

22 July 2013

**HDFC***Sturdy credit growth, stable asset quality; Buy*Rating: **Buy**

Target Price: ₹873

Share Price: ₹803

**Key takeaways**

**Robust retail loan growth, stable spreads.** HDFC's advances grew 19.4% yoy (24% on adjusting for "sell-down" in loans), with retail loans growing 24.1% yoy (31% on adjusting for "sell-down" in loans). Robust loan growth, coupled with stable 2.3% spreads, led to net interest income (NII) growth of 17.5% yoy. We estimate HDFC's loans to record a 19.4% CAGR over FY13-16, led by healthy demand from retail customers.

**Fees decline, higher income from dividends, stable productivity.** Fees declined 11.9% yoy (38.1% qoq); its share in non-interest income fell from 23% in 1QFY13 to 16.1% in 1QFY14. Income from dividends grew 36.1% yoy (167% qoq) and comprised 13.5% of profits before tax, compared to 11.6% in 1QFY13. Productivity was stable, with cost-income up 44bps yoy to 9.1%, one of the lowest among peers.

**Stable asset quality, well-capitalized for growth.** Asset quality is the best in class, with gross NPA at 0.77% of loans, down from 0.79% in 1QFY13. While non-performing loans for individuals fell 6bps yoy to 0.61% of loans, they increased 8bps for non-individual loans to 1.08%. We expect HDFC's prudent growth and high NPA provision buffer to keep credit costs low over FY13-16. With capital adequacy of 16.3% (tier-1 of 14%), it is adequately capitalized for growth opportunities in housing finance.

**Our take.** Robust loan growth, sturdy spreads and stable asset quality have driven profits. We have a Buy rating as we expect the RoE over FY14-15 to hold above 20%, supported by healthy business growth, stable spreads and the robust performance of subsidiaries. Our sum-of-parts-valuation price target is ₹873. We value the mortgage business at ₹594 (3.3x FY14e BV) and the subsidiaries at ₹279. **Risk:** Significant slowdown in the mortgage market, leading to slower-than estimated loan growth.

Key data	HDFC IN / HDFC.BO
52-week high / low	₹931 / ₹670
Sensex / Nifty	20150 / 6029
3-m average volume	US\$45.5m
Market cap	₹1,267bn / US\$21.3bn
Shares outstanding	1554.1m

Shareholding pattern (%)	Jun '13	Mar '13	Dec '12
Promoters	-	-	-
- of which, Pledged	-	-	-
Free Float	100.0	100.0	100.0
- Foreign Institutions	73.6	73.7	73.2
- Domestic Institutions	13.0	13.2	13.8
- Public	13.4	13.1	13.0

Financials (YE Mar)	FY14e	FY15e
Net interest income (₹m)	75,219	90,728
Net profit (₹m)	57,814	68,167
EPS (₹)	37.0	43.2
Growth (%)	18.1	16.7
PE (x)*	21.7	18.6
PBV (x)*	4.6	4.1
RoE (%)	20.5	21.4
RoA (%)	2.6	2.6
Dividend yield (%)	1.8	2.1
Net NPA (%)	0.5	0.5

Source: Anand Rathi Research (\*standalone)

Quarterly results (YE: Mar)	1QFY13	1QFY14	% yoy	FY12	FY13	% yoy
Net interest income (₹m)	15,265	17,936	17.5	59,060	69,061	16.9
Non-interest income (₹m)	276	80	(71.0)	2,915	3,507	20.3
Operating expenses (₹m)	1,342	1,635	21.8	4,519	5,389	19.3
Cost-to-income (%)	8.6	9.1	44bps	7.3	7.4	13bps
Pre-provisioning profit (₹m)	14,199	16,381	15.4	57,456	67,178	16.9
Provisions (₹m)	400	300	(25.0)	800	1,450	81.3
PBT (₹m)	13,799	16,081	16.5	56,656	65,728	16.0
Tax (₹m)	3,780	4,350	15.1	15,430	17,245	11.8
PAT (₹m)	10,019	11,731	17.1	41,226	48,483	17.6
EPS (₹)	6.7	7.5	12.1	27.5	31.5	14.2

Source: Company

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹m)**

Year-end: Mar	FY12	FY13	FY14e	FY15e	FY16e
Net interest income	53,278	61,841	75,219	90,728	107,520
NII growth (%)	18.7	16.1	21.6	20.6	18.5
Non-interest inc	8,697	10,727	9,400	9,734	10,670
Total income	61,975	72,567	84,619	100,462	118,190
Total Inc growth (%)	16.5	17.1	16.6	18.7	17.6
Op. expenses	4,519	5,389	6,099	7,242	8,557
Operating profit	57,456	67,178	78,520	93,221	109,633
Op profit growth (%)	16.4	16.9	16.9	18.7	17.6
Provisions	800	1,450	917	1,103	1,333
PBT	56,656	65,728	77,603	92,117	108,301
Tax	15,430	17,245	19,789	23,951	28,158
PAT	41,226	48,483	57,814	68,167	80,142
PAT growth (%)	16.6	17.6	19.2	17.9	17.6
FDEPS (₹/share)	27.9	31.4	37.0	43.2	50.3
DPS (₹/share)	11.0	12.5	15.0	17.5	20.5

Source: Company, Anand Rathi Research

**Fig 2 – Balance sheet (₹m)**

Year-end: Mar	FY12	FY13	FY14e	FY15e	FY16e
Share capital	2,954	3,093	3,124	3,155	3,186
Reserves & surplus	187,222	246,907	277,681	313,690	355,785
Deposits	574,881	795,215	498,544	997,803	1,088,004
Borrowings	453,466	273,739	843,689	672,937	680,003
Minority interests	362,928	519,328	575,243	649,732	952,004
Total liabilities	1,581,451	1,838,282	2,198,280	2,637,318	3,078,981
Advances	1,259,855	1,521,062	1,808,940	2,168,666	2,590,486
Investments	122,070	136,135	201,335	233,904	337,961
Cash & bank bal	190,904	172,411	176,700	221,361	134,739
Fixed & other assets	8,622	8,674	11,306	13,387	15,796
Total assets	1,581,451	1,838,282	2,198,280	2,637,318	3,078,981
No. of shares (m)	1,477	1,546	1,562	1,577	1,593
Deposits growth (%)	n/a	n/a	n/a	n/a	n/a
Advances growth (%)	24.1	20.7	18.9	19.9	19.5

Source: Company, Anand Rathi Research

**Fig 3 – Key ratios @ ₹803**

Year-end: Mar	FY12	FY13	FY14e	FY15e	FY16e
NIM (%)	4.0	3.9	3.9	3.9	3.9
Other inc / total inc (%)	14.0	14.8	11.1	9.7	9.0
Cost-income (%)	7.3	7.4	7.2	7.2	7.2
Provision coverage (%)	39.4	39.9	40.5	40.5	40.8
Dividend payout (%)	7.3	6.4	6.8	7.3	7.6
Credit-deposit (%)	347.1	292.9	314.5	333.8	272.1
Investment-deposit (%)	33.6	26.2	35.0	36.0	35.5
Gross NPA (%)	0.8	0.8	0.7	0.7	0.7
Net NPA (%)	0.6	0.6	0.5	0.5	0.5
BV (₹)	128.8	161.7	179.8	200.9	225.3
Adj BV (₹)	123.7	156.1	173.5	193.9	217.6
CAR (%)	14.6	16.4	15.0	14.0	6.5
- Tier 1 (%)	11.7	13.9	13.6	12.8	6.0
RoE (%)	22.7	22.0	21.8	22.8	23.7
RoA (%)	2.8	2.8	2.9	2.8	2.8

Source: Company, Anand Rathi Research

**Fig 4 – PE band**



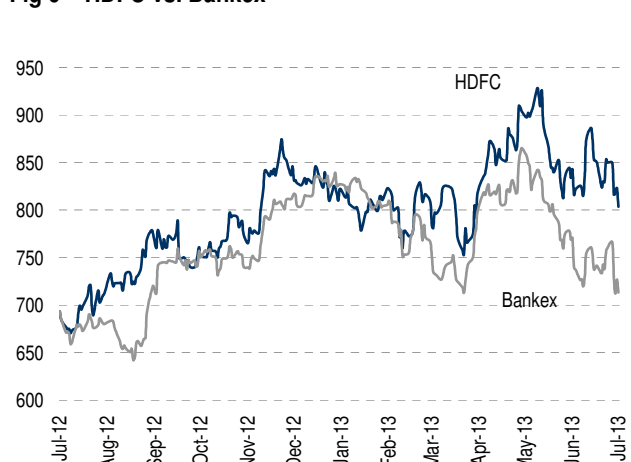
Source: Bloomberg, Anand Rathi Research

**Fig 5 – Price-to-book band**



Source: Bloomberg, Anand Rathi Research

**Fig 6 – HDFC vs. Bankex**



Source: Bloomberg

## Results highlights

**Fig 7 – 1QFY14 Results vs Expectations**

(₹m)	1QFY14	1QFY13e	Var %	1QFY13	YoY %	4QFY13	QoQ %
Net interest income	17,936	18,196	(1.4)	15,265	17.5	21,214	(15.5)
Non-interest income	18,016	18,516	(2.7)	15,541	15.9	19,101	(5.7)
Pre-provisioning profits	16,381	16,900	(3.1)	14,199	15.4	21,247	(22.9)
PAT	11,731	11,843	(0.9)	10,019	17.1	15,552	(24.6)

Source: Company, Anand Rathi Research

**Fig 8 – 1QFY14 results**

(₹m)	1QFY14	1QFY13	YoY	4QFY13	QoQ
Credit	176,993	148,262	19.4	170,046	4.1
Individuals	118,429	95,413	24.1	111,321	6.4
Corporate bodies + others	58,564	52,849	10.8	58,725	(0.3)
Borrowings	163,269	143,812	13.5	158,828	2.8
Net NPAs %	0.8	0.8	(2)	0.7	7
Net NPAs (individual)%	0.6	0.7	(6)	0.6	3
Net NPAs (corporate)%	1.1	1.0	8	0.9	17
Capital adequacy %	16.3	14.6	170	16.2	10
Tier-1 %	14.0	11.8	220	13.8	20

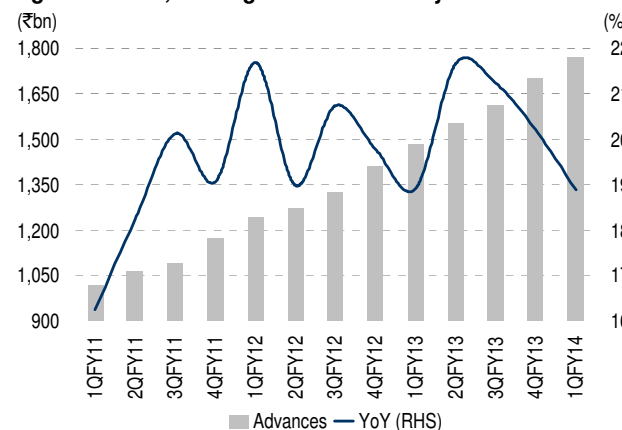
Source: Company, Anand Rathi Research

### Healthy credit growth, loans to individuals grow faster

At 19.4% yoy, HDFC's credit growth in 1QFY14 was slower than the past four-quarter average of 21%. Credit growth was chiefly driven by loans to individuals, which grew a robust 24% yoy (6.4% qoq), compared to loans to corporate bodies (11% yoy, -0.6% qoq).

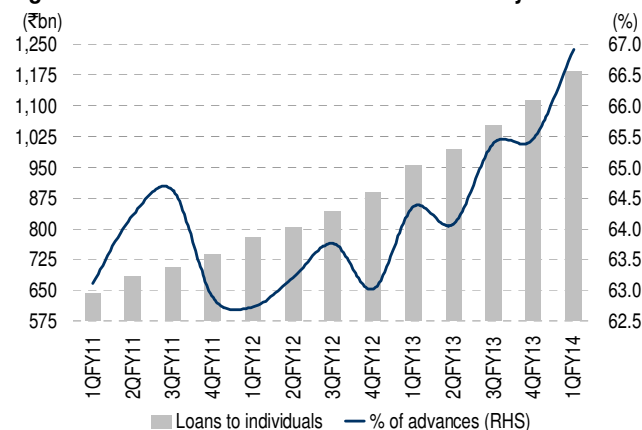
Advances grew 24% yoy on adjusting for "sell-down" in loans, with retail loans growing 31% yoy on adjusting for "sell-down" in loans. Over Mar-Jun'13, loans to individuals contributed to 102% of HDFC's overall loan growth, compared to -2% from loans to corporate bodies. Management has attributed the slower growth in loans to corporate customers to ample liquidity and availability of cheaper sources of credit in 1QFY14. We estimate a 19.4% CAGR in HDFC's credit over FY13-16, with a 19.6% CAGR in loans to individuals over the same period.

**Fig 9 – In FY14, credit growth was healthy**



Source: Company, Anand Rathi Research

**Fig 10 – Share of loans to individuals has steadily risen**

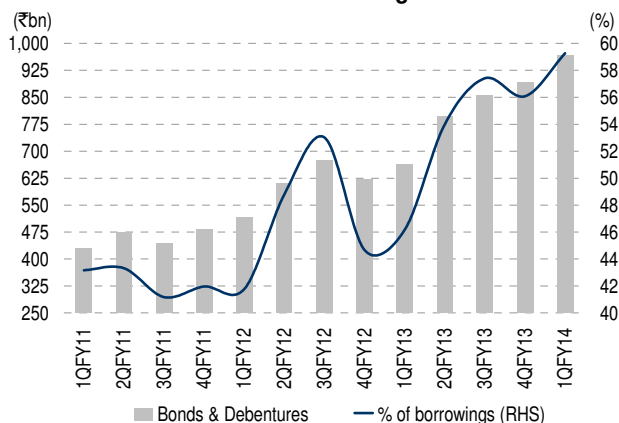


Source: Company, Anand Rathi Research

### Stable spreads and healthy loan growth drive NII

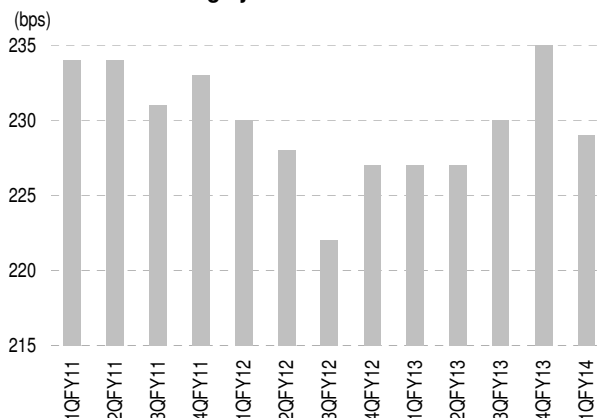
Interest spreads, at 2.3%, were stable. Despite stable spreads, net interest income grew slower than credit, due to slower growth in loans to corporate bodies, where yields are better. Hence, NIM fell from 4% in 1QFY13 to 3.9% in 1QFY14 due to the change in loan mix towards lower-yielding loans to individuals - now comprising 66.9% of total loans compared to 64.4% in 1QFY14.

**Fig 11 – Share of bonds / debentures in borrowings has increased**



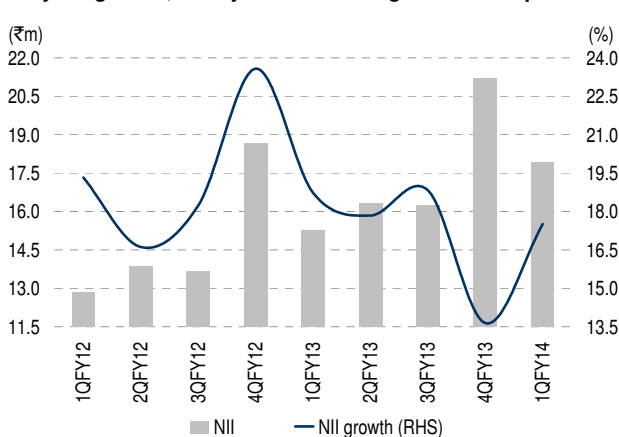
Source: Company

**Fig 12 – Spreads have been largely stable**



Source: Company

**Fig 13 – Healthy NII growth, led by robust credit growth and spreads**

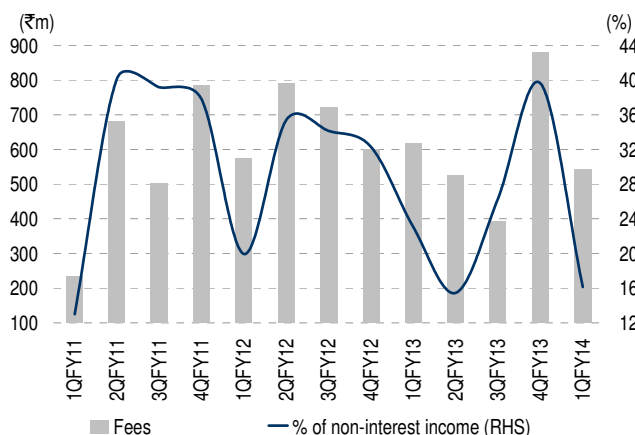


Source: Company

### Fees decline, higher income from dividends, stable productivity

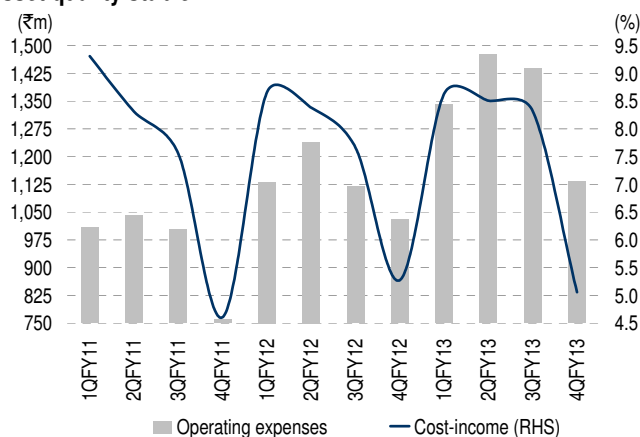
Fees declined 11.9% yoy (38.1% qoq); their share in non-interest income fell from 23% in 1QFY13 to 16.1% in 1QFY14. Income from dividends grew 36.1% yoy (167% qoq) and comprised 13.5% of profits before tax, compared to 11.6% in 1QFY13. Productivity was stable, with cost-income up 44bps yoy to 9.1%, one of the lowest among peers.

**Fig 14 – Share of fees in non-interest income has declined**



Source: Company

**Fig 15 – Asset quality stable**



Source: Company

### Stable asset quality, well-capitalised for growth

Asset quality is the best in class, with gross NPA at 0.77% of loans, down from 0.79% in 1QFY13. While non-performing loans for individuals fell 6bps yoy to 0.61% of loans, they increased 8bps for non-individual loans to 1.08%. We expect HDFC's prudent growth and high NPA provision buffer to keep credit costs low over FY13-16. With capital adequacy of 16.3%, (tier-1 of 14%), it is adequately capitalized for growth opportunities in housing finance.

**Fig 16 – Asset quality stable**

	1QFY13	2QFY13	3QFY13	4QFY13	1QFY14
NPA (%)	0.79	0.77	0.75	0.70	0.77
NPAs: individual loans (%)	0.67	0.65	0.62	0.58	0.61
NPAs: non-individual loans (%)	1.00	0.89	0.91	0.91	1.08

Source: Company

## Valuations

**We have arrived at our price target based on a sum-of-parts valuation.**

- Core lending business – ₹595 a share at a PABV multiple of 3.3x FY14e BV. In our two-stage DDM, we assume cost of equity at 14.6%.

### Subsidiaries -

- Life insurance – based on appraisal value, at ₹55.7 a share.
- HDFC AMC – based on 5% of equity AUM, 1.5% of debt AUM and 8% of PMS AUM, at ₹20.7 a share.
- GRUH Finance – ₹6.5 a share at a PABV multiple of 2.7x FY14e BV.
- HDFC Real Estate Fund - based on 10% of AUM, at ₹4.9 a share.

We have attributed a 20% holding-company discount to the subsidiaries, resulting in a value of ₹278 a share.

**Fig 17 – Past one-year forward-P/BV**



Source: Bloomberg, Anand Rathi Research

### Risks

- A slower-than-expected growth rate of the Indian economy.
- Aggressive monetary tightening, and measures that could further slow down the economy.
- More-than-expected increase in bad loans.

## Financials

We introduce FY16 estimates and expect a 19.4% CAGR in the loan book over FY13-16. We estimate an 18.2% earnings CAGR in net profit over the same period.

**Fig 18 – Income Statement**

Year-end: Mar (₹m)	FY12	FY13	FY14e	FY15e	FY16e
Net Interest Income	53,278	61,841	75,219	90,728	107,520
Growth (%)	18.7	16.1	21.6	20.6	18.5
Non-interest Income	8,697	10,727	9,400	9,734	10,670
Total Income	61,975	72,567	84,619	100,462	118,190
Non-interest inc / Total Inc (%)	14.0	14.8	11.1	9.7	9.0
Operating Expenses	4,519	5,389	6,099	7,242	8,557
Pre-provisioning profit	57,456	67,178	78,520	93,221	109,633
Growth (%)	16.4	16.9	16.9	18.7	17.6
Provisions	800	1,450	917	1,103	1,333
Profit Before Tax	56,656	65,728	77,603	92,117	108,301
Taxes	15,430	17,245	19,789	23,951	28,158
Tax Rate (%)	27.2	26.2	25.5	26.0	26.0
Consolidated profit after tax	41,226	48,483	57,814	68,167	80,142
Growth (%)	16.6	17.6	19.2	17.9	17.6
Number of Shares (m)	1,477	1,546	1,562	1,577	1,593
Earnings Per Share (₹)	27.9	31.4	37.0	43.2	50.3

Source : Company, Anand Rathi Research

**Fig 19 – Balance Sheet**

Year-end: Mar (₹m)	FY12	FY13	FY14e	FY15e	FY16e
Share Capital	2,954	3,093	3,124	3,155	3,186
Reserves and Surplus	187,222	246,907	277,681	313,690	355,785
Borrowings	<b>190,176</b>	<b>250,000</b>	<b>280,804</b>	<b>316,844</b>	<b>358,971</b>
Deposits	1,028,347	1,068,954	1,342,233	1,670,741	1,768,007
Other Liabilities & Provisions	362,928	519,328	575,243	649,732	952,004
<b>Total Liabilities</b>	<b>1,581,451</b>	<b>1,838,282</b>	<b>2,198,280</b>	<b>2,637,318</b>	<b>3,078,981</b>
Advances	1,259,855	1,521,062	1,808,940	2,168,666	2,590,486
Investments	122,070	136,135	201,335	233,904	337,961
Net current assets	190,904	172,411	176,700	221,361	134,739
Fixed & Other Assets	8,622	8,674	11,306	13,387	15,796
<b>Total Assets</b>	<b>1,581,451</b>	<b>1,838,282</b>	<b>2,198,280</b>	<b>2,637,318</b>	<b>3,078,981</b>
No. of shares (m)	1,477	1,546	1,562	1,577	1,593

Source : Company, Anand Rathi Research

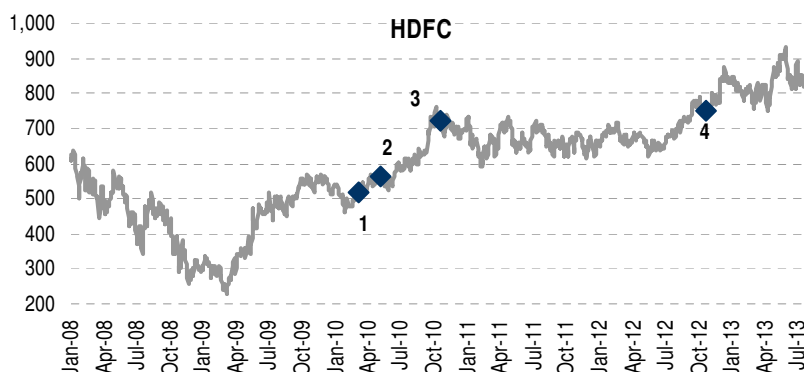
## Appendix

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	Date	Rating	TP (₹)	Share Price (₹)
1	5-Mar-10	Buy	619	517
2	4-May-10	Buy	671	561
3	18-Oct-10	Buy	835	724
4	22-Oct-13	Buy	873	751

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Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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