Sharekhan by BNP PARIBAS

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HDFC Bank

Q1 a mixed bag as NPLs rise

Banks & Finance	Sharekhan code: HDFCBANK	Result Update

Summary

- Operational performance was mixed in Q1FY2022.NII growth at 8.6% y-o-y in Q1QFY22 was lowest since Q1FY16 due to slower retail loan growth. NIM slid 10 bps lower q-o-q to 4.1%. PAT met expectations despite higher provisions, but this provides bank adequate cushions going ahead.
- Asset quality deteriorated q-o-q primarily due to subdued collections given the lockdowns in April-May amid the second wave of COVID-19. Advances rose decently and an improved CASA ratio helped sustain NIM q-o-q.
- HDB financials earnings contracted 44% y-o-y in 1Q due to the end wave of pandemic. GNPL to 7.75% in 1Q from 3.9% in 4QFY21
- Stock currently trades at 3.9x/3.4x its FY2022E/FY2023E ABVPS, it has underperformed the broad BSE Sensex by 5% in the past 12 months, indicating a favourable risk-reward.
- We retain a Buy with an unchanged price target (PT) of Rs. 1,810.

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. 1,522**	
Price Target: **Rs. 1,810**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

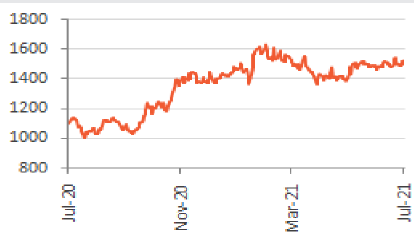
Company details

Market cap:	Rs. 841,001 cr
52-week high/low:	Rs. 1,650/994
NSE volume: (No of shares)	87.0 lakh
BSE code:	500180
NSE code:	HDFCBANK
Free float: (No of shares)	409 cr

Shareholding (%)

Promoters	26.0
FII	39.8
DII	13.0
Others	23.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3	6.5	-4.1	38
Relative to Sensex	1	-2	-12	-5

Sharekhan Research, Bloomberg

Q1FY2022 results saw steady operational performance, and Asset quality deteriorated (amid the second wave of COVID-19).NIM fell 10 bps q-o-q to 4.1% due to excess liquidity. Asset quality surprised negatively, with GNPA deteriorating q-o-q. Meanwhile, a decent pick-up in advances and stable CASA helped NIM sustain sequentially. PAT was in line with our expectations despite additional contingent provisions of Rs.600 crore, mainly amid the second wave of COVID-19. However, we believe that the bank is well-placed with adequate provisions, which provides a cushion for profitability, going forward. Total provisions at 146% of GNPL as of June shield the balance sheet. Retail credit growth remained subdued at 9.3% y-o-y indicating continuing bank's cautious stance aided further by the lockdown in April-May. This impacted loan origination and sale of third party products. Corporate loan growth remains very strong, leading to retail share slipping to 45% from 47% in Mar-21. Bank has indicated its strategy would continue to capture market share incorporate loans and has built a strong commercial banking and rural portfolio (33% of the total portfolio). It expects thisto be a strong earnings driver, going forward. NII stood at Rs. 17009 crore for Q1FY22, up 8.6% y-o-y (in line with expectations), while PAT stood at Rs. 7,730 crore, up 16.4% y-o-y,in line with expectations. NIMs came in at 4.1% (10 bps lower sequentially and within the guidance range) due to healthy advances growth and high CASA share. Retail collection efficiency (CE) and bounce rates were impacted severely in April-May-21 amid the second COVID-19 wave and the subsequent lockdowns. However the collection efficiencies have improved in June & July-21 basis is encouraging. This has led slippages at 2.54% in Q1FY22 higher than 1.66% seen in Q4FY2022.Asset Quality and profitability performance for subsidiaries, deteriorated. GNPAs of its subsidiary HDB Financial, (a subsidiary of HDFC Bank) increased to 7.75% in 1QFY22 from 3.9% in Q4FY21. 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 dynamic environment. We retain a Buy rating on the stock with an unchanged price target (PT) of Rs. 1,810.

Key positives

- Earnings rose 16% y-o-y despite a 24% y-o-y increase in provisions. The provision cushion would shield the balance sheet from any adverse economic downturn.
- Growth traction was healthy as domestic advances rose by 14% y-o-y; indicating market share gains.
- NIMs stable at 4.1%, in line with the long-term guidance range.

Key negatives

- Gross NPLs increased 24% y-o-y to INR17099 cr in 1Q led by the 2nd wave of Covid. The subsequent lockdown led to lower collections and recovery.
- Slowest y-o-y growth in NII in Q1FY22 since Q1FY16
- Weak financial performance of HDB Financials with earnings contracting 44% y-o-y

Our Call

HDFC Bank currently trades at 3.9x/3.4x its FY2022E/FY2023E ABVPS, and stock has underperformed the broad indices by 5% over the past 1 year. The risk-reward is now favourable. Considering the challenging times, we expect resilience and a strong business model will be all the more important, as evident with HDFC Bank which is well-capitalised and has a strong balance sheet. The bank's consistency is buoyed by its robust underwriting capability, risk measurement standards and focused on high quality corporates, which support the valuations. We find the management's focus for stable NIMs, and a structurally improving cost-income ratio encouraging, while the high provisioning buffer should support asset quality and profitability. We have fine-tuned our estimates and the target multiple for the bank considering the dynamic environment. We retain a Buy rating on the stock with a unchanged price target (PT) of Rs. 1,810.

Key Risks

Prolonged uncertainty due to intermittent lockdowns may impact growth and rise in NPAs in unsecured and other retail segments can pose a risk to profitability.

Valuation Rs cr

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Net interest income	56,186	64,880	77,416	88,679	1,05,416
Net profit	26,257	31,117	36,258	43,006	52,773
EPS (Rs)	47.9	56.5	65.9	78.1	95.9
PE (x)	31.8	26.9	23.1	19.5	15.9
Adj book value (Rs/share)	299.8	348.3	392.1	445.5	511.3
P/ABV (x)	5.1	4.4	3.9	3.4	3.0
RoE (%)	16.4	16.7	16.9	17.6	18.9
RoA (%)	1.9	1.9	1.9	2.0	2.0

Source: Company; Sharekhan estimates

HDFC Bank Q1 FY2022 Concall Notes

On economy: High frequency data such as power demand, automobile sales and rural demand were severely impacted in April-May 2021 due to localised lockdown led by second COVID-19 wave. It however picked in June-21. Bank has improved its ranking to second place as debt arrangers. Efforts on franchise building continue and balance sheet remains resilient.

Market share gains across board: Bank signed up 1.71 lakh village level entrepreneurs - 15,656 (from ~13,500 in Q3FY21) business correspondents. In its Healthcare initiative, has reached out to more than 200 hospitals and has activated funding at hospitals in Q1FY22.Bank has successfully acquired 2.67mn corporate salary accounts

Liquidity: Average liquidity coverage ratio stood at 126% and the excess liquidity has impacted NIMs by 10 bps.

CRAR: The CRAR is at 19.1% and CET-1 is at 17.9%

Technology-related outages: Card management, sourcing, activation – investments are continuously being made. Three-fourths of sourcing comes from existing customers of the bank – they all have debit cards and can give instalment or revolving facility on debit cards. Portfolio activation in cards were up. Bank is doing independent Audit which is in final stage and will update more as it hears from the regulator. Looking to build capabilities on core system, partnering with OEMs etc. Setting highest standards – recovery time, recovery point, consolidation of data centers and enhancement in security.

Asset sales: The bank sold Rs. 1,800 crore worth of assets and will continue to do so wherever it finds a higher economic value.

Asset quality: Gross NPLs increased 24% y-o-y to Rs. 17,099 crore. This was led by a decrease in – 1) loan originations, 2) sale of third-party products, 3) use of credit and debit cards by customers and the lower collection. This led to continued rise in the number of defaults and consequently higher NPLs and provisions. HDFC Bank has made adequate and prudent provisions. Total provisions were 146% of total GNPLs as of Q1FY22.

Recoveries: Recoveries were impacted due to the second wave of COVID-19 and lockdown has been at 14% (versus 30% in Q4FY21)

Provision coverage: Loan loss provisions for Q1FY22 stood at Rs. 4219.7 crore out of total provision of Rs. 4,831 crore. The bank also held floating provisions of Rs. 1450 crore and contingent provision of Rs.6,596 crore.

Movement of NPLs: Core annualised slippages in Q4FY21 is 2.54% or Rs7300 crore. GNPLs excluding agri is 1.3%.Core credit cost is 1.47% (as compared to 1.11% in the previous quarter).

Business outlook: In the retail segment, the bank is seeing resilience in middle-class customers, who are now coming back. We expect robust growth in personal loans, home loans, etc. We expect strong growth in Q2FY2022 although the bank will have to be more careful and do more micro-issue focused, but the outlook is positive.

Restructuring: Restructuring under the RBI's resolution framework for COVID-19 was approximately 60 bps of advances and was done as per the customers' request.

Provision Coverage: In Q1FY22, the bank set aside higher provision because of anticipated stress due to weak collections and COVID second wave. PCR (calculated) was stable at 67% and was lower than 70% in Q4FY21

Risk assessment of Advances book: As externally rated, nearly 86% of the wholesale portfolio is AA & AAA. In Q1FY21, the management has shared that the risk assessment is also done internally by scale of HDB - 1 to 10, which has served the bank well over the years and is time tested. As of Q1FY22, the weighted average asset scale of 1 to 10 stood at 4.35 against 4.43 in Q4FY21. The unsecured books have a better underwriting process in the absence of any collateral. The credit to top 20 borrowers are at a scale of 2.12. Around 65% of the incremental portfolio are 'AA or above'.

Deposits: Deposits stood at Rs13,45,829 crore and grew by 13.3% y-o-y and 0.8% q-o-q; CASA ratio stood at 45.5% against 43% in the previous quarter. Retail deposits contributed to 80% of total deposits.

HDB Financial: Loan book increased 1% y-o-y to Rs. 57,390 crore. Net income rose 3% to Rs. 1656 crore while PPoP decreased 15% y-o-y to Rs. 644 crore. Net profit contracted 44% to Rs. 133 crore in Q1FY22 due to 4% y-o-y increase in provisions. GNPA increased to 7.75% in Jun-21 from 3.9% in March 2021.

Results | Rs cr

Particulars	Q1FY22	Q1FY21	y-o-y %	Q4FY21	q-o-q%
Interest income	30483	30377.97	0.35%	30423.59	0.2%
Interest expense	13474.00	14712.55	-8.42%	13303.44	1.3%
Net interest income	**17009.00**	**15665.42**	**8.58%**	**17120.15**	**-0.6%**
Non-interest income	6288.50	4075.31	54.31%	7593.91	-17.2%
Net total income	23297.50	19740.73	18.02%	24714.06	-5.7%
Operating expenses	8160.58	6911.46	18.07%	9181.29	-11.1%
Pre-provisioning profit	**15136.92**	**12829.27**	**17.99%**	**15532.77**	**-2.5%**
Provisions	4831.00	3891.52	24.14%	4693.70	2.9%
Profit before tax	10305.92	8937.75	15.31%	10839.07	-4.9%
Tax	2577.00	2279.00	13.08%	2652.56	-2.8%
Profit after tax	**7728.92**	**6658.75**	**16.07%**	**8186.51**	**-5.6%**
Asset Quality					
Gross NPAs	17098.50	13773.46	24.14%	15086.00	13.3%
-Gross NPA (%)	1.47	1.36	11 bps	1.32	15 bps
Net NPAs	5819.12	3279.96	77.41%	4554.82	27.8%
-Net NPA (%)	0.48	0.33	15 bps	0.36	12 bps
Key reported ratios (%)					
NIM (%)	4.10	4.20	-10 bps	4.30	20 bps
CASA (%)	45.50	40.00	5.5 ppt	46.00	0.5 ppt

Source: Company; Sharekhan Research; Note – ppt – percentage point

Outlook and Valuation

■ Sector view - Credit growth yet to pick up, private banks are better placed

System-level credit offtake, which is still subdued, is now improving, with credit growth of over 5.8% in the latest fortnight. On the other hand, deposits rose by ~10%, which indicate relatively healthy economic scenario. Moreover, the accommodative stance of the Reserve Bank of India (RBI), resulting in surplus liquidity, provides succour in terms of easy availability of funds and lower cost of funds for banks and financials. Going forward, 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 increased risk-off behaviour, with tactical market share gains for well-placed players. We believe private banks which are retail focused, strong capital and superior asset quality (with high coverage and provisions buffers) are structurally better placed to take-off once the situation normalises.

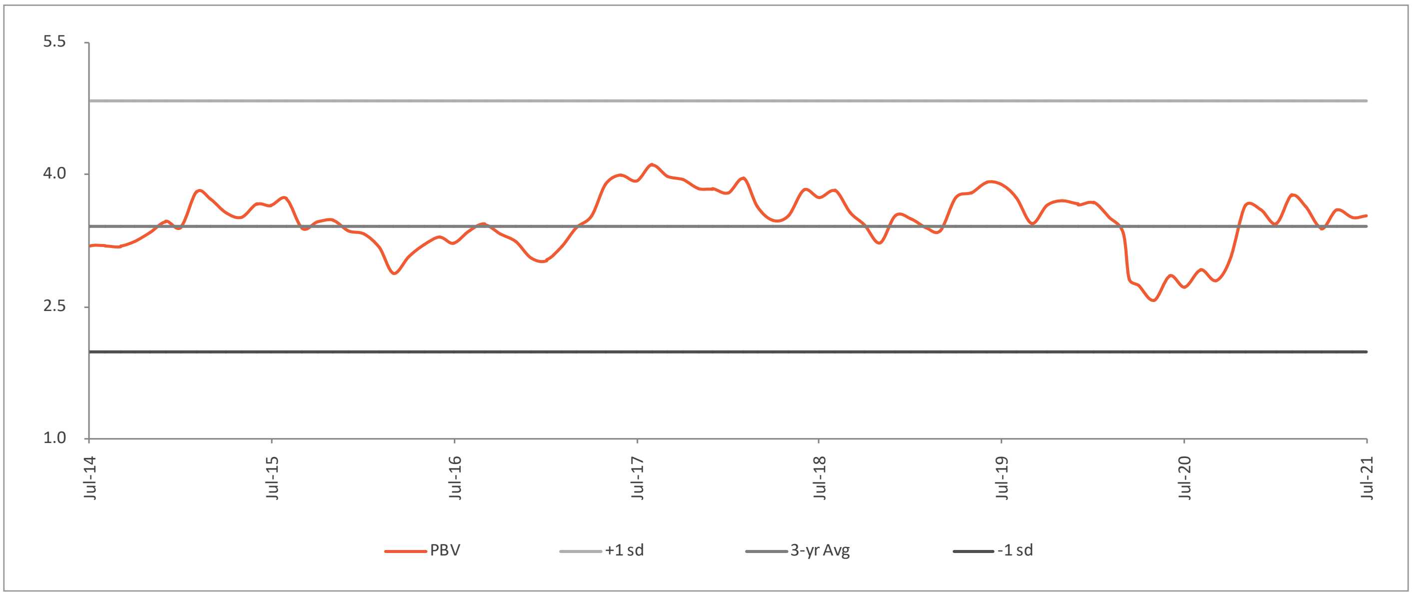
■ Company outlook - strong fundamentals to continue

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. Going forward, we see growth outlook improving on credit cost and growth, even though medium-term challenges remain. The bank has built strong provision buffer, which work as a 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. 1,451 crore and contingent provisions of Rs. 6,596 crore (June 2021) along with comfortable capitalisation levels (Tier-1 ratio at 17.9%) 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 an unchanged price target (PT) of Rs. 1,810

HDFC Bank currently trades at 3.9x/3.4x its FY2022E/FY2023E ABVPS, and stock has underperformed the broad indices by 5% over the past 1 year. The risk-reward is now favourable. Considering the challenging times, we expect resilience and a strong business model will be all the more important, as evident with HDFC Bank which is well-capitalised and has a strong balance sheet. The bank's consistency is buoyed by its robust underwriting capability, risk measurement standards and focused on high quality corporates, which support the valuations. We find the management's focus for stable NIMs, and a structurally improving cost-income ratio encouraging, while the high provisioning buffer should support asset quality and profitability. We have fine-tuned our estimates and the target multiple for the bank considering the dynamic environment. We retain a Buy rating on the stock with a unchanged price target (PT) of Rs. 1,810.

One-year forward PBV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs)	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
HDFC Bank	1,522	3.9	3.4	23.1	19.5	1.9	2.0	16.9	17.6
ICICI Bank	660	2.0	2.7	22.4	18.1	1.0	1.6	12.7	14.0
Axis Bank	771	2.5	2.2	23.2	21.7	0.7	1.4	9.5	9.4

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

Prolonged uncertainty due to intermittent lockdowns may impact growth and rise in NPAs in unsecured and other retail segments can pose a risk 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc/The	6.2
2	HDFC Investment Ltd	5.5
3	SBI-ETF NIFTY 50	3.3
4	EUROPACIFIC GROWTH FUND	3.6
5	LIFE INSURANCE CORPORATION OF INDIA	3.4
6	SBI Funds Management Pvt Ltd	2.9
7	Morgan Stanley	1.7
8	FIL Ltd	1.4
9	FMR LLC	1.1
10	ICICI PRUDENTIAL Life Insurance Co Ltd	1.0

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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