Repco Home Finance – BUY

25 March 2014

Initiating coverage

A niche player in a crowded market

We initiate coverage on Repco Home Finance (RHF) with a BUY recommendation and a target price of Rs390/share (2.5x FY16ii BV). RHF enjoys the benefit of small scale and operation in a niche segment. It is poised to build on its current platform by driving strong loan growth, to sustain superior profitability and gain scale. Increasing leverage should drive 25% earnings Cagr without dilution for the next 3-4 years. We believe this will help RHF sustain its premium valuations.

Housing Finance: Enough for all. Housing finance in India is a multi-layered space where financiers exploit gaps in terms of geographies, customer segments, and average ticket sizes, to evolve niche strategies and tailor-made credit delivery processes. Smaller players create a niche, depending on their internal appetite for risk and growth, to beat competition. Fine market segmentation creates enough opportunity for meaningful Housing Finance Companies (HFCs) to gain scale, drive profitability, and deliver superior returns.

RHF: All about execution and growth. RHF's core strengths are its expertise in assessing a risky customer class, maintaining consistent and institutionalised credit delivery process, and ability to operate with a lean cost structure. A relatively niche geographic presence, under-served target segment, and penetration will allow RHF to deliver 28% Cagr in loans through FY16ii. So long as RHF maintains the quality of execution, we believe it will be able to generate robust loan growth.

High growth trajectory, superior profitability to support valuations. We believe RHF would generate earnings Cagr of 25% through FY16ii, driven by high non-dilutive growth, stable margins, lean cost structure, and low credit costs. This, along with its small scale, niche positioning, and ability to leverage balance sheet and generate +20% ROE in the medium term will ensure continuation of premium valuations versus peers. Improving macro-economic conditions and lower interest rates will increase the upside potential.

Company update

CMP	**Rs323**
12-mth TP (Rs)	**390 (21%)**
Market cap (US$m)	**330**
Bloomberg	**REPCO IN**
Sector	**Banks**

Price performance (%)

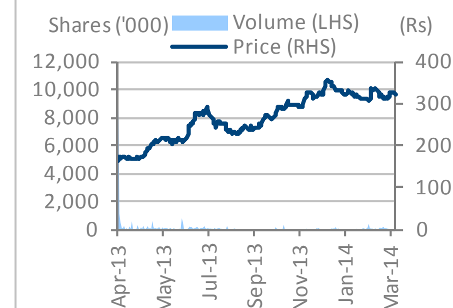
	1M	3M	1Y
Absolute (Rs)	(2.6)	(5.2)	0.0
Absolute (US$)	0.1	2.1	0.0
Rel. to Sensex	(8.6)	(10.1)	0.0
Cagr (%)		**3 yrs**	**5 yrs**
EPS		10.5	26.1

Shareholding pattern (%)

Promoters	37.4
FII	6.4
DII	12.0
Public	44.2

52Wk High/Low (Rs)	373/158
Shares o/s (m)	62
Daily volume (US$ m)	0.2
Dividend yield FY14ii (%)	0.4
Free float (%)	30.0

Stock performance



Financial summary (Rs m)

Y/e 31 Mar, Parent	FY12A	FY13A	FY14ii	FY15ii	FY16ii
Pre prov. operating inc. (Rs m)	972	1,160	1,476	1,862	2,401
Pre-exceptional PAT (Rs m)	615	800	1,011	1,263	1,587
Reported PAT (Rs m)	615	800	1,011	1,263	1,587
Pre-exceptional EPS (Rs)	13.2	12.9	16.3	20.3	25.5
Growth (%)	5.7	(2.7)	26.3	24.9	25.7
IIFL vs. consensus (%)			(8.0)	(9.9)	(8.7)
PER (x)	24.4	25.1	19.8	15.9	12.6
Book value (Rs)	65	102	117	135	158
PB (x)	**4.9**	**3.2**	**2.8**	**2.4**	**2.0**
CAR (%)	16.5	25.5	23.4	21.0	19.3
ROA (%)	2.5	2.4	2.4	2.3	2.3
ROE (%)	**22.3**	**17.1**	**14.9**	**16.1**	**17.4**

Source: Company, IIFL Research. Priced as on 24 March 2014

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Company snapshot

Repco Home Finance (RHF) is a housing finance company formed in 2000, promoted by Repco Bank and headquartered in Chennai, Tamil Nadu (TN). RHF has found a niche in providing Home Loans (HL) and Loan against property (LAP) to an under-served customer segment, usually avoided by larger banks and NBFCs. It focuses on peripheries of tier-1 cities and in centres designated as tiers 2 and 3. RHF has evolved strong processes for origination, centralised credit appraisal and monitoring, and collections and recoveries. Management's strict control over internal processes, supplemented by regular internal audits, branch audits, and tough action in case of non-compliance help it maintain discipline among employees and tackle operational risk.

There is significant geographic concentration in RHF's branch presence and business, i.e., 52% of branches are present in TN and 64% of the business comes from this state. Despite this, its own penetration in TN and other south Indian states is low, providing RHF the opportunity to deepen penetration in existing geographies in addition to expansion into new locations such as Maharashtra, Orissa, Gujarat and West Bengal.

RHF's customer profile predominantly comprises non-salaried individuals (55% of loans) with a loan mix of 17.5% constituting lending under LAP. This makes RHF's loan book relatively riskier compared with larger HFC's such as LICHF and HDFC. Although this reflects in relatively higher GNPA ratios, RHF's loan pricing and aggressive provisioning policies strive to mitigate this risk.

As a result of tier 1 ratio of 25%, RHF's ROE of 15% is currently subdued. However, by virtue of operating in a low-risk business, RHF can significantly lever up the balance sheet from 6.3x now to about 12-13x. This could potentially increase ROE to +20% in 5 years without any dilution.

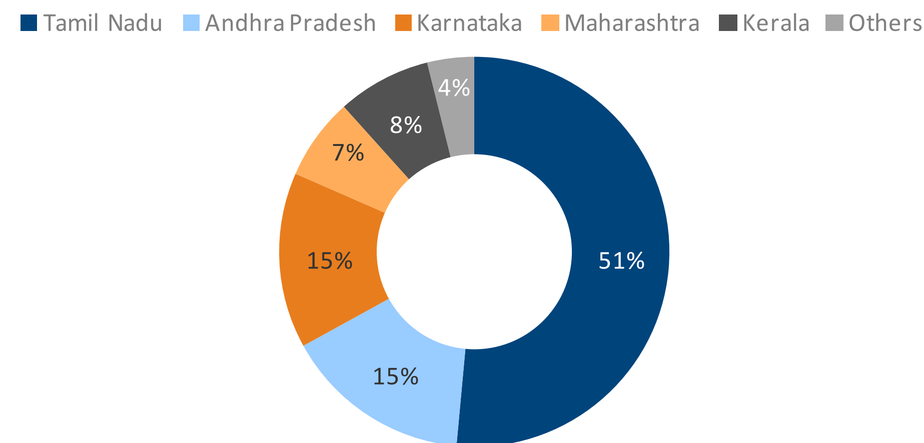
Figure 1: Shareholding pattern of RHF as of December '13

Shareholders	% share
Repatriates Co Operative Finance & Development (Repco) Bank	37.37
First Carlyle Growth VI	14.5
WCP Holdings III	10.0
Creador I LLC	7.5
SBI Emerging Businesses Fund	3.1
First Carlyle Growth VI	3.3
Nomura India Investment Fund Mother Fund	1.8
Citigroup Global Markets Mauritius Pvt Ltd	1.1
Bengal Finance & Investment Pvt Ltd	1.3
Reliance Capital Trustee Co. Ltd A/c Reliance Banking Fund	1.2
BNP Paribas L1	1.4

Source: BSE, IIFL Research

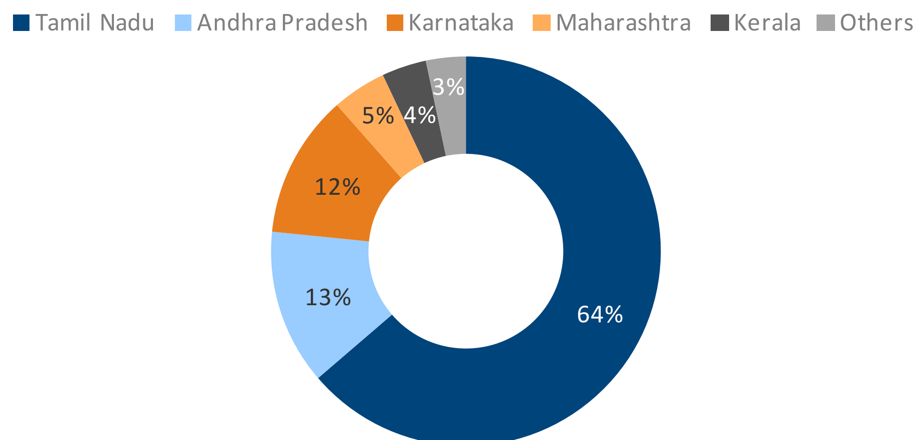
RHF had awarded 0.93mn shares to its employees at Rs78/share, which was below the then market price. Although this is a rare practice, it complies with SEBI guidelines and has been made available to all employees. Further, by mandate, RHF and Repco Bank have a common Managing Director.

Figure 2: State-wise retail network as of 3QFY14



Source: Company, IIFL Research

Figure 3: State-wise loan book break-up as of 3QFY14



Source: Company, IIFL Research

Figure 4: Management background

Name	Designation	Remarks
T. S. Krishna Murthy	Chairman	Has had a 50-year distinguished career in the IRS, serving as Chief Commissioner of Income Tax, in the Department of Company Affairs, Additional Secretary – Department of Expenditure, Ministry of Finance and as the Chief Election Commissioner of India.
R Varadarajan	Managing Director	He has 37years of experience of which the first 23 were spent in various capacities in Syndicate Bank. He joined RHF in 2000 as a General Manager. His term is due to end in September 2015
V. Raghu	Executive Director	He has varied experience in the financial services sector with State Bank of India, National Housing Bank and the Reserve Bank of India. He was associated with the Indian Wind Turbine Manufacturers Association before joining RHF.

Source: Company, IIFL Research

About Repco Bank

Repco Bank was incorporated in the year 1969 as the Repatriates Co-operative Finance and Development Bank as a Multi-state Co-operative Society under the Madras Co-operative Societies Act. It was formed to promote rehabilitation of repatriates from Burma and Sri Lanka by the Ministry of Home Affairs along with the State Governments of Tamil Nadu, Kerala, Andhra Pradesh and Karnataka. Initially, Repco Bank was allowed to provide banking services to the repatriates. However, as the flow of repatriates decline post 1987-88, the bank was allowed to widen the provision of banking services to the wider population. Voluntarily, Repco Bank follows various directives of the RBI for other co-operative banks in terms of Income recognition, asset classification, provisioning, KYC, etc. As of FY13, Repco Bank's deposit base was Rs51bn, advances were Rs39.2bn and profits were Rs860mn. Its GNPA ratio of 1.56% was 100% provided for.

Figure 5: Shareholding pattern of Repco Bank

Shareholders	% share
Government of India	73.3
Government of Tamil Nadu	2.9
Government of Andhra Pradesh	1.7
Government of Kerala	0.6
Government of Karnataka	0.2
Repatriates	21.3

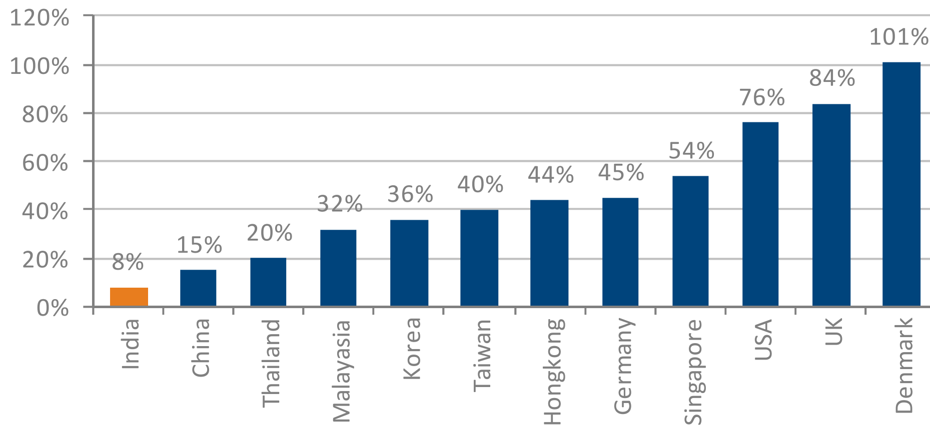
Source: Company, IIFL Research

Housing Finance: Enough for all

Competitive dynamics in the Indian housing finance space ensures that each player positions itself according to its internal philosophies regarding risk-taking, growth and customer orientation and external factors such as competitive positioning, funding availability, and rating. However, the diversity in the Indian markets ensures that each financier has enough to play with and grow. Meanwhile, the inherent structural demand drivers such as low home ownership, shortage of housing units, and low credit penetration persist and provide the much-needed platform to the housing finance industry.

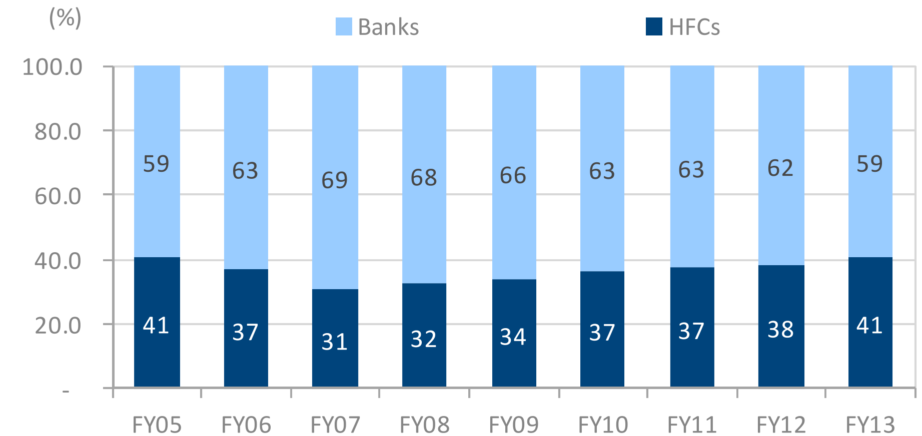
The housing finance space is crowded with banks and specialised HFCs jostling for market share. Despite having wider presence and lower funding costs, banks have lost market share to HFCs. This is because specialised housing finance needs a tailor-made business model and consistent focus. Focus of banks keeps shifting between housing finance and other forms of lending. This allows HFCs to gain market share as other loans find favour with banks.

Figure 6: Mortgages/GDP versus other countries



Source: European Mortgage Federation, HOFINET and HDFC, IIFL Research

Figure 7: HFC's have been gaining market share from banks



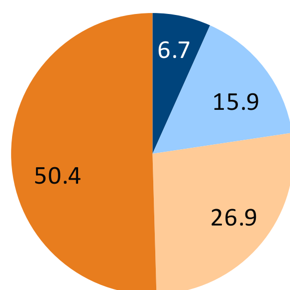
Source: RBI, NHB, IIFL Research

HFCs proliferate by filling gaps in geographies, customer segment

There are gaps in the housing finance market with respect to geographies, ticket sizes and customer profiles which small HFCs exploit, to beat competition from banks and larger peers. This creates a clear segmentation in terms of operating segments between these three sets of lenders in the housing finance space.

Banks are primarily present in metro and urban centres with some PSU Banks having presence in semi-rural areas as well. Large private banks have so far restricted themselves to wealthier cities and towns where business volumes and ease of appraisal are higher. Additionally, banks restrict such lending to branches in select geographies, depending on business potential. This is especially true of PSU banks for which housing credit formed 9.2% of their loans in FY13 despite their large branch networks.

Figure 8: Scheduled Commercial Banks' distribution of credit by geography in FY13



Source: NHB, IIFL Research

NBFCs, on the other hand, are spread over urban, semi-urban and rural centres. Their low operating-cost structure, regulatory arbitrage with regard to SLR/CRR/priority sector lending and business model targeted solely at housing finance allows them to compete effectively versus larger lenders. Smaller NBFCs have developed the expertise to penetrate deeper into geographies by evolving their risk assessment capabilities and adopting a lean cost structure.

Banks and HFCs also differentiate themselves in terms of their target customer segments. Large financiers typically focus on salaried customers having stable incomes and ready documentation. Such customers also command lower lending rates, which make it difficult for niche HFCs to compete. Smaller housing finance companies complement their larger counterparts by lending to the non-salaried customer, who is a professional, non-professional, or self-employed. Risk assessment, in such cases, is the primary expertise on which HFC's focus.

Figure 9: Attributes on which lenders segment customers

Customer segment	Risk	Product preference	Sector	Income pattern
Salaried	**Low-Medium**			
Professional	Low	Home loan	Government, private sector	Stable
Non-professional	Medium	Home loan	Domestic help, chauffer	Variable
Non-salaried/ Self-employed	**Medium-High**			
Professional	Medium	Home loan/LAP	Doctors, lawyers, CA, etc	Variable
Non-professional	High	LAP/Home loan	Shop-owners, traders, vendors, etc.	High fluctuation

Source: IIFL Research; CA: Chartered Accountants

Niche positioning allows for differentiation

We have assessed HFCs on various metrics to ascertain their relative market positioning based on their risk-taking ability and growth orientation. We have used customer profile, product mix, loan–to-value (LTV) ratio, and geographic concentration to evaluate risk-taking ability. On the other hand, a strong distribution infrastructure, small scale, and well-known brand are the growth enablers used in our evaluation. We have evaluated HFCs on a scale of 1-5 on these parameters and based on an average, represented their relative positioning as shown.

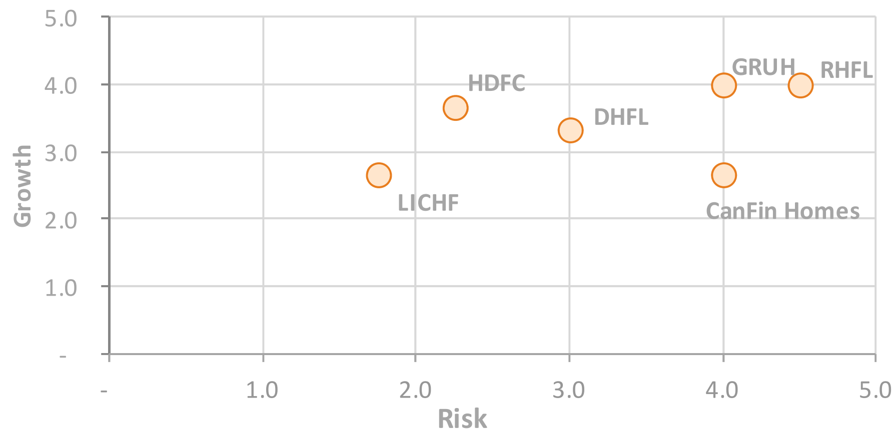
Figure 10:Metrics on which we have scored various HFCs

Metric	Remarks
Risk	
Customer profile	Higher mix of self-employed/non-professionals - higher risk
Product mix	Funding purchase of land, plots, construction, LAP - higher risk
LTV	High LTV - higher risk
Geographic concentration	Higher concentration - higher risk
Growth-enablers	
Distribution model	Strong distribution model - higher growth
Scale	Small scale - higher growth
Brand	Strong brand - higher growth

Source: IIFL Research

HFCs position themselves depending on the market opportunity, their internal risk-handling capability and their desire for growth. The grid below reveals clear segmentation in the housing finance market. HDFC and LICHF, being larger and well-established players with large scale, are more focused on larger centres, have a higher proportion of salaried individuals and focus on regular home loans. Comparatively, smaller entities like GRUH, RHFL and CanFin Homes lack competitive prowess in large centres, in funding and in brand recall. They compensate for these by focusing on under-served markets where they would have better pricing power to earn larger spreads and strengthening their risk-handling capabilities. HFCs also use the LTV and instalment to income (IIR) ratios as measures to control risk on their balance sheets.

Figure 11:Growth orientation versus risk-taking ability of various HFCs



Source: IIFL Research

Figure 12:Comparative Loan-to-value (LTV) and instalment to income ratio (IIR) of HFC's

(%)	RHFL	DHFL	GRUH	HDFC	LICHF
LTV	65	43	65	65	55
IIR	50	38	NA	33	35

Source: Company data, IIFL Research

RHF: All about execution and growth

Structural drivers to sustain superior loan growth

RHF is well positioned to drive growth through deeper penetration, servicing under-served customers, strong regional brand recall and higher risk-taking capability. It operates chiefly in tier-2 and tier-3 centres (2/3rd of branches in these areas as of Q3FY14) and in peripheries of tier 1 centre. Its chief target customer segment comprises the self-employed professionals and non-professionals (55% of loans) who are largely under-served by the banking system and not actively pursued by larger HFCs. Finally, given Repco Bank's 45 years of operations and RHF's own 14-year operating history, RHF has a reasonable brand recall in the four southern states which are its catchment area. Driven by these factors, RHF will likely deliver 27% disbursements Cagr and 28% loan Cagr over FY14-16ii.

Reasonable exclusivity in operating centres

Niche HFCs are present in mutually exclusive geographies with a large portion of the market to exploit and each can grow at a relatively strong pace in their respective catchment area. While GRUH is firmly focused on west and central India, Repco and Sundaram Home Finance are entrenched in the four southern states, especially in TN, AP and Kerala. DHFL is a much larger entity compared with these and has a more uniform pan-India spread. It enjoys relatively less competition in northern and central India.

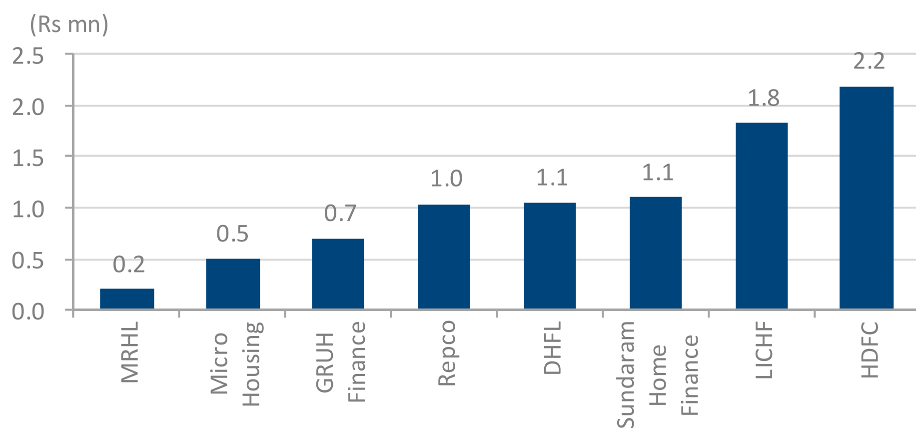
Geographic and customer discrimination also creates a variance in average ticket sizes. For example, HDFC and LICHF have more concentration in metros and urban areas that are characterised by higher per unit home prices, larger home units and higher LTVs, all of which contribute to higher ticket sizes. Hence, competition for RHF is largely limited to Sundaram Home Finance in its catchment area and possibly with GRUH and DHFL as well given their concentration on similar customer segments where there is a geographic overlap.

Figure 13:% of branch network in different States

(%)	RHF	GRUH	DHFL	Sundaram Home
TN	50.5	3.6	2.0	40.0
AP	15.2	-	10.0	26.7
Karnataka	14.3	10.9	15.4	9.5
Kerala	7.6	-	0.7	15.2
Maharashtra	6.7	29.7	16.4	4.8
Gujarat	1.9	29.0	7.0	-
MP	-	14.5	3.7	1.0
UP	-	-	2.0	-
Rajasthan	-	7.2	6.7	-
Haryana	-	-	7.0	-
Others	3.8	5.1	29.1	2.9

Source: Company, IIFL Research

Figure 14:Average ticket size of housing loans for HFCs

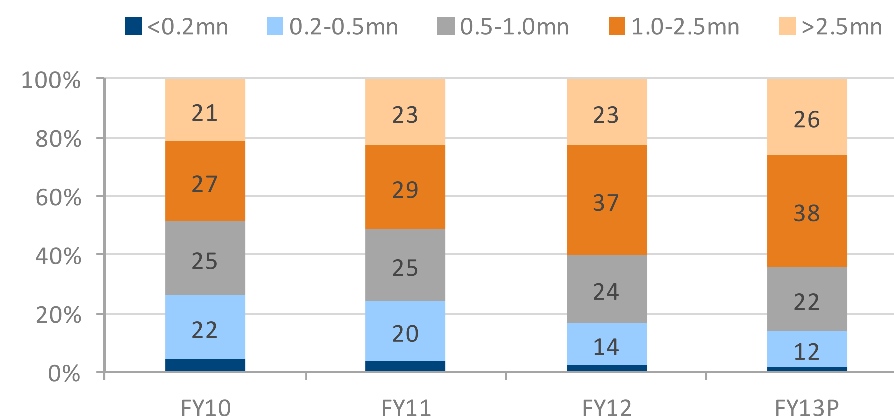


Source: IIFL Research

Large under-served market vacated by larger financiers

Banks typically focus on large-ticket lending to salaried customers in metros and urban areas, which leaves out a large population of borrowers. Higher risk, difficulty of assessment in the absence of documentation, reliable credit history, and little or no banking habits/history, often keep larger lenders away from these borrowers. However, lenders such as GRUH and RHF exploit this risk-aversion and have developed the expertise to assess such borrowers, structure products and price loans accordingly.

Figure 15:Increasing proportion of large ticket disbursements by PSBs vacates the smaller ticket lending space



Source: NHB, IIFL Research

As more large-ticket loans are serviced by banks and large HFCs, smaller financiers find a ready fleet of customers waiting to be serviced and with lower bargaining power. We believe financiers in the Rs0.5-1.5mn ticket size category could deliver long uninterrupted growth as larger competitors shy away from risk and new entrants face teething issues before transforming into full-blown competitors.

Branch expansion and deeper penetration

RHF's business is concentrated in the four Southern states, especially TN which dominates the branch distribution as well as accounts for 64% of RHF's business. Despite this, RHF is present in only 53 centres of the 218 talukas in TN which indicates the potential for penetration-led growth available to HFCs.

Talukas in the hinterland are largely devoid of organised lenders with high dependence on local moneylenders for finance. There is immense scope for disintermediation by institutional lenders who fine-tune their lending infrastructure, risk assessment capability and operating expenses to suit the requirements in these geographies.

Though RHF's growth strategy is entirely branch led, the company has not resorted to aggressive branch addition in the past and it continues to focus on scaling up of branches to drive growth. Going ahead, the company plans to add 15 branches annually with approximately two-third in the south and the remaining in Rest of India. However, in a better operating environment, RHF has the option to scale up growth by stepping up branch addition.

Figure 16:Despite its size, organized housing finance remains an under-penetrated segment. Meaningful existing players could use their scale and expertise to improve market share

(No. of branches/talukas)	RHF	GRUH	DHFL	Sundaram	Talukas
TN	53	5	6	42	218
AP	16	-	30	28	220*
Karnataka	15	15	46	10	209*
Kerala	8	-	2	16	63
Maharashtra	7	41	49	5	353
Gujarat	2	40	21	-	226
MP	-	20	11	1	263
UP	-	-	6	-	305
Rajasthan	-	10	20	-	243
Haryana	-	-	21	-	67
Others	4	7	87	3	
Total	**105**	**138**	**299**	**105**	**2,167**

*cities/towns, total talukas not available; Source: State websites, IIFL Research

Tight process control at the core of operations

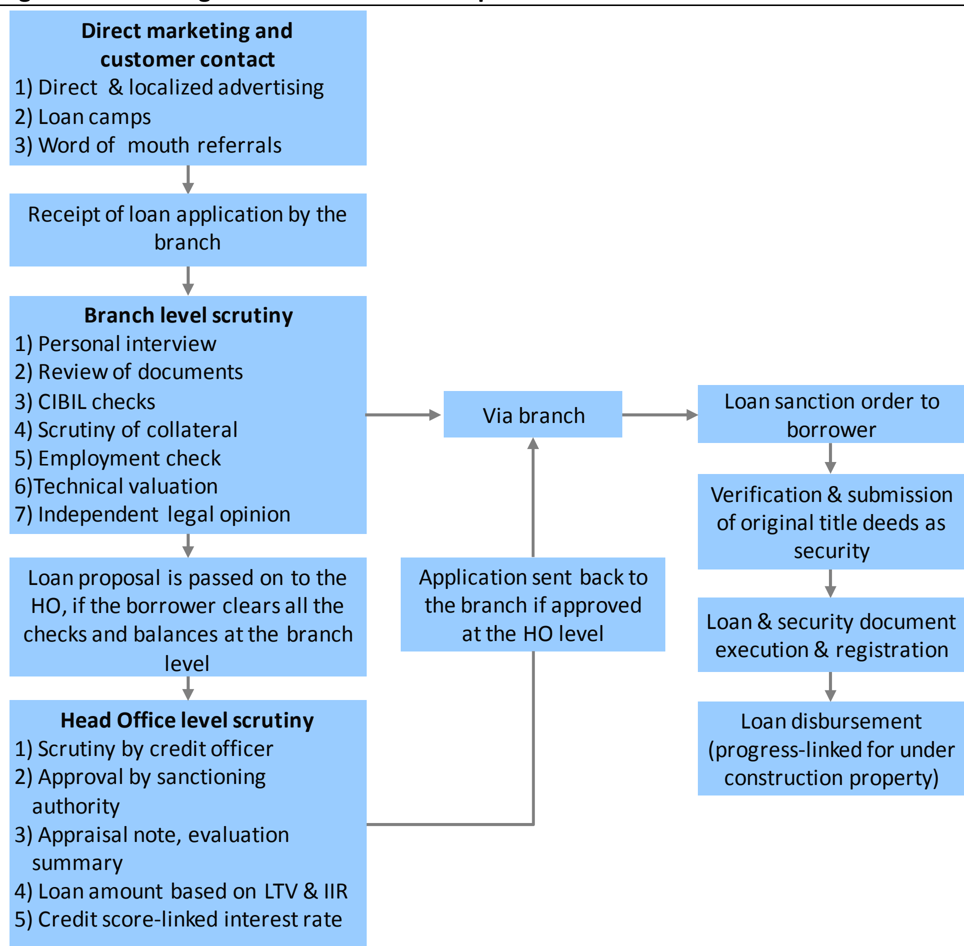
RHF has developed a self-reliant model for sourcing, appraisal, monitoring and collection of loans. Keeping all aspects of operations in the companies' control enables RHF to deliver superior and uniform service and maintain asset quality checks and balances. The model also ensures complete 'ownership' of the customer excluding customer contact with external agents to the extent possible. This ensures greater customer loyalty, referrals and brand building.

Direct sourcing strategy helps retain 'process control'

RHF's primary sources of customer acquisition are walk-ins, 'loan melas' and referrals. Of these, loan melas contribute +60% of originations. RHF places a lot of emphasis on 'loan melas' with each branch having to conduct this exercise bi-monthly. Branches typically advertise through pamphlets, local dailies, and word of mouth. RHF claims +50% conversion rate in these melas, where there is a primary assessment of customer documents and an in-principle upfront sanction is given to the customer. The customer then approaches the branch for further checks.

The HFC has recently run a pilot program hiring direct sales agents (DSAs) in Maharashtra for business growth. Should this be successful, the DSA model would be increasingly employed in new geographies where its brand is not highly recognised and hiring and maintenance of trained professionals are relatively challenging.

Figure 17: Sourcing and loan disbursement process



Source: Company, IIFL Research

Rigorous credit appraisal keeps risks in check

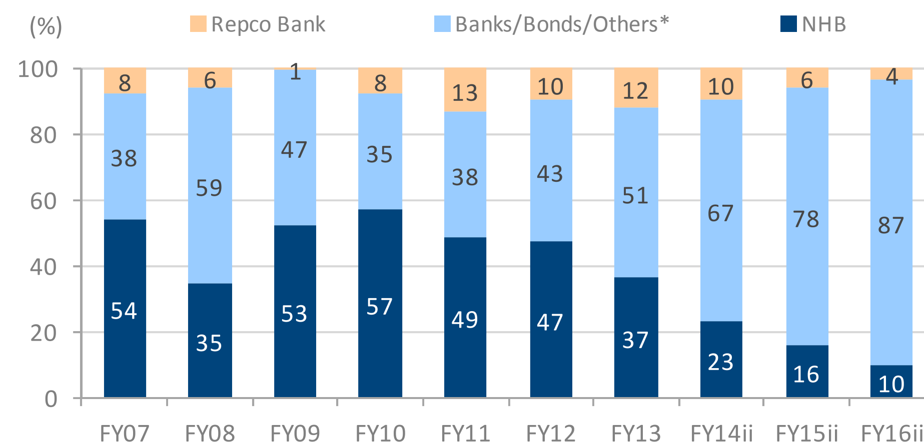
The credit appraisal mechanism is split into two parts as explained by the schematic above. The preliminary appraisal takes place at the branch level by the branch manager, branch-level valuers and lawyers. The main appraisal process, however, is centralised at the head office level where extensive credit checks, property encumbrances, valuation, etc. are carried out. There is a well-defined escalation policy depending on the size of the loan which improves oversight on risk under-writing. In case of loans to self-employed or non-salaried, it is mandatory for the branch officer to visit the premises of the borrower on multiple occasions to ascertain the business' health, cash flows, viability, etc. and then arrive at a credit score for the borrower. This is where RHF differentiates itself from competition and a loosening of this process could well lead to an increase in NPAs.

Buoyant earnings trajectory to sustain

Pricing power, change in product mix to help maintain margins

A potential change in the funding mix could pressure RHF's margins. NHB re-finance facility, which costs 8.1% and formed nearly half the borrowing portfolio in FY11 is being wound down since NHB introduced a spread cap of 2% for on-lending on these funds. Most of these funds were from the Rural Housing Fund scheme. Other schemes of NHB are relatively costly and attract the spread cap too. We expect NHB refinance to be replaced by market borrowings which will cost higher (~10-10.5%).

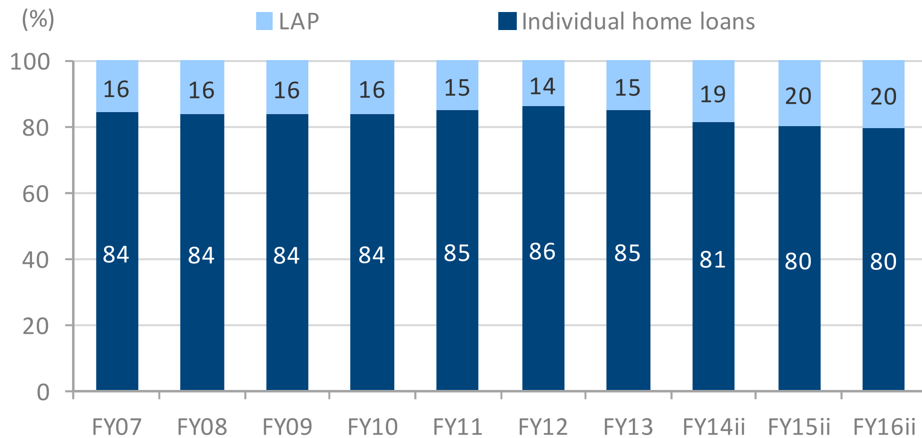
Figure 18:Due to the spread cap of 2% on NHB finance, NHB's refinance will dwindle and be replaced by higher cost funding from bonds/NCDs/ECB



*Currently this segment consists only of Bank borrowings; Source: Company, IIFL Research

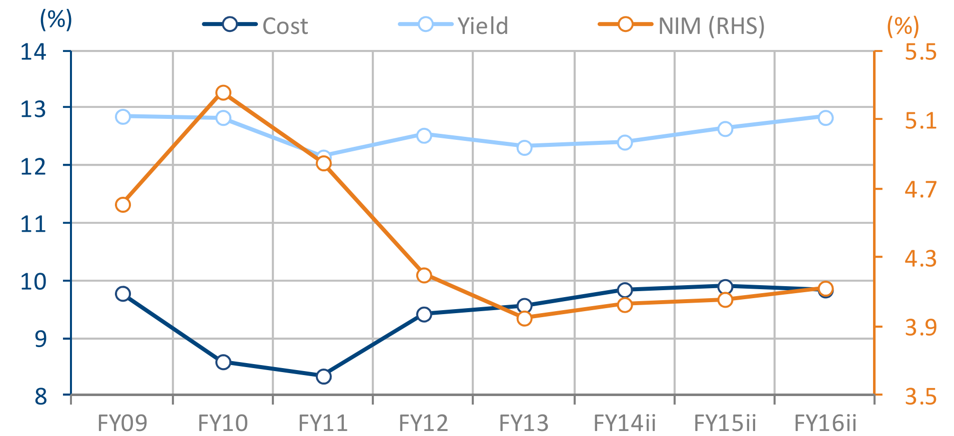
RHF will likely change the product mix to offset margin pressure from the change in funding mix. Its superior and differentiated service proposition to an under-served segment allows RHF to maintain relatively higher yields in both home loans as well as in LAP. RHF plans to grow the LAP portfolio to ~20% of loans versus 17.5% currently. This should add approximately 10bps to NIMs. Further, the ALM remains well matched from an interest rate reset perspective. Nearly 100% of the assets are floating rate and re-price quickly whereas 32% of the liabilities are fixed rate. Hence, we expect NIMs to remain stable at 3.9-4% through FY16ii.

Figure 19: Focus on higher yielding LAP to improve portfolio yields



Source: Company, IIFL Research

Figure 20: The increase in yields should offset the rise in interest costs, keeping margins stable to marginally higher



Source: Company, IIFL Research

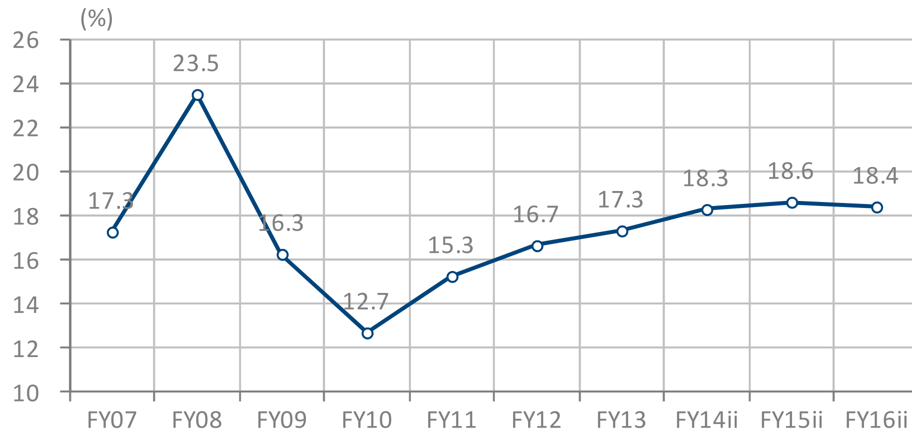
RHF to maintain a low operating cost structure

RHF's cost ratios are better compared with other financiers such as GRUH and DHFL. A typical branch attracts annual spending of Rs0.6-0.8mn – rent of Rs20,000-25,000/month and has 3-4 employees drawing a salary of Rs10,000-15,000/month. Operating in tier-2 and tier-3 centres and centralisation of operations allow for efficiency gains.

However, we believe cost-to-income ratio is likely to rise marginally from 17% levels of FY13 to about 20% in the next 2-3 years due to new business development and branding initiatives of the company. Major sources of increase operating expenses will likely be:

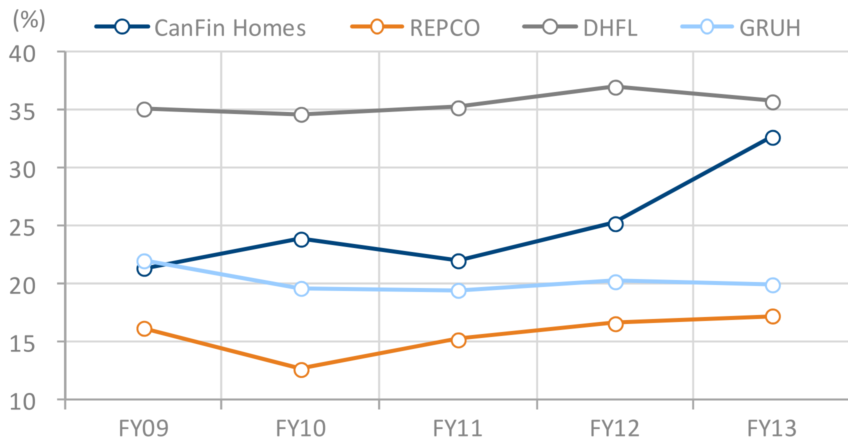
- Higher advertising and promotion expenses for entry into newer geographies
- Investment into higher commission channels like DSAs
- Employee stock option (ESOP) program
- Cost of added incentives such as providing free home insurance, etc.

Figure 21:Cost/income ratio to trend higher but remain within 20%



Source: Company, IIFL Research

Figure 22:Cost/income ratios lowest among regional peers

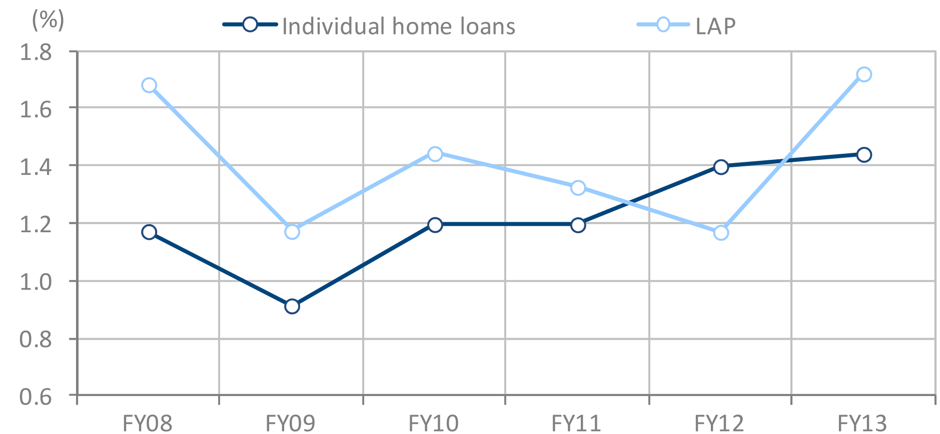


Source: Company, IIFL Research

Accelerated provisioning could inflate credit costs

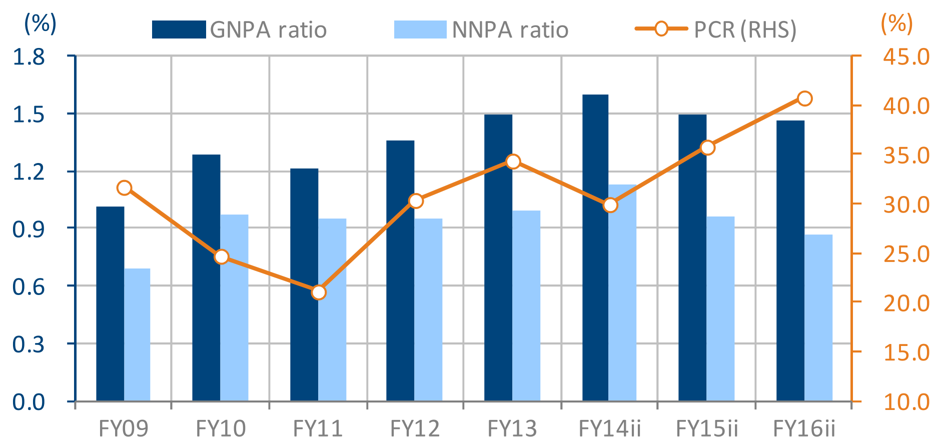
RHF has a relatively higher GNPA ratio compared with competition given its operations in riskier segments. However, sustained efforts at tightening risk assessment processes and recoveries have led to gradual reduction in the NPA ratios. LAP has a relatively higher proportion of NPAs (2.35% as of 3QFY14) as compared to the regular home loan portfolio (1.96%). Although we expect credit costs in the ongoing business to remain steady, RHF plans to accelerate its provisioning policy to increase the coverage ratio to ~50% from the 37% currently. Hence, we build in loan loss provisions of 20-25bps over FY15-16ii. We do not expect significant worsening in asset quality from current levels.

Figure 23: Asset quality in LAP is slightly more stressed than the home loan portfolio



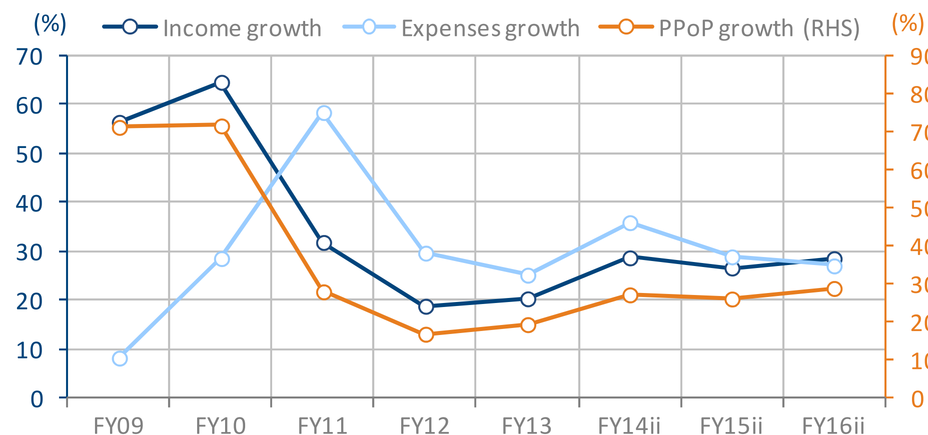
Source: Company, IIFL Research

Figure 24: GNPAs to sustain at current levels, provision coverage to increase



Source: Company, IIFL Research

Figure 25: Revenue jaws could narrow as expenses inch up



Source: Company, IIFL Research

Improving profitability would sustain buoyancy in earnings, valuations

Strong loan growth momentum, stable margins and contained cost ratios would be strong drivers of core earnings for RHF in the medium term. Although revenue jaws could narrow from current levels as marketing and distribution expenses increase, operating profit growth will continue to trend at ~28% Cagr over FY14-16ii. Slightly aggressive provisioning could impound earnings Cagr to 25% over the same period.

In our view, housing finance remains the only NBFC business which can still generate +20% ROE consistently, driven by strong ROA and higher leverage compared with other asset financiers. Given its high capitalisation (25% tier 1 ratio) RHF can grow at 30% Cagr for another 5 years and achieve a 20% RoE without requiring capital infusion. Its current leverage is 6.3x, which would increase to a maximum of 12-13x in 8 years at a 30% loan Cagr. Given that ROA can remain stable at 2.3% in the medium term, RHF is in a good position to improve ROE through leverage and consistent execution.

Figure 26: RoE decomposition

Y/e 31 Mar	FY12	FY13	FY14ii	FY15ii	FY16ii
Interest income	12.1	11.7	11.7	12.0	12.2
Interest expense	8.1	8.0	8.0	8.2	8.3
Net interest income	**4.0**	**3.7**	**3.7**	**3.8**	**3.8**
Processing fees	0.4	0.4	0.3	0.2	0.2
Penal interest	0.1	0.1	0.1	0.1	0.1
Others	0.1	0.1	0.1	0.1	0.1
Non-interest income	0.7	0.6	0.5	0.5	0.4
Total operating income	4.7	4.2	4.2	4.2	4.2
Total operating expenses	0.8	0.7	0.8	0.8	0.8
Pre provision operating profit	**3.9**	**3.5**	**3.5**	**3.4**	**3.5**
Provisions for loan losses	0.6	0.3	0.3	0.3	0.4
Profit before tax	3.3	3.2	3.2	3.1	3.1
Taxes	0.8	0.8	0.8	0.8	0.8
Net profit	**2.5**	**2.4**	**2.4**	**2.3**	**2.3**
Leverage	9.0	7.1	6.3	6.9	7.6
RoE	**22.3**	**17.1**	**14.9**	**16.1**	**17.4**

Source: Company, IIFL Research

Figure 27:Key earnings drivers

(%)	FY12	FY13	FY14ii	FY15ii	FY16ii
Loan growth	35.3	26.4	31.1	28.7	27.4
Net interest margin	4.0	3.7	3.8	3.8	3.9
Net int income growth	19.2	21.4	30.9	28.2	30.2
Core fee income growth	12.9	6.2	5.0	3.0	3.0
Non-int inc as % of total	14.0	13.3	11.9	10.8	9.7
Operating costs growth	29.7	25.2	35.9	28.9	27.1
Cost/income ratio	16.7	17.3	18.3	18.6	18.4
Gross NPAs as % of loans	1.4	1.5	1.6	1.5	1.5
Total provision charges as % of loans	0.6	0.3	0.3	0.3	0.4
Tax rate	24.7	26.0	26.0	25.0	26.0
Net NPL % of net worth	8.7	5.5	7.2	6.8	6.7

Source: Company, IIFL Research

Figure 28:Comparison with peers

	NIM		C/I ratio		GNPA		PCR		Tier 1 ratio	
	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii
RHFL	3.8	3.8	18.3	18.6	1.6	1.5	30	36	23.4	21.0
DHFL*	1.4	1.4	34.1	35.5	0.8	0.8	100	100	11.7	11.7
GRUH*	4.4	4.4	20.4	19.8	0.5	0.6	100	100	11.6	11.4
LICHF	2.1	2.1	15.1	15.1	0.8	0.8	35	37	10.1	10.0
HDFC	3.5	3.5	7.9	7.9	0.8	0.8	30	30	16.5	15.7

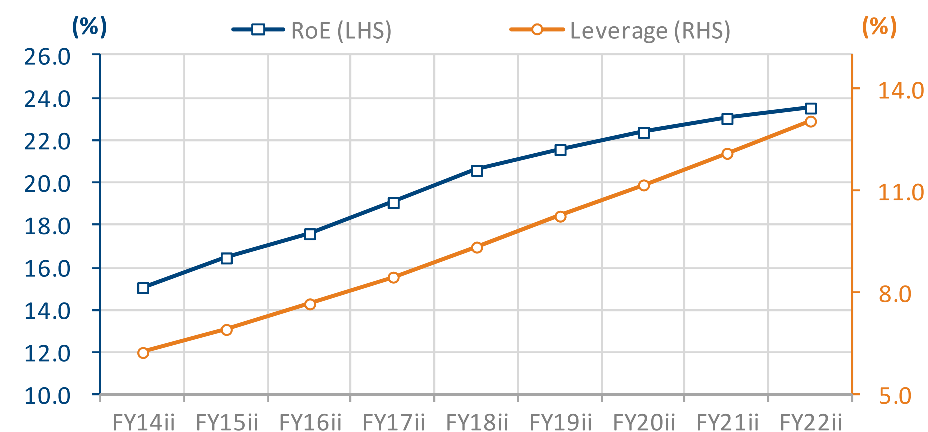
*Bloomberg estimates; Source: Company, IIFL Research

Figure 29: Comparison with peers

	RoA		RoE		Leverage		P/BV		P/E	
	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii	FY14ii	FY15ii
RHFL	2.4	2.3	14.9	16.1	6.3	6.9	2.8	2.4	19.8	15.9
DHFL*	1.4	1.4	16.3	17.2	11.9	12.3	0.7	0.6	5.0	4.2
GRUH*	3.0	2.8	30.2	28.8	10.1	10.2	8.0	6.4	29.0	24.0
LICHF	1.5	1.4	18.4	17.8	12.6	12.8	1.5	1.3	9.0	8.0
HDFC	2.7	2.6	20.7	22.0	7.7	8.4	4.8	4.4	24.5	20.9

*Bloomberg estimates; Source: Company, IIFL Research

Figure 30: RHF would take 4-5 years to achieve an ROE of 20% and about eight years to fully lever the current capital at 30% loan Cagr



Source: Company, IIFL Research

Figure 31:P/BV trend

Source: Company, IIFL Research

We believe RHF will continue to trade at premium multiples underpinned by its small scale and niche business model, inherently high profitability with the ability to improve return ratios, high

capitalisation, and consistent execution. Asset quality overhang would be minimal given a secured loan book. We are confident of RHF being able to deliver on these parameters. Any downward trend in interest rates could also prove to be a trigger for profitability. We would peg a 12-month fair value multiple at 2.5x FY16ii BV or Rs390/share, which yields an upside of 21% from current market price. Initiate with BUY and TP of Rs390s/share.

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar, Parent	FY12A	FY13A	FY14ii	FY15ii	FY16ii
Net interest income	1,002	1,217	1,592	2,040	2,657
Fee Income	112	119	125	128	132
Portfolio gains	0	0	0	0	0
Others	52	68	90	119	153
Non-interest income	164	187	214	248	285
Total operating income	1,166	1,403	1,807	2,288	2,942
Total operating expenses	194	243	330	426	541
Pre provision operating profit	**972**	**1,160**	**1,476**	**1,862**	**2,401**
Provisions for loan losses	155	92	110	179	256
Other provisions	0	0	0	0	0
Profit before tax	816	1,068	1,366	1,684	2,144
Taxes	202	268	355	421	558
Net profit	**615**	**800**	**1,011**	**1,263**	**1,587**

Balance sheet summary (Rs m)

Y/e 31 Mar, Parent	FY12A	FY13A	FY14ii	FY15ii	FY16ii
Net loans & advances	28,041	35,447	46,474	59,820	76,209
Placements to other banks	49	53	57	68	83
Cash & equivalents	244	2,187	409	781	796
Other interest-earning assets	81	81	89	111	138
Total interest-earning assets	**28,415**	**37,768**	**47,029**	**60,780**	**77,227**
Fixed assets	33	45	56	70	91
Other assets	79	112	140	175	227
Total assets	**28,527**	**37,924**	**47,224**	**61,025**	**77,545**
Customer deposits	0	0	0	0	0
Other interest-bearing liabilities	24,860	30,647	38,606	51,199	66,242
Total interest-bearing liabilities	24,860	30,647	38,606	51,199	66,242
Non-interest-bearing liabilities	634	932	1,352	1,420	1,490
Total liabilities	**25,495**	**31,579**	**39,958**	**52,619**	**67,733**
Total Shareholder's equity	**3,033**	**6,345**	**7,266**	**8,406**	**9,812**
Total liabilities & equity	**28,527**	**37,924**	**47,224**	**61,025**	**77,545**

Source: Company data, IIFL Research

Ratio analysis - I

Y/e 31 Mar, Parent	FY12A	FY13A	FY14ii	FY15ii	FY16ii
Balance Sheet Structure Ratios (%)					
Loans / Deposits	0.0	0.0	0.0	0.0	0.0
Loan Growth	35.3	26.4	31.1	28.7	27.4
Growth in Deposits	0.0	0.0	0.0	0.0	0.0
Growth in Total Assets (%)	33.9	32.9	24.5	29.2	27.1
Profitability Ratios					
Net Interest Margin	4.0	3.7	3.8	3.8	3.9
ROA	2.5	2.4	2.4	2.3	2.3
ROE	22.3	17.1	14.9	16.1	17.4
Non-Int Income as % of Total Income	14.0	13.3	11.9	10.8	9.7
Net Profit Growth	5.7	30.2	26.3	24.9	25.7
FDEPS Growth	5.7	(2.7)	26.3	24.9	25.7
Efficiency Ratios (%)					
Cost to Income Ratio	16.7	17.3	18.3	18.6	18.4
Salaries as % of Non-Interest costs	54.1	58.0	57.6	58.1	57.1

Ratio analysis - II

Y/e 31 Mar, Parent	FY12A	FY13A	FY14ii	FY15ii	FY16ii
Credit Quality Ratios (%)					
Gross NPLs as % of loans	1.4	1.5	1.6	1.5	1.5
NPL coverage ratio	30.9	34.3	29.9	35.8	40.7
Total prov charges as % avg loans	0.6	0.3	0.3	0.3	0.4
Net NPLs as % of net loans	0.9	1.0	1.1	1.0	0.9
Capital Adequacy Ratios (%)					
Total CAR	16.5	25.5	23.4	21.0	19.3
Tier I capital ratio	16.5	25.5	23.4	21.0	19.3

Source: Company data, IIFL Research

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SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

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