



HDFC

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,110	HDFC IN
	REUTERS CODE
S&P CNX: 4,090	HDFC.BO

24 January 2007

Neutral

Previous Recommendation: Neutral

Rs1,643

Equity Shares (m)	249.6
52-Week Range	1,701/962
1,6,12 Rel.Perf.(%)	0/14/-14
M.Cap. (Rs b)	409.9
M.Cap. (US\$ b)	9.3

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROAE (%)	ROAA (%)	P/ABV* RATIO
3/06A	17,873	12,573	50.4	21.1	32.6	9.2	15.0	30.1	2.7	9.3
3/07E	21,777	15,269	61.2	21.4	26.8	7.5	13.0	30.8	2.7	7.6
3/08E	26,432	18,369	73.6	20.3	22.3	6.2	13.0	30.4	2.6	6.3

HDFC posted 25% PAT growth in 3QFY07, beating our estimate of 21% growth, as tax rates were lower than expected while business growth and margins continued to be at its historic levels. On the business front, approvals were up 27% to Rs79b while disbursements grew 26% to Rs62b. Loan growth continued to be strong at 25% to Rs527b.

- ⚡ Outstanding loan portfolio grows by 25%
- ⚡ Spreads remain stable at 2.17%
- ⚡ Tier-I comfortable at 8.1%
- ⚡ Gross NPLs at 1.3%

We are not factoring in any slowdown in HDFC's business growth despite recent rate hikes. While a number of bankers have voiced some slowdown in retail lending, we believe that HDFC would continue to grow at 25-28% for the next couple of years, with stable margins. However, we maintain **Neutral**, as upsides from current levels are likely to be limited. Our target price of Rs1,470 is based on P/B of 4x FY08E and we have added Rs405 as value of subsidiaries (after adjusting for a 20% holding company discount).

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Income from Operations	9,326	10,452	10,520	12,358	12,457	14,468	14,545	15,493	42,655	56,963
Other Income	22	33	33	41	28	95	39	27	129	190
Total Income	9,348	10,485	10,553	12,399	12,485	14,563	14,585	15,520	42,784	57,153
YoY Change (%)	22.5	24.3	24.4	29.7	33.6	38.9	38.2	25.2	25.4	33.6
Interest and Other Charges	5,669	6,072	6,398	6,773	8,014	9,137	9,475	8,750	24,911	35,376
Other Expenses	561	537	582	440	667	686	614	543	2,118	2,510
Total Expenses	6,229	6,608	6,979	7,213	8,681	9,823	10,089	9,293	27,030	37,886
PBDT	3,118	3,876	3,574	5,186	3,805	4,740	4,495	6,227	15,754	19,267
YoY Change (%)	23.5	23.0	23.4	24.0	22.0	22.3	25.8	20.1	23.5	22.3
Depreciation	42	48	51	47	37	39	47	57	187	180
PBT	3,076	3,828	3,523	5,140	3,767	4,701	4,448	6,170	15,567	19,087
Provision for Tax	604	839	678	874	799	1,021	886	1,112	2,994	3,817
PAT	2,473	2,990	2,845	4,265	2,968	3,680	3,562	5,059	12,573	15,269
YoY Change (%)	20.8	20.5	20.5	22.6	20.0	23.1	25.2	18.6	21.3	21.4

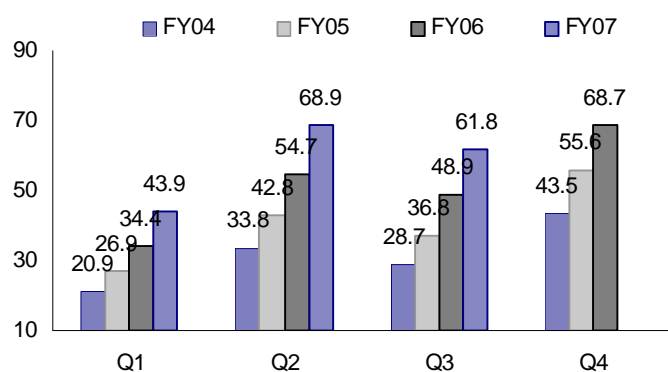
E: MOST Estimates

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Outstanding loan portfolio grows by 25%

On the business front, approvals were up 27% YoY to Rs79b while disbursements were up 26% to Rs62b. Loan growth continued to be strong at 25% to 527b. The management highlighted that contrary to expectations, there have been no big slowdown in mortgages in the segment which HDFC operates in. While ICICI Bank results suggested that the housing market is slowing down (retail disbursements had slowed down to 12% for ICICI Bank), HDFC management is confident of maintaining the current growth rates. Within the loan portfolio for HDFC, individual loans continue to grow strongly, while the corporate loan portfolio has been largely flat QoQ.

QUARTERLY DISBURSEMENTS (RS B)



Source: Company / Motilal Oswal Securities

Spreads remain stable

NIMs have remained stable at 2.17%, as HDFC has been raising lending rates to counter the higher cost of funds. With PLR being again raised from January 2007, margins are likely to remain stable at 2.15%-2.2%. While cost of funds would rise for HDFC, we believe that the intent would be to pass this on to borrowers and maintain margins. With banks finding this market unattractive, we believe that HDFC can actually gain market share in the mortgages market.

Tier-I comfortable at 8.1%

Capital adequacy increased QoQ to 13.7%. Tier-I capital is at 8.1%. The management does not foresee any requirements of capital raising, as it has avenues to improve on its capital – raising perpetual debt (NHB will have to approve this), FCCB conversion (will add 300-350bp to Tier-I capital).

Gross NPLs at 1.3%

On a 90-day overdue basis, NPLs have declined 1.26% (1.49% as of 3QFY06). On a 180-day past due basis also NPLs are 0.99% (1.11% as of 3QFY06). HDFC continues to carry sufficient provisions on its books totaling Rs3.97b as at 3QFY07.

Valuation and view

We are not factoring in any slowdown in HDFC's business growth despite recent rate hikes. While a number of bankers have voiced some slowdown in retail lending, we believe that HDFC would continue to grow at 25-28% for the next couple of years, with stable margins. However, we maintain **Neutral**, as upsides from current levels are likely to be limited. Our target price of Rs1,470 is based on P/B of 4x FY08E and we have added Rs405 as value of subsidiaries (after adjusting for a 20% holding company discount).

HDFC: an investment profile

HDFC was incorporated in 1977 as the first specialized mortgage company in India. Besides this core business, it has evolved as a financial conglomerate with interests in the banking, insurance and mutual funds business by having stakes in companies like HDFC Standard Life Insurance Co., HDFC Asset Management Co., HDFC Bank, Intelenet Global, CIBIL and HDFC Chubb General Insurance Co. It functions through a wide network of 223 offices, direct selling agents and outreach programs.

Key investment arguments

- ✍ Huge potential in housing mortgage segment in India and HDFC being the leader in the market, is set to benefit the most.
- ✍ Strong management, high brand value, high return on equity, and low net NPA levels, distinguish HDFC from other players in the sector.
- ✍ Has diversified interests in banking, insurance and mutual fund businesses, all of which have been adding significant value for investors.

Key risks

- ✍ Its associate, HDFC Bank has also entered the mortgage business, generating conflict of interest in the longer term.

Recent developments

- ✍ The Cabinet Committee on Economic Affairs (CCEA) had on 6 September 2006, cleared HDFC's property fund, which will bring Rs32.4b of FDI into the country.

Valuation and view

- ✍ Consistent loan book expansion by aggressive loan approvals and disbursements will drive core earnings growth over a couple of years.
- ✍ We expect earnings to grow by 20% in FY08.
- ✍ Adjusting for value in subsidiaries (~Rs405 per share), the stock trades at 22.3x FY08E EPS and 6.2x FY08E BV. We maintain **Neutral**.

Sector view

- ✍ Industry has been growing at a rate of 30-35% for the last few years.
- ✍ Increasing urbanization, rising disposable income, low interest rates and existing tax sops will keep the demand for mortgages buoyant.
- ✍ Competition is unlikely to put any further pressure on rates. Dominated by many small regional players.

COMPARATIVE VALUATIONS

		HDFC	HDFC BANK	ICIC BANK
PE (x)	FY07E	26.8	29.0	26.5
	FY08E	22.3	22.2	21.5
P/ABV (x)	FY07E	7.6	5.4	3.8
	FY08E	6.3	4.5	3.4
RoE (%)	FY07E	30.8	19.8	14.0
	FY08E	30.4	21.7	15.5
RoA (%)	FY07E	2.7	1.3	1.1
	FY08E	2.6	1.3	1.0

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	0.0	0.0	0.0
Domestic Inst	6.1	6.5	6.8
Foreign	79.9	79.5	78.3
Others	14.0	14.0	14.9

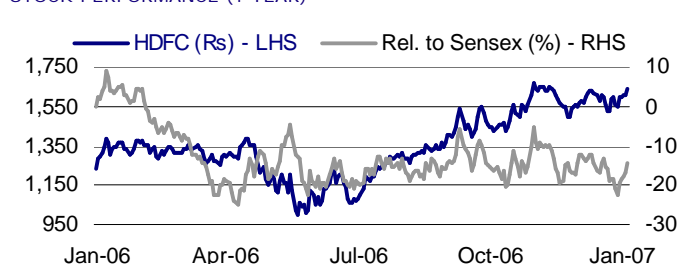
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	61.2	58.2	5.2
FY08	73.6	68.7	7.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,643	1,470	-	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Operating Income	32,989	41,981	55,256	70,455	88,195
Fees and Other Income	1,116	803	1,897	2,371	2,930
Total Income	34,104	42,784	57,153	72,826	91,125
Growth (%)	10.8	25.5	33.6	27.4	25.1
Interest and Other Charges	19,594	24,911	35,376	46,394	59,427
Net Income	14,510	17,873	21,777	26,432	31,698
Growth (%)	20.5	23.2	21.8	21.4	19.9
Staff Expenses	649	803	930	1,080	1,230
Other Expenses	1,293	1,496	1,760	2,100	2,430
PBT	12,568	15,573	19,087	23,252	28,038
Tax	2,202	3,000	3,817	4,883	5,888
Tax Rate (%)	17.5	19.3	20.0	21.0	21.0
PAT	10,366	12,573	15,269	18,369	22,150
Growth (%)	21.7	21.3	21.4	20.3	20.6
Proposed Dividend	4,235	4,991	5,615	6,239	7,487

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Share Capital	2,491	2,496	2,496	2,496	2,496
Reserves and Surplus	36,340	42,188	51,842	63,972	78,635
	3,634	4,219	5,184	6,397	7,864
Net Worth	38,831	44,683	54,338	66,468	81,131
Term Loans	166,897	199,957	251,945	317,451	399,988
Bonds	121,176	179,840	233,792	303,929	395,108
Deposits	78,401	87,425	96,167	105,783	116,361
Loan Funds	366,474	467,221	581,904	727,163	911,457
Growth (%)	27.8	27.5	24.5	25.0	25.3
Total Liabilities	405,305	511,904	636,241	793,631	992,588
Loans Granted	360,115	449,901	571,375	719,932	907,114
Growth (%)	28.7	24.9	27.0	26.0	26.0
Investments	31,300	38,763	42,640	46,904	51,594
Net Current Assets	10,247	19,993	19,207	23,502	30,288
Fixed Assets	2,949	2,473	2,720	2,992	3,292
Deferred Tax Asset	694	774	300	300	300
Total Assets	405,305	511,904	636,241	793,631	992,588

ASSUMPTIONS					
(%)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Growth in Sanctions	29.6	29.0	28.0	28.0	28.0
Growth in Disbursals	27.6	27.0	27.0	26.0	26.0
Dividend	170.0	200.0	225.0	250.0	300.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Spreads Analysis (%)					
Yield on Housing	8.4	8.5	9.3	9.7	9.8
Avg Yield - Earning Assets	8.5	8.5	9.0	9.4	9.5
Avg Cost - Int Bearing Liab	6.0	6.0	6.7	7.1	7.3
Net Interest Margin	2.4	2.5	2.5	2.5	2.5
Profitability Ratios (%)					
RoE	28.5	30.1	30.8	30.4	30.0
RoA	2.9	2.7	2.7	2.6	2.5
Op. Exps / Net Income	11.1	11.0	10.6	10.1	9.6
Fee Income / Loan Portfoli	0.6	0.6	0.7	0.7	0.7
Int Charges / Operating Inc	59.4	59.3	64.0	65.8	67.4

Growth Ratios					
Operating Income	12.1	27.3	31.6	27.5	25.2
Interest Charges	4.6	27.1	42.0	31.1	28.1
Net Income	20.5	23.2	21.8	21.4	19.9
Net Profit	21.7	21.3	21.4	20.3	20.6
Loan Portfolio	28.7	24.9	27.0	26.0	26.0
Loan Funds	27.8	27.5	24.5	25.0	25.3

Efficiency Ratios (%)					
Gross NPAs (Rs m)	4,107	4,464	4,807	5,311	5,946
Gross NPAs	1.1	1.0	0.8	0.7	0.7
Net NPAs (Rs m)	338	659	688	912	1,547
Net NPAs	0.1	0.1	0.1	0.1	0.2
CAR	13.4	15.0	13.0	13.0	13.0

Valuation					
EPS (Rs)	416	50.4	612	73.6	88.8
Growth (%)	20.5	21.1	21.4	20.3	20.6
P/E (x)	39.5	32.6	26.8	22.3	18.5
Book Value (Rs)	156	179	218	266	325
Growth (%)	13.3	14.9	21.6	22.3	22.1
P/BV (x)	10.5	9.2	7.5	6.2	5.1
Adjusted BV (Rs)	155	176	215	263	319
P/ABV (x)	10.6	9.3	7.6	6.3	5.2

E: MOST Estimates

N O T E S



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Disclosure of Interest Statement

	HDFC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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