

## HDFC BANK

INR 1,043

*Mr consistent*

BUY



HDFC Bank, following the footsteps of ICICI Bank and SBI, has approved fund raising plans for USD 1 bn (12.7% dilution at current levels) in FY08E. It has announced preferential issue of 13.6 mn shares at INR 1023 per share to HDFC Group, to maintain the parent's stake at or above 23%. For the balance, it may resort to public offering or private placement in domestic or international markets.

The capital raising is likely to help the bank meet capital adequacy requirements under the Basel II norms and aid rapid loan book growth. We consider this fund raising exercise a positive for the bank, as it would be significantly book accretive, raising money at ~5.0x FY07 book. We expect the **book value per share to grow 64%** Y-o-Y to INR 330 by March 2008.

We are raising our credit growth forecast by 2% points to 32.5% CAGR over FY07-09E, Due to equity infusion, NIMs would improve by 8-14bps during FY08-09E, We are increasing our profit forecast by 4% for FY08E and 5% for FY09E to factor in higher credit growth and equity money. However, due to equity dilution in FY08E our EPS for FY08E at INR 43 stands reduced by 7%, while FY09E EPS at INR 58 is 12% higher than earlier estimates.

The stock has underperformed its peers by 10-20% in the last one year and has returned just 10% in the last six months, despite strong operating performance. Post the capital issue, the stock will be trading at 3.2x FY08E, 2.9x FY09E book (diluted), and 18.0x FY09E earnings.

Amongst rising concerns on asset quality and margins in higher interest rate scenario, we believe HDFC bank would fare well compared with its peers on the back of its stable and predictable growth.

## Financials

Year to March	FY06	FY07	FY08E	FY09E
Revenues (INR mn)	36,698	52,259	65,085	82,402
Rev growth (%)	51.1	42.4	24.5	26.6
Net Interest Income (INR mn)	25,458	37,096	44,631	56,835
Net profit (INR mn)	8,708	11,415	15,543	20,836
Shares outstanding (mn)	313.1	319.4	359.9	359.9
EPS (INR)	27.8	35.7	43.2	57.9
EPS growth (%)	29.5	28.5	20.8	34.1
P/E (x)	27.8	29.2	24.2	18.0
Price to book (x)	4.7	5.3	3.2	2.9
Price to PPOP (x)	16.1	11.6	10.8	8.3
ROE (%)	17.7	19.5	17.0	16.4

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Bloomberg : HDFCB IN

## Market Data

52-week range (INR) : 1,150 / 620  
Share in issue (mn) : 319.3  
M cap (INR bn/USD mn) : 333.0 / 8,128.6  
Avg. Daily Vol. BSE ('000) : 145.4

## Share Holding Pattern (%)

Promoters : 21.6  
MFs, FIs & Banks : 6.4  
FII's : 32.4  
Others : 39.6

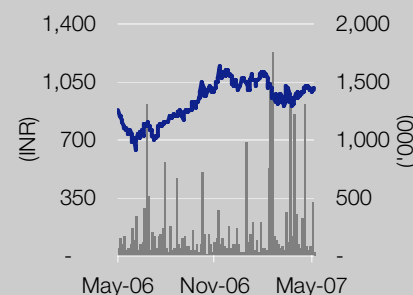
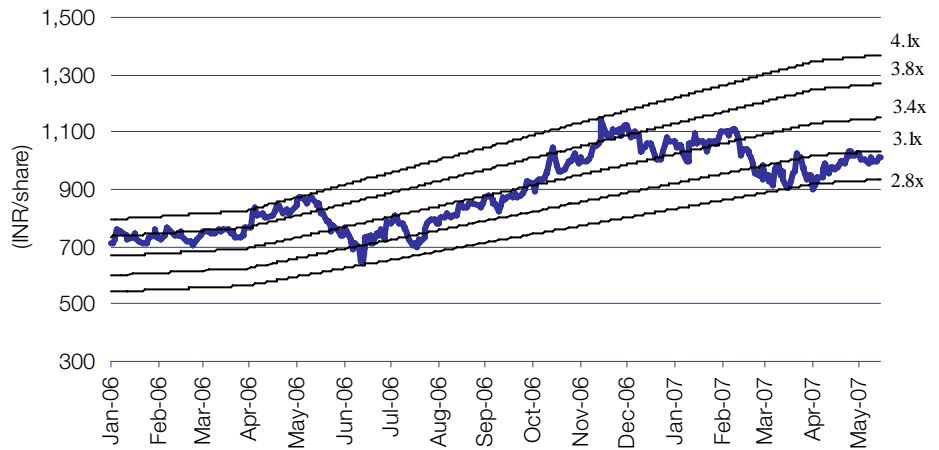


Chart 1: One-year forward P/B



Source: Edelweiss research

**\* Valuations**

HDFC Bank has always traded at a premium to peer banks due to its steady growth, earnings quality, and M&A premium. We expect the bank to generate 27% EPS CAGR over FY07-09E and ~17% ROE in FY08-09. Using our 3-stage DDM, we arrive at a target value of INR 1320 per share, which would value the stock at 3.5x FY09E book and 23x FY09E EPS, implying 25% upside in 18 months. We upgrade the stock to **'BUY'** from **'ACCUMULATE'**.

## Financial Statement

Income statement					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
Interest income	30,935	44,753	68,890	83,660	106,091
Interest expenses	13,156	19,295	31,795	39,028	49,256
Net Interest income	17,779	25,458	37,096	44,631	56,835
Non interest income	6,513	11,240	15,163	20,454	25,567
- Fee & forex income	6,961	11,445	15,727	19,973	24,967
- Misc. income	208	314	121	480	600
- Investment profits	(656)	(519)	(685)	0	0
Net revenues	24,293	36,698	52,259	65,085	82,402
Operating expense	10,854	16,911	24,208	30,305	37,074
- Employee exp	2,767	4,868	7,769	10,800	13,805
- Other opex	8,087	12,043	16,439	19,505	23,269
Preprovision profit	13,439	19,787	28,051	34,780	45,328
Provisions	3,643	7,249	11,663	12,254	15,131
- Loan loss provisions	1,762	4,798	8,661	9,414	12,291
- Investment depreciation	1,881	2,452	3,002	2,840	2,840
PBT	9,796	12,538	16,388	22,526	30,196
Taxes	3,140	3,830	4,973	6,983	9,361
PAT	6,656	8,708	11,415	15,543	20,836
Extraordinaries	0	0	0	0	0
Reported PAT	6,656	8,708	11,415	15,543	20,836
EPS	21.5	27.8	35.7	43.2	57.9
DPS	4.0	5.5	7.0	9.0	11.0
Payout ratio (%)	18.6	19.8	19.6	20.8	19.0

### Growth ratios (%)

Year to March	FY05	FY06	FY07	FY08E	FY09E
NII growth	32.9	43.2	45.7	20.3	27.3
Fees growth	76.5	64.4	37.4	27.0	25.0
Opex growth	34.0	55.8	43.2	25.2	22.3
PPOP growth	43.6	44.1	41.5	21.0	30.3
PPP growth	33.3	47.2	41.8	24.0	30.3
Provisions growth	26.4	99.0	60.9	5.1	23.5
PAT growth	30.6	30.8	31.1	36.2	34.1

### Operating ratios (%)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Yield on advances	7.7	8.9	10.6	10.8	11.1
Yield on investments	7.2	7.1	8.2	8.2	8.2
Yield on assets	6.9	7.3	8.8	9.1	9.6
Net interest margins	3.9	4.2	4.7	4.9	5.2
Cost of funds	3.0	3.4	4.2	4.5	4.9
Cost of deposits	3.3	3.4	4.4	4.7	4.8
Cost of borrowings	5.1	7.5	8.1	8.7	9.0
Spread	3.8	4.0	4.6	4.6	4.7
Cost-income	44.7	46.1	46.3	46.6	45.0
Tax rate	32.1	30.5	30.3	31.0	31.0

**Balance sheet**

<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08E</b>	<b>FY09E</b>
<b>Liabilities</b>					
Equity capital	3,099	3,131	3,194	3,599	3,599
Reserves	42,100	49,864	61,138	115,048	131,342
<b>Net worth</b>	<b>45,199</b>	<b>52,995</b>	<b>64,332</b>	<b>118,647</b>	<b>134,941</b>
Sub bonds/pref cap	5,000	17,020	27,970	40,970	48,970
Deposits	363,543	557,968	682,979	763,657	988,211
Borrowings	47,900	28,585	184	5,000	10,000
Other liabilities	52,645	78,495	136,891	64,361	83,286
<b>Total</b>	<b>514,286</b>	<b>735,063</b>	<b>912,356</b>	<b>992,635</b>	<b>1,265,408</b>
<b>Assets</b>					
Loans	255,663	350,613	469,448	633,755	823,881
Investments					
<i>Gilts</i>	<i>112,338</i>	<i>196,386</i>	<i>231,610</i>	<i>168,062</i>	<i>197,699</i>
<i>Others</i>	<i>81,160</i>	<i>87,554</i>	<i>74,038</i>	<i>96,265</i>	<i>124,369</i>
Cash & equi	44,740	69,190	91,539	67,489	87,334
Fixed assets	7,083	8,551	9,667	10,113	10,189
Other assets	13,302	22,770	36,054	16,951	21,936
<b>Total</b>	<b>514,286</b>	<b>735,063</b>	<b>912,356</b>	<b>992,635</b>	<b>1,265,408</b>
<b>Balance sheet ratios</b>					
Credit growth	31.2	33.4	24.4	35.0	30.0
Deposit growth	19.6	53.5	22.4	11.8	29.4
EA growth	21.5	42.5	23.1	11.4	27.7
SLR ratio	27.3	33.5	28.0	22.0	20.0
C-D ratio	89.0	77.4	78.7	95.0	95.4
Low-cost deposits	60.6	55.4	54.6	53.6	53.6
Gross NPA ratio	1.4	1.2	1.5	1.6	1.9
Net NPA ratio	0.2	0.4	0.4	0.4	0.6
Provision coverage	86.2	74.4	73.3	72.7	69.3
Incremental slippage	1.0	1.8	2.1	2.1	2.2
Capital adequacy	12.2	11.4	13.1	15.7	14.2
- Tier 1	9.6	8.6	8.6	11.8	10.2

**Ratios**

Year to March	FY05	FY06	FY07	FY08E	FY09E
<b>ROA decomposition (%)</b>					
Net interest income/Assets	3.9	4.2	4.7	4.9	5.2
Fees/Assets	1.6	1.9	2.0	2.2	2.3
Investment profits/Assets	(0.1)	(0.1)	(0.1)	0.0	0.0
Net revenues/Assets	5.4	6.0	6.7	7.1	7.5
Operating expense/Assets	(2.4)	(2.8)	(3.1)	(3.3)	(3.4)
Provisions/Assets	(0.8)	(1.2)	(1.5)	(1.3)	(1.4)
Taxes/Assets	(0.7)	(0.6)	(0.6)	(0.8)	(0.9)
Total costs/Assets	(3.9)	(4.6)	(5.2)	(5.4)	(5.6)
ROA	1.5	1.4	1.5	1.7	1.9
Equity/Assets	8.0	8.0	7.5	10.0	11.5
ROE	18.5	17.7	19.5	17.0	16.4

**Valuation metrics**

Year to March	FY05	FY06	FY07	FY08E	FY09E
EPS	21.5	27.8	35.7	43.2	57.9
<i>EPS growth (%)</i>	<i>20.1</i>	<i>29.5</i>	<i>28.5</i>	<i>20.8</i>	<i>34.1</i>
Book value per share	145.9	169.2	201.4	329.7	375.0
Adjusted book value/share	144.5	165.8	196.7	323.4	364.4
Price/Earnings	24.8	27.8	29.2	24.2	18.0
Price/ BV	3.7	4.6	5.2	3.2	2.8
Price/ ABV	3.7	4.7	5.3	3.2	2.9
Dividend yield (%)	<i>0.4</i>	<i>0.5</i>	<i>0.7</i>	<i>0.9</i>	<i>1.1</i>
Price to income	21.2	13.7	10.3	9.4	7.7
Price to PPOP	22.9	16.1	11.6	10.8	8.3

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### RATING INTERPRETATION

<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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