2 November 2012 │ 34 pages

Thrifts and Mortgage Finance (GICS) │ Banks (Citi)
Asia Pacific │ India

Housing Development Finance Corp. (HDFC.BO)

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

New Reasons to Love an Old Love

- **Reinitiating at Buy with a TP of Rs860** — We believe HDFC is in a sweet spot strategically, structurally and cyclically, which should precipitate a virtuous upcycle in loan growth (21%+), ROE (22%+) and stock returns – with upside risk. We reinitiate coverage of HDFC, post a lengthy Legal restriction, with a Buy rating and a target price of Rs860. Risks lie in competitive intensity, valuations and higher rates.
- **Strategically: A shift** — HDFC is positioned for a new stage of growth: a) Significant capital generation – subsidiaries are now throwing back capital (higher growth, pay-outs and acquisitions?); b) Greater securitization – a yield/growth tool; and c) an HDBK merger option – falling reserve requirement is a positive. HDFC could be ready to go beyond business as usual.
- **Structurally: A move** — The broader operating environment appears favourable: a) Potential ECB funding (big, if it happens), and recent MF and FII debt limit expansions could be a game changing mix; b) The expanded loan acquisition machinery is firing on all cylinders; and c) Regulatory overhangs have lifted. The 'usual business' is getting easier, competition notwithstanding.
- **Cyclically: A swing** — It is also a nice time to do business: a) Easing liquidity and interest rates are good for funding; b) The mortgage market appears to be bouncing back (+31% HDFC growth in 2Q13); and c) Competitor banks are hamstrung with base-rate-linked pricing constraints. A good festive season is ahead.
- **Profitably: As always** — HDFC should generate a three-year net profit CAGR of 18%, loan growth of 21% and a sustained ROE of +22% in FY13-15E. The key risk lies in competitor intensity and irrationality, which would erode spreads.
- **It's all coming together** — We see a very favorable strategic, structural and cyclical confluence in play to comfortably justify an SOTP-based target price of Rs860, with the core business at 4x FY14E PBV.

Buy	**1**
from Sell/Low Risk	
Price (01 Nov 12)	Rs758.00
Target price	Rs860.00
from Rs250.00	
Expected share price return	13.5%
Expected dividend yield	1.6%
Expected total return	**15.0%**
Market Cap	Rs1,167,379M
	US$21,696M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2011A	35,350	23.80	22.4	31.9	6.4	21.7	1.2
2012A	41,226	27.57	15.8	27.5	5.9	22.7	1.5
2013E	48,646	31.39	13.8	24.2	4.6	22.1	1.6
2014E	57,172	36.89	17.5	20.5	4.1	21.4	1.7
2015E	67,229	43.38	17.6	17.5	3.6	22.2	2.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2011	2012	2013E	2014E	2015E
Valuation Ratios					
P/E adjusted (x)	31.9	27.5	24.2	20.5	17.5
P/E reported (x)	31.9	27.5	24.2	20.5	17.5
P/BV (x)	6.4	5.9	4.6	4.1	3.6
P/Adjusted BV diluted (x)	6.5	5.9	4.7	4.2	3.7
Dividend yield (%)	1.2	1.5	1.6	1.7	2.0
Per Share Data (Rs)					
EPS adjusted	23.80	27.57	31.39	36.89	43.38
EPS reported	23.80	27.57	31.39	36.89	43.38
BVPS	118.05	128.76	163.12	185.04	211.22
Tangible BVPS	118.05	128.76	163.12	185.04	211.22
Adjusted BVPS diluted	116.66	128.72	161.19	181.07	204.76
DPS	9.00	11.00	12.00	13.00	15.00
Profit & Loss (Rsm)					
Net interest income	44,646	53,181	64,396	76,233	88,284
Fees and commissions	2,455	2,897	3,187	3,505	3,856
Other operating Income	6,080	5,897	6,597	7,707	9,060
Total operating income	**53,181**	**61,975**	**74,180**	**87,445**	**101,199**
Total operating expenses	-3,812	-4,519	-5,198	-5,944	-6,801
Oper. profit bef. provisions	**49,370**	**57,456**	**68,982**	**81,501**	**94,398**
Bad debt provisions	-700	-800	-1,418	-1,540	-1,668
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**48,670**	**56,656**	**67,564**	**79,961**	**92,730**
Tax	-13,320	-15,430	-18,918	-22,789	-25,501
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**35,350**	**41,226**	**48,646**	**57,172**	**67,229**
Adjusted earnings	35,350	41,226	48,646	57,172	67,229
Growth Rates (%)					
EPS adjusted	22.4	15.8	13.8	17.5	17.6
Oper. profit bef. prov.	24.2	16.4	20.1	18.1	15.8
Balance Sheet (Rsm)					
Total assets	**1,395,021**	**1,675,199**	**1,980,669**	**2,370,189**	**2,833,629**
Avg interest earning assets	1,188,976	1,437,800	1,726,383	2,072,159	2,496,823
Customer loans	1,179,305	1,416,391	1,723,687	2,096,915	2,552,091
Gross NPLs	9,903	12,328	15,184	18,649	22,851
Liab. & shar. funds	**1,395,021**	**1,675,199**	**1,980,669**	**2,370,189**	**2,833,629**
Total customer deposits	246,251	362,928	424,626	501,058	596,259
Reserve for loan losses	8,039	12,180	12,180	12,180	12,180
Shareholders' equity	**173,165**	**190,176**	**249,811**	**283,387**	**323,467**
Profitability/Solvency Ratios (%)					
ROE adjusted	21.7	22.7	22.1	21.4	22.2
Net interest margin	3.75	3.70	3.73	3.68	3.54
Cost/income ratio	7.2	7.3	7.0	6.8	6.7
Cash cost/average assets	0.3	0.3	0.3	0.3	0.3
NPLs/customer loans	0.8	0.9	0.9	0.9	0.9
Reserve for loan losses/NPLs	81.2	98.8	80.2	65.3	53.3
Bad debt prov./avg. cust. loans	0.1	0.1	0.1	0.1	0.1
Loans/deposit ratio	478.9	390.3	405.9	418.5	428.0
Tier 1 capital ratio	11.0	11.7	13.7	13.0	12.3
Total capital ratio	13.7	14.6	16.4	15.6	14.5

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Contents

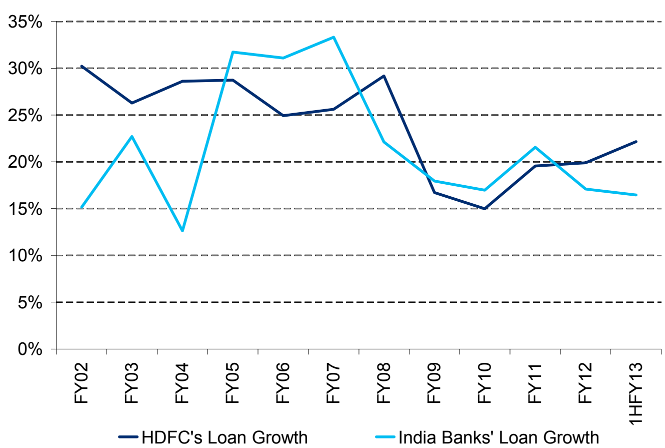
A Love Story

The First Love

A market darling…for the right reasons

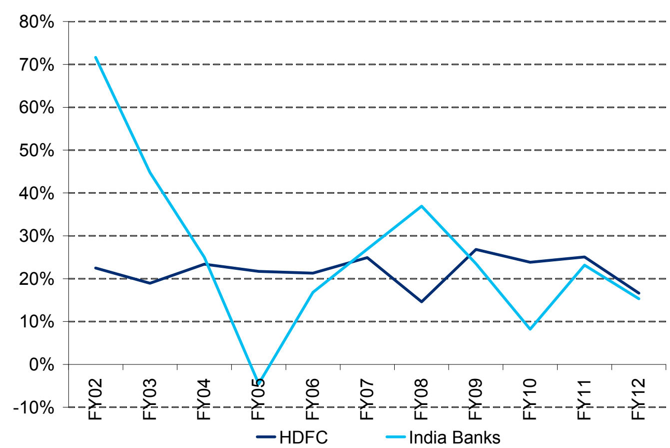
We reinitiate coverage of HDFC, post a lengthy Legal restriction, with a Buy[1] rating and a target price of Rs860. HDFC – needs no introduction – has been one of India's most loved stocks over the past two decades, but here's why it is what it is. It has over this period grown its asset book at a 10 Yr CAGR of 23% and profits at a CAGR of 22% (and consistently), and the stock has returned 28% pa. Probably, more importantly, it has done so in an almost linear fashion – consistently, without any material ups or downs, or changes in management, strategy and business profile. This high-growth, profitability and consistency also stand out in the broader financial sector in India, which fundamentally has also prospered.

Figure 1. Relative Loan Growth — HDFC versus India Banks (% YoY)



Source: Citi Research, Company Data, RBI

Figure 2. Relative Profit Growth — HDFC versus India Banks (% YoY)



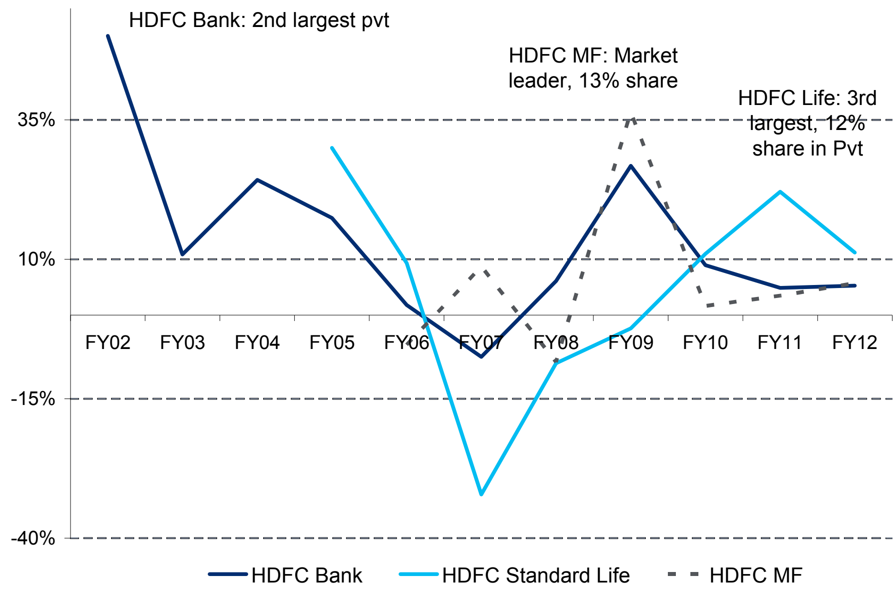
Source: Citi Research, Company Data, RBI

The business, the management and the subsidiaries

HDFC's way of doing business, we believe, has also been ingrained in its subsidiary businesses that straddle banking, life insurance, asset management and general insurance. Each of these businesses enjoys market leadership, generates above-industry returns, has a low tolerance for risk, and their management teams exhibit significant credibility and stability. These have further enhanced HDFC's franchise, added value and positioned the group as India's premium financial sector player.

[1]Our previous rating was Sell/Low Risk. Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. Risk ratings, which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). Investment Ratings of Buy, Hold and Sell were a function of our expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.

Figure 3. HDFC Subsidiaries — Growth Rates Relative to Respective Industries (%)

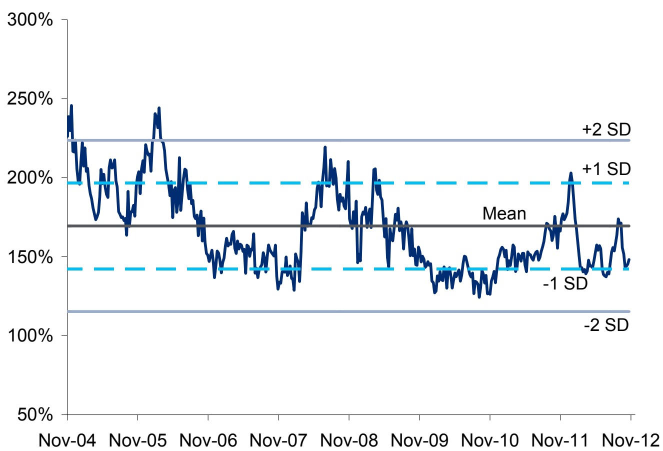


Source: Citi Research, Company Data

HDFC's consistently high and relative premium valuations reflect the market's affection for the business

This mix along with the management premium that HDFC has in our view deservedly earned has reflected in the stock's valuation premium. While relative premiums have tended to swing – higher in a challenging environment and lower in more aggressive and easy-money environments – they have been fairly steady over time and tended to grow. The markets and investors, not surprisingly, have long loved the HDFC story. So it's an old love story.

Figure 4. Relative Valuation: HDFC 1 Yr Fwd P/BV vs Citi's Banks Index



Source: Citi Research, Bloomberg

Figure 5. Relative Valuations: HDFC 1 Yr Fwd P/E vs Citi's Banks Index

Source: Citi Research, Bloomberg

Thinking Strategic: Subs Have Grown Up

But HDFC could be looking at a new stage of growth

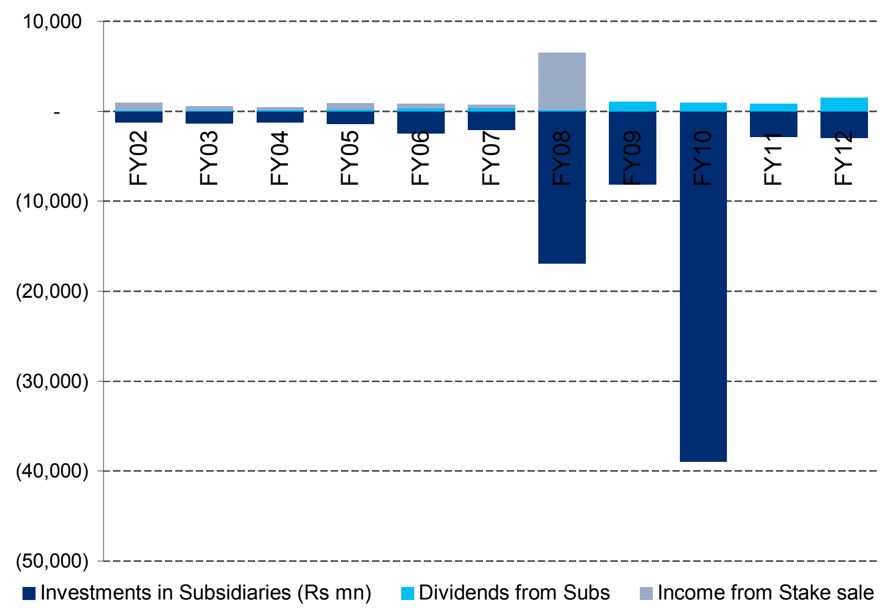
While HDFC's own business has continued to grow and mature, we believe it has an increasing number of strategic options ahead. These are not necessarily new, but with its maturing subsidiaries, and a developing financial system, HDFC has the option of tweaking its business ahead. These are also not binary, and HDFC could well do, or be influenced by, one or more at the same time. It could also choose to do very little – which is what it has done for a while, and this is something that has served it well all these years. But we sense change ahead.

Capital generator – as subsidiaries/associates mature

All investments done…and as subsidiaries start generating strong returns...cash is beginning to flow into HDFC…and it will be sitting on increasingly surplus capital

HDFC has been consistently investing in its subsidiaries over the last 15 years – HDFC Bank, Life Insurance, the AMC and General Insurance – a mix of growth capital, and its desire to maintain a certain level of shareholding (HDFC Bank). We believe this cycle is now done for Life Insurance, the AMC and General Insurance. HDBK too is unlikely to need additional capital with the frequency of the past, and HDFC's 23%+ stake might afford it the luxury of not participating in a new raising and still maintain its stake at over 20%, which has been its stated objective.

Figure 6. HDFC — Cash Flow From Subsidiaries (FY02-12)



Source: Citi Research, Company Data

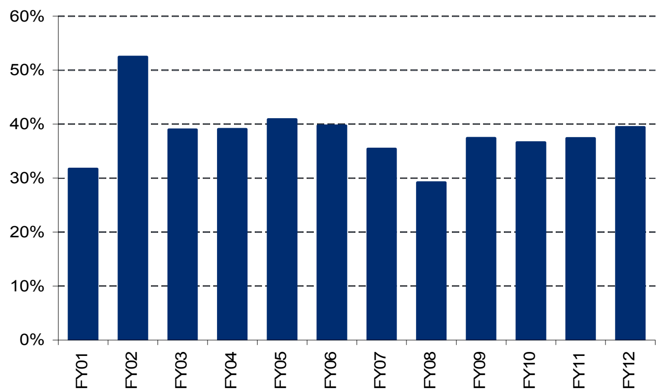
Life Insurance will be the lumpy one, and will be the Delta …dividends (1-3 years), and possibly a stake sale in an IPO, along the way

We believe the capital cycle is now positioned to reverse – with the insurance business likely to start paying dividend over the next 1-3 years (and the likelihood of listing/stake sell-down over time), we believe HDFC could well start getting into a significant capital-generation cycle. HDFC Bank and the AMC should see steady increases in dividend.

Throwing up capital and more options ……more growth, higher pay-outs and even acquisitions across the group…management seems ready for it

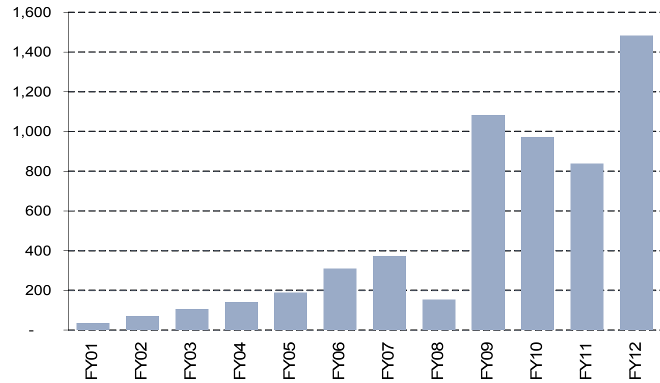
We foresee a change in the return structure and capital management of HDFC 's business – rising dividend pay-outs, potential capital buybacks and the resultant higher ROE. Or HDFC could well use more of its capital, i.e. higher growth (in evidence in the last quarter). It could also suggest greater appetite to use its increasing capital by buying assets or businesses, though there are only limited opportunities across the broader space the group operates in.

Figure 7. HDFC — Dividend Payout Ratio (Percentage)



Source: Citi Research, Company Data

Figure 8. HDFC — Dividend from Subsidiaries (Rupees Million)



Source: Citi Research, Company Data

Securitization option: Higher returns, or higher growth

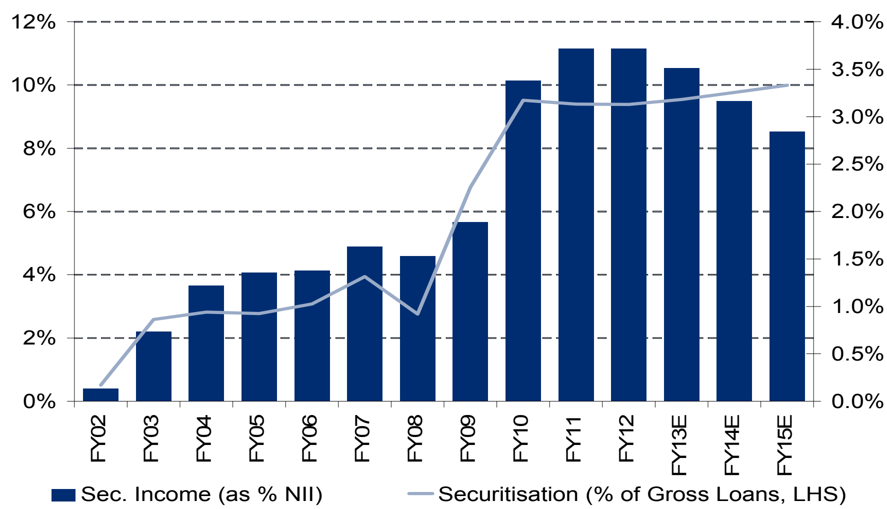
On-off approach to securitization so far …in part because of market, and regulations….. but in part because not decided on the return – balance-sheet trade-off that goes with it…

HDFC has a relatively soft or on/off experience / commitment to securitization. This has been in-part on account of a broader acquirer market that has varied with the environment and an operating environment that has been inconsistent (regulatory and tax). However, HDFC too has been a little ambivalent towards it over the years. This is in part because of the regulatory uncertainty and swings surrounding the product. In addition HDFC too has been unsure on whether to keep its growth on its books, or to trade off higher returns with lower balance-sheet growth.

We would expect greater securitization…boosting yields

What HDFC has so far largely done is keep the majority of this growth on balance-sheet, and securitized relatively smaller portions. This too has been primarily to HDFC Bank (as a part of its sourcing arrangement); and the aggregate portfolio stands at about 9.4% of its outstanding book. We would expect that to rise.

Figure 9. HDFC — Securitization Income (% NII) and Share of Gross Loan (FY02-15E, Rs mn, %)

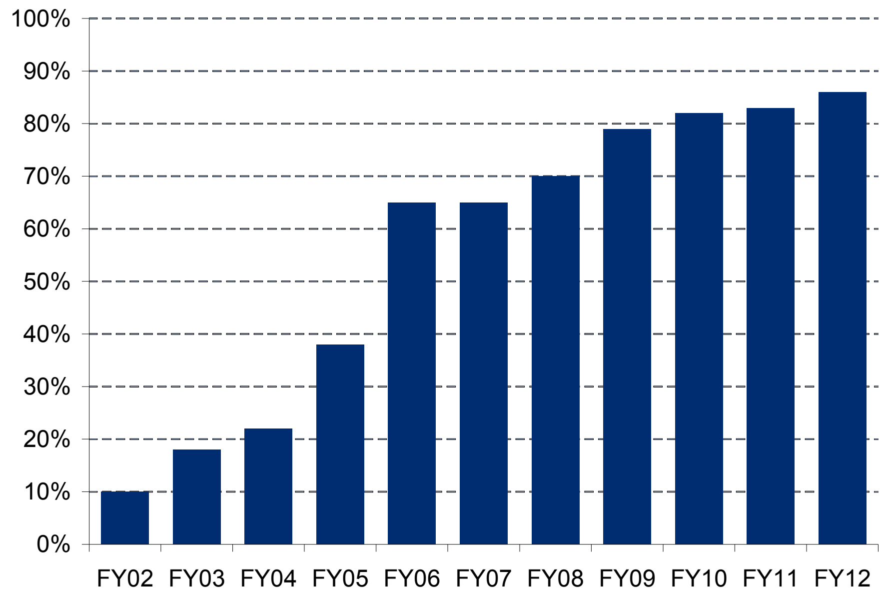


Source: Citi Research, Company Data

Securitization economics remain robust…but will be nominally lower, and the challenge lies in finding an acquirer market

HDFC's current securitization portfolio is very profitable; about 1.4% spread, with limited capital allocation against. This is set to change on the back of regulatory changes; average yields are likely to head towards about 1% (90bps for HDFC Bank), but HDFC will no longer need to take any credit costs (or allocate capital against this portfolio), and its administrative costs against this will also come down.

Figure 10. HDFC — Share of Sourcing from Third Party Channels (FY02-FY12, %)



Source: Citi Research, Company Data

Aggressive loan growth in 2QFY13 (+31%) – suggests HDFC could have enough loan acquisitions to grow balance-sheet and the off-balance-sheet book

While there remain some regulatory / tax challenges with securitization, we believe securitization fundamentally offers HDFC significant upside – the potential to arbitrage its credit skills and low operating costs, and its ever broadening distribution (albeit at some acquisition cost). This would also offer HDFC the potential to generate higher asset acquisition and growth (in recent evidence, +31% disbursement growth in 2QFY13) – a trend one should look out for.

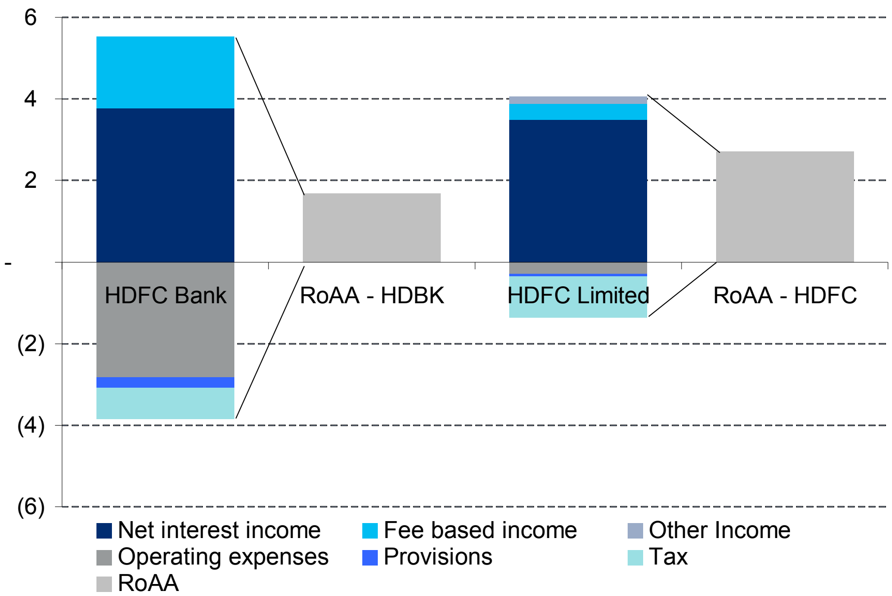
Merger option with HDBK

Not new…and regulations or business momentum have not changed enough for a push to merge…

This is not new – but has clearly shifted off the centre-stage, relative to a few years ago. It also remains a little un-economical at this stage, given the still high reserve ratios (CRR+SLR) that commercial banks carry. In addition, there is a lack of regulatory clarity on the bank holding company option and tax-related issues – an option that could also have been considered.

In addition, from an economic stand-point, the incentive to merge has probably moderated a bit. This is because of the strong economics of both businesses, closer to the end of the capital need requirements of HDFC Bank, and the significant synergies that HDFC – HDFC Bank have generated, as also the broader HDFC group (Insurance and Mutual Fund businesses).

Figure 11. RoAA Decomposition — HDFC and HDFC Bank (% of Avg. Assets, FY12)

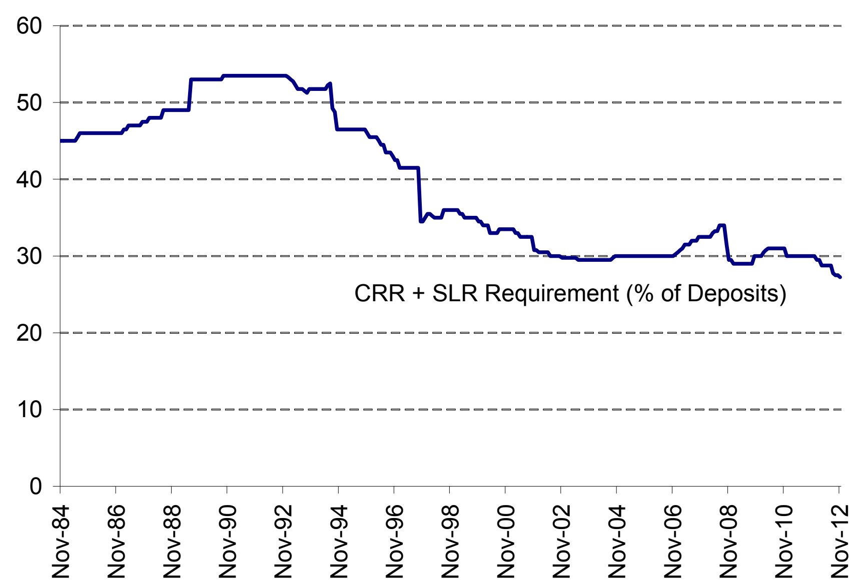


Source: Citi Research, Company Data

High reserve requirements – the primary push-back to a merger between the two – have been coming down; probably still too high, but there could be more talk

We do, however, believe that the primary push-back to the merger – the high regulatory costs of the SLR and CRR – has eased a bit, as both have moderated. They collectively stand at about 27.25% currently - probably still too high to warrant a quick move. We would however expect this to come onto the table if SLR + CRR continue to move down. It's early days, but given it will probably be more in consideration as greater capital leverage and optimization strategies take centre stage.

Figure 12. Falling Reserve Ratios – Historical SLR and CRR Requirements (% of Deposits)



Source: RBI, Citi Research

Strategically, at a turning point...?

Strategically, we believe HDFC might be at a turning point, with greater optionality, on capital, growth and its business structure than in a long time. We also believe it is not an either or scenario – there probably will be higher growth, greater securitization, higher capital distribution and more working together with HDFC Bank, and its other subsidiaries. We expect more strategic change and initiatives than we witnessed over the last few years.

Structurally – Ready for the Best Years

The core businesses' operating environment could be looking up

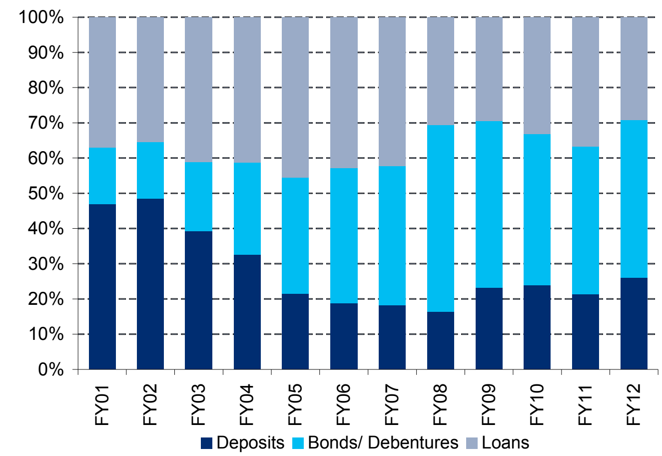
HDFC's operating environment (regulatory and competitive) – the platform of its core mortgage business – also appears very favorably positioned, in our view. It's in part a regulatory expectation, in some measure a franchise that is well positioned, and in part it is about the competitive landscape.

Funding – ready to open up

HDFC's funding has worked well …but it has had challenges, constraints and has been potentially the weak link in its business model

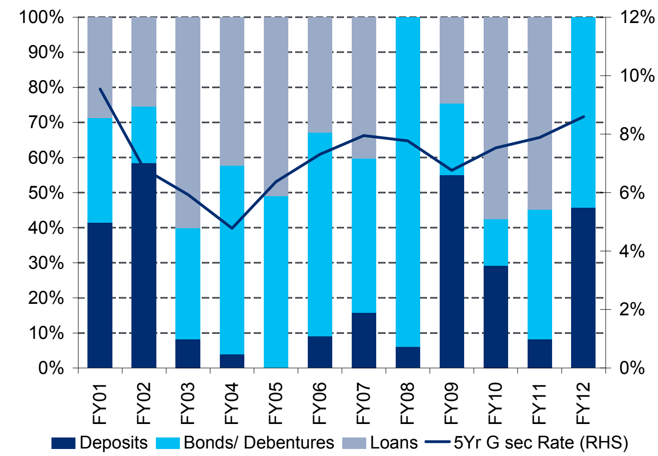
HDFC has been very flexible with its broader funding profile – consistently shifting between the more whole-sale versions of its funding (Bank term lending and Financial markets) and retail deposits. This mix has varied with interest rates, liquidity and the competitive environment, and HDFC as stated, has managed a fine balance (more deposits when rates / liquidity are tight, more whole-sale when the environment is easier). But we believe funding has been a challenge for HDFC, and if there is any potential vulnerability in its business model, we believe it would lie in potential constraints in its funding options.

Figure 13. Outstanding Funding Mix (Percentage)



Source: Citi Research

Figure 14. Incremental Funding Mix (Percentage)



Source: Citi Research

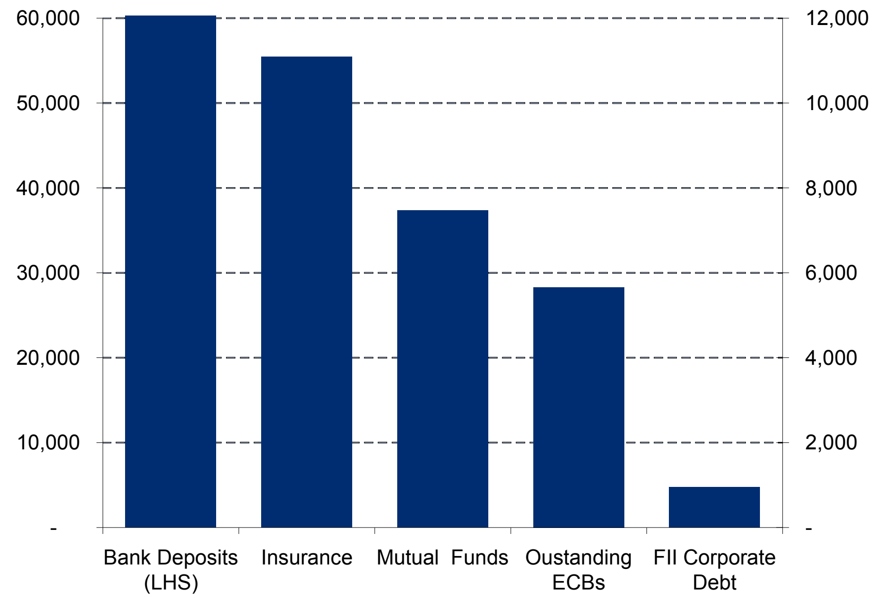
But if ECB funding opens up for HDFC (we think it's likely near term), it could be big

We believe there are structural upsides ahead. These would lie in the offshore funding option (External Commercial Borrowings – ECB's) being opened up to HDFC and other housing finance companies. When will this happen? It remains hard to call (RBI / Government needs to take the decision), but with the government progressively raising foreign investment limits in debt categories, infrastructure finance companies now allowed to raise offshore debt, in our view, it's more a when rather than an if.

It would be long term, should be attractively priced…and the pool could be very large

This is particularly so because such funding would be long term (which the RBI/Government prefer), would be restricted to only a handful of HFCs, and is mortgages – an extremely prioritized area of lending, as far as the regulator is concerned. We believe this could open up a significant vista / opportunity for incremental funding for HDFC. And it should be attractive from a pricing and maturity perspective.

Figure 15. Funding Options – Bank Deposits, Insurance, Mutual Funds, ECBs and FII Corporate Debt (Rupees Billion)



Source: Citi Research, AMFI, IRDA, SEBI, RBI

Expanded limits for FII investments in debt is already a boost…11% of HDFC's bonds are held by them

The relatively aggressive opening up of FII debt investments in corporate debt is also helping HDFC, as foreigners can now access HDFC paper in local currency. This is already an important source of funding for HDFC (11% of its paper issued in FY12 was held by foreigners). With the significant increase in limits in the recent past we believe this should be an increasing source of funding.

And the domestic debt MF window has been expanded…

Domestic Mutual Funds – A new Window: One of the primary borrowers for HDFC's bonds/debentures are the MF's, and HDFC was getting a little capped out as MF's had a 30% cap on aggregate exposures to finance companies. SEBI has now provided an additional 10% exposure limit for HFCs, effectively opening up a Rs500 billion new market. This is probably priced in to near term funding costs – but could be a meaningful positive, medium term.

These funding boosts could be material

This mix could materially boost HDFC's funding options – greater availability and flexibility, possibly lower costs, and fundamentally lower risk. Some of these gains are already in – but medium term, these could materially enhance HDFC's balance-sheet, P&L and growth management.

Growth & distribution – more broad-based

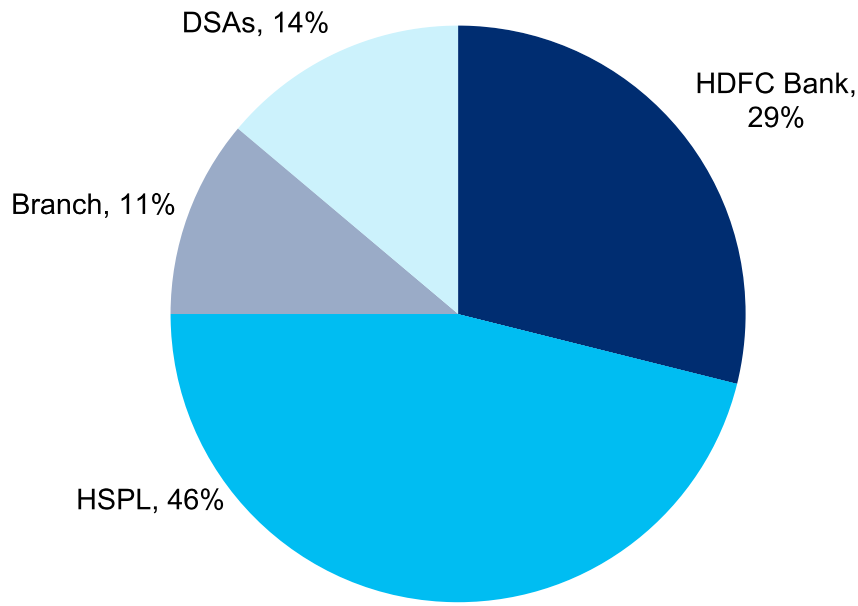
Loan disbursals grew 31% in 2QFY13 – has something changed materially

The growth option: HDFC's retail loan disbursals grew 31% in the most recent quarter – a significant step up over the last few years. And this is in an environment that until recently was tough. Is this an aberration, or could it be a recurrent theme. And if so, how is it possible?

It could be its distribution...has expanded and broadened substantially, and appears capable of supporting substantially higher growth levels

We argue that this could be a recurrent theme, given its distribution expansion and spread. In fact, a big evolution of HDFC's business over the decade has probably been on the distribution side, where it has shifted from a branch walk-in customer model to a substantially more diversified one. This model has also evolved from one that was fairly out-sourced as also dependent on HDFC Bank, that now has a much better balance between its different constituents.

Figure 16. HDFC — Distribution Mix of Sourcing of Loans (As on 30 Sep,2012)



Source: HDFC

Greater push, a higher variable cost…but credit and control remain in-house…

We believe this distribution structure is key to some of the more aggressive loan growth witnessed in more recent times: it is scale, variable pricing / costs, keeps credit / risks management in-house, and can be further expanded. It is also reasonably balanced across players, and so its dependency on a distributor tends to be relatively limited. While HDFC's distribution has always been strong, it is now more broad-based than before, adequately incentivizes its distribution agents (1% of loan), and we believe is better positioned than before to step up growth, if it so desires.

Competitive landscape – relatively barren

It's a great market and competitive intensity comes and goes….but for such an attractive market, it's not that competitive

While mortgages have been much loved in India as an asset class, given its growth and credit profile, it is probably less competitive than what one would expect. This is in part because of regulatory and market structures (hard for non-established HFCs to get long-term funding), in part because the dominant government banks have not been able to push the product effectively enough – relying solely on walk-in customers, and in part because private sector peers have had an on-off approach to the product, given profitability levels that in cases are less attractive than what they see on the corporate side of the business. This has effectively meant that the competitive landscape has remained somewhat stable, limiting competition that could be distortive for both pricing and risks.

Figure 17. Competitive Landscape — India Mortgage Loans Market (As on FY12, Rupees Mn, %)

	HDFC	LIC HF	ICICI Bank	SBI	Axis	Other SCBs
Current Rate (%)	10.75	10.80	10.50	10.25	10.75	10.5-11.5
Home Loans (Rs mn)	1,404,211	630,802	576,640	1,027,390	281,775	1,998,900
Share of Loan Book (%)	100%	100%	23%	11%	16%	7%
Overall Market Share (%)	24%	11%	10%	17%	5%	34%
5 Yr Home Loans CAGR (%)	20.0%	29.1%	-2.0%	25.2%	40.8%	9.2%
3 Yr Home Loans CAGR (%)	18.1%	31.6%	0.0%	23.9%	39.3%	8.9%

Source: Citi Research, Company Data

And while the festival season brings some pricing competition…HDFC is not seeing any of the extreme bouts of competition witnessed in the past

The most recent market scenario suggests little change – a few players are more aggressive, but the system has stayed relatively stable. We could see enhanced competition if the broader economy remains weak / asset quality build-up, which could see a shift to mortgages. Else, it remains a fairly benign environment for HDFC – giving it the flexibility to better calibrate its growth and profitability than has been the case in the past.

Regulatory tightening – almost all done?

It's been an overhang…

The Indian financial system has faced an evolving regulatory environment – a general tightening of norms, in line with global trends. This has affected mortgage players including HDFC, and has been an overhang. We believe this is probably almost all done – and therefore incrementally, should limit risks. In fact, risks, if any, would potentially lie more to the upside.

Figure 18. Regulatory Scenario for Housing Finance Companies – Changes across Parameters

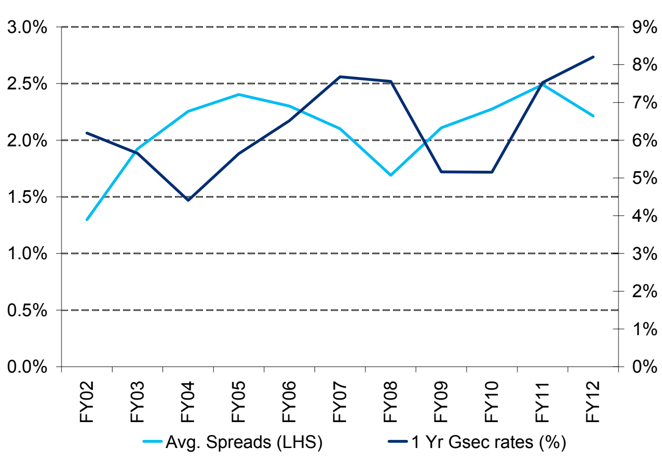
Parameters	Earlier	Now	Status
Asset Quality	180 days	90 days	Already in Sync
General Provisioning	25bps	40bps	Significant surplus provisioning
Securitization	Allowed	Non Risk Sharing only	Potential change in model
Capital Adequacy	12%	12%	Risk of a raise
Basel 3 Impact		No specific guidelines	Banks more at Risk
Pricing	Few restrictions	Base rate linked, no prepayment penalties	Already
MFs funding	30% NBFC cap	30% + 10% for Housing Finance cos	Will free up to Rs500b of additional funding
FII investment in corporate debt	$15bn	$20bn	Increased from $6bn in 2008
ECBs	Not allowed	Not Allowed	High probability of being allowed

Source: Citi Research, NSE, RBI, NHB

But seems to be largely done

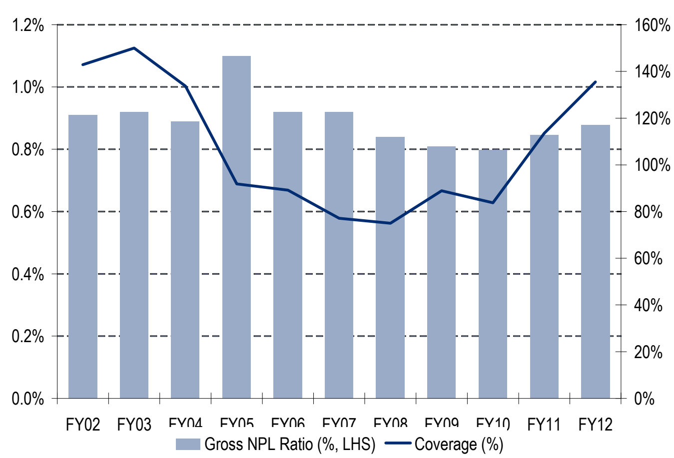
The regulatory environment has been tightening, as is the case globally, in the Indian Financial sector – and more so in the non-banking sector. This has been an overhang. And HDFC has had to face a more restrictive policy environment on NPL recognition, general provisioning (on dual rate loans), changes in securitization and only its loan pricing flexibility. Bottom-line, this has weighed down HDFC. We think these overhangs are probably over now; the one outstanding one remains on a potential hike in capital-adequacy norms. Given HDFC's significant Tier 1 cushion, it should not be an issue.

Figure 19. HDFC — Spreads and 1 Yr G- Sec Yields (FY02-12, %)



Source: Citi Research, Company Data, RBI

Figure 20. HDFC — Gross NPLs and Coverage Ratio (FY02-12, %)



Source: Citi Research, Company Data

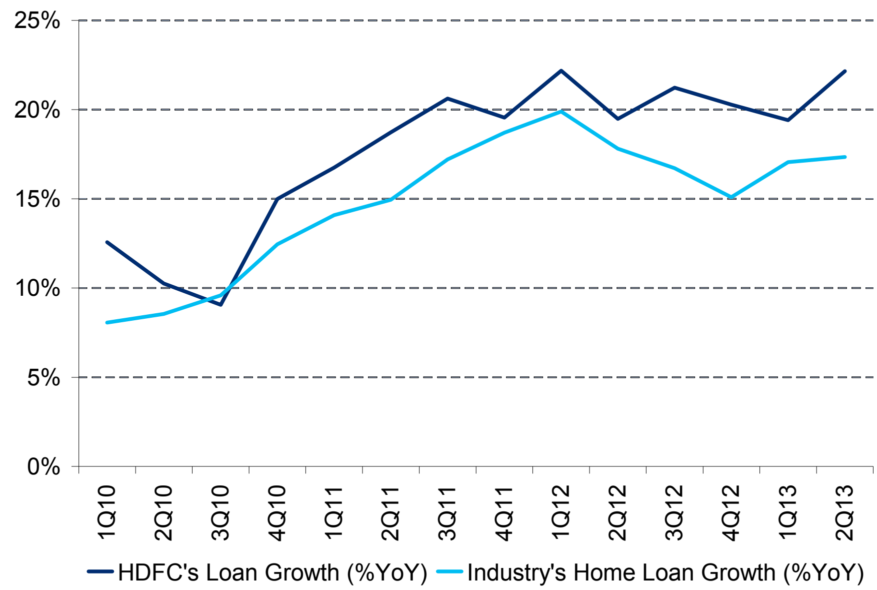
The Cycle: Ready to Get Up and Dance…

While HDFC's business has been relatively indifferent to the structural environment, we believe its current cyclical outlook is favorable on three counts.

Growth is up 31% yoy...the darkest days of the property market seem past, and the festive season is upon us

Loan demand – growth option: HDFC has already witnessed some acceleration in loan demand in the most recent weeks. More importantly, in our view, with interest rates beginning to move down and average property rates having stayed somewhat stable for the last few years, we would expect broader industry growth to rise. We believe a step-up in underlying mortgage demand should not only improve growth upside for HDFC, but also offer greater pricing flexibility.

Figure 21. Growth in Home Loans — HDFC versus the Overall Industry (% YoY)



Source: Citi Research, RBI, Company Data

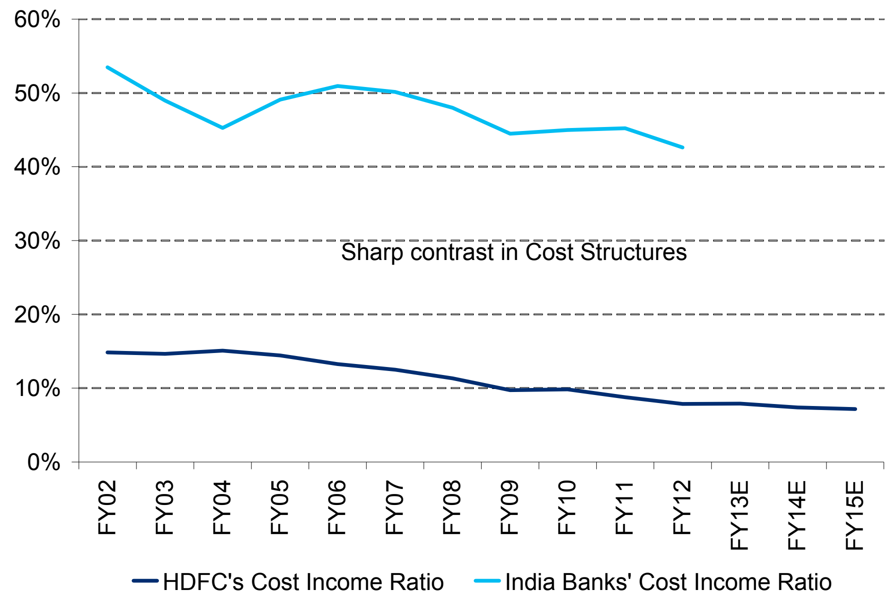
Pricing competition remains somewhat restrained….though the festive season noise has started …and disruptive pricing can hurt

But there will be more competition too: Slackening corporate demand and rising asset risks in the broader economy have historically seen the broader banking sector move in more aggressively to the mortgage market. We see this beginning to happen this time around too – and this will potentially be a challenge for HDFC. This will likely be a challenge this time too, though it has so far appeared relatively restrained. HDFC, however, does carry the risk of irrational pricing competition from banks. It has happened in the past, and can play up again: if banks struggle for growth, are constrained by asset quality on account of the weak industrial cycle, or want to build a strong market presence. This could be HDFC's biggest challenge given its moderate spreads and dependence of NII.

Liquidity is easing, rates are falling…..this works best for HDFC…particularly when market rates fall more than policy ones

Easy liquidity, falling rates – a bonus: HDFC is primarily a wholesale borrower (~75% of funds), with about 24% of its deposits generated through its retail deposit program. We believe the current easing liquidity and interest rate environment (we expect a 50bps cut) should make funding for HDFC both easier, and cheaper, than when liquidity is tight, and relative to more retail deposit-funded banks (which are its primary competition). While we believe some of this has already played through in incremental borrowing costs (which have fallen 25-75bps) over the last quarter, it should fundamentally support easier funding, and raise flexibility, going forward. Works best when liquidity eases but policy rates do not fall; like currently, where there is downward pressure on pricing

Figure 22. HDFC — Cost Income Ratio Relative to India Banks (FY02-FY15E, Percentage)



Source: Citi Research, Company Data

Banks …HDFC's primary competition – given some fixed funding and cost structures, are constrained in a falling rate environment

A falling interest rate environment also creates problems for its primary competitors, the banks. This is because 30-45% of their deposits are typically fixed rate (CASA), so their costs tend to be relatively rigid as rates go down. And they operate off significantly higher operating cost structures vs HDFC (1.2-2-2% of assets, vs 30bps for HDFC). This effectively sets a much higher spread bar for banks, and beyond a certain level of interest rates, tends to become a meaningful constraint.

Falling rates work for HDFC's business…and its stock

We believe at the aggregate, an easier interest rate / liquidity environment has played to the advantage of HDFC – in growth, and stock returns, and we believe this time should be similar.

…And Keep Pace With the Young Ones

HDFC should continue to grow rapidly, and profitably

HDFC's consistent and strong growth also now means that it has a big balance-sheet, it needs to grab even larger business to maintain its growth rates, and do so profitably to maintain its fundamentally high profitability (ROAA: 2.7%). Can it do so without impacting its risk or return profile?

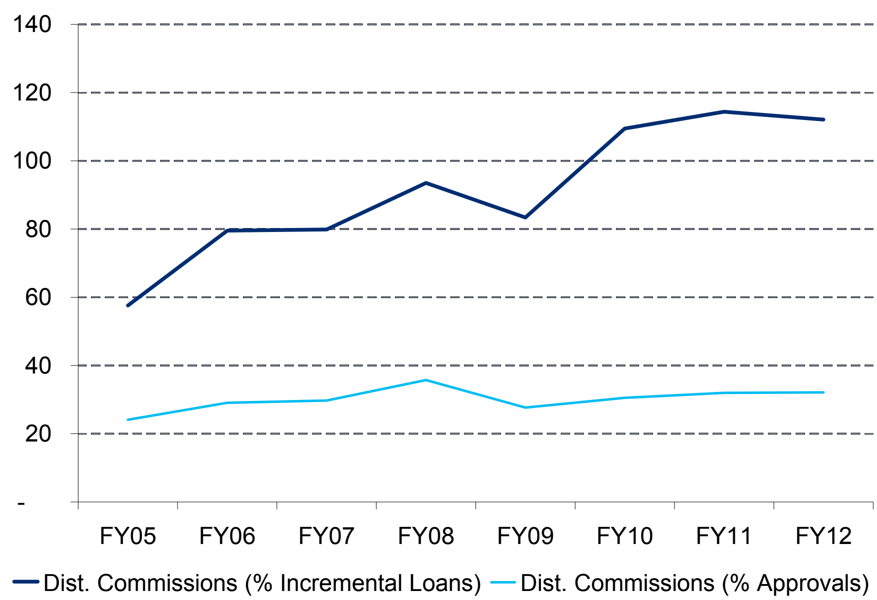
3-year CAGR of 18% in earnings, 20% balance-sheet growth…..risks to the upside

We expect HDFC to generate an 18% CAGR in earnings over FY12-FY15E, marginally lower than its 22% average over the last three years. This should be on the back of balance-sheet growth of 20% pa, with some acceleration in its securitized pool. The earnings composition should also not alter materially – but we do expect a greater bias towards NII, as fee incomes moderate (and is also increasingly offset in acquiring new customers), and treasury gains (sale of investments) moderate.

Higher loan growth…on and off balance-sheet…..the primary driver of upside expectations

While HDFC's earnings trajectory and balance have been very predictable over the years, we see upside to earnings. It could come from more rapid loan growth (on balance-sheet, or through greater securitization), as we have argued previously in this report. We also do not believe it will be an either or scenario – it's more likely to be a mix of higher balance-sheet growth, as also more securitized assets that lie off balance-sheet. We do expect the share of securitization in NII to go up, and explicitly model and highlight it in Figure 9.

Figure 23. HDFC — Distribution Commissions As % of Approvals and % of Incremental Loans (FY05-FY12, Bps)

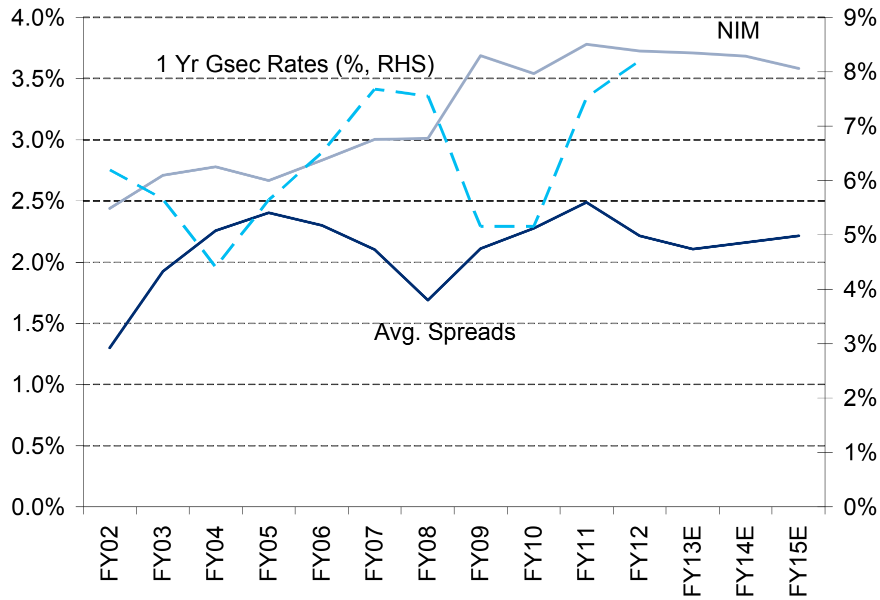


Source: Citi Research, Company Data

Loan acquisition costs will rise … and they effectively do impact upfront profitability, given that an increasing share of growth is through third parties

Is there a cost to this higher growth – yes, a mix of slightly higher operating cost, but more importantly (and variably) greater loan acquisition costs. These costs will rise as growth (on and off-balance-sheet) rises – and the costs will tend to be up-fronted, but will tend to add to overall returns, as the balance-sheet growth. We do expect at least 1-2 years of operating costs to be on the higher side to – as HDFC is expanding its office space through some incremental rentals.

Figure 24. HDFC — Spreads, NIMs and 1 Yr GSec Rates (FY02-15E, Percentage)



Source: Citi Research, Company Data, RBI

Spread risk…is there…

But, the big question – can spreads and margins hold, in what will be a competitive environment, what is effectively a commoditized product – HDFC has limited pricing power (a 25bps premium to the market average is what we believe), and the effective cost of accelerating growth (which we anticipate) at the pricing level. In addition, HDFC's balancing of its retail / wholesale asset book will influence spreads – the higher the share of wholesale, the better the overall profile of spreads should be.

…but easier to handle in a falling rate environment

We would expect a slight, albeit gradual, decline in spreads – the pace determined by what happens on HDFC's funding front, the pricing response of banks at the aggregate, and most critically, the broader interest rate environment. The lower the interest rates go, the better it is for HDFC's spreads – the higher they go, the more challenging it gets. Bottom-line, we see an easier and lower interest rate environment near and medium term, which should be fundamentally favorable to HDFC.

The accounting question …some spot light on how HDFC has accounted for one-off provisions, and its accounting for certain funding

There has been some recent spotlight on HDFC's accounting practices, on two counts. These are: a) Adjusting for stepped up provisioning directly via the balance-sheet; and b) Funding by way of Non-convertible debentures (NCDs), where as per Indian accounting, interest is debited to the balance-sheet, and does not flow through the P&L (or impact spreads).

The provisioning was for a one-off, has largely been released, and is now sitting as surplus provisions in its books…not an issue, in our view

In our view, on one-off provisioning through the balance-sheet: was a prudentially mandated provisioning by the regulator, has been largely released, and will now sit as surplus provisions against loans. That management has meaningfully raised credit costs through the P&L suggests there will only be more coverage going forward, and this will only add to loan coverage

The NCD… has been the case for a while, can be argued both ways, but is as per accounting, disclosed, for the stated purpose of investing in subsidiaries, and will likely be less significant over time…

On the NCDs, management has some time argued that this funding is for its investments in its subsidiaries; and they would likely follow the same form of funding, if they were to invest more in their subsidiaries. This is not funding for the base business, and so should not impact its P&L. We estimate, if routed through the P&L (accounting norms are that it should be directly from the BS), it would moderate spreads by about 30bps. While this can be debated either ways, but given that it is disclosed, adjusted for, will likely fall as the rest of the businesses grows, we do not believe it is material for estimates, or the stock, from here.

Comfort on capital….and regulatory requirements should remain the same (12%, with 6% Tier 1)

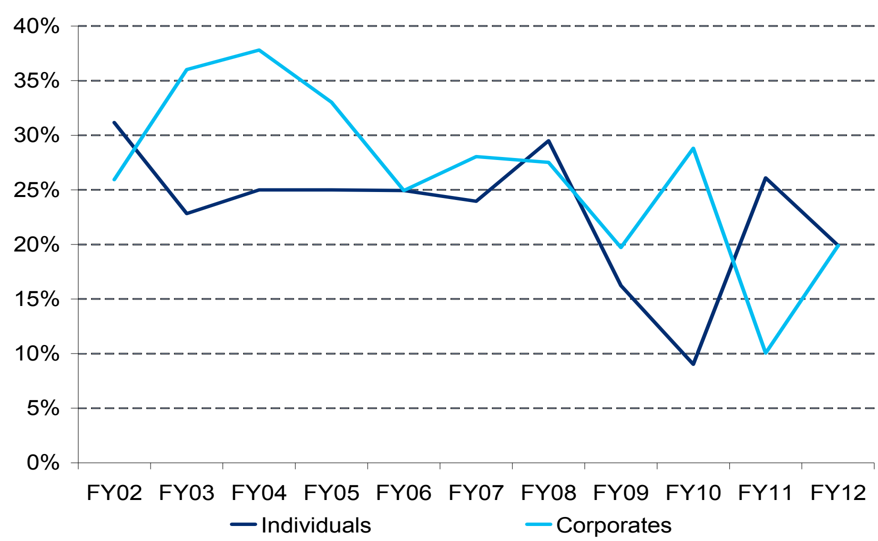
HDFC will be generating surplus capital – as argued previously, and so should generally be comfortable on adequacy. We also believe that its current capital adequacy requirements (12%, Tier 1 at 6%) are unlikely to change from a regulatory perspective; that should provide HDFC with enough capital to grow more aggressively. And as we have argued, we do expect to be more aggressive in utilizing its capital – dividend payouts, more growth and potentially some acquisition activity, if an opportunity arises.

The portfolio balance, and return, option

Wholesale assets are higher yielding and higher risk…..and until recent years had grown more rapidly

HDFC's 68%/ 32% Retail / Wholesale asset portfolio has faced some scrutiny over the recent past, given that spreads are disproportionally higher on the wholesale book, as also over the recent years the asset risk has been higher than the retail book than over the last two decades. That growth had been higher than retail in FY09/10, the broader property market was perceived to be under greater stress and asset risk, and it is a market where the brand franchise counts for less relative to retail, has also been under question.

Figure 25. HDFC — Growth in Retail and Corporate Loan Segment (% YoY)

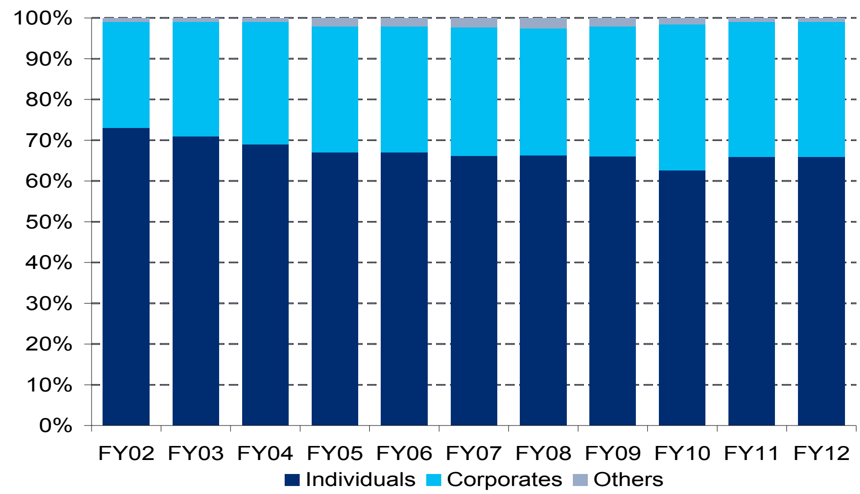


Source: Citi Research, HDFC

We think it's fair and necessary to have the portfolio …lends flexibility, ties in with core business…and HDFC has a significant edge to it

Importantly, we believe this portfolio is synergistic with the retail portfolio (and in some measure with HDFC Property Funds), adds to premiums' HDFC's credit capabilities and HDFC's overall business is stronger with wholesale as part of the pie. As long as HDFC can demonstrate its ability to manage the mix around an average level (i.e. no structural shifts away from either part of the portfolio), we believe it's probably more of a value add than a drag. So what does that mean – our view would be a 75:25% mix is probably fair – around which the mix can vary depending on the cyclical environment.

Figure 26. HDFC — Outstanding Loan Mix (Percentage)



The corporate book, while lumpier, riskier and a bigger user of capital, is more profitable too. We believe a judicious share is appropriate; a 'mortgage-only' book is too rigid, restrictive and lets go the higher return opportunities.

Also leverages HDFC's credit skills, and its low-cost operating structure

Figure 27. HDFC – Yield and Spread Differentials between Retail and Corporate Segments (%)

	Yields	Borrowing Cost	Spreads	Historical Range	Fee Component
Retail	11.4	9.5	1.9	1.8%-2.0%	Lower
Corporate	14.0	11.2	2.8	2.8%-3.0%	Higher

Source: HDFC

Should be a trend-line 18% profit growth over the next three years

Figure 28. HDFC — Profit and Loss Account (FY09-FY15E, Rupees Million)

Year to 31 Mar	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Income from rupee loans	99,310	99,790	112,446	153,532	192,265	226,327	263,155
Management fees	1,149	2,317	2,204	2,684	2,952	3,247	3,572
Other fees	229	226	251	213	235	258	284
Lease rentals	147	241	231	98	193	212	234
Dividends, property income	1,957	2,327	2,252	3,097	3,456	4,254	4,966
Other Interest Income	7,132	6,614	7,800	11,217	12,100	12,144	12,787
Capital Gains	252	2,094	3,597	2,702	2,948	3,241	3,860
Total Income	**110,177**	**113,608**	**128,781**	**173,543**	**214,150**	**249,684**	**288,857**
Interest Expense	73,728	69,847	74,988	110,934	139,353	161,474	186,706
- Interest on loans	23316	19972	24280	31411	34221	39461	46156
- Interest on deposits	14708	17841	20320	29645	38393	43970	49379
- Interest on bonds	35704	32034	30389	49878	66739	78044	91170
Establishment expenses	360	414	447	526	683	834	1001
Employee expenses	1386	1467	1755	2058	2367	2722	3130
Other expenses	1241	1176	1418	1730	1937	2170	2430
Depreciation	175	182	192	205	211	219	241
Provision for doubtful debts	500	580	700	800	1418	1540	1668
Other charges	596	783	611	634	617	764	952
Total expenses	**77,986**	**74,448**	**80,111**	**116,887**	**146,586**	**169,723**	**196,127**
Profit before tax	32,190	39,160	48,670	56,656	67,564	79,961	92,730
Tax	9,365	10,895	13,320	15,430	18,918	22,789	25,501
Profit after tax	**22,825**	**28,265**	**35,350**	**41,226**	**48,646**	**57,172**	**67,229**
Growth (% YoY)	-6	24	25	17	18	18	18

Source: Citi Research estimates, Company Data

With balance-sheet growth about 20%...loan growth should be higher at 21% over FY12-15E …with upside risks

Figure 29. HDFC — Balance Sheet (FY09-FY15E, Rupees Million)

	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
ASSETS							
Fixed assets	2,034	2,221	2,340	2,340	2,573	2,831	3,114
Equity Investments	9,838	8,490	9,095	8,774	9,213	9,674	10,157
Preference capital	839	773	871	714	643	578	521
Bonds	10,504	12,701	15,425	2,891	3,180	3,498	3,848
Other investments	45,819	8,615	13,581	26,581	29,240	32,163	35,380
Rupee loans	851,981	979,670	1,171,266	1,404,211	1,711,507	2,084,735	2,539,911
subsidiaries	37,688	76,696	79,351	81,814	81,814	81,814	81,814
Cash and advances	15,685	50,241	64,053	54,729	60,797	66,532	63,270
Deposits	16,479	9,789	18,786	64,404	51,523	56,675	62,343
Current assets	25,702	17,218	20,254	28,741	30,178	31,687	33,272
Total assets	**1,016,569**	**1,166,414**	**1,395,021**	**1,675,199**	**1,980,669**	**2,370,189**	**2,833,629**
LIABILITIES							
Equity capital	2,845	2,871	2,934	2,954	3,063	3,063	3,063
Capital & Reserves	128,529	149,106	170,231	187,222	246,748	280,324	320,404
Loans	248,143	321,369	424,898	406,966	476,150	576,142	697,132
Bonds	53,397	59,509	37,967	0			
Deposits	193,747	230,811	246,251	362,928	424,626	501,058	596,259
Bonds + Debentures	323,949	330,929	416,239	591,631	692,208	851,416	1,047,242
FCCB	5,576	4,285	0	0	0	0	0
Tier 2	13,750	18,750	28,750	29,750	34,750	44,750	44,750
current liabilities	46,634	48,785	67,751	93,749	103,123	113,436	124,779
Total liabilities	**1,016,569**	**1,166,414**	**1,395,021**	**1,675,199**	**1,980,669**	**2,370,189**	**2,833,629**
Growth (%YoY)	20.4%	14.7%	19.6%	20.1%	18.2%	19.7%	19.6%

Source: Citi Research estimates, Company Data

A pretty and stable picture…with risks more to the upside

Figure 30. HDFC — Key Business Parameters (FY09-FY15E, Percentage)

Year to 31 Mar	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Profitability Ratios							
RoAE (%)	18.2	20.0	21.7	22.7	22.1	21.4	22.2
RoAA (%)	2.5	2.6	2.8	2.7	2.7	2.6	2.6
Operating Ratios							
Average Loan Yields (%)	12.6	10.9	10.5	11.9	11.9	11.6	11.4
Average Yields (%)	12.0	10.2	9.7	11.1	11.6	11.3	11.0
Average Cost of Funds (%)	9.9	7.9	7.3	8.9	9.4	9.2	8.7
Average Spreads (%)	2.1	2.3	2.5	2.2	2.1	2.2	2.2
Net Interest Margins (%)	3.7	3.5	3.8	3.7	3.8	3.7	3.6
Dividend Payout Ratio (%)	37.4	36.6	37.3	39.4	37.8	34.8	34.2
Growth Rates (% YoY)							
Balance Sheet	20.4	14.7	19.6	20.1	18.2	19.7	19.6
Net Loans	16.7	15.0	19.6	19.9	21.9	21.8	21.8
Gross Loans	21.7	18.5	19.4	20.0	22.0	22.1	22.1
Securitized Loans O/S	198.4	66.7	17.9	19.8	24.0	25.0	25.0

Source: Citi Research estimates, Company Data

The Value – Staying Pricey

HDFC has a lot going for it…so it will be expensive…but how much

So how should HDFC trade – and be valued – at an absolute level given its cyclical upside, structural optionality and possibly rising strategic optionality. And how should it trade relative to the broader financial sector and the Indian market given the onset of a growth slowdown and rising asset risks. We argue that in this broader environment, HDFC should trade at high multiples, both relative to peers and its past. This has been the case in the past (and works against HDFC when the broader market environment is strong and positive) – and we believe so should be the case now.

Figure 31. HDFC — 1 Yr Fwd P/BV Chart

Source: Citi Research, Bloomberg, Data central

Figure 32. HDFC — 1 Yr Fwd P/E Chart

Source: Citi Research, Bloomberg, Data central

We see fair value at Rs860 per share…..it's a mix of well valued businesses

We believe the diversity of HDFC's business, the momentum of the subsidiaries, and the large amount of capital it has suggest that value can be best appreciated or captured by a sum-of-the-parts valuation methodology. This has been the case over the most recent years, and we do not see that changing. This is our preferred valuation methodology.

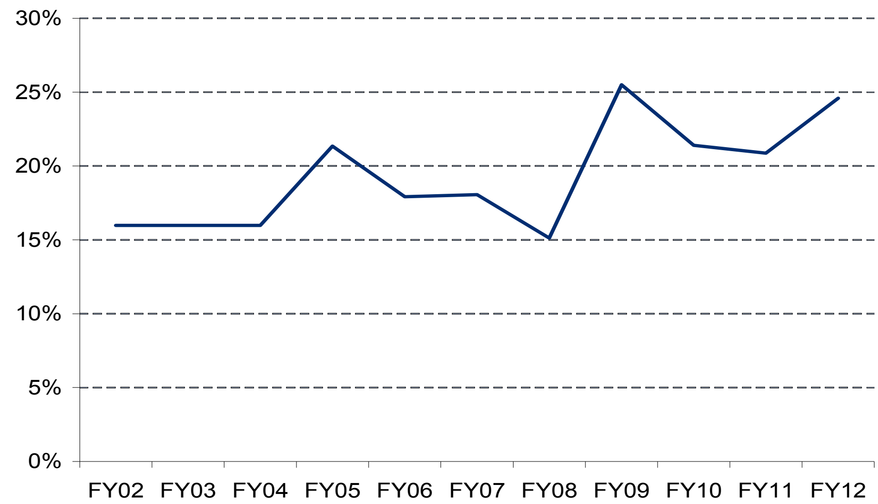
Figure 33. HDFC – Sum of Parts Valuation

Business	Total Value, Rsm	Value per share, Rs	Basis of valuation
Life Insurance	76,206	50	Valued at 15x 1Yr Fwd NBAP and 2x Embedded Value – slight premium to sector benchmarks to reflect return to profitability
Asset management	47,070	31	6% of AUMs – peers' multiple
Non-life insurance	4,422	3	Valued at 1.5x PBV – peers' multiple
Alternative Asset Management	4,330	3	8% of AUMs
Associate Bank- HDFC Bank	354,974	231	Valued at HDFCB target price (Rs645)
Total Subsidiary value	**487,002**	**316**	
HDFC Value	836,975	544	4x PBV FY14E (near long-term avg) - after adjusting for investments in subsidiaries.
Total Value	**1,323,978**	**860**	

Source: Citi Research

Some of it is captured by the market….though there is more that's still unlisted (Life Insurance and Asset Management)

Figure 34. HDFC — Unrealized Gains on Listed Investments (As % of its Market Capitalization)

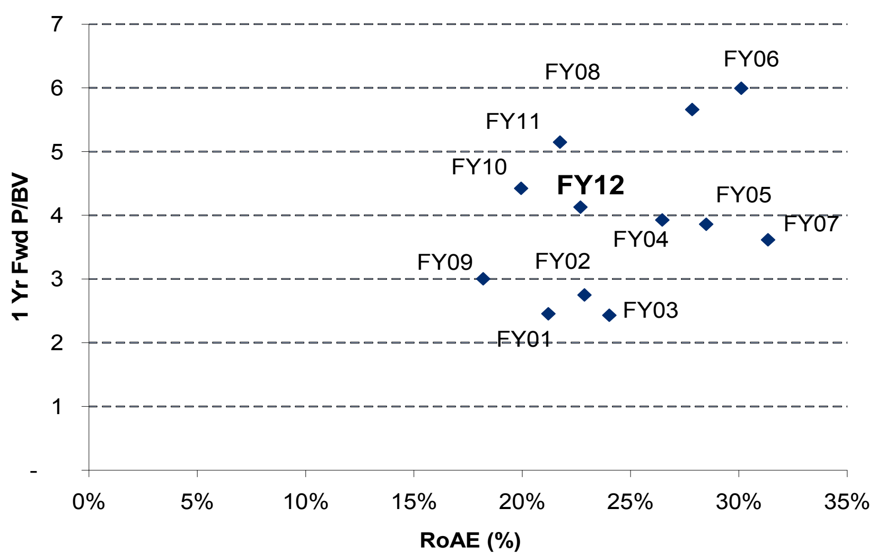


Source: Citi Research, Company Data

HDFC has always been expensive…it's in the middle of the last decades range

What could change this valuation framework? We believe the SOTP framework should hold its ground given the relatively different benchmarks for each of the businesses and their still relatively high growth potential. We see the framework shifting to a more consolidated version only if the businesses are amalgamated more closely at the legal and operating levels, which we do not envisage at this stage.

Figure 35. HDFC — Valuation Matrix for RoAE (%) and 1 Yr Fwd P/BV (FY01-FY12)



Source: Citi Research, Company Data

Longer term valuation range at 3-5x 1yr Fwd PBV – benchmark of a 4x average – supported by strategic, structural and cyclical tailwinds

We believe the primary HDFC valuation debate centres around the very high multiples that the core mortgage business trades at; a range of about 3-5x PBV 1 yr forward over the last decade. This is high, in the context of its return structure, growth rates and the fact that mortgages as a product have limited pricing power (though HDFC continues to charge a premium, it's probably capped at about 25bps).

We value the core business at 4x FY14E P/B – in large measure reflecting its longer term average – but more critically, reflecting what we believe is an upward business bias. We have argued this in the report – strategic, structural and cyclical – which is where we believe there could be upside biases too.

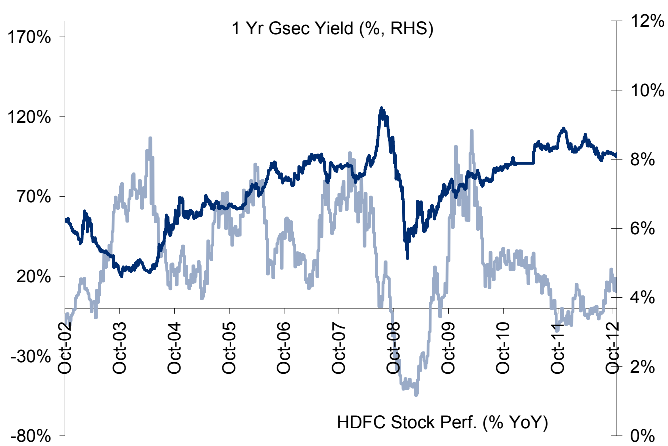
Downside risks lie in spread pressure, competitive intensity or asset strains on this wholesale asset book

We believe downside valuation risks could play up on account of competition driven spread compression, a slowdown in growth, or if any asset quality strains were to show up (particularly on the whole sale loan book). We also believe a sharp turnaround in the broader banking market could hurt HDFC's valuations on a relative basis as investors move to financial stocks more leveraged to an economic upcycle.

Interest rates a swing factor…and falling rates – which we expect – should be a significant stock driver

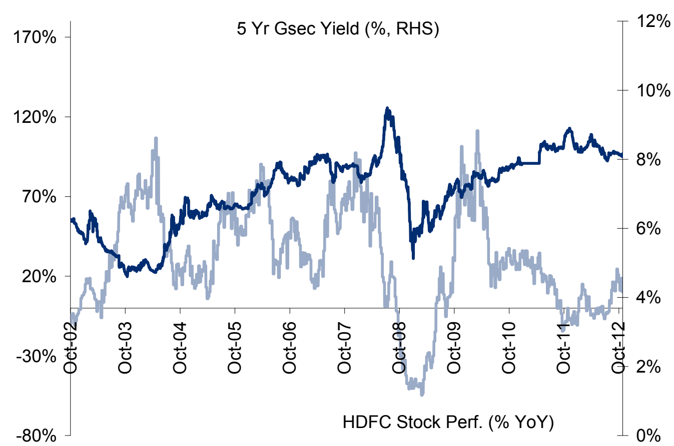
We see interest rates as a swing factor – lower rates should be better for HDFC, as funding becomes easier, its low cost structure is fundamentally more suited to lower rates, and its engine driver – the housing market – benefits more fundamentally than other asset class. The evidence of HDFC's stock correlation with interest rates is relatively moderate (visually, see Figs 36/37). We however believe it's a key swing factor – and HDFC's underlying business gains on falling rates and should translate into strong absolute and relative stock performance.

Figure 36. HDFC – Stock Performance vs. 1 Yr GSec Rate (Percentage)



Source: Citi Research, RBI, Bloomberg

Figure 37. HDFC – Stock Performance vs. 5 Yr GSec Rate (Percentage)



Source: Citi Research, RBI, Bloomberg

Figure 38. HDFC — Relative Valuation Matrix

	Target Price	Rating	P/E	P/E	P/B	P/B	ROE	ROE	ROA	ROA	Div. Yld	EPS Growth	EPS Growth
	Rs		x	x	x	x	%	%	%	%	%	%YoY	%YoY
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY13E	FY14E
HDFC Ltd	860	Buy	24.2	20.5	4.6	4.1	22.1%	21.4%	2.7%	2.6%	1.6%	13.8%	17.5%
LIC Housing Fin	290	Buy	11.1	8.9	1.8	1.5	17.5%	18.3%	1.6%	1.7%	1.6%	19.6%	24.7%
Private Banks	-	-	17.3	15.3	2.8	2.4	17.6%	18.6%	2.7%	2.6%	1.4%	20.2%	23.8%
India Banks	-	-	11.2	9.5	1.9	1.5	16.6%	17.6%	1.2%	1.3%	2.0%	13.6%	22.6%

Source: Citi Research estimates

Housing Development Finance Corp.

Company description

HDFC was set up in 1978 and today is India's premier housing-finance company with around 25% market share in mortgages and a loan book of Rs1.4trn as at FY12. It has had strong asset quality and gross NPLs of below 1% for several years. The company has more than 300 offices and 90 outreach programs. HDFC has strongly positioned itself across the banking and financial-services space. It has a commercial bank (23% ownership), and has subsidiary businesses in life insurance, non-life insurance and asset management.

Investment strategy

We rate HDFC a Buy with a target price of Rs860. It offers exposure to the high-growth mortgage market in India and to market leadership through its associates and subsidiary companies in commercial banking, life insurance and asset management. We believe HDFC is in a sweet spot strategically, structurally and cyclically. Strategically, its subsidiaries have started generating and returning increased capital, which could see HDFC increasing its growth rates and payouts, and potentially even buying new businesses. Structurally, we see upside in the funding market through an opening up of the ECB space. We believe the regulatory overhang is largely done and competitive intensity, though high, is not intensifying. We believe there is cyclical upside too – a long growth push-up, and easier liquidity and interest rates.

Valuation

Our target price of Rs860 is based on a sum-of-the-parts valuation, reflecting the significant and diverse values of its subsidiaries. We value the parent HDFC business at 4x PBV (long-term average), HDFC Bank at our target price of Rs645 (using an EVA method, with a secondary benchmark of 3.5x FY14E P/BV), the life-insurance business at 15x NBAP or 2x embedded value (slight premium to sector benchmarks to reflect return to profitability), and the asset-management business at 6% of assets (peer-group multiple) – all benchmarked off FY14E. We believe the rising strategic options and the structural and operating environment are all favorably positioned to support these multiples. In addition, HDFC has always traded at a premium on account of its high quality and credible management, which further adds to valuation upside.

Risks

The following downside risk could cause the shares to trade above our target price. The risks are primarily external in the form of aggressive and disruptive price competition, a challenging and unstable interest-rate environment, regulatory and policy changes, and market dislocations. Potential business risks are asset deterioration, mismatches and operational risks.

HDFC Bank

(HDBK.BO; Rs630.65; 2)

Valuation

Our target price of Rs645 is based on an EVA model, assuming a loan-loss ratio of 100bps, a long-term cost/income ratio of 42% and a spread of 280bps. We use the EVA model as our standard valuation methodology for the India banking universe as it dynamically adjusts the economic value of the business. As a secondary benchmark, we apply 3.5x 1 year forward P/BV for a fair value of Rs634. A 3.5x P/BV is a premium to almost all other Indian commercial banks, but is justified, we believe, by HDBK's structurally higher margin, de-risked earnings and balance sheet mix, as well as by gains in the consumer-lending franchise. This multiple is in the middle of its PBV multiples in previous cycles.

Risks

The key downside and upside risks to our target price lie in: (1) any negative/positive news on asset quality; (2) potential management changes; (3) emergence of high quality and scale competitors; and (4) changing risk perceptions of private banks. If any of these factors has a greater impact than we expect, the stock could have difficulty achieving our target price.

LIC Housing Finance

(LICH.BO; Rs251.50; 1)

Valuation

We value LIC Housing at Rs290 based on 1.8x one-year forward P/BV (Mar14E). Its historical trading range is 0.5-2.5x one-year forward P/BV. We believe a re-rating is warranted from the historical mean given the company's significant improvements in market position, asset quality and return profile. However, we also benchmark LIC Housing to other non-banking finance companies in India and believe that LIC Housing should trade at a discount to peers due to its lower return profile, weaker and inconsistent track record on net interest margins and significantly higher competition in the mortgage segment. Our target price is also at a discount to our target multiples for private sector banks (2.0x - 3.0x one-year forward P/BV).

We also see a fair value basis for LIC Housing shares at Rs280 based on our EVA model, which captures the long-term value of the business, and is a standard valuation measure for our India Banking coverage. Our EVA model assumes: a) a risk-free rate of 8.0%, in line with our assumptions for other banks; b) longer-term loan loss provisions of 15bps given its low asset risk profile, c) loan spreads of 150bps which is lower than banking industry averages of 200bps, and d) long-term fee income growth of 10%.

Risks

Key downside risks that could cause the stock to continue to trade below our target price include: a) Slower-than-expected economic recovery and more specifically mortgage financing growth, b) Reversal towards a higher interest rate / tight liquidity environment which could hurt its net interest margins, c) A sharp dip in the asset quality environment in the mortgage segment, d) Any increase in competitive intensity, and e) Regulatory changes.

Appendix A-1

Analyst Certification

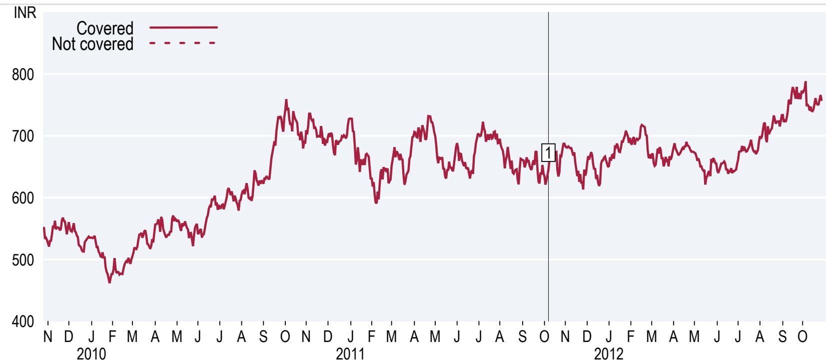
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Housing Development Finance Corp. (HDFC.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Aditya Narain, CFA



	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed		

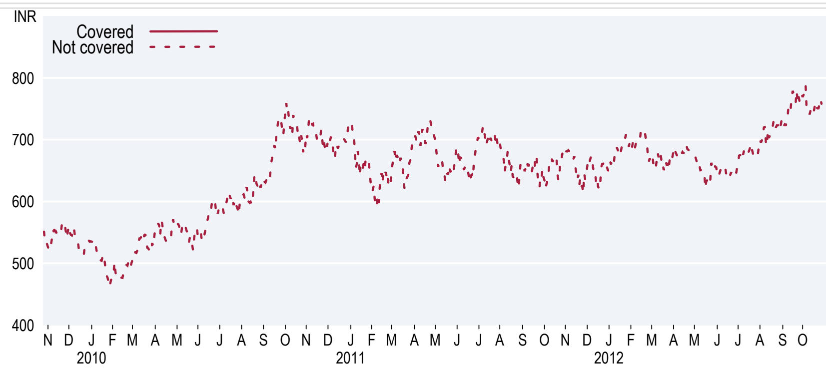
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Housing Development Finance Corp. (HDFC.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Aditya Narain, CFA



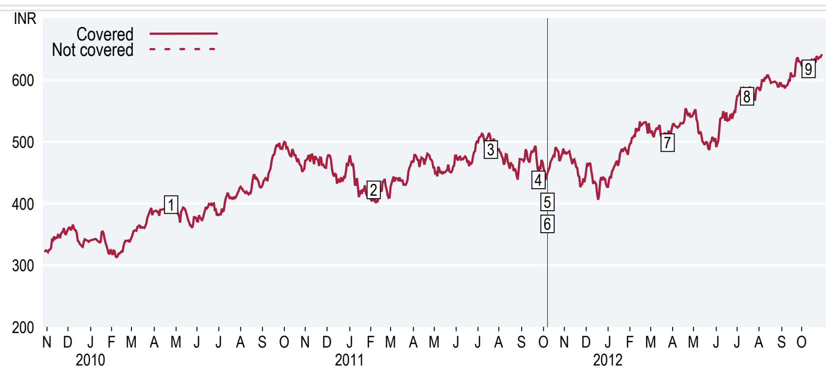
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

HDFC Bank (HDBK.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Aditya Narain, CFA
Covered since March 26 2012



	Date	Rating	Target Price	Closing Price
1	26-Apr-10	2L	*410.00	398.18
2	4-Feb-11	2L	*445.00	403.87
3	20-Jul-11	2L	*535.00	502.85
4	26-Sep-11	2L	*500.00	450.15
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*2	500.00	449.80
7	26-Mar-12	2	*550.00	510.55
8	16-Jul-12	2	*620.00	582.90
9	10-Oct-12	2	*645.00	618.15

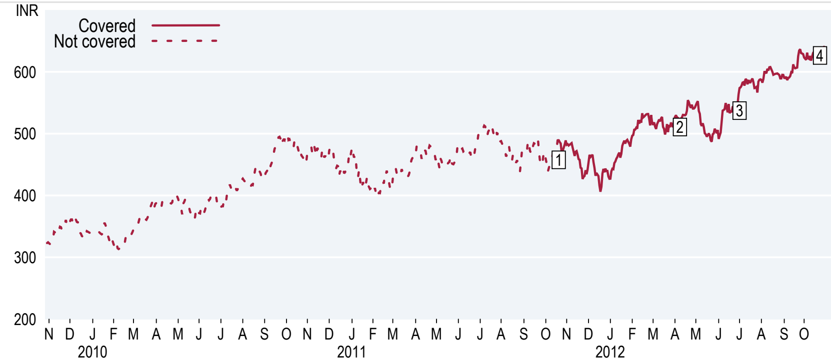
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

HDFC Bank (HDBK.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Aditya Narain, CFA
Covered since March 26 2012



	Date	Rating	Target Price	Closing Price
1	20-Oct-11	*ADD LP	-	489.50
2	9-Apr-12	*REM LP	-	522.95
3	30-Jun-12	*N	-	563.50
4	23-Oct-12	*ADD LP	-	633.30

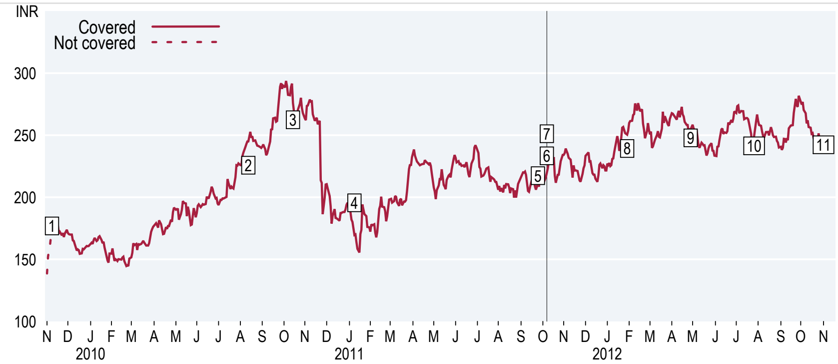
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

LIC Housing Finance (LICH.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since November 9 2009



	Date	Rating	Target Price	Closing Price
1	9-Nov-09	*3M	*148.00	175.77
2	12-Aug-10	3M	*210.80	245.03
3	14-Oct-10	3M	*262.00	276.01
4	9-Jan-11	3M	*170.00	180.15
5	26-Sep-11	3M	*188.00	211.15
6	7-Oct-11	Stock rating system changed		
7	7-Oct-11	*3	188.00	216.10
8	30-Jan-12	3	*229.00	250.45
9	27-Apr-12	3	*250.00	254.80
10	26-Jul-12	*1	*280.00	249.25
11	1-Nov-12	1	*290.00	248.75

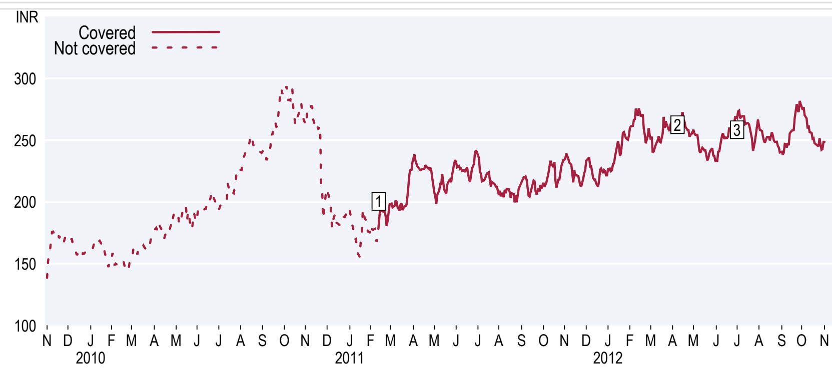
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

LIC Housing Finance (LICH.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since November 9 2009



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	171.90
2	9-Apr-12	*REM LP	-	262.55
3	30-Jun-12	*N	-	269.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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