

April 25, 2007

HDFC Bank

Quarterly
Update

Sterling operational performance

ACCUMULATE

Price Target Price
Rs1,013 **Rs1,110**

Sensex **14,137**

Price Performance

(%)	1M	3M	6M	12M
Absolute	(2)	(6)	2	21
Rel. to Sensex	(7)	(5)	(8)	2

Source: Capitaline

Stock Details

Sector	Banking
Reuters	HDBK.BO
Bloomberg	HDFCB.IN
Equity Capital (Rs mn)	3,193.9
Face Value	Rs10
52 Week H/L	1150/620
Market Cap	Rs317.0bn/USD7bn
Daily Avg Volume (No of shares)	787,995
Daily Avg Turnover (US\$)	19mn

Shareholding Pattern (%)

(31st Dec.'06)	
Promoters	21.6
FII	51.5
Institutions	5.6
Private Corp.	7.9
Public	13.5

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HDFC Bank's robust operational performance, 51.2% yoy growth in the NII to Rs11.2bn with NIM of 4.5% and 47.6% yoy growth in the pre-provision profit to Rs8.3bn, was ahead of expectations. With branch expansion, the CASA float has increased substantially. With the bank continuing with its prudent provisioning policy, the net profit growth was at 30.3% yoy, in line with our estimates. The bank continues to enjoy robust asset quality with GNPA and NNPA at 1.2% and 0.4% of customer asset, which has kept the provisioning at 1.0% of advances despite rising proportion of retail assets.

We continue to like robust business model of HDFC Bank and robust quality of its earnings as well as assets. However, its current valuations at 17.7x its FY2009E EPS and 3.9x FY2009E P/ABV seem to be fairly pricing in the positives. We maintain our Accumulate rating on the stock with price target of Rs1,110.

NII grows by 51.2% - NIM surprise positively

HDFC Bank's NII grew by 51.2% yoy to Rs11.2bn driven by 28.2% yoy growth in core customer assets to Rs500bn and a 30bps expansion in NIM (excluding one-time interest income on CRR balances) to 4.5%.

(%)	Q4FY07	Q4FY06	Q3FY07	Change in bps	
				yoy	qoq
Yield on advances*	10.9	8.8	9.8	208.1	113.1
Yield on assets*	8.4	7.8	8.1	59.0	31.0
Cost of funds*	3.9	3.6	3.8	23.7	3.8
NIM	4.5	4.2	4.3	35.3	27.2

Source: Company, Emkay Research

* Calculated on basis of average quarterly balances

The expansion in NIM was a strong positive surprise looking at the fact the expansion has come over the existing margins, which are the highest in the industry.

High CASA and better yields drive margins but may be sustained partially

A robust expansion in CASA float at 57.7% of the total deposits (55.4% in Q4FY06 and 55% in Q3FY07) coupled with ~200bps expansion in yield on advances has helped the bank to achieve a sort of feat as the NIM expanded by 30bps to 4.5% despite being the highest in the industry.

The expansion in yield on advances was driven by a) improving proportion of retail portfolio in total customer assets b) increase in the PLR totaling to 250bps over H2FY07.

Notably the expansion in yields has come despite the fact that the proportion of personal loans and business banking loans has remained stable or declined over last year.

Retail loan portfolio mix

	Rs mn	% yoy change	Proportion (%)	Change in bps	
				yoy	qoq
Auto Loans	70,000.0	45.8	24.7	209	40
Personal Loans	44,000.0	33.3	15.5	(2)	(41)
CVs	48,000.0	(2.0)	17.0	(615)	(179)
Loan Against Securities	13,000.0	(27.8)	4.6	(390)	(59)
2-Wheelers	20,000.0	5.3	7.1	(190)	(71)
Business Banking	52,000.0	116.7	18.4	705	82
Credit Cards	20,000.0	42.9	7.1	46	(11)
Others	16,000.0	128.6	5.7	235	240
Total	283,000.0	33.5			

HDFC Bank's CASA mix improved by 230bps yoy to 57.7% compared with 55.4% last year and 55% in the preceding quarter. The improvement in CASA float was driven by a) conscious efforts by the bank to not to resort to high cost bulk deposits and term deposits during the quarter when the rates were highest and b) robust expansion in the branch network as it added about 101 new branches during the quarter.

CASA mix

	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
Total deposits	683.0	558.0	667.5	22.4	2.3
Savings	195.9	161.9	192.4	21.0	1.8
% Of total	28.7	29.0	28.8		
Current	198.1	147.5	174.3	34.3	13.6
% Of total	29.0	26.4	26.1		
Total CASA	394.0	309.4	366.7	27.3	7.4
% Of total	57.7	55.4	54.9		

Source: Company

We believe that as the bank continues to expand its balance sheet, the term deposit growth will pick up and put pressure on CASA mix and NIM. Nevertheless, we expect the bank to continue to enjoy high NIM of 4.2% driven by increase in the PLR and robust CASA mix which may stabilise at 55%.

Fee income growth slower due to high base effect

The fee income during the quarter grew by just 5.8% yoy during Q4FY07 due to high base effect as during Q4FY06, the fee income on the sale of third party products like mutual funds was exceptionally high due to buoyancy in the equity markets in Q4FY06. In fact on sequential basis, the fee income has grown by 7.5%.

The slower growth in the fee income was more than compensated by the gains on the Forex and derivative transactions that more than doubled over the same quarter last year. As a result the total non-interest income grew by 29.7% yoy to Rs3.9bn.

Expenditure under controlled despite branch expansion

The operating expenditure grew by 41.8% yoy to Rs6.8bn with the bank adding 101 new branches during the quarter. With controlled expenditure the operating profit grew by 42.2% yoy to Rs8.0bn.

Stable provisioning reflects robust asset quality

Despite a strong growth in balance sheets and particularly in retail assets, coupled with increased provisioning requirements for the standard assets, HDFC Bank's loan loss provisions (on NPA as well as standard assets) still continue to remain stable at 1.05% of the customer assets. The gross NPA remained under control at 1.2% and net NPA at 0.4% despite the fact that the proportion of retail asset is increasing. One time impact of increased provisioning (1% to 2%) on standard assets belonging to four classes, viz., credit cards, personal loans, commercial real estate and loans against securities was Rs1.2bn.

Rs mn	Q4FY07	Q4FY06	Q3FY07	% yoy chg	% qoq chg
General loan loss provision	1.4	1.1	1.9	26.7	-27.5
As % of customer assets	1.05	1.08	1.48		
One-time provisions	1.2				
Other provisions	0.6	0.7	0.6	-11.9	4.6
Total provisions	3.3	1.8	2.7	26.7	-27.5

Source: Company

Comfortable capital adequacy

The bank had a comfortable Tier I capital adequacy ratio of 8.6% at the end of March 2006 as the bank did Rs2bn perpetual bond issue in Q2FY07. We believe that with stable RoE of 21%+ expected over next three years, the bank will not have to dilute equity at least till FY2008. Also the bank still has enough headroom (Rs6-7bn) to raise quasi Tier I capital

Valuations and view

We are maintaining our estimates on the bank. We expect the bank's earnings to grow at CAGR of 30% over FY2006-09E driven by stable growth of 25% in the customer assets and NIM of 4% and RoE to remain at strong 21%+ over the same period. Nonetheless, we believe that at 4.6x FY08E and 3.9x FY09E adjusted book value, the stock fairly takes into account this positives. We maintain our Accumulate rating on the stock with price target of Rs1, 110.

Quarterly results

Rs mn	FY07	FY06	% yoy chg	Q4FY07	Q4FY06	% yoy chg	% qoq chg
Net interest income	37,095.7	25,458.4	45.7	11,177.1	7,394.1	51.2	20.4
Other Income	15,162.4	11,239.8	34.9	3,944.3	3,041.5	29.7	5.7
<i>Fee</i>	12,991.0	10,451.0	24.3	3,563.0	3,367.0	5.8	7.5
<i>Other</i>	2,171.4	788.8		381.3	-325.5		
Net Income	52,258.1	36,698.2	42.4	15,121.4	10,435.6	44.9	16.1
Operating Expenses	24,208.0	16,910.9	43.2	6,839.3	4,823.2	41.8	13.0
Operating Profit	28,050.1	19,787.3	41.8	8,282.1	5,612.4	47.6	18.8
Provisions & Contingencies	11,662.5	7,252.7	60.8	3,302.8	1,816.0	81.9	24.0
<i>General loan loss</i>	7,388.0	4,797.0	54.0	1,398.0	1,103.0	26.7	-27.5
<i>One time provision</i>	0.0	0.0	0.0	1,211.0	0.0	0.0	0.0
<i>Amortisation</i>	2,411.0	2,455.0	-1.8	632.0	717.0	-11.9	4.6
Profit before tax	16,387.6	12,534.6	0.0	4,979.3	3,796.4	31.2	15.7
Provision for Taxes	4,973.0	3,827.3	29.9	1,543.6	1,164.3	32.6	14.4
Net Profit	11,414.6	8,707.3	31.1	3,435.7	2,632.1	30.5	16.2
Extra-ordinary Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted Profit after tax	11,414.6	8,707.3	31.1	3,435.7	2,632.1	30.5	16.2

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	P/ABV (x)	PE (x)
FY2006	37,595	8,708	27.8	154.3	1.4	17.7	6.6	36.4
FY2007E	52,258	11,415	34.8	184.3	1.3	19.0	5.5	30.4
FY2008E	65,714	14,588	44.9	218.8	1.3	21.0	4.6	23.1
FY2009E	82,258	19,156	57.6	261.4	1.3	23.1	3.9	17.6

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