Sharekhan
by BNP PARIBAS

Housing Development Finance Corporation

Pragmatism prevails, modest performance

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 2,124**	
Price Target: **Rs. 2,500**	↔

↑ Upgrade ↔ No change ↓ Downgrade

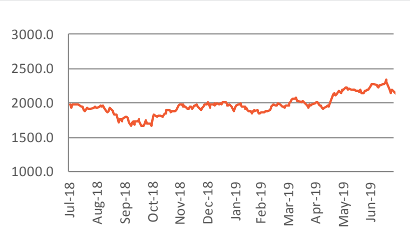
Company details

Market cap:	Rs. 3,66,471 cr
52-week high/low:	Rs. 2357/1646
NSE volume: (No of shares)	30.2 lakh
BSE code:	500010
NSE code:	HDFC
Sharekhan code:	HDFC
Free float: (No of shares)	172.5 cr

Shareholding (%)

Promoters	0.0
FII	74.7
DII	14.4
Others	10.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.9	20.6	30.5	-1.1
Relative to Sensex	11.1	26.3	27.5	-1.0

Sharekhan Research, Bloomberg

HDFC posted modest results for Q1FY2020. On one hand, the bank's net interest income (NII) growth was the lowest in the past 4-5 quarters due to slower growth in AUM; while on the other, its asset quality and margins remained stable, which we find positive considering present times. Balance sheet strength, consistency and quality of earnings continue to be the key differentiators for HDFC, which also are key support to the premium valuations it enjoys. We maintain our loan growth estimates over FY2019-FY2021, intact at a ~16% CAGR, considering ease in competition, HDFC's diversified liability franchise and higher coverage. In our view, AUM growth should remain healthy (on market share gains) with spreads maintained (diversified liability franchise but cautious stance of management on riskier assets) and well-contained credit costs. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,500.

Key positives

- As per NHB norms, HDFC is required to carry a total provision of Rs. 3,366 crore, against which total provisions carried at the end of Q1FY2020 were at Rs. 6,470 crore.
- Despite slower growth and conservative approach, spreads at 2.25% and net interest margin at 3.3% are largely stable, indicating the quality of franchise.

Key negatives

- NII registered weak growth of 10.9% y-o-y due to multi-quarter low growth in advances.

Our Call

Valuation

Valuation – HDFC is currently available at ~4x its FY2021E BV, which we believe is reasonable considering strong operating metrics, consistency and sustainable business model. While the NBFC industry faces its own challenges, the consistency and relative outperformance of HDFC will help it to sustain premium valuations. We maintain our loan growth estimates over FY2019-FY2021, intact at a ~16% CAGR, considering ease in competition, HDFC's diversified liability franchise and higher coverage. In our view, AUM growth should remain healthy (on market share gains) with spreads maintained (diversified liability franchise but cautious stance of management on riskier assets) and well-contained credit costs. We maintain our Buy rating on the stock with an unchanged PT of Rs. 2,500.

Key Risks

Credit rating downgrades, leading to defaults in the developer portfolio can impact the industry.

Valuation — Rs cr

Particulars	FY18	FY19	FY20E	FY21E
PAT (Rs)	10,959	9,632	10,083	11,946
EPS (Rs)	65.4	55.9	58.4	69.2
P/E (x)	32.5	38.0	36.4	30.7
BVPS (Rs)	389.4	449.4	486.4	531.3
P/BV (x)	5.5	4.7	4.4	4.0
ROE (%)	16.7	12.3	12.0	13.0
ROA (%)	3.0	2.2	2.0	2.1

Source: Company, Sharekhan Research

Cautious growth causes slower operating performance:

HDFC posted modest results for Q1FY2020, where on one hand its NII growth was lowest in the past 4-5 quarters due to slower growth in AUM; while on the other hand, its asset quality remained stable on a q-o-q and y-o-y basis in percentage terms, which was positive considering present times.

During the quarter, NII (Calculated) increased by 10.9% y-o-y to Rs. 3,161.1 crore due to a multi-quarter low loan book growth/AUM growth. Given uncertainty and risk averseness in the lending environment for non-individual loans, the corporation opted to be prudent by curtailing some of its lending to non-individual loans.

NIM (including income on loans sold) at 3.30% was down 20 BPS y-o-y but stable sequentially. Interest spread stood at 2.25% (down 3 BPS y-o-y), and the HFC is likely to have benefitted by the recent decline in cost of funds (COF) for the stronger and better-rated NBFCs. We believe, at present times, when the NBFC sector is seeing challenges on rising COF and liquidity front, the fact that HDFC has been able to maintain its stable margins speaks about the business model strength.

On a sequential basis, the spread on individual loan book stood at 1.91% (stable from 1.91% in Q4FY2019), while the spread on non-individual loans was 3.07% (down 10 BPS from 3.17% in Q4FY2019).

In accordance with Ind-AS, pre-provisions profit for the quarter stood at Rs. 2,980 crore, posting even weaker growth when compared to NII and book growth, partly due to the absence of dividend income in Q1FY2020. Dividend income in the current year was Rs. 1 crore as against Rs. 586 crore (including Rs. 581 crore from HDFC Bank and GRUH Finance) in the previous year. In the current financial year, dividend from HDFC Bank and GRUH Finance is likely to be received in Q2.

During the quarter, HDFC made provisions (as per ECL in IND AS) worth Rs. 470 crore. Provisions carried as a percentage of the Exposure at Default (EAD) are equivalent to 1.55%; and on the basis of classification of assets under Ind AS, as of June 30, 2019, 98.5% of the EAD comprised Stage 1 and 2 assets, which indicates quality of the book.

There was a one-time gain due to stake sale in GRUH Finance of Rs. 1,894 crore, which resulted in net profit of Rs. 3,203.1 crore during Q1FY2020, which was up 45.8% y-o-y and 11.9% q-o-q, and was in line with estimates.

Management favours pragmatism, asset quality healthy: Given the uncertainty and risk averseness in the lending environment for non-individual loans, the corporation opted to be prudent by curtailing some of its lending to non-individual loans.

Hence, during the quarter, HDFC reported weak growth in loan book to Rs. 4,16,597 crore, up 11.2% y-o-y, and assets under management (AUM) growth of 12.8% y-o-y, which was multi-quarter low growth rate, indicating management's strategy of cautious growth. Individuals' loan growth comprised 74% of AUM and grew by 17%, and the developer segment's growth was marginal.

Considering the current liquidity challenges before real estate players, HDFC's calibrated growth in the developers' segment will be taken as a cautious and prudent step. During Q1FY2020, HDFC assigned loans amounting to Rs. 7,230 crore compared to Rs. 9,714 crore in the corresponding quarter of the previous year, indicating a slower traction there too. As per National Housing Bank norms, asset quality was largely stable, with GNPA loans at Rs. 5,315 crore or 1.29% of the loan portfolio as against 1.18% in Q4FY2019. However, as per NHB norms, HDFC is required to carry a total provision of Rs. 3,366 crore, against which provisions at end of Q1FY2020 stood at Rs. 6,470 crore.

Results Rs cr

Particulars	Q1FY20	Q1FY19	YoY%	Q4FY19	QoQ%
Interest Income & Fees	10781	9096	18.5	10343	4.2
Interest and Other Charges	7739	6353	21.8	7182	7.8
Net Interest Income	3042	2743	10.9	3161	-3.8
Other Income	321	863	-62.8	923	-65.2
Total Income	**3363**	**3606**	**-6.7**	**4084**	**-17.7**
Total Expenses	382	510	-25.1	316	20.9
PPoP	**2981**	**3096**	**-3.7**	**3768**	**-20.9**
Profit on Sale of Investments	1894	0	NA	321	NA
Provisions and Loan losses	890	20	4417.8	398	123.6
PBT	3985	3076	29.5	3691	8.0
Tax Expense	782	880	-11.1	829	-5.7
Profit After Tax	**3203**	**2196**	**45.8**	**2862**	**11.9**

Source: Company; Sharekhan Research

Loan Mix (%)

Particulars	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Individuals	68.8%	68.9%	69.3%	70.0%	68.9%	70.0%	70.3%	71.0%	71.4%
Corporate	29.6%	29.6%	29.1%	28.5%	29.5%	28.0%	27.9%	27.3%	26.9%
Others	1.5%	1.6%	1.4%	1.8%	1.6%	2.0%	1.5%	1.7%	1.7%

Source: Company; Sharekhan Research

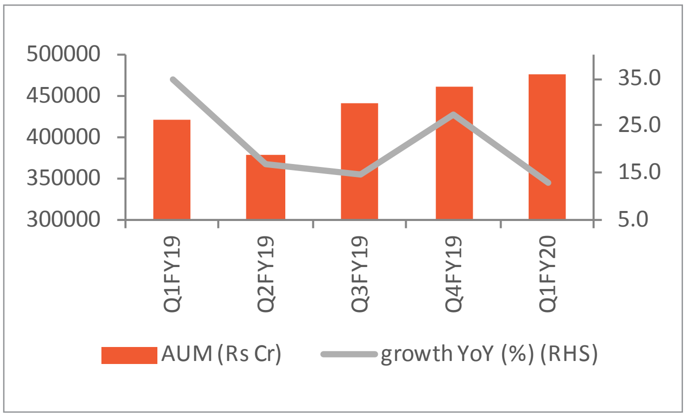
Expected Credit Loss(ECL) based on Exposure At Default (EAD) Rs cr

Particulars	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20
Expected Credit Loss(ECL)					
Gross Stage 3	5145	5022	5618	5743	6228
ECL Provision Stage 3	2361	1946	2238	2499	2476
Net Stage 3	2784	3076	3380	3244	3752
Coverage Ratio% Stage 3	**45.9%**	**38.7%**	**39.8%**	**43.5%**	**39.8%**
Gross Stage 1 & 2	369459	377429	385548	401389	410096
ECL Provision Stage 1 & 2	2754	3068	2966	3379	3994
Net Stage 1 & 2	366705	374361	382582	398010	406102
ECL Provision % Stage 1 & 2	0.7%	0.8%	0.8%	0.8%	1.0%
ECL/EAD	**1.4%**	**1.3%**	**1.3%**	**1.4%**	**1.6%**

Source: Company; Sharekhan Research

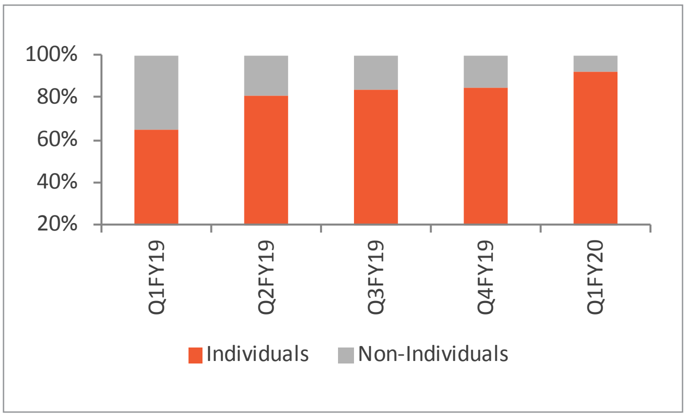
Financials in charts

AUM trend



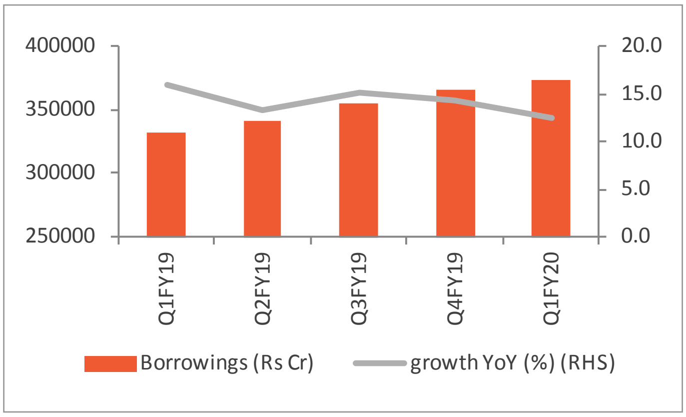
Source: Company, Sharekhan Research

Loan Mix



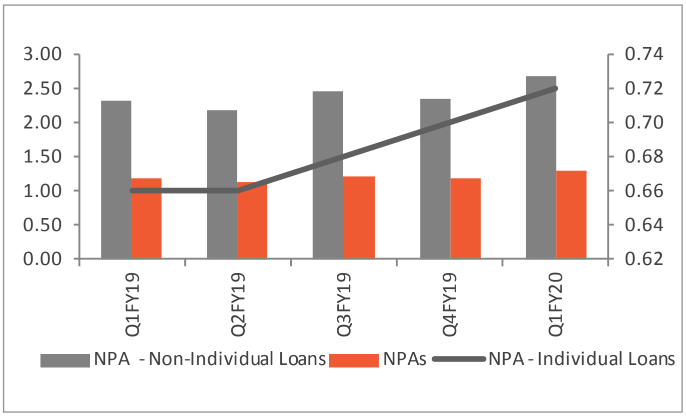
Source: Company, Sharekhan Research

Borrowings trend



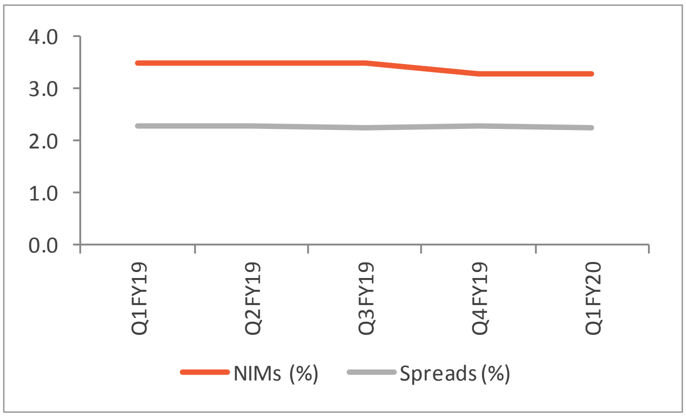
Source: Company, Sharekhan Research

Asset Quality Movement



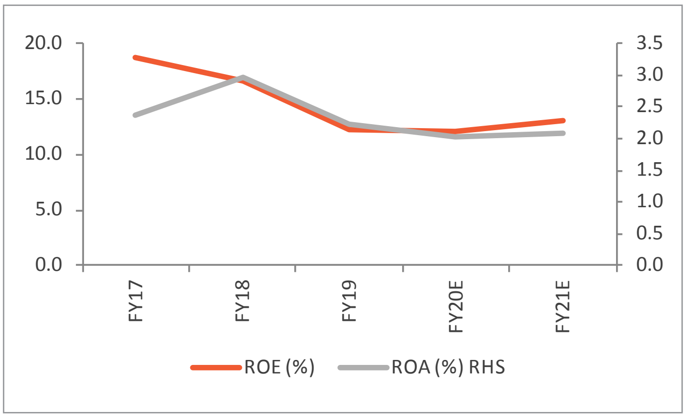
Source: Company, Sharekhan Research

Margins, Cost of Funds and Yields on Advances



Source: Company, Sharekhan Research

Return Ratios



Source: Company, Sharekhan Research

Outlook

HDFC's results were mixed, but seen in present circumstances, the pragmatic growth stance is justified. While healthy asset quality, high provisions cover and stable margins continue to be supportive, notably, in such times, we believe the need to have cautious growth, especially for players such as HDFC, is further emphasised.

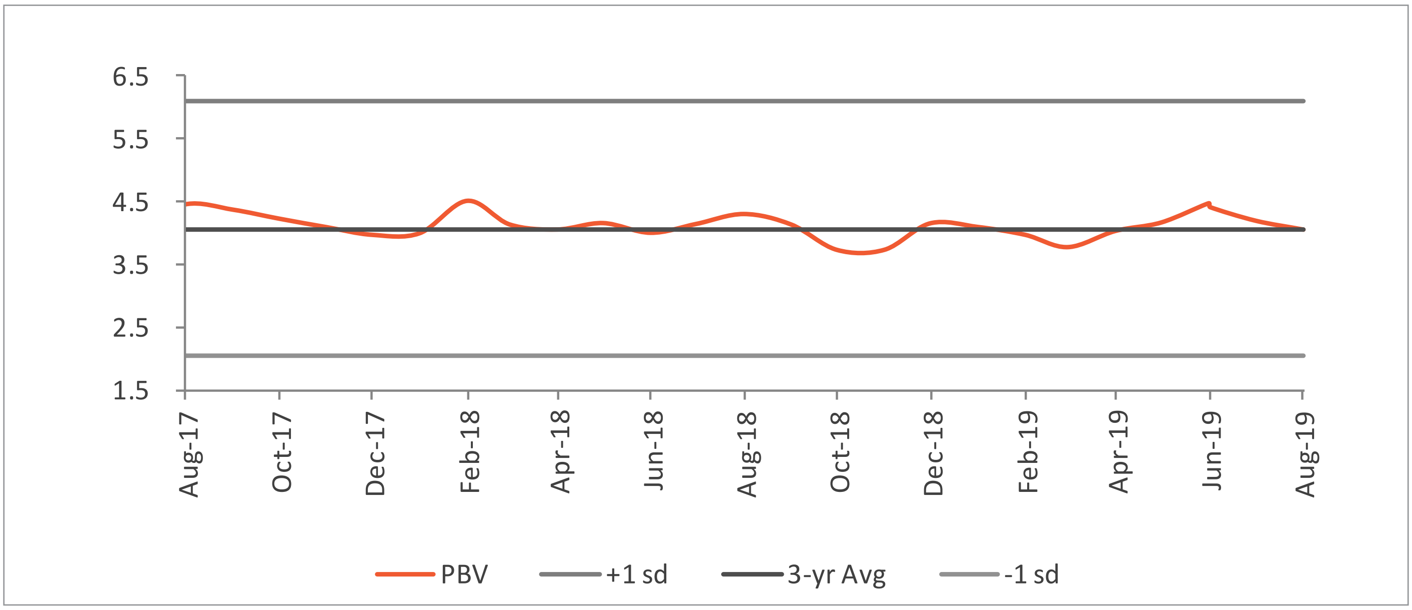
Balance sheet strength, consistency and quality of earnings continue to be the key differentiators for HDFC, which are key support to the premium valuations it enjoys. Given the market dominance of HDFC, we expect the leadership to sustain going forward, as HDFC capitalises on the benefits of reduced competitive pressure from other NBFC peers and PSU banks.

HDFC's strong operating metrics, supported by its industry's best credit rating, enables it to attract best rates and, hence, optimum COF, which are crucial support for margins. The company is well capitalised at CRAR of 18.8% and Tier-1 of 17.3% (minimum requirement of 12% and 6%, respectively) and, hence, is comfortably placed.

Valuation

HDFC is currently available at ~4x its FY2021E BV, which we believe is reasonable considering strong operating metrics, consistency and sustainable business model. While the NBFC industry faces its own challenges, the consistency and relative outperformance of HDFC will help it to sustain premium valuations. We maintain our loan growth estimates over FY2019-FY2021 intact at ~16% CAGR, considering ease in competition, HDFC's diversified liability franchise and higher coverage. In our view, AUM growth should remain healthy (on market share gains) with spreads maintained (diversified liability franchise but cautious stance of management on riskier assets) and well-contained credit costs. We maintain our Buy rating on the stock with an unchanged PT of Rs. 2,500.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
HDFC Ltd	2124	4.4	4.0	36.4	30.7	2.0	2.1	12.0	13.0
PNB Housing Finance	709	1.4	1.2	9.7	7.5	1.1	1.0	14.5	16.4
Can Fin Homes	379	2.5	2.1	14.5	11.7	1.8	1.8	18.3	18.8
Sundaram Finance Limited*	1497	3.1	2.7	23.9	20.9	2.2	2.2	13.1	13.3
Cholamandalam Investment and Finance Company Limited*	266	2.8	2.3	14.9	12.4	2.3	2.3	20.4	20.1

*Source: Company, Sharekhan research; *Bloomberg estimates*

About company

The Housing Development Finance Corporation (HDFC) Limited is a name that has been associated with the Indian housing sector for the last four decades. As pioneers in housing mortgages, it is a brand name that has been characterised by trust, solidity, both financial and managerial and sound principles. Since the day of its incorporation in 1977, HDFC has defined and set high standards in the housing finance sector. The loan book stood at Rs 4,16,597 crore as of 30th June 2019 of which individual loans comprise 74%. As at March 31, 2019, HDFC Bank's distribution network includes 5,103 branches and 13,160 ATMs in 2,748 locations

Investment theme

HDFC Ltd has a strong portfolio of subsidiaries which are market leaders in their own respective fields, which add to the value of the parent. By virtue of its strong market position it has been able to withstand most market headwinds in recent past, and even in the present liquidity squeeze, had a negligible impact. Going forward, we believe that HDFC's strong rating profile and strong book quality bolsters its ability to raise funds at market competitive rates provide cushion to its NIMs. Though the retail lending book of HFCs is witnessing healthy growth trends, a conservative growth approach in the corporate book was due to sluggish demand from good quality corporates along with the cautious stand preferred by management. We believe due to its buoyant retail book, a quality developer finance book (with sufficient cover) and opportunity of quality market share gains (AUM growth), access to reasonably priced funds and superior underwriting practices it is an attractive business franchise.

Key Risks

Credit rating downgrades, leading to defaults in the developer portfolio can impact the industry.

Additional Data

Key management personnel

Deepak Parekh	Chairman
Renu S Karnad	Managing Director
Keki M Mistry	Vice Chairman & CEO
Ajay Agarwal	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Vanguard Group Inc/The	4.4
2	BlackRock Inc	3.9
3	Life Insurance Corp of India	3.7
4	Republic of Singapore	3.7
5	Invesco Ltd	3.4
6	OppenheimerFunds Inc	3.0
7	JPMorgan Chase & Co	2.9
8	Capital Group Cos Inc/The	2.2
9	SBI Funds Management Pvt Ltd	2.1
10	FMR LLC	2.0

Source: Bloomberg

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