



REPCO HOME FINANCE LIMITED

Issue Details

Repco Home Finance Limited (RHFL) is proposing to come out with an Initial Public Offer (IPO) for a fresh issue of 1,57,20,262 equity shares with a face value of Rs. 10/- each. The issue is being made through the 100% book building process wherein not more than 50% of the net issue (the issue less the employee reservation portion of 1,80,000 equity shares) would be available for allotment on a proportionate basis to qualified institutional buyers. Further, not less than 15% of the net issue would be available for allotment on a proportionate basis to non-institutional bidders and not less than 35% of the net issue would be available for allotment on a proportionate basis to retail individual bidders, subject to valid bids being received at or above the issue price. Post IPO, the shares will be listed on the National Stock Exchange and Bombay Stock Exchange.

Proposed Use of IPO Proceeds

The company intends to use the net proceeds (issue proceeds net of issue related expenses) for augmenting its capital base to meet its future growth related capital requirements.

Relationship Contact IPO Grading

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ICRA has assigned an 'IPO Grade 3', indicating average fundamentals, to the proposed initial public offering of Repco Home Finance Limited ("RHFL"/ "The Company"). ICRA assigns IPO grading on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

Analyst Contact

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An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include, inter alia, business and competitive position, financial position and prospects, management quality, corporate governance and history of compliance and litigation.

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Strengths

- Favourable long term demand outlook for mortgage loans due to low penetration of housing finance in India as compared to the developed economies
- RHFL's established presence in the housing finance market in South India, especially in Tier-II and Tier-III cities, for over a decade focussing on a niche customer segment
- Experience of the management team and, their long standing association with the company
- Healthy profitability indicators, notwithstanding some moderation witnessed in the recent past

Concerns

- Concentrated resource/funding profile with 48% funding from NHB, 52% from banks
- Modest and regionally concentrated nature of business (largely in South India), which exposes the company to competitive pressures; limiting the scope of margin and scale expansion
- Susceptibility to adverse regulatory changes, which could impact the overall business and financial profile of the company
- Currently subdued business environment, which coupled with high interest rates, notwithstanding some correction in the recent past, exerts pressure on business growth and profitability
- Sizeable exposure to self employed segment; could exert pressure on the company's asset quality under unfavourable economic conditions

Grading Rationale

The assigned grading factors in the long term favourable demand outlook for mortgage loans in India due to currently low penetration levels and, RHFL's established position in the South Indian housing finance market in a niche customer segment. With a sizeable share of its branches in Tier-II and Tier-III cities, RHFL focuses on the largely under-penetrated customer segment, both salaried and self-employed, which has helped the company grow profitably so far. Notwithstanding its recent initiatives to expand to newer markets, RHFL is concentrated largely in South India (98% of the portfolio in March 2012) exposing it to competitive pressures thus limiting the scope for scale and margin expansion at least over the medium term. Further, a sizeable proportion of the company's loans are to the self-employed segment, which is largely credit untested and could be vulnerable to adverse economic cycles. As a result of this, 30+ delinquencies are relatively high at 14.8% as on September 30, 2012, however 90+ delinquencies remain under control at 2.1%. The grading also takes note of the currently subdued operating environment, which exerts pressure on the business growth, profitability and asset quality of all housing finance companies (HFCs) including RHFL. However, the company experienced management team and its systems which are developed and pruned over the years of operations provide comfort to an extent. The company is faced with a deteriorating trend in its profitability and its asset quality indicators over the last two-three financial years. RHFL's profitability indicator nevertheless continues to remain healthy (ROE 22.3% in fiscal 2012) vis-à-vis industry standards and, it currently has a comfortable capitalization profile (gearing 8.3 times in March 2012). ICRA however notes that ability of the company to diversify its funding profile, which is presently highly concentrated and, to efficiently expand its operations in newer geographies is yet to be established, which is critical for its future business growth and to maintain a healthy financial profile.

Company Profile

Established in the year 2000 as a wholly owned subsidiary of Repco Bank Limited (Repco Bank), RHFL is a housing finance company based in Chennai with a network of 68 branches and 20 centres (As on March 31, 2012) across Tamil Nadu, Karnataka, Andhra Pradesh, Kerala, Maharashtra, Gujarat, Orissa and the Union Territory of Puducherry. In December 2007, the Carlyle Group¹, through its Asian arm – Carlyle Asia Growth Fund – infused Rs. 76 crore equity into RHFL for a 49.98% stake in the company. As of March 31, 2012, RHFL had a loan portfolio of Rs. 2,804 crore and reported a net profit of Rs. 61 crore on a total income of Rs. 319 crore for the year ended on that date compared to a net profit of Rs. 58 crore on a total income of Rs. 226 crore, in fiscal 2011.

¹ Refers to First Carlyle Growth VI and its nominees

Recent Results

During the half year ended September 30, 2012, the company reported a net profit of Rs. 36 crore on a total loan portfolio of Rs. 3,098 crore as on that date as compared to a net profit of Rs. 25 crore on a total loan portfolio of Rs. 2,431 crore for the half year ended September 30, 2011.

Promoters and Management

Particulars	Pre-IPO shareholding	Post-IPO shareholding
Repco Bank Limited- Promoter	50.02%	37.37%
Carlyle Group:	49.98%	37.34%
First Carlyle Growth VI	49.70%	37.13%
Mr. Madhava Menon Shankar Narayanan – Director	0.25%	0.19%
Other Individuals	0.03%	0.02%
Public	0.00%	25.29%
Total (A)+(B)	100.00%	100.00%

Source: Company

RHFL is promoted by Repco Bank Limited (Repco Bank), which currently holds about 50.02% equity shareholding in the company. Repco Bank is a GOI owned Cooperative Bank established in the year 1969 to help and promote the rehabilitation of repatriates from Sri Lanka, Myanmar, Vietnam and other countries. Repco Bank's operations are largely in the four South Indian states and in the Union Territory of Puducherry. During 2011-12, Repco Bank reported a net profit of Rs. 73 crore on a total asset base of Rs. 4,875 crore vis a vis a net profit of Rs. 56 crore on a total asset base of Rs. 3,654 crore in 2010-11.

During 2007-08, Carlyle Group infused about Rs. 76 crore into the company in the form of equity and CCPS. The CCPS were converted to equity shares in July 2009. As on September 30, 2012, Carlyle group owns about 49.98% equity shares in RHFL.

Mr. R. Varadarajan is the Managing Director of RHFL and Repco Bank and, is actively involved in providing an overall strategic and operational direction to the company. The Board of Directors are from diverse fields and have considerable experience with various Government institutions, banks and other financial institutions. Most of the key management personnel have been associated with the company for more than 5 years and have experience in the housing finance business and banking services.

Corporate Governance

RHFL has a 10 member Board, which includes a Non-Executive Chairman, the Managing Director, and 8 Non-Executive Directors, including 2 representatives from Carlyle. Of the total board strength of 10, 4 Directors are independent. The constitution of the Board is in compliance with Clause 49 of the Listing Agreement. The company has also constituted the following committees: Audit Committee, Shareholders Grievance Committee, Remuneration Committee, IPO Committee, Management Committee and Compensation Committee.

Business and Competitive Position

Low housing finance penetration provides a favourable growth outlook

Housing finance penetration in India presently is low at about 7%, and it has remained stagnant at the current levels for about five years now. Low housing finance penetration, on the back of a favourable demographic profile, changing social fabric (urbanisation and nuclearisation of the family system) and, incentives (tax benefits) for house buyers provide a favourable view on the long term growth prospects for housing finance business in the country. However, the faster pace of increase in the property prices vis a vis income levels, high interest rates and inflation levels have impacted affordability.

Increase in the market share of HFCs over the recent past; however banks are expected to hold a sizeable share of the market

The total estimated housing credit outstanding in India as on March 31, 2012 was at over Rs. 6.26 lakh crore as against Rs. 5.35 lakh crore as on March 31, 2011, a growth of about 17%. HFCs and Non Banking Finance Companies (NBFCs) grew at about 28% during 2011-12, while scheduled commercial banks (SCBs) reported a 12% growth in their housing loan portfolio during the same period. Consequently, the share of HFCs and NBFCs in the housing finance market increased from about 32% in March 2011 to about 35% in March 2012. HFCs and NBFCs are likely to witness an increase their market share going forward on the strength of their focused approach and a comparatively superior service level; however SCBs are expected to hold a sizeable share in the housing finance market, on the strength of their extensive branch network, a broad customer base, access to low cost funds and a mandatory priority sector lending requirements.

Unfavourable regulatory changes could have an adverse impact on HFCs business and profitability

HFCs in India work under the regulations of the NHB. Any adverse changes in the regulatory framework are likely to have an adverse impact on the business and the financial performance of the HFCs including RHFL. Some of the recent regulatory changes include, increase in the standard asset provisioning requirement (from 0.25% to 0.40%), removal of pre-payment penalty for floating rate housing loans, change in eligibility and restriction on bank lending to HFCs under priority sector classification for banks, uniformity in the interest rate changed to new and old customers (notified in April 2012, not implemented yet) and restriction on Loan to value (LTV) ratio etc are expected to have an adverse impact on the business and financial performance of the HFCs.

RHFL is a regional player with a modest scale of operations

RHFL with a portfolio size of about Rs. 3,098 crore as on September 30, 2012 (Rs 2,804 crore as on March 30 2012, about 1% market share among HFCs) is small HFC. Of the total portfolio as on September 30, 2012, about 86% were housing loans. The company caters to individual borrowers in both the salaried and non-salaried (self employed professional and self employed non-professional) segments, accounting for about 47% and 53% respectively of the total portfolio as on September 30, 2012. The company was able to grow its portfolio at a healthy rate of 35% and 47% during 2011-12 and 2010-11; higher than the industry levels due to its small asset base. RHFL achieved disbursements of about Rs.496 crore in the first six months 2012-13 vis a vis

Table 1: Key portfolio characteristics

	Mar-12	Mar-11
Average ticket size (Rs. lakhs)	8.89	8.06
Proportion of loans above 80% LTV	14%	12%
Proportion of loans to Salaried customers	46%	45%
Proportion of non-housing loans	14%	16%
Proportion of floating rate loans		
Share of loans in Tamil Nadu	67%	68%

Source: Company Reports

Rs.498 crore during the same corresponding period in the last financial year, indicating stagnant levels, inline with the subdued operating environment.

Table 2: Product-wise breakup of Portfolio

Portfolio (in Rs. cr)	Sep-12		Mar-12			Mar-11			Mar-10		
	O/S	% share	O/S	% share	% growth	O/S	% share	% growth	O/S	% share	% growth
Housing Loans	2,652	86%	2,403	86%	37%	1,751	84%	50%	1,165	83%	49%
Non-Housing Loans	446	14%	401	14%	24%	324	16%	33%	243	17%	17%
Total	3,098	100%	2,804	100%	35%	2,075	100%	47%	1,408	100%	42%

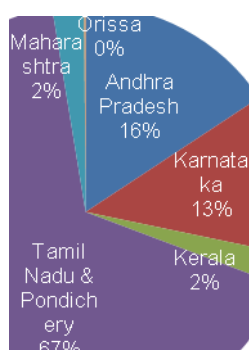
Source: Company Reports

Table 3: Customer Segment-wise breakup of Portfolio

Portfolio (In Rs. crore)	Sep-12		Mar-12			Mar-11			Mar-10		
	O/S	% share	O/S	% share	% growth	O/S	% share	% growth	O/S	% share	% growth
Salaried	1,465	47%	1,304	46%	40%	932	45%	50%	621	44%	36%
Professional & Self employed	140	5%	129	5%	8%	120	6%	46%	82	6%	55%
Loans to Businessmen	1,493	48%	1,371	49%	34%	1,023	49%	45%	704	50%	47%
Total	3,098	100%	2,804	100%	35%	2,075	100%	47%	1,408	100%	42%

Source: Company Reports

Chart 1: State wise Portfolio Break-up-March-2012



The company has a concentrated nature of business, with about 98% of its business from the four South Indian states; of which, Tamil Nadu (TN) accounted for about 67% of the total portfolio outstanding as on March 31, 2012. Although the company has taken initiatives to improve its regional diversification by opening new branches in West Bengal, Orissa and Gujarat during the previous year and in the current year so far, RHFL's business is expected to remain concentrated in the South India states, particularly TN over the medium term at least. The above is likely to exert competitive pressure on the company from both SCBs and other HFCs, thus limiting RHFL's scope of scale and margin expansion.

Source: Company Reports

Deterioration in RHFL's asset quality in the recent past

Table 4: Trend in asset quality indicators

(In Rs. crore)	Sep-12	Sep-11	Mar-12	Mar-11	Mar-10	Mar-09
Gross NPA	65.6	42.7	38.4	25.2	17.4	9.5
Provisions	16.6	12.0	11.8	7.0	4.4	2.6
Net NPA	49.0	30.7	26.6	18.2	13.0	6.9
Gross Advances	3097.8	2,409.2	2,802.2	2,075.2	1,404.0	988.5
Gross NPA %	2.12%	1.77%	1.37%	1.21%	1.24%	0.96%
Net NPA %	1.59%	1.28%	0.95%	0.88%	0.93%	0.70%
Provision cover	25%	28%	31%	28%	25%	27%
Net NPA/Net-worth	14.46%	11.27%	8.77%	7.35%	6.67%	4.41%

Source: Company Reports

RHFL's gross non-performing assets (NPAs) as a proportion of its advances has increased during the period March 2010 to March 2012, while HFCs (all HFCs consolidated) registered a declining trend during the same period. RHFL's gross NPAs further increased to about 2.12 % in September 2012 as compared to 1.37% in March 2012 and 1.77% in September 2011. The above was on account of the subdued

economic environment, which has exerted pressure on the re-payment capability of its borrowers. Pressure was witnessed across the lending profile of the company, but majorly in the non-salaried segment.

The company, in view of the above, has taken initiatives to improve its monitoring and collection processes. Further, HFCs generally are faced with higher delinquencies during the year, which are regularized by the end of the financial year. Also, availability of laws like the SARFAESI Act has helped HFCs including RHFL in loan recoveries thus reducing credit losses. However, considering the ongoing weakness in the operating environment, the asset quality of RHFL is expected to be under some pressure in the near to medium term at least. Nevertheless, in light of strong recovery systems, adequate cushion available in the form of equity of the borrower (only 14% portfolio as on September 30, 2012 was at more than 80% LTV) and access to SARFAESI, eventual credit losses may not increase sharply from current levels.

Financial position

IPO proceeds to support medium term growth plan

RHFL's gearing increased to about 8.15 times on September 30, 2012 vis-a-vis 7.38 times on March 31, 2011 and 6.53 in March 31, 2010, due to strong growth even as its annual internal capital generation (PAT-Dividend / Average assets) was strong at over 2.2% over the last two years. As sizeable proportion of its portfolio carried lower risk weights, its reported capital adequacy ratio (CAR) as on March 31, 2012 and September 30, 2012 was comfortable at 16.50% and 15.94%, comprising entirely of Tier-I capital.

The IPO proposed is expected to significantly improve the overall capitalisation profile of the company to support its envisioned growth going forward.

Concentrated funding profile limits financial flexibility

RHFL has predominantly used National Housing Bank refinance (43% of total borrowings as on September 2012) to fund its disbursements, while the remaining was from various SCBs and from the parent company, Repco Bank. More than 60 out of its 68 branches of RHFL as in March 2012 are in Tier II and Tier III towns and a significant portion of its portfolio qualifies as rural housing finance, and is eligible for low-cost funding from NHB. The cost of borrowing from NHB was about 8% in September 2012, while the same from banks stood at about 11%. As the company's bank funds are generally linked to the base rate any reduction in the systemic rates is likely to favourably impact the company cost of bank funds and vice versa. Limited funding diversity, however, constraints RHFL's bargaining power with its lenders and makes the company's profitability susceptible to adverse movement in the systemic interest rates. Therefore, ability of the company to diversify its funding sources would be critical for controlling its overall cost of funds, as the scale of operations increases going forward.

The company's overall cost of borrowing witnessed an increase from about 8.92% in April 2011 to about 9.58% in March 2012. RHFL's average cost of bank funds increased from about 9.33% for 2011-12 to about 9.51% for the first six months of 2012-13. The same is expected to moderate to an extent in the second half of the year, inline with the anticipated downward systemic rate movement.

Earnings profile remains strong albeit some pressure on margins

Table 5: Summary Earnings Profile

(Amounts in Rs. crore)	Sep-12 6M	Mar-12 12M	Mar-11 12M	Mar-10 12M	Mar-09 12M
Net Interest Income	62.1	114.5	96.3	72.4	45.3
Other Income	1.3	2.1	1.8	1.4	1.0
Operating Income	63.4	116.6	98.1	73.8	46.3
Operating Expenses	9.8	19.4	15.0	9.5	7.4
Operating Profit	53.6	97.2	83.1	64.3	38.9
Provisions and loan losses	5.9	15.5	3.9	3.2	0.6
PBT	47.8	81.6	79.3	61.2	38.3
PAT	35.6	61.5	58.2	44.4	28.1
Yield on Average Earning Assets (%)	12.6%	12.9%	12.6%	13.0%	13.1%
Non-interest income (other than loan related fees)/ Average Assets	0.1%	0.1%	0.1%	0.1%	0.1%
Cost of average interest bearing funds (%)	9.5%	9.3%	8.3%	8.5%	9.7%
Gross Interest Spread (%)	3.1%	3.6%	4.3%	4.5%	3.4%
Net Interest Margin (%)	4.1%	4.6%	5.3%	5.7%	5.1%
Operating Expenses /Average Assets	0.7%	0.8%	0.8%	0.7%	0.8%
Provisions & Write offs / Average Assets (%)	0.4%	0.6%	0.2%	0.2%	0.1%
Cost to Income Ratio (%)	15.4%	16.7%	15.3%	12.8%	15.9%
Profit before Taxes / Average Assets	3.2%	3.3%	4.4%	4.8%	4.2%
Profit after Taxes / Average Assets (%)	2.4%	2.5%	3.2%	3.5%	3.0%

(Amounts in Rs. crore)	Sep-12 6M	Mar-12 12M	Mar-11 12M	Mar-10 12M	Mar-09 12M
Profit after Taxes / Networth	22.2%	22.3%	26.3%	25.3%	18.6%

Source: Annual Report/RHFL

RHFL had enjoyed a healthy gross interest spread in the past as compared to most of its peers, largely on account of its less penetrated target market (Tier-II and Tier-III cities); however the same has been displaying a deteriorating trend in the recent past due to the increase in competitive pressures and in the cost of funds for the company. The yield of the company has remained range bound at about 12.5-13% during the last two–three years, while the cost of funds have increased from 8.3% during 2010-11 to about 9.5% for the six months period ended September 30, 2012. Consequently, the company's gross interest spread declined from about 4.3% in 2010-11 to 3.1% for the six months ended September 30, 2012. The company's fee based income is meagre.

The company's operating cost has moderated over the years and presently is about 0.7-0.8% of average total assets, largely in line with the industry standards (0.7% in 2011-12). The provision costs increased considerably during 2011-12 due to changes in the provisioning policies; however the same was higher at 0.39% for the six months ended September 30, 2012 vis-à-vis 0.21% in 2010-11, due to the increase in the delinquencies. During 2011-12, pursuant to the change company's NPA provisioning policy in accordance with the NHB requirements and the amendment in the standard provisioning requirement (increased to 0.4%), the company had a onetime impact of about Rs.10 crore on its overall profits.

In line with the decline in the gross interest spread, the net profitability and return on networth also eroded over the last two years, however the same remained healthy at about 2.4% and 22% respectively for the six month period ended September 30, 2012. While the company is likely to benefit from lower cost of funds in a softening interest rate environment going ahead, the lending yields could also moderate given the prevailing competitive scenario. Consequently, interest spreads are expected to moderate from current levels. The relatively low operating cost levels of the company could endure healthy operating profitability while higher provisioning costs arising out of increase in delinquency levels could impact net profitability. Nonetheless, RHFL's return on networth is likely to remain strong and favourable in comparison to peers over the medium term.

Contingent liabilities

Contingent liabilities on the book of the company as on September 30, 2012 are detailed in the table below:

Table 6: Contingent liabilities not provided for as on September 30, 2012

Particulars	Rs. Crore
Claims against the Company not acknowledged as Debts	0.21
Disputed Income tax liability	0.20

Source: RHFL Annual Report 2012

Litigation history

The litigations outstanding against the company, its directors and group entities are as on September 30, 2012 are detailed in the table below:

Table 7: Summary of Litigations against the company and related parties

Category	Against Company	Against Director	Against Promoter	Against Group Entities
Criminal Proceedings	NIL	NIL	NIL	NIL
Securities law proceeding	NIL	NIL	NIL	NIL
Civil Proceedings	15	NIL	15	NIL
Tax Proceedings	NIL	NIL	NIL	NIL
Labour Cases	NIL	NIL	NIL	NIL
Consumer Cases	7	NIL	3	NIL
Other proceedings	1	NIL	NIL	NIL
Total Amount (Rs. crore)	3.08	NIL	14.94	NIL

Source: Company Reports

Apart from the above, investigation by the Central Bureau of Investigation against the erstwhile Managing Director of the company is pending.

There are also legal proceedings initiated by the company and the promoter. The amounts involved in the same are Rs 0.26 crore and Rs. 39 crore respectively.

In Fiscal 2012, the company experienced seven cases of fraud amounting to Rs 2.42 crore in aggregate and between the period April 1, 2012 to September 30, 2012, the company experienced one case of fraud amounting to Rs 0.01 crore. The company is currently examining the facts of the case and loan documentation.

**ICRA Limited***An Associate of Moody's Investors Service***CORPORATE OFFICE**

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