Robust growth to continue

Mr Keki Mistry, Vice-chairman and CEO of HDFC, presented at IIFL's Enterprising India Conference 2011. The mortgage lender reiterated it was confident it can maintain 18–20% loan growth along with 2.1–2.3% spreads, which should drive earnings growth at over 20%+ annually. Key takeaways:

Demand outlook remains robust: HDFC re-iterated that affordability, barring a few pockets in the country, continues to improve, driven by rising disposable income levels and affordable interest rates. Further, favourable trends of rising urbanisation and India's demographic advantage will continue to drive demand for mortgages in the foreseeable future, leading to steady-state loan growth of 18–20% annually for HDFC.

Spreads manageable despite expected rise in rates: Rising borrowing costs would likely raise concerns about HDFC's ability to maintain its lending spreads. Given its well-matched asset-liability position and ability to proactively manage split between deposits and wholesale borrowing, management expressed confidence on sustaining lending spreads in the 2.1–2.3% range. HDFC expects the competitive environment to turn for the better, with most banks now withdrawing teaser-rate products.

No significant risks to asset quality: Given HDFC's conservative underwriting practices, NPAs and credit losses have remained best-in-class—since inception, HDFC has written off only 0.04% of cumulative loan disbursements. HDFC expressed comfort on the asset quality outlook in its corporate loan portfolio too, citing its careful choice of borrowers and strong collaterals held.

Group companies to increase contribution to overall profitability: Group companies accounted for 15% of HDFC's consolidated earnings in FY10. With an improvement in the profitability of life and non-life insurance companies and higher economies of scale driving up profitability of the other group companies, these entities' overall contribution to group profits from is likely to improve, according to management.

Company update

CMP	**Rs650**
12-mth TP (Rs)	***760 (17%)***
Market cap (US$ m)	**20,964**
Bloomberg	**HDFC IN**
Sector	**Banks**

Shareholding pattern (%)

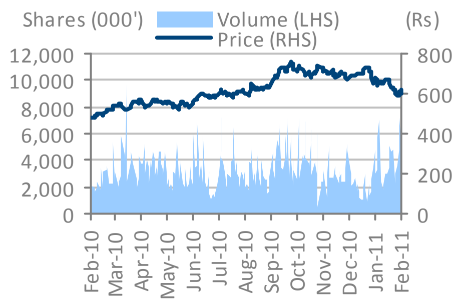
Promoters	0.0
FIIs	59.1
DIIs	13.5
Others	12.3

52Wk High/Low (Rs)	861/472
Shares o/s (m)	1465
Daily volume (US$ m)	44
Dividend yield FY11ii (%)	1.4
Free float (%)	100.0

Price performance (%)

	1M	3M	1Y
HDFC	-1.9	-7.2	32.2
Rel. to Sensex	**0.1**	**-0.1**	**19.5**
Axis Bank	7.3	-7.7	23.4
ICICI Bank	5.7	-9.2	25.8
St Bk of India	10.4	-9.3	42.3

Stock performance



Financial summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Pre prov. operating inc. (Rs m)	32,690	39,740	47,425	57,871	70,491
Net profit (Rs m)	22,825	28,265	33,899	41,376	50,410
EPS (Rs)	16.0	19.7	23.4	28.5	34.8
Growth (%)	-6.4	22.7	18.7	22.1	21.8
IIFL vs consensus (%)			-1.5	1.3	6.4
PER (x)	38.8	31.6	26.7	21.8	17.9
Book value (Rs)	92	106	121	136	154
PB (x)	**6.7**	**5.9**	**5.2**	**4.6**	**4.0**
CAR (%)	15.1	14.6	13.9	12.7	11.9
ROA (%)	2.6	2.7	2.8	2.8	2.8
ROE (%)	**18.2**	**20.0**	**20.7**	**22.2**	**24.0**
Dividend yield (%)	1.0	1.2	1.4	1.7	2.1

Source: Company, IIFL Research. Priced as on 17 February 2011

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Assumptions

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Loan growth (%)	16.1	14.9	22.4	24.7	24.8
Proportion of individual loans (%)	54.8	50.2	61.3	62.8	62.8
Proportion of corporate loans (%)	44.7	52.4	38.3	36.5	36.6
Interest rate spread (%)	2.3	2.3	2.1	2.2	2.2
Non-interest income as % of total income	4.9	11.3	11.1	10.7	10.4
Salaries as % of Non-Interest Costs	43.8	45.2	45.4	45.5	45.6
Total prov as % avg loans (bp)	6.3	6.3	6.1	5.9	5.7

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Net interest income	34,074	38,101	45,309	55,440	67,694
Fee Income	1,149	2,317	2,432	2,797	3,217
Portfolio gains	252	2,094	2,722	3,321	4,052
Others	376	466	513	564	621
Non-interest income	1,778	4,877	5,668	6,683	7,889
Total operating income	35,852	42,978	50,977	62,123	75,584
Total operating expenses	3,162	3,238	3,552	4,252	5,093
Pre provision operating profit	**32,690**	**39,740**	**47,425**	**57,871**	**70,491**
Provisions for loan losses	500	580	667	800	960
Profit before tax	**32,190**	**39,160**	**46,758**	**57,071**	**69,531**
Taxes	9,365	10,895	12,858	15,694	19,121
Net profit	**22,825**	**28,265**	**33,899**	**41,376**	**50,410**

Balance sheet summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Net loans & advances	851,981	979,670	1,199,597	1,497,064	1,868,656
Cash & equivalents	17,185	52,242	33,929	36,558	37,148
Other interest-earning assets	104,687	107,275	120,410	125,424	130,842
Total interest-earning assets	**973,854**	**1,139,186**	**1,353,936**	**1,659,047**	**2,036,645**
Fixed assets	2,034	2,221	2,332	2,449	2,571
Other assets	40,681	25,007	35,028	41,955	52,266
Total assets	**1,016,569**	**1,166,414**	**1,391,296**	**1,703,451**	**2,091,482**
Customer deposits	193,747	230,811	288,514	360,643	450,804
Other interest-bearing liabilities	644,814	734,842	870,702	1,078,976	1,338,844
Total interest-bearing liabilities	838,561	965,653	1,159,217	1,439,619	1,789,647
Non-interest-bearing liabilities	46,634	48,785	56,907	66,633	78,154
Total liabilities	**885,195**	**1,014,438**	**1,216,124**	**1,506,252**	**1,867,802**
Total Shareholder's equity	**131,374**	**151,977**	**175,173**	**197,199**	**223,680**
Total liabilities & equity	**1,016,569**	**1,166,414**	**1,391,296**	**1,703,451**	**2,091,482**

Source: Company data, IIFL Research

Ratio analysis - I

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Balance Sheet Structure Ratios (%)					
Loan Growth	16.2	15.0	22.4	24.8	24.8
Growth in Deposits	71.5	19.1	25.0	25.0	25.0
Growth in Total Assets (%)	20.4	14.7	19.3	22.4	22.8
Profitability Ratios					
Net Interest Margin	3.7	3.5	3.5	3.5	3.5
Return on Average Assets	2.6	2.7	2.8	2.8	2.8
Return on Average Equity	18.2	20.0	20.7	22.2	24.0
Non-Interest Income as % of Total Income	5.0	11.3	11.1	10.8	10.4
Net Profit Growth	-6.3	23.8	19.9	22.1	21.8
FDEPS Growth	-6.4	22.7	18.7	22.1	21.8
Efficiency Ratios (%)					
Cost to Income Ratio	8.8	7.5	7.0	6.8	6.7
Salaries as % of Non-Interest costs	43.8	45.3	45.4	45.5	45.6

Ratio analysis - II

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Credit Quality Ratios (%)					
Gross NPLs as % of loans	0.8	0.8	0.8	0.8	0.8
NPL coverage ratio	88.6	84.6	83.5	83.5	83.5
Total provision charges as % avg loans	0.1	0.1	0.1	0.1	0.1
Net NPLs as % of net loans	0.1	0.1	0.1	0.1	0.1
Capital Adequacy Ratios (%)					
Total CAR	15.1	14.6	13.9	12.7	11.9
Tier I capital ratio	13.2	12.8	12.2	11.4	10.9

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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