

12 February 2021

HDFC Ltd. – BUY

CMP :Rs.2,767.0
Target Price :Rs. 3,312.0
Upside : 20%+
Stop Loss :Rs.2,416.0 (closing basis)

Investment Thesis

Recently, the stock price of Housing Development Finance Corporation Ltd. (HDFC) corrected by ~1% from 52-week high of Rs.2,784.00 with growing concerns around the asset quality and retail business growth impacted due to the lockdown after spread of Covid-19.

HDFC, first specialized and largest housing finance company (HFC), has witnessed healthy loan traction of 20% CAGR since FY07. Including banks, it is second after SBI with a market share of ~16% in individual loan and total outstanding loan book is Rs.3,421bn of which individual loans account for ~69%. HDFC has witnessed healthy traction of 18% CAGR in loan book compared with 16% industry CAGR in the past four years mainly driven by individual loans. By virtue of its strong market position, HDFC 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 may 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 challenges.

Sources of funding of HDFC are well diversified, which include bank loans (13%), bonds & commercial paper (56%) and deposits (31%). HDFC, owing to its brand, higher credit rating and sound track record of timely repayments, has ability to immediately change its borrowings mix profile to suit its need and take advantage of the prevailing market conditions. Such flexibility in the funding profile enables HDFC to maintain a healthy track record of sustaining reported spreads and NIMs above 2.2% and 3.5%, respectively, across volatile interest rate cycles. It also earns ~1.2% spread on loans sold to banks. With slower traction in the corporate book, we expect margins to remain under pressure, partly offset by a declining rate cycle. We expect NIMs to remain broadly stable at ~3.3% with reported spreads to be maintained close to ~2.2-2.3% levels.

Financials

- During the past 5 years, Interest Income of HDFC grew at a CAGR of 10.7% while PAT grew at a CAGR of 24.3% in the same period.

Standal. (Rs. Mn)	FY18	FY19	FY20	FY21E	FY22E
NII	95,893	104,385	115,712	133,069	153,030
% growth	1.3	8.9	10.9	15.0	15.0
PAT	109,593	96,325	177,697	204,351	235,004
ABV (INR)	383.5	443.0	491.6	550.4	616.2
P/ABV (x)	7.2	6.2	5.6	5.0	4.5
EPS (INR)	65.4	56.0	102.6	118.0	135.7
P/E (x)	42.3	49.4	27.0	23.4	20.4
RoE (%)	17.1%	12.6%	20.9%	21.4%	22.0%

- NII growth of HDFC increased at a healthy rate of 34.2% YoY to Rs.36,470mn in Q2FY21 led by AUM growth and steady asset quality.

Stock Data

Market Cap (Rs. Mn)	49,75,020
Market Cap (\$ Mn)	68,310.0
Shares O/S (in Mn)	1,732.1
Avg. Volume (3 month)	3,449,000
52-Week Range (Rs.)	2,784.00 / 1,473.45

Shareholding Pattern

Promoters	0.00%
FII's	71.95%
Institutions	17.33%
Others (incl. body corporate)	10.72%

Performance (%)	1M	6M	1Yr
Absolute	3.5%	54.5%	14.2%
BSE Bankex	11.1%	64.9%	14.1%

Key Ratios

Div Yield	0.8%
TTM PE	28.4x
ROE	20.2%
TTM EPS (Rs.)	97.3/-

- Asset quality of HDFC improved with GNPA ratio came down by ~6bps QoQ to 1.81% (GNPA:Rs.85,110mn vs ~Rs.86,310mnQoQ).
- NPA of HDFC in the individual book decreased by 8bps QoQ at 0.84% while that of the non-individual portfolio deteriorated by 9bps QoQ to 4.19% in Q2FY21.
- HDFC's AUM grew by 10% YoY to Rs.54,02,700mn in Q2FY21 on the back of a pick-up in disbursement in individual loans, which grew 9% YoY and accounted for ~75% of the overall portfolio.

Key Business Highlights

- HDFC is engaged in financing by way of loans for the purchase or construction of residential houses, commercial real estate and certain other purposes in India. The Company's segments include loans, life insurance, general insurance and asset management.
- HDFC also provides insurance products, portfolio management, mutual fund, property investment management, project management, investment consultancy and property related services.
- HDFC's subsidiaries include HDFC Developers Ltd., HDFC Investments Ltd., HDFC Trustee Co. Ltd. and HDFC Asset Management Co. Ltd., among others.

Valuation

- HDFC has one of the best asset quality parameters in the industry considering its large size. As on Q2FY21, GNPA was at Rs.86.3bn while NNPA remained nil owing to 100% provision coverage ratio. Similarly, GNPA ratio at 1.8% is lower than industry ratio while credit cost is lowest in the industry at 0.08%. Reasons for such a benign asset quality are HDFC's conservative lending policies, which enable it to avoid customers defaulting on loans. On an average, it lends only up to 66% of the assessed value of an asset. Other reasons include preventing aggressive loan growth or going for higher market share, 90% of individual portfolio belonging to salaried class wherein the default is lower. Further, exposure to real estate developers, which is only 13% of the total loan portfolio, is backed by collateral of 2.0x the loan size. We expect the asset quality of HDFC to remain healthy, going forward.
- HDFC has the best operating efficiency in the industry with the cost-to-income ratio at less than 7%, whereas its peers like LIC Housing Finance and Dewan Housing Finance have a cost-to-income ratio of 14% and ~40%, respectively. This is mainly due to the in-house sourcing model of HDFC compared to the DSA based model (90%) of LIC Housing Finance and branch based model of Dewan Housing Finance. Further, the lower employee base of HDFC, compared to other HFCs and banks enables HDFC to maintain such low ratios. We believe, with best operating efficiency, HDFC will be able to maintain these measures going ahead.
- With first specialized and largest housing finance company, healthy traction of 18% CAGR in loan book, well diversified sources of funding, one of the best asset quality parameters in the industry and best operating efficiency with the cost-to-income ratio at less than 7%, we value HDFC at 5.40x FY22E ABV of Rs.613.40 to arrive at target price of Rs.3,312.00, an upside of ~20%.

Risk & Concern

- Any significant negative announcement by the regulator may act against HDFC and may impact the performance in the short term.
- Any significant steps taken to gain market share by the players in the banking industry will impact the business of HDFC in the short-term.
- Any unstable interest rate environment may adversely impact cost of fund of HDFC.

Graphs & Charts

Figure 1: Interest Income Trend

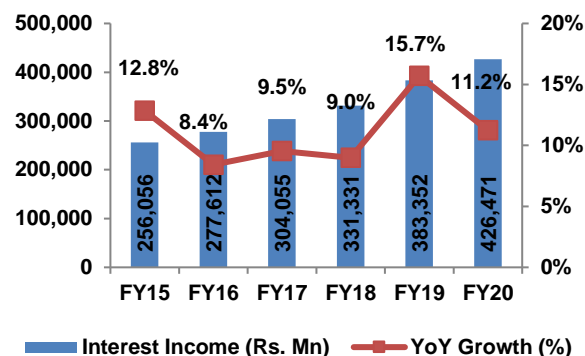


Figure 2: NII Trend

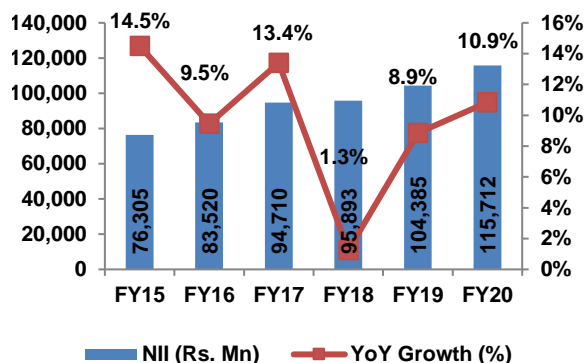


Figure 3: PAT Trend

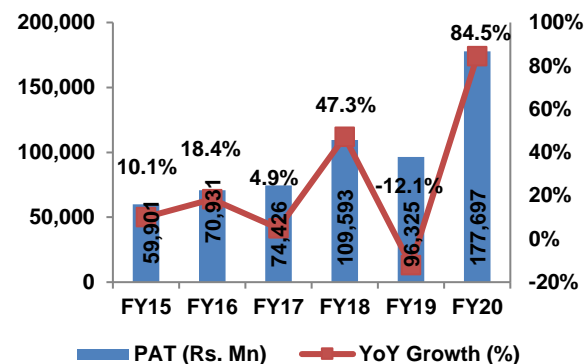
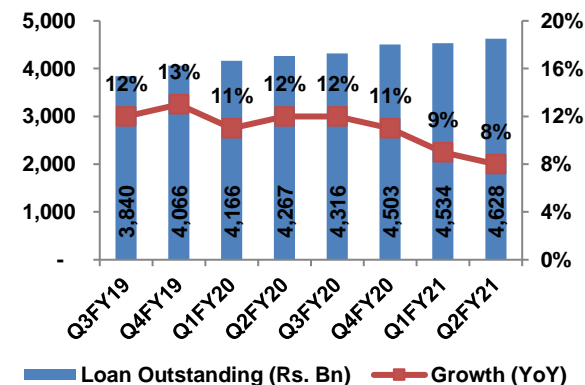


Figure 4: Credit Growth Trend



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