

## Company Flash

11 January 2007 | 6 pages

### HDFC Bank (HDBK.BO)

#### Hold: 3QFY07 – In-Line, but Some Fee Growth Pressures

- 31% yoy profit growth – in-line with expectations** – No surprises here – HDBK’s profits are up in-line with historic growth rates, and in-line with our and consensus estimates. While qualitatively robust, there appears to be some moderation in fee and loan growth levels.
- Fees – up 33%, but pace of growth eases** – HDBK continues to generate strong fee growth; but they have eased off in the quarter. Weaker fees are offset by a marked slowdown in operating cost expansion, and some easing in provisioning.
- Retail asset expansion muted; overall book growth in-line** – Retail assets are now growing more slowly; yoy expansion is modest, and the portfolio is flat over the quarter. While this slack has been comfortably taken up by the corporate book; loan growth at 35% yoy, the predominant part of HDBK’s asset business, does appear to have slowed.
- High margins sustain – and drive profitability, in a potentially challenging quarter** – HDBK continues to sustain its 4% plus margins; commendable in a quarter with rate volatility. Interesting to note, HDBK reduced its higher-cost term deposits in the quarter; in likely contrast to the market, suggesting a slight profit preference to growth.
- Overall steady, though fee growth rates ease** – The results continue to be stamped by high quality and good profitability. There does appear a slight moderation in fee and retail asset growth, comfortably offset for now. Maintain Hold/Low Risk (2L) recommendation, with a Rs955 price target.

<b>Hold/Low Risk</b>	<b>2L</b>
Price (11 Jan 07)	Rs999.35
Target price	Rs955.00
Expected share price return	-4.4%
Expected dividend yield	0.6%
<b>Expected total return</b>	<b>-3.8%</b>
Market Cap	Rs314,945M US\$7,085M

**Figure 1. Statistical Abstract**

Year to	Net Profit	FD EPS	EPS Growth	P/E	P/BV	ROAE	ROAA	Div Yld
March	(Rs Mils.)	(Rs)	(%)	(X)	(X)	(%)	(%)	(%)
FY05	6,650	21.8	24.6	45.8	6.9	18.4	1.4	0.5
FY06	8,709	27.3	25.1	36.6	5.9	17.7	1.4	0.6
FY07E	12,074	37.6	37.9	26.6	5.0	20.8	1.5	0.6
FY08E	15,875	49.5	31.5	20.2	4.1	22.8	1.6	0.7
FY09E	20,512	63.9	29.2	15.6	3.3	24.0	1.6	0.8

Source: Citigroup Investment Research

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See page 4 for Analyst Certification and important disclosures.

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## HDFC Bank

### Company description

HDFC Bank, which began operations in 1994, is 24%-owned by HDFC - India's premier mortgage-finance institution. In 2000 HDFC Bank took over private-sector Times Bank. HDFC Bank is headquartered in Mumbai and has a network of more than 410 branches spread across 191 cities. It also serves its customers in 90 locations through phone banking. The bank has a network of more than 1,000 ATMs. About 13% of the bank's equity is listed on the NYSE in the form of ADS. HDFC Bank entered into an arrangement with HDFC in FY04 through which HDFC Bank sources mortgages for HDFC. HDFC Bank pays HDFC for credit appraisal and operations and receives a fee for sourcing. In addition, HDFC Bank buys back 70% of mortgages at a price of 125bps lower than the yield of the mortgages. HDFC Bank has had strong and steady growth over the past 10 years and continues to grow at more than 30%.

### Investment thesis

We rate HDFC Bank as Hold/Low Risk (2L) with a 12-month target price of Rs955. We believe HDFC Bank should be able to generate a premium to its current trading level as it sustains asset growth, consolidates its distribution, leverages off new capital and stabilizes its business mix with increased retail returns. HDFC Bank should also enjoy increased growth and stability in its fee franchise due to its consistently widening distribution platform. While we expect HDFC Bank to trade in the 3-4x P/BV band, we see it edging up as it starts leveraging its recently raised capital and raises ROEs from the sub-20% level. We remain positive on the bank's prospects and management's ability to deliver, but in the near term the stock's performance could be moderated by high valuations relative to ROE and peers, uncertainty on the interest rate environment, progress in mortgage sharing with its parent HDFC, and high pricing competition in the market.

### Valuation

Our valuation is based on our EVA-based methodology, which values HDFC Bank at Rs955. Our EVA value is based on an 8% risk-free rate, higher-than-industry margins (275bps vs 230bps average) and higher capital ratio (6.75% vs 6% average).

Our target price is also benchmarked off a 4x one-year forward P/BV, which corresponds to a fair value of Rs891. The basis for our target multiple - a distinct premium to all other Indian commercial banks - is HDBK's structurally higher margin, de-risked earnings and balance sheet mix, and gains in the consumer-lending franchise. Our target multiple is at a significant premium to the Indian banking average. We believe a re-rating from these levels would be difficult.

We prefer using an EVA-based valuation benchmark to P/BV because EVA concentrates on the economic value creation of the bank.

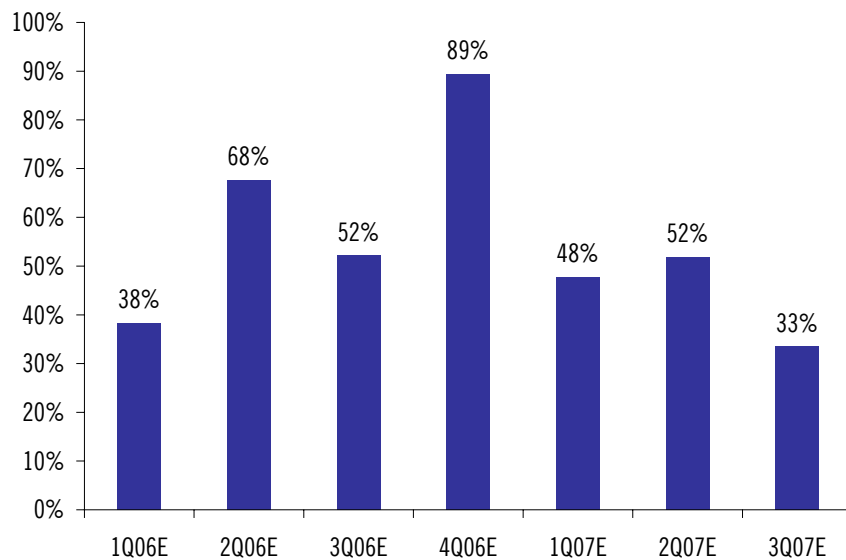
### Risk

We rate HDFC Bank as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share-price volatility. The downside and upside risks to our target price lie in: (1) any negative/positive news on asset quality; (2) management changes; (3) emergence of high quality and scale competitors; and the (4) the HDFC Bank-HDFC agreement. If any of these factors has a

greater impact than we expect, the stock could have difficulty achieving our target price.

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**Figure 2. Fees Income (YOY growth, Percent)**



Source: Company Reports and Citigroup Investment Research

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## Analyst Certification Appendix A-1

We, Aditya Narain, CFA and Manish Chowdhary, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

### IMPORTANT DISCLOSURES

#### HDFC Bank (HDBK.BO)

##### Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



#	Date	Rating	Target Price	Closing Price
1:	12 Jan 04	2L	*395.00	364.75
2:	19 Apr 04	2L	*420.00	377.90
3:	8 Oct 04	2L	*455.00	408.10
4:	10 Jan 05	2L	*540.00	489.30
5:	17 Feb 05	2L	*600.00	558.15
6:	17 Oct 05	2L	*745.00	656.25
7:	12 May 06	2L	*945.00	875.35
8:	16 Jul 06	2L	*825.00	706.85
9:	28 Sep 06	2L	*955.00	927.55

\*Indicates change.

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