

HDFC Bank

In-line numbers, credit costs the key driver

HDFCB reported in-line profits (Rs 12.0bn, up 32%/y/y) for 2Q. The key driver was lower credit costs, with delinquencies and provisions continuing at well below trend levels. This offset a slight squeeze on NIMs, largely due to a slight fall in the CASA ratio. Overall, the bank delivered solid numbers.

- Improving asset quality.** Credit cost improvement continued to be strong, with a 25bp q/q improvement to 80bp for 2Q. Retail asset quality has been very strong for all banks, given rising incomes, greater industry discipline and improving effectiveness of credit bureaus. Our forecasts imply an uptick from here, as we factor in a slowing economy.
- Slow PPOP growth.** There was a small margin squeeze (10bp q/q, based on our calculations), driven mainly by an ~180bp drop in the CASA ratio. The CASA squeeze was largely led by migration to term deposits because of high interest rates. We think CASA migration could remain a little pressured for 1-2 more quarters – strong customer addition (branch additions have been robust) is an offset.
- Loan growth in line.** The headline 20% y/y loan growth number is tainted by lumpy year-end balances in Sep 10 and core loan growth was 26% y/y. The LDR dipped ~150bps to 81.7% from 83.1% (term deposit addition was very strong). Retail loans slightly outpaced the wholesale segment - while demand in some segments like autos is slowing, CV and business banking has picked up the slack.
- Top pick.** HDFCB remains our top pick, given its earnings resilience and improving ROAs. Improving return ratios has been the hallmark of the bank's performance in the last 2-3 years, and we expect ROEs to touch 20-21% by FY14 – levels not attained since the early noughties. The premium valuations are supported by fundamentals, in our view.

Overweight

HDBK.BO, HDFCB IN

Price: Rs491.85

Price Target: Rs560.00

India

Financials

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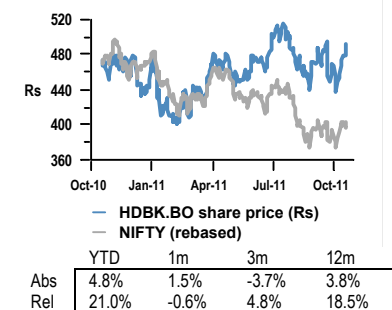
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Price Performance



HDFC Bank (Reuters: HDBK.BO, Bloomberg: HDFCB IN)

Year-end Mar (Rs in mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Operating Profit (Rs mn)	60,806	77,788	92,435	116,838	147,472
Net Profit (Rs mn)	29,493	39,264	50,890	64,497	81,331
Cash EPS (Rs)	12.89	16.88	21.88	27.73	34.96
Fully Diluted EPS (Rs)	11.36	17.11	21.88	26.65	33.67
DPS (Rs)	2.40	3.30	4.28	5.42	5.62
EPS growth (%)	22.1%	31.0%	29.6%	26.7%	26.1%
ROE	16.1%	16.7%	18.6%	20.3%	21.6%
P/E	38.2	29.1	22.5	17.7	14.1
BVPS (Rs)	94.04	109.11	125.98	147.36	175.75
P/BV	5.2	4.5	3.9	3.3	2.8
Div. Yield	0.5%	0.7%	0.9%	1.1%	1.1%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

52-wk range (Rs)	519.50 - 396.00
Market cap (Rs mn)	1,150,099
Market cap (\$ mn)	23,331
Shares outstanding (mn)	2,338
Fiscal Year End	Mar
Price (Rs)	491.85
Date Of Price	19 Oct 11
Avg daily value (Rs mn)	984.3
Avg daily value (\$ mn)	20.0
Avg daily vol (mn)	0.2
NIFTY	5,139
Exchange Rate	49.30

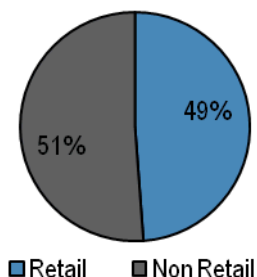
See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company Description

HDFC Bank is the second-largest private bank in India. It has ~48% exposure to the retail segment which is the highest among Indian banks. HDFC Bank's loan book is ~US\$36bn in FY11 with ~48% of it being retail assets and ~20% of it being auto loans.

Loan Break up



Source: Company

EPS: J.P. Morgan vs consensus

	J. P.	
	Morgan	Consensus
FY12E	21.9	21.7
FY13E	27.7	27.5

Source: Bloomberg, J.P.Morgan estimates

P&L sensitivity metrics	EBITDA Impact (%)	EPS Impact (%)
NIMs		
Impact of each 10bps	3.0%	4.7%
Cost to Income		
Impact of each 100bps	2.1%	3.3%
Provisions/Assets		
Impact of each 10bps	0.0%	4.7%

Source: J.P.Morgan estimates

Price target and valuation analysis

Our Sep-12 PT for HDFCB of Rs560 is based on 2 stage Gordon growth model implying 3.8x FY13 book. Our valuations factor in Cost fo Equity at 14.0%, Normalised ROE of ~23% and terminal growth of 5%.

Risk free rate	8.0%
Equity Risk Premium	6.0%
Beta	1.00
Cost of Equity	14.0%

Terminal growth	5.0%
Stage 2 growth	30.0%
Sep-12 PT	560

Normalized ROE

NIM/Assets	4.3%
Non- interest income/assets	2.0%
Revenues/Assets	6.2%
Costs/Assets	-2.9%
Provisions/Assets	-0.7%
Taxes/Assets	-0.9%
ROA	1.84%
ROE	23.0%

HDFCB trades at a premium to other banks but we believe that it is a safe option in an uncertain environment. Higher rates slowing retail demand and credit costs normalisation are key risks to our Overweight recommendation.

Figure 1: HDFCB 2Q12 Financials

	2Q11	1Q12	2Q12	YoY	QoQ	Comments
Interest income	48,100	59,780	67,177	39.7%	12.4%	
Interest expenses	22,837	31,300	37,732	65.2%	20.5%	
Net interest income	25,263	28,480	29,445	16.6%	3.4%	NII lower than expected due to a marginal miss on margins
Non-interest income	9,607	11,200	12,117	26.1%	8.2%	
Operating expenses	16,799	19,346	20,304	20.9%	4.9%	Inline with expectations
Pre prov profit	18,071	20,334	21,258	17.6%	4.5%	
Provisions	4,545	4,437	3,661	-19.5%	-17.5%	Lower provisions compensated miss on margins
Profit before tax	13,526	15,897	17,598	30.1%	10.7%	
Provision for tax	4,405	5,047	5,604	27.2%	11.0%	
Profit after tax	9,121	10,850	11,994	31.5%	10.5%	
NIMs	4.20%	4.20%	4.10%	-0.1%	-0.1%	Marginal contraction in margins mainly due to ~180bps drop in CASA
NII / GII	52.5%	47.6%	43.8%	-8.7%	-3.8%	
Cost - Income	48.2%	48.8%	48.9%	0.7%	0.1%	
Prov / PPP	25.1%	21.8%	17.2%	-7.9%	-4.6%	
Tax rate	32.6%	31.7%	31.8%	-0.7%	0.1%	
Balance sheet data						
Advances	1,570,906	1,755,160	1,885,022	20.0%	7.4%	Strong sequential loan growth driven by retail credit growth
Deposits	1,953,209	2,111,512	2,306,764	18.1%	9.2%	
Credit to Deposit	80.4%	83.1%	81.7%	1.3%	-1.4%	
Asset Quality						
Gross NPA	18,412	18,331	18,949	2.9%	3.4%	
Net NPA	4,085	3,185	3,553	-13.0%	11.5%	Asset quality continues to remain robust
Gross NPA (%)	1.16	1.04	1.00	(0.16)	(0.04)	
Net NPA(%)	0.30	0.20	0.20	(0.10)	0.00	
CASA Ratio	50.6	49.1	47.3	(3.30)	(1.73)	High rates leading to migration
Tier-1	12.7%	11.4%	11.5%	-1.2%	0.1%	
CAR	17.0%	16.9%	16.5%	-0.5%	-0.4%	
Other Income:						
Fees	8,570	9,227	9,879	15.3%	7.1%	
Forex	1,523	2,301	2,180	43.1%	-5.3%	
Treasury	-521	-413	-13			

Source: Company, J.P.Morgan

Loan growth: Loan book growth was robust with 7.4% sequential growth driven largely the retail book. Retail book growth of 11% q/q was driven by growth across the board with strong growth in the CV/CE book (+25% q/q). Moderating car sales had led to slower auto loan growth at ~19% y/y. Management expects retail loan growth to remain stronger than the corporate loan book even in 2HFY12.

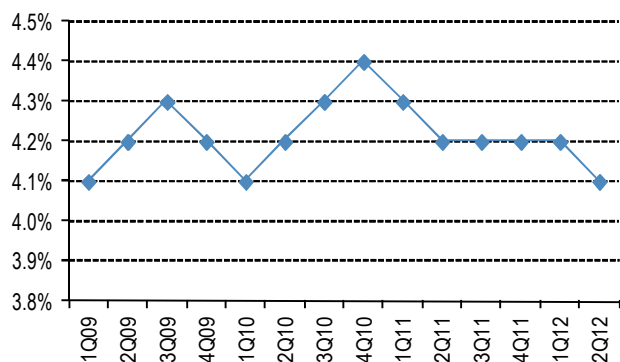
Figure 2: HDFCB 2Q12: Retail credit driving loan growth

(Rs mn)	2Q11	1Q12	2Q12	y/y	q/q
Car Loans	207,610	232,170	246,060	18.5%	6.0%
2 wheeler loans	17,800	20,670	21,730	22.1%	5.1%
CV/CE Loans	69,570	90,550	113,480	63.1%	25.3%
Total Auto loans	294,980	343,390	381,270	29.3%	11.0%
Personal loans	93,240	109,800	120,040	28.7%	9.3%
Credit Cards	41,340	54,050	58,550	41.6%	8.3%
SME	114,900	153,910	168,470	46.6%	9.5%
Home Loans	91,760	110,410	123,440	34.5%	11.8%
Loan against securities/shares	10,230	10,670	9,800	-4.2%	-8.2%
Other Retail	45,590	56,400	67,210	47.4%	19.2%
Retail Total	692,040	838,630	928,780	34.2%	10.7%
Non-Retail Loans	893,080	932,356	973,239	9.0%	4.4%
Total Loan book	1,585,120	1,770,986	1,902,019	20.0%	7.4%

Source: Company, J.P.Morgan

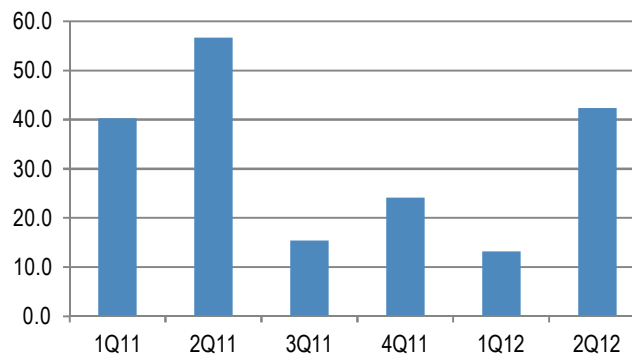
Margins: Margins did moderate by ~10bps q/q mainly due to drop in CASA ratios. CA growth continues to remain muted due to high rates but SA growth has been relatively strong at 6.5% q/q and the CASA ratio drop was a function of high term deposit growth at 13% q/q. Advances yield improvement has been slow given the relatively high fixed rate loan book but rollovers over the next 2-3 qtrs should aid margins.

Figure 3: Marginal moderation in margins



Source: Company, J.P.Morgan

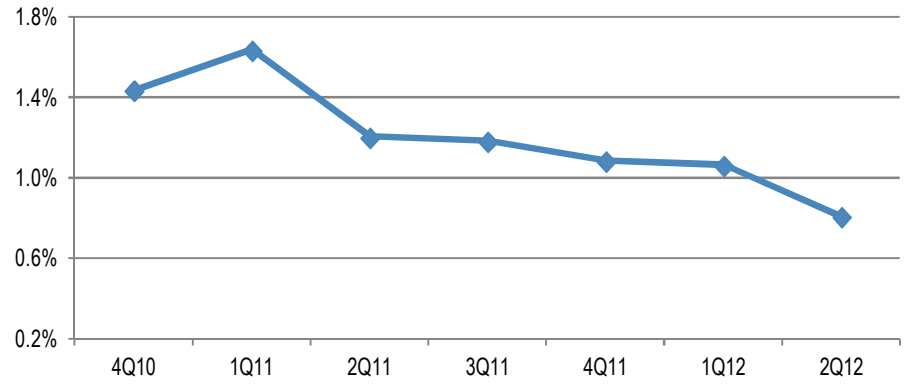
Figure 4: SA growth has been robust (Qtrly SA accretion – Rs bn)



Source: Company, J.P.Morgan

Asset quality continues to remain robust with net accretion remaining low at <RS1bn in 2Q12. According to the management, retail asset quality has been running better than their expectations, their early tracking indicators do not point to any material reversal in the asset quality trend. HDFCB continues to build on the counter cyclical floating buffer with ~Rs1.5bn addition in this qtr and total stock of floating provisions is now >Rs10bn.

Figure 5: Credit costs continues to dip (including floating and general provisions)



Source: Company, J.P.Morgan

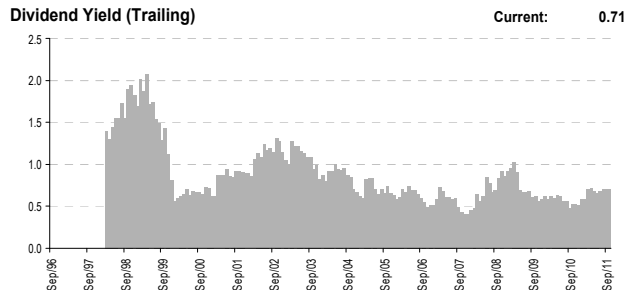
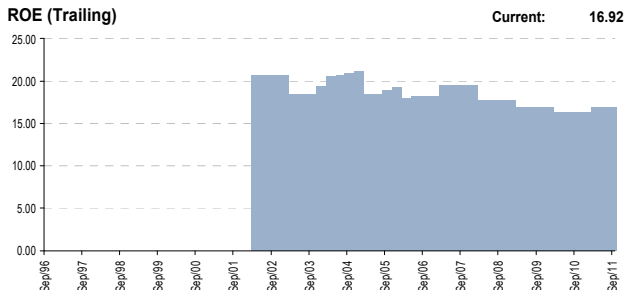
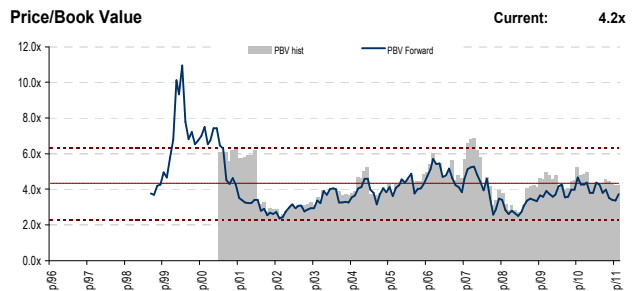
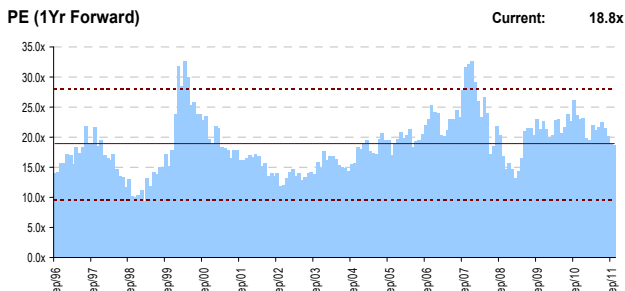
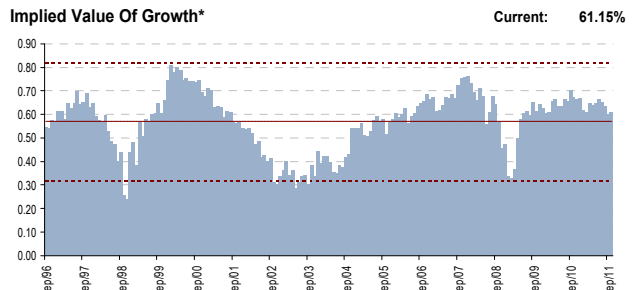
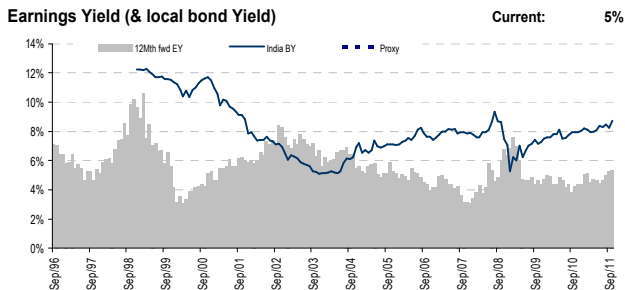
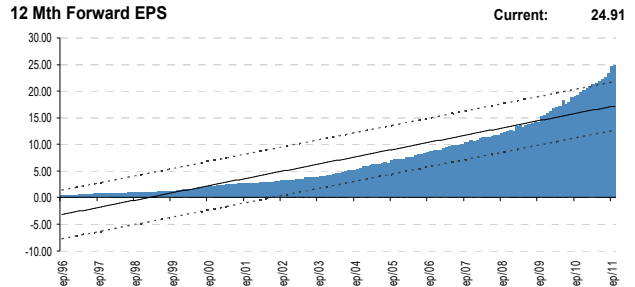
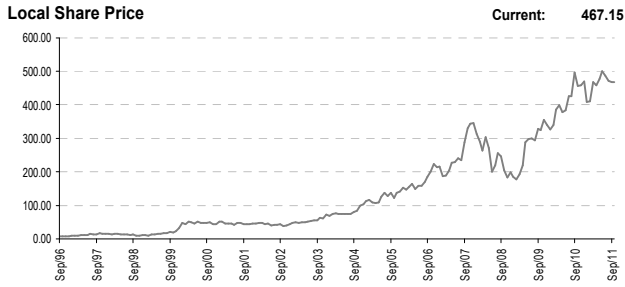
HDFC Bank: Summary of Financials

Income Statement						Growth Rates					
Rs in millions, year end Mar	FY10	FY11	FY12E	FY13E	FY14E		FY10	FY11	FY12E	FY13E	FY14E
NIM (as % of avg. assets)	4.3%	4.4%	4.3%	4.5%	4.5%	Loans	26.9%	26.8%	23.9%	24.0%	24.9%
Earning assets/assets	96.0%	95.0%	95.5%	97.1%	97.4%	Deposits	14.7%	26.1%	17.9%	23.6%	23.1%
Margins (% of earning assets)	4.1%	4.2%	4.1%	4.3%	4.4%	Assets	21.4%	24.7%	16.3%	21.4%	23.4%
						Equity	43.0%	17.9%	15.5%	17.0%	19.3%
Net Interest Income	83,866	105,431	123,670	154,123	191,595	RWA	19.8%	25.2%	26.0%	30.0%	30.0%
Total Non-Interest Income	34,585	43,886	52,355	63,380	76,085	Net Interest Income	13.0%	25.7%	17.3%	24.6%	24.3%
Fee Income	34,408	45,176	52,855	63,955	76,746	Non-Interest Income	19.1%	26.9%	19.3%	21.1%	20.1%
						of which Fee Grth	12.6%	31.3%	17.0%	21.0%	20.0%
Other Operating Income	177	-1,290	-500	-	-	Revenues	17.2%	24.6%	18.7%	23.5%	25.2%
Total operating revenues	118,451	149,317	176,026	217,503	267,680	Costs	4.2%	24.1%	16.9%	20.4%	19.4%
						Pre-Provision Profits	26.9%	27.9%	18.8%	26.4%	26.2%
Operating costs	-57,645	-71,529	-83,591	-100,664	-120,208	Loan Loss Provisions	13.9%	-11.0%	-10.8%	39.6%	26.0%
						Pre-Tax	-	-	-	-	-
Pre-Prov. Profits	60,806	77,788	92,435	116,838	147,472	Attributable Income	31.4%	33.1%	29.6%	26.7%	26.1%
Provisions	-21,405	-19,061	-17,013	-23,749	-29,932	EPS	22.1%	31.0%	29.6%	26.7%	26.1%
Other Inc/Exp. (treasury Income)	3,491	-534	0	2,500	3,000	DPS	20.0%	37.5%	29.6%	26.7%	3.7%
Exceptionals	0	0	0	0	0						
Pre-tax	600	58,193	75,422	95,590	120,540	Balance Sheet Gearing	FY10	FY11	FY12E	FY13E	FY14E
Tax	13,399	18,929	24,533	31,093	39,208	Loan/deposit	76.0%	77.4%	80.7%	81.0%	80.8%
Minorities	-	-	-	-	-	Investment/assets	3.4%	6.2%	5.6%	4.7%	3.9%
Other Distbn.	-	-	-	-	-	Loan/Assets	56.6%	57.7%	61.5%	62.8%	63.6%
Attributable Income	29,493	39,264	50,890	64,497	81,331	Customer deposits/liab.	83.3%	82.8%	84.5%	85.6%	86.7%
						LT debt/liabilities	5.8%	5.2%	6.1%	5.8%	5.7%
Per Share Data Rs	FY10	FY11	FY12E	FY13E	FY14E	Asset Quality/Capital	FY10	FY11	FY12E	FY13E	FY14E
EPS	12.89	16.88	21.88	27.73	34.96	Loan loss reserves/loans	-1.1%	-0.9%	-0.8%	-0.8%	-0.7%
DPS	2.40	3.30	4.28	5.42	5.62	NPLs/loans	1.5%	1.0%	1.0%	1.0%	0.9%
Payout	18.6%	19.6%	19.6%	19.6%	16.1%	Specific loan loss reserves/NPLs	0.0%	0.0%	0.0%	0.0%	0.0%
Book value	94.04	109.11	125.98	147.36	175.75	Growth in NPLs	-6.8%	-8.6%	16.2%	20.3%	15.7%
Fully Diluted Shares	2,288.72	2,326.13	2,326.13	2,326.13	2,326.13	Tier 1 Ratio	13.3%	12.2%	11.3%	10.4%	9.6%
						Total CAR	18.4%	16.2%	16.3%	14.7%	13.4%
Key Balance sheet Rs in millions	FY10	FY11	FY12E	FY13E	FY14E	Du-Pont Analysis	FY10	FY11	FY12E	FY13E	FY14E
Net Loans	1,286,800	1,627,785	2,016,465	2,499,214	3,120,361	NIM (as % of avg. assets)	4.3%	4.4%	4.3%	4.5%	4.5%
LLR	14,247	13,979	16,340	19,660	22,747	Earning assets/assets	96.0%	95.0%	95.5%	97.1%	97.4%
Gross Loans	1,272,553	1,613,806	2,000,125	2,479,554	3,097,614	Margins (as % of Avg. Assets)	4.1%	4.2%	4.1%	4.3%	4.4%
NPLs	18,533	16,943	19,687	23,687	27,406	Non-Int. Rev./ Revenues	29.2%	29.7%	29.8%	29.1%	28.4%
Investments	75,572	172,776	182,075	183,892	186,239	Non IR/Avg. Assets	1.7%	1.8%	1.7%	1.8%	1.7%
Other earning assets	59,551	146,002	78,757	86,633	95,296	Revenue/Assets	5.8%	6.0%	5.9%	6.1%	6.1%
Avg. IEA	1,947,939	2,374,807	2,865,470	3,466,318	4,260,263	Cost/Income	48.7%	47.9%	47.5%	46.3%	44.9%
Goodwill	-	-	-	-	-	Cost/Assets	-2.8%	-2.9%	-2.8%	-2.8%	-2.7%
Assets	2,224,598	2,773,517	3,226,180	3,917,012	4,831,778	Pre-Provision ROA	3.0%	3.1%	3.1%	3.3%	3.4%
						LLP/Loans	-1.9%	-1.3%	-0.9%	-1.1%	-1.1%
Deposits	1,674,044	2,085,864	2,476,948	3,059,972	3,832,391	Loan/Assets	56.1%	57.8%	60.2%	62.7%	63.7%
Long-term bond funding	129,153	143,941	195,263	227,233	274,844	Other Prov, Income/ Assets	0.2%	-0.0%	0.0%	0.1%	0.1%
Other Borrowings	63,531	69,471	114,471	129,471	149,471	Operating ROA	3.0%	3.1%	3.1%	3.3%	3.4%
Avg. IBL	1,661,475	2,016,501	2,451,007	2,979,708	3,697,220	Pre-Tax ROA	2.1%	2.3%	2.5%	2.7%	2.8%
Avg. Assets	2,028,653	2,499,057	2,999,849	3,571,596	4,374,395	Tax rate	-	-	-	-	-
Common Equity	215,240	253,793	293,042	342,787	408,821	Minorities & Outside Distbn.	0.0%	0.0%	0.0%	0.0%	0.0%
RWA	1,549,830	1,939,600	2,443,896	3,177,065	4,130,184	ROA	1.5%	1.6%	1.7%	1.8%	1.9%
Avg. RWA	1,421,828	1,744,715	2,191,748	2,810,480	3,653,625	RORWA	2.1%	2.3%	2.3%	2.3%	2.2%
						Equity/Assets	9.0%	9.4%	9.1%	8.9%	8.6%
						ROE	16.1%	16.7%	18.6%	20.3%	21.6%

Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile
HDFC Bank Ltd. (INDIA / Financials)
 As Of: 13-Oct-2011

Global Equity Quantitative Analysis
 Quant_Strategy@jpmorgan.com



Summary

HDFC Bank Ltd.		SEDOL		B5Q3JZ5		As Of:		13-Oct-11			
INDIA						Local Price:		467.15			
Financials						EPS:		24.91			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	18.75x	9.43	32.61	18.38	18.88	28.10	9.67	-50%	74%	-2%	1%
P/BV (Trailing)	4.25x	2.52	6.85	4.25	4.33	6.36	2.30	-41%	61%	0%	2%
Dividend Yield (Trailing)	0.71	0.40	2.08	0.72	0.87	1.59	0.15	-43%	195%	2%	24%
ROE (Trailing)	16.92	16.36	21.21	18.44	18.50	21.49	15.52	-3%	25%	9%	9%
Implied Value of Growth	61.1%	0.24	0.81	0.60	0.57	0.82	0.32	-61%	32%	-2%	-7%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, J.P. Morgan Calcs

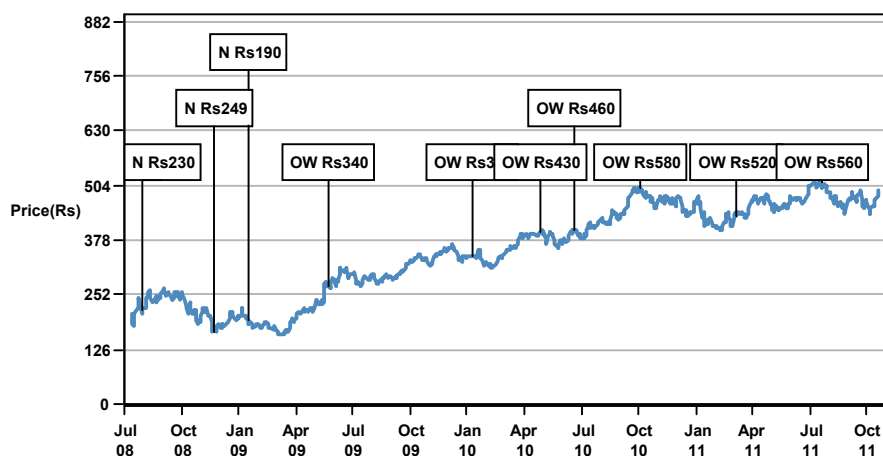
* Implied Value Of Growth = (1 - EY/Cost of equity) where cost of equity = Bond Yield + 5.0% (ERP)

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HDFC Bank (HDBK.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
30-Jul-08	N	218.81	230.00
22-Nov-08	N	165.82	249.00
15-Jan-09	N	195.51	190.00
22-May-09	OW	274.20	340.00
06-Jan-10	OW	341.67	380.00
25-Apr-10	OW	397.92	430.00
19-Jun-10	OW	399.77	460.00
02-Oct-10	OW	500.15	580.00
06-Mar-11	OW	434.63	520.00
20-Jul-11	OW	510.85	560.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Jul 30, 2008.

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

J.P. Morgan ratings: OW = Overweight, N= Neutral, UW = Underweight

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	51%	44%	33%
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