

January 12, 2012

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Rating	Accumulate
Price	Rs687
Target Price	Rs725
Implied Upside	5.5%
Sensex	16,038
Nifty	4,831

(Prices as on January 12, 2012)
Trading data

Market Cap. (Rs bn)	1,008.3
Shares o/s (m)	1,466.9
3M Avg. Daily value (Rs m)	1596.6

Major shareholders

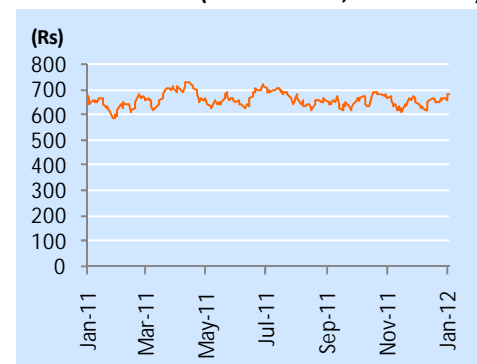
Promoters	0.00%
Foreign	58.22%
Domestic Inst.	29.05%
Public & Other	12.62%

Stock Performance

(%)	1M	6M	12M
Absolute	6.2	(0.3)	1.0
Relative	5.1	12.6	18.9

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	33.2	32.6	1.7
2014	40.1	38.7	1.7

Price Performance (RIC: HDFC.BO, BB: HDFC IN)


Source: Bloomberg

HDFC's Q2FY12 PAT of Rs9.8bn was in line with our estimates. Reported PAT growth of 10% YoY was lower than the historic trend of ~20% YoY growth, mainly due to one-off investment gain booked in Q3FY11, adjusted for which PAT growth was ~20% YoY. Q3FY12 was another steady quarter, with stable asset quality, robust credit growth and funding flexibility aiding margins. HDFC offers stable growth with low asset quality risks. However, with limited upside to our September 2011 price target, we maintain 'Accumulate' on the stock.

- **Stable growth:** Loan book grew by ~21% YoY, with ~18-19% growth in overall approvals and disbursements was better than <15% YoY growth in banks mortgage book. Volumes have been low in Mumbai; however, management is seeing robust volumes from Tier-2 & 4 cities, aiding credit growth.
- **Funding flexibility high:** HDFC's reliance on bank funding has come off from a high of ~36.5% in March 2011 to <20% in just nine months, with bank's rate remaining higher than AAA corporate borrowing rates. This displays HDFC's ability to significantly change liability profile to maintain spreads. Overall spreads did contract in Q3FY12 v/s Q2FY12, mainly due to Rs1.0bn P&L charge relating to cross-currency swaps that required recognising losses on FX exposure, without considering the interest rate differential.
- **Accounting policy on cross-currency swaps:** HDFC disclosed that they have Rs4.2bn of notional MTM hit that need to be amortized over next 7-8yrs (assuming USD/INR at 53). These notional losses do not factor in ~5% annual rate benefit on FX borrowing (for 7-8 yrs) and possible reversals if rupee appreciates. In terms of economic value, the swap would be value destructive only if USD/INR depreciation is sharp enough to cumulatively net off 5% annual rate benefit over 7-8yrs (not the case now).

Key Financials (Y/e March)	2011	2012	2013E	2014E
Net interest income (Rs m)	41,335	50,413	63,199	77,808
Growth (%)	26.1	22.0	25.4	23.1
Non-interest income (Rs m)	11,847	11,963	12,811	13,751
Operating Profit (Rs m)	49,370	57,971	70,913	85,655
PAT (Rs m)	35,350	41,333	50,508	60,962
EPS (Rs)	24.1	28.2	33.2	40.1
Growth (%)	22.4	16.9	17.8	20.7
Net DPS (Rs)	9.0	10.5	12.9	15.5

Profitability & valuation	2011	2012	2013E	2014E
Spreads / Margins (%)	3.2	3.3	3.5	3.6
RoAE (%)	21.7	22.2	21.9	21.7
RoAA (%)	2.8	2.7	2.8	2.8
P/E (x)	28.5	24.4	20.7	17.2
P/BV (x)	5.8	5.1	4.0	3.5
P/ABV (x)	5.8	5.1	4.0	3.5
Net dividend yield (%)	1.3	1.5	1.9	2.3

Source: Company Data; PL Research

Exhibit 1: Q3FY12 Financials : Strong, stable, and predictable

	3Q11	2Q12	3Q12	YoY	QoQ
Net interest income	10,997	13,064	12,894	17.2%	-1.3%
Fees	603	853	827	37.2%	-3.0%
Net revenues	11,600	13,918	13,721	18.3%	-1.4%
Operating expenditure	1,153	1,409	1,319	14.3%	-6.4%
Operating profit	10,447	12,508	12,403	18.7%	-0.8%
Investment profit	1,672	869	880	-47.4%	1.3%
Profit before tax	12,129	13,377	13,292	9.6%	-0.6%
Tax	3,220	3,670	3,470	7.8%	-5.4%
PAT	8,909	9,707	9,822	10.3%	1.2%
Extraordinary income (excl. Tax)	1,228	630	650	-47.1%	3.1%
Adjusted PAT	7,680	9,077	9,172	19.4%	8.2%
Balance sheet					
Liabilities					
Share Capital	2,929	2,944	2,948	0.7%	0.1%
Reserves and Surplus	175,164	183,971	192,305	9.8%	4.5%
Loan funds					
Term Loans	375,191	323,243	249,829	-33.4%	-22.7%
Bonds	443,906	610,505	673,681	51.8%	10.3%
Deposits	259,087	317,280	347,451	34.1%	9.5%
Total	1,078,184	1,251,027	1,270,962	17.9%	1.6%
Current liabilities	50,028	68,144	78,486	56.9%	15.2%
Assets					
Loans					
Individuals	701,494	802,680	842,999	20.2%	5.0%
Corporates	373,318	451,442	461,609	23.7%	2.3%
Others	15,701	15,802	17,472	11.3%	10.6%
Total	1,090,512	1,269,924	1,322,079	21.2%	4.1%
Investments	145,671	149,804	134,451	-7.7%	-10.2%
Current	63,398	78,208	79,816	25.9%	2.1%
Fixed assets	2,329	2,346	2,355	1.1%	0.4%

Source: Company Data, PL Research

Adjusted PAT growth at ~21% YoY

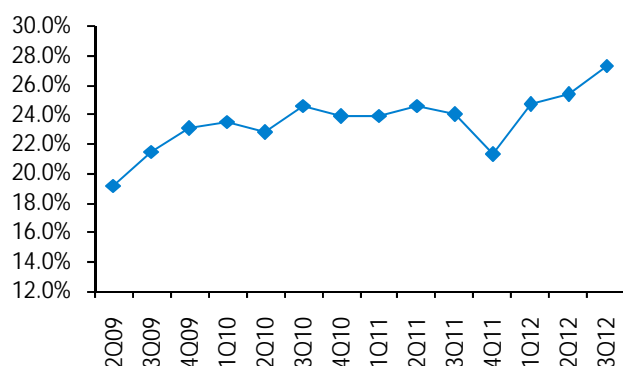
Reliance on bank funding has come off significantly due to high base rate – Higher proportion of bonds+ deposits demonstrates funding flexibility

Loan growth has been robust at ~21% YoY.

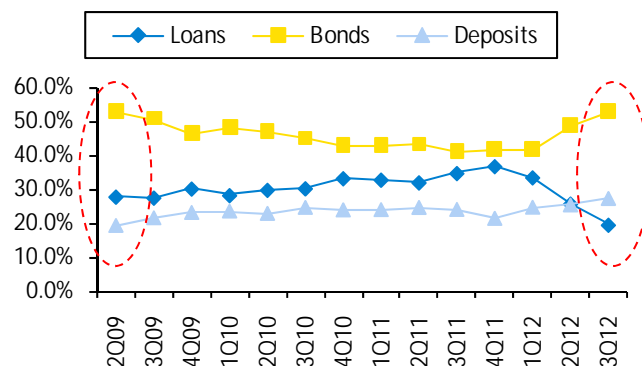
Exhibit 2: Retail leading the wholesome disbursements

Operating data	3Q11	2Q12	3Q12	YoY	QoQ
Disbursements	135,344	207,335	161,059	19.0%	-22.3%
Borrowings	1,078,184	1,251,027	1,270,962	17.9%	1.6%
Loans	1,090,512	1,269,924	1,322,079	21.2%	4.1%
Loans (including sold portfolio)	1,206,822	1,401,614	1,456,919	20.7%	3.9%
Total borrowings	1,078,184	1,251,027	1,270,962	17.9%	1.6%
Cost-income	9.9%	10.1%	9.6%	-0.3%	-0.5%
Gross NPL (%)	0.85%	0.82%	0.85%	0.0%	0.0%
NIM	3.49%	3.66%	3.55%	0.1%	-0.1%
Spreads	2.39%	2.37%	2.15%	-0.24%	-0.23%
ROE	20.4%	21.1%	20.6%	0.2%	-0.6%

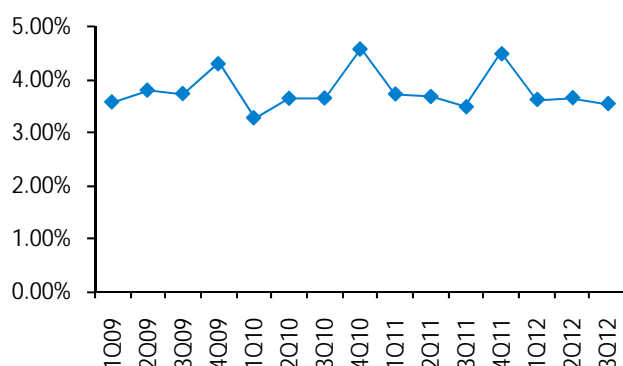
Source: Company Data, PL Research

Exhibit 3: Deposits becoming dominant in the funding mix


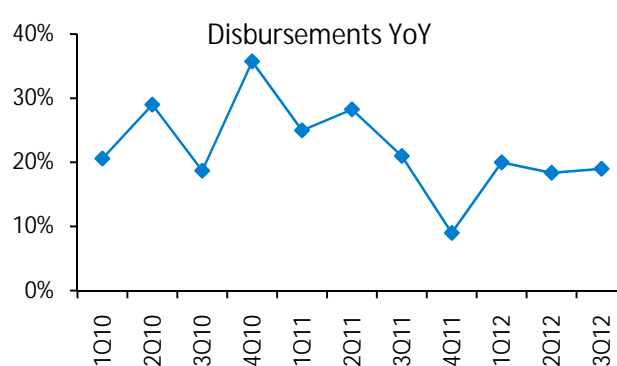
Source: Company Data, PL Research

Exhibit 4: Low dependence on bank lending now


Source: Company Data, PL Research

Exhibit 5: NIM's remain stable


Source: Company Data, PL Research

Exhibit 6: Disbursement growth remain robust


Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Int. Inc. / Opt. Inc.	116,934	159,850	189,723	230,432
Interest Expenses	75,599	109,437	126,523	152,624
Net interest income	41,335	50,413	63,199	77,808
<i>Growth (%)</i>	<i>26.1</i>	<i>22.0</i>	<i>25.4</i>	<i>23.1</i>
Non interest income	11,847	11,963	12,811	13,751
<i>Growth (%)</i>	<i>16.1</i>	<i>1.0</i>	<i>7.1</i>	<i>7.3</i>
Net operating income	53,181	62,376	76,011	91,559
Expenditure				
Employees	1,755	2,036	2,342	2,693
Other expenses	2,056	2,368	2,756	3,210
Depreciation	—	—	—	—
Total expenditure	3,812	4,404	5,098	5,903
PPP	49,370	57,971	70,913	85,655
<i>Growth (%)</i>	<i>24.2</i>	<i>17.4</i>	<i>22.3</i>	<i>20.8</i>
Provision	700	735	809	889
Other income	—	—	—	—
Exchange Gain / (Loss)	700	735	809	889
Profit before tax	48,670	57,236	70,104	84,766
Tax	13,320	15,903	19,596	23,804
<i>Effective tax rate (%)</i>	<i>27.4</i>	<i>27.8</i>	<i>28.0</i>	<i>28.1</i>
PAT	35,350	41,333	50,508	60,962
<i>Growth (%)</i>	<i>25.1</i>	<i>16.9</i>	<i>22.2</i>	<i>20.7</i>

Balance Sheet (Rs m)

Y/e March	2011	2012	2013E	2014E
Sources of funds				
Equity	2,934	2,934	3,043	3,043
Reserves & Surplus	163,572	189,469	253,151	290,496
Networth	173,165	199,062	262,853	300,199
<i>Growth (%)</i>	<i>13.9</i>	<i>15.0</i>	<i>32.0</i>	<i>14.2</i>
Loan funds	907,854	1,031,604	1,211,604	1,416,604
<i>Growth (%)</i>	<i>—</i>	<i>13.6</i>	<i>17.4</i>	<i>16.9</i>
Deposits	246,251	347,501	407,501	537,501
Other Liabilities	67,751	85,849	103,946	122,044
Total	1,395,021	1,664,016	1,985,904	2,376,347
Application of funds				
Net fixed assets	2,340	2,444	2,535	2,610
Advances	1,171,266	1,406,403	1,706,413	2,066,570
<i>Growth (%)</i>	<i>19.6</i>	<i>20.1</i>	<i>21.3</i>	<i>21.1</i>
Net current assets	121,537	122,757	134,244	147,158
Investments	20,955	28,145	28,145	28,145
<i>Growth (%)</i>	<i>58.7</i>	<i>34.3</i>	<i>—</i>	<i>—</i>
Deferred tax asset	—	—	—	—
Other Assets	78,923	104,267	114,568	131,864
Total	1,395,021	1,664,016	1,985,904	2,376,347

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Int. Inc. / Operating Inc.	35,594	37,420	39,970	43,018
Income from securitization	—	—	—	—
Interest Expenses	21,300	25,149	26,905	30,124
Net Interest Income	14,294	12,270	13,064	12,894
<i>Growth</i>	<i>15.4</i>	<i>16.5</i>	<i>18.0</i>	<i>17.2</i>
Non interest income	2,265	796	1,722	1,707
Net operating income	16,559	13,067	14,786	14,601
<i>Growth</i>	<i>23.6</i>	<i>20.7</i>	<i>18.0</i>	<i>10.0</i>
Operating expenditure	1,010	1,312	1,409	1,319
PPP	15,550	11,755	13,377	13,282
<i>Growth</i>	<i>22.8</i>	<i>21.6</i>	<i>18.0</i>	<i>9.6</i>
Provision	—	—	—	—
Exchange Gain / (Loss)	—	—	—	—
Profit before tax	15,550	11,755	13,377	13,282
Tax	4,120	3,310	3,670	3,470
Prov. for deferred tax liability	—	—	—	—
<i>Effective tax rate (%)</i>	<i>26.5</i>	<i>28.2</i>	<i>27.4</i>	<i>26.1</i>
PAT	11,430	8,445	9,707	9,812
<i>Growth</i>	<i>23.4</i>	<i>21.6</i>	<i>20.2</i>	<i>10.3</i>

Key Ratios

Y/e March	2011	2012	2013E	2014E
CMP (Rs)	687	687	687	687
Eq. Shrs. O/s. (m)	1,467	1,467	1,522	1,522
Market Cap (Rs m)	1,008,313	1,008,313	1,045,948	1,045,948
Market Cap to AUM (%)	0.7	0.6	0.5	0.4
EPS (Rs)	24.1	28.2	33.2	40.1
Book Value (Rs)	118.1	135.7	172.7	197.3
Adjusted Book Value (Rs)	118.1	135.7	172.7	197.3
P/E (x)	28.5	24.4	20.7	17.2
P/BV (x)	5.8	5.1	4.0	3.5
P/ABV (x)	5.8	5.1	4.0	3.5
DPS (Rs)	9.0	10.5	12.9	15.5
Dividend Yield (%)	1.3	1.5	1.9	2.3

Asset Quality

Y/e March	2011	2012	2013E	2014E
Gross NPAs (Rs m)	9,019	10,829	13,139	15,913
Net NPAs (Rs m)	—	—	—	—
Gross NPAs to Gross Adv. (%)	0.8	0.8	0.8	0.8
Net NPAs to Net Adv. (%)	—	—	—	—
NPA Coverage (%)	—	—	—	—

Profitability (%)

Y/e March	2011	2012	2013E	2014E
NIM	3.2	3.3	3.5	3.6
RoAA	2.8	2.7	2.8	2.8
RoAE	21.7	22.2	21.9	21.7

Source: Company Data, PL Research.

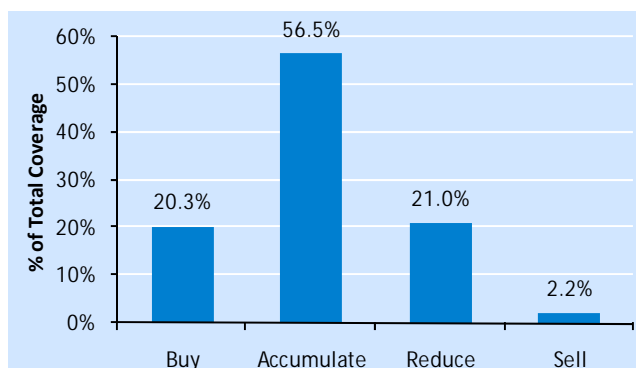


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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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