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Rating	Accumulate
Price	Rs821
Target Price	Rs840
Implied Upside	2.3%
Sensex	20,894
Nifty	6,205

(Prices as on October 21, 2013)
Trading data

Market Cap. (Rs bn)	1,212.8
Shares o/s (m)	1,477.0
3M Avg. Daily value (Rs m)	4009.6

Major shareholders

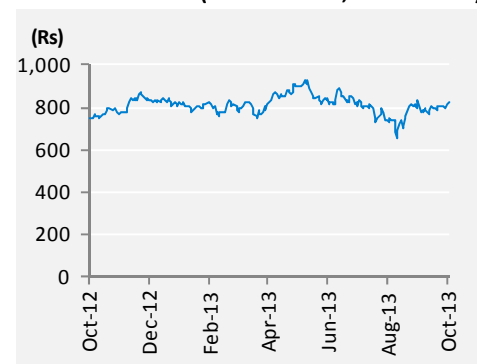
Promoters	0.00%
Foreign	73.09%
Domestic Inst.	13.82%
Public & Other	13.09%

Stock Performance

(%)	1M	6M	12M
Absolute	1.3	0.4	9.0
Relative	(1.8)	(9.5)	(2.8)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2014	36.8	35.8	2.8
2015	44.5	42.0	5.8

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


Source: Bloomberg

HDFC's Q2 PAT of Rs16.8bn (+10% YoY) was in line with expectations, with strong individual growth, funding flexibility and higher investment yields aiding core PBT (+16% YoY). Though funding environment has eased, asset mix change and competitive pressure are likely to constraint spreads. Risks from builder book also remain. Hence, post the current rally, we believe, risk-reward over the next six months is not attractive and we prefer HDFCB over HDFC Ltd (just <10% valuation difference).

- **Individual book surprises:** Builder book growth moderates further with just 8% growth leading to moderation in overall AUM growth (18% YoY) but individual book growth continues to remain strong at ~22% YoY. HDFC seems to have managed the growth-margin equation well but with no growth in builder book & significant base impact in the individual book, we expect growth to come off.
- **But marginal inch up in builder NPAs:** In-line with difficult macro environment, builder book NPAs inched up to 1.2% from 1.1% driven by Rs2bn accretion from an existing developer account netted off to some extent by an upgrade in corporate a/c. Slower builder disbursements growth over the last three quarters is positive but we expect volatility to inch up in builder book asset quality.
- **Spreads fine in Q2 aided by higher investment yields; We expect some moderation:** Spreads were down just ~5bps QoQ, with HDFC's funding flexibility (bank funding increased 3x QoQ) again aiding margins but NIM improvement was largely linked to significant increase in investment yields which should moderate in H2FY14. Though borrowing costs have eased, rapid asset mix change (300bps increase in share of individual loans) and competitive pricing in mortgages should lead to some pressure on margins.
- **Other highlights: (1) Reported Tier-1 ratios have inched up by +250bps** due to lower risk weights (higher than our expectations) and this almost nets off impact from treating HDFCB investments as capital deduction rather than risk weight-RWA was down by ~15% **(2) AMC profitability** up, largely driven by some profitable exits for HDFC's property funds.

Key Financials (Y/e March)	2012	2013	2014E	2015E
Net interest income (Rs m)	49,765	57,988	70,433	86,294
Growth (%)	20.4	16.5	21.5	22.5
Non-interest income (Rs m)	12,210	14,579	15,621	16,749
Operating Profit (Rs m)	57,456	67,178	79,927	96,091
PAT (Rs m)	41,226	48,483	56,870	68,741
EPS (Rs)	27.9	31.4	36.8	44.5
Growth (%)	15.8	12.3	17.3	20.9
Net DPS (Rs)	12.5	12.5	14.7	17.7

Profitability & valuation	2012	2013	2014E	2015E
Spreads / Margins (%)	3.2	3.2	3.3	3.3
RoAE (%)	22.7	22.0	21.3	22.5
RoAA (%)	2.7	2.7	2.6	2.6
P/E (x)	29.4	26.2	22.3	18.5
P/BV (x)	6.4	5.1	4.5	3.9
P/ABV (x)	6.4	5.1	4.5	3.9
Net dividend yield (%)	1.5	1.5	1.8	2.2

Source: Company Data; PL Research

Exhibit 1: Q2FY14 Financials : Banking upon retail loans

NII growth supported by healthy loan growth in the individual book – Spreads were largely flat QoQ

Fee income shows some signs of improvement after some quarters of disappointment

Bank Funding substituted some Bond funding and jumped sharply to 27% from <10% in Q1FY14 of total funding

Individual book growth still going strong also offsetting slowdown in builder book

	2Q13	1Q14	2Q14	YoY	QoQ
Net interest income	15,804	17,382	17,494	10.7%	0.6%
Fees	613	634	722	17.9%	13.9%
Net revenues	16,417	18,016	18,216	11.0%	1.1%
Operating expenditure	1,877	1,935	1,870	-0.4%	-3.4%
Operating profit	14,540	16,081	16,346	12.4%	1.6%
Investment profit	941	0	868	-7.8%	-
Profit before tax	15,481	16,091	17,223	11.3%	7.0%
Tax	3,970	4,350	4,550	14.6%	4.6%
PAT	11,511	11,741	12,673	10.1%	7.9%
Balance sheet					
Borrowings					
Term Loans	197,240	128,190	329,180	66.9%	156.8%
Bonds	798,040	967,540	852,000	6.8%	-11.9%
Deposits	482,620	536,960	551,660	14.3%	2.7%
Total	1,477,900	1,632,690	1,732,840	17.3%	6.1%
Loans					
Individuals	994,012	1,184,291	1,247,490	25.5%	5.3%
Corporates	537,633	566,198	580,630	8.0%	2.5%
Others	19,635	19,438	20,740	5.6%	6.7%
Total Loans	1,551,280	1,769,928	1,848,860	19.2%	4.5%
Investments	150,241	171,991	134,907	-10.2%	-21.6%

Source: Company Data, PL Research

Exhibit 2: Operating Matrix

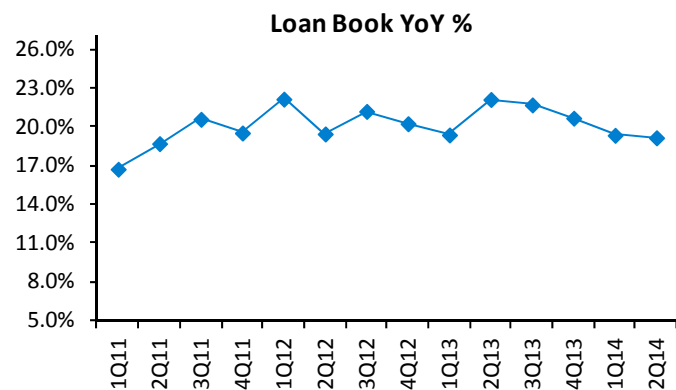
No sell downs in Q2FY14 as HDFCB decided not to buy mortgages given margin pressure

Retail NPAs improve but builder book shows more stress but looks manageable

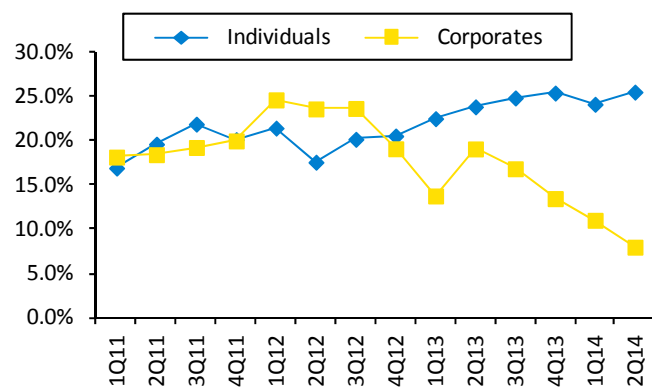
Spreads remain relatively stable than expected

Operating data	2Q13	1Q14	2Q14	YoY	QoQ
Loans (on B/S)	1,546,353	1,769,930	1,843,500	19.2%	4.2%
Stock of Sell down Loans	157,480	172,920	164,970	4.8%	-4.6%
Total AUM	1,703,833	1,942,850	2,008,470	17.9%	3.4%
Gross NPL (%)					
Individual book	0.65%	0.61%	0.59%	-0.06%	-0.02%
Builder book	0.89%	1.08%	1.19%	0.30%	0.11%
Calculated NIMs					
Calculated Spreads	2.12%	1.84%	1.86%	-0.26%	0.02%
Individual Spreads (Reported)		2.01%	1.98%		-0.03%
Builder Spreads (Reported)		2.82%	2.76%		-0.06%
ROE	20.5%	18.3%	18.7%	-1.8%	0.4%

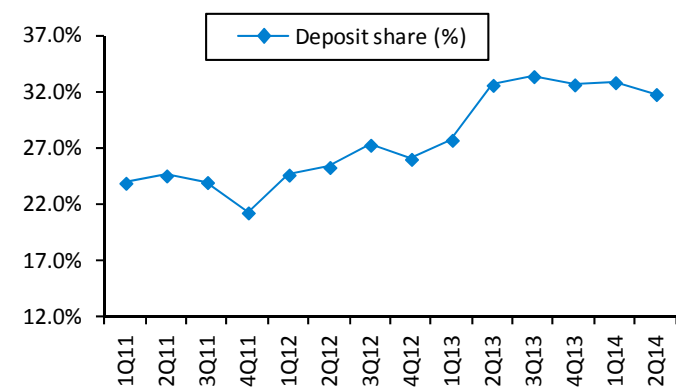
Source: Company Data, PL Research

Exhibit 3: Loan book growth moderates marginally


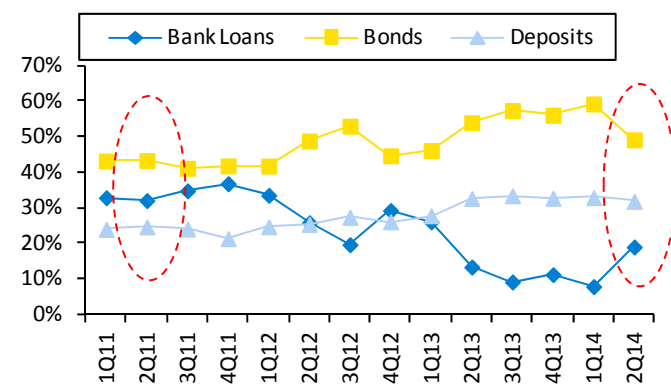
Source: Company Data, PL Research

Exhibit 4: Retail growth remains strong; corporate moderates sharply


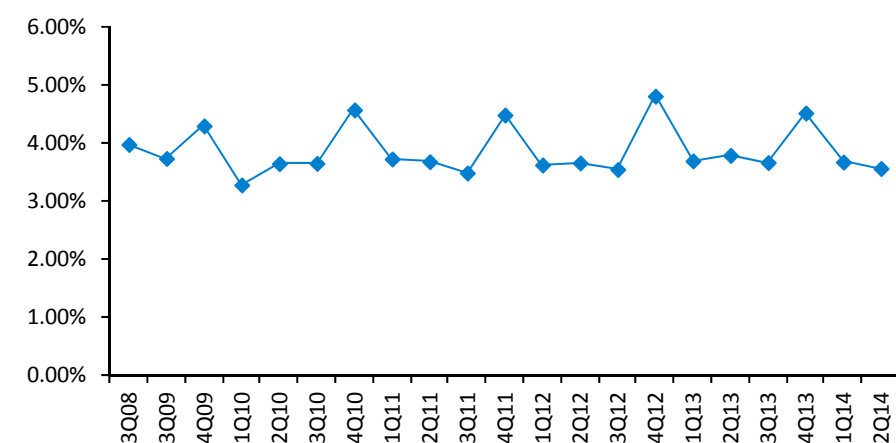
Source: Company Data, PL Research

Exhibit 5: Deposit share continues to be steady funding source


Source: Company Data, PL Research

Exhibit 6: Sharp increase in Bank funding by replacing Bond funding


Source: Company Data, PL Research

Exhibit 7: NIMs remain stable despite RBI's recent move on rates


Source: Company Data, PL Research

Expect ROE improvement to be gradual post the Warrant conversion in FY13

	2009	2010	2011	2012	2013	2014	2015	2016
Reported PAT	22,825	28,265	35,350	41,226	48,483	56,870	68,741	80,374
Dividends	1,957	2,327	2,252	3,097	4,807	5,287	5,816	6,398
Adjustment for Zero Coupon	431	1,924	5,321	4,851	3,800	2,700	2,700	2,700
Adjusted PAT	20,580	24,649	29,532	34,880	41,131	49,773	61,116	72,168
% growth	-13%	20%	20%	18%	18%	21%	23%	18%

Subsidiary Stake

HDFC Life	72.4%	72.6%	72.4%	72.4%	72.4%	72.4%	72.4%	72.4%
HDFC Bank	19.4%	23.7%	23.4%	23.1%	22.8%	22.8%	22.8%	22.8%
Gruh Finance	61.5%	61.4%	60.7%	60.4%	59.7%	59.7%	59.7%	59.7%
HDFC General insurance	74.0%	74.0%	74.0%	74.0%	73.9%	73.9%	73.9%	73.9%
HDFC AMC	60.0%	60.0%	60.0%	59.9%	59.8%	59.8%	59.8%	59.8%
Others	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Subsidiary performance

HDFC Life	-5030	-2752	-990	2710	4515	5869	7337	8437
HDFC Bank	22448	29493	39264	51671	67263	81337	102456	127045
Gruh Finance	503	690	915	1203	1460	1898	2467	3208
HDFC General insurance	-257	-943	-364	-397	1545	1777	2043	2350
HDFC AMC	1291	2084	2422	2691	3190	3509	3860	4246
Others		500	1860	280	-1000	200	500	700
Proportionate income	1601	6478	12070	16223	21526	27539	34463	41965
Calculated consolidated PAT	22181	31126	41602	51103	62656	77312	95579	114133
Reported Consolidated PAT	23100	32410	45280	54630	66400	80012	98279	116833

Reported Standalone Equity	131374	151977	173165	190176	250000	284197	325532	373863
Reported Consolidated Equity	138437	181822	211901	244240	320600	377939	448812	533602

Adjusted ROEs - Consol	19.4%	21.1%	22.4%	22.2%	22.1%	23.1%	23.2%
Reported ROEs - Consol	20.2%	23.0%	24.0%	23.5%	22.9%	23.8%	23.8%

Standalone Equity	131374	151977	173165	190176	250000	284197	325532	373863
Subsidiary investment	33678	76696	79351	79351	79351	79351	79351	79351
Adjusted Standalone Equity	114535	113629	133490	150500	210325	244521	285857	334187

Adjusted Standalone PAT	21632	26139	31563	37253	44180	52876	64483	75826
Adjusted Standalone ROE		22.9%	25.5%	26.2%	24.5%	23.3%	24.3%	24.5%

Adjusted Subsidiary PAT	549	4987	10039	13850	18476	24436	31096	38307
Adjusted Subsidiary Capital	23,903	68,194	78,412	93,740	110,276	133,418	162,956	199,414
Adjusted Subsidiary ROE		10.8%	13.7%	16.1%	18.1%	20.1%	21.0%	21.1%

Source: Company Data, PL Research

Exhibit 8: HDFC SOTP of Rs840/share

	Value per share
HDFC Bank	216
HDFC Standard Life	55
HDFC Asset Management	13
Total Subsidiary valuation	285
Mar-14 PT	840
Implied lending business value	555
Lending business valuation	Sep-14 book
Net Profit (Sep-14)	62,805
Less dividend income	3886
Adjusted Profit (sep-14)	58,919
Shares	1546
Adj. EPS (Sep-14)	38.1
Implied Sep-14 P/E	14.6
Implied Sep-14 P/B	3.30

Source: PL Research

Income Statement (Rs m)

Y/e March	2012	2013	2014E	2015E
Int. Inc. / Opt. Inc.	161,333	196,897	228,233	272,286
Interest Expenses	111,568	138,909	157,800	185,992
Net interest income	49,765	57,988	70,433	86,294
<i>Growth (%)</i>	<i>20.4</i>	<i>16.5</i>	<i>21.5</i>	<i>22.5</i>
Non interest income	12,210	14,579	15,621	16,749
<i>Growth (%)</i>	<i>3.1</i>	<i>19.4</i>	<i>7.1</i>	<i>7.2</i>
Net operating income	61,975	72,567	86,054	103,043
Expenditure				
Employees	2,058	2,462	2,807	3,171
Other expenses	2,461	2,927	3,320	3,781
Depreciation	—	—	—	—
Total expenditure	4,519	5,389	6,127	6,952
PPP	57,456	67,178	79,927	96,091
<i>Growth (%)</i>	<i>16.4</i>	<i>16.9</i>	<i>19.0</i>	<i>20.2</i>
Provision	800	1,450	1,160	1,276
Other income	—	—	—	—
Exchange Gain / (Loss)	800	1,450	1,160	1,276
Profit before tax	56,656	65,728	78,767	94,815
Tax	15,430	17,245	21,897	26,074
<i>Effective tax rate (%)</i>	<i>27.2</i>	<i>26.2</i>	<i>27.8</i>	<i>27.5</i>
PAT	41,226	48,483	56,870	68,741
<i>Growth (%)</i>	<i>16.6</i>	<i>17.6</i>	<i>17.3</i>	<i>20.9</i>

Balance Sheet (Rs m)

Y/e March	2012	2013	2014E	2015E
Sources of funds				
Equity	2,954	3,093	3,093	3,093
Reserves & Surplus	180,563	240,248	274,445	315,780
Networth	190,176	250,000	284,197	325,532
<i>Growth (%)</i>	<i>9.8</i>	<i>31.5</i>	<i>13.7</i>	<i>14.5</i>
Loan funds	1,028,347	1,068,950	1,273,950	1,598,950
<i>Growth (%)</i>	<i>—</i>	<i>3.9</i>	<i>19.2</i>	<i>25.5</i>
Deposits	362,928	519,330	649,330	759,330
Other Liabilities	93,749	117,028	140,275	163,522
Total	1,675,199	1,955,308	2,347,751	2,847,334
Application of funds				
Net fixed assets	2,340	2,379	2,403	2,409
Advances	1,408,746	1,700,460	2,067,083	2,533,940
<i>Growth (%)</i>	<i>20.3</i>	<i>20.7</i>	<i>21.6</i>	<i>22.6</i>
Net current assets	112,350	138,475	147,495	162,150
Investments	39,205	33,631	38,231	38,231
<i>Growth (%)</i>	<i>87.1</i>	<i>(14.2)</i>	<i>13.7</i>	<i>—</i>
Deferred tax asset	—	—	—	—
Other Assets	112,559	80,362	92,539	110,604
Total	1,675,199	1,955,308	2,347,751	2,847,334

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q3FY13	Q4FY13	Q1FY14	Q2FY14
Int. Inc. / Operating Inc.	51,056	54,720	55,015	57,950
Income from securitization	—	—	—	—
Interest Expenses	35,215	34,398	37,633	40,457
Net Interest Income	15,841	20,322	17,382	17,494
<i>Growth</i>	<i>22.9</i>	<i>12.6</i>	<i>18.7</i>	<i>10.7</i>
Non interest income	1,449	2,057	634	1,590
Net operating income	17,290	22,379	18,016	19,083
<i>Growth</i>	<i>18.4</i>	<i>14.6</i>	<i>15.9</i>	<i>9.9</i>
Operating expenditure	1,839	1,382	1,935	1,870
PPP	15,451	20,997	16,081	17,213
<i>Growth</i>	<i>16.3</i>	<i>15.1</i>	<i>16.5</i>	<i>11.2</i>
Provision	—	—	—	—
Exchange Gain / (Loss)	—	—	—	—
Profit before tax	15,451	20,997	16,081	17,213
Tax	4,050	5,445	4,350	4,550
Prov. for deferred tax liability	—	—	—	—
<i>Effective tax rate (%)</i>	<i>26.2</i>	<i>25.9</i>	<i>27.1</i>	<i>26.4</i>
PAT	11,401	15,552	11,731	12,663
<i>Growth</i>	<i>16.2</i>	<i>17.3</i>	<i>17.1</i>	<i>10.0</i>

Key Ratios

Y/e March	2012	2013	2014E	2015E
CMP (Rs)	821	821	821	821
Eq. Shrs. O/s. (m)	1,477	1,546	1,546	1,546
Market Cap (Rs m)	1,212,797	1,269,785	1,269,785	1,269,785
Market Cap to AUM (%)	0.7	0.6	0.5	0.4
EPS (Rs)	27.9	31.4	36.8	44.5
Book Value (Rs)	128.8	161.7	183.8	210.5
Adjusted Book Value (Rs)	128.8	161.7	183.8	210.5
P/E (x)	29.4	26.2	22.3	18.5
P/BV (x)	6.4	5.1	4.5	3.9
P/ABV (x)	6.4	5.1	4.5	3.9
DPS (Rs)	12.5	12.5	14.7	17.7
Dividend Yield (%)	1.5	1.5	1.8	2.2

Asset Quality

Y/e March	2012	2013	2014E	2015E
Gross NPAs (Rs m)	10,425	11,903	14,470	17,738
Net NPAs (Rs m)	—	—	—	—
Gross NPAs to Gross Adv. (%)	0.7	0.7	0.7	0.7
Net NPAs to Net Adv. (%)	—	—	—	—
NPA Coverage (%)	—	—	—	—

Profitability (%)

Y/e March	2012	2013	2014E	2015E
NIM	3.2	3.2	3.3	3.3
RoAA	2.7	2.7	2.6	2.6
RoAE	22.7	22.0	21.3	22.5

Source: Company Data, PL Research.

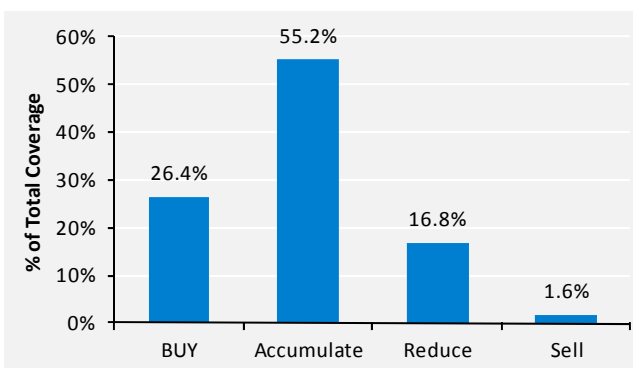


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Rating Distribution of Research Coverage



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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