HDFC Bank (HDFBAN)

ICICI direct Research

CMP: |₹ 1626 | Target: |₹ 2050 (26%) | Target Period: 12 months | **BUY**

August 4, 2023

Revival in growth with steady RoA to aid valuation; merger benefit to accrue with a lag

About the stock: HDFC Bank is a leading private sector bank with consistent growth and operational performance over various cycles. Post merger, the bank has become the second largest in terms of size with diversified portfolio. The bank has maintained superior return ratios compared to its peers resulting in premium valuations.

- Largest private sector bank with loan book of ₹ 16 lakh crore
- Consistent performance with +4% NIM and +15% RoE in past many years

Investment Rationale

- **Strengthening of distribution capabilities to enable future growth:** HDFC Bank has been aggressive in strengthening its distribution capabilities across channels with continued focus on semi urban & rural areas. Branch count has increased from 6342 in Mar'22 to 7860 in Jun'23 in-line with strategy to double branch in FY22-25E. Such expansion is expected to keep opex elevated, though is expected to enable garnering of liabilities. Thus, CD ratio at ~110% (post-merger) is expected to normalize at 85-88%, in next 3-4 years.
- **Steady operational performance to regain normalised RoA:** On proforma basis, HDFC Bank, post-merger, has reported 13% growth in advances, however, management seemed confident of revival in credit off-take to 17-18% in FY24, as non-individual book run down recedes. Liabilities accretion to bring CD ratio from more than 100% (post-merger) to normalised level of ~85% remains in focus. Margins (post-merger) are expected to moderate in near term at 3.8-3.9%, however, decline in CI ratio (expected at 34-35%) and moderation in credit cost (given substantial increase in home loan book) is expected to result in steady RoA at 1.8-1.9% in FY24-25E.
- **Merger to result in near term volatility; integration benefit to accrue gradually**: Merger of HDFC Bank & HDFC Ltd has led to accretion of ₹6 lakh crore of asset base and ₹6.4 lakh crore of liabilities. Management remains confident of integration benefit with substantial cross selling opportunities, thus, expecting merged entity to grow at 17-18% in FY24E (with receding of non-individual book from parent).

Rating and Target price

- Historically, HDFC Bank has delivered consistent strong business growth coupled with superior return ratios. Post merger, integration and accretion of liabilities remain the focus area. Management is confident of pedalling growth to 17-18% with steady return ratio at 1.8-1.9% in FY24-25E, though we expect some volatility in near term.
- Valuing the merged entity on SOTP basis assigning 2.5x FY25E ABV for lending business (merged basis) and ₹ 144 for subsidiaries arriving at a target of ₹ 2050 per share. Maintain BUY rating on the stock.

HDFC BANK

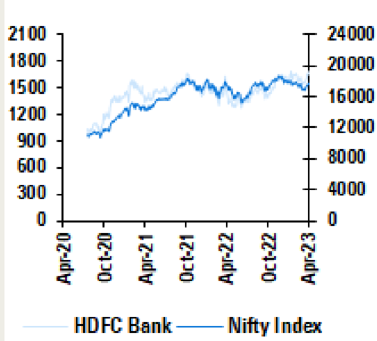
Particulars

Particulars	Amount
Market Capitalisation	₹ 1231403 crore
52 week H/L	1758/1365
Networth	₹ 293814 crore
Face value	₹ 1
DII holding (%)	29.8
FII holding (%)	54.0

Risks to our call

1) Slower than expected business growth
2) Shift in borrowing with deposits on a slower than expected pace

Price performance



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Conviction Ideas

ICICI Securities – Retail Equity Research

Key Financial Summary

₹ crore	FY21	FY22	FY23	3 year CAGR (FY19-FY22)	FY24E	FY25E	3 year CAGR (FY22-25E)
NII	64,880	72,010	86,842	10%	1,20,937	1,39,639	17%
PPP	57,362	64,077	70,405	7%	1,06,854	1,23,285	21%
PAT	31,117	36,961	44,109	12%	68,548	78,644	21%
ABV (₹)	361.3	425.0	494.3		644.7	753.5	
P/E	28.8	24.4	20.6		17.0	14.8	
P/ABV	4.5	3.8	3.3		2.5	2.2	
RoA	2.0	2.0	2.1		1.9	1.9	
RoE	15.3	15.4	15.7		14.5	14.3	

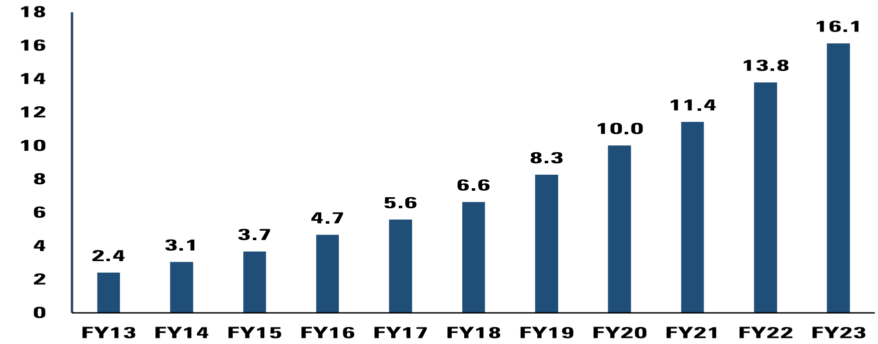
Source: Source: Company, ICICI Direct Research

Company Background

HDFC Bank is a leading and largest private sector bank with advances at ₹ 16 lakh crore, spread across product portfolio including retail, SME and wholesale segment. The bank has consistently delivered healthy business growth and operational performance over various cycles with superior return ratios at +15% RoE in past many years.

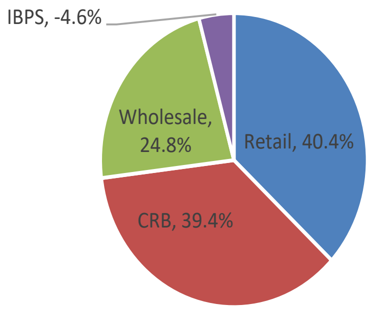
The bank has undertaken merger with its parent, effective from July 2023. Post merger, the bank has become the second largest in terms of size with diversified portfolio. Advances book, as of June 2023, stood at ₹ 22.4 lakh crore while deposit base is at ₹ 20.6 lakh crore. Merged entity is placed with large and diversified product profile across retail, MSME and corporate sector. Distribution channel remains strong with more than 7800 branches and continued focus on digital offering.

Exhibit 1: Consistent advances growth in last decade (Rs lakh crore)



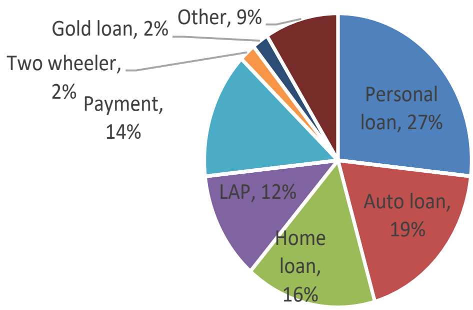
Source: Company, ICICI Direct Research

Exhibit 2: Breakup of advances as of June 2023



Source: Company, ICICI Direct Research

Exhibit 3: Diversified retail book (Q1FY24)



Source: Company, ICICI Direct Research

Investment Rationale

Merger to result in near term volatility; integration benefit to accrue gradually

Merger of HDFC Bank and HDFC Ltd has led to accretion of ₹6 lakh crore of asset base (individual home loans and non-individual loan portfolio) while ₹6.4 lakh crore of liabilities (wherein individual deposit base is at ~₹ 1.1 lakh crore). In the near term, integration is expected to remain the primary focus with merger related cost (including stamp duty) which is manageable.

In the long run, management remains confident of the integration benefit of the merger with large cross selling opportunities on both liabilities and asset side, as a large proportion of customers who have liabilities relation with HDFC Bank do not have a home loan from the group, while on the contrary huge customer base with home loan from parent entity could be approached for liabilities relation with the bank. Thus, management is expecting merged entity to grow at 17-18% in FY24E. Within loan book, bank will not conduct land financing and project financing due to regulatory requirement. Non-individual loans of HDFC Ltd is seen to continue to run down for next 2 quarters, however, bank intends to selectively engage in the business.

Exhibit 4: Breakup of advances as of June 2023 (merged basis)

Loans (₹ bn)	Jun'22	Mar'23	Jun'23	YoY
Retail	5,579	6,346	6,578	18%
CRB	4,981	6,292	6,428	29%
Wholesale	3,640	4,097	4,046	11%
Subtotal (HDFCB pre-merger)	**14,199**	**16,734**	**17,053**	**20%**
HDFC's individual loans	4,427	4,945	5,054	14%
Subtotal (core)	**18,626**	**21,679**	**22,107**	**19%**
HDFC's non-individual loans	1,343	1,215	1,097	(18%)
Subtotal	**19,969**	**22,894**	**23,204**	**16%**
IBPC/BRDS	(117)	(592)	(753)	
Proforma merged gross advances	**19,852**	**22,302**	**22,451**	**13%**

Source: Company, ICICI Direct Research

Exhibit 5: Liabilities base of merged entity (June 2023)

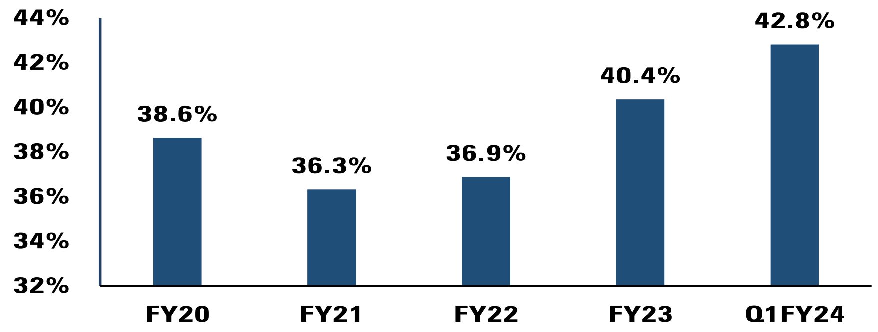
Deposits (₹ bn)	Jun'22	Mar'23	Jun'23	YoY
HDFCB deposits (pre-merger)	**16,048**	**18,834**	**19,131**	**19%**
HDFC's retail deposits*	1,021	1,112	1,124	10%
Subtotal	**17,069**	**19,946**	**20,255**	**19%**
HDFC's non-retail deposits	691	415	397	-43%
Proforma merged deposits	**17,761**	**20,361**	**20,651**	**16%**

Source: Company, ICICI Direct Research

Strengthening of distribution capabilities to enable future growth

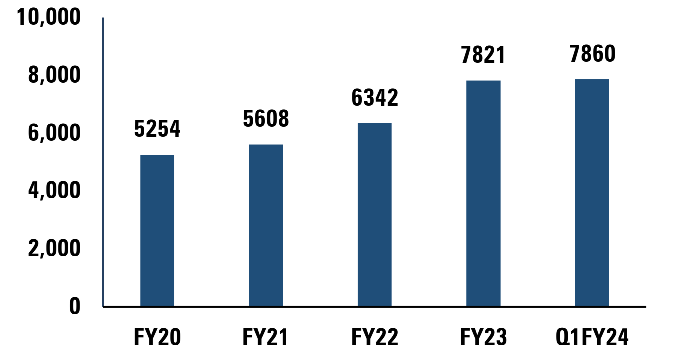
HDFC Bank has been aggressive in strengthening its distribution capabilities across channels with continued focus on semi urban and rural areas. The bank has been aggressive in branch expansion since Dec 2021 with number of branches increasing from 6342 in Mar'22 to 7860 in Jun'23. Such branch expansion has kept opex higher, however, increasing distribution capabilities will enable customer addition and thus liabilities accretion. The bank envisages to target on customer accretion by strengthening distribution and improve client relationship to garner liabilities while pricing of deposits is seen to remain competitive. While pre-merger CD ratio remained at 85-88%, the same is expected to increase to ~120% post-merger which the bank is estimating to normalize within next 3-4 years.

Exhibit 6: Strengthening of distribution led to higher CI ratio in FY23-Q1FY24



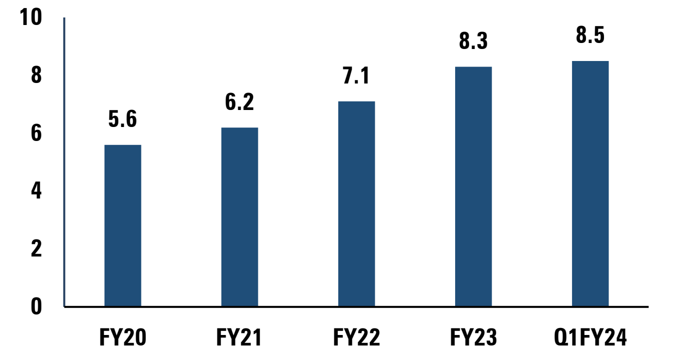
Source: Company, ICICI Direct Research

Exhibit 7: Aggressive branch expansion undertaken in FY24



Source: Company, ICICI Direct Research

Exhibit 8: Focus on customer accretion



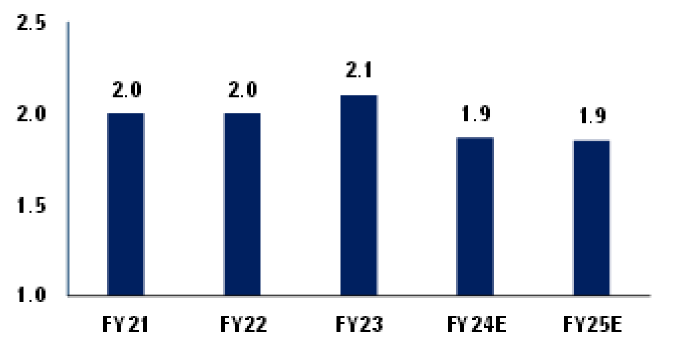
Source: Company, ICICI Direct Research

Operational performance to regain normalisation gradually

On proforma basis, HDFC Bank, post-merger, has reported 13% growth in advances, however, management seemed confident of revival in credit off-take to 17-18% in FY24, as non-individual book run down recedes. However, the main focus area is expected to be accretion of liabilities to bring CD ratio from 100% plus level (post-merger) to ~85% level (standalone bank) which will lead to improvement in LDR and margins. Thus, the bank aims to continue with aggressive strengthening of distribution capabilities (plan to double branch in FY22-25E) and higher engagement with customers. Focus on improving digital offering will continue coupled with increasing physical presence. Thus, we expect CI ratio to remain elevated in FY24-25E, post which the new branches will start achieving break-even level.

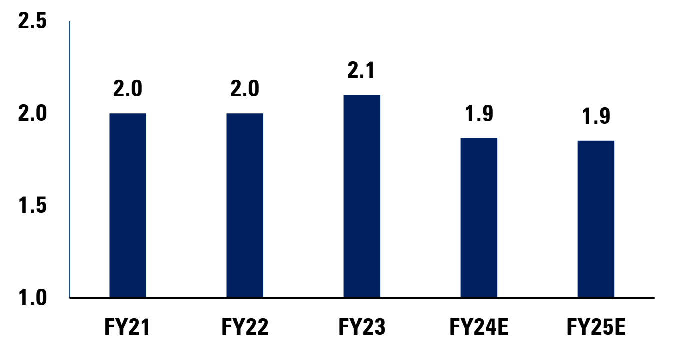
Operationally, post-merger, margins are expected to moderate in near term at 3.8-3.9%, led by lower proportion of CASA considering merged entity. However, decline in CI ratio (expected at 34-35%) and moderation in credit cost (given substantial increase in home loan book) is expected to result in steady RoA at 1.8-1.9% in FY24-25E.

Exhibit 9: NIM (merged) could witness moderation in FY24-25E



Source: Company, ICICI Direct Research

Exhibit 1: RoA to remain broadly steady at 1.8-1.9% in FY24-25E



Source: Company, ICICI Direct Research

Valuation and outlook

Historically, HDFC Bank has delivered consistent strong business growth coupled with superior return ratios. Post merger, integration and accretion of liabilities remain the focus area. Management is confident of pedalling growth achieving normalized level with steady return ratio, however, given gradual revival in business momentum, focus on deposit accretion, capex for branch expansion is seen to keep return ratio volatile in near term, though long term fundamental remain buoyant. Thus, we remain positive on the stock and value the merged entity on SOTP basis assigning 2.5x FY25E ABV for lending business (merged basis) and ₹ 144 for subsidiaries (post discount at 15%) arriving at a target of ₹ 2050 per share. Maintain **BUY** rating on the stock.

Exhibit 1: SOTP valuation

Business Segment	Basis of valuation	HDFC's stake (%)	₹/share
HDFC Bank (merged)	2.5x FY25E ABV	100.00	1,906
HDFC AMC	21x FY25E EPS	52.59	35
HDFC Life Insurance	2.2x FY25E EV	50.40	82
HDFC ERGO		50.50	13
HDB fin Serv		94.80	24
HDFC Sec		95.60	13
Bandhan Bank	2x FY25 ABV	4.95	3
Value per share			2,075
Discount @ 15%			25
Value per share for HDFC Bank			2,050

Source: Company, ICICI Direct Research

Key risks and concerns

Slower than expected business growth

HDFC Bank has delivered consistent strong growth in credit growth in the past decade. However, in past fiscals, post Covid, moderation is witnessed in the pace of business growth. Post-merger, management remain confident of 17-18% growth in advances as non-individual book (from parent) recedes gradually in next 2 quarters. However, slow revival in advance growth, given increasing competition, could impact earnings growth estimate and thus valuation.

Shift in borrowing with deposits on a slower than expected pace

HDFC Bank, with its continued focus and healthy network, has seen healthy liabilities franchise with CASA ratio consistently being above 40%. However, post-merger, CASA ratio is to decline at ~39%. Bank is undertaking aggressive branch expansion and improved engagement with customers to increase pace of accretion of liabilities, though deposit pricing is to remain competitive. Higher deposit accretion and especially low cost deposit is seen to support margins, however, slower than expected pace in deposit accretion amid intense competition among lenders is seen to keep margins and thus earnings momentum lower.

Gradual improvement in opex and credit cost could impact RoA

Post merger, HDFC Bank is expected to witness decline in margins at 3.8-3.9%, however, anticipated improvement in opex and credit cost is expected to offset the pressure enabling the bank to deliver broadly steady RoA with volatility in near term. Lower than expected improvement in opex to impact RoA trajectory ahead.

Financial Summary

Exhibit 2: Profit & Loss statement			(₹ crore)	
(Year-end March)	FY22	FY23	FY24E	FY25E
Interest Earned	127753	161586	244255	283955
Interest Expended	55744	74743	123318	144316
NII	72010	86842	120937	139639
Growth (%)			39.3	15.5
Other income	29510	31215	42261	47860
Total Income	101519	118057	163198	187499
Employee cost	12032	15512	20111	23195
Other operating Exp.	25410	32140	36233	41018
PPP	64077	70405	106854	123285
Provisions	15062	11920	16170	19187
PBT	49015	58485	90685	104098
Taxes	12054	14377	22137	25454
Net Profit	36961	44109	68548	78644
Growth (%)			55.4	14.7
EPS	66.7	79.1	95.5	109.5

Source: Company, ICICI Direct Research

Exhibit 3: Key ratios				
(Year-end March)	FY22	FY23	FY24E	FY25E
Valuation				
No. of Equity Shares	554.6	558.0	718.1	718.1
EPS (₹)	66.7	79.1	95.5	109.5
BV (₹)	433.0	502.2	658.0	767.5
ABV (₹)	425.0	494.3	644.7	753.5
P/E	24.4	20.6	17.0	14.8
P/BV	3.8	3.2	2.5	2.1
P/ABV	3.8	3.3	2.5	2.2
Yields & Margins (%)				
Net Interest Margins	4.1	4.1	3.8	3.8
GNPA	1.4	1.2	1.1	1.1
ROE	15.4	15.7	14.5	14.3
ROA	2.0	2.1	1.9	1.9

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet Statement			(₹ crore)	
(Year-end March)	FY22	FY23	FY24E	FY25E
Sources of Funds				
Capital	555	558	718	718
Reserves and Surplus	239538	279641	471764	550408
Networth	240093	280199	472482	551126
Deposits	160900	152111	2372700	2755282
Borrowings	523599	622877	697413	794484
Other Liabilities & Provisions	1143944	1410895	129584	145049
Total	2068535	2466081	3672179	4245942
Applications of Funds				
Fixed Assets	6084	8017	11562	12575
Investments	455539	517001	687165	786556
Advances	1368821	1600586	2565665	2975237
Other Assets	85765	146713	213797	257417
Cash with RBI & call money	152327	193765	193989	214155
Total	2068535	2466081	3672179	4245942

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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