FIRST LIGHT

19 October 2020

RESEARCH

HDFC Bank | Target: Rs 1,400 | +17% | BUY

Resilient quarter; confident commentary

HCL Technologies | Target: Rs 980 | +18% | BUY

Guidance raised on robust, broad-based performance

Federal Bank | Target: Rs 55 | +5% | ADD

Strong operating performance

SUMMARY

HDFC Bank

HDFC Bank reported a commendable Q2FY21 with 18% YoY growth in operating profit and PAT. Management is confident of growth opportunities and portfolio quality despite challenges. Headline NPAs declined due to the court's interim stay on loan classification but HDFCB indicted that even using its analytical models to accelerate recognition, GNPA would have been stable at ~1.4%. Demand resolution for the retail moratorium portfolio is expected to reach 97% in Oct'20. We raise FY21-FY23 EPS 2-8% and revise our Sep'21 TP to Rs 1,400 (vs. Rs 1,275).

Click here for the full report.

HCL Technologies

HCL Tech (HCLT) reported 6.4% QoQ USD growth coming from mid-high single digit recovery across verticals. Margins stood strong at 21.6%. Given the upgraded FY21 margin and growth guidance, we raise FY22/FY23 EPS by 9%/8% and keep FY21 EPS unchanged. Rolling valuations over, we have Sep'21 TP of Rs 980 (vs. Rs 920). Company's strong software business, healthy deal wins, traction in mode-2, 3 and cloud/infrastructure expertise offer good midterm growth visibility. Reiterate BUY.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	910

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.73	1bps	6bps	(102bps)
India 10Y yield (%)	5.90	(1bps)	(13bps)	(60bps)
USD/INR	73.38	(0.1)	0.1	(3.1)
Brent Crude (US$/bbl)	43.16	(0.4)	9.0	(28.0)
Dow	28,494	(0.1)	1.8	5.4
Shanghai	3,332	(0.3)	1.6	11.9
Sensex	39,728	(2.6)	2.5	1.7
India FII (US$ mn)	**14 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(0.5)	41.4	(14,638.4)	(4,878.9)
FII-E	156.4	1,233.5	5,273.6	11,876.5

Source: Bank of Baroda Economics Research

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Federal Bank

Despite robust growth in operating profit (40% YoY), Federal Bank's (FB) Q2FY21 PAT declined 26% YoY to Rs 3.1bn as the standard asset provision buffer was raised to ~0.5% of loans (vs. ~0.2% in Q1). Without the court's stay on NPA classification, fresh slippages would have been ~Rs 2.4bn. Management expects Covid-related restructuring at 2-3% of loans. Sep'20 collection efficiency at 95% was back to pre-Covid levels. Fee income grew 68% QoQ as all revenue streams improved. Maintain ADD; Sep'21 TP Rs 55.

Click here for the full report.

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BUY
TP: Rs 1,400 | ▲ 17%

HDFC BANK | Banking | 17 October 2020

Resilient quarter; confident commentary

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HDFC Bank reported a commendable Q2FY21 with 18% YoY growth in operating profit and PAT. Management is confident of growth opportunities and portfolio quality despite challenges. Headline NPAs declined due to the court's interim stay on loan classification but HDFCB indicted that even using its analytical models to accelerate recognition, GNPA would have been stable at ~1.4%. Demand resolution for the retail moratorium portfolio is expected to reach 97% in Oct'20. We raise FY21-FY23 EPS 2-8% and revise our Sep'21 TP to Rs 1,400 (vs. Rs 1,275).

Asset quality shows buoyant trends: HDFCB's GNPA ratio declined to ~1.1% (~1.4% in Q1) due to the Supreme Court's interim stay on NPA classification Per the bank, had it used its analytical models and recognised those accounts on a prudent basis coupled with accelerated recognition, GNPAs would have still been flat at ~1.4%. Demand resolution for the retail moratorium portfolio stood at 95% in Sep'20 and is expected to reach 97% in Oct'20 and revert to pre-Covid levels of 99% over the next couple of months. Management did not put a number on the potential restructured book but said they remain conservative.

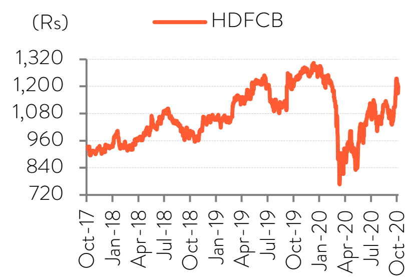
Wholesale continues to spur loan growth: Advances increased ~16% YoY led by ~27% growth in the wholesale portfolio. The bank continued to expand this business without diluting its credit standards, as much of the incremental growth was from AA-rated corporates. Retail advances grew at a subdued 5% YoY but early trends are positive with disbursements up 80-85% YoY and 2.5x QoQ. Excess liquidity shaved 15bps off NIM which declined to 4.1% (4.3% in Q1).

Reiterate BUY: We increase our FY21-FY23 EPS estimates by 2-8% to adjust for lower operating expense and credit cost assumptions, while now valuing the core book at 3.2x Sep'22E P/BV (vs. 2.8x earlier) – this yields a higher SOTP-based TP of Rs 1,400 (vs. Rs 1,275 earlier).

Ticker/Price	HDFCB IN/Rs 1,199
Market cap	US$ 89.8bn
Shares o/s	5,490mn
3M ADV	US$ 190.3mn
52wk high/low	Rs 1,306/Rs 739
Promoter/FPI/DII	26%/37%/37%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	482,432	561,863	649,511	760,941	900,462
NII growth (%)	20.3	16.5	15.6	17.2	18.3
Adj. net profit (Rs mn)	210,782	262,573	296,368	337,300	401,074
EPS (Rs)	39.6	48.0	54.0	61.5	73.1
P/E (x)	30.3	25.0	22.2	19.5	16.4
P/BV (x)	4.4	3.8	3.4	3.0	2.6
ROA (%)	1.8	1.9	1.8	1.8	1.8
ROE (%)	16.5	16.4	16.3	16.3	17.1

Source: Company, BOBCAPS Research

BUY
TP: Rs 980 | ⮝ 18%

HCL TECHNOLOGIES | IT Services | 16 October 2020

Guidance raised on robust, broad-based performance

HCL Tech (HCLT) reported 6.4% QoQ USD growth coming from mid-high single digit recovery across verticals. Margins stood strong at 21.6%. Given the upgraded FY21 margin and growth guidance, we raise FY22/FY23 EPS by 9%/8% and keep FY21 EPS unchanged. Rolling valuations over, we have Sep'21 TP of Rs 980 (vs. Rs 920). Company's strong software business, healthy deal wins, traction in mode-2, 3 and cloud/infrastructure expertise offer good midterm growth visibility. Reiterate BUY.

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Robust operational performance: HCLT's broad-based USD revenue growth of 6.4% QoQ outperformed estimated growth of 5.2%. Life sciences, media and retail showed the highest recovery among verticals. Mode-2 delivered the best growth of 9.5% QoQ and the software business increased at a strong 7.3%. HCLT continues to enhance partnerships with cloud hyperscalers, i.e. IBM cloud, Google cloud, AWS and Microsoft Azure. EBIT margin at 21.6% – a 22-quarter high – grew 110bps QoQ and exceeded our estimate by 80bps. Salary hikes are planned from Q3 and have been factored into the new guidance.

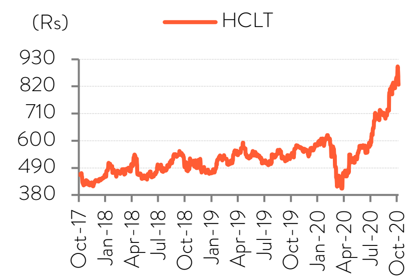
Improved deal signings: HCLT signed 15 transformational deals in Q2 vs. 11 in Q1, led by key industry verticals including life sciences, healthcare, energy & utilities and manufacturing. Most deals revolve around modernisation and digital transformation. The pipeline remains strong, growing 20% QoQ on the back of market share gains from vendor consolidation.

Guidance raised: HCLT updated its revenue growth guidance for Q3 and Q4FY21 to a range of 1.5-2.5% QoQ CC and expects FY21 growth to be positive (vs. 2.3-0.8% YoY CC revenue decline before). EBIT margin guidance for the year has been upgraded from 19.5-20.5% to 20-21%. Positive seasonality from products business is expected to moderate slightly in Q3.

Ticker/Price	HCLT IN/Rs 827
Market cap	US$ 30.6bn
Shares o/s	2,713mn
3M ADV	US$ 102.2mn
52wk high/low	Rs 911/Rs 375
Promoter/FPI/DII	60%/27%/13%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	604,280	706,780	761,595	871,156	953,334
EBITDA (Rs mn)	140,020	166,930	199,470	233,720	257,680
Adj. net profit (Rs mn)	99,757	110,940	124,883	147,851	166,274
Adj. EPS (Rs)	36.7	40.9	46.0	54.5	61.3
Adj. EPS growth (%)	16.3	11.5	12.6	18.4	12.5
Adj. ROAE (%)	25.2	23.5	22.5	23.6	23.5
Adj. P/E (x)	22.6	20.2	18.0	15.2	13.5
EV/EBITDA (x)	16.0	13.3	11.2	9.5	8.2

Source: Company, BOBCAPS Research

RESULT REVIEW

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TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 55 | ▲ 5%

FEDERAL BANK | Banking | 16 October 2020

Strong operating performance

Despite robust growth in operating profit (40% YoY), Federal Bank's (FB) Q2FY21 PAT declined 26% YoY to Rs 3.1bn as the standard asset provision buffer was raised to ~0.5% of loans (vs. ~0.2% in Q1). Without the court's stay on NPA classification, fresh slippages would have been ~Rs 2.4bn. Management expects Covid-related restructuring at 2-3% of loans. Sep'20 collection efficiency at 95% was back to pre-Covid levels. Fee income grew 68% QoQ as all revenue streams improved. Maintain ADD; Sep'21 TP Rs 55.

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Headline NPA ratio stable: FB's GNPA ratio was largely stable at 2.8% as fresh slippages were negligible due to the Supreme Court's stay on NPA classification for the sector and also recoveries worth Rs 1bn. Fresh slippages ex-SC order were ~Rs 2.4bn and will be recognised in Q3. FB has prudently booked interest reversal (Rs 0.3bn) and made regulatory provisions on these slippages in Q2.

The bank's slippages over the next few quarters could be 30-40% higher than its 10-quarter average run-rate of Rs 3bn-3.5bn, depending on how its restructured portfolio pans out. Management expects this portfolio to be at 2-3% of loans but has already made 10% provisions on the same in Q2.

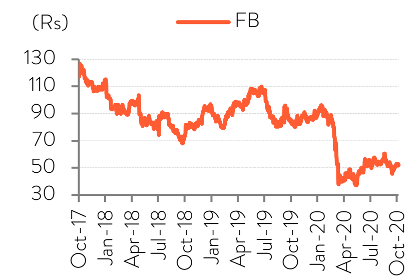
Loan growth drops but retail deposits see strong traction: Overall loan growth dropped to 6% YoY mainly as the corporate book dipped 3% YoY. FB saw strong 54% YoY and 24% QoQ growth in its gold loan portfolio. Deposits grew ~12% YoY driven by a 20% rise in CASA deposits. The CASA ratio and retail deposit share improved to 33.7% and 93% respectively (32% and 91.6% in Q1).

Maintain ADD: We reiterate ADD on FB with an unchanged Sep'21 TP of Rs 55 as we believe its high exposure to SMEs and mid-corporates will keep near-term profitability under pressure.

Ticker/Price	FB IN/Rs 52
Market cap	US$ 1.4bn
Shares o/s	1,992mn
3M ADV	US$ 26.0mn
52wk high/low	Rs 97/Rs 36
Promoter/FPI/DII	0%/32%/68%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	41,763	46,489	49,983	56,383	63,562
NII growth (%)	16.6	11.3	7.5	12.8	12.7
Adj. net profit (Rs mn)	12,439	15,428	12,484	15,017	17,792
EPS (Rs)	6.3	7.8	6.3	7.5	8.9
P/E (x)	8.3	6.7	8.3	6.9	5.8
P/BV (x)	0.8	0.7	0.7	0.6	0.6
ROA (%)	0.8	0.9	0.7	0.7	0.7
ROE (%)	9.8	11.1	8.3	9.3	10.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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