

# HDFC Bank

28 June 2021

Reuters: HDBK.BO; Bloomberg: HDFCB IN

## A covid-proof year blemished by tech glitches

FY21 was an exceptional year for HDFC Bank (HDFCB) as it crossed the milestone of Rs300bn in PAT (+19%) and >Rs11tn in loans. Over the last two decades (FY01-FY21), the bank's PAT and assets have grown at 28% and 27% CAGR, respectively. In what seemed to be a very challenging year due to the Covid-19 pandemic, especially 1HFY21 (which was marred by a nation-wide lockdown), the bank's delivery on credit growth seemed effortless. As systemic aversion to unsecured credit increased, HDFCB strategically shifted focus towards the wholesale segment (+21%). FY21 was also a year of change of guard at the bank, as founder CEO/MD Mr. Aditya Puri was replaced by Mr. Sashidhar Jagdishan. In a (pandemic) year, which shed light on the bank as the most resilient one, we also saw some blemishes in the form of tech glitches and the GPS device miss-selling. The bank has completed the technology audit and the report has been submitted to the RBI. We expect a positive outcome on this front, which should mean that the bank will be able to resume new credit card issuance. The bank's acknowledgement on some of these matters is a prominent feature of its FY21 annual report. Technology will continue to remain an integral enabler of growth and scale for the bank going forward. Apart from the retail segment, SME and business banking segments will be accorded equal focus. High growth in the MSME segment is expected to add to earnings disproportionately. We expect strong growth outlook for the bank. Credit cost (ex-contingent provisions) was 76bps (+11bps over last 10-year average). Asset quality remains best-in-class with overall GNPA at 1.32% along with 70% PCR. The bank's digital ecosystem approach towards certain segments such as Auto and Healthcare highlights its 'ahead-of-the-curve' thinking (in line with global success stories). The bank remains one of our top picks in the banks space. We expect the bank to remain an outperformer in terms of credit growth and deliver 24% CAGR in PAT over FY21-23E. We expect the bank to deliver average ROE of more than 18% over FY22-23E. We retain BUY with a target price (TP) of Rs1,839, based on 3.6x FY23E ABV.

**On growth strategy:** Increasingly, banks are moving away from being product-centric to being customer-centric. In line with the broad financialization theme, the bank intends to transform its branches into phigital financial marketplace. Besides offering plain-vanilla products, wealth management and private banking have been added as core focus areas. Further, besides having a continued focus on the corporate cluster and government business, the bank has created a new business segment of Commercial banking (MSME) and Rural banking to capture the next wave of growth. To realize its growth objectives, the bank has formulated Project Future Ready.

**Becoming more granular in retail:** The bank is a leading player in the payments ecosystem with a dominant share in the card issuance and acquisition business. To further complement its suite of retail offerings, the bank will scale up its Buy-Now-Pay-Later (BNPL) offering with multiple variants and customised solutions in partnership with large brands. Earlier in FY21, the bank also launched 'summer treats' to boost sales and send a confidence message to merchants and customers.

**Payments the pathway to MSMEs:** The bank also has strong plans to grow the Commercial and SME payment solutions business, which is seeing strong growth traction. Several curated solutions have been rolled out for the Corporate and SME segment and the plan is to grow this segment by 2x in the coming two years. In MSMEs – the largest customer segment – the bank will continue to focus on merchant acquisitions. The bank is looking to grow its current 2mn acceptance points by 10x in the next 3-5 years. This growth target will be aided through expansion into deeper geographies and partnerships with small merchants and neighborhood kirana stores. The merchant acquisition strategy will be further supported by SmartHub 3.0 – a comprehensive banking and payment solution for merchants. During FY21, the bank saw good recovery in merchant spends due to enhanced merchant sign-ups, deep customer engagements and value-added services. Faster growth in the MSME segment is expected to add disproportionately to earnings given that earnings from this segment are 2.2x that of large corporates, on every rupee lent. At the current run-rate, the bank expects the MSME book to surpass the private sector large corporate book in 12-18 months, thereby adding another/third strong pillar of earnings growth.

**Tech an integral part of Project Future Ready:** With a vision to build a technology led bank, the bank has begun architecting its tech stack for the future. The underlying core technology is being further fortified to make it resilient and scalable to handle the ever-increasing load of digital transactions. Some of the initiatives being taken as part of the technology transformation agenda are infrastructure scalability, disaster recovery, security enhancement and monitoring mechanisms.

**Proposed amendments to ESOP plans:** The bank has proposed amendments to its ESOP plan to ensure greater accountability and recognition. One part of the amendment aims at ensuring that employees being moved out of the standalone bank and transferred to a subsidiary will continue to be entitled to receive stock options. In case of termination of an employee, all unvested options shall stand forfeited. In case an employee's service is terminated on account of misconduct, all vested options shall lapse.

**Asset quality resilient:** During FY21, the bank's asset quality was one of the most resilient. Despite the enormous stress formation in the system, the internal ratings across most portfolios held up well throughout FY21. The SME portfolio's actual risk performance turned out to be far better than estimated. Gradually, we have seen cash flow and other key metrics, such as HDB ratings, self-funding ratio and retail collection trends improve across segments, resulting in low NPAs for the bank.

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## BUY

Sector: Banking

CMP: Rs1,508

Target Price:Rs1,839

Upside: 22%

**RaghavGarg, CFA**

 Research Analyst  
 raghav.garg@nirmalbang.com  
 +91-22-6273 8192

**Arjun Bagga**

 Research Associate  
 arjun.bagga@nirmalbang.com  
 +91-22-6273 8111

### Key Data

Current Shares O/S (mn)	5,524.1
Mkt Cap (Rsbn/US\$bn)	8,332.2/112.3
52 Wk H / L (Rs)	1,789/993
Daily Vol. (3M NSE Avg.)	8,931,009

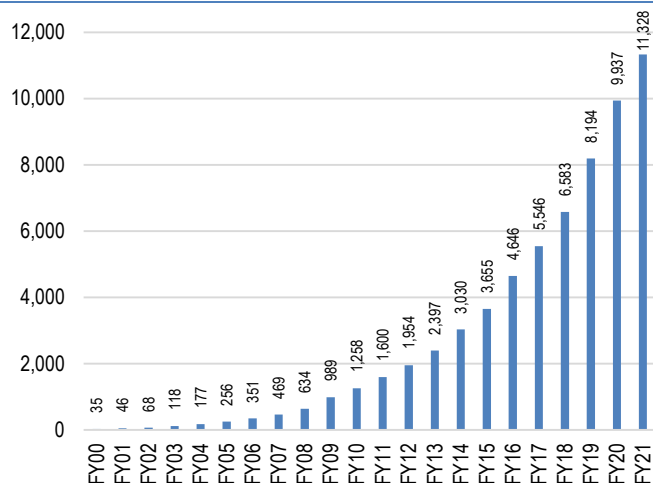
### Price Performance (%)

	1 M	6 M	1 Yr
HDFC Bank	0.3	6.8	42.8
Nifty Index	2.4	14.0	52.3

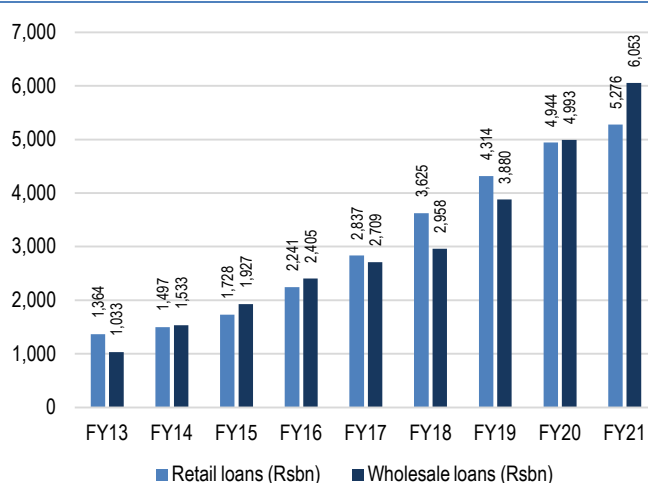
Source: Bloomberg

**Key highlights from the FY21 annual report:**

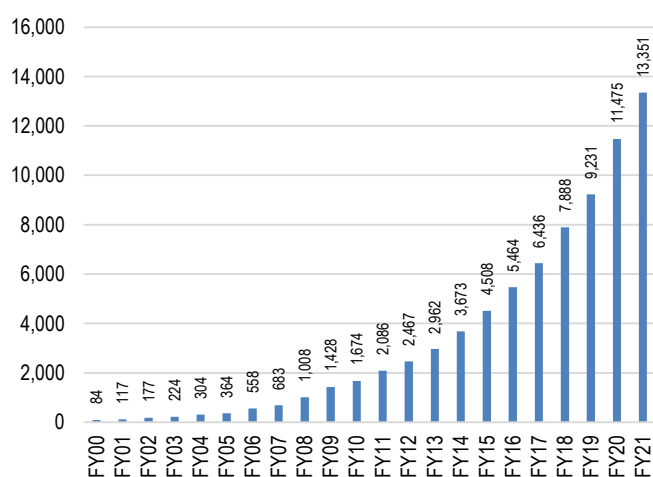
- HDFC Bank has agreed to purchase 4.99% stake in HDFC Ergo General Insurance.
- Technology audit is over and the report has been submitted to the RBI. The decision by the regulator is awaited.
- The bank has embarked on a technology transformation agenda. Initiatives being undertaken under this agenda are: infra scalability, disaster recovery, security enhancement and monitoring mechanisms.
- In terms of growth strategy, the bank will continue to focus on improving its corporate market share and government business. Simultaneously, it will focus on the MSME and business banking segment. The bank has also added wealth management and private banking as core focus areas.
- The bank's corporate banking portfolio grew by 23% to Rs2.98tn. The bank's emerging corporate segment also witnessed significant growth during FY21.
- The bank is aiming to grow the SME segment by 2x in the coming two years.
- The bank has outlined 10 growth engines under Project Future Ready.
- As part of its retail strategy, the bank will scale up BNPL and will launch several new variants of this product in partnership with large brands during FY22.
- In the merchant business, the bank has 47% market share. MSME being a large customer segment will remain a key focus area. To support its merchant acquisition and MSME growth strategy, the bank has launched a merchant focused-app called SmartHub 3.0. This app will be further developed into a superapp ecosystem.
- Merchant acquisition will be supported by penetration into deeper geographies and focus will be on acquiring small merchant and kirana stores. Earlier, the merchant acquisition focus was dominated by large merchants in top 30 cities.
- MSME/trader book stood at Rs2tn.
- The bank wants to grow its merchant acceptance points of 2mn currently by 10x in the next 3-5 years.
- ECLGS disbursements during the year were Rs296.22bn.
- The bank has entered into strategic alliances with healthcare providers such as Apollo. This will be further developed under the bank's ecosystem approach.
- Personal loans category has been surging back to pre-covid levels. About 80% of incremental loans were to employees of top-rated Indian companies.
- Manpower in non-life sales has been increased.
- Fee from life insurance distribution grew 26% to Rs27.5bn, accounting for 17% of total fee income. Fee from non-life distribution grew 47% to Rs4bn, accounting for 2% of total fee income.
- Share of 20 largest deposits is stable at 4% of total deposits.
- Security receipts outstanding increased from Rs4.4bn in FY20 to Rs19.9bn in FY21. During 2HFY21, the bank undertook the sale of some stress retail assets. Out of total such sales, Rs10bn were in 4QFY21.
- Cost of deposits for the year was 4.04% compared to 4.91% in FY20.
- The number of merchant acceptance points increased from ~1.8mn in FY20 to 2.1mn in FY21 (FY16-21 CAGR: 38%).
- The share of digital transactions in total retail transactions increased marginally to 95.7%.
- Retail deposits grew by 21% Rs10.6tn. Wholesale deposits growth was flat.
- Retail segment accounted for 65% of the total provisioning for the year (5-year high).

**Exhibit 1: Advances (Rsbn) – FY01-21 CAGR: 32%**


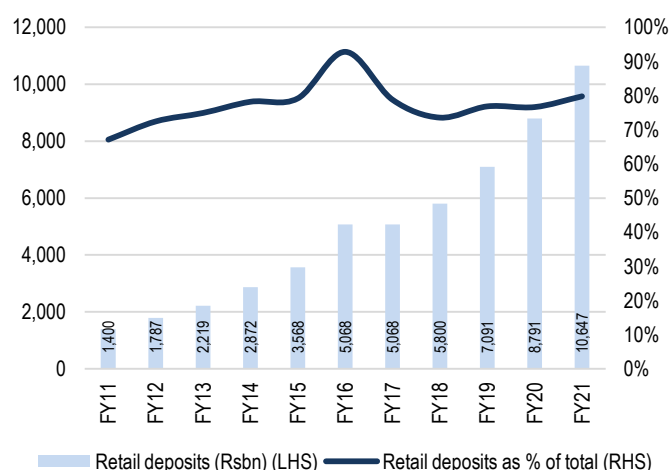
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 2: Advances mix (Rsbn)**


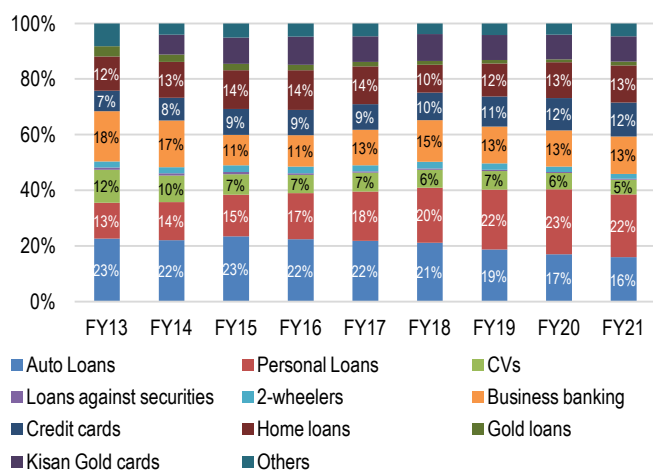
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 3: Deposits (Rsbn)**


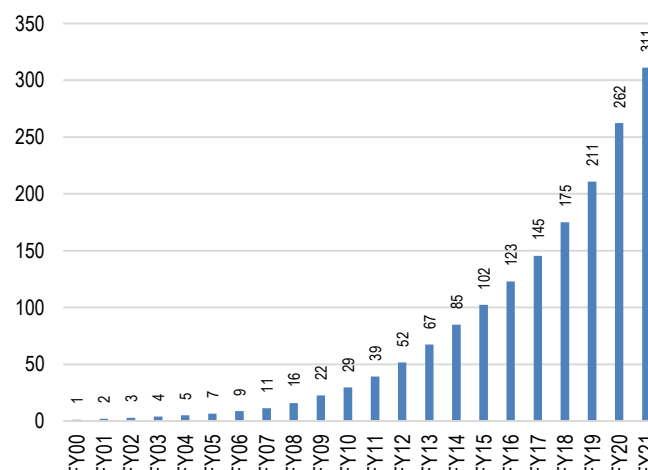
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: Retail deposits**


Source: Company, Nirmal Bang Institutional Equities Research

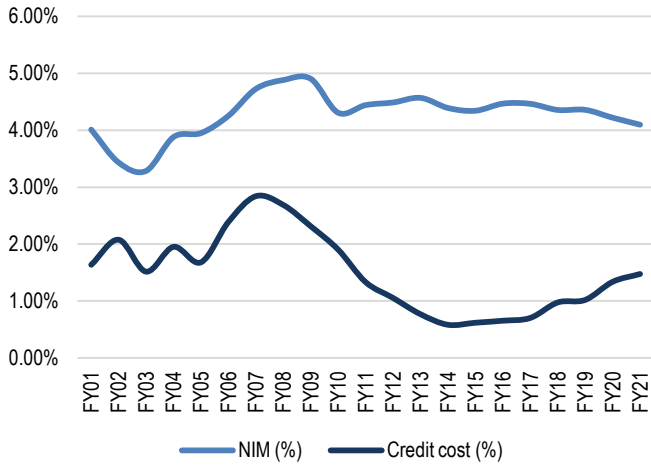
**Exhibit 5: Retail loan book mix (%)**


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: PAT (Rsbn)**


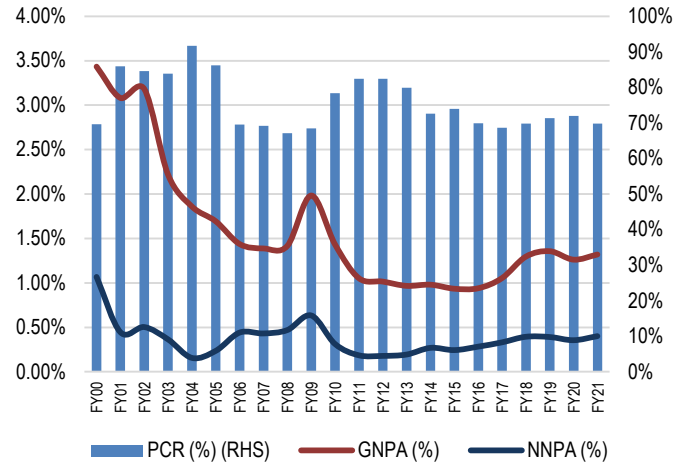
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: NIMs and credit cost (%)**



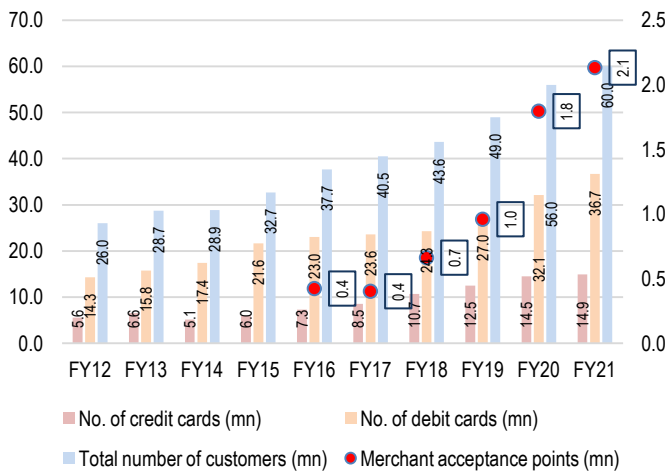
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 8: Asset quality metrics**



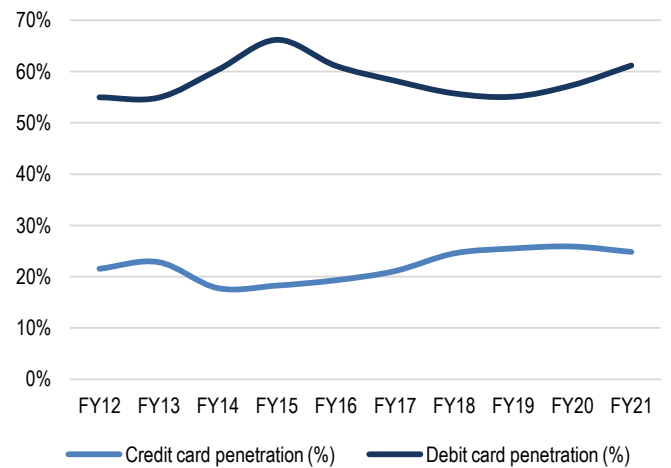
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 9: Key data on retail business**



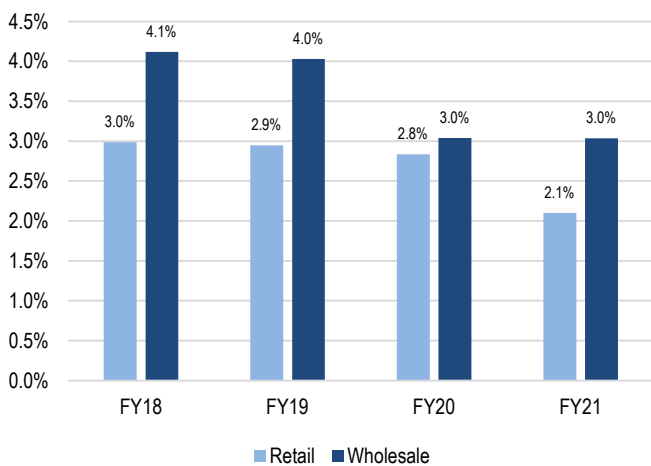
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 10: Card penetration among existing customers**



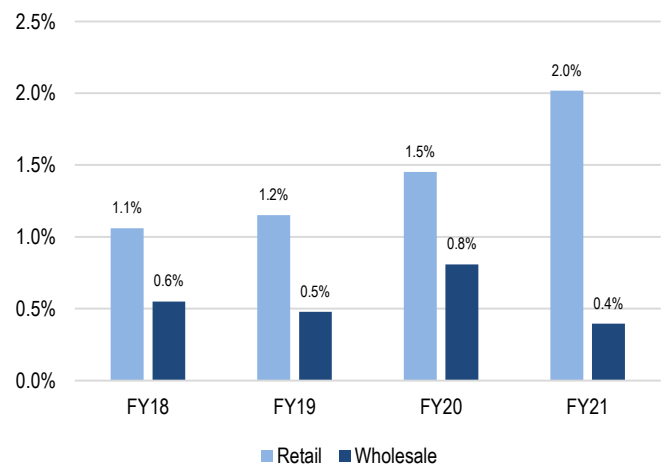
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 11: Segment wise profitability**



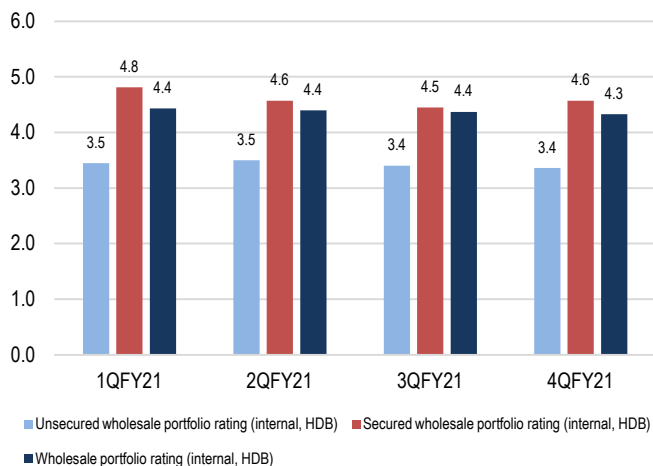
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 12: Segment wise credit cost**

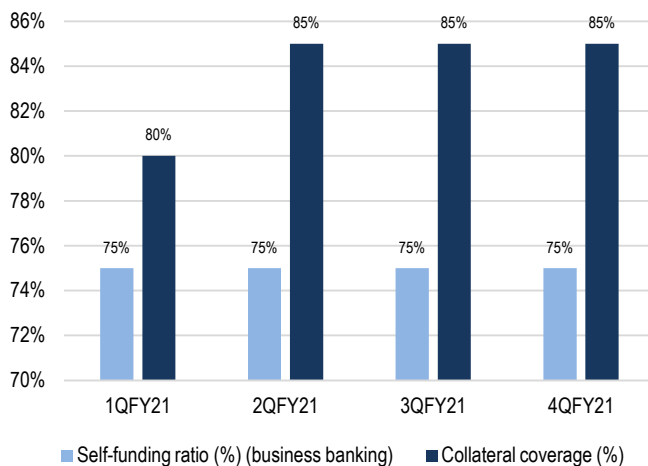


Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 13: Wholesale portfolio ratings**



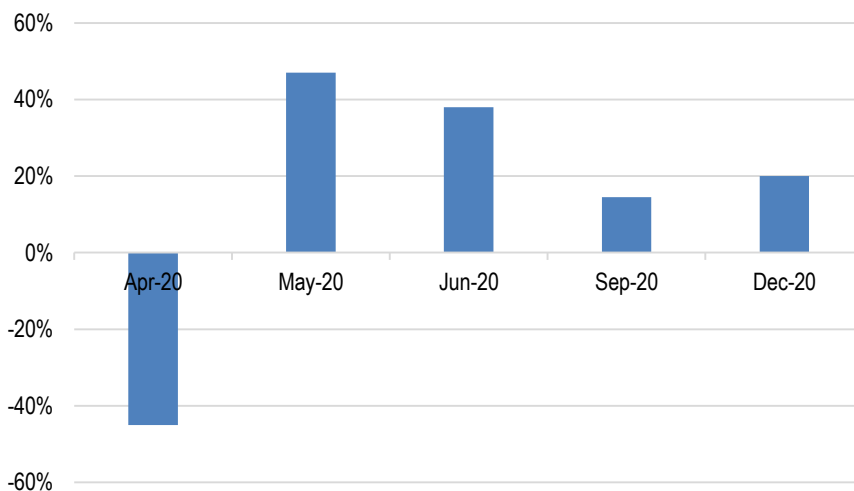
**Exhibit 14: SME/business banking portfolio credit quality**



Source: Company, Nirmal Bang Institutional Equities Research

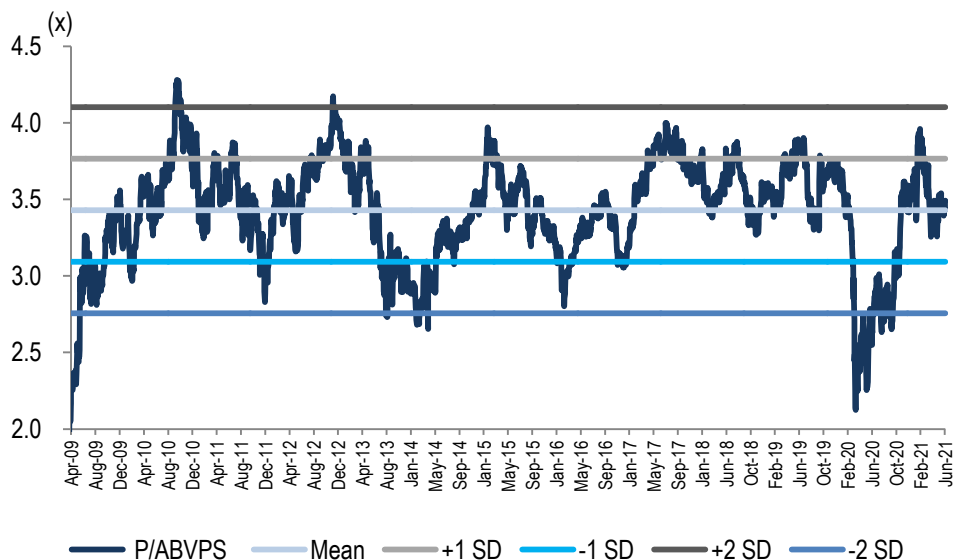
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 15: Growth in large corporate collections**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 16: One-year forward P/ABV**



Source: Company, Nirmal Bang Institutional Equities Research

**Financial statements**
**Exhibit 17: Income statement**

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	9,89,721	11,48,127	12,08,582	14,06,879	16,52,340
Interest expense	5,07,288	5,86,264	5,59,787	6,37,138	7,40,963
<b>Net interest income</b>	<b>4,82,432</b>	<b>5,61,863</b>	<b>6,48,796</b>	<b>7,69,741</b>	<b>9,11,377</b>
Non-interest income	1,76,259	2,32,350	2,52,049	2,97,418	3,42,030
Net Revenue	6,58,691	7,94,213	9,00,845	10,67,158	12,53,407
Operating Expense	2,61,194	3,06,975	3,27,226	3,83,018	4,48,385
-Employee Exp	77,618	95,257	1,03,648	1,19,195	1,37,074
-Other Exp	1,83,576	2,11,719	2,23,578	2,63,822	3,11,311
<b>Operating profit</b>	<b>3,97,497</b>	<b>4,87,238</b>	<b>5,73,618</b>	<b>6,84,141</b>	<b>8,05,022</b>
Provisions	75,501	1,21,424	1,57,029	1,58,788	1,65,492
PBT	3,21,997	3,65,814	4,16,590	5,25,353	6,39,531
Taxes	1,11,215	1,03,498	1,05,425	1,32,231	1,60,970
<b>PAT</b>	<b>2,10,782</b>	<b>2,62,315</b>	<b>3,11,165</b>	<b>3,93,122</b>	<b>4,78,561</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 19: Balance sheet**

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	5,447	5,483	5,513	5,513	5,513
Reserves & Surplus	14,86,617	17,04,377	20,31,696	23,46,193	27,29,042
<b>Shareholder's Funds</b>	<b>14,92,064</b>	<b>17,09,860</b>	<b>20,37,208</b>	<b>23,51,706</b>	<b>27,34,555</b>
<b>Deposits</b>	<b>92,31,409</b>	<b>1,14,75,023</b>	<b>1,33,50,602</b>	<b>1,57,24,688</b>	<b>1,85,40,364</b>
Borrowings	11,70,851	14,46,285	13,54,873	15,31,007	17,14,728
Other liabilities	5,51,083	6,73,944	7,26,022	9,39,110	8,89,910
<b>Total liabilities</b>	<b>1,24,45,407</b>	<b>1,53,05,113</b>	<b>1,74,68,705</b>	<b>2,05,46,511</b>	<b>2,38,79,556</b>
Cash/Equivalent	8,13,476	8,66,187	11,94,704	13,80,456	16,20,407
Advances	81,94,012	99,37,029	1,13,28,366	1,34,17,721	1,55,25,723
Investments	29,05,879	39,18,267	44,37,283	51,89,147	61,18,320
Fixed Assets	40,300	44,319	49,093	54,002	59,403
Other assets	4,91,740	5,39,311	4,59,259	5,05,185	5,55,703
<b>Total assets</b>	<b>1,24,45,407</b>	<b>1,53,05,113</b>	<b>1,74,68,705</b>	<b>2,05,46,511</b>	<b>2,38,79,556</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 18: Key ratios**

Y/E March	FY19	FY20	FY21	FY22E	FY23E
<b>Growth (%)</b>					
NII growth	20.3	16.5	15.5	18.6	18.4
Pre-provision profit growth	21.8	22.6	17.7	19.3	17.7
PAT growth	20.5	24.4	18.6	26.3	21.7
<b>Business (%)</b>					
Deposit growth	17.0	24.3	16.3	17.8	17.9
Advance growth	24.5	21.3	14.0	18.4	15.7
CD	88.8	86.6	84.9	85.3	83.7
CASA	42.4	42.2	46.1	47.4	47.3
<b>Operating efficiency (%)</b>					
Cost-to-income	39.7	38.7	36.3	35.9	35.8
Cost-to-assets	2.3	2.2	2.0	2.0	2.0
<b>Spreads (%)</b>					
Yield on advances	10.5	10.1	8.9	9.0	9.0
Yield on investments	7.5	6.0	5.6	5.5	5.6
Cost of deposits	4.8	4.9	4.0	4.0	3.9
Yield on assets	8.9	8.6	7.6	7.6	7.6
Cost of funds	5.2	5.0	4.1	4.0	4.0
NIMs	4.4	4.2	4.1	4.2	4.2
<b>Capital adequacy (%)</b>					
Tier I	15.8	17.2	17.6	17.1	16.6
Tier II	1.3	1.3	1.2	1.2	1.2
Total CAR	17.1	18.5	18.8	18.3	17.8
<b>Asset Quality (%)</b>					
Gross NPA	1.4	1.3	1.3	1.3	1.2
Net NPA	0.4	0.4	0.4	0.4	0.4
Provision coverage	71.4	72.0	69.8	71.2	69.7
Slippage	2.2	2.2	1.6	1.6	1.5
Credit-cost	1.0	1.3	1.5	1.3	1.1
<b>Return (%)</b>					
ROE	16.5	16.4	16.6	17.9	18.8
ROA	1.8	1.9	1.9	2.1	2.2
RORWA	2.4	2.7	2.9	3.1	3.2
<b>Per share</b>					
EPS	39	48	56	71	87
BV	274	312	370	427	496
ABV	268	305	361	417	486
<b>Valuation</b>					
P/E	39.0	31.5	26.7	21.1	17.4
P/BV	5.5	4.8	4.1	3.5	3.0
P/ABV	5.6	4.9	4.2	3.6	3.1

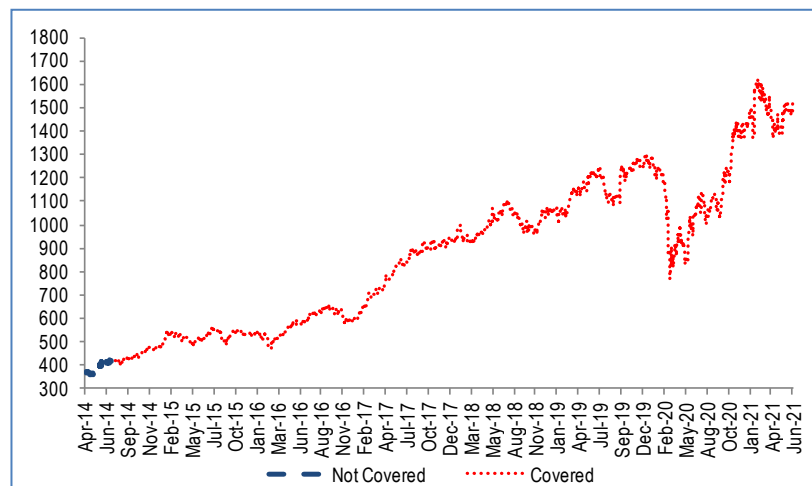
Source: Company, Nirmal Bang Institutional Equities Research

## 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
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
19 April 2021	Buy	1,431	1,839
28 June 2021	Buy	1,508	1,839

\*Stock split 2 for 1 on 19 September 2019

## Rating track graph





## DISCLOSURES

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### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
GirishPai	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