Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Housing Development Finance Corporation

Q2 rides on strong operational show

Banks & Finance	Sharekhan code: HDFC	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 2,043**	
Price Target: **Rs. 2,400**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

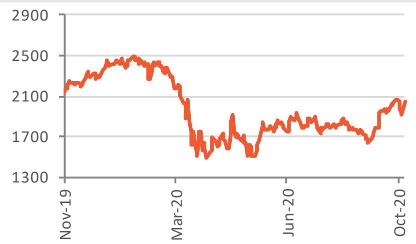
Company details

Market cap:	Rs. 366,820 cr
52-week high/low:	Rs. 2,499 / 1,473
NSE volume: (No of shares)	55.1 lakh
BSE code:	500010
NSE code:	HDFC
Free float: (No of shares)	179.6 cr

Shareholding (%)

Promoters	0.0
FII	70.3
DII	18.5
Others	11.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.5	7.8	0.9	-6.5
Relative to Sensex	13.0	2.5	-17.0	-6.2

Sharekhan Research, Bloomberg

Summary

- Q2 FY2021 results were strong, with operational results beating expectations; asset quality improved sequentially and margins too rose.
- Overall collection efficiency for individual loans stood at 96.3% in September (first month after RBI moratorium ended) which is encouraging
- Asset quality improved with overall NPA ratio falling 6 bps q-o-q to 1.81%; company is better capitalised (Tier-I at 19.5%; up from 16.2% in Q1 FY2021) which adds to balance sheet strength.
- HDFC is currently available at reasonable valuations of 3.7x / 3.4x its FY2022E / FY2023E ABV; We maintain our Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 2,400.

HDFC's Q2 FY2021 were strong with, operational numbers beating expectations and asset quality improving q-o-q, while margins also rose. Net interest income (NII) stood at Rs. 3,426 crore, up 29.4% y-o-y and 15.2% q-o-q, in line with expectations. Due to sequentially lower provisions, PAT slipped by 1.03% q-o-q to Rs. 3,011 crore, but was above expectations. Overall collection efficiency for individual loans stood at 96.3% in September (the first month after the moratorium ended). Collection efficiency for non-moratorium customers stood at 99.5%. For H1FY2021, cost-to-income ratio stood at 8.5% as compared to 9.7% in the previous year. Business traction improved and was almost near-normal, with Q2FY21, individual loan approvals rising 9% y-o-y. Disbursements were back at 95% levels of the previous year. Individual loan disbursements for September were 11% higher y-o-y. Asset quality improved with overall NPA ratio at 1.81%, down 6 bps q-o-q. Segment-wise, NPA in Individual Loans stood at 0.84% (0.92% in Q1 FY2021) but NPA – non-individual loans was at 4.19% (4.10% in Q1 FY2021). Due to the Supreme Court's order no additional borrower accounts under moratorium category have been classified as an NPA. However, HDFC classified such accounts as Stage-3 and were provided for accordingly. We opine that balance sheet strength, consistency, and quality of earnings continue to be the key differentiators for HDFC, and will help it tide over medium-term challenges. The company is well-capitalised (Tier-I at 19.5%; up from 16.2% in Q1 FY2021) which adds to the balance Sheet strength. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates. We maintain our Buy rating on the stock with a revised SOTP based price target (PT) of Rs. 2,400.

Key positives

- Spreads stood at 2.27% and NIM was stable at 3.2% for the half-year ended September 30, 2020 (3.3% for Q2). Capital adequacy is at healthy 20.7% as against regulatory requirement of 14%.
- AUM growth remained healthy, increasing by 10.2% y-o-y with on-balance sheet advances growth of 11.3% y-o-y showing improving traction, led by a growth of 10.4% y-o-y and 3.2% q-o-q. NIMs increased to 3.3% for Q2 FY2021, from 3.1% in Q1 FY2021.

Key negatives

- Non-interest income fell by 69.9% y-o-y and down 59.3% q-o-q mainly due to 70% y-o-y decline in dividend income to Rs. 323 crore (Rs. 1074 crore in Q2) and also absence of profit from sale of securities (Rs. 1,241 crore in Q1FY2021; Rs. 1,627 crore in Q2 FY2020).

Our Call

Valuations: HDFC is currently available at 3.7x / 3.4x its FY2022E / FY2023E adjusted book value, which we believe is reasonable considering its robust operating metrics, pedigree, strong brand recall across product categories, and a sustainable business model. Even as the NBFC industry faces its own challenges, consistency and relative outperformance of HDFC will help it sustain growth as well as valuations. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates. We maintain our Buy rating on the stock with a revised SOTP-based PT of Rs. 2,400.

Key Risks

Slower recovery in economy, higher slippages due to COVID-19 vulnerabilities, and slippages could impact earnings outlook.

Valuations Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Interest Income	11,403	15,194	11,716	12,523	15,331
PAT	9,632	17,770	10,994	11,303	13,241
EPS	55.9	102.9	61.3	63.0	73.9
P/E (x)	36.5	19.9	33.3	32.4	27.7
ABVPS	400.9	449.2	517.1	558.1	606.0
P/ABV (x)	5.1	4.5	4.0	3.7	3.4
ROE %	12.3	31.1	10.9	10.4	11.3
ROA %	2.2	5.5	2.0	1.8	1.8

Source: Company; Sharekhan estimates

Key Concall Highlights

- **Business Update:** Q2 was very good in terms of growth. Pick-up was faster than anticipated earlier. For individual loans, disbursement was at 95%, and volume growth kept improving m-o-m. Loans sanctioned and disbursed during September 2020 rose by 21% y-o-y and 11% as compared to the previous month. Individual loan approvals in October were up 58% y-o-y and disbursements were up 35% y-o-y. If average of October / November/ December of last year, then disbursement growth would have been 22% for September 2020.
- **Loans sold:** Loans sold in the preceding 12 months amounted to Rs 14,138 crore (PY: Rs 23,767 crore).
- **Affordable Housing:** During the half-year ended September 30, 2020, 35% of home loans approved in volume terms and 18% in value terms have been to customers from Economically weaker sections (EWS) and low income groups (LIG). Till Q2 FY2021 18% of loans in terms of value to EWS segment.
- **AUM performance:** On an AUM basis, the growth in the individual loan book was 9%. The growth in non-individual loan book was 13%. The growth in the total loan book on an AUM basis was 10%.
- **Loan book breakup:** Loan book comprised - Individual loans - 75%, construction finance 11%, LRD 8% while the balance was made up of corporate loans.
- **Unrealised gains** on listed subsidiaries stood at Rs. 196,344 crore.
- **Normalized Asset Quality:** Normalised GNPA would have been higher by 4 bps at 0.8% for individual and non-individual loans. Had moratorium not been provided, asset classification would have been higher by Rs 7,900 crore.
- **Provisions:** Total provision needed was Rs. 5,621 crore, against which the total provisions carried amounted to Rs. 12,304 crore. Additional COVID-19 provisions totalled Rs. 1,200 crores, of which Rs. 284 crore was for Q2.
- **Loans Sold:** Loans sold during Q2FY2021 amounted to Rs. 3,026 crores, due to which the lender had to provide upfront. Q2 FY2021 NII would have been Rs. 3,806 crore (adding back securitisation income)
- **Stable margins:** NIM rose by 10 bps to 3.3%; spreads stable at 2.26%
- **Like-to-like comparison:** To facilitate a like-for-like comparison, after adjusting dividend, profit on sale of investments, fair value adjustments, net gains on loans assigned, charge for employee stock options and provisioning, HDFC's adjusted profit before tax for Q2, stood at Rs 3,366 crore as compared to Rs 2,646 crore in the previous year, reflecting a growth of 27%.
- **Collection efficiency** was 96.3% of what was due in September after the lockdown was lifted.
- **Growth outlook:** Best time for consumers as interest rates are low. Many states have given incentive for Home buying, and many developers are offering price discounts. Moreover, a young population and government schemes like CLSS, etc are also enablers. The penetration level of mortgages in India is low. Given these factors, HDFC Ltd's disbursement in October has been the second-highest ever done.
- **Restructuring outlook** is not clear at the moment, but the company doesn't deem it to be very high.

Results Rs cr

Particulars	Q2FY21	Q2FY20	YoY %	Q1FY21	QoQ %
Interest income	10825.1	10478.3	3.3	10790.7	0.3
Interest expense	7399.1	7830.0	-5.5	7817.1	-5.3
Net interest income	**3426.0**	**2648.3**	**29.4**	**2973.6**	**15.2**
Non-interest income	907.6	3015.8	-69.9	2228.6	-59.3
Net total income	4333.6	5664.1	-23.5	5202.2	-16.7
Operating expenses	224.7	379.6	-40.8	396.4	-43.3
Pre-provisioning profit	**4108.9**	**5284.5**	**-22.2**	**4805.8**	**-14.5**
Provisions	436.0	754.1	-42.2	1199.0	-63.6
Profit before tax	3672.9	4530.4	-18.9	3606.8	1.8
Tax	661.7	568.5	16.4	555.3	19.2
Profit after tax	**3011.3**	**3961.9**	**-24.0**	**3051.5**	**-1.3**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View - Long term Demand for Housing and mortgages is expected to continue

Long-term structural indicators remain strong for housing and mortgages in India. The ruling Interest rates are low, and several States have also given incentive for home-buying, which is likely to prop up demand. Moreover, pricing is looking to soften and as per Industry comments, many developers are offering price discounts. India has a young population, and government schemes like CLSS, etc which will facilitate even the affordable housing segments are also enablers along with low penetration levels of mortgages in India.

■ Company View - Strong metrics, with resilient asset quality

Q2 results were strong and Collections and disbursals picking up is positive. While there was sequential improvement in asset quality, there was some impact due to the lockdown. However, we expect a high provisions cover and stable margins to be supportive. Balance sheet strength, consistency, and quality of earnings continue to be the key differentiators for HDFC, which support long-term investments. The company is well capitalised (due to recent Equity raise) and is comfortably placed. Given the market dominance of HDFC, we expect the leadership to sustain going forward, as the business environment normalises. HDFC's strong operating metrics, supported by its industry's best credit rating, enable it to attract best rates and, hence, optimum COF, which will be crucial supports for margins.

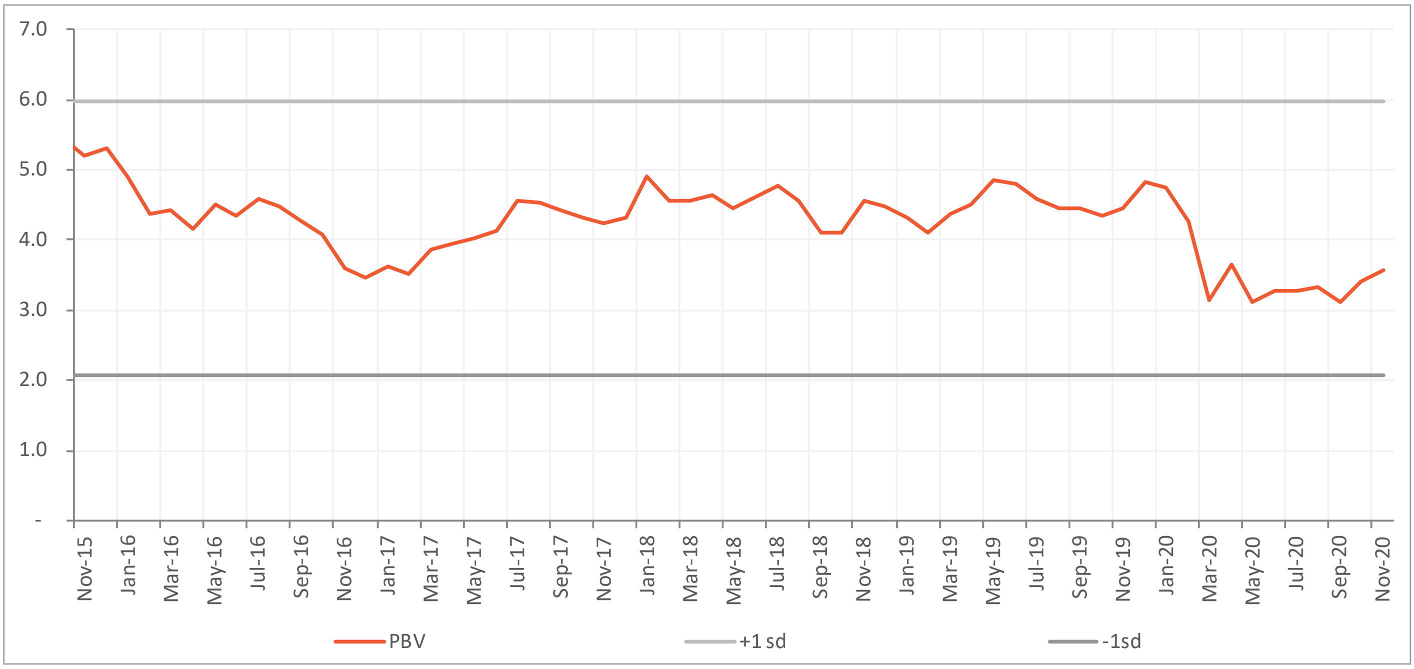
■ Valuation - Retain Buy with revised PT of Rs 2,400

HDFC is currently available at 3.7x / 3.4x its FY2022E / FY2023E adjusted book value, which we believe is reasonable considering its robust operating metrics, pedigree, strong brand recall across product categories, and a sustainable business model. Even as the NBFC industry faces its own challenges, consistency and relative outperformance of HDFC will help it sustain growth as well as valuations. We have fine-tuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates. We maintain our Buy rating on the stock with a revised SOTP-based PT of Rs. 2,400.

SOTP Valuation

		Valuation Parameter	Multiple	Value per share
HDFC Ltd (standalone)		FY23E BVPS	2.2	1,333
	% Stake	**Valuation Parameter**	**Multiple**	**Value per share**
HDFC AMC	52.71	FY23E EPS	28.0	192
HDFC Life	50.1	FY23E EVPS	4.0	378
HDFC Bank	26.1	FY23E BVPS	3.2	1202
Others				15
				1787
Holdco discount	40%			
Final Value per share				**2405**

One-year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HDFC Ltd	2,043	4.0	3.7	33.3	32.4	2.0	1.8	10.9	10.4
LIC Housing Finance	299	0.8	0.7	8.0	5.9	0.8	1.1	9.9	12.4

Source: Company, Sharekhan research

About company

Housing Development Finance Corporation (HDFC) Limited is a major provider of finance for housing in India. The company is also present in banking, life and general insurance, asset management, venture capital, realty, education, deposits, and education loans via its formidable subsidiaries. As pioneers in housing mortgages, it is a brand name that has been characterised by trust, solidity, both financial and managerial, and sound principles. Established in 1977, HDFC has been able to maintain and set high standards in the housing finance sector.

Investment theme

HDFC 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 the recent past. The impact of COVID-19 is likely to be seen across industries and would impact growth and credit cost for NBFCs, including HDFC. However, balance sheet strength, consistency, and quality of earnings continue to be the key differentiators for HDFC, and will help it tide over medium-term challenges We believe HDFC is an attractive business franchise due to its strong retail book, a quality developer finance book (with sufficient cover), opportunity of quality market share gains (AUM growth), access to reasonably priced funds, and superior underwriting practices.

Key Risks

Slower recovery in economy, higher slippages due to COVID-19 vulnerabilities, and slippages could impact earnings outlook.

Additional Data

Key management personnel

Renu S Karnad	Managing Director
Keki M Mistry	Vice Chairman & CEO
Mr V Srinivasa Rangan	Whole Time Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.2
2	Vanguard Group Inc/The	4.1
3	Invesco Ltd	3.8
4	INVESCO ADVISERS INC	3.4
5	Republic of Singapore	3.0
6	BlackRock Inc	2.7
7	SBI Funds Management Pvt Ltd	2.7
8	JPMorgan Chase & Co	2.7
9	Standard Life Aberdeen PLC	2.0
10	FMR LLC	1.6

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;