HDFC Bank

01 June, 2022

Reuters: HDBK.BO; Bloomberg: HDFCB IN

Analyst Meet Update

Execution underway on multiple fronts

HDFC Bank is aiming to double the post-merger balance sheet in 5 years and expects eventual steady-state ROA of 2% given the merger benefits. Reserves maintenance is expected to be ROA/ROE neutral-to-accretive. Overall commentary around the merger rationale was positive. Besides the mortgage business, the bank is undertaking multiple measures across retail, corporate and commercial/rural banking (CRB) segments in order to achieve growth. The bank would also be stepping up its retail liability garnering efforts in the near term to support the balance sheet well ahead of the merger. Given the expected liability build-up, we expect intermittent impact on margins, but the structural outlook remains positive given the high market share in unsecured segments. In the near term, the bank is expected to roll out multiple digital products, including an industry-first xpress auto loan. Investments in branches, human capital and technology will continue, leading to elevated opex ratios in the near term. However, the bank expects to achieve ~35% opex/income (ex-mortgages) in the next 3-5 years. Including mortgages, opex/income is likely to be 30% or lower. We have come away positively overwhelmed from the insightful session on the bank's overall future growth strategy. Execution, especially on garnering huge amounts of liability, is of paramount importance and will need to be closely monitored. We maintain our ROA/ROE estimate of 2%/17.6% by FY24E. We maintain BUY on the stock with a target price (TP) of Rs2,042 (3.4x FY24E ABVPS + value of subsidiaries).

Retail growth to pick up, supported by new product launches: Overall commentary was positive and mostly similar to the recent earning's call wherein the management highlighted that growth is likely to pick up pace in the retail segment across product lines. We had seen the bank pulling back on retail loans during the pandemic period. However, with covid risks now mostly behind us, the bank is expected to press the retail growth pedal. Besides having a strong market share in unsecured categories (credit cards, personal loans etc), the bank is expected to get aggressive in gold loans too by increasing the branch count offering this product by 3-4x. Further, the bank is also working to extend the 10-second personal loan product to new-to-bank (NTB) customers. The bank also plans to grow the home loan book aggressively given the massive opportunity presented by the housing sector. Overall retail growth is expected to be higher going forward.

Corporate growth is expected to do well too: Even though retail loan book is expected to grow at a higher rate, corporate growth is expected to be healthy too. The optimism on the corporate credit comes from expectations on capex revival, supported by government expenditure as well as private sector capex. Supply chain finance is expected to be a key focus area for the bank. In FY22, the bank delivered 15.7% growth in the corporate segment compared to 0.9% growth for the industry. The bank also highlighted about its intentions to be a larger bank to the MNC sector. Although, the MNCs may not represent too large an asset opportunity, they are more likely to be fee and forex income generators. The bank is unlikely to participate heavily in lending via corporate bonds. Focus, in terms of corporate exposure, will be higher on creating loan assets. Profitability wise, the bank tends to enjoy one of the best corporate RAROC in the industry, with 54% of the portfolio categorized as 'low capital, high return'. 49% of the portfolio is rated AAA and 87% is rated AA/above.

CRB to clock 25-30% growth: In recent times, we have seen the CRB segment clocking growth rates of 25-30%, driven by expansion in semi-urban and rural areas. Going forward too, the bank expects that given the credit demand gap in the MSME sector, the CRB segment has the potential to grow at 25-30%. Besides supporting growth, CRB is also expected to be a major PSL generator for the bank, taking care of 65-70% of the required PSL mobilization. The segment is expected to deliver >3% ROA and GNPA of less than 1.2%. As per estimates, the total credit demand by the MSME sector is Rs50trn, out which there is a demand gap of Rs20trn. As of FY22, the bank held a market share of 18.4% in terms of MSME lending and it is likely to inch up further. The bank stated the CRB opportunity is large enough to accommodate a 25-30% CAGR without diluting the credit underwriting standards. CRB growth will be additionally supported by SmartHub for merchants (integrated merchant ecosystem).

Retail liabilities an area of critical importance; will be supported by branch expansion: In the run up to the merger, the bank expects to build on its retail liability base. In 3.5 years, the bank expects to double its retail deposits. This will be supported by extensive branch expansion, along with focused efforts to garner such liabilities. The bank also highlighted about reorganizing sales processes to include deposit garnering as it wasn't a key metric before. Recent CASA ratio number (48%) has been on the higher side and the long-term average of 40-41% should be taken as a more reasonable expectation. Garnering granular TDs will also be a focus area. The bank stated that it is unlikely to adopt an approach wherein it would offer higher rates to attract deposits. Rather, given the strength of the HDFC brand name, branch expansion and improving deposit-garnering culture are likely to be the key growth drivers. Corporate segment growth is expected to help drive salary account acquisition, which will also help drive retail liability growth.

Payments space strategically important: Even though the payments business by itself may not make as much money, the bank feels it is an important tool to acquire customers. The bank will be launching an upgraded version of Payzapp (named Payzapp 2.0), which has enhanced features and better cross-sell potential on the back of data analytics. Overall, Payzapp is expected to be a key customer acquisition tool for the bank.

Merger economics are long-term positive: Although the near-term liability garnering initiative may weigh on the margins and profitability, the long-term economics are expected to be positive given the benefit on the mortgage book from low cost of funds and other synergies. Currently, <2% of HDFC Bank customers have a home loan from HDFC while 5% have taken a home loan from another lender, which presents a huge opportunity for the bank itself. Overall view on housing is very bullish and the bank expects to capture this opportunity by harnessing HDFC Ltd's expertise. Further, the bank highlighted current pre-approved offers outstanding, indicating the growth potential in the retail segment. With regards to the various merger related concerns, CRR/SLR reserve maintenance is expected to be ROA/ROE neutral-to-accretive. On PSL requirements, the impact is unlikely to be significant. Given that the bank has started merger-related roadshows, the overall feedback from investors has been positive. On subsidiaries ownership, the bank would prefer to hold more than 50%. However, it would also be comfortable holding less than 30% if the RBI directs. First set of merger-related approvals should come in by Sept'22/Oct'22.

BUY

Sector: Banking

CMP: Rs1,384

Target Price: Rs2,042

Upside: 48%

Raghav Garg, CFA
Research Analyst
raghav.garg@nirmalbang.com
+91-22-6273 8192

Key Data

Current Shares O/S (mn)	5,551
Mkt Cap (Rsbn/US$bn)	7,710.4/99.3
52 Wk H / L (Rs)	1,725/1,278
Daily Vol. (3M NSE Avg.)	12,822,720

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Bank	0.3	(7.7)	(8.1)
Nifty Index	(3.0)	(3.4)	6.5

Source: Bloomberg

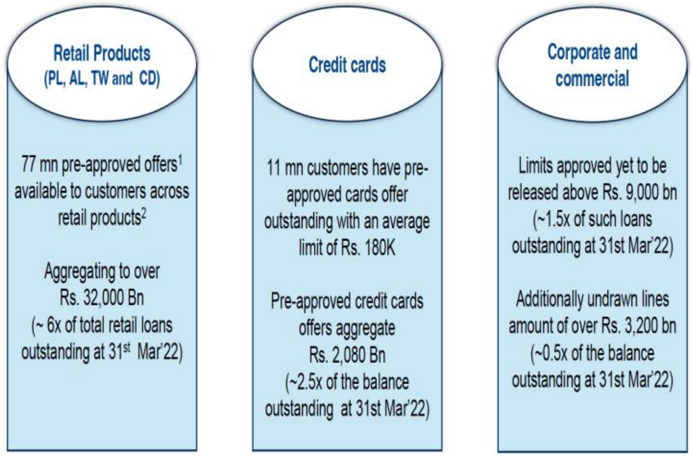
Exhibit 1: Consistently gaining market share

Deposits Market share	As of 31st Mar'22	Market share gains over			
		1 Year (vs. Mar'21)	2 Years (vs. Mar'20)	3 Years (vs. Mar'19)	5 Years (vs. Mar'17)
HDFC Bank	9.5%	91 bps	126 bps	231 bps	368 bps
Top 3 peers combined	13.3%	103 bps	137 bps	227 bps	380 bps

Advances Market share	As of 31st Mar'22	Market share gains over			
		1 Year (vs. Mar'21)	2 Years (vs. Mar'20)	3 Years (vs. Mar'19)	5 Years (vs. Mar'17)
HDFC Bank	11.6%	115 bps	197 bps	315 bps	478 bps
Top 3 peers combined	15.6%	98 bps	166 bps	230 bps	361 bps

Source: Company, Nirmal Bang Institutional Equities Research

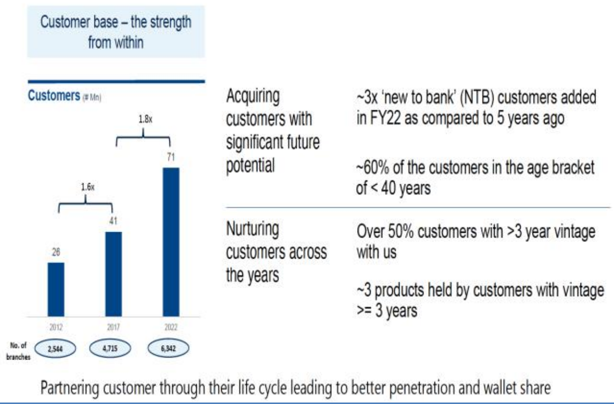
Exhibit 2: Large pre-approved base a key growth enabler



[1]Total offers may include multiple offer provided to the same customer across multiple products
[2]Retail Products include Personal Loans (PL, Auto Loans (AL), Two-wheeler loans (TW) and Consumer Durable loans (CD)

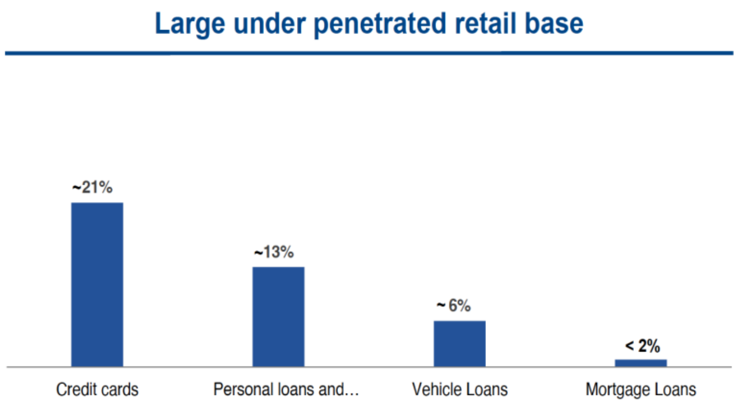
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: New customer acquisition is going strong



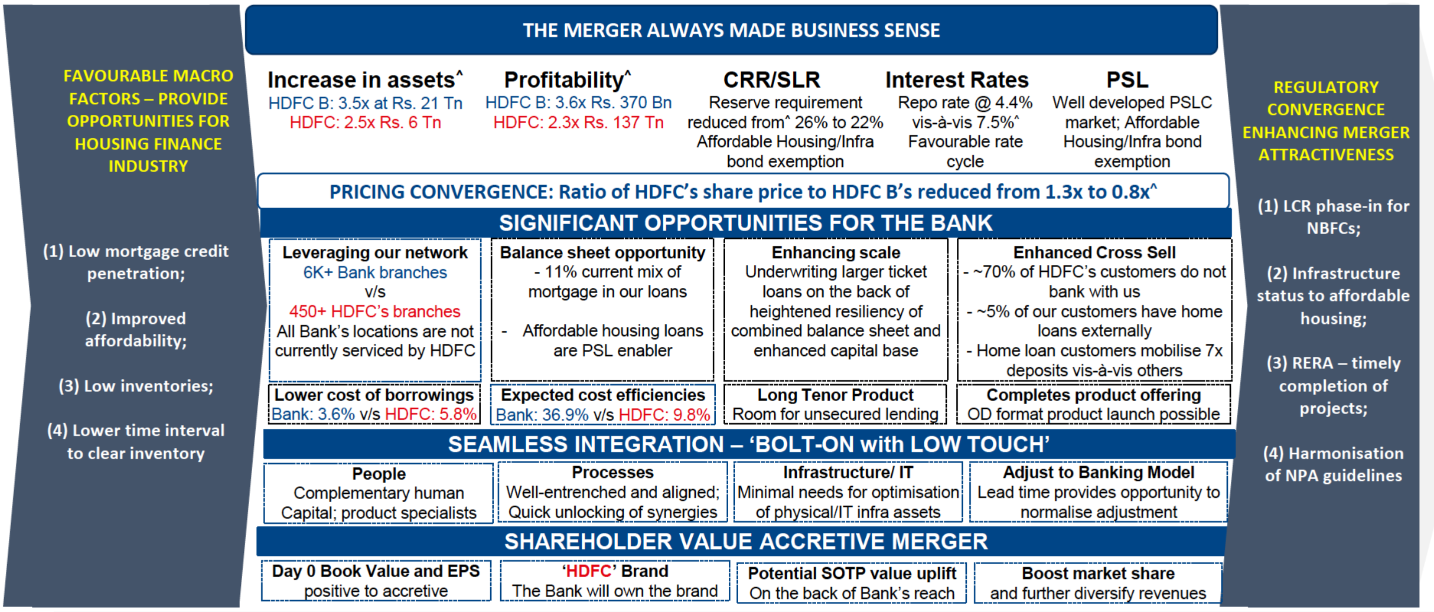
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Penetration into existing customer provides growth fillip



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Merger makes sense



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: CRR/SLR reserve maintenance ROA/ROE neutral-to-accretive; PSL unlikely to have significant impact

CRR/SLR Requirements – illustrative	**For CRR**	**For SLR**
Total liabilities	475	475
Less: Affordable housing bonds	75	75
Less: Interbank borrowings	125	
NDTL	**275**	**400**
Reserve requirements	4.5%	18%
To be maintained	~13	~72

HDFC Ltd.'s 40-50K liquid assets; and 40-50K from Bank's surplus

Reserves maintenance is neutral to accretive to ROA and ROE

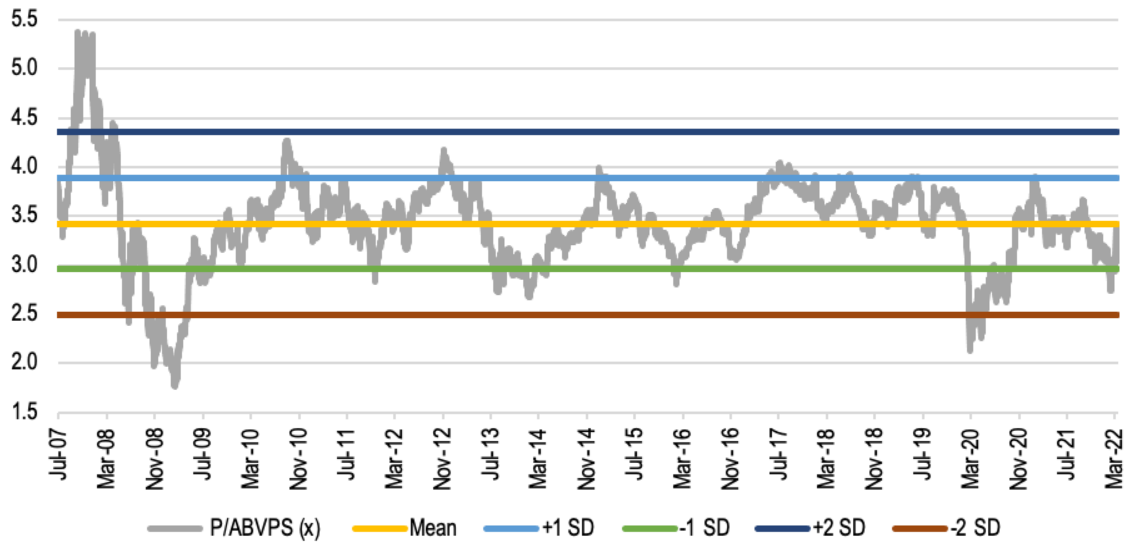
PSL Requirements – illustrative	
Total loans	575
Less: Affordable housing assets backed by bonds	75
ANBC base for PSL requirement	**500**
PSL required to be maintained	~200
PSL available with HDFC Limited	~25
PSL to be generated	175
50% of PSL through affordable housing/ core PSL	~80-90
50% of PSL (agri – SMF/Micro etc.)	~80-90

Lead time until effective date + 12-15 months

- Bank's mortgage loans **~50% PSL eligible**
- **On-balance sheet PSL businesses** typically generate **RoA between 2.5% to 3.0%**
- **Cost of PSLC** purchases range from ~50 bps to ~200 bps; this is **~5 to 10 bps in the ROA** unmitigated
- Organic and inorganic mix of PSL is BAU in banking model – continues to be an opportunity

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Financial statements

Exhibit 8: Income statement

Y/E March (Rsmn)	FY20	FY21	FY22	FY23E	FY24E
Interest Income	11,48,127	12,08,582	12,77,531	15,26,264	17,81,744
Interest expense	5,86,264	5,59,787	5,57,435	6,62,920	7,69,067
Net interest income	**5,61,863**	**6,48,796**	**7,20,096**	**8,63,343**	**10,12,677**
Non-interest income	2,32,350	2,52,049	2,95,102	3,12,328	3,56,424
Net Revenue	7,94,213	9,00,845	10,15,198	11,75,672	13,69,102
Operating Expense	3,06,975	3,27,226	3,74,422	4,46,179	5,17,590
-Employee Exp	95,257	1,03,648	1,20,317	1,35,507	1,50,645
-Other Exp	2,11,719	2,23,578	2,54,105	3,10,672	3,66,945
Operating profit	**4,87,238**	**5,73,618**	**6,40,776**	**7,29,493**	**8,51,512**
Provisions	1,21,424	1,57,029	1,50,619	1,48,067	1,51,690
PBT	3,65,814	4,16,590	4,90,157	5,81,426	6,99,822
Taxes	1,03,498	1,05,425	1,20,541	1,46,345	1,76,145
PAT	**2,62,315**	**3,11,165**	**3,69,616**	**4,35,081**	**5,23,677**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Balance sheet

Y/E March (Rsmn)	FY20	FY21	FY22	FY23E	FY24E
Share capital	5,483	5,513	5,546	5,546	5,546
Reserves & Surplus	17,04,377	20,31,696	23,95,384	27,56,542	31,93,202
Shareholder's Funds	**17,09,860**	**20,37,208**	**24,00,929**	**27,62,087**	**31,98,747**
Deposits	**1,14,75,023**	**1,33,50,602**	**1,55,92,174**	**1,83,76,398**	**2,15,93,846**
Borrowings	14,46,285	13,54,873	18,48,172	17,25,810	17,81,830
Other liabilities	6,73,944	7,26,022	8,44,075	10,02,936	11,59,404
Total liabilities	**1,53,05,113**	**1,74,68,705**	**2,06,85,351**	**2,38,67,231**	**2,77,33,827**
Cash/Equivalent	8,66,187	11,94,704	15,23,269	16,31,997	20,13,257
Advances	99,37,029	1,13,28,366	1,36,88,209	1,59,30,140	1,83,15,140
Investments	39,18,267	44,37,283	45,55,357	52,74,137	62,48,039
Fixed Assets	44,319	49,093	60,837	65,633	70,909
Other assets	5,39,311	4,59,259	8,57,678	9,65,324	10,86,481
Total assets	**1,53,05,113**	**1,74,68,705**	**2,06,85,351**	**2,38,67,231**	**2,77,33,827**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Key ratios

Y/E March	FY20	FY21	FY22	FY23E	FY24E
Growth (%)					
NII	16.5	15.5	11.0	19.9	17.3
Pre-provision profit	22.6	17.7	11.7	13.8	16.7
PAT	24.4	18.6	18.8	17.7	20.4
Business (%)					
Deposit growth	24.3	16.3	16.8	17.9	17.5
Advance growth	21.3	14.0	20.8	16.4	15.0
CD	86.6	84.9	87.8	86.7	84.8
CASA	42.2	46.1	48.2	48.3	48.0
Operating efficiency (%)					
Cost-to-income	38.7	36.3	36.9	38.0	37.8
Cost-to-assets	2.2	2.0	2.0	2.0	2.0
Spreads (%)					
Yield on advances	10.1	8.9	7.9	8.0	8.1
Yield on investments	6.0	5.6	5.8	6.1	6.1
Cost of deposits	4.9	4.0	3.6	3.6	3.6
Yield on assets	8.6	7.6	7.0	7.2	7.2
Cost of funds	5.0	4.1	3.5	3.5	3.5
NIMs	4.2	4.1	3.9	4.1	4.1
Capital adequacy (%)					
Tier I	17.2	17.6	17.9	17.7	17.5
Tier II	1.3	1.2	1.0	1.0	1.0
Total CAR	18.5	18.8	18.9	18.7	18.5
Asset Quality (%)					
Gross NPA	1.3	1.3	1.2	1.2	1.1
Net NPA	0.4	0.4	0.3	0.3	0.3
Provision coverage	72.0	69.8	72.7	73.2	74.1
Slippage	2.2	1.6	1.9	1.6	1.5
Credit-cost	1.3	1.5	1.2	1.0	0.9
Return (%)					
ROE	16.4	16.6	16.7	16.9	17.6
ROA	1.9	1.9	1.9	2.0	2.0
RORWA	2.7	2.9	3.0	3.0	3.1
Per share					
EPS	48	56	67	78	94
BV	312	370	433	498	577
ABV	305	361	425	489	567
Valuation					
P/E	28.9	24.5	20.8	17.6	14.7
P/BV	4.4	3.7	3.2	2.8	2.4
P/ABV	4.5	3.8	3.3	2.8	2.4

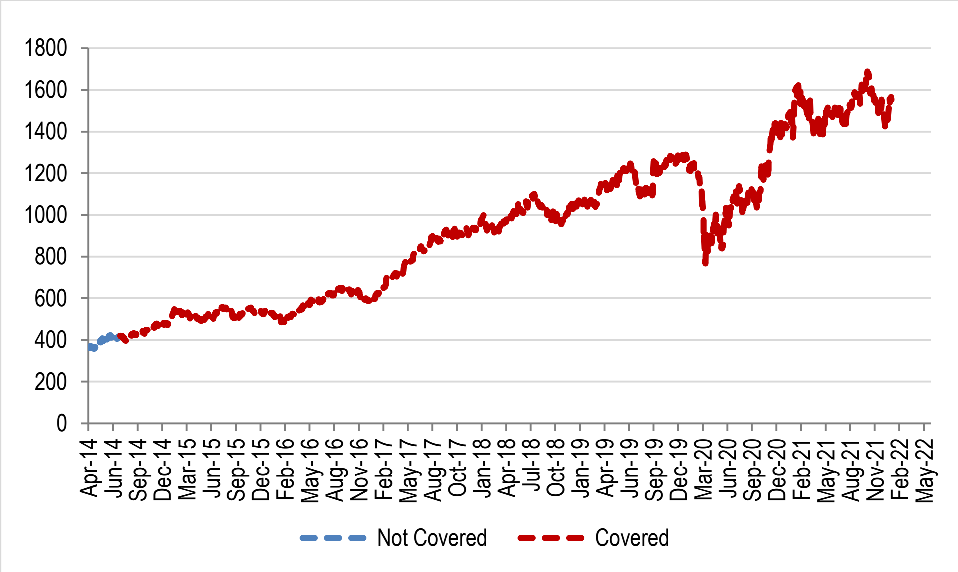
Source: Company, Nirmal Bang Institutional Equities Research

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
23 September 2020	Buy	1,038	1,494
7 October 2020	Buy	1,162	1,487
19 October 2020	Buy	1,094	1,484
26 November 2020	Accumulate	1,403	1,594
8 January 2021	Buy	1,416	1,680
18 January 2021	Buy	1,466	1,740
21 February 2021	Buy	1,545	1,832
18 April 2021	Buy	1,431	1,839
18 July 2021	Buy	1,521	1,817
26 September2021	Buy	1,602	1,954
18 October2021	Buy	1,687	1,962
16 January 2022	Buy	1,543	2,006
14 March 2022	Buy	1,430	2,151
5 April 2022	Buy	1,654	2,151
17 April 2022	Buy	1,464	2,042
01 June 2022	Buy	1,384	2,042

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

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

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SELL < -5%

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Team Details:

Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address
B-2, 301/302, Marathon Innova,
Nr. Peninsula Corporate Park,
Lower Parel (W), Mumbai-400013.
Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010