



HDFC

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,843	HDFC IN
S&P CNX: 4,399	REUTERS CODE
	HDFC.BO

22 July 2009

Neutral

Previous Recommendation: Neutral

Rs2,410

Equity Shares (m)	287.1
52-Week Range	2,619/1,116
1,6,12 Rel.Perf.(%)	1/4/7
M.Cap. (Rs b)	692.0
M.Cap. (US\$ b)	14.6

YEAR	NET INCOME	PAT	Adj EPS	EPS	AP/E*	P/BV	CAR	ROAE	ROAA	AP/ABV*
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
3/08A	30,532	19,400	68.3	11.9	28.9	5.7	16.5	22.2	2.6	6.3
3/09A	35,852	22,825	80.2	17.5	25.2	5.2	15.1	18.2	2.5	6.1
3/10E	41,224	26,655	92.8	15.7	19.1	4.7	13.9	19.2	2.4	4.8
3/11E	48,055	31,170	108.6	16.9	15.9	4.2	13.8	20.1	2.4	4.0

* Price is adjusted for value of key ventures. BV is adjusted for investments in key ventures

Business growth picks up: HDFC's 1QFY10 PAT increased 21% to Rs5.65b as against our estimate of Rs5.87b. Key highlights:

- Disbursements grew 21% YoY to Rs87b and sanctions grew 22% YoY to Rs123b, highlighting a surge in demand.
- Loan growth (including real estate commercial deposits and bonds) slowed down to 12% YoY. However, adjusted for Rs14b loans sold to HDFC Bank in 1QFY10 and cumulative sell-downs of Rs56b, the overall loan book grew 20% YoY and individual loans grew 16% YoY.
- Core NII growth was just 8% in 1QFY10; including fees, NII grew 13% - in line with loan growth. Spreads declined by 7bp YoY/QoQ to 2.19%.
- Fees grew 9x in 1QFY10 and capital gains were Rs510m v/s nil a year ago, driving up profits during the quarter.
- PBT growth excluding capital gains was 12% YoY.
- Asset quality remains robust, with gross NPA of 0.98% on 90 days overdue basis.

Maintain Neutral, as valuations are rich: We estimate earnings CAGR of 17% over FY09-11. We expect core RoE to improve to 25% by FY10/11. The stock trades at AP/ABV of 4x FY11E (price adjusted for value of key ventures and book value adjusted for investment in those ventures) and AP/E of 16x. Valuations are rich; maintain **Neutral**.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY09				FY10				FY09	FY10E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Interest Income	22,435	25,279	28,587	30,141	26,894	27,557	15,333	45,197	106,442	114,981
Interest Expense	15,684	17,573	20,427	20,641	19,628	19,300	9,846	29,983	74,324	78,757
Net Interest Income	6,751	7,707	8,160	9,500	7,266	8,256	5,488	15,214	32,118	36,224
YoY Change (%)	34.2	20.8	14.9	5.3	7.6	7.1	-32.8	60.1	16.7	12.8
Profit on sale of investments	0	226	15	12	513	300	200	237	252	1,250
Other operating income	700	646	590	1,317	1,035	974	800	681	3,254	3,490
Net Operating Income	7,451	8,578	8,766	10,828	8,814	9,530	6,488	16,132	35,623	40,964
YoY Change (%)	28.1	29.0	5.1	13.8	18.3	11.1	-26.0	49.0	17.4	15.0
Other Income	51	55	56	66	49	51	52	108	229	260
Total Income	7,503	8,633	8,821	10,894	8,863	9,581	6,540	16,240	35,852	41,224
Operating Expenses	904	874	886	498	944	940	890	780	3,162	3,553
Pre provisioning Profit	6,599	7,760	7,936	10,396	7,919	8,641	5,650	15,460	32,690	37,671
YoY Change (%)	28.7	30.5	3.6	16.2	20.0	11.4	-28.8	48.7	18.0	15.2
Provisions	100	160	120	120	120	176	177	177	500	650
PBT	6,499	7,600	7,816	10,276	7,799	8,465	5,473	15,283	32,190	37,021
YoY Change (%)	28.7	-15.2	-11.3	-5.8	20.0	11.4	-30.0	48.7	-4.6	15.0
Provision for Tax	1,818	2,258	2,348	2,943	2,150	2,370	1,532	4,313	9,365	10,366
PAT	4,681	5,342	5,468	7,334	5,649	6,095	3,940	10,970	22,825	26,655
YoY Change (%)	25.6	-17.4	-15.7	-4.4	20.7	14.1	-27.9	49.6	-6.3	16.8

E: MOSL Estimates

Business growth picks up

Disbursements grew 21% YoY to Rs87b and sanctions grew 22% YoY to Rs123b in 1QFY10, highlighting a surge in demand. However, loan growth (including real estate commercial deposits and bonds) slowed down to 12% YoY, as individual home loan growth was just 5% YoY (flat QoQ). Rs14b of loans were sold to HDFC Bank during 1QFY10. Adjusted for cumulative sell-downs of Rs56b to HDFC Bank, loan book grew 20% YoY and individual loans grew 16% YoY.

Spreads at 2.2%; management sees no pressure

Interest income grew 20% YoY (we have included treasury interest income) and interest expense grew 25% YoY. NII grew 8% YoY to Rs7.3b. Spreads declined by 7bp QoQ and YoY to 2.19% in 1QFY10. The management believes that comfort on funding costs would enable it to maintain spreads despite a cut in lending rates.

Other operating income growth strong

Fee income was Rs442m in 1QFY10 v/s Rs49m in 1QFY09 due to stronger fees on wholesale business during the quarter. Capital gains were Rs513m in 1QFY10 as against nil in 1QFY09. Excluding capital gains, PBT growth was 12% YoY. While dividend income in 1QFY10 is the same as in 1QFY09, it excludes dividend of ~Rs520m from HDFC Bank, which will be accounted in 2QFY10.

EARNINGS SNAPSHOT (RS M)

	1QFY10	1QFY09	YOY GR (%)	4QFY09	QOQ GR (%)
Interest Income	26,894	22,435	20	30,141	-10.8
Interest Expense	19,628	15,684	25	20,641	-4.9
Net Interest Income	7,266	6,751	8	9,500	-23.5
Fees	442	49	807	752	-41.3
NII Including fees	7,708	6,800	13	10,252	-24.8
Dividend	562	599	-6	533	5.4
Net Operating Income	8,269	7,398	12	10,785	-23.3
Other Income	80	104	-23	98	-17.9
Net Income	8,350	7,503	11	10,883	-23.3
Operating Expenses	944	904	4	498	89.4
Provisions	120	100	20	120	0.0
PBT ex capital gains	7,286	6,499	12	10,265	-29.0
Capital Gains	513	0	NA	12	4285.5
Reported PBT	7,799	6,499	20	10,276	-24.1

Source: Company/MOSL

Maintain Neutral

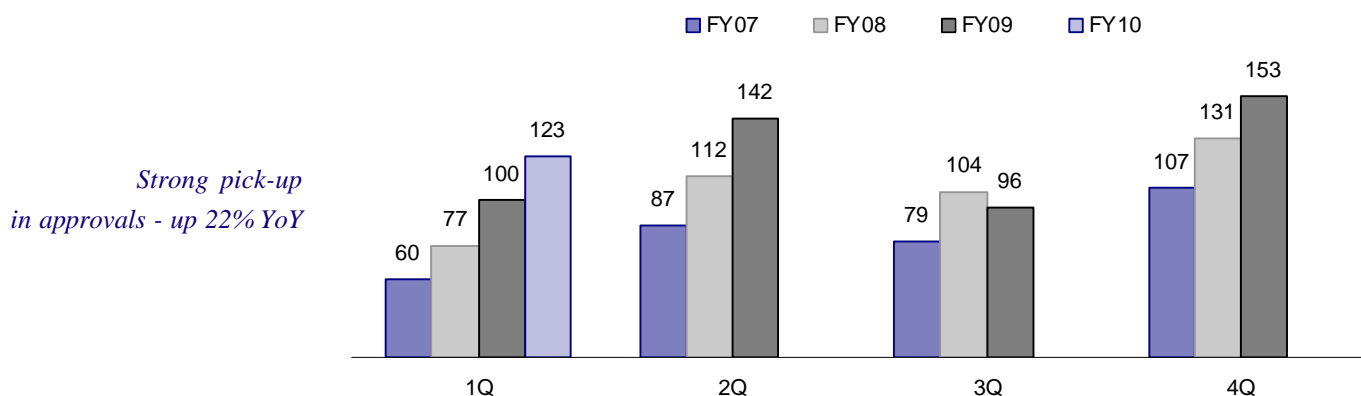
We expect HDFC to report EPS of Rs93 in FY10 and Rs109 in FY11. BV would be Rs509/share in FY10 and Rs570/share in FY11. Key investments, namely HDFC Bank, HDFC Standard Life, HDFC AMC, HDFC General Insurance, Gruh Finance and Property Funds are valued (post 20% holding company discount) at Rs686/share on FY11 basis. The stock trades at AP/ABV of 4x FY11E (price adjusted for value of key ventures and book value adjusted for investment in those ventures) and AP/E of 16x. Valuations are rich. We maintain **Neutral**, with a target price of Rs2,190 (3.5x core FY11E BV + Rs686/share for other businesses).

SOTP FY11E BASED (RS)

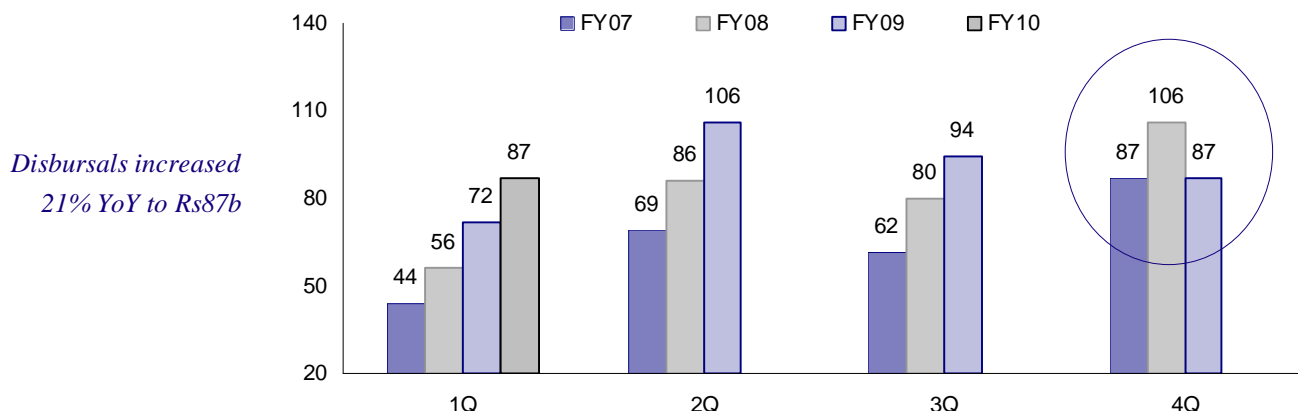
	VALUE (RS B)	VALUE (USDB)	VALUE/SH. (RS)	% OF TOTAL	RATIONALE
Core business	432	9.1	1,504	68.7	3.5x FY11 Adjusted BV (for invests in subs and historical invests in HDFC Bank)
Key Ventures					
HDFC Bank	160	3.4	559	25.5	Valued at Rs1477/share 2.8x FY11E BV
HDFC Standard Life (72.5% stake)	55	1.2	192	8.8	15x FY11E NBAP; 10% APE CAGR in FY09- FY11E
HDFC AMC (60% stake)	16	0.3	54	2.5	3% FY11E AUM
HDFC General Insurance (74% stake)	6	0.1	20	0.9	Recent state sale value
Property Funds	6	0.1	23	1.0	12% of total AUM USD1b
Gruh Finance	3	0.1	10	0.5	Valued at 1.5x FY11E BV
Total Value of Ventures	246	5.2	858	39.2	
Less: 20% holding discount	49	1.0	172	7.8	
Value of Key Ventures	197	4.1	686	31.3	
Target Value Post 20% Holding	629	13.2	2,190	100.0	
CMP	692	14.6	2,410		
Upside - %	-9	-9	-9		
Target Price w/o 20% Holding	678	14.3	2,362		
CMP	692	14.6	2,410		
Upside - %	-2	-2	-2		

Source: MOSL

LOAN SANCTION TRENDS (RS B)



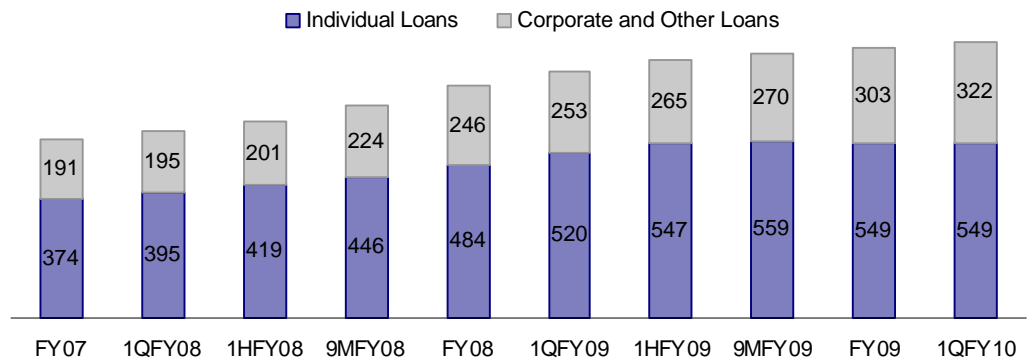
DISBURSAL TRENDS (RS B)



Source: Company/MOSL

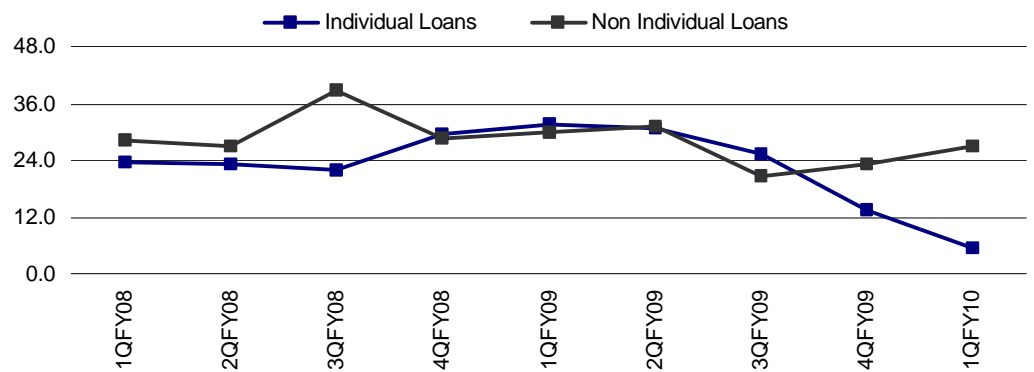
LOAN BOOK COMPOSITION (RS B)

Loan book growth slowed down to 13% due to sell-down of home loans; adjusted for sell-down, loans grew 20% YoY



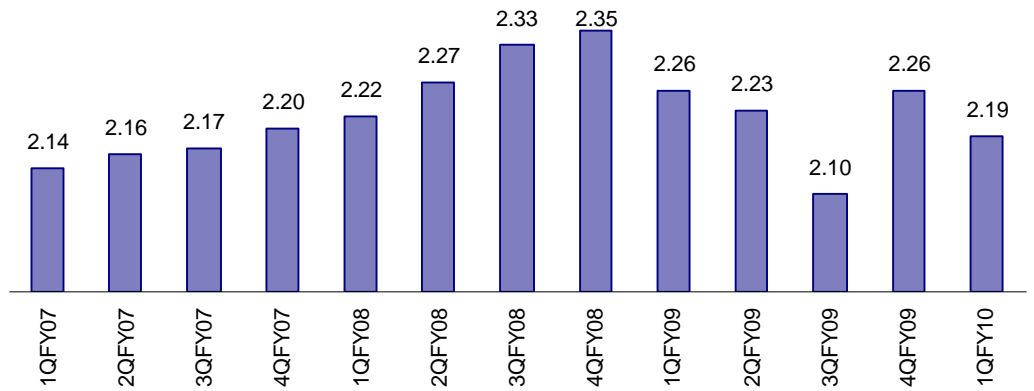
TREND IN LOAN GROWTH FOR INDIVIDUAL AND NON-INDIVIDUAL LOANS (%)

Adjusted for sell-down to HDFC Bank, individual loans grew 16% YoY



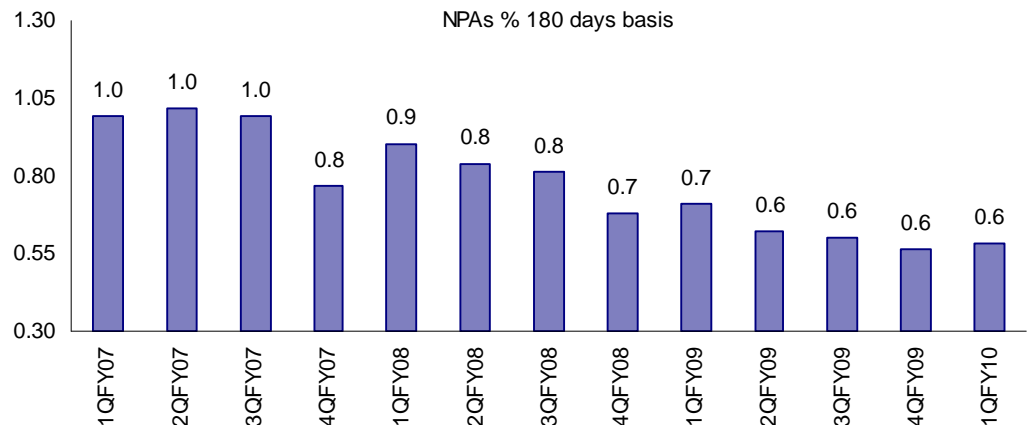
SPREADS (%)

Spreads declined 7bp QoQ and YoY to 2.19%



TREND IN ASSET QUALITY

Asset quality remains robust



Source: Company/MOSL

HDFC: an investment profile

Company description

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 businesses by having stakes in companies like HDFC Standard Life Insurance Co, HDFC Asset Management Co, HDFC Bank, CIBIL and HDFC General Insurance Co. It functions through a wide network of 267 offices, direct selling agents and outreach programs.

Key investment arguments

- ✍ Huge potential in the 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

- ✍ The Corporation is in the process of undertaking QIP offering of warrants simultaneously with secured redeemable NCD to QIBs for the maximum amt of Rs40b. The warrants can be exchanged at the option of the warrant holder at a later date for a maximum of 10.95m equity shares, (3.5% of the expanded capital).
- ✍ Reduced Retail PLR for new borrowers by 50bp.

Valuation and view

- ✍ Consistent loan book expansion by aggressive loan approvals and disbursements will drive core earnings growth over the next couple of years.
- ✍ We expect earnings to grow at ~17% CAGR over FY09-11E.
- ✍ We value key investments at Rs686 per share and core lending business at 3.5x FY11E ABV. **Neutral.**

Sector view

- ✍ With the pick up in economic growth; housing loan growth is expected to pick up significantly.
- ✍ Increasing urbanization, rising disposable income, low interest rates and existing tax sops will keep the demand for mortgages buoyant.
- ✍ Increasing competition from PSU banks may lead to pressure on yields and spreads going forward.

COMPARATIVE VALUATIONS

		HDFC*	HDFC BANK	ICICI BANK*
P/E (x)	FY10E	19.1	23.1	17.3
	FY11E	15.9	17.4	13.4
P/BV (x)	FY10E	4.8	3.2	1.9
	FY11E	4.0	2.8	1.8
RoE (%)	FY10E	19.2	15.9	11.0
	FY11E	20.1	17.0	13.6
RoA (%)	FY10E	2.4	1.4	1.0
	FY11E	2.4	1.6	1.2

* Valuation adjusted for investment in key subsidiaries

SHAREHOLDING PATTERN (%)

	JUN-09	MAR-09	JUN-08
Promoter	0.0	0.0	0.0
Domestic Inst	12.8	12.3	10.7
Foreign	75.1	75.1	76.1
Others	12.1	12.7	13.3

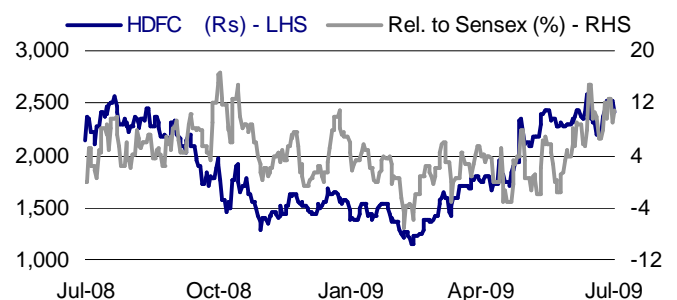
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY10	92.8	91.9	1.0
FY11	108.6	106.2	2.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,410	2,190	-	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2008	2009	2010E	2011E	
Interest Income	78,958	106,442	114,981	131,728	
Interest Expended	51,429	74,324	78,757	89,232	
Net Interest Income	27,529	32,118	36,224	42,496	
<i>Change (%)</i>	63.3	16.7	12.8	17.3	
Fees and Other Charges	632	1,149	1,390	1,459	
Other Operating Income	2,174	2,356	3,350	3,800	
Miscellaneous Income	197	229	260	300	
Net Income	30,532	35,852	41,224	48,055	
<i>Change (%)</i>	39.0	17.4	15.0	16.6	
Operating Expenses	2,839	3,162	3,553	3,963	
Operating Income	27,692	32,690	37,671	44,092	
<i>Change (%)</i>	41.3	18.0	15.2	17.0	
Provisions/w rite offs	320	500	650	800	
PBT	27,372	32,190	37,021	43,292	
Extraordinary Items	6,363	0	0	0	
Reported PBT	33,735	32,190	37,021	43,292	
Tax	9,373	9,365	10,366	12,122	
<i>Tax Rate (%)</i>	34.2	29.1	28.0	28.0	
Reported PAT	24,363	22,825	26,655	31,170	
<i>Change (%)</i>	55.1	-6.3	16.8	16.9	
PAT adjusted for Extra ordinary	19,400	22,825	26,655	31,170	
<i>Change (%)</i>	25.6	17.7	16.8	16.9	
Proposed Dividend	8,308	9,941	11,758	13,438	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2008	2009	2010E	2011E	
Capital	2,840	2,844	2,871	2,871	
Reserves & Surplus	116,633	128,529	143,161	160,892	
Net Worth	119,473	131,373	146,032	163,764	
Loans from Banks	211,998	248,143	309,030	333,610	
Bonds/Debentures	366,552	396,671	476,005	571,206	
Deposits	112,963	193,747	213,121	245,090	
Borrowings	691,512	838,561	998,157	1,149,906	
<i>Change (%)</i>	20.9	21.3	19.0	15.2	
Other Liabilities & Prov.	33,220	46,635	52,314	58,016	
Total Liabilities	844,205	1,016,569	1,196,503	1,371,685	
Cash and bank balance	7,777	8,000	11,028	5,776	
Investments	69,150	104,687	130,859	130,859	
<i>Change (%)</i>	88.6	51.4	25.0	0.0	
Housing loans	733,278	851,981	998,157	1,173,373	
<i>Change (%)</i>	29.8	16.2	17.2	17.6	
Net Fixed Assets	2,085	2,034	1,979	1,949	
Deferred Tax Assets	1,466	2,158	2,000	2,000	
Other Assets	30,449	47,708	52,479	57,727	
Total Assets	844,205	1,016,569	1,196,503	1,371,685	

ASSUMPTIONS	(%)			
Sanctions Grow th	27.6	15.6	18.0	18.0
Disbursements Grow th	25.6	20.6	18.5	18.0
Loan Grow th	29.8	16.2	17.2	17.6
Borrow ings Grow th	20.9	21.3	19.0	15.2
Dividend	250.0	300.0	350.0	400.0

E: MOSL Estimates

RATIOS				
Y/E MARCH	2008	2009	2010E	2011E
Spreads Analysis (%)				
Avg Yield on Housing Loans	11.2	12.5	11.7	11.5
Avg. Yield on Earning Assets	11.1	12.0	10.9	10.8
Avg. Cost-Int. Bear. Liab.	8.1	9.7	8.6	8.3
Interest Spread	2.9	2.3	2.4	2.4
Net Interest Margin	3.9	3.6	3.4	3.5
Profitability Ratios (%)				
RoE	22.2	18.2	19.2	20.1
Core Lending RoE	28.0	23.7	24.9	25.2
RoA	2.6	2.5	2.4	2.4
Efficiency Ratios (%)				
Int. Expended/Int.Earned	65.1	69.8	68.5	67.7
Other Inc./Net Income	9.8	10.4	12.1	11.6
Fees/Total income	0.8	1.0	1.2	1.1
Op. Exps./Net Income	9.3	8.8	8.6	8.2
Empl. Cost/Op. Exps.	41.5	43.8	44.9	46.3
Asset Quality (%)				
Gross NPAs	6,160	7,016	8,719	10,716
Gross NPAs to Adv.	0.8	0.8	0.9	0.9
Net NPAs	1,540	800	2,180	2,679
Net NPAs to Adv.	0.2	0.1	0.2	0.2
CAR	16.5	15.1	13.9	13.8
VALUATION				
Book Value (Rs)	420.6	461.9	508.6	570.3
Price-BV (x)	5.7	5.2	4.7	4.2
Adjusted BV* (Rs)	312.6	330.4	373.2	429.7
Adj Price-ABV (x)	6.3	6.1	4.8	4.0
EPS (Rs)	68.3	80.2	92.8	108.6
EPS Growth (%)	11.9	17.5	15.7	16.9
Adj Price-Earnings (x)	28.9	25.2	19.1	15.9
OPS (Rs)	97.5	114.9	131.2	153.6
OPS Growth (%)	25.9	17.9	14.2	17.0
Adj Price-OP (x)	20.2	17.6	13.5	11.2

E: MOSL Estimates; * Book Value is adjusted by deducting investments in key ventures from net worth



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	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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