07 May 2016

Company Research

Repco Home Finance (RHFL.NS)

India | Banks

BUY (prev: Hold)

Price: INR612.10

Target: INR750.00 (prev: INR735.00)

Forecast Total Return: 22.9%

Market Cap: INR38bn

Average daily volume: 94k

Differentiated

Repco has built a niche in the housing finance space with high share of self-employed (58%), high share of construction loans (50%) and origination through loans "melas" (60%). We expect the company to post loan book and EPS growth of c.25% CAGR over FY15-18E given its small size, potential for geographic expansion and niche operating segments (within housing finance). We expect RoEs to improve to 19% as financial leverage improves from 7.0x to 8.0x over FY16E-FY19E. Post recent share price weakness, Repco trades at 2.5x FY18E P/B. Upgrade to BUY with a revised TP of Rs750.

- **Housing finance company with competitive advantages** – Repco is a niche HFC with focus on self-employed segment, high share of loans for construction of houses and higher (versus peers) Instalment to income ratio. As a result, 30 days+ past dues for the company is 12%+. A higher softer delinquency acts as a barrier to entry for Banks and large HFCs seeking to operate in Repco's target segment. Despite high soft delinquencies, net write-offs are just 0.06% of cumulative disbursements as of FY2015 highlighting superior underwriting. Cost effective loan origination through loan "melas" and referrals is another source of competitive advantage.
- **Loan book should grow at 25% CAGR over FY16E-FY19E** – We expect Repco to post loan book growth of 25% CAGR over FY16E-FY19E given it is operating in a) under-penetrated self-employed segment; b) it has significant potential of geographical expansion as well as penetration in existing states and c) current small size of the company at 0.7% of industry.
- **RoEs should improve to 19% till FY2019E** – We expect RoEs to increase to 19% by FY18E as financial leverage increases from 7.0x to 8.0x. We have factored in a 10bps decline in RoAs over FY16E-FY18E on account of increase in financial leverage.
- **Valuations** – At 2.5x FY18E P/B, we find the stock attractive given sustainable growth and healthy RoEs. We value Repco using excess return of equity methodology with a cost of equity of 12.0%. We have increased our 12 month TP to Rs750 (Rs 735) as we upgrades our estimates.

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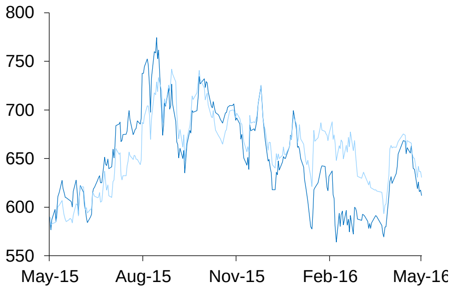
Financials and valuation — Year end: 31 March

	2014A	2015A	2016E	2017E	2018E
Total operating income (INRm)	2,106	2,613	3,321	4,135	5,084
Operating expenses (INRm)	388	547	700	844	1,019
Impairments (INRm)					
Exceptionals (INRm)	0	0	0	0	0
Profit before tax (reported) (INRm)	1,492	1,862	2,328	2,856	3,610
EPS (reported)	17.7	19.8	24.9	30.5	38.6
DPS (INR)	1.2	1.5	1.9	2.3	2.9
tNAV per share (INR)	119.2	139.0	166.7	200.6	243.3
PE (reported) (x)	34.5	30.9	24.6	20.1	15.9
Dividend yield (%)	0.2	0.2	0.3	0.4	0.5
Price/tNAV (x)	5.1	4.4	3.7	3.1	2.5
Return on equity (reported) (%)	0.3	0.2	0.2	0.2	0.2
Core tier 1 capital ratio (CRD IV "fully loaded") (%)	0.2	0.2	0.3	0.2	0.2
Loans:deposit ratio (%)	n.m.	n.m.	n.m.	n.m.	n.m.

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	(3.1)	(3.1)	3.8
Price rel to India S&P BSE 500 - BSE	(4.9)	(6.6)	7.0

Source: FactSet

Self-employed and small-ticket housing are pockets of opportunity in housing finance…

We estimate the demand potential of affordable housing finance (ticket size less than Rs1mn) at Rs10.5Trn.

The current size of the segment is Rs1.5Trn.

Housing finance is a large segment with a current size of Rs11Trn and growing at ~17% YoY. It remains one of the fastest growing segments with low credit costs among financial services. Within housing finance, the profitability of the loans vary for different segments.

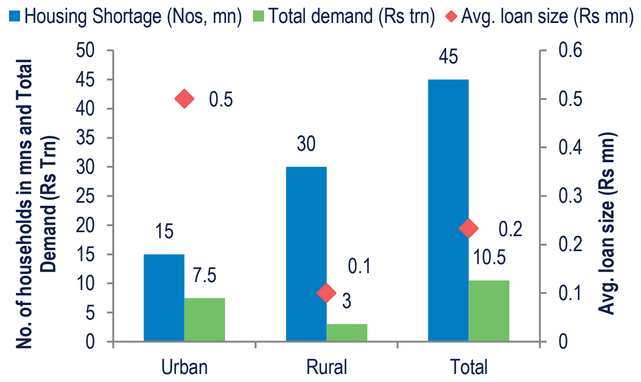
Large ticket size salaried housing is commoditized where pricing is the biggest deciding factor. Our back of the envelope calculation suggests that the salaried segment is well penetrated leading to lower (than market) growth rate and profitability.

The two segments within housing finance where significant growth opportunities exist are a) low ticket size home loans and b) self-employed home loans, in our view. These segments have –

- Low penetration of home loans
- Opportunity size is huge
- Some pricing power for lenders

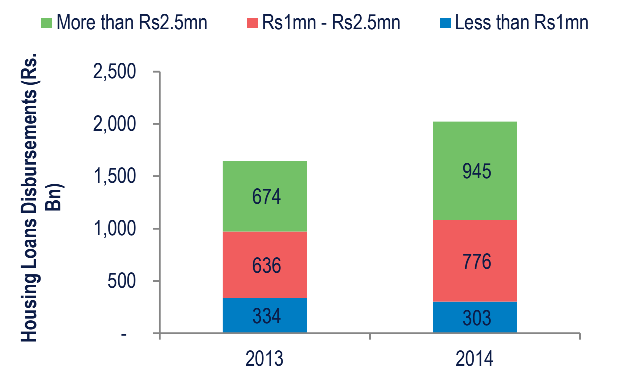
As a result, banks and housing finance companies are incrementally focusing on these two segments particularly in the mid to large ticket size self-employed segment.

Figure 1: Affordable housing finance demand potential at Rs10.5Trn



Source: NHB, Investec Securities estimates

Figure 2: Housing Loans disbursements at just Rs303bn



Source: NHB

Table 1: Self-employed segment remains under-penetrated with respect to housing loans

	Urban			Rural		
	Salaried	Self-employed	Total male work force	Salaried	Self-employed	Total male work force
Work Force (Nos, Mn)	49.7	49.3	120.0	18.0	135.5	250.0
Housing Loans outstanding (Nos, Mn)	9.6	2.4	12.0	2.0	2.0	4.0
Target segment for Housing Loans (Nos, Mn)	30	30		9.0	67.8	
Penetration Rate	32.2%	8.1%		22.2%	3.0%	

Source: NSSO, NHB, Investec Securities estimates

…however, these segments are not easy to operate

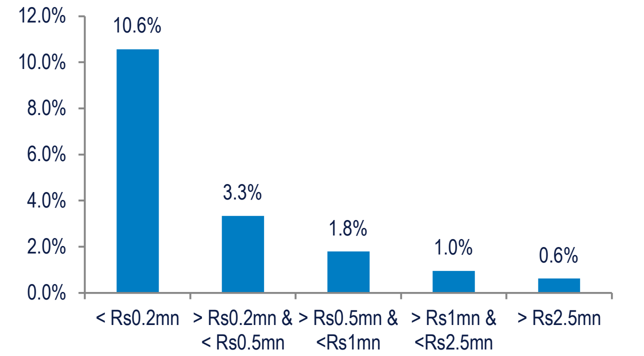
The barriers to entry to the segment are high delinquencies, high operating costs, subjective appraisal, and low awareness about the product.

Self-employed and small ticket size segments are not easy to operate –

- **Subjective appraisal** – The appraisal process in the low ticket size and self-employed segment is more involved that appraising a salaried customer given actual income is different from reported income. Moreover, in the low income group the surplus income for EMI is a low percentage of the income leading to thin margin of error in assessment.

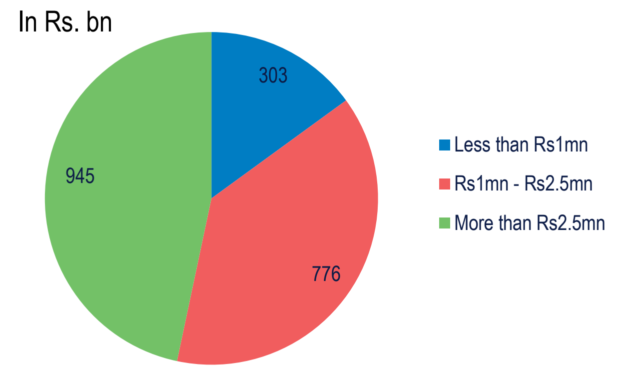
- **High operating costs** – Given the subjective and involved nature of assessment and lower ticket size of loans, the operating costs are high in the segment.
- **High delinquencies** – The delinquencies are high in the low ticket size segment which is highlighted by the experience of PSU banks. PSU banks reported GNPAs of 1.8%+ for ticket size of less than Rs1mn.
- **Small current size of the segment** – The sub Rs1mn segment is Rs303bn in size which is just 15% of the total market leading to large players focusing on more than Rs1mn ticket size segment.
- **Awareness about the availability of finance** – The target borrowers are not aware that they can avail loans for housing at affordable rates. This leads to problems of sourcing and demand for the loans.

Figure 3: GNPA of PSU Banks across ticket size for home loans



Source: NHB

Figure 4: Sub Rs1mn ticket size segment is small for large players



Source: NHB

Repco Home Finance has built a niche in these segments

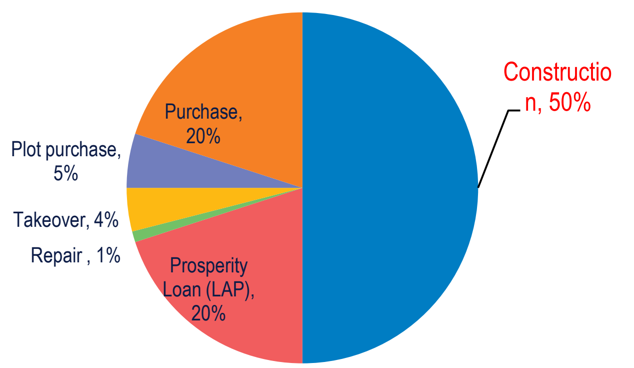
Repco is operating in niche segment within the housing finance sector.

Repco home finance is operating in the affordable housing finance segment and its customer base is predominantly self-employed. The company has certain difference versus its peers which lead to relatively benign competitive environment for the company. These differences are as follows –

- **High share of self-construction of home** – ~50% of the loans are for self-construction of houses which is highest among the top HFCs (Figure 5).
- **High share of self-employed segment** – ~55% of the customers are self-employed which is again highest among the top HFCs (Figure 6).
- **Cost effective loan origination strategy** – ~60% of the loans are originated through loan melas which is a cost effective origination model. The other predominant channel of acquisition is referrals.
- **High Income to instalment Ratio versus peers** – The income to instalment ratio for Repco Home Finance at ~50% is higher than peers. Moreover, Repco also considers income from other sources and relatives while assessing the eligibility of the borrower.
- **Higher soft delinquencies** – The soft delinquencies i.e. 30 days past due is ~12% for Repco. The 90 days GNPAs are also on the higher side versus peers.

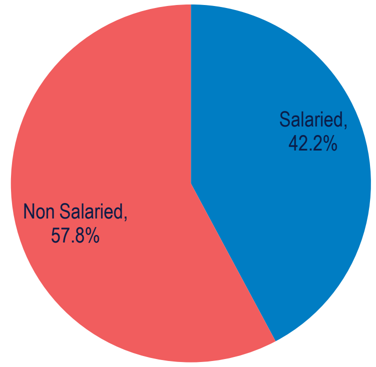
These differentiating factors highlight that Repco underwrites a slightly riskier business versus peers. The historical experience suggests that it has been able to a) adequately price risks, b) recover loans despite higher slippages. The net write-offs since inceptions are just Rs43mn (0.06% of cumulative disbursements) as of FY2015.

Figure 5: Loan book breakup (9MFY2016)



Source: Company Data

Figure 6: High share of self-employed customers



Source: Company Data

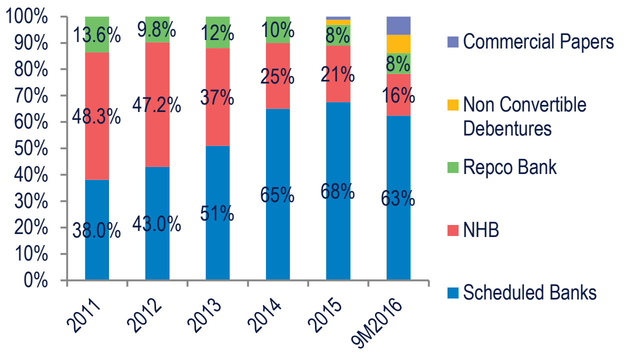
The share of NHB funding has come down over last five years. We expect the share to stabilise at current levels. The share of money-market instruments will increase leading to stable and diversified funding.

Funding profile has stabilised

Over the last four years, the company has reduced the dependence on NHB funding from ~50% to ~15%. Despite the reduction in low cost NHB funding, Repco has posted strong balance sheet growth and maintained its margins. Over time, it has diversified its liability mix through NCDs & Commercial Papers and increasing the share of bank funding (Figure 7).

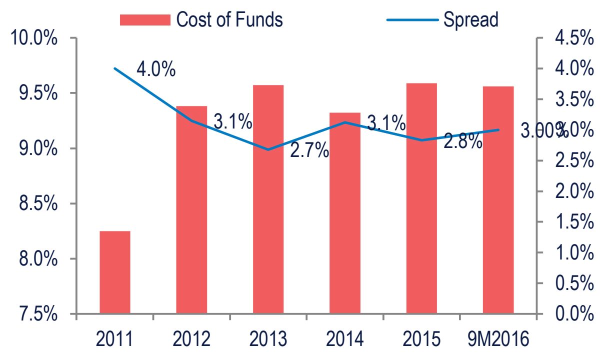
The primary reason for reduction in NHB funding was instituting on-lending spread cap of 2% applicable to borrowings under Rural Housing Fund (at 2% spreads the product was not economical for the company). NHB has increased the spreads to 3.5% under the scheme and hence we do not expect the NHB share to decline materially from hereon.

Figure 7: Funding profile has diversified



Source: Company Data

Figure 8: Maintained spreads despite reduction in NHB funding

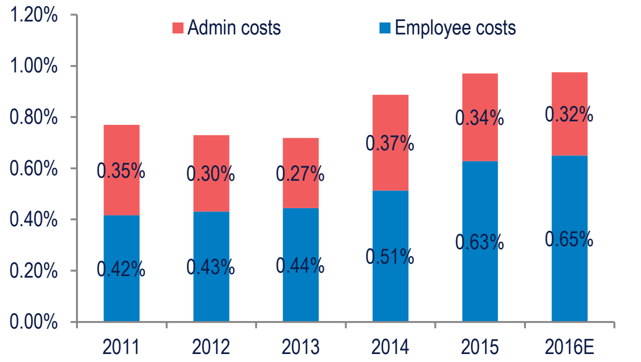


Source: Company Data

Operating costs growth should normalise

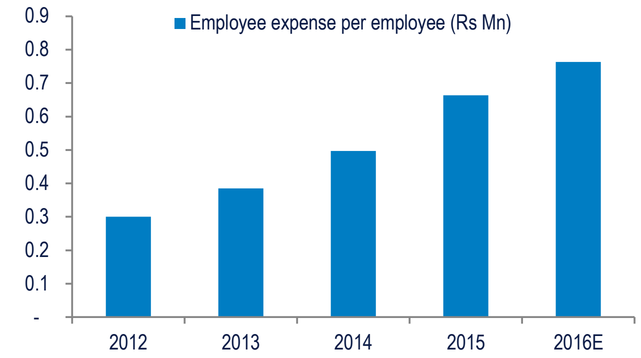
During the last three years, operating expenses as % of loan book has growth from 0.7% to 1% driven by sharp increase in employee costs (Figure 9). Employee costs increased on account of a) increase in salary and b) ESOP expenses. The employee expenses per employee have increased Rs0.3mn to Rs0.75mn from FY2012 to FY2016E (Figure 10). This has helped the company to maintain one of the lowest attrition rates of ~6% in the industry. Incrementally, we expect employee costs to grow at ~25% YoY driven by 10%-12% wage inflation and remaining growth on account of employee addition.

Figure 9: Opex/Loan book has increased in last three years



Source: Company Data, Investec Securities estimates

Figure 10: Empl. exp. per empl. has grown at 26% CAGR (FY12-16E)

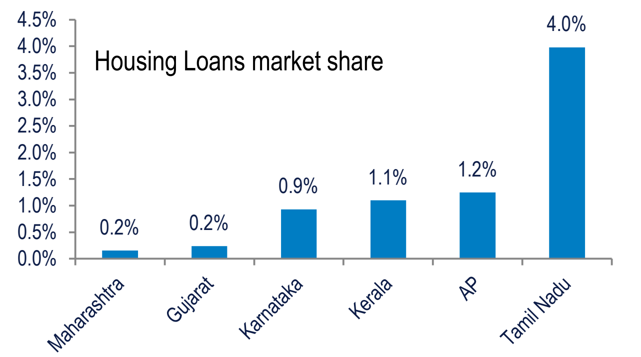


Source: Company Data, Investec Securities estimates

Loan book growth should sustain at 25% CAGR over FY16E-FY18E

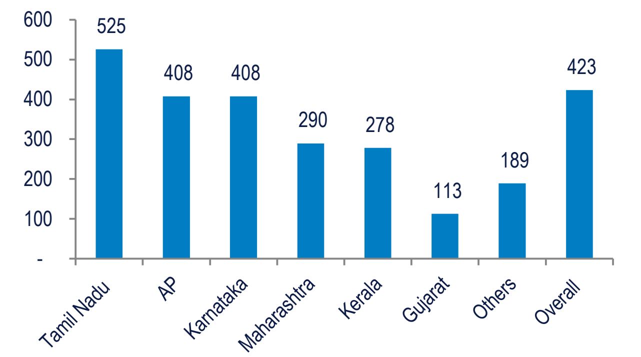
Repco Home Finance has posted a loan book and disbursement CAGR of 34% and 30% over last five years (FY10-FY15). We believe a 25% loan book CAGR is achievable given a) small size of the company, b) potential of further geographic penetration (Figure 11) and c) potential of housing finance in self-employed segment. The company with a loan book of Rs71.5bn as of 9MFY16 is just 0.7% of housing finance sector (loans outstanding of Rs11Trn).

Figure 11: State-wise market share



Source: Company Data, NHB, Investec Securities estimates

Figure 12: Loans per branch – state wise



Source: Company Data

Return ratios to improve

RoEs have been improving over the last three years on account of increase in leverage from 6.1x in FY2014 to 7.2x for FY2016E. We expect leverage to increase to 8.4x which will drive RoEs to 19%. We expect a slight compression on spreads and RoAs over FY2016E to FY2019E.

Table 2: We expect RoEs to improve to 19% as financial leverage improves

	2011	2012	2013	2014	2015	2016E	2017E	2018E	2019E
NII	4.7%	4.1%	3.7%	4.5%	4.4%	4.3%	4.2%	4.1%	3.9%
Fee Income and Other	0.8%	0.7%	0.6%	0.6%	0.6%	0.6%	0.5%	0.5%	0.5%
Total Income	5.5%	4.8%	4.3%	5.0%	4.9%	4.9%	4.7%	4.6%	4.4%
Employee costs	0.4%	0.4%	0.4%	0.5%	0.6%	0.7%	0.6%	0.6%	0.6%
Operating costs	0.3%	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%	0.3%
Operating profit	4.8%	4.1%	3.6%	4.2%	3.9%	3.9%	3.8%	3.7%	3.6%
Credit costs	0.2%	0.6%	0.3%	0.5%	0.4%	0.4%	0.5%	0.4%	0.5%
PBT	4.6%	3.4%	3.3%	3.6%	3.6%	3.5%	3.3%	3.3%	3.1%
PAT (before DTL)	3.3%	2.5%	2.5%	2.6%	2.6%	2.5%	2.4%	2.4%	2.3%
RoE (before DTL)	**26.3%**	**22.3%**	**17.1%**	**16.0%**	**17.1%**	**17.9%**	**18.3%**	**19.1%**	**19.0%**
Leverage (x)	8.0	8.8	6.9	6.1	6.6	7.2	7.6	8.1	8.4

Source: Company Data, Investec Securities estimates

Change in estimates

We have upgraded our loan book growth estimates for FY17 and FY18.

Loan loss provisions have been revised upwards on account of management guidance of increasing PCR to 100% by FY19E.

Table 3: Changes in estimates

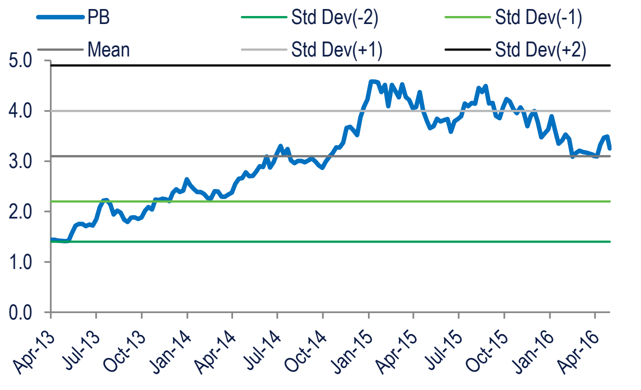
	Old		New		% Change	
Rs millions	**FY17E**	**FY18E**	**FY17E**	**FY18E**	**FY17E**	**FY18E**
Loan Book	96,119	119,066	98,604	124,887	*3%*	*5%*
NII	3,391	4,026	3,667	4,517	*8%*	*12%*
Total Income	3,756	4,469	4,135	5,084	*10%*	*14%*
Opex	789	932	815	989	*3%*	*6%*
Pre-provisioning profit	2,967	3,537	3,320	4,094	*12%*	*16%*
Provisions	253	298	434	455	*72%*	*53%*
PBT	2,685	3,209	2,856	3,610	*6%*	*12%*
PAT	1,783	2,131	1,897	2,397	*6%*	*12%*
EPS	29.0	34.0	31	39	*5%*	*13%*

Source: Investec Securities estimates

Valuations

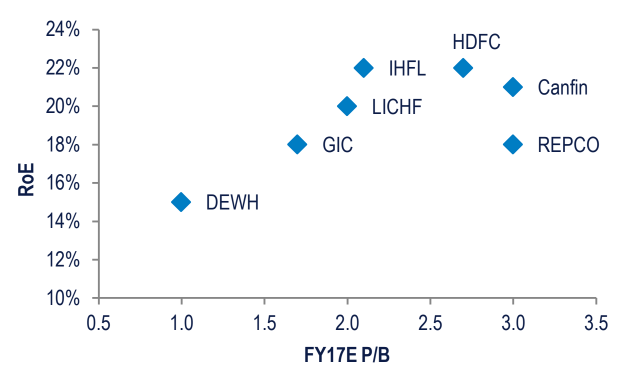
We value Repco Home finance using two stage excess return on equity model with cost of equity of 12%. At our target price, Repco is valued at 3.1x FY18E P/B. Repco Home finance trades at 2.5xFY18E P/B and 14x FY18E P/E. On P/B bands, the stock trades at mean valuations and versus peers it is trading on the higher side.

Figure 13: Repco – Band Chart



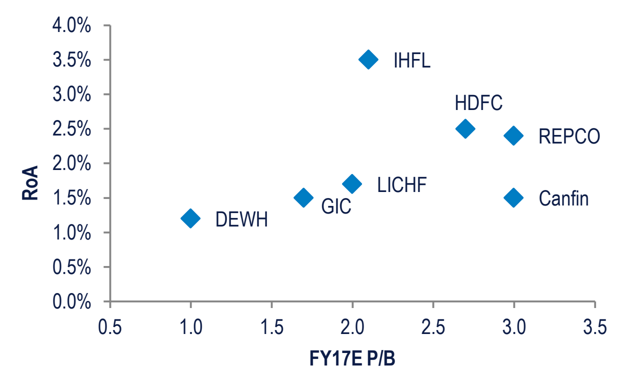
Source: Bloomberg

Figure 14: Repco – ROEs versus P/B



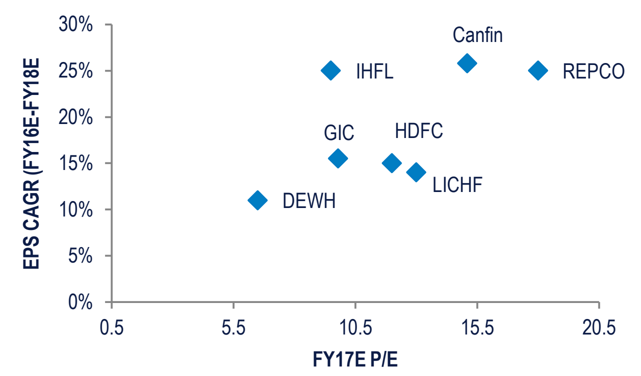
Source: Factset

Figure 15: Repco – RoAs versus P/B



Source: Factset

Figure 16: Repco – EPS CAGR (FY16E – FY18E) versus P/E



Source: Factset

Table 4: Valuation ratios

Valuation Metrics	2014	2015	2016E	2017E	2018E
P/E*	34.4	27.6	22.3	18.2	14.4
P/BV*	5.1	4.4	3.7	3.0	2.5
ROA	2.6%	2.6%	2.5%	2.4%	2.4%
ROE	16.0%	17.1%	17.9%	18.3%	19.1%
Dividend Yield	0.2%	0.2%	0.3%	0.4%	0.5%
BV	119	131	156	187	225
Diluted EPS (Rs)	18	20	25	31	39

Implied Valuation Ratios	2014	2015	2016E	2017E	2018E
P/E	42.3	34.0	27.4	22.4	17.7
P/BV	6.3	5.4	4.5	3.7	3.1

*Adjusted for deferred tax liability, Source: Investec Securities estimates

Table 5: Key Ratios and metrics

Key Ratios	2014	2015	2016E	2017E	2018E
Yield on Loans	12.45%	12.42%	12.30%	12.10%	12.05%
Cost of funds	9.32%	9.59%	9.35%	9.10%	9.10%
Spread	3.1%	2.8%	3.0%	3.0%	2.9%
NIM	4.5%	4.3%	4.3%	4.2%	4.0%
Gross NPAs	1.5%	1.3%	1.4%	1.5%	1.4%
Net NPAs	0.7%	0.5%	0.5%	0.4%	0.3%

Capital Ratios	2014	2015	2016E	2017E	2018E
Total CAR ratio	24.5%	20.3%	22.4%	21.1%	20.2%
Tier 1 CAR	24.5%	20.3%	22.4%	21.1%	20.2%

Source: Investec Securities estimates

Investec

Table 6: Financial Summary

P&L Summary	2014	2015	2016E	2017E	2018E
Net Interest Income	1,861	2,310	2,934	3,667	4,517
Fee Income	186	231	314	396	495
Other Income	59	72	72	72	72
Total Income	**2,106**	**2,613**	**3,321**	**4,135**	**5,084**
Operating expenses	**364**	**518**	**670**	**815**	**989**
Operating Costs	153	183	223	263	309
Employee Costs	211	335	447	552	680
Pre Provisioning Profit	**1,742**	**2,095**	**2,650**	**3,320**	**4,094**
Provisions	226	203	293	434	455
Operating Profit	**1,516**	**1,891**	**2,358**	**2,886**	**3,639**
Depreciation	24	29	29	29	29
PBT	**1,492**	**1,862**	**2,328**	**2,856**	**3,610**
Less:Tax	390	489	629	771	975
PAT before DTL	**1,101**	**1,373**	**1,700**	**2,085**	**2,635**
DTL	-	142	154	189	238
PAT after DTL	**1,101**	**1,231**	**1,546**	**1,897**	**2,397**
Basic EPS (Rs)	18	20	25	31	39
Diluted EPS (Rs)	18	20	25	31	39
Dividend per share(Rs)	1.2	1.5	1.9	2.3	2.9

Balance Sheet Summary	2014	2015	2016E	2017E	2018E
Equity					
Reserves and Surplus					
Networth	7,411	8,121	9,682	11,596	14,016
Deferred tax liability	-	529	683	871	1,109
Borrowings	39,020	51,044	66,975	86,386	110,250
Total Sources of funds	**46,431**	**59,694**	**77,339**	**98,854**	**125,375**
Loan Book	46,621	60,129	77,278	98,604	124,887
Investments	124	124	124	124	124
Fixed Assets	50	89	89	89	89
Other Assets	187	-	-	-	-
Net working Capital	(578)	(835)	(835)	(835)	(835)
Total Application of funds	**46,404**	**59,508**	**76,657**	**97,982**	**124,266**

Source: Investec Securities estimates

Summary Financials (INRm)

Year end: 31 March

Income Statement	2014	2015	2016E	2017E	2018E
Net interest income	1,861	2,310	2,934	3,667	4,517
Other operating income	244	303	386	468	567
Total operating income	**2,106**	**2,613**	**3,321**	**4,135**	**5,084**
Net insurance claims	0	0	0	0	0
Net operating income pre impairments	**1,718**	**2,065**	**2,621**	**3,290**	**4,065**
Impairments					
Net operating income					
Expenses	388	547	700	844	1,019
Operating income					
JVs and associates	0	0	0	0	0
Profit before tax pre-exceptionals	**1,492**	**1,862**	**2,328**	**2,856**	**3,610**
Exceptionals	0	0	0	0	0
Profit before tax	**1,492**	**1,862**	**2,328**	**2,856**	**3,610**
Tax	390	631	782	960	1,213
Profit after tax	1,101	1,231	1,546	1,897	2,397
Minorities/Preference dividends					
Profit attributable	1,101	1,231	1,546	1,897	2,397
EPS (reported)	17.7	19.8	24.9	30.5	38.6
DPS (INR)	1.2	1.5	1.9	2.3	2.9
Average number of group shares (m)	62	62	62	62	62
Total number of shares in issue (m)	62	62	62	62	62

Balance sheet	2014	2015	2016E	2017E	2018E
Customer loans	46,621	60,129	77,278	98,604	124,887
Customer deposits	0	0	0	0	0
RWAs	13,605	18,380	24,883	30,247	42,695
Core tier 1 capital ratio (%)	0.2	0.2	0.3	0.2	0.2

Source: Company accounts, Investec Securities estimates

Target Price Basis

Excess return on equity

Key Risks

Correction in real estate prices; Competition

Disclosures

Third party research disclosures

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	Expected total return	All stocks		Corporate stocks	
	12m performance	Count	% of total	Count	% of total
Buy	greater than 10%	197	61%	84	43%
Hold	0% to 10%	93	29%	10	11%
Sell	less than 0%	34	10%	1	3%

Source: Investec Securities estimates

Stock ratings for Indian stocks — Stock ratings for research produced by Investec Bank plc

	Expected total return	All stocks		Corporate stocks	
	12m performance	Count	% of total	Count	% of total
Buy	greater than 15%	45	61%	0	0%
Hold	5% to 15%	18	24%	0	0%
Sell	less than 5%	11	15%	0	0%

Source: Investec Securities estimates

Stock ratings for African* stocks — Stock ratings for research produced by Investec Securities Limited

	Expected total return	All stocks		Corporate stocks	
	12m performance	Count	% of total	Count	% of total
Buy	greater than 15%	33	45%	5	15%
Hold	5% to 15%	20	27%	1	5%
Sell	less than 5%	21	28%	3	14%

Source: Investec Securities estimates

*For African countries excluding South Africa, ratings are based on the 12m implied US dollar expected total return (ETR). This is derived from the expected local currency (LCY) ETR by making assumptions on the 12month forward exchange rates for the respective currencies. For South African stocks, ratings are based on the ETR in rand terms.

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Company disclosures

Repco Home Finance

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Recommendation history (for the last 3 years to previous day's close)

Repco Home Finance (RHFL.NS) – Rating Plotter as at 07 May 2016

Source: Investec Securities / FactSet

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