Equity Research

Equity Research Report   Housing Finance   Date: May 6, 2019

HDFC

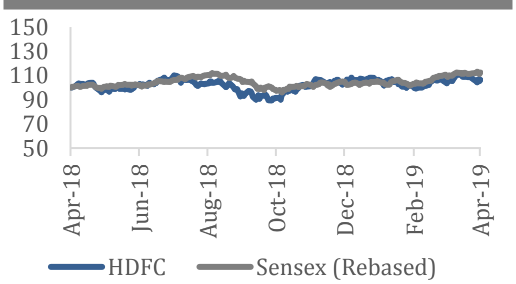
Analyst Recommendation: BUY

BSE Code:	500010	NSE:	HDFC	Reuters Code:	HDFC.NS	Bloomberg Code:	HDFC:IN

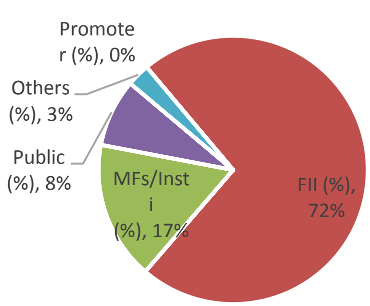
CMP:	**Rs 1,967**
1 Year Target -	**Rs 2,202**

Face Value	2.0
Market Cap (Rscr)	338,650
52 week high/low	2,071/1,646
Avg. Daily Volume (6m)	2.9 Cr
Shares O/S (Cr)	171.9
Book Value per Share (Rs)	366.4
Sensex	38,600
Nifty	11,598

1 yr. Price Chart of Stock and BSE



Shareholding pattern as on 31st March 2019



Investor's Rationale

- **Healthy traction in AUM continues:** HDFC, the largest HFC, witnessed healthy loan traction of 20% CAGR since FY07, which has been ahead of industry CAGR of ~15%. However, HDFC's Assets under management (AUM) growth slowed down to 15% in 9MFY19. Such a slowdown was attributable to muted growth of 8% in non-individual segment and growth of 17% in individual segment. Going ahead, given the company's second highest market share in individual housing loans, we expect AUM to grow at a CAGR of 18% over FY18-21E.

- **Best in class operating efficiency:** HDFC has a healthy track record of maintaining NIM above 3.0% across volatile interest rate cycles on the back of its flexible funding profile. Going forward, we expect NIMs (calculated) to remain broadly stable at ~3.0%. Besides, HDFC has the best operating efficiency in the industry with the cost-to income ratio at <8%. We expect best-in-class cost ratios and adequate provisioning buffer will ensure steady operational performance and project the company to report RoA 0f 2.2% and RoE of 18.1% by FY21E.

- **Resilient asset quality:** HDFC has one of the best asset quality parameters in the industry considering its large size. The major reasons for such a benign asset quality have been HDFC's conservative lending policies, which enable it to avoid customers defaulting on loans. Further, given HDFC's conservative lending policy along with 100%+ provision coverage ratio (PCR), we remain relatively comfortable on overall asset quality profile of the company and expect Gross NPA ratio to be at ~1.4% and nil Net NPA by FY21E.

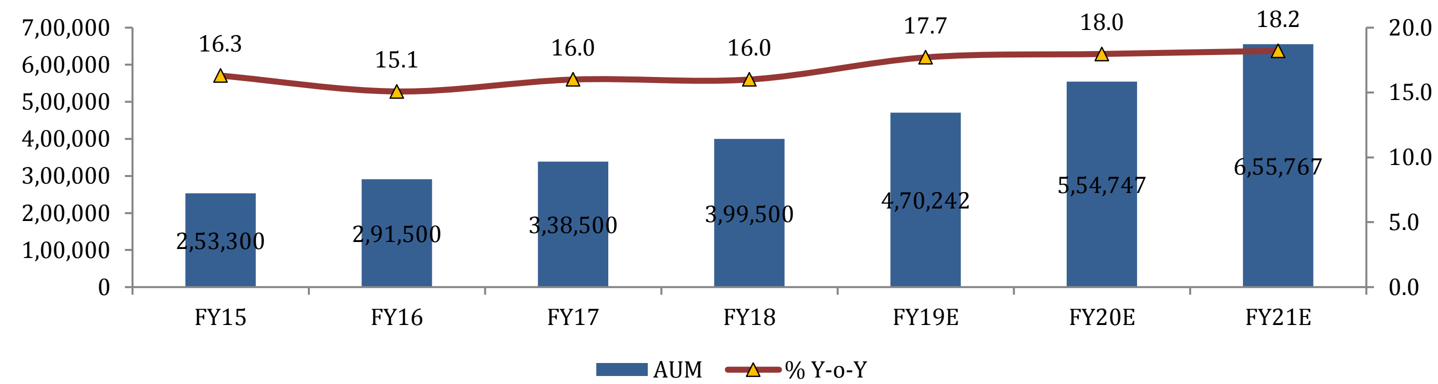
Valuation: We believe that amid rising interest rates and liquidity tightening, housing finance companies (HFCs) could face pressure on margins. However, HDFC continues to remain our top pick within housing finance companies (HFCs) given its competitive edge over its peers backed by strong growth in business, flexible borrowing profile, stable margin and well-managed asset quality. Further, HDFC, being a market leader in retail lending space, has successful sailed through sector headwinds in the past. Going forward, HDFC will continue to command premium valuations given its consistent track record in earnings and business growth. Hence, we assign BUY rating on the stock with a target price of Rs2,200 based on sum of the parts (SOTP) methodology where we value its standalone business at Rs1,195 (P/ABV of 2.8x for FY21E) and subsidiaries at Rs1005.

	FY18	FY19E	FY20E	FY21E
Net Int. Income	11,493	13,248	15,415	18,064
Pre Pro Profit	15,719	14,266	16,875	19,897
Net Profit	12,164	9,415	11,140	13,134
EPS	72.6	55.5	65.7	77.4
P/E	27.1	35.4	30.0	25.4
P/BV	5.4	5.1	4.8	4.4
P/ABV	5.4	5.2	4.9	4.6
RoE (%)	24.1	14.9	16.6	18.1
RoA (%)	3.3	2.2	2.2	2.2

Healthy traction in AUM continues

HDFC, the largest HFC, witnessed healthy loan traction of 20% CAGR since FY07, which has been ahead of industry CAGR of ~15%. It should be noted that HDFC has been able to maintain such healthy growth on a higher base. This is owing to its unique strengths such as strong franchise, brand pedigree, in-house model (sources ~83% of loans inhouse), large network, dedicated business & experienced management. However, HDFC's Assets under management (AUM) growth slowed down to 15% in 9MFY19. Such a slowdown was attributable to muted growth of 8% in non-individual segment and growth of 17% in individual segment. Going ahead, given the company's second highest market share in individual housing loans, we expect AUM to grow at a CAGR of 18% over FY18-21E. We expect retail loan growth to remain in the range of 18-20% YoY while developer loan growth could be more calibrated due to liquidity constraints.

Loan book to grow at a CAGR of 18% over FY18-21E

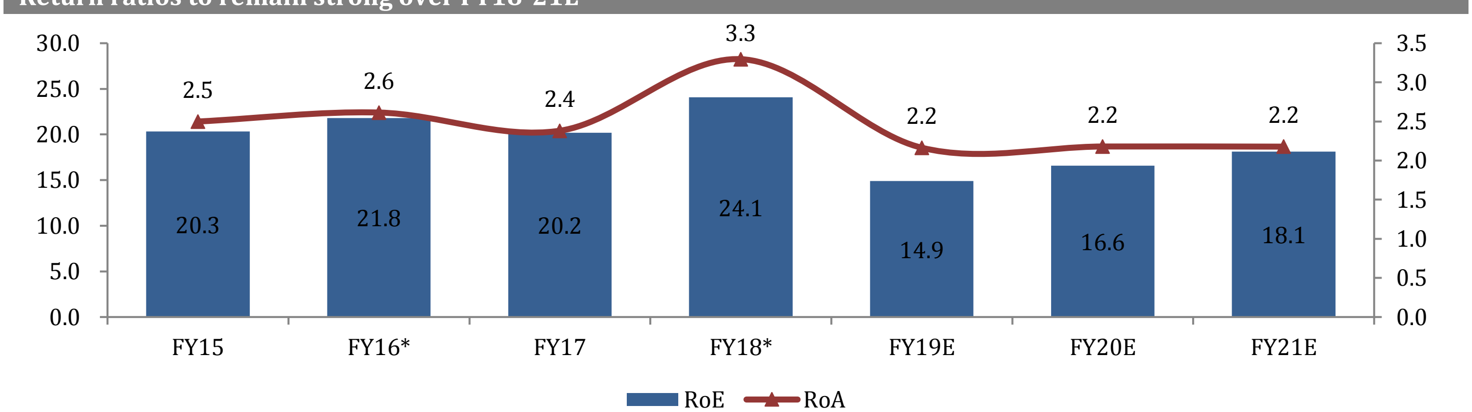


Source: Company, In-house research

Best in class operating efficiency

HDFC has a healthy track record of maintaining NIM above 3.0% across volatile interest rate cycles on the back of its flexible funding profile. Going forward, with slower traction in the corporate book, we expect margins to remain under pressure, partly offset by a declining rate cycle. Therefore, we expect NIMs (calculated) to remain broadly stable at ~3.0%. Besides, HDFC has the best operating efficiency in the industry with the cost-to income ratio at <8%. This is mainly due to the in-house sourcing model of HDFC compared to the DSA based model and branch-based model of other housing finance companies (HFCs). As of H1FY19, 77% of loans were sourced through HDFC subsidiary while rest 23% were done through DSA mode or through direct walk-in. Further, the lower employee base of HDFC, compared to other HFCs and banks enables the company to maintain such low ratios. We expect best-in-class cost ratios and adequate provisioning buffer will ensure steady operational performance and project the company to report RoA 0f 2.2% and RoE of 18.1% by FY21E.

Return ratios to remain strong over FY18-21E

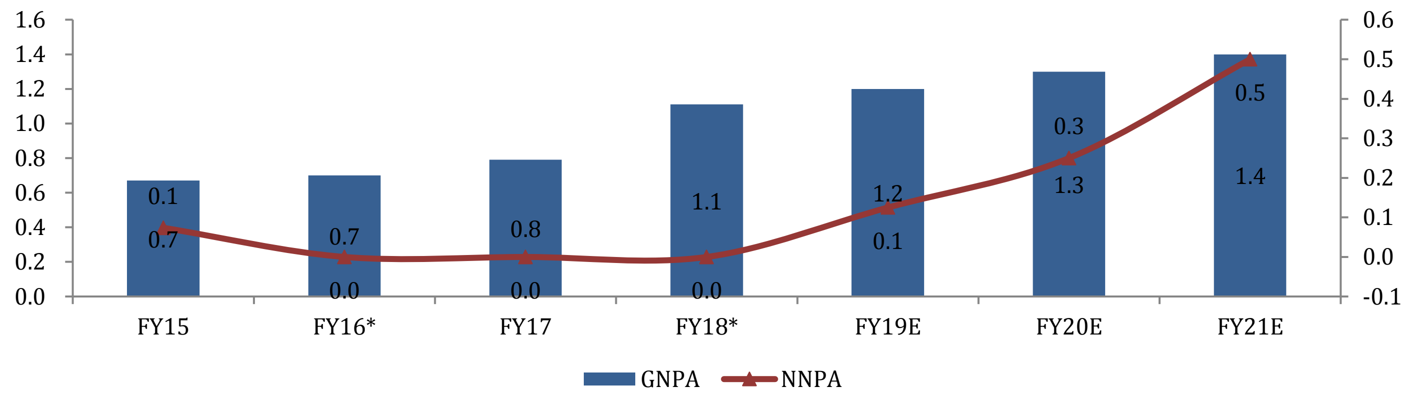


Source: Company, In-house research

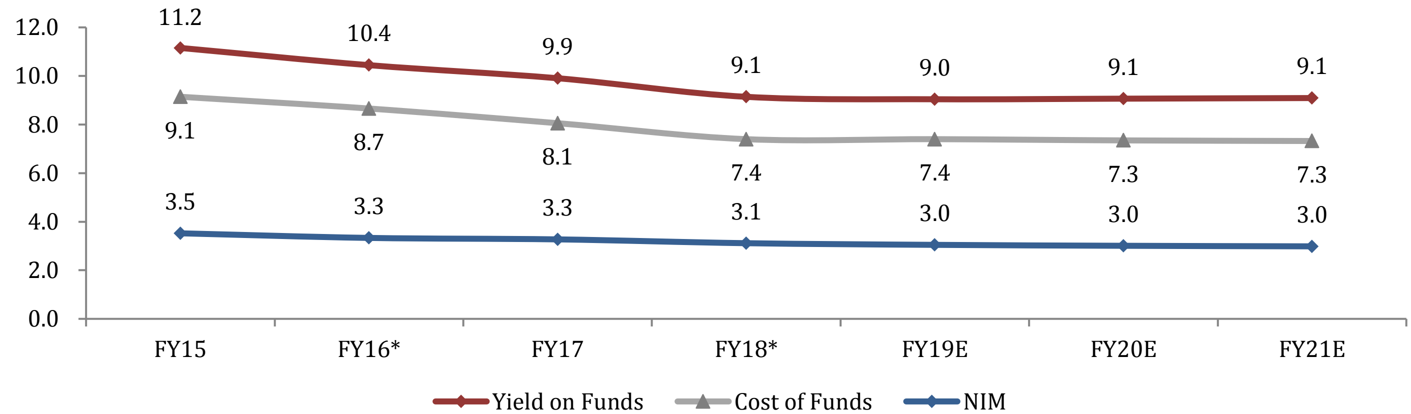
Resilient asset quality

HDFC has one of the best asset quality parameters in the industry considering its large size. The major reasons for such a benign asset quality have been HDFC's conservative lending policies, which enable it to avoid customers defaulting on loans. Notably, asset quality remained largely stable in Q3FY19 as Gross non-performing asset (NPA) ratio increased by 9 bps sequentially to 1.2%. Gross NPA ratio in corporate segment increased by 28 bps QoQ to 2.5% while in individual loans it stayed steady (↑2 bps QoQ) at 0.7%. HDFC is taking a conservative approach and its benign asset quality is not only the function of its operating segment, but also reflects its strong know-how (particularly in non-individual loan segment). Hence, we expect overall asset quality in its developer loan portfolio to remain stable in the medium term despite a weak market condition. Further, given HDFC's conservative lending policy along with 100%+ provision coverage ratio (PCR), we remain relatively comfortable on overall asset quality profile of the company and expect Gross NPA ratio to be at ~1.4% and nil Net NPA by FY21E.

Asset quality to deteriorate slightly but remain one off the best in the industry over FY18-21E



NIM to remain stable at 3.0% over FY18-21E



Source: Company, In-house research

Outlook and Valuation

We believe that amid rising interest rates and liquidity tightening, housing finance companies (HFCs) could face pressure on margins. However, HDFC continues to remain our top pick within housing finance companies (HFCs) given its competitive edge over its peers backed by strong growth in business, flexible borrowing profile, stable margin and well-managed asset quality. Further, HDFC, being a market leader in retail lending space, has successful sailed through sector headwinds in the past. Going forward, HDFC will continue to command premium valuations given its consistent track record in earnings and business growth. Hence, we assign BUY rating on the stock with a target price of Rs2,200 based on sum of the parts (SOTP) methodology where we value its standalone business at Rs1,195 (P/ABV of 2.8x for FY21E) and subsidiaries at Rs1005.

Sum of the parts (SOTP) valuation

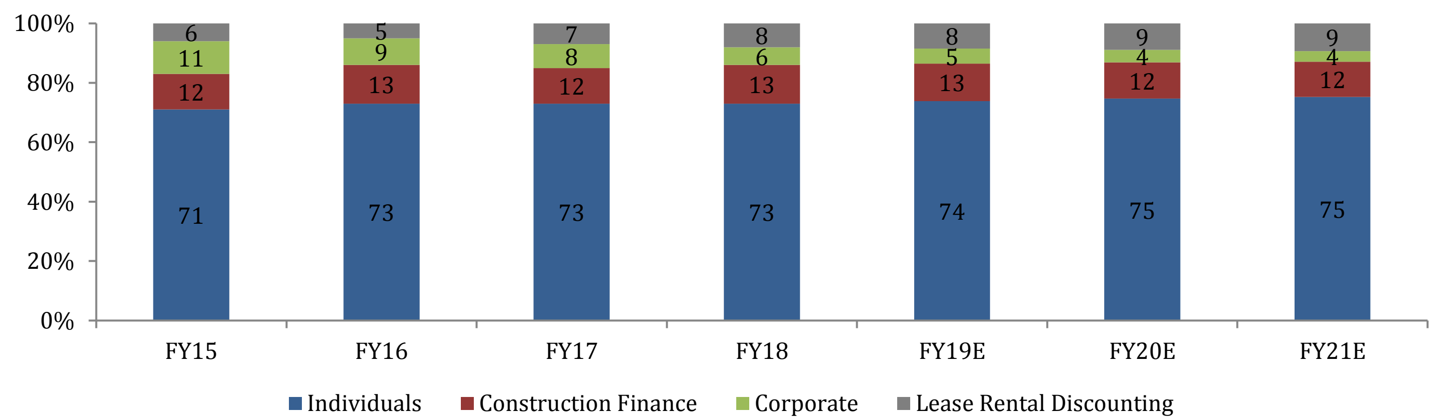
Particulars	Basis	Multiple	Year	Value/Share
HDFC (standalone)	ABV	2.8x	FY21E	1,195
HDFC Bank	ABV	3.7x	FY21E	799
Gruh Finance	Current Market Price			80
Life Insurance	Current Market Price			252
General Insurance	Stake Sale to Ergo			16
Asset Management	Current Market Price			108
		Less: 20% holding discount to subsidiaries		(251)
		Target Price		2,200

HDFC Limited: Business overview

Housing Development Finance Corporation Ltd. (HDFC) is India's largest provider of housing finance in India with a network of 326 offices catering to over 2,400 towns & cities spread across the country. The Company provides long-term housing loans to low and middle-income individuals, as well as to corporations. HDFC also provides construction finance to real estate developers, besides providing lease financing facilities to companies and development authorities for infrastructure and other assets. Besides the core business of mortgages, HDFC has evolved into a financial conglomerate, diversifying into other businesses through its subsidiaries viz., HDFC Standard Life Insurance, HDFC Asset Management Company, HDFC Bank, and HDFC General Insurance Company.

HDFC's total AUM as on FY18 was at Rs399,500cr with individual loans amounting to Rs290,800cr (73% of total advances). Its market share including banks is ~16%, which is second highest after SBI. In the past four years, the major driver has been the individual loan book, which grew at 19% CAGR as compared to 11% seen in the corporate book. This is owing to a strained economic environment leading to a weak investment cycle. Further, risks in the corporate portfolio also increased, leading the company to focus more on the relatively lower defaulting individual loan portfolio. Proportion of individual loan in the total book is on the up move from 71% in FY15 to 73% in FY18. The company, owing to its brand value, higher credit rating and sound track record of timely repayments has the ability to immediately change its borrowing mix profile to suit its needs and adapt to prevailing market conditions. It includes bank loans (21% of total borrowing), bonds & commercial paper (49%) and deposits (29%) as of Q3FY19.

AUM mix improves in CVs and CEs, while declines in Auto/Utility vehicles segment



Source: Company, In-house research

Key Risks

- Increase in competition and sustained slack in the mortgage market can lead to lower growth than our estimates.
- Risk of fraud and NPA accretion due to increase in interest rates and fall in property prices is inherent to the mortgage business.
- Any significant negative announcement by the regulator should act against the company and may impact the performance in the short term.

Balance Sheet (Standalone)

(Rs crore)	FY18	FY19E	FY20E	FY21E
Liabilities				
Capital	335	339	339	339
Reserves and Surplus	61,067	64,691	69,131	75,095
Borrowings	319,912	383,730	460,508	547,918
Provisions	5,274	3,074	3,626	5,838
Other Liabilities	15,086	16,817	19,839	23,452
Total Liabilities	**401,674**	**468,651**	**553,444**	**652,642**
Assets				
Fixed Assets	644	644	644	644
Investments	30,533	28,891	34,083	40,290
Advances	365,545	431,212	508,703	601,338
Other Assets	3,581	6,468	7,631	9,020
Cash And Balances	1,371	1,436	2,383	1,350
Total Assets	**401,674**	**468,651**	**553,444**	**652,642**

Profit & Loss Account (Standalone)

(Rs crore)	FY18	FY19E	FY20E	FY21E
Interest Income	33,728	39,314	46,459	55,020
Interest Expense	22,235	26,066	31,044	36,955
Net Interest Income	**11,493**	**13,248**	**15,415**	**18,064**
Non Interest Income	5,184	2,445	2,885	3,410
Net Income	16,676	15,693	18,300	21,474
Operating Expenses	958	1,427	1,425	1,577
Total Income	38,911	41,759	49,344	58,430
Total Expenditure	23,193	27,493	32,469	38,532
Pre Provisioning Profit	**15,719**	**14,266**	**16,875**	**19,897**
Provisions	455	971	1,144	1,352
Profit Before Tax	15,264	13,295	15,730	18,546
Tax	3,100	3,879	4,590	5,412
Net Profit	**12,164**	**9,415**	**11,140**	**13,134**

Key Ratios & Valuations (Standalone)

Y.E. March	FY18	FY19E	FY20E	FY21E
Per share data (Rs.)				
EPS	72.6	55.5	65.7	77.4
DPS	3.5	20.7	24.0	24.0
BV	366.4	383.3	409.5	444.6
ABV	366.4	380.1	402.0	426.9
Valuation (%)				
P/E	27.1	35.4	30.0	25.4
P/BV	5.4	5.1	4.8	4.4
P/ABV	5.4	5.2	4.9	4.6
Div. Yield	0.2	1.1	1.2	1.2
Spreads (%)				
Yield on Funds	9.1	9.0	9.1	9.1
Cost of Funds	7.4	7.4	7.3	7.3
Capital (%)				
CAR	19.2	17.3	15.6	14.3
Tier I	17.3	15.4	13.7	12.4
Asset (%)				
GNPA	1.1	1.2	1.3	1.4
NNPA	0.0	0.1	0.3	0.5
Management (%)				
Debt/Equity	5.2	5.9	6.6	7.3
Cost/ Income	5.7	9.1	7.8	7.3
Earnings (%)				
NIM	3.1	3.0	3.0	3.0
ROE	24.1	14.9	16.6	18.1
ROA	3.3	2.2	2.2	2.2

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Between 10% & -5%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than -5%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.*

** HDFC is a large-cap company.*

MJP

Member: BSE, NSE, MCX, MCX-SX, CDSL

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