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HDFC Bank

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Strong growth momentum to continue…

HDFC Bank, a new-generation bank, is the second largest private sector bank in India. The Bank has a nationwide distribution network of 4,787 branches and 12,635 ATM's in 2,691 cities/towns as of FY18. The bank has grown its balance sheet at a healthy pace of 22% CAGR over FY13-18 maintaining high profit CAGR of 21%.

Investment Rationale

Advances growth continues to outpace industry average: HDFC Bank's loan growth continues to remain healthy with 19% YoY increase in FY18 mainly driven by robust growth (↑28% YoY) in retail loans. Corporate loan growth has been healthy (↑9% YoY) but looks little subdued due to higher base of FY17. Going forward, we expect the bank to continue to outpace the industry growth rate (13%) and factor 20% CAGR in advances over FY18-20E as the bank is well-poised to capture a higher share of the incremental credit demand.

Net Interest Margin (NIM) intact: HDFC Bank has consistently maintained its NIM at a superior level of ~4.5%+ over the last five years even as market yields in the overall economy were falling. Despite pricing pressure, NIMs are expected to sustain at the current levels over FY18-20E on account of following factors. (1) Higher CASA ratio, and (2) Higher share of fixed rate retail loans.

Pristine asset quality: HDFC bank continues to maintain strong asset quality as Gross and Net non-performing asset (NPA) ratios stood broadly stable at 1.3% (↑1 bps QoQ) and 0.4% (↓4 bps QoQ) as of FY18, respectively. Moreover, higher provisions helped the bank to improve provision coverage ratio (PCR) by 334 bps QoQ to 69.2%. Besides, low restructured book (0.1%), nil 5:25 & SDR and Rs1,450cr floating provisions lend further comfort. Hence, we don't expect any negative surprise on asset quality front and expect asset quality to remain broadly stable with Gross/Net NPA ratios of 1.3%/0.4% by FY19E.

Robust profitability: Superior asset quality and faster than systemic credit growth has enabled HDFC Bank to maintain the earnings momentum. Further, HDFC Bank has gradually reduced its C/I ratio (from 49.6% in FY13 to 41% in FY18) through increasing automation of processes across lending, credit, branch banking, operations, etc. bringing in efficiency improvements. As a result, HDFC Bank's net profit has grown at a robust pace of 21% CAGR over FY13-18. Going forward, we expect NII and net profit to grow at a healthy CAGR of 20% and 21%, respectively over FY18-20E on the back of healthy credit growth coupled with improving operating efficiency.

Valuation: We maintain HDFC Bank as a preferred pick in the banking sector. HDFC Bank is best-placed among peers in terms of managing the near-term challenges of capital adequacy (Basel-III norms), liquidity and asset quality. Moreover, we expect the bank to continue to report healthy core performance on the back of stable margins and strong growth in advances. It will help the bank to maintain superior return ratios with RoE of ~20% and RoA of ~2% over FY18-20E. Overall, strong fundamentals and stable asset quality would enable the bank to gain market share. As a result, HDFC bank will continue to enjoy valuation premium within banking space. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,188 (4.0x FY20E P/ABV).

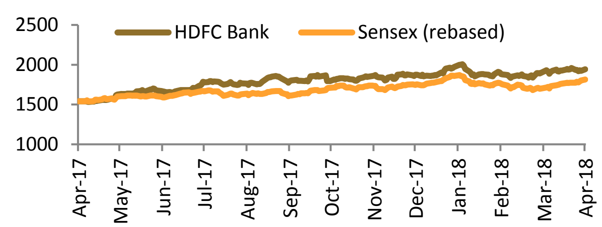
Market Data

Rating	**BUY**
CMP (Rs.)	1,945
Target (Rs.)	2,188
Potential Upside	13%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	2,014/1,524
Adj. all time High (Rs.)	2,014
Decline from 52WH (%)	4.8
Rise from 52WL (%)	25.8
Beta	0.9
Mkt. Cap (Rs.Cr)	505,008

Fiscal Year Ended

Y/E	FY17	FY18	FY19E	FY20E
Interest Income (Rs.Cr)	69,306	80,241	93,758	109,370
Interest Expense (Rs.Cr)	36,167	40,146	45,722	51,584
Net Interest Income (Rs. Cr)	33,139	40,095	48,036	57,786
Pre Pro Profit (Rs. Cr)	25,732	32,625	39,131	47,299
EPS	56.8	67.4	80.9	98.0
P/E (x)	28.9	24.0	19.9	28.9
P/BV (x)	4.7	4.1	3.5	4.7
P/ABV (x)	4.9	4.2	3.6	4.9
ROE (%)	17.9	17.9	18.3	18.9
ROA (%)	1.8	1.8	1.9	2.0

One-year Price Chart



Shareholding Pattern	Mar-18	Dec-17	Chg.
Promoters (%)	25.6	25.7	(0.1)
Public (%)	74.4	74.3	0.1

HDFC Bank is the second largest private sector bank in India.

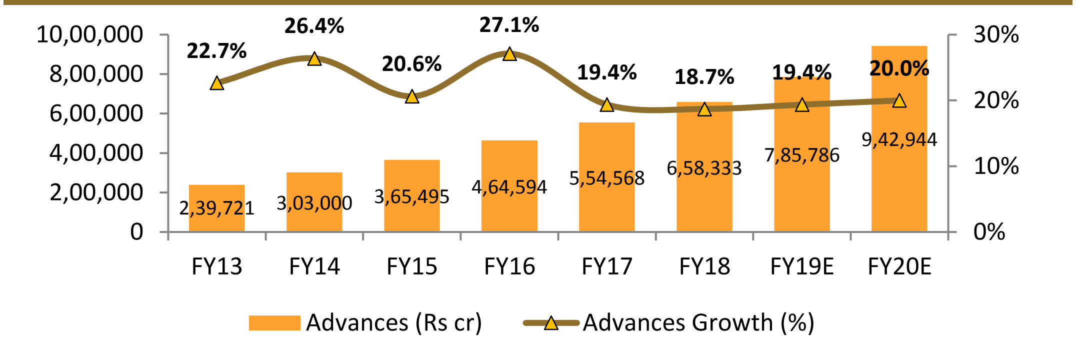
HDFC Bank - Company Overview

HDFC Bank, a new-generation bank, is the second largest private sector bank in India. The Bank has a nationwide distribution network of 4,787 branches and 12,635 ATM's in 2,691 cities/towns as of FY18. The bank has grown its balance sheet at a healthy pace of 22% CAGR over FY13-18 maintaining high profit CAGR of 21%.

Advances growth continues to outpace industry average

HDFC Bank's loan growth continues to remain healthy with 19% YoY increase in FY18 mainly driven by robust growth (↑28% YoY) in retail loans. Corporate loan growth has been healthy (↑9% YoY) but looks little subdued due to higher base of FY17. Going forward, we expect the bank to continue to outpace the industry growth rate (13%) and factor 20% CAGR in advances over FY18-20E as the bank is well-poised to capture a higher share of the incremental credit demand.

Advances to grow at a CAGR of 20% over FY18-20E

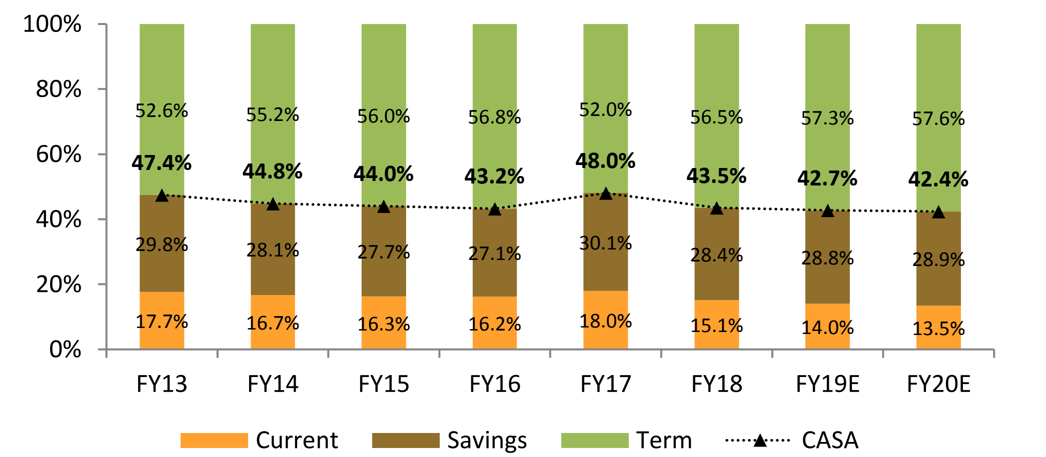


Source: Company, In-house research

Superior retail liability franchise

HDFC Bank enjoys superior liability franchise and scores one of the highest CASA ratio in the financial space. The bank has successfully maintained CASA ratio above 43% over the last five years which benefits it with the lowest cost of funds compared to peers. Further, with a decrease in savings rate, we expect the cost of funds to decline further for the bank. With 4,729 branches and focus on retail banking, we expect the CASA Ratio to remain in the high range of 45%-50%. We expect deposits to growth at a CAGR of 15% over FY17-19E driven by the strong traction in retail deposits.

CASA ratio is one of the best in the industry

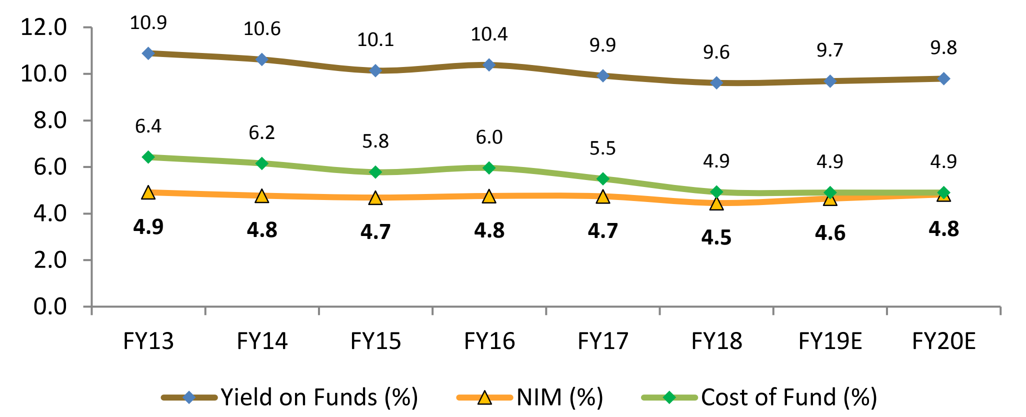


Source: Company, In-house research

Net Interest Margin (NIM) intact

HDFC Bank has consistently maintained its NIM at a superior level of ~4.5%+ over the last five years even as market yields in the overall economy were falling. The higher proportion of retail loans in the bank's portfolio has aided in maintaining the net interest margins. Despite pricing pressure, NIMs are expected to sustain at the current levels over FY18-20E on account of following factors. (1) Higher CASA ratio, and (2) Higher share of fixed rate retail loans (~2/3 of total retail book).

NIM to improve further to 4.8% over FY18-20E

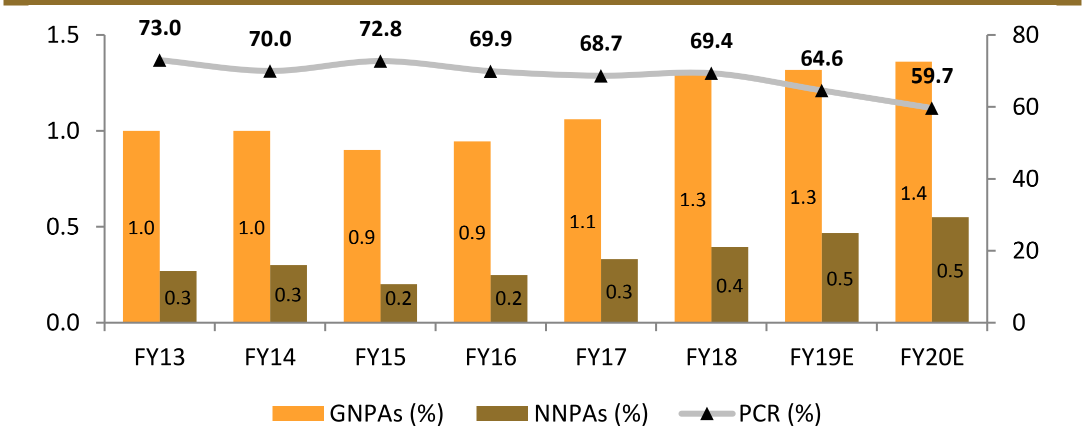


Source: Company, In-house research

Pristine asset quality

HDFC bank's asset quality trend continues to be relatively stronger than peers despite challenging macro environment largely due to stringent credit origination practices, relentless monitoring system and adequate provisioning. Notably, Gross and Net non-performing asset (NPA) ratios stood broadly stable at 1.3% (↑1 bps QoQ) and 0.4% (↓4 bps QoQ) as of Q4FY18, respectively. Moreover, higher provisions helped the bank to improve provision coverage ratio (PCR) by 334 bps QoQ to 69.2%. Besides, low restructured book (0.1%), nil 5:25 & SDR and Rs1,450cr floating provisions lend further comfort. Hence, we don't expect any negative surprise on asset quality front and expect asset quality to remain broadly stable with Gross/Net NPA ratios of 1.3%/0.4% by FY19E.

Best in-class asset quality

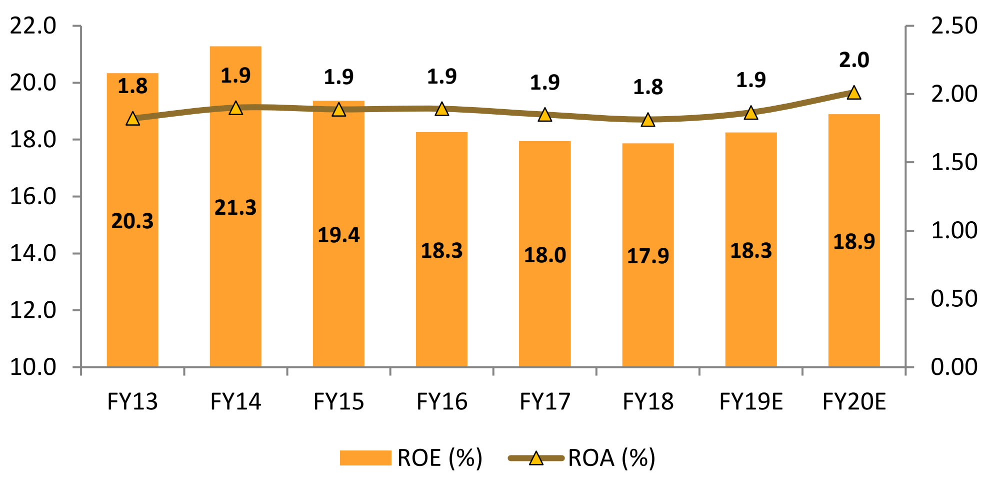


Source: Company, In-house research

Robust profitability

Superior asset quality and faster than systemic credit growth has enabled HDFC Bank to maintain the earnings momentum. Further, HDFC Bank has gradually reduced its C/I ratio (from 49.6% in FY13 to 41% in FY18) through increasing automation of processes across lending, credit, branch banking, operations, etc. bringing in efficiency improvements. As a result, HDFC Bank's net profit has grown at a robust pace of 21% CAGR over FY13-18. Going forward, we expect NII and net profit to grow at a healthy CAGR of 20% and 21%, respectively over FY18-20E on the back of healthy credit growth coupled with improving operating efficiency.

Return ratios to remain robust over FY18-20E

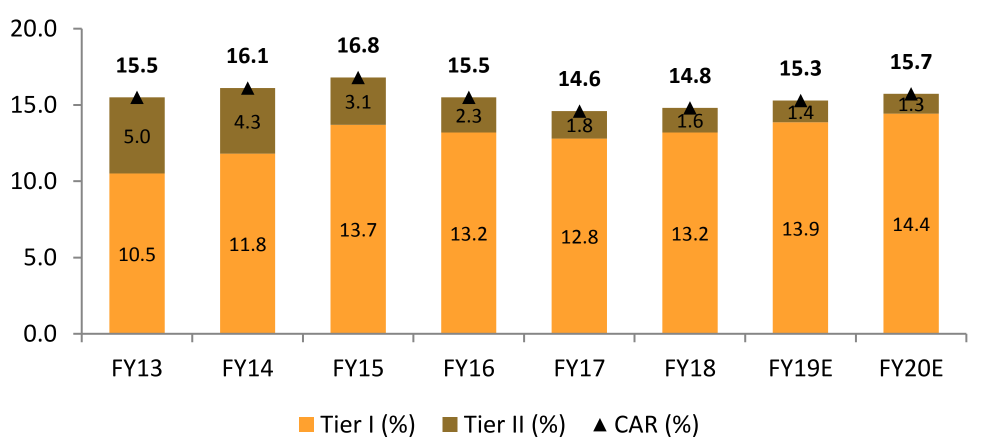


Source: Company, In-house research

Adequately capitalized

The Bank's capital adequacy ratio (CAR) as per Basel III norms continues to remain strong at 14.8% with Tier-I capital ratio of 13.2% as of FY18. Besides, HDFC Bank is in the process to raise Rs240bn (not yet built into the numbers) of equity capital in FY19 for supporting its loan growth and meeting higher capital requirement due to its classification as systematically important bank by the RBI. However, the approval is pending approval from the Finance ministry as the bank seeks to raise more than Rs50bn of foreign capital.

Well capitalized to support growth momentum over FY18-20E



Source: Company, In-house research

Outlook and Valuation

We maintain HDFC Bank as a preferred pick in the banking sector given the bank's rich track record of impressive business & profitability growth, superior NIM, robust asset-liability management, fine balance between corporate & retail exposure, stable asset quality and healthy return profile since inception. Further, we expect the bank to continue to report healthy core performance on the back of stable margins and strong growth in advances. It will also help the bank to maintain superior return ratios with RoE of ~20% and RoA of ~2% over FY18-20E. Overall, strong fundamentals and stable asset quality would enable the bank to gain market share. As a result, HDFC bank will continue to enjoy valuation premium within banking space. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,188 (4.0x FY20E P/ABV).

Key Risks:

- **Lower growth than expected:** We expect loan growth of 20% over FY18-20E largely led by higher growth in retail assets. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.
- **Increase in slippages:** We have factored in credit cost of 0.9% for FY18E and FY19E each. Increase in slippages beyond our estimates can result into increase in credit cost and hence it may affect the profitability of the bank.
- **Spike in Interest rates:** We expect the interest rate (repo rate) to remain broadly stable over FY18-19E. However, any further increase in interest rates may affect the margins of the bank and hence the operating matrix. Additionally, it may have negative impact on investments in capex, which may also impact asset quality of the bank adversely.

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY17	FY18	FY19E	FY20E
Interest Income	69,306	80,241	93,758	109,370
Interest Expense	36,167	40,146	45,722	51,584
Net Interest Income	**33,139**	**40,095**	**48,036**	**57,786**
Non Interest Income	12,296	15,220	17,749	20,365
Net Income	45,436	55,315	65,785	78,151
Operating Expenses	19,703	22,690	26,655	30,853
Total Income	81,602	95,462	111,507	129,735
Total Expenditure	55,870	62,837	72,377	82,436
Pre Provisioning Profit	**25,732**	**32,625**	**39,131**	**47,299**
Provisions	3,593	5,927	7,075	8,490
Profit Before Tax	22,139	26,697	32,056	38,809
Tax	7,589	9,211	11,059	13,389
Net Profit	**14,550**	**17,487**	**20,997**	**25,420**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY17	FY18	FY19E	FY20E
Liabilities				
Capital	513	519	519	519
Reserves and Surplus	88,950	105,776	123,191	144,874
Deposits	643,640	788,771	895,158	1,023,169
Borrowings	74,029	123,105	120,616	113,153
Other Liabilities and Provisions	56,709	45,764	47,540	57,048
Total Liabilities	**863,840**	**1,063,934**	**1,187,025**	**1,338,764**
Assets				
Cash and Balances	48,952	122,915	112,639	98,052
Investments	214,463	242,200	249,301	255,792
Advances	554,568	658,333	785,786	942,944
Fixed Assets	3,627	3,607	3,588	3,568
Other Assets	42,230	36,879	35,710	38,408
Total Assets	**863,840**	**1,063,934**	**1,187,025**	**1,338,764**

Key Ratios (Standalone)

Y/E	FY17	FY18	FY19E	FY20E
Per share data (Rs.)				
EPS	56.8	67.4	80.9	98.0
DPS	9.5	11.0	11.5	12.0
BV	349.1	409.6	476.7	560.3
ABV	341.9	399.6	462.6	540.3
Valuation (%)				
P/E	34.2	28.9	24.0	19.9
P/BV	5.6	4.7	4.1	3.5
P/ABV	5.7	4.9	4.2	3.6
Div. Yield	0.5	0.6	0.6	0.6
Capital (%)				
CAR	14.6	14.8	15.3	15.7
Tier I	12.8	13.2	13.9	14.4
Tier II	1.8	1.6	1.4	1.3
Asset (%)				
GNPA	1.1	1.3	1.3	1.4
NNPA	0.3	0.4	0.5	0.5
PCR	68.7	69.4	64.6	59.7
Management (%)				
Credit/ Deposit	86.2	83.5	87.8	92.2
Cost/ Income	43.4	41.0	40.5	39.5
CASA	48.0	43.5	42.7	42.4
Earnings (%)				
NIM	4.7	4.5	4.6	4.8
ROE	17.9	17.9	18.3	18.9
ROA	1.8	1.8	1.9	2.0

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** HDFC Bank is a large-cap bank

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