

HDFC Bank

25 July 2017

Reuters: HDBK.BO; Bloomberg: HDFCB IN

Higher Fee Income Offsets Higher Provisioning

HDFC Bank's net interest income or NII grew 20% in 1QFY18 driven by credit growth of 23%. Net interest margin or NIM expanded 10bps sequentially, but it was flattish on YoY basis at 4.4%. Retail loans grew 25% and constituted 66% of overall loan book, whereas the corporate loan segment grew 21%. Non-interest income grew at a healthy rate of 25% with fee income up 30%. Treasury profits were decent at Rs3.3bn against Rs2.8bn a year ago. Provisioning optically witnessed a spike of 80% at Rs15.6bn, which can be attributed to additional standard asset provisioning to stressed sectors of Rs1.2bn and higher specific provision for its delinquency in the agriculture segment. Asset quality witnessed slight increase with gross non-performing assets or GNPA's increasing 19bps sequentially to 1.2% and slippage of 2.2% (60% of slippage relates to the agriculture segment on the back of the announced agriculture loan waivers). Backed by healthy provisioning, the provision coverage ratio was healthy at 65%. We have increased our ABV estimate by 1% for FY19. We have retained Buy rating on the stock with a target price of Rs2,025, valuing it at 4.4x P/ABV FY19E financials (30% premium to mean).

Healthy business momentum: Deposits and advances grew 17%/23%, respectively, YoY. CASA deposit ratio improved 410bps YoY to 44%, though it fell 400bps sequentially as the previous quarter includes certain one-offs. As per internal classification, the retail segment grew 25% while the adjusted corporate segment grew 20%. The retail segment accounted for 66% of the loan book.

Valuation and outlook: HDFC Bank delivered another stable performance, with its numbers largely in line with our expectations. GNPA's were around 1% consecutively for each of the past seven years, whereas restructured loans were miniscule. No exposure to the accounts mentioned in the Reserve Bank of India's review last year and also no divergence at the recent review does reinforce our confidence on its asset quality being of the highest standard. Its CASA deposit franchise is strongest compared to peers. We are structurally positive on HDFC Bank considering its healthy asset quality, superior deposit franchise and credit underwriting, structurally better NIM and the ability to maintain RoA at ~2.0% and RoRWA at ~2.5% in the long run.

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BUY

Sector: Banking

CMP: Rs1,707

Target Price: Rs2,025

Upside: 19%

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Key Data

Current Shares O/S (mn)	2,573.9
Mkt Cap (Rsbn/US\$bn)	4,465.9/69.4
52 Wk H / L (Rs)	1,748/1,158
Daily Vol. (3M NSE Avg.)	1,378,100

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Bank	3.4	36.9	41.0
Nifty Index	4.1	17.6	16.7

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)
Interest income	186,687	165,160	181,144	13.0	3.1
Interest expenses	92,980	87,346	90,593	6.5	2.6
Net interest income	93,707	77,814	90,551	20.4	3.5
NIM (%)	4.4	4.4	4.3	-	10 bps
Non-interest income	35,167	28,066	34,463	25.3	2.0
Operating income	128,874	105,880	125,014	21.7	3.1
Staff costs	16,575	15,851	15,527	4.6	6.7
Other operating expenses	37,100	31,837	36,693	16.5	1.1
Total operating expenses	53,675	47,688	52,220	12.6	2.8
Cost-to-income (%)	41.6	45.0	41.8	(339bps)	(12bps)
Operating profit	75,199	58,192	72,794	29.2	3.3
Provisions	15,588	8,667	12,618	79.9	23.5
PBT	59,611	49,525	60,176	20.4	(0.9)
Tax	20,673	17,136	20,275	20.6	2.0
-effective tax rate	34.7	34.6	33.7	8bps	99bps
PAT	38,938	32,389	39,901	20.2	(2.4)
EPS (Rs)	15.1	12.8	15.6	18.4	(2.8)
BV (Rs)	366.2	301.2	349.1	21.6	4.9
Deposits	6,713,761	5,737,545	6,436,396	17.0	4.3
Advances	5,809,758	4,706,225	5,545,682	23.4	4.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Net interest income	223,957	275,915	331,390	399,890	476,568
Pre-provision profit	174,046	213,635	257,321	316,768	377,086
PAT	102,159	122,962	145,486	174,702	209,359
EPS (Rs)	40.8	48.6	56.8	68.2	81.7
ABV (Rs)	249.9	287.6	346.5	395.9	460.2
P/E (x)	41.9	35.1	30.1	25.0	20.9
P/ABV (x)	6.8	5.9	4.9	4.3	3.7
GNPAs (%)	0.9	0.9	1.1	1.4	1.7
NNPAs (%)	0.2	0.3	0.3	0.4	0.4
RoA (%)	1.9	1.9	1.8	1.9	1.9
RoE (%)	19.4	18.3	17.9	18.1	18.7

Source: Company, Nirmal Bang Institutional Equities Research

Healthy growth in non-interest income

Non-interest income grew at a healthy rate of 25% with fee income up 30%. Treasury profits were decent at Rs3.3bn against Rs2.8bn a year ago. Forex income dipped 6% on YoY basis.

Slight increase in GNPAs

Asset quality witnessed a slight increase with GNPAs increasing 19bps sequentially to 1.2% (60% of the increase relates to the agriculture segment on the back of announced agriculture loan waivers). Backed by healthy provisioning, provision coverage ratio was healthy at 65%. Provisioning optically witnessed a spike of 80% to Rs15.6bn, which can be attributed to additional standard asset provisioning to stressed sectors of Rs1.2bn and higher specific provision for its delinquency in the agriculture segment.

NIM to remain in the range of 4.0%-4.4%

NIM expanded 10bps sequentially, but it was flattish on YoY basis at 4.4%. The management highlighted that NIM will remain in the range of 4.0%-4.4% and there is no basis to believe that it will move out of the indicated range in either direction.

Moderate growth in operating expenses

Operating expenses grew 13% YoY, with employee expenses up 5% and other opex rising 17%. Cost-to-income ratio improved 339bps YoY to 41.6%. The management expects operational productivity to improve and foresees a pick-up in its digital strategy.

Exhibit 2: Actual performance versus our estimates

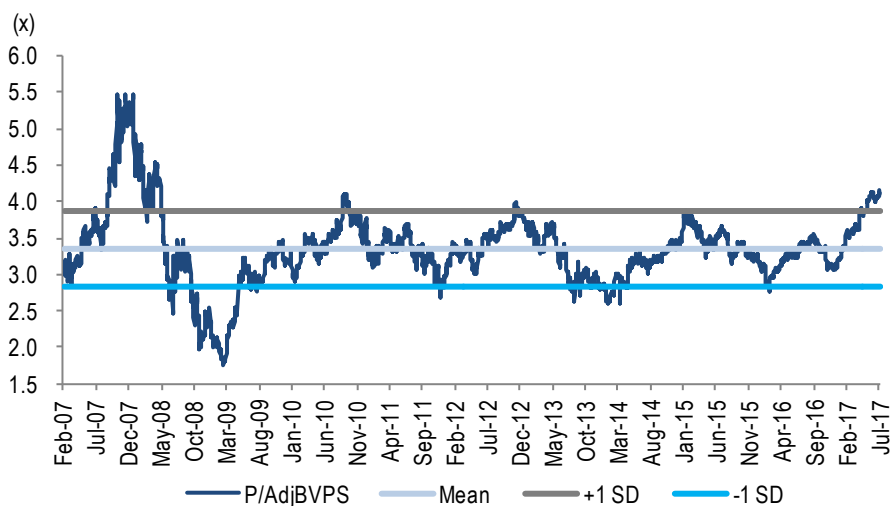
(Rsmn)	1QFY18	1QFY17	4QFY17	YoY (%)	QoQ (%)	1QFY18E	Devi. (%)
Net interest income	93,707	77,814	90,551	20.4	3.5	93,398	0.3
Pre-provision profit	75,199	58,192	72,794	29.2	3.3	69,073	8.9
PAT	38,938	32,389	39,901	20.2	(2.4)	38,560	1.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate		Earlier estimate		% Revision	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net interest income (Rsmn)	399,890	476,568	399,890	476,568	-	-
NIM (%)	4.7	4.7	4.7	4.7	-	-
Operating profit (Rsmn)	305,562	365,992	296,657	355,461	3.0	3.0
Profit after tax (Rsmn)	174,702	209,359	174,113	207,255	0.3	1.0
EPS (Rs)	68.2	81.7	67.9	80.9	0.3	1.0
ABV (Rs)	395.9	460.2	394.4	455.0	0.4	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/ABV


Source: Company, Nirmal Bang Institutional Equities Research

Conference-call summary

- Growth in fee income witnessed some traction because of certain one offs, like fees from oil marketing companies (~5% of the total increase), strong distribution of mutual funds, especially on the equity side, credit card fees and commissions.
- Business banking segment has not witnessed any significant impact because of implementation of Goods and Services Tax or GST as the demand is constant and fairly stable.
- Staffing costs in 1QFY18 were flattish, but employee costs were not up significantly. There were reductions in the past two quarters. However, wage hikes should drive costs upwards in the next quarter.
- Loan slippage stood at Rs31bn, recoveries at Rs17.5bn, upgrades at Rs4.9bn and write-offs at Rs7.37bn.
- The foreign loan portfolio was Rs200bn versus Rs130bn in 1QFY17.
- The home loan portfolio witnessed an increase of 15.4%, of which Rs2.5bn was because of the purchase of loans (originated by the bank) from HDFC.
- 60% of total loan slippage was on account of agricultural loan portfolio. The bank has provided ~50% against agricultural loans. This can be attributed to uncertainty because of the effects of demonetisation as well as change in farmer behaviour in anticipation of loan waivers being announced by respective state governments.
- As the full details of the loan waivers are not yet available, the bank has chosen to make higher provisioning, Farmers are anticipating that they will get loan waivers and are opting not to pay until their eligibility for the same is determined. However, loan waiver will only be a part of the outstanding loan, and the farmer will have to pay the remaining portion of the loan.
- Contribution of agricultural loan NPLs to GNPA is ~5%.
- Fixed-deposit growth has picked up and margins declined slightly.
- As regards corporate loan book, the demand is mainly for meeting working capital requirement and very little capital expenditure is witnessed. Bond substitutions have also driven down corporate lending.
- Exchange gains have increased mainly because of the trading of interest rate swaps for funding the Indian rupee or INR balance sheet. This also dragged the cost of funding down.
- The bank has also issued AT-I bonds during the quarter and its CET-I capital stands at 12.44%. The bank is not looking to raise any additional capital for the time being.
- Provision for exposure to sensitive sectors has increased.
- The bank does not have any significant exposure to the 12 companies identified by NCLT. The bank had exposure to only one account and has provided fully against it.

Financial statements

Exhibit 5: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Interest income	484,699	602,214	693,058	804,560	938,107
Interest expenses	260,742	326,299	361,668	404,670	461,539
Net interest income	223,957	275,915	331,390	399,890	476,568
Fee income	65,842	77,590	88,117	103,978	124,774
Other income	18,194	22,610	23,453	25,144	28,848
Net revenues	307,993	376,115	442,960	529,012	630,190
Operating expenses	139,875	169,797	197,033	223,450	264,197
-Employee expenses	47,510	57,022	64,836	71,423	81,765
-Other expenses	92,365	112,775	132,197	152,027	182,432
Operating profit	168,118	206,318	245,927	305,562	365,992
Investment profit	5,928	7,317	11,394	11,206	11,093
Pre-provision profit	174,046	213,635	257,321	316,768	377,086
Provisions	20,759	27,256	35,941	53,663	61,786
-Loan loss provision	20,199	25,736	35,941	53,663	61,786
-Investment depreciation	-38	152	-	-	-
-Other provisions	598	1,368	-	-	-
PBT	153,287	186,379	221,380	263,105	315,300
Tax	51,128	63,417	75,894	88,403	105,941
PAT	102,159	122,962	145,486	174,702	209,359

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Equity capital	5,013	5,056	5,125	5,125	5,125
Reserves & surplus	615,081	721,723	890,934	1,028,161	1,200,045
Shareholders' funds	620,094	726,779	896,059	1,033,286	1,205,170
Deposits	4,507,956	5,464,242	6,436,396	7,723,675	9,422,884
-Current deposits	735,654	884,247	1,155,740	1,348,832	1,603,713
-Saving deposits	1,249,266	1,478,862	1,935,790	2,386,338	2,981,061
-Term deposit	2,523,036	3,101,133	3,344,866	3,988,506	4,838,110
Borrowings	452,136	530,185	740,289	741,576	743,275
-Subordinate debt	156,299	144,279	222,087	222,730	223,580
Other liabilities	324,845	367,251	567,093	631,183	721,858
Total liabilities	5,905,031	7,088,457	8,639,837	10,129,720	12,093,188
Cash/cash equivalent	363,315	389,189	489,521	627,416	816,028
Advances	3,654,950	4,645,940	5,545,682	6,639,869	8,084,197
Investments	1,664,599	1,638,858	2,144,633	2,337,725	2,592,606
Fixed assets	31,217	33,432	36,268	39,068	41,868
Other assets	190,950	381,038	422,298	485,643	558,489
Total assets	5,905,031	7,088,457	8,638,402	10,129,720	12,093,188

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

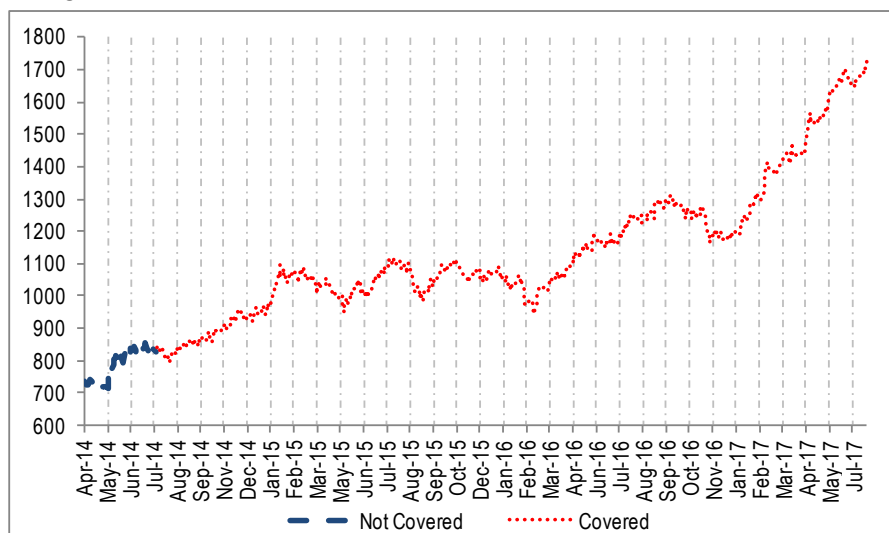
Y/E March	FY15	FY16	FY17	FY18E	FY19E
Growth (%)					
NII growth	21.2	23.2	20.1	20.7	19.2
Pre-provision profit growth	21.2	22.7	20.4	23.1	19.0
PAT growth	20.5	20.4	18.3	20.1	19.8
Business (%)					
Deposit growth	22.7	21.2	17.8	20.0	22.0
Advances' growth	20.6	27.1	19.4	19.7	21.8
Business growth	21.8	23.9	18.5	19.9	21.9
Credit deposit	81.1	85.0	86.2	86.0	85.8
CASA deposit	44.0	43.2	48.0	48.4	48.7
Operating efficiency (%)					
Cost-to-income	45.4	45.1	44.5	42.2	41.9
Cost-to-assets	2.8	2.9	2.8	2.6	2.6
Productivity (Rsmn)					
Business per branch	2,033.6	2,236.8	2,541.3	2,808.1	3,174.4
Business per employee	107.4	115.5	142.1	167.0	192.0
Profit per branch	25.5	27.2	30.9	34.2	38.0
Profit per employee	1.3	1.4	1.7	2.0	2.3
Spread (%)					
Yield on advances	11.1	10.8	10.2	9.9	9.7
Yield on investments	7.4	8.5	8.4	8.4	8.4
Cost of deposits	5.7	5.9	5.5	5.2	5.0
Yield on assets	9.8	10.1	9.7	9.4	9.3
Cost of funds	5.3	5.6	5.1	4.8	4.6
NIM	4.5	4.6	4.6	4.7	4.7
Capital adequacy (%)					
Tier I	13.7	13.2	12.8	12.5	12.2
Tier II	3.1	2.3	1.8	1.5	1.3
Total CAR	16.8	15.5	14.6	14.0	13.5
Asset quality (%)					
Gross NPAs	0.9	0.9	1.1	1.4	1.7
Net NPAs	0.2	0.3	0.3	0.4	0.4
Provision coverage	73.9	69.9	68.7	72.8	77.9
Slippage	1.4	1.4	1.4	1.6	1.5
Credit costs	0.6	0.6	0.7	0.8	0.8
Return (%)					
RoE	19.4	18.3	17.9	18.1	18.7
RoA	1.9	1.9	1.8	1.9	1.9
RoRWA	2.7	2.6	2.5	2.5	2.5
Per share					
EPS	40.8	48.6	56.8	68.2	81.7
BV	247.4	287.5	349.7	403.2	470.3
ABV	249.9	287.6	346.5	395.9	460.2
Valuation					
P/E	41.9	35.1	30.1	25.0	20.9
P/BV	6.9	5.9	4.9	4.2	3.6
P/ABV	6.8	5.9	4.9	4.3	3.7

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

Rating Track Graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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