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Results

HDFC Bank: Operational performance continues to be on track

News Roundup

Corporate

- GMR Infrastructure Ltd, which is currently modernizing the Delhi airport and also building the new airport in Hyderabad, has bagged the tender for developing the Sabiha Gokcen International (SGA) airport in Istanbul, Turkey. (BS)
- Private sector lender HDFC Bank Ltd is marketing a US\$ 600 mn sale of American Depository Shares and the deal will price on July 18. The offering of New York Stock Exchange-listed shares has an over-allotment option of up to US\$ 90 mn (ET)
- Reliance is pushing automakers to sell vehicles through its various retail formats. The company had recently sent a proposal to Bajaj Auto for retailing the latter's bikes through its outlets. Reliance is also in talks with India's largest motorcycle manufacturer Hero Honda. (ET)
- Reliance Energy Ltd plans to invest Rs 600 bn over the next five years to add 15,000 MW of power generation capacity. (FE)

Economic and political

- Buoyed by high growth rate in petroleum refinery product output and higher production of finished carbon steel, the index for infrastructure industries registered a growth of 8.7% in May this year compared with 7.2% in May 2006. (BL)
- The government is examining a proposal to affect a big hike in the ceiling for investments by foreign institutional investors (FIIs) in the Indian debt market. The cap at present is US\$4.7 bn (US\$3.2 bn in government securities and US\$1.5 bn in corporate debt).
- Gas producers - Reliance Industries (RIL) and Oil and Natural Gas Corporation (ONGC) - today asked the government's Committee of Secretaries to do away with regulated (read subsidized) price of gas. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

India	Change, %			
	10-Jul	1-day	1-mo	3-mo
Sensex	15,010	(0.2)	6.6	13.9
Nifty	4,406	(0.3)	6.3	14.1
Global/Regional indices				
Dow Jones	13,502	(1.1)	0.6	8.1
Nasdaq Composite	2,639	(1.2)	2.6	7.3
FTSE	6,631	(1.2)	1.0	3.4
Nikkie	18,061	(1.1)	1.3	2.2
Hang Seng	22,561	(1.4)	9.4	10.3
KOSPI	1,893	(0.1)	10.3	25.1
Value traded - India				
		Moving avg, Rs bn		
	10-Jul	1-mo	3-mo	
Cash (NSE+BSE)	155.6	142.4	140.5	
Derivatives (NSE)	327.2	418.4	220.5	
Deri. open interest	759.0	623.1	474.4	

Forex/money market

	Change, basis points			
	10-Jul	1-day	1-mo	3-mo
Rs/US\$	40.4	-	(39)	(243)
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.0	3	(20)	(8)

Net investment (US\$m)

	9-Jul	MTD	CYTD
FIs	218	1,759	5,712
MFs	(47)	111	(88)

Top movers -3mo basis

Best performers	Change, %			
	10-Jul	1-day	1-mo	3-mo
RELIANCE CAPITAL	1,162	0.2	21.3	72.1
BALAJI TELEFILMS L	243	0.1	10.5	67.0
STATE BANK OF IND	1,551	(1.3)	15.7	58.0
GREAT EASTERN SH	334	(1.1)	15.1	52.4
MOSER BAER INDIA	492	(1.1)	13.1	51.1
Worst performers				
POLARIS SOFTWARE	155	0.1	(4.8)	(13.5)
CIPLA LTD	212	0.2	0.2	(10.4)
ESSEL PROPACK LT	65	(0.9)	(3.6)	(9.9)
RAYMOND LIMITED	305	0.2	(1.9)	(9.0)
SUN PHARMACEUTI	995	(1.5)	(5.9)	(8.7)

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Banking**HDBK.BO, Rs1148**

Rating	IL
Sector coverage view	Neutral
Target Price (Rs)	1,180
52W High -Low (Rs)	1274 - 693
Market Cap (Rs bn)	366.6

Financials

March y/e	2007	2008E	2009E
Sales (Rs bn)	52.3	64.7	82.4
Net Profit (Rs bn)	11.4	14.7	18.9
EPS (Rs)	35.7	46.1	59.2
EPS gth	28.5	29.0	28.3
P/E (x)	32.1	24.9	19.4
P/B (x)	5.7	4.8	4.1
Div yield (%)	0.6	0.8	1.0

Shareholding, March 2007

	% of Pattern Portfolio	Over/(under) weight
Promoters	21.6	-
FIs	51.3	2.6
MFs	3.1	0.9
UTI	-	-
LIC	3.0	0.8

HDFC Bank: Operational performance continues to be on track

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- **HDFC Bank reported a PAT of Rs3.2 bn—yoy growth of 34% and 4% higher than our estimates**
- **Lower NII growth due to lower average interest earning assets and strong non-interest income key operational highlights in this quarter.**
- **We would be revising our estimates and outlook on the stock post further discussion with the management**

HDFC Bank reported a PAT of Rs3.2 bn -- yoy growth of 34% and 4% higher than our estimates. Net interest income growth was relatively subdued, primarily due to lower average interest bearing assets in the current quarter rather than a contraction in NIM. In fact, HDFC Bank reported a marginal improvement in NIM to 4.2% in 1QFY08 from 4.1% in 1QFY07. Non-interest revenues remained robust at the bank driven by higher fee and exchange income. The sustainability of this revenue stream will be dependent on buoyant capital markets and its ability to sell treasury products to corporate customers. (a) Provision of Rs576 mn, which was made against the reserves of the bank as a transitional measure on adoption of the revised AS-15 guidelines on employee benefits and (b) Equity infusion of Rs13.9 bn by HDFC at price of Rs1,024 per share on June 29, 2007 are the other highlights of the current quarter. We would be revising our estimates and outlook on the stock post further discussion with the management.

Net interest income growth was moderate. HDFC Bank reported a moderate growth of 28% yoy in NII in 1QFY08 and recorded an income of Rs10.4 bn under this head. Lower average earning assets in the current quarter led the bank to report a lower-than-expected NII growth despite a marginal increase in NIM to 4.2% in 1QFY08 from 4.1% in 1QFY07. It is to be noted that the bank had reduced its asset growth in the 4QFY07 quarter (total assets were Rs912 bn and Rs896 bn in 4QFY07 and 3QFY07 respectively), which implied that the bank had a lower base of assets to earn interest income in the current quarter. There was also likely a mismatch in resource mobilization and resource deployment, which led the bank to incur higher interest costs in the current quarter. CASA ratio of the bank has come down to a more sustainable level of 52% as of June 2007 down from the high level of 58% as of March 2007.

Non-interest income growth was robust, sustainability is critical. Non-interest revenue for HDFC Bank in 1QFY08 was Rs5.8 bn-growth of 65%yoy and 39% higher than our estimates. Fee income and exchange income were the key contributors for this revenue line. Bank management has indicated that the fee income (income of Rs3.7 bn in 1QFY08) was driven by sale of mutual fund and insurance products. Sustainability of the high growth (at close to 28%yoy) of this income stream would depend on the continued buoyancy in capital markets. Exchange income for the bank in 1QFY08 was Rs1.5 bn (163% yoy growth), which the management suggested was driven by sale of large ticket exchange rate related treasury products to corporates.

Provisions and operating expenses were largely in line with expectations. HDFC Bank made credit provisions (standard asset + NPL provisions) of Rs3 bn in 1QFY08- higher standard asset provisions on retail assets, capital market exposure and NPL provisions due to focus on riskier personal loan category were the drivers of this expense line. Employee expenses increased by 71% yoy to Rs2.8 bn in 1QFY08, management indicated that this was driven by wage inflation and increase in the employee strength at the bank.

Provisions under revised AS-15 guidelines and investment by HDFC - other key highlights. HDFC Bank made a one-time provision of Rs576 mn (post tax) to comply with the revised AS-15 guidelines for employee benefits. This provision was adjusted against the networth of the bank. As per the revised AS-15 guidelines companies have to also provide for accumulated leave balances of its employees, e.g. if an employee has accumulated 180 days of leave and decides to exercise her option of going on leave, financial impact of recruiting a similar resource for the said period to maintain the company's operations has to be accounted in the financial statements. HDFC Bank made this provision in the current quarter to comply with this requirement. Management has indicated that going forward; provision for the accumulated leave of its employees will be routed through the P&L based on an actuarial valuation.

HDFC has made an investment of Rs13.9 bn on June 29, 2007 at Rs1,024 per share. This is in lieu with the intention of HDFC to maintain its stake in the bank at close to 22% after the proposed equity raising of Rs42 bn or US\$1 bn by HDFC Bank in the current fiscal year. Capital adequacy ratio of the bank is comfortable at 13.1% with a Tier I ratio of 9.2% as of June 2007.

HDFC Bank quarterly performance

(Rs mn)

	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	% chg	1Q08KS	Actual Vs KS
Interest income	13,785	15,043	16,357	17,593	19,898	21,259	41.3		
Interest on advances	8,227	9,058	9,958	11,373	12,953	14,536	60.5		
Interest on invt	5,126	5,195	5,933	5,848	6,010	6,172	18.8		
Other interest	432	790	465	372	936	551	(30.3)		
Interest expense	6,391	6,867	7,901	8,307	8,721	10,836	57.8		
Net interest income	7,394	8,176	8,456	9,286	11,177	10,422	27.5	11,856	(12.1)
Net interest income - Recurring	7,394	8,176	8,456	9,286	11,177	10,422	27.5	11,856	(12.1)
NII - post investment amortization	6,677	7,577	7,880	8,682	10,545	9,782	29.1	11,206	(12.7)
Non-int.income	3,042	3,508	3,977	3,733	3,944	5,798	65.3	4,179	38.7
fee income	3,367	2,906	3,141	3,314	3,563	3,722	28.1	3,429	8.5
exchange income	463	558	582	630	1,033	1,465	162.5	750	95.3
Non treasury income	3,910	3,531	3,771	3,944	4,600	5,199	47.3	4,179	24.4
Op. expenses	4,823	5,527	5,791	6,050	6,839	7,744	40.1	8,291	(6.6)
Employee cost	1,376	1,664	1,813	2,138	2,153	2,839	70.6	2,495	13.8
Other cost	3,448	3,864	3,978	3,912	4,686	4,905	27.0	5,795	(15.4)
Operating profit	5,612	6,157	6,642	6,969	8,282	8,477	37.7	7,744	9.5
Provisions and cont.	1,816	2,639	3,057	2,664	3,303	3,711	40.6	3,250	14.2
Investment Amortization	717	599	576	604	632	640	6.8	650	(1.5)
NPLs	1,103	1,854	2,207	1,929	2,609	2,997	61.7	2,600	15.3
PBT	3,796	3,518	3,585	4,305	4,979	4,766	35.5	4,494	6.0
Tax	1,164	1,125	955	1,349	1,544	1,553	38.0	1,393	11.5
Net profit	2,632	2,393	2,629	2,956	3,436	3,212	34.2	3,101	3.6
Tax rate (%)	30.7	32.0	26.6	31.3	31.0	32.6	1.9	31.0	5.1
Op.profit excl treasury gains	6,480	6,180	6,436	7,180	8,938	7,878	27.5	7,744	1.7
PBT-invnt gains+depreciation	5,381	4,140	3,955	5,120	6,267	4,807	16.1	5,144	(6.6)

Liability side details (Rs bn)

Total Deposit	558.0	606.3	634.5	667.5	683.0	816.0	34.6		
Savings deposits	161.9	172.4	182.4	192.4	195.9	209.3	21.4		
Current deposits	147.5	146.7	148.5	174.3	198.1	210.9	43.7		
Term deposits	248.6	287.2	303.6	300.8	289.0	395.9	37.9		
CASA to total deposits	55.4	52.6	52.2	54.9	57.7	51.5			
Borrowings	28.6	41.4	29.8	45.1	28.2	27.8	(33.0)		
CASA as % of deposits and borrowings	52.7	49.3	49.8	51.5	55.4	49.8			

Asset side details

Customer assets	389.9	457.6	493.3	539.0	499.9	590.9	29.1		
Direct credit	350.6	405.7	427.8	482.0	469.4	538.4	32.7		
Invt	39.3	52.0	65.5	57.0	30.5	52.5	1.1		
Corporate / others	177.6	226.4	241.2	279.0	216.6	284.0	25.4		
Retail loans	212.3	231.2	252.1	260.0	283.3	306.9	32.7		
Car loans	48.0	50.0	56.0	61.0	70.0	80.0	60.0		
Loan against sec	17.5	13.5	13.0	13.0	13.0	11.0	(18.5)		
Personal loans	33.0	37.0	41.0	40.0	44.0	54.0	45.9		
Two wheeler	19.0	18.0	18.5	19.5	20.0	18.0	-		
Credit cards	14.0	15.0	17.0	18.0	20.0	21.0	40.0		
Commercial vehicles	49.0	52.0	58.0	47.0	48.0	47.0	(9.6)		
Business Banking	24.0	33.0	38.0	44.0	52.0	54.0	63.6		
Retail loans to customer assets (%)	54.4	50.5	51.1	48.2	56.7	51.9			

NIM (%)

	4.0	4.1	4.0	4.0	4.5	4.2			
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Capital adequacy ratios

CAR (%)	11.4	11.7	12.1	12.8	13.1	13.1			
Tier I	8.6	8.3	8.2	8.4	8.6	9.2			
Tier II	2.8	3.4	3.9	4.4	4.5	3.9			

Asset quality details

Net NPLs (Rsmn)	1,402	1,831	1,973	2,156	2,000	2,364			
- % to advances	0.40	0.40	0.4	0.4	0.4	0.4			

Other details

Branches	535	535	535	583	684	753			
ATM network	1,323	1,348	1,382	1,471	1,605	1,716			
Cities covered	228	228	228	263	316	320			
Debit cards (mn)	3.9	NA	NA	4.0	4.1	4.3			
Credit cards	2.4	NA	NA	2.8	2.9	3.0			

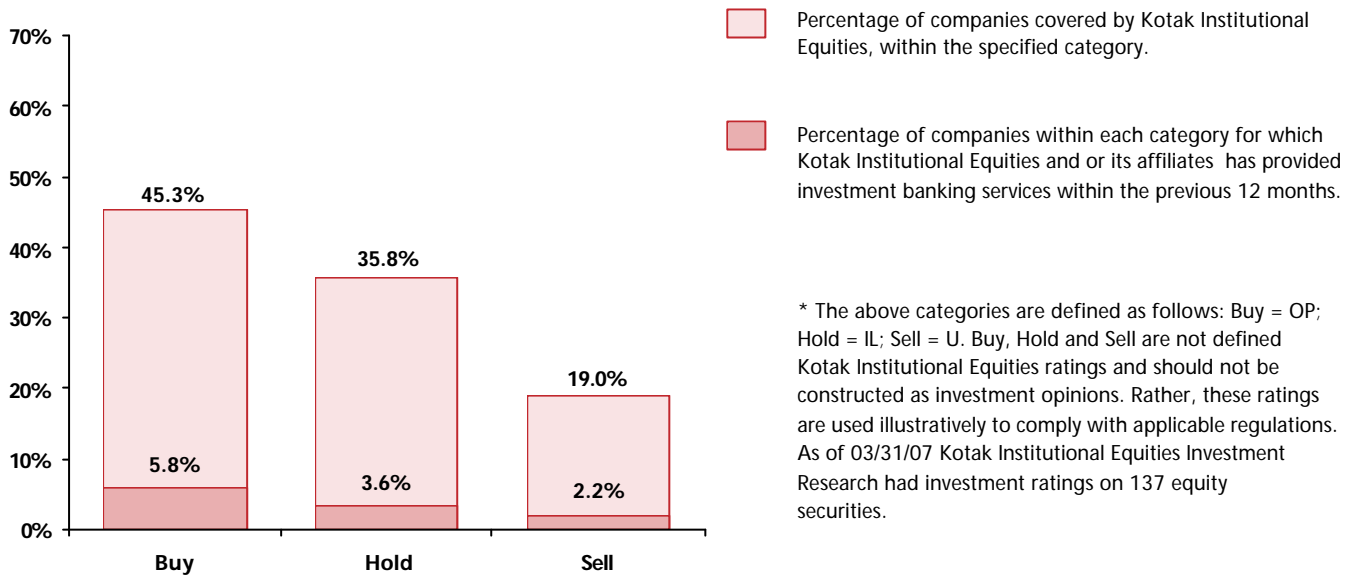
	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08	% chg	1Q08KS	Actual Vs KS
Balance sheet snapshot (Rs bn)									
CAPITAL AND LIABILITIES									
Capital	3	3	3	3	3	3	6.2		
Reserves and surplus	50	52	55	59	61	78	47.9		
Deposits	558	606	634	667	683	816	34.6		
Borrowings	29	41	30	45	28	28	(33.0)		
Subordinated debt	17	21	28	31					
Other liabilities and provisions	78	73	93	91	137	132	81.7		
Total	735	797	844	896	912	1,057	32.6		
ASSETS									
Cash and balances with RBI	33	49	44	45	52	85	74.1		
Balances with banks, money at call and short notice	36	22	19	35	40	36	65.6		
Investments	284	284	311	297	306	352	23.6		
Advances	351	406	428	480	469	538	32.7		
Fixed assets	9	9	9	10	10	10	15.4		
Other assets	23	27	33	29	36	35	29.9		
Total	735	797	844	896	912	1,057	32.6		

Source: Company, Kotak Institutional Equities estimates.

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Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities.

As of March 31, 2007

Ratings and other definitions/identifiers

Current rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.

IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

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