

ADD

TP: Rs 2,510 | ▲ 6%

HDFC BANK

| Banking

| 20 July 2019

Mixed quarter

HDFC Bank's (HDFCB) Q1FY20 PAT at Rs 56bn (+21% YoY) was largely in line with our estimates. GNPA inched up to 1.4% but was stable ex-agri at 1.17%. The bank created contingent/additional general provisions worth Rs 1.7bn/Rs 0.9bn which led to a sharp rise in provisions for Q1. Loan growth at 17% YoY slipped to a 10-quarter low following a rundown of corporate loans due to repayments. Gross impaired assets for HDB Financial Services rose 50bps QoQ to 2.3% of loans. Maintain ADD with a Mar'20 TP of Rs 2,510.

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Loan growth disappoints: At 17% YoY, HDFCB's loan growth was at a 10-quarter low, due to slower growth in both corporate (~18%) and retail (~16%) loans. Excluding the tepid vehicle finance segment, retail advances grew 19.3%.

Buffers to strengthen balance sheet: Slippages rose to ~Rs 42bn (Rs 36bn in Q4), which led to a 4bps QoQ increase in GNPA ratio to 1.4%. Provisions shot up 40% QoQ as specific provisions were stepped up on the unsecured portfolio, contingent provisions worth Rs 1.65bn were created, and additional general provisions were made on standard assets in the NBFC/HFC categories. Management highlighted the rise in customer leverage, frequency of borrowing and ticket size for the industry in the personal loan segment.

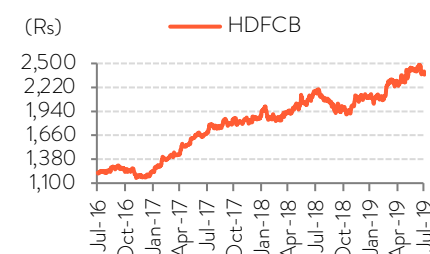
Poor show by HDB Fin Services: HDB's gross impaired loans increased to 2.3% due to stress in its CE/CV portfolio and higher losses on repossession. NII growth slowed to 12.9% YoY as NIM dipped 30-40bps.

Maintain ADD: We like HDFCB for its strong processes, risk management practices and stable asset quality, but do see risks emerging for the bank on NII (from slowing loan growth) and margins (declining CASA ratio, tepid growth in high-yield unsecured retail credit). Retain ADD.

Ticker/Price	HDFCB IN/Rs 2,376
Market cap	US\$ 93.9bn
Shares o/s	2,723mn
3M ADV	US\$ 100.8mn
52wk high/low	Rs 2,503/Rs 1,885
Promoter/FPI/DII	27%/39%/34%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	174,867	210,782	258,229	318,769	382,952
EPS (Rs)	67.8	79.3	94.8	117.1	140.6
P/E (x)	35.0	30.0	25.1	20.3	16.9
P/BV (x)	5.8	4.3	3.8	3.3	2.9
ROA (%)	1.8	1.8	1.9	1.9	1.8
ROE (%)	17.9	16.5	16.2	17.6	18.4

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q4FY19	Q1FY19	YoY (%)	QoQ (%)
Income statement					
Net interest income	132,943	130,895	108,136	22.9	1.6
Non-interest income	49,703	48,712	38,181	30.2	2.0
Fees	35,516	36,921	31,710	12.0	(3.8)
FX	5,767	4,033	4,996	15.4	43.0
Trading Profits	2,120	2,289	(2,832)	(174.9)	(7.4)
Others	6,300	5,469	4,307	46.3	15.2
Net total income	182,645	179,607	146,316	24.8	1.7
Core Revenues	180,525	177,318	149,148	21.0	1.8
Staff expenses	22,174	20,744	18,105	22.5	6.9
Other operating expenses	48,999	50,427	41,734	17.4	(2.8)
Total operating expenses	71,173	71,171	59,839	18.9	0.0
Pre-provisioning profit	111,472	108,436	86,478	28.9	2.8
Total provisions	26,137	18,892	16,294	60.4	38.3
Profit before tax	85,336	89,544	70,184	21.6	(4.7)
Tax	29,654	30,693	24,169	22.7	(3.4)
Profit after tax	55,682	58,851	46,014	21.0	(5.4)
Key balance sheet items					
Loans	8,297,298	8,194,012	7,086,487	17.1	1.3
Deposits	9,545,537	9,231,409	8,057,853	18.5	3.4
CASA ratio (%)	39.7	42.4	41.7	(199bps)	(267bps)
Yields and margins (%)					
Yield on advances	10.6	10.5	10.2	40bps	7bps
Yield on investments	7.1	7.1	7.1	4bps	5bps
Cost of funds	5.4	5.3	5.1	28bps	13bps
Spread	3.7	3.9	3.7	8bps	(13bps)
NIM	4.3	4.4	4.2	10bps	(10bps)
Key ratios (%)					
Cost to income ratio	39.0	39.6	40.9	(193bps)	(66bps)
Tax rate	34.8	34.3	34.4	31bps	47bps
Asset quality					
Gross NPAs	117,690	112,242	95,386	23.4	4.9
Net NPAs	35,672	32,145	29,071	22.7	11.0
Coverage Ratio (%)	69.7	71.4	69.5	17bps	(167bps)
Gross NPA ratio (%)	1.4	1.4	1.3	7bps	4bps
Net NPA ratio (%)	0.4	0.4	0.4	2bps	4bps
Capital adequacy (%)					
Tier-I Ratio	15.6	15.8	13.1	250bps	(20bps)
Tier-II Ratio	1.3	1.3	1.5	(20bps)	0bps
Total CAR Ratio	16.9	17.1	14.6	230bps	(20bps)

Source: Company, BOBCAPS Research

Valuation methodology

We maintain our Mar'20 target price of Rs 2,510 for HDFCB which is derived using the SOTP method. The core book has been adjusted for investment in subsidiaries and valued at 3.4x FY21E P/BV – this is based on a two-stage Gordon growth model given that we expect the business to continue growing much faster than the industry for the next few years. Our SOTP valuation also includes the value of the bank's NBFC and broking businesses.

HDFCB is trading at 3.3x FY21E P/BV. Maintain ADD as we like the bank for its strong processes, risk management practices and stable asset quality. However, we do see risks emerging on NII (from slowing loan growth) and margins (declining CASA ratio, tepid growth in high-yield unsecured retail credit).

FIG 2 – SOTP VALUATION

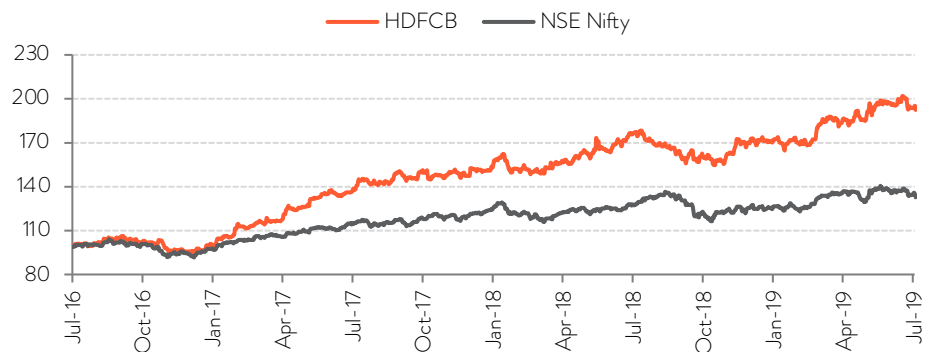
Sum-of-the-Parts	Company value (Rs bn)	Stake in company (%)	Value for HDFCB (Rs bn)	Per share (Rs)	Contribution to TP (%)	Comments
Core Business	6,467	100	6,467	2,375	95	Valued at 3.4x FY21E P/BV on Gordon Growth Model
HDB Financial	317	96	304	112	4	Valued at 3x FY21E P/BV
HDFC Securities	65	98	64	23	1	Valued at 12x FY21E P/E
Sum-of-the-Parts			6,835	2,510	100	

Source: Company, BOBCAPS Research

FIG 3 – CORE BUSINESS VALUATION

Gordon growth model	Assumptions
Risk-free rate (%)	7.0
Equity risk premium (%)	5.0
Beta	1.0
Cost of equity (%)	11.8
Blended ROE (%)	19.1
Initial high growth period (yrs)	10.0
Payout ratio of high-growth phase (%)	20.0
Long-term growth (%)	4.8
Long term dividend payout ratio (%)	75.0
Justified P/BV Multiple (x)	3.4
BVPS adj. for investment in subsidiary (Rs)	696
Value per share of core business (Rs)	2,375

Source: Company, BOBCAPS Research

FIG 4 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- Economic slowdown:** In our view, HDFCB's loan portfolio broadly imitates India's GDP mix by catering to the consumption theme. A slower-than-expected pickup in India's economic growth or a slowdown in job creation coupled with a sharp rise in interest rates could affect demand for retail loans and margins.
- Leadership risk:** The bank will witness a change at the helm after three decades, with MD & CEO Aditya Puri retiring in Oct'20. While we continue to believe that HDFCB's process-driven business will hold it in good stead, the stock could be negatively affected should there be a slew of senior management exits during the transition phase.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	400,949	482,432	592,722	724,667	882,660
NII growth (%)	21.0	20.3	22.9	22.3	21.8
Non-interest income	152,203	176,259	208,640	245,332	288,323
Total income	553,152	658,691	801,363	969,999	1,170,983
Operating expenses	(226,904)	(261,194)	(318,710)	(378,907)	(458,779)
Operating profit	326,248	397,497	482,653	591,092	712,204
Operating profit growth (%)	26.8	21.8	21.4	22.5	20.5
Provisions	(59,275)	(75,501)	(88,174)	(104,131)	(127,195)
PBT	266,973	321,997	394,478	486,961	585,009
Tax	(92,106)	(111,215)	(136,250)	(168,192)	(202,057)
Reported net profit	174,867	210,782	258,229	318,769	382,952
Adjustments	0	0	0	0	0
Adjusted net profit	174,867	210,782	258,229	318,769	382,952

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	5,190	5,447	5,447	5,447	5,447
Reserves & surplus	1,057,760	1,486,617	1,684,420	1,928,597	2,221,938
Net worth	1,062,950	1,492,064	1,689,867	1,934,044	2,227,385
Deposits	7,887,706	9,231,409	11,548,439	14,424,950	17,982,603
Borrowings	1,260,946	1,207,248	1,482,067	1,781,986	2,147,619
Other liabilities & provisions	427,741	514,686	576,449	687,796	823,541
Total liabilities and equities	10,639,343	12,445,407	15,296,821	18,828,775	23,181,148
Cash & bank balance	1,229,151	813,476	842,359	873,156	906,013
Investments	2,422,002	2,905,879	3,478,432	4,189,535	5,058,704
Advances	6,583,331	8,194,012	10,161,216	12,621,424	15,677,295
Fixed & Other assets	404,859	532,040	814,815	1,144,660	1,539,136
Total assets	10,639,343	12,445,407	15,296,821	18,828,775	23,181,148
Deposit growth (%)	22.5	17.0	25.1	24.9	24.7
Advances growth (%)	18.7	24.5	24.0	24.2	24.2

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	67.8	79.3	94.8	117.1	140.6
Dividend per share	0.0	14.9	19.0	23.4	28.1
Book value per share	409.6	547.9	620.5	710.2	817.9

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	35.0	30.0	25.1	20.3	16.9
P/BV	5.8	4.3	3.8	3.3	2.9
Dividend yield (%)	0.0	0.6	0.8	1.0	1.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	4.2	4.2	4.3	4.2	4.2
Non-interest income	1.6	1.5	1.5	1.4	1.4
Operating expenses	2.4	2.3	2.3	2.2	2.2
Pre-provisioning profit	3.4	3.4	3.5	3.5	3.4
Provisions	0.6	0.7	0.6	0.6	0.6
PBT	2.8	2.8	2.8	2.9	2.8
Tax	1.0	1.0	1.0	1.0	1.0
ROA	1.8	1.8	1.9	1.9	1.8
Leverage (x)	9.8	9.0	8.7	9.4	10.1
ROE	17.9	16.5	16.2	17.6	18.4

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	21.0	20.3	22.9	22.3	21.8
Pre-provisioning profit	26.8	21.8	21.4	22.5	20.5
EPS	18.6	16.9	19.6	23.4	20.1
Profitability & Return ratios (%)					
Net interest margin	4.4	4.4	4.5	4.5	4.5
Fees / Avg. assets	1.2	1.2	1.2	1.1	1.1
Cost-Income	41.0	39.7	39.8	39.1	39.2
ROE	17.9	16.5	16.2	17.6	18.4
ROA	1.8	1.8	1.9	1.9	1.8
Asset quality (%)					
GNPA	1.3	1.4	1.4	1.5	1.4
NNPA	0.4	0.4	0.4	0.4	0.3
Provision coverage	69.8	71.4	71.3	71.3	77.3
Ratios (%)					
Credit-Deposit	83.5	88.8	88.0	87.5	87.2
Investment-Deposit	30.7	31.5	30.1	29.0	28.1
CAR	14.8	17.1	15.8	14.5	13.5
Tier-1	13.2	15.8	14.6	13.5	12.7

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

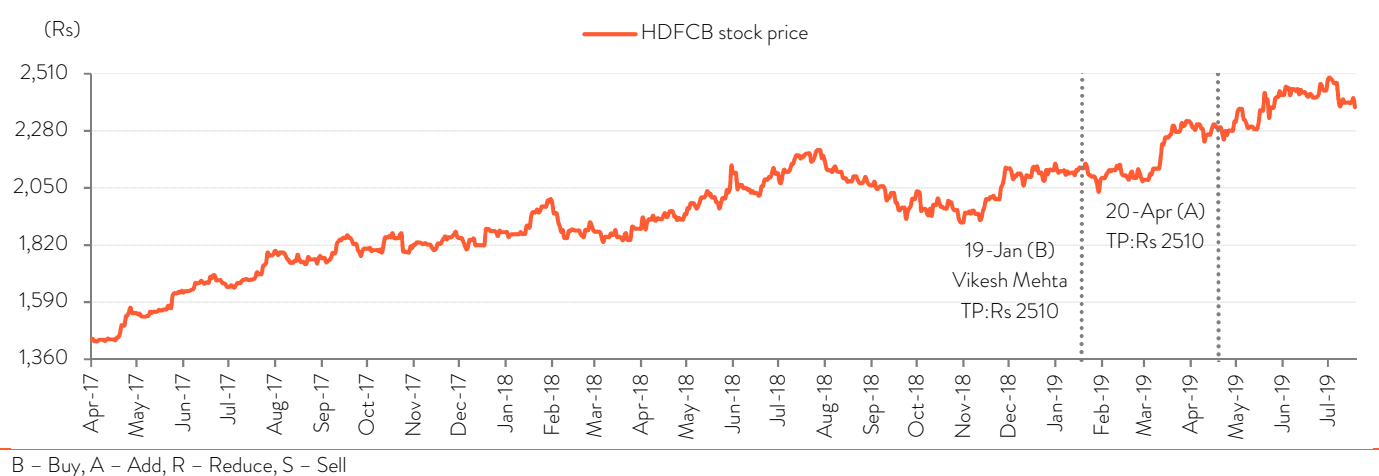
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: HDFC BANK (HDFCB IN)



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