

## EARNINGS REVIEW

## Housing Development Finance Corporation

Sell

Equity Research

## Below expectations on lower top line/spreads; Retain Sell

## What surprised us

HDFC reported 1QFY14 PAT of Rs11.7bn (+17% yoy), 6% below GSe and 2% below Bloomberg consensus. Adjusting for dividends, PAT grew 13.5% yoy and missed our estimates by 11%. **Key highlights: 1) NII** came in at Rs15.2bn (+17% yoy), 10% below Gse as cost of funds (calculated) came in higher than our estimates. **2) Lending spreads** (calculated) declined 34bp yoy on higher cost of funds and lower yields as high yield developer book grew at a modest pace of 11% yoy. **3) Non-interest income** was 6% ahead of Gse on higher dividend (Rs 2.2bn, +28% vs Gse) and fee income (+4% vs Gse, +12% yoy) while capital gains booked during the quarter were nil. **4) Disbursements** grew a healthy 17% yoy, 2% above GSe, driven by the individuals segment. Loan book grew 19% yoy, led by loans to individuals, which grew a strong 24% yoy (+6% qoq). **5) Asset quality** remained stable as gross NPLs were at 0.8% of loans but NPLs on the non-individual loan book have now moved up to 1.1% (+17bps qoq and +8bps yoy). HDFC booked provisions of Rs300mn (33% below GSe) vs. GSe of Rs448mn. Going forward, with the interest rate shifting upwards (1Y/10Y yields up 40-140bps respectively), lending spreads could remain under pressure in the coming quarters.

## What to do with the stock

We fine tune our FY14E-FY16E EPS estimates to incorporate trends seen in 1QFY13 but retain our 12m SOTP-based TP of Rs740. HDFC is currently trading at 3.5X FY14E core mortgage book and 18X standalone FY14E EPS, valuations which are at a premium and not reflective of the rising competition in the housing finance space which could put pressure on profitability. **Risks:** higher spreads, lower-than-estimated competition.

## HDFC: Summary of estimates

Rs mn	FY14E	FY15E	FY16E	Y-o-Y Growth (%)		
				FY14E	FY15E	FY16E
NII	69,984	80,547	93,118	13%	15%	16%
PAT	54,028	62,003	71,387	11%	15%	15%
Advances	2,012,398	2,324,318	2,679,203	18%	15%	15%

Source: Company data, Goldman Sachs Research estimates.

## INVESTMENT LIST MEMBERSHIP

Asia Pacific Sell List

## Coverage View: Neutral

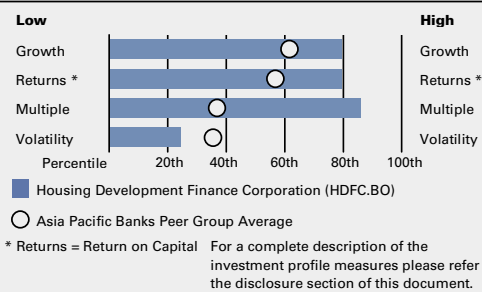
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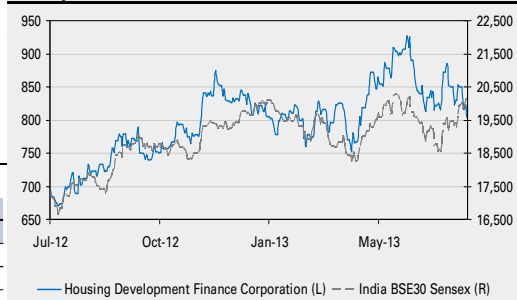
## Investment Profile



Key data	Current
Price (Rs)	803.50
12 month price target (Rs)	740.00
Market cap (Rs mn / US\$ mn)	1,242,492.2 / 20,845.4
Foreign ownership (%)	73.7

	3/13	3/14E	3/15E	3/16E
EPS (Rs) New	31.35	34.76	39.90	45.93
EPS revision (%)	0.0	(1.1)	1.7	1.0
P/B (X)	4.6	4.4	4.0	3.5
P/E (X)	23.7	23.1	20.1	17.5
Dividend yield (%)	1.7	1.7	2.0	2.3
P/PPOP (X)	18.5	16.4	14.3	12.4
PPOP growth (%)	16.9	12.7	14.8	15.1
Preprovision ROA (%)	3.7	3.6	3.6	3.6
Credit cost (%)	0.1	0.1	0.1	0.1
ROA (%)	2.67	2.55	2.54	2.56
ROE (%)	22.0	20.3	20.8	21.4

## Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(1.9)	(2.3)	15.9
Rel. to India BSE30 Sensex	(7.4)	(2.8)	(0.7)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 7/19/2013 close.

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# Housing Development Finance Corporation: Summary Financials

Profit model (Rs mn)	3/13	3/14E	3/15E	3/16E	Balance sheet (Rs mn)	3/13	3/14E	3/15E	3/16E
Net interest income	61,840.6	69,984.3	80,547.0	93,117.6	Gross loans	1,704,118.0	2,017,630.5	2,330,295.8	2,686,093.5
Non-interest income	10,726.7	11,759.2	13,433.7	15,235.8	NPLs	11,988.6	15,093.0	17,366.8	20,018.4
Operating revenue	72,567.3	81,743.5	93,980.8	108,353.4	Loan loss reserves	3,656.3	5,232.2	5,977.6	6,890.3
Non-interest expense	(5,388.9)	(6,012.6)	(7,058.3)	(8,273.9)	<b>Total interest earning assets</b>	<b>1,804,210.0</b>	<b>2,126,311.5</b>	<b>2,453,483.1</b>	<b>2,822,749.6</b>
Preprovision operating profit	67,178.4	75,730.8	86,922.5	100,079.5	Other non-interest earning assets	151,097.5	147,710.7	152,337.6	157,101.9
Total provision charge	(1,450.0)	(1,685.0)	(1,946.2)	(2,243.3)	<b>Total assets</b>	<b>1,955,307.5</b>	<b>2,274,022.2</b>	<b>2,605,820.6</b>	<b>2,979,851.5</b>
Associates	0.0	0.0	0.0	0.0	Customer deposits	519,328.2	597,227.4	686,811.5	789,833.3
Pretax profit	65,728.4	74,045.9	84,976.3	97,836.2	Total interest-bearing liabilities	1,588,281.1	1,859,370.1	2,151,549.6	2,480,643.8
Tax	(17,245.0)	(20,018.0)	(22,973.0)	(26,449.6)	<b>Total equity</b>	<b>250,000.0</b>	<b>281,054.7</b>	<b>313,992.7</b>	<b>351,915.5</b>
Minorities	--	--	--	--	<b>CAMEL ratios (%)</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>
<b>Net profit</b>	<b>48,483.4</b>	<b>54,027.8</b>	<b>62,003.3</b>	<b>71,386.6</b>	C: Tier 1 capital ratio	13.9	16.3	15.9	15.6
Dividends	(19,329.3)	(21,647.8)	(24,843.4)	(28,603.1)	C: Equity/loans	14.7	14.0	13.5	13.1
Dividends payout (%)	39.9	40.1	40.1	40.1	C: Equity/assets	12.8	12.4	12.0	11.8
<b>Earnings growth drivers (%)</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>	A: NPL ratio	0.7	0.7	0.7	0.7
Net interest margin	3.40	3.31	3.30	3.33	A: Loan loss reserves/NPLs	30.5	34.7	34.4	34.4
Provision charge/total loans	0.09	0.08	0.08	0.08	E: Net interest margin	3.40	3.31	3.30	3.33
<b>YoY Growth (%)</b>					E: Non int inc/oper revenues	14.78	14.39	14.29	14.06
Customer deposits	--	--	--	--	E: Cost-income ratio	7.4	7.4	7.5	7.6
Loans	20.7	18.3	15.5	15.3	E: ROAA	2.67	2.55	2.54	2.56
Net interest income	16.1	13.2	15.1	15.6	L: Loan/deposit ratio	327.4	337.0	338.4	339.2
Fee income	(10.1)	15.0	12.5	15.0	<b>Loan portfolio (%)</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>
Non-interest income	23.4	9.6	14.2	13.4	Commercial & corporate	NM	NM	NM	NM
Operating revenue	17.1	12.6	15.0	15.3	Mortgages/home loans	100.0	100.0	100.0	100.0
Operating expenses	(19.3)	(11.6)	(17.4)	(17.2)	Consumer	NM	NM	NM	NM
<b>Preprovision operating profit</b>	<b>16.9</b>	<b>12.7</b>	<b>14.8</b>	<b>15.1</b>	<b>Valuation (current price)</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>
Provision charges	81.3	16.2	15.5	15.3	P/E basic (X)	23.7	23.1	20.1	17.5
Pretax profit	16.0	12.7	14.8	15.1	P/B (X)	4.60	4.44	3.98	3.55
Net profit	17.6	11.4	14.8	15.1	P/PPOP (X)	18.5	16.4	14.3	12.4
EPS	12.3	10.9	14.8	15.1	Dividend yield (%)	1.7	1.7	2.0	2.3
DPS	13.6	11.4	14.8	15.1	EPS, basic (Rs)	31.35	34.76	39.90	45.93
<b>Market dimensions</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>	EPS, fully-diluted (Rs)	31.35	34.76	39.90	45.93
No of branches	331.0	350.0	350.0	350.0	EPS, basic growth (%)	12.3	10.9	14.8	15.1
No of staff (000)	1.8	1.9	1.9	2.0	EPS, fully diluted growth (%)	12.3	10.9	14.8	15.1
Revenues/staff (Rs)	727,557.3	767,157.1	820,357.1	927,478.3	BVPS (Rs)	161.67	180.85	202.04	226.44
Net profit/staff (Rs)	486,092.9	507,047.8	541,226.0	611,051.5	DPS (Rs)	12.50	13.93	15.99	18.40
<b>DuPont analysis (%)</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>					
ROE	22.0	20.3	20.8	21.4					
x leverage	12.1	12.6	12.2	11.9					
= ROA	2.67	2.55	2.54	2.56					
<b>% of assets</b>	<b>3/13</b>	<b>3/14E</b>	<b>3/15E</b>	<b>3/16E</b>					
Net interest income	3.40	3.31	3.30	3.33					
Fee income	0.13	0.13	0.13	0.13					
Non-interest income	0.59	0.56	0.55	0.55					
Operating revenue	3.99	3.87	3.85	3.88					
Operating expenses	0.30	0.28	0.29	0.30					
Preprovision operating profit	3.70	3.58	3.56	3.58					
Loan loss provisions	0.08	0.08	0.08	0.08					
Pretax profits	3.62	3.50	3.48	3.50					
Taxes	0.95	0.95	0.94	0.95					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

**Exhibit 1: HDFC reported 1QFY14 PAT below expectations as NII missed**  
**HDFC 1QFY14 results snapshot**

HDFC						Var.			Act vs est
	Rs mn unless stated	Q1FY13	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q1FY14E	Q-o-Q (%/bp)	
<b>Income statement</b>									
Interest income	46,934	49,284	50,614	53,918	52,854	52,997	-2%	13%	0%
Interest on housing loans	44,012	46,024	48,433	50,985	50,351	50,598	-1%	14%	0%
Income from investments	2,922	3,260	2,181	2,933	2,503	2,399	-15%	-14%	4%
Interest expenses	33,882	35,414	35,215	34,398	37,633	36,100	9%	11%	4%
<b>Net interest income</b>	<b>13,052</b>	<b>13,870</b>	<b>15,399</b>	<b>19,520</b>	<b>15,221</b>	<b>16,897</b>	<b>-22%</b>	<b>17%</b>	<b>-10%</b>
<b>yoy growth (%)</b>	<b>19%</b>	<b>11%</b>	<b>24%</b>	<b>12%</b>	<b>17%</b>	<b>29%</b>			
<b>Non interest income</b>	<b>2,489</b>	<b>3,489</b>	<b>1,890</b>	<b>2,859</b>	<b>2,795</b>	<b>2,637</b>	<b>-2%</b>	<b>12%</b>	<b>6%</b>
<b>Fee income</b>	<b>618</b>	<b>525</b>	<b>391</b>	<b>879</b>	<b>544</b>	<b>522</b>	<b>-38%</b>	<b>-12%</b>	<b>4%</b>
Dividends	1,596	1,945	452	814	2,171	1,699	167%	36%	28%
Capital Gains	202	941	963	1,049	0	300	-100%	-100%	-100%
Other income	74	78	84	116	80	116	-31%	9%	-31%
<b>Total income</b>	<b>15,541</b>	<b>17,358</b>	<b>17,290</b>	<b>22,379</b>	<b>18,016</b>	<b>19,534</b>	<b>-19%</b>	<b>16%</b>	<b>-8%</b>
<b>Operating expenses</b>	<b>1,294</b>	<b>1,421</b>	<b>1,380</b>	<b>1,059</b>	<b>1,580</b>	<b>1,684</b>	<b>49%</b>	<b>22%</b>	<b>-6%</b>
Salary	609	621	642	590	744	784	26%	22%	-5%
Other costs	685	800	738	468	836	900	78%	22%	-7%
Depreciation	48	56	59	73	55	57	-24%	16%	-3%
<b>Preprovision profit</b>	<b>14,199</b>	<b>15,881</b>	<b>15,851</b>	<b>21,247</b>	<b>16,381</b>	<b>17,793</b>	<b>-23%</b>	<b>15%</b>	<b>-8%</b>
Provisions	400	400	400	250	300	448	20%	-25%	-33%
Profit before tax	13,799	15,481	15,451	20,997	16,081	17,345	-23%	17%	-7%
Tax	3,780	3,970	4,050	5,445	4,350	4,857	-20%	15%	-10%
<b>Net profit</b>	<b>10,019</b>	<b>11,511</b>	<b>11,401</b>	<b>15,552</b>	<b>11,731</b>	<b>12,488</b>	<b>-25%</b>	<b>17%</b>	<b>-6%</b>
<b>yoy growth (%)</b>	<b>19%</b>	<b>19%</b>	<b>16%</b>	<b>17%</b>	<b>17%</b>	<b>25%</b>			
Effective tax rate(%)	27%	26%	26%	26%	27%	28%	4%	-1%	-3%
PBDT+provisions	14,173	15,860	15,826	21,204	16,356	17,734	-23%	15%	-8%
<b>yoy growth (%)</b>	<b>19%</b>	<b>17%</b>	<b>17%</b>	<b>15%</b>	<b>15%</b>	<b>25%</b>			
PBT and capital gains	13,523	14,463	14,404	19,832	16,001	16,929	-19%	18%	-5%
<b>yoy growth (%)</b>	<b>17%</b>	<b>16%</b>	<b>17%</b>	<b>14%</b>	<b>18%</b>	<b>25%</b>			
<b>Key balance sheet items (Rs mn)</b>									
Disbursements	156,427	250,668	142,905	274,520	183,184	179,891	-33%	17%	2%
<b>yoy growth (%)</b>	<b>20%</b>	<b>21%</b>	<b>-11%</b>	<b>29%</b>	<b>17%</b>	<b>15%</b>			
Advances	1,482,623	1,551,280	1,609,410	1,700,462	1,769,928	1,774,074	4%	19%	0%
<b>yoy growth (%)</b>	<b>19%</b>	<b>22%</b>	<b>22%</b>	<b>21%</b>	<b>19%</b>	<b>19.7%</b>			
Individual loans	954,129	994,012	1,052,370	1,113,207	1,184,291	1,170,889	6%	24%	1%
Non-individual loans	509,977	537,633	539,350	569,567	566,198	585,444	-1%	11%	-3%
Loans sold down	3,005	25,180	7,204	16,360	14,355	3,683			
Net investments	151,825	150,241	145,780	136,135	171,991	136,131	26%	13%	26%
Networth	204,656	244,269	255,481	250,000	264,096	264,484	6%	29%	0%
Total assets	1,741,912	1,806,371	1,837,699	1,955,308	2,022,678	2,034,715	3%	16%	-1%
Total Borrowings	1,438,116	1,477,900	1,488,700	1,588,281	1,632,690	1,652,864	3%	14%	-1%
<b>Key Ratios</b>									
Yield on loans	12.18	12.14	12.26	12.32	11.61		(72)	(57)	
Average cost of funds	9.58	9.72	9.50	8.94	9.35		40	(23)	
NIMs (pre provisions)	3.06	3.13	3.39	4.12	3.06		(106)	1	
Reported spreads	2.27	2.27	2.28	2.30	2.29		(1)	2	
Reported spreads on individual loans			1.95	1.96	2.01				
Reported spreads on non-individual loans			2.79	2.94	2.82				
<b>Capital adequacy</b>									
Overall CAR(%)	14.6	16.7	17.5	16.4	16.3				
Tier I CAR(%)	11.8	14.1	14.9	13.9	14.0				
<b>Asset quality</b>									
Gross NPL (% of loans)	0.80	0.78	0.76	0.71	0.77		7	(3)	
Reported NPLs on individual loans	0.67			0.58	0.61				
Reported NPLs on non-individual loans	1.00			0.91	1.08				
Net NPL (% of loans)	0.49	0.49	0.49	0.49	0.49				

Source: Company data, Goldman Sachs Research estimates.

# Disclosure Appendix

## Reg AC

We, Rahul Jain, Tabassum Inamdar, CFA, Venkat Surapaneni and Shyam Srinivasan, CFA, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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**Growth** is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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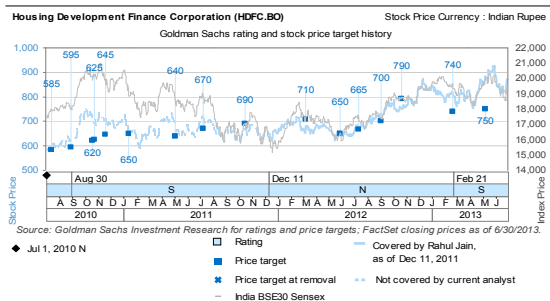
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