HDFC Bank – BUY

CMP Rs1,944 Target Rs2,270

Sector: Banking	
Sensex:	17,694
CMP (Rs):	1,944
Target price (Rs):	2,270
Upside (%):	16.7
52 Week h/l (Rs):	1986 / 1063
Market cap (Rscr) :	89,001
6m Avg vol ('000Nos):	917
No of o/s shares (mn):	458
FV (Rs):	10
Bloomberg code:	HDFCB IB
Reuters code:	HDBK.BO
BSE code:	500180
NSE code:	HDFCBANK

Prices as on 23 Apr, 2010

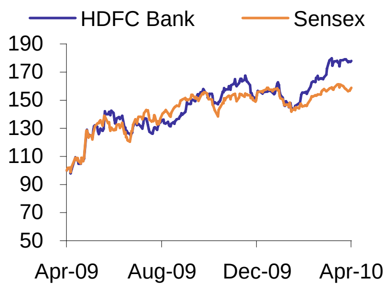
Shareholding pattern

December '09	(%)
Promoters	23.9
Institutions	38.6
Non promoter corp hold	8.8
Public & others	28.7

Performance rel. to sensex

(%)	1m	3m	1yr
HDFC Bank	1.7	10.7	18.2
ICICI Bank	4.2	11.2	72.8
Axis Bank	4.9	14.7	89.1
Yes Bank	12.3	(0.5)	207.3

Share price trend



- Strong business growth momentum continues; deposit growth outpace advance growth after four quarters
- Despite lower C/D ratio, NIM improve by 10bps qoq aided by expansion in spread
- Non-interest income lowered by G-Sec trading losses; C/I deteriorate marginally on robust branch expansion in FY10
- Asset quality continues to improve at fast clip; capital adequacy remains strong
- Upgrade book value estimates marginally; maintain BUY rating and target price of Rs2,270 on HDFC Bank

Result table

(Rs m)	Q4 FY10	Q3 FY10	% qoq	Q4 FY09	% yoy
Total Interest Income	40,531	40,348	0.5	42,508	(4.7)
Interest expended	(17,018)	(18,109)	(6.0)	(23,988)	(29.1)
Net Interest Income	**23,514**	**22,239**	**5.7**	**18,520**	**27.0**
Other income	9,036	8,530	5.9	11,147	(18.9)
Total Income	**32,549**	**30,769**	**5.8**	**29,667**	**9.7**
Operating expenses	(15,605)	(14,532)	7.4	(13,962)	11.8
Provisions	(4,399)	(4,477)	(1.7)	(6,574)	(33.1)
PBT	12,545	11,760	6.7	9,131	37.4
Tax	(4,178)	(3,575)	16.9	(2,822)	48.0
Reported PAT	**8,366**	**8,185**	**2.2**	**6,309**	**32.6**
EPS	**73.1**	**71.9**	**1.7**	**59.3**	**23.2**

Key Ratios	Q4 FY10	Q3 FY10	chg qoq	Q4 FY09	chg yoy
NIM (%)	**4.4**	**4.3**	**0.1**	**4.2**	**0.2**
Yield on adv (%)*	9.9	10.4	(0.5)	12.5	(2.7)
Yield on inv (%)*	6.6	6.5	0.1	7.4	(0.8)
Yield on funds (%)*	7.9	8.4	(0.5)	9.7	(1.8)
Cost of funds (%)*	4.0	4.6	(0.6)	6.5	(2.5)
CASA (%)	**52.0**	**51.7**	**0.4**	**44.4**	**7.7**
C/D (x)	**75.2**	**77.3**	**(2.11)**	**69.2**	**5.9**
Non-int income (%)	18.2	17.5	0.8	20.8	(2.5)
Cost to Income (%)	**47.9**	**47.2**	**0.7**	**47.1**	**0.9**
Provisions/Income (%)	13.5	14.6	(1.0)	22.2	(8.6)
BV (Rs)	470.1	463.1	7.1	353.7	116.4
RoE (%)	**15.6**	**15.5**	**0.0**	**16.8**	**(1.2)**
RoA (%)	1.6	1.6	-	1.2	0.4
CAR (%)	**17.4**	**18.3**	**(0.9)**	**15.1**	**2.3**
Gross NPA (%)	**1.4**	**1.6**	**(0.2)**	**2.0**	**(0.6)**
Net NPA (%)	0.3	0.5	(0.2)	0.6	(0.3)

*Source: Company, India Infoline Research; * Computed by us*

Strong business growth momentum continues; deposit growth outpace advance growth after four quarters

HDFC bank delivered a strong business growth of 6.9% qoq in Q4 FY10 comprising 5.2% loan growth and 8.2% deposit growth. With an above-trend C/D ratio of 77% in Q3 FY10, bank grew deposits significantly ahead of advances lowering the ratio to 75%. With modest increase in H1 FY10, full-year deposit growth stood at 17% against robust 27% for advances. Investments declined 9% qoq while there was a substantial increase in balance with other banks and money at call. With lower growth in deposits, bank utilized borrowings to fund credit growth in a significant way. Bank targets to grow advances ahead of the system in FY11.

Despite lower C/D ratio, NIM improve by 10bps qoq aided by expansion in spread

In our initiating coverage report on HDFC Bank dated 23rd November 2009, we had highlighted the exemplary NIM management ability of the bank. We had also estimated firm NIM for the bank in H2 FY10. So, Q4 FY10 margin expansion by 10bps qoq despite deteriorating in C/D ratio is not surprising. The NIM expansion was mainly driven by a sharp contraction in cost of funds on marginally higher CASA (30bps qoq) and re-pricing of term deposits. During FY10, HDFC Bank focused on improving CASA % and grew its savings and current deposits by robust 43% and 31% respectively while the term deposits remained flat. Yield on advances continue to decline materially qoq impacted by surplus liquidity and weak (though improving) demand for credit. Bank expects YoA to stabilize in H1 FY11 and increase in H2 FY11 by 50-100 bps. On the other hand, the cost of deposits in expected to start increasing from Q1 FY11 with recent raise in deposits rates by the bank, re-calculation of savings interest on daily basis and 100bps increase in CRR over the past three months. Resultantly, management expects NIM could correct from current 4.4% to 3.9-4.2%.

Non-interest income lowered by G-Sec trading losses; C/I deteriorate marginally on robust branch expansion in FY10

Other income of the bank increased 6% qoq to Rs9.04bn and contributed 18% to the total income. The core fee income was Rs7.65bn representing a healthy 5.7% qoq growth, much in-line with the loan growth during the quarter. The forex/derivates income was substantially higher qoq at Rs1.8bn. The bank suffered a loss of Rs473mn on revaluation/sale of its G-Sec investment portfolio due to increase in bond yields. The operating expenses of the bank grew ahead of the loan growth at 7.4% qoq due to robust branch expansion (313) in FY10. Resultantly, C/I ratio increased 70bps qoq to 47.9%. In our November report, we had mentioned about C/I ratio having bottomed out as there was negligible room for further operational leverage. We expect the ratio to further inch up in forthcoming quarters and stabilize near 51% as the bank plans to add 150+ branches in the current year.

Asset quality continues to improve at fast clip; capital adequacy remains strong

For the third consecutive quarter, GNPLs of the bank declined qoq in absolute terms signifying substantial improvement in asset quality. Over the past three quarters, it has declined by 16% aided by strong recoveries. As a % of gross advances, GNPL came down to 1.4% from 2.1% in Q1 FY10. The restructured assets stood at negligible 0.3% of advances (standard restructured being 0.2%), continuing to be one of the lowest in the industry. With fast improving asset quality, provisioning came down further to annualized 1.4% of average advances. We expect provisioning ratio to decline further in the next couple of quarters to 1.2% aided by strong loan growth and continued improvement in asset quality. Despite marginally lower provisions qoq, the provisioning cover improved to 75% from 72%. NNPL % declined to 0.3% from 0.5% in the previous quarter. Despite continuance of robust loan growth, the CAR remains high at 17.4% (Tier-1 capital at 13.3%) due to capital infusion of ~Rs36bn by the parent HDFC on warrant conversion in Q3 FY10. We reckon that HDFC Bank does not require any further capital in the next 3 years even if its advances were to grow by 25%+ yoy.

Upgrade book value estimates marginally; maintain BUY rating and target price of Rs2,270

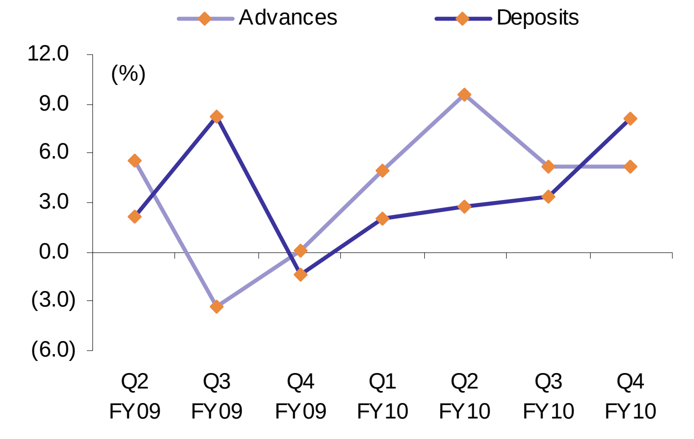
Post the better-than-expected NIM, net profit and asset quality performance by the bank in Q4 FY10, we upgrade FY11 and FY12 book value estimates marginally by 2-3%. We retain BUY recommendation on HDFC Bank and also the target price of Rs2,270 implying valuation of 3.8x FY12 P/BV. In our view, HDFC Bank offers industry-best growth, profitability and asset quality and thereby is the best play in the ensuing credit upcycle.

Financial summary

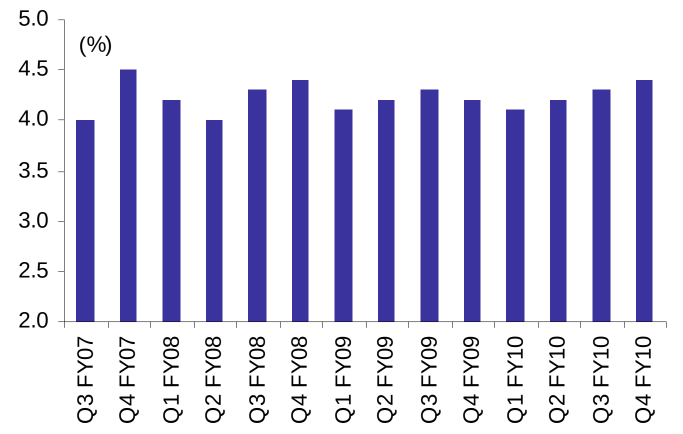
Y/e 31 Mar (Rs m)	FY09	FY10	FY11E	FY12E
Total operating income	107,118	121,942	143,023	178,072
yoy growth (%)	42.6	13.8	17.3	24.5
Operating profit (pre-provisions)	51,790	64,297	69,237	86,578
Net profit	22,449	29,487	33,544	42,554
yoy growth (%)	41.2	31.3	13.8	26.9
EPS (Rs)	52.8	64.4	73.3	93.0
BVPS (Rs)	353.9	470.2	528.3	602.6
P/E (x)	36.8	30.2	26.5	20.9
P/BV (x)	5.5	4.1	3.7	3.2
ROE (%)	16.9	16.1	14.7	16.4
ROA (%)	1.4	1.5	1.4	1.4
Dividend yield (%)	0.5	0.6	0.7	0.8
CAR (%)	15.7	17.4	15.4	13.5

Source: Company, India Infoline Research

Deposits grew ahead of advances after four quarters of underperformance

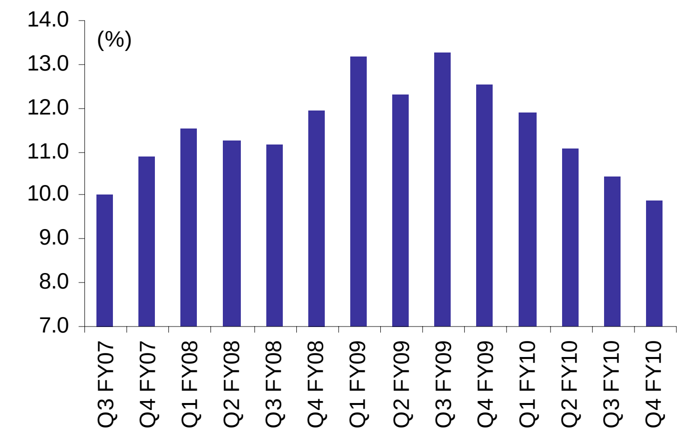


NIM improve despite dip in C/D ratio due to spread expansion

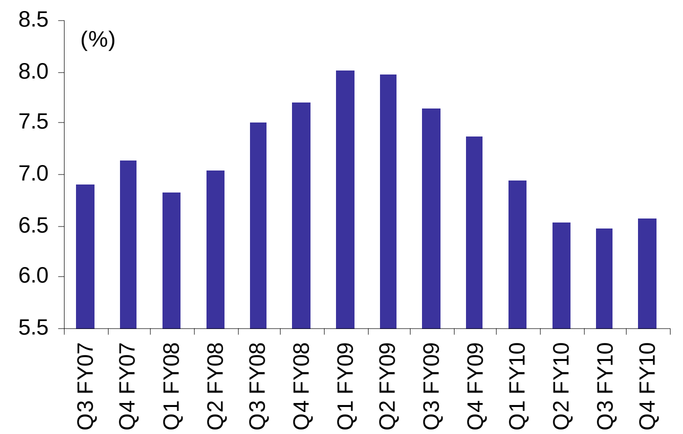


Source: Company, India Infoline Research

YoA* continue to decline impacted by significant liquidity and weak credit demand

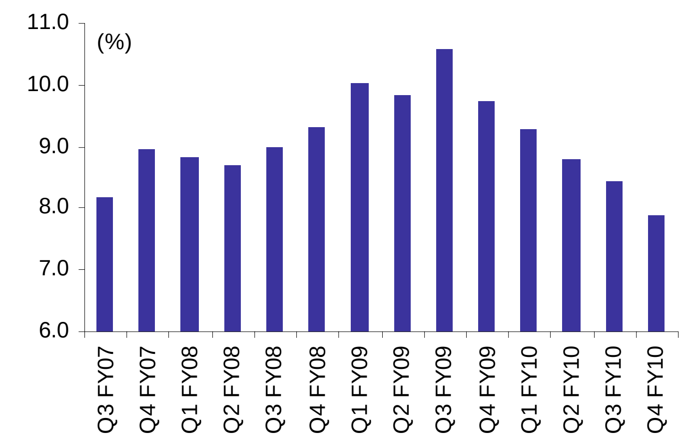


Yield on investments* remain stable qoq aided by higher yields

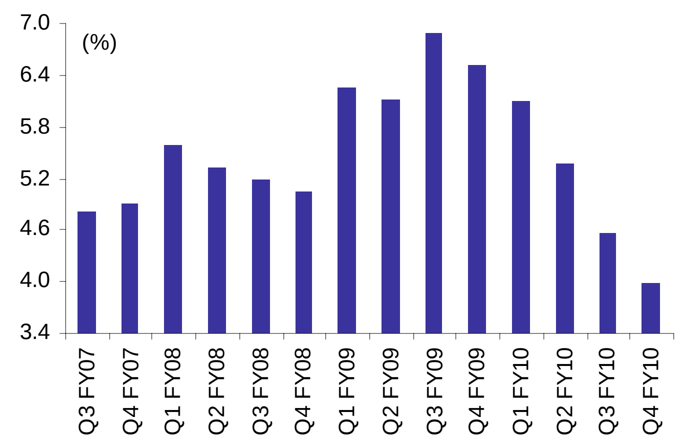


Source: Company, India Infoline Research

Yield on funds* fall due to lower yield on advances

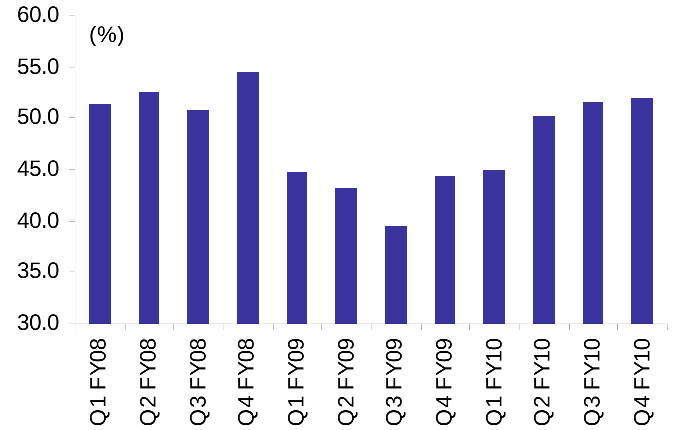


Cost of funds* decline sharply aided by CASA improvement and re-pricing of term deposits

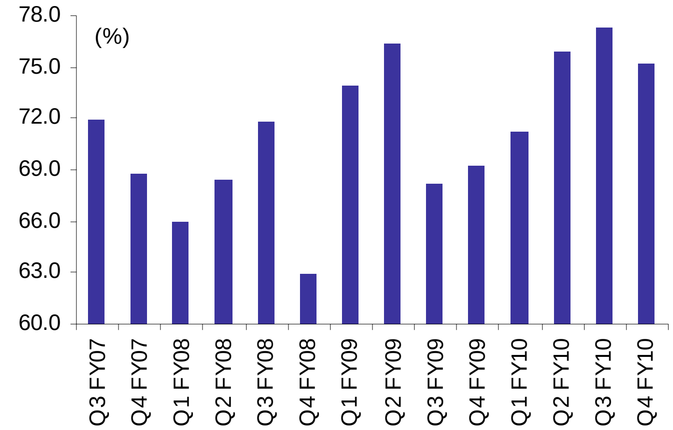


Source: Company, India Infoline Research

CASA improve marginally with robust growth in current deposits

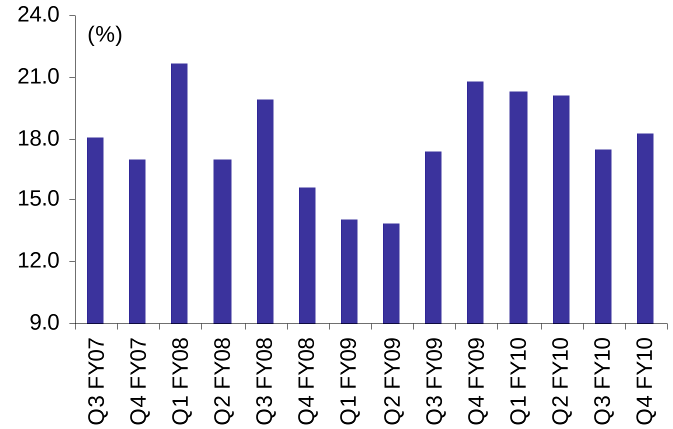


C/D ratio decline on higher growth in deposits

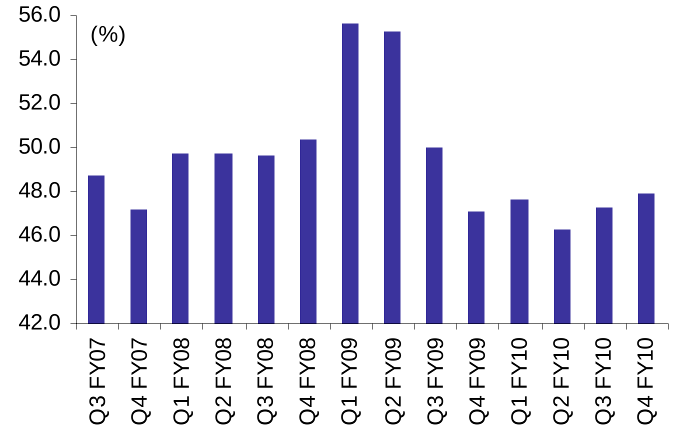


Source: Company, India Infoline Research

Non-int income % depressed by loss on revaluation/sale of G-Sec investments

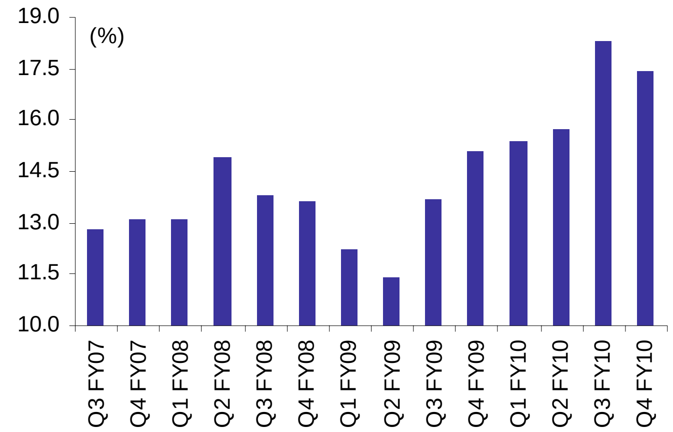


C/I ratio deteriorate on strong branch expansion in the past few quarters

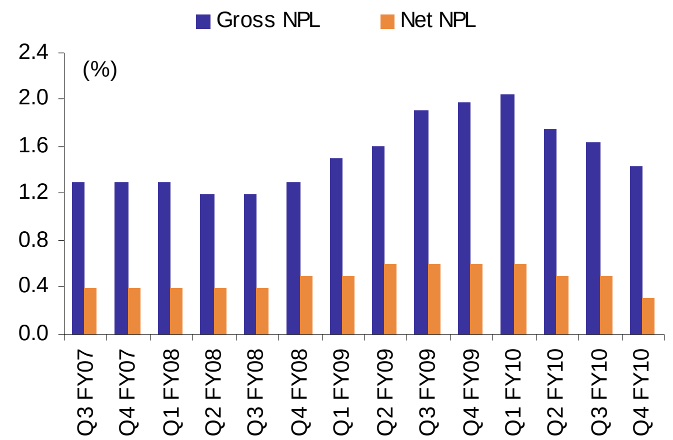


Source: Company, India Infoline Research

Capital adequacy remains robust after the warrant conversion by parent HDFC



Asset quality continues to improve; GNPL decline qoq by 8%



Source: Company, India Infoline Research

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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