Repco Home Finance Ltd - Positive

Credible performance in a tough quarter

Healthy disbursements, steady spread and reasonable control on NPLs

Q3 FY19 was a challenging quarter for HFCs and NBFCs with many of them constrained to do business due to calibrated or marginal availability of liquidity. In context of this and the sticky issues in the home state of TN, Repco delivered a healthy 12% yoy growth in disbursements and loan portfolio. The non-TN portfolio (particularly Karnataka, Maharashtra, Telangana and Gujarat) continues to grow by a strong 23-25% yoy driven by branch expansion and market penetration, and its share in the overall loan book rose to 42%. The asset profile also continues to move towards home loans and salaried customers (informal segment).

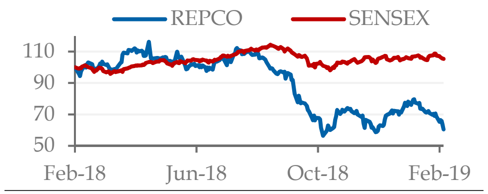
While the funding cost went up by 15-20bps qoq with increased reliance on banks and them introducing/expanding spread over MCLR, the lending spread was sustained at 3% with significant lending rate hike coming into effect for FY18-ending portfolio and upward adjustment in disbursement rate during the year. Incremental lending spread is at 2.5%. While loan portfolio re-pricing would be gradual henceforth, the cost of funding is expected to stabilize. Repco is again tapping the CP market where short-term money is available at rates prevailing before the crisis.

CMP (Rs) 336

Stock data (As on Feb 15, 2019) **Sector: Financials**

Sensex:	35,809
52 Week h/l (Rs)	653/ 293
Market cap (Rs mn)	21,011
Enterprise value (Rs mn)	-
6m Avg t/o (Rs mn):	276
FV (Rs):	10
Div yield (%):	0.6
Bloomberg code:	REPCO IN
BSE code:	535322
NSE code:	REPCOHOME

Stock performance



Shareholding pattern (As of Dec'18 end)

Promoter	37.1%
FII+DII	46.8%
Others	16.1%

Exhibit 1: Result table

Y/e 31 Mar (Rs mn)	Q3 FY19	Q2 FY19	% qoq	Q3 FY18	% yoy
Operating Income	3,038	2,909	4.4	2,743	10.7
Interest expended	(1,848)	(1,755)	5.3	(1,621)	14.0
Net Interest Income	**1,190**	**1,154**	**3.1**	**1,122**	**6.1**
Other income	2	51	-	3	-
Total Income	**1,192**	**1,205**	**(1.1)**	**1,125**	**5.9**
Operating expenses	(253)	(236)	7.3	(218)	16.0
Provisions	(182)	35	-	(265)	-
PBT	757	1,004	(24.6)	642	17.9
Tax	(201)	(338)	(40.7)	(218)	(8.0)
PAT	**556**	**666**	**(16.4)**	**424**	**31.2**

Source: Company, YSL

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Exhibit 2: Key Ratios

(%)	Q3 FY19	Q2 FY19	% qoq	Q3 FY18	% yoy
NIM	4.4	4.5	(0.1)	4.7	(0.3)
Yield*	11.5	11.4	0.2	11.7	(1.0)
Cost of Funds*	9.0	8.9	0.1	8.2	0.8
Spread	3.0	3.1	(0.1)	3.3	(0.3)
Cost to Income	21.2	19.6	1.7	19.4	1.8
Gross NPA	3.9	3.6	0.3	3.7	0.2
ECL	0.8	0.7	0.1	NA	-
Cum. RoA	2.4	2.5	(0.1)	2.4	-
Cum. RoE	18.7	19.0	(0.3)	18.7	-

Source: Company, YSL
*Calculated

Exhibit 3: Business Information

Particulars	Q3 FY19	Q2 FY19	% qoq	Q3 FY18	% yoy
AUM	**106,668**	**103,820**	**2.7**	**94,904**	**12.4**
Sanctions	8,052	8,340	(3.5)	7,725	4.2
Disbursements	7,332	7,766	(5.6)	6,571	11.6
Customer Mix*					
Salaried	47,894	45,681	4.8	38,721	23.7
Non-Salaried	58,774	58,139	1.1	56,183	4.6
Product Mix*					
HL	87,041	84,821	2.6	76,967	13.1
LAP	19,627	18,999	3.3	17,937	9.4
Geographical Mix*					
Tamil Nadu	61,441	60,631	1.3	57,607	6.7
Non-Tamil Nadu	45,227	43,189	4.7	37,297	21.3

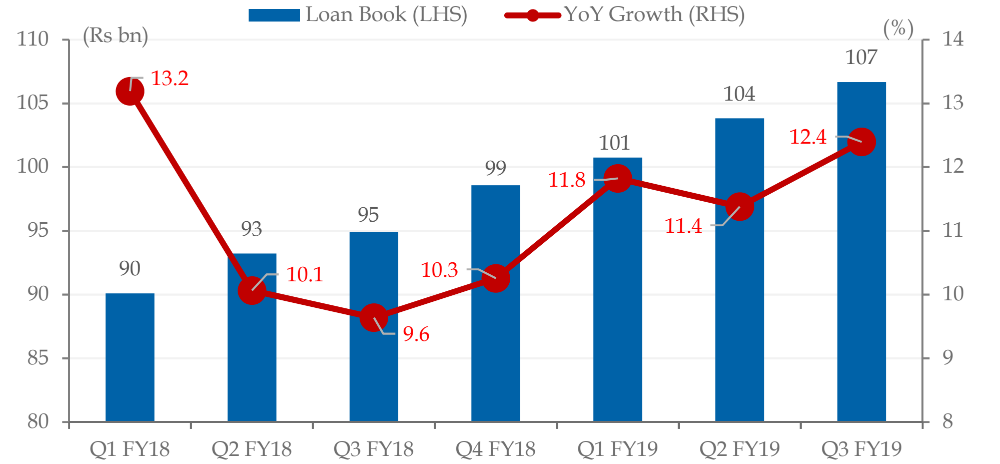
Source: Company, YSL
*Calculated

The operating cost has been much higher in the year due to increased legal expenses (SAFAESI initiation), steady pace of branch expansion and fees paid to KYC consultants. Notably, all the sourcing and legal costs have been recognized upfront and not amortized or capitalized. Though company recovered Rs300mn worth of NPLs in Q3 FY19, the pool refrained from coming down due to persistent new accruals in TN as well as other states. Asset quality outlook is encouraging with SARFAESI initiated in ~50% cases (properties seized in accounts worth ~Rs450mn), about 50% of the non-SARFAESI NPLs being technical NPLs (active accounts) and structural operating changes made to sharpen focus on collection and recovery. Considering, Repco's history of negligible principal loss/write-off, the ECL based credit cost should settle at benign levels.

Near-term operational concerns priced-in; valuation is attractive

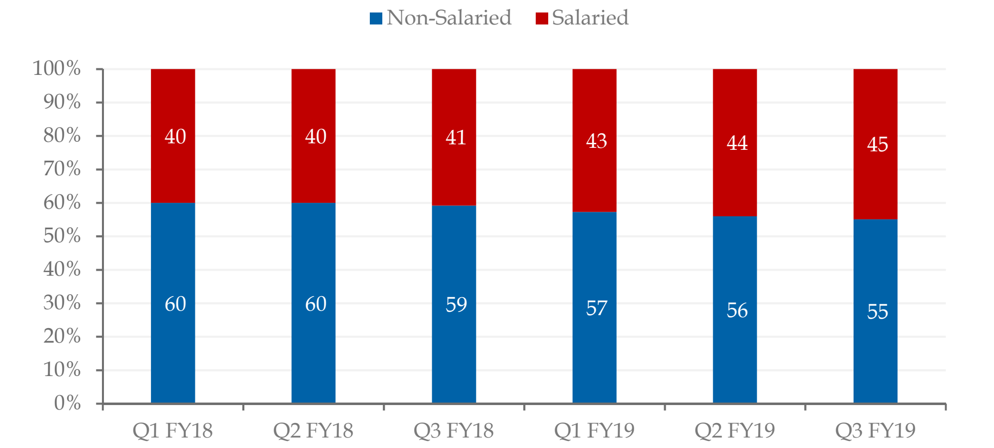
While the management has taken noteworthy steps to diversify out of TN and resolve the stressed accounts, concerns over growth and to some extent on profitability will likely prevail in the near term. It is quite possible that structural growth and profitability could start returning after further waning of issues related to sand mining and recovery from a large set of current NPLs. With spreads being protected through a well-defined transmission mechanism and cost ratios poised to improve, the trend RoA/RoE of 2.3%/18-20% can be achieved in FY21. The current valuation of 1.4x P/BV and 8.7x P/E seems to be largely discounting the near-term uncertainty but the not the long-term prospects.

Exhibit 4: Steady loan book growth



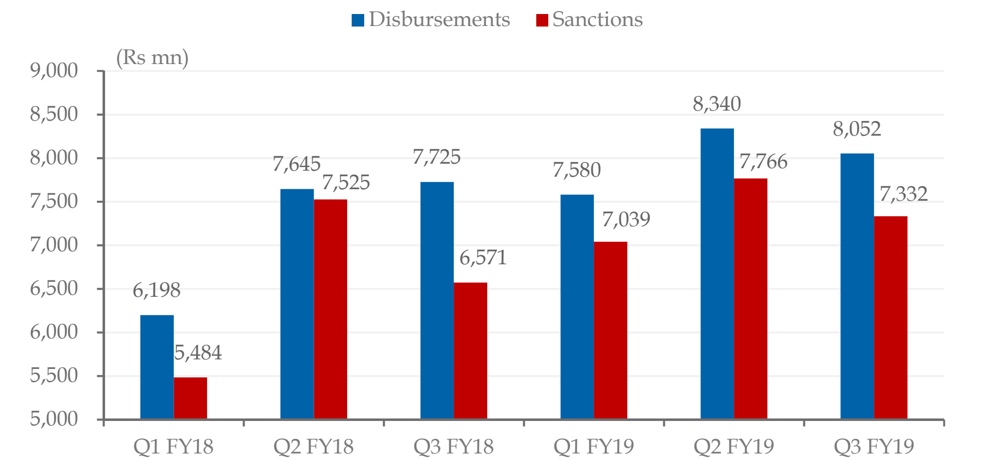
Source: Company, YSL

Exhibit 6: Customer Segment – Shift towards Salaried continues



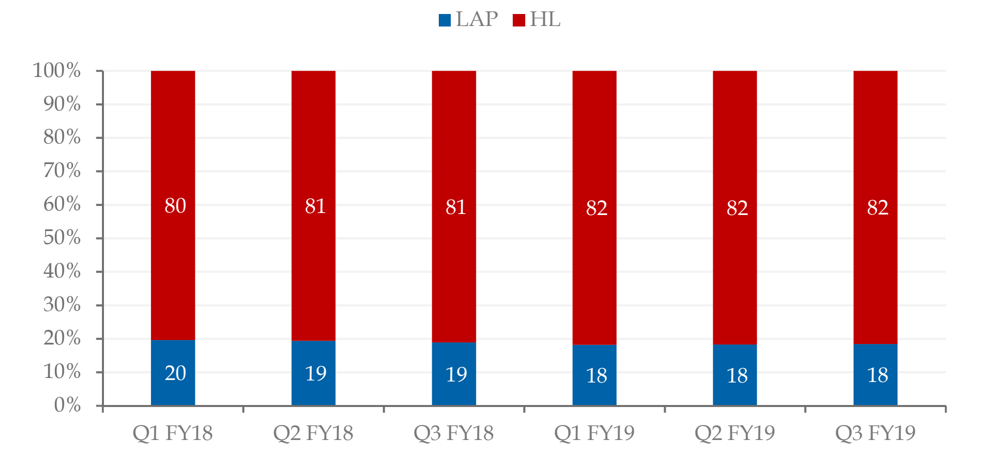
Source: Company, YSL

Exhibit 5: Healthy disbursements in a tough funding scenario



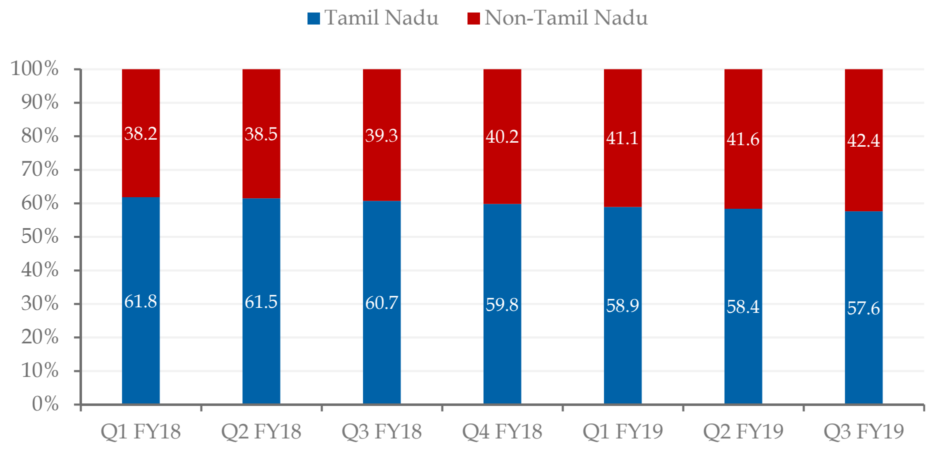
Source: Company, YSL

Exhibit 7: Product Mix - Shift towards Home Loans



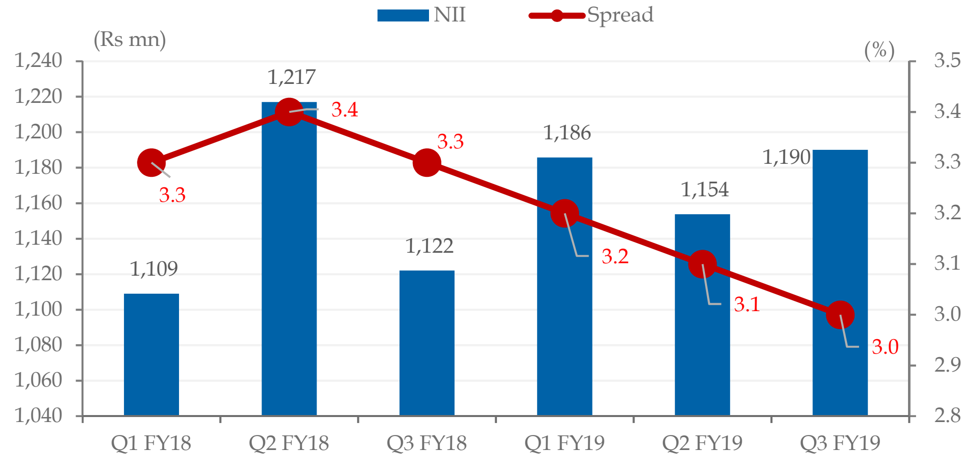
Source: Company, YSL

Exhibit 8: State Mix – Further shift away from the home state



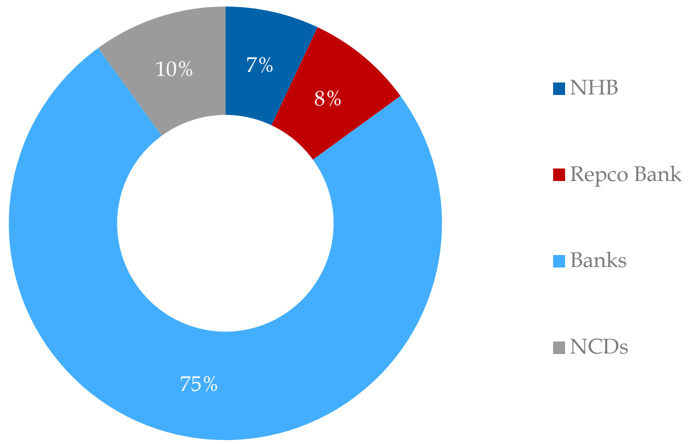
Source: Company, YSL

Exhibit 10: Pressure on Spread weighing on NII growth



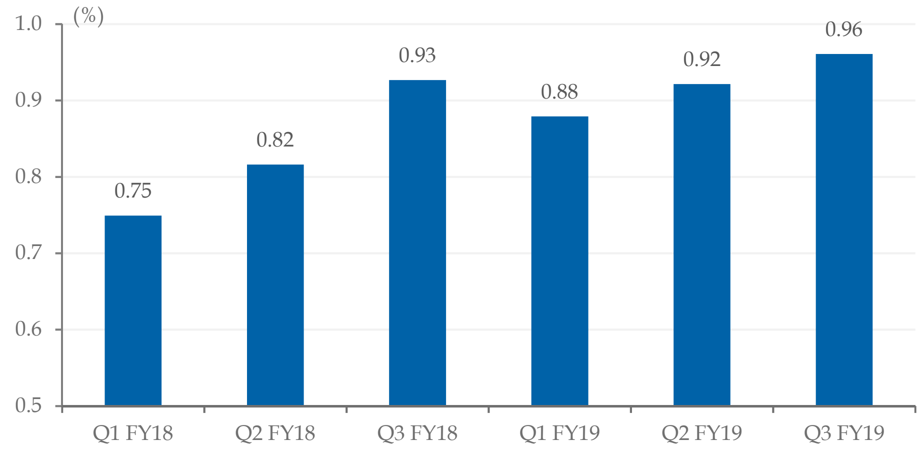
Source: Company, YSL

Exhibit 9: Increased reliance on Banks; CPs reduced to zero



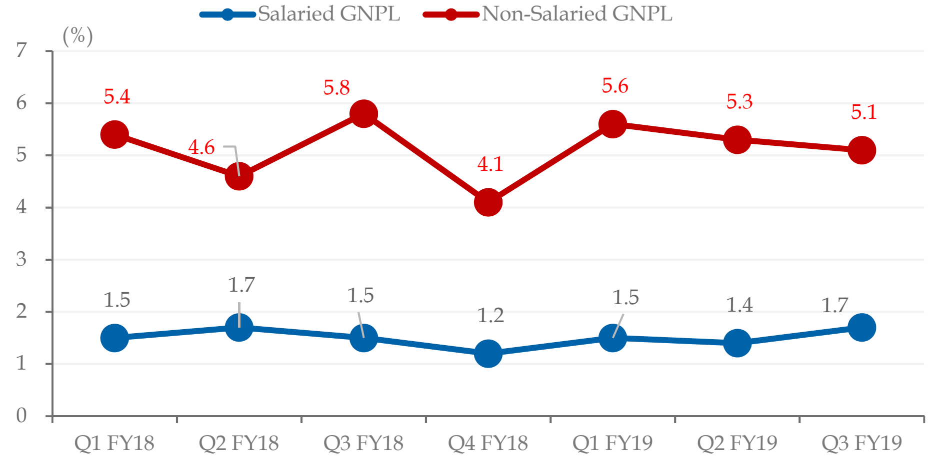
Source: Company, YSL

Exhibit 11: Uptick in Opex/Avg. AUM*



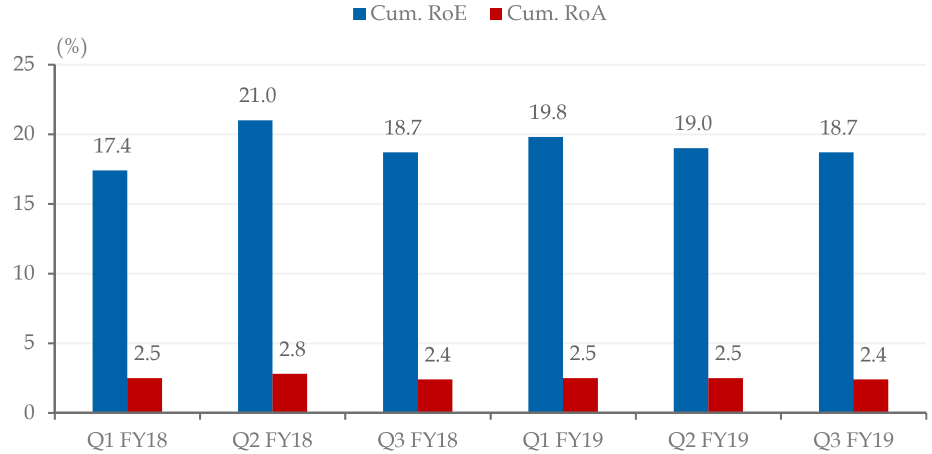
Source: Company, YSL
*Calculated

Exhibit 12: A surprising increase in Salaried NPLs



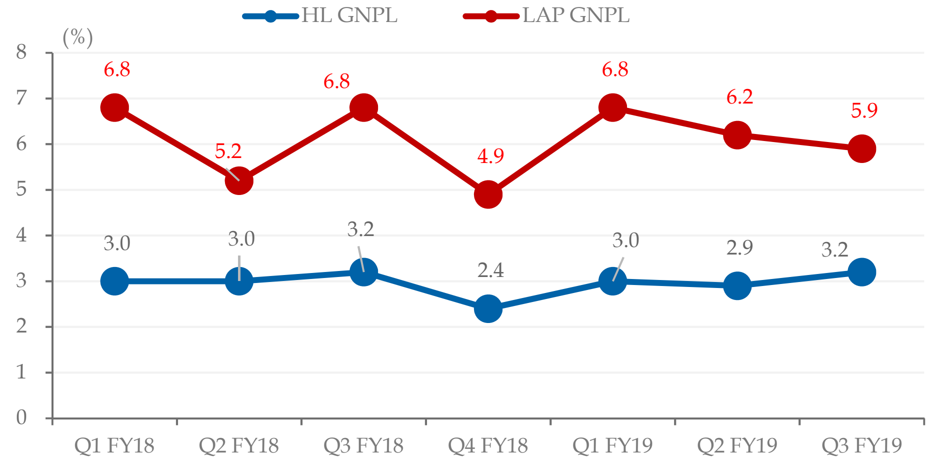
Source: Company, YSL

Exhibit 14: Healthy profitability maintained



Source: Company, YSL

Exhibit 13: Improvement in LAP GNPLs on back of recoveries



Source: Company, YSL

CONFERENCE CALL HIGHLIGHTS

- ✓ Adequate liquidity is available for loan growth. Unutilized facilities from banks and NHB combined at Rs12bn+. Repco is in the process to secure additional funding lines worth Rs20bn; of which, Rs10b is at an advanced stage of negotiation.
- ✓ Having reduced the CP exposure to zero by end Q3 FY19, the company has again started tapping this market. It can borrow 3-month money at rates prevailing before the liquidity crisis.
- ✓ All borrowings except CP and NCDs are at floating rate which totals to about 90%. Refinance from NHB has a 3-yr reset, Bank term loans are linked to 3m, 6m and 1-yr MLRs and the working capital facility has annual re-pricing.
- ✓ Many banks are pursuing for an increase in spread above the MCLR. So, funding will depend on both MCLR movement and any change in the opportunistic spread. Nonetheless, Repco has built a mechanism to pass any increase in funding cost.
- ✓ From April 1, 2018, the company introduced the concept of minimum lending rate (MLR) which would be calculated monthly based on trends in funding cost, cost of operations and cost of equity. The rates on all floating loans (pre-dominant portion) will be reset semi-annually. The entire portfolio outstanding at the end of March 2018 was re-priced on October 1 as per the prevailing MLR and the disbursements in 9m FY19 were as based on MLR and these loans will get re-priced every six months.
- ✓ In Q3 FY19, the annualized portfolio run-off rate (prepayments + repayments) further declined to 17.4% as against 18.5% in the preceding quarter. In Q3 FY18, it stood at elevated 20%. This is suggestive of competitive intensity easing-off, particularly driven by funding challenges encountered by NBFCs/HFCs post IL&FS crisis.
- ✓ In the home state of Tamil Nadu (TN) there has been some movement towards resolution with regards to key issues. Registration issue seems largely resolved and sand mining is not as major an issue today. Even competition has receded. The recent reduction in GST on unsold inventory and other policy measures could act as catalyst too. Management expects FY20 loan growth to be better than FY19.
- ✓ Opex has been trending higher in recent quarters driven by higher legal charges incurred with regards to SARFAESI actions and fee being paid to KYC consultant for double-checking credentials of customer for all LAP loans and home loans exceeding Rs5mn. The fee that is paid per file is being recognized upfront. Even other loan sourcing expenditures including DSA commissions are taken upfront and not amortized.
- ✓ From next year, Repco would start amortizing all loan sourcing and related expenses over the life of the loan, which is as per Ind AS. This coupled with expected branch/employee level productivity improvement will drive cost/income ratio towards 18-19% in FY20.
- ✓ To enhance resource productivity and to have a firm grip on the operations, Repco has created a vertical organizational structure based on sales, credit, collection and administration. Earlier, the company had a branch banking model wherein the branches were doing all activity except for underwriting and it was up to the BM to utilize his staff. The management plans to improve employee’s business productivity from Rs120mn pa to Rs150mn pa over the next two years.

- Against current gross NPLs at 3.9%, the company holds an ECL-based provisioning cover of more than 20%. The management has been tweaking the ECL model as advised by its consultant E&Y. This has been causing some volatility in quarterly credit cost. In Q3 FY19, the credit cost appeared higher in comparison to H1 FY19 largely due to excess provisioning (IGAAP related) being subsumed in Networth of Q2 FY19 and consequent alignment of incremental provisioning with the ECL model.
- Management expects ECL model to stabilize by March. They believe that Ind AS captures credit cost better than NHB provisioning method given that most 90+ dpd cases represent technical NPLs with customers continuing to pay current installments while gradually clearing the arrears. So, such cases get upgraded and there is Nil principal loss. A significant number of Repco's customers in the Salaried segment belong to the informal sector.
- Management is aggressively pursuing NPL resolutions through SARFAESI. It has been initiated in nearly 50% of NPLs in terms of value. Customers typically come and pay during the SAFAESI process and thus Repco has been able to recover ~Rs300mn in Q3 FY19. In cases worth Rs450mn, the company has even repossessed the property.
- Of the non-SARFAESI NPLs, accounts worth Rs1bn are technical NPLs with a high likelihood of getting regularized on clearance of arrears. Overall, the NPL portfolio is granular with the Top 100 accounts constituting about 10%.
- The company has opened two asset recovery branches (ARBs), one each in TN and Bangalore. ARBs are manned by specialized recovery officers and the stressed loans from surrounding branches have been transferred to it.
- New NPL accrual rate remains sticky though, coming from the back-book and not from loans underwritten in recent period. NPL level in TN is little higher at 4.1% versus 3.8% in other states.
- Management expects the gross NPL ratio to improve to 3% in Q4 FY19 and to 2.7-2.8% by the end of FY20.
- Repco is looking to maintain RoA at 2.3-2.4% and RoE at 18%+ in the longer run.

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ADD 5% to 15%

HOLD -15% to +5%

SELL > - 15%

NOT RATED

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