Repco Home Finance

View: Positive

Viewpoint

A differentiated business model; expanding market provides opportunity **CMP: Rs618**

Key points

- **Unique business model strengthens ability to maintain margins:** Repco Home Finance (RHFL) has an attractive business model in the housing finance space, which caters to an under-served segment largely neglected by banks and other NBFCs. The small-ticket, non-salaried segment is a lucrative opportunity but also a very challenging proposition, which RHFL has managed well through its robust risk management process, deep understanding of the market and a clear focus. Banks and large HFCs have found it difficult to penetrate the non-salaried segment despite it being a comparatively high-yielding segment because the low ticket size of loans and personalised service requirement. Self-occupied residential real estate is an attractive segment because immovable collateral is considered relatively safe. While NBFC-HFCs do have a presence in the small ticket size housing loan segment (below-the-radar segment), experience and deeper knowledge of the market are key differentiators for HFCs and difficult to be challenged by banks. This explains why RHFL has been able to maintain its NIMs ~4-4.7% for the last five years despite interest rate fluctuations and fierce competition in the Housing Finance market.
- **Matured loan book, strong asset quality give comfort:** Notwithstanding quarterly fluctuations, RHFL has been able to maintain its improving asset quality trend on an annual basis. The quarterly volatility in Gross NPA has resulted in the provision coverage ratio (PCR) of 43.6%. However, on an annual basis, the PCR improved by 230BPS YoY, which was mainly due to the quarterly volatility in assets (PCR was stable at ~63.5% in FY2016). RHFL has a reasonably matured loan book with average duration of ~10 years with ~15-18% p.a. repayment/prepayment rate. The GNPA at 2.65% and Net NPA at 1.41% have increased by 134BPS and 103BPS since March 2016. RHFL sees GNPA volatility on a QoQ basis, but on an annual basis, the GNPA have been trending downwards. Therefore, the rise in GNPA in Q3FY2017 was due to delay in payment collection at the end of September 2016 and also due to demonetisation. Considering that the impact of demonetisation on the Indian economy is still unfolding, we believe that RHFL's asset quality may see volatility in the next 2-3 quarters.
- **Diversified asset base; well managed operations:** We believe that RHFL is having a well diversified loan book mix, with large ticket (>Rs1 crore) loans to around 200 borrowers (0.5-1% of total loans). The management has indicated that going forward it will further reduce focus on large ticket loans. Also, the management indicates that while the outstanding loans are adequately covered by security value, a possible correction in the residential property market may make housing more affordable, resulting in a significant business opportunity. RHFL has a conservative loan sanctioning policy, and caps the Loan to Value (LTV) at 55% in the Loan Against Property (LAP) segment. It also follows a conservative policy on the Loan to Installment Ratio (IIR) to ensure that its servicing capability is maintained.
- **Robust risk management system behind low slippages:** Over the years, RHFL has developed robust risk management systems & processes in all areas of operations - like loan origination, credit appraisal, loan disbursement and collection & recovery. This can be gauged from the fact that since inception RHFL has written off loans aggregating to just under Rs5.0 crore (<6BPS of cumulative disbursements). RHFL has maintained a relatively decent asset quality (NNPA in the range of 50-160BPS in the last 12 quarters).
- **Affordable housing identified as a thrust area by Government of India:** The Indian Government has identified Affordable Housing as one of the main thrust areas of its larger economic reform policy and has floated various measures, like interest subvention schemes (viz. 6.5% on EWS/LIG section), additional interest deduction of Rs50,000 for first-time home buyer (announced in Union Budget for FY2018) and 100% deduction of profit on affordable homes etc. Such measures are indicative of the present government's relentless focus and thrust on Affordable Housing, especially for the EWS/LIG segment. Programs like "Housing for All/PMAY" offer market expansion opportunities, which coupled with lower unit costs and interest subvention benefits offer a large universe for HFCs (including RHFL) to cherry pick borrowers.

Key risks:

- Geographical concentration risk, as ~85% of the loan book comes from four southern states.
- Unfavorable regulatory stance may impact profitability.

Valuation: We are positive on the low-ticket housing finance business and believe that there is a big opportunity for growth in this segment. While the next 2-3 quarters may see some stress due to demonetisation, we are confident on RHFL's business model. We believe that at 3x FY2018E Adjusted Book Value Per Share, the valuations are attractive. We believe that there may be 18-20% upside from the current level for long-term investors.

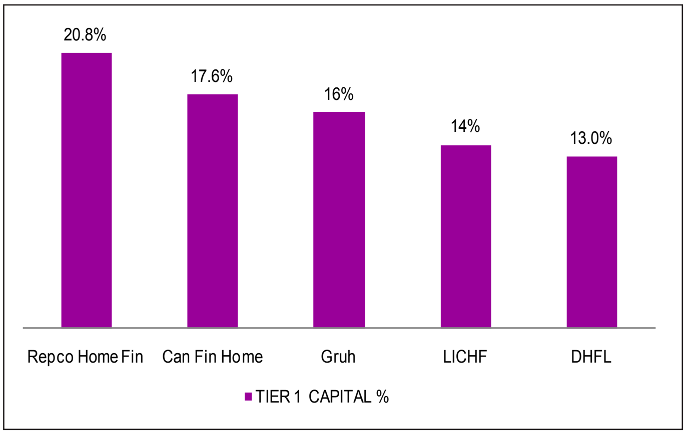
Valuation Rs cr

Particulars	FY14	FY15	FY16	FY17E	FY18E
Net Interest Income	209.4	260.4	332.4	396.0	499.5
Growth (%)	49.7	24.4	27.6	19.1	26.1
Pre-provisioning profit	174.2	209.5	273.4	325.1	416.1
Growth (%)	48.2	20.2	30.5	18.9	28.0
PAT	110.1	123.1	150.1	206.9	266.5
Growth (%)	37.4	11.8	22.0	37.8	28.8
EPS	17.7	19.7	24.0	33.1	42.6
Growth (%)	37.5	11.4	21.6	37.8	28.8
BVPS	118.7	130.2	152.7	182.1	219.9
Growth (%)	16.4	9.7	17.2	19.3	20.8
P/E (x)	15.1	25.9	26.4	19.2	14.9
P/BV (x)	2.2	3.9	4.2	3.5	2.9

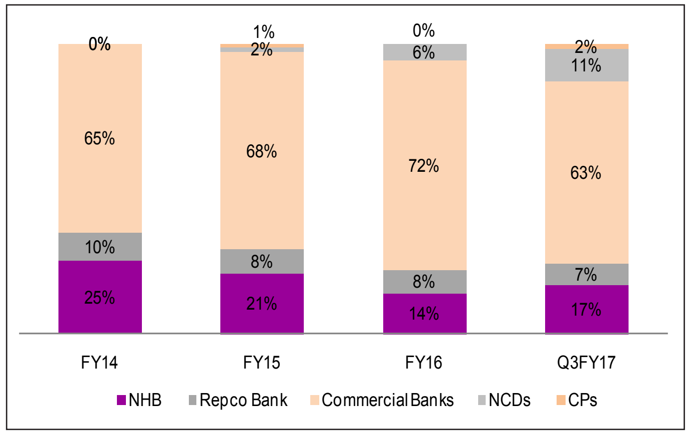
Peer comparision

Particulars	P/BV (x)			ROE (%)			ROA (%)		
	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
Repco Home Finance	4.0	3.4	2.8	17.0	19.8	21.2	2.2	2.4	2.5
Gruh Finance	15.9	13.0	10.6	31.4	29.9	29.7	2.4	2.3	2.3
DHFL	1.9	1.7	1.5	15.1	16.4	16.9	1.2	1.2	1.3
LIC Housing Fin	3.1	2.7	2.3	19.6	19.4	20.9	1.5	1.5	1.6
Can Fin Homes	5.8	4.9	3.9	19.1	22.7	23.4	1.6	1.9	1.8

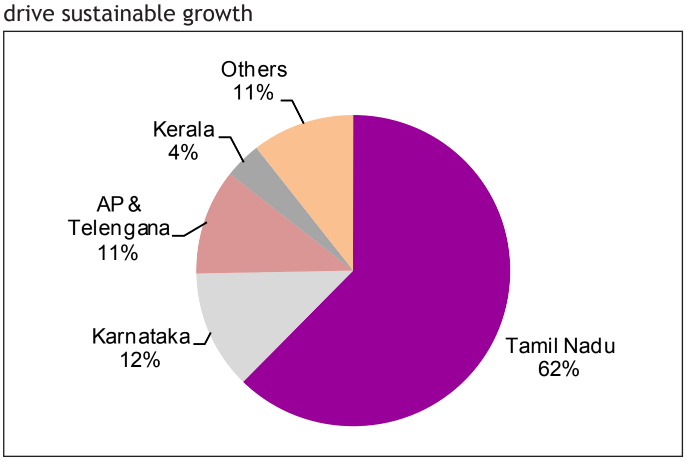
Relatively higher Tier 1 capital vs peers (Tier 1 of Gruh, Repco, DHFL, LICHF, Canfin Homes and GIC Housing)



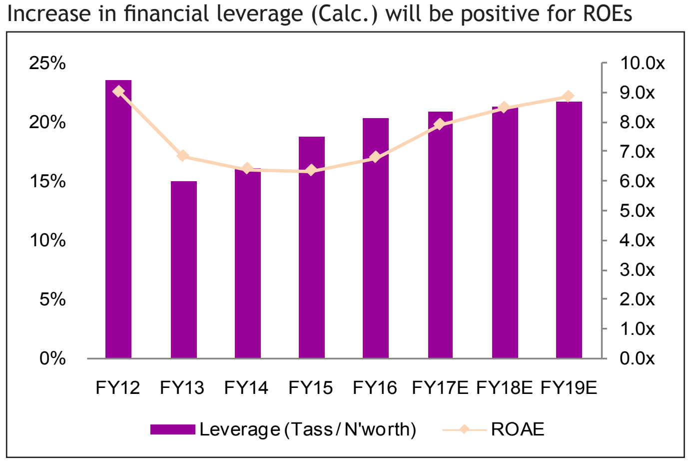
Borrowing mix for Repco in last 3 years; Reducing dependence on bank borrowing a positive for cost of funds



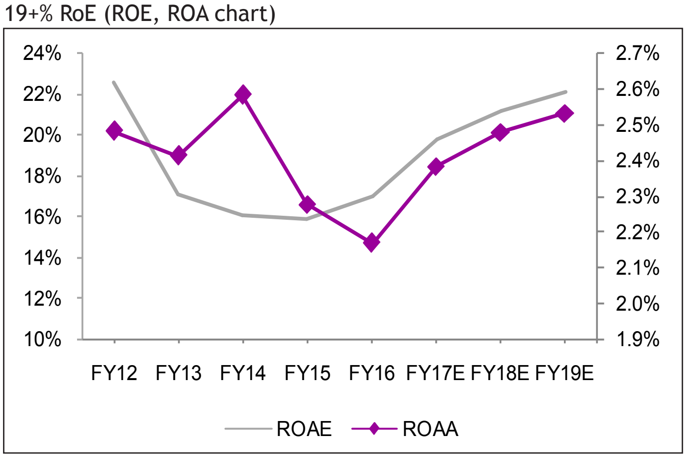
A South-heavy geographical distribution – local knowledge helps drive sustainable growth



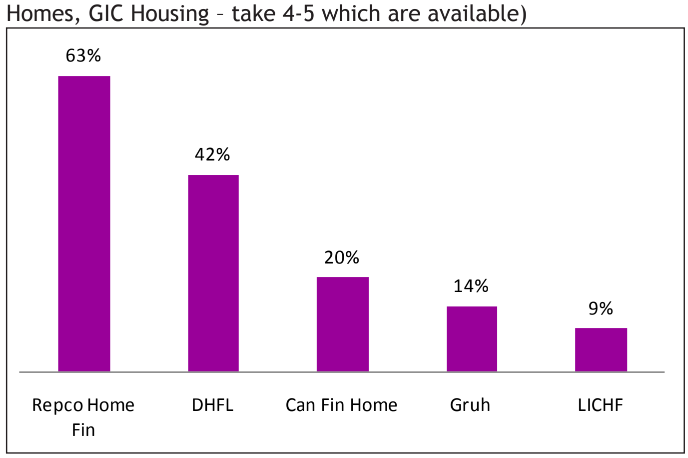
Increase in financial leverage (Calc.) will be positive for ROEs



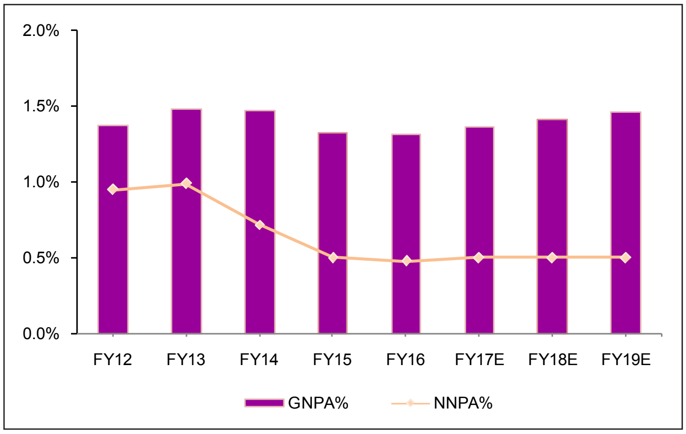
19+% RoE (ROE, ROA chart)



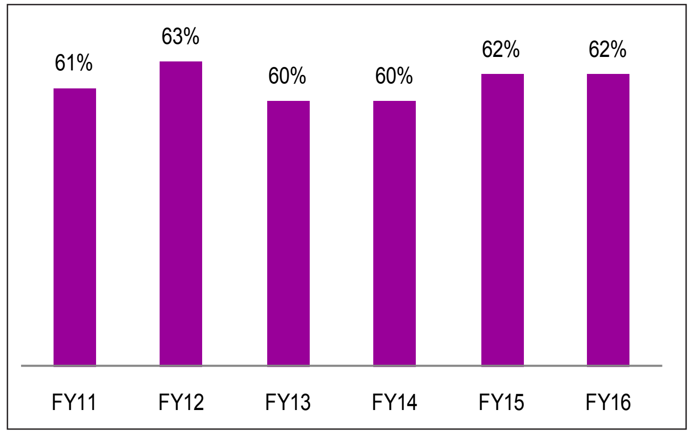
Proportion of bank borrowings remains very high vs peers (bank borrowing / total borrowings of Gruh, Repco, DHFL, LICHF, Canfin Homes, GIC Housing – take 4-5 which are available)



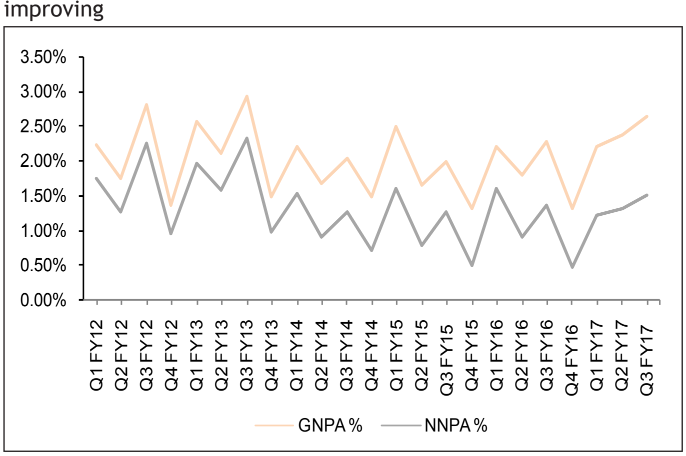
Strong asset quality maintained



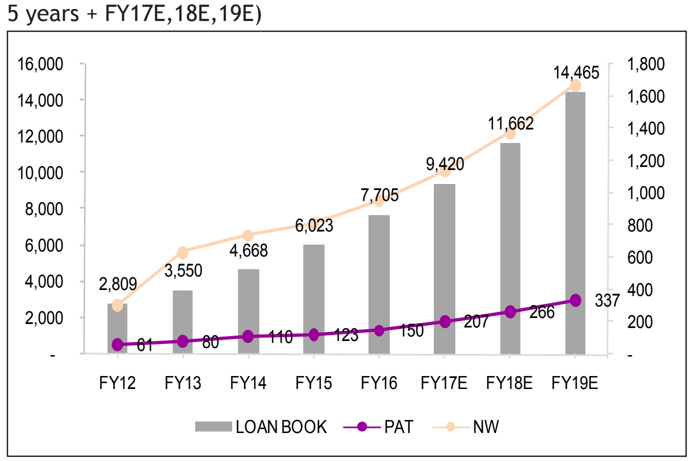
Consistent LTV (yearly) helps to maintain asset quality



Despite intra-quarter volatility in asset quality, annual trend is improving



Asset growth justifying Net Worth growth (AUM, Net Worth in last 5 years + FY17E,18E,19E)



Company background:

Repco Home Finance (RHFL) is a well-run NBFC-HFC (Non Banking Finance Company - Housing Finance Company) operating in the housing finance space to Salaried (40.3% of loan book) and Non-salaried (59.7%) segments. It is operating in a niche business segment, which caters to an under-served segment of small-ticket (average loan per unit of Rs13 lakh) and Non-salaried borrowers as well as small-ticket salaried borrowers. RHFL's loan book comprises 20.6% LAP while the rest is Individual Home Loans. Self-occupied residential real estate is an attractive business and is considered relatively safe and immovable collateral. Still, banks have so far not been able to meaningfully penetrate this segment since this clientele requires a high-level of servicing, which banks find difficult to maintain.

Since its IPO in March 2013, RHFL has grown its Net Worth by 40%, its loan book by 55% and its PAT by 80% and is still well capitalised (20% tier1 CRAR), indicating effective and efficient use of capital. Repco Bank (65% owned by GOI & State Govts) holds a 37% shareholding in RHFL. Business-wise, RHFL has strong concentration in South India (Tamil Nadu, Karnataka, Telengana and Andhra Pradesh together account for ~90% of its total loan book), which also helps RHFL to provide strong on-ground understanding of the region. A strong market understanding has not only helped RHFL to have a high growth trajectory, but it has also enabled it to maintain a relatively decent asset quality (NNPA ~50-160BPS in last 12 quarters). However, demonetisation adversely impacted the company's business. Along with a relatively weak Q3FY2017 performance, the asset quality has increased sharply. We believe that a traditionally strong Q4 would help the company to improve its performance in the short term.

The HFC enjoys "AA" ratings (Stable) from ICRA, CARE (which has improved from AA-) and we expect it to improve further, with incremental improvement in its asset quality. As on December 31, 2016, its retail network comprised 121 branches and 32 satellite centers spread across 11 states and the Union Territory of Puducherry.