

HDFC Bank Ltd.



HDFC Bank Ltd

Stable quarter; profitability intact

CMP INR 1795	Target INR 2046	Potential Upside 13.9%	Market Cap (INR Mn) 4,819,541	Recommendation ACCUMULATE	Sector BFSI
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Result highlights

On the earnings front, HDFC Bank posted a robust quarter with PAT growing to Rs. 41,510 mn, up 20.1% yoy and 6.6% qoq primarily on account of strong advances growth and non-interest income. Advances for the quarter grew 22.3%. Total interest income grew 15.2% yoy (5.4% qoq), with advances yield at 10.2% against 10% for Q1FY18 and 10.10.4% for Q2FY17. NIM (calculated) came in at 4.5%, largely unchanged. The stability in NIM can be attributed to reduction in cost of funds which in return could be attributed to strong CASA growth (23.6% yoy). Other income grew strongly with fees and commission income growing 24% yoy, thus aiding total income grow of 22.6% yoy (3.7% qoq). Improvement in operational efficiency helped operating profit which grew 30% yoy and 4% qoq. Asset quality deterioration was visible as gross NPAs inched up by 2 bps to 1.26% against 1.24% for Q1FY18 while net NPAs were at 0.43% (vs. 0.44% for Q1FY18). On the whole, profitability of the bank remained more or less intact with annualized RoA and RoE standing stable at 1.8% and 17.5% respectively.

MARKET DATA

Shares outs (Mn)	2584
EquityCap (INR Mn)	5168
Mkt Cap (INR Mn)	4819541
52 Wk H/L (INR)	1877/1159
Volume Avg (3m K)	1636.2
Face Value (INR)	2
Bloomberg Code	HDFCB IN

KEY FINANCIALS

Particulars (INR Mn)	FY15	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income	2,23,957	2,75,915	3,31,392	4,10,200	4,99,130	6,01,540
Pre-provision profits	1,74,045	2,13,635	2,57,324	3,14,711	3,84,928	4,67,423
Net Profit	1,02,159	1,22,962	1,45,496	1,73,149	2,12,560	2,58,694
EPS (Rs.)	40.8	48.6	56.8	67.6	82.9	101.0
BVPS (Rs.)	247.4	287.5	349.1	405.9	456.6	518.8
ABVPS (Rs.)	243.8	282.2	341.9	398.7	449.4	511.6
P/ABV (x)	4.2	3.8	4.2	4.5	4.0	3.5

Source: Company, KRChoksey Research

Advances growth momentum continues

HDFC Bank has continued to outperform on the advances growth front with a strong 22.3% yoy growth. Domestic retail advances grew 29% yoy, within which personal loans, credit cards and business banking grew at 36%, 45% and 44% respectively. Business banking has been growing because of the bank's large branch network and the bank going out actively to acquire customers. One could say business banking growth is being driven by market share gains through active distribution and acquisition strategy. Moreover, the bank has continued to maintain its growth momentum despite witnessing high competitive intensity in personal loans, SME and CVs mainly on account of better products, leveraging brand name and technology. On the other side, the total corporate loan book also posted a healthy growth on account of demand for working capital loans and small-time capex. Further, the growth in corporate book was also a function of market share gains (demand for fresh loans stay muted on account of subdued private capex) wherein the bank is witnessing customers from other bank shifting relationships to HDFC Bank.

Retail mix, end of Q2FY18, stands at 55% against 52% for Q1FY18 and 51% for Q2FY17 which shows the share of retail mix has been increasing. On incremental basis, retail contributed in majority.

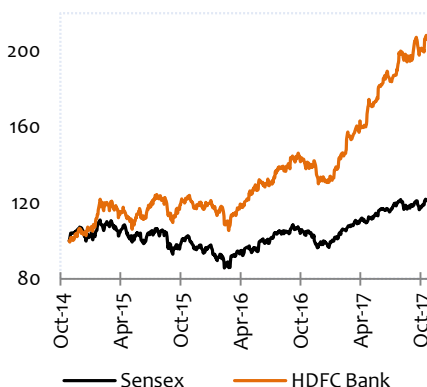
Total interest earning assets increased by 19% yoy and 4.3% qoq. With a stable NIM (of 4.5%), the company posted an NII growth of 22% yoy and 4% qoq.

Asset quality deteriorates slightly

Gross NPAs for the quarter stood at 1.26%, up 24 bps yoy and 2 bps qoq. Net NPAs stood at 0.43%, up 13 bps yoy but down 1 bps qoq. Provisioning expense rose 97% yoy. As a result, credit costs for the quarter came in 0.8% against 0.8% for Q1FY18 and 0.5% for Q2FY17.

With respect to the project loan account, the bank is in dialogue with the RBI regarding its classification. The bank maintains this account as a standard one in its book and has also made contingent provisions of about Rs. 700 crore (Rs. 300 from floating provisions, rest through P&L) With respect to NPAs on account of farm loan waivers, the bank has not seen any meaningful change in asset quality.

SHARE PRICE PERFORMANCE

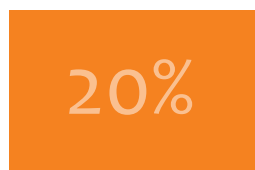


MARKET INFO

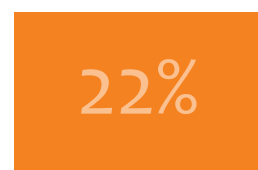
SENSEX	33043
NIFTY	10295

SHARE HOLDING PATTERN (%)

Particulars	Sep 17	Jun 17	Mar 17
Promoters	21.02	21.11	21.2
FIIIs	33.91	34.31	34.35
DIIIs	11.53	10.95	10.55
Others	33.54	33.64	33.91
Total	100	100	100



Advances CAGR between FY 17 and FY 20E



NII CAGR between FY 17 and FY 20E

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Strong income growth, aided by lower cost of funds and strong growth in non-interest income

While total interest income grew by 15.2% yoy and 5.4% qoq, interest expense grew by 9.3% yoy and 6.7% qoq, thus helping NII grow at 22% yoy and 4.1% qoq. On the other hand, non-interest income grew by 24.3% yoy and 2.5% qoq, mainly driven by fee and commission income which grew by 24% yoy (bond gains were up 25%). Despite yields being a victim of increased competitive intensity, NIM was largely stable mainly on account of lower cost of funds which was aided by strong CASA growth of 24% yoy. CASA as of Q2FY18 stood at 43% versus 44% for Q1FY18 and 40% for Q2FY17.

In Q1FY18, high growth in non-interest income was driven by tractions in a few products along with some one-offs. However, growth rate of 24% in Q2FY18 is still much higher than management's own guidance of 18-20% sustainable growth rate.

Strong operational efficiency aided pre-provisioning profit growth

Along with total income increasing 22.6% yoy, the bank has displayed impeccable control on costs with total operating expenses growing 14% yoy and 3% qoq, thus driving pre-provisioning profit higher. Employees costs during the quarter grew by 4% yoy, signifying the bank's focus on improving employee productivity. Other expenses grew 19% yoy and 3% qoq. As a result, cost/income ratio stood at 41.5% for Q2FY18, improving ~320 bps yoy and ~20 bps qoq.

Going forward, we expect employee costs to be slightly higher on account of inflation and annual raises. Operational efficiency at the bank is being driven by improved productivity by changing processes and reducing touch-points. Bank's move to digital has also triggered improved sales times. While the management does not guide specific numbers, it continues to maintain its stance on improving cost/income ratio further to somewhere around low 40's.

Valuation & Recommendation: HDFC Bank has continued to display strong earnings momentum supported by advances growth of 22% despite economy-wide credit growth remaining muted (expect ROE of 19.8%/21% by FY19E/FY20E). Along with building a strong CASA franchise, the bank is expected to display strong control on the operational front as well owing to digitization initiatives. We expect the bank to see strong growth momentum on back of continuing retail loans origination, along with market share gains in the corporate loans segment (20% advances CAGR over up to FY20). Higher than minimum provisioning on standard assets and negligible exposure to the 12 accounts identified by the RBI reinforce our confidence in the bank's asset quality and prudent provisioning policy. Hence, we recommend to ACCUMULATE after assigning a multiple of 4x to FY20E ABVPS which values the stock at Rs. 2,046 per share, offering an upside of 13.9% from current levels.

Key Ratios	Q2FY18	Q2FY17	Q1FY18	Y-o-Y	Q-o-Q
Yield on avg advances (%)	10.2%	10.4%	10.0%	-28	18
NIM (%)	4.6%	4.5%	4.7%	6	-8
Cost to income ratio	41.5%	44.7%	41.6%	-323	-18
Gross NPAs	77,028	50,690	72,429	52%	6%
Net NPAs	25,968	14,889	25,282	74%	3%
GNPA (%)	1.26%	1.02%	1.24%	24	2
NNPA (%)	0.43%	0.30%	0.44%	13	-1
Provision coverage (%)	66.3%	70.6%	65.1%	-434	119
CD ratio (%)	87.7%	83.6%	86.5%	419	121
Capital adequacy ratio (%)	15.10%	15.40%	15.60%	-30	-50
RoA (%)	1.78%	1.75%	1.74%	3	4
Leverage (x)	9.7	9.8	9.5		
RoE (%)	17.3%	17.2%	16.5%	15	78

Source: Company, KRChoksey Research

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Income Statement (INR Mn)	Q2FY18	Q2FY17	Q1FY18	Y-o-Y	Q-o-Q
Interest income	1,96,703	1,70,699	1,86,687	15.2%	5.4%
Interest expense	99,182	90,764	92,980	9.3%	6.7%
Net interest income	97,521	79,936	93,708	22.0%	4.1%
Noninterest income	36,059	29,010	35,167	24.3%	2.5%
Total income	1,33,580	1,08,945	1,28,874	22.6%	3.7%
- Employee costs	17,158	16,572	16,575	3.5%	3.5%
- Other operating expenses	38,243	32,128	37,100	19.0%	3.1%
Operating expenses	55,401	48,700	53,675	13.8%	3.2%
Pre-provision profit	78,179	60,246	75,200	29.8%	4.0%
Provisions	14,762	7,490	15,588	97.1%	-5.3%
Profit before tax	63,417	52,756	59,612	20.2%	6.4%
Tax expense	21,907	18,202	20,673	20.4%	6.0%
Net profit	41,510	34,553	38,939	20.1%	6.6%

Source: Company, KRChoksey Research

Balance Sheet items	Q2FY18	Q2FY17	Q1FY18	Y-o-Y	Q-o-Q
Deposits	68,93,459	59,17,306	67,13,761	16.5%	2.7%
Borrowings	10,15,311	7,70,385	8,60,117	31.8%	18.0%
Investments	24,02,790	20,60,286	21,61,083	16.6%	11.2%
Advances	60,48,669	49,44,178	58,09,758	22.3%	4.1%
Total Assets	93,36,373	78,88,270	89,56,531	18.4%	4.2%

Source: Company, KRChoksey Research

Key highlights from Q2FY18 earnings call:

- NII and other income have helped total income growth. Reported NIMs have held stable at 4.3%. Other income growth has been driven by 24% yoy growth in fee income.
- **Strong advances growth driven by the retail segment:** Advances growth during the quarter was driven by the retail segment, the share of which increased in the total advances mix. Within the retail segment, growth was driven by PL, CC and business banking. Corporate loan book growth has been driven by market share gains as customers have been shifting their relationships to HDFC Bank.
- The bank has exposure to a project loan account which had undergone 5/25 restructuring in February 2016. Since the conduct of the account remains standard, the bank is in dialogue with the regulator regarding its classification. The account is a domestic project loan account which has been provided to the tune of about Rs. 700 crore (partly from floating provisions, partly through the P&L during Q2FY18). Current floating provisions, as of Q2FY18, stand at Rs. 1000 crore.
- Government savings is a focus and growth area for the bank as the government digitizes its own payments.
- **Bank will continue to focus on improving efficiency further:** The bank has been able to improve its cost/income ratio on account of increased productivity of its employees. This has come on back of changing process and reducing touchpoints. Move to digital has helped reduce sales time immensely. Without guiding for a specific numbers, the bank has said it would continue to work towards improving its cost/income ratio through various measures.
- **Farm loan stress remains unchanged:** Stress from farm loan waivers witnessed in Q1FY18 remains more or less unchanged (no meaningful change in the stress levels).

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Key highlights from Q2FY18 earnings call (contd.):

- Corporate segment immensely competitive:** Overall yields have come down partially because of high growth in corporate segment which is seeing a lot of competition internally as well as from other borrowing avenues such as bonds market and commercial papers. The competition in corporate segment is especially high in the corporate and emerging corporate segments.
- Competitive pressures building up in retail:** In terms of retail lending, competition is high in home and auto loans and is now increasing in PL, SME and CVs. The retail segment in general has become more competitive also because banks have shifted focus from corporate to retail, plus growth of NBFCs is also putting some pressure.
- Gaining market share in business banking:** Business banking has been growing because of the bank's large branch network. The bank has been actively going out to acquire customers and these customers are usually from other banks (market share gains). In short, business banking segment of the bank is growing and gaining market share on account of active distribution and acquisition strategy.
- Stable NIMs despite increasing competition:** Despite the competition, the bank has been able to maintain its NIMs by offering better products and by leveraging its brand name and technology.
- Overseas exposure stands at Rs. 21,000 crore, which is quite low when compared to a total loan of Rs. 6 lacs.

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Income Statement (Amounts in INR Mn)	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Interest income	4,84,699	6,02,214	6,93,060	8,31,903	9,90,963	11,80,372
Interest expense	2,60,742	3,26,299	3,61,667	4,21,703	4,91,833	5,78,832
Net interest income	2,23,957	2,75,915	3,31,392	4,10,200	4,99,130	6,01,540
Non interest income	89,964	1,07,517	1,22,965	1,40,622	1,68,746	2,02,496
Total income	3,13,920	3,83,432	4,54,357	5,50,822	6,67,776	8,04,035
Operating expenses	47,510	57,022	64,837	73,722	83,826	95,314
Employee costs	92,366	1,12,775	1,32,197	1,62,389	1,99,122	2,41,298
Other operating expenses	1,39,875	1,69,797	1,97,033	2,36,112	2,82,948	3,36,612
Pre-provision profit	1,74,045	2,13,635	2,57,324	3,14,711	3,84,928	4,67,423
Provisions	20,750	27,256	35,933	51,243	61,492	73,789
Profit before tax	1,53,295	1,86,379	2,21,391	2,63,468	3,23,436	3,93,634
Tax expense	51,136	63,417	75,894	90,319	1,10,876	1,34,941
Net profit	1,02,159	1,22,962	1,45,496	1,73,149	2,12,560	2,58,694

Source: Company, KRChoksey Research

Balance sheet (Amounts in INR Mn)	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
SOURCES OF FUNDS						
Share capital	5,013	5,056	5,125	5,125	5,125	5,125
Reserves & surplus	6,15,081	7,21,721	8,89,498	10,34,995	11,64,857	13,24,277
Shareholders' funds	6,20,094	7,26,778	8,94,624	10,40,120	11,69,982	13,29,402
Borrowings	4,52,136	5,30,185	7,40,289	8,88,346	10,66,016	12,79,219
Deposits	45,07,956	54,64,242	64,36,397	77,23,676	92,68,411	1,11,22,093
Other liabilities & provisions	3,24,845	3,67,251	5,67,093	5,86,040	7,81,410	10,12,268
TOTAL LIABILITIES & EQUITY	59,05,031	70,88,456	86,38,402	1,02,38,182	1,22,85,819	1,47,42,982
USES OF FUNDS						
Cash and cash equivalent	3,63,315	3,89,188	4,89,521	5,87,425	7,04,910	8,45,892
Investments	16,64,599	16,38,858	21,44,633	25,73,560	30,88,272	37,05,926
Advances	36,54,950	46,45,940	55,45,682	66,54,818	79,85,782	95,82,939
Fixed assets	31,217	33,432	36,267	38,575	40,883	43,190
Other assets	1,90,949	3,81,038	4,22,298	3,83,804	4,65,972	5,65,035
TOTAL ASSETS	59,05,031	70,88,456	86,38,402	1,02,38,182	1,22,85,819	1,47,42,982

Source: Company, KRChoksey Research

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Key ratios	FY2015	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Growth rates						
Advances (%)	20.6%	27.1%	19.4%	20.0%	20.0%	20.0%
Deposits (%)	22.7%	21.2%	17.8%	20.0%	20.0%	20.0%
Total assets (%)	20.1%	20.0%	21.9%	18.5%	20.0%	20.0%
NII (%)	21.2%	23.2%	20.1%	23.8%	21.7%	20.5%
Pre-provisioning profit (%)	21.2%	22.7%	20.5%	22.3%	22.3%	21.4%
PAT (%)	20.5%	20.4%	18.3%	19.0%	22.8%	21.7%
Balance sheet ratios	81.1%	85.0%	86.2%	86.2%	86.2%	86.2%
Credit/Deposit (%)	44.0%	43.2%	48.0%	44.0%	45.0%	46.0%
CASA (%)	61.9%	65.5%	64.2%	65.0%	65.0%	65.0%
Advances/Total assets (%)	9.5	9.8	9.7	9.8	10.5	11.1
Leverage (x)	81.1%	85.0%	86.2%	86.2%	86.2%	86.2%
Operating efficiency						
Cost/income (%)	44.6%	44.3%	43.4%	42.9%	42.4%	41.9%
Opex/total assets (%)	2.4%	2.4%	2.3%	2.3%	2.3%	2.3%
Opex/total interest earning assets (%)	2.5%	2.5%	2.4%	2.4%	2.4%	2.4%
Profitability						
NIM (%)	4.3%	4.5%	4.5%	4.6%	4.6%	4.6%
RoA (%)	1.9%	1.9%	1.9%	1.8%	1.9%	1.9%
RoE (%)	18.0%	18.5%	17.9%	18.1%	19.8%	21.2%
Asset quality						
Gross NPA (%)	0.9%	0.9%	1.1%	1.1%	1.2%	1.3%
Net NPA (%)	0.2%	0.3%	0.3%	0.3%	0.2%	0.2%
PCR (%)	74%	70%	69%	69%	69%	69%
Slippage (%)	0.5%	0.5%	0.6%	0.8%	0.8%	0.8%
Credit cost (%)	0.9%	0.9%	1.1%	1.1%	1.2%	1.3%
Per share data / Valuation						
EPS (Rs.)	40.8	48.6	56.8	67.6	82.9	101.0
BV (Rs.)	247.4	287.5	349.1	405.9	456.6	518.8
ABV (Rs.)	243.8	282.2	341.9	398.7	449.4	511.6
P/E (x)	25.4	21.9	25.2	26.8	21.8	17.9
P/BV (x)	4.2	3.7	4.1	4.5	4.0	3.5
P/ABV (x)	4.2	3.8	4.2	4.5	4.0	3.5

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Date	CMP (INR)	TP (INR)	Recommendation
25-Oct-17	1,795	2,046	ACCUMULATE
25-Jul-17	1,736	2,016	BUY
25-Jan-17	1,280	1,457	BUY
26-Oct-16	1,240	1,457	BUY
22-Jul-16	1,223	1,420	BUY
27-Jan-16	1,037	1,260	BUY
23-Oct-15	1,094	1,260	BUY
25-Apr-15	1,007	1,200	BUY
13-Apr-15	1,043	1,200	BUY
17-Feb-15	1,067	1,200	ACCUMULATE
7-Jan-15	942	993	ACCUMULATE

Rating Legend	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% - 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than -5%

ANALYST CERTIFICATION:

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