

Housing Development Finance (HDFC.BO)

Result: Consolidating Earnings and Growth

- Business stays in good shape** — HDFC's profits are up 17% yoy (2% below our estimates): and are qualitatively good. The businesses' momentum/profitability/quality are all robust, suggesting it's another 'business as usual' quarter.
- The sub surge gets more material** — HDFC's consolidated profit growth though is 34% (2X of standalone); its subs growth/profitability is coming (and is faster), driving 31% of consol profits, and raising ROEs. The quarter's consol surge is backed by the Bank (+30%) and boosted by Life Insurance (a material jump in profits). This is boosting, broadening and raising HDFC's profitability – and should increasingly become the new benchmark.
- Spreads stay comfortable** — HDFC's spreads remain comfortable (retail spreads rise); reflecting a generally easy funding / pricing environment, and suggesting it is business as usual. While there continues to be funding churn (further reduction of bank funding) and a loan shift (retail now 70%; 100% of incremental loans); HDFC continues to sustain a steady spread profile across interest rate/ competition cycles.
- And growth remains good too** — HDFC's gross loan book is up 20%, and its retail disbursements rise 31% – growth remains well on track. While its wholesale book remains flat (a tough market); strong retail growth is compensating – and with overall spreads sustaining, HDFC's growth / profitability play seems pretty comfortable.
- Could the recent funding challenges become a problem?** — HDFC is largely a wholesale funded entity (wholesale accounts for 68% of stock; 21% of incremental funding in FY13); could be exposed to recent funding challenges. But it's still early days, HDFC does borrow more at the long end (greater short end pain) and its current book is well matched, so potential risks are only incremental. Management suggests they're comfortably covered on funding for July, will resort to deposits if challenges persist (similar to FY13). We do see this as a challenge for the broader financial system – HDFC is a part of it, but usually does better. We would watch closely, but not worry too much. Maintain Neutral.

Neutral	2
Price (19 Jul 13)	Rs821.50
Target price	Rs940.00
Expected share price return	14.4%
Expected dividend yield	1.5%
Expected total return	15.9%
Market Cap	Rs1,276,719M
	US\$21,369M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2011A	35,350	23.80	22.4	34.5	7.0	21.7	1.1
2012A	41,226	27.57	15.8	29.8	6.4	22.7	1.3
2013E	48,874	31.23	13.3	26.3	5.1	22.2	1.5
2014E	57,577	36.79	17.8	22.3	4.5	21.7	1.8
2015E	67,697	43.26	17.6	19.0	4.0	22.6	2.0

Source: Powered by dataCentral

Aditya Narain, CFA

+91-22-6175-9879
aditya.narain@citi.com

Pooja Kapur

+91-22-6175-9881
pooja.kapur@citi.com

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Fiscal year end 31-Mar	2011	2012	2013E	2014E	2015E
Valuation Ratios					
P/E adjusted (x)	34.5	29.8	26.3	22.3	19.0
P/E reported (x)	34.5	29.8	26.3	22.3	19.0
P/BV (x)	7.0	6.4	5.1	4.5	4.0
P/Adjusted BV diluted (x)	7.0	6.4	5.1	4.6	4.1
Dividend yield (%)	1.1	1.3	1.5	1.8	2.0
Per Share Data (Rs)					
EPS adjusted	23.80	27.57	31.23	36.79	43.26
EPS reported	23.80	27.57	31.23	36.79	43.26
BVPS	118.05	128.76	161.67	181.76	206.07
Tangible BVPS	118.05	128.76	161.67	181.76	206.07
Adjusted BVPS diluted	116.66	128.72	159.78	177.88	199.75
DPS	9.00	11.00	12.50	14.50	16.50
Profit & Loss (Rsm)					
Net interest income	44,646	53,181	62,192	74,639	88,270
Fees and commissions	2,455	2,897	2,765	3,041	3,345
Other operating Income	6,080	5,897	8,005	8,781	9,634
Total operating income	53,181	61,975	72,961	86,461	101,249
Total operating expenses	-3,812	-4,519	-5,392	-6,143	-6,950
Oper. profit bef. provisions	49,370	57,456	67,569	80,318	94,299
Bad debt provisions	-700	-800	-1,450	-1,445	-1,564
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	48,670	56,656	66,119	78,873	92,735
Tax	-13,320	-15,430	-17,245	-21,296	-25,039
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	35,350	41,226	48,874	57,577	67,697
Adjusted earnings	35,350	41,226	48,874	57,577	67,697
Growth Rates (%)					
EPS adjusted	22.4	15.8	13.3	17.8	17.6
Oper. profit bef. prov.	24.2	16.4	17.6	18.9	17.4
Balance Sheet (Rsm)					
Total assets	1,395,021	1,675,199	1,955,308	2,344,662	2,803,299
Avg interest earning assets	1,188,976	1,437,800	1,713,703	2,046,716	2,468,895
Customer loans	1,179,305	1,416,391	1,712,640	2,096,915	2,552,091
Gross NPLs	9,903	12,328	15,184	18,615	22,822
Liab. & shar. funds	1,395,021	1,675,199	1,955,308	2,344,662	2,803,299
Total customer deposits	246,251	362,928	519,330	501,058	596,259
Reserve for loan losses	8,039	12,180	12,180	12,180	12,180
Shareholders' equity	173,165	190,176	250,000	281,066	318,663
Profitability/Solvency Ratios (%)					
ROE adjusted	21.7	22.7	22.2	21.7	22.6
Net interest margin	3.75	3.70	3.63	3.65	3.58
Cost/income ratio	7.2	7.3	7.4	7.1	6.9
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	65.4	53.4
Bad debt prov./avg. cust. loans	0.1	0.1	0.1	0.1	0.1
Loans/deposit ratio	478.9	390.3	329.8	418.5	428.0
Tier 1 capital ratio	26.8	11.7	13.7	12.9	12.1
Total capital ratio	33.4	14.6	16.4	15.5	14.3

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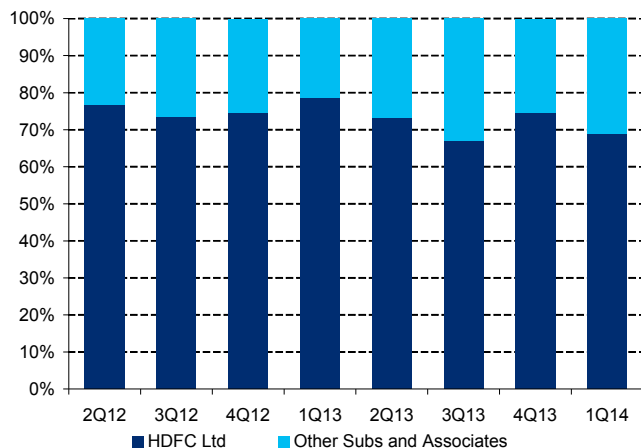


Figure 1. HDFC – 1QFY14 Results: Key Financial Highlights (Rupees Million, Percentage)

	1Q14	1Q13	YoY %	4Q13	QoQ%	CIRA Comments
Interest Income	52,844	46,924	12.6	53,906	-2.0	
Interest Expense	(37,633)	(33,882)	11.1	(34,398)	9.4	
Net Interest Income	15,211	13,042	16.6	19,508	-22.0	Steady spreads, and in sync with loan growth ... a little below expectations
Fee-Based Income	544	618	-11.9	879	-38.1	Weak - reflecting accelerating retail asset acquisition
Other Non-Interest Income	2,262	1,882	20.2	1,992	13.5	
Non Interest Income	2,806	2,499	12.3	2,871	-2.3	
Operating Income	18,016	15,541	15.9	22,379	-19.5	
Operating Expenses	(1,635)	(1,342)	21.8	(1,132)	44.5	A little elevated - but off low levels
Pre-Provision Profit	16,381	14,199	15.4	21,247	-22.9	
Charges for Bad Debts	(300)	(400)	-25.0	(250)	20.0	A step down - given significant excess loan loss coverage - and a well behaving asset book
Operating Profit	16,081	13,799	16.5	20,997	-23.4	
Pre-Tax Profit	16,081	13,799	16.5	20,997	-23.4	
Tax	(4,350)	(3,780)	15.1	(4,980)	-12.7	
Net Profit	11,731	10,019	17.1	16,017	-26.8	2% below expectations
EPS	8.0	6.8	17.1	10.06	-20.8	
Customer Loans	1,769,930	1,482,623	19.4	1,700,460	4.1	Strong retail growth, partly offset by a flat wholesale book - growth appears comfortable
Customer Deposits	536,960	399,434	34.4	519,330	3.4	Trend line growth - might need to rely more on deposits near term, given recent wholesale funding uncertainty
AIEA	1,405,608	1,174,313	19.7	1,856,775	-24.3	
AIBL	1,803,883	1,336,651	35.0	559,329	222.5	
Total Assets	2,022,678	1,746,758	15.8	1,955,308	3.4	
Avg Assets	1,988,993	1,710,979	16.2	1,896,503	4.9	
Non-Performing Loans (NPL)	13,628	11,713	16.4	11,903	14.5	Asset quality remains very comfortable
Loan Loss Reserves (LLR)	(18,006)	(17,110)	5.2	(17,923)	0.5	Excess coverage - cushion for P&L provisioning
Shareholders' Funds	264,096	204,656	29.0	250,000	5.6	
Book Value Per Share	179	139	29.0	162	11.0	
Key Ratios (%)	1Q14	1Q13	Bps Δ YoY	4Q12	Bps Δ QoQ	
ROAA (annualized)	2.4	2.3	1.7	3.3	-92.1	
ROAE (annualized)	17.8	19.6	-181.5	24.9	-711.6	
Net Interest Margin (bps)	390	400	-10.2	420	-30.7	Steady in spite of loan mix change, and competition
Fee Inc/Operating Income	3.0	4.0	-95.4	3.9	-91.0	
Other Non-Interest Inc/Op Inc	15.6	16.1	-50.9	12.8	274.2	
Op. Cost/ Operating Income	9.1	8.6	44.1	5.1	401.9	
Loan-to-Deposit Ratio (LDR)	329.6	371.2	-4156.1	327.4	218.7	
NPL/Loan Ratio	0.77	0.79	-2.0	0.70	7.0	
LLR/NPL Ratio	132.1	146.1	-1395.8	150.6	-1845.0	

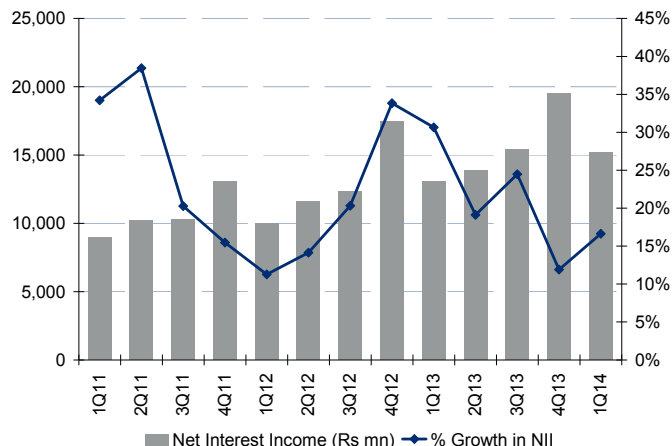
Source: Citi Research, Company Data

Figure 2. HDFC: Consolidated Profit Contribution Mix (Rs mn)



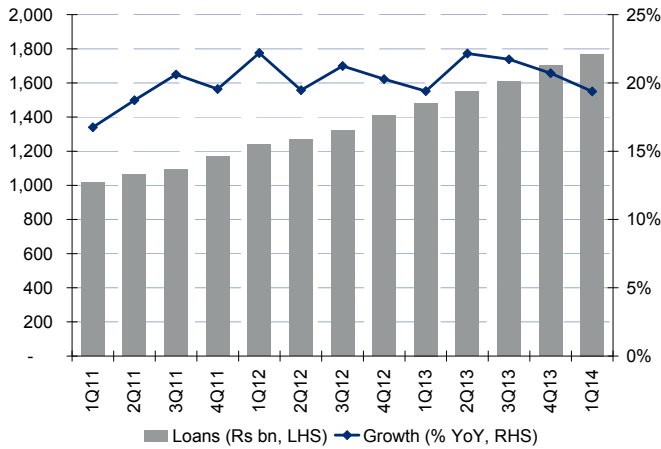
Source: Citi Research, Company Data

Figure 3. HDFC: Net Interest Income (Rs mn, % YoY)



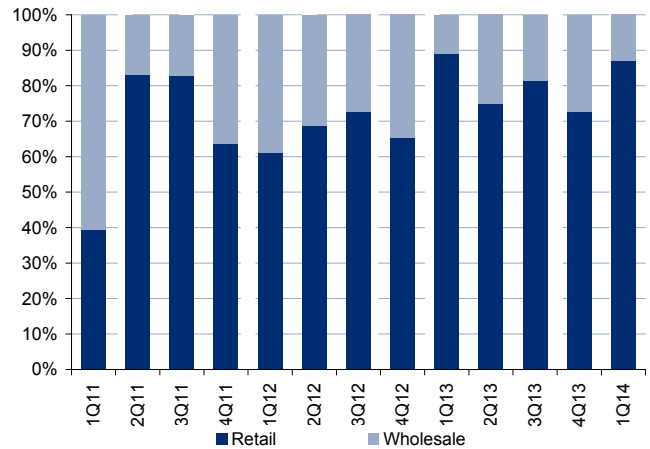
Source: Citi Research, Company Data

Figure 4. HDFC: Loans and Loan Growth (Rs mn, % YoY)



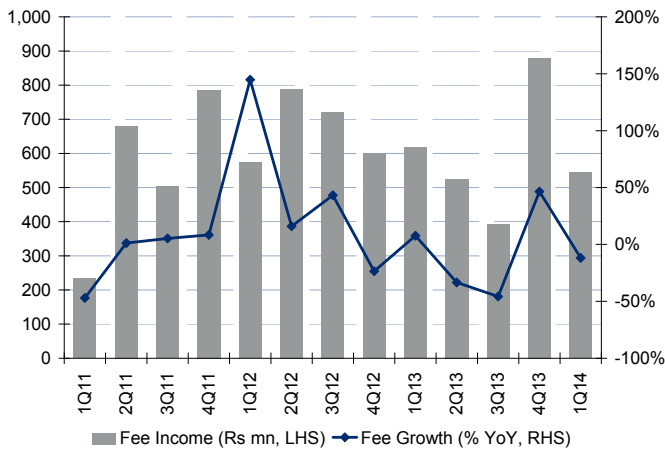
Source: Citi Research, Company Data

Figure 5. Incremental Retail Vs. Wholesale Loan Growth Mix (% of On Balance Sheet Loans, YTD)



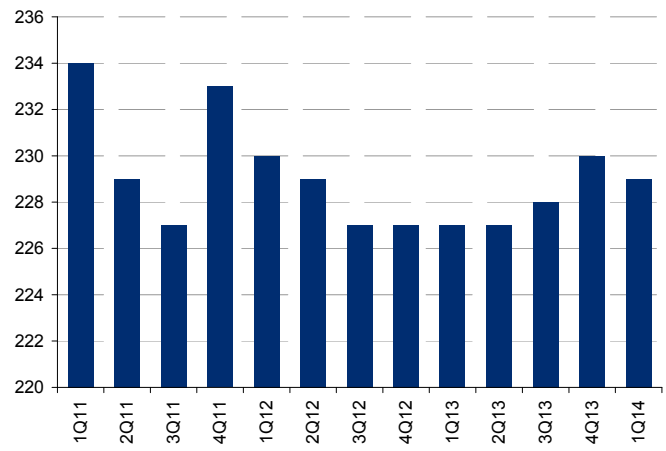
Source: Citi Research, Company Data

Figure 6. HDFC: Fee Income and Fee Growth (Rs mn, % YoY)



Source: Citi Research, Company Data

Figure 7. HDFC: Cumulative Loan Spreads (Bps)



Source: Citi Research, Company Data

Housing Development Finance

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 Neutral. 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, and the environment remains supportive. There is also some leverage to the market, coming from its subsidiaries. However, given the stock's sharp outperformance, we see modest upsides from here.

Valuation

Our target price of Rs940 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 4.0x PBV (long-term average), HDFC Bank at our target price of Rs750 (using a benchmark of 3.75x Sep 14E P/BV, with a secondary EVA method), 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 Sep'14E. 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 key downside 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. Key upside risks to our recommendation include a better competitive environment and its business impact on expanding margins and profitability, consequently.

Appendix A-1

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IMPORTANT DISCLOSURES

**Housing Development Finance
(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		

	Date	Rating	Target Price	Closing Price
2	2-Nov-12	*1	*860.00	767.30

	Date	Rating	Target Price	Closing Price
3	23-May-13	*2	*940.00	902.95

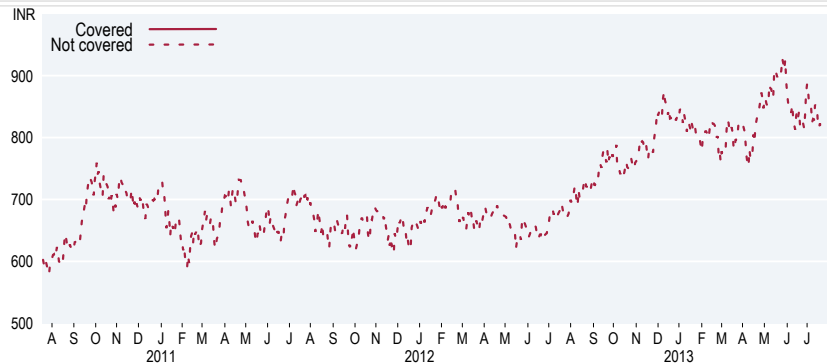
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

**Housing Development Finance
(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

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Citi Research Equity Ratings Distribution

Data current as of 30 Jun 2013

Citi Research Global Fundamental Coverage

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	40%	12%	6%	88%	6%

% of companies in each rating category that are investment banking clients 53% 50% 45% 58% 51% 49%

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