

July 28, 2008

BUY

Price **Rs1,127** Target Price **Rs1,500**

Sensex **14,349**

Price Performance

(%)	1M	3M	6M	12M
Absolute	11	(25)	(29)	(3)
Rel. to Sensex	6	(10)	(10)	3

Source: Capitaline

Stock Details

Sector	Banks
Reuters	HDBK.BO
Bloomberg	HDFCB@IN
Equity Capital (Rs mn)	4246
Face Value	10
No. of shares (mn)	425
52 Week H/L	1825/890
Market Cap	Rs479bn/USD11.3bn
Daily Avg Volume (No of shares)	1.2mn
Daily Avg Turnover (US\$)	31.9mn

Shareholding Pattern (%)

	J'08	M'08	D'07
Promoters	19.4	23.3	23.3
FII/NRI	50.9	49.3	50.3
Institutions	5.6	5.8	6.2
Private Corp	10.0	8.9	8.1
Public	14.1	12.8	12.1

Kashyap Jhaveri
kashyap.jhaveri@emkayshare.com

+91 22 6612 1249

Pradeep Agrawal
pradeep.agrawal@emkayshare.com

+91 22 6612 1340

HDFC BankResult
Update**CBOP merger to cost Rs7bn more**

HDFC Bank's has reported net profit of Rs4.6bn for Q1FY09, which is marginally ahead of our expectations. The NII (on like to like basis) has grown by 53.2% yoy driven by stable NIMs of 4.1%. The fee income has reported a good 29% yoy growth. The operating profit has grown by 31% yoy (on like to like basis) to Rs12.9bn and net profit by 32.7% yoy to Rs4.6bn.

The bank seemingly has taken Rs7bn (Rs5bn for NPAs and Rs2bn for other accounting policies) hit on the balance sheet to realign the accounting and provisioning policies of erstwhile Centurion Bank of Punjab (CBOP). On positive side, the **RoE of the bank (excluding treasury losses) is back to about 17.5%** with likely improvement in the coming quarters. The NPAs at net level have remained at 0.5% with provision cover of 67%.

At the current valuations of 15.2x its FY2010E EPS and 2.3x FY2010E P/ABV, the stock seems quite attractive. We retain BUY rating on the stock with a price target of Rs1,500.

NII grows 53.2%yoy

HDFC Bank's NII grew by 53.2% yoy to Rs16.4bn on like to like basis driven by 47.2% yoy growth in advances (on like to like basis) to Rs968bn. The NIMs remained stable at 4.1% on yoy basis, albeit lower than 4.3% reported in Q4FY08.

Rs mn	Q1FY09	Q1FY08	% yoy change
Net interest income	17,235	11,249	53.2
Other Income	5,934	7,272	-18.4
Net Income	23,169	18,521	25.1
Operating Expenses	12,894	9,842	31.0
Operating profit	10,275	8,679	18.4
Provisions	3,445	3,455	-0.3
Profit before tax	6,830	5,224	30.8
Provision for Taxes	2,187	1,725	26.8
Net Profit	4,644	3,499	32.7

Source: Companies, Emkay Research

Note:

1. We have combined Centurion Bank of Punjab's and HDFC Bank's Q1FY08 numbers to arrive at like to like figures
2. The consolidation of account has been with effect from April 1, 2008 although effective date of merger is May 23, 2008

Higher yields help maintain margins

The NIM's remained stable driven by better yields on advances and investments. However, the NIMs contracted by ~30bps on sequential basis as the balance sheet size as at the end of Q4FY08 was artificially down driven by sell of loans to reduce priority sector lending obligations.

NIM analysis

(%)	Q1FY09	Q1FY08	Q4FY08	Change in bps yoy	qoq
Yield on advances	13.2	11.5	11.9	162.5	124.2
Yield on investments	8.0	6.8	7.7	114.1	25.8
Yield on assets	9.6	8.4	8.9	119.5	66.4
Cost of funds	5.0	4.4	4.0	63.0	105.9
NIM	4.6	4.0	5.0	59.6	-36.4
Core NIM's	4.1	4.1	4.4	0.0	-30.0

Source: Company, Emkay Research * Calculated on basis of average quarterly balances

Advances growth remains healthy.....

The bank registered a 80%yoy growth in the overall advances driven by a strong growth in retail assets.

The growth in the retail assets was led by personal loans, business banking loans and auto loans. The commercial vehicles/auto loans portfolio has seen sharp jump driven by consolidation of CBOP's portfolio. Credit cards business has also seen significant expansion.

Retail loan portfolio mix

	Rs mn	% yoy change	Proportion (%)	Change in bps	
				yoy	qoq
Auto Loans	113,000	41.3	20.6	-567	-386
Personal Loans	84,000	55.6	15.3	-242	-163
CVs	80,000	70.2	14.6	-85	-58
Loan Against Securities	10,800	-1.8	2.0	-164	-147
2-Wheelers	25,000	35.1	4.5	-152	73
Business Banking	137,000	132.2	24.9	559	318
Credit Cards	35,000	66.7	6.4	-52	-165
Others	64,700	346.2	11.8	702	529
Total	549,500	80.2			

Source: Company, Emkay Research

CASA ratio takes hit due to CBOP's low CASA

The CASA ratio has declined by 660bps over last year and 964bps sequentially. We believe this is mainly because of CBOP merger as CBOP's CASA ratio was much lower at 25%.

Deposit mix

Rs bn	Q1FY09	Q1FY08	Q4FY08	% yoy chg	% qoq chg
Total Deposits	1,309.2	816.0	1,007.7	60.4	29.9
Savings	318.5	209.3	261.5	52.2	21.8
Current	268.7	210.9	287.6	27.4	-6.6
Total CASA	587.2	420.1	549.1	39.8	6.9
CASA (%)	44.9	51.5	54.5	-663bps	-964 bps

Source: Company, Emkay Research

Fee income growth remains strong

The fee income (CEB+derivatives/forex gains) grew by a 29.1% to Rs6.7bn. The other income has grown by sedate 3.6% yoy to Rs5.9bn driven mainly by treasury losses of Rs776mn (treasury loss of Rs41mn last year).

Fee income

Rs mn	Q1FY09	Q1FY08	Q4FY08	% yoy chg	% qoq chg
Fee income	5112	3722	4904	37.3	4.2
Treasury	-776	-41	114	1,792.7	-780.7
Other	1598	1477	475.4	8.2	236.1
Total	5,934	5,158	5,493		

Source: Company, Emkay Research

Opex continues to remain high

During the quarter, the operating expenses have grown by 31% yoy to Rs12.9bn. Both, employee expenses as well as other Opex grew by similar proportion to Rs5.4bn and Rs7.5bn respectively. The Opex/assets ratio has also moved up from 3.1% to 3.4%. We see rise in Opex ratios on two accounts

- The increase in expenses has been mainly driven by branch expansion
- Higher Opex/assets ratio of CBOP at 3.6%

Merger results in rise in reported gross NPA plus balance sheet write off

The gross NPAs during the quarter have gone up by ~Rs6bn over Q4FY08 on account of Rs5.2bn of stressed asset taken over from CBOP.

However, the bank has also taken a hit of Rs5bn in the balance sheet through deduction from reserves to realign the provision coverage of CBOP's stressed assets to its own level, viz., 67%.

Our back of the envelope calculations suggest that the additional stressed assets which could have arisen over and above the reported ones and which have been written off could be approximately Rs4.6-5bn.

Comfortable capital adequacy

The bank had Capital adequacy of 12.2% and tier I CAR at 9.3% at the end of Q1FY09 down from 13.6% and 10.3% as at the end of Q4FY08.

Valuations and view

At the current valuations of 15.4x its FY2010E EPS and 2.3x FY2010E P/ABV, the stock seems quite attractive. We retain BUY rating on the stock with a 12m price target of Rs1,500.

Quarterly results (reported numbers)

Rs mn	Q1FY09	Q1FY08	Q4FY08	% yoy chg	% qoq chg
Net interest income	17,235	9,855	16,421	74.9	5.0
Other Income	5,934	5,725	5,493	3.6	8.0
<i>Fee income</i>	6,710	5,199	5,379	29.1	24.7
<i>Other</i>	-776	526	114	-247.4	-780.5
Net Income	23,169	15,581	21,914	48.7	5.7
Operating Expenses	12,894	7,744	11,027	66.5	16.9
Operating Profit	10,275	7,837	10,887	31.1	-5.6
Provisions & Contingencies	3,445	3,071	4,651	12.2	-25.9
<i>Loan loss provision</i>	3,244	2,398	2,930	35.3	10.7
Profit before tax	6,830	4,766	6,236	43.3	9.5
Provision for Taxes	2,187	1,553	1,525	40.8	43.5
Net Profit	4,644	3,212	4,711	44.6	-1.4

Valuation table

Y/E March 31	Net income	Net profit	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2007	52,258	11,419	35.8	185.1	1.4	19.5	42.7	6.1
FY2008	75,110	15,902	44.9	306.0	1.4	17.7	30.7	3.7
FY2009E	102,310	19,654	45.4	339.8	1.2	14.5	24.8	3.3
FY2010E	135,146	32,162	70.1	480.3	1.6	16.9	15.2	2.3

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Emkay Global Financial Services Ltd.
Paragon Center, H -13 -16, 1st Floor,
Pandurang Budhkar Marg, Worli, Mumbai – 400 013.
Tel no. 6612 1212. Fax: 6624 2410