



HDFC Bank

BSE SENSEX 18,684
S&P CNX 5,604

Rs2,052

Neutral

Bloomberg HDFCB IN
Equity Shares (m) 462.6
52-Week Range 2,518/1,550
1,6,12 Rel.Perf.(%) -2/-6/14
M.Cap. (Rs b) 949.3
M.Cap. (US\$ b) 20.8

YEAR	NET INCOME	PAT	EPS	EPS	P/E	BV	P/BV	P/ABV	ROAA	ROAE
END	(RS M)	(RS M)	(RS)	GR. (₹)	(X)	(RS)	(X)	(X)	(%)	(%)
3/10A	121,942	29,487	64.4	22.1	31.9	470.3	4.4	4.4	1.5	16.1
3/11E	146,937	39,049	84.4	31.0	24.3	543.1	3.8	3.8	1.6	16.7
3/12E	176,965	50,957	110.2	30.5	18.6	630.0	3.3	3.3	1.7	18.8
3/13E	214,975	63,714	137.7	25.0	14.9	738.7	2.8	2.8	1.7	20.1

* Includes pro forma merged figures for HDFC Bank and CBoP

HDFC Bank's 3QFY11 PAT grew ~33% YoY to Rs10.9b (2% higher than our estimate). Despite higher funding costs, NIM was stable QoQ at 4.2%. CASA ratio remained strong at ~51% (stable QoQ) and high yielding retail loans drove overall loan growth. CASA deposits grew 21% YoY, led by 31% YoY growth in SA deposits. Asset quality improved further, with GNPA declining 3% QoQ. PCR (ex write-offs) improved to 81% v/s 78% in 2QFY11 and restructured loans remained stable QoQ at 30bp of standard loans.

Key highlights

- Loans grew ~1.3% QoQ and ~33% YoY for 3QFY11 to ~Rs1.6t. Few one-off wholesale loans that the bank granted in 1HFY11 were redeemed during the quarter, impacting QoQ loan growth. Excluding these, loans grew ~6% QoQ. Retails loans grew ~10% QoQ, led by growth across segments.
- CASA deposits grew 21% YoY (down 2% QoQ). While SA deposit growth remains strong (up 31% YoY and 3% QoQ), CA deposits declined 8% QoQ and grew just 8% YoY. HDFC Bank had Rs30b of one-off float money as at end-2QFY11; adjusted for this, CA deposits were flat QoQ.
- Credit cost declined to 0.74% v/s 1.17% a quarter ago and 1.5% a year ago. Of the NPA provision of Rs2.9b during the quarter, Rs1b is ad-hoc. The bank also made separate provision of Rs1.7b, of which Rs1.2b is for MFI and Rs0.5b is to take care of contingencies. The bank's total MFI exposure stands at 0.6% of overall loans, of which 1/3rd is towards Andhra Pradesh.

Valuation and view: While key operating parameters would remain superior, valuations at 3.3x FY12E BV and 18.6x FY12E EPS are at premium. We maintain **Neutral** rating and would review once valuations correct from current levels.

QUARTERLY PERFORMANCE

	FY10				FY11				(RS MILLION)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE	FY10	FY11E
Interest Income	40,931	39,919	40,348	40,531	44,202	48,100	52,300	54,610	161,729	199,211
Interest Expense	22,375	20,361	18,109	17,018	20,190	22,837	24,533	26,309	77,863	93,869
Net Interest Income	18,556	19,558	22,239	23,514	24,011	25,263	27,767	28,301	83,866	105,342
% Change (Y-o-Y)	7.7	4.8	12.4	27.0	29.4	29.2	24.9	20.4	13.0	25.6
Other Income	10,796	10,535	8,991	9,036	9,904	9,607	11,278	10,805	38,076	41,595
Net Income	29,351	30,093	31,230	32,549	33,916	34,870	39,045	39,107	121,942	146,937
Operating Expenses	14,165	14,163	14,993	15,605	16,429	16,799	18,318	18,773	57,645	70,318
Operating Profit	15,187	15,930	16,237	16,944	17,487	18,071	20,727	20,334	64,297	76,619
% Change (Y-o-Y)	47.8	41.9	11.4	7.9	15.1	13.4	27.7	20.0	24.2	19.2
Other Provisions	6,588	5,941	4,477	4,399	5,550	4,545	4,659	4,440	21,400	19,194
Profit before Tax	8,598	9,989	11,760	12,545	11,937	13,526	16,068	15,893	42,897	57,425
Tax Provisions	2,537	3,114	3,575	4,178	3,820	4,405	5,190	4,961	13,410	18,376
Net Profit	6,061	6,875	8,185	8,366	8,117	9,121	10,878	10,932	29,487	39,049
% Change (Y-o-Y)	30.5	30.2	31.6	32.6	33.9	32.7	32.9	30.7	31.3	32.4
Interest Exp./Interest Income (%)	54.7	51.0	44.9	42.0	45.7	47.5	46.9	48.2	48.1	47.1
Other Income/Net Income (%)	36.8	35.0	28.8	27.8	29.2	27.6	28.9	27.6	31.2	28.3
Cost/Income Ratio (%)	48.3	47.1	48.0	47.9	48.4	48.2	46.9	48.0	47.3	47.9
Provisions/Operating Profits (%)	43.4	37.3	27.6	26.0	31.7	25.1	22.5	21.8	33.3	25.1
Tax Rate (%)	29.5	31.2	30.4	33.3	32.0	32.6	32.3	31.2	31.3	32.0

E: MOSL Estimates

RESULTS ANALYSIS (RS M) : REPORTED NUMBERS

	3QFY11	3QFY10	YOY GR. %	2QFY11	QOQ GR. %	FY10	FY11E	FY12E
Interest Income	52,300	40,348	30	48,100	9	161,729	199,211	250,087
Interest Expense	24,533	18,109	35	22,837	7	77,863	93,869	126,515
Net Interest Income (NII)	27,767	22,239	25	25,263	10	83,866	105,342	123,572
Other Income	11,278	8,991	25	9,607	17	38,076	41,595	53,393
- Fees and others	9,417	7,713	22	8,605	9	28,523	34,925	42,789
- Treasury Income	-307	-265	16	-521	-41	3,451	-500	2,000
- Forex Income	2,168	1,543	41	1,523	42	6,102	7,170	8,604
Net Income	39,045	31,230	25	34,870	12	121,942	146,937	176,965
Total Operating Costs	18,318	14,993	22	16,799	9	57,645	70,318	82,297
- Staff Costs	7,251	5,786	25	7,106	2	22,892	28,615	34,338
- Other Opex	11,068	9,207	20	9,693	14	34,753	41,704	47,959
Operating Profit	20,727	16,237	28	18,071	15	64,297	76,619	94,669
Provisions	4,659	4,477	4	4,545	3	21,400	19,194	19,732
PBT	16,068	11,760	37	13,526	19	42,897	57,425	74,937
Tax	5,190	3,575	45	4,405	18	13,410	18,376	23,980
Tax Rate %	32.3	30.4		32.6		31.3	32.0	32.0
PAT	10,878	8,185	33	9,121	19	29,487	39,049	50,957
Deposits	1,922,016	1,547,888	24	1,953,209	-2	1,674,044	1,992,113	2,539,944
CASA Ratio %	50.5	51.7		50.6		52.0	50.5	47.3
Loans	1,591,838	1,196,135	33	1,570,906	1	1,258,306	1,635,798	2,044,747
Gross NPA (Rs B)	17.8	19.7	-10	18.4	-3	18.2	17.7	19.9
Gross NPA %	1.1	1.6		1.2		1.4	1.1	1.0
Net NPA (Rs B)	3.3	5.4	-39	4.1	-19	3.9	3.1	3.0
Net NPA %	0.2	0.5		0.3		0.3	0.2	0.1
Yields on Advances %*	10.0	10.4		9.7		10.8	10.4	10.6
Cost of Funds %*	4.7	4.4		4.5		4.7	4.8	5.2
NIM %**	4.2	4.3		4.2		4.7	4.9	4.7
Tier I CAR %	12.1	13.8		12.7		13.3	12.4	11.2
Tier II CAR %	4.2	4.5		4.3		4.1	3.5	2.8
Branches	1,780	1,725		1,765		1,725	1,925	2,125
ATMs	5,121	3,898		4,721		4,232	5,232	6,232

* Calculated, ** Reported basis for quarterly no and calculated for yearly numbers

Overall loan growth moderates QoQ; retail loans grow ~10% QoQ

Overall loan growth moderated QoQ to 1.3%, led by run down in wholesale portfolio. Core loan growth stood at 5.7% QoQ and ~39% YoY. Even on a reported basis, loan growth remained strong at 33%, led by retail loan growth of 36%. For FY11, management is targeting loan growth of 28-30%, implying 4QFY11 growth of less than 3% QoQ. Retail loans grew ~10% QoQ and 36% YoY, and growth was across segments. Growth in auto loans (up 36% YoY and 6% QoQ), CV and CE loans (up 49% YoY and 12% QoQ), and business banking loans (up 41% YoY and 13% QoQ) continues to be strong. Home loans grew 20% QoQ and 42% YoY on a lower base. Home loans now constitute 6.9% of overall portfolio.

Management expects loan growth to remain strong on the back of (1) increased focus on medium / long tenure corporate (especially infrastructure) loans, (2) strong demand for auto loans, (3) selective disbursement in unsecured loans like personal loans and credit cards, (4) strong growth from rural and semi-urban areas for existing products., and (5) continued buy-back of home loans from HDFC Limited to fulfill priority sector targets.

NIM stable QoQ at 4.2%

NIM remained stable QoQ at 4.2% (down 10bp YoY), despite rising cost of funds. Strong traction in CASA deposits and higher proportion of retail loans (56.5% of loans v/s 52.2% a quarter ago) helped the bank to maintain NIM. Management expects to maintain NIM above 4% in 4QFY11 and FY12 as well.

We expect NIM to remain stable/decline marginally from 4.2% on account of (1) strong CASA ratio, a boon in a rising interest rate scenario, and (2) improved asset yields. CD ratio remains elevated at 80%+ on account of higher capitalization and float money related accounting treatment under other liabilities. Management mentioned adjusted CD ratio to be at 76-77%.

Strong performance on CASA deposits

Deposits grew 24% YoY and declined 1.6% QoQ to Rs1.95t. Savings deposits reported robust growth of 31% YoY and 3% QoQ, whereas CA deposits moderated with ~8% QoQ decline and 8% YoY increase. On a YoY basis, CASA deposits grew 21% (down 2% QoQ). At end-2QFY11, the bank had one-off float money of Rs30b, adjusted for which CA deposits were flat QoQ. Performance on CASA front is impressive, considering rising cost of deposits. Despite a rising rate environment, the management expects to maintain CASA ratio at 48%+ v/s 50% as at 3QFY11.

Fee income growth picks up QoQ; core C/I ratio improves

Other income grew 17% QoQ and 25% YoY to Rs11.3b on account strong growth in fee income and higher forex income. Fee income growth was strong at 9% QoQ and 22% YoY to Rs9.4b. On a lower base, forex income grew 40%+ QoQ and YoY to Rs2.2b (partially helped by higher trading profits in 3QFY11). The bank booked loss on sale of investment of Rs307m in 3QFY11 v/s trading loss of Rs521m in 2QFY11 and Rs265m in 3QFY10. Management expects fee income to grow ~18% in FY11. Cost to core income ratio improved to 49.3% v/s 50.1% in 3QFY10 as a result of cost efficiency. Operating expenses grew 9% QoQ and 22% YoY to Rs18.3b.

Asset quality remains among the best in the industry

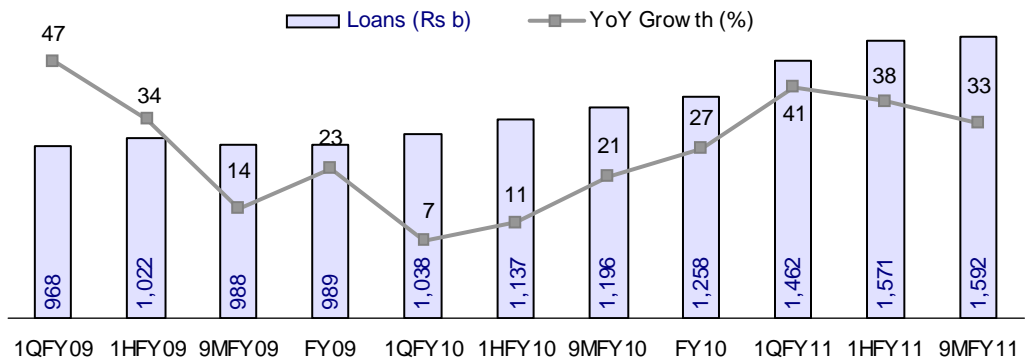
GNPA declined 3% QoQ to Rs17.8b (1.11% v/s 1.16% a quarter ago and 1.63% a year ago). NNPA declined 19% QoQ to Rs3.3b (0.2% v/s 0.3% in 2QFY11 and 0.45% in 3QFY10). Provision coverage ratio improved further to ~81% (v/s 78% a quarter ago and 72% a year ago). Lower pressure on margins and a sharp decline in credit cost will lead to a sharp improvement in risk-adjusted margins.

Valuation and view

HDFC Bank is best placed in the current environment, with (1) CASA ratio of ~50%, (2) strong growth outlook of 25-30%, (3) improving operating efficiency, and (4) lower credit costs, led by best-in-class asset quality. In our view, EPS growth will be ~29% CAGR over FY10-13 against 25% delivered over FY05-10. While we remain positive on the bank's business, we believe valuations are rich. Over FY05-10, peak one-year forward P/BV was 5x and average P/BV was 3.3x. While key operating parameters would remain superior, valuations at 3.3x FY12E BV and 18.6x FY12E EPS are at premium. We maintain our **Neutral** rating and would review this once valuations correct from current levels.

Trend in loan growth

Adjusted loan growth stood at 5.7% QoQ and ~39% YoY. For FY11, management is targeting loan growth of 28-30%, implying 4QFY11 growth of less than 3% QoQ



Source: Company/MOSL

Loan break-up (Rs b)

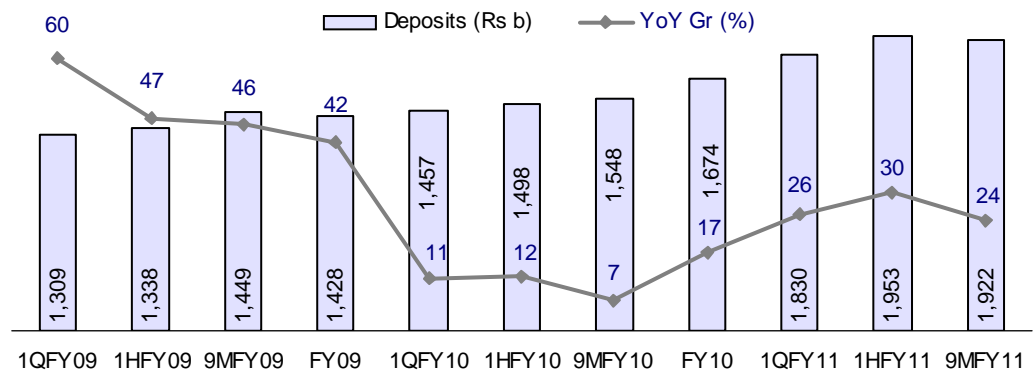
Strong loan growth across retail loan segments

	1QFY10	1HFY10	9MFY10	FY10	1QFY11	1HFY11	9MFY11
Auto Loans	161	171	181	196	214	232	246
CVs	77	80	84	94	100	112	125
2Ws	18	18	17	18	19	20	22
Personal Loans	85	84	85	88	90	95	100
Credit Cards	38	38	38	38	39	42	46
LAS	7	8	8	9	10	11	12
Business Banking	122	123	127	139	144	158	179
Home loans	62	64	77	87	95	91	110
Others	42	43	43	51	49	61	62

Source: Company/MOSL

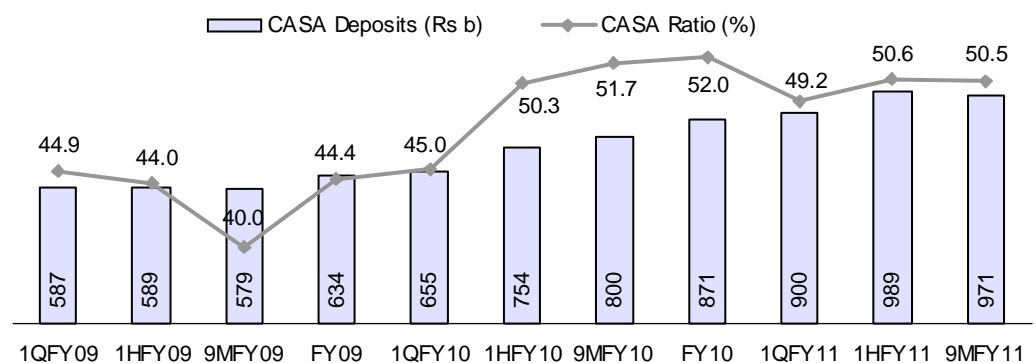
Deposit growth (%)

Deposit growth moderates QoQ



CASA trend

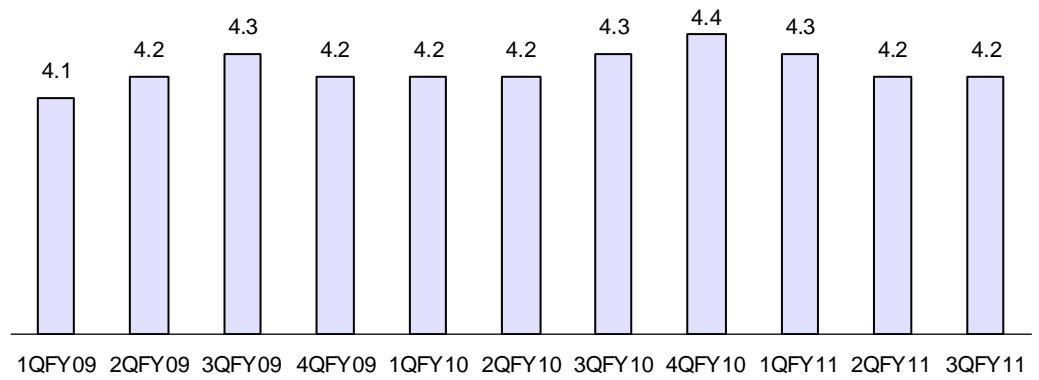
CASA deposits grew 21% YoY (down 2% QoQ). At end-2QFY11, the bank had one-off float money of Rs30b; adjusted for this, CA deposits were flat QoQ.



Source: Company/MOSL

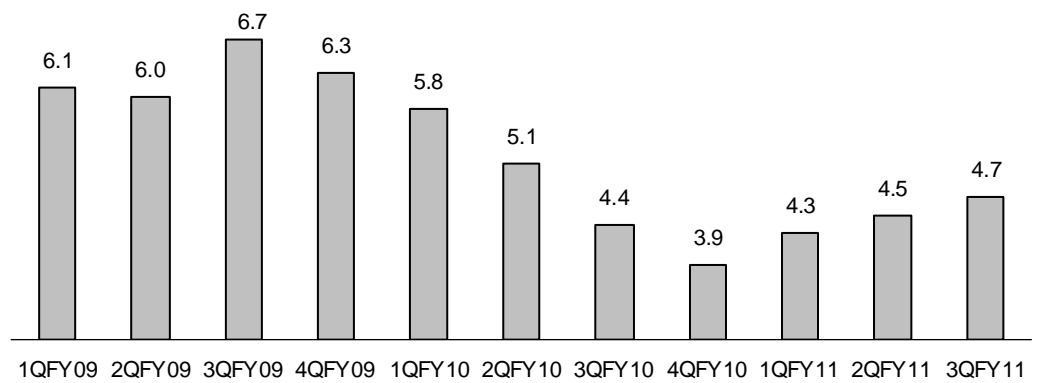
Margin trend (reported, %)

Despite higher cost of funds, NIM was stable at 4.2% due to strong traction in CASA and higher proportion of retail loans.



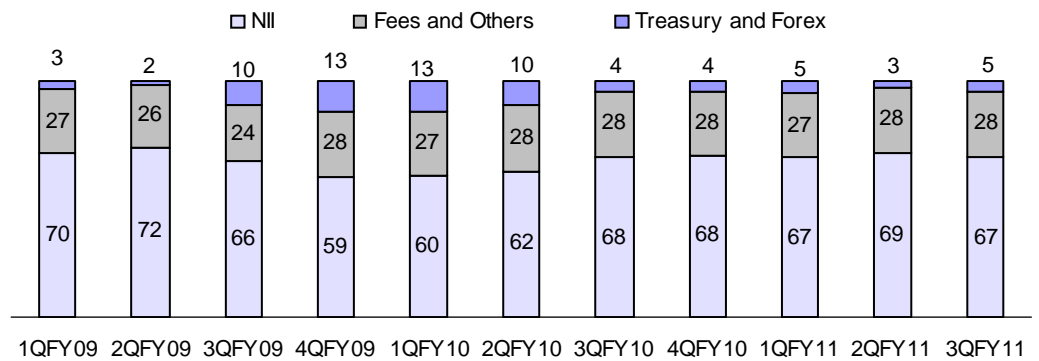
Trend in cost of funds (calculated, %)

Increase in bulk deposit rates and retail term deposit rates leads to rise in cost of funds.

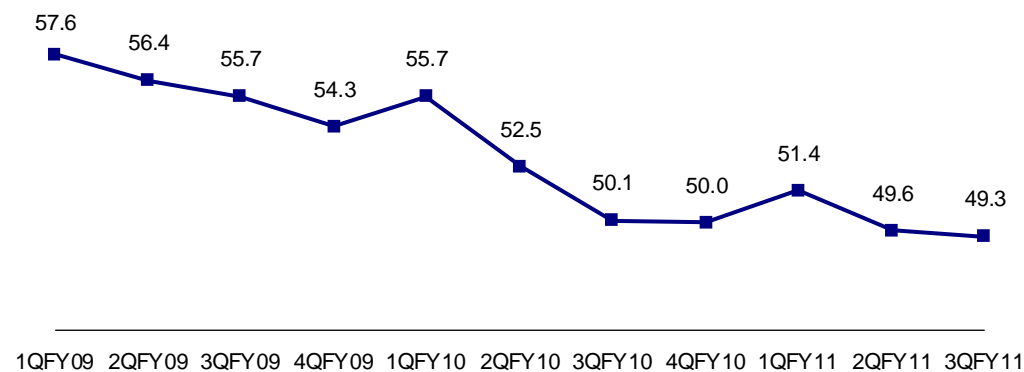


Break-up of income (%)

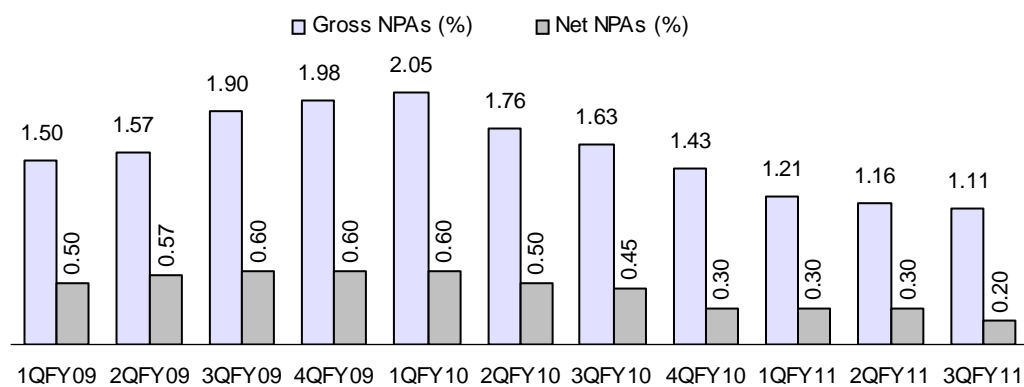
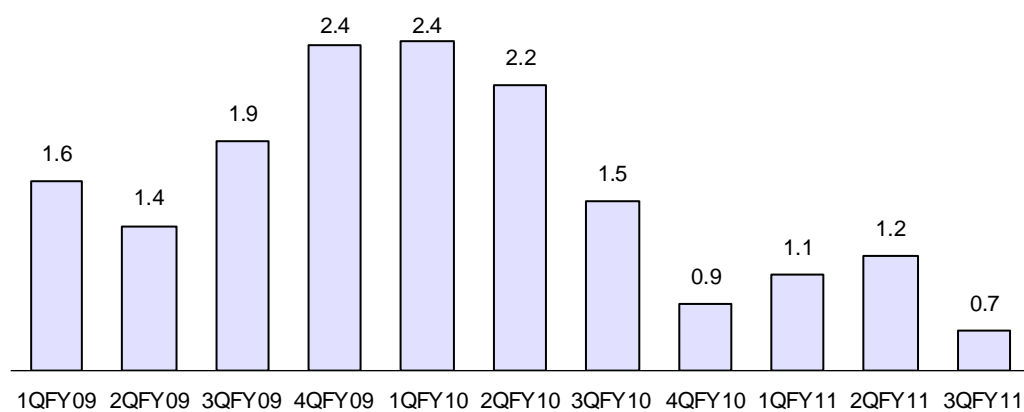
Strong growth in forex income



Core cost to income ratio improves (%)



Source: Company/MOSL

NPA trend (%)**Trend in credit cost (%)**

Source: Company/MOSL

HDFC Bank: an investment profile

Company background

HDFC Bank, incorporated in 1994 by HDFC Limited, is the second largest private sector bank in India, with a balance sheet size of ~Rs2.5t. Rated as one of the best banks in India, it has 1,780 branches. It has been consistently growing its earnings at over 30% over several quarters.

Key investment arguments

- Strong focus on retail loans (56% of loans) and high proportion of CASA deposits (50% of total deposits) enable superior margins of over 4%.
- Gross NPAs at 1.1% and net NPAs at 0.2%, with restructured standard loans of just ~10bp, are among the lowest in the industry, indicating superior risk management skills.
- After the rundown of the CBOP book and with a lower proportion of unsecured retail loans, credit costs are expected to come off sharply in FY11.
- Core operating profitability is improving at a faster pace, with strong loan growth, stable margins and improving operating leverage.

Key risks

- Sustaining current business parameters with increase competitive pressures is a key risk.

Recent developments

- The bank has raised the base rate from 7.5% to 7.75%.

Valuation and view

- While we remain positive on the bank's business, we believe valuations are rich. Over FY05-10, peak one-year forward P/BV was 5x and average P/BV was 3.3x.
- While key operating parameters would remain superior, valuations at 3.3x FY12E BV and 18.6x FY12E EPS are at premium. We maintain our **Neutral** rating and would review this once valuations correct from current levels.

Sector view

- Loan growth remains strong. However, rising inflation and increasing interest rates are the near-term headwinds for the sector.
- Our economist expects current tightness in liquidity to start easing in 4QFY11, allaying the pressure of significant NIM compression.
- We believe that margins would start compressing, but gradually. With strong loan growth and high CD ratio, there is strong pricing power with banks.
- Banks with high CASA deposits and lower proportion of bulk deposits will be preferred bets.

Comparative valuations

		HDFC BK	Axis BK	ICICI BK*
P/E (x)	FY11E	24.3	16.0	17.8
	FY12E	18.6	13.3	13.6
P/BV (x)	FY11E	3.8	2.8	2.2
	FY12E	3.3	2.4	1.9
RoE (%)	FY11E	16.7	18.9	12.0
	FY12E	18.8	19.5	14.1
RoA (%)	FY11E	1.6	1.6	1.3
	FY12E	1.7	1.6	1.5

* Price adjusted for value of key ventures and BV adjusted for investments in those key ventures

Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	23.4	23.5	23.9
Domestic Inst	10.9	10.2	11.2
Foreign	48.1	48.5	46.4
Others	17.7	17.8	18.5

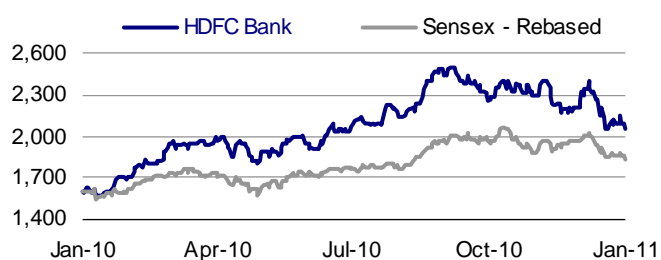
EPS: MOSL forecast v/s Consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	84.4	84.3	0.1
FY12	110.2	109.4	0.7

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
2,052	-	-	Neutral

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT (PRO FORMA MERGED WITH CBoP)				(RS MILLION)		
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Interest Income	123,000	163,323	161,729	199,211	250,087	316,119
Interest Expense	63,791	89,111	77,863	93,869	126,515	166,143
Net Interest Income	59,209	74,212	83,866	105,342	123,572	149,976
<i>Change (%)</i>		25.3	13.0	25.6	17.3	21.4
Non Interest Income	29,195	32,906	38,076	41,595	53,393	64,999
Net Income	88,403	107,118	121,942	146,937	176,965	214,975
<i>Change (%)</i>		21.2	13.8	20.5	20.4	21.5
Operating Expenses	47,226	55,328	57,645	70,318	82,297	96,358
Pre Provision Profits	41,177	51,790	64,297	76,619	94,669	118,617
<i>Change (%)</i>		25.8	24.2	19.2	23.6	25.3
Provisions (excl tax)	16,043	18,791	21,400	19,194	19,732	24,920
PBT	25,134	32,999	42,897	57,425	74,937	93,696
Tax	7,604	10,549	13,410	18,376	23,980	29,983
<i>Tax Rate (%)</i>	30.3	32.0	31.3	32.0	32.0	32.0
PAT	17,530	22,449	29,487	39,049	50,957	63,714
<i>Change (%)</i>		28.1	31.3	32.4	30.5	25.0
Equity Dividend (Incl tax)	3,606	4,254	5,493	7,029	9,172	11,468
Core PPP*	37,989	47,964	60,847	77,119	92,669	116,367
<i>Change (%)</i>		26.3	26.9	26.7	20.2	25.6

*Core PPP is (Nil+Fee income-Opex)

BALANCE SHEET				(RS MILLION)		
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Equity Share Capital	4,243	4,254	4,577	4,626	4,626	4,626
Reserves & Surplus	133,649	146,328	210,677	246,592	286,818	337,114
Net Worth	137,892	150,582	215,254	251,218	291,444	341,740
Deposits	1,225,776	1,428,116	1,674,044	1,992,113	2,539,944	3,238,428
<i>Change (%)</i>		16.5	17.2	19.0	27.5	27.5
of which CASA Dep	601,478	633,597	871,039	1,005,038	1,202,553	1,473,127
<i>Change (%)</i>	36.9	5.3	37.5	15.4	19.7	22.5
Borrowings	126,536	154,414	190,688	208,813	229,563	249,097
Other Liabilities & Prov.	146,480	162,428	206,159	226,015	270,106	323,292
Total Liabilities	1,604,193	1,832,708	2,224,586	2,614,128	3,264,527	4,083,527
Current Assets	175,802	175,066	299,424	240,190	331,206	437,843
Investments	563,385	588,175	586,076	644,684	773,620	947,685
<i>Change (%)</i>		4.4	-0.4	10.0	20.0	22.5
Loans	796,089	988,831	1,258,306	1,635,798	2,044,747	2,555,934
<i>Change (%)</i>		24.2	27.3	30.0	25.0	25.0
Fixed Assets	15,462	17,067	21,228	21,995	22,053	21,294
Other Assets	53,455	63,568	59,551	71,462	92,900	120,770
Total Assets	1,604,193	1,832,708	2,224,586	2,614,128	3,264,527	4,083,527

ASSET QUALITY				(%)		
GNPA (Rs M)	9,070	19,881	18,168	17,654	19,878	24,048
NNPA (Rs M)	2,985	6,276	3,921	3,089	2,982	3,607
GNPA Ratio	1.13	1.98	1.43	1.07	0.96	0.93
NNPA Ratio	0.37	0.63	0.31	0.19	0.15	0.14
PCR (Excl Tech. write off)	67.1	68.4	78.4	82.5	85.0	85.0

E: MOSL Estimates

Financials and Valuation

RATIOS

Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Spreads Analysis (%)						
Avg. Yield-Earning Assets	10.4	10.9	9.0	9.2	9.5	9.6
Avg. Yield on loans	12.6	13.6	10.8	10.4	10.6	10.9
Avg. Yield on Investments	7.1	7.0	6.8	7.6	7.5	7.5
Avg. Cost-Int. Bear. Liab.	5.7	6.3	4.7	4.8	5.2	5.4
Avg. Cost of Deposits	5.6	6.0	4.5	4.6	5.0	5.2
Interest Spread	4.7	4.6	4.3	4.4	4.3	4.2
Net Interest Margin	5.0	4.9	4.7	4.9	4.7	4.6
Profitability Ratios (%)						
RoE	16.2	15.6	16.1	16.7	18.8	20.1
RoA	1.3	1.3	1.5	1.6	1.7	1.7
Int. Expense/Int.Income	51.9	54.6	48.1	47.1	50.6	52.6
Fee Income/Net Income	29.4	27.1	28.4	28.6	29.0	29.2
Non Int. Inc./Net Income	33.0	30.7	31.2	28.3	30.2	30.2
Efficiency Ratios (%)						
Cost/Income*	57.8	56.9	51.3	50.1	49.5	47.6
Empl. Cost/Op. Exps.	34.3	40.5	39.7	40.7	41.7	42.8
Busi. per Empl. (Rs m)	47.2	45.0	51.2	59.6	66.7	75.2
NP per Empl. (Rs lac)	0.5	0.5	0.6	0.7	0.8	0.9
* ex treasury						
Asset-Liability Profile (%)						
Loans/Deposit Ratio	64.9	69.2	75.2	82.1	80.5	78.9
CASA Ratio	49.1	44.4	52.0	50.5	47.3	45.5
Investment/Deposit Ratio	46.0	41.2	35.0	32.4	30.5	29.3
G-Sec/Investment Ratio	66.1	88.7	87.1	86.5	85.4	85.4
CAR	13.6	15.8	17.4	16.0	14.0	12.4
<i>Tier 1</i>	<i>10.3</i>	<i>10.6</i>	<i>13.3</i>	<i>12.4</i>	<i>11.2</i>	<i>10.2</i>
VALUATION						
Book Value (Rs)	325.0	354.0	470.3	543.1	630.0	738.7
<i>Change (%)</i>	<i>55.5</i>	<i>8.9</i>	<i>32.8</i>	<i>15.5</i>	<i>16.0</i>	<i>17.3</i>
Price-BV (x)	6.3	5.8	4.4	3.8	3.3	2.8
Adjusted BV (Rs)	320.4	344.3	464.6	538.7	625.8	733.7
Price-ABV (x)	6.4	6.0	4.4	3.8	3.3	2.8
EPS (Rs)	41.3	52.8	64.4	84.4	110.2	137.7
<i>Change (%)</i>	<i>22.1</i>	<i>27.7</i>	<i>22.1</i>	<i>31.0</i>	<i>30.5</i>	<i>25.0</i>
Price-Earnings (x)	49.7	38.9	31.9	24.3	18.6	14.9
Dividend Per Share (Rs)	8.5	10.0	12.0	15.2	19.8	24.8
Dividend Yield (%)	0.4	0.5	0.6	0.7	1.0	1.2
<i>E: MOSL Estimates</i>						



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HDFC Bank

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