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Housing Development Finance Corporation

Evergreen

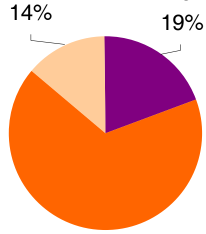
Stock Update

Growing steadily despite competition

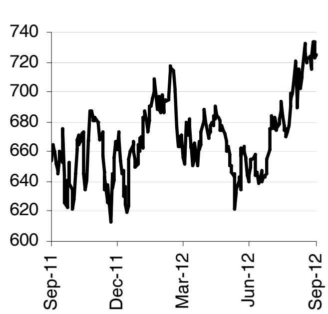
Buy; CMP: Rs724

Company details	
Price target:	Rs785
Market cap:	Rs108,601 cr
52-week high/low:	Rs741/ 600
NSE volume: (no. of shares)	30.1 lakh
BSE code:	500010
NSE code:	HDFC
Sharekhan code:	HDFC
Free float: (no. of shares)	148.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.3	14.9	9.9	11.2
Relative to Sensex	1.7	4.4	9.6	5.5

We interacted with the management of HDFC recently to understand the impact of the rising competition in the mortgage segment on the company and the other industry trends. According to the management, the spate of rate cuts announced by banks for mortgage loans will not have any impact on HDFC's business growth as the company enjoys a premium of 25-50 basis points in interest rates due to its better servicing levels and lower turn-around time compared with its peers. Except for State Bank of India (SBI), the other public sector banks (PSBs) are unlikely to provide any major competition to HDFC. Further, the company continues to focus on the quality of its book instead of market share. Hence, it should be able to grow the book at 20% in FY2013. The spreads are likely to be maintained within the guided range of 2.15-2.35% (2.27% in Q1FY2013). We believe the company is well capitalised and better equipped to face the competition. We estimate its earnings would expand at a compounded annual growth rate (CAGR) of 19% over FY2012-14. We maintain our Buy recommendation on HDFC with a sum-of-the-parts (SOTP)-based price target of Rs785 (valuing the subsidiaries and the investments at Rs235 per share).

Growing competition unlikely to have a significant impact on growth and spreads

Given the spate of rate cuts announced by the PSBs as well as the private banks, and the slowing of the credit growth in the corporate segment, the competition has intensified in the mortgage segment. However, since the difference in the lending rates of banks and HDFC is not significant, it's unlikely to affect the company. Normally, HDFC enjoys an interest rate premium of 25-50 basis points compared with its peers due to its better servicing levels and turn-around time. Further, the company's priority remains maintaining the quality of its book rather than market share. Hence, it should be able to grow its book at a steady rate. The management believes that barring SBI there is not much formidable competition to the company.

Increased contribution from newer geographies to support growth

HDFC's growing presence and distribution network (~2,400 towns and cities) resulted in an increased business contribution from the newer geographies. The traction in retail disbursements (up 23% year on year in Q1FY2013) continues which accounts for about 66% of the total loans disbursed. While the slowdown continues in the residential properties within the metro regions (metro + tier-I cities = ~55% of the volume), the incremental growth from the tier-II and tier-III cities is likely to support the disbursement growth going ahead.

Spreads to remain in the guided range

The spreads have consistently remained in the range of 2.15-2.35% as guided by the management. While the spreads for the developers' loans are around 2.8%, the retail spreads are 1.93%, which gets compensated by the lower risk weightage and provisions. The proportion of borrowings from NCDs increased (46% in Q1FY2013 vs 36% in Q1FY2012) due to HDFC's lower costing compared with banks. Going ahead, the re-pricing of the dual-rate loans coupled with the easing of the funding cost will cushion the spreads.

Asset quality stays robust; provision write-backs will aid earnings growth

Due to stringent risk management practices the asset quality of HDFC remains robust and the quality is likely to sustain going ahead. HDFC continues to carry surplus provisions as it has provisions of Rs1,711 crore against non-performing assets of Rs1,190 crore. Also, the company had provided 2% for the dual-rate home loans (as required by the regulator). Of these 0.4% will be retained as standard asset provisions while the remaining will get reversed in FY2014. This will aid the earnings growth. We estimate the earnings would grow at about 19% over FY2012-14.

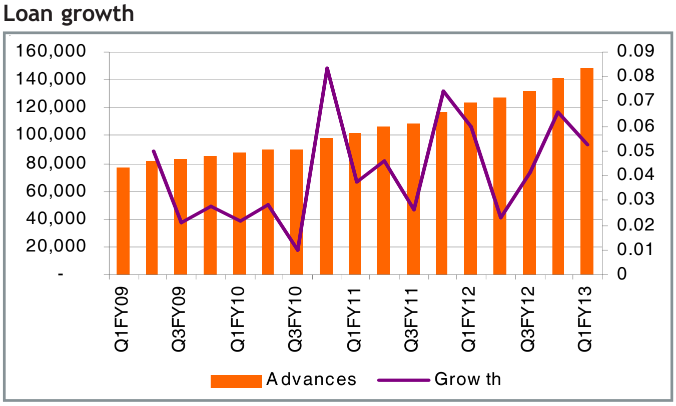
Comfortable capital position

HDFC's capitalisation remains comfortable as its capital adequacy ratio stands at 14.6% against 12% required by the National Housing Board (NHB). Recently, almost 100% of the warrants issued by HDFC got converted which improves the capitalisation levels. The management believes the capital requirement will remain unchanged (also affirmed by the NHB) for the housing finance companies, given the higher risk weightage. Going ahead, the management does not expect any dilution in equity as the subsidiaries (insurance etc) etc are in a self-funding mode and the surplus could be infused into HDFC Bank, if required.

Valuation

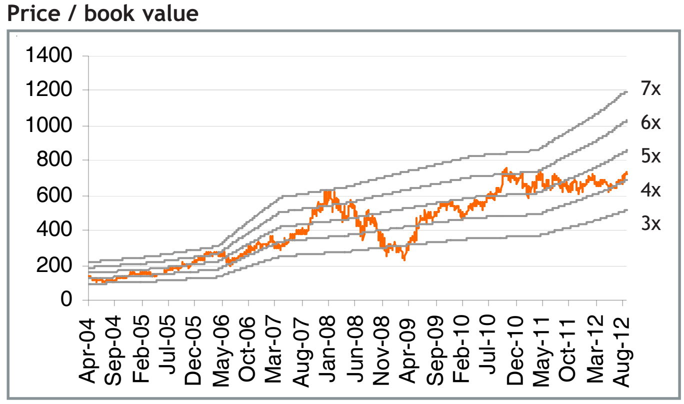
We believe the company is well capitalised and better equipped to take on the competition and estimate its earnings would expand at a CAGR of 19% over FY2012-14. We maintain our Buy recommendation on HDFC with an SOTP-based price target of Rs785 (valuing the subsidiaries and the investments at Rs235 per share).

Loan growth



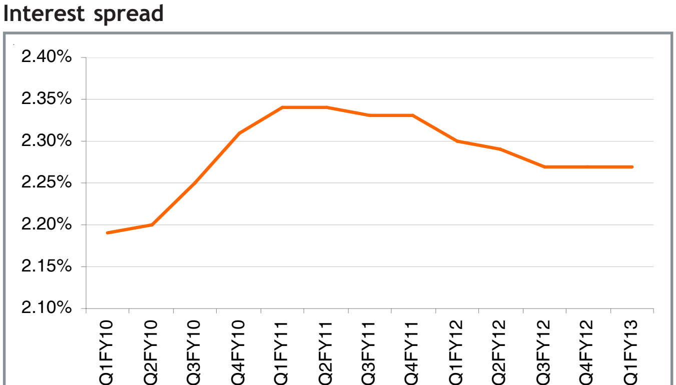
Source: Company

Price / book value



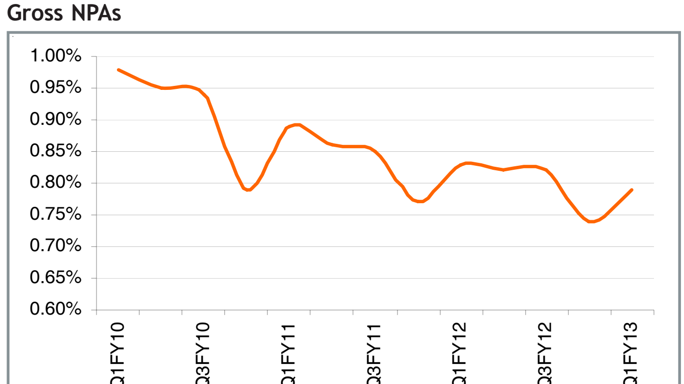
Source: Company

Interest spread



Source: Company

Gross NPAs



Source: Company

Financials

Profit & Loss statement

(Rs cr)

Particulars	FY10	FY11	FY12	FY13E	FY14E
Net interest income	3,388	4,247	4,998	6,110	7,569
Other income	910	1,072	1,199	1,347	1,515
Operating expenses	306	362	431	520	629
Operating profit	3,992	4,957	5,766	6,937	8,454
Depreciation & provision	76	89	101	146	170
PBT	3,916	4,868	5,666	6,791	8,284
Tax	1,090	1,332	1,543	1,902	2,402
PAT before EO	2,826	3,536	4,123	4,890	5,882

Balance sheet

(Rs cr)

Particulars	FY10	FY11	FY12	FY13E	FY14E
Liabilities					
Equity capital	287	293	295	307.2	307.2
Reserves & surplus	14,911	17,023	17,822	23,509	29,783
Networth	15,198	17,317	18,118	23,817	30,090
Borrowings	96,565	115,410	139,128	164,034	194,623
Term loans	32,137	42,490	40,697	50,627	63,638
Bonds, debentures	41,347	48,296	62,138	68,041	74,505
Deposits	23,081	24,625	36,293	45,366	56,481
Current liabilities & provisions	4,878	6,775	10,275	11,302	12,432
Total liabilities	116,641	139,502	167,520	199,152	237,145
Assets					
Loans	97,967	117,127	140,422	168,506	202,713
Investments	10,727	11,832	12,207	13,672	15,278
Deferred tax asset	286	448	628	722	831
Current assets, loans and advances	7,439	9,861	14,029	15,993	18,072
Net block	222	234	234	259	252
Total assets	116,641	139,502	167,520	199,152	237,145

Key ratios

Particulars	FY10	FY11	FY12	FY13E	FY14E
Per share data					
EPS	19.7	24.1	27.9	31.8	38.3
BV	105.9	118.1	122.7	155.1	195.9
ABV	84.8	96.6	100.2	132.3	172.0
Spreads (%)					
Yield on funds	9.6	9.2	10.6	10.03	9.65
Cost of funds	7.8	7.1	8.8	8.0	7.8
Net interest margins	3.1	3.3	3.3	3.3	3.5
Operating ratios (%)					
Interest expended/ Interest earned	67.6	64.0	69.1	66.6	65.0
Cost to income	7.1	6.8	7.0	7.0	6.9
Non interest income/ Total income	8.0	8.3	6.9	6.9	6.6
Return ratios (%)					
RoE	18.6	20.4	22.8	20.5	19.5
RoA	2.6	2.8	2.7	2.7	2.7
Assets/Equity	7.7	8.1	9.2	8.4	7.9
Growth ratios (%)					
Net interest income	10.9	25.4	17.7	22.2	23.9
PPP	21.5	24.2	16.3	20.3	21.9
PAT	23.8	25.1	16.6	18.6	20.3
Advances	15.0	19.6	19.9	20.0	20.3
Deposits	15.2	19.5	20.6	17.9	18.6
Valuation ratios (%)					
P/E	36.8	30.1	26.0	22.8	18.9
P/BV	6.8	6.1	5.9	4.7	3.7
P/ABV	8.5	7.5	7.2	5.5	4.2

Cement

Sector Update

August 2012 dispatches affected by monsoon

- **Cumulative volume of pan-India players declined by 4.9% YoY in August 2012:** The volume growth of the two largest domestic cement players, ACC and Ambuja Cement, was affected by the monsoon rains during August 2012. ACC has posted a year-on-year (Y-o-Y) decline of 6.9% in its dispatches for the month. On the other hand, Ambuja Cement has posted a 2.4% Y-o-Y contraction in its dispatches for the same period. Hence, the cumulative dispatches of the pan-India players declined by 4.9% year on year (YoY). On a sequential basis (ie compared with the July 2012 figures), the cumulative dispatches of the pan-India players declined by 10.5%.

- **Cement offtake affected by monsoon:** In terms of demand, cement dealers have confirmed that the cement offtake in most parts of the country was affected by the monsoon season. The cement offtake in the northern, western and central regions was relatively better due to improved rural consumption and a partial pick-up in the execution of infrastructure projects. However, the slowdown in the demand in the southern region continued during August 2012. Going ahead, the dealers expect the cement offtake to remain muted till mid October 2012.

- **Cement prices declined by around Rs12-15/bag in most parts of India:** During August 2012, the cement prices corrected by an average of Rs12-15/bag in most parts of the country on account of the seasonal weakness (due to the monsoon rains). The correction in the cement prices was more severe in the southern region. According to the dealers, the cement prices may fall further in September 2012 due to a lacklustre demand environment. After taking into account the seasonal decline, we expect the average realisation for FY2013 to be higher (marginally) as compared with that in FY2012.

- **Outlook: remain positive on UltraTech and Orient Paper:** With the likely increase in the infrastructure spending in H2FY2013 and strong rural consumption, we expect the demand to grow at around 8% in FY2013 against the 6.3% growth witnessed in FY2012. This would be achieved on the back of higher volumes and price realisations. The concern remains in terms of cement makers' failure to adhere to supply discipline which could be a key risk to the cement prices. Additional concerns remain in terms of cost pressures due to a sharp increase in the power tariff and an increase in the freight cost due to a rise in fuel prices and the lead distance.

  We maintain our neutral stand on the sector. However, we are selectively positive on UltraTech Cement in the large-cap space and Orient Paper and Industries in the mid-cap space.

Player-wise dispatches (in million tonne)

Particulars	Aug-12	Aug-11	YoY %	Jul-12	MoM %
ACC	1.75	1.88	-6.9	1.88	-6.9
Ambuja Cements	1.45	1.49	-2.4	1.70	-14.6
Total pan-India players	**3.20**	**3.37**	**-4.9**	**3.58**	**-10.5**

ACC: poor performance compared with other large player likes Ambuja Cement

ACC's dispatches for August 2012 declined by 6.9% to 1.75mmt compared with that in August 2011. On a month-on-month (M-o-M) basis also, the company's dispatches declined by 6.9%. On a year-till-date (YTD) basis (ie January-August 2012), the company has registered a growth of just 2.2% in its dispatches. Going ahead, we expect the volume growth of the company to improve on account of the stabilisation of its new capacities at Bargarh and Chanda. Further, the company is also planning to set up a clinker unit in the eastern region with a capacity of 2.8mtpa to cater to the growing demand in the eastern region. The project is expected to come on stream by Q1FY2015.

Ambuja Cement: dispatches declined by 2.4% YoY

Ambuja Cement's dispatches for August 2012 declined by 2.4% YoY to 1.45mmt. The production during the month decreased by 3.9% YoY. On a sequential basis (ie compared with July 2012), the dispatches of the company declined by 14.6% which reflects the impact of the monsoon. The capacity for the month increased to 27mtpa from 18.5mtpa in the previous year.

Cement price update

Prices declined in August 2012, more correction likely in near term

- During August 2012, the cement prices corrected by an average of Rs12-15/bag in most parts of the country on account of the seasonal weakness (due to the monsoon rains). The correction in the cement prices was more severe in the southern region. According to the dealers, the cement prices may fall further in September 2012 due to a lacklustre demand environment. After taking into account the seasonal decline, we expect the average realisation for FY2013 to be higher (marginally) as compared with the average realisation of FY2012.

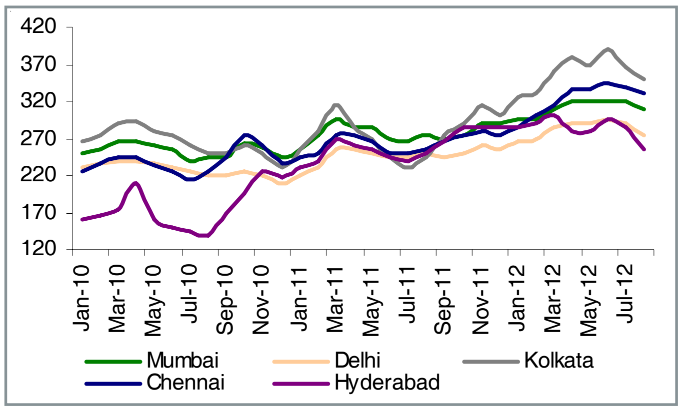
- As per our recent channel check, the cement prices in Mumbai and the other cities of Maharashtra decreased by Rs10-12/bag to around Rs310 during August 2012. The cement offtake was affected in the city primarily due to the monsoon. Hence, cement prices are expected to correct more in the near term. In Gujarat also cement prices corrected (Rs10/bag); currently the average price of cement in the state is around Rs255-260/bag.

- The cement prices in Kolkata witnessed a correction of Rs15/bag during August 2012. Almost all the companies have decreased their prices in the city and the nearby areas. With the price cut in August 2012, the average price of cement is around Rs350/bag, which is the highest in the country. The dealers are of the view that the prices could come under more pressure in the near term due to the seasonal weakness.

- In the southern region, Hyderabad continues to witness a sluggish demand but the cement offtake has partially recovered in the other areas of Andhra Pradesh. The cement prices in Hyderabad corrected sharply by around Rs30/bag in August on an M-o-M basis and stood at Rs255/bag. As per the dealers, the cement offtake in Hyderabad is expected to be lacklustre going ahead in the absence of any major infrastructure project by the state government. In the other states of the southern region, like Karnataka, Tamil Nadu and Kerala, the demand environment is relatively better. In Chennai the prices have declined by Rs20/bag to Rs320-325/bag.

- Further, the cement offtake in the major cities of Gujarat, like Baroda, Surat, Ahmedabad and Mehsana was affected adversely during the month due to the monsoon season. The cement prices declined by Rs10-15/bag during August 2012 and currently the average price of cement in the major cities of Gujarat stands at Rs255-260 per bag. The cement prices are likely to correct by Rs10-15/bag in most parts of the country in the near term.

Cement price trend in major cities



Source: Cement dealers

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a postition in the companies mentioned in the article.

Sharekhan Stock Idea

Evergreen

GlaxoSmithKline Consumer Healthcare
Housing Development Finance Corporation
HDFC Bank
Infosys
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Auto
Bajaj FinServ
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Corporation Bank
Crompton Greaves
Divi's Laboratories
GAIL India
Glenmark Pharmaceuticals
Godrej Consumer Products
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Oil India
Piramal Enterprises (Piramal Healthcare)
PTC India
Punj Lloyd
Sintex Industries
State Bank of India
Tata Global Beverages (Tata Tea)
Wipro

Cannonball

Allahabad Bank
Andhra Bank
IDBI Bank
Madras Cements
Shree Cement

Emerging Star

Axis Bank (UTI Bank)
Cadila Healthcare
Eros International Media
Gateway Distriparks
Greaves Cotton
IL&FS Transportation Networks
IRB Infrastructure Developers
Kalpataru Power Transmission
Max India
Opto Circuits India
Thermax
Yes Bank
Zydus Wellness

Ugly Duckling

AGC Networks
Ashok Leyland
Bajaj Corp
CESC
Deepak Fertilisers & Petrochemicals Corporation
Dishman Pharmaceuticals & Chemicals
Federal Bank
Gayatri Projects
India Cements
Ipca Laboratories
Jaiprakash Associates
Kewal Kiran Clothing
Mcleod Russel India
NIIT Technologies
Orbit Corporation
Polaris Financial Technology
Pratibha Industries
Provogue India
Punjab National Bank
Ratnamani Metals and Tubes
Raymond
Selan Exploration Technology
Sun Pharmaceutical Industries
Torrent Pharmaceuticals
UltraTech Cement
Union Bank of India
United Phosphorus
V-Guard Industries

Vulture's Pick

Mahindra Lifespace Developers
Orient Paper and Industries
Tata Chemicals
Unity Infraprojects