

HDFC (CMP Rs 1245) is a shareholder's dream company. **Deepak Pareikh** the chairman of HDFC is considered the smartest financial minds around. While HDFC is known more as a mortgage lender the inherent value of business that this company holds is oblivious to the general investor.

The break up of the joint family system and the movement of people away from their ancestral homes in search of better jobs created huge demand for housing in the early 1990's. While HDFC was quick to capitalize on this opportunity by extending housing finance the sheer pace of sustained growth at 25% to 30% for a major part of the last decade has created huge shareholder wealth. A snap shot of the company's financial reflect the following:

Market price	1245
RoE	28.8%
Market Capitalization	Rs 31,075 crores
Book value	186
Sustainable Growth	25%
Inherent value of subsidiaries	532 (Read note below)
EPS Fy 07 (E)	Rs 60.00
PE Fy 07	20.75
Value of core business	733(1245 – 532)
PE ratio of the core business	12.23
Overall PEG	0.83
PEG Fy 07 on core business	0.49
Book value	186
Price to Adjusted book	6.69 times.

Key highlights:

- **Excellent management.** Deepak Pareikh is a pioneer in the Indian Banking Industry
- Huge scope for housing loan companies. **Mortgages contribute to only 3% of GDP in India** whereas it is 10-15% in South east Asian economies and about 50% in the US.
- Very **high RoE of around 30%**. HDFC has been expanding its RoE by almost 1% each year. Other ratios like the **return on assets at 3%** with a **more than 2% spread** are also very attractive..
- In spite of a very high dividend pay out (40% of EPS) **HDFC will continue to record a CAGR of more than 25%.**
- **Excellent loan portfolio with near 0% NPA .**
- Unlike Banks **HDFC has to maintain SLR only on public deposits**
- **Diluted equity only once** over the past 10 years
- **Huge value in subsidiaries** which is yet to be unlocked.

Over the last **decade HDFC has made significant investments in banking, insurance, BPO and AMC . Most of these businesses are now achieving traction and growing faster than the normal mortgage business of the parent.** For HDFC earnings have continued to grow at above 25% and above for the past five years while these related diversifications show higher growth.

Subsidiary businesses	Value of Value per
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HDFC's holding	share	
HDFC Bank	Rs 5516 crores	221
Insurance	Rs 6000 crores	120
Mutual Fund Business	Rs 700 crores	28
Unbooked Treasury gains	Rs 700 crores	28
Intelenet	Rs 640 crores	13
Total value as on today		Rs 410
Add 30% for the growth this year		Rs122
Value of subsidiary on one year forward basis		Rs 532

Note :Investors could argue that valuation of subsidiaries held by parent companies are reflected at a discount to market price. But since I have not calculated the value of unlisted entities the same could be offset by that.

HDFC Bank: HDFC holds **22.2% stake in HDFC Bank**. On a present market capitalization of Rs 24,850 crores for HDFC Bank this **stake works out to Rs 5516 crore** for HDFC. For each of the 24.96 crore equity shares of HDFC the same works out to **Rs 221 per share**.

Insurance: HDFC Standard Life grew at more than 130% last year and will report a growth of 75% this year. Like all other private sector insurance companies the venture is still reporting losses. After the initial supernormal growth phase the new business for HDFC Standard Life could show a secular CAGR growth of 25%+. **Brokerages like Motilal Oswal have valued the Insurance business at of Rs 6,000 crores**. Since it is estimated that HDFC will finally hold only 50% in this venture the value per share for each of the 24.91 crore shares of HDFC works out to be (Rs 6,000 crores/24.91 x 50%).Rs 120 per share

I have **assigned a 50% value to HDFC since the investment bankers opine that HDFC's final shareholding pattern in HDFC Standard Life would be 50% only**.

AMC: HDFC AMC should be **valued at 7% of Assets under management** . The assets under management have a higher equity component equity component.. **Assuming a total AUM of Rs 20,000 crores HDFC's stake will be valued at Rs 700 crores** . This gives us a per share value of Rs 28 for the mutual fund business.

Unrealized gains in the Investment portfolio: The HDFC management had stated that it is **sitting on Rs 700 crores of unrealized gains arising from its holding in listed companies** only. This figure does not include **gains from price appreciation in unlisted businesses like Chalet Hotels, ILFS, HDFC Chubb and HDFC Venture Fund** . The net gain from listed

businesses amounts to about **Rs 28 per share**.

Intelenet: Motilal Oswal has **valued Intelenet at 20 times FY06E earnings**. The company grew by 100% in the previous year and at that valuation Intelenet should be worth around Rs640 crore.. **The value for HDFC's stake comes to around Rs320 crores** which for each of the 24.91 crore outstanding shares of HDFC **comes to about Rs 13 per share**

Recommendation: Investors trying to create a diversified broad based portfolio **should buy HDFC. The stock has the potential to go up by 8 to 10 times in the next decade.** Very rarely investors get stocks which they can buy and forget. HDFC is one of them .