GRUH FINANCE LIMITED

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Rating

ICRA has assigned an LAA+ (pronounced as L double A plus) rating to the Rs. 3 billion Non-Convertible Debenture Programme of GRUH Finance Limited (GRUH). ICRA has also reaffirmed its LAA+ ratings to GRUH's NCD programme. This is the high-credit -quality rating assigned by ICRA. The rated instrument carries low credit risk. These ratings carry a stable outlook.

ICRA has also reaffirmed its MAA+ (pronounced as M double A plus) rating to the Fixed Deposit Programme of GRUH. This rating is the high-credit-quality rating assigned by ICRA. The rated deposits programme carries low credit risk.

(Please refer to the annexure for the rating history)

Key Financial Indicators

	31.03.2008	31.03.2007	31.03.2006
Equity Capital	346	346	265
Net Worth (Reported)	1,903	1642	869
Total Loans	17,696	13,766	10,691
Total Assets	20,181	15191	12013
Total Income	2,042	1460	1,031
Net Interest Income	672	469	320.
Profit Before Tax (PBT) (reported)	593	370	262
Profit After Tax (PAT) (reported)	423	296	217
Interest income / ATA [1]	10.65%	9.77%	8.75%
Cost of average interest bearing funds	7.79%	7.14%	6.44%
Total Operating Income net of interest expenses/ ATA	4.70%	4.40%	3.89%
Expenses/ATA (%)	1.15%	1.14%	1.06%
Prov. & Charge offs / ATA	0.20%	0.55%	0.42%
PAT / ATA	2.39%	2.18%	2.03%
PAT / Reported Net Worth	23.89%	23.52%	27.04%
Cost to Income Ratio	24%	26%	27%
Dividend/PAT (reported) (%)	38%	41%	31%
Dividend rate (%)	40%	30%	25%
Total Debt/Net Worth (reported) times	9.32	7.95	12.43
Capital / Risk weighted Assets	18.15%	16.31%	14.25%
Tier I capital	15.45%	13.03%	9.61%

Note: Amount in Rs. million

Website:
www.icra.in

[1] *Calculated as (Total assets excluding current liabilities for current year + Total Assets excluding current liabilities for previous year)/2*

Credit Strengths

- Availability of funding and liquidity support and inputs for formulation of overall strategy from its strong promoter, HDFC
- Sound franchise and brand image in rural parts of Western India (Gujarat and Maharashtra) helps mobilise deposits and expand the home loan portfolio
- Strong focus on recoveries helps maintain the asset quality

Credit Challenges

- Maintenance of the asset quality in light of the growing assessed income portfolio and builder loans
- Management of asset-liability mismatches in the short-to-medium term, although refinance risk remains relatively low
- Protection of profitability, which is largely dependent on interest income with limited contribution from fee-based activities

Rating Rationale

The ratings factor in GRUH's strong parentage (being a subsidiary of HDFC, rated LAAA, MAAA and A1+ for its various debt instruments by ICRA) and its sound network in Western India. The ratings also take into account the ability of the company to maintain its superior earnings and control its asset quality while also growing its loan book by expanding its geographical reach. GRUH's portfolio typically consists of 'small ticket[2]' loans spread across the rural and semi-urban regions of Western India, where the yields are relatively higher than the higher ticket loans in urban regions. GRUH has maintained a low level of NPAs (Gross NPA% of 1.39% as on September 2008).

ICRA has taken note of the increase in the proportion of loans extended to self-employed professionals (33% of the total portfolio as on March 31, 2008 as against 27% for the previous year) and builder loans (4% of the total loans as on March 31, 2008), thereby making GRUH more vulnerable to issues related to asset quality, as the inherent risks associated with these segments are higher. Nevertheless, these risks are partially mitigated by GRUH's stricter lending norms (for builder segment); completely in-house appraisal and recovery and well-established systems. Any further increase in the interest rates and possible correction in the property prices may have an impact on the demand for home loans in 2008-09, thereby resulting in a decline in disbursements for GRUH. Further, with the rise in its cost of funds, the company has reset the interest rates on its existing home loans. This may have an impact on delinquencies in case the increased EMIs affect the cash flows of customers.

ICRA also draws comfort from the adequate capitalisation levels of GRUH, with Tier 1 capital at 15.46% and net worth in relation to assets at 9.43% as on March 31, 2008. In light of the internal capital generation and sufficient headroom available to raise Tier II capital, GRUH is not likely to face any pressures on the capital front to fund its future growth. GRUH has funded relatively long-term assets through shorter-term borrowings, thus resulting in asset liability mismatches in the short to medium term. Nevertheless, ICRA expects the liquidity of GRUH to remain comfortable in the short to medium term on the back of its strong ownership and availability of diverse funding sources.

Company Profile

GRUH is an established housing finance company [HFC] with a loan portfolio of Rs. 17.70 billion as on March 31, 2008. HDFC is the largest shareholder in GRUH with a stake of 61.5% as on September 30, 2008. While GRUH continues to operate as an independent entity, the high parental shareholding translates into strong management and strategic inputs from HDFC. Moreover, HDFC's top management has a significant presence in GRUH's Board of Directors. The company's corporate office is located in Ahmedabad and the company has a distribution network of 87 retail offices across 7 states. For the six months ended September 30, 2008, GRUH reported a net profit of Rs. 159.9 million as against Rs. 117.4 million for the previous year, registering a growth of 36%. The total loan portfolio of the company stood at Rs. 20.14 billion as on September 30, 2008. GRUH reported a gross NPA% of 1.39% as on September 30, 2008 as compared to 2.26% as on September 30, 2007.

[2] *GRUH's average ticket size was Rs. 0.56 million as on March 31, 2008*

Recent Results

For the half year ended September 30, 2008, GRUH has reported an 18% increase in NII which coupled with 25% growth in other income based income and lower provisioning has resulted in a 36% increase in its net profits. The company has reported a 66% growth in disbursements to Rs. 4.19 billion for the six months ended September 30, 2008 from Rs. 2.53 billion for the six months ended September 30, 2007. GRUH's outstanding portfolio has grown by 33% to Rs. 20.14 billion in H1 FY 08. There has been an improvement in the asset quality indicators of the company, with gross NPA declining to 1.39% as on September 30, 2008 from 2.26% as on September 30, 2007.

Table 1: H1 FY 09 Results

	Q2 FY 09	Q2 FY 08	Growth y-o-y	H1 FY 09	H1 FY 08	Growth y-o-y	2007-08
Interest Income	609.1	416.0	46%	1,166.70	823.6	42%	1882.9
Interest Expended	467.7	288.7	62%	859.60	563.5	53%	1216.7
Net Interest Income	141.4	127.3	11%	307.10	260.1	18%	666.2
Other Income	50.5	24.3	108%	85.90	54.8	57%	149.1
Total Income	191.9	151.6	27%	393.00	314.9	25%	815.3
Other Operating Expenses	54.8	43.1	27%	101.20	84.0	20%	179.4
Operating Profit	137.1	108.5	26%	291.80	230.9	26%	635.9
Prov. Towards NPA's	16.8	19.8	-15%	48.40	67.0	-28%	43.3
PBT	120.3	88.7	36%	243.40	163.9	49%	592.6
Current Tax	38.2	21.7	76%	83.50	46.5	80%	169.2
PAT	82.1	67.0	23%	159.90	117.4	36%	423.4

Note: Amount in Rs. Million; Q2: Second Quarter; H1: First Half; y-o-y: year- on- year

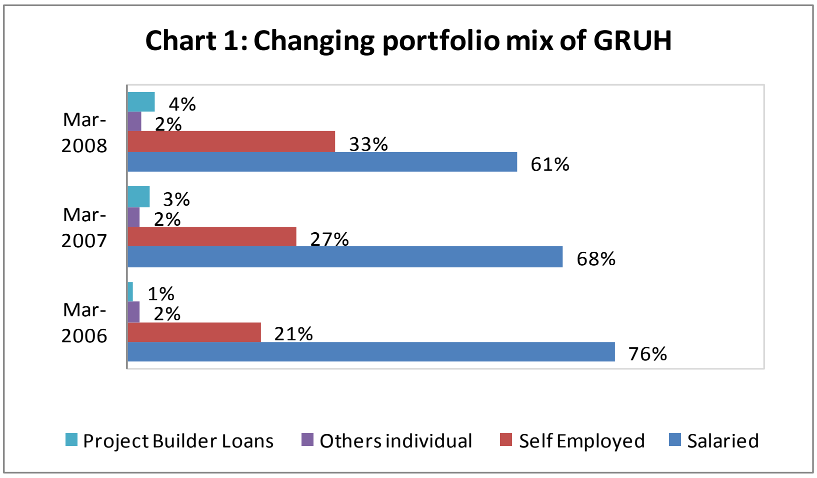
Credit Perspective

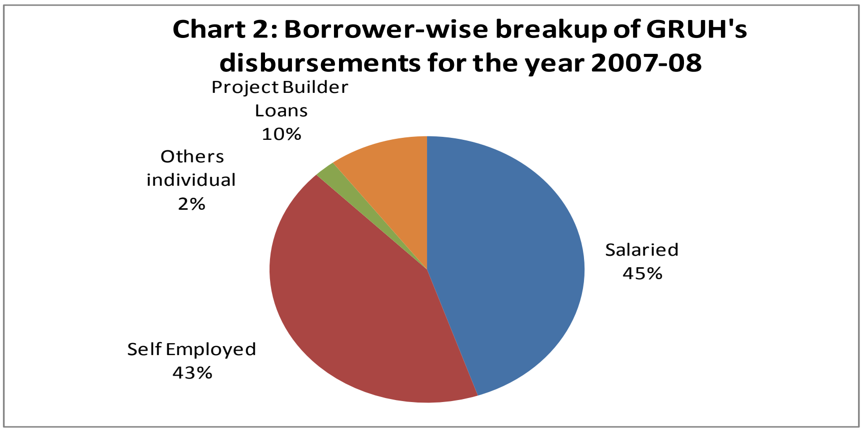
Stable shareholding pattern with strong parental support from HDFC

ICRA derives significant comfort from GRUH's status as a subsidiary of HDFC (rated LAAA, MAAA and A1+ for its various debt instruments by ICRA), which holds an equity stake of 61.5% as on September 30, 2008. While GRUH operates as an independent entity, it continues to receive management as well as funding support from HDFC. HDFC has provided funding support to GRUH primarily through loan buy-outs, thereby bolstering its capital adequacy levels. In 2003-04, HDFC directly subscribed to GRUH's Rs. 100 million tier II bonds. With HDFC as its parent, GRUH has been able to access funds at competitive rates from banks as well as the debt market (through issue of debentures).

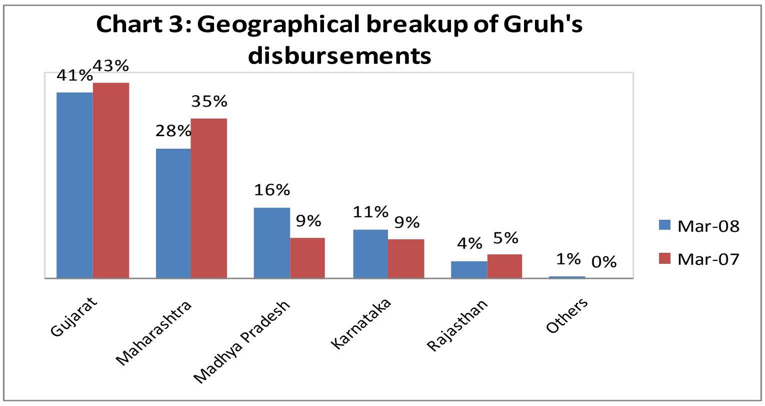
Portfolio shift towards self-employed and builder loans

GRUH's portfolio has gone up to 17.70 billion as on March 31, 2008 from Rs. 13.77 billion as on March 31, 2007 at a growth of 29 % as compared to 24% achieved by other HFCs. GRUH's loan exposure is characterised by middle income borrowers, relatively low-ticket size, and comfortable LCR (Loan to Cost Ratio). There has been a decline in the loans extended to salaried individuals to 61% of the total portfolio as on March 31, 2008 as compared to 68% as on March 31, 2007. This is because the company is focussing on tapping the unmet demand of the self-employed segment, whose proportion has increased to 33% as on March 31, 2008 from 27% as on March 31, 2007. The company plans to maintain its focus on the self-employed segment, as its yields are relatively higher than the salaried segment. In case of self employed segment, the company also relies on assessed income in order to determine the borrowing capacity. This assessment was started about five years back but the portfolio is yet to see a complete cycle. Hence, the impact of such assessments on asset quality is yet to be seen.





In 2006-07, GRUH started expanding its builder loan portfolio, which increased to Rs 0.75 billion as on March 31, 2008 from Rs. 0.45 billion as on March 31, 2007. Currently, this segment constitutes only 4% of the total portfolio. The company plans to build its builder loan portfolio gradually, as its yields are higher by 200 – 300 bps. The inherent risks in these high-yielding segments are higher. Nevertheless, the risks are likely to be mitigated by the cautious approach adopted by GRUH with respect to large ticket loans.



In terms of geographies, GRUH is primarily concentrated in Gujarat (47% of total non-builder portfolio as on March 31, 2008) and Maharashtra (35%). Incrementally, these contributed to 69% of disbursements in 2007-08 as against 77% in 2006-07, with the balance coming from the other states like Madhya Pradesh, Karnataka, Rajasthan, Tamil Nadu and Chhattisgarh. These states contributed to 31% of disbursements in 2007-08 as against 23% the previous year. The company currently has around 87 branches out of which 7 were opened in the current year. Since the socio-economic patterns in these states are largely similar to those in the ones that GRUH currently operates, its expansion risks are relatively low. GRUH continues to maintain lending rates higher than those offered by leading players in metropolitan cities.

Incrementally, the growth of the company is expected to be driven by better yielding self-employed and builder segments. GRUH's ability to maintain strict control over the asset quality in these segments would remain critical. GRUH's stricter lending norms (for builder segment); completely in-house appraisal and recovery and well-established systems are expected to help the company control its asset quality.

GRUH has been sourcing retail business through third-party channels by appointment of GRUH Referral Associates (GRA). GRAs only source loans while GRUH retains control over the credit, legal and technical appraisals. About 62% of the total disbursements in 2007-08 were sourced through these GRAs. GRUH continues to maintain lending rates higher than those offered by leading HFCs in metropolitan cities. ICRA expects the company to grow at a moderate pace on the strength of its rural network, geographical expansion and increased disbursements to self-employed professionals.

Table 2: Portfolio Characteristics

	Mar-08	**Mar-07**	**Mar-06**
Average Ticket Size (portfolio basis) Rs million	0.56	0.51	0.44
Proportion of floating rate loans	93%	89%	83%
% portfolio at more than 80% LCR	32%	36%	39%
% portfolio at greater than 20 years residual maturity	3%	NA	NA
% portfolio at Instalment to Income ratio of more than 40%	24%	31%	20%
Prepayments %	9.56%	7.89%	7.79%

Delinquencies could rise in future

Table 3: Asset quality of GRUH

	Mar-08	**Mar-07**	**Mar-06**
Gross NPA	197	188	159
Provisions required as per NHB norms	39	37	31
Excess Provisions	159	151	103
Total NPA provisions carried on books	198	188	134
Net NPA	0	0	25
Gross NPA %	1.12%	1.36%	1.48%
Net NPA %	0%	0%	0.23%
Net NPA/ Net worth	0%	0%	2.87%

Note: Amount in Rs. million

The gross NPA of GRUH reduced to 1.12% as on March 31, 2008 from 1.36% as on March 31, 2007. The company continues to maintain excess provisions, resulting in zero net NPA position as on March 31, 2008. With increase in EMIs on existing loans and rise in inflation, the borrowing capacity of these borrowers is likely to decline, thereby resulting in a rise in delinquencies for the company in FY 09. In addition, the concentration risk of the company is expected to increase along with increase in larger-ticket builder loans. Any slippage in this segment could result in deterioration in the asset quality indicators of the company. Nevertheless, GRUH is likely to partially mitigate its concentration risk with the help of its strong monitoring and recovery systems.

Adequate capitalisation levels

With the change in risk weightages on housing loans of less than Rs. 2 million from 75% to 50% with effect from July 2007, the risk weighted assets for GRUH reduced by 3% despite an increase of 29% in the loan portfolio in 2007-08. However, with growth in its loan portfolio, its net worth in relation to total assets declined to 9.43% as on March 31, 2008 from 10.81% as on March 31, 2007 while its gearing increased to 9.32 times from 7.95 times along the same period. From a regulatory capital point of view, GRUH has adequate capitalisation levels with a Tier I% of 15.46% as on March 31, 2008 (CAR of 18.15% as on March 31, 2008). The strong Tier I capital and adequate internal capital generation give GRUH sufficient scope to raise Tier II capital. ICRA does not envisage capital to be a constraining factor for GRUH to fund its future growth.

Table 4: Capital Adequacy of GRUH

	Mar-08	Mar-07	Mar-06
Loans & Advances	17696.1	13765.9	10691
% growth	29%	29%	31%
Total RWA	11887.8	12212.98	9044
% growth	-3%	35%	83%
Tier I	15.46%	13.03%	9.61%
Tier II	2.69%	3.28%	4.64%
CRAR	18.15%	16.31%	14.25%
Net worth as % of total assets	9.43%	10.8%	7.2%

Note: Amount in Rs million.

Liquidity expected to remain comfortable; interest rate risk remains relatively low

As in the case of all housing finance companies, GRUH has funded relatively long-term assets through shorter-term borrowings, resulting in asset liability mismatches in the short to medium term. However, any liquidity risk is mitigated by its low refinancing risk, considering the company's financial flexibility and access to diverse funding sources. As for interest rate risk, its liabilities are likely to get repriced faster than its assets, thereby exposing its earnings in a rising interest rate scenario. The capacity of the company to pass on any further hikes in interest rates to its end customers may be constrained if the customers are unable to pay increased EMIs as a result of such interest rate hikes. Nevertheless, a substantial proportion of variable rate assets (93% of total loans) and its demonstrated capability to increase its lending yields are mitigants against loss of earnings on this account.

Shift in borrowings towards short-term funds in order to maintain competitive cost of funds

Table 5: Borrowing Mix of GRUH

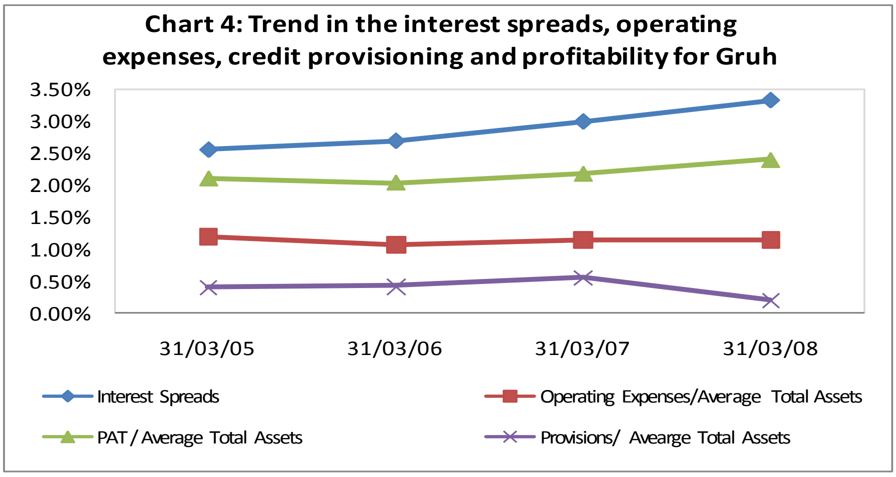
	Mar-08	%share	Mar-07	% share	Mar-06	% share
Bank borrowings	8,967	50%	6850	53%	4383	40%
NCD	1,600	9%	2250	17%	850	8%
Subordinated NCD	400	2%	500	4%	500	5%
NHB Refinancing	1,899	11%	2273	17%	3609	33%
Fixed deposits	1,865	11%	1179	9%	959	9%
Commercial Paper	3,000	17%	0	0%	500	5%
Total	17,730	100%	13052	100%	10800	100%
Average cost of funds	7.79%		7.14%		6.44%	

Note: Amount in Rs million.

With the rise in interest rates, the cost of funds for GRUH also rose to 7.79% in 2007-08 from 7.14% in 2006-07. GRUH has access to diverse funding sources, with bank borrowings forming the major source of funding (51% of total borrowings as on March 31, 2008). In order to manage its borrowing cost more efficiently, the company has been trying to replace its short-term bank borrowings with commercial papers. About 51% of its fresh borrowings in 2007-08 were in the form of commercial papers as against 26% in 2006-07. Consequently, the proportion of commercial paper borrowings in the total borrowings for GRUH increased to 17% as on March 31, 2008. As there are small mismatches in its asset liability profile in the short term, its cost of funds is expected to rise significantly, resulting in a pressure on spreads in 2008-09. Nevertheless, the refinancing risk of the company is low, considering its healthy financial flexibility and track record in servicing liabilities.

Superior earnings could decline from current levels over the medium term

GRUH continues to maintain profitability (profit after tax as % of average assets deployed) of over 2% on the strength of healthy interest spreads, low operating expenses and a moderate level of credit provisions.



Its credit provisions in relation to average total assets reduced to 0.20% in 2007-08 from 0.55% in 2006-07. This is because its excess provisions in 2006-07 were sufficient to cover the incremental NPAs as well, thus resulting in lower provision requirement in 2007-08. However, in light of the change in the asset mix and deterioration in the operating environment, its credit provisioning requirement could increase in the short to medium term; however the excess provisions being carried by GRUH could mitigate the impact on the profitability. Its yield on advances increased by 110 bps to 11.97% as on March 31, 2008 from 10.87% as on March 31, 2007 while its cost of funds increased by 65 bps, thus resulting in an increase in its overall spreads to 3.32% from 2.99% along the same period. This trend is unlikely to continue and there might be some compression in its interest spreads over the medium term. Even at the reduced levels, its profitability is likely to remain comparable to similarly rated HFCs. GRUH reported a PAT[3] of Rs. 423 million over an asset base of Rs. 20181 million as on March 31, 2008. In H1 FY 09, GRUH reported a net profit of Rs. 159.9 million as against Rs. 117.4 million in H1 FY 08, registering a growth of 36%.

September 2008

[3] *PAT: Profit After Tax*

Annexure 1: Rating History

	Amount Outstanding [as on 31.03.2008] (in Rs. million)	Maturity Date	Rating Outstanding	Previous Ratings	
			September 2008	September 2007	September 2006
Rs. 3 billion debenture programme	-	Yet to be placed	LAA+ (stable)		
Rs. 3 billion debenture programme	500	October 2012	LAA+ (stable)	LAA+ (stable)	
Rs. 2 billion debenture programme	1100	September 2012	LAA+ (stable)	LAA+ (stable)	LAA+ (stable)
Rs. 2 billion debenture programme	400	February 2013	LAA+ (stable)	LAA+ (stable)	LAA+ (stable)
Fixed Deposit Programme	1861	-	MAA+	MAA+	MAA+

Annexure 2: Past Financials

Rs. million	Mar-08	Mar-07	Mar-06
Interest Income	1,883	1,329	934
Interest Expenses	1,211	860	614
Net Interest Income	672	468	320
Fee Based income	159	130	95
Total Net Income	831	599	415
Operating expenses	203	154	113
Operating Profits	629	444	302
Provisions / write offs (net of recovery)	36	75	45
Operating profits (post provisions)	593	370	258
Subvention money / sale from investments	-	-	1
PBT	593	370	259
Tax	182	89	63
deferred tax	(13)	(15)	(21)
PAT	423	296	217
Dividend (including tax on dividend)	162	121	76
Liabilities			
Equity	346	346	265
Net Reserves	1,556	1,296	604
Net Worth	1,903	1,642	869
Borrowings (including interest accrued but not due)	17,869	13,218	10,890
Other Liabilities	409	330	241
Total Liabilities	20,181	15,191	12,000
Assets			
Home Loans- self employed	5775	3651	2233
Home loans to Salaried	10810	9403	8166
Loans to other Individuals	359	256	197
Loans to Developers	752	456	95
Investments	166	175	231
Current assets	2,319	1,250	1,077
Total Assets	20,181	15,191	12,000

	Mar-08	Mar-07	Mar-06
% increase			
Interest Income	42%	42%	28%
Interest Expenses	41%	40%	22%
Net Interest Income	44%	46%	41%
Fee Based income	22%	36%	7%
Total Income	39%	44%	31%
Operating expenses	31%	37%	19%
Operating Profits	42%	47%	36%
Provisions / write offs	-52%[Ψ]	67%	38%
Operating profits (post provisions)	60%	43%	36%
PBT	60%	43%	25%
Tax	104%	41%	22%
PAT	43%	36%	30%
Dividend	33%	61%	19%
Liabilities			
Equity	0%	31%	0%
Net Reserves	20%	115%	29%
Net Worth	16%	89%	18%
Borrowings (including interest accrued but not due)	35%	21%	33%
Other Liabilities	24%	37%	-45%
Total Liabilities	33%	27%	28%
Assets			
Home loans	27%	26%	31%
Other Loans	56%	144%	22%
Investments	-5%	-24%	6%
Current assets	85%	16%	12%
Total Assets	33%	27%	28%

[Ψ] GRUH had NPA provisions of Rs. 197 million as on March 31, 2008 as against a regulatory requirement of Rs. 39 million. Thus, the incremental provisions in 2007-08 have been lower than those in 2006-07.

In Rs. million	Mar-08	Mar-07	Mar-06
Interest Bearing Assets	19,249	14,654	11,592
Interest Bearing Liabilities	17,869	13,218	10,890
Average Total Assets	17,686	13,595	10,674
Yield on advances	11.97%	10.87%	9.90%
Yield on average Interest Bearing assets	11.11%	10.13%	9.13%
Cost of average Interest Bearing liabilities	7.79%	7.14%	6.44%
Interest Spreads	3.32%	2.99%	2.69%
Interest Earned / Avg. Total Assets	10.65%	9.77%	8.75%
Interest Paid / Avg. Total Assets	6.85%	6.33%	5.75%
Net Interest Margin/Avg. Tot Assets	3.80%	3.45%	3.00%
Non Interest Income/Avg. Tot Assets	0.90%	0.96%	0.89%
Operating Expenses/Avg. Total Assets	1.15%	1.14%	1.06%
Operating profits /Avg. Total Assets	3.55%	3.27%	2.83%
Provisions	0.20%	0.55%	0.42%
Operating Profit / Avg. Total Assets	3.35%	2.72%	2.42%
Trading Profits (securitization income)	0.00%	0.00%	0.01%
PBT / Average Total Assets	3.35%	2.72%	2.43%
Tax / PBT	28.55%	20.08%	16.34%
PAT / Average Total Assets	2.39%	2.17%	2.03%
(PAT - dividend) / Average Total Assets	1.48%	1.28%	1.32%
PAT/ Average Net worth	23.89%	23.52%	27.04%
Dividend Payouts (including tax on dividend)	38.22%	41.13%	34.85%
Cost to income ratio	24.37%	25.81%	27.15%

	Mar-08	Mar-07	Mar-06
Gross NPA	197	188	159
Provisions	197	188	134
Net NPA	0	0	25
Gross Advances	17696	13766	10691
Net Advances	17499	13577	10558
Gross NPA%	1.12%	1.36%	1.48%
Net NPA%	0.00%	0.00%	0.23%
Net NPA/Net-worth	0.00%	0.00%	2.87%

Risk -weighted assets	11888	12213	9050
Tier 1 capital	1837	1592	869
Tier II capital	320	400	420
Total capital	2157	1992	1289
Tier 1 %	15.45%	13.03%	9.60%
Tier II %	2.69%	3.28%	4.64%
CRAR	18.15%	16.31%	14.24%