



HDFC Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,370	HDFCB IN
	REUTERS CODE
S&P CNX: 2,835	HDBK.BO

14 January 2009

Buy

Previous Recommendation: Buy

Rs977

		YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROAE	ROAA	P/ABV
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
Equity Shares (m)	424.3	3/08A*	88,645	17,386	41.0	21.1	23.9	3.0	13.5	16.1	1.3	3.1
52-Week Range	1,825/800	3/09E	106,389	22,592	53.2	29.9	18.4	2.8	12.1	15.8	1.3	2.9
1,6,12 Rel.Perf.(%)	10/24/8	3/10E	130,669	28,470	67.1	26.0	14.6	2.4	11.3	17.9	1.4	2.6
M.Cap. (Rs b)	414.7	3/11E	159,150	36,196	85.3	27.1	11.5	2.1	10.7	19.5	1.4	2.2
M.Cap. (US\$ b)	8.5											

* Includes pro forma merged figures for HDFC Bank and CBoP

Results in line: HDFC Bank reported merged numbers with Centurion Bank of Punjab (CBoP) for 3QFY09. Hence the same is not comparable to the previous year. However, in order to compare, we have merged 3QFY08 numbers for CBoP as well. On adjusted numbers, (1) NII grew 22%, in line with estimate, (2) other Income grew 12% YoY, higher than estimate on the back of strong treasury profits (Rs2.3b v/s Rs1.3b), (3) adjusted PAT grew 30% YoY, in line with estimate, and (4) gross NPA ratio increased to 1.9%, while net NPA was stable at 0.6%.

- Adjusted deposits 21% YoY to Rs1.4t. CASA ratio declined to 40% v/s 44% in 2QFY09. CASA deposit grew only 4% YoY. Loans declined 3% QoQ and increased 14% YoY on adjusted basis to Rs988b. Investment book has increased by 43% QoQ to Rs633b. Customer assets declined QoQ by 7%. HDFC Bank has built up the SLR book and liquid investments during the quarter. Management was risk averse and preferred liquidity during the quarter.
- Reported margin improved to 4.3% v/s 4.2% in 2QFY09.
- In absolute terms, gross NPAs increased 14% QoQ to Rs19.1b and net NPAs increased 5% QoQ to Rs6.1b.

Maintain Buy: We have not included HDFC warrant conversion in our estimates. We expect earnings CAGR of 28% over FY08-11E on 20% CAGR in assets (combining HDFC Bank with CBoP from FY08 itself). RoA is likely to remain high at 1.3-1.4% with RoE of 18% in FY10 and 20% in FY11. We estimate BV of Rs349 and Rs402 in FY09 and FY10 respectively. We expect EPS to be Rs53 in FY09 and Rs67 in FY10. The stock trades at 2.8x FY09E BV and 2.4x FY10E BV and 18.4x FY09E and 14.6x FY10E EPS. Maintain **Buy** with a target price of Rs1,200, an upside of 23%.

	(RS MILLION)									
	FY08				FY09*				FY08	FY09E*
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	20,692	23,628	27,269	29,562	36,217	39,912	44,685	45,578	101,150	166,392
Interest Expense	10,836	12,001	12,893	13,141	18,983	21,248	24,893	25,460	48,871	90,583
Net Interest Income	9,855	11,627	14,376	16,421	17,234	18,665	19,793	20,118	52,279	75,810
Growth (%)	30.1	47.6	65.6	55.7	74.9	60.5	37.7	22.5	50.7	45.0
Other Income	5,725	4,824	6,789	5,493	5,934	6,431	9,394	8,820	22,825	30,579
Net Income	15,581	16,451	21,165	21,914	23,169	25,096	29,186	28,938	75,103	106,389
Operating Expenses	7,744	8,184	10,501	11,027	12,894	13,867	14,606	14,714	37,456	56,080
Operating Profit	7,837	8,267	10,664	10,887	10,275	11,229	14,581	14,224	37,647	50,308
Growth (%)	41.0	36.3	67.5	42.3	31.1	35.8	36.7	30.7	46.8	33.6
Provisions and Contingencies	3,071	2,894	4,231	4,651	3,445	3,460	5,318	4,862	14,843	17,085
Profit Before Tax	4,766	5,373	6,432	6,236	6,830	7,768	9,263	9,362	22,804	33,223
Provision for Taxes	1,553	1,688	2,139	1,525	2,187	2,488	3,046	2,911	6,905	10,631
Net Profit	3,212	3,685	4,294	4,711	4,643	5,280	6,217	6,451	15,899	22,592
Growth (%)	34.2	40.1	45.2	37.1	44.5	43.3	44.8	36.9	39.3	42.1
Int Exp/ Int Earned (%)	52.4	50.8	47.3	44.5	52.4	53.2	55.7	55.9	48.3	54.4
Other Income/Total Income (%)	36.7	29.3	32.1	25.1	25.6	25.6	32.2	30.5	30.4	28.7
Cost to Income Ratio (%)	49.7	49.7	49.6	50.3	55.7	55.3	50.0	50.8	49.9	52.7
Provisions/Operating Profit %	39.2	35.0	39.7	42.7	33.5	30.8	36.5	34.2	39.4	34.0
Tax Payout %	32.6	31.4	33.2	24.4	32.0	32.0	32.9	31.1	30.3	32.0

E: MOSL Estimates; *FY09 numbers include merger of CBoP

RESULTS ANALYSIS (RS M) : REPORTED NUMBERS

	3QFY09	3QFY08	YOY GR. %	2QFY09	QOQ GR. %	FY08E#	FY09E	FY10E
Interest Income	44,685	27,269	63.9	39,912	12.0	122,487	166,392	197,543
Interest Expense	24,893	12,893	93.1	21,248	17.2	63,462	90,583	102,409
Net Interest Income (NII)	19,793	14,376	37.7	18,665	6.0	59,026	75,810	95,134
Other Income	9,394	6,789	38.4	6,431	46.1	29,619	30,579	35,535
- Fees and others	6,445	4,732	36.2	5,912	9.0	22,911	25,258	30,310
- Treasury Income	2,321	1,315	76.5	-156	-1,587.8	3,188	1,800	1,000
- Forex Income	628	742	-15.4	675	-7.0	3,521	3,521	4,225
Net Income	29,186	21,165	37.9	25,096	16.3	88,645	106,389	130,669
Total Operating Costs	14,606	10,501	39.1	13,867	5.3	46,313	56,080	66,050
- Staff Costs	5,821	3,528	65.0	6,116	-4.8	15,809	23,713	28,455
- Other Opex	8,784	6,973	26.0	7,751	13.3	30,504	32,368	37,595
Operating Profit	14,581	10,664	36.7	11,229	29.9	42,332	50,308	64,619
Provisions	5,318	4,231	25.7	3,460	53.7	17,443	17,085	23,358
- NPAs/Std Assets	4,654	3,501	32.9	3,373	38.0	14,610	16,085	23,358
- Others	664	730	-9.1	87	660.5	2,833	1,000	0
PBT	9,263	6,433	44.0	7,768	19.2	24,889	33,223	41,261
Tax	3,046	2,139	42.4	2,488	22.4	7,502	10,631	12,791
Tax payout %	32.9	33.2		32.0		30.1	32.0	31.0
PAT	6,217	4,294	44.8	5,280	17.8	17,386	22,592	28,470
Deposits	1,448,620	993,869	45.8	1,337,805	8.3	1,230,642	1,476,770	1,772,124
CASA Ratio %	40.0	50.9		44.0		49.0	41.0	42.5
Loans	987,842	713,868	38.4	1,022,223	-3.4	802,589	1,043,366	1,272,907
Gross NPA %	1.9	1.2		1.6		1.7	2.2	3.4
Net NPA %	0.6	0.4		0.6		0.5	0.8	1.1
Yields on Advances %*	13.3	11.2		12.3		12.6	12.9	12.5
Cost of Funds %*	6.7	5.0		6.0		5.9	6.4	6.1
NIM %**	4.3	4.3		4.3		5.0	4.9	5.1
Tier I CAR %	9.7	10.5		8.8		10.6	8.9	8.3
Tier II CAR %	4.0	3.3		2.6		2.9	3.2	3.0
Branches	1,412	754		1,412		1,412	1,420	1,570
ATMs	3,177	1,977		2,890		2,890		

* Calculated, ** Reported basis for quarterly no and calculated for yearly numbers; # Numbers are proforma merged for HDFC Bank & CBoP
3QFY09 results are merged for CBoP and hence are not strictly comparable to 3QFY08. 2QFY09, FY08, FY09E and FY10E numbers are for merged entity.

Results Highlights

Balance sheet growth in favor of G-Secs: Loans declined 3% QoQ and increased 14% YoY on adjusted basis to Rs988b. Customer assets also degrew 7% QoQ to Rs1t. C-D ratio declined to 68% v/s 76% in 2QFY09 and 72% in 3QFY08 (adjusted basis) and customer assets to deposits ratio stood at 69.5% v/s 81% in 2QFY09. Retail loans grew 2% QoQ and the share in total loans increased to 59% v/s 54% in 2QFY09.

Investment book has increased 43% QoQ to Rs633b. Customer assets declined QoQ by 7%. HDFC Bank has built up the SLR book and liquid investments during the quarter. Management was risk averse and preferred liquidity during the quarter.

3QFY09 PERFORMANCE (RS M)

	REPORTED			PRO-FORMA MERGED		CBOP 3QFY08
	3QFY09	3QFY08	YOY GR. (%)	3QFY08	HDFC+CBOP YOY GR. (%)	
Nil	19,793	14,376	38	16,275	22	1,900
Other Income	9,394	6,789	38	8,389	12	1,600
Treasury	2,321	1,315	77	1,565	48	250
Fees/others	7,073	5,474	29	6,824	4	1,350
Net Income	29,186	21,165	38	24,664	18	3,500
Opex	14,606	10,501	39	12,720	15	2,219
Operating Profit	14,581	10,664	37	11,945	22	1,281
Provisions	5,318	4,231	26	4,774	11	543
PBT	9,263	6,433	44	7,171	29	738
PAT	6,217	4,294	45	4,777	30	483
Deposits	1,448,620	993,869	46	1,200,969	21	207,100
CASA Deposits	579,448	505,630	15	556,370	4	50,740
Loans	987,842	713,868	38	864,703	14	150,835
Gross NPAs	19,114	8,670	120	14,306	34	5,637
Net NPAs	6,143	2,798	120	5,342	15	2,544

Source: Company/MOSL

Margin improves 10bp QoQ to 4.3%

Reported margin improved to 4.3% v/s 4.2% in 2QFY09 (standalone margin in 3QFY08 was 4.3%). CRR cut coupled with the strong pricing power and no cut in PLR (cut of 25bp only in the last 15 days) in 3QFY09 helped the bank to improve its margin on a QoQ basis. Yield on funds (calculated) increased 73bp QoQ to 10.6% and cost of funds increased only 71bp QoQ to 6.7%.

CASA growth pressure evident: Reported deposits grew 46% YoY and adjusted deposits by 21% YoY to Rs1.4t. Current account deposits declined 5% QoQ and savings accounts deposits were flat QoQ. While CASA deposits growth was 15% YoY on reported basis, it grew only 4% on adjusted basis. For the last six consecutive quarters (despite merger of CBoP from 1QFY09), current account balances are flat for HDFC Bank. As a result, CASA ratio declined to 40% v/s 44% in 2QFY09 and 46% in 3QFY08 (adjusted basis).

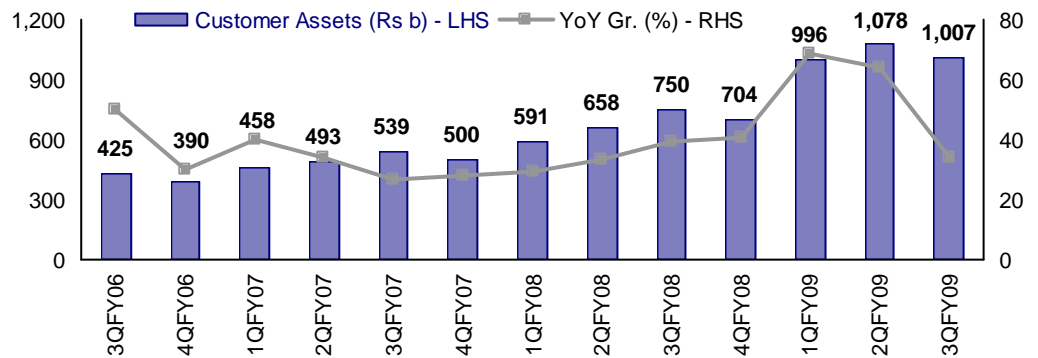
Some stress on asset quality: Gross NPAs on merged basis increased to 1.9% (1.6% a quarter ago), while net NPAs increased to 0.6% (0.57% a quarter ago). In absolute terms, gross NPAs increased 14% QoQ to Rs19.1b and net NPAs increased 5% QoQ to Rs6.1b. Provision coverage ratio increased to 68% v/s 65% a quarter ago. The bank made NPA provision of Rs4.7b in 3QFY09 v/s Rs3.4b a quarter ago.

CAR improves 230bp QoQ: CAR improved to 13.7% in 3QFY09 v/s 11.4% largely on the back of 1) Rs17.3b of subordinated bonds raised as Tier II capital and internal accruals, 2) reduction in risk weight on certain asset class by RBI, and 3) QoQ decline in loan book. On a QoQ basis, Tier I ratio improved 90bp to 9.7%.

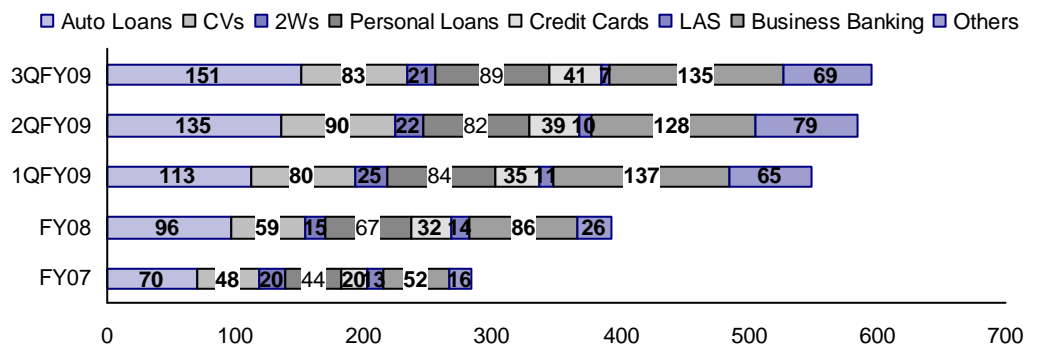
Earnings CAGR of 28% over FY08-10E

We have not included HDFC warrant conversion in our estimates. We expect earnings CAGR of 28% over FY08-11E on 20% CAGR in assets (combining HDFC Bank with CBoP from FY08 itself). RoA is likely to remain high at 1.3-1.4% with RoE of 18% in FY10 and 20% in FY11. We estimate BV of Rs349 and Rs402 in FY09 and FY10 respectively. We expect EPS to be Rs53 in FY09 and Rs67 in FY10. The stock trades at 2.8x FY09E BV and 2.4x FY10E BV and 18.4x FY09E and 14.6x FY10E EPS. Maintain **Buy** with a target price of Rs1,200, an upside of 23%.

CUSTOMER ASSETS DECLINE QOQ..

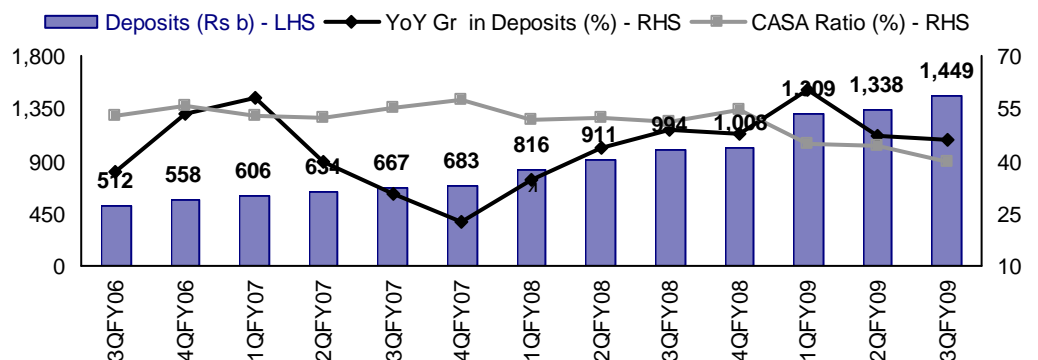


RETAIL LOANS BREAK-UP (RS596B)



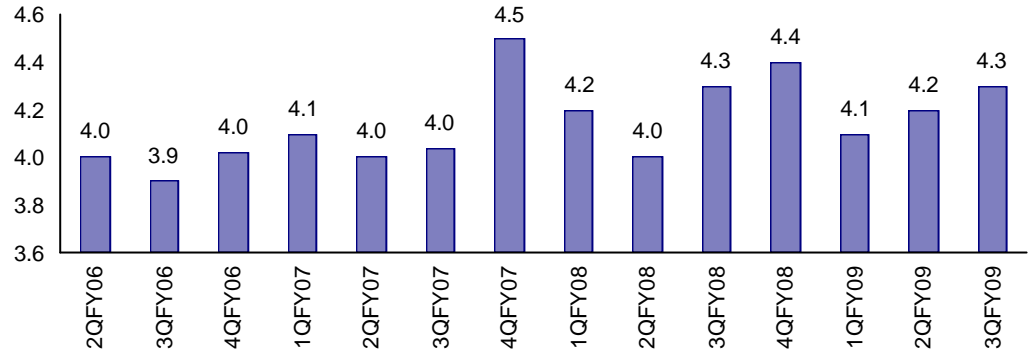
CASA RATIO IMPACTED DUE TO LIQUIDITY CRUNCH AND HIGH TERM DEPOSIT RATES

CASA deposit growth at 4% is disappointing

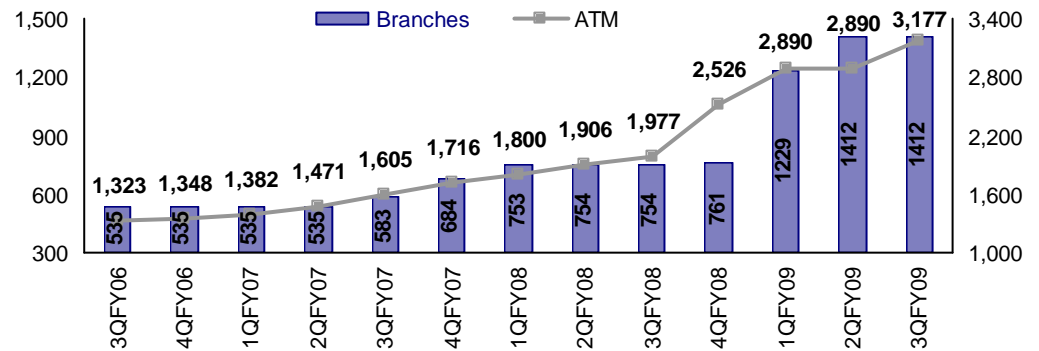


Source: Company/MOSL

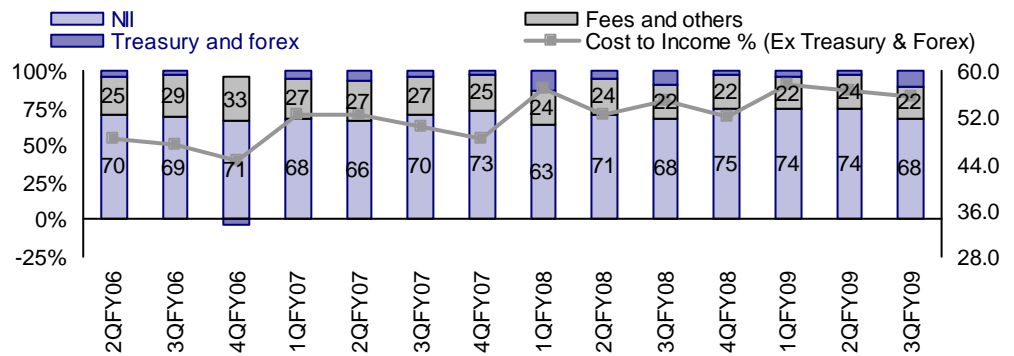
MARGINS IMPROVE DUE TO PRICING POWER



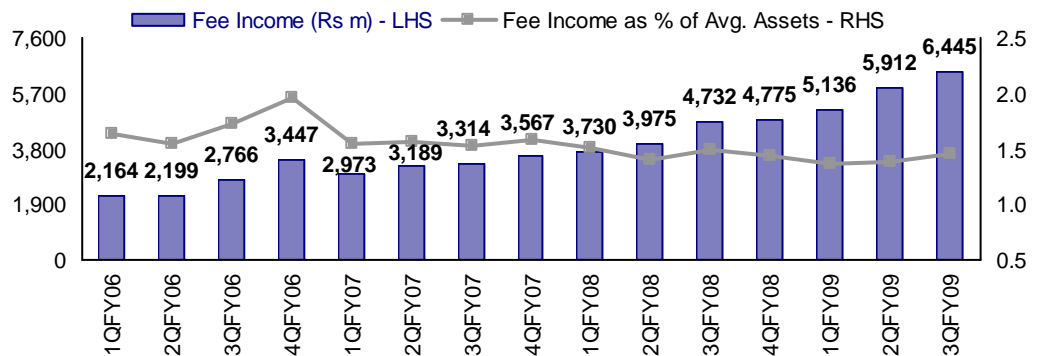
BRANCH AND ATM NETWORK



INCOME COMPOSITION AND COST TO INCOME RATIO %



FEE INCOME GROWTH MUTED AT 4% YOY



Source: Company/MOSL

HDFC Bank: an investment profile

Company description

HDFC Bank, incorporated in 1994 by HDFC Ltd., is the second largest private sector bank in India, with a balance sheet size of Rs1.8t. Rated as one of the best banks in India it has a network of 1,412 branches. The bank has been consistently growing its loan book and earnings at over 30% for the last several quarters.

Key investment arguments

- ✎ Strong focus on retail loans (now 59% of advances) and high proportion of low-cost funds (40% of total deposits) enables consistent growth of over 30% in core earnings.
- ✎ Management quality is rated as among the best.
- ✎ Net NPAs of 0.6%, despite being an aggressive lender, indicates superior risk management skills.

Key investment risks

- ✎ Higher unsecured retail loan exposure could hurt HDFC Bank's profitability if NPA levels increase significantly.
- ✎ In our view, the acquisition of CBoP was expensive and integration risks prevail.

Recent developments

- ✎ The bank acquired Centurion Bank of Punjab in a share swap deal valuing CBoP at around Rs120b.

Valuation and view

- ✎ We expect earnings CAGR of 28% over FY08-11E on 20% CAGR in assets (combining HDFC Bank with CBoP from FY08 itself). RoA is likely to remain high at 1.3-1.4% with RoE of 18% in FY10 and 20% in FY11. We estimate BV of Rs349 and Rs402 in FY09 and FY10 respectively. We expect EPS to be Rs53 in FY09 and Rs67 in FY10. The stock trades at 2.8x FY09E BV and 2.4x FY10E BV and 18.4x FY09E and 14.6x FY10E EPS. Maintain **Buy** with a target price of Rs1,200, an upside of 23%.

Sector view

- ✎ YTD loan growth of 23% and deposit growth of 21%.
- ✎ Concerns on slowing economic growth.
- ✎ Selective buying with favor for banks with higher earnings visibility and reasonable valuations.

COMPARATIVE VALUATIONS

		HDFC BK	AXIS BK	ICICI BK
P/E (x)	FY09E	18.4	14.0	13.3
	FY10E	14.6	11.3	10.3
P/BV (x)	FY09E	2.8	2.2	1.0
	FY10E	2.4	1.9	0.9
RoE (%)	FY09E	15.8	17.0	7.7
	FY10E	17.9	18.2	9.3
RoA (%)	FY09E	1.3	1.3	0.9
	FY10E	1.4	1.2	1.1

SHAREHOLDING PATTERN (%)

	DEC-08	SEP-08	DEC-07
Promoter	19.4	19.4	24.4
Domestic Inst	10.6	9.5	6.2
Foreign	47.8	49.2	50.3
Others	22.3	22.0	19.1

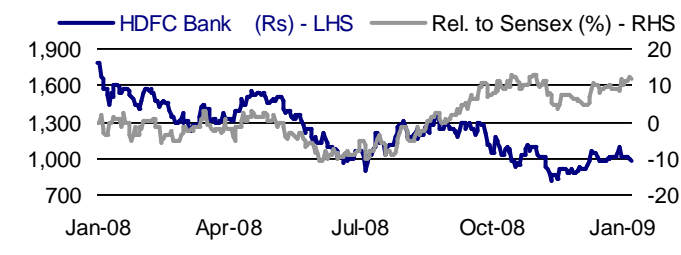
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	53.2	52.4	1.4
FY10	67.1	64.8	3.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
977	1,200	22.8	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
Interest Income	78,812	122,487	166,392	197,543	237,853	
Interest Expended	38,784	63,462	90,583	102,409	121,065	
Net Interest Income	40,028	59,026	75,810	95,134	116,788	
<i>Change (%)</i>		47.5	28.4	25.5	22.8	
Other Income	19,569	29,619	30,579	35,535	42,362	
Net Income	59,597	88,645	106,389	130,669	159,150	
<i>Change (%)</i>		48.7	20.0	22.8	21.8	
Operating Expenses	31,266	46,313	56,080	66,050	75,957	
Operating Income	28,331	42,332	50,308	64,619	83,193	
<i>Change (%)</i>		49.4	18.8	28.4	28.7	
Other Provisions	10,098	17,443	17,085	23,358	30,735	
PBT	18,233	24,889	33,223	41,261	52,458	
Tax	5,596	7,502	10,631	12,791	16,262	
<i>Tax Rate %</i>	31	30	32	31	31	
PAT	12,637	17,386	22,592	28,470	36,196	
<i>Change (%)</i>		37.6	29.9	26.0	27.1	
Proposed Dividend	1,879	3,606	4,518	5,125	5,429	
PPP	28,943	39,144	48,508	63,619	82,193	
<i>Change (%)</i>		35.2	23.9	31.2	29.2	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2007	2008	2009E	2010E	2011E	
Capital	3,734	4,243	4,243	4,243	4,243	
Reserves & Surplus	74,314	133,650	143,956	166,431	196,274	
Net Worth	78,048	137,893	148,199	170,673	200,517	
Deposits	831,617	1,230,642	1,476,770	1,772,124	2,144,270	
<i>Change (%)</i>		48.0	20.0	20.0	21.0	
CASA Deposits	439,474	602,646	605,476	753,153	911,315	
Borrowings	72,184	91,845	108,845	113,845	127,748	
Other Liab & Provisions	115,336	146,480	183,100	238,030	309,439	
Total Liabilities	1,097,184	1,606,860	1,916,914	2,294,672	2,781,974	
Current Assets	106,432	176,809	174,549	153,136	187,695	
Investments	351,798	558,545	614,399	767,999	921,599	
<i>Change (%)</i>		58.8	10.0	25.0	20.0	
Loans	581,661	802,589	1,043,366	1,272,907	1,552,946	
<i>Change (%)</i>		38.0	30.0	22.0	22.0	
Net Fixed Assets	13,040	15,462	17,781	20,448	23,515	
Other Assets	44,253	53,455	66,819	80,182	96,219	
Total Assets	1,097,184	1,606,860	1,916,914	2,294,672	2,781,974	

KEY ASSUMPTIONS		(%)				
Deposit Growth	49.0	48.0	20.0	20.0	21.0	
Loans Growth	65.9	38.0	30.0	22.0	22.0	
Investments Growth	23.9	58.8	10.0	25.0	20.0	
Provision Coverage	64.7	68.5	65.0	66.0	70.0	
Dividend	70.0	85.0	106.5	120.8	128.0	

E: MOSL Estimates

RATIOS

Y/E MARCH	2007	2008	2009E	2010E	2011E
Spreads Analysis (%)					
Avg. Yield-Earn Assets	9.1	10.4	10.8	10.5	10.4
Avg. Cost-Int. Bear. Liab.	5.3	5.9	6.4	6.1	6.0
Interest Spread	3.8	4.5	4.4	4.4	4.4
Net Interest Margin	4.6	5.0	4.9	5.1	5.1

Profitability Ratios (%)

RoE	19.3	16.1	15.8	17.9	19.5
RoA	1.4	1.3	1.3	1.4	1.4
Int. Exp./Int. Earned	49.2	51.8	54.4	51.8	50.9
Other Income/Net Inc.	32.8	33.4	28.7	27.2	26.6

Efficiency Ratios (%)

Op Exp/Net Income*	52.5	52.2	52.7	50.5	47.7
Employee Cost/Op.Exps	31.9	34.1	42.3	43.1	43.1
Business per Emp. (Rs m)	43.2	43.1	43.8	44.6	45.0
Net Profit per Empl. (Rs m)	0.5	0.4	0.4	0.5	0.5

*** Ex treasury****Asset Liability Profile (%)**

Loans/Deposit Ratio	69.9	65.2	70.7	71.8	72.4
CASA Ratio %	52.8	49.0	41.0	42.5	42.5
Invest./Deposit Ratio	42.3	45.4	41.6	43.3	43.0
G-Sec/Investment Ratio	75.4	66.7	75.8	75.8	78.9
Gross NPAs to Advances	1.7	1.7	2.2	3.4	4.1
Net NPAs	3,443.9	4,314.9	8,134.3	14,573.3	18,952.2
Net NPAs to Advances	0.6	0.5	0.8	1.1	1.2
CAR	13.1	13.5	12.1	11.3	10.7
Tier 1	8.6	10.6	8.9	8.3	8.0

VALUATION

Book Value (Rs)	209.0	325.0	349.3	402.3	472.6
Price-BV (x)	4.7	3.0	2.8	2.4	2.1
Adjusted BV (Rs)	203.0	318.4	336.8	379.9	443.6
Price-ABV (x)	4.8	3.1	2.9	2.6	2.2
EPS (Rs)	33.8	41.0	53.2	67.1	85.3
EPS Growth	21.7	21.1	29.9	26.0	27.1
Price Earnings (x)	28.9	23.9	18.4	14.6	11.5
OPS (Rs)	75.9	99.8	118.6	152.3	196.1
OPS Growth	30.3	31.5	18.8	28.4	28.7
Price-OP (x)	12.9	9.8	8.2	6.4	5.0

E: MOSL Estimates

N O T E S



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Disclosure of Interest Statement

HDFC Bank

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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