

BUY

TP: Rs 1,480 | ▲ 16%

HDFC BANK

| Banking

| 18 January 2020

Better retail asset quality trends

HDFC Bank's (HDFCB) Q3FY20 PAT at Rs 74bn (+33% YoY) was ahead of our estimates largely due to strong non-interest income. GNPA inched up to 1.42%, and a corporate account as well as the agri segment drove ~40% of slippages. Management stated that delinquency trends across retail products were steady, barring the CV/CE segments. The SMA-2 book was stable in Q3 and remains low in absolute terms. HDFCB will apply to RBI with a list of candidates for the new CEO in Jul/Aug'20. BUY with a revised TP of Rs 1,480 (vs. Rs 1,440) on rollover.

Vikesh Mehta

research@bobcaps.in

Stable outlook on retail asset quality: HDFCB's core slippages were stable at Rs 38.4bn, which included lumpy corporate and agriculture slippages worth Rs 15bn (60-65% from agri). Ex-agri, the GNPA ratio held at 1.2%. Retail asset quality trends across auto, credit cards and personal loans were steady with an improving bias, though the CV/CE portfolio is facing stress due to economic factors. Gross stage 3 impaired assets in HDB Financials increased to 3% (vs. 2.72% in Q2), largely on account of stress in the CV portfolio. Provisions rose 38% YoY/13% QoQ to Rs 30bn as they included accelerated provisions and one-off corporate provisions worth Rs 7bn.

Strong growth in corporate portfolio: Overall loan growth remained strong at 20% YoY backed by 27% growth in the corporate book. As per management, corporate growth was led by new customer acquisition and deepening of relationships with existing clients among PSUs and the energy, agri, power, fertiliser and consumer segments. NIM was broadly stable at 4.2% and would have been higher but for excess liquidity in Q3.

Maintain BUY: We like HDFCB for its strong processes, risk management practices and steady asset quality. Maintain BUY as we roll forward to a Mar'21 TP of Rs 1,480, revised from Rs 1,440 earlier.

| | |
|------------------|-------------------|
| Ticker/Price | HDFCB IN/Rs 1,278 |
| Market cap | US\$ 49.1bn |
| Shares o/s | 2,733mn |
| 3M ADV | US\$ 99.4mn |
| 52wk high/low | Rs 1,306/Rs 1,011 |
| Promoter/FPI/DII | 27%/39%/34% |

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|-------------------------|---------|---------|---------|---------|---------|
| Net interest income | 400,949 | 482,432 | 592,722 | 724,667 | 882,660 |
| NII growth (%) | 21.0 | 20.3 | 22.9 | 22.3 | 21.8 |
| Adj. net profit (Rs mn) | 174,867 | 210,782 | 276,225 | 358,062 | 435,247 |
| EPS (Rs) | 33.9 | 39.6 | 50.7 | 65.7 | 79.9 |
| P/E (x) | 37.7 | 32.3 | 25.2 | 19.4 | 16.0 |
| P/BV (x) | 6.2 | 4.7 | 4.1 | 3.5 | 3.0 |
| ROA (%) | 1.8 | 1.8 | 2.0 | 2.1 | 2.1 |
| ROE (%) | 17.9 | 16.5 | 17.3 | 19.5 | 20.3 |

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

| (Rs mn) | Q3FY20 | Q2FY20 | Q3FY19 | YoY (%) | QoQ (%) |
|---------------------------------|----------------|----------------|----------------|-------------|-------------|
| Income Statement | | | | | |
| Net interest income | 141,729 | 135,150 | 125,768 | 12.7 | 4.9 |
| Non-interest income | 66,693 | 55,887 | 49,210 | 35.5 | 19.3 |
| Net total income | 208,422 | 191,038 | 174,978 | 19.1 | 9.1 |
| Staff expenses | 24,550 | 23,551 | 19,676 | 24.8 | 4.2 |
| Other operating expenses | 54,418 | 50,506 | 47,517 | 14.5 | 7.7 |
| Total operating expenses | 78,968 | 74,057 | 67,193 | 17.5 | 6.6 |
| Pre-provisioning profit | 129,454 | 116,981 | 107,784 | 20.1 | 10.7 |
| Total provisions | 30,436 | 27,007 | 22,115 | 37.6 | 12.7 |
| Profit before tax | 99,019 | 89,974 | 85,669 | 15.6 | 10.1 |
| Tax | 24,854 | 26,524 | 29,810 | (16.6) | (6.3) |
| Profit after tax | 74,165 | 63,450 | 55,859 | 32.8 | 16.9 |
| Balance Sheet | | | | | |
| Loans | 9,360,295 | 8,969,838 | 7,809,512 | 19.9 | 4.4 |
| Deposits | 10,674,335 | 10,216,149 | 8,525,019 | 25.2 | 4.5 |
| CASA ratio (%) | 39.5 | 39.3 | 40.7 | (120bps) | 24bps |
| Yields and margins (%) | | | | | |
| Yield on advances | 10.2 | 10.4 | 10.6 | (38bps) | (21bps) |
| Yield on investments | 6.7 | 6.7 | 7.3 | (61bps) | 1bps |
| Cost of funds | 5.3 | 5.4 | 5.5 | (16bps) | (10bps) |
| Spread | 3.6 | 3.6 | 3.8 | (18bps) | 0bps |
| NIM | 4.2 | 4.2 | 4.3 | (10bps) | 0bps |
| Key ratios (%) | | | | | |
| Cost to income ratio | 37.9 | 38.8 | 38.4 | (51bps) | (88bps) |
| Tax rate | 25.1 | 29.5 | 34.8 | (970bps) | (438bps) |
| Asset quality | | | | | |
| Gross NPAs | 134,273 | 125,082 | 109,029 | 23.2 | 7.3 |
| Net NPAs | 44,684 | 37,910 | 33,015 | 35.3 | 17.9 |
| Coverage Ratio (%) | 66.7 | 69.7 | 69.7 | (300bps) | (297bps) |
| Gross NPA ratio (%) | 1.4 | 1.4 | 1.4 | 4bps | 4bps |
| Net NPA ratio (%) | 0.5 | 0.4 | 0.4 | 6bps | 6bps |
| Capital adequacy (%) | | | | | |
| Tier-I Ratio | 17.1 | 16.2 | 15.8 | 130bps | 90bps |
| Tier-II Ratio | 1.4 | 1.3 | 1.5 | (10bps) | 10bps |
| Total CAR Ratio | 18.5 | 17.5 | 17.3 | 120bps | 100bps |

Source: Company, BOBCAPS Research

Valuation methodology

We like HDFCB for its strong processes, risk management practices and stable asset quality. On rolling valuations over, we have a revised Mar'21 target price of Rs 1,480 (from Rs 1,440).

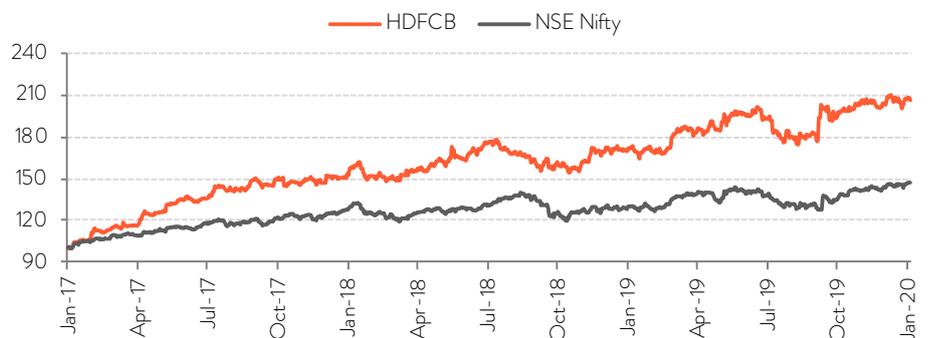
Our target price is derived using the SOTP method. The core book has been adjusted for investment in subsidiaries and valued at 3.4x FY22E P/BV – this is based on a two-stage Gordon Growth Model given that we expect the business to continue growing much faster than the industry for the next few years. Our SOTP model also includes the value of the bank's NBFC and broking businesses.

FIG 2 – SOTP VALUATION

| Sum of Parts | Company value (Rs bn) | Stake in company (%) | Value for HDFCB (Rs bn) | Per share (Rs) | Contribution to TP (%) | Comments |
|---------------------|-----------------------|----------------------|-------------------------|----------------|------------------------|--|
| Core Business | 7,632 | 100 | 7,632 | 1,401 | 95 | Valued at 3.4x FY22E P/BV on Gordon Growth Model |
| HDB Financial | 317 | 96 | 350 | 64 | 4 | Valued at 3x FY22E P/BV |
| HDFC Securities | 65 | 98 | 80 | 15 | 1 | Valued at 12x FY22E P/E |
| Sum of Parts | | | 8,061 | 1,480 | 100 | |

Source: BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Economic slowdown:** In our view, HDFCB's loan portfolio broadly imitates India's GDP mix by catering to the consumption theme. A slower-than-expected pickup in India's economic growth or a slowdown in job creation coupled with a sharp rise in interest rates could affect demand for retail loans and margins.
- Leadership risk:** The bank will witness a change at the helm after three decades, with MD & CEO Aditya Puri retiring in Oct'20. While we continue to believe that HDFCB's process-driven business will hold it in good stead, the stock could be negatively affected should there be a slew of senior management exits during the transition phase.

FINANCIALS

Income Statement

| Y/E 31 Mar (Rs mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| Net interest income | 400,949 | 482,432 | 592,722 | 724,667 | 882,660 |
| NII growth (%) | 21.0 | 20.3 | 22.9 | 22.3 | 21.8 |
| Non-interest income | 152,203 | 176,259 | 208,640 | 245,332 | 288,323 |
| Total income | 553,152 | 658,691 | 801,363 | 969,999 | 1,170,983 |
| Operating expenses | (226,904) | (261,194) | (318,710) | (378,907) | (458,779) |
| Operating profit | 326,248 | 397,497 | 482,653 | 591,092 | 712,204 |
| Operating profit growth (%) | 26.8 | 21.8 | 21.4 | 22.5 | 20.5 |
| Provisions | (59,275) | (75,501) | (94,599) | (109,826) | (127,195) |
| PBT | 266,973 | 321,997 | 388,054 | 481,265 | 585,009 |
| Tax | (92,106) | (111,215) | (111,829) | (123,204) | (149,762) |
| Reported net profit | 174,867 | 210,782 | 276,225 | 358,062 | 435,247 |
| Adjustments | 0 | 0 | 0 | 0 | 0 |
| Adjusted net profit | 174,867 | 210,782 | 276,225 | 358,062 | 435,247 |

Balance Sheet

| Y/E 31 Mar (Rs mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Equity capital | 5,190 | 5,447 | 5,447 | 5,447 | 5,447 |
| Reserves & surplus | 1,057,760 | 1,486,617 | 1,698,205 | 1,972,481 | 2,305,879 |
| Net worth | 1,062,950 | 1,492,064 | 1,703,652 | 1,977,927 | 2,311,326 |
| Deposits | 7,887,706 | 9,231,409 | 11,548,439 | 14,424,950 | 17,982,603 |
| Borrowings | 1,260,946 | 1,207,248 | 1,482,067 | 1,781,986 | 2,147,619 |
| Other liabilities & provisions | 427,741 | 514,686 | 576,449 | 687,796 | 823,541 |
| Total liabilities and equities | 10,639,343 | 12,445,407 | 15,310,607 | 18,872,659 | 23,265,089 |
| Cash & bank balance | 1,229,151 | 813,476 | 842,359 | 873,156 | 906,013 |
| Investments | 2,422,002 | 2,905,879 | 3,478,432 | 4,189,535 | 5,058,704 |
| Advances | 6,583,331 | 8,194,012 | 10,161,216 | 12,621,424 | 15,677,295 |
| Fixed & Other assets | 404,859 | 532,040 | 828,600 | 1,188,543 | 1,623,077 |
| Total assets | 10,639,343 | 12,445,407 | 15,310,607 | 18,872,659 | 23,265,089 |
| Deposit growth (%) | 22.5 | 17.0 | 25.1 | 24.9 | 24.7 |
| Advances growth (%) | 18.7 | 24.5 | 24.0 | 24.2 | 24.2 |

Per Share

| Y/E 31 Mar (Rs) | FY18A | FY19A | FY20E | FY21E | FY22E |
|----------------------|-------|-------|-------|-------|-------|
| EPS | 33.9 | 39.6 | 50.7 | 65.7 | 79.9 |
| Dividend per share | 0.0 | 7.4 | 10.1 | 13.1 | 16.0 |
| Book value per share | 204.8 | 273.9 | 312.8 | 363.1 | 424.4 |

Source: Company, BOBCAPS Research

Valuations Ratios

| Y/E 31 Mar (x) | FY18A | FY19A | FY20E | FY21E | FY22E |
|--------------------|-------|-------|-------|-------|-------|
| P/E | 37.7 | 32.3 | 25.2 | 19.4 | 16.0 |
| P/BV | 6.2 | 4.7 | 4.1 | 3.5 | 3.0 |
| Dividend yield (%) | 0.0 | 0.6 | 0.8 | 1.0 | 1.3 |

DuPont Analysis

| Y/E 31 Mar (%) | FY18A | FY19A | FY20E | FY21E | FY22E |
|-------------------------|-------|-------|-------|-------|-------|
| Net interest income | 4.2 | 4.2 | 4.3 | 4.2 | 4.2 |
| Non-interest income | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 |
| Operating expenses | 2.4 | 2.3 | 2.3 | 2.2 | 2.2 |
| Pre-provisioning profit | 3.4 | 3.4 | 3.5 | 3.5 | 3.4 |
| Provisions | 0.6 | 0.7 | 0.7 | 0.6 | 0.6 |
| PBT | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 |
| Tax | 1.0 | 1.0 | 0.8 | 0.7 | 0.7 |
| ROA | 1.8 | 1.8 | 2.0 | 2.1 | 2.1 |
| Leverage (x) | 9.8 | 9.0 | 8.7 | 9.3 | 9.8 |
| ROE | 17.9 | 16.5 | 17.3 | 19.5 | 20.3 |

Ratio Analysis

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|--|-------|-------|-------|-------|-------|
| YoY growth (%) | | | | | |
| Net interest income | 21.0 | 20.3 | 22.9 | 22.3 | 21.8 |
| Pre-provisioning profit | 26.8 | 21.8 | 21.4 | 22.5 | 20.5 |
| EPS | 18.6 | 16.9 | 28.0 | 29.6 | 21.6 |
| Profitability & Return ratios (%) | | | | | |
| Net interest margin | 4.4 | 4.4 | 4.5 | 4.5 | 4.5 |
| Fees / Avg. assets | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 |
| Cost-Income | 41.0 | 39.7 | 39.8 | 39.1 | 39.2 |
| ROE | 17.9 | 16.5 | 17.3 | 19.5 | 20.3 |
| ROA | 1.8 | 1.8 | 2.0 | 2.1 | 2.1 |
| Asset quality (%) | | | | | |
| GNPA | 1.3 | 1.4 | 1.4 | 1.5 | 1.4 |
| NNPA | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 |
| Provision coverage | 69.8 | 71.4 | 73.9 | 75.3 | 80.6 |
| Ratios (%) | | | | | |
| Credit-Deposit | 83.5 | 88.8 | 88.0 | 87.5 | 87.2 |
| Investment-Deposit | 30.7 | 31.5 | 30.1 | 29.0 | 28.1 |
| CAR | 14.8 | 17.1 | 18.2 | 17.3 | 16.6 |
| Tier-1 | 13.2 | 15.8 | 16.9 | 16.2 | 15.6 |

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

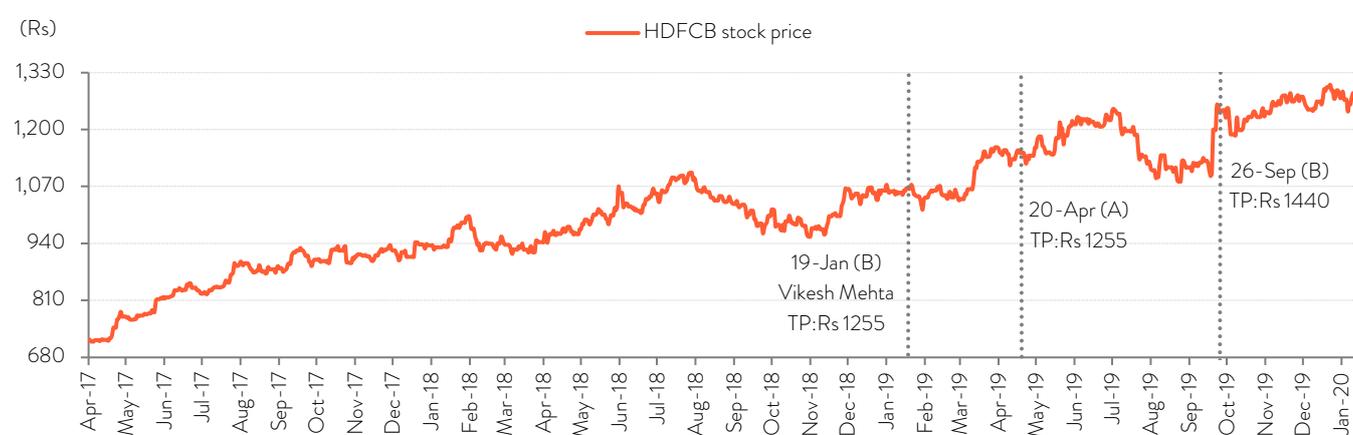
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: HDFC BANK (HDFCB IN)



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

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