ARIHANT capital markets ltd.

Date: 10th Dec 2010

Dewan Housing Finance Limited – 'Post' Deal

BUY

CMP: ₹ 262 | **Target Price: ₹ 399** | **Industry: NBFC**

Stock Info	
Market Capital	₹ 2791 cr
Equity Capital	₹ 104 cr
Avg Trading Vol.	213022(Qtly)
52 WK High/Low	347/178
Face Value	10

BSE Group	B
BSE Code	511072
NSE Symbol	DEWANHOUS
Bloomberg	DEWH IN
Reuters	DWHN.BO
BSE Sensex	19509
NSE Nifty	5857

Shareholding Pattern (As on 30th Sept, 2010)	
Promoters	41.6
Domestic Institutions	10.2
Foreign	33.3
Corporate	10.6
Public & Others	4.3

Dewan Housing (DHFL) along with allies bought Deutsche Postbank Home Finance Ltd. (DPHFL) for ₹ 1079cr. The deal though seems to be out of earlier proclaimed focus of the DHFL towards lower and middle income group, it is not very unrelated and not an over expensive one given the valuations of other listed housing companies. The deal brings in increased network, set of new customers and an experienced and trained team. We find the deal to be overall positive for the Co and recommend a BUY with a target price of ₹399.

Impact of the Deal

- **Scale and Size Boost -** The Deal enlarges the focus of DHFL from low and middle income group to upper middle income group. The Co also gets more presence in the North especially NCR where it had scanty presence hitherto. This acquisition will reduce the gap in size between the top second housing in India from more than 4 times to 2.5 times. With DPHFL loan book more than 40% of DHFL, DHFL expects the consolidated balance sheet to cross ₹ 20,000 crore by end of FY11.

- **Healthy Loan Growth in New Subsidiary Expected** – With FY10 disbursement of ₹ 1750 cr, DPHFL targets to grow it by 30% in FY11. In the first half it has already disbursed ₹ 1000 cr and despite the disturbance due to this deal, Dewan Housing is confident that the targeted growth is achievable. DPHFL grew its loan book at a CAGR of 19% over FY08-10 and we can expect the same to grow at the rate of 23% over FY10-12E. DHFL has defied any slowdown in its business despite the latest fracas in the real estate sector.

- **Scope For Improvement In Profits of Post bank -** Co believes that with more than 60 years of experience in the business, it has scope to bring in efficiencies and improve the NIM as well as RoE of the DPFHL. Some of the steps outlined by DHFL to improve NIM includes diversifying the loan book of DPHFL from a nearly 100% individual loan portfolio and include small proportion of non-individual loans which have higher yields. For improvement in bottom-line DHFL plans to bring in cost efficiency and increase fee income by exploring cross selling of Insurance products as well as provide other services. The Co expects to improve the NIM by around 20-30 bps over FY12.

- **Business Operations to Maintain Status Quo –** The management and staff of DPHFL will continue and its business sourcing, underwriting and other strategies will maintain a status quo. This can be considered to be good as it would allow DHFL to adapt easily to the new segment. The management of DHFL poses good faith on the team of DPHFL. However, DPHFL has heavy employee cost as compared to DHFL which can be expected to create some imbalances. DHFL plans to cover up the increased employee cost with improved fee income.

- **Positive ALM GAP -** At present DPHFL has positive ALM gap with asset duration of 10years and liability duration of 6.5 years which would be beneficial in the face of rising interest rate scenario. DPHFL spreads are near about 2.5% which is lower than DHFL which earns spreads of more than 3% as per our calculation.

- **Adequate Capital -** The capital adequacy ratio of DHFL on a standalone basis is as high as 21% with 98% in Tier I. Post acquisition on a consolidated basis the ratio will dip to around 18% with Tier II rising to 8-9%. However DPHFL has comfortable leverage of around 10 times and even DHFL has historically maintained the leverage at less than 11 times. The low leverage allows the Co to explore loan funds in future instead of dilution of equity. After raising capital twice in FY10, DHFL had indicated that it would not raise any further capital for the next two years. Post this acquisition also the Co sees no immediate requirement of capital and would take a call based on the pace of growth in future.

- **Healthy Asset Quality –** One of the strong points about DPHFL is healthy asset quality. With net NPA NIL, its GNPA was also low at 0.7% in FY10. This assures of the prudence followed in loan sanctioning and loan recovery mechanism.

- **Reasonable Valuation** – The price paid by DHFL for DPHFL assumes approx 19% CAGR growth in the book value over FY10-12E and values the Co at 1.6 times the FY12E book value. This assumption is close to our quick calculation for DPHFL FY12 book value. Thus we feel that the price is not unreasonable given the fact that other housing companies are getting a much higher valuation.

- **Concerns –** The upper middle income segment that DPHFL caters to is more competitive and may see pressure for expansion.

- **Valuation** – The deal has increased the size and reach of the Co while there is reasonable visibility of the business in future. Major concerns would be increase in defaults, more than expected dip in demand and increased competition. At CMP of ₹ 268 it is trading at 1.53x of FY12E P/BV and 9xP/E. We value the stock at 1.8 times the book value of FY12E (RoE 20%, CoE 16%, g 5%) and arrive at a **price target of ₹ 399 over a period of 12 months giving a potential upside of 48%.** Target price considers DHFL Vysya and Deutsche Postbank at ₹ 41 while the shares of HDIL add ₹ 3.6 per share. We recommend a "BUY".

₹ in cr	Loan	Branches	Loans/Branch	NIM%	NNPA %	Dividend %	CAR %	RoE %	FY12E Target P/BV*
FY10 Comparision									
Deutsche Post Bank	4,318	25	172.7	2.6	0	NA	NA	14.3	NA
GIC housing	2,866	27	106	1.6	1.5	45	17.7	18.3	1.95
Gruh Finance	2,454	95	26	3.7	0	65	16.6	28.4	3.75

* Bloomberg Consensus

Deal Details

Deal	Dewan housing along with allies bought Deutsche Postbank Home Finance (DPHF), the Indian mortgage lending subsidiary of Deutsche Postbank AG
Share Bought	1) Dewan Housing – 67.5% 2) Caledonia : Long term Investor in DHFL – 14% 3) Wadhwan Housing Pvt Ltd : Promoters Group Private Entity – 18.5%
Deal Value	₹1079 cr; of which DHFL will pay ₹ 729 cr
Deal Valuation	2.1 times trailing P/BV and 1.6 times FY12E (As per management)
Deal Closure	Long stop date of payment 31st March 2011 - subject to approval by NHB
Deal Financing	Plan to use Tier II subordinated debt for acquisition. 50% of it already received. Cost of debt is ~10.25%.

Basic Profile and Comparison

Deutsche Postbank Home Finance – DPHFL formerly Birla Home Finance Ltd, is registered with National Housing Bank (NHB). It is Indian mortgage lending subsidiary of Deutsche Postbank AG. With support of its parent in Germany it has grown well and at a CAGR of 19% over the last three year, the Co has reached a loan book size of ₹ 4813 cr. This is a little more than 43% of the loan book of DHFL.

The Co has pan India presence with concentration in North where it has around 47% of its operations. The Co services through 25 branches, 14 sales offices and 3 processing units. The Co lends in the range of ₹ 12-16 lacs and its customers are on an average in the ₹ 30000 per month income bracket. Its LTV is reasonable at 65% with 90% of assets floating in nature.

₹ in Cr	Deutsche Postbank Home Finance	Dewan Housing
	Acquiree	Acquirer
Loan Book (Sept 2010)	4813	11145
Balance Sheet Size	5500	11400
Equity	281	104
H1FY11 PAT	38	145
Customers	32000	~160000
Retail Customer Profile	Mid Income	Low Income
Commercial Real Estate loans	None	~1%
Ticket Size	12-16 lacs	7.5 lacs
Touch Points	42	340
3 yr loan CAGR	19	45
Liability Profile	Diversified	Diversified
H1FY11 Net worth	524	1496
Net NPA	0%	0.41%
NIM	2.6	3.0
Cost to Income	40%	34.5%

DPFHL Annual Financials (Quick Forward Calculation)

₹ in Cr	FY08	FY09	FY10	FY11E	FY12E
Equity	228	281	281	281	281
Reserves	71	115	176	255	361
Total Shareholders' Funds	352	397	458	537	643
Loan Funds	2,742	3,659	4,051	4,982	6,128
YoY	*29%*	*33%*	*11%*	*23%*	*23%*
Cost of Funds	*8.97*	*10.19*	*8.62*	*8.65*	*8.80*
Total Liabilities	**3,095**	**4,056**	**4,508**	**5,519**	**6,771**
Advances	3,034	3,744	4,318	5,311	6,532
YOY growth	*29%*	*23%*	*15%*	*23%*	*23%*
Yield on Interest	*11.1*	*12.8*	*11.5*	*11.7*	*11.9*
Spread	*2.15*	*2.57*	*2.83*	*3.05*	*3.10*
Net Block	8	10	10	11	12
Investments	23	20	17	17	17
Net Current Assets	18	270	150	167	196
Net Deferred Tax	12	12	13	13	13
Total Assets	**3,095**	**4,056**	**4,508**	**5,519**	**6,771**

₹ in Cr	FY08	FY09	FY10	FY11E	FY12E
Interest income	299.2	432.4	461.8	563	705
Interest	218.4	326.0	332.5	391	489
NII	**80.8**	**106.4**	**129.4**	**172.6**	**215.8**
Other Income	12.1	17.6	34.7	34.5	51.8
CTI	*62.5*	*49.7*	*48.6*	*47.0*	*45.0*
Operating Income	**92.9**	**124.0**	**164.1**	**207.1**	**267.6**
Total Expenditure	58.1	61.7	79.7	97.3	120.4
Operating Profit	**34.8**	**62.4**	**84.4**	**109.8**	**147.2**
Net Profit	**25.8**	**44.4**	**60.8**	**79.1**	**106.1**
YOY growth	**200%**	**72%**	**37%**	**30%**	**34%**

DHFL H1FY11 Results Brief

- **Robust Performance** – The first half of the year has been quite robust for the Co as it posted a growth of 110% at the net profit level. This includes as exceptional item of ₹ 35 cr related to part-sale of HDIL shares which also benefits as long term capital gain. The yoy growth before tax and before this exceptional item was around 54% with good contribution from core lending business as well as other activities.

- **Continued Momentum** – The loan growth momentum continued on the back of improved demand. The sanctions in the saw a jump of 79% at ₹4000 cr while disbursement saw a jump of 68% at ₹2950 cr. The second half generally witnesses stronger growth than the first half. However this year as the first half has been quite robust, the Co does not plan to overstretch but is confident of a robust loan sanction pipeline carry forward to FY12. Loan growth in the first half of the year was 55% and we assume the FY11 growth at 53%. DHFL has ambitious plans to reach an AUM of ₹ 25000 cr by FY13 suggesting a 42% CAGR growth between FY10-13. Post this acquisition the same may undergo a change.

- **Impact of Base Rate not alarming** – With base rate introduction, the Co saw a jump in the cost of funds by 20 bps in one month. But with reduction in the bank borrowing and increase in yields and retail BPLR, the net interest margin improved marginally. With sufficient line of credit available from the bank, the Co would explore CP's for funding, if required.

- **Growth in non-core income strong as guided** – As guided by management, its thrust on the cross selling of insurance products is materialising very well. Income from selling insurance, project advisory and property broking has grown 145% on a YoY basis. DHFL expects the same momentum to continue ahead also.

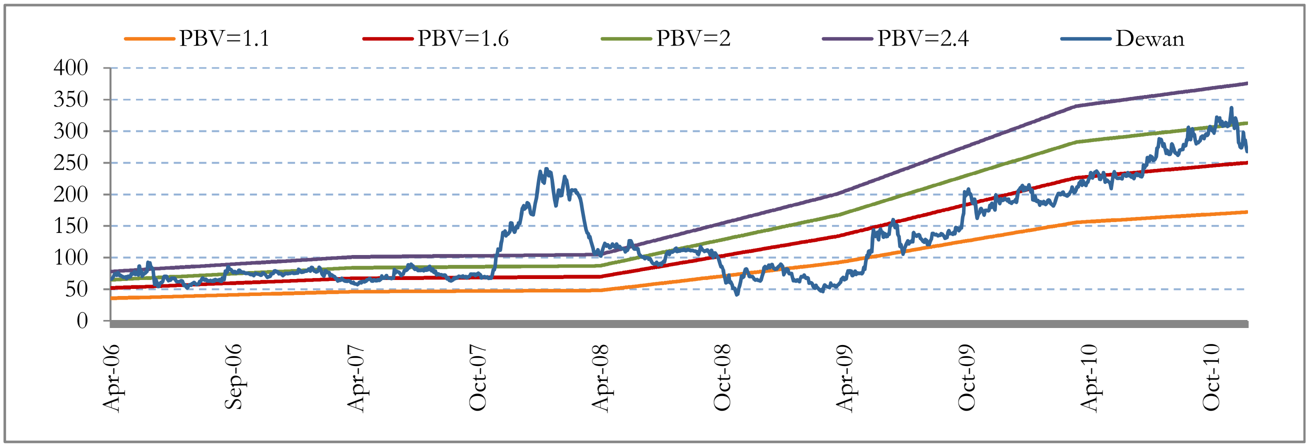
- **Asset Quality Holds on** – The gross NPA has been on a constant decline for DHFL and from the levels of 1.6% in FY08 it has fallen to 1.07% in last quarter. The Net NPA is comfortable below sub 50bps (0.41%). With just 1% of loan to the builders, 70% to salaried individuals, low LTV of 70% and non-DSA model, the Co has managed a good recovery profile. The provision coverage is strong at 62% aided by allocation of profit on sale of HDIL shares towards coverage. Further proceeds from HDIL share sale is also expected to be appropriated towards improving coverage.

	Q2FY11	Q2FY10		H1FY11	H1FY10	
Interest Earned	309.8	233.8	32.5	586.3	439.5	33.4
Interest Expenses	212.3	172.1	23.3	409.9	321.3	27.6
NII	97.6	61.7	58.1	176.4	118.2	49.3
Other Operational Income	20.4	11.7	74.4	42.3	19.5	116.6
Other Income	0.6	0.6	3.4	1.1	1.0	16.3
Total Other Income	21.0	12.3	71.0	43.4	20.5	111.8
Operating Income	118.6	74.0	60.2	219.9	138.7	58.6
EXPENDITURE	41.2	23.6	74.8	75.8	45.4	66.9
Staff Expenses	15.0	8.0	87.2	27.6	18.28	51.1
Total Other Exp	26.2	15.6	68.4	48.2	27.2	77.6
Profit Before Exceptional Item	77.4	50.4	53.4	144.0	93.2	54.5
Exceptional item	35.4	0.0		35.4	0	
Profit Before Tax	112.8	50.4	123.7	179.5	93.2	92.5
Provision for Taxation	19.4	12.9	49.7	34.8	24.45	42.1
Profit After Tax	93.5	37.5	149.2	144.7	68.8	110.4

	H1FY11	H1FY10
Sanction (₹ in Cr)	3995	2237
Disbursement (₹ in Cr)	2943	1753
NIM% (Q2)	3.01	2.97
Gross NPA%	1.07	1.44
Net NPA%	0.41	1.06
EPS without Exceptional (H1)	11.4	9.8
Cost to Income	34.5	32.8

About Dewan Housing Finance Limited

Dewan Housing is a housing finance company (HFC) with a focus on providing financing products for the underserved low and middle income segments of the Indian population. Apart from this it also sells third party insurance products, provide value-added property consulting and advisory services. It also offers financial support to develop infrastructure facilities and for slum development. Co is eligible for refinance and financial support from the National Housing Bank and has been permitted by the RBI to accept NRI deposits. For the first time in the history of housing finance, the Co. introduced a housing loan, offering dual protection by way of accident risk cover and property insurance, free of cost to borrowers. Vigilant to inorganic opportunities, in 2004, it acquired 58.2% stake in Vysya Bank Housing Finance Limited and later tried to take over IDBI housing Finance before finally picking up Deutsche Postbank now.



Annual Standalone Financials (Post the Deal)

Income Statement

Year to 31st March (₹ Cr)	FY09	FY10	FY11E	FY12E
Interest Income	651	889	1,292	1,913
Interest Expenses	493	670	952	1,457
NII	**158**	**220**	**340**	**456**
- growth %	*44*	*39*	*55*	*34*
Other Income	42	103	165	223
Operating Income	**201**	**323**	**505**	**679**
- growth %	*26*	*61*	*56*	*35*
Operating Expenses	71	112	169	242
- Staff Cost	28	39	55	79
- Other Exp.	42	73	114	162
Gross Profits	**130**	**211**	**336**	**437**
- growth %	*17*	*62*	*59*	*30*
Provisions	6	9	15	22
Profit Before Taxes	**124**	**202**	**321**	**415**
Taxes	32	52	83	108
Profit After Taxes	**92**	**151**	**237**	**307**
- growth %	*11*	*64*	*57*	*30*

Statement of Affairs

As on 31st March (₹ Cr)	FY09	FY10	FY11E	FY12E
Capital	120	85	104	104
Preference Capital	3	3		-
Reserves & Surplus	394	788	1,455	1,719
Networth	514	873	1,559	1,823
Borrowings	5,876	8,926	13,669	19,066
- growth %	*48*	*52*	*53*	*39*
Other liabilities & provisions	121	143	307	433
Total Liabilities	**6,511**	**9,943**	**15,535**	**21,322**
ASSETS				
Advances	5807	8758	13367	18993
- growth %	*40*	*51*	*53*	*42*
Investments	109	131	893	965
Fixed assets	50	217	220	225
Other assets	546	837	1055	1139
Total Assets	**6,511**	**9,943**	**15,535**	**21,322**

Ratio Analysis				
	FY09	FY10	FY11E	FY12E
Basic Ratio (₹)				
EPS	15	20	24	30
Book Value per share	75	106	150	175
Dividend per share	2.5	3.0	3.0	3.5
Asset Quality (%)				
Gross NPAs	1.5	1.2	1.1	1.0
Net NPAs	1.0	0.7	0.4	0.4
NPA Coverage	29.9	37.1	61.9	63.0
Business Performance (%)				
Loan Growth (%)	39.6	50.8	52.6	42.1
Leverage	12.3	12.4	10.5	10.9
Avg Business Growth (%)	43.7	51.4	52.9	40.8
Operating profit margin (%)	18.8	21.2	23.0	20.5
Net profit margin (%)	13.2	15.2	16.3	14.4

Ratio Analysis				
	FY09	FY10	FY11E	FY12E
Spread analysis (%)				
Average Yield on Advances	13.1	12.2	11.5	11.7
Average cost of Funds	10.0	9.0	8.4	8.9
Interest Spread	3.1	3.2	3.1	2.8
Net Interest Margin	3.1	3.0	2.9	2.6
Efficiency Indicator (%)				
Cost to Income	35.2	34.7	33.5	35.6
Return Ratios				
Return on Avg. Net Worth	20.6	22.8	19.5	18.2
Return on Average Assets	1.7	1.8	1.9	1.7
Valuation ratios (x)				
P/E	17.7	13.6	11.3	9.1
P/BV	3.57	2.52	1.79	1.53
Dividend Yield	0.93	1.12	1.12	1.31

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Stock Rating Scale

BUY	:	>20%
ACCUMULATE	:	12-20%
HOLD	:	5-12%
REDUCE	:	<5%

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