	7,498	8,880	10,563	12,632
Networth	**7,411**	**8,121**	**9,504**	**11,187**	**13,255**
Borrowings	39,020	51,044	66,081	84,267	106,285
Other liabilities	960	1,592	1,751	1,926	2,119
Total liabilities	**47,390**	**60,757**	**77,336**	**97,380**	**121,659**
Fixed assets	50	89	98	108	119
Investments	124	124	136	150	165
Cash & Bank Balances	219	175	459	578	723
Advances	46,680	60,221	76,480	96,365	120,456
Other current assets	317	148	162	179	197
Total assets	**47,390**	**60,757**	**77,336**	**97,380**	**121,659**

Per share data

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
No. of shares	62.2	62.4	62.4	62.4	62.4
EPS	17.7	19.7	26.9	32.7	40.2
BV	119.2	130.2	152.4	179.4	212.6

Source: Company, Antique

Growth ratios (%)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Advances	31.5	29.0	27.0	26.0	25.0
Borrowings	25.3	30.8	29.5	27.5	26.1
NII	52.0	24.4	26.8	23.0	23.0
PPP	48.1	20.2	26.1	24.3	22.8
PAT	37.6	11.8	36.3	21.7	22.9

Cost ratios (%)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Cost to income	18.4	21.0	21.0	20.0	20.0
Cost to average assets	0.9	1.0	1.0	0.9	0.9

Margins

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
Yield on funds	12.5	12.5	12.2	12.2	12.2
Cost of deposits	9.3	9.6	9.1	9.1	9.1
Spreads	3.3	2.9	3.1	3.1	3.1
NIMs	4.6	4.4	4.4	4.3	4.2

Return ratios (%)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
RoA	2.6	2.3	2.4	2.3	2.3
RoE	16.0	15.8	19.0	19.7	20.5

Valuations (x)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
P/E	32.7	29.4	21.6	17.7	14.4
P/BV	4.9	4.5	3.8	3.2	2.7

Asset quality & adequacy (%)

Year-ended March 31	FY14	FY15	FY16e	FY17e	FY18e
GNPA	1.5	1.3	1.4	1.4	1.4
NNPA	0.7	0.5	0.7	0.7	0.7
Tier 1	24.5	19.3	17.8	16.6	15.7

Source: Company, Antique