AXIS SECURITIES

Result Update
18th July, 2023

HDFC Bank Ltd.

BFSI - Banks

BUY
Target Price
2,050

Inline Quarter; All Eyes on Post-Mergers Performance!

Est. Vs. Actual for Q1FY24: NII – INLINE; PPOP – INLINE ; PAT – BEAT

Changes in Estimates post Q1FY24

As HDFCB will be reporting as a merged entity in FY24 and onwards, % change in estimates would not be comparable

Recommendation Rationale

- **Maturing distribution network to support strong business growth** – HDFCB has strategically utilized the benign credit cost environment to build the distribution network. It expects these branches to mature, gain traction, and begin contributing healthily to business growth by the time credit costs revert to their mean of 90-110bps. Maturing branch network will help the bank in building a strong deposits franchise. In addition to this, the merger offers the bank an opportunity to offer its liability products to ~2.5-3 Mn of the 4 Mn HDFC customers, thereby supporting healthy deposit growth.
- **Merged Entity's credit growth momentum to sustain** – The demand visibility across segments continues to remain healthy. However, the bank will pursue these opportunities at the right price, at an appropriate time, and will prioritize credit quality. The demand for mortgages (merged entity) has been buoyant as seen from the strong log-in vs. historical trends. While retail portfolio growth is seen to remain robust, the bank will continue to review and rationalize the wholesale lending book at HDFC, as it looks to align the business with the bank's (standalone) approach towards the segment before resuming growth in that portfolio. ***The management remains confident of clocking ~17-18% credit growth for the merged entity.***

Sector Outlook: Positive

Company Outlook: As a merged entity, the bank remains well-positioned to deliver sustainable growth given (1) The larger addressable customer base, (2) Higher cross-selling opportunities for both asset (mainly retail) and liability products, and (3) A more stable loan book given a lower share of unsecured products and higher share of longer-tenor mortgages.

Current Valuation: 2.9x FY25E ABV; Earlier Valuation: 3.2x Sep'24E ABV

Current TP: Rs 2,050/share; Earlier TP: Rs 1,975/share

Recommendation: We **maintain** our **BUY** recommendation on the stock.

Alternate Ideas from Coverage Stocks

Federal Bank (TP – Rs 160)

Financial Performance

- Given Q1 is a seasonally soft quarter, HDFCB's **advances** growth was flat QoQ (+1% QoQ). Credit growth was driven by the Retail (+18%/4% YoY/QoQ) and the CRB (29%/3% YoY/QoQ) segment, while the corporate book de-grew by 1% QoQ. As a merged entity, HDFCB's advances grew by ~16% YoY.
- **NII** grew by 21%/1% YoY/QoQ and **NIMs** (reported) remained stable QoQ at ~4.1%. Fee income and treasury gain drove **non-interest income growth** of +44%/6% YoY/QoQ. Opex growth continued to remain elevated, growing at 34/4% YoY/QoQ and dragging PPOP growth. **The C-I Ratio** inched up to 42.8% from 40.6%/42.0% YoY/QoQ. **PPOP** grew by 22% YoY and remained flat QoQ. Stable credit costs of ~70bps aided earnings growth of 30% YoY, flat QoQ.
- Despite seasonally higher slippages from the agri book, **asset quality** remains steady at 1.17% vs. 1.12% QoQ. The restructured book tapered to 27bps vs. 32bps QoQ.

Outlook

We expect HDFCB to deliver a strong credit growth of 17% CAGR over the medium term, which will be primarily led by the retail portfolio. Deposit mobilization will be closely monitored, as we believe it remains a key lever in supporting the bank's healthy credit growth. The maturing branches and increased focus on improving retail TD penetration amongst its customers should help the bank deliver ~20% CAGR deposit growth over FY24-26E. We believe the pressure of NIMs would be largely offset by improving cost ratios and steady credit costs of ~70bps (+/-5bps), enabling the bank to deliver an RoA ranging between 1.9-2% over FY24-26E. The merged entity remains well-placed in terms of regulatory compliance w.r.t SLR/CRR/PSL.

Valuation & Recommendation

We value the core book at 2.9x FY25E ABV vs. its current valuation of 2.6x FY25E ABV and assign a value of Rs 165/share to subsidiaries of the merged entity, thereby arriving at a target price of Rs 2,050/share, implying an upside of 22% from the CMP.

Key Financials (Standalone)

(Rs Bn)	Q1FY24	QoQ (%)	YoY (%)	Axis Est.	Variance
Net Interest Income	236.0	+1.1	+21.1	238.8	-1.2
PPOP	187.7	+0.8	+22.2	187.5	+0.1
Net Profit	119.5	-0.8	+30.0	115.9	+3.1
NNPA (%)	0.3	+3 bps	-5 bps	0.3	-
RoA (%)	2.1	-10 bps	+30 bps	2.0	-8 bps

Source: Company, Axis Research

(CMP as of 17 July, 2023)

CMP (Rs)	1,679
Upside /Downside (%)	22%
High/Low (Rs)	1758/1338
Market cap (Cr)	12,65,709
Avg. daily vol. (6m) Shrs.	1,44,15,783
No. of shares (Cr)	753.8

Shareholding (%)

	Dec-22	Mar-23	Jun-23
Promoter	25.7	25.6	25.5
FIIs	32.1	32.2	33.4
MFs / UTI	18.4	18.5	17.6
Others	23.8	23.7	23.5

Financial & Valuations

Y/E Mar (Rs Bn)	FY24E	FY25E	FY26E
NII	1,186	1,471	1,749
PPOP	993	1,250	1,477
Net Profit	631	784	928
EPS (Rs)	83.7	104.0	123.1
ABV (Rs)	577.0	650.7	736.9
P/ABV (x)	2.9	2.6	2.3
RoA (%)	2.0	2.0	2.0
NNPA (%)	0.3	0.3	0.3

Change in Estimates (%)

Y/E Mar	FY24E	FY25E
NII	N.A	N.A
PPOP	N.A	N.A
PAT	N.A	N.A

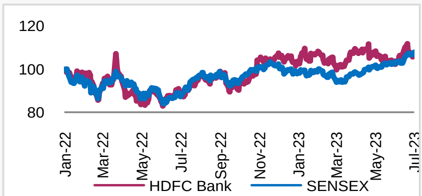
ESG disclosure Score**

Environmental Disclosure	40.1
Social Disclosure Score	56.7
Governance Disclosure Score	92.4
Total ESG Disclosure Score	**63.1**
Sector Average	**39.1**

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2022 disclosures

Relative performance



Source: AceEquity, Axis Securities

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Recommendation Rationale & Key Highlights

- **NIMs to move in a narrow range –** Post the merger, the mortgage book of HDFC moving to repo-rate pricing exposes margins to more volatility in case of any rate changes. However, addressing concerns on margin volatility, the management has indicated that the margins for HDFC moved in a very narrow range despite the sharp increase in the repo rate (+250 bps since May'22). This is primarily because these loans were hedged from an interest rate risk perspective, and the merged entity will continue to use hedging instruments to minimize the impact on NIMs. For the merged entity, we expect margin pressures to surface in the near term primarily owing to the increased share of lower-yielding (vs. other retail products) mortgage loans and higher cost liabilities of HDFC.

  The CoF differential between HDFC and HDFCB has ranged between 220-290bps over the past 5 years. Substituting the high-cost liabilities with lower-cost deposits will help narrow the gap thereby aiding NIMs. We expect margins to contract to ~3.9% in FY25E, before improving to 4% by 26E.

Key Risks to our Estimates and TP

- The key risk to our estimates remains a slowdown in overall credit momentum or the bank's inability to ensure deposit mobilization which could potentially derail earnings momentum for the bank.

- Slower substitution of lower-cost deposits could continue to hurt margins

Valuation – SOTP Calculation

	Stake Held (%)	Valuation Methodology	Value Per Share
HDFC Bank - Parent		2.9x FY25E Adj. BV	1,887
Subsidiaries			
HDB Financial Services	94.8	2x FY25E BV	43
HDFC Securities	95.6	14x FY25E EPS	24
HDFC Life	50.3	2.6x FY25E EV	94
HDFC AMC	52.6	28x FY25E EPS	32
HDFC Ergo	50.5	25x FY25E EPS	15
Total Subsidiary Value			207
Less: 20% holding discount			41
Net Value of Sub.			165
Target Price			2,050
CMP			1,679
Potential Upside (%)			*22%*

Source: Axis Securities

Results Review

Rs Bn	Q1FY24	Q1FY23	% YoY	Q4FY23	% QoQ
Net Interest Income	236	195	21.1	234	1.1
Non-Interest Income	92	64	44.5	87	5.7
Operating expenses	141	105	33.9	135	4.4
-- Staff Cost	*48*	*35*	*36.6*	*44*	*9.6*
Pre provision profits	188	154	22.2	186	0.8
Provisions and contingencies	29	32	-10.3	27	6.5
PBT	159	122	30.6	159	-0.1
Provision for Tax	40	30	32.7	39	1.9
PAT	120	92	30.0	120	-0.8
Deposits	19,131	16,048	19.2	18,834	1.6
CASA Deposits	8,130	7,350	10.6	8,362	-2.8
CASA Ratio %	*42.5*	*45.8*	*-331bps*	*44.4*	*-190bps*
Advances	16,155	13,951	15.8	16,006	0.9
Retail	*6,578*	*5,579*	17.9	*6,346*	3.7
Commercial & Rural Banking	*5,632*	*4,365*	29.0	*5,474*	2.9
Agri	*796*	*616*	29.3	*817*	-2.5
Corporate	*4,046*	*3,639*	11.2	*4,097*	-1.2
C/D Ratio	84.4	86.9		85.0	
NIMs - Reported (%)	4.1	4.0	10bps	4.1	0bps
Cost-Income ratio (%)	42.8	40.6	222bps	42.0	86bps
Gross NPA (%)	1.2	1.3	-11bps	1.1	5bps
Net NPA (%)	0.3	0.3	-5bps	0.3	3bps
PCR (%)	74.9	72.9		75.8	

Source: Company, Axis Securities

HDFC Bank – Bigger and Stronger!

HDFC Bank's (HDFCB) merger with HDFC Ltd. (HDFC) has created a financial behemoth which remains well-placed to deliver superior and sustainable growth over the medium-long term. The merger will provide the bank (1) A larger customer base, (2) Better cross-sell opportunities, (3) More stability to the merged entity's loan book with higher longer-tenure secured housing loans and de-risking the book with a lower share of unsecured loans.

We expect ***margin pressures to surface*** owing to the increased share of lower-yielding mortgage books along with higher-cost (vs. the bank) liabilities becoming liabilities of the merged entity. However, healthy growth in the retail book and replacing the higher-cost liabilities with granular low-cost deposits would help margins recover over the medium term. Moreover, HDFC's lean cost structure (the C-I Ratio ranges between 9-10%) and improving productivity (of the standalone bank) would benefit the cost ratios of the merged entity. Both HDFC and HDFCB have been able to maintain strong asset quality across cycles and we expect credit costs to continue to remain benign (~70bps +/-5 bps) over the medium term backed by healthy asset quality. Thus, ***improving cost ratios and steady credit costs should offset the impact on NIMs, enabling the merged entity to deliver RoA of ~2% over FY24-26E.***

Merger Benefit 1 – Larger Serviceable Customer Base, Higher Cross-Sell Opportunities

- ✓ As of Mar'23, HDFCB's customer base stood at ~83 Mn. Post the merger, at a group level (including HDFC and the AMC/insurance subsidiaries) the customer base could increase to ***~116 Mn customers, thereby offering the bank a larger serviceable customer base***. The longer tenor loans of HDFC will also help the merged entity build a sticky customer base.
- ✓ The bank, at the time of the merger announcement (Apr'22) had highlighted that ~70% of HDFC's customers do not bank with HDFCB. ***The merger will help the bank bridge this gap to an extent and will provide significant cross-sell opportunities for both its asset (mainly retail) and liability products.***
- ✓ The % of customers having a mortgage product with HDFCB has been low. Post the merger, by way of running pre-approved offers, the bank will focus on growing the mortgage book to a larger addressable customer base.

Merger Benefit 2 – Portfolio Diversification, Credit growth to remain buoyant

- ✓ Most banks have been relying on unsecured products to drive credit growth supported by better risk appetite and improved cashflows of borrowers. HDFCB's share of unsecured products in the overall portfolio mix stood at ~30% in Mar'23. The merger would help the bank de-risk the book, as the share of unsecured products would reduce to ~22% (in Mar'23) on a proforma basis.
- ✓ HDFCB has been highlighting that the pricing pressure in the corporate segment, especially the better-rated larger corporates has been high owing to intense competition. Thus, leveraging HDFC's distribution and expertise, HDFCBs own branch network and cross-selling other retail products may help drive robust growth in the retail portfolio.
- ✓ HDFCB's focus on growing the Commercial and Rural banking segment (CRB) given its role in improving the PSL-compliant portfolio has enabled the bank to maintain a healthy growth momentum in the portfolio.
- ✓ ***We believe HDFCB's credit growth momentum would be largely driven by the retail and CRB segment and expect the merged entity to deliver a healthy ~17% CAGR growth over FY24-26E.***

Merger Benefit 3 – Leveraging branch network to drive Deposit Growth

- ✓ Post the merger, the liabilities of HDFC (higher cost vs HDFCB) would be classified as the liabilities of the bank and can be substituted at maturity. Resultantly, the share of borrowings in the overall borrowings mix would increase and remain higher vs. the standalone bank (Deposit/Total borrowings has been 88-90% over the past decade). Similarly, the CASA Ratio for the bank would drop immediately post the merger. HDFCB's deposit growth has been healthy at ~18%+ CAGR over the past decade, far ahead of the systemic deposit growth of ~10% CAGR over the same period.
- ✓ HDFCB has been accelerating the pace of customer acquisition, making efforts to increase its retail TD penetration among its customer base and investing heavily in increasing the branch infrastructure, to drive superior deposit growth. The bank has also guided to add 1,500 branches annually over the medium term. Here on, (1) improving branch vintage resulting in faster deposit accretion and (2) cross-selling of liability products to customers and (3) improving TD penetration will drive deposit growth for the bank. Deposit mobilization is a critical factor for the bank to sustain its strong growth momentum. We expect HDFCB to deliver a healthy ~20% CAGR over FY24-26E.
- ✓ As stated in Q1FY24 concall, post the merger, the C/D ratio has increased to ~109% vs. historical levels of 84-85% for the standalone bank. The management believes the bank could take upto 3-4 years to achieve a C/D Ratio of ~84-85% for the merged entity.

Financials (Standalone)

Profit & Loss

(Rs Bn)

Y/E March	FY23	FY24E	FY25E	FY26E
Net Interest Income	**868**	**1,186**	**1,471**	**1,749**
Other Income	312	403	487	573
Total Income	**1,181**	**1,590**	**1,959**	**2,322**
Total Operating Exp	477	596	709	845
PPOP	**704**	**993**	**1,250**	**1,477**
Provisions & Contingencies	119	150	201	236
PBT	**585**	**844**	**1,048**	**1,241**
Provision for Tax	144	213	264	313
PAT	**441**	**631**	**784**	**928**

Source: Company, Axis Securities **FY24 onwards are post-merger numbers

Balance Sheet

(Rs Bn)

Y/E March	FY23	FY24E	FY25E	FY26E
SOURCES OF FUNDS				
Share Capital	6	8	8	8
Reserves	2,796	4,606	5,193	5,889
Shareholder's Funds	**2,802**	**4,613**	**5,201**	**5,896**
Total Deposits	18,834	24,837	29,799	35,679
Borrowings	2,068	6,544	6,423	7,190
Other Liabilities & Provisions	957	1,434	1,516	1,785
Total Liabilities	**24,661**	**37,429**	**42,940**	**50,551**
APPLICATION OF FUNDS				
Cash & Bank Balance	1,938	2,679	2,246	2,676
Investments	5,170	7,358	8,371	9,978
Advances	16,006	25,531	29,973	35,129
Fixed & Other Assets	1,547	1,862	2,351	2,767
Total Assets	**24,661**	**37,429**	**42,940**	**50,551**

Source: Company, Axis Securities **FY24 onwards are post-merger numbers

Ratio Analysis (%)

Y/E March	FY23	FY24E	FY25E	FY26E
VALUATION RATIOS				
EPS	79.1	83.7	104.0	123.1
Earnings Growth (%)	*18.6*	*5.9*	*24.2*	*18.4*
BVPS	502.2	612.0	690.0	782.3
Adj. BVPS	487.5	577.0	650.7	736.9
ROAA (%)	1.9	2.0	2.0	2.0
ROAE (%)	16.8	17.0	16.0	16.7
P/E (x)	21.2	20.1	16.1	13.6
P/ABV (x)	3.4	2.9	2.6	2.3
Dividend Per Share	19.0	21.0	26.0	30.8
Dividend Yield (%)	*1.1*	*1.2*	*1.6*	*1.8*
PROFITABILITY				
Yield on Assets (%)	7.5	7.7	7.8	7.8
Cost of Funds (%)	3.9	4.4	4.3	4.3
Spreads (%)	3.6	3.3	3.5	3.5
NIM (%)	4.1	4.0	3.9	4.0
OPERATING EFFICIENCY				
Cost/Avg. Asset Ratio (%)	2.1	1.9	1.8	1.8
Cost-Income Ratio (%)	40.4	37.5	36.2	36.4
BALANCE SHEET STRUCTURE RATIOS				
Loan Growth (%)	16.9	59.5	17.4	17.2
Deposit Growth (%)	20.8	31.9	20.0	19.7
Equity/Assets (%)	11.4	12.3	12.1	11.7
Equity/Advances (%)	17.5	18.1	17.4	16.8
CAR (%)	19.3	20.3	19.3	18.6
Tier 1 CAR (%)	17.1	18.3	17.5	17.1
ASSET QUALITY				
Gross NPLs (Rs Bn)	180.2	318.1	365.3	420.7
Net NPLs (Rs Bn)	43.7	79.4	91.5	105.8
Gross NPLs (%)	1.1	1.2	1.2	1.2
Net NPLs (%)	0.3	0.3	0.3	0.3
Coverage Ratio (%)	75.8	75.0	75.0	74.9
Provisions/Avg. Adv(%)	0.8	0.7	0.7	0.7
ROAA TREE (%)				
Net Interest Income	3.8	3.8	3.7	3.8
Non-Interest Income	1.4	1.3	1.2	1.2
Operating Cost	2.1	1.9	1.8	1.8
Provisions	0.5	0.5	0.5	0.5
ROAA	1.9	2.0	2.0	2.0
Leverage (x)	8.7	8.4	8.2	8.4
ROAE	16.8	17.0	16.0	16.7

Source: Company, Axis Securities **FY24 onwards are post-merger numbers

HDFC Bank Price Chart and Recommendation History

Date	Reco.	TP	Research
18-Jan-21	BUY	1,710	Result Update
19-Apr-21	BUY	1,785	Result Update
06-Jul-21	BUY	1,785	Company Update
16-Jul-21	BUY	1,720	Result Update
05-Oct-21	BUY	1,770	Company Update
18-Oct-21	BUY	1,935	Result Update
17-Jan-22	BUY	1,985	Result Update
05-Apr-22	BUY	1,985	Company Update
18-Apr-22	BUY	1,960	Result Update
18-Jul-22	BUY	1,840	Result Update
25-Jul-22	BUY	1,840	AAA
17-Oct-22	BUY	1,800	Result Update
16-Jan-23	BUY	1,860	Result Update
17-Apr-23	BUY	1,975	Result Update
24-Apr-23	BUY	1,975	Company Update
18-Jul-23	BUY	2,050	Result Update

Source: Axis Securities

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HOLD	Between 10% and -10%
SELL	Less than -10%
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UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
NO STANCE	We do not have any forward looking estimates, valuation or recommendation for the stock

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