HDFC Bank

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Reuters: HDBK.BO; Bloomberg: HDFCB IN

HDFC Bank: Annual Report Analysis

Semi-urban & rural (SURU) penetration through Digital 2.0: One of the most prominent flavors that one would get while surfing through the bank's latest annual report is its focus on technology. Digitisation is expected to be the key enabler for embarking on the next leg of growth for the bank and renew its push into semi-urban and rural markets. Currently, the bank is offering products such as pre-harvest and post-harvest crop loans, two-wheeler loans, auto loans, gold loans, among others. A key aspect of further penetration in villages would be by way of improving financial literacy. Customers in each village would be educated about various products and services of HDFC Bank.

- **Milk-to-money – an initiative to drive rural penetration**: This initiative will fuel growth in the dairy segment and also drive financial inclusion. The bank plans to scale the programme to cover 3,000 villages and more than 0.8mn farmers over the next 2-3 years.
- **Strengthening presence in north-east**: The bank has announced addition of 100 more banking outlets over the next three years. As part of the 'semi-urban and rural' strategy, this will take the total banking outlets in the region to 230, including 18 in Sikkim. The bank is also working closely with the government to set up 650 CSCs in the region.
- **Association with Common Service Centres (CSCs)** is helping offer cost-effective services to the hinterlands of India. The CSCs, managed by a Village Level Entrepreneur (VLE), serve as access points for delivering essential public utilities, healthcare, financial, education and agrarian services. The bank is leveraging this network to provide banking solutions nationwide.
- **SURU penetration strategy will be two-fold**: SURU regions account for 60% of India's population. They also represent a very low credit-to-deposit ratio, which represents deposits business for the bank and low asset penetration represents credit opportunities. With the right infrastructure already in place (more than half the banking outlets and a third of the workforce), the bank is well positioned to maximise this opportunity. Distribution footprint will be enhanced through CSCs. With the help of VLEs, the bank intends to create a large distribution network to capture opportunities in the SURU markets.
- **What is digital 2.0 about?** (1) Providing customer with a frictionless financial experience (2) Moving customer from a single transaction to a complete financial journey (pay, save, invest, borrow, shop, trade, insure, advice) (3) Improving cost efficiencies through automation and reduction in origination costs.

Progressing well under Digital 2.0:

- Launched a fully digital account opening process which helps acquire new customers in a few minutes.
- 'SmartHub' has over 1.7mn merchant acceptance points ranging across scan and pay QR codes, Android POS, Mobile POS, link-based web solutions and payment gateway. The bank is the leading acquiring bank, processing over 48% of the total merchant transactions in the country.
- Provided the widest range of solutions to central and state governments across departments such as transit (metro, bus, waterways), tolls, FASTag, DBT, eNAM, among others.
- Processing time for a loan application in a branch or online is now almost similar.
- Moving to a customer-oriented approach from the traditional product-oriented approach as part of digital solutions for enterprises.
- Big data analytics and machine learning have enabled to acquire, serve and retain customers. A new capability for delivering in-store finance for new-to-bank and non-pre-approved customers has been launched in select stores.

Going phygital: Retail branch banking business is being reimagined through the levers of digital processes and big data analytics. From choosing products based on consumption and spending patterns arrived at through data analytics, to going completely paperless with documentation, the focus is on leveraging technology. Teams have been trained to become more customer-centric than being product-centric. Retail branch banking is the key business driver of the bank with over 40% of human resources in branch banking galvanizing retail deposits, retail trade and forex business, more than half of the unsecured business, a significant part of the secured business and more than 3/4th of fee-based third-party business and business banking.

Millenia range of cards to deepen the credit card customer base: As per the bank, millennials (34% of the population) is a segment that has not been addressed by the traditional large banks. In light of this opportunity, the bank has launched a range of cards tailored to millennial needs and aspirations under the 'Millennia' brand – Millennia Credit Card, Millennia Debit Card, Millennia Prepaid Card and EasyEMI Card. The product suite has been designed keeping in mind the 'spend anywhere, earn everywhere' theme. The 'Millennia' range allows customers to earn CashBacks on every online and offline spends. The EasyEMI Card offers the convenience of auto EMI conversion for aspirational purchases. In March 2020, Millennia has crossed 1mn subscriber base. Given the untapped opportunity in this segment, the bank plans to expand the 'Millennia' portfolio beyond cards to offer holistic banking ecosystem.

BUY

Sector: Banking

CMP: Rs1,103

Target Price: Rs1,425

Upside: 29%

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Key Data

Current Shares O/S (mn)	5,490.3
Mkt Cap (Rsbn/US$bn)	6,030.8/80.4
52 Wk H / L (Rs)	1306/739
Daily Vol. (3M NSE Avg.)	20,267,250

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Bank	7.7	(14.1)	(8.7)
Nifty Index	6.4	(10.8)	(4.5)

Source: Bloomberg

Counter-cyclical nature: Being prudent, the bank has maintained a balance between retail and wholesale banking business. However, in FY20, wholesale business has helped counter the downturn in certain retail segments as a result of the overall slowdown in consumption. For FY20, wholesale loan book has grown by 29% YoY while growth in the retail loan book is 15% YoY. The bank continues to offer the entire gamut of products to its corporate customers, such as payments, tax solutions, government business, trade finance services, cash management solutions and corporate cards.

- The bank is the second largest collector of direct taxes. So far, the bank has partnered with government authorities and conceived more than 300 customised digital solutions for them.

What's S&P saying? "Overall, we believe HDFC Bank's individual creditworthiness is significantly stronger than the average of the Indian banking sector, reflected in its SACP of BBB+."

Sectoral opportunities outlined by the bank: Healthcare is likely to get a boost as the management of the pandemic underscores the need to expand capacity. A boost to healthcare is likely to impact pharma and medical equipment segments positively. Private participation is highly likely. The potential in terms of credit and non-fund business is large. Another sector highlighted in the annual report is food processing. Formalisation of micro-food processing segment is likely to boost cluster-wise growth and will therefore offer credit opportunities to banks particularly through microfinance and self-help group channels.

Current pandemic places payments on a higher growth trajectory: It is not just the savings that are likely to see elevated levels in the wake of the current health crisis. Restricted movement and social distancing are likely to provide structural tailwinds to electronic payment habits, which should bode well for digital banking. The bank also provides the widest range of payment solutions to central and state governments across departments. Thrust on developing the electronic payments ecosystem has also led to foray into consumer durable finance. The bank was the first to introduce debit card EMI online and at in-store merchants. Besides consumer durables, the customers can avail EMI offers on lifestyle, education insurance among other categories.

- **The bank is a leading player in the payments ecosystem**. Every third rupee spent on cards in India happens on an HDFC Bank's issued instrument. The bank currently has 1.8mn merchant acceptance points across India and plans to scale it up by 2-3x over the next few years. On the acquiring side, the market share is even larger and more dominant with approx. 50% of electronic card volume which consumers swipe at online and offline merchants in the country going through HDFC Bank network. In light of this, the focus will be on on-boarding small merchants including kirana stores into the formal banking system by digitizing their payment solutions and thereby, capturing their banking business. With payment solutions being the acquisition tool, the ultimate value proposition would include offering a complete suite of financial services.
- **Key operational data points:**

  Merchant acceptance touch points are up 87% YoY at 1.8mn (FY19: 0.96mn, FY18: 0.66mn).

  Credit cards o/s are up 16% YoY at 14.5mn (FY19: 12.5mn, FY18: 10.7mn).

  Debit cards o/s are up 19% YoY at 32.1mn (FY19: 27mn, FY18: 24.3mn).

Succession planning: On the recommendations of the Search Committee and the NRC, the Board of Directors, at its meeting on April 18th 2020, had finalized the names of three candidates in the order of preference, for the position of MD/CEO. The bank has submitted its application to the RBI with these names for the latter's approval.

Best is yet to come: The bank will continue to invest in technology, computing and AI to provide better customer offerings. The aim is to become a Digital First Bank in a way that ensures that costs reduce while at the same time reach is increased. In light of this, the bank has been following six key strategy principles:

1. Reimagining the branch channel from a banking storefront to a financial services marketplace
2. Leveraging Bharat's growth potential based on the semi-urban and rural footprint
3. Developing a payments business with a differentiated business model that leverages the bank's offerings
4. Transform customer journey into omnichannel customer experiences
5. Virtual relationship management
6. Enhancing subsidiaries' value

Strategic priorities:

- Re-imagining the branch channel
- Leadership in the payments business
- Strengthening presence in semi-urban and rural regions
- Virtual relationship management

Long-term strategic objectives:

- Increase customer base
- Enhance range of products and services
- Drive operational efficiency
- Maintain healthy asset quality
- Expand geographic reach
- Lower cost of funds

Other business-related updates:

- The portfolio performance must be seen in context of the overall industry de-growth. This was countered by tapping new customers, leveraging CSCs and selling loans to Kisan Gold Card/Sustainable Livelihood Initiative customers. There has also been a strong focus on internal bank customers.
- About 80% of the personal loans were to the employees of top-rated companies with reasonably high disposable income.
- Originated about Rs23.5bn of home loans every month during FY20.
- Growth in fee income from life insurance distribution business was 48% YoY and that in general/health insurance distribution business was 22% YoY. The bank mobilised life insurance premium worth Rs45.9bn during FY20. Premium mobilization in general/health insurance segment grew by 3.61% to Rs23.6bn.
- Manpower across non-life insurers has been strengthened to increase business from the non-motor insurance space.
- Wholesale bank was the key growth engine during FY20. The bank was able to expand its share of customer wallet through sharper customization, cross-selling and expansion into greater geographies. Corporate banking continued to be the biggest contributor to wholesale banking in terms of asset size. As per the bank, during FY20, large companies preferred to deal with fewer banks, which the bank was able to capitalize on. Domestic book outstanding in this segment was Rs2.4trn, increasing 57% over last year.
- In the emerging corporates group, the bank has been able to acquire new customers as well as increase wallet share in case of existing customers. In the last five years, this business has more than doubled its presence to over 50 cities in India.

- In the government business, the bank sustained its focus on tax collections, collecting direct tax of over Rs3trn and indirect tax of approx. Rs39.3bn during FY20. In addition, the bank collected over Rs1.82trn in GST.
- Loans against gold jewellery increased from Rs59bn in FY19 to Rs62bn in FY20. The entry of organised players in gold finance has increased the awareness and transparency. The availability of an asset and ease of securing a loan have made gold finance a convenient and a viable credit option. In light of this opportunity, the bank added 150 more branches, taking the total to 800 through which gold loans are offered. In FY21, the bank plans to make gold loans available in even more branches in rural areas.
- Advances to the MSME sector grew by 23.4% YoY to Rs1.6trn. Loans to the micro sector alone stood at Rs664bn. The challenges faced by businesses due to covid-19 is likely to further accelerate digitalisation. The bank also increased the usage of analytics-based credit appraisal tool, which was launched in FY19 for new customer acquisitions. This is facilitated by submission of digital bank statements and combination of scores arrived at by the analytics model. This digital appraisal process has emerged as a major growth engine as it helps customers know whether their loans (Rs1.1mn to Rs50mn) have been sanctioned or rejected within 3 hours.

Outlook:

- The RBI could deliver further rate cuts to support growth.
- Growth will remain subdued in 1HFY21 with growth contracting in 1Q and 2Q followed by a gradual recovery in 2H.

Financial statements

Exhibit 1: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Interest Income	802,414	989,721	1,148,127	1,284,850	1,542,010
Interest expense	401,465	507,288	586,264	634,222	759,450
Net interest income	**400,949**	**482,432**	**561,863**	**650,628**	**782,561**
Non-interest income	152,203	176,259	232,350	230,136	274,938
Net Revenue	553,152	658,691	794,213	880,764	1,057,499
Operating Expense	226,904	261,194	306,975	326,799	386,563
-Employee Exp	68,057	77,618	95,257	103,827	116,286
-Other Exp	158,846	183,576	211,719	222,972	270,277
Operating profit	**326,248**	**397,497**	**487,238**	**553,965**	**670,936**
Provisions	59,275	75,501	121,424	170,102	154,780
PBT	266,973	321,997	365,814	383,862	516,156
Taxes	92,106	111,215	103,498	96,913	129,917
PAT	**174,867**	**210,782**	**262,315**	**286,949**	**386,240**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20	FY21E	FY22E
Share capital	5,190	5,447	5,483	5,490	5,490
Reserves & Surplus	1,057,760	1,486,617	1,704,377	1,985,888	2,349,935
Shareholder's Funds	**1,062,950**	**1,492,064**	**1,709,860**	**1,991,379**	**2,355,425**
Deposits	**7,887,706**	**9,231,409**	**11,475,023**	**13,999,528**	**17,079,424**
Borrowings	1,231,050	1,170,851	1,446,285	1,157,028	925,623
Other liabilities	457,637	551,083	673,944	733,410	746,322
Total liabilities	**10,639,343**	**12,445,407**	**15,305,113**	**17,881,345**	**21,106,794**
Cash/Equivalent	1,229,151	813,476	866,187	1,303,464	1,278,358
Advances	6,583,331	8,194,012	9,937,029	11,386,042	13,486,033
Investments	2,422,002	2,905,879	3,918,267	4,549,847	5,636,210
Fixed Assets	36,072	40,300	44,319	48,751	53,626
Other assets	368,787	491,740	539,311	593,242	652,566
Total assets	**10,639,343**	**12,445,407**	**15,305,113**	**17,881,345**	**21,106,794**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Key ratios

Y/E March	FY18	FY19	FY20	FY21E	FY22E
Growth (%)					
NII growth	21.0	20.3	16.5	15.8	20.3
Pre-provision profit growth	26.8	21.8	22.6	13.7	21.1
PAT growth	20.2	20.5	24.4	9.4	34.6
Business (%)					
Deposit growth	22.5	17.0	24.3	22.0	22.0
Advance growth	18.7	24.5	21.3	14.6	18.4
CD	83.5	88.8	86.6	81.3	79.0
CASA	43.5	42.4	42.2	40.5	42.5
Operating efficiency (%)					
Cost-to-income	41.0	39.7	38.7	37.1	36.6
Cost-to-assets	2.4	2.3	2.2	2.0	2.0
Spreads (%)					
Yield on advances	10.3	10.5	10.1	9.5	9.7
Yield on investments	7.1	7.5	6.0	5.6	5.7
Cost of deposits	4.6	4.8	4.9	0.0	0.0
Yield on assets	8.7	8.9	8.6	8.0	8.2
Cost of funds	4.9	5.2	5.0	4.5	4.6
NIMs	4.4	4.4	4.2	4.1	4.2
Capital adequacy (%)					
Tier I	13.2	15.8	17.2	16.9	16.1
Tier II	1.6	1.3	1.3	1.4	1.4
Total CAR	14.8	17.1	18.5	18.3	17.5
Asset Quality (%)					
Gross NPA	1.3	1.4	1.3	1.6	1.3
Net NPA	0.4	0.4	0.4	0.4	0.3
Provision coverage	69.8	71.4	72.0	75.8	81.3
Slippage	2.3	2.2	2.2	1.8	1.5
Credit-cost	1.0	1.0	1.3	1.6	1.2
Return (%)					
ROE	17.9	16.5	16.4	15.5	17.8
ROA	1.8	1.8	1.9	1.7	2.0
RORWA	2.4	2.4	2.7	2.6	2.9
Per share					
EPS	33.7	38.7	47.8	52.3	70.3
BV	204.8	273.9	311.8	362.7	429.0
ABV	199.8	268.0	305.4	354.1	422.8
Valuation					
P/E	32.7	28.5	23.1	21.1	15.7
P/BV	5.4	4.0	3.5	3.0	2.6
P/ABV	5.5	4.1	3.6	3.1	2.6

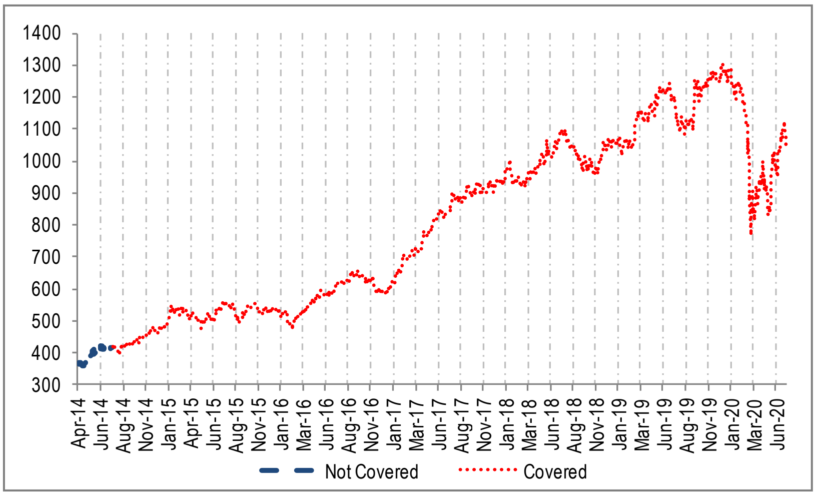
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
22 July 2014	Buy	830	960
8 October 2014	Buy	860	960
22 October 2014	Buy	897	1,060
16 February 2015	Buy	1,066	1,265
24 April 2015	Buy	1,012	1,265
22 July 2015	Buy	1,095	1,265
23 October 2015	Buy	1,095	1,265
27 January 2016	Buy	1,041	1,305
25 April 2016	Buy	1,094	1,315
22 July 2016	Buy	1,230	1,450
26 October 2016	Buy	1,247	1,570
25 January 2017	Buy	1,270	1,570
14 February 2017	Buy	1,311	1,690
24 April 2017	Buy	1,499	1,820
25 July 2017	Buy	1,707	2,025
25 October 2017	Buy	1,866	2,205
22January 2018	Buy	1,952	2,301
23 April 2018	Buy	1,961	2,301
23 July 2018	Buy	2,189	2,541
9 October 2018	Buy	1,945	2,519
22 October 2018	Buy	1,968	2,442
21 January 2019	Buy	2,131	2,443
8 April 2019	Accumulate	2,306	2,514
22 April 2019	Accumulate	2,293	2,547
8 July 2019	Accumulate	2,472	2,719
22 July 2019	Accumulate	2,376	2,576
7 October 2019	Accumulate	1,190	1,335
22 October 2019	Accumulate	1,229	1,334
8 January 2020	Accumulate	1,257	1,322
20 January 2020	Accumulate	1,278	1,358
27 March 2020	Buy	898	1,282
9 April 2020	Buy	889	1,282
20 April 2020	Buy	915	1,260
9 July 2020	Buy	1,110	1,347
20 July 2020	Buy	1,103	1,425

**Stock split 2 for 1 on 19 September 2019*

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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