Initiating Coverage | 2 September 2015

Sector: Financials

GRUH Finance

The cash machine

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MOTILAL OSWAL

GRUH Finance | The cash machine

GRUH Finance

Motilal Oswal

BSE Sensex	S&P CNX
25,696	7,786

CMP: INR232 | TP: INR295 (+27%) | Buy

The cash machine

Focused player with consistent track record

- **Urbanization and affordable housing are the mega trends that will translate into a meaningful lending opportunity of INR9t over the next decade.**
- **GRUH has a first-mover advantage in a large opportunity space and is a key beneficiary of government's thrust on affordable housing.**
- **Consistent operating/financial performance and strong HDFC parentage has fetched AA+ credit ratings. Presence in rural housing finance helps it avail cheaper NHB funds aiding spreads.**
- **Consistency+ Sustainability +Stability + Scalability =Premium valuation; 10-year avg. RoE/RoA of +28%/+2.5%. Valuation reflective of uniqueness of business model. Initiate with a Buy rating.**

Stock Info

GRUH FINANCE LIMITED
We help you build homes

Bloomberg	GRHF IN
Equity Shares (m)	363.4
52-Week Range (INR)	317/183
1, 6, 12 Rel. Per (%)	4/3/16
M.Cap. (INR b)/(USD b)	84.3/1.3
Avg Val(INRm)/Vol'000	112/450
Free float (%)	41.4

Financial Snapshot (INR b)

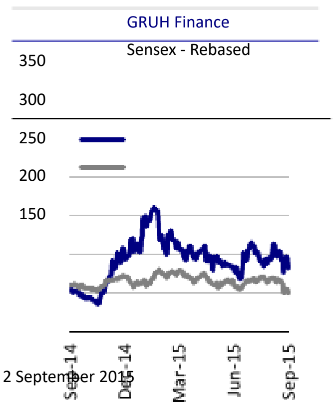
Y/E MAR	2016E	2017E	2018E
NII	4.2	5.3	6.7
PPP	4.0	5.0	6.4
PAT	2.5	3.2	4.1
EPS (INR)	7.0	8.8	11.3
EPS Gr. (%)	24.3	26.8	28.3
BV/Sh. (INR)	24.1	29.8	37.2
ABV/Sh. (INR)	24.1	29.8	37.2
RoA (%)	2.4	2.4	2.4
RoE (%)	31.9	32.8	33.8
Payout (%)	30.0	30.0	30.0
Valuations			
P/E (x)	33.3	26.3	20.5
P/BV (x)	9.6	7.8	6.2
Div. Yield (%)	0.9	1.1	1.5

Shareholding pattern (%)

	Jun-15	Mar-15	Jun-14
Promoter	58.6	58.6	59.2
DII	3.1	2.5	0.7
FII	12.3	12.7	16.5
Others	26.0	26.2	23.6

FII Includes depository receipts

Stock Performance (1-year)



Affordable housing a mega lending opportunity: Large opportunity size, secured nature of lending, favorable regulatory regime, limited competition from banks, liability support from NHB makes the affordable housing finance segment dynamics very attractive. While these factors have enabled HFCs to deliver strong returns; in our view, government's strong push to affordable housing via its "Housing for all by 2022" scheme coupled with multiple long term growth drivers makes the future much more promising for the affordable housing finance segment specialist like GRUH. Approx 68% of India's population lives in rural areas, facing shortage of ~44m housing units as per our estimates; even if half of the houses get institutional finance it translates into an INR9t financing opportunity over the next decade.

GRUH has first mover advantage in large opportunity space: Housing finance to small-ticket segment (ticket size <INR1m) remains abysmally low, despite regulators favoring small-ticket loans by allowing lower risk weight of 50% and cheaper refinance options (NHB refinances at 7-9%). GRUH with three decades of experience has a steep learning curve and has developed an operating model suiting the unique challenges faced by this segment. In our view GRUH is likely to be a key beneficiary of the large opportunities. We expect GRUH to clock a +25% CAGR in loan growth over the next 10 years v/s a 27% CAGR over the last decade.

Lower competition imparts pricing power; NHB refinancing and AA+ credit ratings aid superior spreads: GRUH's strong presence in underserved areas where competition is low imparts pricing power resulting in higher yields. Further, NHB through its various schemes refinances banks and HFCs at 7-9% to encourage lending in semi-urban and rural areas. Given the areas where GRUH operates and the segments it targets, GRUH is a major beneficiary of these schemes (NHB funds form 34% of the borrowings).

GRUH Finance

Also, consistent operating/financial performance record with strong parentage has fetched AA+ ratings. Combination of higher yields, high credit ratings and NHB refinancing helps GRUH generate 3.5%+ spreads and 4%+ margins.

Lean operating costs and impeccable asset quality cornerstone of supernormal profits: Aided by lean operating costs (C/I ratio 15.8% (Q1FY16), in-line with large HFCs), stable margins (4%+) and credit cost (<20bp over the next three years), GRUH is likely to post 26% CAGR in net profit over FY15-18E; we expect it to report RoA of 2.4% and RoE of 34% by FY18E. Conservative lending practices such as a) LTV of 65% and installment-to-income ratio of 50% and b) small developer/builder loan portfolio have enabled GRUH to maintain stable asset quality, with gross GNPL/NNPA of 0.52%/0.15% and coverage ratio of 72% (as of 1QFY16).

Superior and sustainable return ratios: GRUH commands significant premium over peers due to a) long track record of consistent financial/operating performance, b) immense potential of scalability due to massive opportunity in the segment, c) strong parentage of HDFC Ltd., d) best-in-class return ratios with a 10-year average RoE/RoA of +28%/2.5% e) efficient use of capital (no dilution in the last 10 years), f) flawless execution—NPLs never went above 2%, even during the worst of times.

We expect GRUH to continue to trade at premium multiples, led by its niche business model, high capitalization, consistent execution, inherently high profitability with the ability to sustain return ratios, and minimal asset quality overhang—given a secured loan book. Ongoing downward trend in interest rates could also prove to be a trigger for profitability. We initiate coverage with a **Buy rating** and a target price of INR295, based on residual income model, which yields an upside of 27% from current market price.

Exhibit 1: Key Operating Matrix (%)

Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Yields on loans	11.7	13.0	12.9	13.1	12.8	12.6	12.4	12.4
Cost of funds	7.6	9.1	9.3	9.6	9.3	9.2	9.1	9.1
NIMs	4.8	4.7	4.5	4.3	4.3	4.1	4.0	3.9
Cost / Income	20.0	19.2	18.8	18.4	16.7	16.2	15.6	14.9
GNPA	0.8	0.5	0.3	0.3	0.3	0.3	0.2	0.2
RoAE	31.4	34.2	33.3	32.2	30.9	31.9	32.8	33.8
RoAA	3.0	3.1	2.9	2.8	2.5	2.4	2.4	2.4
EPS (INR)	2.6	3.4	4.1	4.9	5.6	7.0	8.8	11.3
EPS Growth	31.1	31.0	19.9	20.2	14.2	24.3	26.8	28.3
BVPS (INR)	9.0	10.9	13.8	16.9	19.6	24.1	29.8	37.2

E: MOSL Estimates

Exhibit 2: Housing Finance Companies: Valuation metrics

	CMP	Tgt Price	Upside	3yr EPS	P/BV (x)			RoA (%)			RoE (%)		
	(INR)	(INR)	(%)	CAGR	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
HDFC	1,158	1,388	20	10.9	5.9	5.3	4.7	2.5	2.6	2.6	25.5	23.6	24.4
LICHF	425	541	27	14.5	2.7	2.3	2.0	1.4	1.5	1.5	17.5	20.2	21.3
DEWH	445	710	60	12.8	1.4	1.2	1.1	1.3	1.3	1.3	15.1	15.6	17.3
IHFL	726	790	9	18.6	3.9	3.5	3.0	4.0	3.9	3.8	30.8	32.3	33.5
GRHF	**232**	**295**	**27**	**18.0**	**11.8**	**9.6**	**7.8**	**2.5**	**2.4**	**2.4**	**30.9**	**31.9**	**32.8**
REPCO	701	901	28	14.3	5.4	4.6	3.9	2.3	2.2	2.1	15.9	17.5	19.2

Source: MOSL

Affordable housing: A Mega lending opportunity

Urbanization and affordable housing are mega trends of the next decade

- **Massive opportunity emanating from urbanization and thrust on affordable housing. In our view, will result in INR9t lending opportunity over the next decade.**
- **GRUH likely to be a key beneficiary of Housing for all by 2022 scheme**
- **Limited competition in the space leaves ample room for GRUH to expand**

Massive opportunity emanating from urbanization and thrust on affordable housing

Despite the mortgage industry growing almost 25x in the last 15 years (from INR400b in 2000 to INR10t in 2015), the opportunity for housing financiers continues to remain large owing to multiple growth drivers: a) Continued urbanization ensuring strong housing demand in tier-2 and tier-3 cities, b) rising income with increasing affordability, c) shrinking/nuclear families, d) tax incentives and excessive slum development and housing shortage in urban areas resulting in increased thrust on affordable housing.

Nearly 68% of India's population lives in rural areas, which faces significant housing shortage (43.7mn units, as per the working group on rural housing for the 12th Five-Year Plan). One of the main reasons for this shortfall (besides high poverty) is the lack of formal institutional financing mechanism and framework.

Exhibit 3: : Total rural housing shortage at ~44m units

Factors	Shortage (million)
No. of households without houses - 2012	4.2
No. of temporary houses - 2012	20.2
Shortage due to congestion - 2012	11.3
Shortage due to obsolescence - 2012	7.5
Additional housing shortage arising between 2012-17	0.6
Total rural housing shortage	**43.7**

Source: MOSL

Exhibit 4: Even if 50% units are financed, financing requirement at ~INR9t

Est. number of units financed (mn)	21.9
Average cost of rural house (INR mn)	0.6
Loan-to-value ratio	70%
Average loan per house (INR mn)	0.42
Total financing requirement (INR bn)	9,177

Source: MOSL

As per the Planning Commission, only 9% of the rural households sourced institutional finance to build their houses in 2012. Even if 22m houses (50% of the required houses) need funding with an average ticket size of INR0.6m (with 70% LTV), this could be an INR9t+ opportunity over the next decade. In our view, players in this space would continue to witness higher-than-system loan book growth over the next decade as these mega trends translate into significant lending opportunities.

Housing shortage in India to increase to 114m by 2022 from 63m in 2012

Despite strong growth in housing supply in recent years, India still faces a shortage of houses—especially in urban areas. In 2012, the housing shortage in urban India was estimated at 18.8m units and at 44m units in rural areas. Nearly the entire shortage was estimated to be in Economically Weaker Section (EWS) and Low Income Group (LIG) segments of the population.

Exhibit 5: Estimated housing requirement by 2022

	Urban (M units)	Rural (M units)	Total (M units)
Housing shortage in 2012	19	44	63
Requirement by 2022	27.5	24	51.5
Total	**46.5**	**68**	**114.5**

Source: MOSL, NAREDCO

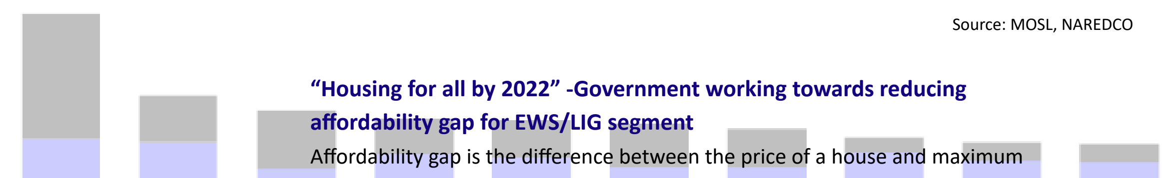
Industry experts estimate that housing requirement in India would increase to 114m units by 2022 from 60m in 2012. Majority of the demand, ~68m houses or 60% of the total demand, is expected to come from rural areas. Further, 50% of the housing requirement would be in the LIG and Middle Income Group (MIG) segments.

Exhibit 6: Housing requirement in 2022 by income group

Income group	% of housing need
EWS	40
LIG	30
MIG	20
HIG	10

Source: MOSL, NAREDCO

Exhibit 7: Housing requirement in top 10 states by 2022



Source: MOSL, NAREDCO

"Housing for all by 2022" -Government working towards reducing affordability gap for EWS/LIG segment

Affordability gap is the difference between the price of a house and maximum amount a household can pay. The task force on promoting affordable housing in 2012 estimated affordability gap for EWS segment at INR0.1-0.2m and that in LIG segment at INR0.7-1.2m.

Government under its "Housing for all by 2022" mission intends to plug this affordability gap by providing 20m houses to the EWS and LIG in cities and small towns of India by 2022.

Highlight of the scheme is that government would provide interest subsidy of 6.5% on housing loans of tenure of up to 15 years to the EWS/LIG segment. As per our calculations a 6.5% interest subsidy on an INR0.6m loan at 10.5% interest for 15 years; monthly EMI will reduce from INR 6,632/month to INR4,438/month that translates into a monthly saving of INR2,194/month.

Exhibit 8: Expected monthly savings on EMI

Loan Amount (INR)	600,000.0	600,000.0
Tenure (Years)	15	15
Interest rate (%)	10.50%	4.00%
Monthly EMI (INR)	6,632.0	4,438.0
EMI Savings/month (INR)		2,194.0

Source: MOSL

Based on the above calculations, interest savings over the tenure of the loan for EWS segment (on loan of INR0.6m) is ~INR0.4m and for LIG segment (on loan of INR1.5m) is ~INR1m, thus eliminating the affordability gap by providing interest subsidy on housing loans.

Exhibit 9: Interest subsidy scheme eliminates affordability gap

	EWS (Loan of INR 0.6m)		LIG (Loan of INR1.5m)	
	w/o interest subsidy	with interest subsidy	w/o interest subsidy	with interest subsidy
Affordability Gap (INR m)	0.1-0.2	0.1-0.2	0.7-1.2	0.7-1.2
Interest savings over 15 years (INR m)	0	~0.4	0	~1m
Effective affordability gap	0.1-0.2	-	0.7-1.2	-

Source: MOSL

Further, to increase the addressable market size of the scheme, income ceiling for EWS has been revised from INR0.1m pa to INR0.3m pa and the ceiling for LIG has been hiked from INR0.3m pa to INR0.6m pa.

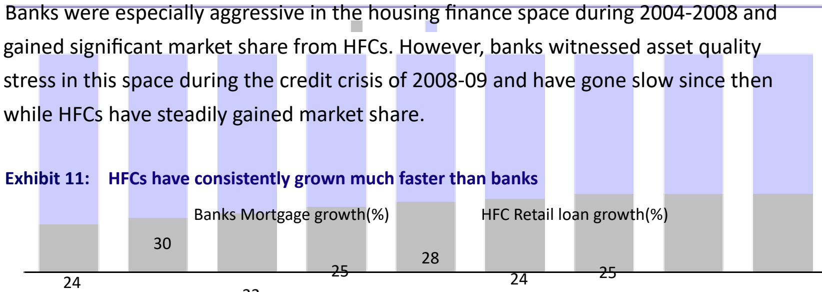
Banks' reluctance to lend in this segment leaves ample space for niche HFCs

Banks have traditionally competed on lower interest rates while housing finance companies have maintained their turf through better product offering and service quality over the life of the mortgage. Although HFCs have lost their competitiveness vis-à-vis commercial banks especially amongst the salaried class in metro areas, they continue to dominate the small-ticket and self-employed segments across geographies.

Exhibit 10: HFCs are steadily gaining market share in mortgage industry

HFC Banks

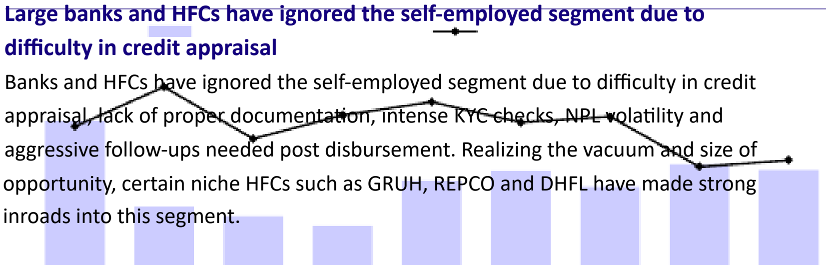
77.9 75.1 73.0 69.9 67.7 66.2 64.1 64.2 63.9



Source: MOSL

Banks were especially aggressive in the housing finance space during 2004-2008 and gained significant market share from HFCs. However, banks witnessed asset quality stress in this space during the credit crisis of 2008-09 and have gone slow since then while HFCs have steadily gained market share.

Exhibit 11: HFCs have consistently grown much faster than banks

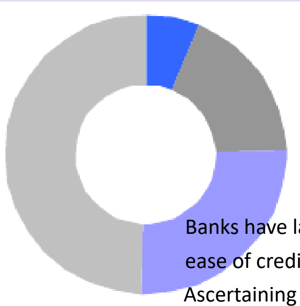


Source: MOSL

Large banks and HFCs have ignored the self-employed segment due to difficulty in credit appraisal

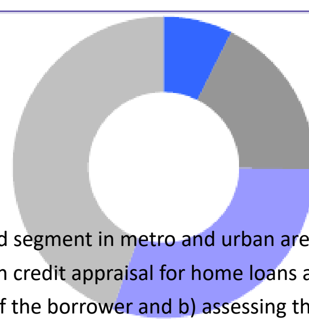
Banks and HFCs have ignored the self-employed segment due to difficulty in credit appraisal, lack of proper documentation, intense KYC checks, NPL volatility and aggressive follow-ups needed post disbursement. Realizing the vacuum and size of opportunity, certain niche HFCs such as GRUH, REPCO and DHFL have made strong inroads into this segment.

Exhibit 12: 76% of home loans by banks are in Urban areas



Source: MOSL, NHB

Exhibit 13: SBI's 25% HL are in semi-urban & rural areas



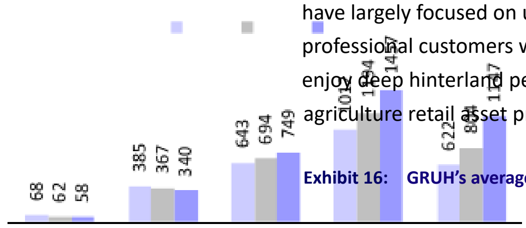
Source: MOSL, NHB

GRUH Finance

Banks have largely focused on the salaried segment in metro and urban areas due to ease of credit appraisal. Two key factors in credit appraisal for home loans are: a) Ascertaining the repayment capabilities of the borrower and b) assessing the legal & practical aspects of the property that is being financed.

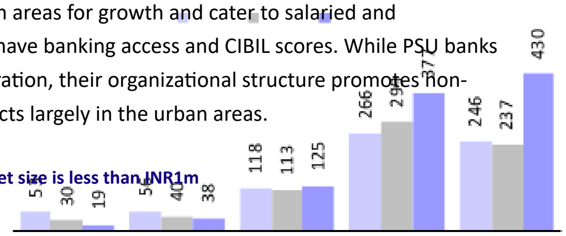
While availability of long credit history and regular cash-flows make salaried class the safest borrower class in terms of repayment capability, relatively clear property titles in metro areas increase the ease of property appraisal. As such, commercial banks as well as large HFCs continue to focus on the salaried segment in metro and urban areas. This leaves a lot of room for the smaller housing finance players such as Repco Home, Dewan and Gruh Finance, in self-employed segment even in metro and urban areas, not to mention the low level of competition in tier-2 and tier-3 cities.

Exhibit 14: Banks' O/S credit in home loans (INR b)



Source: MOSL, NHB

Exhibit 15: Banks' disbursements in home loans (INR b)

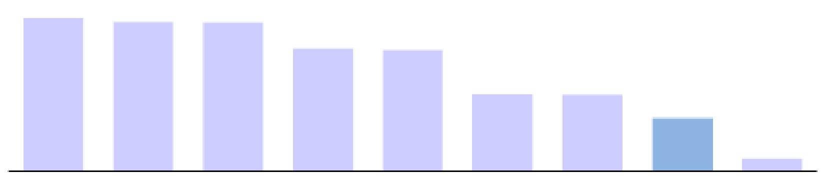


Source: MOSL, NHB

Leaving ample room for niche HFCs such as GRUH

Banks' focus on small-ticket loans has been restricted to priority housing, and they have largely focused on urban areas for growth and cater to salaried and professional customers who have banking access and CIBIL scores. While PSU banks enjoy deep hinterland penetration, their organizational structure promotes non-agriculture retail asset products largely in the urban areas.

Exhibit 16: GRUH's average ticket size is less than INR1m



Source: MOSL

Banks and large HFCs' disproportionate focus on the urban salaried segment has left the non-salaried segment as well as tier-2 and tier-3 market open to anyone who has the capabilities to operate in that segment. This segment is characterized by low ticket sizes and irregular cash flows. Smaller HFCs such as GRUH Finance and Repco Home have operated profitably in this segment on the back of their carefully crafted appraisal techniques and low-cost operating model.

Exhibit 17: Competitive landscape in housing finance

	Presence	Target segment	Sourcing	Avg. ticket size (INRm)	Average yields (%)	Asset quality
SBI	Metro & Urban	Salaried & professionals	Largely DSAs	2.3	9.90	NA
HDFC	Metro, Urban & Semi urban	85% customers are salaried	Branches, DSAs, HDFC Bank, distribution subsidiary	2.3	9.90	0.70%
LIC Housing	Metro & Urban	88% customers are salaried	LIC agents, DSAs Branches, DSAs	1.9	10.50	0.61%

Sundaram Home	Metro, Urban & Semi urban	-	-	1.3	12.00	0.31%
Repco Home	Semi urban & Metro outskirts,	44% customers are salaried, rest are self employed	Branches	1.2	12.60	1.32%
Dewan Housing	Urban & Semi urban	Salaried & professionals	Branches	1.2	12.00	0.70%
GRUH Finance	**Semi urban and rural**	**60% customers are salaried, rest are self employed**	**Branches & Referral associates**	**0.8**	**12.50**	**0.28%**
Mahindra Home	Rural	Mostly self-employed	-	0.2	16.00	5%

Source: MOSL

Present in niche rural and semi-urban markets

Rural focus yields dual benefit of pricing power and low cost of funds

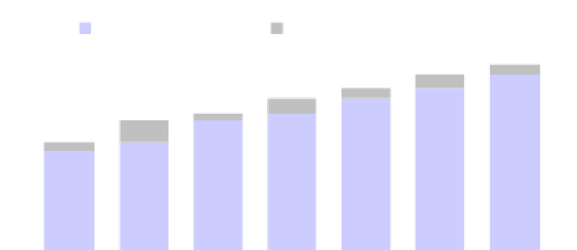
- **Strong presence in high-growth states with large demand for housing**
- **Exposure to self-employed segment gives pricing power and funding benefits.**
- **Deeper penetration and geographical expansion to drive 29% CAGR over the next three years.**

GRUH: Strong presence in states with large demand for housing

GRUH founded in 1986, was the first company in India to focus solely on rural housing finance opportunity. Over the years it has mastered the art of financing India's non-urban housing landscape and has developed an operating model to counter unique segment challenges. The company primarily offers small-ticket loans to home buyers of the low- and middle-income group segments, where yields are generally higher. With nearly three decades of experience in this segment; its credit appraisal and recovery systems are well adept to suit the market it operates in.

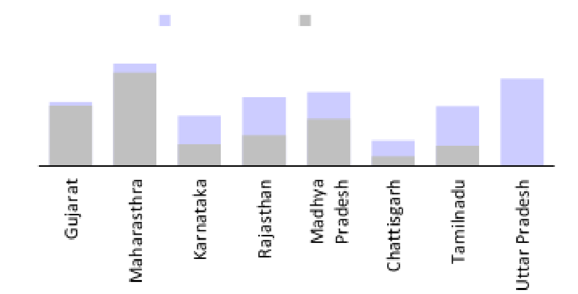
GRUH has also penetrated deep into states where demand for housing is expected to remain high. Thanks to its unique business model where it sources over 60% of its business from GRUH referral associates, the company has penetrated even into areas where it does not have physical presence.

Exhibit 18: Steady branch expansion



Source: Company, MOSL

Exhibit 19: Deep penetration in states of operation



Source: Company, MOSL

Among the top 10 states where housing demand is expected to remain high, GRUH has strong presence in six (constitute 54% of the total housing demand in the country). The company has also entered Uttar Pradesh, where housing demand is expected to be the highest by 2022. Thus, the company is in a sweet spot to capitalize on the large latent housing demand in India.

Exhibit 20: GRUH is present in states where demand for housing is high

Urban housing requirment (Mn units) Rural housing requirment (Mn units) Penetration in states (%)

Uttar Pradesh	146	54	0.3
Maharashtra	55	50	91
Bihar	69	19	-
Andhra Pradesh	40	37	-
West Bengal	42	34	-
Madhya Pradesh	51	22	63
Rajasthan	45	21	45
Tamil Nadu	18	39	34
Gujarat	21	29	94
Karnataka	21	28	43

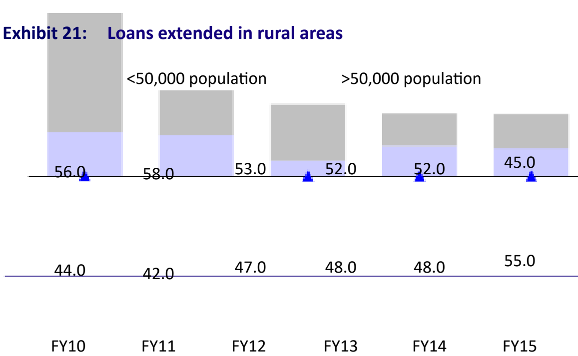
Source: Company, MOSL

Focus on the underserved segment imparts pricing power and above-

industry growth rates

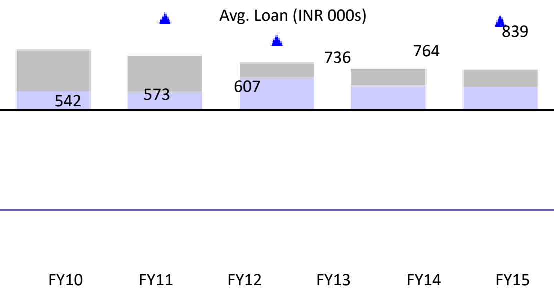
GRUH portfolio primarily consists of small-ticket loans (average ticket size INR839k) in small towns and cities with population of <50,000. GRUH is increasingly focusing on penetrating small towns and cities as these areas have robust demand of housing, but are largely underserved by banks and large HFCs in terms for providing financing. Limited competition has helped GRUH command pricing power along with above industry growth rates.

Exhibit 21: Loans extended in rural areas



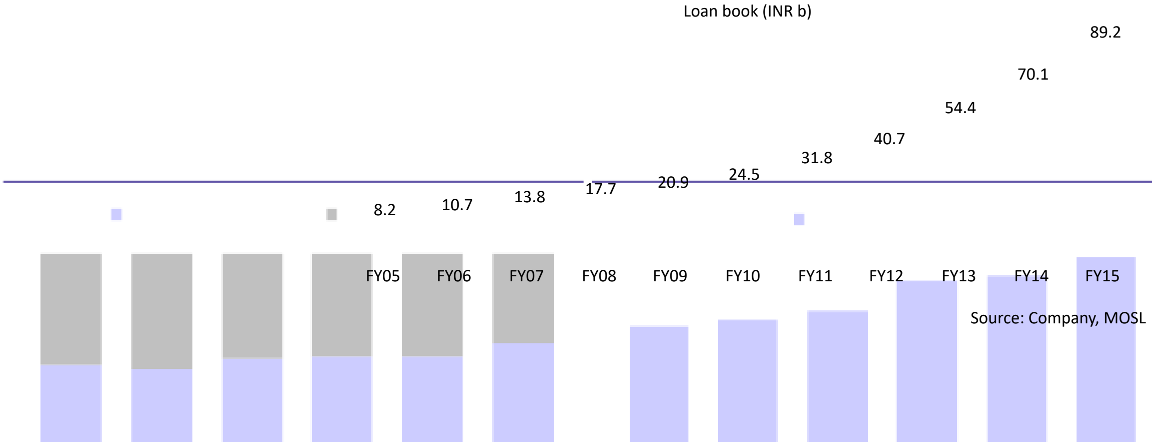
Source: Company, MOSL

Exhibit 22: Average ticket size



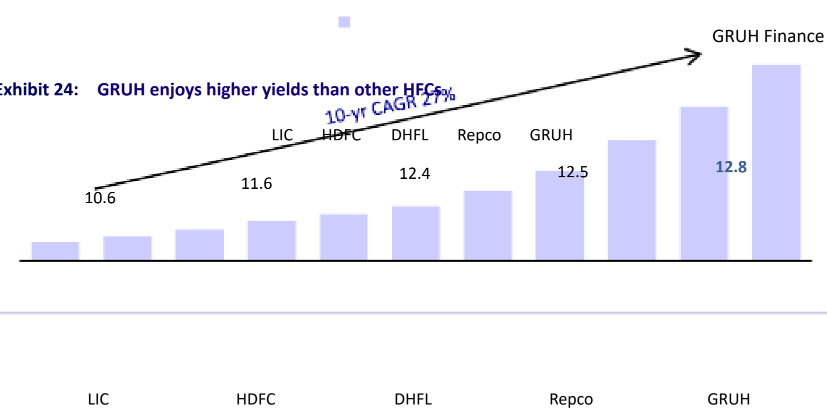
Source: Company, MOSL

Exhibit 23: First mover advantage-GRUHs loan book has grown 27% CAGR over last decade



Source: Company, MOSL

Exhibit 24: GRUH enjoys higher yields than other HFCs

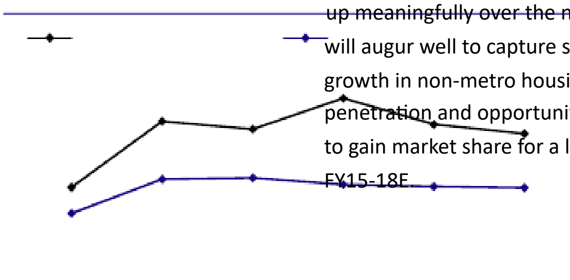


Source: Company, MOSL

GRUH has posted a 29.4% CAGR over the past five years (FY10-FY15), albeit on a smaller size, as against the industry CAGR of 18.1%. Although GRUH is a small player in the housing financing industry, its market has increased from 53bps in FY09 to

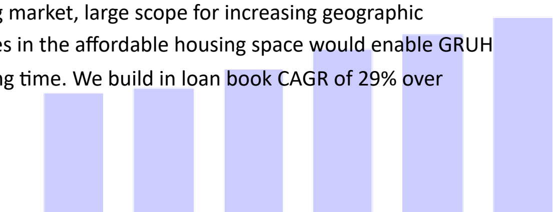
88bps in FY15 on the back of its strategic focus on affordable housing market.

Exhibit 25: GRUH's growth has been above industry growth



Source: Company, MOSL

Exhibit 26: GRUH has steadily gained market share



Source: Company, MOSL

Given the large unmet rural housing demand in India and low penetration of mortgage, we believe the company is well positioned to continue to gain market share over the medium term. Further, we expect future growth to come from company's strategy to penetrate further into small towns and cities with population <50,000—especially in states where demand for rural housing is expected to remain high. We estimate that GRUH would double its market share to 166bps by FY21.

Given the government's strong thrust on affordable housing, the segment could pick up meaningfully over the next 10 years; GRUH's dominance in non-metro regions will augur well to capture such opportunities as and when they come. Secular growth in non-metro housing market, large scope for increasing geographic penetration and opportunities in the affordable housing space would enable GRUH to gain market share for a long time. We build in loan book CAGR of 29% over FY15-18E.

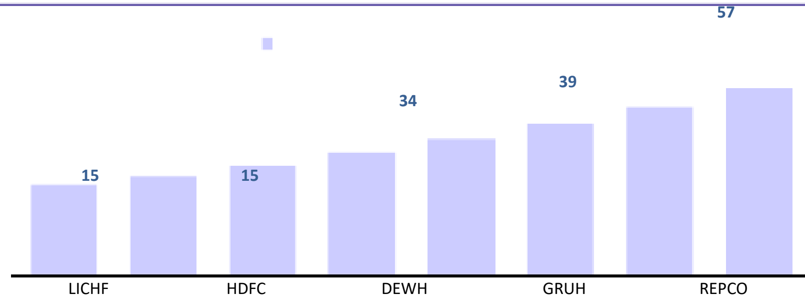
Exhibit 27: Strong demand in rural housing is expected to drive market share gains

Source: Company, MOSL

Banks and large HFCs favor salaried segment in rural and urban markets

Banks and large HFCs primarily focus on salaried borrowers as can be seen by the fact that salaried borrowers account for 80-85% of the total outstanding loans. The reason behind this skew toward the salaried segment is the ease in validating the income levels and the repayment capabilities. Further, lenders have traditionally viewed the salaried segment as one with stable cash flows and, hence, consider it as a low–risk proposition.

Exhibit 28: Share of non-salaried loans lower among large HFCs



Source: Company, MOSL

This has led organized lenders to ignore self-employed borrowers, which account for 34% of the workforce, and forced them to rely on personal loans or loans from unorganized sources at higher interest rates.

Rural and semi-urban housing finance or finance for self-employed remains a highly under-penetrated opportunity. There are only a few players that have tapped into these opportunities and have now reached sizes of consequence. GRUH has been a pioneer in rural housing and has built a portfolio of ~INR90bn over the last 29 years.

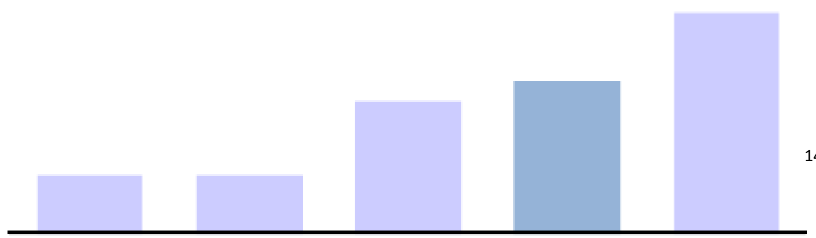


Exhibit 29: Self-employed constitute 34% of the workforce; share in loans is ~10%

Salaried
16%

Casual labour
50%

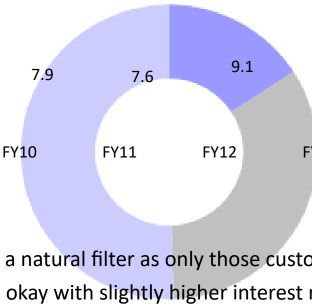
Self employed
34%

Source: NSSO, MOSL

Focus on profitability over growth

GRUH has battled competitive pressures several times over the past decade, especially in urban areas—ICICI Bank aggressively doled out home loans at 7% in 2006 and SBI launched its teaser rate products at 8% in 2009. However, GRUH maintained its product pricing at around 11% despite the competition and slowed down its lending growth to 18% to maintain home loan pricing at 11%.

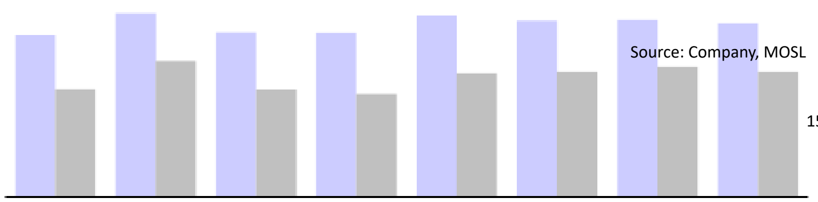
Exhibit 30: GRUH has maintained yields at 12%+



Source: Company, MOSL

GRUH's loan pricing acts as a natural filter as only those customers will opt for loans from the company who are okay with slightly higher interest rates and prefer service quality in terms of turnaround time and transparency; these factors act as the key differentiators that enable the company to charge high yields vis-à-vis larger HFCs.

Exhibit 31: PAT growth has been at +20%



Source: Company, MOSL

Product portfolio designed for specific needs and segments

GRUH has designed four basic products to tap the rural housing finance opportunity: (a) Suraksha is the basic mortgage product for salaried individuals; (b) Suvidha is similar to Suraksha except for the fact that it caters to self-employed individuals with no direct income proof and income estimation is through surrogate methods; (3) Sajavat is a home improvement loan product. (4) Samruddhi is a loan given primarily to self-employed for purchase of office or business premises

Exhibit 32: GRUH's product offerings

	Gruh Suraksha	Gruh Suvidha	Gruh Sajavat	Gruh Samruddhi	LAP	Developer Loan
Purpose	Loan to salaried individuals and professionals based on formal income proof	Loans to professionals and self-employed based on appraisal income, calculated based on surrogate income proof	Loans offered to fund repair and renovation of their existing home	Loans offered to individuals to purchase of offices for their business	Loan offered for professionals for various business needs, collateralized by property.	-
LTV (%)	up to 85	up to 85	up to 85	up to 85	up to 85	-
Tenure (Years)	up to 25	up to 15	up to 15	Variable	Variable	Variable
Interest (%)	9.95-12.7	10.15-13.4	11.0-13.75	12.5-15.25	12.25-17.0	13-17
Loan book share (%)	54*	31*	<1.0*	4	6*	4

* Based on FY13 data Source: Company, MOSL

Exhibit 33: Home loans constitute 92% of loan book

Exhibit 34: Loan mix (%)

Home Loans NRP Loans Developer Loans

3.0 3.0 4.0 5.0 3.0 3.6

6.0 5.0 4.0 4.0 5.0 4.2

91.0 92.0 92.0 91.0 92.0 92.2

FY10 FY11 FY12 FY13 FY14 FY15

Source: Company, MOSL

NRP Loans 4%

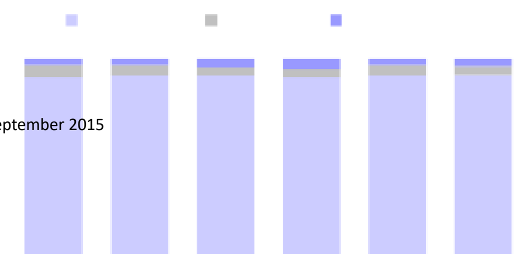
Developer Loans 4%

Home Loans 92%

Source: Company, MOSL

Unique sourcing model: over 60% of business via GRUH referral associates

Unlike the DSA model that is widely followed by banks (which results in disconnect between the sanctioning officer and customer), GRUH works on referral associate program, where the only task of a referral associate is to pass on the leads to a GRUH employee. Credit appraisal, monitoring and recovery are the responsibility of the employee. A referral associate can be anyone—GRUH's own public deposit seeking agents, agents of other NBFCs, freelancers, etc.



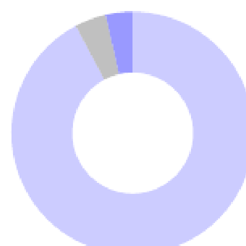


Exhibit 35: Majority of new business is sourced from DSA

Business from DSA (%)

57.0 (FY10), 54.0 (FY11), 58.6 (FY12), 63.3 (FY13), 61.5 (FY14), 61.0 (FY15)

Source: Company, MOSL

Exhibit 36: Commission paid for each loan sourced

Fees per loan (%)

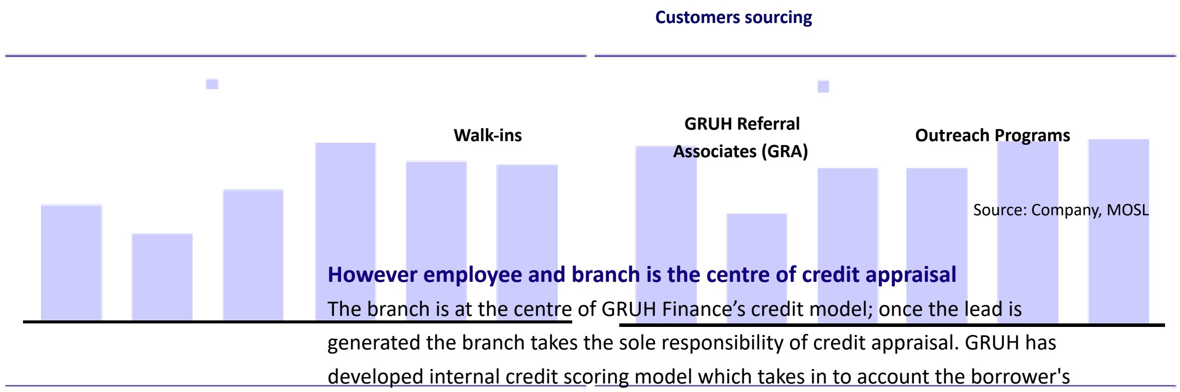
0.4 (FY10), 0.3 (FY11), 0.4 (FY12), 0.4 (FY13), 0.4 (FY14), 0.4 (FY15)

Source: Company, MOSL

The referral associates are given incentives based on their loyalty and the quantum of business they refer. Currently, referral associates account for over 60% of the total value of GRUH's home loans. The model has helped the company in expanding reach without opening a branch at the taluka level, thus minimizing operating costs. The success of the model is evident from the fact that despite having only 40 branches in Gujarat, the company is present in almost all the 224 talukas.

In order to generate more sales, GRUH also conducts outreach programs from each of the retail offices to potential taluka places. The outreach marketing program also serves as a center for collecting installments besides providing enquiry handling, file opening and disbursement services.

Exhibit 37: Sourcing channels for GRUH



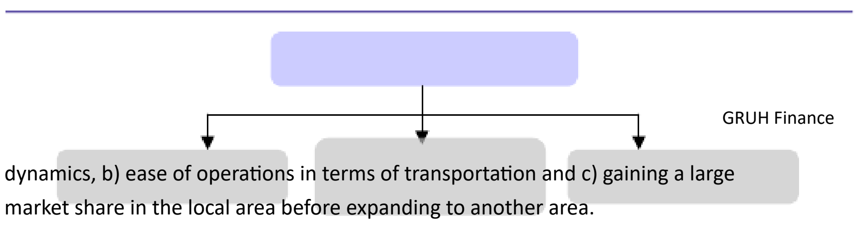
Source: Company, MOSL

However employee and branch is the centre of credit appraisal

The branch is at the centre of GRUH Finance's credit model; once the lead is generated the branch takes the sole responsibility of credit appraisal. GRUH has developed internal credit scoring model which takes in to account the borrower's credit score based on 23 different inputs. The exhaustive model captures the borrower's cash flows, income generating capability, spending patterns and historic credit behavior, if any for each of its customer classes - salaried, professionals and self-employed. The pricing is designed to price the risk within each customer class. If the credit score is favorable, the subsequent activities of field investigation, personal discussion, technical visit and reference/ legal verification start.

Well-calibrated geographic expansion

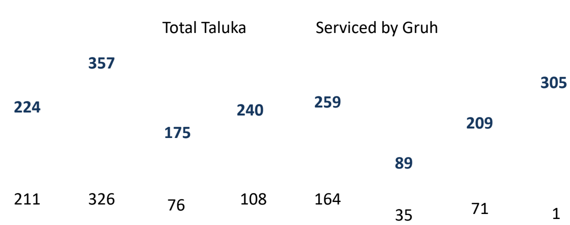
GRUH follows a well-calibrated branch expansion strategy whereby a new branch is opened at a district or taluka nearest to the existing branch. The strategy has worked in its favor and has multiple benefits: a) Strong understanding of local area



dynamics, b) ease of operations in terms of transportation and c) gaining a large market share in the local area before expanding to another area.

Although this strategy results in relatively slower branch growth, it allows the branch to obtain strong understanding of local area dynamics and build robust operating processes.

Exhibit 38: State-wise penetration for GRUH



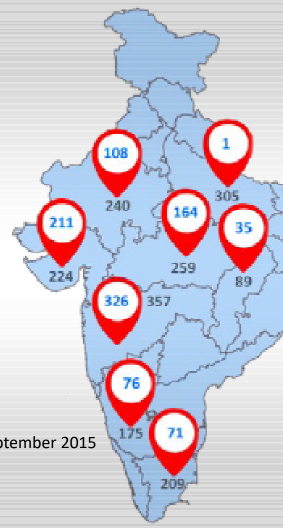
State-wise penetration for GRUH

The company continues to follow a similar model in South India, where it entered in the second-half of the last decade. The progress in terms of loan book accretion is currently slow but is expected to pick up once it consolidates its position in those areas. This strategy has resulted in best-in-class asset quality despite operating in a segment perceived risky by most other players. We note that GRUH has negligible net NPAs for the last seven years.

Creating banking awareness to minimize collections costs

Monthly collection is the biggest challenge faced by rural financers due as the rural populace lack banking habits and prefers to make cash payments. Collecting monthly payments from over 150,000 customers scattered across 992 talukas is a daunting task. GRUH has consciously pushed its customers to route repayments through banking channels and it does not collect cash at its branches or at customers' doorstep.

Majority of collections are managed by taking postdated cheques; the company has also established a network of collection centers by entering into tie-ups with banks having wide rural network and instructs borrowers to deposit cash into collection accounts at the nearest branches of those commercial banks. Cash collections constitute less than 5% of the total collections and only a few branches are allowed to collect cash. This helps it save money on cash collection/management and helps company operate with only 580 employees without outsourcing any credit activity.



Best-in-class liability profile aids spread

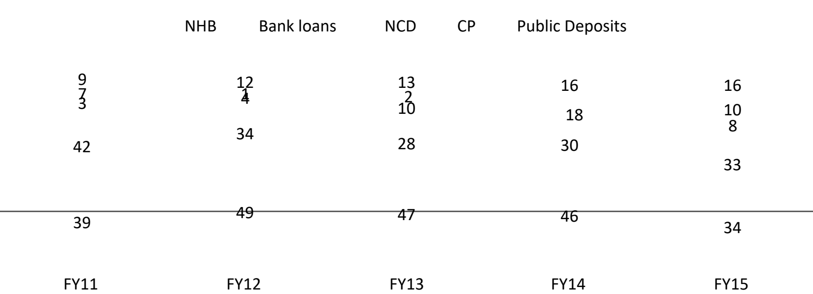
Consistent track record and strong HDFC parentage fetches AA+ ratings

- **Consistent track record, strong parentage helps GRUH fetch AA+ ratings**
- **Disbursements in underserved areas helps GRUH avail low cost NHB funds**

Well diversified liability profile

Given its long track record of consistent operating performance, profitability profile and strong parentage, GRUH Finance has a well-diversified liability profile. Public deposits, commercial banks, refinance from NHB and NCDs are the main sources of funds. Moreover given that more than 45% of disbursements continue to happen in areas where population is below 50,000, GRUH has been a disproportionate beneficiary of low cost NHB refinancing.

Exhibit 39: Bank and NHB loans constitute nearly two-thirds of the borrowings

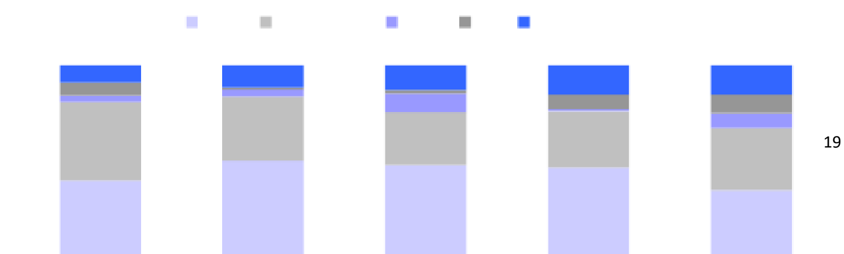


Source: Company, MOSL

Big beneficiary of low cost NHB funding

As part of its focus on rural housing, the government via NHB offers various schemes under which NHB refinances banks and HFCs. Most of the schemes are designed to encourage lending in semi-urban, rural and periphery of urban areas, where ticket sizes are generally low. Given the design of schemes, GRUH and Can Fin Homes have been the disproportionate beneficiaries of low-cost funds released by NHB. Also, they aid in reducing the asset liability management (ALM) mismatches on their balance sheets and eventually help in reducing the cost of borrowings.

GRUH operates in a niche segment, catering to the lower-income group in rural and semi-urban areas; over 45% of its disbursements have been in towns and cities with population less than 50,000. The company is increasing its penetration in these towns and cities and, incrementally, nearly 60% of the disbursements are in area with sub-50,000 population. As a result, a sizeable portion of its portfolio qualifies as rural housing finance and is eligible for low-cost funding from NHB. As of 1QFY16, NHB accounts for 32% of the total borrowings.



GRUH Finance

Exhibit 40: NHB borrowings form a major part of small HFCs' funding profile

HDFC	DHFL	LICHF	GIC HF	Sundaram Housing	Repco	GRUH
1	3	3.5	12.7	20	21.4	**32**

Source: Company, MOSL

Illustrative of uniqueness of model; GRUH has availed over 13% of the total NHB disbursement to HFCs in FY14. The company has also received over 20% of the NHB disbursements to HFCs under the Golden Jubilee Rural Housing Finance Scheme.

Exhibit 41: GRUH: Large beneficiary of NHB re-financing

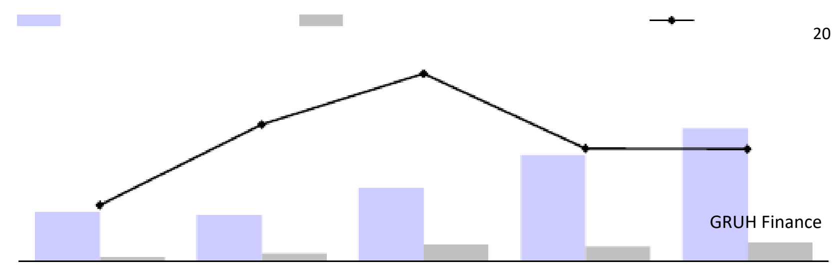
	NHB's Disb to HFC's (INR b)	Refinancing availed by Gruh (INR b)	Gruh' share (%)
FY10	35.4	2.4	6.7
FY11	33.1	5.5	16.5
FY12	53.0	12.0	22.7
FY13	76.9	10.5	13.6
FY14	96.3	13.0	13.5

Source: Company, NHB, MOSL

Exhibit 42: Refinancing schemes of NHB

	Rural Housing Fund	Golden Jubilee Rural Housing	Liberalized Refinancing Schemes	Energy Efficient Housing scheme	Urban Low Income Housing	Affordable Housing
Objective	Housing to weaker sections; the government announced the quantum in budget funds allocated from RIDF	Refinancing for rural housing	To refinance construction, purchase, repairs, upgrade of dwelling units	Promote use of solar equipment in homes	Low-income housing in urban areas	To provide refinancing assistance for affordable housing projects
Loan Size	Below INR 1.5mn	Less than Rs1.5mn	Concessional rates —below INR 0.5m	Up to INR 50,000	Below INR1.0mn	Below INR3m
Location	Rural	Rural	Any	Urban	Urban	Urban
Tenure	3-7 years	1-15years	1-15years	1-15years	5-15 years	5 years
Interest Rates	Fixed with spreads cap of 200bp 6.5% for loans <0.2m 7% for loans from INR 0.2-0.5m 7.5% for loan of INR0.5-1m	Fixed/floating	Fixed/floating	Fixed	Fixed with spreads cap of 275bp	Fixed/floating
Ultimate Borrower	Weaker section	Any	Any	Any	Annual income less than INR0.2m	Any

Source: NHB



At 9.3%, GRUH's cost of funds is comparable to large HFCs

NHB and bank loans account for nearly two-thirds of GRUH's funding needs. As bank funds are generally linked to the base rate, the ongoing systemic reduction in base rates would favorably impact the company's cost of funds. Moreover GRUH has effectively tapped different sources of borrowing to keep its cost of funds under check. As a result, the average cost of funds has broadly remained steady over the past few years—from 9.13% in FY12 to 9.25% in FY15. The cost is expected to moderate in the coming quarters, in line with the expected decline in the wholesale rates.

Exhibit 43: GRUH's cost of funds has remained largely stable

Cost of Fund (%)

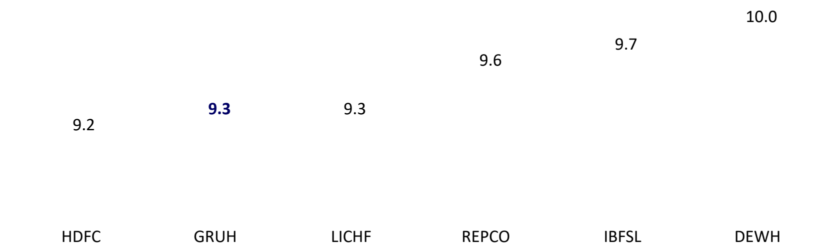
	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Cost of Fund (%)	10.0	7.9	7.6	9.1	9.3	9.6	9.3

Source: Company, MOSL

GRUH's cost of borrowing is comparable to that of large HFCs, primarily due to 1) higher proportion of NHB refinancing in total loan book, 2) higher public deposits franchise compared with other players and 3) strong parental support that aids in credit rating.

Exhibit 44: AA+ rating, consistent track record and NHB refinancing lower the cost of funds

HDFC	GRUH	LICHF	REPCO	IBFSL	DEWH



Source: MOSL

Strong debt market franchise

On back of strong wholesale debt market franchises, GRUH has also de-emphasized its bank funding and has even done an admirable job of collecting deposits and renewing old ones.

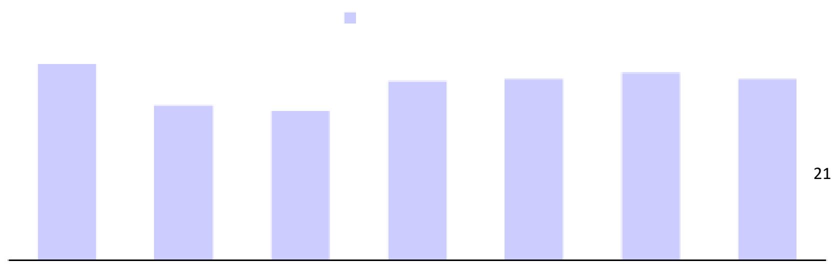
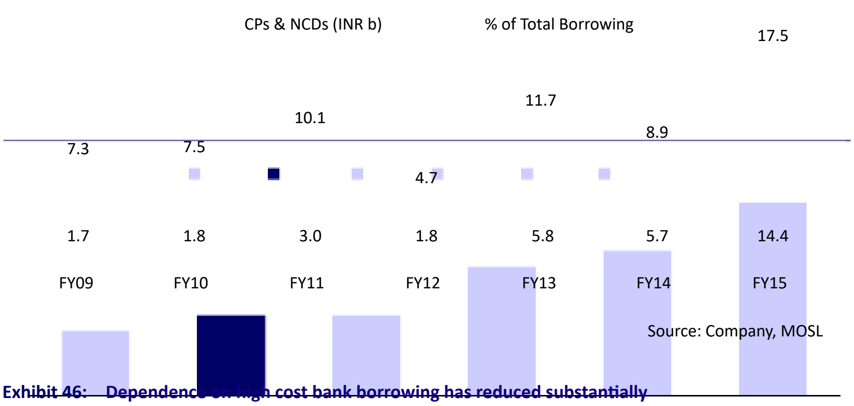
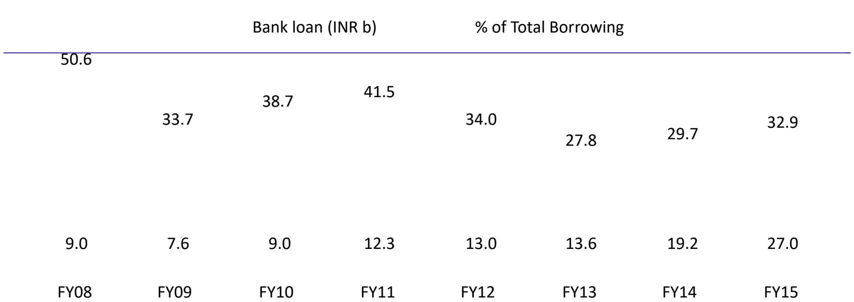


Exhibit 45: GRUH has been increasing share of low cost debt market instruments



Source: Company, MOSL

Exhibit 46: Dependence on high cost bank borrowing has reduced substantially

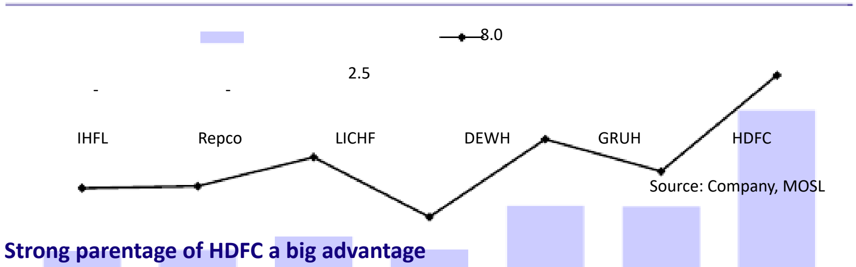


Source: Company, MOSL

Higher public deposits franchise compared with other players

GRUH has developed a strong deposit franchise, with 16% of its funding coming from this channel. The company has leveraged its strong parentage and better credit ratings to garner public deposits. Compared with other HFCs, GRUH enjoys higher proportion of granular public deposits in its borrowing mix.

Exhibit 47: Higher share of public deposits compared with other HFCs



Source: Company, MOSL

Strong parentage of HDFC a big advantage

Besides having solid operating metrics, GRUH also benefits from being a subsidiary of housing sector leader HDFC (which owns 58.6% of its equity; high parental shareholding translates into strong management and strategic inputs from HDFC). Strong parental support from HDFC aids in GRUH's credit rating and enables it to access fund from banks and debt market (via issuance of commercial paper and debentures) at competitive rates.

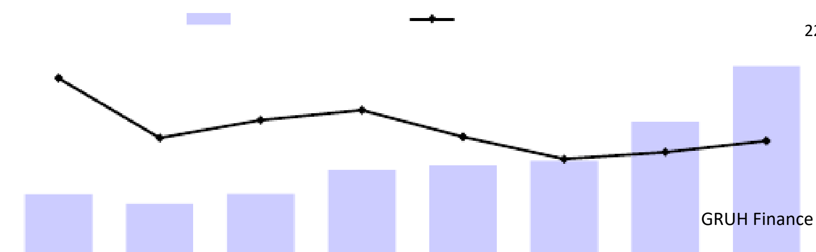


Exhibit 48: GRUH's credit rating

Product	Rating by CRISIL	Rating by ICRA
Public Deposits	FAAA	MAAA
NCD	AA+ (Stable)	AA+ (Positive)
Sub. NCD	AA+	AA+
Commercial Paper	A1+	A1+

Source: Company, MOSL

HDFC's top management has a significant presence in GRUH's board—HDFC's vice-chairman and CEO is the non-executive chairman of and its managing director is also on the company's board. Further, GRUH's current managing director is a former HDFC employee.

Securitization yet to be explored; can be a further value add

A large chunk of GRUH's assets qualify as priority sector assets, the securitized paper appetite from banks is likely to be high. The company has not been exploring this route, but with increasing size we feel that the 100bps cost advantage through the same can be a boost to profitability.

Well managed asset quality with healthy PCR

GNPAs below 1% over the last five years

GRUH maintained asset quality despite lending to the low-income group

GRUH operates in a niche segment, catering to the lower-income group in rural and semi-urban areas, which is perceived as a riskier segment. Nearly 50% of the company's cumulative disbursement has been toward loans of <INR0.3m; whereas in terms of family income, 52% of the disbursements is to individuals with family income of less than INR15,000/month.

Exhibit 49: 50% of disbursements toward loans <INR0.3m

>INR1m 8%

>INR0.5m to INR1m 21%

Upto INR0.3m 50%

>INR0.3m to INR0.5m 21%

Source: Company, MOSL

Exhibit 50: 52% loans to individuals with income up to INR15k

>50k 6%

>25k to 50k 18%

Upto 15k 52%

>15k to 25k 24%

Source: Company, MOSL

Despite operating in this segment, GRUH's asset quality has been stable with GNPA at 0.28% (FY15). The GNPAs are completely provided for, resulting in provision coverage of 100% and nil NNPA. Given the stringent credit appraisal methodology, conservative lending approach with lower LTVs, focus on recovery and adequate provisioning, we believe that asset quality would remain under check over the medium term.

Exhibit 51: Asset quality expected to remain under check

GNPA (%) NNPA (%)

0.82

0.52 0.05

Exhibit 52: Provision coverage to remain at 100%

PCR (%)

100 100 100 100 100 100 100

0.32 0.27 0.28 0.26 0.24 0.22

85

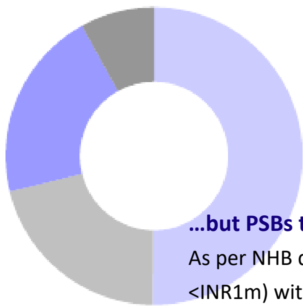
FY11 FY12 FY13 FY14 FY15 FY16E FY17E FY18E

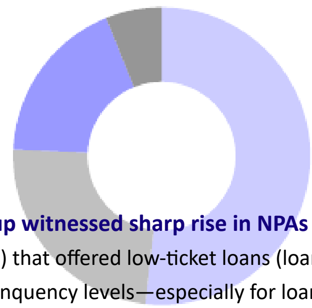
FY11 FY12 FY13 FY14 FY15 FY16E FY17E FY18E

Source: Company, MOSL

Source: Company, MOSL

GRUH also offers loans to developers for residential and commercial projects. These developer loans constitute a small percentage of the total loan book (3.6% in FY15), and asset quality has been impeccable in this segment with GNPA at zero.

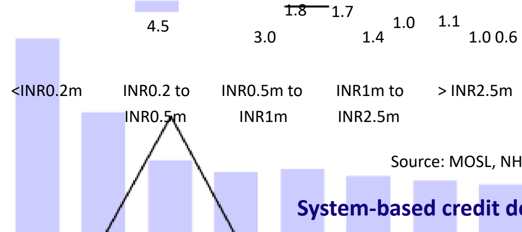




…but PSBs that lent to low income group witnessed sharp rise in NPAs

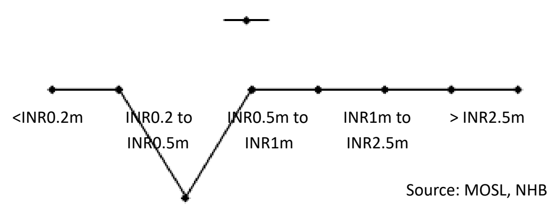
As per NHB data, Public Sector Banks (PSBs) that offered low-ticket loans (loans of <INR1m) witnessed a sharp increase in delinquency levels—especially for loans below INR0.2m. In fact, the delinquency levels increased with the decrease in the ticket size—higher NPAs in loans below INR0.2m and relatively lower NPA in case of loan above INR1m. As a result, PSBs increased focus on loans above INR2.5m and reduced disbursements in loans below INR1m to maintain asset quality.

Exhibit 53: NPA (%) in different loan segments for PSBs



Source: MOSL, NHB

Exhibit 54: Home loan disbursements (INR b) by PSBs



Source: MOSL, NHB

System-based credit decisions with lower LTVs aid asset quality

Loan approval process is decentralized at GRUH to increase efficiency and improve the turnaround time. However, loans beyond a certain limit are referred to the management committee for approval.

GRUH has also adopted a system-based credit sanction structure where the credit evaluation is done using a customized credit score model and human intervention is minimal. The model evaluates each individual applicant on various credit parameters, including income, assets, liabilities, savings, and asset creation tendencies. GRUH has set an interest rate band for each product within the model and a customer is offered an interest rate based on individual credit score.

Exhibit 55: 65% of cumulative disbursements at <75% LTV

>85%
3%

81% to 85%
15%

Exhibit 56: 70% of incremental disbursements at <75% LTV

81% to 85%
3%

>85%
0%

Upto 75%

76% to 80%
17%

Upto 75%
65%

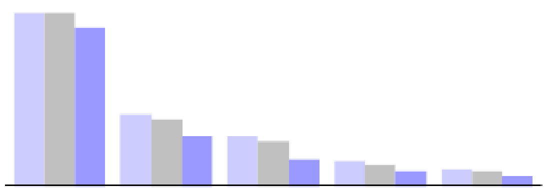
76% to 80%
27%

70%

Source: Company, MOSL

Source: Company, MOSL

Historically, 65% of the loans disbursed were at an LTV of <75%. However, in a sign of increasing conservatism, 70% loans disbursed in FY15 were at an LTV of less than 75%. Further, to maintain asset quality, the company follows conservative lending practices where it offers loans at lower LTVs (with average LTVs maintained below 60%).



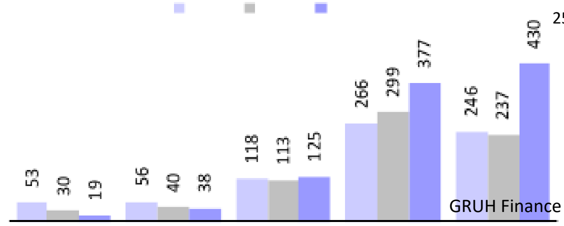


Exhibit 57: Average LTV maintained at ~60%

LTV (%)

FY10	FY11	FY12	FY13	FY14	FY15
60	60	58	57	55	59

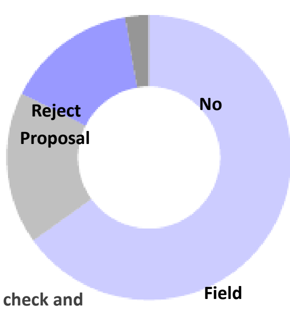
Source: Company, MOSL

Exhibit 58: Loan approval process

Referral Associates

Branch

Initial Screening:
23 parameter credit scoring model

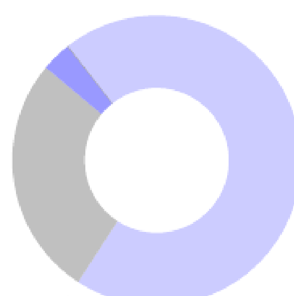


Reject Proposal

No

Favorable credit score?

Yes



Reference check and personal discussion

Field Investigation

Legal Verification

Technical Visit and verification of documents

Reject Proposal

No

Disbursal criteria met?

Yes

Disbursal

Source: Company, MOSL

Employees' incentives tied to asset quality

Credit evaluation, appraisal, documentation, servicing and recovery of loans are carried out by GRUH's experienced in-house employees. In order to reduce NPAs, incentive structure of branch employees is closely linked to the asset quality of the loans they approve and service. This ensures that the set norms of credit evaluation and appraisal are not diluted and similar standards are maintained across all branches.

Earnings to grow 26% CAGR over FY15-18E

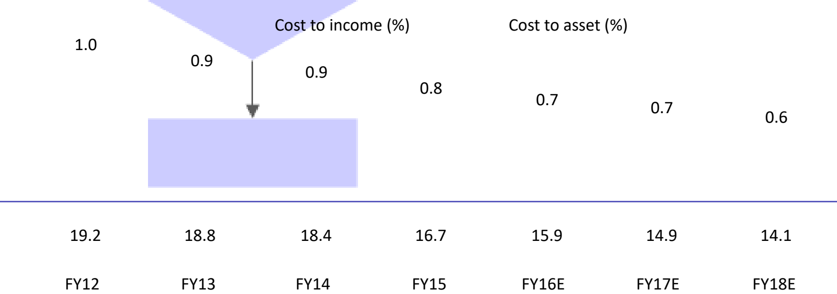
Low operating costs, steady margins and credit cost to drive earnings

GRUH's PAT is likely to grow at 26% CAGR over FY15-18E, on back of healthy loan growth (29%), low operating costs, stable margins and credit costs (<20bp over the next three years). We expect GRUH to report ROA/ROE of 2.4%/34% respectively by FY18E.

Lean operating cost structure

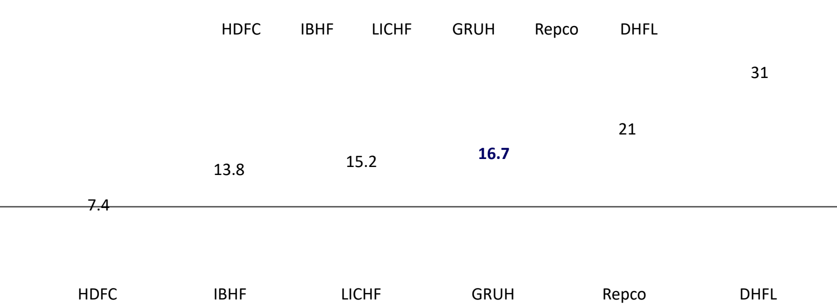
GRUH has maintained a low operating cost structure despite operating in the rural areas. The company has kept its operational costs at the minimal by using referral associates to source the business and efficient employee utilization. This has resulted in its cost-income ratio, which is in-line with large HFCs at 16.7% for FY15 (15.8% in 1QFY16).

Exhibit 59: CI ratio <20%; cost to asset <1%



Source: Company, MOSL

Exhibit 60: Cost to income comparable to large HFCs

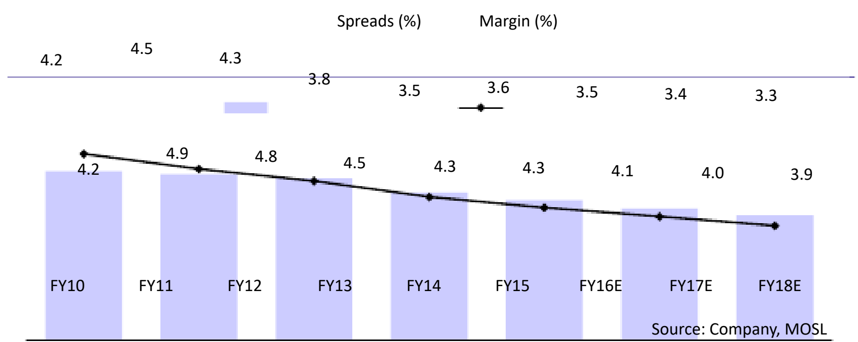


Source: Company, MOSL

Spreads/margin to remain at 3%+/4%+ respectively

GRUH's strong presence in underserved areas where competition is low imparts pricing power resulting in higher yields. Further, GRUH is able to borrow from markets at competitive rates due to its strong parentage and higher credit rating (AA+); it also avails cheaper financing from NHB through its various schemes, thus keeping its cost of funds low. This dual benefit has resulted in GRUH maintaining spreads and margins of 3%+and 4%+ respectively.

Exhibit 61: Spreads and margins sustained over 3% and 4% respectively

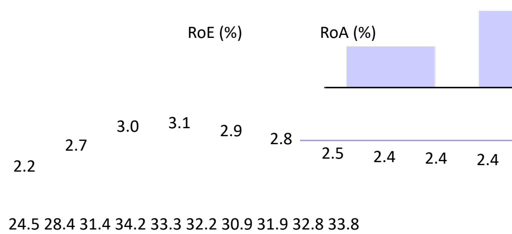


Source: Company, MOSL

Earnings to grow 26% CAGR, RoEs to expand to 34% by FY18E

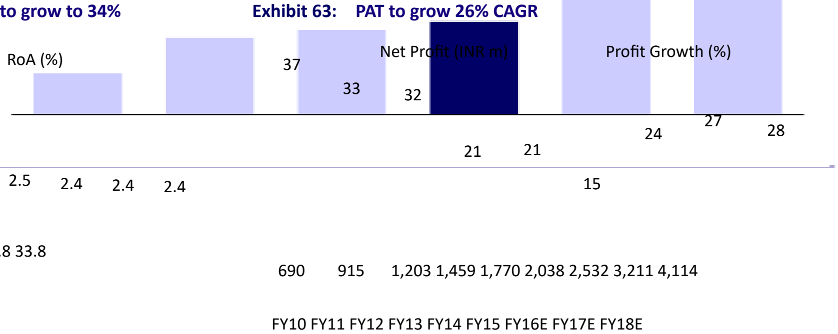
On back of strong pricing power, high credit ratings and access to cheap NHB refinancing, GRUH has been able to maintain 4%+ NIM. Lean operating costs and low credit costs (currently at lowest levels, expected to remain the same) have helped generate RoA of 2.4%. Given the niche business model and immense potential of scalability due to massive opportunity, GRUH will witness healthy earning and growth trajectory. We expect RoE to expand to 34% by FY18E.

Exhibit 62: RoA to remain at ~2.4%; RoE to grow to 34%

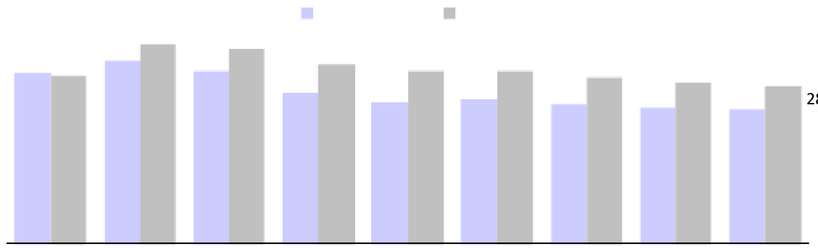


Source: Company, MOSL

Exhibit 63: PAT to grow 26% CAGR



Source: Company, MOSL

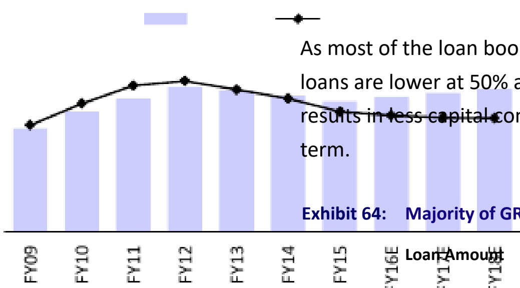


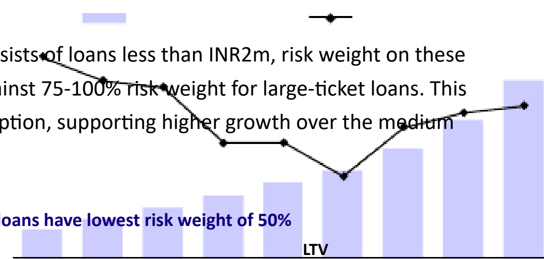
Well capitalized for sustained growth

Lower ticket size leads to lower risk weights

GRUH is adequately capitalized to post a 29% loan book CAGR

GRUH's capitalization levels are adequate (total CAR at 15.6% in 1QFY16) and most of the capital is in the form of Tier 1 capital (Tier 1 CAR: 14.1%). The company last raised equity via rights issue in 2006 and has since then maintained its capital levels via issuance of subordinated debt in small sizes and internal accruals. Tier II capital currently stands at 1.4% and can go up to 6.0%, providing ample room to raise subordinated debt without diluting shareholder stake.





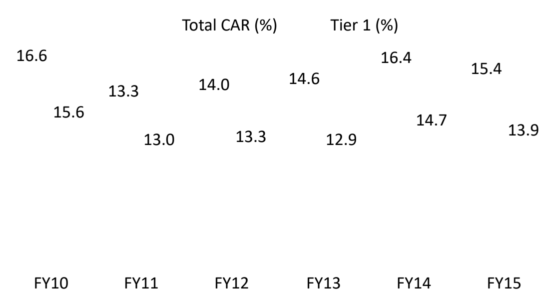
As most of the loan book consists of loans less than INR2m, risk weight on these loans are lower at 50% as against 75-100% risk weight for large-ticket loans. This results in less capital consumption, supporting higher growth over the medium term.

Exhibit 64: Majority of GRUH's loans have lowest risk weight of 50%

	LTV		
Loan Amount	**<75%**	**<80%**	**>80%**
Up to INR2m	50%	50%	50%
INR 2-7.5m	50%	50%	100%
Above INR7.5m	75%	100%	100%

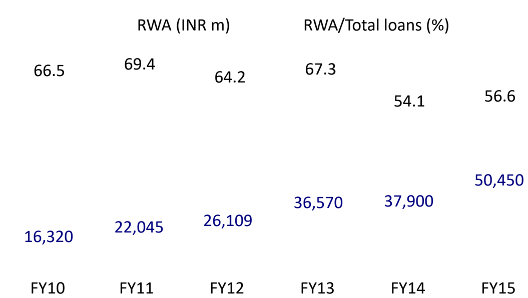
Source: MOSL, Company

Exhibit 65: Healthy capital adequacy ratio



Source: Company, MOSL

Exhibit 66: Lower RWA; leads to less capital consumption



Source: Company, MOSL

Consistent and sustainable performance

Consistency + Sustainability + Stability + Scalability = Premium valuation

- **Long track record of consistent operating/financial performance coupled with 30% RoEs have led to multiple re-rating from 3x to 8x**
- **Strong parentage, best in class returns ratios and immense potential of scalability will continue to drive premium valuations**

Superior and sustainable return ratios

GRUH commands significant premium over peers due to a) long track record of consistent financial/operating performance, b) immense potential of scalability due to massive opportunity in the segment, c) strong parentage of HDFC ltd., d) best-in-class return ratios (with 10-year average RoE/RoA of +28%/2.5% over the last decade), e) efficient use of capital (has not diluted in the last 10 years), and f) flawless execution—NPLs have never gone above 2%, not even during the worst of times.

Earnings CAGR at 28% over the past three years coupled with +30% RoEs has resulted in steady re-rating of the stock over the last three years, with its one-year forward book multiple expanding from 3x in FY11 to 8x in FY15. The fact that it has never raised capital since FY05 despite growing at CAGR of 27% over FY05-15 highlights the strength of the business model. Current valuations suggest strong market share gains and a long period of supernormal growth for the company. The current stock price discounts FY17E book value by 9x, making it the most expensive financial stock in the country. However, given the size of the opportunity, the market is factoring in continuous market share gains and consistent performance over the long term (as has been displayed in other HDFC group companies).

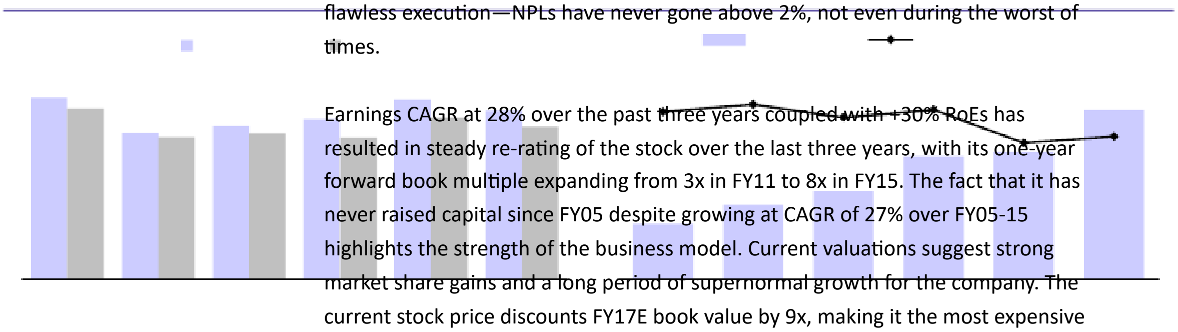
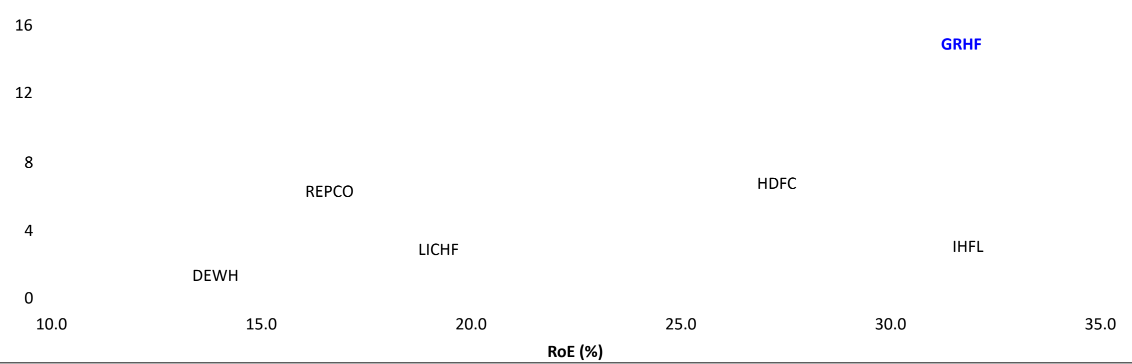


Exhibit 67: GRUH trades at a significant premium to other HFCs



Source: Company, MOSL

While it can easily be argued that GRUH is at the peak of its profitability, we believe that it could sustain for many years. The opportunity size for GRUH over the next 10 years is absolutely large, given the low levels of penetration outside West India and new possibilities emerging out of the thrust on affordable housing. Given its small size at INR93bn as of June 2015, we believe that the company can achieve 25% loan book CAGR over the next decade.

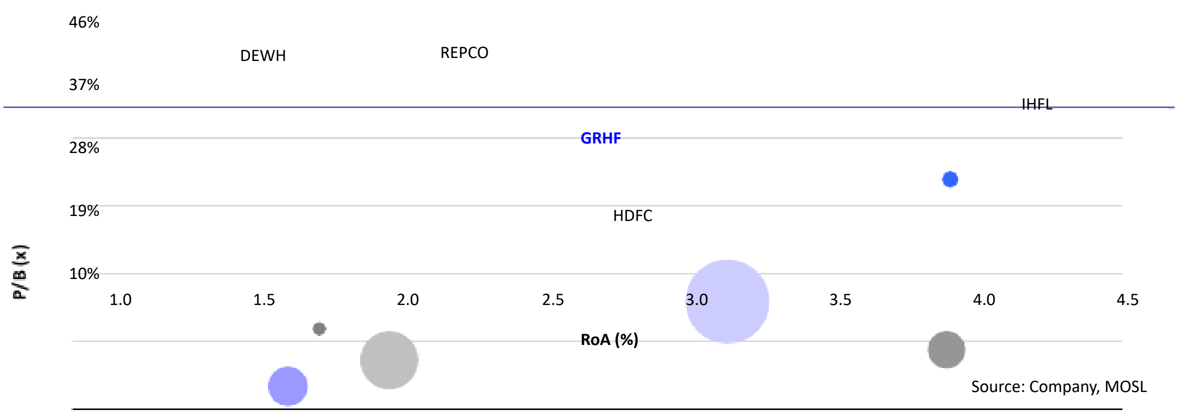
GRUH Finance

We value GRHF based on residual income model assuming earnings CAGR of 18% by FY35E, Rf=7.75%, β=0.71, risk premium of 5% and terminal growth rate of 5%. We expect GRHF's net profit to grow at CAGR of 26% over FY15-18E and RoEs to touch ~34% by FY18E.

Our assumptions for residual income model are highlighted in the exhibit 71 below. We have arrived at our FY18E target P/BV of 7.9x using the formula P/B = (ROE-g)/(Ke-g) where we assumed long term RoE of 18%, Ke of 12% and sustainable growth rate of 11% over the long term.

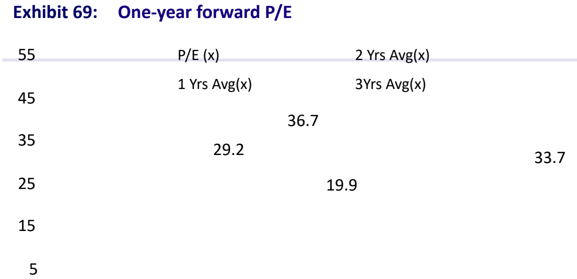
In our view GRHF would continue to trade at premium valuation- led by its niche business model, high capitalization, consistent execution, inherently high profitability with the ability to sustain return ratios, and minimal asset quality overhang (given a secured loan book). We assign **Buy** rating to the stock with target price of INR295.

Exhibit 68: Superior ROA and loan growth



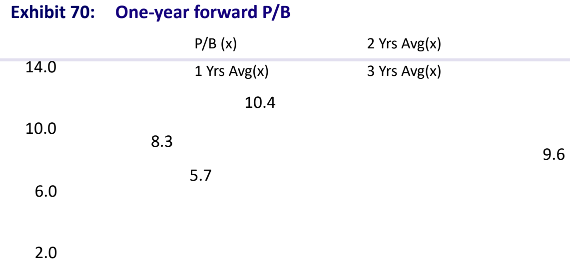
Source: Company, MOSL

Exhibit 69: One-year forward P/E



Source: Company, MOSL

Exhibit 70: One-year forward P/B

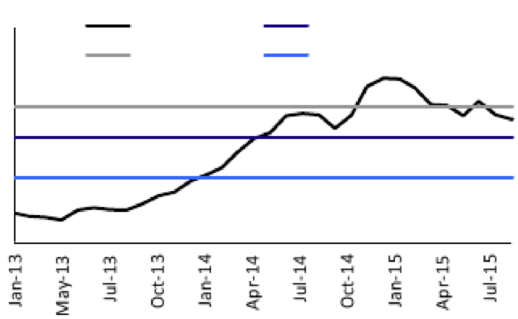


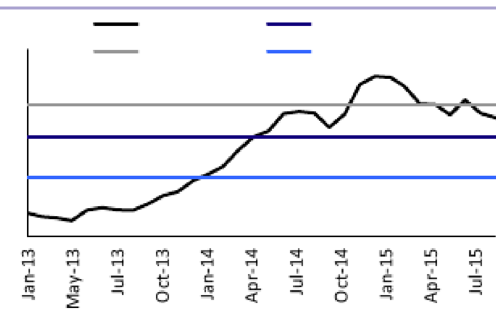
Source: Company, MOSL

Exhibit 71: Residual Income (INR Million)

	FY15	FY16E	FY17E	FY18E	FY19E	FY22E	FY23E	FY26E	FY27E	FY30E	FY31E	FY35E
Net Profit	2,038	2,532	3,211	4,118	5,148	10,055	12,066	20,849	23,977	36,466	40,112	58,728
% growth		24.3	26.8	28.3	25.0	25.0	20.0	20.0	15.0	15.0	10.0	10.0
EPS (A)	5.6	7.0	8.8	11.3	14.2	27.7	33.2	57.4	66.0	100.3	110.4	161.6
Dividend Payout (%)	35.7	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
BVPS	19.6	24.1	29.8	37.2	47.1	94.4	117.6	219.1	265.3	449.7	527.0	921.5
% growth		23.1	23.8	24.7	26.7	25.8	24.6	22.4	21.1	18.5	17.2	14.0
CoE*BVPS (B)		2.3	2.8	3.5	4.3	8.7	11.0	20.8	25.5	44.2	52.4	94.2
RoE (Avg. Equity) (%)		31.9	32.8	33.8	33.6	32.7	31.3	28.8	27.2	24.2	22.6	18.7
Residual Income (A-B)		4.7	6.0	7.9	9.8	18.9	22.2	36.5	40.5	56.1	58.0	67.4
% growth			28.6	30.3	25.2	24.5	17.3	18.4	10.8	11.9	3.3	4.2
Terminal Value (TV)												937.4
Discount Factor		0.94	0.84	0.75	0.67	0.48	0.43	0.31	0.28	0.20	0.18	0.12
PV of Residual Income		4.4	5.1	5.9	6.6	9.2	9.6	11.4	11.3	11.2	10.4	7.8
PV of Terminal Value												96.9
BV per share		19.6										
PV of Residual income		178.8										
Terminal Value		96.9										
TP (INR)		**295.3**										
Upside (%)		**27.3**										

Source: Company, MOSL





Company background

GRUH Finance (GRHF) was established in 1986 as Gujarat Rural Housing Finance Ltd and was promoted by HDFC and Aga Khan Fund for Economic Development (AKFED). The company commenced operations in 1988 from Ahmedabad and later became a subsidiary of HDFC in June 2000.

GRUH primarily provides home loans to individuals and families for purchase, construction, extension, repair and renovation. The company also offers loans to the self-employed segment and professionals for the purchase of office premises and developers. GRHF operates in a niche segment, catering to the lower-income group in rural and semi-urban areas. The company has diversified geographically and operates in eight Indian states through 162 branches.

The company relies on third-party channels, GRUH Referral Associates (GRAs), for sourcing majority of its business. GRAs only source loans while GRUH retains control over the credit, legal and technical appraisals. Business sourced through GRAs was 61% of the total disbursements made during FY15. GRUH also conducts outreach programs from its retail offices to potential taluka places. The outreach marketing program also serves as a centre for collecting installments besides providing enquiry handling, file opening and disbursement services.

Management details

GRUH's senior management comprises professionals who have significant experience in the housing finance industry. The average tenor of the company’s senior management is over 15 years. The team is led by Mr. Sudhin Choksey, who is the managing director since 2000. Other key personnel are Mr. Kamlesh Shah (executive director) and Jayesh Jain (CFO).

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Exhibit 72: Management Details

Name	Designation	Age	Education	
Mr. Keki Mistry	Non-executive Chairman	57	Chartered Accountant	Mr. Keki M. Mistry is the Vice Chairman & CEO of HDFC. He is a Fellow of the Institute of Chartered Accountants of India. Mr. Mistry serves as a director on the board of several companies, including HDFC Bank Limited, HDFC Standard Life Insurance Co. Ltd., HDFC Asset Management Company and Sun Pharma. He has been on the board of GRUH since 2000 and has been the chairman of the company since 2002.
Mr. Sudhin Choksey	CEO, Managing Director	57	Chartered Accountant	Mr. Sudhin Choksey, the managing director of GRUH, is a Fellow Member of the Institute of Chartered Accountants of India. He was appointed as the CEO of the company in 1998 and the managing director in 2000. He has been on the board of GRUH since May 1996. He has experience of handling functional areas of finance, commercial and general management both in India and abroad.
Mr. Kamlesh Shah	Executive Director	-	Chartered Accountant	Mr. Kamlesh Shah, the executive director of GRUH, is a Chartered Accountant from the Institute of Chartered Accountants of India. He has been employed with GRUH since 1990. He has experience of handling functional areas of operations, finance, human resources and administration. He is on the board of GRUH since 2010.
Ms. Renu Karnad	Non-executive Director	62	Masters in Economics	Ms. Renu Sud Karnad, the managing director of HDFC, holds a Master's degree in Economics from the University of Delhi and is a law graduate. She is a Parvin Fellow—Woodrow Wilson School of International Affairs, Princeton University, U.S.A. She has been employed with HDFC since 1978. She is responsible for the lending operations of HDFC. She is the chairperson of HDFC Property Ventures Ltd. She has been on the board of GRUH since 2000.
Mr. SM Palia	Independent Non-executive Director	76	Degree in Commerce, Law and and Banking	Mr. S.M. Palia is a development banker. He holds a degree in Commerce, Law Banking [CAIIB, CAIB London)] and has 25 years of experience with IBDI in various capacities. He retired as executive director of IDBI in 1989 and has been on the board of GRUH since 1993. He was the vice chairman of the company from 1993 to 2000 and appointed chairman of the company in January 2001 for one year.
Mr. Rohit Mehta	Independent Non-executive Director	84	Graduate in Law	Mr. Rohit C. Mehta is a prominent and successful industrialist possessing a wide and varied experience in the management of business and industry. He is a law graduate from the Bombay University. He has also been the president of FICCI. He is the Chairman of Torrent Cables Ltd. and has been on the board of GRUH since 1987. He was the chairman of the company from 1987 to 1998.
Mr. Prafull Anubhai	Independent Non-executive Director	76	B.Sc (Economics)	Mr. Prafull Anubhai is a corporate advisor. He is the chairman of the Board of Management of the Ahmedabad University. He has done his B.Sc. (Econ.) from the London School of Economics and attended PMD at Harvard Business School. He has 30 years of experience as the chief executive of textile manufacturing operations. He has been on the board of GRUH since 1987.
Mr. KG Krishnamurthy	Independent Non-executive Director	54	B.Tech, MBA	Mr. K.G. Krishnamurthy is the managing director & CEO of HDFC Property Ventures Limited (HPVL). Prior to that, he was employed with HDFC as Senior general manager—Technical Services. He is a graduate from IIT Kharagpur with a management degree from Jamnalal Bajaj Institute of Management, Mumbai. He has over two decades of experience in real estate. He has been on the board of GRUH since 2004.
Mr. SG Mankad	Independent Non-executive Director	67	IAS	Mr. S.G. Mankad, IAS (retd), holds a Masters in History from University of Delhi. He has served in various capacities both in the government of India and the state of Gujarat. His last assignment was as chief secretary, Govt. of Gujarat. He is on the board of GRUH since 2010.
Mr. Biswamohan Mahapatra	Independent Non-executive Director	-	MSM, MBA, MA	Mr. Biswamohan Mahapatra was a career central banker, over 33 years in RBI. In RBI, he worked in various capacities and retired as executive director in 2014. He holds a Master of Science in Management (MSM) degree from Arthur D. Little Management Institute, Cambridge, USA, MBA from University of Delhi, Master of Arts from JNU, Delhi.

Source: Company, MOSL

Key risks

Regulatory risk

Regulatory changes such as increase in risk weights and cap on the interest spread under refinancing schemes can also impact the company. A change in the terms and eligibility conditions of refinancing schemes can also adversely impact margins. Adverse regulatory changes will have a negative impact on growth and profitability of the company.

Concentrated borrowing profile

NHB's refinancing and bank borrowings constitute almost all of GRUHs' total borrowings. The remaining borrowing needs are fulfilled by other sources such as public deposits. Strong future growth would require higher borrowings and proportion of NHB refinancing may decline, thus forcing GRUH to tap other sources of borrowings such as NCDs and public deposits.

Rich valuations leave little room for earnings deviation from the current trajectory

GRUH derives such rich multiples due to ~30% earnings CAGR expectations over the medium term (approx. 10 years). In case any of the above-mentioned risks materialize, earnings may disappoint and we could see meaningful value erosion.

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Financials and valuations

Income Statement (INR Million)

Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Interest Income	3,410	4,856	6,181	8,130	10,211	12,860	16,481	21,251
Interest Expended	2,009	3,101	4,044	5,436	6,777	8,646	11,203	14,530
Net Interest Income	**1,401**	**1,755**	**2,137**	**2,694**	**3,433**	**4,213**	**5,277**	**6,720**
Change (%)	46.5	25.3	21.8	26.1	27.4	22.7	25.3	27.3
Fee Income	143	172	223	271	331	440	575	704
Other operating income	45	55	78	53	58	63	68	73
Other Income	15	59	23	7	4	4	5	5
Net Income	**1,604**	**2,041**	**2,460**	**3,025**	**3,826**	**4,720**	**5,924**	**7,502**
Change (%)	24.4	27.3	20.5	23.0	26.5	23.4	25.5	26.6
Operating Expenses	320	392	463	556	640	767	926	1,118
Operating Income	**1,283**	**1,650**	**1,997**	**2,469**	**3,186**	**3,953**	**4,998**	**6,384**
Change (%)	24.0	28.6	21.1	23.6	29.0	24.1	26.4	27.7
Provisions/write offs	27	22	29	24	177	213	255	300
PBT	**1,256**	**1,628**	**1,968**	**2,445**	**3,008**	**3,740**	**4,743**	**6,083**
Tax	341	424	509	675	970	1,208	1,532	1,965
Tax Rate (%)	27.1	26.1	25.9	27.6	32.3	32.3	32.3	32.3
PAT	**915**	**1,203**	**1,459**	**1,770**	**2,038**	**2,532**	**3,211**	**4,118**
Change (%)	32.7	31.5	21.2	21.3	15.2	24.3	26.8	28.3
Proposed Dividend	450	472	522	632	875	889	1,127	1,446

Balance sheet (INR Million)

Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Capital	352	353	357	360	727	727	727	727
Reserves & Surplus	2,828	3,503	4,553	5,712	6,388	8,032	10,115	12,788
Net Worth	**3,179**	**3,856**	**4,910**	**6,072**	**7,115**	**8,758**	**10,842**	**13,515**
Secured Loans	**29,622**	**38,293**	**49,115**	**64,439**	**82,072**	**106,919**	**139,309**	**180,041**
Change (%)	27.5	29.3	28.3	31.2	27.4	30.3	30.3	29.2
Total Liabilities	**32,801**	**42,148**	**54,025**	**70,512**	**89,187**	**115,678**	**150,151**	**193,556**
Cash and bank balance	1,237	1,695	221	832	741	1,484	2,122	2,185
Investments	347	244	651	530	798	878	922	968
Change (%)	5.9	-29.5	166.6	-18.7	50.7	10.0	5.0	5.0
Loans	**31,768**	**40,668**	**54,378**	**70,090**	**89,154**	**114,967**	**148,993**	**192,557**
Change (%)	29.5	28.0	33.7	28.9	27.2	29.0	29.6	29.2
Net Fixed Assets	122	116	118	110	137	137	137	137
Other Assets	-673	-575	-1,344	-1,050	-1,643	-1,788	-2,024	-2,291
Total Assets	**32,801**	**42,148**	**54,025**	**70,512**	**89,187**	**115,678**	**150,151**	**193,556**

Assumptions (%)

	2011	2012	2013	2014	2015	2016E	2017E	2018E
Loan Growth	29.5	28.0	33.7	28.9	27.2	29.0	29.6	29.2
Borrowings Growth	27.5	29.3	28.3	31.2	27.4	30.3	30.3	29.2
Investments Growth	5.9	-29.5	166.6	-18.7	50.7	10.0	5.0	5.0
Dividend	2.2	2.3	2.5	1.5	2.0	2.1	2.7	3.4

E: MOSL Estimates

Financials and valuations

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Ratios

Y/E March	2011	2012	2013	2014	2015	2016E	2017E	2018E
Spreads Analysis (%)								
Avg. Yield on Earning Assets	11.7	13.0	12.9	13.1	12.8	12.6	12.4	12.4
Avg. Cost-Int. Bear. Liab.	7.6	9.1	9.3	9.6	9.3	9.2	9.1	9.1
Interest Spread	4.1	3.9	3.6	3.5	3.6	3.4	3.3	3.3
Net Interest Margin	4.8	4.7	4.5	4.3	4.3	4.1	4.0	3.9
Profitability Ratios (%)								
RoAE	31.4	34.2	33.3	32.2	30.9	31.9	32.8	33.8
RoAA	3.0	3.1	2.9	2.8	2.5	2.4	2.4	2.4
Int. Expended/Int.Earned	58.9	63.9	65.4	66.9	66.4	67.2	68.0	68.4
Other Inc./Net Income	0.9	2.9	0.9	0.2	0.1	0.1	0.1	0.1
Efficiency Ratios (%)								
Fees/Operating income	4.1	3.5	3.6	3.3	3.2	3.3	3.4	3.2
Op. Exps./Net Income	20.0	19.2	18.8	18.4	16.7	16.2	15.6	14.9
Empl. Cost/Op. Exps.	49.1	50.2	50.6	57.0	55.0	55.1	55.2	55.3
Asset-Liability Profile (%)								
Loans/Borrowings Ratio	107.2	106.2	110.7	108.8	108.6	107.5	107.0	107.0
Debt/Equity (x)	9.3	9.9	10.0	10.6	11.5	12.2	12.8	13.3
Gross NPAs	259	211	176	189	251	295	353	427
Gross NPAs to Adv.	0.8	0.5	0.3	0.3	0.3	0.3	0.2	0.2
Net NPAs	-21	-184	27	0	0	0	0	0
Net NPAs to Adv.	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Valuation								
Book Value (INR)	9.0	10.9	13.8	16.9	19.6	24.1	29.8	37.2
Price-BV (x)	12.8	10.6	8.4	6.9	11.8	9.6	7.8	6.2
Adjusted BV (INR)	9.1	11.3	13.7	16.9	19.6	24.1	29.8	37.2
Price-ABV (x)	12.8	10.3	8.5	6.9	11.8	9.6	7.8	6.2
EPS (INR)	2.6	3.4	4.1	4.9	5.6	7.0	8.8	11.3
EPS Growth (%)	31.1	31.0	19.9	20.2	14.2	24.3	26.8	28.3
Price-Earnings (x)	44.6	34.0	28.4	23.6	41.4	33.3	26.3	20.5
OPS (INR)	3.6	4.7	5.6	6.9	8.8	10.9	13.8	17.6
OPS Growth (%)	22.5	28.0	19.7	22.5	27.9	24.1	26.4	27.7
Price-OP (x)	31.8	24.8	20.7	16.9	26.5	21.3	16.9	13.2

E: MOSL Estimates

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