27 October 2020

Company Update | Sector: Financials

HDFC Bank

BSE SENSEX	S&P CNX
40,522	11,889

HDFC BANK

Stock Info

Bloomberg	HDFCB IN
Equity Shares (m)	5,504
M.Cap.(INRb)/(USDb)	6787.7 / 90.6
52-Week Range (INR)	1304 / 739
1, 6, 12 Rel. Per (%)	10/5/-4
12M Avg Val (INR M)	14449
Free float (%)	78.8

Financials Snapshot (INR b)

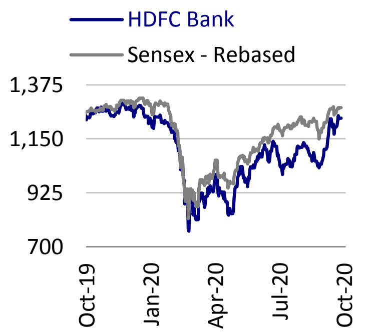
Y/E MARCH	FY20	FY21E	FY22E	FY23E
NII	561.9	648.1	740.8	864.8
OP	487.5	565.5	663.8	778.5
NP	262.6	300.9	364.7	437.7
NIM (%)	4.2	4.1	4.1	4.2
EPS (INR)	48.0	54.9	66.5	79.8
EPS Gr. (%)	21.2	14.2	21.2	20.0
BV/Sh. (INR)	311.8	357.1	413.4	482.3
ABV/Sh. (INR)	300.3	342.3	394.1	460.5
Ratios				
RoE (%)	16.4	16.4	17.3	17.8
RoA (%)	1.9	1.8	1.9	2.0
Payout (%)	24.8	17.5	15.4	13.6
Valuations				
P/E(X)	25.7	22.5	18.5	15.4
P/BV (X)	4.0	3.5	3.0	2.6
P/ABV (X)	4.1	3.6	3.1	2.7
Div. Yield (%)	1.0	0.8	0.8	0.9

Shareholding pattern (%)

As On	Sep-20	Jun-20	Sep-19
Promoter	21.2	21.2	21.3
DII	18.6	18.0	17.3
FII	49.1	48.8	49.4
Others	11.1	12.0	12.1

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR1,233 TP: INR1,500 (+22%) Buy

Business trends undergoing swift normalization

Margins to stabilize; collection trends near pre-COVID levels

- **HDFC Bank (HDFCB) has built an exceptional banking franchise, powered by flawless execution. It consistently challenges the status quo – as reflected in its product and digital innovation – and yet persistently adheres to the basics of banking with regard to underwriting standards. The bank has reported remarkable improvement in collection efficiency, to 97% of pre-COVID levels, and is well-placed to gain incremental market share on both the asset and liability fronts.**
- **The bank is seeing improving trends across key business verticals, with some segments like Credit Cards showing strong buoyancy. The Credit Cards segment grew 6% QoQ, with spends also back at pre-COVID levels. Corporate growth remains robust, and the bank continues to focus on high-rated borrowers, which has aided decline in RWA / total assets to ~65% (v/s 75% in FY19). HDFCB has prudently made contingent + floating provisions of ~INR77.6b, which would allow the bank to absorb any asset quality issues as business trends normalize fully.**
- **We estimate HDFCB to deliver a ~19% PAT CAGR over FY20–FY23E, with ROA/ROE at 2.0%/17.8% for FY23E. Maintain Buy, with revised TP of INR1,500 (3.3x Sep'22E ABV).**

Retail cycle holding well; strengthening distribution in rural/semi-urban markets to aid growth

HDFCB is the largest private bank, with a market leadership position across various retail products (Vehicle, Personal Loans, Credit Cards, etc.). Hence, its performance is the yardstick for assessing the health of the overall retail cycle. The bank has reported a ~97% collection efficiency, which has assuaged concerns not only on the asset quality outlook for the bank but also the broader retail cycle. HDFCB is well-placed to gain incremental market share as recovery strengthens. Meanwhile, a strong geographical reach in the rural and semi-urban markets – which have proved to be more resilient amid the pandemic – provides a strong growth engine for the bank.

Corporate segment continues to drive growth; expect balanced contribution as Retail makes a comeback

HDFC Bank has shown robust traction in the corporate portfolio, thus compensating for the softness in retail lending. The Corporate segment reported 26.5% YoY growth in 2QFY21, while Retail loans grew at a tepid ~5% YoY (~7% YoY in 1QFY21). In 1HFY21, the Corporate segment entirely contributed to overall loan growth, raising the segment's share to 52% of total loans. As per strategy, the bank continues to focus on lending to high-rated corporates, which has enabled steep decline in RWA / total assets to ~65% (v/s 75% in FY19). However, with early signs of recovery seen across several retail verticals, we expect a more balanced growth outlook, even as we estimate HDFCB to deliver a 15% loan growth CAGR over FY20–23E.

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Margins on the cusp of bottoming out; expect gradual recovery from FY22

For the past two quarters, most private banks have reported decline in margins due to the slowing of credit growth, higher liquidity, and yield pressures from sharp monetary easing. As a result, HDFCB has reported 20bp QoQ decline in margins to 4.1%. However, with the revival in retail disbursements, a healthy uptick in the CASA ratio, and gradual repricing in the deposits portfolio, we expect margins to stabilize at current levels and improve from FY22.

Asset quality seeing sharp recovery; contingent prov. offers comfort

Several banks have recently indicated a sharp recovery in collection trends. Banks such as HDFCB, Indian Bank, and FB have reported collection efficiencies of 95–97%; BANDHAN, too, has reported a collection efficiency of ~90%. KMB collection efficiency also reached close to pre-COVID levels (barring unsecured portfolio). Furthermore, numerous banks have suggested corporate restructuring would be significantly slower than anticipated. On the other hand, the stress in the Mid-Corporate and SME segments has been significantly addressed by the credit guarantee scheme. HDFCB's stress in the MSME segment also declined to 3% (v/s 9% in 1QFY21). Overall, expect restructuring to be in the low single digits. HDFCB has prudently made contingent + floating provisions of INR77.6b, which would allow the bank to absorb any asset quality issues as business trends normalize fully. We estimate credit cost to sustain at 1.5% for FY21 and moderate to 1.3% by FY23.

Earnings cycle showing signs of bottoming out; estimate steady growth rates after 2HFY21

HDFCB delivered steady earnings in 1HFY21, reporting the usual 19% YoY growth in net profit. The bank appeared completely oblivious to the global pandemic despite having built a strong provisioning cushion. We expect HDFCB to maintain a steady growth trend from FY22. But, we remain conservative in our earnings outlook over 2HFY21, largely as COVID-related impairments peak, while the tax rate base normalizes to ~25% in 2HFY20 (v/s ~32% in 1HFY20). Nevertheless, we continue to project steady core operating profit growth of ~21% YoY in 2HFY21 v/s ~11% YoY in 1HFY21. Our estimates for the Banking sector further suggest that over 3QFY20–1QFY21 results, we cut private sector aggregate earnings by 29%/25% for FY21E/FY22E (40%/31% for FY21E/FY22E, excluding HDFC Bank). However, we have turned more constructive and have recently increased earnings for many banks (please refer to Exhibit-19 for details).

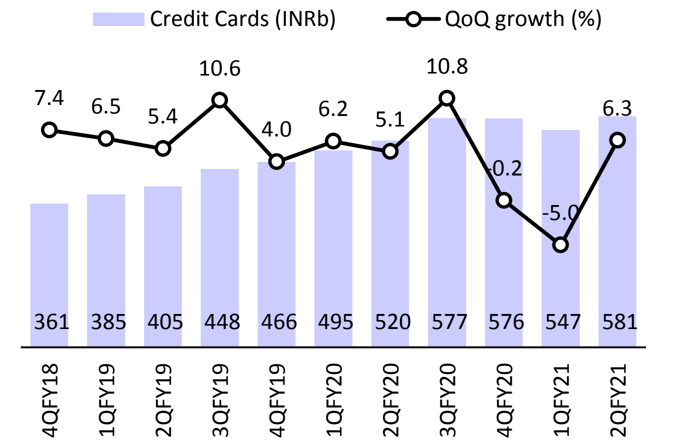
Valuation and view

HDFCB continues to deliver strong growth in a challenging macro environment, and the business momentum has swiftly moved toward pre-COVID levels. Furthermore, the bank's operating performance remains strong despite margin pressure and lower fee income trends. However, we expect the margin trajectory to now stabilize, and an uptick in unsecured retail would support fee income trends. Also, HDFCB continues to make healthy provisions to further strengthen the balance sheet. Thus, a higher provision buffer would limit the damage on asset quality and enable the bank to quickly recover to a normal growth run-rate. We estimate a 19% PAT CAGR over FY20–23E, with ROA/ROE of 2.0%/17.8% for FY23E. Maintain **Buy**, with revised TP of INR1,500 (3.3x Sep'22E ABV).

Retail cycle holding well; strengthen distribution in rural/semi-urban markets

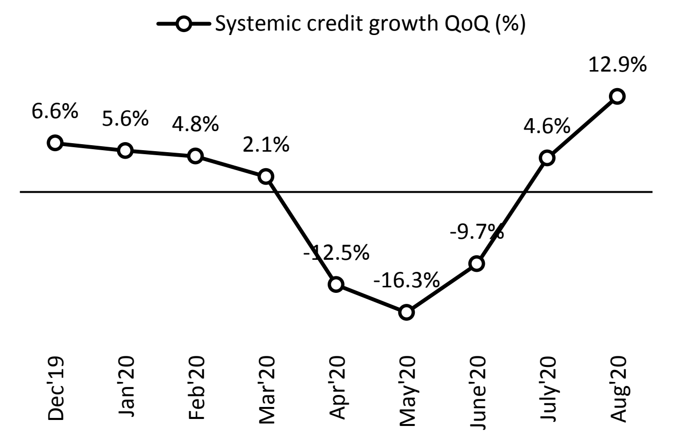
- HDFC Bank has built an exceptional retail franchise over the past two decades, with strong processes, digitalization, and an excellent talent pool. Also, the bank has sufficient product verticals to reflect strong growth despite already having high market share in segments such as Personal Loans, Credit Cards, etc. **During the quarter, the bank's credit card growth revived to 6.3% QoQ, with card spends back at pre-COVID levels.** Furthermore, with the launch of 'Festive Treats 2.0' with a higher reach over the last year, we expect credit card financing to reflect robust trends in 3QFY21.
- Some of the lead indicators suggest that the semi-urban and rural markets are now seeing accelerating trends v/s urban/metros. **HDFC Bank, over the last decade, has increased its focus in these geographies, with ~52% of the total branches located in these regions (v/s 27% in FY10).** Thus, the bank is well-placed to benefit and gain incremental market share from these markets. We are now seeing a strong uptick in two-wheelers, tractors, and gold financing in the semi-urban and rural markets. Thus, HDFC Bank is poised to gain market share and reflect strong trends.
- **Overall, the bank has indicated its collection efficiency in retail has reached ~97% of pre-COVID levels as** no major deterioration, such as job losses and salary cuts, has been seen in its customer base.
- Some of the recent digital initiatives, such as personal loan approvals in 10 seconds and loans against mutual funds, have also helped accelerate growth trends. **Recently, the bank hinted at launching a completely digitalized version for auto loan financing. This could be a game-changer for the bank in terms of gaining incremental market share despite the sector facing cyclical headwinds.**
- Overall, we believe the bank would continue to maintain strong underwriting standards and does not need to take excessive risk as it manufactures the best financial products in the industry.

Exhibit 1: Credit Cards growth revives sequentially at 6.3% QoQ



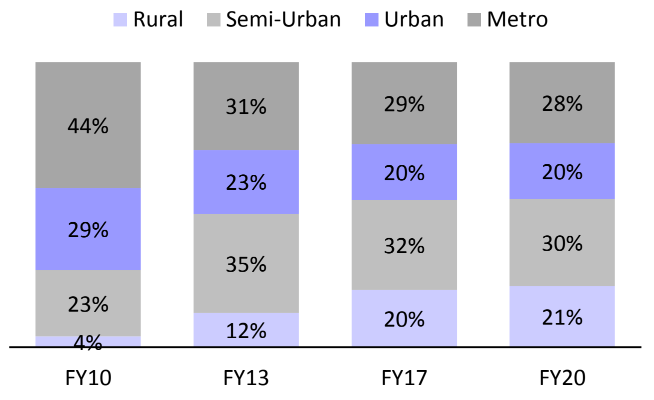
Source: MOFSL, Company

Exhibit 2: …system-level data further suggests revival in CC growth sequentially



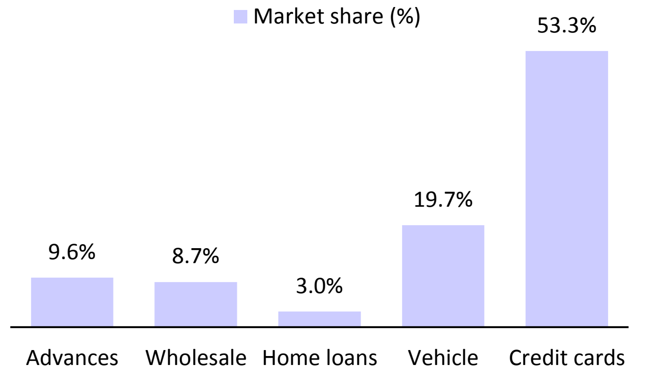
Source: MOFSL, Company

Exhibit 3: ~51% branch share in rural/semi-urban



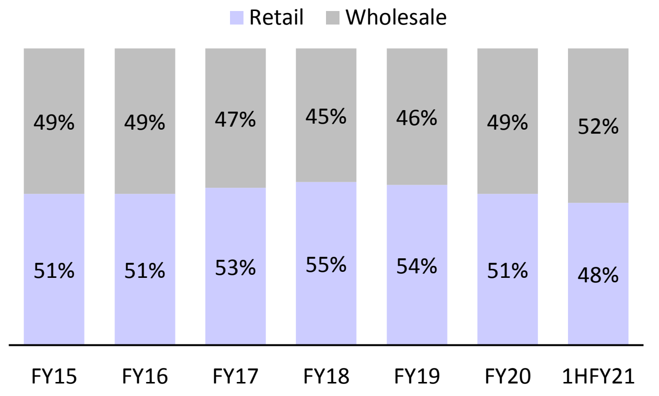
Source: MOFSL, Company

Exhibit 4: Market share trends across key segments



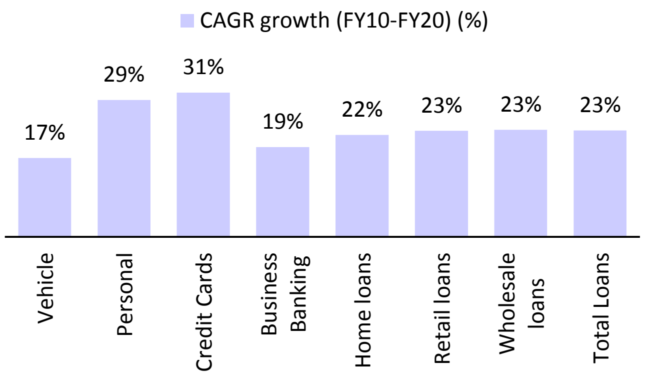
Source: MOFSL, Company

Exhibit 5: Domestic loan mix increases toward wholesale to ~52%



Source: MOFSL, Company

Exhibit 6: Loan growth CAGR across key segments



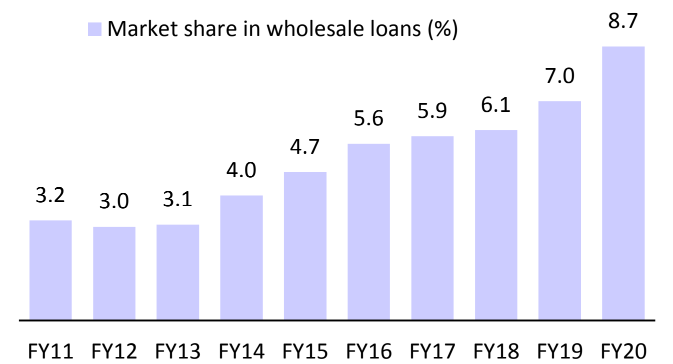
Source: MOFSL, Company

Focus on high-rated corporates; expect balanced contribution as Retail makes a comeback

As per strategy, the bank continues to focus on lending to high-rated corporates, which has enabled steep decline in RWA / total assets to ~65% (v/s 75% in FY19). However, with early signs of recovery across several retail verticals, we expect a more balanced growth outlook, even as we expect HDFCB to deliver a 15% loan growth CAGR over FY20–23E.

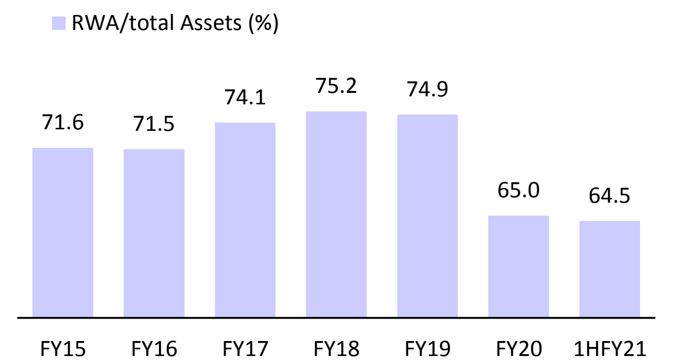
- HDFC Bank's market share in wholesale lending has been lower v/s certain retail segments, such as Auto and unsecured businesses. However, in the last few years, HDFC Bank has shown robust traction in the corporate portfolio, thus compensating for the softness in retail lending. The Corporate segment thus reported 26.5% YoY growth in 2QFY21, while Retail loans grew at a tepid ~5% YoY (~7% YoY in 1QFY21). In 1HFY21, the Corporate segment entirely contributed to overall loan growth, raising the segment's share to 52% of total loans. **Overall, market share in corporate lending increased to 8.7% in FY20 v/s 6.1% in FY18.**
- The robust trends in wholesale lending are driven by the bank's deepening existing relationships with corporates – it provides better cash management and supply chain financing solutions. Also, market share gains are led by cautious risk strategy by other competitive peers (AXSB and ICICIBC) in growing corporate portfolio.
- The bank's strategic focus remains on lending to high-rated corporates, **which has enabled steep decline in RWA / total assets to ~65% (v/s 75% in FY19).** In disbursement trends in wholesale lending, more than 50% was put toward financing working capital, 30% toward capex, and so forth.
- Furthermore, we note that growth in the corporate sectors remains broad-based, with no increased risk seen in any particular sector/borrowers. **Exposure to the top 20 borrowers has declined to 12% v/s 14.3% in FY15.** Also, loan growth trends across sectors suggest highly broad-based trends v/s reliance on any specific sectors.
- However, with early signs of recovery across multiple retail verticals, we expect a more balanced growth outlook even as we expect HDFCB to deliver a 15% loan growth CAGR over FY20–23E.

Exhibit 7: Market share in wholesale loans increases to 8.7%



Source: MOFSL, Company

Exhibit 8: RWA / Total assets improve sharply

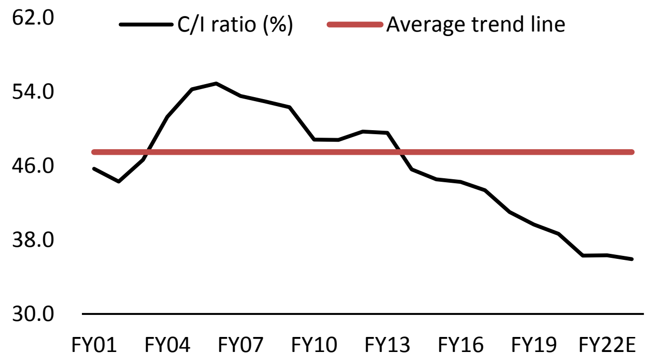


Source: MOFSL, Company

Cost ratios in control; benefits from digitalization to aid further decline

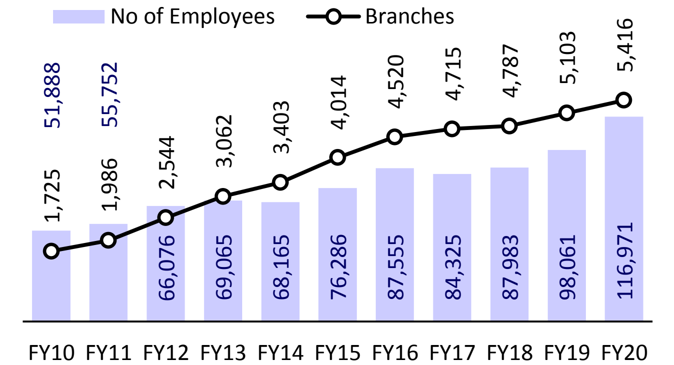
- HDFCB has shown a steady improvement in operating costs. This has enabled it to maintain healthy earnings growth as the benefit of technology is finally reflected, with the C/I ratio over the last five years having improved by ~600bp. The benefit has come despite the bank adding 1400 branches and ~41k employees over a similar period. Digitalization has helped improve costs sharply, led by lower customer acquisition costs, servicing costs, etc. ~95.1% of transactions currently happen digitally, which has enabled the bank to materially lower its costs.
- Furthermore, the COVID-19 pandemic has warranted the role of technology in providing seamless banking services. Thus, we can expect further technology-related investments in the near term as the bank focuses on completely digitalizing auto financing over the next few months. Overall, the bank has indicated further improvement in the cost-income ratio to ~35% levels over the medium term.

Exhibit 9: Cost ratios improve significantly, led by digital initiatives over past decade…



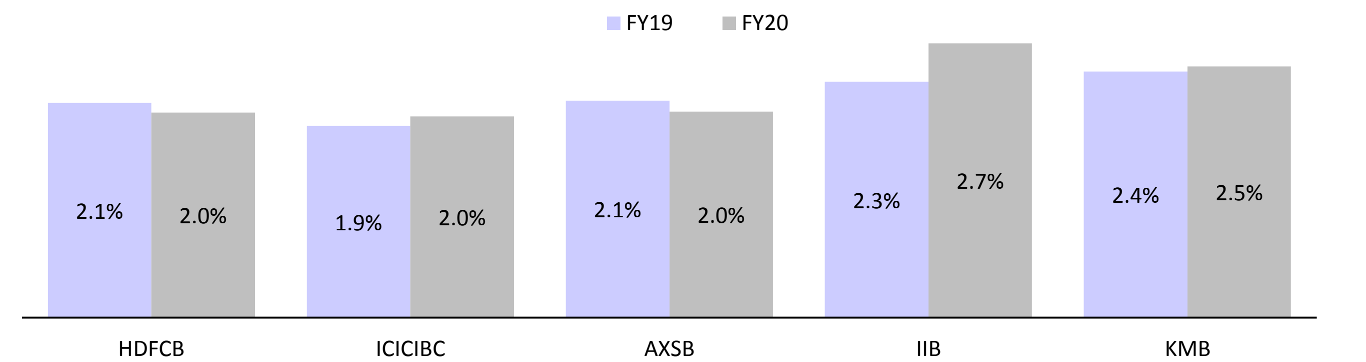
Source: Company, MOFSL

Exhibit 10: …despite banks continuing to add employees and branches



Source: Company, MOFSL

Exhibit 11: Cost/Asset ratio trends across key large private banks (%)



Source: MOFSL, Company

Margins on the cusp of bottoming out; expect gradual recovery from FY22

For the past two quarters, most private banks have reported decline in margins due to the slowing of credit growth, higher liquidity, and yield pressures from sharp monetary easing. As a result, HDFCB has reported 20bp QoQ decline in margins to 4.1%. However, with the revival in retail disbursements, a healthy uptick in the CASA ratio, and gradual repricing in the deposits portfolio, we expect margins to stabilize at current levels and improve from FY22.

Exhibit 12: NIM trends across banks – pressured for the past few quarters; expect NIM to stabilize going forward

NIM (%)	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21
AXSB	3.40	3.51	3.57	3.55	3.40	NA
DCBB	3.67	3.67	3.71	3.64	3.42	NA
HDFCB	4.30	4.20	4.20	4.30	4.30	4.10
ICICIBC	3.61	3.64	3.77	3.87	3.69	NA
IIB	4.05	4.10	4.15	4.25	4.28	NA
KMB	4.49	4.61	4.69	4.72	4.40	4.52
YES	2.80	2.70	1.40	1.90	3.00	NA
FB	3.15	3.01	3.00	3.04	3.07	3.13
RBK	4.31	4.35	4.57	4.93	4.85	NA
SBIN	2.81	2.90	3.05	2.97	3.01	NA

Source: MOFSL, Company

Exhibit 13: Cost of deposits on the decline

Cost of Deposits (%)	1QFY21	YoY (bps)	QoQ (bps)
AXSB	4.73%	(66)	(28)
HDFCB	NM	NM	NM
ICICIBC	4.53%	(55)	(25)
KMB	NM	NM	NM
SBIN	4.48%	(59)	(46)
IIB	5.73%	(113)	(32)
DCBB	6.67%	(32)	(21)
FB	5.37%	(60)	(37)
RBK	6.27%	(73)	(13)

Source: MOFSL, Company

Exhibit 14: Cost of funds on the decline

Cost of Funds (%)	1QFY21	YoY (bps)	QoQ (bps)
AXSB	4.93%	(77)	(27)
HDFCB*	4.53%	(85)	(22)
ICICIBC	4.61%	(62)	(31)
KMB*	4.18%	(117)	(40)
SBIN*	4.37%	(48)	(23)
IIB	5.10%	(84)	(42)
DCBB	6.82%	(32)	(20)
FB*	5.17%	(66)	(19)
RBK	6.10%	(70)	(30)

*On a calculated basis

Source: MOFSL, Company

CASA ratios improve; lower SA & TD differential further aiding growth

Prior to FY21, most banks were reporting healthy growth in term deposits, led by healthy traction in retail TD. On the other hand, CASA growth was moderately slower, resulting in some moderation in CASA ratios (barring for KMB). However, post FY20, with decline in consumption and an increase in savings (on account of COVID-led uncertainty), banks are reporting healthy growth in CASA deposits, resulting in an uptick in CASA ratios. Banks such as KMB, FB, SBIN, and RBK have posted an increase in their CASA ratios in the past few quarters, while banks such as ICICIBC and IIB have seen some moderation. HDFCB, too, reported an increase in 2QFY21 after seeing decline in 1QFY21. Most other banks also reported improved CASA ratios in 2QFY21.

We believe the impetus for strong incremental growth in term deposits is low. This is attributable to the narrowing of the differential between SA and TD accounts, driven by 135–200bp decline in TD rates in the past year. This is likely to aid growth in CASA deposits, enabling further improvement in CASA ratios.

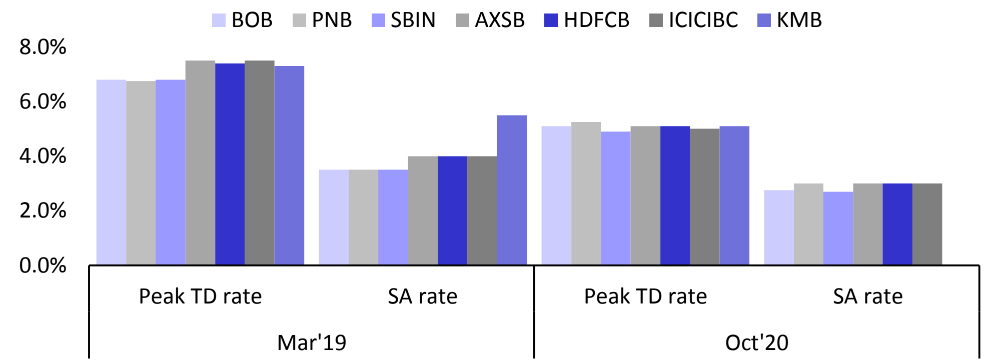
Peak TD rates decline 135–200bp in the past year

Exhibit 15: CASA ratio trends across bank for the past few quarters

CASA (%)	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21
AXSB	41.0	41.0	41.0	41.0	41.0	NA
DCBB	24.5	23.2	23.2	21.5	21.9	NA
HDFCB	39.7	39.3	39.5	42.2	40.1	41.6
ICICIBC	45.2	46.7	47.0	45.1	42.5	NA
IIB	43.1	41.4	42.4	40.4	40.0	40.4
KMB	50.7	53.6	53.7	56.2	56.7	57.1
YES	30.2	30.8	32.1	26.6	25.8	NA
FB	31.4	31.6	31.5	30.5	32.0	33.7
RBK	25.8	26.5	26.8	29.6	30.1	31.1
SBIN	45.1	45.1	44.7	45.2	45.3	NA

Source: MOFSL, Company

Exhibit 16: Differential between peak TD and SA rate trends over Mar'19–Oct'20



Source: MOFSL, Company

Exhibit 17: One-year peak TD rates across banks

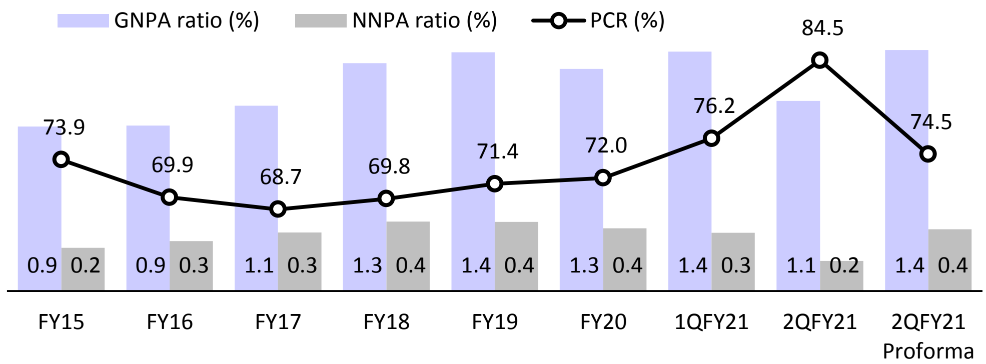
Peak Deposit rate (%)	Mar'19	Jun'19	Aug'19	Sep'19	Nov'19	Apr'20	May'20	June'20	July'20	Oct'20	Change (bps)
BOB	6.80	6.80	6.70	6.60	6.40	5.70	5.70	5.30	5.20	5.10	-150
PNB	6.75	6.75	6.75	6.60	6.40	5.80	5.75	5.50	5.40	5.25	-135
SBIN	6.80	6.80	6.70	6.70	6.25	5.70	5.30	5.30	5.20	4.90	-180
AXSB	7.50	7.50	7.20	7.00	6.85	6.10	5.80	5.80	5.50	5.10	-190
HDFCB	7.40	7.40	7.30	7.00	6.85	6.00	5.75	5.50	5.30	5.10	-190
ICICIBC	7.50	7.50	7.10	7.00	6.85	6.00	5.75	5.50	5.30	5.00	-200
KMB	7.30	7.30	6.90	6.80	6.50	5.80	5.25	5.25	5.20	5.10	-170
Repo Rate	6.25	5.75	5.40	5.40	5.15	4.40	4.00	4.00	4.00	4.00	-140

Source: MOFSL, Company website

Asset quality seeing sharp recovery; contingent prov. offers comfort

Several banks have recently indicated a sharp recovery in collection trends. Banks such as HDFCB, Indian Bank, and FB have reported collection efficiencies of 95–97%; BANDHAN, too, has reported a collection efficiency of ~90%. KMB collection efficiency also reached close to pre-COVID levels (barring unsecured portfolio). Furthermore, numerous banks have suggested corporate restructuring would be significantly slower than anticipated. On the other hand, the stress in the Mid-Corporate and SME segments has been significantly addressed by the credit guarantee scheme. HDFCB's stress in the MSME segment also declined to 3% (v/s 9% in 1QFY21). Overall, expect restructuring to be in the low single digits. HDFCB has prudently made contingent + floating provisions of INR77.6b, which would allow the bank to absorb any asset quality issues as business trends normalize fully. We estimate credit cost to sustain at 1.5% for FY21 and moderate to 1.3% by FY23.

Exhibit 18: Asset quality trends – total provision coverage (incl. floating, contingent, general provisions) at 195% of reported GNPA or 154% of proforma GNPA



Source: MOFSL, Company

Exhibit 19: Exposure to stressed sectors, as collated from Basel III disclosures,

% of total exposure	AXSB			ICICIBC			SBIN		
	FB	**NFB**	**Total**	**FB**	**NFB**	**Total**	**FB**	**NFB**	**Total**
NBFCs	2.5%	0.4%	2.2%	2.7%	NA	2.1%	4.2%	NA	3.6%
Entertainment	0.3%	0.7%	0.4%	NA	NA	NA	NA	NA	NA
Aviation	NA	NA	NA	NA	NA	NA	0.3%	NA	0.2%
Hotels & Tourism	NA	NA	NA	NA	NA	NA	0.4%	NA	0.3%
Metal & Metal Products	3.1%	5.7%	3.4%	1.9%	6.2%	2.8%	4.1%	9.2%	4.9%
Construction	2.4%	13.8%	3.6%	1.8%	11.2%	3.7%	7.3%	14.9%	8.4%
Power	2.4%	3.0%	2.4%	1.9%	3.1%	2.1%	8.4%	7.0%	8.2%
Real Estate (ex of LRD)	4.2%	1.0%	3.9%	3.2%	NA	2.5%	4.2%	NA	3.6%
Telecom	2.0%	4.5%	2.3%	1.5%	NA	1.2%	1.5%	2.3%	1.6%
Gems & Jewellery	NA	NA	NA	0.6%	0.7%	0.6%	0.5%	0.2%	0.4%
Total of above	**16.9%**	**29.1%**	**18.2%**	**13.6%**	**21.1%**	**15.1%**	**30.9%**	**33.5%**	**31.3%**

Source: MOFSL, Company

Exhibit 20: Exposure to stressed sectors, as collated from Basel III disclosures

% of total exposure	IIB			HDCFB			KMB		
	FB	NFB	Total	FB	NFB	Total	FB	NFB	Total
NBFCs	1.8%	1.3%	1.7%	3.7%	0.2%	3.4%	4.6%	0.2%	4.0%
Entertainment	0.3%	0.2%	0.3%	NA	NA	NA	NA	NA	NA
Aviation	0.1%	0.0%	0.1%	NA	NA	NA	NA	NA	NA
Hotels & Tourism	0.6%	0.3%	0.5%	NA	NA	NA	NA	NA	NA
Metal & Metal Products	2.1%	2.7%	2.3%	2.7%	8.0%	3.2%	2.3%	2.4%	2.3%
Construction	1.5%	9.3%	3.6%	1.5%	10.3%	2.2%	1.7%	18.8%	3.9%
Power	1.6%	10.6%	4.0%	4.9%	3.6%	4.8%	NA	NA	NA
Real Estate (ex of LRD)	4.4%	1.3%	3.6%	3.9%	3.7%	3.9%	4.6%	1.1%	4.1%
Telecom	0.9%	4.8%	1.9%	2.8%	3.0%	2.9%	NA	NA	NA
Gems & Jewellery	2.1%	1.1%	1.8%	0.6%	0.4%	0.6%	NA	NA	NA
Total of above	**15.5%**	**31.7%**	**19.8%**	**20.2%**	**29.2%**	**20.9%**	**13.3%**	**22.4%**	**14.5%**

Source: MOFSL, Company

Exhibit 21: Snapshot of moratorium book and provisions as of 1QFY21

1QFY21 (INR b)	Advances	Moratorium 1.0	Moratorium 2.0		Provisions				
		as a % of loans	as a % of loans	In value terms	COVID-19 related	Additional/ Contingent	Total	as a % of loans	as a % of Morat book
AXSB	5,613	25–28%	9.7%	545	30.0	38.9	68.9	1.2%	12.7%
BANDHAN	697	~71%	24%	167	14.4	3.4	17.8	2.6%	10.6%
DCBB	251	~60%	26%	65	1.0	1.0	2.0	0.8%	3.0%
HDFCB**	10,033	NA	9%	903	15.5	54.5	70.0	0.7%	7.8%
ICICIBC	6,312	~30%	18%	1,105	82.8	14.0	96.7	1.5%	8.8%
IIB**	1,981	~50%	16%	317	12.0	NA	12.0	0.6%	3.8%
IDFC First	1,041	~35%	28%	291	6.0	NA	6.0	0.6%	2.1%
KMB	2,040	~26%	9.65%	197	12.6	NA	12.6	0.6%	6.4%
FB	1,213	~35%	24%	291	1.9	0.0	1.9	0.2%	0.6%
RBK	567	~33%	13.7%	78	3.6	NA	3.6	0.6%	4.6%
AUBANK	263	~25%	11%	29	2.8	NA	2.8	1.1%	9.6%
Equitas	144	~93%	43%	62	1.4	NA	1.4	1.0%	2.3%
SBIN*	22,983	~23%	9.5%	2,183	30.0	NA	30.0	0.1%	1.4%
SBI Cards	219	~17%	7%	15	4.9	NA	4.9	2.2%	31.9%

** For SBIN, moratorium book represents term loans that paid less than two EMIs*

***For IIB, the proportion of customers availing moratorium was disclosed in the 1QFY21 earnings call*

Source: MOFSL, Company

Earnings cycle showing signs of bottoming out; estimate steady growth rates after 2HFY21

- We believe the earnings cycle in the Banking sector has bottomed out. The sector should start to stabilize **as margins are on the cusp of bottoming out – aided by a reduction in the cost of funds, as most banks have lowered their SA/TD rates by 135–200bp in the past year.** Moreover, as the disbursement trend improves, we expect fee income to also reflect better trends in the coming quarters.
- HDFCB delivered steady earnings in 1HFY21, reporting the usual 19% YoY growth in net profit. The bank appeared completely oblivious to the global pandemic despite having built a strong provisioning cushion. We expect HDFCB to maintain a steady growth trend from FY22. But, we remain conservative in our earnings outlook over 2HFY21, largely as COVID-related impairments peak, while the tax rate base normalizes to ~25% in 2HFY20 (v/s ~32% in 1HFY20). Nevertheless, we continue to project steady core operating profit growth of ~21% YoY in 2HFY21 v/s ~11% YoY in 1HFY21.
- Overall, our estimates for the Banking sector further suggest that over 3QFY20–1QFY21 results, we cut private sector aggregate earnings by 29%/25% for FY21E/FY22E (40%/31% for FY21E/FY22E, excluding HDFC Bank). However, we have turned more constructive and have recently increased earnings for many banks such as KMB, ICICIBC, Federal etc.

Exhibit 22: We believe the earnings downgrade cycle to have bottomed out….

	Estimates post 3QFY20		Estimates post 1QFY21		Current Estimates		*% Change over 1QFY21*	
PAT (INR b)	**FY21E**	**FY22E**	**FY21E**	**FY22E**	**FY21E**	**FY22E**	***FY21E***	***FY22E***
Private Banks								
AXSB	121.9	174.5	61.6	110.0	53.2	96.3	*-13.6%*	*-12.5%*
BANDHAN	40.3	49.3	35.4	45.7	35.4	45.6	*0.0%*	*-0.2%*
DCBB	5.1	6.5	2.3	3.2	2.8	3.6	*21.7%*	*12.5%*
HDFCB	342.5	415.7	301.5	357.3	300.9	364.7	*-0.2%*	*2.1%*
ICICIBC	189.1	229.6	104.1	157.4	115.1	174.7	*10.6%*	*11.0%*
IIB	70.8	93.6	45.5	63.9	22.2	48.5	*-51.2%*	*-24.1%*
KMB	76.4	92.0	54.5	69.8	54.8	68.9	*0.6%*	*-1.3%*
FB	21.7	26.8	12.9	16.9	15.3	21.4	*18.9%*	*26.4%*
RBK	11.3	16.6	5.3	8.1	6.9	10.8	*30.2%*	*33.3%*
AUBANK	10.4	14.7	6.3	8.8	7.6	10.4	*20.6%*	*18.2%*
Total for private banks	**889.5**	**1,119.3**	**629.4**	**841.1**	**614.2**	**844.9**	***-2.4%***	***0.4%***
Total for private banks (excl HDFCB)	**547.0**	**703.6**	**327.9**	**483.8**	**313.3**	**480.2**	***-4.4%***	***-0.8%***
PSU Banks								
BOB	63.5	92.8	6.7	31.4	1.7	23.8	*-74.6%*	*-24.2%*
SBIN	319.5	417.6	152.2	224.0	148.9	224.2	*-2.2%*	*0.1%*
Total for PSB	**383.0**	**510.4**	**158.9**	**255.4**	**150.6**	**248.0**	***-5.2%***	***-2.9%***
Total	**1,272.5**	**1,629.7**	**788.3**	**1,096.5**	**764.8**	**1,092.9**	***-3.0%***	***-0.3%***

Source: MOFSL, Company

Valuation and view

- Corporate loan growth for HDFCB remains strong and is compensating well for the softness in its retail portfolio (due to muted growth in Vehicles / Credit Cards). Although, among the retail assets, growth is picking up in Business Banking and Credit Cards.
- The fee income profile has been impacted by decline in economic activity on account of the COVID-19 crisis. However, it has improved on a QoQ basis. Furthermore, strong cost control, led by further digitalization, is likely to drive overall improvement in the bank's return ratios. Although margins have declined in the current quarter, they are expected to remain stable due to moderation in the cost of funds, aided by a strong and granular liability franchise. As corporate lending gains momentum with the revival in economic activity, we believe corporate fees would also reflect improving trends.
- Asset quality ratios saw sequential decline, aided by the SC stay order on NPA recognition. However, if not for the dispensation, GNPA/NNPA would have been at ~1.37%/0.35% – stable YoY/QoQ on a like-to-like basis. The bank intends to use its analytical models to determine slippages, resulting in the expedited recognition of NPAs. CV/CE and unsecured retail loans to the Self-Employed segment need to be monitored amid COVID-19, and we expect a rise in delinquency trends in the near term. However, PCR improved ~830bp QoQ to ~84%. This, along with a floating provision of INR14.5b and contingent provision of INR63b, should keep credit cost under control. Overall, we expect NNPA to remain at 0.6% in FY22E.
- Furthermore, strong capitalization and liquidity levels should help HDFCB sustain its growth momentum over the next few years.
- **Buy, with Target Price of INR1,500:** HDFCB continues to deliver strong growth in a challenging macro environment, and the business momentum has swiftly moved toward pre-COVID levels. Furthermore, the bank's operating performance remains strong despite margin pressure and lower fee income trends. However, we expect the margin trajectory to now stabilize, and an uptick in unsecured retail would support fee income trends. Also, HDFCB continues to make healthy provisions to further strengthen the balance sheet. Thus, a higher provision buffer would limit the damage on asset quality and enable the bank to quickly recover to a normal growth run-rate. We estimate a 19% PAT CAGR over FY20–23E, with ROA/ROE of 2.0%/17.8% for FY23E. **Maintain Buy, with revised TP of INR1,500 (3.3x Sep'22E ABV).**

Financials and Valuations

Income Statement (INRb)

Y/E March	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Interest Income	693.1	802.4	989.7	1,148.1	1,298.7	1,456.0	1,675.4
Interest Expense	361.7	401.5	507.3	586.3	650.6	715.2	810.6
Net Interest Income	**331.4**	**400.9**	**482.4**	**561.9**	**648.1**	**740.8**	**864.8**
Growth (%)	20.1	21.0	20.3	16.5	15.3	14.3	16.7
Non Interest Income	123.0	152.2	176.3	232.6	239.6	301.9	350.2
Total Income	**454.4**	**553.2**	**658.7**	**794.5**	**887.7**	**1,042.7**	**1,215.0**
Growth (%)	18.5	21.7	19.1	20.6	11.7	17.5	16.5
Operating Expenses	197.0	226.9	261.2	307.0	322.2	378.9	436.5
Pre Provision Profits	**257.3**	**326.2**	**397.5**	**487.5**	**565.5**	**663.8**	**778.5**
Growth (%)	20.4	26.8	21.8	22.6	16.0	17.4	17.3
Core PPP	**220.9**	**311.0**	**380.3**	**465.9**	**533.4**	**626.6**	**734.9**
Growth (%)	19.7	40.8	22.3	22.5	14.5	17.5	17.3
Provisions (excl tax)	35.9	59.3	75.5	121.4	163.5	176.4	193.5
PBT	**221.4**	**267.0**	**322.0**	**366.1**	**402.0**	**487.4**	**585.0**
Tax	75.9	92.1	111.2	103.5	101.2	122.7	147.2
Tax Rate (%)	34.3	34.5	34.5	28.3	25.2	25.2	25.2
PAT	**145.5**	**174.9**	**210.8**	**262.6**	**300.9**	**364.7**	**437.7**
Growth (%)	18.3	20.2	20.5	24.6	14.6	21.2	20.0

Balance Sheet

Y/E March	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Equity Share Capital	5.1	5.2	5.4	5.5	5.5	5.5	5.5
Reserves & Surplus	855.6	1,057.8	1,486.6	1,704.4	1,952.4	2,261.0	2,639.4
Net Worth	**860.7**	**1,063.0**	**1,492.1**	**1,709.9**	**1,957.9**	**2,266.5**	**2,644.9**
Deposits	6,436.4	7,887.7	9,231.4	11,475.0	13,368.4	15,641.0	18,456.4
Growth (%)	17.8	22.5	17.0	24.3	16.5	17.0	18.0
of which CASA Dep	3,091.5	3,430.9	3,912.0	4,846.3	5,534.5	6,553.6	7,844.0
Growth (%)	30.8	11.0	14.0	23.9	14.2	18.4	19.7
Borrowings	740.3	1,231.0	1,170.9	1,446.3	1,397.4	1,433.1	1,480.3
Total Liabilities	**8,638.4**	**10,639.3**	**12,445.4**	**15,305.1**	**17,485.3**	**20,201.2**	**23,554.0**
Current Assets	489.5	1,229.2	813.5	866.2	1,196.0	1,365.9	1,535.1
Investments	2,144.6	2,422.0	2,931.2	3,918.3	4,329.7	4,935.8	5,626.9
Growth (%)	9.5	12.9	21.0	33.7	10.5	14.0	14.0
Loans	5,545.7	6,583.3	8,194.0	9,937.0	11,129.5	12,910.2	15,234.0
Growth (%)	19.4	18.7	24.5	21.3	12.0	16.0	18.0
Fixed Assets	36.3	36.1	40.3	44.3	48.8	53.6	59.0
Total Assets	**8,638.4**	**10,639.3**	**12,445.4**	**15,305.1**	**17,485.3**	**20,201.2**	**23,554.0**

Asset Quality

Y/E March	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
GNPA	58.9	86.1	112.2	126.5	233.8	313.9	366.2
NNPA	18.4	26.0	32.1	35.4	55.2	82.0	92.6
GNPA Ratio	1.1	1.3	1.4	1.3	2.1	2.4	2.4
NNPA Ratio	0.3	0.4	0.4	0.4	0.5	0.6	0.6
Slippage Ratio	1.5	2.1	1.9	1.9	2.7	2.3	2.0
Credit Cost	0.6	0.8	0.9	1.0	1.5	1.4	1.3
PCR (Excl Tech. write off)	68.7	69.8	71.4	72.0	76.4	73.9	74.7

Financials and Valuations

Ratios

Y/E March	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Yield & Cost Ratios (%)							
Avg. Yield-Earning Assets	**9.6**	**9.4**	**9.6**	**9.0**	**8.7**	**8.5**	**8.4**
Avg. Yield on loans	10.2	10.3	10.5	10.1	9.7	9.5	9.4
Avg. Yield on Invt	7.8	7.2	7.6	6.1	6.5	6.4	6.3
Avg. Cost-Int. Bear. Liab.	**5.5**	**4.9**	**5.2**	**5.0**	**4.7**	**4.5**	**4.4**
Avg. Cost of Deposits	5.3	4.6	4.8	4.9	4.5	4.3	4.2
Interest Spread	**4.2**	**4.5**	**4.4**	**4.0**	**4.0**	**4.0**	**4.0**
Net Interest Margin	**4.6**	**4.4**	**4.4**	**4.2**	**4.1**	**4.1**	**4.2**
Capitalisation Ratios (%)							
CAR	14.6	14.8	17.1	18.5	18.6	18.5	18.4
Tier I	12.8	13.3	15.8	17.2	17.5	17.5	17.5
Tier II	1.8	1.6	1.3	1.3	1.1	1.0	0.9
Business and Efficiency Ratios (%)							
Loans/Deposit	86.2	83.5	88.8	86.6	83.3	82.5	82.5
CASA Ratio	48.0	43.5	42.4	42.2	41.4	41.9	42.5
Cost/Assets	2.3	2.1	2.1	2.0	1.8	1.9	1.9
Cost/Total Income	43.4	41.0	39.7	38.6	36.3	36.3	35.9
Cost/Core Income	45.8	42.2	40.7	39.7	37.7	37.7	37.3
Int. Expense/Int.Income	52.2	50.0	51.3	51.1	50.1	49.1	48.4
Fee Income/Total Income	21.8	22.8	23.5	24.1	20.9	23.1	23.1
Non Int. Inc./Total Income	27.1	27.5	26.8	29.3	27.0	29.0	28.8
Empl. Cost/Total Expense	32.9	30.0	29.7	31.0	32.2	31.2	31.2
Investment/Deposit	33.3	30.7	31.8	34.1	32.4	31.6	30.5

Valuation

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
RoE	17.9	17.9	16.5	16.4	16.4	17.3	17.8
RoA	1.8	1.8	1.8	1.9	1.8	1.9	2.0
RoRWA	2.4	2.4	2.4	2.6	2.7	2.9	3.0
Book Value (INR)	167.9	204.8	273.9	311.8	357.1	413.4	482.3
Growth (%)	16.9	22.0	33.8	13.8	14.5	15.8	16.7
Price-BV (x)	**7.3**	**6.0**	**4.5**	**4.0**	**3.5**	**3.0**	**2.6**
Adjusted BV (INR)	165.4	193.9	262.8	300.3	342.3	394.1	460.5
Price-ABV (x)	**7.5**	**6.4**	**4.7**	**4.1**	**3.6**	**3.1**	**2.7**
EPS (INR)	28.4	33.9	39.6	48.0	54.9	66.5	79.8
Growth (%)	16.7	19.4	16.9	21.2	14.2	21.2	20.0
Price-Earnings (x)	**43.4**	**36.4**	**31.1**	**25.7**	**22.5**	**18.5**	**15.4**
Dividend Per Sh (INR)	5.5	7.8	9.0	11.9	9.6	10.2	10.8
Dividend Yield (%)	**0.4**	**0.6**	**0.7**	**1.0**	**0.8**	**0.8**	**0.9**

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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