Repco Home Finance

Homing In

UNRATED

25 September 2014
BSE Sensex: 26468
Sector: Financials

Stock data

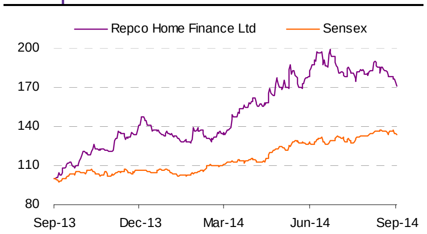
CMP (Rs)	411
Mkt Cap (Rsbn/USDm)	25.6 / 416
Bloomberg code	REPCO IN
1-yr high/low (Rs)	515/236
6-mth avg. daily volumes (m)	0.258
6-mth avg. daily traded value (Rsm/US$m)	105 / 1.72
Shares outstanding (m)	62
Free float (%)	62.6
Promoter holding (%)	37.4

We recently interacted with the management of Repco Home Finance (Repco) to get an update on the business and future prospects. Key takeaways:

- **Niche player, small size; expect healthy growth:** Repco is a relatively smaller and niche mortgage financier, based primarily in South India. Its focus customer segment of non-salaried borrowers in Tier 2/ Tier 3 cities continues to be relatively under-penetrated. The management believes this would help sustain 25-30% loan growth annually over the next 3-4 years.
- **Asset quality healthy; should improve hereon:** Repco's asset quality remains healthy with NPLs of 2.5% as of Q1FY15. According to the management, there is a seasonal rise in NPLs in Q1 due to uneven cash flows of borrowers (non-salaried). Hence, NPLs should decline to normalized levels through the remaining part of the fiscal (FY14 NPLs at 1.5%). At 36.4%, coverage levels are low but Repco intends to raise it to 70% gradually over the medium term.
- **Stable margins, improving leverage should boost RoE:** NIMs are relatively strong at 4%+ with loan spreads of 3.2%. The management believes these are sustainable in the medium term as any decline in loan yields will be matched with a reduction in cost of funding. RoA was healthy at 2.6% in FY14 with RoE of 16%. Tier 1 capital is relatively higher at 23.5%, and the management expects this to shore up RoE in the medium term as leverage rises (asset / equity 6.4x now).

We believe India's mortgage segment is likely to continue growing at a fast clip with stable asset quality in the medium term. Repco is likely to see increased competitive intensity in both the home and new markets, though its relatively niche positioning will mitigate profitability risks. The stock trades at 3.4x FY14 P/BV and 23.2x FY14 P/E.

Price performance – relative and absolute



(%)	3-mth	6-mth	1-yr
Repco Home Fin	(6.5)	25.7	70.5
BSE Sensex	4.6	20.0	33.3

Key financial ratios

As on 31 March	FY10	FY11	FY12	FY13*	FY14
Net Profit	443	582	614	800	1,101
EPS (Rs)	10.4	12.5	13.2	14.7	17.7
EPS growth (%)	*(25.5)*	*20.1*	*5.7*	*11.3*	*20.3*
PE (x)	39.4	32.8	31.1	27.9	23.2
P/BV (x)	9.0	7.7	6.3	3.5	3.4
P/Adj BV (x)	10.5	8.3	6.9	4.3	3.6
P/PPOP (x)	39.4	30.7	26.3	22.0	14.9
RoA (%)	3.5	3.2	2.5	2.4	2.6
RoE (%)	28.5	26.3	22.3	17.1	16.0
Dividend Yield (%)	0.3	0.2	0.3	0.3	0.3

** calculated on weighted average shares*

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Repco: A niche mortgage financier with strong growth prospects

Repco is a relatively small, niche, mortgage financing company operating primarily in southern India. It offers home loans to individuals and loans against residential property (LAP) in Tier 2/ 3 cities. Headquartered in Tamil Nadu, Repco has been promoted by a government-owned cooperative bank – The Repatriates Co-operative Finance and Development Bank (Repco Bank), which owns a 37.4% stake in Repco Home Finance. Repco has consciously stayed away from developer loans.

Repco has a network to 122 branches as of Q1FY15 with four southern states (Tamil Nadu, Andhra Pradesh, Kerala and Karnataka) constituting a significant proportion of the branch network and ~90% of loans. However, over the past couple of years, Repco has expanded its operations to five other states (Maharashtra, MP, West Bengal, Gujarat, Orissa).

Exhibit 1: Repco – Key statistics

	FY12	FY13	FY14	Q1FY15
Loan book (Rs m)	28,022	35,447	46,619	48923
Average loan value per unit (Rs m)	0.9	1.0	1.1	1.1
Number of live accounts	24,939*	34,739*	49,093	50,486
Employees	350	385	465	472
Branches	88	92	122	128

*Source: Company, IDFC Securities Research; *calculated*

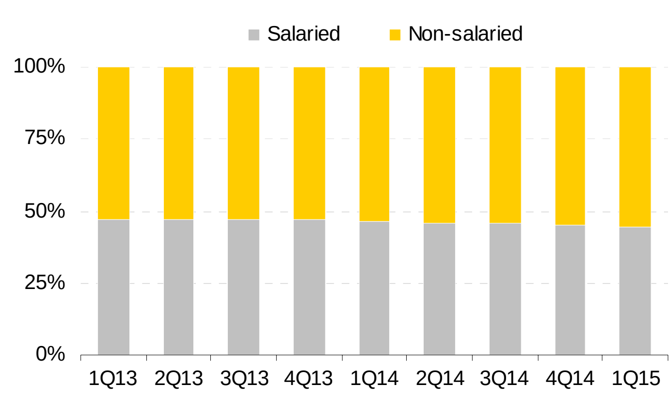
❑ Non-salaried borrowers – key customer segment

Within the home loan segment, Repco offers loans for: a) purchase of new/ used dwelling units as well as loans for purchase of land, and b) construction of housing units. Loans against property are primarily offered to individuals/ SMEs against self-occupied residential property.

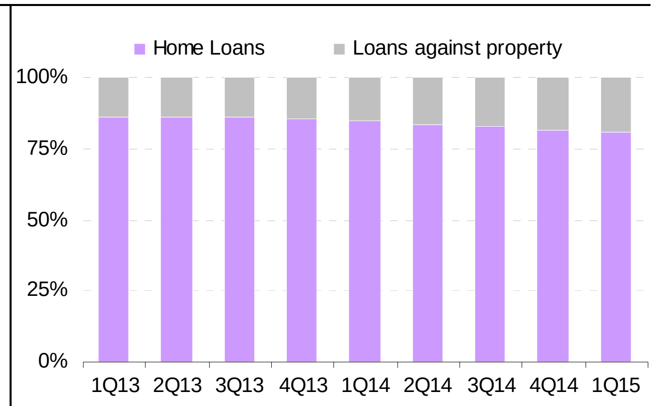
Unlike larger housing finance companies (HFCs), Repco has a significant proportion of its loans to non-salaried borrowers (55% of total loans as of Q1FY15) which includes professionals as well as non-professionals. Moreover, ~66% of Repco's loan book is towards Tier 2 and Tier 3 cities, which is a significantly underpenetrated market. Loans against property form ~19% of the total loans and the management plans to limit LAP around current levels. Average loan size for Repco's loan book stands at Rs1.1m, among the lowest in the industry and significantly lower than larger peers – reflecting its relatively semi-urban bias.

Repco's key competitive advantages are: a) its relatively smaller size and a quick turnaround time; b) a sound understanding of housing market in Tier 2/ 3 cities; and c) ability to appraise credit in the non-salaried segment (with a significant proportion of customers without formal income documents).

Exhibit 2: Loan mix (salaried vs non-salaried, %)



Loan mix (home loans vs LAP, %)



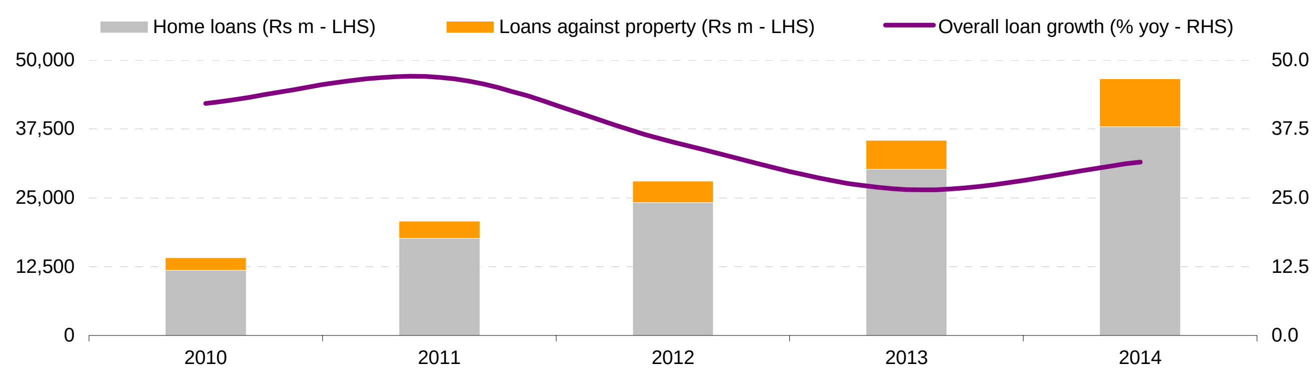
Source: Company, IDFC Securities Research;

Expect robust growth to sustain in the medium term

India's housing loan segment remains an attractive long-term growth opportunity given: a) low home ownership levels; b) reduction in family size - nuclearization of families; and c) significantly low mortgage-to-GDP penetration of 8%. The mortgage segment also remains the most competitive, albeit the opportunity for banks is restricted to the salaried borrower segment given lack of formal income documentation in the non-salaried segment, especially in Tier 2/ Tier 3 cities. This segment, thus, represents a large opportunity for smaller lenders such as Repco.

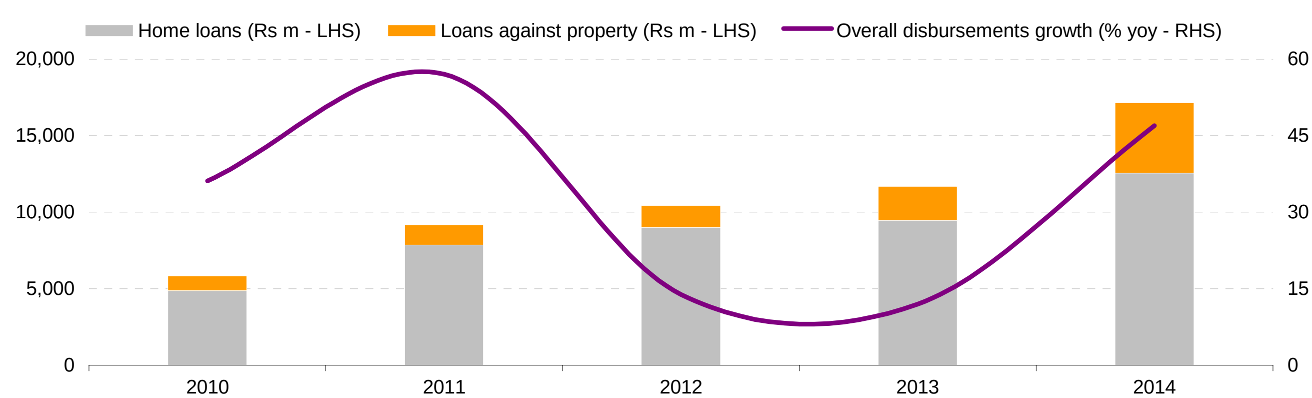
Repco has grown its loan book rapidly with a strong 36% CAGR with a 32% CAGR in disbursements over FY09-14. The management expects mortgage demand to remain strong in the medium term due to underpenetration in the addressable market and has guided to 25-30% loan growth in the medium term, led by increasing penetration in existing locations as well as geographical expansion into newer states.

Exhibit 3: Loan growth (% yoy)



Source: Company, IDFC Securities Research

Exhibit 4: Disbursements growth (% yoy)



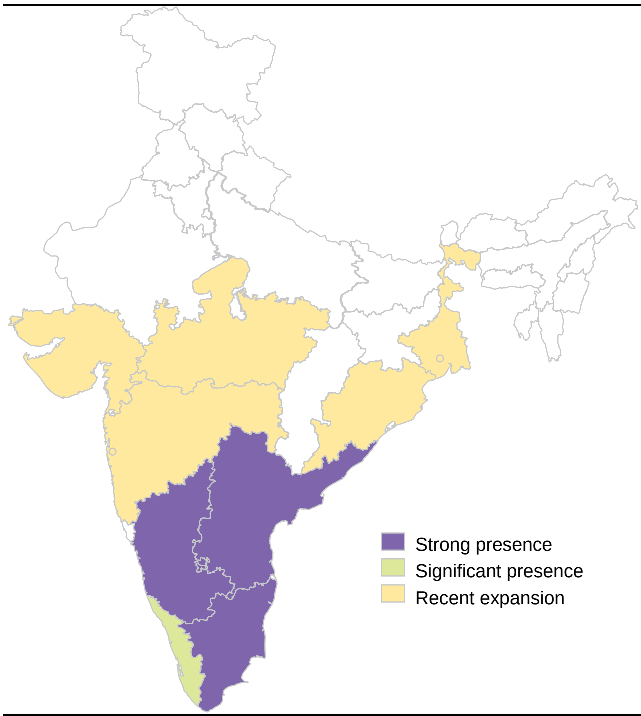
Source: Company, IDFC Securities Research;

❑ Branch expansion to increase reach and geographical diversification

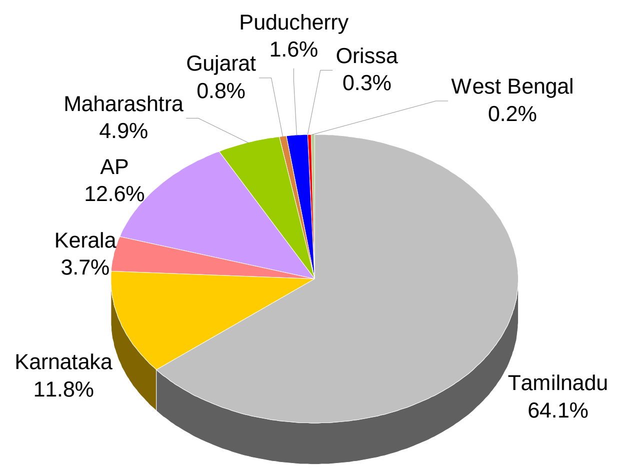
Repco has increased its branch network to 122 from 45 branches in 2009. While it remains predominantly a South Indian franchise, ~45% of its incremental branch network added since FY12 has been outside the southern states. The management plans to add 15 new branches annually for the next 2-3 years. Of the new branches, 1/3rd will be outside the southern states. The management wants to increase density of its branches in the five non-southern states it is already present in (viz Maharashtra, Madhya Pradesh, Orissa, West Bengal and Gujarat) rather than entering new states.

While near-term growth will continue to be driven by existing and new branches in the South, the non-southern state branches will likely start contributing meaningfully to growth in the next 2-3 years.

Exhibit 5: Repco – Branch network



Repco – Loan distribution state-wise



Source: Company, IDFC Securities Research; as of Q1FY15

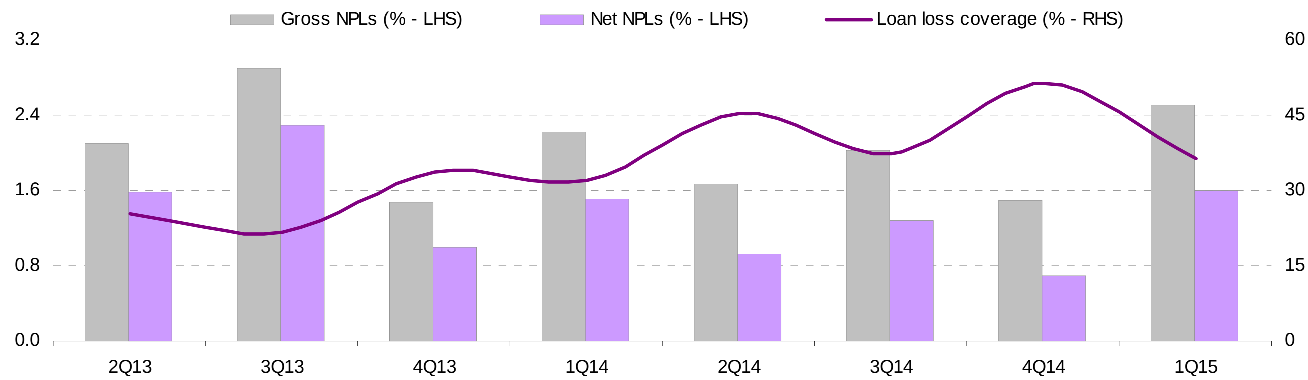
Asset quality: A notch lower than peers, but stable

Repco's asset quality has largely remained stable with GNPLs at 1.5% (as of March 2014). Repco exhibits significant seasonality in its asset quality trends with Q1 showing the highest levels of GNPLs (2.5% in Q1FY15 vs 2.2% in Q1FY14) which gradually declines by Q4 of every year. The management attributes this to seasonal nature of cash flows for the non-salaried borrowers, which affects collection efficiency during the early part of the fiscal.

Repco runs a centralized credit appraisal, application processing and monitoring model, and all credit requests are approved/ rejected at the central office with branches authorized only to source credit. Repco's underlying asset quality remains healthy with a cautious approach to lending – the management caps LTVs at 60% for the self-employed borrowers and 80% for salaried ones. Average LTVs at origination, are however, significantly lower at 60% for individual borrowers. Moreover, for loans against property, LTVs are at 50% at origination.

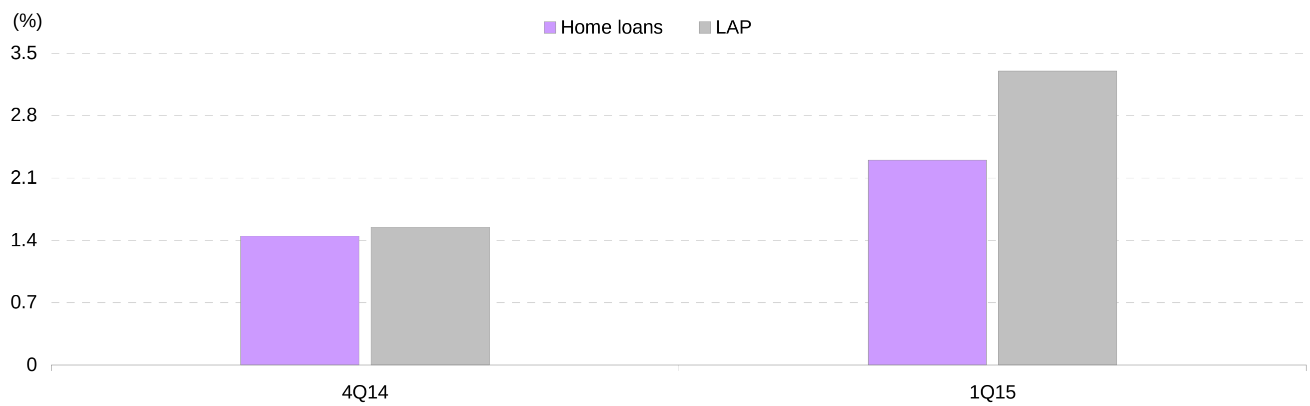
While Repco's GNPLs are a notch higher than peers (e.g. Gruh Finance's GNPLs at 0.3% as of March 2014), the housing finance segment is unlikely to see significant asset quality risks over the near to medium term as underlying asset prices have remained largely stable and economic activity has started to show signs of a consumption-led revival. Moreover, the absence of large ticket developer loans in Repco's loan book mitigates the possibilities of a sudden asset quality shock.

Exhibit 6: Repco – Gross NPLs, Net NPLs and Loan loss coverage (%)



Source: Company, IDFC Securities Research

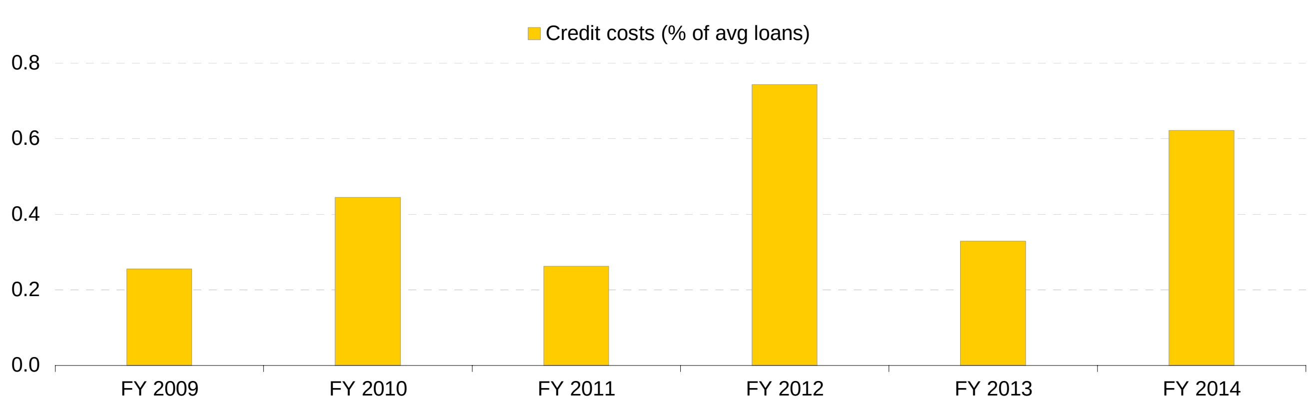
Exhibit 7: Segmental Gross NPLs (%)



Source: Company, IDFC Securities Research

Repco's loan loss coverage remains relatively lower at 36.4% (Q1FY15). The management has indicated that the company has historically faced minimal eventual losses (Rs40m of loss since inception) and thus has remained comfortable with low coverage. However, going forward, the management intends to gradually increase loan loss coverage to over 70%.

Exhibit 8: Repco – credit costs (% of average loans)



Source: Company, IDFC Securities Research

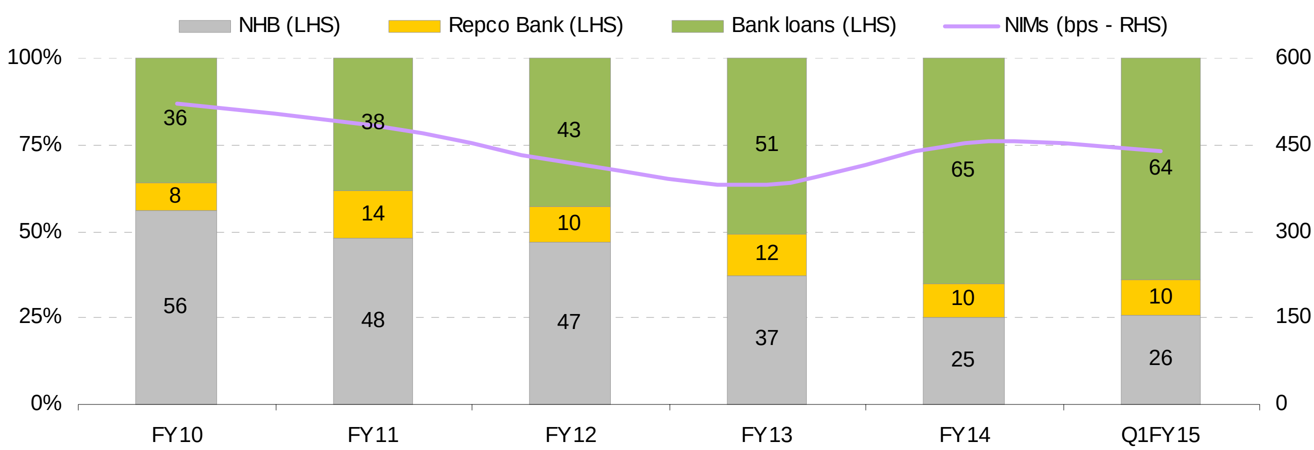
Funding mix: Bank loans dominate

Repco's funding mix is dominated by term loans from banks, with 64% of total borrowings coming from the banking sector as at Q1FY15. Given its exposure to rural housing, Repco is also eligible for refinance from National Housing Bank (NHB) at concessional rates of 8-8.1%. Total NHB refinance (including refinance concessional rates for loans constituted the remaining ~26% of Repco's funding mix.

While borrowing from NHB is significantly cheaper (average cost of 8.4% vs ~10.25% for bank borrowings), its proportion of funding relative to overall funding has been declining steadily over the last few years (56% of total funding was from NHB in FY09). This is largely due to eligibility criteria for concessional rate refinance from NHB (maximum loan spread on rural housing loans of 2.5% for refinance eligibility vs Repco's average loan spreads of 3%+). Over the medium term, this should lead to lower funding from NHB as a proportion of its total funding.

Repco's asset-liability is well matched in terms of interest rates (both asset and liabilities on floating rates; six months reset for bank borrowings) as well as tenor (asset duration of 8-9 years; bank term loans for 10 years). Repco also aims to diversify its funding mix towards ECBs as well as some proportion of securitization to address the reduced proportion of NHB refinance over the medium term.

Exhibit 9: Repco – funding mix (%)

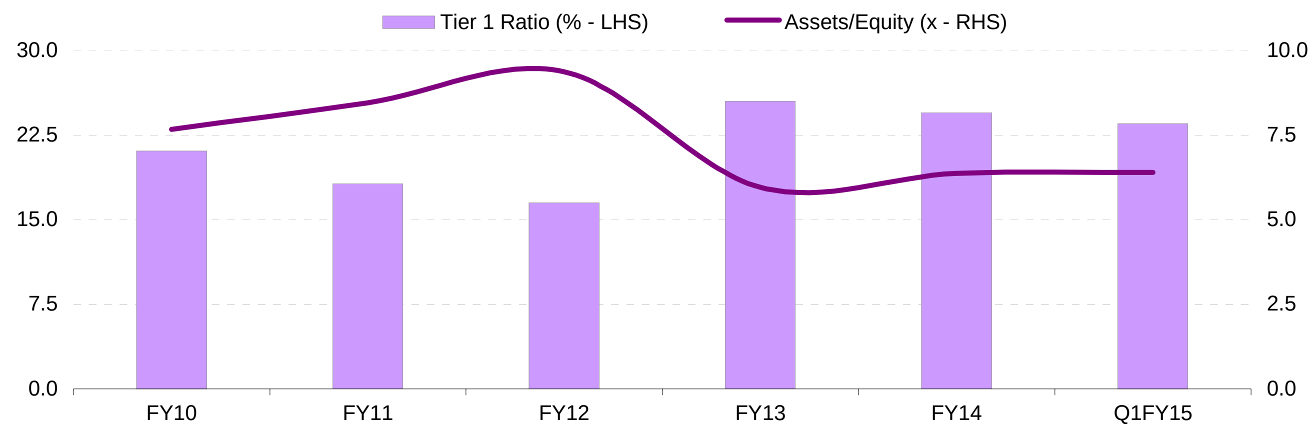


Source: Company, IDFC Securities Research

Capital adequacy comfortable

Repco's capital adequacy is quite comfortable with a Tier 1 ratio of 23.5%. Repco raised equity capital of Rs2.7bn through an initial public offering (IPO) at a price of Rs172 per share in March 2013. At 6.4x, Repco's leverage ratio (assets/ equity) remains significantly lower as compared to other HFCs (10-12x asset / equity). The management believes that these capital ratios are sufficient to sustain growth over the next 3-4 years.

Exhibit 10: Tier 1 ratio (%) and leverage trends (x)



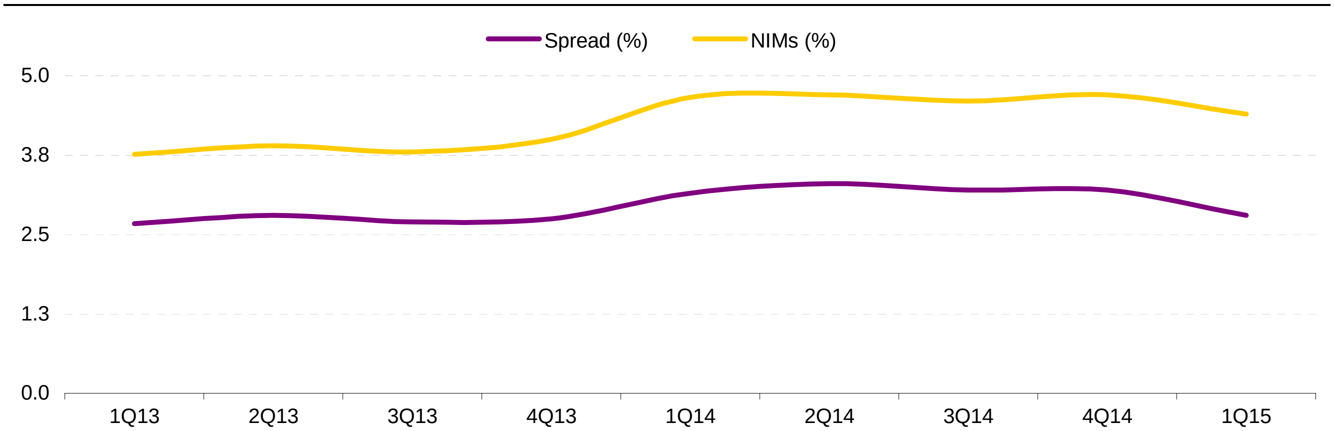
Source: Company, IDFC Securities Research

Lending spreads superior and likely to remain stable

Repco's loan yields (12.6% in FY14) are relatively higher than for most larger peers, especially banks, as its target non-salaried segment in Tier2/ 3 cities offers higher yields of 13% on home loans and ~16% on LAP. Within the salaried segment, loan yields are largely in line with competition at 10.5-11.0%. We expect loan yields in the mortgage industry to decline gradually over the next 2-3 years due to rising competition from banks as they increase penetration into Tier 2 and Tier 3 cities.

Repco's loan spreads are relatively healthy at 3.2% and among the highest in peer group. Despite tight liquidity and higher cost of funding, loan spreads have remained largely stable at ~3.2% over the last couple of years. However, with wholesale funding costs easing recently, Repco's cost of funding is also expected to reduce over the medium term. NIMs too are strong at over 4.4% (Q1FY15). Given its relatively higher focus on small ticket loans where banking penetration is relatively lower, the management expects to maintain loan spreads above 3% and NIMs above 4% in the medium term.

Exhibit 11: Repco – NIMs and spreads (%)

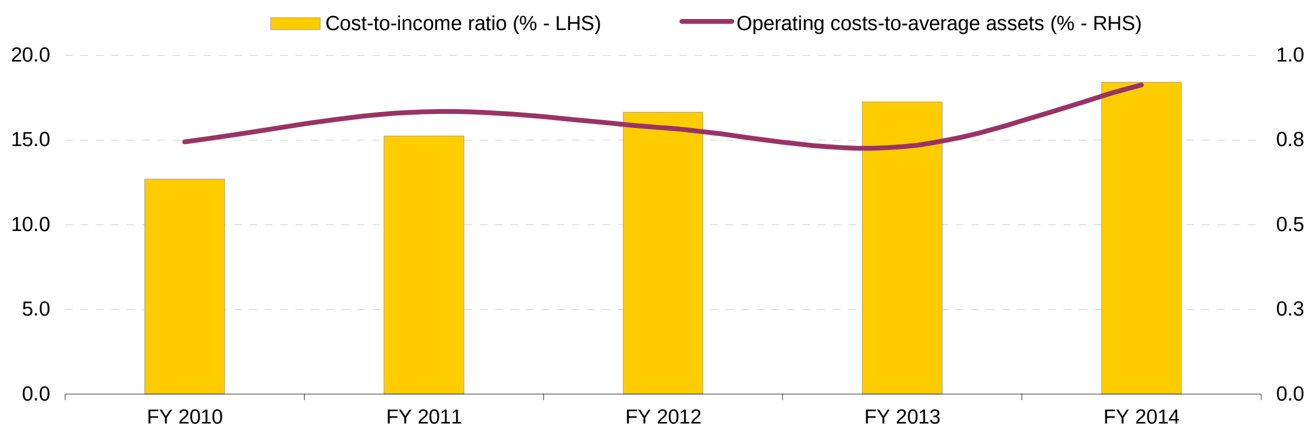


Source: Company, IDFC Securities Research

Cost ratios to remain stable despite branch expansion

Repco's cost-to-income ratio was stable at 18.4% for FY14 (19.2% in Q1FY15) with operating cost-to-average assets at 0.9% in FY14. Repco operates with a relatively leaner operating cost model given that branches are used primarily for sourcing of business. Each branch usually employs 2-3 employees and Repco has historically worked with a thumb rule of ~Rs100m of business (loans) per employee. The management aims to maintain a similar ratio going forward as well despite adding new branches.

Exhibit 12: Repco – cost-to-income ratio (%), operating costs (% of average loans)

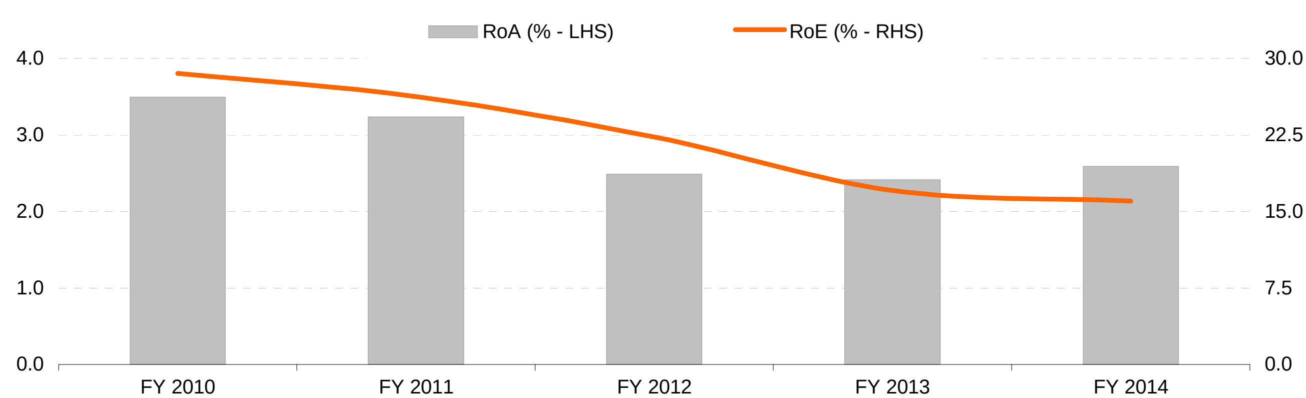


Source: Company, IDFC Securities Research

Healthy profitability; RoE to improve with leverage

Repco has a healthy profitability with RoA of 2.6% and RoE of 16% in FY14. Its RoAs are likely to decline by ~20bp in FY15 due to a higher effective tax rate of ~34% vs 26% (higher incidence of deferred taxes). However, RoE should remain largely stable at ~16% and the management expects this to improve going forward as it increases leverage on the capital raised.

Exhibit 13: Repco – return ratios trends



Source: Company, IDFC Securities Research

Exhibit 14: HFCs - Dupont comparison (FY14)

(% of average assets)	Repco	LIC HF	HDFC	DHFL	Gruh Finance
Net interest income	4.5	2.2	3.4	2.5	4.2
Non-interest Income	0.4	0.3	0.6	0.5	0.5
Operating Income	5.0	2.5	3.9	3.0	4.7
Operating Expenses	(0.9)	(0.4)	(0.3)	(0.9)	(0.9)
Pre-provisioning operating profit	4.0	2.1	3.6	2.0	3.8
Provisions	(0.5)	0.0	0.0	(0.2)	0.0
Profit before tax	3.5	2.1	3.6	1.9	3.8
Taxes	(0.9)	(0.6)	(0.9)	(0.5)	(1.1)
RoAA	**2.6**	**1.5**	**2.6**	**1.4**	**2.8**
Leverage (x)	6.4	12.7	8.1	12.3	11.9
RoAE	**16.5**	**19.0**	**21.3**	**16.6**	**33.0**

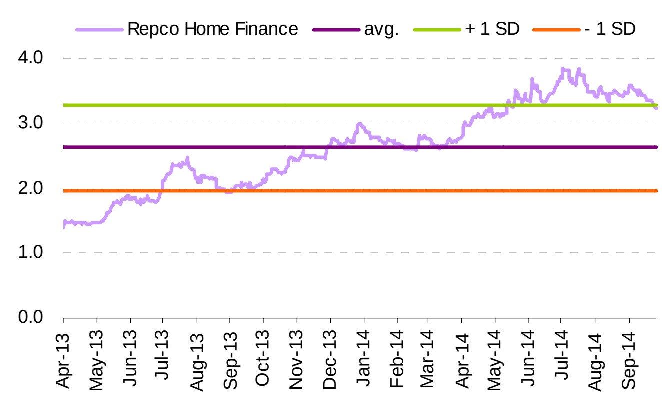
Source: Company, IDFC Securities Research

Exhibit 15: Comparative Valuations (FY14)

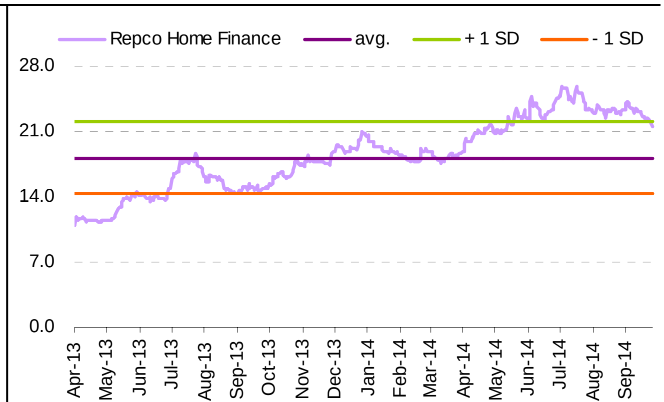
	Repco	LIC HF	HDFC	DHFL*	Gruh Finance
Price (Rs/ share**)	411	302	1,057	318	192
RoAA (%)	2.6	1.5	2.6	1.4	2.8
RoAE (%)	16.5	18.8	20.5	16.6	33.0
P/BV (x)	3.4	2.0	5.9	1.1	11.4
P/E (x)	23.2	11.6	30.3	7.7	38.9
Dividend Yield (%)	0.3	1.5	1.2	2.5	0.8

*Source: Company, Bloomberg, IDFC Securities Research;*includes special dividend of Rs3/share; **as on 25th Sep 2014*

Exhibit 16: Repco – Trailing P/BV (x)



Repco – Trailing P/E (x)



Source: Company, IDFC Securities Research

Income statement

Year to 31 Mar (Rs m)	FY10	FY11	FY12	FY13	FY14
Net Interest Income	**656**	**864**	**1,033**	**1,258**	**1,916**
yoy growth (%)	*63.1*	*31.8*	*19.6*	*21.8*	*52.3*
Fee Income	89	117	133	144	190
Trading Profits	(1)	-	-	-	-
Non Interest income	88	117	133	144	190
Net Operating Revenue	744	981	1,166	1,402	2,106
yoy growth (%)	*64.6*	*31.9*	*18.8*	*20.2*	*50.3*
Operating Expenses	(94)	(150)	(194)	(242)	(388)
yoy growth (%)	*28.6*	*58.4*	*29.7*	*24.6*	*60.4*
PPOP	**649**	**831**	**972**	**1,160**	**1,718**
yoy growth (%)	*71.6*	*28.0*	*16.9*	*19.4*	*48.1*
Provisions for Bad Debts	(38)	(39)	(155)	(92)	(226)
Other Provisions	-	-	-	-	(1)
Profit Before Tax	611	793	816	1,067	1,491
Tax	(168)	(211)	(202)	(268)	(390)
Profit After Tax	**443**	**582**	**614**	**800**	**1,101**
yoy growth (%)	*64.2*	*31.1*	*5.7*	*30.1*	*37.7*

Balance sheet

As on 31 Mar (Rs m)	FY10	FY11	FY12	FY13	FY14
Customer Loans	**14,116**	**20,735**	**28,022**	**35,447**	**46,619**
yoy growth (%)	*42.2*	*46.9*	*35.1*	*26.5*	*31.5*
Investments	21	21	81	81	124
Cash & bank balances	642	85	175	2,101	219
Fixed Assets	17	30	33	45	50
Other Assets	164	75	118	139	192
Total assets	**14,960**	**20,945**	**28,429**	**37,813**	**47,204**
Networth	**1,950**	**2,477**	**3,033**	**6,345**	**7,411**
Borrowings	12,577	18,098	24,860	30,647	39,020
Other Liabilities	451	397	615	932	959

Key Financial Ratios

Year to 31 Mar	FY10	FY11	FY12	FY13	FY14
RoA	3.5	3.2	2.5	2.4	2.6
RoE	28.5	26.3	22.3	17.1	16.0
Tier I Capital adequacy	16.4	12.8	13.3	24.9	24.0
Gross NPL	1.2	1.2	1.4	1.5	1.5
Net NPL	0.9	0.9	0.9	1.0	0.7
Loan Loss Coverage	25.3	27.7	30.8	33.7	51.5
AUM / Equity	7.7	8.5	9.4	6.0	6.4
Assets / Equity	7.7	8.5	9.4	6.0	6.4
Dividend Payout	10.5	8.0	8.3	8.6	6.8

Key valuation metrics

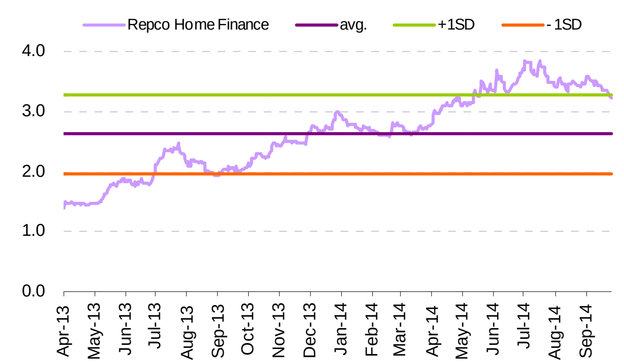
Year to 31 Mar	FY10	FY11	FY12	FY13	FY14
Net Profit	443	582	614	800	1,101
EPS (Rs)	10.4	12.5	13.2	14.7	17.7
EPS growth (%)	(25.5)	20.1	5.7	11.3	20.3
PE (x)	39.4	32.8	31.1	27.9	23.2
P/BV (x)	9.0	7.7	6.3	3.5	3.4
P/Adj BV (x)	10.5	8.3	6.9	4.3	3.6
P/PPOP (x)	39.4	30.7	26.3	22.0	14.9
RoA (%)	3.5	3.2	2.5	2.4	2.6
RoE (%)	28.5	26.3	22.3	17.1	16.0
Dividend Yield (%)	0.3	0.2	0.3	0.3	0.3

** calculated on weighted average shares*

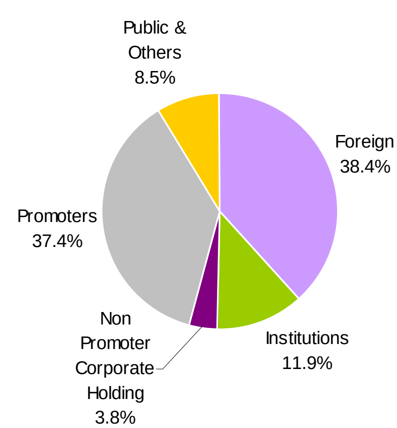
Key Operating Ratios

Year to 31 Mar (Rs m)	FY10	FY11	FY12	FY13	FY14
Net Interest Margin	522	484	420	381	451
Non Interest Income / Operating Income	11.8	11.9	11.4	10.3	9.0
Cost/Income	12.7	15.3	16.7	17.3	18.4
Operating Expense/Avg assets	0.7	0.8	0.8	0.7	0.9
Credit Costs / Avg Loans	0.4	0.3	0.7	0.3	0.6
Effective Tax Rate	27.5	26.6	24.7	25.1	26.2
Net Interest Margin (AUM)	522	484	420	381	451

Trailing P/BV (x)



Shareholding pattern



As of June 2014

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