HDFC Bank

Accumulate

DART
DOLAT ANALYSIS & RESEARCH THEMES
IN-DEPTH, PRECISE, ACTIONABLE

Result Update

Provisions play spoilsport

Q2FY18 witnessed mild setback of asset quality as GNPA stood tad higher at 1.26% against 1.24% in Q1FY18 and 1.02% in Q2FY17. Elevated provisions (up 97% YoY) was primarily led by prudent provisioning against a project loan account approved under the JLF restructuring mechanism for the second quarter in a row. PAT stood in-line at ₹ 41.5bn (up 20% YoY) on the back of strong NII led by healthy 22% YoY advances growth and core fee income performance (up 24%+ YoY forming 72% of the overall other income). Despite yield pressures, NIMs at 4.3% stood strong largely aided by SA reduction of 50 bps during the quarter. The bank continues to outpace systemic credit growth (22%+ YoY growth in Q2FY18) and systemic credit quality (GNPAs restricted to ~1.3% levels, NNPAs at 0.4%) and therefore continues to command superior valuations ahead of peer-set.

Sustained strong operating metrics

PPoP for the bank stood strong at 30% YoY growth driving PAT on the back of healthy NII and core fee income. The granular retail franchise and emerging corporate segment abetted business momentum with corporate advances growing at 24% and retail 22% YoY respectively. The retail: wholesale mix stood at 55:45, and the bank maintains leadership position across retail products and maintains market share in the wholesale segment. Against this backdrop, we envisage 22% advances CAGR over FY17-19E (in-line with balance sheet growth).

Continued spike in provisions

Q2FY18 witnessed a spike in provisions as the bank set aside contingency provisions on one project loan account (2.3% share) that stood standard on its book throughout and was part of the JLF restructuring mechanism. Provisions stood high over past two consecutive quarters. We believe the provisions to remain high for FY18 and likelihood of marginal blips in asset quality ahead cannot be ruled out. Hence, we tweak our FY18 provisions estimates by 6% and maintain GNPAs spike to 1.4% levels for FY19.

With minimal pain on credit quality, adequate provision cover (should rise to 70%+ FY18-19E) and sustainable higher margins, HDFC Bank continues to maintain an edge over its peers. Recommend ACCUMULATE.

Q2FY18 Result (₹ Mn)

Particulars	Q2FY18	Q2FY17	Q1FY18	QoQ (%)	YoY (%)
Interest earned	196,703	170,699	186,687	5.4	15.2
Interest expended	99,182	90,764	92,980	6.7	9.3
Net interest income	**97,521**	**79,936**	**93,707**	**4.1**	**22.0**
Other income	36,059	29,010	35,167	2.5	24.3
Total Net Income	**133,580**	**108,945**	**128,874**	**3.7**	**22.6**
Operating expenses	55,401	48,700	53,675	3.2	13.8
Pre-provision profits	**78,179**	**60,246**	**75,199**	**4.0**	**29.8**
Provisions	14,762	7,490	15,588	(5.3)	97.1
Tax expense	21,907	18,202	20,673	6.0	20.4
Reported Net Profit	**41,510**	**34,553**	**38,938**	**6.6**	**20.1**
Advances	**6,048,669**	**4,944,178**	**5,809,758**	**4.1**	**22.3**
NIM (%)	4.3	4.2	4.4	(10)	10
CASA (%)	42.9	40.0	44.0	(110)	290
Gross NPA (%)	1.3	1.0	1.2	2	24

CMP	₹1,859
Target / Upside	₹ 2,000/8%
BSE Sensex	32,607
NSE Nifty	10,207
Scrip Details	
Equity / FV	₹ 5,168mn/₹ 2/-
Market Cap	₹ 4,804bn
	USD 74bn
52-week High/Low	₹ 1,159/877
Avg. Volume (no)	1,618,129
NSE Symbol	HDFCBANK
Bloomberg Code	HDFCB IN
Shareholding Pattern Sep'17 (%)	
Promoters	21.0
MF/Banks/FIs	16.9
FIIs	52.5
Public / Others	9.6

Valuation (x)

	FY17	FY18E	FY19E
P/E	32.5	27.3	22.7
P/ABV	5.4	4.7	4.0
ROAA	1.9	1.8	1.8
ROAE	17.9	17.7	18.3

Estimates (₹ mn)

	FY17	FY18E	FY19E
NII	331,392	396,399	478,765
OPPAT	257,324	307,259	371,112
PAT	145,496	174,784	209,850
Adj. BV	344.4	396.9	460.5

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DOLAT CAPITAL

October 24, 2017

Valuation and Recommendation

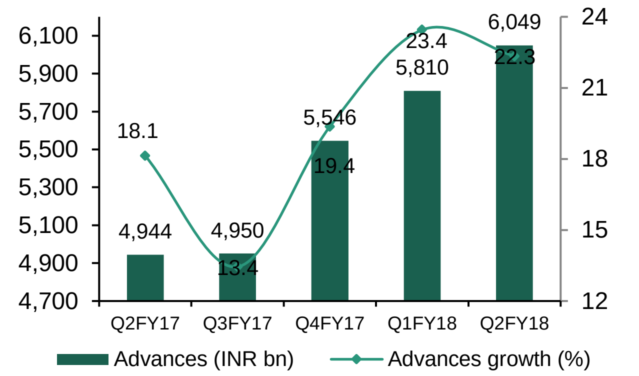
We remain sanguine of the business momentum ahead and the liability franchise expansion (both in terms of CASA and branch) stands on a firm footing, the structural story of HDFC Bank stands intact. The rich liability franchise, minimal credit quality stress and superior return ratios reinforce our confidence in the bank's growth and earnings visibility over a longer horizon defending superior valuation metrics.

We expect sustainable earnings performance ahead with strong 19%+ NII CAGR, in-line with 19%+ earnings CAGR that should translate into superior return profile (RoEs at 17-18%+ and RoAs at 1.8%) over FY18-19E. Defying macro challenges, HDFC Bank continues to maintain business momentum and earnings traction each quarter with best-in-class asset quality vis-à-vis peers. Against this backdrop, we raise the target multiple to 4.3x P/ABV FY19E, arriving at a TP of ₹ 2,000. We maintain ACCUMULATE recommendation on the stock on expensive valuations and likelihood of incremental NPA built-up ahead albeit gradual. Currently, the stock trades at 4.0x P/ABV FY19E.

Q2FY18 Key Conference Call Takeaways:

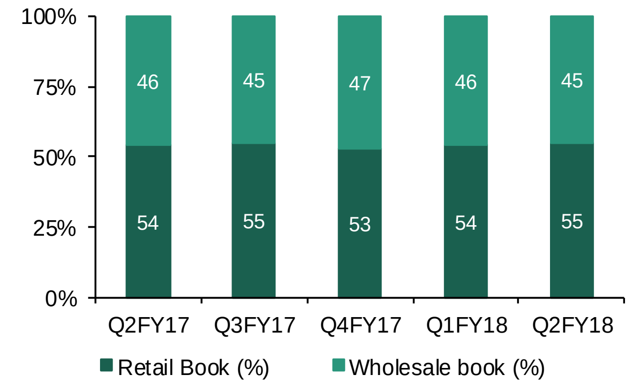
- The one project loan account that witnessed almost Rs 7bn provisions during Q2FY18 underwent 5/25 restructuring which was approved by JLF in Feb' 16. The account stood standard for the bank as it never surpassed 90 dpd norm.
- The Q1FY18 slip-ups on account of farm/agri loan waivers stand as status quo today with no meaningful improvement/deterioration.
- The overall yields remain pressurized on account of higher proportion of corporate book in the overall mix. Despite that, reduction in SA rates aided NIMs to stay higher than industry averages. For last few quarters, NIMs have stood range-bound at 4.1-4.3% levels largely supported by deposit franchise.
- RWA grew in-line with loan growth; focus remains on better rated corporates that should continue to drive lower risk weights.
- Overseas advances stood at ~ Rs 210bn during the quarter gone by.
- Cost-income came as a big positive on the back of improved employee productivity, digital initiatives and bettering credit operations.
- The bank being now systematically important bank (SIB) as designated by RBI during the period, it requires to maintain additional CET 1 at 0.15% by fiscal year end. Against this backdrop, during the H1FY18, the bank augmented capital base by raising additional tier I bonds of ₹ 80bn and Tier II bonds of ₹ 20 bn. The tier I CAR stood maintained at 13% levels with capital conservation buffer of 1.25%.

Exhibit 1: Strong corporate and retail segments drive overall advances



Source: DART, Company

Exhibit 2: Retail book regaining its share



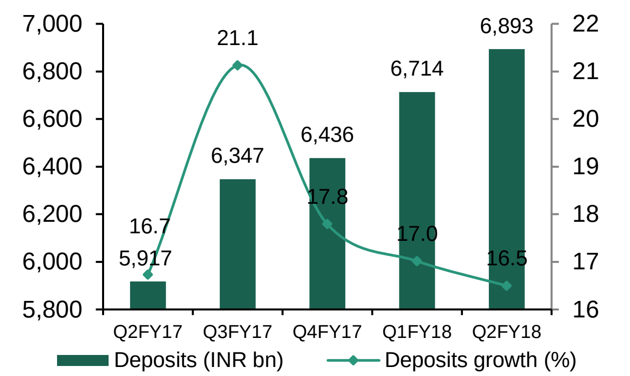
Source: DART, Company

Exhibit 3: Loan book breakup

Particulars (₹ mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	YoY	QoQ
Auto Loans	564,830	584,490	620,520	660,110	690,530	22.3	4.6
% of total retail loan book	22.4%	22.4%	21.9%	21.8%	21.3%		
Personal Loans	447,060	464,540	500,670	555,390	606,920	35.8	9.3
% of total retail loan book	17.7%	17.8%	17.6%	18.3%	18.7%		
CV/CE	165,980	175,630	192,210	197,060	202,520	22.0	2.8
% of total retail loan book	6.6%	6.7%	6.8%	6.5%	6.2%		
Loans against securities	12,600	12,710	14,610	14,470	16,040	27.3	10.9
% of total retail loan book	0.5%	0.5%	0.5%	0.5%	0.5%		
2-wheelers	58,230	61,140	62,900	65,320	68,830	18.2	5.4
% of total retail loan book	2.3%	2.3%	2.2%	2.2%	2.1%		
Business banking	315,160	321,290	362,350	404,460	455,280	44.5	12.6
% of total retail loan book	12.5%	12.3%	12.8%	13.4%	14.0%		
Credit cards	213,360	236,730	259,950	291,010	308,310	44.5	5.9
% of total retail loan book	8.5%	9.1%	9.2%	9.6%	9.5%		
Kisan Gold Card	244,250	234,710	261,550	276,850	311,040	27.3	12.3
% of total retail loan book	9.7%	9.0%	9.2%	9.1%	9.6%		
Home loans	335,590	354,080	383,650	387,830	400,150	19.2	3.2
% of total retail loan book	13.3%	13.6%	13.5%	12.8%	12.3%		
Gold Loans	50,210	47,090	48,000	49,870	50,680	0.9	1.6
% of total retail loan book	2.0%	1.8%	1.7%	1.6%	1.6%		
Others	116,820	118,450	130,250	125,890	133,180	14.0	5.8
% of total retail loan book	4.6%	4.5%	4.6%	4.2%	4.1%		
Total Retail Loans	2,524,090	2,610,860	2,836,660	3,028,260	3,243,480	28.5	7.1
% of total loan book	51.1%	54.7%	51.2%	52.1%	53.6%		
Wholesale loans	2,420,088	2,163,290	2,709,020	2,781,498	2,805,189	15.9	0.9
% of total loan book	49.0%	45.3%	48.8%	47.9%	46.4%		
Loan Book	4,944,178	4,774,150	5,545,680	5,809,758	6,048,669	22.3	4.1

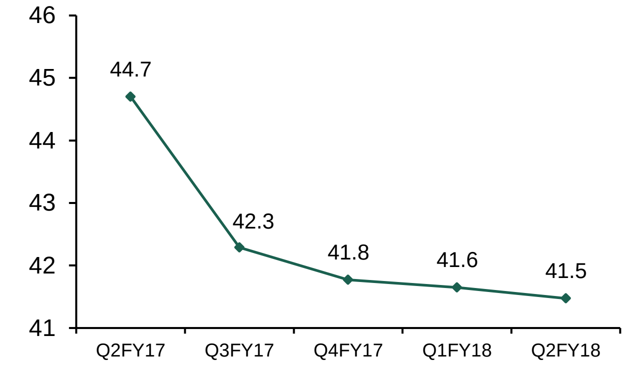
Source: DART, Company

Exhibit 4: CASA down from peak; yet 40% levels maintained driving healthy deposits



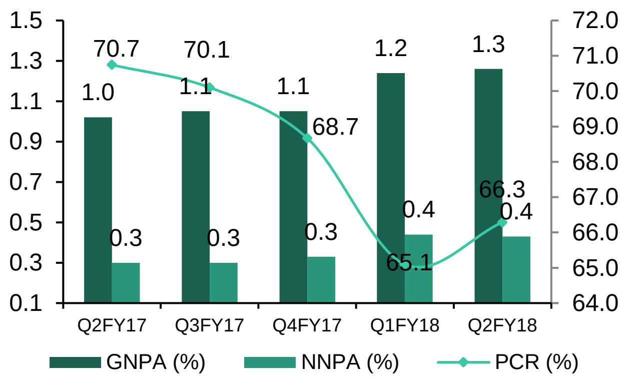
Source: DART, Company

Exhibit 5: Consistent improvement in C/I ratio



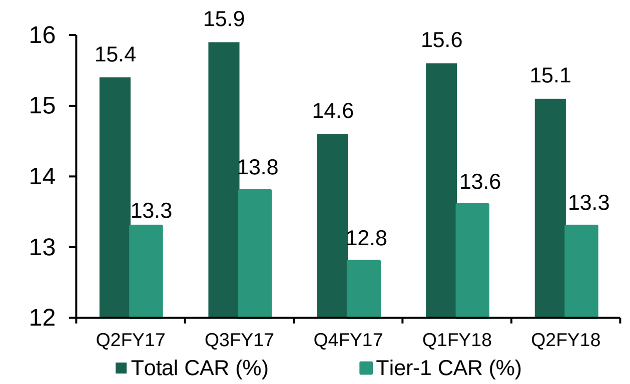
Source: DART, Company

Exhibit 6: Gross NPAs slightly deteriorated; PCR improved



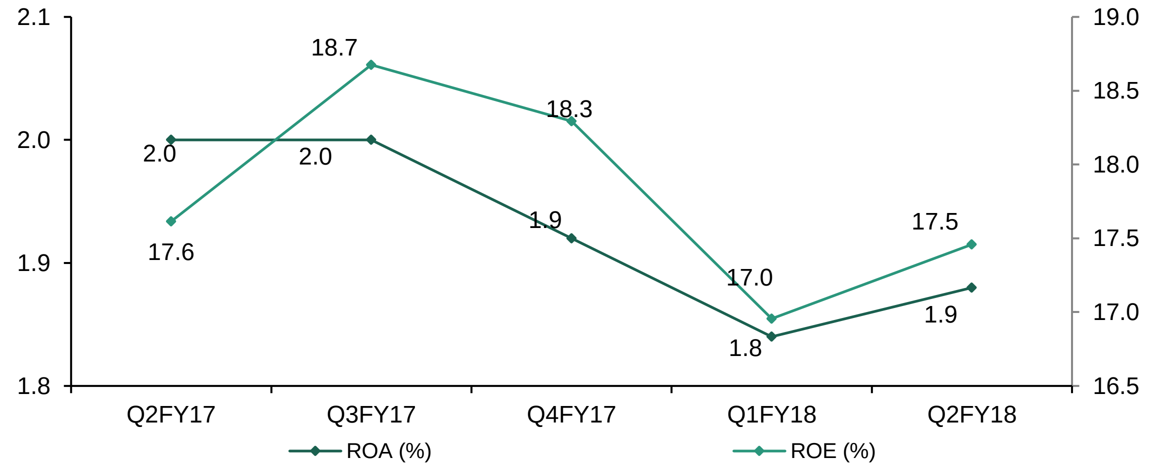
Source: DART, Company

Exhibit 7: CAR remains steady; bank raised Tier II bonds



Source: DART, Company

Exhibit 8: Robust ROA and ROE trend



Source: DART, Company

Income Statement (₹ mn)

Particulars	Mar16	Mar17	Mar18E	Mar19E
Interest income	602,214	693,060	831,804	990,908
Interest expense	(326,299)	(361,667)	(435,405)	(512,143)
Net interest income	**275,915**	**331,392**	**396,399**	**478,765**
growth (%)	*23*	*20*	*20*	*21*
Non-interest income	107,517	122,965	142,740	165,473
Operating income	**383,432**	**454,357**	**539,139**	**644,237**
Operating expenses	(169,797)	(197,033)	(231,880)	(273,125)
- Staff expenses	(57,022)	(64,837)	(75,705)	(89,101)
Pre-provisions profit	**213,635**	**257,324**	**307,259**	**371,112**
growth (%)	*23*	*22*	*19*	*21*
Provisions & Contingencies	(27,256)	(35,933)	(44,426)	(57,904)
Pre-tax profit	**186,379**	**221,391**	**262,833**	**313,209**
Tax (current + deferred)	(63,417)	(75,894)	(88,049)	(103,359)
Net profit	**122,962**	**145,496**	**174,784**	**209,850**
growth (%)	*20*	*18*	*20*	*20*

Balance Sheet (₹ mn)

Particulars	Mar16	Mar17	Mar18E	Mar19E
Cash and balance with RBI/Banks	389,188	489,521	519,483	645,320
Investments	1,638,858	2,144,633	2,386,498	2,918,253
Advances	4,645,940	5,545,682	6,758,933	8,299,742
Interest earning assets	**6,673,986**	**8,179,836**	**9,664,914**	**11,863,315**
Fixed assets (Net block)	33,432	36,267	38,938	44,198
Other assets	381,038	422,298	806,152	825,607
Total assets	**7,088,456**	**8,638,402**	**10,510,005**	**12,733,120**
Deposits	5,464,242	6,436,397	7,839,074	9,710,708
Other interest bearing liabilities	530,185	740,289	818,984	1,044,633
Total Interest bearing liabilities	**6,361,678**	**7,743,778**	**9,479,574**	**11,531,816**
Other liabilities and provisions	367,251	567,093	821,517	776,475
Share capital	5,056	5,125	5,125	5,125
Reserves & surplus	721,721	889,498	1,025,306	1,196,179
Shareholders' funds	**726,778**	**894,624**	**1,030,431**	**1,201,304**
Total equity & liabilities	**7,088,456**	**8,638,402**	**10,510,005**	**12,733,120**

E – Estimates

Important Ratios

Particulars	Mar16	Mar17	Mar18E	Mar19E
Valuation ratios				
Adjusted EPS (₹)	48.8	57.2	68.2	81.9
BVPS (₹)	287.5	349.1	402.1	468.8
Adj. Book NAV/share (₹)	284.0	344.4	395.9	460.5
PER (x)	38.1	32.5	27.3	22.7
Price/Book (x)	6.5	5.3	4.6	4.0
Price/Adjusted book (x)	6.5	5.4	4.7	4.0
Dividend Yield (%)	0.5	0.6	0.7	0.7
Du-Pont ratios				
NII/Avg. Assets (%)	4.2	4.2	4.1	4.1
Non-int. income/Avg Assets	1.7	1.6	1.5	1.4
Cost / Avg Assets	2.6	0.1	2.4	2.4
Non-tax Prov. / Avg Assets	0.4	0.5	0.5	0.5
Tax Provisions / Avg Assets	1.0	1.0	0.9	0.9
ROA (%)	1.9	1.9	1.8	1.8
ROE (%)	17.8	17.9	17.7	18.3
Balance Sheet ratios				
Loan growth (%)	19.4	19.4	21.9	22.8
Deposit growth (%)	21.2	17.8	21.8	23.9
Loans/Deposits (%)	85.0	86.2	86.2	85.5
Investments/Deposits (%)	30.0	33.3	30.4	30.1
CASA ratio (%)	43.2	48.0	47.3	46.8
Profitability ratios				
NIMs (%)	4.3	4.3	4.4	4.4
Interest spread (%)	3.8	3.9	3.8	3.9
Yield on advances (%)	10.8	10.6	10.5	10.3
Cost of deposits (%)	5.9	5.3	5.0	4.9
Efficiency/other P/L ratios				
Non-interest income/Net income (%)	28.0	27.1	26.5	25.7
Cost/Income (%)	44.3	43.4	43.0	42.4
Asset quality ratios				
Gross NPLs (%)	0.9	1.1	1.2	1.4
Net NPLs (%)	0.3	0.3	0.4	0.4
Net NPLs/Net worth (%)	1.8	2.1	2.3	2.6
Loan prov./Avg loans (%)	0.6	0.7	0.7	0.8
Provisions cover (%)	69.9	68.7	70.0	72.0
Capitalisation ratios				
Tier I cap.adequacy (%)	13.2	12.8	12.5	12.0
Total cap.adequacy (%)	15.5	14.6	13.9	13.3

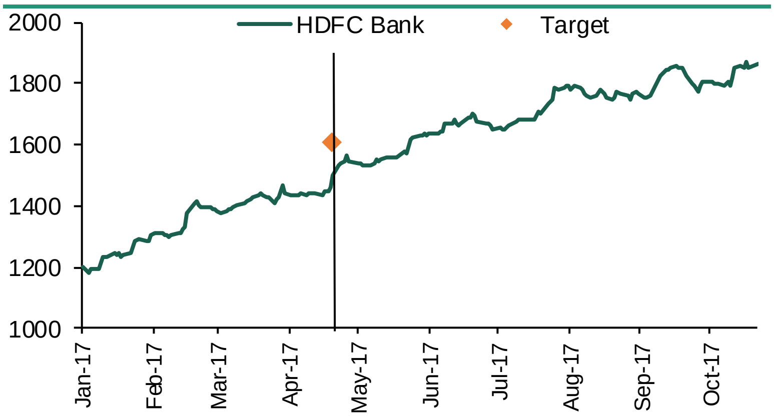
E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

Buy	**> 20%**
Accumulate	**10 to 20%**
Reduce	**0 to 10%**
Sell	**< 0%**

Rating and Target Price History



	Rating	TP (₹)	CMP (₹)
Apr'17	Accumulate	1,610	1,497

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