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Stock Update

HDFC Bank

An encouraging show

Banks & Finance	Sharekhan code: HDFCBANK	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,466**	
Price Target: **Rs. 1,810**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

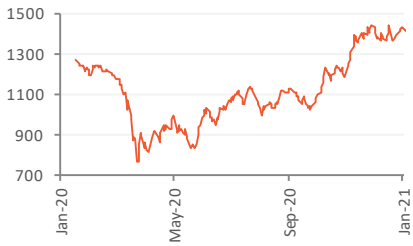
Company details

Market cap:	Rs. 8,07,615 cr
52-week high/low:	Rs. 1,494/739
NSE volume: (No of shares)	118.5 lakh
BSE code:	500180
NSE code:	HDFCBANK
Free float: (No of shares)	433.9 cr

Shareholding (%)

Promoters	21.1
FII	50.8
DII	18.4
Others	9.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.9	22.3	38.0	13.9
Relative to Sensex	-1.1	-0.3	3.6	-3.1

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on HDFC Bank with a revised price target (PT) of Rs. 1,810.
- Q3FY2021 results were strong as operational performance exceeded expectations, margins rose; asset quality improved on a q-o-q basis; advances & CASA saw a healthy pick-up q-o-q.
- Management commentary was positive and reassuring, indicating a bright long-term outlook; net interest margin (NIMs) stood at 4.2% (up 10 bps q-o-q and within the guidance range) due to healthy advances growth and high CASA share.
- HDFC Bank currently trades at 3.7x/3.2x its FY2022E/FY2023E ABVPS, which we find is reasonable; we have fine-tuned our estimates and the target multiple for the bank considering improving earnings visibility.

Q3FY2021 results were strong with operational performance exceeding expectations, improving margins and market share gains. Asset quality improved q-o-q basis with a healthy pick-up in advances and CASA help in NIM expansion q-o-q basis. Results indicated a return to normalcy with collection efficiency improving to near normal in December. The management commentary was positive and reassuring and indicated a bright long-term outlook. For Q3FY2021, net interest income (NII) was at Rs. 16,317 crore, up 15.1% y-o-y (in line with expectations), while PAT stood at Rs. 8,758 crore, up 18.1% y-o-y (better than expectations). Net interest margin (NIMs) came at 4.2% (up 10 bps sequentially and within the guidance range) due to healthy advances growth and high CASA share, despite the excess balance sheet liquidity and lower loan yields. Collection trends were encouraging, with demand resolutions (collections efficiency) at ~97% for December (from ~95% in September 2020 and 97% in October 2020), which reflect HDFC Bank's superior customer profile and robust collection mechanisms and indicate a positive revert to normalcy for the bank. The management commentary was encouraging, and indicated that cost to income ratio is expected to revert to 38-39% in the short run but continue to pare down on the long term basis. The restructured book (under COVID-19) at 0.5% of advances is manageable and some portion of the same is already a part of the proforma GNPA. However, asset quality and profitability performance for subsidiaries were sub-par, with a rise in proforma GNPAs and elevated provisions reflecting challenges. The bank indicates a strong deal pipeline in corporate segment and expects robust retail credit pickup, led by healthy disbursement trends. Going forward, we expect the bank to further leverage technology/reach to gain market share across business lines, buoyed by better efficiencies and, thereby, deliver superior RoAs. We expect HDFC Bank's business quality and franchise strength will help it tide over near-term challenges and to be well placed to benefit from normalcy in business. We have fine-tuned our estimates and the target multiple for the bank considering the waning of headwinds and improving earnings visibility. We retain a Buy rating on the stock with a revised price target (PT) of Rs. 1,810.

Key positives

- CASA deposits improved to 43% (was 41.6% of total deposits for Q2FY2021) despite healthy deposit growth, CASA growing by robust 29.6% q-o-q.
- Growth traction was healthy as domestic advances rose by 14.9% y-o-y; indicating market share gain for the bank.
- Net interest margin (NIM) increased sequentially, to 4.2% (from 4.1% in Q2 FY2021) and was within the guidance range, helped by lower cost of funds and growth.

Key negatives

- Difference between reported numbers and normalised GNPAs have widened in Q3 (GNPAs difference is 57 bps, NNPAs difference is 31 bps; higher as compared to 29 bps and 18 bps in Q2); however healthy provision coverage of reported GNPA is 260% and that of pro-forma GNPA is 148% provides comfort.

Our Call

Valuation: HDFC Bank currently trades at 3.7x/3.2x its FY2022E/FY2023E ABVPS, which we find is reasonable. We believe the bank's consistency is buoyed by its robust underwriting capability and risk measurement standards, which provide support for valuations. We find management's indications for stable NIMs, and a structurally improving cost-income ratio encouraging, while the high provisioning buffer should provide support to asset quality and profitability. We have fine-tuned our estimates and the target multiple for the bank considering the improving earnings visibility. We retain a Buy rating on the stock with a revised price target (PT) of Rs. 1,810.

Key risk

An elongated phase of uncertainty due to a prolonged recovery and intermittent slowdown may affect growth, the rise in NPAs in unsecured and other retail segments may pose risks to profitability.

Valuations Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Net interest income	56,186	69,271	79,025	88,969
Net profit	26,257	30,955	39,163	43,743
EPS (Rs)	47.9	56.2	71.2	79.5
PE (x)	30.6	26.1	20.6	18.4
Adj book value (Rs/share)	301.1	349.6	398.1	452.5
P/ABV (x)	4.9	4.2	3.7	3.2
RoE (%)	16.4	16.7	18.2	17.8
RoA (%)	1.9	1.9	2.0	1.9

Source: Company; Sharekhan estimates

Key Conference call takeaways

- **Asset quality:** Proforma slippage ratio stood at 1.86%, while proforma GNPA stood at 1.38%. Proforma NNPA was at 0.40%. Interest reversals on proforma slippages have been considered during the quarter. Proforma GNPA also includes a part of the restructuring book assets. Excluding the agricultural book, pro-forma GNPA ratio is 1.2%, which is the same for sequential and prior-year quarter.
- **Provisions:** Of the total Rs. 3,414 crore provisions during the quarter, Rs. 2,400 crore are provisions on pro-forma NPA. The provisions also include about Rs. 5,000 crore of general provisions, the provision coverage of reported GNPA is 260% and that of proforma GNPA is 148%.
- **Restructuring book:** Restructuring as per the RBI resolutions framework for COVID-19 is at 0.5% of the total advances. Restructuring has been done on customer request. There are few corporate restructuring cases but they are insignificant amount.
- **Cost to Income:** The C/I ratio is expected to be back to 38-39% in the short term, but in the medium term the management intends to continue to pare down.
- **Wholesale portfolio:** The book is continuing to do well. Most of the growth is coming from well rated public and private sector enterprises. Average rating of the portfolio has remained steady; around 90% of the externally rated book is rated 'A and above'. Average internal rating of incremental wholesale loans is 4.37, which corresponds to the external rating of AA / AAA.
- **SME Book:** In the SME portfolio, 30+ DPD has shown improvement since September. Stress in the book is as per bank's stress test of ~2.3%. Delinquency trends have shown improvement across all buckets.
- **Retail portfolio:** Demand resolution is 97% (was ~98% pre-COVID level). The management believes that the bank will reach pre-COVID levels soon. Collections resolution is improving month-on-month. Recovery in Written off accounts is also doing well. Bank is observing bullish growth rate in Retail working capital loans, home loans, auto loans, LAP etc. There is double-digit q-o-q growth in the disbursement.
- **Loans sold:** During Q3FY2021, the bank sold off some retail assets, but financial impact is already taken on books.
- **Gold loan:** Gold loan is also seeing good growth, and bank is looking at physical distribution with liability branches to grow. Home Loans have benefitted form stamp duty reduction, etc, steps.
- **MFI:** In the MFI segment, normal run-rate expected to resume form January 2021 itself.
- **ECLGS disbursements:** Disbursements under ECLGS-1 was Rs. 22,100 crore and for ECLGS-2 Rs. 579 crore.
- **CASA:** Bank saw 20% y-o-y growth in SA accounts, and 15% y-o-y in CA account. During Q3, bank opened 2 million liability relations, and so far 2.3 lakh CASA accounts have opened in FY2021.
- **Credit Cards and business banking:** Cards grew by 32% QoQ, merchant acquisition volumes were up 20% QoQ
- **LCR:** The LCR for Q3 stood at 146%, mainly due to excess liquidity position, which impacts NIMs by ~15 bps.
- **Fee income:** The fee & commission has retail contribution of 94%, remaining from wholesale.
- **Subsidiaries:** There was mixed performance in the Subsidiaries. Overall asset quality trend in its NBFC subsidiary, HDB Fin Services (HDFC Bank holds 95.1% in HDB), remains sub-par, with HDB Financials posting loss of Rs 44.3 crores. While the reported book quality improved with GNPA at 2.7% (versus 4.5% in Q2FY2021) and Net NPA at 1.7% of net advances, however, on a proforma basis, the GNPA stood at 5.9% (was 5.1% in Q2 FY2021). However, HDFC Securities (bank holds 96.5% stake) posted profit of Rs 166 crores, up 64% YOY.
- **Branches:** Bank expects to add 100 branches by the end of the year.

Results **Rs cr**

Particulars	Q3FY21	Q3FY20	y-o-y %	Q2FY21	QoQ %
Interest income	30,079.7	29,369.7	2.4	29,977.0	0.3
Interest expense	13,762.1	15,196.8	-9.4	14,200.6	-3.1
Net interest income	**16,317.6**	**14,172.9**	**15.1**	**15,776.4**	**3.4**
Non-interest income	7,443.2	6,669.0	11.6	6,092.5	22.2
Net total income	23,760.8	20,841.9	14.0	21,868.8	8.7
Operating expenses	8,574.8	7,896.8	8.6	8,055.1	6.5
Pre-provisioning profit	**15,186.0**	**12,945.1**	**17.3**	**13,813.8**	**9.9**
Provisions	3,414.1	3,043.0	12.2	3,703.5	-7.8
Profit before tax	11,771.9	9,902.1	18.9	10,110.3	16.4
Tax	3,013.6	2,485.4	21.3	2,597.2	16.0
Profit after tax	**8,758.3**	**7,416.8**	**18.1**	**7,513.1**	**16.6**
Asset Quality					
Gross NPAs	8,825.6	13,427.3	-34.3	11,304.6	-21.9
-Gross NPA (%)	0.81	1.42	-61 bps	1.08	-27 bps
Net NPAs	1,016.0	4,468.4	-77.3	1,756.1	-42.1
-Net NPA (%)	0.09	0.48	-39 bps	0.17	-8 bps
Key reported ratios (%)					
NIM (%)	4.2	4.2	0 bps	4.1	10 bps
CASA (%)	43.0	40.0	300 bps	41.6	140 bps

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Credit growth yet to pick-up, private banks placed better

Overall, the bank's aggregate credit offtake is still tepid at ~6.7%, for the latest period. This indicates a gradual recovery, though credit offtake pace is still sub-normal. However, deposits have rose by 11.5% (best since March 31, 2017) which indicates healthy economic scenario, which along with a sustained accommodative monetary stance provides succour in terms of lower cost of funds for banks and financial services companies. The loan moratorium has duly ended, which is a relief; and going forward, the collection efficiency is likely to be a function of book quality, client profile as well as economic pickup. At present, we believe the banking sector is likely to see a gradual normalization in business offtake, with increased risk-off behaviour, and expect tactical market share gains for well-placed players. We believe private banks, with improved capitalisation and strong asset quality (with high coverage, provisions buffers) are structurally better placed to take-off once the situation normalises.

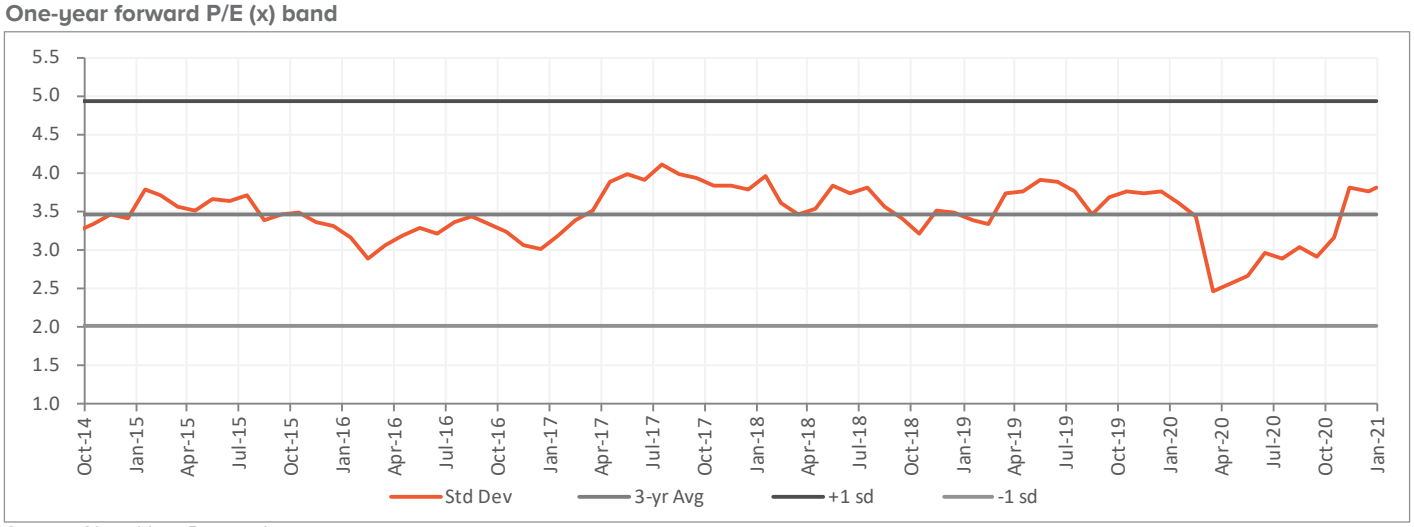
Company Outlook – Improved outlook

We believe structural drivers are in place for HDFC Bank, helping it gain market share, aided by operational efficiencies and best-in-class asset quality. Succession in the top management has been smooth and now the focus shifts back to business fundamentals. Going forward, we see outlook improving on credit cost and growth, even though challenges remain. However, the bank has built strong provision buffer, which work as strong bulwark against probable future risks. Notably, the franchise continues to be one of the best-managed and strongest business models and needs to be seen from a long-term perspective. Overall, asset quality looks sanguine, with its calibrated growth and strong underwriting and assessment capabilities and healthy digitalisation benefits adding to the moat of its business strength. HDFC Bank's floating provision cushion of Rs. 1,450 crore and contingent provisions of Rs. 8,656 crore along with comfortable capitalisation levels (Tier-1 ratio at 17.6%) are additional positives. We believe HDFC Bank's business quality and franchise strength will help it tide over near-term challenges.

Valuation – Maintain Buy with Price target of Rs 1,810

HDFC Bank currently trades at 3.7x/3.2x its FY2022E/FY2023E ABVPS, which we find is reasonable. We believe the bank's consistency is buoyed by its robust underwriting capability and risk measurement standards, which provide support for valuations. We find management's indications for stable NIMs, and a structurally improving cost-income ratio encouraging, while the high provisioning buffer should provide support to asset quality and profitability. We have fine-tuned our estimates and the target multiple for the bank considering the improving earnings visibility. We retain a Buy rating on the stock with a revised price target (PT) of Rs. 1,810.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HDFC Bank	1,466	4.2	3.7	26.1	20.6	1.9	2.0	16.7	18.2
ICICI Bank	543	2.7	2.4	26.8	20.1	1.2	1.4	10.7	12.2
Axis Bank	675	2.1	1.9	27.8	16.6	0.7	1.1	8.0	11.4

Source: Company, Sharekhan research

About company

HDFC Bank is the largest private sector bank with a pan-India presence. The bank has been designated by the Reserve Bank of India (RBI) as a domestic systemically important bank (D-SIB), underlining its importance in the financial system. 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. The bank's loan book is well balanced between retail and 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 strong presence in the retail segment with strong asset quality and best-in-class margins. Not only the bank, but its strong and marquee parentage enjoy arguably the strongest brand recall in the country, which is at a significant competitive advantage in the Indian banking space. Buoyed by a strong brand appeal, impressive corporate governance, and strong management team (consistency in performance and best-in-class granular clientele) has enabled HDFC bank to be a long-term wealth creator for investors, and the above factors still hold true. The bank continues to report consistent margins and advances growth over the years across various credit/interest rate cycles and has been able to maintain its asset quality too, which is indicative of the strong business franchise strength and leadership qualities. We believe the bank has a strong business model and is relatively well placed to tide over near-term challenges.

Key Risks

An elongated phase of uncertainty due to a prolonged recovery and intermittent slowdown may affect growth, the rise in NPAs in unsecured and other retail segments may pose risks to profitability.

Additional Data

Key management personnel

Mr Sashidhar Jagdishan	Managing Director/CEO
Mr Jimmy Tata	Chief Risk Officer
Mr Srinivasan Vaidyanathan	Group Chief Financial Officer
Mr Vinay Razdan	Chief Human Resources Officer
Mr Ashish Partharsarthy	Treasurer
Ms Ashima Bhat	Head - Finance & Strategy

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	6.2
2	HDFC Investment Ltd	5.5
3	LIC	3.1
4	SBI Funds Management Pvt Ltd	2.9
5	50 SBI-ETF Nifty	2.8
6	Morgan Stanley	1.7
7	FIL Ltd	1.4
8	FMR LLC	1.1
9	ICICI PRUDENTIAL Life Insurance Co Ltd	1.0
10	JPMorgan Chase & Co	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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