HDFC Bank

21 January 2019

Reuters: HDBK.BO; Bloomberg: HDFCB IN

3QFY19 Result Update

Fee Income Traction Outweighs NIM Stagnation

HDFC Bank (HBL) reported 3QFY19 results with the key pointers being (1) NIM at 4.3% was flat QoQ as well as YoY and seems to have settled at this level for now (2) Core fee income growth at 27% YoY continued to remain strong deriving strength from (a) payments business and (b) cash management, among others. (3) Overall asset quality remains in control but agri book remains a niggling issue and a key monitorable (4) Operating expenses continued to track lower than total income. Per se, on the key P&L items, HBL posted NII growth of 22% YoY at Rs125,768mn, PPOP growth of 28% YoY at Rs107,784mn and PAT growth of 20% YoY at Rs55,859mn. We have revised our estimates for FY19/FY20/FY21 and have retained a Buy rating on HBL with a revised target price of Rs2,443 (from Rs2,442 earlier) and valuing the stock at 3.2x 1HFY21E P/BV. *However, we continue to recommend switching from HBL to ICICI Bank, albeit with somewhat lower outperformance expectations over relatively short horizons. We first made this recommendation in our 1QFY19 result note: Margin Hits A Wall. ICICI has outperformed HBL by 43% since this call.*

NIM at 4.3% was flat QoQ as well as YoY and seems to have settled at this level for now: In 2QFY19, HBL had executed a total equity capital raise amounting to Rs 235.9bn, via preferential allotment to HDFC Limited (Rs 85bn), qualified institutional placement (Rs 27.75bn) and the remaining quantum from American Depository Reciepts. This meant that there was no need to bid aggressively for bulk deposits which was evident since the management stated that traction in term deposits during 3QFY19 was for granular deposits. However, CASA growth at to 13% YoY continued to lag time deposits growth of 29% YoY. HBL SA card remains 3.5%. HBL still Within CASA, current account deposits growth was also tepid at 10.5% (was 7% YoY in 1QFY19). Rise in yield could have been faster but for conscious prudential strategy to maintain higher liquidity via lower-yielding assets in investment book. Consequently, LCR for HBL stood at 122% as against a regulatory requirement of 90%. ~65-70% of loan book is fixed rate and, therefore, HBL, has comparably lower recourse to MCLR-linked repricing. This aspect is not necessarily structural since retail book has a tenure of ~1.5-2 years. Overall, however, NIM seems to have stagnated since 1QFY19 and may not expand from this relatively lower level (compared with HBL's own historical range) for the foreseeable future (we first pointed this out in our 1QFY19 result note whose link is provided above).

Core fee income growth at 27% YoY continued to remain strong deriving strength from (a) payments business and (b) cash management, among others: Fees in payments business is being driven both by higher spends as well as by lower acquisition cost drag. Having re-examined transaction costing, cash management fees also saw improved traction within wholesale fees. Further, HBL has been seeing improved fees from (c) insurance third-party distribution fees, which got a leg up due to the open architecture eco-system and (d) other retail fees.

Overall asset quality remains in control but agri book remains a niggling issue and a key monitorable: Total slippage ratio for the bank was 2.04% (Rs 4.0bn of gross slippage) in 3QFY19. Excluding agri book, this would have been 1.7%. In fact, excluding agri book, GNPA ratio has been stable 1.1% both QoQ and YoY. Overall GNPA ratio at 1.38%, up 5 bps QoQ and standard restructured pipeline remained nil. Floating provisions helped keep total provision coverage ratio at 115%.

Operating expenses continued to track lower than total core income: Operating expenses grew 17.2% YoY, slower than total income at 23.4% YoY, resulting in a C/I ratio decline to 38.4% from 40.4% an year ago. We have highlighted in our recent sector report (Power Play to Digital Dreams) that HBL is ahead of the curve on digital strategy (along with KMB, ICICI, AXIS). Spurt in banking outlet count by 138 in 3QFY19 is non-recurring in nature.

Valuation and outlook: We have retained our NII estimates, revised our PPOP estimates by 0.1%/0.1%/0.1% and PAT estimates by 0.1%/0.1%/0.1% for FY19/FY20/FY21, respectively. We have retained Buy rating on HBL and revised our target price to Rs2,443 (from Rs2,442 earlier), valuing the stock at 3.2x 1HFY21E P/BV.

BUY

Sector: Banking

CMP: Rs2,131

Target Price: Rs2,443

Upside: 15%

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Key Data

Current Shares O/S (mn)	2,719.5
Mkt Cap (Rsbn/US$bn)	5,793.2/81.4
52 Wk H / L (Rs)	2,220/1,829
Daily Vol. (3M NSE Avg.)	3,143,611

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Bank	0.9	(2.7)	9.1
Nifty Index	1.4	(0.9)	0.1

Source: Bloomberg

Y/E March (Rsmn)	3QFY19	3QFY18	2QFY19	YoY (%)	QoQ (%)
Interest income	258,903	205,813	241,996	25.8	7.0
Interest expenses	133,135	102,669	124,362	29.7	7.1
Net interest income	**125,768**	**103,143**	**117,634**	21.9	6.9
NIM (%)	***4.3***	***4.3***	***4.3***	-	-
Non-interest income	49,210	38,692	40,156	27.2	22.5
Total income	**174,978**	**141,835**	**157,790**	23.4	10.9
Staff costs	19,676	16,913	19,092	16.3	3.1
Other operating expenses	47,517	40,410	43,898	17.6	8.2
Total operating expenses	67,193	57,322	62,991	17.2	6.7
Cost- to-income (%)	*38.4*	*40.4*	*39.9*	(201bps)	(152bps)
Pre-Provisioning Operating profit	**107,784**	**84,513**	**94,800**	27.5	13.7
Provisions	22,115	13,514	18,200	63.6	21.5
PBT	**85,669**	**70,999**	**76,600**	20.7	11.8
Tax	29,810	24,573	26,543	21.3	12.3
-effective tax rate	34.8	34.6	34.7	19bps	15bps
PAT	**55,859**	**46,426**	**50,057**	20.3	11.6
EPS (Rs)	20.5	17.9	18.4	14.6	11.5
BV (Rs)	525.7	390.2	505.0	34.7	4.1
Deposits	8,525,019	6,990,264	8,333,641	22.0	2.3
Advances	7,809,512	6,312,147	7,508,381	23.7	4.0

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Asset Quality

- Gross slippage ratio for quarter stands at 2.04% (Rs. 40 bn). Ex-agri, it is 1.7%.
- Barring agri, asset quality across the segments has been stable (even improving in some cases). In case of agri portfolio, the bank has seen some sort of asset quality aggravation (spurt in charge to ENR) on account of loan waivers and general elections that are coming up. In light of this, the bank has taken a conservative stance and provided Rs. 3,350 mn in the form of contingent provisions, a large part of which is in anticipation of farm loan waivers being announced going forward. This, coupled with some natural calamities in states like Kerala and Maharashtra (where food commodity prices have corrected), could lead to spike in agri NPAs going forward. The bank expects some impact (rise in NPAs) in June 2019 quarter, not so much in March 2019 quarter.
- Besides Rajasthan, MP and Chhattisgarh, two other states have announced loan waivers but guidelines aren't out yet.
- As per the bank, historically, they have not been writing off NPAs in the agri segment. However, given the current scenario (of farm loan waivers being announced more frequently than before), the bank maybe coming up with some policy which may involve some level of write-offs.
- The bank started seeing spike in agri NPAs since June 2017 due to farm loan waivers.
- Within Business banking, the smaller ticket size lending business is called the emerging small enterprises group. This loan book is very granular and has been growing well and has been stable from credit perspective. The area the bank isn't growing is agri commodities due to concern regarding asset quality (as outlined in December of 2017). Since then the bank has made rectifications to this book. A large part of this agri commodity book continues to be well performing.
- The bank has virtually zero exposure to IL&FS.
- LTVs on auto/CV loans have been stable (well below 90% for cars). CV LTVs have been range-bound.
- Gross NPAs ex-agri is 1.1% which has been roughly flat yoy and qoq. Gross NPAs ex-agri have been stable throughout the year. Though there may have been some change in absolute values, but in percentage terms, performance has been stable as underlying portfolios have also grown.
- Early bucket delinquency rate across most retail assets has been stable.
- As per the bank, there should be not too much difference between stage 1 and stage 3 provisions (between IND-AS and IGAAP). Though IND-AS stage 2 provisions could be slightly more than IGAAP.
- Business banking is entirely secured.
- The bank has been cautious and selective in its exposures to NBFCs/HFCs. As alluded earlier, the bank looks for parentage, business model and consistency of cash flows before taking exposure to NBFCs/HFCs. There hasn't been any material change in the bank's exposure to these segments since FY18-end. The bank's current exposure to these segments is below the internal limit.

Business and Loan Growth

- From a sectoral perspective, the bank doesn't see any change in their overall outlook. The bank is witnessing stable growth across segments though there is some slowdown in the two/four-wheeler categories primarily due to slowdown in underlying sales. The bank expects to see tepid growth in these segments relative to prior growth rates and hence financing in these segments could be impacted.
- In LAP too, the bank has witnessed some level of slowdown primarily because of pricing levels going below acceptable thresholds. Though, the bank's own LAP portfolio has been stable. Overall, the bank expects pricing pressure in LAP segment to reduce on account of issues and challenges being faced by the NBFCs.
- Agri is largely directed lending as there is a requirement to do so. The portfolio return at the topline level is good as the rates charged by HDFC Bank are not the same as what the PSBs would get (they are 10-12% for HDFC Bank, higher than PSBs). The bank believes a key reason for differential in rates charged by them versus the PSBs is on account of subsidy receipts. Loans are typically given based on product

program which are reviewed frequently. Further, loans are extended to farmers from very small to large ones, depending on the permissible lending allowed as per the scale and size of the farm. Ticket size to can vary from small to large, depending on the size of the farm and the crop involved. These farm loans are not primarily priced on LGD expectation.

- The bank hasn't bought any portfolios expect for home loans from HDFC (Rs. 62 bn during the quarter).
- Bulk of the unsecured growth in personal loans has been holding up well.

Margin, Liabilities and Liquidity

- The bank has been focusing on granular time deposits since January 2018. In terms of card rates, the bank has been a pioneer in pushing up retail granular time deposit rates, especially around 1-2 year maturity bucket.
- Liquidity coverage at 122% is strong, though may be created some drag on margins but the bank is comfortable with it as of now. Overall, the bank does not seem too worried about lowering CASA as long as yields are moving up and NIM is stable.
- Bulk of time deposits accretion is retail in nature. The bank has taken steps to communicate to customers the higher rates offered by them.
- Reasons for decrease in CASA ratio also include:
    - Customers paying off their EMIs from their SA balances (not negative per se)
    - Customers converting their SA balances to TDs or buying third party products (not negative per se)
    - Customers maybe transferring SA balances to other banks

Operating Expenses

- The bank has tracked IT spend as % of net revenue as one of its metrics. It is currently about 3-4%.
- The bank has appetite to add about 150-200 branches per year. Invariably, the bank's branch addition has been rear-ended towards 3rd/4th quarter of the year. So, this quarter's spurt in not necessarily a stable run rate.
- Incrementally, the branch addition has been roughly equally divided between urban and semi-urban.

Fee and Other Income

- The primary driver in fee income has been payments business. There as been an improvement in spends as well as a reduction in acquisition cost drag. Another area contributing to fee income is cash management. The bank, since re-examining its transactions-related costing, has been able to lift its wholesale fee income.
- Debit card fees as % of total core fee income is about 7% while credit card fee is roughly around 25-30%. Credit card proportion has increased over time.

Subsidiaries

- Margins for HDB (NBFC subsidiary) came down from 7.2% to 6.7% due to rise in cost of funds. Advances book, of the sub, stands at ~Rs. 500 bn, up 26% yoy. In terms of asset quality, GNPAs are at 2.07%, flat yoy.

Others

- Srinivas Vaidyanathan has joined HDFC Bank on 1st December 2018. He is an ex-Citi Banker with 27 years of experience, including in locations such as Singapore. The bank believes he would be a good asset to the bank.
- Payouts to sales agents are accounted for on accrual basis.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	331,392	400,949	463,345	564,637	708,570
Pre-provisioning Operating profit	257,323	326,248	396,052	490,010	619,261
PAT	145,498	170,671	213,474	269,749	346,826
EPS (Rs)	56.8	65.8	79.1	99.9	128.5
BV (Rs)	349.1	409.6	557.7	655.0	780.9
P/E (x)	37.5	32.4	26.9	21.3	16.6
P/BV (x)	6.1	5.2	3.8	3.3	2.7
Gross NPAs (%)	*1.1*	*1.3*	*1.4*	*1.4*	*1.3*
Net NPAs (%)	*0.3*	*0.4*	*0.4*	*0.3*	*0.3*
RoA (%)	*1.8*	*1.8*	*1.8*	*1.9*	*2.0*
RoE (%)	*17.9*	*17.4*	*16.6*	*16.5*	*17.9*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	3QFY19	3QFY18	2QFY19	*YoY (%)*	*QoQ (%)*	3QFY19E	*Devi. (%)*
Net interest income	125,768	103,143	117,634	*21.9*	*6.9*	118,126	*6.5*
Pre-provisioning Operating profit	107,784	84,513	94,800	*27.5*	*13.7*	102,963	*4.7*
PAT	55,859	46,426	50,057	*20.3*	*11.6*	55,584	*0.5*

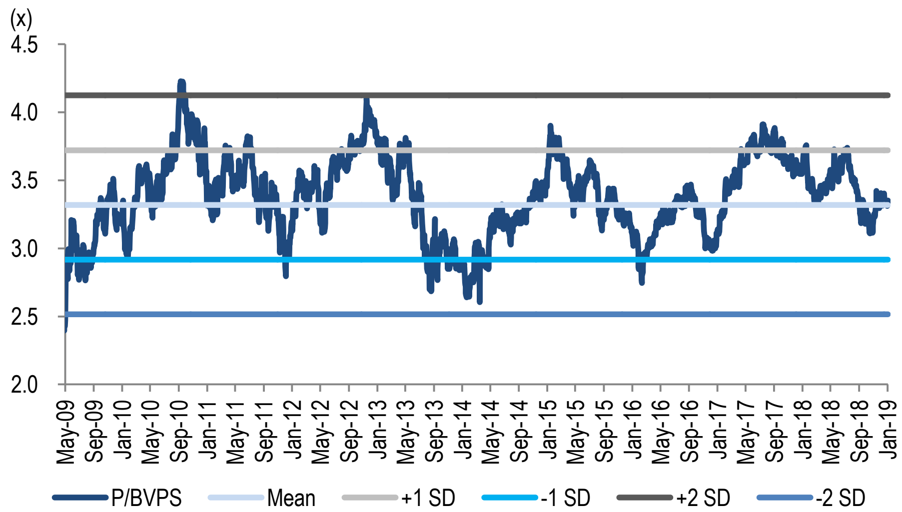
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	463,345	564,637	708,570	463,345	564,637	*708,570*	-	-	-
NIM (%)	*4.3*	*4.4*	*4.4*	*4.3*	*4.4*	*4.4*	-	-	-
Operating profit (Rsmn)	396,052	490,010	619,261	395,685	489,647	*618,692*	*0.1*	*0.1*	*0.1*
Profit after tax (Rsmn)	213,474	269,749	346,826	213,232	269,510	*346,451*	*0.1*	*0.1*	*0.1*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	693,060	802,414	987,806	1,202,786	1,498,409
Interest expenses	361,667	401,465	524,461	638,149	789,839
Net interest income	**331,392**	**400,949**	**463,345**	**564,637**	**708,570**
Fee income	111,585	142,960	177,271	221,651	277,906
Other income	11,380	9,243	10,725	13,424	15,743
Net revenues	454,357	553,152	651,341	799,712	1,002,219
Operating expenses	197,033	226,904	255,289	309,703	382,958
-Employee expenses	64,837	68,057	75,449	82,973	93,118
-Other expenses	132,197	158,846	179,840	226,730	289,841
Pre-provisioning Operating profit	**257,323**	**326,248**	**396,052**	**490,010**	**619,261**
Provisions	35,933	63,471	72,606	81,299	93,766
-Loan-loss provision	35,375	59,275	72,606	81,299	93,766
-Provision for investment	(76)	305	-	-	-
-Other provisions	635	3,892	-	-	-
PBT	221,390	262,777	323,445	408,711	525,495
Taxes	75,893	92,106	109,971	138,962	178,668
PAT	**145,498**	**170,671**	**213,474**	**269,749**	**346,826**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	20.1	21.0	15.6	21.9	25.5
Pre-provision profit growth	20.5	26.8	21.4	23.7	26.4
PAT growth	18.3	17.3	25.1	26.4	28.6
Business (%)					
Deposit growth	17.8	22.5	22.1	23.2	25.7
Advance growth	19.4	18.7	23.0	24.0	26.4
Business growth	18.5	20.8	22.5	23.6	26.0
CD	86.2	83.5	84.1	84.6	85.1
CASA	48.0	43.5	44.0	46.0	46.7
Operating efficiency (%)					
Cost-to-income	43.4	41.0	39.2	38.7	38.2
Cost-to-assets	2.5	2.4	2.2	2.2	2.2
Productivity (Rsmn)					
Business per branch	2,541.3	3,023.0	3,627.3	4,392.4	5,426.4
Business per employee	142.1	164.0	199.3	246.3	304.3
Profit per branch	30.9	35.7	43.7	54.1	68.2
Profit per employee	1.7	1.9	2.4	3.0	3.8
Spread (%)					
Yield on advances	10.2	10.3	10.4	10.4	10.4
Yield on investments	7.8	7.1	7.2	7.1	7.1
Cost of deposits	5.3	4.6	5.0	5.0	4.9
Yield on assets	9.5	9.1	9.2	9.3	9.4
Cost of funds	5.4	4.9	5.2	5.2	5.2
NIMs	4.6	4.5	4.3	4.4	4.4
Capital adequacy (%)					
Tier I	12.8	13.3	14.6	13.9	13.1
Tier II	1.8	1.6	1.6	1.6	1.5
Total CAR	14.6	14.8	16.2	15.4	14.6
Asset quality (%)					
Gross NPAs	1.1	1.3	1.4	1.4	1.3
Net NPAs	0.3	0.4	0.4	0.3	0.3
Specific provision coverage	68.7	69.8	73.9	75.7	77.6
Slippage	1.4	2.1	1.5	1.5	1.2
Credit-cost	0.6	0.8	0.9	0.8	0.7
Return (%)					
RoE	17.9	17.4	16.6	16.5	17.9
RoA	1.8	1.8	1.8	1.9	2.0
RoRWA	2.5	2.4	2.4	2.4	2.5
Per share					
EPS	56.8	65.8	79.1	99.9	128.5
BV	349.1	409.6	557.7	655.0	780.9
ABV	346.8	405.2	551.6	646.7	772.2
Valuation (x)					
P/E	37.5	32.4	26.9	21.3	16.6
P/BV	6.1	5.2	3.8	3.3	2.7
P/ABV	6.1	5.3	3.9	3.3	2.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

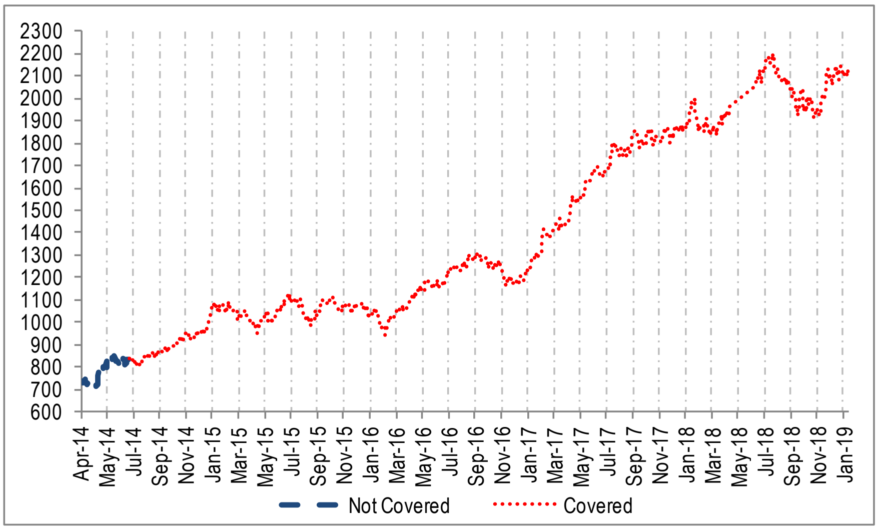
Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity capital	5,125	5,190	5,399	5,399	5,399
Reserves & surplus	889,500	1,057,760	1,500,178	1,762,908	2,102,715
Shareholders' funds	**894,625**	**1,062,950**	**1,505,577**	**1,768,307**	**2,108,115**
Deposits	**6,436,396**	**7,887,706**	**9,628,997**	**11,863,907**	**14,912,323**
-Current deposits	1,155,738	1,192,826	1,492,495	1,898,225	2,415,796
-Saving deposits	1,935,786	2,238,102	2,744,264	3,559,172	4,548,258
-Term deposits	3,344,872	4,456,779	5,392,239	6,406,510	7,948,268
Borrowings	740,289	1,231,050	1,306,758	1,598,268	1,995,887
Other liabilities	567,093	457,637	131,527	116,200	182,981
Total liabilities	**8,638,402**	**10,639,343**	**12,572,859**	**15,346,681**	**19,199,305**
Cash/equivalent	489,521	1,229,151	1,052,675	1,405,725	1,776,837
Advances	5,545,682	6,583,331	8,097,497	10,040,896	12,691,693
Investments	2,144,633	2,422,002	2,940,464	3,303,232	4,018,947
Fixed assets	36,267	36,072	39,679	43,647	48,012
Other assets	422,298	368,787	442,544	553,181	663,817
Total assets	**8,638,401**	**10,639,343**	**12,572,859**	**15,346,681**	**19,199,305**

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
22 January 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

Rating track graph



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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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