Indiabulls

HDFC BANK LTD RESEARCH

EQUITY RESEARCH

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RESULTS REVIEW

HDFC Bank — Buy

Impressive performance: Bright Prospects

HDFC Bank reported impressive results for Q1'09, post its merger with Centurion Bank of Punjab (CBoP), which came into effect from May 23, 2008. Year-over- year, net profit surged 44.6% to Rs. 4.6 bn, net interest income rose by 74.9% to Rs. 17.2 bn, and fee income increased by 37.3%. Advances grew by 79.8%, while deposits grew by 60.4%. Post the merger, key metrics of HDFC Bank are as follows:

- ***Strong core performance***: The Bank's core performance remained strong despite the merger—net interest income (NII) increased by 52.5% yoy on a proforma basis. However, the net interest margin (4.1%) and CASA (44.9%) were impacted adversely. We expect the NIM and CASA to bounce back once CBoP is completely assimilated in its existing network.

- ***Pressure on margins***: Year over year, net advances grew 79.8% while deposits grew 60.4%. However, these enlarged deposits and advances can pressurise margins in a slowing economy and a rising interest rate scenario.

- ***Asset quality moderated***: Maintaining asset quality has been HDFC Bank's forte. This quarter, however, the Bank recorded a 111.6% yoy increase in its gross NPAs. This, we believe is more on account of the merger with CBoP than due to a deterioration in asset quality, since HDFC Bank's net NPA ratio stood at 0.5% of net advances this quarter.

Share Data

Market Cap	Rs. 470.8 bn
Price	Rs. 1,108.65
BSE Sensex	14,577.87
Reuters	HDBK.BO
Bloomberg	HDFCB IN
Avg. Volume (52 Week)	0.13 mn
52-Week High/Low	Rs. 1787.90 / Rs. 903.60
Shares Outstanding	424.6 mn

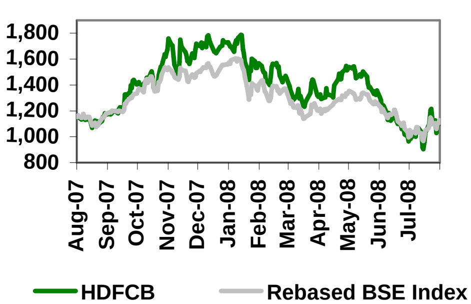
Valuation Ratios (Standalone)

Year to 31 March	2009E	2010E
EPS (Rs.)	54.1	66.0
+/- (%)	16.8%	21.9%
PER (x)	20.5x	16.8x
P / PPP (x)	8.4x	7.1x
P / BV (x)	3.5x	3.4x

Shareholding Pattern (%)

Promoter	23
FIIs	26
Institutions	8
Public & Others	43

Relative Performance



Key Figures

Quarterly Data	Q1'08	Q4'08	Q1'09	YoY %	QoQ%	FY07	FY08	YoY %
(Figures in Rs mn, except per share data)								
Net Interest Income	10,422	16,421	17,235	65.4%	5.0%	34,685	52,279	50.7%
Operating Income	26,417	21,914	23,169	(12.3%)	5.7%	49,847	75,110	50.7%
Pre-Prov Profit	7,837	10,887	10,275	31.1%	(5.6%)	25,639	37,654	46.9%
Net Profit	3,212	4,711	4,644	44.6%	(1.4%)	11,415	15,902	39.3%
Cost/Operating Income(%)	43.1%	50.3%	55.7%	-		48.6%	49.9%	-
NIM ratio	4.2%	4.4%	4.1%	-		-	-	-
NPA ratio	0.4%	0.5%	0.5%	-		0.4%	0.5%	-
Per Share Data (Rs.)								
PPP per share	23.5	30.3	24.2	3.0%	(20.1%)	81.1	108.0	33.2%
EPS	9.6	13.1	11.0	14.6%	(16.0%)	36.1	45.6	26.3%
BVPS	211.5	324.4	313.8	48.4%	(3.3%)	201.4	324.4	61.0%

Result Highlights

Total income and NII surged while NIM was affected adversely

HDFC Bank's total income for Q1'09 grew by 59.6% yoy and stood at Rs. 42.2 bn. The NII increased 74.9% yoy to Rs. 17.2 bn, driven by an increase in interest on investments and interest on advances. The NIM declined from its Q4'08 level and stood at a little over 4.1%. This fall was due to the merger with CBoP and a massive rise in deposits.

Non-interest income increased by 3.6% yoy to Rs. 5.9 bn. Fees and commission, a major constituent of other income, increased by 37.3%. This increase in fee income was marred by a loss on revaluation/sale of investments of Rs. 0.8 bn. Foreign exchange/derivative revenues accounted for the remaining portion of other income. We expect non-interest income to keep growing as fees and commission account for a large proportion of the total other income. Operating expenses shot up 66.4% yoy on account of the merger. Provisions and contingencies increased 12.2% yoy. After providing Rs. 2.2 bn for taxation, the Bank earned a net profit of Rs. 4.6 bn, a yoy growth of 44.6%.

The above results of HDFC Bank cannot be compared to Q1'08 results because of the merger with CBoP. An apt apple-to-apple comparison, adding CBoP's Q1'08's results to HDFC's, is as follows:

Remarkable performance despite proforma comparison of Q1'09 with Q1'08

- Interest earned grew by 44% yoy and interest expended rose by 37.1%. This resulted in a rise of 52.5% in the NII.
- Other income decreased by 16.9% yoy and operating expenses rose by 32.9%, resulting in a 17.5% rise in operating profit. However, net profit surged 31.1% yoy due to a slight decrease in provisions other than tax.

Thus the Bank's performance has been remarkable.

The balance sheet of the Bank increased by 59.5% yoy post the merger as deposits grew by 60.4% to exceed Rs. 1.3 tn and advances grew by 79.8%. The CASA ratio fell to 44.9%. The Bank's total customer assets, (including advances, corporate debentures, and investments in securitised paper, etc. net of loans securitised and participated out) were Rs. 995.5 bn.

Outlook

Sound fundamentals make HDFC Bank a strong performer. Despite taking a nominal hit on its NIM post the merger with CBoP, NII grew by 74.9% yoy and fee income by 37.3% yoy. This pulled up net profit by 44.6% and on a proforma basis, by 31.1%.

Merger with CBoP: an essential determinant of growth

The merger with CBoP is an essential determinant of HDFC Bank's growth. On the one hand, deposit and advances base has enlarged; on the other, this has exerted pressure on margins as well as increased the NPAs. Also, the merger has given HDFC Bank access to 394 more branches, which increases its coverage considerably and will lead to strengthening of the core business and earnings. At the same time, this will mean enlarged operating costs, which have been increasing at a steady rate.

Given HDFC Bank's sentient management, we believe that the Bank will revert back to its more profitable numbers once CBoP is integrated in the former's existing network.

Valuation

We have valued HDFC Bank by using the three-stage Discounted Equity Cash Flow Model. Assuming a sustainable ROE of 15%, we arrive at a terminal growth rate of 8.78%. Cost of equity is assumed at 15%. The stock quotes a forward P/ABV of 3.5x for 2009 as against 4.1x for 2008. We maintain our Buy rating on the stock with a revised target price of Rs. 1,400 for FY09.

Income Statement

(Rs mn, Yr. ending March 31)	FY07	FY08	FY09E	FY10E
Interest Income	66,462	101,170	166,709	191,315
Interest Expense	31,793	48,874	88,234	105,563
Net Interest Income	**34,669**	**52,297**	**78,475**	**85,752**
YoY Growth (%)	*36.2%*	*50.8%*	*50.1%*	*9.3%*
Other Income	15,773	23,758	36,299	50,247
Operating Income	**50,441**	**76,054**	**114,773**	**135,999**
YoY Growth (%)	*36.3%*	*50.8%*	*50.9%*	*18.5%*
Operating Expense	24,740	38,264	59,019	70,116
Pre-Provisioning Profit	**25,702**	**37,791**	**55,755**	**65,883**
Provisions and Contingencies	9,251	14,849	21,985	24,712
Profit Before Tax	**16,450**	**22,942**	**33,770**	**41,171**
Tax	5,016	7,020	10,806	13,175
Net Profit	**11,435**	**15,922**	**22,963**	**27,996**
YoY Growth (%)	*30.6%*	*39.2%*	*44.2%*	*21.9%*

Balance Sheet

(Rs mn, as on March 31)	FY07	FY08	FY09E	FY10E
Cash and balances with RBI	90,734	148,280	225,585	264,369
Investments	305,670	492,880	769,795	923,755
YoY Growth (%)	*7.7%*	*61.2%*	*56.2%*	*20.0%*
Advances	469,448	634,269	974,027	1,168,832
YoY Growth (%)	*33.9%*	*35.1%*	*53.6%*	*20.0%*
Fixed Assets (Net)	9,875	11,963	13,267	14,322
Other Assets	37,355	44,539	67,661	80,923
Total Assets	**913,083**	**1,331,931**	**2,050,335**	**2,452,201**
Deposits	682,643	1,006,314	1,571,011	1,885,213
YoY Growth (%)	*22.5%*	*47.4%*	*56.1%*	*20.0%*
Borrowings	28,154	44,789	73,299	80,628
YoY Growth (%)	*-1.5%*	*59.1%*	*63.7%*	*10.0%*
Other Liabilities & Provisions	137,296	165,108	266,544	318,786
Total Liabilities	**848,093**	**1,216,210**	**1,910,853**	**2,284,628**
Share Capital	3,480	3,914	4,682	4,749
Reserves & Surplus	61,510	111,807	134,799	162,824
Total Equity & Liabilities	**913,083**	**1,331,931**	**2,050,335**	**2,452,201**

Key Ratios

	FY07	FY08	FY09E	FY10E
Per share data (Rs.)				
Shares outstanding (mn)	319.4	354.4	424.6	424.6
Basic EPS	36.6	46.4	54.1	66.0
Diluted EPS	36.4	45.7	53.5	65.3
Book value per share	202.6	325.5	313.8	327.5
Adj. book value per share	202.6	325.5	313.8	327.5
Valuation ratios (x)				
P/PPP	11.8x	12.4x	8.4x	7.1x
P/E	25.9x	28.5x	20.5x	16.8x
P/B	4.7x	4.1x	3.5x	3.4x
P/ABV	4.7x	4.1x	3.5x	3.4x
Performance ratio (%)				
Return on avg. assets	1.4%	1.4%	1.4%	1.2%
Return on avg. net worth	19.3%	17.6%	18.0%	18.2%
Balance Sheet ratios (%)				
Advances to deposits	68.8%	63.0%	62.0%	62.0%
Borrowings to advances	6.0%	7.1%	7.5%	6.9%
Investments to assets	33.5%	37.0%	37.5%	37.7%
Investments to deposits	44.8%	49.0%	49.0%	49.0%
Net Worth to assets	7.1%	8.7%	6.8%	6.8%
Productivity ratio (Rs. mn)				
Opt. expense per employee	1.2	1.0	1.2	1.4
Net profit per employee	0.5	0.4	0.5	0.6
Asset per employee	42.5	35.2	41.0	49.0
Operating ratios (%)				
Operating cost to operating income	49.0%	50.3%	51.4%	51.6%
Operating cost to avg. assets	3.0%	3.4%	3.5%	3.1%

Source: Bank data, Indiabulls research

Note: Some ratios are as per Indiabulls definitions and may not match figures declared by the Bank

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