

RESULT ANALYSIS
HDFC Ltd
Hold
Share Data

Market Cap	Rs. 785.30 bn
Price	Rs. 2,756.30
BSE Sensex	16,440.56
Reuters	HDFC.BO
Bloomberg	HDFC IN
Avg. Volume (52 Week)	1.40 mn
52-Week High/Low	Rs. 2,836 / 1,151
Shares Outstanding	284.9 mn

CMP captures potential upside

HDFC's Q2'10 net profit increased by 22.9% yoy and 17.5% sequentially to Rs. 6.6 bn primarily due to increase in other operating income, which was driven by an increase in the fee and charges and the profit on revaluation of investments. In addition, HDFC reported a satisfactory growth in its loan-book as well as net interest margin. Factoring in the similar loan book growth in the upcoming quarters, our fair value estimate for the stock is Rs. 2,960, which offers a limited upside of 7.4% from the CMP. Thus, we do not merit position-building and maintain our Hold rating.

Valuation Ratios (Standalone)

Year to 31 March	2010E	2011E
EPS (Rs.)	80.5	77.0
+/- (%)	0.3%	(4.3)%
PER (x)	34.2x	35.8x
P / PPP (x)	23.9x	23.7x
P / ABV (x)	5.3x	5.0x

Growth momentum in loan likely to increase: HDFC's advances increased 2.8% sequentially to Rs. 895.2 bn. Loans to individuals, which accounted for 64% of the total loans, increased by 4.0% sequentially. With the improving demand environment for residential mortgages as a result of low property prices and attractive financing rates, we estimate HDFC's advances to grow by 5-6% for the rest of the year. However, increasing competition from the PSBs might pose a challenge for HDFC.

Shareholding Pattern (%)

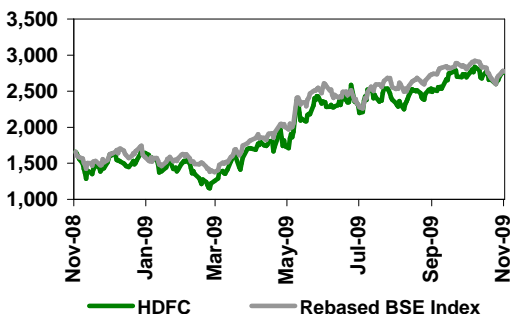
Promoter	-
FII's	60
Institutions	28
Public & Others	12

Margins likely to remain subdued: HDFC's net interest margin for Q2'10 increased by 18 bps sequentially to 3.0%. We expect the NIMs to remain stable for FY10 at ~3% as the increase in the cost of bonds, which forms a significant portion of the total interest cost, is likely to mitigate the increase in the yields on loan and investments.

Holding >1% (Non-Promoter)

Citigroup Strategic Holdings Mauritius Ltd	9.09
CMP Asia Ltd	5.41
Europacific Growth Fund	4.43
Life Insurance Corporation of India	2.64
Citigroup Holdings Mauritius Ltd	2.62

Asset quality intact: HDFC's gross NPA ratio decreased marginally by 3 bps sequentially to 0.95%. We do not anticipate a significant rise in delinquencies as the credit approval and disbursement standards, and follow-up processes remain robust, which assist in taking remedial measures and prevent a sharp rise in NPAs.

Relative Performance

Key Figures
Quarterly Data

(Figures in Rs. mn, except per share data)

	Q2'09	Q1'10	Q2'10	YoY%	QoQ%	H1'09	H1'10	YoY%
Net Interest Income	7,461	6,686	7,364	(1.3)%	10.1%	13,977	14,049	0.5%
Net Operating Income	8,691	8,863	10,137	16.6%	14.4%	16,194	19,000	17.3%
Pre-Prov Operating Profit	7,818	7,919	9,269	18.6%	17.0%	14,416	17,189	19.2%
Net Profit	5,400	5,649	6,639	22.9%	17.5%	10,081	12,289	21.9%
NPLs	1.04%	0.98%	0.95%	-	-	1.04%	0.95%	-
Spread	-	-	-	-	-	2.24%	2.20%	-
Cost/Net operating income	10.1%	10.6%	8.6%	-	-	11.0%	9.5%	-
Per Share Data (Rs.)								
PPP per share	26.6	26.9	31.8	19.4%	18.5%	49.3	58.7	19.0%
Diluted EPS	18.4	19.2	22.8	23.9%	18.9%	34.5	42.0	21.7%
Book value per share	454.8	480.9	513.9	13.0%	6.9%	454.8	513.9	13.0%

Result Highlights

In Q2'10, HDFC's net profit increased by 22.9% yoy and 17.5% sequentially to Rs. 6.6 bn, primarily driven by a strong rise in the fee and charges, and the profit on revaluation of investments.

- In Q2'10, NII showed a healthy sequential growth of 10.1% to Rs. 7.4 bn. However, NIM increased by 18 bps sequentially as the effect of fall in average cost of funds was mitigated by a sharp drop in the yields on loans and investments.
- Other operating income increased 22.2% sequentially to Rs. 1.4 bn, primarily due to a sequential increase of 52.4% in fee and other charges.
- In addition to the improvement in operating income, the cost-income ratio of HDFC improved and witnessed a decline of 149 bps yoy and 209 bps sequentially to 8.6%. As a result, Pre-Provisioning Profit increased 17.0% qoq to Rs. 9.3 bn.
- HDFC's loan-book increased 10.3% yoy and 2.8% qoq to Rs. 895.2 bn. Loan approvals for the quarter increased 31.9% qoq to Rs. 161.6 bn while disbursements increased impressively by 57.2% sequentially to Rs. 136.5 bn.
- As expected, HDFC's gross NPA ratio remained almost flat at 0.95%. It decreased marginally by 3 bps sequentially, in line with the previous quarters. We expect the delinquencies to largely remain flat as the credit approval and disbursement standards, and follow-up processes remain robust, which assist in taking remedial measures and prevent a sharp rise in NPAs.
- At the close of Q2'10, HDFC's Tier 1 capital adequacy ratio stood at 13.4% while total capital adequacy ratio stood at 14.9% vis-à-vis the regulatory minimum of 6% and 12%, respectively.

Valuation

Our fair value estimate of Rs. 2,960 for FY10 is based on the sum-of-the-parts (SOTP) valuation methodology. The standalone business of HDFC has been valued using the three-stage Discounted Equity Cash Flow (DECF) model. Our key assumption for cost of equity is 16.16% and a

terminal growth rate is 13.78%. HDFC's subsidiaries have been valued as follows:

- The Corporation's 22.8% stake in HDFC Bank has been valued at Rs. 595, based on our fair value estimate of Rs. 1,738 for the Bank.
- HDFC Standard Life Insurance Company has been valued at a target new business achieved profit (NBAP) multiple of 18x. This values HDFC's 72.4% stake in the life insurance business at Rs. 383.
- HDFC ERGO General Insurance Company has been valued at a P/E multiple of 20.0x, which gives a price of Rs. 32 per share for HDFC's 74% stake.
- HDFC Asset Management Company has been valued at 7% of its AUM, which gives a valuation of Rs. 126.
- The remaining subsidiaries of HDFC have been valued at 1.0x P/B multiple.

SOTP Methodology Table:

Target Price Calculation		
Company	Value	Basis
HDFC - Main Business	1,765	DECF Valuation (Cost of Equity: 16.16%, Terminal Growth Rate: 13.78%)
HDFC - Bank	595	Fair Value Estimate of Rs.1,738 for HDFC Bank, arrived at using DECF
HDFC Standard Life Insurance Company Ltd	383	18x NBAP multiple with NBAP margin assumed at 19%
HDFC ERGO General Insurance Company Ltd.	32	P/E multiple of 20.0x
HDFC - Asset Management Company Ltd	126	7% of AUM
Remaining Subsidiaries	58	Based on 1.0x P/B multiple.
Total	2,960	

Our fair value estimate implies an upside of 7.4% to the current market price of Rs. 2,756.30. Therefore, we maintain our **Hold** rating.

Sensitivity Analysis of the Fair Value Estimate for HDFC – Main Business:

Terminal growth	Cost of Equity				
	15.86%	16.01%	16.16%	16.31%	16.46%
13.48%	1,786	1,682	1,589	1,507	1,433
13.63%	1,893	1,775	1,672	1,580	1,498
13.78%	2,015	1,882	1,765	1,662	1,571
13.93%	2,156	2,003	1,871	1,755	1,653
14.08%	2,321	2,144	1,991	1,860	1,745

Income Statement					Key Ratios				
(Rs mn, Yr. ending March 31)	FY08	FY09	FY10E	FY11E		FY08	FY09	FY10E	FY11E
Interest Income	77,840	104,863	105,752	123,701	Per share data (Rs.)				
Interest Expense	51,429	74,324	77,155	91,811	Shares outstanding (mn)	284	284	285	285
Net Interest Income	26,411	30,538	28,597	31,890	Basic EPS	85.8	80.2	80.5	77.0
YoY Growth (%)	60.3%	15.6%	-6.4%	11.5%	Diluted EPS	85.8	80.2	80.5	77.0
Other Operating Income	4,121	5,314	7,811	4,740	Book value per share	420.6	461.9	516.2	555.8
Operating Income	30,532	35,852	36,408	36,630	Adj. book value per share	420.6	461.9	516.2	555.8
YoY Growth (%)	36.9%	17.4%	1.5%	0.6%	Valuation ratios (x)				
Operating Expense	2,839	3,162	3,521	3,534	P/PPP	24.4x	24.0x	23.9x	23.7x
Pre-Provisioning Profit	27,692	32,690	32,887	33,096	P/E	27.8x	34.3x	34.2x	35.8x
Provisions and Contingencies	320	500	752	1,744	P/B	5.7x	6.0x	5.3x	5.0x
Profit Before Tax	27,372	32,190	32,135	31,352	P/ABV	5.7x	6.0x	5.3x	5.0x
Exceptional Items	6,363	-	-	-	Performance ratio (%)				
Tax	9,373	9,365	9,202	9,406	Return on avg. assets	3.2%	2.5%	2.1%	1.6%
Net Profit	24,363	22,825	22,933	21,946	Return on avg. net worth	27.8%	18.2%	16.5%	14.4%
YoY Growth (%)	55.1%	-6.3%	0.5%	-4.3%	Balance Sheet ratios (%)				
					Advances to Loan Funds	105.6%	101.6%	99.5%	97.5%
					Borrowings to advances	71.4%	75.7%	77.5%	77.9%
					Investments to assets	8.2%	10.3%	12.2%	11.9%
					Investments to deposits	40.7%	54.0%	64.2%	58.4%
					Net Worth to assets	14.2%	12.9%	12.3%	10.8%
					Productivity ratio (Rs. mn)				
					Opt. expense per employee	1.9	2.1	2.3	2.1
					Net profit per employee	16.2	15.3	14.7	12.8
					Asset per employee	561.2	682.3	771.8	855.4
					Operating ratios (%)				
					Operating cost to operating income	9.3%	8.8%	9.7%	9.6%
					Operating cost to avg. assets	0.4%	0.3%	0.3%	0.3%
Balance Sheet									
(Rs mn, as on March 31)	FY08	FY09	FY10E	FY11E					
Cash and balances with RBI	7,777	15,688	5,877	5,792	Source: Company data, Indiabulls research				
Investments	69,150	104,687	146,747	174,974	Note: Some ratios are as per Indiabulls definitions and may not match				
YoY Growth (%)	88.6%	51.4%	40.2%	19.2%	figures declared by the Company				
Loans	729,979	851,981	991,645	1,211,091					
YoY Growth (%)	29.2%	16.7%	16.4%	22.1%					
Fixed Assets (Net)	2,085	2,034	1,924	1,730					
Current Assets	35,213	42,178	54,009	73,347					
Total Assets	844,205	1,016,569	1,200,202	1,466,934					
Deposits	170,092	193,747	228,497	299,358					
YoY Growth (%)	10.0%	13.9%	17.9%	31.0%					
Loan Funds/ Other Borrowings	521,420	644,814	768,238	943,227					
YoY Growth (%)	24.9%	23.7%	19.1%	22.8%					
Other Liabilities & Provisions	33,220	46,634	56,410	66,012					
Total Liabilities	724,732	885,195	1,053,144	1,308,597					
Share Capital	2,840	2,844	2,849	2,849					
Reserves & Surplus	116,633	128,529	144,209	155,488					
Total Equity & Liabilities	844,205	1,016,569	1,200,202	1,466,934					
Note: Standalone HDFC numbers									

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