REPCO Home Finance Ltd. (REPCO)

BUY

Sector Relative to Market	Stock Relative to Sector	Date
Outperform	Outperform	17 January 2014

REPCO Home Finance Ltd (REPCO)

REPCO Home Finance Ltd (REPCO), a subsidiary of REPCO Bank Ltd, a Government of India enterprise, is a niche housing finance company having significant focus on the under-served Tier II & III cities. The total network of REPCO stands at 102 branches and satellite centers, with about 90% of them in southern India, as on September 30, 2013. Despite its loan book growing at a 38% 5-year CAGR, REPCO has been able to maintain a healthy asset quality of 0.92% Net NPA (non-performing assets) as on September 30, 2013. The total write-offs since inception have been mere 0.08% of REPCO's cumulative disbursements. With the consistent growth in its business and a low cost model the company has been able to maintain better RoAs than its peers at around 2.5% and higher NIMs of nearly 4%. At the current price the stock is trading at valuations of 2.1 its FY2016E Adj. BV. We initiate coverage on the stock with a BUY rating at a fair value of Rs.396/share.

Focus on underpenetrated markets and segments: REPCO focuses on tier II and tier III cities and peripheral areas of tier I cities. This leads to lower competition from banks for REPCO leading to higher advances growth (~25%YoY) vis-a-vis industry average growth of ~15% for last 3 years and better margins. Further, non-salaried class is highly underpenetrated and relatively less competitive and offers better yields. With continued focus on non-salaried class, REPCO is expected to maintain higher yields going forward. REPCO maintains almost 50:50 ratio between salaried and non-salaried class. The firm's exposure to non-salaried class is highest in the industry. Niche positioning aids growth and margins.

Differentiated business model: REPCO has a differentiated business model which helps in higher than industry growth (loan book growing at a 5 year CAGR of 38%) as well as better margins (4.7% NIMs as on September 30, 2013). REPCO's maintains low operating cost of below 20% of its net total income by way of a lean branch model having mere 3-4 employees per branch. Further, unlike its peers, the company has "zero" exposure to the high risk developer loans (having highest slippages in the industry, recently), which gives it an advantage on the asset quality front.

Loan book to grow at 28% over the next 2 years: We expect the loan book to grow by about 28% over FY2015-16 to Rs.7,340 crore in FY2016. The company aims to add about 15 new branches per year with about 2/3rd in southern states and the rest in non-southern regions. Further, an increase in average ticket size of home loans disbursed is expected to be another major growth driver for the company. The current average ticket size is around Rs.10 lakh which is well below the allowable Rs.15 lakh limit, as directed by NHB. REPCO expects to raise the average ticket size to Rs.15 lakh over next 3 year, after which the management foresees an upward revision in the allowable limit.

Key risks on the stock: Geographical concentration (63% of the total advances emanate from Tamil Nadu) is risk for the company. Aggression from banks/other NBFCs can impact the advances growth of the company. The exposure to non-salaried segment is a riskier segment and may lead to higher than industry NPAs.

Valuation: We believe that the stock would be able to benefit from the growth in the mid-tier loan financing segment especially in the low ticket item. Considering its high NIMs and availability of low cost financing from NHB would make REPCO key beneficiary of growth in the low cost housing segment. Strong growth in advances, followed by stable margins, better asset quality and lower cost to income ratio is likely to lead to a strong growth in earnings. The stock is currently trading at 2.1x FY2016E Adj. BV. We recommend BUY on the stock with a target price of Rs.396 valuing the company at 2.6x its FY2016E Adj. BV of Rs.152 per share.

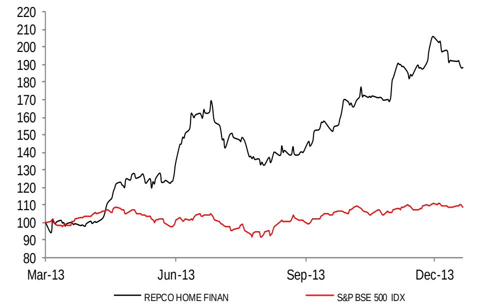
Key Data	
CMP (Rs.)	325
Target Price (Rs.)	396
Upside %	22

Stock Information	
BSE Code	535322
NSE Code	REPCOHOME
No. of shares (Cr.)	6.22
Market Cap (Rs. Cr.)	2,020
Free float (Rs. Cr.)*	603
52 Week H / L (Rs.)	373.3/158.1
Avg. Daily vol. in lakh (12M, NSE)	0.84

** 74.69% shares of REPCO are locked in.*

Shareholding Pattern (%)	Dec-13	Mar-13
Promoters	37.4	37.4
FII	6.4	5.6
DII	12.0	12.3
Non Institutions.	44.2	44.7
Bodies Corporate	3.4	3.8

Indexed Performance Since Listing



Price Performance (%)	1m	3m	9m
REPCO	0.5	24.4	14.5
BSE500	2.0	4.8	5.2
BSE MIDCAP	0.8	11.2	13.2
CNX FIN	-1.7	1.9	-1.4

Source: Bloomberg, Centrum Wealth Research

Y/E Mar (Rs. Cr.)	NII	Growth %	Net Profit	Growth %	Net NPA %	EPS (Rs.)	P/E	Adj. BV (Rs.)	P/Adj. BV
2012A	103	19.6	61	-8.0	0.95	9.9	32.9	60	5.46
2013A	126	21.8	80	30.1	0.98	12.9	25.3	96	3.37
2014E	158	25.5	100	25.1	0.78	16.1	20.2	111	2.94
2015E	202	28.1	129	28.8	0.66	20.7	15.7	129	2.52
2016E	254	25.7	162	25.8	0.53	26.1	12.5	152	2.14

Source: Company, Centrum Wealth Research

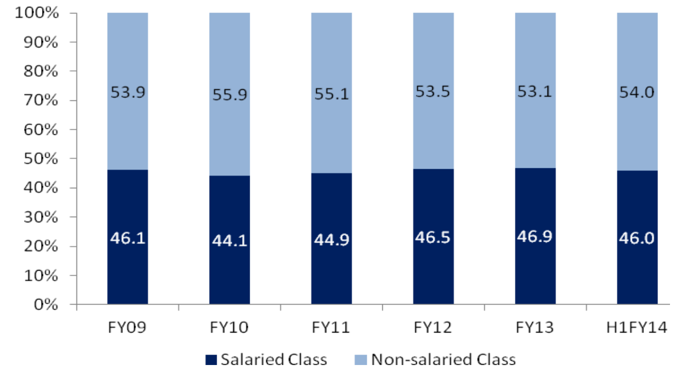
***Siddhartha Khemka**, VP Research*
***Payal Pandya**, Research Analyst*

Focus on underpenetrated markets and segments

REPCO focuses on tier II and tier III cities and peripheral areas of tier I cities. This leads to lower competition from banks for REPCO leading to higher advances growth (~25%YoY) vis-a-vis industry average growth of ~15% for last 3 years and better margins. Also, the company caters to a mid-sized loan segment with the current average ticket size of around Rs.10 lakh. A majority of the large size finance companies cater to loans that are above Rs.20 lakh while the smaller companies have an average loan size of around Rs.5-10 lakh. As a result, it leaves a considerable scope for growth for loan requirements in the range of Rs.5-15 lakh.

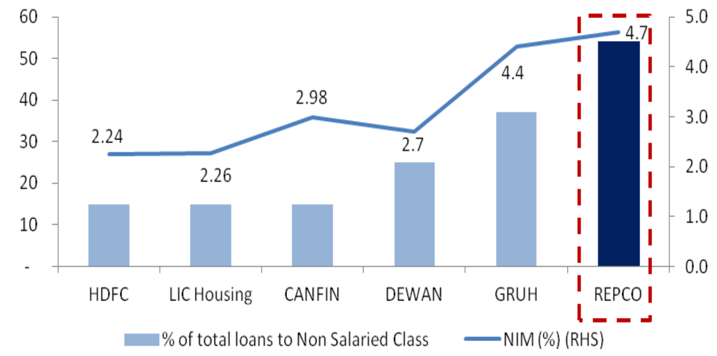
Further, non-salaried class is highly underpenetrated and relatively less competitive and offers better yields. With continued focus on non-salaried class, REPCO is expected to maintain higher yields going forward. REPCO maintains almost 50:50 ratio between salaried and non-salaried class. The firm's exposure to non-salaried class is highest in the industry. This niche positioning by REPCO helps it in higher growth and better margins.

Exhibit 1: High exposure to non-salaried segment …



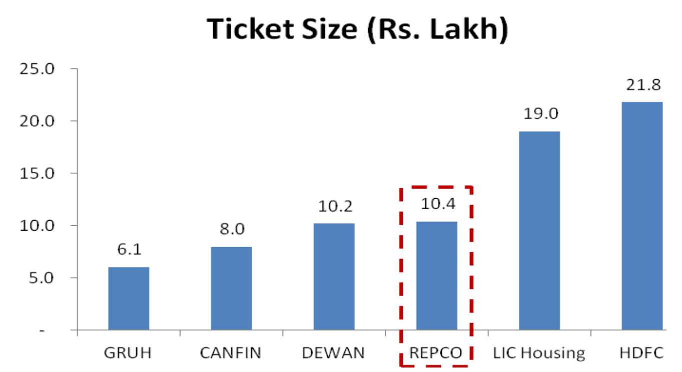
Source: Company, Centrum Wealth Research

Exhibit 2: … helping in better than industry NIMs



Source: Company, Centrum Wealth Research

Exhibit 3: Operating in mid-segment of loans



Source: Company, Centrum Wealth Research

Differentiated business model

REPCO has a differentiated business model which helps in higher than industry growth as well as better margins.

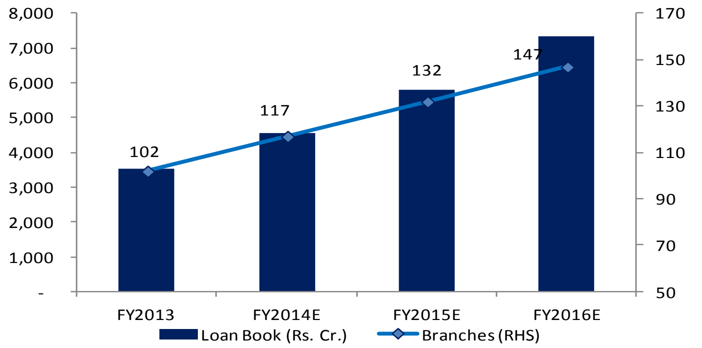
- **Low cost operations:** The company manages a low operating cost by way of a lean branch model with mere 3-4 employees per branch, using centralized credit approval mechanism and lower rentals in the tier II & III cities. The cost-income ratio for the company is well below 20%.
- **Direct marketing and customer contact:** REPCO has avoided the industry practice of using marketing agents and reaches out to its customers directly through its branches which operate as a single point of contact. This helps the company to have a direct relation with its customers and also reduce costs by avoiding commissions.
- **No exposure to developer loans:** REPCO has zero exposure to developer / builder loans (a relatively lumpy and riskier segment), thus helping in maintaining healthy asset quality.

Future Growth Prospects

The company focuses on 3 key growth drivers -

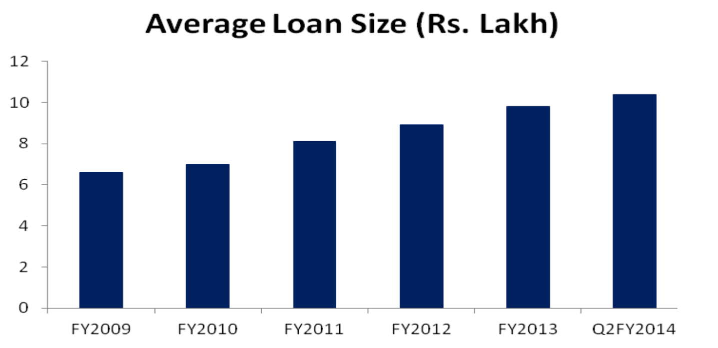
- **Growth in existing network:** The loan book of REPCO is expected to grow at a pace of 25-30% each year mainly on the back of growth coming from the existing branches. In all the company has 82 branches and 20 satellite centers spread across 8 states. Of these, 92 branches / satellite centers are in the south.
- **New branch additions:** REPCO aims to add about 15 new branches every year with about 2/3rd in southern states and the rest in non-southern regions. The breakeven period for the branches in the southern region is less than a year, as a result of which these new branches are expected to contribute to the overall business and profitability growth within a year.
- **Increase in the average ticket size:** An increase in average ticket size of home loans disbursed is expected to be another major growth driver for the company. The current average ticket size is around Rs.10 lakh which is well below the allowable Rs.15 lakh limit under the Golden Jubilee and Rural Housing Finance schemes, as directed by NHB. Over the last 5 years the average ticket size of the company has grown by more than 50% and going forward, REPCO expects it to increase to about Rs.15 lakh over next 3 year.

Exhibit 4: Loan book growth driven by branch expansion



Source: Company, Centrum Wealth Research

Exhibit 5: Consistent growth in average loan size



Source: Company, Centrum Wealth Research

Over the next three years, the company's loan book is expected to grow nearly 2x on the back of a 1.4x expansion in the overall network and a nearly 50% increase in the average ticket size.

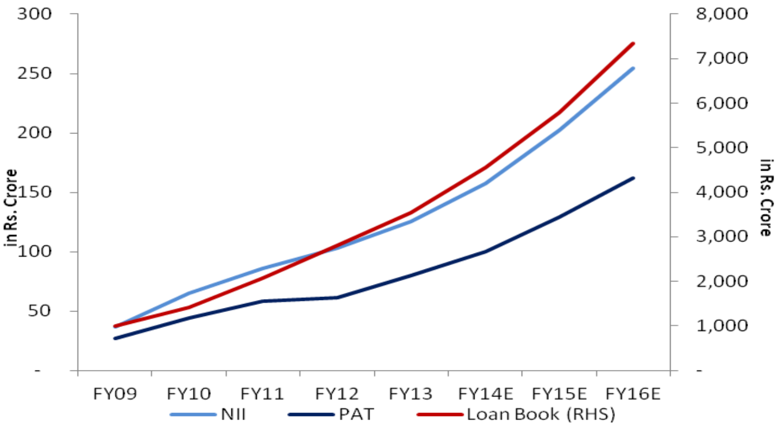
Consistent performance

REPCO has consistently posted robust growth in its NII (net interest income) during the last few quarters. In Q2FY2014, the NII grew by 56% YoY to Rs.47 crore backed by a higher growth of 31% YoY in the interest income compared to a growth of 19% YoY in the interest expenses. The company has posted an average net profit growth of over 40% YoY during the last 3 quarters. For the quarter, REPCO reported a NIM of 4.7%, which was largely due to the spread improving to 3.3% during the quarter. The management expects to maintain its spreads well above 3%, going forward.

Over the last 5 years, the company has maintained a balanced loan book composition of the high yielding non-salaried (self employed segment) and the less risky assets of the salaried class of borrowers. This healthy composition has led to the overall loan book expanding by 3.6 times from Rs.991 crore in FY2009 to Rs.3,545 crore in FY2013. During the same period, the NII and net profit of the company also posted robust growth of 3.4 times and 3 times, respectively. Currently, the loan book of REPCO stands at Rs.4,036 crore as on September 30, 2013. Since FY2009, the company has consistently maintained its NIMs above 4% except in FY2013 when the NIMs were marginally below at 3.95% for the full year. However, the company has improved the same and got back to the level of 4.7% for the H1FY2014 and is expected to remain around the same levels going forward.

Going ahead, the NII, net profit and the loan book of the company are expected to grow at a healthy pace at a 3 year CAGR of 27-28% each.

Exhibit 6: Fundamental growth to remain strong



Source: Company, Centrum Wealth Research

No major impact from NHB's implementation of 2% Cap on refinance schemes

The National Housing Bank (NHB), the wholly owned subsidiary of the Reserve Bank of India (RBI), which supports the housing finance sector, has set a cap of 2% spread on the lending rates for specialized mortgage lenders under the Rural Housing Finance (RHF) scheme. The borrowing cost for REPCO under NHB's RHF scheme is around 8-8.1%. With a 2% cap on lending rates the effective lending rate for the company would be around 10%. As this could have adversely impacted the company's margins, REPCO has put a hold on borrowings from NHB under the special RHF scheme.

The company has a well diversified borrowing profile with about 63% funds borrowed from banks, 30% borrowings from NHB and the remaining 7% from REPCO bank. The company has approvals for raising Rs.500 crore through non-convertible debentures (NCDs) and Rs.100 crore through the commercial paper (CP) route. Further, to minimize the risk on its spreads, the company may consider various other schemes offered by NHB such as the Golden Jubilee Window wherein the cost of funds may increase by about 100bps but it would have no restrictions on the lending rate. As a result, REPCO is confident to manage a 3% spread going forward. Further, the company expects to be eligible for raising funds through ECB route by FY2016 and may consider the option as it would reduce the borrowing cost further.

Valuation

We believe that the stock would be able to benefit from the growth in the mid-tier loan financing segment especially in the mid-sized loan segment. Considering its high NIMs and availability of low cost financing from NHB would make REPCO key beneficiary of growth in the low cost housing segment. Strong growth in advances, followed by stable margins, better asset quality and lower cost to income ratio is likely to lead to a strong growth in earnings. The stock is currently trading at 2.1x FY2016E Adj. BV. We recommend BUY on the stock with a target price of Rs.396 valuing the company at 2.6x its FY2016E Adj. BV of Rs.152 per share.

Exhibit 7: Peer Comparison

Company	M. Cap	CMP	Loan Book		NIM	GNPA	NNPA	RoE	RoA	BVPS (Rs. / Share)			P/BVPS		
	(Rs. Cr.)	(Rs.)	FY2013 (Rs. Cr.)	5Yr CAGR (%)	(%) for FY2013					FY13	FY14E	FY15E	FY13	FY14E	FY15E
HDFC	130,984	840	170,046	15.6	2.3	0.7	-	23.6	2.8	207	179	210	4.1	4.7	4.0
LTFH	12,118	71	33,310	42.0	5.3	2.0	1.3	14.3		32	37	42	2.2	1.9	1.7
LIC HF	10,532	208	77,812	28.8	2.2	0.6	0.4	17.1		129	151	174	1.6	1.4	1.2
GRUH	4,719	262	5,438	23.2	4.4	0.3	0.1	33.3	2.9	28	34	43	9.5	7.7	6.2
DEWAN	2,645	206	33,900	50.7	2.7	0.7	-	18.1	1.7	252	291	337	0.8	0.7	0.6
REPCO	**2,008**	**323**	**3,545**	**40.0**	**3.9**	**1.5**	**0.9**	**17.1**	**2.5**	**102**	**111**	**129**	**3.2**	**2.9**	**2.5**
GIC	560	104	4,539	13.5	2.8	1.9	-	16.2	1.8	102	114	128	1.0	0.9	0.8
CANFIN	338	165	4,016	16.1	2.9	0.4	-	14.6	1.6	191	220	254	0.9	0.8	0.6

Source: Company, Bloomberg Consensus Estimates, Centrum Wealth Research

Technical View

Exhibit 8: Technical Chart on REPCO Home Finance

Source: Centrum Wealth Research

Due to insufficient history, a clear technical view for the scrip is not available. However its trend since listing has been bullish with a higher high trend within a channel. Currently at the lower end of the channel, demand is likely to set in and a move towards 380 is likely in the next 4-6 months.

Financials

Income Statement

(In Rs. Crore)	FY2012A	FY2013A	FY2014E	FY2015E	FY2016E
Interest Income	306	391	498	623	774
Interest Expense	202	266	341	421	520
Net Interest Income (NII)	**103**	**126**	**158**	**202**	**254**
Growth %	*19.6*	*21.8*	*25.5*	*28.1*	*25.7*
Other Operating Income	13	15	20	27	34
Net Total Income	**117**	**140**	**178**	**229**	**288**
Employee Expense	11	14	18	22	26
Operating & Administration Expenses	9	10	12	14	16
Total Operating Expenses	19	24	30	36	42
Pre-Provisioning Profit (PPP)	**97**	**116**	**148**	**193**	**246**
Growth %	*4.5*	*19.4*	*27.4*	*30.4*	*27.6*
Provisions and Bad Debts Written off	16	9	14	21	30
Profit before tax	**82**	**107**	**134**	**172**	**216**
Tax	20	27	33	43	54
Tax Rate %	*24.7*	*25.1*	*25.1*	*25.1*	*25.1*
Net Profit	**61**	**80**	**100**	**129**	**162**
Growth %	*(8.0)*	*30.1*	*25.1*	*28.8*	*25.8*

Balance Sheet

(In Rs. Crore)	FY2012A	FY2013A	FY2014E	FY2015E	FY2016E
Equity Share Capital	46	62	62	62	62
Reserves and Surplus	257	572	662	778	924
Net Worth	**303**	**635**	**724**	**840**	**986**
Loan Funds / Borrowings	**2,486**	**3,065**	**3,870**	**4,921**	**6,238**
Growth %	*60.4*	*23.3*	*26.3*	*27.1*	*26.8*
Current Liabilities and Provisions	39	60	75	90	125
Other Liabilities	25	34	49	64	79
Total Liabilities	**2,853**	**3,792**	**4,718**	**5,915**	**7,428**
Cash and Bank Balance	18	210	129	83	39
Investments	8	8	8	8	8
Loan Book	**2,814**	**3,554**	**4,553**	**5,789**	**7,339**
Growth %	*35.2*	*26.3*	*28.1*	*27.1*	*26.8*
Net Deferred Tax	8	11	16	21	26
Fixed Assets, net	3	4	5	6	7
Other Assets	2	5	6	7	8
Total Assets	**2,853**	**3,792**	**4,718**	**5,915**	**7,428**

Ratios

(In Rs. Crore)	FY2012A	FY2013A	FY2014E	FY2015E	FY2016E
Operating Ratios (%)					
NIM	4.21	3.94	3.89	3.90	3.87
Empl. Cost as % to Opex	54.12	58.02	59.74	60.88	61.70
Cost-Income	16.64	17.32	17.01	15.85	14.67
Yield on advances	12.5	12.3	12.3	12.0	11.8
Yield on assets	12.3	11.8	11.7	11.7	11.6
Cost of funds	10.0	9.6	9.8	9.6	9.3
Spread	2.5	2.7	2.5	2.5	2.5
Cost-Income Ratio	16.6	17.3	17.0	15.8	14.7
Credit cost	0.6	0.3	0.4	0.4	0.5
Effective tax rate	24.7	25.1	25.1	25.1	25.1
Dividend Pay out	8.3	8.5	8.7	8.7	8.8
RoA	2.5	2.4	2.4	2.4	2.4
RoE	22.6	17.1	14.7	16.5	17.8
Leverage	9.4	6.0	6.5	7.0	7.5
%GNPA	1.4	1.5	1.6	1.7	1.8
%NNPA	1.0	1.0	0.8	0.7	0.5
Provisioning Coverage	29.7	34.3	50.0	60.0	70.0
EPS	13.2	12.9	16.1	20.7	26.1
BV	65.3	102.1	116.5	135.2	158.6
ABV	59.5	96.5	110.7	128.9	152.2
PE	24.6	25.2	20.2	15.7	12.5
PABV	5.5	3.4	2.9	2.5	2.1

Source: Company, Centrum Wealth Research

Appendix A

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