DHFL

Changing Rules Changing Lives

Maintaining Its Turf

Driven by strong disbursement and focus on asset quality, DHFL is well-positioned to deliver sustainable and profitable growth

Incorporated in 1984, Dewan Housing Finance Corp Limited (DHFL) primarily provides housing loans to individuals, and loans against property to its housing loan customers, especially to low-income and lower-middle-income groups (LMI) in Tier II and Tier III cities with a market share of around 4%.

DHFL has a pan-India presence, with customer touch points in 367 locations as on 30th Sept '14. Over 85% of DHFL's loan portfolio is exposed to middle income group salaried customers and self-employed individuals with low reported incomes.

DHFL has a very low LTV (Loan-to-Value) ratio of 49%-50% as on 30th Sept '14 and its average ticket size stands within ₹10 lakh - ₹11 lakh limit.

INVESTMENT RATIONALE

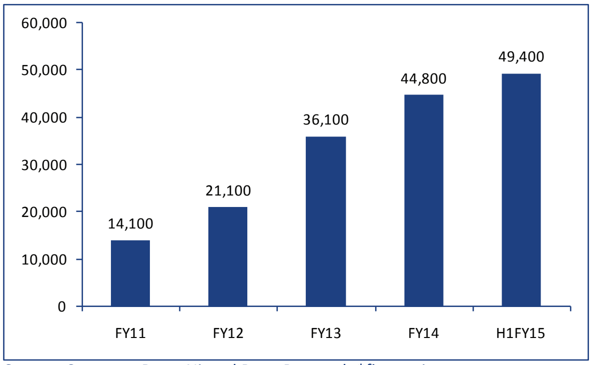
Healthy Growth In AUM

DHFL has been able to achieve a steady and significant growth in its AUM by focusing on relatively smaller towns and cities where competition is less.

DHFL witnessed a CAGR growth of 47% in its AUM over FY11-FY14 and is targeting to double its AUM by FY17E (to reach ₹1,00,000 crore) by increasing its presence across the country and setting up branches in the untapped LMI markets. Moreover, we believe that increase in disposable income in smaller cities in the country will drive growth in the housing sector, thereby increasing the demand for housing loans.

Amalgamation of First Blue (FBHFL) has further strengthened DHFL's competitive position in the housing finance segment. Post the amalgamation, DHFL has gained entry into diversified product segments, regions, and income groups. While DHFL traditionally had an established position in the low- and middle-income segments, the amalgamation enables the company to cater to the middle- and upper-middle-income segments.

AUM



Source: Company Data, Nirmal Bang Research *figures in crores

NIMs To Witness Improvement

DHFL has witnessed an improvement in cost of funds from 10.63% in FY13 to 10.46% in H1FY15, which has led to improvement in margins over the period. NIMs stood at 2.76% in H1FY15, as compared to 2.72% in FY12.

Going forward, margins are likely to witness improvement as the management aims to increase contribution to (loan against property) LAP/project loans. Project loans are high-yielding loans (~15% rate) higher by almost 300-400 bps while LAP are higher by 200 bps, as compared to that offered on individual loans (~11-12%).

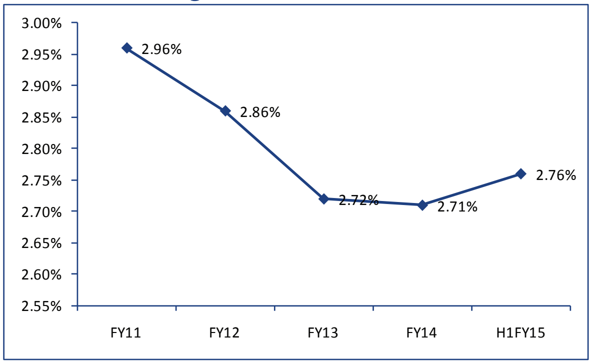
DHFL relies heavily on banks and NHB (National Housing Bank) for its funding needs (68% in FY14). The management aims to bring down the proportion of bank borrowings from 68% to 45%-55% in the next 2 years and is targeting to increase the proportion of bond borrowings from 20% in FY14 to 35%-40% in the next 2 years.

We believe that the change in borrowing mix will result in lower borrowing costs for the company and contributing to improvement of NIMs will increase margins.

In June '14, CARE Ratings revised the rating on NCD of DHFL upwards to AAA from AA+. Similar rating was revised to AAA for fixed deposits as well as long-term bank facilities, subordinated debt and perpetual debt.

With rating upgrade, the company's borrowing cost is expected to come down. All these reasons will help the company in improving the margins in the longer run.

Net Interest Margins



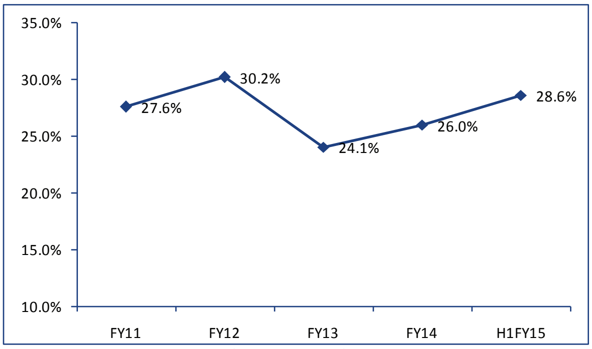
Source: Company Data, Nirmal Bang Research

High Cost-To-Income Ratio: Scope For Improvement

DHFL has a higher cost-to-income ratio as compared to peers in the housing finance industry owing to a branch-based model unlike distribution-based model of LIC Housing Finance and in-house sourcing model of HDFC.

However, steps are being taken to improve the cost-to-income by improving the operating leverage, which should reduce the cost-to-income ratio, going forward. Any improvement in this ratio will lead to significant improvement in return ratios of the company.

Cost-to-Income Ratio



Source: Company Data, Nirmal Bang Research

Focus On Non-Interest Income

DHFL has started focusing on fee income through various verticals, which includes cross-selling insurance, property services and technical services to customers.

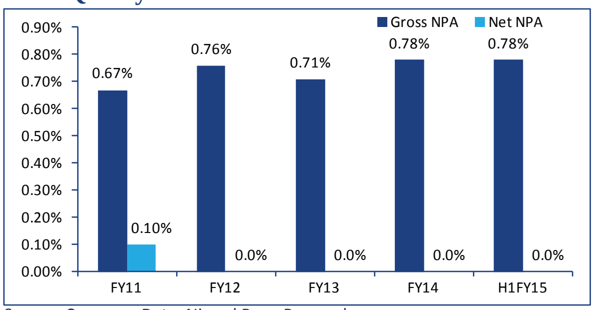
Entry In Various Business Segments

DHFL has entered into the life insurance business through a joint venture called DHFL Pramerica Life Insurance, with US-based Prudential Financial and owns 74% stake in the company. This JV will help DHFL with wider distribution, enabling higher premium growth. As there is no major capital infusion, we believe that this life insurance entity will further add a feather to its cap. The company has also entered into the MF business with the acquisition of 50% share in Pramerica MF for ₹25 crore. All these will be long-term positives for the company.

Stable Asset Quality

DHFL has maintained a healthy asset quality. Its gross NPA stood at 0.78% in H1FY15 as compared to 0.67% in FY11 with zero net NPA. Adequate underwriting standards, lower loan-to-value ratio have enabled DHFL to maintain a healthy asset quality. The asset quality is likely to remain stable going forward as loan proposals go through rigorous checks by their in-house credit and legal teams and it maintains two separate underwriting teams for salaried and self-employed individuals. It also has a team of civil engineers for technical evaluations of projects. Lower LTV between 47% and 50% considering current property valuations further reduces risk.

Asset Quality



Source: Company Data, Nirmal Bang Research

Adequately Capitalized

DHFL's Capital Adequacy Ratio stood at 16.17% with Tier I ratio of 11.56% in H1FY15. DHFL is adequately capitalized for robust loan growth, going forward.

Healthy Return Ratios

RoE stood at 18.75% for H1FY15 as compared to 16.79% in FY12 whereas RoA stood at 1.7% for H1FY15 as against 1.59% in FY12. Going forward, led by healthy growth rate, improving NIMs, lower operating expenses and control on the asset quality, return ratios (RoE and RoA) will continue to remain strong in the long run.

RISK FACTORS

• The company operates in a highly competitive environment facing competition from banks and other financial institutions, which have access to cheaper funds. If the company is forced to reduce its lending rates, then it might impact its NIMs.

• Slowdown in the mortgage market can impact the company's operating performance.

• Any regulatory changes relating to the housing finance companies can have an adverse impact on the overall performance of the company.

• Higher-than-expected slippages will impact asset quality.

FINANCIALS

Income Statement	FY12	FY13	FY14
Net Interest Income	385	667	875
Other Income	304	331	356
Total Income	**689**	**998**	**1,231**
Operating Expenses	267	342	426
Provisions	24	45	70
PBT	398	611	735
Tax	92	159	206
	23.10%	26.00%	28.00%
PAT	**306**	**452**	**529**

Source: Company Data, Nirmal Bang Research

Financial Ratios	FY12	FY13	FY14
NIMs	2.90%	2.70%	2.70%
Cost-to-Income	38.80%	34.30%	34.60%
RoE	17.10%	17.10%	15.50%
RoA	1.60%	1.60%	1.30%
Capital Adequacy Ratio	18.60%	23.50%	22.20%
Gross NPA	0.80%	0.70%	0.80%
Net NPA	0.00%	0.00%	0.00%
EPS	30.41	35.2	41.2
P/E	12.5	10.8	9.2
Book Value	174	252.5	278.4
P/BV	2.2	1.5	1.4

Source: Company Data, Nirmal Bang Research

VIEWS AND VALUATIONS

DHFL operates in the mortgage financing business where growth and asset quality have been proven to be healthy in the last few years. We expect their robust loan book to continue with healthy asset quality trends.

Recent ratings upgrade by CARE, rising proportion of LAP and focus on securitization will aid margins. Driven by strong disbursement and focus on asset quality, DHFL is well-positioned to deliver sustainable and profitable growth. Healthy asset quality and prudent provisioning policy makes it better placed among its peers.

Going forward, with an improvement in operating performance, the return ratios are set to improve. At the CMP (current market price), the stock is trading at 1.1x and 0.95x FY15E and FY16E BVPS and 6.95x and 5.8x FY15E and FY16E EPS, respectively, which is attractive and at significant discount to its peer**S.**