

HDFC Bank | BUY

Soft at the 'margin', strong at the 'core'

HDFCB reported a net profit of INR 46.0bn in 1QFY19 (+18.2% YoY), 2.2% below our estimates. Core PPOP growth was strong at +24% YoY. Profit miss was largely led by softer than expected NII growth (+15.4% YoY). The topline moderated as margins contracted 10bps QoQ led by faster growth in term deposits (+25% YoY), lower yields on investments and higher growth in low yielding corporate and home loan segments. HDFCB's bottomline was also impacted by MTM provisions on the AFS investment book (INR 3.9bn, 4.4% of core PPOP), which was fully recognised in the quarter. Slippage was slightly elevated for the quarter at INR 35.5 bn (2.1% annualised), primarily due to pressure on the agri loan book (~20% of slippages). Loan growth was strong at 22% YoY, led by retail loans (+26% YoY). Retail loan book witnessed secular loan growth across personal loans (+40% YoY), credit cards (+33% YoY) and business banking (+24% YoY). We continue to like HDFCB for its top-notch asset quality, robust retail franchise, strong balance sheet growth and best-in-class management pedigree. Maintain BUY with unchanged TP.

- Margin contracts, capital raise to help :** HDFCB's NIM contracted 10bps sequentially to 4.2% in 1QFY19. This was on account of a) faster growth in relatively costlier time deposits (25% YoY) vs SA deposits (+17% YoY) b) reduction in yields on the investment book, as the investment book moved to lower modified duration of 1.6 years c) higher slippages on the agri book leading to reversals (~20% of overall slippage of INR 35.5bn) and d) higher growth on low yielding home loan book (+21% QoQ) as Bank re-initiated mortgage purchases from its parent after 4 quarters, covering up for the backlog. We believe the upcoming capital raise of INR 240bn should help HDFCB expand its margins. Our estimates factor in NIM of 4.3%/4.4% over FY19E/FY20E.
- Agri book leads to slight elevation in slippages:** Slippages for the quarter were slightly elevated at INR 35.5bn (2.1% annualised) with specific credit cost at 0.9% annualised (vs 0.75% in 4QFY18). Management indicated that there were no lumpy slippages for the quarter. Slippages from the agri segment were the main culprit, as ex-agri slippages for the quarter was at 1.7%. We note that NPLs on the agri loan book have moved up to ~6.2% (vs 5.3% in 1QFY18). However, management remains committed to growing this loan book (up 20% YoY in 1QFY19) despite the associated elevated credit costs, in order to avoid the negative carry from RIDF bonds / PSLCs. PCR was stable at ~70% and HDFCB holds INR 14.5bn of floating provisions over and above this. Management indicated that there was no immediate cause for concern on its business banking loan book, and continues to see healthy asset quality on this front (especially on LAP).
- Capital raise on track; Retain BUY:** As retail growth (especially mortgage) was strong during the quarter, RWA growth was 6% QoQ (vs loan growth of c.8% QoQ) and the bank's CET1 ratio stood at 12.1%. HDFC Bank's INR155bn capital raise (ex-preferential allotment of INR 85bn to HDFC Ltd.) remains on track. With substantial branch expansion in semi-urban and tier-2 markets in past 3 yrs, HDFCB is likely to continue gaining market share, deliver strong return ratios and maintain superior profitability versus peers. HDFCB remains a preferred pick, retain BUY with unchanged TP.



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	2,500
Upside/(Downside)	14.2%
Previous Price Target	2,500
Change	0.0%

Key Data – HDFCB IN

Current Market Price	INR2,189
Market cap (bn)	INR5,700.6/US\$82.8
Free Float	80%
Shares in issue (mn)	2,562.5
Diluted share (mn)	
3-mon avg daily val (mn)	INR5,630.0/US\$81.8
52-week range	2,220/1,685
Sensex/Nifty	36,496/11,010
INR/US\$	68.9

Price Performance

%	1M	6M	12M
Absolute	5.1	11.5	28.5
Relative*	2.8	10.4	12.8

* To the BSE Sensex

Financial Summary

	(INR mn)				
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Profit	1,22,962	1,45,497	1,74,867	2,14,583	2,66,411
Net Profit (YoY) (%)	20.4%	18.3%	20.2%	22.7%	24.2%
Assets (YoY) (%)	20.0%	21.9%	23.2%	18.2%	18.9%
ROA (%)	1.9%	1.9%	1.8%	1.8%	1.9%
ROE (%)	18.3%	17.9%	17.9%	17.0%	17.0%
EPS	48.6	56.8	67.4	78.9	97.9
EPS (YoY) (%)	19.3%	16.7%	18.7%	17.0%	24.2%
PE (x)	45.0	38.6	32.5	27.8	22.4
BV	287	349	410	539	615
BV (YoY) (%)	16.2%	21.4%	17.3%	31.6%	14.0%
P/BV (x)	7.61	6.27	5.34	4.06	3.56

Source: Company data, JM Financial. Note: Valuations as of 20/Jul/2018

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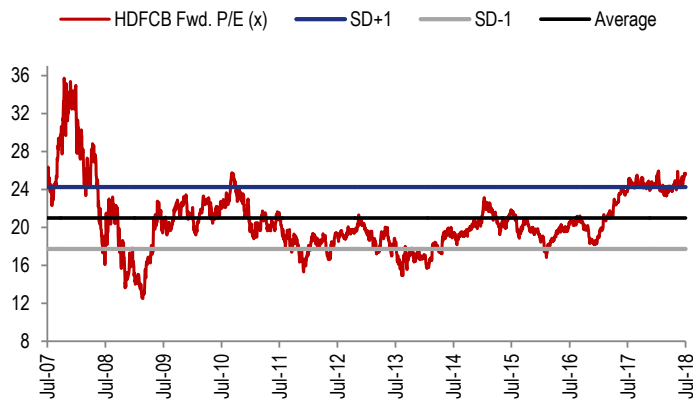
JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Key trends for 1QFY19

Exhibit 1. HDFC Bank: Result Summary 1Q19

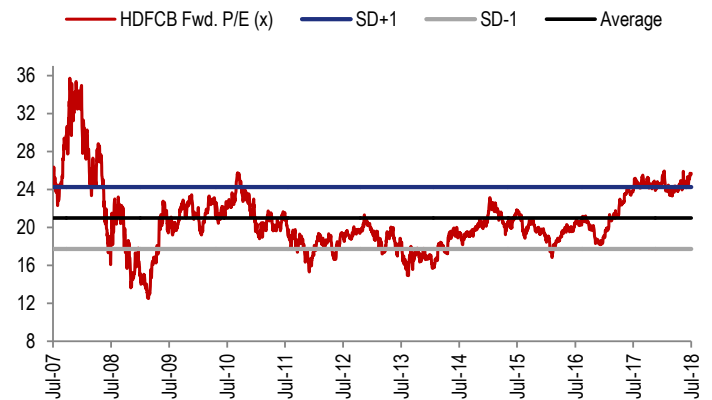
Earnings Table (Rs. mn.)	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
NII	93,707	1,06,577	1,08,136	15.4%	1.5%
Fee based Income	25,781	33,297	31,710	23.0%	-4.8%
Forex Income	2,968	4,164	4,996	68.3%	20.0%
Trading Profits	3,314	-220	-2,832	-185.5%	1187.3%
Other Misc Income	3,104	5,045	4,307	38.8%	-14.6%
Non-Interest income	35,167	42,286	38,181	8.6%	-9.7%
Total Income	1,28,874	1,48,863	1,46,316	13.5%	-1.7%
Employee Cost	16,575	17,412	18,105	9.2%	4.0%
Other Operating Expenses	37,100	43,094	41,734	12.5%	-3.2%
Total Operating Expenses	53,675	60,506	59,839	11.5%	-1.1%
Operating Profit	75,199	88,357	86,478	15.0%	-2.1%
Loan Loss Provisions	13,432	11,320	14,322	6.6%	26.5%
Total Provisions	15,588	15,411	16,294	4.5%	5.7%
PBT	59,612	72,946	70,184	17.7%	-3.8%
Tax	20,673	24,953	24,169	16.9%	-3.1%
Reported Profit	38,938	47,993	46,014	18.2%	-4.1%
Balance sheet (Rs. bn.)					
Deposits	6,714	7,877	8,058	20.0%	2.3%
Net Advances	5,810	6,583	7,086	22.0%	7.6%
Total Assets	8,957	10,639	10,804	20.6%	1.5%
Low-cost Deposits (%)	44.0%	43.6%	41.7%	-2.3%	-1.9%
Loan-Deposit ratio (%)	86.5%	83.6%	87.9%	1.4%	4.4%
Key Ratios					
Credit Quality					
Gross NPAs (Rs. mn.)	72,429	86,070	95,386	31.7%	10.8%
Net NPAs (Rs. mn.)	25,282	26,010	29,071	15.0%	11.8%
Gross NPA (%)	1.2%	1.30%	1.33%	0.10%	0.04%
Net NPA (%)	0.4%	0.40%	0.41%	-0.02%	0.02%
Loan Loss Provisions (%)	1.1%	0.85%	1.00%	-0.11%	0.15%
Coverage Ratio (%)	65.1%	69.8%	69.5%	4.4%	-0.3%
Capital Adequacy					
Tier I (%)	13.6%	13.20%	13.10%	-0.5%	-0.1%
CAR (%)	15.6%	14.80%	14.60%	-1.0%	-0.2%
Du-pont Analysis					
NII / Assets (%)	4.3%	4.24%	4.03%	-0.23%	-0.20%
Non-Interest Inc. / Assets (%)	1.6%	1.68%	1.42%	-0.17%	-0.26%
Operating Cost / Assets (%)	2.4%	2.40%	2.23%	-0.21%	-0.17%
Operating Profits / Assets (%)	3.4%	3.51%	3.23%	-0.19%	-0.29%
Provisions / Assets (%)	0.7%	0.61%	0.61%	-0.10%	0.00%
ROA (%)	1.8%	1.91%	1.72%	-0.05%	-0.19%

Exhibit 2. HDFC Bank: One year forward P/BV (x)



Source: Company, JM Financial

Exhibit 3. HDFC Bank: One year forward P/E (x)



Source: Company, JM Financial

Valuations

We value HDFC Bank using 2-stage Gordon Growth model. Our assumptions and target price are given below.

Exhibit 4. HDFC Bank: Valuation Summary

Initial no of years	10
Growth rate for the first 10 years (%)	18%
Payout ratio for the first 10 years (%)	15%
Perpetual growth rate (%)	4%
Perpetual payout ratio (%)	80%
K1	1.84
K2	16.4x
Fully adjusted FY20E BVPS (Rs)	614
Target P/BV (x)	3.8x
Fair value (rounded off)	2,358

Source: Company, JM Financial

We value HDFCB using SOTP method after building a capital raise at INR 1900/sh in the standalone bank and valuing two of its major subsidiaries at INR 141/share.

Exhibit 5. SOTP

HDFC Bank SOTP	Holding (%)	Valuation Methodology	Value per Share	Contribution to TP (%)
HDFC Bank - Parent	100.0%	3.8x fwd FY20E BV	2,358	94%
HDB Financial Services	95.9%	3.3x FY20E BV	106	4%
HDFC Securities	97.9%	25x FY20 EPS	50	2%
Less: Cost of investments			-15	-1%
Total (Rs.)			2,500	100%

Source: Company, JM Financial

Key quarterly trends

Exhibit 6. HDFC Bank : Gross loan mix (as per internal classification)

Gross Loan Mix (Rs bn) - as per internal classification	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
Domestic Retail	3,841	4,584	4,800	25.0%	4.7%
Wholesale and overseas	2,016	2,059	2,353	16.7%	14.3%
Total Loans (Gross)	5,857	6,643	7,153	22.1%	7.7%
Domestic Retail	65.6%	69.0%	67.1%	1.5%	-1.9%
Wholesale and overseas	34.4%	31.0%	32.9%	-0.9%	2.1%
Total Loans (Gross)	100%	100%	100%		

Source: Company, JM Financial

Exhibit 7. HDFC Bank: Domestic retail loan mix (as per internal classification)

Domestic Retail Loans Mix (Rs bn) - As per internal classification	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
Car Loans	737	860	883	19.8%	2.7%
2 wheeler loans	77	96	103	33.7%	7.0%
CTG loans (CV+CE)	385	459	472	22.7%	2.7%
Sub-total - Auto Loans	1,199	1,416	1,458	21.6%	3.0%
Personal loans	561	724	785	40.1%	8.4%
Credit Cards	291	361	388	33.3%	7.4%
Business Banking	881	1,095	1,096	24.4%	0.0%
LAS	30	39	36	20.2%	-8.1%
Home Loans	388	363	440	13.5%	21.4%
Gold Loans	51	54	55	7.8%	2.4%
Kisan Gold Card	281	355	338	20.1%	-4.8%
Other Retail	159	178	204	28.0%	14.5%
Domestic Retail loans	3,841	4,584	4,800	25.0%	4.7%
Car Loans	19.2%	18.8%	18.4%	-0.8%	-0.4%
2 wheeler loans	2.0%	2.1%	2.2%	0.1%	0.0%
CTG loans (CV+CE)	10.0%	10.0%	9.8%	-0.2%	-0.2%
Sub-total - Auto Loans	31.2%	30.9%	30.4%	-0.8%	-0.5%
Personal loans	14.6%	15.8%	16.4%	1.8%	0.6%
Credit Cards	7.6%	7.9%	8.1%	0.5%	0.2%
Business Banking	22.9%	23.9%	22.8%	-0.1%	-1.1%
LAS	0.8%	0.8%	0.7%	0.0%	-0.1%
Home Loans	10.1%	7.9%	9.2%	-0.9%	1.3%
Gold Loans	1.3%	1.2%	1.2%	-0.2%	0.0%
Kisan Gold Card	7.3%	7.7%	7.0%	-0.3%	-0.7%
Other Retail	4.1%	3.9%	4.2%	0.1%	0.4%
Domestic Retail loans	100%	100%	100%		

Source: Company, JM Financial

Exhibit 8. HDFC Bank: Domestic retail loan mix (as per RBI classification)

Retail Loans Mix (Rs bn) - As per basel 2	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
Car Loans	660	764	777	17.6%	1.6%
2 wheeler loans	65	87	92	41.3%	6.4%
CTG loans (CV+CE)	197	234	249	26.1%	6.2%
Sub-total - Auto Loans	922	1,085	1,117	21.1%	3.0%
Personal loans	555	719	779	40.2%	8.3%
Credit Cards	291	361	385	32.2%	6.5%
Business Banking	404	541	521	28.7%	-3.8%
LAS	14	18	17	20.8%	-3.7%
Home Loans	388	363	440	13.5%	21.4%
Gold Loans	50	51	51	2.6%	1.0%
Kisan Gold Card	277	347	331	19.7%	-4.4%
Other Retail	126	141	163	29.7%	16.0%
Retail Loans Total	3,028	3,625	3,805	25.6%	5.0%
Car Loans	21.8%	21.1%	20.4%	-1.4%	-0.7%
2 wheeler loans	2.2%	2.4%	2.4%	0.3%	0.0%
CTG loans (CV+CE)	6.5%	6.5%	6.5%	0.0%	0.1%
Sub-total - Auto Loans	30.5%	29.9%	29.4%	-1.1%	-0.6%
Personal loans	18.3%	19.8%	20.5%	2.1%	0.6%
Credit Cards	9.6%	10.0%	10.1%	0.5%	0.1%
Business Banking	13.4%	14.9%	13.7%	0.3%	-1.3%
LAS	0.5%	0.5%	0.5%	0.0%	0.0%
Home Loans	12.8%	10.0%	11.6%	-1.2%	1.6%
Gold Loans	1.6%	1.4%	1.3%	-0.3%	-0.1%
Kisan Gold Card	9.1%	9.6%	8.7%	-0.4%	-0.9%
Other Retail	4.2%	3.9%	4.3%	0.1%	0.4%
Retail Loans Total	100%	100%	100%		

Source: Company, JM Financial

Exhibit 9. HDFC Bank: Fee income split

Fee Income Composition (Rs mn)	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
Fees and commissions	25,781	33,297	31,710	23.0%	-4.8%
Forex and derivatives	2,968	4,164	4,996	68.3%	20.0%
Trading gains/losses	3,314	-220	-2,832	-185.5%	1187.3%
Miscellaneous inc	3,104	5,045	4,307	38.8%	-14.6%
Total	35,167	42,286	38,181	8.6%	-9.7%
Fees and commissions	73.3%	78.7%	83.1%	9.7%	4.3%
Forex and derivatives	8.4%	9.8%	13.1%	4.6%	3.2%
Trading gains/losses	9.4%	-0.5%	-7.4%	-16.8%	-6.9%
Miscellaneous inc	8.8%	11.9%	11.3%	2.5%	-0.7%
Total	100.0%	100.0%	100.0%		

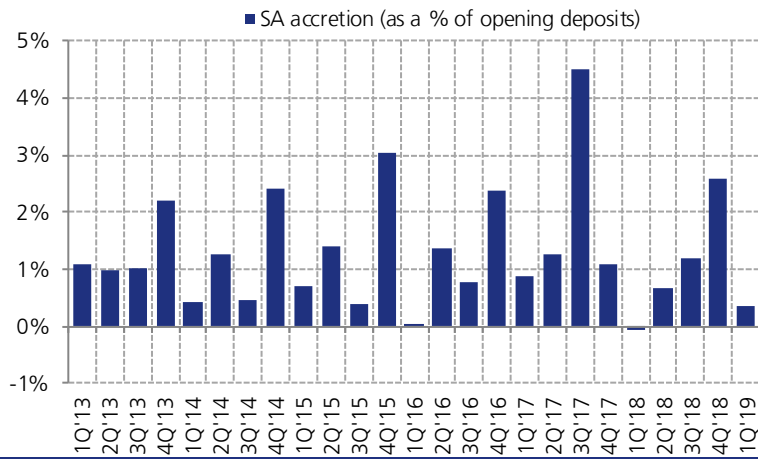
Source: Company, JM Financial

Exhibit 10. HDFC Bank: Deposit composition

Deposits Composition (Rs bn)	1Q18	4Q18	1Q19	YoY (%)	QoQ (%)
Current	1,020	1,193	1,093	7.1%	-8.4%
Saving	1,931	2,238	2,267	17.4%	1.3%
Time	3,762	4,446	4,698	24.9%	5.7%
Total Deposits	6,714	7,877	8,058	20.0%	2.3%
Current	15.2%	15.1%	13.6%	-1.6%	-1.6%
Saving	28.8%	28.4%	28.1%	-0.6%	-0.3%
CASA	44.0%	43.6%	41.7%	-2.3%	-1.9%
Time	56.0%	56.4%	58.3%	2.3%	1.9%
Total	100%	100%	100%		

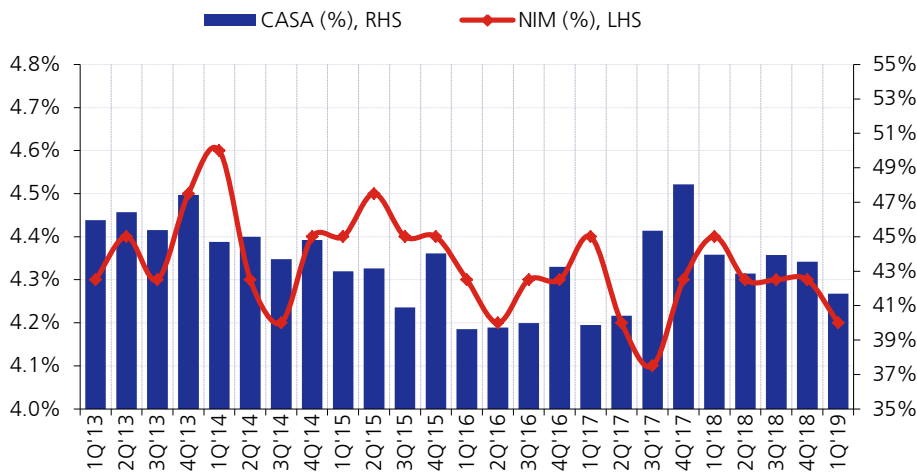
Source: Company, JM Financial

Exhibit 11. HDFC Bank: SA accretion (%)



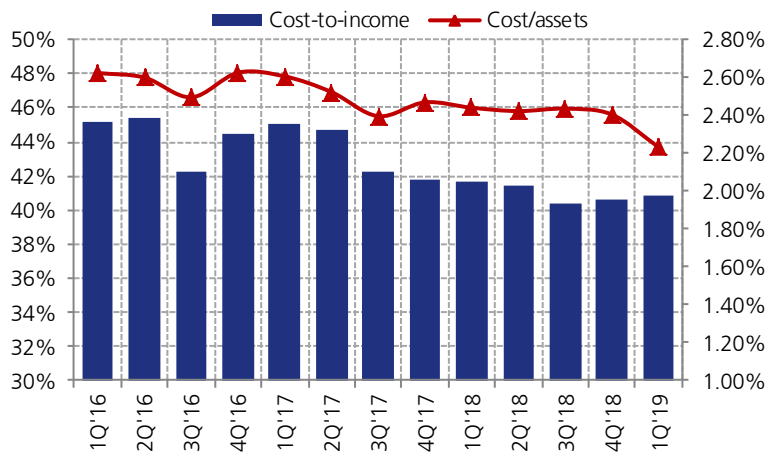
Source: Company, JM Financial

Exhibit 12. HDFC Bank: Trends for CASA and NIM



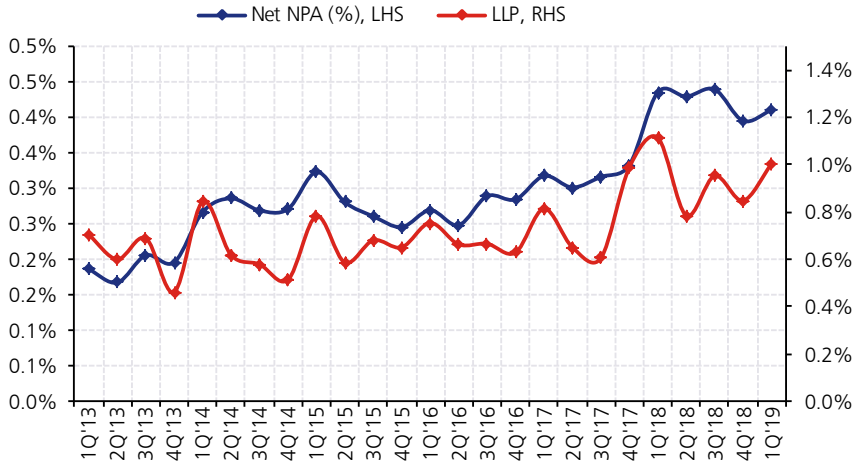
Source: Company, JM Financial

Exhibit 13. HDFC Bank: Trends in cost ratios



Source: Company, JM Financial

Exhibit 14. HDFC Bank: Net NPA and LLP trends



Source: Company, JM Financial

Financial Tables (Standalone)

Profit & Loss						(INR bn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E	
Net Interest Income	276	331	401	479	576	
Profit on Investments	7	11	9	8	9	
Exchange Income	12	13	15	18	21	
Fee & Other Income	88	99	128	147	173	
Non-Interest Income	108	123	152	173	203	
Total Income	383	454	553	652	778	
Operating Expenses	170	197	227	263	302	
Pre-provisioning Profits	214	257	326	389	477	
Loan-Loss Provisions	26	35	55	57	66	
Provisions on Investments	0	0	0	0	0	
Others Provisions	1	1	4	5	5	
Total Provisions	27	36	59	62	71	
PBT	186	221	267	327	405	
Tax	63	76	92	112	139	
PAT (Pre-Extraordinaries)	123	145	175	215	266	
Extra ordinaries (Net of Tax)	0	0	0	0	0	
Reported Profits	123	145	175	215	266	
Dividend paid	29	34	41	51	60	
Retained Profits	94	112	134	164	206	

Source: Company, JM Financial

Key Ratios					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Growth (YoY) (%)					
Deposits	21.2%	17.8%	22.5%	21.0%	21.0%
Advances	27.1%	19.4%	18.7%	23.0%	23.0%
Total Assets	20.0%	21.9%	23.2%	18.2%	18.9%
NII	23.2%	20.1%	21.0%	19.4%	20.2%
Non-interest Income	19.5%	14.4%	23.8%	13.5%	17.3%
Operating Expenses	21.4%	16.0%	15.2%	15.8%	14.8%
Operating Profits	22.7%	20.4%	26.8%	19.2%	22.6%
Core Operating profit	22.6%	19.2%	28.9%	20.1%	22.9%
Provisions	31.4%	31.8%	65.0%	5.0%	14.2%
Reported PAT	20.4%	18.3%	20.2%	22.7%	24.2%
Yields / Margins (%)					
Interest Spread	3.68%	3.68%	3.73%	3.81%	3.88%
NIM	4.42%	4.39%	4.33%	4.32%	4.38%
Profitability (%)					
Non-IR to Income	28.0%	27.1%	27.5%	26.5%	26.0%
Cost to Income	44.3%	43.4%	41.0%	40.3%	38.8%
ROA	1.89%	1.85%	1.81%	1.85%	1.94%
ROE	18.3%	17.9%	17.9%	17.0%	17.0%
Assets Quality (%)					
Slippages	1.57%	1.54%	2.34%	1.75%	1.60%
Gross NPA	0.94%	1.05%	1.30%	1.23%	1.21%
Net NPAs	0.28%	0.33%	0.40%	0.37%	0.36%
Provision Coverage	69.9%	68.7%	69.8%	70.0%	70.0%
Specific LLP	0.51%	0.62%	0.81%	0.69%	0.64%
Net NPAs / Networth	1.8%	2.1%	2.4%	2.0%	2.2%
Capital Adequacy (%)					
Tier I	13.22%	12.79%	13.25%	16.11%	15.38%
CAR	15.53%	14.55%	14.82%	17.32%	16.49%

Source: Company, JM Financial

Balance Sheet						(INR bn)
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E	
Equity Capital	5	5	5	5	5	
Reserves & Surplus	722	889	1,058	1,461	1,667	
Deposits	5,464	6,436	7,888	9,544	11,548	
Borrowings	530	740	1,231	1,178	1,303	
Other Liabilities	367	567	458	389	428	
Total Liabilities	7,088	8,638	10,639	12,578	14,952	
Investments	1,639	2,145	2,422	2,976	3,443	
Net Advances	4,646	5,546	6,583	8,097	9,960	
Cash & Equivalents	526	608	1,229	885	924	
Fixed Assets	33	36	36	39	42	
Other Assets	244	303	369	581	584	
Total Assets	7,088	8,638	10,639	12,578	14,952	

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
NII / Assets	4.25%	4.21%	4.16%	4.13%	4.18%
Other Income / Assets	1.65%	1.56%	1.58%	1.49%	1.47%
Total Income / Assets	5.90%	5.78%	5.74%	5.61%	5.65%
Cost / Assets	2.61%	2.51%	2.35%	2.26%	2.19%
PBP / Assets	3.29%	3.27%	3.38%	3.35%	3.46%
Provisions / Assets	0.42%	0.46%	0.61%	0.54%	0.52%
PBT / Assets	2.87%	2.82%	2.77%	2.81%	2.95%
Tax rate	34.0%	34.3%	34.5%	34.3%	34.3%
ROA	1.89%	1.85%	1.81%	1.85%	1.94%
RoRWAs	2.58%	2.49%	2.43%	2.46%	2.57%
Leverage	9.8	9.7	10.0	8.6	8.9
ROE	18.3%	17.9%	17.9%	17.0%	17.0%

Source: Company, JM Financial

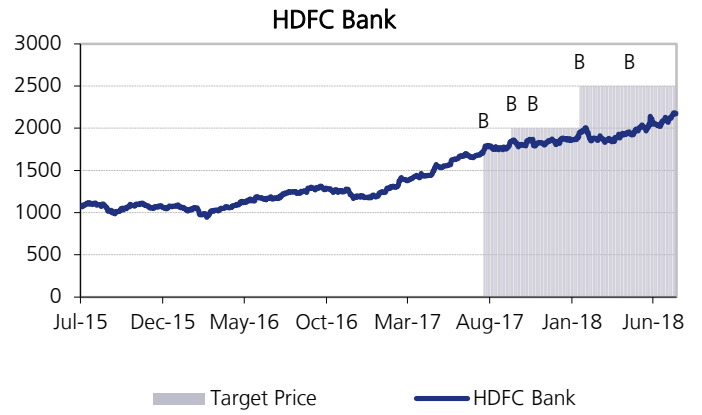
Valuations					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Shares in Issue	2,528.2	2,562.5	2,595.1	2,721.3	2,721.3
EPS (INR)	48.6	56.8	67.4	78.9	97.9
EPS (YoY) (%)	19.3%	16.7%	18.7%	17.0%	24.2%
PER (x)	45.0	38.6	32.5	27.8	22.4
BV (INR)	287	349	410	539	615
BV (YoY) (%)	16.2%	21.4%	17.3%	31.6%	14.0%
ABV (INR)	287	349	410	539	615
ABV (YoY) (%)	15.9%	21.3%	17.4%	31.6%	14.0%
P/BV (x)	7.61	6.27	5.34	4.06	3.56
P/ABV (x)	7.62	6.28	5.35	4.06	3.56
DPS (INR)	11.5	13.2	15.7	18.7	22.2
Div. yield (%)	0.5%	0.6%	0.7%	0.9%	1.0%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
24-Jul-17	Buy	1,800	
14-Sep-17	Buy	2,000	11.1
24-Oct-17	Buy	2,000	0.0
19-Jan-18	Buy	2,500	25.0
22-Apr-18	Buy	2,500	0.0

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited
(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081

Member of BSE Ltd., National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst – INH000000610

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Definition of ratings	
Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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