July 19, 2020

Result Report Q1 FY21 | Sector: Financials

YES SECURITIES
INSTITUTIONAL EQUITIES

HDFC Bank Limited

BUY	CMP Rs1,098	Target Rs1,470	Upside 34%

HIGHLIGHTS

- ✓ Earnings and Core PPOP beat of 15% and 5% respectively, driven by lower than anticipated opex. NII growth of 18% and decline in core fees were largely in-line with our expectations.
- ✓ Loan originations in Retail segment being down ~70% was the prime reason behind lower opex (-16% qoq and -3% yoy). This reflects high flexibility and modularity of cost structure, and alleviates concerns around operating deleverage from growth slowdown.
- ✓ Credit cost was elevated at 1.6% as the bank augmented contingent provisions by Rs10bn, made accelerated provisions on upfronted slippages (<90dpd) and raised overall core PCR to 76%. The expedited recognition of NPAs was based on analytical models.
- ✓ HDFC Bank continues to accrete capital led by lower risk intensity of incremental growth (tepid yoy growth in RWA) and sustained high profitability. Over the past 12 months, ~80% of the incremental growth has been in corporate segment (all highly-rated entities).
- ✓ Only 9% of the bank's portfolio under moratorium as of 30th June, and 97% comprised 0 dpd (non-delinquent) customers as of 29th Feb. This implies potentially lower NPL flow and higher collectability of moratorium pool. Cheque bounce rate is improving too.
- ✓ The bank doused concerns over recent senior management exits, leadership succession and asset quality. HDFC Bank distributed increments, bonusses and promotion to employees in Q1 FY21.
- ✓ With a wide distribution platform, sustained liability accretion and robust capital position, it possesses the ability to push the peddle on growth when market improves.

Our View

- ✓ Retain BUY and as the Top Pick in the sector with reinforced conviction. Have raised FY21/22 EPS estimates by 9%/6% with positive tweaks to growth, opex and credit cost assumptions.
- ✓ Stand-alone bank trades at 2.5x/15x FY22 ABV/EPS. We value the majority holding in HDB Finance and HDFC Sec at Rs69/share
- ✓ We increase 12m TP to Rs1,470. Demonstrated resilience in growth/profitability and increasing relative attractiveness would lead to a secular re-rating.

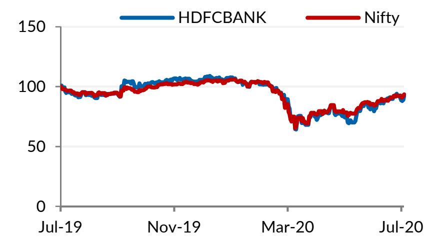
Risk to our call

- ✓ A prolonged Covid episode and lingering uncertainty around MD & CEO succession

Stock data (as on Jul 17, 2020)

Nifty	10,902
52 Week h/l (Rs)	1306 / 739
Market cap (Rs/USD mn)	6030796 / 80389
Outstanding Shares (mn)	5,490
6m Avg t/o (Rs mn):	16,717
Div yield (%):	-
Bloomberg code:	HDFCB IN
NSE code:	HDFCBANK

Stock performance



	1M	3M	1Y
Absolute return	12.2%	20.7%	-8.2%

Shareholding pattern (As of Jun'19 end)

Promoter	26.1%
FII+DII	58.4%
Others	15.2%

Δ in earnings estimates

	FY20	FY21e	FY22e
EPS (New)	47.9	51.3	69.9
EPS (Old)	47.9	46.9	65.9
% change	-	9.3	6.1

Exhibit 1: Financial Summary

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E
Operating income	658,691	794,470	872,399	1,065,635
PPOP	397,497	487,495	550,075	665,954
Net profit	210,781	262,573	281,149	383,158
yoy growth (%)	20.5	24.6	7.1	36.3
EPS (Rs)	38.7	47.9	51.3	69.9
Adj.BVPS (Rs)	268.0	305.4	348.1	408.6
P/E (x)	28.4	22.9	21.4	15.7
P/adj.BV (x)	4.1	3.6	3.2	2.7
ROE (%)	16.5	16.4	15.3	18.0
ROA (%)	1.8	1.9	1.7	2.0
CAR (%)	17.1	18.5	19.6	19.0

Source: Company, YES Sec – Research

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CON-CALL HIGHLIGHTS

- ✓ Top Management clarified that there is no turmoil in the senior management of the bank and that bulk of the recent attrition was amicable and driven by individual's aspiration to pursue something else.
- ✓ The bank also emphasized that it has solid management depth, as demonstrated by consistent superior execution even after some senior leadership exits in the past.
- ✓ On management succession, Mr. Puri alluded that the prime successor has been with the bank for 25+ years and has trained under him and now it is on the RBI to decide.
- ✓ During Q1 FY21, the bank distributed increments, bonusses and promotion to employees for the year FY20.
- ✓ About 9% of the bank's portfolio is under moratorium as of 30th June. The proportion is higher in Retail, SME and Business Banking segments and lower in Corporate segment. Of the moratorium portfolio, regular customers (0 dpd as of 29th Feb) comprises 97% and about 90% are customers who had taken the first moratorium.
- ✓ Cheque bounce rate across retail products is improving. The bank's collection infra is intact and resolution rates have improved to 65-70% of pre-covid level.
- ✓ Given the focus on high-quality salaried customers and conservative underwriting in unsecured lending, the portfolio quality in PL and Cards is holding-up. In SME lending, the earlier assessment of 9-10% of portfolio being vulnerable has been brought down to 4-5%.
- ✓ In Corporate segment, the internal weight average risk rating (way more stringent than external rating) of the portfolio has been improving sequentially with incremental growth driven by loans to highly-rated corporates/conglomerates, MNCs and PSU Navratnas.
- ✓ The management clarified that the bank is not a part of the heard rushing to raise money. Despite growing its balance sheet/advances, the bank has been able to generate capital internally (net 30bps accretion in Q1 FY21 and 140 bps in FY20) due to robust profitability and lower risk intensity of growth.
- ✓ The bank also has the option of raising capital by divesting its stake in subsidiaries. Capital raising by HDB Financial will be done at an opportune time.
- ✓ No risk to NIM from asset mix and asset quality; it will be maintained in the historical band (10 years) of 4.1-4.5%. The bank has largely sustained margins across cycles through robust risk management and running a nearly matched duration for assets and liabilities.
- ✓ Current cost/income ratio of 35% is not sustainable in the near term. It will normalize towards 38-39% when retail loan originations normalize. However, structural cost optimization/efficiency efforts and digitation penetration will drive cost/income towards 35% over next 3-4 years.
- ✓ In Q1 FY21, the bank recognized accelerated slippages (accounts <90 dpd) based on its analytical model. A contingent provision of Rs10bn was created, taking the total to Rs40bn. The bank now holds contingent and floating provisions equivalent to 54 bps of its advances.
- ✓ The bank acquired 1.2mn liability customers in Q1 FY21, catching-up to ~80% of Q1 FY20 volume. Payments traction stood at ~70% of January levels. Areas like online education, subscription services and e-commerce witnessed acceleration. Origination in some retail products like tractors, 2w and small cars is recuperating fast.
- ✓ With strong management, motivated employees, wide distribution platform, sustained liability accretion and robust capital position, the bank possesses the ability to push the peddle when the market improves.

Exhibit 2: Result Table

(Rs mn)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Total Interest Income	303,780	298,850	1.6	273,916	10.9
Interest expended	(147,126)	(146,810)	0.2	(140,973)	4.4
Net Interest Income	156,654	152,040	3.0	132,943	17.8
Other income	40,753	60,326	(32.4)	49,703	(18.0)
Total Income	197,407	212,366	(7.0)	182,645	8.1
Operating expenses	(69,115)	(82,778)	(16.5)	(71,173)	(2.9)
PPOP	128,293	129,588	(1.0)	111,472	15.1
Provisions	(38,915)	(37,845)	2.8	(26,137)	48.9
PBT	89,378	91,743	(2.6)	85,336	4.7
Tax	(22,791)	(22,466)	1.4	(29,654)	(23.1)
PAT	66,586	69,277	(3.9)	55,682	19.6

Source: Company, YES Sec – Research

Exhibit 3: Business Data

(Rs mn)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Advances	10,032,989	9,937,029	1.0	8,297,298	20.9
- Retail loans	4,750,050	4,943,990	(3.9)	4,431,530	7.2
- Corp loans	5,282,939	4,993,039	5.8	3,865,768	36.7
Deposits	11,893,873	11,475,023	3.7	9,545,537	24.6
- CA	1,500,770	1,742,480	(13.9)	1,256,630	19.4
- SA	3,273,580	3,103,770	5.5	2,533,380	29.2
- Others	7,119,523	6,628,773	7.4	5,755,527	23.7
Investments	3,793,504	3,918,267	(3.2)	2,985,032	27.1
Borrowings	1,163,890	1,446,285	(19.5)	1,008,941	15.4
RWA	10,107,740	9,947,160	1.6	9,656,350	4.7

Source: Company, YES Sec – Research

Exhibit 4: Key Ratios

(%)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	chq yoy
NIM	4.3	4.3	-	4.3	-
Yield on advances*	9.6	10.0	(0.3)	10.6	(0.9)
Yield on funds*	8.2	8.5	(0.3)	9.1	(0.9)
Cost of funds*	4.5	4.7	(0.2)	5.4	(0.9)
CASA	40.1	42.2	(2.1)	39.7	0.4
C/D	84.4	86.6	(2.2)	86.9	(2.6)
Non-interest income	20.6	28.4	(7.8)	27.2	(6.6)
Cost to Income	35.0	39.0	(4.0)	39.0	(4.0)
Prov. /Avg. Adv.	1.6	1.6	(0.0)	1.3	0.3
RoE	15.0	16.2	(1.2)	14.3	0.7
RoA	1.8	2.0	(0.2)	1.8	(0.1)
CAR	18.9	18.5	0.4	16.9	2.0
Gross NPA	1.4	1.3	0.1	1.4	(0.0)
Net NPA	0.3	0.5	(0.2)	0.4	(0.1)

Source: Company, YES Sec – Research

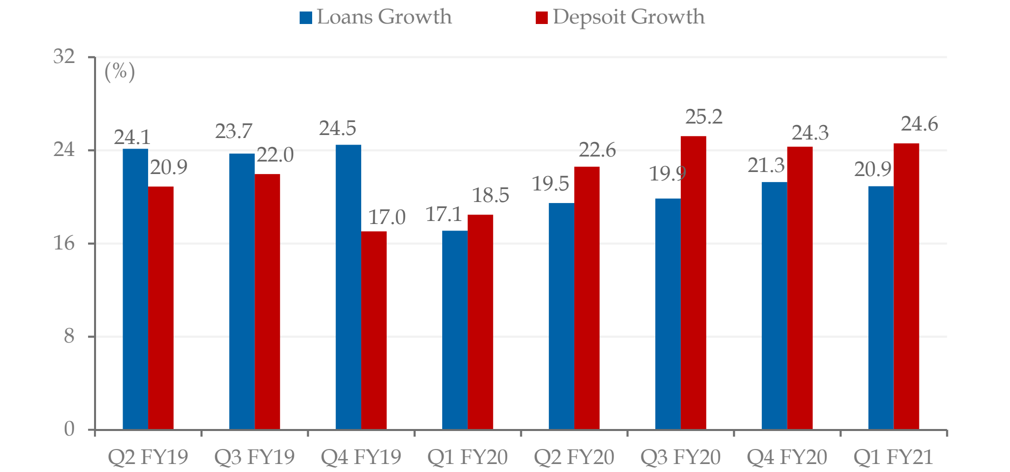
*Calculated

Exhibit 5: Retail Loan Mix

(Rs mn)	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Auto Loans	810,820	839,350	(3.4)	819,130	(1.0)
CV/CE	278,010	290,450	(4.3)	292,290	(4.9)
Two Wheelers	95,680	98,550	(2.9)	100,700	(5.0)
Personal Loans	1,115,670	1,155,570	(3.5)	971,480	14.8
Business Banking	605,960	641,240	(5.5)	577,200	5.0
LAS	15,010	18,010	(16.7)	17,800	(15.7)
Credit Cards	546,980	575,750	(5.0)	495,230	10.4
Home Loans	626,520	634,450	(1.2)	557,690	12.3
Gold	55,710	54,300	2.6	52,320	6.5
Others	599,690	636,320	(5.8)	547,690	9.5
Total	**4,750,050**	**4,943,990**	**(3.9)**	**4,431,530**	**7.2**

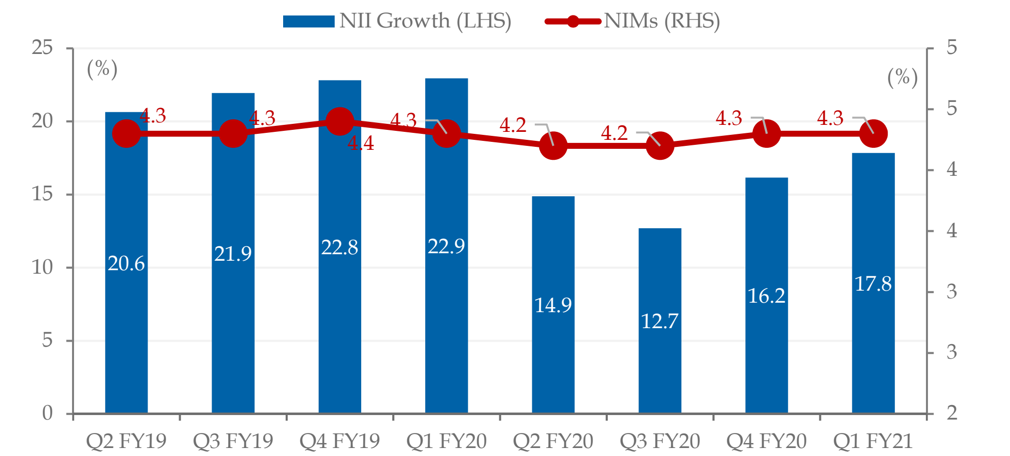
Source: Company, YES Sec – Research

Exhibit 6: Business growth remains robust; market share gains continue



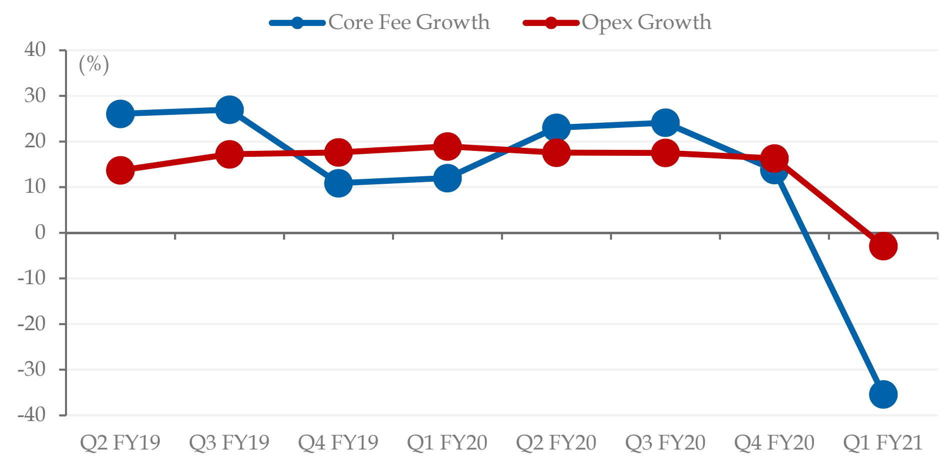
Source: Company, YES Sec – Research

Exhibit 7: NII growth accelerates; NIM stable



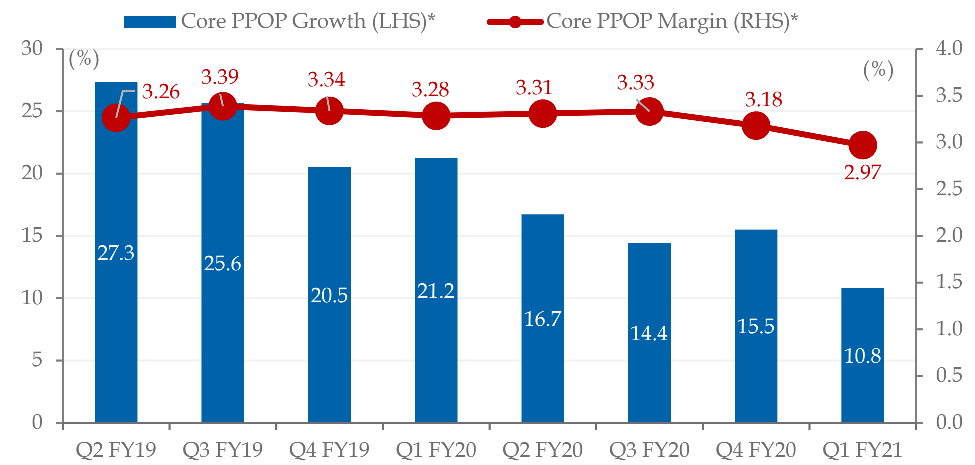
Source: Company, YES Sec – Research

Exhibit 8: Fee severely impacted by Covid; opex declines on lower originations



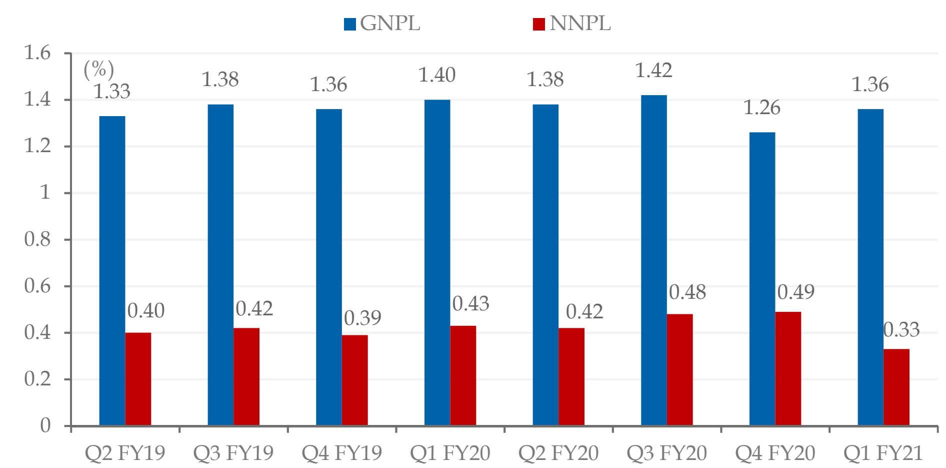
Source: Company, YES Sec – Research

Exhibit 9: Core PPOP margin and growth impacted by lower fee income



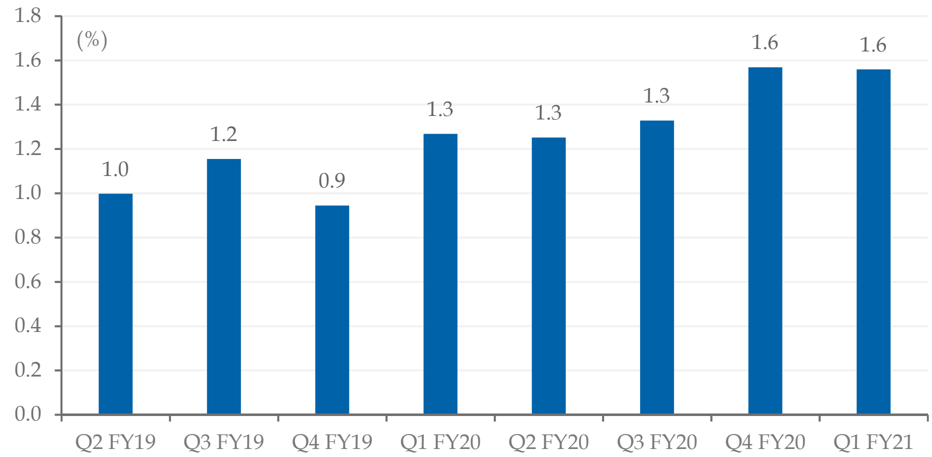
Source: Company, YES Sec – Research

Exhibit 10: GNPL % increase on accelerated recognition; PCR raised significantly



Source: Company, YES Sec – Research

Exhibit 11: Credit cost remains elevated on upfront recognition and provisioning of stress and addition to contingent provision



Source: Company, YES Sec – Research

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