Stock Update

Sharekhan
by BNP PARIBAS

Housing Development Finance Corporation

Outlook improves for the leader

Sector: Banks & Finance
Company Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 2,149**	
Price Target: **Rs. 2,500**	↔

↑ Upgrade ↔ No change ↓ Downgrade

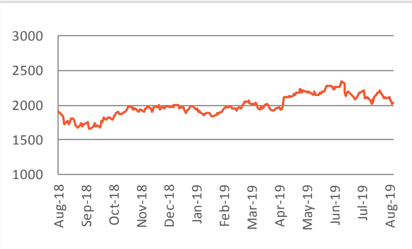
Company details

Market cap:	Rs. 3,70,665 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 (%)

FII	74.7
DII	14.4
Others	10.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.4	-2.6	9.3	8.2
Relative to Sensex	-1.3	2.3	5.8	11.6

Sharekhan Research, Bloomberg

We believe the slew of measures taken by the government and the regulator is likely to benefit strong HFCs such as HDFC, which is likely to see improved appetite for its borrowing requirements, which presents the company with an opportunity to optimise its cost of funds. This will likely see less pressure on its pricing, with possibility of improvement of spreads from Q1 levels. Positive business growth fundamentals would support strong earnings growth and help the company sustain its valuation premium as compared to peers. We believe the outlook for HDFC has improved with supportive government measures, which will provide growth momentum with the potential of margin expansion. We maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,500.

Supportive government measures augur well, HDFC well placed to benefit: To alleviate pressure and increase the funds availability, especially to the HFC sector, the government has announced a slew of supportive measures. This was in the backdrop of increased pressure points seen for NBFCs, triggered by the default by a infrastructure financier conglomerate, the fallout of which pushed up financing costs for a range of borrowers including developers and NBFCs.

Some of these measures announced last week included steps such as the National Housing Bank (NHB) to provide increased support for HFCs via additional funding of Rs. 20,000 crore (from Rs. 10,000 crore earlier). Public sector banks (PSBs) have been asked to fast-track collaboration with NBFCs for co-origination of loans. While the RBI's measures would help ease flow of credit to NBFCs, we believe it will primarily be helpful to mainly strong players (with high capital adequacy and low NPAs) who will be able to take the maximum benefit in terms of increased PSU Bank's appetitive for sell-down as well as best funding rates (especially considering the present risk aversion mood of market participants). At the very least, we believe it will provide additional liquidity to HDFC at reasonable rates. HDFC has been able to hold its NIMs steady at 3.3%, despite a ~50 BPS y-o-y increase in costs of funds over the years.

HDFC had Tier 1 of 17.3% and total NPAs% at ~1.3%, indicating its strong business case and enjoys AAA rating by both CRISIL and ICRA (rating agencies). Therefore, we believe HDFC, while already placed well, will see better opportunities, which provide support (and probable upside potential) to its margins, given the above positive facilitative measures by the government.

Our Call

Valuation – Best of the lot, outlook improves as supportive measures provide a boost: HDFC is currently available at ~4x its FY2021E BV, which we believe is reasonable considering its strong operating metrics, consistency and sustainable business model. Despite the NBFC industry facing challenges, we expect the consistency and relative outperformance of HDFC will help it to sustain premium valuations. Going forward, improving appetite for HDFC's sell-down/funding paper will result in pricing advantage. For the past year, while strong NBFCs were able to raise funds (from banks), it was at a higher cost and HDFC also saw a 5 BPS impact on its spreads in Q1. In our view, AUM growth should remain healthy (on market share gains) with upside potential for spreads. We believe the outlook for HDFC has improved with supportive government measures, which will provide growth momentum with potential of margin expansion. 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 crore)	10,959	9,632	10,083	11,946
EPS (Rs)	65.4	55.9	58.4	69.2
P/E	32.5	38.0	36.8	31.0
BVPS	389.4	449.4	486.4	531.3
P/BV	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 estimates

Supportive government measures augur well, HDFC well placed to benefit: To alleviate pressure and increase funds availability, especially to the NBFC and HFC sectors, the government has announced a slew of supportive measures. This was in the backdrop of increased pressure points seen for NBFCs, triggered by the default by a infrastructure financier conglomerate, the fallout of which pushed up financing costs for a range of borrowers including developers and NBFCs.

Some of these measures announced last week included steps such as National Housing Bank (NHB) to provide increased support for HFCs via additional funding of Rs. 20,000 crore (from the Rs. 10,000 crore earlier). PSBs have been asked to fast-track collaboration with NBFCs for co-origination of loans. Earlier as well, to boost credit, RBI ruled that bank credit to registered NBFCs (other than MFIs) for on-lending has been made eligible for classification as priority sector status. Moreover, the allowing of Partial Credit enhancement (PCE) facility to strong NBFCs. Going forward, its low cost of funds will be further bolstered by improving appetite for HDFC's sell-down/funding paper will result in pricing advantage.

Improved appetite for sell-down of loans from HDFC will help: While the RBI's measures would help ease flow of credit to NBFCs, we believe it will primarily be helpful to strong players (with high capital adequacy and low NPAs) who will be able to take the maximum benefit in terms of increased PSU bank's appetitive for sell-down as well as best funding rates (especially considering the present risk aversion mood of market participants). At the very least, we believe it will provide additional liquidity to HDFC at reasonable rates.

Eligiblity criteria for NBFCs and HFCs for purchase of pooled assets

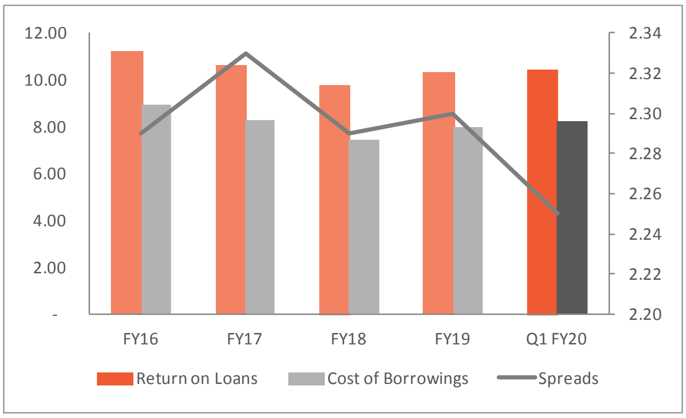
Particulars	CRAR - NBFCs	CRAR - HFCs	HDFC
Minimum CRAR requirement	15%	12%	18.80%
Profitablity	PAT positive in either FY18 or FY19		Profitable
Borrowing quality of the NBFCs	Should not be under SMA category		is rated AAA by Rating agencies
Maximum NPA	Should be under 6%		~1.3%

Source: Company, Sharekhan Estimates

HDFC had Tier 1 of 17.3% and total NPAs% at 1.29%, indicating its strong business case and also enjoys AAA rating by both CRISIL and ICRA (rating agencies). Therefore, we believe HDFC, while already placed well, will see better opportunities, which provide support (and probable upside risks) to its margins, given the above positive facilitative measures by the government.

Spreads likely to improve, were under pressure in Q1: HDFC has been able to hold its NIMs at 3.3%, but reported spreads declined by 5BPS in Q1 from FY19 levels.

Spreads movement

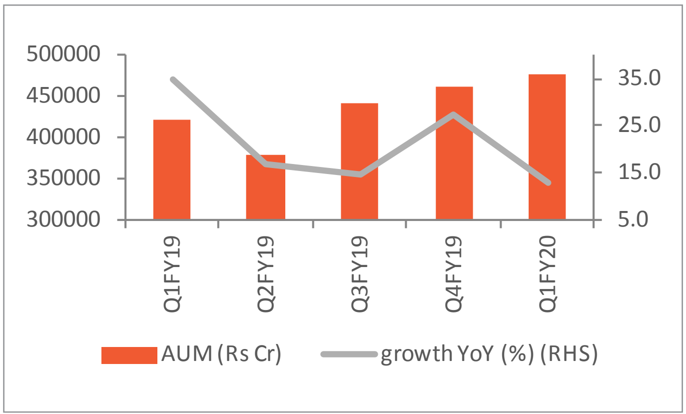


Source: Company, Sharekhan Research

The spreads had been impacted (although by a small 5BPS) in Q1 due to higher cost of funds for the company. We believe while AUM growth should remain healthy (helped by market share gains), the scenario has improved for the spreads. We expect the diversified liability franchise for HDFC is positive, there is an opportunity for the HFC to optimise its cost of funds. Hence, we expect the spreads to see an upside in the medium term.

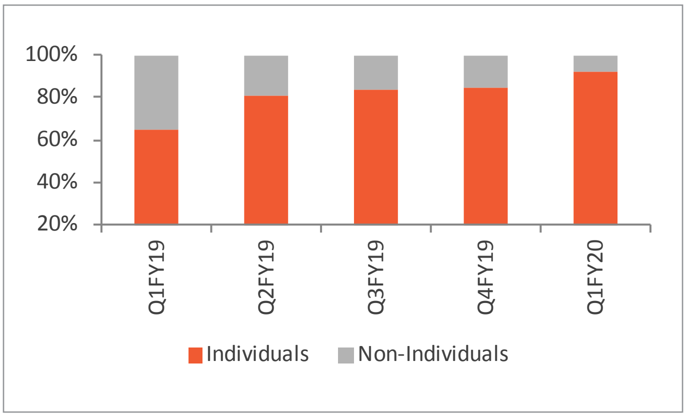
Financials in charts

AUM trend



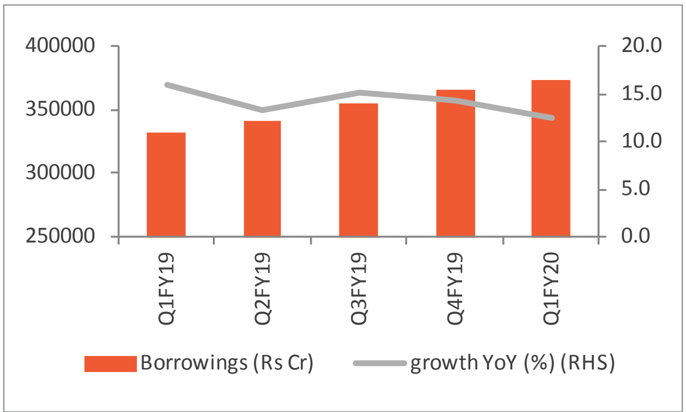
Source: Company, Sharekhan Research

Loan Mix



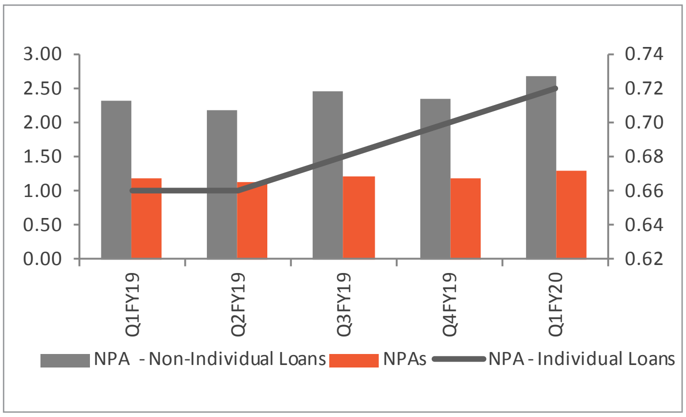
Source: Company, Sharekhan Research

Borrowings trend



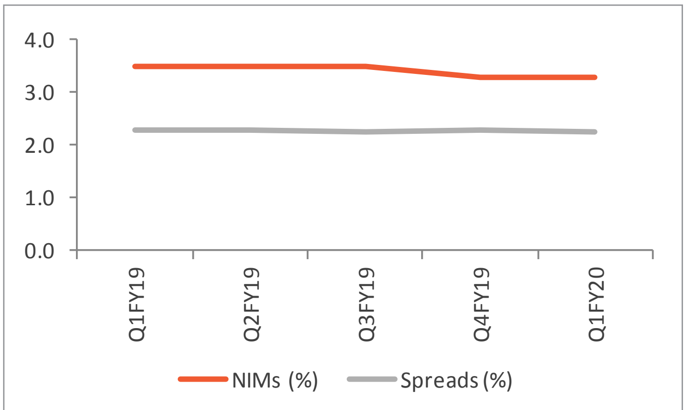
Source: Company, Sharekhan Research

Asset Quality Movement



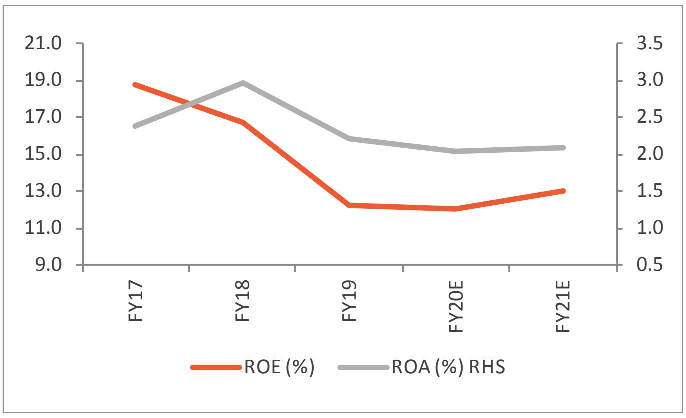
Source: Company, Sharekhan Research

Margins movement



Source: Company, Sharekhan Research

Return Ratios



Source: Company, Sharekhan Research

Outlook

Best of the lot, outlook improves as supportive measures provide a boost: We believe the slew of measures taken by the government and the regulator are likely to benefit strong HFCs such as HDFC, which is likely to see improved appetite for its borrowing requirements, which presents the company with an opportunity to optimise its cost of funds. This will likely see less pressure on its pricing, with possibility of improvement of spreads from Q1 levels. Positive business growth fundamentals would support strong earnings growth and help the company sustain its valuation premium as compared to peers.

While healthy asset quality, high provisions cover and stable margins continue to be supportive, 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 its leadership to sustain going forward, as HDFC capitalises on the benefits of reduced competitive pressure from other NBFC peers and PSU banks.

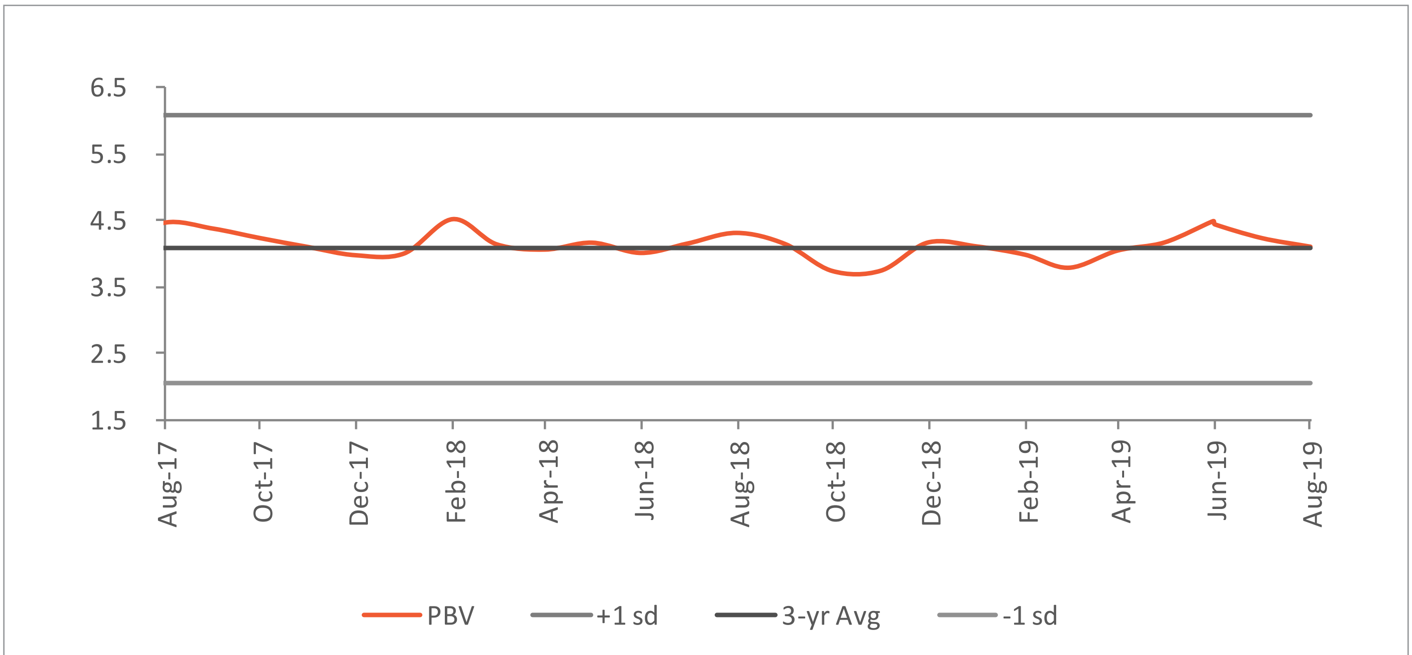
HDFC's strong operating metrics, supported by its industry's best credit rating, enables it to attract best rates and, hence, optimum COF, which are crucial support for its margins. The company is well capitalised at CRAR of 18.8% and Tier-1 of 17.3% (minimum requirement of 12% and 6%, respectively) and, hence, is comfortably placed. We believe the outlook for HDFC has improved with supportive government measures, which will provide growth momentum with a potential of margin expansion in the medium term.

Valuation

HDFC is currently available at ~4x its FY2021E BV, which we believe is reasonable considering its strong operating metrics, consistency and sustainable business model. Despite the NBFC industry facing challenges, we expect the consistency and relative outperformance of HDFC to help it to sustain its premium valuations. HDFC is best placed in the NBFC lot, with its core lending business having advantages of lowest funding costs, has adequate capital and a large retail and developer network. Going forward, its low cost of funds will be further bolstered by improving appetite for HDFC's sell-down/funding paper, which would result in pricing advantage.

For the past year, while strong NBFCs were able to raise funds (from banks), it was at a higher cost and HDFC saw a 5 BPS impact on its spreads in Q1. Going forward, we expect cost of funds for HDFC to come down, which will augur well for its margins and growth. In our view, AUM growth should remain healthy (on market share gains) with upside potential for spreads. We believe the outlook for HDFC has improved with supportive government measures, which will provide growth momentum with a potential of margin expansion. 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

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 for the long term.

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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