



HDFC

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,784	HDFC IN
	REUTERS CODE
S&P CNX: 5,869	HDFC.BO

30 October 2007

Under Review

Previous Recommendation: Buy

Rs2,756

Equity Shares (m)	271.0
52-Week Range	2,965/1,397
1,6,12 Rel.Perf.(%)	-4/23/38
M.Cap. (Rs b)	747.0
M.Cap. (US\$ b)	18.8

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROAE	ROAA	P/ABV*
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	RATIO
3/07A	22,294	15,704	62.1	23.2	44.4	12.6	13.0	31.3	2.8	12.6
3/08E	28,072	21,219	78.3	26.1	35.2	7.7	13.0	23.7	2.5	7.8
3/09E	35,008	23,632	82.3	5.1	33.5	5.9	13.0	20.5	2.6	6.0

- ✦ HDFC reported 76% PAT growth in 2QFY08 - in line with our estimates. Intelnet stake sale during 2QFY08 led to stronger growth in PAT, while growth in earnings from core operations was a robust 24% YoY.
- ✦ On the business front, approvals were up 29% to Rs112b, while disbursements grew 29% to Rs86b. Loan growth remained strong at 24%.
- ✦ Spreads have increased 8bp QoQ to 2.3% in 2QFY08. During 1H08, spreads were 2.27% v/s 2.16% in 1HFY07. We expect HDFC to reduce lending rates and thereby maintain spread at 2.2-2.3%.
- ✦ On a 90-day overdue basis, gross NPLs have declined to 1.16% (1.22% as of 1QFY08). On a 180-day overdue basis, gross NPAs have declined to 0.84%, against 0.90% in 1QFY08.
- ✦ HDFC has raised Rs31b through a preferential allotment to Carlyle and Citigroup. This coupled with the FCCB conversion has increased its Tier I CAR to 12.4% in September 2007.
- ✦ The ability of the management to maintain its strong growth in a slowing market is highly commendable. We expect a steady trend in growth to continue going forward as well with spreads being in the range of 2.2 -2.3%. The stock has been one of the best performers among large cap financial stocks. It is up by 12% over the last one month, 40% over 3 months and 70% over 6 month period. At current valuations, adjusting for the value of subsidiaries (Rs700 per share), the stock trades at 25x FY09E EPS and 4.4x FY09E BV. The stock is **Under Review**.

QUARTERLY PERFORMANCE

(Rs Million)

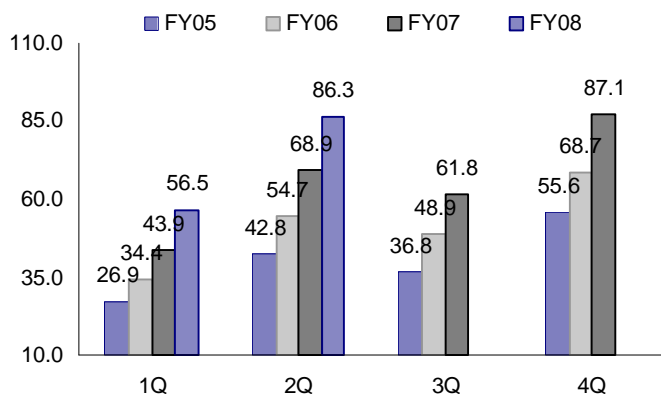
Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Income from Operations	12,457	14,468	14,545	17,285	18,270	18,886	19,491	21,890	58,755	78,536
Other Income	28	95	39	45	34	39	50	97	208	220
Total Income	12,485	14,563	14,585	17,330	18,304	18,925	19,541	21,987	58,963	78,756
YoY Change (%)	33.6	38.9	38.2	39.8	46.6	29.9	34.0	26.9	37.8	33.6
Interest and Other Charges	8,014	9,137	9,475	10,042	12,451	12,238	12,791	13,204	36,669	50,684
Other Expenses	667	686	614	474	765	823	798	452	2,442	2,839
Total Expenses	8,681	9,823	10,089	10,517	13,217	13,061	13,590	13,655	39,110	53,523
PBDT	3,805	4,740	4,495	6,813	5,087	5,864	5,951	8,331	19,852	25,234
YoY Change (%)	22.0	22.3	25.8	31.4	33.7	23.7	32.4	22.3	26.0	27.1
Depreciation	37	39	47	52	37	40	48	75	175	200
PBT	3,767	4,701	4,448	6,761	5,050	5,824	5,903	8,256	19,678	25,034
Pre-tax profit on Intelnet stake sale	0	0	0	0	0	3,133	0	0	0	3,133
Reported PBT	3767	4701	4448	6761	5050	8,957	5,903	8,256	19678	28,166
Provision for Tax	799	1,021	886	1,261	1,322	2,493	1,417	1,716	3,974	6,948
Reported PAT	2,968	3,680	3,562	5,501	3,728	6,464	4,486	6,541	15,704	21,219
YoY Change (%)	20.0	23.1	25.2	29.0	25.6	75.6	25.9	18.9	24.9	35.1

E: MOSt Estimates

Outstanding loan portfolio grew 25%

On the business front, approvals were up 29% YoY to Rs112b while disbursements grew 25% YoY to Rs86b. Loan growth continued to be strong at 24% to Rs620b in 2QFY08. This is in line with our view that as banks go slow in mortgages, housing finance companies are likely to increase market share, in turn maintaining growth rates. While disbursements for HDFC increased 25%, mortgage disbursements for ICICI Bank declined by 23% in 2QFY08. Individual loans for HDFC have grown 23% YoY, while corporate loan portfolio has grown 27% YoY.

QUARTERLY DISBURSEMENTS (RS B)

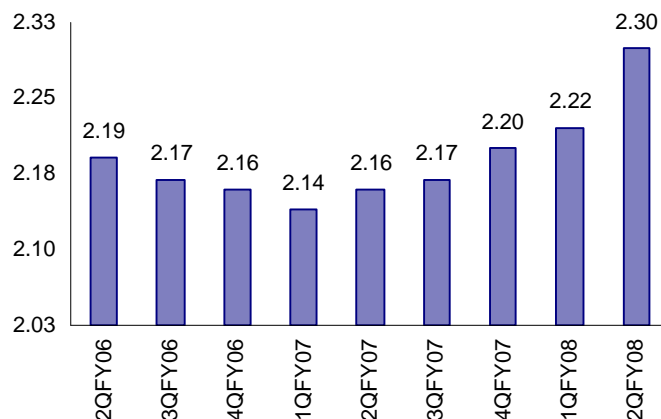


Source: Company/Motilal Oswal Securities

Spreads improve to 2.3%, up from 2.22% in 1QFY08

Spreads have increased 8bp QoQ to 2.3% in 2QFY08. During 1H08, spreads were 2.27% v/s 2.16% in 1HFY07. This has been possible as shorter end rates had declined during the quarter, while lending yields remained firm. With liquidity being extremely comfortable post the capital raising, borrowing costs are likely to decline. We expect HDFC to reduce lending rates and thereby maintain maintains at 2.2-2.3%.

SPREAD ON LOANS (%)



Source: Company/Motilal Oswal Securities

Intelnet stake sale boosts profits

While PBT before one-offs increased 24% YoY, PAT increased 76% YoY to Rs6.5b due to sale of Intelnet being booked during the quarter. In line with our estimates, HDFC booked an exceptional profit before tax of Rs3.13b on stake sale in the BPO venture – Intelnet - during the quarter.

Tax rate during the quarter has, however, increased significantly. Assuming 22% tax rate for long term capital gain on stake sale in Intelnet during the quarter, effective tax rate for core lending business has increased to 31% in 2QFY08 v/s 20-24% in couple of past quarters. For FY08, we have factored in an effective tax rate of 25% for the lending operations of the company.

Gross NPLs at 0.84%

On a 90-day overdue basis, gross NPLs have declined to 1.16% (1.22% as of 1QFY08). On a 180-day overdue basis, gross NPAs have declined to 0.84%, against 0.90% in 1QFY08. This has been against the trend witnessed by few other players in mortgages, who have seen a rising trend in NPLs. HDFC continues to carry sufficient provisions (totaling Rs7.6b as at 2QFY08 - about 1.2% of the total loan book).

Raised capital to support strong growth

HDFC has raised Rs31b through a preferential allotment to Carlyle and Citigroup. This coupled with the FCCB conversion has increased its Tier I CAR to 12.4% in September 2007 from 8.1% in September 2006. Total capital adequacy has increased to 17% from 13.5% a year ago and 13.8% in 1QFY08.

Valuation and view

The ability of the management to maintain its strong growth in a slowing market is highly commendable. We expect a steady trend in growth to continue going forward as well with spreads being in the range of 2.2 -2.3%. The stock has been one of the best performers amongst large cap financial stocks. It is up by 12% over the last one month, 40% over 3 months and 70% over 6 month period. At current valuations, adjusting for the value of subsidiaries (Rs700 per share), the stock trades at 25x FY09E EPS and 4.4x FY09E BV. The stock is **Under Review**.

HDFC: an investment profile

Company description

HDFC was incorporated in 1977 as the first specialized mortgage company in India. Besides this, it has also 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, 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. HDFC, being the leader in the market, is set to benefit the most.
- ✍ Strong management, high brand value, high RoE, 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 investment risks

- ✍ Increase in NPAs on account of sharp rise in interest rates during last one year.

Recent developments

- ✍ Raised Rs31b through a preferential allotment to Carlyle and Citigroup.
- ✍ Sold its stake in Intelnet BPO to Blackstone.
- ✍ Sold 24% stake in general insurance venture to ERGO.

Valuation and view

- ✍ Consistent loan book expansion by aggressive approvals and disbursements will drive core earnings growth over a couple of years.
- ✍ We expect earnings (pre-exceptionals) to grow by 23% CAGR over next two years.
- ✍ The stock is **Under Review**.

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)	FY08E	34.1	33.1	33.8
	FY09E	33.5	23.8	25.5
P/ABV (x)	FY08E	7.8	4.9	2.9
	FY09E	6.0	4.3	2.7
RoE (%)	FY08E	24.5	17.2	11.4
	FY09E	20.4	17.1	11.0
RoA (%)	FY08E	2.6	1.4	1.0
	FY09E	2.6	1.5	1.1

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	0.0	0.0	0.0
Domestic Inst	6.7	6.5	6.5
Foreign	80.0	78.9	79.5
Others	13.3	14.6	14.1

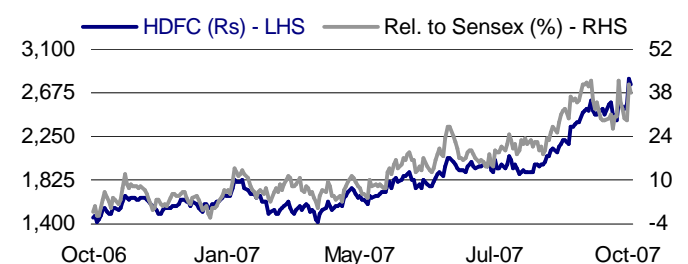
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	80.8	71.2	13.5
FY09	82.3	85.0	-3.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,756	-	-	UR

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007	2008E	2009E	
Operating Income	41,981	58,069	77,736	99,937	
Fees and Other Income	803	893	1,020	1,240	
Total Income	42,784	58,963	78,756	101,177	
Growth (%)	25.5	37.8	33.6	28.5	
Interest and Other Charges	24,911	36,669	50,684	66,169	
Net Income	17,873	22,294	28,072	35,008	
Growth (%)	23.2	24.7	25.9	24.7	
Staff Expenses	803	913	1,050	1,207	
Other Expenses	1,496	1,704	1,989	2,291	
PBT	15,573	19,678	25,034	31,510	
Growth (%)	23.9	26.4	27.2	25.9	
Exceptional Item	0.0	0.0	3,132.5	0.0	
Reported PBT	15,573	19,678	28,166	31,510	
Tax	3,000.0	3,974.0	6,947.6	7,877.5	
Tax Rate (%)	19.3	20.2	24.7	25.0	
PAT post exceptional item	12,573	15,704	21,219	23,632	
Growth (%)	21.3	24.9	35.1	11.4	
Proposed Dividend	4,991	5,566	6,775	7,896	

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2006	2007	2008E	2009E	
Share Capital	2,496	2,530	2,710	2,871	
Reserves and Surplus	42,188	52,984	94,103	130,860	
Net Worth	44,683	55,514	96,813	133,732	
Term Loans	199,954	242,242	302,802	393,643	
Bonds	179,840	225,844	282,305	366,997	
Deposits	87,421	103,844	119,421	143,305	
Loan Funds	467,214	571,930	704,528	903,945	
Growth (%)	27.5	22.4	23.2	28.3	
Total Liabilities	511,897	627,444	801,342	1,037,676	
Loans Granted	449,901	565,124	734,661	955,059	
Growth (%)	24.9	25.6	30.0	30.0	
Investments	38,763	36,662	45,828	48,119	
Net Current Assets	19,986	22,297	17,009	30,120	
Fixed Assets	2,473	2,131	2,344	2,578	
Other Assets	774	1,231	1,500	1,800	
Total Assets	511,897	627,444	801,342	1,037,676	

ASSUMPTIONS		(%)			
Y/E MARCH	2006	2007	2008E	2009E	
Growth in Sanctions	29.0	28.0	28.0	28.0	
Growth in Disbursals	27.0	27.0	30.0	26.0	
Dividend	200.0	220.0	250.0	275.0	

E: MOST Estimates

RATIOS					
Y/E MARCH	2006	2007	2008E	2009E	
Spreads Analysis (%)					
Yield on Housing	8.5	9.6	10.7	10.8	
Avg Yield - Earning Assets	8.5	9.4	10.1	10.3	
Avg Cost - Int Bearing Liab.	6.0	7.1	7.9	8.2	
Net Interest Margin	2.5	2.4	2.7	2.8	

Profitability Ratios (%)					
RoE	30.1	31.3	23.7	20.5	
RoA	2.7	2.8	2.5	2.6	
Op. Exps / Net Income	11.0	9.8	9.1	8.4	
Fee Income / Loan Portfolio	3.3	2.6	2.3	2.3	
Int Charges / Operating Income	59.3	63.1	65.2	66.2	

Growth Ratios					
Operating Income	27.3	38.3	33.9	28.6	
Interest Charges	27.1	47.2	38.2	30.6	
Net Income	23.2	24.7	25.9	24.7	
PBT	23.9	26.4	27.2	25.9	
Loan Portfolio	24.9	25.6	30.0	30.0	
Loan Funds	27.5	22.4	23.2	28.3	

Efficiency Ratios (%)					
Gross NPAs (Rs m)	4,464	7,855	11,811	15,484	
Gross NPAs	10	0.1	0.2	0.2	
Net NPAs (Rs m)	659	86	1,242	1,415	
Net NPAs	0.0	0.0	0.0	0.0	
CAR	15.0	13.0	13.0	13.0	

Valuation					
EPS (Rs)	50.4	62.1	78.3	82.3	
Growth (%)	21.1	23.2	26.1	5.1	
P/E (x)	54.7	44.4	35.2	33.5	
Book Value (Rs)	179	219	357	466	
Growth (%)	14.9	22.5	62.8	30.4	
P/BV (x)	15.4	12.6	7.7	5.9	
Adjusted BV (Rs)	176	219	353	461	
P/ABV (x)	15.6	12.6	7.8	6.0	

E: MOST Estimates



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Disclosure of Interest Statement

HDFC

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|---|----|
| 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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