

HDFC Ltd

Rs 673

Consistent operating performance

BUY

HDFC posted 20.2% y-o-y and 14.8% q-o-q growth in reported earnings to Rs 971 crore, in line with our estimate of Rs974 crore and marginal above street expectation. Net interest income grew by 14.1% y-o-y to Rs 1,164 crore, led by healthy loan (including loan sold) growth 24.2% y-o-y. Ex-treasury gains, earnings grew by 18.6% y-o-y & 8.9% q-o-q to Rs 908 crore. The loan book (excl. sold loans) expanded by 19.5% while after adjusting for sell-downs it grew by 24.2% y-o-y. On YTD basis, Approvals and disbursements growth were 18% y-o-y and 19% y-o-y respectively showing moderation in loan demand owing to rising interest rate environment and higher real estate prices. Maintain positive outlook and recommend BUY.

**Steady NII growth led by stable spreads and healthy loan growth:** NII grew 14.1% y-o-y & 16.6% q-o-q to Rs 1,164 crore lower than our estimates. The deviation was primarily attributed to lower-than expected asset re-pricing and lower surplus from mutual funds. The reported spread pegged at 2.29% flat on q-o-q basis. Loan book incl. sell-downs grew by 24.2% y-o-y to Rs 1,31,981 crore. We believe HDFC continues to maintain spread in the range of 2.2% -2.3%, going forward. We model in 22.7% CAGR in loan book over FY11-13 driven by retail and wholesale business.

**Trading gains surprised positively:** Trading gains positively surprised to Rs87 crore vs Rs16 crore in Q1FY12 despite of adverse market condition in financial markets both fixed income and equity reflecting superior fund management capabilities. Unrealized gains was down (-8% q-o-q) to Rs 21,336 crore.

**Developer loans drive loan growth:** Loan book adjusting for sell downs grew by 24.2% y-o-y to Rs 1,31,981 crore while growth excl. sold loans pegged at 19.5% y-o-y to Rs 1,26,992 crore. Developer loans accelerated while individual loans slowed down as reflected in change in the incremental loan mix- developer loan mix increased by 235bps q-o-q to 42% on incremental basis. Retail loans stood at 63% of the loan book in Q2FY11.

**Asset quality continues to be impeccable:** Broadly asset quality continues to be impeccable despite tough macro environment. Gross NPAs (90 days) stood at 82bps vs 83bps in Q1FY12. The company has excess provisions of Rs 329 crore over required under the prudential norms providing enough margins of safety to earnings. The management has indicated that recent launched fixed housing loan product does not attract teaser loan's standard asset provisioning (2% vs normalized 40bps provisioning).

**Diversified & competitive funding mix:** HDFC continued to maintain well diversified borrowing profile across product instruments and market segments. Borrowings grew 14.6% y-o-y to Rs 125,103 crore, in asset growth. During the quarter, the borrowing mix remained stable among term loans (34%), Bonds (42%) and Deposits (25%).

#### Valuation & Outlook

HDFC has delivered another consistent performance on most of the operating parameters during the quarter. Business growth continued to be in line with management's guidance while asset quality remains best in class. Steady NII growth, higher-than expected trading gains and stable spreads were key highlights from the result. We expect 20.6% CAGR in core earnings on the back of strong loan growth, stable margin and lower credit cost. Market leadership in housing finance sector, superior underwriting standards, stable spreads, well diversified borrowing profile, quality of earnings and unlocking value of subsidiaries are key value drivers for the stock. At Rs 673, the stock is trading at 4.7x FY13 core book value and 12.6x FY13 core earnings. RoA and RoE continue to remain at superior levels ~ 2.8% and 23.9% respectively in FY13. We have tweaked our earnings estimate downward by 1.3% and 4% for FY12 & FY13 respectively factoring lower loan growth and steady spreads. The stock has outperformed the market by 5.8% in last three months reflecting resilient earning performance in tough macro environment. **We believe interest rates are at peak level and reversal in interest rate cycle would benefit wholesale funded entities such as HDFC and re-rate valuation multiple going forward. Hence, we reiterate our positive outlook and BUY rating on the stock with revised target price of Rs785 (Potential upside 16.7%).**

#### Key Financials

Rs Crore

Rs in crore	FY10	FY11	FY12E	FY13E
Net interest income	3486	4446	5555	7092
Net Profits	2826	3535	4208	5330
EPS	19.7	24.1	28.7	36.3
BVPS	106	118	135	159
PE (x)	36.2	29.5	24.8	19.6
PB (x)	6.7	6.0	5.3	4.5
Core P/B (x)	7.9	8.2	6.5	5.1
Dividend yield (x)	1.2%	1.5%	1.6%	1.8%

Source: Company, KRChoksey Research

Target Price (Rs): 785

Potential Upside : 16.7%

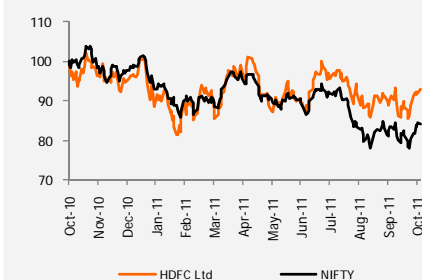
Previous TP (Rs): 796

Market Data	
Equity sh. O/S (Cr)	147.1
MCap (Rs crs)	294.3
52 Wk H/L (Rs)	99,097
Avg Vol (3m avg)	764/582
Fee float (%)	2566216
Face Value (Rs)	2
Bloomberg Code	HDFC IN

#### Market Info:

SENSEX	17,025
NIFTY	5,118

#### Price Performance



#### Share Holding pattern (%)

Particulars	Sep-11	Jun-11	Change
Promoters	-	-	-
FII's	58.2	58.1	0.1
Institutions	29.1	29.3	-0.2
Others	12.7	12.6	0.1
Total	100	100	0

Source: BSE

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### Key Highlights

- Pre-provisioning profit went up 17.9% y-o-y to Rs 1.355 crore.
- Loans sold during the preceding twelve months amounted to Rs 4,989 crores. Off- balance book stands at Rs13,169 crore, showing a growth 28% y-o-y. Interest income includes 1.54% income generated from the off balance sheet book.
- Loan spread remained stable at 2.29% vs 2.30% in Q1FY12. Net interest margin stood at 4.3% for the quarter.
- The company withdrawn Rs254.7 crore from the additional reserve to meet the additional provision required due to changes in provisioning norms on assets (increased from 25bps to 40bps).
- The Capital Adequacy Ratio stood at 13.8% whereas Tier I capital stood at 11.7%.
- The unrealized gains on listed investments (excl. the appreciation in the value of the unlisted investments) stood at Rs 21,335 crore against Rs 21,213 crore in Q2FY11.

### Earning Revision

Rs in crore	FY12e		Change	FY13e		Change
	Old	New	(%)	Old	New	(%)
Net interest income	5555	5532	-0.4%	7092	6849	-3.4%
Pre-provision profits	5910	5833	-1.3%	7485	7186	-4.0%
Net Profits	4208	4152	-1.3%	5330	5116	-4.0%

Source: KRChoksey Research

### KRChoksey Estimates Vs Market Consensus

	FY12			FY13		
	KRC	Bloomberg	Vari (%)	KRC	Bloomberg	Vari (%)
EPS (Rs)	28.3	27.7	2.1%	34.9	32.5	7.4%
DPS (Rs)	12	11	10.0%	13	12	7.3%
BVPS (Rs)	135	135	-0.3%	157	158	-0.9%
Net Profits (Rs in crs)	4152	4152	0.0%	5116	4957	3.2%
Adjusted PAT (Rs in crs)	4152	4146	0.1%	5116	4946	3.4%
RoA (%)	2.7%	2.7%	4 bps	2.8%	2.8%	1 bps
RoE (%)	22.4%	22.4%	1 bps	23.9%	22.7%	-121 bps

Source: Bloomberg, KRChoksey Research

### SOTP Valuation

Based on FY13 Estimates	Holding (%)	Value per share	Basis of Valuation
Mortgage business	100%	506	Based on RI Model
HDFC Bank	23%	198	Target Price
Gruh Finance	60%	5.8	Based on Market Price
Life Insurance	72%	52	16x NBAP Multiple
Asset Management business	60%	22	5%age of AUM
Others		20	
Subsidiary/Associate		298	
Adjustment for holding company discount @20%		238	
Mortgage + subs value per share (Rs)		744	
Unrealized gains (assumed)		41	
Fair value per share		785	

Source: KRChoksey Research

**Q2FY12 – Result Analysis**

Rs in crore	Q2FY12	Q1FY12	Q2FY11	y-o-y	q-o-q
Interest income	3,854	3,513	2,737	40.8%	9.7%
Interest expenses	2,691	2,515	1,718	56.6%	7.0%
Net interest income	1,164	998	1,019	14.1%	16.6%
Non interest income	315	309	233	35.1%	1.8%
- Fee income	79	57	68	15.9%	37.7%
- Trading gains	87	16	59	47.3%	434.3%
Operating income	1,479	1,308	1,253	18.0%	13.1%
Operating expenses	124	113	104	19.0%	9.5%
Pre-provision profits	1,355	1,195	1,149	17.9%	13.4%
Provisions	17	18	15	13.3%	-5.6%
Profit before tax	1,338	1,177	1,134	18.0%	13.7%
Tax	367	331	326	12.6%	10.9%
Net Profit	971	846	808	20.2%	14.8%
Adjusted PAT	908	833	766	18.6%	8.9%
<b>Balance sheet</b>					
Share capital	294	294	292	-	-
Reserve & Surplus	18,397	17,776	16,889	-	-
Net worth	18,692	18,070	17,181	-	-
Borrowings	125,103	123,519	109,175	14.6%	1.3%
Total Liabilities	143,794	141,589	126,356	13.8%	1.6%
Loans	126,992	124,168	106,287	19.5%	2.3%
- Retail	80,268	77,886	68,263	17.6%	3.1%
- Corporate loans	45,144	44,823	36,523	23.6%	0.7%
- Others	1,580	1,458	1,501	5.3%	8.3%
Investments	14,980	17,328	17,559	-14.7%	-13.5%
Net current assets	1,006	-607	1,975	-	-
Fixed assets	235	235	223	-	-
Total Assets	143,794	141,589	126,356	13.8%	1.6%
Approvals	23,815	19,443	20,723	14.9%	22.5%
Disbursements	19,691	14,075	16,646	18.3%	39.9%
Loan sold	4,989	3,123	4,858	2.7%	59.8%
Loan book growth incl. loan sold	126,992	124,167	111,145	24.0%	6.2%
<b>Spread analysis</b>					
Spread - reported	2.28%	2.30%	2.34%	-2 bps	-6 bps
Yield on avg loans	11.7%	10.8%	9.6%	84 bps	211 bps
Cost of funds	8.7%	8.4%	6.6%	24 bps	208 bps
Spread	2.4%	2.1%	2.7%	26 bps	-34 bps
<b>Asset quality</b>					
Non performing loans (90 days overdue)	0.83%	0.83%	0.86%	0 bps	-3 bps
Nonperforming loans (six months past due)	0.55%	0.55%	0.53%	0 bps	2 bps
Provision for Contingencies	1525	1173	727	109.8%	30.0%
Provision / outstanding loans	1.20%	0.94%	0.68%	26 bps	52 bps
<b>Capital Adequacy ratios</b>					
Tier I	11.7%	12.2%	13.0%	-50 bps	-130 bps
Tier II	2.1%	1.6%	1.1%	50 bps	100 bps
CAR	13.8%	13.8%	14.1%	0 bps	-30 bps

Source: Company, KRChoksey Research

Exhibit 1: Approval and sanction trend

Approvals and disbursements moderated marginally to 18% y-o-y & 19% y-o-y reflecting higher interest rate regime impacting loan demand from individuals and real estate developers

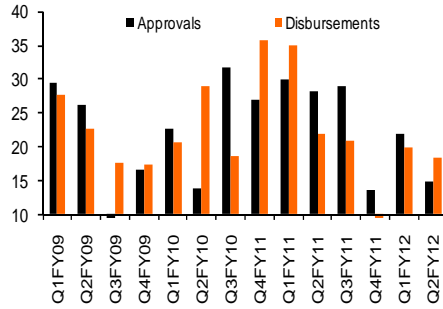


Exhibit 2: Loan book growth – Segment wise

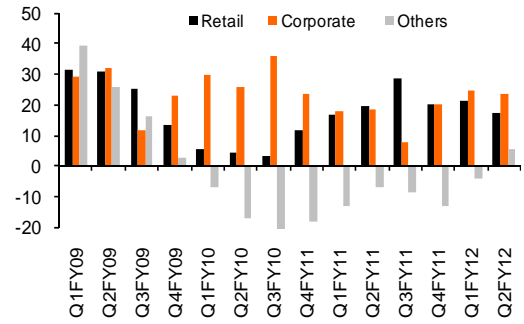


Exhibit 3: Loan mix – Outstanding basis

Retail loans contribute 63% of outstanding loan book. On incremental basis, share of retail loan has increased marginally to 58%.

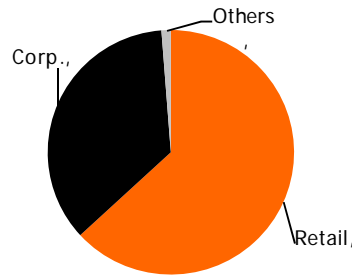


Exhibit 4: Incremental Loan mix

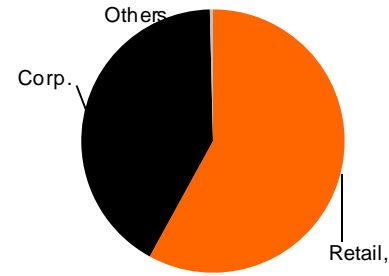


Exhibit 5: Stable spread both y-o-y and q-o-q basis

Spread remained stable at 2.30% q-o-q, reflecting reasonable pricing power of the company in a rising interest rate environment.

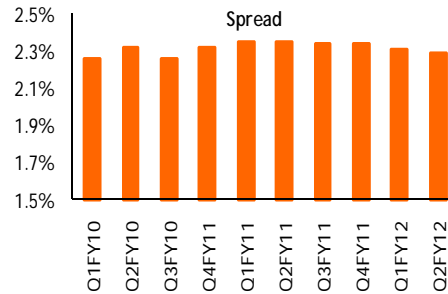


Exhibit 6: Improving asset quality trend

Asset quality remains impeccable both y-o-y and sequential basis. The company has excessive asset provision amounting to Rs329 cr over regulatory requirement

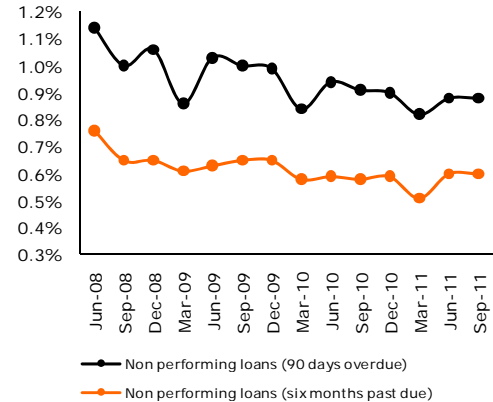


Exhibit 7: Improvement in cost to income ratio trends

Cost to income further shot up to 10.1% v/s 10.0% a year ago.

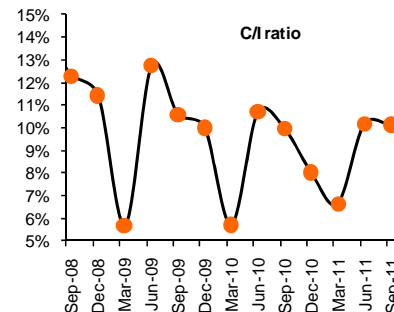
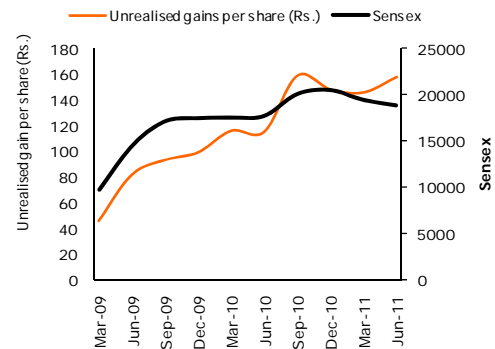


Exhibit 8: Unrealized gains corrected in line with market

Unrealized gains on listed equities stand at Rs 21,336 crore.



Source: Company, KRChoksey Research

## Financials

### Income Statement

Rs in crore	FY10	FY11	FY12E	FY13E
Interest earned	10549	12006	15285	19501
Interest expenses	7063	7560	9754	12652
<b>Net Interest Income (NII)</b>	<b>3486</b>	<b>4446</b>	<b>5532</b>	<b>6849</b>
-- Core fee Income	232	220	226	247
Non interest income	812	872	726	802
Operating income	4298	5318	6257	7651
Operating expenses	147	176	193	212
-Employee costs	177	206	232	253
-Other operating expenses	324	381	425	465
<b>Pre-provision profits</b>	<b>3974</b>	<b>4937</b>	<b>5833</b>	<b>7186</b>
Provisions	58	70	65	80
PBT	3916	4867	5767	7105
Provision for taxes	1090	1332	1615	1990
<b>Net profit</b>	<b>2826</b>	<b>3535</b>	<b>4152</b>	<b>5116</b>
Dividend (Inc. tax)	1205	1534	1716	1888

### Spread Analysis

	FY10	FY11	FY12E	FY13E
Yield on housing loans	10.66%	10.28%	10.83%	11.33%
Cost of borrowings	7.83%	7.13%	7.63%	8.13%
Spread	2.13%	2.36%	2.35%	2.36%
Net interest margin	3.08%	3.41%	3.53%	3.59%

### Core ratios

	FY10	FY11	FY12E	FY13E
Cost to income ratio	7.5%	7.2%	6.8%	6.1%
RoAA	2.6%	2.8%	2.7%	2.8%
RoAE	20.0%	21.7%	22.4%	23.9%
Core RoA	2.7%	2.9%	2.8%	2.8%
Core RoE	31.9%	41.1%	38.6%	37.6%

### Per Share Data

Per share data	FY10	FY11	FY12E	FY13E
EPS (Rs)	19.7	24.1	28.3	34.9
DPS (Rs)	8	10	12	13
BVPS (Rs)	106	118	135	157
Adj. BVPS (Rs)	49.0	60.6	77.2	99.2
PE (x)	34.2	27.9	23.8	19.3
PB (x)	6.4	5.7	5.0	4.3
Core P/B (x)	7.2	7.5	6.0	4.7
Core P/E (x)	22.6	18.3	15.6	12.6
Dividend yield (%)	1.2%	1.6%	1.7%	1.9%

Source: KRChoksey Research

### Balance Sheet

Rs in crore	FY10	FY11	FY12E	FY13E
Equity capital	287	293	293	293
Reserve and Surplus	14911	17023	19459	22687
Net worth	15198	17317	19753	22981
Borrowings	96565	115410	140159	170970
CL and provisions	4878	6775	8018	9349
<b>Total</b>	<b>116641</b>	<b>139502</b>	<b>167930</b>	<b>203299</b>
Loans	97967	117127	144494	176257
Investments	10727	11832	11832	11832
Deferred tax assets	286	448	448	448
Current assets	7439	9861	10916	14515
Fixed assets	222	234	240	246
<b>Total</b>	<b>116641</b>	<b>139502</b>	<b>167930</b>	<b>203299</b>

### Dupont Analysis

	FY10	FY11	FY12E	FY13E
Interest income	9.66%	9.37%	9.94%	10.51%
Interest expense	6.47%	5.90%	6.35%	6.82%
Net interest income	3.19%	3.47%	3.60%	3.69%
Non interest income	0.74%	0.68%	0.47%	0.43%
- trading gains	0.19%	0.28%	0.13%	0.12%
Operating income	3.94%	4.15%	4.07%	4.12%
Operating expenses	0.30%	0.30%	0.28%	0.25%
Pre- provision profits	3.64%	3.85%	3.79%	3.87%
Provisions	0.05%	0.05%	0.04%	0.04%
Profit before tax	3.59%	3.80%	3.75%	3.83%
Tax expense	1.00%	1.04%	1.05%	1.07%
Net profit	2.59%	2.76%	2.70%	2.76%
Adjusted PAT	1.10%	1.20%	1.12%	1.02%

### Growth ratios

	FY10	FY11	FY12E	FY13E
Approvals	23%	24%	20%	19%
Disbursement	27%	20%	20%	19%
Loan growth	16%	17%	23%	21%
Net interest income	9%	28%	24%	24%
Non interest income	117%	7%	-17%	11%
Pre- provision profits	22%	24%	18%	23%
Net profits	24%	25%	17%	23%

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**HDFC Ltd**

Date	Recom	CMP (Rs)	TP (Rs)
18-Oct-11	BUY	673	785
4-Oct-11	BUY	634	796
11-Jul-11	HOLD	712	796
11-May-11	BUY	662	760
14-Jan-11	BUY	642	744

**Rating Legend**

Our Rating	Upside
<b>Buy</b>	More than 15%
<b>Hold</b>	5% - 15%
<b>Reduce</b>	0 – 5%
<b>Sell</b>	Less than 0%

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