Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

HDFC Bank Ltd

Mixed bag Q2

Stock Update

Result Update

Banks	Sharekhan code: HDFCBANK

Reco/View: Buy	↔	CMP: Rs. 1,530	Price Target: Rs. 1,900	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

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 30.61

Updated Aug 08, 2023

High Risk

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

Source: Morningstar

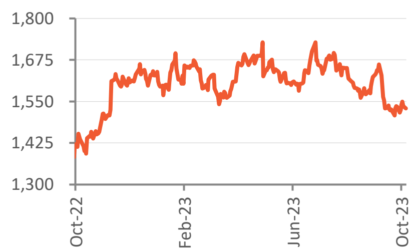
Company details

Market cap:	Rs. 11,59,639 cr
52-week high/low:	Rs. 1,758 / 1,412
NSE volume: (No of shares)	191.7 lakh
BSE code:	500180
NSE code:	HDFCBANK
Free float: (No of shares)	750.6 cr

Shareholding (%)

Promoters	-
FII	52.1
DII	30.6
Others	17.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.9	-7.0	-9.6	6.3
Relative to Sensex	-5.5	-7.2	-19.1	-7.9

Sharekhan Research, Bloomberg

Summary

- HDFC Bank reported PAT at Rs. 15,977 crore on the merged basis beating consensus and our estimates by 9%/8% respectively mainly due to lower tax rate led by one off item i.e. write back of tax provisions amounting to ~Rs. 1,000 crore from a favorable appellate orders.
- NIMs were lower at ~3.6% based on interest earning assets for the merged entity in Q2FY24 vs ~3.7-3.8% in Q1FY23 based on the proforma disclosed earlier. Excess liquidity built up required for LCR and for incremental CRR led to ~25 bps negative impact on NIMs resulting in NII missing consensus and our estimates by 3%/2% respectively.
- Management guided that NIMs would normalize gradually over the next few quarters as liquidity was made available through debt funding and it would require time to retire as they are not short term in nature. Despite significant margin pressure, bank reported RoA of ~2.0% led by higher other income, lower credit cost and lower tax expense.
- The stock trades at 2.2x/2.0x its FY2024E/FY2025E core BV estimates. We maintain our Buy rating with an unchanged PT of Rs. 1,900.

HDFC Bank reported mixed performance in Q2FY2024. Year-on and sequential numbers are not comparable as this is the first quarter reported after merger. Net interest income (NII) grew by ~30% y-o-y /16% q-o-q. NIMs were lower at ~3.6% based on interest earning assets for the merged entity in Q2FY24 vs ~3.7-3.8% in Q1FY23 based on the proforma disclosed earlier. Excess liquidity built up required for LCR and for incremental CRR led to lower NIMs. NIMs would normalize gradually over the next few quarters as liquidity was made available through debt funding and it would require time to retire as they are not short term in nature. Core fee income grew by ~20% y-o-y/ 10% q-o-q. Bank expects core fee income to grow in the mid-high teens. Net trading and mark-to-market gains were reported at Rs. 1041 crore vs. loss of Rs. 387 crore in Q2FY2023 and Rs. 552 crore gains in the last quarter. Total operating expenses were higher by 37% y-o-y/10% q-o-q. Operating profit (PPoP) grew by 31% y-o-y/21% q-o-q. Annualised total credit cost stood at 49 bps vs. 71 bps in the last quarter and 87 bps in Q2FY2023. The bank maintain contingency and floating provisions of Rs. 15,600 crore (0.67% of net advances). PBT grew by 40% y-o-y/24% q-o-q. Gross advances net of IBPC/BRDS grew by 5% q-o-q on like to like basis. Retail (ex- mortgages) grew by 2.5% q-o-q, Mortgages grew by 3.5% q-o-q commercial & rural banking, and corporate loans (ex. Non individual loans of erstwhile HDFC Ltd) grew by ~9.7% q-o-q and ~5.8% y-o-y, respectively. Non individual loans of erstwhile HDFC Ltd declined by 6% q-o-q on like to like basis. Total deposit mobilisation was strong post-merger grew by 5.3% q-o-q on like to like basis. CASA ratio now stands at 37.6%. GNPA/NNPA ratios were reported at 1.34%/0.35% vs 1.4%/0.40% q-o-q on like to like basis. Net slippages were at Rs. 3,300 crore (~0.57% annualised as % of net advances).

Key positives

- Incremental deposit accretion was strong sequentially (~5.3%)
- Lower credit cost (~49 bps)
- Contingent & floating provision buffers stand at 67 bps of loans.

Key negatives

- Higher than expected NIM pressure.
- CASA ratio dipped to 37.6% vs 42.5% q-o-q.

Management Commentary

- The banks focus is on higher deposit mobilisation through branch expansion, building new liability relationship by cross-sell/upsell, and relentless execution.
- The bank reiterated and is confident of sustaining RoA of 1.9-2.1% for the merged entity basis. The macro outlook is positive, which should support asset quality and, in turn, lower credit cost at least in the near term.
- Bank remained confident on the asset quality of non-individual loans of erstwhile HDFC Ltd.
- NIMs would normalize gradually over the next few quarters as liquidity was made available through debt funding and it would require time to retire as they are not short term in nature.

Our Call

Valuation – We maintain our Buy rating on the stock with an unchanged TP of Rs. 1,900

The stock currently trades at 2.2x/2.0x its FY2024E/FY2025E core BV estimates. The key challenge remains that at this point of the cycle is higher CD ratio (c. 107%) than industry. We believe that loan growth is expected to be in low mid-teens in near term which should bring the CD ratio at normalised level gradually. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,900 as valuations are reasonable and have priced in all the barring factors that could weigh down the earnings trajectory of the merged entity. The probability of further de rating is very bleak.

Key Risks

Slower deposit mobilisation; economic slowdown; tech outage.

Valuation Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Interest Income	72,010	1,06,090	1,18,841	1,46,348
Net profit	36,962	60,348	64,205	74,894
EPS (Rs.)	66.3	85.9	91.4	102.3
P/E (x)	20.2	15.6	14.6	13.1
P/BV (x)	3.1	2.4	2.2	2.0
RoE	16.7	18.5	14.8	15.3
RoA	1.9	2.3	1.9	1.9

Source: Company; Sharekhan estimates

Key result highlights

- **NIMs were lower than expectations:** NIMs were lower at ~3.6% based on interest earning assets for the merged entity in Q2FY24 vs ~3.7-3.8% in Q1FY23 based on the proforma disclosed earlier. Excess liquidity built up required for LCR and for incremental CRR led to lower NIMs. NIMs would normalize gradually over the next few quarters as liquidity was made available through debt funding and it would require time to retire as they are not short term in nature. Margins should also improve gradually as high-cost wholesale funding of HDFC Ltd gets replaced with retail funding (CASA and retail deposits) and improving loan mix towards other retail high-yielding segments.
- **Asset-quality continues to remain stable to positive:** GNPA/NNPA ratios were reported at 1.34%/0.35% vs 1.4%/0.40% q-o-q on like to like basis. Net slippages were at Rs. 3,300 crore (~0.57% annualised as % of net advances). The bank does not foresee any incremental pressure on asset quality. Bank is confident on the asset quality of non-individual loans of erstwhile HDFC Ltd. Credit costs stood at 49 bps versus 79 bps in the last quarter. Total unutilised contingent provisions stood at 0.67% of advances.
- **Loan growth:** Gross advances net of IBPC/BRDS grew by 5% q-o-q on like to like basis. Retail (ex- mortgages) grew by 2.5% q-o-q, Mortgages grew by 3.5% q-o-q commercial & rural banking, and corporate loans (ex. Non individual loans of erstwhile HDFC Ltd) grew by ~9.7% q-o-q and ~5.8% y-o-y, respectively. Non individual loans of erstwhile HDFC Ltd declined by 6% q-o-q on like to like basis. Domestic macros are holding up well and there is no slowdown in demand.. LCR during the quarter was 126% versus 116% in the last quarter and that for the merged entity was at 121%.
- **Deposit mobilisation remains the key monitorable:** Total deposit mobilisation was strong post-merger grew by 5.3% q-o-q on like to like basis. CASA ratio now stands at 37.6%.. For faster deposit mobilisation, the focus is on branch expansion, building new liability relationships with existing customers, and more focus on term deposits as penetration is lower. The added 2.7 mn new liability relationship during the quarter with total customer base at 91 mn.
- **Return ratio guidance:** The bank is confident of sustaining RoA of 1.9-2.1% for the merged entity. The macro outlook is positive, which should support asset quality and, in turn, lower credit cost at least in the near term.

Results

Rs cr

Particulars	2QFY24 (merged basis)	2QFY23	1QFY24	Y-o-Y %	Q-o-Q %
Interest Inc.	67,698	38,586	48,587	75.4%	39.3%
Interest Expenses	40,313	17,565	24,988	129.5%	61.3%
Net Interest Income	**27,385**	**21,021**	**23,599**	**30.3%**	**16.0%**
NIM (%)	3.60	4.10	4.30	-12.2%	-16.3%
Core Fee Income	6,936	5,803	6,290	19.5%	10.3%
Other Income	3,772	1,793	2,940	110.4%	28.3%
Net Income	**38,093**	**28,617**	**32,829**	**33.1%**	**16.0%**
Employee Expenses	5,170	3,524	4,782	46.7%	8.1%
Other Opex	10,229	7,701	9,275	32.8%	10.3%
Total Opex	**15,399**	**11,225**	**14,057**	**37.2%**	**9.5%**
Cost to Income Ratio	40.4%	39.2%	42.8%		
Pre-Provision Profit	**22,694**	**17,392**	**18,772**	**30.5%**	**20.9%**
Provisions & Contingencies - Total	2,903	3,240	2,860	-10.4%	1.5%
Profit Before Tax	**19,791**	**14,152**	**15,912**	**39.8%**	**24.4%**
Tax	3,814	3,546	3,960	7.5%	-3.7%
Effective Tax Rate	19%	25%	25%		
Reported Profits	**15,977**	**10,606**	**11,952**	**50.6%**	**33.7%**
Basic EPS (Rs)	21.1	19.1	21.4	10.8%	-1.3%
Diluted EPS (Rs)	21.0	19.0	21.3	10.6%	-1.2%
RoA (%)	2.0	2.0	1.9		
Advances	**23,31,233**	**14,79,873**	**16,15,672**	**57.5%**	**44.3%**
Deposits	**21,72,858**	**16,73,408**	**19,13,096**	**29.8%**	**13.6%**
Gross NPA	**31,578**	**18,301**	**19,064**	**72.5%**	**65.6%**
Gross NPA Ratio (%)	1.34	1.23	1.17		
Net NPA	**8,073**	**4,883**	**4,777**	**65.3%**	**69.0%**
Net NPAs Ratio (%)	0.35	0.33	0.30		
PCR - Calculated	**74.4%**	**73.3%**	**74.9%**		

Source: Company; Sharekhan Research; Note YoY & QoQ numbers are not comparable

Outlook and Valuation

■ Sector Outlook – Deposit mobilisation to be in focus; banks with a superior liability franchise placed better:

System-level credit offtake grew by ~20% y-o-y in the fortnight ending September 22, 2023, indicating loan growth has been sustaining, given distinct signs of an improving economy, revival of investments, and strong demand. On the other hand, deposits rose by ~13%. The gap between advances and deposits growth has again widened. We are seeing strong traction in loan growth and overall deposit growth is challenging and is mainly led by time deposits rather than CASA. Margins are expected to be lower as deposits get repriced at higher costs to fund growth. Overall asset-quality outlook is stable to positive for the sector. We believe banks with a robust capital base and strong retail deposit franchise are well-placed to capture growth opportunities.

■ Company Outlook – Execution is key

Improvement in NIM profile, strong retail deposit mobilisation resulting in normalization of CD ratio in turn leading to sustainable loan growth path, building strong reach & distribution; broadening customer base and enabling technology remains key monitorable in near term. The bank has a good track record of strong execution capabilities, has consistently delivered superior performance, and its track record is unmatched across the sector.

■ Valuation – We maintain our Buy rating on the stock with an unchanged PT of Rs. 1,900

The stock currently trades at 2.2x/2.0x its FY2024E/FY2025E core BV estimates. The key challenge remains that at this point of the cycle is higher CD ratio (c. 107%) than industry. We believe that loan growth is expected to be in low mid-teens in near term which should bring the CD ratio at normalised level gradually. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,900 as valuations are reasonable and have priced in all the barring factors that could weigh down the earnings trajectory of the merged entity. The probability of further de rating is very bleak.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
HDFC Bank	1,530	11,59,639	14.6	13.1	2.2	2.1	14.8	15.3	1.9	1.9
ICICI Bank	951	6,66,149	15.9	14.5	2.4	2.1	16.6	15.5	2.1	2.1
Axis Bank	1,005	3,09,790	12.0	11.0	1.9	1.7	17.4	16.2	1.7	1.7

Source: Company, Sharekhan estimates

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. 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. HDFC Bank and HDFC Limited have successfully completed one of India's largest financial services mergers. Now the merged entity is looking to work through the opportunities immediately.

Investment theme

The bank has consistently reported healthy 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 its strong business franchise strength and leadership qualities. The merged entity is looking to work through the opportunities immediately and the bank has already started its expansion journey with accelerated investments in the branch and distribution network and technology etc. This would continue and would help in gaining sustained loan and deposit market share over the medium term.

Key Risks

Slower deposit mobilisation; economic slowdown; tech outage.

Additional Data

Key management personnel

Mr. Sashidhar Jagdishan	Managing Director and CEO
Mr. Kaizad Bharucha	Deputy MD
Mr. Srinivasan Vaidyanathan	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	SBI Funds Management Ltd	4.95
2	LIC	4.33
3	Capital Group INC	2.46
4	FMR LLC	2.18
5	Republic of Singapore	1.97
6	HDFC AMC LTD	1.84
7	Vanguard Group INC	1.79
8	ICICI Prudential AMC Co. Ltd	1.65
9	UTI AMC LTD	1.58
10	BlackRock Inc	1.53

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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