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20 YEARS

Initiating Coverage

Repco Home Finance Ltd.

19-November-2020

RETAIL RESEARCH

Repco Home Finance Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Housing Finance	Rs. 238	Buy at LTP and add on dips to Rs.221-225 band	Rs. 268	Rs.299	2 quarters

HDFC Scrip Code	REPHOME
BSE Code	535322
NSE Code	REPCOHOME
Bloomberg	REPCO IN
CMP Nov 18, 2020	238
Equity Capital (Rs cr)	62.6
Face Value (Rs)	10.0
Eq- Share O/S (cr)	6.26
Market Cap (Rs cr)	1488.9
Book Value (Rs)	285.6
Avg. 52Wk Volumes	332091
52 Week High	366.2
52 Week Low	90.3

Share holding Pattern % (Sept, 2020)	
Promoters	37.1
Institutions	39.3
Non Institutions	23.6
Total	100.0

Fundamental Research Analyst
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Our Take:

Repco Home Finance Ltd (RHFL) is a niche player in the small-ticket housing finance market (median Rs 1.5 mn). It focusses on underserved markets, especially the self-employed in Tier 2 and 3 cities. Factors like low mortgage penetration, government's impetus for 'Housing for All' and incentives for affordable housing bode well for the company. Long term prospects of the sector look good but near term growth prospects are seen to be muted due to the standstill situation of the economy brought about by the lockdown due to Covid-19. Overall core housing credit growth is expected to moderate to single digit in FY21E - lower than three-year CAGR of 16% led by the Covid-19 induced crisis. The company has witnessed a steady growth in the past by increasing its geographical footprint by deepening reach selectively in existing regions and expanding to new regions, continuing focus on under penetrated markets. Comfortable capital adequacy levels and healthy profitability, balanced portfolio mix, robust risk management systems and processes, strong foothold in south India with an established track record, stable and experienced senior management team bode well to capitalise on underpenetrated mortgage financing opportunity of the country.

The year gone by was a challenging one for HFCs from both a microeconomic and macroeconomic point of view but the company's financial performance and overall financial health remained strong. The company will continue to maintain the non-housing book at or below 20% with continued focus on small ticket loans and will strike a right balance between salaried and non-salaried loans which help in keeping the balance sheet quality robust. Once the current uncertainty is over, the company will attempt to restart its granular retail only growth strategy. Target segment of the company will continue to be small salaried customers employed with MSMEs and SMEs and unsalaried customers running MSMEs, small shops and the like with aspirations to own a house in Tier 2, Tier 3 and Tier 4 towns.

Valuations & Recommendation:

Repco Home Finance is in a niche segment within housing finance – lending to unsalaried MSME owners for property in Tier 2,3 and 4 towns with an average lending of Rs.15 lakhs. While the opportunity is large, the recent Covid related disruption may lead to some asset quality issues for the company for the near term. However once the economy is back on track, a lot of their issues can get resolved soon. Repco faced multiple issues like slow growth in home market, liquidity crisis in NBFC industry and rising delinquencies in non-salaried segment. Problems of the past (sand mining and the registration ban in Tamil Nadu) continue to impact the company's growth. As a result,

Repco underwent huge de-rating with 1-yr forward price to book multiple falling to less than 1.0x from a peak of 4x during FY17. Since then, it has added capacity to grow business outside home turf and added specialised branches to focus on recovery of bad loans. At such low valuations, Repco could be a good acquisition candidate.

We think the base case fair value of the stock is Rs.268 (0.9xFY22E ABV) and the bull case fair value of the stock is Rs.299 (1.0xFY22E ABV) over the next two quarters. Investors can buy the stock at the LTP and add on dips to Rs. 221-225 band (0.75xFY22E ABV)

Financial Summary (Consolidated)

Particulars (Rs cr)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY18	FY19	FY20	FY21E	FY22E
NII	135	116	*16.1*	125	*7.3*	436	443	492	491	513
PPoP	116	102	*13.1*	108	*7.0*	382	377	420	414	429
PAT	81	101	*-19.7*	64	*26.3*	201	235	280	228	261
EPS (Rs)	13	16	*-19.8*	10	*26.3*	32.2	37.6	44.8	36.5	41.7
P/E (x)						7.4	6.3	5.3	6.5	5.7
P/ABV (x)						1.3	1.1	1.0	0.9	0.8
RoAA (%)						2.1	2.3	2.4	1.9	2.0

(Source: Company, HDFC sec)

Q2FY21 Result Review:

The company reported PAT of Rs 80.8cr in Q2FY21 as against Rs 100.6cr in the same quarter of previous year. The degrowth in PAT numbers were mainly due to higher provisions of Rs 72cr. PPoP was at Rs 115.5cr (vs Rs 102.1cr in Q2FY20) supported by lower interest cost. As the country observed partial lockdown restrictions, the company's operation matrix like disbursement and AUM growth saw subdued growth. However, NII rose 16.1%/7.35% YoY/QoQ. Relatively lower credit cost for the quarter aided profitability. PPoP grew 13% YoY, as the company reported higher operating expense during the quarter.

AUM growth continued to slow, reaching just 5.2% YoY (slowest ever). We continue to expect sluggish loan growth, amid likely stiff competition from banks and uninspiring macros. The silver lining was the sequential improvement in asset quality; GNPAs dipped 5bps QoQ to 3.95%, somewhat aided by the standstill classification benefit and collections in overdue accounts. However, asset quality risks still persists. RHFL's collection efficiency which stood at 60-65% in Aug 20, improved and reached 93% in Sep 2020. ~Rs8 bn of loans (6.3% of book) have not serviced even a single EMI.

Triggers:

Housing Sector – Near Term 'Uncertain'; Medium Term 'Positive':

Rapid urbanisation, increasing income levels, emerging nuclearisation of families and growing aspirations are the key growth drivers of the housing sector. With the country's mortgage financing being underpenetrated at sub-10% of GDP, NBFCs and HFCs have taken advantage of this potential and have been the biggest drivers of housing finance growth. The mortgage to GDP ratio for India is expected to grow significantly over the next few years compared to other developing countries. Also, the difference between home loan interest rate and rental yield is at decadal low making purchasing a house more attractive than renting it.

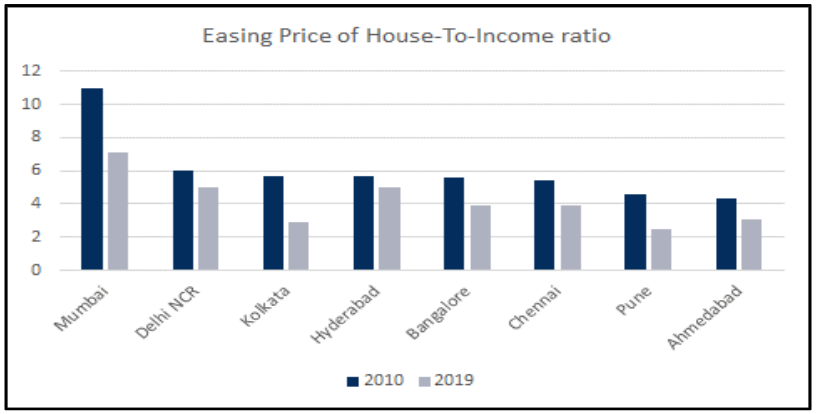
Long term prospects of the sector look good but near term growth prospects are seen to be muted due to the standstill situation of the economy brought about by the lockdown. Overall core housing credit growth is expected to moderate to single digit in FY21E - lower than three-year CAGR of 16% led by the Covid-19 induced crisis. In addition, a significant reduction in competitive intensity within the HFC universe, a steady normalisation in disbursements, consolidation in the developer book, adequate capitalisation and a residential cycle showing early signs of recovery provides comfort. Most HFCs expect 70-95% of pre-Covid disbursement run rate by year end.

Well positioned to benefit from affordable housing gap:

The affordable housing finance sector holds prominence in India's financial sector. Affordable housing HFCs have grown faster than the industry in the past five years. Demand is expected to revive faster in this segment leading to high double digit growth, led by anticipation of faster revival of rural economy and niche availability by lenders. Government initiatives towards boosting affordable housing and vision of Housing for All bode well from long term stand point. The Government has undertaken several initiatives under the Pradhan Mantri Awas Yojana (PMAY) with the aim of building 50 million houses in urban and rural India by 2022. The Company extends affordable housing loans under rural housing, urban housing, PMAY (CLSS) schemes-EWS/LIG/MIG. The company caters to the need of the underserved such as the non-salaried segment, MSMEs, blue collared employees and others.

Improving Price of house-To-Income ratio:

Despite being India's most expensive housing markets, Mumbai recorded significant improvement in housing affordability from eleven times the annual household income in 2010, to a little over seven times the annual income in 2019. Similar trends is seen across major cities. Although the company's target clients are not those living Tier-1 cities. Fall in the price of house-to-income ratio indicates increasing affordability in the housing space across India.

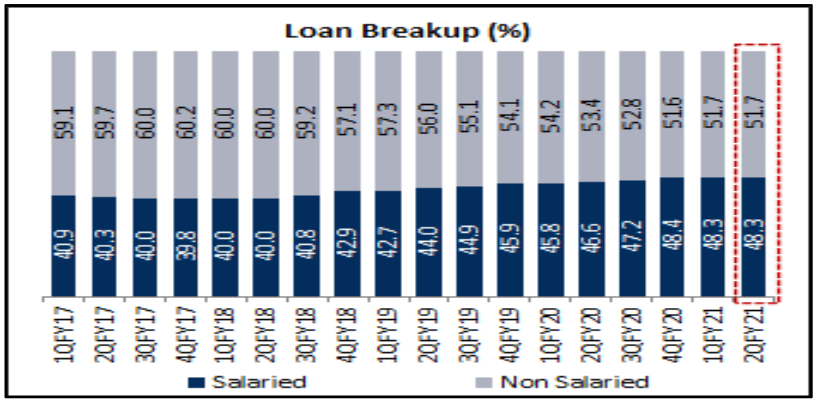


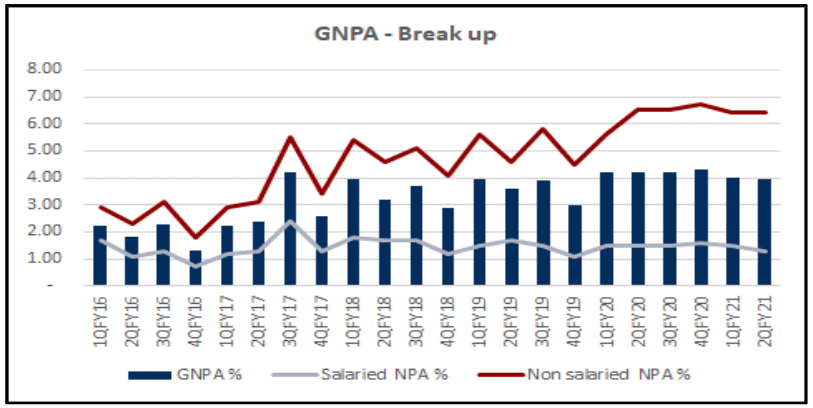
(Source: statista.com)

Focus on Niche Segment – Self-employed and low ticket size:

RHFL has traditionally focused on the niche non-salaried segment, especially in tier 2 and tier 3 cities, which has allowed it to realise higher yields on its loans (which are 75-100bps higher than those of the salaried class), owing to challenges in the underwriting process for this class of borrowers which is largely based on 'assessed income'. The incentive structure is well aligned, with collections being an important parameter for Sales, Credit and Branch managers. Competition from banks and big HFCs is low, especially in the self-employed segment, due to income assessment-related challenges. Strong credit appraisal process, and a deep understanding of client segments and geographies, helped the company to establish its position in this low penetrated segment over the last decade. Although non-salaried segments continue to form more than 50% of its loan book, its share has been reducing. Increase in mix of salaried home loans could be yield dilutive in the medium term but improve the overall asset quality.

We are positive on RHFL's presence in an under-served market and grip on the self-employed segment. However, current challenges are likely to reset its near-term growth, which may moderate EPS growth. Given that asset quality is subdued in self-employed segment, the ability of RHFL to bring back the customers to regular repayments post the moratorium period and improve the asset quality amidst the current environment remains a key monitorable.





(Source: Company, HDFC sec)

Comfortable Capital Position:

RHFL's capital adequacy ratio (CAR) as at Sep 30, 2020 was 26.8% consisting entirely of Tier-1 capital. The company has been able to maintain a comfortable CAR of above 20% over the last five years ended March 31, 2020, aided by healthy accruals and modest growth. CAR stood at 25.85% as on March 31, 2020, as against 23.90% as on March 31, 2019. The entire CAR is made up of Tier I capital, thereby providing cushion to raise Tier II capital, if required. Over the medium term, as and when risk spreads revert to the mean, the company could securitize its loan assets and explore other options to maintain its capital adequacy to support its loan book growth. The current leverage of the company at ~7x also is lower than other HFCs which leaves enough scope for growth without much dilution in the near term.

Healthy Profitability:

RHFL has been able to maintain interest spread of around 3% for the last five years ended March 31, 2020. Spread coupled with stable operational expenditure and credit costs helped RHFL in maintaining RoAA over 2% the last few years. NIM remained flat at 4.39% in FY20 (4.33% in FY19). The yield on advances increased from 11.36% in FY19 to 11.75% in FY20 with company increasing lending rates on account of increase in cost of borrowings to 8.48% in FY20 (8.24% in FY19). Opex to average assets remained at flat at 0.93% in FY20. PPoP increased from Rs 377cr in FY19 to Rs 420cr in FY20. RoAA improved from 2.27% in FY19 to 2.44% in FY20 majorly due to decrease in tax rates during FY20, despite higher provisioning amount due to COVID. Although we expect the loan book to grow at slower pace; better

portfolio quality, due to tightened underwriting, collection and appraisal initiatives of the company will continue to support healthy profitability. We expect better RoAA incremental growth post-Covid in affordable housing, LAP, self-employed segment led by a combination of falling cost of funds and pricing power in certain segments.

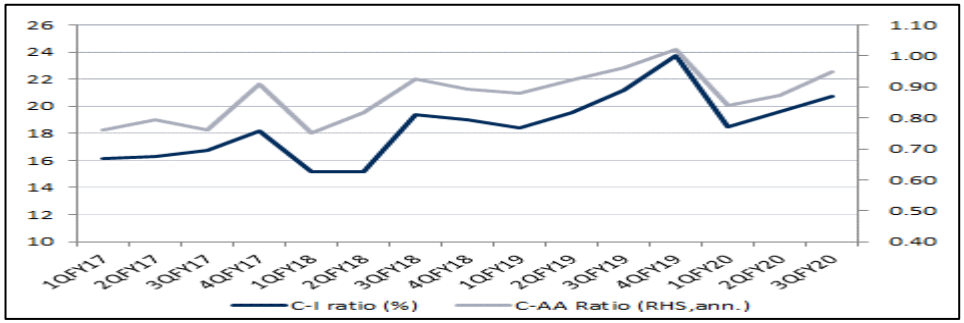
RoAA Tree:

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Net Interest Income	4.47%	4.39%	4.39%	4.38%	4.65%	4.29%	4.29%
Non Interest Income	0.46%	0.44%	0.43%	0.38%	0.27%	0.31%	0.29%
Operating Cost	0.91%	1.01%	0.93%	0.80%	0.84%	0.95%	0.93%
Provisions	0.53%	0.38%	0.57%	0.62%	0.80%	0.16%	0.52%
Tax	0.91%	1.17%	1.16%	1.17%	1.13%	1.21%	0.70%
RoAA	**2.58%**	**2.28%**	**2.17%**	**2.17%**	**2.14%**	**2.27%**	**2.44%**

(Source: Company, HDFC sec)

Scope for reduction in cost of funds:

RHFL's cost-to-income (C/I) ratio is high ~20%, compared to other HFCs, given the small ticket size business and considerable effort required to assess income levels in the self-employed space. The company's expansion plan in other states would help in achieving higher disbursements per branch, moderating the C/I ratio. We have seen modest growth in average loan per branch over the years, with a higher loan book growth in the states, the C/I ratio is expected to trend lower. Loan melas and referrals help in sourcing loans forming and controlling cost.



(Source: Company, HDFC sec)

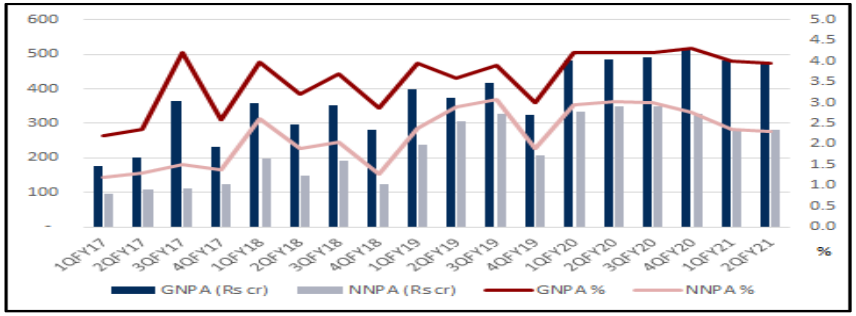
RETAIL RESEARCH

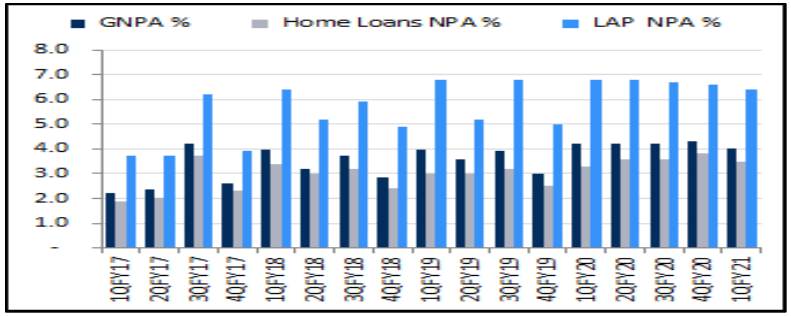
Asset Quality – Key Monitorable:

RHFL saw some weakness in asset quality parameters with increase in Gross NPA from 2.95% as on March 31, 2019 to 4.33% as on March 31, 2020. Historically, the GNPA level of RHFL has shown seasonality wherein GNPA levels have remained higher in June & December quarter. However, during FY20, GNPA levels continued to remain high at above 4.2% in all the four quarters. With expected fall in real estate prices & slowdown in economic growth due to impact of Covid-19, improvement in asset quality/recovery of bad loans in non-housing segment expected to be delayed. GNPA however witnessed some improvement in Q2FY21; Stage-3 assets which constituted 4.33% (Rs. 511.7cr) of the overall loan book as on March 31, 2020 fell to 3.95% (Rs 280.1crs) as on Sep 30, 2020. The provision coverage ratio on Stage-3 assets stood at about 41% at the end of Sep-end 2020. GNPA in non-housing segment continues to remain high at 6.2% as on Sep 30, 2020.

Given the tilt of the loan book towards the unsalaried segment and focus on Tier 2 & 3 areas of the country, the asset quality of the book exhibits significant volatility as they are more vulnerable to adverse economic cycles. Majority of the salaried customers work for micro, small and medium enterprises and also have volatile cash flows. To focus on recovery of the non-performing loans, RHFL had set up two exclusive recovery branches set up at Chennai and Bangalore in 2019 for recovery of these bad loans.

The Company's impairment loss allowance in respect of its loan portfolio as on Sep 30, 2020, includes an amount estimated by the management as potential Covid-19 impact. The company recognised an expected credit loss of Rs. 243.2cr, including an additional impairment loss allowance of Rs.51.2cr. Going forward, containing incremental slippages and undertaking effective recoveries from the overdue accounts would be critical to keep the asset quality under control.

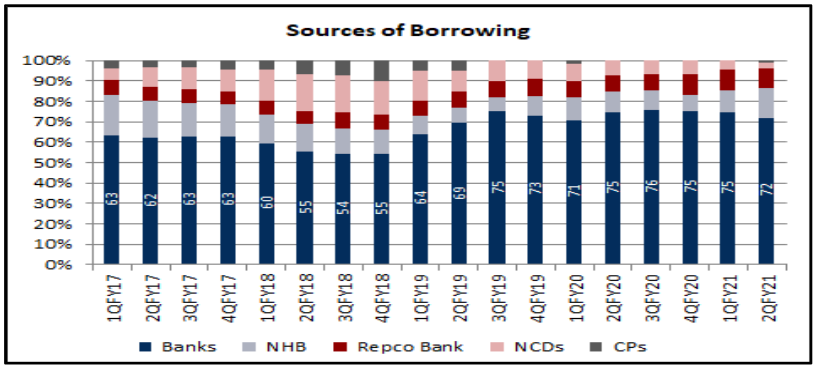


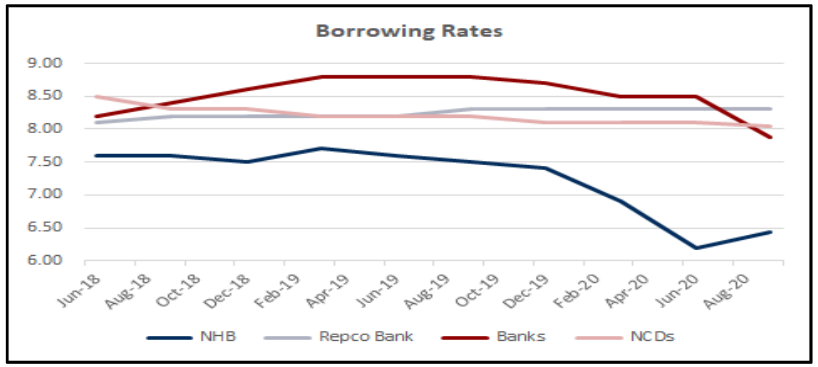


(Source: Company, HDFC sec)

Sources of Funding:

The company has a diversified sources of funding spread across five verticals viz. refinance from NHB, long-term bank loans, working capital loan from Repco Bank, non-convertible debentures (NCDs) and commercial papers (CPs). Bank borrowings is the major source of funding for RHFL, followed by other sources namely NHB Refinance, NCD and CP. RHFL has increased the borrowings from the bank since FY19 due to favorable interest rates. Therefore, bank borrowing as a % of total borrowings increased from 54% as on March 31, 2018 to 75% as on March 31, 2020 (excluding Repco bank). Given the relatively higher yields of NCD borrowing, RHFL has brought down the borrowing exposure to ~5%. Borrowings from NHB refinance, and Repco bank stood at 15% and 10% respectively as on Sep 30, 2020. Support from its parent company Repco Bank, which is Govt-owned also provides additional comfort. Favorable change in source of funding could support higher NIMs going ahead.





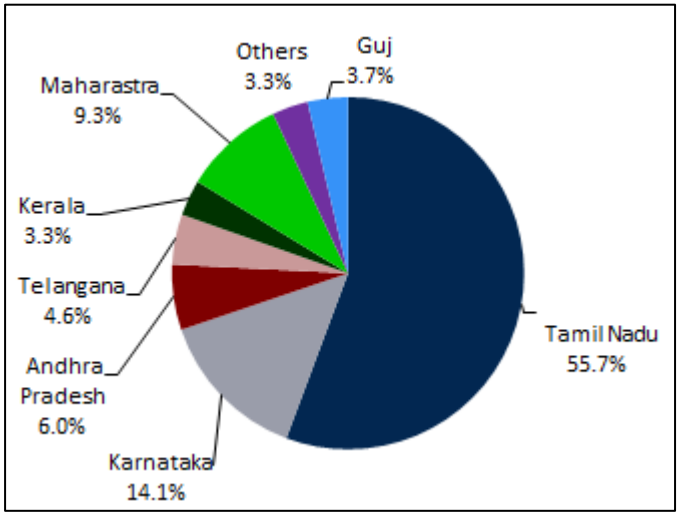
(Source: Company, HDFC sec)

Loan Growth to remain decent; albeit with a slower pace:

The competition within the Individual home loans segment has intensified over the last few months, as banks are flooded with surplus deposits, interest rates have been slashed aggressively, and hence, the lending to individual segment has become crowded. As highlighted by the management in Q1FY21 interaction, the takeover rate of customer has increased substantially recently. Since RHFL has a strong footing on the non-salaried segment, it faces limited competition from other HFCs and Banks. Stricker quality screening of client in this segment, over decade of experience in their strong foothold in South-India, could partially off-set the aggressive lending by banks and help achieve modest loan growth. Tepid growth expectations is also because of the company's higher concentration in Tamil Nadu.

Concerns:

Concentration in South India: RHFL portfolio is concentrated in South India with five South Indian states constituting around 84% as on Sep 30, 2020. Tamil Nadu (TN) accounted for about 56% of the total portfolio outstanding as on Sep 30, 2020, followed by Karnataka (14%), Maharashtra (9%), Andhra Pradesh (6%), Telangana (5%), Kerala (3%), Gujarat (4%) and the rest from Pondicherry, Jharkhand, Orissa, West Bengal and Madhya Pradesh. In FY20, the company ventured into the State of Rajasthan with a branch and added 2 more branches by the end of the year. Although the company has taken initiatives to improve its regional diversification by opening new branches in other states, RHFL's business is expected to remain concentrated in the South India states, particularly TN over the medium term. High exposure to Tamil Nadu has resulted in greater susceptibility to State specific adverse developments and slow-down in real estate sector in the region. The number of branches and satellite units are 153 and 24 respectively as on Sep 30, 2020.



(Source: Company, HDFC sec)

Relatively higher exposure to riskier borrower segments: RHFL lends primarily towards the housing finance needs of the relatively riskier asset class comprising of low/middle-income borrowers in the informal sector and slowdown on account of Covid-19 is expected to negatively impact credit profile of borrowers in this segment. This is expected to have an impact on the asset quality and profitability going forward. However, with moderate LTV and increased focus on collections, the ultimate losses could be restricted to a large extent. As on March 30, 2020, 84% of the outstanding portfolio is of below 70% LTV.

Slow-down in Real-estate Sector: The ongoing health crisis has cast a shadow of doubt on near term demand for housing and housing finance sector. Company's ability to raise resources at competitive rates in these difficult times adverse scenario could impact profitability and increase the loan book meaningfully could be hampered.

Company Profile:

Repco Home Finance Limited (RHFL) is a housing finance company (HFC) registered with National Housing Bank (NHB). RHFL was established in April 2000 as a wholly-owned subsidiary of the 'Repatriates Cooperative Finance and Development Bank Limited' (Repco Bank), a Government of India enterprise. The current stake of the promoter in Repco Home Finance is 37.13%. The company offers mainly two products – individual home loans (81%) and loans against property (LAP) (19%) in low ticket sizes. The company provides a variety of tailor-made home loan products to individual borrowers in both salaried and non-salaried (self-employed professional and self-employed non-professional) classes to suit various requirements.

RHFL follows a hub-and-spoke model and has a presence in twelve States and one Union Territory through its network of 153 branches and 24 satellite centers (sub-branches) as on Sep 30, 2020. RHFL has an AUM of Rs. 12,089cr as on Sep 30, 2020, with an average ticket size of Rs. 15 lakhs, primarily concentrated in South India. The company's focus is on under-penetrated markets in Tier 2 & Tier 3 cities and has 48% of its portfolio to the salaried segment & the rest towards the self-employed segment of borrowers. RHFL's greater focus is on direct sourcing of acquisition – are loan camps (35% of incremental originations) , customer walk-ins, referrals; the company also employs direct selling agent and sales team for customer acquisition. It is well recognized brand in south India with an established track record, stable and experienced senior management team.

Repco Home Finance Ltd.

INCOME STATEMENT

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	1,085	1,163	1,317	1,365	1,414
Interest Expenses	649	720	825	874	901
Net Interest Income	**436**	**443**	**492**	**491**	**513**
Non interest income	25	32	34	33	35
Operating Income	**461**	**475**	**526**	**524**	**548**
Operating Expenses	79	98	107	110	119
PPoP	382	377	420	414	429
Prov & Cont	75	17	59	109	80
Profit Before Tax	307	360	360	305	349
Tax	106	125	80	77	88
PAT	**201**	**235**	**280**	**228**	**261**

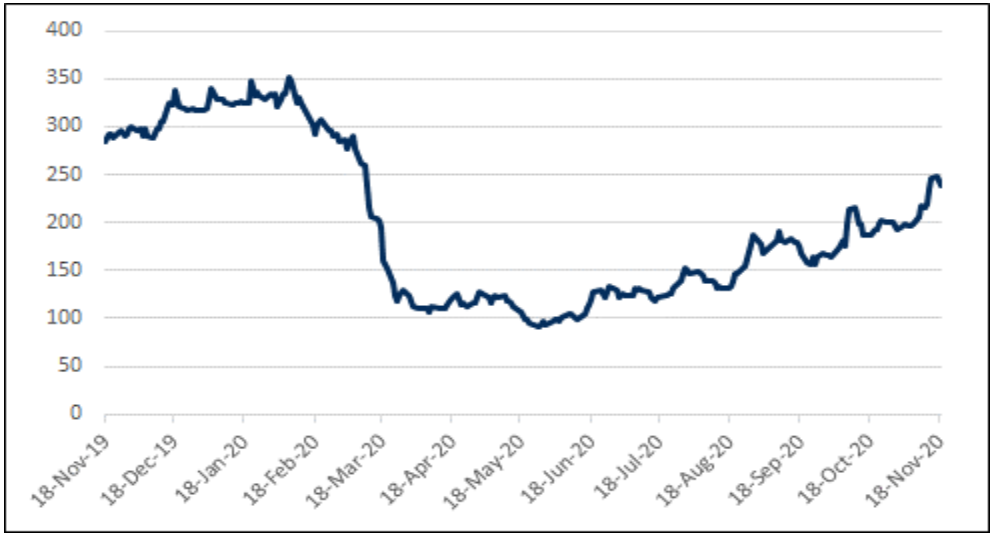
BALANCE SHEET

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Share Capital	63	63	63	63	63
Reserves & Surplus	1,246	1,465	1,724	1,938	2,183
Shareholder funds	**1,308**	**1,527**	**1,787**	**2,000**	**2,246**
Borrowings	8,134	9,349	10,109	10,574	11,007
Other Liab & Prov.	288	81	98	37	111
SOURCES OF FUNDS	**9,731**	**10,957**	**11,994**	**12,611**	**13,364**
Fixed Assets	14	16	17	20	24
Investment	16	22	22	26	26
Cash & Bank Balance	26	58	324	365	386
Advances	9,649	10,838	11,588	12,154	12,873
Other Assets	27	24	43	47	54
TOTAL ASSETS	**9,731**	**10,957**	**11,994**	**12,611**	**13,364**

RATIO ANALYSIS

As at March (Rs cr)	FY18	FY19	FY20	FY21E	FY22E
Return Ratios (%)					
Calc. Yield on adv	11.7	11.4	11.7	11.5	11.3
Calc. Cost of borr	8.3	8.2	8.5	8.5	8.4
Calc. NIM	4.7	4.3	4.4	4.1	4.1
RoAE	16.5	16.6	16.9	12.1	12.3
RoAA	2.1	2.3	2.4	1.9	2.0
Asset Quality Ratios (%)					
GNPA	2.9	3.0	4.3	6.4	6.6
NNPA	1.6	1.4	1.9	3.2	3.0
Growth Ratios (%)					
Advances	10.3	12.0	7.2	2.8	5.9
NII	18.6	1.7	11.0	-0.2	4.4
PPoP	15.1	-1.4	11.4	-1.4	3.6
PAT	10.3	16.7	19.5	-18.6	14.4
Valuation Ratios					
EPS (Rs)	32.2	37.6	44.8	36.5	41.7
P/E (x)	7.4	6.3	5.3	6.5	5.7
Adj. BVPS (Rs)	185.0	220.1	249.9	258.5	298.1
P/ABV (x)	1.3	1.1	1.0	0.9	0.8
Dividend per share (Rs)	2.5	2.5	2.5	2.0	2.2
Dividend Yield (%)	1.1	1.1	1.1	0.8	0.9
Other Ratios					
Cost-Income (%)	17	21	20	21	22
Leverage (x)	7.7	7.3	6.9	6.5	6.1

One Year Stock Price Chart



(Source: Company, HDFC sec)

Disclosure:

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