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SECTOR UPDATE

Housing Finance

Housing for all - expansion in the opportunity pie

The new government's strong focus on housing sector and subsequent actions suggest a sharp increase in opportunity pie for the home financiers. Recently announced measures such as additional tax incentive on home loans, infra status for housing loans, etc point to the increasing Governmental focus on housing sector. In addition to this, there are several policy level actions quicker approval processes, incentivizing the developers, revamping of the existing schemes, etc that are being planned to achieve their goal of 'housing for all by 2022'. This could well result in construction of more than 20 million pakka houses and an investment in excess of INR6545bn.

Within the housing finance landscape, we prefer the small Housing Finance Companies (HFCs) like Repco and Gruh Finance over banks and other HFCs due to - 1) presence in under-served markets where lower completion leads to better pricing power, 2) stringent appraisal practices and low cost operating model and 3) borrowing cost advantage in the form of subsidized NHB funding. We estimate strong multi-year growth in earnings for both Repco Home Finance as well as Gruh Finance and upgrade them to BUY. Inability to source small ticket sized loans remains the key risk for both these HFCs.

Baby steps towards 'housing for all' increases the opportunity pie

The new government has already started complementing its vision of housing for all by 2022 with concrete actions - doling out additional tax incentive on housing loans, increasing the NHB's rural fund allocation to INR80bn, classifying affordable housing loans as infrastructure loan and exempting banks from CRR/SLR requirements on funds raised for such loans. As per NHB, housing shortage stands at 18.7 million units and that translates into a financing opportunity of INR6545bn. The Government's resolve to provide 'pakka' houses for all will enlarge this pie further.

Niche HFCs to remain key beneficiaries of the growing opportunity

Most of the above opportunities will prop in urban peripheries as well as semi-urban areas. Also, the ticket sizes would be small and house owners would be earning their livelihoods from the informal sector. Banks and large HFCs have limited presence in this segment owing to the high appraisal risks and operating costs. Niche HFCs such as Repco and Gruh Finance with their specialized appraisal skills and low cost operating models are well positioned to capture this impending opportunity.

Multi-year visibility in earnings, upgrade to BUY

Presence in under-served markets, pricing power on the asset side, stringent cost control as well as credit appraisal processes will ensure strong RoEs over FY14-25E. We have been positive on the niche HFC segment since our initiation in Jun'13 and the recent developments improve the long term visibility and increase our optimism. We upgrade the niche HFC segment to BUY. Our residual income analysis suggests meaningful upside from current levels (Avg RoE over FY15-35 for Repco and Gruh at 20% and 28%).

Repco Home Finance Ltd.

Current Reco	: BUY
Previous Reco	: HOLD
CMP	: INR413
Target Price	: INR573
Potential Return	: 39%

GRUH Finance Ltd.

Current Reco	: BUY
Previous Reco	: HOLD
CMP	: INR191
Target Price	: INR240
Potential Return	: 26%

Recommendation

	Rating	CMP	Target	EPS (INR)		BV (INR)		RoE	
				FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Gruh	BUY	191	240	7.2	9.2	25.2	31.2	31.7	32.7
Repco	BUY	413	573	27.4	35.1	152.5	181.5	19.4	21.0

Source: Company, Antique

Measures announced by the new government in the housing segment

- Additional tax incentive on home loans by increasing the exemption limit
- Setting up of a Mission on Low-Cost Affordable Housing to be anchored by the NHB.
- A sum of INR40bn earmarked for NHB with a view to increase the flow of cheaper credit for affordable housing to the urban poor.

Measures under active consideration for housing sector

- Working towards easier flow of FDI into the sector
- Increasing the ceiling for necessary environmental approvals - housing project on less than 50,000 sq meters of land will not require any environment clearance. At present, a housing project built on 20,000 sq meters parcel of land doesn't require any green nod.
- Allowing self certification of projects - a developer can get a project assessed and certified that all the rules and regulations are being followed in the construction of the project. If any deviation is found at the later stage, strict action against the developer and the architect who verified the project will be taken
- New integrated National Housing Mission will be launched soon by merging some of the flagship schemes of UPA government like Indira Awas Yojana, Rajiv Awas Yojana, Rajiv Gandhi Rinn yojana and others.

Valuations of niche HFCs - why are higher multiples justified?

- Huge addressable opportunity size - multiple times their existing loan books
- Limited competition due to the niche developed in under-served markets
- Higher than peer RoEs will require negligible capital infusion over the long term journey

Key assumptions of residual model

FY15-35e	Gruh	Repco
Earnings CAGR	19%	19%
Average RoEs	28%	21%

Source: Company, Antique

Repc Home Finance Limited - Financials

Income statement (INRm)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
Interest income	3,912	5,156	6,496	8,305	10,796
Interest expenses	2,656	3,248	4,097	5,287	6,861
NII	1,255	1,908	2,399	3,018	3,935
Other income	148	198	237	285	341
Total income	1,403	2,106	2,636	3,302	4,276
Operating expenses	243	388	488	611	791
PPP	1,160	1,718	2,148	2,691	3,485
Provisions	92	227	141	150	227
Pre tax profit	1,068	1,491	2,008	2,541	3,258
Tax expense	268	390	663	839	1,075
PAT	800	1,101	1,345	1,702	2,183

Balance sheet (INRm)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
Share capital	622	622	622	622	622
Reserves & Surplus	5,724	6,789	7,457	8,861	10,661
Networth	6,345	7,411	8,079	9,482	11,282
Borrowings	31,132	39,020	52,013	68,829	90,732
Other liabilities	447	960	1,496	1,646	1,811
Total liabilities	37,924	47,390	61,589	79,957	103,825
Fixed assets	45	50	55	60	66
Investments	81	124	136	150	165
Cash & Bank Balances	2,101	219	364	473	615
Advances	35,501	46,680	60,684	78,890	102,556
Other current assets	197	317	349	384	422
Total assets	37,924	47,390	61,589	79,957	103,825

Per share data

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
No. of shares	62.2	62.2	62.2	62.2	62.2
EPS	12.9	17.7	21.6	27.4	35.1
BV	102.1	119.2	130.0	152.5	181.5

Source: Company, Antique

Growth ratios (%)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
Advances	26.5	31.5	30.0	30.0	30.0
Borrowings	25.2	25.3	33.3	32.3	31.8
NII	21.6	52.0	25.7	25.8	30.4
PPP	19.4	48.1	25.1	25.3	29.5
PAT	18.5	37.6	22.2	26.5	28.2

Cost ratios (%)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
Cost to income	17.3	18.4	18.5	18.5	18.5
Cost to average assets	0.8	0.9	0.9	0.9	0.9

Margins

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
Yield on funds	12.3	12.5	12.1	11.9	11.9
Cost of deposits	9.5	9.3	9.0	8.8	8.6
Spreads	2.8	3.3	3.1	3.2	3.3
NIMs	3.9	4.6	4.5	4.3	4.3

Return ratios (%)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
RoA	2.4	2.6	2.5	2.4	2.4
RoE	17.1	16.0	17.4	19.4	21.0

Valuations

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
P/E	33.9	24.7	20.2	16.0	12.4
P/BV	4.3	3.7	3.4	2.9	2.4

Asset quality & adequacy (%)

Year ended 31 Mar	2013	2014	2015e	2016e	2017e
GNPA	1.5	1.5	1.5	1.4	1.4
NNPA	1.0	0.7	0.7	0.7	0.7
Tier 1	25.5	24.5	19.0	17.2	15.7

Source: Company, Antique

GRUH Finance Limited - Financials

Income statement (INRm)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Interest earned	6,181	8,130	10,187	12,548	16,039
Interest expended	4,044	5,436	6,515	7,924	10,173
NII	2,137	2,694	3,672	4,624	5,866
Other income	323	327	372	425	485
Net income	2,460	3,021	4,044	5,049	6,351
Operating expenditure	463	564	705	881	1,102
Staff costs	234	317	397	496	620
Pre provisioning profit	1,997	2,457	3,339	4,167	5,250
Bad debts written off	16	-	224	174	164
Provisions	13	17	81	101	130
PBT	1,968	2,440	3,034	3,892	4,956
Current tax	514	682	1,001	1,284	1,635
Deferred tax	(5)	(8)	-	-	-
PAT	1,459	1,766	2,033	2,608	3,320

Balance sheet (INRm)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Liabilities					
Share capital	357	360	721	721	721
Reserves & Surplus	4,553	5,712	6,671	8,363	10,518
Networth	4,910	6,072	7,391	9,084	11,239
Borrowings	49,145	64,475	83,595	107,356	137,771
Total liabilities	54,055	70,547	90,986	116,439	149,010
Assets					
Advances	54,378	70,090	90,417	115,733	148,139
Investments	652	530	636	763	915
Net current assets	(1,217)	(352)	(387)	(426)	(469)
Fixed assets	118	110	127	146	168
DTA	125	169	194	224	257
Total assets	54,055	70,547	90,986	116,439	149,010

Margin analysis (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Yield on funds	12.8	12.7	12.4	11.9	11.9
Cost of deposits	9.2	9.6	8.8	8.3	8.3
Spreads	3.6	3.2	3.6	3.6	3.6
NIMs	4.4	4.3	4.5	4.5	4.4

Per share data

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
EPS	8.2	9.8	5.6	7.2	9.2
BVPS	27.5	33.7	20.5	25.2	31.2
DPS	2.5	3.0	1.7	2.2	2.8

Source: Company, Antique

Growth indicators (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Advances	33.2	28.9	29.0	28.0	28.0
Borrowings	27.9	31.2	29.7	28.4	28.3
NII	21.6	26.1	36.3	25.9	26.9
PPP	20.9	23.0	35.9	24.8	26.0
PAT	21.0	21.0	15.1	28.3	27.3
Total assets	27.9	30.5	29.0	28.0	28.0

Cost ratios (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Cost to income	18.8	18.7	17.4	17.5	17.3
Cost to avg loans	1.0	0.9	0.9	0.8	0.8

Return ratios (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
RoAA	3.0	2.8	2.5	2.5	2.5
RoAE	33.3	32.2	30.2	31.7	32.7

Valuations (x)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
P/E	26.9	22.4	39.0	30.4	23.9
P/B	8.0	6.5	10.7	8.7	7.1

RoA tree (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
Interest earned	12.8	13.1	12.6	12.1	12.1
Interest expended	8.4	8.7	8.1	7.6	7.7
Gross interest spread	4.4	4.3	4.5	4.5	4.4
Other income	0.7	0.5	0.5	0.4	0.4
Total income	5.1	4.8	5.0	4.9	4.8
Employee expenses	0.5	0.5	0.5	0.5	0.5
Other expenses	0.5	0.4	0.4	0.4	0.4
Operating income	4.1	3.9	4.1	4.0	4.0
Provisions	0.1	0.0	0.4	0.3	0.2
Pre-tax earnings	4.1	3.9	3.8	3.8	3.7
Tax	1.1	1.1	1.2	1.2	1.2
RoA	3.0	2.8	2.5	2.5	2.5
Leverage	11.0	11.3	12.0	12.6	13.1
RoE	33.3	32.2	30.2	31.7	32.7

Asset quality (%)

Year-ended Mar 31	2013	2014	2015e	2016e	2017e
GNPA (%)	0.3	0.3	0.5	0.5	0.5
NNPA (%)	-	-	-	-	-
Coverage (%)	100.0	100.0	100.0	100.0	100.0

Source: Company, Antique