FINBITS INDIA

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# MARKET COMMENTARY

Making Young India Financially Literate

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Happy Investing!

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# COMPANY OVERVIEW

# HDFC Limited : An Introduction

**Market Data**

| | |
|---|---|
| NSE | HDFC |
| BSE | 500010 |
| Mkt Cap ( Rs) | 4.463T |
| Face Value | 2 |

## Corporate Actions

**Dividend History**

Housing Development Finance Corporation Ltd. has declared 25 dividends since June 11, 2001.

In the past 12 months, Housing Development Finance Corporation Ltd. has declared an equity dividend amounting to Rs 21.00 per share.

At the current share price of Rs 2455.15, this results in a dividend yield of 0.86%.

| Ex-Date | Dividend Amount | Dividend Type |
|---|---|---|
| July 9, 2020 | 21.00 | FINAL |
| July 19, 2019 | 17.50 | FINAL |
| Mar. 15, 2019 | 3.50 | INTERIM |
| July 19, 2018 | 16.50 | FINAL |
| Mar. 22, 2018 | 3.50 | INTERIM |
| July 14, 2017 | 15.00 | FINAL |

**Bonus History**

Housing Development Finance Corporation Ltd. has given 1 bonus since Dec. 12, 2002. The last Bonus that Housing Development Finance Corporation Ltd. anoununced was in the ratio 1:1 with ex-date of Dec. 12, 2002.

Did you know that probably the most successful bank in the past 25 years which has an almost unblemished record actually does not like to speak of itself? It does not celebrate any landmark and may not appear to be the most employee-friendly organisation. But it is still a company people like to work for because it is extremely professional. This organisation is HDFC Bank which is run to near perfection and has been delivering shareholder value incessantly.

Arguably the most successful bank in the past 2 decades and also with an unblemished record, but why does this company not like to speak about itself? It avoids celebrating any landmark but which banker would not like to work for this company? The company under our study today is Housing Development Finance Corporation Limited, oh yes, this is the full form of the renowned HDFC ( NSE CODE : HDFC). HDFC which was founded in 1977, by Hasmukhbhai Parekh as the first company to specialise in mortgages. HDFC was quick to adapt to the market and the focus soon shifted from mortgages when ICICI Bank went from providing housing loans to auto loans and everything in between. No no, don’t confuse yourself with HDFC LTD and HDFC Bank, the later is just a subsidiary of the former. Though there are speculations about a possible merger between the two.

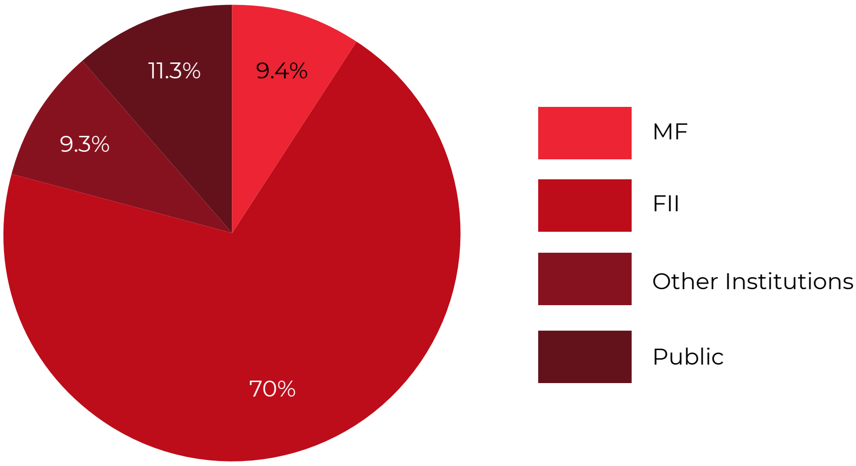
| Ex-Date | Bonus Ratio | Record Date |
|---|---|---|
| Dec. 9, 2020 | 1 : 1 | Dec. 16, 2002 |

**Split History**

Housing Development Finance Corporation Ltd. has split the face value 1 time since Aug. 18, a2010. Housing Development Finance Corporation Ltd. had last split the face value of its shares from Rs 10 to Rs 2 in 2016.The share has been quoting on an ex-split basis from Aug. 18, 2010.

| Ex-Date | Old FV | New FV | Record Date |
|---|---|---|---|
| Aug. 18, 2010 | 10 | 2 | Aug. 20, 2010 |

Shareholding Summary for Housing Development Finance Corporation Limited




As you can see Foreign Institutional Investors (FII), basically as the name suggests, investors who invest in assets belonging to a different country have a larger chunk of HDFC LTD ( 70 %). This number may look fancy for now but if you just have a sneak peak into the past then you might see that they have decreased their stake in the September quarter. Mutual Funds, the common man and other investors contribute nearly equally.

# Strength v/s Weakness

## STRENGTH

The stock is nearing its 52 week high and a couple of factors contributing to this success is that the annual net profits and book value per share has been consistently growing over the past two years. Book value of equity share basically is an indicator of HDFC's net asset value per share.

## WEAKNESS

The profit margin of HDFC has been on a decline and this has therefore caused a direct impact on the profits of the company. HDFC has the highest long term debt to equity (2.5) in the blue chips stocks.

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# RATIO ANALYSIS

# The Ratio Scoreboard

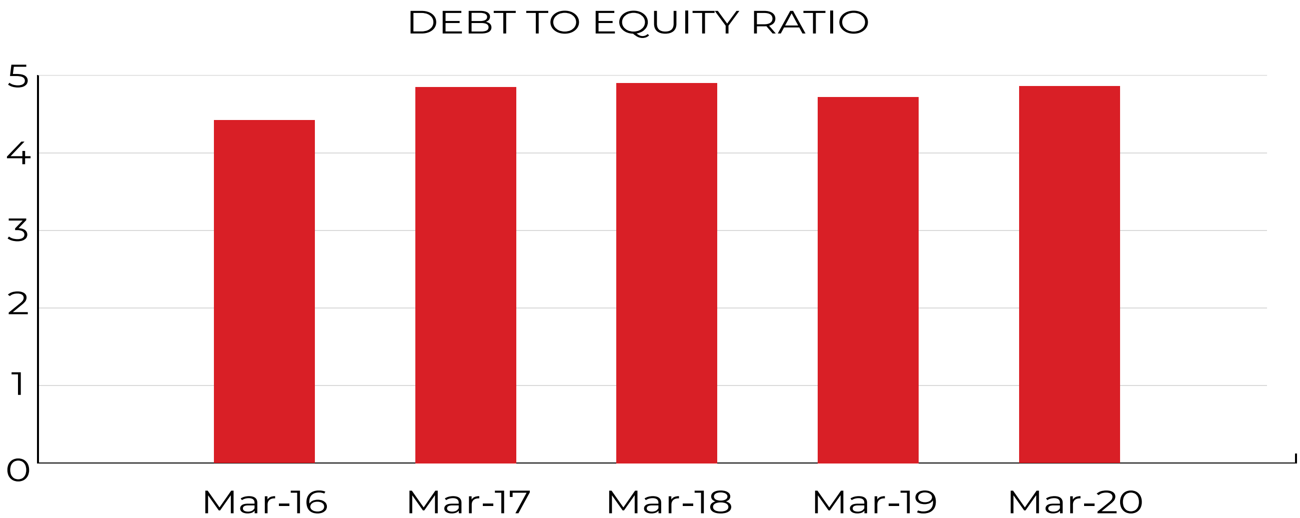
Let us circle back to a simple statement – HDFC provides services related to ₹. It can be very complicated if we go deeper but this is enough to understand why the analysis (especially the ratio analysis) of financial institutes is different as compared to a company that has it business revolving around a core tangible product.

These financial institutions generally make revenue by providing loans, money management services like mutual funds, etc. It has several subsidiaries like HDFC bank and HDFC finance which manage a specialized department of this huge financial business.

# Solvency Ratios

It is necessary for a bank to have enough provision for the time of crisis which allows it to stay afloat. When it has strengthened it foundation, it can focus on profitability.

***Debt to equity ratio:*** A relation between Debt and Equities tells us if the company needs to borrow a huge amount to make its ends meet in an unforeseen situation. A higher ratio means that company will be a high on debt in a situation of crisis whereas a lower ratio means the equity holdings are capable of keeping the company solvent.

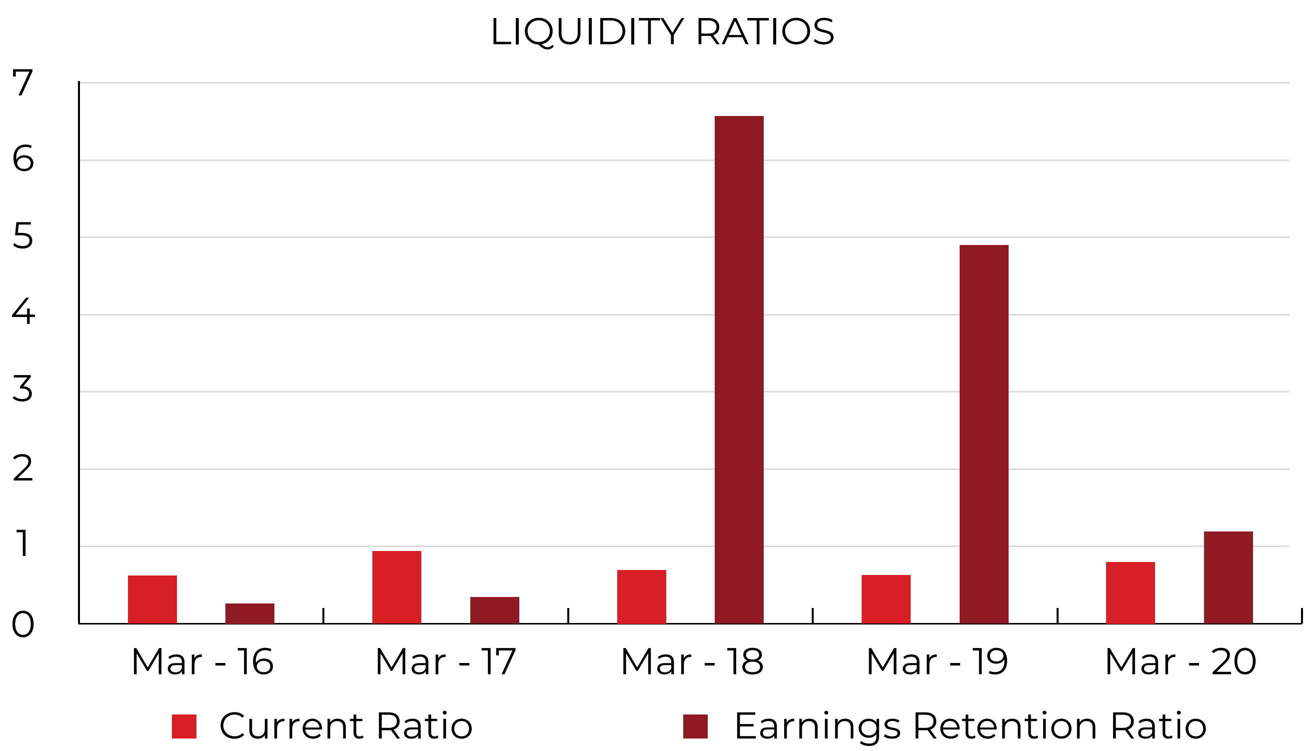


HDFC has a stable platform and is far from insolvency. The ratio ranges between 4 and 5 which means that for every 4 to 5 units of debt, HDFC can use a unit of shareholder's equity to avoid getting closer to solvency. It is also deeply penetrated in the market and so are its subsidiaries tackling any worry regarding solvency.

# Liquidity Ratios

Suppose you borrow a few bucks from a friend temporarily and pay it off immediately once you get hold of your monthly paycheck without asking for further monetary help from another friend, you are said have sufficient liquidity to avoid any obligation. Liquidity ratios provide us the measure of the company's ability to pay off its liabilities without raising any external capital. Let us look at two important ratios which are enough to determine how sound is HDFC ltd in terms of liquidity.

Current ratio: It is a comparison of the institute's current assets and current liabilities. It tells us if the firm would be able pay off its short-term liabilities (less than one year) without raising any external capital. The higher it is, the more assets the bank has as compared to its liabilities.



HDFC has a decreasing current ratio since 2018, which means that its current assets are decreasing in comparison to its current or short-term liabilities. Still, its ratio has not dipped below 1 so we can safely say that it has managed to keep itself sufficiently liquid. On a more positive note, reducing current ratio to a value between 1 and 2 means a good utilization of its resources which can be reflected in its profitability.

Earnings retentions ratio: Earning Retention Ratio or Plowback Ratio is the ratio that measures the amount of earnings retained after dividends have been paid out to the shareholders.

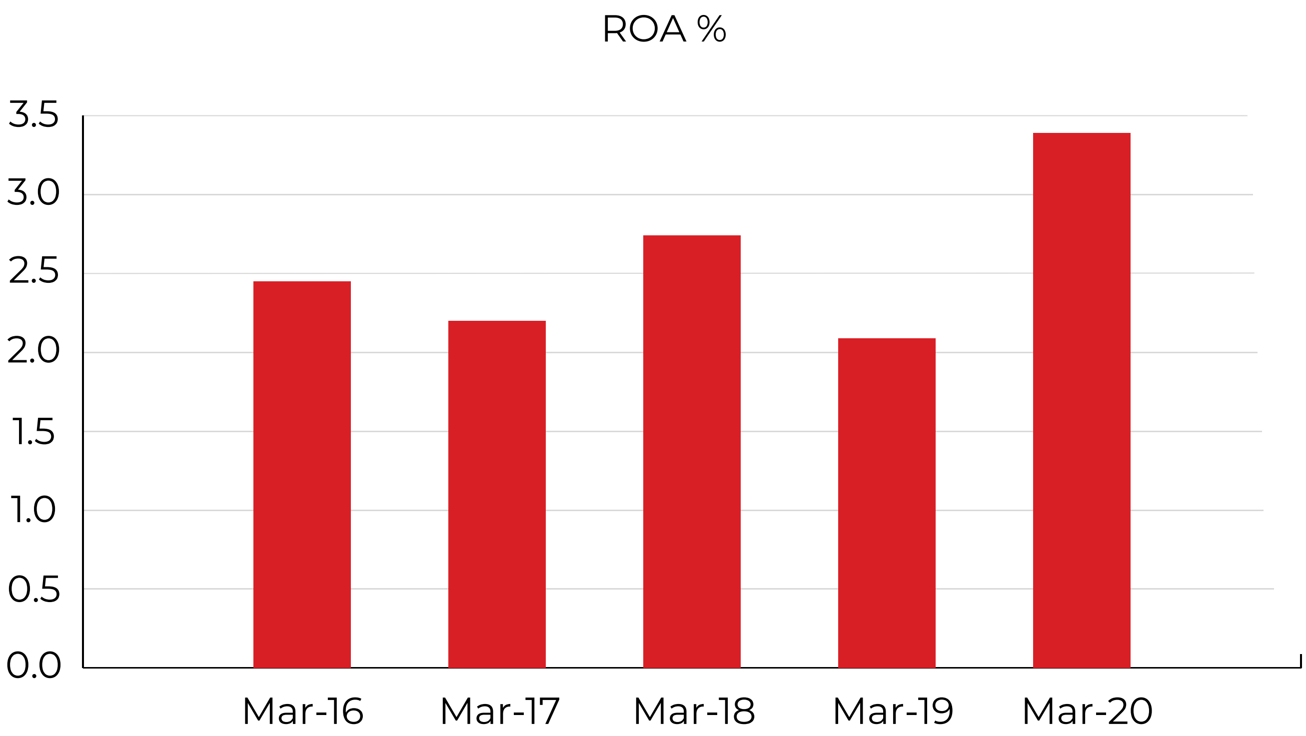
The more practical investor expects company to avoid paying high dividends and use that liquidity for the growth of company. HDFC has a constant and sustainable value for a company which regularly pays dividends. Although, the values are not too high, it is enough to keep the cash flowing to meet its short-term obligations.

HDFC may not be highly liquid, but it has balanced its resources well by using them up to a certain limit. Optimized use of resources is the best way to ensure liquidity along with profitability.

# Profitability Ratios

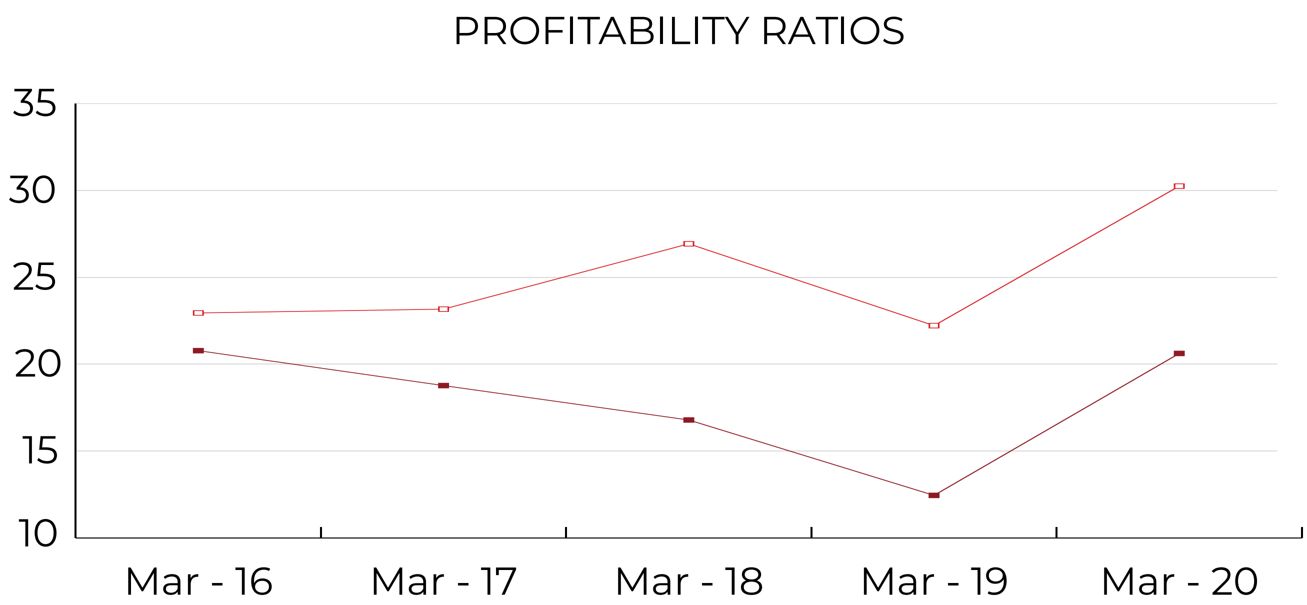
Now that HDFC has proven to be solid in terms of solvency and liquidity, let us see if it is making a reasonable profit.

ROA: Indeed, a very simple and effective ratio. It is the returns, or the income earned against the total assets over a period of time. If I own a house (cost: Rs. 6,00,00,000) and rent it for a year (rent: Rs. 6,00,000 PA), then the rent is my income, the house is my asset and the ratio of them gives me the returns I earned on my asset (1%).




HDFC has displayed a 3.39% ROA this year, which is a huge improvement and considered highly profitable.

ROE: Another commonly used indicator, return on equity is the total income over the book value. Although widely used, book value has its critics. It may not be the best indicator for profitability, but HDFC, yet again has given a consistent result in terms of ROE.



From the above graphs, we can confidently say that HDFC bank has not only proven to be profitable, but also consistent. It has displayed a great performance in the financial year 2019-2020 with a rise in profitability while maintaining sustainable liquidity.

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# INTO THE FUTURE

# FINtionary : The Financial Dictionary

- **AUM:** Assets Under Management, is the cumulative market value of the investments that a person (aka, portfolio manager), or entity (aka, a financial institution/ investment company) handles on behalf of their investors.

- **NBFC:** Nonbank Financial Companies (NBFCs) are financial institutions that provide banking services but are not equipped with a banking license. NBFCs cannot take traditional demand deposits from the public.

- **NIM:** Net Interest Margin (NIM), is a metric of measurement that compares the net interest income generated by a financial firm, with the outgoing interest that it must pay holders of savings accounts and certificates of deposit (CDs). This metric provides key insights into the profitability of a financial firm's interest income versus their interest expenses.

- **CAGR:** Compound Annual Growth Rate (CAGR) is the rate of return that can aid an investment growth from its beginning balance to its end balance. This presumes that the profits gained were reinvested at the end of each year of the investment's total lifespan.

- **PAT:** The total operational profit after deducting tax expenses. This is also referred to as the net income earned from the business.

- **ABV:** Accredited Business Valuation.

- **RoA:** Return on Assets (RoA) illustrates how profitable a company is relative to its total assets. The company's efficiency of using assets to generate earnings can be estimated using the RoA percentage.

- **RoE:** Return on Equity (RoE), is a metric used to measure financial performance. This involves calculating the ratio of net income to the shareholders' equity. Since shareholders' equity is its debt deducted from the company's assets, RoE is often considered the return on net assets, and also a measure of profitability of an institution in relation to stockholders' equity.

- **NPA:** Non-Performing Assets are loans or advances that are in jeopardy of default.

# The Rich get Richer!

Headlined by a considerable improvement in AUM growth, and steady asset quality- HDFC Ltd boasts higher estimates for Q2FY21. However, cumulative Profit After Tax (PAT) growth has been stunted due to lower "Other income" during the quarter. During the quarter that ended in September 2020, HDFC Ltd has committed INR 3026 crore in loans to HDFC Bank.

**Exhibit 1: Key Financial Summary**

| INR (Crore) | FY 18 | FY 19 | FY 20E | FY 21E | FY 22E |
|---|---|---|---|---|---|
| Net Interest Income (NII) | 9,635 | 11,402 | 12,990 | 14,526 | 16,677 |
| Pre-Provision Profit (PPP) | 15,305 | 14,052 | 26,402 | 17,345 | 19,417 |
| PAT | 10,959 | 9,630 | 8,887 | 10,928 | 12,852 |
| ABV (INR) | 319 | 452 | 502 | 598 | 616 |
| P/E | 28 | 32 | 17 | 34 | 25 |
| P/ABV | 6 | 4 | 3 | 3 | 3 |
| RoA | 3 | 2 | 4 | 2 | 2 |
| RoE | 24 | 14.4 | 22 | 10 | 12 |

# At a glance: Variance Analysis, Estimate Changes

When it comes to disbursement to individual loans, we observe a faster reversion to pre-COVID levels, thus propelling b/s growth. Owing to this, advances momentum is expected to gain traction and have values close to 11.5% CAGR in FY20-22E. HDFC's supporting margins are raised thanks to the institution shedding excess liquidity, and the deployment of capital. Volatility in the uncertain times ahead can be absorbed by the 2.6% provision buffer, and the improvements observed in collection in the individual home loan at 96.3%. Given the recently raised capital, steady pick-up in earnings, and improvement in return ratios (RoE and RoA) by FY22E, the business can be valued at INR 2200 per share, and subsidiaries at 15% holding company discount.

**Exhibit 2: Variance Analysis** *in INR Cr*

| Particulars | Q1FY21 | QoQ (in %) | Q2FY20 | Q2FY21 | Q2FY21E | YoY (in %) | Comments |
|---|---|---|---|---|---|---|---|
| NII | 3,392 | 7.5 | 2,719 | 3,647 | 3,400 | 34 | Stable Margins aid in healthy growth of NII |
| Reported NIM (in %) | 3.1 | 10bps | 3.3 | 3.2 | 0 | -10 bps | |
| Other (Income) | 1,810 | -62 | 2,945 | 687 | 953 | -76.7 | Other Income is low since dividends have not been paid by subsidaries |
| Net Income | 5,202 | -16.7 | 5,663 | 4,334 | 4,355 | -23.5 | |
| PPP | 4,806 | -17.4 | 5,284 | 3,968 | 3,952 | -24.9 | |
| Provision | 1,199 | -63.6 | 754 | 436 | 806 | -42.2 | Data as of September 2020 shows COVID-19 provisioning at INR 1200 Crores (approximately 22bps of advances) |
| PBT | 3,607 | -2.1 | 4,530 | 3,532 | 3,144 | -22 | |
| Tax Outgo | 555 | 19.2 | 569 | 662 | 820 | 16.3 | |
| PAT | 3,052 | -5.9 | 3,962 | 2,870 | 2,332 | -28 | |
| **Key Metrics** | | | | | | | |
| GNPA | 8,631 | -1.4 | 5,676 | 8,511 | 9,154 | 50 | |
| Loans | 4,65,685 | 2 | 4,26,739 | 4,75,121 | 4,60,990 | 11 | |
| Borrowings | 4,32,899 | -2.6 | 3,88,976 | 4,20,899 | 4,31,170 | 8 | |

`**Exhibit 3: Estimate Changes**

| | FY21E | | | FY22E | | |
|---|---|---|---|---|---|---|
| INR Cr | Model 1 | Model 2 | Net Change | Model 1 | Model 2 | Net Change |
| NII | 13,567 | 14,510 | 6.9 | 15,820 | 16,672 | 5 |
| PPP | 16,376 | 17,325 | 5.79 | 16,677 | 19,415 | 16 |
| NIM (% calc) | 2.5 | 2.7 | 16bps | 2.7 | 2.8 | 11bps |
| PAT | 7,690 | 10,925 | 42.067 | 10,420 | 12,852 | 23 |

`**Exhibit 4: Assumption**

| | | | Model 2 | |
|---|---|---|---|---|
| INR Cr | FY19 | FY20 | FY21E | FY22E |
| Credit Growth (%) | 13.4 | 10.8 | 8.3 | 13.6 |
| NIM (% calc) | 2.7 | 2.7 | 2.7 | 2.9 |
| Cost-to-income ratio | 10.4 | 5.4 | 8.6 | 9.2 |
| GNPA (INR Cr) | 4,798 | 8,701 | 12,880 | 15,362 |

# The Verdict, aka, TL;DR

The Housing Development Finance Corporation Limited (HDFC Ltd) has a substantial envelope of subsidiaries that add value to the parent company, since most are market leaders in their respective spaces. Owing to its firm market position, the banking mogul has been able to stand strong through most tumultuous phases in the market, as of the recent past. We can't deny that the impact of COVID-19 shall be seen across industries and may likely impact growth and credit costs for NBFCs, including HDFC. However, we have observed that the key distinguishers for the banking service will remain consistency, balance sheet strength, and the quality of earnings amongst others. We cannot overlook the possibility of term challenges; however, we have faith that if HDFC holds fort in the aforementioned market situation, it has the potential to sail through the tides.

HDFC ranks as an attractive business franchise because of its high-caliber underwriting practices, opportunity of AUM growth (market share gains), powerful retail book, an excellent developer finance book, with adequate cover, and the availability of reasonably priced funds.

However, if the picture was all rosy, you wouldn't need this handbook!

Although the future may seem bright for HDFC, there are a few risks every teenvestor should consider pondering over. Given past performance, HDFC shows slower recovery and higher slippages owing to vulnerabilities brought forth by COVID-19 could impact prospective earnings.

## Analysts Disclosure

I, **Chinmay Joshi**, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities.

I, **Ishaan Shetty**, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities.

I, **Shehzeen Khan**, author and the name subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect my views about the subject issuer(s) or securities.

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