Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy



# HDFC Bank

## Business momentum strong, but GNPAs rise q-o-q

| Banks | Sharekhan code: HDFCBANK |
|---|---|

| Reco/View: Buy | ↔ | CMP: **Rs. 1,364** | Price Target: **Rs. 1,800** | ↔ |
|---|---|---|---|---|

↑ Upgrade ↔ Maintain ↓ Downgrade

### 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 | | ↔ | |

### ESG Disclosure Score NEW

ESG RISK RATING 31.4
Updated July 08, 2022

High Risk

| NEGL | LOW | MED | HIGH | SEVERE |
|---|---|---|---|---|
| 0-10 | 10-20 | 20-30 | 30-40 | 40+ |

*Source: Morningstar*

### Company details

| | |
|---|---|
| Market cap: | Rs. 757,660 cr |
| 52-week high/low: | Rs. 1724/ 1271 |
| NSE volume: (No of shares) | 92.9 lakh |
| BSE code: | 500180 |
| NSE code: | HDFCBANK |
| Free float: (No of shares) | 438.9 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 21.0 |
| FII | 32.3 |
| DII | 27.1 |
| Others | 19.6 |

### Price chart


### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 6.5 | -6.9 | -10.4 | -10.4 |
| Relative to Sensex | 4.8 | 1.5 | 2.4 | -10.9 |

*Sharekhan Research, Bloomberg*


### Summary

- HDFC Bank clocked a PAT of Rs. 9,196 crore (up 19% y-o-y/ down 8.5% q-o-q) which was in line with consensus. However, PAT was 2% below our estimates mainly led by higher treasury losses.
- NII met expectations, rising by 14.5% y-o-y and 3.2% q-o-q led by healthy net advances growth of 21.6% y-o-y along with a pick-up in retail loans (21.7% y-o-y vs 15.2% y-o-y in last quarter). NIMs were stable q-o-q. Core PPoP grew by 14.7% y-o-y and 2.2% q-o-q.
- GNPA & NNPA rose 11.7% q-o-q / 10.9% q-o-q. GNPA/NNPA ratio`s rose sequentially by 11 bps/3bps reported at 1.28%/0.35% led by some stress in agri (due to seasonality factor) and in corporate book .
- Bank has good track record of execution capabilities and have consistently given healthy returns in terms of ROA irrespective of economic cycles and RoE consistently above cost of capital. Per management comment in Q1FY23 earning conference call, near-term focus would be on merger with HDFC Ltd in terms of regulatory dispensations. Stock trades at 2.6x and 2.2x its FY2023E and FY2024E core BV. We maintain Buy with an unchanged PT of Rs. 1800.


**HDFC Bank reported in line operating performance with consensus for Q1FY2023. Net Interest income grew by 14.5% y-o-y /3.2% q-o-q led by healthy overall loan growth and pick up in retail loans especially. NIMs remained stable q-o-q at 4.2%. Core fee income grew by 70.4% y-o-y on lower base. Bank reported a treasury loss of Rs. 1,312 crore. Total operating expenses were up by 28.7% y-o-y/ 3.4% q-o-q mainly due to branch addition costs, employee costs and higher business volumes. PPoP grew mutedly by 1.5% y-o-y and was down 6% q-o-q mainly due to the treasury loss. However, Core PPoP grew by 14.7% y-o-y/ 2.2% q-o-q. Total credit cost stood at 91 bps vs 97 bps in Q4FY22 and 168 bps in Q1FY22. The bank continued to maintain contingency buffers of Rs. 11,081 crores (0.8% of advances). PAT grew by 19% y-o-y and down by 8.5% q-o-q. Net advances grew by 21.6% y-o-y/ 1.9% q-o-q. Among advances, retail, commercial & rural banking and corporate loans growing by ~21.7% y-o-y, 28.9% y-o-y and ~15.7% y-o-y, respectively. Deposit mobilisation was also strong, grew by ~19.2% y-o-y with CASA deposits increasing by 20% y-o-y. CASA ratio stood at 45.8%. GNPA & NNPA were up by 11.7% q-o-q / 10.9% q-o-q and GNPA/NNPA ratio`s rose sequentially by 11 bps/3bps reported at 1.28%/0.35% led by some stress in agri (due to seasonality factor) and in corporate book. Annualized slippages ratio (bad loan formation) stood at 2.1% vs 1.2% in last quarter. Restructured book stood at 0.76% of advances vs 1.15% in last quarter. Slippage ratio for the quarter stood at 50 bps out of which 10-12 bps slippages accrued from restructured book.**

### Key positives

- Strong loan growth and healthy deposit mobilization with market share gains.
- Total contingent provisions at Rs. 11,081 crore (0.8% of total advances) provides a cushion.

### Key negatives

- Annualised slippages ratio (bad loan formation) stood at 2.1% vs 1.2% in last quarter.
- Asset quality detoriated sequentially led by some stress in agri (due to seasonality factor) and corporate loan book.

### Management Commentary

- Bank expects to sustain healthy growth in retail & CRB segment.
- Asset quality across segments is holding up well and bank do not foresee any incremental pressure on asset quality going forward.
- Bank is yet to hear on dispensation from RBI. Only approval on scheme of amalgamation stating no objection is received.

**Revision in estimates –** We have increased our FY2023E/24E/25E earnings estimates factoring in higher NII growth.

### Our Call

**We maintain our Buy rating with an unchanged price target of Rs. 1,800:** We believe that the bank is on an accelerated growth path with strong advances growth led by retail and MSME segment along with healthy low-cost deposit mobilisation. The bank's continuous building up of its digital capabilities and franchise network is likely to bode well for growth going ahead. The stock has under-performed its peers in the past 12 months. The bank is well-capitalised and has the ability to manage asset quality across cycles and deliver superior return ratios irrespective of economic cycles and reap opportunities from a revival in the economy going ahead. Per management comment in Q1FY23 earning conference call, near-term focus would be the status of the merger with HDFC Ltd in terms of regulatory dispensations. The stock is currently trading at 2.6x/2.2x its FY2023E and FY2024E core ABV.

### Key Risks

Economic slowdown due to which slower loan growth and higher than anticipated credit cost.

**Valuation (Standalone)** Rs cr

| Particulars | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|
| Net Interest Income | 72,010 | 84,478 | 1,00,294 | 1,16,560 |
| Net profit | 36,962 | 43,303 | 51,837 | 60,027 |
| EPS (Rs) | 66.3 | 77.4 | 91.8 | 105.4 |
| P/E (x) | 19.5 | 16.7 | 14.1 | 12.3 |
| P/BV (x) | 3.0 | 2.6 | 2.2 | 1.9 |
| RoE | 16.7 | 16.5 | 16.8 | 16.4 |
| RoA | 1.9 | 1.9 | 1.9 | 1.8 |

*Source: Company; Sharekhan estimates*

## Key result highlights

**NII growth led by pick up in retail loans:** Net Interest income grew by 14.5% y-o-y /3.2% q-o-q led by healthy overall loan growth and a pick-up in retail loans especially. NIMs (based on interest earning assets) remained stable q-o-q at 4.2%. Around 55% of total loans are floating rate loans, while the balance 45% comprises fixed rate loans. Repricing of floating rate book happens based on three/ six months depending upon the loan contract. There should be an uptick in margins going forward as floating rate book gets repriced gradually and share of retail increases in the overall mix. Core fee income grew by 70.4% y-o-y on lower base. Bank reported treasury loss of Rs. 1,312 crores.

**C/I ratio should trend downwards over medium to long term:** Total operating expenses rose by 28.7% y-o-y/ 3.4% q-o-q mainly due to addition of branches, employee costs and higher business volumes (especially retail where cost are up fronted). The cost to income ratio reported stood at 40.6% vs 38.3% in last quarter and 35% in Q1FY22. Core cost to income ratio excluding MTM treasury losses for the quarter stood at 38.6%. Overall tech spends accounted for 8-9% of opex. Bank expects C/I ratio should trend downwards towards mid 30 over next 3-5 years as technology-led productivity and efficiencies comes in.

**Asset quality expected to benign going ahead:** Asset quality detoriated sequentially led by some stress in agri-portfolio (due to seasonality factor) and in corporate book. Bank`s GNPA & NNPA were up by 11.7% q-o-q / 10.9% q-o-q and GNPA/NNPA ratio`s rose sequentially by 11 bps/3bps reported at 1.28%/0.35%. Total annualised slippages ratio (bad loan formation) stood at 2.1% (Rs.7,200 crore) vs 1.2% (Rs. 4,000 crore) in last quarter. Recoveries and upgrades amounted to Rs. 3,000 crore vs Rs. 2,100 crore in last quarter. Write offs stood at Rs. 2,400 crore vs Rs. 1,700 crore in last quarter. Restructured book stood 0.76% of advances vs 1.15% in last quarter. Slippage ratio for the quarter stood at 50 bps out of which 10-12 bps slippages accrued from restructured book. Asset quality across segments is holding up well and bank do not foresee any incremental pressure on asset quality. Total unutilized contingent provisions stood at 0.8% of advances.

**Bank expects to sustain healthy growth in retail & CRB segment going ahead:** Net advances grew by 21.6% y-o-y/ 1.9% q-o-q. Among advances, retail, commercial & Rural banking and corporate loans growing by ~21.7% y-o-y, 28.9% y-o-y and ~15.7% y-o-y, respectively. In retail segment, personal, auto, payment products and LAP segment grew by 23% y-o-y, 13% y-o-y, 27% y-o-y and 26% y-o-y respectively. Two-wheeler loans book fell by 3% y-o-y. Bank believes retail growth should sustain going ahead as demand environment is better across products. Card spends are also turning higher led by discretionary spends. However, credit line utilization is 70-80% at pre pandemic level and it should pick up. Bank also expects to sustain healthy growth in the CRB segment by adding new geographies capturing supply & distribution chain and by adding relationship manager and innovative products. Bank affirmed that economic activity continued to hold during Q1FY23. It also gave up incremental opportunity in corporate book of Rs. 40,000-50,000 crore due to rate irrationality from peers during the quarter.

**Healthy mobilisation of low-cost deposits:** Deposits mobilization was strong. 2.6 mn new liability relationship were acquired during the quarter (59% y-o-y, 10% q-o-q). Total deposits grew by ~19.2% y-o-y with CASA deposits increasing by 20% y-o-y. CASA ratio stood at 45.8% vs 45.5% in Q1FY22. Term deposits grew by 18.5% y-o-y. Overall retail deposits grew by 19% y-o-y and accounts for 82% of total deposits. There would be some uptick in term deposit rate going forward.

**Others:** Branch expansion to continue on guided lines (1500-2000 branches in next 2 years) however there was slowdown in addition in branch during the quarter. 36 new branches were added during the quarter. 250 branches in WIP stage. New payment app and mobile app expected to be launched in H2FY23. In FY23 on PSLC front, bank expects to acquire organically 2/3 of required, rest purchase PSLC/ investments in the government's Rural Infrastructure Development Fund (RIDF) (based on balancing cost & return between these instruments because prices are dynamic). The bank is yet to hear on dispensation from RBI. Only approval on scheme of amalgamation is received.

Results | Rs cr

| Particulars | Q1FY23 | Q1FY22 | Q4FY22 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| Interest Inc. | 35,172 | 30,483 | 33,449 | 15.4% | 5.2% |
| Interest Expenses | 15,691 | 13,474 | 14,576 | 16.5% | 7.6% |
| Net Interest Income | 19,481 | 17,009 | 18,873 | 14.5% | 3.2% |
| NIM (%) | 4.20 | 4.10 | 4.20 | | |
| Core Fee Income | 6,620 | 3,885 | 5,630 | 70.4% | 17.6% |
| Other Income | -231 | 2,403 | 2,007 | -109.6% | -111.5% |
| Net Income | 25,870 | 23,298 | 26,510 | 11.0% | -2.4% |
| Employee Expenses | 3,500 | 2,766 | 3,145 | 26.6% | 11.3% |
| Other Opex | 7,002 | 5,395 | 7,008 | 29.8% | -0.1% |
| Total Opex | 10,502 | 8,160 | 10,153 | 28.7% | 3.4% |
| Cost to Income Ratio | 40.6% | 35.0% | 38.3% | | |
| Pre Provision Profits | 15,368 | 15,137 | 16,357 | 1.5% | -6.0% |
| Provisions & Contingencies - Total | 3,188 | 4,831 | 3,312 | -34.0% | -3.8% |
| Profit Before Tax | 12,180 | 10,306 | 13,045 | 18.2% | -6.6% |
| Tax | 2,984 | 2,577 | 2,989 | 15.8% | -0.2% |
| Effective Tax Rate | 24% | 25% | 23% | | |
| Reported Profits | 9,196 | 7,730 | 10,055 | 19.0% | -8.5% |
| Basic EPS (Rs) | 16.6 | 14.0 | 18.1 | 18.6% | -8.3% |
| Diluted EPS (Rs) | 16.5 | 13.9 | 18.0 | 18.7% | -8.3% |
| RoA (%) | 1.8 | 1.8 | 2.1 | | |
| | | | | | |
| Advances | 13,95,068 | 11,47,652 | 13,68,821 | 21.6% | 1.9% |
| Deposits | 16,04,760 | 13,45,829 | 15,59,217 | 19.2% | 2.9% |
| | | | | | |
| Gross NPA | 18,034 | 17,099 | 16,141 | 5.5% | 11.7% |
| Gross NPA Ratio (%) | 1.28 | 1.47 | 1.17 | | |
| Net NPA | 4,888 | 5,486 | 4,408 | -10.9% | 10.9% |
| Net NPAs Ratio (%) | 0.35 | 0.48 | 0.32 | | |
| PCR - Calculated | 72.9% | 67.9% | 72.7% | | |

*Source: Company, Sharekhan Research*

## Outlook and Valuation

### ■ Sector view - Credit growth accelerating; Top private banks placed better

System-level credit offtake grew by ~13.3% y-o-y in the fortnight ending June 17 2022, indicating loan growth has been sustaining given the distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.8%, which also reflect a healthier economic scenario but are trailing advances growth. Bottom-up story is intact and we should see loan growth accelerate, while margins would continue to expand in a higher interest rate cycle. Asset quality is not a big issue from the corporate loans end as only de-leveraging is being observed and from the retail side, there could be some pressure but nothing significant. Asset quality to remain stable except the MFI segment. Banks are in sweet spot in terms of fundamentals & reasonable valuations. In past two years, banks have been cautious on lending to 'BB & below', thus general risk which they are carrying on corporate portfolio is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure have been taken into credit cost. In terms of MSME, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe that large banks with a strong capital base and asset quality (with high coverage and provision buffers), are well placed to capture growth opportunities.

### ■ Company outlook - Structural drivers in place with strong execution capabilities

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. The bank has built a strong provision buffer, which work as a strong cushion against probable future risks. Notably, the franchise continues to be one of the best- managed and with strong and prudent business models and needs to be seen from a long-term perspective. With its risk calibrated growth, strong underwriting, assessment capabilities and building new digital capabilities would be adding to the moat of its business strength. HDFC Bank's sufficient buffer of floating provision and contingent provisions along with comfortable capitalization levels (CAR ratio at 18.1%) are key positives. Per management comment in Q1FY23 earning conference call, near-term focus would be the status of the merger with HDFC Ltd in terms of regulatory dispensations.

### ■ Valuation

**We maintain our Buy rating with an unchanged price target of Rs. 1,800**: We believe that the bank is on an accelerated growth path with strong advances growth led by retail and MSME segment along with healthy low-cost deposit mobilisation. The bank's continuous building up of its digital capabilities and franchise network is likely to bode well for growth going ahead. The stock has under-performed its peers in the past 12 months. The bank is well-capitalised and has the ability to manage asset quality across cycles and deliver superior return ratios irrespective of economic cycles and reap opportunities from a revival in the economy going ahead. Per management comment in Q1FY23 earning conference call, near-term focus would be the status of the merger with HDFC Ltd in terms of regulatory dispensations. The stock is currently trading at 2.6x/2.2x its FY2023E and FY2024E core ABV.

**Peer Comparison**

| Banks | CMP (Rs / Share) | MCAP (Rs Cr) | P/E (x) | | P/B (x) | | RoE (%) | | RoA (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E |
| HDFC Bank | 1364 | 7,57,660 | 16.7 | 14.1 | 2.6 | 2.2 | 16.8 | 16.4 | 1.9 | 1.9 |
| ICICI Bank | 751 | 5,22,498 | 21.0 | 19.5 | 2.5 | 2.1 | 14.7 | 15.5 | 1.8 | 2.0 |
| Axis Bank | 663 | 2,03,483 | 10.9 | 8.8 | 1.4 | 1.2 | 13.7 | 13.1 | 1.4 | 1.4 |

*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

Economic slowdown due to which slower loan growth and higher than anticipated credit cost

## Additional Data

**Key management personnel**

| | |
|---|---|
| Mr Sashidhar Jagdishan | Managing Director/CEO |
| Mr. Kaizad Bharucha | Executive Director |
| Mr Srinivasan Vaidyanathan | Group Chief Financial Officer |
| Mr Jimmy Tata | Chief Risk Officer |

*Source: Company*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | HDFC Investment Ltd | 5.4 |
| 2 | Capital Group Cos Inc/The | 4.5 |
| 3 | SBI Funds Management Pvt Ltd | 3.7 |
| 4 | LIFE INSURANCE CORPORATION OF INDIA | 2.1 |
| 5 | Morgan Stanley | 2.1 |
| 6 | Euro Pacific Growth Fund | 2.0 |
| 7 | FMR LLC | 1.9 |
| 8 | FIL Ltd | 1.5 |
| 9 | ICICI PRUDENTIAL Asset Management | 1.4 |
| 10 | Invesco | 1.4 |

*Source: Bloomberg (Data as on March 2022)*

## 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*

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only



Compliance Officer: Ms. Priya Sonavane; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

**Registered Office:** Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.