

HDFC - BUY

Investment overview

- HDFC is a financial conglomerate with its presence in the entire gamut of financial services.
- The company, on consolidated basis, has registered a growth of 25.08% in its net profit after tax for the quarter ended June 30, 2012.
- HDFC's loan approvals grew by 17% and loan disbursements grew by 20% in the passing quarter.
- Despite challenging environment, HDFC has seen sanctions and disbursements growing at a healthy pace.

Business Overview

Housing Development Finance Corporation Limited (HDFC) established in 1977 has turned the concept of housing finance for the growing middle class in India into a world-class enterprise with excellent reputation for professionalism, integrity and impeccable service. Over the years, HDFC has emerged as a financial conglomerate with its presence in the entire gamut of financial services including banking, insurance (life and non-life), asset management, real estate venture capital and more recently education loans.

HDFC has a wide network of 318 offices (which includes 77 offices of HDFC's wholly owned distribution company HDFC Sales Private Limited) catering to over 2,400 towns & cities spread across the country. It also has offices in Dubai, London and Singapore and service associates in the Middle East region, to provide housing loans and property advisory services to Non-Resident Indians (NRIs) and Persons of Indian Origin (PIOs).

HDFC's wide product range includes loans for purchase and construction of a residential unit, purchase of land, home improvement loans, home extension loans, non-residential premises loans for professionals and loan against property, while its flexible repayment options include Step Up Repayment Facility (SURF) and Flexible Loan Installment Plan (FLIP). HDFC also has a robust deposits mobilisation programme. HDFC has been able to mobilise deposits from over 10 lac depositors.

Today, HDFC is recognised as one of the Best Managed Companies in India and is a model housing finance company for developing countries with nascent housing finance markets. HDFC has undertaken several consultancy assignments in various countries across Asia, Africa and East Europe to support and establish their housing finance institutions.

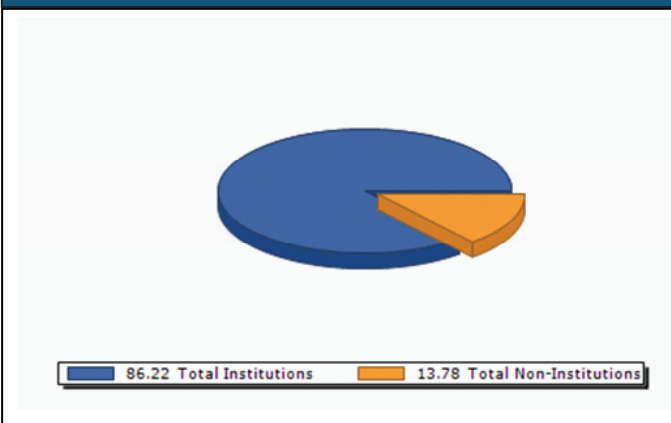
Its subsidiaries and associate companies include, HDFC Bank, HDFC Asset Management Company Ltd, HDFC Standard Life Insurance Company Limited, HDFC Sales, HDFC ERGO General Insurance Company Ltd (formerly HDFC General Insurance Company Ltd), while other companies co-promoted by HDFC include, HDFC Realty Ltd, HDFC Trustee Company Ltd, GRUH Finance Ltd, HDFC Developers Ltd. HDFC Property Ventures Ltd, HDFC Ventures Trustee Company Ltd, HDFC Investments Ltd. HDFC Holdings Ltd, Credit Information Bureau (India) Ltd.

Financial Health

For the quarter ended June 30, 2012, HDFC reported a rise of 19% in its profit after tax to Rs 1,001.91 crores as compared to Rs 844.53 crore in the corresponding quarter of the previous year. Total income has increased by 29.29% at Rs 4,934.95 crore for the quarter under review as compared to Rs 3,816.93 crore for the quarter ended June 30, 2011.

Stock Data		05/10/2012
Current Mkt Price (Rs)		749.65
52 Week High		793.85
52 Week Low		600.85
Mkt Cap (Rs. in Cr)		115293.9
Return in last one Month (%)		3.46

Share Holding



Performance in last one year



Y-o-Y Performance

(Rs. in Cr.)			
Particulars	Mar-12	Mar-11	Change(%)
Net Sales	29930.45	25783.67	16.08
Other Income	27.08	27.55	-1.71
Total Expenditure	12138.24	12642.08	-3.99
Operating Profit	17819.29	13169.14	35.31
Interest	11551.92	7876.07	46.67
Profits After Tax	4489.77	3704.83	21.19
Reserve & Surplus	24063.92	20720.83	16.13
Reported EPS(Rs)	36.99	30.87	19.80
Core EBITDA Margin (%)	59.45	50.97	16.63

The company, on consolidated basis, has registered a growth of 25.08% in its net profit after tax attribute to the Corporation and its subsidiaries at Rs 1275.86 crore for the quarter under review as compared to Rs 1020.06 crore for the same quarter in the previous year. The total income of the company has increased by 21.64% at Rs 7276.51 crore for Q1FY13 as compared Rs 5981.96 crore for the corresponding quarter previous year.

Total assets of the company increased by 17% to Rs 1,74,676 crore as against Rs 148,831 crore as at June 30, 2011. The loan book of the company during the quarter stood at Rs 1,48,262 crore as against Rs 1,24,168 crore in the corresponding previous quarter. HDFC's capital adequacy ratio stood at 14.6% of the risk weighted assets, as against the minimum requirement of 12%. Tier 1 capital was 11.8% against a minimum requirement of 6%.

Industry Scenario

The Indian housing mortgage industry is on a strong footing, given the immense growth potential and its ability to weather ups and downs in the real estate sector. Housing shortage over the last few decades is one of the major drivers of growth of the housing finance industry. This is especially true in rural and semi-urban areas though a significant level of shortage continues to persist in urban areas as well. Mortgage industry in India is characterized by the first-time home borrower primarily in working class group and with limited liability. In earlier days home-buyers in India were debt averse and opted for external funding only as a last resort, but with the changing living conditions and increasing requirements the priorities changed and now people are more relying on debt for their housing need. The accessibility of housing finance has improved over the years with a growing number of customers willing and able to take loans to finance the purchase or construction of their homes. This has resulted from higher levels of disposable income among the salaried class. Government too has been consistently provided greater incentives in the form of tax deductions to individuals availing themselves of housing loans. Not only that, the government has introduced increasingly liberalized policies with respect to the housing sector which has helped sustain the growth of the housing finance industry. The government eased the external commercial borrowing (ECB) norms by allowing non-banking finance companies and housing finance companies to raise money overseas through FCCBs subject to RBI approval.

Indians are in general moving from a joint family structure to a nuclear family system. This in turn leads to an increased demand for housing stock and hence the trend promotes the growth of the housing finance industry. The growing employment opportunities coupled with affordable property prices and availability of easy finance have resulted in increasing number of people migrating from smaller towns to tier-II and tier-III cities. There has been a shift in the typical age profile of home loan customers from late 30s and early 40s age group in the late 1990s to mid 30s presently. However, a steady change in India's housing finance sector is currently underway, with mortgage financing being available more easily and debt being increasingly seen as an acceptable means of financing home purchase.

After a lull in 2008-09, real estate prices are back to their peak levels of 2007, though there has been demand revival but higher interest rates have restricted growth in tier-I cities. Housing Finance Companies (HFCs) and banks form two major groups of housing finance providers in India. HFCs are facing competition from banks as the housing finance industry, which was dominated by HFCs a few years ago, has seen the share of banks steadily increasing in last

Q-o-Q Performance

(Rs. in Cr.)			
Particulars	Jun-12	Jun-11	Change(%)
Net Sales	4934.95	3816.93	29.29
Expenditure	169.40	126.68	33.72
Other Income	7.36	4.67	57.60
EBITDA	4772.91	3694.92	29.17
Interest	3388.21	2514.93	34.72
Net Profit	1001.91	844.53	18.64
EBITDA Margin (%)	0.97	0.97	-0.09
NPM (%)	0.02	0.02	-8.24
EPS	6.77	5.75	17.74

Profit & Loss

(Rs. in Cr.)			
Particulars	Mar-12	Mar-11	Change(%)
Net Sales	29930.45	25783.67	16.08
Total Income	29957.53	25811.22	16.06
Total Expenditure	12138.24	12642.08	-3.99
Operating Profit	17819.29	13169.14	35.31
Profits After Tax	4489.77	3704.83	21.19

Balance Sheet

(Rs. in Cr.)			
Particulars	Mar-12	Mar-11	Change(%)
Share Capital	295.39	293.37	0.69
Reserve & Surplus	24063.92	20720.83	16.13
Total Liabilities	105594.47	87408.15	20.81
Investments	53049.11	43265.21	22.61
Current Liabilities	102938.35	85444.64	20.47
Net Current Assets	-78695.78	-61456.79	28.05
Total Assests	105594.47	87408.15	20.81

Key Ratios

Particulars	Mar-12	Mar-11
Reported EPS (Rs)	36.99	30.87
Core EBITDA Margin (%)	59.45	50.97
EBIT Margin (%)	59.37	50.89
ROA (%)	4.65	3.62
ROE (%)	19.83	18.95
ROCE (%)	11.62	10.26
Price/Book (x)	4.09	4.89
Net Sales Growth (%)	16.08	1.46
EBIT Growth (%)	35.43	17.43
PAT Growth (%)	21.19	40.92
Total Debt/Mcap (%)	1.43	1.15

couple of years. Housing finance provides a very attractive opportunity for banks to employ funds with relatively low default rates, moderate spreads, low credit risk weight, and comparatively faster growth than other lending businesses. However the outlook of the housing finance industry remains healthy as the Indian economy has demonstrated robust performance in the last few years and there is a strong linkage of demand for housing with economic growth.

Investment Rationale

- HDFC numbers came as per expectations in the first quarter of the fiscal and the company posted significant growth in its loan book. During the quarter ended June 30, 2012 the loan book of the company grew by Rs 7,387.74 crore of which Rs 6,635.07 crore, representing 90% of the increase was on account of the surge in the individual loan book. On the same time, loan approvals grew by 17% and loan disbursements grew by 20% as compared to the corresponding quarter in the previous year. Gross non-performing loans (NPL) as at June 30, 2012 amounted to Rs 1,190 crore, which was equivalent to 0.79% of the loan portfolio. Marking the thirtieth consecutive quarter end at which the percentage of non-performing loans has been lower than the corresponding quarter in the previous year. However, sequentially NII growth showed sign of slowing to 18.7%, lower than 23.4% reported in 4QFY12. Consequently, NIMs too were down at 4.1% from 4.4%. The growth in both home loan approvals and disbursements was lower than last year, indicating that demand for loans was weakening.
- At present HDFC has a widespread branch reach with nearly 320 own outlets. Besides, more than 2,500 branches of HDFC Bank market HDFC's mortgage loans. It has also tied-up recently with IndusInd Bank to spread its reach. Moreover, cross-selling of financial products and services continued to form the cornerstone of HDFC's marketing strategy, thereby providing a wide range of financial services and products under the 'HDFC umbrella'. HDFC also organises property fairs across major cities in the country with an aim to provide a wide spectrum of approved projects under a single roof. Going further, the management does not see any stress on its retail portfolio as the retail customers continue to repay their loans timely. So far in FY13, retail segment has shown higher growth representing 90% of the increase.
- HDFC is well placed to deliver 18-20% loan growth with stable margins and asset quality driven by growth in the smaller towns. As per the present loan book, the loans to developers constitute 13% of total loans, while 67% is from retail home loan customers. For the rest of the 20%, HDFC give loans to other companies to meet their own or their employees' real estate requirements. The company also disburses loans in the form of rental discounting, wherein it disburse fresh loans to companies against the rent receivables from their existing properties and this composition is likely to continue. Despite challenging environment, sanctions and disbursements continued to grow at a healthy pace. While metros have seen some moderation in demand due to high interest rates and property prices, growth from smaller towns is holding-up well and is likely to drive growth.
- In August 2009, HDFC had issued warrants - along with

non-convertible debentures (NCDs) of Rs 10 lakh each - to qualified institutional buyers. The issue, comprising zero coupon NCDs aggregated to Rs 4,000 crore. Out of this, Rs 2,000 crore NCDs were redeemed in August 2011 and the balance Rs 2,000 crore were redeemed on August 24 this year. Every warrant holder had a right to exchange warrants with one equity share of the lender but with an additional payment (or conversion price) of Rs 600 per equity share. Pursuant to the exchange of the warrants, the Corporation issued and allotted 5,47,43,150 equity shares of Rs 2 each and realised an amount of Rs 3,284.59 crore, representing 99.95% of the warrants issued. The proceeds from the warrant exchange will be used to replace the zero coupon bonds and consequently the Corporation will not earn any additional interest income on the amounts raised. These warrants were offered at a price of Rs 55 and gave investors nearly 121.8% return on conversion. HDFC is now replacing the high cost bank term loans with borrowings through relatively low cost bonds and debentures, it is also planning to raise up to Rs 500 crore (\$89.51 million) through five-year bonds at 9.50 percent.

- In its latest initiative to attract home buyers wary of fluctuating interest rates, HDFC has launched a TruFixed Home Loan as an Independence Day special; under this product the customer has the option to choose a Fixed Interest Rate Period (FIRP) between 3 to 10 years. Once the fixed rate period is over, for floating loan the rate will be decided as HDFC RPLR minus the spread as applicable currently on the loan amount being availed under this product. In the case of the 'Truefixed' loan, similar to conventional home loans, borrowers will be allowed to make part-repayments out of their own funds without attracting any penalty.
- At the CMP of Rs 749.65, HDFC is trading at a TTM P/E of 21.12x and 4.14x of P/BV, we would recommend 'BUY' in the scrip with a price target of Rs 823 for a long term investment outlook. A strong loan book growth coupled with a better asset quality is likely to continue adding up its profit. Despite steep increase in rates, HDFC has been able to maintain its spreads through its active asset-liability management. At present, home ownership levels in India are under penetrated and considering the favourable demographics, and as the affordability levels of the masses increase, HDFC can reap positive results in the long run. HDFC's consolidated profit is likely to grow faster, driven by growth of profit in HDFC Bank and the profits of the life and general insurance subsidiaries. HDFC has from time to time entered into risk management arrangements in order to hedge its exposure to foreign exchange and interest rate risks. The currency risk on the borrowings is actively hedged through a combination of dollar denominated assets, long term forward contracts, principal only swaps, full currency swaps and currency options. The management is of the view that not only is the longer-term potentials of mortgage financing strong in India, near-to-medium term demand is also holding-up well and believes that easing of wholesale liquidity and interest rates will support HDFC's ability to gain market share from banks.

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