

HDFC

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(Rs 614.70) Under Performer

Reiterating

Profits boosted by income from treasury management and securitisation income

HDFC has reported a 20.7% increase in net profit to Rs1672mn for Q2FY03 compared to Q2FY02. Its profits have surged due to a non-recurring income of Rs245.7mn, on account of treasury management (Rs177.1mn) and securitisation income (Rs68.6mn). But for this non-recurring item, HDFC's profit growth would have been a mere 10.5%.

Net interest margins (NIM) for Q2FY03 are stable at 2.9%. However, NIM (excluding dividend) at 2.25% has declined by 14 basis points YoY. Fee-based income in the quarter has also fallen by 2% on account of reduction in administration and processing fees (down to 1% from 1.8% earlier) as well as appointment of direct sales agents (DSAs). HDFC's fee income would have been lower, but for the Rs20mn fees received on account of conversion of fixed rate loans to floating rate loans.

Results Snapshot	Rs Mn			Comment
	Q2FY03	Q2FY02	% chg	
Interest Income	7087.7	6120.1	15.81	<i>Loan approvals in Q2 FY03 at Rs3190cr have increased by 28% Vs a 32% growth in Q1; disbursals in Q2 FY03 at Rs2615cr is up 32%, higher than 31% in Q1. While these are fairly strong numbers, they are lower than competition.</i>
Interest on loans	5492.3	4821.2	13.92	
Lease rental income	114.4	128.5	(10.97)	
Dividend Income	390.8	265.9	46.97	
Other operating income	1090.2	904.5	20.53	
Interest & Fin charges	5143.4	4724.7	8.86	<i>Includes Rs245.7mn on account of securitisation income</i>
Net Interest Income	1944.3	1395.4	39.34	
Non-fund income	517.5	594.8	(13.00)	
Fee Income	236.3	240.9	(1.91)	<i>Includes Rs225mn on account of rights renunciation in HDFC Chubb General Insurance Co Ltd., a subsidiary company</i>
Profit on sale of investment	281.2	353.9	(20.54)	
Net Revenue	2461.8	1990.2	23.70	
Other Income	17.5	18.7	(6.42)	
Expenses	341.8	281.5	21.42	
Employee cost	132.2	104.1	26.99	
Establishment Expenses	209.6	177.4	18.15	
PBDT	2137.5	1727.4	23.74	
Depreciation	41.8	58.9	(29.03)	
Provisions				
PBT	2095.7	1668.5	25.60	
Tax	424.2	283.6	49.58	
PAT	1671.5	1384.9	20.69	

Margins to be negatively impacted

HDFC's mortgages business is increasingly getting commoditised and banks with the advantage of lower costs are slashing interest rates aggressively. After the last round of major cuts effected by SBI and ICICI Bank (10.5% monthly reducing, on a 15-year floating loan), smaller players like Standard Chartered Bank have reduced interest rates further on floating rate loan to 10.25% (daily reducing) for a 15-year floating rate loan.

This may lead to another round of interest rate cut on mortgages. We believe that HDFC will be unable to hold on to its premium pricing and will need to bring down its lending rates further which are about 25-50 basis points higher than its competitors. This shall put pressure on HDFC's net interest margins, which have so far not declined much.

1:1 Bonus cleared and Buyback subsequent to NHB slashing risk weights

HDFC's Board has cleared the proposal of issuing 1:1 bonus. HDFC proposes to buy back up to 5% of its shares. This is however contingent on

- a) NHB reducing the risk weight on mortgages from 75% to 50%
- b) Getting an exemption from the government as its debt equity ratio exceeds the maximum of 2:1 prescribed under Section 77A of the Companies Act, 1956.

We maintain that buyback at such a high premium is not accretive for shareholders who remain with the company subsequent to the buyback.

We maintain our Under Performer rating on the stock

HDFC has hitherto enjoyed premium valuations on account of its clean Balance Sheet (gross NPAs of 1.19% and 143% provisioning cover), good growth rates and management strength. We believe that with competition intensifying in the mortgages business, HDFC would lose market share and its growth rate would slacken. On such a competitive backdrop, we believe that HDFC's premium valuation of 2.4x FY03 book value and 11.5x FY03 earnings are unjustified.

Stock Ratings Absolute Returns

Buy	:	> 25%
Out Performer	:	16 - 25%
Market Performer	:	0 - 15%
Under Performer	:	< 0%

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