Sharekhan
by BNP PARIBAS

HDFC Bank

Performance In line; Outlook bright

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 1,099**	
Price Target: **Rs. 1,400**	↔

↑ Upgrade ↔ No change ↓ Downgrade

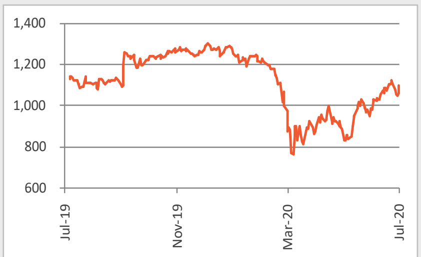
Company details

Market cap:	Rs. 603,464 cr
52-week high/low:	Rs. 1304/739
NSE volume: (No of shares)	78.9 lakh
BSE code:	500180
NSE code:	HDFCBANK
Sharekhan code:	HDFCBANK
Free float: (No of shares)	431.9 cr

Shareholding (%)

Promoters	26.1
FII	36.7
DII	21.8
Others	15.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.0	23.6	-16.2	-13.1
Relative to Sensex	6.0	13.8	-7.1	-11.9

Sharekhan Research, Bloomberg

For Q1FY21, HDFC Bank's operational performance was largely in line with expectations, but asset quality deteriorated slightly q-o-q, as agriculture loans turned a pain point. Nevertheless, management commentary was positive and reassuring and indicated a bright long-term outlook. For Q1FY21, the net interest income (NII) stood at Rs. 15,665 crores, up 17.8% y-o-y (in line with expectations), while PAT stood at Rs. 6,658 crore, up 19.6% y-o-y (in line) with net interest margins (NIMs) at 4.3%, stable sequentially and within the guidance range. Other income at Rs 4,075.3 crore, amounted to 20.6% of net revenues, helped by treasury gains even though core fee income was weak. A continued slowdown in economic activity led to a decrease in retail loan origination, sale of third-party products, use of credit and debit cards by customers, efficiency in collection efforts and waivers of certain fees, due to which core fee income was lower by ~Rs. 2,000 crore. Total advances were at Rs. 1,003,299 crore, up by a healthy 20.9% y-o-y, much above industry growth, indicating market share gains for the bank. Domestic advances grew by 21% y-o-y, wherein domestic retail loans grew by a slower by 7.2% y-o-y (was 14% in Q4) but domestic wholesale loans grew faster by 37.6% (was 29.3% in Q4). Core credit cost ratio was 1.08% (from 0.77% in Q4 FY20). The GNPAs were at 1.36% of gross advances (1.2% excluding agri NPAs) and were higher from 1.26% as on Q4 FY20 (1.1% excluding Agri NPAs). However, the bank has a healthy balance sheet, and held adequate provisions cover (floating provisions of Rs. 1,451 crore, contingent provisions of Rs 4,002 crore) as on Q1-end. Total provisions (comprising specific, floating, contingent and general provisions) were 149% of the GNPAs, which will be support to profitability.

The recent exits and events at the top management level were well clarified by the bank (due to superannuation and personal reasons etc). The management reiterated that the recent whistle-blowing event will not adversely impact the loan book. The succession of Mr. Aditya Puri will be keenly watched, but the bank has that hinted the successor is likely to be an internal candidate. The bank has already finalized three candidates for the position of the MD & CEO (to succeed Mr. Puri who retires in October 2020) and the matter is with the RBI now. We expect slower credit growth for H1 FY21E and also some impact on profitability due to lower fee income, etc, for the banking sector, including HDFC Bank due to the COVID-19. However, HDFC Bank's business quality and franchise strength will help it tide over near-term challenges. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,400.

Key positives

- Net interest margin (NIM) was stable sequentially at 4.3% helped by a lower cost of funds and growth.
- Cost-to-income ratio was at 35.0% as against 39% for the corresponding quarter ended June 30, 2019. Operating expenses were lower primarily due to lower loan origination and sales volumes.

Key negatives

- CASA deposits stood at 40.1% of total deposits were down from 42.2%, as on March 2020.

Our Call

Valuation: HDFC Bank currently trades at a reasonable ~2.7x its FY2022E book value per share (BVPS), which is reasonable. We believe that the bank's strong consistency is buoyed by its strong underwriting capability and risk measurement standards, which are strong support for its valuations. We opine that any weakness in the stock would be an opportunity for investors to add it to their long-term portfolio. We retain our Buy rating with an unchanged price target (PT) of Rs. 1,400.

Key Risks

An elongated phase of uncertainty due to intermittent lockdowns may impact growth, and rise in NPAs in unsecured and other retail segments can pose risks to profitability.

Valuation Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Net interest income	40,095	48,243	56,186	69,271	80,787
Net profit	17,487	21,070	26,257	30,955	40,245
EPS (Rs)	33.7	38.7	48.0	56.6	73.6
PE (x)	32.6	28.4	22.9	19.4	14.9
Book value (Rs/share)	204.8	272.3	310.9	348.4	403.6
P/BV (x)	5.4	4.0	3.5	3.2	2.7
RoE (%)	17.9	16.5	16.4	17.1	19.5
RoA (%)	1.8	1.8	1.9	1.9	2.1

Source: Company; Sharekhan estimates

Key Concall Highlights

Top management changes: Mr. Mittal, the chief technology officer, and Mr. Abhay Aima, the Head – Equities and Private Banking, exited the bank. The bank clarified on the top leadership changes in the team. Mr. Mittal (was Chief technology officer) had communicated 1 year before that he wanted to leave, and has gone to Oxford for further studies. Mr Aima (has been since inception) had expressed alternate career interest, and having served his notice period and was let go amicably. As to a whistle-blowing incident in the auto loans business, the bank conducted an internal inquiry. The bank clarified that the event has no impact on the loan book. But some personal misconduct were found out with some employees. Mr Ashok Khanna, head of the auto loans segment, had also participated in the enquiry process. Subsequently, he superannuated on March 31, 2020 upon expiry of his tenure and as per the original terms of employment

COVID-19 response: The bank has given all due bonuses and increments, etc to employees and moved all excess staff to the collections segment.

Long-term roadmap: After interaction with Silicon Valley companies, the bank had decided to offer customers 'frictionless' products and services to customers in line with the shift in technology. The bank has formulated the action plan and was implementing is successfuylly, which has helped and metrics have improved - a healthy 18.9% CRAR, minimal delinquencies, etc.

Altico account: The bank has already provided for the said loans. Deposits will have to be refunded to Altico (~Rs. 210 crore as mandated by RBI). The impact will be minimal as it is fairly small amount.

Demand outlook: The economy has recovered sharply since April. Consumption of crude oil, electricity, etc, trends in e-way bills are encouraging, and capacity utilisation is also picking up. The rural economy is buoyant, aided by strong monsoons. However, demand may also cool off slightly as part of the demand was pent-up. Also, due to re-imposition of lockdown in a few states which would impact business going forward.

Customer transactions picking up: The bank saw strong traction in terms of small-ticket size, high-frequency transactions. The payments business has bounced back in June, to 70% of pre-COVID levels. On an average, the bank witnessed ~2.25 lakh customer interactions per day during Q1 FY21. HDFC Bank has acquired ~1.2 million liability customers in Q1 FY21 (is ~80% of normal levels).

Corporate loans: The bank focused on high-quality corporate entities and witnessed some demand, as seen in the Q1 numbers. The bank is seeing a shift in corporates' preference towards banks from debt markets. June collections stood at 94% of its y-o-y collections in the corporate book. Strong brand and digital bandwidth helped in gaining of market share. Remains poised for further market share gains. Asset-quality trend of corporate loan book is strong with ~86% of the externally-rated portfolio being 'AA & above'.

Unsecured book rating better than secured book: Quality of portfolio is robust in case of cashflow-based loans or loans against property (LAP). Weighted average rating in unsecured book is 3.4 as against 4.8 on secured book (both are as per bank's internal rating scales, a lower rating is better), shows the lower probability of default in its unsecured book.

SME loans: As per the management's conservative estimate, ~9-11% of customers may face difficulty in repaying loans. However, at present, only ~5% of loans have been impacted as indicated by current flows. Moreover, current flows are improving month-on-month.

Retail loans: Retail loan origination is down by ~70% in Q1 FY21, mainly due to the bank's conservative approach. Moreover, there was some conservatism from consumers who are slow to borrow. Due to the above, personal loan book origination has declined by ~86%. Also, car sourcing has dropped by ~80%. The credit cards book has declined by 4.4% q-o-q and vehicle finance book also de-grew, however tractor segment book grew by 26%. Two-wheeler & tractor loans are now at pre-COVID levels.

Retail asset quality trends: Early trends are positive, even though business volumes have suffered, the portfolio quality has not been impacted significantly., while cheque bounce rate have declined. Collection infrastructure has been intact despite COVID-19; in fact, the collection team has been augmented by the sales team (20,000 additional people on collection activity). The resolution rate is at 60-65% of normal trend.

Unsecured personal loans: As stated earlier, the personal loans are being offered almost entirely to salaried borrowers. Almost 98% of moratorium customers continue to receive salary in the personal loan segment and only 5% of the clients have seen a salary cut of 20% and above. Despite this, cash balances in savings account are going up.

Succession planning: The bank has already shared names with the RBI and awaiting clearance. Internally, there is expected to be no continuity issues. Mr. Puri, the MD & CEO, stated the successor has been with HDFC Bank since long time which indicates that the successor is likely to an internal candidate.

Moratorium: The share of moratorium book as of Q1FY21-end is 9% of the total loan book, including all loan portfolios, including agriculture.

Provisions: The bank made a contingent provision of Rs. 4,500 crore and already has general a provision of Rs. 1,430 crore, which the management believes is sufficient. However, it will continue to monitor the situation.

Capital raising: The bank has adequate capital at the moment, and doesn't feel the need to raise more now.

Margin outlook: Margins within the guided range of 4.1-4.4% and bank has managed ALM well with an appropriate risk based pricing policy. It will continue to see the margins within the stated band.

Operating costs: Operating performance saw cost-to-income ratio falling to 35% as loan sourcing costs were not apparent in Q1, which is not normal. Going forward, C/I ratio is likely to go to 38-39% in the next few quarters. However, over a 3-year horizon, the ratio is expected to come down to 35%.

Results Rs cr

Particulars	Q1FY21	Q1FY20	y-o-y %	Q4FY20	q-o-q%
Interest income	30,378.0	27,391.6	10.9	29,885.1	1.6
Interest expense	14,712.6	14,097.3	4.4	14,681.7	0.2
Net interest income	**15,665.4**	**13,294.3**	**17.8**	**15,203.4**	**3.0**
Non-interest income	4,075.3	4,970.3	-18.0	6,032.6	-32.4
Net total income	19,740.7	18,264.5	8.1	21,236.0	-7.0
Operating expenses	6,911.5	7,117.3	-2.9	8,277.8	-16.5
Pre-provisioning profit	**12,829.3**	**11,147.2**	**15.1**	**12,958.2**	**-1.0**
Provisions	3,891.5	2,613.7	48.9	3,784.5	2.8
Profit before tax	8,937.8	8,533.6	4.7	9,173.7	-2.6
Tax	2,279.0	2,965.4	-23.1	2,246.6	1.4
Profit after tax	**6,658.8**	**5,568.2**	**19.6**	**6,927.0**	**-3.9**
Asset Quality					
Gross NPAs	13,773.5	11,769.0	17.0	12,650.0	8.9
-Gross NPA (%)	1.36	1.40	-4 bps	1.26	10 bps
Net NPAs	3,280.0	3,567.2	-8.1	3,542.4	-7.4
-Net NPA (%)	0.33	0.43	-10 bps	0.36	-3 bps
Key reported ratios (%)					
NIM (%)	4.3	4.3	0 bps	4.3	0 bps
CASA (%)	40.1	39.7	44 bps	42.0	-186 bps

Source: Company; Sharekhan Research

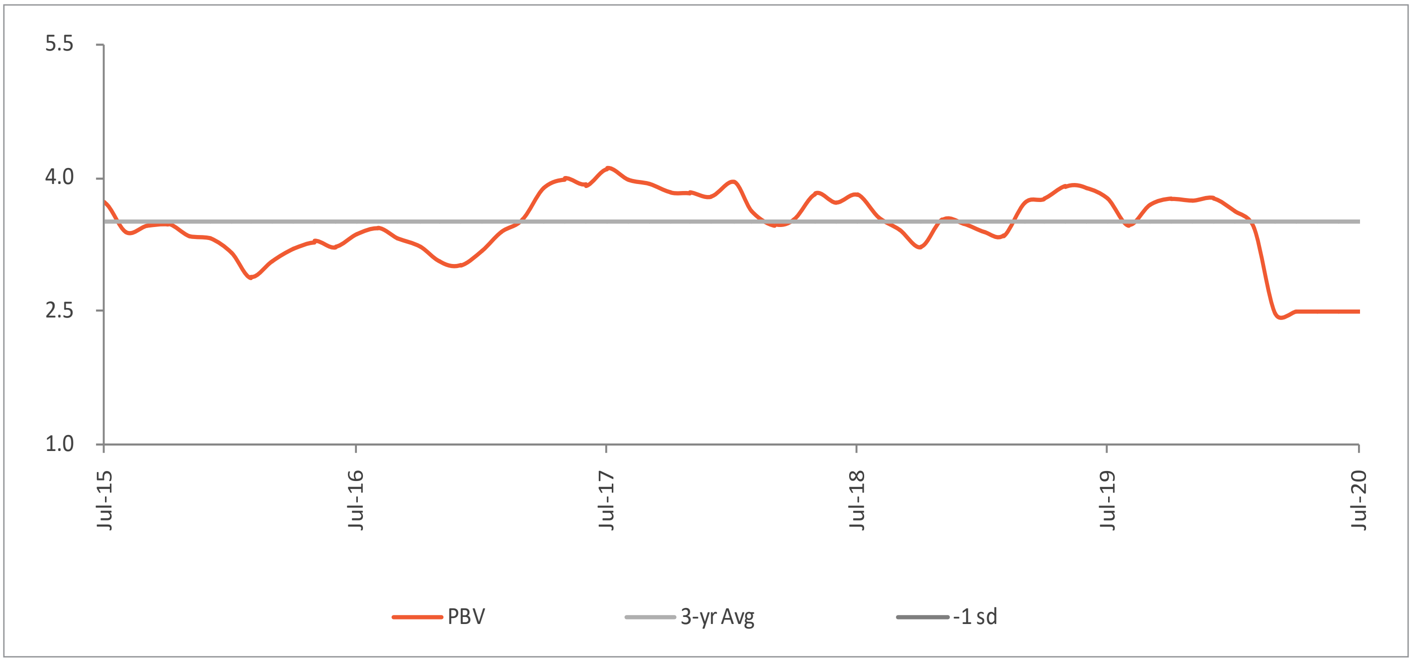
Outlook

We believe that structural drivers are in place for HDFC Bank, helping it gain market share, aided by operational efficiencies and best-in-class asset quality. The top management succession will be keenly watched, and the bank has already finalised three candidates to succeed Mr. Aditya Puri (whose term ends in October 2020) and has now indicated that there may be an internal candidate for the same. Recent events and exits were well clarified to by the management. Business upheavals caused the cost-to-income (C/I) ratio to decline to 35% levels, which may normalise to ~39% levels, but the bank expects the same to ease further in the medium term. Going forward, we expect challenges on credit cost and growth. However, the bank has built strong provision buffer, which are at ~149% of GNPAs which we believe work as strong bulwark against probable future risks. The bank's operating performance remains strong, but we expect growth to return largely in FY22E, as the economy the demand environment improve. Notably, the franchise continues to be one of the best-managed and strongest business models and needs to be seen from a long-term perspective. Overall, the asset-quality picture looks sanguine, with its calibrated growth and strong underwriting and assessment capabilities and healthy digitalisation benefits adding to the moat of its business strength. HDFC Bank's floating provision cushion of Rs. 1,450 crore and contingent provisions of Rs 4,002 crores along with comfortable capitalization levels (Tier-1 ratio at 17.5%) are additional positives. We believe HDFC Bank's business quality and franchise strength will help it tide over near-term challenges.

Valuation

HDFC Bank currently trades at a reasonable ~2.7x its FY2022E book value per share (BVPS), which is reasonable. We believe that the bank's strong consistency is buoyed by its strong underwriting capability and risk measurement standards, which are strong support for its valuations. We opine that any weakness in the stock would be an opportunity for investors to add it to their long-term portfolio. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 1,400.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HDFC Bank	1,099	3.2	2.7	19.4	14.9	1.9	2.1	17.1	19.5
ICICI Bank	354	1.8	1.7	19.1	13.8	1.0	1.3	9.6	12.4
Axis Bank	433	1.4	1.2	17.2	10.3	0.7	1.1	8.0	12.4

Source: Sharekhan Research; Bloomberg 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. HDFC Bank caters to a wide range of banking services covering commercial and investment banking on the wholesale side and transactional / branch banking on the retail side. Its 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.

Investment theme

HDFC Bank is among the top performing banks in the country having strong presence in the retail segment with strong asset quality and best in class margins. Not only the bank, but its strong and marquee parentage enjoy arguably the strongest brand recall in the country which is a significant competitive advantage in the Indian banking space. Buoyed by a strong brand appeal, impressive corporate governance and strong management team (consistency in performance and best-in-class granular clientele) has enabled HDFC bank to be a long-term wealth creator for investors, and the above factors still hold true. The bank continues to report consistent margins and advances growth over the years across various credit / interest rate cycles, and has been able to maintain its asset quality too indicative of the strong business franchise strength and leadership qualities. We believe the Bank has a strong business model, and is relatively well placed to tide over near term challenges.

Key Risks

An elongated phase of uncertainty due to intermittent lockdowns may impact growth, and rise in NPAs in unsecured and other retail segments can pose risks to profitability.

Additional Data

Key management personnel

Mr Aditya Puri	Managing Director
Mr Jimmy Tata	Chief Risk Officer
Mr Srinivasan Vaidyanathan	Group Chief Financial Officer
Mr Arvind Vohra	Group Head, Retail Branch Banking at HDFC Bank
Mr Arvind Kapil	Group Head - Unsecured Loans, Home, and Mortgage Loans
Ms Ashima Bhat	Group Head - Finance, Administration & Infrastructure

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Unit Trust of India	4.6
2	SBI Funds Management Pvt Ltd	3.9
3	Dodge & Cox	3.6
4	BC ASIA INVESTMENTS	3.4
5	Vanguard Group Inc/The	2.6
6	ICICI Prudential Asset Management	2.6
7	Capital Group Cos Inc/The	2.5
8	ICICI PRUDENTIAL CAPITAL P	2.3
9	HDFC Asset Management Co Ltd	2.3
10	BlackRock Inc	2.2

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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