



HDFC Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,983	HDFCB IN
	REUTERS CODE
S&P CNX: 6,027	HDBK.BO

19 October 2010

Neutral

Previous Recommendation: Neutral

Rs2,366

		YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GR. (%)	P/E (X)	P/BV (X)	CAR (%)	ROAE (%)	ROAA (%)	P/ABV (X)
Equity Shares (m)	462.6	3/09A	107,118	22,449	52.8	27.7	44.8	6.7	15.8	15.6	1.3	6.9
52-Week Range	2,518/1,550	3/10A	121,942	29,487	64.4	22.1	36.7	5.0	17.4	16.1	1.5	5.1
1,6,12 Rel.Perf.(%)	-3/7/24	3/11E	145,297	39,078	84.5	31.1	28.0	4.4	15.8	16.8	1.6	4.4
M.Cap. (Rs b)	1094.5	3/12E	177,240	51,539	111.4	31.9	21.2	3.7	14.0	19.0	1.7	3.8
M.Cap. (US\$ b)	24.7	* Includes pro forma merged figures for HDFC Bank and CBoP										

HDFC Bank's 2QFY11 PAT, grew ~33% YoY to Rs9.1b, driven by strong loan growth and improved operating parameters. Despite a rise in cost of funds, NIM decline was restricted to 10bp QoQ to 4.2%, as traction in CASA was strong. Strong loan growth and pick up in fee income led to strong core operating profit growth of 30% YoY. Key highlights:

- Strong loan growth of ~38% YoY and ~7% QoQ (on a higher base) for 2QFY11 to ~Rs1.6t. Even after adjusting for a one-off opportunity in wholesale loans, core loan growth was 32% YoY against 19% for the industry.
- Retails loans grew ~8% QoQ led by growth in segment of retail (excluding home loans). Home loans declined 4% QoQ as the bank has not exercised the option to buy back loans from HDFC.
- CASA deposits grew 31% YoY and 10% QoQ. CASA ratio was stable YoY but increased 140bp QoQ to 50.6%. Savings deposits grew 38% YoY and 10% QoQ to Rs595b.
- Asset quality is one of the best in the industry with provision coverage ratio of 78%. GNPA increased by 3% QoQ; GNPA in absolute amount declined by 5bp QoQ and NNPA was stable.

Valuation and view: HDFC Bank is best placed in the current environment with (1) CASA ratio of ~50%, (2) strong growth outlook of 25-30%, (3) improving operating efficiency, and (4) lower credit costs, led by best-in-class asset quality. We expect RoE to be 17% by FY11 and 19% by FY12. The stock trades at 4.4x FY11E BV, 3.7x FY12E BV, 28x FY11E and 21.2x FY12E EPS. While the key operating parameters will be the best among its peers, valuations factor-in all positives, in our view. We maintain **Neutral** with a target price of Rs2,390.

	QUARTERLY PERFORMANCE								(RS MILLION)	
	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	40,931	39,919	40,348	40,531	44,202	48,100	52,181	57,913	161,729	202,396
Interest Expense	22,375	20,361	18,109	17,018	20,190	22,837	25,674	30,077	77,863	98,778
Net Interest Income	18,556	19,558	22,239	23,514	24,011	25,263	26,508	27,836	83,866	103,618
% Change (Y-o-Y)	7.7	4.8	12.4	27.0	29.4	29.2	19.2	18.4	13.0	23.6
Other Income	10,437	10,074	8,530	9,036	9,399	9,607	10,996	11,678	38,076	41,679
Net Income	28,992	29,632	30,769	32,549	33,410	34,870	37,503	39,514	121,942	145,297
Operating Expenses	13,806	13,702	14,532	15,605	15,923	16,799	17,580	19,163	57,645	69,465
Operating Profit	15,187	15,930	16,237	16,944	17,487	18,071	19,924	20,351	64,297	75,832
% Change (Y-o-Y)	47.8	41.9	11.4	7.9	15.1	13.4	22.7	20.1	24.2	17.9
Other Provisions	6,588	5,941	4,477	4,399	5,550	4,545	4,106	4,164	21,400	18,365
Profit before Tax	8,598	9,989	11,760	12,545	11,937	13,526	15,818	16,187	42,897	57,468
Tax Provisions	2,537	3,114	3,575	4,178	3,820	4,405	5,062	5,103	13,410	18,390
Net Profit	6,061	6,875	8,185	8,366	8,117	9,121	10,756	11,083	29,487	39,078
% Change (Y-o-Y)	30.5	30.2	31.6	32.6	33.9	32.7	31.4	32.5	31.3	32.5
Interest Exp/Interest Income (%)	54.7	51.0	44.9	42.0	45.7	47.5	49.2	51.9	48.1	48.8
Other Income/Net Income (%)	36.0	34.0	27.7	27.8	28.1	27.6	29.3	29.6	31.2	28.7
Cost/Income Ratio (%)	47.6	46.2	47.2	47.9	47.7	48.2	46.9	48.5	47.3	47.8
Provisions/Operating Profits (%)	43.4	37.3	27.6	26.0	31.7	25.1	20.6	20.5	33.3	24.2
Tax Rate (%)	29.5	31.2	30.4	33.3	32.0	32.6	32.0	31.5	31.3	32.0

E: MOSL Estimates

RESULTS ANALYSIS (RS M) : REPORTED NUMBERS

	2QFY11	2QFY10	YOY GR. %	1QFY11	QOQ GR. %	FY10	FY11E	FY12E
Interest Income	48,100	39,919	20	44,202	9	161,729	202,396	258,443
Interest Expense	22,837	20,361	12	20,190	13	77,863	98,778	132,068
Net Interest Income (NII)	25,263	19,558	29	24,011	5	83,866	103,618	126,375
Other Income	9,607	10,535	-9	9,904	-3	38,076	41,679	50,865
- Fees and others	8,605	7,396	16	7,971	8	28,523	34,717	41,645
- Treasury Income	-521	1,629	NA	215	NA	3,451	250	1,500
- Forex Income	1,523	1,510	1	1,718	-11	6,102	6,712	7,719
Net Income	34,870	30,093	16	33,916	3	121,942	145,297	177,240
Total Operating Costs	16,799	14,163	19	16,429	2	57,645	69,465	81,476
- Staff Costs	7,106	5,541	28	6,671	7	22,892	29,416	35,299
- Other Opex	9,693	8,622	12	9,758	-1	34,753	40,049	46,176
Operating Profit	18,071	15,930	13	17,487	3	64,297	75,832	95,764
Provisions	4,545	5,941	-24	5,550	-18	21,400	18,365	19,971
PBT	13,526	9,989	35	11,937	13	42,897	57,468	75,793
Tax	4,405	3,114	41	3,820	15	13,410	18,390	24,254
Tax Rate %	32.6	31.2		32.0		31.3	32.0	32.0
PAT	9,121	6,875	33	8,117	12	29,487	39,078	51,539
Deposits	1,953,209	1,498,053	30	1,830,333	7	1,674,044	2,025,594	2,552,248
CASA Ratio %	50.6	50.3		49.2		52.0	52.8	50.9
Loans	1,570,906	1,136,720	38	1,462,484	7	1,258,306	1,635,798	2,044,747
Gross NPA (Rs B)	18.4	20.3	-9	17.9	3	18.2	19.3	22.5
Gross NPA %	1.2	1.8		1.2		1.4	1.2	1.1
Net NPA (Rs B)	4.1	6.0	-32	4.1	-1	3.9	3.9	4.5
Net NPA %	0.3	0.5		0.3		0.3	0.2	0.2
Yields on Advances %*	9.7	11.1		9.7		10.8	10.7	11.0
Cost of Funds %*	4.5	5.1		4.3		4.7	5.0	5.4
NIM %**	4.2	4.2		4.3		4.7	4.7	4.7
Tier I CAR %	12.7	10.9		12.4		13.3	12.3	11.2
Tier II CAR %	4.3	4.8		3.9		4.1	3.5	2.8
Branches	1,765	1,506		1,725		1,725	1,925	2,125
ATMs	4,721	3,573		4,393		4,232	5,232	6,232

* Calculated, ** Reported basis for quarterly no and calculated for yearly numbers

Retail loans grow strongly...

Retail loans grew 8% QoQ and 31% YoY across segments. Auto loans (up 36% YoY and 8% QoQ), CV and CE (up 41% YoY and 12% QoQ) and business banking loans (up 29% YoY and 9% QoQ) growth remains strong. Home loans declined 4% QoQ and grew 42% YoY on a lower base. During the quarter, the bank did not exercise options to buy back loans from HDFC Ltd.

...driving overall loan growth

Overall loan growth was strong at 7% QoQ (on a higher base) and 38% YoY. Even after adjusting for one-off opportunity in wholesale loans, core loan growth was 32% YoY against 19% growth for the industry. The management expects growth to be strong due to (1) increased focus on medium/long tenure corporate (especially infrastructure) loans, (2) strong demand for auto loans, (3) selective disbursement in unsecured loans like personal loans and credit cards, (4) strong growth from rural and semi-urban areas for existing products, and (5) continued buy-back of home loans from HDFC Ltd to fulfill priority sector targets. While the management guides for over 25% loan growth, we believe loan growth will accelerate to 30% in FY11. YTD loan growth is 23.6% against the industry growth 6%.

Stellar performance on CASA deposits

Deposits grew 30% YoY and 7% QoQ to Rs1.95t. CASA growth was robust during the quarter increasing by 10% QoQ. Savings deposits posted robust growth of 11% QoQ and CA deposits grew ~9% QoQ. CASA deposits grew 31% YoY, (savings grew at a healthier 38%). CASA performance is impressive considering the rising cost of deposits. Despite pressure on CASA ratio (due to a rising interest rate scenario), the management expects to maintain it at over 48% against 50% as on 2QFY11.

Margins superior at 4.2%

NIM declined by 10bp QoQ (stable YoY) from elevated levels of 4.3%, due to the rising cost of funds. However, the fall in NIM was restricted due to strong traction in low cost deposits and improvement in yield on loans. Despite a rise in bulk deposit rates and retail term deposits rates (up ~100bp across maturities and expectations of another deposit rate hike in October 2010), the management expects to maintain margins of 4.1-4.2% in FY11. We expect margins to be stable or decline marginally from 4.2% due to (1) strong CASA ratio, and (2) improved asset yields in a rising interest rate scenario.

Sequential growth of 8% in fees impressive

Other income declined 9% YoY to Rs9.6b due to a loss on the sale of investments. The bank booked a loss on the sale of investment of Rs521m in 2QFY11 against a trading gain of Rs1.63b in 2QFY10 and Rs215m in 1QFY11. Fee income growth was strong at 8% QoQ and 16% YoY. The management expects fee income to grow by ~18% in FY11 despite pressure on third-party distribution fees (15% of overall fee income) as increased volume growth will compensate for an expected decline in insurance commission.

Asset quality best in the industry

Gross NPAs increased by 3% QoQ to Rs18.4b. Gross NPA ratio was 1.16% v/s 1.21% a quarter earlier and 1.76% a year earlier. Net NPAs were sequentially stable at Rs4.1b. Net NPA ratio was 0.3% v/s 0.5% in 2QFY10. Provision coverage ratio was strong at 78% (77% a quarter earlier). From 1QFY11 the bank began to recognize floating provisions as part of tier-II capital rather than netting up from NNPA. Outstanding restructured loans at a mere 10bp of gross standard loans also give comfort on the balance sheet quality. Lower pressure on margins and a sharp decline in credit cost will lead to a sharp improvement in risk-adjusted margins.

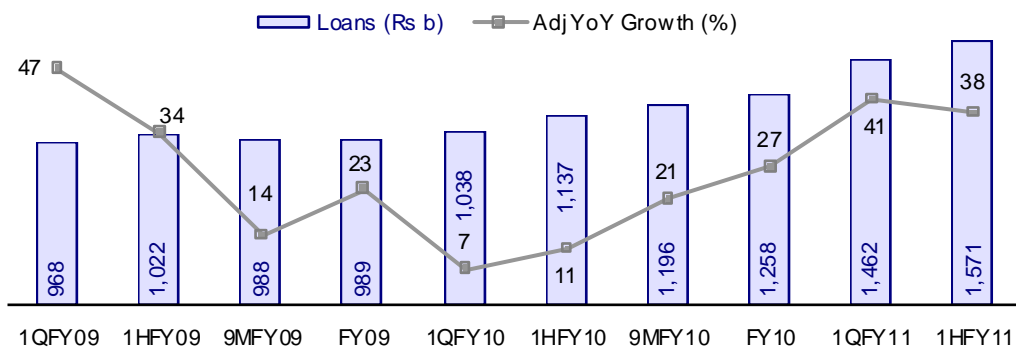
Valuation and view

HDFC Bank is best placed in the current environment with (1) CASA ratio of ~50% (a boon in a rising interest rate scenario), (2) strong growth outlook of 25-30%, (3) improving operating efficiency, and (4) lower credit costs, led by best-in-class asset quality. In our view, EPS growth will be 30% CAGR over FY10-12 against 25% posted over FY05-10.

We expect EPS to be Rs85 in FY11 and Rs111 in FY12. We expect RoE to be 17% by FY11 and 19% by FY12. We estimate BV of Rs543 in FY11 and Rs631 in FY12. The stock trades at 4.4x FY11E BV, 3.7x FY12E BV, 28x FY11E and 21.2x FY12E EPS. While the key operating parameters would be the best among peers, valuations factor in all positives, in our view. We maintain **Neutral** with a target price of Rs2,390.

Loan growth

Core loan growth of 32% YoY v/s reported loan growth of 38% in 2QFY11; expect loan CAGR of 25%+ over the next two years



Source: Company/MOSL

Loan break-up (Rs b)

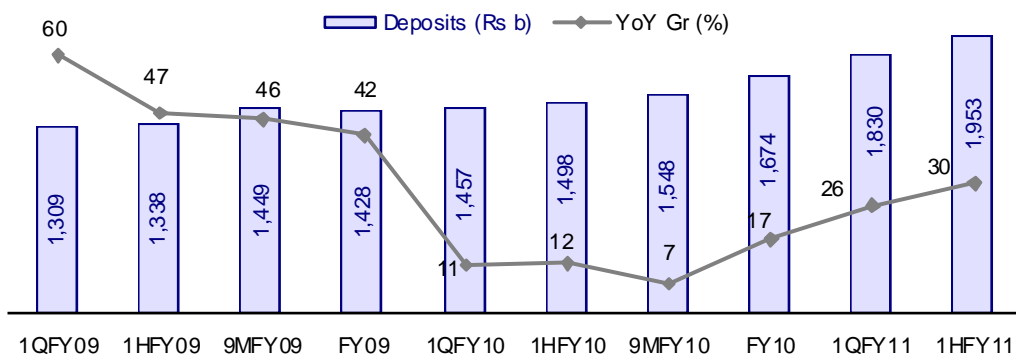
Strong loan growth in all retail loans segment; risk appetite increases

	1QFY10	1HFY10	9MFY10	FY10	1QFY11	1HFY11
Auto Loans	161	171	181	196	214	232
CVs	77	80	84	94	100	112
2Ws	18	18	18	18	19	20
Personal Loans	85	84	85	88	90	95
Credit Cards	38	38	38	38	39	42
LAS	7	8	9	9	10	11
Business Banking	122	123	127	139	144	158
Home loans	62	64	78	87	95	91
Others	42	43	43	51	49	61

Source: Company/MOSL

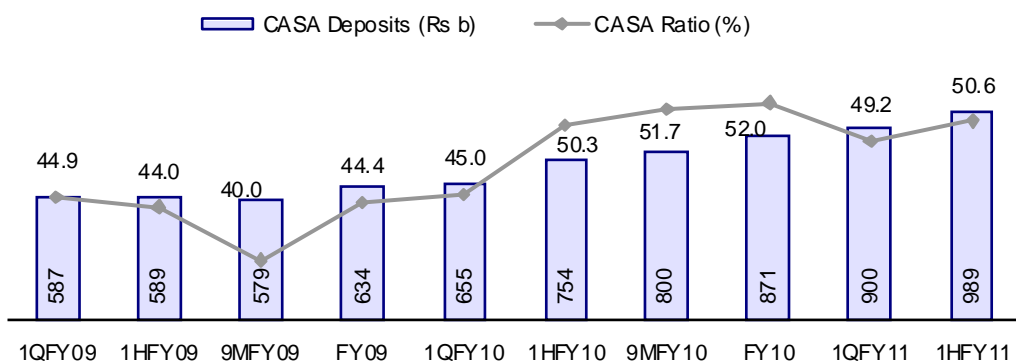
Deposit growth (%)

Deposit growth improves, albeit on a lower base



CASA trends

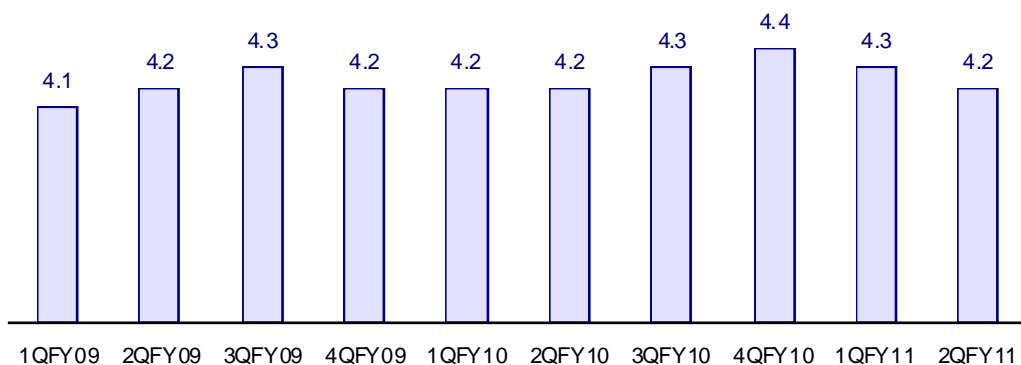
CASA ratio is impressive at 50%+; impressive CASA growth of 30%+ YoY and ~10% QoQ



Source: Company/MOSL

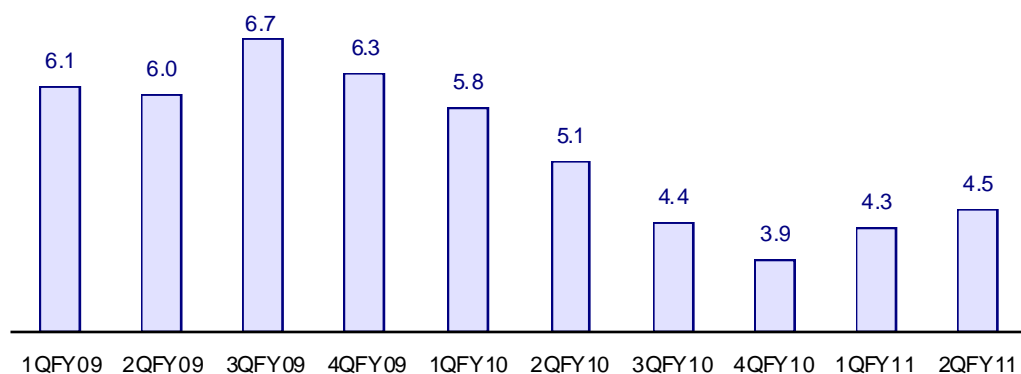
Margin trend (%)

Despite a rise in CoF, NIM decline was restricted to 10bp QoQ to 4.2% due to strong traction in CASA



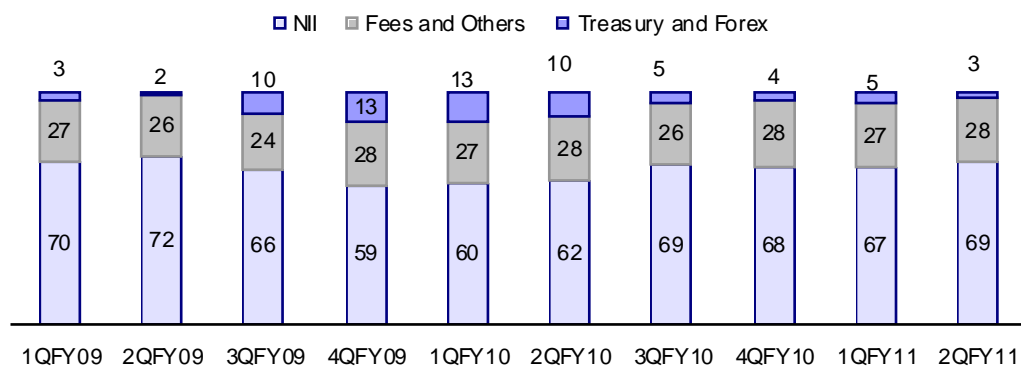
Cost of funds (Cal. %)

Increase in bulk deposit rates and retail term deposits rates lead to rise in CoF



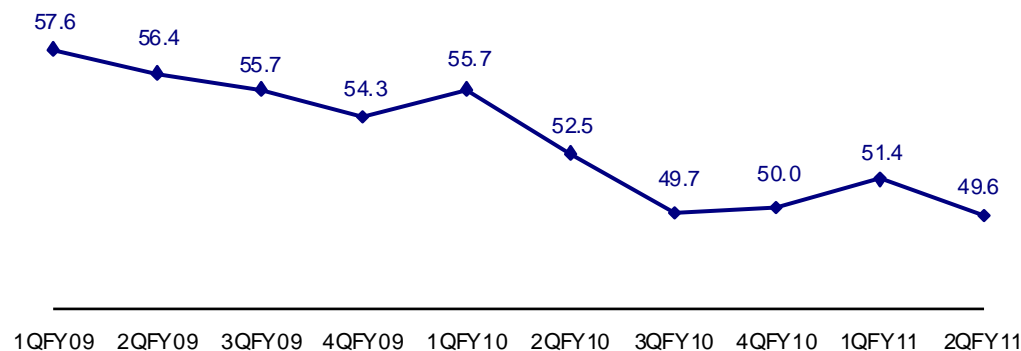
Break-up of income (%)

Proportion of core income improves significantly



Core cost-to-income ratio (%)

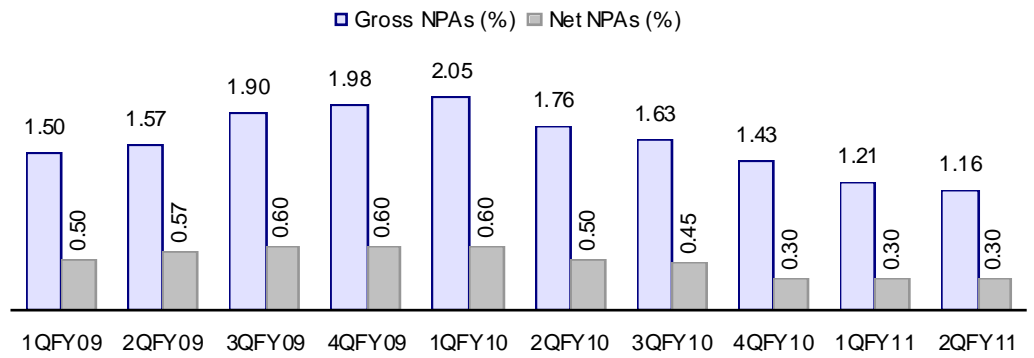
Cost to core income ratio improved due to cost efficiency; expect gradual improvement going forward



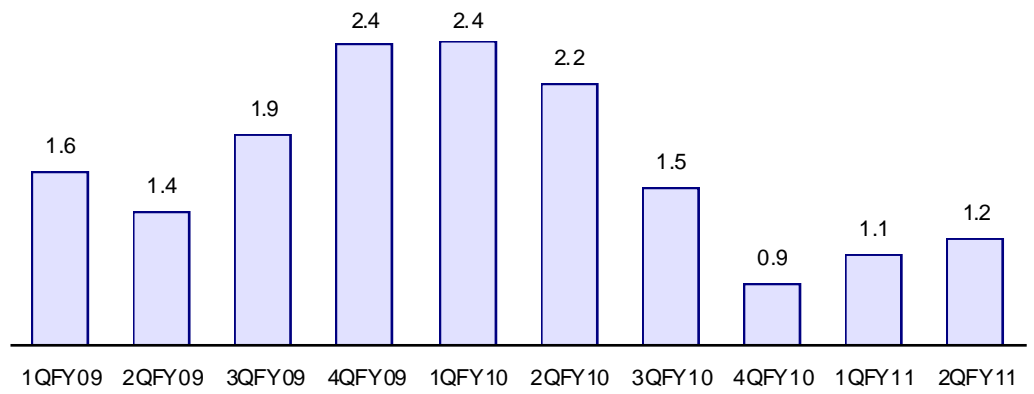
Source: Company/MOSL

NPA trend (%)

Lower slippages lead to improving asset quality



Credit cost (%)



Source: Company/MOSL

HDFC Bank: an investment profile

Company background

HDFC Bank, incorporated in 1994 by HDFC Limited, is the second largest private sector bank in India, with a balance sheet size of over Rs2.4t. Rated as one of the best banks in India, it has 1,765 branches. The bank has been consistently growing its earnings at over 30% over the past several quarters.

Key investment arguments

- Strong focus on retail loans (52% of loans) and high proportion of CASA deposits (50% of total deposits) enable superior margins of over 4%.
- Gross NPAs at 1.2% and net NPAs at 0.3%, with restructured standard loans of just 10bp, are among the lowest in the industry, indicating superior risk management skills.
- After the rundown of the CBOP book and with a lower proportion of unsecured retail loans, credit costs are expected to come off sharply in FY11.
- Core operating profitability is improving at a faster pace, with strong loan growth, stable margins and improving operating leverage.

Key risks

- Sustaining current business parameters with increase competitive pressures is a key risk.

Comparative valuations

		HDFC BK	Axis BK	ICICI BK*
P/E (x)	FY11E	28.0	18.9	22.0
	FY12E	21.2	15.3	17.9
P/BV (x)	FY11E	4.4	3.2	2.3
	FY12E	3.7	2.7	2.0
RoE (%)	FY11E	16.8	18.2	12.8
	FY12E	19.0	19.3	14.4
RoA (%)	FY11E	1.6	1.7	1.4
	FY12E	1.7	1.7	1.5

* Price adjusted for value of key ventures and BV adjusted for investments in those key ventures

Shareholding Pattern (%)

	Sep-10	Jun-10	Sep-09
Promoter	23.5	23.6	19.3
Domestic Inst	10.2	11.3	12.5
Foreign	48.5	46.5	48.5
Others	17.8	18.7	19.8

Recent developments

- Raised the base rate from 7.25% to 7.5%.
- Appointed Partho Datta as Additional Director from 30 September 2010.

Valuation and view

- We expect RoE to be 17% by FY11 and 19% by FY12, with tier-I capital at over 11% in FY12. We estimate book value (BV) of Rs543/share in FY11 and Rs631/share in FY12. We expect EPS of Rs85 in FY11 and Rs111 in FY12.
- The stock trades at 21.2x FY12E EPS and 3.7x FY12E B.V. We maintain **Neutral** with a target price of Rs2,390.

Sector view

- In FY10 loans and deposits grew 17%. We expect loan growth of 20% in FY11 with an upward bias. Deposit growth will be calibrated with loan growth.
- We factor-in 15-20bp improvement in blended margins, led by improving yield on assets and higher CASA ratio.
- Our concern over asset quality is diminishing with the improvement in economic activity.
- We prefer banks with a strong core deposit franchise, higher tier-I capital and high provision coverage ratio.

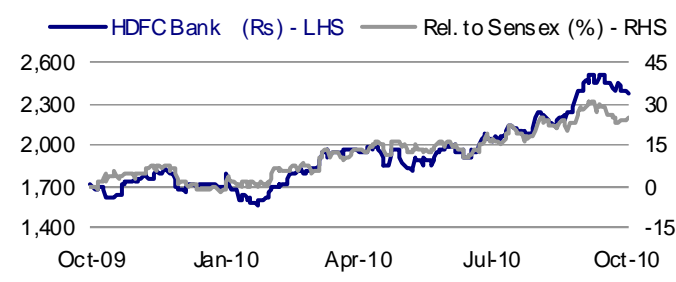
EPS: MOST forecast v/s Consensus (Rs)

	MOST Forecast	Consensus Forecast	Variation (%)
FY11	84.5	81.0	4.3
FY12	111.4	105.0	6.1

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
2,366	2,390	1.0	Neutral

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT (PRO FORMA MERGED WITH CBoP)						(RS MILLION)
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Interest Income	123,000	163,323	161,729	202,396	258,443	328,159
Interest Expense	63,791	89,111	77,863	98,778	132,068	174,349
Net Interest Income	59,209	74,212	83,866	103,618	126,375	153,811
<i>Change (%)</i>		25.3	13.0	23.6	22.0	21.7
Non Interest Income	29,195	32,906	38,076	41,679	50,865	59,769
Net Income	88,403	107,118	121,942	145,297	177,240	213,579
<i>Change (%)</i>		21.2	13.8	19.2	22.0	20.5
Operating Expenses	47,226	55,328	57,645	69,465	81,476	94,921
Pre Provision Profits	41,177	51,790	64,297	75,832	95,764	118,658
<i>Change (%)</i>		25.8	24.2	17.9	26.3	23.9
Provisions (excl tax)	16,043	18,791	21,400	18,365	19,971	23,898
PBT	25,134	32,999	42,897	57,468	75,793	94,760
Tax	7,604	10,549	13,410	18,390	24,254	30,323
<i>Tax Rate (%)</i>	30.3	32.0	31.3	32.0	32.0	32.0
PAT	17,530	22,449	29,487	39,078	51,539	64,437
<i>Change (%)</i>		28.1	31.3	32.5	31.9	25.0
Equity Dividend (Incl tax)	3,606	4,254	5,493	7,034	9,277	11,599
Core PPP*	37,989	47,964	60,847	75,582	94,264	116,908
<i>Change (%)</i>		26.3	26.9	24.2	24.7	24.0

*Core PPP is (Nil+Fee income-Opex)

BALANCE SHEET						(RS MILLION)
Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Equity Share Capital	4,243	4,254	4,577	4,626	4,626	4,626
Reserves & Surplus	133,649	146,328	210,677	246,615	287,301	338,168
Net Worth	137,892	150,582	215,254	251,241	291,927	342,794
Deposits	1,225,776	1,428,116	1,674,044	2,025,594	2,552,248	3,190,310
<i>Change (%)</i>		16.5	17.2	21.0	26.0	25.0
of which CASA Dep	601,478	633,597	871,039	1,070,185	1,299,808	1,559,770
<i>Change (%)</i>	36.9	5.3	37.5	22.9	21.5	20.0
Borrowings	126,536	154,414	190,688	208,813	229,563	256,005
Other Liabilities & Prov.	146,480	162,428	206,159	226,015	270,515	324,979
Total Liabilities	1,604,193	1,832,708	2,224,586	2,647,632	3,277,723	4,045,058
Current Assets	175,802	175,066	299,424	212,692	276,154	344,111
Investments	563,385	588,175	586,076	703,291	843,950	1,012,740
<i>Change (%)</i>		4.4	-0.4	20.0	20.0	20.0
Loans	796,089	988,831	1,258,306	1,635,798	2,044,747	2,555,934
<i>Change (%)</i>		24.2	27.3	30.0	25.0	25.0
Fixed Assets	15,462	17,067	21,228	24,390	27,118	29,368
Other Assets	53,455	63,568	59,551	71,462	85,754	102,905
Total Assets	1,604,193	1,832,708	2,224,586	2,647,632	3,277,723	4,045,058

ASSET QUALITY						(%)
GNPA (Rs M)	9,070	19,881	18,168	19,347	22,461	23,964
NNPA (Rs M)	2,985	6,276	3,921	3,869	4,492	4,793
GNPA Ratio	1.13	1.98	1.43	1.17	1.09	0.93
NNPA Ratio	0.37	0.63	0.31	0.24	0.22	0.19
Slippage Ratio	2.60	4.29	2.64	2.40	2.25	2.25
PCR (Excl Tech. write off)	67.1	68.4	78.4	80.0	80.0	80.0

E: MOST Estimates

Financials and Valuation

RATIOS

Y/E MARCH	2008	2009	2010	2011E	2012E	2013E
Spreads Analysis (%)						
Avg. Yield-Earning Assets	10.4	10.9	9.0	9.2	9.6	9.9
Avg. Yield on loans	12.6	13.6	10.8	10.7	11.0	11.2
Avg. Yield on Investments	7.1	7.0	6.8	7.1	7.1	7.4
Avg. Cost-Int. Bear. Liab.	5.7	6.3	4.7	5.0	5.4	5.7
Avg. Cost of Deposits	5.6	6.0	4.5	4.8	5.3	5.6
Interest Spread	4.7	4.6	4.3	4.3	4.2	4.2
Net Interest Margin	5.0	4.9	4.7	4.7	4.7	4.7

Profitability Ratios (%)

RoE	16.2	15.6	16.1	16.8	19.0	20.3
RoA	1.3	1.3	1.5	1.6	1.7	1.8
Int. Expense/Int.Income	51.9	54.6	48.1	48.8	51.1	53.1
Fee Income/Net Income	29.4	27.1	28.4	28.5	27.9	27.2
Non Int. Inc./Net Income	33.0	30.7	31.2	28.7	28.7	28.0

Efficiency Ratios (%)

Cost/Income*	57.8	56.9	51.3	50.2	48.5	46.8
Empl. Cost/Op. Exps.	34.3	40.5	39.7	42.3	43.3	43.9
Busi. per Empl. (Rs m)	47.2	45.0	51.2	59.9	67.0	75.0
NP per Empl. (Rs lac)	0.5	0.5	0.6	0.7	0.8	0.9

* ex treasury

Asset-Liability Profile (%)

Loans/Deposit Ratio	64.9	69.2	75.2	80.8	80.1	80.1
CASA Ratio	49.1	44.4	52.0	52.8	50.9	48.9
Investment/Deposit Ratio	46.0	41.2	35.0	34.7	33.1	31.7
G-Sec/Investment Ratio	66.1	88.7	87.1	80.6	81.7	81.9
CAR	13.6	15.8	17.4	15.8	14.0	12.6
<i>Tier 1</i>	<i>10.3</i>	<i>10.6</i>	<i>13.3</i>	<i>12.3</i>	<i>11.2</i>	<i>10.3</i>

VALUATION

Book Value (Rs)	325.0	354.0	470.3	543.1	631.1	741.0
<i>Change (%)</i>	<i>55.5</i>	<i>8.9</i>	<i>32.8</i>	<i>15.5</i>	<i>16.2</i>	<i>17.4</i>
Price-BV (x)	7.3	6.7	5.0	4.4	3.7	3.2
Adjusted BV (Rs)	320.4	344.3	464.6	537.7	624.7	734.3
Price-ABV (x)	7.4	6.9	5.1	4.4	3.8	3.2
EPS (Rs)	41.3	52.8	64.4	84.5	111.4	139.3
<i>Change (%)</i>	<i>22.1</i>	<i>27.7</i>	<i>22.1</i>	<i>31.1</i>	<i>31.9</i>	<i>25.0</i>
Price-Earnings (x)	57.3	44.8	36.7	28.0	21.2	17.0
Dividend Per Share (Rs)	8.5	10.0	12.0	15.2	20.1	25.1
Dividend Yield (%)	0.4	0.4	0.5	0.6	0.8	1.1

E: MOST Estimates



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HDFC Bank

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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