Housing Development Finance Corp Ltd.

Investment Rationale

To benefit from "Housing for all by 2022"

Recently, government has launched Pradhan Mantri Awas Yojana (PMAY) housing scheme, along with its long planned Smart Cities mission and the Atal Mission for Rejuvenation and Urban Transformation (AMRUT) urban renewal initiative. Through the mission, government intends to create 2 crore houses by 2022 by providing a central grant of Rs 1- 2.3 lakh per house by way of a 6.5% interest subvention scheme, look to create 100 smart cities through a Rs 48,000 crore initiative and push for urban infrastructure upgrade of 500 cities in the Rs 50,000 crore scheme. The government's mission is to provide affordable homes to the economical weaker section and lower income section of urban people and at the same time the construction of smart cities would provide the urban people a quality of life. The urban reforms thrust will provide the much needed fillip for infrastructure development across India and investments of Rs 3 lacs crore planned over the next five years would definitely provide a strong impetus for growth to more than 250 allied industries. HDFC is a strong candidate for "Housing for all by 2022" since it focuses on the low cost and affordable housing segment with average ticket size (on cumulative disbursement) of Rs 6.5 lacs. HDFC has been working with various government agencies and lending to beneficiaries who are in the EWS and LIG segment. Given the core expertise of HDFC in the niche LMI segment, it can be expected that HDFC will be a significant beneficiary for the financing of affordable housing and also demand–supply mismatch in low and middle income segment of tier II and III cities.

Healthy growth in individual loans, signs of revival in non-individual book

HDFC is the first specialized housing finance company (HFC) in India and also the largest. Including the bank, it comes second after SBI with a market share of ~16% (on an individual loan basis). Its total outstanding loan book stands at Rs. 267116 crore

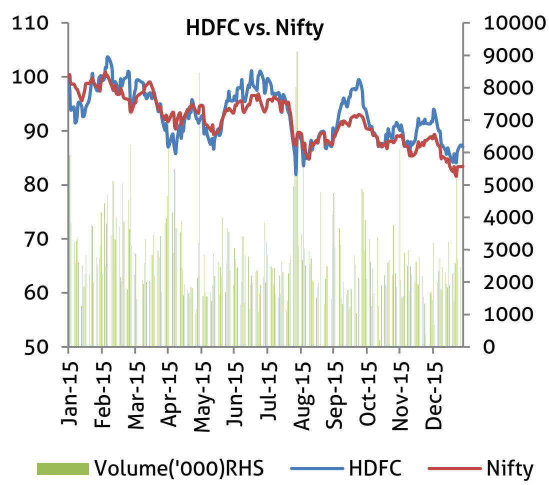
In Rs. Cr.	FY14	FY15	FY16E	FY17E
Net interest Income	6666.0	7631.0	8775.7	10267.5
NIM (%)	3.4	3.4	3.3	3.4
PAT	5440.0	5990.0	6888.5	8059.5
EPS (Rs)	34.9	38.0	43.7	51.2
BV (Rs)	179.1	196.7	226.6	251.1
GNPA (%)	0.7	0.7	0.7	0.7
ROA (%)	2.6	2.5	2.6	2.6

Consensus Estimate: Ashika Research

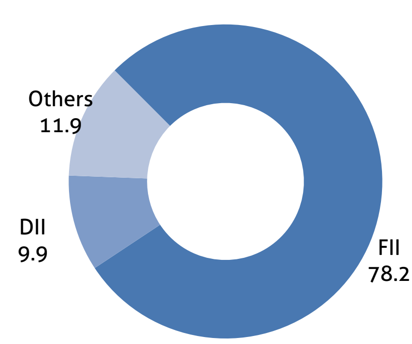
February 01, 2016	
Recommendation	Buy
Closing price	Rs. 1180
Target price	Rs. 1400
Potential upside	19%

Company Information	
BSE Code	500010
NSE Code	HDFC
Bloomberg Code	HDFC IN
ISIN	INE001A01036
Market Cap (Rs. Cr)	185911
Outstanding shares(Cr)	157.9
52-wk Hi/Lo (Rs.)	1402.3 / 1093.2
Avg. daily volume (1yr. on NSE)	2,700,236
Face Value(Rs.)	2
Book Value	285.3

Relative performance chart (one year)



Share holding pattern as on Sep 2015 (%)



Investment Rationale Cont...

as on Q2FY16 of which individual loans account for more than 70% while the corporate account for ~30% in Q2FY15. According to the management high-margin non-individual loans have shown some signs of recovery over the past couple of quarters, while the individual loans continue to report healthy growth including loans sold. HDFC has witnessed healthy traction of 18% CAGR in the past four years compared to industry CAGR of 17% mainly driven by the individual loan segment. The company has been able to maintain its leading position despite a challenging macro environment. This is owing to its unique strengths such as a strong franchise, brand pedigree, in-house model, large network and a dedicated business.

Strong return ratios

HDFC has reported excellent return ratios in the past as compared to its peers on the back of consistent and healthy growth in loans, impeccable margins, improving asset quality and stellar operating efficiency. The company has been able to generate strong Return on Net Worth (RoNW) as well as Return on Assets (RoA) over the years. RoNW has been consistently above 20% from FY10 onwards while RoA have been above 2.5% since FY10. For FY15, RoNW and RoA stand at 20.3% and 2.5% respectively. With improvement in micro economic condition and rising demand for housing loan due to financing for affordable housing, the company is expected to generate handsome returns in the future.

Superior Asset Quality

HDFC has one of the best asset quality parameters in the industry. HDFC has been able to maintain strong asset quality over the years due to high LTV and higher concentration of salaried employees of the housing loan mix with the major chunk of the loan to the salaried customers from government organizations. The major reasons for such benign asset quality have been HDFC's conservative lending policies, which enable it to avoid customers defaulting on loans. Gross NPA for the company has remained in a tight range of 0.7-0.8% during the last five years while Net NPA is nil since FY11 on account of 100% provision coverage ratio. In fact, the company carries good amount of excess provision over and above the regulatory requirement, thus giving confidence of maintaining healthy asset quality going forward. The figures for Gross NPA as well as Net NPA also lingered at the same historic levels for 9MFY16.

Robust financial performance over the years

HDFC has depicted strong set of financials over the years. During FY10-15, net interest income (NII) grew at a CAGR of 18.5% while PAT grew by 22% CAGR. The dividend payout ratio has also been maintained at over 40% for the last five years. The strong set of operating profit is on account of management's efforts to maintain the cost to income ratio at below 8%. For FY15 cost to income ratio stands at 7.6%, best operating efficiency in the industry, mainly due to the in-house sourcing model. The company also earns one of the highest net interest margin (NIM) in the industry and has been above 4% mark for the last three years. For FY15, NIM has been at 4.0%. The company has been able to consistently earn superior margins by putting cap on the cost of funds over the years. The cost of the borrowings is around 9.0% - 9.5% while the yield on advances has been around 11.5% - 12.0%. The lower cost of funds is on account of the borrowing profile of the company wherein only 11% of the borrowings are from banks, which is generally at higher cost.

Distribution network to support growth

HDFC's distribution network spans 392 outlets which include 113 offices of HDFC's distribution company and HDFC Sales Private Limited (HSPL). HDFC also covers additional locations through its outreach programmes. Distribution channels form an integral part of the distribution network with home loans being distributed through HSPL, HDFC Bank Limited and third party direct selling associates.

Key Risks

- A slowdown in the real estate market could impact retail loan growth significantly
- Increasing competition from banks in the home loans space could impact revenue growth momentum

Valuation

HDFC continues to post good set of numbers despite sluggish economic environment. HDFC is one of the strongest player in the affordable housing segment on the back drop of government's initiative of "Housing for all by 2022". The company has been able to grow its loan book at a CAGR of 18% for the last five years with RoE of more than 20% and RoA of more than 2.5% and is now expected to grow at the same pace in near future. The management commentary suggests that growth in non-individual book will be much better over the next one year which will support spreads and profitability. The long-term growth prospects remain strong as mortgages in India are still underpenet rated and increased urbanization should underpin sustained growth. HDFC's competitive positioning remains strong, given its execution strengths and the leverage from HDFC Bank's distribution. PAT growth, which has been lagging loan growth due to multiple regulatory adjustments, should now start to normalize. Recovery in the wholesale loan segment should also help. On the back of its strong brand equity, stable and experienced management, consistent track record in earnings and business growth, stable asset quality and attractive return ratios, HDFC has commanded premium valuations over the years. At the CMP, the scrip trades at P/BV of 4.5x FY17E BV and investors are advised to BUY the stock for a target of Rs 1400. In all parameters the stock is traded at below its historical average valuation. Hence, it gives a good entry point for a bluechip company like HDFC.

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