

HDFC BANK

BANKS & FINANCIAL SERVICES

BUY

Target Price: Rs 2,000

Superior show continues

HDFC Bank's Q1FY18 PAT at Rs 38.9 bn was in line with our estimate, with higher-than-expected interest income largely set off by additional provisions – key impact from agri NPAs. Loan growth seems to be on a path of acceleration, climbing to 23.4% YoY after three quarters of below 20% YoY growth. Margin expanded to 4.4% (up 10 bps QoQ) largely benefitting from declining cost of funds.

Q1 saw some deterioration in headline asset quality (GNPL ratio up by 19 bps QoQ to 1.24%). Of the total increase in GNPLs, ~60% pertained to the agriculture sector, as recoveries were impacted due to farmers' anticipation of farm loan waivers. We remain constructive on HDFC Bank's asset quality and do not foresee any significant deterioration either in retail or wholesale book.

CMP : Rs 1,735
Potential Upside : 15%

MARKET DATA

No. of Shares : 2,574 mn
Free Float : 79%
Market Cap : Rs 4,465 bn
52-week High / Low : Rs 1,740 / Rs 1,159
Avg. Daily vol. (6mth) : 2.4 mn shares
Bloomberg Code : HDFCB IB Equity
Promoters Holding : 21%
FII / DII : 34% / 11%

Q1FY18 highlights: (a) Growth continued to be led by retail loans (~30% YoY), with unsecured and business loans leading the charge; (b) Core fee income growth was strong (~30% YoY) driven by higher traction in some of the products (MF distribution, credit cards and retail loan products) and few one-offs; (c) CASA ratio declined 430 bps QoQ to 44% (on unfavorable base created during demonetization) primarily on a sharp increase in fixed deposits (up 12% QoQ) and 12% QoQ run-off in current account deposits (a usual Q1 phenomenon).

Maintain BUY with revised TP of Rs 2,000 (15% upside from CMP): HDFC Bank is one of our preferred picks amongst the banks. We revise our TP to Rs 2,000 (4.3x FY19 P/ABV vs. 3.7x earlier) to factor in the high growth rate, conservative stance on bad assets, no legacy issues and top quartile return ratios. Expansion in fee income will be a driver for return ratios while gaining market share along with significant retail presence. At CMP of Rs 1,735, the stock trades at 4.4/3.7x FY18E/FY19E P/ABV of Rs 397/Rs 465. We have not factored in any value from HDB Financials or HDFC Securities in our valuations.

Financial summary (Standalone)

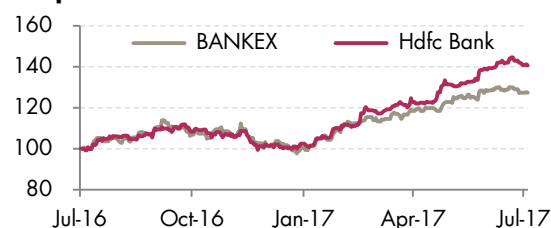
| Y/E March | FY16 | FY17 | FY18E | FY19E |
|-----------------|------|------|-------|-------|
| PAT (Rs bn) | 123 | 145 | 174 | 210 |
| EPS (Rs) | 49 | 57 | 68 | 82 |
| EPS chg (%) | 19.3 | 16.7 | 19.8 | 20.7 |
| Book value (Rs) | 287 | 349 | 404 | 472 |
| Adj. BV (Rs) | 284 | 345 | 397 | 465 |
| PE (x) | 35.7 | 30.5 | 25.5 | 21.1 |
| P/ABV (x) | 6.1 | 5.0 | 4.4 | 3.7 |
| RoE (%) | 18.3 | 17.9 | 18.1 | 18.8 |
| RoA (%) | 1.8 | 1.8 | 1.8 | 1.9 |
| Net NPA (%) | 0.3 | 0.3 | 0.4 | 0.3 |

Source: Company, Axis Capital

Key drivers

| (%) | Q3FY17 | Q4FY17 | Q1FY18 |
|-------------------|--------|--------|--------|
| Loan growth (YoY) | 13 | 19 | 23 |
| NIM | 4.1 | 4.3 | 4.4 |
| CASA | 45 | 48 | 44 |
| GNPA ratio | 1.1 | 1.1 | 1.2 |

Price performance



Conference call highlights

Business banking and unsecured loans lead the charge

- ◆ Loan growth seems to be on a path of recovery (climbing to 23.4% YoY after three quarters of below 20% YoY growth) led by retail loans (now 52% of loans; up ~30% YoY), with non-secured loans (personal loans and credit card up ~37% YoY) and business loans (up ~58% YoY) leading the charge
- ◆ An overseas book of Rs 201 bn de-grew a sharp 39.1% YoY primarily on run-off in FCNR advances
- ◆ Home loan growth moderated to 15.4% YoY due to lower purchase of loan portfolio. During Q1, HDFCB purchased Rs 25 bn vs. an average run-rate of Rs 30 bn. The management confirmed that the traction in sourcing of home loans continues (no moderation in the same)
- ◆ On corporate loan book, the management stated that in the current environment, growth is a function of gaining market share. It believes that better relationship with corporates, quick turnaround time and competitive pricing could help grow the corporate book

Share of corporate vs. retail stands at 48:52 with retail gaining 100 bps QoQ

Exhibit 1: Composition of loans with detailed break-up of retail loans

| (%) | Q4FY16 | Q1FY17 | Q2FY17 | Q3FY17 | Q4FY17 | Q1FY18 |
|---------------------|------------|------------|------------|------------|------------|------------|
| Auto | 10.8 | 11.1 | 11.4 | 11.8 | 11.2 | 11.4 |
| CV | 3.2 | 3.3 | 3.4 | 3.5 | 3.5 | 3.4 |
| 2W | 1.2 | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 |
| PL | 8.0 | 8.6 | 9.0 | 9.4 | 9.0 | 9.6 |
| BB | 5.4 | 5.4 | 6.4 | 6.5 | 6.5 | 7.0 |
| LAS | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 |
| CC | 4.4 | 4.5 | 4.3 | 4.8 | 4.7 | 5.0 |
| HL | 6.9 | 7.1 | 6.8 | 7.2 | 6.9 | 6.7 |
| GL | 1.0 | 1.0 | 1.0 | 1.0 | 0.9 | 0.9 |
| Kisan Gold Card | 4.8 | 4.7 | 4.9 | 4.7 | 4.7 | 4.8 |
| Others | 2.3 | 2.4 | 2.4 | 2.4 | 2.3 | 2.2 |
| Total Retail Credit | 48.2 | 49.5 | 51.1 | 52.7 | 51.2 | 52.1 |
| Large corp. | 51.8 | 50.5 | 48.9 | 47.3 | 48.8 | 47.9 |
| Total Loans | 100 | 100 | 100 | 100 | 100 | 100 |

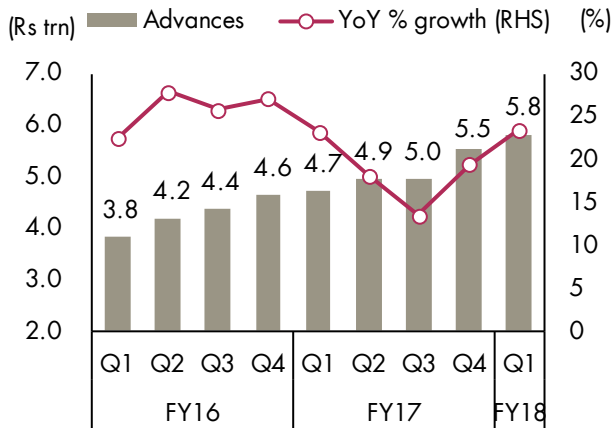
Source: Company

Growth continued to be led by retail loans (now 52% of loans; up ~30% YoY), with non-secured loans (personal loans: ~37% YoY and credit card: ~37% YoY) and business loans (up ~58% YoY) leading the charge

No impact of GST on business banking portfolio

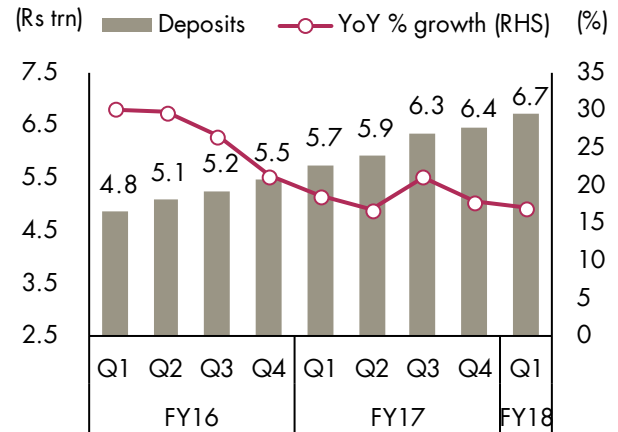
- ◆ Management said that it has not witnessed any visible impact on its business banking portfolio due to GST and that it will continue to gain market share in the business banking segment from NBFCs and PSU banks

Exhibit 2: Loan growth seems to be on recovery after a blip during demonetization



Source: Company, Axis Capital

Exhibit 3: Trend in deposits accretion, growth



Source: Company, Axis Capital

Resilient margin (up 10 bps QoQ); decline in CASA – a typical Q1 phenomenon

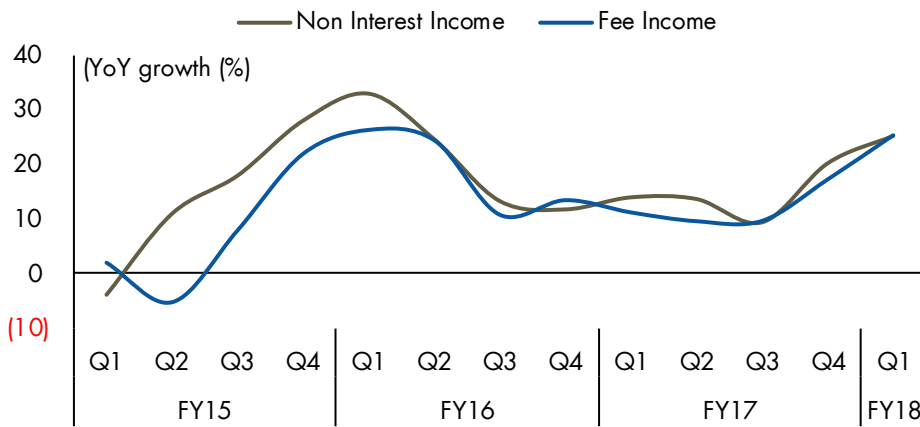
- ◆ CASA ratio declined 430 bps QoQ in Q1 (on an unfavorable base created due to demonetization) primarily on a sharp increase in fixed deposits (up 12% QoQ) and 12% QoQ run-off in current account deposits (a usual Q1 phenomenon)
- ◆ Margin improved 10 bps QoQ at 4.4% benefiting from improvement in cost of funds and stable yields (increased share of higher yield non-secured retail advances). Management reiterated its margin guidance range of 4.1-4.5%

Fee income driven by strong traction in few products and some one-off items

- ◆ Core fee income grew a strong 30% YoY largely on higher traction in some products (MF distribution, credit cards and retail loan products) and few one-offs. Management is confident of maintaining core fee income growth trend
- ◆ Among one-offs in fee income, that from oil marketing companies contributed ~4.5% to overall fee income. Adjusting for one-offs in core-fee income, the growth would have been ~20% YoY
- ◆ On forex income, the management said the income growth has been healthy at mid-teens. However, the drag on overall forex income has been due to cost on swaps, which is taken up by the trading desk to fund rupee balance sheet

Growth in forex income remains healthy in mid-teens; however, the drag is due to cost on swaps, which is taken up by the trading desk to fund rupee balance sheet

Exhibit 4: Trend in non-interest income and core fee income



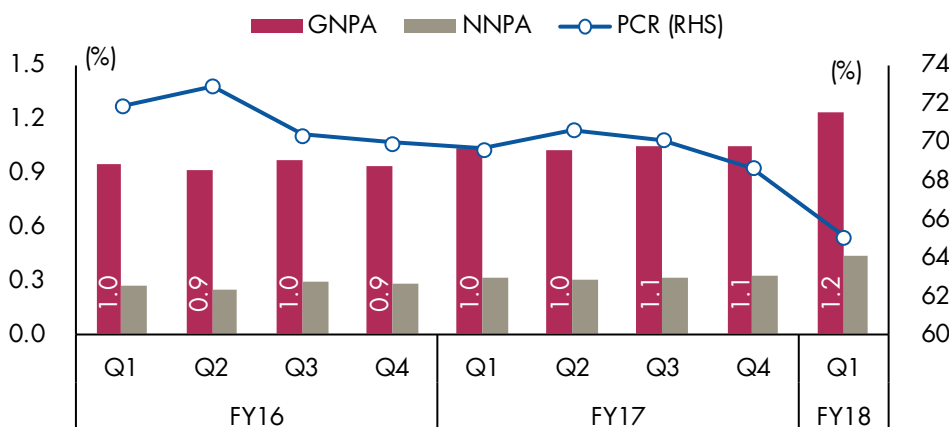
Fee income grew ~25% YoY, slightly above the advances growth, primarily on a favorable base

Source: Company, Axis Capital

Agri portfolio deteriorates the asset quality

- ◆ Asset quality deteriorated somewhat, with GNPLs up by 23% QoQ (ratio up by 19 bps QoQ to 1.24%), primarily as the recoveries were hurt due to borrowers' expectation of farm loan waivers. Out of total increase in GNPLs, about 60% pertained to the agriculture sector
- ◆ The bank has provided higher provisions than mandated by the RBI. It has provided 50% provision on its agri NPL portfolio
- ◆ Provisions rose a sharp 80% YoY due to Rs 3.7 bn of provision on non-performing agri NPLs and Rs 1.2 bn of incremental standard asset provision on stressed assets as suggested by the RBI
- ◆ The bank reported fresh slippages of Rs 310 bn, ~60% of which are from agri segment and the remaining are from normal course of business. Reductions amount to Rs 175 bn (Rs 4.9 bn – upgrades; Rs 7.4 bn of write-offs and Rs 5.3 bn of recoveries)

Exhibit 5: Stable asset quality



Bank reported fresh slippages of Rs 310 bn, ~60% of which are from agri segment and the remaining are from normal course of business

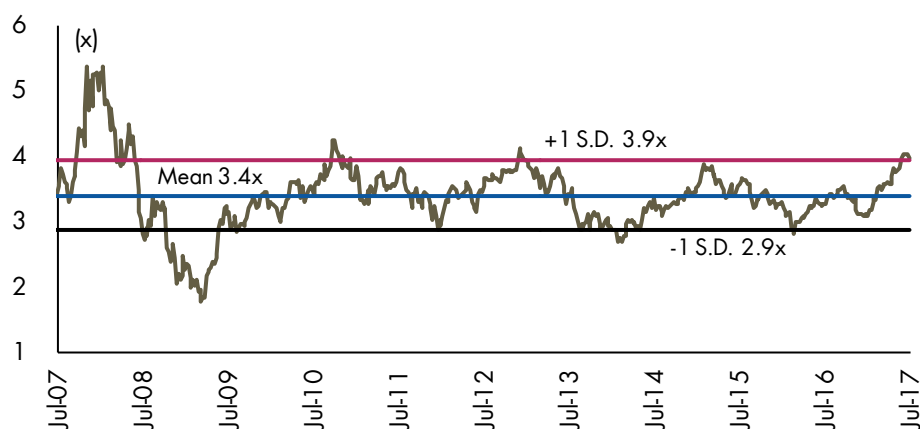
Source: Company, Axis Capital

No immediate plan to raise capital

- ◆ Bank has raised Rs 80 bn of Tier I bonds to provide comfort and cushion on capital. Tier I capital is at 13.6% with CET of 12.4%

- Given the comfortable capital position, the bank has no intention or any timeline of raising capital in the near term

Exhibit 6: 10 years P/ABV movement chart



Source: Bloomberg, Axis Capital

Exhibit 7: Results update

| (Rs mn) | Quarter ended | | | 12 months ended | | | | |
|---------------------------------|----------------|----------------|-----------|-----------------|------------|----------------|----------------|-----------|
| | Jun-17 | Jun-16 | % chg | Mar-17 | % chg | Mar-18E | Mar-17 | % chg |
| Interest income | 186,687 | 165,160 | 13 | 181,144 | 3 | 813,724 | 693,060 | 17 |
| Interest expended | 92,980 | 87,346 | 6 | 90,593 | 3 | 414,841 | 361,667 | 15 |
| Net interest income | 93,707 | 77,814 | 20 | 90,551 | 3 | 398,884 | 331,392 | 20 |
| Non-interest income | 35,167 | 28,066 | 25 | 34,463 | 2 | 141,839 | 122,965 | 15 |
| Net income | 128,874 | 105,881 | 22 | 125,014 | 3 | 540,722 | 454,357 | 19 |
| Operating expenses | 53,675 | 47,689 | 13 | 52,220 | 3 | 225,914 | 197,033 | 15 |
| Operating profit | 75,199 | 58,192 | 29 | 72,794 | 3 | 314,808 | 257,324 | 22 |
| Provision & Contingencies | 15,588 | 8,667 | 80 | 12,618 | 24 | 50,711 | 35,933 | 41 |
| PBT | 59,612 | 49,525 | 20 | 60,176 | (1) | 264,098 | 221,391 | 19 |
| Tax | 20,673 | 17,136 | 21 | 20,275 | 2 | 89,793 | 75,894 | 18 |
| Net profit | 38,938 | 32,389 | 20 | 39,901 | (2) | 174,304 | 145,496 | 20 |
| Yields & Margins (%) | | | | | | | | |
| Yield on advances | 10.2 | 10.7 | (0.5) | 10.3 | (0.1) | 10.1 | 10.2 | (0.2) |
| Cost of funds | 5.0 | 5.5 | (0.4) | 5.1 | (0.0) | 5.3 | 5.4 | (0.1) |
| Net interest margin | 4.4 | 4.4 | 0 bps | 4.3 | 10 bps | 4.5 | 4.4 | 6 bps |
| Cost to income ratio | 41.6 | 45.0 | (339) bps | 41.8 | (12) bps | 41.8 | 43.4 | (159) bps |
| Asset quality | | | | | | | | |
| Gross NPAs (Rs bn) | 72.4 | 49.2 | 47.2 | 58.9 | 23.1 | 84.0 | 58.9 | 42.7 |
| Gross NPAs (%) | 1.2 | 1.0 | 20 bps | 1.1 | 19 bps | 1.2 | 1.1 | 17 bps |
| Net NPAs (Rs bn) | 25.3 | 14.9 | 69.3 | 18.4 | 37.1 | 25.2 | 18.4 | 36.7 |
| Net NPAs (%) | 0.4 | 0.3 | 12 bps | 0.3 | 11 bps | 0.4 | 0.3 | 4 bps |
| Provisioning coverage (%) | 65.1 | 69.7 | (456) bps | 68.7 | (358) bps | 70.0 | 68.7 | 133 bps |
| Capital (%) | | | | | | | | |
| Tier-I | 13.6 | 13.3 | 30 bps | 12.8 | 80 bps | 12.0 | 12.8 | (83) bps |
| CAR | 15.6 | 15.5 | 10 bps | 14.6 | 100 bps | 13.8 | 14.6 | (75) bps |
| Balance sheet (Rs bn) | | | | | | | | |
| Advances | 5,810 | 4,706 | 23 | 5,546 | 4.8 | 6,812 | 5,546 | 22.8 |
| Deposits | 6,714 | 5,738 | 17 | 6,436 | 4.3 | 7,760 | 6,436 | 20.6 |
| CASA (%) | 44.0 | 39.9 | 408 bps | 48.0 | (407) bps | 46.1 | 48.0 | (191) bps |

Source: Company, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs bn)

| Y/E March | FY16 | FY17 | FY18E | FY19E |
|------------------------------|--------------|--------------|--------------|--------------|
| Interest earned | 602 | 693 | 814 | 974 |
| Interest expended | (326) | (362) | (415) | (499) |
| Net interest income | 276 | 331 | 399 | 476 |
| Non interest income | 108 | 123 | 142 | 169 |
| Net income | 383 | 454 | 541 | 645 |
| Operating expenses | (170) | (197) | (226) | (264) |
| Staff expenses | (57) | (65) | (69) | (75) |
| Other operating expenses | (113) | (132) | (157) | (189) |
| Operating profit | 214 | 257 | 315 | 382 |
| Provisions & contingencies | (27) | (36) | (51) | (63) |
| Pre-tax profit | 186 | 221 | 264 | 319 |
| Tax expense | (63) | (76) | (90) | (108) |
| Profit after tax | 123 | 145 | 174 | 210 |
| Extraordinary item | - | - | - | - |
| Minority interest/Associates | - | - | - | - |
| Adj. PAT | 123 | 145 | 174 | 210 |

Balance sheet (Rs bn)

| Y/E March | FY16 | FY17 | FY18E | FY19E |
|---------------------------|--------------|--------------|---------------|---------------|
| Total assets | 7,408 | 8,638 | 10,343 | 12,279 |
| Cash & Balances with RBI | 389 | 490 | 561 | 642 |
| Investments | 1,958 | 2,145 | 2,468 | 2,788 |
| Advances | 4,646 | 5,546 | 6,812 | 8,308 |
| Fixed assets | 33 | 36 | 37 | 36 |
| Other assets | 381 | 422 | 466 | 506 |
| Total liabilities | 7,408 | 8,638 | 10,343 | 12,279 |
| Equity capital | 5 | 5 | 5 | 5 |
| Preference capital | - | - | - | - |
| Reserves & surplus | 722 | 889 | 1,029 | 1,204 |
| Networth | 727 | 895 | 1,034 | 1,209 |
| Borrowings | 850 | 740 | 866 | 980 |
| Deposits | 5,464 | 6,436 | 7,760 | 9,372 |
| Other liabilities & prov. | 367 | 567 | 683 | 719 |

Source: Company, Axis Capital

Key ratios

| Y/E March | FY16 | FY17 | FY18E | FY19E |
|---------------------------------|------|------|-------|-------|
| Per share data | | | | |
| FDEPS (Rs.) | 49 | 57 | 68 | 82 |
| BV (Rs.) | 287 | 349 | 404 | 472 |
| Adj. BV (Rs.) | 284 | 345 | 397 | 465 |
| DPS (Rs.) | 10 | - | 12 | 12 |
| Dividend payout (%) | 20 | - | 17 | 15 |
| Yields & Margins (%) | | | | |
| Yield on advances | 10.8 | 10.2 | 10.1 | 10.0 |
| Cost of deposit | 5.9 | 5.3 | 5.2 | 5.2 |
| Net interest margin | 4.4 | 4.4 | 4.5 | 4.4 |
| Asset quality (%) | | | | |
| Gross NPAs | 0.9 | 1.1 | 1.2 | 1.2 |
| Net NPAs | 0.3 | 0.3 | 0.4 | 0.3 |
| Credit cost | 0.6 | 0.7 | 0.8 | 0.7 |
| Provisioning coverage | 69.9 | 68.7 | 70.0 | 72.0 |
| Capital (%) | | | | |
| Tier-I | 13.2 | 12.8 | 12.0 | 11.4 |
| CAR | 15.5 | 14.6 | 13.8 | 13.0 |
| Efficiency (%) | | | | |
| ROA | 1.8 | 1.8 | 1.8 | 1.9 |
| ROE | 18.3 | 17.9 | 18.1 | 18.8 |
| Cost to income | 44 | 43 | 42 | 41 |
| CASA | 43 | 48 | 46 | 45 |
| Effective tax rate | 34 | 34 | 34 | 34 |
| Growth (%) | | | | |
| Net interest income | 23 | 20 | 20 | 19 |
| Fee income | 18 | 12 | 17 | 21 |
| Operating expenses | 21 | 16 | 15 | 17 |
| Profit after tax | 20 | 18 | 20 | 21 |
| Advances | 27 | 19 | 23 | 22 |
| Deposits | 21 | 18 | 21 | 21 |
| Total assets | 25 | 17 | 20 | 19 |

Source: Company, Axis Capital

Note: Dividend for FY17 will reflect in FY18 due to change in reporting method as per regulations

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