

Execution at the core; aims to deliver unchanged RoE

Adequate investments to ensure sustainable long-term growth

We met the top management team of HDFC Bank (HDFCB) represented by Mr. Sashi Jagdishan, CEO; Mr. Srinivasan V, CFO; and Mr. Bhavin Lakhpatwala, Head IR & Strategy, to discuss the bank's growth, margin outlook and focus areas post-merger. Here are the key takeaways from the discussion:

Loan growth momentum to sustain; aims to double the balance sheet in four years

Loan growth is likely to remain healthy, and the bank expects to double the balance sheet in about four years, which is close to its historical run rate (FY13-23 CAGR at 21%).

The recent liquidity build-up (via HDFC Ltd balance sheet) places the bank well to pursue growth in FY24 without worrying much on the funding side. Good momentum in the mortgage business and improved cross-selling will boost growth in retail assets, while stable traction in MSME will help it maintain overall broad-based growth. The MSME space is witnessing strong activity and has seen improvement in its self-funding ratio, which is a leading indicator of portfolio health. The rapid branch expansion and a strong thrust on MSME lending should lead to robust growth in this segment. **We estimate loan growth for the merged entity to sustain at 12% over the remaining 9MFY24, while the loan CAGR will recover to 17% over FY24-26E.**

Aggressive branch expansion to drive liability mobilization; over 90% of new branches on track to meet business goals

Deposits will remain the prime focus area as they are the key source of funding. The role of affordable housing and infra bonds will be limited in overall growth. HDFCB plans to continue with its aggressive branch expansion run rate of 1,400-1,500 branches in FY24 and aims to increase its total branch count to 13k-14k to sustain the growth trajectory over the medium term. The bank also has ~500 branches of HDFC Ltd, which will be scaled up over the year. Most of the branches are opened in the regions where the bank sees healthy liability potential and has limited presence currently. **HDFCB has one of the highest deposit productivity rates in the industry, and the management mentioned that the productivity of new branches is also tracking well with over 90% of branches generating business as per internal projections.** Thus, the ongoing pace of capacity building and adequate investments in the business will enable the bank to maintain a healthy growth rate in the coming years.

Employee attrition higher at junior levels; expansion in management team improves overall bandwidth

HDFCB has 13 levels for employees, and the attrition is higher in lower 3 levels at ~35% and the bank aims to bring it down to ~15%. Above the level 3, attrition is in single digits. The management team is spearheading a cultural transformation to build a future-ready tech bank by improving employee engagement, visiting the branches and conducting bus tours across far-flung areas. The bank has thus done bus tours in 13 states across India and plans to cover other states over the year. This has helped improve employee connect and sharpen business focus across teams. Alongside, the bank has also strengthened the management bandwidth to drive sustained growth across business verticals. The bank currently has 34 senior management people (which are 1 level below CEO) and this number used to be 13 when Mr. Jagdishan took over as CEO. Most of the senior positions are filled by internal employees, which points to improving management bandwidth across all levels.

HDFC Bank



Mr. Sashidhar Jagdishan, HDFC Bank

Mr. Jagdishan joined HDFCB as a manager in the finance department in 1996 and became Business Head – Finance in 1999. He became CFO of the bank in 2008 and took charge as the CEO in Oct'20. He has overall experience of 30 years and is a qualified CA. He holds a Master's degree in Economics from the University of Sheffield, UK.

On recent disclosures -

- **Reduction in networth:** The reduction in net worth of erstwhile HDFC Ltd happened largely due to the migration from IND-AS to IGAAP and was more of accounting in nature. The provisions toward credit policy harmonization were undertaken to strengthen the balance sheet and to ensure that the PCR ratio remains steady even after the merger.
- **Asset quality deterioration and higher specific/contingent provisions:** The bank undertook higher general and contingent provisions at INR39b and specific NPA provisions of INR38b to maintain the strength of the merged entity's balance sheet. **These additional provisions do not reflect any change in view on underlying asset quality and differ from the erstwhile provisioning, which was based on an estimated loss approach as per IND-AS.** The bank thus expects the recovery rate to remain robust over the coming years, though unwinding in the wholesale book of HDFC Ltd will continue in the near term.

Other highlights:

- **Overall PSL compliance on track; remain watchful of segmental targets:** Meeting PSL targets in select segments like Small and Marginal Farmer may not be easy, but the management believes that the bank is well positioned to comply with overall PSL requirements. Thus, the bank does not expect any material impact on profitability arising from PSL shortfall and believes that it is well on track to deliver 2% RoA in the medium term. The use of Inter Bank Participation Certificate further helps the bank in complying with PSL targets as this effectively results in reducing the Adjusted Net Bank Credit.
- **Credit environment remains exceptionally benign:** Delinquencies in the unsecured portfolio are running better than those in the secured portfolio. Strong growth in the mortgage business and the focus on cross-sell of other secured/unsecured retail products will enable healthy growth and improve underwriting quality.
- **Competitive intensity rising:** Competition in the industry has intensified, with PSU banks getting competitive in wholesale lending. As a result, HDFCB had to let go of a lending opportunity worth INR1t in the wholesale business due to unattractive pricing (INR300b foregone in 1QFY24).

Valuations and view: Execution remains the key; improving operating performance to drive gradual recovery

The management believes that execution remains the most important aspect for the bank and that HDFCB has everything in place to deliver strong profitability and growth trajectory over the coming years (similar to pre-merger levels). While the merged entity is expected to begin its journey on a softer note, we expect the operating performance to recover gradually from 2HFY24 onward. We expect margins to recover to 3.8% by FY26E and expect improvement in cost ratios, which should enable a ~21% CAGR in PPOP over FY23-26E, leading to RoA/RoE of 2%/17% by FY26E (reaching back to pre-merger levels). **The stock has corrected 10% in the recent weeks and the ADR premium has also shrunk to more than 12-month lows as investors remain watchful on growth and RoE recovery for the merged entity. The stock is thus trading at attractive valuations of 2.1x Mar'25E ABV and ~13x EPS and offers a favorable risk-reward for long-term investors. We maintain BUY with a TP of INR1,950 (premised on 2.7x Mar'25E ABV + INR206 from subs). We believe that a gradual recovery in growth and earnings will improve the stock's performance.**

Exhibit 1: Merged GNPA stands at 1.4%, NNPA stands at 0.4% as on 1st Jul'23

Particulars	Mar-23 HDFCB	Jun-23 HDFCB	1 st Jul-23 HDFCB Merged
Gross NPA (%)	1.1%	1.2%	1.4%
Retail GNPA (%)	1.0%	0.9%	0.9%
CRB GNPA (%)	1.6%	1.8%	1.8%
CRB ex-Agri GNPA (%)	1.1%	1.2%	1.2%
Wholesale GNPA (%)	0.5%	0.4%	0.4%
e-HDFCL Individual GNPA (%)			1.0%
e-HDFCL Non-Individual GNPA (%)			6.7%
Net NPA	0.3%	0.3%	0.4%
Specific provision coverage (%)	76%	75%	74%
Contingent and floating provisions as a % of advances	0.7%	0.7%	0.7%
Total provisions as a % of advances	2.0%	2.0%	2.2%
Total provisions (ex-specific) as a % of advances	1.1%	1.1%	1.1%

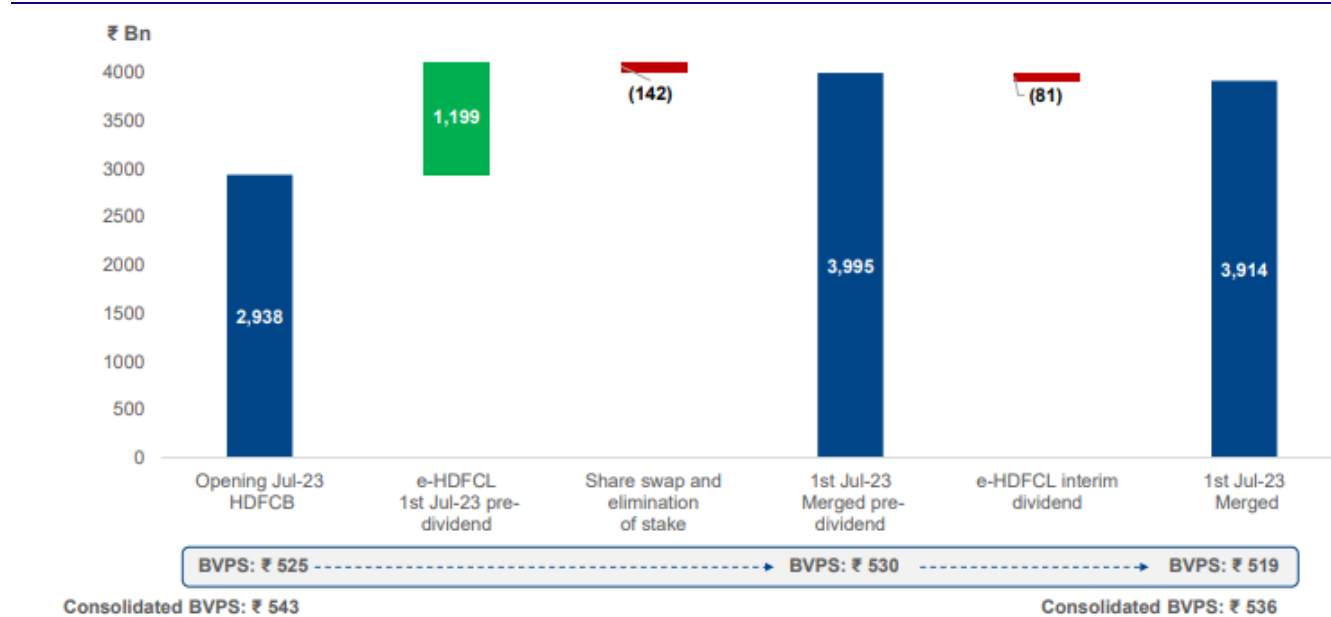
Exhibit 2: Return ratios to moderate in short term with significant decline in margins

Financials	HDFCB Standalone		Proforma Merged HDFCB Q1FY24
	FY23	Q1FY24	
NIM (interest bearing assets)	4.3%	4.3%	3.9% - 4.0%
NIM (total assets)	4.1%	4.1%	3.7% - 3.8%
Cost to income	40%	43%	~40%
Credit costs as a % of advances	0.7%	0.7%	~0.6%
RoA	2.1%	2.1%	1.9% - 2.0%
RoE	17.4%	17.3%	~16%
EPS – standalone	79	21	20
EPS – consolidated	83	22	22
BVPS – standalone	502	525	519
BVPS – consolidated	519	543	536
Capital adequacy ratio	19.3%	18.9%	19.2%

Exhibit 3: HDFCB to have a merged loan book of INR22.2t and deposits of INR20.6t as on 1st Jul'23

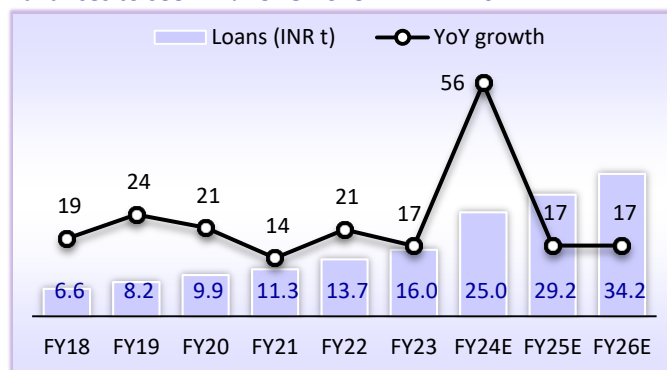
₹ Bn.	HDFCB 30-Jun-23	HDFCB Merged Opening
Share capital & reserves	2,938	3,914
Deposits	19,131	20,638
Borrowings	2,094	6,869
Other liabilities	854	1,125
Total	25,017	32,546
Loans and advances	16,157	22,210
Cash & equivalent	1,607	1,610
Investments	5,658	6,984
Fixed and other assets	1,595	1,742
Total	25,017	32,546

Exhibit 4: Merged entity net worth to be at INR3.91t vs. INR2.94t for HDFCB standalone as on 1st Jul'23

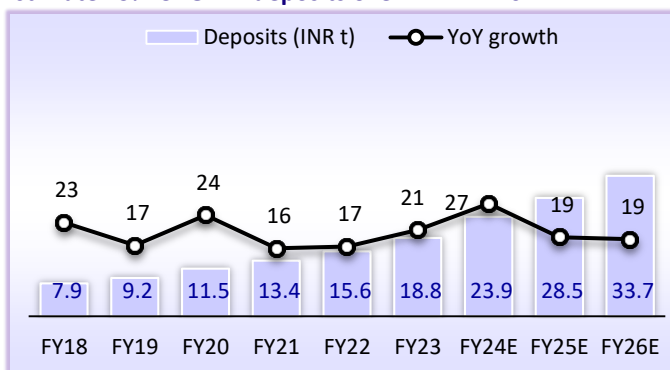


STORY IN CHARTS

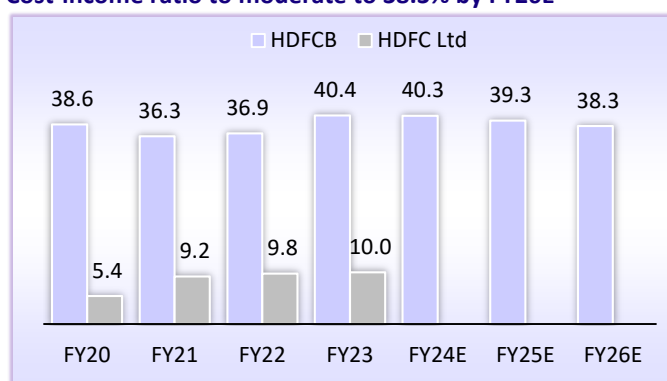
Advances to see ~17% CAGR over FY24-FY26E



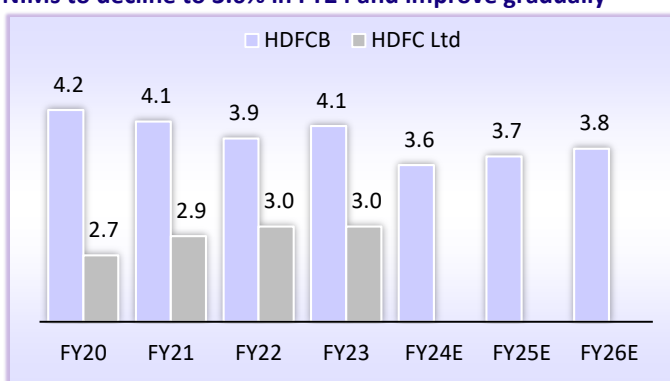
Estimate 19% CAGR in deposits over FY24-FY26E



Cost-income ratio to moderate to 38.3% by FY26E



NIMs to decline to 3.6% in FY24 and improve gradually

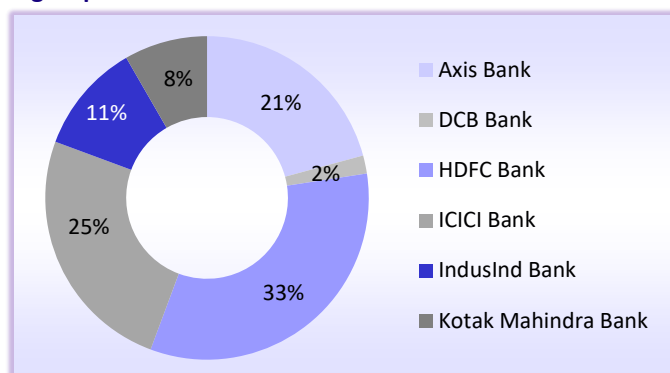


FY24 branch expansion plans of major banks

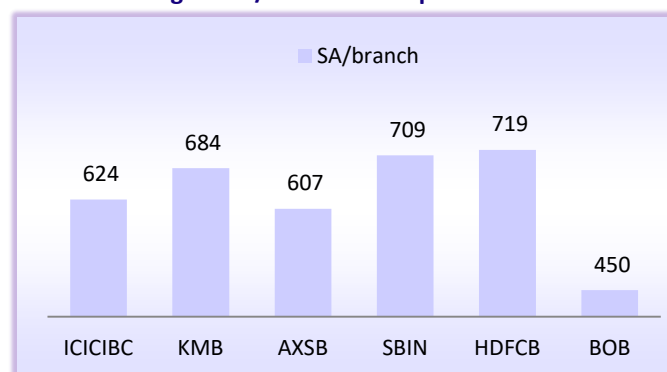
Branch expansion guidance		FY24
ICICIB		600-700
KMB		150
AXSB		500
FEDB		100
HDFCB		1,400-1,500
IIB		250-300

Source: MOFSL, Company

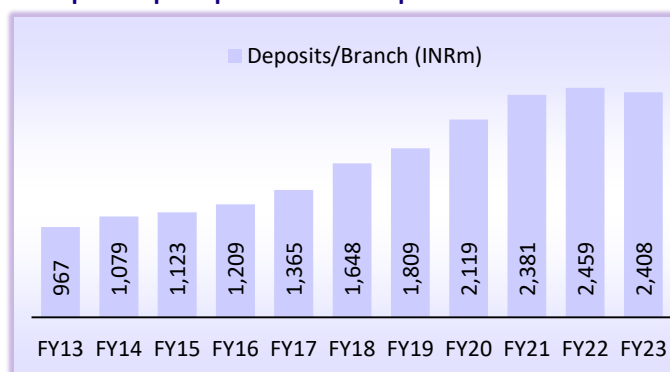
HDFCB has the highest share of branches among some of the largest private banks



HDFCB has a higher SA/branch vs. its peers



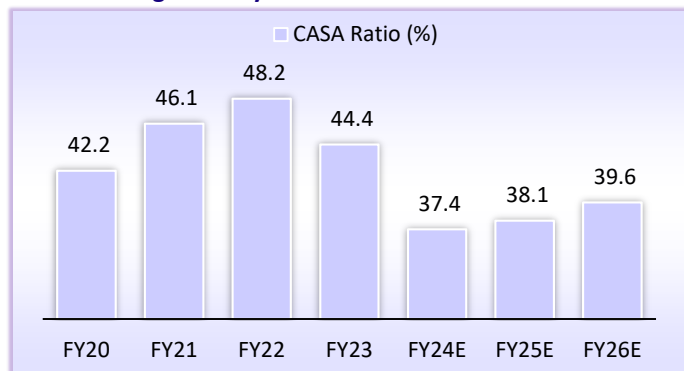
We expect deposit per branch to improve further



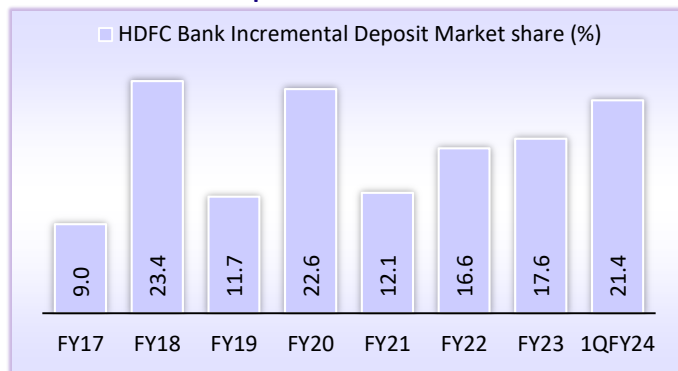
Source: MOFSL, Company

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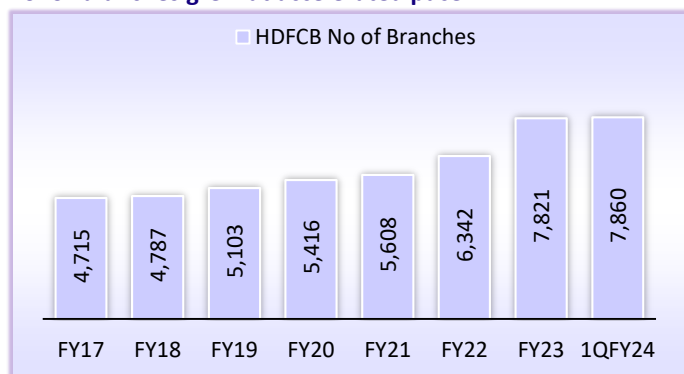
Estimate merged entity CASA to moderate to 37.4% in FY24E



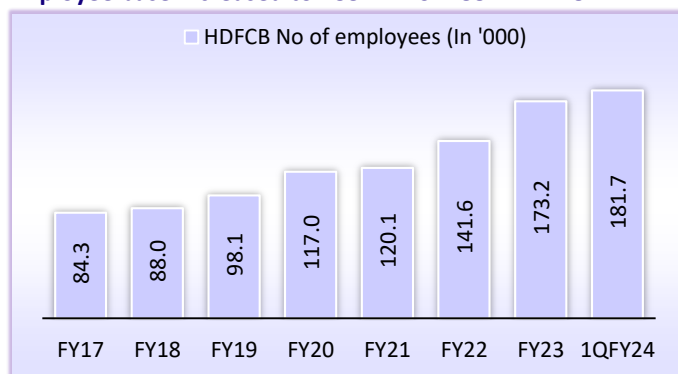
HDFCB incremental deposit market share increased to 21%



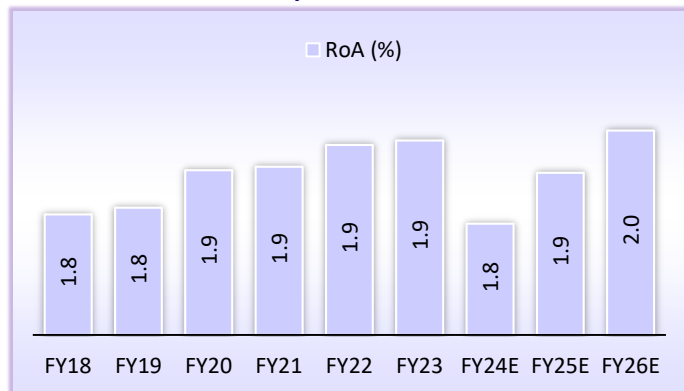
No. of branches grew at accelerated pace



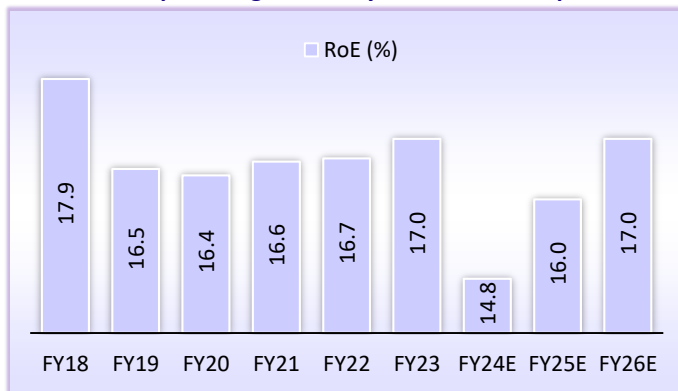
Employee base increased to 188.7k from 88k in FY18



ROA to increase to 2.0% by FY26E

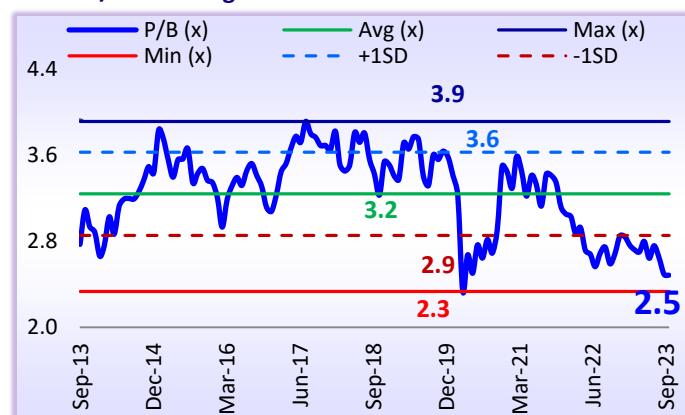


ROE to rise to pre-merge levels by FY26E after a dip in FY24E



Source: MOFSL, Company

HDFCB P/B is trading at a low of ~2.5x



HDFCB SOTP Valuation

	Value INR b	Per Share INR	% of Total
HDFC Bank	13,125.7	1,744	89.4
HDB Financial Services	534.4	71	3.6
HDFC Securities	203.4	27	1.4
HDFC Life Insurance	792.9	105	5.4
HDFC Ergo General Insurance	130.1	17	0.9
HDFC AMC	244.0	32	1.7
HDFC Credila	10.1	1	0.1
Bandhan Bank	20.7	3	0.1
Value of Subs (Post Holdco Disc)	1,548.4	206	10.6
Target Price	14,674.1	1,950	

Source: MOFSL, Company

Exhibit 5: SOTP-based pricing

	Value INR b	Value USD b	Per Share INR	% of Total Value	Rationale
HDFC Bank	13,125.7	159.1	1,744	89.4	2.7x FY25E ABV
HDB Financial Services	534.4	6.5	71	3.6	3.5x FY25E Net worth
HDFC Securities	203.4	2.5	27	1.4	18x FY25E PAT
HDFC Life Insurance	792.9	9.6	105	5.4	2.8x FY25E EV
HDFC Ergo General Insurance	130.1	1.6	17	0.9	25x FY25E PAT
HDFC AMC	244.0	3.0	32	1.7	26x FY25E PAT
HDFC Credalia	10.1	0.1	1	0.1	3.5x FY25E BV
Bandhan Bank	20.7	0.3	3	0.1	1.6x FY25E BV
Total Value of Subs	1,935.5	23.5	257	13.2	
Less: 20% holding Disc	387.1	4.7	51	2.6	
Value of Subs (Post Holding Disc)	1,548.4	18.8	206	10.6	
Target Price	14,674.1	177.9	1,950		

Exhibit 6: DuPont Analysis: Return ratios to remain healthy

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	8.57	8.27	7.38	6.70	7.13	7.56	7.71	7.67
Interest Expense	4.40	4.23	3.42	2.92	3.30	4.12	4.18	4.06
Net Interest Income	4.18	4.05	3.96	3.77	3.83	3.44	3.53	3.61
Core Fee Income	1.34	1.38	1.15	1.22	1.06	0.89	0.91	0.93
Trading and others	0.19	0.30	0.39	0.33	0.31	0.25	0.27	0.27
Non-Interest income	1.53	1.68	1.54	1.55	1.38	1.14	1.18	1.20
Total Income	5.71	5.73	5.50	5.32	5.21	4.58	4.71	4.81
Operating Expenses	2.26	2.21	2.00	1.96	2.10	1.85	1.85	1.84
Employee cost	0.67	0.69	0.63	0.63	0.68	0.59	0.59	0.59
Others	1.59	1.53	1.36	1.33	1.42	1.26	1.26	1.25
Operating Profits	3.44	3.51	3.50	3.36	3.11	2.74	2.86	2.97
Core operating Profits	3.26	3.22	3.11	3.03	2.79	2.48	2.59	2.70
Provisions	0.65	0.88	0.96	0.79	0.53	0.35	0.35	0.36
PBT	2.79	2.64	2.54	2.57	2.58	2.38	2.50	2.60
Tax	0.96	0.75	0.64	0.63	0.63	0.59	0.62	0.64
RoA	1.83	1.89	1.90	1.94	1.95	1.80	1.89	1.96
Leverage (x)	9.0	8.7	8.7	8.6	8.7	8.2	8.5	8.6
RoE	16.5	16.4	16.6	16.7	17.0	14.8	16.0	17.0

Financials and valuations

Income Statement

	(INR b)							
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	989.7	1,148.1	1,208.6	1,277.5	1,615.9	2,583.8	3,036.3	3,516.2
Interest Expense	507.3	586.3	559.8	557.4	747.4	1,408.1	1,646.5	1,861.9
Net Interest Income	482.4	561.9	648.8	720.1	868.4	1,175.7	1,389.8	1,654.4
Growth (%)	20.3	16.5	15.5	11.0	20.6	35.4	18.2	19.0
Non-Interest Income	176.3	232.6	252.0	295.1	312.1	390.2	464.3	547.9
Total Income	658.7	794.5	900.8	1,015.2	1,180.6	1,565.9	1,854.1	2,202.3
Growth (%)	19.1	20.6	13.4	12.7	16.3	32.6	18.4	18.8
Operating Expenses	261.2	307.0	327.2	374.4	476.5	631.0	729.4	843.6
Pre Provision Profits	397.5	487.5	573.6	640.8	704.0	934.9	1,124.7	1,358.7
Growth (%)	21.8	22.6	17.7	11.7	9.9	32.8	20.3	20.8
Core PPP	380.3	465.9	549.2	601.7	659.2	876.2	1,050.1	1,270.7
Growth (%)	22.3	22.5	17.9	9.6	9.6	32.9	19.8	21.0
Provisions (exc. tax)	75.5	121.4	157.0	150.6	119.2	120.3	138.6	165.6
PBT	322.0	366.1	416.6	490.2	584.9	814.5	986.1	1,193.1
Tax	111.2	103.5	105.4	120.5	143.8	200.4	242.6	293.5
Tax Rate (%)	34.5	28.3	25.3	24.6	24.6	24.6	24.6	24.6
PAT	210.8	262.6	311.2	369.6	441.1	614.2	743.6	899.6
Growth (%)	20.5	24.6	18.5	18.8	19.3	39.2	21.1	21.0

Balance Sheet

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	5.4	5.5	5.5	5.5	5.6	7.5	7.5	7.5
Reserves & Surplus	1,486.6	1,704.4	2,031.7	2,395.4	2,796.4	4,333.6	4,926.6	5,668.2
Net Worth	1,492.1	1,709.9	2,037.2	2,400.9	2,802.0	4,341.1	4,934.2	5,675.7
Deposits	9,231.4	11,475.0	13,350.6	15,592.2	18,833.9	23,933.5	28,480.9	33,749.8
Growth (%)	17.0	24.3	16.3	16.8	20.8	27.1	19.0	18.5
of which CASA Deposits	3,912.0	4,846.3	6,156.8	7,510.5	8,359.9	8,951.1	10,851.2	13,364.9
Growth (%)	14.0	23.9	27.0	22.0	11.3	7.1	21.2	23.2
Borrowings	1,170.9	1,446.3	1,354.9	1,848.2	2,067.7	6,851.4	7,503.4	8,220.0
Other Liabilities & Prov.	551.1	673.9	726.0	844.1	957.2	1,273.8	1,439.4	1,640.9
Total Liabilities	12,445.4	15,305.1	17,468.7	20,685.4	24,660.8	36,399.8	42,357.8	49,286.5
Current Assets	813.5	866.2	1,194.7	1,523.3	1,937.7	2,044.0	2,231.0	2,497.2
Investments	2,931.2	3,918.3	4,437.3	4,555.4	5,170.0	7,362.1	8,613.7	9,991.9
Growth (%)	21.0	33.7	13.2	2.7	13.5	42.4	17.0	16.0
Loans	8,194.0	9,937.0	11,328.4	13,688.2	16,005.9	24,970.5	29,215.5	34,182.2
Growth (%)	24.5	21.3	14.0	20.8	16.9	56.0	17.0	17.0
Fixed Assets	40.3	44.3	49.1	60.8	80.2	136.7	147.3	172.3
Other Assets	466.5	539.3	459.3	857.7	1,467.1	1,886.5	2,150.3	2,442.9
Total Assets	12,445.4	15,305.1	17,468.7	20,685.4	24,660.8	36,399.8	42,357.8	49,286.5

Asset Quality

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
GNPA	112.2	126.5	150.9	161.4	180.2	319.7	326.5	378.0
NNPA	32.1	35.4	45.5	44.1	43.7	84.9	88.1	97.6
GNPA Ratio	1.4	1.3	1.3	1.2	1.1	1.3	1.1	1.1
NNPA Ratio	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Slippage Ratio	1.9	1.9	1.5	2.1	1.7	1.6	1.5	1.5
Credit Cost	0.9	1.3	1.5	1.2	0.8	0.5	0.5	0.5
PCR (Exc. Tech. write off)	71.4	72.0	69.8	72.7	75.8	73.5	73.0	74.2

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Yield and Cost Ratios (%)								
Avg. Yield-Earning Assets	9.6	9.0	8.1	7.4	8.0	8.3	8.5	8.4
Avg. Yield on loans	10.5	10.1	8.9	7.9	8.6	8.9	9.0	8.9
Avg. Yield on Inv.	7.6	6.1	5.6	5.8	6.5	6.8	6.9	6.9
Avg. Cost-Int. Bear. Liabilities	5.2	5.0	4.1	3.5	3.9	4.9	4.9	4.8
Avg. Cost of Deposits	4.8	4.9	4.0	3.4	3.9	4.4	4.5	4.4
Interest Spread	4.4	4.0	4.0	3.9	4.1	3.4	3.6	3.6
Net Interest Margin	4.4	4.2	4.1	3.9	4.1	3.6	3.7	3.8

Capitalisation Ratios (%)

CAR	17.1	18.3	18.5	18.7	19.3	19.3	18.5	17.9
Tier I	15.8	17.0	17.3	17.7	17.1	17.7	17.1	16.8
Tier II	1.3	1.2	1.2	1.0	2.2	1.5	1.3	1.1

Business and Efficiency Ratios (%)

Loans/Deposit	88.8	86.6	84.9	87.8	85.0	104.3	102.6	101.3
CASA Ratio	42.4	42.2	46.1	48.2	44.4	37.4	38.1	39.6
Cost/Assets	2.1	2.0	1.9	1.8	1.9	1.7	1.7	1.7
Cost/Total Income	39.7	38.6	36.3	36.9	40.4	40.3	39.3	38.3
Cost/Core Income	40.7	39.7	37.3	38.4	42.0	41.9	41.0	39.9
Int. Expense/Int. Income	51.3	51.1	46.3	43.6	46.3	54.5	54.2	53.0
Fee Income/Total Income	23.5	24.1	20.9	22.9	20.4	19.4	19.3	19.3
Non Int. Inc./Total Income	26.8	29.3	28.0	29.1	26.4	24.9	25.0	24.9
Emp. Cost/Total Expense	29.7	31.0	31.7	32.1	32.6	32.0	32.1	32.2
Investment/Deposit	31.8	34.1	33.2	29.2	27.5	30.8	30.2	29.6

Valuation

RoE	16.5	16.4	16.6	16.7	17.0	14.8	16.0	17.0
RoA	1.8	1.9	1.9	1.9	1.9	1.8	1.9	2.0
RoRWA	2.4	2.6	2.8	2.8	2.9	2.8	2.9	2.9
Book Value (INR)	274	312	370	433	502	577	656	754
Growth (%)	33.8	13.8	18.5	17.2	16.0	14.9	13.7	15.0
Price-BV (x)	5.6	4.9	4.1	3.5	3.1	2.7	2.3	2.0
Adjusted BV (INR)	263	300	357	420	489	561	638	734
Price-ABV (x)	5.8	5.1	4.3	3.6	3.1	2.7	2.4	2.1
EPS (INR)	39.6	48.0	56.6	66.8	79.3	81.6	98.8	119.5
Growth (%)	16.9	21.2	17.8	18.1	18.6	2.9	21.1	21.0
Price-Earnings (x)	38.6	31.9	27.1	22.9	19.3	18.8	15.5	12.8

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NOTES

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SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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