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Rating	BUY
Price	Rs679
Target Price	Rs800
Implied Upside	17.8%
Sensex	17,489
Nifty	5,306

(Prices as on July 11, 2012)
Trading data

Market Cap. (Rs bn)	1,002.6
Shares o/s (m)	1,477.0
3M Avg. Daily value (Rs m)	1685.8

Major shareholders

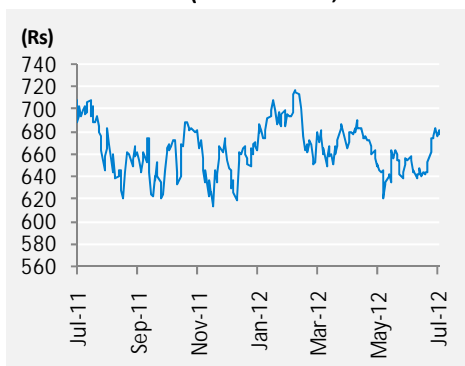
Promoters	0.00%
Foreign	66.74%
Domestic Inst.	19.48%
Public & Other	13.78%

Stock Performance

(%)	1M	6M	12M
Absolute	3.4	(0.3)	(4.3)
Relative	(1.5)	(8.4)	2.3

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	32.3	32.0	1.0
2014	37.8	38.1	-0.6

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


Source: Bloomberg

We upgrade HDFC to 'BUY' from 'Accumulate' with a PT of Rs800/share as last two years of under performance (largely technical) has created a sweet spot for long-term investors. The mortgage business will continue to deliver +25% ROEs with ~20% growth and we believe valuations at <3.0x 1-yr fwd book is extremely reasonable. Q1FY13 margin and growth performance addresses concerns on competitive intensity and related growth pressures. We do not consider accounting issues very significant and any investor concerns are likely to get addressed as HDFC moves to IFRS accounting in H2FY13.

- Q1FY13- A steady quarter:** HDFC reported PAT of Rs10bn, up 19% YoY, in line with our estimates. Margins continue to remain stable driven by flexibility in funding mix. Individual loan growth surprised us with ~24% YoY growth, more than offsetting slower growth in the corporate/developer book (Refer page 5&6).
- Mortgage valuations extremely reasonable (Page 2):** Though reported ROEs are at 21-22%, ROEs adjusted for subsidiary investments and also interest on zero coupon bonds is +24-25% which we expect will sustain. With no asset quality/regulatory risk and more importantly large de-rating over the last two years relating to technical factors (secondary sale by strategic investors), we believe mortgage business valuations is extremely reasonable at <3.0x 1-yr fwd book. HDFC is currently trading at the lower end of trading band with no dilution in growth or return ratios v/s historic levels - **Top pick among defensive financials.**
- IFRS accounting to address accounting concerns if any (page 4):** ZCB issuance has been in line with investments in subsidiaries (not consolidated) and we see limited impact from reserve accounting for ZCB interests. Moreover, HDFC is moving to IFRS accounting from Q2FY13 and that would address investor concerns if any. Consolidated ROEs remain at ~22-23% even after factoring in ZCB interests.

Key Financials (Y/e March)	2011	2012	2013E	2014E
Net interest income (Rs m)	41,335	49,765	62,220	74,155
Growth (%)	26.1	20.4	25.0	19.2
Non-interest income (Rs m)	11,847	12,210	12,554	13,476
Operating Profit (Rs m)	49,370	57,456	69,542	81,570
PAT (Rs m)	35,350	41,226	49,462	57,975
EPS (Rs)	24.1	27.9	32.3	37.8
Growth (%)	22.4	15.8	15.7	17.2
Net DPS (Rs)	9.0	11.0	13.2	15.5

Profitability & valuation	2011	2012	2013E	2014E
Spreads / Margins (%)	3.2	3.2	3.4	3.4
RoAE (%)	21.7	22.7	22.4	21.5
RoAA (%)	2.8	2.7	2.7	2.7
P/E (x)	28.2	24.3	21.0	17.9
P/BV (x)	5.7	5.3	4.1	3.6
P/ABV (x)	5.7	5.3	4.1	3.6
Net dividend yield (%)	1.3	1.6	1.9	2.3

Source: Company Data; PL Research

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Mortgage business valuations very reasonable v/s return ratios

- Valuing HDFC's mortgage business requires adjustment to be made to HDFC's networth and implied ROEs. We notice a misconception among investors of deducting entire ~Rs80bn of investment in subs/associates from book value but ignoring that implied ROEs in that case would be ~30%.
- We assume investments in subsidiaries/associates to be funded at 50:50 debt: equity and adjust dividends and interest on ZCBs accordingly. The mortgage business generates ROEs of 24-25% and on that book, current valuations at **2.8x FY14 book** seem extremely reasonable.

Exhibit 1: Mortgage business valuation extremely reasonable v/s return ratios

	2009	2010	2011	2012E	2013E	2014E	Average ROEs
Reported Basis							
Networth	131,374	151,977	173,165	190,176	252,273	286,554	
Total Assets	982,891	1,088,964	1,324,670	1,593,385	1,769,989	2,134,270	
PAT	21,162	26,287	33,435	38,594	47,040	55,311	
Book Value	92.37	105.87	118.05	128.76	164.70	187.08	
ROA	2.54%	2.73%	2.77%	2.83%	2.94%	2.97%	
ROE	16.87%	18.55%	20.57%	21.24%	21.26%	20.53%	20.9%
Adjusted for Investments - 50% Equity funded, 50% debt funded							
Networth ex. Sub investment	114,535	113,629	137,990	149,269	208,866	240,647	
Assets adjusted	982,891	1,088,964	1,324,670	1,593,385	1,769,989	2,134,270	
Adjusted PAT	20,210	24,594	31,166	36,241	44,458	52,580	
EPS							
Book Value	80.53	79.15	94.07	101.07	136.36	157.11	
ROA	2.54%	2.73%	2.58%	2.83%	2.94%	2.97%	
ROE	18.44%	21.56%	24.77%	25.23%	24.83%	23.39%	24.5%
Adjusted P/B - Current price					3.20	2.78	
Adjusted P/B - Target price					4.15	3.60	
Adjusted for Investments - 100% Equity funded, 0% debt funded							
Networth ex. Sub investment	97,695	75,281	102,814	108,362	165,459	194,740	
Assets adjusted	982,891	1,088,964	1,324,670	1,593,385	1,769,989	2,134,270	
Adjusted PAT	19,258	22,901	28,896	33,888	41,877	49,850	
Book adjusted for split	68.69	52.44	70.09	73.37	108.02	127.14	
ROA	2.54%	2.73%	2.39%	2.83%	2.94%	2.97%	
ROE	20.53%	26.48%	32.45%	32.09%	30.59%	27.68%	29.1%
Adjusted P/B					4.04	3.43	
Adjusted P/B - Target price					5.24	4.45	

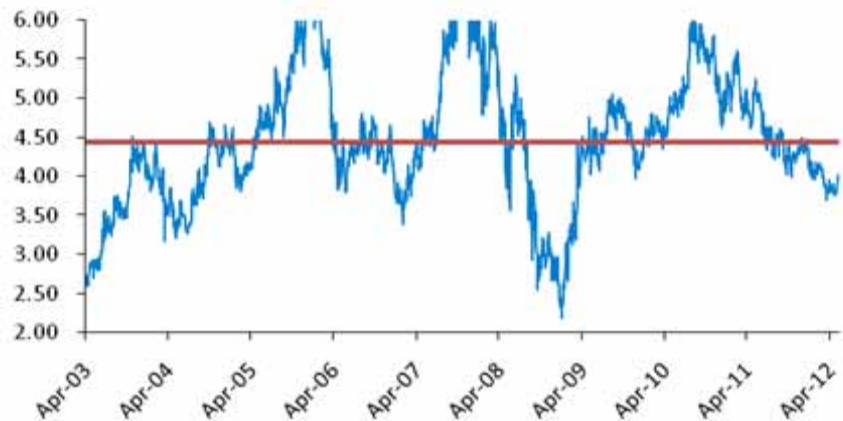
Source: Company Data, PL Research

Exhibit 2: Our subsidiary valuation of Rs235/share not aggressive

	Value per share	Method
HDFC Bank	180	18.5x Sep-13 EPS
HDFC Standard Life	43	Appraisal value
HDFC Asset Management	11	4% of AUM
Fair value of key subsidiaries	234	
HDFC Ltd (standalone)	566	2-stage Gordon Growth
Sep-13 PT	800	

Source: Company Data, PL Research

Source: Company Data, PL Research

Exhibit 3: Stock has got de-rated without any change in growth/return ratios (1yr fwd P/B)


Source: Company Data, PL Research

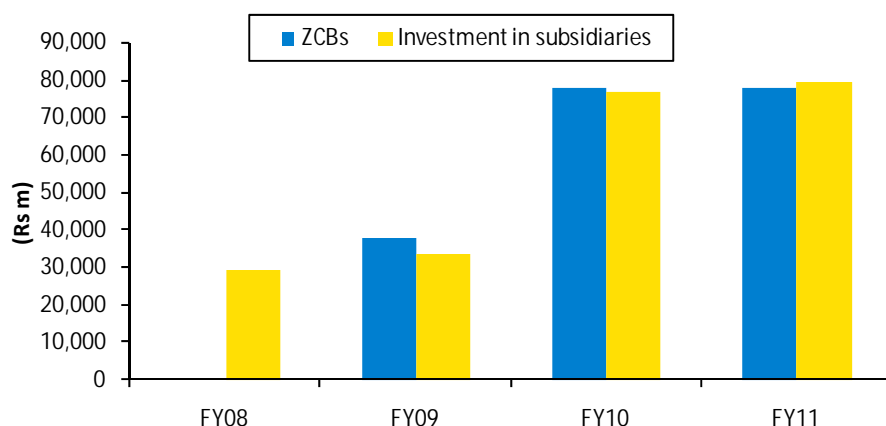
Exhibit 4: Huge secondary supply has largely caused the under performance

Date		Shares (m)	Average Price / share	Value (m)
Feb-12	City	1453	658	955,435
Feb-12	Carlyle	20	677	13,540
Jun-11	City	16.5	643	10,610
Total		1,490	658	979,585

Source: Company Data, PL Research

IFRS accounting from H2FY13 to address any accounting concerns

Exhibit 5: ZCB issuance has been in line with investment in subs/associates



Zero coupon issuance has been in line with growth in investments in subs/associates and hence, we do not believe P&L has been understated

Source: Company Data, PL Research

Exhibit 6: Consolidated ROEs at 22-23% despite netting of ZCB interest

	FY11	FY12	FY13E	FY14E
Standalone equity	173,165	190,176	252,273	286,554
Consolidated equity	211,901	244,240	318,745	369,749
PAT of significant subsidiaries				
HDFC Bank	39,260	51,670		
HDFC Life insurance		2,710		
HDFC AMC	2,421	2,691		
HDFC General	(364)	(397)		
Gruh Finance	915	1,203		
Proportionate Subsidiary PAT	11,676	16,904	21,130	26,412
Dividend income	2,252	3,097	3,871	4,838
Net accretive income	9,423	13,807	17,259	21,574
Adjustment for Zero coupon bonds	5,321	4,851	4,851	4,851
Actual accretion in income	4,102	8,956	12,408	16,723
Reported standalone PAT	35,350	41,226	49,462	57,975
Reported consolidated PAT	45,284	54,625		
Adjusted consolidated PAT	39,452	50,183	61,870	74,698
Standalone ROEs		22.7%	22.4%	21.5%
Consolidated ROEs		22.0%	22.0%	21.7%

Source: Company Data, PL Research

Adjusted for ZCB interest, consolidated ROEs still high at ~22-23% in line with standalone ROE

Management to start reporting under IFRS from H2FY13 and that should address any investor concerns on accounting

Exhibit 7: Q1FY13 Financials : Steady Qtr

NII grew 19.3% YoY supported by strong growth in retail book; sequential fall is largely seasonal

Opex higher mainly due to higher standard of asset provisioning

	1Q12	4Q12	1Q13	YoY	QoQ
Net interest income	12,270	18,049	14,638	19.3%	-18.9%
Fees	634	681	701	10.6%	2.9%
Net revenues	12,904	18,731	15,339	18.9%	-18.1%
Operating expenditure	1,312	1,280	1,742	32.8%	36.1%
Operating profit	11,593	17,451	13,597	17.3%	-22.1%
Investment profit	163	791	202	24.5%	-74.4%
Profit before tax	11,755	18,252	13,799	17.4%	-24.4%
Tax	3,310	4,980	3,780	14.2%	-24.1%
PAT	8,445	13,272	10,019	18.6%	-24.5%
Liabilities					
Share Capital	2,940	2,954	2,977	1.3%	0.8%
Reserves and Surplus	177,761	187,222	201,678	13.5%	7.7%
Loan funds					
Term Loans	414,279	406,966	374,844	-9.5%	-7.9%
Bonds	515,905	621,381	663,838	28.7%	6.8%
Deposits	305,004	362,928	399,434	31.0%	10.1%
Total	1,235,187	1,391,275	1,438,116	16.4%	3.4%
Assets					
Loans					
Individuals	778,860	887,779	954,129	22.5%	7.5%
Corporates	448,233	501,896	509,977	13.8%	1.6%
Others	14,585	19,071	18,517	27.0%	-2.9%
Total	1,241,677	1,408,746	1,482,623	19.4%	5.2%
Investments	173,282	122,070	151,825	-12.4%	24.4%

Growth being funded from bonds and deposits due to higher base rate for bank loans – Advantage of funding flexibility continues

Growth driven by individual mortgages – addresses growth concern

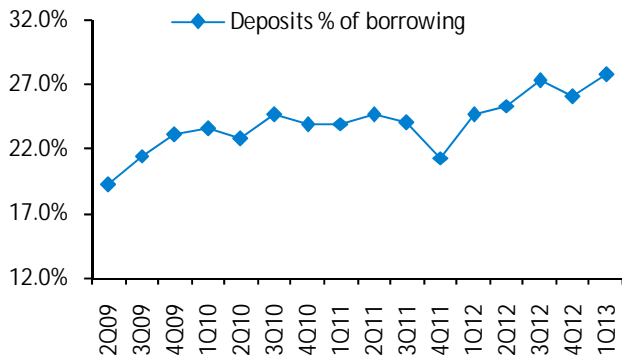
Source: Company Data, PL Research

Exhibit 8: Operating Matrix

Operating data	1Q12	4Q12	1Q13	YoY	QoQ
Disbursements	130,320	212,416	156,384	20.0%	-26.4%
Borrowings	1,235,187	1,391,275	1,438,116	16.4%	3.4%
Loans	1,241,680	1,408,746	1,482,623	19.4%	5.2%
Loans (including sold portfolio)	1,359,708	1,554,306	1,621,343	19.2%	4.3%
Funds	1,235,187	1,391,275	1,438,116	16.4%	3.4%
Cost-income	10.2%	6.8%	11.4%	1.2%	4.5%
Gross NPL (%)	0.83%	0.74%	0.79%	0.0%	0.1%
NIM	3.63%	4.82%	3.70%	0.1%	-1.1%
Spreads	2.26%	3.67%	2.28%	0.02%	-1.39%
ROE	19.1%	27.5%	20.3%	1.2%	-7.2%

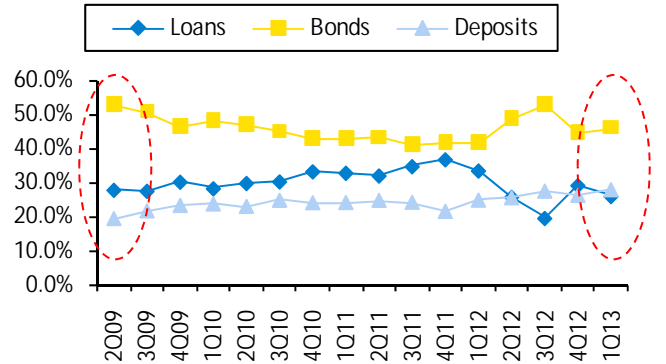
Source: Company Data, PL Research

Exhibit 9: Funding from deposits have been increasing in a tightening monetary environment



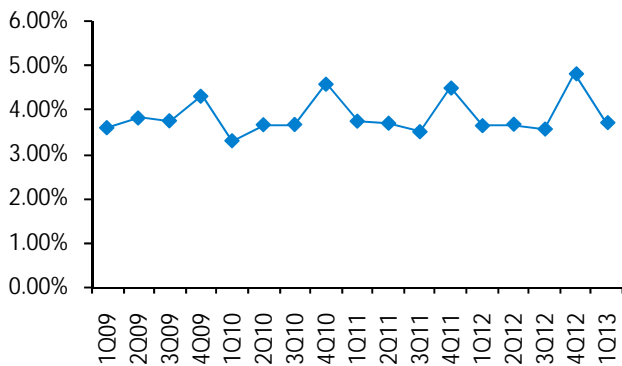
Source: Company Data, PL Research

Exhibit 10: Growth largely deposit/bond funded



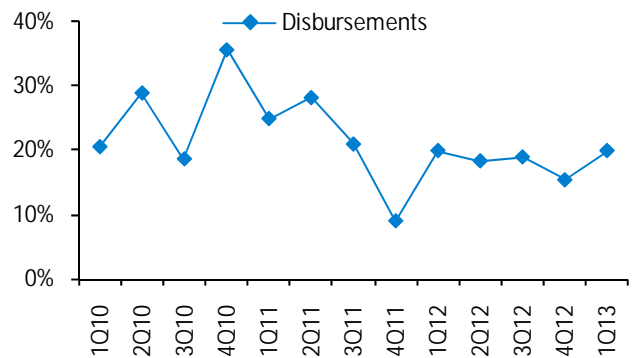
Source: Company Data, PL Research

Exhibit 11: NIMs remain stable; sequential fall is due to seasonality



Source: Company Data, PL Research

Exhibit 12: Disbursement growth has picked up



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Int. Inc. / Opt. Inc.	116,934	161,333	188,615	226,627
Interest Expenses	75,599	111,568	126,395	152,472
Net interest income	41,335	49,765	62,220	74,155
<i>Growth (%)</i>	<i>26.1</i>	<i>20.4</i>	<i>25.0</i>	<i>19.2</i>
Non interest income	11,847	12,210	12,554	13,476
<i>Growth (%)</i>	<i>16.1</i>	<i>3.1</i>	<i>2.8</i>	<i>7.3</i>
Net operating income	53,181	61,975	74,775	87,631
Expenditure				
Employees	1,755	2,058	2,367	2,722
Other expenses	2,056	2,461	2,865	3,339
Depreciation	—	—	—	—
Total expenditure	3,812	4,519	5,232	6,061
PPP	49,370	57,456	69,542	81,570
<i>Growth (%)</i>	<i>24.2</i>	<i>16.4</i>	<i>21.0</i>	<i>17.3</i>
Provision	700	800	880	968
Other income	—	—	—	—
Exchange Gain / (Loss)	700	800	880	968
Profit before tax	48,670	56,656	68,662	80,602
Tax	13,320	15,430	19,201	22,628
<i>Effective tax rate (%)</i>	<i>27.4</i>	<i>27.2</i>	<i>28.0</i>	<i>28.1</i>
PAT	35,350	41,226	49,462	57,975
<i>Growth (%)</i>	<i>25.1</i>	<i>16.6</i>	<i>20.0</i>	<i>17.2</i>

Balance Sheet (Rs m)

Y/e March	2011	2012	2013E	2014E
Sources of funds				
Equity	2,934	2,954	3,063	3,063
Reserves & Surplus	163,572	180,563	242,550	276,831
Networth	173,165	190,176	252,273	286,554
<i>Growth (%)</i>	<i>13.9</i>	<i>9.8</i>	<i>32.7</i>	<i>13.6</i>
Loan funds	907,854	1,028,347	1,087,854	1,292,854
<i>Growth (%)</i>	<i>—</i>	<i>13.3</i>	<i>5.8</i>	<i>18.8</i>
Deposits	246,251	362,928	422,928	552,928
Other Liabilities	67,751	93,749	93,749	93,749
Total	1,395,021	1,675,199	1,856,803	2,226,084
Application of funds				
Net fixed assets	2,340	2,340	2,325	2,295
Advances	1,171,266	1,408,746	1,684,892	2,025,259
<i>Growth (%)</i>	<i>19.6</i>	<i>20.3</i>	<i>19.6</i>	<i>20.2</i>
Net current assets	121,537	112,350	140,729	153,642
Investments	20,955	39,205	22,949	22,949
<i>Growth (%)</i>	<i>58.7</i>	<i>87.1</i>	<i>(41.5)</i>	<i>—</i>
Deferred tax asset	—	—	—	—
Other Assets	78,923	112,559	126,403	142,432
Total	1,395,021	1,675,199	1,977,297	2,346,578

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q2FY12	Q3FY12	Q4FY12	Q1FY13
Int. Inc. / Operating Inc.	39,970	43,018	47,438	48,520
Income from securitization	—	—	—	1
Interest Expenses	26,905	30,124	29,389	33,882
Net Interest Income	13,064	12,894	18,049	14,638
<i>Growth</i>	<i>18.0</i>	<i>17.2</i>	<i>26.3</i>	<i>19.3</i>
Non interest income	1,722	1,707	1,472	903
Net operating income	14,786	14,601	19,521	15,541
<i>Growth</i>	<i>18.0</i>	<i>10.0</i>	<i>17.9</i>	<i>18.9</i>
Operating expenditure	1,409	1,319	1,280	1,742
PPP	13,377	13,282	18,242	13,799
<i>Growth</i>	<i>18.0</i>	<i>9.6</i>	<i>17.3</i>	<i>17.4</i>
Provision	—	—	—	—
Exchange Gain / (Loss)	—	—	—	—
Profit before tax	13,377	13,282	18,242	13,799
Tax	3,670	3,470	4,980	3,780
Prov. for deferred tax liability	—	—	—	—
<i>Effective tax rate (%)</i>	<i>27.4</i>	<i>26.1</i>	<i>27.3</i>	<i>27.4</i>
PAT	9,707	9,812	13,262	10,019
<i>Growth</i>	<i>20.2</i>	<i>10.3</i>	<i>16.0</i>	<i>18.6</i>

Key Ratios

Y/e March	2011	2012	2013E	2014E
CMP (Rs)	679	679	679	679
Eq. Shrs. O/s. (m)	1,467	1,477	1,532	1,532
Market Cap (Rs m)	995,698	1,002,554	1,039,718	1,039,718
Market Cap to AUM (%)	0.7	0.6	0.5	0.4
EPS (Rs)	24.1	27.9	32.3	37.8
Book Value (Rs)	118.1	128.8	164.7	187.1
Adjusted Book Value (Rs)	118.1	128.8	164.7	187.1
P/E (x)	28.2	24.3	21.0	17.9
P/BV (x)	5.7	5.3	4.1	3.6
P/ABV (x)	5.7	5.3	4.1	3.6
DPS (Rs)	9.0	11.0	13.2	15.5
Dividend Yield (%)	1.3	1.6	1.9	2.3

Asset Quality

Y/e March	2011	2012	2013E	2014E
Gross NPAs (Rs m)	9,019	10,425	12,468	14,987
Net NPAs (Rs m)	—	—	—	—
Gross NPAs to Gross Adv. (%)	0.8	0.7	0.7	0.7
Net NPAs to Net Adv. (%)	—	—	—	—
NPA Coverage (%)	—	—	—	—

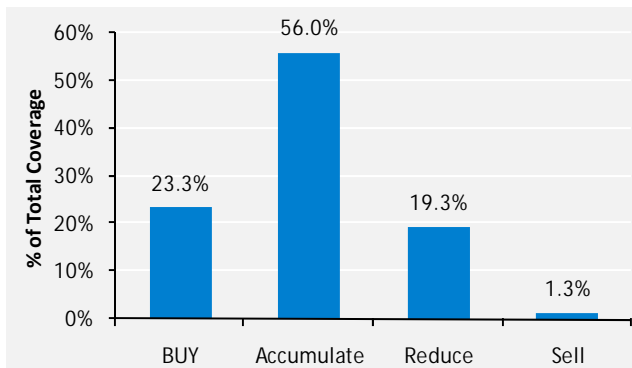
Profitability (%)

Y/e March	2011	2012	2013E	2014E
NIM	3.2	3.2	3.4	3.4
RoAA	2.8	2.7	2.7	2.7
RoAE	21.7	22.7	22.4	21.5

Source: Company Data, PL Research.

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Rating Distribution of Research Coverage



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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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