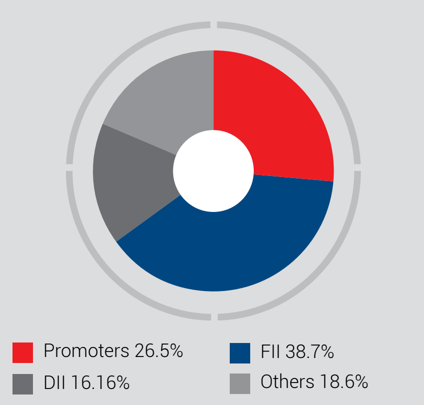
HDFC Bank Ltd.

CMP: Rs 2,090	Rating: BUY	Target: Rs 2,407

Company Information	
BSE Code	500180
NSE Code	HDFCBANK
Bloomberg Code	HDFCB IN
ISIN	INE040A01026
Market Cap (Rs. Cr)	569,655
Outstanding shares(Cr)	271.95
52-wk Hi/Lo (Rs.)	22201828.5
Avg. daily volume (1yr. on NSE)	2,473,470
Face Value(Rs.)	2
Book Value (Rs)	525.52

Shareholding pattern as of December 2018



Investment Rationale

Dominant market position

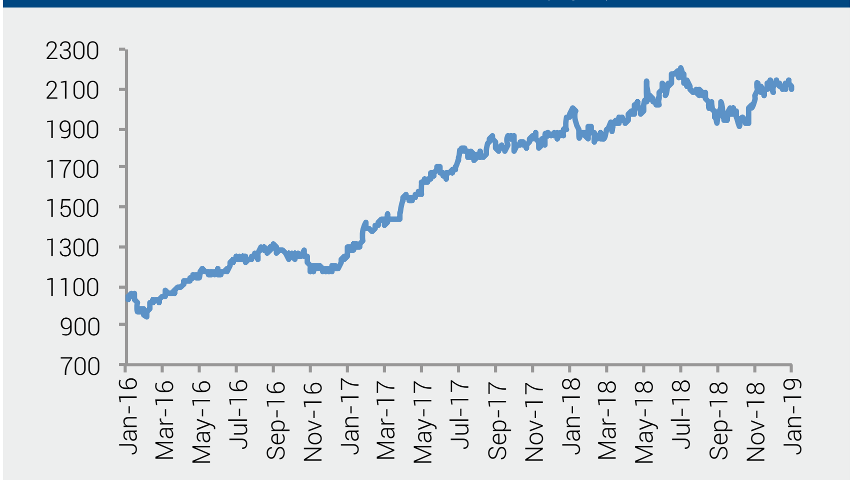
HDFC Bank Ltd. is the fastest growing large bank, accounting for ~25% of incremental market share in FY18 with strong customer base of over 43 million. It is a comprehensive bank with a balanced presence across retail, SME and corporate segments through significant reach (nearly 5000 branches pan India), brand value and wide range of product offering. It has steady presence in urban, semi-urban and rural areas. In the private banking space, HDFC bank is the largest and most profitable bank, with total asset of Rs 10.6 trillion and net profit of Rs 175 billion as of FY18. The bank has one of the strongest liability franchises, aided by wide presence, superior technology offerings and comprehensive product packages in transaction banking. As the semi urban and rural areas are underpenetrated, HDFC bank started focusing on these areas 4 to 5 years back and currently 53% of its total banking outlets are in Semi-urban and rural locations. The bank has opened more than 900 branches in last two fiscal years primarily in unbanked areas. Moreover, the operating costs for these branches are lower and thus would breakeven earlier than branches in urban areas. HDFC Bank has a strong market share in credit cards driven by cross selling to existing customers (~65% of credit card portfolio) while existing customers account for ~50% of the personal loan segment. Expansion in rural regions will enable the bank to earn strong fee income thus supporting robust other income growth (which accounts ~28% of net revenues in FY18). Its dominance in private banking space, deep reach to customers and wide range of financial products make HDFC bank different from other financial institutions. Over the years, growth has been strong for HDFC bank and it continues to be an excellent power of compounding story in coming years also.

HDFC bank is one of the best bank in maintaining healthy asset quality in the industry. Bank has maintained a specific provision cover at 70% of NPAs with total coverage ratio over 120%.

Low funding costs entail healthy margins

HDFC bank is amongst the lowest deposit costs bank in the industry. In past 3 years, the bank witnessed decline in its cost of deposits from 5.91% in FY16 to 4.82% in FY18. Low cost deposit is due to bank's healthy proportion of CASA deposits which has been in the range of 44 to 48% in last 3 years. Low cost funds coupled with stable interest rate cycle helped the bank to maintain healthy NIMs over the years. For the last 3 years, bank has maintained average NIMs of 4.3% while cost of deposits declined from 5.91% in FY16 to 4.82% in FY18. Higher yield from assets on account of higher proportion & product mix of retail loans also supported its stable NIMs. Post demonetization, the bank reported a few quarters of higher-than-usual corporate book growth, as it utilized the excess liquidity and the low cost of funds environment in building a lower-yield corporate book. However, with tightening of the rate environment and continued weakness in deposit growth, the bank is focusing more on high-yield retail book. In its domestic loan portfolio, retail accounts for 55%, thus one of the leading players across retail loan categories. The bank's retail loan book grew at a CAGR of 22% in past 5 years which is healthy in banking sector. The bank's ability to maintain healthy proportion of CASA deposits and focus on high yield retail loan would keep its NIMs stable over the years.

HDFC Bank Ltd. Price Chart (3 yrs)



Stable asset quality

HDFC bank is one of the best bank in maintaining healthy asset quality in the industry. Bank has maintained a specific provision cover at 70% of NPAs with total coverage ratio over 120%. As the bank mainly operates in retail segment which accounts 55% of loan portfolio and is very selective in project finance, is the primary factor behind superior asset quality performance since existence. Management believes that capacity utilization above 80% will be the indication for beginning of investment cycle (currently capacity utilization ~76%) which looks to be a few quarters away. The pickup in the investment cycle is required for large ticket project finance. For last 3 years the bank has maintained average gross NPA and net NPA of 1.10% and 0.34% respectively, which is commendable in the industry. However, in last 3 years asset quality has marginally deteriorated on account of cyclical trends in its agriculture loan portfolio, volatile monsoon season and frequent farm loan waivers announced by various state governments. The crisis in NBFC and HFCs sector has also not deterred its portfolio. The bank management has reviewed its existing NBFC portfolio and believes that the portfolio is well-positioned, and it does not see an immediate concern on any exposure. Management highlighted that 85% of the lending is to high-rated NBFCs based on an internal risk assessment. Management has also confirmed that there is also no modification in the previously sanctioned loans to the sector. Further, bank's strong operating efficiencies and stable asset quality lead to steady rise in RoA. Since FY10, the RoA has increased from 1.5% to 1.8% in FY18, thus demonstrating strong operating efficiencies and healthy asset growth. The most notable thing is that strong RoA growth has come without compromising on asset quality and margins. By improving its operating efficiencies, the bank has brought down its cost to income ratio from

HDFC BANK

We understand your world

48% in FY10 to 41% in FY18. It is expected that improvement in RoA over the next 3 years should be driven more by operating synergies coming out of digital banking initiatives and lower branch additions and recruits, thereby boosting productivity ratios. Further, the recent capital raise of Rs 240 billion would help the bank to strengthen its capital base in effort to sustain its growth momentum and strong return ratios.

Stellar Q3FY19 performance

HDFC bank has reported strong Q3FY19 numbers on the back of ~24% yoy growth in advances at Rs 780,951 crore, contributed equally by retail and corporate books together with stable margins of ~4.3%, supported by the recent capital raised and stable yields. This is the second consecutive quarter of high growth and the trend is expected to sustain given the uptick in system growth. Other income remained supportive with growth of 27% yoy at Rs 3,869.2 crore, aided by strong fee income growth of 27% yoy. The bank also managed to lower its costs both yoy and qoq as suggested by decline in cost to income ratio (201 bps YoY and 152 bps QoQ) at 38.40%, thus together contributing to strong operating profit growth of 28% yoy.

Slippages during the quarter stood at Rs 4000 crore (against Rs 3285 crore last quarter) mainly contributed by bank's Agri portfolio. Slippage ratio stood at 2%, however excluding agri loan, it was at 1.76%. To a large extent, the spike in agri slippages was due to farm loan waivers in some states. The bank has thus made Rs 322 crore contingent provision keeping election in hindsight which would be majorly utilized towards agri NPAs. Total provisions was thus higher by 64% yoy and 22% qoq which limited the growth in bottomline to 20% yoy at Rs 5586 crore. Asset quality otherwise remained stable with GNPA (%) at 1.38% (+5 bps QoQ) while provisioning coverage stood at 70%. Besides, the bank has reported virtually NIL divergences as per the RBI's risk based supervision for FY18.

Key Risks

- Higher inflation may prompt RBI to hike the interest rate, which could result in higher cost of funds and lower margins for bank.
- Slowdown in economy and higher unemployment could increase the NPA for the bank as weak economic growth would hurt the earnings of corporate and individuals.

Valuation

HDFC Bank has built a strong retail franchisee over the years and has been growing consistently thus gaining market share across retail products. On account of a strong CASA franchisee, it has been able to earn consistently strong NIMs of 4.3% and being a retail bank hasn't been subjected to asset quality hiccups and has maintained adequate capitalization levels and healthy return ratios. It's expansion into the rural & semi-urban areas and cross-selling to existing customers ensures plenty of room to grow and thus generating healthy interest income as well as fee income. The recent capital raise should aid further growth momentum and despite increasing competition, it is expected to lead from the front. HDFC bank is best-positioned to gain market share momentum on both the credit and deposit sides, with best-in-class risk assessment and wide presence. Thus, we recommend our investors to BUY the scrip with target of Rs 2,407, from 12 months investment perspective. Currently, the bank is valued at P/BV of 3.7x on FY20E BVPS of Rs 559.5.

Particulars (in Rs Cr)	**FY17**	**FY18**	**FY19E**	**FY20E**
Net interest Income	33,139.2	40,094.9	48,424.0	58,308.5
NIM (%)	4.3%	4.4%	4.3%	4.3%
Operating Profit	25,732.4	32,624.8	38,762.4	46,904.7
PAT	14,549.7	17,486.8	20,919.6	25,017.1
EPS (Rs)	53.5	64.4	77.0	92.1
BV (Rs)	329.2	391.2	540.2	559.5
GNPA (%)	1.1%	1.3%	1.3%	1.3%

Source: Ace equity & Ashika Research

Ashika Stock Broking Ltd.

Ashika Stock Broking Limited ("ASBL") started its journey in the year 1994 and is presently offering a wide bouquet of services to its valued clients including broking services, depository services and distributorship of financial products (Mutual funds, IPO & Bonds). It became a "Research Entity" under SEBI (Research Analyst) Regulations 2014 in the year of 2015 (Reg No. INH000000206).

ASBL is a wholly owned subsidiary of Ashika Global Securities (P) Ltd., a RBI registered non-deposit taking NBFC Company. ASHIKA GROUP (details enumerated on our website www.ashikagroup.com) is an integrated financial service provider inter alia engaged in the business of Investment Banking, Corporate Lending, Commodity Broking, Debt Syndication & Other Advisory Services.

There were no significant and material disciplinary actions against ASBL taken by any regulatory authority during last three years except routine matters.

DISCLOSURE

Research reports are being prepared and distributed by ASBL in the sole capacity of being a Research Analyst under SEBI (Research Analyst) Regulations 2014. The following disclosures and disclaimer are an essential part of any Research Report so being distributed.

1) ASBL or its associates, its Research Analysts (including their relatives) may have financial interest in the subject company(ies). And, the said financial interest is not limited to having an open stock market position in /acting as advisor to /having a loan transaction with the subject company(ies) apart from registration as clients.

2) ASBL or its Research Analysts (including their relatives) do not have any actual / beneficial ownership of 1% or more of securities of the subject company(ies) at the end of the month immediately preceding the date of publication of the source research report or date of the concerned public appearance. However, ASBL's associates may have actual / beneficial ownership of 1% or more of securities of the subject company(ies).

3) ASBL or its Research Analysts (including their relatives) do not have any other material conflict of interest at the time of publication of the source research report or date of the concerned public appearance. However, ASBL's associates might have an actual / potential conflict of interest (other than ownership).

4) ASBL or its associates may have received compensation for investment banking, merchant banking, brokerage services and for other products and services from the subject companies during the preceding 12 months. However, ASBL or its associates or its Research analysts (forming part of Research Desk) have not received any compensation or other benefits from the subject companies or third parties in connection with the research report/ research recommendation. Moreover, Research Analysts have not received any compensation from the companies mentioned in the research report/ recommendation in the past twelve months.

5) The subject companies in the research report/ recommendation may be a client of or may have been a client of ASBL during the twelve months preceding the date of concerned public appearance for investment banking/ merchant banking / brokerage services.

6) ASBL or their Research Analysts have not managed or co-managed public offering of securities for the subject company(ies) in the past twelve months. However, ASBL's associates may have managed or co-managed public offering of securities for the subject company(ies) in the past twelve months.

7) Research Analysts have not served as an officer, director or employee of the companies mentioned in the report/ recommendation.

8) Neither ASBL nor its Research Analysts have been engaged in market making activity for the companies mentioned in the report / recommendation.

DISCLAIMER

The research recommendations and information are solely for the personal information of the authorized recipient and does not construe to be an offer document or any investment, legal or taxation advice or solicitation of any action based upon it. This report is not for public distribution or use by any person or entity, where such distribution, publication, availability or use would be contrary to law, regulation or subject to any registration or licensing requirement. We will not treat recipients as customer by virtue of their receiving this report. The report is based upon the information obtained from public sources that we consider reliable, but we do not guarantee its accuracy or completeness. ASBL shall not be in anyways responsible for any loss or damage that may arise to any such person from any inadvertent error in the information contained in this report. The recipients of this report should rely on their own investigations.