



VISIT NOTE

HDFC Bank Ltd. (HDFCB IN)

March 22nd, 2011

Adequately capitalized to outperform industry **Not Rated (CMP: ₹2206)**

Market Cap: ₹1025bn; USD22.8bn

We recently met the management of HDFC Bank Ltd (HDFCB) to get an update on the bank's strategy. We understand that HDFC Bank is well-placed to report 5-7% credit growth in FY11, higher than the system growth of 23% in 9M11. The management expects the GDP growth will be at 7.5%-7.75% in FY12 with an upwards bias. The higher credit growth would be mobilized by 18-20% growth in deposits during the same period. The bank has reported 28%, 20% and 33% growth in NII, operating income and PAT respectively during 9M11, compared to the same period previous year.

We believe that HDFC bank will not witness any slowdown in credit growth, since 56% of its loan portfolio is retail exposure and 44% is wholesale exposure. The current rise in commodity prices has increased the working capital requirements for the Corporates. In our opinion the exposure to wholesale portfolio will increase as compared to the retail segment.

Strong growth in NII

HDFC Bank reported 24.9% YoY and 9.9% QoQ growth in Net interest income during 3Q11. The growth in NII was higher despite the interest expenses reporting 35.3% growth in 3Q11, compared to the same period last year. The growth has been higher due to high C/D ratio at 81.3% in 9M11, compared to 74.8% during the same period previous year. We believe that with major exposure to high yielding retail segment the bank is likely to pass on any hike in the interest rates.

Expansion in branch network

The bank currently has 1825 branches of which 68% of the branch network is present in the top 9 cities. The bank shall have 2000 branches by the end of FY12 and plans to further add 150 branches every year. The management indicated that post the acquisition of CBoP, the branches are operating to their full productivity as expected. We assume that an addition in the branch network will not see any significant upside in C/I ratio due to the higher growth in income. The C/I ratio of the bank is currently at 46.9% in 3Q11, which has improved from 48.1% in 2Q11.

Fee-based income continues robust growth

HDFC Bank has reported 23% growth in fee-based income during 9M11, compared to the same period last year. The foreign exchange and derivative revenues registered 41% growth in 9M11. The removal of fees for ATM's, IRDA capping expenses of insurance companies and entry load of MF's has resulted in slower growth in fee income in the last 1-2 years. Since 80% of the fee income comes from retail and 20% from the corporate segment we assume that the bank will see slower pace of growth in fee-based income moving forward.

Asset Quality

The bank has reported GNPA at 1.1% and Net NPA at 0.5% during 9M11, it has seen an increase in provision coverage ratio from 76.9% in 1Q11 to 81.4% in 3Q11. HDFC Bank is the only bank to make the provision of ₹1bn for total Microfinance exposure of ₹8bn, out of this around one third would be from Andhra Pradesh. The bank has no exposure to telecom players issuing spectrum beyond 6.2MHz and the real estate sector contributes to 0.5% of total NPA's. The provisioning charge has declined in the past 2 quarters to 1.2%. The management expects the charges to go up post 4Q11 due to resumption of surplus general provisioning.

Vishal Shah

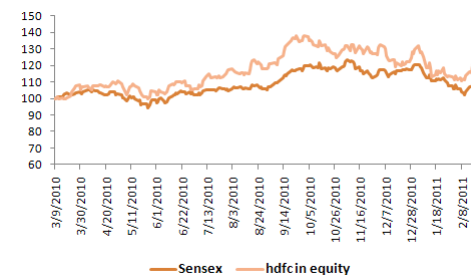
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Industry: **Banking**

Market Data

| | |
|------------------------|---------------------|
| Market Cap. | ₹1025bn/ US\$22.8bn |
| Share Cap. (mn) | 4649.7 |
| 52 Wk High/Low | 2539 / 1628 |
| Avg. Vol. (Weekly'000) | 1036 |

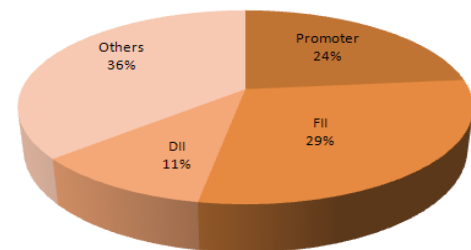
(Price Performance (RIC: HDB.BO, BB: HDFCB IN))



Shareholding Pattern

(As on 31st Dec 2010)

(%)



| Financials (₹ Mn) | FY08 | FY09 | FY10 |
|---------------------|--------|--------|--------|
| Interest Income | 101150 | 163323 | 161729 |
| Interest Expenses | 48871 | 89111 | 77863 |
| Net Interest Income | 52279 | 74212 | 83866 |
| Operating Profit | 36876 | 52070 | 64327 |
| PAT | 15902 | 22449 | 29487 |
| EPS | 44.9 | 52.8 | 64.4 |
| BV | 324.4 | 353.9 | 470.2 |
| P/E | 49.2 | 41.8 | 34.2 |
| P/BV | 6.8 | 6.2 | 4.7 |
| P/ABV | 7.0 | 6.5 | 4.8 |

Changing industry dynamics

HDFC Bank has witnessed a change in demand dynamics in the retail as well as wholesale sectors. The bank will witness a higher growth in wholesale funding due to an increase in the working capital requirement by the companies arising as a result of the spike in commodity prices. We expect slower pace of growth for its fee-income as it is linked to the growth in the retail portfolio (transaction based). We expect the current 56% retail exposure to reduce as the wholesale portfolio growth would move up. The bank has witnessed slowdown in its fee income due to regulatory changes.

Strong growth in B/S

HDFC Bank has reported CAGR of 35.7% each for Advances and Deposits during FY05-10. The growth has been higher than that of the industry. We believe that the bank will continue to report 5-7% credit growth higher than the industry. The credit deposit ratio improved to 82.8% in 3Q11 from 80.4% in 2Q11, the higher growth was on account of marginal fall in deposits sequentially.

Deregulation in interest rates

We had an interaction with the bank on the deregulation of interest rates affecting the CASA proportion of the bank and its impact on margins. The bank currently pays 3.5% interest on its savings account and to service the account it incurs additional expenses of 100-150bps. In case of deregulation of interest rates the banking sector might immediately witness an increase of 100-150bps from the current 3.5%, which will drop to the former levels. As the savings account of any bank remain to be its core strength; the banking industry will not price it wrongly, because the higher interest rates will have an adverse impact on its margins.

HDFC Bank currently has 50.5% low cost deposits to its total deposit base during 3Q11. The savings account contributes 62.9% to the total low cost deposit base. The savings account has reported 8.3% YoY growth in 3Q11, compared to the same period last year.

Tier-I of more than 12% will drive the credit growth

The capital adequacy ratio of the bank stood at 16.3%, with Tier-I at 12.1%. The strong headroom in CAR can help the bank to grow at a faster pace than the industry. Going ahead, we expect HDFC to report a higher credit market share as it is well placed. As per the management the current market share in Auto is 22-25% and CV loans are 15-20% during 3Q11.

Unique Identification Project a long-term initiative

The estimated cost of UID project is estimated to cost around US\$2.2-\$4.4bn. The programme will have a significant positive impact on India's growth and fiscal health in the years to come. The government is looking forward to empanel Corporates who are willing to implement the project. HDFC Bank is one amongst them to take the initiative for coordinating with the government. We believe this will be positive for the bank in the long-term.

Outlook

We remain positive on the earnings growth story of the bank considering its Tier-I at 12.1%, 1825 branches, 1.6% RoA, Strong CASA composition at 50.5% and quality of management. The stock is trading at FY11 and FY12 P/BV of 3.8x and 3.4x respectively as per consensus estimates on Bloomberg.

FINANCIAL DETAILS

Table 1: Quarterly

| ₹ Millions | Q3FY11 | Q3FY10 | YoY (%) | Q2FY11 | QoQ |
|-----------------------------|---------|---------|---------|--------|-------|
| Interest Income | 52299.6 | 40348.1 | 29.6 | 48101 | 8.7 |
| - Interest on advances | 39503.8 | 30389.2 | 30.0 | 36732 | 7.5 |
| - Interest on Investments | 12258.3 | 9801.6 | 25.1 | 11003 | 11.4 |
| - Interest on RBI Balances | 517.1 | 120.1 | 330.6 | 355 | 45.7 |
| - Interest on Others | 20.4 | 37.2 | -45.2 | 11 | 85.5 |
| Interest Expenses | 24532.7 | 18109.0 | 35.5 | 22837 | 7.4 |
| Net Interest Income | 27766.9 | 22239.1 | 24.9 | 25264 | 9.9 |
| Other Income | 11278.2 | 8530.1 | 32.2 | 9607 | 17.4 |
| Total Income | 39045.1 | 30769.2 | 26.9 | 34871 | 12.0 |
| Operating expenses | 18318.2 | 14531.7 | 26.1 | 16799 | 9.0 |
| - Staff Expenses | 7250.5 | 5785.9 | 25.3 | 7106 | 2.0 |
| - Other Operating expenses | 11067.7 | 8745.8 | 26.5 | 9693 | 14.2 |
| Operating Profit | 20726.9 | 16237.5 | 27.6 | 18072 | 14.7 |
| Provision for contingencies | 4658.7 | 4477.2 | 4.1 | 4545 | 2.5 |
| PBT | 16068.2 | 11760.3 | 36.6 | 13527 | 18.8 |
| Provision for taxes | 5189.9 | 3574.8 | 45.2 | 4505 | 15.2 |
| Net profit | 10878.3 | 8185.5 | 32.9 | 9022 | 20.6 |
| Equity | 4643.3 | 4552.4 | 2.0 | 4626 | 0.4 |
| EPS | 23.4 | 18.0 | 30.3 | 19.5 | 20.1 |
| Ratios (%) | | | | | |
| Int.exp/Int earned | 46.9 | 44.9 | - | 47.5 | - |
| Cost/Income | 46.9 | 47.2 | - | 48.2 | - |
| Gross NPAs (₹) | 17817.6 | 19741.0 | -9.7 | 18412 | -3.2 |
| Net NPAs (₹) | 3306.7 | 4784.5 | -30.9 | 4085 | -19.1 |
| Gross NPAs | 1.10 | 1.6 | - | 1.16 | - |
| Net NPAs | 0.50 | 0.5 | - | 0.30 | - |
| ROA | 1.60 | 1.4 | - | 1.52 | - |
| CAR | 16.30 | 18.3 | -10.9 | 17.00 | -4.1 |

Source: Company and Systematix Institutional Research

INCOME STATEMENT

| Income Statement (₹ Millions) | 2007 | 2008 | 2009 | 2010 |
|---|-------|--------|--------|--------|
| Interest Income | | | | |
| Interest/Discount on advances and bills | 43342 | 69667 | 121367 | 120983 |
| Income on Investments | 22986 | 28720 | 40080 | 39813 |
| Interest on balance with RBI & inter-bank funds | 2529 | 2724 | 1843 | 810 |
| Others | 33 | 38 | 33 | 124 |
| Total Interest Income | 68890 | 101150 | 163323 | 161729 |
| Interest Expenses | 31795 | 48871 | 89111 | 77863 |
| Interest on deposits | 26953 | 43827 | 80155 | 69977 |
| Interest on RBI / Inter-bank borrowings | 2741 | 2424 | 5565 | 7455 |
| Others | 2101 | 2620 | 3392 | 431 |
| Net Interest Income | 37096 | 52279 | 74212 | 83866 |
| Other Income | 15102 | 22054 | 34706 | 38106 |
| Total Income | 52198 | 74333 | 108918 | 121972 |
| Employees cost | 7769 | 13014 | 22382 | 22892 |
| Other operating expenses | 16439 | 24443 | 34466 | 34753 |
| Total operating expenses | 24208 | 37456 | 56848 | 57645 |
| Operating profit | 27990 | 36876 | 52070 | 64327 |
| Provisions and contingencies | 11603 | 14066 | 19077 | 21436 |
| Profit before tax (PBT) | 16388 | 22811 | 32993 | 42891 |
| Tax provisions | 4973 | 6909 | 10543 | 13404 |
| Profit after tax (PAT) | 11415 | 15902 | 22449 | 29487 |
| (% change) | 31.1 | 39.3 | 41.2 | 31.3 |
| EPS | 35.7 | 44.9 | 52.8 | 64.4 |
| Share capital | 3,194 | 3,544 | 4,254 | 4,577 |

Source: Systematix Institutional Research

BALANCE SHEET

| Liabilities (₹ Millions) | 2006 | 2007 | 2008 | 2009 | 2010 |
|--------------------------------|----------------|----------------|------------------|------------------|------------------|
| Share Capital | 3,131 | 3,194 | 3,544 | 4,254 | 4,577 |
| Reserves & Surplus | 49,864 | 61,138 | 111,428 | 146,274 | 210,648 |
| Deposits | 557,968 | 682,979 | 1,007,686 | 1,428,116 | 1,674,044 |
| Borrowings | 45,605 | 60,980 | 78,440 | 191,602 | 256,091 |
| Other liabilities & provisions | 78,496 | 104,065 | 130,668 | 62,463 | 79,226 |
| Total liabilities | 735,064 | 912,356 | 1,331,766 | 1,832,708 | 2,224,586 |
| Cash and balances with RBI | 33,066 | 51,825 | 125,532 | 135,272 | 154,833 |
| Bal. with banks | 36,124 | 39,714 | 22,252 | 39,794 | 144,591 |
| Advances | 350612.6 | 469447.8 | 634269 | 988830.5 | 1258305.9 |
| Investments | 283,940 | 305,648 | 493,935 | 588,176 | 586,076 |
| Fixed Assets | 8,551 | 9,667 | 11,751 | 17,067 | 21,228 |
| Other Assets | 22,771 | 36,055 | 44,027 | 63,568 | 59,552 |
| Total Assets | 735,064 | 912,356 | 1,331,766 | 1,832,708 | 2,224,586 |

Source: Systematix Institutional Research

RATIOS

| (A) Efficiency Ratios | FY07 | FY08 | FY09 | FY10 |
|--------------------------------|--------|--------|---------|---------|
| Int. exp/Int. earned | 46.2 | 48.3 | 54.6 | 48.1 |
| NII/Total Income | 71.1 | 70.3 | 68.1 | 68.8 |
| Cost/Income | 46.4 | 50.4 | 52.2 | 47.3 |
| C-D Ratio | 68.7 | 62.9 | 69.2 | 75.2 |
| I-D Ratio | 44.8 | 49.0 | 41.2 | 35.0 |
| Incremental CD ratio | 95.1 | 50.8 | 84.3 | 109.6 |
| Incremental ID ratio | 17.37 | 57.99 | 22.42 | -0.85 |
| (B) Spreads (%) | FY07 | FY08 | FY09 | FY10 |
| Yield on Assets | 8.8 | 9.4 | 10.8 | 8.3 |
| Yield on Advances | 10.6 | 12.6 | 15.0 | 10.8 |
| Yield on Investments | 7.8 | 7.2 | 7.4 | 6.8 |
| Cost of Funds | 4.7 | 5.3 | 6.6 | 4.4 |
| Cost of Deposits | 4.3 | 5.2 | 6.6 | 4.5 |
| Net Interest Spread | 5.1 | 5.2 | 5.4 | 4.9 |
| Net Interest Margin | 4.7 | 4.9 | 4.9 | 4.3 |
| Spreads on Advances | 6.2 | 7.4 | 8.4 | 6.3 |
| Spreads on Investments | 3.5 | 2.0 | 0.8 | 2.3 |
| (C) Solvency | FY07 | FY08 | FY09 | FY10 |
| Gross NPAs (₹) | 6577.6 | 9069.7 | 19880.7 | 18167.4 |
| Net NPAs (₹) | 2028.9 | 2985.2 | 6276.0 | 3921.0 |
| Gross NPAs/ Gross Advances | 1.4 | 1.4 | 2.0 | 1.4 |
| Provisions/ Net Advances | 1.5 | 1.6 | 1.6 | 1.5 |
| Net NPAs/ Net Advances | 0.4 | 0.5 | 0.6 | 0.3 |
| Provision coverage ratio | 69.2 | 67.1 | 68.4 | 78.4 |
| (D) Measures of Investment | FY07 | FY08 | FY09 | FY10 |
| EPS (₹) | 35.7 | 44.9 | 52.8 | 64.4 |
| BV (₹) | 201.4 | 324.4 | 353.9 | 470.2 |
| Adjusted BV (₹) | 195.1 | 316.0 | 339.1 | 461.6 |
| Avg.ROE | 19.46 | 17.74 | 16.91 | 16.12 |
| Avg.ROA | 1.39 | 1.42 | 1.42 | 1.45 |
| Pre-tax ROA | 1.4 | 1.4 | 1.4 | 1.5 |
| Pre-provisioning operating ROA | 3.4 | 3.3 | 3.3 | 3.2 |
| Pre-provisioning operating ROE | 47.7 | 41.1 | 39.2 | 35.2 |
| P/E | 61.7 | 49.2 | 41.8 | 34.2 |
| P/BV | 11.0 | 6.8 | 6.2 | 4.7 |
| P/ABV | 11.3 | 7.0 | 6.5 | 4.8 |
| Effective tax rate | 30.3 | 30.3 | 32.0 | 31.3 |

Source: Systematix Institutional Research

RATIOS

| E) Breakdown of ROA (%) | 2007 | 2008 | 2009 | 2010 |
|--------------------------------|-------------|-------------|-------------|-------------|
| Interest Income | 7.6 | 7.6 | 8.9 | 7.3 |
| Interest Expenses | 3.5 | 3.7 | 4.9 | 3.5 |
| NII/avg.assets | 4.1 | 3.9 | 4.0 | 3.8 |
| Non-NII/avg.assets | 1.7 | 1.7 | 1.9 | 1.7 |
| Total income | 5.7 | 5.6 | 5.9 | 5.5 |
| Operating exp/avg.assets | 2.9 | 3.3 | 3.6 | 2.8 |
| Operating profit/avg.assets | 3.4 | 3.3 | 3.3 | 3.2 |
| Provisions/avg.assets | 1.4 | 1.3 | 1.2 | 1.1 |
| PBT/avg.assets | 2.0 | 2.0 | 2.1 | 2.1 |
| Tax/avg.assets | 0.6 | 0.6 | 0.7 | 0.7 |
| PAT/avg.assets | 1.4 | 1.4 | 1.4 | 1.5 |
| F) Growth Rates (%) | 2007 | 2008 | 2009 | 2010 |
| Interest income | 53.9 | 46.8 | 61.5 | -1 |
| Interest expenses | 64.8 | 53.7 | 82.3 | -12.6 |
| NII | 45.7 | 40.9 | 42 | 13 |
| Other income | 24.4 | 46 | 57.4 | 9.8 |
| Total income | 38.8 | 42.4 | 46.5 | 12 |
| Operating profit | 35.3 | 31.7 | 41.2 | 23.5 |
| Net profit | 31.1 | 39.3 | 41.2 | 31.3 |
| Deposits | 22.4 | 47.5 | 41.7 | 17.2 |
| Advances | 33.9 | 35.1 | 55.9 | 27.3 |

Source: Systematix Institutional Research

For any queries contact us at: Institutional Team

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Stock Ratings

| | |
|-----------------------|---|
| BUY (B) | The stock's total return is expected to exceed 20% over the next 12 months. |
| ACCUMULATE (A) | The stock's total return is expected to be within 10-20% over the next 12 months. |
| HOLD (H) | The stock's total return is expected to be within 0-10% over the next 12 months. |
| SELL (S) | The stock's is expected to give negative returns over the next 12 months. |
| NOT RATED (NR) | The analyst has no recommendation on the stock under review. |

Industry Views

| | |
|------------------------|--|
| ATTRACTIVE (AT) | Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months. |
| NEUTRAL (NL) | Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months. |
| CAUTIOUS (CS) | Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months. |

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