

# RepcO Home Finance



**Catch it young**

## Repc Home Finance: Catch it young

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Investors are advised to refer through disclosures made at the end of the Research Report.

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# Repco Home Finance

BSE Sensex  
27,507

S&P CNX  
8,319

CMP: INR600

TP: INR726 (+21%)

Buy



## Stock Info

Bloomberg	REPCO IN
Equity Shares (m)	61.0
52-Week Range (INR)	725/369
1, 6, 12 Rel. Per (%)	0/13/30
M.Cap. (INR b)	36.6
M.Cap. (USD b)	0.6
AvgVal. INRm/Vol'000	105/201
Free float (%)	62.8

## Financial Snapshot (INR Million)

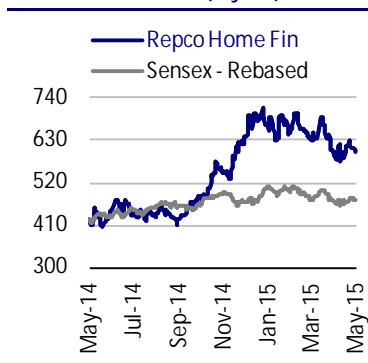
Y/E March	2016E	2017E	2018E
Net Income	3,321	4,183	5,421
OP	2,660	3,388	4,467
NP	1,596	2,027	2,674
EPS (INR)	26	33	43
BV/Share (INR)	153	182	219
P/E (x)	23.4	18.5	14.0
P/BV (x)	3.9	3.3	2.7
ROE (%)	18.1	19.4	21.4
ROA (%)	2.2	2.2	2.2
Div. Payout (%)	12	12	12
Div. Yield (%)	0.4	0.5	0.7

## Shareholding pattern (%)

As on	Mar-15	Dec-14	Mar-14
Promoter	37.3	37.3	37.4
DII	16.0	16.5	10.5
FII	29.4	30.1	6.6
Others	17.4	16.2	45.6

FII Includes depository receipts

## Stock Performance (1-year)



## Catch it young

### Multi-year growth play on under-penetrated small ticket housing finance

- n Niche presence in self-employed segment offers profitable growth prospects. Market share is a mere 60bps in FY15.
- n NHB's refinancing aids borrowing costs; ratings upgrade a catalyst to lower cost of funds.
- n Healthy asset quality despite operating in self-employed segment. Committed to increase PCR to 100%.
- n Lean operating cost, steady margins and credit cost to drive earnings CAGR of 29% over FY15-18E.
- n Low gearing (7.4x) and rising RoEs to help deliver 30% loan growth CAGR for next five year without dilution. A modest expansion in branch network can support this growth with an option to step up growth.
- n Superior and sustainable return ratios; initiate coverage with a Buy.

**Niche presence in self-employed segment offers strong growth prospects and imparts pricing power:** Housing finance to self-employed and small ticket segment (INR1m v/s INR2.5m+ large HFCs) remains underpenetrated, despite regulators favoring small ticket size loans by allowing lower risk weight (50% v/s 75% on loans above INR3m) and cheaper refinance options (NHB refinances at 7-9%). Repco has very well exploited the gaps in the housing finance market with respect to right geographies, lower ticket size and customer profile. This strategy has worked well as underpenetrated/less-crowded markets helped the company with strong growth (delivered 2x sector average growth over FY10-15) and better pricing power with superior yields (12.5%+ v/s 11% for bigger HFCs).

**NHB's refinancing aids borrowing costs; ratings upgrade a catalyst to lower cost of funds:** NHB offers various schemes under which it refinances banks and HFCs at attractive rates of 7-9%. Most of these schemes are designed to encourage lending in semi-urban, rural and periphery of urban areas where ticket sizes are low. Given the design of schemes, REPCO has been a disproportionate beneficiary of the low-cost funds as NHB funds form 21% of borrowings. The combination of higher yields and low cost funding helps Repco generate 3%+ spreads and 4.5% margins. Likely ratings upgrade from (A+ to AA-) will help it reduce the funding cost and tap low-cost funds from money market.

**Healthy asset quality despite operating in self-employed segment:** REPCO adheres to conservative lending practices such as a) LTV of 65% and installment-to-income ratio of 50%, b) no-use of DSA model and c) zero developer/builder loan portfolio. Moreover, it follows two-tier credit appraisal policy whereby the head office pursues credit appraisal and credit scrutiny is done by credit officer. These practices have enabled the company to maintain stable asset quality, with gross GNPL/NNPA of 1.3%/0.5% and coverage ratio of 62% (as on FY15). Total loans written off since inception stand at a mere INR40m (0.08% of total cumulative) disbursements.

**Lean operating cost, steady margins and credit cost to drive earnings CAGR of 29% over FY15-18E:** Aided by lean operating cost (CI ex ESOP ~18%), steady margins (4.5%) and credit cost (45bp over the next three years), REPCO's net profit is likely to post 29% CAGR over FY15-18E; we expect it to report RoA of 2.2% and RoE of 21% by FY18E.

**Superior and sustainable return ratios; initiate coverage with a Buy:** Despite a healthy RoA, the current RoEs at 16% seem optically low due to significant under-leverage (7.4x v/s 12x-13x for other HFCs). With stable execution and steady RoA of 2.2%, RoE should ideally be ~25% on a fully leveraged basis. Even if Repco delivers 30% CAGR in loans for the next five years, it will continue to witness expansion in RoE without requiring significant dilution. We model a peak RoEs of 24% by FY20 before the next dilution.

In our view, Repco will continue to trade at premium multiples led by its niche business model, high capitalization, consistent execution, inherently high profitability with the ability to improve return ratios, and minimal asset quality overhang—given a secured loan book. Ongoing downward trend in interest rates could also prove to be a trigger for profitability. We initiate coverage with a **Buy** and assign a fair value multiple of 4x FY17E P/BV INR726 per share, which yields an upside of 21% from current market price.

#### Exhibit 1: Key operating metrics (%)

Y/E March	2010	2011	2012	2013	2014	2015	2016E	2017E	2018E
Yields on loans	12.9	12.2	12.4	12.2	12.6	12.5	12.6	12.5	12.4
Cost of funds	8.5	8.3	9.4	9.6	9.3	9.6	9.2	9.0	8.9
NIMs	5.4	4.9	4.2	3.9	4.6	4.4	4.5	4.3	4.3
Cost / Income	12.7	15.3	16.7	17.3	18.4	21.0	19.9	19.0	17.6
GNPA	1.2	1.2	1.4	1.5	1.5	1.3	1.2	1.1	1.0
RoE	25.6	26.5	22.3	17.1	16.0	15.9	18.1	19.4	21.4
RoA	3.50	3.24	2.48	2.41	2.58	2.28	2.24	2.16	2.20
EPS (INR)	9.5	12.5	13.2	12.9	17.7	19.7	25.6	32.5	42.9
EPS Growth	178.7	31.1	5.7	-2.7	37.6	11.4	29.7	27.0	31.9
BVPS (INR)	42.0	53.3	65.3	102.1	118.7	130.2	152.9	181.6	219.5

Source: Company, MOSL

#### Exhibit 2: Housing finance companies: Valuation Metrics

	CMP (INR)	Tgt Price (INR)	Upside (%)	3yr EPS CAGR	P/BV (x)			RoA (%)			RoE (%)		
					FY16E	FY17E	FY18E	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E
HDFC	1,243	1,395	12	18.2	5.6	5.0	4.5	2.5	2.5	2.6	21.4	22.8	24.4
LICHF	419	526	26	19.4	2.2	1.9	1.6	1.6	1.3	1.3	22.0	18.0	18.1
DEWH	440	735	67	23.7	1.2	1.0	0.9	1.3	1.3	1.3	15.4	16.4	17.5
IHFL	594	735	24	20.4	2.8	2.4	2.1	3.9	3.9	3.7	31.9	33.5	35.3
GRHF*	233	NA	NA	27.6	9.1	7.2	6.5	2.8	2.9	2.9	32.9	31.7	31.0
REPCO	600	726	21	29.5	3.9	3.3	2.7	2.2	2.2	2.2	18.1	19.4	21.4

Source: Company, MOSL\*Bloomberg Estimate

## Niche in self-employed segment

**Strong foothold in the under-penetrated segment offers growth potential**

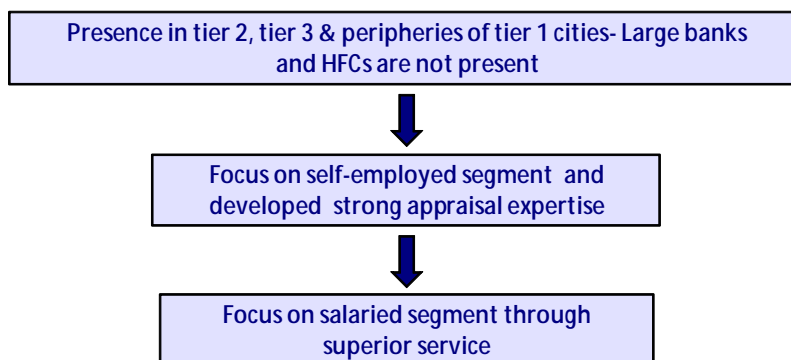
- n Self-employed accounts for 34% of the workforce; however, its share is 10% of the mortgage loans from banks and large housing finance companies.
- n Exposure to self-employed segment gives pricing power and funding benefits.
- n Deeper penetration and geographical expansion to drive 30% CAGR over next 3 years.

Most tier I cities are catered by banks and large HFCs. This offers huge untapped opportunity in the self-employed segment in under-penetrated areas.

### Focus on self-employed borrowers in under-penetrated areas

REPCO's business model caters to the mortgage needs of customers in the self-employed segment and low- and middle-income group. The company has evolved from a regional player (concentrated in Tamil Nadu) and now has a more diverse presence. It has carved a niche for itself by a) building presence in tier II and III cities and peripheries of tier I cities, b) focusing on the self-employed segment through its strong appraisal technique, and c) tapping salaried employees through superior customer service.

**Exhibit 3: Strategy - focus on self-employed and underserved areas**



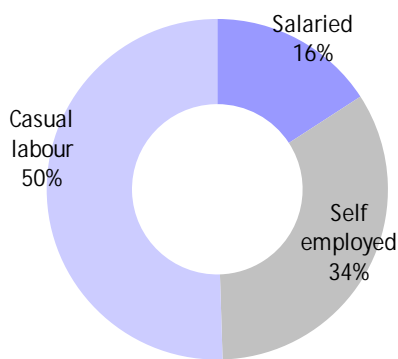
Source: Company, MOSL

Despite accounting for 34% of the workforce, the self-employed segment has been ignored by large banks and HFCs due to difficulty in credit appraisal.

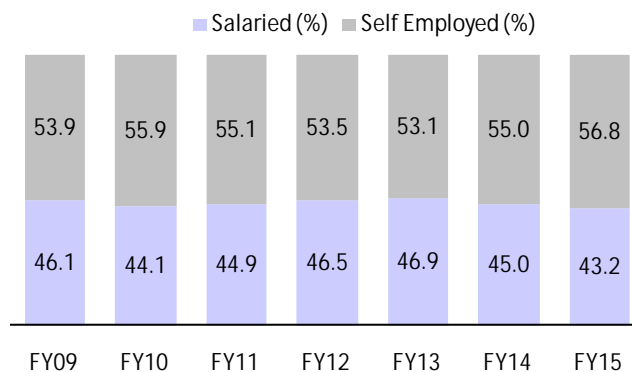
### Large banks and HFCs have ignored the self-employed segment due to difficulty in credit appraisal

The strategy to focus on self-employed segment has worked well in its favor as most tier I cities are widely catered by banks and NBFCs, thereby leaving limited room for a new player, who will not survive the existing competition. Also, as per the National Sample Survey office, the segment accounts for 34% of the workforce but accounts for ~10% of the loans—large banks and HFCs have ignored the segment due to difficulty in credit appraisal, lack of proper documentation, intense KYC checks, NPL volatility and aggressive follow-ups needed post disbursement. Realizing the vacuum and size of opportunity, certain niche HFCs, including REPCO, have made strong inroads into this segment.

**Exhibit 4: Self-employed workforce is 34%; share in loans is ~10%**      **Exhibit 5: Capturing market: Self-employed accounts for 56%+ of loan book**



Source: NSSO, MOSL



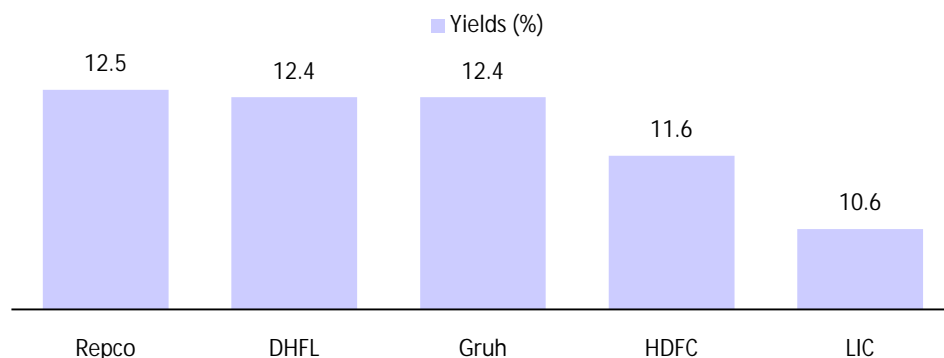
Source: Company, MOSL

Focus on self-employed helps impart pricing power, and avail low-cost NHB funding

**Strategic focus on underserved segment yields dual benefit**

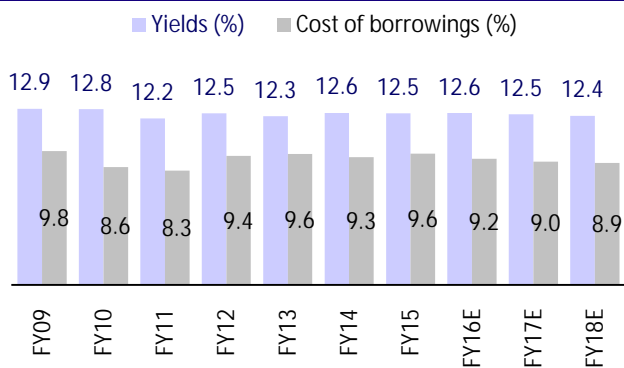
REPCO’s portfolio comprises low-ticket size loans (average ticket size INR1.2m) in areas with low population. Around two-thirds of its total business emanates from tier II and III cities. This proposition gives dual benefit to the company—both on the asset and liability side. On the lending side, balanced mix of loans to self-employed and loan against property (LAP) helps it command pricing power, thus resulting in better yields. On the liability side, it gets dual benefit of NHB’s refinancing facility and better rate from banks, giving it access to cheaper avenues of borrowing. This leads to healthy margins; coupled with lean operating cost model (Cost Income 21%, including ESOP charge; ~18% excluding ESOP charge), this generates superior return ratios.

**Exhibit 6: REPCO commands higher yields v/s large HFCs**



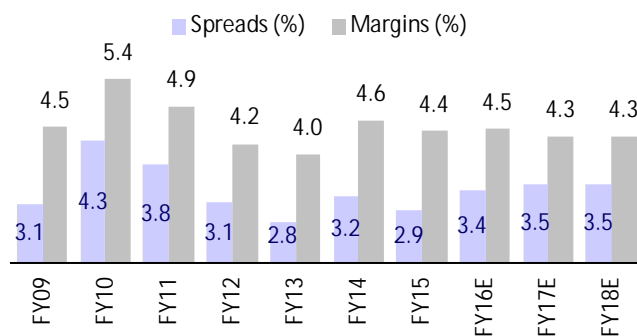
Source: Company, MOSL

**Exhibit 7: Superior yields of +12.5% and low CoF at 9.6%...**



Source: Company, MOSL

**Exhibit 8: ...leads to +3% spreads and +4.3% NIM**



Source: Company, MOSL

**Loan book dominated by non-salaried segment**

Loan book mix is dominated by non-salaried category, which forms 56%+ of the loan book. REPCO also offers loans against property (+19% of loan book), though it has no exposure to developer loans. The self-employed segment is under-penetrated and underserved by larger HFCs and banks, hence less competitive.

**Exhibit 9: REPCO has the highest proportion of non-salaried loans**

Company	% of Non-Salaried Loans
Repc Home Finance	57
Gruh Finance	37
Dewan Housing	25
HDFC	15
LIC Housing Finance	15

Source: Company, MOSL

REPCO has successfully penetrated into this segment, given its direct customer contact, tailored approach and personal evaluation processes followed during credit appraisal. This segment has lesser competition and hence yields are higher. As of FY15, the company had a yield of 12.5% and NIM of 4.5%+. It had a network of 142 branches (almost 75% in underserved areas) and satellite offices as of March 2015.

**Exhibit 10: Wide range of products**

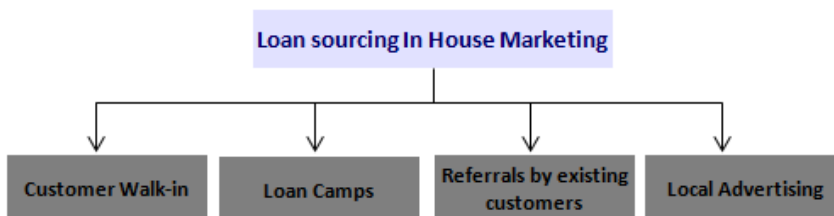
Home loan Product	Product Details
Dream Home Loan	Loans for the construction or purchase of a property.
Home Makeover Loan	Loans for the purpose of repairs, renovation, and / or extension of a property.
Plot Loans	Loans for outright purchase of plots for construction of a house.
Super Loan	Loans for construction, including extensions on land owned by borrower's parents.
Fifty Plus Loan	Persons above 50 years; loan repayments & disbursements are structured around the retirement
NRI Housing Loan	Loans to non-resident Indians for the construction and purchase of houses in India.
Prosperity Loan	Loans against mortgage of immovable property for such purposes as may be desired by the borrower.
New Horizon Loan	Loans for purchase and / or construction of non-residential and commercial property.
<b>LAP Products</b>	
Prosperity Loan	Loans against mortgage of immovable property for such purposes as may be desired by the borrower.
New Horizon Loan	Loans for purchase and/or construction of non-residential and commercial property.

Source: Company, MOSL

### In-house loan sourcing, sans marketing intermediaries

The company's marketing strategy focused on direct and localized advertising. Loan camps, customer walk-ins and referrals from existing customers are the key sourcing channels used by REPCO.

**Exhibit 11: Loan sourcing through direct marketing initiatives, referrals**



Source: Company, MOSL

Loan camps are the primary channel for sourcing and constitute +50% of the total loans sourced

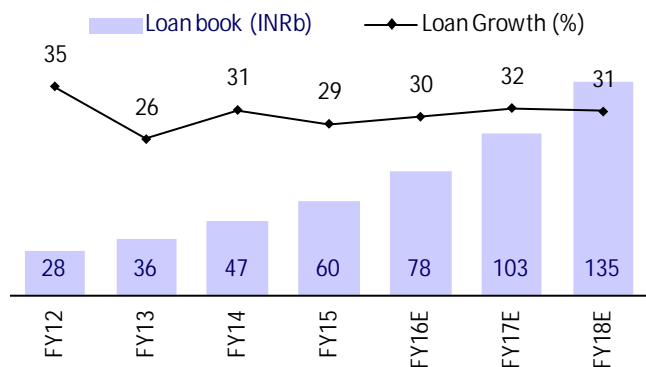
Among its channels, loan camps are the primary channel for sourcing and constitute +50% of the total loans sourced. Promotions for loan camps are done by circulation of pamphlets and a print advertisement through local newspapers two to three days prior to the camps. The major incentive for a customer to attend the loan camp is quick in-principle approval and waiver of administrative fees of 0.5%. REPCO does not use marketing intermediaries to communicate or service its customers. It also relies on local advertising—it gives ads in local newspapers and local TV channels—and referrals by existing customers.

While historically increase in customer additions and increase in average ticket size has driven the loan book growth, further growth will be driven by deeper penetration and branch expansion.

### Deeper penetration, geographical expansion leads loan growth (30% CAGR)

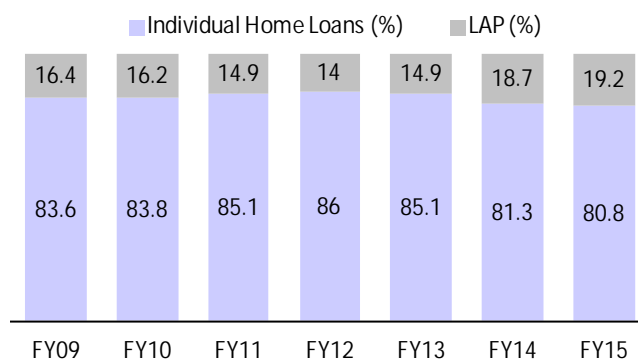
Over the last five years (FY10-15), REPCO's loan book posted 34% CAGR. While the small base effect contributed to strong growth rates, the company also steadily gained market share—up from 0.2% in FY08 to 0.6% in FY15. While historically the increase in customer additions and average ticket size has driven the loan book, further growth will be driven by its strategy to a) expand in neighboring areas of existing branches, thereby encashing on the brand and leveraging the experience of its familiarity of local customers' profile, b) expand footprint in a phased manner by selectively setting up branches in states such as Gujarat, Maharashtra, Odisha and West Bengal and c) increasing the proportion of LAP to +20%.

**Exhibit 12: Loan book to post CAGR of 30% over the next three years**



Source: Company, MOSL

**Exhibit 13: Increasing proportion of LAP to support growth**

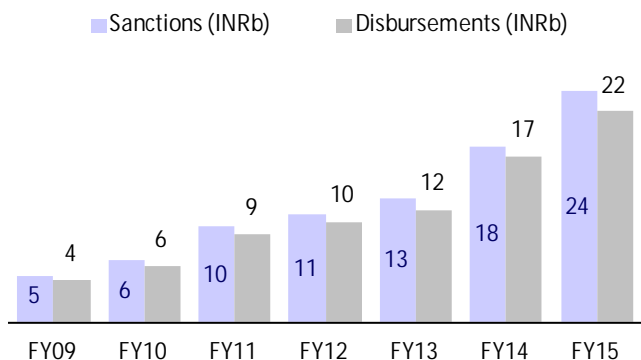


Source: Company, MOSL



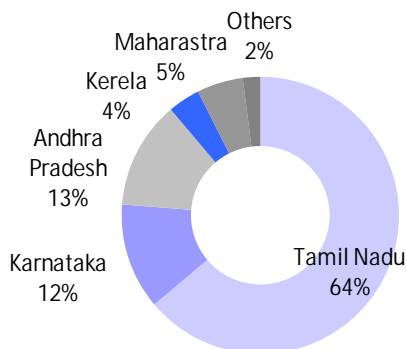
While REPCO remains a relatively small player in the housing finance market, we believe this well chalked out strategy will aid it gain market share, which will drive a healthy loan CAGR of 30% over FY15-18E.

**Exhibit 14: Healthy growth in sanctions, disbursements**



Source: Company, MOSL

**Exhibit 15: Region-wise loan book**

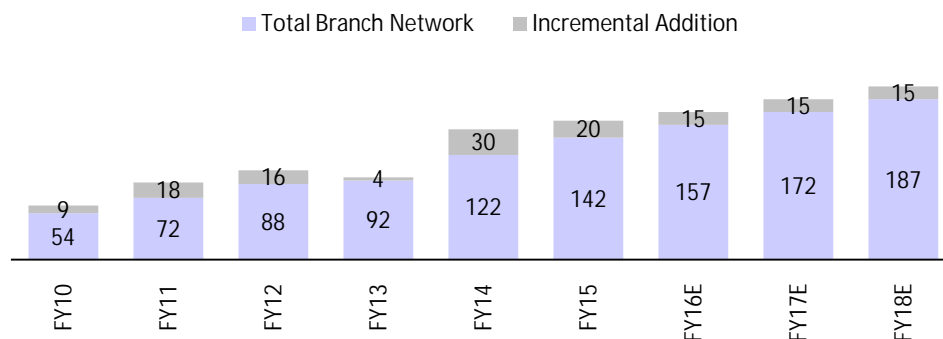


Source: Company, MOSL

**Well-calibrated branch expansion**

REPCO has established its presence in the housing finance market in South India, with 88% of its branch network located in this region. The company focuses on Southern India (particularly Tamil Nadu), but is expanding gradually to other states. Currently, the loan book is concentrated in Tamil Nadu (63%), followed by Andhra Pradesh (13%) and Karnataka (12%); South India constitutes +91% of the loan book.

**Exhibit 16: Calibrated network expansion**

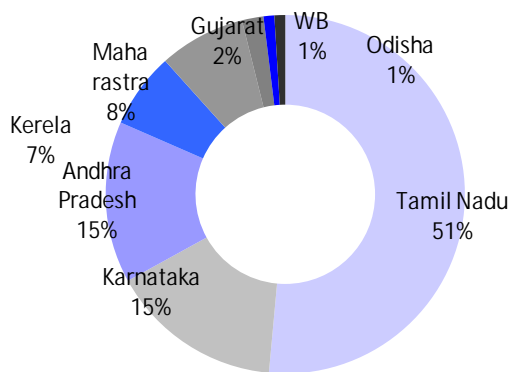


Source: Company, MOSL

Though Repco’s growth strategy is entirely branch led, it has not resorted to aggressive branch additions in the past and continues to focus on scaling up its existing branches to drive growth. Going ahead, the company plans to add 15 branches annually, with approximately two-thirds in the South and the remaining in the Rest of India. However, in a better operating environment, Repco has the option to scale up growth by adding more branches.

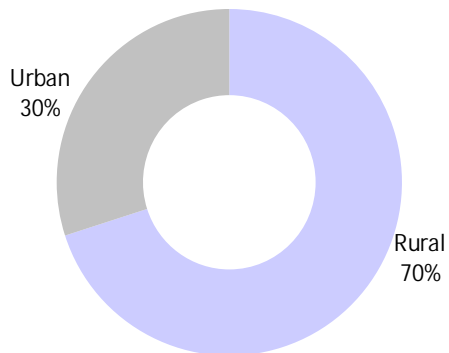
REPCO initially focused on South India (primarily Tamil Nadu). However, over the past three to four years, it has been expanding in other states such as Maharashtra (started in FY10), Gujarat (FY12), West Bengal (FY12) and Odisha (FY13) by opening branches and satellite centers. The company intends to increase the penetration in the southern region and gradually expand in other regions/states. Hence, it intends to expand the branch network in a calibrated manner.

**Exhibit 17: Geographical expansion in western, eastern regions**



Source: Company, MOSL

**Exhibit 18: Around 70% of the branches are in rural areas**



Source: Company, MOSL

## NHB refinance aids borrowing cost

### Presence in underserved segment helps avail advantages of NHB funding

- n REPCO has mainly used NHB refinance to fund its disbursements, while the remaining was from various Scheduled Commercial Banks and the parent company, Repco Bank.
- n NHB refinance aids borrowing profile and helps generate superior margins.
- n Ratings upgrade to help diversify the funding base.

### Beneficiary of NHB funding due to small ticket size

Refinancing from the National Housing Bank (NHB), bank loans and short-term credit facilities from its promoter Repco Bank are the key sources of funds. REPCO caters to the under-banked section and has a small ticket size, which makes it eligible for refinance under various schemes of NHB. Over 70% of REPCO's branches, as of March 2015, are in tier II and III towns and a significant portion of its portfolio qualifies as rural housing finance and is eligible for low-cost funding from NHB. As of March 2015, NHB's refinance constitutes 21% of the total borrowings and has an average cost of 8.02%.

Given the design of schemes, small HFCs have been the disproportionate beneficiaries of the low-cost funds released by NHB.

NHB offers various schemes under which it refinances banks and HFCs. Most of these are designed to encourage lending in semi-urban, rural areas and periphery of urban areas, where ticket sizes are generally low. Given the design of schemes, small HFCs (REPCO, Gruh and Can Fin Homes) have been the disproportionate beneficiaries of low-cost funds released by NHB. Also, they aid in reducing the asset liability management (ALM) mismatches on their balance sheets and eventually help in reducing the cost of borrowings.

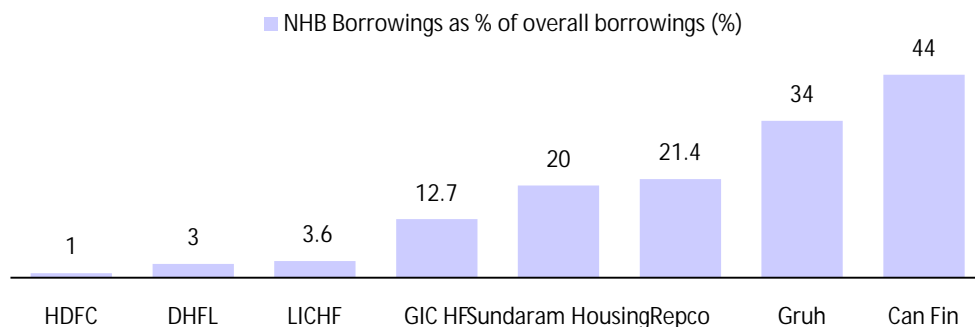
**Exhibit 19: Refinance Schemes of NHB**

	Rural Housing Fund	Golden Jubilee Rural Housing	Liberalized Refinance Schemes	Energy Efficient Housing Scheme	Urban Low Income Housing	Affordable Housing
<b>Objective</b>	Housing to weaker sections, Government announced the quantum in budget -funds allocated from RIDF	Refinance for rural housing		Promote use of solar equipment in homes	low income housing in urban areas	To provide refinance assistance for affordable housing projects
<b>Loan Size</b>	Below INR 1.5mn	Less than Rs1.5mn	Below INR 0.5m	Upto INR 50,000	Below INR1.0mn	Below INR3.0mn
<b>Location</b>	Rural	Rural	Any	Urban	Urban	Urban
<b>Tenure</b>	3-7 years	1-15years	1-15years	1-15years	5-15 years	5 years
<b>Interest Rates</b>	Fixed with spreads cap of 250bp	Fixed/floating	Fixed/floating	Fixed	Fixed with spreads cap of 275bp	Fixed/floating
	6.5% for loans <0.2m					
	7% for loans from INR 0.2-0.5m					
	7.5% for loan of INR0.5-1M					
<b>Ultimate Borrower</b>	Weaker Section	Any	Any	Any	Annual income less than INR0.2m	Any

Source: NHB

Large HFCs (such as LICHF and HDFC) have the inherent advantage of strong parentage and size; thus, it becomes easier for them to mobilize resources through debt markets. However, small HFCs have traditionally relied on commercial banks and NHB for borrowings. NHB has various schemes under which it refinances banks and HFCs. Most of the schemes are formulated to encourage lending in semi-urban, rural areas and periphery of urban areas, where ticket sizes are generally low.

**Exhibit 20: NHB borrowings form a major part for niche HFCs**



Source: Company, MOSL

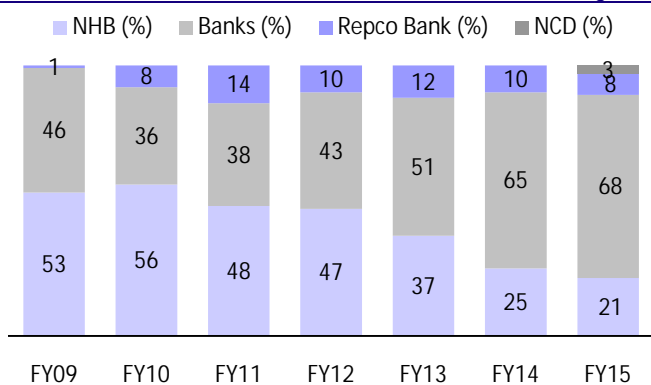
Niche HFCs have been the disproportionate beneficiaries of low-cost funds released by NHB as they have designed schemes that fit NHB's criterion.

Small HFCs have been the disproportionate beneficiaries of low-cost funds released by NHB as they have designed schemes that fit NHB's criterion. This also aids to reduce ALM mismatches on their balance sheets and eventually reduce the cost of borrowings.

**Banks, NHB dominate the company's borrowing mix**

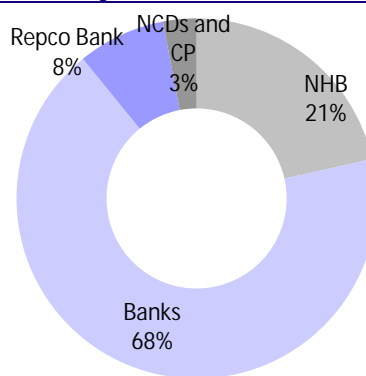
REPCO has mainly used NHB refinance (21% of total borrowings as in FY15) to fund disbursements, while the remaining was from various SCBs and from the parent company, Repco Bank. The cost of borrowing from NHB was ~8% in March 2015, while the same from banks stood at 10%. As bank funds are generally linked to the base rate, ongoing reduction in the systemic rates is likely to favorably impact the company's cost of bank funds and vice versa.

**Exhibit 21: NHB and banks constitute 97% of borrowings**



Source: Company, MOSL

**Exhibit 22: Borrowing mix (%)**



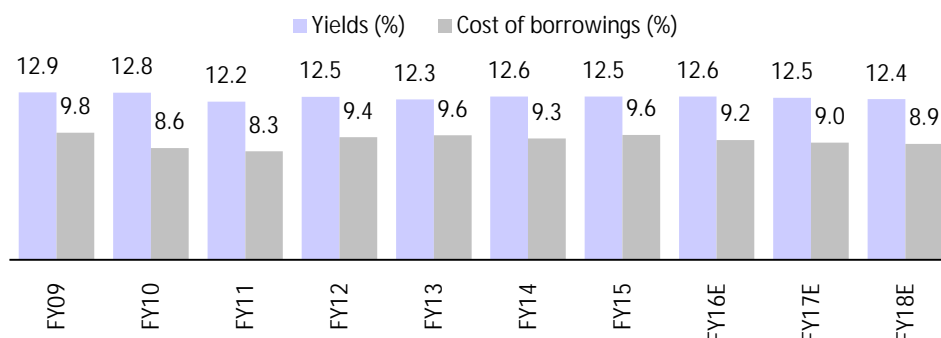
Source: Company, MOSL

Limited funding diversity is a constraint to REPCO's bargaining power with its lenders and makes the company's profitability susceptible to adverse movement in systemic interest rates. Thus, its ability to diversify funding sources would be critical to control its overall cost of funds, as the scale of operations increases going

forward. The average cost of bank funds increased from 9.33% for FY12 to 9.6% for FY15. The same is expected to moderate to an extent in the ensuing quarters, in line with the expected downward revision in the wholesale rates.

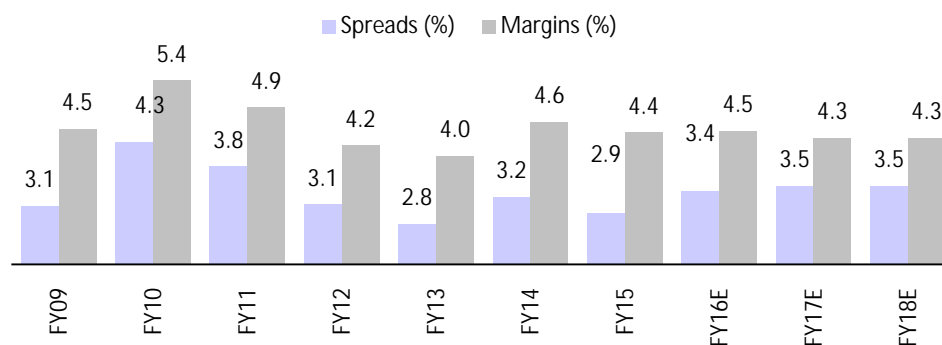
Post the ratings upgrade, Repco has started raising resources via low-cost NCDs.

**Exhibit 23: Healthy yields and margins**



Source: Company, MOSL

**Exhibit 24: Spreads of over 3%+ and NIM of over 4.3%+**



Source: Company, MOSL

**Ratings upgrade unveils new avenues to diversify borrowing**

After going public in April 2013, REPCO’s credit rating was upgraded in September 2013. ICRA upgraded its long-term rating (term loans from banks) from [ICRA] A+ to [ICRA] AA- and also assigned AA- to its NCD and A1+ to commercial paper. The upgrade is likely to open new avenues and will help to tap money market instruments like CPs and NCDs. Most of REPCO’s peers already enjoy benefits of diversifying the borrowing mix. Options to diversify the funding mix will aid the company manage its ALM and price products in a better way.

**Exhibit 25: REPCO’s credit rating**

Rating Agency	Instrument	Ratings
ICRA	Term Loan	AA-
ICRA	NCD	AA-
ICRA	CP	A1+
CARE	Term Loan	AA-
CARE	NCD	AA-
CARE	CP	A1+

Source: Company, MOSL

While the ratings were upgraded to AA- from A+ (on its term loans), it is still two notches below peers; the key reasons for this are a) REPCO’s parent is a multi-state co-operative bank, which is not under the Ministry of Finance, b) relatively higher

leverage at 9x (pre-rating) and c) past unlisted status. However, post the capital raising through an IPO in April 2013, REPCO's leverage reduced to 7.4x, is listed since the last two years and has delivered consistent performance across all parameters. In our view, these two important aspects along with low gearing and strong performance can lead to further rating upgrades over near to medium term.

A sizable portion of loans originated by REPCO qualifies for PSL

### **Securitization window yet to be explored**

A sizable portion of loans originated by REPCO qualifies for priority sector assets. A securitization window can give funding at lower than bank base rates and can also help to lower risk weights. However, REPCO is yet to explore this window. We believe that given the kind of assets it generates, its sell-down of assets will generate huge demand from banks.

### **NHB's spreads cap has limited impact**

In September 2013, NHB placed a spread cap of 200bp (latter increased the cap to 250bp) for refinancing scheme under the Rural Housing Fund (RHF) and 275bp for special refinancing for urban low-income housing. Thus, the funding proportion from NHB has declined from 37% in FY13 to 21% for FY15.

Post the spreads cap, REPCO refrained from availing refinance under RHF as management does not intend to do business at spreads below 300bp. However, we believe the impact will be minimal as a) there is limited competition in markets and segments catered by REPCO. Hence, it commands pricing power to pass on the increased funding costs; b) spreads cap is applicable only for incremental loans (disbursements), proportion of which in total loan book will be minimal; c) REPCO can utilize refinancing for other schemes such as Golden Jubilee Rural Housing Finance scheme (rate of interest is 8%) or Liberalized Refinance Scheme (rate of interest is 9.5%); and d) the company intended to increase the LAP portfolio (higher yields compared with home loans) by another 100-150bp which can absorb the impact of funding cost over a period of time.

## Vigilant processes lead to healthy asset quality

### In-house origination and recovery, and conservative lending practices

- n REPCO follows an in-house two-tier appraisal system to check the origination process.
- n The company adopts conservative lending practices such as LTV of 65% and instalment-to-income ratio of 50%, b) no-use DSA model and c) no lumpy developer loans.
- n Due to its presence in the self-employed segment, there is seasonality in asset quality. However, cumulative credit losses since inception in 2000 have been a mere 0.08% of cumulative loans disbursed.

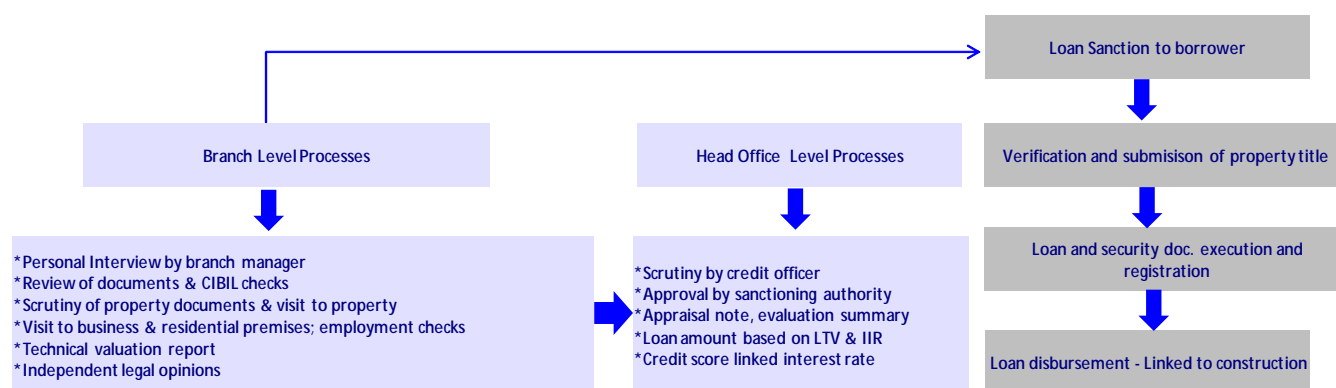
### Stringent processes, multiple-level checks ensure healthy asset quality

REPCO has a two-tier credit appraisal policy, which involves the branch and head office. The branch's role consists of origination of loan, disbursements and documentation. The company's appraisal process is entirely driven by employees, unlike banks where field investigation is largely outsourced. Employees are responsible for sourcing, credit appraisal, assessing credit worthiness, disbursing loans and monitoring repayments and collections. The appraisal process involves assessing the repayment capacity of a borrower, valuing the property and simplicity in repossessing the property (in case of LAP).

Unlike banks, where the field investigation is largely outsourced, REPCO's employees are responsible for sourcing, credit appraisal, assessing credit worthiness, disbursing loans and monitoring repayments and collections.

A branch does not have the authority to sanction loans and it is done by the head office. Post sourcing, documentation and appraisal by the branch, it recommends the borrower to the head office, which does the credit scrutiny, credit appraisal, credit score-linked interest rate and evaluation. The head office has a team of credit and legal officers who have the authority to sanction loans up to INR1.5m. Loans above INR1.5m and up to INR7.5m are cleared by the DGM, while those above INR7.5m are done by the senior management such as CGMs and EDs. The borrower is eligible to take a loan up to the amount arrived by standardized calculation and interest rates are linked to credit scores. Strong internal controls exist at all levels—loan approval limits, customers have no contact with the credit appraisal team.

Exhibit 26: Multiple-level credit appraisals



Source: Company, MOSL

**Exhibit 27: Loan Sanction**

Ticket Size (INRm)	Sanction Authority
Up to 1.5m	Credit officers at Head office
1.5-7.5	DGM Credit
7.5-10	CGM Credit
10m -20m	ED
20m -30m	Management Committee
Up to 100m	Board

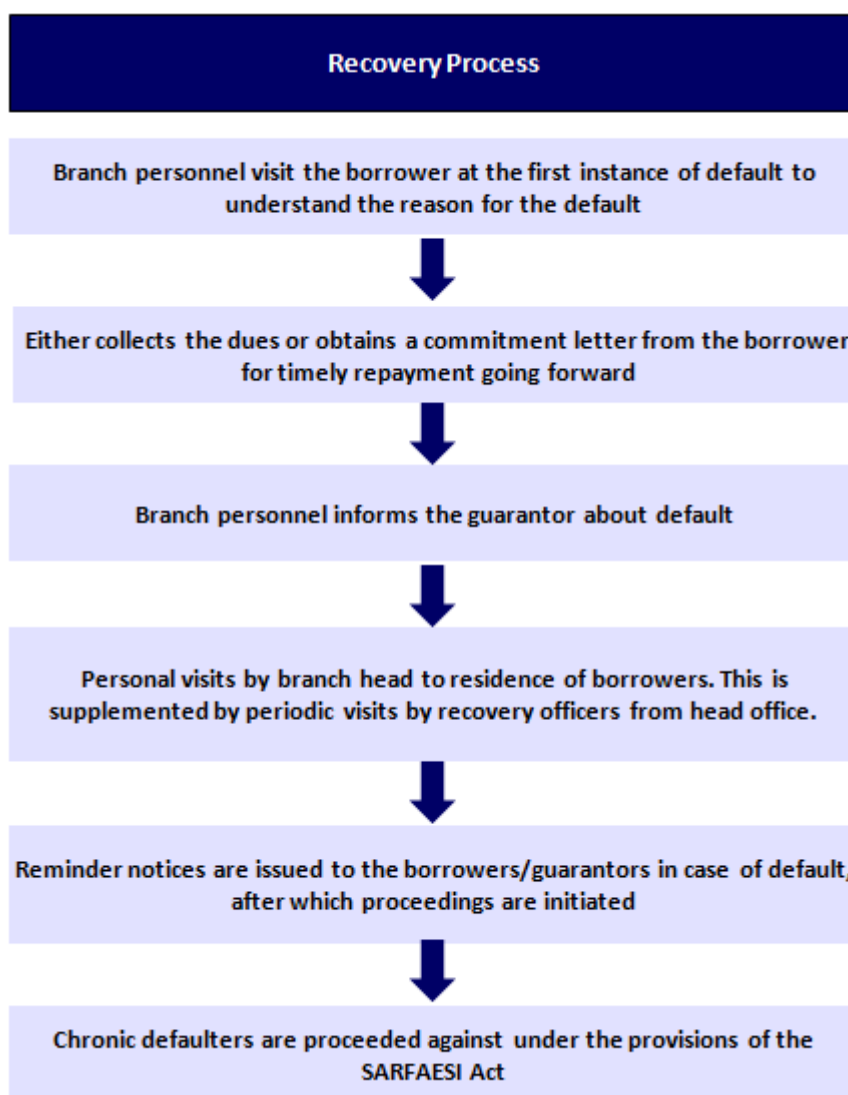
Source: Company, MOSL

Strong risk management ensures a multi-level check mechanism, has maintained stable asset quality.

**Coordinated monitoring and recovery efforts from branch, head office**

REPCO follows a rigorous monitoring, collection and recovery mechanism. This includes (a) mandatory site visits in case of loans for property under construction, (b) inspection of branches by head office personnel periodically on a formal or informal basis, and (c) visits by branch and head office personnel in relation to the recovery of non-performing loans.

**Exhibit 28: Recovery Process**



Source: Company, MOSL

REPCO has measures for coordination between branches and corporate office to ensure efficient monitoring of loans. It has a clear policy structure in case of a



default (as depicted in the chart above). Some of the key coordination measures are: (a) monthly performance scoring of branches on recovery, (b) monthly MIS report and branch manager's report, (c) half-yearly and annual review meetings to assess performance and market situation, and (d) periodic departmental meetings at head office.

Implementation of these rules ensures a multi-level check mechanism, which has helped REPCO maintain a stable asset quality, with gross NPLs of 1.32% and coverage ratio of +62% (as in FY15). Since inception, it has written off a mere 0.08% of the cumulative disbursements done till date.

### **Conservative lending practices**

Due to its presence in the non-salaried segment in tier II, III and peripheries of tier I cities, the company has implemented strong asset quality control at multiple levels—employee policy, appraisal criterion and system level. It follows conservative lending practices such as a) LTV of 65% and installment-to-income ratio of 50%, b) non-use of DSA model, and c) no exposure to lumpy developer/builder loan portfolio. These practices ensure healthy asset quality.

### **LTV of 65%, installment-to-income ratio of 50%**

The average LTV ratio is 65%, while LTV in case of salaried class varies between 65% and 80% compared with 60-65% in case of non-salaried class. However, the LTV ratio for LAP does not cross 50%. REPCO also considers this ratio while lending and the average ratio for the last five years stands at 50% of the gross monthly income of borrowers.

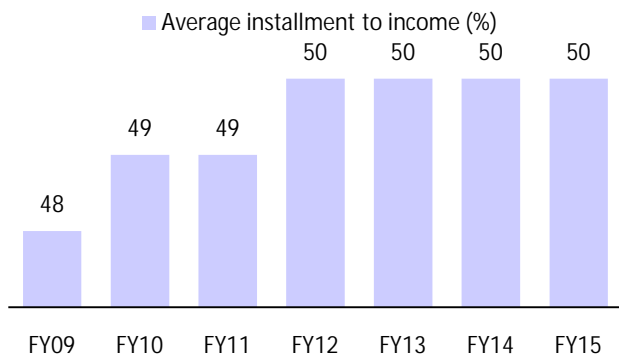
### **Direct customer connect, non-use of direct selling agents**

REPCO does not use direct selling agents and relies on its own employees to source loans. Most customers are walk-in customers sourced through loan camps or referred by existing customers. The branch acts as a single point of contact for customers. Sourcing through these channels helps direct connect with customers and ensures healthy loan origination, which reduces default rates.

### **No developer/builder loans**

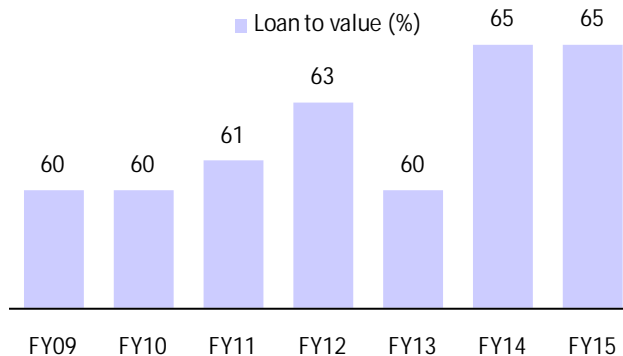
REPCO does not have exposure to developer/builder loans, which has also helped it to maintain a healthy asset quality.

**Exhibit 29: Average income-to-installment is at 50%**



Source: Company, MOSL

**Exhibit 30: LTV of 60% gives comfort**

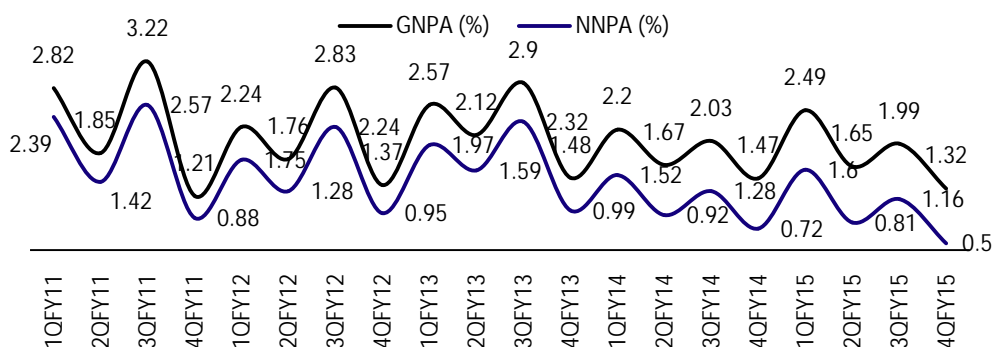


Source: Company, MOSL

**Higher proportion of self-employed leads to volatility in asset quality**

REPCO's GNPA's in FY15 stood at 1.32%, while NNPA's stood at 0.5%. NPL levels are higher than the industry average due to its presence in the self-employed segment (v/s other players who are largely focused on the salaried segment) and as the cash flows of self-employed individuals are uneven, leading to volatility in asset quality. Although NPL levels are volatile, actual loan losses to the company are miniscule. REPCO has written off only 0.08% of the cumulative disbursements made since its inception in 2000.

**Exhibit 31: Presence in the self-employed segment is marred by lumpiness in income, brings volatility in asset quality**

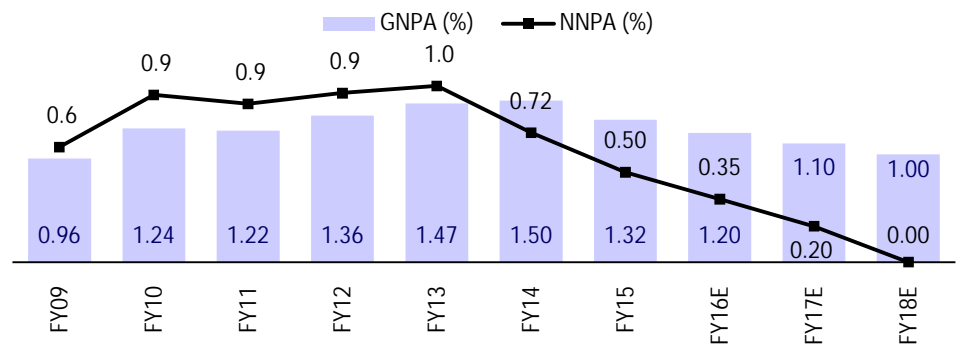


Source: Company, MOSL

**Asset quality outlook remains stable**

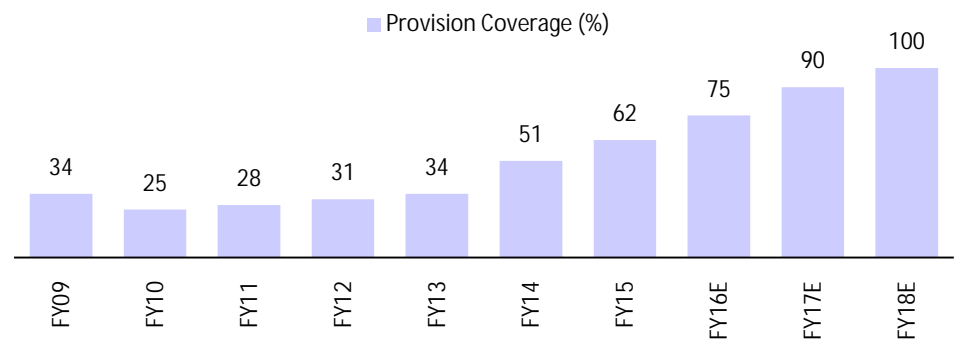
Though the company's presence in the self-employed segment leads to higher NPLs, NPL levels have remained high historically as it was not listed and recoveries were less aggressive. However, since listing, the management has enhanced focus on recoveries and NPL levels have improved significantly YoY. Also, there has been continuous improvement in the asset quality. For FY15, GNPA's were 1.32% compared with 1.47% in the same quarter last year. REPCO is actively using the SARFAESI Act window to recover loans and has significantly boosted the recovery process; it has already won ~90% of cases in SARFAESI. We expect the asset quality to remain stable and factor 40bp credit cost for FY16E/17E.

**Exhibit 32: While seasonal variations will remain, overall asset quality is likely to be healthy**



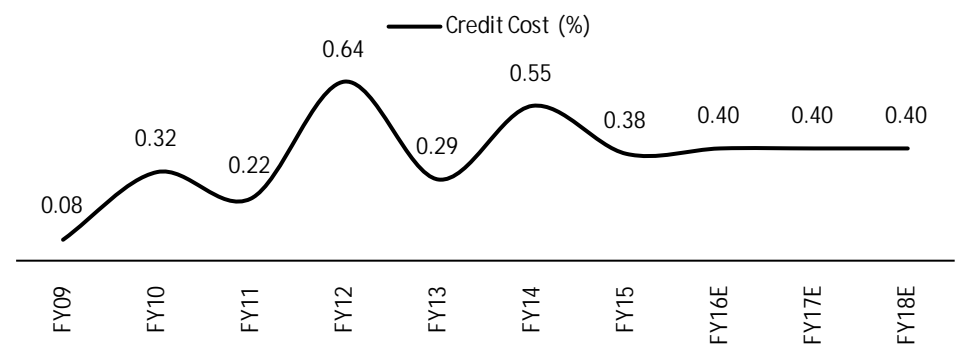
Source: MOSL, Company

**Exhibit 33: Management committed to increase the coverage to 100%**



Source: MOSL, Company

**Exhibit 34: Credit cost to remain stable at 40bp**



Source: Company, MOSL

## Earnings to post 29% CAGR over FY15-18E

Lean cost structure, stable margins and credit cost to drive earnings

- n Efficient resources utilization ensures low operating cost.
- n Spreads to remain at 3%+ and margins at 4.3%+.
- n Credit costs to remain stable at 40bp.
- n Net profit CAGR of 29% CAGR over FY15-18E, RoA of +2.2% and RoE of 19%+ by FY17E.

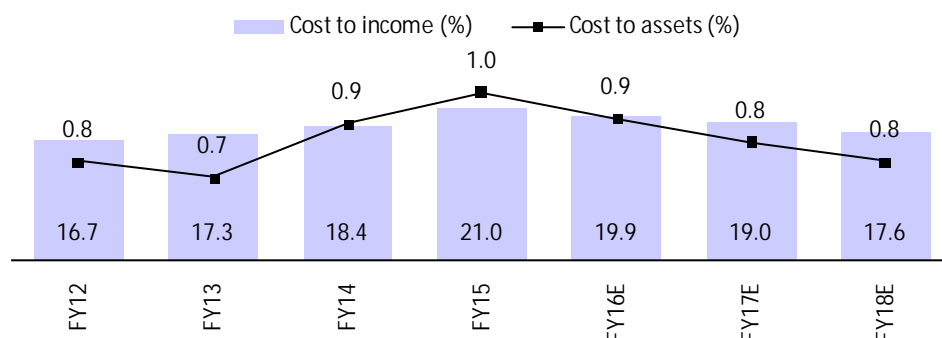
REPCO's net profit is likely to witness a 29% CAGR over FY15-18E, driven by healthy loan CAGR (30%), steady margins and stable credit costs (40bp over the next three years). We expect the company to report RoA of 2.2%+ and RoE of 19%+ by FY17E.

Efficient employee utilization and implementation of centralized technology helps maintain lean costs

### Lean operating cost structure

Despite having a branch-centric business origination model, with operations in semi-urban areas, REPCO has kept its operational costs low through efficient employee utilization and implementation of centralized technology. This is reflected in its best-in-class operating ratios, with average cost-to-income ratio at 21% and cost-to-assets at 0.8% over the past five years. While the CI has increased during the last year, this is primarily due to ESOP provision.

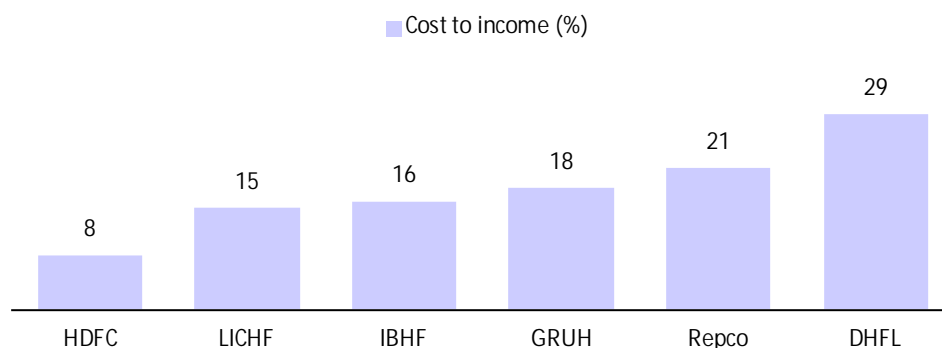
Exhibit 35: CI ratio below 21%, cost-to-assets below 1% for the last five years



\*Including non cash ESOP charges; 18% excluding ESOP charges

Source: Company, MOSL

Exhibit 36: Despite lower ticket size, cost ratios similar to large HFCs



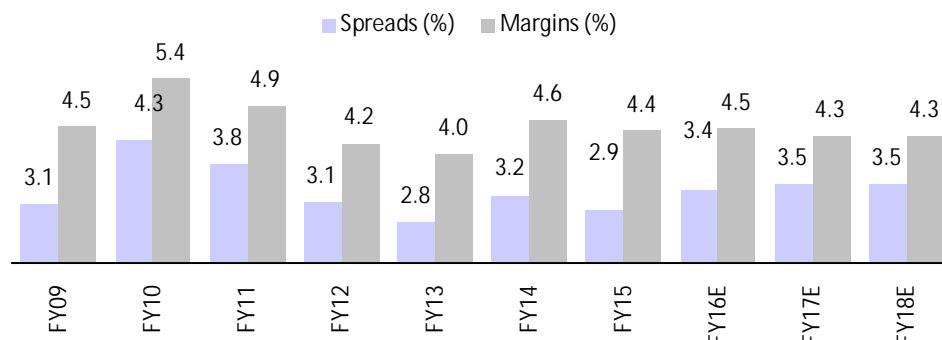
Source: Company, MOSL

### Spreads to remain at 3%+, margins at 4%+

Balanced mix of non-salaried segment, whereby it can charge 50-75bp higher than the salaried class, enables the company sustain yields of +12%. On the liability side, it gets the dual benefit of NHB's refinancing facility and better rate from banks, thus

providing access to cheaper avenues of borrowings. This aided REPCO to sustain margins of over 4% for the last five years.

**Exhibit 37: Margins at 4%+ for the last five years**

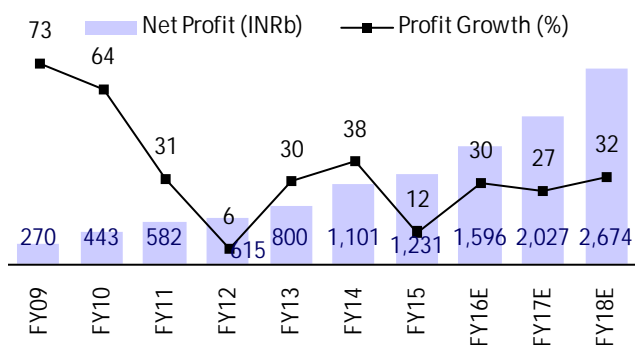


Source: Company, MOSL

**Earnings to clock 29% CAGR, RoEs to grow to 21% by FY18E**

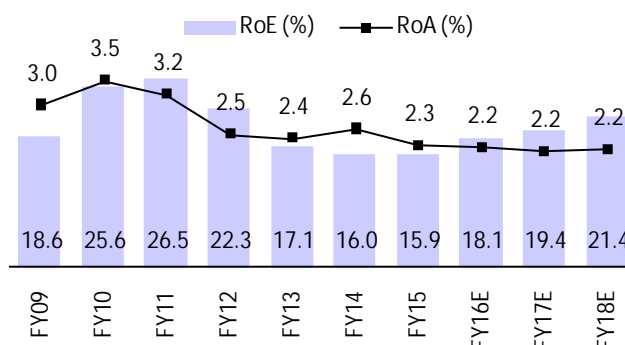
Strong pricing power and cheaper NHB refinance helped the company generate 4.5%+ NIM, while lean cost of operations and negligible credit costs helped generate +2.2% RoA. Due to operations in underserved and less competitive segment, REPCO has strong growth visibility and limited challenges, which will ensure healthy earnings and growth trajectory. While it has been operating at 2.2%+ RoA, FY15 RoE stands at 16% due to lower leverage. However, we expect RoE to increase to 19%+ in FY17E. We expect peak RoE of 24% by FY20 before the next dilution.

**Exhibit 38: PAT to witness 30% CAGR**



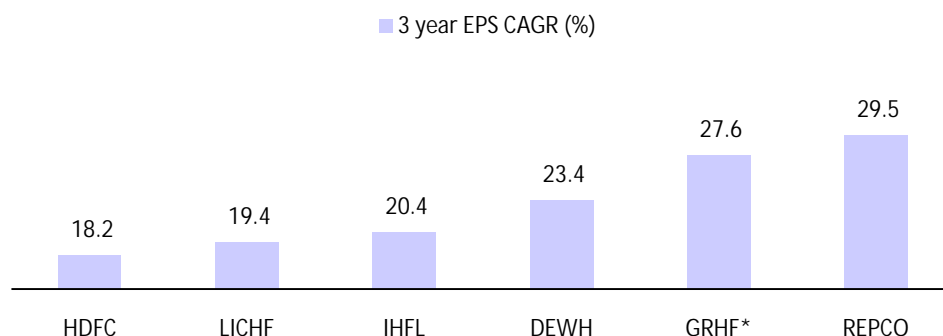
Source: Company, MOSL

**Exhibit 39: RoA to remain at 2.2%+, RoE at ~20%**



Source: Company, MOSL

**Repco to post highest EPS CAGR over next three years- highest among the peer group**



Source: Company, MOSL

## Well capitalized for the next four years

### Lower risk weights enable lower capital consumption

- n Healthy capitalization provides sufficient buffer for growth, without dilution.
- n Lower ticket size leads to lower risk weights.
- n Securitization can be used to reduce gearing.

### Healthy capitalization to ensure growth without dilution

REPCO stands well capitalized with an overall capital of 20%, and the entire capital is Tier 1. It raised INR2.7b in March 2013 through a primary issue of shares at INR172 per share, which increased its capital. Post the IPO, leverage declined to 7.4x in FY15 compared with 9x in FY12. Currently Repco is under-leveraged compared with other HFCs, which have a gearing of 12-13x. Lower leverage leaves ample scope for growth without dilution (can grow 30% for five years). Moreover, REPCO currently does not securitize its portfolio and hence has enough room to reduce leverage by using this tool.

### Lower ticket size leads to lower risk weights

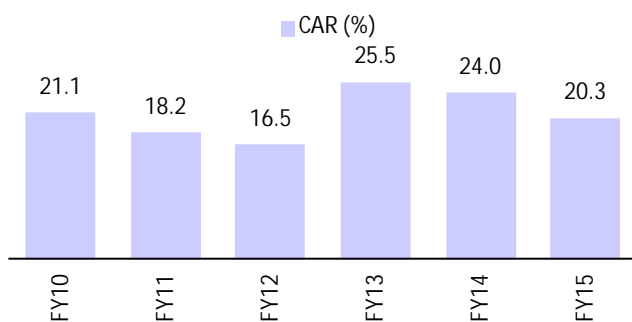
Risk weights on the loan book are lower owing to lower loan ticket sizes (over 70% of the loan book is less than INR2m), implying less capital consumption. Currently, REPCO has Tier 1 capital of +20% and we believe it is well capitalized for at least four years of growth.

**Exhibit 40: Lower ticket size leading to lower risk weights**

Ticket Size	Borrower Type	LTV	Risk Weight (%)
Upto INR2mn	Individual	<90%	50
INR2-7.5mn	Individual	<80%	50
Above INR 7.5mn	Individual	<75%	75

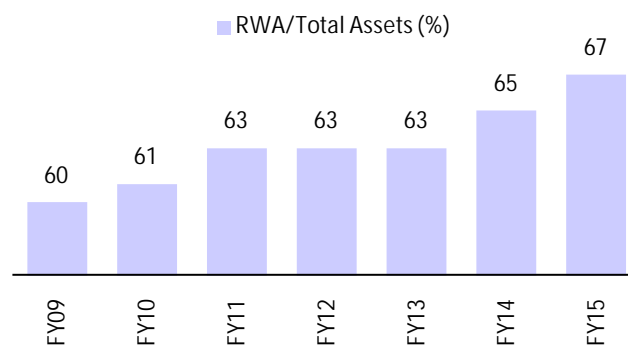
Source: Company, MOSL

**Exhibit 41: Healthy CAR, Tier 1 accounts for almost the entire capital**



Source: MOSL, Company

**Exhibit 42: Lower risk weights due to lower ticket size**



Source: MOSL, Company

## Superior return ratios; Initiate with a Buy

Estimate 2.2%+ RoA and 19%+ RoE over the next three years

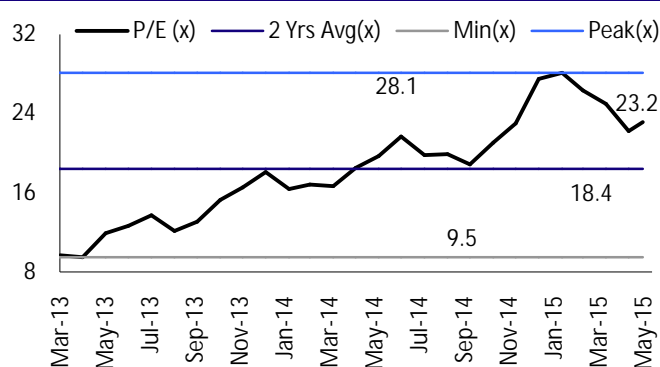
- n REPCO has delivered strong business and earnings growth, driven by niche presence in high-yielding underserved and self-employed segment.
- n RoAs healthy at 2.2%+; Increasing leverage will drive RoE expansion.
- n Initiate coverage with BUY with a target price of INR726.

REPCO has established a strong presence in southern states and is expanding to other geographies. Over the last decade, the company has built a scalable business model with a well-balanced portfolio. The presence in high-yielding self-employed category enables it to generate superior yields, and exposure in the underserved and low-income segment helps to draw cheaper borrowings from NHB translating into 2.2%+ RoA.

Despite a healthy RoA, the current RoEs at 16% seem optically low due to significant under-leverage (7.4x v/s 12-13x for other HFCs). With stable execution and steady RoA of 2.2%, RoE should ideally be 25% on a fully leveraged basis. Even if Repco delivers 30% CAGR in loans for the next five years, it will continue to witness expansion in RoE without requiring significant dilution.

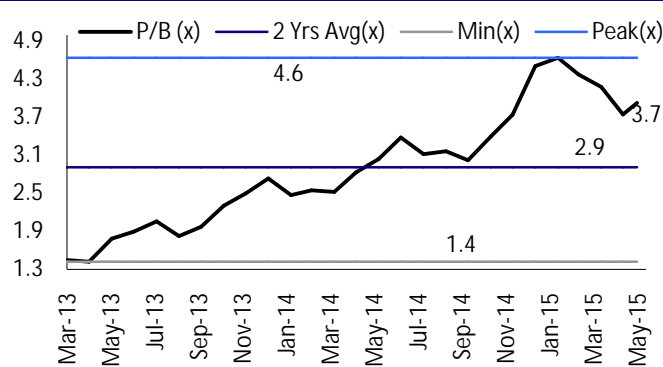
In our view Repco will continue to trade at premium multiples led by its niche business model, inherently high profitability with the ability to improve return ratios, high capitalization, consistent execution, and minimal asset quality overhang—given a secured loan book. Ongoing downward trend in interest rates could also prove to be a trigger for profitability. We initiate coverage with a Buy rating and assign multiple at 4x FY17E P/BV INR726 per share, which yields an upside of 21% from current market price.

Exhibit 43: One-year forward P/E



Source: Bloomberg

Exhibit 44: One-year forward P/B



Source: Bloomberg

## Company background

- n REPCO was established in 2000 as a wholly owned subsidiary of Repatriates Co-operative Finance and Development Bank (Repco Bank).
- n In December 2007, the Carlyle Group through its Asian arm, Carlyle Asia, infused INR760m equity into REPCO for a 49.98% stake in the company and exited post IPO.
- n Repco Bank has been operating in South India since 1969 and all of its 76 branches are located in South India, with ~7m customers.

Repco Home Finance Ltd (REPCO) is a Chennai-based housing finance company. It was established in 2000 as a wholly owned subsidiary of Repatriates Co-operative Finance and Development Bank (Repco Bank). The Government of India owns 76.83% in Repco Bank and Repatriates owns 17.51%; the remaining is owned by the governments of Tamil Nadu (3.05%), Andhra (1.81%), Kerala (0.62%) and Karnataka (0.18%).

In December 2007, private equity firm Carlyle Group infused INR760m equity into REPCO for a 49.98% stake in the company. In February 2013, Carlyle offloaded some of its stake to other private equity players.

In December 2007, the Carlyle Group—through its Asian arm, Carlyle Asia—infused INR760m equity into REPCO for a 49.98% stake in the company. In February 2013, Carlyle offloaded some of its stake to other private equity players and completely exited the stock post IPO.

REPCO primarily finances the construction and/or purchase of residential and commercial properties (individual home loans and loans against property). It has a network of 106 branches and 36 satellite centers (as of March 2015) across Tamil Nadu, Karnataka, Andhra Pradesh, Kerala, Maharashtra, Gujarat, Orissa and the union territory of Puducherry.

The company's strategy consists of advertising via loan camps and word-of-mouth referrals from existing customers. Thus, most of its customers are walk-ins and it does not use marketing intermediaries. The branches source loans and carry out the preliminary checks on credit worthiness of the borrower, post which the application is sent to the centralized processing unit for approval. Branches are also responsible for assisting in documentation, disbursing loans and monitoring repayments and collections.

### Management details

The senior management comprises professionals with significant experience in all areas of banking and housing finance. The team is led by Mr R Varadarajan, Managing Director, who has laid a strong foundation. Other key personnel are Mr V Raghu and Mr P Natarajan (Executive Directors). Currently, Mr Varadarajan is also the Managing Director of Repco Bank (the parent of Repco Home Finance). The Employees own 1.4% of ESOPs with an exercise price of INR75.



## Exhibit 45: Management profile

Name	Designation	Age	Education	Experience in Financial services (Years)	Prior assignments
Mr. T.S. Krishna Murthy	Chairman (Independent & Non-executive Director)	72	B.S.E., M.S.E & Masters in FM	50	Secretary to Government of India
Mr. R. Varadarajan	Managing Director	58	MSC	35	Syndicate bank
Mr. V Raghu	Executive Director	58	B.S.E., M.S.E	32	RBI & NHB
Mr. P Natrajan	Executive Director	56	Bachelor in Commerce	30	Repc Bank
Mrs. Sanjeevane Kuty	Non-executive and non-independent director	NA	IAS	32	Currently Additional secretary to Ministry of home affairs
Mr. B. Anand	Non-executive and non-independent director	NA	Masters in English	24	Government of Tamil Nadu
Mr. Thomas Paul Diamond	Non-executive and independent director	75	Master's in Economics & Financial Mgmt	40	LIC of India

Source: MOSL, Company

## Repco Bank

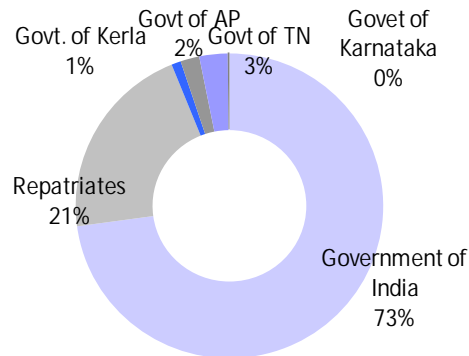
### A Government of India enterprise

- n Repco Bank was established to help and promote the rehabilitation of repatriates from Sri Lanka, Myanmar, Vietnam and other countries.
- n The bank is a Government of India enterprise and the state governments of Tamil Nadu, Kerala, Karnataka and Andhra Pradesh also have a stake in it.
- n Repco Bank has been operating in South India since 1969 and all of its 76 branches are located in South India, with ~7m customers.

Repco Home Finance was promoted by The Repatriates Co-operative Finance and Development Bank Ltd (Repco Bank) and is a Government of India owned enterprise, with the State Governments of Tamil Nadu, Kerala, Karnataka and Andhra Pradesh also having a stake.

Repco Bank has been operating in South India since 1969 and all of its 76 branches are located in South India, with ~7m customers.

#### Exhibit 46: Repco Bank's shareholding



Source: Company, MOSL

Repco Bank was established to help and promote the rehabilitation of repatriates from Sri Lanka, Myanmar, Vietnam and other countries. The bank is under the administrative control of FFR Division, Ministry of Home Affairs and Government of India. Constitutionally, it is a multi-state cooperative society.

The bank's operations extend to Tamil Nadu, Andhra Pradesh, Karnataka and Kerala, and the Union Territory of Puducherry.

## Key risks

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### Regulatory risk

Regulatory changes such as increase in risk weights and cap on the interest spread under refinance schemes can also impact the company. Further, a change in the terms and eligibility conditions of refinance schemes can also adversely impact margins. Adverse regulatory changes will have a negative impact on growth and profitability of the company.

### Concentrated borrowing profile

NHB's refinance and bank borrowings constitute almost all of REPCO's total borrowings. The remaining borrowing needs are fulfilled by banks, including the promoter bank. Strong future growth would require higher borrowings and proportion of NHB refinancing may decline, thus forcing REPCO to tap other sources of borrowings such as NCDs and public deposits.

### Concentration of loan book

High concentration risk as 70% of the book comes from Tamil Nadu (25% from Chennai). Any sharp correction in these markets can affect growth. We do not expect NPAs to be a concern, though growth can take a back seat.

### Management tenure

The current management's tenure is for the next three years. If it does not take an extension, management change is a key risk for investors looking beyond the three-year horizon. Also, Repco Bank and Repco Home have the same Managing Director.

## Financials and valuations

Income statement		(INR Million)						
Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Interest Income	2,138	3,055	3,912	5,156	6,691	8,685	11,287	14,702
Interest Expended	1,279	2,023	2,656	3,248	4,318	5,589	7,344	9,536
<b>Net Interest Income</b>	<b>860</b>	<b>1,032</b>	<b>1,255</b>	<b>1,908</b>	<b>2,373</b>	<b>3,096</b>	<b>3,944</b>	<b>5,167</b>
Change (%)	32.6	20.1	21.6	52.0	24.4	30.5	27.4	31.0
Other Operating Income	121	134	148	197	239	224	239	255
<b>Net Income</b>	<b>981</b>	<b>1,166</b>	<b>1,403</b>	<b>2,106</b>	<b>2,613</b>	<b>3,321</b>	<b>4,183</b>	<b>5,421</b>
Change (%)	31.9	18.9	20.4	50.0	24.1	27.1	26.0	29.6
Operating Expenses	150	194	243	388	547	661	795	954
<b>Operating Income</b>	<b>831</b>	<b>972</b>	<b>1,160</b>	<b>1,718</b>	<b>2,065</b>	<b>2,660</b>	<b>3,388</b>	<b>4,467</b>
Change (%)	28.0	16.9	19.4	48.0	20.2	28.8	27.4	31.9
Provisions/write offs	39	155	92	226	203	277	363	476
<b>PBT</b>	<b>793</b>	<b>816</b>	<b>1,068</b>	<b>1,492</b>	<b>1,862</b>	<b>2,383</b>	<b>3,025</b>	<b>3,991</b>
Tax	211	202	268	390	631	786	998	1,317
Tax Rate (%)	27	25	25	26	34	33	33	33
<b>Reported PAT</b>	<b>582</b>	<b>615</b>	<b>800</b>	<b>1,101</b>	<b>1,231</b>	<b>1,596</b>	<b>2,027</b>	<b>2,674</b>
Change (%)	31.1	5.7	30.2	37.6	11.8	29.7	27.0	31.9

Balance sheet		(INR Million)						
Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Capital	464	464	622	622	624	624	624	624
Reserves & Surplus	2,013	2,568	5,724	6,760	7,498	8,909	10,700	13,064
<b>Net Worth</b>	<b>2,477</b>	<b>3,033</b>	<b>6,345</b>	<b>7,381</b>	<b>8,121</b>	<b>9,532</b>	<b>11,324</b>	<b>13,688</b>
Borrowings	2,534	2,486	3,678	39,020	51,044	70,447	92,744	121,543
<b>Borrowings</b>	<b>18,098</b>	<b>24,860</b>	<b>30,647</b>	<b>39,020</b>	<b>51,044</b>	<b>70,447</b>	<b>92,744</b>	<b>121,543</b>
Change (%)	42.2	37.4	23.3	27.3	30.8	38.0	31.6	31.1
Other liabilities	397	634	932	960	1,592	1,671	1,755	1,842
<b>Total Liabilities</b>	<b>20,973</b>	<b>28,527</b>	<b>37,924</b>	<b>47,361</b>	<b>60,757</b>	<b>81,651</b>	<b>105,822</b>	<b>137,073</b>
<b>Loans</b>	<b>20,758</b>	<b>28,090</b>	<b>35,500</b>	<b>46,619</b>	<b>60,129</b>	<b>78,275</b>	<b>103,049</b>	<b>135,048</b>
Change (%)	48.3	35.3	26.4	31.3	29.0	30.2	31.6	31.1
<b>Investments</b>	<b>21</b>	<b>81</b>	<b>81</b>	<b>124</b>	<b>124</b>	<b>136</b>	<b>150</b>	<b>165</b>
Change (%)	0.0	292.7	0.0	54.0	0.0	10.0	10.0	10.0
Net Fixed Assets	30	33	45	49	89	94	98	103
Other assets	164	323	2,299	569	414	3,146	2,525	1,757
<b>Total Assets</b>	<b>20,973</b>	<b>28,527</b>	<b>37,924</b>	<b>47,361</b>	<b>60,757</b>	<b>81,651</b>	<b>105,822</b>	<b>137,073</b>

E: MOSL Estimates

## Financials and valuations

### Ratios

Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
<b>Spreads Analysis (%)</b>								
Avg Yield on Housing Loans	12.2	12.4	12.2	12.6	12.5	12.6	12.5	12.4
Avg. Yield on Earning Assets	12.3	12.5	12.3	12.5	12.5	12.5	12.4	12.3
Avg. Cost-Int. Bear. Liab.	8.3	9.4	9.6	9.3	9.6	9.2	9.0	8.9
Interest Spread	4.0	3.1	2.7	3.2	2.9	3.3	3.4	3.4
Net Interest Margin	4.9	4.2	3.9	4.6	4.4	4.5	4.3	4.3

### Profitability Ratios (%)

RoE	26.5	22.3	17.1	16.0	15.9	18.1	19.4	21.4
RoA	3.24	2.48	2.41	2.58	2.28	2.24	2.16	2.20
Int. Expended/Int.Earned	59.8	66.2	67.9	63.0	64.5	64.3	65.1	64.9
Other Inc./Net Income	12.3	11.5	10.5	9.4	9.2	6.8	5.7	4.7

### Efficiency Ratios (%)

Op. Exps./Net Income	15.3	16.7	17.3	18.4	21.0	19.9	19.0	17.6
Empl. Cost/Op. Exps.	48.2	54.1	58.0	54.3	61.2	60.8	60.7	60.7

### Asset Quality (%)

Gross NPAs	252	382	525	703	912	1,153	1,466	1,878
Gross NPAs to Adv.	1.2	1.4	1.5	1.5	1.3	1.2	1.1	1.0
Net NPAs	182	265	348	457	593	749	953	1,221
Net NPAs to Adv.	0.9	0.9	1.0	0.7	0.5	0.4	0.2	0.0
CAR	18.2	16.5	25.5	24.0	22.0	20.0	20.0	20.0

### Valuation

Book Value (INR)	53.3	65.3	102.1	118.7	130.2	152.9	181.6	219.5
Price-BV (x)	11.2	9.2	5.9	5.1	4.6	3.9	3.3	2.7
EPS (INR)	12.5	13.2	12.9	17.7	19.7	25.6	32.5	42.9
EPS Growth YoY	31.1	5.7	-2.7	37.6	11.4	29.7	27.0	31.9
Price-Earnings (x)	47.9	45.3	46.6	33.9	30.4	23.4	18.5	14.0
Dividend per share (INR)	0.9	1.0	1.3	1.2	1.5	2.6	3.3	4.3
Dividend yield (%)		0.2	0.2	0.2	0.3	0.4	0.5	0.7

E: MOSL Estimates

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