MOTILAL OSWAL

1 June 2022

Update | Sector: Financials

HDFC Bank

BSE SENSEX	S&P CNX
55,566	16,585

HDFC BANK

Stock Info

Bloomberg	HDFCB IN
Equity Shares (m)	5,546
M.Cap.(INRb)/(USDb)	7702.1 / 99.2
52-Week Range (INR)	1724 / 1278
1, 6, 12 Rel. Per (%)	3/-4/-15
12M Avg Val (INR M)	11987
Free float (%)	79.0

Financials Snapshot (INR b)

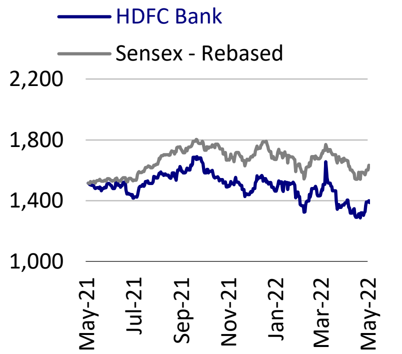
Y/E March	FY22	FY23E	FY24E
NII	720.1	860.7	1,023.1
OP	640.8	756.5	895.0
NP	369.6	445.4	535.2
NIM (%)	3.9	4.0	4.1
EPS (INR)	66.8	80.3	96.5
EPS Gr (%)	18.1	20.1	20.2
ABV (INR)	433.0	500.9	584.0
Con. BV (INR)	420.3	485.5	565.4
Ratios			
RoE (%)	16.7	17.2	17.8
RoA (%)	1.9	2.0	2.1
Valuations			
P/BV (x) Con.	20.8	17.3	14.4
P/ABV (x)	3.2	2.8	2.4
P/E (x)	3.3	2.9	2.5

Shareholding pattern (%)

As On	Mar-22	Dec-21	Mar-21
Promoter	21.0	21.0	21.1
DII	20.1	18.8	17.3
FII	47.6	49.1	51.0
Others	11.3	11.1	10.6

FII Includes depository receipts

Stock performance (one-year)



CMP: INR1,387 TP: INR1,850 (+33%) Buy

Building a future ready bank

Merger process on track; Balance Sheet to double in the next four-to-five years

We attended HDFCB's analyst day, where the management highlighted how the bank is getting future ready, with a focus on strengthening its digital capabilities and sustainable profitable growth. The bank is planning various new initiatives, with equal emphasis on providing a superior experience to its customers. Growth is likely to be broad based, with a target to double its Balance Sheet over the next four-to-five years even on a merged basis. It explained its rationale for the merger and addressed key investor concerns. We expect ~18%/20% loans/PAT CAGR over FY22-24E, with RoA/RoE at 2.1%/17.8% in FY24. HDFCB remains one of our preferred picks. We expect the stock to recover gradually as revenue and margin revive over FY23, while further clarity emerges on several aspects related to its merger with HDFC. We maintain our Buy rating with a TP of INR1,850/share.

Credit growth outlook healthy; aspires to double the Balance Sheet in four-to-five years

Credit demand is likely to remain healthy, led by its focus across segments such as Retail and Wholesale, with Commercial and Rural Banking growing at a higher pace (25-30%). PSU capex is likely to be unveiled over the next eight-to-ten months, while the recovery in private capex may be slightly delayed. The Housing sector has been performing well since CY20 and is expected to be the biggest contributor to GDP. This, along with its superior proposition in Auto/Unsecured loans, will drive Retail growth. Overall, the bank aspires to double its Balance Sheet over the next four-to-five years, even on a merged basis.

Mortgages to be a key growth driver, improves the portfolio mix

Mortgages penetration, at 2%, is the lowest v/s 21%/13%/6% penetration for Credit Cards/Personal/Vehicle loans. Around 70% of HDFC customers do not bank with HDFCB. Also, 5% of HDFCB customers have availed mortgages externally. This provides a significant growth opportunity. Undertaking the Mortgage business also provides an opportunity to cross-sell Consumer Durable loans. Currently, ~2k out of 6.3k branches offer mortgages. This is likely to increase going forward. The mix of Unsecured loans post-merger is likely to reduce to 22% from ~30% at present, which will increase its appetite to undertake Unsecured loans. We believe the merger will enable HDFCB to create a more diversified portfolio and reduce its reliance on cyclical business segments (Credit Card and Vehicle loans).

Drag of meeting PSL/SLR/CRR requirement to be controlled

Over the past years, the regulatory requirements in terms of SLR/CRR have fallen (to 22% v/s 28% earlier), while the borrowing mix of NBFCs has improved as they have strengthened their Balance Sheet. The SLR/CRR requirement stands at INR850b, with both HDFCB and HDFC (quantum of G-Sec rose to INR500b v/s INR40b a few years back) having sufficient headroom to meet the same without raising incremental liability. The PSL requirement is likely to be ~INR1.75t, of

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which 50% will be met by PSLC/Affordable Housing loans. The total cost of PSLC purchases is likely to be 5-10bp. For the balance, the bank has ~33 months to be compliant. The management believes it can meet the regulatory requirement without any challenges.

Branch banking to drive deposit mobilization; C/I ratio to moderate

HDFCB's focus remains on garnering deposits, with branch banking playing a significant role. The management said that deposit mobilization rose significantly as branches age (10x/25x deposits with 10-15/over 15-year old branches). Around 60% of branches are less than 10 years old, thus improving vintage will drive deposit growth. The bank is looking to add 1.5k-2k branches annually and will continue to invest in the business and on its staff. Despite that, the C/I ratio is likely to moderate to mid-30s (excluding mortgages) over the next three-to-five years. Including mortgages, the C/I ratio is likely to be in early 30s and the aim is to pare it down to sub-30% over the long term.

Corporate Banking remains a 2% RoA business

While the bank went slow on the Retail segment during the COVID-19 pandemic, Corporate asset growth picked up opportunistically. HDFCB posted a robust growth (16%) in Corporate loans in FY22 as compared to 1% for the system. The bank looks at the Corporate segment not just from an asset-gathering exercise, but as a segment that helps in increasing liability opportunities and fee income. The book is well-diversified, with a large part lent at a floating rate. Thus, improving its ability to pass on rate hikes. The management aims to become the largest and preferred bank for MNCs as it provides opportunities to engage with employees and build strong liability relationships. A huge opportunity exists in new-to-bank (NTB) customers, after applying suitable size and credit filters (~3x of the current book size of INR4t).

Significant opportunity exists in Commercial and Rural Banking

Commercial and Rural Banking (CRB) is considered to be the bank's PSL engine, generating 65-70% of the total PSL for the bank. The management is confident of growing by 25-30% in this segment, with a RoA of over 3%. The bank has grown well in this segment and improved its market share by ~600bp over the last two years to 18.4% in FY22. Out of the over 6,300 branches of the bank, only 2,300 branches have a MSME book of over 25% of their branch book. This implies immense scope to grow. On Agri, the bank aims to improve market share by ~300bp to 9% by FY24. The driver for this will be increased geographical penetration, with an improved presence in 0.2m villages (from 0.13m villages at present). The management aims to double its customer base/revenue by FY24/FY25.

Housing business to drive the Retail portfolio

The management is bullish on the Housing business and expects the segment to be a primary driver of growth. It has launched several new products, with customer focus as its top priority and working backwards to identify possible gaps. Among these, is an industry first Xpress Credit Vehicle loan – an end-to-end digital loan processed within 30 minutes for existing as well as new customers. The bank plans to increase distribution by 3-4x to improve growth in Gold loans. With increased adoption of analytics and AI, it endeavors to enhance customer experience. Home loans will be a strong driver, with higher penetration among salary account holders. HDFCB is confident of over 20% growth in Retail assets on a sustained basis.

Focus on building its Retail customer franchise and enhancing cross-selling

Over the last three years, Retail deposits grew 2x. The bank aims to double the same over the next 3.5 years. It has gained market share in deposits, with a growth rate of ~2x that of the industry. Growth is broad-based, with gains in more than 90% of the districts that it caters to. A combination of digitization and humanization is helping the bank clock a robust performance. HDFCB has embraced the open architecture model across all branches and products. It has an 8% market share in Life Insurance and 1% in non-Life as a distributor. It also contributes 4.4% to the overall AUM of the Mutual Fund industry.

Market leadership across payments products; new initiatives to aid growth

HDFCB offers a whole bouquet of products in payments and consumer financing, and has a leadership position in both the offline (44%) and online (48%) card acceptance business (POS). It has a 13%/25% market share in UPI (P2M)/EPI. The bank aims to increase its merchant count to 20m from 3m at present. It follows a holistic approach, which results in sustained and improving profitability. The payment ecosystem has evolved significantly as the entry point of souring customers and increasing the mix of NTB/NTC customers. The bank is undertaking various new initiatives, with the launch of PayZapp 2.0 (a comprehensive Mobile commerce payments app) and SmartHub Vyapaar 2.0 (which integrates the entire mobile merchant ecosystem), thus providing a seamless customer experience to drive further growth.

Digital sourcing gaining share, helping improve cross-sell and reduce TAT

The number of digital transactions rose 3x in FY21-22 from FY18-19 levels, with 93% of all transactions being undertaken digitally. Monthly active users/financial Mobile Banking transactions grew 40%/51% YoY, while the same for Internet Banking grew 20%/32% YoY. e-commerce card volumes on the payment gateway saw a 1.75x growth in the past three years, with ~45m UPI transactions being undertaken on a daily basis. Personal loans (97%), Auto loans (80%), Credit Cards (79%), Fixed Deposits (76%), Term Deposits (69%), Savings Accounts (67%), Recurring Deposits (55%) and Salary Accounts (46%) were sourced digitally. The bank invests in core technology transformation and a lot of new initiatives and products are being planned to be launched over the next four quarters. This is likely to result in exponential growth, with a 4x rise in Savings Accounts and a 2x increase each in Personal/Auto loans and Credit Cards.

Valuation and view

HDFCB appears well-positioned to continue to deliver healthy, sustainable growth, supported by new initiatives and expansion in its digital offerings. It has delivered strong business growth v/s its peers, resulting in constant market share gains. This was propelled by sustained momentum in the Retail segment, along with robust growth in Commercial and Rural Banking and a sharp pick-up in Wholesale loans. Earnings have been buoyant, led by a benign credit cost, even as NII and PPOP growth has been modest due to margin pressures. Asset quality ratios remain pristine, while the restructured book remains controlled ~1.14% of loans. Healthy PCR and contingent provisioning buffer provide comfort on asset quality. We estimate 18%/20% loans/PAT CAGR over FY22-24, with a FY24 RoA/RoE of 2.1%/17.8%. HDFCB remains one of our preferred top picks. We expect the stock to recover gradually as revenue and margin revive over FY23, while further clarity emerges on several aspects related to its merger with HDFC. **We maintain our Buy rating with a TP of INR1,850/share (3.1x FY24E ABV + INR104 from subsidiaries).**

Key takeaways from the session with the top management

Opening session by Mr. Sashidhar Jagdishan – MD and CEO, Mr. Kaizad Bharucha – Executive Director, and Mr. Srinivasan Vaidyanathan - CFO

- India has navigated the pandemic rather well and admirably compared to other economies
- GDP growth, inflation and other metrics were on track to deliver healthy growth for FY23 till Mar'22. However, the Russia-Ukraine war has played a spoil sport and disrupted the recovery
- Inflation has peaked in Apr'22. It is likely to fall down in the near term. Inflation is expected to inch up again and peak till Sep'22 and is then likely to fall down to pre-COVID levels by end of FY23
- Overall, still expect Indian to deliver a GDP growth in excess of 7.25-7.5% GDP for FY23, despite crude being at USD115-120
- Spends behavior and credit demand is likely to remain healthy which will drive the economy
- Capex primarily Government capex is likely to be unveiled in the next eight-to-ten months. Private Capex would also see traction over FY23, though the recovery has been delayed due to the current environment
- The Housing sector has been doing well since 2020 led by multiple factors:
  - Improved Developer discipline – Post implementation of RERA
  - NBFC crisis has strengthened the developer Balance Sheet
  - Inventory times have fallen ~20% from peak with a lower time interval
  - Affordability has improved due to lower loan rates/EMI (down to INR23 from INR50 per salary of INR100) and moderation in property prices
- Mortgages penetration is lowest at 2% v/s higher penetration levels for other products such as Credit Cards, Vehicle loans, etc.
- Around 70% of HDFC's customers are not banking with HDFCB which provides significant opportunity to grow
- Around 5% of HDFCB customers have availed mortgages externally
- Average turnaround time for home loan processing for HDFCB is eight-to-ten days which is even higher at 15 days in some places
- Further, the Housing sector is expected to grow well and likely to be the biggest contributor of GDP
- All the above factors led to rational behind HDFCB looking to expand its mortgage business and looked for merger
- Not only mortgages, even consumer durable which comes along with a purchase of a house provides significant opportunity to grow
- Currently, ~2k branches out of the total of 6.3k branches are offering mortgages. Post-merger, this is likely to increase with more branches offering mortgages.
- Mix of unsecured products stands ~35% of total advances which is likely to come down to 20-25% post the merger
- Overall, the bank believes that it can continue to double its Balance Sheet in four-to-five years on a merged Balance Sheet
- The bank will continue to add 1,500-2,000 branches per year
- Deposit mobilization increases significantly as the branches ages. Around 60% of branches are at an inflection point, which will drive growth in deposits

- The focus will remain on garnering deposits. Cost of funds differential between HDFCB and HDFC stands ~240bp – the benefit of which will accrue post the merger which will also aid profitability
- The bank is equally focused on improving the customer experience and constant focus is on reducing the customer complaints. Total complaints is expected to come down by 20-30% in FY22
- C/I ratio fell down to 36-37% over FY20-22 v/s 39-40% at pre-COVID levels due to moderation in Retail loans. As retail lending picks up, C/I ratio is likely to inch up
- Bank will continue to invest in business and people. However, despite that the C/I ratio is likely to come down and fall to mid-30s (excluding mortgages) over the next three-to-five years.
- Including mortgages, C/I ratio is likely to be early 30s. The aim is to bring it down to below 30% over the long term
- Profitability of the Corporate book stands healthy and is still a 2% RoA business. The bank doesn't do any lending, which is not an 18-20% RoE business during its entire life cycle
- The number of merchant relationships with HDFCB is likely to increase multifold to ~20m over the next few years
- **Regulatory requirement for Merger**
- Over four-to-five years back, the Balance Sheet of HDFC stood at INR3t
- The SLR/CRR requirement (26-27%) was INR800-900b
- Further, the PSL requirement stood at INR800-900b
- Thus, the bank had to raise ~INR1.6t worth of deposits which was difficult and thus shelved the merger ideas
- However, over the past years, regulatory requirement has come down while mix G-Sec has improved for NBFCs
- Requirement of SLR/CRR came down to 22% and large NBFCs improved their Balance Sheet
- The quantum of G-Sec investments increased to INR500b v/s INR40b earlier
- Thus, currently, on a total Balance Sheet of INR5t for HDFC, SLR/CRR requirement stands at INR700b. Both HDFCB and HDFC has sufficient headroom to meet this without raising incremental liability
- Further, the PSL requirement is likely to be ~INR1.75t. Around 50% of this would be met by PSLC's/Affordable Housing loans
- By the end of this year, all branches would start to do Gold loans which would also aid in maintaining the PSL requirement
- Further, affordable home loans would also meet the PSL requirement
- The total cost of PSLC purchases is likely to be ~5-10bp
- For the remaining 50%, the bank has ~33 months to take care of it. Thus, the management believes that the bank can meet the regulatory requirement without any challenges
- Further, the purchase consideration has also moderated for HDFC w.r.t HDFCB share price
- CCI approval is likely to come by Sep'22
- The bank has taken in principal approval from the regulator for the merger
- In terms of stake in HDFC Life and HDFC Ergo, the preference of the bank is to increase the stake to 50% and continue to work as subsidiaries

- However, if regulatory approval doesn't come, the bank will look to comply and bring it down to 30%
- On HDB Financials too, if the regulator asks, the bank will follow a glide path to reduce the stake
- As long as the tax neutrality is not resolved, there is not much push on the NOFHC structure
- The focus towards the subsidiaries would increase from a mere distributor to enhance the value which will, in turn, increase the value of HDFCB

Session #2: Corporate Cluster

- Government expenditure has picked up and has led to the emergence of green shoots across some segments of the economy
- In 3QFY22, the bank launched a new supply chain (SCM) platform to cater to clients. This has led to a substantial increase in customer engagement and thus volumes.
- In FY22, the bank grew much faster than the industry in corporate banking. While the system grew 0.9%, Bank posted a strong growth of 15.7% in FY22
- Corporate Banking asset grew at 22% CAGR over last two years
- The bank's idea of Corporate Banking is not just from an asset perspective. The segment offers tremendous ancillary services, which helps in increasing liability opportunities and fee income.
- Presence across the entire corporate ecosystem is important – funding working capital and term loan needs, providing forex services, managing supply chain management, handling payment volumes and increasing engagements with salary account holders
- The book is well diversified across tenors and industries. A large part of the book is floating rate and thus, ability to pass rate hike is much better in a rising rate environment
- Of the book, 62% is lent to domestic companies with 38% towards PSU
- The portfolio is also well rated with a large part of the book in AA to AA+
- Currently, the bank has employee salary accounts of more than 2,000 companies, with close to 4.4m employees. This customer base has an outstanding savings balance of INR541b and therefore provides float. This is also a strong audience for cross-sell of various products and services the Bank offers
- Digital to create scale on the trade side of the corporate channel
- The bank is one of the largest movers of cash in the country with strong cash management services. This leads to short built up in the float (time lag between collection and payment of current account holder). Other than this, it helps in garnering deep insights about corporates, which would otherwise not be available
- The bank has embarked on an architectural change to move away from legacy IT system to a Cloud-based platform to improve business and internal processes. This will improve the ability to take a larger wallet share of existing customers
- The platform also helps in pricing products better
- On the MNC side, the aim of the bank is to be one of the largest and preferred Banks for MNCs in India. Most of these MNCs are asset light, and hence opportunity is on the liability side and from cross-selling to employees

- A huge opportunity exists in NTB customer segment. After applying suitable filters, opportunity size of this is ~INR11t - 3x of the current book size of INR4t
- The PLI Scheme has been rolled out by the government in 14 sectors. Approved applicants within these have started laying out capex plans

Session #3: Commercial and Rural Banking

- Commercial and Rural Banking is considered to be the PSL engine of the bank
- Customer segment evolves with lifecycle as a retail SME of today becomes a Wholesale SME tomorrow and a mid-corporate sometime later
- The objective is to deliver a 25-30% growth rate with a RoA of over 3%
- Around 65-70% of the bank's PSL is generated by this segment
- In this segment, several products are clubbed together with geographical focus as a common point
- Opportunity size of this segment is huge. Total SME credit demand is of INR50t. Out of this INR20t is serviced by Banks and NBFCs. INR10t is done by the proprietor in his/her own name. Therefore, there is a credit gap of INR20t, which will be funded by organized sector over time
- Market share in MSME segment improved to 18.4% from 12% in the last two years
- Today, the bank is present in more than 600 districts. This has grown from 450 districts, four years ago; Customer base is fairly equitable across these districts
- Around 80% of the bank's 6,300 branches do MSME lending. Only 2,300 branches have a MSME book of over 25% of their branch book.
- On Agri
  - Market share at 6.4% with a target of reaching 9% by FY24
  - Excluding HDFCB, private bank credit in this segment is INR800b while HDFCB does close to INR700b
- The aim is to expand CRB segment through geographical penetration (to 0.2m from 0.13m villages), focus on Agri-allied crops, government schemes, and small and marginal farmers
- It is the numero uno player in vehicle finance, not just amongst Banks but also compared to NBFCs
- The plan is to build on the Healthcare sector
- Growth, PSL and Income are three key components of our strategy
- Branch leads, direct and digital sourcing are key sourcing channels
- Disbursements in FY23 to be book size of FY22
- It aims to double its customer base by FY24
- It aims to double FY22 revenue by FY25

Session #4: Retail Assets

- Launched an industry first Xpress Credit Vehicle Loan – It is an end-to-end digital with a processing time of less than 30 minutes with KYC done via a video call. This is not just for existing account holders, but for anyone
- The management is confident of over 20% growth in Retail assets
- Operate a consistently good quality portfolio with prudent pricing
- Several new products have been launched in a process similar to FinTechs – keeping customer focus as top priority and working backwards to identify possible gaps

- The aim is to grow Unsecured products by further penetration in the Government segment
- Consolidating Gold loans by increasing distribution by 3-4x
- It aspires to launch digital end-to-end Personal loans for new to bank customers by 3QFY23
- Target geographical expansion of retail assets into newer areas
- Plans to strengthen digital adoption with adoption of analytics to improve processing time and thus, customer experience
- The bank has aggressive plans to grow Home loans by focus on salary account holders, government scheme, and enhanced channel distribution in Commercial and Rural Banking is considered to be the PSL engine of the bank

Session #5: Payments Business

- HDFCB offers a whole bouquet of products in payments and Consumer financing
- Its numero uno in offline and online card acceptance
- Cards acceptance business (POS): 44% market share in offline cards; 48% market share in online cards acquiring
- Around 13% market share in UPI (P2M); 25% market share in EPI
- Total merchant acquiring spends stands at INR14.6t in FY21-22
- Focus remains on sustained profitability which accrues with sustained usage by customer and superior acquisition
- Payment ecosystems have evolved significantly, with the payments business being the entry point of souring customers for the new age players
- The process of risk underwriting, acquisition of customers and behavior is evolving as the NTC customers are increasing
- Holistic approach results in sustained and improving profitability
- The card acceptance/partnerships business helps the bank in acquiring NTB customers
- PayZapp 2.0 – a comprehensive Mobile commerce payments app is likely to be launched soon
- Around 3m customers are active on PayZapp on a MoM basis out of a total of ~15m customers
- PayZapp is a good customer acquisition channel and could be used as a merchant acquisition tool as well
- Average ticket size stands at INR1,900 with around three transactions per customer
- It has launched a self-service Do It Yourself (DIY) digital platform
- SmartHub Vyapaar 2.0 is launched which integrates entire mobile merchant ecosystem. POS, QO, PG, UPI in a single app, banking products, lending products and offer other value added services

Session #6: Digital and Technology

- The number of digital transactions in FY21-22 was 3x of FY18-19
- Mobile banking: Monthly active users grew 40% YoY, financial transaction grew by 51%
- Around 93% of all transactions are being carried out digitally
- Internet Banking: Monthly active users grew 20% YoY, financial transaction grew 32%, and 76% of FDs are being booked online

- e-commerce card volumes on payment gateway grew 1.75x in three years
- Around 45m UPI transactions are being done on a daily basis
- Digitally sourced retail assets: Personal Loans (97%), Auto Loans (80%), Credit cards (79%)
- Digitally sourced liabilities: Fixed Deposits (76%), Term Deposits (69%), Savings accounts (67%), Recurring Deposits (55%) and Salary accounts (46%)
- The bank is investing in Core Technology Transformation
- Also planning to launch a New enhanced Wealth app
- A lot of new initiatives and products are being planned to be launched over the next four quarters
- Zero touch onboarding is likely to result in exponential growth with a 4x rise in Savings accounts and a 2x increase each in Personal/Auto loans and Credit Cards

Session #7: Retail Customer Franchise and Life Cycle Management

- Retail deposits grew 2x in the last three years. The target is to grow another 2x over the next 3.5 years
- Growth is over 2x of industry growth; Bank has gained market share in 90% of districts and showcases broad-based strength
- Customer acquisition grew 1.9x over FY18-22 to 8.3m. The target is to reach 10m over the next 15 months
- The strategy of digitization and humanization is helping the bank to post strong numbers
- Branch breakeven is improving. Vintage branch breakeven was 2-2.5 years. Some branches now break even in nine-to-ten months. Around 55% of branches breakeven within 12-24 months
- Credit worthiness, intent and propensity are mashed together to build a superior level window
- The segment focused marketing is relevant and the bank is focusing on the same
- Employee segmentation and curated propositions are an important part of Employee Banking Solutions
- Aiming for a 2x growth in rural in 18-24 months through a differentiated proposition

Session #8: Government and Institutional Business

- Targets 20% market share in the top 35 schemes of the Government of India
- Market leader in direct tax with a 25% market share
- New business opportunities have come up for various government businesses and schemes
- Main proposition of the government business is to provide digitization solutions to various government institutions
- Religious institutions and housing societies are few more segments the Bank is trying to make inroads in
- The aim is to double the Government and Institutional Business over the next two years
- There are several benefits of building alternate banking channels and partnerships

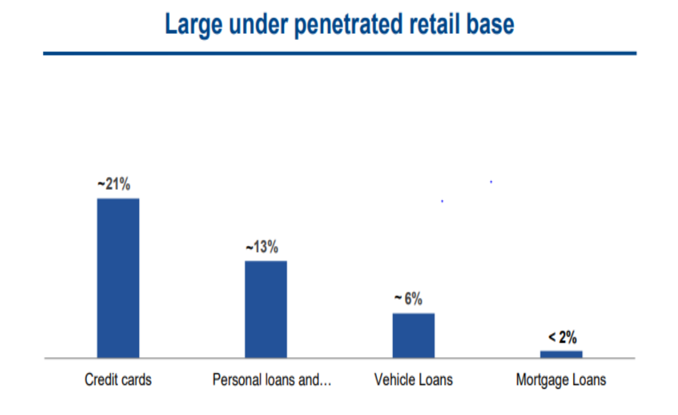
Session #9: Third Party Products and Virtual Channels

- Distributes Mutual Fund and Insurance products under an open architecture model across all branches
- It has market share of 8% in Life Insurance and 1.1% of the overall industry. It has plans to improve share of non-Life
- In the case of Mutual Funds, its market share to overall AUM stands at 4.4%
- It is imperative to ensure that the sale is undertaken in a proper manner, otherwise it may lose the customer
- It is the only bank to check with customer for confirmation of purchase. This ensures complains are the lowest for HDFCB.
- With the help of partners, started a 'pre-approved sum assured' on the basis of age, activities, and income of the customer
- In the long run, virtual channel will become a single-digit cost structure

Session #10: Wealth and Digital Marketing

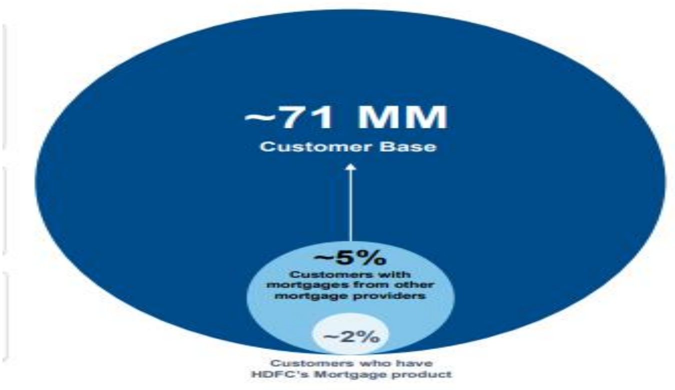
- These are the two pillars of growth (among 10) identified by CEO for growth
- Digital marketing is now considered as a full-fledged sales channel
- Manage Active AUM of INR1t
- Around 83-85% of the market is largely between HNW, Affluent and Mass-Affluent customers
- 90% of incremental revenue comes from these segments
- Most of the skilling to handle these relationships is being done internally
- It employs a hub and spoke model for wealth coverage
- Moved away from transaction led model to relationship led model
- Currently, wealth app is in testing phase and the Bank plans to launch the same in 2QFY23
- It manages close to INR36t in demat accounts
- Distribution is focused on B-30 as it contributes a large amount to AUM
- Digital marketing answers the key questions: how does a customer get credit and how does a customer invest money
- There is a strong growth in preference for HDFCB (through external surveys conducted)
- Consumer interaction with Bank happens through 13 different channels

Exhibit 1: Sub-2% of HDFCB's customers has a Home loan with HDFC



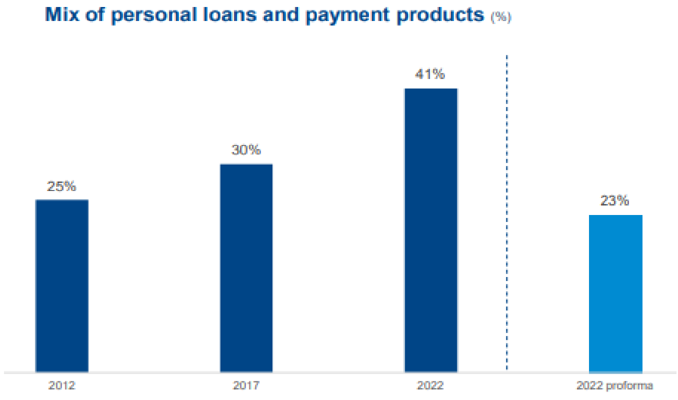
Source: MOFSL, Company

Exhibit 2: Huge opportunity even at its existing customer base



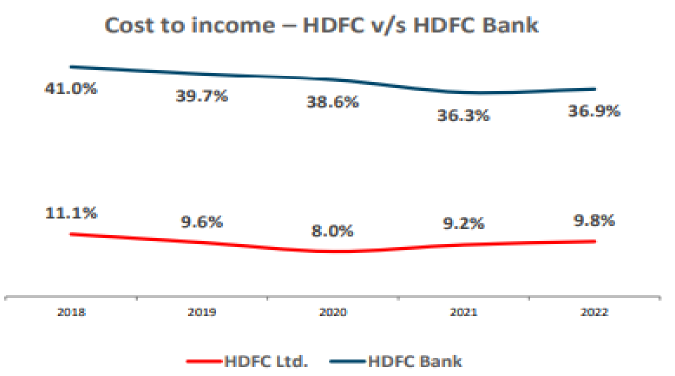
Source: MOFSL, Company

Exhibit 3: Share of Personal loans to fall post-merger



Source: MOFSL, Company

Exhibit 4: Scope for improvement in the C/I ratio



Source: MOFSL, Company

Exhibit 5: CRR and SLR requirements after the merger

CRR and SLR

CRR/SLR Requirements – illustrative	For CRR	For SLR
Total liabilities	475	475
Less: Affordable housing bonds	75	75
Less: Interbank borrowings	125	
NDTL	**275**	**400**
Reserve requirements	4.5%	18%
To be maintained	~13	~72

HDFC Ltd.'s 40-50K liquid assets; and 40-50K from Bank's surplus

Source: MOFSL, Company

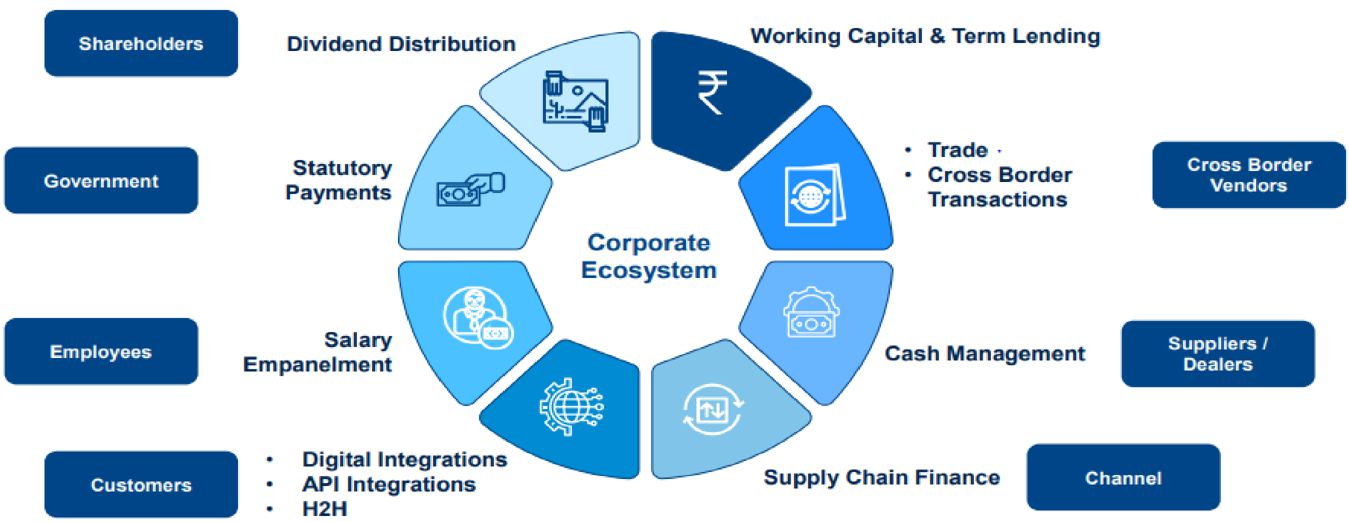
Exhibit 6: Cost of PSLC has a marginal impact of 5-10bp in RoA

PSL Requirements – illustrative	
Total loans	575
Less: Affordable housing assets backed by bonds	75
ANBC base for PSL requirement	**500**
PSL required to be maintained	~200
PSL available with HDFC Limited	~25
PSL to be generated	175
50% of PSL through affordable housing/ core PSL	~80-90
50% of PSL (agri – SMF/Micro etc.)	~80-90

Lead time until effective date + 12-15 months

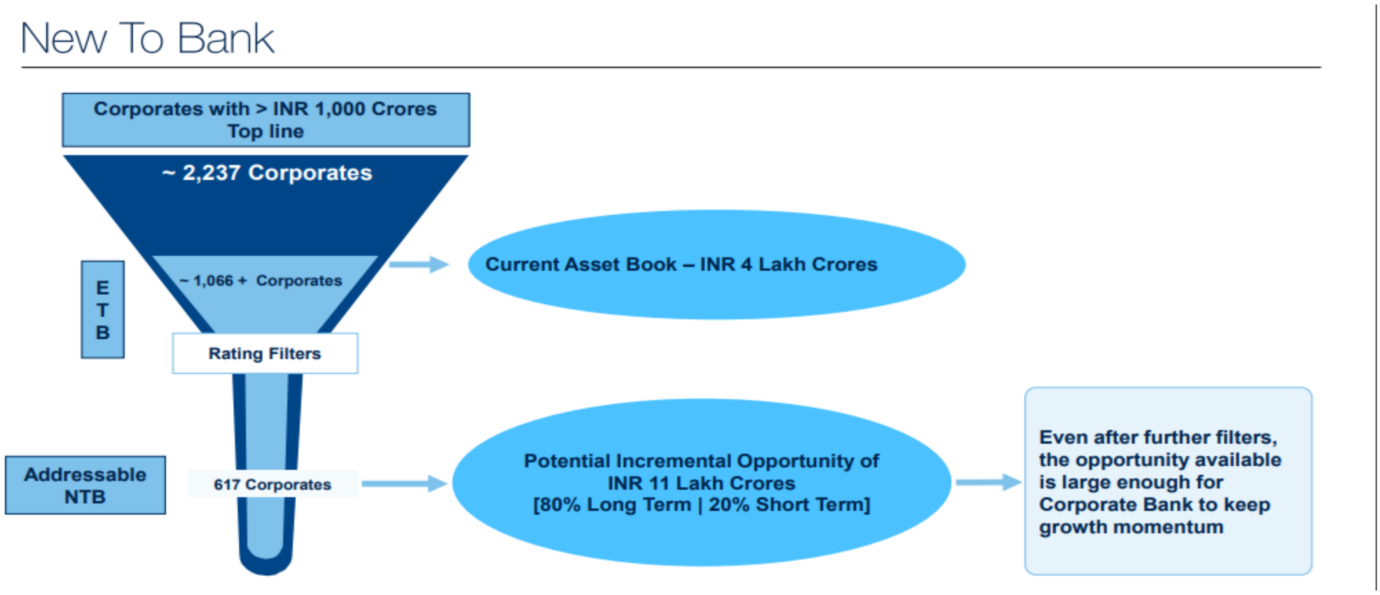
Source: MOFSL, Company

Exhibit 7: Corporate business attractive due to a wide range of customer engagement



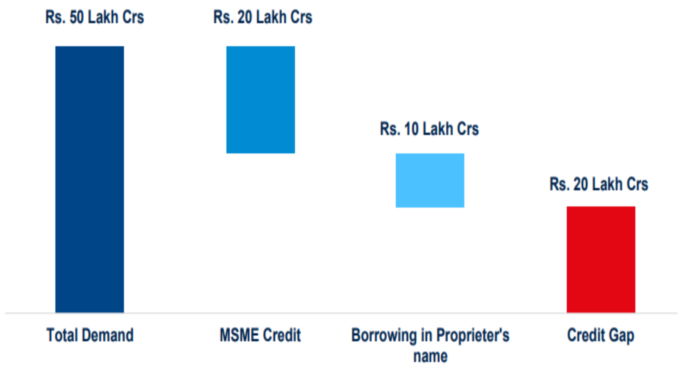
Source: MOFSL, Company

Exhibit 8: New to Bank (NTB) segment presents a huge scope for growth – ~3x of its existing book



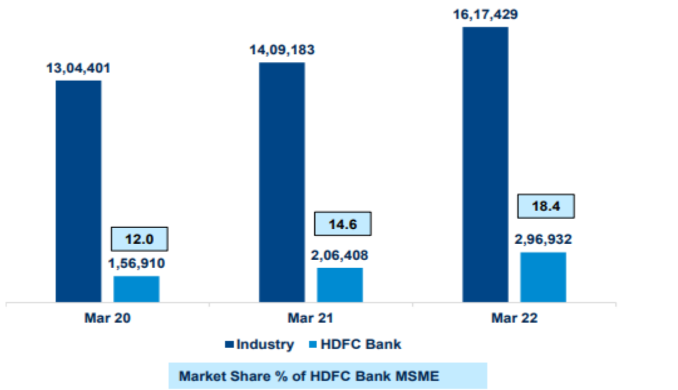
Source: MOFSL, Company

Exhibit 9: SME credit gap, formalization to fill the gap



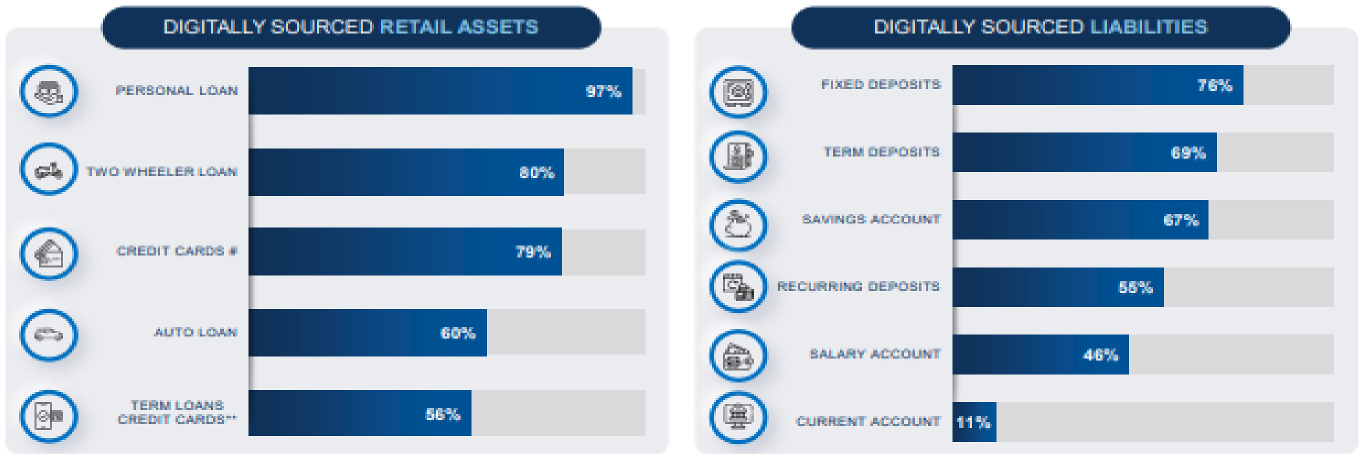
Source: MOFSL, Company

Exhibit 10: Market share gain in MSME over the last two years



Source: MOFSL, Company

Exhibit 11: Higher sourcing of assets and liabilities, led by digital across various products



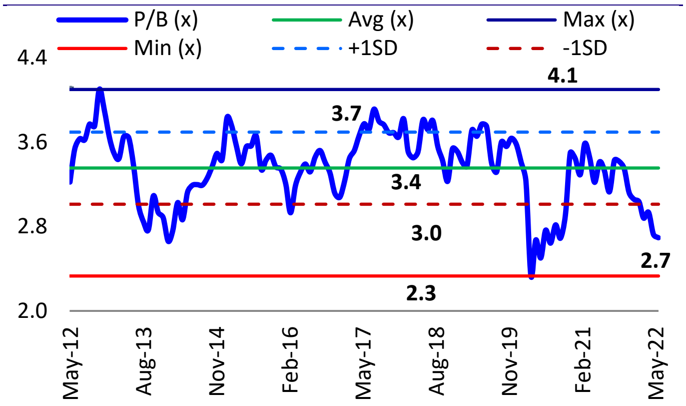
Source: MOFSL, Company

Valuation and view

- HDFCB delivered a strong growth in advances in 4QFY22, led by strong sequential trends in Retail loans. The growth was also led by robust trends in Commercial and Rural Banking, while Wholesale advances too saw a strong pick up. We expect loan growth to remain healthy and thus estimate loans to grow by 18% each in FY23E/FY24E. Deposit growth remains strong, led by CASA, which should support the margin trajectory.
- The bank's fee income improved over 4QFY22 and we expect the momentum to remain healthy. Strong cost control, led by further digitalization, is likely to drive an overall improvement in return ratios. Margin declined sequentially QoQ; though we expect a gradual increase in margin on account of lower cost of funds as well as a strong and granular liability franchise.
- Strong capitalization and liquidity levels should help HDFCB sustain its growth momentum over the next few years. This makes the bank better placed to tide over the crisis and gain incremental market share.
- Asset quality continued to witness an improvement over 4QFY22, led by lower slippages. GNPA/NNPA moderated to 1.17%/0.32%. Restructuring book declined to ~INR157b (1.14% of total loans). Moreover, PCR improved to ~73%, which, along with a floating provision of INR14.5b and contingent provision of INR96.9b, would keep credit cost in check and limit the impact on profitability. We expect NNPA to remain at 0.4% in FY22-24.

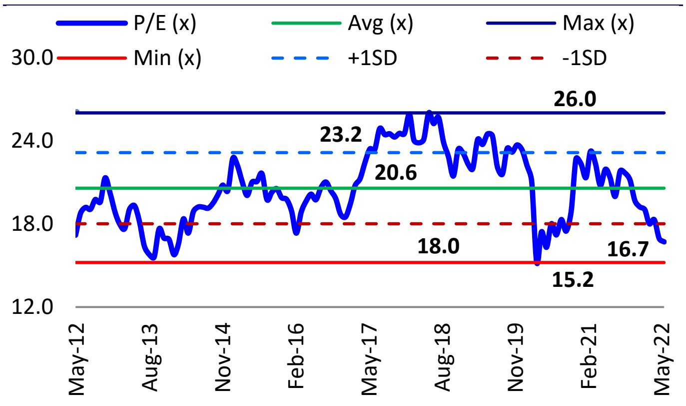
- **Buy with a TP of INR1,850/share:** HDFCB appears well-positioned to continue to deliver healthy, sustainable growth supported by new initiatives and expansion in its digital offerings. It has delivered strong business growth v/s its peers, resulting in constant market share gains. This was propelled by a sustained momentum in the Retail segment along with robust growth in Commercial and Rural Banking and a sharp pick-up in wholesale loans. Earnings have been buoyant led by a benign credit cost even as NII and PPOP growth has been modest due to pressure on margins. Asset quality ratios remain pristine, while the restructured book remains controlled ~1.14% of loans. Healthy PCR and contingent provisioning buffer provide comfort on asset quality. We estimate 18%/20% loans/PAT CAGR over FY22-24E, with RoA/RoE at 2.1%/17.8% for FY24E. HDFCB remains one of our preferred picks. We expect the stock to recover gradually as revenue and margin revive over FY23, while further clarity emerges on several aspects related to the merger with HDFC. **We maintain our Buy rating, with TP of INR1,850 per share (3.1x FY24E ABV and INR104 from subsidiaries).**

Exhibit 12: One-year forward P/B ratio



Source: MOFSL, Company

Exhibit 13: One-year forward P/E ratio



Source: MOFSL, Company

Exhibit 14: DuPont Analysis – Return ratios to improve steadily

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Interest income	8.81	8.32	8.57	8.27	7.38	6.70	7.36	7.52
Interest expense	4.60	4.17	4.40	4.23	3.42	2.92	3.51	3.60
Net interest income	**4.21**	**4.16**	**4.18**	**4.05**	**3.96**	**3.77**	**3.85**	**3.92**
Core fee income	1.12	1.31	1.34	1.38	1.15	1.21	1.20	1.21
Trading and others	0.44	0.27	0.19	0.30	0.39	0.34	0.33	0.33
Non-interest income	**1.56**	**1.58**	**1.53**	**1.68**	**1.54**	**1.55**	**1.53**	**1.54**
Total income	**5.33**	**5.74**	**5.71**	**5.73**	**5.50**	**5.32**	**5.39**	**5.46**
Operating expenses	**2.51**	**2.35**	**2.26**	**2.21**	**2.00**	**1.96**	**2.00**	**2.03**
Employee cost	0.82	0.71	0.67	0.69	0.63	0.63	0.64	0.64
Others	1.68	1.65	1.59	1.53	1.36	1.33	1.36	1.38
Operating profit	**3.27**	**3.38**	**3.44**	**3.51**	**3.50**	**3.36**	**3.39**	**3.43**
Core operating profit	**2.83**	**3.11**	**3.26**	**3.22**	**3.11**	**3.02**	**3.05**	**3.10**
Provisions	**0.46**	**0.61**	**0.65**	**0.88**	**0.96**	**0.79**	**0.72**	**0.68**
PBT	**2.82**	**2.77**	**2.79**	**2.64**	**2.54**	**2.57**	**2.67**	**2.75**
Tax	0.97	0.96	0.96	0.75	0.64	0.63	0.68	0.69
RoA	**1.85**	**1.81**	**1.83**	**1.89**	**1.90**	**1.94**	**1.99**	**2.05**
Leverage (x)	9.7	9.8	9.0	8.7	8.7	8.6	8.6	8.7
RoE	**17.9**	**17.9**	**16.5**	**16.4**	**16.6**	**16.7**	**17.2**	**17.8**

Financials and valuations

Income Statement (INR b)

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Interest Income	693.1	802.4	989.7	1,148.1	1,208.6	1,277.5	1,644.5	1,962.8
Interest Expense	361.7	401.5	507.3	586.3	559.8	557.4	783.7	939.7
Net Interest Income	**331.4**	**400.9**	**482.4**	**561.9**	**648.8**	**720.1**	**860.7**	**1,023.1**
Growth (%)	20.1	21.0	20.3	16.5	15.5	11.0	19.5	18.9
Non-Interest Income	123.0	152.2	176.3	232.6	252.0	295.1	342.3	400.5
Total Income	**454.4**	**553.2**	**658.7**	**794.5**	**900.8**	**1,015.2**	**1,203.1**	**1,423.6**
Growth (%)	18.5	21.7	19.1	20.6	13.4	12.7	18.5	18.3
Operating Expenses	197.0	226.9	261.2	307.0	327.2	374.4	446.5	528.6
Pre Provision Profit	**257.3**	**326.2**	**397.5**	**487.5**	**573.6**	**640.8**	**756.5**	**895.0**
Growth (%)	20.4	26.8	21.8	22.6	17.7	11.7	18.1	18.3
Core PPP	**220.9**	**311.0**	**380.3**	**465.9**	**549.2**	**603.0**	**711.9**	**842.5**
Growth (%)	19.7	40.8	22.3	22.5	17.9	9.8	18.1	18.3
Provisions (exc. tax)	35.9	59.3	75.5	121.4	157.0	150.6	160.3	178.6
PBT	**221.4**	**267.0**	**322.0**	**366.1**	**416.6**	**490.2**	**596.2**	**716.4**
Tax	75.9	92.1	111.2	103.5	105.4	120.5	150.8	181.3
Tax Rate (%)	34.3	34.5	34.5	28.3	25.3	24.6	25.3	25.3
PAT	**145.5**	**174.9**	**210.8**	**262.6**	**311.2**	**369.6**	**445.4**	**535.2**
Growth (%)	18.3	20.2	20.5	24.6	18.5	18.8	20.5	20.2

Balance Sheet

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Equity Share Capital	5.1	5.2	5.4	5.5	5.5	5.5	5.5	5.5
Reserves and Surplus	855.6	1,057.8	1,486.6	1,704.4	2,031.7	2,395.4	2,772.2	3,233.3
Net Worth	**860.7**	**1,063.0**	**1,492.1**	**1,709.9**	**2,037.2**	**2,400.9**	**2,777.7**	**3,238.8**
Deposits	6,436.4	7,887.7	9,231.4	11,475.0	13,350.6	15,592.2	18,242.8	21,526.6
Growth (%)	17.8	22.5	17.0	24.3	16.3	16.8	17.0	18.0
of which CASA Dep.	3,091.5	3,430.9	3,912.0	4,846.3	6,156.8	7,510.5	8,373.5	9,923.7
Growth (%)	30.8	11.0	14.0	23.9	27.0	22.0	11.5	18.5
Borrowings	740.3	1,231.0	1,170.9	1,446.3	1,354.9	1,848.2	2,030.3	2,367.7
Other Liabilities and Prov.	601.0	457.6	551.1	673.9	726.0	844.1	945.4	1,039.9
Total Liabilities	**8,638.4**	**10,639.3**	**12,445.4**	**15,305.1**	**17,468.7**	**20,685.4**	**23,996.2**	**28,173.0**
Current Assets	489.5	1,229.2	813.5	866.2	1,194.7	1,523.3	1,581.3	1,768.2
Investments	2,144.6	2,422.0	2,931.2	3,918.3	4,437.3	4,555.4	5,284.2	6,182.5
Growth (%)	9.5	12.9	21.0	33.7	13.2	2.7	16.0	17.0
Loans	5,545.7	6,583.3	8,194.0	9,937.0	11,328.4	13,688.2	16,152.1	19,059.5
Growth (%)	19.4	18.7	24.5	21.3	14.0	20.8	18.0	18.0
Fixed Assets	36.3	36.1	40.3	44.3	49.1	60.8	68.1	76.3
Other Assets	422.3	368.8	466.5	539.3	459.3	857.7	910.5	1,086.5
Total Assets	**8,638.4**	**10,639.3**	**12,445.4**	**15,305.1**	**17,468.7**	**20,685.4**	**23,996.2**	**28,173.0**

Asset Quality

Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
GNPA	58.9	86.1	112.2	126.5	150.9	161.4	197.1	241.1
NNPA	18.4	26.0	32.1	35.4	45.5	44.1	57.0	71.1
GNPA Ratio	1.1	1.3	1.4	1.3	1.3	1.2	1.2	1.3
NNPA Ratio	0.3	0.4	0.4	0.4	0.4	0.3	0.4	0.4
Slippage Ratio	1.5	2.1	1.9	1.9	1.5	1.7	1.7	1.7
Credit Cost	0.6	0.8	0.9	1.0	1.1	1.2	1.0	0.9
PCR (Excl. Tech. write off)	68.7	69.8	71.4	72.0	69.8	72.7	71.1	70.5

Financials and valuations

Ratios								
Y/E March	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Yield and Cost Ratios (%)								
Avg. Yield on Earning Assets	**9.6**	**9.4**	**9.6**	**9.0**	**8.1**	**7.4**	**8.2**	**8.3**
Avg. Yield on loans	10.2	10.3	10.5	10.1	8.9	7.9	8.8	8.9
Avg. Yield on Inv.	7.8	7.2	7.6	6.1	5.6	5.8	6.3	6.5
Avg. Cost on Int. Bear. Liab.	**5.5**	**4.9**	**5.2**	**5.0**	**4.1**	**3.5**	**4.2**	**4.3**
Avg. Cost of Deposits	5.3	4.6	4.8	4.9	4.0	3.9	3.9	4.0
Interest Spread	**4.2**	**4.5**	**4.4**	**4.0**	**4.0**	**3.9**	**4.0**	**4.0**
Net Interest Margin	**4.6**	**4.4**	**4.4**	**4.2**	**4.1**	**3.9**	**4.0**	**4.1**
Capitalization Ratios (%)								
CAR	14.6	14.8	17.1	18.3	18.5	18.9	18.0	17.3
Tier I	12.8	13.3	15.8	17.0	17.3	17.9	17.0	16.6
Tier II	1.8	1.6	1.3	1.2	1.2	1.0	0.9	0.8
Business and Efficiency Ratios (%)								
Loans/Deposit	86.2	83.5	88.8	86.6	84.9	87.8	88.5	88.5
CASA Ratio	48.0	43.5	42.4	42.2	46.1	48.2	45.9	46.1
Cost/Assets	2.3	2.1	2.1	2.0	1.9	1.8	1.9	1.9
Cost/Total Income	43.4	41.0	39.7	38.6	36.3	36.9	37.1	37.1
Cost/Core Income	45.8	42.2	40.7	39.7	37.3	38.3	38.5	38.6
Int. Expense/Int. Income	52.2	50.0	51.3	51.1	46.3	43.6	47.7	47.9
Fee Income/Total Income	21.8	22.8	23.5	24.1	20.9	22.6	22.2	22.1
Non Int. Inc./Total Income	27.1	27.5	26.8	29.3	28.0	29.1	28.5	28.1
Emp. Cost/Total Expense	32.9	30.0	29.7	31.0	31.7	32.1	31.8	31.7
Investment/Deposit	33.3	30.7	31.8	34.1	33.2	29.2	29.0	28.7
Valuation								
RoE	17.9	17.9	16.5	16.4	16.6	16.7	17.2	17.8
RoA	1.8	1.8	1.8	1.9	1.9	1.9	2.0	2.1
RoRWA	2.4	2.4	2.4	2.6	2.8	2.9	3.0	3.0
Book Value (INR)	167.9	204.8	273.9	311.8	369.5	433.0	500.9	584.0
Growth (%)	16.9	22.0	33.8	13.8	18.5	17.2	15.7	16.6
Price-to-BV (x)	**8.3**	**6.8**	**5.1**	**4.4**	**3.8**	**3.2**	**2.8**	**2.4**
Adjusted BV (INR)	165.4	193.9	262.8	300.3	356.8	420.3	485.5	565.4
Price-to-ABV (x)	**8.4**	**7.2**	**5.3**	**4.6**	**3.9**	**3.3**	**2.9**	**2.5**
EPS (INR)	28.4	33.9	39.6	48.0	56.6	66.8	80.3	96.5
Growth (%)	16.7	19.4	16.9	21.2	17.8	18.1	20.1	20.2
Price-to-Earnings (x)	**48.9**	**40.9**	**35.0**	**28.9**	**24.5**	**20.8**	**17.3**	**14.4**

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Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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