

February 12, 2008

FOR PRIVATE CIRCULATION

**Equity**

	11 Feb 08	% Chg		
		1 Day	1 Mth	3 Mths
<b>Indian Indices</b>				
Sensex	16,631	(4.8)	(20.1)	(11.2)
Nifty	4,857	(5.1)	(21.7)	(13.5)
Banking	9,745	(4.1)	(21.9)	(4.3)
IT	3,282	(2.4)	(13.7)	(7.2)
Healthcare	3,519	(3.2)	(15.9)	(8.4)
FMCG	2,053	(5.6)	(14.3)	(0.2)
PSU	7,775	(6.1)	(25.2)	(21.2)
CNX Midcap	6,761	(5.5)	(24.7)	(7.5)
<b>World indices</b>				
Nasdaq	2,320	0.7	(4.9)	(10.2)
Nikkei	13,017	(1.4)	(7.6)	(16.4)
Hangseng	22,616	(3.6)	(14.6)	(17.0)

**Value traded (Rs cr)**

	11 Feb 08	% Chg - 1 Day
Cash BSE	7,538	22.7
Cash NSE	13,651	0.0
Derivatives	41,257	4.7

**Net inflows (Rs cr)**

	7 Feb 08	% Chg	MTD	YTD
FII	(168)	(68)	4,725	(12,502)
Mutual Fund	(78)	(63)	199	7,778

**FII open interest (Rs cr)**

	8 Feb 08	% chg
FII Index Futures	24,838	(3.8)
FII Index Options	7,636	(3.7)
FII Stock Futures	25,697	(8.5)
FII Stock Options	129	82.4

**Advances/Declines (BSE)**

	11 Feb 08	A	B1	B2	Total	% Total
Advances	18	33	57	108	7	
Declines	202	629	528	1,359	92	
Unchanged	1	3	9	13	1	

**Commodity**

	11 Feb 08	% Chg		
		1 Day	1 Mth	3 Mths
Crude (NYMEX) (US\$/BBL)	93.3	(0.3)	0.6	(1.4)
Gold (US\$/OZ)	923.5	0.1	3.0	16.2
Silver (US\$/OZ)	17.5	1.7	7.5	21.1

**Debt/forex market**

	11 Feb 08	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.48	7.50	7.54	7.91
Re/US\$	39.70	39.64	39.30	39.35

**Sensex**



Source: Bloomberg

**ECONOMY NEWS**

- India could withstand the global financial crisis and continue to grow at more than 8% because of its sound economic and monetary policies in the past, said Dominique Strauss-Kahn, Managing Director, IMF. (BL)
- India's software and services exports are expected to cross the \$40-bn mark in FY08 contributing nearly 64% to the overall revenue aggregate, a Nasscom study has said. The domestic market is expected to touch \$23 bn in 2008. (BS)
- DoT has mooted a proposal for increasing additional spectrum charges and also suggested slashing of one-time fixed spectrum charges. The spectrum charges under the new proposal are lower than the earlier suggestions of Trai. (BS)
- The double taxation avoidance agreement between India and Cyprus is all set to lose the capital gains tax exemption benefit. (ET)
- China is ready to join Pakistan and Iran to build a pipeline to transport Iranian gas if India does not participate in the project, sources said. (BL)

**CORPORATE NEWS**

- The legal battle on the simmering gas supply dispute between **RIL** and **RNRL** is likely to continue in the Bombay High Court, as both camps were unable to reach an amicable solution according to the court's earlier order. (ET)
- BG Group of the UK is keen on picking 25-30% stake in **ONGC's** Krishna Godavari and Mahanadi basin deep sea oil and gas exploration blocks off the east coast. (BS)
- **DLF** is still working on listing a \$1.5-bn property trust in Singapore and expects the IPO to be launched in the second quarter of this year, despite bruising market conditions. (ET)
- **TCS** will increase the salary of its employees by close to 15% this year. The usual pay hikes to its employees this year also would not mean any compromise on the company's overall profit margins. (BS)
- The Power Minister has sought the Prime Minister's intervention to get natural gas from Panna/Mukta and Tapti fields for **NTPC's** power plants. (ET)
- The diagnostics division of **Nicholas Piramal India** is planning to become one of the top three diagnostics players in the domestic market over the next two years via acquisitions and by introducing new in-licensed and in-house-developed diagnostic products. (BS)
- **Panacea Biotech** has opened an R&D centre in Mumbai for both conventional and biotech drugs. (BL)
- **IOB** is likely to cut lending rate by 25 basis points for select consumer loans. (BS)
- **Welspun Gujarat Stahl Rohren** has said it is increasing its steel plate making capacity to 2 MT per year from 1.5 MT at present. (BL)
- **Biocon** has said it has agreed to buy 70% of German drug maker AxiCorp GmbH for €30 mn. AxiCorp is a specialized marketing and distribution firm. (BL)
- **Sterlite Technologies** has said it has won a contract worth \$17.5 mn from Ethiopia's EEPCo. (BL)
- Anil Ambani has acquired 10% in Sequans Communications, a French WiMax chip manufacturer. The investment was made through Reliance Technology Ventures, the corporate venture capital arm of ADAG and a wholly-owned subsidiary of **Reliance Capital**.

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, Tol: Times of India, BSE = Bombay Stock Exchange

## FROM OUR RESEARCH TEAM

### INITIATING COVERAGE

**Sarika Lohra**  
sarika.lohra@kotak.com  
+91 22 6634 1480

## HDFC

PRICE : Rs.2638  
TARGET PRICE : Rs.3142

RECOMMENDATION : BUY  
FY09E P/ABV: 5.6x

With an excellent management team, HDFC has consistently demonstrated a robust financial performance. The company has maintained high return ratios and has the best asset quality in the industry. We believe HDFC will remain in a sweet spot, since major banks in India are adhering to a passive approach in the mortgage loan segment. Meanwhile, improved disposable income and change in demographic dynamics would accelerate demand for housing. This would drive the growth for the mortgage finance business. In the wake of strong demand from the housing and real estate segment, we expect HDFC's core business (mortgage finance) to continue to grow at ~25% CAGR over FY07-09E to Rs.890 bn. This strong business growth trend is reflected in its 9MFY08 performance where the company's outstanding loan portfolio grew 29% YoY to Rs.660 bn.

In addition to this, we believe HDFC's subsidiaries, namely, HDFC Bank, HDFC Mutual Fund, HDFC Standard Life, and HDFC General Insurance (in partnership with Ergo of Germany) create significant value for the company. We have valued the company on an SoTP method to arrive at a fair value of Rs.3245 per share. The subsidiaries contribute Rs.773 per share (after considering 15% holding company discount), which is 25% of the consolidated value of the company. At the current market price, the stock trades at 28.0x its FY09E EPS of Rs.94 and 5.6x its FY09E ABV of Rs.468. At our target price, the stock offers a 19% upside. We recommend a BUY on the stock with an SoTP 12-month price target of Rs.3142.

#### Stock details

BSE code	: 500010
NSE code	: HDFC
Market cap (Rs bn)	: 748
Free float (%)	: 100
52-wk Hi/Lo (Rs)	: 3257 / 3262
Avg. daily volume BSE	: 140379
Avg. daily volume NSE	: 601395
Shares o/s (mn)	: 283

#### Summary table (year end Mar)

(Rs bn)	FY07	FY08E	FY09E
Int. Income	53.1	75.3	92.9
Int. expenses	36.7	51.0	62.4
NII	16.5	24.3	30.5
Non-Int Income	5.8	12.8	10.4
Total Income	22.29	37.12	40.94
Optg Profit	19.9	34.2	37.3
PAT	15.7	24.5	27.1
GNPA - 6 mths(%)	0.8	0.9	0.9
NNPA (%)	0.2	0.3	0.3
NIMs (%)	2.9	3.4	3.4
RoA (%)	2.8	3.4	3.0
RoE (%)	31	29	21
Divi. Payout (%)	35.4	27.7	30.8
EPS (Rs)	62.1	86.5	94.1
BV (Rs)	219.4	407.8	475.8
Adj. BV (Rs)	214.5	401.4	467.9
P/E (x)	42.5	30.5	28.0
P/ABV (x)	12.3	6.6	5.6

Source: Company & Kotak Securities - Private Client Research

#### Investment Rationale

- ▣ **Strong macro fundamentals augment business growth:** Growing population, increasing urbanization and increasing trend of nuclear families is leading to an increase in demand for housing. Increased population of earning youths, with higher disposable income has also led to an improvement in affordability. With growing housing requirement the demand for housing finance is likely to remain buoyant. The lower mortgage penetration is indicated by a lower mortgage to GDP ratio of 6% in India, as compared to 71% in the US. This offers a huge potential for housing finance companies in India.
- ▣ **Placed on solid ground:** HDFC is a leader in the mortgage finance segment with over 30% market share in India. The company is well placed to tap the opportunity in the current scenario of rising demand for housing and easing competition with banks (particularly large private banks). These banks are reducing exposure to the housing loan segment. We expect HDFC to continue to witness traction on its disbursement growth. We expect disbursements of the company to demonstrate a CAGR of 25% over FY07-2009E leading to a loan book of Rs.890 bn by FY09E.
- ▣ **Preeminent returns ratios:** On the back of steady growth in earnings, HDFC has been consistently maintaining higher return ratios. The RoE of the company was consistently maintained at around 30% while the RoA of the company remained firm at around 3%. On the back of lumpy income from treasury operations and gains from reshuffling of partnership in its subsidiaries, HDFC's RoE and RoA are expected to remain firm in FY08E at 27% and 3.2%, respectively.

- ❑ **Asset quality remains intact:** Strong growth in the loan book at over 25% CAGR notwithstanding, HDFC's asset quality has retained its sheen. With the management's conscious efforts to contain delinquencies, the NPA ratio of the company consistently remained lower at around 0.4%. Going forward, the management feels the asset quality at HDFC would remain strong.
- ❑ **Value addition from subsidiaries:** HDFC with its subsidiaries, offer a vast gamut of services. We have valued HDFC's subsidiaries, namely; HDFC Standard Life, HDFC Bank, HDFC AMC, HDFC General Insurance and Gruh Finance. With regards to the valuations, we are of the view that the subsidiaries contribute around 25% of the value to the stock. We have valued the subsidiaries at Rs.773 per share for HDFC factoring in 15% holding company discount.
- ❑ **Attractive valuations:** The unlocking of the unrealized gains in its investments book would lead to lumpiness in non-interest income of the company. The impending value unlocking from the subsidiaries, particularly the life insurance business would be a key trigger for the company. Strong earnings visibility coupled with outstanding return ratios would continue to fetch premium valuations for the stock.

### Valuations

We have valued HDFC on an SoTP basis as imminent value unlocking from the significant investment in insurance (life and general), venture capital and AMC also adds value to the company. The unrealized gains on its investment book would lead to lumpy treasury gains in future. We have valued the core business using dividend discount model to arrive at a fair value of the business at Rs.2369, while the rest of the subsidiaries are valued at Rs.773 (after considering 15% holding company discount). After accounting for the value from subsidiaries we have arrived at a fair price target of Rs.3142. At the current market price of Rs.2638, the stock trades at 28.0x its FY09 EPS of Rs.94.1 and 5.6x its FY09E ABV of Rs.468. However, if we strip off the 25% value of investment in subsidiary from the current market price, the stock is trading at its FY09E P/E of 19.8x and P/ABV of 4.0x. Hence we recommend a **BUY** on the stock with a 12-month price target of Rs.3142.

*We recommend **BUY** on HDFC  
with a price target of  
**Rs.3142***

### Risks & Concerns

- ❑ **Renewed interest of banks in housing space may increase competition:** the company's business growth is vulnerable to the risk of loss of market share to banks, which might impact its business growth. Nevertheless, HDFC with its distribution partners - HDFC Bank, Gruh Housing and HLSIL would continue to hold a significant share of the pie.
- ❑ **Higher NIMs may not be sustainable in future:** Going forward, with the increase in leverage and vanishing impact of the preferential issue of shares and FCCB conversions, the company may not see NIMs at the current high levels. However, even after accounting for a marginal pressure on the margins due to a recent cut in the PLR, the NIMs of the company are expected to remain at attractive levels.
- ❑ **Downturn in housing industry:** Any downturn in the housing industry would lead to increase in defaults which would impact its asset quality and in turn would also impact future business growth.

**Bulk deals**

<b>Trade details of bulk deals</b>					
<b>Date</b>	<b>Scrip name</b>	<b>Name of client</b>	<b>Buy/ Sell</b>	<b>Quantity of shares</b>	<b>Avg. Price (Rs)</b>
11-Feb	Arealty	Mavi Investment Fund Limited	B	75,000	399.99
11-Feb	Axon Infotec	Anmol Finance Company	B	4,500	50.00
11-Feb	Axon Infotec	Chirag Securities	B	6,500	50.00
11-Feb	Commit Cap S	Ajay Maheshwari	B	25,519	15.84
11-Feb	Commit Cap S	Rama Lakshmi Adivi	S	21,669	16.11
11-Feb	Malu Paper	Pragiri Finvest India Pvt. Ltd.	B	119,650	34.55
11-Feb	Malu Paper	JVS Securities Pvt. Ltd.	S	120,000	34.55
11-Feb	Prithvi Info	M M Technobuild Private Ltd.	B	500,000	292.41
11-Feb	Shree Ashta	Mavi Investment Fund Ltd.	B	100,000	330.00
11-Feb	Shree Ashta	Pooja Equiresearch Pvt Ltd.	S	79,603	330.00
11-Feb	Tribhvan Hsg	Online Capital Securities P	B	45,000	27.86
11-Feb	Venus Remeds	Merrill Lynch Capital Markets			
		Espana S.A. S.V.	B	200,000	490.00
11-Feb	Venus Remeds	Yash Shares and Stock Private	S	54,339	490.00

Source: BSE

## Gainers & Losers

Nifty Gainers & Losers				
	Price (Rs)	% change	Index points	Volume (mn)
<b>Gainers</b>				
VSNL	482	8.7	1.9	1.6
Satyam Comp	424	3.6	1.7	3.7
TCS	906	0.9	1.3	0.8
<b>Losers</b>				
Reliance Ind	2,277	(6.2)	(37.6)	4.8
Reliance Com	588	(8.9)	(20.5)	7.2
ONGC	942	(5.5)	(20.2)	1.4

Source: Bloomberg

## Forthcoming events

COMPANY/MARKET	
Date	Event
12-Feb	J Kumar Infraprojects listing on BSE & NSE; TCS holds press meet to announce new initiative; Sumeet Industries holds press meet for expansion plans; Ginni Systems organizes a seminar on emerging technology
13-Feb	V-Guard Industries holds press conference to discuss on IPO
19-Feb	ABB to announce earnings and dividend

Source: Bloomberg

## Research Team

Name	Sector	Tel No	E-mail id
Dipen Shah	IT, Media, Telecom	+91 22 6634 1376	dipen.shah@kotak.com
Sanjeev Zarbade	Capital Goods, Engineering	+91 22 6634 1258	sanjeev.zarbade@kotak.com
Teena Virmani	Construction, Cement, Mid Cap	+91 22 6634 1237	teena.virmani@kotak.com
Awadhesh Garg	Pharmaceuticals, Hotels	+91 22 6634 1406	awadhesh.garg@kotak.com
Apurva Doshi	Logistics, Textiles, Mid Cap	+91 22 6634 1366	doshi.apurva@kotak.com
Saurabh Gurnurkar	IT, Media, Telecom	+91 22 6634 1273	saurabh.gurnurkar@kotak.com
Saurabh Agrawal	Metals, Mining	+91 22 6634 1291	agrawal.saurabh@kotak.com
Saday Sinha	Banking, Economy	+91 22 6634 1440	saday.sinha@kotak.com
Rohit Ledwani	Retail	+91 22 6634 1507	rohit.ledwani@kotak.com
Sarika Lohra	NBFCs	+91 22 6634 1480	sarika.lohra@kotak.com
Chetan Shet	FMCG, Power	+91 22 6634 1382	chetan.shet@kotak.com
Shrikant Chouhan	Technical analyst	+91 22 6634 1439	shrikant.chouhan@kotak.com
Kaustav Ray	Editor	+91 22 6634 1223	kaustav.ray@kotak.com
K. Kathirvelu	Production	+91 22 6634 1557	k.kathirvelu@kotak.com

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