

HDFC

Another consistent quarter

India Equity Research | Banking and Financial Services



HDFC reported consistent earnings growth of 19% YoY to INR10bn, in line with expectations. Although core NII grew 26% YoY, it was offset by lower surplus from investment in mutual funds (off 52% YoY). Individual loan growth of 23% YoY (no sell downs to HDFC Bank in Q1FY13) led 19% advance growth. Dividend income came in higher than expectations due to dividend from HDFC Investments (dividend not yet accrued on HDFC Bank investment). We maintain 'HOLD' with TP of INR676.

Loan growth led by individual segment

Loan book grew 19% YoY and 5% QoQ, to INR1.48tn, led by individual loan book growth of 23% YoY (7% QoQ). The proportion of individual loans improved 140bps to 64.4%. There was no sell down to HDFC Bank in Q1FY13 (similar to trend in Q1FY12), but management continues with its guidance of sell downs of ~INR50bn in full year FY13. After adjusting for sell downs in FY12, individual loan book grew 29%. We maintain our loan growth estimate of 20% CAGR over FY12-14E.

NPLs rose marginally in Q1 following historical trend

- Gross NPLs, following historical trend, inched up in Q1FY13 to 0.79% (by INR1.2bn, to INR11.9bn). While the individual loan book has shown consistent decline in NPLs, from 1.06% in FY08 to 0.55% in FY12, gross NPLs in the non-individual segment have more than doubled to 1.55% (from 0.84% in FY11).
- On incremental loans, the company provided for 40bps standard asset provisioning by taking a hit on P&L. Provisioning was higher in Q1FY13 at INR400mn, of which, INR280mn is likely towards standard asset provisioning.

Outlook and valuations: Consistent core; maintain 'HOLD'

HDFC's performance reinforces our expectation of 20% loan growth, stable margins (at 3.5%) and insignificant stress on asset quality. We are now routing standard asset provisioning through P&L against earlier practice of utilizing excess reserves, thereby revising earning estimates marginally downward but no revision in book value. We expect 19% earnings CAGR and RoE of 22-23% over FY12-14. However, due to utilization of excess reserves towards interest on zero coupon bonds, book value accretion will be 19%. Our SOTP fair value is INR676/ share (FY13E) (valuing the core book at 4.2x and investments at INR223). We maintain 'HOLD/ Sector Performer'.

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Equalweight

MARKET DATA (R: HDFC.BO, B: HDFC IN)

CMP	: INR 679
Target Price	: INR 676
52-week range (INR)	: 726 / 600
Share in issue (mn)	: 1,489.3
M cap (INR bn/USD mn)	: 1,011 / 18,263
Avg. Daily Vol.BSE/NSE('000)	: 3,399.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	-	-	-
MF's, FI's & Banks	19.5	20.3	29.0
FII's	66.7	66.2	58.2
Others	13.8	13.5	12.7

* Promoters pledged shares : NIL
(% of share in issue)

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	0.5	3.5	5.8
3 months	(4.2)	(4.8)	(4.8)
12 months	2.1	(5.6)	(4.0)

Kunal Shah
+91 22 4040 7579
kunal.shah@edelcap.com

Nilesh Parikh
+91 22 4063 5470
nilesh.parikh@edelcap.com

Suruchi Chaudhary
+91 22 6623 3316
suruchi.chaudhary@edelcap.com

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Financials

Year to March	Q1FY13	Q1FY12	Growth (%)	Q4FY12	Growth (%)	FY12	FY13E	FY14E
Inc. from oper. (INR mn)	15,265	12,857	18.7	18,668	(18.2)	59,060	71,217	85,213
PAT (INR mn)	10,019	8,445	18.6	13,261	(24.4)	41,226	48,853	58,193
BV per share (INR)						129	161	179
Adj book value						73	107	124
Diluted EPS (INR)	6.7	5.7	18.2	8.8	(24.4)	27.9	31.8	37.8
Price/ Book (x)						5.3	4.2	3.8
Diluted P/E (x)						24.3	21.3	18.0

Net interest income growth in line with asset growth

- While core net interest income grew 26% YoY, it was offset by lower surplus from investment in mutual funds (off 52% YoY). Therefore, net interest income (including surplus from MF investments) grew 19% in line with asset growth. Funding cost inched up 75bps QoQ due to back-ended nature of borrowings towards the end of fiscal 2012 (full interest impact felt in Q1FY13) and amortization of foreign currency translation reserves.
- Foreign currency translation reserves, which stood at INR2.06bn in FY12, went up to INR4.45bn due to rupee depreciation in Q1FY13.

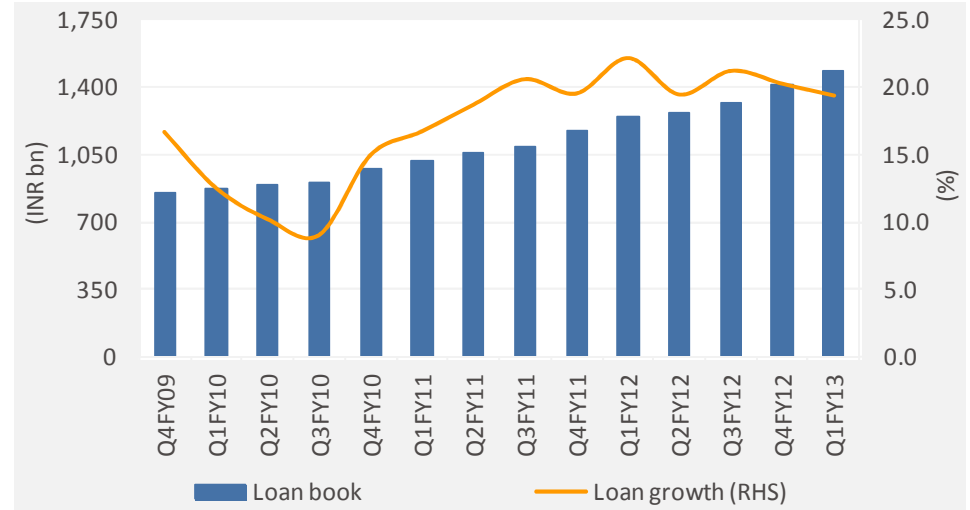
ZCBs: Blended cost net of tax adjusted against net worth

- HDFC would carry zero coupon bonds (ZCBs) on a steady state basis at ~INR75bn, equivalent to the value of its investments in HDFC Bank and insurance companies. The average cost of ZCBs is 9.5-9.7% and it has adjusted interest on ZCBs INR1.49bn (net of tax) from reserves.
- In our estimates, the blended cost of ~9-10% on these are knocked off from securities premium account as per its accounting policy—INR6bn (INR4 per share).

Other highlights

- Other interest income came in higher at INR2.5bn (up 34% YoY), mainly due to interest on deposits, government securities etc.
- Dividend income was higher than expectation due to dividend from HDFC Investments (distribution of dividend received by HDFC Investments from HDFC Bank in FY12). HDFC is yet to accrue dividend from its direct investment in HDFC Bank.

Chart 1: Loan growth led by individual segment; non-individual loans were flat



Source: Company

Chart 2: Gross NPLs marginally up in Q1FY13 (due to seasonality)

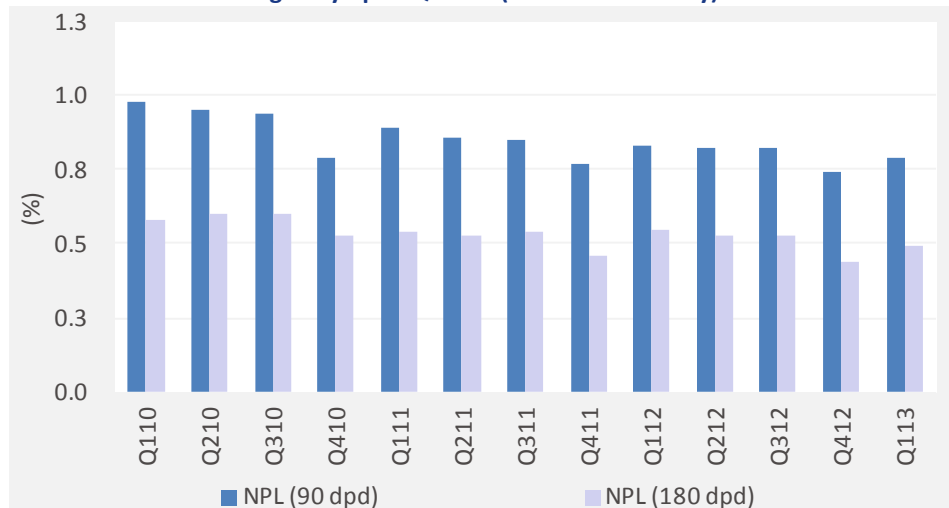
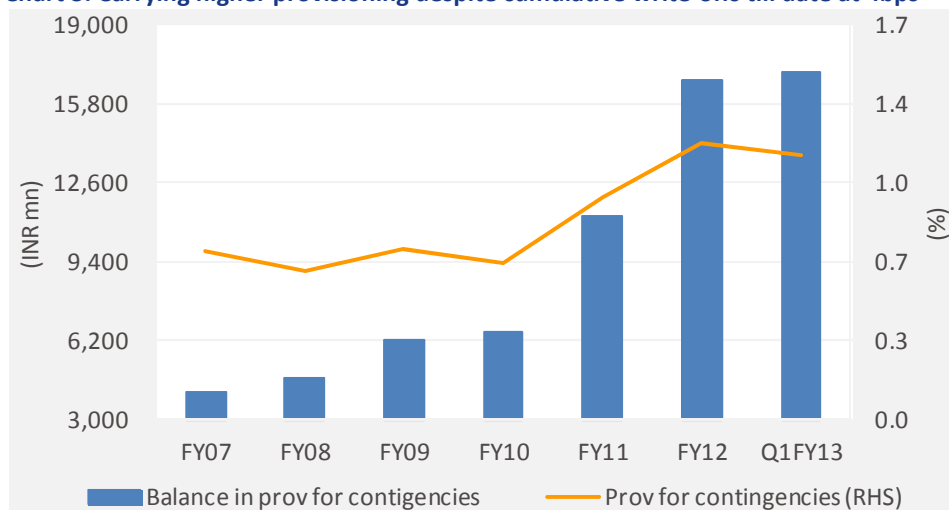


Chart 3: Carrying higher provisioning despite cumulative write-offs till date at 4bps



Source: Company

Table 1: NIMs (calc) compress due to higher funding cost

(%)	Q1FY13	Q4FY12	Change (bps)	Q1FY12	Change (bps)
Yield on home loans	12.2	13.1	(89)	11.0	114
Yield on assets	11.0	11.9	(96)	10.6	42
Cost of funds	9.6	8.8	75	8.4	116
Margins	3.1	4.4	(139)	3.2	(15)

Source: Company, Edelweiss research

Table 2: Book value accretion after adjusting for interest on ZCBs and provisioning

(INR mn)	FY09	FY10	FY11	FY12	FY13E	FY14E
Networth (Opening)	119,473	131,374	151,977	173,165	190,176	247,897
Add: Profits	22,825	28,265	35,350	41,226	48,853	58,193
Add: equity/warrant issuances	552	6,316	9,776	3,071	34,968	2,709
Less: Dividend	9,805	11,905	15,516	18,897	21,078	25,108
Total	133,046	154,050	181,587	198,595	252,919	283,692
Less: Utilization						
Provisioning	1,188		2,986	3,499	1,339	1,186
Interest on zero coupon bonds (net of tax)	431	1,988	5,321	4,851	5,972	6,114
Utilized from Shelter assistance reserve	52	85	115	69	100	100
Reversal of teaser loan provisioning					(2,389)	
Networth (Closing)	131,374	151,977	173,165	190,176	247,897	276,292
Book value per share (INR)	92.4	105.9	118.1	128.8	161.5	179.4
Contribution to growth in book value (%)		15.7	13.9	9.8	30.4	11.5
- Internal accruals		21.5	23.3	23.8	25.7	23.5
- Equity infusion		4.8	6.4	1.8	18.4	1.1
- Dividend		(9.1)	(10.2)	(10.9)	(11.1)	(10.1)
- Utilization		(1.6)	(5.5)	(4.9)	(2.6)	(3.0)

Source: Company

Table 3: SOTP valuation

FY13E	Method	AUMs/book /earnings (INR mn)	Multiple (x)	Value of business (INR mn)	HDFC holding(%)	Value of HDFC's interest (INR mn)	Value per share (INR)
HDFC core mortgage business	PB	164,083	4.2	695,713	100.0	695,713	453
HDFC Bank	Fair value	1,273,090	1.0	1,273,090	23.2	295,357	192
Asset management	% of AUM	1,091,467	5.0	54,573	60.0	32,744	21
Venture Capital	% of AUMs	57,609	10.0	5,761	100.0	5,761	4
HDFC Life Insurance	Appraisal value	3,635	30.3	110,101	72.4	79,680	52
Others						13,530	9
Value of subs						427,072	279
Value (at 20% holding company discount)						341,657	223
Total						1,037,370	676

Source: Edelweiss research

Financials snapshot
(INR mn)

Year to March	Q1FY13	Q1FY12	Growth (%)	Q4FY12	Growth (%)	FY12	FY13E	FY14E
Interest income	46,464	35,131	32.3	46,198	0.6	161,551	171,038	202,720
Interest exp	33,882	25,149	34.7	29,389	15.3	111,568	110,782	130,458
Net interest income	12,582	9,982	26.0	16,808	(25.1)	49,983	60,256	72,263
Dividend income	1,596	1,322	20.7	615	159.4	3,097	3,964	4,756
Others	1,087	1,553	(30.0)	1,244	(12.6)	5,980	6,998	8,194
Net income from ops	15,265	12,857	18.7	18,668	(18.2)	59,060	71,217	85,213
Other income	74	47	57.6	63	17.2	213	213	213
Net revenues	15,339	12,904	18.9	18,730	(18.1)	59,273	71,431	85,426
Depreciation	48	45	7.4	59	(18.4)	205	216	228
Other expenses	1,694	1,267	33.7	1,221	38.8	5,113	6,858	8,022
Profit before tax before	13,597	11,593	17.3	17,451	(22.1)	53,954	64,356	77,177
Profit on Sale of Investments	202	163		791		2,702	3,000	3,000
Profit before tax	13,799	11,755	17.4	18,241	(24.4)	56,656	67,356	80,177
Provision for taxes	3,780	3,310	14.2	4,980	(24.1)	15,430	18,503	21,983
PAT	10,019	8,445	18.6	13,261	(24.4)	41,226	48,853	58,193
Reported net profit (including extraordinaries)	10,019	8,445	18.6	13,261	(24.4)	41,226	48,853	58,193
NII/GII (%)	27.1	28.4		36.4		30.9	35.2	35.6
Cost/income (%)	11.4	10.2		6.8		7.7	7.3	7.0
Tax rate (%)	27.4	28.2		27.3		27.2	27.5	27.4
Balance sheet data (INR bn)								
Borrowings	1,438	1,235	16.4	1,391	3.4	1,391	1,619	1,943
Mortgage assets	1,483	1,242	19.4	1,409	5.2	1,409	1,692	2,038

Company Description

HDFC is India's largest provider of housing finance, primarily focusing on retail housing. The company has widened its distribution network to 304 offices in India. It also covers over 90 locations through its outreach programme, which has helped the corporation disburse housing loans in more than 2,400 towns and cities in India. It has also supplemented the distribution channel through the appointment of direct selling agents (DSA). As on June, 2012, 66.7% of the shares are held by foreign institutional investors/foreign direct investments and 13.8% by individuals. Besides the core business of mortgages, HDFC has evolved into a financial conglomerate, diversifying into other businesses through its subsidiaries viz., HDFC Standard Life Insurance (73%), HDFC Asset Management Company (60%), HDFC Bank (23.2%), and HDFC General Insurance Company (74%).

Investment Theme

HDFC is the strongest and the most venerable play on Indian mortgages over the long term. We expect the company, with its strong brand recall, superior real estate knowledge, and revamped distribution strategy, to attain 20% CAGR in loan disbursement over FY12-14E. Besides the core business, HDFC's insurance, AMC, banking, BPO, and real estate private equity businesses are also growing at a rapid pace and the estimated value of its investments/subsidiaries explains HDFC's ~35% market capitalisation. Value of stakes in HDFC Bank and HDFC Standard Life form a significant portion of its unrealised gains. The stock has always traded at a premium to other financial stocks due to its stable earnings profile, superior asset quality and strong management.

Key Risks

Increase in competition and sustained slack in the mortgage market can lead to lower growth than our estimates.

Higher-than-expected increase in funding cost and inability to pass the cost to customers in the current tightening monetary environment will adversely affect margins and profitability. Risk of fraud and NPA accretion due to increase in interest rates and fall in property prices is inherent to the mortgage business.

Financial Statements

Key assumption

HDFC		FY10	FY11	FY12	FY13E	FY14E
Macro	GDP(Y-o-Y %)	8.4	8.4	6.5	6.4	7.0
	Inflation (Avg)	3.6	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.3	6.8
	USD/INR (Avg)	47.4	45.6	47.9	51.5	50.0
Company	Credit growth	15.0	19.6	20.3	20.1	20.5
	Borrowing growth	15.0	22.0	17.0	18.0	20.0
	Yield on asset	10.1	9.7	11.2	10.0	10.0
	Cost of funds	7.8	7.1	8.8	7.4	7.3
	NIMs	3.3	3.5	3.5	3.5	3.6

Income statement

		(INR mn)				
Year to March		FY10	FY11	FY12	FY13E	FY14E
Interest income		104,506	118,070	161,551	171,038	202,720
Interest expended		70,631	75,599	111,568	110,782	130,458
Net interest income		33,875	42,471	49,983	60,256	72,263
Non interest income		7,008	7,113	9,290	11,175	13,163
- Fee & forex income		2,317	2,204	2,684	3,220	3,865
- Income from investments		1,898	2,175	3,198	3,677	4,229
- Misc. income		2,794	2,734	3,408	4,277	5,070
Income from operations		40,884	49,584	59,273	71,431	85,426
Net revenues		40,884	49,584	59,273	71,431	85,426
Operating expenses		3,237	3,811	4,519	5,192	5,964
- Employee exp		1,467	1,755	2,058	2,367	2,722
- Depreciation /amortisation		182	192	205	216	228
- Other opex		1,589	1,864	2,256	2,609	3,015
Preprovision profit		37,646	45,773	54,754	66,239	79,462
Profit on sale of investments		2,094	3,597	2,702	3,000	3,000
Provisions		580	700	800	1,883	2,285
PBT		39,160	48,670	56,656	67,356	80,177
Taxes		10,895	13,320	15,430	18,503	21,983
PAT		28,265	35,350	41,226	48,853	58,193
Reported PAT		28,265	35,350	41,226	48,853	58,193
Basic number of shares (mn)		1,436	1,467	1,477	1,535	1,540
Basic EPS (INR)		19.7	24.1	27.9	31.8	37.8
Diluted number of shares (mn)		1,436	1,467	1,477	1,535	1,540
Diluted EPS (INR)		19.7	24.1	27.9	31.8	37.8
DPS (INR)		7.2	9.0	11.0	11.8	14.0
Dividend pay out (%)		42.6	43.4	45.7	43.1	43.1

Growth metrics (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Net interest income	10.9	25.4	17.7	20.6	19.9
Net revenues growth	19.9	23.7	16.5	20.1	18.8
Opex growth	2.6	17.7	18.6	14.9	14.9
PPP growth	16.0	21.6	19.6	21.0	20.0
Provisions growth	14.5	20.7	14.3	135.4	21.4
PAT growth	23.8	25.1	16.6	18.5	19.1

Operating ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Yield on assets	10.1	9.7	11.2	10.0	10.0
Yield on advances	10.9	10.5	10.9	10.7	10.6
Cost of funds	7.8	7.1	8.8	7.4	7.3
Spread	2.2	2.6	2.4	2.6	2.6
Net interest margins	3.3	3.5	3.5	3.5	3.6
Cost-income	8.0	7.8	7.7	7.3	7.0
Tax rate	27.8	27.4	27.2	27.5	27.4

Balance sheet

(INR mn)

As on 31st March	FY10	FY11	FY12E	FY13E	FY14E
Liabilities					
Equity capital	2,871	2,934	2,954	3,070	3,079
Share premium	57,796	62,189	58,000	86,880	83,466
Reserves & surplus	91,309	108,043	129,222	157,947	189,747
Net worth	151,977	173,165	190,176	247,897	276,292
Total deposits	230,811	246,251	362,928	428,255	513,906
Secured Loans	636,057	816,415	919,847	1,071,963	1,295,312
Unsecured Loans	98,785	91,439	108,500	118,841	133,854
Total liabilities	1,117,630	1,327,270	1,581,451	1,866,956	2,219,364
Assets					
Loans	979,670	1,171,266	1,408,746	1,691,778	2,037,930
Investments	107,275	118,324	122,070	126,013	130,370
<i>Current assets</i>	74,392	98,610	140,291	131,096	134,301
<i>Current liabilities</i>	48,785	67,751	98,278	91,699	94,421
Net current assets	25,607	30,859	42,014	39,397	39,880
Fixed assets (net block)	2,221	2,340	2,340	2,223	2,096
Other assets	2,857	4,481	6,282	7,544	9,088
Total assets	1,117,630	1,327,270	1,581,451	1,866,956	2,219,364
Balance sheet ratios (%)					
Loan growth	15.0	19.6	20.3	20.1	20.5
Deposit growth	19.1	6.7	47.4	18.0	20.0
EA growth	15.2	18.7	19.1	18.1	18.9
CAR	14.6	14.0	9.4	11.3	10.7

Sanctions and disbursements

(INR mn)

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Sanctions (INR mn)	606,110	751,850	901,540	1,081,848	1,298,218
Disbursements (INR mn)	504,130	603,140	711,130	853,356	1,024,027
Disbursements to sanction ratio (%)	83.2	80.2	78.9	78.9	78.9
Disbursements growth (%)	27.1	19.6	17.9	20.0	20.0
Sanctions growth (%)	23.3	24.0	19.9	20.0	20.0

RoE decomposition (%)

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Net interest income/assets	3.3	3.5	3.5	3.5	3.6
Non interest income/assets	0.7	0.6	0.6	0.7	0.6
Investment gains/assets	0.2	0.3	0.2	0.2	0.1
Net revenues/Assets	4.1	4.4	4.3	4.3	4.4
Operating expense/assets	0.3	0.3	0.3	0.3	0.3
Provisions/assets	0.1	0.1	0.1	0.1	0.1
Taxes/assets	1.0	1.1	1.1	1.1	1.1
Total costs/assets	1.4	1.5	1.4	1.5	1.5
ROA	2.7	2.9	2.8	2.8	2.9
Equity/assets	13.6	13.4	12.6	12.8	12.9
ROAE	20.0	21.7	22.7	22.3	22.2

Valuation metrics

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Diluted EPS (INR)	19.7	24.1	27.9	31.8	37.8
EPS growth (%)	22.7	22.4	15.8	14.0	18.8
Book value per share (INR)	106	118.1	128.8	161.5	179.4
Adjusted book value per share (INR)*	52	64.0	73.4	106.9	123.7
Diluted P/E (x)	34.5	28.2	24.3	21.3	18.0
Price/ BV (x)	6.4	5.8	5.3	4.2	3.8
Price/ Adj. Earnings (x)*	31.0	24.4	19.6	17.3	14.4
Price/ Adj. BV (x)*	10.2	8.0	6.6	4.3	3.5
Dividend yield (%)	1.1	1.3	1.6	1.7	2.1

* adjusted for value of investments in subsidiaries

Peer comparison valuation

	Price (INR)	Mcap (INR bn)	P/ABV		ROE (INR)		P/E (x)	
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
HDFC Ltd	679	1,011	4.3	3.5	22.3	22.2	21.3	18.0
IDFC	140	212	1.5	1.4	14.3	15.2	9.8	9.2
LIC Housing Finance	270	136	1.9	1.6	18.7	18.8	14.4	14.4
Mahindra Finance	694	72	2.2	1.8	23.4	24.2	29.6	23.4
Manappuram Finance	34	29	1.0	0.9	20.8	17.0	1.6	2.0
MCX	1,129	58	4.7	3.9	29.1	27.5	17.8	15.4
Muthoot Finance	138	51	1.4	1.3	27.5	26.4	5.6	4.7
PFC	185	180	1.1	1.0	17.5	18.4	6.5	5.5
Reliance Capital	374	92	0.6	0.4	6.4	6.9	12.2	10.7
Rural Electrification Corp	197	195	1.1	1.0	21.3	20.4	9.3	9.7
Shriram City Union Finance	682	36	1.8	1.5	22.0	21.5	31.0	31.7



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	REDUCE	SU	H	Axis Bank	BUY	SO	M
Bank of Baroda	HOLD	SP	L	Federal Bank	BUY	SO	M
HDFC	HOLD	SP	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	H
IndusInd Bank	BUY	SO	H	Infrastructure Development Finance Co Ltd	BUY	SO	M
ING Vysya	BUY	SO	M	Karnataka Bank	BUY	SO	L
Kotak Mahindra Bank	REDUCE	SU	L	LIC Housing Finance	HOLD	SP	M
Mahindra & Mahindra Financial Services	BUY	SO	M	Manappuram General Finance	BUY	SO	M
Multi Commodity Exchange of India	BUY	SO	M	MUTHOOT FINANCE	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	H	Power Finance Corp	BUY	SO	L
Punjab National Bank	REDUCE	SU	M	Reliance Capital	BUY	SO	M
Rural Electrification Corporation	BUY	SO	L	Shriram City Union Finance	BUY	SO	H
South Indian Bank	HOLD	SP	M	State Bank of India	HOLD	SP	M
Union Bank Of India	HOLD	SP	H	Yes Bank	BUY	SO	M

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
Sector Underperformer (SU)	Stock return < 1.25 x Sector return
	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.

Board: (91-22) 4009 4400, Email: research@edelcap.com

Vikas Khemani	Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Nischal Maheshwari	Co-Head Institutional Equities & Head, Research	nischal.maheshwari@edelcap.com	+91 22 4063 5476
Nirav Sheth	Head Sales	nirav.sheth@edelcap.com	+91 22 4040 7499

Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, IndusInd Bank, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Multi Commodity Exchange of India, Manappuram General Finance, Mahindra & Mahindra Financial Services, MUTHOOT FINANCE, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Union Bank Of India, ING Vysya, Yes Bank

Recent Research

Date	Company	Title	Price (INR)	Recos
10-Jul-12	Indusind Bank	No asset quality strain; strong core fee income; <i>Result Update</i>	344	Buy
10-Jul-12	Bank of Baroda	Outperformance on asset quality narrowing down; <i>Visit Note</i>	710	Hold
29-Jun-12	ING Vysya Bank	Asset quality stable even in testing times;	366	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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