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Asia Pacific
Equity Research
Diversified Financials

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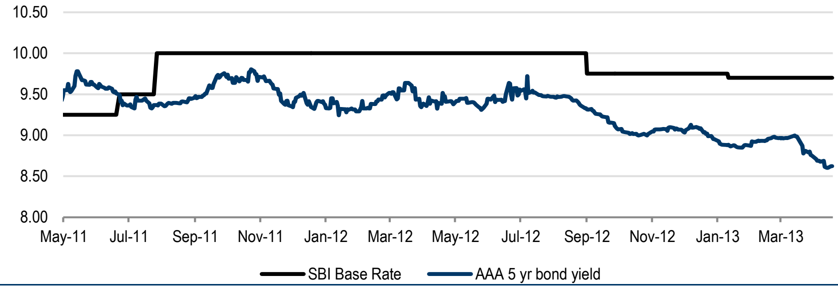
India Mortgage Sector

SECTOR REVIEW

Market position of HFCs should remain strong

Figure 1: **Fall in bond yields should help housing finance companies (HFCs) become competitive on cost of funds versus banks**

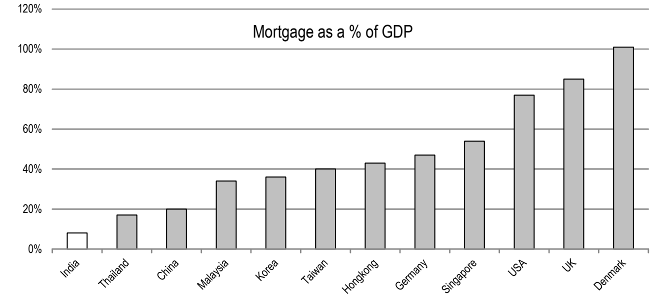


Source: Bloomberg, NSE, Company data, Credit Suisse estimates

- **Beneficiaries of bonds.** Bond markets are now the prime funding source (~60%) for Indian mortgage financiers such as HDFC and LIC Housing Finance (LICHF). The easing bond yield cycle is driving a rapid drop in their funding costs. In particular, LICHF that had witnessed a 90-bp spread compression over the past two years is now well positioned to see a strong NIM rebound.
- **Threat from banks overdone.** One of the common concerns about HFCs has been the potential increase in competitive intensity from the banks, given the slowdown in other lending opportunities (corporate segment), particularly post the dismantling of the pre-payment charge regime. However, banks in India have migrated to a base-rate regime in the past two years and are not allowed to lend below that. Bank mortgage rates are already close to their base rates and therefore room for competitive pricing is limited without a sharp cut in base rate. Given the likely pressure on NIMs from sharp base rate cuts, stickiness in retail deposit rates and bank funding costs, base rate cuts are unlikely to match the bond yield drop. Further, our detailed analysis shows that the profitability of the mortgage business for banks is lower than for HFCs, and their own benchmark profitability.
- **Initiating coverage on LICHF with OUTPERFORM; maintain OUTPERFORM on HDFC.** The structural growth story in India's mortgage segment remains strong and the HFCs continue to be the most efficient and profitable players in the segment. We initiate coverage on LIC Housing Finance with our TP implying 32% upside, as with the NIM rebound we expect earnings growth of 31% in FY14 after the 8% growth in FY13. Also, we expect re-rating for LICHF as its ROA/ROE improves back from 1.4%/17.1% to 1.7%/21.1% over the next 3 years. Also, we raise our TP for HDFC to Rs1,045 as with improved competitiveness, its P/E discount to retail banks should moderate. With wholesale funding rates now ~25 bp lower than the retail deposit rates, we maintain our OVERWEIGHT on the NBFC sector. Other NBFCs, such as SHTF (O), IDFC (O) and MMFS (N), are also potential beneficiaries of falling wholesale rates, in our view.

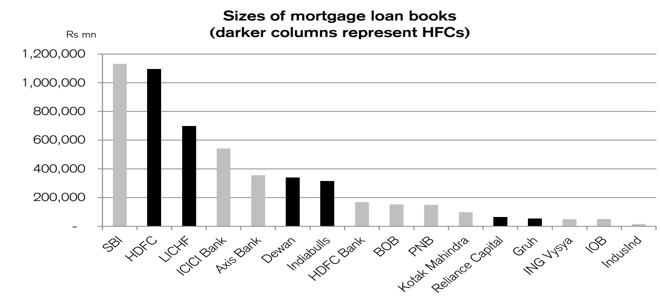
Focus charts

Figure 2: **Low mortgage penetration in India should ensure sustained growth over the long term**



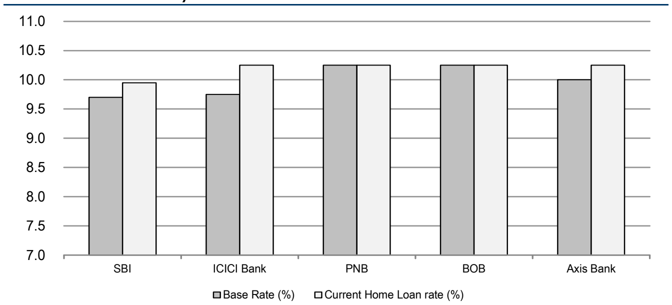
Source: HDFC, Credit Suisse research

Figure 3: **Specialist housing finance companies (HFCs) are significant players in the home loan market**



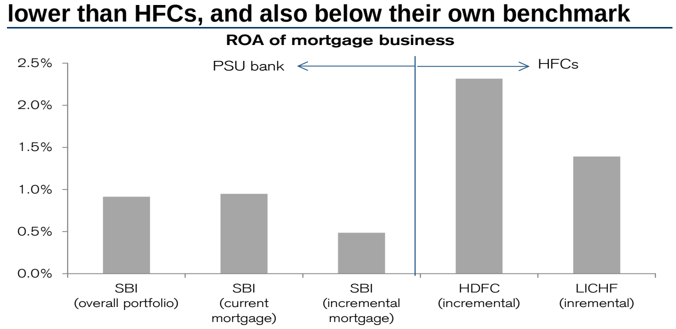
Source: Company data, Credit Suisse research

Figure 4: **Concerns about pricing aggression by banks seem overdone; base rate sets a floor on home loan rates**



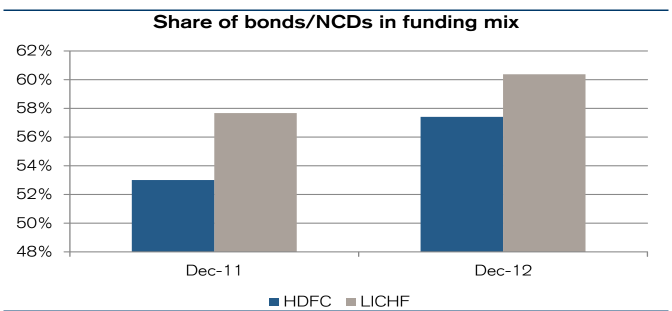
Source: Company data, Credit Suisse research

Figure 5: **Profitability of mortgage business for banks lower than HFCs, and also below their own benchmark**



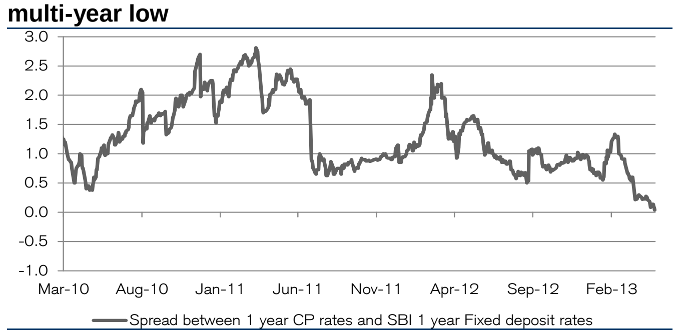
Source: Company data, Credit Suisse estimates

Figure 6: **HFCs are moving to bond markets for funding**



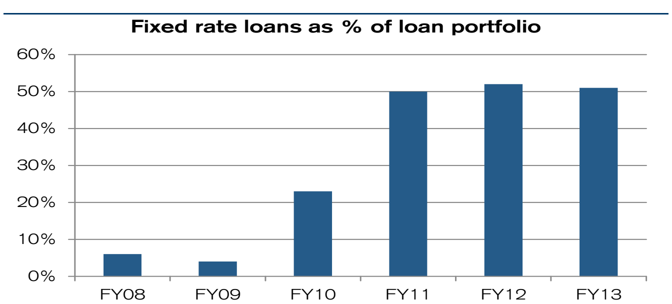
Source: Company data, Credit Suisse estimates

Figure 7: **Spread between wholesale and retail rates is at multi-year low**



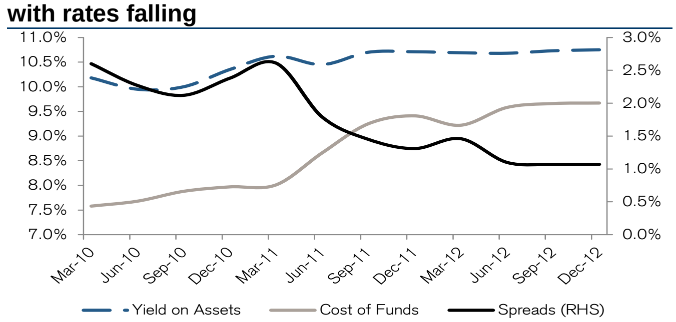
Source: Company data, Credit Suisse estimates

Figure 8: **LICHF has a high proportion of fixed rate* loans in its book ...**



** All LICHF loans have an initial 2- to 5-year fixed rate period before resetting to a floating rate. Source: Company data, Credit Suisse estimates*

Figure 9: **... which has hurt the company in a rising interest rate environment; the company could now benefit with rates falling**



Source: Company data, Bloomberg

Market position of HFCs should remain strong

HFCs should retain competitiveness versus banks

Our analysis shows that room for banks to turn more aggressive on pricing is limited

There have been concerns recently about the renewed aggression shown by banks in the home loan market—given aggressive pricing by PSU banks such as SBI. Our analysis, on the other hand, shows that the room for banks to turn more aggressive on pricing without affecting profitability is limited (especially since we are now in a base-rate regime). Moreover, the recent trend of non-bank sources of funding for HFCs (along with easing of bond yields) should help HFCs improve their competitiveness on cost of funds versus banks. On non-pricing factors, we believe HFCs could continue to retain an upper hand given their specialisation. Thus, overall we believe HFCs should continue to remain competitive in the mortgage market.

We reiterate our OUTPERFORM rating on HDFC with a higher target price of Rs 1,045.

Mortgage: Secular growth in an underpenetrated industry

The mortgage industry in India is 9-11 years behind other regional EMs like China and Thailand

The Indian mortgage industry has grown at a 16% CAGR over the past five years. Based on our analysis, the mortgage industry in India is 9-11 years behind other regional EMs like that in China and Thailand, in terms of penetration in the economy. Due to various structural drivers, such as young population, reducing family size, urbanisation and rising income levels, we believe the growth rates in this segment should remain healthy over the longer term.

LICHF: A fast-growing HFC with strong parent backing

LICHF is the third-largest player in the Indian mortgage industry, and has grown faster than the No. 1/No. 2 players in recent years. In addition to the industry drivers discussed earlier, we believe that strong backing from its parent LIC (whose distribution network LICHF rides on) could help LICHF sustain healthy growth.

With sizeable fixed rate exposure (unlike other home finance companies with floating rate loans, most of LICHF's loans have an initial 2-5 year fixed rate period), LICHF has been at the receiving end of a rising interest rate cycle over the past few years. The resultant spread/NIM compression has led to RoE erosion (700 bp over three years). However, with wholesale rate already easing and overall interest rates likely going down, we believe LICHF should benefit going forward. We build a 20 bp NIM expansion in each of FY14 and FY15, leading to a 400 bp ROE expansion and a 28% EPS CAGR over three years.

At 1.8x/10.1x FY14E P/BV/ P/E, we believe the stock is attractively valued (12-20% discount to historical averages). Also, we expect re-rating for LICHF as its ROA/ROE improves back from 1.4%/17.1% to 1.7%/21.1% over the next 3 years. We initiate coverage on LICHF with an OUTPERFORM rating and a Rs365 target price.

Sector valuation summary

Figure 10: **Housing finance companies—valuation summary**

Company	Current price	Rating	Target	Mkt cap	BVPS (Rs)			P/B (x)			EPS (Rs)			P/E (x)			Loan book (Rs mn)	Loan book 3-year	ROE (%)
17-May-13	**Rs**		**Rs**	**US$ bn**	**FY13**	**FY14E**	**FY15E**	**FY13**	**FY14E**	**FY15E**	**FY13**	**FY14E**	**FY15E**	**FY13**	**FY14E**	**FY15E**	**FY13**	**CAGR**	**FY13**
Coverage Universe																			
HDFC	904	O	1,045	25.4	162	181	209	5.6	5.0	4.3	32	38	44	28.2	24.0	20.3	1,700,460	20%	22.0
LIC Housing Finance	276	O	365	2.5	129	156	183	2.1	1.8	1.5	21	27	34	13.3	10.1	8.1	778,120	27%	17.1
Cor business																			
HDFC	534	O	660	15.0	108	126	152	4.9	4.2	3.5	27	33	39	16.0	13.8	12.0	1,700,460	20%	22.0
Not-rated																			
Indiabulls Finance	272			1.5	175	191	240	1.6	1.4	1.1	65	75	86	6.8	13.8	12.0	344,250	46%	23.2
Reliance Capital	357			1.6	500	522	549	0.7	0.7	0.7	28	30	37	12.9	12.0	9.7	137,600	16%	5.7
Gruh Finance	223			0.7	28	35	48	7.9	6.5	4.7	8	9	11	27.4	25.3	21.0	50,030	25%	33.3
Dewan Housing	174			0.4	190	245	325	0.9	0.7	0.5	38	42	57	4.5	4.1	3.0	310,200	38%	17.2
Repco	202			0.2	102	na	na	2.0	na	na	17	na	na	11.8	na	na	35,448	36%	17.2
GIC Housing Finance	117			0.1	105	134	na	1.1	0.9	Na	18	24	na	6.7	4.9	na	45,392	16%	14.9

Note: O = OUTPERFORM, N = NEUTRAL, U = UNDERPERFORM.

Source: Company data, Credit Suisse estimates, IBES estimates for Not Covered companies

Figure 11: India financials—valuation summary

17-May-13	CS rating	Current price Rs	Target price Rs	Market cap (US$ bn)	BVPS (Rs) FY14E	BVPS (Rs) FY15E	P/B (x) FY14E	P/B (x) FY15E	P / adj BV (x) FY14E	P / adj BV (x) FY15E	EPS (Rs) FY14E	EPS (Rs) FY15E	EPS growth (%) FY14E	EPS growth (%) FY15E	P/E (x) FY14E	P/E (x) FY15E	ROE (%) FY14E	ROE (%) FY15E
Private sector																		
Axis	O	1,533	1,800	13.1	795	913	1.9	1.7	2.0	1.8	125	147	9	17	12.2	10.4	16.9	17.2
HDFC Bank	O	719	770	31.1	181	216	4.0	3.3	4.0	3.3	36	45	25	26	20.1	15.9	21.3	22.7
ICICI	N	1,229	1,202	25.8	634	698	1.9	1.8	2.0	1.8	83	96	15	16	14.8	12.8	13.7	14.2
Kotak Mahindra	N	792	680	11.0	248	288	3.2	2.7	3.2	2.7	34	40	20	17	23.0	19.7	16.2	16.2
Yes Bank	U	542	466	3.5	229	268	2.4	2.0	2.4	2.0	41	48	14	16	13.1	11.3	18.8	20.2
J&K Bank	O	1,318	1,700	1.2	1,209	1,408	1.1	0.9	1.2	1.0	227	251	2	11	5.8	5.2	20.3	19.2
IndusInd	N	511	465	5.3	163	189	3.1	2.7	3.1	2.7	26	32	20	23	19.8	16.0	16.9	18.1
ING Vysya	O	621	693	1.7	340	388	1.8	1.6	1.8	1.6	49	58	23	19	12.6	10.6	15.4	16.1
Public sector																		
Bank of Baroda	O	739	873	5.7	824	942	0.9	0.8	1.1	0.9	121	145	18	19	6.1	5.1	15.7	16.4
Bank of India	N	325	367	3.5	428	490	0.8	0.7	1.0	0.9	59	64	21	9	5.5	5.0	15.8	14.2
PNB	N	835	837	5.4	1,030	1,204	0.8	0.7	1.1	0.9	174	194	19	12	4.8	4.3	17.9	17.5
SBI	N	2,425	2,237	30.1	1,987	2,256	1.2	1.1	1.5	1.3	295	353	4	20	8.2	6.9	14.8	15.7
Union Bank	U	244	232	2.6	288	341	0.8	0.7	1.1	1.0	43	49	20	13	5.7	5.0	17.6	16.0
IOB	U	64	63	1.1	156	169	0.4	0.4	0.7	0.6	15	18	146	19	4.2	3.6	10.0	11.1
Non-bank finance companies																		
HDFC	O	904	1,045	25.4	181	209	5.0	4.3	5.0	4.3	38	44	17	18	24.0	20.3	22.0	22.8
IDFC	O	163	190	4.5	102	115	1.6	1.4	1.6	1.4	15	17	21	17	11.1	9.5	15.4	16.0
Shriram Transport	O	791	860	3.3	400	475	2.0	1.7	2.0	1.7	75	87	16	16	10.6	9.1	20.3	19.8
M&M Finance	N	243	200	2.5	94	109	2.6	2.2	2.7	2.3	18	20	5	10	13.4	12.2	21.0	19.9
LIC Housing Finance	**O**	**276**	**365**	**2.5**	**156**	**183**	**1.8**	**1.5**	**1.8**	**1.5**	**27**	**34**	**31**	**25**	**10.1**	**8.1**	**19.0**	**20.0**
L&T Finance	N	83	50	2.6	36	41	2.3	2.0	2.5	2.2	4.6	5.4	24	19	18.1	15.2	13.6	14.2
Core business																		
ICICI	N	1,035	1,008	21.7	516	583	2.0	1.8	2.1	1.9	75	86	16	15	13.8	12.0	15.2	15.7
HDFC	O	534	660	15.0	126	152	4.2	3.5	4.2	3.5	33	39	23	20	16.3	13.6	27.9	28.3

Note: O = OUTPERFORM, N = NEUTRAL, U = UNDERPERFORM.

Source: Company data, Credit Suisse estimates

HFCs should retain competitiveness versus banks

Recent trends in the Indian mortgage sector show that market is consolidating in the hands of larger firms. Large HFCs such as HDFC and LICHF are benefitting from these trends.

However, there have been some concerns recently about the renewed aggression shown by banks in the home loan market—given aggressive pricing by PSU banks such as SBI. Our analysis, on the other hand, shows that the room for banks to turn more aggressive on pricing is limited (especially since we are now in a base-rate regime). Moreover, the recent trend of non-bank sources of funding for HFCs (along with easing of bond yields) should help HFCs improve their competitiveness on cost of funds versus banks. On non-pricing factors, we believe HFCs could continue to retain an upper hand given their specialisation. Thus, overall we believe HFCs should continue to remain competitive in the mortgage market.

Recent trends in the Indian mortgage sector show that market is consolidating in the hands of larger HFCs

HFCs are significant players in the mortgage market

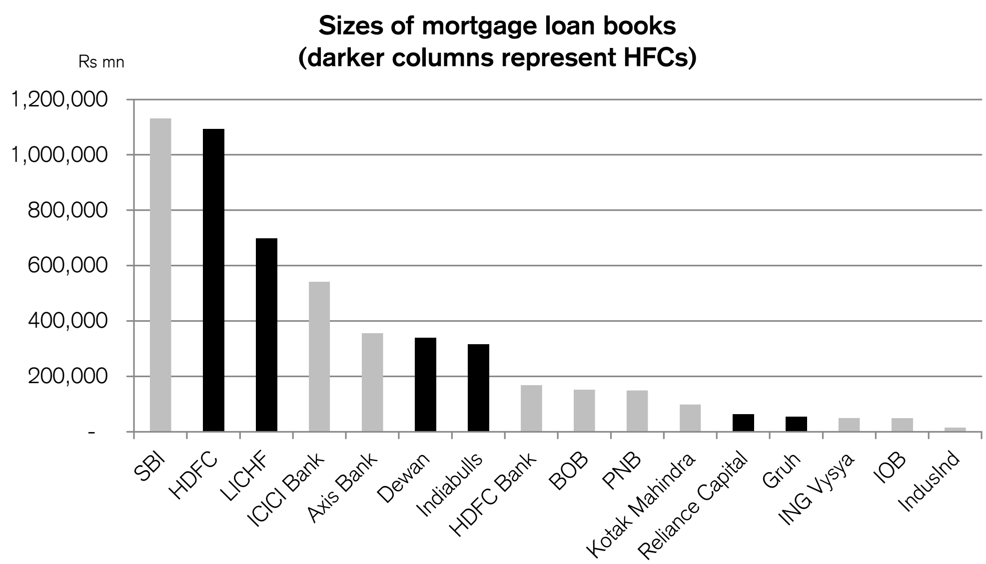
The housing finance market is catered to by both banks and specialised housing finance NBFCs. The banks currently have a lion's share of the loan assets (64% as of FY3/12). However, note that the share of HFCs has increased steadily from 26% to 36% over the past seven years.

Moreover, when compared with only the mortgage loan books of banks, we note that HFCs are of comparable size (see chart below).

While banks have traditionally competed on interest rates, we believe the attraction for HFCs comes from the specialised focus that these entities bring to the business. For instance, for many home buyers (for whom the impending investment is probably the largest one in their lifetimes), the comfort of working with a specialist with years of experience and understanding of the market/developers is valuable, in our view.

While banks have traditionally competed on interest rates, we believe the attraction for HFCs comes from the specialised focus that these entities bring to the business

Figure 12: HFCs are sizeable players in the mortgage market



Source: NHB, RBI, Company data, Credit Suisse research

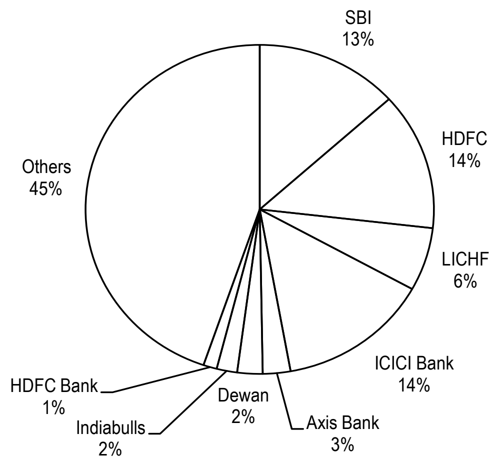
Market consolidating?

The share of top three home loan financiers has remained ~41% between FY09 and FY12. However, it is worth noting that the composition of top three has changed, with LICHF replacing ICICI Bank at the No. 3 spot.

The share of top three home loan financiers remained ~41% between FY09 and FY12

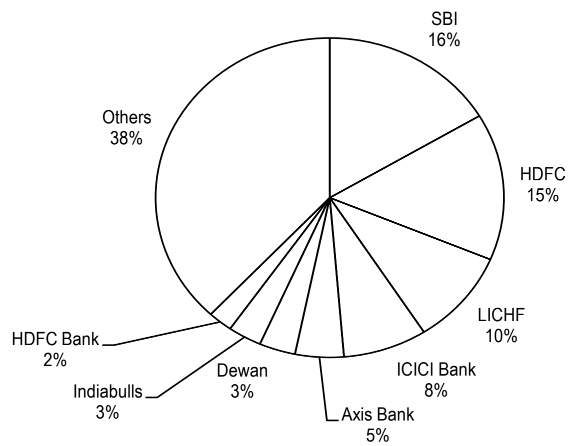
Looking at the rise in market share of the top eight financiers (explicitly listed in the below figures), we notice that the market share of the leaders has increased from 55% to 62% over the past three years, accompanied by a shrinking of the tail of the market. This trend indicates a consolidation of the market amongst the larger financiers.

Figure 13: Market share breakdown on outstanding housing loans (FY09)



Source: Company data, Credit Suisse research

Figure 14: Market share breakdown on outstanding housing loans (FY12)



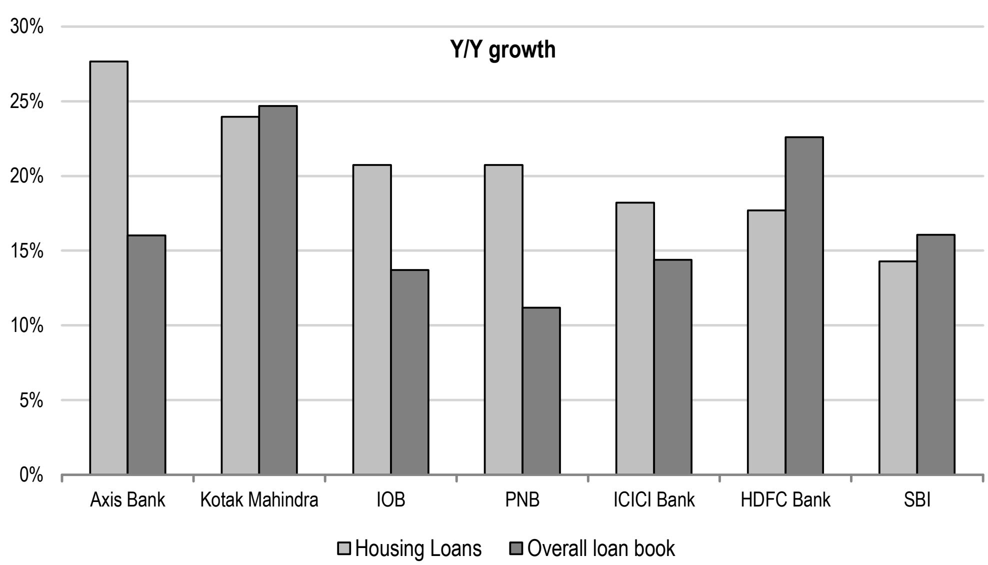
Source: Company data, Credit Suisse research

Concerns on recent aggression shown by banks

Banks have shown strong focus on housing loans in recent quarters. With slowing growth in the traditional corporate loan market, it is feared that banks will be increasingly aggressive in home loans, leading to loss of market share and profitability for HFCs.

With slowing growth in the traditional corporate loan market, it is feared that banks will be increasingly aggressive in home loans, leading to loss of market share and profitability for HFCs

Figure 15: Housing loans growth has exceeded total loan growth for most banks



Source: Company data, Dec-12 YoY growth for SBI and POB, Mar-13 YoY growth for other banks

Prepayment risk

The belief is that with the abolition of prepayment penalty on home loans (trend started mid-2011 and formalised as rule by NHB in Oct-11 and RBI in mid-2012), there are risks of portfolio buyout of HFC home loans by banks, using attractive interest rates as a lure.

Boils down to interest rate aggression by banks

The biggest competitive tool that banks use against HFCs in the home loan market is pricing, in our view. SBI's current home loan rate for retail borrowers at 9.95% and 10.25% (for loans below/above Rs3 mn respectively) is the most aggressive price available. At the lower end, this is only 20 bp above the bank's base rate. The concerns among investors is whether there is room available for banks to cut home loan rates further. Our analysis below shows that this room could be limited.

The biggest competitive tool that banks use against HFCs in the home loan market is pricing, in our view

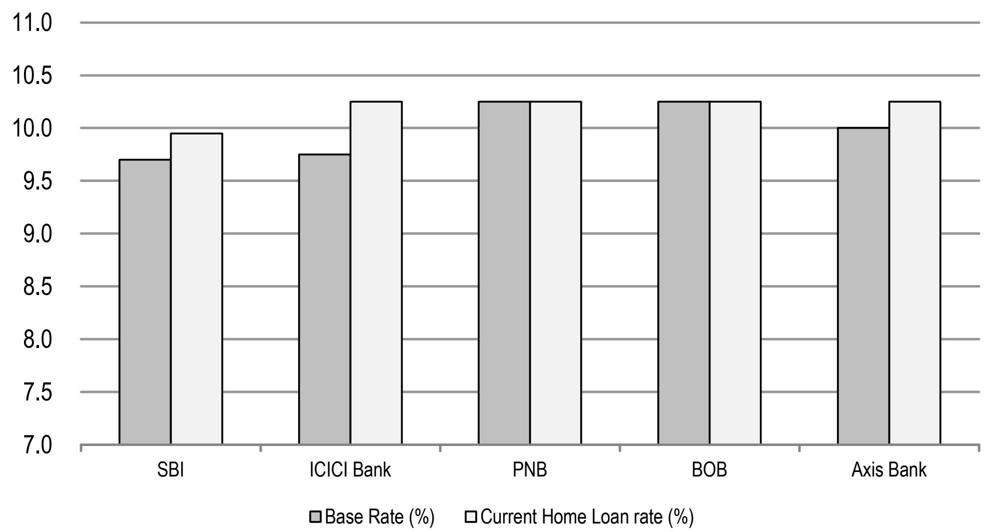
Factors that could prevent further aggression from banks

Base rate regime prevents aggressive undercutting

Unlike 2008/09, when SBI disrupted the market with 'teaser' home loans with initial home loan rates fixed at 8% in the first year and 9% in the second and third years (versus prevailing rate at that time of 10.25%), banks now cannot price home loan rate below the base rate.

Banks now cannot price the home loan rate below the base rate

Figure 16: **Banks' home loan rates are already close to their base rates**



Source: Company data, Credit Suisse research

Reducing base rates has other consequences for banks, including a drop in yields across all loan portfolios linked to base rates, making this move unlikely particulary given the existing pressures on profitablility (note that the funding costs for banks can be quite sticky, especially for the ones with high retail liabilities).

1. **Incremental home loan profitability already well below benchmark returns for banks**

In the table below, we present our analysis of returns for SBI from its home loan portfolio (for home loans priced at 10.25%). We notice that the incremental RoA of 0.5% is significantly below last year's reported RoA of 0.9% for the bank. This is not to say that banks will not continue to price aggressively in the home loan market (in a slowing economy, there is always trade-off between growth and profitability). However, our point is that the room left for banks to cut rates further is limited.

Our analysis shows that the room left for banks to cut rates further is limited

The other conclusion from this analysis, is that at a given home loan rate, the business is far more profitable for HFCs than for the banks.

Figure 17: Profitability of mortgage business for SBI (placeholder for a PSU bank) is below its overall benchmark returns

Profitability of mortgage biz	PSU Bank (SBI template) Cumulative	PSU bank (SBI template) Incremental	HFC (HDFC template) Incremental	HFC (LICHF template) Incremental
Interest income / total assets	9.7%	9.7%	10.7%	10.8%
Home loan lending rate assumed (monthly compounded)	*10.3%*	*10.3%*	*10.3%*	*10.3%*
Interest expense / total assets	6.0%	8.3%	7.4%	8.6%
Cost of deposits assumed	*6.2%*	*8.7%*	*9.2%*	*9.6%*
NII / total assets	3.7%	1.4%	3.3%	2.2%
Fee income / total assets	0.2%	0.2%	0.2%	0.2%
Opex / total assets	2.2%	0.5%	0.3%	0.4%
Credit cost / total assets	0.4%	0.3%	0.1%	0.1%
Pretax profit / total assets	1.3%	0.7%	3.1%	1.9%
Taxes / total assets	0.3%	0.2%	0.8%	0.5%
ROA	**0.9%**	**0.5%**	**2.3%**	**1.4%**
Current reported RoA [benchmark FY12]	**0.9%**	**0.9%**	**2.7%**	**1.4%**
Leverage	26.6	26.6	9.1	12.4
RoE	25.2%	13.4%	21.0%	17.3%
Current reported RoE [benchmark FY12]	15.7%	15.7%	22.7%	17.1%
Tier 1 ratio assumed (same as last reported level)	9.5%	9.5%	12.7%	10.7%

Notes:

1) *SBI yield on total assets is lower than that implied by home loan rate, due to SLR/CRR burden on deposits.*

2) *Incremental cost of deposits assumed at 8.7%/9.2% for HDFC. Cost of borrowing for HDFC assumed at 8.1% (incremental basis). Bond/NCD yields for HDFC/LICHF assumed at the levels seen in recent transactions. No low-cost CASA funding for SBI in the incremental analysis, since we are working on an incremental business basis. The higher leverage for SBI makes the interest expense as a percentage of assets appear higher than others.*

3) *We have assumed the Tier 1 ratios as last reported by the bank/companies. The **leverage appears higher** than the reported consolidated leverage for SBI and HDFC because of the smaller risk-weight assigned to retail home loans vs other loan asset classes that these entities carry.*

4) *This analysis focuses only on retail home loans. For this reason, the yields/RoA for HDFC calculated in this analysis are lower than HDFC's reported numbers which include wholesale loan portfolio.*

5) *No priority sector burden assumed for SBI. With home loans currently accounting for 11% of total loan book, we assume the bank must find it easy to meet the incremental PSL requirement without material impact on returns.*

6) *Credit cost for SBI mortgage business is based on home loan NPA reported by BoB (avg 1.8% for LTM), and assuming a 5 year average tenure.*

7) *Opex/assets for SBI assumed as 20 bp above that of HDFC reported numbers, to account for higher efficiency of operations of HDFC.*

8) *Both banks and HFCs enjoy tax benefits under Section 36 (1) viii of Income Tax Act. These benefits have been incorporated in the analysis.*

Source: Company data, Credit Suisse estimates

2. LTV ratio capped

Under current guidelines, LTV on home loans is capped at 80%. Further, there is higher capital charge on loans with higher LTV (see figures below). We believe these could prevent aggression from banks on LTV.

Figure 18: **RBI has capped LTVs for home loans at 80%**

Amount	Maximum LTV
Up to Rs 2 mn	90%
Exceeding Rs2 mn	80%

Source: RBI, Credit Suisse research

Figure 19: **Higher charge on LTV above 75%**

LTV	Amount	Risk weight
LTV up to 75%	Up to Rs3 mn	50%
LTV up to 75%	Rs3 mn-Rs7.5 mn	75%
LTV up to 75%	Exceeding Rs7.5 mn	125%
LTV above 75%	Up to Rs7.5 mn	100%
LTV above 75%	Exceeding Rs7.5 mn	125%

Source: RBI, Credit Suisse research

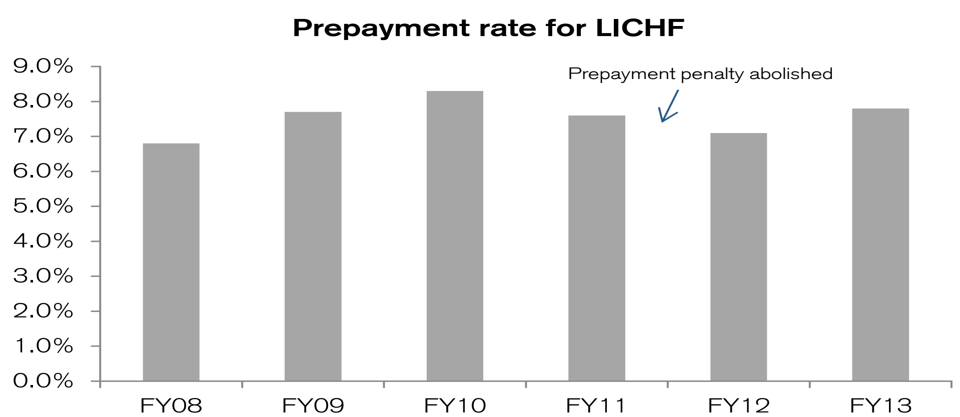
Negligible impact of prepayment penalty abolition on loans with low ticket size

Data from LICHF shows that pre-payment rate for LICHF remains within historical ranges, nearly two years after prepayment penalties started to be withdrawn. This indicates that this is not a serious threat for the competitiveness of HFCs (or market leaders in general).

This is particularly true for loans with low ticket sizes. Loans with ticket sizes of Rs10 mn and above have seen increasing prepayments. But loans of smaller ticket sizes have not seen an increase in prepayments as evidenced by LICHF and HDFCs prepayment rate over the last few years

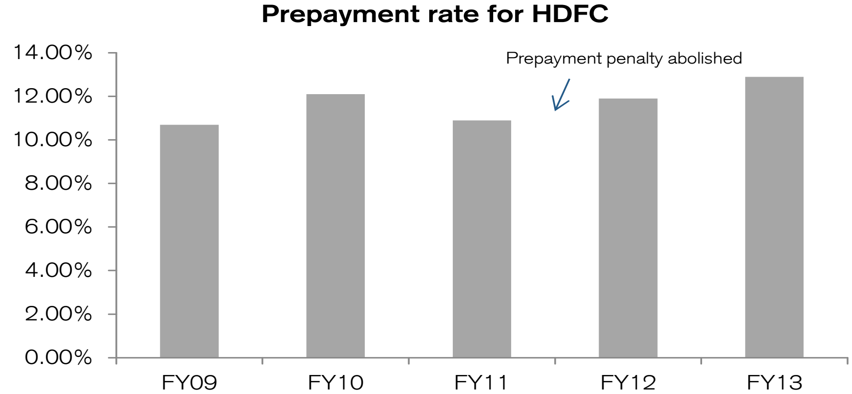
Pre-payment rate for LICHF has remained within historical ranges, even two years after prepayment penalties started to be withdrawn

Figure 20: **Pre-payment rate for LICHF has remained within historical range, despite penalty being withdrawn**



Source: Company data, Credit Suisse research

Figure 21: **Similarly for HDFC, the prepayment rate has remained range-bound**



Source: Company data, Credit Suisse research

Easing liquidity should help HFCs on funding costs

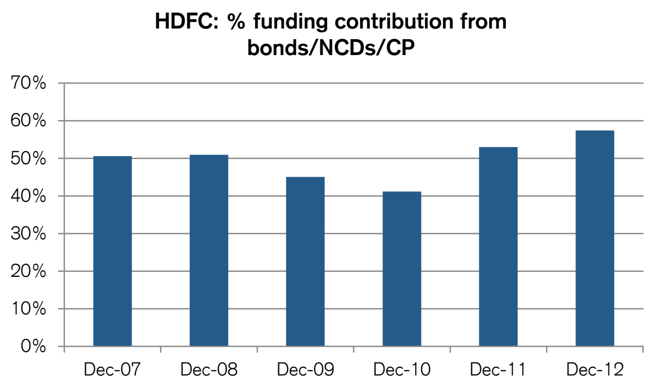
Reducing dependence on banks for funds

Across HFCs, we notice a trend of increasing funding from non-bank routes—in particular, the rising share of bonds/NCDs.

Across HFCs, we notice a trend of increasing funding from non-bank routes—in particular rising share of bonds/NCDs. If this trend continues, it could help HFCs bypass the bank base-rate floor on funding costs.

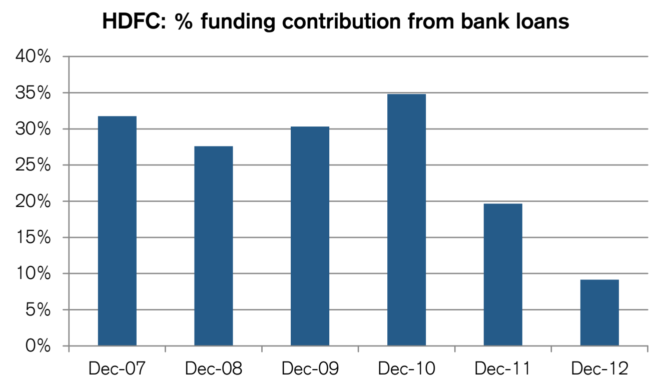
Across HFCs, we notice a trend of increasing funding from non-bank routes—in particular rising share of bonds/NCDs

Figure 22: **HDFC is seeing an increase in bonds/NCDs in funding mix ...**



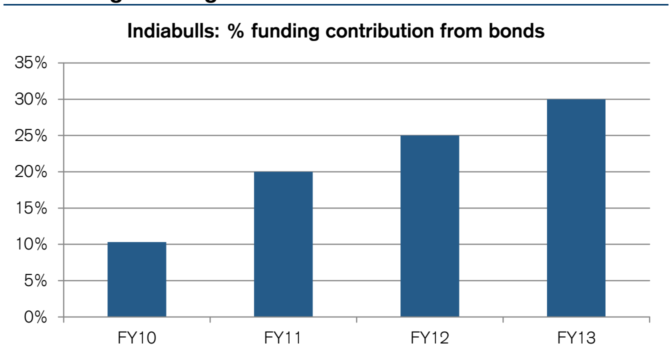
Source: Company data, Credit Suisse estimates

Figure 23: **… while bank term loans are becoming less relevant**



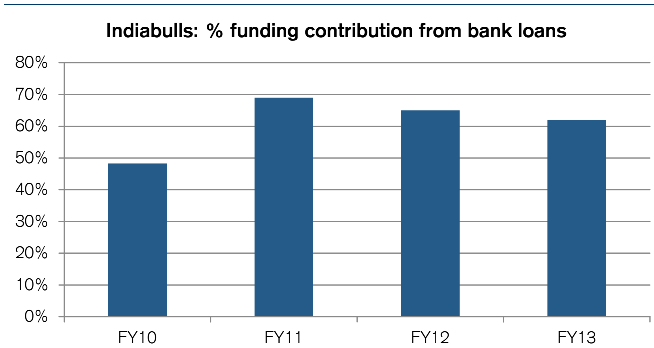
Source: Company data, Credit Suisse estimates

Figure 24: **Indiabulls is also seeing a similar trend with increasing funding from bonds …**



Source: Company data, Credit Suisse estimates

Figure 25: **… and decreasing dependency on bank loans**



Source: Company data, Credit Suisse estimates

Figure 26: **LICHF is seeing increasing dependence on NCDs**

Outstanding Sources of funding	FY12	FY13
Bank	31.8%	29.8%
NCD / bonds	**57.7%**	**60.6%**
Sub. Debt & Upper Tier II	5.3%	4.3%
Deposits	0.5%	0.9%
LIC	1.0%	0.4%
NHB	3.3%	3.6%
Misc.	0.5%	0.3%

Source: Company data, Credit Suisse estimates

Figure 27: **Bank loans as a percentage of borrowings have been decreasing rapidly**

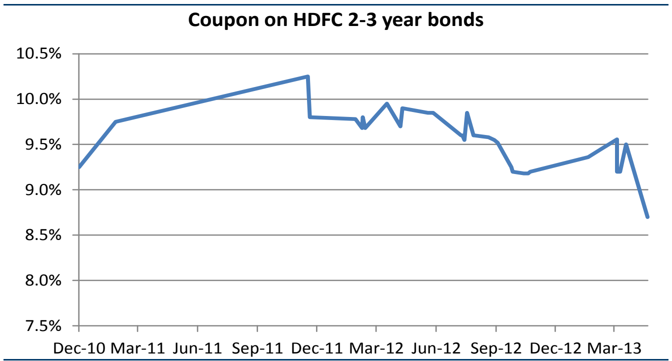
	FY11	FY12	FY13	Bank loan's share of incremental borrowing in FY13
LIC Housing Finance	28%	32%	30%	21%
Indiabulls	69%	65%	62%	51%
HDFC	37%	29%	9%	-278%

Source: Company data, Credit Suisse estimates

Wholesale rates falling sharply

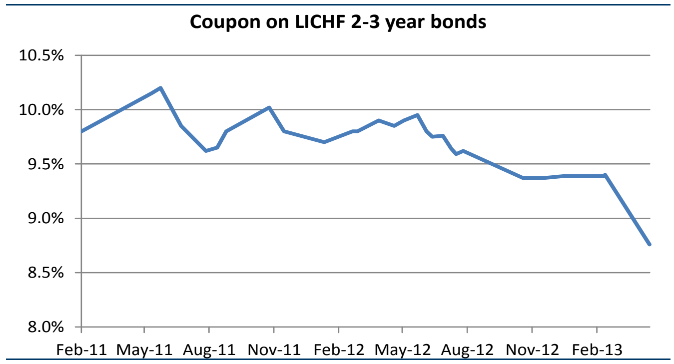
In the context of growing importance of bonds/NCDs to HFC funding, it is important to note the sharp decline in yields on new bond/NCD issuances in recent weeks. Both HDFC and LICHF are seeing rates on long-term bonds fall to less than 9%.

Figure 28: **HDFC's NCD coupons have fallen sharply in recent issuances …**



Source: Company data, Bloomberg, Credit Suisse

Figure 29: **… so have coupons on LICHF's NCDs**



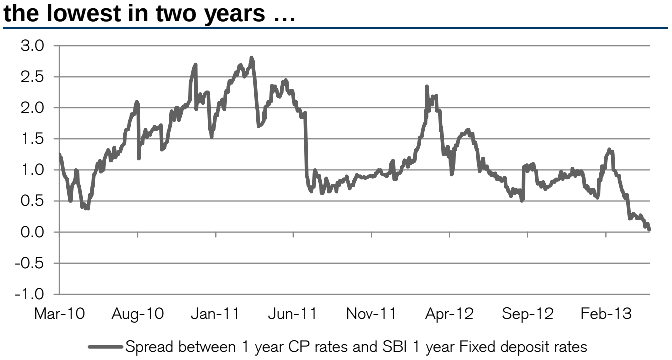
Source: Company data, Credit Suisse

Spreads between retail and wholesale funding declining

We also highlight that the spread between one-year CP rates and SBI's one-year FD rate is at a multi-year low, indicating that the cost of funds differential between banks and non-banks is reducing.

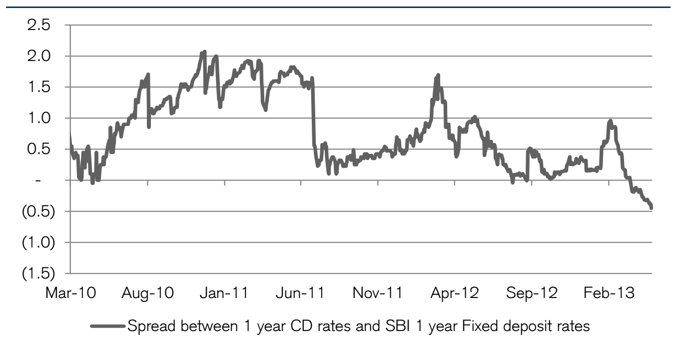
The spread between one-year CP rates and SBI's one-year FD rate is at a multi-year low

Figure 30: **The spread between wholesale (one-year CP rates) and retail rates (one-year SBI fixed deposit rate) is the lowest in two years …**



Source: Company data, Bloomberg, Credit Suisse

Figure 31: **… so is the spread on one-year CD rates and one-year SBI fixed deposit rate**



Source: Company data, Bloomberg, Credit Suisse

Mortgage: Secular growth in an underpenetrated industry

The Indian mortgage industry has grown at a 16% CAGR over the past five years. Based on our analysis, the mortgage industry in India is 9-11 years behind other regional Ems such as China and Thailand, in terms of penetration in the economy. Due to various structural drivers, like young population, reducing family size, urbanisation and rising income levels, we believe the growth rates in this segment should remain healthy over the longer term.

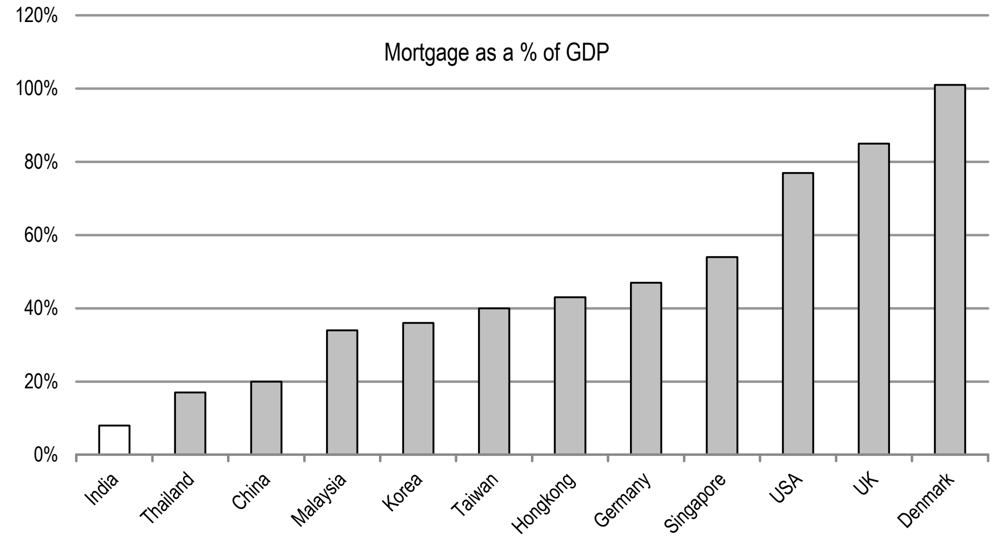
The mortgage industry in India is 9-11 years behind other regional EMs

Low mortgage penetration in India

At less than 8%, India's mortgage penetration (as a percentage of GDP) is quite low compared with other countries, including other emerging economies in the region.

At less than 8%, India's mortgage penetration (as a percentage of GDP) is quite low

Figure 32: **Mortgage as a percentage of GDP**



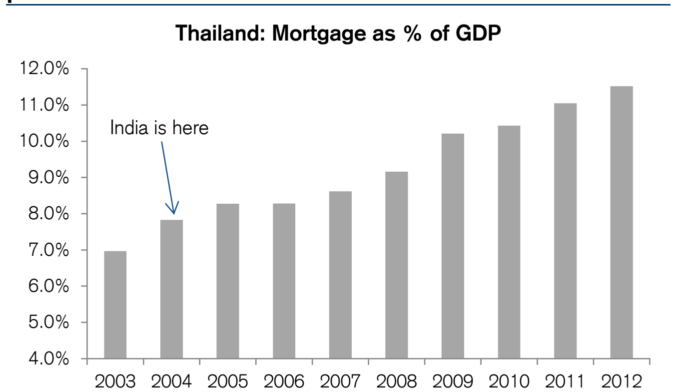
Source: HDFC, Credit Suisse estimates

A look at the past growth in other countries shows that at current penetration levels, India is 9-11 years behind other countries such as China and Thailand.

Figure 33: **India is 11 years behind China's mortgage penetration**

Source: CEIC, Credit Suisse estimates

Figure 34: **India is nine years behind Thailand's mortgage penetration**



Source: CEIC, Credit Suisse estimates

Structural drivers for long-term growth

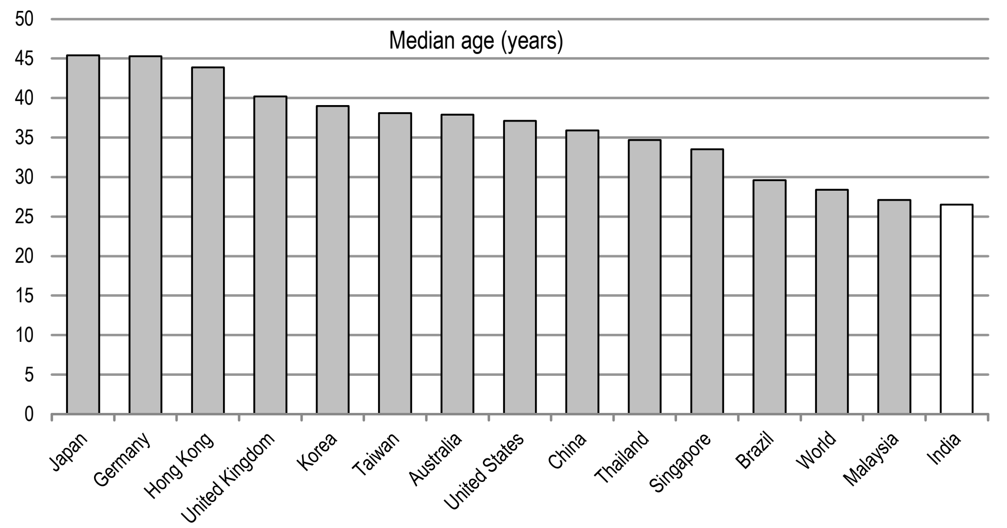
We believe that a number of drivers are in place to ensure strong and sustained growth in the mortgage/home loan segment in India.

1. Young population

With a median age at a little over 25 years, Indian population will continue to supply potential working age home owners over the longer term, willing to leverage based on their future income expectations to purchase houses.

With a median age at a little over 25 years, the Indian population will continue to supply potential working age home owners over the longer term

Figure 35: **India' median age is lower than most of the developing nations**



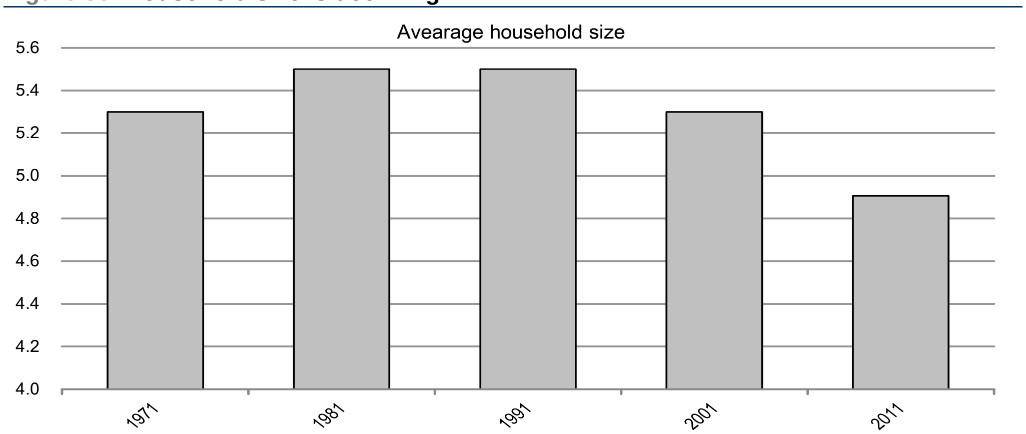
Source: CIA Factbook

2. Shrinking family sizes/nuclear families

With falling household sizes and nuclear families becoming popular, more homes could be required. More often than not, these homes could be bought by the younger generation moving out to set up families outside their ancestral town/village, i.e., individuals without sufficient surplus funds but with future cash flow streams that can be leveraged.

With falling household sizes and nuclear families becoming popular, more homes could be required.

Figure 36: **Household size is declining**

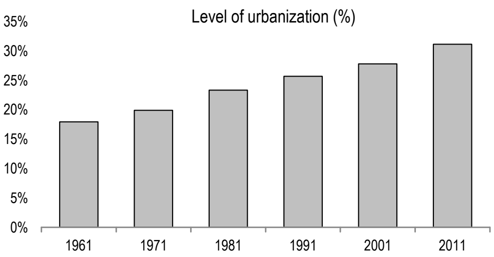


Source: Census of India, Credit Suisse research

3. Urbanisation

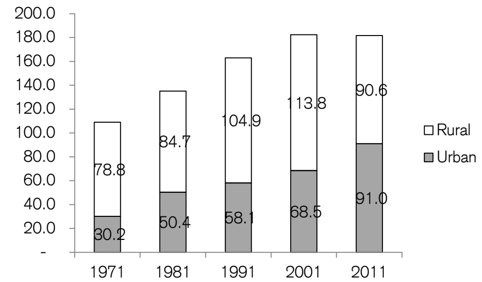
The proportion of population in urban areas continues to increase, with the latest census data showing that the absolute increase in population in urban India in the 2001-11 decade was higher than the addition to rural India—indicating migration. This could lead to sustained demand for homes in urban areas.

Figure 37: Urban population is rising as a percentage of overall population



Source: Census India, Credit Suisse research

Figure 38: In the last decade, the absolute addition to urban population was higher than for rural population



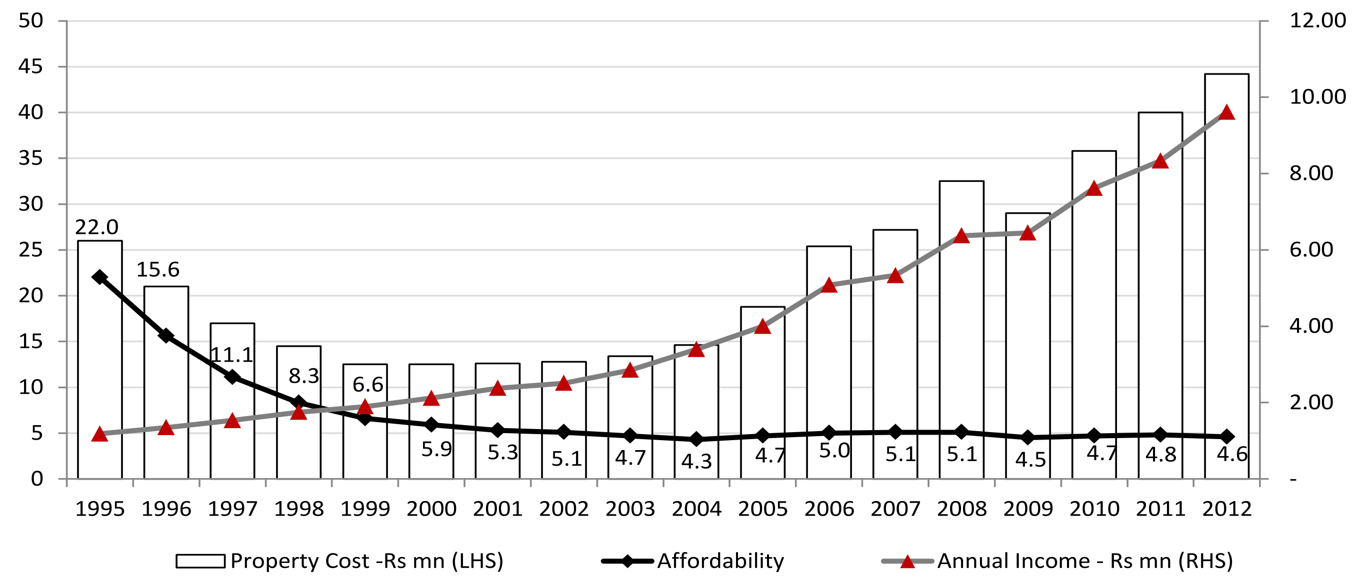
Source: Company data, Credit Suisse research

4. Rising incomes => rising affordability

Income levels have risen faster than property prices in the past couple of decades, leading to increasing affordability

Income levels have risen faster than property prices in the past couple of decades, leading to increasing affordability. Data from HDFC Ltd. below shows that affordability in Mumbai (measured through property cost as a multiple of annual income) has steadily fallen, from 22x to sub-5x over the past 15 years.

Figure 39: Despite 7% CAGR in property prices in the past 15 years, affordability is rising due to faster income growth



Source: HDFC, Credit Suisse research

5. Improving land records

Improving land records could be a potential growth driver in future, especially in rural areas

The National Land Records Modernization Programme (NLRMP) was launched by Government of India in August 2008, with an aim to modernise management of land records, minimise scope of land/property disputes—moving eventually towards guaranteed conclusive titles to immovable properties in the country. For more details, please refer to detailed work done by Neelkanth Mishra and others—India: The Silent Transformation, published on 13 March 2013.

We believe unclear land titles could be a significant hindrance to home loan financiers. This is particularly true in rural areas which are not important for the organised home finance industry currently, but could be a potential growth driver in future (see below for a discussion on rural opportunity).

6. Tax incentives from the government

Tax incentives for borrowers

Government provides tax incentives to both borrowers and lenders

Section 24/80C of the income tax act allows for deductions from taxable income on interest up to a limit of Rs0.15 mn and principal repayments on mortgage loans up to a maximum of Rs0.1 mn. Including these tax savings, the effective cost of borrowing for a home loan of less than Rs2 mn becomes 6.4% (as against headline rates of ~10%-plus).

Figure 40: **Tax incentives reduce the rate of interest by 30-40%**

	2012	2002	2000
Loan amount (Rs)	2,000,000	2,000,000	2,000,000
Nominal Interest Rate(%)	10.25%	10.75%	13.25%
Max deduction for interest allow ed	150,000	150,000	75,000
Deduction on principal	100,000	20,000	20,000
Tax rate applicable	**30.90%**	**31.50%**	**34.50%**
Tenor (years)	15	15	15
Total amount paid per year	305,000	269,028	307,620
Interest component	205,000	215,000	265,000
Principal repaid	100,000	54,028	42,620
Tax amount saved	77,250	53,550	32,775
Effective interest paid on home loan	127,750	161,450	232,225
Effective interest on home loan	**6.40%**	**8.10%**	**11.60%**

Source: HDFC, Credit Suisse research

Tax incentives for lenders

Section 36(1)(viii) of the Income-tax Act 1961 allows deduction in respect of special reserve created and maintained by an entity for a maximum 20% of the profits derived from certain businesses (including home loan mortgage business). This lowers the tax rate for HFCs by 20% as their entire profits are eligible under this clause.

Figure 41: **Taxes for HFCs are 20% lower than corporate tax rate**

Particulars	Rates
Corporate tax rate	33.99%
Deduction allowed under section 36(1) (viii) on eligible profits	20%
Effective tax rate for eligible companies	27.2%

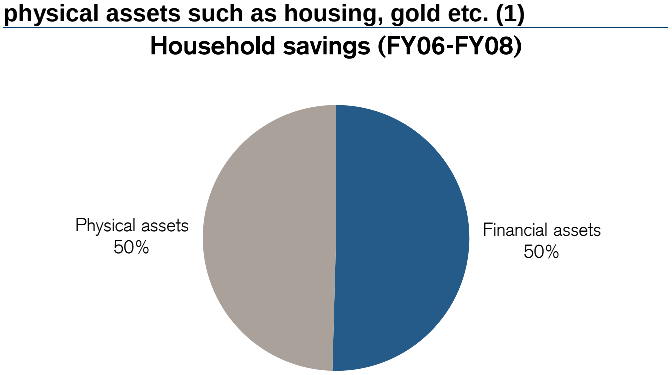
Source: Income Tax Act 1961, Credit Suisse estimates

7. Saving in physical assets still important

Savings in physical assets increased in popularity between 2008 and 2011

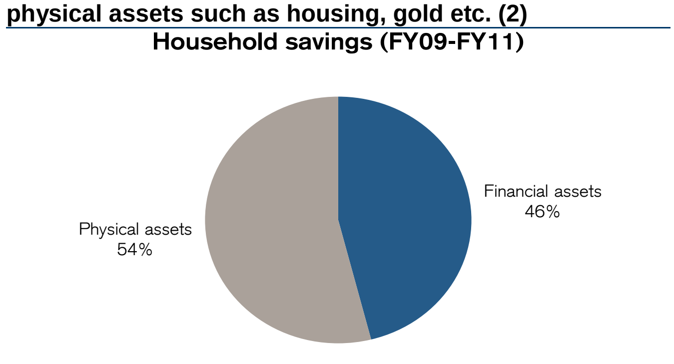
Indians still prefer to make most of their savings in assets which they can touch and feel (primarily land, housing, precious metals). In fact, data from RBI shows that savings in physical assets increased in popularity between 2008 and 2011 (latest data available). This could give an added support to house purchases/mortgage industry, in our view.

Figure 42: **Indian households still prefer saving in physical assets such as housing, gold etc. (1)**



Source: RBI, Credit Suisse estimates

Figure 43: **Indian households still prefer saving in physical assets such as housing, gold etc. (2)**



Source: RBI, Credit Suisse estimates

LIC Housing Finance Ltd

(LICH.BO / LICHF IN)

Rating	OUTPERFORM*
Price (17 May 13, Rs)	275.65
Target price (Rs)	365.00[1]
Upside/downside (%)	32.4
Mkt cap (Rs mn)	139,110 (US$ 2,528)
Number of shares (mn)	504.66
Free float (%)	59.7
52-week price range	297.2 - 211.6
ADTO - 6M (US$ mn)	14.0

*Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.
[1]Target price is for 12 months.

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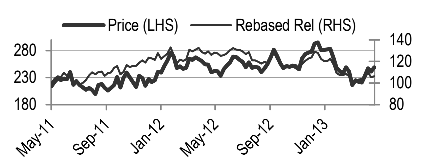
INITIATION

Beneficiary of an easing bond market

- **We initiate coverage on LICHF with an OUTPERFORM rating and a Rs365 target price, implying 32% upside.** LICHF is the third-largest mortgage player in India (second largest among non-banks) with a 10% market share. The company has grown faster than industry recently, clocking a three-year loanbook CAGR of 27%. We believe one of the key strengths of LICHF is its strong parentage (parent LIC is the largest insurance company in India). Exclusive access to over 7,000 agents of its parent makes LICHF's distribution system quite formidable versus competition, in our view.
- **Suffered in the previous rising interest rate cycle, should now benefit.** In an industry with largely floating-rate assets, LICHF has sizeable (~50%) fixed-rate exposure on its loan book. In a tightening interest rate environment over the past few years, this has caused margin compression, leading to ~700 bp ROE drop over three years. However, with funding costs for the company beginning to drop, we believe the company should claw back some of its lost margins over the coming years.
- **Catalysts.** With current back-book yield comparable to incremental market lending rates and sharp decline in bond yields showing up in recent issuances, we believe LICHF should start seeing NIM expansion. We build a 20 bp NIM expansion in each of the following two years. Further upside could come from operational costs (cost/income ratio halved over the past five years to 3.6%; we assume no further efficiency benefits).
- **Valuation looks attractive.** At 1.8x/10x FY14E P/B/ P/E, we believe the stock is attractively valued (12-20% discount to historical averages). The stock's 66% discount to HDFC is also below historical average.
- **Investment risks.** Key risks to our OUTPERFORM rating and Rs365 target price include aggressive competition from banks (by sacrificing profitability), reversal in interest rate cycle and frequent management changes leading to changes in strategy.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 20236.56 on 15/05/13
On 15/05/13 the spot exchange rate was Rs54.78/US$1

Performance over	1M	3M	12M
Absolute (%)	18.4	11.0	13.9
Relative (%)	11.1	7.2	-12.3

Financial and valuation metrics

Year	3/13A	3/14E	3/15E	3/16E
Pre-prov Op profit (Rs mn)	14,970.9	19,831.4	25,612.0	31,529.9
Pre -tax profit (Rs mn)	14,180.4	18,925.0	24,048.9	29,837.5
Net attributable profit (Rs mn)	10,488.6	14,015.2	17,823.6	22,126.1
EPS (CS adj.) (Rs)	20.79	27.23	33.97	42.17
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	25.7	30.9	38.1
EPS growth (%)	7.7	31.0	24.7	24.1
P/E (x)	13.3	10.1	8.1	6.5
Dividend yield (%)	1.3	1.7	2.1	2.7
CS adj. BVPS (Rs)	129.5	156.1	183.3	217.0
P/B (x)	2.13	1.77	1.50	1.27
ROE (%)	17.1	19.0	20.0	21.1
ROA (%)	1.4	1.6	1.7	1.7
Tier 1 Ratio (%)	10.7	10.9	10.4	10.0

Source: Company data, Thomson Reuters, Credit Suisse estimates.

LIC Housing Finance Ltd LICH.BO / LICHF IN

Price (17 May 13): **Rs275.65**, Rating:**: OUTPERFORM**, Target Price: **Rs365.00**, Analyst: **Sunil Tirumalai**

Target price scenario			
Scenario	**TP**	**%Up/Dwn**	**Assumptions**
Upside	414.00	50.19	NIMs to expand by 80 bps over next 2 years, GNPAs to fall to 50bps; will lead to multiple expansion
Central Case	365.00	32.41	NIMs to expand by 40 bps over next 2 years, GNPAs to remain stable
Downside	295.00	7.02	NIMs fall by 50 bps over next 2 years, GNPAs increase to 100bps, multiple doesn't revert to mean

Key earnings drivers	3/13A	3/14E	3/15E	3/16E
Loan growth	23.4	20.6	19.7	19.7
NIM (%)	2.18	2.39	2.56	2.64
Credit costs (before reversal of provisions)	0.10	0.17	0.18	0.13
Credit costs (after reversal of provisions)	0.11	0.10	0.15	0.13
Asset yields	10.6	10.6	10.6	10.6

Valuation	3/13A	3/14E	3/15E	3/16E
EPS growth (%)	7.7	31.0	24.7	24.1
P/E (x)	13.3	10.1	8.1	6.5
P/B (x)	2.13	1.77	1.50	1.27
P/TB (x)	2.13	1.77	1.50	1.27
Dividend yield (%)	1.31	1.68	2.13	2.65

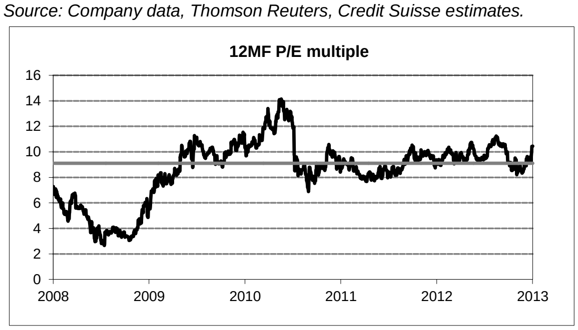
Per share data	3/13A	3/14E	3/15E	3/16E
Shares (wtd avg.) (mn)	504.6	514.7	524.7	524.7
EPS (Credit Suisse) (Rs)	**20.79**	**27.23**	**33.97**	**42.17**
BVPS (Rs)	129	156	183	217
Tangible BVPS (Rs)	129	156	183	217
DPS (Rs)	3.60	4.63	5.88	7.30

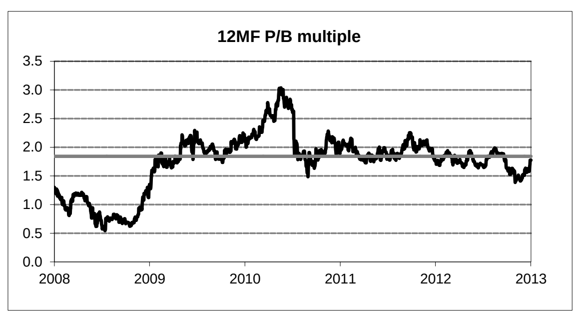
Income statement (Rs mn)	3/13A	3/14E	3/15E	3/16E
Interest income	74,591	91,020	109,217	130,619
Interest expense	59,246	70,475	82,826	98,054
Net interest income	**15,345**	**20,545**	**26,391**	**32,566**
Fee and commission income	1,168	1,424	1,710	2,047
Trading income	—	—	—	—
Insurance income (& premiums)	—	—	—	—
Other income	1,704	1,714	2,040	2,242
Total non-interest income	**1,168**	**1,424**	**1,710**	**2,047**
Total income	**16,513**	**21,969**	**28,101**	**34,613**
Personal expense	1,004	1,223	1,469	1,758
Other expenses	2,243	2,628	3,059	3,567
Total expenses	**3,247**	**3,851**	**4,528**	**5,325**
Pre-provision profit	**14,971**	**19,831**	**25,612**	**31,530**
Loan loss provisions	790	906	1,563	1,692
Operating profit	**14,180**	**18,925**	**24,049**	**29,837**
Associates/JV	—	—	—	—
Other non-operating inc./(exp.)	—	—	—	—
Pre-tax profit	**14,180**	**18,925**	**24,049**	**29,837**
Taxes	3,640	4,858	6,174	7,660
Net profit before minorities	**10,540**	**14,067**	**17,875**	**22,178**
Minority interests	(6.7)	(6.7)	(6.7)	(6.7)
Preferred dividends	—	—	—	—
Exceptionals/extraordinaries	—	—	—	—
Reported net profit	**10,489**	**14,015**	**17,824**	**22,126**
Analyst adjustments	—	—	—	—
Net profit (Credit Suisse)	**10,489**	**14,015**	**17,824**	**22,126**

Key ratios	3/13A	3/14E	3/15E	3/16E
Profitability and margins				
ROE stated	17.1	19.0	20.0	21.1
ROE - CS adj.	17.1	19.0	20.0	21.1
ROA - CS adj.	1.45	1.59	1.68	1.74
Gearing (x)	11.9	12.0	11.9	12.1
Asset quality (%)				
NPL/ gross loans	0.61	0.61	0.61	0.61
B/S loan loss coverage	147	138	138	136
Loan/ deposit ratio	—	—	—	—
Capital ratios (%)				
Capital adequacy ratio	15.8	15.8	15.2	14.8
Tier 1 ratio	10.7	10.9	10.4	10.0
Equity Tier 1 ratio	10.7	10.9	10.4	10.0
Growth(%)				
Revenue	10.2	30.0	27.3	22.3
Operating expense	23.8	18.6	17.6	17.6
Pre-provision profit	7.6	32.5	29.1	23.1
Net profit	14.1	33.6	27.2	24.1
Deposit	—	—	—	—

Source: Company data, Thomson Reuters, Credit Suisse estimates.

Balance sheet (Rs mn)	3/13A	3/14E	3/15E	3/16E
Assets				
Gross customer loans	778,120	938,594	1,123,381	1,344,832
Risk provisions	6,946	7,850	9,411	11,101
Net customer loans	**771,174**	**930,744**	**1,113,970**	**1,333,731**
Interbank Loans	—	—	—	—
Investment & Securities	1,950	1,950	1,950	1,950
Cash & cash equivalents	15,235	23,277	28,278	34,697
Fixed Assets	732.4	734.4	748.0	774.7
Intangibles	—	—	—	—
Other assets	10,443	10,582	10,738	10,919
Total assets	**799,535**	**967,287**	**1,155,683**	**1,382,072**
Liabilities				
Interbank deposits	—	—	—	—
Customer deposits	—	—	—	—
Total deposits	**—**	**—**	**—**	**—**
Other liabilities	734,207	885,347	1,059,504	1,268,217
Total liabilities	**734,207**	**885,347**	**1,059,504**	**1,268,217**
Shareholders' equity	**65,334**	**81,926**	**96,159**	**113,828**
Minority interests	7.6	14.3	21.0	27.8
Preferred stock	—	—	—	—
Total liabilities & equity	**799,549**	**967,287**	**1,155,683**	**1,382,072**





Source: IBES

LICHF: A fast-growing HFC with strong parent backing

LICHF is the third-largest player in the Indian mortgage industry, and has grown faster than No. 1/No. 2 players in recent years. In addition to the industry drivers discussed earlier, we believe that strong backing from its parent LIC (whose distribution network LICHF rides on) could help LICHF sustain healthy growth.

LICHF is the third-largest player in the Indian mortgage industry

With sizeable fixed rate exposure (unlike other home finance companies with floating-rate loans, most of LICHFs loans have an initial 2-5 year fixed rate period), LICHF has been at the receiving end of a rising interest rate cycle over the past few years. The resultant spread/NIM compression has led to RoE erosion (700 bp over three years). However, with wholesale rate already easing and overall interest rates likely going down, we believe LICHF should benefit going forward. We build a 20 bp NIM expansion in each of FY14 and FY15, leading to a 400 bp ROE expansion and a 28% EPS CAGR over three years.

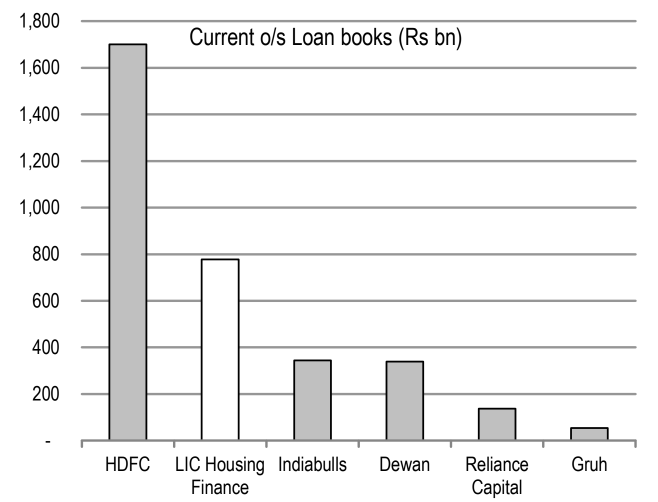
With wholesale rate already easing and overall interest rates likely going down, we believe LICHF should benefit going forward

At 1.8x/10.1x FY14E P/BV/ P/E, we believe the stock is attractively valued (12-20% discount to historical averages). We initiate coverage on LICHF with an OUTPERFORM rating and a Rs365 target price.

Fast growing, second-largest HFC

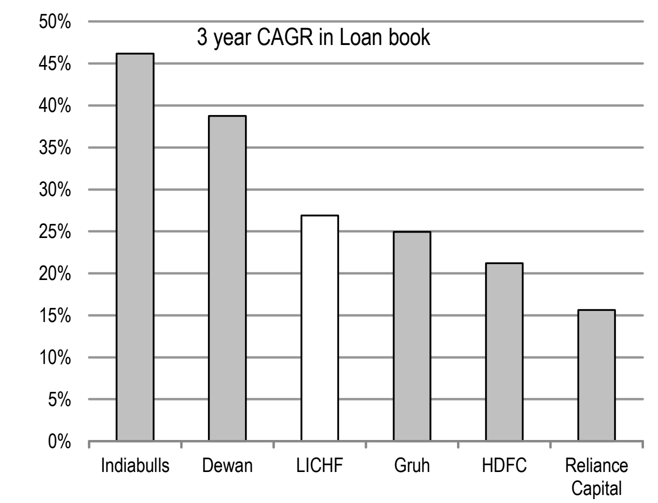
LICHF has been one of the fastest-growing HFCs in recent years, clocking 27% and 29% CAGR over the past three and five years, respectively. The company now has the third-largest mortgage portfolio in the country (second largest among HFCs).

Figure 44: **LICHF is the second-largest HFC in India**



Source: Company data, Credit Suisse research

Figure 45: **LICHF is one of the fastest-growing HFC**



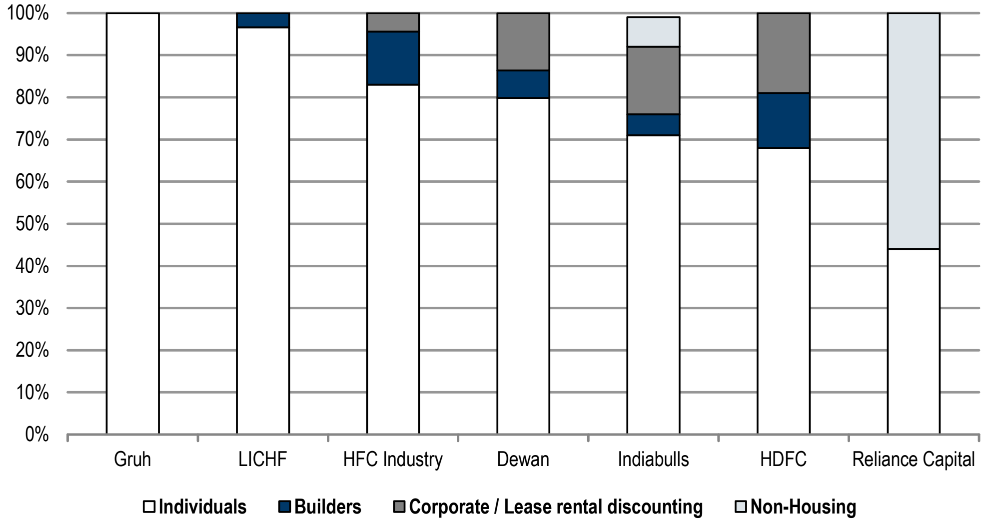
Source: Company data, Credit Suisse research

Retail-focused housing finance company

The unique feature of LICHF versus other leading HFCs is its strong focus on retail home loans. Developer/corporate loans and loans against property account for less than 10% of its loan book. This compares with the 20-30% non-retail home loan portfolio of other HFCs. Note that nearly 90% of LICHF's customers are from the salaried class.

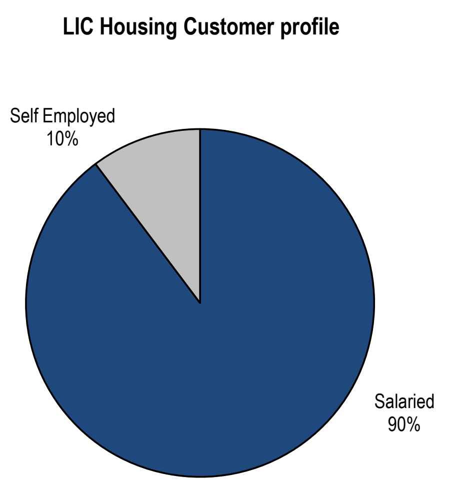
The unique feature of LICHF versus other leading HFCs is its strong focus on retail home loans

Figure 46: LIC Housing finance has the maximum exposure to retail home loans



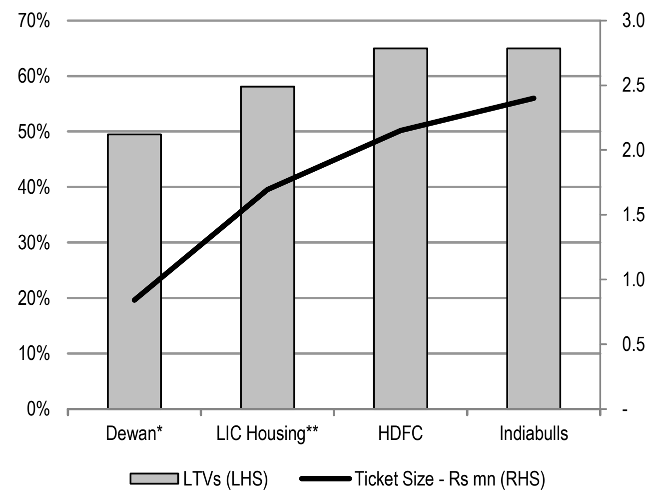
Source: NHB, Company data, Credit Suisse research

Figure 47: 90% of LICHF customers are from the salaried class



Source: Company data, Credit Suisse estimates

Figure 48: LIC Housing Finance average LTV as well as ticket size is lower than those of HDFC and Indiabulls



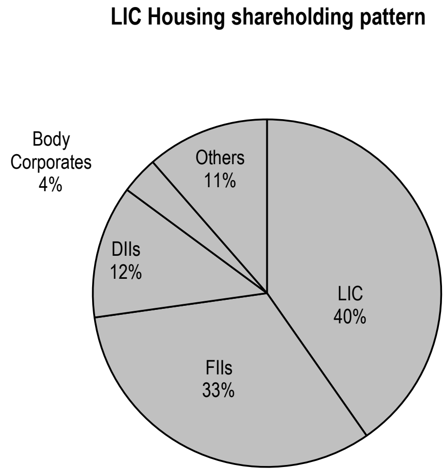
** LTV for Deewan housing is 47-52%, ** Incremental ticket size.*
Source: Company data, Credit Suisse research

Strong parent backing

LICHF is promoted by LIC, the largest life insurance company in India with an investment corpus of ~Rs15 tn. LIC owns a 40.3% stake in LICHF.

LICHF is promoted by LIC, the largest life insurance company in India

Figure 49: **LIC Housing shareholding pattern**



Source: Company data, BSE, Credit Suisse research

Higher credit rating

LICHF enjoys the highest ratings from CRISIL and CARE (AAA). One of the reasons for the high credit ratings could be the strong parentage and backing of LIC. Superior credit rating allows it to raise money at competitive rates from the market.

LICHF enjoys the highest ratings from CRISIL and CARE (AAA).

Figure 50: **Credit ratings for HFCs**

Company	Rating	Agency
HDFC	AAA	ICRA, CRISIL
LICHF	AAA	CARE, CRISIL
Indiabulls	AA+, AA	CARE, CRISIL

Source: Company data

Riding on the strength of parent's sales agents—distribution advantage

In addition to the financial support that parent LIC provides to LICHF, there is another level of support provided. LICHF leverages on the wide network of LIC agents to source home loan customers. Nearly 7,000-8,000 of LIC agents also double up as home loan agents for LICHF. In FY13, nearly 60% of new home loan originations came through such agents for LICHF—which we believe is a strong competitive advantage for the company versus competitors, which rely on DSAs (who may not exclusively align with any HFCs).

LICHF leverages on the wide network of LIC agents to source home loan customers

Loans from LIC

Although the current loan outstanding from LIC (at Rs280 mn) is less than 1% of the total borrowings, LIC in the past has extended loans to LICHF at lower-than-market borrowing rates. In FY03, LIC's contribution to borrowings was as high as 45%. LICHF can turn to LIC for funding, if the need arises in the future.

LICHF can turn to LIC for funding, if the need arises in the future

Expect healthy growth to be sustained

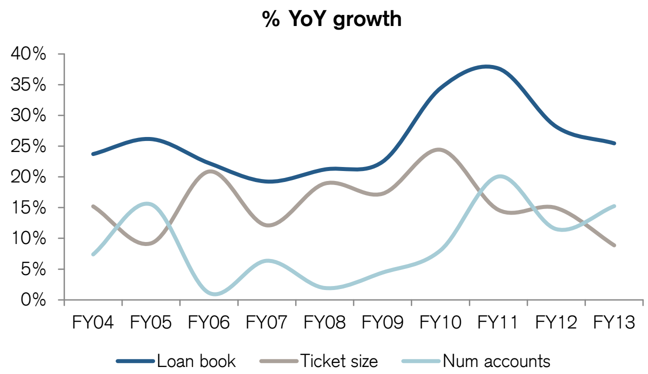
Low penetration with growing share for HFCs

In the earlier section, we discussed the long-term structural drivers for the home loan market in India. We believe that the shift in market towards specialist home loan companies (as against banks which also lend home loans) could help HFCs such as LICHF.

Growth driven by both volumes and value

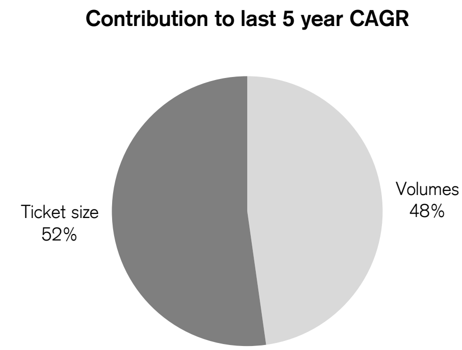
LICHF's loan growth over the past several years has been driven by an equal mix of both volumes and appreciation (increasing ticket size). This shows that the growth is not solely dependent on continuous rise in real estate price in any of its markets. In fact, in years when ticket sizes (or real estate prices) have fallen, volumes have picked up—leading to sustained growth.

Figure 51: Volumes and ticket size have helped sustain high growth



Source: Company data, Credit Suisse estimates

Figure 52: Both volumes and ticket size have equally contributed to growth in the past five years



Source: Company data, Credit Suisse estimates

CS expects healthy loan book growth over the next three years

LICHF's loan growth over the past several years has been driven by an equal mix of both volumes and appreciation

We build in a 20% CAGR in loan book over the next three years. We also expect the project loan book to grow at 10%.

Figure 53: CS expects healthy loan book growth over the next three years

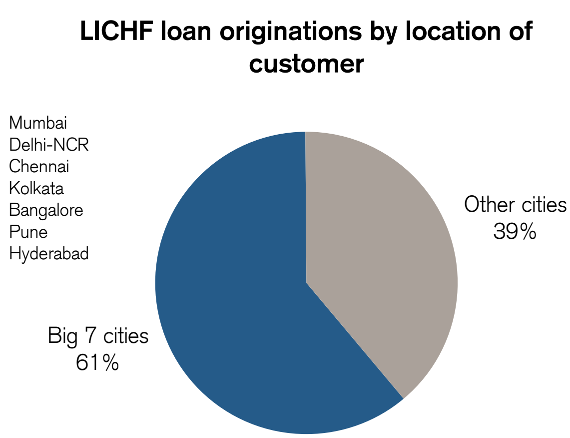
	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Loan book (Rs mn)	276,793	380,814	510,898	630,802	778,120	938,594	1,123,381	1,344,832

Source: Company data, Credit Suisse estimates

Longer-term growth to be driven by expansion outside top metros

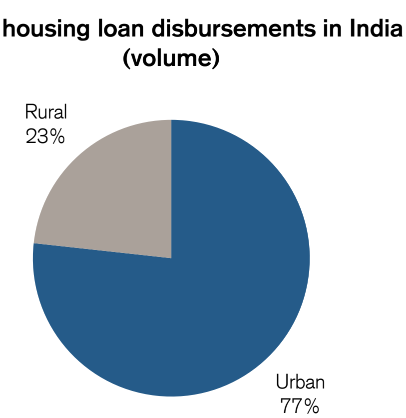
About 61% of LICHF's current business comes from top seven cities of India, a number that has been steadily falling as the company expands into other cities. We believe this expansion outside could be a longer-term growth driver for the company.

Figure 54: Over the medium term, LICHF has opportunity to expand beyond current concentration in top metros



Source: Company data, Credit Suisse research

Figure 55: Over the longer term, the industry has potential to expand into rural areas



Source: NHB, Credit Suisse research

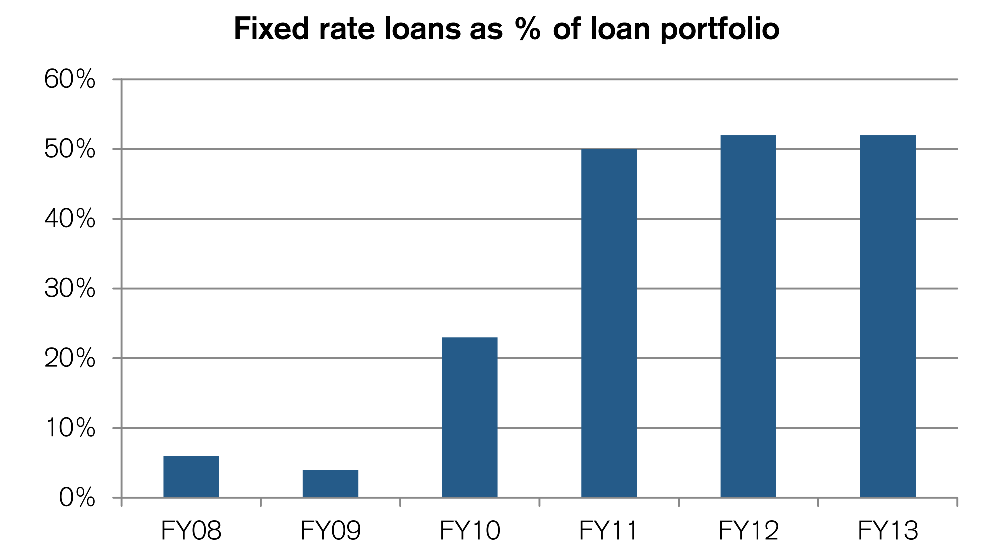
Suffered in a rising interest rate environment

LICHF carries significant interest rate risk with a fixed-rate-heavy loan portfolio

While most other lenders have moved on to floating-rate home loans, LICHF has continued to follow a strategy of offering dual-rate home loans—with rates fixed for initial two-five years followed by a reset to floating rates. All new loans originated by the company are of this dual-rate nature. Over the past five years, fixed-rate loans as a percentage of loan book have increased from less than 5% to over 50%.

While most other lenders have moved on to floating-rate home loans, LICHF has continued to follow a strategy of offering dual-rate home loans

Figure 56: **LIC has seen a significant rise in fixed-rate loans in its portfolio over the past few years**



*Source: * All LICHF loans have an initial 2- to 5-year fixed rate period before resetting to a floating rate. Source: Company data, Credit Suisse estimates*

Figure 57: **LICHF's strategy on loan pricing is in contrast to competitors**

Lender	Incremental retail home loan disbursements
LICHF	Only Fix-o-floaty loans, where the rate is fixed for the initial two-five years
SBI	Floating rate loans only
HDFC	Primarily floating rate loans

Source: Company data, Credit Suisse research

Figure 58: **Description of LICHFs current loan schemes**

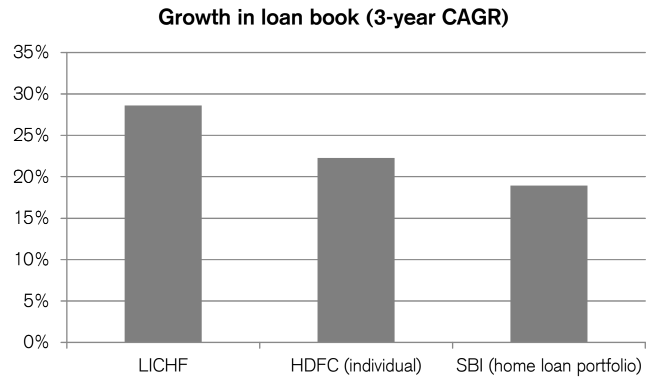
Fixed	Floating
Fixed for 2 years at 10%*/10.25%#	Reset to floating rate post 2 years - current floating rate is 11.25%
Fixed for 3 years at 10.25%*/10.5%#	Reset to floating rate post 3 years - current floating rate is 11.25%

*Source: Company data, Credit Suisse research, Note: * for loans upto Rs 30 lakhs (3mn) # for loans between Rs 30lakhs and Rs 75 lakhs (Rs3 mn-Rs7.5 mn)*

Market share focus could have driven its dual-rate strategy

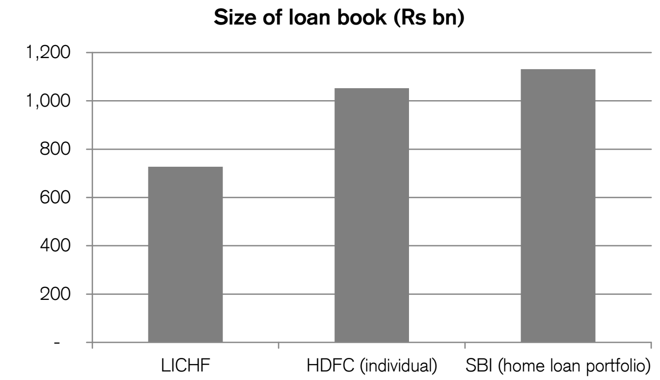
With competition moving onto floating-rate loans, it appears there is no compelling reason for LICHF to offer dual-rate loans with the initial fixed-rate component. We believe that in a rising interest rate environment, LICHF wanted to attract customers with the lure of stable interest rate/EMI in the initial few years (when the EMI/incomes ratio is likely to be the highest). We note that the company's loan growth has been far superior than the two larger lenders (despite being comparable in size). Clearly, the company absorbed interest risk with an eye on growth.

Figure 59: LICHF has delivered faster growth than the top two lenders ...



Source: Company data, Credit Suisse research

Figure 60: … despite being comparable in size



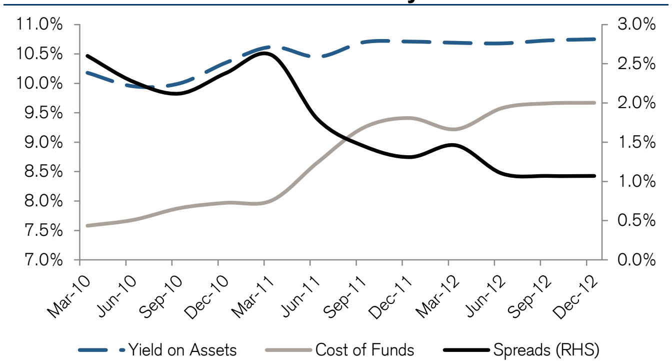
Source: Company data, Credit Suisse research

Pains of the fixed-rate strategy is visible in spread/RoA compression over the past few years

As a result of this dual-rate strategy, we note that LICHF was faced with a loan book with a high concentration of fixed rate loans and rising costs of funds. The resultant squeeze on spreads (2.5% to 1% over two years) was the primary driver of the RoA compression (from 2% to 1% levels). In the same period, we note that other lenders such as HDFC (with a largely floating rate portfolio) could manage their spreads in a narrow band.

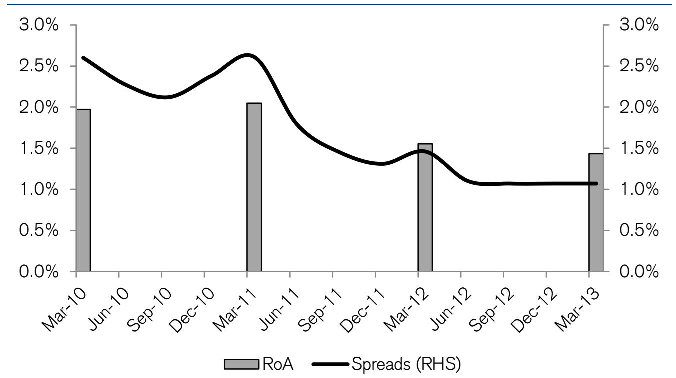
LICHF was faced with a loan book with high concentration of fixed rate loans with rising costs of funds

Figure 61: LICHF—spread compression in a rising interest-rate environment in recent years …



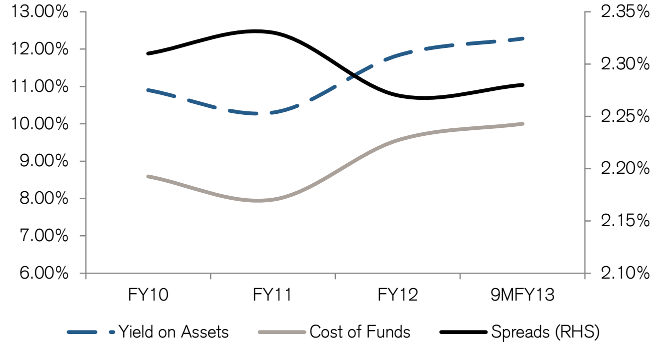
Source: Company data, Credit Suisse research

Figure 62: … which has led to RoE compression



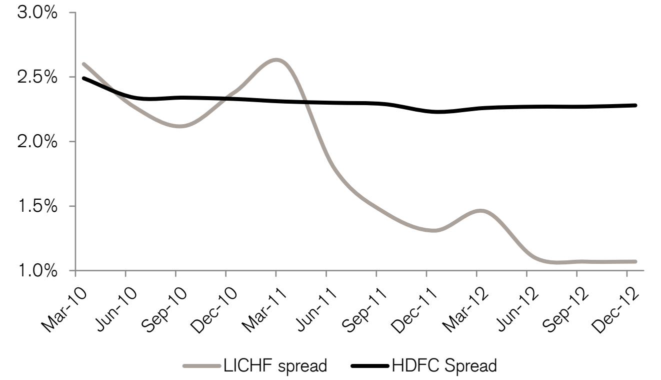
Source: Company data, Credit Suisse research

Figure 63: **In the same period, HDFC has managed to maintain spreads stable, due to floating rate assets (1)**



Source: Company data, Credit Suisse research

Figure 64: **In the same period, HDFC has managed to maintain spreads stable, due to floating rate assets (2)**



Source: Company data, Credit Suisse research

Should benefit in a falling interest rate environment

LICHF could now benefit in an environment of easing interest rates

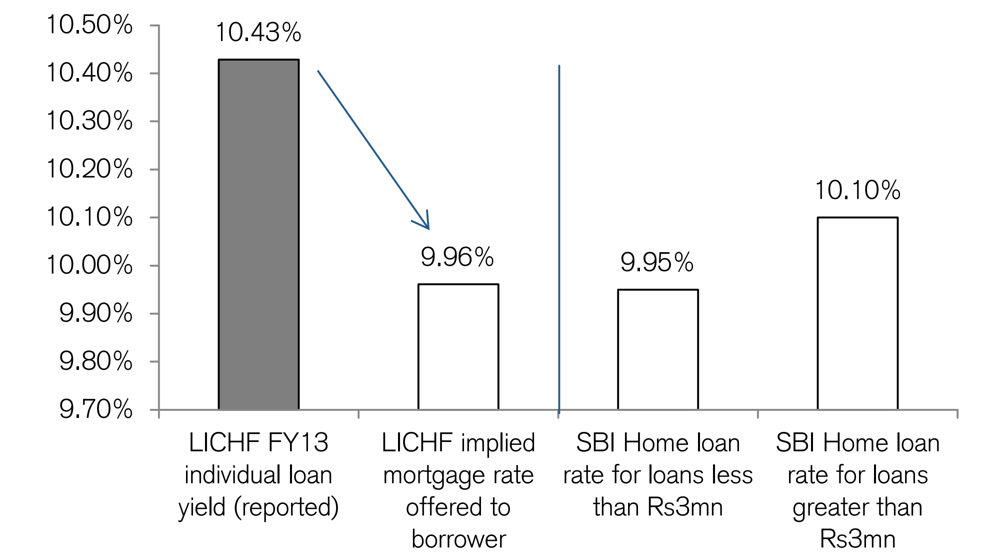
On the flip side, LICHF could now benefit in an environment of easing interest rates.

Even if we assume that the interest rates in the economy do not come down incrementally over the near term, LICHF could still benefit, as we see below.

Yield on back book is at par with current aggressive bank rates

First, we note that the yield on back book for LICHF is at par with the current new home loan rates offered by banks. Thus, there is negligible risk of yields compressing when the fixed-rate loans come up for floating repricing. It is important to note that ~80% of the old 'teaser' loan portfolio of LICHF has already been repriced to floating rate.

Figure 65: **LICHF already running back book at par with incremental aggressive lending rates of banks**



Source: Company data, Credit Suisse research

In the previous section we argued that the scope for banks to cut rates further is limited (without any changes to general interest rates).

Bank borrowings being replaced by lower-cost NCDs

We note that LICHF has been increasingly sourcing funds through NCDs at a lower rate than bank term-loan rates (even below base rates of banks). In FY13, NCDs accounted for nearly 74% of incremental funds for the company.

LICHF has been increasingly sourcing funds through NCDs at a lower rate than bank term-loan rates

Figure 66: **Rising importance of non-bank sources of funding**

Outstanding sources of funding	FY12	FY13
Bank	31.8%	29.8%
NCD + ZCB	57.7%	60.6%
Sub. debt and upper Tier 2	5.3%	4.3%
Deposits	0.5%	0.9%
LIC	1.0%	0.4%
NHB	3.3%	3.6%
Misc.	0.5%	0.3%
Cost of borrowings	**FY12**	**FY13**
Bank	11.1%	10.6%
NCD + ZCB	9.2%	9.4%
Sub. debt and upper Tier 2	8.9%	8.9%
Deposits	9.2%	9.6%
LIC	6.8%	6.8%
NHB	8.0%	9.0%
Misc.	8.0%	7.6%
Blended	**9.7%**	**9.8%**

Source: Company data, Credit Suisse research

Figure 67: **NCDs accounted for ~75% of incremental funds for LICHF**

Share of incremental borrowing	
Borrowing instrument	**FY13**
Bank	21.0%
NCD + ZCB	73.6%
Sub. debt and upper Tier 2	-0.4%
Deposits	3.0%
LIC	-2.0%
NHB	5.2%
Misc.	-0.3%
Total	100.0%

Source: Company data, Credit Suisse research

While the lowest yield at which LICHF sold its NCDs in FY13 was 9.1% (10-year money), management on the recent earnings call announced that in a deal in early April 2013, the company closed a 10-year NCD issue at a 8.9% rate.

While the lowest yield at which LICHF sold its NCDs in FY13 was 9.1% (10-year money), management on the recent earnings call announced that in a deal in early April 2013, the company closed a ten-year NCD issue at a 8.9% rate

LICHF should see 10 bp fall in cos of funds each of next three years (assuming no changes to interest rates)

Assuming that LICHF is able to raise NCDs incrementally at 9% (including the existing NCDs maturing), our analysis shows that LICHF should see an average 10 bp fall in cost of borrowing in each of the next three years.

Figure 68: **Cost of borrowing for LICHF should trend lower (assuming no further changes to any interest rates)**

Borrowing instrument (% composition)	FY12	FY13	FY14E	FY15E	FY16E
Bank	31.8%	29.8%	27.8%	25.8%	23.8%
NCD + ZCB	57.7%	60.6%	62.6%	64.6%	66.6%
Sub. debt and upper Tier 2	5.3%	4.3%	4.3%	4.3%	4.3%
Deposits	0.5%	0.9%	0.9%	0.9%	0.9%
LIC	1.3%	0.4%	0.4%	0.4%	0.4%
NHB	3.3%	3.6%	3.6%	3.6%	3.6%
Misc.	0.1%	0.3%	0.3%	0.3%	0.3%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Wtd avg cost of borrowing	**FY12**	**FY13**	**FY14E**	**FY15E**	**FY16E**
Bank	11.1%	10.6%	10.6%	10.6%	10.6%
NCD + ZCB	9.2%	9.4%	9.3%	9.2%	9.1%
Sub. debt and upper Tier 2	8.9%	8.9%	8.9%	8.9%	8.9%
Deposits	9.2%	9.6%	9.6%	9.6%	9.6%
LIC	6.8%	6.8%	6.8%	6.8%	6.8%
NHB	8.0%	9.0%	9.0%	9.0%	9.0%
Misc.	8.0%	7.6%	7.6%	7.6%	7.6%
Total	9.72%	9.76%	9.65%	9.53%	9.47%

Source: Company data, Credit Suisse estimates

Expect NIM expansion

In our estimates, we assume a 20 bp NIM expansion for LICHF in each of the next two years.

We assume a 20 bp NIM expansion for LICHF in each of the next two years

Figure 69: **We build in a 40 bp NIM expansion over the next three years**

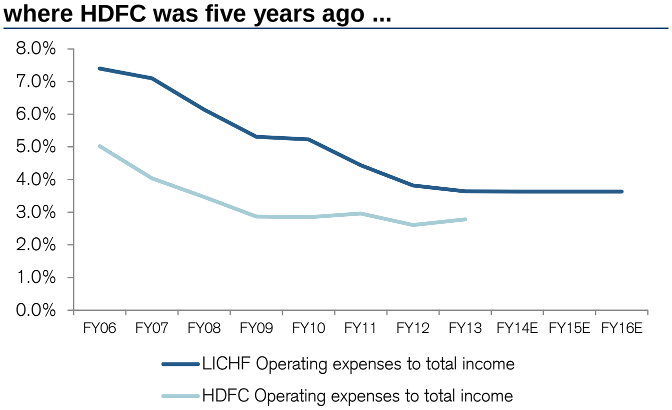
	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Yield on total assets	10.4%	9.4%	9.6%	10.1%	10.2%	10.2%	10.2%	10.2%
Cost of Funds on total assets	7.6%	6.9%	6.7%	7.8%	8.1%	7.9%	7.7%	7.7%
NIM on total assets	2.8%	2.5%	3.0%	2.4%	2.1%	2.3%	2.5%	2.5%
NIM on loan assets	2.9%	2.7%	3.1%	2.4%	2.2%	2.4%	2.6%	2.6%

Source: Company data, Credit Suisse estimates

Improving cost efficiency over the last few years

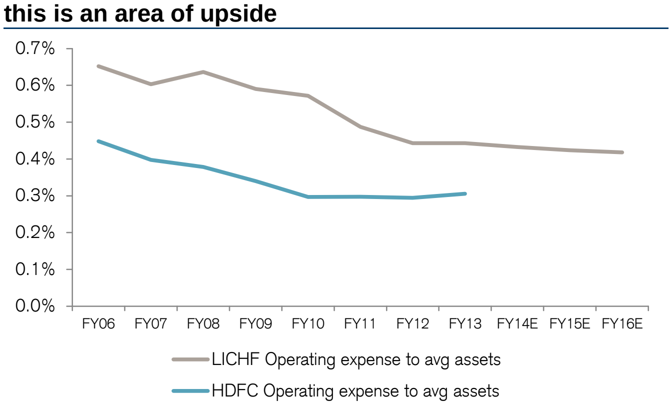
With growing size, we note that LICHF has been improving significantly on cost efficiency. With further growth, while this trend could continue, we assume no further operating efficiency benefits for the company.

Figure 70: **LICHF's operating cost levels are at the level where HDFC was five years ago ...**



Source: Company data, Credit Suisse estimates

Figure 71: **… we build no further savings on opex, and this is an area of upside**



Source: Company data, Credit Suisse estimates

Expect stable asset quality

While LICHF has seen a spurt in NPAs in its developer loan portfolio (~10% of developer loans), the impact on overall loan book remains limited due to the small size of this portfolio. Going forward, we build in stable NPA levels.

Reversal of teaser loan provisions to help keep credit costs low

Over the next 12-15 months, LICHF could potentially writeback provisions amounting to Rs2,470 mn (related to 2% provision for teaser loans mandated by the NHB). The company can write back these provisions if even after one year of repricing to floating rates, these teaser loans remain standard. With an increase in specific provision coverage ratio assumed, the total coverage ratio (including teaser and standard assets) in our model remains 135%-plus of GNPA for the next three years (versus 147% for FY13). We believe this is a fairly conservative assumption.

Over the next 12-15 months, LICHF could potentially writeback provisions amounting to Rs2,470 mn (related to 2% provision for teaser loans mandated by the NHB)

Figure 72: **Expect total coverage ratio to remain at ~140% of GNPA for the next three years**

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Coverage ratio	81%	82%	84%	68%	41%	50%	60%	60%
Total coverage ratio*	81%	82%	200%	243%	147%	138%	138%	136%
NNPA	0.21%	0.12%	0.08%	0.13%	0.35%	0.30%	0.24%	0.24%
Credit costs (% of assets)	0.0%	-0.1%	0.6%	0.3%	0.1%	0.1%	0.1%	0.1%

** Including teaser and standard assets.*

Source: Company data, Credit Suisse estimates

Capital adequacy comfortable

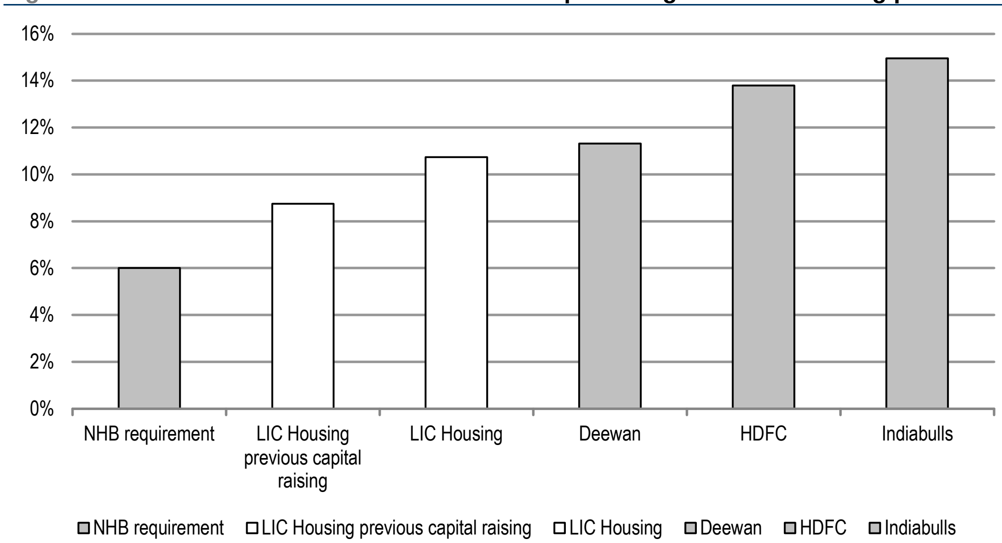
At ~11%, LICHF's Tier 1 ratio remains comfortable above the NHB requirement of 6%. We note that the last time the company raised equity when Tier 1 ratio hit 8.75%.

Figure 73: **Comfortable on capital adequacy**

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Tier 1 ratio	9.2%	10.3%	9.0%	11.0%	10.7%	10.9%	10.4%	10.0%
Tier 2 ratio	4.3%	4.7%	6.0%	5.7%	5.1%	4.9%	4.8%	4.7%
Capital adequacy ratio	13.5%	14.9%	15.0%	16.7%	15.8%	15.8%	15.2%	14.8%

Source: Company data, Credit Suisse estimates

Figure 74: **LICHF's Tier 1 ratio is comfortable despite being the lowest among peers**



Source: Company data, Credit Suisse research

Expect improving return profile

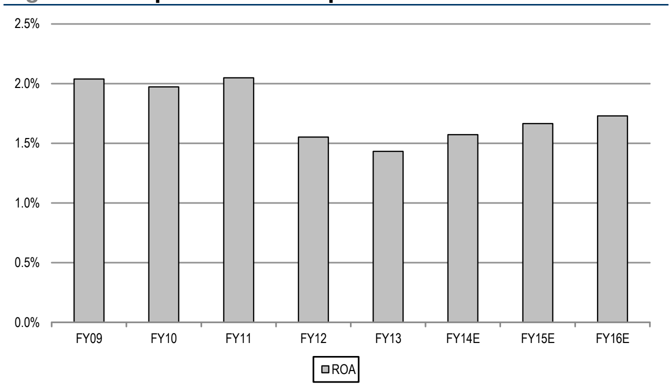
With improving NIM and stable operating/credit costs, our expectation is for the company to return to 20%-plus RoE levels over the next few years.

Figure 75: **DuPont analysis**

	FY09	FY10	FY11	FY12	FY13	FY14E	FY15E	FY16E
Interest income / total assets	10.4%	9.4%	9.6%	10.1%	10.2%	10.2%	10.2%	10.2%
Interest expense / total assets	7.6%	6.9%	6.7%	7.8%	8.1%	7.9%	7.7%	7.7%
NII / total assets	2.8%	2.5%	3.0%	2.4%	2.1%	2.3%	2.5%	2.5%
Fee income / total assets	0.5%	0.5%	0.3%	0.3%	0.3%	0.3%	0.2%	0.2%
Other income / total assets	0.1%	0.0%	0.5%	0.2%	0.1%	0.1%	0.1%	0.1%
Opex / total assets	0.6%	0.6%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%
Credit cost / total assets	0.0%	-0.1%	0.6%	0.3%	0.1%	0.1%	0.1%	0.1%
Pretax profit / total assets	2.7%	2.6%	2.8%	2.1%	1.9%	2.1%	2.2%	2.3%
Taxes / total assets	0.8%	0.8%	0.7%	0.5%	0.5%	0.5%	0.6%	0.6%
ROA	2.0%	2.0%	2.0%	1.6%	1.4%	1.6%	1.7%	1.7%
Avg leverage	12.8	12.2	12.2	12.0	12.0	12.1	12.0	12.2
RoE	26.1%	24.1%	24.9%	18.6%	17.1%	19.0%	20.0%	21.1%

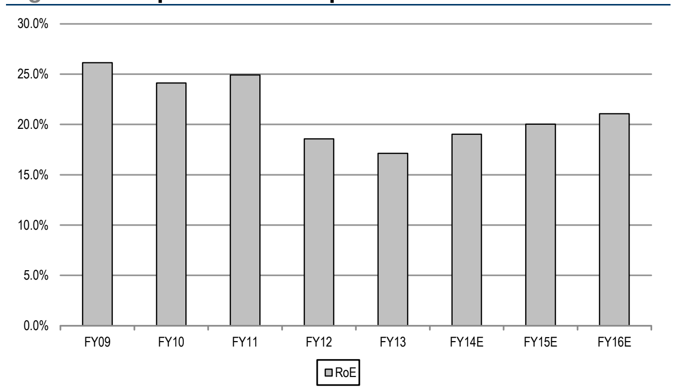
Source: Company data, Credit Suisse estimates

Figure 76: **Expect ROA to improve to 1.7%**



Source: Company data, Credit Suisse estimates

Figure 77: **Expect ROE to improve from 17.1% to 21.1%**



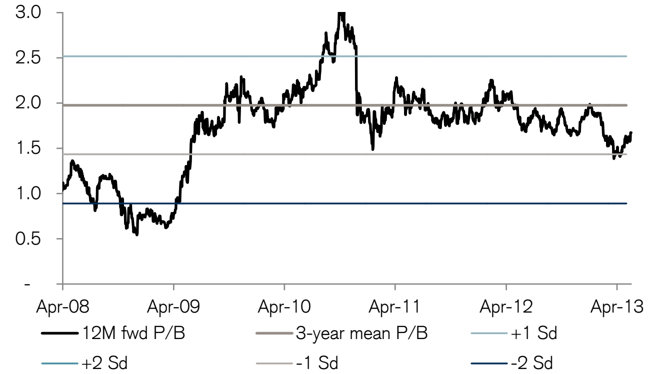
Source: Company data, Credit Suisse estimates

Valuation looks attractive

On our FY14/FY15 estimates, the LICHF stock is trading at 1.8x/1.5x P/B, which appears inexpensive compared with the three year mean of 2.0x (one-year forward on consensus). Even on P/E basis, stock appears cheap at 10.1/8.1 FY14E/FY15E (compared with three-year historical mean of 10x). The stock's current discount to HDFC on P/B at 66% is also higher than the three-year average of 56%. Also, we expect re-rating for LICHF as its ROA/ROE improves back from 1.4%/17.1% to 1.7%/21.1% over the next 3 years.

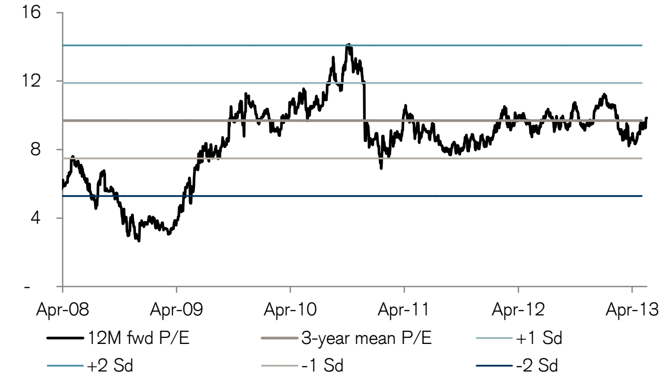
LICHF stock is trading at 1.8x/1.5x P/B, which appears inexpensive compared with the three-year mean of 2.0x

Figure 78: LIC Housing is trading below its five-year mean one-year forward P/B



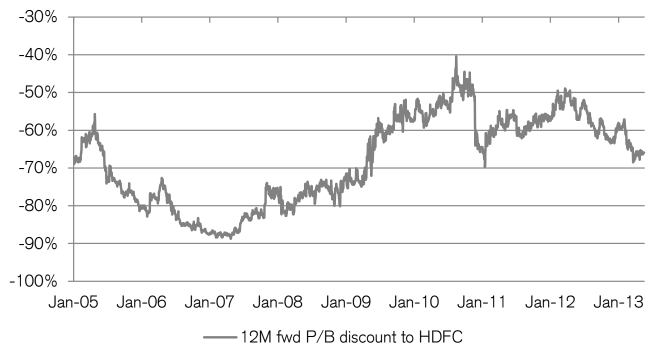
Source: IBES, Credit Suisse estimates

Figure 79: LIC Housing finance—one-year forward P/E band



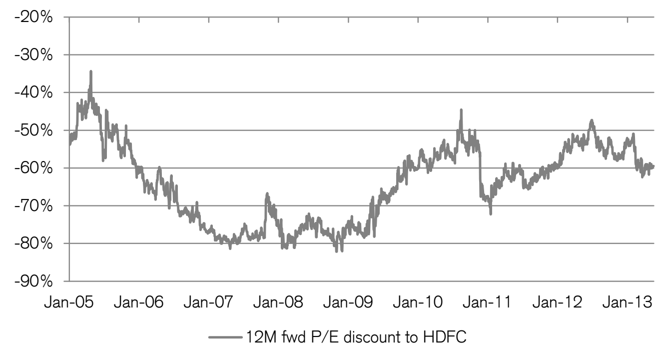
Source: IBES, Credit Suisse estimates

Figure 80: One-year forward P/B discount to HDFC



Source: IBES, Credit Suisse estimates

Figure 81: One-year forward P/E discount to HDFC



Source: IBES, Credit Suisse estimates

Initiate with an OUTPERFORM rating and Rs365 target price

Our 12-month forward target price of Rs365 is based on a P/B multiple of 2.0x (similar to the historical average) on our 24-month forward book value of Rs183. Our target price implies 32% potential upside from current levels.

We initiate coverage on LICHF with an OUTPERFORM rating.

Investment risks

The key risks to our OUTPERFORM rating and Rs365 target price include:

- With its sizeable fixed-rate loan exposure (versus floating-rate loans of competition), LICHF risks further compression in margins if interest rates tighten sharply in the market.
- While we expect no further increase in competitive aggression from banks, banks could sacrifice profitability and turn more aggressive on pricing. This could impact LICHF's market position.
- The developer and LAP portfolios for LICHF are currently small (less than 10% of loan book). However, if these segments grow fast, there could be asset quality risks in such untested areas for LICHF.
- LICHF has seen frequent management changes in the past, with senior management appointed by parent LIC. This could lead to the risk of frequent strategy changes.

Financial Summary

Figure 82: **Income statement**

Rs mn (year-end 31 March)	FY11	FY12	FY13A	FY14E	FY15E	FY16E
Net interest income (NII)	**13,720**	**13,916**	**15,345**	**20,545**	**26,391**	**32,566**
Fee income	1,501	1,322	1,168	1,424	1,710	2,047
Other non-interest income	2,549	1,297	1,704	1,714	2,040	2,242
Non-interest income	**4,050**	**2,619**	**2,873**	**3,137**	**3,749**	**4,289**
Total income	**17,770**	**16,535**	**18,218**	**23,683**	**30,140**	**36,855**
Operating expenses	2,261	2,623	3,247	3,851	4,528	5,325
Pre-provisioning profits	**15,508**	**13,912**	**14,971**	**19,831**	**25,612**	**31,530**
Provisions for contingencies	2,609	1,561	790	906	1,563	1,692
PBT	**12,899**	**12,351**	**14,180**	**18,925**	**24,049**	**29,837**
Tax	3,207	3,188	3,640	4,858	6,174	7,660
Share of Assoicates/Minorities	-181	32	-51	-51	-51	-51
PAT	**9,512**	**9,195**	**10,489**	**14,015**	**17,824**	**22,126**

Source: Company data, Credit Suisse estimates

Figure 83: **Balance sheet**

Rs mn (year-end 31 March)	FY11	FY12	FY13A	FY14E	FY15E	FY16E
Equity capital	41,916	57,102	65,334	81,926	96,159	113,828
Borrowed funds	451,628	560,873	687,660	829,478	992,783	1,188,490
Current liabilities and provisions	25,055	31,367	43,584	52,412	62,576	74,756
Provision for NPA	7,099	9,102	9,902	11,321	13,577	16,100
Total liabilities	**525,698**	**658,445**	**806,480**	**975,137**	**1,165,094**	**1,393,173**
Investments	1,735	1,717	1,950	1,950	1,950	1,950
Loans and advances	510,898	630,802	778,120	938,594	1,123,381	1,344,832
Cash and bank balances	5,865	16,464	15,235	23,277	28,278	34,697
Other current assets	5,016	6,512	7,955	8,093	8,249	8,430
Fixed assets	486	741	732	734	748	775
Deferred tax asset	1,698	2,208	2,489	2,489	2,489	2,489
Total assets	**525,698**	**658,445**	**806,480**	**975,137**	**1,165,094**	**1,393,173**

Source: Company data, Credit Suisse estimates

Figure 84: **Key ratios**

	FY11	FY12	FY13A	FY14E	FY15E	FY15E
Growth (YoY) (%)						
Borrowed funds	29.9%	24.2%	22.6%	20.6%	19.7%	19.7%
Advances	34.2%	23.5%	23.4%	20.6%	19.7%	19.7%
Total assets	30.4%	25.3%	22.5%	20.9%	19.5%	19.6%
NII	54.7%	1.4%	10.3%	33.9%	28.5%	23.4%
Non-interest income	110.3%	-35.3%	9.7%	9.2%	19.5%	14.4%
Operating expenses	13.5%	16.0%	23.8%	18.6%	17.6%	17.6%
Operating profits	76.2%	-10.3%	7.6%	32.5%	29.1%	23.1%
Core operating profits	50.2%	-1.2%	9.5%	34.4%	28.8%	23.4%
Provisions including write-offs	nm	-40.2%	-49.3%	14.7%	72.5%	8.3%
PAT (Pre-extraordinaries)	38.3%	-3.3%	14.1%	33.6%	27.2%	24.1%
Adj. PAT	38.3%	-3.3%	14.1%	33.6%	27.2%	24.1%
Reported PAT	38.3%	-3.3%	14.1%	33.6%	27.2%	24.1%
Yields / margins (%)						
Interest spread (%)	2.3%	1.4%	1.1%	1.3%	1.5%	1.6%
NIM (%) [standalone]	3.1%	2.4%	2.2%	2.4%	2.6%	2.6%
Profitability (%)						
ROA (%)	2.0%	1.6%	1.4%	1.6%	1.7%	1.7%
ROE (%)	24.9%	18.6%	17.1%	19.0%	20.0%	21.1%
Cost to income (%)	16.5%	18.9%	21.2%	18.7%	17.2%	16.4%
Assets quality (%) [standalone]						
Gross NPAs (%)	0.5%	0.4%	0.6%	0.6%	0.6%	0.6%
Net NPAs (%)	0.1%	0.1%	0.4%	0.3%	0.2%	0.2%
Capital adequacy (%)						
Tier I (%)	9.0%	11.0%	10.7%	10.9%	10.4%	10.0%
CAR (%)	15.0%	16.7%	15.8%	15.8%	15.2%	14.8%

Source: Company data, Credit Suisse estimates

Figure 85: **Du Pont analysis**

	FY11	FY12	FY13A	FY14E	FY15E	FY16E
NII / assets (%)	3.0%	2.4%	2.1%	2.3%	2.5%	2.5%
Other income / assets (%)	0.9%	0.4%	0.4%	0.4%	0.4%	0.3%
Total income / assets (%)	3.8%	2.8%	2.5%	2.7%	2.8%	2.9%
Cost to assets (%)	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%
PPP / assets (%)	3.3%	2.3%	2.0%	2.2%	2.4%	2.5%
Provisions / assets (%)	0.6%	0.3%	0.1%	0.1%	0.1%	0.1%
ROA (%)	2.0%	1.6%	1.4%	1.6%	1.7%	1.7%

Source: Company data, Credit Suisse estimates

Housing Development Finance Corp (HDFC.BO / HDFC IN)

Rating	**OUTPERFORM***
Price (17 May 13, Rs)	903.50
Target price (Rs)	(from 903.00) 1,045.00[1]
Upside/downside (%)	15.7
Mkt cap (Rs mn)	1,397,889 (US$
Number of shares (mn)	1,547.19
Free float (%)	90.0
52-week price range	909.8 - 634.8
ADTO - 6M (US$ mn)	39.4

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.

Research Analysts

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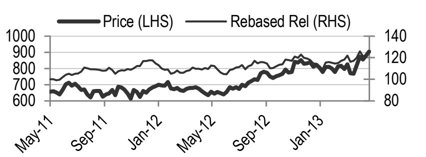
Improving competitiveness

- **Beneficiaries of falling bond yields.** Bond markets are now the prime funding source (~56%) for HDFC versus 42% in FY11. The bank borrowings have dropped from 37% to 11% during the same period. The easing bond yield cycle is driving a rapid drop in HDFC's funding costs. In recent weeks, HDFC's incremental funding cost in bond markets has been 8.5%.
- **HDFC in a sweet spot in the mortgage segment.** The structural growth story in India's mortgage segment remains strong and the HFCs continue to be the most efficient and profitable players in the segment. One of the common concerns about HFCs has been the potential increase in competitive intensity from the banks. However, banks in India have migrated to a base-rate regime in the past two years and are not allowed to lend below that. Bank mortgage rates are already close to their base rates and therefore room for competitive pricing is limited without a sharp cut in base rate. Given the likely pressure on NIMs from sharp base rate cuts, stickiness in retail deposit rates and bank funding costs, base rate cuts are unlikely to match the bond yield drop
- **Business momentum has remained robust.** Even as interest rates and mortgage rates increased sharply, loan growth at HDFC continued to remain healthy. Retail growth momentum has remained intact (up 25% YoY in FY13), contributing 80% of incremental loan growth in FY13. This compares to 15% mortgage loan growth for banks in FY13. Despite slowdown in cities like Mumbai, growth from other urban centres and demand from Tier-II cities remains strong. Further, its distribution strength has increased with expansion in the number of HDFC Bank's branches (54% increase in last 2 years). It has also added to its distribution strength with sourcing arrangement from IndusInd and Ratnakar banks, which will help accelerate its growth.
- **Increase TP to Rs1,045:** We raise our TP for HDFC to Rs1,045 as with improved competitiveness and wholesale funding rates now ~25 bp lower than the retail deposit rates, its P/E discount to retail banks should moderate. We value HDFC's core business at 16.5x P/E (ten-year historical average) on FY15 earnings. We reiterate OUTPERFORM.

Share price performance



The price relative chart measures performance against the S&P BSE SENSEX IDX which closed at 20212.96 on 15/05/13
On 15/05/13 the spot exchange rate was Rs54.78/US$1

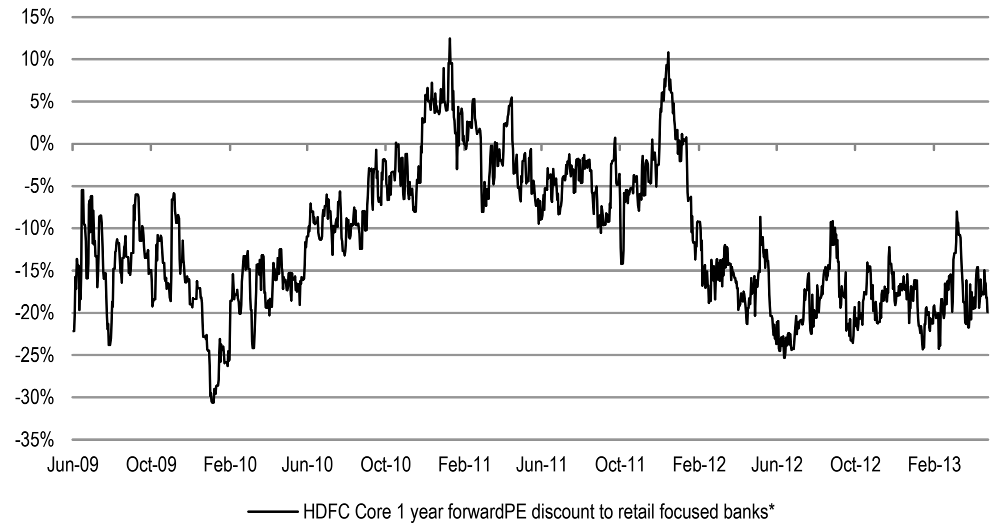
Performance Over	1M	3M	12M
Absolute (%)	10.4	9.9	42.4
Relative (%)	3.1	6.0	16.1

Financial and valuation metrics

Year	3/12A	3/13E	3/14E	3/15E
Pre-prov Op profit (Rs mn)	54,742.4	67,958.0	81,856.3	96,941.7
Pre -tax profit (Rs mn)	56,644.3	66,158.3	80,038.5	94,822.6
Net attributable profit (Rs mn)	41,214.3	48,494.0	58,268.1	68,746.4
EPS (CS adj.) (Rs)	28.00	32.08	37.68	44.46
Change from previous EPS (%)	n.a.	-1.3	-1.7	-1.6
Consensus EPS (Rs)	n.a.	31.5	36.6	43.2
EPS growth (%)	15.0	14.6	17.5	18.0
P/E (x)	32.3	28.2	24.0	20.3
Dividend yield (%)	1.4	1.6	1.8	1.8
CS adj. BVPS (Rs)	128.8	161.7	181.0	208.6
P/B (x)	7.02	5.59	4.99	4.33
ROE (%)	22.7	22.0	22.0	22.8
ROA (%)	2.7	2.6	2.7	2.7
Tier 1 Ratio (%)	11.6	13.3	12.7	12.4

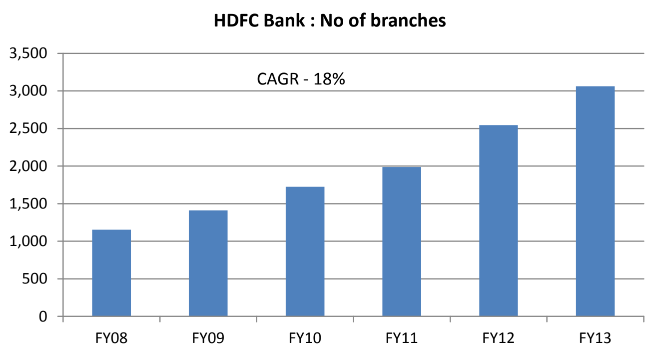
Source: Company data, Thomson Reuters, Credit Suisse estimates.

Figure 86: Discount to peer private retail banks should moderate going ahead



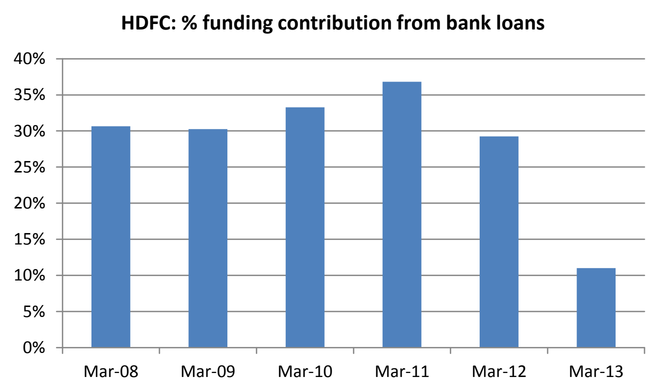
*Source: Company data, Credit Suisse estimates, * retail banks – HDFC Bank, Kotak, IndusInd,*

Figure 87: HDFC Bank expansion is leading to increasing distribution strength



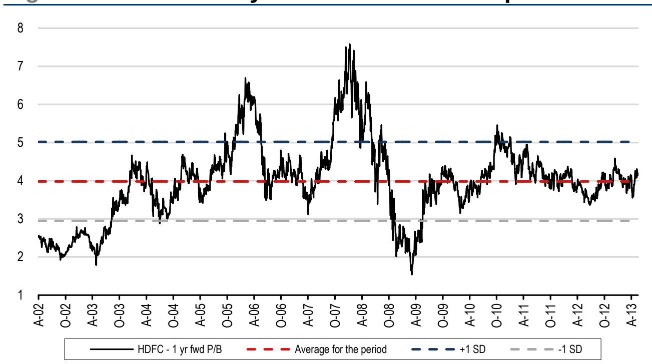
Source: Company data, Credit Suisse estimates

Figure 88: HDFC funding from banks has dropped



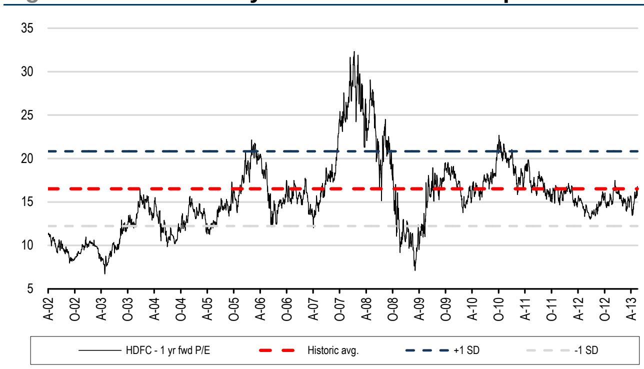
Source: Company data, Credit Suisse estimates

Figure 89: HDFC one-year forward P/B multiple



Source: IBES, Credit Suisse estimates

Figure 90: HDFC one-year forward P/E multiple



Source: IBES, Credit Suisse estimates

Figure 91: **SOTP valuations**

Sum of parts	Basis	Multiple	Year	Rs/sh
Core mortgage business	PE	16.5	FY15	650
HDFC Bank	Target price		FY15	286
Asset Management	AUM	5.0%	FY15	26
Private equity	AUM	7.5%	FY15	2
Life insurance	NBAP	16	FY15	50
Non-life insurance	BV	2	FY15	7
Gruh	Mkt Price			15
HDFC target price				**1045**

Source: Credit Suisse estimates.

CREDIT SUISSE

Companies Mentioned *(Price as of 17-May-2013)*

Axis Bank Limited (AXBK.BO, Rs1532.8)
Bank of Baroda (BOB.BO, Rs738.75)
Bank of India (BOI.BO, Rs324.9)
DHFL (DWNH.NS, Rs174.45)
GICHFL (GICH.NS, Rs118.95)
Gruh Finance (GRUH.NS, Rs229.75)
HDFC Bank (HDBK.BO, Rs718.7)
Housing Development Finance Corp (HDFC.BO, Rs903.5, OUTPERFORM, TP Rs1045.0)
ICICI Bank (ICBK.BO, Rs1228.6)
ING Vysya Bank (VYSA.BO, Rs621.15)
Indiabulls (IBUL.BO, Rs272.3)
Indiabulls (IBUL.BO^E13, Rs272.3)
Indiabulls (IBUL.BO^E13, Rs272.3)
Indiabulls (IBUL.BO^E13, Rs272.3)
Indiabulls (IBUL.BO^E13, Rs272.3)
Indiabulls (IBUL.BO^E13, Rs272.3)
Indian Overseas Bank (IOBK.BO, Rs64.05)
IndusInd Bank (INBK.BO, Rs511.15)
Infrastructure Development Finance Co Ltd (IDFC.BO, Rs163.4)
Jammu and Kashmir Bank (JKBK.BO, Rs1318.25)
Kotak Mahindra Bank Ltd (KTKM.BO, Rs791.6)
L&T Finance Holdings Limited (LTFH.BO, Rs82.7)
LIC Housing Finance Ltd (LICH.BO, Rs275.65, OUTPERFORM, TP Rs365.0)
Mahindra and Mahindra Financial Services Ltd (MMFS.BO, Rs242.6)
Punjab National Bank Ltd (PNBK.BO, Rs834.75)
Reliance Capital Ltd (RLCP.BO, Rs374.1)
Shriram Transport Finance Co Ltd (SRTR.BO, Rs789.2)
State Bank Of India (SBI.BO, Rs2424.6)
Union Bank of India (UNBK.BO, Rs243.5)
Yes Bank Ltd (YESB.BO, Rs542.3)

Disclosure Appendix

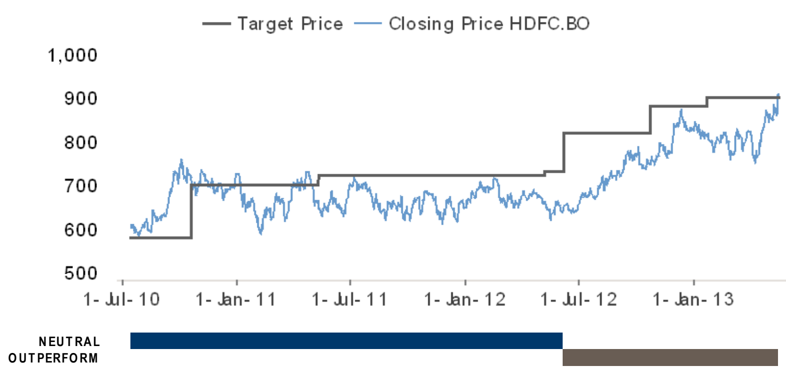
Important Global Disclosures

Sunil Tirumalai and Ashish Gupta, each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Price and Rating History for Housing Development Finance Corp (HDFC.BO)

HDFC.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating
15-Jul-10	609.35	582.00	N
19-Oct-10	720.50	702.00	
11-May-11	665.55	725.00	
07-May-12	663.55	732.00	
07-Jun-12	655.05	821.00	O
22-Oct-12	750.50	882.00	
21-Jan-13	814.50	903.00	

** Asterisk signifies initiation or assumption of coverage.*



The analyst(s) responsible for preparing this research report received Compensation that is based upon various factors including Credit Suisse's total revenues, a portion of which are generated by Credit Suisse's investment banking activities

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark*over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and non-Japan Asia stocks, ratings* *are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; Australia, New Zealand are, and prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.*

Restricted (R) : In certain circumstances, Credit Suisse policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of Credit Suisse's engagement in an investment banking transaction and in certain other circumstances.

Volatility Indicator [V] : A stock is defined as volatile if the stock price has moved up or down by 20% or more in a month in at least 8 of the past 24 months or the analyst expects significant volatility going forward.

Analysts' sector weightings are distinct from analysts' stock ratings and are based on the analyst's expectations for the fundamentals and/or valuation of the sector* relative to the group's historic fundamentals and/or valuation:

Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.

Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.

Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.

**An analyst's coverage sector consists of all companies covered by the analyst within the relevant sector. An analyst may cover multiple sectors.*

Credit Suisse's distribution of stock ratings (and banking clients) is:

Global Ratings Distribution

Rating	Versus universe (%)	Of which banking clients (%)
Outperform/Buy*	42%	(53% banking clients)
Neutral/Hold*	39%	(47% banking clients)
Underperform/Sell*	15%	(39% banking clients)
Restricted	3%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Price Target: (12 months) for LIC Housing Finance Ltd (LICH.BO)

Method: Our target price of Rs 365 is based on a P/B multiple of 2.0x on our 24M forward book value of Rs183

Risk: Risks to our target price of Rs 365 are: 1) a slowdown in mortgages 2) reversal of declining interest rate scenario 3) frequent management changes

Price Target: (12 months) for Housing Development Finance Corp (HDFC.BO)

Method: Our Rs1045 target price for Housing Development Finance Corp. (HDFC) is derived using a sum-of-the-parts method, with the mortgage lending business at 16.5x FY15E earnings. We are ascribing a value of Rs286 to HDFC's share of HDFC Bank, based on our target price for HDFC Bank, Rs 50 for the life insurance and Rs52 for the other subsidiaries.

Risk: Risks that may impede achievement of our target price of Rs1045 for Housing Development Finance Corp (HDFC) include: (1) slowing equity markets, which would impact the growth and valuation of the life insurance and asset management businesses; and (2) a slowdown in mortgages.

Please refer to the firm's disclosure website at www.credit-suisse.com/researchdisclosures for the definitions of abbreviations typically used in the target price method and risk sections.

See the Companies Mentioned section for full company names

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