

Company Results

24 April 2007 | 8 pages

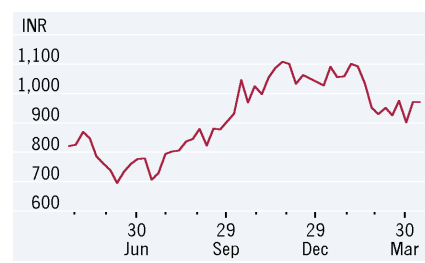
HDFC Bank (HDBK.BO)

Hold: 4QFY07 Results - A Profitable, but Slow Quarter

- Profits up 30.6%, in-line with expectations** — HDBK's profits are up 30.6%, and not surprisingly, in-line with our and consensus estimates. It is another good quarter – though characterized by some volatility with a sharp jump in margins, and almost no asset growth. Results reflect HDBK's ability to manage and control its business; as also some of the challenges of a competitive market place. Maintain Hold/Low Risk (2L) recommendation, with a Rs1155 price target.
- Margins drive profitability, fees stay soft** — A near 50bp margin jump is the primary profit driver, and should be the best show in the sector. It has been achieved by staying out of the competitive deposit market, limiting asset growth, and benefiting from large deposit floats. Expect margins to moderate, but stay 4% plus. Fees are a more modest profit performer; and will likely lag asset growth over next 2 quarters.
- Asset growth the trade-off – should be back on track** — There is no loan growth in the quarters – lags peers and the market. Management categorical this is tactical – sees enough demand, should maintain an equal split between corporate and retail, and expects to get back to its 25-30% growth path. We expect a growth bounce back; another slack quarter could, however, be a valuation risk.
- Asset quality remains stable - No undue pressures** — While provisioning is up – on account of regulatory increases, underlying NPLs remain low, and management sees trends largely in-line with expectations. There probably are some product pressures, reflecting high growth and product risks; management comfortable with its portfolio, provisioning and the environment.

Hold/Low Risk	2L
Price (24 Apr 07)	Rs1,013.60
Target price	Rs1,155.00
Expected share price return	14.0%
Expected dividend yield	0.6%
Expected total return	14.5%
Market Cap	Rs323,733M US\$7,802M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	6,650	21.80	24.6	46.5	6.9	18.4	0.4
2006A	8,709	27.28	25.1	37.2	6.0	17.7	0.5
2007E	11,568	35.94	31.7	28.2	5.1	20.0	0.6
2008E	15,628	48.41	34.7	20.9	4.2	22.6	0.7
2009E	20,647	63.95	32.1	15.8	3.4	24.4	0.8

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	46.5	37.2	28.2	20.9	15.8
P/E reported (x)	46.5	37.2	28.2	20.9	15.8
P/BV (x)	6.9	6.0	5.1	4.2	3.4
P/Adjusted BV diluted (x)	7.1	6.1	5.2	4.3	3.5
Dividend yield (%)	0.4	0.5	0.6	0.7	0.8
Per Share Data (Rs)					
EPS adjusted	21.80	27.28	35.94	48.41	63.95
EPS reported	21.80	27.28	35.94	48.41	63.95
BVPS	145.86	169.24	198.33	240.23	296.94
Tangible BVPS	145.86	169.24	198.33	240.23	296.94
Adjusted BVPS diluted	142.32	165.18	193.60	234.50	289.86
DPS	4.50	5.50	6.00	7.00	8.00
Profit & Loss (RsM)					
Net interest income	17,779	25,543	35,098	44,380	56,663
Fees and commissions	5,740	10,451	14,422	18,027	22,534
Other operating Income	1,639	1,683	2,253	2,776	3,535
Total operating income	25,158	37,676	51,773	65,182	82,732
Total operating expenses	-10,854	-16,911	-23,904	-29,970	-37,576
Oper. profit bef. provisions	14,304	20,765	27,869	35,212	45,156
Bad debt provisions	-1,762	-4,798	-7,836	-8,451	-9,983
Non-operating/exceptionals	-2,758	-3,348	-3,022	-3,779	-4,809
Pre-tax profit	9,784	12,620	17,011	22,983	30,363
Tax	-3,134	-3,910	-5,444	-7,354	-9,716
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	6,650	8,709	11,568	15,628	20,647
Adjusted earnings	6,650	8,709	11,568	15,628	20,647
Growth Rates (%)					
EPS adjusted	24.6	25.1	31.7	34.7	32.1
Oper. profit bef. prov.	40.4	45.2	34.2	26.3	28.2
Balance Sheet (RsM)					
Total assets	515,604	735,064	949,968	1,204,968	1,541,982
Avg interest earning assets	455,856	604,693	812,031	1,040,820	1,331,688
Customer loans	330,257	437,209	569,774	738,013	957,423
Gross NPLs	4,390	5,087	7,318	7,922	10,948
Liab. & shar. funds	515,604	735,064	949,968	1,204,968	1,541,982
Total customer deposits	363,543	557,968	737,657	975,117	1,289,625
Reserve for loan losses	5,291	5,378	7,946	10,291	11,493
Shareholders' equity	45,199	52,995	62,503	75,705	93,578
Profitability/Solvency Ratios (%)					
ROE adjusted	18.4	17.7	20.0	22.6	24.4
Net interest margin	3.90	4.22	4.32	4.26	4.26
Cost/income ratio	43.1	44.9	46.2	46.0	45.4
Cash cost/average assets	2.3	2.7	2.8	2.8	2.7
NPLs/customer loans	1.3	1.2	1.3	1.1	1.1
Reserve for loan losses/NPLs	120.5	105.7	108.6	129.9	105.0
Bad debt prov./avg. cust. loans	0.6	1.3	1.6	1.3	1.2
Loans/deposit ratio	90.8	78.4	77.2	75.7	74.2
Tier 1 capital ratio	9.6	8.6	8.1	7.6	7.2
Total capital ratio	12.2	11.4	12.6	11.1	10.1

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Figure 1. 4Q07 Financial Results HDFC Bank

	4Q07	4Q06	YoY %	3Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	19,898	13,785	44.3	17,593	13.1	
Interest Expense	(8,721)	(6,391)	36.5	(8,307)	5.0	
Net Interest Income	11,177	7,394	51.2	9,286	20.4	Well ahead of expectations, as management trades margins for growth - boosted by a Rs300m CRR gain
Fee-Based Income	4,600	3,830	20.1	3,944	16.6	Average show - in part because of a high base effect (exceptional 4Q06), and in part a carry through of account rationalization in the previous quarter - expect slack for another 2 quarters
Other Non-Interest Income	(656)	(789)	-16.8	(211)	210.9	A mix of an expected mark down on the corporate bond portfolio, and MT M losses
Non Interest Income	3,944	3,042	29.7	3,733	5.7	
Operating Income	15,121	10,436	44.9	13,019	16.1	
Operating Expenses	(6,839)	(4,823)	41.8	(6,050)	13.0	Higher than expected, after cost checks earlier in the year - likely reflective of an aggressive branch expansion during quarter, with over a 100 branches added
Pre-Provision Profit	8,282	5,612	47.6	6,969	18.8	
Charges for Bad Debts	(2,609)	(1,103)	136.5	(1,929)	35.3	Incorporates a large one of regulator driven charge on higher GP for standard assets - will be an industry trend, particularly for consumer heavy portfolio's. Specific provisioning in line with expectations, though a little lower than previous quarter. Does not tell a tale
Other Operating Items	(694)	(713)	-2.7	(735)	-5.6	
Operating Profit	4,979	3,796	31.2	4,305	15.7	
Pre-Tax Profit	4,979	3,796	31.2	4,305	15.7	
Tax	(1,543)	(1,164)	32.5	(1,349)	14.4	Remains at the marginal level
Net Profit	3,436	2,632	30.6	2,956	16.2	In line with expectations
EPS	10.8	8.4	12.2	9.4	14.0	
Customer Loans	469,448	350,612	33.9	480,214	-2.2	Asset degrowth in the quarter - management stays out of the market on account of competitive and relatively irrational deposit pricing - does moderate growth levels, which are below historical levels, and lower than industry average - little change in loan portfolio mix
Customer Deposits	682,979	557,968	22.4	667,487	2.3	Stays out of the bulk deposit market - effectively improves mix, though expected growth should see low cost deposit proportion retrace from the current high 55% level
AIEA	776,267	701,381	10.7	829,794	-6.5	
AIBL	711,871	581,090	22.5	688,440	3.4	
Total Assets	912,356	735,063	24.1	896,077	1.8	Flat quarter - unusual for the last quarter
Avg Assets	904,216	705,646	28.1	869,853	4.0	
Non-Performing Loans (NPL)	6,500	5,000	30.0	6,500	0.0	Stays in check; management suggest asset quality largely in line with expectations, with little directional flavor. Expects a relatively balanced portfolio and growth mix should keep asset quality in check, and predictable.
Loan Loss Reserves (LLR)	(4,622)	(3,537)	30.7	(4,700)	-1.7	
Shareholders' Funds	64,332	52,995	21.4	61,835	4.0	
Book Value Per Share	204	170	20.3	196	4.0	
Key Ratios (%)	4Q07	4Q06	Bps Δ YoY	3Q07	Bps Δ QoQ	Citigroup Investment Research Comments
ROAA (annualized)	1.51	1.43	7	1.32	19	
ROAE (annualized)	21.37	19.87	150	19.12	224	
Net Interest Margin (bps)	450	422	28	403	47	Sharp jump in margins - asset push through, and trade-off with growth in the quarter
Fee Inc/Operating Income	30.4	36.7	-628	30.3	13	A dip - on relatively modest fee growth, and a strong NII show
Other Non-Interest Inc/Op Inc	26.1	29.1	-306	28.7	-259	
Op. Cost/ Operating Income	45.2	46.2	-99	46.5	-124	Remain within targeted levels, but absolute growth is higher than in previous quarters
Loan-to-Deposit Ratio (LDR)	68.7	62.8	590	71.9	-321	
NPL/Loan Ratio	1.2%	1.4	-141	1.4	3	
LLR/NPL Ratio	71	71	37	72	-120	Overall coverage - including GP, in excess of 115%

Source: Company Reports and Citigroup Investment Research

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HDFC Bank

Company description

HDFC Bank, which began operations in 1994, is 24%-owned by HDFC - India's premier mortgage-finance institution. In 2000 HDFC Bank took over private-sector Times Bank. HDFC Bank is headquartered in Mumbai and has a network of more than 684 branches spread across 316 cities. It also serves its customers in 90 locations through phone banking. The bank has a network of more than 1,600 ATMs. About 13% of the bank's equity is listed on the NYSE in the form of ADS. HDFC Bank entered into an arrangement with HDFC in FY04 through which HDFC Bank sources mortgages for HDFC. HDFC Bank pays HDFC for credit appraisal and operations and receives a fee for sourcing. In addition, HDFC Bank buys back 70% of mortgages at a price of 125bps lower than the yield of the mortgages. HDFC Bank has had strong and steady growth over the past 10 years and continues to grow at more than 30%.

Investment thesis

We rate HDFC Bank as Hold/Low Risk (2L) with a 12-month target price of Rs1155. We believe HDFC Bank should be able to generate a premium to its current trading level as it sustains asset growth, consolidates its distribution, leverages off new capital and stabilizes its business mix with increased retail returns. HDFC Bank should also enjoy increased growth and stability in its fee franchise due to its consistently widening distribution platform. While we expect HDFC Bank to trade in the 3-4x P/BV band over the longer term, we see it trading at the upper end of its trading band, as it raises ROE's on capital that is now getting fully leveraged. We remain positive on the bank's prospects and management's ability to deliver, but in the near term the stock's performance could be moderated by high valuations relative to ROE and peers, uncertainty on interest rates, possible capital raising, and competitive pricing, particularly on the deposit pricing front.

Valuation

Our valuation is based on our EVA-based methodology, which values HDFC Bank at Rs1155. Our EVA value is based on an 8% risk-free rate, higher-than-industry margins and higher capital ratio (6.75% vs 6% average). Our revised EVA is premised on revised earnings, and higher spread and fee growth expectations over the longer term, which are premised on a reduced SLR going forward.

Our target price is also benchmarked off a 4x FY08E P/BV of Rs961. The basis for our target multiple - a distinct premium to all other Indian commercial banks - is HDBK's structurally higher margin, de-risked earnings and balance sheet mix, and gains in the consumer-lending franchise. We believe a re-rating from current levels would be difficult.

We prefer using an EVA-based valuation benchmark to P/BV because EVA concentrates on the economic value creation of the bank.

Risks

We rate HDFC Bank as Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share-price volatility. The downside and upside risks to our target price lie in: (1) any negative/positive news on asset quality; (2) management changes; (3) emergence of high quality and scale competitors; and (4) the HDFC Bank-HDFC agreement. If any of these factors has a greater

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impact than we expect, the stock could have difficulty achieving our target price.

Appendix A-1

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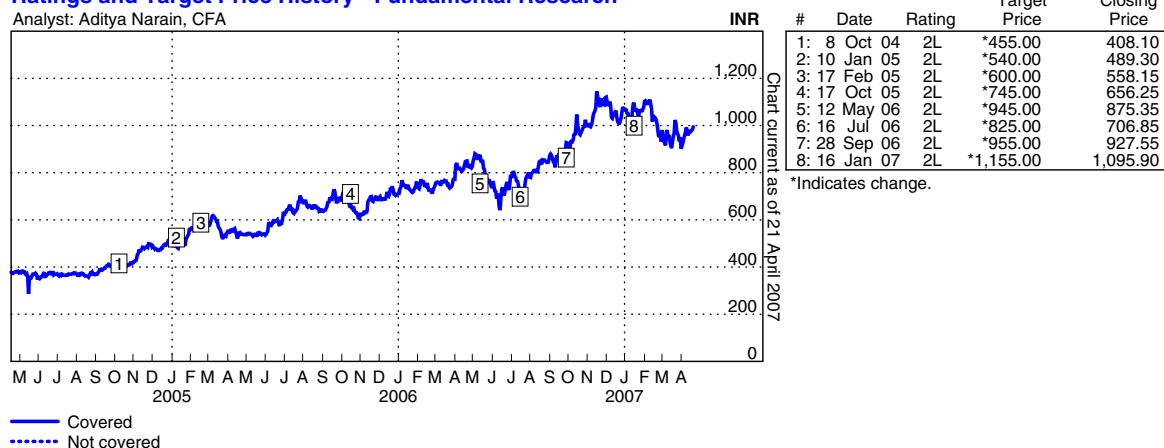
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HDFC Bank (HDBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



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