Emkay ©
Your success is our success

HDFC Bank

Superior asset quality and capital adequacy; Accumulate

CMP	Target Price
Rs1,066	Rs1,250 (■)
Rating	**Upside**
ACCUMULATE (■)	17.3 %

- HDFC Bank's credit rose 17% yoy (6.1% qoq) and deposits rose 18.6% yoy (6% qoq) in 3QFY15. Robust NIM of 4.8% (up 16bps yoy) and stable core cost-income (up 37bps yoy, down 350bps qoq) to 43.4%, resulted in core PPP rising 17.6% yoy (13.8% qoq)
- Gross NPAs rose 3.2% qoq, but NPA coverage rose 123bps qoq to 73.9%. The bank's gross NPAs (1% of loans) and net NPAs (0.3% of loans) are some of the best in the sector
- Capital adequacy (CAR) of 15.7% (tier-1 capital of 12%) is more than sufficient to meet Basel-3 norms and business growth over FY15-17e. With the recent capital raise of Rs98bn, CAR has further strengthened by ~220bps
- We have an ACCUMULATE rating, as we favour the bank for its strong fundamentals and consistent profit growth and expect it to be the best placed of its peers in managing the challenges ahead—of capital adequacy (Basel-III norms) and credit quality

- **Prudent credit growth, NIM improves yoy.** At 17% yoy, advances grew slower than deposits (at 18.6% yoy), resulting in the credit-deposit ratio falling 116bps yoy to 83.8%. Credit growth was largely driven by the domestic corporate segment (~22% yoy) with slower growth in retail loans (~12% yoy). Driven by the stable proportion of CASA at 40.9%, NIM rose 16bps yoy (down 20bps qoq) to 4.8%. Ahead, we do not expect significant NIM gains, given likely sluggish asset yields in FY16 and the stretched credit-deposit ratio. We estimate NIM over FY15-16 at 4.5%.
- **Modest fees, strong Treasury profits, stable productivity**. Fuelled by modest fee growth (7.9% yoy) with fees-to-earning assets at 1.7%, non-interest income rose 18% yoy (23.8% qoq). Treasury profits were Rs2.7bn and comprised 5.6% of pre-provisioning profits. Excl. Treasury, pre-provisioning profits grew 17.6% yoy (13.8% qoq). We expect likely robust business growth to continue the traction in fee income, and estimate fees-to-earning assets over FY15-17 at 1.5%. Productivity was stable, with core cost-to-income falling 350bps yoy to 43.4%, and cost-to assets down 6bps qoq to 2.7%.
- **Superior asset quality and capital adequacy, NPA coverage improves.** Asset quality experienced minor stress, with gross NPAs up 3.2% qoq, and NPA coverage (excl. technical write-offs) improving 123bps qoq to 73.9%. The bank's gross NPAs (1% of loans) and net NPAs (0.3% of loans) are some of the best in the sector. With capital adequacy of 15.7% (tier-1 capital: 12%), the bank is well-capitalized for more than 20% business growth over FY16-17.
- **Valuations and risks.** We favour the bank for its strong fundamentals and consistent profit growth and expect it to be the best placed of its peers in managing the challenges ahead—of capital adequacy (Basel-III norms) and credit quality. Hence, we maintain our Buy rating. At our Mar'17 target of Rs1,250, the stock would trade at PBV of 4.4x FY16e and 3.8x FY17e. **Risk.** Slower-than-estimated economic growth could impact business growth and asset quality.

Financial Snapshot (Standalone)

(Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Net income	2,26,637	2,64,023	3,11,774	3,73,450	4,51,018
Net profit	67,263	84,784	1,02,789	1,28,212	1,56,296
EPS (Rs)	28.3	35.3	41.4	51.3	62.1
ABV (Rs)	150.2	177.8	242.2	279.9	325.8
RoA (%)	1.8	1.9	1.9	2.0	2.0
RoE (%)	20.3	21.3	19.7	19.4	20.3
PE (x)	37.7	30.2	25.8	20.8	17.2

Source: Company, Emkay Research

Change in Estimates

EPS Chg FY15E/FY16E (%)	NA
Target Price change (%)	NA
Previous Reco	Under Review

Emkay vs Consensus

EPS Estimates		
	FY15E	FY16E
Emkay	41.4	51.3
Consensus	42.8	52.6
Mean Consensus TP		Rs 1,103

Stock Details

Bloomberg Code	HDFCB IN
Face Value (Rs)	2
Shares outstanding (mn)	2,504
52 Week H/L	1,101 / 629
M Cap (Rs bn/USD bn)	2,668 / 42.90
Daily Avg Volume (nos.)	16,97,021
Daily Avg Turnover (US$ mn)	28.8

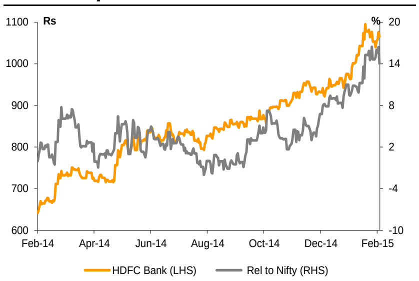
Shareholding Pattern Oct '15

Promoters	21.7%
FIIs	32.6%
DIIs	9.9%
Public	35.8%

Price Performance

(%)	1M	3M	6M	12M
Absolute	11	16	31	69
Rel. to Nifty	(2)	12	17	17

Relative price chart



Source: Bloomberg

Clyton Fernandes
clyton.fernandes@emkayglobal.com
+91 22 66121340

Sohail Halai
sohail.halai@emkayglobal.com
+91 22 66121336

Superior asset quality and capital adequacy

Slower retail credit growth, stable CASA share, NIM improves yoy

At 17% yoy, HDFC Bank's credit growth was largely driven by the domestic corporate segment (~22% yoy). Retail loans grew slower, at ~12% yoy, chiefly held back by slower growth in the gold (-5.1% and commercial-vehicle (-21%) sub-segments. While there was decline in yoy growth in the business banking segment (-19.8% yoy), management attributed it to upgradation of customers into wholesale banking, due to higher exposures or turnovers. Management remains confident of growing credit 3-5% ahead of industry, but does not intend to become increasingly competitive despite the recent capital infusion of Rs98bn. The proportion of retail assets in total loans expected to come at more than 50% over FY16-17.

CASA (low-cost deposits) grew 18.1% yoy. The proportion of CASA in deposits dropped marginally, by 16bps yoy to 40.9%. Average CASA per branch was Rs447m, and is one of the best of peers. We estimate a 21.7% CAGR in business over FY14-17.

Exhibit 1: Prudent credit growth, but stretched credit-deposits persisted in 3QFY15

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Advances (Rsbn)	2,415	2,397	2,586	2,686	2,967	3,030	3,121	3,273	3,471
YoY (%)	*24.3*	*22.7*	*21.2*	*16.0*	*22.9*	*26.4*	*20.7*	*21.8*	*17.0*
Credit-deposit (%)	85.0	80.9	85.3	85.8	85.0	82.5	83.9	83.8	83.8

Source: Company, Emkay Research

Exhibit 2: Slower-than-past growth in retail loans over 9MFY15

Rsbn	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15	YoY	QoQ
Personal	168	175	186	193	201	204	215	231	248	23.5	7.2
Credit cards	100	101	106	109	117	123	133	140	154	31.2	9.7
Loan against shares	11	12	10	9	10	11	10	11	12	17.2	13.7
CVs	164	161	168	170	167	144	133	139	132	(21.1)	(4.7)
Auto	300	309	323	325	336	331	348	378	400	19.1	5.9
Two-wheeler	29	30	30	31	33	33	34	36	40	21.4	9.2
Business banking	231	245	239	257	266	250	223	220	213	(19.8)	(2.8)
Home	159	168	171	164	161	193	196	196	200	23.9	2.1
Gold loans	47	50	48	44	41	40	39	39	39	(5.1)	1.1
Kisan Gold Card	50	60	-	79	86	106	110	129	136	58.2	5.7
Others	40	53	123	59	57	61	63	64	74	29.6	16.3
Total	**1,300**	**1,364**	**1,404**	**1,440**	**1,476**	**1,497**	**1,502**	**1,581**	**1,648**	**11.7**	**4.2**
YoY (%)	*29.6*	*27.3*	*25.5*	*16.9*	*13.6*	*9.7*	*7.0*	*9.8*	*11.7*		

Source: Company, Emkay Research

Exhibit 3: Robust low-cost deposit franchise, one of the best among peers

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
CASA (Rsbn)	1,289	1,405	1,356	1,409	1,434	1,646	1,600	1,686	1,694
YoY (%)	14.2	17.7	14.5	10.7	11.2	17.2	18.0	19.7	18.1
CASA share (%)	45.4	47.4	44.7	45.0	41.1	44.8	43.0	43.2	40.9
Avg CASA per branch (Rsm)	486	464	447	457	446	472	447	452	447

Source: Company, Emkay Research

NIM likely to hover at 4.6% over FY15-16

NIM, at 4.8%, rose 16bps yoy, but fell 20bps qoq; while the yield on earning assets fell 16bps yoy, the cost of funds decreased 40bps yoy. Despite the share of CASA falling 16bps yoy to 40.9%, a stretched credit-deposit of 83.8% kept NIM stable qoq. Ahead, we do not expect significant NIM gains, given likely sluggish asset yields in FY16 and the stretched credit-deposit ratio. We estimate NIM over FY16-17 at 4.5%.

Exhibit 4: Strong NII growth (yoy), led by healthy business growth

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
NII (Rsbn)	40	43	44	45	46	50	52	55	57
YoY (%)	27.8	20.6	21.0	15.3	16.4	15.3	17.0	23.1	23.0

Source: Company, Emkay Research

Exhibit 5: Despite prudent lending, NIM has remained steady at 4.8%, one of the best in the sector

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Yield on earning assets (%)	10.8	10.8	10.8	10.8	10.5	10.2	10.5	10.7	10.4
Yield on advances (%)	12.7	13.0	12.4	12.3	12.2	12.5	12.2	12.2	11.9
Yield on investments (%)	8.6	8.0	9.1	9.5	8.9	7.6	8.2	9.0	8.8
Cost of funds (%)	6.9	6.7	6.7	6.8	6.7	6.3	6.4	6.5	6.3
NIM (%)	4.8	5.0	4.9	4.8	4.6	4.7	4.8	5.0	4.8

Source: Company, Emkay Research

Modest fees, robust Treasury profits, stable productivity

Despite the addition of 59 branches during the quarter, productivity was stable, with cost-to-assets down 6bps yoy to 2.7%. Also, the bank's core cost-to-income declined 350bps qoq to 43.4%. More branches are likely to be added in FY16, which we estimate would keep cost-assets at 2.5% over FY15-16.

Fuelled by modest fee growth (7.9% yoy) with fees-to-earning assets at 1.7%, non-interest income rose 18% yoy (23.8% qoq). Treasury profits were Rs2.7bn and comprised 5.6% of pre-provisioning profits. Excl. Treasury, pre-provisioning profits grew 17.6% yoy (13.8% qoq). We expect likely robust business growth to continue the traction in fee income, and estimate fees-to-earning assets over FY15-17 at 1.5%. Productivity was stable, with core cost-to-income falling 350bps yoy to 43.4%, and cost-to assets down 6bps qoq to 2.7%.

Exhibit 6: Modest fee-income growth, but fees-to-average earning assets high at 1.7%

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Fees & Commissions (Rsbn)	17	16	16	19	19	18	16	18	21
YoY (%)	11.9	0.7	9.1	27.4	14.2	12.0	2.0	(5.3)	7.9
% of avg earnings assets	2.03	1.83	1.79	1.98	1.90	1.68	1.53	1.59	1.72

Source: Company, Emkay Research

Exhibit 7: Robust treasury gains aided non-interest income progression

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Treasury gains (Rsm)	1,358	649	1,995	(1,733)	509	333	250	951	2,655
% of PPP	4.4	2.2	6.0	(5.1)	1.3	0.9	0.7	2.3	5.6
Core PPP	29,856	28,978	31,066	35,600	38,371	37,460	38,188	39,651	45,131
YoY (%)	21.4	11.5	19.1	28.3	28.5	29.3	22.9	11.4	17.6

Source: Company, Emkay Research

Exhibit 8: Productivity improved, despite continued investments in distribution

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Avg. quarterly profit per branch (Rsm)	6.6	6.0	5.7	6.0	6.8	6.5	6.2	6.4	7.3
Core cost-income (%)	48.3	52.0	49.4	45.2	43.0	45.9	45.4	46.9	43.4
Cost-assets (%)	3.1	3.4	3.1	2.9	2.7	2.8	2.8	3.0	2.8

Source: Company, Emkay Research

Superior asset quality and capital adequacy, NPA coverage improves

Asset quality experienced minor stress, with gross NPAs up 3.2% qoq, and NPA coverage (excl. technical write-offs) improving 123bps qoq to 73.9%. The bank's gross NPAs (1% of loans) and net NPAs (0.3% of loans) are some of the best in the sector. Also, restructured loans are negligible at 0.1% of loans. With capital adequacy of 15.7% (tier-1 capital: 12%), the bank is well-capitalized for more than 20% business growth over FY16-17. With the recent capital raise of Rs98bn, CAR has further strengthened by ~220bps.

Exhibit 9: Superior asset quality, NPA coverage improved qoq

	3QFY13	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Annualized NPA prov (bps)	52	94	76	31	46	38	62	54	61
NPA coverage (%)	79.6	79.9	74.7	73.9	73.6	72.6	70.0	72.7	73.9

Source: Emkay Research, Company

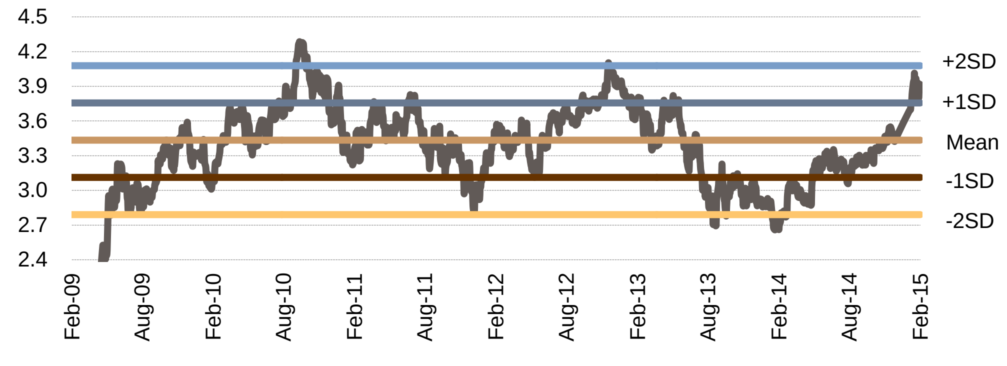
Valuation and risks

Strong credit growth, healthy fees and robust asset quality are likely to drive a 22.6% earnings CAGR over FY14-17. We favour the bank for its strong fundamentals and consistent profit growth over the past five years. We expect it to be the best placed of its peers in managing the challenges ahead—of capital adequacy (for Basel-III norms) and credit quality. Hence, we maintain our Buy rating. At our Mar'17 target of Rs1,250, the stock would trade at PBV of 4.4x FY16e and 3.8x FY17e.

Risk

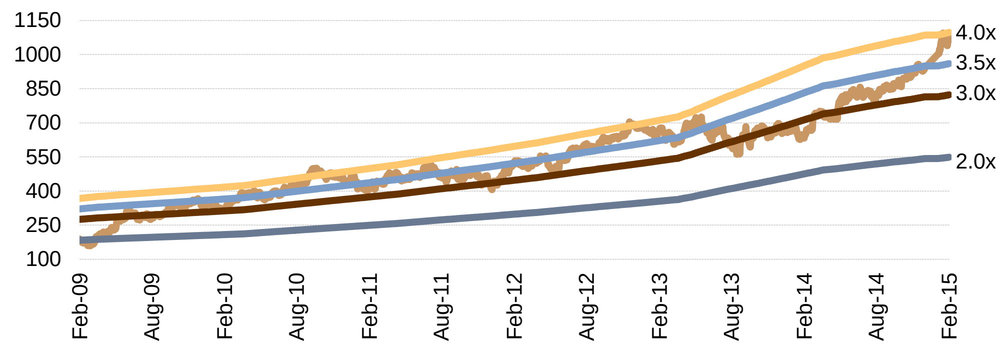
Less-than-expected economic growth over FY15-16, leading to NPAs being more than estimated, consequently leading to higher credit costs.

Exhibit 10: HDFC Bank is trading a +1SD above its past five-year mean one-year forward PBV



Source: Capitaline, Company, Emkay Research

Exhibit 11: Historical price-to-book value



Source: Company, Emkay Research, Capitaline

Key Financials (Standalone)

Income Statement

Y/E Mar (Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Net interest income	**1,58,111**	**1,84,826**	**2,24,270**	**2,75,265**	**3,37,891**
Other income	**68,526**	**79,196**	**87,504**	**98,186**	**1,13,127**
Fee income	51,669	57,349	65,092	74,855	86,084
Net income	**2,26,637**	**2,64,023**	**3,11,774**	**3,73,450**	**4,51,018**
Operating expenses	1,12,361	1,20,422	1,36,869	1,62,451	1,94,389
Pre provision profit	**1,14,276**	**1,43,601**	**1,74,905**	**2,10,999**	**2,56,629**
PPP excl treasury	**1,13,012**	**1,42,561**	**1,70,405**	**2,09,249**	**2,55,629**
Provisions	11,806	15,890	20,102	17,909	21,243
Profit before tax	**1,02,470**	**1,27,711**	**1,54,803**	**1,93,090**	**2,35,386**
Tax	35,207	42,927	52,014	64,878	79,090
Tax rate	34	34	34	34	34
Profit after tax	**67,263**	**84,784**	**1,02,789**	**1,28,212**	**1,56,296**

Balance Sheet

Y/E Year End (Rs mn)	FY13	FY14	FY15E	FY16E	FY17E
Equity	4,759	4,798	4,968	5,000	5,030
Reserves	3,57,383	4,29,988	6,05,977	7,05,028	8,25,775
Net worth	**3,62,141**	**4,34,786**	**6,10,945**	**7,10,028**	**8,30,805**
Deposits	29,62,470	36,73,375	44,17,233	53,89,024	66,14,456
Borrowings	3,30,066	3,94,390	4,33,829	4,77,212	5,24,933
Total liabilities	**40,03,319**	**49,15,995**	**59,16,795**	**70,76,531**	**85,20,488**
Cash and bank	1,46,274	2,53,456	3,32,510	3,53,492	3,96,889
Investments	11,16,136	12,09,511	14,13,515	16,70,597	19,84,337
Loans	23,97,206	30,30,003	36,66,303	44,72,890	54,56,926
Others	1,90,144	2,51,246	2,92,881	3,50,288	2,57,745
Total assets	**40,03,319**	**49,15,995**	**59,16,795**	**70,76,531**	**85,20,488**

Key Ratios (%)

Y/E Year End	FY13	FY14	FY15E	FY16E	FY17E
NIM	4.6	4.4	4.4	4.5	4.6
Non-II/avg assets	1.9	1.8	1.6	1.5	1.5
Fee income/avg assets	1.4	1.3	1.2	1.2	1.1
Opex/avg assets	3.0	2.7	2.5	2.5	2.5
Provisions/avg assets	0.3	0.4	0.4	0.3	0.3
PBT/avg assets	2.8	2.9	2.9	3.0	3.0
Tax/avg assets	1.0	1.0	1.0	1.0	1.0
RoA	1.8	1.9	1.9	2.0	2.0
RoAE	20.3	21.3	19.7	19.4	20.3
GNPA (%)	1.0	1.0	1.0	0.9	0.8
NNPA (%)	0.2	0.3	0.3	0.2	0.2

Per Share Data (Rs)	FY13	FY14	FY15E	FY16E	FY17E
EPS	28.3	35.3	41.4	51.3	62.1
BVPS	152.2	181.2	246.0	284.0	330.3
ABVPS	150.2	177.8	242.2	279.9	325.8
DPS	5.5	6.8	8.0	9.9	12.1

Valuations (x)	FY13	FY14	FY15E	FY16E	FY17E
PER	37.7	30.2	25.8	20.8	17.2
P/BV	7.1	6.0	4.4	3.8	3.3
P/ABV	7.1	6.0	4.4	3.8	3.3
P/PPOP	22.2	17.8	15.1	12.6	10.4
Dividend Yield (%)	0.5	0.6	0.8	0.9	1.1

Growth (%)	FY13	FY14	FY15E	FY16E	FY17E
NII	22.7	16.9	21.3	22.7	22.8
PPOP	21.7	25.7	21.8	20.6	21.6
PAT	30.2	26.0	21.2	24.7	21.9
Loans	22.7	26.4	21.0	22.0	22.0

Quarterly (Rs mn)	Q3FY14	Q4FY14	Q1FY15	Q2FY15	Q3FY15
NII	46,348	49,526	51,716	55,110	59,050
NIM(%)	4.6	4.7	4.8	5.0	4.9
PPOP	38,880	37,793	38,438	40,602	46,336
PAT	23,257	23,265	22,330	23,815	28,886
EPS (Rs)	38.85	38.79	37.10	39.46	47.75

Shareholding Pattern (%)	Mar-14	Jun-14	Sep-14	Dec-14	Feb-15
Promoters	22.6	22.6	22.5	22.5	21.7
FIIs	34.1	34.0	33.9	33.8	32.6
DIIs	9.8	10.0	9.8	9.9	9.9
Private Corp	8.1	8.1	8.3	8.2	8.4
Public	33.4	33.5	33.9	33.8	35.8

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

Emkay Global Financial Services Ltd.
CIN - L67120MH1995PLC084899
7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India
Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com