

Results in line, Caution on agricultural book

HDFC bank reported a steady profit growth of 20% YoY aided by a NII growth of 22% YoY on stable NIMs, a robust core fees (27% YoY) coupled with the support of investment gains and improving costs (C/I lower by ~200 bps). The only variation was the higher credit costs at 19 bps of assets, of which 3 bps is contingency provisions on the agricultural portfolio in anticipation of likely political stress. The asset quality worsened, with GNPA increasing 5 bps to 1.38%. Fresh slippages were 0.34% of total assets at ₹ 400bn, higher by 22% sequentially.

22% QoQ growth in slippages, expect upside risk in asset quality

GNPA rose 5 bps QoQ to 1.38%, in large part driven by the agriculture book. GNPA in non-agricultural portfolio has remained stable at 1.1%. The agricultural book contributed a larger share in fresh slippages, apart from provisions. Our back of the envelope assessment estimates ~45% of fresh slippages from this book. The increase in perception of political risk, book seasoning, coupled with a higher share of unsecured book are factors likely to contribute higher NPA at 1.4% in FY19 and 1.5% in FY20. The farm packages are likely to drive some consumption demand, but this is likely to be offset by a higher risk aversion.

NIMs to navigate increase in unsecured loans and expensive TD

NIMs remained stable at 4.3%, as the 30 bps increase in funding costs, caused by higher share of term deposit) was offset by an improved yield. Advances in the quarter grew 24% YoY, led by a strong traction in 2W, housing, personal, and credit cards but some pullback in agricultural and commodity business. We expect growth to be driven by unsecured loans, skewed towards urban and semi urban, as end user demand in vehicles is likely to remain tepid and caution in the rural portfolio.

Rollover to FY21, Accumulate at 3.3x FY21E P/ABV

We maintain our estimates, on rollover. We have factored an advance and PAT CAGR of 25% and 20% over FY19-20E and improving RoA at 1.9% Valuing the bank at 3.3x FY21E P/ABV, Accumulate.

Q3FY19 Result (₹ Mn)

Particulars	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Interest earned	258,903	205,813	25.8	241,996	7.0
Interest expended	133,135	102,669	29.7	124,362	7.1
Net interest income	125,768	103,143	21.9	117,634	6.9
Other income	49,210	38,692	27.2	40,156	22.5
Total Net Income	174,978	141,835	23.4	157,790	10.9
Operating expenses	67,193	57,322	17.2	62,991	6.7
Pre-provision profits	107,784	84,513	27.5	94,800	13.7
Provisions	22,115	13,514	63.6	18,200	21.5
Tax expense	29,810	24,573	21.3	26,543	12.3
Extraordinary gains					
Reported Net Profit	55,859	46,426	20.3	50,057	11.6
			(bps)		(bps)
Advances	(21.7)	27.5	(4918)	24.1	(4580)
NIM (%)	4.3	4.3	0	4.3	0
RoA	1.8	2.0	(16)	1.8	0
RoE	15.9	18.9	(290)	16.4	(40)
Gross NPA (%)	1.4	1.3	9	1.3	5

CMP	₹ 2,130
Target / Upside	₹ 2,450 / 15%
BSE Sensex	36,387
NSE Nifty	10,907

Script Details

Equity / FV	₹ 5,434mn / ₹ 2
Market Cap	₹ 5,793bn
	US\$ 81bn
52-week High/Low	₹ 2,220/₹ 1,829
Avg. Volume (no)	2,903,710
NSE Symbol	HDFCBANK
Bloomberg Code	HDFCB IN

Shareholding Pattern Dec'18(%)

Promoters	26.6
MF/Banks/FIs	15.4
FII	39.2
Public / Others	18.9

Valuation (x)

	FY19E	FY20E	FY21E
P/E	27.9	23.4	19.1
P/ABV	4.0	3.5	3.0
ROAA	1.8	1.9	1.9
ROAE	16.4	15.8	16.8

Estimates (₹ mn)

	FY19E	FY20E	FY21E
NII	489,440	591,020	713,262
PPOP	394,525	455,769	537,795
PAT	207,784	247,419	303,340
Adj BV	530.8	605.7	699.2

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Con call highlights:

▪ Asset Quality

- Gross slippages of ` 40bn
- GNPA at 1.38% vs 1.33% QoQ vs non Agri GNPA at 1.1% across 2QFY19 and 3Q18
- Bank has taken conservative contingent of ₹ 3.35 bn primarily against its agricultural book in anticipation of political risks.
- A spike in GNPA is expected, especially from 1QFY20 onwards, if not in March
- Provisions Coverage including specific, general and floating amounts to 115% of GNPA as on Dec 2018.
- Risky states are the specific states with upcoming elections, general election and elections facing natural calamities i.e Maharashtra, Kerala among others
- Excluding Agriculture, provisions and NPAs have remained stables
- Currently the management has no specific policy on write-off, given the never-ending cycle of waivers, it may have one in the future.

▪ Advances outlook

- No material changes in outlook, currently stable.
- Vehicles
 - May witness slowdown 2W and 4W. Sales in the segment have come off and have witnessed a relatively tepid growth. Expect a lower growth traction on account of demand slowdown alone, not in terms of market share capture
 - Expect 2W to pick up eventually
- LAP
 - The bank's portfolio is stable and better in comparisons to its quality in the past
 - Have seen some correction in pricing which had been below acceptable threshold.
- Business banking
 - Small ticket (emerging enterprising) is granular and stable from business and credit perspective.
 - No portfolio buyouts (except home loans of ₹ 650 bn)
- Not keen on growing agriculture commodity as they had concerns in NPL around December last year coupled with higher commodity price risk
- Agricultural book:
 - Direct lending only, portfolio level is healthy, rates commensurate. Yield at 10-12%
 - The yield, product offering and sometimes even the range of customer segment between PSU and PVB are varied.
 - The bank reviews its product programs frequently
- NBFC: Fresh exposure cautious but open, rely on business model, portfolio and parentage

- **Core fee driver are:**
 - Payment business volume
 - Better spread in acquiring business; Acquisition of debit cards have increased, plus a better spread (on account of regulatory caps around demonetization) have reduced per unit losses.
 - Higher issuance and acquiring business volumes have lowered net losses.
 - Debit Card fees is 7% and credit card fees is 25% of core fees.
- **Deposit**
 - Increased focus on granular term deposits since Jan 2018; and have raised retail rates to make them attractive even in 1-2-year bucket.
 - Dedicated frontline staff for retail Term deposit and have witnessed high deposit growth in term since January 2018.
 - If margin is stable, happy with lower CASA.
 - Continue to maintain to have a policy to be more liquid.
- **Gross debits:**
 - Off the components in gross credits; the debits to EMI, debits moving to TD and in house distribution are the drivers of debits. It believes it is healthy amore so because the debits are on account of transfer to term deposits.
 - Concern is when debits are moving to other banks, which is not material
- **HDB financials:**
 - Margin reduced from 7.2% to 6.7%
 - Growth in AUM is 26% YoY to ₹ 500 bn
 - NPL at 2.07% same as last December
- **IT spends: 3-4% opex of net revenue**
- **Branch expansion:**
 - 150-200 branches every year is the bank's appetite
 - Branch expansion is generally rear ended
 - Incrementally 50% is expected to be in semi urban and urban

Exhibit 1: Quarterly Performance

(₹ Mn)	Q3FY18	Q4FY18	1QFY19	2QFY19	3QFY19
Advances	7,508,381	7,508,381	7,508,381	7,508,381	7,809,512
YoY (%)	28.0	19.0	22.0	24.0	23.7
QoQ (%)	4.0	4.0	8.0	6.0	4.0
Deposits	6,990,264	7,887,706	8,057,853	8,333,641	8,525,019
YoY (%)	16.0	10.0	23.0	20.0	22.0
QoQ (%)	3.0	1.0	13.0	2.0	2.3
Advances Mix (%)					
Wholesale	46	45	46	55	55
Retail	54	55	54	45	45
Vehicles	30	30	29	29	29
Housing loans	11	10	12	12	12
Personal loans	20	20	20	21	21
Credit cards	10	10	10	10	11
LAS	0	1	0	0	0
Business banking	14	15	14	13	13
Kisan gold cards	9	10	9	9	8
Gold loans	1	1	1	1	1
Others	4	4	4	4	4
Deposits Mix (%)					
- Current deposits	14	15	14	14	13
- Saving deposits	29	28	28	28	28
- Term deposits	56	57	58	58	59
CASA growth YoY	7	11	14	18	13
Contribution ratios (Computed) (%)					
Yield on advances	10.5	10.3	10.2	10.3	10.6
Yields on interest earning assets	9.2	8.8	8.8	9.0	9.3
Yield on investments	6.9	7.1	7.1	7.0	7.3
Cost of deposits	5.2	5.0	5.1	5.2	5.5
NIMs	4.6	4.4	4.2	4.4	4.5
Asset quality and capital ratios (%)					
GNPA	1.3	1.3	1.3	1.3	1.4
NNPA	0.4	0.4	0.4	0.4	0.4
PCR	66.3	69.8	69.5	69.9	70.0
NNPA to NW	2.8	2.5	2.7	2.5	2.4
Tier 1	13.6	13.2	13.1	14.7	15.8
CAR	15.5	14.8	14.6	17.1	17.3
CASA	43.9	43.5	41.7	41.7	40.7
Credit - Deposit	90.3	83.5	87.9	90.1	91.6
Dupont as a percentage of average assets (%)					
Interest income	8.7	8.5	8.4	8.6	9.2
Interest expenses	4.4	4.2	4.4	4.4	4.5
Net interest income	4.4	4.2	4.0	4.2	4.7
Non-interest Income	1.6	1.7	1.4	1.4	1.6
Total expenses	2.4	2.4	2.2	2.2	2.7
- Cost to income	40.4	40.6	40.9	39.9	38.4
Provisions	0.6	0.6	0.6	0.6	0.8
Tax	1.0	1.0	0.9	0.9	0.9
RoA	2.0	1.9	1.7	1.8	1.9
Leverage	9.6	9.7	10.0	9.2	8.3
RoE	18.9	18.5	17.2	16.4	15.9

Source: DART, Company

Profit and Loss Account (₹ Mn)

Particulars	FY18A	FY19E	FY20E	FY21E
Interest Income	802,414	995,595	1,209,444	1,506,191
Interest expenses	401,465	506,155	618,423	792,929
Net interest income	400,949	489,440	591,020	713,262
Other incomes	152,203	174,460	190,604	202,190
Total expenses	226,904	269,375	325,856	377,658
- Employee cost	68,057	78,843	87,864	97,871
- Other	158,846	190,533	237,992	279,787
Pre provisioning profit	326,248	394,525	455,769	537,795
Provisions	59,275	79,701	80,892	78,188
Profit before taxes	266,973	314,824	374,877	459,607
Tax provision	92,106	107,040	127,458	156,266
Profit after tax	174,867	207,784	247,419	303,340
Adjusted profit	174,867	207,784	247,419	303,340

Balance Sheet (₹ Mn)

Particulars	FY18A	FY19E	FY20E	FY21E
Sources of Funds				
Equity Capital	5,190	5,434	5,434	5,434
Reserves & Surplus	1,057,760	1,459,902	1,665,992	1,928,004
Minority Interest	0	0	0	0
Net worth	1,062,950	1,465,337	1,671,427	1,933,438
Borrowings	1,231,050	1,292,602	1,938,903	3,490,026
- Deposits	7,887,706	9,107,276	10,477,669	12,089,058
- Other interest bearing liabilities	0	0	0	0
Current liabilities & provisions	457,637	354,647	437,195	498,573
Total Liabilities	10,639,343	12,219,862	14,525,193	18,011,095
Application of Funds				
Cash and balances with RBI	1,229,151	779,991	744,994	778,954
Investments	2,422,002	2,862,626	3,061,030	3,820,809
Advances	6,583,331	8,156,797	10,263,647	12,925,569
Fixed assets	36,072	39,029	44,276	50,280
Other current assets, loans and advances	368,787	381,419	411,246	435,483
Total Assets	10,639,343	12,219,862	14,525,193	18,011,095

E – Estimates

Important Ratios

Particulars	FY18A	FY19E	FY20E	FY21E
(A) Margins (%)				
Yield on advances	10.4	10.6	10.7	10.7
Yields on interest earning assets	8.7	9.1	9.4	9.5
Yield on investments	7.1	7.5	7.2	7.3
Costs of funds	4.9	5.2	5.4	5.7
Cost of deposits	4.6	4.9	5.2	5.3
NIMs	4.4	4.4	4.6	4.5
(B) Asset quality and capital ratios (%)				
GNPA	1.3	1.4	1.5	1.6
NNPA	0.4	0.4	0.4	0.4
PCR	69.8	70.0	75.0	75.0
Slippages	0.4	0.4	0.4	0.4
NNPA to NW	2.4	2.4	2.3	2.6
CASA	43.5	41.3	38.7	36.3
CAR	14.8	16.0	15.8	14.8
Tier 1	13.2	14.8	14.7	13.9
Credit - Deposit	83.5	89.6	98.0	106.9
(C) Dupont as a percentage of average assets				
Interest income	8.3	8.7	9.0	9.3
Interest expenses	4.2	4.4	4.6	4.9
Net interest income	4.2	4.3	4.4	4.4
Non interest Income	1.6	1.5	1.4	1.2
Total expenses	2.4	2.4	2.4	2.3
- cost to income	41.0	40.6	41.7	41.3
Provisions	0.6	0.7	0.6	0.5
Tax	1.0	0.9	1.0	1.0
RoA	1.8	1.8	1.9	1.9
Leverage	8.6	7.1	7.4	8.1
RoE	17.9	16.4	15.8	16.8
RoRwa	2.2	2.1	2.2	2.2
(D) Measures of Investments				
EPS - adjusted	67.4	76.5	91.1	111.6
BV	409.6	539.3	615.1	711.6
ABV	403.0	530.8	605.7	699.2
DPS	13.1	13.0	13.0	13.0
Dividend payout ratio	19.4	17.0	14.3	11.6
(E) Growth Ratios (%)				
Net interest income	21.0	22.1	20.8	20.7
PPoP	26.8	20.9	15.5	18.0
Adj PAT	20.2	18.8	19.1	22.6
Advances	18.7	23.9	25.8	25.9
Total borrowings	66.3	5.0	50.0	80.0
Total assets	23.2	14.9	18.9	24.0
(F) Valuation Ratios				
Market Cap (₹ mn)	5,793,215	5,793,215	5,793,215	5,793,215
CMP (₹)	2130	2130	2130	2130
P/E (x)	31.6	27.9	23.4	19.1
P/BV (x)	5.2	4.0	3.5	3.0
P/ABV (x)	5.3	4.0	3.5	3.0
Div Yield (%)	0.6	0.6	0.6	0.6

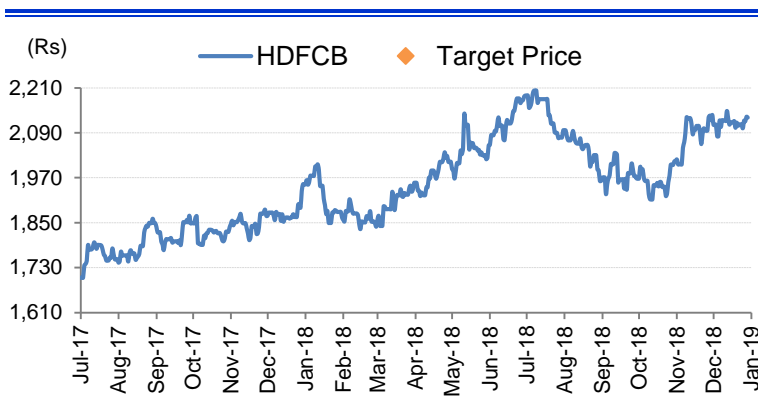
E – Estimates

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



Month	Rating	TP (₹)	Price (₹)
Oct-18	Buy	2,400	2,000
Dec-18	Accumulate	2,400	2,112

*Price as on recommendation date

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