COMPANY UPDATE

BUY
TP: Rs 1,869 | ⮝ 22%

HDFC BANK | Banking | 19 January 2022

Balanced Growth

- **Bank remains reasonably stable during turbulence**
- **Growth likely to sustain supported by enhanced digital infrastructure**
- **Maintain BUY on the back of strong franchise & profitability. Raise TP from Rs. 1,800 to Rs. 1,869**

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Momentum to sustain: HDFC Bank continues to grow its Balance Sheet in a sustained manner, albeit the growth rate is likely to have moderated to around 15% on a sustainable basis in our view, as compared to ~ 20% growth which it has experienced over the last 10 years. This is for several reasons which we believe could play out over the medium term, including emergence of economy from the impact of Covid resulting in slower growth and increased digitisation leading to nearly similar advantages that most of the well-run banks and other players would have in terms of reach and offerings, leading to even greater competitive landscape. We believe growth of more than 15% in the medium term would likely be considered robust for an established bank like HDFC Bank. It continues to be one of the key leading players in various retail segments such as personal loans, credit cards and auto loans. Banks also issued ~1.3Mn new cards after restrictions were lifted in August 2021 underscoring strong distribution ability.

Profitability & Capital Adequacy: HDFC Bank's profitability and Capital Adequacy is likely to remain industry leading, just as it has in the medium term, given its ability to manage the franchise, and its risk management. This will likely help maintain its RoE's in 17-19% range, significantly higher than its Cost of Equity. Increasing operating efficiency had led to cost-income ratio to come down from ~44% in FY16 to ~36% in FY21. We forecast slightly lower cost income levels due to continuing efficiencies, further boosted by increased digitisation. We expect total capital to remain in 18-20% range in the medium term, offering adequate headroom for faster growth.

Valuation. We believe that HDFC Bank has ability to generate superior returns on the back of its strong franchise and risk management capabilities. We value its core business at 3.4x Mar'24 P/ABV and add Rs 88 from subsidiaries to arrive at its SOTP valuation of Rs. 1,869 (from Rs. 1,800), hereby maintaining a BUY rating. Worsening of covid induced stress in asset remains one of the key risks to our estimates and valuation.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HDFCB IN/Rs 1,529
Market cap	US$ 113.7bn
Free float	74%
3M ADV	US$ 125.9mn
52wk high/low	Rs 1,725/Rs 1,342
Promoter/FPI/DII	26%/37%/37%

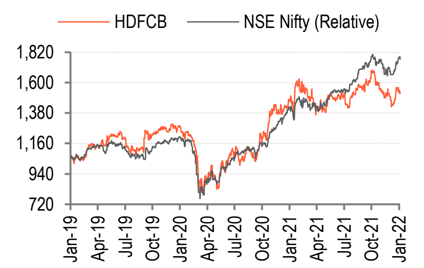
Source: NSE | Price as of 18 Jan 2022

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Net interest income	6,48,796	7,39,653	8,47,540
NII growth (%)	15.5	14.0	14.6
Adj. net profit (Rs mn)	3,11,165	3,82,526	4,53,034
EPS (Rs)	56.6	69.2	81.7
Consensus EPS (Rs)	57.7	66.8	81.0
P/E (x)	27.0	22.1	18.7
P/BV (x)	4.1	3.7	3.2
ROA (%)	1.9	2.0	2.1
ROE (%)	16.6	17.6	18.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

Loan & Deposit Mix: Mix of advances appropriate (granular) in our view with a balance of retail and corporate, not swinging on any side materially. The Bank seems to have churned its book between retail and wholesale effectively in the past without getting impacted materially through the cycles as compared to other banks in the peer group, thus generating far greater RoE's reflecting superior risk management. For instance, Retail book coming down from ~55% in FY18 to around ~45% currently and vice versa for the wholesale book appears to have been timely, especially on the wholesale book where the risks stand reasonably mitigated insofar as leverage and asset quality issues are concerned. Several other banks have found themselves caught in the FY17-20 loan cycle with significantly diminished parameters. However, a reasonable part of growth in the wholesale segment has been from MSME/SME/Emerging segment, which can potentially get further tested in the current environment. As of Q3FY22, bank's advances grew by ~17% YoY and ~5% QoQ to Rs 12,608Bn. The growth in advances was driven by 29% YoY growth in CRB Advances while the Retail and Corporate (& other Wholesale advances) grew by 13% and 8% YoY respectively. The restrictions on new card issuances had been lifted in August 2021. Bank has issued ~1.3Mn new cards (of which 0.95Mn have been issued in Q3FY22) since then

Deposit base: Deposits remain granular with a CASA at 47% as at Q3FY22, a meaningful rise from 43% at Q3FY21-end. HDFC Bank's CASA ratio has been on a higher side compared to other private sector banks. As at Q3FY22, ~83% of the deposits are from retail (Q2FY22: 82%, Q3FY21: 80%) which helps lower cost of deposits. In Q3FY22, Bank's deposits grew by 14% YoY and 3% QoQ to Rs 14,459Bn

Stress Pool: Total stress pool (FY21 and 9MFY) stands at around 5% of advances (ECLGS + Restructured + Gross NPA+SRs). Excluding ECLGS, which is backed the Government Guarantee, the stress pool would be at ~2.6%. Gross and net NPA's have remained more or less in a narrow range (~1-1.4 & ~0.25- 0.4) for last couple of years, amongst the lowest in the industry reflecting superior underwriting and risk management/Governance. The bank's Gross/Net NPA as at Q3FY22 stood at 1.26%/0.37% respectively. Provision coverage ratios again have been and are amongst the best in the industry with the current PCR being 71% as at Q3FY22. We forecast similar trends for HDFC Bank going forward in the medium term. As at Q3FY22, out of the total restructured book (which stands at 1.37% of advances) 40% is secured with collateral. Out of the unsecured portion, two-thirds are from salaried customers/segment, of which approximately 40% have a CIBIL score of more than 700. As per the management, the potential impact of restructuring on GNPA would be around 10-20bps. Having said the above, write-offs as a percentage of opening GNPA have increased in FY20 & FY21 (~73%). Recoveries amounted to 27% and 23% respectively of the written off amount. Unless there has been a permanent loss of business/earnings, with further opening up recovery can inch up. Write-offs will remain one of the important factors to watch out for.

Yields and Cost of funds: We forecast a mild increase in both yields and costs of funds to build a mildly rising interest rate scenario in the medium term. We don't believe that interest would rise meaningfully (a repo rate hike by 1% gradually may not be too damaging) and that policy support is likely to remain supportive for some time. Reported NIM for Q3FY22 of 4.1% remained flat YoY and QoQ. (NIM has remained flat at 4.1% in all the 3Qtrs of FY22). With mild changes in the yield and cost structure, impact spreads and NIMs would not be material. In fact, a sharp rise, say 1 % rise in both yields and costs would tend to widen the NIMs by about 20-30 bps under our assumed asset and liability structure going forward. Everything else remaining same, RoE's would improve marginally under such a scenario under the assumed structure. We expect NIM's to range 4.10%-4.30% in the medium term close to what they have been in the recent past.

Other Income: Core fee income i.e. Commission, exchange & brokerage, has been on a declining trend. From ~2% of average advances in FY15 it has dropped to ~1.5% in FY21. Its share in total other income has dropped from ~73% to ~64% during the same period, after rising to a high of ~78% in FY19. We build in a retracement to similar levels i.e. around 70% gradually given that FY 21 was an exceptional year and fall may have been exacerbated. Nearly 20% of core fee income in FY21 came from insurance distribution business as compared to 15% in FY20. Misc. income comprises of writebacks (recoveries) from written off accounts. Total other income, expected to remain around 26-27% of total oncome, is expected to grow at an average of ~10% over the medium term in our view, given the environment in the near term and a gradual pick up thereon.

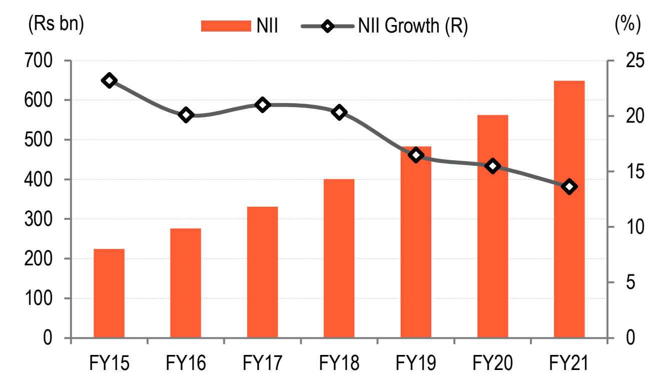
Digital: While HDFC Bank has been one of banks which have been at the forefront when it comes to adopting technology in various aspects of banking business, it has had its challenges with tech driven outages in the past. The environment now, partly due to Covid has led to banks intensifying their efforts towards further digitization. Innovation in digital space increasingly supported by regulation, though evolving, has further necessitated investments in technology across the banking value chain. HDFC Bank, as a part of its continuing strategy in this space possibly also intensified by RBI restrictions in the past, has been adopting technology towards digitizing its current products and services, API's, onboarding, personalization, underwriting thru AI & ML and risk control. Updating legacy systems and ensuring that core system is always 'ON' is a part of this strategy.

Subsidiaries:

HDB Financial Services Ltd - NFBC with a loan book of Rs 604Bn as at Q3FY22, floated by HDFC Bank with 95% ownership. HDB is in the business of loans, fee-based income and BPO services. It offers consumer loans, enterprise loans incl. loans to small businesses, asset finance (vehicle, construction equipment, tractor loans, etc.) and micro-lending, mostly to first time buyers and under-served segments. Its fee income component comprises of insurance and mutual fund distribution business. BPO services are largely offered to HDFC Bank towards collection services and back-office support. RoE/RoA for FY21 stood at 4.8%/0.6% and H2 FY22 annualized RoE stands at ~6.5%. The NBFC reported net profit of Rs 304cr for Q3FY22 (v/s a loss of 146cr for Q3FY21). Stage 3 assets as at Q3FY22 stood at 6.05% (Q3FY21: 5.9%, FY20: 3.9%, FY21: 4.5%) while the Total CAR stands at 20.3%.

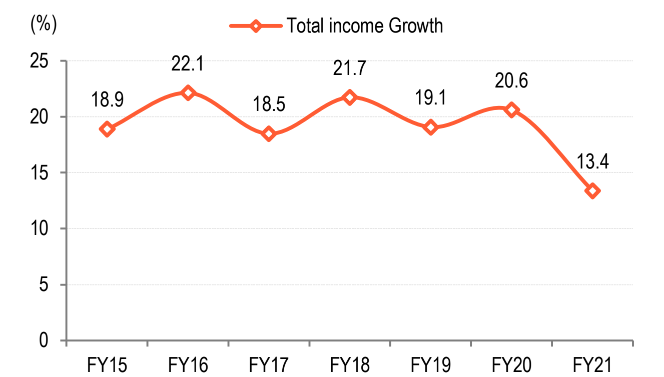
HDFC Securities (HSL) – Owned 96% by HDFC Bank, HDFC Securities provides broking services in the capital markets. It also acts as distributor of financial products and is a registered Agent with IRDA. For Q3FY22, it reported strong performance with 58% YoY growth in its Revenue and Net profit to Rs 536cr and Rs 258cr respectively. Brokerage & Fee (B&F) income accounted for ~74% of the total income in H2FY22 as compared to ~82% in FY21. Share of Interest income shot up to ~23% of total income in H2FY22 versus ~15% in FY22. B&F grew 32% YOY (H2FY22 over H2FY21) as compared to YOY growth of ~66% (FY21 over FY20). Fee income as a component of B&F income comprises mainly of commission on sale of insurance products and was ~12.5% of B&F income in FY21. ROE was 51.6% on average equity for FY21.

Fig 1 – NII & NII Growth



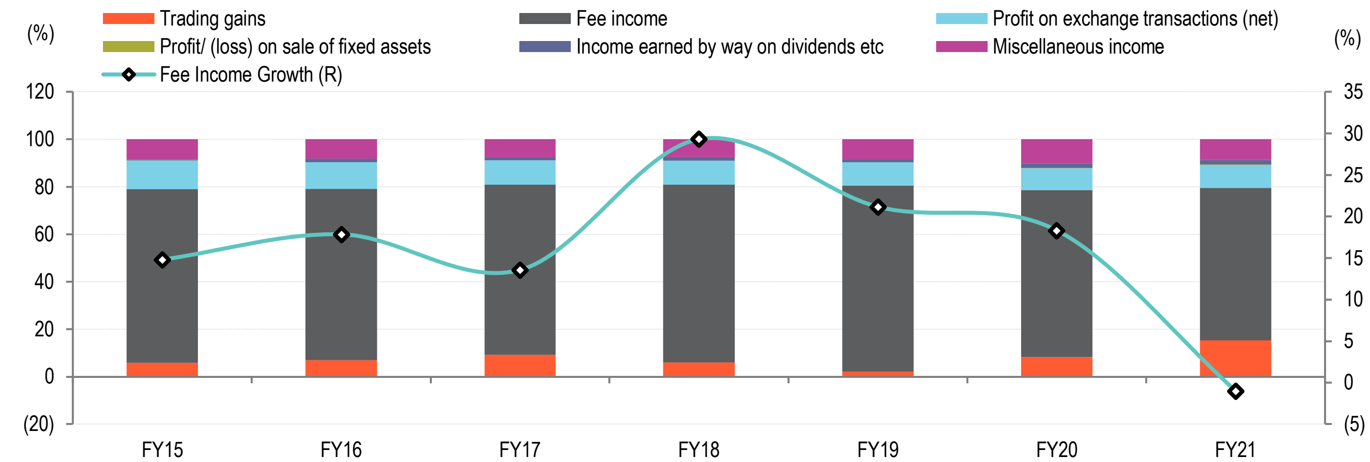
Source: Company, BOBCAPS Research

Fig 2 – Total Income Growth



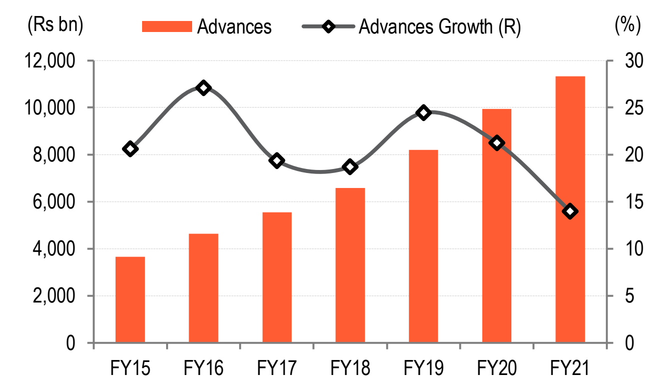
Source: Company, BOBCAPS Research

Fig 3 – Other Income & Fee income Growth



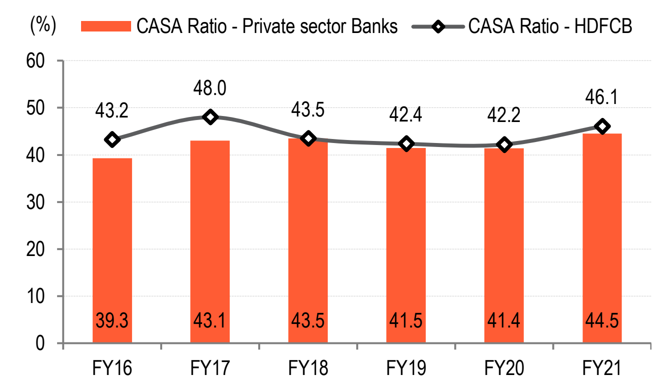
Source: Company, BOBCAPS Research

Fig 4 – Advances



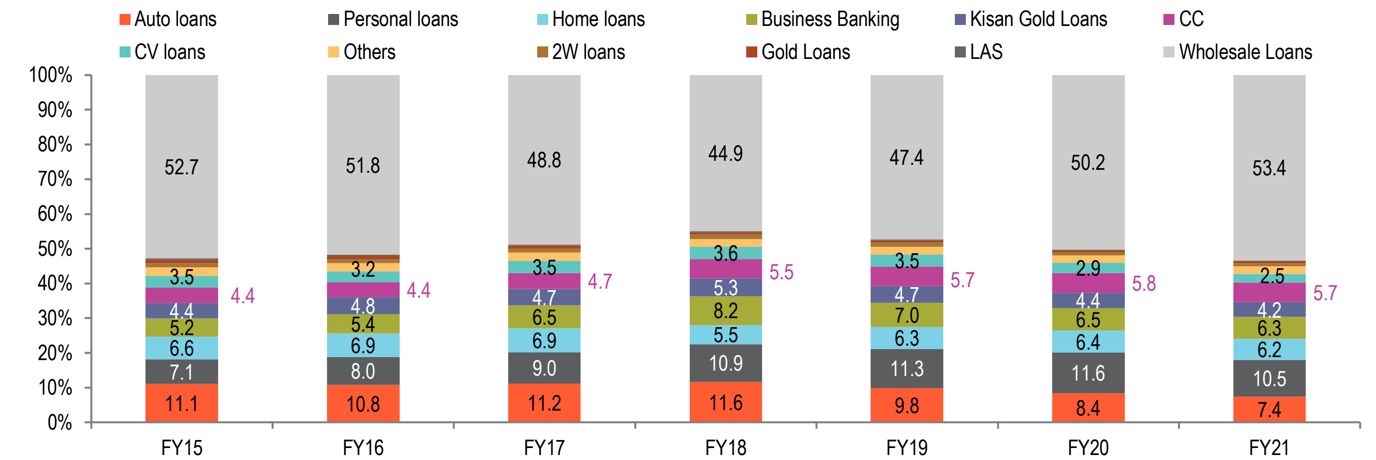
Source: Company, BOBCAPS Research

Fig 5 – CASA



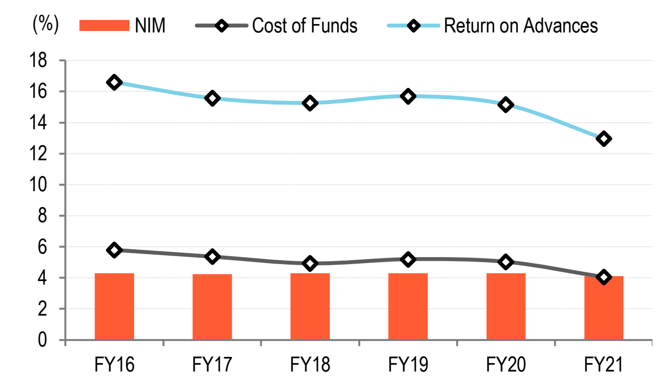
Source: Company, RBI, BOBCAPS Research

Fig 6 – Loan Portfolio Mix



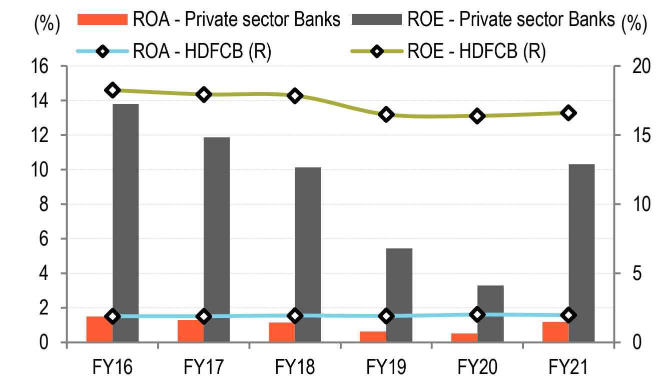
Source: Company, BOBCAPS Research

Fig 7 – NIM, Cost of Funds & Return on Advances



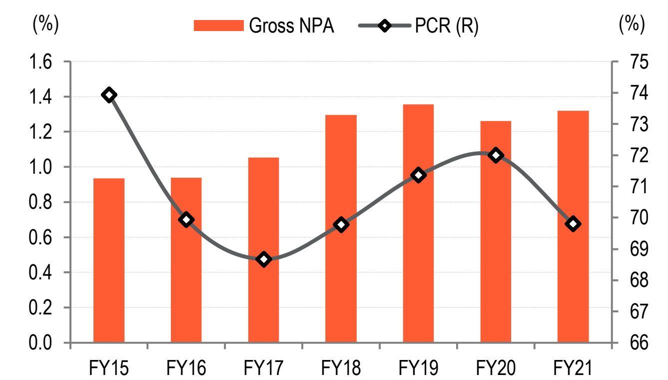
Source: Company, BOBCAPS Research

Fig 8 – ROA & ROE



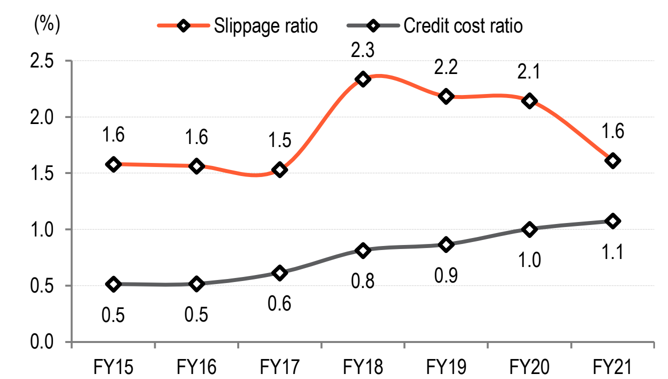
Source: Company, RBI, BOBCAPS Research

Fig 9 – GNPA & PCR



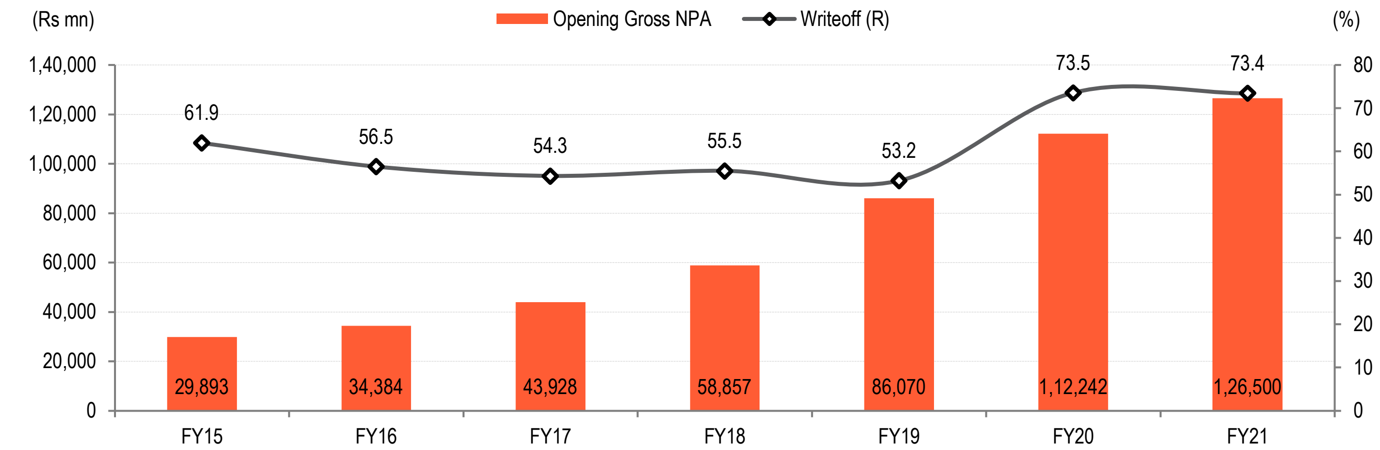
Source: Company, BOBCAPS Research

Fig 10 – Slippage & Credit Cost Ratio



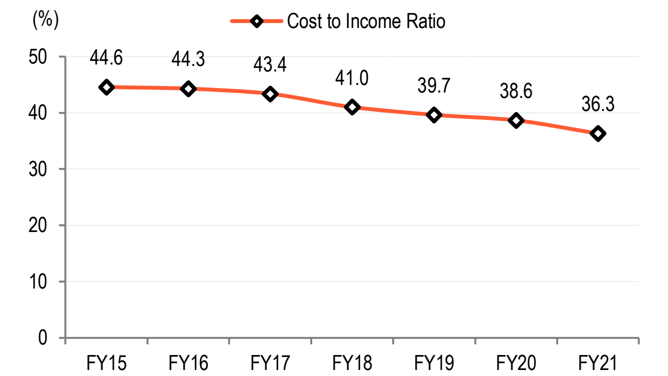
Source: Company, BOBCAPS Research

Fig 11 – Write-offs from GNPAs



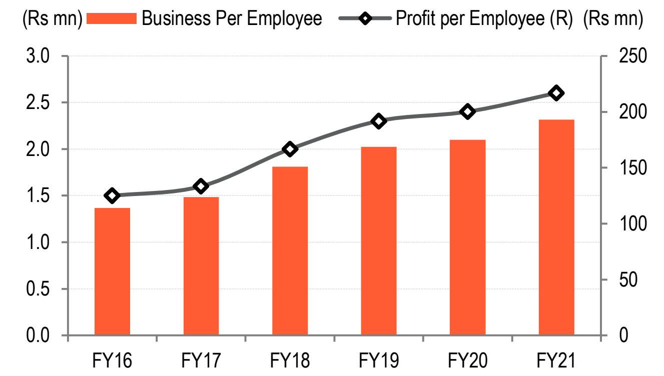
Source: Company, BOBCAPS Research

Fig 12 – Cost to Income Ratio



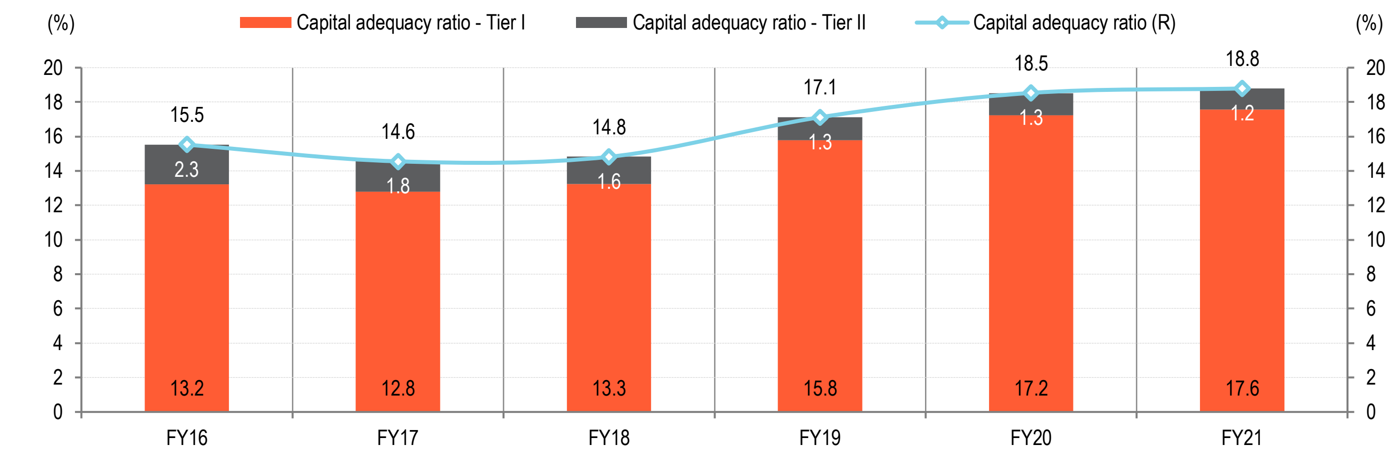
Source: Company, BOBCAPS Research

Fig 13 – Business Per Employee



Source: Company, BOBCAPS Research

Fig 14 – Capital Adequacy



Source: Company, BOBCAPS Research

Valuation methodology

We believe that HDFC Bank has ability to generate superior returns on the back of its strong franchise and risk management capabilities. **We value its core business at 3.4x Mar'24 P/ABV and add Rs 88 from subsidiaries to arrive at its SOTP valuation of Rs. 1,869 (from Rs. 1,800), hereby maintaining a BUY rating.**

Fig 15 – Revised Estimates

Particulars	New			Old		Change (%)	
P&L (Rs bn)	**FY22E**	**FY23E**	**FY24E**	**FY22E**	**FY23E**	**FY22E**	**FY23E**
Net interest income	739.7	847.5	984.3	765.7	920.3	(3.4)	(7.9)
Other Income	277.4	311.3	352.3	266.7	298.2	4.0	4.4
Operating cost	356.8	405.6	458.1	368.0	432.3	(3.0)	(6.2)
Total provisions	146.1	144.2	162.9	162.2	183.1	(9.9)	(21.2)
Net Profit	382.5	453.0	532.3	373.6	448.7	2.4	1.0
Balance Sheet (Rs bn)							
Share Capital	5.5	5.5	5.5	5.5	5.5	0.5	0.5
Deposits	15,219.7	17,502.6	20,128.0	15860.5	18985.0	(4.0)	(7.8)
Advances	13,027.6	14,981.8	17,229.0	13367.5	16041.0	(2.5)	(6.6)
Total assets	20,285.7	23,270.5	26,707.9	20503.0	24268.2	(1.1)	(4.1)
Key Ratios							
RoA	2.0	2.1	2.1	2.0	2.0	3.0	3.8
RoE	17.6	18.4	18.9	17.2	18.2	2.2	0.6
NIM	4.1	4.2	4.2	4.2	4.3	(1.6)	(2.5)
Yield on Advances	8.1	8.5	8.6	9.2	9.4	(12.0)	(10.1)
Cost of Funds	3.5	3.7	3.8	4.2	4.4	(17.1)	(15.6)
Cost to income	35.1	35.0	34.3	35.7	35.5	(1.6)	(1.3)
GNPA	1.3	1.1	1.1	1.1	1.0	15.3	18.1
NNPA	0.4	0.3	0.3	0.3	0.2	22.6	44.8
Total CAR	19.5	19.4	19.3	18.1	17.4	8.0	11.5
Tier1 CAR	18.3	18.3	19.5	17.0	16.4	7.9	11.7
BVPS	416.4	474.2	542.2	417.5	475.1	(0.3)	(0.2)
ABVPS	411.2	465.0	531.3	412.2	470.2	(0.2)	(1.1)
Growth (%)							
Advances Growth	15.0	15.0	15.0	18.0	20.0	(16.7)	(25.0)
Deposit Growth	14.0	15.0	15.0	18.8	19.7	(25.5)	(23.9)
NII Growth	14.0	14.6	16.1	18.0	20.2	(22.3)	(27.8)
Net Profit Growth	22.9	18.4	17.5	20.1	20.1	14.3	(8.3)
OPEX Growth	9.0	13.7	12.9	12.5	17.5	(27.5)	(21.7)

Source: Company, BOBCAPS Research

Fig 16 – Valuation summary

Valuation	(Rs)
Mar'24 ABVPS	531
Less: Equity Investments in Subs	7
Mar'24 ABVPS	524
Justified P/ABV Multiple	3.4
Value per share (Bank Standalone)	**1,781**
Subsidiaries (after 20% discount)	
HDB Financials	45
HDFC Securities	43
Consolidated SOTP Valuation	**1,869**

Source: BOBCAPS Research

Key risks

Any bank is subject to system wide risks and greater the reach, risks increase due to greater interconnectedness. Some of key risks that may play out:

- Steep rise in interest rates driven by inflation for example, impacting asset quality materially, both on the wholesale and retail front.
- Impact of the recent Covid crisis on the overall economy in case it continues to play out potentially impacting the asset quality and growth further.

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Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net interest income	**5,61,863**	**6,48,796**	**7,39,653**	**8,47,540**	**9,84,271**
NII growth (%)	16.5	15.5	14.0	14.6	16.1
Non-interest income	2,32,608	2,52,049	2,77,435	3,11,254	3,52,275
Total income	7,94,471	9,00,845	10,17,088	11,58,794	13,36,546
Operating expenses	(3,06,975)	(3,27,226)	(3,56,839)	(4,05,643)	(4,58,112)
Operating profit	4,87,495	5,73,618	6,60,249	7,53,152	8,78,433
Op. profit growth (%)	22.6	17.7	15.1	14.1	16.6
Provisions	(1,21,424)	(1,57,029)	(1,46,102)	(1,44,235)	(1,62,933)
PBT	3,66,072	4,16,590	5,14,147	6,08,916	7,15,500
Tax	(1,03,498)	(1,05,425)	(1,31,622)	(1,55,883)	(1,83,168)
Reported net profit	**2,62,573**	**3,11,165**	**3,82,526**	**4,53,034**	**5,32,332**
Adjustments	0	0	0	0	0
Adjusted net profit	**2,62,573**	**3,11,165**	**3,82,526**	**4,53,034**	**5,32,332**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Equity capital	5,483	5,513	5,542	5,542	5,542
Reserves & surplus	17,04,377	20,31,696	23,02,332	26,22,854	29,99,479
Net worth	17,09,860	20,37,208	23,07,875	26,28,396	30,05,021
Deposits	1,14,75,023	1,33,50,602	1,52,19,687	1,75,02,639	2,01,28,035
Borrowings	14,90,664	14,07,907	19,92,313	22,60,809	25,66,753
Other liab. & provisions	6,29,565	6,72,988	7,65,854	8,78,638	10,08,087
Total liab. & equities	**1,53,05,113**	**1,74,68,705**	**2,02,85,728**	**2,32,70,482**	**2,67,07,897**
Cash & bank balance	8,66,187	11,94,704	17,33,155	17,69,782	12,16,206
Investments	39,18,267	44,37,283	44,83,159	50,73,004	65,49,184
Advances	99,37,029	1,13,28,366	1,30,27,621	1,49,81,764	1,72,29,029
Fixed & Other assets	5,83,630	5,08,352	10,41,793	14,45,931	17,13,477
Total assets	**1,53,05,113**	**1,74,68,705**	**2,02,85,728**	**2,32,70,482**	**2,67,07,897**
Deposit growth (%)	24.3	16.3	14.0	15.0	15.0
Advances growth (%)	21.3	14.0	15.0	15.0	15.0

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
EPS	48.0	56.6	69.2	81.7	96.0
Dividend per share	11.9	0.0	17.3	20.4	24.0
Book value per share	311.8	369.5	416.4	474.2	542.2

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
P/E	31.8	27.0	22.1	18.7	15.9
P/BV	4.9	4.1	3.7	3.2	2.8
Dividend yield (%)	0.8	0.0	1.1	1.3	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Net interest income	4.0	4.0	3.9	3.9	3.9
Non-interest income	1.7	1.5	1.5	1.4	1.4
Operating expenses	2.2	2.0	1.9	1.9	1.8
Pre-provisioning profit	3.5	3.5	3.5	3.5	3.5
Provisions	0.9	1.0	0.8	0.7	0.7
PBT	2.6	2.5	2.7	2.8	2.9
Tax	0.7	0.6	0.7	0.7	0.7
ROA	1.9	1.9	2.0	2.1	2.1
Leverage (x)	8.7	8.7	8.7	8.8	8.9
ROE	16.4	16.6	17.6	18.4	18.9

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Net interest income	16.5	15.5	14.0	14.6	16.1
Pre-provisioning profit	22.6	17.7	15.1	14.1	16.6
EPS	21.2	17.8	22.3	18.1	17.5
Profitability & Return ratios (%)					
Net interest margin	4.2	4.1	4.1	4.1	4.2
Fees / Avg. assets	1.2	1.0	1.0	1.0	1.0
Cost-Income	38.6	36.3	35.1	35.0	34.3
ROE	16.4	16.6	17.6	18.4	18.9
ROA	1.9	1.9	2.0	2.1	2.1
Asset quality (%)					
GNPA	1.3	1.3	1.3	1.1	1.1
NNPA	0.4	0.4	0.4	0.3	0.3
Slippage ratio	2.1	1.6	1.5	1.3	1.3
Credit cost	1.0	1.1	0.9	0.8	0.8
Provision coverage	72.0	69.8	70.6	70.0	69.3
Ratios (%)					
Credit-Deposit	86.6	84.9	85.6	85.6	85.6
Investment-Deposit	34.1	33.2	29.5	29.0	32.5
CAR	18.5	18.8	19.5	19.4	19.3
Tier-1	17.2	17.6	18.4	18.3	18.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

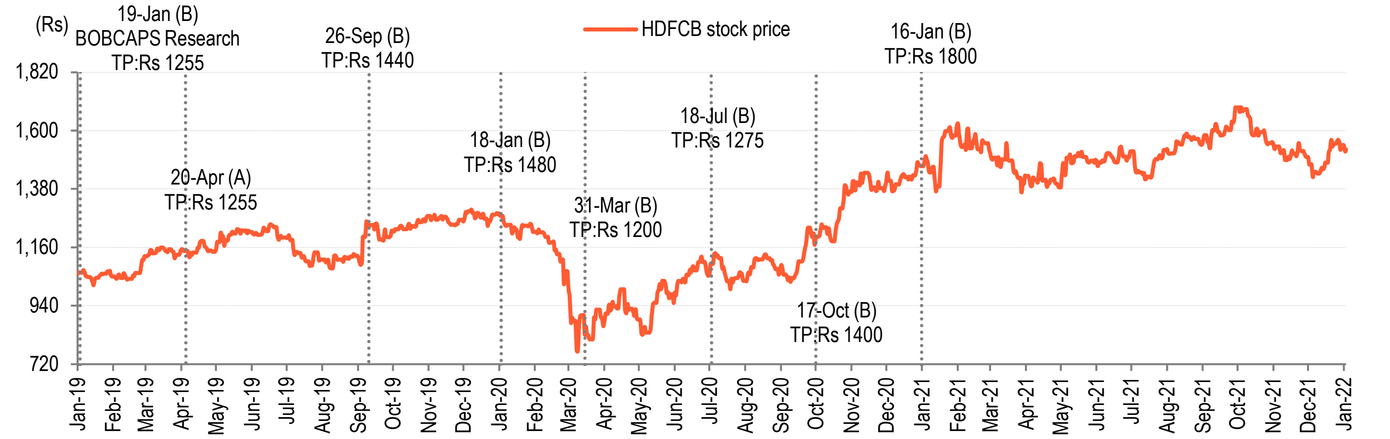
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HDFC BANK (HDFCB IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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