

HDFC Ltd announced its merger with HDFC Bank

CMP: INR 1,657

Rating: Accumulate

Target Price: INR 1,910

Stock Info

BSE	500180
NSE	HDFCBANK
Bloomberg	HDFCB IN
Reuters	HDBK.BO
Sector	Banks
Face Value (INR)	1
Equity Capital (INR Cr)	554
Mkt Cap (INR Cr)	918,785
52w H/L (INR)	1,725 / 1,292
Avg Yearly Vol (in 000')	7,496

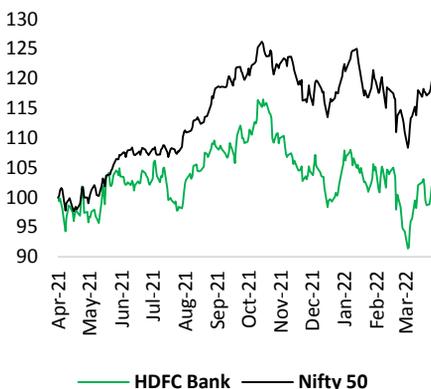
Shareholding Pattern %

(As on Dec, 2021)

Promoters	25.8
FII	37.5
DII	22.9
Public & Others	13.8

Stock Performance (%)	1m	3m	12m
HDFC Bank	21.2	8.4	11.4
Nifty 50	11.1	1.4	21.4

HDFC Bank Vs Nifty



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HDFC Ltd's board has announced its merger with HDFC Bank subject to necessary approval. The share swap ratio is 42 shares of HDFC Bank for every 25 shares of HDFC and merger is likely to be closed over the next 16-18 months (by Q3FY24). Based on pro-forma Dec'21 numbers, merger is ~3% EPS-accretive and ~8% BVPS-accretive for HDFC Bank. The combined entity will have advances book of INR 17,86,669 cr (HDFC AUM: INR 525,806 cr and HDFC Bank advances of INR 12,68,863 cr). This merger will enhance the value proposition and customer experience for the combined entity. The combined entity will benefit from HDFC Ltd's expertise in specific lending businesses with low cost to income ratio.

Key Highlights of the call:

- The MD & CEO of the bank, would continue as CEO of the combined entity.
- Each employee of HDFC will occupy position in the bank and will be re-aligned if necessary.
- PSL requirement will increase due to bringing the HDFC Limited loan book on bank's book. There will be multiple avenues to meet PSL requirement including PSLC.
- The combined entity will bring together strengths of the two organizations which will enhance customer relationship. HDFC Ltd's book will have access to HDFC Bank's low-cost funding franchise. The combined entity would have a larger balance sheet and would be able to make larger ticket loans.
- Cross sell opportunities will increase. ~70% of HDFC customers do not bank with HDFC Bank which indicates a great opportunity. ~80% of HDFC Bank customers do not have mortgages, indicating low penetration of mortgage book. With this merger, cross sell opportunities will increase and also, there would be other synergies for the combined entity.
- There have been significant regulatory changes over the last few years which have reduced barriers for a potential merger. HDFC Ltd has INR 80,000 cr worth of bonds, with 7 years' of maturity which would not attract CRR CLR requirement. Interest rates are lower currently than in the past, hence the negative carry on CRR/SLR would be lower.
- Any investment by HDFC in HDFC Bank has to be reduced from Tier-1 capital and hence has a negative impact on RoE. Any future infusion of capital by HDFC Limited into HDFC Bank to maintain stake would have resulted in a drag on HDFC Limited RoE.

Valuation & View: We view this as a positive development as the merger will be beneficial for both the entity. The proposed merger will result in further diversification of HDFC Bank's book (mainly into mortgage business), high cross sell opportunities and better and scalable distribution network with high customer base. We revise our rating on the stock to 'Accumulate' from 'Buy' with a target price of INR 1,910 (unchanged), based on 3.6x FY24E P/ABV .

Particulars (INR Cr)	FY21	FY22E	FY23E	FY24E
NII	64,880	74,885	84,467	96,129
PPOP	57,362	62,098	71,540	83,296
PAT	31,117	34,518	41,543	50,289
BVPS (INR / Share)	369.5	416.5	473.0	541.4
NIM (%)	4.1%	4.1%	4.0%	4.0%
RoA (%)	1.9%	1.8%	1.9%	2.0%
RoE (%)	16.6%	15.9%	16.9%	18.0%
P/ABV (x)	4.6	4.1	3.6	3.1

Source: Company, Arihant Research

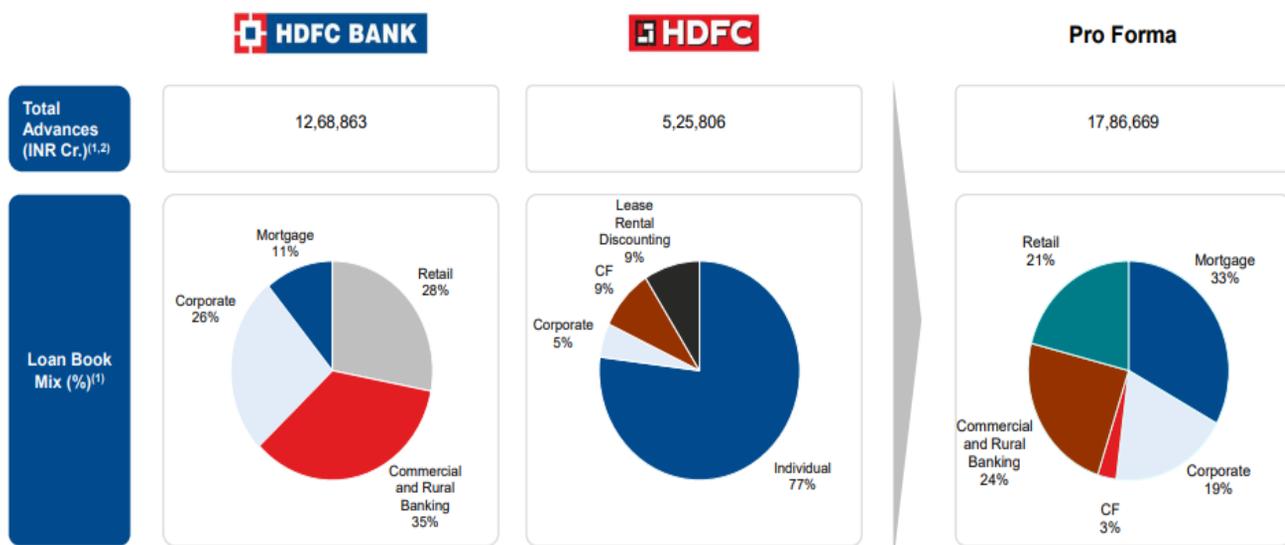
Key Concall Highlights

- In 2020, RBI issued guidelines which laid out a roadmap for conversion of large NBFCs in to full-scale commercial banks. NBFCs are also required to move to a core financial services platform, similar to core banking system (CBS) for banks. Scale-based regulations could further harmonise regulations between banks and NBFCs in the future.
- HDFC Ltd’s ~21% shareholding in HDFCB would be cancelled, thereby potentially opening up legroom of ~7% for additional holding by FPIs in HDFC Bank. HDFC’s shareholding in HDFC Bank is considered as foreign shareholding and outstanding foreign holding post-merger would be ~65-67%.
- Management is awaiting regulatory clarity regarding merging of HDB Financial.
- HDFC Bank has been ramping-up its distribution network over the last couple of years. The bank has a large appetite to grow distribution and will start to grow it faster.
- Over a period of time, HDFC branches will get converted into full bank branches.
- Merger expected to be EPS accretive from year 1.
- CET1 ratio of the combined entity would improve as HDFC Ltd has a capital adequacy ratio 22% after reducing the investments made by HDFC Ltd in the bank.

Exhibit 1: Pro Forma numbers for combined entity

in cr. unless stated	HDFC Bank	HDFC	Pro Forma numbers (For Merged entity)
Equity Shares Outstanding (# MM)	554	181	742
Annualized PAT	35,875	13,388	49,263
Earnings per Share (INR/Share)	65	74	67
Net Worth	229,640	115,400	330,768
Book Value per Share (INR/Share)	414	638	446
Advances	1,268,863	525,806	1,794,669
CAR (%)	19.5%	22.4%	19.8%

Exhibit 1: Portfolio mix pre and post merger



Source: Company, Arianth Research

Note: As of Dec 31st, 2021; Basis addition without adjustments to bank model. Not to be considered as continuing in the future

Key Financials

INR Cr	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	1,14,813	1,20,858	1,35,505	1,52,910	1,73,661
Interest Expense	58,626	55,979	60,619	68,443	77,532
Net Interest Income	56,186	64,880	74,885	84,467	96,129
Non interest income	23,261	25,205	24,538	28,507	33,152
Operating income	79,447	90,084	99,423	1,12,973	1,29,281
- Employee expense	9,526	10,365	11,434	12,449	13,550
- Other operating expense	21,172	22,358	25,891	28,983	32,436
Operating Expense	30,698	32,723	37,325	41,433	45,986
PPOP	48,750	57,362	62,098	71,540	83,296
Provisions	12,142	15,703	15,703	15,703	15,703
PBT	36,607	41,659	46,395	55,838	67,593
Tax Expense	10,350	10,542	11,877	14,294	17,304
PAT	26,257	31,117	34,518	41,543	50,289
EPS (INR)	47.89	56.44	62.61	75.36	91.22

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Balance Sheet (INR Cr)	FY20	FY21	FY22E	FY23E	FY24E
Source of Funds					
Share capital	548	551	551	551	551
Reserves & Surplus	1,70,438	2,03,170	2,29,058	2,60,215	2,97,932
Net-worth	1,70,986	2,03,721	2,29,609	2,60,767	2,98,484
Borrowings	1,44,629	1,35,487	1,62,585	1,95,102	2,34,122
Deposits	11,47,502	13,35,060	15,48,670	17,96,457	20,83,890
Other liabilities & provisions	67,394	72,602	87,345	1,05,083	1,26,422
Total Equity & Liabilities	15,30,511	17,46,871	20,28,209	23,57,408	27,42,917
Uses of Funds					
Cash & bank balances	86,619	1,19,470	1,40,310	1,63,288	1,89,776
Net investments	3,91,827	4,43,728	5,00,750	5,65,098	6,37,716
Loans & advances	9,93,703	11,32,837	13,02,762	15,04,690	17,45,441
Fixed assets	4,432	4,909	4,508	4,587	4,666
Other assets	53,931	45,926	79,880	1,19,745	1,65,319
Total Assets	15,30,511	17,46,871	20,28,209	23,57,408	27,42,917

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

Key Ratio	FY20	FY21	FY22E	FY23E	FY24E
Growth Rates					
Advances (%)	21.3%	14.0%	15.0%	15.5%	16.0%
Deposits (%)	24.3%	16.3%	16.0%	16.0%	16.0%
Total assets (%)	23.0%	14.1%	16.1%	16.2%	16.4%
NII (%)	16.5%	15.5%	15.4%	12.8%	13.8%
Pre-provisioning profit (%)	22.6%	17.7%	8.3%	15.2%	16.4%
PAT (%)	24.6%	18.5%	10.9%	20.4%	21.1%
B/S Ratios					
Credit/Deposit (%)	86.6%	84.9%	84.1%	83.8%	83.8%
CASA (%)	42.2%	46.1%	47.4%	48.8%	50.2%
Advances/Total assets (%)	64.9%	64.8%	64.2%	63.8%	63.6%
Leverage - Total Assets to Equity	9.0	8.6	8.8	9.0	9.2
CAR (%)	17.1%	15.8%	17.5%	16.4%	16.1%
Operating efficiency					
Cost/income (%)	38.6%	36.3%	37.5%	36.7%	35.6%
Opex/total assets (%)	2.0%	1.9%	1.8%	1.8%	1.7%
Opex/total interest earning assets	2.3%	2.1%	2.1%	2.0%	1.9%
Profitability					
NIM (%)	4.2%	4.1%	4.1%	4.0%	4.0%
RoA (%)	1.9%	1.9%	1.8%	1.9%	2.0%
RoE (%)	16.4%	16.6%	15.9%	16.9%	18.0%
Asset quality					
Gross NPA (%)	1.3%	1.3%	1.5%	1.4%	1.3%
Net NPA (%)	0.4%	0.4%	0.4%	0.4%	0.4%
PCR (%)	75.0%	75.0%	75.0%	75.0%	75.0%
Per share data / Valuation					
EPS (INR)	47.9	56.4	62.6	75.4	91.2
BVPS (INR)	311.8	369.5	416.5	473.0	541.4
ABVPS (INR)	305.3	361.3	407.5	463.6	530.7
P/E (x)	32.3	27.4	24.7	20.5	16.9
P/BV (x)	5.3	4.5	4.0	3.5	3.1
P/ABV (x)	5.4	4.6	4.1	3.6	3.2

Source: Arianth Research, Company Filings, Ace Equity, Bloomberg

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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