

Set to turn the tables, though gradually

BFSI - Banks ▶ Visit Note ▶ September 11, 2023

TARGET PRICE (Rs): 2,100

We expect HDFCB to post moderate growth in the near term, as HDFCL's loan book decelerates (mainly corporate), while near-term core margins (3.7-3.8% on merged basis vs. standalone 4.1%) contract by 10-15bps due to ICRR+excess liquidity impact. However, growth should accelerate (15% CAGR over FY24-26E), as mortgage engine fires up from the bank's platform, which along with the gradual replacement of HDFCL's high-cost borrowings (80-85% to be replaced via retail deposits), as they mature, should lead to margin normalization. We have cut our earnings/BV est. by ~4%/5-6% to reflect the near-term margin softness, higher opex due to investments in the phygital network, and merger-related adjustments. Thus, we revise our TP to Rs2,100 (valuing the core bank at 2.8x its Sep-25E ABV+subs/inv. value at Rs185) from Rs2,150. However, retain BUY, as we believe the merger drag should ease soon, which along with improvement in the bank's RoA/RoE back to ~2%/16-17% over FY25-26E, benefiting from the merger's synergies, should be positive. Further, given KMB undergoing mgmt. transition (typically leading to business/valuation softness as seen in HDFCB), HDFCB with stable mgmt., better return profile and valuation (2x vs. 2.1x for KMB) offers a good bet from a medium-long term view. The long-awaited listing of HDB Fin should be another stock catalyst going ahead.

HDFC Bank: Financial Snapshot (Standalone) - Merged financials from FY24E

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net profit	369,614	441,101	665,716	774,071	917,938
Loan growth (%)	20.8	16.9	14.0	15.6	16.6
NII growth (%)	11.0	20.6	11.7	16.3	18.8
NIM (%)	3.9	4.1	3.7	3.7	3.8
PPOP growth (%)	11.7	9.9	12.8	16.5	18.8
Adj. EPS (Rs)	66.8	79.3	87.5	102.4	121.4
Adj. EPS growth (%)	18.1	18.6	10.7	17.0	18.6
Adj. BV (INR)	428.3	497.8	568.6	650.6	744.9
Adj. BVPS growth (%)	17.5	16.2	6.5	14.4	14.5
RoA (%)	1.9	1.9	1.9	2.0	2.0
RoE (%)	16.7	17.0	15.6	16.5	17.1
P/E (x)	23.2	19.7	16.4	14.1	11.9
P/ABV (x)	3.6	3.1	2.6	2.2	2.0

Source: Emkay Research; Merged financials from FY24E

H1FY24 to be a period of consolidation: HDFCB's loan growth, on a merged basis in Q1, was slower at 14% and should remain so in the near term due to continued deceleration in HDFCL's corp. book. However, it should improve from H2, led by festive pick-up and gradual mortgage book scale-up from the bank's platform, partly offset by any IBPC sale, which HDFCB may conduct for B/S mgmt. Deposit growth was also lower in Q1 at 16% YoY (Rs290bn QoQ on a merged basis), which the bank expects to improve without competing on rates, in a way leading to some moderation in its higher LDR at 109%. However, we believe near-term core margins (3.7-3.8% on a merged basis vs. standalone 4.1%) could contract by 10-15bps due to ICRR + excess liquidity impact, but gradually normalize as the impact of ICRR eases out, given RBI's recent decision to withdraw ICRR by early October. Additionally, the bank would report merged financials from Q2FY24E, accounting for the impact of IndAS to I-GAAP migration on the P&L for HDFCL (mainly non-recognition of interest on NPAs, assignment income/sourcing cost) and op. net worth (adj. for investments in HDFCB, harmonization of NPA provisions, and other policy adjustments). The bank would recognize consideration from warrant conversion in Q2, while CREDILA's stake sale gains could possibly be recognized in Q3, subject to regulatory approvals. Factoring these adjustments and earnings cut (~4%), we lower our ABV est. on net basis for FY24-26E by 5-6%.

Incremental focus will be on juicing up the mortgage business and deposit mobilization to refinance high-cost borrowings: HDFCB believes the acquisition of the mortgage business from HDFCL will bring with it multiple benefits - new secured credit growth avenue from the banking platform with unique cost/franchisee advantage, higher portfolio duration, PSL benefit (Rs1.1trn being already PSL compliant), and, most notably, a huge opportunity to cross-sell other assets/liabilities. The bank believes it is not perturbed by the higher share of mortgage (30%/35% incl. LRD/CF) in its book (as it is so for other large PVBs like ICICI/KMB) and, thus, the impact on blended margins, as it still has better RoA/RoE than the bank's standalone book, given lower operational, credit, and capital cost. As of now, the mortgage business's arrangement is similar to pre-merger, but eventually, in the next 12 months, the bank would offer mortgage business from most of its branches once the systems/processes are in place. The merger would also open up the opportunity to better cross-sell banking products and vice-versa with the insurance/MF business subsidiaries and, thus, generate higher fees. On the liability front, the bank has been ramping up branches and would look at gradual replacement of HDFCL's high-cost borrowings (80-85% to be replaced via retail deposits) as they mature. The bank also remains open to explore bulk deposits (subject to the right pricing) and would look to build a long-term bond book to match the long-term mortgage book.

Unwinding of merger benefits to help reclaim 2% RoA/17% RoE by FY26E; Retain BUY

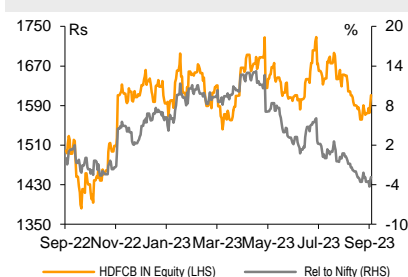
We have cut our earnings/ABV est. by ~4%/5-6% to reflect near-term margin softness, higher opex due to investments in the phygital network, and merger-related adjustments. However, we expect the bank's RoA/RoE to improve from 1.9%/15.6% in FY24E (merged) to ~2%/17% by FY26E, benefiting from better growth/margins and fees, as merger synergies kick in. We retain BUY with a revised TP of Rs2,100 (valuing the core bank at 2.8x Sep-25E ABV + subs/inv. value at Rs185/share).

Target Price - 12M	Jun-24
Change in TP (%)	(2.3)
Current Reco.	BUY
Previous Reco.	BUY
Upside/(Downside) (%)	29.4
CMP (08-Sep-23) (Rs)	1,623.4

Stock Data	Ticker
52-week High (Rs)	1,758
52-week Low (Rs)	1,365
Shares outstanding (mn)	7,573.8
Market-cap (Rs bn)	12,295
Market-cap (USD mn)	148,233
Net-debt, FY24E (Rs mn)	NA
ADTV-3M (mn shares)	19
ADTV-3M (Rs mn)	31,690.0
ADTV-3M (USD mn)	382.1
Free float (%)	99.0
Nifty-50	19,820
INR/USD	82.9
Shareholding, Jul-23	
Promoters (%)	-
FPIs/MFs (%)	46.6/25.9

Price Performance

(%)	1M	3M	12M
Absolute	(1.6)	0.9	8.4
Rel. to Nifty	(2.8)	(5.1)	(2.7)

1-Year share price trend (Rs)**Anand Dama**

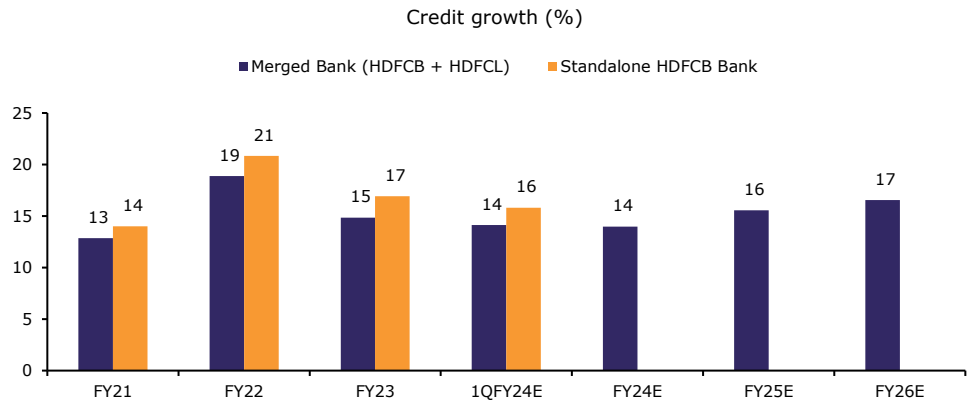
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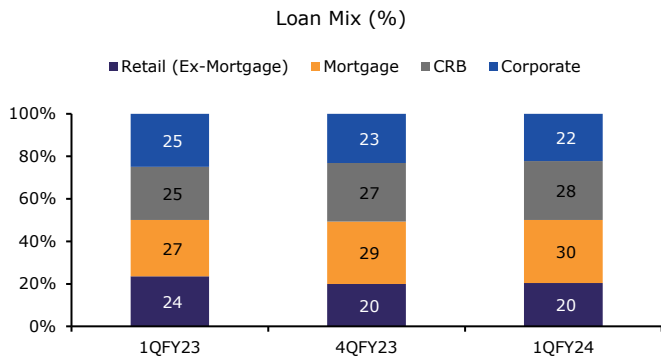
Story in Charts

Exhibit 1: FY24 will be a year of consolidation, post which we expect growth to improve as the bank revives from the merger drag and scales up mortgage growth



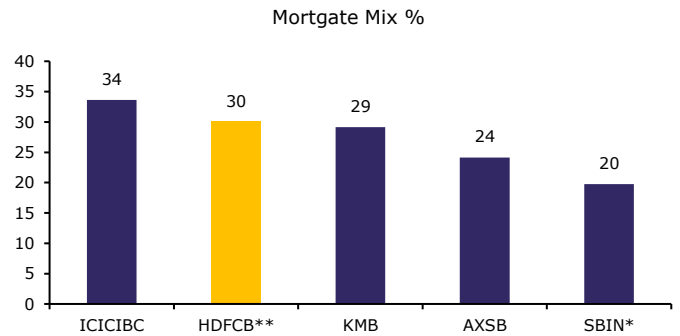
Source: Emkay Research

Exhibit 2: HDFCB's loan mix on a merged basis



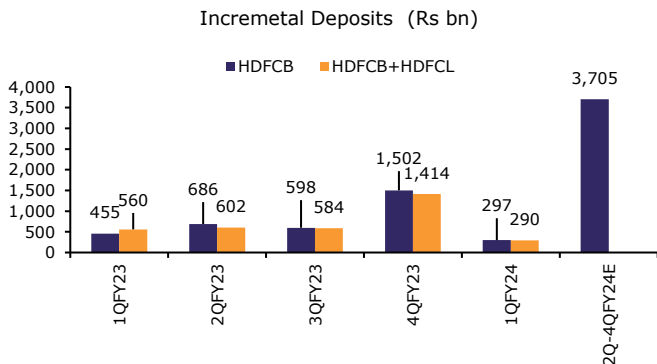
Source: Emkay Research

Exhibit 3: Mortgage mix for HDFCB to be higher at 30%, similar to large banks like ICICI and KMB



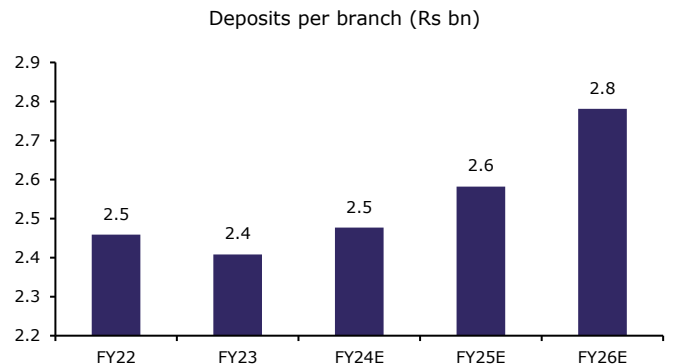
Source: Emkay Research; *Ex-LAP **35% reported incl. LRD/CF

Exhibit 4: We expect deposit mobilization to accelerate over Q2-Q4FY24E



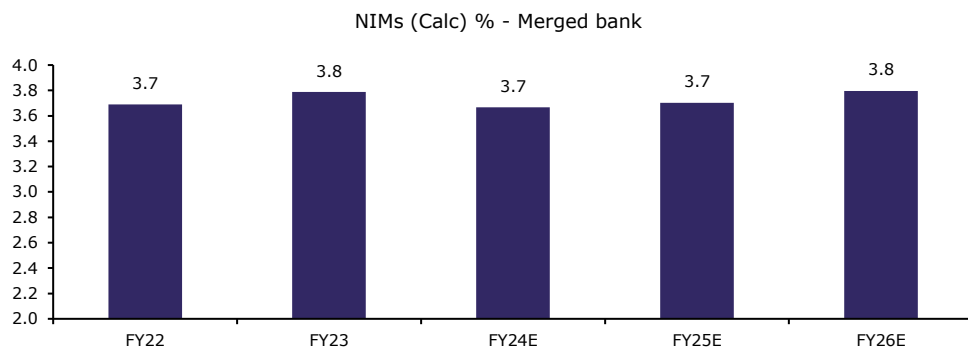
Source: Emkay Research

Exhibit 5: ...but meaningful pick-up should be seen over FY25-26E as branches gain vintage



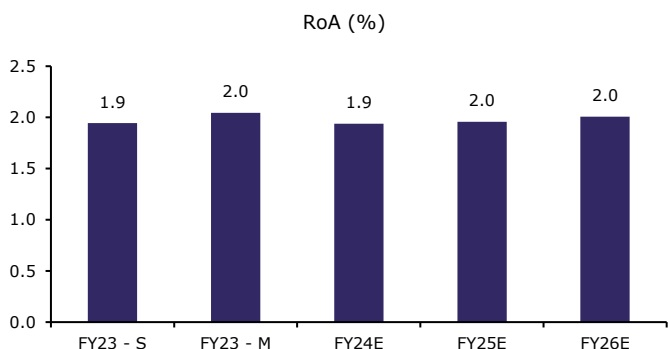
Source: Emkay Research

Exhibit 6: We expect some softness in NIMs over FY24-25E, mainly due to the recent ICRR impact, regulatory drag and gradual reduction in yields due to a higher share of the floating book (incl. mortgage), but recover gradually as the bank refinances high-cost borrowings with deposits



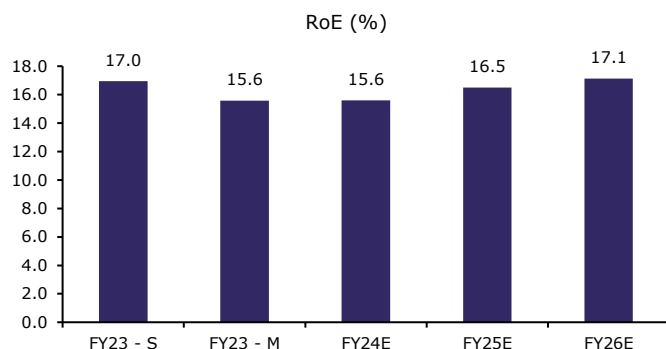
Source: Emkay Research

Exhibit 7: RoAs (M) to moderate due to margin pressure/higher opex, but to gradually recover as merger synergies kick in



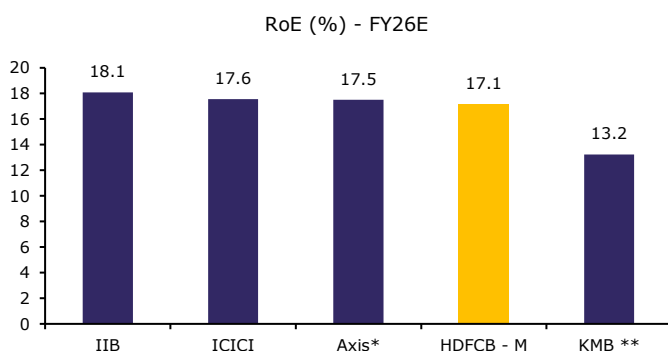
Source: Emkay Research; M - Merged, S - Standalone bank pre-merger

Exhibit 8: ...which along with better growth/leverage should help it reclaim 17% RoE, as seen in the standalone bank before the merger



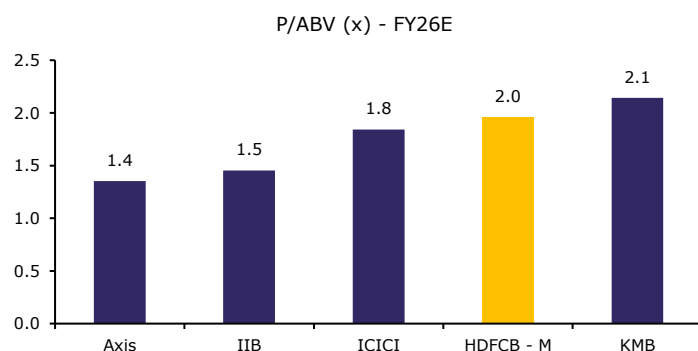
Source: Emkay Research; M - Merged, S - Standalone bank pre-merger

Exhibit 9: HDFCB to report healthy RoE by FY26E (better than KMB)

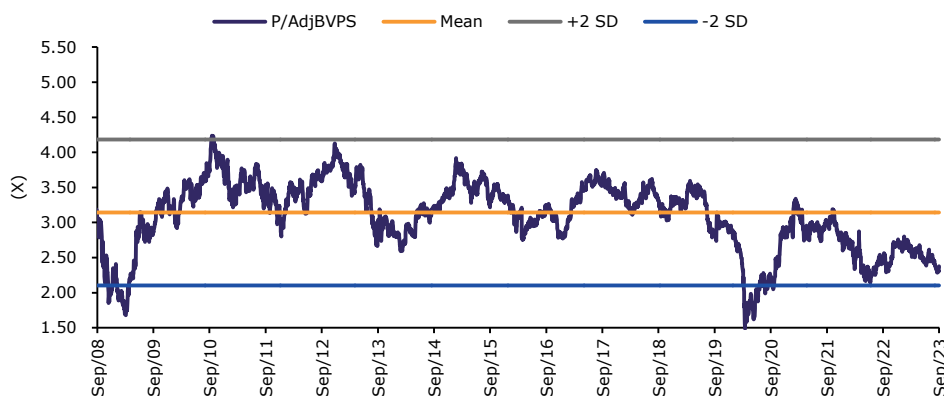


Source: Emkay Research; *Partly inflated due to lower capital **Partly suppressed due to higher capital

Exhibit 10: ...but still trades at a slight discount to KMB



Source: Emkay Research' P/ABV adj. for subs. valuations

Exhibit 11: HDFCB trades at a valuation of 2.5x its one-year forward ABV

Source: Bloomberg, Emkay Research

Exhibit 12: Revision in Estimates for merged bank

Y/E March (Rs mn)	FY24E			FY25E			FY26E		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Net income	1,652,533	1,670,432	1.1%	1,948,565	1,970,699	1.1%	2,284,526	2,333,271	2.1%
PPOP	1,034,715	1,040,312	0.5%	1,205,018	1,211,554	0.5%	1,419,234	1,439,452	1.4%
PAT	693,550	665,716	-4.0%	808,914	774,071	-4.3%	949,171	917,938	-3.3%
EPS (Rs)	91.2	87.5	-4.0%	107.0	102.4	-4.3%	125.4	121.4	-3.2%
BV (Rs)	609.3	577.0	-5.3%	689.8	660.7	-4.2%	790.2	757.1	-4.2%

Source: Emkay Research

Exhibit 13: Key Assumptions

	FY23A	FY24E	FY25E	FY26E
Loan Growth (%)	14.8	14.0	15.6	16.6
Deposit Growth (%)	18.3	19.7	20.2	22.0
NIM (%)	3.8	3.7	3.7	3.8
GNPA (%)	1.2	1.2	1.2	1.3
Credit Cost (%)	0.7	0.7	0.7	0.7

Source: Emkay Research

HDFC Bank : Standalone Financials and Valuations (Merged financials from FY24E onwards)

Profit and Loss					
Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	1,277,531	1,615,856	2,722,791	3,024,038	3,413,006
Interest Expense	557,435	747,433	1,538,218	1,646,384	1,775,785
Net interest income	720,096	868,422	1,184,573	1,377,654	1,637,221
NII growth (%)	11.0	20.6	11.7	16.3	18.8
Other income	295,099	312,162	485,860	593,045	696,050
Total Income	1,015,195	1,180,585	1,670,432	1,970,699	2,333,271
Operating expenses	374,422	476,521	630,121	759,145	893,818
PPOP	640,773	704,064	1,040,312	1,211,554	1,439,452
PPOP growth (%)	11.7	9.9	12.8	16.5	18.8
Core PPOP	617,947	717,475	948,876	1,093,646	1,309,753
Provisions & contingencies	150,618	119,197	150,317	176,700	212,263
PBT	490,155	584,867	889,995	1,034,854	1,227,189
Extraordinary items	0	0	0	0	0
Tax expense	120,541	143,766	224,279	260,783	309,252
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	369,614	441,101	665,716	774,071	917,938
PAT growth (%)	18.8	19.3	10.3	16.3	18.6
Adjusted PAT	369,614	441,101	665,716	774,071	917,938
Diluted EPS (Rs)	66.3	78.7	119.2	139.7	165.7
Diluted EPS growth (%)	17.8	18.6	10.9	17.2	18.6
DPS (Rs)	15.5	19.1	20.9	22.0	25.0
Dividend payout (%)	23.3	24.0	23.9	21.5	20.6
Effective tax rate (%)	24.6	24.6	25.2	25.2	25.2
Net interest margins (%)	3.9	4.1	3.7	3.7	3.8
Cost-income ratio (%)	36.9	40.4	37.7	38.5	38.3
Shares outstanding (mn)	5,545.5	5,579.7	7,562.4	7,562.4	7,562.4

Source: Company, Emkay Research; Merged financials from FY24E

Asset Quality and Other Metrics					
Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Asset quality					
Gross NPLs	161,409.3	180,190.0	303,231.5	364,872.8	441,880.4
Net NPLs	44,076.7	43,684.2	84,904.8	102,164.4	123,726.5
GNPA ratio (%)	1.2	1.1	1.2	1.2	1.3
NNPA ratio (%)	0.3	0.3	0.3	0.4	0.4
Provision coverage (%)	72.7	75.8	72.0	72.0	72.0
Gross slippages	268,614.3	244,000.0	335,172.8	410,942.2	513,384.2
Gross slippage ratio (%)	1.9	1.5	1.3	1.4	1.5
LLP ratio (%)	1.2	0.8	0.7	0.7	0.7
NNPA to net worth (%)	1.8	1.5	1.9	2.0	2.1
Capital adequacy					
Total CAR (%)	18.9	19.3	18.6	18.3	18.1
Tier-1 (%)	17.9	17.1	16.9	16.8	16.8
CET-1 (%)	16.7	16.4	15.8	15.9	16.0
RWA-to-Total Assets (%)	65.4	64.3	66.0	66.0	66.0
Miscellaneous					
Total income growth (%)	7.7	22.6	66.4	12.7	13.6
Opex growth (%)	14.4	27.3	25.8	20.5	17.7
Core PPOP growth (%)	15.5	16.1	2.3	15.3	19.8
PPOP margin (%)	40.7	36.5	32.4	33.5	35.0
PAT/PPOP (%)	57.7	62.7	64.0	63.9	63.8
LLP-to-Core PPOP (%)	24.4	16.6	15.8	16.2	16.2
Yield on advances (%)	7.9	8.6	9.5	9.1	8.9
Cost of funds (%)	3.5	3.9	5.4	4.9	4.6

Source: Company, Emkay Research; Merged financials from FY24E

Balance Sheet					
Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	5,546	5,580	7,562	7,562	7,562
Reserves & surplus	2,395,384	2,796,424	4,381,376	4,989,075	5,717,953
Net worth	2,400,929	2,802,004	4,388,938	4,996,637	5,725,516
Deposits	15,592,174	18,833,947	24,357,036	29,268,153	35,693,947
Borrowings	1,848,172	2,067,656	6,432,836	6,737,977	6,225,339
Interest-bearing liab.	17,440,346	20,901,602	30,789,872	36,006,131	41,919,287
Other liabilities & prov.	844,075	957,209	1,537,699	1,368,361	1,425,703
Total liabilities & equity	20,685,351	24,660,815	36,716,509	42,371,129	49,070,506
Net advances	13,688,209	16,005,859	25,173,552	29,090,304	33,907,458
Investments	4,555,357	5,170,014	7,005,747	8,184,243	9,414,928
Cash, other balances	1,523,269	1,937,651	2,401,610	2,736,466	3,143,946
Interest earning assets	19,766,835	23,113,524	34,580,909	40,011,013	46,466,333
Fixed assets	60,837	80,165	121,443	130,465	140,350
Other assets	857,678	1,467,125	2,014,156	2,229,652	2,463,823
Total assets	20,685,351	24,660,815	36,716,509	42,371,129	49,070,506
BVPS (Rs)	434.2	503.7	577.0	660.7	757.1
Adj. BVPS (INR)	428.3	497.8	568.6	650.6	744.9
Gross advances	13,805,542	16,142,365	25,391,879	29,353,012	34,225,612
Credit to deposit (%)	87.8	85.0	103.4	99.4	95.0
CASA ratio (%)	48.2	44.4	38.4	36.5	35.4
Cost of deposits (%)	3.4	3.7	4.8	4.6	4.4
Loans-to-Assets (%)	66.2	64.9	68.6	68.7	69.1
Net advances growth (%)	20.8	16.9	14.0	15.6	16.6
Deposit growth (%)	16.8	20.8	19.7	20.2	22.0
Book value growth (%)	17.2	16.0	6.3	14.5	14.6

Source: Company, Emkay Research; Merged financials from FY24E

Valuations and Key Ratios					
Y/E March	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	23.2	19.7	16.4	14.1	11.9
P/B (x)	3.6	3.1	2.5	2.2	1.9
P/ABV (x)	3.2	2.8	2.6	2.2	2.0
P/PPOP (x)	14.0	12.8	11.0	9.5	8.0
Dividend yield (%)	1.0	1.2	1.3	1.4	1.5
DuPont-RoE split (%)					
NII/avg assets	3.8	3.8	3.5	3.5	3.6
Other income	1.5	1.4	1.4	1.5	1.5
Fee income	1.0	1.1	0.8	0.8	0.9
Opex	2.0	2.1	1.8	1.9	2.0
PPOP	3.4	3.1	3.0	3.1	3.1
Core PPOP	3.2	3.2	2.8	2.8	2.9
Provisions	0.8	0.5	0.4	0.4	0.5
Tax expense	0.6	0.6	0.7	0.7	0.7
RoA (%)	1.9	1.9	1.9	2.0	2.0
Leverage ratio (x)	8.6	8.7	8.0	8.4	8.5
RoE (%)	16.7	17.0	15.6	16.5	17.1
Quarterly data					
Rs mn, Y/E March	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24
NII	194,814	210,212	229,878	233,518	235,991
NIM (%)	4.2	4.3	4.3	4.3	4.3
PPOP	153,678	173,922	190,241	186,209	187,720
PAT	91,960	106,058	122,595	120,475	119,518
EPS (Rs)	16.56	19.04	21.98	21.59	21.37

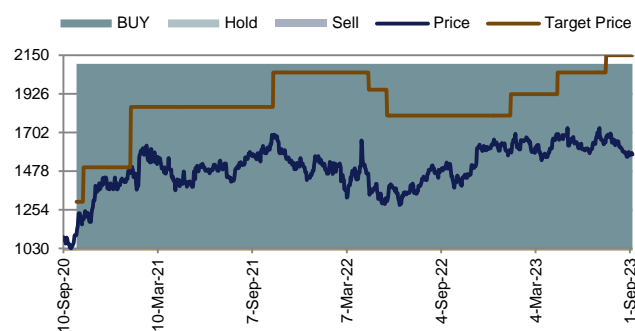
Source: Company, Emkay Research; Merged financials from FY24E

RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
17-Jul-23	1,679	2,150	Buy	Anand Dama
25-May-23	1,610	2,050	Buy	Anand Dama
24-Apr-23	1,688	2,050	Buy	Anand Dama
15-Apr-23	1,692	2,050	Buy	Anand Dama
09-Mar-23	1,631	1,925	Buy	Anand Dama
15-Jan-23	1,601	1,925	Buy	Anand Dama
04-Jan-23	1,610	1,800	Buy	Anand Dama
16-Oct-22	1,439	1,800	Buy	Anand Dama
04-Oct-22	1,453	1,800	Buy	Anand Dama
17-Jul-22	1,362	1,800	Buy	Anand Dama
01-Jun-22	1,395	1,800	Buy	Anand Dama
23-May-22	1,304	1,800	Buy	Anand Dama
18-Apr-22	1,395	1,950	Buy	Anand Dama
05-Apr-22	1,608	2,050	Buy	Anand Dama
04-Apr-22	1,657	2,050	Buy	Anand Dama
16-Jan-22	1,545	2,050	Buy	Anand Dama
04-Jan-22	1,529	2,050	Buy	Anand Dama
17-Oct-21	1,687	2,050	Buy	Anand Dama
05-Oct-21	1,595	1,850	Buy	Anand Dama
18-Jul-21	1,522	1,850	Buy	Anand Dama
18-Apr-21	1,429	1,850	Buy	Anand Dama
05-Apr-21	1,450	1,850	Buy	Anand Dama
20-Jan-21	1,492	1,850	Buy	Anand Dama
17-Jan-21	1,467	1,850	Buy	Anand Dama
06-Jan-21	1,421	1,500	Buy	Anand Dama
18-Oct-20	1,199	1,500	Buy	Anand Dama
05-Oct-20	1,114	1,300	Buy	Anand Dama

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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