Global Markets Research

Dewan Housing Finance

Strong levers, but needs to deliver

Cheapest play in the flourishing housing finance space...

The housing finance space has fared better than other credit segments recently (NPA: sub 1.5% vs 4.5% for banking) due to stable real estate prices, healthy wage growth, and under penetration. Dewan Housing Finance (DEWH IN), with its niche in lower- and middle-income (LMI) segment, has benefited from being an early entrant. Trading at 0.9x FY16E P/BV, it is cheap vs peers trading at 1.6-6.4x P/BV FY16E.

...but for known reasons

Cheap valuations, however, are on account of lower ROA at 1.3% vs peer at ~2.4%. Weak NIMs on high liability costs at 2.7% vs ~3.5% for private peers and high CI ratio at 31% vs ~18% remain a drag on ROA.

Significant scope for rerating if moves made in the right direction

Improved CI profile could trigger lower CoF: There remains immense scope for improvement in the CI ratio with "other expenses" above optimal levels, in our view. We assume a ~28% CI ratio for FY16, but every further 1% improvement in the CI ratio (via higher income or lower cost) is likely to improve ROA by 2bps. Higher profitability could trigger improved ratings, also lowering CoF eventually.

Rising securitization share to support NIM: With a CAR at 16%, we expect AUM to grow by 20% and loan book by 17%, over FY15-16E, increasing share of securitized book where DHFL earns additional spreads of ~150bp. Along with a favorable interest rate environment, this should result in 25bps NIM expansion over FY15-16E to 2.85%.

Rising LAP share saves margin, but could be a drag on valuations

The share of LAP, a relatively risky segment vs individual housing, has increased by ~500bp YoY to 16% of the book in FY14. The same helped lower margin deterioration from First Blue book. With management's comfort level at 20% for LAP share in loan book, we expect some pressure on long-term average valuations.

Rating: Accumulate

Target Price: INR 380

Upside: 14%

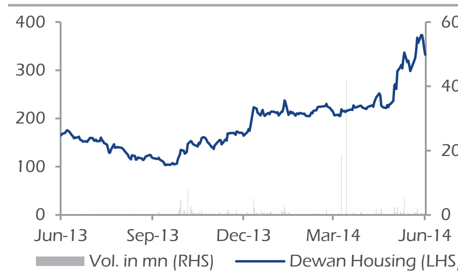
CMP: INR 332 (as on 13 June 2014)

Key data

Bloomberg /Reuters Code	DEWH IN/DWNH.BO
Current /Dil Shares O/S (mn)	128/128
Mkt Cap (INR bn/USD mn)	43/716
Daily Volume (3M NSE Avg)	520,810
Face Value (INR)	10
1 USD = INR 59.7	

Note: *as on 13 June 2014; Source: Bloomberg

Price & Volume



Source: Bloomberg

Shareholding (%)	Q1FY14	Q2FY14	Q3FY14	Q4FY14
Promoter	38.1	39.3	39.3	39.3
Institutional Investor	40.1	38.5	32.4	32.4
Other Investor	15.6	15.6	16.3	16.2
General Public	6.3	6.6	12.1	12.2

Source: BSE

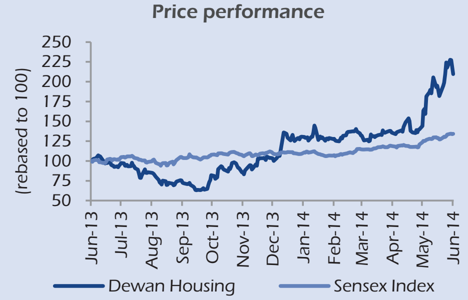
Price performance (%)	3M	6M	12M
Sensex	15.9	21.8	34.0
Dewan Housing Finance	57.5	102.4	101.4
HDFC	14.5	18.3	19.2
LIC Housing	39.8	58.2	24.4

Source: Bloomberg

Valuation

Weak valuations across HFCs on increasing competition with banks and concerns over margin pressure from First Blue acquisition primarily hurt valuations of DHFL over FY11-13. Over the past year, however, prices have more than doubled and the stock now trades at 0.9x P/BV FY16E vs 1.1x historical average. Due to rising pressure on margin after the First Blue acquisition, DHFL will likely trade at lower valuations of 1x forward P/BV. A disproportionate rise in large ticket loans could be one of the key risks to our expectations of an improved ROE of 18% and a ROA of 1.5% by FY16E, apart from any significant deviation in interest rate assumptions.

Price performance



Source: Bloomberg

Key Financials

YE March	NII (INR mn)	YoY (%)	PPoP (INR mn)	YoY (%)	PAT (INR mn)	YoY (%)	EPS (INR)	YoY (%)	ROAE (%)	ROAA (%)	P/E (x)	P/ABV (x)
FY13	7,427	58.3	6,703	56.2	4,580	48.3	34.5	34.3	17.4	1.6	5.5	0.7
FY14	9,932	33.7	8,160	21.7	5,290	15.5	41.3	19.7	15.5	1.3	4.1	0.6
FY15E	12,320	24.0	10,240	25.5	6,704	26.7	52.3	26.7	17.4	1.4	6.4	1.0
FY16E	15,291	24.1	12,854	25.5	8,471	26.4	66.1	26.4	18.9	1.6	5.0	0.9

Note: pricing as on 13 June 2014; Source: Company, Elara Securities Estimate

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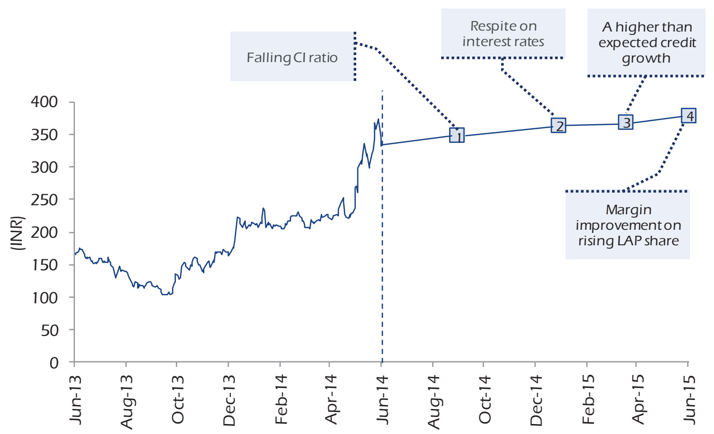
Elara Securities (India) Private Limited

Valuation trigger



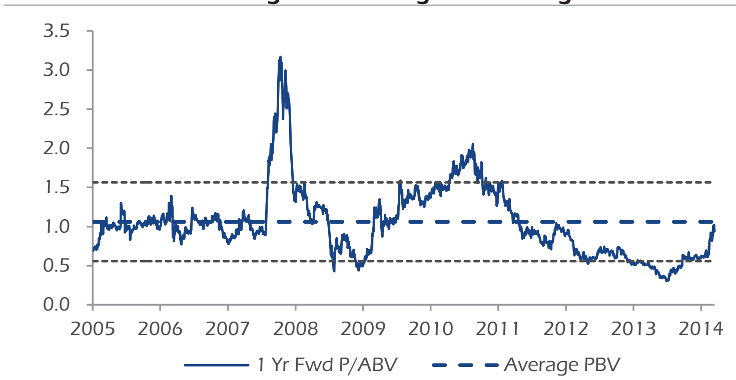
Source: Company, Bloomberg, Elara Securities Estimate

Valuation overview

Risk Free Rate (%)	8.00
Beta (x)	1.20
Equity Risk Premium (%)	6.00
Cost of Equity (%)	15.20
Sum of PV of residual income	74
BVPS	279
DHFL Valuation per share	**352**
DHFL Pramerica valuation per share	**27**
Price target	**380**
CMP	332
Upside/downside (%)	**14**
Implied FY15E PBV	**1.2**
Implied FY16E PBV	**1.0**

Source: Elara Securities Estimate

Valuation driver- trading close to long term average valuations



Source: Bloomberg, Company, Elara Securities Estimate

Investment summary

- A flourishing housing finance space supports profit for HFCs even amidst a downcycle
- Margin to improve on rising share of securitized book
- The CI ratio is expected to improve hereafter
- Higher LAP share could drag valuations lower

Valuation trigger

1. Falling CI ratio
2. Respite on interest rates
3. A higher than expected credit growth
4. Margin improvement on rising LAP share

Key risks

- Any weakness in real estate prices could hurt asset quality
- Elevated interest rate environment

Our assumptions

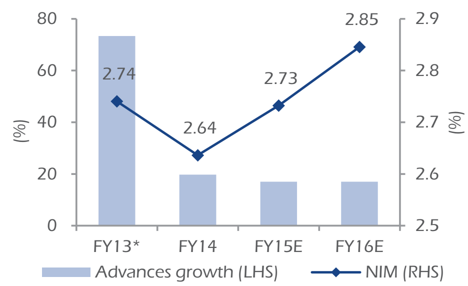
- AUM growth of 20% and loan book growth of 17% over FY15-16E
- Operating expenses to grow at 18% over 18% CAGR over FY15-16E
- Cost of funds to improve by 12 bps and 15 bps respectively over FY15E and FY16E
- Share of securitized book to increase to 14% by of AUM by FY16E.

Financials (YE March)

Income Statement (INR mn)	FY13	FY14	FY15E	FY16E
Net Interest Income	7,427	9,932	12,320	15,291
Add: Other income	2,783	1,939	2,366	2,886
Total Income	**10,210**	**11,871**	**14,686**	**18,177**
Less: Operating Expenses	3,507	3,711	4,309	5,153
Pre-provision operting profit	**6,703**	**8,160**	**10,240**	**12,854**
Less: provisions	450	700	925	1,082
PBT	**6,169**	**7,351**	**9,315**	**11,772**
Less: taxes	1,588	2,061	2,612	3,300
Reported PAT	**4,580**	**5,290**	**6,704**	**8,471**
Balance Sheet	FY13	FY14	FY15E	FY16E
Networth	32,371	35,750	41,365	48,460
Borrowings	320,403	394,869	453,040	530,057
Other liabilities	2,664	3,328	8,973	10,435
Total liabilities	**355,438**	**433,947**	**503,378**	**588,952**
Net Working Capital	6,203	10,238	10,068	11,779
Advances	339,036	405,966	474,980	555,727
Investments	2,750	5,759	5,034	5,890
Fixed Assets	4,379	9,877	10,571	11,779
Other Assets	3,069	2,106	2,726	3,778
Total assets	**355,436**	**433,947**	**503,378**	**588,952**
Ratios	FY13	FY14	FY15E	FY16E
Per Share data & Valuation Ratios				
EPS - Diluted	34	41	52	66
DPS	5	8	7	9
Book Value per share (BVPS)	252	279	323	378
Adjusted BVPS	252	279	323	378
ROAA	1.61	1.34	1.43	1.55
ROAE	17.4	15.5	17.4	18.9
Price / Earnings	5.5	4.1	6.4	5.0
Price / Book	0.7	0.60	1.0	0.9
Price / Adjusted BV	0.7	0.6	1.0	0.9
Dividend Yield (%)	2.7	4.8	2.2	2.8
Dividend payout (%)	13.5	19.4	14.0	14.0
Yields and Costs				
Yield on Assets	14.2	12.7	12.8	12.7
Cost of funds	10.6	10.6	10.5	10.3
NIM	2.74	2.64	2.73	2.85
Asset Quality				
Gross NPA (%)	0.7	0.8	0.9	0.8
Net NPA (%)	0.0	0.0	0.0	0.0
Cumulative Provisions (%)	0.8	0.8	0.9	0.8
Operational Ratios				
Cost-Income ratio	34.3	31.3	29.3	28.3
Cost-Average assets	1.2	0.9	0.9	0.9
Fee Income as a % of Total Income	27.3	16.3	16.1	15.9
Stated provisions / avg Advances	0.17	0.19	0.21	0.21

Note: pricing as on 13 June 2014; Source: Company, Elara Securities Estimate

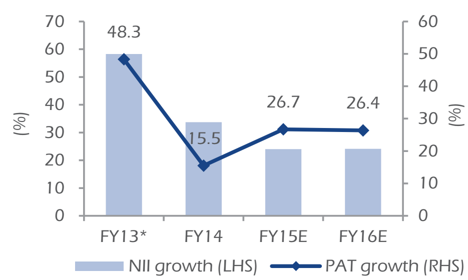
Advances growth and NIM trend



* FY13 numbers include First Blue merger

Source: Company, Elara Securities Estimate

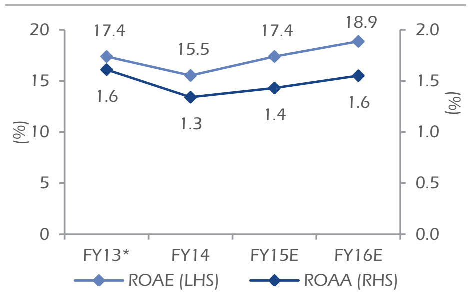
NII vs PAT growth



* FY13 numbers include First Blue merger

Source: Company, Elara Securities Estimate

Return ratios



Source: Company, Elara Securities Estimate

Margins to improve on increasing share of securitized portfolio

Improvement in CI ratio to support profitability as well as lower CoF, further supporting PAT

Financials

Investment rationale: Cost efficiency remains a key trigger

- **A flourishing housing finance space presents scope for credit growth and stable asset quality**
- **Margin triggers from increased securitization and higher LAP share**
- **Cost rationalization could also lead to lower cost of funds on better rating profile**

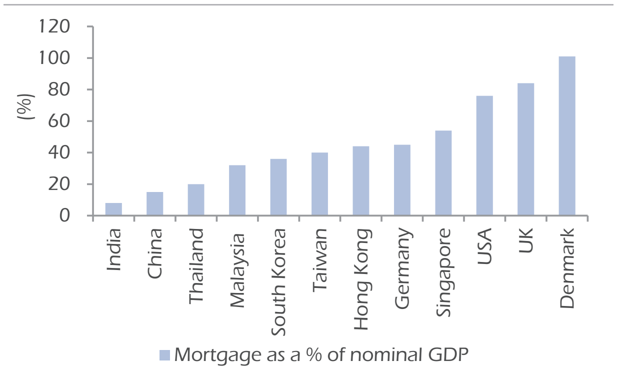
Housing finance in a sweet spot

With improving sentiments along with a stable government at the Centre, we expect real estate prices to remain elevated and benefit the housing finance segment as most loans are backed by property value.

Additionally, even as penetration in the mortgage market has been increasing steadily, the segment remains underpenetrated relative to peer countries (refer to Exhibit 1). Moreover, there remains a large chunk of funds (~25%) financed by moneylenders and other sources that institutional financing is yet to tap (refer to Exhibit 2). Therefore, despite increasing competition in the mortgage lending space, we believe there is still space for everyone on scope for higher penetration.

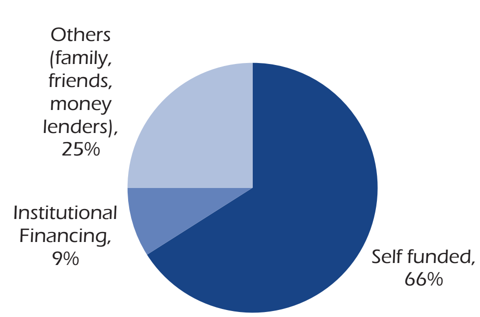
Gross NPA at sub-1.5% for the HFCs vs 4.5% for the banking space, largely comes from buoyant housing prices which back these loans and partly also stable wages.

Exhibit 1: Mortgage penetration remains low



Source: Company, Elara Securities Research

Exhibit 2: Resources for home construction in India

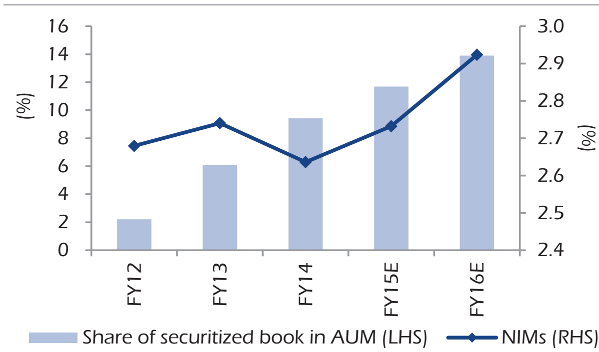


Source: NHB, Elara Securities Research

Rising securitized book could support margin

With a CAR at 16%, Tier 1 at 12% and no intentions of raising equity capital in the medium term, management intends to extensively utilize the securitization route to grow. Therefore, we expect AUM to grow by 20% even as loan book grows by 17% over the next two years, increasing the share of securitized book. All else constant, a higher share of securitized book (refer to Exhibit 3) should support margins as DHFL earns additional spreads of ~150bps on securitized book.

Exhibit 3: Share of securitized book in AUM



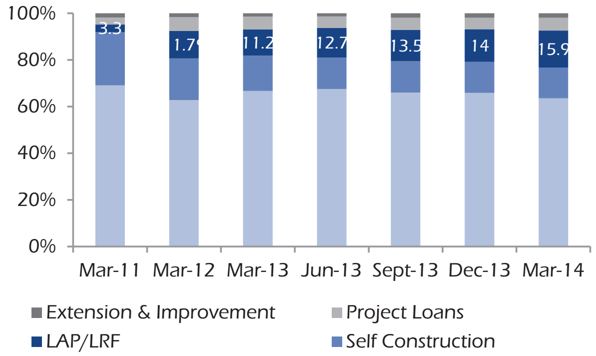
Source: Company, Elara Securities Estimate

Increasing LAP share shores up margin but raises balance sheet risk

Despite First Blue acquisition, which would entail lending to low yielding large ticket loans, DHFL has been able to largely contain margin, by continuously increasing high-yielding loan against property (LAP) share in book, apart from increased securitization. LAP share has increased by ~500 bps YoY in FY14 to 16% of the book.

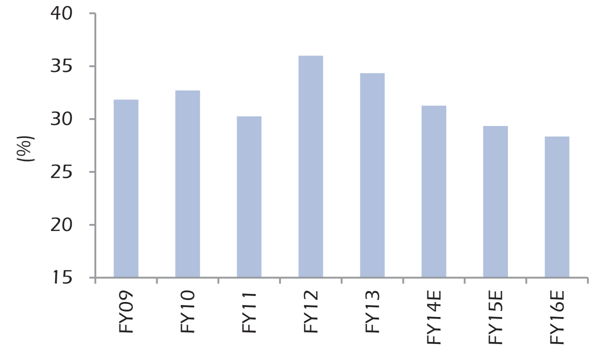
A higher risk profile of LAP loans compared to individual housing will result in DHFL getting slightly lower levels of valuations in our opinion, keeping all else constant.

Exhibit 4: Increasing share of LAP in credit



Source: Company, Elara Securities Research

Exhibit 6: DHFL's CI ratio over time



Source: NHB, Elara Securities Estimate

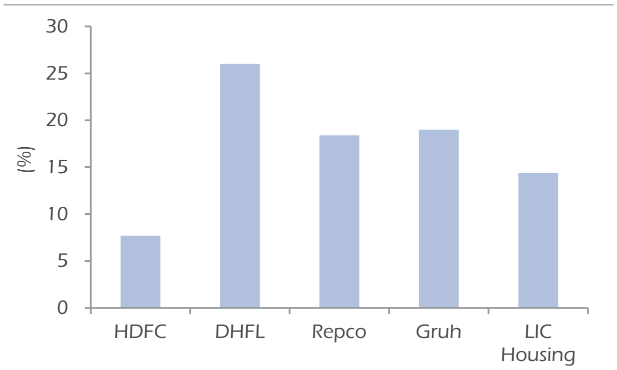
Cost rationalization to support returns

DHFL's cost-income ratio at 31% remains well above comparable HFCs using the branch model like Gruh and Repco (refer to Exhibit 4).

However, the CI ratio has improved over the past two years, and management expects the same to come down to 25% in the next 1-2 years. In FY14, part of the improvement came from the change in accounting treatment of business-sourcing income. We assume operating costs growth of 17-20% even as income grows at 23-24%, pulling the ratio lower by 300bps to 28.3% by FY16E.

However, given the differential in CI ratio compared to peers, there remains significant scope for improvement. We believe "other expenses" remain above optimal levels, and any further improvement in costs leaves space for significant upside potential in prices.

Exhibit 5: CI ratio compared to peers (FY14)



Source: Company, Elara Securities Research

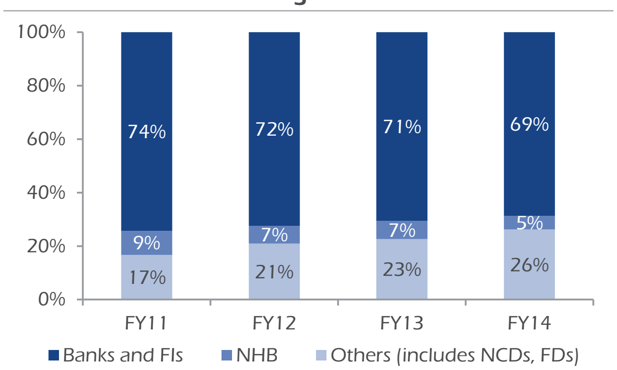
CoF improvement dependent partly on cost efficiency

The cheapest source of funding for DHFL and most other HFCs comes from the National Housing Board (NHB) at ~8% currently. As an HFC grows, the share of NHB funds inadvertently comes down as lending amount to an entity is a share of NHB's net worth. We therefore do not rule out the NHB share (refer to Exhibit 4) will taper off gradually even as total borrowings from NHB increase.

Even as DHFL's reliance on bank funds has come down over time, bank borrowings at 69% as on FY14 continue to be a major source of funding for the firm. We therefore expect overall cost of funds to move in line with bank lending rates and do not foresee any major relative efficiency on cost of funds in the interim even though they are at the higher end of industry average (refer to Exhibit 5).

However, better operational efficiency could result in high ratings for DHFL on account of an improved PPoP profile and eventually lower cost of borrowing from both the banking system as well as fixed deposits. Fixed deposits spreads for DHFL vs peers at 150-200bp is too high, resulting in almost no additional benefits vs bank borrowings.

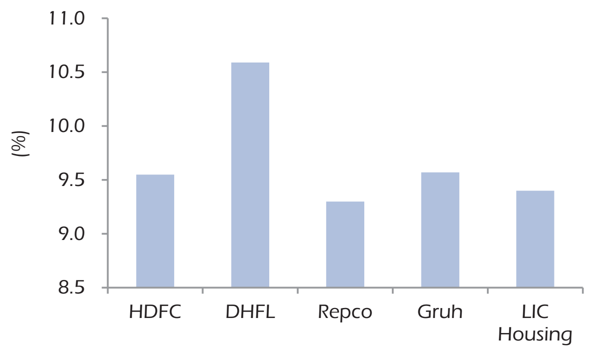
Exhibit 7: Share of funding sources over time



Source: Company, Elara Securities Research

Financials

Exhibit 8: FY14 cost of funds for various HFCs

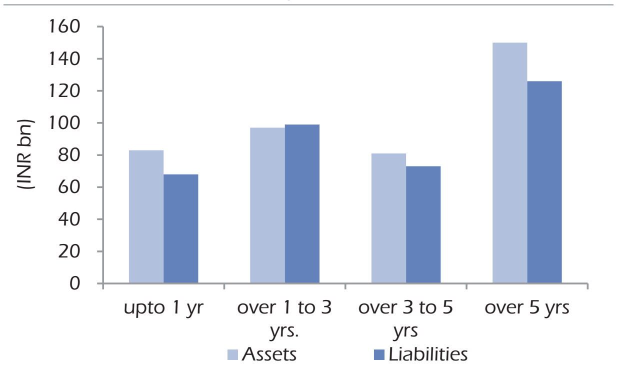


Source: Company, Elara Securities Research

A balanced ALM induces margin stability

Adjusted for prepayments and renewals in accordance with the guidelines issued by the National Housing Bank, DHFL's ALM profile is reasonably balanced and assures margin stability.

Exhibit 9: DHFL's maturity profile



Source: Company, Elara Securities Research

Insurance business, a wild card

The Group recently entered into the life insurance business through DHFL Pramerica Life Insurance, a JV with US-based Prudential Financial. Carried out at a minimal value of INR 1 and capital commitment of INR 0.32bn over the next four years for a 50% stake in the business, DHFL Pramerica is an asset-light acquisition for DHFL. Pramerica has committed INR 4bn over the same time period.

Pramerica factors in ~INR 3.25bn of premium from the insurance business annually, which DHFL was earlier generating for its insurance partner, ICICI Prudential, by bundling a "one-time premium" housing insurance product along with housing loans.

With a capital employment of INR 8,572mn at the end of March 2014, we value the business at INR 27 per share for DHFL shareholders currently. There could however be a far higher potential from the business in the long run if managed efficiently.

Exhibit 10: DHFL Pramerica valuation

(INR mn)	March 2014
Total capital employed	8,572
Holding company discount of 20%	6,858
DHFL's 50% share	3,429
Per share value (INR)	26.7

Source: Company, Elara Securities Research

Managing perceptions

To do away with investor perceptions over their head office in HDIL Towers (and perceived links with the HDIL Group despite their formal separation in 2009), management decided to invest ~INR 7bn for a new office. However, future operating costs (post 1-2 years) should get a breather from the same to some extent.

Additionally, the Group made some major appointments recently, inducting Milind Sarwate (previously Group CFO at Marico), Ravishankar G (previously CFO & Acting CEO at Jet Airways), M. Suresh (previously MD and CEO Tata AIA Life Insurance) and K Srinivas (previously President at Bajaj Auto) in various leadership roles to enhance the Group's capabilities to realize its ambitious growth plans. We hope the move will lead to a more rational corporate strategy for DHFL, rewarding shareholders in the long run.

Peer comparison

There are two key aspects in our opinion that differentiate housing finance companies: the way they manage their cost of funds and their cost-income ratio or operating efficiency. We find DHFL weaker than peers in both these aspects. We expect efficiency in operating costs for DHFL has a huge scope and could be a key trigger to valuations.

However, as far as COF is concerned, we expect no major efficiency to come in on a relative basis unless ratings improve (which could follow from improved CoF), lowering cost of market borrowings as well as fixed deposits. Better cost efficiency could eventually trigger higher ratings on improved profitability indicators.

Key risks

- A slump in real estate prices could hurt asset quality
- Higher-than-expected interest rates
- Risks to improvement in margin if share of large-ticket housing loans increases disproportionately to LMI segment loans

Exhibit 11: Peer comparison

FY14	Price (INR)	Mcap (INR bn)	NIM (%)	CoF (%)	CI ratio (%)	Gross NPA (%)	ROA (%)	ROE (%)	CAR (%)	FY16E P/BV (x)
HDFC	982	1,436.3	3.5	9.55	8	0.70	2.6	22.0	19.0	4.4
DHFL	344	41.4	2.7	10.59	31	0.78	1.4	15.5	16.4	0.9
Repco	417	26.2	4.7	9.30	18	1.50	2.7	16.4	24.5	2.5
Gruh	185	61.3	4.2	9.57	19	0.27	2.8	32.0	16.4	6.9
LIC Housing	318	164.0	2.2	9.40	14	0.67	1.5	18.0	-	1.6

Note: pricing as on 13 June 2014; Source: Company, Bloomberg, Elara Securities Estimate

Exhibit 12: DuPont analysis (%)

Du Pont Analysis	FY09	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E
Net Interest Income	3.3	3.0	2.6	2.5	2.6	2.5	2.6	2.8
Add: Other income	0.4	0.9	1.3	1.1	1.0	0.5	0.5	0.5
Total Income	3.7	4.0	3.9	3.5	3.6	3.0	3.1	3.3
Less: Operating Expenses	1.2	1.3	1.2	1.3	1.2	0.9	0.9	0.9
Pre-provision profits	2.5	2.7	2.7	2.3	2.4	2.1	2.2	2.4
Less: provisions	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
PBT	2.3	2.5	2.6	2.1	2.2	1.9	2.0	2.2
Less: taxes	0.6	0.6	0.6	0.5	0.6	0.5	0.6	0.6
Reported PAT	1.7	1.9	2.1	1.6	1.6	1.3	1.4	1.6
ROAA	1.7	1.9	2.1	1.6	1.6	1.3	1.4	1.6
Leverage (x)	12.0	12.2	10.8	10.6	10.8	11.6	12.2	12.2
ROAE	20.8	23.0	22.2	17.2	17.4	15.5	17.4	18.9

Source: Company, Elara Securities Estimate

Valuation & Recommendation

- **DHFL is among the cheapest in the housing finance space**
- **First Blue acquisition hurt valuations on concerns over margin squeeze**
- **Cost rationalization could be a key trigger to better valuations**

Historically, Dewan Housing Finance has traded at 1.1x and 6.4x average 1 yr forward P/BV and P/E respectively. The stock is currently trading at one-year forward P/BV of 1x and P/E of 6x. Its stock price has almost doubled over the past few months, primarily on easing of concerns over several issues, including Dewan's First Blue merger and DHFL Pramerica acquisition.

We expect the HFC to deliver an earnings CAGR of 26% over FY15-16E with a standalone value of INR 350 per share using the residual income model, implying a one-year forward P/BV of 1x, after factoring in an EPS CAGR of ~26% over FY15-16E, a ~15% CAGR over FY17-21E and 4% terminal growth thereafter. We assume long term sustainable ROE of 18%

The cost of equity has been arrived at using the capital asset pricing model (CAPM), assuming an 8% risk-free rate, a 6% equity risk premium, and a three-year adjusted weekly beta.

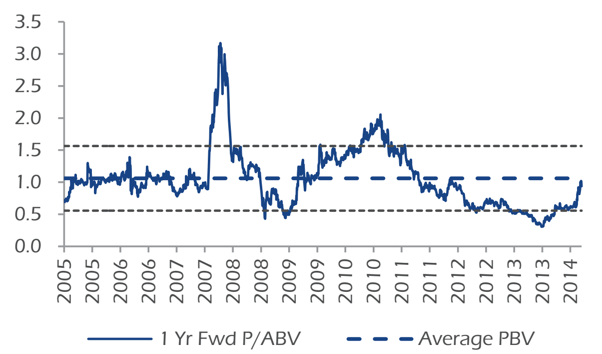
Adding DHFL Pramerica's valuation, we arrive at a target price of INR 380.

Exhibit 14: Residual income valuation

Risk Free Rate (%)	8.00
Beta (x)	1.20
Equity Risk Premium (%)	6.00
Cost of Equity (%)	15.20
Sum of PV of residual income	74
BVPS	279
DHFL Valuation per share	**353**
DHFL Pramerica valuation per share	**27**
Price target	**380**
CMP	**332**
Upside/downside (%)	**14**

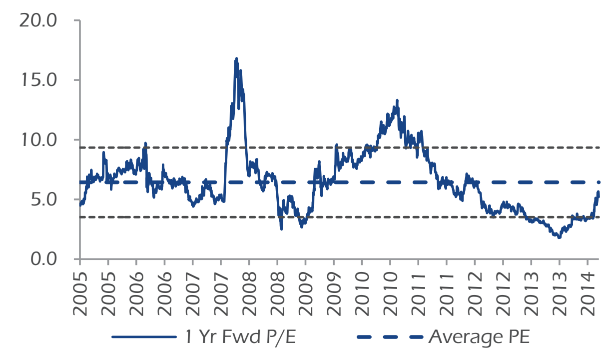
Note: pricing as on 13 June 2004; Source: Elara Securities Estimate

Exhibit 13: One-year forward P/ABV range



Source: Company, Bloomberg, Elara Securities Estimate

Exhibit 15: One-year forward P/E range



Source: Company, Bloomberg, Elara Securities Estimate

Company Description

Dewan Housing Finance, incorporated in 1984, is the second-largest private sector housing finance NBFC in India. With its corporate office in Mumbai, it is present across 290 company-operated locations in India and 151 alliances. The Group is present in the housing finance space through there housing finance companies – DHFL, DHFL Vysya Housing Finance (DHFL Vysya) and Aadhar Housing Finance, with key focus areas being low- to middle-income (LMI) borrowers in Tier 2 and Tier 3 cities. After the acquisition and merger of First Blue Home Finance, DHFL also now caters to the middle- and upper-middle income group. The Group recently entered the Life Insurance business through DHFL Pramerica Life Insurance, a JV with US-based Prudential Financial.

Board of Directors & Management

Kapil Wadhawan – Chairman & Managing Director

Kapil Wadhawan joined DHFL as a Director in 1996 and pursuant to the approval of the Central Government was appointed as an Executive Director in 1997. He was elevated to the post of Managing Director in 2000 and was designated as Vice Chairman and Managing Director in 2007. He was named Chairman & Managing Director in 2009. Kapil has an MBA from Edith Cowan University, Australia.

Dheeraj Wadhawan – Director

Dheeraj Wadhawan is a promoter of the company. He has more than 12 years of experience in real estate & construction industries. He joined the board as a Non-Executive Director in 2008. He has a degree in construction management from the University of London.

RP Khosla – Independent Director

RP Khosla (Retd. IAS) is the former Secretary to the Government of India and has held senior positions in various government undertakings in the past. He has been on the board as an Independent Director since 1993.

GP Kohli – Independent Director

GP Kohli is a former Managing Director of Life Insurance Corporation of India (LIC) and has vast experience in the areas of insurance, housing, human resource development, information technology and marketing. GP has been on the board as an Independent Director since 2001. He has a master's degree in English literature MA (Honors) and a diploma in Labor Laws, Labor Welfare and Personnel Management - LLD.

Jamie Cayzer-Colvin – Nominee Director

Jamie Cayzer-Colvin is Director of Caledonia Investments Plc (UK), having joined Caledonia in 1995. Initially working at its specialty chemicals subsidiary, he became an investment executive in 1999. Before joining, Jamie was commissioned as an Army Officer He is currently Chairman of The Henderson Smaller Companies Investment Trust and a non-executive director of India Capital Growth Fund and Polar Capital Holdings. Jamie has an MBA from Henley Management College. He joined the board as a Nominee Director of M/s Caledonia Investments in 2013.

Ajay Vazirani – Director

A senior Partner at M/s. Hariani & Co, Ajay Vazirani has more than 16 years of experience advising clients and specializes in real estate & real estate financial transactions, corporate & commercial law, mergers & acquisitions, private equity & funds, and media & entertainment. He has also handled various cross-border transactions. He is on the board as an Independent Director since 2008.

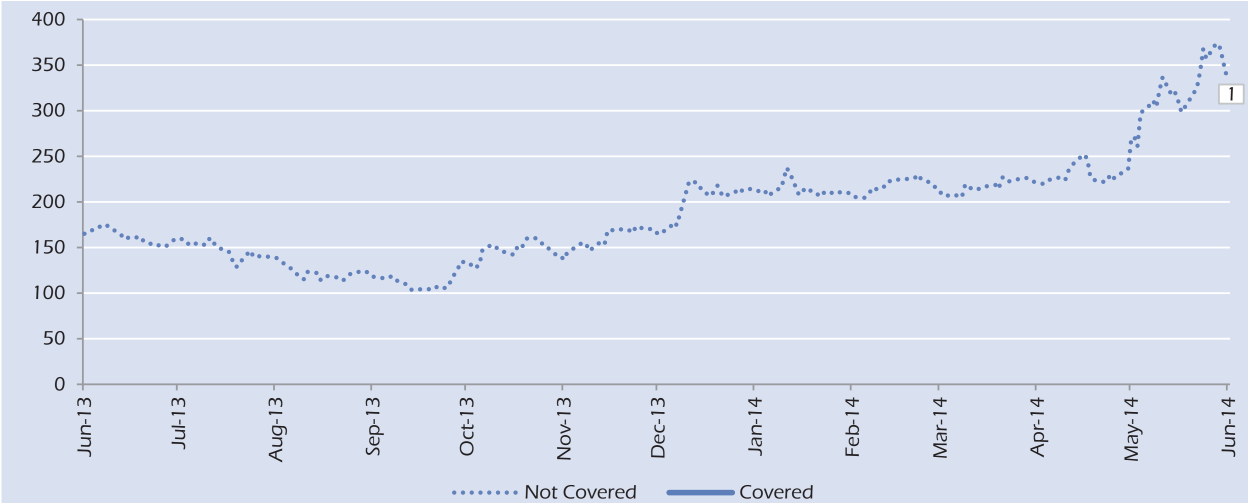
VK Chopra – Independent Director

A Fellow Member of the Institute of Chartered Accountants of India (FCA) by profession, VK Chopra had a long career in banking, having served in that sector for more than 36 years in different capacities. He was Chairman & Managing Director of Corporation Bank and SIDBI and Executive Director of Oriental Bank of Commerce for a long tenure. He joined the board as an Independent Director in 2008.

M Venugopalan – Independent Director

Commercial banker for nearly four and a half decades, M Venugopalan started his career as a probationary officer with Bank of India in 1966. In 2003, he returned to Bank of India as Chairman and Managing Director. He joined the board as an Independent Director in 2013.

Coverage History



	Date	Rating	Target Price	Closing Price
1	13-Jun-2014	Accumulate	INR 380	INR 332

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%