"REPCO Home Finance Q1FY15 Earnings Conference Call"

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MODERATOR	**MR. SUNESH KHANNA – ANALYST, MOTILAL OSWAL SECURITIES**

Moderator Ladies and Gentlemen, good day, and welcome to Repco Home Finance Q1FY15 Earnings Conference Call hosted by Motilal Oswal Securities. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sunesh Khanna of Motilal Oswal Securities, thank you and over to you Mr. Khanna.

Sunesh Khanna Thank you Mallika. Good afternoon everyone and welcome to Repco Home Finance Earnings call to discuss Q1FY15 results. We have with us Mr. Varadarajan – Managing Director of the company, Mr. V. Raghu – the Executive Director, and Mr. K. Ashok – Chief General Manager, Credit. May I now request Mr. Varadarajan to take us through the financial highlights post which we can open the floor for question and answer session. Over to you Sir.

Varadarajan Thank you. Good afternoon everyone and a very warm welcome to the Repco Home Finance Limited conference call for the quarter ended 30th June, 2014. We are happy to report a loan book growth of 31% during the quarter driven by 24% growth in disbursements. Pre DTL Earnings witnessed an increase of 26% driven by healthy margins. We managed to achieve this growth in earnings even on the back of a higher base owing to 57% jump in net profit in the same period last year, and a slightly higher NPA. As in the past, GNPAs inched up to 2.49% in Q1 FY15 – however this, we would like to reiterate is technical in nature and not a reflection of the underlying asset quality. We didn't make any fresh additional provisions this quarter and hence, the NNPA stood at 1.60%, consequently the PCR fell to 36.4% from the levels seen in Q4 of FY'14 but improved marginally from 32.1% seen in Q1 FY14. We are committed to our stance of improving our PCR to 100% in a few years. During this quarter under review, we earned a spread of 2.8% and a NIM of 4.4%. Both were under pressure owing to higher NPAs and also because unlike last year we didn't have access to fresh equity. However, we feel we will be able to sustain our long term target of a 3% spread and 4% NIM. The share of the LAP portion to the total book was 19.2%. Pre DTL return ratios remained stable with ROA at 2.7% and ROE at 17%. Post DTL figures were 2.6% and 16.5% respectively on trailing twelve month basis .

Capital adequacy ratio continues to be comfortable at 23.5% consisting entirely of Tier-I. We believe we are well positioned to fuel our growth with deeper penetration in the existing geographies and contiguous expansion in regions outside the south. During the quarter we opened six new satellite centers of which one was opened in Hyderabad and the rest in the State of Tamil Nadu. We are confident that these centers will be converted into branches in the course of time.

Our retail network as on 30th June, 2014 comprised of 91 branches and 37 satellite centers spread across 10 states and the Union Territory of Puducherry.

On the macroeconomic front, food and fuel inflation played the spoilsport. With the underlying tension in Iraq and uncertainty surrounding the monsoon we don't expect the interest rate scenario to turn conducive at least in the current calendar year. However we believe through various options available to us we will be in a position to protect our margins should interest rates increase from here on. Regardless of the ephemeral macroeconomic uncertainties prevalent now, our outlook for the mortgage sector continues to be positive. If some of the points outlined in the manifesto of the new Government are anything to go by, the situation will only get better. Our unique focus on the under penetration segments of non-salary borrowers and Tier-II and III Cities would continue to drive our growth. Non-salaried segment comprised 55.3% of the loan book as on 30th June, 2014.

Repco Home Finance is a long term borrower with diversified sources of borrowing which it aims to further diversify in the coming quarters. Currently bank borrowings comprise about 64% of the total borrowings, NHB about 26% and Repco Bank about 10% as of 30th June 2014. Let me now quickly summarize the financial highlights for Q1FY15.

- Total income from operations stood at Rs. 156.0 crores, up 31% from last year.
- Net interest income was Rs. 53.0 crores up 25%.
- Pre DTL PAT stood at Rs 28.0 crores, up 26% year on year. Post DTL PAT was Rs. 24.8 crors, up 11% from the previous year.
- Sanctions grew 35% to Rs. 481.1 crores. Disbursements grew by 24% year on year to Rs 414.6 crores
- Our loan book stood at Rs 4,892.3 crores, registering a growth of 31% year on year
- We reported a NIM of 4.4% and a spread of 2.8% for the quarter ended 30st June'14

Finally with our strong capital position, an efficient and scalable operating model, we believe that we can continue to compete effectively in expanding the Repco Home brand. We will strive to maintain our loan book growth and profitability with deeper penetration in the existing market and wider geographic expansion into the newer markets.

At this point I would like to thank all of you for joining the call. We will now take the questions.

Moderator Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Hardik Doshi from First Voyager. Please go ahead.

Hardik Doshi My first question was, you mentioned that you see a seasonal increase in the gross NPAs in the first quarter. Can you just explain the cause of this?

Varadarajan About 55% of our loan book comprises of non-salaried segment, where the income profile of the borrowers is lumpy. Generally, in the first quarter other expenses take priority over payment of housing dues. However, the defaulting borrowers pay their dues along with penal interest in subsequent quarters. Likewise, our NPA levels peak in the first quarter and come back to normal levels by end of the year.

Hardik Doshi Okay, but I just want to understand, what you mean by income profile being lumpy?

Varadarajan Unlike salaried class, non-salaried class doesn't get a fixed income every month.

Hardik Doshi Okay, got it. But this time the impact of seasonality seems to be a little higher than it was in Q1 of last year. If I look at the sequential increase, it is higher than what the sequential increase was in Q1 in last year. So what is giving the confidence that all of this is technical in nature?

Varadarajan We have been observing this trend for the past so many years, which gives us the confidence that the dues are recoverable in subsequent months.

Hardik Doshi Okay, I guess you are still in touch with all these customers?

Varadarajan Of course we are in regular touch with our borrowers. NPAs are technical in nature because of the 90-day norm. Money will come back over a period of time. The money we have written-off in the past 14 years as unrecoverable is just about Rs. 4 crores out of cumulative disbursements of over Rs. 7000 crores.

Hardik Doshi Got it. My second question was as we are expanding our branches and we are getting larger in size, obviously one of the challenges would be to keep on maintaining our credit culture and possibly changing our systems and processes. So when you talk more from a two- to three-year perspective what are we thinking of in terms of our underwriting processes and maintaining our credit culture?

Varadarajan The credit culture probably will continue to remain the same; the underwriting process is reviewed periodically. We keep fine tuning it and believe that with the current growth rate and all other things this model is scalable. As and when some changes are required we will adopt because we are open to improvements in our processes. We gauge our performance constantly on various parameters and incorporate changes that we perceive would be beneficial. This gives us the confidence.

Hardik Doshi Okay, the last question was on the LAP front. Can you tell us about the profile of your LAP book in terms of what is the average AUM, LTV, and are these customers largely the same customers to whom you gave housing loans?

Varadarajan The average LTV in the case of LAP loan is 50% and the asset under management is around Rs. 940 crores. Some of the LAP borrowers are our existing customers.

Hardik Doshi What percentage of your LAP customers overlap with your mortgage customers?

Varadarajan 20-30%.

Hardik Doshi Remaining customers are new?

Varadarajan That's right.

Hardik Doshi All right.

Moderator Thank you. The next question is from the line of Jyoti Kumar from Spark Capital. Please go ahead.

Jyoti Kumar Just a couple of questions, first now that you have reached 19% in LAP book, incrementally is it fair to assume that LAP and regular mortgage book will grow in synch with each other?

Varadarajan You are right. We would maintain a balance of 80-20%. LAP exposure will be capped at 20%.

Jyoti Kumar Sure, other question I had was on region wise breakup of your loan book in AP. Can you bifurcate that into Telangana and residual part of AP?

Varadarajan We have not done this so far. Combined exposure to Andhra right now is 13%.

Jyoti Kumar The third question I had is actually a corollary of the second one. We have come across quite a few instances where prices have surged significantly in the residual part of AP in the last five to six months. Are you tightening your credit norms, slowing down your credit in some of these areas because we hear prices have gone up by almost 3X in the past 6-8 months?

Varadarajan Yes you are right Jyoti, I think with the expectation of where the capital is going to be in the residual Andhra the prices have been going up. We are moving in a cautious manner, however, it is not that we have completely stopped disbursing loans. The coastal Andhra is not affected; it is the southern portion closer to the Tamil Nadu border where the prices have seen a surge.

Jyoti Kumar Other than these two regions, are we seeing some other places where prices have gone up or is it just these two regions?

Varadarajan No, in the other regions, there has not been much of an increase in prices. Vizag or even the Telangana region of Hyderabad and Secunderabad, these places have also not witnessed a great increase in prices.

Jyoti Kumar Okay Sir.

Moderator Thank you. The next question is from the line of Sanket Chheda from Equirus Securities. Please go ahead.

Sanket Chheda I had a question on our provision coverage ratio. When we compare the same of our peers, generally they have near 100% of provision coverage, and while we are only at 35 to 40%, so just wanted to know the way forward. If we increase our coverage it will be easier to compare on the lines of ROAs.

Varadarajan Yes, as far as provision coverage ratio is concerned, if you see in the first quarter, it will appear low because the NPA levels are generally higher. When NPA comes down subsequently the provision coverage ratio also increases. Our intention, as I mentioned in the opening remarks, is to take it to 100% over a period of time. In the current year we will have a substantial increase in the PCR by the end of the year.

Sanket Chheda Okay, you intend to take it to 100% by this year?

Varadarajan No, over a period of time. It may not happen this year.

Sanket Chheda Okay, just wanted housing and non-housing portfolio bifurcation in terms of percentage, if you have that?

Varadarajan Housing is 80.8%, the LAP is 19.2%.

Sanket Chheda Okay, and just the last question, what is salaried and non-salaried bifurcation? Do we intend to bring down the non-salaried portion?

Varadarajan The bifurcation now is 55.3% to non-salaried segment and 44.7% to salaried segment. Our objective is to keep it 50-50 with a range of 5%.

Sanket Chheda Okay.

Moderator Thank you. The next question is from the line of Gaurav Maheshwari from Unilazer. Please go ahead.

Gaurav Maheshwari Yes Sir, a couple of questions, the first is basically on your spread, was it lower because of the change in your borrowing mix?

Varadarajan There are two reasons for that. One, the cost has marginally gone up; the other reason is because of higher NPAs we couldn't recognize income on some of the assets.

Gaurav Maheshwari Shall we see it going back to 3% next quarter onwards?

Varadarajan We expect it to go to 3%.

Gaurav Maheshwari The second question is more regulatory in nature, so last year we saw this cap which came in under a couple of schemes of NHB. With the new Government focusing on housing for all by 2020, do you think that such bottlenecks could be reversed because what we also get to know from other NBHCs that the off-take under those schemes declined quite substantially?

Varadarajan That is why if you see, NHB has now increased the cap from 2% to 2.5%. Our company has also launched a special scheme called Repco Rural to take advantage of that scheme. Generally, many of the HFCs have not taken funds from RHF scheme where NHB has put the ceiling on the lending rate because lending to rural segment at that margin is not viable, taking into account the various operational costs and other things. We had represented to the National Housing Bank to enhance the spread to 3%. However, I think probably as a first step the spread has been revised to 2.5%. We are hopeful.

Gaurav Maheshwari Okay, so that should also help us on borrowing cost side, or is it already factored into the numbers right now?

Varadarajan Yes absolutely.

Gaurav Maheshwari So that benefit will come in subsequent quarters or it is already there in the numbers now?

Varadarajan It will come in subsequent quarters, because we have taken this fund only towards the end of the last quarter.

Gaurav Maheshwari Okay got it. Since earlier our focus was wherever we are operating in the South of India Repco Home Finance would have a branch closer to Repco Bank, so that we get benefits from the bank, in terms of the customer referrals etc. Now that we are expanding in other geographies what is the thought process over there and how do we generate footfalls and leads?

Varadarajan That is a thing of the past and not part of current policy**.** Barring a couple of branches Repco Bank and Repco Home Finance are not co-located. Even in the places where we are co-located, we don't share the premises. We try to keep an arm's length distance from the parent.

Gaurav Maheshwari Okay, do you have a loan book size in mind that you would like to reach in the next 3 years?

Varadarajan We don't have a number in mind. However, we are confident of maintaining the current growth rate. We feel 25-30% growth rate is sustainable in the medium term.

Gaurav Maheshwari Right that is what you have reiterated in most of the calls**.** Good.

Moderator Thank you. The next question is from the line of Sneha Ganatra from Subhkam Ventures. Please go ahead.

Sneha Ganatra Regarding the borrowing mix, any plans to borrow through NCD or ECB route?

Varadarajan Definitely plans are there with us to enter the debt market. We will closely watch the market conditions and enter at the right time.

Sneha Ganatra Okay. Any plans to borrow in the current quarter?

Varadarajan We are always open, provided the market conditions turn conducive.

Sneha Ganatra Okay and what about the branch expansion plan.

Varadarajan We still maintain that we will open 15 branches in a year. Out of that two thirds will be in the southern region, rest in other regions.

Sneha Ganatra Okay. What is your outlook on the operating cost going ahead?

Varadarajan Operating cost will most likely be sustained at the current levels.

Sneha Ganatra Okay. What is the CAR level we would like to maintain and the gearing we are comfortable with?

Varadarajan See, the CAR is now around 23.5% as against the requirement of 12% by the regulator. I think any CAR above that 12% is a comfortable level for us. The gearing is around 5.5, depending on the business requirement we will slowly increase it to 7-8 levels.

Moderator Thank you. The next question is from the line of Hiren Dasani from Goldman Sachs. Please go ahead.

Hiren Dasani How confident are you of maintaining 30% loan growth trajectory?

Varadarajan Quite confident. We think it is sustainable in the medium term.

Hiren Dasani Okay. The home loan growth seems to be slowing, it is coming more from the LAP side. Do you have any internal cap for LAP?

Varadarajan It was a conscious decision to increase the exposure in LAP as the spreads are attractive – there isn't any slowdown in the growth of home loans. However, LAP portion will be capped at 20%.

Hiren Dasani Okay. Any plans to do any builder loans?

Varadarajan No, we will not.

Hiren Dasani Okay.

Moderator Thank you. The next question is from the line of Bobby Jayaraman from Frunze Investments. Please go ahead.

Bobby Jayaraman In terms of your expansion, could you take me through the rationale behind expanding in a lot of different states versus going deeper in a single state? For example I see in your pie chart that you have 0.3% of your book in Orissa, 0.2% in West Bengal and in quite a few states you have a very small exposure. Why not go full fledged in a few states?

Varadarajan See the strategy for us is to become a pan India Company over a period of time. We are now sowing the seeds for future growth, that is why we said we would like to concentrate more on the existing geographies where we are doing good business, and the strategy is also to expand on a contiguous basis. What we would like to do is to consolidate our position in these states, take the business to reasonable levels before we start expanding into the other regions of the country.

Bobby Jayaraman In terms of the costs, do the new states entail high cost or you are seeing the same level of traction that you see in states where you have stronger presence?

Varadarajan States of Maharashtra and Gujarat have smaller operating expenses as compared to other states. Generally speaking, initially expansion into new areas will add to the cost but over a period of time the new branches start adding to profits.

Moderator Thank you. The next question is from the line of Sangam Iyer from Subhkam. Please go ahead.

Sangam Iyer It is just a clarification on previous question asked by another participant. When you said that you are looking at the spreads going back to 3% plus levels, given the current backdrop wherein you know cost of funds have gone up, , what could be the drivers for the spreads going back to 3% levels?

Management Firstly, when NPA level comes down we will be able to book income on assets on which we didn't book any this time around. Secondly, as mentioned earlier we will be availing refinance from NHB under the rural housing fund which will help us lower our average cost of funds.

Sangam Iyer And in the interim, I mean in the next 6 to 12 months period, are we looking to increase our leverage?

Varadarajan Yes, it will go up. It has to go up gradually for us to be able to grow 25-30%.

Sangam Iyer What are your targeted GNPA & NNPA levels?

Varadarajan I don't think we will be in a position to give you any target as of now. Our endeavor will be to bring them down to FY14 levels.

Moderator Thank you. The next question is from the line of Sanket Chheda from Equirus Securities. Please go ahead.

Sanket Chheda What is the average LTV, is it still around 60%?

Varadarajan Yes, the average LTV on the book is 62%.

Sanket Chheda And I was wondering if I can get our NPA breakup in terms of housing and non-housing.

Varadarajan GNPA on the LAP portion is 3.3% as at the end of June 2014 and on the housing loan side it was 2.3%.

Sanket Chheda Why our competitors with comparable average ticket size have significantly lower NPAs?

Varadarajan It is this way because we have significant exposure to the non-salaried segment. As mentioned before, this segment has a lumpy income profile.

Sanket Chheda So it is because the exposure to non-salaried class is more?

Varadarajan Correct.

V. Raghu What we want to reiterate is exposure to non-salaried segment may result in higher inta-year technical NPAs but not in credit loss.

Moderator Thank you. The next question is from the line of Jyoti Kumar from Spark Capital. Please go ahead.

Jyoti Kumar Sir, couple of data related questions. First, in this NHB borrowing of Rs. 1,070 crores how much would be from rural housing fund?

V. Raghu It is around Rs. 650 crores.

Jyoti Kumar So you would have borrowed little more than Rs. 100 crores in this new 2.5% spread cap scheme?

V. Raghu No, we have taken about Rs. 50 crores.

Jyoti Kumar Sir, the other question that I had was if our current spreads are at 2.8% and if you are borrowing from RHF at 2.5% is it not margin dilutive?

V. Raghu That is why we have not borrowed much from the rural housing fund.

Moderator Thank you. The next question is from the line of Jigar Walia from OHM Group. Please go ahead.

Jigar Walia My question is as far as our LAP portfolio is concerned is it more from the older branches?

Varadarajan You are absolutely right, LAP loans are mostly from our old branches.

Jigar Walia And as far as new branches are concerned, are we employing DSAs?

Varadarajan No, we are using our old model of sourcing proposals through loan camps.

Jigar Walia And can you give us a little more color on the loan camps, how often do we do it and typically what is the attendance and conversion?

Varadarajan The loan camps are held at branch level once in two months. What we do is we advertise locally and invite people with whatever supporting papers they have. Post initial appraisal, an in-principle sanction is given to prospective borrowers and they are given a checklist of documents to be produced when they visit the branch at a later date for further processing. Historically, the conversion rate has been about 70%.

Jigar Walia Now, when we open new branches would the new branches follow the same 25 kilometer radius convention for conducting loan camps or would that be around 50 to 100 kilometer radius or even far away?

V. Raghu As far as possible we try to follow the 25 km radius norm because property inspections, subsequent follow ups with borrowers and other things become difficult to manage if the distance range is increased from the base branch. What we do is we advise the branch managers to send us a report and recommendation for opening a satellite center if they find a potential beyond 25 kilometer radius. If found feasible, we open a satellite center - a one man office. The man will source proposals and send them to the base branch. Once the business of the satellite center picks up and reaches an optimal level we convert that into a branch and see if there is potential beyond another 25 kilometers radius.

Jigar Walia And sir, what would be your total number of clients?

Varadarajan Number of clients is around 50,486 as at the end of June 2014.

Jigar Walia And generally do we have steady prepayment rates?

Varadarajan We receive about Rs. 10-15 crores per month as prepayments.

Jigar Walia Would it be fair to assume that much of our LAP loans would contain an equal mix of commercial, construction and business loans?

Varadarajan Yes.

Jigar Walia And sir, do we have any meaningful competition presently in the states or the districts where we are present. Could our spreads be impacted because of this?

Varadarajan Completion will not impact spreads. Since the potential is huge and the existing institutions alone can't meet the housing shortage we have now, there is room for more companies to enter the pace and have a market share

Moderator Thank you. The next question is from the line of Nischint C from Kotak. Please go ahead.

Nischint C I just wanted to understand what is the growth in number of loans disbursed?

Varadarajan As at the end of March we had about 49,000 borrowers. Now we have taken this to about 50,500 on outstanding basis.

Nischint C This is net of reduction in number of accounts owing to prepayments?

Varadarajan Yes.

Nischint C And the number of accounts that are closed would be broadly linear during the year?

Varadarajan Yes.

Nischint C Do you right now have the figure of number of accounts for the first quarter of last year?

Varadarajan The number of accounts at the end of the first quarter last year was 43,500.

Moderator Thank you. The next question is from the line Hiren Dasani from Goldman Sachs Asset Management Company. Please go ahead.

Hiren Dasani Just a small clarification. So the effective tax rate going forward would be 33%, 34%?

Varadarajan That's right.

Hiren Dasani And the second thing is on the cost to income ratio, when will we start getting some operating leverage or is it fair to assume that our cost-to-income ratio will remain around similar levels for quite some time?

Varadarajan Mr. Dasani, since we are on expansion mode I think the cost will probably initially go up and settle around 20%. Once the new branches start contributing to profits over a period of time cost to income ratio should start coming down.

Hiren Dasani So at least for the next couple of years you do not seem to be seeing that?

Varadarajan No.

Moderator Thank you. The next question is from the line Devesh Mehta from Ambit Capital. Please go ahead.

Aadesh This is Aadesh here. Sir, what would be the LTV on the LAP loans which have become NPAs? What will be the current LTV?

V. Raghu For LAP loans the LTV is capped at 50%.

Aadesh But 50% would be at the point of origination, right?

V. Raghu That's right. Based on current market value it would be much lower.

Moderator Thank you. The next question is from the line of Sneha Ganatra from Subhkam Ventures. Please go ahead.

Sneha Ganatra Sir, have you done securitization in this quarter?

V. Raghu Not yet.

Sneha Ganatra Any plans?

V. Raghu Yeah, we are planning to do.

Sneha Ganatra Any talks going on?

V. Raghu No, not yet. We are now identifying the pool. I think once we identify the pool then we will start the exercise and we will start negotiating.

Moderator Thank you. The next question is from the line Vellayan Lakshmanan from Accurate Data. Please go ahead.

Vellayan Lakshmanan I would just like to know your average acquisition cost per customer.

V. Raghu We are spending around Rs. 20,000 per loan camp that is all. It is not much.

Varadarajan So for 60 odd customers we spend about Rs. 20,000.

Vellayan Lakshmanan How many customers do you kind of lose?

Varadarajan You are asking about conversion rates in loan camps?

Vellayan Lakshmanan No, after you acquire a customer and typically how many customers you lose in a year? I know that should be very negligible but since you are expanding to a larger geography?

Varadarajan We lose about 600-900 customers a year because of prepayments.

Vellayan Lakshmanan I wanted to know how many customer you lose because of defaults?

Varadarajan We don't lose customers because of NPAs as such. It's only when we write-off loans as unrecoverable that we take customers off our system.

Moderator Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to Mr. Sunesh Khanna for his closing comments.

Sunesh Khanna Thank you Mallika. On behalf of Motilal Oswal Securities I would like to thank the senior management team of Repco Home Finance and all the participants for joining. Thanks a lot.

Varadarajan On behalf of the company we also would like to thank everyone who participated in the call and thank you Sunesh for organizing this.

Moderator Thank you very much. Ladies and gentlemen, on behalf of Motilal Oswal Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines.