

Sector: Banks & Finance  
Result Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 1,239</b>	
Price Target: <b>Rs. 1,510</b>	↔

↑ Upgrade ↔ No change ↓ Downgrade

## Company details

Market cap:	Rs. 6,77,636 cr
52-week high/low:	Rs. 1285/942
NSE volume: (No of shares)	43.9 lakh
BSE code:	500180
NSE code:	HDFCBANK
Sharekhan code:	HDFCBANK
Free float: (No of shares)	430.6 cr

## Shareholding (%)

Promoters	26.2
FII	37.6
DII	17.2
Others	19.0

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	12.4	2.1	8.1	25.5
Relative to Sensex	4.5	0.8	6.8	9.7

Sharekhan Research, Bloomberg

HDFC Bank clocked a strong earnings performance for Q2FY2020 with robust growth in profit after tax (PAT) helped by better efficiencies, fee income and a lower tax rate. Net interest income (NII), at Rs. 13,515 crore, rose 14.9% y-o-y, slower than our estimate of a 21% y-o-y growth. NIMs dipped marginally by 10 bps on account of a cautious loan book expansion and higher deposit accretion; however, at 4.2%, NIMs are within the guidance given by the management. Operating performance was in line with estimates, with advances growing by 19.5% y-o-y (we anticipated a ~19% YOY growth), which is better than Q1 performance. While growth in auto loan segment was subdued, it was well complemented by other segments including corporate loans. The pace of growth in advances remains slightly below the normal run-rate. However, given the circumstances, we are not complaining. Sequentially, NPA performance was stable, with GNPA's improving by 2 bps to 1.4%. The bank used a lower tax rate to make Rs. 660 crore of contingency provisions; as a result, provisions jumped 48% y-o-y, with specific loan-loss provisions amounting to Rs. 2,038 crore, lower than in Q1. Other income jumped 39% y-o-y on back of a healthy fee income of Rs. 4,054 crore, which rose 14% q-o-q, which we believe is a strong performance. This helped the bank reduce cost / income (C/I) ratio to 38.8% from 39.9% in Q2FY2019. A lower effective tax rate of 29.5% and steady operating performance helped the bank and the management commentary on delinquencies and outlook of portfolios was steady. The management indicated that certain provisions made in Q2 were precautionary and not anticipatory. Moreover, the bank stated that it wrote off loans worth Rs. 1,589 crore in Q2FY2020. We find that HDFC Bank's results are largely in line and positive on most counts. We find the valuation attractive, given the bank's franchise quality and consistency. We retain our Buy rating on the stock with unchanged price target of Rs. 1,510.

## Key Positives

- Fee income rose strongly by 14% q-o-q.
- Strategy to leverage technology and deeper penetration pulled down C/I ratio to 38.8% from 39.9% in Q2 FY19; apart from strong access to sticky customer base both in Liability as well as asset side.

## Key Negatives

- Retail growth was slower at 15% y-o-y, marginally slower than industry rate as well. This was mainly because of auto loans, which grew by only ~3.0% y-o-y and also because certain segments such as gold loans and LAS showed weak traction.
- NIMs fell marginally by 10 bps on account of cautious loan book expansion and higher deposit accretion.

**Valuation:** HDFC Bank currently trades at 3.5x its FY2021E BVPS, which we believe is attractive for a bank with its strengths and consistency. HDFC Bank continues to be at a strong position, performing consistently, buoyed by its ability to grow profitability (but at own pace) and strong underwriting and risk-measurement standards with pricing strength. We maintain our Buy rating on the stock with a unchanged PT of Rs. 1,510.

## Key Risks

Rise in NPAs in unsecured and other retail segments can pose risks to profitability.

## Valuation

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Net interest income (Rs cr)	40,095	48,243	57,079	69,780
Net profit (Rs cr)	17,487	21,070	26,124	32,767
EPS (Rs)	33.7	38.7	47.7	59.9
PE (x)	36.8	32.0	25.9	20.7
Book value (Rs/share)	204.8	272.3	305.9	350.7
P/BV (x)	6.0	4.5	4.0	3.5
RoE (%)	17.9	16.5	16.5	18.2
RoA (%)	1.8	1.8	1.9	2.0

Source: Company; Sharekhan estimates

## HDFC Bank Q2 FY20 Concall Transcript

- ◆ The current asset-liability committee (ALCO) strategy to maintain a higher-than-usual liquidity position led to an impact of 10-15 bps on NIM. Adjusted for the same, core NIM would be at around 4.3%. The bank offset the drag by monetising the investments in the form of trading gains.
- ◆ If the bank had reduced liquidity coverage ratio (LCR) to 115%, the net interest income would have grown approximately by 19%.
- ◆ Fees and commission income was strong, of which retail segment constitutes approximately 91% and wholesale constitutes 9%. However, Mutual funds distribution income continued to be affected by changes in regulations that came in earlier quarters.
- ◆ **Forex and derivatives income:** This income stream grew by 31.4% y-o-y, and the growth was primarily granular in nature, being driven by retail customers who contributed ~ two-thirds of the total.
- ◆ **Network growth:** HDFC Bank added 489 branches on year-on-year basis, 184 branches were added during Q2 FY20. The staff count also increased by 16,301 during the last 12 months, and 7,054 employees were added during Q2FY2020.
- ◆ The bank continued to hold floating provisions of Rs. 1,451 crore as on Q2 FY20; total provisions comprising specific, general floating provisions were 114% of the GNPA's
- ◆ **Credit Cost:** The core credit cost ratio (specific loan-loss provisions were 0.9% of advances). Excluding Agri, the ratio was 0.92% (Q1FY20 = 0.93% and Q2 FY19 = 0.82%). Recoveries have been recorded as miscellaneous income; core credit cost ratio (net of recoveries) was 0.68% (was 0.88% in Q2 FY20 and 0.66% in Q2 FY19). The core slippage was Rs. 3,714 crore and write-offs were at Rs. 1,589 crore. The GNPA in agri fell to 5.64% from 6.06% in Q2FY2019.
- ◆ **Tax benefit:** The year-to-date impact of reduced tax rate was approximately Rs 1,650 crore. The deferred tax asset was reassessed at the current tax rate and approximately Rs. 1,200 crore was written down, representing the full effect of the change in tax rate. This resulted in a net tax benefit of approximately Rs. 450 crore in the quarter.
- ◆ **Retail deposit:** Retail deposits, which constituted 77% of total deposits increased by 24% over the previous year, as a result of the bank's focus on granular deposits.
- ◆ Vehicle loan segment, continued to see moderate growth owing to slowdown in automobile sales volumes.
- ◆ **Risk weights reduction:** The reduction in risk weights of certain retail loans had an impact of around 80-90 bps; resulted in beneficial impact of 80-90 BPS on the capital adequacy ratio.
- ◆ **Banking outlets & reach:** In FY2020, HDFC Bank added 211 banking outlets, taking the total network to 5,314 banking outlets. 52% of the branches are in semi-urban and rural areas. The bank has signed up village-level entrepreneurs, of which 32,242 are on-boarded as business facilitators. Of these, ~40% are actively sourcing now. Year-to-date, the bank acquired 3.2 million new liability relationships, an increase of 53% y-o-y. The bank has ~10 million relationship-managed customers of which ~6 million are virtually managed. The credit card base was at 13.3 million and 1.3 million merchant acceptance spots.
- ◆ **HDB Financial:** The bank adopted best NPA recognition practice during Q2 such as daily recognition and if a borrower had two facilities outstanding and even if one is delinquent (the other still standard), the bank has tagged it as NPA. The board is yet to finalise timing of listing of the subsidiary.
- ◆ **Provisions –** The rise in provisions during the quarter is precautionary and not anticipatory. Provisions stepped up to improve the coverage on the personal loan or unsecured loan portfolio.
- ◆ **Wage increase:** Out of the 23%, 17% is principally just on account of the growth in number of employee.
- ◆ **Retail credit slowing:** Retail credit growth fell to 14-15% y-o-y mainly as auto loans (comprises ~17% of book on the retail side) has grown only by 2.3%.
- ◆ **Capital raising:** The bank is adequately capitalised as of now. It will think about issuing perpetual bonds in the future, when it has more clarity from regulatory and tax perspectives.
- ◆ **Corporates:** The bank is reasonably well balanced on both retail and wholesale. Growth will emanate from both segments in now and in future as well.
- ◆ **Overseas expansion:** The bank has no plans as of now.
- ◆ **DTA impact:** Had taken deferred tax asset (DTA) impact of Rs. 1,650 crore, going forward, the ETR will be 25.2% after this one-time adjustment.

Results					Rs cr
Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %
Interest income	28166.3	24199.6	16.4	27391.6	2.8
Interest expense	14651.2	12436.2	17.8	14097.3	3.9
<b>Net interest income</b>	<b>13515.0</b>	<b>11763.4</b>	<b>14.9</b>	<b>13294.3</b>	<b>1.7</b>
Non-interest income	5588.7	4015.6	39.2	4970.3	12.4
<b>Net total income</b>	<b>19103.8</b>	<b>15779.0</b>	<b>21.1</b>	<b>18264.5</b>	<b>4.6</b>
Operating expenses	7405.7	6299.1	17.6	7117.3	4.1
<b>Pre-provisioning profit</b>	<b>11698.1</b>	<b>9480.0</b>	<b>23.4</b>	<b>11147.2</b>	<b>4.9</b>
Provisions	2700.7	1820.0	48.4	2613.7	3.3
Profit before tax	8997.4	7660.0	17.5	8533.6	5.4
Tax	2652.4	2654.3	-0.1	2965.4	-10.6
<b>Profit after tax</b>	<b>6345.0</b>	<b>5005.7</b>	<b>26.8</b>	<b>5568.2</b>	<b>14.0</b>

Source: Company; Sharekhan Research

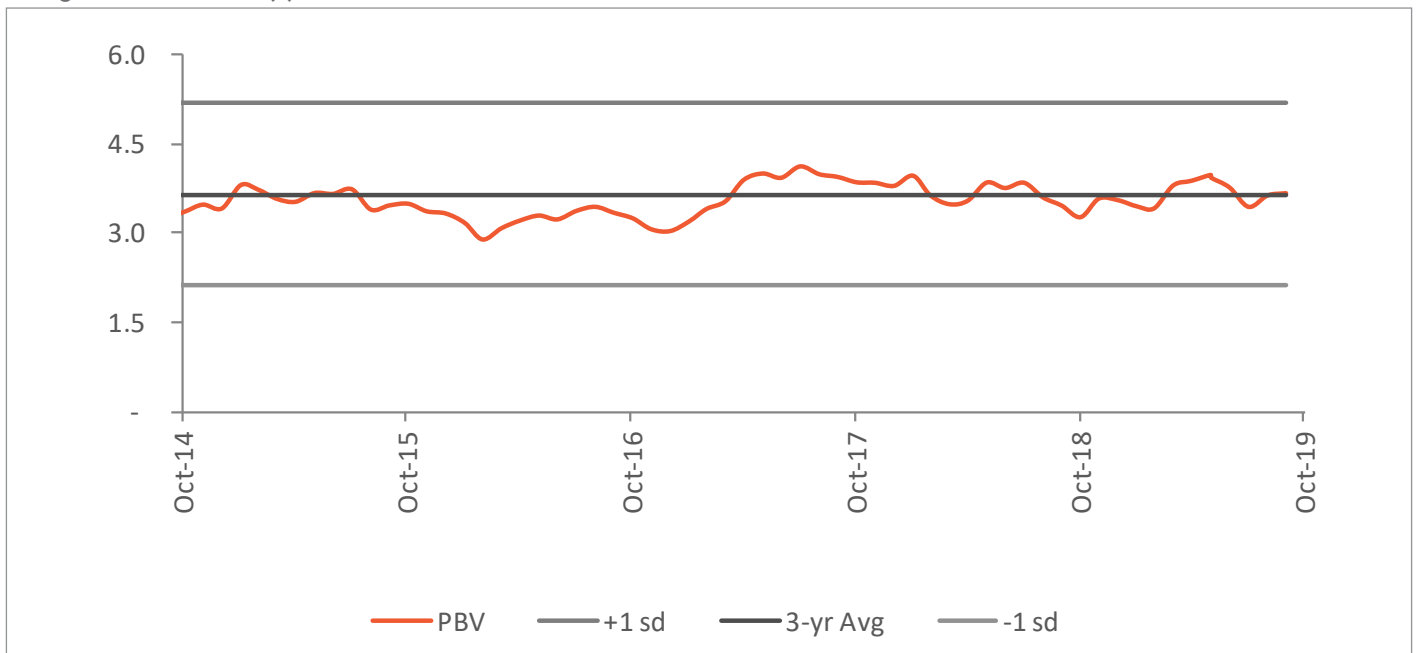
**Outlook**

We believe that structural drivers are well in place for the bank, helping it achieve market share gains, aided by operational efficiencies and best-in-class asset quality. HDFC Bank’s operating performance remains strong, and we expect growth to pick up in H2FY2020 as the bank sees demand improve due to better monsoons, stimulus measures benefits and its own efforts. Notably, the franchise continues to be one of the best-managed and strongest business models and needs to be seen with a long-term perspective. Overall, the asset-quality picture looks sanguine, with its calibrated growth and already strong underwriting and assessment capabilities, with healthy digitalisation benefits adding to the moat of its business strength. HDFC Bank’s floating provision cushion of Rs. 1,450 crore and comfortable capitalisation levels (Tier 1 at 16.2%) are further positives.

**Valuation**

HDFC Bank currently trades at 3.5x its FY2021E BVPS, which we believe is attractive for a bank with its strengths and consistency. HDFC Bank continues to be at a strong position, performing consistently, buoyed by its ability to grow profitability (but at own pace) and strong underwriting and risk-measurement standards with pricing strength. We maintain our Buy rating on the stock with a revised PT of Rs. 1,510.

One year forward P/BV (x) band



Source: Sharekhan Research

**Peer Comparison**

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
HDFC Bank	1239	4.1	3.5	25.9	20.7	1.9	2.0	16.5	18.2
IndusInd Bank	1341	3.0	2.5	17.9	14.0	1.5	1.6	16.5	17.8
Kotak Mahindra Bank	1629	6.2	5.4	48.6	40.7	1.9	1.9	13.7	14.2

Source: Company, Sharekhan research

## About company

HDFC Bank is a largest private bank having pan-India presence. The bank has been designated by the RBI as a Domestic Systemically Important Bank (D-SIB), which means that its continued functioning is critical for the economy. HDFC Bank caters to a wide range of banking services covering commercial and investment banking on the wholesale side and transactional / branch banking on the retail side. Its loan book consists of 46% retail and 54% wholesale loans. As a business entity, HDFC Bank continues to deliver steady performance with well-maintained margins and conservative asset-quality performance.

## Investment theme

HDFC Bank is among the top performing banks in the country having deep roots in the retail segment. Despite the general slowdown in credit growth, the bank continues to report strong growth in advances from retail products. Over the years, under credit / interest rate cycles, HDFC Bank has been able to not only sustain its business growth, but also been able to maintain its asset quality along with improving margins, which is indicative of the strong business franchise strength and leadership qualities. We believe that Relatively high margins (compared with its peers), strong branch network and better asset quality make HDFC Bank a attractive business with a scope for expansion in its valuations bolstered by its consistency and strong balance sheet quality.

## Key Risks

- ♦ Rise in NPAs in unsecured and other retail segments can pose risks to profitability.

## Additional Data

### Key management personnel

Mr Aditya Puri	Managing Director
Mr Kaizad Bharucha	Executive Director
Mr Jimmy Tata	Chief Risk Officer
Mr Sashi Jagdishan	Group Chief Financial Officer
Mr Arvind Vohra	Group Head, Retail Branch Banking at HDFC Bank
Mr Arvind Kapil	Group Head - Unsecured Loans, Home, and Mortgage Loans
Ms Ashima Bhat	Group Head - Finance, Administration & Infrastructure

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Housing Development Finance Corp	15.81
2	Capital Group Cos Inc/The	7.04
3	HDFC Investment Ltd	5.48
4	SBI Funds Management Pvt Ltd	2.70
5	50 SBI-ETF NIFTY	2.35
6	Life Insurance Corp of India	2.04
7	FIL Ltd	1.13
8	HDFC Asset Management Co Ltd	1.12
9	ICICI Prudential Life Insurance Co	1.07
10	Reliance Capital Trustee Co Ltd	1.03

Source: Bloomberg

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