

#### RESULT ANALYSIS

##### Share Data

Market Cap	Rs. 662.40 bn
Price	Rs. 2,328.60
BSE Sensex	15,009.77
Reuters	HDFC.BO
Bloomberg	HDFC IN
Avg. Volume (52 Week)	0.30 mn
52-Week High/Low	Rs. 2,619 / 1,116.1
Shares Outstanding	284.6 mn

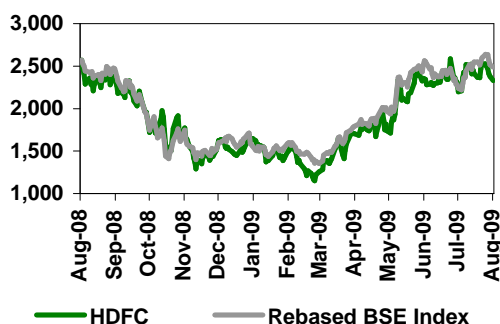
##### Valuation Ratios (Standalone)

Year to 31 March	2010E	2011E
EPS (Rs.)	76.3	76.2
+/- (%)	(4.9)%	(0.1)%
PER (x)	30.5x	30.6x
P / PPP (x)	21.2x	20.9x
P / ABV (x)	4.6x	4.3x

##### Shareholding Pattern (%)

Promoter	0
FII's	60
Institutions	28
Public & Others	12

##### Relative Performance



#### HDFC Ltd

**Hold**

##### Fairly Valued

HDFC's Q1'10 net profit declined 23% qoq to Rs. 5.6 bn driven by a sharp fall in the net interest income (NII) and in the fee and charges. While the growth in its loan-book and in other operating income was satisfactory, the contraction in spreads resulting in the decline of NII is a cause for concern. Although we have reduced the estimates for average spreads in the near term, we have increased those for loan-book expansion, which bolsters our fair-value estimate to Rs. 2,501. Presently the stock trades at a P/B multiple of ~4.7x, which we believe is fairly high given the uncertainty regarding its Insurance businesses. Current prices, in our view, do not merit position-building, and therefore, we maintain our Hold rating.

**Spreads likely to decline marginally:** HDFC's net interest income remained almost flat (+2.6% yoy), and declined by 23.2% qoq to Rs. 6.7 bn, following the trend displayed by its average spreads. The year-over-year average spread declined because of a rise in the cost of funds. However, the sequential fall was driven by a sharp dip in yields. For Q2'10, we expect spreads to contract marginally as the cost of bonds, which forms a significant portion of the total interest cost, is unlikely to decline commensurate to the decline in yields. We estimate the average spread for Q2'10 at 2.17%.

**Loan growth likely to increase:** HDFC's advances increased 2.2% sequentially to Rs. 870.5 bn. We estimate its advances to grow by 5-6% in Q2'10 driven by strong disbursal to corporates and individuals. Real estate developers have succeeded in improving their cash flows and capital structures, which has facilitated the flow of bank credit to them. The

##### Key Figures

Quarterly Data	Q1'09	Q4'09	Q1'10	YoY%	QoQ%	FY08	FY09	YoY%
(Figures in Rs. mn, except per share data)								
Net Interest Income	6,516	8,709	6,686	2.6%	(23.2)%	26,411	30,538	15.6%
Net Operating Income	7,503	10,883	8,863	18.1%	(18.6)%	30,532	35,852	17.4%
Pre-Prov Operating Profit	6,599	10,396	7,919	20.0%	(23.8)%	27,692	32,690	18.0%
Net Profit	4,681	7,334	5,649	20.7%	(23.0)%	24,363	22,825	(6.3)%
Adjusted Net Profit	4,681	7,334	5,649	20.7%	(23.0)%	18,000	22,825	26.8%
NPLs	1.09%	0.81%	0.98%	-	-	0.84%	0.81%	-
Spread	-	-	-	-	-	2.3%	2.2%	-
Cost/Net operating income	12.1%	4.7%	10.6%	-	-	9.3%	8.8%	-
<b>Per Share Data (Rs.)</b>								
PPP per share	22.7	36.0	26.9	18.6%	(25.3)%	96.9	112.7	16.3%
Diluted EPS	16.1	25.4	19.2	19.2%	(24.4)%	85.3	78.7	(7.7)%
Book value per share	436.4	461.9	480.9	10.2%	4.1%	420.6	461.9	9.8%

improvement in the developers' fundamentals is at least in part dependant on a strong retail demand for housing in the low- and mid-end segments. This enlarged pie of demand in these segments should provide HDFC with some head-room for growth even in face of stiff competition from SBI.

***NPLs unlikely to rise significantly:*** Although the gross NPA ratio declined from 1.09% in Q1'09 to 0.98% in Q1'10, it is much higher than 0.81% recorded in Q4'09. We maintain that we do not anticipate a significant rise in delinquencies even as HDFC plans to become slightly aggressive in its lending in comparison to its past record. This is because its credit approval and disbursal standards, and follow-up processes remain robust, which assist in taking remedial measures and preventing a sharp rise in NPAs.

***Insurance businesses:*** HDFC Standard Life's new business premium for Q1'10 decreased by 16.0% yoy to Rs. 4.13 bn. Even with equity markets showing signs of recovery, we do not believe that ULIP subscriptions, primary drivers of insurance revenue, are likely to pick-up in the next 1-2 quarters. Therefore, we have marginally reduced growth rates in the near-term. This yields a slightly lower fair-value estimate for the business.

***AMC—growing fast:*** At the close of the first quarter, the assets under management (AUM) stood at Rs. 725 bn, an increase of 25% sequentially, and 37.5% yoy. Expectedly, the proportion of equity has grown from 26% in March 2009 to 28% in June 2009; in line with the recovery in equity markets. With rising equity markets we expect the equity component of mutual funds to continue increasing. For FY10, we maintain our estimate of 40% yoy growth in the AUM.

### Valuation

Our fair value estimate of Rs. 2,501 for FY10 is based on the sum-of-the-parts (SOTP) valuation methodology. The standalone business of HDFC has been valued using the three-stage Discounted Equity Cash Flow (DECF) model. Our key assumption for cost of equity is 16.24% and a terminal growth rate is 13.4%. We have upward revised the estimates for loan growth and fee & charges, which has bolstered our fair-value estimate to Rs. 1,526.

HDFC's subsidiaries have been valued as follows:

- The Corporation's 22.6% stake in HDFC Bank has been valued at Rs. 375, based on our fair value estimate of Rs. 1,446 for the Bank.
- HDFC Standard Life Insurance Company has been valued at a target new business achieved profit (NBAP) multiple of 18x. This values HDFC's 72.4% stake in the life insurance business at Rs. 383.
- HDFC ERGO General Insurance Company has been valued at a P/E multiple of 20.0x, which gives a price of Rs. 32 per share for HDFC's 74% stake.
- HDFC Asset Management Company has been valued at 7% of its AUM, which gives a valuation of Rs. 126.
- The remaining subsidiaries of HDFC have been valued at 1.0x P/B multiple.

### SOTP Methodology Table:

Target Price Calculation		
Company	Value	Basis
HDFC - Main Business	1,526	DECF Valuation (Cost of Equity: 16.24%, Terminal Growth Rate: 13.4%)
HDFC - Bank	375	Fair Value Estimate of Rs.1,446 for HDFC Bank, arrived at using DECF
HDFC Standard Life Insurance Company Ltd	383	18x NBAP multiple with NBAP margin assumed at 19%
HDFC ERGO General Insurance Company Ltd.	32	P/E multiple of 20.0x
HDFC - Asset Management Company Ltd	126	7% of AUM
Remaining Subsidiaries	58	Based on 1.0x P/B multiple.
<b>Total</b>	<b>2,501</b>	

Our fair value estimate implies an upside of 7.4% to the current market price of Rs. 2,328.60. Therefore, we maintain our **Hold** rating.

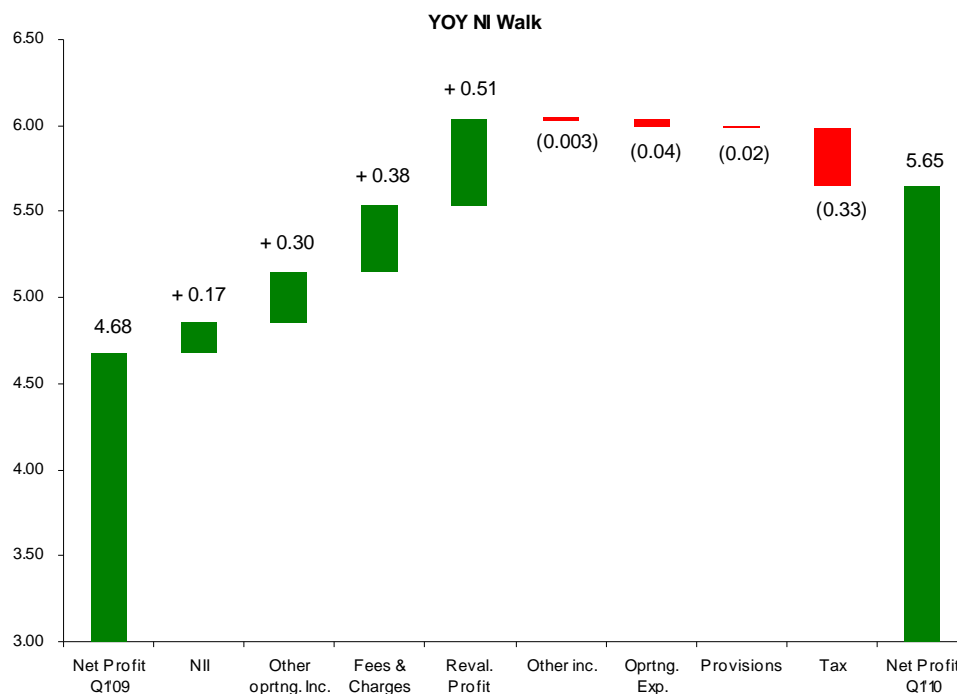
### Sensitivity Analysis of the Fair Value Estimate:

		Cost of Equity				
		15.74%	15.99%	16.24%	16.49%	16.74%
Terminal growth	12.93%	2,530	2,406	2,300	2,210	2,131
	13.18%	2,662	2,515	2,392	2,288	2,198
	13.43%	2,823	2,646	2,501	2,379	2,276
	13.68%	3,023	2,805	2,630	2,486	2,366
	13.93%	3,278	3,003	2,787	2,614	2,472

### Result Highlights and Outlook

Over Q1'09, HDFC's net profit increased by 20.7% yoy to Rs. 5.65 bn, primarily driven by a strong rise in the fee & charges, and in the profit on revaluation of investments.

Sequentially, however, the net profit fell by 23% because of a sharp decline (23.2%) in the net interest income, and in the fee & charges (47.0%).



All Figures in Rs. bn

### Loan growth likely to increase

HDFC's loan-book increased 12.6% yoy (2.2% qoq) to Rs. 870.5bn. Loan approvals for the quarter increased 23% yoy to Rs. 122.6 bn, and disbursals increased 21% to Rs. 86.9 bn. The sequential growth in loan-book for Q1'10 missed our estimate of 5% primarily because a large proportion of the demand for loans in the low-end (and some of mid-end) segment was usurped by SBI.

For Q2'10, we estimate HDFC's advances growth at 5-6% qoq, chiefly driven by corporate loans. Corporates have succeeded in improving their cash-flows, a result of price-reduction and collection from pre-launch offers of new projects. They have also improved their capital structures by

reducing the proportion of debt and infusing capital through QIPs. This has improved the flow of bank-credit to these companies, and we expect this to continue.

Meanwhile, price-reduction, and low interest rates continue to fuel demand in the low-and mid-end housing segments. This translates into an enlarged pie of retail home-loans, which in our view, should provide HDFC with some head-room to grow despite being faced with stiff competition from SBI in the low-end segment.

### ***Spreads likely to decline marginally***

HDFC's average spreads declined in Q1'10 in comparison those in both Q1'09 and Q4'09. Comparing with Q1'09, while the yields have remained stable, the cost of funds has shot up significantly, driven by cost of term loans and deposits. Over the previous quarter, however, while the costs have remained stable, the yields have fallen sharply.

For Q2'10, we do not expect the cost of bonds (which forms a substantial portion of the total cost of funds) to come down. This, in tandem with falling yields, is likely to compress the average spread to 2.17%.

### ***NPLs unlikely to rise significantly***

HDFC's gross NPA ratio decreased from 1.09% in Q1'09 to 0.98% in Q1'10. It is, however, higher than the 0.81% recorded in the last quarter. Based on a six months overdue basis, the non-performing loans as at June 30, 2009 stood at 0.58% of the loan portfolio as against 0.71% in the previous year. We maintain that we do not anticipate a significant rise in delinquencies even as HDFC plans to become slightly aggressive in its lending in comparison to its past record. This is because credit approval and disbursal standards, and follow-up processes remain robust, which assist in taking remedial measures and prevent a sharp rise in NPAs.

### ***Capital adequacy and profitability***

At the close of Q1'10, HDFC's total capital adequacy ratio stood at 15.0% vis-à-vis the regulatory minimum of 12%. Of this, Tier I capital adequacy was 13.7%. The Return on Average Assets (annualised) for Q1'10 was 2.2% and the Return on Equity was 16.8%.

### EQUITY RESEARCH

August 10, 2009

Income Statement					Key Ratios				
(Rs mn, Yr. ending March 31)	FY08	FY09	FY10E	FY11E		FY08	FY09	FY10E	FY11E
Interest Income	77,840	104,863	105,797	122,881	<b>Per share data (Rs.)</b>				
Interest Expense	51,429	74,324	77,470	91,508	Shares outstanding (mn)	284	284	285	285
<b>Net Interest Income</b>	<b>26,411</b>	<b>30,538</b>	<b>28,327</b>	<b>31,373</b>	Basic EPS	85.8	80.2	76.3	76.2
YoY Growth (%)	60.3%	15.6%	-7.2%	10.8%	Diluted EPS	85.8	80.2	76.3	76.2
Other Operating Income	4,121	5,314	6,467	4,040	Book value per share	420.6	461.9	502.2	541.0
<b>Operating Income</b>	<b>30,532</b>	<b>35,852</b>	<b>34,794</b>	<b>35,413</b>	Adj. book value per share	420.6	461.9	502.2	541.0
YoY Growth (%)	36.9%	17.4%	-3.0%	1.8%	<b>Valuation ratios (x)</b>				
Operating Expense	2,839	3,162	3,570	3,699	P/PPP	24.4x	20.3x	21.2x	20.9x
<b>Pre-Provisioning Profit</b>	<b>27,692</b>	<b>32,690</b>	<b>31,224</b>	<b>31,714</b>	P/E	27.8x	29.0x	30.5x	30.6x
Provisions and Contingencies	320	500	483	742	P/B	5.7x	5.0x	4.6x	4.3x
<b>Profit Before Tax</b>	<b>27,372</b>	<b>32,190</b>	<b>30,741</b>	<b>30,972</b>	P/ABV	5.7x	5.0x	4.6x	4.3x
Exceptional Items	6,363	-	-	-	<b>Performance ratio (%)</b>				
Tax	9,373	9,365	9,033	9,292	Return on avg. assets	3.2%	2.5%	2.0%	1.7%
<b>Net Profit</b>	<b>24,363</b>	<b>22,825</b>	<b>21,709</b>	<b>21,680</b>	Return on avg. net worth	27.8%	18.2%	15.8%	14.6%
YoY Growth (%)	55.1%	-6.3%	-4.9%	-0.1%	<b>Balance Sheet ratios (%)</b>				
<b>Balance Sheet</b>					Advances to Loan Funds	105.6%	101.6%	102.7%	100.6%
(Rs mn, as on March 31)	FY08	FY09	FY10E	FY11E	Borrowings to advances	71.4%	75.7%	74.0%	74.4%
Cash and balances with RBI	7,777	15,688	10,439	13,391	Investments to assets	8.2%	10.3%	9.0%	8.6%
Investments	69,150	104,687	106,007	123,944	Investments to deposits	40.7%	54.0%	45.1%	40.3%
YoY Growth (%)	88.6%	51.4%	1.3%	16.9%	Net Worth to assets	14.2%	12.9%	12.1%	10.7%
Loans	729,979	851,981	1,007,641	1,230,571	<b>Productivity ratio (Rs. mn)</b>				
YoY Growth (%)	29.2%	16.7%	18.3%	22.1%	Opt. expense per employee	1.9	2.1	2.3	2.0
Fixed Assets (Net)	2,085	2,034	1,880	1,687	Net profit per employee	16.2	15.3	13.7	11.5
Current Assets	35,213	42,178	53,056	72,084	Asset per employee	561.2	682.3	746.2	762.8
<b>Total Assets</b>	<b>844,205</b>	<b>1,016,569</b>	<b>1,179,024</b>	<b>1,441,677</b>	<b>Operating ratios (%)</b>				
Deposits	170,092	193,747	234,939	307,798	Operating cost to operating income	9.3%	8.8%	10.3%	10.4%
YoY Growth (%)	10.0%	13.9%	21.3%	31.0%	Operating cost to avg. assets	0.4%	0.3%	0.3%	0.3%
Loan Funds/ Other Borrowings	521,420	644,814	745,758	915,065	<i>Source: Company data, Indiabulls research</i>				
YoY Growth (%)	24.9%	23.7%	15.7%	22.7%	<i>Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Company</i>				
Other Liabilities & Provisions	33,220	46,634	55,414	64,875					
<b>Total Liabilities</b>	<b>724,732</b>	<b>885,195</b>	<b>1,036,111</b>	<b>1,287,738</b>					
Share Capital	2,840	2,844	2,846	2,846					
Reserves & Surplus	116,633	128,529	140,067	151,093					
<b>Total Equity &amp; Liabilities</b>	<b>844,205</b>	<b>1,016,569</b>	<b>1,179,024</b>	<b>1,441,677</b>					

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