

HDFC Bank

₹ 2,316

Impressive operating performance

BUY

The net profit for the quarter as well for the whole fiscal grew by 33% y-o-y to ₹ 1,115 crore and ₹ 3,927 crore respectively, in line with our expectations, while core profit grew by ~20% y-o-y. On sequential basis, earnings grew by 2.5% on the back of strong loan growth of 27% and resilient margin of 4.2%. Opex increased by 25% primarily on account of network expansion whereas LLP (incl. floating provisions) increased by 2.3% y-o-y to ₹ 330 crore. The strong liability franchise (CASA improved by 219bps q-o-q to 52.7%) helped the bank maintain its track record of superior margin. Non-interest income zoomed by 32% y-o-y and 11% q-o-q to ₹ 1,256 thanks to healthy traction in core fee income. Asset quality further improved as gross NPA declined 5bps sequentially, coverage ratio improved by 150bps q-o-q to 82.5%. The board has approved stock split of 1: 5 to buttress up retail investors participation.

NII growth moderation q-o-q: Net interest income moderated to 20.8% y-o-y due to muted loan growth and marginal decline in net interest margins during the quarter. Net interest margin dipped 7bps q-o-q due to moderation in CD ratio and rising cost of fund. However, On sequential basis, Cost of funds went up 14bps against yield on advances up 49bps. The bank has hiked base rate by 95bps and 75 bps BPLR during the quarter, We believe that net interest margins are likely to remain at healthy level of 4% plus going forward.

Core fee income & forex profit key drivers for non interest income - Non- interest income accelerated 31.2% y-o-y and 11.3% q-o-q to ₹ 1,256 crore against ₹ 951 crore a year ago. Strong fee income and healthy forex profits continue to drive non-interest income contributing ~31% of operating income. Fee income grew 30.7% y-o-y and 6.1% q-o-q driven by retail and corporate segment. We expect fee income to grow at 19.5% CAGR over FY11-13e.

Investment in network expansion led OPEX grow 24% y-o-y- The other operating expenses increased by 25% y-o-y to ₹ 1,265 crore as the bank continued to invest in network expansion. It added 206 new branches and 350 new ATMs during the quarter. The increase in employee cost was flat q-o-q though it grew 23% y-o-y to ₹ 733 crore. Further, the cost to income ratio remained flat at 48.8% y-o-y but increased by 190bps on sequential basis due aggressive network expansion strategy.

Headline Asset Quality held well- Asset quality continued to improve further as gross NPA declined by 6.7% y-o-y and 4.9% q-o-q basis to ₹ 1,694 crore which is equivalent to 1.05% of gross advances. The loan loss provision inched up by 2.3% y-o-y to ₹ 330 crore primarily because of higher floating provision of ₹ 230 crore made during the quarter; however, total provisioning declined by 7.4% q-o-q. We believe improving macro environment and corporate earnings will continue to remain at healthy levels going forward.

Healthy capital adequacy and superior return ratio -Capital adequacy stood at 16.2% against 17.4% a year ago while tier I stood at 12.2%. The bank reported annualized RoA of 1.6% in Q4FY11 as well as in FY11.

Valuation & Recommendation

HDFC Bank has performed well on most of the operating parameters during the quarter. Retail business saw strong momentum driven by commercial vehicle and auto loans. We believe superior margins, healthy fee income profile, improving branch productivity are key value drivers for the bank. We expect net earnings to grow at 26.6% CAGR over FY11-13e, supported by NII growth and fee income progression. At ₹ 2316 the stock is trading at 3.9x FY12 book and 20.9x FY12 earnings. We expect RoA and RoE remain at 1.7% and 19.1% in FY12. We believe HDFC bank continues to outpace industry growth in medium driven by branch expansion and sharper strategic focus on quality earning growth in medium term. We have increased our target price to ₹ 2,670 factoring quality earning growth visibility in medium term. Hence we maintain our BUY rating on the stock with a target price of ₹ 2,670 (Potential upside 15.3%).

Key Financials

Particulars	FY10	FY11	FY12E	FY13E
Net Interest Income	8,387	10,544	12,627	15,146
Pre Provision Profit	6,430	7,725	10,079	12,351
Net Profit	2,949	3,926	5,149	6,283
EPS	64.4	84.4	110.7	135.0
BVPS	470	546	613	716
ABVPS	462	539	598	698
P/E	36.0	27.4	20.9	17.1
P/ABV	5.0	4.3	3.9	3.3

Source: Company, KRChoksey Research

Price Outlook (₹): ₹ 2,670

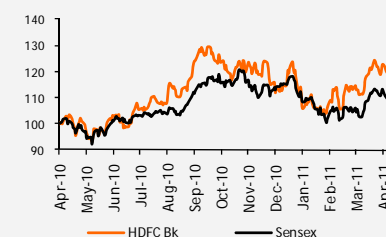
Market Data	April 19, 2011
Shares outs (Cr)	46.5
Equity Cap (₹. Cr)	465.2
Mkt Cap (₹. Cr)	107,731
52 Wk H/L (₹)	2,518/1785
Avg Vol (1yr avg)	8,63,618
Face Value (₹)	10
Bloomberg Code	HDFCB IN

Market Info:

SENSEX	19,091
NIFTY	5,745

(Closing prices on 18th April, 2011)

Price Performance



Share Holding pattern (%)

Particulars	Mar-11	Dec-10	Chg
Promoters	23.4	23.4	-
FII's	28.5	29.4	-0.8
Institutions	11.6	10.9	0.8
Others	36.5	36.4	0.1
Total	100	100	-

Source: BSE

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Moderation in NII growth

Net interest income moderated to 20.8% y-o-y due to muted loan growth and marginal decline in net interest margins during the quarter. Net interest margin dipped 7bps q-o-q due to moderation in CD ratio and rising cost of fund. However, On sequential basis, Cost of funds went up 14bps against yield on advances up 49bps. The bank has hiked base rate by 95bps and 75 bps BPLR during the quarter, We believe that net interest margins are likely to remain at healthy level of 4% plus going forward.

Exhibit :1 Loan and NII growth Trend

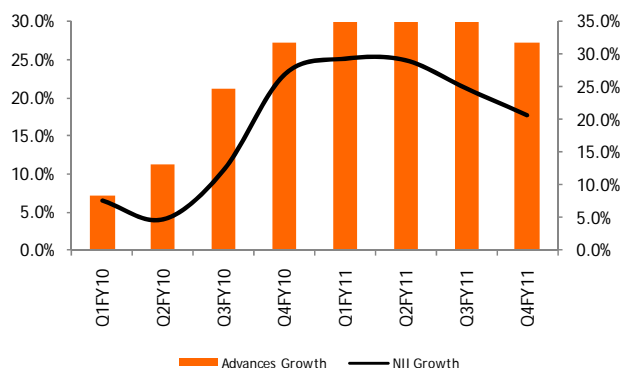
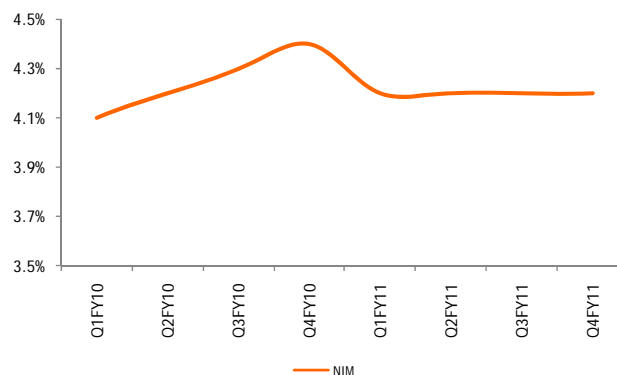


Exhibit : 2 Strong & stable Net interest margin



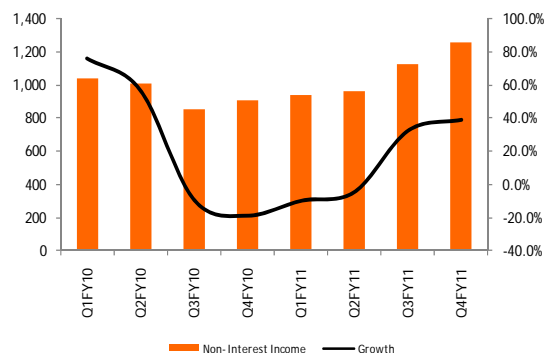
Source: Company, KRChoksey Research

Core fee income & forex profit key drivers for non interest income

Non-interest income accelerated 31.2% y-o-y and 11.3% q-o-q to ₹ 1,256 crore against ₹ 951 crore a year ago. Strong fee income and healthy forex profits continue to drive non-interest income contributing ~31% of operating income. Fee income grew 30.7% y-o-y and 6.1% q-o-q driven by retail and corporate segment. The bank made a trading profit of ₹8.6 crore against ₹ 47 crore trading loss a year ago. The bank has reclassified ATM charges paid to other banks under other operating line item vs previously netting from fees and commission income. We expect fee income to grow at 19.5% CAGR over FY11-13e.

Exhibit :3 Non-interest income growth

(INR crore)	Q4FY11	Q3FY11	Q4FY10	YoY (%)	QoQ (%)
Fee Based Income	1,001	943	813	23.2%	6.1%
Treasury Income	9	-31	-47	-118.2%	-128.0%
Income from Forex Trans	245	217	180	36.3%	13.2%
Non- Interest Income	1,255	1,129	956	31.2%	11.1%

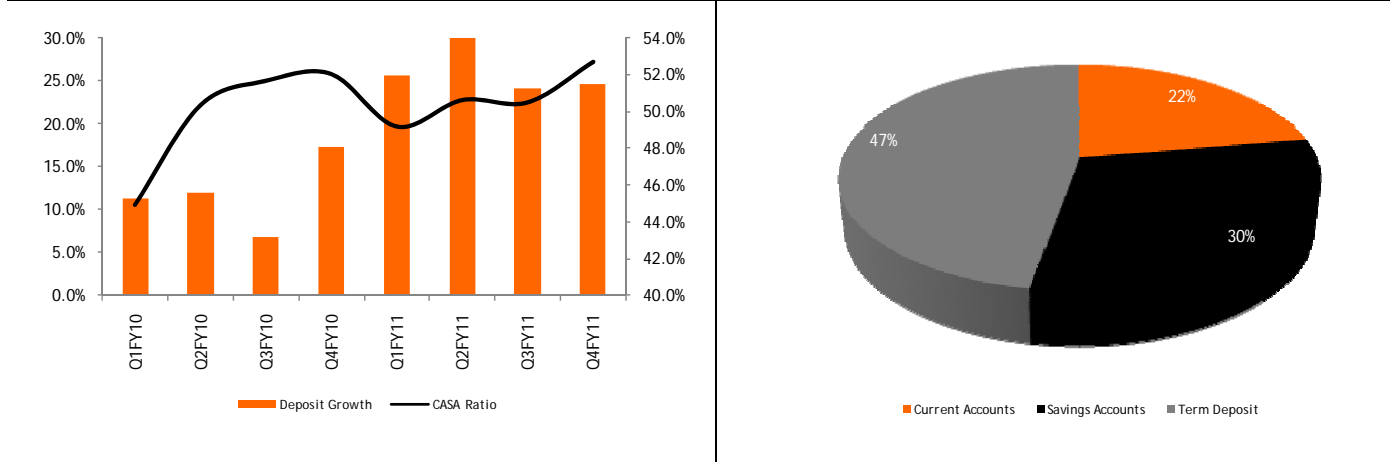


Source: Company, KRChoksey Research

Deposit growth at 24.6% y-o-y, CASA remains strong

Deposits grew at 24.6% y-o-y and 8.5% on q-o-q basis to ₹ 208,586 crore. Current account deposits surged by 29% sequentially while savings deposits also grew by 26% y-o-y and 3.9% q-o-q leading to 219bps improvement in CASA ratio which pegged at 52.7%. However, adjusted CASA (year end CA flow) was at 51%, reflecting superior quality of liability franchise. Cost of funds however increased by 17bps q-o-q due to ~20bps rise in cost of deposits due to hike in deposit rates.

Exhibit :4 CASA ratio and Growth in term deposits trend

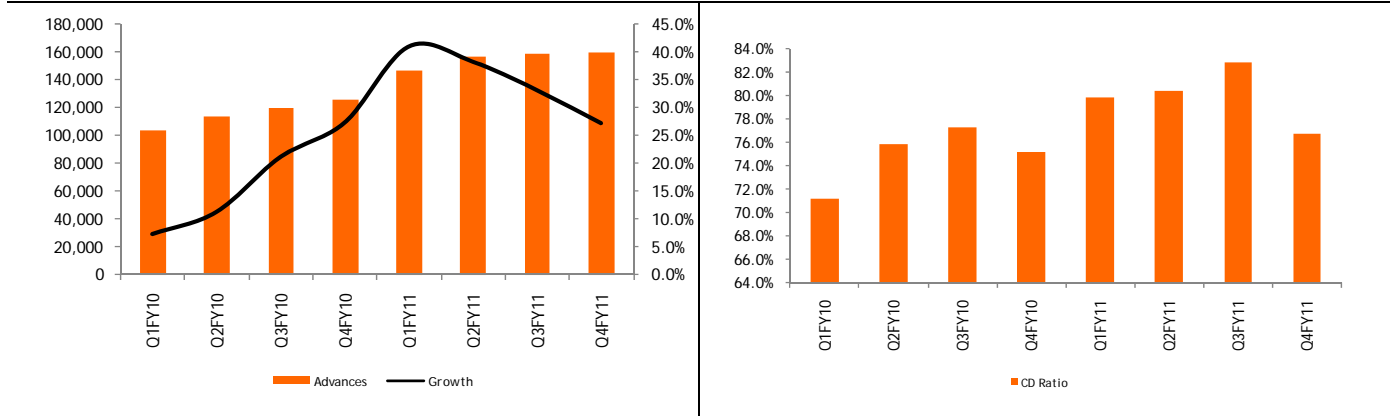


Source: Company, KRChoksey Research

CD Ratio moderated to 76.7%

Moderation in loan growth is in line with management’s earlier guidance. Loan book grew 27.1% y-o-y and 0.50% q-o-q, resulting in to moderation CD ratio by 610bps. Run down of short term 3G loans, sale of commercial vehicle portfolio were primary drivers for moderation in loan growth on sequential basis. HDFC bank purchased ₹550 crore mortgage assets from HDFC Ltd during the quarter and sold ₹1500 crore CV and auto portfolio. Retail and corporate loans grew 27% y-o-y during the quarter. Growth in retail loan book was driven by commercial vehicle (33% y-o-y), and Home loan (32% y-o-y). We expect loan book to grow at 25% CAGR over FY11-13 driven by corporate and retail business segment.

Exhibit :5 Advances growth & CD Ratio Trend

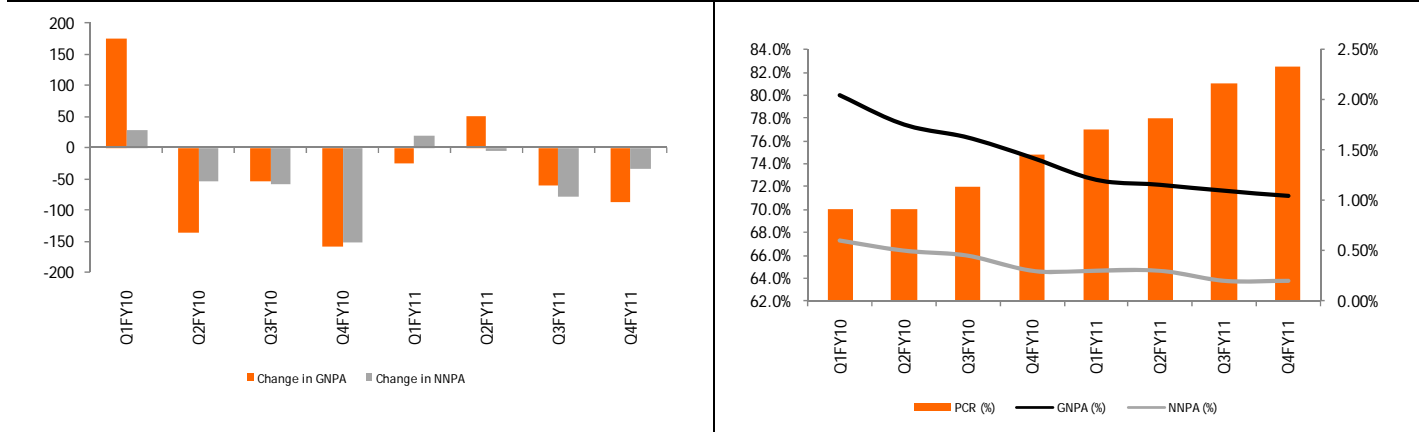


Source: Company, KRChoksey Research

Asset Quality remains healthy

Asset quality continued to improve further as gross NPA declined by 6.7% y-o-y and 4.9% q-o-q basis to ₹ 1,694 crore which is equivalent to 1.05% of gross advances. In absolute terms, gross NPA declined by ₹ 88 crore q-o-q. The loan loss provision inched up by 2.3% y-o-y to ₹ 330 crore primarily because of higher floating provision of ₹ 230 crore made during the quarter; however, total provisioning declined by 7.4% q-o-q. Coverage ratio improved by 150bps q-o-q to 82.5% (excl. technical write offs). Restructured assets stood at 0.40% of total advances, out of that 0.1% were NPAs. Exposure to MFI stood at 0.5%-0.6% of total loan book. We believe improving macro environment and corporate earnings will continue to remain at healthy levels going forward.

Exhibit :6 Gross NPA and Net NPA Trend

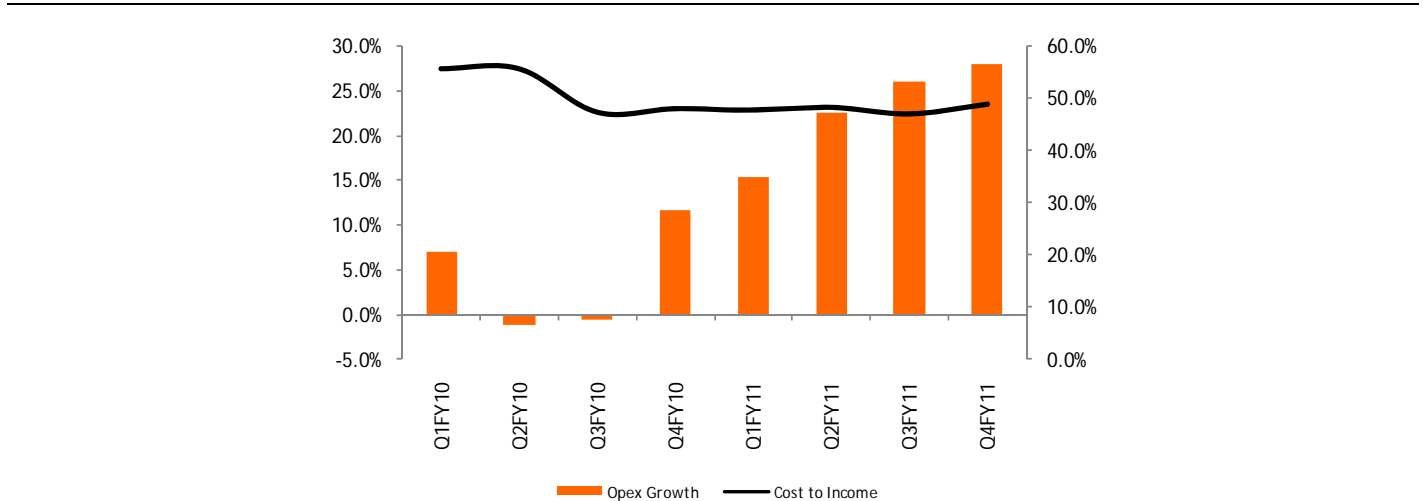


Source: Company, KRChoksey Research

Investment in network expansion led OPEX grow 24% y-o-y

The other operating expenses increased by 25% y-o-y to ₹ 1,265 crore as the bank continued to invest in network expansion. It added 206 new branches and 350 new ATMs during the quarter. The increase in employee cost was flat q-o-q though it grew 23% y-o-y to ₹ 733 crore. Further, the cost to income ratio remained flat at 48.8% y-o-y but increased by 190bps on sequential basis due aggressive network expansion strategy. The bank is likely to add 200-250 more branches in FY12 maintaining current opex growth rate.

Exhibit :7 Cost to income ratio



Source: Company, KRChoksey Research

Quarterly Result Analysis

NII grew 20.8% driven by volume growth and resilient margin of 4.2%

Robust fee income growth coupled with traction in forex profits boosted non-interest income

LLP inched up by 2.3% primarily because of higher floating provisions however total provisions (excl. taxes) declined sequentially by 7.4%

(₹ crore)	Q4FY11	Q3FY11	Q4FY10	YoY (%)	QoQ (%)	FY11	FY10	YoY (%)
Interest earned	5,469	5,230	4,053	34.9%	4.6%	19,929	16,173	23.2%
Interest expanded	2,629	2,453	1,702	54.5%	7.2%	9,385	7,786	20.5%
Net interest income	2,839	2,777	2,351	20.8%	2.3%	10,544	8,387	25.7%
Non interest income	1,256	1,128	951	32.1%	11.3%	4,284	3,901	9.8%
Operating income	4,095	3,905	3,302	24.0%	4.9%	14,828	12,288	20.7%
Operating expenses	1,998	1,832	1,608	24.3%	9.1%	7,102	5,858	21.2%
Pre-prov profits	2,097	2,073	1,694	23.8%	1.2%	7,726	6,430	20.2%
Provisions	431	466	440	-1.9%	-7.4%	1,907	2,141	-10.9%
Profit before tax	1,666	1,607	1,254	32.8%	3.7%	5,819	4,289	35.7%
Tax expense	551	519	418	31.8%	6.1%	1,892	1,340	41.2%
Net profit	1,115	1,088	837	33.2%	2.5%	3,927	2,949	33.2%

Advances grew by 27% y-o-y while deposits grew by 24.6% as a result CD Ratio normalized to 76.7%

Key Balance items & others	Q4FY11	Q3FY11	Q4FY10	YoY (%)	QoQ (%)
Advances	159,983	159,184	125,831	27.1%	0.5%
Investments	70,929	63,014	58,608	21.0%	12.6%
Deposits	208,586	192,202	167,404	24.6%	8.5%
Gross NPAs	1,694	1,782	1,817	-6.7%	-4.9%
Net NPAs	296	331	392	-24.4%	-10.4%
GNPA %	1.05%	1.10%	1.43%	-38 bps	-5 bps
NNPA %	0.20%	0.20%	0.30%	-10 bps	0 bps
Provision coverage %	82.5%	81.0%	74.8%	770 bps	150 bps
CAR	16.2%	16.3%	17.4%	-120 bps	-10 bps

Source: Company, KRChoksey Research

Earnings Revision

₹ in crore	FY12e		Change	FY13e
	Old	New	(%)	
Net Interest Income	13171	12627	-4.1%	15146
Pre Provision Profit	9483	10079	6.3%	12351
Net Profit	5107	5149	0.8%	6283

Source: KRChoksey Research

Financials

Income Statement

₹ in crore	FY10	FY11	FY12E	FY13E
Interest earned	16,173	19,929	26,022	32,356
Interest expenses	7,786	9,385	13,396	17,211
Net Interest Income (NII)	8,387	10,544	12,627	15,146
-- Core fee Income	3,441	4,332	5,156	6,187
Non interest income	3,808	4,284	5,386	6,437
Operating income	12,194	14,827	18,012	21,583
Operating expenses	5,764	7,102	7,933	9,231
-Employee cost	2289	2836	2926	3249
-Other operating expenses	3,475	4,266	5,007	5,982
Pre-provision profits	6,430	7,725	10,079	12,351
Provisions	2,140	1,907	2,589	3,211
PBT	4,290	5,818	7,490	9,140
Provision for taxes	1341	1892	2342	2857
Net profit	2,949	3,926	5,149	6,283
EPS	64.4	84.4	110.7	135.0

Balance Sheet

₹ in crore	FY10	FY11	FY12E	FY13E
Equity share capital	458	465	465	465
Reserve and Surplus	21062	24914	28064	32853
Net worth	21520	25379	28529	33318
Deposits	167404	208586	260733	320701
Borrowings	12916	14394	16553	19036
Other liabilities and provisions	20616	28993	36799	46706
Total	222459	277354	342615	419764
Cash in hand and Bal. with RBI	15483	25101	22451	27353
Balances with RBI	14459	4568	13289	13873
Investments	58608	70929	86042	102624
Advances	125831	159983	199978	249973
Fixed assets	2123	2171	2605	3126
Other assets	5955	14601	18251	22814
Total	222459	277354	342615	419764

Key Working Ratios

ROAA Decomposition	FY10	FY11	FY12E	FY13E
NII/Total Avg Assets	4.1%	4.2%	4.1%	4.0%
Fee Income/Total Avg Assets	1.7%	1.7%	1.7%	1.6%
Treasury Income/Total avg assets	0.2%	0.0%	0.1%	0.1%
Employee Cost/Total avg Assets	1.1%	1.1%	0.9%	0.8%
Operating Costs/Total avg Assets	2.8%	2.8%	2.6%	2.4%
Provisions/Total avg Assets	1.1%	0.8%	0.8%	0.8%
Tax/Total avg Assets	0.7%	0.8%	0.8%	0.7%
ROAA	1.5%	1.6%	1.7%	1.6%

Business Profile	FY10	FY11	FY12E	FY13E
Advances	125,831	159,983	199,978	249,973
Credit Deposits ratio	75%	77%	77%	78%
Deposits	167,404	208,586	260,733	320,701
CASA Deposits	87,104	109,908	126,455	152,333
CASA Ratio	52.0%	52.7%	48.5%	47.5%

Return Ratios	FY10	FY11	FY12E	FY13E
ROAA	1.5%	1.6%	1.7%	1.6%
RoAE	16.3%	16.9%	19.1%	20.3%

Asset Quality Profile	FY10	FY11	FY12E	FY13E
Gross NPA	1,817	1,694	2,727	3,282
Net NPA	392	296	682	820
Gross NPA as % of Advances	1.4%	1.4%	1.4%	1.3%
Net NPA as % of Advances	0.3%	0.4%	0.3%	0.3%
Credit Costs	1.7%	1.2%	1.3%	1.3%

Spread Analysis	FY10	FY11	FY12E	FY13E
Avg Yield On Advances	10.8%	8.7%	8.9%	8.9%
Avg Yield On Investments	6.8%	7.1%	7.0%	7.0%
Avg Yield On Int Earning Assets	8.0%	8.0%	8.2%	8.2%
Avg Cost Of Deposits	4.5%	4.4%	4.6%	4.7%
Avg Cost of Funds	4.6%	4.6%	4.7%	4.8%
Spread	3.4%	3.4%	3.5%	3.4%
NIM	4.3%	4.3%	4.3%	4.2%

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HDFC Bank			
Date	Recommendation	CMP	Target
19-Apr-11	BUY	2,316	2,670
28-Jan-11	BUY	2,051	2,466
21-Oct-10	HOLD	2,337	2,466
19-Jul-10	HOLD	2,050	2,173
26-Apr-10	BUY	1,990	2,184

Rating Legend	
Our Rating	Upside
Buy	15% - 25%
Hold	10% - 15%
Reduce	Nil - 10%
Sell	Less than 0%

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