



**HDFC**

BSE SENSEX	S&P CNX
18,860	5,655
Bloomberg	HDFC IN
Equity Shares (m)	1,460.1
52-Week Range	780/460
1,6,12 Rel.Perf.(%)	-2/0/20
M.Cap. (Rs b)	937.4
M.Cap. (US\$ b)	20.8

**Rs642**

**Neutral**

YEAR	NET INCOME	PAT	Adj. EPS	EPS	AP/E*	ABV*	PI/BY	API/ABV*	ROAA	Core ROE
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(RS)	(X)	(X)	(%)	(%)
3/10A	42,978	28,265	19.7	22.7	24.8	79.6	6.1	6.1	2.7	25.3
3/11E	51,714	34,220	23.4	19.0	19.9	94.3	5.2	4.9	2.8	25.5
3/12E	61,648	40,952	28.0	19.7	15.6	110.6	4.6	4.0	2.8	25.6
3/13E	73,621	49,086	32.4	15.5	13.5	121.2	3.6	3.6	2.8	26.6

\* Price is adj. for value of key ventures. BV is adj. by deducting invst. in key ventures from net worth

HDFC's 3QFY11 PAT increased 33% YoY to Rs8.9b (against our estimate of Rs8.2b) boosted by higher treasury gains of Rs1.7b (against our estimate of Rs1.1b). Reported loan growth accelerated to 21% YoY. Key highlights are:

- In 3QFY11 disbursements grew 21% YoY to Rs135b and sanctions grew ~29% YoY to Rs164b. For 9MFY11, disbursements were up 25% YoY. Individual sanctions and disbursements grew 39% YoY and 38% YoY in 9MFY11.
- Loan grew 21% YoY (up 2.6% QoQ). Adjusted for cumulative sell-downs over the past 12 months (Rs53.9b), AUM grew 22% YoY. During 3QFY11 HDFC sold down assets worth Rs20b.
- In 3QFY11, core NII growth was 20% YoY, marginally lower than our estimates of 24%. Reported spreads (cumulative) were sequentially stable at 2.33% and improved by 8bp YoY in 9MFY11. For the quarter the spread was 2.3%.
- HDFC booked gains of Rs1.7b due to IL&FS stake sale, which is taxed at ~20%.
- Asset quality remains strong with gross NPA of 0.85% on 90 days overdue basis and 0.54% on 180 days overdue basis. In respect of increase provisioning requirement under the recent NHB guidelines, HDFC made new provisioning of Rs4.2b. It adjusted Rs2.7b of provisions directly through general reserves and another Rs1b from the excess provisioning it was carrying.

**Valuation and view:** We expect HDFC to report EPS of Rs23.4 in FY11 and Rs28 in FY12, translating into FY10-12 EPS CAGR of ~19%. We expect core RoE to improve to 25-26% by FY11/12. The stock trades at 4x FY12E adjusted price/ABV (price adjusted for value of key ventures and book value adjusted for investment in those ventures) and adjusted P/E of 15.6x. Valuations are rich, reflecting strong growth prospects. Maintain **Neutral** with an SOTP target price of Rs702.

**QUARTERLY PERFORMANCE**

(Rs Million)

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	26,894	26,209	25,994	27,307	26,549	28,020	30,667	36,752	106,404	121,988
Interest Expense	19,628	18,365	17,042	15,595	17,196	17,176	19,928	23,940	70,631	78,240
<b>Net Interest Income</b>	<b>7,266</b>	<b>7,844</b>	<b>8,952</b>	<b>11,712</b>	<b>9,353</b>	<b>10,845</b>	<b>10,739</b>	<b>12,811</b>	<b>35,773</b>	<b>43,748</b>
YoY Change (%)	7.6	1.8	9.7	23.3	28.7	38.3	20.0	9.4	11.4	22.3
Profit on Sale of Investments	513	613	514	454	0	590	1,672	832	2,094	3,094
Other operating income	1,035	1,627	1,061	1,162	1,422	1,045	823	1,332	4,885	4,622
<b>Net Operating Income</b>	<b>8,814</b>	<b>10,083</b>	<b>10,527</b>	<b>13,328</b>	<b>10,775</b>	<b>12,480</b>	<b>13,233</b>	<b>14,976</b>	<b>42,752</b>	<b>51,464</b>
YoY Change (%)	18.3	17.5	20.1	23.1	22.3	23.8	25.7	12.4	20.0	20.4
Other Income	49	54	53	70	48	47	49	106	226	250
<b>Total Income</b>	<b>8,863</b>	<b>10,137</b>	<b>10,580</b>	<b>13,398</b>	<b>10,824</b>	<b>12,527</b>	<b>13,282</b>	<b>15,082</b>	<b>42,978</b>	<b>51,714</b>
Operating Expenses	944	868	847	579	1,008	1,041	1,003	660	3,238	3,712
<b>Pre Provisioning Profit</b>	<b>7,919</b>	<b>9,269</b>	<b>9,733</b>	<b>12,819</b>	<b>9,816</b>	<b>11,485</b>	<b>12,279</b>	<b>14,422</b>	<b>39,740</b>	<b>48,002</b>
YoY Change (%)	20.0	19.5	22.6	23.3	24.0	23.9	26.2	12.5	21.6	20.8
Provisions	120	140	160	160	150	150	150	188	580	638
<b>PBT</b>	<b>7,799</b>	<b>9,129</b>	<b>9,573</b>	<b>12,659</b>	<b>9,666</b>	<b>11,335</b>	<b>12,129</b>	<b>14,234</b>	<b>39,160</b>	<b>47,364</b>
YoY Change (%)	20.0	20.1	22.5	23.2	23.9	24.2	26.7	12.4	21.7	21.0
Provision for Tax	2,150	2,490	2,860	3,395	2,720	3,260	3,220	3,943	10,895	13,143
<b>PAT (Excl exceptional)</b>	<b>5,649</b>	<b>6,639</b>	<b>6,713</b>	<b>9,264</b>	<b>6,946</b>	<b>8,075</b>	<b>8,909</b>	<b>10,290</b>	<b>28,265</b>	<b>34,220</b>
YoY Change (%)	20.7	24.3	22.8	26.3	23.0	21.6	32.7	11.1	23.8	21.1

E: MOSL Estimates

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### Disbursement growth intact

In 3QFY11, disbursements increased 21% YoY to Rs135b and sanctions grew 29% YoY to Rs164b. Individual business during 9MFY11 was robust with approvals growing by 39% YoY and disbursements growing by 38% YoY. Loan growth improved to 21% YoY to Rs1,090b and AUM grew 22% YoY. Over the past 12 months, HDFC sold loans worth Rs53.9b to HDFC Bank and others. During 3QFY11 HDFC sold loans worth Rs20b to HDFC Bank. Individual loan (including sell down) growth on a reported basis is strong at ~24% YoY.

### Core NII growth marginally lower than our estimates

In 3QFY11 core NII growth was 20% YoY at Rs10.7b, which was marginally lower than our estimate of 24% YoY and lower than the 34% HDFC posted in 1HFY11. Growth in NII including fees slowed to 19% YoY to Rs11.2b. Spreads improved 8bp YoY (flat QoQ) to 2.33%. Yield on loans (calculated) declined ~40bp YoY and cost of funds dropped by 26bp. In line with a rising rates scenario, the cost of funds (calculated) increased 77bp QoQ. Further HDFC used its excess liquidity on the balance sheet, evident from the decline in investments in liquid mutual funds to Rs27.7b v/s Rs61.3b at the end of 2QFY11. Fee income was subdued, growing 5% YoY to Rs503m. HDFC booked Rs1.7b of investment gains in 3QFY11 on account of its IL&FS stake sale.

### Earnings Snapshot (Rs m)

	3QFY11	3QFY10	YoY Gr%	2QFY11	QoQ Gr%
Interest Income	30,667	25,994	18	28,020	9
Interest Expense	19,928	17,042	17	17,176	16
<b>Net Interest Income</b>	<b>10,739</b>	<b>8,952</b>	<b>20</b>	<b>10,845</b>	<b>-1</b>
<b>Fees</b>	<b>503</b>	<b>478</b>	<b>5</b>	<b>681</b>	<b>-26</b>
<b>NII Including fees</b>	<b>11,242</b>	<b>9,430</b>	<b>19</b>	<b>11,526</b>	<b>-2</b>
<b>Dividend</b>	<b>269</b>	<b>409</b>	<b>-34</b>	<b>229</b>	<b>18</b>
<b>Net Operating Income</b>	<b>11,510</b>	<b>9,839</b>	<b>17</b>	<b>11,754</b>	<b>-2</b>
Other Income	100	227	-56	183	-46
<b>Net Income</b>	<b>11,610</b>	<b>10,066</b>	<b>15</b>	<b>11,937</b>	<b>-3</b>
Operating Expenses	1,003	847	18	1,041	-4
Provisions	150	160	-6	150	0
<b>PBT ex capital gains</b>	<b>10,457</b>	<b>9,059</b>	<b>15</b>	<b>10,746</b>	<b>-3</b>
Capital Gains	1,672	514	225	590	na
<b>Reported PBT</b>	<b>12,129</b>	<b>9,573</b>	<b>27</b>	<b>11,335</b>	<b>7</b>
<b>PAT</b>	<b>8,909</b>	<b>6,713</b>	<b>33</b>	<b>8,075</b>	<b>10</b>

Source: Company/MOSL

### Valuation and view

We expect disbursement CAGR of ~22% over FY10-12, reported loan growth of over 20% and including the sell down, we expect loan CAGR of over 22%. We expect HDFC to report EPS of Rs23.4 in FY11 and Rs28 in FY12, translating into FY10-12 EPS CAGR of ~19%. We expect core RoE to improve to 25-26% by FY11/12.

BV will be Rs123 in FY11E and Rs140 in FY12E. Adjusted book value (adjusted for investments in subsidiaries) will be Rs94 in FY11E and Rs111 in FY12E. We are not deducting fresh equity investment in HDFC Bank (Rs40b) from net worth as it was funded by NCDs until FY12. Similarly, we are not including warrant conversion until FY12 in our net worth workings.

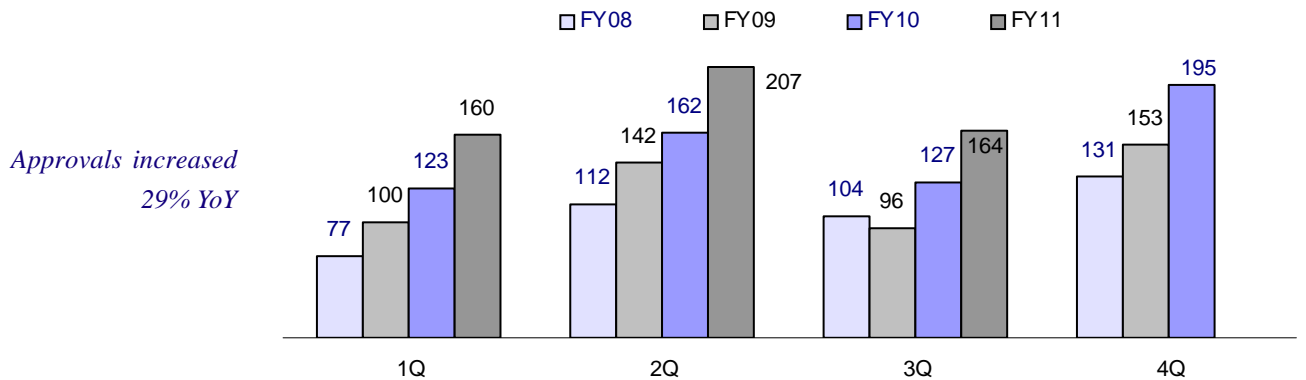
Key investments in HDFC Bank, HDFC Life, HDFC AMC, HDFC General Insurance, Gruh Finance and Property Funds are valued at Rs204 per share (after holding company discount of 20%) on an FY12 basis. The stock trades at 3.9x FY12E adjusted price/ABV (price adjusted for value of key ventures and book value adjusted for investment in those ventures) and adjusted P/E of 15.6x. Valuations are rich, reflecting strong growth prospects. Maintain **Neutral** with an SOTP-based target price of Rs702.

**SOTP FY12E Based (Rs)**

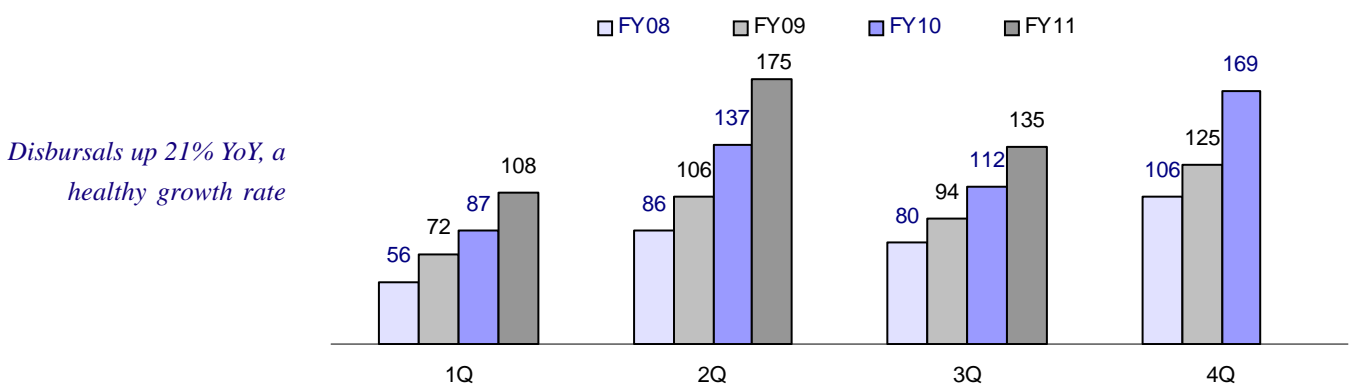
	<b>Value (RS B)</b>	<b>Value (USDB)</b>	<b>Value/ SH. (RS)</b>	<b>% of total</b>	<b>Rationale</b>
Core business	727	16.1	498	<b>70.9</b>	4.5x FY12 Adjusted BV (for invests in subs and historical invests in HDFC Bank)
<b>Key Ventures</b>					
HDFC Bank	260	5.8	178	25.3	Valued at Rs2,390/share 3.8x FY12E BV
HDFC Standard Life (72.5% stake)	66	1.5	46	6.5	15x FY12E NBAP; 15% APE CAGR in FY10- FY12E
HDFC AMC (60% stake)	25	0.6	17	2.5	3.2% FY12E AUM, 14x FY12E PAT
Property Funds	7	0.1	5	0.7	13% of total AUM USD1b
HDFC General Insurance (74% stake)	8	0.2	6	0.8	Last stake sale value + 20%
Gruh Finance	6	0.1	4	0.6	Valued at 2.5x FY12E BV
<b>Total Value of Ventures</b>	<b>372</b>	<b>8.2</b>	<b>255</b>	<b>36.3</b>	
Less: 20% holding discount	74	1.6	51.0	7.3	
<b>Value of Key Ventures</b>	<b>298</b>	<b>6.6</b>	<b>204</b>	<b>29.1</b>	
<b>Target Value Post 20% Holding</b>	<b>1,025</b>	<b>22.7</b>	<b>702</b>	<b>100.0</b>	
<b>Company Discount</b>					
CMP	937	20.8	642		
<b>Upside - %</b>	<b>9</b>	<b>9</b>	<b>9</b>		
<b>Target Price w/o 20% Holding</b>	<b>1,099</b>	<b>24.4</b>	<b>753</b>		
<b>Company Discount</b>					
CMP	937	20.8	642		
<b>Upside - %</b>	<b>17</b>	<b>17</b>	<b>17</b>		

Source: MOSL

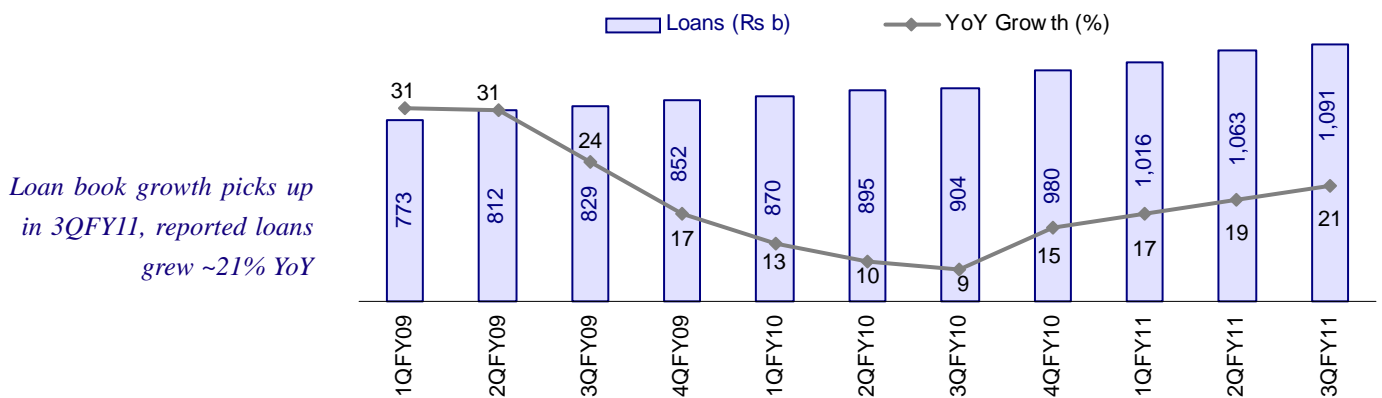
**Loan sanction trends (Rs b)**



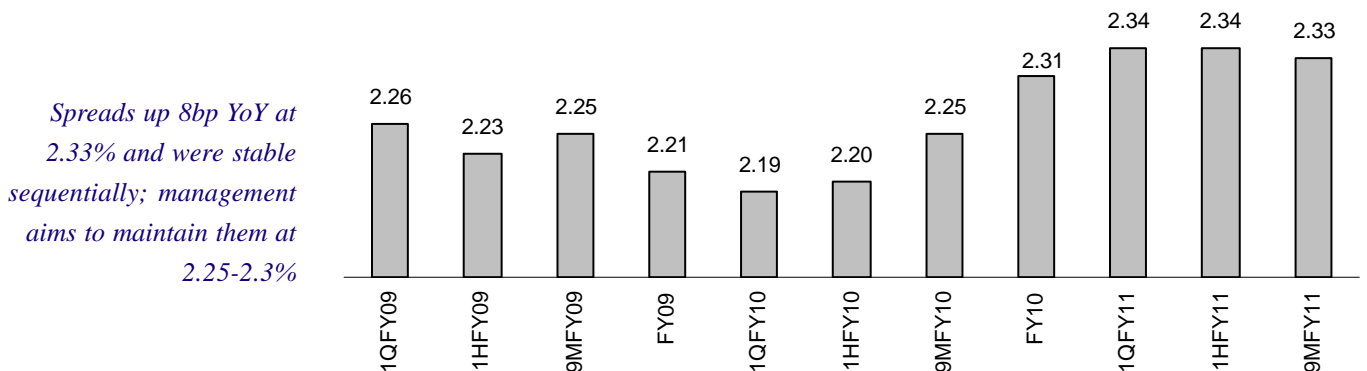
**Disbursal trends (Rs b)**



**Reported loan growth (Rs b)**

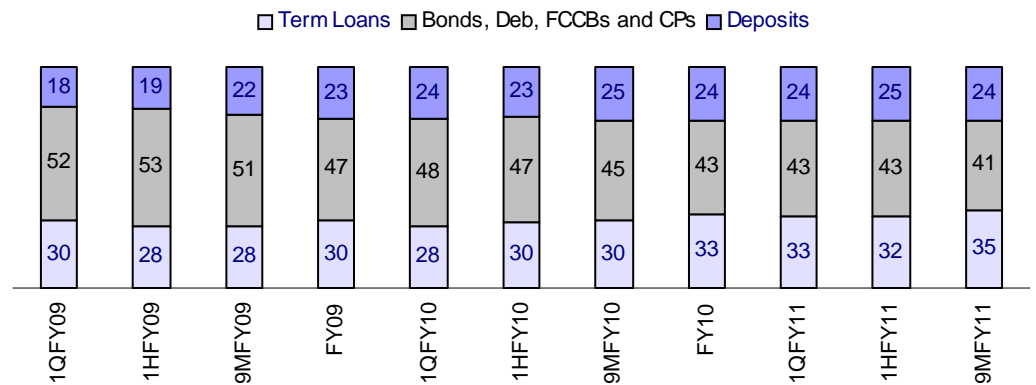


**Spread movement (%)**



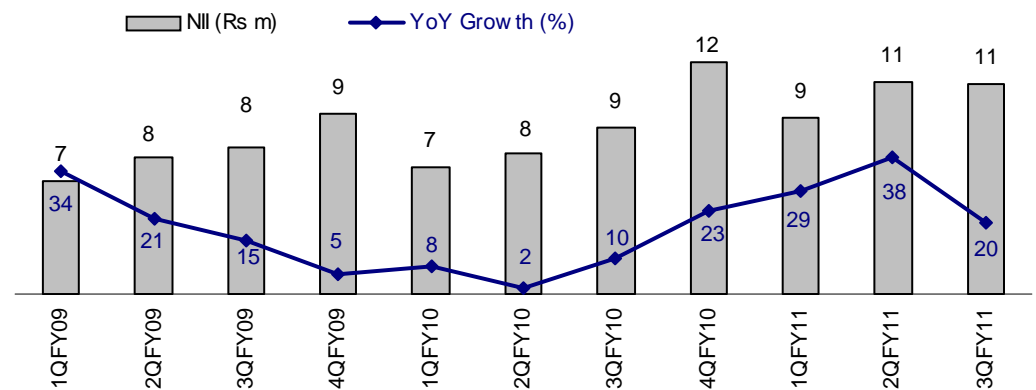
Source: Company/MOSL

**Borrowings (Rs1.07t) mix (%)**

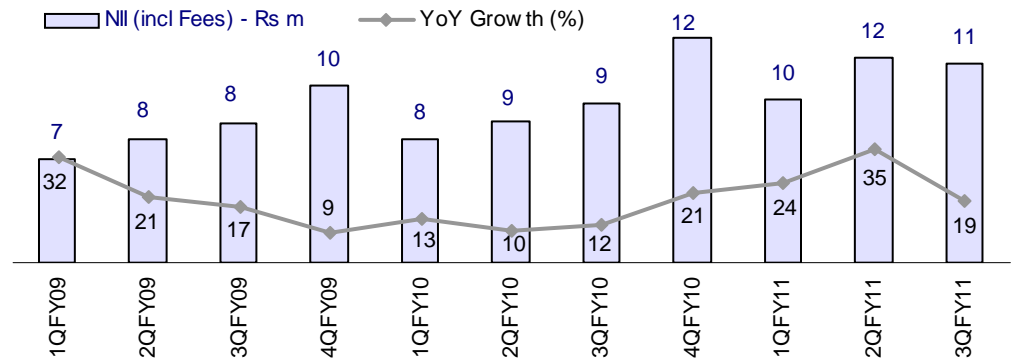


**Strong NII growth of 20% YoY**

*Strong loan growth and stable spreads lead to strong NII growth*

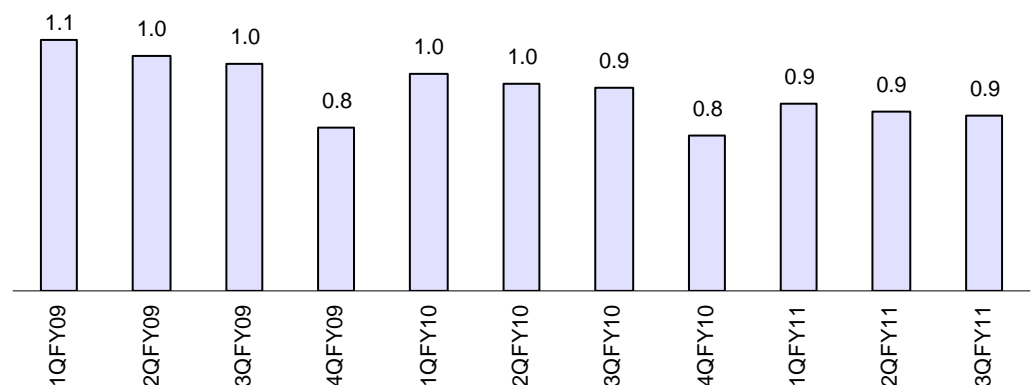


**NII including fees grew 19% YoY**



**Trend in asset quality (%)**

*Increased provisioning requirement under NHB guidelines (Rs2.7b) adjusted directly through reserves*



Source: Company/MOSL

## HDFC: an investment profile

### Company description

HDFC was incorporated in 1977 as India's first specialized mortgage company. Besides this core business, it has evolved as a financial conglomerate with interests in banking, insurance and mutual funds by taking stakes in companies like HDFC Standard Life Insurance Co, HDFC Asset Management Co, HDFC Bank, CIBIL and HDFC General Insurance Co. It functions through 287 offices, direct selling agents and outreach programs.

### Key investment arguments

- Huge potential in the housing mortgage segment in India. HDFC, being the market leader, is set to benefit the most.
- Strong management, high brand value, high RoE and low net NPA distinguish HDFC from other players in the sector.
- HDFC has diversified interests in banking, insurance and mutual funds, all of which have been adding significant value for investors.

### Key investment risks

- Increasing competition from PSU banks and the increasing cost of funds may lead to pressure on yields and spreads going forward.

### Recent developments

- NHB recently increased the standard asset provisioning on dual rate loans to 2% from 0.4%.
- HDFC hiked floating home loan rates by 75bp on 1 December 2010.

### Valuation and view

- We expect HDFC to report EPS of Rs23.4 in FY11 and Rs28 in FY12, translating into FY10-12 EPS CAGR of ~19%. We expect core RoE to improve to 25-26% by FY11/12.
- The stock trades at 4x FY12E adjusted price/ABV (price adjusted for value of key ventures and book value adjusted for investment in those ventures) and adjusted P/E of 15.6x.
- Valuations are rich. Maintain **Neutral**.

### Sector view

- With the pick up in economic growth, housing loan growth is expected to rise significantly.
- Increasing urbanization, rising disposable income and tax sops will keep mortgage demand buoyant.
- Increasing competition from PSU banks and the rising cost of funds may lead to pressure on yields and spreads.

### Comparative valuations

		HDFC*	HDFC Bank	ICICI Bank*
P/E (x)	FY11E	19.9	24.5	17.7
	FY12E	15.6	18.7	13.3
P/BV (x)	FY11E	4.9	3.8	2.1
	FY12E	4.0	3.3	1.9
Core RoE (%)	FY11E	25.5	16.6	11.7
	FY12E	25.6	18.7	13.9
RoA (%)	FY11E	2.8	1.6	1.3
	FY12E	2.8	1.7	1.4

\* Valuation adjusted for investment in key subsidiaries

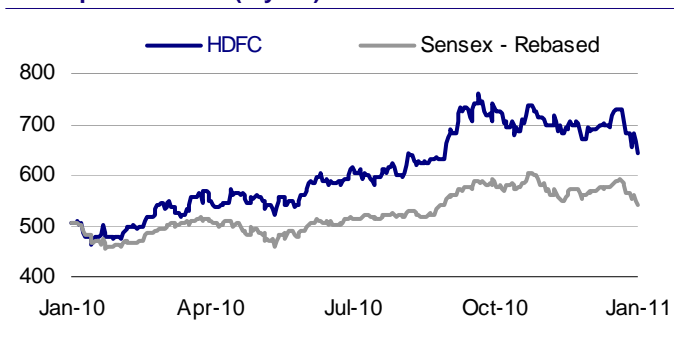
### EPS: MOSL forecast v/s Consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	23.4	23.4	0.0
FY12	28.0	27.9	0.3

### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
642	702	9.3	Neutral

### Stock performance (1 year)



### Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	0.0	0.0	0.0
Domestic Inst	13.5	13.3	13.6
Foreign	74.4	74.5	74.6
Others	12.2	12.2	11.8

## Financials and Valuation

<b>INCOME STATEMENT</b>		<b>(RS MILLION)</b>				
<b>Y/E MARCH</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012E</b>	<b>2013E</b>	
Interest Income	106,442	106,404	121,988	155,239	190,638	
Interest Expended	74,324	70,631	78,240	103,089	128,257	
<b>Net Interest Income</b>	<b>32,118</b>	<b>35,773</b>	<b>43,748</b>	<b>52,150</b>	<b>62,381</b>	
<i>Change (%)</i>	<i>16.7</i>	<i>11.4</i>	<i>22.3</i>	<i>19.2</i>	<i>19.6</i>	
Fees and Other Charges	1,149	2,317	2,311	2,831	3,468	
<b>Net Int. Income (incl fees)</b>	<b>33,267</b>	<b>38,090</b>	<b>46,059</b>	<b>54,981</b>	<b>65,849</b>	
<i>Change (%)</i>	<i>18.1</i>	<i>14.5</i>	<i>20.9</i>	<i>19.4</i>	<i>19.8</i>	
Other Operating Income	2,356	4,662	5,405	6,367	7,422	
Miscellaneous Income	229	226	250	300	350	
<b>Net Income</b>	<b>35,852</b>	<b>42,978</b>	<b>51,714</b>	<b>61,648</b>	<b>73,621</b>	
<i>Change (%)</i>	<i>17.4</i>	<i>19.9</i>	<i>20.3</i>	<i>19.2</i>	<i>19.4</i>	
Operating Expenses	3,162	3,238	3,712	4,265	4,910	
<b>Operating Income</b>	<b>32,690</b>	<b>39,740</b>	<b>48,002</b>	<b>57,383</b>	<b>68,711</b>	
<i>Change (%)</i>	<i>18.0</i>	<i>21.6</i>	<i>20.8</i>	<i>19.5</i>	<i>19.7</i>	
Provisions/write offs	500	580	638	702	772	
<b>PBT</b>	<b>32,190</b>	<b>39,160</b>	<b>47,364</b>	<b>56,682</b>	<b>67,939</b>	
Tax	9,365	10,895	13,143	15,729	18,853	
<i>Tax Rate (%)</i>	<i>29.1</i>	<i>27.8</i>	<i>27.8</i>	<i>27.8</i>	<i>27.8</i>	
<b>Reported PAT</b>	<b>22,825</b>	<b>28,265</b>	<b>34,220</b>	<b>40,952</b>	<b>49,086</b>	
<i>Change (%)</i>	<i>-6.3</i>	<i>23.8</i>	<i>21.1</i>	<i>19.7</i>	<i>19.9</i>	
Proposed Dividend	9,805	11,905	14,093	16,229	19,496	

<b>BALANCE SHEET</b>		<b>(RS MILLION)</b>				
<b>Y/E MARCH</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012E</b>	<b>2013E</b>	
Capital	2,844	2,871	2,920	2,920	3,030	
Reserves & Surplus	128,529	149,106	176,143	201,524	263,522	
<b>Net Worth</b>	<b>131,374</b>	<b>151,977</b>	<b>179,064</b>	<b>204,444</b>	<b>266,552</b>	
<b>Borrowings</b>	<b>838,561</b>	<b>965,653</b>	<b>1,150,009</b>	<b>1,396,815</b>	<b>1,668,138</b>	
<i>Change (%)</i>	<i>21.3</i>	<i>15.2</i>	<i>19.1</i>	<i>21.5</i>	<i>19.4</i>	
<b>Total Liabilities</b>	<b>969,935</b>	<b>1,117,630</b>	<b>1,329,073</b>	<b>1,601,260</b>	<b>1,934,690</b>	
<b>Housing Loans</b>	<b>851,981</b>	<b>979,670</b>	<b>1,185,576</b>	<b>1,440,016</b>	<b>1,737,644</b>	
<i>Change (%)</i>	<i>16.2</i>	<i>15.0</i>	<i>21.0</i>	<i>21.5</i>	<i>20.7</i>	
<b>Investments</b>	<b>104,687</b>	<b>107,275</b>	<b>112,638</b>	<b>118,270</b>	<b>124,184</b>	
<i>Change (%)</i>	<i>51.4</i>	<i>2.5</i>	<i>5.0</i>	<i>5.0</i>	<i>5.0</i>	
Net Fixed Assets	2,034	2,221	2,379	2,527	2,665	
Deferred Tax Assets	2,158	2,857	4,857	5,257	5,657	
Net Current Assets	9,074	25,607	23,622	35,189	64,540	
<b>Total Assets</b>	<b>969,935</b>	<b>1,117,630</b>	<b>1,329,073</b>	<b>1,601,260</b>	<b>1,934,690</b>	

<b>ASSUMPTIONS</b>	<b>(%)</b>				
Sanctions Growth	15.6	23.3	22.5	22.5	22.5
Disbursements Growth	20.6	27.1	22.2	22.5	22.5
Loan Growth	16.2	15.0	21.0	21.5	20.7
Borrowings Growth	21.3	15.2	19.1	21.5	19.4
Dividend Per Share (Rs)	6.0	7.2	8.3	9.5	11.0

*E: MOSL Estimates*

## Financials and Valuation

### RATIOS

YE MARCH	2009	2010	2011E	2012E	2013E
<b>Spreads Analysis (%)</b>					
Avg Yield on Housing Loans	12.5	10.9	10.5	11.1	11.3
Avg. Yield on Earning Assets	12.2	10.2	9.9	10.5	10.8
Avg. Cost-Int. Bear. Liab.	9.7	7.8	7.4	8.1	8.4
Interest Spread	2.4	2.4	2.5	2.4	2.5
Net Interest Margin	3.7	3.4	3.6	3.5	3.5

### Profitability Ratios (%)

RoE	18.2	20.0	20.7	21.4	20.8
Core Lending RoE	23.3	25.3	25.5	25.6	26.6
RoA	2.6	2.7	2.8	2.8	2.8

### Efficiency Ratios (%)

Int. Expended/Int.Earned	69.8	66.4	64.1	66.4	67.3
Other Inc./Net Income	10.4	16.8	15.4	15.4	15.3
Fees/Total income	1.0	2.0	1.8	1.7	1.7
Op. Exps./Net Income	8.8	7.5	7.2	6.9	6.7
Empl. Cost/Op. Exps.	43.8	45.3	43.5	41.6	39.8

### Asset Quality (%)

Gross NPAs to Adv.	0.8	0.8	0.7	0.7	0.7
Net NPAs to Adv.	0.1	0.1	0.1	0.1	0.1
CAR	15.1	14.6	14.1	13.6	15.0

### VALUATION

Book Value (Rs)	92.4	105.9	122.6	140.0	176.0
Price-BV (x)	6.95	6.06	5.2	4.6	3.6
Adjusted BV* (Rs)	67.9	79.6	94.3	110.6	121.2
Adj Price-ABV (x)	7.9	6.1	4.9	4.0	3.6
EPS (Rs)	16.0	19.7	23.4	28.0	32.4
EPS Growth (%)	17.5	22.7	19.0	19.7	15.5
Adj Price-Earnings (x)	33.6	24.8	19.9	15.6	13.5
OPS (Rs)	23.0	27.7	32.9	39.3	45.4
OPS Growth (%)	17.9	20.4	18.8	19.5	15.4
Adj Price-OP (x)	23.5	17.6	14.2	11.1	9.7

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



**N O T E S**



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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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