

BUY

Price	Rs 1,093
Target Price	Rs1,366
Investment Period	12 months

Stock Info

Sector	Banking
Market Cap (Rs cr)	46,473
Beta	1.0
52 WK High / Low	1575/774
Avg Daily Volume	310899
Face Value (Rs)	10
BSE Sensex	11,135
Nifty	3,424
BSE Code	500180
NSE Code	HDFCBANK
Reuters Code	HDBK.BO
Bloomberg Code	HDFCB@IN

Shareholding Pattern (%)

Promoters	19.3
MF/Banks/Indian FIs	22.7
FII/ NRIs/ OCBs	46.8
Indian Public	11.2

Abs.	3m	1yr	3yr
Sensex (%)	28.4	(33.3)	(7.4)
HDFC Bank (%)	25.2	(24.3)	28.5

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Performance Highlights

- Low Net Interest Income growth:** The Bank's Deposits and Advances were flat sequentially, consistent with the Bank's fourth quarter strategy in the past few years. However, growth in Net Interest Income (NII) at 13% yoy was lower than expected. This was partly on account of reduced pricing power on loans as compared to 3QFY2009 and partly on account of the full impact of high-cost Bulk Deposits contracted in 3QFY2009 coming through in 4QFY2009. Consequently, reported NIMs were 10bp lower sequentially at 4.2%. NII growth also appeared low on a yoy basis due to much stronger NIMs in 4QFY2008 of 4.4% on account of substantial zero-cost capital market floats enjoyed by the Bank in that period.
- Robust Fee Income:** The Bank's Fee Income grew at a robust 46% yoy to Rs715cr driven by the Retail Segment comprising cards, third-party distribution, processing fees, etc. as well as the Wholesale Segment comprising Cash Management Services and commission income on LCs, BGs, etc. The Bank also booked substantial Treasury gains of Rs244cr, partly on sale of HTM investments. Forex and Derivative linked income was also strong at Rs153cr.
- Minimal Restructuring:** By the end of FY2009, the Bank had restructured loans amounting to Rs120cr, of which Rs69cr were NPAs. In addition, the Bank disclosed that applications received for loan restructuring, which were pending amounted to Rs305cr, of which Rs254cr were NPAs.
- Net Profit growth robust, largely in line with expectations:** The Bank recorded 34% yoy growth in Net Profit to Rs631cr, which was however marginally below our estimates on account of the lower-than-expected NII. Since the 4QFY2008 numbers don't include effect of the merger with Centurion Bank of Punjab (eCBoP) and standalone numbers for eCBoP are not available for 4QFY2009, yoy comparisons are not on a like-to-like basis.

Key Financials

Y/E March (Rs cr)	FY2008	FY2009	FY2010E	FY2011E
NII	5,228	7,421	9,987	12,607
% chg	40.9	42.0	34.6	26.2
Net Profit	1,590	2,245	2,845	3,531
% chg	39.3	41.2	26.7	24.1
NIM (%)	4.9	4.9	5.0	5.1
EPS (Rs)	44.9	52.8	63.0	78.2
P/E (x)	24.4	20.7	17.3	14.0
P/BV (x)	3.4	3.2	2.4	2.1
P/ABV (x)	3.4	3.2	2.5	2.2
RoAA (%)	1.4	1.4	1.4	1.4
RoANW (%)	17.7	17.2	16.2	16.2

Source: Company, Angel Research

- **CASA improves; Retail loans increase:** The Bank's CASA ratio improved to 44% partly on account of year-end increase in current account balances and partly on account of the sequential fall in term deposits. As for a more indicative average daily balances, growth in current account was negligible during FY2009 due to the substantial fall in capital market floats during the year. On a yoy basis, even adjusting for the eCBoP merger, growth in Retail loans was high at 35%. The Bank's Retail loan book of Rs61,154cr accounted for 61% of its total loans. Within Retail loans, Auto, CV and Two-wheeler loans accounted for 42%, business loans 21% and personal loans and credit cards another 20%. The Bank also kept Rs4,000cr of mortgages on its books to meet priority sector requirements. Management indicated that it continued to expect largely similar growth rates across its broad business segments. Also, within the Retail Segment, management acknowledged an improvement, albeit mild, from the point-of-view of fresh demand as well as deterioration in Asset quality.
- **Continued restraint on Operating expenses:** The Bank continued to focus on cost controls, with its Cost-to-Income ratio declining to 47% from a peak of 56% in 1QFY2009. Staff expenses were 13% lower sequentially partly on account of rationalisation in field staff in line with peers and partly due to an inflated base caused by one-off items in 3QFY2009. The Bank did not add any branches during 4QFY2009 as well (the branch network remained at 2QFY2009 levels of 1,412) although it did add 118 more ATMs. Management has indicated that around 200-250 branch additions have been planned for FY2010E. We believe that the substantial inorganic and organic network expansion since 3QFY2009 will enable the Bank to regain strong traction in CASA deposits and Fee Income marketshare gains over the next 1-2 years, especially once the macro-environment starts improving, progressively restoring financial parameters like CASA ratio and RoE back to pre-merger levels.
- **eCBoP merger progress:** Since the acquisition, HDFC Bank has been gradually exiting some of segments in which eCBoP operated. eCBoP's loan book at the time of acquisition was Rs15,084cr, which has been run down to around Rs10,000cr. Similarly, Fee Income accruing through eCBoP branches up to 3QFY2009 has been lower since the acquisition, even as operating expenses have largely been at same levels, due to which Bottom-line contribution from the eCBoP acquisition has not yet been material since 4QFY2008. While HR and IT integration of the eCBoP branches have been completed, it is likely to take the Bank 12-18 months for productivity improvements to scale up closer to its own branches levels, so that the merger benefits start accruing to its Bottom-line. At present, out of the Bank's total Gross NPAs of Rs1,988cr, 42% (Rs835cr) are attributable to eCBoP, indicating a high rate of slippage in the eCBoP loan portfolio post-acquisition as well.
- **Minimal restructuring attributable to Credit mix; NPAs remain high:** As compared to other Private and PSU Banks, the magnitude of restructuring at around 0.1% of Advances (or even 0.4% including pending applications) has been lower for HDFC Bank to a large extent on account of its Credit mix. The Bank's Credit book comprises 60% Retail loans, where in any case there is no restructuring. Secondly, within its Corporate portfolio, the focus is on larger corporates, due to which the Bank has received fewer applications. In respect of its exposure to smaller corporates also, the focus has largely been on working capital loans, where again restructuring is rare.

At the same time, NPA provisions continue to be high, again in consonance with the Bank's Credit mix. Gross slippages for FY2009 stood at around Rs3,000cr, and NPA provisions at Rs1,727cr, which was 15-20bp higher than expectations as a % of average assets, partly on account of eCBoP-related NPAs. Out of the Total Provisions of Rs657cr during the quarter, NPA provisions were around Rs600cr, also higher than expectations. Management has indicated its intention to maintain provision coverage of at least 60% on incremental NPAs.

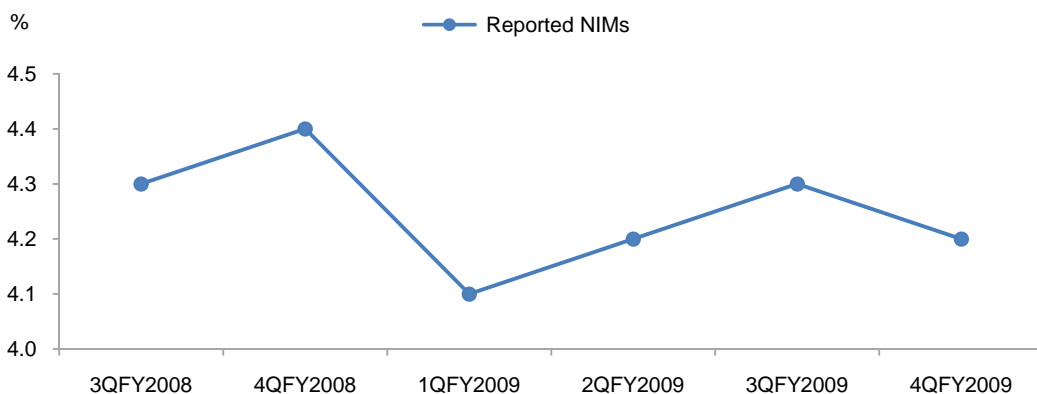
In any case, recoveries are typically low in the segments in which the Bank operates, as reflected in its average recovery rates of around 10% over the past 7-8 years. Consistent with this, the Bank follows a policy of aggressively writing off Retail NPAs within 180/270/360 days depending on the product, much faster than regulatory requirements. Importantly, the Bank has been effective in pricing in the high NPA costs and at the RoA level, remains amongst the highest in the Sector on account of its superior Deposit mix and diversified Fee Income base. More Capital Adequacy (CAR) at 15.7% and Tier 1 CAR at 10.6% remain amongst the highest in the Sector, providing further margin of safety.

- Treasury:** The Bank continued to avoid looking at treasury as a key profit centre. 90% of Investments are SLR, of which 75% are HTM. The balance AFS book has a low duration of 1-1.5 years. However, going by recent trends, booking gains on the HTM book to absorb high NPA provisions from an accounting point-of-view cannot be ruled out for the sector in general. The Bank's HTM book has a duration of 3.5-4 years.

Outlook and Valuation

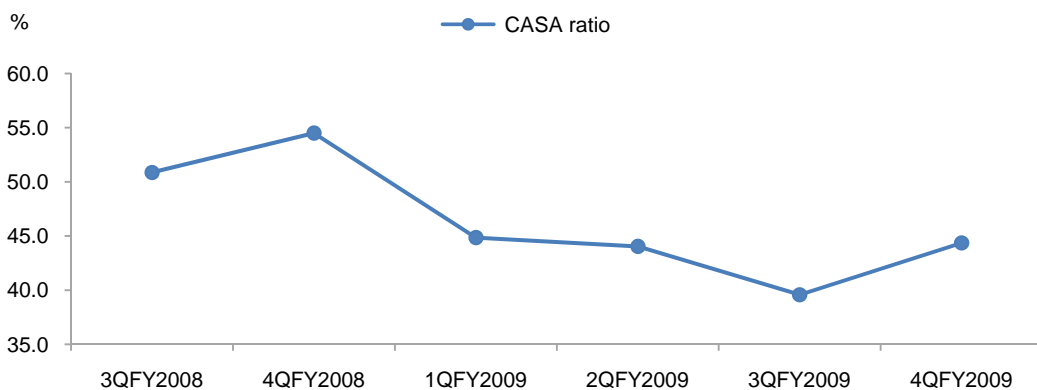
We believe HDFC Bank is among the most competitive banks in the Indian Banking Sector and is poised to maintain its profitable growth over the long term. We believe the Bank's competitive advantages, driving gains in CASA marketshare and traction in multiple Fee Revenue streams, can support up to 5% higher core sustainable RoEs vis-à-vis Sectoral averages over the long term, creating a material margin of safety in our Target valuation multiples. At the CMP, the stock is trading at 17.3x FY2010E EPS of Rs63 and 2.5x FY2010E ABV of Rs445. **We maintain a Buy on the stock, with a Target Price of Rs1,366, implying an upside of 25%.**

Exhibit 1: Trend in reported NIMs



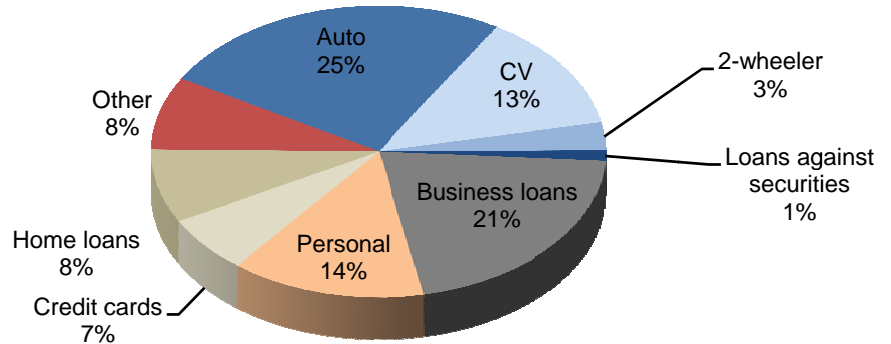
Source: Company, Angel Research

Exhibit 2: Trend in CASA Ratio



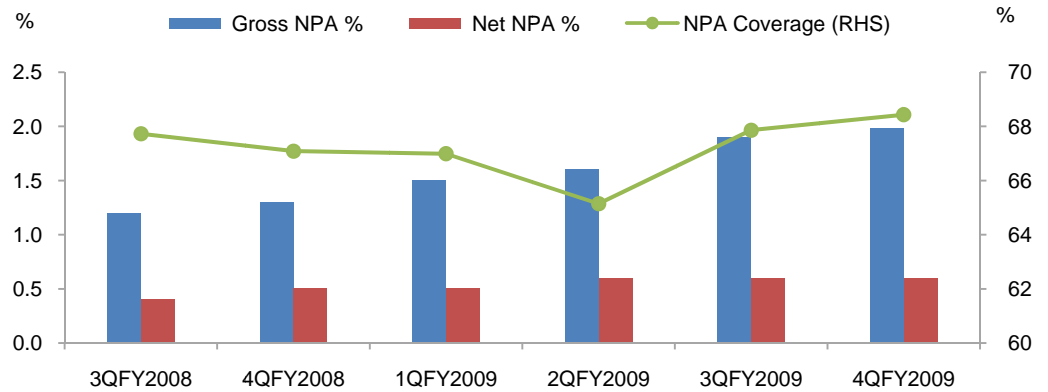
Source: Company, Angel Research

Exhibit 3: Retail Credit mix (FY2009)



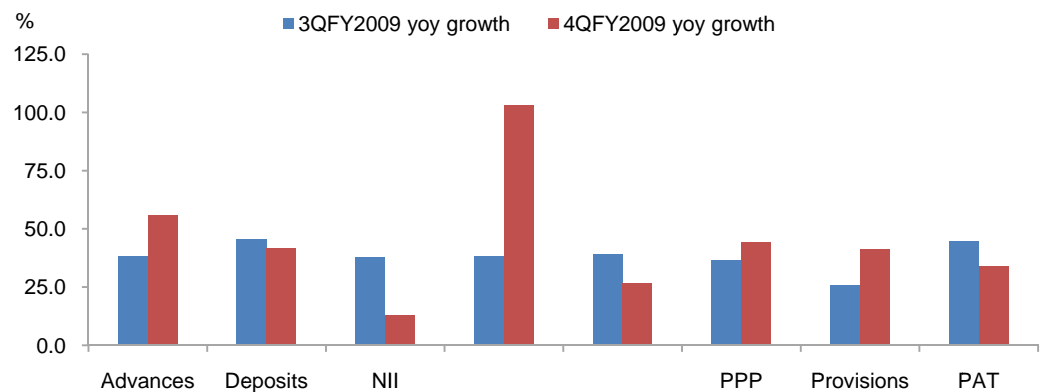
Source: Company, Angel Research

Exhibit 4: Trend in Asset quality



Source: Company, Angel Research

Exhibit 5: NII growth low; Other Income drives growth



Source: Company, Angel Research

Exhibit 6: 4QFY2009 Performance

Y/E March (Rs cr)	4QFY2009	4QFY2008	% chg	FY2009	FY2008	% chg
Interest Earned	4,251	2,956	43.8	16,332	10,172	60.6
Interest Expenses	2,399	1,314	82.5	8,911	4,887	82.3
Net Interest Income	1,852	1,642	12.8	7,421	5,285	40.4
Non-Interest Income	1,115	549	102.9	3,291	2,226	47.8
Total Income	2,967	2,191	35.4	10,712	7,511	42.6
Operating Expenses	1,396	1,103	26.6	5,533	3,746	47.7
Pre-Prov Profit	1,571	1,089	44.3	5,179	3,765	37.5
Provisions & Cont.	657	465	41.3	1,880	1,485	26.6
PBT	913	623	46.5	3,299	2,281	44.7
Prov. for Taxes	282	152	85.1	1,054	691	52.7
PAT	631	471	33.9	2,245	1,590	41.2
EPS (Rs)	14.8	13.3	11.6	52.8	44.9	17.6
Cost to Income (%)	47.1	50.3		51.7	49.9	
Effective Tax Rate (%)	30.9	24.5		32.0	30.3	
Net NPA (%)	0.6	0.5				

Source: Company, Angel Research



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Ratings (Returns) : Buy (Upside > 15%)
Reduce (Downside upto 15%)

Accumulate (Upside upto 15%)
Sell (Downside > 15%)

Neutral (5 to -5%)