

January 12, 2012

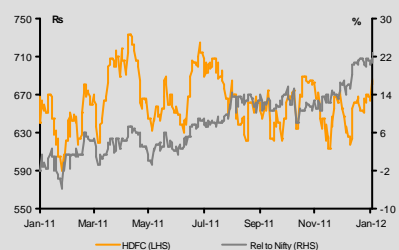
Reco	Previous Reco
Hold	Hold
CMP	Target Price
Rs688	Rs700
EPS change FY12E/13E (%)	NA
Target Price change (%)	NA
Nifty	4,831
Sensex	16,038

Price Performance

(%)	1M	3M	6M	12M
Absolute	6	3	(2)	1
Rel. to Nifty	10	13	19	28

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

Sector	Financial Services
Bloomberg	HDFC@IN
Equity Capital (Rs mn)	2947
Face Value(Rs)	2
No of shares o/s (mn)	1473
52 Week H/L	736/582
Market Cap (Rs bn/USD mn)	1,013/19,605
Daily Avg Volume (No of sh)	2314669
Daily Avg Turnover (US\$mn)	29.3

Shareholding Pattern (%)

	Dec-11	Sep-11	Jun-11
Promoters	0.0	0.0	0.0
FII/NRI	74.1	73.4	73.3
Institutions	13.8	14.1	14.3
Private Corp	1.7	1.8	1.7
Public	10.5	10.8	10.7

Source: Capitaline

Kashyap Jhaveri

kashyap.jhaveri@emkayglobal.com
+91 22 6612 1249

Aalok Shah

aalok.shah@emkayglobal.com
+91 22 6612 1336

- HDFC Q3FY12 results as expected with NII at Rs11.6bn and PAT at Rs9.8bn. Healthy loan growth across all segments and stable spreads (2.3%) were key highlights of the quarter
- M9FY12 growth in sanctions/disbursements continues to remain healthy at 19% each. For Q3, calculated growth in sanctions / disbursements stood at 19%/16% respectively
- Asset quality remains comfortable with GNPA at 0.82% (90-days). HDFC carries a cumulative provisioning of Rs15.8bn (1.2% of loans) on its balance sheet.
- Valuation premium to continue given leadership and superior return ratios. However, our target price of Rs 700 leaves limited room for upside. Maintain HOLD

NII remains largely inline; lower investment gains, however drag APAT

HDFC Q3FY12 NII at Rs11.6bn (up 12.5% yoy) was largely inline with our / street estimates. NII growth during the quarter was aided by healthy loan growth across all segments and substantial shift in borrowing mix. Resultant, calculated NIM at 3% were flat sequentially. The reported NIM / spreads for M9FY12 stood at 4.3%/2.27% respectively. However, despite 19% yoy growth in operating profit, lower investment / gains on sale of investments attributed for mere 10% yoy growth in APAT. Including investment gains in corresponding period of previous year, net profit was actually up 19% yoy. HDFC carries a cumulative provision of Rs15.8bn (1.2% of total loans) significantly above the regulatory requirement.

On the balance sheet front, loan growth came in at 21.2% yoy (4.1% qoq). This growth has clearly shrugged off concerns over material slowdown in loan growth due to interest rates or property prices. Also with repayment ratio at sub-10%, fears over pre-payment remains miniscule. For M9FY12 sanctions / disbursements were up 19% each. Over FY11-13E, we expect HDFC to report 18% CAGR in loan portfolio aided by 17%+ CAGR in sanctions / disbursements each.

Yield Analysis

%	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY bps	QoQ bps
Yield on advances	11.2	12.1	11.6	12.3	12.9	164	59
Yield on total assets	9.8	10.9	10.4	10.9	11.6	183	72
Yield on earning funds	9.3	10.2	9.8	10.3	11.0	171	64
Cost of borrowings	7.1	7.5	8.2	8.6	9.6	249	98
Cost of funds	6.1	6.3	7.0	7.2	7.9	182	72
Spread	2.4	3.2	2.0	2.2	2.0	-38	-18
Spread (reported)	2.3	2.3	2.3	2.3	2.3	-3	-1
NIM	3.2	3.9	2.8	3.1	3.0	-11	-8

Source: Company, Emkay Research, calculated based on average quarterly balances,

Valuation table

Y/E	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	P/E (x)	P/ABV (x)
March 31								
FY10	40,884	26,754	18.6	105.0	2.5	18.9	36.9	6.5
FY11	49,584	32,283	22.0	118.1	2.5	19.9	31.3	5.8
FY12E	57,977	39,078	26.6	131.3	2.6	21.2	25.8	5.2
FY13E	64,078	43,008	29.3	147.3	2.5	20.8	23.5	4.7

Source: Company, Emkay Research

Key financials – Quarterly

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)	YTD'12	YTD'11	YoY (%)
Net Interest Income	10,277	13,027	9,982	11,636	11,557	12.5	-0.7	33,175	29,444	12.7
Other Income	1,333	2,186	2,922	2,282	2,164	62.3	-5.2	7,368	4,927	49.5
Net Income	11,610	15,213	12,904	13,917	13,721	18.2	-1.4	40,543	34,371	18.0
Total Operating Exp	948	707	1,087	1,191	1,065	12.3	-10.6	3,343	2,913	14.8
As % Of Net Income	8.2	4.6	8.4	8.6	7.8			8.2	8.5	
Employee Expenses	451	384	528	526	508	12.8	-3.4	1,561	1,372	13.8
As % Of Net Income	3.9	2.5	4.1	3.8	3.7			3.9	4.0	
Other Expenses	383	250	412	529	424	10.8	-19.8	1,365	1,168	16.8
As % Of Net Income	3.3	1.6	3.2	3.8	3.1			3.4	3.4	
Operating Profit	10,607	14,454	11,773	12,678	12,603	18.8	-0.6	37,054	31,318	18.3
As % Of Net Income	91.4	95.0	91.2	91.1	91.8			91.4	91.1	
Provisions	150	250	180	170	200	NA	17.6	550	450	22.2
PBT	12,129	15,540	11,755	13,377	13,283	9.5	-0.7	38,415	33,130	16.0
Total Tax	3,220	4,120	3,310	3,670	3,470	7.8	-5.4	10,450	9,200	13.6
Adjusted PAT	8,909	11,420	8,445	9,707	9,813	10.1	1.1	27,965	23,930	16.9
Extra Ordinary Items	-1,672	-1,336	-163	-869	-880			-1,911	-2,262	
Reported PAT	7,681	10,438	8,328	9,077	9,162	19.3	0.9	26,568	22,282	19.2
Reported EPS	5.2	7.1	5.7	6.2	6.2	18.5	0.8	18.0	15.3	18.2

Source: Company, Emkay Research

Pan-India penetration has aided growth in individual loans

Despite fears of rising interest rates and elevated levels of property prices, overall loan growth at 21% yoy (4% qoq) appears commendable. Growth in individual loan portfolio continues to remain healthy at 20% yoy (5% qoq). During our recent interaction, the management had clearly stated for increasing mortgage demand in tier-II cities of Pune, Thane, Surat, Baroda, Indore etc. Strong brand name with pan-India presence has ensured healthy growth for the corporation. Even on the corporate loan portfolio front, a 25% yoy growth in loan book during Q3FY12 has aided margin improvement.

Loan mix – Growth witnessed across all segments

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)
Loan portfolio	1,090,512	1,171,266	1,241,677	1,269,924	1,322,079	21.2	4.1
- Individuals	704,714	736,493	778,860	802,680	842,999	19.6	5.0
- Corporate	370,098	421,407	448,233	451,442	461,609	24.7	2.3
- Others	15,701	13,366	14,585	15,802	17,472	11.3	10.6
% of total	100.0	100.0	100.0	100.0	100.0		
- Individuals	64.6	62.9	62.7	63.2	63.8		
- Corporate	33.9	36.0	36.1	35.5	34.9		
- Others	1.4	1.1	1.2	1.2	1.3		

Source: Company, Emkay Research

In a recent move, NHB had made it mandatory for housing finance companies to withdraw pre-payment penalty charge and apply uniform interest rates on floating rate portfolio. In case of HDFC, 80% of its book is floating in nature and resultant the new regulation is expected to hurt margins. In our view, while there is still lack of clarity on implementation of the regulation, we expect the same to be laid out in the phased manner. Lending rates have remained competitive across HFC and Banks, and any churn by the end-user would be difficult. HDFC has historically commanded premium margins (vs LICHF, DHFL) given its loan mix and steady loan growth. However, going forward, with growth pressures given competitive business environment and tightened regulatory requirement, we expect the premium valuation to ease. We have factored 20bps margin contraction for FY13.

Shift in borrowing mix with re-pricing of loans should aid margins

With easing of wholesale rates vis-à-vis bank base rate, HDFC has resorted to raising funds under the bond market / public deposits window. Resultant the share of term loan from banks in total borrowings has reduced from 35% in Q3FY11 to mere 20% now. Against 18% yoy growth in borrowings, term loans from banks were actually down 33% yoy. Also, beginning Q1FY13, the dual loan portfolio (currently 17% of loan book) will be re-aligned to existing lending rate which should aid margins .

Borrowing mix – Increasing reliance on bonds / deposit window

Rs mn	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	YoY (%)	QoQ (%)
Borrowings	1,078,184	1,154,105	1,235,187	1,251,027	1,270,962	17.9	1.6
- Term loans	375,191	424,898	414,279	323,243	249,829	-33.4	-22.7
- Bonds, debentures, FCCB & CPs	443,906	482,956	515,905	610,505	673,681	51.8	10.3
- Deposits	259,087	246,251	305,004	317,280	347,451	34.1	9.5
% of total	100.0	100.0	100.0	100.0	100.0		
- Term loans	34.8	36.8	33.5	25.8	19.7		
- Bonds, debentures, FCCB & CPs	41.2	41.8	41.8	48.8	53.0		
- Deposits	24.0	21.3	24.7	25.4	27.3		

Source: Company, Emkay Research

Stable asset quality; healthy provisions on balance sheet provides comfort

Despite higher exposure to vulnerable segment of corporate loans, HDFC has operated on a stable asset quality. Following NHB requirement towards higher provisioning norms on loan portfolio including teaser loan book, HDFC carries a cumulative provision of Rs15.8bn (1.2% of total loans) on balance sheet. The teaser loan portfolio provision stands at Rs4.5bn which will reverse in Q1FY13. However, given tightened regulatory requirement we have raised our provisioning cost to 6bps of average assets over FY12-13E.

Valuations and view

HDFC has exhibited resilience given its ability to deliver a) strong loan growth b) stable asset quality and c) superior return ratios. Q3 results clearly shrugged-off concerns over any material slowdown in loan growth due to higher interest rates and elevated property prices. Also with repayment ratio at sub-10%, concerns over pre-payment remain miniscule. We expect the mortgage giant to report steady 18% CAGR in loan portfolio over FY11-13E. Even after factoring margin compression and 6bps of credit cost, we expect RoA/RoE to average 2.5%/21% over FY11-13E. Maintain HOLD with target price of Rs700.

Key Financials

Profit and loss (Rs mn)

(Y/E Mar 31)	FY10	FY11	FY12E	FY13E
Net interest income	33,875	42,471	49,480	54,058
Other income	7,008	7,113	8,497	10,020
Net Income	40,884	49,584	57,977	64,078
Operating expenses	3,056	3,620	4,355	5,193
Depreciation	182	192	202	218
Preprovision profit	37,646	45,772	53,420	58,667
Provisions	580	700	966	938
Profit before tax	39,160	48,670	52,454	57,729
Tax	10,895	13,320	13,376	14,721
Tax rate	27.8	14.8	25.5	25.5
Adjusted Profit after tax	26,754	32,283	39,078	43,008

Balance sheet (Rs mn)

(Y/E Mar 31)	FY10	FY11	FY12E	FY13E
Equity share capital	2,871	2,934	2,934	2,934
Reserves And Surplus	149,106	170,231	192,025	216,010
Net worth	151,977	173,165	194,959	218,943
Borrowings	965,653	1,154,105	1,356,073	1,566,264
Deferred tax liability	-2,857	-4,481	-4,481	-4,481
Current liabilities	48,785	67,751	67,854	67,854
Total liabilities	1,163,557	1,390,540	1,614,404	1,848,580
Net block	2,221	2,340	3,215	3,215
Investments	107,275	118,324	123,327	128,292
Loans	979,670	1,171,266	1,385,891	1,620,361
Current assets	74,391	98,610	101,970	96,712
Total assets	1,163,557	1,390,540	1,614,404	1,848,580

As % of assets

(Y/E Mar 31)	FY10	FY11	FY12E	FY13E
Yield on assets	9.6	9.2	9.6	9.5
Spreads	3.1	3.3	3.5	3.2
NIM	3.1	3.3	3.3	3.1
Other income	0.6	0.6	0.6	0.6
Net Income	3.8	3.9	3.9	3.7
Operating expenses	0.3	0.3	0.3	0.3
Preprovision profit	3.5	3.6	3.6	3.4
Provisions	0.1	0.1	0.1	0.1
Profit before tax	3.6	3.8	3.5	3.3
RoAA	2.5	2.5	2.6	2.5
Gross NPA (%)	0.8	0.8	0.8	0.9
Net NPA (%)	0.1	0.0	0.2	0.2

Valuations

(Y/E Mar 31)	FY10	FY11	FY12E	FY13E
Adj PAT (Rs mn)	26,754	32,283	39,078	43,008
No of shares (mn)	1,436	1,467	1,467	1,467
FDEPS (Rs)	18.6	22.0	26.6	29.3
PER (x)	36.9	31.3	25.8	23.5
Book value (Rs)	105.9	118.1	132.9	149.3
P/BV (Rs)	6.5	5.8	5.2	4.6
Adjusted book value (Rs)	105.0	118.1	131.3	147.3
P/ABV (Rs)	6.5	5.8	5.2	4.7
P/PPP (x)	26.2	22.0	18.9	17.2
RoE (%)	18.9	19.9	21.2	20.8
Dividend yield (%)	1.0	1.3	1.3	1.3

Recommendation History: HDFC Ltd. – HDFC IN

Date	Reports	Reco	CMP	Target
06/01/2012	India - Housing Finance Sector Report	Hold	665	700

Recent Research Reports

Date	Reports	Reco	CMP	Target
04/11/2011	Manappuram G F Q2FY12 Result Update	Hold	61	65
02/11/2011	ICRA Q2FY12 Result Update	Reduce	990	900
02/11/2011	Allahabad Bank Q2FY12 Result Update	Accumulate	161	200
02/11/2011	United Bank of India Q2FY12 Result Update	Hold	71	73

Emkay Global Financial Services Ltd.

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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