

Margin compression is evident

July 19, 2013

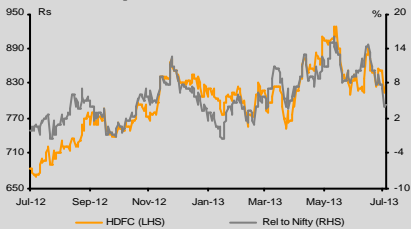
Rating	Previous Reco
Reduce	Reduce
CMP	Target Price
Rs803	Rs760
EPS Chg FY14E/FY15E (%)	NA/NA
Target Price change (%)	NA
Nifty	6,029
Sensex	20,150

Price Performance

(%)	1M	3M	6M	12M
Absolute	-5	-2	-2	16
Rel. to Nifty	-9	-7	-3	-1

Source: Bloomberg

Relative price chart



Source: Bloomberg

Stock Details

Sector	Banking & Financial Services
Bloomberg	HDFC IB
Equity Capital (Rs mn)	3,108
Face Value(Rs)	2
No of shares o/s (mn)	1,554
52 Week H/L	931/ 631
Market Cap (Rs bn/USD mn)	1,248/ 20,911
Daily Avg Volume (No of sh)	3,092,961
Daily Avg Turnover (US\$mn)	44.4

Shareholding Pattern (%)

	Jun'13	Mar'13	Dec'12
Promoters	N/A	N/A	N/A
FII/NRI	73.6	73.7	73.2
Institutions	13.0	13.2	13.8
Private Corp	2.8	2.9	3.1
Public	10.5	10.2	9.9

Source: Bloomberg

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- **HDFC Q1FY14 NII at Rs14.6bn (+16% yoy) below estimates. However with higher dividend income, net profit at Rs11.7bn largely inline with est. NIM came in at 2.9% (calc)**
- **Retail loans (+24% yoy) drive overall loan growth (+19% yoy). Borrowings growth at 13.5% yoy only. NIMs could have been lower if not for asset mix change from cash to loans**
- **NII growth moderates to 16% yoy and vindicates our view on pricing pressure. Change in mix towards retail loans (150bps qoq) and competitive pressure are key reasons for same**
- **Stock has underperformed in past 3-6months and is in-sync with our view of impending risk to earnings. Valuations are on the higher side given easing core-mortgage RoE**

Results inline; results vindicate our view of pricing pressures

HDFC Q1FY14 NII at Rs14.6bn (+16% yoy) was lower than consensus estimates of Rs15.3bn. However, aided by higher other income at Rs3.45bn (primarily being in nature of dividend income from HDFC Bank), operating profit at Rs16.4bn grew 17% yoy and was in line with consensus estimates of Rs16.5bn. While reported net profit at Rs11.7bn grew 17% yoy; adjusted for investment gains, net profit grew 19% yoy. NII growth has decelerated to 16% yoy levels vs 21% yoy for past three years and corroborates our view of pricing pressure and the resultant impact thereby on margins. Our Q1FY14 NIM came in at 2.9%, flat yoy, and -108bps qoq. However, the reported spreads at 2.27% were led by improvement in retail spreads (2.01% in Q1FY14 vs 1.96%). **The margins could have been even lower but for just 13.5% yoy growth in borrowings as HDFC shifted some of the short term deposits/advances into loans.**

On the balance sheet front: Loan growth at 19.4% yoy / 4% qoq was largely retail in nature. Retail portfolio (ex-sell down to HDFC Bank) grew 24% yoy / 6% qoq vs mere 11% yoy growth in non-retail loan (corporate + others) portfolio. Disbursements during the quarter grew 17% yoy.

Exhibit 1: Yield analysis

%	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	YoY	QoQ
						bps	bps
Yield on advances	12.9	12.8	12.6	12.9	12.1	-83	-86
Yield on earning funds	11.8	11.6	11.6	11.9	11.1	-70	-83
Yield on total assets	10.9	10.9	11.0	11.3	10.5	-39	-77
Cost of int bearing liab.	9.6	9.7	9.5	8.9	9.3	-23	40
Cost of funds	7.9	8.0	7.7	7.3	7.6	-36	31
Spread	2.2	1.9	2.1	3.0	1.7	-47	-123
Spread (reported)	2.3	2.3	2.3	2.3	2.3	2	-1
NIM (calc)	3.0	2.9	3.2	4.0	2.9	-3	-108

Source: Company, Emkay Research

Financial Snapshot (Standalone)

(Rsmn)

Y/E	Net	Net	EPS	ABV	RoA	RoE	PE	P/ABV
Mar	Income	Profit	(Rs)	(Rs)	(%)	(%)	(x)	(x)
FY12A	59,273	41,226	26.6	127.3	2.6	21.6	30.2	6.3
FY13A	69,412	48,483	29.8	160.1	2.6	21.0	26.9	5.0
FY14E	81,440	56,499	34.6	179.2	2.6	20.2	23.2	4.5
FY15E	93,414	64,234	39.6	198.0	2.5	20.8	20.3	4.1

Exhibit 2: Key financials - Quarterly

Rs mn	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	YoY (%)	QoQ (%)	YTD'14	YTD'13	YoY (%)
Net Interest Income	12,582	12,941	14,757	18,994	14,565	15.8	-23.3	14,565	12,582	15.8
Other Income	2,756	3,476	1,569	2,336	3,451	25.2	47.7	3,451	2,756	25.2
Net Income	15,339	16,417	16,326	21,330	18,016	17.5	-15.5	18,016	15,339	17.5
Total Operating Exp	1,294	1,421	1,380	1,059	1,580	22.1	49.2	1,580	1,294	22.1
As % Of Net Income	8.4	8.7	8.5	5.0	8.8			8.8	8.4	
Employee Expenses	609	621	642	590	744	22.2	26.0	744	609	22.2
As % Of Net Income	4.0	3.8	3.9	2.8	4.1			4.1	4.0	
Other Expenses	510	555	584	286	576	13.1	101.8	576	510	13.1
As % Of Net Income	3.3	3.4	3.6	1.3	3.2			3.2	3.3	
Operating Profit	13,997	14,940	14,888	20,198	16,381	17.0	-18.9	16,381	13,997	17.0
As % Of Net Income	91.3	91.0	91.2	94.7	90.9			90.9	91.3	
Provisions	400	400	400	250	300	-25.0	20.0	300	400	-25.0
PBT	13,799	15,481	15,451	20,997	16,081	16.5	-23.4	16,081	13,799	16.5
Total Tax	3,780	3,970	4,050	5,445	4,350	15.1	-20.1	4,350	3,780	15.1
Adjusted PAT	9,872	10,811	10,690	14,775	11,731	18.8	-20.6	11,731	9,872	18.8
Extra Ordinary Items	-202	-941	-963	-1,049	0	-100.0	-100.0	0	-202	
Reported PAT	10,019	11,511	11,401	15,552	11,731	17.1	-24.6	11,731	10,019	17.1
Reported EPS	6.7	7.0	6.9	9.6	7.6	13.3	-20.6	7.6	6.7	13.3

Source: Company, Emkay Research

Key highlights

- Retail segment drives overall loan growth:** Loan growth at 19.4% yoy / 4% qoq was predominantly led by growth in retail loans (+24% yoy / 6% qoq). Growth in non-retail loan segment (corporate + others) has slowed down to 11% yoy vs 15%yoy for past 4-quarters given tepid credit demand and cautious stance adopted by the management towards the segment.
- Results vindicate our views on margin maintenance:** Growth in NII has slowed down to 16% yoy vs. 21% yoy for past 3-years and clearly vindicates our view on pricing pressure and the impact thereby on margins. This is even as borrowing mix has moved in favor of bonds / debentures and deposits over bank term loans. We are factoring in NIM at 3.2% over FY13-15E
- NIMs could have been lower if not for asset mix change:** In Q1FY14, HDFC's loan book grew by almost Rs65bn and current investments were up Rs34bn, However, almost 50% of the funding has come from redemption of short term deposits and short term advances. As the balance sheet funding gets transmitted into higher borrowings, the margins will be under further pressure.
- Non-interest income aided overall growth; C/income ratio was at sub-9%:** Non-interest income at Rs3.45bn (+25% yoy) was aided by Rs2.2bn of dividend income (largely from HDFC Bank). Adjusted for the same, total income would have grown at 15.3% yoy. Fee income at Rs544mn declined 12% qoq and comprised 1.1% of disbursements (annualized). C/income came in at 8.8% levels.
- Asset quality comfortable; cumulative provisioning at 1% of loans:** Asset quality remains comfortable with overall GNPA at 0.77% with retail GNPA at 0.61% (0.58% in Q4FY13) and non-retail at 1.08% vs 0.91% in Q4FY13. Cumulative provisioning stood at Rs18bn (1% of loans) including NPA provisioning of Rs5.0bn and balance towards contingencies.
- Adequate capital for growth; relaxation in risk weights / provisioning to further cushion overall capital:** Q1FY14 total CAR stood at 16.3% including tier-I CAR at 14%. In a recent move, RBI has lowered risk-weights and provisioning requirement on individual loans across various categories. It has also announced for creation of a separate category 'Residential Housing within the commercial real estate space (CRE)' which would attract a lower risk weight of 75% and provisioning at 75bps vs 100% risk weight / 100bps provisioning on CRE portfolio. While NHB is yet to announce for such relaxation for housing finance companies, for HDFC, if these regulation were to come by, according to management it would improve its overall CAR by ~200bps.

Valuations and view

Q1FY14 results vindicate our view on pricing pressure as reflected from moderating NII growth (16% yoy for Q1FY14 vs. 21%yoy for past 3-years) and the impact thereby on margins. Even as borrowing mix has shifted in favor of bonds / debentures over bank term loans, the current liquidity squeeze will put pressure on overall cost of borrowings. On the asset side, with competitive individual mortgage space and muted growth in non-retail segment, incremental margins will be under pressure for sometime. We have retained our earnings largely intact and are now factoring in 15% CAGR in each NII / PAT over FY13-15E. With impending risk to earnings growth, we continue to retain our REDUCE rating with target price of Rs 760.

Key risks: a) Within the BFSI space, mortgage companies remain the safe bet given their stronger earnings visibility and limited NPA and b) strong revival in corporate segment or faster than expected southward trajectory of interest rates.

Exhibit 3: Loan mix – growth witnessed across all segments

Rs mn	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	YoY (%)	QoQ (%)
Loan portfolio	1,477,773	1,551,270	1,609,410	1,695,710	1,764,827	19.4	4.1
- Individuals	954,129	994,010	1,052,370	1,113,210	1,184,291	24.1	6.4
- Corporate	509,977	537,630	539,350	569,550	566,198	11.0	-0.6
- Others	13,667	19,630	17,690	12,950	14,338	4.9	10.7
% of total	100.0	100.0	100.0	100.0	100.0		
- Individuals	64.6	64.1	65.4	65.6	67.1		
- Corporate	34.5	34.7	33.5	33.6	32.1		
- Others	0.9	1.3	1.1	0.8	0.8		

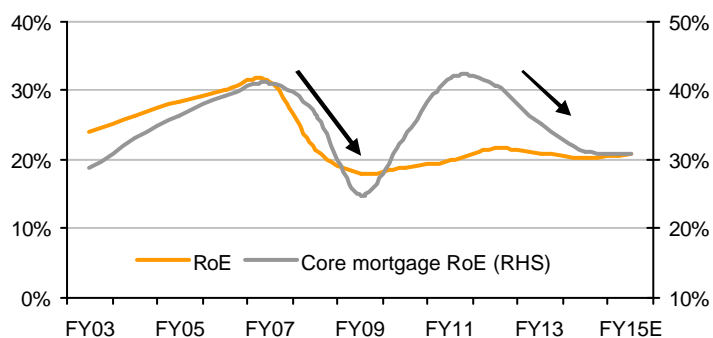
Source: Company, Emkay Research

Exhibit 4: Borrowing profile

Rs mn	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	YoY (%)	QoQ (%)
Borrowings	1,438,116	1,477,900	1,488,700	1,588,280	1,632,690	13.5	2.8
- Term loans	374,844	197,240	136,400	178,240	128,190	-65.8	-28.1
- Bonds, debentures, FCCB & CPs	663,838	798,040	854,670	890,710	967,540	45.7	8.6
- Deposits	399,434	482,620	497,630	519,330	536,960	34.4	3.4
% of total	100.0	100.0	100.0	100.0	100.0		
- Term loans	26.1	13.3	9.2	11.2	7.9		
- Bonds, debentures, FCCB & CPs	46.2	54.0	57.4	56.1	59.3		
- Deposits	27.8	32.7	33.4	32.7	32.9		

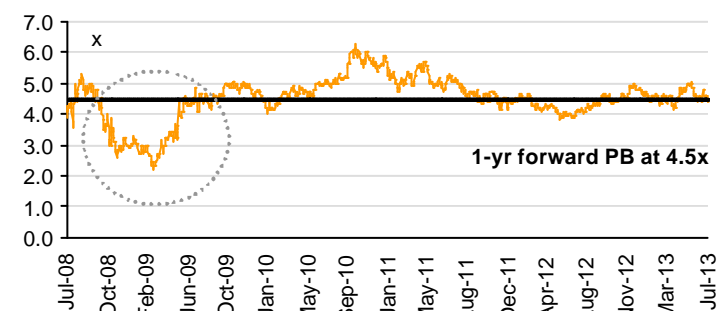
Source: Company, Emkay Research

Exhibit 5: Trend in RoE and core-mortgage RoE



Source: Company, Emkay Research

Exhibit 6: 1-yr forward PB averaged 4.5x for past 5-years



Source: Company, Emkay Research

Exhibit 7: SOTP valuation

	Basis	Period	Rs m	Multiple (x)	Stake (%)	% in total	Value/sh (Rs)
Standalone	BV	FY15ii	218,379	3.0	100.0	56.0	425
HDFC Bank stake (20% holding co discount)	BV	FY15ii	535,770	2.8	23.4	30.0	228
HDFC Standard Life	EV+NBAP	FY15ii	113,704	12.0	72.4	7.0	53
HDFC General Ins	PAT	FY13	1,544	10.0	74.0	1.0	7
HDFC AMC	AUM	FY13	1,021,420	5.0	59.8	2.6	20
HDFC Venture Cap	AUM	FY13ii	19,367	10.0	80.5	0.1	1
Gruh Finance (20% discount)	Mkt val		43,010	0.8	60.6	1.8	14
Unrealised gains - Others	Mkt val		18,000	1.0		1.5	12
Total						100	760

Source: Emkay Research

Key Financials

Income Statement

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Net interest income	49,983	59,275	67,659	77,722
Other income	9,290	10,137	13,781	15,691
Net income	59,273	69,412	81,440	93,414
Operating expenses	4,519	5,389	6,447	7,485
Pre provision profit	54,754	64,023	74,993	85,929
PPP excl treasury	0	0	0	0
Provisions	800	1,450	2,372	2,827
Profit before tax	53,954	62,573	72,621	83,102
Tax	15,430	17,245	20,103	22,853
Tax rate	28.6	27.6	27.7	27.5
Profit after tax	41,226	48,483	56,499	64,234

Balance Sheet

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Liabilities				
Equity	2,954	3,093	3,093	3,093
Reserves	187,222	246,969	279,718	313,888
Net worth	190,176	250,062	282,810	316,980
Deposits	1,391,275	1,588,280	1,834,463	2,146,322
Borrowing & Others	93,749	97,481	108,060	117,689
Total liabilities	1,675,199	1,935,823	2,225,334	2,580,992
Assets				
Cash and bank	124,910	84,689	84,463	84,248
Investments	122,070	136,135	130,287	133,678
Customer assets	1,408,746	1,695,710	1,992,200	2,345,554
Others	19,474	19,289	18,321	17,450
Total assets	1,675,199	1,935,823	2,225,334	2,580,992

Key Ratio (%)

Y/E Mar (Rsmn)	FY12A	FY13A	FY14E	FY15E
Spreads	2.7	2.5	2.2	2.2
Non-Il/avg assets	0.6	0.6	0.7	0.7
Fee income/avg assets	0.0	0.0	0.0	0.0
Opex/avg assets	0.3	0.3	0.3	0.3
Provisions/avg assets	0.1	0.1	0.1	0.1
PBT/avg assets	3.7	3.6	3.7	3.6
Tax/avg assets	1.0	1.0	1.0	1.0
RoA	2.7	2.7	2.7	2.7
RoAE	21.6	21.0	20.1	20.4
GNPA (%)	0.8	0.7	0.7	0.7
NNPA (%)	0.2	0.1	0.1	0.1

Valuation Table

Y/E Mar	FY12A	FY13A	FY14E	FY15E
Net profit (Rs mn)	41,226	48,483	56,499	64,234
Shares in issue (mn)	1,477	1,546	1,546	1,546
EPS (Rs)	27.9	31.4	36.5	41.5
PER (x)	30.5	27.1	23.3	20.5
FDEPS(Rs)	26.6	29.8	34.6	39.6
FDPER (x)	33.3	29.7	25.5	22.3
Book value (Rs)	128.8	161.7	181.1	200.2
P/BV (x)	6.2	5.0	4.4	4.0
Adj book value (Rs)	127.3	160.1	179.2	198.0
P/ABV (x)	6.3	5.0	4.5	4.1
P/PPP (x)	21.7	19.4	16.6	14.5
Dividend yield (%)	1.4	1.6	1.8	2.1

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