

# HDFC Bank

## Continues to be on strong footing

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Rating	<b>BUY</b>
Price	Rs1,865
Target Price	Rs2,136
Implied Upside	14.5%
Sensex	32,607
Nifty	10,208

(Prices as on October 24, 2017)

### Trading data

Market Cap. (Rs bn)	4,779.5
Shares o/s (m)	2,562.5
3M Avg. Daily value (Rs m)	2888.2

### Major shareholders

Promoters	25.73%
Foreign	41.51%
Domestic Inst.	14.11%
Public & Other	18.65%

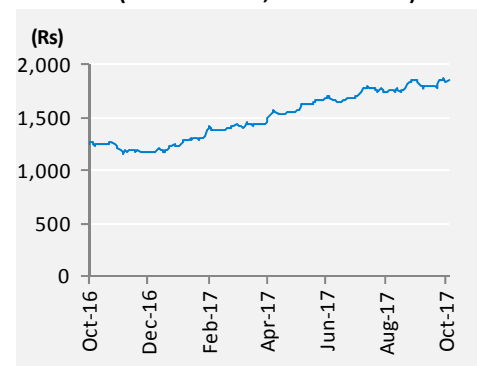
### Stock Performance

(%)	1M	6M	12M
Absolute	2.2	21.7	47.4
Relative	0.1	11.7	31.7

### How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2018	68.5	68.8	-0.5
2019	83.6	83.6	-0.1

### Price Perf. (RIC: HDBK.BO, BB: HDFCB IN)



Source: Bloomberg

*HDFCB continued to deliver strong operational performance led by strong NII & other income. The blip on the strong performance was from by elevated credit cost which was done on one project loan exposure as contingent provision (Rs4.0bn + Rs3.0bn from floating). Loan growth continued to be decent and led by retail helping maintain overall margin trend. We continue to remain positive given the market leadership in most products, steady margin, improved fee trends and better RORWAs. Maintain BUY with a revised TP of Rs2,136 (up from Rs1,945) based on 4.3x Sep-19 ABV (rolled over from Mar-19).*

- **Strong operating performance:** HDFCB delivered strong ~30% YoY PPOP growth led by robust 22% YoY NII growth and 24% YoY other income, while continued control on opex growth at 14% YoY. Opex control was mainly on lower staff expenses as bank improved productivity & digitized processes, while fees & Fx continued to contribute strongly to other income growth. Bank's C/I ratio was down 18bps QoQ at 41.5% for which bank expect it to remain benign in foreseeable future as income is expected to remain upbeat.
- **Loan growth continues to be spearheaded by retail growth:** Loan book growth of 22.3% YoY was relatively slower but retail growth was strong at ~29% YoY led by all segments especially Biz banking, unsecured loans & Auto loans. Home loans and other retail showcased steady growth. Wholesale loan growth was slower at 16% YoY and has been mainly led by working capital requirement.
- **CASA accretion slow but not a concern:** CASA ratio came off to 43% down 110bps QoQ mainly on higher net outflow from CA but was still better off pre-demonetisation. Net CA outflow has led to slower deposit growth of 16% YoY. Bank expects CASA growth momentum to continue in H2FY18, but at a lower rate than 2HFY17 as FY17 had an impact of demonetisation flow in CASA of H2FY17.
- **Credit cost relatively remains higher:** Bank provided Rs4.0bn as contingent provisions from P&L while utilized Rs3.0bn from floating provisions mainly for one project loan a/c under 5:25 scheme which is standard in bank's book (we believe it to be from steel). Bank has represented to RBI to keep it standard. As a result, credit cost was relatively higher. But overall there has been no large deterioration in asset quality as most trends remained in a range.

Key financials (Y/e March)	2016	2017	2018E	2019E
Net interest income	275,915	331,392	399,809	481,146
Growth (%)	23.2	20.1	20.6	20.3
Operating profit	213,635	257,324	314,096	375,716
PAT	122,962	145,496	175,412	214,162
EPS (Rs)	48.8	57.2	68.5	83.6
Growth (%)	17.3	17.0	19.8	22.1
Net DPS (Rs)	9.5	—	11.0	12.0

Profitability & Valuation	2016	2017	2018E	2019E
NIM (%)	4.15	4.13	4.25	4.32
RoAE (%)	18.3	17.9	18.2	19.0
RoAA (%)	1.85	1.81	1.87	1.92
P / BV (x)	6.5	5.3	4.6	3.9
P / ABV (x)	6.8	5.7	4.9	4.1
PE (x)	38.2	32.6	27.2	22.3
Net dividend yield (%)	0.5	—	0.6	0.6

Source: Company Data; PL Research

**Exhibit 1: Operating performance continues to be upbeat but offset by provisioning**

	(Rs m)	Q2FY18	Q2FY17	YoY gr. (%)	Q1FY18	QoQ gr. (%)
<i>NII growth was strong on continued strong loan growth and largely maintained margins</i>	Interest income	1,96,703	1,70,699	15.2	1,86,687	5.4
	Interest Expended	99,182	90,764	9.3	92,980	6.7
	<b>Net interest income (NII)</b>	<b>97,521</b>	<b>79,936</b>	<b>22.0</b>	<b>93,707</b>	<b>4.1</b>
<i>Other income growth was led by all parameters</i>	- Treasury income	3,559	2,835	25.5	3,314	7.4
	Other income	36,059	29,010	24.3	35,167	2.5
	<b>Total income</b>	<b>1,33,580</b>	<b>1,08,945</b>	<b>22.6</b>	<b>1,28,874</b>	<b>3.7</b>
<i>Bank continues to keep strong control on opex especially on employee expenses</i>	Operating expenses	55,401	48,700	13.8	53,675	3.2
	-Staff expenses	17,158	16,572	3.5	16,575	3.5
	-Other expenses	38,243	32,128	19.0	37,100	3.1
<i>Credit cost remained elevated from trend levels as bank made contingent provisions on one project loan account under 5:25</i>	<b>Operating profit</b>	<b>78,179</b>	<b>60,246</b>	<b>29.8</b>	<b>75,199</b>	<b>4.0</b>
	Core operating profit	74,620	57,411	30.0	71,885	3.8
	Total provisions	14,762	7,490	97.1	15,588	(5.3)
	<b>Profit before tax</b>	<b>63,417</b>	<b>52,756</b>	<b>20.2</b>	<b>59,612</b>	<b>6.4</b>
	Tax	21,907	18,202	20.4	20,673	6.0
	<b>Profit after tax</b>	<b>41,510</b>	<b>34,553</b>	<b>20.1</b>	<b>38,938</b>	<b>6.6</b>
<b>Balance sheet (Rs m)</b>						
	Deposits	68,93,459	59,17,306	16.5	67,13,761	2.7
	Advances	60,48,669	49,44,178	22.3	58,09,758	4.1
<b>Profitability ratios</b>						
<i>Margins were marginally lower sequentially but remains in-line with guidance and trend levels</i>	YoA – Calc	10.4	10.7	(34)	10.2	15
	CoF - Calc	5.1	5.5	(41)	5.0	8
	<b>NIM - Rep</b>	<b>4.3</b>	<b>4.2</b>	<b>10</b>	<b>4.4</b>	<b>(10)</b>
	RoaA	1.8	1.8	2	1.8	4
	RoaE - Calc	17.5	17.6	(16)	17.0	50
<b>Asset Quality</b>						
<i>Overall asset quality for bank was steady but bank improved its PCR ratio</i>	Gross NPL (Rs mn)	77,028	50,690	52.0	72,429	6.3
	Net NPL (Rs mn)	25,968	14,687	76.8	25,282	2.7
	Restructured Assets (Rs mn)					
	Gross NPL ratio	1.3	1.0	24	1.3	1
	Net NPL ratio	0.4	0.3	13	0.4	(1)
<i>CASA ratio has been coming off on slower CA (net outflow in last two quarters)</i>	Coverage ratio - Calc	66.3	71.0	(474)	65.1	119
	Rest. assets/ Total adv.					
	<b>Business &amp; Other Ratios</b>					
	Low-cost deposit mix	42.9	40.0	290	44.0	(110)
	Cost-income ratio	41.5	44.7	(323)	41.6	(18)
	Non int. inc / total income	27.0	26.6	37	27.3	(29)
	Credit deposit ratio	87.7	83.6	419	86.5	121
	CAR	15.1	15.4	(30)	15.6	(50)
	Tier-I	13.3	13.3	-	13.6	(30)

Source: Company Data, PL Research

## Key Q2FY18 Concall Highlights

### Balance sheet & Outlook

- **Loan book** – Domestic loan book growth has been strong mainly on strong traction from retail. **Outlook:** Bank will continue to see robust growth in all loan segments.
  - **Retail loans** – Unsecured loans, Auto loans led by 2W, Cars and credit cards have been the driver of core consumer loans. Other retail growth was steady.
  - **Business banking** – Business banking growth was strong on back of new customer acquisitions mainly small businesses in manufacturing & services mainly driven by branch/distribution led acquisitions.
  - **Corporate loans** – Mainly has been led by working capital. Banks overseas loan book stands at Rs210.0bn.
- **Deposit** – CASA flow growth was relatively slower at ~24% YoY and has been on back of CA net outflow which has been under pressure but has been still better than last year pre-demonetisation. CASA should continue

### Margins/Pricing/Yields

- Home loan had been seeing pressure on yields but in recent times personal loans, CV/CE and SME/Biz banking has also seen higher pressure on yields. Bank has majority of floating loans linked to MCLR.
- Margins though down by 10bps QoQ at 4.3% has been steady with trends as helped by savings rate cut by 50bps in Q2 quarter and decent momentum in SA deposits. **Outlook** – Bank believes margin should be in range of 4.1%-4.3%.

### Fee income/Opex

- **Fees** – Fee growth continued to be strong and above b/s growth. Also Fx related fees saw good traction.
- **Opex** - Bank continues to channelize processes to digital and improve productivity keeping cost to income lower. Bank expects and intends to have lower cost to income in next few years as revenue will outpace cost. Sales commission to agents has seen slightly higher growth as CV/Auto continue to remain dealer driven and also been relatively growing faster.

### Asset quality

- Overall asset quality in CV/CE/Auto have remained in range, while there has been some continued strain in SME/Biz banking and Agri has seen one-off strain in Q1FY18 already.

- Bank has not seen any meaningful recovery in the Agri loans NPAs (KCC) and neither has it deteriorated. Bank expects some recovery in Q3FY18 based on crop cycle.
- Credit cost remained high on back of contingent provisions of Rs3.5-4.0bn created on one project loan account under 5:25 scheme which the bank is in dialogue with RBI for keeping it standard (it has been standard). Bank also utilized Rs3.0bn of floating provisions on the same account. O/s floating provisions were at Rs10.0bn.

## Capital

- Bank does not see challenge in maintaining additional 15bps of Tier-I by Apr-18 on being tagged as SIB. Bank saw higher RWA growth in the quarter as non-credit RWA as bank had higher liquidity invested in Debt MFs which attracts higher RWA.

**Exhibit 2: Strong retail loan book growth of ~27% YoY led by unsecured and biz bank loans**

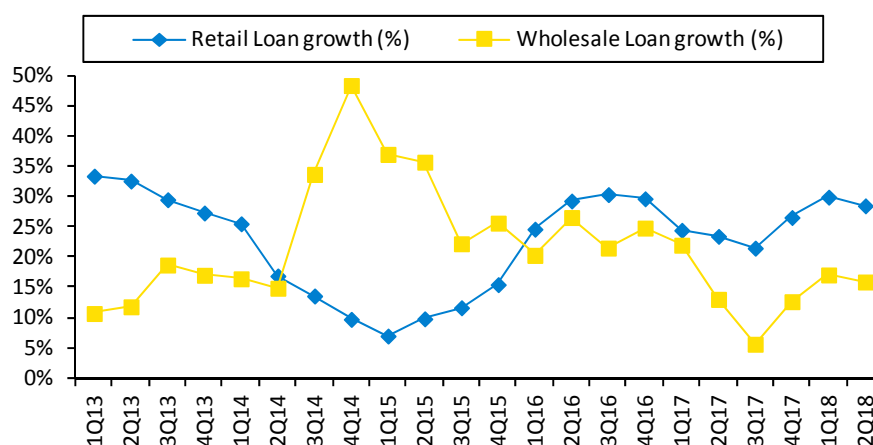
Loan Composition (Rs m)	Q2FY18	Q2FY17	YoY gr. (%)	Q1FY18	QoQ gr. (%)
<i>Vehicle loans though continued to be strong was relatively slower in momentum mainly on slower CV loan growth</i>					
Car Loans	6,90,530	5,64,830	22.3	6,60,110	4.6
CV loans	2,02,520	1,65,980	22.0	1,97,060	2.8
2 wheeler loans	68,830	58,230	18.2	65,320	5.4
<b>Sub-total - Auto Loans</b>	<b>9,61,880</b>	<b>7,89,040</b>	<b>21.9</b>	<b>9,22,490</b>	<b>4.3</b>
<i>Unsecured segment continues to be robust mainly on both credit card and personal loans</i>					
Personal loans	6,06,920	4,47,060	35.8	5,55,390	9.3
Business banking	4,55,280	3,15,160	44.5	4,04,460	12.6
Loan against shares	16,040	12,600	27.3	14,470	10.9
Credit Cards	3,08,310	2,13,360	44.5	2,91,010	5.9
<i>Business banking continues to see strong growth</i>					
Home loans	4,00,150	3,35,590	19.2	3,87,830	3.2
Gold Loans	50,680	50,210	0.9	49,870	1.6
Other Retail	4,44,220	3,61,070	23.0	4,02,740	10.3
<i>Other retail loans grew at steady pace</i>					
<b>Retail Loans</b>	<b>32,43,480</b>	<b>25,24,090</b>	<b>28.5</b>	<b>30,28,260</b>	<b>7.1</b>
<b>Non Retail Loans</b>	<b>28,05,189</b>	<b>24,20,088</b>	<b>15.9</b>	<b>27,81,498</b>	<b>0.9</b>
<b>Total Advances</b>	<b>60,48,669</b>	<b>49,44,178</b>	<b>22.3</b>	<b>58,09,758</b>	<b>4.1</b>

Source: Company Data, PL Research

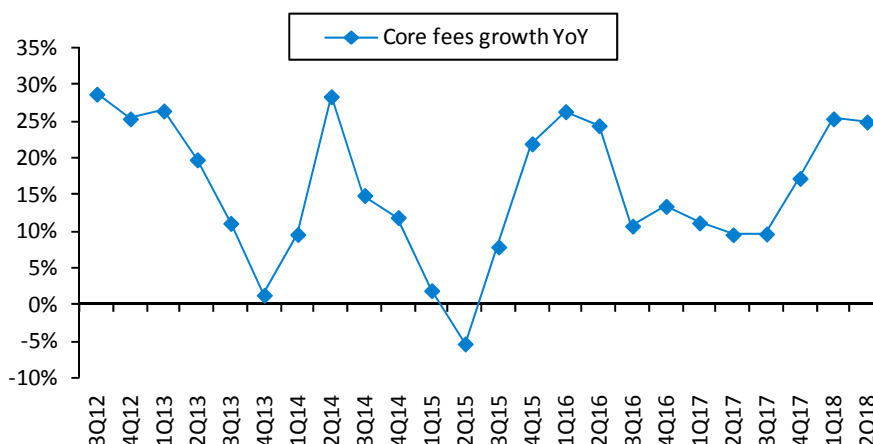
**Exhibit 3: Loan book composition as per internal classification**

Loan Composition (Rs m)	Q2FY18	Q2FY17	YoY gr. (%)	Q1FY18	QoQ gr. (%)
Car Loans	7,89,990	6,44,290	22.6	7,37,460	7.1
CV loans	4,03,610	3,35,610	20.3	3,84,500	5.0
2 wheeler loans	85,350	71,180	19.9	77,240	10.5
<b>Sub-total - Auto Loans</b>	<b>12,78,950</b>	<b>10,51,080</b>	<b>21.7</b>	<b>11,99,200</b>	<b>6.7</b>
Personal loans	6,13,130	4,50,240	36.2	5,60,670	9.4
Business banking	9,64,850	6,57,940	46.6	8,80,880	9.5
Loan against shares	32,190	20,520	56.9	29,560	8.9
Credit Cards	3,08,310	2,13,360	44.5	2,91,010	5.9
Home loans	4,00,290	3,35,740	19.2	3,87,970	3.2
Gold loans	52,510	50,930	3.1	51,300	2.4
Other Retail	4,82,220	4,11,570	17.2	4,40,380	9.5
<b>Retail Total</b>	<b>41,32,450</b>	<b>31,91,380</b>	<b>29.5</b>	<b>38,40,970</b>	<b>7.6</b>

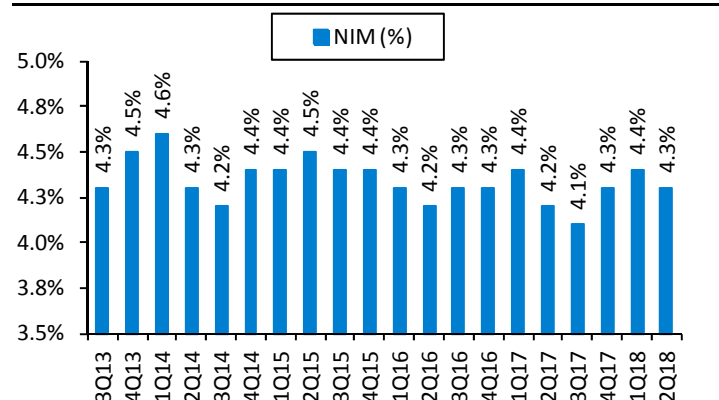
Source: Company Data, PL Research

**Exhibit 4: Domestic loan growth was robust at 26.8% YoY led by both segments**


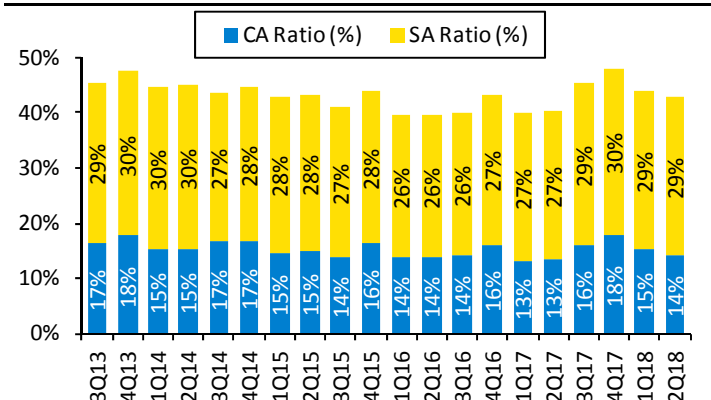
Source: Company Data, PL Research

**Exhibit 5: Core fees growth continue to be strong**


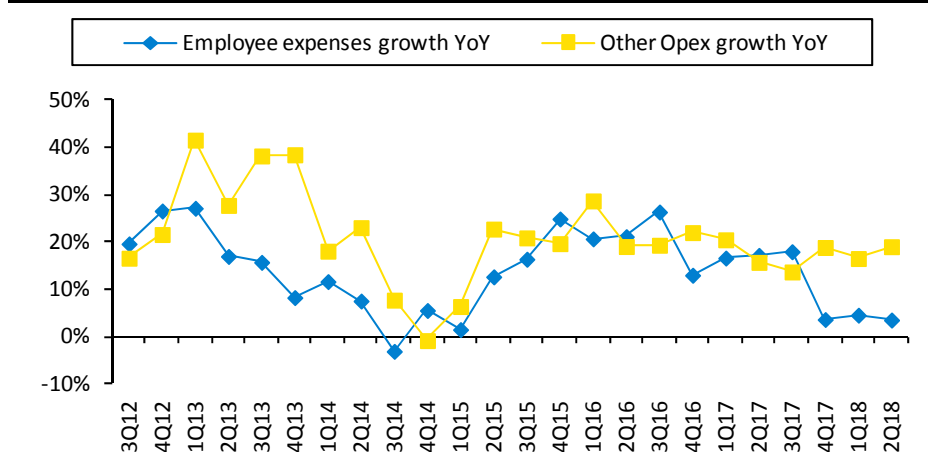
Source: Company Data, PL Research

**Exhibit 6: Margins remained broadly steady at 4.3%**


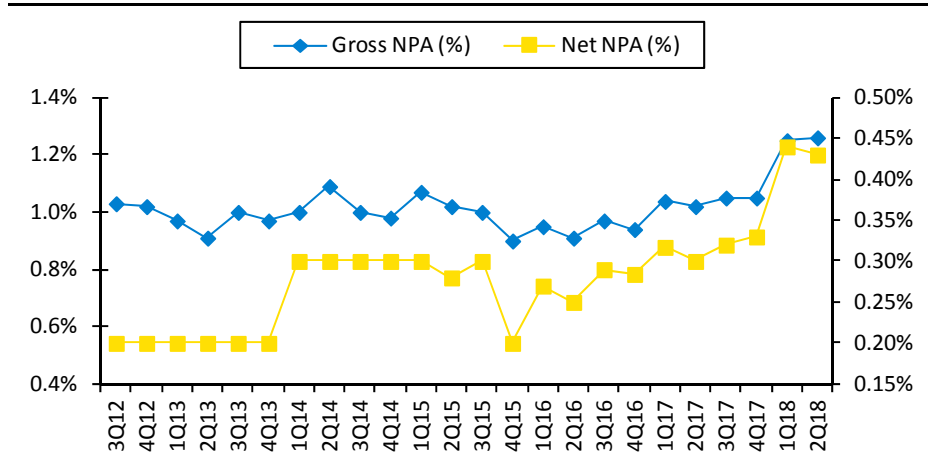
Source: Company Data, PL Research

**Exhibit 7: CASA mix came off on weakness in CA book**


Source: Company Data, PL Research

**Exhibit 8: Overall opex continues to be under control as staff cost growth is quite slow**


Source: Company Data, PL Research

**Exhibit 9: Asset quality continues to be stable and at healthy levels**


Source: Company Data, PL Research

#### Exhibit 10: We increase our TP to Rs2,136 (from Rs1,945) on 4.3x Sep-19 ABV, rolled over from Mar-19 ABV

PT calculation and upside	
Fair price – EVA	2,134
Fair price - P/ABV	2,138
<b>Average of the two</b>	<b>2,136</b>
<b>Target P/ABV</b>	<b>4.3</b>
<b>Target P/E</b>	<b>23.0</b>
Current price, Rs	1867
<b>Upside (%)</b>	<b>14.4%</b>
Dividend yield (%)	0.7%
<b>Total return (%)</b>	<b>15.1%</b>

Source: Company Data, PL Research

#### Exhibit 11: Change in earnings estimates – We have slightly tweaked our estimates on deposit growth, other income and credit cost

Rs (mn)	Old estimates		Revised estimates		% change		Introducing
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY20E
Net interest income	4,01,310	4,85,285	3,99,809	4,81,146	(0.4)	(0.9)	5,84,101
Operating profit	3,10,973	3,74,447	3,14,096	3,75,716	1.0	0.3	4,56,609
Net profit	1,76,595	2,13,331	1,75,413	2,14,164	(0.7)	0.4	2,62,353
EPS, Rs.	68.9	83.2	68.5	83.6	(0.7)	0.4	102.4
ABVPS, Rs.	382.9	450.5	383.5	451.2	0.2	0.1	537.3
<b>Price target, Rs.</b>	<b>1,945</b>		<b>2,136</b>		<b>9.8</b>		
<b>Recommendation</b>	<b>BUY</b>		<b>BUY</b>				

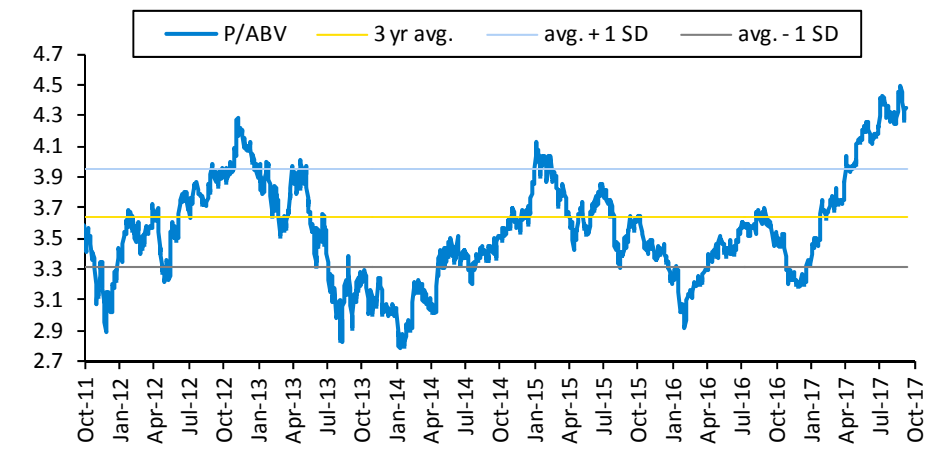
Source: Company Data, PL Research

#### Exhibit 12: Return ratios are likely to improve to normalized level of +20% for HDFCB

RoA decomposition	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Interest income	9.50	9.22	8.96	9.27	8.64	8.59	8.55	8.55
Interest expenses	5.22	5.08	4.82	5.02	4.51	4.33	4.23	4.17
<b>Net interest income</b>	<b>4.28</b>	<b>4.14</b>	<b>4.14</b>	<b>4.25</b>	<b>4.13</b>	<b>4.25</b>	<b>4.32</b>	<b>4.39</b>
Treasury income	0.28	0.32	0.29	0.30	0.30	0.27	0.24	0.24
Other Inc. from operations	1.57	1.46	1.38	1.35	1.23	1.24	1.23	1.19
<b>Total income</b>	<b>6.14</b>	<b>5.92</b>	<b>5.80</b>	<b>5.90</b>	<b>5.66</b>	<b>5.76</b>	<b>5.79</b>	<b>5.82</b>
Employee expenses	1.07	0.94	0.88	0.88	0.81	0.74	0.73	0.70
Other operating expenses	1.97	1.76	1.71	1.74	1.65	1.68	1.69	1.69
<b>Operating profit</b>	<b>3.10</b>	<b>3.22</b>	<b>3.22</b>	<b>3.29</b>	<b>3.21</b>	<b>3.34</b>	<b>3.37</b>	<b>3.43</b>
Tax	0.82	0.96	0.94	0.98	0.95	0.98	1.01	1.03
Loan loss provisions	0.45	0.36	0.38	0.42	0.45	0.50	0.44	0.43
<b>RoAA</b>	<b>1.82</b>	<b>1.90</b>	<b>1.89</b>	<b>1.89</b>	<b>1.81</b>	<b>1.87</b>	<b>1.92</b>	<b>1.97</b>
<b>RoAE</b>	<b>20.34</b>	<b>21.28</b>	<b>19.37</b>	<b>18.26</b>	<b>17.95</b>	<b>18.17</b>	<b>19.04</b>	<b>19.81</b>

Source: Company Data, PL Research

Exhibit 13: HDFCB 1 year forward P/ABV trend – Premium valuations warranted



Source: Company Data, PL Research



## Income Statement (Rs m)

Y/e March	2016	2017	2018E	2019E
Int. Earned from Adv.	448,279	520,553	624,804	757,339
Int. Earned from Inv.	141,200	159,443	164,948	168,091
Others	12,736	13,064	17,018	26,650
Total Interest Income	602,214	693,060	806,771	952,080
Interest expense	326,299	361,667	406,961	470,934
<b>NII</b>	<b>275,915</b>	<b>331,392</b>	<b>399,809</b>	<b>481,146</b>
Growth (%)	23.2	20.1	20.6	20.3
Treasury Income	7,317	11,394	10,500	7,500
NTNII	100,200	111,571	130,910	156,535
Non Interest Income	107,517	122,965	141,410	164,035
Total Income	709,732	816,025	948,180	1,116,115
Growth (%)	23.5	15.0	16.2	17.7
Operating Expense	169,797	197,033	227,123	269,466
<b>Operating Profit</b>	<b>213,635</b>	<b>257,324</b>	<b>314,096</b>	<b>375,716</b>
Growth (%)	22.7	20.5	22.1	19.6
NPA Provisions	21,336	31,453	40,012	41,863
Investment Provisions	152	(76)	(69)	(62)
Total Provisions	27,256	35,933	46,697	49,247
<b>PBT</b>	<b>186,379</b>	<b>221,391</b>	<b>267,398</b>	<b>326,469</b>
Tax Provisions	63,417	75,894	91,986	112,307
Effective Tax Rate (%)	34.0	34.3	34.4	34.4
<b>PAT</b>	<b>122,962</b>	<b>145,496</b>	<b>175,412</b>	<b>214,162</b>
Growth (%)	20.4	18.3	20.6	22.1

## Balance Sheet (Rs m)

Y/e March	2016	2017	2018E	2019E
Par Value	2	2	2	2
No. of equity shares	2,528	2,563	2,563	2,563
Equity	5,056	5,125	5,125	5,125
Networth	726,778	894,624	1,036,082	1,213,205
Adj. Networth	713,574	876,184	1,015,925	1,190,191
Deposits	5,464,242	6,436,397	7,594,948	9,174,697
Growth (%)	21.2	17.8	18.0	20.8
Low Cost deposits	2,363,108	3,091,525	3,387,347	4,367,156
% of total deposits	43.2	48.0	44.6	47.6
<b>Total Liabilities</b>	<b>7,407,961</b>	<b>8,638,402</b>	<b>10,155,170</b>	<b>12,122,332</b>
Net Advances	4,645,940	5,545,682	6,765,732	8,457,165
Growth (%)	27.1	19.4	22.0	25.0
Investments	1,958,363	2,144,633	2,190,245	2,284,950
<b>Total Assets</b>	<b>7,407,961</b>	<b>8,638,402</b>	<b>10,155,170</b>	<b>12,122,332</b>

Source: Company Data, PL Research.

## Quarterly Financials (Rs m)

Y/e March	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Interest Income	176,056	181,144	186,687	196,703
Interest Expense	92,965	90,593	92,980	99,182
<b>Net Interest Income</b>	<b>83,091</b>	<b>90,551</b>	<b>93,707</b>	<b>97,521</b>
Non Interest Income	31,427	34,463	35,167	36,059
CEB	22,068	25,230	25,781	26,140
Treasury	3,986	1,804	3,314	3,559
<b>Net Total Income</b>	<b>114,518</b>	<b>125,014</b>	<b>128,874</b>	<b>133,580</b>
Operating Expenses	48,425	52,220	53,675	55,401
Employee Expenses	16,886	15,527	16,575	17,158
Other Expenses	31,539	36,693	37,100	38,243
<b>Operating Profit</b>	<b>66,093</b>	<b>72,794</b>	<b>75,199</b>	<b>78,179</b>
Core Operating Profit	62,107	70,990	71,885	74,620
Provisions	7,158	12,618	15,588	14,762
Loan loss provisions	6,944	9,779	13,432	10,788
Investment Depreciation	—	—	—	—
<b>Profit before tax</b>	<b>58,935</b>	<b>60,176</b>	<b>59,612</b>	<b>63,417</b>
Tax	20,281	20,275	20,673	21,907
<b>PAT before EO</b>	<b>38,653</b>	<b>39,901</b>	<b>38,938</b>	<b>41,510</b>
Extraordinary item	—	—	—	—
<b>PAT</b>	<b>38,653</b>	<b>39,901</b>	<b>38,938</b>	<b>41,510</b>

## Key Ratios

Y/e March	2016	2017	2018E	2019E
CMP (Rs)	1,865	1,865	1,865	1,865
Equity Shrs. Os. (m)	2,528	2,563	2,563	2,563
Market Cap (Rs m)	4,715,447	4,779,532	4,779,532	4,779,532
M/Cap to AUM (%)	63.7	55.3	47.1	39.4
EPS (Rs)	48.8	57.2	68.5	83.6
Book Value (Rs)	287	349	404	473
Adj. BV (100%) (Rs)	273	329	383	451
P/E (x)	38.2	32.6	27.2	22.3
P/BV (x)	6.5	5.3	4.6	3.9
P/ABV (x)	6.8	5.7	4.9	4.1
DPS (Rs)	9.5	—	11.0	12.0
Dividend Yield (%)	0.5	—	0.6	0.6

## Profitability (%)

Y/e March	2016	2017	2018E	2019E
NIM	4.1	4.1	4.3	4.3
RoAA	1.8	1.8	1.9	1.9
RoAE	18.3	17.9	18.2	19.0

## Efficiency

Y/e March	2016	2017	2018E	2019E
Cost-Income Ratio (%)	44.3	43.4	42.0	41.8
C-D Ratio (%)	85.0	86.2	89.1	92.2
Business per Emp. (Rs m)	130	140	152	170
Profit per Emp. (Rs lacs)	15.8	16.9	18.6	20.6
Business per Branch (Rs m)	729	785	856	955
Profit per Branch (Rs m)	9	10	10	12

## Asset Quality

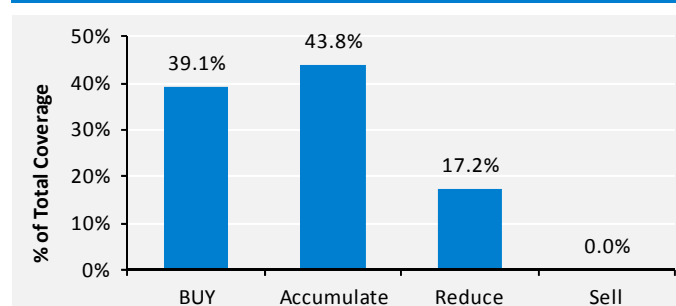
Y/e March	2016	2017	2018E	2019E
Gross NPAs (Rs m)	43,928	58,857	68,253	76,901
Net NPAs (Rs m)	13,204	18,440	20,157	23,014
Gr. NPAs to Gross Adv. (%)	0.9	1.1	1.0	0.9
Net NPAs to Net Adv. (%)	0.3	0.3	0.3	0.3
NPA Coverage (%)	69.9	68.7	70.5	70.1

Source: Company Data, PL Research.

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