

**Key player of housing for all..**

Dewan Housing Finance Corporation (DHFL) is the 3<sup>rd</sup> largest private sector housing finance company (HFC) in terms of AUM in India. It primarily provides housing finance to individuals, especially to the low and lower-middle-income groups in Tier II, III and IV cities. The company also offers non-housing loans such as loan against properties (LAP), SME and developer loans.

**Investment Rationale**

➤ **Strong AUM growth:** DHFL has witnessed robust AUM growth of 38% CAGR in the past five years led by a strong CAGR of 33% and 30% in sanctions and disbursements, respectively over FY11-16. Further, it was partly led by amalgamation of First Blue Home Finance Ltd in FY13. The company's primary focus area remains Tier II to IV cities. However, with increasing competition in the housing finance segment, the company has increased its focus on wholesale loan book in the recent years. We expect DHFL's loan book to grow at a CAGR of 20% over FY16-18E mainly driven by higher growth in affordable housing loans and developer loan book.

➤ **Stable Net Interest Margin (NIM):** DHFL has been replacing high cost bank borrowings with low cost non-convertible debentures (NCDs) over the last four years. As a result, the share of bank borrowings has come down to 56% as of FY16 from 74% in FY11, while the share of capital market borrowings has gone up to 33% from 13%. This has led to the company's NIM improvement to 2.7% in FY15 from 2.3% in FY12. However, with housing finance being a very competitive business, we don't expect NIM to improve further substantially and expect it to remain stable at 2.6% over FY16-18E.

➤ **Healthy Asset Quality:** Centralized underwriting process, in-house credit & legal team and lower LTV (45%) have enabled DHFL to maintain strong asset quality over the last five years. It's Gross / Net NPA remains at a low level of 0.9% / 0.6% as of FY16. Going ahead, we don't expect any major hiccups in asset quality related to home loans. However, given the increasing share of developer loans in total loan portfolio, we have factored in higher NPAs and expect Gross / Net NPA to remain at 1.2% / 0.9% by FY18E.

➤ **Profitability to improve further:** DHFL enjoys average, though improving, earnings profile. Its return on assets (RoA) and return on equity (RoE) were at 1.2% and 15.1%, respectively in FY16 which were lower than that of its peers. However, we expect return ratios to improve over FY16-18E with increasing share of high yielding non-housing portfolio coupled with better operational efficiency.

**Valuation:** DHFL is a play on the high growth Indian housing finance industry, which is driven by rising income levels, growing urbanization and low penetration of housing finance and shortage of affordable housing. We like DHFL due to its consistent loan growth, stable NIM, strong asset quality, better capital adequacy, improving return ratios and reasonable valuations. At CMP of Rs297, the stock is trading at P/ABV of 1.7x and 1.5x for FY17E and FY18E, respectively, a steep discount to other HFCs (trading >2.5x FY18E P/ABV). We assign BUY rating on the stock with target price of Rs385 based on 2.0x FY18E P/ABV.

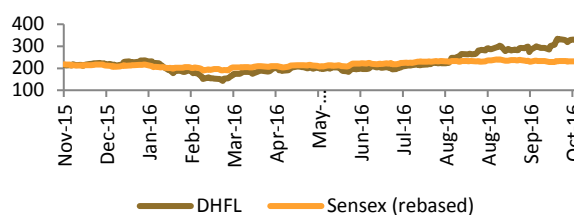
**Market Data**

<b>Rating</b>	<b>BUY</b>
<b>CMP (Rs.)</b>	297
<b>Target (Rs.)</b>	385
<b>Potential Upside</b>	30%
<b>Duration</b>	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	337/141
Adj. all time High (Rs.)	337
Decline from 52WH (%)	12
Rise from 52WL (%)	111
Beta	2.2
Mkt. Cap (Rs.Cr)	9,308

**Fiscal Year Ended**

Y/E	FY15	FY16	FY17E	FY18E
Net Interest Income (Rs. Cr)	1,380	1,669	2,025	2,412
Pre-Pro Profit (Rs. Cr)	1,048	1,277	1,582	1,894
Net Profit (Rs. Cr)	621	729	908	1,076
EPS	21.3	25.0	29.0	34.4
P/E (x)	13.9	11.9	10.3	8.7
P/BV (x)	1.9	1.7	1.5	1.3
P/ABV (x)	2.2	1.9	1.7	1.5
ROE (%)	15.1	15.1	16.3	16.5
ROA (%)	1.3	1.2	1.3	1.3

**One-year Price Chart**



Shareholding Pattern	Sep-16	Jun-16	Chg.
Promoters (%)	39.3	34.9	4.4
Public (%)	60.7	65.1	(4.4)

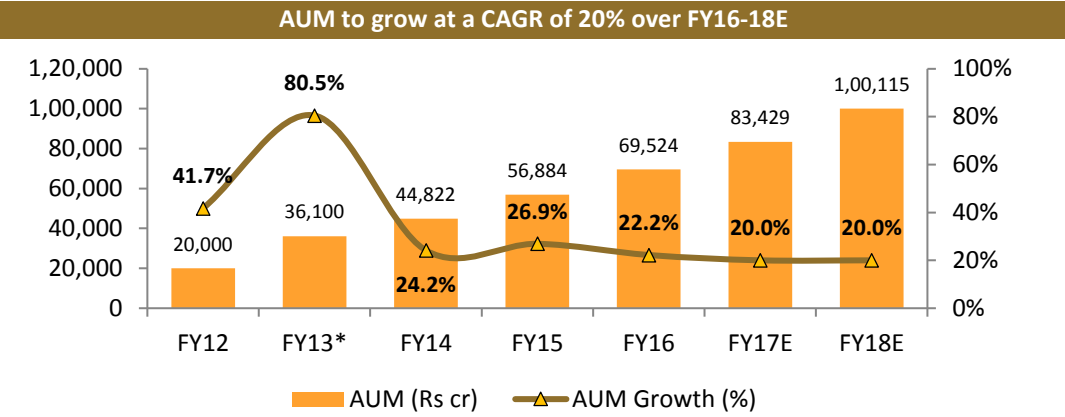
**DHFL is the third largest private sector housing finance company (HFC) in India.**

### DHFL - Company Overview

Dewan Housing Finance Corporation (DHFL) is the 3rd largest private sector housing finance company (HFC) in terms of AUM in India. It primarily provides housing finance to individuals, especially to the low and lower-middle-income groups in Tier II, III and IV cities. The company also offers non-housing loans such as loan against properties (LAP), SME and developer loans.

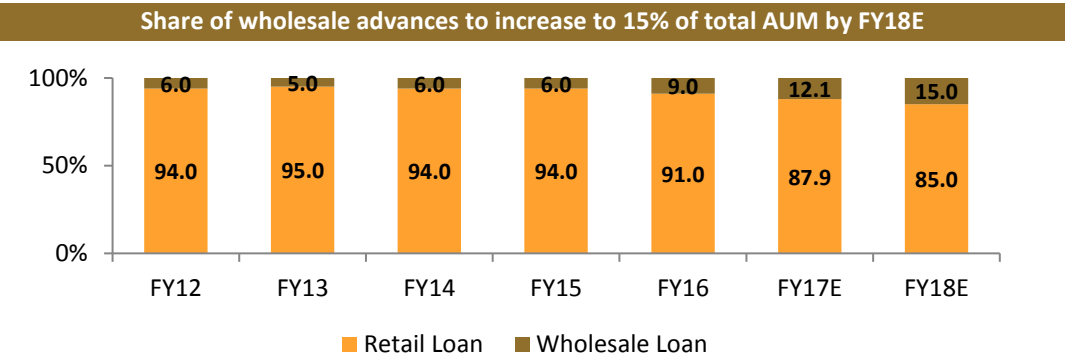
### Strong AUM Growth

DHFL has witnessed robust AUM growth of 38% CAGR in the past five years led by a strong CAGR of 33% and 30% in sanctions and disbursements, respectively over FY11-16. Further, it was partly led by amalgamation of First Blue Home Finance Ltd in FY13.



Source: Company, In-house research; \*Amalgamation of First Blue Home Finance Ltd. with DHFL

Over the last few years the company has built a niche presence in retail loan portfolio by lending to self-employed as well as salaried class, which will aid strong growth in the coming years. The company's primary focus area remains Tier II to IV cities where there is relatively low competition from scheduled commercial banks (SCBs). However, with increasing competition in the housing finance segment, the management has also increased its focus on wholesale loan book in the recent years. As a result, the share of wholesale loan book in total loan book has increased to 12% (in Q2FY17) as compared to 5% as of FY13. However, most of the loans are towards residential projects only. Overall, DHFL is well positioned to capture the opportunities arising in the Lower Income Group (LIG) and Mid Income Group (MIG) segments due to lower interest rates and current government's focus on the Affordable Housing Segment. We expect DHFL's loan book to grow at a CAGR of 20% over FY16-18E mainly driven by higher growth in affordable housing loans and developer loan book.

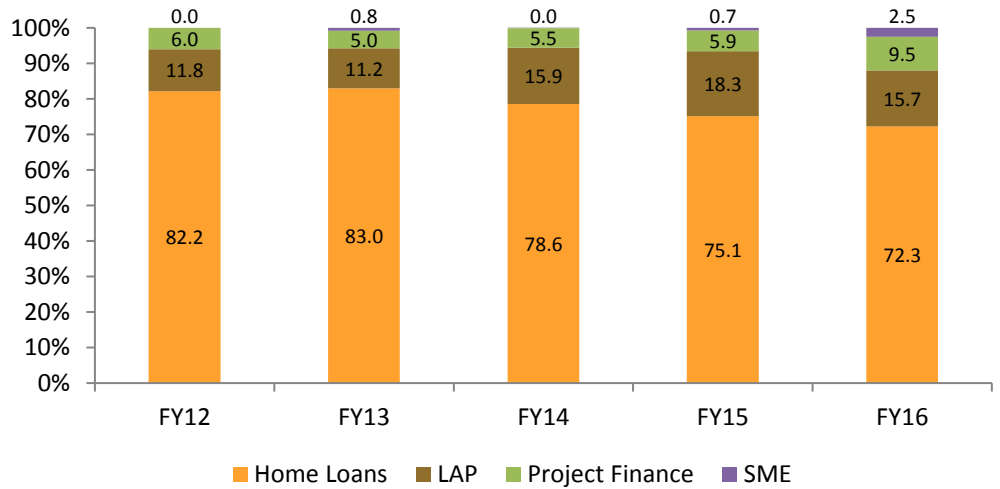


Source: Company, In-house research

### Diversified Loan Book

DHFL has a diversified loan book, with home loans accounting for 72% of the advances. Home loans normally carry a low risk of default as witnessed historically. Within home loans, ~83% of the advances are towards purchase of flats whereas ~18% is accounted by self-construction. The high yielding LAP and projects loans accounted for 16% and 10%, respectively in FY16. Further, the company has recently forayed into lending to the SME segment which accounts for 3% of the total loan portfolio.

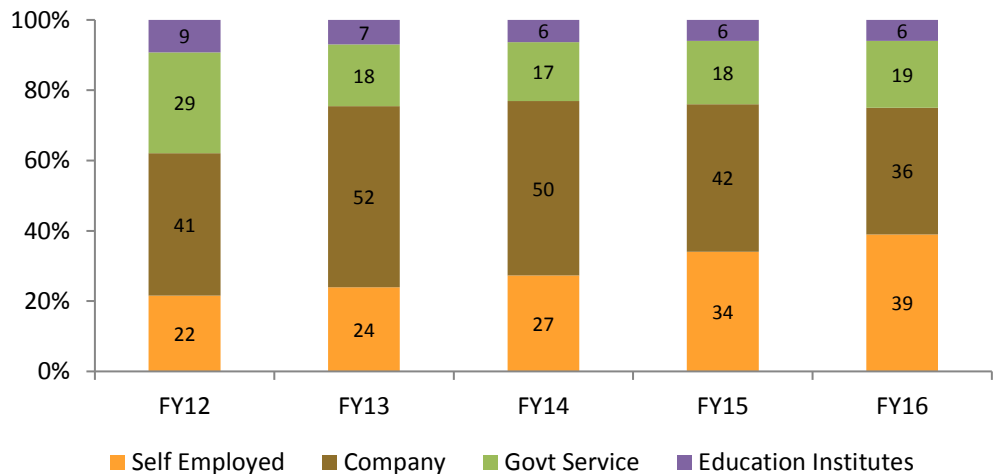
#### Increasing share of high yielding LAP and Project Loans



Source: Company, In-house research

Based on customer profile the company's loan book is well diversified with ~55% of it accounted by service holders, within which ~19% is towards government employees while the balance is accounted by private sector employees. In order to diversify its client base, DHFL has increased advances to the self-employed segment over the last few years which now accounts for 39% of the loan book as compared to 22% in FY12. The company is also engaged in funding the construction of educational institutes which accounts for 6% of the loan book.

#### Well diversified customer mix

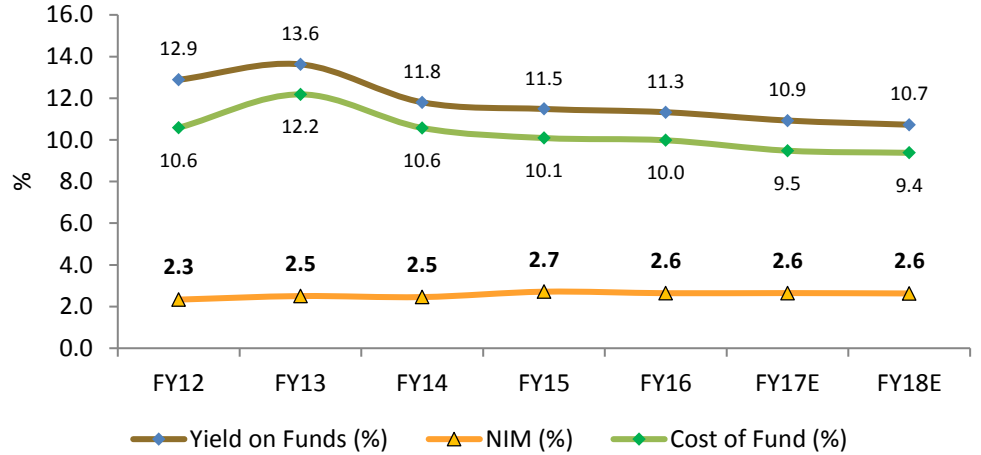


Source: Company, In-house research

### Stable Net Interest Margin (NIM)

DHFL has been replacing high cost bank borrowings with low cost non-convertible debentures (NCDs) over the last four years. As a result, the share of bank borrowings has come down to 56% as of FY16 from 74% in FY11, while the share of capital market borrowings has gone up to 33% from 13%. This has led to the company's NIM improvement to 2.7% in FY15 from 2.3% in FY12. However, with housing finance being a very competitive business, we don't expect NIM to improve further substantially and expect it to remain stable at 2.6% over FY16-18E.

NIM to remain stable at 2.6% over FY16-18E

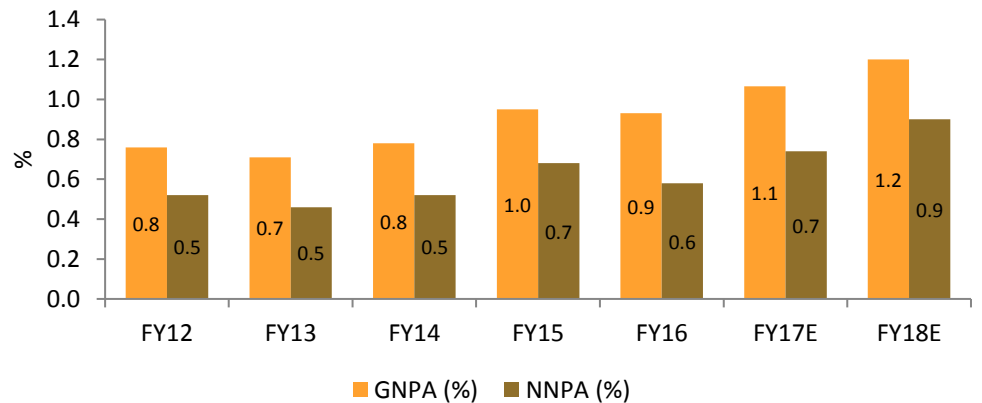


Source: Company, In-house research

### Healthy Asset Quality

Centralized underwriting process, in-house credit & legal team and lower LTV (45%) have enabled DHFL to maintain respectable asset quality over the last four years. DHFL has loan book with an average ticket size of around Rs.1.2 mn, which remains significantly lower than that of its peers. As a result, DHFL has successfully maintained asset quality at healthy level over the last five years. It's Gross / Net NPA remains at a low level of 0.9% / 0.6% as of FY16. Going ahead, we don't expect any major hiccups in asset quality related to home loans. However, given the increasing share of developer loans in total loan portfolio, we have factored in higher NPAs and expect Gross / Net NPA to remain at 1.2% / 0.9% by FY18E.

Asset quality to remain healthy over FY16-18E

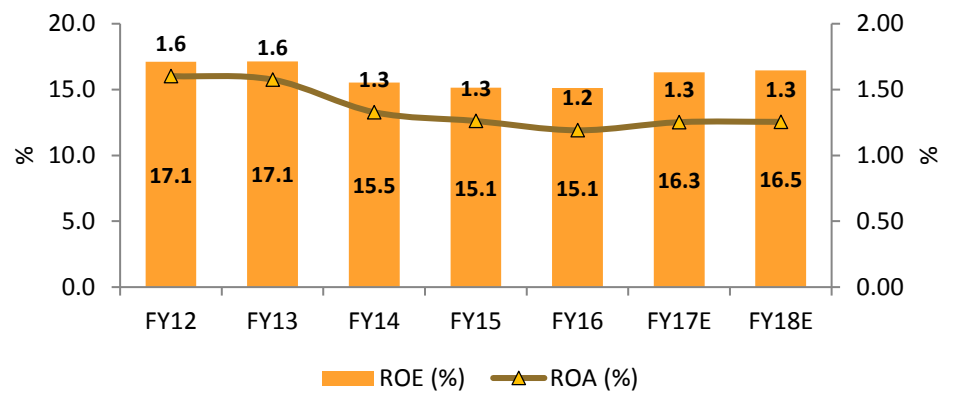


Source: Company, In-house research

### Profitability to improve further

DHFL enjoys average, though improving, earnings profile. Its return on assets (RoA) and return on equity (RoE) were at 1.2% and 15.1%, respectively in FY16 which were lower than that of its peers. It was mainly due to relatively low proportion of high yielding non-housing portfolio and high operating expenses. However, we expect return ratios to improve over FY16-18E with increasing share of high yielding non-housing portfolio coupled with better operational efficiency. Therefore, we expect net profit to grow at 21% CAGR over FY16-18E. Notably, the company surprised positively with better than expected operating efficiency in Q2FY17 as it reported 4% YoY decline in other operating expenses on the back of lower marketing and legal expenses.

Return ratios to improve further over FY16-18E

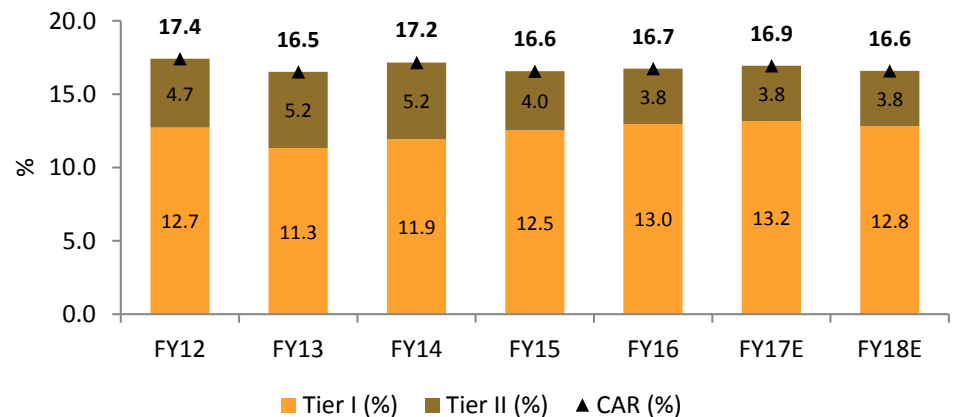


Source: Company, In-house research

### Adequately Capitalized

DHFL's capital adequacy ratio (CAR) stood at 16.7% with tier I ratio of 13.0% which was well above the regulatory requirement of 12.0%. Moreover, the promoters infused Rs 375 cr through conversion of outstanding warrants during Q2FY17. Notably, the warrants conversion was one year ahead of deadline and reinforces the promoter's long term commitment towards the company. This will help the company in meeting its capital requirement over FY16-18E.

Well capitalized to support growth momentum over FY16-18E



Source: Company, In-house research

## Outlook and Valuation

DHFL is a play on the high growth Indian housing finance industry, which is driven by rising income levels, growing urbanization and low penetration of housing finance and shortage of affordable housing. Given the current low interest rate regime, the housing finance industry is likely to emerge stronger. While competition in the housing finance segment will remain high, DHFL will continue to benefit from the strong growth potential in its target customer segment (Tier II, III and IV cities) with faster turnaround time over medium to long term. We like DHFL due to its consistent loan growth, stable NIM, strong asset quality, better capital adequacy, improving return ratios and reasonable valuations. At CMP of Rs297, the stock is trading at P/ABV of 1.7x and 1.5x for FY17E and FY18E, respectively, a steep discount to other HFCs (trading >2.5x FY18E P/ABV). We assign BUY rating on the stock with target price of Rs385 based on 2.0x FY18E P/ABV.

## Key Risks:

- **Lower growth than expected:** We expect AUM growth of 20% over FY16-18E largely led by higher growth in home and project loans. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.
- **Significant deterioration in asset quality:** Any significant deterioration in asset quality will affect our provisioning and slippages assumption and hence remains risk to our estimates.
- **Spike in interest rates:** We expect the interest rate (repo rate) to reduce over FY16-18E. However, any further increase in interest rates may affect the business and margins of the company and hence the operating matrix.

**Profit & Loss Account (Standalone)**

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
Interest Income	5,839	7,159	8,357	9,845
Interest Expense	4,460	5,490	6,332	7,432
<b>Net Interest Income</b>	<b>1,380</b>	<b>1,669</b>	<b>2,025</b>	<b>2,412</b>
Non-Interest Income	142	157	176	197
Net Income	1,522	1,827	2,201	2,609
Operating Expenses	474	550	619	715
<b>Total Income</b>	<b>5,982</b>	<b>7,317</b>	<b>8,533</b>	<b>10,041</b>
<b>Total Expenditure</b>	<b>4,934</b>	<b>6,040</b>	<b>6,951</b>	<b>8,148</b>
<b>Pre-Provisioning Profit</b>	<b>1,048</b>	<b>1,277</b>	<b>1,582</b>	<b>1,894</b>
Provisions	105	175	227	291
<b>Profit Before Tax</b>	<b>943</b>	<b>1,102</b>	<b>1,355</b>	<b>1,603</b>
Tax	322	373	447	527
<b>Net Profit</b>	<b>621</b>	<b>729</b>	<b>908</b>	<b>1,076</b>

**Balance Sheet (Standalone)**

Y/E (Rs. Cr)	FY15	FY16	FY17E	FY18E
<b>Liabilities</b>				
Capital	146	292	313	313
Reserves and Surplus	4,490	4,725	5,798	6,648
Borrowings	40,526	51,556	61,867	74,241
Provisions	466	654	822	1,031
Other Liabilities	9,011	10,626	11,268	12,632
<b>Total Liabilities</b>	<b>54,638</b>	<b>67,853</b>	<b>80,069</b>	<b>94,865</b>
<b>Assets</b>				
Cash and Balances	676	3,408	2,978	2,684
Investments	1,006	893	998	1,108
Advances	51,040	61,775	74,130	88,956
Fixed Assets	985	781	820	861
Other Assets	931	996	1,144	1,256
<b>Total Assets</b>	<b>54,638</b>	<b>67,853</b>	<b>80,069</b>	<b>94,865</b>

**Key Ratios (Standalone)**

Y/E	FY15	FY16	FY17E	FY18E
<b>Per share data (Rs.)</b>				
EPS	21.3	25.0	29.0	34.4
DPS	6.0	6.0	5.0	6.0
BV	159.1	171.9	195.2	222.4
ABV	135.3	159.7	177.9	197.2
<b>Valuation (%)</b>				
P/E	13.9	11.9	10.3	8.7
P/BV	1.9	1.7	1.5	1.3
P/ABV	2.2	1.9	1.7	1.5
Div. Yield	2.0	2.0	1.7	2.0
<b>Capital (%)</b>				
CAR	16.6	16.7	16.9	16.6
Tier I	12.5	13.0	13.2	12.8
Tier II	4.0	3.8	3.8	3.8
<b>Asset (%)</b>				
GNPA	1.0	0.9	1.1	1.2
NNPA	0.7	0.6	0.7	0.9
<b>Management (%)</b>				
Debt / Equity	10.6	12.2	11.9	12.4
Cost / Income	31.1	30.1	28.1	27.4
<b>Earnings (%)</b>				
NIM	2.7	2.6	2.6	2.6
ROE	15.1	15.1	16.3	16.5
ROA	1.3	1.2	1.3	1.3

#### Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
<b>Buy</b>	More than equal to 10%	<b>Buy</b>	More than equal to 15%
<b>Hold</b>	Upside or downside is less than 10%	<b>Accumulate*</b>	Upside between 10% & 15%
<b>Reduce</b>	Less than equal to -10%	<b>Hold</b>	Between 0% & 10%
		<b>Reduce/sell</b>	Less than 0%

\* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

\* DHFL is a mid-cap stock.

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