



HDFC

STOCK INFO.	BLOOMBERG
BSE Sensex: 17,287	HDFC IN
	REUTERS CODE
S&P CNX: 5,166	HDFC.BO

30 April 2008

Buy

Rs2,800

Previous Recommendation: Buy

Equity Shares (m)	287.7
52-Week Range	3,262/1,532
1,6,12 Rel.Perf.(%)	2/13/43
M.Cap. (Rs b)	805.7
M.Cap. (US\$ b)	20.0

YEAR	NET INCOME	PAT	EPS	EPS	AP/E*	P/BV	CAR	ROAE	ROAA	AP/ABV*
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	RATIO
3/07A	21,964	15,704	62.1	23.2	33.7	12.8	13.0	29.0	2.5	13.4
3/08E	30,532	24,363	85.8	38.2	24.4	6.7	16.5	22.2	2.7	6.6
3/09E	37,392	24,932	86.6	1.0	24.1	5.8	15.0	19.3	2.7	5.8
3/10E	45,710	30,621	106.4	22.8	19.6	5.2	14.0	20.8	2.8	5.3

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

Strong performance: HDFC's 4QFY08 reported PAT grew by 40% YoY on the back of: (1) strong operating performance; and (2) exceptional capital gain on stake sale in the general insurance venture. Excluding capital gains (pre tax ~Rs2b in 4QFY08) PBT from core operations posted strong 32% YoY growth to Rs8.9b (v/s estimate of Rs8.4b). Business momentum continues to be strong with approvals up 28% and disbursements up 26% in FY08. Spreads improved to 2.33%. Gross NPAs are at 0.7% on 180 days overdue basis.

For full year FY08, HDFC recorded pre tax exceptional profit of Rs6.4b. Adjusted for the exceptional, PBT recorded strong growth by 41% to Rs27.4b and PAT was up by 34% to Rs19.4b.

- Loan growth continued to be strong at 29% to 730b in FY08. Disbursements were up 22% YoY to Rs106b in 4QFY08. This continued traction is commendable when other players, mainly banks, are experiencing a slowdown in housing demand (ICICI Bank's housing disbursements were down 50% YoY in 4QFY08). Management is confident of sustaining 25% growth in loans over next couple of years.
- Spreads have improved to 2.33% in FY08 from 2.17% in FY07. While in the long run, spreads would reduce to ~2.2%; we believe that HDFC can sustain the higher spreads for the next couple of quarters.

Maintain Buy: We value HDFC's key investment at Rs710 per share (post 20% holding company discount). Adjusted for these investments, the stock trades at 24x FY09E EPS and 20x FY10E EPS. Maintain **Buy** with a price target of Rs3,265 (24x FY10E EPS + Rs710 of subs value), an upside of 17%.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY07				FY08				FY07	FY08
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Income from Operations	12,457	14,468	14,538	17,285	18,270	18,886	21,504	23,112	58,425	81,764
Other Income	28	95	39	45	34	39	44	90	208	197
Reported Total Income	12,485	14,563	14,577	17,330	18,304	18,925	21,547	23,202	58,633	81,961
Total Income ex invst. profits	11,975	13,382	13,896	16,454	18,044	18,912	20,513	23,159	55,705	80,628
YoY Change (%)	30.7	35.3	40.2	43.6	50.7	41.3	47.6	40.8	37.0	39.8
Interest and Other Charges	8,014	9,137	9,475	10,042	12,451	12,238	13,160	13,598	36,669	51,429
Other Expenses	667	686	614	474	765	823	741	664	2,442	2,993
Total Expenses	8,681	9,823	10,089	10,517	13,217	13,061	13,901	14,262	39,110	54,422
PBDT	3,805	4,740	4,488	6,813	5,087	5,864	7,646	8,940	19,523	27,538
YoY Change (%)	22.0	22.3	25.6	31.4	33.7	23.7	70.4	31.2	23.9	41.1
Depreciation	37	39	47	52	37	40	44	45	175	166
PBT Pre exceptional income	3,767	4,701	4,441	6,761	5,050	5,824	7,602	8,896	19,348	27,372
Exceptional Profits	0	0	0	0	0	3,133	1,209	2,021	330	6,363
Reported PBT	3,767	4,701	4,441	6,761	5,050	8,957	8,812	10,916	19,678	33,735
Provision for Tax	799	1,021	886	1,261	1,322	2,493	2,323	3,235	3,974	9,373
Reported PAT	2,968	3,680	3,555	5,501	3,728	6,464	6,489	7,681	15,704	24,363
YoY Change (%)	20.0	23.1	25.0	29.0	25.6	75.6	82.5	39.6	24.9	55.1
PAT ex exceptional	2,968	3,680	3,555	5,501	3,728	4,505	5,880	6,880	14,511	19,442
YoY Change (%)	20.0	23.1	25.2	29.0	25.6	22.4	65.4	25.1	24.9	34.0

E: MOST Estimates

Business growth commendable in slowing environment

Approvals increased 23% YoY to Rs131b in 4QFY08 and 28% in FY08 to Rs425b. Disbursements were up 22% YoY to Rs106b in 4QFY08 and 26% in FY08 to Rs329b. Strong loan growth continued at 29% to 730b in FY08. This is in line with our view that as banks go slow in mortgages, the pure mortgage finance companies are likely to increase market share and thereby maintain their growth. Management is confident of sustaining 25% CAGR in loan book over next several years (27% CAGR in FY03-08).

DISBURSEMENTS IN MORTGAGES (RS B)

	FY07				FY08			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
ICICI Bank	63	70	78	74	45	54	50	37
HDFC	44	69	62	87	56	86	80	106

Source: Company/Motilal Oswal Securities

Exceptional profits boost earnings

HDFC sold ~24% stake in its general insurance venture in 4QFY08 to Ergo making an exceptional pre-tax profit of Rs2b. HDFC has sold 6% stake in life insurance to Standard Life making a pre-tax exceptional profit of Rs1.2b in 3QFY08 and has exited from its BPO operation - Intelnet making a pre-tax exceptional profit of Rs3b in 2QFY08.

Thus for FY08, HDFC has recorded pre tax exceptional profits of Rs6.4b. Adjusted for these exceptionals, PBT in FY08 grew strong by 41% to Rs27.4b and PAT grew by 34% to Rs19.4b. HDFC's tax rate (on lending operations) has increased from ~22% a couple of years ago to ~29% in FY08 on account of partial withdrawal of tax benefits under Income Tax Act. Management expects a tax rate of 25-26% going forward.

No equity dilution necessary mid term

Post the capital raising in FY08, capital adequacy has improved to 16.8%. Tier I CAR increased to 14.6% (v/s required 6%). High Tier I CAR implies that HDFC would be able to infuse capital of Rs40b in HDFC Bank (expected over next 18-24 months to keep its shareholding in the bank at >20% post CBoP acquisition) without resorting to equity dilution. RBI in its policy has allowed housing loans up to Rs3m to be assigned 50% risk weight v/s a cap of Rs2m earlier. This regulatory change, when it becomes effective for HDFC, would further release capital and improve CAR. Management also plans to list its asset management venture and life insurance over next 12-18 months which would:

- (a) unlock value for the shareholders; and
- (b) provide capital to the parent.

HDFC's RoE from core lending would increase to 25% by FY09 and 27% by FY10 and the internal accruals would sustain the loan book growth for future.

Recommendation: Maintain Buy

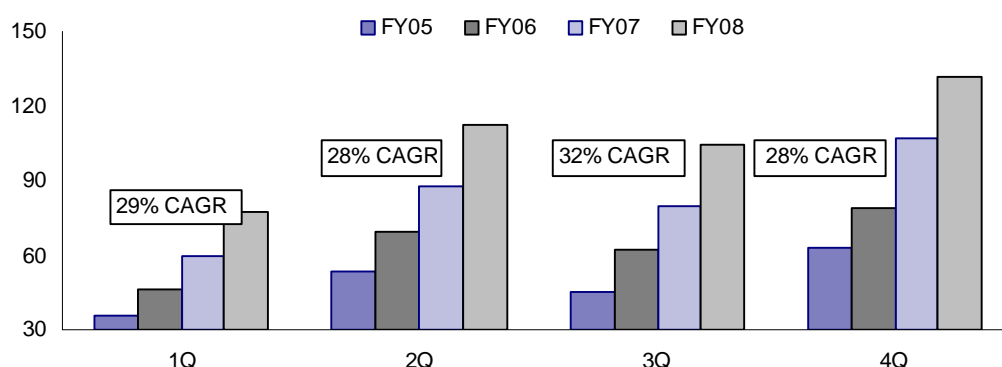
We expect earnings (pre-exceptional) to post 23% CAGR on the back of loan book CAGR of 25% over FY08-10E. We value HDFC's key investment viz. HDFC Bank, HDFC Standard Life, HDFC AMC, HDFC General Insurance, Gruh Finance and Property Funds at Rs710 per share (post 20% holding company discount). Adjusted for these investments, the stock trades at 24x FY09E EPS and 20x FY10E EPS. RoE of the core lending business remains attractive at 25%+. Maintain **Buy** with a price target of Rs3,265 (24x FY10E EPS + Rs710 of subs value), an upside of 17%.

HDFC: SOTP FY10E BASED

	VALUE (RSB)	VALUE (US\$B)	VALUE/ (SHARE RS)	% OF TOTAL	RATIONALE
HDFC	734.9	18.5	2,554.0	78.2	24x FY10E EPS
Key Ventures					
HDFC Bank (23% stake)	111.2	2.8	386.5	11.8	Unrealised gains at Rs1550/share (3.5x FY10E BV) of HDFC Bank pre CBoP merger
HDFC Standard Life (72.5% stake)	88.7	2.2	308.1	9.4	15x FY10E NBAP; 45% CAGR in APE in FY07-10E
HDFC AMC (60% stake)	35.9	0.9	124.9	3.8	6% FY10E AUM
HDFC General Insurance (74% stake)	8.2	0.2	28.5	0.9	Current stake sale value + 20% growth assumed for FY10
Gruh Finance	5.5	0.1	19.1	0.6	Valued at 3x FY10E BV
Property Funds	6.3	0.2	21.9	0.7	15% of total AUM USD1b
Total Value of Ventures	255.8	6.4	889.1	27.2	
Less: 20% holding Discount	51.2	1.3	177.8	5.4	
Value of Key Ventures	204.7	5.2	711.3	21.8	
Target Value Post 20% Holding					
Company Discount	939.6	23.7	3,265.4	100.0	
CMP (Rs)	805.7	20.3	2,800.0		
Upside (%)	16.6	16.6	16.6		
Target Price w/o 20% Holding					
Company Discount	990.7	25.0	3,443.2		
CMP (Rs)	805.7	20.3	2,800.0		
Upside (%)	23.0	23.0	23.0		

Source: Motilal Oswal Securities

QUARTERLY APPROVALS (RS B)

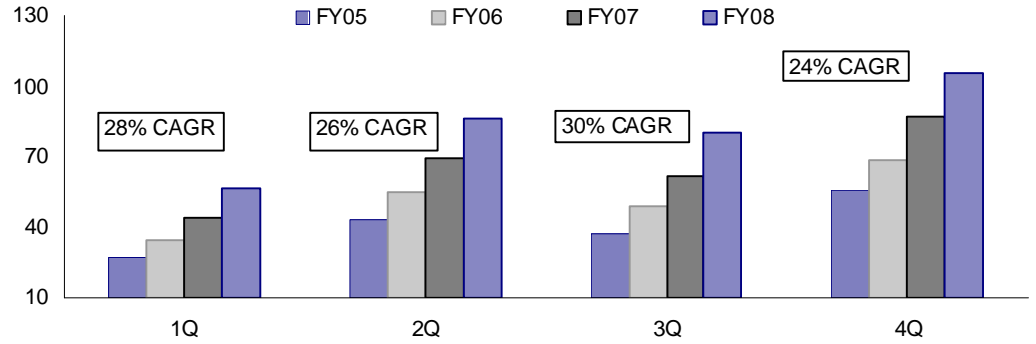


Approvals sustain historical growth despite slowing environment

Source: Company/Motilal Oswal Securities

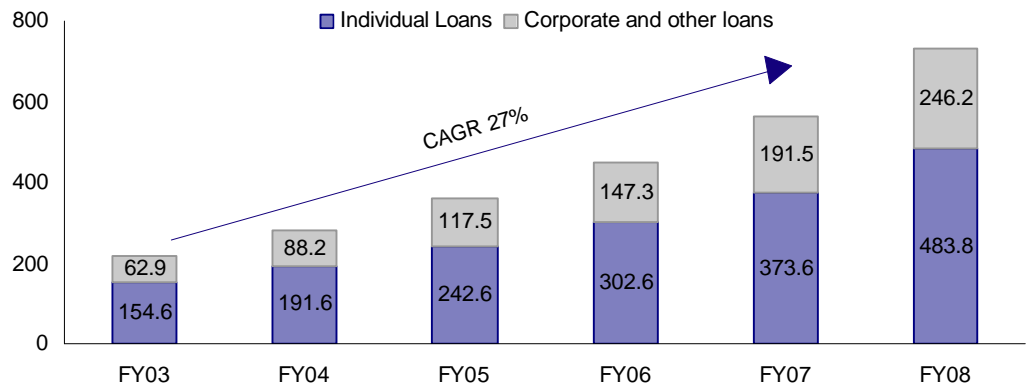
QUARTERLY DISBURSALS (RS B)

Disbursals growth maintained



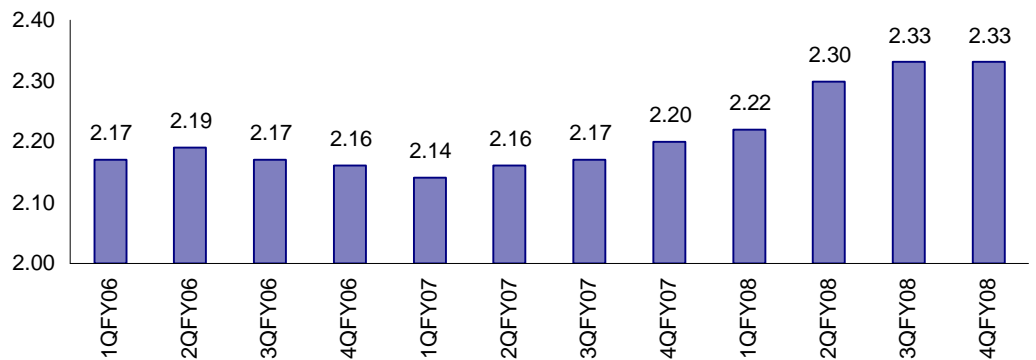
LOAN BOOK (RS B)

Loan book would sustain 25% CAGR over FY08-10E



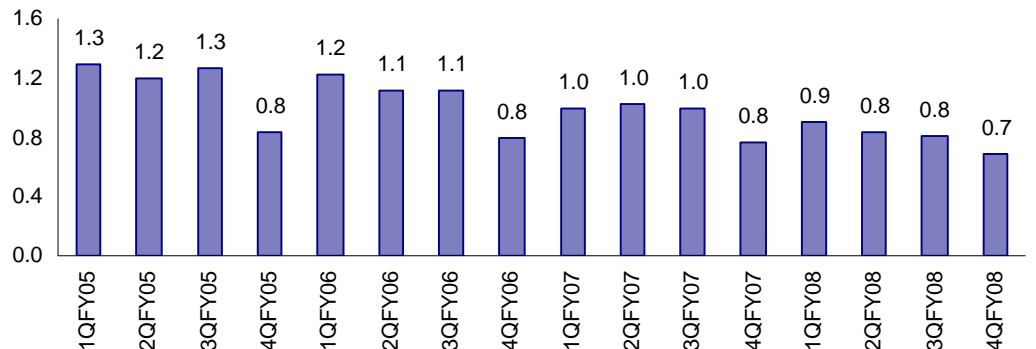
SPREAD ON LOANS (%)

Spreads can remain high in FY09



NPAS % 180 DAYS BASIS

Asset quality robust despite strong loan book growth



Source: Company/Motilal Oswal Securities

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 244 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

- ✍ 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 loan approvals and disbursements will drive core earnings growth over the next couple of years.
- ✍ We expect earnings (pre-exceptional) to grow at 23% CAGR over FY08-10E
- ✍ We value key investments at Rs711 per share and core lending business at 24x FY10E EPS. Maintain **Buy**.

Sector view

- ✍ Industry has significantly slowed down during FY08 as banks are extremely cautious.
- ✍ 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	ICICI BANK*
PE (x)	FY09E	24.1	25.2	13.0
	FY10E	19.6	19.1	10.3
P/BV (x)	FY09E	5.8	4.1	1.5
	FY10E	5.3	3.5	1.4
RoE (%)	FY09E	19.3	17.4	10.7
	FY10E	20.8	19.8	12.4
RoA (%)	FY09E	2.7	1.4	1.2
	FY10E	2.8	1.4	1.3

* Valuation adjusted for investment in key ventures

SHAREHOLDING PATTERN (%)

	MAR-08	DEC-07	MAR-07
Promoter	0.0	0.0	0.0
Domestic Inst	9.2	7.9	5.7
Foreign	77.9	79.3	79.5
Others	12.9	12.8	14.8

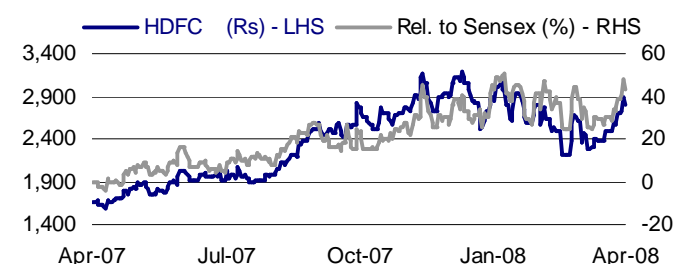
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	86.6	82.5	5.0
FY09	106.4	97.2	9.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,800	3,265	16.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(Rs Million)
Y/E MARCH	2006	2007	2008	2009 E	2010 E	
Operating Income	41,981	57,740	81,131	100,847	124,905	
Fees and Other Income	803	893	829	872	872	
Total Income	42,784	58,633	81,961	101,720	125,778	
<i>Growth (%)</i>	25.5	37.0	39.8	24.1	23.7	
Interest and Other Charges	24,911	36,669	51,429	64,327	80,068	
Net Income	17,873	21,964	30,532	37,392	45,710	
<i>Growth (%)</i>	23.2	22.9	39.0	22.5	22.2	
Staff Expenses	803	913	1,178	1,413	1,626	
Other Expenses	1,496	1,704	1,982	2,287	2,705	
PBT	15,573	19,348	27,372	33,692	41,380	
<i>Growth (%)</i>	23.9	24.2	41.5	23.1	22.8	
Exceptional Item	0.0	330	6,363	0.0	0.0	
Reported PBT	15,573	19,678	33,735	33,692	41,380	
Tax	3,000.0	3,974.0	9,372.5	8,759.9	10,758.7	
<i>Tax Rate (%)</i>	19.3	20.5	27.8	26.0	26.0	
PAT Pre Exceptional	12,573	15,704	20,256	24,932	30,621	
<i>Growth (%)</i>	21.3	24.9	29.0	23.1	22.8	
Reported PAT	12,573	15,704	24,363	24,932	30,621	
Proposed Dividend	4,991	6,512	8,308	10,773	13,466	

BALANCE SHEET						(Rs Million)
Y/E MARCH	2006	2007	2008	2009 E	2010 E	
Share Capital	2,496	2,530	2,840	2,877	2,877	
Reserves and Surplus	42,188	52,984	116,633	135,945	153,100	
Net Worth	44,683	55,514	119,473	138,823	155,977	
Term Loans	199,954	242,242	211,998	254,397	305,277	
Bonds	179,840	225,844	366,552	476,518	595,647	
Deposits	87,421	103,844	112,963	135,555	162,666	
Borrowings	467,214	571,930	691,512	866,470	1,063,590	
<i>Growth (%)</i>	27.5	22.4	20.9	25.3	22.7	
Total Liabilities	511,897	627,444	810,986	1,005,293	1,219,567	
Loans Granted	449,901	565,124	729,980	912,474	1,140,593	
<i>Growth (%)</i>	24.9	25.6	29.2	25.0	25.0	
Investments	38,763	36,662	69,150	60,970	66,820	
Net Current Assets	19,986	22,297	8,305	27,755	7,631	
Fixed Assets	2,473	2,131	2,085	2,293	2,523	
Other Assets	774	1,231	1,466	1,800	2,000	
Total Assets	511,897	627,444	810,986	1,005,293	1,219,567	

ASSUMPTIONS						(%)
Y/E MARCH	2006	2007	2008	2009 E	2010 E	
Growth in Sanctions	30.0	30.0	27.6	25.0	25.0	
Growth in Disbursals	27.6	26.6	25.2	25.0	25.0	
Dividend	200	220	250	320	400	

E: MOST Estimates

RATIOS

Y/E MARCH	2006	2007	2008	2009 E	2010 E
Spreads Analysis (%)					
Yield on Housing	8.5	9.6	11.1	11.0	11.0
Avg Yield - Earning Assets	8.5	9.4	10.9	10.7	10.9
Avg Cost - Int Bearing Liab.	6.0	7.1	8.1	8.3	8.3
Spread	2.5	2.4	2.7	2.5	2.6
Net Interest Margin	2.5	2.7	3.4	3.4	3.4

Profitability Ratios (%)

RoE	30.1	29.0	22.2	19.3	20.8
RoA	2.7	2.5	2.7	2.7	2.8
Op. Exps / Net Income	11.0	10.0	8.8	8.3	7.8
Fee Income / Loan Portfolio	3.3	2.6	1.9	1.5	1.2
Int Charges / Operating Income	59.3	63.5	63.4	63.8	64.1

Growth Ratios

Operating Income	27.3	37.5	40.5	24.3	23.9
Interest Charges	27.1	47.2	40.3	25.1	24.5
Net Income	23.2	22.9	39.0	22.5	22.2
PBT	23.9	24.2	41.5	23.1	22.8
Loan Portfolio	24.9	25.6	29.2	25.0	25.0
Loan Funds	27.5	22.4	20.9	25.3	22.7

Gross NPAs %	1.0	0.9	0.8	0.7	0.6
Net NPAs %	0.1	0.2	0.2	0.2	0.1
CAR	15.0	13.0	16.5	15.0	14.0

Valuation

EPS (Rs)	50.4	62.1	85.8	86.6	106.4
Growth (%)	21.1	23.2	38.2	1.0	22.8
AP/E (x)	41.5	33.7	24.4	24.1	19.6
Book Value (Rs)	179	219	421	482	542
Growth (%)	14.9	22.5	91.7	14.7	12.4
P/BV (x)	15.6	12.8	6.7	5.8	5.2
Adjusted BV* (Rs)	138	156	316	358	397
P/ABV (x)	15.1	13.4	6.6	5.8	5.3

E: MOST Estimates



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOS*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOS or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOS or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOS and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOS has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

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

This information is subject to change without any prior notice. MOS reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOS is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.