RESULT ANALYSIS

Share Data

Market Cap	Rs. 643.7 bn
Price	Rs. 2,266.20
BSE Sensex	14,106.58
Reuters	HDFC.BO
Bloomberg	HDFC IN
Avg. Volume (52 Week)	0.2 mn
52-Week High/Low	3,257 / 1,788
Shares Outstanding	284.0 mn

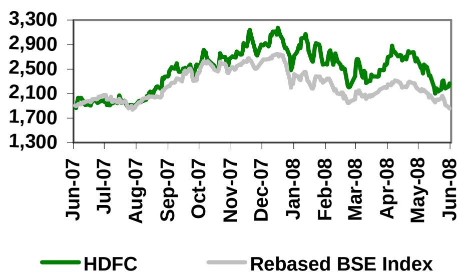
Valuation Ratios (Standalone)

Year to 31 March	2009E	2010E
EPS (Rs.)	123.2	172.6
+/- (%)	44.4%	40.1%
PER (x)	18.4x	13.1x
P / PPP (x)	13.1x	9.8x
P / ABV (x)	4.4x	3.6x

Shareholding Pattern (%)

Promoter	0
FIIs	61
Institutions	26
Public & Others	13

Relative Performance



HDFC Ltd. — Buy

Maintaining momentum despite a slowdown

HDFC continued to experience consistent growth in FY08. Net profit surged 55% in FY08, while asset size increased 29%. We reiterate our **Buy** rating on the stock due to the following factors:

- ***Sustained momentum in the core business despite a slowdown.*** Loans grew at 29% over the year. The CAGR for mortgage lending for the last 5 years is 27%. In a period of slowdown, essentially in FY08, the Company maintained its growth rate by substituting corporate loans with individual loans. We are upbeat about the future of HDFC as it stays focused on maintaining its key strengths: holding the momentum in lending despite changes in the demand dynamics and following sound risk-management policies.
- ***Increase in spreads and margins will sustain the growth momentum.*** In Q4'08, spreads increased by 14 bps to 2.32%. The net interest margin (based on quarterly averages) went up 29 bps yoy to 1.26%. Going forward, high margins coupled with the growth in advances will help in sustaining the growth momentum.
- ***Sound risk management policies will assure a healthy asset quality.*** The Company has consistently reduced its NPLs by adhering to sound risk-management policies such as adopting a low loan-to-value ratio (average of 65%, maximum of 85%) and lending primarily to end-users of the property. At the end of FY08, gross NPLs (3 months) fell 8 bps yoy to 0.84% and the credit cost fell 8 bps to 0.84%.

Key Figures (Standalone)

Quarterly Data	Q4'07	Q3'08	Q4'08	YoY%	QoQ%	FY07	FY08	YoY%
(Figures in Rs mn, except per share data)								
Net Interest Income	5,224	6,656	8,805	68.5%	32.3%	16,472	26,411	60.3%
Net Operating Income	7,287	8,388	9,604	31.8%	14.5%	21,964	30,532	39.0%
Pre-Prov Operating Profit	6,761	7,602	8,896	31.6%	17.0%	19,348	27,372	41.5%
Net Profit	5,501	6,489	7,681	39.6%	18.4%	15,704	24,363	55.1%
Spread (%)	2.17%	2.27%	2.30%	-	-	2.18%	2.32%	-
Cost to net operating income (%)	7.2%	9.4%	7.4%	-	-	11.9%	10.3%	-
Per Share Data (Rs.)								
PPP per share	25.0	26.1	30.6	22.4%	16.9%	71.8	95.8	33.5%
EPS	20.3	22.3	26.4	29.9%	18.2%	58.3	85.3	46.4%
Adj. book value per share	494.0	924.0	845.0	71.1%	(8.5)%	494.0	845.0	71.1%

Result Highlights

Mortgage business: Unabated growth

27% CAGR for disbursements

HDFC's balance sheet grew 29% over the year to Rs. 811 bn. Total loan disbursements increased 26%, a shade above the management's guidance of 25%. At the end of Q4'08, outstanding loans stood at 730 bn, a 29% yoy increase. The Company has consistently maintained a growth rate of around 25% in mortgage disbursements – its CAGR for mortgage disbursements stands at 27% for the last 5 years. To tackle the slowdown in domestic housing loans, it shifted focus from corporate demand to individual demand. In FY08, loans to corporate consumers increased 25% vis-à-vis 29% in FY07, while disbursals to individuals climbed to 29% from 23% in FY07.

Though the domestic mortgage loan market is witnessing a slowdown, we do not expect any significant downturn for HDFC as it is focusing on the small and medium ticket loans which are relatively less affected by the rising interest rates. This is because even in a high interest rate regime, a housing loan holds a tax benefit for a small-ticket loan buyer. However, large-ticket loan consumers find the tax benefit virtually inconsequential in case of high interest rates.

Impressive rise in total business

The Company's total business grew 26% yoy. Deposits grew 9% to Rs. 113 bn, slower than the growth in advances as the Company focused on debt market instruments such as bonds and debentures for borrowing. Bonds, debentures, commercial papers, and FCCBs collectively contributed 45% to the total funds requirement vis-à-vis 29% in FY07.

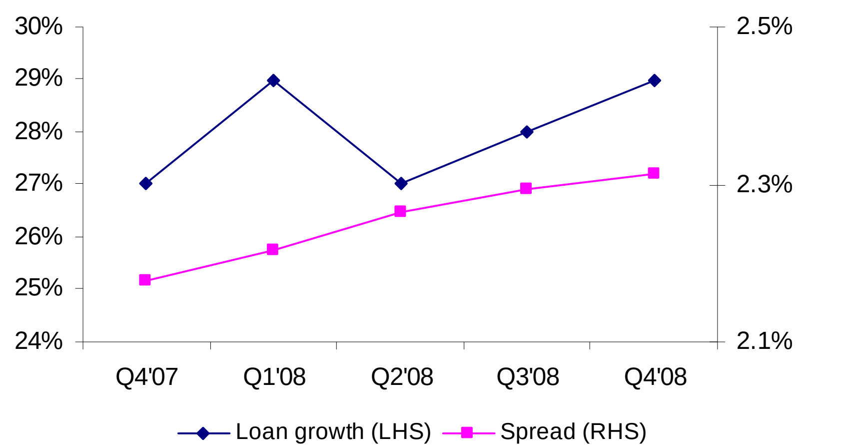
Excellent asset quality

Asset quality also continued to improve. Gross NPLs (3 months) fell 8 bps over the year to 0.84% of the loan portfolio. HDFC's credit cost – provisions as a percentage of the loan portfolio, is very low at 0.63%. It has followed excellent risk-management practices over the years. It has maintained an average loan-to-value ratio of 65%, with a maximum ratio of 85%. The relatively lesser loan burden on the borrower leads to a relatively lower risk of default. Further, to reduce the risk of defaults among individual borrowers, the Company primarily lends to end-users as opposed to investors or speculators. Historically, end users have accounted for more than 90% of the individual borrower market. Sustaining the loan growth target to around 25% also indicates that the Company prefers quality over quantity in lending.

Increase in spread and NIM

Net interest income (NII) went up 69% yoy to Rs. 8.8 bn as the increase in the loan book was accompanied by a 14 bps rise in the spreads. NIM (based on quarterly averages) increased 29 bps in Q4'08 to 1.26%. Maintaining of spreads over the past few years has helped HDFC in sustaining the growth momentum – it has led to balance sheet growth being accompanied by improved profitability trends.

Sustained increase in advances and spread



Source: Company data, Indiabulls research

Sharp fall in non-interest income

Other income, consisting primarily of dividend income, profit on sale of investments, and the surplus arising from deployment of funds in the cash management schemes of mutual funds, fell sharply by 61% in the last quarter. This was essentially on account of a 98% fall in profit made on the sale of investments. Consequently, other income as a proportion of the net operating income fell from 28% to 8% yoy. However, this loss should not affect the Company's prospects in any significant way as mortgage lending, which accounts for majority of its assets (90% as at the end of FY08), is in a strong position.

Low cost-to-income ratio

For the quarter, operating expenses increased 35% yoy to Rs. 708.7 mn. For FY08, this increase was less pronounced at 21%. At the end of FY08, its cost-to-income ratio fell to 10% from 12% in FY07, on account of a 5% fall in the depreciation expense.

In Q4'08, profit before tax increased 62%. However, this figure consists of an exceptional item–profit of Rs. 2 bn, made on the sale of equity in its general insurance subsidiary to ERGO International. Excluding the gains from this sale, adjusted profit before tax was up 31.6%.

Equity sales drove profit

HDFC, over the year, divested its equity stake in many companies. In the second quarter, it sold its stake in Intelenet Global Service for around Rs. 3.1 bn. In Q3'08, it sold around 7% stake in its life insurance business to Standard Life Company. As a result, profit after tax for FY08 increased 55%. Excluding the exceptional items, profit after tax increased 26% to Rs. 1.9 bn.

Non-core businesses: On the growth track

HDFC Standard Life Insurance Company ***(HDFC's stake – 72.56%)*** reported a total premium income of Rs. 48.6 bn for FY08, a 70% yoy increase. The life insurance arm enjoys an 8% market share among private players and 4% in the overall market.

Impressive performance by non-core businesses

HDFC Asset Management Company ***(HDFC's stake – 60%)*** too performed well. Its asset under management increased 73% yoy, while profit after tax surged 74% to Rs. 1.1 bn.

HDFC Bank ***(HDFC's stake – 23.27%)*** witnessed a 39% yoy increase in net profit to Rs. 15.9 bn. Net interest income shot up 51% on account of the Bank's high level of net interest margin (NIM) and CASA ratio. Its merger with Centurion Bank of Punjab will add more branches to its network, further enhancing the growth prospects.

Outlook

HDFC has been one of the most consistent players in the Indian financial services industry. It has struck a fine balance between growth and quality by sustaining its growth rate of advances and by continuously improving the asset quality. While the housing loan demand in the economy is witnessing a slowdown, especially for high-value loans, HDFC is maintaining its growth rate by focusing on low-value loans and by lending more to individuals rather than to corporate bodies. There is immense potential in the domestic home loan market. Mortgage-to-GDP ratio, despite rising over the past few years, is extremely low at 6-6.5%. In addition, a rich experience in lending and handholding the customer during the purchase process has helped HDFC win the trust of its customers.

No full-stops for HDFC

Valuation

Our target price of Rs. 3,050 for FY09E for HDFC is based on the sum-of-the-parts valuation methodology. We have arrived at a target P/B multiple of 4.01x for the standalone business by using the two-stage Gordon growth model (assuming a sustainable RoE of 21%). Thus, the standalone mortgage business is valued at Rs. 2,086.

Trading at a forward P/ABV of 4.4x for FY09E and 3.6x for FY10E

The Company's stake in HDFC Bank has been valued at Rs. 468 on the basis of our target price of Rs. 1,639 for the same. HDFC Standard Life has been valued at a target NBAP (new business achieved profit) multiple of 18x. This values HDFC's stake in the insurance business at Rs. 334. The AMC has been valued at 8% of its AUM, which gives a valuation of Rs. 161. The total target value of Rs. 3,050 indicates a potential upside of around 35%. Hence, we maintain our **Buy** rating on the stock.

Target Price Calculation

Company	Value	Basis
HDFC - Main Business	2,086	Based on our revised target P/B multiple of 4.01x.
HDFC - Bank	468	Based on our target price of Rs. 1,639 for HDFC Bank
HDFC - Life Insurance	334	18x NBAP multiple with NBAP margin assumed at 20%
HDFC - Asset Management	161	8% of AUM
Total	**3,050**	

Income Statement

(Rs mn, Yr. ending March 31)	FY07	FY08	FY09E	FY10E
Interest Income	53,140	77,840	92,011	114,868
Interest Expense	36,669	51,429	54,892	65,609
Net Interest Income	**16,472**	**26,411**	**37,118**	**49,259**
YoY Growth (%)	*27.2%*	*60.3%*	*40.5%*	*32.7%*
Other Income	5,493	4,121	5,769	8,077
Net Operating Income	**21,964**	**30,532**	**42,887**	**57,336**
YoY Growth (%)	*28.7%*	*39.0%*	*40.5%*	*33.7%*
Operating Expense	2,286	3,203	4,030	5,074
Pre-Provisioning Profit	**19,678**	**33,735**	**46,917**	**62,410**
YoY Growth (%)	*31.9%*	*71.4%*	*39.1%*	*33.0%*
Profit Before Tax	**19,678**	**33,735**	**46,917**	**62,410**
Tax	3,974	9,373	11,729	13,106
Net Profit	**15,704**	**24,363**	**35,188**	**49,304**
YoY Growth (%)	*31.8%*	*55.1%*	*44.4%*	*40.1%*

Balance Sheet

(Rs mn, as on March 31)	FY07	FY08	FY09E	FY10E
Investments	36,662	69,150	94,044	131,662
YoY Growth (%)	*-5.4%*	*88.6%*	*36.0%*	*40.0%*
Advances	565,124	729,980	912,474	1,140,593
YoY Growth (%)	*25.6%*	*29.2%*	*25.0%*	*25.0%*
Fixed Assets (Net)	2,131	2,085	2,179	2,357
Other Assets	51,797	42,991	58,544	63,659
Total Assets	**655,713**	**844,206**	**1,067,242**	**1,338,271**
Loans	571,930	691,512	871,305	1,093,488
YoY Growth (%)	*22.4%*	*20.9%*	*26.0%*	*25.5%*
Other Liabilities & Provisions	28,269	33,220	45,179	60,991
Total Liabilities	**600,199**	**724,732**	**916,484**	**1,154,480**
Share Capital	2,530	2,840	2,895	2,895
Reserves & Surplus	52,984	116,633	147,862	180,896
Total Equity & Liabilities	**655,713**	**844,206**	**1,067,242**	**1,338,271**

Key Ratios

	FY07	FY08	FY09E	FY10E
Per share data (Rs.)				
Shares outstanding (mn)	253.0	284.0	289.5	289.5
Basic EPS	62.8	89.9	129.8	181.9
Diluted EPS	58.4	85.3	123.2	172.6
Book value per share	219.4	420.6	520.8	634.9
Adj. book value per share	219.4	443.0	520.8	634.9
Valuation ratios (x)				
P/PPP	19.3x	18.2x	13.1x	9.8x
P/E	26.0x	26.6x	18.4x	13.1x
P/B	6.9x	5.4x	4.4x	3.6x
P/ABV	6.9x	5.1x	4.4x	3.6x
Performance ratio (%)				
ROAA	2.6%	3.2%	3.7%	4.1%
ROAE	31.3%	27.8%	26.0%	29.5%
Balance Sheet ratios (%)				
Advances to assets	86.2%	86.5%	85.5%	85.2%
Investments to assets	5.6%	8.2%	8.8%	9.8%
Loans to assets	87.2%	81.9%	81.6%	81.7%
Net Worth to assets	8.5%	14.2%	14.1%	13.7%
Operating ratios (%)				
Operating cost to income	11.9%	10.3%	9.4%	8.9%
Operating cost to assets	0.3%	0.4%	0.4%	0.4%
Productivity ratios (%)				
Opt. expense per employee	1.65	2.22	2.63	3.13
Net profit per employee	11.31	16.86	22.97	30.37
Asset per employee	472.42	584.23	696.77	824.26

Source: Company data, Indiabulls research

Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Company

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