

HFCs Update

Defensiveness merits premium

HFC stocks have underperformed the Bankex by more than 15% YTD, on increased competition and regulatory concerns, with investors expecting spreads to fall and growth to slow. Whilst we think spreads can indeed fall, we still expect 15% ROE from the retail business with c.2%-5% ROE being added by the corporate business and hence a blended 18-20% ROE. So we believe HFCs offer robust ROEs married with highly defensive business models, the lowest sector credit costs and >20% growth rates - a pretty compelling combination. Hence we still like the sector and highlight LICHF as our top pick. We regard HDFC highly, but we're Neutral give sub 10% upside. DEWH has the highest upside potential but perceived governance issues remain an overhang.

Environment is challenging...

Given recent change in regulations, with the abolition of prepayment penalties, standard rates for new and existing borrowers and with expectation of an increase in capital requirements, the regulatory environment is challenging for the HFCs. The situation has been further exacerbated by increased competition from the banking system, which needs new avenues of growth, hence our concerns of a slowdown in growth and of HFCs' profitability.

...however we still find the sector attractive

Regulatory concerns overdone: In our opinion much of the concern is overdone, given that changes in prepayments and standard interest rates were brought in by the regulators 12 months ago, and in last three quarters results since then we have not seen any deterioration. At the same time the regulator has specifically come out and clarified that capital requirements will not be increased. There have been positive developments around PSL status being retained for on lending to HFCs (up to 10 lakhs) and an increase in limits of funding available from mutual funds.

Increased competition may indeed cause some reduction in profitability of HFCs, perhaps a c.200bps reduction in ROEs by our calculations, however we think ROEs will remain high at >17%-18%. We also expect growth to remain in excess of 20% for the companies, given housing finance is one of the very few structural growth sectors and that growth does come at the expense of credit quality, with NPLs remaining low. All in all we see an attractive sector which offers consistent c.18% ROE (22%+ for HDFC) with negligible volatility in earnings and >20% growth rates.

Valuations

Baring HDFC, HFCs are trading at a discount to NBFCs with similar RoEs and growth expectations, which we expect to reverse given the defensiveness and structural growth drivers of the sector. HDFC's core mortgage book (stripping out movement in HDFC Bank) has underperformed YTD and the core mortgage book is trading at one standard deviation below its mean. However, we do not see significant upside given our expectation of some reduction in spreads and hence we remain Neutral with a revised FV of Rs.837 (increase in FV from Rs.722 is due to rollover to FY14). LICHF is trading at 1.5x FY14E book value, a more than 50% discount to HDFC, and is our top pick with our view that NIMs will now increase after several quarters of pressure. DEWH is trading at 0.9x FY14E book and offers the highest upside in the space, but comes with the caveat of perceptions around corporate governance.

Housing Dev Fin

NEUTRAL 7% upside
Fair Value Rs837.06

Bloomberg ticker	HDFC IN
Share Price	Rs779.35
Market Capitalisation	Rs1,160,647.77m
Free Float	100%

LIC Housing Finance

BUY 26% upside
Fair Value Rs308.30

Bloomberg ticker	LICHF IN
Share Price	Rs245.40
Market Capitalisation	Rs123,844.30m
Free Float	65%

Dewan Housing Finance

BUY 52% upside
Fair Value Rs287.03

Bloomberg ticker	DEWH IN
Share Price	Rs189.35
Market Capitalisation	Rs22,168.61m
Free Float	45%

Source: Espirito Santo Investment Bank Research, Company Data, Bloomberg

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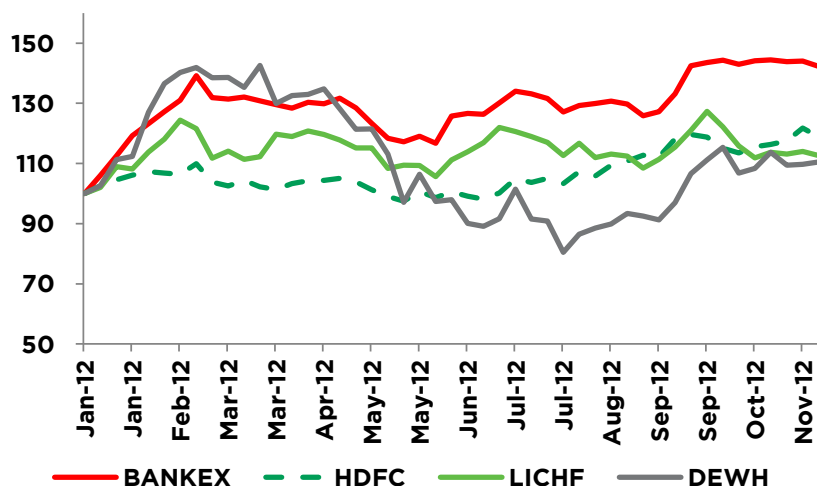
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Housing finance companies have underperformed

Housing finance companies have underperformed YTD given the concerns around:

- Tightening regulatory environment
- Expectation of deterioration in operating environment given competition.

Figure 1 HFCs have underperformed Bankex YTD



Source: Espirito Santo Investment Bank Research, Company Data

We remain bullish on the prospects of the housing finance companies and highlight these as some of the most defensive stocks in the financial sector, but that defensiveness does not come at the expense of growth.

Regulatory environment was challenging but limited impact

There have been many regulatory changes in housing finance over the last year, e.g. a) the abolition of prepayment penalties; b) reduction in LTV cap to 80% and c) standard interest rates for old and new loans etc. It was expected that as a result of these changes there could be deterioration in the operating environment as investors expected more churn and a reduction in spreads. After more than three quarters since these regulations were implemented, we have analysed if there has been any deterioration in the operating environment for the companies, and we conclude that;

- Prepayments have remained stable:** As is visible from figures 2 and 3, there has been no increase in prepayments for either LIC Housing or Dewan Housing who disclose numbers on a quarterly basis. We do not expect HDFC to be any different either.
- Reduction in spreads:** Given that National Housing Bank (NHB) prescribed that old and new loans are to be priced at a same rate, there were concerns that spreads in the business would fall significantly. Although we do expect some reduction in spreads for some of the housing finance companies in the longer term, with higher yielding existing loans (spreads of around 2%) fully replaced by lower spread new loans (spread of c.1.75%), in the near term we have not seen any reduction in spreads due to reduction in rates in the individual housing loan segment. LICHF was the only one where spreads have reduced meaningfully, however that is solely due to its corporate loan book and re-pricing of liabilities at a higher rate. We have not seen any reduction in yields on individual loans.

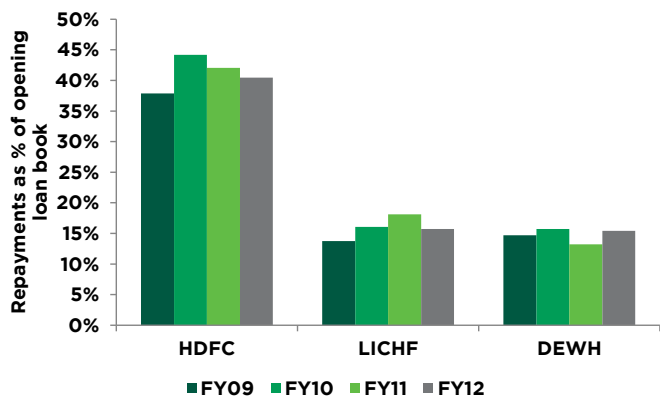
There are concerns that the regulatory environment in the housing finance space may become more restrictive in the future, with an increase in tier-1 capital requirements. Whilst we believe that there is an arbitrage for HFC stocks and this may be removed in future with an increase in tier 1 capital



requirements (from current Tier-1 requirement of 6% to 10%), so far NHB has clearly specified that it is not planning to increase HFCs' tier-1 capital requirements in the near term ([see link attached](#)). Also, there has been some relaxation from the RBI on classification of PSL loans by banks to HFCs, where the RBI had earlier removed the PSL classification to these types of loans, but has now again provided PSL status to certain types of loans (loans up to 10lac).

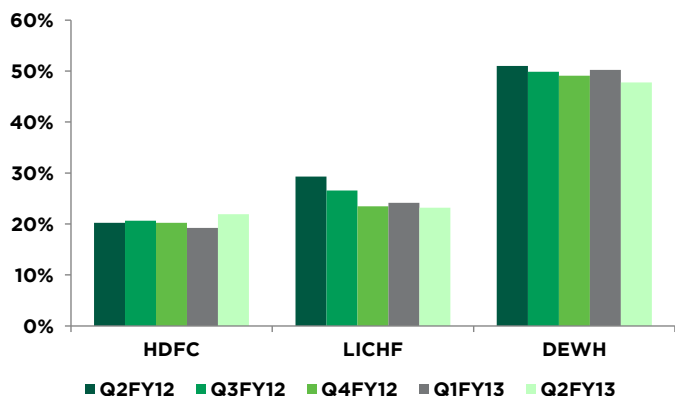
Hence on the regulatory front, although there could be some tightening from its earlier position, in the foreseeable future the sector participants will benefit from the regulator's belief that this is a critical sector which needs regulatory support.

Figure 2 Repayments rates have remained stable...



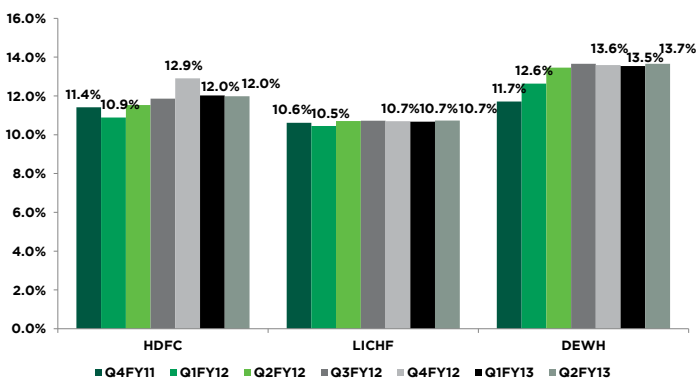
Source: Espirito Santo Investment Bank Research, Company Data

Figure 4 Loan book growth has remained robust



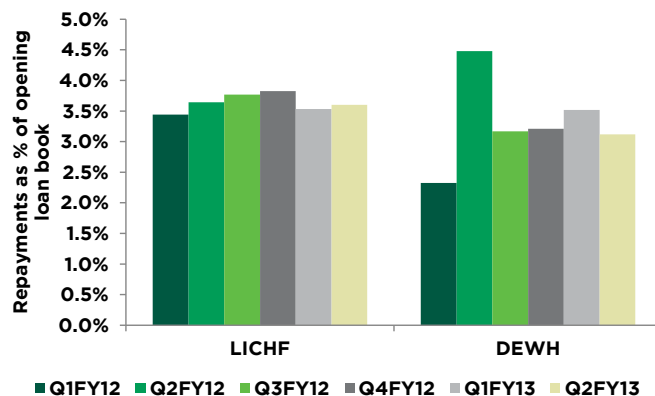
Source: Espirito Santo Investment Bank Research, Company Data

Figure 6 Yields have not fallen



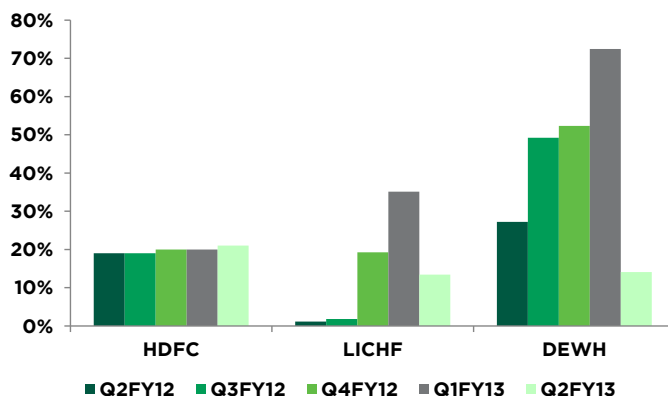
Source: Espirito Santo Investment Bank Research, Company Data

Figure 3 ...despite removal of pre-payment penalty



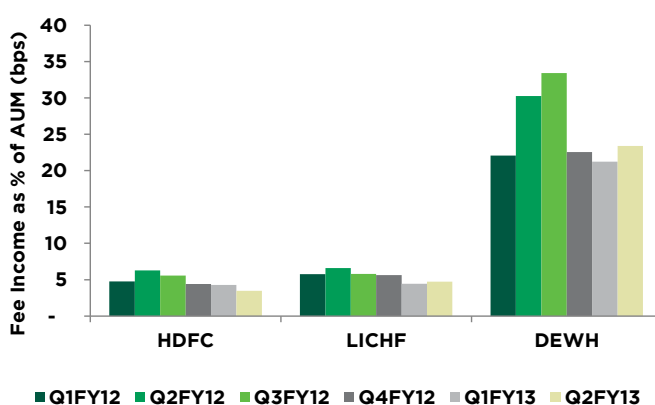
Source: Espirito Santo Investment Bank Research, Company Data

Figure 5 Disbursements slowed down due to non-individual portfolio



Source: Espirito Santo Investment Bank Research, Company Data

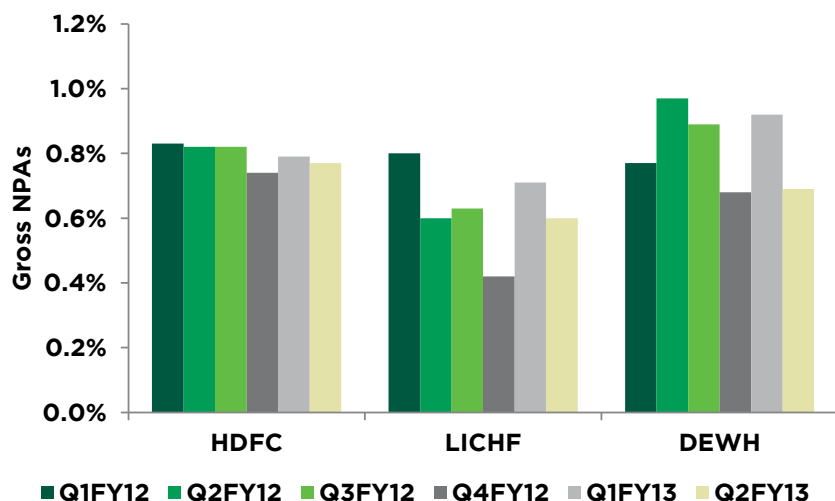
Figure 7 Fees income has come down



Source: Espirito Santo Investment Bank Research, Company Data



Figure 8 Credit quality has remained stable



Source: Espirito Santo Investment Bank Research, Company Data

Increase in competitive intensity: cyclical or structural?

Competitive intensity has been one of the major concerns about HFCs highlighted by investors. With the banks struggling for avenues of growth, they are focussing more on the housing finance market to drive growth which means a) greater price competition leading to lower yields, b) lower growth for HFCs and also higher churn and finally, c) higher credit cost as competition could change the behaviour of customers. Although we think that the concerns are valid to an extent, they tend to be overdone in our opinion and we don't see a major shift in the fundamentals for HFCs.

- Growth rate has remained high:** We have not seen any reduction in the growth rate for HFCs and most of the companies are still comfortable with a guidance of more than a 20% YoY growth rate. Also, the churn in the past few months has not increased (see data above).
- Pricing war leading to lower yields:** This has been a real concern as the banks have been consistently driving the rates lower and we have seen rates reducing by 50-75bps over the last six months. As a result of this we expect some reduction in the yields of the HFCs (75bps reduction), but the impact may not be significant as of yet given the borrowing costs have also declined (more than 50bps in last six months). Also, most of the HFCs barring HDFC can always increase their corporate loan portfolio to compensate for this as currently there is very little competition from banks.
- Increased credit cost:** We think this concern is overdone as HFCs have been very conservative in underwriting and not seen any weakness in underwriting quality. This is clearly visible from the last six quarters' results where we have not seen any deterioration in credit quality.

Also, in our opinion, other than SBI in the PSU space, most of the increased competition is cyclical, given banks have no core competence in housing finance. We see private sector banks like Axis and ICICI as credible competitors, however PSU banks in our opinion (except SBI) have neither the franchise nor underwriting skills and hence once the investment cycle opens up, we may see them moving towards more lucrative businesses like corporate loans.

Figure 9 Cost of funds have risen but seems stable now

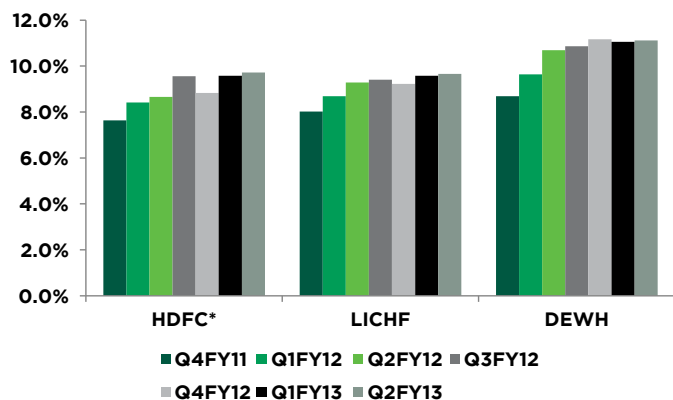
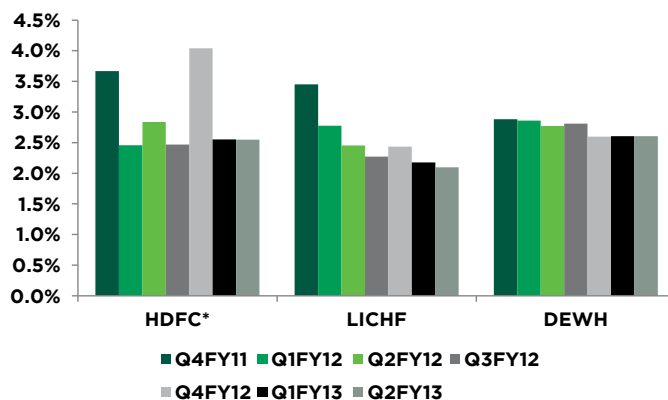


Figure 10 NIMs have stabilized now



Source: Espirito Santo Investment Bank Research, Company Data

Source: Espirito Santo Investment Bank Research, Company Data

RoEs still expected to be around 18-20%

Given the competition and regulatory changes, we expect the spreads to reduce to 1.7% on the retail portfolio from c.2%. Even in this scenario, we estimate that the retail portfolio will generate RoEs in excess of 15% and the non-housing portfolio will contribute 3%-4% to the RoEs, depending on their share in overall portfolio (see table 1).

Table 1 DuPont Analysis for a HFC

Non-Housing Portfolio	0%	5%	10%	15%
Spread on Retail	1.7%	1.7%	1.7%	1.7%
Spread on non-retail	6.0%	6.0%	6.0%	6.0%
Spread on portfolio	1.70%	1.92%	2.13%	2.35%
NII	2.26%	2.47%	2.68%	2.89%
Fee Income	0.30%	0.30%	0.30%	0.30%
Total Income	2.56%	2.77%	2.98%	3.19%
Staff cost	0.15%	0.15%	0.15%	0.15%
Operating Cost	0.20%	0.20%	0.20%	0.20%
Pre-provisioning profit	2.21%	2.42%	2.63%	2.84%
Provisions	0.15%	0.15%	0.15%	0.15%
Pre-Tax RoA	2.06%	2.27%	2.48%	2.69%
Tax Rate	27%	27%	27%	27%
Post-Tax RoA	1.51%	1.66%	1.81%	1.97%
Leverage	11	11	11	11
RoE	16.6%	18.3%	19.9%	21.6%

Source: Espirito Santo Investment Bank Research, Company Data

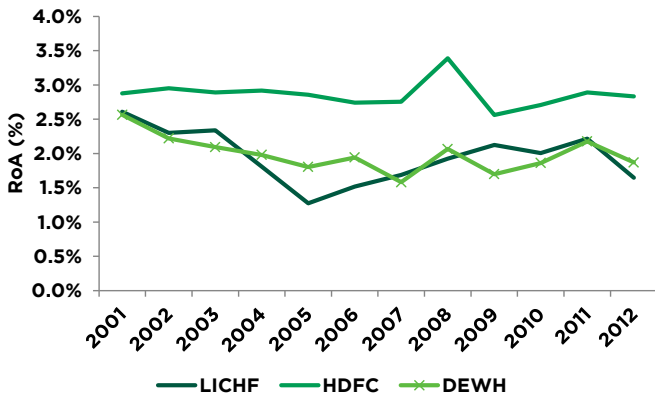
Housing Finance remains the most defensive in financials space

So whilst we admit there are pressures on the sector, we think concerns on these are overdone. We like the sector given its defensive characteristics and consistency in earnings shown over many years. Also the ROEs have been amongst the most consistent (see figure 11, 12, 13 & 14). HFCs (barring HDFC) are trading at a discount to other financial sector stocks which have been more volatile and where asset quality pressures are greater.

Right now we think the market is overlooking the consistency in earnings of these stocks. Our view is that HFCs should trade at premium to the NBFC stocks with similar RoE expectations, given the unusual combination of defensiveness, consistency (the mortgage business has a largely annuity nature of income with longer duration) and growth.

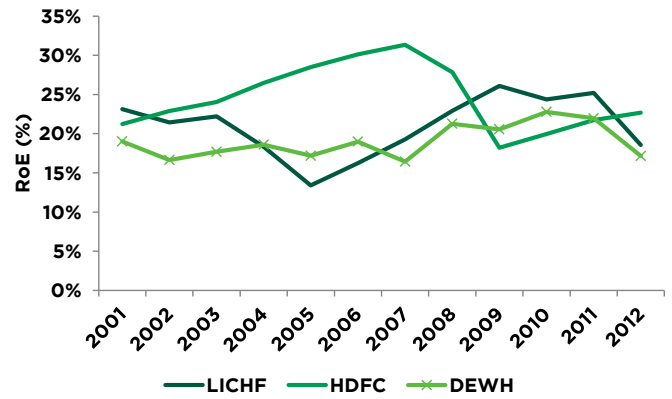


Figure 11 RoAs of leading HFCs



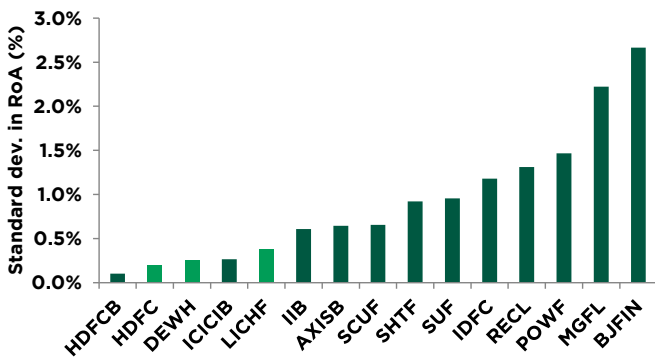
Source: Espirito Santo Investment Bank Research, Company Data

Figure 12 RoEs of leading HFCs



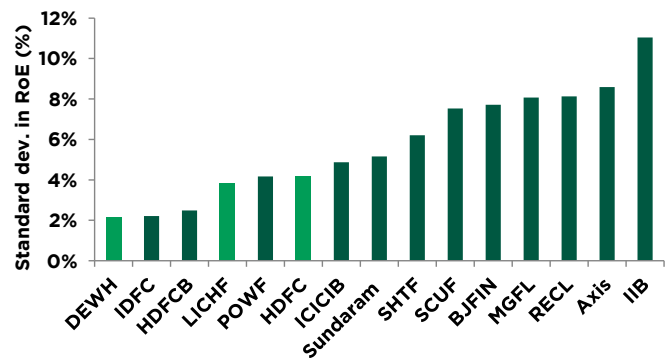
Source: Espirito Santo Investment Bank Research, Company Data

Figure 13 Std. dev. In RoAs of financial companies



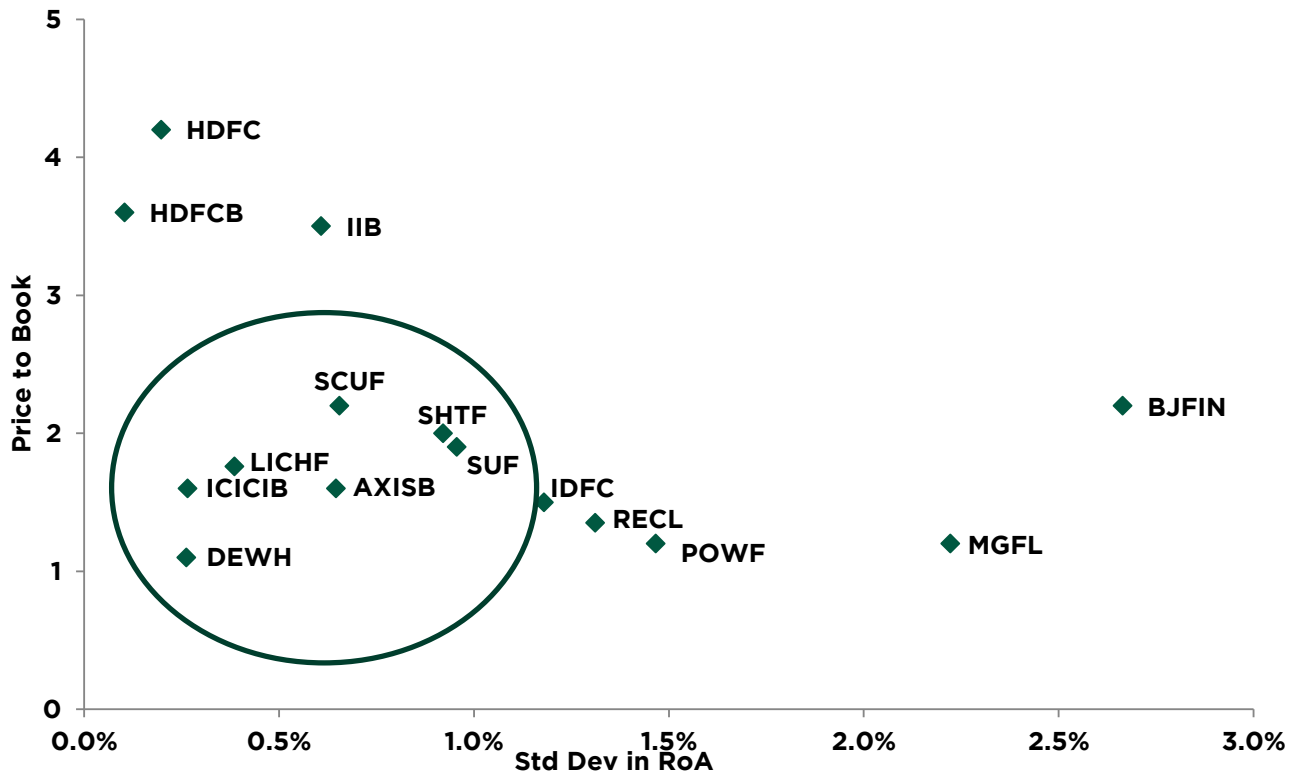
Source: Espirito Santo Investment Bank Research, Company Data

Figure 14 Std. dev. In RoEs of financial companies



Source: Espirito Santo Investment Bank Research, Company Data

Figure 15 P/B to standard deviation in RoAs



Source: Espirito Santo Investment Bank Research, Company Data



HDFC has underperformed YTD

HDFC has been one of the most consistent performers in the Indian financial sector space and hence has always traded at a premium to the other financial sector stocks. However, if we strip out the impact of the movement of HDFC bank on the stock price over the last 4-5 quarters, we can clearly see the implied valuation for the underlying housing finance book has declined given the negativity surrounding the sector in general and HDFC in particular. Whilst we don't see significant upside given a still premium valuation, this should still be a core portfolio holding, as in our view it is one of the best quality stocks in the financial services space that consistently yields above its cost of equity each year.

Signs of deterioration in Q2 may be a quarterly blip

The contribution of income from the mortgage book (NII + Fee income + other operating income) to standalone PBT growth reduced drastically in Q2 FY13 (see Table 2 and Figures 16 and 17 below), which has been compensated for by an increase in income from investments (dividend income + profit from sale of investments). However, it is difficult to conclude whether it is a one quarter blip or structural pressure on the mortgage book. Moreover, the standalone PBT growth has slowed down in recent times leading to underperformance of the stock in CY12.

Table 2 Contribution of core mortgage income in PBT growth has declined...

	FY07	FY08	FY09	FY10	FY11	FY12	Q1FY13	Q2FY13
NII	103%	97%	95%	54%	93%	105%	102%	68%
Fee income	0%	-1%	11%	17%	-1%	6%	2%	-13%
Other income	2%	0%	1%	0%	0%	0%	1%	1%
Core mortgage income	105%	96%	106%	70%	92%	111%	106%	56%
Dividend income	2%	-6%	26%	5%	-1%	11%	13%	63%
Profit sale of investments	0%	17%	-22%	26%	16%	-11%	2%	3%
Income from investments	2%	11%	4%	32%	15%	-1%	15%	66%
Staff cost	-3%	-3%	-4%	-1%	-3%	-4%	-4%	-5%
Other operating costs	-3%	-3%	-2%	0%	-3%	-5%	-6%	2%
Operating costs	-6%	-6%	-7%	-1%	-6%	-9%	-10%	-3%
Depreciation	0%	0%	0%	0%	0%	0%	0%	0%
Provisions	-2%	-1%	-4%	-1%	-1%	-1%	-11%	-19%
PAT growth YoY	26%	39%	18%	22%	24%	16%	17%	16%

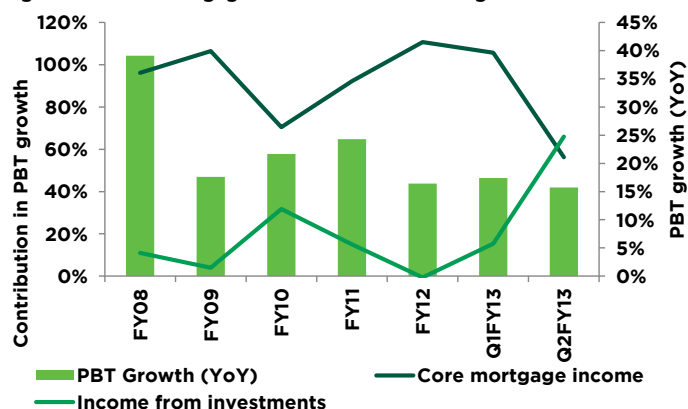
Source: Espirito Santo Investment Bank Research, Company Data

Figure 16 HDFC core mortgage book has underperformed



Source: Espirito Santo Investment Bank Research, Company Data

Figure 17 Core mortgage business has showed signs of deterioration



Source: Espirito Santo Investment Bank Research, Company Data

Spreads may decline to 2.1% and RoE on core book to 23%

Our calculation suggests that HDFC is charging around 11.5% interest to old customers on which it is earning a spread of 2.1%. We expect the spread on the individual loans to compress to 1.75% from the current 1.96% as the proportion of low spread loans increases and high yielding loans either re-price or mature. HDFC operates in the high ticket segment (incremental ticket size of Rs.2m) with more concentration in metros. We expect its customer



base to be more rate sensitive than LICHF and DEWH and hence further strengthening our view of reduction in yields for HDFC.

As a result, the spreads should stabilise at 2.1% assuming the same spreads on non-housing loans. At these spreads, the RoE on the core mortgage book should reduce to 22% (see table below).

Table 3 RoEs may decline to around 23%

Du-Pont analysis (Core-mortgage book)		Comments
Spread	2.1%	
NII	3.0%	At 11x Leverage
Fee Income	0.16%	Net of commissions paid
Opex	0.36%	Inclusive of provisions
Pre-Tax RoA	2.8%	
Tax Rate	27%	
Post-Tax RoA	2.1%	
Leverage	11	
RoE	22.7%	

Source: Espirito Santo Investment Bank Research, Company Data

At this RoE, we see limited potential of a re-rating from the current valuation of 3.8x FY14E book value and hence retain our Neutral rating on HDFC. At the same time we stress that if a company can earn >20% ROE stable state without showing any sign of cyclicality, it should retain its premium valuation and hence we do not expect the multiple to compress in the near to medium term. **Hence, this is a stock which can deliver a near 10% spread over its cost of equity (12.5%) in the medium term, whilst growing its loan book at 20%.**

Table 4 Old vs. New HDFC

Rs millions	Old		New		% Change	
	FY13E	FY14E	FY13E	FY14E	FY'11	FY'12
Loan Book	1,676,408	1,994,925	1,676,408	1,994,925	0%	0%
Net Interest Income	58,588	68,847	54,075	64,497	-8%	-6%
Total Income	70,865	81,764	70,454	80,167	-1%	-2%
Operating expenses	4,978	5,665	5,347	6,047	7%	7%
Pre Provisioning Profit	65,887	76,099	65,108	74,120	-1%	-3%
Provisions	1242	1826	1,242	1,826	0%	0%
PBT	64,440	74,068	63,660	72,088	-1%	-3%
PAT	47,041	54,069	46,472	52,624	-1%	-3%
EPS (Rs)-Diluted	31	35	30	34	-2%	-2%

Source: Espirito Santo Investment Bank Research, Company Data

LICHF remains our top pick in the sector

LICHF is our top pick in the housing finance space given the defensive characteristics and at the same time offering the possibility of margin expansion over the next three quarters by 40-50bps (see our note attached), as well as scope for multiple expansion. Also, we expect the company to generate more than 18% ROE stable state. The stock is trading at 1.5x FY14E book which is at a significant discount to HDFC.

DEWH offers highest upside but with a caveat

From a pure valuation perspective, we see the highest potential upside on DEWH and as we have highlighted on many occasions, this is the company which enjoys several competitive advantages in its areas of focus: it caters to low and middle income groups with a focus on Tier-II/Tier-III cities and affordable housing. In our view it will be the biggest beneficiary of the recent changes in priority sector lending regulations, as the incremental ticket size of the company is Rs.10 lakh. Moreover, given the government's focus on affordable housing, we expect more regulatory relaxation (e.g. allowing ECB route) which may help DEWH disproportionately compared with other HFCs.



However, the perceived risks around to its promoter group mean that it may take some time for any re-rating to happen. We have looked at its corporate governance in detail over last 3-4 years, but we have not found anything specific which suggests to us a red flag. It has six independent directors out of nine directors including a former secretary of the Govt of India and a former full-time member of SEBI. In addition, a private equity house holds a substantial stake with a board seat that gives some credence to the independence of the board and scrutiny of corporate governance. We have an AMBER rating on the stock on corporate governance purely due to the perceived weakness due to relatives of the promoters being involved in the real estate business.

Valuation: HFCs should trade at premium to NBFCs

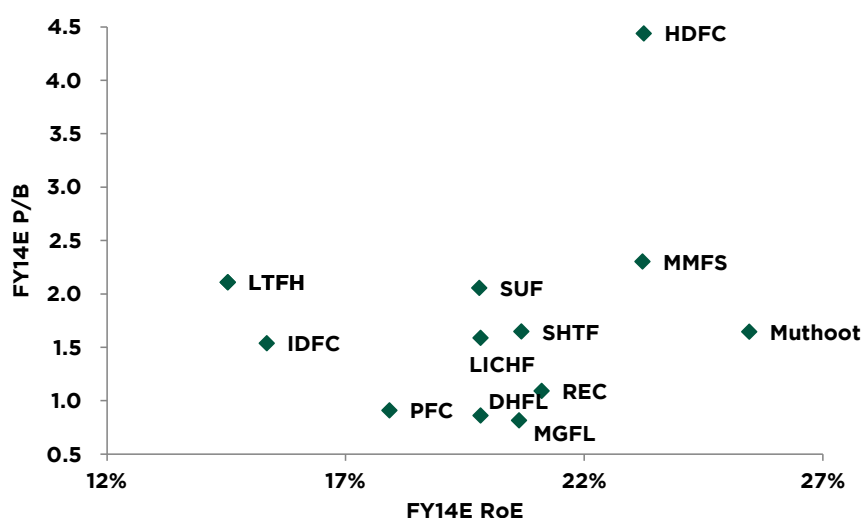
Owing to the defensiveness and consistency of HFCs, we believe that HFCs should trade at a premium to other NBFCs whose businesses are cyclical. Moreover, HFCs, barring HDFC, are trading at discount to the entire NBFC pack (barring MGFL) with similar RoEs expectations.

Figure 18 Relative Valuation table

HFCs	Rating	Fair Value (Rs)	CMP (Rs)	Mar. Cap (Rs bn)	Mar. Cap (\$mn)	RoA		RoE		P/E		P/B	
						FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
HDFC	NEUTRAL	838	777	1,087	21,749	2.5%	2.5%	23%	23%	25	21	5.2	4.5
LICHF	BUY	308	243	112	2,234	1.4%	1.5%	18%	20%	13	9	1.7	1.5
DHFL	BUY	287	197	21	420	1.4%	1.4%	19%	20%	6	5	1.1	0.9
						1.8%	1.8%	20%	21%	14	11	2.7	2.3
NBFCs	Rating	Fair Value (Rs)	CMP (Rs)	Mar. Cap (Rs bn)	Mar. Cap (\$mn)	RoA		RoE		P/E		P/B	
						FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
MMFS	NOT RATED		980	93	1,853	3.4%	3.3%	24%	23%	13	11	2.7	2.3
SUF	NOT RATED		984	50	994	3.0%	3.1%	20%	20%	13	11	2.5	2.1
MGFL	NEUTRAL	39	33	25	499	3.9%	3.8%	21%	21%	5	4	1.0	0.8
Muthoot	NOT RATED		204	69	1,379	3.5%	3.2%	29%	25%	8	7	2.0	1.6
SHTF	BUY	681	609	125	2,506	3.4%	3.3%	21%	21%	10	9	2.0	1.6
LTFH	BUY	56	77	120	2,408	1.8%	2.0%	13%	15%	20	15	2.4	2.1
						3.2%	3.1%	21%	21%	12	10	2.1	1.8
IFCs	Rating	Fair Value (Rs)	CMP (Rs)	Mar. Cap (Rs bn)	Mar. Cap (\$mn)	RoA		RoE		P/E		P/B	
						FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
IDFC	BUY	165	158	217	4,335	2.5%	2.5%	14%	15%	13	11	1.8	1.6
PFC	NEUTRAL	199	182	218	4,362	2.3%	2.3%	18%	18%	6	5	1.0	0.9
REC	BUY	236	218	196	3,915	2.5%	2.5%	21%	21%	6	6	1.3	1.1
LTFH	BUY	56	77	120	2,408	1.8%	2.0%	13%	15%	20	15	2.4	2.1
						2.3%	2.3%	17%	17%	8	7	1.6	1.4

Source: Espirito Santo Investment Bank Research, Company Data

Figure 19 Relative Valuation chart



Source: Espirito Santo Investment Bank Research, Company Data



HDFC valuation

We value HDFC on a SOTP basis with the core business valued on the excess return on equity method using a cost of equity of 12.5%. We have used a lower cost of equity due to HDFC's size, strong market positioning, successful track record and lower beta. We have valued the mortgage business at Rs. 480 per share implying a valuation of 3.7x FY14E adjusted book value. We have valued its subsidiaries and investment in HDFC Bank at Rs.357 per share, valuing HDFC at Rs. 837, representing 7% upside.

Table 5 HDFC SOTP

	Stake	Valuation	Rs / Share	Valuation Methodology
HDFC Bank	23%	346,894	226	Based on our target price of Rs. 640
HDFC Standard Life	72%	103,135	67	Appraisal Value Method (FY14E EV+12x FY14ENBAP)
HDFC General Insurance	74%	11,632	8	Discounted Cash Flow (2.0x FY12 Book Value)
HDFC Asset Management	60%	42,526	28	Discounted Cash Flow (7.1% of FY13E AUM)
GRUH Finance	60%	21,480	14	Based on market value
Mortgage business		737,032	480	Excess return method (3.7x FY14E adjusted BV)
Other investments			15	
Total SOTP			837	

Source: Espirito Santo Investment Bank Research, Company Data

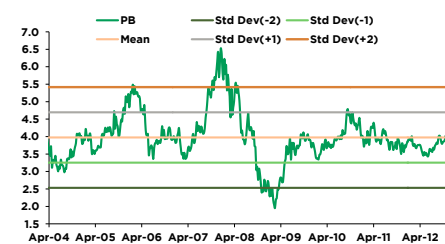
LICHF valuation

We value LICHF at Rs.308, 26% upside from the current level, after assuming a 14.5% COE. This implies a 1.9x FY14E P/B multiple. Currently the stock trades at more than a 50% discount to HDFC which we think is unjustified, given the higher growth rate we forecast for the company and with a similar ROE and asset quality.

DEWH valuation

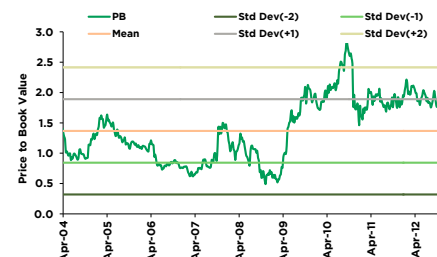
We value DEWH at Rs.287, 52% upside from current levels, after taking a cost of equity of 16%. We have taken a higher cost of equity for the company given smaller size of the company as compared with HDFC and LICHF. This implies a 1.4x FY14E adjusted book value. We have raised our FV for DEWH from Rs.280 due to rollover from FY13 to FY14. We have not changed our estimates for Dewan,

Figure 20 HDFC Band Chart



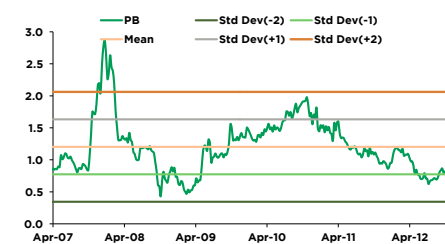
Source: Espirito Santo Investment Bank Research, Company Data

Figure 21 LICHF Band Chart



Source: Espirito Santo Investment Bank Research, Company Data

Figure 22 DEWH Band Chart



Source: Espirito Santo Investment Bank Research, Company Data

Valuation Methodology

We have used excess return on equity method to calculate the fair value of HDFC's mortgage book, using a cost of equity of 12.5%. Our model is a two stage model with time horizon of forty years, first ten years of explicit forecast and next thirty years of declining ROEs to CoEs on a straight line basis.

Figure 23 Valuation Methodology disclosures (HDFC mortgage book)

HDFC excess return on equity calculation																				
Cost of Equity	12.5%																			
Shares in Issue	1,536																			
Free cash flow to equity NPV	Rs. Mn	Rs./share																		
	737,234	480																		
Rs. Mn	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	Mar-28	Mar-29	Mar-30	Mar-31	Mar-32
Beginning book Value	110,825	169,632	199,059	232,179	269,119	310,977	359,843	415,105	479,324	554,008	640,695	725,355	819,429	923,700	1,038,982	1,166,112	1,305,947	1,459,359	1,627,224	1,810,421
Net Profit	40,005	47,093	53,696	63,201	71,994	84,528	95,966	111,982	130,696	152,162	172,775	191,987	212,799	235,269	259,449	285,378	313,084	342,583	373,871	406,931
Cost of Equity	13,853	21,204	24,882	29,022	33,640	38,872	44,980	51,888	59,916	69,251	80,087	90,669	102,429	115,463	129,873	145,764	163,243	182,420	203,403	226,303
ROAE	36%	28%	27%	27%	27%	27%	27%	27%	27%	27%	27%	26%	26%	25%	25%	24%	24%	23%	23%	22%
Excess Return	26,152	25,889	28,813	34,179	38,354	45,656	50,986	60,094	70,781	82,911	92,689	101,318	110,370	119,807	129,576	139,614	149,841	160,163	170,468	180,628
Discount Factor	1.0	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Present Value	25,126	22,110	21,873	23,063	23,005	24,342	24,163	25,316	26,504	27,597	27,424	26,646	25,801	24,895	23,934	22,923	21,868	20,777	19,657	18,514
Rs. Mn	Mar-33	Mar-34	Mar-35	Mar-36	Mar-37	Mar-38	Mar-39	Mar-40	Mar-41	Mar-42	Mar-43	Mar-44	Mar-45	Mar-46	Mar-47	Mar-48	Mar-49	Mar-50	Mar-51	Mar-52
Beginning book Value	2,009,817	2,226,262	2,460,574	2,713,533	2,985,864	3,278,228	3,591,206	3,925,286	4,280,850	4,658,157	5,057,333	5,478,355	5,921,034	6,385,011	6,869,738	7,374,472	7,898,263	8,439,951	8,998,159	9,571,292
Net Profit	441,724	478,189	516,243	555,778	596,661	638,730	681,796	725,640	770,015	814,645	859,227	903,428	946,892	989,239	1,030,068	1,068,961	1,105,486	1,139,201	1,169,658	1,196,411
Cost of Equity	251,227	278,283	307,572	339,192	373,233	409,779	448,901	490,661	535,106	582,270	632,167	684,794	740,129	798,126	858,717	921,809	987,283	1,054,994	1,124,770	1,196,411
ROAE	22%	21%	21%	20%	20%	19%	19%	18%	18%	17%	17%	16%	16%	15%	15%	14%	14%	13%	13%	13%
Excess Return	190,496	199,906	208,671	216,587	223,428	228,952	232,895	234,979	234,909	232,376	227,060	218,634	206,763	191,113	171,351	147,152	118,203	84,207	44,888	-
Discount Factor	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Present Value	17,356	16,190	15,022	13,859	12,709	11,576	10,467	9,387	8,342	7,335	6,371	5,453	4,584	3,766	3,001	2,291	1,636	1,036	491	-

Source: Espirito Santo Investment Bank Research, Company Data



Table 6 Traffic Lights: criteria for judgement (HDFC)

Parameter	Traffic signal	Reasons
Accounting & governance	GREEN	The company has one of the best corporate governance practices in India. The company adjusts for provisions directly from reserves and also adjusts for the premium on zero coupon bonds through the Security Premium account. However we think the high level disclosure and highest degree of governance warrant a green for the company
Franchise strength	GREEN	HDFC is one of the most revered companies among its customers. Its distribution network covers more than 2,400 cities & towns of India.
Earnings momentum	GREEN	The likelihood of downgrades is limited on the stock.

Source: Company, Espirito Santo Investment Bank Research

Table 7 Traffic lights: criteria for judgement (LICHF)

Parameter	Traffic signal	Reasons
Accounting & governance	GREEN	The accounting practices followed by the company are among the best in the industry. The company follows the practice of passing all provisions through P&L. We had an AMBER rating only due to the "Loan for Bribe" case which emerged during December 2010. However, the company was able to come out of the scam without any impact on its operations and hence we have upgraded the rating to GREEN.
Franchise strength	GREEN	A strong brand that helps on both sides of balance sheet along with a competitive advantage on cost of funding and two decades of experience in the industry.
Earnings momentum	GREEN	The earnings momentum is positive as there are upgrades in the recent past.

Source: Company, Espirito Santo Investment Bank Research

Table 8 Traffic Lights criteria (DEWH)

Parameter	Traffic signal	Reasons
Accounting & governance	AMBER	The company adjusts for provisions directly from reserves in spite of passing it through P&L. This inflates the earnings of the company.
Franchise strength	AMBER	The franchise strength is weak as compared with HDFC and LICHF. However, it has good presence in Southern and Western parts of India and has tie-ups with banks in the Northern and Eastern parts of India
Earnings momentum	GREEN	There have been upgrades recently and we expect further upgrades in FY13 and FY14 numbers.

Source: Company, Espirito Santo Investment Bank Research

Risks to Fair Value

Risk factors for Dewan

Any further news flow about potentially weak corporate governance could lead to a further de-rating of the stock. In addition, any weakness in other income could have a negative impact on profitability.

Risk factors for LICHF:

Other than the macro factors concerning the entire housing finance sector, our investment case on LICHF mainly depends on an increase in NIMs from hereon given conversion of teaser rate loans into floating rate loans. However, we see a risk if there is no NIM expansion due to increase in cost of funds or the teaser rate loans start getting prepaid.

Risk factors for HDFC:

Any significant deterioration in the broader economy could lead to downside risk to our estimates. An upside risk is if the company were to post a higher growth rate than LICHF.



HDFC

Recommendation:
Fair Value:

NEUTRAL
INR 837

Share Price: INR 779.35
Upside / Downside 7%

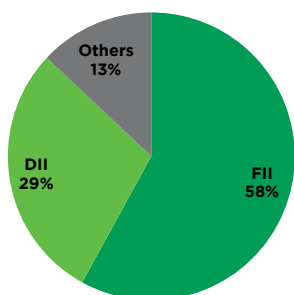
3 Month ADV (\$m) 35
Free Float 100%
52 Week High / Low 600-726

Bloomberg: HDFC IN Equity
Model Published On: 27 November 2012

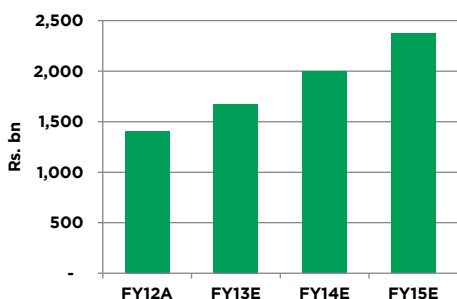
Shares In Issue (mm) 1,536
Market Cap (\$bn / Rs bn) \$19.7 bn/Rs. 986 bn
FII holding 67%

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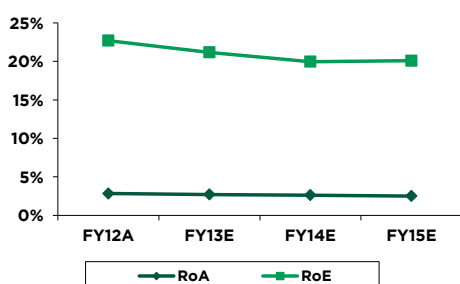
Shareholding Pattern



Loan Book Growth



RoE & RoA Trends



Valuation Metrics	2011	2012	2013E	2014E	2015E
Adjusted P/E	27	24	22	19	17
Adjusted P/BV	5.6	5.1	4.1	3.6	3.3
ROA	3%	3%	3%	3%	3%
ROE	22%	23%	21%	20%	20%
Dividend Yield	1.1%	1.4%	1.5%	1.7%	1.9%

Book value per share (BVPS)	118	129	162	181	203
Adjusted BVPS	64	75	110	130	151

Implied Valuation Ratios	2011	2012	2013E	2014E	2015E
P/E	35	30	28	24	22
P/BV	7.1	6.5	5.2	4.6	4.1

P&L Summary	2011	2012	2013E	2014E	2015E
Net Interest Income	42,471	49,983	54,075	64,497	74,057
Fee Income	2,204	2,684	2,620	3,168	3,770
Other Income	8,507	9,308	13,759	12,501	12,501
Total Income	53,181	61,975	70,454	80,167	90,328
Operating expenses	3,620	4,313	5,347	6,047	6,774
Operating Costs	1,864	2,256	2,832	3,143	3,451
Employee Costs	1,755	2,058	2,515	2,904	3,323
Pre Provisioning Profit	49,561	57,662	65,108	74,120	83,554
Provisions	700	800	1,242	1,826	2,215
Operating Profit	48,861	56,862	63,866	72,294	81,339
Depreciation	192	205	205	205	205
PBT	48,670	56,656	63,660	72,088	81,133
Less: Tax	(13,320)	(15,430)	(17,188)	(19,464)	(21,906)
PAT	35,350	41,226	46,472	52,624	59,227
EPS	24	28	30	34	39

Balance Sheet Summary	2011	2012	2013E	2014E	2015E
Equity	2,934	2,954	2,954	2,954	2,954
Reserves and Surplus	170,231	187,222	246,029	275,457	308,577
Networth	173,165	190,176	248,983	278,411	311,530
Borrowings	1,154,105	1,391,275	1,602,230	1,893,526	2,241,758
Total Sources of funds	1,327,270	1,581,451	1,851,213	2,171,936	2,553,288

Loan Book	1,171,266	1,408,746	1,676,408	1,994,925	2,373,961
Investments	118,324	122,070	122,070	122,070	122,070
Fixed Assets	2,340	2,340	2,340	2,340	2,340
Other Assets	4,481	6,282	6,282	6,282	6,282
Net working Capital	30,859	42,014	44,114	46,320	48,636
Total Application of funds	1,327,270	1,581,451	1,851,213	2,171,936	2,553,288

Key Ratios	2011	2012	2013E	2014E	2015E
Yield on Loans	10.5%	11.9%	11.9%	11.3%	10.8%
Cost of funds	7.1%	8.8%	9.2%	8.7%	8.3%
Spread	3.3%	3.1%	2.7%	2.6%	2.5%
NIM	3.9%	3.9%	3.5%	3.5%	3.4%
Gross NPAs	0.8%	0.7%	0.8%	0.8%	0.8%
Net NPAs	0.0%	0.0%	0.0%	0.0%	100.0%

Capital Ratios	2011	2012	2013E	2014E	2015E
CAR	14%	13%	16%	16%	15%
Tier 1 CAR	12%	11%	14%	14%	13%
Asset/Equity (x)	7.7	8.3	7.4	7.8	8.2

Efficiency Ratios	2011	2012	2013E	2014E	2015E
Fee Income/Total Income	4%	4%	4%	4%	4%
Cost/Total Income	7%	7%	8%	8%	7%
Cost/Average Assets	0.3%	0.3%	0.3%	0.3%	0.3%

Growth Ratios	2011	2012	2013E	2014E	2015E
Loan Book	20%	20%	19%	19%	19%
NII	25%	18%	8%	19%	15%
PAT	25%	17%	13%	13%	13%



LIC Housing Finance

Recommendation:

Fair Value:

Share Price: INR 245
Upside / Downside: 26%

3 Month ADV (\$m): 11
Free Float: 65%
52 Week High / Low: 208-290

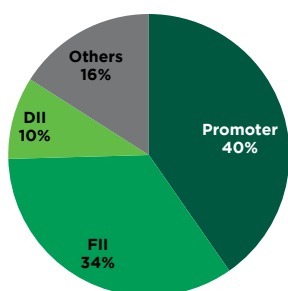
Bloomberg: LICHF IN
Model Published On: 27 November 2012

Shares In Issue (mm): 551
Market Cap (\$bn / Rs bn): \$2.3 bn/Rs. 130 bn
FII holding: 32%

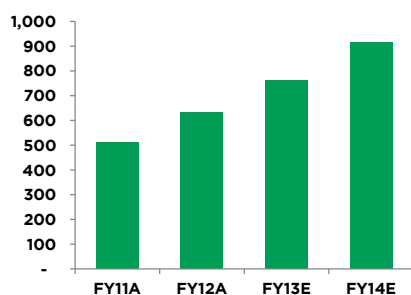
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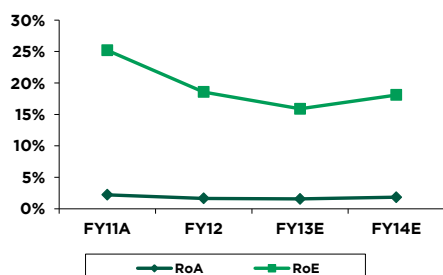
Shareholding Pattern



Loan Book (Rs. Bn)



Margin Trends



Valuation Metrics	2011	2012	2013E	2014E	2015E
P/E	12.2	13.5	12.7	8.9	7.4
P/BV	2.8	2.2	1.7	1.5	1.3
ROA	2.2%	1.6%	1.6%	1.8%	1.8%
ROE	25.2%	18.6%	15.9%	18.1%	18.9%
Dividend Yield	1.4%	1.5%	1.6%	1.9%	2.3%

BV	88	113	141	163	190
Diluted EPS (Rs)	20	18	19	27	33

Implied Valuation Ratios	2011	2012	2013E	2014E	2015E
P/E	15.4	17.0	15.9	11.2	9.3
P/BV	3.5	2.7	2.2	1.9	1.6

P&L Summary	2011	2012	2013E	2014E	2015E
Net Interest Income	13,723	13,916	16,379	21,614	26,119
Fee Income	1,501	1,322	1,077	1,418	2,372
Other Income	2,546	1,003	702	667	733
Total Income	17,770	16,241	18,157	23,699	29,225
Operating expenses	2,200	2,297	2,447	2,885	3,356
Operating Costs	1,449	1,572	1,702	1,949	2,231
Employee Costs	750	724	744	936	1,125
Pre Provisioning Profit	15,570	13,944	15,710	20,814	25,868
Provisions	2,609	1,561	1,279	393	1,108
Operating Profit	12,961	12,383	14,431	20,421	24,760
Depreciation	64	74	74	74	74
PBT	12,897	12,309	14,357	20,347	24,686
Less:Tax	3,207	3,167	3,690	5,229	6,344
PAT	9,691	9,142	10,667	15,118	18,341
Share of Profit of Associate	(174)	-	-	-	-
Net Profit	9,517	9,142	10,667	15,118	18,341
EPS (Rs)-Diluted	20	18	19	27	33
Diluted EPS (Rs)	20	18	19	27	33
Dividend per share(Rs)	3	4	4	5	6

Balance Sheet Summary	2011	2012	2013E	2014E	2015E
Equity	950	1,010	1,010	1,010	1,010
Reserves and Surplus	40,741	55,812	76,500	88,632	103,350
Networth	41,691	56,822	77,510	89,642	104,360
Borrowings	451,628	560,873	671,385	812,229	984,161
Total Sources of funds	493,319	617,695	748,895	901,871	1,088,522
Loan Book	510,898	630,802	762,888	916,794	1,104,422
Investments	14,032	1,640	1,640	1,640	1,640
Fixed Assets	339	622	622	622	622
Other Assets	1,834	2,353	2,353	2,353	2,353
Net working Capital	(33,783)	(17,723)	(18,609)	(19,540)	(20,517)
Total Application of funds	493,319	617,695	748,895	901,871	1,088,522

Key Ratios	2011	2012	2013E	2014E	2015E
Yield onLoans	10.25%	10.48%	10.75%	11.00%	10.85%
Cost of funds	8.17%	9.07%	9.50%	9.54%	9.30%
Spread	2.1%	1.4%	1.3%	1.5%	1.6%
NIM	3.1%	2.44%	2.35%	2.57%	2.58%
Gross NPAs	0.5%	0.4%	0.5%	0.6%	0.5%
Net NPAs	0.0%	0.1%	0.2%	0.1%	0.1%

Capital Ratios	2011	2012	2013E	2014E	2015E
Total CAR ratio	14.9%	16.0%	17.3%	16.8%	0.0%
Tier 1 CAR	8.6%	9.7%	11.0%	10.6%	0.0%

Efficiency Ratios	2011	2012	2013E	2014E	2015E
Operating Cost/Income	12%	14%	13%	12%	11%
Direct Costs/Opearing costs	66%	68%	70%	68%	66%
Wage costs/Total operating costs	34%	32%	30%	32%	34%

Growth Ratios	2011	2012	2013E	2014E	2015E
Loan Book	34%	23%	21%	20%	20%
NII	55%	1%	18%	32%	21%
PAT	38%	-4%	17%	42%	21%

Source: Company filings, Espirito Santo Investment Bank Research



Dewan Housing Finance

Recommendation:

Fair Value:

BUY
INR 287

Share Price: INR 189.35
Upside / Downside 52%

3 Month ADV (\$m) 1.3
Free Float 45%
52 Week High / Low 189-323

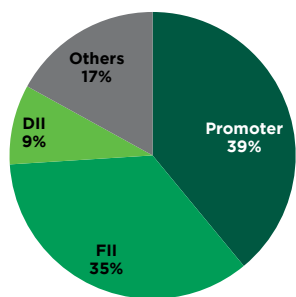
Bloomberg: DEWH IN
Model Published On: 27 November 2012

Shares In Issue (mm),(Post FBHF merger) 128
Market Cap (\$mn / Rs bn) \$338 mn/Rs. 17 bn
FII holding 35%

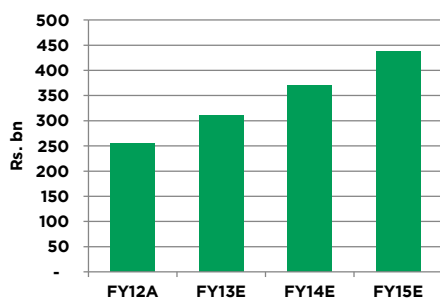
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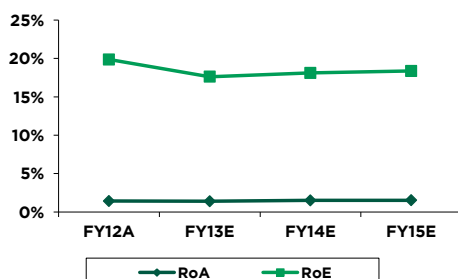
Shareholding Pattern



Loan Book Growth



Margin Trends



Valuation Metrics	2011	2012	2013E	2014E	2015E
P/E	7	7	6	5	4
P/BV	1.6	1.3	1.1	0.9	0.7
ROA	1.9%	1.4%	1.4%	1.5%	1.5%
ROE	26%	20%	18%	18%	18%
Dividend Yield	2%	2%	2%	2%	3%

Book value per share (BVPS)	149	173	214	251	294
Adjusted BVPS	116	143	174	211	255

Implied Valuation Ratios	2011	2012	2013E	2014E	2015E
P/E	10	10	9	7	6
P/BV	2.5	2.0	1.6	1.4	1.1

P&L Summary	2011	2012	2013E	2014E	2015E
Net Interest Income	5,178	5,522	7,733	9,323	10,931
Fee Income	1,944	3,102	2,103	2,277	2,632
Other Income	91	44	44	44	44
Total Income	7,213	8,668	9,879	11,644	13,606
Operating expenses	2,575	3,275	3,602	3,903	4,293
Operating Costs	1,554	2,085	2,292	2,456	2,668
Employee Costs	1,022	1,189	1,310	1,447	1,625
Pre Provisioning Profit	4,638	5,393	6,277	7,741	9,313
Provisions	214	463	461	291	465
Operating Profit	4,424	4,931	5,816	7,450	8,848
Depreciation	68	74	81	85	90
PBT	4,356	4,857	5,734	7,365	8,759
Less:Tax	(1,131)	(1,304)	(1,548)	(1,989)	(2,365)
PAT	3,225	3,553	4,186	5,376	6,394
Less: Minority Interest	(283)	(328)	-	-	-
Profit after MI	2,943	3,224	4,186	5,376	6,394
EPS	28	28	33	42	50

Balance Sheet Summary	2011	2012	2013E	2014E	2015E
Equity	1,044	1,168	1,168	1,168	1,168
Reserves and Surplus	14,512	19,046	26,147	30,878	36,428
Minority Interest	2,525	1,927	0	0	0
Networth + MI	18,081	22,142	27,315	32,046	37,596
Borrowings	206,897	251,736	301,918	356,078	419,347
Deferred Tax Liability	-40	-60	-60	-60	-60
Total Sources of funds	224,938	273,818	329,173	388,064	456,883
Loan Book	199,304	255,006	311,622	369,766	437,762
Investments	6,876	2,474	2,474	2,474	2,474
Fixed Assets	2,354	2,562	2,562	2,562	2,562
Goodwill	3,452	3,495	5,035	5,035	5,035
Other Assets	24	-	-	-	-
Net working Capital	12,926	6,800	7,480	8,228	9,050
Total Application of funds	224,937	270,336	329,173	388,064	456,883

Key Ratios	2011	2012	2013E	2014E	2015E
Yield on Loans	11.8%	12.6%	12.6%	12.5%	12.3%
Cost of funds	9.2%	10.2%	10.2%	10.2%	10.1%
Spread	2.6%	2.4%	2.4%	2.3%	2.2%
NIM	3.1%	2.4%	2.7%	2.7%	2.7%
Gross NPAs	0.7%	0.7%	1.0%	0.8%	0.8%
Net NPAs	0.1%	0.0%	0.3%	0.1%	0.1%

Capital Ratios	2011	2012	2013E	2014E	2015E
CAR	19%	18%	17%	16%	16%
Tier 1 CAR	13%	13%	15%	14%	14%
Asset/Equity (x)	12.4	12.2	12.1	12.1	12.2

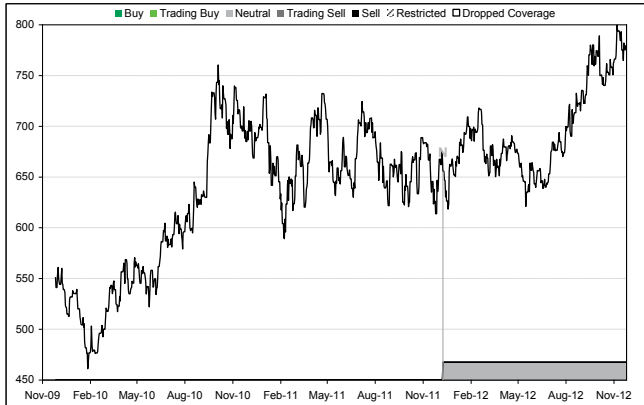
Efficiency Ratios	2011	2012	2013E	2014E	2015E
Fee Income/Total Income	27%	36%	21%	20%	19%
Cost/Total Income	36%	38%	36%	34%	32%
Cost/Average Assets	1.1%	1.3%	1.2%	1.1%	1.0%

Growth Ratios	2011	2012	2013E	2014E	2015E
Loan Book		28%	22%	19%	18%
NII	121%	7%	40%	21%	17%
PAT	126%	-1%	18%	28%	19%



Housing Dev Fin

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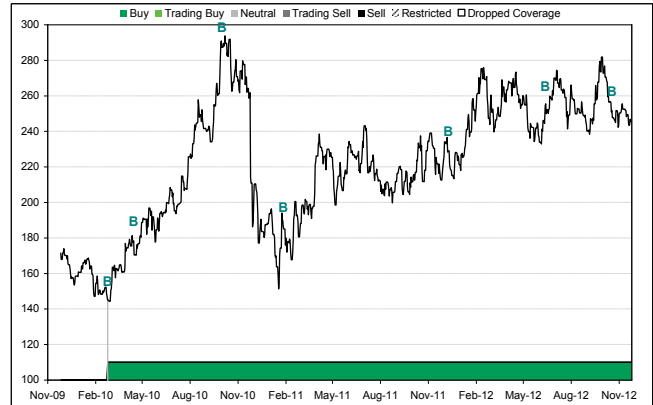


Report date	Recommendation	Fair value	Share price
2011 December 9	Neutral	Rs722.00	Rs669.00

Source: Bloomberg, Espirito Santo Investment Bank Research

LIC Housing Finance

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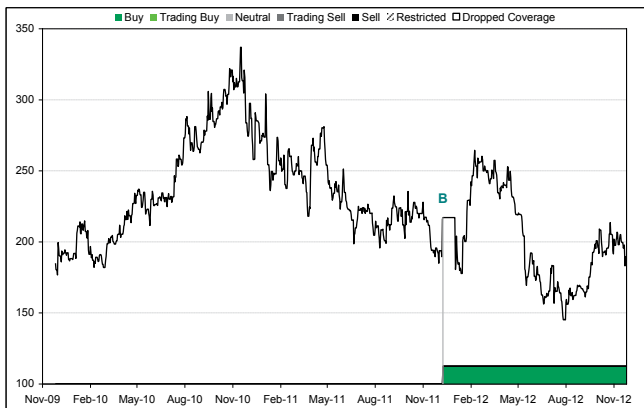


Report date	Recommendation	Fair value	Share price
2012 October 18	Buy	Rs308.30	Rs251.20
June 12	Buy	Rs280.00	Rs244.00
2011 December 9	Buy	Rs260.00	Rs228.00
January 27	Buy	Rs255.00	Rs184.95
2010 October 1	Buy	Rs1607.00	Rs289.52
April 15	Buy	Rs943.00	Rs170.42
February 24	Buy	Rs894.00	Rs145.09

Source: Bloomberg, Espirito Santo Investment Bank Research

Dewan Housing Finance

DEWH IN



Report date	Recommendation	Fair value	Share price
2011 December 9	Buy	Rs280.00	Rs217.00

Source: Bloomberg, Espirito Santo Investment Bank Research

Please visit our website at www.EspiritoSantoIB.co.uk for up to date recommendation charts.



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BUY	Analyst expects at least 10% upside potential to fair value, which should be realized in the next 12 months
NEUTRAL	Analyst expects upside/downside potential of between +10% and -10% to fair value, which should be realized in the next 12 months
SELL	Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months

TRADING RATING	DEFINITION
TRADING BUY	Analyst expects a positive short-term movement in the share price (max duration 2 months from the time Trading Buy is announced) and may move out of line with the fair value estimate during that period
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Ratings Distribution

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	Recommendation	Count	% of Total	Count	% of IBC	% of Total
12 Month Rating:						
Buy		227	47.5%	22	62.9%	4.6%
Neutral		170	35.6%	11	31.4%	2.3%
Sell		81	16.9%	2	5.7%	0.4%
Restricted		0	0.0%	0	0.0%	0.0%
Under Review		0	0.0%	0	0.0%	0.0%
Trading Rating:						
Trading Buy		0	0.0%	0	0.0%	0.0%
Trading Sell		0	0.0%	0	0.0%	0.0%
Total recommendations		478	100%	35	100%	7.3%

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