January 28, 2013 VISIT NOTE

Dewan Housing Finance Ltd.

SENSEX: 20,104 CMP: INR 197

SPA THE FINANCIAL ADVISORS

BFSI

We recently met the management of Dewan Housing Finance to understand its business strategy in the stagnant business environment and to gauge its asset quality and exposure towards project loan segment. DHFL is the third largest housing financing companies with outstanding loan book of INR 232 bn & overall market share of around ~3.5%. It is present at over 461 locations pan India. Given below are key takeaways from the visit:-

Consolidated loan book to grow at +25% CAGR

DHFL is targeting to grow its loan book at a CAGR of more than 25% over the next couple of years to INR 376 bn in FY14, thereby outperforming the housing mortgage industry which is expected to grow at ~18%. This will be on the back of more than 30% growth in standalone book, which focuses largely on housing finance in tier II and III cities. The increase in disposable income in these cities has lead to good growth in housing demand thereby increasing the demand for housing loans.

DHFL believes that it is relatively insulated from increasing competition in the mortgage finance industry as DHFL's target market is low and middle income self-employed segment residing in outskirts of larger metros(~80% of loan book), where competition from banks is relatively low.

NIMs expected to remain stable at ~ 3%

NIMs are expected to remain stable at ~3% aided by increasing contribution from high yielding non-retail loans (i.e LAP/LRF + project loans) and easing borrowing cost. DHFL has increased the share of Loan against property (LAP) & project financing from 6.3% in FY11 to 18.6% in Q2FY13 and is further targeting to increase it to 25% of the loan book in coming quarters. Non-retail loan segment usually enjoys higher yields of ~400 bps than individual retail loan segment. Moreover with bank borrowings constituting ~70% of total borrowing, cost of funds is expected to decline marginally with softening in base rates.

Healthy fee income growth to continue

Fee income is expected to continue its healthy rate of growth. DHFL has superior business model, wherein its fee income growth is directly correlated with loan book growth as it garners ~1% fee from cross-selling insurance to its own customers. This also safeguards mutual interests. It also derives fees from TCM services to developers & construction clients. ~99% of its fee income comes from insurance & TCM services while remaining ~1% constitutes disbursement fees.

Asset quality likely to remain robust

DHFL has a negligible gross NPA of 0.69% where as Net NPA is nil & its PCR is 116.23%. The asset quality is likely to remain robust as all the loan proposals go through rigorous checks by the in-house credit & legal team 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. In Project financing (6% of total loan book) DHFL undertakes 99% of lending to projects which have attained more than 50% completion. Apart from that, for LAP, DHFL provides loan at LTV between 47-52% considering current property valuations thereby mitigating its risk.

C/I ratio to improve

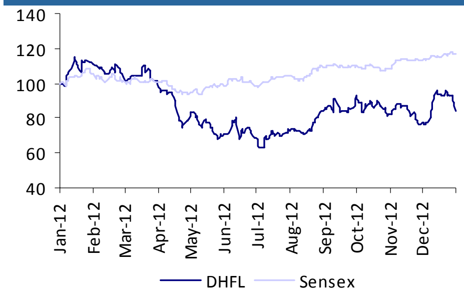
DHFL's C/I ratio is higher than that of peers primarily due to its branch model for loan origination rather than direct selling agent model followed by peers and a presence in tier II and III cities (where branch and employee productivity are relatively lower). It is looking to improve its operating leverage by reducing the cost to income ratio from 29.6% in H1FY13 to ~25% over the next 3-4 years.

Outlook & Valuation

DHFL being the third largest player in the housing finance industry is well placed to benefit from continued growth in India's mortage market. Niche presence in tier II & III cities and stronghold in the low - and middle-income segments ensures lower competition for the company. With the FBHFL (mid- to high-ticket size player) acquisition, DEWH is now well placed to capture housing demand across income segments. Expected improvement in NIMs coupled with stable asset quality provides additional comfort. The company expects to deliver ~20% CAGR in earnings driven by ~25% growth in loan book and NIMs of ~3%% over FY13E-15E. Currently the stock is trading at 1.0x its TTM BV of INR 187.

Shareholding (%)	Dec-12
Promoters	35.28
FIIs	41.67
DIIs	1.24
Others	21.81

Relative Price Performance



Key Data	
BSE Code	511072
NSE Code	DHFL
Bloomberg Code	DEWH IN
Reuters Code	DWNH.BO
Shares Outstanding (mn)	117.31
Face Value	10
Mcap (INR bn)	22.69
52 Week H/L	279.00/142.25
2W Avg. Qty.NSE	230936
Free Float (INR Bn)	14.66
Beta	0.92

Y/E March (INR mn)	FY09	FY10	FY11	FY12
Interest income	6906	9906	14494	24678
Interest Expended	4956	6715	9731	17992
Net interest income	1949	3190	4762	6685
Growth (%)	26.3%	63.7%	49.3%	40.4%
NIM (%)	2.9%	3.0%	3.0%	2.9%
APAT	959	1511	2378	3067
Growth (%)	16.1%	57.4%	57.5%	29.0%
EPS (INR)	15.1	17.8	22.8	26.3
P/E	3.7	11.5	10.9	9.3
P/BV	0.7	1.9	1.8	1.4
Net NPA	1.0%	0.7%	0.1%	0.0%
RoA	1.9%	2.0%	2.0%	1.9%
RoE	22.9%	22.2%	19.5%	19.0%
Dividend Yield (%)	4.6	1.5	1.3	1.5

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Change in borrowing mix to reduce cost of funds in long term

DHFL is looking to fund its incremental loan book borrowing through the wholesale route (taking advantage of reduced rates & the recent ECB window opened by RBI which are low cost) as against relatively high cost bank borrowings, which provides a cost saving of ~100-150bp. Currently ~70% of LICHF's borrowings are through banks and it aims to reduce it to ~40% over the next three years.

First Blue Home Finance providing enormous synergies

FBHFL (67.5% holding) provides enormous synergies to DHFL as a) it caters to upper-mid income customers as against LMI customers being serviced by DHFL and b) it conducts business through North India, where DHFL has minimal presence providing a huge market potential to tap upon. Although DHFL has got the approval for merger of FBHFL with itself, it will continue to operate independently as a separate Strategic Business Unit (SBU) under the brand name of "First Blue"

New PSL lending norms beneficial

DHFL has welcomed RBI directive on priority sector lending norms related to bank loans to housing finance companies. Banks can now consider loans given to housing finance companies as PSL subject to an aggregate loan limit of INR 10 lakh per borrower. DHFL is one of the prime beneficiaries of this directive as its average ticket of loan book is INR 8.42 lakh.

Key Financial Metrics of DHFL

Financial Summary (INR mn)	H1FY13	H1FY12	Chg
Total Income	15568	10867	43.26%
Net Interest Income	2961	2117	39.87%
Processing & Other Fees	664	528	25.76%
TPP Fee Income	288	283	1.77%
Interest expenses	11654	7939	46.79%
Operating expense	1360	1017	33.73%
Provision for Contingencies	300	149	101.34%
PBT	2227	1741	27.91%
PAT	1637	1377	18.88%

Key Ratios for Period Ended	H1FY13	H1FY12	Chg
Gross NPA	0.69%	0.97%	28 bps
Net NPA	0.00%	0.26%	26 bps
NPA Coverage ratio	116.23%	73.02%	4321 bps
CAR	16.52%	17.40%	(88 bps)
NIM	2.84%	2.79%	5 bps
Cost to Income ratio	29.55%	27.75%	(180 bps)
Return on Assets	1.80%	1.96%	(16 bps)
Return on Equity	18.86%	19.43%	(57 bps)

Financial

Income Statement

Y/E March (INR mn)	FY09	FY10	FY11	FY12
Interest income	6906	9906	14494	24678
Growth (%)	*32.4%*	*43.4%*	*46.3%*	*70.3%*
Interest Expended	4956	6715	9731	17992
Net Interest Income	1949	3190	4762	6685
Growth (%)	*26.3%*	*63.7%*	*49.3%*	*40.4%*
Non Interest Income	19	20	373	19
Net Income	1968	3210	5135	6705
Operating Expenditure	727	1188	1721	2721
Operating Income	1241	2022	3415	3984
Tax	324	515	764	920
PAT	918	1507	2651	3064
Extraordinary Items	(42)	(4)	273	(4)
APAT	959	1511	2378	3067
Growth (%)	*16.1%*	*57.4%*	*57.5%*	*29.0%*
EPS (INR)	15.1	17.8	22.8	26.3

Balance Sheet

Y/E March (INR mn)	FY09	FY10	FY11	FY12
SOURCES OF FUNDS				
Share Capital	635	850	1044	1168
Reserves	3940	7884	14440	19159
Total Shareholders Funds	4575	8734	15484	20327
Borrowings	58764	89268	148954	193079
Growth (%)	48.0%	51.9%	66.9%	29.6%
Total Liabilities	**63339**	**98002**	**164438**	**213406**
APPLICATION OF FUNDS				
Fixed Assets	498	2165	2223	2465
Advances	58066.2	87584	129096.7	182429.8
Growth (%)	39.6%	50.8%	47.4%	41.3%
Current Assets	3690	6940	24412	23884
Investments	1085	1314	8707	4628
Total Assets	**63339**	**98002**	**164438**	**213406**

Key Ratio

Y/E March (INR mn)	FY09	FY10	FY11	FY12
Per Share Data (INR)				
EPS	14.7	17.8	24.7	25.7
BVPS	75.0	106.0	148.0	174.0
DPS	2.5	3.0	3.5	3.5
Profitability Ratios				
Cost of Deposits	10.1%	8.6%	9.7%	10.9%
Net Interest Margin	2.9%	3.0%	3.0%	2.9%
RoA	1.9%	2.0%	2.0%	1.9%
RoE	22.9%	22.2%	19.5%	19.0%
Aseet Quality Ratios				
Gross NPA	1.5%	1.2%	0.7%	0.8%
Net NPA	1.0%	0.7%	0.1%	0.0%
PCR	32.4%	37.0%	85.2%	118.2%
Valuation Ratios				
P/E	3.7	11.5	10.9	9.3
P/BV	0.7	1.9	1.8	1.4
Dividend Yield	4.6	1.5	1.3	1.5

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2. Group/Directors ownership of the stock - No
3. Broking relationship with company covered - No

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