INSTITUTIONAL EQUITY RESEARCH

HDFC Bank (HDFCB IN)

Strong growth in business

INDIA | BANKING | Quarterly Update

21 July 2015

HDFC Bank reported PAT of Rs 26.9bn, in line with our estimates of Rs 27bn. It surprised positively on loan growth and fee income. Businesses saw momentum, driven by retail assets and traction in term deposits (accretion in term deposits in the wholesale segment in anticipation of a decline in deposit rate). Operating cost remained elevated as the bank added capacity in urban areas. Anticipating an improvement in business, the bank seems to have been adding capacity in terms of branches as well as manpower, which might keep the cost-to-income ratio under pressure in the short term. Improvement in the bank's credit growth (gained market share as it outpaced sluggish industry growth with a huge margin) has translated into a pick up in core fee income.

- **NII growth seeing traction:** NII growth improved 24% yoy (+6% qoq) to Rs 64bn, primarily due to strong loan growth (22% yoy) and stable NIM at 4.34%. NIM declined marginally (yoy and qoq) due to strong growth in term deposits, dragging the credit-deposit ratio down to 79% vs. 84% last year. The management has guided at NIMs of 4.1-4.5% for FY16. We believe that factors such as cut in base rate and competitive pressure on some of its retail loan products will put NIMs under pressure.

- **Advances growth driven by retail loans:** Advances grew 22% yoy driven by strong expansion in the retail loan book, which increased by 26% yoy, while wholesale loans grew 17%. The primary drivers of retail loans were auto (25% yoy), personal (34%), home (37%), credit cards (27%) and kisan credit card (51%). Retail loans form 49% of its overall loan book.

- **Non-interest income showing signs of improvement:** Non-interest income increased by 33% yoy led by strong growth in core fee income (+28% yoy to Rs 23bn) particularly the distribution-fee income. Forex income reported a strong growth of 55% yoy due to large chunky flows from corporate customers. Treasury operations reported a gain of Rs 1.2bn against modest Rs 250mn in Q1FY15.

- **Operating expenses rising:** Operating costs increased 26% yoy to Rs 40bn led by 21% growth in employee expenses and 29% growth in other opex. Higher growth in other expenses is because of: (1) large branch additions in metro and urban centres (317) in the last year and (2) higher commission expenses due to strong retail loan growth. The cost-to-income ratio was 46% compared to 45.4% in Q1FY15.

- **Stable asset quality:** Slippage in Q1FY16 was Rs 13.9bn vs. Rs 17.2bn in Q4FY15. Slippages were largely from agri and SME segments. Outstanding floating provision increased marginally to Rs 15.58bn. The provision-coverage ratio, including floating provision, declined to 115% from 118%. Gross NPA ratio increased 2bps qoq to 0.95%, while net NPA ratio also increased 2bps qoq to 0.27%. The outstanding restructured book stood at 0.1% of advances.

Outlook and valuation

We expect earnings momentum to continue followed by improvement in RoA, which we expect to improve to 2% by FY17. We believe the bank will deliver a loan book growth of ~20% over FY15-17. NIMs are likely to remain slightly under pressure due to cut in lending rates, but we expect fee income growth to gain traction. Going forward, balance sheet growth will drive operating profit. At the CMP, the stock trades at 3.4x FY17E ABVPS of Rs 324 vs. 10-year median valuation of 3.5x. Given better earnings visibility and superior asset quality (compared to peers that are reeling under asset-quality pressure), we maintain Buy with a PT of Rs 1225 (3.75x FY17 ABVPS) vs. Rs 1,135 earlier.

BUY (Maintain)

CMP RS 1098

TARGET RS 1225 (+12%)

COMPANY DATA

O/S SHARES (MN) :	2511
MARKET CAP (RSBN) :	2802
MARKET CAP (USDBN) :	66.2
52 - WK HI/LO (RS) :	1122 / 791
LIQUIDITY 3M (USDMN) :	41.5
PAR VALUE (RS) :	2

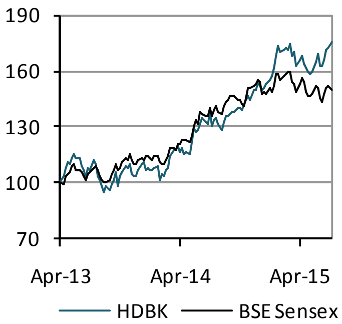
SHARE HOLDING PATTERN, %

PROMOTERS :	21.7
FII / NRI :	51.5
FI / MF :	9.7
NON PROMOTER CORP. HOLDINGS :	2.2
PUBLIC & OTHERS :	15.0

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	8.2	11.0	34.0
REL TO BSE	4.2	9.0	23.1

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY15	FY16E	FY17E
Pre-prov ROE (%)	33.0	30.9	32.0
Pre-prov ROA (%)	3.3	3.3	3.3
Net Profit	1,02,159	1,22,544	1,47,806
% growth	20.5	20.0	20.6
EPS (Rs)	40.8	48.9	59.0
Adj BVPS (Rs)	244.9	281.2	326.1
ROE (%)	19.4	18.4	19.2
P/E (x)	26.9	22.5	18.6
Adj P/BV (x)	4.5	3.9	3.4

Source: PhillipCapital India Research Est.

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Result update

(Rs mn)	Q1FY16	Q1FY15	YoY growth	Q4FY15	QoQ growth
Interest Earned	140,411	112,201	25.1	130,064	8.0
Interest Expended	76,523	60,485	26.5	69,932	9.4
Net interest income	63,888	51,716	23.5	60,132	6.2
Net interest margins	4.3	4.4	-0.1	4.4	-0.1
Non interest income	24,619	18,506	33.0	25,638	-4.0
Total Income	88,507	70,222	26.0	85,769	3.2
Total operating expenses	40,008	31,784	25.9	38,550	3.8
Payroll costs	13,590	11,259	20.7	13,256	2.5
Others	26,418	20,525	28.7	25,294	4.4
Pre-provision Profit	48,499	38,438	26.2	47,220	2.7
Provisions & Contingencies	7280	4828	50.8	5767	26.2
% Operating income	15.0	12.6	2.5	12.2	2.8
PBT	41,219	33,610	22.6	41,453	-0.6
Provision for Taxes	14,262	11,280	26.4	13,384	6.6
% of PBT	34.6	33.6	1.0	32.3	2.3
Net Profit	26,957	22,330	20.7	28,069	-4.0
Equity	5,013	4,815	4.1	5,013	0.0
EPS, Rs	10.7	9.3	15.7	11.2	-4.2
Advances	3,820,104	3,121,090	22.4	3,654,950	4.5
Deposits	4,841,744	3,720,740	30.1	4,507,960	7.4
Advances / Deposits (%)	78.9	83.9	-5.0	81.1	-2.7
Gross NPAs	36522	33562	8.8	34384	6.2
Gross NPAs (%)	0.95	1.10	-0.2	0.90	0.0
Net NPAs	10277	10074	2.0	8963	14.7
Net NPAs (%)	0.27	0.30	0.0	0.20	0.1
CAR – Total	12.8	11.1	1.7	13.7	-0.9

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15	FY16e	FY17e
Interest on Loans	3,16,869	3,71,808	4,37,804	5,27,554
Interest on Investments	90,368	1,07,056	1,23,114	1,41,582
Others	4,118	5,835	6,127	6,433
Total Interest Earned	4,11,355	4,84,699	5,67,045	6,75,568
Total Interest Expended	2,26,529	2,60,742	3,03,207	3,60,968
Net Interest Income	**1,84,826**	**2,23,957**	**2,63,838**	**3,14,600**
Total non interest income	**79,196**	**89,964**	**1,03,611**	**1,19,316**
Total Income	**2,64,023**	**3,13,920**	**3,67,449**	**4,33,916**
Personnel Expenses	41,790	47,510	54,636	63,924
Other Expenses	78,632	92,366	1,07,078	1,24,169
Total Op expenses	**1,20,422**	**1,39,875**	**1,61,714**	**1,88,093**
Net Inc (Loss) before prov	1,43,601	1,74,045	2,05,735	2,45,823
Provision for NPAs	16,326	20,198	23,834	26,217
Provision for Invst deprn	-2,659	559	-1,000	-1,000
Net Inc (Loss) before tax	**1,27,721**	**1,53,287**	**1,82,901**	**2,20,606**
Provision for Income Tax	42,937	51,128	60,357	72,800
Net Profit	**84,784**	**1,02,159**	**1,22,544**	**1,47,806**

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15	FY16e	FY17e
Assets				
Cash & Bal with RBI	3,95,836	3,63,315	3,90,301	4,25,033
Loans, Adv & Int accrued	30,30,003	36,54,950	43,85,940	53,47,122
Investments	12,55,460	17,20,919	19,56,087	22,93,458
Fixed Assets (Net)	29,399	31,217	37,461	44,953
Other assets	2,05,297	1,34,629	1,53,477	1,74,964
Total Assets	**49,15,995**	**59,05,031**	**69,23,267**	**82,85,529**
Liabilities				
Share capital	4,798	5,013	5,013	5,013
Reserves and Surplus	4,29,988	6,15,081	7,06,834	8,19,450
Hybrid Capital	2,000	2,000	2,000	2,000
Debt	1,63,868	1,80,254	1,89,267	2,08,194
Borrowing	2,28,522	2,69,881	2,83,375	3,11,713
Total Deposits	36,99,293	45,37,906	54,53,255	66,46,374
Other liab incld prov	3,87,526	2,94,895	2,83,522	2,92,785
Total Liabilities	**49,15,995**	**59,05,031**	**69,23,267**	**82,85,529**

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY14	FY15	FY16e	FY17e
Earnings and Valuation Ratios				
Pre-provision Operating RoAE (%)	36.0	33.0	30.9	32.0
RoAE (%)	21.3	19.4	18.4	19.2
Pre-provision Operating ROA (%)	3.2	3.2	3.2	3.2
RoAB (%)	1.99	1.96	1.97	2.00
EPS (Rs.)	35.3	40.8	48.9	59.0
Dividend per share (Rs.)	6.9	8.5	10.5	12.0
Book Value (Rs.)	181.2	247.4	284.0	328.9
Adj BV (Rs.)	178.8	244.9	281.2	326.1
Revenue Analysis				
Interest income on IBA (%)	9.7	9.3	9.1	9.1
Interest cost on IBL (%)	6.1	5.7	5.6	5.5
NIM on IBA / AWF (%)	4.3	4.3	4.2	4.3
Core fee Inc / AWF (%)	1.7	1.5	1.4	1.4
Portfolio gains / Total Inc (%)	0.4	1.9	1.4	1.0
Op.Exp / TI (%)	45.8	45.4	44.6	43.8
Op.Exp / AWF (%)	2.8	2.7	2.6	2.5
Employee exps / Op exps (%)	34.7	34.0	33.8	34.0
Tax / Pre-tax earnings (%)	33.6	33.4	33.0	33.0
Asset Quality				
GNPAs / Gr Adv (%)	1.0	0.9	0.8	0.7
NNPAs / Net Adv (%)	0.3	0.2	0.2	0.2
Growth Ratio				
Loans (%)	26.4	20.6	20.0	21.9
Investments (%)	8.7	37.1	13.7	17.2
Deposits (%)	22.3	22.7	20.2	21.9
Networth (%)	20.1	42.6	14.8	15.8
Net Int Income (%)	16.9	21.2	17.8	19.2
Non-fund based income (%)	16.6	7.7	17.3	16.4
Non-Int Exp (%)	7.2	16.2	15.6	16.3
Profit Before Tax (%)	31.0	20.0	19.3	20.6
Net profit (%)	26.0	20.5	20.0	20.6
Asset / Liability Profile				
Avg CASA/ Deposits (%)	45.4	44.1	43.3	42.4
Avg Adv / Avg Dep (%)	79.9	80.4	79.8	79.8
Avg Invst / Avg Dep (%)	35.9	36.1	36.8	35.1
Incr Adv / Deposits (%)	93.9	74.5	79.9	80.6
Avg Cash / Avg Dep (%)	9.9	9.2	7.5	6.7
Capital Adequacy Ratio:	16.0	16.8	15.8	15.1
Tier I (%)	11.7	13.7	13.1	12.6
Internal Capital Generation rate (%)	18.9	18.6	15.5	16.5
NNPAs to Equity (%)	1.9	1.4	1.4	1.2

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