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Rating	Accumulate
Price	Rs751
Target Price	Rs800
Implied Upside	6.5%
Sensex	18,793
Nifty	5,717

(Prices as on October 22, 2012)
Trading data

Market Cap. (Rs bn)	1,108.8
Shares o/s (m)	1,477.0
3M Avg. Daily value (Rs m)	4076.3

Major shareholders

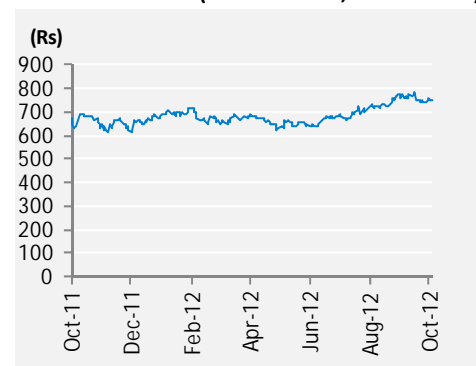
Promoters	0.00%
Foreign	68.72%
Domestic Inst.	18.03%
Public & Other	13.25%

Stock Performance

(%)	1M	6M	12M
Absolute	(3.8)	9.9	18.5
Relative	(4.0)	1.7	6.6

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	32.3	31.8	1.6
2014	37.8	37.8	0.2

Price Performance (RIC: HDFC.BO, BB: HDFC IN)


Source: Bloomberg

HDFC reported in-line Q2FY13 PAT with higher-than-expected dividend income making up for higher-than-expected opex. Growth trends remain robust and flexibility in funding is aiding margins. Since our July-12 upgrade, HDFC has moved up ~17% despite higher competitive intensity. Implied valuations on the mortgage business has inched up from 2.8x to ~3.2x FY14 book, providing only ~10% upside to our Sep-13 PT of Rs825/share and hence, we downgrade HDFC to 'Accumulate'.

- Positives - Growth trends robust; margins stable:** Loan growth at 24% YoY was robust, driven by ~27% YoY growth in individual AUMs. Margins were stable QoQ and the key highlight was the flexibility in funding mix with share of bank funding coming off from 26% to 13% with a proportional increase in deposits and bonds. Possible margin pressure due to competition and loan mix will be netted off by sharp drop in wholesale rates and high flexibility in funding.
- Other Q2FY13 highlights: (1)** Opex has inched up ~30% over the last three quarters and part of the jump is explained by new corporate office leased but not moved in and thus opex growth is expected to normalize in 2-3 quarters **(2)** Tax rate was lower largely due to lower tax rate on investment gains and dividends received **(3)** Dividend income jumped substantially in Q2FY13 as dividends from HDFC Bank was accounted for in Q2 in FY13 v/s Q1 in FY12.
- Valuation catch-up largely done:** Accounting concerns, sluggish book growth and technical supply factors led to a HDFC trading at ~20-25% discount to its historic average valuations (in Jun-July 2012) but with ~20% move up in the last three months, HDFC now trades closer to fair valuations with just 10% potential upside and hence our downgrade. The mortgage business will continue to generate ~24-25% core ROEs with ~20% growth and hence premium valuations will be sustained.

Key Financials (Y/e March)	2011	2012	2013E	2014E
Net interest income (Rs m)	41,335	49,765	62,220	74,155
Growth (%)	26.1	20.4	25.0	19.2
Non-interest income (Rs m)	11,847	12,210	12,554	13,476
Operating Profit (Rs m)	49,370	57,456	69,542	81,570
PAT (Rs m)	35,350	41,226	49,462	57,975
EPS (Rs)	24.1	27.9	32.3	37.8
Growth (%)	22.4	15.8	15.7	17.2
Net DPS (Rs)	9.0	11.0	13.2	15.5

Profitability & valuation	2011	2012	2013E	2014E
Spreads / Margins (%)	3.2	3.2	3.4	3.4
RoAE (%)	21.7	22.7	22.4	21.5
RoAA (%)	2.8	2.7	2.7	2.7
P/E (x)	31.2	26.9	23.2	19.8
P/BV (x)	6.4	5.8	4.6	4.0
P/ABV (x)	6.4	5.8	4.6	4.0
Net dividend yield (%)	1.2	1.5	1.8	2.1

Source: Company Data; PL Research

Exhibit 1: Q2FY13 Financials : Strong loan growth and steady margin

	2Q12	1Q13	2Q13	YoY	QoQ	
Net interest income	13,064	14,638	15,804	21.0%	8.0%	
<i>NII grew 18% YoY supported by strong growth loan book and stable margin</i>	Fees	853	701	613	-28.2%	-12.6%
Net revenues	13,918	15,339	16,417	18.0%	7.0%	
<i>Higher growth in opex reflects expenses towards new corporate office</i>	Operating expenditure	1,409	1,742	1,877	33.2%	7.7%
Operating profit	12,508	13,597	14,540	16.2%	6.9%	
	Investment profit	869	202	941	8.3%	365.0%
Profit before tax	13,377	13,799	15,481	15.7%	12.2%	
	Tax	3,670	3,780	3,970	8.2%	5.0%
PAT	9,707	10,019	11,511	18.6%	14.9%	
<i>Higher dividend income compensates for higher opex</i>	Liabilities					
	Share Capital	2,944	2,977	3,078	4.5%	3.4%
	Reserves and Surplus	183,971	201,678	241,191	31.1%	19.6%
	Loan funds					
	Term Loans	323,243	374,844	197,240	-39.0%	-47.4%
	Bonds	610,505	663,838	798,040	30.7%	20.2%
<i>Growth being funded from bonds and deposits due to higher base rate for bank loans – Advantage of funding flexibility continues</i>	Deposits	317,280	399,434	482,620	52.1%	20.8%
	Total	1,251,027	1,438,116	1,477,900	18.1%	2.8%
	Assets					
	Loans					
	Individuals	802,680	954,129	994,012	23.8%	4.2%
	Corporates	451,442	509,977	537,633	19.1%	5.4%
	Others	15,802	18,517	19,635	24.3%	6.0%
<i>Growth driven by both the individual mortgages and corporate book</i>	Total	1,269,924	1,482,623	1,551,280	22.2%	4.6%
	Investments	149,804	151,825	150,241	0.3%	-1.0%

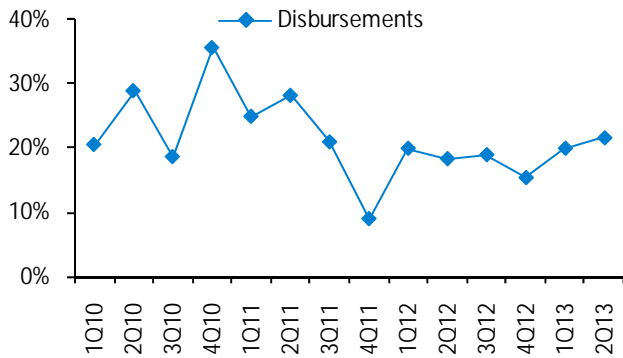
Source: Company Data, PL Research

Exhibit 2: Operating Matrix

	2Q12	1Q13	2Q13	YoY	QoQ
Operating data					
Disbursements	207,335	156,384	252,178	21.6%	61.3%
Borrowings	1,251,027	1,438,116	1,477,900	18.1%	2.8%
Loans	1,269,924	1,482,623	1,546,353	21.8%	4.3%
Loans (including sold portfolio)	1,372,934	1,621,343	1,703,833	24.1%	5.1%
Funds	1,251,027	1,438,116	1,477,900	18.1%	2.8%
Cost-income	10.1%	11.4%	11.4%	1.3%	0.1%
Gross NPL (%)	0.82%	0.79%	0.77%	-0.1%	0.0%
NIM	3.69%	3.70%	3.80%	0.1%	0.1%
Spreads	2.37%	2.28%	2.27%	-0.10%	-0.01%
ROE	21.1%	20.3%	20.5%	-0.6%	0.2%

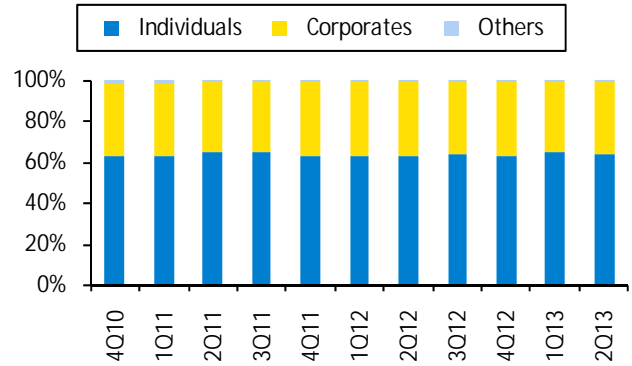
Source: Company Data, PL Research

Exhibit 3: Disbursement growth has picked up



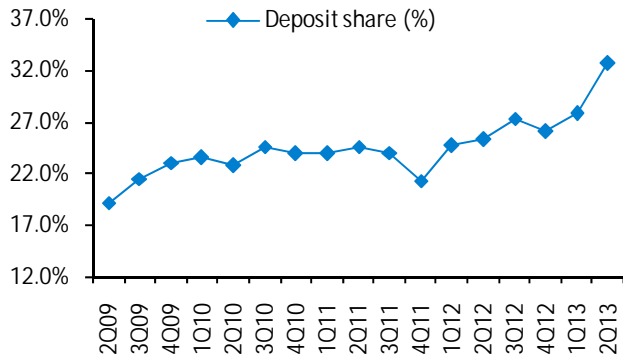
Source: Company Data, PL Research

Exhibit 4: Both the retail and corporate book contributing to growth



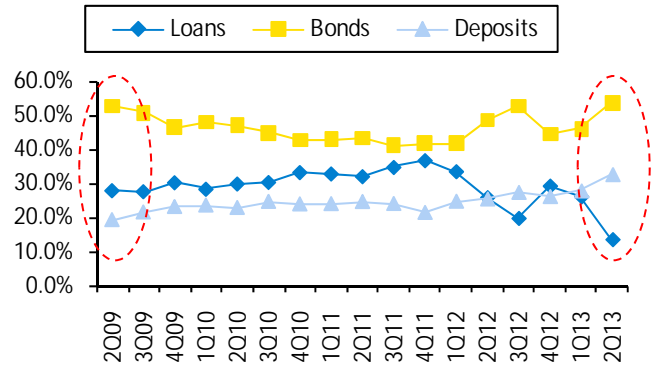
Source: Company Data, PL Research

Exhibit 5: Funding from deposits have been increasing



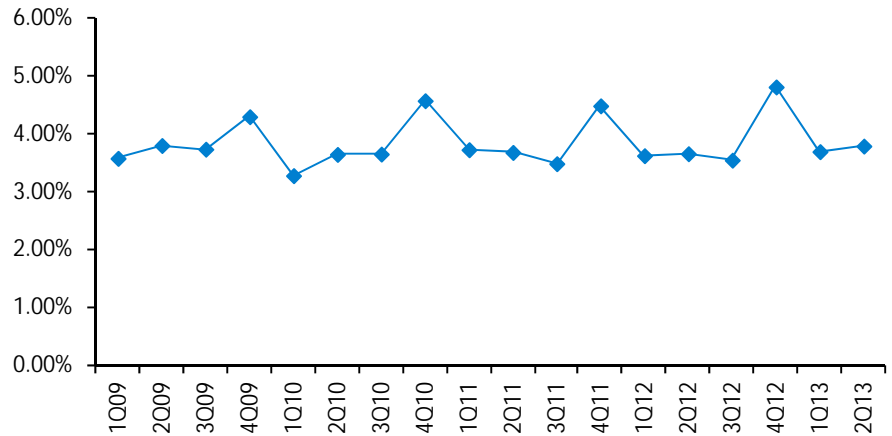
Source: Company Data, PL Research

Exhibit 6: Growth largely deposit/bond funded



Source: Company Data, PL Research

Exhibit 7: NIMs remain stable, barring seasonal volatility



Source: Company Data, PL Research

**Exhibit 8: Our subsidiary valuation of Rs235/share not aggressive**

	Value per share	Method
HDFC Bank	199	3.75x FY14 book
HDFC Standard Life	49	Appraisal value
HDFC Asset Management	11	4% of AUM
Fair value of key subsidiaries	259	
HDFC Ltd (standalone)	566	2-stage Gordon Growth
Sep-13 PT	825	

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Int. Inc. / Opt. Inc.	116,934	161,333	188,615	226,627
Interest Expenses	75,599	111,568	126,395	152,472
Net interest income	41,335	49,765	62,220	74,155
<i>Growth (%)</i>	<i>26.1</i>	<i>20.4</i>	<i>25.0</i>	<i>19.2</i>
Non interest income	11,847	12,210	12,554	13,476
<i>Growth (%)</i>	<i>16.1</i>	<i>3.1</i>	<i>2.8</i>	<i>7.3</i>
Net operating income	53,181	61,975	74,775	87,631
Expenditure				
Employees	1,755	2,058	2,367	2,722
Other expenses	2,056	2,461	2,865	3,339
Depreciation	—	—	—	—
Total expenditure	3,812	4,519	5,232	6,061
PPP	49,370	57,456	69,542	81,570
<i>Growth (%)</i>	<i>24.2</i>	<i>16.4</i>	<i>21.0</i>	<i>17.3</i>
Provision	700	800	880	968
Other income	—	—	—	—
Exchange Gain / (Loss)	700	800	880	968
Profit before tax	48,670	56,656	68,662	80,602
Tax	13,320	15,430	19,201	22,628
<i>Effective tax rate (%)</i>	<i>27.4</i>	<i>27.2</i>	<i>28.0</i>	<i>28.1</i>
PAT	35,350	41,226	49,462	57,975
<i>Growth (%)</i>	<i>25.1</i>	<i>16.6</i>	<i>20.0</i>	<i>17.2</i>

Balance Sheet (Rs m)

Y/e March	2011	2012	2013E	2014E
Sources of funds				
Equity	2,934	2,954	3,063	3,063
Reserves & Surplus	163,572	180,563	242,550	276,831
Networth	173,165	190,176	252,273	286,554
<i>Growth (%)</i>	<i>13.9</i>	<i>9.8</i>	<i>32.7</i>	<i>13.6</i>
Loan funds	907,854	1,028,347	1,208,347	1,413,347
<i>Growth (%)</i>	<i>—</i>	<i>13.3</i>	<i>17.5</i>	<i>17.0</i>
Deposits	246,251	362,928	422,928	552,928
Other Liabilities	67,751	93,749	93,749	93,749
Total	1,395,021	1,675,199	1,977,297	2,346,578
Application of funds				
Net fixed assets	2,340	2,340	2,325	2,295
Advances	1,171,266	1,408,746	1,684,892	2,025,259
<i>Growth (%)</i>	<i>19.6</i>	<i>20.3</i>	<i>19.6</i>	<i>20.2</i>
Net current assets	121,537	112,350	140,729	153,642
Investments	20,955	39,205	22,949	22,949
<i>Growth (%)</i>	<i>58.7</i>	<i>87.1</i>	<i>(41.5)</i>	<i>—</i>
Deferred tax asset	—	—	—	—
Other Assets	78,923	112,559	126,403	142,432
Total	1,395,021	1,675,199	1,977,297	2,346,578

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Int. Inc. / Operating Inc.	43,018	47,438	48,520	51,218
Income from securitization	—	—	1	1
Interest Expenses	30,124	29,389	33,882	35,414
Net Interest Income	12,894	18,049	14,638	15,804
<i>Growth</i>	<i>17.2</i>	<i>26.3</i>	<i>19.3</i>	<i>21.0</i>
Non interest income	1,707	1,472	903	1,554
Net operating income	14,601	19,521	15,541	17,358
<i>Growth</i>	<i>10.0</i>	<i>17.9</i>	<i>18.9</i>	<i>17.4</i>
Operating expenditure	1,319	1,280	1,742	1,877
PPP	13,282	18,242	13,799	15,481
<i>Growth</i>	<i>9.6</i>	<i>17.3</i>	<i>17.4</i>	<i>15.7</i>
Provision	—	—	—	—
Exchange Gain / (Loss)	—	—	—	—
Profit before tax	13,282	18,242	13,799	15,481
Tax	3,470	4,980	3,780	3,970
Prov. for deferred tax liability	—	—	—	—
<i>Effective tax rate (%)</i>	<i>26.1</i>	<i>27.3</i>	<i>27.4</i>	<i>25.6</i>
PAT	9,812	13,262	10,019	11,511
<i>Growth</i>	<i>10.3</i>	<i>16.0</i>	<i>18.6</i>	<i>18.6</i>

Key Ratios

Y/e March	2011	2012	2013E	2014E
CMP (Rs)	751	751	751	751
Eq. Shrs. O/s. (m)	1,467	1,477	1,532	1,532
Market Cap (Rs m)	1,101,238	1,108,820	1,149,924	1,149,924
Market Cap to AUM (%)	0.8	0.7	0.6	0.5
EPS (Rs)	24.1	27.9	32.3	37.8
Book Value (Rs)	118.1	128.8	164.7	187.1
Adjusted Book Value (Rs)	118.1	128.8	164.7	187.1
P/E (x)	31.2	26.9	23.2	19.8
P/BV (x)	6.4	5.8	4.6	4.0
P/ABV (x)	6.4	5.8	4.6	4.0
DPS (Rs)	9.0	11.0	13.2	15.5
Dividend Yield (%)	1.2	1.5	1.8	2.1

Asset Quality

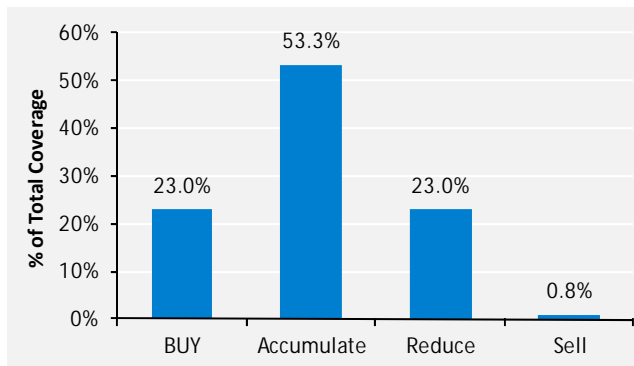
Y/e March	2011	2012	2013E	2014E
Gross NPAs (Rs m)	9,019	10,425	12,468	14,987
Net NPAs (Rs m)	—	—	—	—
Gross NPAs to Gross Adv. (%)	0.8	0.7	0.7	0.7
Net NPAs to Net Adv. (%)	—	—	—	—
NPA Coverage (%)	—	—	—	—

Profitability (%)

Y/e March	2011	2012	2013E	2014E
NIM	3.2	3.2	3.4	3.4
RoAA	2.8	2.7	2.7	2.7
RoAE	21.7	22.7	22.4	21.5

Source: Company Data, PL Research.

Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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