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HDFC Bank

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Enviable performance 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 4,804 branches and 12,808 ATM's in 2,666 cities/towns as of Q1FY19. 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

- **Above industry growth rate in advances to continue:** HDFC Bank continued to report strong loan growth of 22% YoY in Q1FY19 (↑18% YoY in FY18) led by 26% YoY growth in retail and 18% YoY growth in corporate loans. 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.

- **Time-tested growth strategy will help maintain stable margins:** HDFC Bank has consistently maintained its net interest margin (NIM) at a superior level of ~4.5%+ over the last five years even as market yields in the overall economy were falling. Even though NIM declined by 20 bps YoY to 4.6% in Q1FY19, we expect NIM (calc) o remain above 4.5% over FY18-20E as the bank believes that the interest rate cycle has bottomed out and has recently increased MCLR in order to offset the pressure on funding cost.

- **Asset quality risks well in control:** 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 NPA ratio has remained around 1% during the last eight years whereas restructured loans remain miniscule which provides further comfort. Hence, we don't expect any major negative surprises on the asset quality front over near to medium term.

- **Efficiency gains to drive 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 the bank. As a result, HDFC Bank's net profit has grown at a robust pace of 21% CAGR over FY13-18. Going forward, return ratios are expected to improve further on the back of- a) cost-income ratio is likely to come down as digitization plays a key role from client's acquisition to disbursement; b) credit cost was elevated in last year due to higher Agri slippage which is likely to remain moderate and hence a comparatively lower credit cost.

Valuation: HDFC Bank delivered another quarter (Q1FY19) with strong and stable performance. We are structurally positive on the bank given its top-notch asset quality, robust retail franchise, strong balance sheet growth and best-in-class management pedigree. Further, with its recent capital raising plan of Rs24,000cr, the bank is expected to accelerate balance sheet growth from here and continue gaining market share in both assets and liabilities. We expect the bank to maintain superior return ratios with RoE of ~19% and RoA of ~2% over FY18-20E. As a result, HDFC bank will continue to enjoy premium valuation within banking space. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,388 (4.4x FY20E P/ABV).

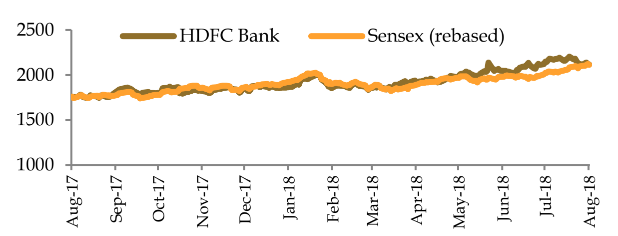
Market Data

Rating	**BUY**
CMP (Rs.)	2,091
Target (Rs.)	2,388
Potential Upside	14%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	2,219/1,685
Adj. all time High (Rs.)	2,219
Decline from 52WH (%)	4.7
Rise from 52WL (%)	25.5
Beta	1.2
Mkt. Cap (Rs.Cr)	544,438

Fiscal Year Ended

Y/E	FY17	FY18	FY19E	FY20E
Interest Income (Rs.Cr)	69,306	80,241	94,936	112,775
Interest Expense (Rs.Cr)	36,167	40,146	47,353	55,642
Net Interest Income (Rs. Cr)	33,139	40,095	47,583	57,133
Pre Pro Profit (Rs. Cr)	25,732	32,625	39,267	47,760
EPS	56.8	67.4	80.5	97.6
P/E (x)	31.0	26.0	21.4	31.0
P/BV (x)	5.1	4.4	3.7	5.1
P/ABV (x)	5.2	4.5	3.9	5.2
ROE (%)	17.9	17.9	18.2	18.9
ROA (%)	1.8	1.8	1.9	1.9

One-year Price Chart



Shareholding Pattern	Jun-18	Mar-18	Chg.
Promoters (%)	25.5	25.6	(0.1)
Public (%)	74.5	74.4	0.1

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

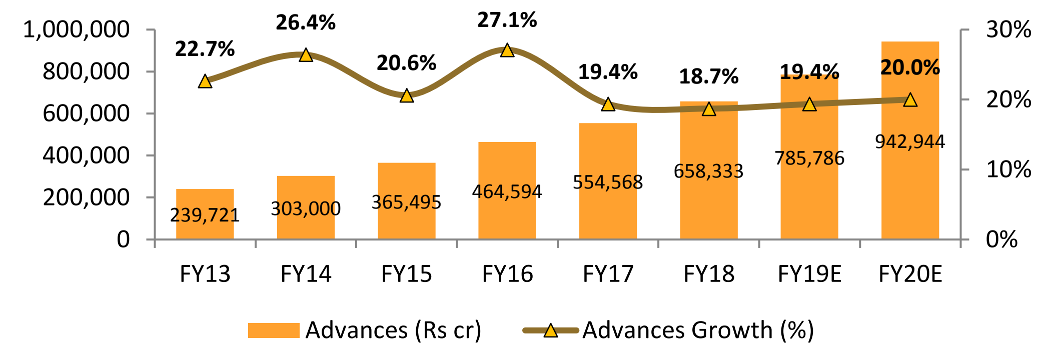
HDFC Bank - Company Overview

HDFC Bank, a new-generation bank, is the second largest private sector bank (in terms of assets) in India. The Bank has a nationwide distribution network of 4,804 branches and 12,808 ATM's in 2,666 cities/towns as of Q1FY19. The bank has grown its balance sheet at a healthy pace of 22% CAGR over FY13-18 maintaining high profit CAGR of 21%.

Above industry growth rate in advances to continue

HDFC Bank continued to report strong loan growth of 22% YoY in Q1FY19 (↑18% YoY in FY18) led by 26% YoY growth in retail and 18% YoY growth in corporate loans. Retail loan book witnessed secular loan growth across personal loans (↑40% YoY), credit cards (↑33% YoY), two-wheelers (↑41% YoY), CV (↑26% YoY) and business banking (↑24%YoY). 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

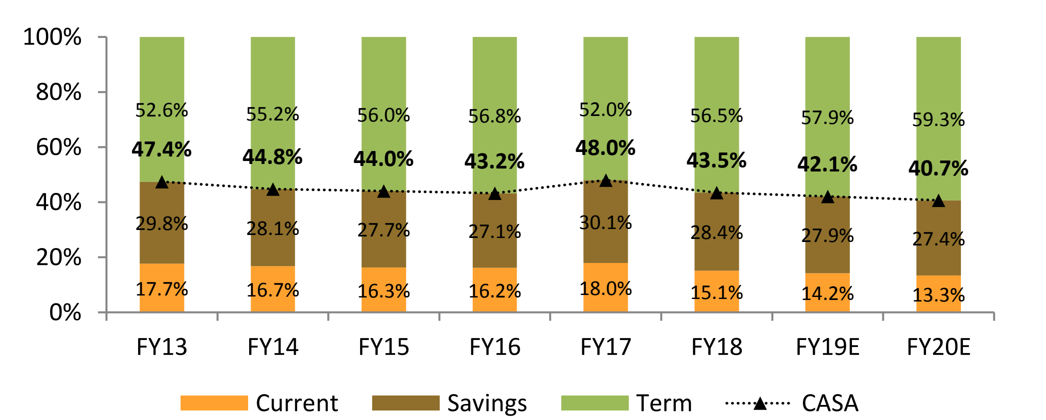


Source: Company, In-house research

Strong 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 4,804 branches and focus on retail banking, we expect the CASA Ratio to remain in the high range of 40%-45%. We expect deposits to growth at a CAGR of 17% over FY18-20E driven by the strong traction in retail deposits.

CASA ratio is one of the best in the industry

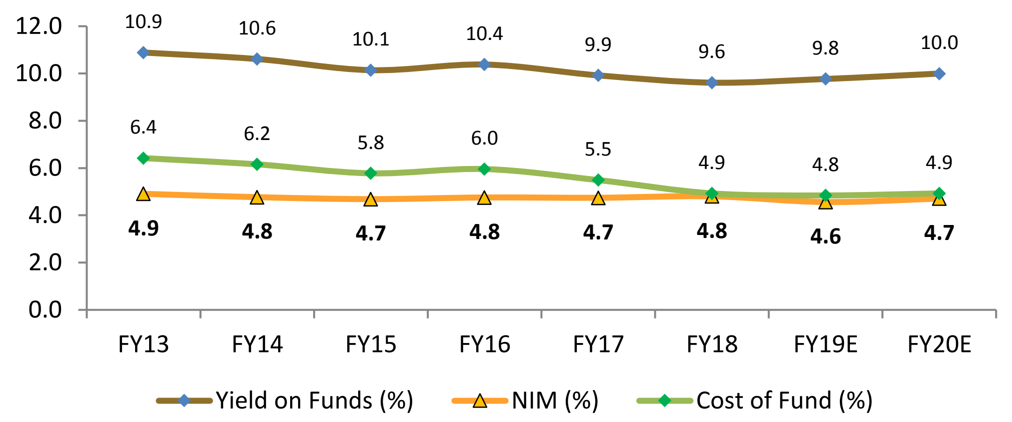


Source: Company, In-house research

Time-tested growth strategy will help maintain stable margins

HDFC Bank has consistently maintained its NIM (calc) 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 unsecured retail loans in the bank's portfolio has aided in maintaining the net interest margins. Even though NIM declined by 20 bps YoY to 4.6% in Q1FY19, we expect NIM (calc) o remain above 4.5% over FY18-20E as the bank believes that the interest rate cycle has bottomed out and has recently increased MCLR in order to offset the pressure on funding cost.

NIM (calc) to remain above 4.5% mark over FY18-20E

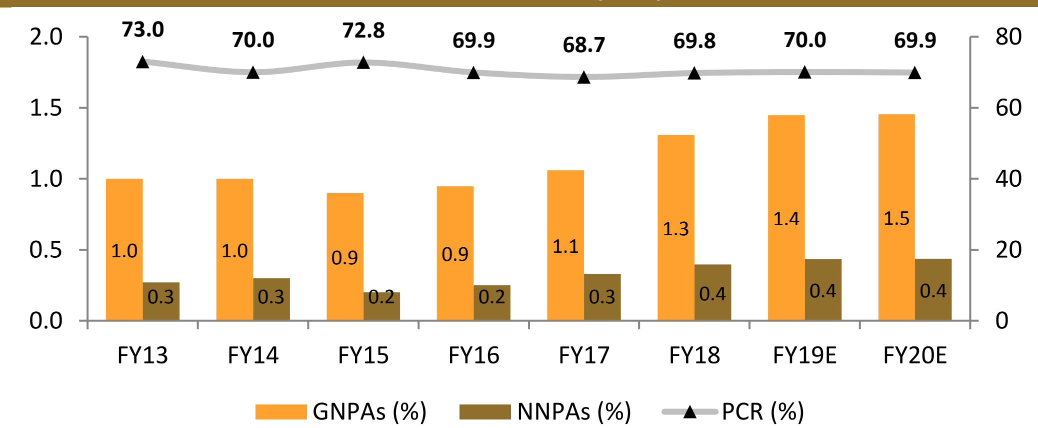


Source: Company, In-house research

Asset quality risks well in control

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 of the bank remain broadly stable in Q1FY19 at 1.3% (↑3 bps QoQ) and 0.4% (↑1 bps QoQ), respectively. The provision coverage ratio (PCR) also remained steady at 69%. Notably, Gross NPA ratio has remained around 1% during the last eight years whereas restructured loans remain miniscule which provides further comfort. Hence, we don't expect any major negative surprises on the asset quality front over near to medium term.

Best in-class asset quality

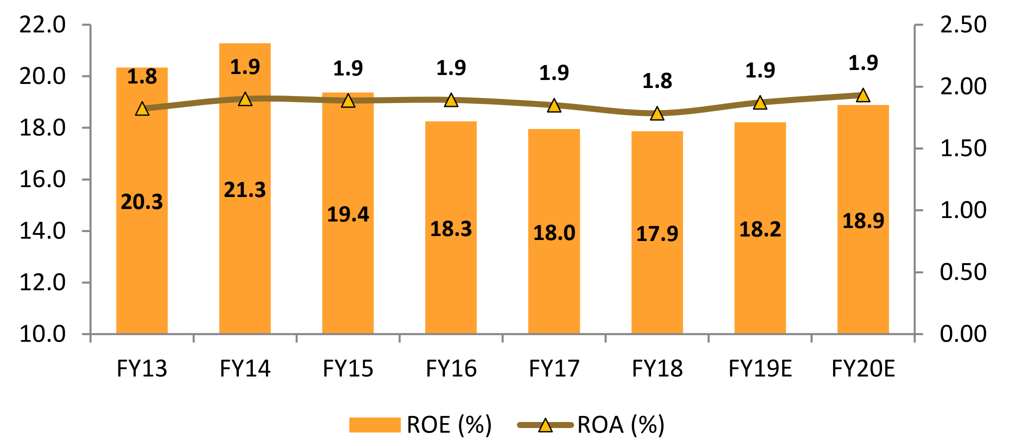


Source: Company, In-house research

Efficiency gains to drive 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, return ratios are expected to improve further on the back of- a) cost-income ratio is likely to come down as digitization plays a key role from client's acquisition to disbursement; b) credit cost was elevated in last year due to higher Agri slippage which is likely to remain moderate and hence a comparatively lower credit cost.

Return ratios to remain robust over FY18-20E

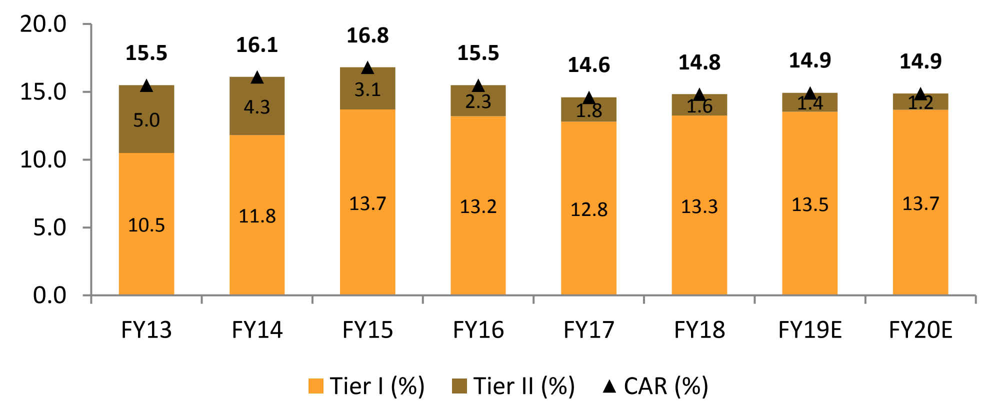


Source: Company, In-house research

Capital raising to provide further strength

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. Overall, it will provide further strength to the bank to capitalize on emerging lending opportunities. (Notably, we have not factored capital raising in our model.)

Capital raising to provide further strength over medium term



Source: Company, In-house research

Outlook and Valuation

HDFC Bank delivered another quarter (Q1FY19) with strong and stable performance. We are structurally positive on the bank given its top-notch asset quality, robust retail franchise, strong balance sheet growth and best-in-class management pedigree. Further, with its recent capital raising plan of Rs24,000cr, the bank is expected to accelerate balance sheet growth from here and continue gaining market share in both assets and liabilities. Overall, the bank will continue to report healthy core performance on the back of stable margins and strong growth in advances. We expect the bank to maintain superior return ratios with RoE of ~19% and RoA of ~2% over FY18-20E. As a result, HDFC bank will continue to enjoy premium valuation within banking space. Hence, we maintain a BUY rating on the stock with a target price (TP) of Rs2,388 (4.4x 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 FY19E and 1.0% for FY20E 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 FY19-20. 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	94,936	112,775
Interest Expense	36,167	40,146	47,353	55,642
Net Interest Income	**33,139**	**40,095**	**47,583**	**57,133**
Non Interest Income	12,296	15,220	17,631	20,213
Net Income	45,436	55,315	65,214	77,346
Operating Expenses	19,703	22,690	25,947	29,586
Total Income	81,602	95,462	112,567	132,988
Total Expenditure	55,870	62,837	73,300	85,228
Pre Provisioning Profit	**25,732**	**32,625**	**39,267**	**47,760**
Provisions	3,593	5,927	7,271	8,962
Profit Before Tax	22,139	26,697	31,996	38,798
Tax	7,589	9,211	11,038	13,385
Net Profit	**14,550**	**17,487**	**20,957**	**25,413**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY17	FY18	FY19E	FY20E
Liabilities				
Capital	513	519	521	521
Reserves and Surplus	88,950	105,776	123,200	144,950
Deposits	643,640	788,771	923,406	1,082,097
Borrowings	74,029	123,105	121,011	132,012
Other Liabilities and Provisions	56,709	45,764	46,754	56,105
Total Liabilities	**863,840**	**1,063,934**	**1,214,893**	**1,415,686**
Assets				
Cash and Balances	48,952	122,915	125,427	146,983
Investments	214,463	242,200	257,169	270,524
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	42,923	51,667
Total Assets	**863,840**	**1,063,934**	**1,214,893**	**1,415,686**

Key Ratios (Standalone)

Y/E	FY17	FY18	FY19E	FY20E
Per share data (Rs.)				
EPS	56.8	67.4	80.5	97.6
DPS	0.0	0.0	13.6	14.1
BV	349.1	409.6	475.1	558.6
ABV	341.9	399.6	462.0	542.8
Valuation (%)				
P/E	36.8	31.0	26.0	21.4
P/BV	6.0	5.1	4.4	3.7
P/ABV	6.1	5.2	4.5	3.9
Div. Yield	0.0	0.0	0.6	0.7
Capital (%)				
CAR	14.6	14.8	14.9	14.9
Tier I	12.8	13.3	13.5	13.7
Tier II	1.8	1.6	1.4	1.2
Asset (%)				
GNPA	1.1	1.3	1.4	1.5
NNPA	0.3	0.4	0.4	0.4
PCR	68.7	69.8	70.0	69.9
Management (%)				
Credit/ Deposit	86.2	83.5	85.1	87.1
Cost/ Income	43.4	41.0	39.8	38.3
CASA	48.0	43.5	42.1	40.7
Earnings (%)				
NIM	4.7	4.8	4.6	4.7
ROE	17.9	17.9	18.2	18.9
ROA	1.8	1.8	1.9	1.9

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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