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We met the HDFC management

Quick Note

September 13, 2012	
Rating Remains	**Neutral**
Target price Remains	INR 780
Closing price September 12, 2012	INR 757

Key notes from the meeting

We met the management of HDFC and the key themes to highlight are – 1) good traction on retail mortgages and an incremental shift away from corporate loans 2) improving liquidity driving market funding costs lower and hence a shift in the borrowing mix.

- Retail growth would be strong in Q2FY13 due to a relatively lower base in H1FY12 and also on no sell-down to HDFC Bank (which is aligning its mortgage buyouts in line with recent RBI guidelines). For 2QFY13 loan growth would be close to 30% before sell-down. It is likely that the loan sell down to HDFC Bank could get pushed out into Q3FY13. HDFC continues to be cautious on the corporate loan front. Incremental retail versus corporate mix likely to be in the 90:10% range as in 1QFY13.
- Mumbai's contribution to H1FY13 growth was insignificant. Residential prices have been holding up so far and with 100,000 flats coming up for supply over the next few quarters there could be possible upside to retail lending given that in tighter economic situations, ready flats sell better. The last few months have seen an uptrend in resale of residential properties. Management expects residential property price declines to be limited to 10%, should there be a price correction.
- Distinction between individual and corporate loans: 1) Spread 193bps for retail and 280bps for corporate, 2) 40bps standard asset provisioning for retail vs 100bps for corporate, 3) 70-75% blended risk weight on retail vs 100% on corporate, 4) All put together – RoEs are comparable – 24-25%, 5) Fee income on retail is effectively nil as the upfront fee received is paid out as commission expenses 6) Corporate fee is 25-50bps on a blended basis 7) HDFC match funds the retail and corporate loan books. Longer-duration liabilities are earmarked for retail loans and matched cost of funds is lower for retail loans.
- HDFC has repaid INR180bn of bank loans so far in FY13 and replaced it with bonds which are coming 120-140bps cheaper. Improving liquidity conditions in the market are driving market borrowing costs lower. It would need incremental funding of INR270-300bn for FY13. The following are the funding costs for HDFC from the three main sources – bank loans - 10.5%, retail deposits - 9.7-9.8%, bonds - 9.1-9.2%. INR32bn has come from warrant conversion and would also help support NIMs.
- 3rd party contribution to loan sourcing has gone up because of an increase in the number of organized distributors like IndusInd Bank and Ratnakar Bank. HDFC's lending rates are not directly comparable with banks as many bank loans come with additional costs like life insurance policies bundled with home loans, higher third party legal and technical fees and varying service levels.

Valuation: HDFC currently trades at 3.3x FY13F ABV. At our TP of INR780, HDFC trades at 3.4x FY13F ABV of INR161.7.

Research analysts

India Banks

Vijay Sarathi - NFASL
vijay.sarathi@nomura.com
+91 22 4037 4457

Abhishek Bhattacharya - NFASL
abhishek.bhattacharya@nomura.com
+91 22 4037 4034

Amit Nanavati - NSFSPL
amit.nanavati@nomura.com
+91 22 4037 4361

Appendix A-1

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
HDFC	HDFC IN	INR 757	12-Sep-2012	Neutral	Not rated	A4,A5

A4 A Nomura Group Company had an investment banking services client relationship with the issuer during the past 12 months.

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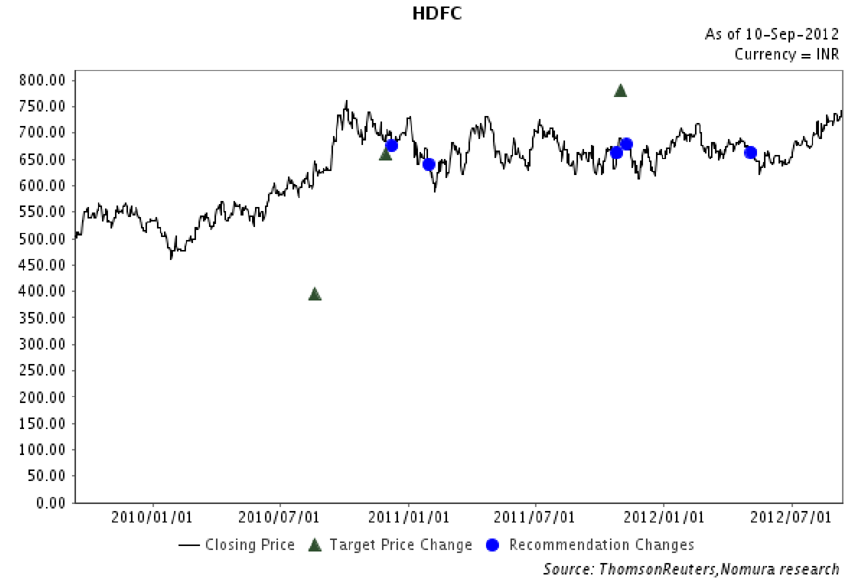
Previous Rating

Issuer name	Previous Rating	Date of change
HDFC	Buy	26-Apr-2012

HDFC (HDFC IN) **INR 757 (12-Sep-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-Apr-12	Neutral		674.10
31-Oct-11	Buy		688.85
31-Oct-11		780.00	688.85
17-Oct-11	Not Rated		673.45
21-Jan-11	Suspended		651.20
30-Nov-10	Neutral		686.65
30-Nov-10		660.00	686.65
19-Aug-10		394.00	645.05

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value HDFC's core mortgage business at INR555 and its subsidiaries at INR225 to arrive at our SOTP-based TP of INR780. At our TP, HDFC would trade at 3.4x our FY13F ABV of INR161.7 and 19.2x our FY13F EPS of INR28.9.

Risks that may impede the achievement of the target price Accelerated monetary policy easing, higher than expected domestic economic growth and value unlocking in the life insurance subsidiary are key upside catalysts. The potential downside risks are a relative tight money policy, regulatory uncertainty and heightened global macro risks.

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STOCKS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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