

HDFC Bank

Remains strong in all areas

January 20, 2018

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Rating	BUY
Price	Rs1,951
Target Price	Rs2,136
Implied Upside	9.5%
Sensex	35,512
Nifty	10,895

(Prices as on January 19, 2018)

Trading data

Market Cap. (Rs bn)	5,000.0
Shares o/s (m)	2,562.5
3M Avg. Daily value (Rs m)	3089.7

Major shareholders

Promoters	21.20%
Foreign	40.57%
Domestic Inst.	14.81%
Public & Other	23.42%

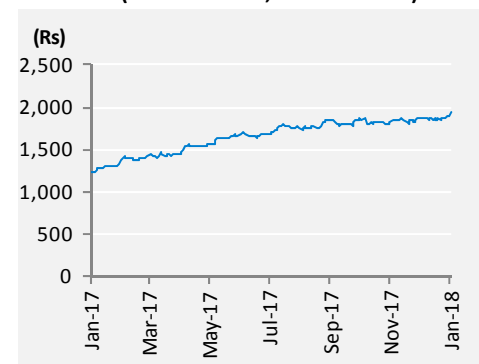
Stock Performance

(%)	1M	6M	12M
Absolute	3.5	15.3	58.0
Relative	(1.4)	4.1	28.0

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	83.4	84.0	-0.8
2020	101.2	101.6	-0.4

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



Source: Bloomberg

HDFCB earnings were in-line and continued deliver with its strong operational performance with robust top line growth & controlled opex. Bank received its divergence report on NPA for FY17 which made it recognize Rs20.5bn of loans into NPAs but one large NPA of Rs17.1bn was recovered by the Bankers' JLF in Q3FY18 and hence have minimal impact on asset quality. Bank has utilized released provisions towards floating provisions and existing stressed assets. Bank continues to deliver strong loan growth with stable liability franchise helping it gain market share. We remain positive on the stock with retain "BUY" with TP of Rs2,136 based on 4.3x Sep-19 ABV.

■ **Unhindered operating performance continues:** Bank's PPOP growth continued to be strong at 28% YoY (core PPOP at 32% YoY) on the back of 24% YoY growth in NII, on stable margins of 4.3% and 30% growth fee income (partly on lower base). Bank retained strong control on staff opex, but other opex was up on higher commissions and investment in non-brick & mortar initiatives. Bank expects benefits to flow through with further reduction C/I ratio as productivity of earlier opened branches has been coming through with lower branch additions.

■ **Loan growth strong; liabilities franchise stable:** Loan growth was strong at 27.5% YoY led by retail growth, while non-retail growth was also decent at 25% YoY. Auto/2W, Unsecured credit, business banking helped overall retail loan growth, while home loan was slower at 8% YoY (-5% QoQ) as bank did not buy-back any loans. Bank continues to gain market share in most product segments and expects loan growth to remain robust. **On Liabilities,** CASA ratio slightly improved to 43.9% up 100bps QoQ with deposits growth slightly slower due to demonetisation base effect.

■ **High divergence in asset quality, but large recovery as well:** Bank received RBI's audit report for FY17 on NPA divergence with gross divergence of Rs20.5bn on three a/c which bank had to recognize as NPA but bankers' JLF upgraded one a/c of Rs17.1bn helping minimize overall impact on asset quality, while rest two a/c were already NPAs in H1FY18. Bank did not reverse provisions released and added back Rs3.0bn to floating provisions and rest were allocated to standard stressed assets & Agri NPAs. We do not see any large asset quality issues but we believe credit cost to remain high at 65-70bps in FY18 & FY19.

Key financials (Y/e March)	2017	2018E	2019E	2020E
Net interest income	331,392	404,540	484,310	578,684
Growth (%)	20.1	22.1	19.7	19.5
Operating profit	257,324	323,736	385,239	456,394
PAT	145,496	174,758	215,966	262,259
EPS (Rs)	57.2	67.8	83.4	101.2
Growth (%)	17.0	18.6	22.9	21.4
Net DPS (Rs)	—	10.9	13.0	16.0

Profitability & Valuation	2017	2018E	2019E	2020E
NIM (%)	4.13	4.35	4.48	4.54
RoAE (%)	17.9	17.9	18.9	19.6
RoAA (%)	1.81	1.88	2.00	2.06
P / BV (x)	5.6	4.8	4.1	3.5
P / ABV (x)	5.9	5.1	4.3	3.6
PE (x)	34.1	28.8	23.4	19.3
Net dividend yield (%)	—	0.6	0.7	0.8

Source: Company Data; PL Research

Exhibit 1: Operating performance continues to be upbeat but provisioning continues

	(Rs m)	Q3FY18	Q3FY17	YoY gr. (%)	Q2FY18	QoQ gr. (%)
<i>NII growth was strong on continued strong loan growth and largely maintained margins</i>	Interest income	2,05,813	1,76,056	16.9	1,96,703	4.6
	Interest Expended	1,02,669	92,965	10.4	99,182	3.5
	Net interest income (NII)	1,03,143	83,091	24.1	97,521	5.8
<i>Other income was better from strong fees due to base effect and strong Fx related fees</i>	- Treasury income	2,594	3,986	(34.9)	3,559	(27.1)
	Other income	38,692	31,427	23.1	36,059	7.3
	Total income	1,41,835	1,14,518	23.9	1,33,580	6.2
<i>Bank continues to keep strong control on employee expenses</i>	Operating expenses	57,322	48,425	18.4	55,401	3.5
	-Staff expenses	16,913	16,886	0.2	17,158	(1.4)
	-Other expenses	40,410	31,539	28.1	38,243	5.7
<i>Credit cost still remain elevated at 70-75bps (annualized) as bank did not utilize released provisions</i>	Operating profit	84,513	66,093	27.9	78,179	8.1
	Core operating profit	81,919	62,107	31.9	74,620	9.8
	Total provisions	13,514	7,158	88.8	14,762	(8.5)
	Profit before tax	70,999	58,935	20.5	63,417	12.0
	Tax	24,573	20,281	21.2	21,907	12.2
	Profit after tax	46,426	38,653	20.1	41,510	11.8
Balance sheet (Rs m)						
	Deposits	69,90,264	63,47,046	10.1	68,93,459	1.4
	Advances	63,12,147	49,50,433	27.5	60,48,669	4.4
Profitability ratios						
<i>Margins remained stable</i>	YoA – Calc	10.5	10.7	(20)	10.4	10
	CoF - Calc	5.2	5.4	(25)	5.1	3
	NIM - Rep	4.3	4.1	20	4.3	-
	RoaA	2.0	1.9	6	1.8	16
	RoaE	18.9	18.7	18	17.5	139
Asset Quality						
<i>Overall asset quality remained stable despite divergence on NPAs with RBI for FY17 as bank upgraded 1 large a/c in Q3FY18</i>	Gross NPL (Rs mn)	82,349	52,323	57.4	77,028	6.9
	Net NPL (Rs mn)	27,737	15,643	77.3	25,968	6.8
	Restructured Assets (Rs mn)					
	Gross NPL ratio	1.3	1.1	24	1.3	3
	Net NPL ratio	0.4	0.3	12	0.4	1
	Coverage ratio - Calc	66.5	70.1	(360)	66.3	21
<i>CASA mix slightly improves sequentially</i>	Rest. assets/ Total adv.					
	Business & Other Ratios					
	Low-cost deposit mix	43.9	45.0	(110)	42.9	100
	Cost-income ratio	40.4	42.3	(187)	41.5	(106)
	Non int. inc / total income	27.3	27.4	(16)	27.0	28
	Credit deposit ratio	90.3	78.0	1,230	87.7	255
	CAR	15.5	15.9	(40)	15.1	40
	Tier-I	13.6	13.8	(20)	13.3	30

Source: Company Data, PL Research

Key Q3FY18 Concall Highlights

Balance sheet & Outlook

- **Loan book** – Growth continued to be strong in retail at 30% YoY, while corporate loan book grew at 24% YoY. Secured business segments saw higher growth than the unsecured segments this quarter. **Auto loan** continued to be strong especially **2W** but in **CVs** in some segment bank has been cautious. In **unsecured**, personal loans growth continued to be doing well with 50% of origination from existing customer base. **Credit cards** has seen some higher revolvers and also on back of festive season with 70% origination from existing customers. **Outlook:** Bank will continue to see robust growth in all loan segments.

Margins/Pricing/Yields

- Margins were largely stable at 4.3%. **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 partly also due to base effect and also MF, TPD products continue to do well. Also Fx related fees saw good traction.
- **Opex** – Staff expenses continued to remain under strong control, while other opex was up as bank commissions to agent increased on back of strong sales & loan book growth. Bank has been slowing down branch expansion, while productivity of earlier opened branches showing improvement leading to lower C/I ratio, which bank expects to improve further.

Asset quality

- Bank saw Rs45.9bn of slippages in the quarter of which Rs20.5bn was on back of divergence with RBI as of FY17 end but bank recovered Rs17.1bn from the divergent a/c as decided by Bankers' JLF, helping overall asset quality.
- **Credit cost/Provisions** – Bank had made Rs7.0bn of provisions in Q2FY18 of which it reversed Rs3.0bn to floating provision from the provisions released of upgrade of a/c and rest were allocated incrementally to Agri NPAs from Q1FY18 and towards standard stressed assets defined by RBI. Credit cost overall has remained high with 70-75bps (annualized) as bank undertook slightly higher write-offs.

Capital

- Bank has been consuming 100-150bps of capital every year, RBI tagging it as Systematically Important Bank (SIB) and considering the growth outlook for next 2-3 years it has taken approval to raise capital of Rs240bn.

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

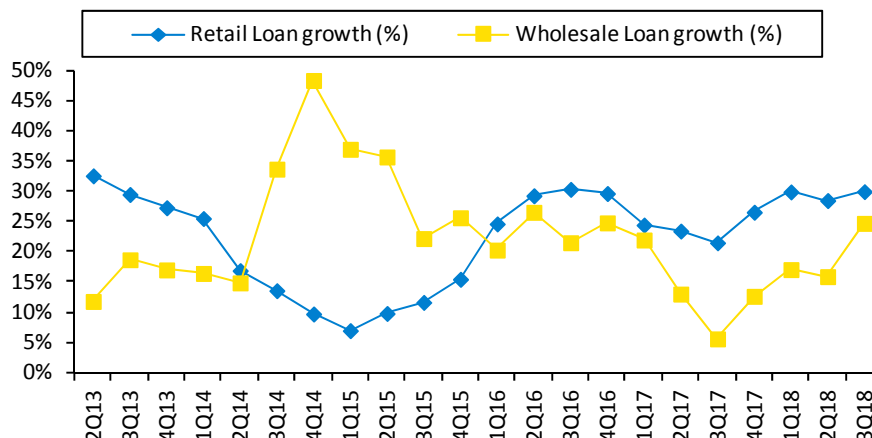
Loan Composition (Rs m)	Q3FY18	Q3FY17	YoY gr. (%)	Q2FY18	QoQ gr. (%)
Car Loans	7,30,570	5,84,490	25.0	6,90,530	5.8
CV loans	2,14,030	1,75,630	21.9	2,02,520	5.7
2 wheeler loans	76,910	61,140	25.8	68,830	11.7
Sub-total - Auto Loans	10,21,510	8,21,260	24.4	9,61,880	6.2
Personal loans	6,68,170	4,64,540	43.8	6,06,920	10.1
Business banking	4,69,890	3,21,290	46.3	4,55,280	3.2
Loan against shares	16,710	12,710	31.5	16,040	4.2
Credit Cards	3,36,220	2,36,730	42.0	3,08,310	9.1
Home loans	3,81,290	3,54,080	7.7	4,00,150	(4.7)
Gold Loans	50,570	47,090	7.4	50,680	(0.2)
Other Retail	4,49,290	3,53,160	27.2	4,44,220	1.1
Retail Loans	33,93,650	26,10,860	30.0	32,43,480	4.6
Non Retail Loans	29,18,497	23,39,573	24.7	28,05,189	4.0
Total Advances	63,12,147	49,50,433	27.5	60,48,669	4.4

Source: Company Data, PL Research

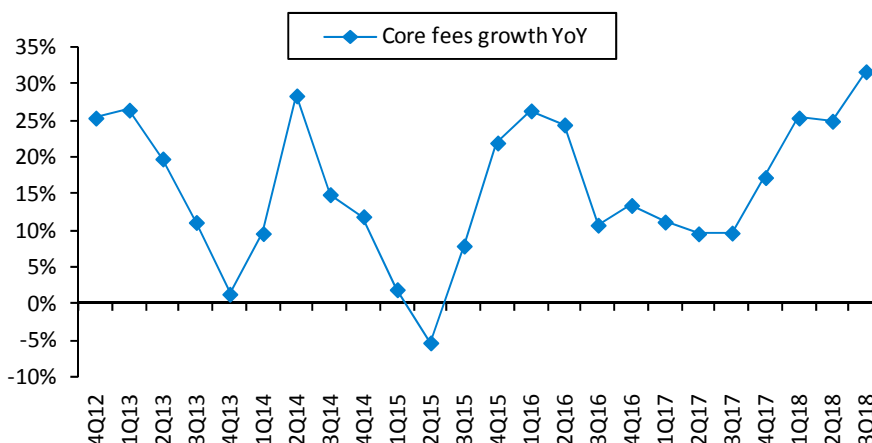
Exhibit 3: Loan book composition as per internal classification

Loan Composition (Rs m)	Q3FY18	Q3FY17	YoY gr. (%)	Q2FY18	QoQ gr. (%)
Car Loans	8,25,140	6,55,450	25.9	7,89,990	4.4
CV loans	4,25,480	3,45,260	23.2	4,03,610	5.4
2 wheeler loans	92,240	71,070	29.8	85,350	8.1
Sub-total - Auto Loans	13,42,860	10,71,780	25.3	12,78,950	5.0
Personal loans	6,74,850	4,68,260	44.1	6,13,130	10.1
Business banking	10,08,100	6,35,820	58.6	9,64,850	4.5
Loan against shares	34,580	22,490	53.8	32,190	7.4
Credit Cards	3,36,220	2,36,730	42.0	3,08,310	9.1
Home loans	3,81,330	3,54,230	7.7	4,00,290	(4.7)
Gold loans	52,990	48,180	10.0	52,510	0.9
Other Retail	4,97,630	4,00,780	24.2	4,82,220	3.2
Retail Total	43,28,560	32,38,270	33.7	41,32,450	4.7

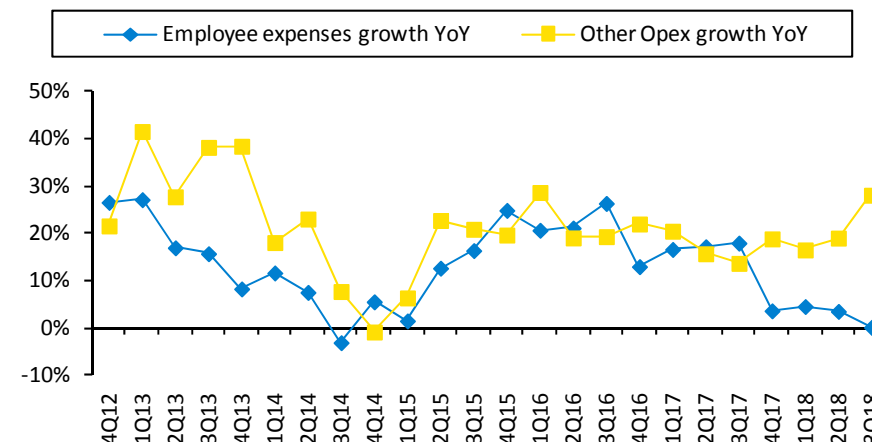
Source: Company Data, PL Research

Exhibit 4: Retail loan continues to be strong, wholesale improves on lower base effect


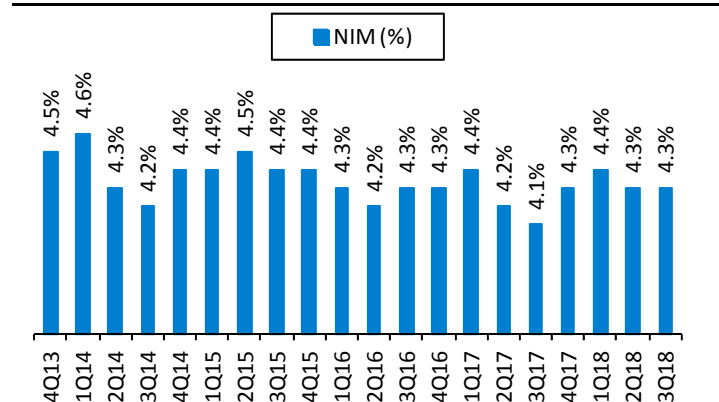
Source: Company Data, PL Research

Exhibit 5: Core fees was very strong partly on lower base


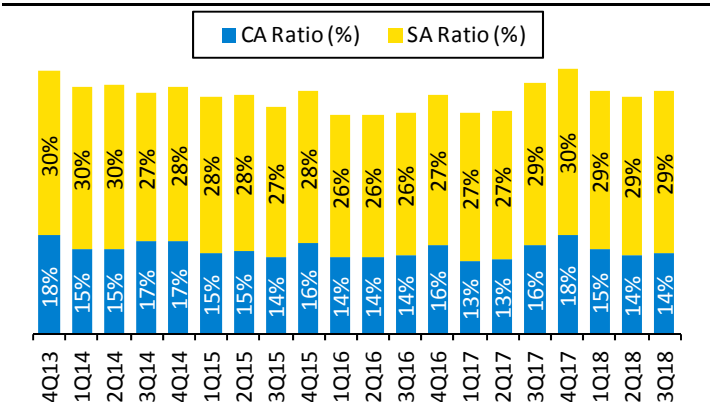
Source: Company Data, PL Research

Exhibit 6: Strong control on staff opex but other opex was much higher


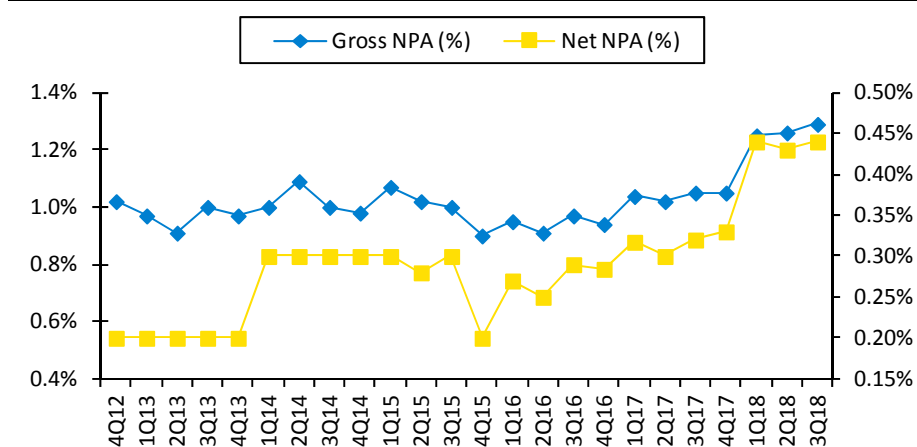
Source: Company Data, PL Research

Exhibit 7: Margins remained steady at 4.3%


Source: Company Data, PL Research

Exhibit 8: CASA mix slightly improved sequentially


Source: Company Data, PL Research

Exhibit 9: Asset quality largely stable with bank upgrading one large a/c which came in from divergence with RBI


Source: Company Data, PL Research

Exhibit 10: We maintain our TP of Rs2,136 on 4.3x Sep-19 ABV

PT calculation and upside	
Fair price – EVA	2,136
Fair price - P/ABV	2,135
Average of the two	2,136
Target P/ABV	4.3
Target P/E	23.1
Current price, Rs	1952
Upside (%)	9.4%
Dividend yield (%)	0.7%
Total return (%)	10.1%

Source: Company Data, PL Research

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

(Rs mn)	Old			Revised			% Change		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Net interest income	399,809	481,146	584,101	404,540	484,310	578,684	1.2	0.7	(0.9)
Operating profit	314,096	375,716	456,609	323,736	385,239	456,394	3.1	2.5	(0.0)
Net profit	175,413	214,164	262,353	174,759	215,968	262,262	(0.4)	0.8	(0.0)
EPS (Rs)	68.5	83.6	102.4	67.8	83.4	101.2	(0.9)	(0.3)	(1.1)
ABVPS (Rs)	383.5	451.2	537.3	385.3	455.1	537.2	0.5	0.9	(0.0)
Price target (Rs)	2,136			2,136					
Recommendation	BUY			BUY					

Source: Company Data, PL Research

Exhibit 12: Bank's ROA should see gradual improvement towards 2.0% by FY20

RoA decomposition	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Interest income	9.50	9.22	8.96	9.27	8.64	8.64	8.69	8.75
Interest expenses	5.22	5.08	4.82	5.02	4.51	4.29	4.21	4.20
Net interest income	4.28	4.14	4.14	4.25	4.13	4.35	4.48	4.54
Treasury income	0.28	0.32	0.29	0.30	0.30	0.29	0.25	0.25
Other Inc. from operations	1.57	1.46	1.38	1.35	1.23	1.28	1.31	1.27
Total income	6.14	5.92	5.80	5.90	5.66	5.92	6.04	6.06
Employee expenses	1.07	0.94	0.88	0.88	0.81	0.73	0.70	0.67
Other operating expenses	1.97	1.76	1.71	1.74	1.65	1.71	1.77	1.81
Operating profit	3.10	3.22	3.22	3.29	3.21	3.48	3.56	3.58
Tax	0.82	0.96	0.94	0.98	0.95	0.98	1.08	1.08
Loan loss provisions	0.45	0.36	0.38	0.42	0.45	0.62	0.49	0.44
RoAA	1.82	1.90	1.89	1.89	1.81	1.88	2.00	2.06
RoAE	20.34	21.28	19.37	18.26	17.95	17.91	18.86	19.59

Source: Company Data, PL Research

Exhibit 13: HDFCB 1 year forward P/ABV trend – Valuations now at demanding levels



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Int. Earned from Adv.	520,553	627,882	759,453	938,149
Int. Earned from Inv.	159,443	163,516	163,355	156,860
Others	13,064	12,625	16,384	18,825
Total Interest Income	693,060	804,023	939,192	1,113,835
Interest expense	361,667	399,483	454,882	535,151
NII	331,392	404,540	484,310	578,684
Growth (%)	20.1	22.1	19.7	19.5
Treasury Income	11,394	11,500	9,500	11,000
NTNII	111,571	134,828	158,778	182,519
Non Interest Income	122,965	146,328	168,278	193,519
Total Income	816,025	950,352	1,107,470	1,307,354
Growth (%)	15.0	16.5	16.5	18.0
Operating Expense	197,033	227,133	267,349	315,809
Operating Profit	257,324	323,736	385,239	456,394
Growth (%)	20.5	25.8	19.0	18.5
NPA Provisions	31,453	49,246	45,567	47,381
Investment Provisions	(76)	115	103	93
Total Provisions	35,933	57,334	52,981	56,605
PBT	221,391	266,401	332,259	399,790
Tax Provisions	75,894	91,643	116,293	137,531
Effective Tax Rate (%)	34.3	34.4	35.0	34.4
PAT	145,496	174,758	215,966	262,259
Growth (%)	18.3	20.1	23.6	21.4

Balance Sheet (Rs m)

Y/e March	2017	2018E	2019E	2020E
Par Value	2	2	2	2
No. of equity shares	2,563	2,591	2,591	2,591
Equity	5,125	5,182	5,182	5,182
Networth	894,624	1,057,296	1,232,690	1,445,015
Adj. Networth	876,184	1,029,768	1,210,426	1,421,368
Deposits	6,436,397	7,337,492	8,621,553	10,345,864
Growth (%)	17.8	14.0	17.5	20.0
Low Cost deposits	3,091,525	3,272,521	4,103,859	4,862,556
% of total deposits	48.0	44.6	47.6	47.0
Total Liabilities	8,638,402	9,973,989	11,641,353	13,826,777
Net Advances	5,545,682	6,765,732	8,423,336	10,529,170
Growth (%)	19.4	22.0	24.5	25.0
Investments	2,144,633	2,208,759	2,112,101	2,036,976
Total Assets	8,638,402	9,973,989	11,641,353	13,826,777

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Interest Income	181,144	186,687	196,703	205,813
Interest Expense	90,593	92,980	99,182	102,669
Net Interest Income	90,551	93,707	97,521	103,143
Non Interest Income	34,463	35,167	36,059	38,692
CEB	25,230	25,781	26,140	28,721
Treasury	1,804	3,314	3,559	2,594
Net Total Income	125,014	128,874	133,580	141,835
Operating Expenses	52,220	53,675	55,401	57,322
Employee Expenses	15,527	16,575	17,158	16,913
Other Expenses	36,693	37,100	38,243	40,410
Operating Profit	72,794	75,199	78,179	84,513
Core Operating Profit	70,990	71,885	74,620	81,919
Provisions	12,618	15,588	14,762	13,514
Loan loss provisions	9,779	13,432	10,788	11,487
Investment Depreciation	—	—	—	—
Profit before tax	60,176	59,612	63,417	70,999
Tax	20,275	20,673	21,907	24,573
PAT before EO	39,901	38,938	41,510	46,426
Extraordinary item	—	—	—	—
PAT	39,901	38,938	41,510	46,426

Key Ratios

Y/e March	2017	2018E	2019E	2020E
CMP (Rs)	1,951	1,951	1,951	1,951
Equity Shrs. Os. (m)	2,563	2,591	2,591	2,591
Market Cap (Rs m)	5,000,039	5,055,648	5,055,648	5,055,648
M/Cap to AUM (%)	57.9	50.7	43.4	36.6
EPS (Rs)	57.2	67.8	83.4	101.2
Book Value (Rs)	349	408	476	558
Adj. BV (100%) (Rs)	329	385	455	537
P/E (x)	34.1	28.8	23.4	19.3
P/BV (x)	5.6	4.8	4.1	3.5
P/ABV (x)	5.9	5.1	4.3	3.6
DPS (Rs)	—	10.9	13.0	16.0
Dividend Yield (%)	—	0.6	0.7	0.8

Profitability (%)

Y/e March	2017	2018E	2019E	2020E
NIM	4.1	4.3	4.5	4.5
RoAA	1.8	1.9	2.0	2.1
RoAE	17.9	17.9	18.9	19.6

Efficiency

Y/e March	2017	2018E	2019E	2020E
Cost-Income Ratio (%)	43.4	41.2	41.0	40.9
C-D Ratio (%)	86.2	92.2	97.7	101.8
Business per Emp. (Rs m)	140	149	164	183
Profit per Emp. (Rs lacs)	16.9	18.5	20.8	23.0
Business per Branch (Rs m)	785	841	923	1,028
Profit per Branch (Rs m)	10	10	12	13

Asset Quality

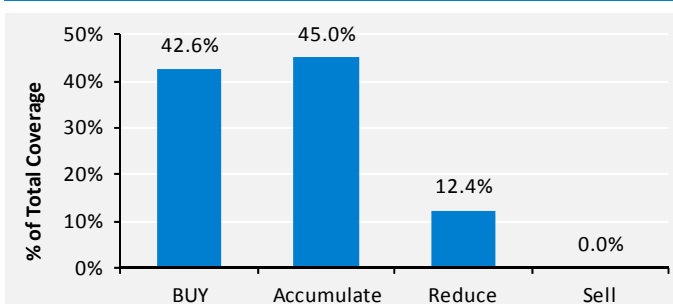
Y/e March	2017	2018E	2019E	2020E
Gross NPAs (Rs m)	58,857	84,857	79,297	85,286
Net NPAs (Rs m)	18,440	27,528	22,264	23,647
Gr. NPAs to Gross Adv. (%)	1.1	1.3	0.9	0.8
Net NPAs to Net Adv. (%)	0.3	0.4	0.3	0.2
NPA Coverage (%)	68.7	67.6	71.9	72.3

Source: Company Data, PL Research.

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Rating Distribution of Research Coverage

PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months
Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months
Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month
Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock
Under Review (UR)	: Rating likely to change shortly

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