

HDFC Bank

BUY

Merger to create robust assets portfolio mix

Apr 04' 2022

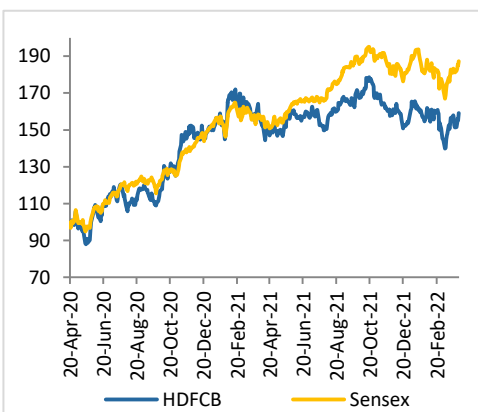
- In a major announcement in the India's financial sector, HDFC Bank approved the merger with the HDFC Ltd. The deal was long speculated as the gradually harmonisation of regulations for banks and HFCs making it less lucrative for both big firms to exist in financing as separate entities.
- As per the merger arrangement, the share exchange ratio shall be 42 shares of HDFC Bank for every 25 shares of HDFC Ltd. Post-merger, HDFC Bank will be 100% owned by public shareholders and existing shareholders of HDFC will own 41% of the HDFC Bank. The equity shares held by HDFC in the Bank will be extinguished as per the Scheme. As of date, HDFC Ltd. along with two of its wholly-owned subsidiaries, holds 21 % of paid-up equity share capital of HDFC Bank. **The merger process is expected to complete within 18 months (Q2,Q3 FY24) as the proposal is subject to approval from various regulatory authorities such as RBI, SEBI, CCI, IRDAI, NCLT and RoC.**
- The motive of the merger is to create a financial behemoth of strength across retail and wholesale alongside mortgage and to create a better assets-liability mix. The merger will bring together longer gestation assets like mortgages with HDFC Bank deposits base which have a significant share of low cost deposits.
- Post-merger, the share of home loan book will increase to 33% from 11% pre- merger level (pro forma basis, as per Dec 31' 2021 figures) which we view positive for the bank as it will increase the proportion of secured lending in retail portfolio, while easing pressure to garner high risky unsecured assets to boost retail loan growth.
- Pro forma advances book of the HDFC Bank (post-merger) will increase to Rs17.9 lakh crore (HDFC Ltd. Loan book stood at Rs5.3 lakh crore). The merger will create +8% delta in BVPS and +3% delta in the EPS; the deal will be earning accretive from year one.
- We view that merger will bring a combination of proven multi decade mortgage underwriting expertise with the well diversified branch network in urban, semi urban and rural geographies. The mgmt will focus on cross selling opportunities of home loan disbursement given the low penetration of home loan in existing bank customers.
- Funding of longer tenure secured assets with long tenor perpetual saving deposits will lead to robust assets portfolio mix (share of saving deposits in bank stood at 33% as of Dec 31' 2022) and improvement in spread as the average CoB for HDFC Ltd. stood at ~7.5% over FY19-FY21. While housing is a secured assets, the same is also a low yielding product and thereby making it difficult to generate healthy NIM in home loan assets. HDFC Ltd. maintains NIM ~3.5% v/s HDFC Bank of over 4%. Given the significant increase in home loan share post- merger, maintaining margin at current level would remain a challenging task for the bank. It will remain crucial to note the impact on bank's valuation if margin drops below the physiological level of 4% going forward. Assets quality of the bank is likely to remain stable as HDFC Ltd. Gross NPLs remained checked at 2.3% in Q3FY22.
- We see that the HDFC Bank will keep higher liquidity in balance sheet in coming future given the pending regulatory approval for the merger. As per the mgmt, regulatory changes for banks and NBFCs like harmonised NPAs norms made the merger process easy. The bank has requested the RBI for phased-in approach for SLR, CRR and PSL requirements.
- We maintain 'Buy' rating on stock with target price of Rs1,960 valuing standalone HDFC Bank's business at Rs1,890 (P/ABV 3.4x FY24E) + value of subsidiaries.

Rating Matrix

CMP	Rs1,656
Rating	Buy
Target Price	Rs1,960
Upside Potential	18.4%
52 week H/L	Rs1,724/1,292
Face value	Rs1
Mar. Cap.	Rs9,18,591 cr
Category	Large Cap
Sector	Banking

Shareholding Pattern

Particulars	Dec'21	Sep'21	Jun'21	Mar'21	Dec'20
Promoters	25.8%	25.8%	25.8%	25.9%	26.0%
FPIs	37.5%	38.2%	38.2%	39.4%	39.8%
MFs	15.0%	14.5%	14.5%	13.7%	13.0%
Insti.	60.4%	60.9%	60.8%	60.9%	60.8%
Non. Inst.	13.6%	13.2%	13.3%	13.1%	13.0%



Key Standalone Financials (Rs cr)

Particulars	FY20	FY21	FY22E	FY23E	FY24E
NII	56,186	64,880	73,324	87,601	99,970
Gr. (%)	16.5%	15.5%	13.0%	19.5%	14.1%
NIM	4.2%	4.1%	4.0%	4.2%	4.1%
PPOP	48,750	57,362	65,186	75,044	83,802
A.PAT	26,257	31,117	36,600	41,466	47,001
Eq./As. (%)	11.2%	11.7%	11.8%	11.8%	11.7%
RoE (%)	16.4%	16.6%	16.6%	16.2%	16.0%
CASA(%)	42.2%	46.1%	46.1%	46.5%	46.6%
GNPA (%)	1.3%	1.3%	1.5%	1.5%	1.5%
P/ABV (x)		4.6	4.0	3.5	3.0

Note: Merger effect has not been factored in our estimates.

Merger Process

Step 1 HDFC Investments Ltd. and HDFC Holdings Ltd., wholly owned subsidiaries of HDFC Ltd., will be merged with and into HDFC

Step 2 HDFC will be merged with and into HDFC Bank.

Swap Ratio:

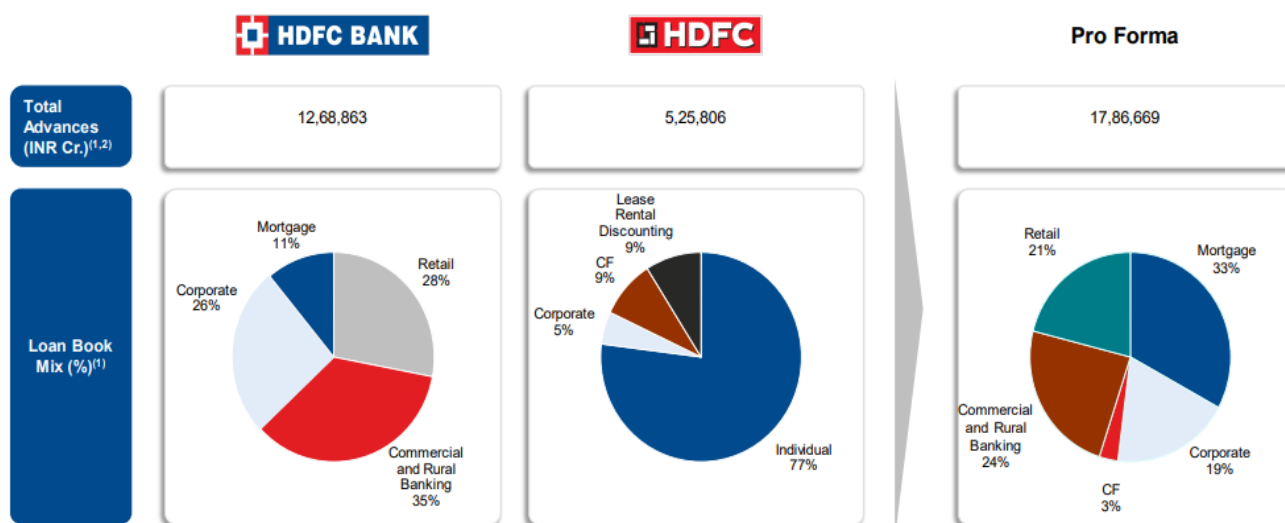
Share exchange ratio shall be 42 equity shares of face value of Rs. 1 each of HDFC Bank for every 25 equity shares of face value of Rs. 2 each of the HDFC Ltd.

Completion of Merger Process: Expected by Q2 / Q3 FY24

Pro Forma Impact on Key Metrics (Dec 31's 2021)

As of Dec 31st, 2021	HDFC Bank	HDFC	Pro forma	Delta
Equity Shares (in Cr)	554	181	742	34%
Annualized PAT (INR Cr.)	35,875	13,388	49,263	37%
Earnings per Share (INR / Share)	65	74	67	3%
Net Worth (INR Cr.)	2,29,640	1,15,400	3,30,768	44%
Book Value per Share (INR / Share)	414	638	446	8%
Advances (INR Cr.)	12,68,863	5,25,806	17,86,669	42%
CAR (%)	19.5%	22.4%	19.8%	+30 bps

Source: Choice Broking Research, Company presentation



Source: Company presentation

Financial statements (Standalone, Rs cr)

P&L Statement

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Interest Earned	1,14,813	1,20,858	1,28,492	1,56,024	1,83,794
Growth (%)	16.0%	5.3%	6.3%	21.4%	17.8%
Interest Expended	58,626	55,979	55,168	68,423	83,824
Growth (%)	15.6%	-4.5%	-1.4%	24.0%	22.5%
Net Interest Income	56,186	64,880	73,324	87,601	99,970
Net Interest Margin NIM (%)	4.2%	4.1%	4.0%	4.2%	4.1%
Other Income	23,261	25,205	29,483	32,561	37,421
% of Interest Income	20.3%	20.9%	22.9%	20.9%	20.4%
Total Income	79,447	90,084	1,02,807	1,20,163	1,37,391
Growth (%)	20.6%	13.4%	14.1%	16.9%	14.3%
Operating & Other expenses	30,698	32,723	37,621	45,119	53,589
C/I (%)	38.6%	36.3%	36.6%	37.5%	39.0%
Pre-Prov. Operating Profit	48,750	57,362	65,186	75,044	83,802
Provisions and contingencies (incl NPA)	12,142	15,703	16,098	18,933	20,201
P&C % of Advances	1.2%	1.4%	1.2%	1.3%	1.2%
Operating Profit before Tax	36,607	41,659	49,089	56,111	63,601
Growth (%)	13.7%	13.8%	17.8%	14.3%	13.3%
Pre-tax Margin %	46.1%	46.2%	47.7%	46.7%	46.3%
Tax	10,350	10,542	12,488	14,645	16,600
% of PBT	28.3%	25.3%	25.4%	26.1%	26.1%
Reported PAT	26,257	31,117	36,600	41,466	47,001
Net Profit Margin %	33.1%	34.5%	35.6%	34.5%	34.2%
Extraordinary Income	0	0	0	0	0
Adjusted PAT	26,257	31,117	36,600	41,466	47,001
Growth (%)	24.6%	18.5%	17.6%	13.3%	13.3%

Balance Sheet

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Cash with Banks & RBI	86,619	1,19,470	86,723	1,13,189	1,35,171
Investments	3,91,827	4,43,728	5,38,916	6,22,647	7,15,811
Advances	9,93,703	11,32,837	12,92,375	14,86,858	17,06,667
Fixed assets	4,432	4,909	5,276	5,326	5,367
Other assets	53,931	45,926	85,092	98,313	1,13,023
TOTAL ASSETS	15,30,511	17,46,871	20,08,382	23,26,333	26,76,039
CAPITAL AND LIABILITIES					
Capital	548	551	553	553	553
Reserves and Surplus	1,70,438	2,03,170	2,36,893	2,73,382	3,13,333
Deposits	11,47,502	13,35,060	15,44,025	17,90,231	20,60,759
Borrowings	1,44,629	1,35,487	1,56,002	1,80,240	2,07,208
Other liabilities and provisions	67,394	72,602	86,171	98,542	1,11,664
TOTAL CAPITAL AND LIABILITIES.....	15,30,511	17,46,871	20,23,643	23,42,948	26,93,517

Financial Ratios	FY20	FY21	FY22E	FY23E	FY24E
Return / Profitability Ratios (%)					
NIM	4.2%	4.1%	4.03%	4.17%	4.12%
Yield on advances	10.1%	8.9%	8.3%	8.8%	9.0%
Yield on investments (ex. trading profit)	6.0%	5.6%	5.2%	5.4%	5.6%
EPS (Diluted) (Rs)	47.8	56.1	65.5	74.2	84.1
RoA	1.9%	1.9%	1.9%	1.9%	1.9%
RoE	16.4%	16.6%	16.6%	16.2%	16.0%
Cost of Deposits	5.0%	3.9%	4.1%	4.8%	4.7%
Operating ratios (%)					
Credit to Deposit	86.6%	84.9%	83.7%	83.1%	82.8%
Cost to income	38.6%	36.3%	36.6%	37.5%	39.0%
CASA	42.2%	46.1%	46.1%	46.5%	46.6%
Investment / Deposit	34.1%	33.2%	34.9%	34.8%	34.7%
Non interest income / Total income	29.3%	28.0%	28.7%	27.1%	27.2%
Capitalization Ratios (%)					
Equity / Assets	11.2%	11.7%	11.8%	11.8%	11.7%
Loans / Assets	64.9%	64.8%	64.3%	63.9%	63.8%
Investments / Assets	25.6%	25.4%	26.8%	26.8%	26.7%
Dividend payout	0.0%	11.6%	10.7%	12.0%	15.0%
Capital adequacy (%)					
Tier-1 CAR	17.2%	17.6%	17.3%	16.6%	16.8%
Tier-2 CAR	1.3%	1.2%	1.2%	1.1%	1.2%
CAR (Basel III)	18.5%	18.8%	18.5%	17.7%	17.9%
Asset Quality ratios (%)					
Gross NPA	1.3%	1.3%	1.5%	1.5%	1.5%
Net NPA	0.4%	0.4%	0.4%	0.4%	0.3%
Coverage Ratio	72.0%	69.8%	72.2%	70.8%	77.2%
Slippage Ratio	1.9%	1.2%	2.6%	2.0%	1.8%
Credit Cost	1.3%	1.1%	1.2%	1.2%	1.1%
Per Share Data (Rs)					
EPS (Diluted)	47.8	56.1	65.5	74.2	84.1
DPS	0.0	6.5	7.0	8.9	12.6
BVPS	311.0	367.5	424.7	490.0	561.5
Adjusted BVPS	304.5	359.3	414.7	478.1	551.2
Valuation ratios (x)					
P/E (x)	34.7	29.5	25.3	22.3	19.7
P/BV (x)	5.3	4.5	3.9	3.4	2.9
P/ABV (x)	5.4	4.6	4.0	3.5	3.0
Growth ratios (%)					
Advances	21.3%	14.0%	14.1%	15.0%	14.8%
Deposits	24.3%	16.3%	15.7%	15.9%	15.1%
Net interest income	16.5%	15.5%	13.0%	19.5%	14.1%
Interest income	16.0%	5.3%	6.3%	21.4%	17.8%
PAT	24.6%	18.5%	17.6%	13.3%	13.3%
Business ratios					
Profit per branch (Rs cr)	4.8	5.5	6.2	6.8	7.5
Business per branch (Rs cr)	395.3	440.1	484.2	541.0	602.0

Source: Choice Broking Research

Choice's Rating Rationale

The price target for a large cap stock represents the value the analyst expects the stock to reach over next 12 months. For a stock to be classified as Outperform (Buy), the expected return must exceed the local risk free return by at least 5% over the next 12 months. For a stock to be classified as Underperform (Reduce, Sell), the stock return must be below the local risk free return by at least 5% over the next 12 months. Stocks between these bands are classified as Neutral (Hold).

Rating Rationale	
BUY	Absolute Return >15%
Hold	Absolute Return Between 0-15%
Reduce	Absolute Return 0 To Negative 10%
Sell	Absolute Return > Negative 10%

Coverage History			
Date	Rating	CMP	Target Price
04-Apr-22	Buy	1,656	1,960
21-Jan-22	Buy	1,510	1,960
26-Oct-21	Buy	1,657	1,960
21-Jul-21	Buy	1,443	1,700
20-Apr-21	Buy	1,390	1,700
17-Feb-21	Buy	1,586	1,860
22-Oct-20	Buy	1,247	1,400

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