Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# HDFC Bank

## Robust NII growth & lower credit cost drives strong earnings

| Banks | Sharekhan code: HDFCBANK |
|---|---|
| Reco/View: Buy ↔ | CMP: **Rs. 1,600** / Price Target: **Rs. 1,920** ↑ |

↑ 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 31.45

Updated Oct 08, 2022

High Risk

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

*Source: Morningstar*

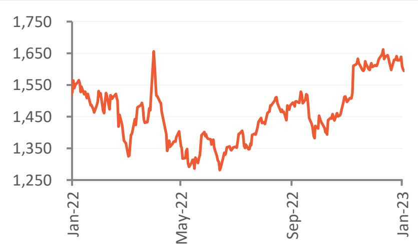
### Company details

| | |
|---|---|
| Market cap: | Rs. 8,92,755 cr |
| 52-week high/low: | Rs. 1,722 / 1,272 |
| NSE volume: (No of shares) | 63.6 lakh |
| BSE code: | 500180 |
| NSE code: | HDFCBANK |
| Free float: (No of shares) | 440.6 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 20.9 |
| FII | 32.2 |
| DII | 27.7 |
| Others | 19.3 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | -3.7% | 11.2% | 18.4% | 3.6% |
| Relative to Sensex | 0.1% | 7.1% | 5.6% | 5.1% |

*Sharekhan Research, Bloomberg*


### Summary

- HDFC Bank reported strong numbers for Q3FY23 with a PAT of Rs. 12,259 crore (up 18.5% y-o-y/ 15.6% q-o-q) led by 13.4% y-o-y growth in operating profit and 6.3% y-o-y decline in provisions.
- Net interest income (NII) grew robustly by 24.6% y-o-y / 9.4% q-o-q while core fee income growth also remained strong (19.3% y-o-y/ 4.3% q-o-q) however opex growth was higher (26.5% y-o-y/ 11.0% q-o-q) due to continued accelerated investments which led to operating profits grew by 13.4% y-o-y/ 9.4% q-o-q.
- Annualized slippages ratio (calc. as % of 12M trailing advances) was higher at 2.1% vs 1.9% in last quarter due to higher seasonally Agri slippages. Annualized credit cost (% of Avg. advances) stood at 75 bps versus 90 bps last quarter. GNPA/NNPA ratios were stable at 1.23%/0.33%. PCR remained stable at ~73%, while restructured book stood at Rs. 6,400 crore (0.42% of loans versus 0.53% in last quarter).
- We remain positive on bank however the near-term focus would continue to be on the various dispensations needed for a smooth transition. Stock trades at 3.0x/2.6x/2.2x its FY2023E/24E/25E core BV estimates. We maintain our buy rating with a revised PT of Rs. 1920.


**HDFC Bank reported strong performance in Q3FY23, marginally beating consensus and our estimates. Net Interest income grew by 24.6% y-o-y /9.4% q-o-q. NIMs (cal.) improved by 20 bps q-o-q to 4.3% however there was a positive impact on NIMs of 5-6 bps due to interest received on tax refund. Core fee income grew by 19.3% y-o-y/ 4.3% q-o-q. Total operating expenses were higher by 26.5% y-o-y/ 11.0% q-o-q led by continued branch expansion, employee addition and higher business volumes. Opex to average assets ratio stood at 2.2% versus 2.1% in last quarter. Thus, Operating profits (PPoP) grew by 13.4% y-o-y /9.4% q-o-q. Annualized credit cost stood at 75 bps versus 90 bps in last quarter. Total provisions were lower by 6.3% y-o-y/ 13.4% q-o-q. The bank continued to maintain contingency & floating provisions of Rs. 10,800 crore (0.72% of advances) however utilized around Rs 200 crore during the quarter. PBT grew by 17.7% y-o-y/ 14.6% q-o-q. Net advances grew by 19.5% y-o-y/ 1.8% q-o-q. Retail, commercial & rural banking and corporate loans grew by ~19.9% y-o-y, 30.2% y-o-y and ~20.3% y-o-y, respectively. Deposit mobilization was strong mainly led by term deposits, grew by ~19.9% y-o-y / 3.6% q-o-q however, CASA deposits growth was tepid at 12.0% y-o-y/ 0.4% q-o-q. CASA ratio stood at 44% versus 45.4% in last quarter. Term deposits grew by 26.9% y-o-y/ 6.2% q-o-q. GNPA in absolute terms were up by 2.5% q-o-q & NNPA were up by 2.9% q-o-q. GNPA/NNPA ratio`s remained stable q-o-q reported at 1.23%/0.33%. Annualized slippages ratio (bad loan formation) stood at 2.1% versus 1.9% in last quarter. Ex-Agri annualized slippage ratio stood at 1.7%. Restructured book stood at 0.42% of advances versus 0.53% in last quarter.**

### Key positives

- Strong NII & Core fee income growth.
- Retail term deposit mobilization was healthy.
- Total contingent provisions at Rs. 10,800 crore (0.72% of total advances).

### Key negatives

- Opex to Avg. assets stood at 2.2% versus 2.1% in last quarter.
- Slippages from Agriculture segment were higher.
- CASA growth tepid

### Management Commentary

- HDFC Bank expects healthy growth momentum going forward and continued focus on faster deposit mobilisation through branch expansion, building new liability relationship with existing customers and more focus on term deposits as penetration is lower with competitive pricing.
- The bank expects stable margins with positive upward bias as benefits of further repricing of floating loans offsets increase in deposits rates & gradual improvement in loan mix towards retail take place.
- Bank is yet to hear on regulatory dispensation from RBI.

### Our Call

**Valuation: We maintain Buy rating on the stock with a revised TP of Rs. 1,920:** We believe the long-term investment thesis of the bank remains strong. The bank is well-capitalized, has strong execution capabilities, can manage its growth levers along with its best-in-class asset quality across cycles and deliver superior return ratios irrespective of economic cycles. However, we believe re-rating in the stock would happen as and when more clarity emerges on the smooth transition of merger. The stock is currently trading at 3.0x/ 2.6x/ 2.0x its FY2023E/24E/25E core BV estimates, respectively. Regulatory dispensations from the RBI would be a key monitorables.

### Key Risks

Slow growth in liability franchise, lower margin than expected

### Valuation (Standalone) Rs cr

| Particulars | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|
| Net Interest Income | 72,010 | 85,234 | 1,00,294 | 1,16,560 |
| Net profit | 36,962 | 44,734 | 51,850 | 60,041 |
| EPS (Rs) | 66.3 | 79.9 | 91.8 | 105.4 |
| P/E (x) | 23.1 | 19.2 | 16.7 | 14.5 |
| P/BV (x) | 3.5 | 3.0 | 2.6 | 2.2 |
| RoE | 16.7 | 17.0 | 16.7 | 16.4 |
| RoA | 1.9 | 2.0 | 1.9 | 1.8 |

*Source: Company; Sharekhan estimates*

## Key result highlights

- **Strong NII & Core fee income growth:** Net Interest income grew by 24.6% y-o-y /9.4% q-o-q. NIMs (calc.) improved by 20bps q-o-q at 4.3% mainly due to higher yields despite rise in cost of funds and higher retail mix. There was a positive effect of 5-6 bps on NIMs due to interest received on income tax refund. Margins trajectory is likely to be stable with positive upward bias going forward as floating rate book gets repriced further gradually offsetting increase in CoFs and share of retail increases in the overall loan mix. Core fee income grew by 19.3% y-o-y/ 4.3% q-o-q. Retail fee income constitutes 93% of total fee income. Share of payments and cards business fees (as a % of total fee income) improved to 34% vs 32% in last quarter and 29% in Q3FY22.
- **Cost growth acceleration:** Total operating expenses rose by 26.5% y-o-y/ 11.0% q-o-q mainly due to addition of branches (684 branches were added during the quarter), employee addition (for existing business growth & new branches) and higher business volumes. The cost to income ratio reported stood at 39.6% versus 39.2% in last quarter and 37% in Q3FY22. Opex to Avg. assets stood at 2.2% versus 2.1% in last quarter. Employee benefit cost included around Rs. 250-300 crore attributable towards ESOP cost. Continued accelerated investments are expected in near to medium term as bank wants to strengthen the franchise.
- **Asset quality outlook stable:** Asset quality remained stable during the quarter. Bank`s GNPA in absolute terms were up by 2.5% q-o-q & NNPA were up by 2.9% q-o-q. GNPA/NNPA ratios remained stable reported at 1.23%/0.33%. Total annualised slippages ratio (bad loan formation) stood at 2.1% (Rs.6,600 crore) versus 1.9% (Rs. 5,700 crore) in the past quarter. Excluding seasonally higher agri-slippages, slippages were Rs. 5300 crore. Recoveries and upgrades amounted to Rs. 3,100 crore versus Rs. 2,500 crore in last quarter. Write offs stood at Rs. 3,100 crore versus Rs. 3,000 crore in the last quarter. There was a sale of NPA to ARC amounting to Rs. 200 crore during the quarter. Restructured book stood 0.42% of advances versus 0.53% in last quarter. Asset quality across segments is holding up well (except seasonal Agri segment) and bank do not foresee any incremental pressure on asset quality. Credit costs stood at 75 bps versus 90 bps in last quarter. Total unutilized contingent provisions stood at 0.72% of advances of ~Rs. 10,800 crore. Bank has utilized around Rs. 200 crore from contingent provisions during the quarter.
- **Loan growth outlook strong:** Net advances grew by 19.5% y-o-y/ 1.8% q-o-q. Among loan segments, Retail, Commercial & Rural banking and corporate loans growing by ~19.9% y-o-y, 30.2% y-o-y and ~20.3% y-o-y, respectively. In retail segment, personal loans, auto, payment products, gold loans and LAP segment grew by 23% y-o-y, 17% y-o-y, 14% y-o-y, 22% y-o-y and 25% y-o-y, respectively. Two-wheeler loans book has started signs of picking up. Bank believes retail growth should sustain going ahead as demand environment & consumer spending is turning out higher. Bank also expects to sustain healthy growth in MSME segment as engagement through digital ecosystem is improving (recently launched Pay Zap and Merchant Vyapar app - trends are encouraging). Bank affirmed that economic activity continued to hold during Q3FY23. In the corporate segment, bank is seeing strong demand trends in NBFCs, telecom PSUs, Retail segment, and infrastructure sector. Although margins in corporate segment are lower but at ROA levels, bank is confident that corporate & wholesale segment would be contributing ~2% ROA. LCR during the quarter was 113%.
- **Healthy mobilisation of deposits mainly led by term deposits:** Deposits mobilization was strong mainly led by term deposits. Total deposits grew by ~19.9% y-o-y /3.6% q-o-q. However, CASA deposits growth was tepid at 12.0% y-o-y/ 0.4% q-o-q. CASA ratio stood at 44.0% versus 45.4% in Q2FY23. Term

deposits grew by 26.9% y-o-y /6.2% q-o-q. Overall retail deposits grew by 22% y-o-y and accounts for 84% of total deposits. For healthy deposit mobilisation, the focus is on branch expansion, building new liability relationship with existing customers and more focus on term deposits as penetration is lower with competitive pricing. Bank is adding more than 2 million customers on liability side over past 6 quarters.

- **Others:** Branch expansion to continue on guided lines (1,500-2,000 branches in next 2 years). Bank added 684 branches while total 841 branches were opened in 9MFY23. 600 branches are in WIP stage. As far as the timeline of the merger is concerned, bank is on track to complete the merger by Q2FY24. Bank is yet to hear on regulatory dispensation from the RBI.

**Result Table** Rs cr

| Particulars | 3QFY23 | 3QFY22 | 2QFY23 | Y-o-Y | Q-o-Q |
|---|---|---|---|---|---|
| Interest Inc. | 42,708 | 32,468 | 38,586 | 31.5% | 10.7% |
| Interest Expenses | 19,720 | 14,025 | 17,565 | 40.6% | 12.3% |
| **Net Interest Income** | **22,988** | **18,443** | **21,021** | **24.6%** | **9.4%** |
| NIM (%) | 4.30 | 4.10 | 4.10 | 4.9% | 4.9% |
| Fee Income | 7,127 | 5,075 | 6,751 | 40.4% | 5.6% |
| Other Income | 1,373 | 3,108 | 845 | -55.8% | 62.5% |
| **Net Income** | **31,488** | **26,627** | **28,617** | **18.3%** | **10.0%** |
| Employee Expenses | 4,126 | 3,154 | 3,524 | 30.8% | 17.1% |
| Other Opex | 8,337 | 6,697 | 7,701 | 24.5% | 8.3% |
| **Total Opex** | **12,464** | **9,851** | **11,225** | **26.5%** | **11.0%** |
| Cost to Income Ratio | 39.6% | 37.0% | 39.2% | | |
| **Pre Provision Profits** | **19,024** | **16,776** | **17,392** | **13.4%** | **9.4%** |
| Provisions & Contingencies – Total | 2,806 | 2,994 | 3,240 | -6.3% | -13.4% |
| **Profit Before Tax** | **16,218** | **13,782** | **14,152** | **17.7%** | **14.6%** |
| Tax | 3,958 | 3,440 | 3,546 | 15.1% | 11.6% |
| Effective Tax Rate | 24% | 25% | 25% | | |
| **Reported Profits** | **12,259** | **10,342** | **10,606** | **18.5%** | **15.6%** |
| Basic EPS (Rs) | 22.0 | 18.7 | 19.1 | 17.6% | 15.3% |
| Diluted EPS (Rs) | 21.9 | 18.5 | 19.0 | 18.3% | 15.2% |
| RoA (%) | 2.2 | 2.2 | 2.0 | | |
| | | | | | |
| **Advances** | **15,06,809** | **12,60,863** | **14,79,873** | **19.5%** | **1.8%** |
| **Deposits** | **17,33,204** | **14,45,918** | **16,73,408** | **19.9%** | **3.6%** |
| | | | | | |
| **Gross NPA** | **18,764** | **16,014** | **18,301** | **17.2%** | **2.5%** |
| Gross NPA Ratio (%) | 1.23 | 1.26 | 1.23 | | |
| **Net NPA** | **5,024** | **4,677** | **4,883** | **7.4%** | **2.9%** |
| Net NPAs Ratio (%) | 0.33 | 0.37 | 0.33 | | |
| **PCR – Calculated** | **73.2%** | **70.8%** | **73.3%** | | |

*Source: Company; Sharekhan Research*

## Outlook and Valuation

### Sector View – Deposits mobilisation to be in focus; Top private banks placed better

System-level credit offtake grew by ~17.4% y-o-y in the fortnight ending December 16, 2022, indicating loan growth has been sustaining, given distinct signs of an improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.4% but are trailing advances growth. We should see loan growth acceleration sustaining. Margins are likely to improve but momentum is expected to moderate, and margins are expected to peak out by H1FY24. Asset quality is not a big issue on the corporate lending end, as only de-leveraging is observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable in the medium term. Banks are in a sweet spot in terms of fundamentals. In the past few years, lenders have been cautious about lending to the 'BB & below' category, thus the general risk, which they are carrying on the corporate portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit costs. In terms of the MSME book, 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 large banks with a strong capital base, strong deposit franchise 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 in gaining market share consistently, along with best-in-class asset quality. Notably, the business continues to be one of the best-managed franchise and should be seen from a long-term perspective. We believe re-rating in the stock would happen as and when more clarity emerges on the smooth transition of merger. The bank's 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 provisions and contingent provisions along with comfortable capitalisation levels (CAR ratio at 19.4%) are key positives.

### Valuation – We maintain Buy rating on the stock with a revised TP of Rs. 1,920

We believe the long-term investment thesis of the bank remains strong. The bank is well-capitalized, has strong execution capabilities, can manage its growth levers along with its best-in-class asset quality across cycles and deliver superior return ratios irrespective of economic cycles.  However, we believe re-rating in the stock would happen as and when more clarity emerges on the smooth transition of merger. The stock is currently trading at 3.0x/ 2.6x/ 2.0x its FY2023E/24E/25E core BV estimates, respectively. Regulatory dispensations from the RBI would be a key monitorables.

**Peer Comparison**

| Particulars | CMP | MCAP | P/E (x) | | P/B (x) | | RoE (%) | | RoA (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Rs/Share | (Rs Cr) | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E |
| HDFCs Bank | 1,600 | 8,92,755 | 19.2 | 16.7 | 3.0 | 2.6 | 17.0 | 16.7 | 2.0 | 1.9 |
| ICICI Bank | 873 | 6,09,306 | 16.9 | 14.2 | 2.5 | 2.1 | 16.0 | 16.2 | 2.0 | 2.0 |
| Axis Bank | 934 | 2,87,262 | 13.1 | 10.6 | 2.0 | 1.7 | 16.4 | 17.1 | 1.6 | 1.8 |

*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. The bank has a strong presence in the retail segment with strong asset quality. Not only the bank, but its strong and marquee parentage enjoys arguably the strongest brand recall in the country, which is a significant competitive advantage in the Indian banking space. The bank's strong brand appeal, impressive corporate governance, and strong management team (consistency in performance and best-in-class asset quality) have enabled it to be a long-term wealth creator for investors, and the above factors still hold true. The bank continues to report consistent return ratios and earnings growth over the years across various credit/interest rate cycles and has been able to maintain its asset quality, which is indicative of the strong business franchise strength and leadership qualities.

## Key Risks

Slow growth in liability franchise, lower margin than expected

## 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 Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | HOUSING DEVELOPMENT FINANCE CORP LTD | 15.50 |
| 2 | HDFC INVESTMENT LTD | 5.38 |
| 3 | SBI FUNDS MANAGEMENT LTD | 4.08 |
| 4 | LIFE INSURANCE CORP OF INDIA | 3.30 |
| 5 | CAPITAL GROUP COS INC | 2.56 |
| 6 | FMR LLC | 1.86 |
| 7 | MORGAN STANLEY | 1.62 |
| 8 | ICICI PRUDENTIAL ASSET MANAGEMNET CO LTD | 1.59 |
| 9 | HDFC ASSET MANAGEMENT CO LTD | 1.41 |
| 10 | UTI ASSET MANAGEMENT | 1.23 |

*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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