

# HDFC Bank

## Trim Exposure

### HOLD

**Price** Rs1,659

**Target Price** Rs1,750 **%Upside** 6% ↑

**Market Capitalisation** Rs711,123bn (US\$15,249mn)

**52 wk range H/L (Rs)** 1,739/774

**Shares o/s (mn)** 427.36 **Daily vol (mn shares)** 1.06

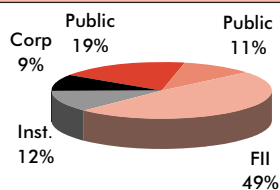
**Reuters** HDBK.BO **Bloomberg** HDFCB IN

**Performance (%)**

	1M	3M	12M	YTD
Absolute	7.6	15.1	58.7	66.7
Relative	7.1	0.7	(4.9)	(5.3)

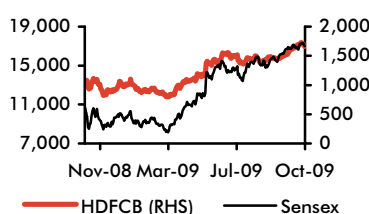
Source: Bloomberg

#### Shareholding pattern (%)



Source: Bloomberg

#### Price performance



Source: Bloomberg

#### Financials (Rs bn)

Y/E Mar	FY09	FY10E	FY11E
Net Int. Inc.	74.21	98.03	124.52
Gross profit	51.79	70.65	96.40
Net profit	22.45	27.95	43.04
Net NPA (%)	0.8	0.8	0.5
NIM (%)	4.7	4.7	4.8
Divi. Yield (%)	0.6	0.6	0.6
EPS (Rs)	52.8	60.6	91.3
Adj. BVPS (Rs)	312.3	417.5	490.8
P/ABV (x)	5.3	4.0	3.4

Source: Company, Ambit Capital research estimates

Analyst  
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- Muted operational performance
- NII growth subdued; strong core fee income boosts net profit
- Sequential 9% growth in loan book; YoY growth in low double-digits
- Gross NPA below 2%; conservative cumulative restructuring augurs well
- Steep upmove robs upside potential; downgrade to 'HOLD' at current levels

HDFC Bank announced a mixed set of numbers in its Q2/H1FY10 results. In its second strictly comparable quarter (on a YoY basis), the bank's core operational performance (as denoted by the growth in NII) was under pressure while loan book growth clocked in the low double-digit territory. The more reassuring aspect is the fact that the bank's asset quality has begun stabilizing (in absolute terms) while the conservative approach towards restructuring continues to lend comfort.

#### Exhibit 1: Quarterly performance

(Rs mn)	Q2FY10	Q2FY09	% chg	FY10E	FY09	% chg
Interest on adv.	30,102	30,614	(1.7)	149,024	121,367	22.8
Interest on inv.	9,596	8,967	7.0	45,715	40,080	14.1
Interest on bal. with RBI	211	330	(36.0)	2,042	1,843	10.8
Other interest	10	2	540.0	37	33	13.1
Interest income	39,919	39,912	0.0	196,818	163,323	20.5
Interest expenditure	20,361	21,248	(4.2)	98,789	89,111	10.9
<b>Net interest income</b>	<b>19,558</b>	<b>18,665</b>	<b>4.8</b>	<b>98,029</b>	<b>74,212</b>	<b>32.1</b>
Other income	10,074	6,431	56.6	38,665	32,906	17.5
<b>Operating profit</b>	<b>15,930</b>	<b>11,229</b>	<b>41.9</b>	<b>70,654</b>	<b>51,790</b>	<b>36.4</b>
Prov. & cont.	5,941	3,460	71.7	29,551	18,791	57.3
Prov. for taxes	3,114	2,488	25.1	13,153	10,549	24.7
<b>Net profit</b>	<b>6,875</b>	<b>5,280</b>	<b>30.2</b>	<b>27,950</b>	<b>22,449</b>	<b>24.5</b>

Source: Company, Ambit Capital research estimates

On the business front, HDFC Bank continued to grow its balance sheet at a steady pace on a sequential basis. While the system witnessed a sluggish growth in advances, the bank accounted for a double-digit share of the incremental lending within the system for the second quarter running.

#### Exhibit 2: Business performance

(Rs bn)	H1FY10	H1FY09	% chg	Q1FY10	% chg
Advances	1,136.72	1,022.22	11.2	1,037.85	9.5
Current deposits	321.70	261.23	23.1	270.26	19.0
Savings deposits	432.49	327.94	31.9	384.89	12.4
CASA deposits	754.19	589.17	28.0	655.15	15.1
Term deposits	743.86	748.64	(0.6)	802.17	(7.3)
Deposits	1,498.05	1,337.81	12.0	1,457.32	2.8
<b>Business</b>	<b>2,634.77</b>	<b>2,360.03</b>	<b>11.6</b>	<b>2,495.17</b>	<b>5.6</b>

Source: Company

**Valuation and recommendation:** The stock has appreciated ~10% over the last month, thereby leaving little room for any potential upside from current levels. As we adjust our discounting factor to price in the time value, our target price moves up from Rs1,700 to Rs1,750, implying a 6% upside from current levels. Hence, we downgrade our recommendation on the stock from 'BUY' to 'HOLD'. Our target price of Rs1,750 factors in the conversion of 26.2mn warrants by HDFC at Rs1,530. At its CMP of Rs1,657, the stock is trading at 4.0x and 3.4x our FY10E and FY11E ABVPS estimates of Rs418 and Rs491 respectively.

**Q1FY10 operational performance sends mixed signals:** HDFC Bank reported a subdued operational performance during the quarter with a negligible 5% YoY growth in NII. However, traction on the core fee income front, coupled with treasury gains, helped shore up the bank's operating profit.

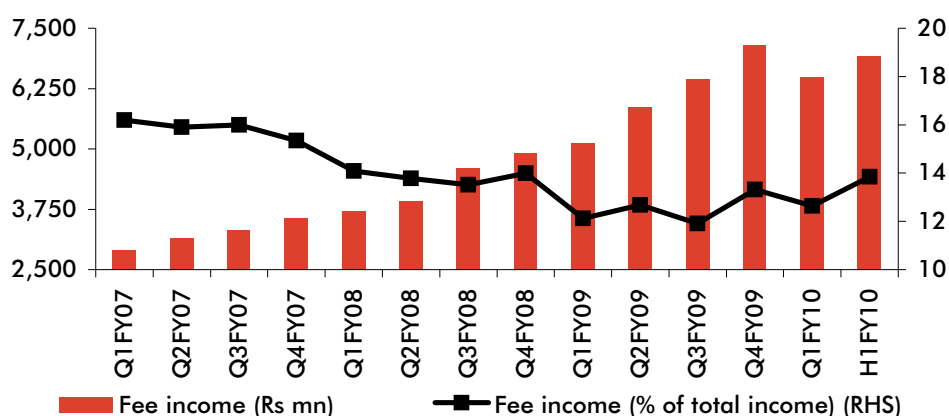
### Exhibit 3: Quarterly performance

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EPS (Rs)	15.9	12.2	30.4	60.6	52.8	14.7

Source: Company, Ambit Capital research estimates

Although traction on the core fee income front was better than our expectations (on a YoY basis), core fee income remains below the earlier secular trend-line proportion of total income. Core fee income has been contributing ~12.8% to the total income (over the last five quarters since the CBoP merger) as against the earlier trend line of 14.8% during the eight quarters prior to the merger.

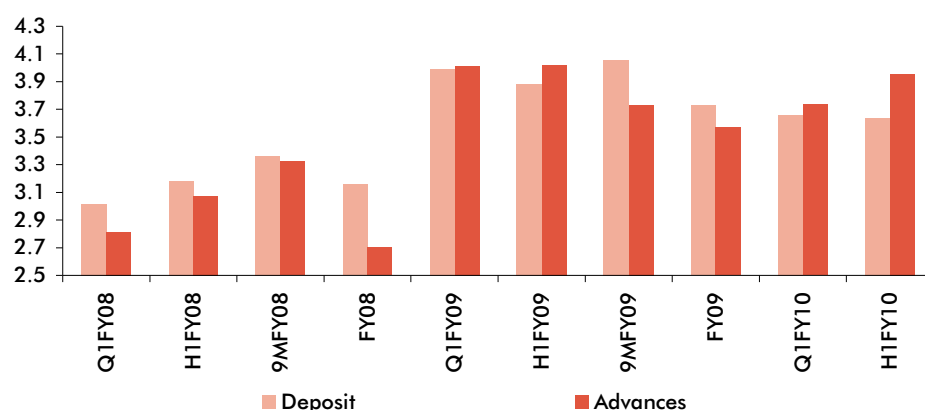
### Exhibit 4: Strong core fee income - yet below secular trend line



Source: Company, Ambit Capital research estimates

**Business growth ahead of expectations:** On the business front, HDFC Bank continued to grow its balance sheet at a steady pace on a sequential basis. While the system witnessed a sluggish growth in advances, the bank accounted for a double-digit share of the incremental lending within the system for the second quarter running (the overall banking system witnessed incremental lending of Rs949bn between 26th Jun'09 and 25th Sep'09).

**Exhibit 5: HDFC Bank market share in system credit / deposits**



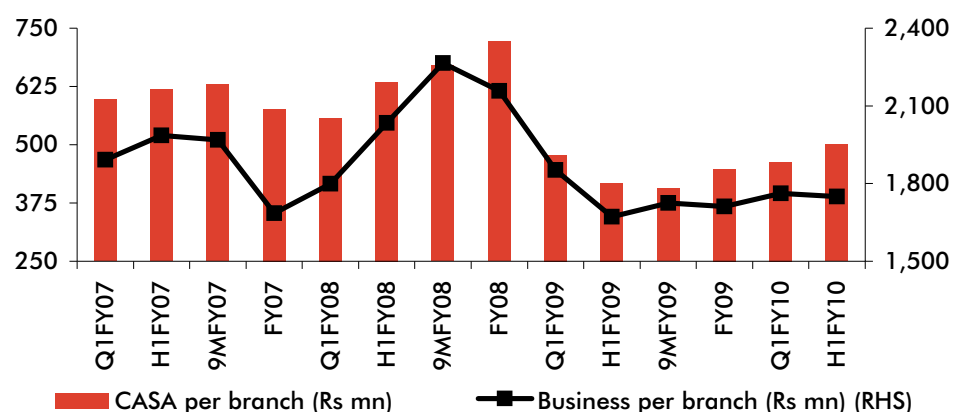
Source: Company, Ambit Capital research estimates

As a result of having cornered a lion's share of the incremental system lending during the quarter, HDFC Bank grew its overall market share in advances within the system to 4%. On the other hand, the bank shed its market share in deposits by a few basis points to 3.6% during the quarter. At a time when the entire banking system added Rs949bn of credit during the quarter, HDFC Bank alone added Rs99bn

**Exhibit 6: Dilution in key business parameters bottoming out**

**From our previous update dated 15th Jul '09**

As can be seen from Exhibit 6, we especially draw comfort from the bank's improving operational efficiency on certain key parameters. However, we continue to believe that the dilution in these core efficiency parameters will last a while longer before they stabilize at higher levels.

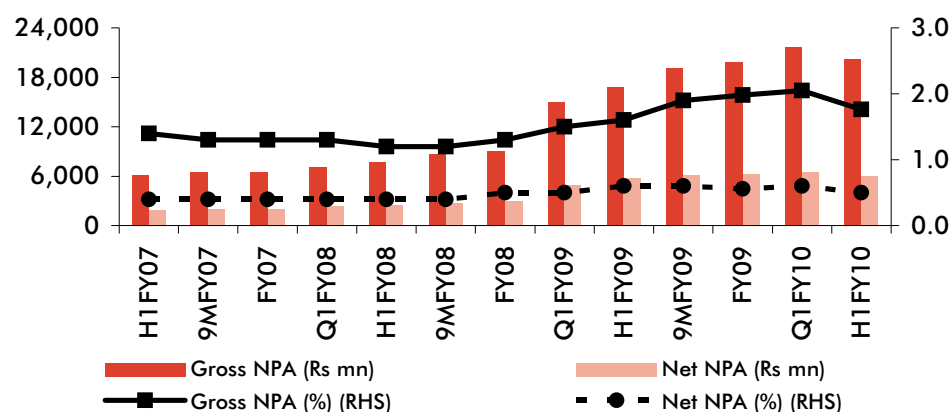


Source: Company, Ambit Capital research estimates

As we mentioned in our earlier update, although the bank's operational efficiency parameters have begun stabilizing and trending upwards, they still continue to remain low (relative to their pre-merger levels).

**Asset quality remains under pressure:** The dilution in the bank's asset quality indicators (which we highlighted in our 'Initiating Coverage' report dated 29th Jun'09) has now bottomed out, a quarter ahead of our expectations, with gross NPAs re-tracing the 2% level that had been breached during the Jun'09 quarter. We also draw comfort from the fact that the cumulative restructured portfolio remains at a negligible Rs6.4bn (amongst the lowest in the system at 0.56% of the overall portfolio) that minimizes the risk of incremental slippages.

#### Exhibit 7: Asset quality likely to improve from current levels



Source: Company, Ambit Capital research estimates

**Valuation and recommendation:** The stock has appreciated ~10% over the last month, thereby leaving little room for any potential upside from current levels. As we adjust our discounting factor to price in the time value, our target price moves up from Rs1,700 to Rs1,750, implying a 6% upside from current levels. Hence, we downgrade our recommendation on the stock from 'BUY' to 'HOLD'. Our target price of Rs1,750 factors in the conversion of 26.2mn warrants by HDFC at Rs1,530.

Our numbers factor in a 28% YoY growth in advances during FY10E and a 30% growth in the loan book during FY11E (on the back of larger appetite for credit given the stronger economic momentum as well as availability of adequate capital).

At its CMP of Rs1,657, the stock quotes at 4.0x and 3.4x our FY10E and FY11E ABVPS estimates of Rs418 and Rs491 respectively.

#### Exhibit 8: Valuation methodology

(Rs/shr)	FY10E	FY11E
EVA valuation	1,482	1,675
P/ABV(x)	2.9	3.7
P/ABV valuation	1,223	1,825
Average	1,353	1,750
Upside (%) (18.4)	5.6	

Source: Ambit Capital research estimates

## HDFC Bank Financial Summary

### Exhibit 9: Balance sheet

Y/E March (Rs bn)	FY07	FY08	FY09	FY10E	FY11E
Capital	3.19	3.54	4.25	4.62	4.72
Reserves and surplus	61.14	111.43	146.27	204.64	242.06
Deposits	682.98	1,007.69	1,428.12	1,789.17	2,300.59
Borrowings	28.15	44.79	26.86	30.86	35.48
Other liabilities & provisions	136.89	164.32	227.21	270.01	324.98
<b>TOTAL</b>	<b>912.36</b>	<b>1,331.77</b>	<b>1,832.71</b>	<b>2,299.29</b>	<b>2,907.83</b>
Cash & balances with RBI	50.75	125.53	135.27	96.52	122.69
Investments	305.65	493.94	588.18	799.60	984.83
Advances	469.45	634.27	988.83	1,269.77	1,650.71
Fixed assets	9.67	11.75	17.07	16.02	15.75
Other assets	37.13	44.03	63.57	79.46	99.33
<b>TOTAL</b>	<b>912.36</b>	<b>1,331.77</b>	<b>1,832.71</b>	<b>2,299.29</b>	<b>2,907.83</b>

### Exhibit 10: Profit & loss

Y/E March (Rs bn)	FY07	FY08	FY09	FY10E	FY11E
Interest income	66.48	101.15	163.32	196.82	261.93
Interest expense	31.79	48.87	89.11	98.79	137.41
<b>Net interest income</b>	<b>34.68</b>	<b>52.28</b>	<b>74.21</b>	<b>98.03</b>	<b>124.52</b>
% Growth	36	51	42	32	27
Treasury income	1.16	4.47	10.09	8.25	10.58
Other inc. from bank. operat.	14.00	18.36	22.81	30.41	40.78
Total income	49.85	75.11	107.12	136.69	175.89
Employees expenses	7.77	13.01	22.38	25.74	33.46
Other operational expenses	16.44	24.44	32.95	40.30	46.02
<b>Operating profit</b>	<b>25.64</b>	<b>37.65</b>	<b>51.79</b>	<b>70.65</b>	<b>96.40</b>
% Growth	30	47	38	36	36
Tax	4.98	6.91	10.55	13.15	20.25
Loan loss provisions	9.25	14.84	18.79	29.55	33.12
<b>Net profit</b>	<b>11.41</b>	<b>15.90</b>	<b>22.45</b>	<b>27.95</b>	<b>43.04</b>
% Growth	31	39	41	25	54

### Exhibit 11: Valuation parameters

Per Share Data	FY07	FY08	FY09	FY10E	FY11E
BVPS (Rs)	201.4	324.4	344.3	453.2	523.2
Adj. BVPS (Rs)	182.0	301.5	312.3	417.5	490.8
Price/ Adj. BVPS (x)	9.1	5.5	5.3	4.0	3.4
EPS (Rs)	35.7	44.9	52.8	60.6	91.3
EPS growth (%)	28.5	25.5	17.6	14.7	50.7
P/E ratio (x)	46.4	36.9	31.4	27.4	18.2

Source: Company, Ambit Capital research estimates

## Explanation of Investment Rating

Investment Rating	Expected return (over 12-Month period from date of initial rating )
Buy	>15%
Hold	5% to 15%
Sell	<5%

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