

## Robust retail growth; spreads contracts q-q

### Quick Note

HDFC reported 2QFY14 PAT of INR12.7bn vs. our INR12.1bn estimate (Street at INR12.4bn) primarily on account of higher non-interest income. Loan growth of 19.2% y-y was in line with our estimate and driven by a robust 25.5% y/y growth in retail loans. The company reported a contraction in spread of 5bps q/q while the asset quality was steady with GNPL ratio of 0.79% (0.77% in 1Q).

#### Key highlights from 2QFY14 were:

- Overall loan growth of 19.2% y-y was driven by a robust 25.5% y-y growth in retail loans while corporate loans grew 8% y/y. Gross of the loans sold, retail loan growth would be 29% y-y and overall loan growth 22% y-y. Approvals and disbursements grew 16% y/y and 18% y/y, respectively. Management continues to guide towards 18-20% loan growth for FY14F. We have built in 18.9% for FY14F.
- Net interest income was flat q-q at INR14.8bn on account of a 5-bp sequential compression in spreads at 2.24% (2.29% in 1QFY14). Spreads on individual loans for 2HFY14 stand at 1.98% (3bps lower than 1Q but higher than 6-quarter average). Corporate loans spreads also contracted to 2.76% for 2HFY14 from 2.82% in 1Q. Non-interest income of INR4.5bn was higher than our estimate of INR3.4bn on account of a strong uptick in surplus from cash management. Management expects individual spreads to hold above 1.9%, while it guided to marginal improvement in developer mix by Mar'14. HDFC also indicated that the skew towards bank loans in its borrowing mix is likely to get reversed in 3Q on lower interest rates.
- Total provisions came in lower at INR150mn versus our expected INR340mn (INR300mn in 1Q), as the GNPL ratio held steady at 0.79% for the quarter and the company benefitted from reduced provisioning requirements for the CRE-RH segment, utilizing around INR153mn during the quarter. GNPL ratio for individual loans improved to 0.59% (0.61% in 1Q), while inching up 11bps q-q to 1.19% for corporate loans.
- Total CAR was 19%—with Tier 1 at 16.5% (16.3% and 14% in 1Q, respectively). The increase in capital ratios was due to a reduction in the risk weights on the CRE-RH segment.
- Loans sold as a proportion of the loan book, which has been steady at around 10% for the past few quarters, closed at 8.9% in 2QFY14. HDFC Bank had earlier talked about some spill over of its mortgage buyout into the third quarter.
- HDFC is carrying INR18.11bn as provisions on its book as against a regulatory requirement of INR13.18bn.

**Valuation: We believe HDFC is fairly valued, currently trading at 2.6x our one-year forward ABV of INR195.3 and 13.7x our one-year forward EPS of INR36.7. Out TP implies 2.8x one-year forward ABV and 14.7x one-year forward EPS for FY14F RoE of 19.8%.**

October 21, 2013

<b>Rating</b> Remains	<b>Neutral</b>
<b>Target price</b> Remains	INR 860
<b>Closing price</b> October 21, 2013	INR 821

#### Research analysts

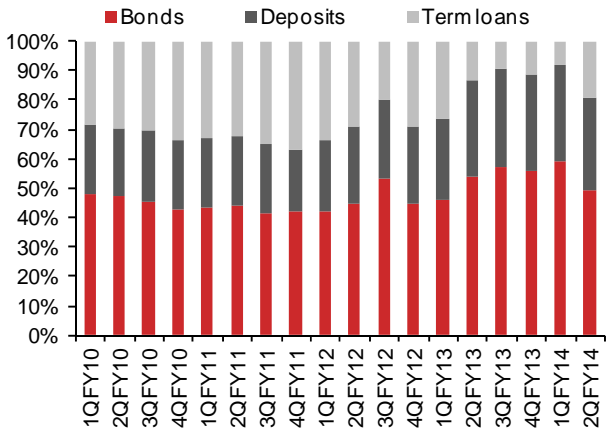
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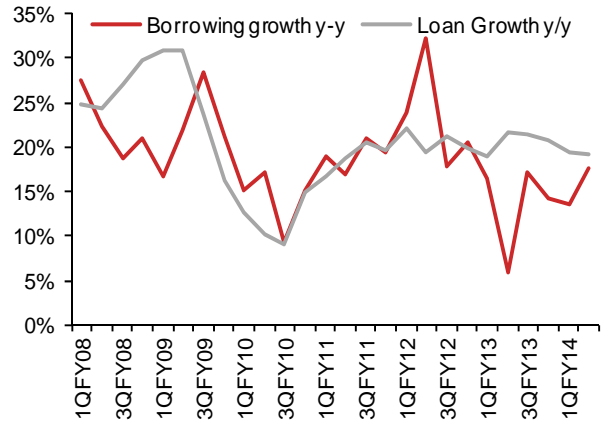
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

**Fig. 1: Funding mix**



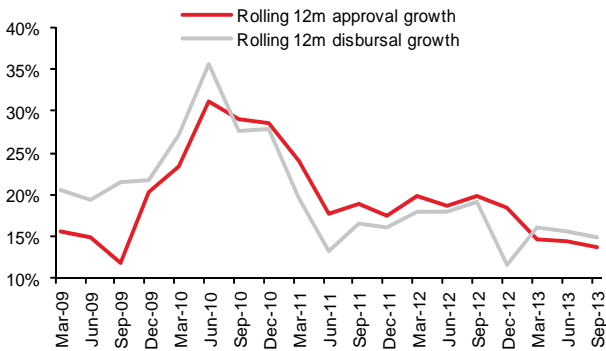
Source: Company data, Nomura research

**Fig. 2: Loan growth vs. borrowing growth**



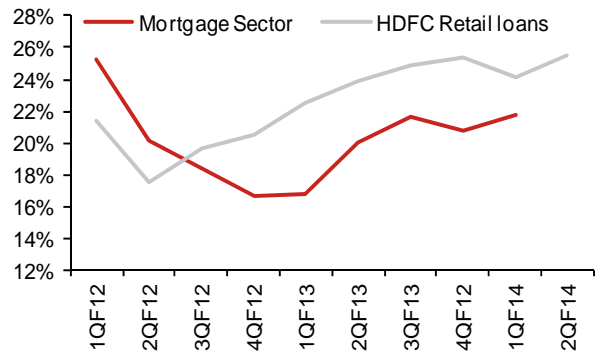
Source: RBI, Company data, Nomura research

**Fig. 3: Rolling 12-m disbursement growth and approval growth trend**



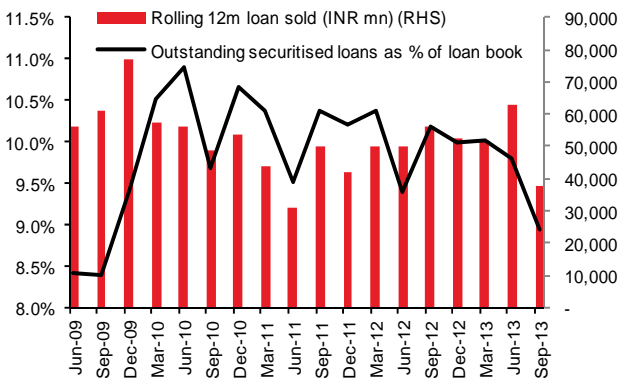
Source: Company data, Nomura research

**Fig. 4: HDFC vs. sector trends in retail mortgage loans**



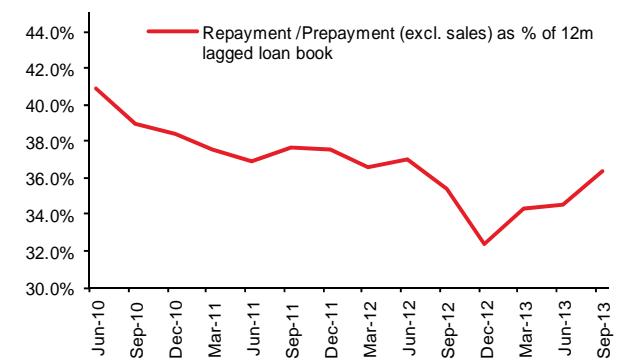
Source: Company data, Nomura research

**Fig. 5: Rolling 12-m loans sold vs. securitised loans as % of loan book**



Source: Company data, Nomura research

**Fig. 6: Repayment / prepayment (excl. sales) as % of 12m-lagged loan book**



Source: Company data, Nomura research

**Fig. 7: Earnings summary**

Earnings summary (INRmn)	2QFY14	1QFY14	2QFY13	%y/y	%q/q	2QFY14F	Variance %
Interest Earned	55,041.2	52,198.0	48,355.3	13.8	5.4	54,331.0	1.3
Interest on loans	52,299.4	50,350.7	46,016.5	13.7	3.9	52,360.2	(0.1)
Interest from treasury	2,741.8	1,847.3	2,338.8	17.2	48.4	1,970.7	39.1
Interest expended	40,197.9	37,382.3	35,163.8	14.3	7.5	39,148.0	2.7
Net interest income	14,843.3	14,815.7	13,191.5	12.5	0.2	15,182.9	(2.2)
Non-interest income	4,498.6	3,451.4	4,416.7	1.9	30.3	3,396.0	32.5
Fee income	628.9	544.0	525.2	19.7	15.6	570.1	10.3
Surplus from deployment in Cash mgmt schemes	1,203.8	645.9	918.1	31.1	86.4	574.4	109.6
Treasury income	867.5	-	941.1	(7.8)	-	300.0	189.2
Dividend income	1,705.0	2,171.3	1,944.7	(12.3)	(21.5)	1,800.0	(5.3)
Total Net income	19,341.9	18,267.1	17,608.2	9.8	5.9	18,578.9	4.1
Operating expense	1,978.6	1,886.1	1,727.0	14.6	4.9	1,897.7	4.3
Employee cost	671.8	744.1	620.8	8.2	(9.7)	706.0	(4.8)
Other Finance Charges	258.6	251.0	250.2	3.4	3.0	262.9	(1.6)
Operating & Administrative costs	953.3	835.6	799.9	19.2	14.1	873.2	9.2
Depreciation	94.9	55.4	56.1	69.2	71.3	55.7	70.5
Pre-prov operating profit	17,363.3	16,381.0	15,881.2	9.3	6.0	16,681.2	4.1
Provisions & Contingencies	150.0	300.0	400.0	(62.5)	(50.0)	340.1	(55.9)
PBT	17,213.3	16,081.0	15,481.2	11.2	7.0	16,341.1	5.3
Tax Provisions	4,550.0	4,350.0	3,970.0	14.6	4.6	4,248.7	7.1
Adjusted net profit	12,663.3	11,731.0	11,511.2	10.0	7.9	12,092.4	4.7
EPS	8.1	7.5	7.5	7.2	7.7	7.7	4.5

Source: Company data, Nomura estimates

**Fig. 8: Loan book breakdown**

Loan Break-up (INRmn)	2QFY14	1QFY14	2QFY13	%y/y	%q/q
Individuals	1,247,490.0	1,184,291.2	994,010.0	25.5	5.3
Corporate Bodies	580,630.0	566,198.4	537,631.0	8.0	2.5
Others	15,380.0	14,336.1	19,634.0	(21.7)	7.3
Total Loans	1,843,500.0	1,764,825.7	1,546,352.9	19.2	4.5

Source Company data, Nomura research

**Fig. 9: Key ratios**

Key Ratios	2QFY14	1QFY14	2QFY13	y/y bps	q/q bps
Reported spread, %	2.24	2.29	2.27	(3)	(5)
Total CAR, %	19.0	16.3	16.7	230	270
Tier I, %	16.5	14.0	14.1	240	250
Cost-income ratio, %	10.2	10.3	9.8	42	(10)
Cost-asset ratio, %	0.41	0.40	0.41	(1)	0
Gross NPA, %	0.79	0.77	0.77	2	2

Source: Company data, Nomura research

# Appendix A-1

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HDFC	HDFC IN	INR 821	21-Oct-2013	Neutral	N/A	A6,A7

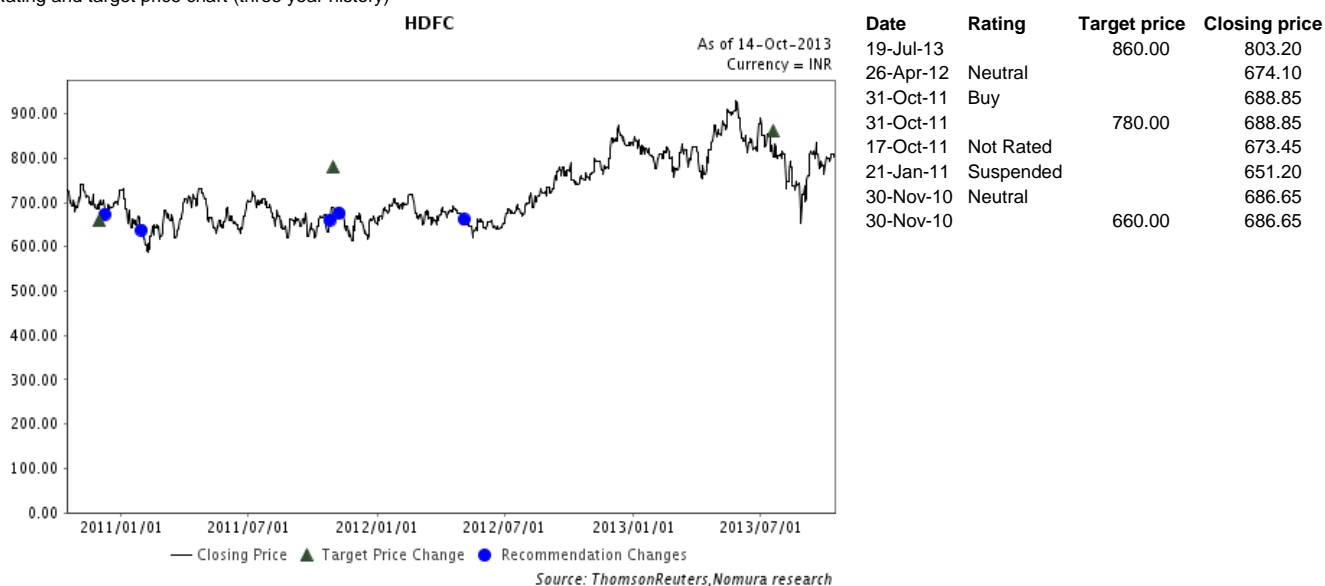
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### HDFC (HDFC IN)

INR 821 (21-Oct-2013) Neutral (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** In deriving our TP of INR860, we use a sum-of-the-parts methodology (SOTP) to value the subsidiaries. The valuation for the subsidiaries works out to be INR320 per share. We value HDFC's core mortgage business using a three-stage residual income valuation method that assumes the following: 1) a 18.5% CAGR for the company's average interest-earning assets during FY13-17F, followed by a CAGR of 12% for FY17-25F and a terminal growth rate of 4% beyond that; 2) average ROE of 21.4% over FY13-25F and a 19.6% terminal value ROE; and 3) discount rates ranging from 13.5% (current cost of equity) for FY13-17F and 12% for FY18-25F with a 10% terminal rate. At our target price, HDFC would trade at 2.8x our avg. FY14/15F ABV of INR195.3 and 14.7x avg. FY14/15F EPS of INR36.7 for an ROE of 19.8% for FY14F. The benchmark index for this stock is MSCI India.

**Risks that may impede the achievement of the target price** Key risk: Higher than expected compression in spreads, lower than expected loan growth and weak asset quality in the corporate segment.

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