Sharekhan by BNP PARIBAS

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Stock Update

Housing Development Finance Corporation

Strong show, yet again

Banks & Finance	Sharekhan code: HDFC	Results Update

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 2,658**	
Price Target: **Rs. 3,100**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 4,78,428 cr
52-week high/low:	Rs. 2,777/1,473
NSE volume: (No of shares)	47.3 lakh
BSE code:	500010
NSE code:	HDFC
Free float: (No of shares)	180.0 cr

Shareholding (%)

Promoters	0.0
FII	72.0
DII	17.3
Others	10.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.4	30.1	52.7	17.0
Relative to Sensex	-0.6	4.9	17.9	-8.3

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 results were strong as operational numbers beat expectations; asset quality improved sequentially and growth traction improved.
- Overall collection efficiency for individual loans stood at 97.6 in December (from 96.3% in September) which is encouraging.
- Asset quality improved with reported NPA ratio declining, proforma NPA well-contained, company is better capitalised (Tier-I at 19.9%) which demonstrates balance sheet strength.
- Stock trades at reasonable valuations of 4.8x / 4.4x its FY2022E / FY2023E ABV; we maintain a Buy with a revised SOTP based price target (PT) of Rs. 3,100.

HDFC's Q3 FY2021 numbers were strong with operational numbers beating expectations and reported asset quality improving q-o-q, with improved growth traction. Net interest income (calculated NII) stood at Rs. 4,410 crore, up 30.5% y-o-y and 17.4% q-o-q, and was in line with expectations. Despite sequentially higher provisions, PAT increased by 1.9% q-o-q to Rs. 2925.8 crore, mainly due to lower interest costs and hence came above expectations. To facilitate a like-for-like comparison, after adjusting for exceptional items, adjusted profit before tax for Q3FY2021 Rs. 3,694 crore reflecting a growth of 27% y-o-y. Overall collection efficiency ratios for individual loans have improved, nearing pre-COVID levels. Collection efficiency for individual loans in December 2020 stood at 97.6% versus 96.3% in September 2020. AUM growth was healthy at 9% y-o-y and 2.2% on q-o-q basis, to Rs. 552,167 crore. There has been a significant recovery and strong growth in the individual business during Q3FY2021. Hence, individual loans (comprising 76% of AUM) grew 10% y-o-y, while non-individual loan book grew by 7%. A smart recovery in individual loans has also been seen over 9M FY2021. For Q1 FY2021 HDFC Ltd had disbursed 27% of the amount disbursed in Q1 FY2020, Q2 FY2021 was much better and HDFC disbursed 95% of amount done in Q2FY2020, and in the Q3, disbursement was 126% of Q3FY2020 levels, indicating a strong pick-up in disbursements. Asset quality performance was enthusing with reported GNPA at 1.67% (down 14BPS QOQ) basis. Even on a proforma basis, the GNPA at 1.91% is only 24 bps higher than the reported numbers, and was up by 8 bps q-o-q. Overall collection efficiency ratios for individual loans have improved, nearing pre-COVID levels. We opine that balance sheet strength, consistency, and quality of earnings continue to be the key differentiators for HDFC and will help it regain normalcy faster than peers. The company is well-capitalised (Tier-I at 19.9%), which adds to the balance Sheet strength. We have finetuned our estimates for FY2021E and FY2022E and introduce FY2023E estimates. We maintain a Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 3,100.

Key positives

- NII growth was supported as excess liquidity carried on books have declined. The excess liquidity being carried on books were of Rs 32,000 crore for Q1 FY2021, Rs 28,000 crore for Q2FY2021, which for Q3 is only 17,000 crore.
- Strong asset quality performance, reported GNPA at 1.67% (down 14 bps q-o-q) basis; even on Proforma basis, the GNPA at 1.91% is only 24 bps higher than the reported numbers.

Key negatives

- Sharp rise in employee costs at Rs 290 crore, up by 90% y-o-y and 60% q-o-q basis.

Our Call

Valuations: HDFC is currently available at 4.8x / 4.4x 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. We believe that the consistency and relative outperformance of HDFC will help it sustain growth as well as valuations. HDFC Ltd carries an MTM unrealised gain of Rs 252,900 crore on account of subsidiaries' value, which provides support to its valuation. The provisions carried by HDFC Ltd as a percentage of the exposure at default (EAD) is equivalent to 2.56%, and low restructured pipeline provides investor comfort. We have fine-tuned our estimates. We maintain a Buy rating on the stock with a revised SOTP-based PT of Rs. 3,100.

Key risk

Slower recovery in economy, higher slippages may 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	13,247
EPS	55.9	102.9	61.3	63.0	73.9
P/E (x)	47.5	25.8	43.3	42.2	36.0
ABVPS	400.9	449.2	517.1	558.1	606.0
P/ABV (x)	6.6	5.9	5.1	4.8	4.4
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 Management Comments

- **Strong demand traction in housing loans:** HDFC Ltd continued to see strong growth in demand for housing loans, and for Q3FY21, demand was better than expected.
- **Loan approvals / disbursement post smart growth:** Loans approvals for individuals for Q3FY2021 was higher by 32% y-o-y and disbursements were higher by 26% y-o-y in Q3 FY2020.
- **Disbursement recovery smart:** Progress of individual loans, in Q1 FY2021 was impacted. Hence for Q1 FY2021 HDFC Ltd disbursed 27% of amount disbursed in Q1 FY2020, Q2 FY2021 was much better and HDFC disbursed 95% of amount done in Q2 FY2020, and in the Q3 HDFC disbursed 126% what was done in Q3 FY2020.
- **Individual loans:** On an aggregate AUM basis, loan book grew by 9% for individual loans. Net growth in loan book has improved to 10%, from 9% in Q2FY2021.
- **Loans sold:** HDFC Ltd sold Rs 7076 crore to HDFC Bank, in pursuance with mortgage sharing agreement. Had these loans not been sold, individual loan growth would have been 16%
- **Affordable housing thrust continues:** In 9MFY2021, ~17% loans in value and 34% loans by number were for economically-weaker-segment (EWS) borrowers by HDFC Ltd.
- **Ticket size:** Actual average loans ticket size is at Rs 28.9 lakh for 9MFY2021 and Rs. 30 lakh for Q3FY2021 loans.
- **Loan book breakup:** Proportion of individual loans stood at 76% (similar to Q2), Construction finance is 11% of total loans, Lease rental Discounting (LRD) is 7% and corporate loans comprises 6% of loans on a balance sheet basis
- **Incremental loan growth** for 9MFY2021 stood at 80% for individual and 20% for non-individual loans. For Q3 was 137% for Individual loans, indicating a strong traction in Individual loans.
- **Unrealised MTM gains on books:** HDFC Ltd carries an MTM unrealised gain of Rs 252,900 crore on account of subsidiaries value.
- **CRAR** is 20.9% Tier 1 is 19.9% and remaining Tier 2 and is way above regulatory requirement
- **Total restructured loans** is 0.9% of AUM and out of this Rs. 510 crore or 76% of restructured assets is for non-individual loans. Around 52% is for loans to just one account, hence the profile is granular.
- **Provision buffer:** HDFC carried Rs. 12,343 crore additional provisions, which is above requirement by RBI. HDFC ltd still carries COVID provision of Rs. 929 crore.
- **Liquidity reduces:** NII growth was despite the surplus liquidity on the books. However, the same has been coming down over the last three quarters, from Rs 32,000 in Q1, Rs 28,000 crore in Q2 and the Q3 FY2021 number is now only Rs 17,000 crore.
- **Strong growth in normalized PAT:** Adjusted PAT at 3694 compared to 2984 crore up 27% for Q3 FY2021. Similar adjusted PAT for 9M FY2021 stands at Rs 10950 crore up by 21% y-o-y.

Results Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y%	Q2FY21	q-o-q%
Revenue from Operations	**11,707.0**	**20,285.3**	**(42.3)**	**11,728.0**	**(0.2)**
Interest Income	10,710.2	10,727.4	(0.2)	10,825.1	(1.1)
Surplus from deployed in Cash Mgmt MF Schemes	127.2	255.4	(50.2)	176.8	(28.1)
Dividend Income	2.2	3.8	(41.0)	323.0	(99.3)
Rental Income	16.5	18.0	(8.1)	19.8	(16.4)
Fee & Commission income	53.2	44.3	19.9	58.8	(9.7)
Profit on loss of control over a subsidiary	-	-	NA	-	NA
Net gain / (loss) on Fair Value Change	230.3	39.0	490.6	166.0	38.8
Fair Value gain (merger of Gruh)	-	9,019.8	NA	-	NA
Profit on Sale of Investment	157.1	-	NA	(0.6)	NA
Profit on Sale of Investment Properties	-	7.4	NA	-	NA
Income on de-recognised / assigned loans	410.3	170.3	141.0	159.0	158.0
Total Operating Income	**11,707.0**	**20,285.3**	**(42.3)**	**11,728.0**	**(0.2)**
Other Income	9.3	6.0	56.2	4.7	97.0
Total Income	**11,716.3**	**20,291.3**	**(42.3)**	**11,732.7**	**(0.1)**
Finance Cost	6,832.7	7,769.6	(12.1)	7,399.1	(7.7)
Net Interest Income	**4,415.0**	**3,383.4**	**30.5**	**3,761.9**	**17.4**
Employee Benefit Expenses	290.5	153.0	89.9	181.1	60.4
Establishment expense	9.0	9.4	(5.1)	7.6	18.1
Other Expenses	186.0	179.4	3.7	141.2	31.8
Depreciation and Amortisation	51.6	42.1	22.8	36.0	43.6
Pre Provision Profit	**4,346.5**	**12,137.8**	**(64.2)**	**3,967.8**	**9.5**
- less: Provision on Expected Credit Losses	594.0	2,995.0	(80.2)	436.0	36.2
Profit before Tax	**3,752.5**	**9,142.8**	**(59.0)**	**3,531.8**	**6.3**
Tax Expense	**826.7**	**770.5**	**7.3**	**661.7**	**24.9**
- Current	756.3	652.6	15.9	592.5	27.6
- Deferred Tax	70.5	117.9	(40.2)	69.2	1.8
Profit after Tax	**2,925.8**	**8,372.3**	**(65.1)**	**2,870.1**	**1.9**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Outlook improves for NBFCs in general and HFCs in particular

Long-term structural indicators remain strong for housing and mortgages in India. Interest rates are low and several states have given incentives for home buying, which is likely to prop up demand. The recent fall in borrowing costs, which was steep for high-rated NBFCs, is another positive. Moreover, rising affordability and softening pricing (helped by tax incentives) are positive for demand offtake and LTV outlook for HFCs. India has a young population and government schemes such as CLSS, etc, which will facilitate even the affordable housing segments, are also enablers along with low penetration levels of mortgages in India (at 10% of GDP, against 18% in China and 56% in the US). We believe that the economic recovery is also gaining momentum and stimulus/supportive measures by the government and the Reserve Bank of India (RBI) will further aid to the same. We believe the outlook has turned positive for the NBFC sector in general and HFCs in particular.

■ Company Outlook – Strong metrics, with resilient asset quality

Q3 results were strong and collections and disbursals picking up is positive. While there was marginal sequential rise in proforma GNPAs, they were well contained and indicate a strong book quality. Also, the high provisions cover and stable margins would continue to be supportive for profitability. 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, even as growth momentum in Housing market is encouraging. 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.

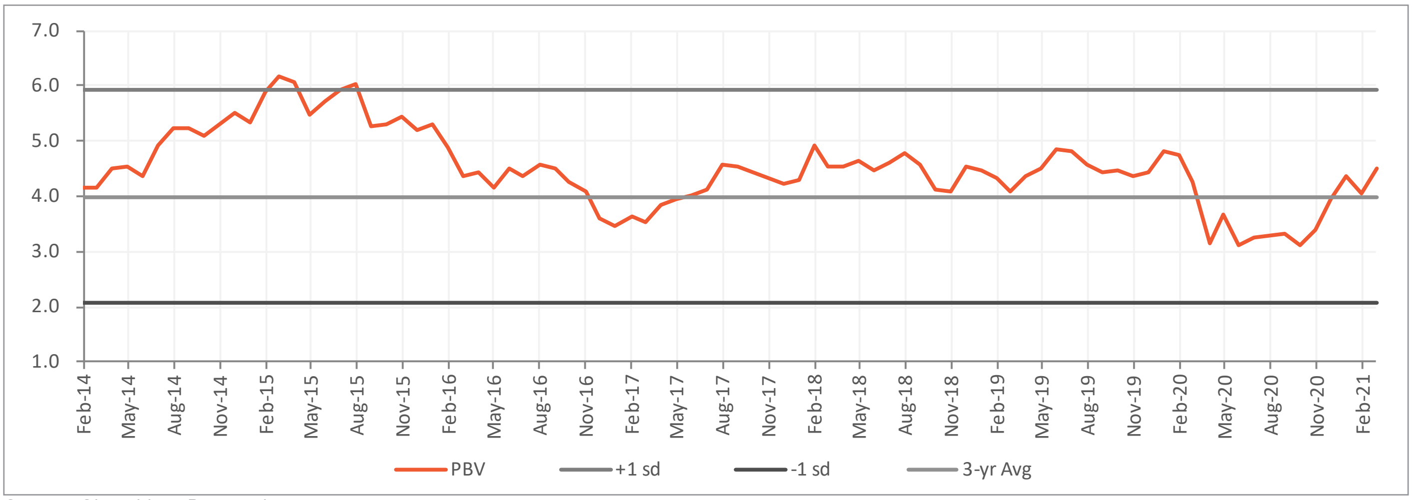
■ Valuation – Retain Buy with revised PT of Rs 3100

HDFC is currently trading at 4.8x / 4.4x 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. We believe that the consistency and relative outperformance of HDFC will help it sustain growth as well as valuations. HDFC Ltd carries an MTM unrealised gain of Rs 252,900 crore on account of subsidiaries' value, which provides support to its valuation. The provisions carried by HDFC Ltd as a percentage of the exposure at default (EAD) is equivalent to 2.56%, and low restructured pipeline provides investor comfort. We have fine-tuned our estimates. We maintain a Buy rating on the stock with a revised SOTP-based PT of Rs. 3,100.

SOTP Valuation

		Valuation Parameter	FY23E BVPS	Multiple	Value per share
HDFC Ltd (standalone)		FY23E BVPS	652.6	2.5	1,624
	% Stake	**Valuation Parameter**	**Value**	**Multiple**	**Value per share**
HDFC AMC	52.68	FY23E EPS	75.0	30.0	170
HDFC Life	49.99	FY23E EVPS	162.4	5.0	477
HDFC Bank	26.1	FY23E BVPS	403.0	3.8	1447
Others					15
					2109
Holdco discount	30%				633
Value added per share					1477
Final Value per share					**3100**

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs/Share)	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HDFC Ltd	2,658	5.1	4.8	43.4	42.2	2.0	1.8	10.9	10.4
LIC Housing Finance	441	1.1	1.0	9.0	7.7	1.08	1.21	12.6	13.5
Can Fin Homes	489	2.5	2.2	14.8	13.2	2.0	2.1	18.5	17.5
PNB Housing	350	0.7	0.6	7.7	6.6	1.0	1.1	9.3	10.1

Source: Company, Sharekhan research

About company

Housing Development Finance Corporation (HDFC) Limited is a major provider of finance for housing in India. The company (via its subsidiaries and group companies) 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. We believe balance sheet strength, consistency, and quality of earnings continue to be the key differentiators for HDFC, and will help it tide over 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 may impact earnings outlook.

Additional Data

Key management personnel

DEEPAK S PAREKH	Chairperson
V. SRINIVASA RANGAN	Executive Director
RENU SUD KARNAD	Executive Director,MD
KEKI M. MISTRY	Executive Director,CEO-MD
Mathew Joseph	Chief Risk Officer
Mr V Srinivasa Rangan	Whole Time Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.0
2	Vanguard Group Inc/The	4.3
3	Invesco Ltd	4.3
4	JPMorgan Chase & Co	3.8
5	Invesco Adviser Ltd	3.7
6	BlackRock Inc	3.1
7	Republic of Singapore	3.0
8	SBI Funds Management Pvt Ltd	2.6
9	FMR LLC	1.8
10	T Rowe Price Group LLC	1.5

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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