

October 17, 2008

## BUY

Price	Target Price
<b>Rs1,087</b>	<b>Rs1,340</b>
<b>Sensex</b>	<b>10,581</b>

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(12)	20	(22)	(26)
Rel. to Sensex	13	43	21	32

Source: Capitaline

### Stock Details

Sector	Banks
Reuters	HDBK.BO
Bloomberg	HDFCB@IN
Equity Capital (Rs mn)	4250
Face Value	10
No. of shares (mn)	425
52 Week H/L	1825/890
Market Cap	Rs462bn/USD9.5bn
Daily Avg Volume (No of shares)	2.1mn
Daily Avg Turnover (US\$)	52.6mn

### Shareholding Pattern (%)

	S'08	J'08	M'07
Promoters	19.4	19.4	23.3
FII/NRI	49.2	50.9	49.3
Institutions	9.5	5.6	5.8
Private Corp	10.4	10.0	8.9
Public	11.6	14.1	12.8

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# HDFC Bank

## Shadow over near term earnings

Result  
Update

HDFC Bank's has reported net profit of Rs5.3bn for Q2FY09, inline with our expectations. The NII (on like to like basis – including CBOP numbers) has grown by 40.0% yoy driven by healthy asset growth. The fee income has grown by 49.9% yoy during the quarter. The operating profit has grown by 21.8% yoy to Rs11.2bn and net profit by 29.3% yoy to Rs5.3bn.

Even after such performance, we see some concerns to earnings on account of deteriorating CASA profile, high Opex ratio and higher provisioning requirement. Despite a very moderate growth in deposits, the CASA profile has declined (though marginally). The Opex/assets ratio continued to remain steep at 3.3%. Assets have seen some more slippages with gross NPAs during the quarter at Rs16.8bn (Rs15.0bn Q1FY09, Rs7.7bn Q2FY08). The provision cover has also slipped to 65.2% compared with 68% in Q2FY08 and 67.0% in Q1FY09.

We downgrade our EPS estimates for FY10 by 9.3% to take into account the above factors. At the current market price, the stock is quoting at 16.0x FY10E EPS and 2.3x FY10E ABV. With near term concerns on earnings we have downgraded our target P/ABV multiple from 3.1x to 2.8x. We maintain our BUY recommendation on the stock with a price target of Rs1,340.

### NII grows by 40% on like to like basis

HDFC Bank's NII grew by 40.0% yoy to Rs18.7bn on like to like basis driven by 18.4% growth (like to like basis) in the total assets. The NIMs were at 4.4% (calculated) compared with 4.0% in Q2FY08 and 4.6% in Q1FY09.

### Income statement on like to like basis

Rs mn	Q2FY09	Q2FY08	Q1FY09	% yoy change	%qoq change
Net interest income	18,664	13,331	17,235	40.0	8.3
Other Income	6,431	6,393	5,934	0.6	8.4
Net Income	25,095	19,729	23,169	27.2	8.3
Operating Expenses	13,867	10,505	12,894	32.0	7.5
Operating profit	11,228	9,218	10,275	21.8	9.3
Provisions	3,460	3,216	3,445	7.6	0.5
Profit before tax	7,768	6,003	6,830	29.4	13.7
Provision for Taxes	2,488	1,920	2,187	29.6	13.8
Net Profit	5,280	4,084	4,644	29.3	13.7

Source: Companies, Emkay Research

Note: We have combined Centurion Bank of Punjab's and HDFC Bank's Q2FY08 numbers to arrive at like to like figures

### Yield analysis

(%)	Q1FY09	Q1FY08	Q4FY08	Change in bps yoy	Change in bps qoq
Yield on advances	12.3	11.3	13.2	102.5	-86.0
Yield on investments	7.9	7.0	8.0	90.0	-2.5
Yield on assets	9.4	8.3	9.6	106.3	-22.0
Cost of funds	5.0	4.2	5.0	76.9	-3.8
NIM	4.4	4.1	4.6	29.4	-18.2

Source: Company, Emkay Research \* Calculated on basis of average quarterly balances

### Advances growth remains healthy.....

The bank registered a 64.1%yoy growth in the overall advances driven by a strong growth in retail as well as corporate advances. Adjusted for merger impact the advances growth was ~34% yoy.

The growth in the retail assets was primarily led by business banking loans, Credit cards and commercial vehicles.

#### Retail loan portfolio mix

	Rs mn	% yoy chg	% qoq chg	Proportion (%)	Change in bps	
					yoy	qoq
Auto Loans	135,000	37.8	19.5	23.1	-212	255
Personal Loans	82,000	43.9	-2.4	14.0	122	-125
CVs	89,500	70.5	11.9	15.3	22	77
Loan Against Securities	10,000	-13.0	-7.4	1.7	28	-25
2-Wheelers	22,400	31.8	-10.4	3.8	115	-71
Business Banking	127,500	88.9	-6.9	21.8	-18	-310
Credit Cards	39,000	66.0	11.4	6.7	9	31
Others	78,600	320.8	21.5	13.5	-65	168
<b>Total</b>	<b>584,000</b>	<b>68.9</b>	<b>6.3</b>			

Source: Company, Emkay Research

#### CASA falls despite sedate deposit growth – albeit marginally

On sequential basis, the deposits have grown at a very moderate pace of 2.2% as the bank redeemed excess investment book to grow advances book. However, even such moderate growth in deposits was achieved mainly on back of term deposits. The lower CASA float was mainly on account of fall in current account deposits. The management has attributed the fall to lower float from capital market operations as the volumes have fallen significantly.

#### Deposit mix

Rs bn	Q2FY09	Q2FY08	Q1FY09	% yoy chg	% qoq chg
Total Deposits	1,338	911	1,309	46.9	2.2
Savings	328	224	319	46.6	3.0
Current	261	255	269	2.6	-2.8
Total CASA	589	478	587	23.2	0.3
CASA (%)	44.0	52.5	44.9	-848bps	-81bps
Term deposits	748.6	432.4	722.0	73.1	3.7

Source: Company, Emkay Research

#### Reported fee income grows strong – flat on like to like basis

The fee income grew by a healthy 33.3% to Rs5.9bn. The income from Forex and derivative segment has seen sharp sequential fall driven by trading losses in the proprietary trading book. However, on yoy basis, the bank has still been able to report a growth of 61.2% in the business.

However, on like to like basis, the other income has remained flat as it has grown by just 0.6% yoy. We find this inexplicable.

#### Fee income

Rs mn	Q2FY09	Q2FY08	Q1FY09	% yoy chg	% qoq chg
Fee income	5,873	3,919	5,112	49.9	14.9
Treasury	-156	462	-776	-133.8	-79.9
Other	714	443	1,598	61.2	-55.3
<b>Total</b>	<b>6,431</b>	<b>4,824</b>	<b>5,934</b>	<b>33.3</b>	<b>8.4</b>

Source: Company, Emkay Research

#### Opex continues to remain high

During the quarter, the operating expenses have grown by 32% yoy to Rs13.9bn primarily driven by higher employee expenditure. The employee expenditure increased by 56.1% to Rs6.1bn. As a result the Opex/assets ratio remained high at 3.3%.

## Asset quality witnesses weakness – provision cover declines

The bank witnessed Rs1.7bn worth of incremental slippages during the quarter. Moreover, the provision cover has also slipped to 65.1% compared with 68.3% in Q2FY08 and 67.0% in Q1FY09. The management has guided that the most part of the slippages is from CBOP's retail and SME portfolio. However, the overall asset quality remained healthy with gross NPAs at 1.6% and net NPAs at 0.3% for the quarter.

### Asset quality

Rs mn	Q2FY09	Q2FY08	Q1FY09	% yoy chg	% qoq chg
Gross NPA	1,676	768	1,503	118	12
% of gross advances	1.6	1.2	1.5		
Net NPA	584	244	496	140	18
% of net advances	0.3	0.4	0.5		
Provision cover (%)	65.1	68.3	67.0	-313	-184

Source: Company, Emkay Research

## Some risks to near-term earnings

We believe that there are some risks to near term earnings on three counts:

- Even as the redemption of investments helped the bank to raise resource during the quarter, the term deposits still grew by 75% yoy and 3.7% qoq. In coming quarter, the growth in advances will be difficult to achieve without raising more of term deposits which will entail higher funding cost
- The cost/asset ratio for the bank has not come down. As compared to an average 2.8% between September 2005 and September 2007, the ratio has shot upto 3.3% on account of CBOP merger and as bank continues to invest in branch network. Higher cost/asset ratio has eaten up 30-32bps from RoA. We believe that the ratio will continue to remain high for at least next two quarters
- Although the bank has been able to contain provisioning for the quarter due some write backs, going forward the provisioning requirement may go up to prop up provision coverage

## Promoter warrants likely support capital adequacy

The bank had Capital adequacy of 11.4% and tier I CAR at 8.8% at the end of Q2FY09 down from 12.2% and 9.3% as at the end of Q1FY09. We believe that the current capital adequacy ratio will suffice for growth over next 2-3 quarters. The warrants issued to promoters (Rs39bn) are due from conversion in Q3FY10 which will prop up tier I capital adequacy. However, key risk here is that the warrant conversion price of Rs1520 is ~40% higher than the current market price.

## Valuations and view

We have downgraded our EPS estimates for FY10 by 9.3% to take into account the above factors. At the current valuations, the stock is quoting at 16.0x FY10E EPS and 2.3x FY10E ABV. With near term concerns on earnings we have downgraded P/ABV multiple from 3.1x to 2.8x. We maintain our BUY recommendation on the stock with a price target of Rs1,340.

Rs per share	Old estimate	New estimate	% change
EPS			
FY10	70.1	63.7	-9.1
ABV			
FY10	490.3	470.6	-4.0

## Quarterly results (reported numbers)

Rs mn	H1FY09	H1FY08	% yoy chg	Q2FY09	Q2FY08	Q1FY09	% yoy chg	% qoq chg
Net interest income	35,899	21,482	67.1	18,664	11,627	17,235	60.5	8.3
Other Income	12,365	10,549	17.2	6,431	4,824	5,934	33.3	8.4
<i>Fee income</i>	13,297	9,561	39.1	6,587	4,362	6,710	51.0	-1.8
<i>Other</i>	-932	988	NA	-156	462	-776	NA	NA
Net Income	48,264	32,031	50.7	25,095	16,451	23,169	52.5	8.3
Operating Expenses	26,761	15,928	68.0	13,867	8,184	12,894	69.4	7.5
Operating Profit	21,503	16,104	33.5	11,228	8,267	10,275	35.8	9.3
Provisions & Contingencies	6,905	5,965	15.8	3,460	2,894	3,445	19.6	0.5
<i>Loan loss provision</i>	6,617	5,130	29.0	3,373	2,732	3,244	23.5	4.0
Profit before tax	14,598	10,139	44.0	7,768	5,373	6,830	44.6	13.7
Provision for Taxes	4,675	3,241	44.2	2,488	1,688	2,187	47.4	13.8
Net Profit	9,923	6,897	43.9	5,280	3,685	4,644	43.3	13.7

## Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2007	52,258	11,419	35.8	185.1	1.4	19.5	40.9	5.8
FY2008E	75,110	15,902	44.9	306.0	1.4	17.7	29.4	3.5
FY2009E	107,809	21,633	50.0	337.6	1.4	15.9	21.6	3.2
FY2010E	135,673	29,166	63.6	467.6	1.4	15.4	16.0	2.3

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