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Global Markets Research

ANCHOR REPORT

India financials: Mortgage finance – The structural story continues

HFCs well placed – expect strong returns with low asset quality risks

17 June 2015

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India Financials

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Mortgage finance in India will continue to remain a structural growth opportunity and housing finance corporations (HFCs) are well placed, especially with the wholesale funding environment remaining favourable. Competition will likely remain intense, but we do not see irrational pricing as the profitability of PSUs is much weaker than in the previous cycle (FY09-10). We are positive on HFCs and upgrade LICHF to Buy as it is the biggest beneficiary of lower wholesale rates. We also initiate coverage with Buy on Indiabulls Housing and Dewan Housing as rating upgrades are driving a structural improvement in their funding profile which should make these HFCs more competent in the prime mortgage market.

Key themes and analysis in this Anchor Report include:

- Why HFCs have gained market share and why we believe that pricing in mortgages will not be as irrational as in the last cycle.
- A detailed update on the LAP (loan against property) market.
- Detailed initiation on Indiabulls Housing and Dewan Housing, and updates on LIC Housing and HDFC Limited.

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Mortgage finance: Structural story continues

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Anchor themes

Mortgages remain a structural story from a growth perspective. Cyclically the domestic rate environment remains favourable for HFCs and banks' ability to compete on pricing is lower than in the previous cycle (FY09-10).

Nomura vs consensus

Our FY16/17F PAT estimates are largely in line with consensus.

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Action: LICHF up to Buy; initiate on Indiabulls, Dewan Housing at Buy

Structural drivers remain in place for mortgage growth in India with penetration still more than 50% lower than peers and cyclically we expect the funding environment to remain favourable. We upgrade LIC Housing to Buy (TP: INR500) as we believe it is the sector's biggest beneficiary of lower wholesale cost of funds. We initiate on Indiabulls (IHFL) and Dewan with Buy ratings as their consistent performance have led to continuous credit rating upgrades and the funding profile improvement should drive up their competitiveness in prime mortgages. Among larger HFCs, our top pick is LICHF and among mid-sized HFCs, we are more convinced on IHFL.

Structural story continues: HFCs appear well placed

With just ~8% mortgage to GDP penetration and rising income levels, we expect 18% CAGR mortgage growth over the next five years. While competition has remained intense, large HFCs have gained share due to their competitive cost of funds and lower opex structure vs banks and smaller HFCs have built niches in funding low cost housing (ticket size of less than INR1.5mn). HDFC/LICHF should continue to remain as the dominant players and we see smaller HFCs like IHFL graduate to become prominent in prime mortgages as their cost of funds become more competitive.

Cyclically funding environment favourable

We expect wholesale funding environment to remain favourable. While banks, especially PSUs, are re-orienting their focus to retail/mortgages, their ability to cut mortgage/base rates is lower than FY08-10 given their weak profitability (ROAs 0.6-0.7% lower than FY09).For smaller HFCs like IHFL/Dewan, credit ratings upgrades should result in significant improvement in their funding profile and acceptance of their bonds. This should help offset any yield pressure on LAP and drive up their competitiveness in prime mortgages.

Valuations and preference among HFCs

1) Among large HFCs, LICHF's valuations seem reasonable at 1.9x FY17F book (BVPS: INR212) as improving margins should drive up ROEs to 18-19% in FY17F. 2) HDFC's valuation at 3.6x FY17F book (BVPS: INR195) is above mean and hence we maintain Neutral. 3) IHFL's re-rating is likely to continue as ROEs at ~27-28% are best in class, improving rating profile should offset any yield pressure and recent management steps to address weak perception of corporate governance is all positive. 4) Dewan's focus on low-cost housing is to its advantage and lower profitability vs peers is reflected in its valuation (1x book). Dewan's use of cashflows have been inefficient in the past and improvement there should drive a re-rating.

Fig. 1: Stocks for action

Company	Code	Rating	Mcap USDbn	Avg To USDmn	Target price	Current price	Upside/ downside
Indiabulls Housing	IHFL IN	Buy *	3.1	11.4	800	556	43.9%
Dewan Housing	DEWH IN	Buy *	0.9	5.5	525	389	35.0%
LIC Housing	LICHF IN	Buy ↑	3.1	17.3	500	395	26.6%
HDFC	HDFC IN	Neutral	29.9	60.6	1,325	1,215	9.1%

Source: Bloomberg, Nomura estimates. Note: * initiating coverage; ↑ upgrading; share prices are as of 15 June 2015 close.

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Contents

Investment thesis: HFCs well placed

HFCs (housing finance companies) **should continue to remain strong value creators:** HFCs have been strong value creators in the past decade with 20-24% CAGR return driven by secular growth opportunities in the mortgage space. Given India's low mortgage penetration levels (9% vs 15-20% for other markets); we believe the secular trend will continue. Mortgage funding is largely pricing sensitive thus only HFCs with the lowest cost of funds (eg, HDFC and LICHF) have consistently gained market share, despite competition from banks, as their low operating cost structure mitigates their cost of funds disadvantage.

Mid-sized HFCs now moving towards the next level driven by their improved funding mix: Apart from HDFC and LICHF, a few HFCs have been operating in niche segments and have built successful business models around those niches. We believe the biggest opportunity for these mid-sized HFCs is to move into prime mortgages as this is still the largest part of India's mortgage market. They have been able to move into this segment because their consistent financial performance has led to rating upgrades over the past two years. IHLF and DHFL fall into this category with IHFL's credit rating (AA+ from CRISIL) now being just one notch below HDFC's and LICHF's.

Rate cycle remains favourable; Ability of banks to cut rates low: Cyclically we believe the funding environment will remain favourable for HFCs as system credit growth remains weak. Although banks are shifting their focus to mortgages and hence competition should intensify, we do not expect this to lead to irrational pricing given PSU banks' current weak profitability. LAP, which contributes more than 20% of loan book for IHFL and DHFL is seeing yield compression which could significantly impact their profitability. However, as explained above, their rating upgrades should bring down their cost of funds and help offset yield pressure in the LAP book.

Valuations reasonable for HFCs: Given reasonable valuations, we upgrade LICHF to Buy from Neutral and maintain HDFC as Neutral. Among mid-sized HFCs, we initiate coverage on IHFL and DHFL with Buy ratings. IHFL has best-in-class ROEs (27-28%) and has tried to address investors' concerns over its corporate governance and this should drive further re-rating. DHFL operates in a good niche (low-cost housing) but may need to demonstrate better use of cash flows to see a meaningful re-rating.

Valuations and preference among HFCs: 1) Among large HFCs, valuation for LICHF seem reasonable at 1.8x FY17F book, as we forecast improving margins to drive up ROEs to 19% in FY17F. **2)** HDFC's valuation at 3.6x FY17F book is above the mean and hence we maintain our Neutral rating. **3)** We believe IHFL's re-rating is likely to continue ROEs at ~27-28% as best in class and its improving ratings should lead it to being more competitive in prime mortgages. Recent management steps to address weak perception of corporate governance is positive, in our view. **4)** DHFL's focus on low-cost housing is to its advantage and lower profitability vs peers is reflected in its valuations (0.9x 2017F book).

Fig. 2: HFCs: Current valuations appear reasonable

	Current price	Mcap USDbn	Rating	Target price	Upside/ downside	P/B		P/E		RoE		RoA	
						FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DHFL	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.7	16.2%	15.9%	1.3%	1.2%
Repco	590	0.6	Not rated	NA	NA	3.97	3.28	23.1	18.7	18.4%	19.7%	2.3%	2.3%
GRHF	219	1.2	Not rated	NA	NA	8.59	6.81	28.8	23.6	32.9%	31.7%	2.8%	2.9%

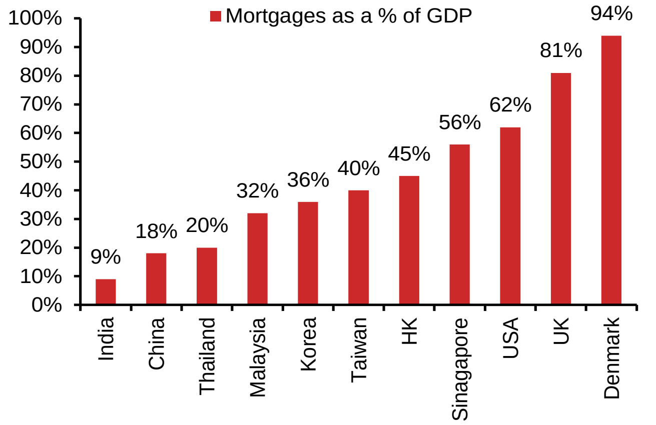
Source: Company data, Bloomberg consensus forecasts for not-rated stocks, Nomura estimates. Note: Share prices are as of 15 June 2015 close. Note: Valuation multiples for HDFC/IHFL are adjusted for subsidiary value/dividends

Stock-wise view and recommendation:

- **HDFC Limited (Neutral**; **TP**: **INR1**,**325):** Over the past decade, HDFC's market share has gradually increased to 14% from 12%. We think the stock offers good structural exposure to increasing mortgage penetration. While wholesale funding should also benefit HDFC, its margins have remained in a tight band through the cycle. Thus we NIMs seem unlikely to improve despite the cost of funds benefit. Valuation at 3.6x FY17F book is above mean levels. Hence, we maintain our Neutral and TP of INR1,325.
- **LIC Housing Finance (Upgrade to Buy**; **TP**: **INR500):** LICHF has also increased its market share to ~9.6% currently from 7% in FY10. LICHF's NIMs are very sensitive to the interest rate cycle and it remains a key beneficiary of lower wholesale funding rates. Thus, LICHF's spreads should improve by ~15bps over the next two years, which could be higher if it is able to increase the proportion of its LAP/builder book. While historically, LICHF's management of ALMs and margins through cycles has been disappointing, we see lower risk in this cycle as a large part of its asset book is fixed rate in a falling rate environment,. Recent correction to <INR400/share has brought its valuation to a reasonable level at 1.8x FY17F book, in our view. We thus upgrade to Buy but maintain our TP of INR500.
- **Indiabulls Housing Finance: (Initiate a**t **Buy** with **TP of INR800):** IHFL has been the fastest-growing HFC over the past five years with a strong presence in LAP (more than 10% market share) and builder financing; and it is now gaining share in mortgages (~3% share). ROEs of 30% are best among peers due to its higher share of LAP/corporate book. We expect this to sustain despite increasing traditional mortgage share; due to a significant improvement in funding profile/mix and increasing leverage. **Two key re-rating catalysts: 1)** Continuous improvement in funding profile as a result of credit ratings upgrades should make IHFL more competitive in mortgages and **2)** various steps taken by management to improve perception relating to corporate governance. Current valuation at 2x FY17F book is cheap, in our view, for sector-best ROEs of ~28% and 23-25% growth. Our TP of INR800 implies ~3x FY17F book.
- **Dewing housing: (Initiate a**t **Buy rating** with **TP of INR525):** DHFL has been one of the fastest-growing HFC over the past decade. It has focused on the lower/middle income (LMI) segment where penetration/competition remains fairly low. While ROEs remain comparatively low at 16% due to the inefficient use of cash, higher leverage/opex, we think valuations more than discount this and recent rating upgrades (AAA by CARE), improving bond mix and management's commitment to improve efficiencies going forward should support valuations. DHFL remains the cheapest Indian mortgage provider currently trading at 0.9x FY17F book vs peers trading at 2-3x FY17F book. Better delivery in terms of cash utilisation and operating efficiency should help the stock re-rate going forward. Our TP of INR525 implies 1.25x FY17F book.

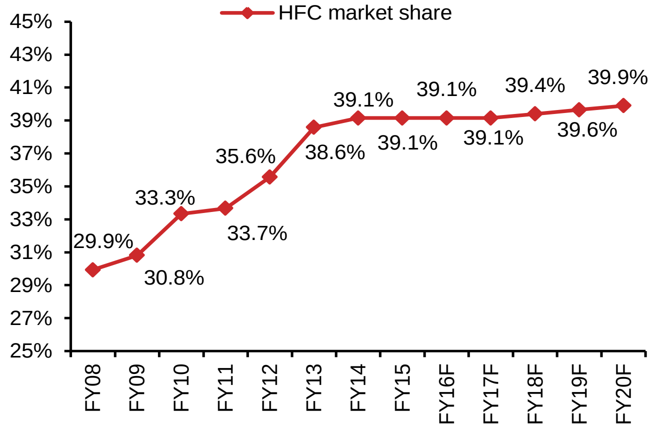
Investment thesis in charts

Fig. 3: Mortgage penetration still low: should continue to improve



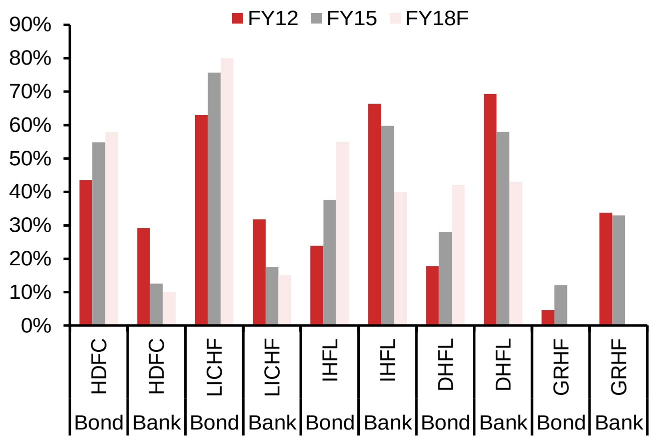
Source: HDFC, Nomura research

Fig. 4: HFCs have gradually gained share: trends should stabilise



Source: Company data, NHB, RBI, Nomura estimates

Fig. 5: Funding mix improving for HFCs: Reliance on bank funding coming down



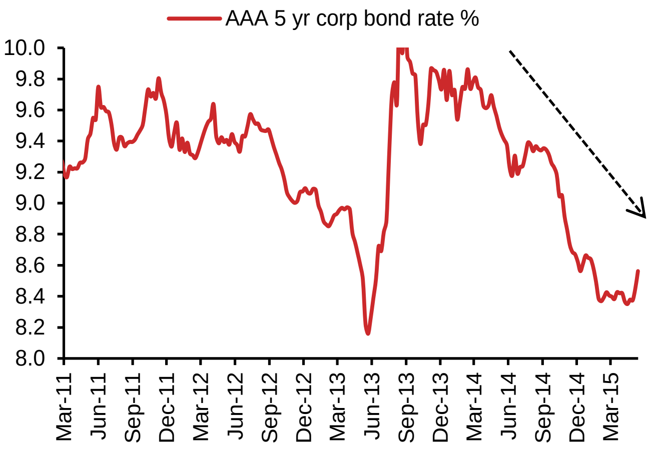
Source: Company data, Nomura estimates

Fig. 6: Ratings upgrades a key catalyst for Indiabulls and Dewan Housing

Long term ratings		FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
	ICRA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil	AA	AA	AA	AA	AA+
	CARE	AA+	AA+	AA+	AA+	AAA
	ICRA	AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AAA

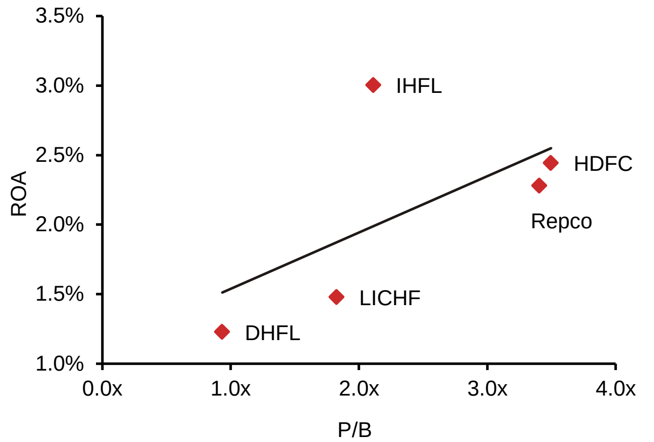
Source: Company data, Bloomberg, Nomura research

Fig. 7: Cyclically we expect liquidity to remain comfortable and hence bond funding should remain cheaper vs bank funding



Source: Bloomberg, Nomura research

Fig. 8: Valuations reasonable relative to ROAs

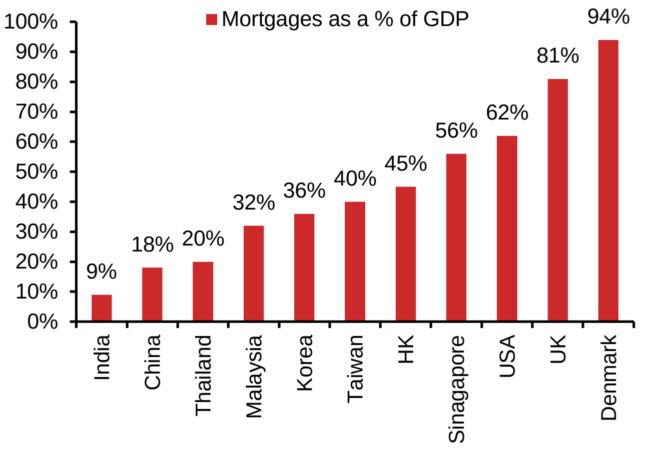


Source: Company data, Nomura estimates

Mortgage opportunity remains large; HFCs continue to gain share

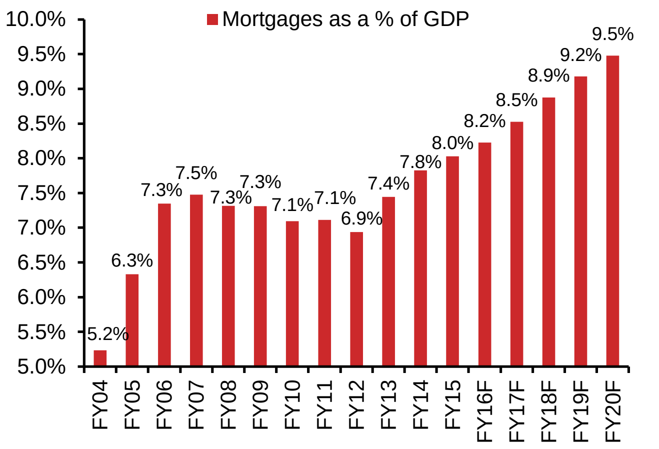
Domestic mortgage market to more than double in the next five years:
India's mortgage penetration at 8% of GDP remains lower than most developing markets at 15-20% penetration despite ~20% CAGR growth in the past decade. Penetration levels have inched up ~25bps annually in the past 10 years leading to penetration improving from 5-6% in FY04-05 to 8-9% currently. With improving income levels and the penetration rate still less 50% of other developing markets, we see mortgage penetration continuing to increase at a similar pace as in the past decade implying ~17-18% CAGR over the next five years with the total mortgage market growing from INR10trn currently to INR23trn by FY20F.

Fig. 9: Mortgage penetration levels still low in India



Source: HDFC, Nomura research

Fig. 10: Penetration continues to inch up at a steady pace barring the spike and normalisation around GFC



Source: RBI, Nomura estimates

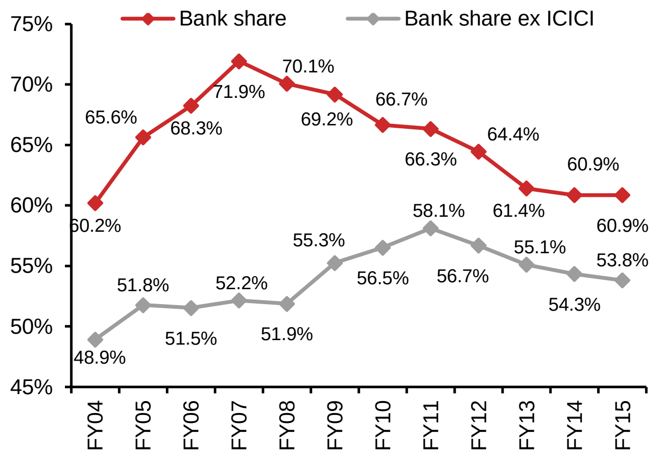
Fig. 11: We expect ~17-18% CAGR opportunity: mortgage market to increase from +INR10trn to ~INR23trn by FY20F

INRbn	Bank Mortgage book	HFC mortgage book	Total mortgage book	HFC market share	Mortgage growth y/y	Real GDP growth	CPI Inflation	Nominal GDP	Mortgage penetration
FY04	894	591	1,485	39.8%		8.0%	3.9%	28,379	5.23%
FY05	1,347	705	2,052	34.4%	38.2%	7.1%	3.1%	32,422	6.33%
FY06	1,852	862	2,714	31.7%	32.2%	9.5%	4.1%	36,934	7.35%
FY07	2,310	902	3,212	28.1%	18.4%	9.6%	7.3%	42,947	7.48%
FY08	2,557	1,092	3,649	29.9%	13.6%	9.3%	6.9%	49,871	7.32%
FY09	2,848	1,268	4,116	30.8%	12.8%	6.7%	9.7%	56,301	7.31%
FY10	3,063	1,532	4,595	33.3%	11.6%	8.6%	13.2%	64,778	7.09%
FY11	3,674	1,864	5,538	33.7%	20.5%	8.9%	10.2%	77,841	7.11%
FY12	4,027	2,222	6,249	35.6%	12.8%	6.7%	8.3%	90,097	6.94%
FY13	4,622	2,904	7,526	38.6%	20.4%	4.5%	10.2%	101,133	7.44%
FY14	5,408	3,479	8,888	39.1%	18.1%	4.7%	9.5%	113,551	7.83%
FY15	6,267	4,032	10,300	39.1%	15.9%	6.0%	7.0%	128,312	8.03%
FY16F	7,291	4,690	11,981	39.1%	16.3%	7.5%	6.0%	145,634	8.23%
FY17F	8,577	5,518	14,095	39.1%	17.6%	8.0%	5.5%	165,295	8.53%
FY18F	10,093	6,561	16,654	39.4%	18.2%	8.0%	5.5%	187,610	8.88%
FY19F	11,793	7,748	19,541	39.6%	17.3%	8.0%	5.5%	212,937	9.18%
FY20F	13,766	9,138	22,904	39.9%	17.2%	8.0%	5.5%	241,684	9.48%
Growth FY04-14	***19.7%***	***19.4%***	***19.6%***						
Growth FY14-20F	***16.8%***	***17.5%***	***17.1%***						

Source: RBI, Nomura estimates

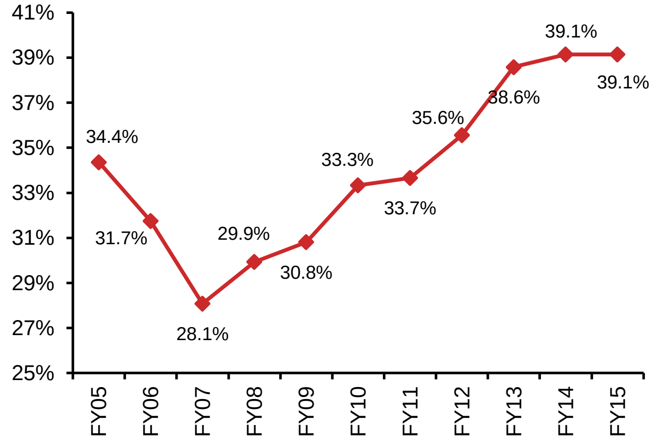
HFCs gained share over the past five years – Should maintain share going forward
Mortgages have remained competitive over the past five to ten years, with ICICI being the most aggressive pre-2008, SBI/LICHF being aggressive between 2009-12 and now all banks/HFCs competing aggressively for the past two years with corporate growth slowing. Despite their relative funding cost disadvantage to banks, HFCs have maintained their market share relative to banks over the past 10 years and gained market share in the past five years due to: 1) increasing reliance on lower cost market borrowing vs bank funding; 2) lower opex structure (opex to assets of 0.4-0.5% of loans vs 1.5-2.0% for banks) and 3) smaller HFCs concentrating and gaining share in the low-cost mortgage market (<INR2mn loans).

Fig. 12: Banks' market share declining over the past five years even excluding ICICI



Source: Company data, RBI, Nomura estimates

Fig. 13: HFCs' share has inched up marginally in past decade



Source: Company data, NHB, Nomura research

Fig. 14: Market shares of most HFCs have been increasing in past 5 years; Axis Bank has gained the most among banks

Market share	FY08	FY12	FY13	FY14	FY15	Incremental market share - FY08-12	Incremental market share - FY12-15	CAGR - FY09-12	CAGR - FY12-15
Private Banks	**70.1%**	**64.4%**	**61.4%**	**60.9%**	**60.9%**	**56.5%**	**55.4%**	***12%***	***16%***
ICICI Bank	18.2%	7.7%	6.3%	6.5%	7.0%	-6.9%	6.0%	-8%	15%
Axis Bank	2.1%	4.2%	4.7%	5.0%	5.2%	7.1%	6.7%	36%	27%
HDFC Bank		2.3%	2.2%	2.2%	2.3%	5.5%	2.4%		19%
Kotak Bank	0.7%	1.3%	1.4%	1.4%	1.4%	2.2%	1.5%	34%	21%
PSUs									
SBI	12.4%	16.4%	15.9%	15.8%	15.4%	22.2%	13.7%	23%	16%
PNB	2.2%	2.2%	1.9%	1.9%	2.1%	2.2%	1.9%	14%	16%
BOB	2.0%	2.3%	2.1%	2.2%	2.2%	2.6%	2.0%	18%	17%
BOI	1.7%	1.3%	1.4%	1.5%	1.6%	0.8%	2.0%	7%	26%
Private banks ex- ICICI	**51.9%**	**54.4%**	**52.9%**	**52.2%**	**51.5%**	**63.5%**	**49.4%**	**17%**	**16%**
HFCs	29.9%	35.6%	38.6%	39.1%	39.1%	**43.5%**	**44.6%**	***19%***	***22%***
HDFC Ltd	13.3%	13.5%	13.9%	13.9%	13.8%	13.9%	14.2%	15%	19%
LIC Housing	5.7%	9.3%	9.6%	9.6%	9.7%	14.4%	10.3%	29%	20%
Dewan housing	1.0%	2.7%	4.0%	3.9%	4.1%	5.1%	6.3%	46%	36%
Indiabulls Financials		2.0%	2.1%	2.2%	2.5%	4.9%	3.3%		27%
Gruh Finance	0.5%	0.6%	0.7%	0.8%	0.9%	0.8%	1.2%	20%	32%
GIC Housing	0.7%	0.6%	0.6%	0.7%	0.6%	0.6%	0.7%	13%	19%
Can Fin Houses	0.5%	0.4%	0.5%	0.7%	0.8%	0.3%	1.4%	9%	45%
PNB Housing		0.6%	0.9%	1.2%	1.6%	1.5%	3.1%		62%
Repco		0.4%	0.4%	0.4%	0.5%	0.9%	0.6%		27%
Total Mortgage Market								***14%***	***18%***

Source: Company data, NHB, RBI, Nomura research

Economics of mortgages: **HFC vs bank:** Our comparison of profitability of mortgages provided by a bank or HFC indicates that whilst an HFC has higher costs of funds (200-250bps higher than for banks) this is mitigated by lower opex costs for HFCs (~125-150bps lower opex to assets) and no regulatory requirement of SLR/CRR (75bps cost of SLR/CRR for banks). So on a total ROA/ROE basis, a mortgage as a product is equally or more profitable for an HFC than for a bank if: 1) the HFC is able to deliver on most efficient/cheap cost of funds especially when competing in the prime mortgage category and 2) find niches on the asset side where banks do not dominate the market.

Banks have an advantage of lower funding cost, making them more competitive on the cost side; however, this is mitigated by the lower opex cost of HFCs vs banks which more than offsets the funding cost benefit.

Fig. 15: ROEs of a plain vanilla mortgage similar or better for HFC than bank

	Plain vanilla mortgages		Small ticket mortgages
	Bank	**HFC**	**HFC-2**
Equity	9.0	9.0	9.0
Borrowings/Deposits	91.0	91.0	91.0
Loans	77.3	95.0	95.0
Investments	22.8	5.0	5.0
Effective Loan yields	10.80%	10.80%	12.50%
Cost of Funds	**6.75%**	**9.00%**	**10.00%**
Yield on investments	7.50%	7.50%	7.50%
NIMs	**3.61%**	**2.45%**	**3.15%**
Fees	**0.25%**	**0.25%**	**0.25%**
Revenues	**3.86%**	**2.70%**	**3.40%**
Opex	1.75%	0.35%	0.75%
PPOP	**2.11%**	**2.35%**	**2.65%**
Credit costs	0.20%	0.20%	0.30%
Pre tax ROA	**1.91%**	**2.15%**	**2.35%**
Tax rate	0.57%	0.64%	0.71%
ROA	**1.33%**	**1.50%**	**1.65%**
Leverage	11.1	11.1	11.1
ROE (%)	**14.8%**	**16.7%**	**18.3%**

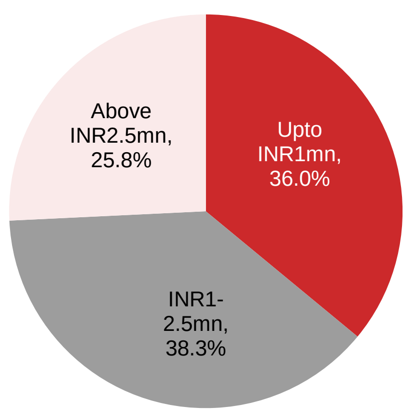
Source: Nomura estimates

Segmenting the housing market: Low-cost housing financing and low financing cost the key differentiators

India's mortgage market can be split by the ticket size of the mortgage loan. There are broadly three categories: 1) >INR2.5mn: generally the metro/urban markets; 2) INR1.0-2.5mn: generally the catchment areas of urban/metro cities and semi urban towns and 3) <INR1.0mn ticket size.

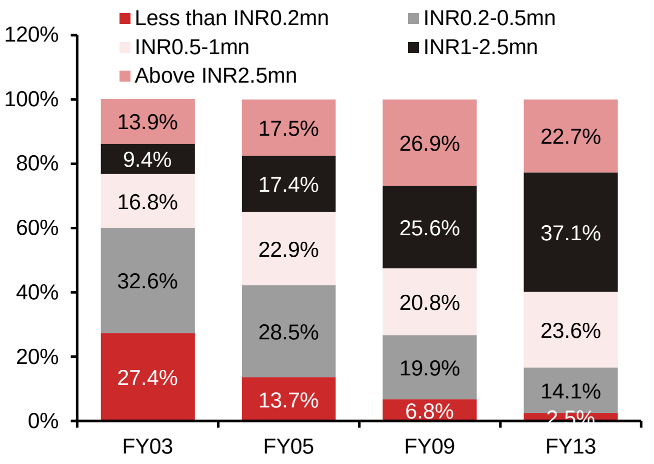
- **Of these three segments, the >INR2.5mn market (prime mortgage market)** is most competitive as the majority of this market is templated lending largely to salaried individuals in urban/metro cities and underwriting challenges in this category are fairly low. We have seen mortgage yield differences with bank base rate down to almost "nil" in this category and as low funding cost is the key differentiator, most large banks/HFCs dominate this market. Among our coverage universe of NBFCs/HFCs, HDFC Limited, LICHF are very active in this market and Indiabulls is now more focused on this segment given its improvement in cost of funds.
- **The INR1-2.5mn loan category** is more a product for semi-urban towns and satellite towns around large cities. Pricing competition is limited to only the upper end of this segment where larger HFCs like HDFC, LICHF and IHFL operate. HFCs like DHFL are present more in the lower end of this category where pricing competition is lower and yields are ~75-100bps higher than the >INR2.5mn category.
- **The <INR1.0mn segment**: This is the low income housing segment which is the least serviced and reach/assessment skill requirement is very different vs the template lending in the >INR2.5mn category. Some niche NBFCs like Gruh Finance (GRHF IN, NR), Repco Finance (REPCO IN, NR) and to some extent DHFL operate in this segment.
- ***So overall for ticket sizes of >INR2.5mn, cost of funding is the key differentiator and for ticket size of <INR2.5mn, ability to assess credit within certain operating cost is the key differentiator*.**

Fig. 16: >60% of o/s mortgages are in the >INR1mn category (FY13)



Source: NHB, Nomura research

Fig. 17: Share of <INR1.0mn mortgages has been coming down in overall mortgage book for banks



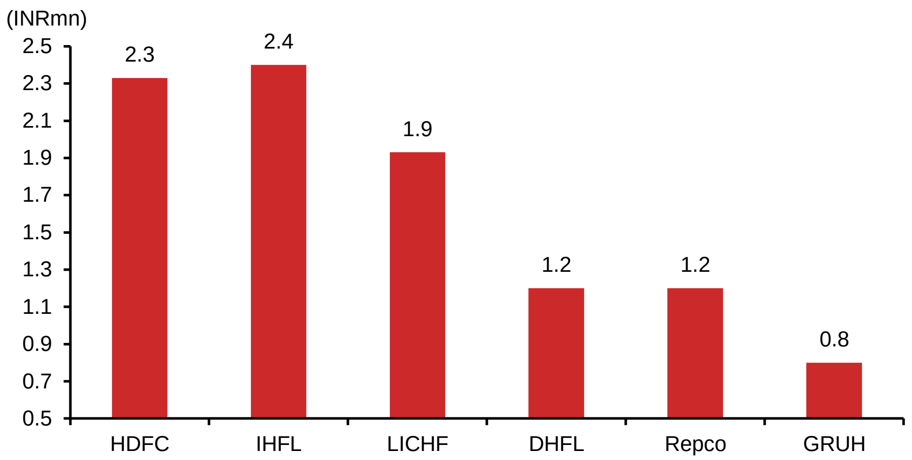
Source: NHB, Nomura research

Fig. 18: Segmenting the mortgage market: % of disbursements in low ticket segment has fallen in the past few years

		>INR2.5mn	INR1-2.5mn	<INR1.0mn
FY10	% of Loans -	26.9%	25.6%	47.5%
FY13	% of Loans -	22.7%	37.1%	40.2%
FY10	% of disbursements -	35.6%	26.4%	37.9%
FY13	% of disbursements -	33.0%	41.6%	25.4%
	Markets/Customers	Concentrated in Urban/Metro cities. Mostly salaried customers and HNIs	Semi-urban towns and sattelite towns around large cities	Semi-urban and rural towns
	Average yields	10-10.25%	10.75-11.5%	11-14%
	Pricing Competition	Very competitive market with rates as low as base rate	Relatively lower competition as compared to prime mortgage market	Very limited competition as it has been an ignored segment
	Key players	All large banks, HFCs - HDFC and LICHF	PSU Banks, HFCs - LICHF, HDFC, IHFL and Dewan	Cooperative Banks, regional Banks, HFCs - Gruh, Repco and DHFL to some extent
	Competitive advantage	Low cost of funds and operating effeciency	Better underwritting ability, competitive cost of funds	Better underwriting ability, higher operating effeciency and NHB funding support

Source: Company data, NHB, Nomura research

Fig. 19: Average ticket sizes of mortgage providers clearly shows the differentiation in product segment targeted (FY14 ticket size)



Source: Company data, Nomura research

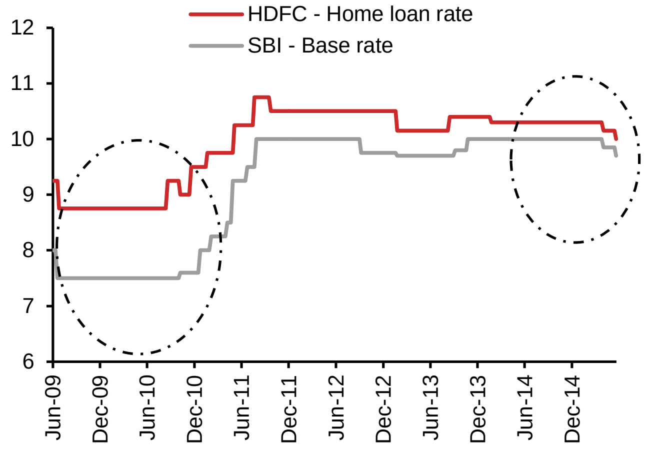
Improvement in funding mix and cost of funds: key investment catalyst for IHFL and DHFL

- The >INR1.5mn category continues to be the largest segment of India's mortgage market contributing 64% of loans and 75% of disbursements but it is the most price competitive as well with mortgages now being written mostly at base rates (vs 75-125bps higher than base rate about four to five years ago). Thus apart from distribution, branding and underwriting, cost of funds is the key differentiator.
- **Among banks**, larger banks with higher CASA ratio have done better in garnering market share and banks with weaker CASA franchise generally have refrained from building a large mortgage book given their cost of funds disadvantage. Among HFCs as well, larger wholesale funded HFCs like HDFC limited and LIC housing who are AAA rated and have the lowest cost of funds have continued to increase their market share.
- Both **IHFL and DHFL** have had a funding disadvantage vs HDFC and LICHF in their cost of funds due both to the mix of funding (IHFL and DHFL are more bank-funded) and also due to higher costs (as IHFL and DHFL's credit ratings are lower). As IHFL

and DHFL are increasing in size and have built a credible history, rating agencies have upgraded their ratings, which has led to improved cost of funds. With further credit ratings upgrades expected and an increase in the share of the wholesale funding mix, we expect, the cost of funds gap to narrow substantially for IHFL vs HDFC and LICHF and increase its ability to compete.

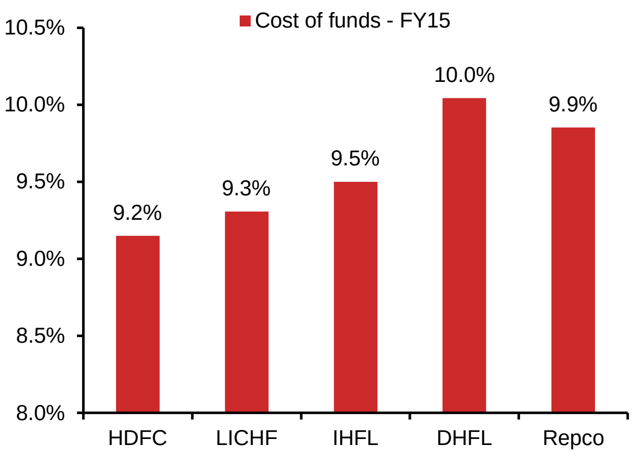
- **Lower incremental cost of funds** is our key investment thesis for both IHFL and DHFL. While both are large loan providers in the LAP market (as discussed in a later section), where yields are certainly on the decline, we expect their cost of funding to improve and that should restrict any material NIM contraction.

Fig. 20: Mortgage rate differentials vs base rate almost negligible, making cost of funds most important differentiator



Source: Company data, Bloomberg, Nomura research

Fig. 21: Larger HFCs have the best cost of funds



Source: Company data, Nomura research

Fig. 22: Larger HFCs have higher reliance of their funding for wholesale market which is cheaper; NHB re-finance is available for rural/low-income urban housing but the pool is very limited

	Current Funding mix					
INRmn	Banks	Bonds	Deposits	NHB	Current cost of funds	Comments
Cost of funds	9.9%-11%	8.5%-9.5%	9%-10%	7-8%		
HDFC	12.6%	54.8%	31.7%	0.9%	9.15%	Bond funding share is the highest and hence HDFC enjoys the lowest cost of funds. While deposits are currently more expensive than bonds, stability of rates is higher in deposits given their retail nature.
LICHF	17.6%	75.7%	2.5%	3.6%	9.31%	LICHF has ramped up its bond mix significantly and now is similar to HDFC. Falling rates and +50% fixed rate asset book makes LICHf a big beenficary of the rate cycle.
Indiabulls	59.8%	40.2%			9.50%	We expect cost of funds to structurally improve for Indiabulls driven by ratings upgrades and higher market acceptability of their bonds. Its CRISIL rating is just one notch below HDFC and LICHF.
Dewan	58.0%	28.0%	8.0%	3.0%	10.04%	Cost of funds for Dewan should see a sharp improvement as it builds up bond book reaping rating upgrade benefits. Leverage too high and further upgrades contingent upon leverage falling.
Gruh	33.0%	17.0%	16.0%	34.0%	9.32%	Cost of funds has been lower for GRUH due to its higher share of NHB re-financing which comes at a cheaper rate and also parent level comfort (HDFC Limited subsidiary) for rating agencies and debt investors.
Repco	80.3%			19.7%	9.85%	Repco has higher reliance on NHB re-financing and that helps it keep its cost of funds low.

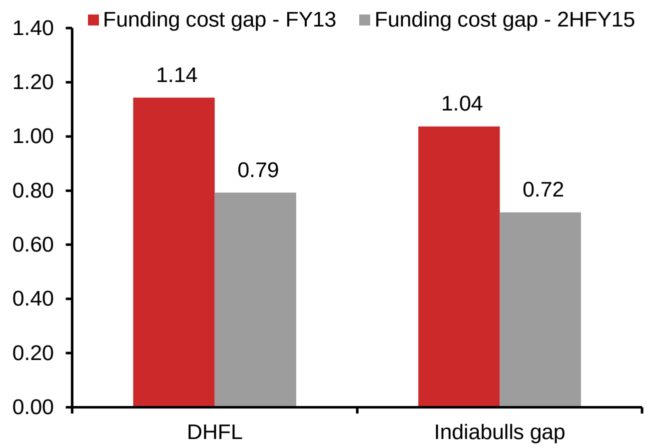
Source: Company data, Nomura research

Fig. 23: Rating agencies have upgraded their ratings on Indiabulls and Dewan

Long term ratings		FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
	Crisil	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
HDFC	CARE	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	ICRA		AAA	AAA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	Crisil		AA-	AA-	AA	AA	AA	AA	AA+
Indiabulls	CARE				AA+	AA+	AA+	AA+	AAA
	ICRA				AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AAA
Gruh	Crisil	AA	AA+	AA+	AA+	AA+	AA+	AA+	AA+
	ICRA		AA+	AA+	AA+	AA+	AA+	AA+	AA+
Repco	CARE							AA-	AA-
	ICRA		A	A	A+	A+	A+	AA-	AA-

Source: Company data, Bloomberg, Nomura research

Fig. 24: Leading to significant reduction in cost of funds and premium paid over HDFC/LICHF's cost of funds



Source: Bloomberg, Nomura research

Fig. 25: Improvement in funding mix over next two to three years to drive down cost of funds for Indiabulls/Dewan

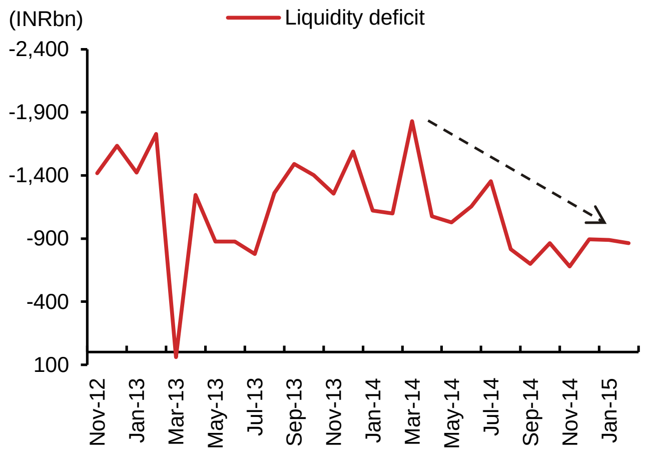
Funding	DHFL			IHFL		
mix%	FY13	FY15	FY18F	FY13	FY15	FY18F
Bonds	24.0%	31.0%	46.0%	30.1%	37.6%	55.0%
Bank	71.0%	58.0%	43.0%	62.3%	59.8%	40.0%
Deposits	6.0%	8.0%	8.0%			
Others	0.0%	3.0%	3.0%	7.7%	2.6%	5.0%

Source: Company data, Nomura estimates

Cyclically funding environment remains favourable

HFCs are wholesale-funded especially the larger HFCs and system liquidity and funding environment are important determinants of profitability over the near- to medium-term. System liquidity has remained comfortable since March 2014 and with only a gradual pick up in corporate credit growth expected (11% in FY16 and 13% in FY17F); we expect system liquidity to remain relatively benign over next 12 months. This should lead to lower wholesale rates and cost of funds for HFCs. ***Apart from the structural growth opportunity, expectations of benign liquidity is also a driver for our positive view on HFCs in general***.

Fig. 26: System liquidity has been comfortable over the past 12 months (chart shows net RBI borrowing of banks)

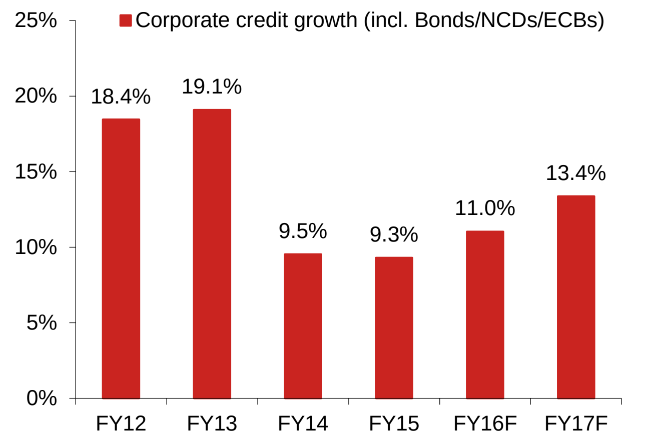


Source: Bloomberg, Nomura research

Fig. 27: Leading to lower wholesale rates

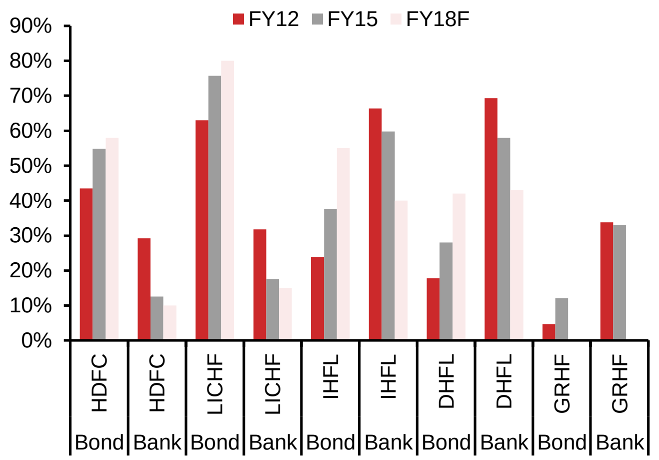
Source: Bloomberg, Nomura research

Fig. 28: We expect a gradual recovery in corporate credit growth and hence liquidity should remain comfortable



Source: RBI, Nomura estimates

Fig. 29: Incremental share of cheaper bond funding has been on the rise and should continue

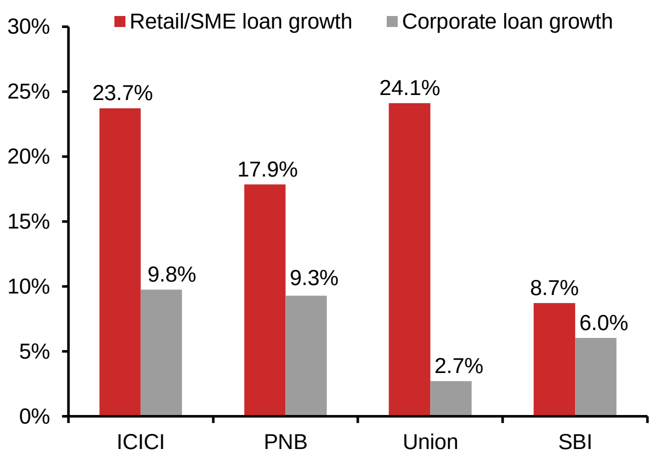


Source: Company data, Nomura estimates

Weaker profitability of banks to restrict their ability to cut base/mortgage rates unlike the previous cycle

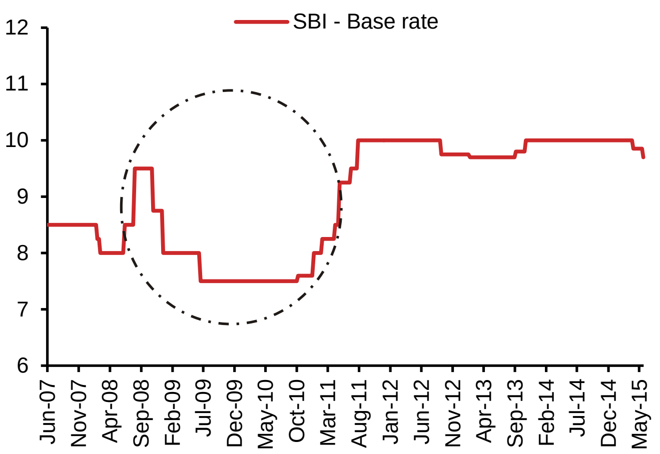
With slower corporate credit growth most banks have indicated retail/MSME to be their focus growth area. While this would mean that pricing competition should remain high for HFCs from banks, we believe the ability of banks to cut the base rate in this cycle is much lower than in the past cycle (after GFC), given their weak profitability. Banks cut the base rate by 150-200bps between September 2008 to December 2009 leading to a significant cut in mortgage rates and 30-40bps impact to their margins over 2QFY09 to 1QFY10. NIMs is already lower by 40-50bps vs FY12 and more importantly, current ROAs/ROEs is 0.5-0.7%/10-12% lower than FY09/10 with significant pressure on asset quality. This should likely restrict banks from cutting their base rate and hence mortgage rates aggressively.

Fig. 30: Most banks concentrating on retail/MSME growth as corporate credit growth has been weak (FY15 growth)



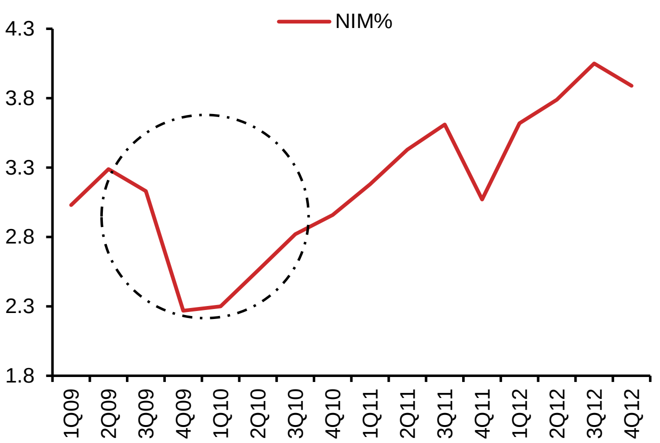
Source: Company data, Nomura research

Fig. 31: After GFC, banks cut base rate and mortgage rates significantly



Source: Company data, Nomura research

Fig. 32: Leading to 70-100bps impact on margins in FY10



Source: Company data, Nomura research

Fig. 33: Current profitability too weak for banks to afford such aggressive cut in rates

ROA tree - PSUs	FY09	FY15	Change
NIMs/Assets	**2.74%**	**2.72%**	**-0.02%**
Fees/Assets	1.12%	0.84%	-0.28%
Investment profits/Assets	0.29%	0.14%	-0.15%
Net revenues/Assets	**4.15%**	**3.69%**	**-0.45%**
Opex/Assets	1.84%	1.86%	0.02%
PPOP/Assets	**2.31%**	**1.84%**	**-0.47%**
Provisioning/Assets	0.43%	0.94%	0.52%
Pre Tax ROA/Assets	**1.88%**	**0.89%**	**-0.99%**
ROAs	**1.15%**	**0.62%**	**-0.53%**
ROEs	**20.1%**	**10.4%**	**-9.7%**

Source: Company data, Nomura research

LAP: substantial growth opportunity but yields likely to come off further

The loan against property (LAP) market has expanded at ~40% CAGR over the past four to five years and is now more than USD20bn market. While growth rates are moderating from over 40%, we believe the opportunity remains fairly large as micro & small manufacturing enterprise (MSME) segment is highly underpenetrated and LAP works as a win-win for the financiers and also borrowers. While growth rates should continue to remain high we are clearly seeing yield pressure in LAP as almost all banks/NBFCs are growing this book aggressively. While LAP still contributes <5% of loans for the larger HFCs like HDFC and LICHF and contraction in yields cannot materially alter profitability for larger HFCs but for mid-sized HFCs including IHFL and Dewan, LAP contributes 20-25% of their current loan book and lower LAP yields could have a meaningful impact on profitability of these HFCs. For detailed discussion on LAP see our December 2014 report *"LAP 101 – Competitive now, yet still attractive"*.

LAP offering and market size:
LAP is the mortgaging of an existing property to secure business or personal loans and is a substitute for unsecured SME or personal loans. It is similar to a mortgage in terms of collateral but servicing of the loan is based on business cashflows. The self-employed account for ~85-90% of total loans and this is largely sourced through DSAs (direct selling agents ~80%). While ticket sizes and yields are higher than traditional mortgages, average tenures are lower. LAP has witnessed robust growth over the past four years with both banks/NBFCs becoming more aggressive in this segment, which has resulted in 40% CAGR over the past four to five years taking the market size to USD20bn.

Fig. 34: LAP vs. home loans

	Home Loans	LAP
Key focus segment	Salaried	Self employeed
Average ticket size	INR2.5-3mn	INR5-7mn
Average tenure	6-7 years	3-4 years
LTVs	75-80% (on agreement value)	55-65% (on market value)
Avg. Loan yields	10-10.5%	11.25-12.5%
Risk weights	55-60%	100%
Sourcing mix	~60% sourced from DSA	~80% sourced from DSA

Source: Company data, Nomura estimates

Fig. 35: LAP market now large enough: size is ~12% of traditional mortgage market

	FY10	FY11	FY12	FY13	FY14	FY15	CAGR (FY10-15)
LAP book	245	392	533	736	978	1,228	38.0%
Mortgages Total	4,595	5,538	6,249	7,526	8,888	10,368	17.7%
LAP (% of mortgage book)	5.3%	7.1%	8.5%	9.8%	11.0%	11.8%	
LAP (% of incremental mortgage growth)		15.6%	19.8%	15.9%	17.8%	16.8%	

Source: Company data, Nomura research

Market size comparison more appropriate to SME financing – Large opportunity still remains: As discussed above, the nature of LAP funding is closer to SME financing rather than traditional mortgages and hence market size and opportunity comparison is more appropriate vs SME financing. SME financing is under-penetrated in India and IFC estimates an INR16trn viable debt financing opportunity for SMEs which is growing every year. Banks SME loan book including medium-size enterprises is INR5trn and as per our estimates LAP book for banks/NBFCs is INR1.2trn. So formal funding available through banks and NBFCs is INR6.2rn which is just 40% of latent demand and the financing opportunity remains large. Currently 80-90% the LAP market is from top 8-10 cities while the SME dispersion should likely be more into both urban and rural markets and so there should be opportunity in LAP financing over time to extend the product beyond the top 8-10 cities. While LAP growth will slow down from +40% CAGR growth seen in last four years given the high base now but with the large untapped SME opportunity, growth should remain structural.

We estimate a ~60% funding gap for SMEs in India and that presents a significant growth opportunity for LAP in the long run.

Fig. 36: MSME presents a large opportunity for LAP – 60% demand still not met

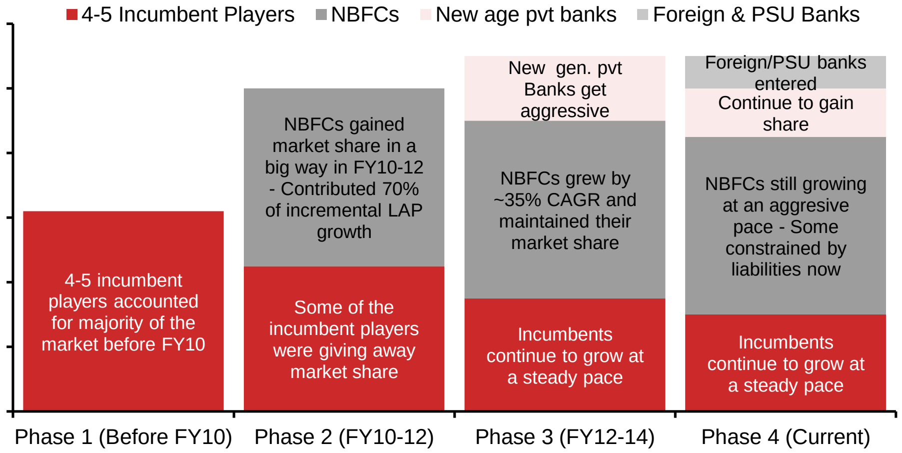
No. of MSME (mn)	46.8
No. of MSME covered by financial institutions (mn)	11
% covered by financial institution	23.5%
% of India Manufaturing	37.5%
% of System GDP	7.3%
% of system Loans	11.6%
Funding required for MSMEs (INRtrn)	32.50
of which equity (INRtrn)	6.50
Of which debt (INRtrn)	26.00
Of which non-viable debt (INRtrn)	9.62
Of which viable debt (INRtrn)	16.38
Current Funding by banks	5.38
Our estimate of System LAP book	1.20
% of viable demand met	40.2%
% of demand gap	**59.8%**
Mix of SMEs in India	
SME in Urban India	55%
SME in Rural India	45%

Source: IFC report, Nomura research

Genesis and market share: Becoming very competitive now

- **Phase 1- Pre FY10:** Asset quality trouble in the retail segment in FY08 led to the drying up of the unsecured personal loans. LAP as a product began to gain some ground as NBFCs started plugging the gaps for SME lending/personal loans.
- **Phase 2 - FY10-12:** NBFCs seize the opportunity, making them the most dominant players between FY10 and FY12. NBFCs contributed ~70% of the incremental LAP growth between FY10-12.
- **Phase 3- FY12-14: Private banks join the party:** Low credit costs experienced in LAP by NBFCs led to an increased LAP focus by private banks. Private banks largely present in the low-risk LAP, thereby limiting the impact on NBFCs.
- **Phase 4- Current status: Foreign banks and PSUs also competing aggressively now** leading to lower LAP yields.

Fig. 37: Evolution of the LAP market



Source: Company data, Nomura research

Fig. 38: LAP: Market share dynamics – HFCs/NBFCs gained share pre FY12 and are now maintaining share as most banks have become aggressive in their LAP offering

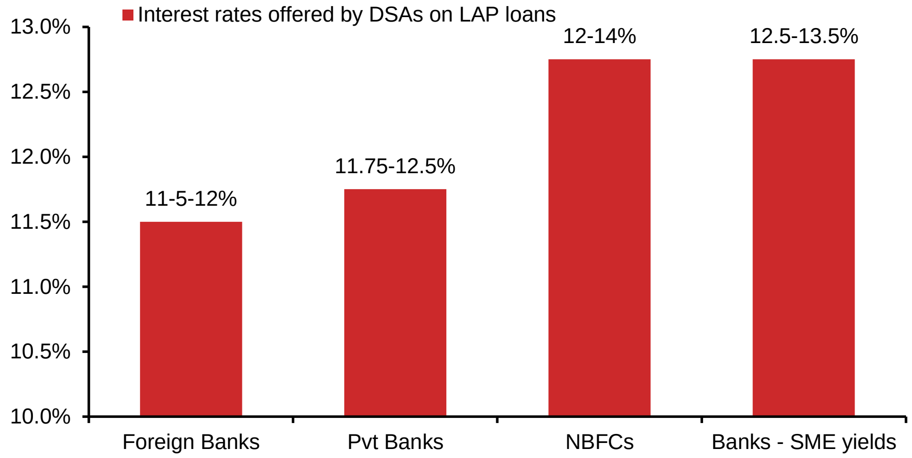
Market share	FY10	FY11	FY12	FY13	FY14	FY15	Incremental market share - FY10-12	Incremental market share - FY12-15
Private Banks	**56.5%**	**48.9%**	**41.8%**	**42.4%**	**42.1%**	**42.3%**	**30.2%**	**42.6%**
ICICI	25.0%	23.4%	15.5%	13.7%	12.9%	12.8%	7.9%	10.8%
Axis	3.1%	2.8%	4.1%	4.4%	6.4%	6.2%	4.8%	7.8%
HDFCB	17.6%	12.6%	11.5%	11.6%	8.9%	7.5%	6.7%	4.5%
Kotak	6.0%	5.4%	5.5%	5.6%	5.5%	5.3%	5.0%	5.1%
IIB	0.0%	0.0%	0.8%	1.9%	2.5%	3.7%	1.4%	5.9%
ING Vysya	2.2%	1.7%	1.7%	2.0%	2.4%	2.4%	1.3%	2.9%
Federal	1.7%	1.4%	1.4%	1.4%	1.7%	1.9%	1.2%	2.3%
DCB	0.9%	1.4%	1.4%	1.9%	1.9%	2.5%	1.9%	3.3%
Private banks ex- ICICI/HDFCB	**13.9%**	**12.9%**	**14.9%**	**17.2%**	**20.4%**	**22.0%**	**15.6%**	**27.3%**
NBFCs	**43.5%**	**51.1%**	**58.2%**	**57.6%**	**57.9%**	**57.7%**	**69.8%**	**57.4%**
Indiabulls	11.6%	13.1%	12.9%	11.7%	10.6%	10.8%	13.9%	9.3%
HDFC	9.3%	8.5%	7.9%	9.5%	10.0%	10.1%	6.8%	11.7%
Religare	5.0%	9.4%	11.0%	7.9%	7.3%	8.2%	15.7%	6.1%
Dewan Housing	1.1%	1.1%	4.7%	5.4%	7.3%	8.2%	7.6%	10.7%
Bajaj Finance	4.5%	5.9%	8.0%	8.0%	7.0%	6.2%	10.7%	4.9%
IIFL	2.6%	4.6%	4.2%	4.0%	4.7%	4.1%	5.5%	4.0%
Reliance	4.2%	4.0%	4.7%	5.5%	4.6%	3.2%	5.0%	2.1%
LICHF	4.3%	3.7%	3.6%	3.6%	3.6%	4.2%	3.0%	4.7%
L&T	0.0%	0.0%	0.0%	0.1%	0.8%	1.1%	0.0%	1.9%
Repco	1.0%	0.8%	0.7%	0.7%	0.9%	0.8%	0.6%	0.9%
Edelweiss	0.0%	0.0%	0.6%	1.2%	1.2%	0.9%	1.0%	1.2%

Source: Company data, Nomura estimates

LAP yields fell in the past 12-18 months; more contraction likely

- LAP commanded better rates in FY10-12 with NBFCs being the only serious LAP provider but with slow-down in corporate demand, banks have entered this segment resulting in a yield compression of ~75bps over the past 1-1.5 years.
- Our feedback from most providers in this category indicates 75-100bps compression in yields due to increased competition and our checks with DSAs (direct selling agents) indicate that foreign banks are now offering the best rates.
- On a longer-term basis, we think a spread of ~100-225bps over mortgages would be more sustainable, which would mean another 50-75bps compression in yields over mortgage rates.

Fig. 39: LAP yields coming off: All banks/NBFCs competing aggressively in LAP



Source: Company data, Nomura estimates

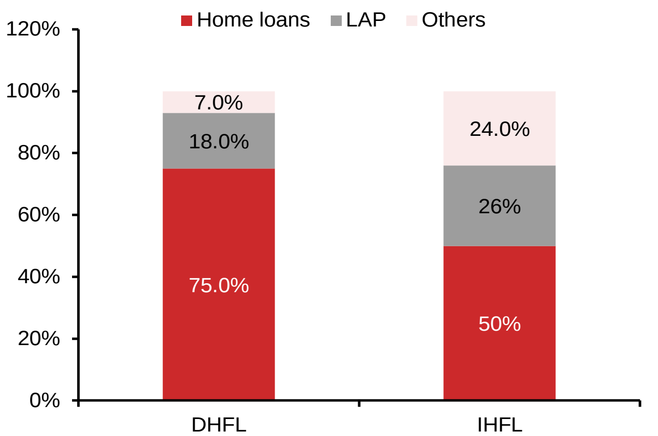
Fig. 40: Our profitability analysis in LAP vs. mortgage suggests LAP to remain relatively profitable even if yields compress further by 50-75bps

	Mortgage ROEs		LAP ROEs		LAP ROEs with lower yields	
Profitability analysis	**Mortgage - Salaried**	**Mortgage - Self employeed**	**LAP - Low risk (HFC)**	**LAP- High risk (NBFC)**	**LAP - Low risk (HFC)**	**LAP- High risk (NBFC)**
Yield on Loans	**10.25%**	**10.75%**	**11.75%**	**13.25%**	**11.25%**	**12.75%**
Cost of Funds	**9.20%**	**9.20%**	**9.20%**	**10.20%**	**9.20%**	**10.20%**
Bond Funding	9.00%	9.00%	9.00%	9.75%	9.00%	9.75%
Bank Funding	10.00%	10.00%	10.00%	10.50%	10.00%	10.50%
Funding Mix (Bond vs Bank)	80:20	80:20	80:20	60:40	80:20	60:40
Spreads - IRR basis	**1.50%**	**2.04%**	**3.14%**	**3.80%**	**2.59%**	**3.25%**
Equity benefit	0.63%	0.72%	1.10%	1.22%	1.10%	1.22%
NIMs	**2.13%**	**2.77%**	**4.24%**	**5.03%**	**3.69%**	**4.47%**
Fees	0.10%	0.10%	0.20%	0.20%	0.20%	0.20%
Revenues	**2.23%**	**2.87%**	**4.44%**	**5.23%**	**3.89%**	**4.67%**
Opex	0.45%	0.50%	0.60%	0.60%	0.60%	0.60%
PPOP	**1.78%**	**2.37%**	**3.84%**	**4.63%**	**3.29%**	**4.07%**
LLPs	0.10%	0.20%	0.25%	0.40%	0.25%	0.40%
PBT	**1.68%**	**2.17%**	**3.59%**	**4.23%**	**3.04%**	**3.67%**
Tax	0.55%	0.72%	1.19%	1.40%	1.00%	1.21%
PAT/ROA	**1.12%**	**1.45%**	**2.41%**	**2.83%**	**2.04%**	**2.46%**
Leverage (x)	14.7	12.7	8.3	8.3	8.3	8.3
Risk weight	65%	75%	100%	100%	100%	100%
Desired Tier-1	10.5%	10.5%	12.0%	12.0%	12.0%	12.0%
ROE	**16.5%**	**18.4%**	**20.1%**	**23.6%**	**17.0%**	**20.5%**
RORWA	**1.73%**	**1.94%**	**2.41%**	**2.83%**	**2.04%**	**2.46%**

Source: Company data, Nomura estimates

Impact on HFCs that we cover/initiate on: LAP contributes just <5% of loans for HDFC and LICHF and hence the impact of lower LAP yields should remain negligible for them. For IHFL and DHFL, LAP contributes 20-25% of their loan books and lower LAP yields should impact their margins. As mentioned above, LAP yields are already ~100bps lower from the top and we see another ~75bps contraction in LAP yields assuming the current funding cost environment. While a 100bps change in LAP yields imply ~25bps margin contraction, we believe that the improvement in funding profile (rating upgrade) and funding mix (higher share of bond funding) should help offset a large part of the margin contraction that could have come due to falling LAP yields.

Fig. 41: LAP contributed ~20-25% of book for IHFL/DHFL



Source: Company data, Nomura research

Fig. 42: Rating upgrade and funding mix change to negate pressure on LAP yields

Long term ratings		FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
	ICRA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil	AA	AA	AA	AA	AA+
	CARE	AA+	AA+	AA+	AA+	AAA
	ICRA	AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AAA

Source: Company data, Bloomberg, Nomura research

Positive on HFCs; upgrade LICHF to Buy; initiate on Indiabulls and Dewan at Buy

We are positive on HFCs:

- HFCs with ~40% market share remain well placed to take advantage of the **structural growth opportunity** in the mortgage space (18% CAGR in mortgages for the next five years)
- We expect HFCs to continue to maintain their **market share** in spite of increasing competition from banks given their opex advantage.
- Cyclically we expect wholesale funding rate environment to remain favorable and HFCs benefit most from lower wholesale rates.
- While banks especially PSUs are refocussing on retail loans including mortgages it is leading to increased competition, we believe the **ability of banks to cut their base rate and hence mortgage rates in this cycle is low** given their weak profitability.

Fig. 43: HFC and NBFCs valuations – Valuations appear reasonable for HFCs after the recent consolidation

	Current	Mcap		Target	Upside/	P/B		P/E		RoE		RoA	
	price	USDbn	Rating	price	downside	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DHFL	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.7	16.2%	15.9%	1.3%	1.2%
Repco	590	0.6	Not rated	NA	NA	3.97	3.28	23.1	18.7	18.4%	19.7%	2.3%	2.3%
GRHF	219	1.2	Not rated	NA	NA	8.59	6.81	28.8	23.6	32.9%	31.7%	2.8%	2.9%
Shriram	821	3.0	BUY	1,100	33.8%	1.76	1.51	11.7	9.2	16.1%	17.6%	2.5%	2.8%
MMFS	236	2.1	Neutral	305	25.7%	2.07	1.80	12.7	10.5	17.3%	18.4%	2.7%	2.8%

Source: Company data, Bloomberg consensus forecasts for not-rated stocks, Nomura estimates. Note: Pricing as of 15 June 2015 close.

Stock wise view and recommendation:

- **HDFC Limited (Neutral with TP of INR1,325):** Over the past decade, HDFC's market share has gradually increased to 14% from 12%. We think the stock offers investors good structural exposure to the increasing mortgage penetration. While wholesale funding should also benefit HDFC, its margins have remained in a tight band through the cycle. Hence, NIMs are unlikely to improve despite the cost of funds benefit. Valuation at 3.6x FY17F book is above mean levels. Thus we maintain our Neutral rating and TP of INR1,325.
- **LIC Housing Finance (Upgrade to Buy**; **TP** maintained at **INR500):** LICHF has also increased its market share to ~9.6% currently from 7% in FY10. LICHF's NIMs are very sensitive to the interest rate cycle and it remains a key beneficiary of lower wholesale funding rates. Thus, LICHF's spreads should improve by ~20bps over the next two years, which could be higher if LICHF is able to increase the proportion of its LAP/builder book. While historically, LICHF management of ALMs and margins through cycles has been disappointing, we believe that with a large part of its asset book being fixed in a falling rate environment, there is lower risk this cycle. Recent correction from INR480/share to INR420 has its brought valuation to a reasonable level at 1.75x FY17F book, in our view. Upgrade to Buy.
- **Indiabulls Housing Finance: (Initiate at Buy** with **TP of INR800):** IHFL has been the fastest-growing HFC over the past five years with a strong presence in LAP (more than 10% market share) and builder financing; and it is now gaining share in mortgages (~3% share). ROEs of 30% are best among peers due to higher share of LAP/corporate book. We expect this to sustain despite the increasing traditional mortgage share; due to a significant improvement in funding profile/mix and increasing leverage. Two key re-rating catalysts: 1) continuing improvement in funding profile as a result of ratings upgrades should make IHFL more competitive in mortgages and 2) various steps taken by management to improve perception relating to corporate governance. Current valuation at 2x 2017F book is cheap, in our view, for sector-best ROEs of ~28% and 23-25% growth. Our TP of INR800 implies ~3x FY17F book.

• **Dewan Housing Finance: Initiate at B**uy with **TP of INR525)**:

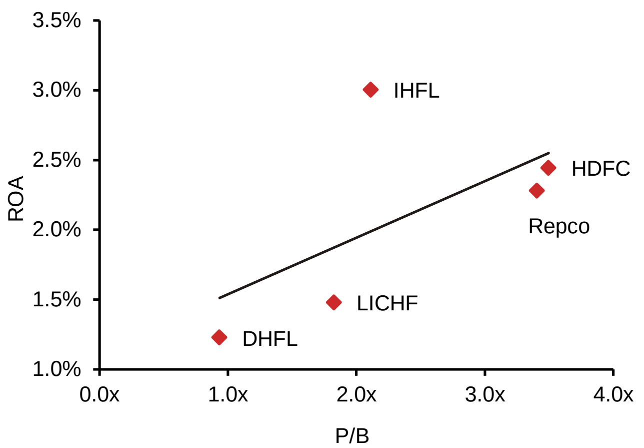
DHFL has been one of the fastest-growing HFC over the past decade. It has focused on the LMI segment where penetration/competition remains fairly low. While ROEs remain comparatively low at 16% due to the inefficient use of cash, higher leverage/opex, we think valuations more than discount this and recent rating upgrades (AAA by CARE), improving bond mix and management's commitment to improve efficiencies going forward should support valuations. DHFL remains the cheapest Indian mortgage provider currently trading at 0.9x FY17F book vs peers trading at 2-3x FY17F book. Better delivery in terms of cash utilisation and operating efficiency should help the stock re-rate going forward. Our TP of INR525 implies 1.25x FY17F book.

Fig. 44: HFCs: TPs and implied upsides

	Current	Mcap		Target	Upside/	P/B		P/E		RoE		RoA	
	price	USDbn	Rating	price	downside	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DHFL	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.7	16.2%	15.9%	1.3%	1.2%

Source: : Company data, Nomura estimates. Note: Share prices are as of 15 June 2015 close.

Fig. 45: Current valuations vs ROAs for HFCs/NBFCs



Source: Company data, Bloomberg, Nomura estimates

Fig. 46: Our FY17F ROE expectations for HFCs

ROA table - FY17F	HDFC	LICHF	DHFL	IHFL
NII	3.3%	2.37%	2.52%	4.69%
Fee	0.6%	0.24%	0.31%	0.64%
Investment	0.0%	0.00%	0.13%	5.33%
Net revenues	3.9%	2.61%	2.95%	0.87%
Opex	0.3%	0.36%	0.85%	4.46%
Provisions	0.1%	0.06%	0.25%	0.34%
Tax	1.1%	0.74%	0.62%	4.11%
Total cost	1.4%	1.16%	1.72%	1.11%
ROA	**2.5%**	**1.44%**	**1.23%**	**3.00%**
Equity/Assets	12.1%	8.15%	8.91%	8.31%
ROE	**21.7%**	**19.0%**	**15.8%**	**31.4%**

Source: Company data, Nomura estimates

Risks to our calls

- **Unfavourable wholesale funding environment:** Apart from the structural growth opportunity, our positive stance on HFCs is based on a favourable wholesale rate environment. We believe that corporate loan growth pick-up would be gradual and hence system liquidity and wholesale funding environment remains comfortable. Spike in wholesale rates should be a risk to our view on overall HFCs and also for Indiabulls housing finance.
- **Higher-than-expected contraction in LAP yields:** LAP yields have fallen by ~100bps and we expect a further 100bps contraction in LAP yields over FY15-18F. LAP is an attractive product from a risk adjusted return perspective and competition should likely increase and given Indiabulls' high reliance on LAP on its lending book, lower LAP yields remain a risk. Every 50bps cut in LAP yields would lead to ~1% cut to IHFL's ROEs.
- **Increased competition from banks**: Prime mortgage remains the most competitive market and any further increase in competition from banks may lead to a rate war which may impact NIMs in the traditional mortgage segment.
- **Lumpy asset quality risk in builder portfolio:** IHFL has not had any defaults in its builder book till now but as the builder book is ~20% of IHFL's loans, lumpy asset quality risks remain. SPV lending would imply that ultimate loss given default should be lower and also IHFL is building a floating provision buffer (INR2bn), but this still does not rule out chances of lumpy NPAs in builder book.

Fig. 47: HFCs: Comparison on fundamental metrics

	HDFC		LICHF		Indiabulls		Dewan	
	2011	2015	2011	2015	2011	2015	2011	2015
Asset Mix:								
Mortgages	57.9%	63.2%	87.5%	92.5%	46.0%	50.0%	92.0%	75.0%
LAP	5.0%	5.0%	4.0%	5.0%	25.0%	26.0%	3.0%	18.0%
Builder + Corporates	37.1%	31.8%	8.5%	2.5%	21.0%	22.0%	3.0%	6.0%
Investments (% of B/S)	8.9%	6.0%	2.6%	2.3%	20.7%	16.9%	9.4%	3.1%
Average Ticket Size (INRmn)	2.3		1.9		2.4		1.1	
Market Share								
Total AUM (INR bn)	1,293	2,533	511	1,084	198	522	141	569
Mortgages	12.7%	13.8%	8.2%	9.7%	1.6%	2.5%	2.3%	4.1%
LAP	8.5%	10.3%	3.7%	4.3%	13.1%	11.1%	1.1%	8.3%
Borrowing Mix:								
Banks	32.9%	12.6%	31.1%	17.6%	69.9%	59.8%	75.0%	58.0%
Bonds	44.7%	54.8%	55.0%	72.7%	19.7%	37.6%	13.0%	28.0%
NHB	1.1%	0.9%	3.4%	3.6%			9.0%	3.0%
Deposits	21.3%	31.7%					4.0%	8.0%
Others			10.4%	6.1%	10.3%	2.6%	0.0%	3.0%
Yields/ Spreads								
Yield on Loans	10.3%	11.5%	10.1%	10.6%	13.6%	14.0%	12.7%	12.5%
Yield on investment	7.3%	7.4%			3.8%	9.5%	12.1%	12.2%
Asset yields	10.2%	11.3%	9.6%	10.2%	11.6%	13.4%	6.6%	4.6%
Cost of funds	7.1%	9.3%	7.8%	9.3%	7.2%	9.9%	9.3%	10.1%
NIMs	3.2%	3.2%	3.2%	2.3%	7.0%	5.9%	4.0%	2.5%
ROE tree								
Net Interest Income/Assets	3.76%	3.39%	3.17%	2.25%	6.90%	5.31%	3.13%	2.48%
Fees/Assets	0.72%	0.64%	0.80%	0.24%	1.47%	0.71%	1.03%	0.36%
Investment profits/Assets	0.00%	0.00%	0.00%	0.00%	8.37%	6.02%	0.68%	0.15%
Net revenues/Assets	4.48%	4.03%	3.97%	2.49%	1.92%	1.00%	4.83%	2.99%
Operating Expense/Assets	0.32%	0.30%	0.48%	0.38%	6.45%	5.02%	1.76%	0.93%
Provisions/Assets	0.06%	0.07%	0.59%	0.01%	1.30%	0.54%	0.15%	0.21%
Taxes/Assets	1.12%	1.12%	0.72%	0.72%	5.15%	4.48%	0.78%	0.63%
Total Costs/Assets	1.50%	1.49%	1.79%	1.10%	1.25%	1.03%	2.68%	1.77%
ROA	2.98%	2.54%	2.19%	1.39%	3.90%	3.44%	2.15%	1.22%
Equity/Assets	7.3	8.0	11.8	13.0	4.3	9.0	11.9	12.4
ROE	21.7%	20.3%	25.8%	18.1%	17.0%	30.8%	25.6%	15.1%

Source: Company data, Nomura research

NOMURA

Indiabulls Housing Finance

INBF.NS IHFL IN

EQUITY: FINANCIALS

Graduating to the next level

Strong LAP player gaining prominence in prime mortgage business, Buy with 44% implied upside

Action: Initiate at Buy with TP of INR800

Indiabulls Housing Finance (IHFL) has been India's fastest-growing housing finance company (HFC) over the past five years, with a strong presence in loan against property (LAP) (+10% share) and builder financing and is now gaining prominence in mortgages (~3% share). IHFL's ROEs of 30% are best-in-class due to its higher share of LAP/corporate book relative to peers. We expect this to sustain despite its increasing mortgage share; due to the significant improvement in its funding profile and increasing leverage. Continuous funding profile improvement and various steps taken by management to improve perception relating to corporate governance should drive further re-rating.

- **Funding profile improvement:** With consistent performance and board level improvements, rating agencies have upgraded IHFL over the past 1-2 years to AA+ (one notch below HDFC/LICHF). Funding cost has become very competitive (just 60-70bps higher HDFC/LICHF) and coupled with an increasing share of bond funding this should make IHFL more completive in the domestic prime mortgage business and net off yield pressure in the LAP business.
- **Addressing perception challenges:** IHFL has faced perception challenges given promoter linkages to a real estate company. Management has addressed these issues by: 1) recently simplifying promoter ownership; 2) increasing share of independent board members and 3) improving board quality. Strong management pedigree and high dividend (65% payout) have historically provided confidence to investors.

Valuation at 2x book looks cheap for 28-30% ROEs, initiate at Buy

We value IHFL at 3.1x FY17F book (BVPS of INR237); adding dividends we arrive at our TP of INR800. Adjusted ROEs of 28-29% are the sector's highest and with growth outpacing the system, we find current valuations attractive at 2x book. Relatively, IHFL is one of the cheaper HFCs at ~8x FY17F P/E (EPS of INR70).

Year-end 31 Mar	FY15	FY16F		FY17F		FY18F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
PPOP (mn)	27,715	N/A	31,698	N/A	37,463	N/A	44,807
Reported net profit (mn)	18,936	N/A	21,767	N/A	25,156	N/A	29,164
Normalised net profit (mn)	18,936	N/A	21,767	N/A	25,156	N/A	29,164
FD normalised EPS	56.69	N/A	61.22	N/A	69.46	N/A	80.53
FD norm. EPS growth (%)	21.1	N/A	8.0	N/A	13.5	N/A	15.9
FD normalised P/E (x)	9.8	N/A	9.1	N/A	8.0	N/A	6.9
Price/adj. book (x)	3.0	N/A	2.7	N/A	2.3	N/A	2.1
Price/book (x)	3.0	N/A	2.7	N/A	2.3	N/A	2.1
Dividend yield (%)	6.3	N/A	6.2	N/A	6.2	N/A	7.3
ROE (%)	30.7	N/A	30.8	N/A	31.3	N/A	31.8
ROA (%)	3.7	N/A	3.5	N/A	3.3	N/A	3.1

Source: Company data, Nomura estimates

Global Markets Research

17 June 2015

Rating Starts at	**Buy**
Target price Starts at	INR 800
Closing price 15 June 2015	INR 556
Potential upside	+43.8%

Anchor themes

Mortgages remain a structural story from a growth perspective. Cyclically rate environment remains favorable for HFCs and ability of banks to compete on pricing is lower than last cycle (FY09-10).

Nomura vs consensus

Our FY16/17F PAT estimates are ~5% lower than consensus as we factor in higher tax rate and higher compression in LAP yields than the Street.

Research analysts

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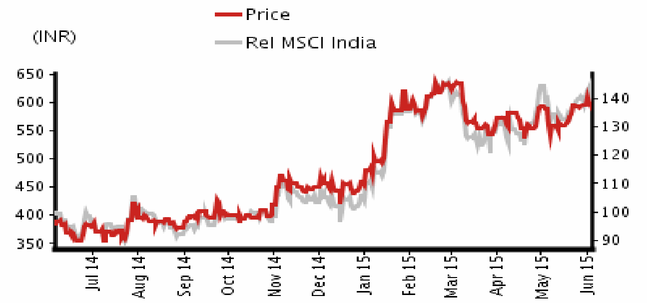
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Indiabulls Housing Finance

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-0.3	-1.6	50.6	M cap (USDmn)	3,087.4
Absolute (USD)	-1.1	-3.2	40.3	Free float (%)	53.4
Rel to MSCI India	3.8	8.3	47.0	3-mth ADT (USDmn)	11.4

Profit and loss (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Interest income	51,865	61,210	77,010	94,277	114,778
Interest expense	-32,824	-39,442	-47,630	-56,956	-69,926
Net interest income	19,041	21,768	29,381	37,320	44,852
Net fees and commissions	3,045	3,945	4,605	5,376	6,277
Trading related profits	4,703	7,549	4,054	2,059	2,065
Other operating revenue	0	0	0	0	0
Non-interest income	7,748	11,494	8,659	7,436	8,342
Operating income	26,789	33,262	38,040	44,756	53,194
Depreciation	-79	-188	-220	-252	-290
Amortisation	0	0	0	0	0
Operating expenses	-1,391	-2,110	-2,321	-2,669	-3,070
Employee share expense	-2,637	-3,249	-3,801	-4,371	-5,027
Pre-provision op profit	22,682	27,715	31,698	37,463	44,807
Provisions for bad debt	-2,864	-2,990	-2,574	-2,899	-3,623
Other provision charges	0	0	0	0	0
Operating profit	19,818	24,725	29,124	34,564	41,184
Other non-op income	0	0	0	0	0
Associates & JCEs	0	0	0	0	0
Pre-tax profit	19,818	24,725	29,124	34,564	41,184
Income tax	-4,133	-5,713	-7,281	-9,332	-11,943
Net profit after tax	15,685	19,012	21,843	25,232	29,240
Minority interests	-44	-76	-76	-76	-76
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	15,642	18,936	21,767	25,156	29,164
Extraordinary items					
Reported NPAT	15,642	18,936	21,767	25,156	29,164
Dividends					
Transfer to reserves	15,642	18,936	21,767	25,156	29,164

Growth (%)

Net interest income	14.4	14.3	35.0	27.0	20.2
Non-interest income	50.6	48.3	-24.7	-14.1	12.2
Non-interest expenses	2.5	51.7	10.0	15.0	15.0
Pre-provision earnings	27.5	22.2	14.4	18.2	19.6
Net profit	23.5	21.1	14.9	15.6	15.9
Normalised EPS	15.9	21.1	8.0	13.5	15.9
Normalised FDEPS	15.9	21.1	8.0	13.5	15.9
Loan growth	15.2	30.6	22.6	25.0	25.0
Interest earning assets	16.1	30.6	22.6	25.0	25.0
Interest bearing liabilities	13.6	33.6	21.6	24.8	24.8
Asset growth	13.5	28.8	20.0	22.9	23.1
Deposit growth		na	na	na	na

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Cash and equivalents	44,190	34,903	40,138	46,159	53,083
Inter-bank lending	0	0	0	0	0
Deposits with central bank	0	0	0	0	0
Total securities	0	0	0	0	0
Other int earning assets	0	0	0	0	0
Gross loans	359,217	468,679	575,118	718,898	898,622
Less provisions	-3,417	-3,950	-5,130	-6,412	-8,015
Net loans	355,800	464,729	569,988	712,485	890,607
Long-term investments	29,470	61,638	64,720	72,486	81,184
Fixed assets	469	541	541	541	541
Goodwill	700	686	686	686	686
Other intangible assets	0	0	0	0	0
Other non IEAs	13,554	9,773	10,745	11,815	12,991
Total assets	444,184	572,270	686,818	844,172	1,039,092
Customer deposits	0	0	0	0	0
Bank deposits, CDs,	355,395	474,870	577,544	720,809	899,836
Other int bearing liabilities	0	0	0	0	0
Total int bearing liabilities	355,395	474,870	577,544	720,809	899,836
Non-int bearing liabilities	31,730	31,062	34,168	37,585	41,344
Total liabilities	387,125	505,932	611,713	758,394	941,179
Minority interest	19	21	21	21	21
Common stock	668	711	724	724	724
Preferred stock	0	0	0	0	0
Retained earnings	56,372	65,606	74,361	85,033	97,168
Reserves for credit losses	0	0	0	0	0
Proposed dividends	0	0	0	0	0
Other equity	0	0	0	0	0
Shareholders' equity	57,040	66,317	75,085	85,757	97,892
Total liabilities and equity	444,184	572,270	686,818	844,172	1,039,092
Non-perf assets	3,417	3,950	5,130	6,412	8,015

Balance sheet ratios (%)

Loans to deposits	na	na	na	na	na
Equity to assets	12.8	11.6	10.9	10.2	9.4

Asset quality & capital

NPAs/gross loans (%)	1.0	0.8	0.9	0.9	0.9
Bad debt charge/gross	0.80	0.64	0.45	0.40	0.40
Loss reserves/assets (%)	0.77	0.69	0.75	0.76	0.77
Loss reserves/NPAs (%)	100.0	100.0	100.0	100.0	100.0
Tier 1 capital ratio (%)	15.1	15.3	14.3	13.1	11.9
Total capital ratio (%)	19.1	18.4	17.4	16.2	15.1

Per share

Reported EPS (INR)	46.83	56.69	61.22	69.46	80.53
Norm EPS (INR)	46.83	56.69	61.22	69.46	80.53
FD norm EPS (INR)	46.83	56.69	61.22	69.46	80.53
DPS (INR)	28.91	35.00	34.36	34.36	40.37
PPOP PS (INR)	67.90	82.97	89.15	103.45	123.72
BVPS (INR)	170.76	186.52	207.33	236.80	270.31
ABVPS (INR)	170.76	186.52	207.33	236.80	270.31
NTAPS (INR)	168.66	184.59	205.44	234.91	268.42

Valuations and ratios

Reported P/E (x)	11.9	9.8	9.1	8.0	6.9
Normalised P/E (x)	11.9	9.8	9.1	8.0	6.9
FD normalised P/E (x)	11.9	9.8	9.1	8.0	6.9
Dividend yield (%)	5.2	6.3	6.2	6.2	7.3
Price/book (x)	3.3	3.0	2.7	2.3	2.1
Price/adjusted book (x)	3.3	3.0	2.7	2.3	2.1
Net interest margin (%)	na	5.31	5.68	5.82	5.60
Yield on assets (%)	na	14.92	14.89	14.70	14.32
Cost of int bearing liab (%)	na	9.50	9.05	8.77	8.63
Net interest spread (%)	na	5.42	5.83	5.93	5.69
Non-interest income (%)	28.9	34.6	22.8	16.6	15.7
Cost to income (%)	15.3	16.7	16.7	16.3	15.8
Effective tax rate (%)	20.9	23.1	25.0	27.0	29.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	na	30.7	30.8	31.3	31.8
ROA (%)	na	3.73	3.46	3.29	3.10
Operating ROE (%)	na	40.1	41.2	43.0	44.9
Operating ROA (%)	na	4.87	4.63	4.52	4.37

Source: Company data, Nomura estimates

Investment thesis: graduating to the next level

- **Company background:** IHFL is the third-largest HFC and part of the Indiabulls group. From a largely LAP/corporate book focused NBFC in FY09, IHFL has graduated to becoming a sizable player in India's prime mortgage space. IHFL continues to maintain its share in the LAP business (>10% share in the past five years) and has increased its market share in traditional mortgages from <1% in FY09 to ~3% in FY15. From a loan mix perspective, 50% is from traditional mortgages, 26% LAP and the rest is builder financing.
- **Fastest-growing HFC**; **should continue to gain share:** IHFL has been one of the fastest-growing HFCs with AUM growth of 38% CAGR in the past five years. In FY09-12, growth was more focused on higher-yielding LAP and corporate book given higher cost of funds, but as IHFL's ratings were upgraded due to its consistent performance and improved cost of funds, it has increased focus on mortgages leading to a gain in market share. With ratings upgrade in FY15 and its ratings now just one notch below HDFC/LICHF, we believe IHFL is well poised to deliver faster-than-system growth of 24% CAGR as it has relatively lower funding cost which should help compete in the INR2.5-5.0mn category. We expect IHFL's share of traditional mortgages to be up from 50% in FY15 to 56% by FY18F.
- **Funding mix change to largely net off pressure in LAP yields:** LAP forms 26% of IHFL's AUMs (FY15) and is seeing significant yield pressure given increasing competition. While overall yields for IHFL should be impacted due to contraction in LAP yields, we believe its higher share of bond funding (38% of total funding currently to 55% by FY18F), coupled with cost advantage from better ratings, should net off yield pressure from the LAP book. While we expect margins to come off by 80-90bps in the next three years, only 30bps of that is driven by lower loan spreads and the majority of that is due to higher leverage.
- **Adjusted ROEs of 28% best in class**; **higher leverage to sustain these ROEs:** IHFL's adjusted ROEs of 28-29% are best-in-class and have been driven by a higher share of high-yielding LAP/corporate book. While LAP yields are under pressure, we expect funding cost advantage to partially net off yield pressure on LAP and with improving leverage we forecast ROEs to sustain at 28-29% going forward.
- **Valuations at 2x FY17F book (BVPS of INR237) remains cheap given sector-best ROEs and higher-than-system growth:** Consensus has had perception challenges with regards to IHFL's corporate governance, given real estate linkages of the promoter and hence valuations multiples for IHFL have lagged its fundamental performance. But with consistent performance, rating upgrade, high dividend payout and more important board level improvements done by the management, we expect re-rating to continue. We value IHFL at 3x FY17F book and adding dividends we arrive at our TP of INR800. Adjusted ROEs of 27-28% are the highest in the sector and with growth outpacing the system; we find current valuations attractive at 2x book. Relatively, IHFL is one of the cheaper HFCs at <8x FY17F P/E (EPS of INR70).

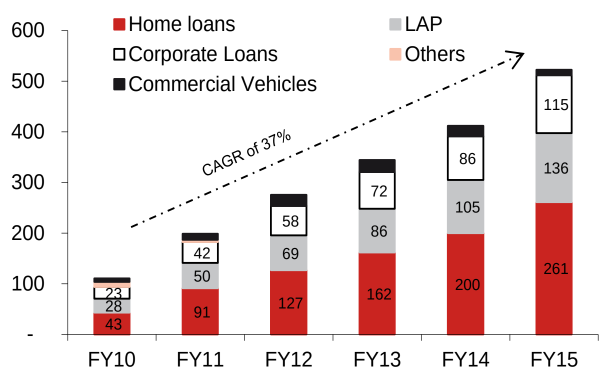
Fig. 48: HFCs and NBFCs comparative valuations – IHFL valuation still reasonable given higher ROEs and growth potential

	Current price	Mcap USDbn	Rating	Target price	Upside/ downside	P/B FY16F	P/B FY17F	P/E FY16F	P/E FY17F	RoE FY16F	RoE FY17F	RoA FY16F	RoA FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DEWH	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.8	16.1%	15.8%	1.2%	1.2%
Repco	590	0.6	Not rated	NA	NA	3.97	3.28	23.1	18.7	18.4%	19.7%	2.3%	2.3%
GRHF	219	1.2	Not rated	NA	NA	8.59	6.81	28.8	23.6	32.9%	31.7%	2.8%	2.9%
Shriram	821	3.0	BUY	1,100	33.8%	1.76	1.51	11.7	9.2	16.1%	17.6%	2.5%	2.8%
MMFS	236	2.1	Neutral	305	25.7%	2.07	1.80	12.7	10.5	17.3%	18.4%	2.7%	2.8%

Source: Company data, Nomura estimates

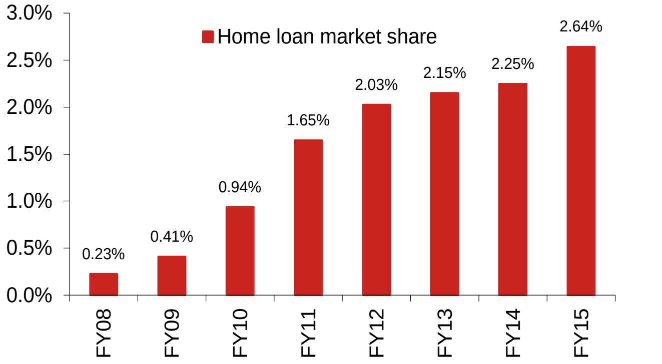
Our thesis in charts:

Fig. 49: Fastest-growing HFC



Source: Company data, Nomura research

Fig. 50: Increasing prominence in the prime mortgage space



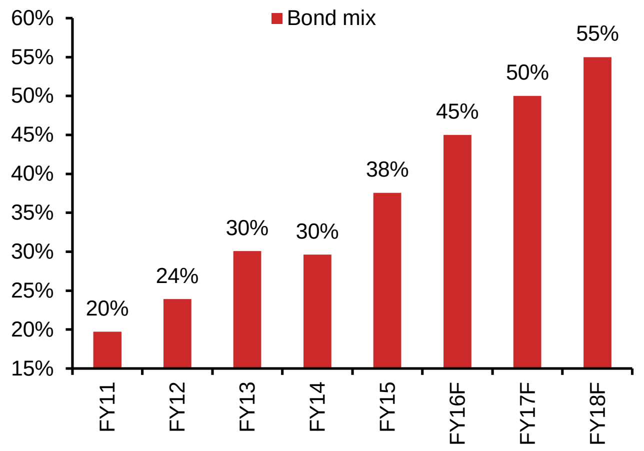
Source: Company data, RBI, NHB, Nomura research

Fig. 51: Ratings upgrades led to significant improvement in funding profile

Long term ratings		FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
	ICRA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil	AA	AA	AA	AA	AA+
	CARE	AA+	AA+	AA+	AA+	AAA
	ICRA	AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AAA

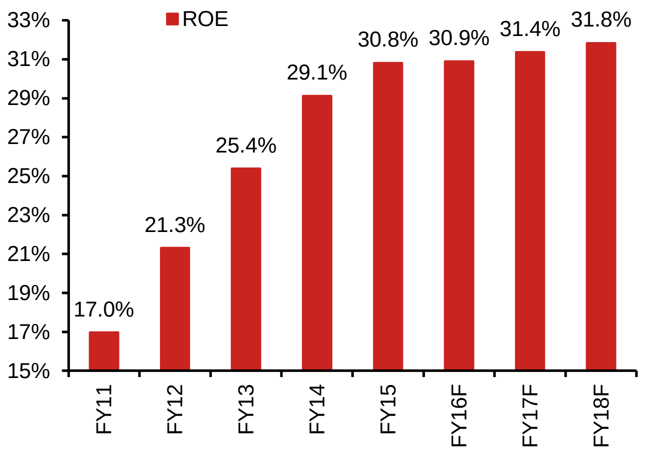
Source: Bloomberg, Nomura research

Fig. 52: Funding mix to also improve given increasing acceptance of IHFL's bonds and both combined to net off yield pressure in LAP business



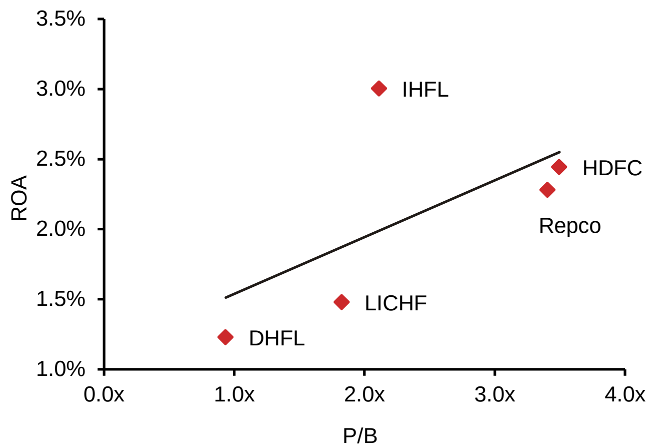
Source: Company data, Nomura estimates

Fig. 53: Best in class ROEs: likely to sustain at 27-28% ROEs



Source: Company data, Nomura estimates

Fig. 54: Valuations seem reasonable given sector-best ROAs and higher growth expected



Source: Company data, Bloomberg, Nomura estimates

Well-diversified HFC; strong LAP player, gaining prominence in the traditional mortgage business

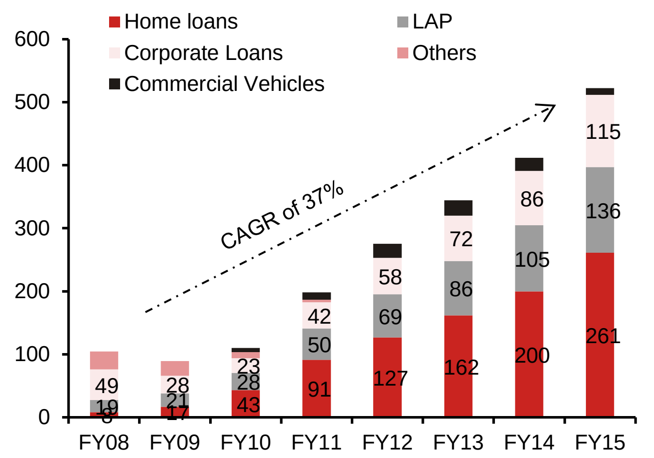
Indiabulls Housing Finance has been one of the fastest-growing HFCs (38% CAGR in the past five years) and is now India's third-largest HFC with a balance sheet of USD9bn. We find Indiabulls Financials' book to be well-diversified with ~50% of its loan book in traditional mortgages, 26% of portfolio in LAP and ~20% book in corporate/building lending. Indiabulls started off with a much smaller proportion of its book as mortgages (<20% of loans in FY09) and traditionally has been a strong player in LAP/SME/builder lending (+10% market share maintained in LAP over the past five years). Over the past 3-4 years with its constant rating upgrades and cost of fund improvement, Indiabulls has steadily been gaining share in the traditional mortgage business as well (~3% share now vs <1% share in FY10).

Fig. 55: Indiabulls Housing Finance: well diversified loan book; market leader in LAP and now steadily gaining share in the traditional mortgage business

	% of AUMs		Market share						
	FY10	FY15	FY10	FY15	CAGR growth	Ticket size (INRmn)	Average yields	Incremental yields	Comments
Mortgage	39%	50%	0.9%	2.5%	43.5%	2.4	11-12%	10.25-11.5%	70% Salaried and 30% non salaried. Non Salaried share higher for Indiabulls v/s HDFC/LICHF - IHFL becoming meaningful now in the mortgage business with ~3% overall markets share.
LAP	25%	26%	11.6%	11.1%	37.6%	6.8	13.3-13.4%	12.9-13%	Early entrants in this business and market share has always been at +10% - LAP continues to contribute ~25% of loan book
Builder book	21%	22%	NA	NA	37.8%		15-16%		This book is largely rent discounting and lenidng to residential SPVs and no lending to builders based on their B/S
CVs	6%	2%	NA	NA	9.6%		15-17%		CV business started in FY10 - Being rolled off currently
Others	9%	0%							

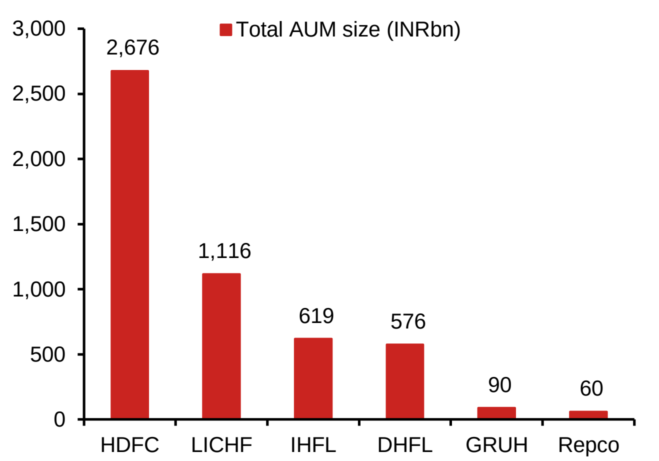
Source: Company data, Nomura research

Fig. 56: AUMs have seen ~37% CAGR over the past five years and are one of India's fastest-growing HFCs



Source: Company data, Nomura research

Fig. 57: IHFL now India's third-largest HFC after HDFC/LICHF (as of FY15)

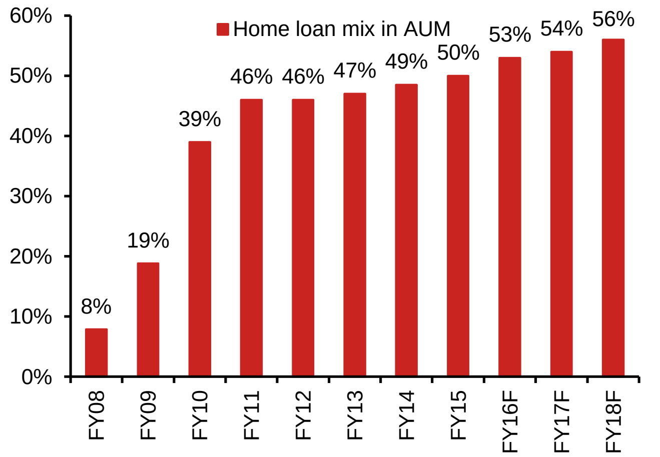


Source: Company data, Nomura research

Traditional mortgages: significant scope to gain share

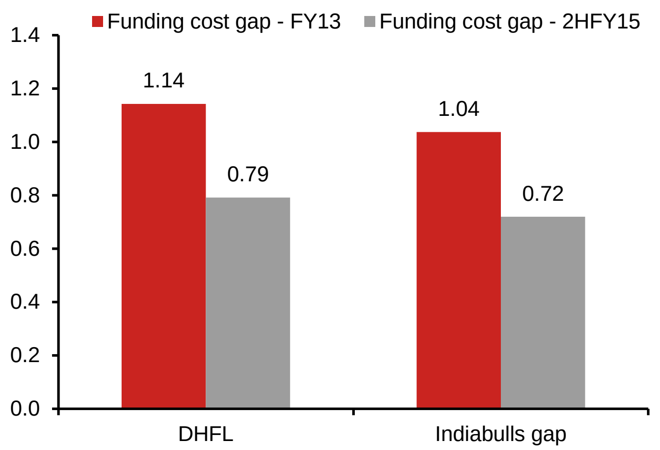
Traditional mortgages contribute ~50% of IHFL's loan book; this has increased from <40% in FY10 and <10% in FY08 as IHFL has become more competitive in its cost of funds. Mortgage portfolio for IHFL is similar to HDFC Limited with an average ticket size of INR2.4mn and LTV of ~70%. The small difference is possibly in higher share of self-employed for IHFL in its traditional mortgage book (~30% are self-employed for IHFL vs 15% of HDFC Limited).

Fig. 58: Traditional mortgages increasing as a % of overall loan portfolio



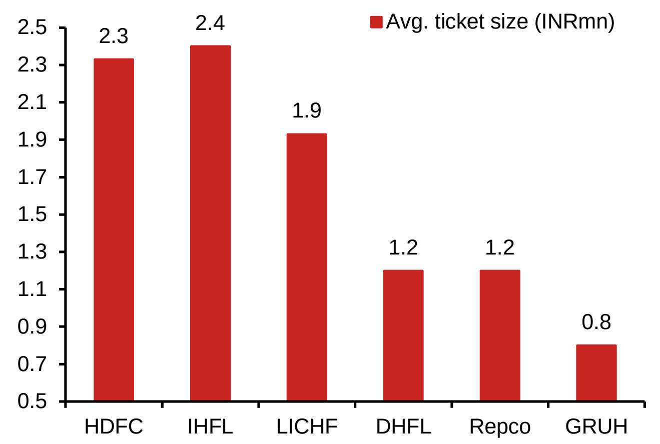
Source: Company data, Nomura estimates

Fig. 59: As funding cost difference between IHFL vs HDFC/LICHF has come off



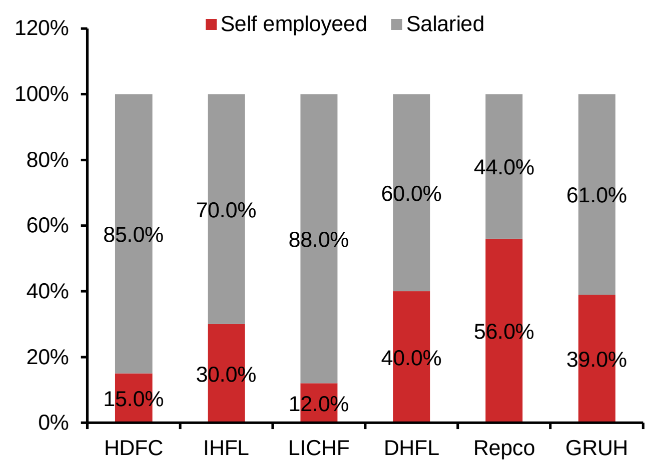
Source: Bloomberg, Nomura research

Fig. 60: Ticket size is similar to HDFC limit at INR2.4mn



Source: Company data, Nomura research

Fig. 61: Share of self-employed higher vs larger HFC peers

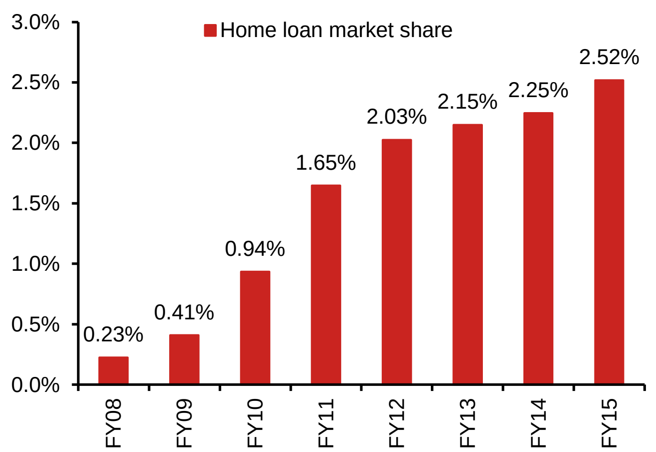


Source: Company data, Nomura research

Mortgage market share still low: scope to gain share and thus outpace system mortgage growth

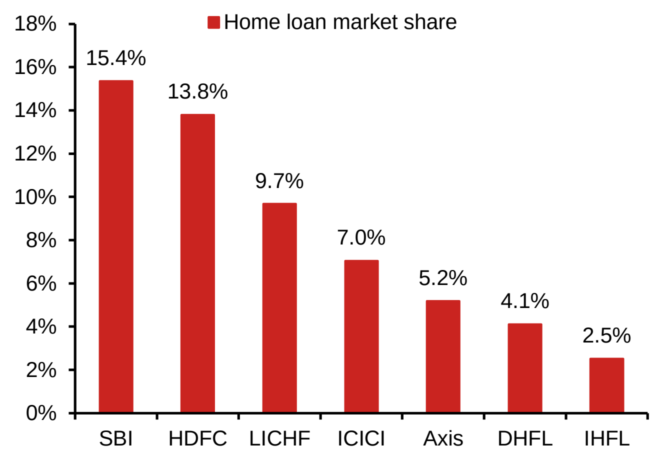
IHFL's mortgage market share rose from <1% in FY09 to ~3% by FY15 and Indiabulls excluding LAP/mortgages is just the fourth-largest HFC and a distant eighth in the overall domestic mortgage market. As mentioned previously, low funding cost remains the key differentiator in the traditional mortgage business and with the gap on cost of funds closing vs peers we expect India bulls to continue to gain share (with market share currently <3%). We expect traditional mortgage book for IHFL to increase at ~26-27% CAGR over FY15-18F vs 18% CAGR expected for the industry. While LAP and corporate book have been significant contributors, mortgages growth has been higher than LAP/corporate book growth for IHFL for the past 2-3 years and this trend should continue.

Fig. 62: Traditional mortgage market share has inched up significantly in the past five years



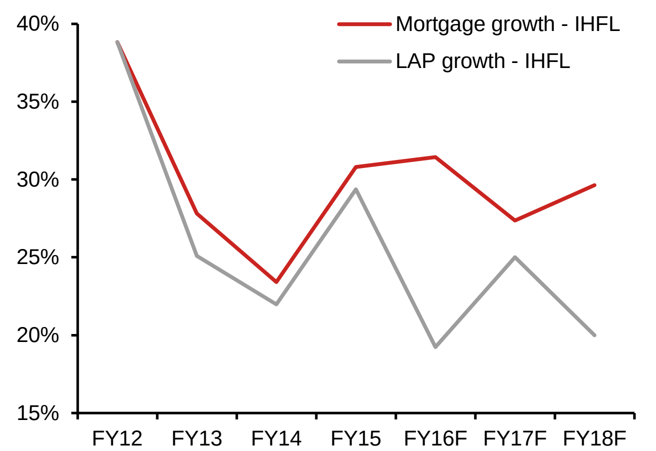
Source: Company data, NHB, RBI, Nomura research

Fig. 63: But market share is still low and thus there is significant scope for market share gains



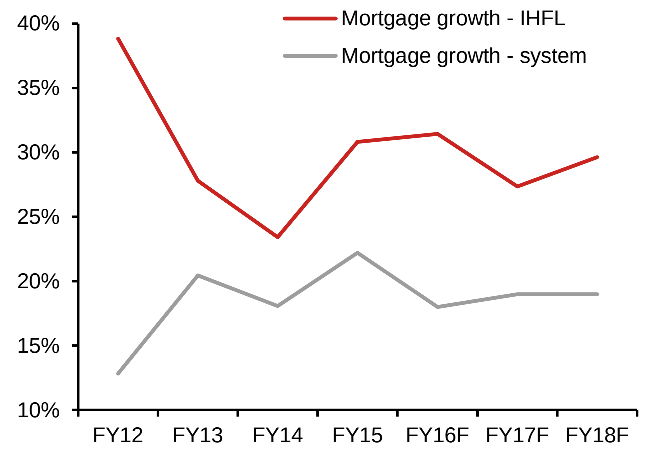
Source: Company data, NHB, RBI, Nomura research

Fig. 64: Mortgages have been growing faster than LAP/corporate book



Source: Company data, Nomura estimates

Fig. 65: Higher-than-system growth to continue for IHFL

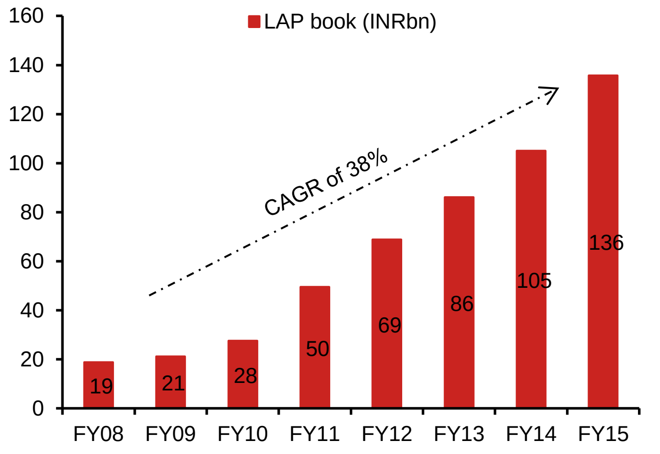


Source: Company data, RBI, NHB, Nomura estimates

LAP: traditionally very strong; growth opportunity still large but yield contraction a reality

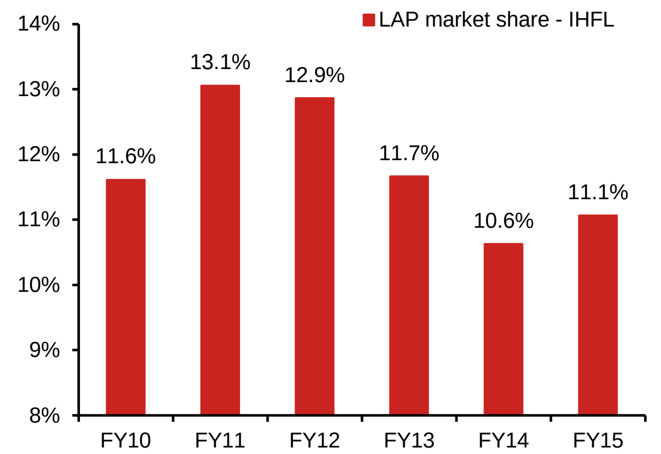
Loan against property (LAP) now contributes ~26% of IHFL's loan book. While the LAP market has evolved and grown in the past 4-5 years, IHFL has been among the first entrants. Our estimates indicate that IHFL's market share in the LAP business has always been +10% (currently ~12%). Like most NBFCs, IHFL's average ticket size is INR7mn with incremental LTV of ~60% in this book.

Fig. 66: IHFL's LAP book has had a 38% CAGR over the past five years



Source: Company data, Nomura research

Fig. 67: IHFL LAP market share has always remained +10%



Source: Company data, RBI, NHB, Nomura research

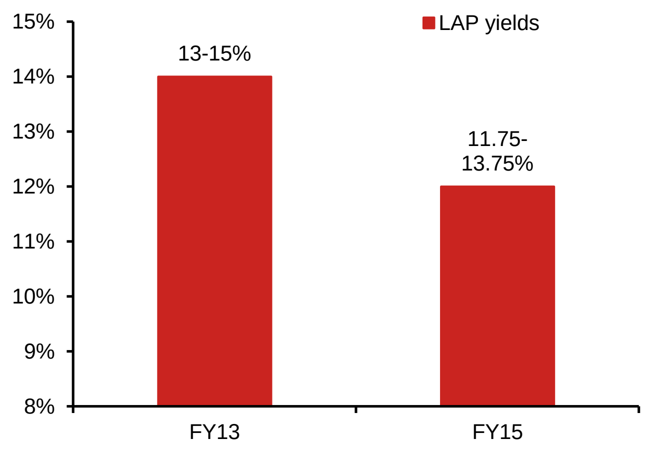
As noted in the industry section, we believe the LAP opportunity remains large in India with 60% of SMEs still not having access to formal bank funding; we think LAP funding is a good alternative for these SMEs. Hence LAP book growth looks secular to us. However, as previously noted in our industry section, competition has increased in LAP book and yields have come off by 100-125bps in the past 12-15 months. We expect further yield compression as competition continues to inch up. Yields coming off the LAP business are negative for IHFL (25% of loan book), but a large part of the margin hit should be netted off by cost of fund improvement driven by rating improvement.

Fig. 68: LAP growth opportunity appears to remain large

No. of MSME	46.8
No. of MSME covered by financial institutions	11
% covered by financial institution	23.5%
Employment generated	106.2
% of India Manufaturing	37.5%
% of System GDP	7.3%
% of system Loans	11.6%
Funding required for MSMEs (INRtrn)	32.50
of which equity	6.50
Of which debt	26.00
Of which non-viable debt	9.62
Of which viable debt	16.38
Current Funding by banks	5.38
Our estimate of System LAP book	1.20
% of viable demand met	40.2%
% of demand gap	**59.8%**
Mix of SMEs in India	
SME in Urban India	55%
SME in Rural India	45%

Source: IFC report, RBI, Nomura estimates

Fig. 69: But yields are coming off and likely to come off further



Source: Company data, Nomura estimates

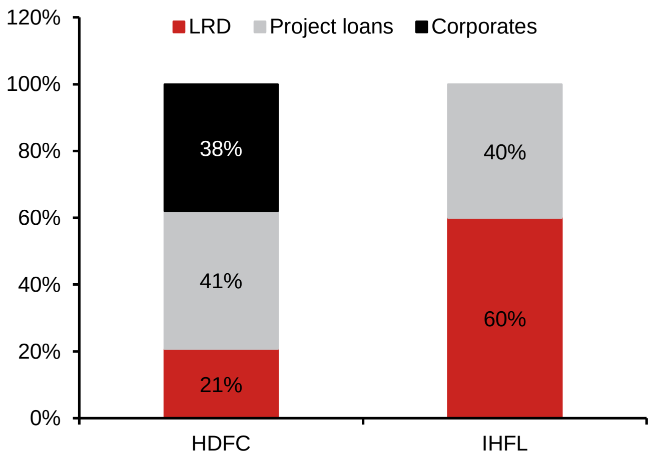
Corporate book: yield maximiser like HDFC Limited

Corporate book contributes ~20-21% of total loans for IHFL and is largely either rent discounting (60% of the builder book) or special purpose vehicles (SPVs) lending to residential projects (40% of builder book) with no balance sheet financing of builders as per management. Share of corporate book has been stable at 21-22% for IHFL and like HDFC limited; builder book lending is a yield maximisation strategy with current yields of +15% in this portfolio for IHFL. While there has been minimal defaults yet in IHFL's builder/corporate book, but like HDFC limited, probability of default remains high in this portfolio though loss given default should be lower. While management is confident of its underwriting, it is building on floating provisions (INR2bn currently) for any contingencies.

Two recent examples highlight lumpy risk in the builder book

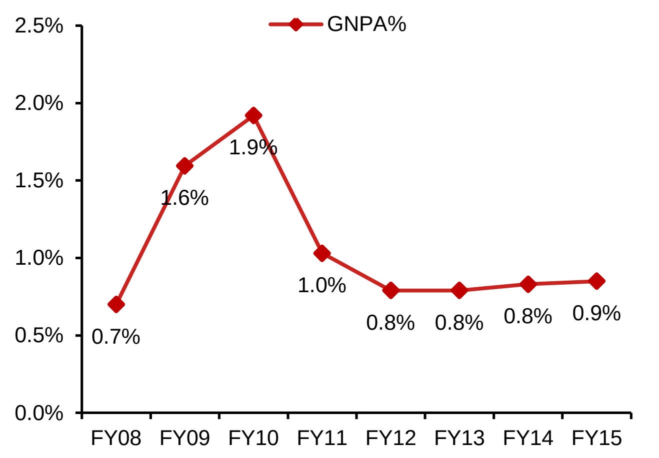
- IHFL had a corporate exposure of INR1bn *to Deccan Chronicle* - Of the INR1bn it has received INR250mn and management is confident the company will recover INR750mn as well, given collateral of three owners' houses the company has. While most PSU banks had to write off their exposure to *Deccan Chronicle*, IHFL given the collateral backed lending, should possibly recover a large part of its exposure to Deccan. This is similar to HDFC's exposure to the UNSP Group, where the collateral structuring provided some confidence on HFDC's large exposure to the UNSP group.
- IHFL has large exposure to INR6bn to central Mumbai currently under construction, a building called Palais Royale. The exposure is very large relative to IHFL's size but it is the sole lender to the project and has the entire project as collateral. The building is under litigation due to the amount of space constructed vs what was originally approved by regulators. The worst-case scenario could be that the builder will have to knock down a few floors. Even taking sales of only the lower space, IHFL is 2.5-3.0x covered on its exposure and does not see any risk of ultimate loss given default. As the company is servicing debt, IHFL has not classified this exposure as NPA but on a prudent basis it is not accruing interest on this INR6bn exposure to Palais Royale.

Fig. 70: Builder book break-up for IHFL vs HDFC Limited (FY15)



Source: Company data, Nomura research

Fig. 71: Asset quality has remained stable for IHFL without any default in builder portfolio



Source: Company data, Nomura research

Funding cost now becoming competitive; mix change key catalysts

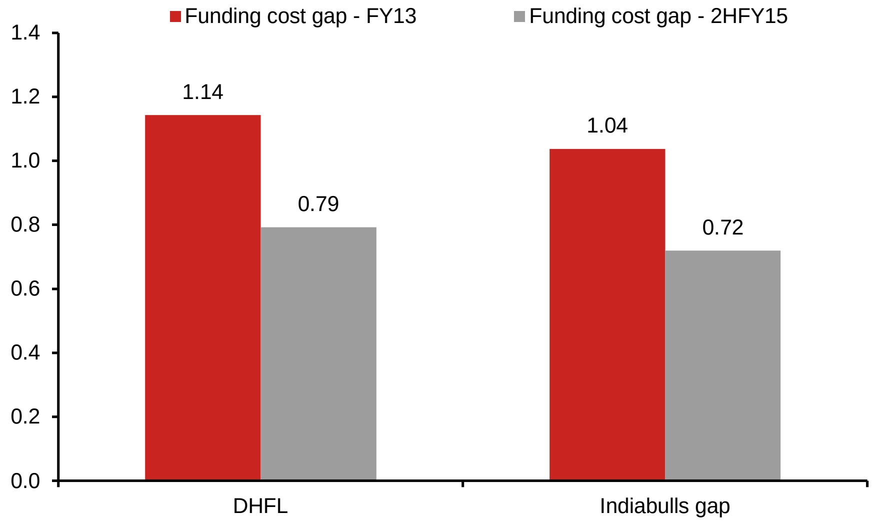
IHFL's funding cost has been ~100-125bps higher than HDFC's and LICHF's about 2-3 years back and given that mortgages spreads are ~150-175bps only, this restricts IHFL's ability to compete in the mortgage market. But Indiabulls has established a consistent track record over the past six to seven years in terms of financial performance leading to continuous ratings upgrade. Currently IHFL's long-term rating at +AA is just one notch lower than that of HDFC/LICHF and hence borrowing cost differentials are coming off significantly.

Fig. 72: Continuous rating upgrade: long-term ratings now just one notch lower to HDFC/LICHF

Long term ratings		FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	ICRA		AAA	AAA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil		AA-	AA-	AA	AA	AA	AA	AA+
	CARE				AA+	AA+	AA+	AA+	AAA
	ICRA				AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AA+	AA+	AA+	AAA
Gruh	Crisil	AA	AA+	AA+	AA+	AA+	AA+	AA+	AA+
	ICRA		AA+	AA+	AA+	AA+	AA+	AA+	AA+
Repco	CARE							AA-	AA-
	ICRA		A	A	A+	A+	A+	AA-	AA-

Source: Company data, Bloomberg, Nomura research

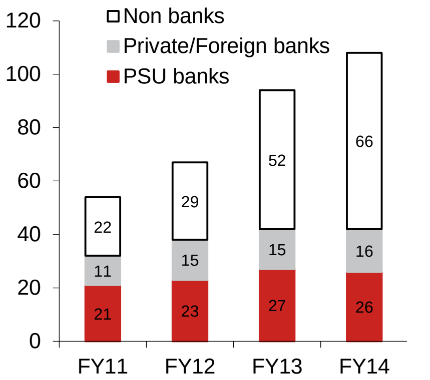
Fig. 73: Continuous rating upgrade: long-term ratings now just one notch lower to HDFC/LICHF



Source: Company data, Bloomberg, Nomura research

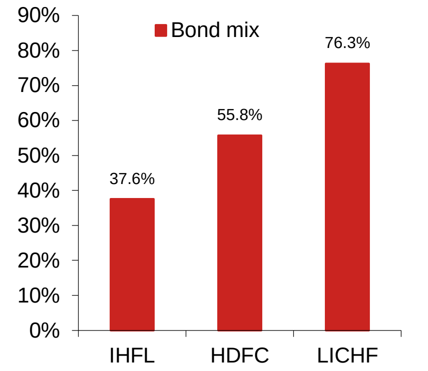
While consistent financial performance should only close the cost of funds gap further, we believe the key benefit of all the rating improvements is only flowing now and with increasing share of bond mix in it is over borrowing mix, we expect significant improvement in cost of funds for IHFL. Currently banks contribute ~60% of IHFL's funding vs 11-17% for HDFC/LICHF and with increasing acceptance of IHFL's bond paper and increasing institutional participation, we estimate bank funding share to decline to ~40% by FY18F. This should aid cost of funds as bond funding currently is >100bps cheaper than bank funding (longer-term differentials have been 50-75bps)

Fig. 74: Growing acceptance of IHFL's paper in the market



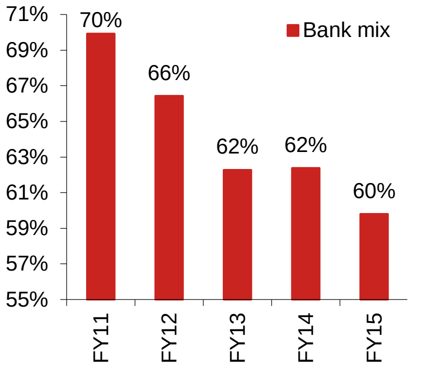
Source: Company data, Nomura research

Fig. 75: IHFL's share of bonds still much lower than HDFC/LICHF



Source: Company data, Nomura research

Fig. 76: Reliance on bank funding to significantly come off

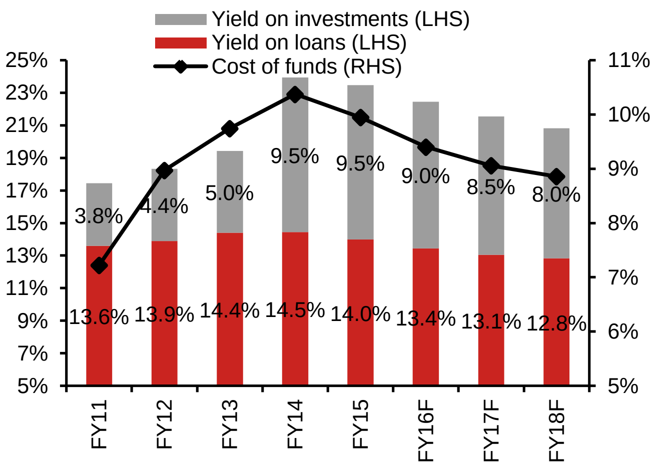


Source: Company data, Nomura research

Improving cost of funds partially negate lower LAP yields

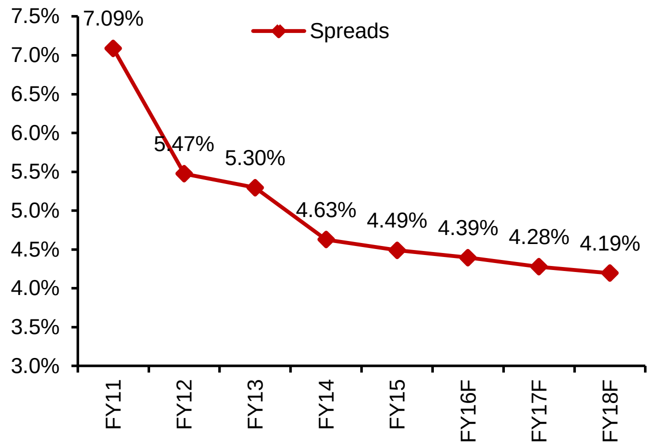
Competition in mortgages is likely to remain intense and with yields on LAP coming off sharply, overall yields and margins for IHFL is already facing downward pressure. Incremental yields are already at ~13% vs 13.3-13.4% in FY15. We believe the favorable rate environment, coupled with funding mix change, should help negate the majority of the yield pressure in mortgages and LAP. Thus we expect loan spreads to come off by just ~25-30bps over the next two years vs 100bps contraction we expect in lending yields. Our expectation of margin contraction is largely due to normalisation in investment yields and higher leverage impact.

Fig. 77: Yield pressure high but cost of funds benefit to also be significant



Source: Company data, Nomura estimates

Fig. 78: Loan spread contraction to be limited



Source: Company data, Nomura estimates

ROEs remain best in class, normalized ROEs of +25%

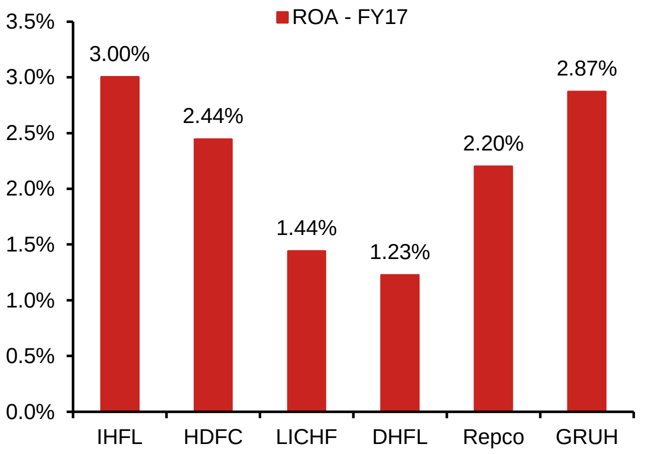
ROEs for IHFL have increased from ~17% in FY11 to +30% in FY15 as balance sheet leverage has increased from 4-5x to ~9x currently, which is a function of both high growth (37% CAGR over FY10-15) and also very high dividend pay out of ~60%. RORWA for IHFL at 4.6-4.7% is one of the highest across HFCs/NBFCs and while we expect some normalisation in ROAs, RORWAs should still remain high at 3.8-4.0% in FY18F.

Fig. 79: We expect reported ROEs of ~30% over FY15-18F

ROE Tree	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
NII	**5.42%**	**6.44%**	**6.90%**	**5.13%**	**5.03%**	**5.27%**	**5.31%**	**4.88%**	**4.69%**	**4.52%**
Fee income	0.93%	1.54%	1.47%	1.45%	0.77%	0.68%	0.71%	0.67%	0.64%	0.61%
Total net revenues	6.35%	7.98%	8.37%	6.58%	5.80%	5.94%	6.02%	5.55%	5.33%	5.13%
Operating expenses	**3.93%**	**2.08%**	**1.92%**	**1.30%**	**1.07%**	**0.91%**	**1.00%**	**0.92%**	**0.87%**	**0.81%**
Operating Profit	**2.42%**	**5.90%**	**6.45%**	**5.28%**	**4.73%**	**5.03%**	**5.02%**	**4.62%**	**4.46%**	**4.32%**
Total Provisioning	1.27%	2.38%	1.30%	0.76%	0.33%	0.64%	0.54%	0.38%	0.34%	0.35%
PBT	1.15%	3.52%	5.15%	4.51%	4.41%	4.40%	4.48%	4.25%	4.11%	3.97%
Total taxes	0.46%	1.15%	1.25%	1.08%	1.04%	0.92%	1.03%	1.06%	1.11%	1.15%
ROA	**0.69%**	**2.37%**	**3.90%**	**3.44%**	**3.37%**	**3.48%**	**3.44%**	**3.19%**	**3.00%**	**2.82%**
Leverage - Total	4.5	3.3	4.3	6.2	7.5	8.4	9.0	9.7	10.5	11.3
Leverage - Loans	2.0	2.5	4.3	5.2	6.1	6.2	7.0	7.6	8.3	9.1
ROE	**3.1%**	**7.9%**	**17.0%**	**21.3%**	**25.4%**	**29.1%**	**30.8%**	**30.9%**	**31.4%**	**31.8%**

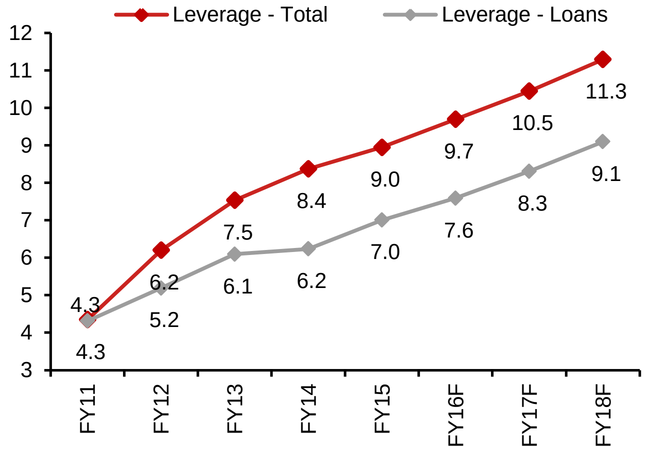
Source: Company data, Nomura estimates

Fig. 80: ROAs/RORWAs highest among HFCs/NBFCs



Source: Nomura estimates, Bloomberg consensus estimates

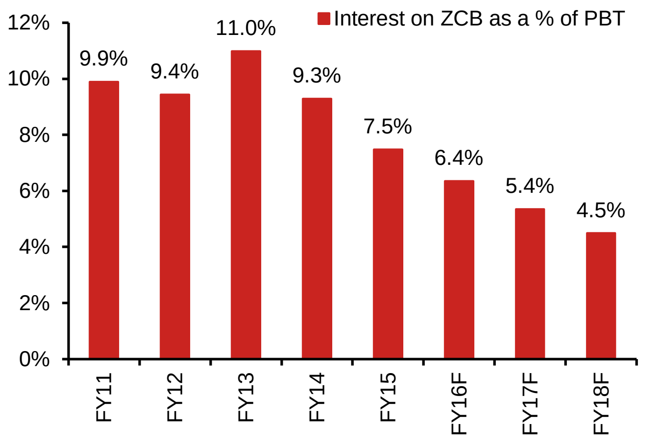
Fig. 81: Leverage likely to inch up further



Source: Company data, Nomura estimates

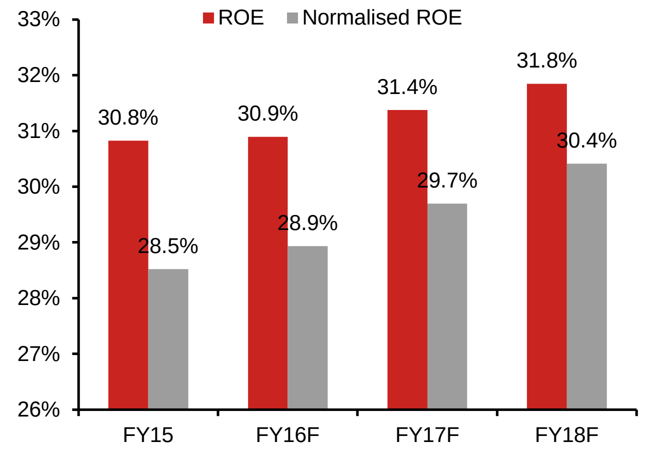
Normalised ROEs lower but still +25%: Reported ROEs for IHFL of +30% in FY15 to some extent are inflated by low tax rates (23% in FY15) and issue of zero coupon bonds, the interest of which is adjusted directly from reserves rather than the P&L and hence profitability is overstated to that extent. Adjusting for the ZCB coupon, reported ROEs should be lower at 28% in FY15. As we do not factor in incremental ZCB issuance, the impact of ZCB interest on reported ROEs should come down from ~10% of PBT to <5% of PBT by FY18F and thus even adjusting for ZCB interest, normalised ROEs should be ~28%.

Fig. 82: Interest on Zero coupon bonds was +10% of PBT earlier but should reduce to ~5% of PBT by FY18F



Source: Company data, Nomura estimates

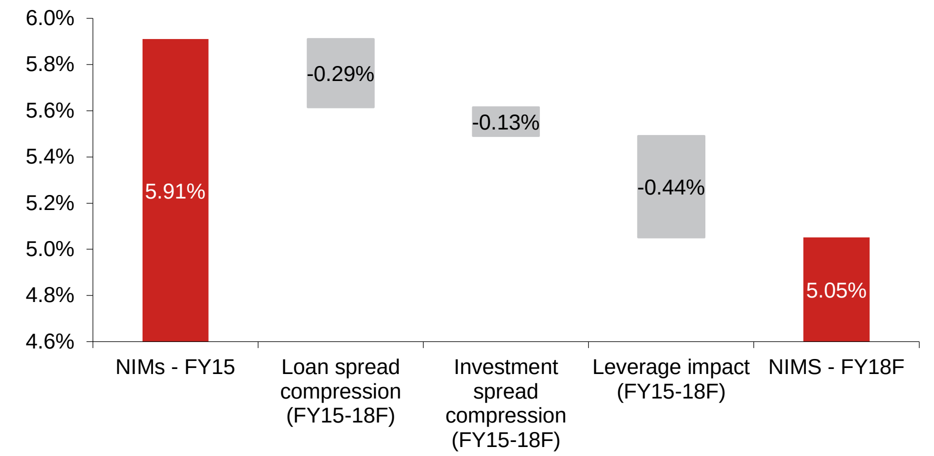
Fig. 83: Normalised ROEs still high at ~28-29%



Source: Company data, Nomura estimates

Yields to normalise but cost of funds moderation also significant: We expect IHFL's yields to moderate from ~13.3-13.4% currently driven by lower margins on LAP book and also overall interest rates coming off. As LAP contribution is large at +25% of loans, lower incremental yields in LAP should impact overall margins but cost of funds improvement driven by: 1) rating change; 2) increasing share of bonds vs banks and 3) favourable rate environment should restrict spread compression. We factor in ~30bps loan spread compression and the rest of the 60-70bps compression in NIMs is a function of lower investment yields and higher leverage.

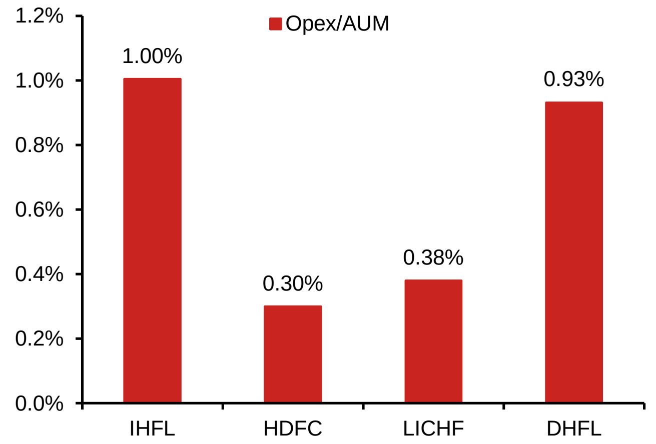
Fig. 84: Contraction in NIMs to be largely driven by increasing leverage



Source: Company data, Nomura estimates

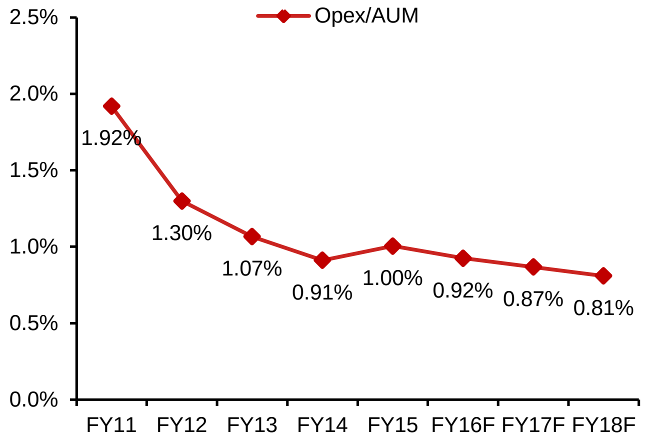
Opex optimisation to continue: IHFL's opex ratios have improved in the past three to four years with opex/AUM declining from ~2% in FY10/11 to ~1% opex/AUM in FY15 as Indiabulls is driving more efficiency from its branches/employees. While higher share of LAP/corporate business and smaller balance sheet size makes comparisons with HDFC/LICHF less relevant, as we believe opex/AUM of 1% still remains high and there is significant scope for efficiency improvement. We factor in opex growth of ~15% over FY15-18F and with higher balance sheet growth; we expect opex/AUMs to come down to 0.8% by FY18F from 1% currently.

Fig. 85: Opex/AUMs much higher than larger HFC peers



Source: Company data, Nomura research

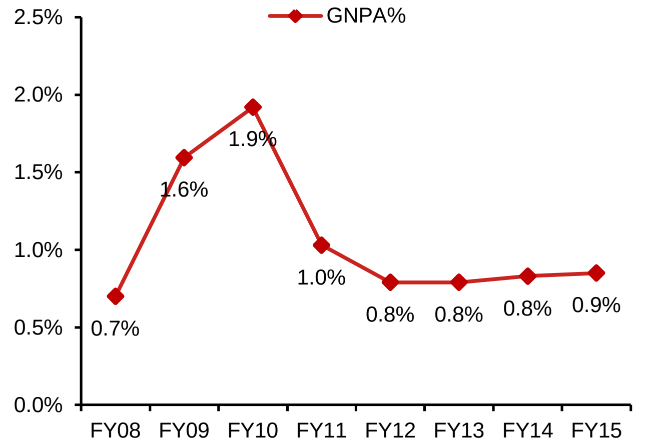
Fig. 86: Gradual opex/AUM improvement likely from here on



Source: Company data, Nomura estimates

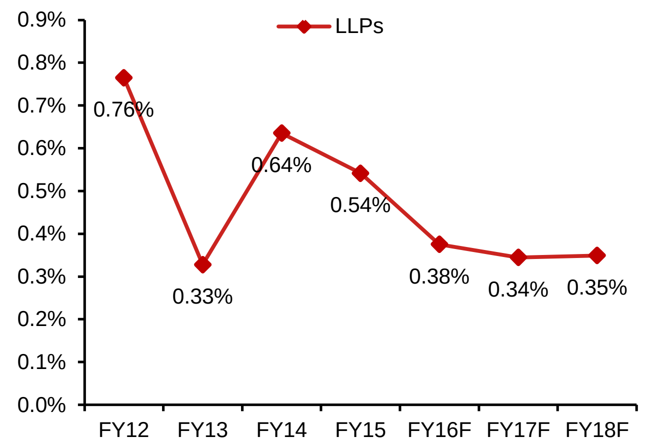
Credit costs not a concern like other HFCs: Credit costs for IHFL have averaged ~40bps over the past four years with 10-15bps going towards building up on floating provisions as asset quality has remained stable. While there has not been any default in large corporate book (+20% of loans) for IHFL, we believe lumpy risks from this book will always remain and thus floating provisions (INR2bn for IHFL currently) can be used in any contingency. As per management IHFL intends to continue to build up the floating provisions buffer.

Fig. 87: Gross NPAs have remained under check



Source: Company data, Nomura research

Fig. 88: Credit costs low like any other HFC



Source: Company data, Nomura estimates

Addressing market concerns:

While Indiabulls Housing Finance has recently performed well, its valuation multiples have significantly lagged fundamentals given the historical promoter linkage to a real estate company. Management has made significant board level changes, and restructured promoter holding to negate any cross holding. As well, dividend payout continues to remain high and rating upgrades add to our confidence and should help address market concerns and drive further re-rating.

Restructuring of promoter holding

- The Indiabulls group had three promoters: Mr. Sameer Gehlaut, Mr Rajiv Rattan and Mr Saurabh Mittal, with Mr. Gehlaut operationally in charge of the real estate and housing finance business and Mr. Rattan and Mr. Mittal in charge of the power/Infrastructure business. Each had cross shareholding and held a board seat the real estate, housing finance, power and infrastructure businesses of the company.
- **In July 2014,** to rationalise and ring-fence the businesses, the promoters have agreed to re-organise promoter shareholding/control, with Mr. Gehlaut retaining control over the real estate/housing finance and securities businesses where Mr. Rattan and Mr. Mittal should relinquish control, board seats and also their stake in these businesses and Mr. Gehlaut should relinquish his holdings/control in the power/infrastructure business. Two independent directors of strong repute, Dr. KC Chakraborty (former RBI deputy governor) and Mr. Malla (former chairman IDBI) have been appointed to the board in place of Mr. Rattan and Mr. Mittal.
- While there still remains a promoter linkage to the real estate business as Mr. Gehlaut retains control of Indiabulls real estate, this re-organisation reduces promoter cross-holding, ring-fences the housing finance business from power/Infrastructure business.

Board composition and quality improvement

IHFL’s board composition has been improving, with independent directors now comprising more than two-thirds vs 50% in FY14. As well, the quality of board members has been improving with recent new hires: K.C. Chakrabarty (former deputy governor, RBI), Justice Surinder Singh Nijjar (retired justice, Supreme Court of India) and Justice Bisheshwar Prasad Singh (retired justice, Supreme Court of India).

Fig. 89: Board composition has improved with more than two-thirds now being independent directors

	FY10	FY11	FY12	FY13	FY14	FY15
Total board members	8	8	8	12	12	12
Independent directors	4	4	4	6	6	8
Non executive directors	6	6	6	8	8	8
% independent	50%	50%	50%	50%	50%	67%

Source: Company data, Nomura research

Strong management pedigree

Management pedigree is very strong, in our opinion, with deeper industry experience and most of these business heads have been employed at very strong mortgage players like HDFC and ICICI bank. We highlight some key members below:

Fig. 90: Management details

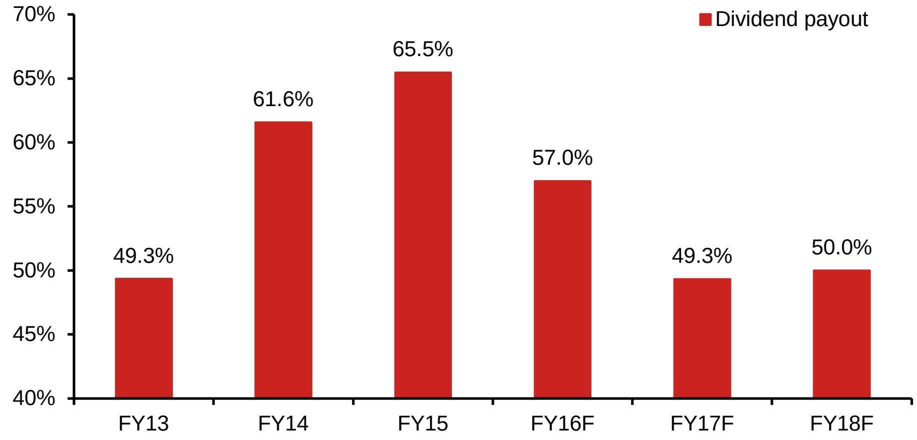
Name	Job Title	Experience	Qualification	Experience Details
Gagan Banga	Vice-Chairman, Managing Director	16yrs	M.B.A	Has over 16 years of industry experienceand is CEO of IHFL since 2006.
Ashwini Kumar Hooda	Deputy Managing Director	14yrs	M.B.A	More than 14 years experience in retail mortgage finance. Has worked with HDFC for 10 years heading Corporate Mortgage Business.
Ajit Kumar Mittal	Executive Director	26yrs	M.B.A	Worked for more than 20 years at the RBI and has been working with IBHFL since 2007, responsible for the company's overall regulatory, governance and compliance matters.
Sachin Chaudhary	Mortgage Business Head	19yrs	P.G.D.B.M	He has been with IHFL for the past 9 years and has a vast experience of over 18 years in the mortgage industry and has worked with ICICI, DHFL and GE Money.
Mukesh Kumar Garg	CFO	27yrs	C.A	Has been CFO of IBHFL for 7 yrs and has over 27 yrsof experience. He is responsible for financial and business planning. Earlier, he was with Bharti Group as their CFO.
Ripudaman Bandral	National Business Manager, LAP	19yrs	M.F.C	He is National Business Manager of mortgage business at IBHFL and has over 19 years of corporate experience. Prior to Indiabulls, he worked with ICICI Bank Ltd, HDFC Ltd.
Pinank Shah	Treasury Head	14yrs	M.M.S	Manages the treasury function at IBHFL and has over 14 years of experience (earlier with HDFC) in the mortgage business with expertise in corporate loans , risk assessment, portfolio quality management and raising funds.
Pankaj Jain	Risk Head	14yrs	C.A	He is the Risk Head at IBHFL and has an experience of over 14 years in mortgage business. Prior to Indiabulls, he worked with Kotak Mahindra Bank and ICICI bank.

Source: Company data, Nomura research

Dividend payout continues to remain high:

Over the past 2-3 years, IHFL's dividend payout has remained high at >50% due to superior ROEs vs AUM growth. The company has been looking at optimising its equity levels and hence was paying higher dividends. This helped in improving its ROEs from 25% in FY13 to 31% in FY15 despite largely flat ROAs. Management indicated that it should maintain a dividend at INR35 or 50% payout (whichever is lower) going forward.

Fig. 91: Dividend pay-out expected to be maintained at 50%



Source: Company data, Nomura estimates

Further re-rating likely; building credibility over time

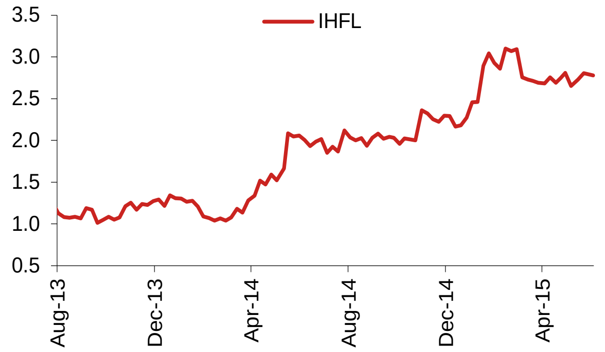
We value Indiabulls Financials at 3x FY17F book and initiate coverage with a TP of INR800, with implied 44% upside (including INR76/share dividends for FY16/17F). Indiabulls currently trades at ~2x F17F book and with +24% CAGR growth and sector-leading return ratios, we expect IHFL to get re-rated further. In the past 12 months IHFL has re-rated from ~1x book to ~2x book as: (1) Management addressed market concerns on group level holdings; 2) consistent performance has led to ROEs moving up and 3) management has maintained higher dividend pay-outs. We expect the re-rating to continue with funding mix change and consistent performance likely to be key drivers.

Fig. 92: Initiate with a TP of INR800

Valuation assumptions	
Cost of Equity	13.5%
Terminal growth	5.0%
Normalised ROE	24.5%
Stage 2 growth	17.0%
Mar-16 PT	800
Implied Mar-17 P/B	3.07
Implied Mar-17 P/E	10.4

Source: Nomura estimates

Fig. 93: Re-rating has started in the past 12 months is likely to continue



Source: Bloomberg, Nomura estimates

Relatively, IHFL is one of the cheapest HFCs, trading at <8x FY17F P/E despite its strong stock performance. Its ROEs are the sector's best, in line with return ratios for HDFC's standalone mortgage business and at least ~8-10% higher than other HFCs. We think that justifies our premium valuation multiple.

Fig. 94: Relative valuations – Indiabulls still the cheapest relative to peers despite its strong stock performance

	Current price	Mcap USDbn	Rating	Target price	Upside/ downside	P/B FY16F	P/B FY17F	P/E FY16F	P/E FY17F	RoE FY16F	RoE FY17F	RoA FY16F	RoA FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DEWH	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.8	16.1%	15.8%	1.2%	1.2%
Repco	590	0.6	Not rated	NA	NA	3.97	3.28	23.1	18.7	18.4%	19.7%	2.3%	2.3%
GRHF	219	1.2	Not rated	NA	NA	8.59	6.81	28.8	23.6	32.9%	31.7%	2.8%	2.9%
Shriram	821	3.0	BUY	1,100	33.8%	1.76	1.51	11.7	9.2	16.1%	17.6%	2.5%	2.8%
MMFS	236	2.1	Neutral	305	25.7%	2.07	1.80	12.7	10.5	17.3%	18.4%	2.7%	2.8%

Source: Company data, Nomura estimates

Risks to our Buy rating

- **Unfavorable wholesale funding environment:** Apart from the structural growth opportunity, our positive stance on HFCs is based on a favourable wholesale rate environment. We think corporate loan growth pick-up will be gradual; hence system liquidity and the wholesale funding environment remain comfortable. A spike in wholesale rates could be a risk to our view on overall HFCs and also for Indiabulls Housing Finance.
- **Higher-than-expected contraction in LAP yields:** LAP yields have come off by ~100bps and we expect further 100bps contraction in LAP yields over FY15-18F. LAP is an attractive product from a risk-adjusted return perspective and competition is likely to increase. Given Indiabulls' s high reliance on LAP on lending book, lower LAP yields remain a risk; every 50bps cut in LAP yields could lead to ~1% cut to IHFL's ROEs.
- **Lumpy asset quality risk in builder portfolio:** IHFL has not had any default in its builder book until now, but as the builder book is ~20% of IHFL's loans, lumpy asset quality risks remain. SPV lending would imply that ultimate loss given default should be lower and also IHFL is building a floating provision buffer (INR2bn), but this still does not rule out likelihood of lumpy NPAs in builder book.

NOMURA

Dewan Housing Finance

DWNH.NS DEWH IN

EQUITY: FINANCIALS

Initiate at Buy with 35% upside potential

Niche player with large opportunity; valuations more than adequately factors in our concerns

Action: Initiate at Buy with 35% potential upside

Dewan Housing Finance (DHFL) has been one of India's fastest-growing HFCs over the past decade with its niche focus in the lower- and middle-income (LMI) segment (Tier 2/3 cities) where penetration/competition remains fairly low. Lower competition and a significant untapped market have helped DHFL to ramp up market share to 4.1% in mortgages and 8% in loan against property (LAP) as on FY15. ROE remains inferior at 16% vs a peer avg of 20-30% due to inefficient use of cash and higher leverage/opex, but recent rating upgrades and management's commitment to improve efficiencies should help the stock re-rate. We initiate at Buy with a TP of INR525 (35% implied upside).

- **Opportunities large, funding profile improving:** Opportunities remain large, in our view, with a 34mn-unit shortfall expected in urban housing by 2022, where any development in the GoI's affordable housing push would benefit DHFL. CARE's recent rating upgrade to AAA should drive funding costs lower in FY16/17F (70-80bps higher than HDFC/LICHF vs 100-120bps in FY13) with improving bond mix to 42% by FY18F vs 28% now.
- **Inferior ROE remains a concern:** Over the past three-four years, DHFL has disappointed investors with its inefficient use of cash (~45% of FY15 NW invested in acquisitions/non-core investments) which has led to leverage inching up to 12-13x in FY15 from 10-11x in FY09/10, pushing ROE down to 16% now vs ~20% in FY09/10. However, DHFL is now committed to focusing on the core business and possibly monetise unrelated investments, which will help address investors' concerns.

Valuation at 0.9x book looks inexpensive despite inferior ROE

DHFL remains the cheapest mortgage play in the sector, trading at 0.9x FY17F book (BVPS of INR419) vs peers at 2-3x. We concede that DHFL's ROE remains inferior but its large potential growth opportunity and improving cash utilisation from here on should drive a re-rating. Our TP of INR525 implies 1.25x FY17F book.

Year-end 31 Mar	FY15		FY16F		FY17F		FY18F
Currency (INR)	Actual	Old	New	Old	New	Old	New
PPOP (mn)	10,480	N/A	13,573	N/A	16,545	N/A	21,132
Reported net profit (mn)	6,213	N/A	7,968	N/A	9,694	N/A	12,440
Normalised net profit (mn)	6,213	N/A	7,968	N/A	9,694	N/A	12,440
FD normalised EPS	42.65	N/A	54.69	N/A	57.86	N/A	74.25
FD norm. EPS growth (%)	3.5	N/A	28.2	N/A	5.8	N/A	28.3
FD normalised P/E (x)	9.1	N/A	7.1	N/A	6.7	N/A	5.2
Price/adj. book (x)	1.2	N/A	1.1	N/A	0.9	N/A	0.8
Price/book (x)	1.2	N/A	1.1	N/A	0.9	N/A	0.8
Dividend yield (%)	2.3	N/A	2.8	N/A	3.0	N/A	3.8
ROE (%)	15.1	N/A	16.2	N/A	15.9	N/A	16.6
ROA (%)	1.3	N/A	1.3	N/A	1.3	N/A	1.4

Source: Company data, Nomura estimates

Global Markets Research

17 June 2015

Rating Starts at	**Buy**
Target price Starts at	INR 525
Closing price 15 June 2015	INR 389
Potential upside	+35%

Anchor themes

Mortgages remain a structural story from a growth perspective. Cyclically the rate environment remains favorable for HFCs and the banks' ability to compete on pricing is lower than in the last cycle (FY09-10).

Nomura vs consensus

Our FY16/17F PAT estimates are largely in line with consensus.

Research analysts

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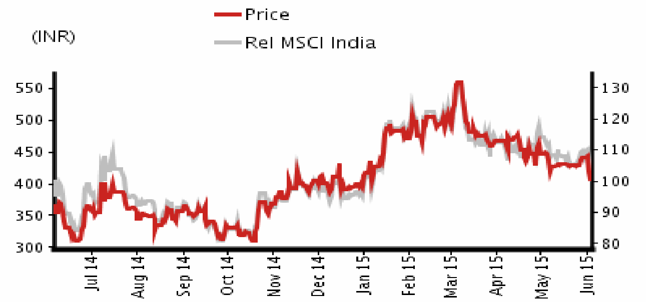
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on Dewan Housing Finance

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-9.7	-19.3	17.9	M cap (USDmn)	884.7
Absolute (USD)	-10.4	-20.6	9.8	Free float (%)	32.9
Rel to MSCI India	-5.6	-9.3	14.3	3-mth ADT (USDmn)	5.6

Profit and loss (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Interest income	46,705	57,226	69,139	82,722	100,691
Interest expense	-37,826	-44,596	-52,905	-62,915	-75,569
Net interest income	8,879	12,630	16,235	19,808	25,123
Net fees and commissions	2,300	1,815	2,088	2,401	2,761
Trading related profits	672	775	920	1,040	1,160
Other operating revenue	0	0	0	0	0
Non-interest income	2,972	2,590	3,008	3,441	3,921
Operating income	11,851	15,220	19,242	23,248	29,043
Depreciation	-109	-255	-335	-415	-495
Amortisation	0	0	0	0	0
Operating expenses	-1,926	-2,522	-3,076	-3,692	-4,430
Employee share expense	-1,765	-1,963	-2,258	-2,596	-2,986
Pre-provision op profit	8,051	10,480	13,573	16,545	21,132
Provisions for bad debt	-700	-1,050	-1,592	-1,968	-2,426
Other provision charges	0	0	0	0	0
Operating profit	7,351	9,430	11,981	14,578	18,707
Other non-op income	0	0	0	0	0
Associates & JCEs	0	0	0	0	0
Pre-tax profit	7,351	9,430	11,981	14,578	18,707
Income tax	-2,061	-3,217	-4,014	-4,883	-6,267
Net profit after tax	5,290	6,213	7,968	9,694	12,440
Minority interests	0	0	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	5,290	6,213	7,968	9,694	12,440
Extraordinary items					
Reported NPAT	5,290	6,213	7,968	9,694	12,440
Dividends					
Transfer to reserves	5,290	6,213	7,968	9,694	12,440

Growth (%)

	FY14	FY15	FY16F	FY17F	FY18F
Net interest income	30.9	42.2	28.5	22.0	26.8
Non-interest income	5.7	-12.8	16.1	14.4	14.0
Non-interest expenses	25.0	30.9	22.0	20.0	20.0
Pre-provision earnings	22.8	30.2	29.5	21.9	27.7
Net profit	17.1	17.4	28.2	21.7	28.3
Normalised EPS	16.9	3.5	28.2	5.8	28.3
Normalised FDEPS	16.9	3.5	28.2	5.8	28.3
Loan growth		25.7	23.0	23.0	23.0
Interest earning assets		25.7	23.0	23.0	23.0
Interest bearing liabilities		23.9	24.1	21.9	23.8
Asset growth		24.4	23.1	22.9	22.9
Deposit growth		na	na	na	na

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Cash and equivalents	9,832	6,764	10,317	14,054	18,321
Inter-bank lending	0	0	0	0	0
Deposits with central bank	0	0	0	0	0
Total securities	0	0	0	0	0
Other int earning assets	0	0	0	0	0
Gross loans	409,175	514,684	633,490	779,586	959,375
Less provisions	-3,175	-4,287	-5,701	-7,406	-9,594
Net loans	406,000	510,397	627,788	772,180	949,781
Long-term investments	7,215	10,062	12,075	14,248	17,383
Fixed assets	9,877	9,846	10,338	10,855	11,398
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Other non IEAs	-2,305	-1,505	-1,505	-1,505	-1,505
Total assets	430,619	535,565	659,014	809,832	995,378
Customer deposits	0	0	0	0	0
Bank deposits, CDs,	394,869	489,207	606,895	739,702	916,056
Other int bearing liabilities	0	0	0	0	0
Total int bearing liabilities	394,869	489,207	606,895	739,702	916,056
Non-int bearing liabilities	0	0	0	0	0
Total liabilities	394,869	489,207	606,895	739,702	916,056
Minority interest	0	0	0	0	0
Common stock	1,284	1,457	1,457	1,675	1,675
Preferred stock	0	0	0	0	0
Retained earnings	34,465	44,901	50,662	68,455	77,646
Reserves for credit losses	0	0	0	0	0
Proposed dividends	0	0	0	0	0
Other equity	0	0	0	0	0
Shareholders' equity	35,750	46,358	52,119	70,130	79,322
Total liabilities and equity	430,619	535,565	659,014	809,832	995,378
Non-perf assets	3,175	4,287	5,701	7,406	9,594

Balance sheet ratios (%)

	FY14	FY15	FY16F	FY17F	FY18F
Loans to deposits	na	na	na	na	na
Equity to assets	8.3	8.7	7.9	8.7	8.0
Asset quality & capital					
NPAs/gross loans (%)	0.8	0.8	0.9	1.0	1.0
Bad debt charge/gross	0.17	0.20	0.25	0.25	0.25
Loss reserves/assets (%)	0.74	0.80	0.87	0.91	0.96
Loss reserves/NPAs (%)	100.0	100.0	100.0	100.0	100.0
Tier 1 capital ratio (%)	11.9	12.5	11.4	12.5	11.5
Total capital ratio (%)	17.2	16.5	14.6	15.1	13.6
Per share					
Reported EPS (INR)	41.19	42.65	54.69	57.86	74.25
Norm EPS (INR)	41.19	42.65	54.69	57.86	74.25
FD norm EPS (INR)	41.19	42.65	54.69	57.86	74.25
DPS (INR)	8.00	9.00	10.94	11.57	14.85
PPOP PS (INR)	62.70	71.94	93.17	98.76	126.14
BVPS (INR)	278.38	318.22	357.76	418.61	473.47
ABVPS (INR)	278.38	318.22	357.76	418.61	473.47
NTAPS (INR)	278.38	318.22	357.76	418.61	473.47

Valuations and ratios

	FY14	FY15	FY16F	FY17F	FY18F
Reported P/E (x)	9.4	9.1	7.1	6.7	5.2
Normalised P/E (x)	9.4	9.1	7.1	6.7	5.2
FD normalised P/E (x)	9.4	9.1	7.1	6.7	5.2
Dividend yield (%)	2.1	2.3	2.8	3.0	3.8
Price/book (x)	1.4	1.2	1.1	0.9	0.8
Price/adjusted book (x)	1.4	1.2	1.1	0.9	0.8
Net interest margin (%)	2.34	2.76	2.85	2.83	2.92
Yield on assets (%)	12.32	12.49	12.15	11.82	11.69
Cost of int bearing liab (%)	10.55	10.09	9.65	9.34	9.13
Net interest spread (%)	1.77	2.40	2.50	2.47	2.57
Non-interest income (%)	25.1	17.0	15.6	14.8	13.5
Cost to income (%)	32.1	31.1	29.5	28.8	27.2
Effective tax rate (%)	28.0	34.1	33.5	33.5	33.5
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	15.5	15.1	16.2	15.9	16.6
ROA (%)	1.35	1.29	1.33	1.32	1.38
Operating ROE (%)	21.6	23.0	24.3	23.8	25.0
Operating ROA (%)	1.87	1.95	2.01	1.98	2.07

Source: Company data, Nomura estimates

Investment thesis: opportunities appear large, valuation cheap, further re-rating likely on better delivery

- **Company background:** Dewan Housing Finance (DHFL) is the fourth-largest HFC by total AUM and third-largest by loan AUM. Its promoters include Mr Kapil Wadhawan and Mr Dheeraj Wadhawan. The company's portfolio is concentrated towards traditional home loans (75% as of FY15) but its LAP loan mix has also edged up more recently (18% as of FY15) despite its late entry into the LAP segment as compared to peers. DHFL is a niche player in the mortgage segment, largely focusing on the LMI segment in Tier 2/3 cities where competition remains fairly limited and opportunities remain large. DHFL's experience in the real estate market has helped it to deliver an AUM CAGR of 45% over the past decade (4.1% market share) and make healthy traction in the LAP segment over the past five years, growing its market share from 1% in FY10 to 8% in FY15.
- **Sizeable growth prospects; rating upgrade to support NIMs:** The GoI and the RBI are putting much emphasis on the affordable housing segment as it is estimated that the urban housing shortfall in 2022 will touch 34mn units and 95% of this will be in the LMI segments where DHFL stands to be the largest beneficiary given its growing supply there. We expect DHFL to continue to deliver a 23-24% AUM CAGR in FY15-18F, driven by lower competition in the LMI segment and improving funding costs on the back of its rating upgrade. While LAP yield compression is a reality, improving the non-retail mix to 27% by FY18F should help to shield from yield pressures to some extent.
- **ROE inferior due to acquisitions/higher opex – Should normalize going forward:** DHFL has the lowest ROEs among peers; we think this is mainly due to its inefficient utilisation of cash in the past, where a large amount was invested in acquisitions which were ROE dilutive (~45% of FY15 net worth invested in acquisitions and office building), leading to frequent capital dilution. This led to an increase in leverage from 10-11x in FY09/10 to 12-13x currently, and is the key reason for the company's inferior ROEs. However, management now seems more committed to improving operational efficiencies and avoiding investment in non-core businesses. DHFL also operates with a higher opex structure as compared to peers, but a large part of this was legal and advertisement expenses, which we think will gradually come down, boding well for its ROEs.
- **Cheapest mortgage play but re-rating contingent on improved delivery:** At ~0.9x FY17F P/B, DHFL is trading at a significant discount to peer HFCs (2-3x) and comparable niche players like Gruh and Repco, (above 3x). While DHFL's FY16F/FY17F ROE of ~16% is well below that of its peers in excess of 20-25%, we still think its valuation is reasonable considering our expectations of significant growth opportunities in the LMI segment and very limited asset quality risk. That said, we also think any meaningful re-rating is contingent upon management delivering on improving cost efficiencies and optimizing cash utilization from here on. We value DHFL at 1.25x FY17F book (INR419) and initiate coverage with a TP of INR525, which implies 35% upside.

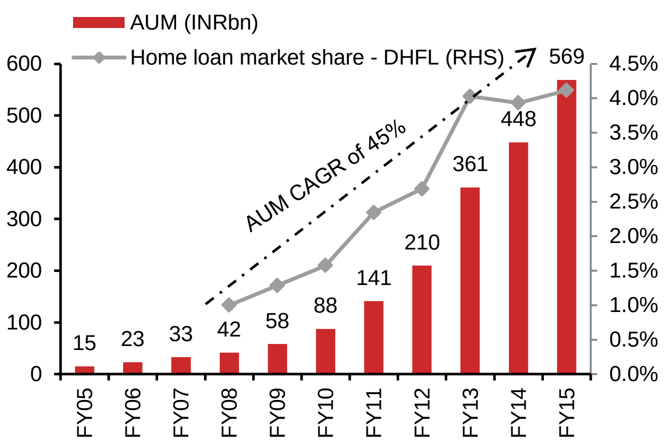
Fig. 95: HFC and NBFC valuation comparison – DHFL's valuation looks reasonable despite factoring in its inferior ROE

	Current price	Mcap USDbn	Rating	Target price	Upside/ downside	P/B FY16F	P/B FY17F	P/E FY16F	P/E FY17F	RoE FY16F	RoE FY17F	RoA FY16F	RoA FY17F
HDFC	1,215	29.9	Neutral	1,325	9.1%	4.23	3.64	17.5	15.1	21.0%	21.7%	2.5%	2.4%
LICHF	395	3.1	Buy	500	26.6%	2.18	1.87	11.9	10.1	19.8%	19.9%	1.4%	1.4%
IHFL	556	3.1	Buy	800	43.9%	2.33	2.04	8.0	6.9	30.9%	31.4%	3.2%	3.0%
DEWH	389	0.9	Buy	525	35.0%	1.09	0.93	7.1	6.8	16.1%	15.8%	1.2%	1.2%
Repco	590	0.6	Not rated	NA	NA	3.97	3.28	23.1	18.7	18.4%	19.7%	2.3%	2.3%
GRHF	219	1.2	Not rated	NA	NA	8.59	6.81	28.8	23.6	32.9%	31.7%	2.8%	2.9%
Shriram	821	3.0	BUY	1,100	33.8%	1.76	1.51	11.7	9.2	16.1%	17.6%	2.5%	2.8%
MMFS	236	2.1	Neutral	305	25.7%	2.07	1.80	12.7	10.5	17.3%	18.4%	2.7%	2.8%

Source: Company data, Nomura estimates; Note: Pricing as on 15th June 2015

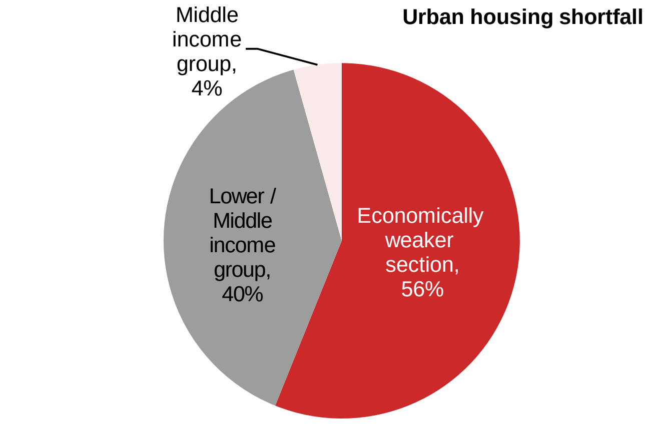
Our thesis in charts

Fig. 96: Fastest growing HFC – AUM CAGR of 45% aid consistent market share gains



Source: Company data, NHB, RBI, Nomura research

Fig. 97: Opportunities remain large especially with ~95% of the urban housing shortfall expected in LMI/EWS segment



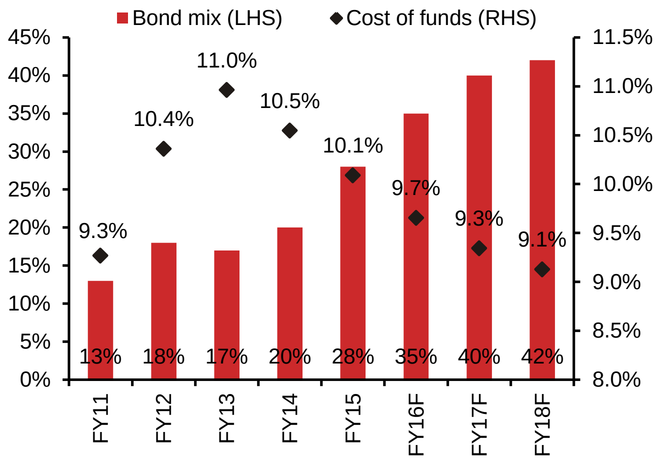
Source: Ministry of Housing and Urban Poverty, Nomura research

Fig. 98: Recent rating upgrade should help cost of funds

Long term ratings		FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
	ICRA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil	AA	AA	AA	AA	AA+
	CARE	AA+	AA+	AA+	AA+	AAA
	ICRA	AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AAA

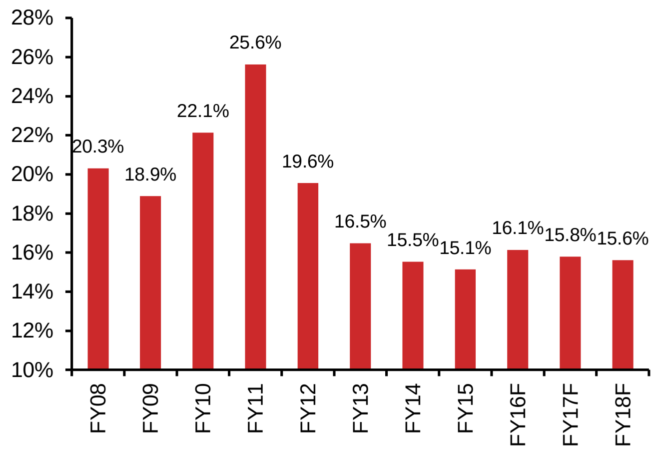
Source: Company data, Nomura research estimates

Fig. 99: Funding cost to benefit from improving bond mix



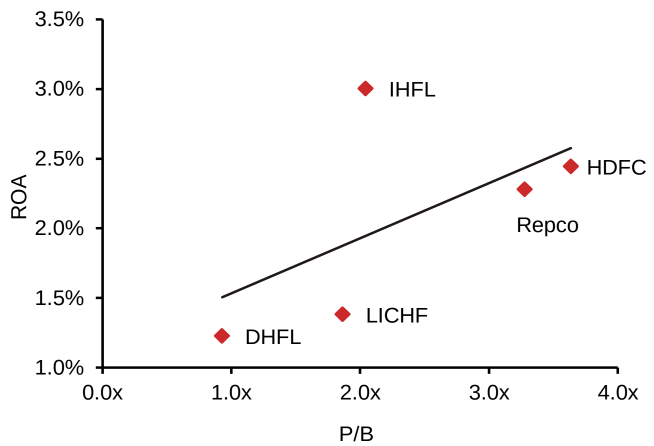
Source: Company data, Nomura estimates

Fig. 100: While ROE remains inferior on higher leverage…



Source: Company data, Nomura estimates

Fig. 101: Current valuation looks reasonable



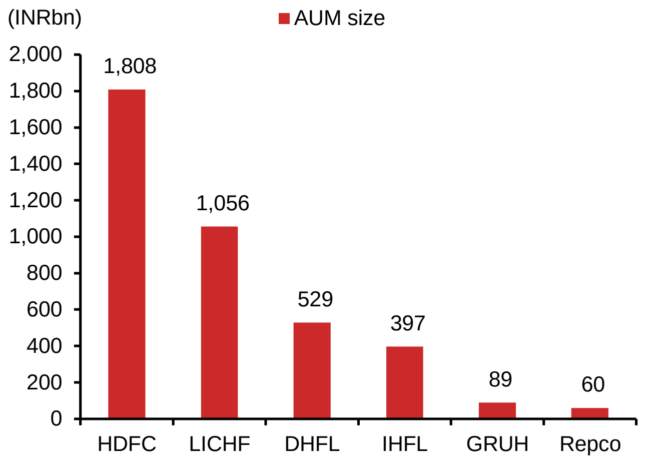
Source: Company data, Nomura estimates

Serving the underserved: one of the fastest-growing HFCs with a niche focus

DHFL is India's fourth-largest player on total AUM (INR580bn) and third-largest player in the home loan market after HDFC and LICHF with AUM of INR530bn in mortgage loans. Its portfolio is concentrated towards traditional home loans (75%) and includes LAP (18%) and developer loans (6%). DHFL is a niche player in the mortgage segment, largely focusing on the LMI segment in tier-2/3 cities where the competition from private banks and HFCs like HDFC/LICHF remains fairly limited.

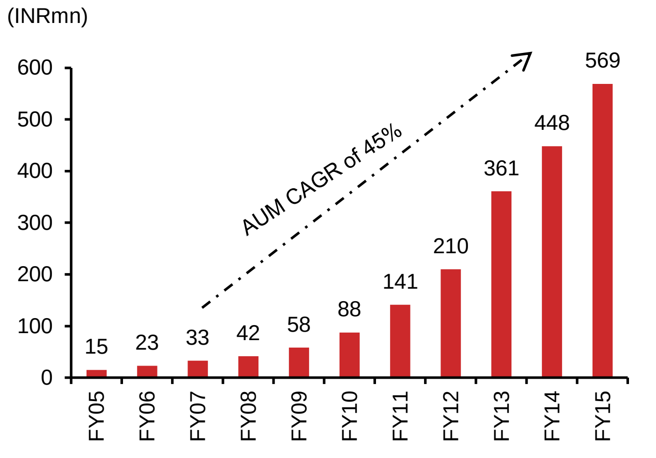
Its borrowers are largely in the salaried segment and in the low/middle-income (LMI) group where ticket sizes are in the range of INR0.4-1.5mn and the average income of borrowers is in the range of INR10,000-35,000/month. Its experience in the real estate market and superior underwriting ability has helped DHFL to deliver an AUM CAGR of 45% (42% CAGR excluding First Blue acquisition) over the past decade. It has consistently gained market share over the past 4-5 years from 1% in FY08 to 4.1% now.

Fig. 102: DHFL: India's third-largest (on mortgage book) HFC after HDFC/LICHF (FY15)



Source: Company data, Nomura research

Fig. 103: AUMs have had at a ~45% CAGR over the past decade, making DHFL one of the fastest-growing HFCs



Source: Company data, Nomura research

Fig. 104: Home loan market share trends – DHFL consistently gaining market share

Market share	FY08	FY12	FY13	FY14	FY15	Incremental market share - FY08-12	Incremental market share - FY12-15	CAGR - FY09-12	CAGR - FY12-15
Private Banks	**70.1%**	**64.4%**	**61.4%**	**60.9%**	**60.9%**	**56.5%**	**55.4%**	***12%***	***16%***
ICICI Bank	18.2%	7.7%	6.3%	6.5%	7.0%	-6.9%	6.0%	-8%	15%
Axis Bank	2.1%	4.2%	4.7%	5.0%	5.2%	7.1%	6.7%	36%	27%
HDFC Bank		2.3%	2.2%	2.2%	2.3%	5.5%	2.4%		19%
Kotak Bank	0.7%	1.3%	1.4%	1.4%	1.4%	2.2%	1.5%	34%	21%
SBI	12.4%	16.4%	15.9%	15.8%	15.4%	22.2%	13.7%	23%	16%
Private banks ex- ICICI	**51.9%**	**54.4%**	**52.9%**	**52.2%**	**51.5%**	**63.5%**	**49.4%**	**17%**	**16%**
HFCs	29.9%	35.6%	38.6%	39.1%	39.1%	**43.5%**	**44.6%**	***19%***	***22%***
HDFC Ltd	13.3%	13.5%	13.9%	13.9%	13.8%	13.9%	14.2%	15%	19%
LIC Housing	5.7%	9.3%	9.6%	9.6%	9.7%	14.4%	10.3%	29%	20%
Dew an housing	1.0%	2.7%	4.0%	3.9%	4.1%	5.1%	6.3%	46%	36%
Indiabulls Financials		2.0%	2.1%	2.2%	2.5%	4.9%	3.3%		27%
Gruh Finance	0.5%	0.6%	0.7%	0.8%	0.9%	0.8%	1.2%	20%	32%
PNB Housing		0.6%	0.9%	1.2%	1.6%	1.5%	3.1%		62%
Repco		0.4%	0.4%	0.4%	0.5%	0.9%	0.6%		27%
Total Mortgage Market								***14%***	***18%***

Source: Company data, NHB, RBI Nomura research

A Pan-India player consistently gaining market share both organically and inorganically

DHFL is a pan-India player with a presence in all segments of the mortgage market through its various acquisitions and subsidiaries/associates: 1) First Blue caters to metro areas in North India with larger ticket sizes of >INR1.5mn, 2) Aadhar Housing caters to lower-income groups in rural areas with ticket sizes of <INR0.5mn, and 3) Avanse provides education loans.

Fig. 105: Growing its presence across India and categories both organically and inorganically

	DHFL	First Blue	DHFL Vysya	Aadhar	Avanse
DHFL's stake		67.56%	9.47%	14.90%	48.39%
Promoters' stake		32.44%	83.89%	62.00%	37.82%
Acquired in		Acquired 67.56% stake in FY12 and amalgamated in FY13	Acquired 9.12% stake in FY04 and reduced it to 9.47% by FY12	Created in FY11	Acquired stake in FY13
Consideration paid by DHFL		INR10.5bn			
Segment	LMI segment	Prime mortgage segment	LMI segment in South India	Caters to EWS segment in rural areas/developing states	Education loans
Avg. ticket size	INR1.1mn	INR1.5-2.5mn	INR0.8mn	INR0.5-1.2mn	INR1.1mn
Presence	Tier II/III cities	Metro cities in North India	South India	Developing states	Prime markets

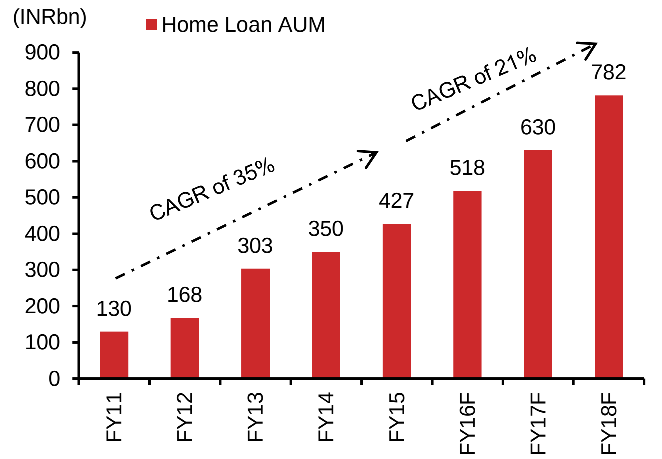
Source: Company data, Nomura research

Consistently gaining market share to become third largest home loan provider

DHFL has consistently gained market share in the past 4-5 years with its traditional home loan market share improving from ~1.5% in FY0 to ~4.1% in FY15. This has come on the company's robust growth in the past 5-6 years, delivering an AUM CAGR of ~40% in FY09-15 both organically and inorganically (First Blue acquisition in FY13), which has helped DHFL to close the gap with HDFC/LICHF and to move up the ranks to become the seventh largest player in traditional mortgage segment.

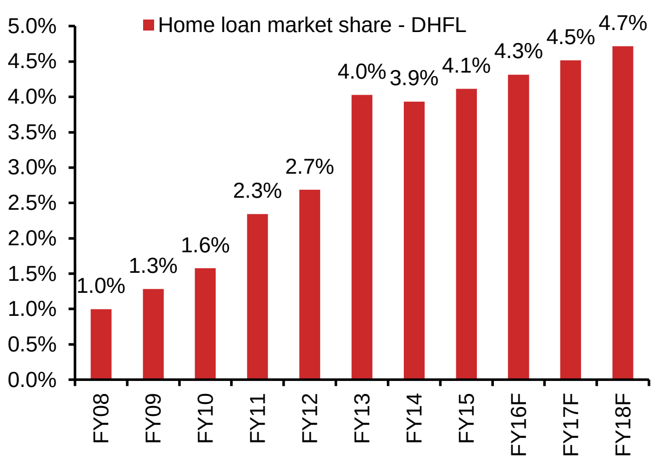
While the market share gap as of FY15 separating DHFL (4.1% market share as on FY15) from LICHF (9.6%) and HDFC (15.4%) remains quite large, we look for DHFL to improve its market share to 4.7% in FY18F with an AUM CAGR of 21-22% in FY15-18F (vs our expectation of an 18% CAGR for the overall mortgage market over the same period), helped by its recent tie-ups with: 1) banks including Yes Bank, Central Bank, United Bank and Punjab and Sind Bank (~5% of loans sourced through this channel) and some 1,500 developers (10-15% loans sourced through this channel).

Fig. 106: Lower competition in LMI segment to support higher-than-system growth in mortgages for DHFL…



Source: Company data, Nomura estimates

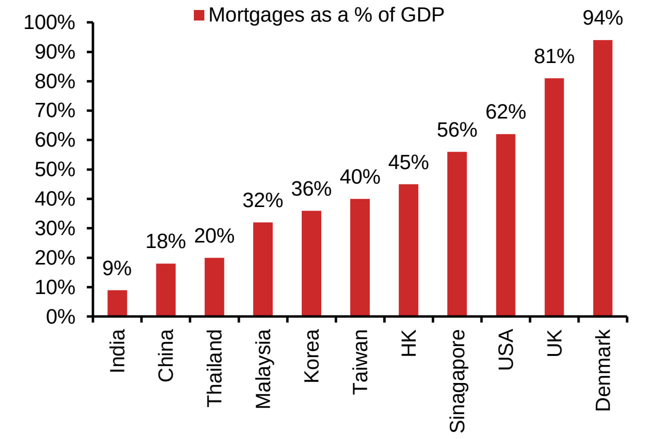
Fig. 107: … helping DHFL to consistently gain market share – we expect 20bps annual market share gain in FY15-18F



Source: Company data, NHB, RBI, Nomura estimates

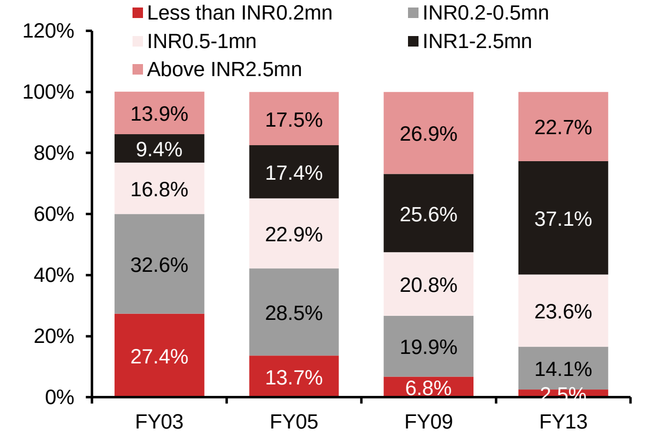
Niche focus and government thrust on affordable housing augur well for growth
As highlighted in our sector analysis, mortgage penetration in India remains fairly low at 9% of GDP vs 15-20% of GDP in other developing countries. Penetration level for loans with a ticket size of <INR1.5mn (LMI segment), which is a focus area for DHFL, is even lower given the decline in the share of bank loans in the <INR1.5mn category over the past decade. We think the opportunities in this segment remain large, especially with the new government now pushing for affordable housing and competition still fairly limited, as is evident from the fact that <INR1mn ticket size loans account for only 40% of the bank's loan book, vs 65% in FY05. This suggests that there is room for DHFL to tap the underserved customers and access untapped markets by improving its reach. We expect DHFL to deliver an AUM CAGR of 23-24% in FY15-18F, driven by continued traction in the mortgage segment and an improving developer mix.

Fig. 108: Mortgage penetration still low in India – we expect it to continue to inch up



Source: Company data, Nomura research

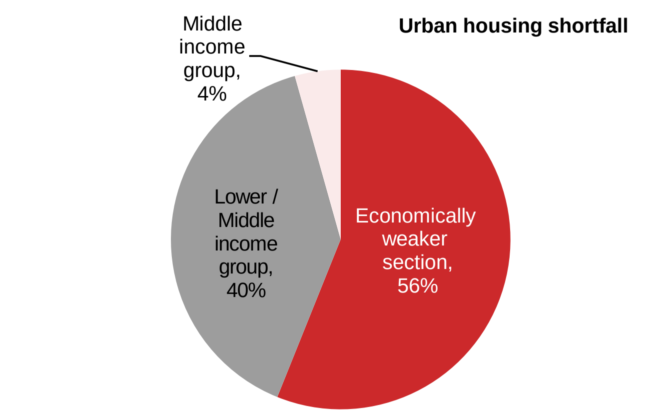
Fig. 109: Share of <INR1.5mn mortgages has come down in banks' overall mortgage book



Source: Company data, Nomura research

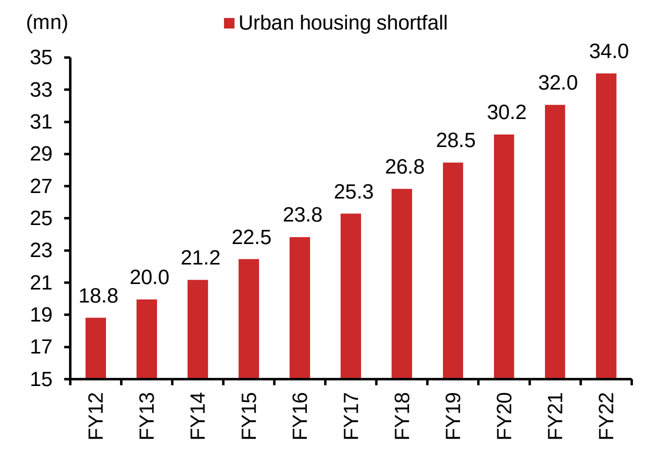
Real estate developers are increasingly focusing on the affordable housing segment due to the new government's thrust towards affordable housing. In our view, DHFL stands to be the key beneficiary given its dominance in this segment. According to the government, there is currently a housing shortfall of 18.8mn units in urban areas (34mn shortfall expected by 2022) and most of this shortage is in the lower- and weaker-income segments. On the lending side as well, we see a mismatch between demand and supply owing to difficulty in accessing credit risk in the LMI segment and improper documentation. With its expertise in this segment and flexibility in lending as an HFC, we think DHFL will be the biggest beneficiary of any developments in this segment.

Fig. 110: Around 40% of the housing shortfall in urban areas is in LMI segment and 56% in economically weaker segment



Source: Ministry of Housing and Urban Poverty

Fig. 111: Housing shortfall expected to touch 34mn by 2022



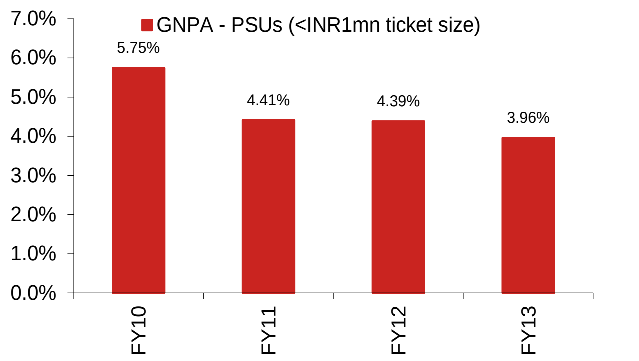
Source: RNCOS, Nomura research

Limited risk from regulatory exemption for affordable housing

The RBI recently incentivised banks to increase lending in the affordable housing segment. It now allows regulatory forbearance on SLR (statutory liquidity ratio)/CRR (Cash reserve ratio)/PSL (priority sector lending) requirements for raising long-term bonds for financing affordable housing. It has also raised the qualifying limits for affordable housing to INR5mn in metro areas and INR4mn outside metro areas, from INR2.5mn and INR1.5mn, respectively.

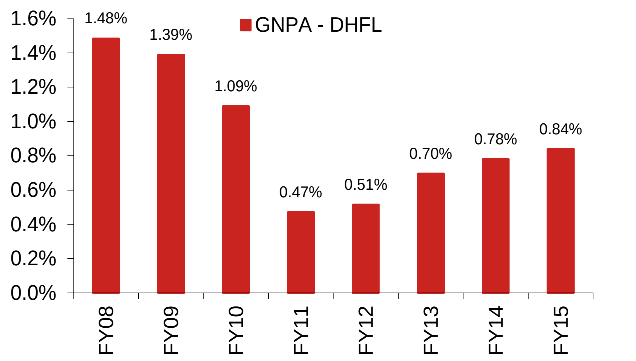
This will likely increase the competition among banks in the LMI segment given that the benefit on funding costs is around 75-100bps due to the SLR/CRR/PSL exemption making up for higher opex incurred towards lending to the LMI segment. However, we note that most banks lack expertise in lending to the LMI segment and this is visible in the inferior underwriting ability of PSU banks, which have recorded much higher Gross NPA than DHFL has maintained over the past four-five years. As well, banks so far have shown little intent cater to this segment, hence we do not see any material increase in competition due to the regulatory forbearance.

Fig. 112: While GNPAs for PSUs have remained high in lower ticket size home loans….



Source: Ministry of Housing and Urban Poverty, Nomura research

Fig. 113: …DHFL has not only maintained better NPA ratios but also managed to improve them in the past 5-6 years

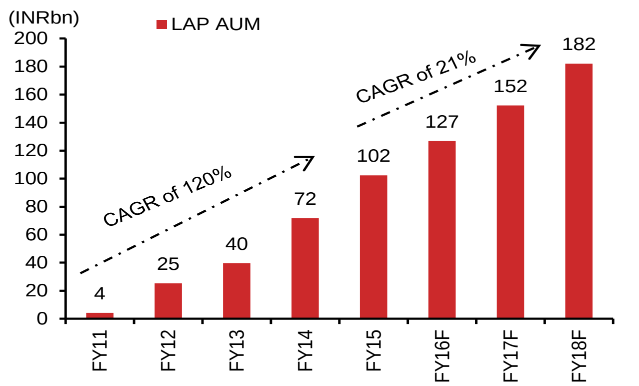


Source: Company data, Nomura research

A serious player in LAP now, which comprises ~18% of total AUM

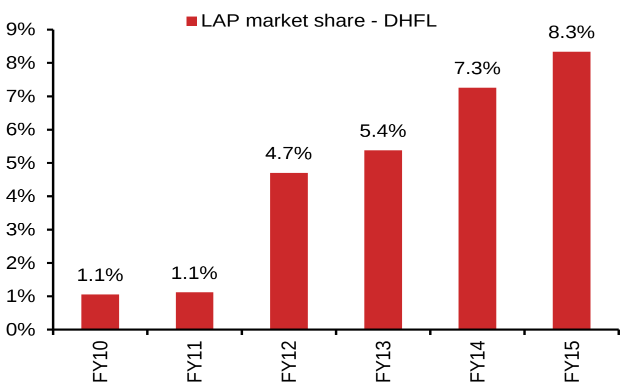
DHFL is a relatively late entrant in the LAP segment compared to peers (eg, IHFL, HDFC, ICICI, and HDFCB). It has, nonetheless, gained significant market share in this segment over the past five-six years from 1% in FY09 to ~8% in FY15. While DHFL's average yield in the LAP book of 75-100% is lower than peers' where yields are closer to 13-14%, we think lower yields have given DHFL an competitive edge which has helped it to deliver a 120% CAGR in FY11-15, vs the LAP market CAGR of ~30% over the same period. While yield pressures in the LAP segment will incrementally make it less attractive given higher potential asset quality risks involved, we still think LAP remains a superior ROE product compared to traditional home loans. Thus, we expect DHFL to maintain its LAP mix in the overall book at around 18% for the next two-three years.

Fig. 114: LAP book has increased at a 120% CAGR over FY11-15…



Source: Company data, NHB, RBI, Nomura estimates

Fig. 115: … which has led to healthy market share gains from 1% in FY10 to 10% in FY15



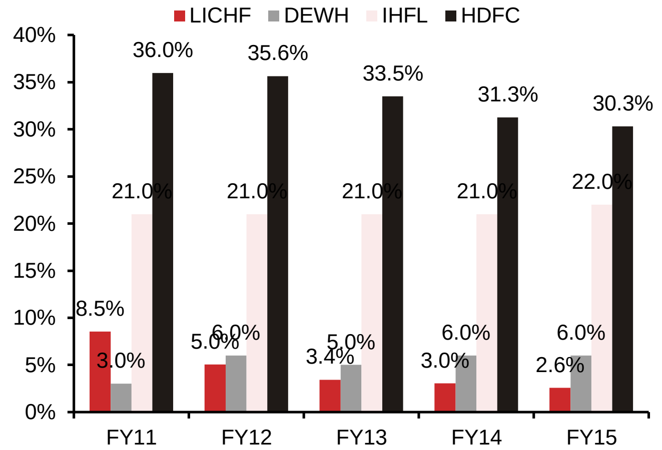
Source: Company data, Nomura research

Developer book small vs peers'; developer mix to improve but remain small

As compared to IHFL, which has a reasonable mix of high-yield LAP and developer loans in its book, DHLF seems to be slowly getting there with its focus on garnering higher yields. The developer mix for DHFL has increased from 3% in FY11 to 6% currently. Despite its real estate background, DHFL has been slower in ramping up this book. The reason for the lower share is that it focuses only on the developers in tier-2/3 cities where the competition and ticket sizes are fairly low, allowing it to demand better rates at around 18-20%. To mitigate the higher risks, it only lends to builders where projects are 30-40% completed and where the builder has put in enough equity to give more comfort on execution risks. The average tenure due to this is lower at around 18-24 months as either the project gets completed sooner or the builder gets the loan refinanced at cheaper rates from other lenders, thus increasing the run-downs in this book. This in our view has also led to inferior builder book mix vs peers.

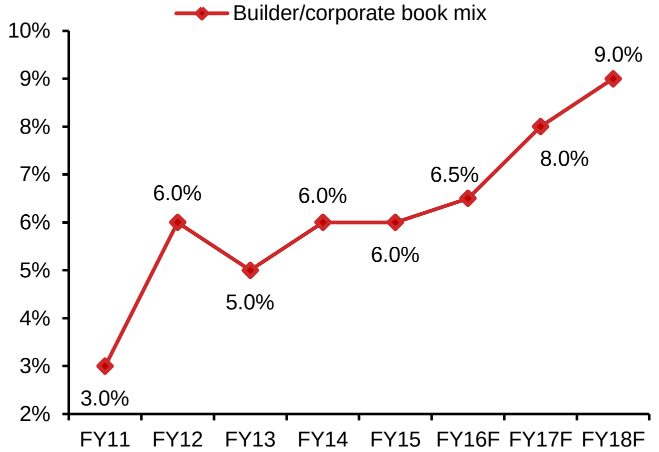
With recent tie-ups with developers and with the company now gaining enough expertise in this segment and having started lending to new projects at early stages, we think developer book will see healthy traction from here on. Also to mitigate falling yields in the LAP book, we think the company will focus on this segment to support overall yields. We expect builder book to increase from 6% currently of total loans to 9% by FY18F, but we do not see this book becoming materially large at around ~20-25% of total loans like that of HDFC/IHFL as run-downs will likely remain fairly high in this segment. Increase in developer loans will also likely support growth in home loans as loan sourcing from builder references will also improve going forward.

Fig. 116: Builder book mix for DHFL is very low compared to peer HFCs'



Source: Company data, Nomura research

Fig. 117: We expect some inch up in builder book mix which should help offset yield pressures in LAP

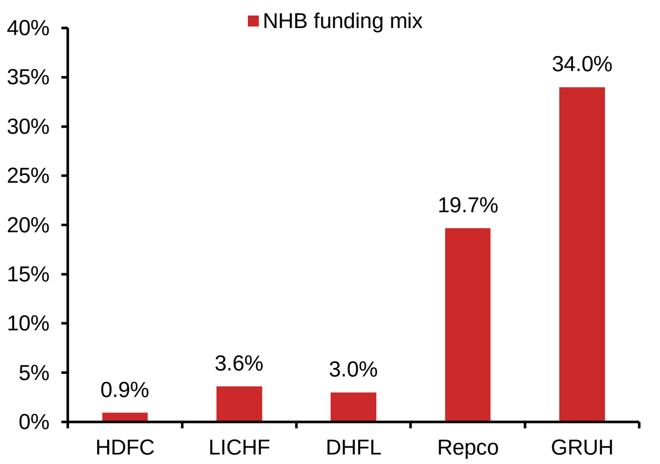


Source: Company data, Nomura estimates

Dewan's cost of funds becoming competitive

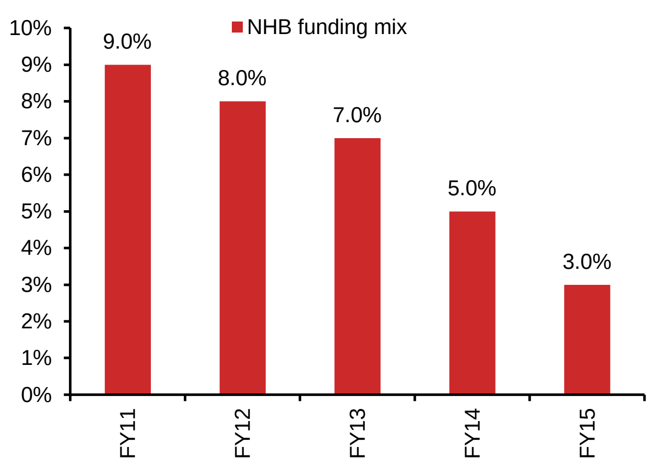
Faced transition risk like any other mid-sized HFC: For any HFC, we think cost competence comes when it is either a small company dependent on cheaper NHB funding or when it graduates to a big HFC where higher proportion of its funding is from is bonds. Mid-sized HFCs like Dewan face some transition risk when share of cheaper NHB funding mix declines (NHB funding has declined from 9% in FY11 to 3% currently for Dewan) and its share and cost of bond funding is not enough to compensate for the cost increase due to lower NHB funding.

Fig. 118: NHB funding has been higher for smaller players (FY15)



Source: Company data, Nomura research

Fig. 119: NHB funding has been coming off as it grows in size



Source: Company data, Nomura research

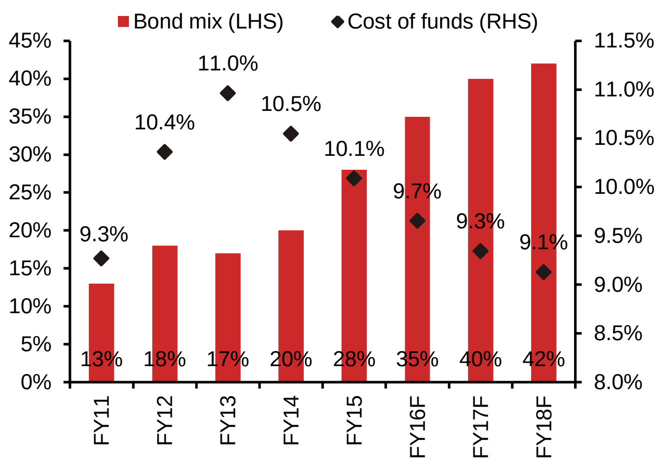
But ratings upgrade coming in at the right time: Dewan was traditionally a weaker liability franchise and that was visible in FY13 where it had to raise bonds at 13-15% (300-400bps higher than HDFC/LICHF vs an avg spread of 100-150bps). Dewan housing has now established a long enough track record of stable financial performance leading to ratings upgrade and better acceptance of its bonds. Recent rating upgrades (AA+ to AAA by CARE) have led to improvement in cost of funds where DHFL is now raising NCDs at 70-80bps higher than HFDC/LICHF vs 100-120bps higher in FY13. In our view, this will help DHFL to be more competitive in higher-ticket segments and also help offset yield pressure in the LAP book. While bond mix at 28% of total funding is lower as compared to peers, we expect this to improve to 42% by FY18.

Fig. 120: DHFL's rating upgrade leading to significant improvement in funding profile

Long term ratings		FY11	FY12	FY13	FY14	FY15
HDFC	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
	ICRA	AAA	AAA	AAA	AAA	AAA
LICHF	Crisil	AAA	AAA	AAA	AAA	AAA
	CARE	AAA	AAA	AAA	AAA	AAA
Indiabulls	Crisil	AA	AA	AA	AA	AA+
	CARE	AA+	AA+	AA+	AA+	AAA
	ICRA	AA	AA	AA	AA	AA+
Dewan	CARE	AA+	AA+	AA+	AA+	AAA

Source: Company data, Bloomberg, Nomura research

Fig. 121: Improving bond mix on rating upgrade to help reduce funding cost



Source: Company data, Nomura estimates

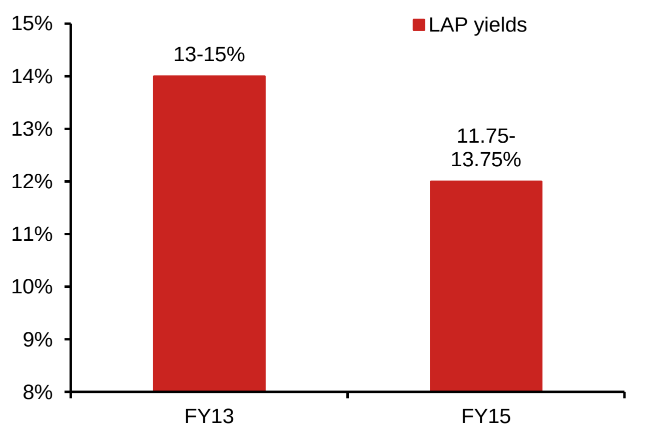
Improving liability and asset mix to partly shield pressure in LAP yields

LAP yields under pressure: LAP yields have been ~200-250bps higher than for traditional mortgage loans in the past 4-5 years, has driven the improvement in yields for Dewan. However, the yield gap of LAP vs mortgages has come off from 200-250bps in the past 4-5 years to the current 100-150bps, and we think it can further converge to 75-100bps going forward. While DHFL's yield in the LAP segment is lower than that of peers and it faces less competition in the <INR1.5mn loan category, overall spreads are likely to remain under pressure given that LAP constitutes 18% of Dewan's loan book.

But asset and liability mix improvement to offset yield pressure:

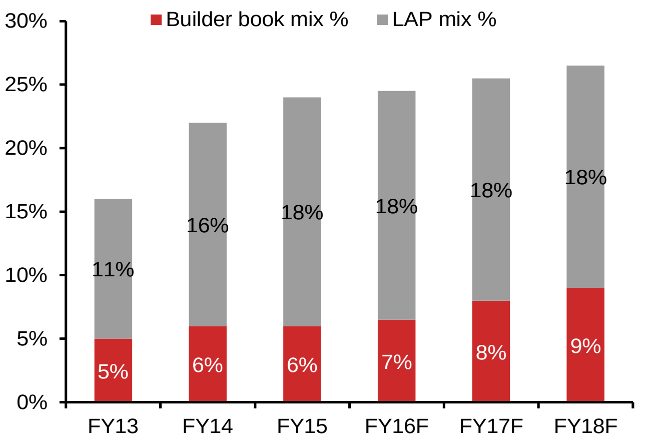
1) Improving asset mix: We think LAP remains a superior ROE product with a similar asset quality experience as mortgages, and we expect Dewan to maintain its LAP share in total AUM at around 17-18% from here on. We expect developer loan mix to gradually improve from 6% to 9% by FY18F. Yields on this segment are significantly higher and that should offset some pressure on margins from falling LAP yields. Overall, we expect the non-retail portfolio to increase from 24% currently to 27% by FY18F, which should help DHFL mitigate yield compression challenges to some extent.

Fig. 122: We expect LAP yields to compress further



Source: Company data, Nomura estimates

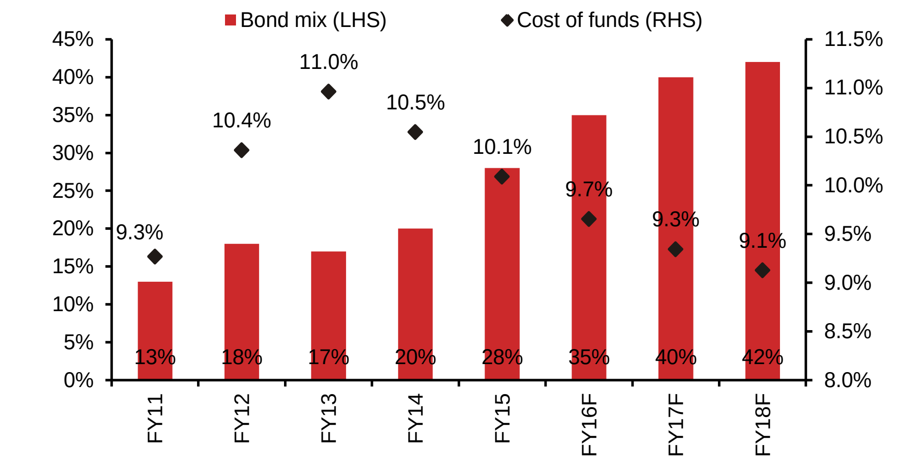
Fig. 123: But the non-retail book mix should improve, offsetting the yield pressure in LAP



Source: Company data, Nomura estimates

2) Liability mix to improve on recent rating upgrade: Recent rating upgrades (AA+ to AAA by CARE) have led to improvement in cost of funds where DHFL is now raising NCDs at 70-80bps higher than HFDC/LICHF vs 100-120bps higher in FY13. We expect DHFL's liability franchise to improve on the back of this with bond mix expected to improve to 42% by FY18F from 28% currently which will further aid cost of funds.

Fig. 124: Improving liability mix to aid funding cost

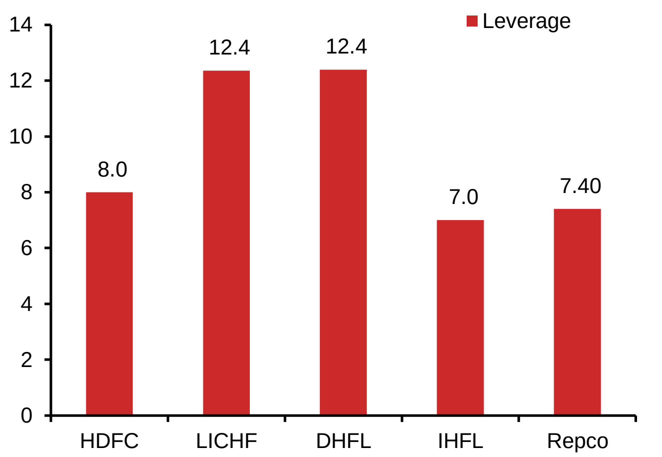


Source: Company data, Nomura estimates

Further ratings upgrade contingent on leverage coming down

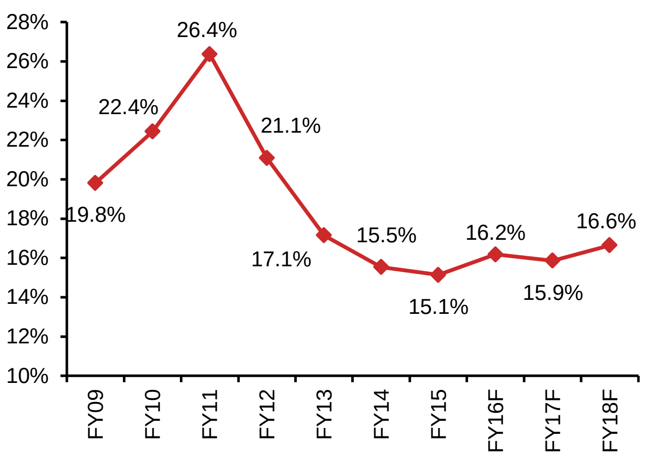
While CARE recently upgraded Dewan's rating from AA+ to AAA, DHFL's leverage remains high and in our view that is one key reason for it not being rated by CRISIL for the long-term bonds. Its leverage is 11-12x, vs an average of 7-10x for peer HFCs. Additionally it remains an inferior ROE company with higher growth prospects, which will keep the leverage higher in our view. This remains a key concern for Dewan and we think further rating upgrades will be difficult to come by unless it increases it equity base. We are building in capital dilution of 15% in FY17F despite which the leverage will likely remain high at 12-13x.

Fig. 125: DHFL's leverage is higher than peers



Source: Company data, Nomura research

Fig. 126: Its low ROEs to keep the leverage high



Source: Company data, Nomura estimates

Inefficient utilisation of cash have led to lower ROEs: delivery on this will be key re-rating catalyst

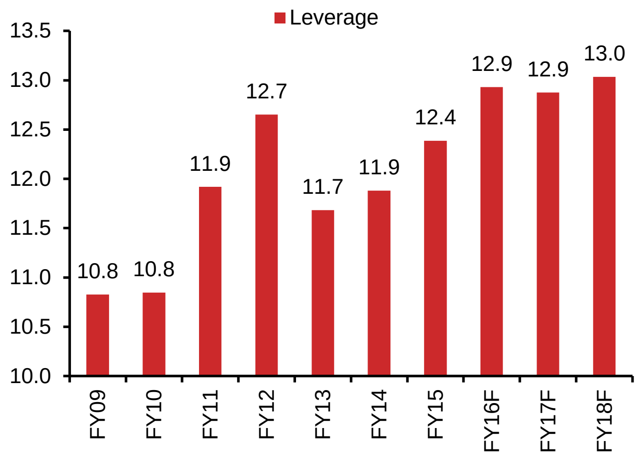
We think high leverage levels for DHFL vs peers has been the key reason for its inferior ROE apart from higher funding cost. DHFL in the past has blocked a considerable amount of its capital in various acquisitions and other non-core investment, which has resulted in leverage levels inching up to 12-13x in FY15, from 10-11x in FY09/10. Such high leverage has capped NIMs, in our view. While we do expect some relief on the funding cost side, for this to translate to NIMs, the company will have to focus on reducing its leverage levels. The only comfort that we derive here is that the management seems to be more committed now to focus more on core business and we think leverage levels can improve if it manages to release some of its capital from its investments.

Fig. 127: DHFL has invested around 40-45% of its current net worth in acquisitions/non-core investments

INRmn	Investments	% of FY15 NW
DHFL Pramerica	320	0.7%
DHFL Vysya	32	0.1%
Aadhar	149	0.3%
Avanse	302	0.7%
First Blue	10,500	22.6%
Building	8,000	17.3%

Source: Company data, Nomura research

Fig. 128: Leverage has increased due to these acquisitions/investments



Source: Company data, Nomura estimates

Summary of acquisitions/investments – Some of them have been earnings dilutive
(1) Acquisition of First Blue- Not expensive but an acquisition not in their domain: One major acquisition in FY11 was of First Blue (erstwhile Deutsche Postbank Home Finance). DHFL acquired a 67.5% stake in the company for a cash consideration of INR7.3bn and in FY13 it merged First Blue into DHFL by issuing 10.8mn shares amounting to INR3.2bn for the balance stake.

First Blue had a loan book of ~48bn which was 33% of DHFL's standalone AUM. The loan book comprised of mainly prime mortgage book where ticket sizes were higher and was concentrated mainly in North India where DEWH had limited presence. We think yields on this book would be ~25-50bps lower than DHFL’s core book and thus the acquisition was ROE dilutive.

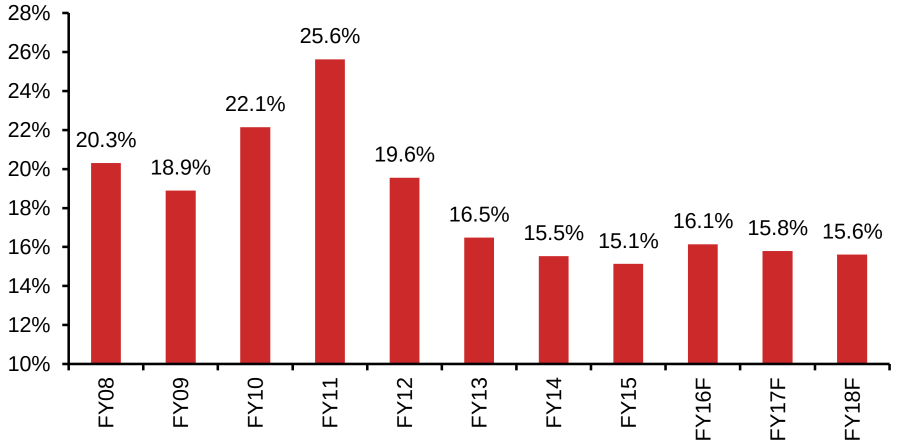
While management reasons that this acquisition gave it access to superior talent and entry in higher ticket mortgages, we believe investing ~65% of their then net worth (FY11) to acquire a book which was not their core competence was not very value accretive. After the merger, ROEs came off from 20% in FY10 to 16-17% in FY12.

Fig. 129: Acquisition details of Deutsche Postbank Home Finance

Loan book		Networth		ROEs		Consideration	Implied trailing P/B
DHFL	First Blue	DHFL	First Blue	DHFL	First Blue	paid	for First Blue
INR140bn	INR48bn	INR11bn	INR5.24bn	20-22%	18-19%	INR10.5bn	2x

Source: Economic times, Nomura research

Fig. 130: ROEs in FY11-13 saw significant impact from acquisition of First Blue



Source: Company data, Nomura estimates

(2) Invested INR8bn (17-18% of FY15 NW) in construction of office building over FY12-15 –Unjustifiable in our view

DHFL invested 17-18% of its equity into the construction of an office building for its own use, while we think it could have easily leased a building and not blocked so much of its capital. It has already spent INR8bn on construction in the past three years and we think the cost already incurred is c.INR23,000/sq ft. Management indicated that the building will be completed in the next two-three years and the company will not incur any material cost on it going forward. The only comforting factor here is that management is already considering selling and leasing back the building which will release much needed capital.

(3) Better deal on insurance acquisition

The company acquired a 50% stake in DLF Pramerica Life Insurance in FY12 for only INR1 and DHFL's promoters acquired another 24% stake for INR326mn. Thereafter, DHFL infused INR320mn. The company is already making profits of INR400mn (FY15) and may also start paying dividends by FY16. We think this was a good acquisition especially considering that it paid almost nothing for it.

With the FDI limits now increased to 49%, DHFL can look to sell part of its stake to a foreign partner which may also release some capital and lead to some windfall gains. The company is still considering options to monetise it, which should be a positive as we are not adding any value of the insurance business to our TP.

Our back of envelope calculation, suggest a valuation of INR15bn for the insurance company applying same NBP multiple/margins as the larger insurers. A 50% stake of DHFL implies a value of ~INR45/share which we have not included in our TP and will offer further upside in case management is able to offload their stake or build this business profitably.

Fig. 131: Back of the envelope valuation for Insurance business

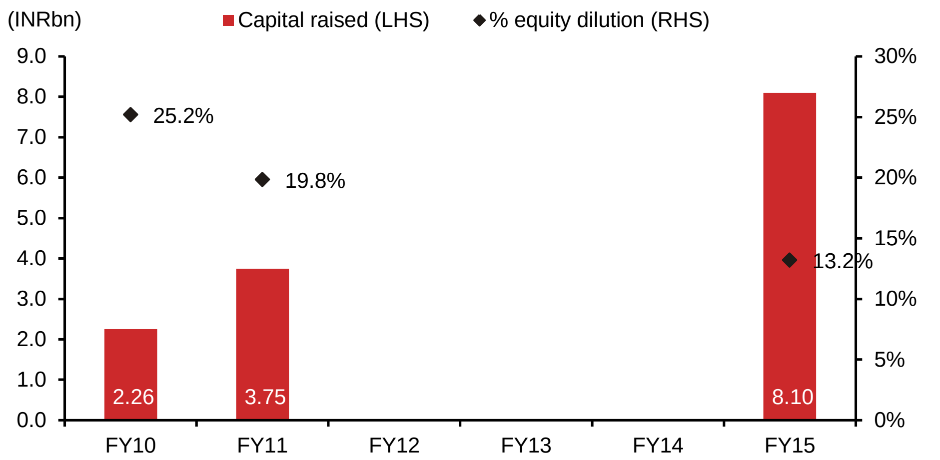
DHFL Pramerica - Back of the envelope valuation	
Appraisal Value (INRmn)	14,977
EV (INRmn)	8,673
Value of future business (INRmn)	6,305
P/NBAP (ex-EV)- FY18	15.6
P/EV	1.73
EV (% of AV)	57.9%
DHFL's stake in insurance business	50%
Contribution to DHFL (INR/share)	45

Source: Nomura estimates

Inefficient use of cash has led to frequent dilutions

On account of such frequent acquisitions and investing in non-core assets like the office building, the company has faced frequent capital dilution. The company raised INR2.3bn in FY10 (25% dilution), INR3.8bn in FY11 (20% dilution) and INR8.1bn in FY15 (13% dilution). Apart from the fact that such use of capital reduced profitability of the company, it has also seen its ROE moderate to 15% now, from ~20% pre FY11, despite leverage inching up to 12-13x currently, from 10-11x in FY10. This has turned the company into the highest levered HFC with leverage of 10-11x vs 7-10x for peers, despite its recent capital infusion in 4QFY15 of INR8bn.

Fig. 132: Frequent dilutions have capped ROE at under 17% in the past 3-4 years

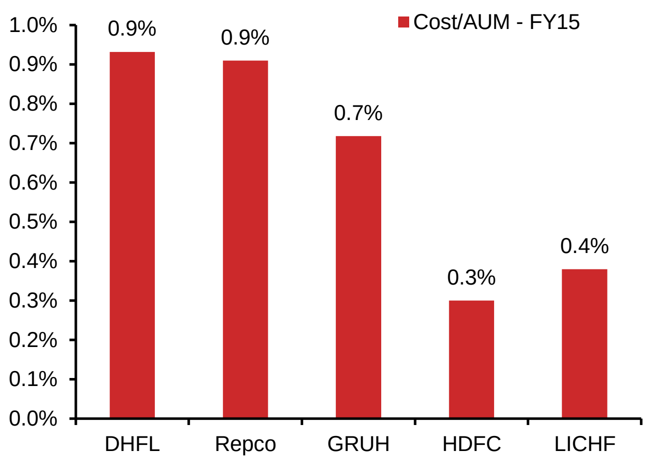


Source: Company data, Nomura research

Opex seems high: we see scope for improvement

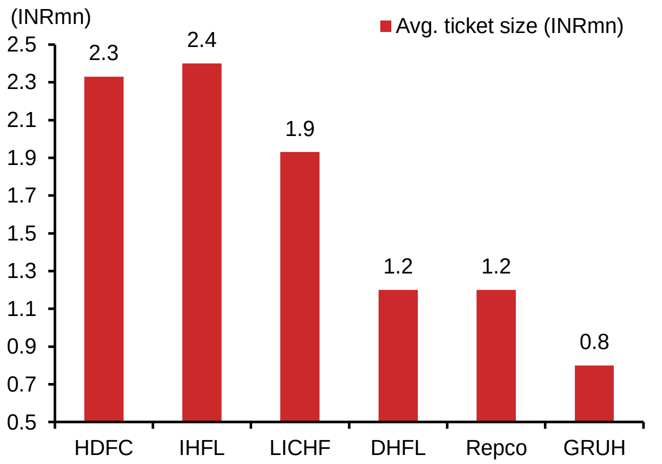
DHFL's cost-to-asset ratio at 0.9% of AUMs is highest amongst the HFCs. We acknowledge that it operates in the LMI segment, where the ticket-size is low and thus costs tend to be higher, but even if we compare it to players like Gruh/Repco which operate in a similar segment with similar ticket size, DHFL's cost-AUM ratio is higher.

Fig. 133: Cost/AUM is one of the highest amongst peers



Source: Company data, Nomura research

Fig. 134: Partly due to low ticket size but still higher than peers with comparable ticket size

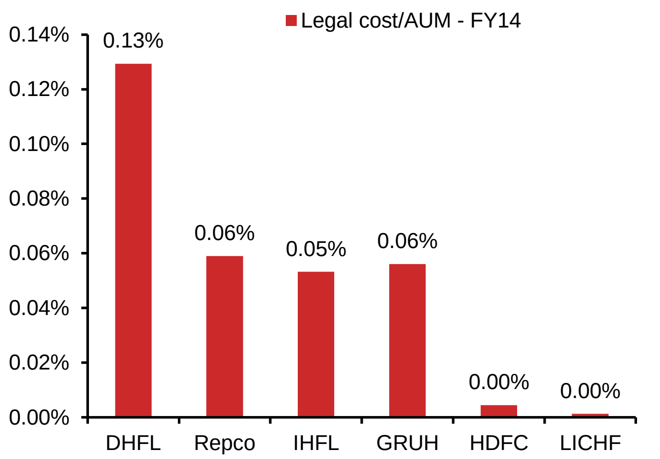


Source: Company data, Nomura research

While some part of the costs can be reasoned...

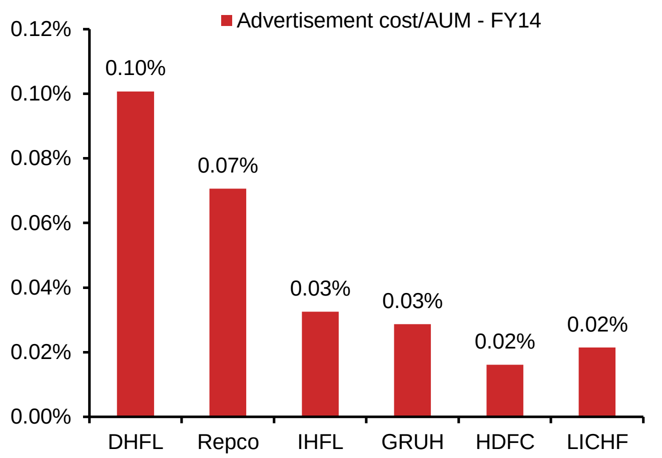
One reason for the higher costs which is more explainable is the company's higher legal costs in the past 2-3 years, which we believe are due to a few acquisitions. In absolute terms, legal costs come to INR580mn in FY14, which was 8-10x more than peers'. Most of this, we expect is attributable to acquisition related costs, which should decline to INR400mn by FY18F (0.04% of AUM) on our estimates. The other part is higher advertisement expense which we think the company would have incurred for brand building and was 3x higher than peers'. We think a large part of the brand-building efforts is behind us and these costs will move closer in line with peers going forward.

Fig. 135: Traditional mortgages increasing as a % of overall loan portfolio



Source: Company data, Nomura research

Fig. 136: Funding cost difference between IHFL vs HDFC/LICHF has come off

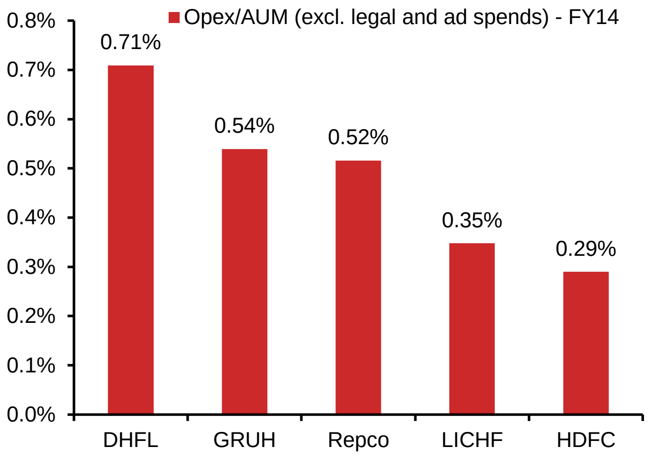


Source: Company data, Nomura research

… we still think there is scope for further improvement

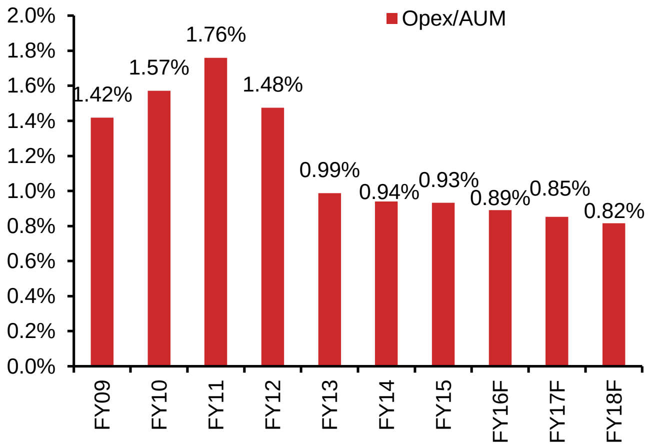
Excluding legal and advertisement costs, we still think the costs remain high compared with peers which operate in similar segments given that at such an AUM size, operating leverage should have started flowing through. We factor in ~10bps improvement in cost to assets for Dewan largely from lower legal/advertising expenses and any further reduction in cost will be positive surprise vs our estimates.

Fig. 137: Opex remains high even after excluding legal and advertisement expense



Source: Company data, Nomura research

Fig. 138: We are building in only a 10bp improvement in opex/AUM by FY18F

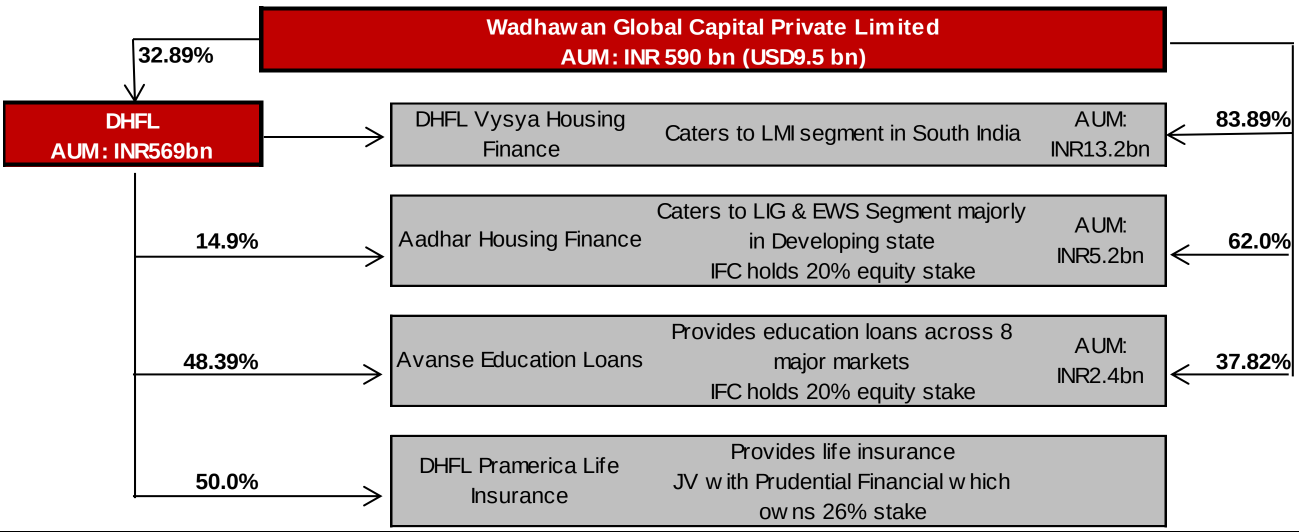


Source: Company data, Nomura estimates

Management bandwidth improving

DHFL separated from HDIL group in 2009 by eliminating cross-holdings with HDIL group. It is now a part of the Rajesh Wadhawan group and Mr. Kapil Wadhawan is now the chairman of DHFL. Rajesh Wadhawan, under its holding company, holds interests in DHFL, Dheeraj Builders and few businesses in the hospitality sector. While the group does have interest in real estate and will remain a concern for investors, the comforting part is that there is no cross holdings with the HDIL group.

Fig. 139: Company holding structure



Source: Company data, Nomura research

With an aim to become a financial conglomerate, DHFL has diversified its business in various verticals. While this improves DHFL's product offerings, it also increases risk of efficiently managing businesses in a way to add shareholder's value. To manage these challenges, DHFL's holding company has hired key professionals which should provide the company with a better strategic direction and enhance synergies across group companies.

Fig. 140: Key professionals hired at group level

Key hires	Details
Milind Sarwate	30 years of experience with Marico (CFO), Godrej, Sanofi Aventis
G Ravishankar	25 years of experience with Jet Airways (acting CEO/CFO), Geometric, GE Capital
Srinath Sridharan	Over 18 yrs of experience in Strategy Management across Automobile, ecommerce, Advertising, Consumer, Realty and Financial services industries
K Srinivas	30 years total experience - 14 years at Bajaj Auto
M Suresh	30 years of experience in sales & distribution with TATA AIA Life (MD & CEO), HDFC Life, ITC

Source: Company data, Nomura research

Cheapest mortgage play: further re-rating likely but contingent on efficient utilisation of cashflows

At ~0.9x FY17F P/B, DHFL is trading at a significant discount to peer HFCs trading at 2-3x and comparable niche players like Gruh and Repco trading above 3x. Admittedly, DHFL's FY16/17F ROE of ~16% is far weaker than peer ROEs of 20-25%, but we still think the valuation is inexpensive considering our expectations of significant growth opportunities in the LMI segment and very limited asset quality risks.

Moreover, falling funding costs on the recent rating upgrade and improving bond mix will likely net off the yield pressures in the LAP book and may lead to some improvement in NIMs, albeit the benefit will likely be capped by increasing leverage. As well, management now seems more committed to improve operational efficiencies and a large part of the cost differential (legal and advertisement cost) is now in the past and should improve going forward.

We value Dewan Housing at 1.25x FY17F book (INR419) and initiate coverage with a TP of INR525, with implied upside of 35%. DHFL remains one of the cheapest HFCs at ~0.9x FY17F book. We expect DHFL to re-rate given its +23% CAGR and benign liquidity conditions. While in the past 12 months, DHFL has re-rated from ~0.7x to ~0.9x book, the re-rating should continue with improving funding mix/cost and efficient utilisation of cash.

Fig. 141: ROEs to remain subdued on the back of capital dilution assumed in FY17F

ROE Decomposition (on AUM)	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
Net Interest Income/Assets	2.98%	2.81%	3.13%	2.26%	2.20%	2.19%	2.48%	2.55%	2.52%	2.59%
Fees/Assets	0.33%	1.03%	1.03%	1.06%	0.65%	0.57%	0.36%	0.33%	0.31%	0.28%
Investment profits/Assets	0.71%	0.64%	0.74%	0.60%	0.27%	0.17%	0.15%	0.14%	0.13%	0.12%
Net revenues/Assets	**4.03%**	**4.47%**	**4.90%**	**3.92%**	**3.12%**	**2.93%**	**2.99%**	**3.02%**	**2.95%**	**2.99%**
Operating Expense/Assets	1.42%	1.57%	1.76%	1.48%	0.99%	0.94%	0.93%	0.89%	0.85%	0.82%
Provisions/Assets	0.12%	0.12%	0.15%	0.20%	0.15%	0.17%	0.21%	0.25%	0.25%	0.25%
Taxes/Assets	0.66%	0.72%	0.78%	0.57%	0.52%	0.51%	0.63%	0.63%	0.62%	0.65%
Total Costs/Assets	**2.20%**	**2.40%**	**2.68%**	**2.25%**	**1.65%**	**1.62%**	**1.77%**	**1.77%**	**1.72%**	**1.71%**
ROA	**1.83%**	**2.07%**	**2.21%**	**1.67%**	**1.47%**	**1.31%**	**1.22%**	**1.25%**	**1.23%**	**1.28%**
Equity/AUM	9.90%	11.58%	10.69%	8.95%	10.52%	8.84%	9.12%	8.19%	8.91%	8.18%
ROE	**19.8%**	**22.4%**	**26.4%**	**21.1%**	**17.1%**	**15.5%**	**15.1%**	**16.2%**	**15.9%**	**16.6%**

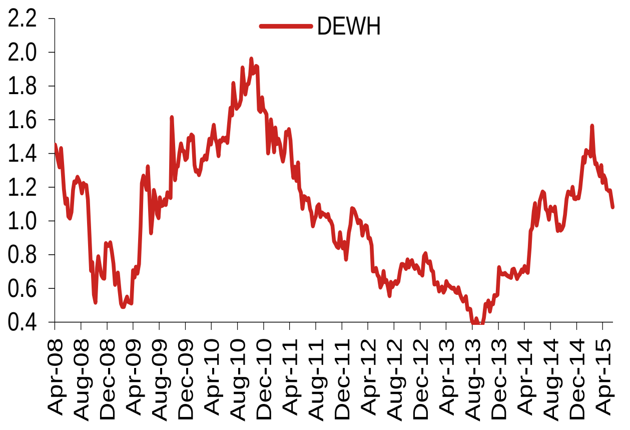
Source: Company data, Nomura estimates

Fig. 142: Initiate with a TP of INR525

Valuation assumption	
Cost of Equity	14.5%
Terminal grow th	5.0%
Normalised ROE	17.3%
Stage 2 grow th	15.0%
Mar-16 PT	525
Implied Mar-17 P/B	1.25
Implied Mar-17 P/E	9.1

Source: Nomura estimates

Fig. 143: Our TP implies 1.25x FY17F book for an ROE of 16%



Source: Company data, Bloomberg, Nomura estimates

Risks

- **Disappointment on utilization of cash:** As highlighted earlier, this has been the biggest disappointment for investors and we think any material re-rating is contingent on the company not utilising cash in acquisitions/non-core investments going forward.
- **Unfavourable wholesale funding environment:** Apart from the structural growth opportunity, our positive view on HFCs is based on a favourable wholesale rate environment. We believe that corporate loan growth will pick up gradually, hence the system liquidity and wholesale funding environment should remain comfortable. A spike in wholesale rates would be a risk to our view on overall HFCs and for DHFL.
- **Higher-than-expected contraction in LAP yields:** LAP yields have come off by ~100bps and we expect further 100bps contraction in LAP yields over FY15-18F. LAP is an attractive product from a risk-adjusted return perspective and competition will likely increase and given DHFL's higher share of LAP, lower LAP yields remain a risk.
- **Lumpy asset quality risk in builder portfolio:** DHFL's builder book is still very small but as it builds up there will be lumpy risks that can be added to the book and since DHFL is relatively new in this segment, it may lack the necessary underwriting skills to the extent that it has demonstrated in the mortgage book.
- **Small bank license:** DHFL has applied for a small bank license with an aspiration to become a full-fledged financial institution, from a mortgage lender. If DHFL gets the license, the business model will completely change for DHFL and we are not sure if it has the management bandwidth or competence to successfully run a small bank where profitability remains a key concern at the moment due to its high cost structure.

NOMURA

LIC Housing Finance LICH.NS LICHF IN

EQUITY: FINANCIALS

Valuations now undemanding; upgrade to Buy

A beneficiary of lower wholesale costs; mortgage pricing unlikely to become irrational

Action: Upgrade to Buy; TP maintained at INR500

LICHF remains one of the best beneficiaries of a falling rate environment; we think the recent 16-18% correction has made its valuations reasonable. Thus, we upgrade to Buy (from Neutral). While competition should remain intense, we believe the ability of PSU banks to cut base/ mortgage rates is low vs. the 2009 cycle, given the current weak profitability of PSU banks. We look for spreads to rise by ~15bps over the next two years and help ROEs sustain at 20%. Any significant improvement in the builder and LAP book proportion would provide further upside.

- **Mortgage pricing less irrational this time:** While the falling wholesale cost of funding is good for HFCs, lower interest costs may also lead to a 2009-like intense competition in mortgages. While banks, especially PSUs, are re-orienting their focus to mortgages, their weak profitability will likely restrict their ability to cut base and mortgage rates, as in 2009. Thus, we expect mortgage pricing to remain rational. LICHF should record 15bps improvement in loan spreads over FY15-18F driven by the lower cost of funds and some upward re-pricing in legacy fixed loans.
- **Well-positioned: Internal catalysts mostly positive:** In 2010, LICHF wrote a lot of fixed rate mortgages, and with wholesale funding costs moving higher, margins in 2012 were negatively impacted. Currently LICHF is uniquely placed with 60% of its assets being fixed in nature in a falling rate environment and part of the fixed loans is likely to be repriced upward. In addition, LICHF's builder-book proportion is currently at a historical low (2.5% of loans) and there could only be a positive catalyst from these levels.

Valuations look reasonable at 1.9x book (BVPS: INR212); up to Buy

We expect ROEs to inch up to 20% by FY17F, driven by ~15bps rise in loan spreads, and valuations at 1.9x book look reasonable after the recent correction; hence, we upgrade LICHF to Buy. We do not see any risk of irrational pricing in mortgages and change in loan mix (LAP + builder book share) can only aid margins from here on.

Year-end 31 Mar	FY15		FY16F		FY17F		FY18F
Currency (INR)	Actual	Old	New	Old	New	Old	New
PPOP (mn)	21,092	27,014	26,032	32,034	30,622		35,742
Reported net profit (mn)	13,862	17,755	16,793	21,049	19,743		23,025
Normalised net profit (mn)	13,862	17,755	16,793	21,049	19,743		23,025
FD normalised EPS	27.45	35.16	33.26	41.68	39.10		45.60
FD norm. EPS growth (%)	5.2	24.3	21.1	18.5	17.6		16.6
FD normalised P/E (x)	14.4	N/A	11.9	N/A	10.1	N/A	8.7
Price/adj. book (x)	2.6	N/A	2.2	N/A	1.9	N/A	1.6
Price/book (x)	2.6	N/A	2.2	N/A	1.9	N/A	1.6
Dividend yield (%)	1.3	N/A	1.5	N/A	1.8	N/A	2.1
ROE (%)	18.1	19.0	19.8	19.4	19.9		19.9
ROA (%)	1.3	1.4	1.4	1.4	1.3		1.3

Source: Company data, Nomura estimates

Global Markets Research

17 June 2015

Rating Up from Neutral	**Buy**
Target price Remains	INR 500
Closing price 15 June 2015	INR 395
Potential upside	+26.6%

Anchor themes

Mortgages remain a structural story from a growth perspective. Cyclically the domestic rate environment remains favourable for HFCs and banks' ability to compete on pricing is lower than in the previous cycle (FY09-10).

Nomura vs consensus

Our FY16/17F PAT estimates are broadly in line with consensus.

Research analysts

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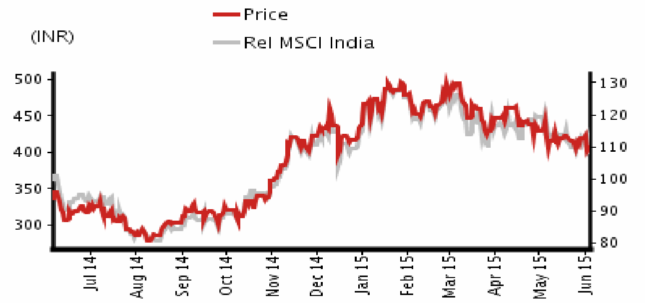
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Key data on LIC Housing Finance

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-5.9	-11.6	28.4	M cap (USDmn)	3,110.3
Absolute (USD)	-6.6	-13.0	19.6	Free float (%)	90.3
Rel to MSCI India	-1.7	-1.6	24.8	3-mth ADT (USDmn)	17.1

Profit and loss (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Interest income	90,903	105,587	123,385	145,879	175,032
Interest expense	-71,744	-83,102	-95,957	-113,512	-137,268
Net interest income	19,158	22,485	27,428	32,367	37,764
Net fees and commissions	2,444	2,399	3,003	3,379	3,952
Trading related profits	0	0	0	0	0
Other operating revenue	0	0	0	0	0
Non-interest income	2,444	2,399	3,003	3,379	3,952
Operating income	21,602	24,884	30,431	35,745	41,716
Depreciation	-76	-94	-103	-113	-125
Amortisation					
Operating expenses	-2,018	-2,405	-2,809	-3,300	-3,882
Employee share expense	-1,038	-1,293	-1,487	-1,710	-1,967
Pre-provision op profit	18,470	21,092	26,032	30,622	35,742
Provisions for bad debt	-215	-73	-714	-857	-1,028
Other provision charges	0	0	0	0	0
Operating profit	18,255	21,019	25,318	29,765	34,713
Other non-op income					
Associates & JCEs					
Pre-tax profit	18,255	21,019	25,318	29,765	34,713
Income tax	-5,083	-7,158	-8,524	-10,022	-11,688
Net profit after tax	13,172	13,862	16,793	19,743	23,025
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	13,172	13,862	16,793	19,743	23,025
Extraordinary items	0	0	0	0	0
Reported NPAT	13,172	13,862	16,793	19,743	23,025
Dividends	-2,656	-2,954	-3,579	-4,207	-4,907
Transfer to reserves	10,516	10,908	13,214	15,535	18,118

Growth (%)

Net interest income	24.6	17.4	22.0	18.0	16.7
Non-interest income	32.1	-1.8	25.2	12.5	17.0
Non-interest expenses	9.7	19.2	16.8	17.5	17.6
Pre-provision earnings	28.2	14.2	23.4	17.6	16.7
Net profit	30.2	5.2	21.1	17.6	16.6
Normalised EPS	30.2	5.2	21.1	17.6	16.6
Normalised FDEPS	30.2	5.2	21.1	17.6	16.6
Loan growth	17.4	18.6	19.8	20.1	19.9
Interest earning assets	17.4	18.6	19.8	20.1	19.9
Interest bearing liabilities	19.3	17.7	20.9	21.1	20.8
Asset growth	18.9	16.8	19.9	20.1	19.9
Deposit growth	na	na	na	na	na

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Cash and equivalents	6,793	6,758	8,168	9,890	11,948
Inter-bank lending					
Deposits with central bank					
Total securities					
Other int earning assets					
Gross loans	915,963	1,086,210	1,301,350	1,563,394	1,875,567
Less provisions	-2,554	-2,603	-3,572	-4,285	-6,856
Net loans	913,409	1,083,607	1,297,778	1,559,109	1,868,712
Long-term investments	25,442	25,640	31,506	36,736	44,377
Fixed assets	756	797	792	868	950
Goodwill					
Other intangible assets					
Other non IEAs	11,370	1,959	2,935	4,539	6,483
Total assets	957,770	1,118,761	1,341,179	1,611,142	1,932,469
Customer deposits	0	0	0	0	0
Bank deposits, CDs,	820,356	965,470	1,166,897	1,412,924	1,706,807
Other int bearing liabilities	0	0	0	0	0
Total int bearing liabilities	820,356	965,470	1,166,897	1,412,924	1,706,807
Non-int bearing liabilities	62,085	75,106	82,884	91,284	100,610
Total liabilities	882,441	1,040,576	1,249,781	1,504,208	1,807,417
Minority interest					
Common stock	1,010	1,010	1,010	1,010	1,010
Preferred stock					
Retained earnings	74,319	77,174	90,389	105,924	124,043
Reserves for credit losses					
Proposed dividends					
Other equity					
Shareholders' equity	75,329	78,184	91,399	106,934	125,053
Total liabilities and equity	957,770	1,118,761	1,341,179	1,611,142	1,932,469
Non-perf assets	6,090	4,947	7,144	9,999	13,711

Balance sheet ratios (%)

Loans to deposits	na	na	na	na	na
Equity to assets	7.9	7.0	6.8	6.6	6.5
Asset quality & capital					
NPAs/gross loans (%)	0.7	0.5	0.5	0.6	0.7
Bad debt charge/gross	0.02	0.01	0.05	0.05	0.05
Loss reserves/assets (%)	0.27	0.23	0.27	0.27	0.35
Loss reserves/NPAs (%)	41.9	52.6	50.0	42.9	50.0
Tier 1 capital ratio (%)	12.2	10.7	10.4	10.2	9.9
Total capital ratio (%)	16.4	14.3	13.4	12.6	12.0
Per share					
Reported EPS (INR)	26.08	27.45	33.26	39.10	45.60
Norm EPS (INR)	26.08	27.45	33.26	39.10	45.60
FD norm EPS (INR)	26.08	27.45	33.26	39.10	45.60
DPS (INR)	4.50	5.00	6.06	7.12	8.31
PPOP PS (INR)	36.58	41.77	51.55	60.64	70.78
BVPS (INR)	149.17	154.83	180.99	211.76	247.64
ABVPS (INR)	149.17	154.83	180.99	211.76	247.64
NTAPS (INR)	149.17	154.83	180.99	211.76	247.64

Valuations and ratios

Reported P/E (x)	15.1	14.4	11.9	10.1	8.7
Normalised P/E (x)	15.1	14.4	11.9	10.1	8.7
FD normalised P/E (x)	15.1	14.4	11.9	10.1	8.7
Dividend yield (%)	1.1	1.3	1.5	1.8	2.1
Price/book (x)	2.6	2.6	2.2	1.9	1.6
Price/adjusted book (x)	2.6	2.6	2.2	1.9	1.6
Net interest margin (%)	2.27	2.25	2.30	2.27	2.20
Yield on assets (%)	10.75	10.57	10.36	10.21	10.21
Cost of int bearing liab (%)	9.52	9.31	9.00	8.80	8.80
Net interest spread (%)	1.23	1.27	1.36	1.41	1.41
Non-interest income (%)	11.3	9.6	9.9	9.5	9.5
Cost to income (%)	14.5	15.2	14.5	14.3	14.3
Effective tax rate (%)	27.8	34.1	33.7	33.7	33.7
Dividend payout (%)	20.2	21.3	21.3	21.3	21.3
ROE (%)	18.8	18.1	19.8	19.9	19.9
ROA (%)	1.49	1.34	1.37	1.34	1.30
Operating ROE (%)	26.1	27.4	29.9	30.0	29.9
Operating ROA (%)	2.07	2.02	2.06	2.02	1.96

Source: Company data, Nomura estimates

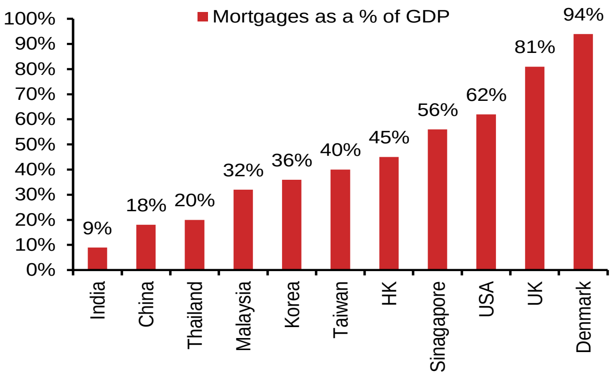
HFCs have gained share in last decade; LICHF seems well placed

Fig. 144: Shares of most HFCs have been rising in mortgages in the past five years; LICHF has gained market share in the past five-eight years

Market share	FY08	FY10	FY11	FY14	FY15	Incremental market share - FY08-12	Incremental market share - FY12-15	CAGR - FY09-12	CAGR - FY12-15
Private Banks	**70.1%**	**66.7%**	**66.3%**	**60.9%**	**60.9%**	**56.5%**	**55.4%**	***12%***	***16%***
ICICI Bank	18.2%	10.2%	8.2%	6.5%	7.0%	-6.9%	6.0%	-8%	15%
Axis Bank	2.1%	3.0%	3.2%	5.0%	5.2%	7.1%	6.7%	36%	27%
HDFC Bank		1.9%	2.1%	2.2%	2.3%	5.5%	2.4%		19%
Kotak Bank	0.7%	1.0%	1.2%	1.4%	1.4%	2.2%	1.5%	34%	21%
SBI	12.4%	15.7%	15.7%	15.8%	15.4%	22.2%	13.7%	23%	16%
PNB	2.2%	2.3%	2.1%	1.9%	2.1%	2.2%	1.9%	14%	16%
BOB	2.0%	2.2%	2.3%	2.2%	2.2%	2.6%	2.0%	18%	17%
BOI	1.7%	1.6%	1.4%	1.5%	1.6%	0.8%	2.0%	7%	26%
Private banks ex- ICICI	**51.9%**	**54.6%**	**56.0%**	**52.2%**	**51.5%**	**63.5%**	**49.4%**	**17%**	**16%**
HFCs	29.9%	33.3%	33.7%	39.1%	39.1%	**43.5%**	**44.6%**	***19%***	***22%***
HDFC Ltd	13.3%	12.9%	12.7%	13.9%	13.8%	13.9%	14.2%	15%	19%
LIC Housing	**5.7%**	**7.2%**	**8.2%**	**9.6%**	**9.7%**	**14.4%**	**10.3%**	**29%**	**20%**
Dewan housing	1.0%	1.6%	2.3%	3.9%	4.1%	5.1%	6.3%	46%	36%
Indiabulls Financials		0.9%	1.6%	2.2%	2.5%	4.9%	3.3%		27%
Gruh Finance	0.5%	0.5%	0.6%	0.8%	0.9%	0.8%	1.2%	20%	32%
Total Mortgage Market								***14%***	***18%***

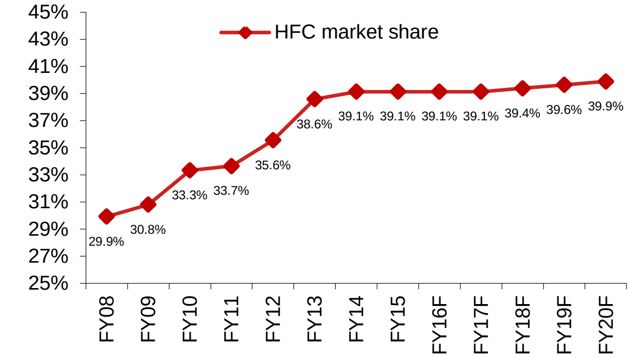
Source: Company data, NHB, RBI, Nomura research

Fig. 145: Mortgage penetration levels still low in India



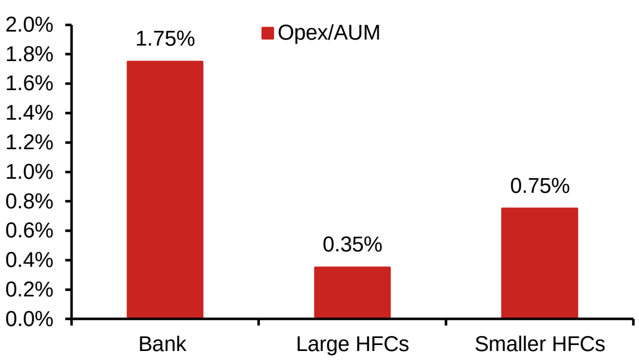
Source: HDFC, Nomura research

Fig. 146: We expect market share gains to continue for HFCs



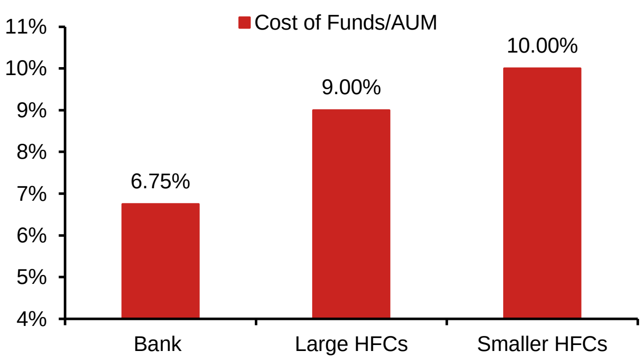
Source: Company data, NHB, RBI, Nomura estimates

Fig. 147: Lower opex for HFCs vs. banks…



Source: Company data, Nomura estimates

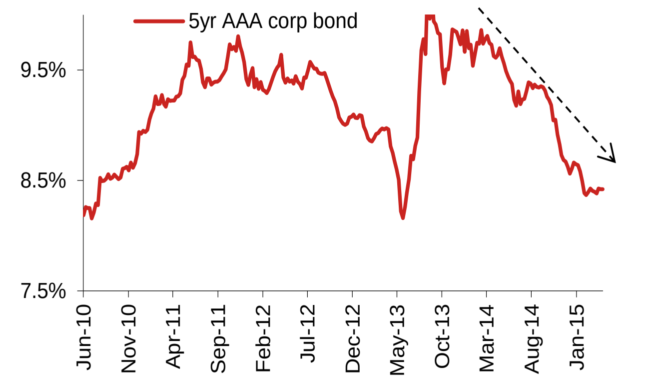
Fig. 148: …nets of funding cost disadvantage



Source: Company data, Nomura estimates

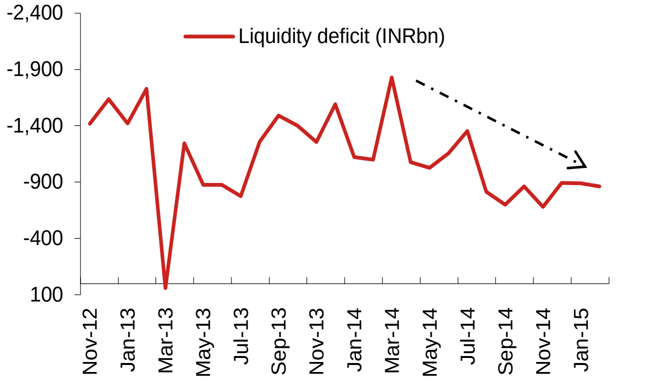
Funding environment remains comfortable; we do not expect irrational pricing from PSU banks this time

Fig. 149: Wholesale rates have moderated



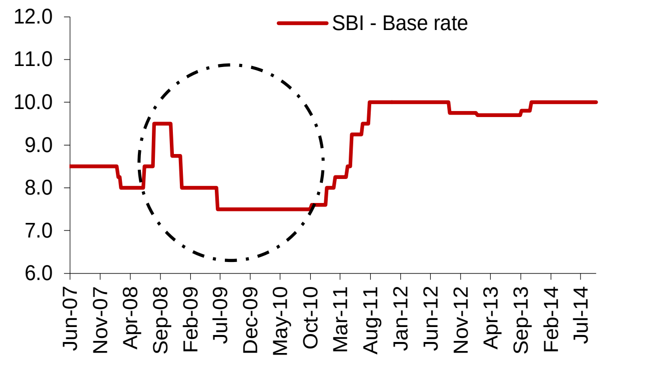
Source: Bloomberg, Nomura research

Fig. 150: Liquidity remains comfortable



Source: Bloomberg, Nomura research

Fig. 151: Banks unlikely to be irrational in mortgage pricing as in FY10…



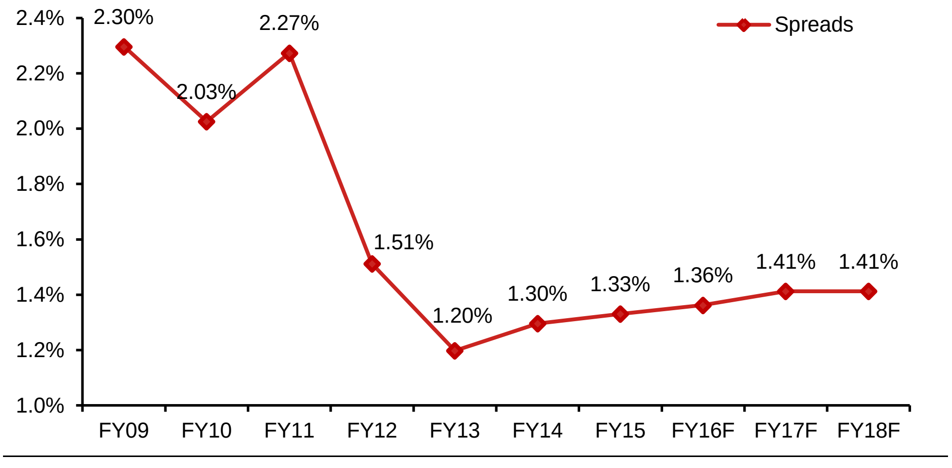
Source: Company data, Bloomberg, Nomura research

Fig. 152: …as profitability remains lower which should restrict them from getting aggressive

ROA tree - PSUs	FY09	FY15	Change
NIMs/Assets	**2.74%**	**2.72%**	**-0.02%**
Fees/Assets	1.12%	0.84%	-0.28%
Investment profits/Assets	0.29%	0.14%	-0.15%
Net revenues/Assets	**4.15%**	**3.69%**	**-0.45%**
Opex/Assets	1.84%	1.86%	0.02%
PPOP/Assets	**2.31%**	**1.84%**	**-0.47%**
Provisioning/Assets	0.43%	0.94%	0.52%
Pre Tax ROA/Assets	**1.88%**	**0.89%**	**-0.99%**
ROAs	**1.15%**	**0.62%**	**-0.53%**
ROEs	**20.1%**	**10.4%**	**-9.7%**

Source: Company data, Nomura research

Fig. 153: We expect spreads to improve gradually



Source: Company data, Nomura estimates

Valuations reasonable at 1.9x book; upgrade to Buy

We look for ROEs for LICHF to inch up to 20% by FY17F, driven by ~15bps improvement in loan spreads and find valuations at 1.9x Mar-17F book (BVPS: INR212) reasonable after the recent correction and hence upgrade LICHF to Buy. We do not see any risk of irrational pricing in mortgages, and changing the loan mix from here onwards can only aid margins. We maintain our target price of INR500, which is based on 2.35x Mar-17F book.

Risks: Excessive pricing competition in the mortgage market, unfavorable funding environment and higher delinquencies in the builder book.

Fig. 154: ROEs remain respectable despite lower margins/ROAs

ROE Decomposition (on AUM)	FY10	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
Net Interest Income/Assets	2.72%	3.17%	2.44%	2.18%	2.27%	2.25%	2.30%	2.27%	2.20%
Fees/Assets	0.55%	0.80%	0.39%	0.26%	0.29%	0.24%	0.25%	0.24%	0.23%
Investment profits/Assets	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Net revenues/Assets	**3.27%**	**3.97%**	**2.83%**	**2.45%**	**2.55%**	**2.49%**	**2.56%**	**2.50%**	**2.43%**
Operating Expense/Assets	0.58%	0.48%	0.42%	0.40%	0.37%	0.38%	0.37%	0.36%	0.35%
Provisions/Assets	-0.09%	0.59%	0.27%	0.11%	0.03%	0.01%	0.06%	0.06%	0.06%
Taxes/Assets	0.76%	0.72%	0.55%	0.50%	0.60%	0.72%	0.72%	0.70%	0.68%
Total Costs/Assets	**1.25%**	**1.79%**	**1.24%**	**1.01%**	**1.00%**	**1.10%**	**1.15%**	**1.12%**	**1.09%**
ROA	**2.01%**	**2.19%**	**1.59%**	**1.44%**	**1.56%**	**1.39%**	**1.41%**	**1.38%**	**1.34%**
Equity/AUM	10.30%	9.35%	9.95%	9.20%	8.91%	7.83%	7.68%	7.49%	7.30%
ROE	**23.6%**	**25.8%**	**18.4%**	**16.6%**	**18.8%**	**18.1%**	**19.8%**	**19.9%**	**19.9%**

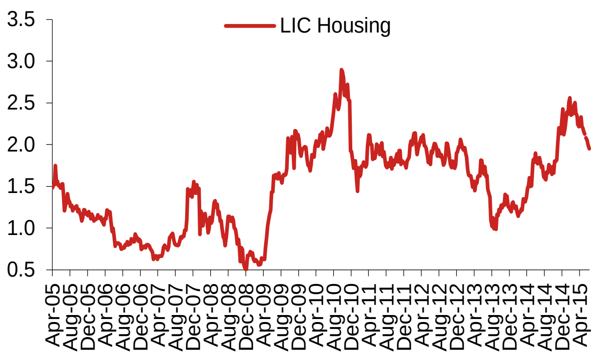
Source: Company data, Nomura estimates

Fig. 155: TP of INR500

Valuation assumptions	
Cost of Equity	13.8%
Terminal growth	5.0%
Normalised ROE	17.8%
Stage 2 growth	18.0%
Mar-16 PT	500
Implied Mar-17 P/B	2.36
Implied Mar-17 P/E	12.8

Source: Nomura estimates

Fig. 156: Currently trades at 1.9x Mar-17F book



Source: Company data, Bloomberg, Nomura estimates

NOMURA

HDFC HDFC.NS HDFC IN

EQUITY: FINANCIALS

Great business, but already in the price

Stability is good, but ability to surprise low

Global Markets Research

17 June 2015

Rating Remains	**Neutral**
Target price Remains	INR 1325
Closing price 15 June 2015	INR 1215
Potential upside	+9.1%

Action: Limited ability to surprise; maintain Neutral and INR1,325 TP

HDFC Limited has improved its market share to 13.8% from 12.7% over the past five years driven by a strong funding mix and distribution and it should maintain its dominant market share position. While volatility of NIMs, growth and earnings are low across credit and rate cycles, HDFC is less leveraged to the easing rate cycle than peers like LICHF, and its current valuation at 3.6x FY17F book (BVPS: INR195) has now become reasonable.

- **Asset mix and funding mix already optimum:** 1) HDFC's share of higher yielding loans at +30% (LAP + builder book) is the highest among India's banks and while corporate loan growth could inch up from current levels, structurally we think proportion of higher yielding loans is capped. 2) On the funding side, 56% of HDFC's funding is currently bonds and incrementally 90% of funding was bonds in FY15; hence, levers from a funding mix change are also lower. Deposit funding at 32% of borrowing is more expensive than bonds, however, we do not see HDFC cutting the deposit share in its funding mix as it adds to the stability in funding mix.
- **Stability in NIMs/growth good**, **but levers to surprise are limited:** As mortgage growth is structural, HDFC recording steady growth is not a surprise, but the ability to maintain NIMs in a thin band irrespective of interest rate cycles has been surprising. Although the market seems to pay for earnings predictability, this makes HDFC less leveraged to the rate cycle and the ability to surprise will be lower, in our view.

Valuation now becoming reasonable again; remain Neutral

While we have nothing much to complain about with regard to HDFC's business, except for the lumpiness in its builder book which also is well collateralised, we believe current valuations are just reasonable at 3.6x FY17F book. Thus, we maintain our Neutral. Among large-cap retail plays, we prefer HDFCB (Buy), and among large HFCs, LICHF (Buy) offers better risk-reward.

Year-end 31 Mar	FY15	FY16F		FY17F		FY18F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
PPOP (mn)	87,891	101,032	101,032	116,961	116,961		136,073
Reported net profit (mn)	59,901	68,914	68,914	79,852	79,852		92,988
Normalised net profit (mn)	59,901	68,914	68,914	79,852	79,852		92,988
FD normalised EPS	38.04	43.76	43.76	50.71	50.71		59.05
FD norm. EPS growth (%)	9.1	15.0	15.0	15.9	15.9		16.5
FD normalised P/E (x)	31.9	N/A	27.8	N/A	24.0	N/A	20.6
Price/adj. book (x)	6.2	N/A	5.5	N/A	4.9	N/A	4.3
Price/book (x)	6.2	N/A	5.5	N/A	4.9	N/A	4.3
Dividend yield (%)	1.2	N/A	1.4	N/A	1.6	N/A	1.9
ROE (%)	20.3	21.0	21.0	21.7	21.7		22.4
ROA (%)	2.5	2.5	2.5	2.5	2.5		2.4

Source: Company data, Nomura estimates

Anchor themes

Mortgages remain a structural story from a growth perspective. Cyclically the domestic rate environment remains favourable for HFCs and banks' ability to compete on pricing is lower than in the previous cycle (FY09-10).

Nomura vs consensus

Our FY16F PAT estimate is largely in line with consensus.

Research analysts

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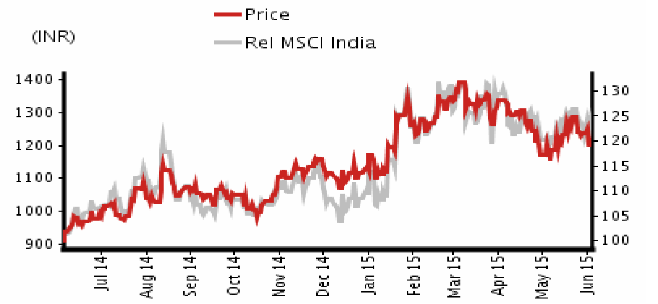
Key data on HDFC

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-1.6	-8.5	24.0	M cap (USDmn)	29,863.3
Absolute (USD)	-2.4	-10.0	15.5	Free float (%)	90.3
Rel to MSCI India	2.5	1.4	20.3	3-mth ADT (USDmn)	60.3

Profit and loss (INRmn)

Year-end 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Interest income	230,323	259,703	296,602	343,824	401,068
Interest expense	-160,294	-179,751	-204,118	-236,752	-276,585
Net interest income	70,030	79,952	92,484	107,072	124,483
Net fees and commissions	9,164	10,593	12,687	15,161	18,159
Trading related profits	2,490	4,413	3,881	3,881	3,881
Other operating revenue	0	0	0	0	0
Non-interest income	11,653	15,005	16,568	19,042	22,040
Operating income	81,683	94,958	109,052	126,114	146,523
Depreciation	-319	-298	-319	-341	-365
Amortisation					
Operating expenses	-3,170	-3,484	-3,989	-4,618	-5,346
Employee share expense	-2,792	-3,285	-3,712	-4,194	-4,739
Pre-provision op profit	75,402	87,891	101,032	116,961	136,073
Provisions for bad debt	-1,000	-1,650	-1,815	-1,997	-2,196
Other provision charges					
Operating profit	74,402	86,241	99,217	114,964	133,877
Other non-op income					
Associates & JCEs					
Pre-tax profit	74,402	86,241	99,217	114,964	133,877
Income tax	-20,000	-26,340	-30,303	-35,113	-40,889
Net profit after tax	54,402	59,901	68,914	79,852	92,988
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	54,402	59,901	68,914	79,852	92,988
Extraordinary items	0	0	0	0	0
Reported NPAT	54,402	59,901	68,914	79,852	92,988
Dividends	-21,847	-23,621	-27,174	-31,487	-36,667
Transfer to reserves	32,555	36,281	41,740	48,364	56,321

Growth (%)

Net interest income	13.3	14.2	15.7	15.8	16.3
Non-interest income	8.2	28.8	10.4	14.9	15.7
Non-interest expenses	17.8	9.9	14.5	15.8	15.8
Pre-provision earnings	12.2	16.6	15.0	15.8	16.3
Net profit	12.2	10.1	15.0	15.9	16.5
Normalised EPS	11.2	10.1	15.0	15.9	16.5
Normalised FDEPS	11.2	9.1	15.0	15.9	16.5
Loan growth	15.9	15.8	17.0	19.1	19.2
Interest earning assets	15.9	15.8	17.0	19.1	19.2
Interest bearing liabilities	16.0	13.2	17.6	19.5	19.6
Asset growth	15.5	12.5	16.5	18.1	18.4
Deposit growth	8.9	16.8	22.5	23.1	19.6

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY14	FY15	FY16F	FY17F	FY18F
Cash and equivalents	43,886	53,541	65,320	79,690	97,222
Inter-bank lending					
Deposits with central bank					
Total securities					
Other int earning assets					
Gross loans	1,984,600	2,297,553	2,689,215	3,203,586	3,818,421
Less provisions	-13,600	-15,744	-18,428	-21,953	-26,167
Net loans	1,971,000	2,281,809	2,670,787	3,181,633	3,792,254
Long-term investments	139,127	142,943	142,943	142,943	142,943
Fixed assets	2,805	6,718	6,718	6,718	6,718
Goodwill					
Other intangible assets					
Other non IEAs	100,757	54,506	72,686	84,370	98,060
Total assets	2,257,574	2,539,517	2,958,454	3,495,354	4,137,198
Customer deposits	565,780	660,880	809,630	996,708	1,191,988
Bank deposits, CDs,	1,277,200	1,425,110	1,643,795	1,934,785	2,313,858
Other int bearing liabilities					
Total int bearing liabilities	1,842,980	2,085,990	2,453,425	2,931,493	3,505,846
Non-int bearing liabilities	135,042	143,827	158,209	174,030	191,433
Total liabilities	1,978,022	2,229,817	2,611,634	3,105,523	3,697,279
Minority interest					
Common stock	3,121	3,149	3,149	3,149	3,149
Preferred stock					
Retained earnings	276,431	306,550	343,670	386,682	436,769
Reserves for credit losses					
Proposed dividends					
Other equity					
Shareholders' equity	279,552	309,700	346,820	389,831	439,919
Total liabilities and equity	2,257,574	2,539,517	2,958,454	3,495,354	4,137,198
Non-perf assets	13,600	15,744	18,428	21,953	26,167

Balance sheet ratios (%)

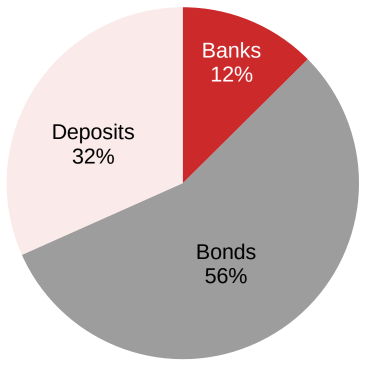
Loans to deposits	350.8	347.7	332.2	321.4	320.3
Equity to assets	12.4	12.2	11.7	11.2	10.6
Asset quality & capital					
NPAs/gross loans (%)	0.7	0.7	0.7	0.7	0.7
Bad debt charge/gross	0.05	0.07	0.07	0.06	0.06
Loss reserves/assets (%)	0.60	0.62	0.62	0.63	0.63
Loss reserves/NPAs (%)	100.0	100.0	100.0	100.0	100.0
Tier 1 capital ratio (%)	15.4	15.3	14.9	14.4	13.9
Total capital ratio (%)	17.9	18.9	18.4	17.6	17.0
Per share					
Reported EPS (INR)	34.55	38.04	43.76	50.71	59.05
Norm EPS (INR)	34.55	38.04	43.76	50.71	59.05
FD norm EPS (INR)	34.86	38.04	43.76	50.71	59.05
DPS (INR)	14.00	15.00	17.26	20.00	23.29
PPOP PS (INR)	47.88	55.81	64.16	74.28	86.41
BVPS (INR)	179.14	196.67	220.25	247.56	279.37
ABVPS (INR)	179.14	196.67	220.25	247.56	279.37
NTAPS (INR)	179.14	196.67	220.25	247.56	279.37

Valuations and ratios

Reported P/E (x)	35.2	31.9	27.8	24.0	20.6
Normalised P/E (x)	35.2	31.9	27.8	24.0	20.6
FD normalised P/E (x)	34.8	31.9	27.8	24.0	20.6
Dividend yield (%)	1.2	1.2	1.4	1.6	1.9
Price/book (x)	6.8	6.2	5.5	4.9	4.3
Price/adjusted book (x)	6.8	6.2	5.5	4.9	4.3
Net interest margin (%)	3.81	3.76	3.73	3.66	3.57
Yield on assets (%)	12.55	12.21	11.98	11.75	11.50
Cost of int bearing liab (%)	9.34	9.15	8.99	8.79	8.59
Net interest spread (%)	3.20	3.06	2.98	2.96	2.91
Non-interest income (%)	14.3	15.8	15.2	15.1	15.0
Cost to income (%)	7.7	7.4	7.4	7.3	7.1
Effective tax rate (%)	26.9	30.5	30.5	30.5	30.5
Dividend payout (%)	40.2	39.4	39.4	39.4	39.4
ROE (%)	20.5	20.3	21.0	21.7	22.4
ROA (%)	2.58	2.50	2.51	2.47	2.44
Operating ROE (%)	28.1	29.3	30.2	31.2	32.3
Operating ROA (%)	3.53	3.60	3.61	3.56	3.51

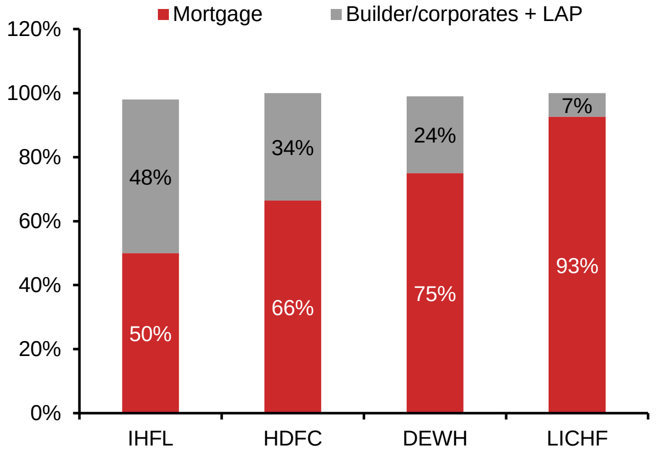
Source: Company data, Nomura estimates

Fig. 157: Funding mix already optimum (FY15)



Source: Company data, Nomura research

Fig. 158: Share of high yielding loans high for HDFC



Source: Company data, Nomura research

Fig. 159: ROEs to remain in a stable band

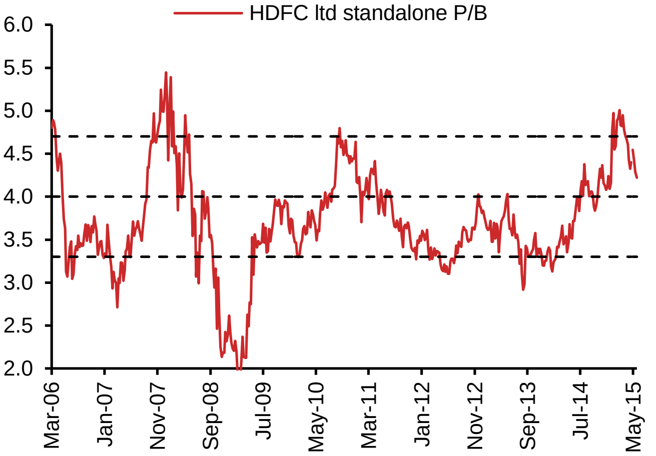
INRmn	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F
Reported PAT	35,350	41,226	48,483	54,402	59,901	68,914	79,852
Dividends	2,252	3,097	4,807	5,556	6,883	8,259	9,911
Adjustment for Zero Coupon	5,321	4,851	4,380	3,572	4,151	4,151	4,151
Adjusted PAT	**29,532**	**34,880**	**40,742**	**46,453**	**50,238**	**57,874**	**67,160**
% growth	19.8%	18.1%	16.8%	14.0%	8.1%	15.2%	16.0%
Subsidiary Stake							
HDFC Life	72.4%	72.4%	72.4%	72.4%	72.4%	71.4%	71.4%
HDFC Bank	23.4%	23.1%	22.8%	22.8%	22.8%	22.8%	22.8%
Gruh Finance	60.7%	60.4%	59.7%	59.7%	59.7%	59.7%	59.7%
HDFC General insurance	74.0%	74.0%	73.9%	73.9%	73.9%	73.9%	73.9%
HDFC AMC	60.0%	59.9%	59.8%	59.8%	59.8%	59.8%	59.8%
Others	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Subsidiary performance							
HDFC Life	-990	2710	4515	7253	7860	8646	9511
HDFC Bank	39264	51671	64749	84784	102159	126677	157080
Gruh Finance	915	1203	1460	1770	2038	2649	3444
HDFC General insurance	-364	-397	1545	1954	1040	1196	1375
HDFC AMC	2422	2691	3190	3578	4160	4576	5034
Others	1860	280	-1000	200	500	700	700
Proportionate income	***12070***	***16223***	***20952***	***29422***	***33956***	***40958***	***49388***
Calculated consolidated PAT	***46923***	***55954***	***66075***	***79447***	***88344***	***102982***	***120698***
Reported Consolidated PAT	***45280***	***54630***	***66400***	***79478***	***87626***	***102264***	***119980***
Reported Standalone Equity	***173165***	***190176***	***250000***	***279552***	***309700***	***346820***	***389831***
Reported Consolidated Equity	***211901***	***244240***	***320600***	***401300***	***461290***	***531760***	***614900***
Adjusted ROEs - Consol	***23.8%***	***24.5%***	***23.4%***	***22.0%***	***20.5%***	***20.7%***	***21.1%***
Reported ROEs - Consol	***23.0%***	***24.0%***	***23.5%***	***22.0%***	***20.3%***	***20.6%***	***20.9%***
Standalone Equity	173165	190176	250000	279552	309700	346820	389831
Subsidiary investment	79351	79351	79351	79351	79351	79351	79351
Adjusted Standalone Equity	***93814***	***110825***	***170649***	***200201***	***230349***	***267469***	***310480***
Adjusted Standalone PAT	29532	34880	40742	46453	50238	57874	67160
Adjusted Standalone ROE	**34.9%**	**34.1%**	**28.9%**	**25.1%**	**23.3%**	**23.3%**	**23.2%**
Adjusted Subsidiary PAT	15748	19750	25658	33025	38106	45108	53538
Adjusted Susidiary Capital	118,087	133,415	149,951	201,099	230,942	264,292	304,420
Adjusted Subsidiary ROE	**14.0%**	**15.7%**	**18.1%**	**18.8%**	**17.6%**	**18.2%**	**18.8%**

Source: Company data, Nomura estimates

Valuations now becoming reasonable again; maintain Neutral

Except for the lumpiness in its builder book (which is also well collateralized), we are satisfied with HDFC's business. We think current valuations are reasonable at 3.6x FY17F book (BVPS: INR195). Thus, we maintain our Neutral rating. Among large-cap retail plays we prefer HDFCB (Buy), and among large HFCs, we think LICHF (Buy) offers better risk-reward.

Fig. 160: Valuations still above mean levels



Source: Company data, Nomura research

Fig. 161: Our SOTP factors in upsides for subsidiaries as well

Key subsidiary valuations	Value per share
HDFC Bank	355
HDFC Standard Life	90
HDFC Asset Management	30
Gruh Finance	32
Fair value of key subsidiaries	**508**
HDFC Ltd (standalone)	**817**
Mar-16 PT	**1,325**
Implied Mar-17 P/E	17.5
Implied Mar-17 P/B	4.2

Source: Nomura estimates

Risk: 1) A very benign funding environment could lead to an increase in margins/spreads and that will be an upside risk. 2) Slower growth in the corporate book will restrict any spread expansion and impact overall fees, which will remain a key downside risk.

Appendix A-1

Analyst Certification

We, Adarsh Parasrampuria and Amit Nanavati, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Dewan Housing Finance	DEWH IN	INR 395	16-Jun-2015	Buy	N/A	
HDFC	HDFC IN	INR 1199	16-Jun-2015	Neutral	N/A	A6,A7
HDFC Bank	HDFCB IN	INR 1008	16-Jun-2015	Buy	N/A	A1,A2,A3,A4,A5,A6,A7
Indiabulls Housing Finance	IHFL IN	INR 556	16-Jun-2015	Buy	N/A	
LIC Housing Finance	LICHF IN	INR 402	16-Jun-2015	Buy	N/A	A1,A2,A6,A7

A1 The Nomura Group has received compensation for non-investment banking products or services from the issuer in the past 12 months.

A2 The Nomura Group had a non-investment banking securities related services client relationship with the issuer during the past 12 months.

A3 The Nomura Group had a non-securities related services client relationship with the issuer during the past 12 months.

A4 The Nomura Group had an investment banking services client relationship with the issuer during the past 12 months.

A5 The Nomura Group has received compensation for investment banking services from the issuer in the past 12 months.

A6 The Nomura Group expects to receive or intends to seek compensation for investment banking services from the issuer in the next three months.

A7 The Nomura Group has managed or co-managed a publicly announced or 144A offering of the issuer's securities or related derivatives in the past 12 months.

Dewan Housing Finance (DEWH IN) **INR 395 (16-Jun-2015)** Buy (Sector rating: N/A)

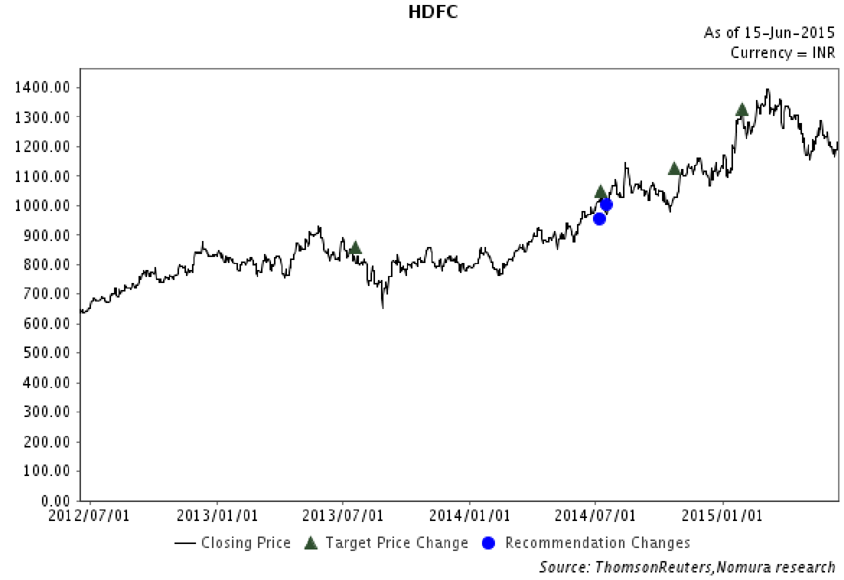
Chart Not Available

Valuation Methodology Our TP of INR525 is based on 1.25x FY17F book value of INR419. MSCI India is the benchmark index for this stock.

Risks that may impede the achievement of the target price Disappointment on utilisation of cash, an unfavourable wholesale funding environment, bigger-than-expected contraction in LAP yields, and lumpy asset quality risk in the builder portfolio.

HDFC (HDFC IN) **INR 1199 (16-Jun-2015)** Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
29-Jan-15		1,325.00	1,315.55
08-Jul-14	Neutral		1,022.20
08-Jul-14		1,050.00	1,022.20
28-Jun-14	Suspended		976.10
19-Jul-13		860.00	803.20

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of INR1,325 implies 4.3x Mar-17F book of INR194 for the mortgage business after deducting for INR508 for its subsidiaries. The benchmark index for this stock is MSCI India.

Risks that may impede the achievement of the target price (1) A very benign funding environment could lead to an increase in margins/spreads and that will be an upside risk. (2) Slower growth in the corporate book will restrict any spread expansion and impact overall fees, which will remain a key downside risk.

Indiabulls Housing Finance (IHFL IN) **INR 556 (16-Jun-2015)** Buy (Sector rating: N/A)

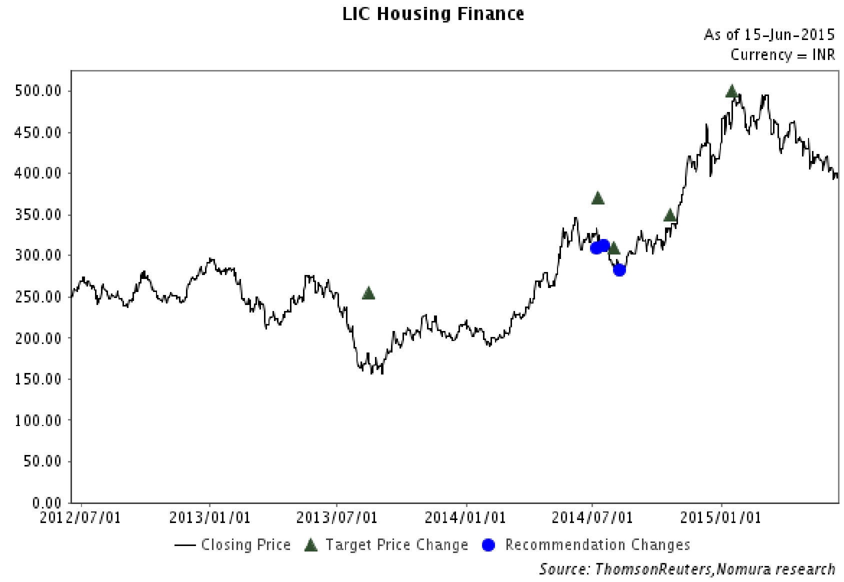
Chart Not Available

Valuation Methodology We value IHFL at 3x FY17F book and adding dividends we arrive at our TP of INR800. Adjusted ROEs of 28-29% is highest in the sector and with growth outpacing system, we find current valuations attractive at 2x book. Relatively, IHFL is one of the cheaper HFCs at ~8x FY17F P/E. The benchmark index for this stock is MSCI India.

Risks that may impede the achievement of the target price Key risks to our call are unfavourable wholesale funding environment,higher than expected contraction in LAP yields and lumpy asset quality risk in builder portfolio.

LIC Housing Finance (LICHF IN) **INR 402 (16-Jun-2015)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
15-Jan-15		500.00	466.15
20-Oct-14		350.00	323.55
31-Jul-14	Neutral		289.205
31-Jul-14		310.00	289.205
08-Jul-14	Buy		320.102
08-Jul-14		370.00	320.102
28-Jun-14	Suspended		316.658
16-Aug-13		255.00	169.609

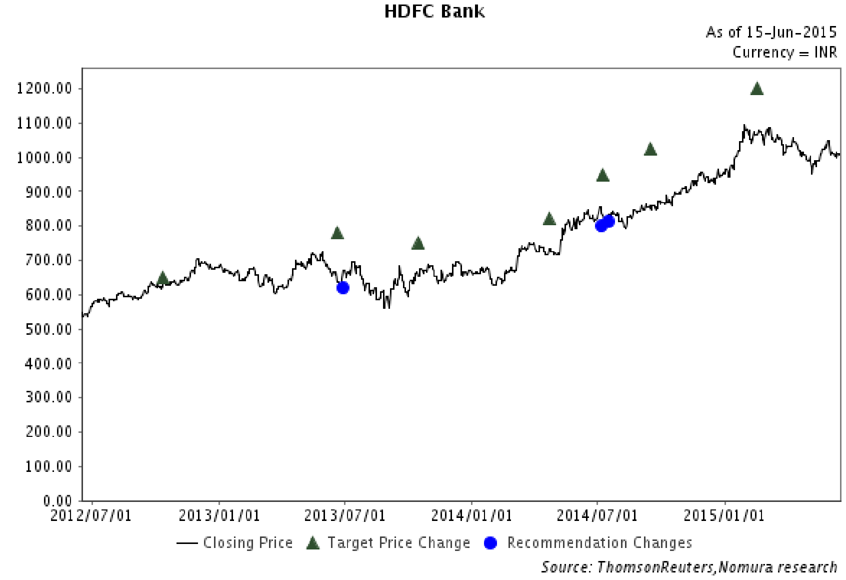
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We expect ROEs for LICHF to inch up to 20% by FY17F, driven by ~15bps improvement in loan spreads and find current valuations reasonable. We do not see any risk of irrational pricing in mortgages, and changing the loan mix from here onwards can only aid margins. We maintain our target price of INR500, which is based on 2.35x Mar-17F book (BVPS: INR212). MSCI India is the benchmark index for this stock.

Risks that may impede the achievement of the target price Excessive pricing competition in the mortgage market, unfavourable funding environment and higher delinquencies in the builder book.

HDFC Bank (HDFCB IN) **INR 1008 (16-Jun-2015)** Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
16-Feb-15		1,200.00	1,067.55
16-Sep-14		1,025.00	851.00
08-Jul-14	Buy		829.25
08-Jul-14		950.00	829.25
28-Jun-14	Suspended		816.20
22-Apr-14		820.00	727.55
16-Oct-13		750.00	652.45
20-Jun-13	Buy		636.60
20-Jun-13		780.00	636.60
12-Oct-12		650.00	631.15

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of INR1,200 is based on 3.6x Mar-17F book of INR332. The benchmark index for this stock is MSCI India.

Risks that may impede the achievement of the target price 1) A slower-than-expected pick-up in retail credit growth; and 2) any significant change in underwriting standards of retail loans.

Rating and target price changes

Issuer	Ticker	Old stock rating	New stock rating	Old target price	New target price
Dewan Housing Finance	DEWH IN	Not rated	Buy	N/A	INR 525
Indiabulls Housing Finance	IHFL IN	Not rated	Buy	N/A	INR 800
LIC Housing Finance	LICHF IN	Neutral	Buy	INR 500	INR 500

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STOCKS

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STOCKS

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