

HDFC Ltd

ADD

Shelter from the storm

CMP: Rs674

Target Price: Rs700

Steady quarter despite increasingly challenging environment. In an operating environment that was turning increasingly challenging, HDFC reported yet another steady quarter. More importantly, management continues to expect 18-20% loan growth going forward, which we expect should translate in to close to 20% net profit growth for full year FY12.

Core revenue growth trends were slightly weak as NII was up 17% yoy (19% in Q1FY12), driven by 20% loan growth (24% ex. loans sold). Interest expenses accelerated, up 57%, although this was mostly offset by interest income growth of 40%. However, modest decline in NII growth may not necessarily be indicative of a sustained challenge in NII increase, particularly as we believe funding costs should have stabilised for the most part. Net interest spread (NIS), which indicates loan yields spread over funding cost, was stable at 2.28% (v/s 2.30% in Q1FY12).

Loan approvals were 18%, while disbursements were 19% during the quarter v/s 22% and 20% in Q1FY12. Asset quality remains pristine and provisions more than covered gross NPAs. EPS growth was 19% yoy and RoE was 21.1% v/s 19% for Q1. Book value was Rs127 v/s Rs123 at end of previous quarter, while unrealised gains per share was Rs145.

Modest changes to estimates. We fine tuned funding mix and costs, among other things. As a result, our FY12 and FY13 EPS estimates are Rs28.2 and Rs33.6 v/s Rs28.0 and Rs35.0 previously.

We expect HDFC's operating performance and consistency to continue to outshine peers' in a tough environment, given large addressable market and management's superior execution track record. However, with the stock holding up reasonably well (down 7.5% YTD v/s Bank Nifty Index down 16.6%), we believe if investor sentiment improves on the back of positive global cues, it could result in the stock underperforming bank peers.

Price target remains Rs700 and represents a headline forward P/book multiple of 4.4x (3.5x adjusted for unrealised gains). Maintain Add rating.

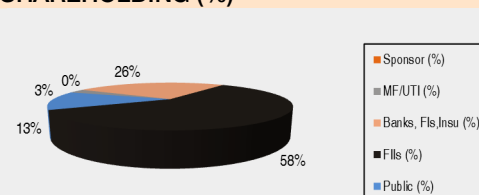
Revenue trends healthy. NII growth was slightly lower than our expectation, given elevated interest expense. Although interest expenses were up 57%, overall net interest income was up 17% as income from operations was up 40%. Interest cost on loan funding was up sharply (79% yoy), although management swapped 'relatively lower cost bonds for bank loans' during the quarter resulting in period ending balances being down 21% qoq. We expect this to show up in lower average loan funding going forward.

KEY DATA

Bloomberg	HDFC IN
Reuters	HDFC.BO
52-wk H/L (Rs)	764/582
6-m avg trd value	US\$37.1mn
Market cap	Rs991.0bn/US\$20.3bn
Shares o/s	1,471.5mn
Face value	Rs2

Source: Bloomberg

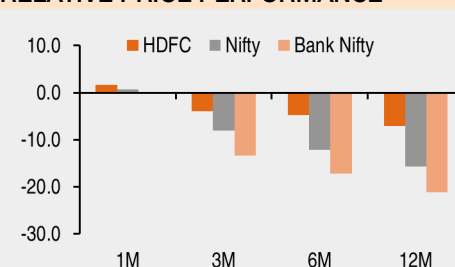
SHAREHOLDING (%)



Source: CMIE

As of 30 September 2011

RELATIVE PRICE PERFORMANCE



Source: Bloomberg

Key financials

(Rs mn)

Y/E Mar	FY11	FY12E	FY13E
Net interest income	42,471	50,460	64,685
EPS (Rs)	24	28	34
Spread (calculated)	3.15	3.17	3.09
RoE	20.8	22.4	23.1
P/E (x)	28.5	23.9	20.0
Adj. Price/BV (x)	7.4	6.6	5.4

Source: Company, BRICS Research

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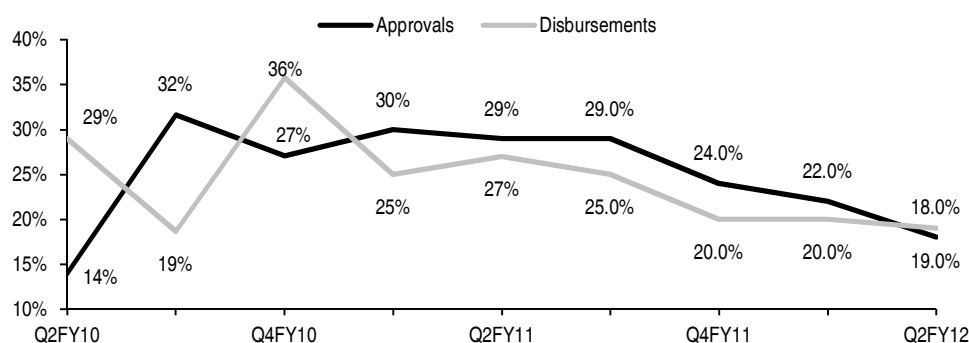
Credit quality remains pristine

Gross NPA ratio was 0.82% v/s 0.83% in Q1FY12 and 0.84% for FY11. Absolute gross NPAs were up 13% yoy, while cumulative provisioning of Rs15.25bn was well in excess of NPAs of Rs10.63bn. During the quarter HDFC increased provision on standard assets to 0.40% from 0.10% as per new regulatory norm. Also, Rs2.55bn was used from additional reserve to provide for standard assets provisioning. We expect HDFC's asset quality to continue to shine even assuming a reasonable slowdown in broader economic growth.

Unrealised gains down slightly

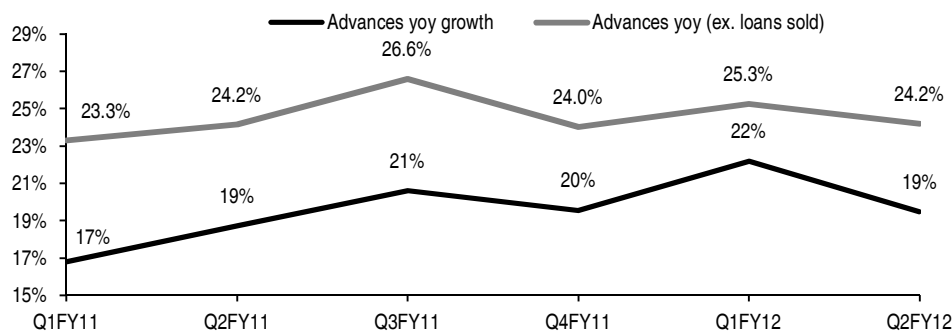
Unrealised gains on investment portfolio was down slightly at Rs213bn v/s Rs232bn both qoq and in prior year. On a per share basis, this works out Rs145.

Exhibit 1: Trend in approvals and disbursements



Source: Company

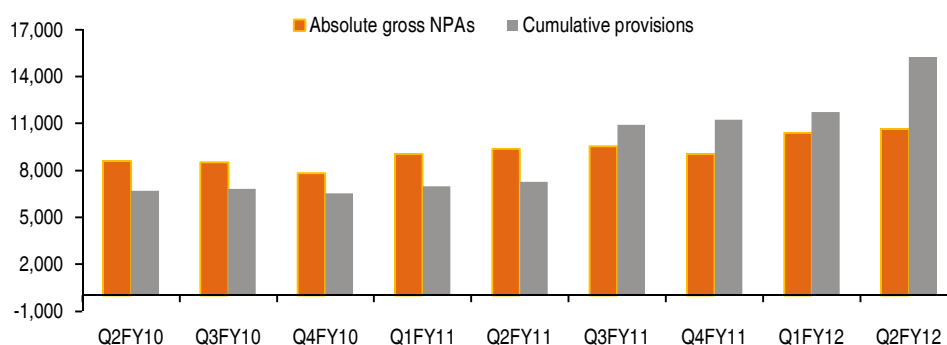
Exhibit 2: Trend in loan growth and also growth excluding loans sold



Source: Company

Exhibit 3: Trend in gross NPAs and cumulative provisions

(Rs mn)



Source: Company

Q2FY12 earnings summary

Exhibit 4: Profit and loss

(Rs mn)

Particulars	Q2FY12	Q2FY12E	variance	Q2FY11	yoy	Q1FY12	qoq
Income from operations	40,771	39,294	3.8%	29,066	40.3%	38,007	7.3%
Interest and other charges	26,905	24,915	8.0%	17,176	56.6%	25,149	7.0%
Net interest income	13,865	14,378	-3.6%	11,890	16.6%	12,857	7.8%
Other income (incl. sale of investments)	921	581	58.5%	637	44.6%	209	340.0%
Total revenue	14,786	14,959	-1.2%	12,527	18.0%	13,067	13.2%
Operating expenses	1,409	1,359	3.7%	1,147	22.8%	1,267	11.2%
Employees cost	526	574	-8.4%	470	12.0%	528	-0.3%
Depreciation	48	46	4.3%	44	9.5%	45	8.3%
Other operating expenses	835	739	13.0%	678	23.3%	739	13.0%
o/w Provisions for contingencies	170	182	-6.7%	150	13.3%	180	-5.6%
Profit/(loss) before tax	13,377	13,600	-1.6%	11,380	17.6%	11,800	13.4%
Tax expense	3,670	3,808	-3.6%	3,260	12.6%	3,310	10.9%
Net profit after tax	9,707	9,792	-0.9%	8,120	19.6%	8,490	14.3%

Source: Company, BRICS Research

Exhibit 5: Earnings per share

(Rs)

Particulars	Q2FY12	Q2FY12E	variance	Q2FY11	yoy	Q1FY12	qoq
Reported EPS – diluted	6.49	6.52	-0.5%	5.45	19.1%	5.65	14.9%
Diluted EPS - operating*	6.09	6.28	-2.9%	5.17	17.9%	5.57	9.3%
Book value - adjusted	127	132	-3.7%	118.00	7.6%	123	3.3%
Diluted shares outstanding est. (mn)	1,496	1,502	-0.4%	1,490	0.4%	1,503	-0.5%

Source: Company, BRICS Research

*Operating basis excludes trading income, depreciation of investments and extraordinary income

Exhibit 6: Profitability and other key metrics

Particulars	Q2FY12	Q2FY12E	Q2FY11	Q1FY12
RoA (calculated)	2.72%	2.70%	2.70%	2.46%
RoE (calculated)	21.1%	20.7%	19.2%	18.7%
Non-interest income % of revenues	6.2%	3.9%	5.1%	1.6%
Tax rate - effective	27.4%	28.0%	28.6%	28.1%
Expense ratio	9.5%	9.1%	9.2%	9.7%
Deposits as a % of loans	25.0%	22.6%	25.3%	24.6%
Net interest spread (reported)	2.28%	2.30%	2.34%	2.30%

Source: Company, BRICS Research

Exhibit 7: Credit quality

Particulars	Q2FY12	Q2FY12E	variance	Q2FY11	yoy	Q1FY12	qoq
Absolute gross NPA (mn)	10,630	11,924	-10.9%	9,393	13.2%	10,382	2.4%
Gross NPA (90 days overdue)	0.82%	0.92%		0.86%		0.83%	
Net NPA	NIL	NIL		0.20%		NIL	
Provision coverage	143.4%	99.9%		77.4%		113.0%	

Source: Company, BRICS Research

Exhibit 8: Capital ratios

Particulars	Q2FY12	Q2FY12E	Q2FY11	Q1FY12
Total shareholders' equity to assets	13.0%	13.1%	13.6%	12.8%
Basel II				
Tier 1 capital	11.70%	13.95%	13.00%	12.20%
CRAR	13.80%	12.32%	14.10%	13.80%

Source: Company, BRICS Research

Exhibit 9: Balances**(Rs bn)**

Particulars	Q2FY12	Q2FY12E	variance	Q2FY11	yoy	Q1FY12	qoq
Total assets	1,438	1,484	-3.1%	1,264	13.8%	1,416	1.6%
Net worth	187	195	-3.9%	172	8.8%	181	3.4%
Loans & advances	1,270	1,379	-7.9%	1,063	19.5%	1,242	2.3%
Borrowings	1,251	1,215	2.9%	1,092	14.6%	1,235	1.3%
o/w Deposits	317	311	2.0%	269	18.0%	305	4.0%

Source: Company, BRICS Research

Financial summary

Income statement (Rs mn)

Y/E 31 March	2010	2011	2012E	2013E
Net interest income	33,875	42,471	50,460	64,685
<i>Growth (%)</i>	10.9	25.4	18.8	28.2
Other income	2,320	3,849	4,214	2,688
Total income (net of interest expense)	42,978	53,181	64,032	77,471
Employee expenses	1,467	1,755	2,053	2,621
Other operating expenses	1,771	2,056	2,492	3,154
Operating expenses	3,238	3,812	4,545	5,775
Operating profit	39,740	49,370	59,487	71,697
<i>Growth (%)</i>	21.6	24.2	20.5	20.5
Provisions and contingencies	580	700	828	980
PBT	39,160	48,670	58,659	70,717
Provision for tax	10,895	13,320	16,424	19,801
PAT	28,265	35,350	42,234	50,916
<i>Growth (%)</i>	23.8	25.1	19.5	20.6

Balance sheet (Rs bn)

Y/E 31 March	2010	2011	2012E	2013E
Total assets	1,118	1,327	1,624	1,973
Total equity	152	173	198	235
Advances	980	1,171	1,413	1,716
Borrowings	966	1,154	1,265	1,652
o/w Deposits	231	246	337	417
Investments	107	118	164	197

Per share data and key ratios

Y/E 31 March	2010	2011	2012E	2013E
Diluted EPS (Rs)	19	24	28	34
RoAA (%)	2.61	2.89	2.86	2.83
RoAE (%)	20.0	20.8	22.4	23.1
BV / Share (Rs)	106	118	134	157
Adj. BV / Share (Rs)	85	91	103	125
Other income / Net revenue (%)	5.7	7.8	7.0	3.6
Cost / Income ratio (%)	8.0	7.7	7.6	7.7
Dividends / Share	7.2	9.0	9.0	10.0
Effective tax rate (%)	27.8	27.4	28.0	28.0

Yields and rates (%)

Y/E 31 March	2010	2011	2012E	2013E
Spread (calculated)	2.95	3.15	3.17	3.09
Yield on advances	10.9	10.1	11.7	11.6
Cost of deposits	8.6	7.0	8.5	8.5
Cost of funds	8.0	7.0	8.6	8.5

Capital ratios (%)

Y/E 31 March	2010	2011	2012E	2013E
Tier I	12.8	12.2	11.3	11.1
Total CRAR	14.6	14.0	12.7	12.3
Equity to assets	13.6	13.0	12.2	11.9

Asset quality & credit metrics (%)

Y/E 31 March	2010	2011	2012E	2013E
Gross NPA ratio	0.79	0.84	0.82	0.76
Net NPA ratio	0.13	—	—	—
Provisions / Loans	0.33	0.22	0.32	0.30
NPA coverage ratio	83.7	124.4	141.1	136.4
Absolute gross NPAs (Rs mn)	7,829	9,039	11,145	12,251

Valuation ratios (x)

Y/E 31 March	2010	2011	2012E	2013E
Price/ Book	—	—	5.0	4.3
Price/ Adj. Book	—	—	6.6	5.4
Price/ Earnings	—	—	23.9	20.0

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and –15%)
SELL:	More than 15% downside

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