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Flashnote

Banks

RBI: NBFC Working Group recos

The committee has recommended a range of norms, more prominent of which are those on NPA recognition and on standard provisioning. Among NBFCs under coverage, prima facie there seems to be no material impact on HDFC Ltd and IDFC. The provision impact on PFC is about 2.2% of existing networth.

RBI- Key recommendations of the Working Group on NBFC sector

- The tier I capital requirement will be 12% to be achieved in three years for all registered deposit taking and non deposit taking NBFCs. Note, as per current regulations, the total capital adequacy ratio (Tier I + Tier II) is 15%.
- Asset classification and provisioning norms similar to banks to be brought in phased manner for NBFCs. Note, this implies NBFCs will have to likely comply with 90 day norm for bad debt recognition and may be required to make standard asset provisioning. (40bps as required by banks)
- Accounting norms applicable to banks may be applied to NBFCs
- Government owned entities that qualify as NBFCs may comply with the regulatory framework applicable to NBFCs at the earliest.
- Board approved limits for bank's exposure to real estate may be made applicable for the bank group as a whole, where there is an NBFC in the group.
- The risk weights for NBFCs that are not sponsored by banks or that do not have any bank as part of the group may be raised to 150% for capital market exposures (CME) and 125% for Commercial Real Estate (CRE) exposures. In case of bank sponsored NBFCs, the risk weights for CME and CRE may be the same as specified for banks

HDFC Limited- No material impact

- Note, HDFC is governed by National Housing Bank (NHB) guidelines. However, if the above mentioned provisions become applicable for HDFC, we believe the impact will likely not be material.
- The tier I was 12.2% as of June 2011 (total CAR of 13.8%). Note, HDFC Limited had issued warrants which are due for conversion in August 2012 (FY13). Given this, we believe HDFC appears comfortable with respect to capital adequacy
- The CRE exposure was about Rs 280bn (24% of loan book) as of March 2011.
- The non performing loans (NPLs) based on 90 day overdue basis were 0.83% of loans and were 0.55% on 180 day over due basis. As regards standard asset provisioning, HDFC appears comfortable on the existing loan book. Further, HDFC provides about 40bps on an incremental basis annually (FY11)
- At the current price, the core mortgage business of HDFC Limited (HDFC IN, Buy) trades at about 4.0x FY13F BV.

IDFC - No material impact

- The tier I was about 21.5% as of June 2011 (total CAR at 24% as of June 2011).
- The cumulative standard asset provision carried by IDFC was about 1.6% of standard assets as of March 2011.On an annualised basis, IDFC provided about 70bps on incremental

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Important disclosures can be found in the Disclosures Appendix.

Analyst

Jatinder Agarwal
+91 22 6715 5306
jatinder.agarwal@rbs.com

83/84 Sakhar Bhawan, Nariman Point, Mumbai 400 021, India

http://research.rbsm.com

disbursements in FY11. Accordingly, IDFC appears to be placed comfortable with respect to standard provisioning norms.

- IDFC recognises NPLs on 180 day over due basis compared to the 90 day NPL recognition norms applicable to banks (which will likely apply to NBFCs as per the draft recommendations). However, at this point, we are unable to quantify the impact of the same. Note, the reported gross non performing assets were 0.2% and net NPAs were 0.1% as of June 2011.
- IDFC being an infrastructure finance company (IFC) follows exposure norms as required under RBI's guidelines for IFCs. As per IFC norms, the exposure to a single project and a single business group is 25% and 40% respectively of the IFC's net owned funds. However, as per banking norms, the exposure ceiling limit is 15% of capital funds in case of a single borrower (additional 5% provided the additional credit exposure is on account of extension of credit to infrastructure projects) and 40% in case of a borrower group (additional 10% for infrastructure projects)
- At the current price, IDFC (IDFC IN, Buy) trades at 1.6x FY12F BV and 11.7x FY12F earnings

PFC-Standard asset provision requirement about 2.2% of existing networth

- The total CAR was 18.9% as of June 2011.
- Assuming a 40bps standard provisioning (as required by banks), the provision requirement works out to about Rs 4.2bn for PFC (40bps on loan book of about Rs 1041bn) as of June 2011. The impact of the one time provision is about 2.2% of June 2011 networth or Rs 3 per share (14% of FY12F net profit). On a recurring basis, the standard provision charge is about 8bps on RoA (about 3% of RoA)
- According to management, PFC recognises NPLs on 180 day over due basis compared to the 90 day NPL recognition norms applicable to banks. At this point, we are unable to quantify the impact of the same. Note, the reported gross NPLs were 0.23% and net NPLs were 0.2% as of June 2011.
- At the current price, PFC (POWF IN, Buy) trades at 0.9x FY12F BV and 6.0x FY12F earnings

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.
Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.
Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.
Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 29 Aug 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	847 (12)	551 (4)
Hold	418 (7)	228 (4)
Sell	80 (6)	48 (0)
Total (IB%)	1345 (10)	827 (3)

Source: RBS

Trading recommendations (as at 29 Aug 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (100)	1 (100)
Trading Sell	0 (0)	0 (0)
Total (IB%)	1 (100)	1 (100)

Source: RBS

Valuation and risks to target price

For a discussion of the valuation methodologies used to derive our price targets and the risks that could impede their achievement, please refer to our latest published research on those stocks at http://research.rbsm.com

Regulatory disclosures

None

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