

HDFC

STOCK INFO.	BLOOMBERG
BSE SENSEX: 8,779	HDFC IN
	REUTERS CODE
S&P CNX: 2,706	HDFC.BO

21 January 2009

Buy

Previous Recommendation: Buy

Rs1,372

Equity Shares (m)	288
52-Week Range	3,090/1,202
1,6,12 Rel.Perf.(%)	3/2/3
M.Cap. (Rs b)	394.9
M.Cap. (US\$ b)	8.0

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)	(%)	(%)	(%)	RATIO
3/07A	21,964	15,704	62.1	23.2	15.2	6.3	13.0	29.0	2.5	5.2
3/08A	30,532	24,363	68.4	10.3	13.8	3.3	16.5	22.2	2.7	2.5
3/09E	35,148	22,362	77.7	13.5	12.4	2.9	14.0	17.4	2.5	2.4
3/10E	39,547	25,098	87.2	12.2	10.4	2.6	12.5	17.5	2.4	2.1

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

**Below estimates:** Reported PAT in 3QFY09 declined 16% to Rs5.5b (v/s est. of Rs6b). HDFC has provided towards exchange loss of Rs500m towards outstanding FCCBs during the quarter (booked in interest expense) – impacting the overall earnings Disbursements grew 17% YoY to Rs94b and sanctions declined 8% YoY to Rs96b in 3QFY09. Loan growth (incl. real estate CDs and bonds) slowed to 23% YoY (from 30% YoY in 1HFY09). Spreads declined QoQ from 2.23% to 2.17%. Fee income was Rs289m in 3QFY09 v/s Rs110m in 3QFY08. We await clarification.

- Investment in MF has increased from Rs14.5b in September 2008 to Rs46.4b in December 2008. This liquidity built up was partly to take care of borrowing repayment commitments (Rs15b) during first week of January 2009. Management has consciously opted to remain liquid due to uncertainties in wholesale borrowing markets.
- The difference between disbursements of Rs96b and actual increase in loan book of mere Rs17b during 3QFY09 was due to bulk repayments from corporate loan book.

**Cutting estimates and target price:** We have cut our earnings estimates by 2% for FY09 and by 8% for FY10. Key investment are valued (post 20% holding company discount) at Rs406 per share on FY09 basis and Rs467 per share on FY10 basis. Adjusted for these ventures the stock trades at 10.4x FY10E EPS and 2.1x FY10 adjusted book (for investments in subs). Maintain **Buy** with a revised target price of Rs1,688/share, an upside of 23%.

Y/E MARCH	(Rs Million)									
	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Income from Operations	18,270	18,886	21,504	23,112	23,135	26,151	29,193	29,859	81,764	108,337
Other Income	34	39	44	90	51	55	56	78	197	240
<b>Reported Total Income</b>	<b>18,304</b>	<b>18,925</b>	<b>21,547</b>	<b>23,202</b>	<b>23,186</b>	<b>26,206</b>	<b>29,248</b>	<b>29,937</b>	<b>81,961</b>	<b>108,577</b>
<b>Total Income ex invst. profits</b>	<b>18,080</b>	<b>18,876</b>	<b>20,513</b>	<b>23,159</b>	<b>23,186</b>	<b>25,980</b>	<b>29,178</b>	<b>29,927</b>	<b>80,628</b>	<b>108,327</b>
YoY Change (%)	51.0	41.1	47.6	40.8	28.2	37.6	42.2	29.2	39.8	32.5
Interest and Other Charges	12,451	12,238	13,160	13,598	15,684	17,573	20,427	19,746	51,429	73,429
Other Expenses	765	823	741	664	967	991	1,006	959	2,993	3,923
Total Expenses	13,217	13,061	13,901	14,262	16,651	18,563	21,387	20,706	54,422	77,353
<b>PBDT</b>	<b>5,087</b>	<b>5,864</b>	<b>7,646</b>	<b>8,940</b>	<b>6,535</b>	<b>7,643</b>	<b>7,861</b>	<b>9,231</b>	<b>27,538</b>	<b>31,224</b>
YoY Change (%)	33.7	23.7	70.4	31.2	28.5	30.3	2.8	3.2	41.1	13.4
Depreciation	37	40	44	45	37	43	45	41	166	166
<b>PBT Pre exceptional income</b>	<b>5,050</b>	<b>5,824</b>	<b>7,602</b>	<b>8,896</b>	<b>6,499</b>	<b>7,600</b>	<b>7,816</b>	<b>9,190</b>	<b>27,372</b>	<b>31,058</b>
<b>PBT Ex Invest. profits</b>	<b>4,826</b>	<b>5,775</b>	<b>6,568</b>	<b>8,870</b>	<b>6,499</b>	<b>7,374</b>	<b>7,801</b>	<b>9,180</b>	<b>26,040</b>	<b>30,808</b>
YoY Change (%)	48.2	64.1	74.7	50.7	34.7	27.7	18.8	3.5	34.6	18.3
Exceptional Profits	0	3,133	1,209	2,021	0	0	0	0	6,363	0
<b>Reported PBT</b>	<b>5,050</b>	<b>8,957</b>	<b>8,812</b>	<b>10,916</b>	<b>6,499</b>	<b>7,600</b>	<b>7,816</b>	<b>9,190</b>	<b>33,735</b>	<b>31,058</b>
Provision for Tax	1,322	2,493	2,323	3,235	1,818	2,258	2,348	2,274	9,373	8,696
<b>Reported PAT</b>	<b>3,728</b>	<b>6,464</b>	<b>6,489</b>	<b>7,681</b>	<b>4,681</b>	<b>5,342</b>	<b>5,468</b>	<b>6,916</b>	<b>24,363</b>	<b>22,362</b>
YoY Change (%)	25.6	75.6	82.5	39.6	25.6	-17.4	-15.7	-10.0	55.1	-8.2
<b>PAT ex exceptional</b>	<b>3,728</b>	<b>4,034</b>	<b>5,554</b>	<b>6,118</b>	<b>4,681</b>	<b>5,342</b>	<b>5,468</b>	<b>6,916</b>	<b>19,442</b>	<b>22,362</b>
YoY Change (%)	25.6	9.6	56.2	11.2	25.6	32.4	-1.5	13.0	34.0	15.0

E: MOSL Estimates

### Results below estimates

HDFC's 3QFY09 reported PAT declined 16% to Rs5.5b (v/s est. of Rs6b). HDFC has provided Rs500m towards outstanding FCCBs during the quarter (booked in interest expense) – impacting overall earnings. Adj. for the HDFC Standard Life stake sale in 3QFY08, PAT declined by 2% (v/s our estimate of 8% growth).

Fee income was Rs289m in 3QFY09 v/s Rs110m in 3QFY08 and Rs60m in 2QFY09. We await clarification on the same.

### Liquidity improved and caution exercised during the quarter

Of the Rs49b of resources raised (deposits + borrowings) during 3QFY09; only Rs17.4b has gone towards loan book and the rest has been invested in mutual funds. Investment in MF has increased from Rs14.5b in September 2008 to Rs46.4b in December 2008. This liquidity built up was partly to take care of borrowing repayment commitments (Rs15b) during first week of January 2009. Management has consciously opted to remain liquid due to uncertainties in wholesale borrowing markets.

The difference between disbursements of Rs96b and actual increase in loan book of mere Rs17b during 3QFY09 was due to bulk repayments from corporate loan book. Management opted not to renew some of the loans up for maturity and got them repaid during the quarter.

### Spreads decline ...; management foresees stability ahead

Interest income grew 43% YoY and interest expense grew 55% YoY. NII grew 18% YoY and 5% QoQ to Rs7.9b. Spreads declined QoQ from 2.23% to 2.17%. We expect spreads to remain stable at current levels as funding costs have come off significantly during 4QFY09.

In the long run, management aims to sustain spreads 2.1-2.2%. Management has reiterated that it would not sacrifice on spreads for balance sheet growth.

### Business growth to slow down

Approvals decreased by 8% YoY to Rs96b in 3QFY09. Disbursements were up 17% YoY to Rs96b in 3QFY09 (positive surprise). Loan portfolio grew by 23% YoY to Rs837b in 3QFY09. Individual loans grew 25% YoY to Rs559b. While disbursement numbers were stronger than expected; sanctions declined in 3QFY09 highlighting the slowdown in real demand and lowering loan book growth expectations.

### Maintain Buy

We have cut our estimates by 2% for FY09 and 8% for FY10. We expect HDFC to report EPS of Rs78 in FY09 and Rs87 in FY10. BV would be Rs476 in FY09 and Rs522

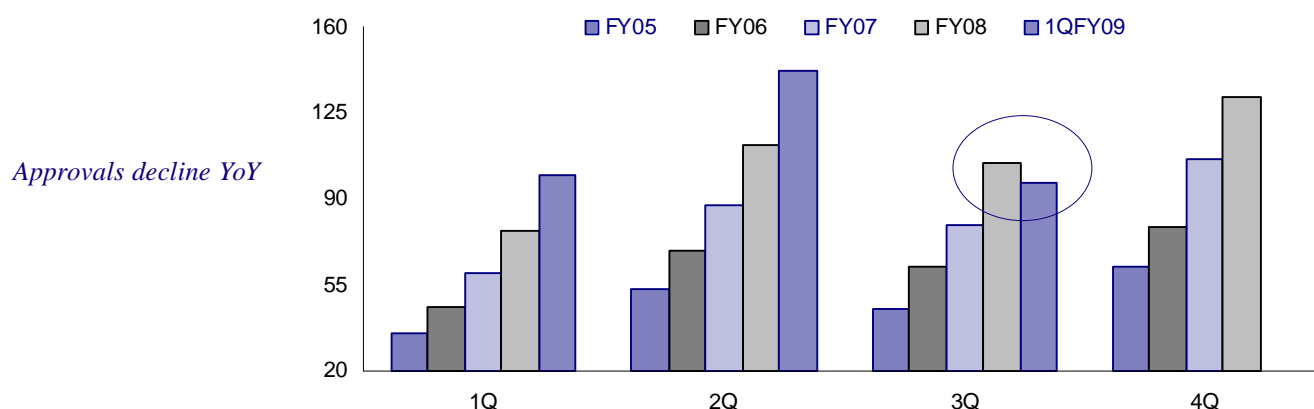
in FY10. We have reduced valuation for HDFC Standard Life factoring in significantly lower growth in new business premiums going forward. Key Investment viz. HDFC Bank, HDFC Standard Life, HDFC AMC, HDFC General Insurance, Gruh Finance and Property Funds are valued (post 20% holding company discount) at Rs407 per share on FY09 basis and Rs467 per share on FY10 basis. Adjusted for these ventures value, stock trades at 10.4x FY10E EPS and 2.1x FY10E adjusted Book (for investments in subs). Maintain **Buy** with a revised target price of Rs1,688/share - an upside of 23%.

## HDFC: SOTP FY10E BASED

	VALUE (RSB)	VALUE (US\$B)	VALUE/ (SHARE RS)	% OF TOTAL	RATIONALE
HDFC	351	7.1	1,221	72.3	14x FY10E EPS
<b>Key Ventures</b>					
HDFC Bank	78	1.6	272	16.1	Unrealized gains at Rs1200/share ( 3x FY10E BV) w/o assuming warrant conversion
HDFC Standard Life (72.5% stake)	55	1.1	192	11.3	12x FY10E NBAP; 15% CAGR in APE in FY08-10E
HDFC AMC (60% stake)	18	0.4	64	3.8	5% FY10E AUM
HDFC General Insurance (74% stake)	8	0.2	28	1.7	Current stake sale value + 20% growth assumed for FY10
Property Funds	5	0.1	18	1.1	10% of total AUM USD1b
Gruh Finance	2	0.0	10	0.6	Valued at 1.5x FY10E BV
<b>Total Value of Ventures</b>	<b>167</b>	<b>3.4</b>	<b>584</b>	<b>34.6</b>	
Less: 20% holding Discount	33	0.7	117	6.9	
<b>Value of Key Ventures</b>	<b>134</b>	<b>2.7</b>	<b>467</b>	<b>27.7</b>	
<b>Target Value Post 20% Holding</b>					
<b>Company Discount</b>	<b>485</b>	<b>9.9</b>	<b>1,688</b>	<b>100.0</b>	
CMP (Rs)	395	8.0	1,372		
<b>Upside (%)</b>	<b>23</b>	<b>23</b>	<b>23</b>		
<b>Target Price 20% Holding</b>					
<b>Company Discount</b>	<b>519</b>	<b>10.5</b>	<b>1,805</b>		
CMP (Rs)	395	8.0	1,372		
<b>Upside (%)</b>	<b>31</b>	<b>31</b>	<b>31</b>		

Source: MOSL

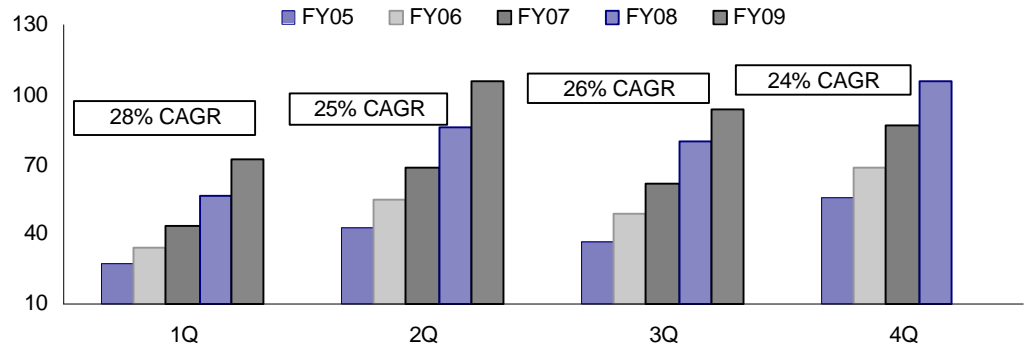
## LOAN SANCTION TRENDS (RS B)



Source: Company/MOSL

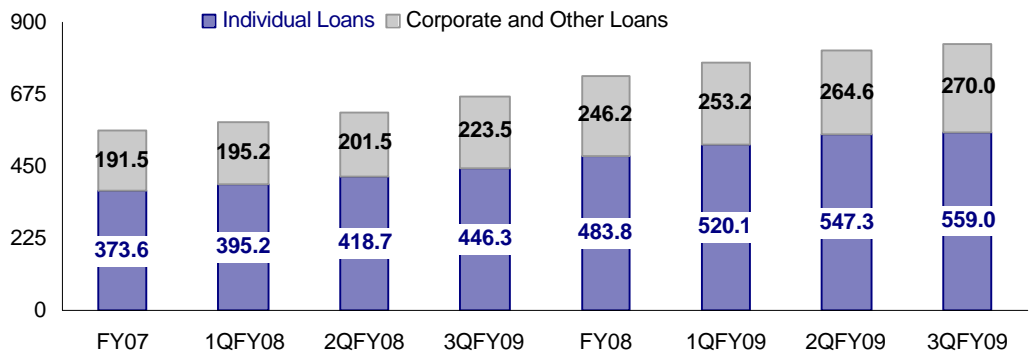
DISBURSALS TRENDS (RS B)

*Disbursals (Rs94b) was a positive surprise*



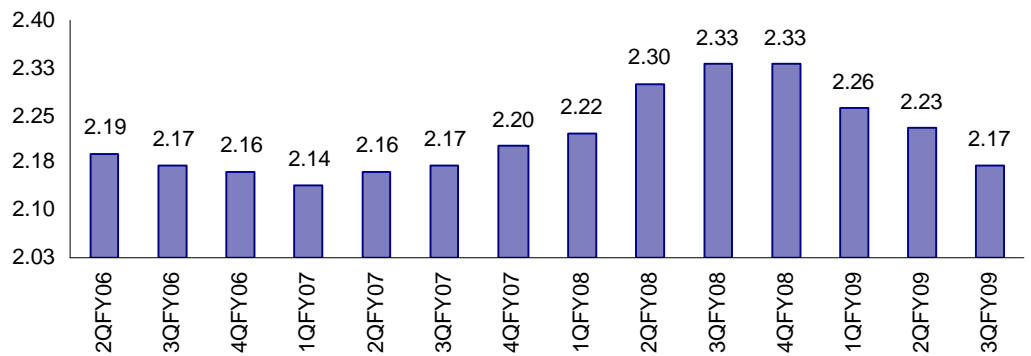
LOAN BOOK TRENDS (RS B)

*Loan book growth would slow down to 18-20% from historical 20-25%*



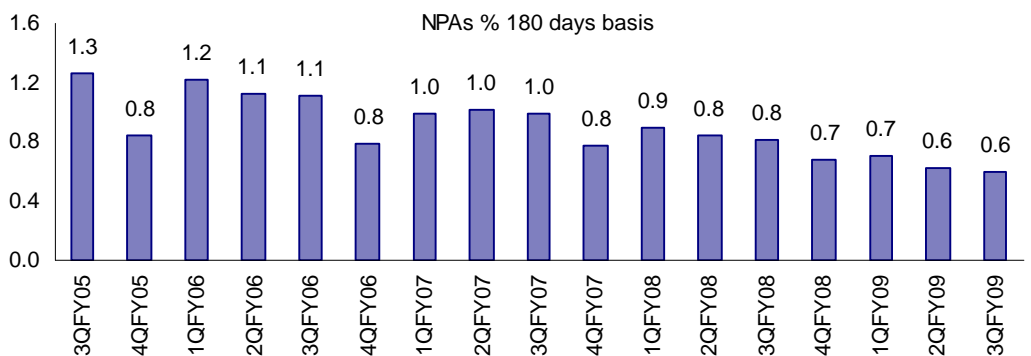
SPREAD ON LOANS (%)

*Spreads decline due to funding cost pressure*



ASSET QUALITY INTACT

*Asset quality robust despite strong loan book growth*



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 262 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

- ✍ Reduced lending rates on new housing loans upto Rs3m by 150bp to 9.75%.

### 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 14% CAGR over FY08-10E.
- ✍ We value key investments at Rs467 per share and core lending business at 14x 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*
P/E (x)	FY09E	12.4	19.6	5.5
	FY10E	10.4	15.6	3.6
P/BV (x)	FY09E	2.9	3.0	0.5
	FY10E	2.6	2.2	0.4
RoE (%)	FY09E	17.4	15.6	8.2
	FY10E	17.5	16.6	9.8
RoA (%)	FY09E	2.5	1.3	0.9
	FY10E	2.4	1.4	1.0

\* Valuation adjusted for investment in key subsidiaries

#### SHAREHOLDING PATTERN (%)

	DEC-08	SEP-08	DEC-07
Promoter	0.0	0.0	0.0
Domestic Inst	13.1	10.9	7.9
Foreign	74.1	75.6	79.3
Others	12.8	13.4	12.8

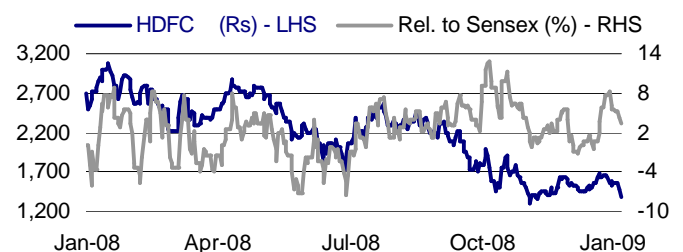
#### EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	77.7	81.3	-4.5
FY10	87.2	97.2	-10.3

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,372	1,688	23	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(Rs Million)
Y/E MARCH	2006	2007	2008	2009E	2010E	
Operating Income	41,981	57,740	81,131	107,578	120,023	
Fees and Other Income	803	893	829	999	1,150	
<b>Total Income</b>	<b>42,784</b>	<b>58,633</b>	<b>81,961</b>	<b>108,577</b>	<b>121,173</b>	
<i>Growth (%)</i>	25.5	37.0	39.8	32.5	11.6	
Interest and Other Charges	24,911	36,669	51,429	73,429	81,626	
<b>Net Income</b>	<b>17,873</b>	<b>21,964</b>	<b>30,532</b>	<b>35,148</b>	<b>39,547</b>	
<i>Growth (%)</i>	23.2	22.9	39.0	15.1	12.5	
Staff Expenses	803	913	1,178	1,472	1,649	
Other Expenses	1,496	1,704	1,982	2,617	3,040	
<b>PBT</b>	<b>15,573</b>	<b>19,348</b>	<b>27,372</b>	<b>31,058</b>	<b>34,858</b>	
<i>Growth (%)</i>	23.9	24.2	41.5	13.5	12.2	
Exceptional Item	0.0	330	6,363	0.0	0.0	
<b>Reported PBT</b>	<b>15,573</b>	<b>19,678</b>	<b>33,735</b>	<b>31,058</b>	<b>34,858</b>	
Tax	3,000.0	3,974	9,373	8,696	9,760	
<i>Tax Rate (%)</i>	19.3	20.5	27.8	28.0	28.0	
<b>PAT Pre Exceptional</b>	<b>12,573</b>	<b>15,704</b>	<b>19,442</b>	<b>22,362</b>	<b>25,098</b>	
<i>Growth (%)</i>	21.3	24.9	23.8	15.0	12.2	
<b>Reported PAT</b>	<b>12,573</b>	<b>15,704</b>	<b>24,363</b>	<b>22,362</b>	<b>25,098</b>	
Proposed Dividend	4,991	6,512	8,308	10,100	11,783	

BALANCE SHEET						(Rs Million)
Y/E MARCH	2006	2007	2008	2009E	2010E	
Share Capital	2,496	2,530	2,840	2,877	2,877	
Reserves and Surplus	42,188	52,984	116,633	134,049	147,364	
<b>Net Worth</b>	<b>44,683</b>	<b>55,514</b>	<b>119,473</b>	<b>136,926</b>	<b>150,241</b>	
Term Loans	199,954	242,242	211,998	233,197	256,517	
Bonds	179,840	225,844	366,552	421,535	505,842	
Deposits	87,421	103,844	112,963	180,740	216,888	
<b>Borrowings</b>	<b>467,214</b>	<b>571,930</b>	<b>691,512</b>	<b>835,472</b>	<b>979,247</b>	
<i>Growth (%)</i>	27.5	22.4	20.9	20.8	17.2	
<b>Total Liabilities</b>	<b>511,897</b>	<b>627,444</b>	<b>810,986</b>	<b>972,398</b>	<b>1,129,488</b>	
<b>Loans Granted</b>	<b>449,901</b>	<b>565,124</b>	<b>729,980</b>	<b>868,676</b>	<b>1,025,037</b>	
<i>Growth (%)</i>	24.9	25.6	29.2	19.0	18.0	
Investments	38,763	36,662	69,150	88,689	83,782	
<b>Net Current Assets</b>	<b>19,986</b>	<b>22,297</b>	<b>8,305</b>	<b>10,941</b>	<b>16,146</b>	
Fixed Assets	2,473	2,131	2,085	2,293	2,523	
Other Assets	774	1,231	1,466	1,800	2,000	
<b>Total Assets</b>	<b>511,897</b>	<b>627,444</b>	<b>810,986</b>	<b>972,398</b>	<b>1,129,488</b>	

ASSUMPTIONS						(%)
Y/E MARCH	2006	2007	2008	2009E	2010E	
Growth in Sanctions	30.0	30.0	27.6	15.0	20.0	
Growth in Disbursals	27.6	26.6	25.6	15.0	15.0	
Dividend	200	220	250	300	350	

E: MOSL Estimates

**RATIOS**

Y/E MARCH	2006	2007	2008	2009E	2010E
<b>Spreads Analysis (%)</b>					
Yield on Housing	8.5	9.6	11.1	12.0	11.0
Avg Yield - Earning Assets	8.5	9.4	10.9	11.8	11.2
Avg Cost - Int Bearing Liab.	6.0	7.1	8.1	9.6	9.0
Spread	2.5	2.4	2.8	2.2	2.2
Net Interest Margin	2.5	2.7	3.4	3.3	3.2
<b>Profitability Ratios (%)</b>					
RoE	30.1	29.0	22.2	17.4	17.5
RoA	2.7	2.5	2.7	2.5	2.4
Op. Exps / Net Income	11.0	10.0	8.8	9.3	9.3
Fee Income / Loan Portfolio	0.3	0.3	0.2	0.2	0.2
Int Charges / Operating Incom	59.3	63.5	63.4	68.3	68.0
<b>Growth Ratios</b>					
Operating Income	27.3	37.5	40.5	32.6	11.6
Interest Charges	27.1	47.2	40.3	42.8	11.2
Net Income	23.2	22.9	39.0	15.1	12.5
PBT	23.9	24.2	41.5	13.5	12.2
Loan Portfolio	24.9	25.6	29.2	19.0	18.0
Loan Funds	27.5	22.4	20.9	20.8	17.2
<b>Valuation</b>					
Adj. EPS (Rs)	50.4	62.1	68.4	77.7	87.2
<i>Growth (%)</i>	21.1	23.2	10.3	13.5	12.2
A/P/E (x)	18.0	15.2	13.8	12.4	10.4
Book Value (Rs)	179	219	421	476	522
<i>Growth (%)</i>	14.9	22.5	91.7	13.1	9.7
P/BV (x)	7.7	6.3	3.3	2.9	2.6
Adjusted BV* (Rs)	138	182	371	404	427
AP/ABV (x)	6.5	5.2	2.5	2.4	2.1

*E: MOSL Estimates; \* Book Value is adjusted by dedcuting investments in key subs from net worth*



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	<b>HDFC</b>
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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