VISIT UPDATE

LARGE CAP

HDFC Bank

Maintain Outperformer

Price: Rs 439 | **BSE Index: 15,792** | **05 October 2011**

Share Data

Reuters code	HDBK.BO
Bloomberg code	HDFCB IN
Market cap. (US$ mn)	20,788
6M avg. daily turnover (US$ mn)	37
Issued shares (mn)	2,338
Target Price	490

Performance (%)	1M	3M	12M
Absolute	(7)	(14)	(10)
Relative	(1)	3	16

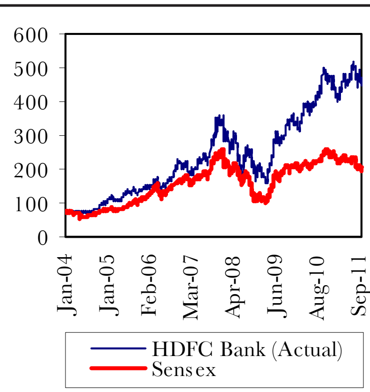
Valuation ratios

Yr to 31 Mar	FY12E	FY13E
EPS (Rs)	21.3	26.5
+/- (%)	25.1	24.7
ABV (Rs.)	124.2	144.9
+/- (%)	14.7	16.7
PER (x)	20.6	16.5
PABV (x)	3.5	3.0
Dividend/Yield (%)	0.9	0.9

Major shareholders (%)

Promoters	23
FIIs	29
MFs	4
BFSI's	7
Public & Others	37

Relative performance



Innate resilience…

We met with HDFC Bank's (HDFCB) management to discuss the macro as well as business outlook for the bank, including asset quality. Management expects systemic growth to moderate to 17-18%, however, bank to grow 4-5% above system. Asset quality trend still remain healthy, but likely to see some pressure from 3QFY12 onwards.

Following are key takeaways:

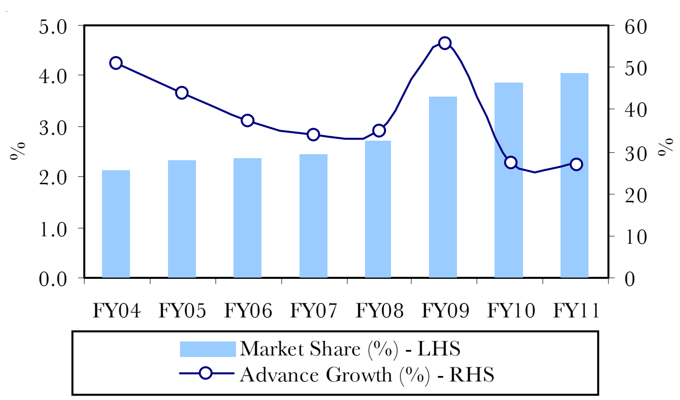
- **Turning cautious, moderating growth given uncertain macro environment:** Adopting a cautious approach, bank expects loan growth to moderate to 22-23% in FY12 from 27% in FY11, as credit quality remains paramount. Corporate demand is still healthy as working capital demand remains strong; however, capex demand is feeble. Retail loan demand, particularly auto, too is moderating but not falling off a cliff. Bank intends to further diversify its retail loan portfolio scaling up its used CV (still in experiment stage) as well as gold loan portfolio, which in the long run should support bank's NIM. Also, bank would continue to buy home loan portfolio from HDFC, which should help achieve its PSL norms as well as increase share of secured portfolio.
- **CASA to normalise; NIMs to remain range bound:** Bank would continue to add ~200-250 branches every year and has already added 145 branches in 1QFY12. As per branch banking head Mr Navin Puri, bank is steadily scaling up its presence in deeper geographies and thus garnering new business (including CASA). CASA ratio is likely to moderate to 46-48% (from current 49%-50%) as cannibilisation effect kicks-in. NIMs may remain range bound (3.9-4.3%) on quarterly basis, as growth moderates and further rate hike will be difficult, whereas, cost pressures remain.
- **Asset quality deterioration imminent, but unlike last cycle:** Asset quality trend till now remains benign, however, expects some pressure going ahead given systemic stress, but is likely to be gradual (last cycle asset quality was also impacted due to CBoP acquisition). Though auto, cards and personal loans within retail portfolio remain vulnerable, bank has relatively lower exposure to stressed corporate sectors and large part of the portfolio being working capital loans. As per management, slippage ratio for FY12 may go up to 1.2-1.5% from 1.1% in FY11 and GNPA ratio at max of 1.4% in FY12. Credit cost is likely to inch up as specific provisioning requirement may go up, however, would reduce floating provisions to off-set the same.

Outlook and valuations: HDFC bank has one of the best liability franchisee with strong & consistent financial performance and sound risk management systems in place resulting in best asset quality even during trying times. Bank remains well-capitalised with Tier I > 11.4% and thus no need to raise capital in the near future. We expect 25% earnings CAGR over FY11-13 with RoE at ~18-19%.Bank continues to command premium, trading at 3x FY13 ABV, due to its consistent performance, relatively resilient business model and stable top management. We maintain our Outperformer rating on the stock with target price of Rs 490.

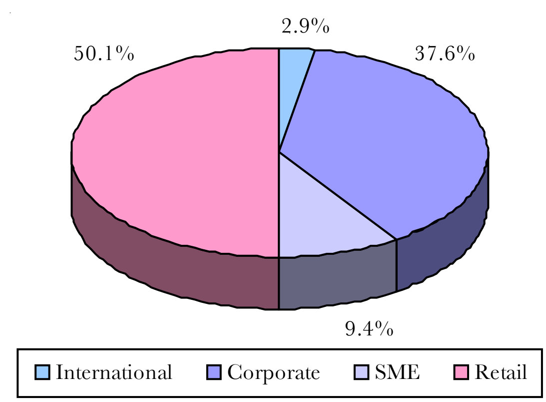
Growth momentum to moderate, as credit quality remains paramount

Bank expects loan growth to moderate to ~22-23% in FY12, as bank would like to play the down-cycle cautiously without taking undue risk. Capex demand is feeble; however, working capital demand still remains strong. Retail loan demand, particularly auto, is showing signs of moderation, but not sharp fall. Competition is steadily increasing in auto space (from NBFCs as well as banks), which could lead to price war, particularly during festive season. However, within retail portfolio, construction equipment business is still showing promising growth, whereas, Used CV business is still in nascent stage. Gold loan portfolio primarily targeted towards HNI customers has silently scaled up to ~1 - 1.5% of loan book and could become as big as Mannapuram Gold finance (> Rs 60 bn) in few years. Bank will continue to buy home loan portfolio from HDFC Ltd during the year to meet its PSL norms. Experiment with education loans has not been fruitful and thus bank may avoid this segment.

HDFCB has consistently outperformed systemic credit growth and in process gained market share; expects loan growth 4-5% above system in FY12

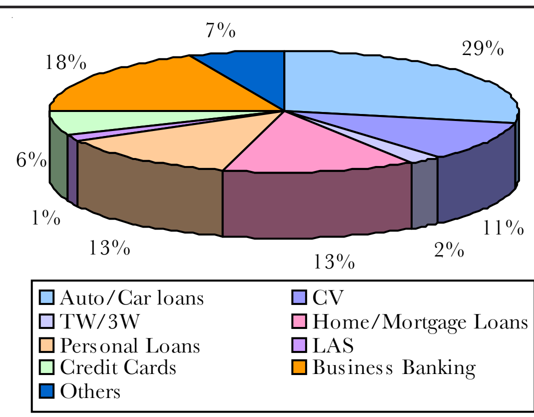


Retail still forms large chunk of loan portfolio; international loan book is steadily expanding

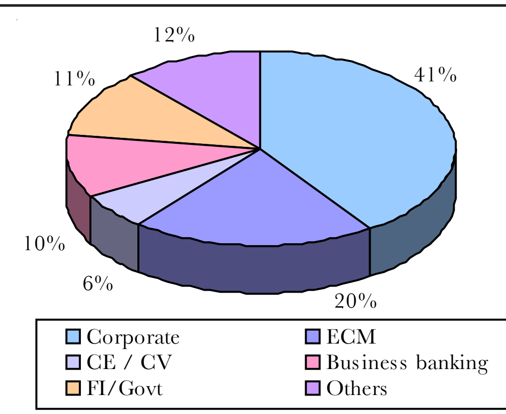


Source: Company, B&K Research

Despite visible slowdown in auto loans, bank expect 30% YoY growth in retail portfolio driven by home loan, CV, business banking and gold loans….



Break-up of wholesale advances; CE/CV portfolio primarily consists of dealer financing

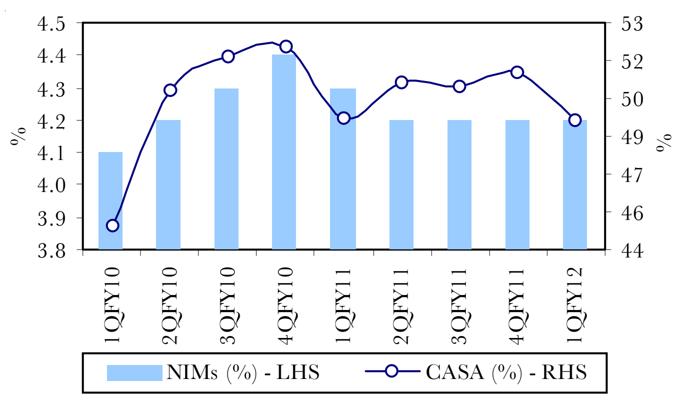


Source: Company, B&K Research

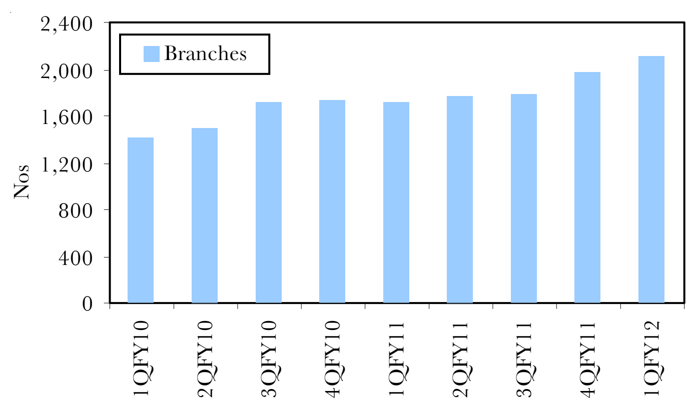
One of the best NIMs > 4%; to remain range bound

After a lull of nearly 5 quarters, bank added 145 branches in 1QFY12 and plans to add ~200-250 branches every year under its renewed branch expansion plan, thereby strengthening its liability franchisee. As per branch banking head Mr Navin Puri, bank is steadily scaling up its presence in deeper geographies and thus garnering new business (including CASA) which helps bank maintain healthy growth momentum. Management expects CASA ratio to moderate to 46-48% (from highs of 49-52%) as term deposit growth picks up. Though bank has reported steady NIMs during past 4 quarters in contrast to the sector, management expects NIM to remain largely range bound (3.9-4.3%), as growth moderates and further rate hike will be difficult, whereas, cost pressures remain.

NIMs (reported) remain largely stable, led by healthy CASA… Depending upon the mix of secured and unsecured lending, management expects NIMs to remain range bound (3.9-4.2%)

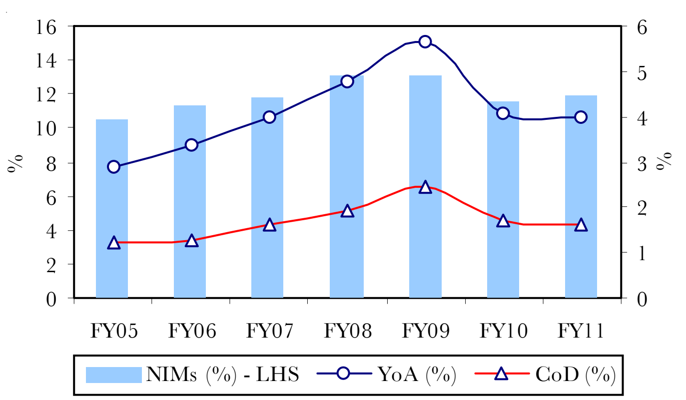


Branch expansion is back on track since past 2 quarters, after nearly a lull of 5 quarters….

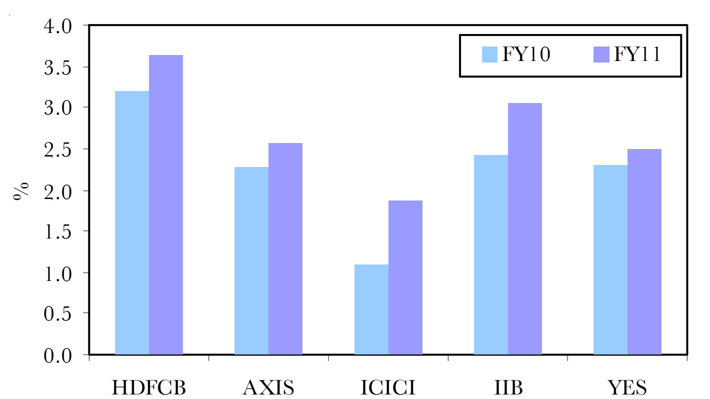


Source: Company, B&K Research

Higher margins during FY08 and FY09 was primarily due to merger of CBoP and better yields…



HDFC Bank relatively remains best among its peers on risk adjusted margins…



Source: Company, B&K Research

Sector wise NPAs: Bank has shown improvement across all sectors except industry…

Sector	FY10 (%)	FY11 (%)	Change (bps)
Agriculture and allied activities	0.91	0.54	(37)
Industry	1.46	1.67	21
Services	3.86	1.59	(227)
Personal Loans	1.11	0.55	(56)

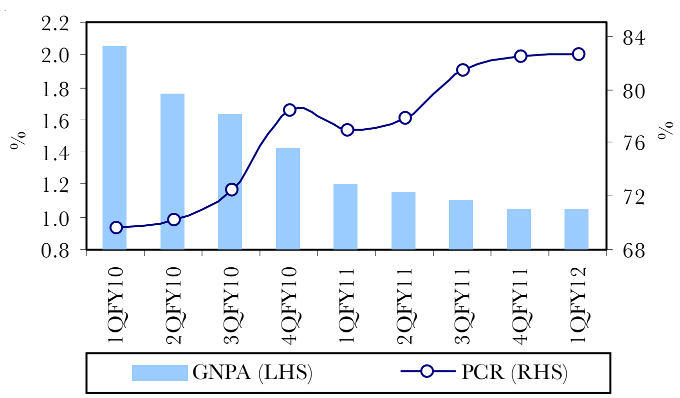
Source: Company, B&K Research

Asset quality deterioration imminent, but unlike last cycle

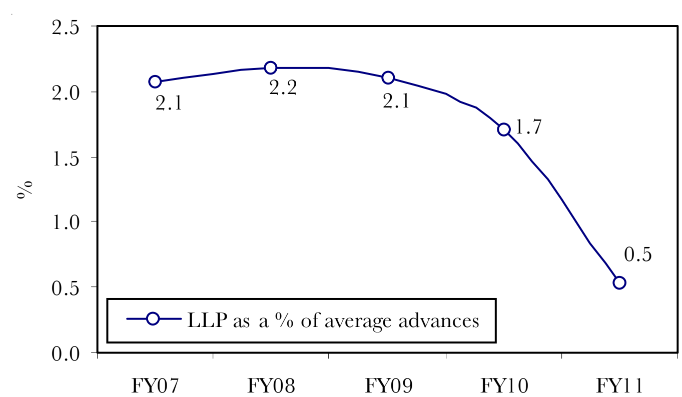
Asset quality trend remains benign, however, expects some pressure going ahead given systemic stress, but is likely to be gradual. During last downturn, bank had seen sharp deterioration in asset quality with GNPA ratio increasing to 2% and slippage ratio at 5.3%, primarily due to acquisition of high risk loans from Centurion Bank of Punjab (contributing ~ 40% of GNPA's in FY09). However, erstwhile CBoP's portfolio has run-off and thus does not pose significant risk anymore.

Bank's retail portfolio, primarily auto/CV, cards and personal loans remain vulnerable to asset quality deterioration given systemic stress. Management has not seen any significant stress till now, however, expect the same to commence since 3QFY12 onwards. On the corporate front, bank has relatively lower exposure to stressed sectors such as power (2%), textiles (1%) and metals (2.4%). Also bank's corporate portfolio is largely working capital loans, which are considered to be relatively less risky as compared to project loans. As per management, slippage ratio for FY12 may go up to 1.2-1.5% from 1.1% in FY11 and GNPA ratio at max of 1.4% in FY12. Credit cost is likely to inch up as specific provisioning requirement may go up, however, would reduce floating provisions (made Rs 2.5 bn in 1QFY12) to off-set the same.

Bank's asset quality remains one of the best in the industry with higher provision coverage…

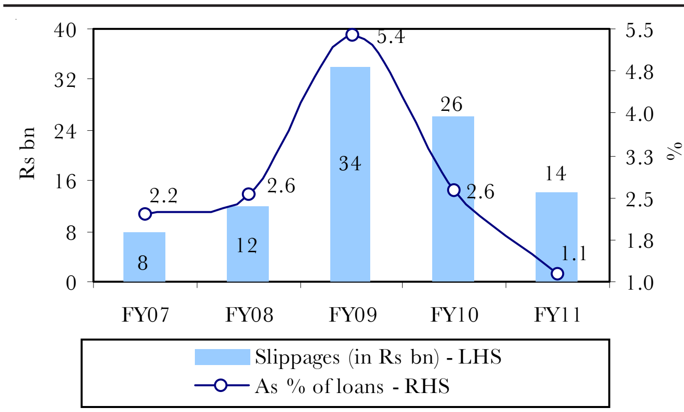


Going forward, we expect credit quality to remain healthy with slight uptick in credit cost as specific provisioning requirement may go up, however, would reduce floating provisions to off-set the same

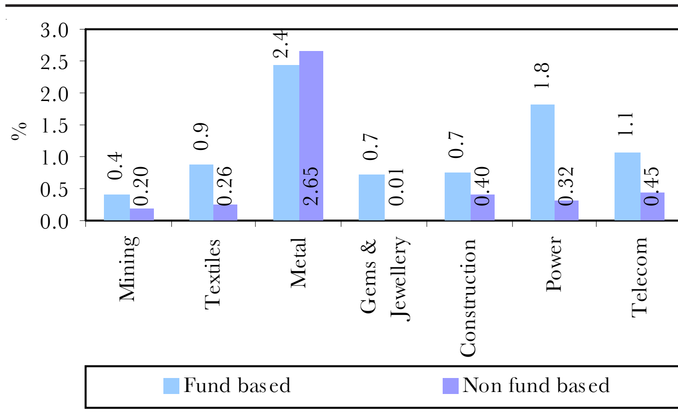


Source: Company, B&K Research

HDFC Bank expect an uptick in slippage ratio to 1.2 - 1.5% in FY12, given systemic stress



HDFC Bank's total exposure to sensitive sectors is relatively lower than its peers…

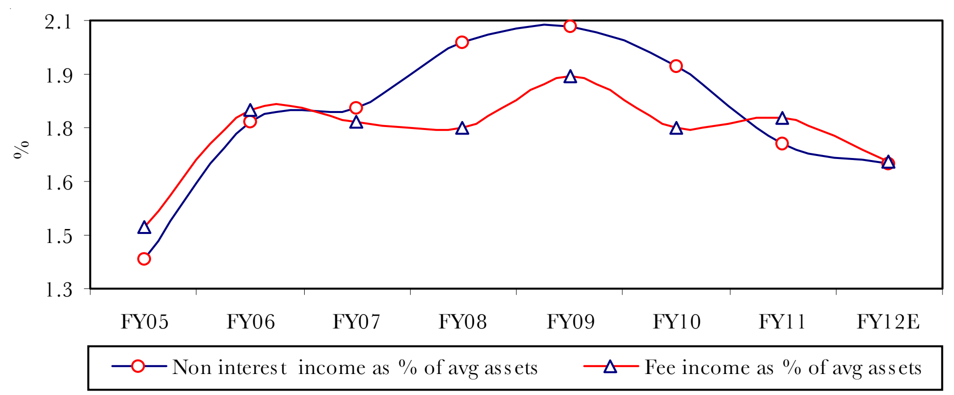


Source: Company, B&K Research

Fee growth to moderate

Bank has healthy fee income base with fee/assets ratio of 1.7%, leading to higher RoA in the range of 1.6%. Fee income from third party distribution contribute nearly 25% of retail fee income, however, given slowdown in the MF/insurance business, this source of fee income is likely to remain subdued. Bank expects fee income to grow by 15% YoY in FY12, down from about 18-20%.

Fee/assets ratio remains healthy at 1.7%...



Source: Company, B&K Research

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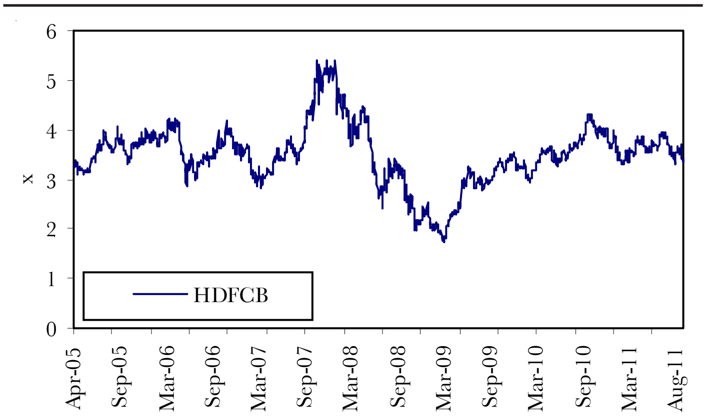
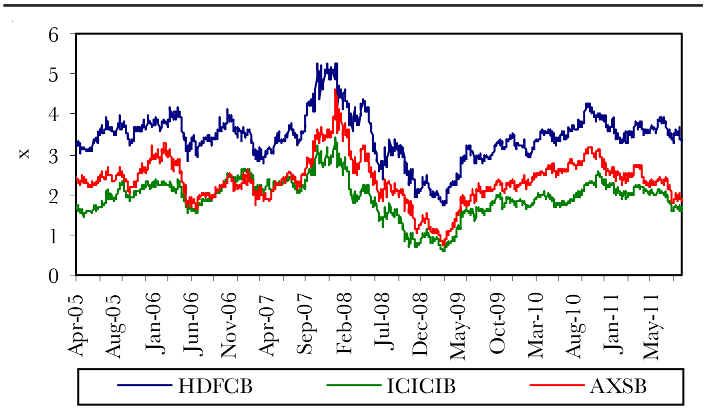
HDFCB trading at nearly 5 yr average P/BV post recent correction....



...but continues to command premium due to its consistent performance and relatively better fundamentals...



Source: B&K Research

Income Statement

Yr end 31 Mar (Rs mn)	FY10	FY11	FY12E	FY13E
Interest income	161,727	199,282	258,466	319,548
Interest expense	(77,863)	(93,851)	(135,158)	(168,326)
Net interest income	**83,864**	**105,431**	**123,307**	**151,222**
Growth (%)	*13.0*	*25.7*	*17.0*	*22.6*
Non-interest income	39,831	43,352	50,779	60,595
Operating income	**123,695**	**148,783**	**174,087**	**211,817**
Operating expenses	(59,398)	(71,529)	(82,132)	(97,591)
- Staff expenses	(22,892)	(28,360)	(33,494)	(39,182)
Pre-provisions profit	**64,297**	**77,254**	**91,954**	**114,227**
Core operating profit	**60,847**	**77,780**	**91,032**	**113,028**
Growth (%)	*26.9*	*27.8*	*17.0*	*24.2*
Provisions & Contingencies	(21,400)	(19,061)	(19,638)	(24,728)
Pre-tax profit (before non-recurring items)	42,897	58,193	72,316	89,499
Pre-tax profit (after non-recurring items)	42,897	58,193	72,316	89,499
Tax (current + deferred)	(13,410)	(18,929)	(22,780)	(27,745)
Net profit	**29,487**	**39,264**	**49,537**	**61,754**
Adjusted net profit	**29,487**	**39,264**	**49,537**	**61,754**
Growth (%)	*31.3*	*33.2*	*26.2*	*24.7*
Net income	**29,487**	**39,264**	**49,537**	**61,754**

Balance Sheet

Yr end 31 Mar (Rs mn)	FY10	FY11	FY12E	FY13E
Cash and balance with RBI/Banks	299,424	296,688	303,517	372,939
Investments	586,076	709,294	871,296	1,042,043
Advances	1,258,306	1,599,827	1,957,572	2,443,180
Int. earning assets	**2,143,806**	**2,605,809**	**3,132,384**	**3,858,161**
Fixed assets (Net block)	21,228	21,706	26,266	32,101
Other assets	59,551	146,011	171,421	188,253
Total assets	**2,224,586**	**2,773,526**	**3,330,071**	**4,078,515**
Deposits	1,674,044	2,085,864	2,582,036	3,172,937
Other interest bearing liab.	129,157	143,941	177,208	217,415
Total Interest bearing liab.	2,009,361	2,519,733	3,037,628	3,735,204
Other liabilities and prov.	206,159	289,929	278,384	344,852
Share capital	4,577	4,652	4,652	4,652
Reserves & surplus	210,648	249,140	287,791	338,659
Shareholders' funds	215,225	253,793	292,443	343,311
Total equity & liab.	**2,224,586**	**2,773,526**	**3,330,071**	**4,078,515**

Key Ratios

Yr end 31 Mar	FY10	FY11	FY12E	FY13E
Valuation ratios (Rs)				
Adjusted EPS	13.4	17.0	21.3	26.5
BVPS	94.0	109.1	125.7	147.6
Adjusted Book NAV/share	92.9	108.3	124.2	144.9
PER (x)	32.8	25.8	20.6	16.5
Price/Book (x)	4.7	4.0	3.5	3.0
Price/Adjusted book (x)	4.7	4.1	3.5	3.0
Dividend Yield (%)	0.6	0.8	0.9	0.9
Du-Pont ratios				
NII/Avg. Assets (%)	4.1	4.2	4.0	4.1
Non-interest income/Avg Assets	2.0	1.7	1.7	1.6
- Fee income/Avg Assets	1.8	1.8	1.7	1.6
- Trading gains/Avg Assets	0.2	0.0	0.0	0.0
Cost/Avg Assets	2.9	2.9	2.7	2.6
Non-tax Provisions/Avg Assets	1.1	0.8	0.6	0.7
Tax Provisions/Avg Assets	0.7	0.8	0.7	0.7
RoA (%)	1.5	1.6	1.6	1.7
Leverage	11.1	10.7	11.2	11.7
RoE (%)	16.1	16.7	18.1	19.4
Balance Sheet ratios (%)				
Loan growth	27.3	27.1	22.4	24.8
Deposit growth	17.2	24.6	23.8	22.9
Loans/Deposits	75.2	76.7	75.8	77.0
Investments/Deposits	35.0	34.0	33.7	32.8
CASA ratio	52.0	52.7	48.8	47.1
Profitability ratios (%)				
NIMs	4.3	4.4	4.3	4.3
Interest spread	3.6	3.7	3.6	3.7
Yield on advances	10.8	10.6	11.2	11.2
Cost of deposits	4.5	4.3	5.1	5.3
Efficiency/other P/L ratios (%)				
Non-interest income/Net income	32.2	29.1	29.2	28.6
Trading income/Net income	2.8	-0.4	0.5	0.6
Cost/Income	48.0	48.1	47.2	46.1
Asset quality ratios (%)				
Gross NPLs	1.4	1.1	1.3	1.5
Net NPLs	0.3	0.2	0.3	0.4
Net NPLs/Net worth	1.8	1.1	1.8	2.7
Loan provisions/Avg loans	1.7	0.5	1.1	1.2
Provisions cover	78.3	82.4	78.0	75.0
Capitalisation ratios (%)				
Tier I cap.adequacy	13.3	12.2	11.9	12.1
Total cap.adequacy	17.4	16.2	16.1	16.3

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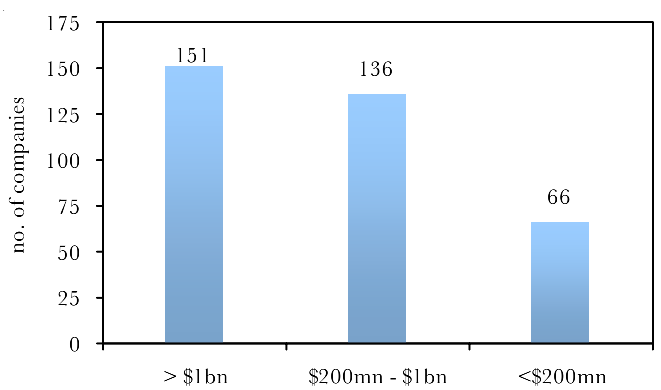
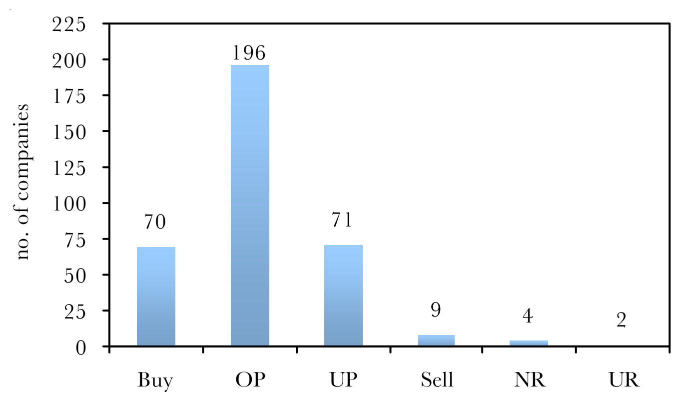
B&K Universe Profile

By Market Cap (US$ mn)



By Recommendation



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1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

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