

APRIL 15, 2010
UPDATE

Coverage view: **Attractive**

Price (Rs): **2,690**

Target price (Rs): **2,700**

BSE-30: **17,639**

Dual home loans scheme re-launched as liquidity remains strong. HDFC has re-launched a limited period dual-rate home loan scheme. Subdued borrowings cost and a strong response to its earlier scheme has prompted HDFC to re-launch the scheme. We expect buoyant housing markets to drive retail business for HDFC over the medium term. Reported loan growth will likely pick up as base effects of loan sell-down to HDFC Bank play out. Retain ADD.

Company data and valuation summary

HDFC				Forecasts/Valuations		
Stock data				2010	2011E	2012E
52-week range (Rs) (high,low)	2,875-1,572			98.2	112.0	132.8
Market Cap. (Rs bn)	765.1			14.5	14.1	18.6
Shareholding pattern (%)				27.4	24.0	20.3
Promoters	0.0			NII (Rs bn)	36.4	40.9
FIs	59.4			Net profits (Rs bn)	27.9	31.9
MFs	3.7			BVPS	505.8	572.0
Price performance (%)				1M	3M	12M
Absolute	0.5	6.7	51.9	P/B (X)	5.3	4.7
Rel. to BSE-30	(2.2)	6.3	(5.6)	ROE (%)	19.7	19.6
				Div. Yield (%)	1.3	1.5

HDFC re-launches dual rate product

Soft interest rates coupled with a strong response to its earlier scheme has prompted HDFC to re-launch a limited period dual-rate home loan scheme. HDFC is now offering two-year fixed rate home loans (8.25% for 1st year followed by 9% for 2nd year) as compared to 8.75% floating rate (for loans up to Rs3 mn) offered currently. The scheme is currently available for limited period (loan applicants up to April 30, 2010) and we understand that the company has already tied up corresponding borrowings for the same, thus protecting its spreads. We believe that HDFC will extend the scheme if interest rates remain low.

Excess liquidity driving discount schemes; will likely get withdrawn as liquidity tightens

We believe that excess liquidity in the system (investments under reverse repo are currently at Rs534 bn) is fueling the discount scheme and such schemes will likely be withdrawn when the excess liquidity in the system dries up. ICICI Bank and Axis Bank withdrew their discounted home loan scheme in March 2010, just two months within their launch, as liquidity had reduced. SBI has continued its discounted scheme and has gained share from other players on account of its aggressive rate offering in FY2010E.

Retail business going strong, reported loan growth to move up

We expect HDFC to report 12% loan growth in FY2010E and 25% in FY2011E versus 10% in 3QFY10. An improving traction in retail business (retail disbursements were up 10% qoq in 3QFY10 and the strong trends continue) will likely now reflect in better loan growth. HDFC had sold down home loans of Rs42 bn (5% of overall loan book) to HDFC Bank in 4QFY09, thereby pulling down the growth in reported loan book to 17% in FY2009 (22% excluding the impact of loan sell-down). The base effect of loan sell-down transactions will now start playing out thus pushing up the reported loan growth for HDFC—which has emerged as one of the key concerns amongst investors over the past 2-3 quarters.

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Latent demand is strong; higher prices also supporting loan growth

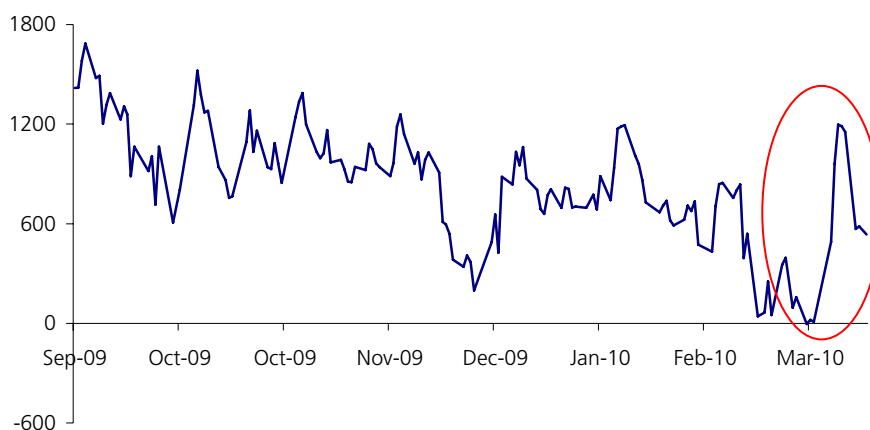
We believe that a strong latent demand and improving economic outlook will likely support growth in mortgages over the medium term. According to our real estate analysts, the underlying momentum in the real estate sector remains strong. Prices have moved up from their bottom (in select pockets as prices are close to its peak) but the retail demand remains strong, thereby driving strong disbursements growth for the housing finance sector. Real estate companies under coverage have together sold 26+ mn sq. ft of residential projects in 9MFY10 compared to our estimates of 38.9 mn sq. ft in FY2010E and 14.9 mn sq. ft in FY2009. Our analysts forecast 50% yoy growth in the revenue of real estate companies—an indication of the strong buoyancy.

Base rate system may not have significant impact

RBI has proposed to benchmark bank lending to base rate from PLR with effect from July 2010. We believe that housing finance companies (HFCs) may not be significantly affected since banks are large players in housing finance markets. A likely change in interest rates will temper HFCs' borrowings cost in the medium term (most high-rated bulk borrowers have been enjoying low interest rates for short to medium term loans from banks due to excess liquidity in the system; the rate of interest will now move up as bank loan pricing becomes much more methodical). However, interest rates on home loans offered by banks have also been low over the past few months and will also need to be re-priced more methodically.

System flush with liquidity

Net reverse repo in the system, September 2009 onwards (Rs bn)



Source: Bloomberg

A comparison of home loan rates for loans up to Rs3 mn

	HDFC (DR2) (%)	HDFC (DR1) (%)	SBI (%)	LICHF (%)
Year 1	8.25	8.25	8.0	8.9
Year 2	9	8.25	8.5	8.9
Year 3		8.25	8.5	8.9
Year 4 onwards	8.75 (a) (b)	8.75 (b)	9.0 (b)	9.75 (b)
Prepayment penalty (%)		3	2	2

Note

DR - dual rate

(a) Applicable from Year 3

(b) Linked to PLR; indicative rate based on current PLR

Source: Company

We expect HDFC's home loan growth to pick up

Movement in HDFC's home loans, March fiscal year-ends, 2007-2012E (Rs mn)

	2007	2008	2009	2010E	2011E	2012E
Disbursements	261,780	328,750	396,500	475,800	570,960	685,152
% growth	27	26	21	20	20	20
Less: Repayments	146,558	163,894	232,498	339,713	319,321	397,329
Repayment rate (%)	33	29	32	38	31	31
O/S housing assets (pre securitisation)	565,123	729,980	893,981	1,030,068	1,281,707	1,569,530
Securitisation during the year			42,000	78,000	93,600	112,320
O/S housing assets	565,123	729,980	851,981	952,068	1,188,107	1,457,210
YoY (%)		29	17	12	25	23

Source: Company, Kotak Institutional Equities estimates

HDFC's loan growth has been low

O/s mortgage loan book of key players, quarterly data (Rs bn)

	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
SBI (Rs bn)	506	521	541	575	624	673
QoQ growth (Rs bn)		15	20	35	49	49
YoY (%)	23	22	21	25	23	29
HDFC (Rs bn)	812	829	894	926	956	981
QoQ growth (Rs bn)		17	66	32	30	25
YoY (%)	31	24	23	20	18	18
ICICI Bank (Rs bn)	617	607	573	535	490	484
QoQ growth (Rs bn)		(10)	(33)	(39)	(45)	(6)
YoY (%)	(8)	(9)	(14)	(18)	(21)	(20)
LIC Housing Fin (Rs bn)	241	253	277	292	319	342
QoQ growth (Rs bn)		12	23	15	27	23
YoY (%)	26	26	26	28	32	35

Source: Company

Core business (mortgage) adds 55% to SOTP, 25% by bank, 10% by insurance

We value HDFC's mortgage business at Rs1,533/share—5.9X core PBR FY2011E. In order to arrive at the core PBT, we deduct capital gains and dividend income from the reported PBT; we deduct book value of all equity investments (in group companies and otherwise) from the reported net worth to calculate the (core) equity available for mortgage business. Subsequently, we are adding the market/estimated value of all equity investments in our SOTP.

We have valued the mortgage business using a residual growth model as of March 2013E and discounted back the value to March 2012E at 12.5% so as to capture the impact of the likely warrant conversion in 2013. At our fair value estimate, the mortgage business will trade at 3.8X core PBR and 15X core PER FY2013E for RoEs of about 26-30% (2% core RoA and leverage of 13-15X). We expect the company to report core PBT growth of 14% in FY2011E and 17% in FY2012E though growth in reported earnings will be somewhat higher due to higher capital gains and dividend income.

HDFC- sum-of-the-parts based valuation (FY2011E)

Business/ subsidiaries	HDFC's holding (%)	Value of companies (Rs mn)	Value per share (Rs)	Valuation methodology
HDFC			1,533	Based on residual growth model; exit multiple of 3.8X PBR FY2013E discounted to FY2011E
Value of subsidiaries and associates			1,019	
HDFC Bank	23	813,600	598	Based on target price
HDFC Standard Life MF	60	47,520	100	4% of March 2011E AUMs- 20% growth assumed
-PMS business	60	1,728	4	10% of AUMs (March 2011E - 20% yoy growth)
Life Insurance	72	113,000	265	13.5% margins and 19X NBV multiple
General insurance	74	8,600	20	Based on deal with ERGO
Gruh Finance	62.0	3,759	7	Based on market price
IDFC	1.9	219,793	13	Based on market price
HDFC Venture capital				
HDFC Property Fund	81	1,500	4	Rs10bn of fund assuming value of 15%
HDFC IT Corridor Fund	81	697	2	Rs4.64bn of fund assuming value of 15%
Real estate fund	60	2,520	5	US\$800 mn assuming value of 7.5%
Equity investments			161	
BVPS of non-strategic investments			35	
Unrealised gains			126	
Listed investments			76	
Unlisted investments			50	
Total value per share			2,713	

Source: Kotak Institutional Equities

HDFC (standalone): Key ratios, March fiscal year-ends, 2007-2012E (%)

	2007	2008	2009	2010E	2011E	2012E
Spread calc						
Average yield on assets (incl fees)	9.9	11.8	11.7	10.6	10.7	10.8
- interest on housing loans	9.6	11.1	12.6	10.9	10.9	10.9
Average cost of funds	7.1	8.1	9.7	8.2	8.2	8.2
Overall spread	2.9	3.7	2.0	2.4	2.5	2.6
Spread on housing loans	2.5	3.0	2.8	2.7	2.7	2.7
NIMs (post-provision)	3.6	4.8	3.5	3.7	3.6	3.6
NIM (pre provisions)	3.6	4.8	3.6	3.8	3.7	3.6
DU PONT Analysis						
Net total income	3.6	4.8	3.7	3.6	3.4	3.4
Net interest income	2.9	3.7	3.5	3.3	3.0	3.0
Capital gains	0.5	1.0	0.0	0.2	0.2	0.2
Dividend income	0.2	0.1	0.2	0.2	0.2	0.2
Net other income	0.2	0.1	0.1	0.2	0.3	0.2
Operating expenses	0.4	0.4	0.3	0.3	0.3	0.3
(1- tax rate)	79.8	72.2	70.9	72.0	71.5	71.5
ROA	2.6	3.2	2.5	2.5	2.4	2.3
Average assets/average equity	11.9	8.6	7.4	7.8	8.2	8.7
ROE	31.3	27.8	18.2	19.7	19.6	20.1
Growth(%)						
Net loans	26	29	17	12	25	23
Total assets	23	29	20	12	21	20
Total income	38	51	24	3	17	23
Interest on Housing Loans	40	49	38	(1)	19	24
Net income before provision	25	69	(4)	17	14	20
Total expenses	12	22	12	13	16	16
PBT	26	71	(5)	20	15	19
PAT	25	55	(6)	22	14	19

Source: Company, Kotak Institutional Equities estimates

HDFC (standalone): P&L and balance sheet, March fiscal year-ends, 2007-2012E (Rs mn)

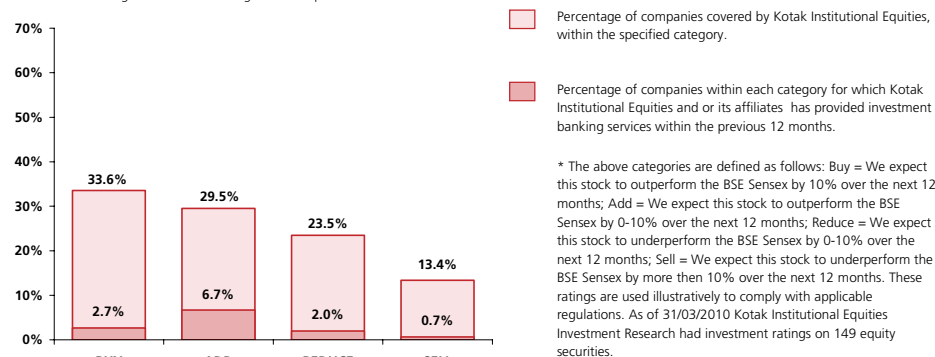
	2007	2008	2009	2010E	2011E	2012E
Income statement						
Total income excluding fee income	58,069	87,494	108,798	111,760	131,049	160,980
Interest on Housing Loans	48,502	72,164	99,310	98,321	116,640	144,170
Dividends	1,179	686	1,957	2,007	2,379	2,699
Lease rentals	110	155	147	133	119	107
Other operating income	8,279	14,489	7,384	11,300	11,911	14,004
Income from investments	5,026	6,794	7,132	8,232	6,628	7,058
Capital gains	3,253	7,695	252	1,900	2,700	3,000
Income/ gains on securitisation	—	—	—	1,168	2,584	3,946
Interest payable	36,669	51,429	74,324	71,324	84,966	105,693
Net Income before provision	21,401	36,065	34,474	40,436	46,084	55,287
Provision	250	320	500	550	616	690
Fee income	686	632	1,149	2,222	2,950	2,726
Total income	58,755	88,126	109,948	113,982	133,999	163,705
Staff expenses	913	1,178	1,386	1,570	1,869	2,235
Total expenses	2,192	2,673	2,987	3,374	3,902	4,526
Depreciation	175	166	175	183	192	202
Other income	208	197	229	229	229	229
Profit before tax	19,678	33,735	32,190	38,780	44,552	52,823
Tax	3,974	9,373	9,365	10,858	12,697	15,054
Profit after tax	15,704	24,362	22,825	27,922	31,854	37,768
- .EPS	62	86	80	98	112	133
EPS (core)	45	56	72	84	94	113
Book value	219	421	462	506	572	650
Book value (core)	145	285	295	201	258	328
Balance sheet						
Net loans	565,123	729,980	851,981	952,068	1,188,107	1,457,210
Total Investments	36,663	69,150	104,688	127,978	134,202	140,798
In equity	18,872	38,616	47,525	86,775	89,275	91,775
Fixed securities	17,790	30,534	57,162	41,203	44,927	49,023
Diminution in value of invt	(396)	(548)	(853)	(853)	(853)	(853)
Cash & deposits	14,437	8,586	17,185	17,185	17,185	17,185
Loans and advances and other assets	36,129	32,938	38,523	38,523	38,523	38,523
Deferred tax assets	1,231	1,466	2,158	2,158	2,158	2,158
Fixed assets owned	2,131	2,085	2,034	2,197	2,372	2,562
Total assets	655,713	844,205	1,016,569	1,140,110	1,382,548	1,658,437
Total borrowings and CL	600,199	724,732	885,195	996,226	1,219,843	1,473,417
Share capital	2,530	2,840	2,845	2,845	2,845	2,845
Reserves	52,984	116,633	128,529	141,039	159,860	182,176
Shareholders fund	55,514	119,473	131,374	143,884	162,705	185,020

Source: Company, Kotak Institutional Equities estimates

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As of March 31, 2010

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