

July 22, 2016

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Rating	BUY
Price	Rs1,228
Target Price	Rs1,350
Implied Upside	9.9%
Sensex	27,711
Nifty	8,510

(Prices as on July 21, 2016)
Trading data

Market Cap. (Rs bn)	3,105.8
Shares o/s (m)	2,528.2
3M Avg. Daily value (Rs m)	1646.2

Major shareholders

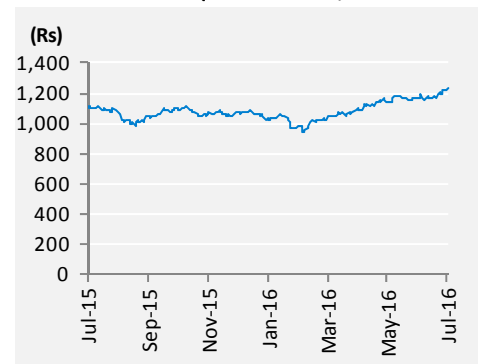
Promoters	21.49%
Foreign	44.44%
Domestic Inst.	13.79%
Public & Other	20.28%

Stock Performance

(%)	1M	6M	12M
Absolute	5.4	20.0	11.8
Relative	2.0	4.4	13.5

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2017	59.0	58.7	0.5
2018	73.0	72.1	1.2

Price Performance (RIC:HDBK.BO, BB:HDFCB IN)


Source: Bloomberg

HDFCB reported another steady quarter of earnings growth at 20% YoY with strong core performance as loan growth continues to be strong along with sequential improvement in margins of 10bps. Loan growth continues to be led by retail in all segments, while wholesale & business banking showed some softness. Overall asset quality saw slight deterioration mainly from business banking. Bank has geared up for the maturity of FCNR deposits and is unlikely to get majorly impacted on loan growth traction, while HDFCB continues to deliver on all counts by gaining market share on both assets & liabilities and remains leader across product lines. We maintain 'BUY' with a PT of Rs1,350 based on 3.6x Mar-18E ABV.

- Operating profit trajectory remains robust:** Operating performance remained robust as HDFCB continued to deliver strong NII of 21% YoY (though miss by 1.7% from PLe), while better treasury (+100% YoY increase) and lower opex led to 20% YoY growth in PPOP. Fee income profile was softer in Q1FY17 as TPPD & Fx fees were weak and continued to maintain fee income guidance in mid-teens. While on margins, better asset mix in retail and stable CASA growth helped improve margins further to 4.4% (up 5-6 bps QoQ), but maintained guidance range of 4.1-4.4% in FY17.
- Loan growth some softness; retail mix sees further improvement:** Loan growth stood at ~23.2% YoY (1.3% QoQ) comparatively slower as wholesale piece saw some slowdown (1.2% QoQ decline) as some short term loans from Q4FY16 moved out and hence retail mix improved slightly to 50.5%. Retail loans continued to be robust from all segments especially in the unsecured. Auto loans continued to grow strong, while business banking loan book saw some weakness. Bank has geared itself up for FCNR deposit maturity by creating liquidity cushion, while we will likely not see major loan growth slowdown in FY17.
- Overall asset quality sees slight deterioration:** Asset quality saw slight deterioration on (i) seasonality in Agri/Retail book and (ii) some stress in the SME/Business banking. GNPL/NNPL increased by 10 bps and 3bps QoQ to 1.04%/0.32%, while restr. portfolio remained stable at 0.1%. The bank also provided from floating provisions the remainder part of the food credit. Stable asset quality and better quality of earnings makes HDFCB our preferred pick.

Key financials (Y/e March)	2015	2016	2017E	2018E
Net interest income	223,957	275,915	336,513	406,656
Growth (%)	21.2	23.2	22.0	20.8
Operating profit	174,045	213,635	265,896	327,666
PAT	102,159	122,962	149,220	184,436
EPS (Rs)	41.7	48.8	59.0	73.0
Growth (%)	17.4	17.3	20.8	23.6
Net DPS (Rs)	8.0	9.5	10.5	12.0

Profitability & Valuation	2015	2016	2017E	2018E
NIM (%)	4.14	4.25	4.28	4.25
RoAE (%)	19.4	18.3	19.0	20.1
RoAA (%)	1.89	1.89	1.90	1.93
P / BV (x)	5.0	4.3	3.7	3.1
P / ABV (x)	5.3	4.5	3.9	3.3
PE (x)	29.5	25.1	20.8	16.8
Net dividend yield (%)	0.7	0.8	0.9	1.0

Source: Company Data; PL Research

Exhibit 1: Q1FY17 Results – Overall stable quarter

	(Rs m)	Q1FY17	Q1FY16	YoY gr. (%)	Q4FY16	QoQ gr. (%)
<i>NII growth was slightly lower than estimates but remains strong</i>	Interest income	165,160	140,411	17.6	159,968	3.2
	Interest Expended	87,346	76,523	14.1	85,434	2.2
	Net interest income (NII)	77,814	63,888	21.8	74,533	4.4
<i>Other income was supported by very strong treasury gains of +100% YoY/QoQ, while fee income was weak with growth of 15% YoY.</i>	- Treasury income	2,769	1,259	119.9	1,155	139.7
	Other income	28,066	24,619	14.0	28,659	(2.1)
	Total income	105,881	88,507	19.6	103,192	2.6
<i>Opex remained slightly high mainly in other expenses</i>	Operating expenses	47,689	40,008	19.2	45,843	4.0
	-Staff expenses	15,852	13,590	16.6	14,980	5.8
	-Other expenses	31,837	26,418	20.5	30,863	3.2
	Operating profit	58,192	48,499	20.0	57,349	1.5
<i>Provisions were in-line with estimates as bank utilized some contingent provisions on Punjab food credit exposure</i>	Core operating profit	55,423	47,240	17.3	56,194	(1.4)
	Total provisions	8,667	7,280	19.1	6,625	30.8
	Profit before tax	49,525	41,219	20.1	50,725	(2.4)
	Tax	17,136	14,262	20.1	16,982	0.9
	Profit after tax	32,389	26,957	20.2	33,742	(4.0)
	Balance sheet (Rs m)					
<i>Advances growth was comparatively slower at 23% YoY which impacted NII growth</i>	Deposits	5,737,545	4,841,744	18.5	5,464,242	5.0
	Advances	4,706,225	3,820,104	23.2	4,645,940	1.3
	Profitability ratios					
<i>Margins expanded further by 10bps to 4.4%, ahead of guidance</i>	YoA – Calc	10.7	11.2	(51)	10.6	6
	CoF - Calc	5.8	6.0	(14)	5.8	4
	NIM	4.4	4.3	10	4.3	10
	RoaA	1.8	1.8	0	1.9	(16)
	RoaE	17.4	17.0	40	18.7	(127)
	Asset Quality					
<i>Overall asset quality deteriorated marginally on seasonality mainly from SME/biz banking, while some from agri as well on seasonality. Have not seen any additions from the corporate book</i>	Gross NPL (Rs mn)	49,209	36,522	34.7	43,928	12.0
	Net NPL (Rs mn)	14,934	10,277	45.3	13,204	13.1
	Restructured Assets (Rs mn)	4,755	3,857	23.3	4,690	1.4
	Gross NPL ratio	1.0	1.0	9	0.9	10
	Net NPL ratio	0.3	0.3	5	0.3	3
	Coverage ratio	69.7	71.9	(221)	69.9	(29)
	Rest. assets/ Total adv.	0.1	0.1	0	0.1	0
	Business & Other Ratios					
	Low-cost deposit mix	39.9	39.6	30	43.0	(310)
	Cost-income ratio	45.0	45.2	(16)	44.4	62
	Non int. inc / total income	26.5	27.8	(131)	27.8	(126)
	Credit deposit ratio	82.0	78.9	313	85.0	(300)
	CAR	15.5	15.7	(20)	15.5	-
	Tier-I	13.3	12.8	50	13.2	10

Source: Company Data, PL Research

Key Q1FY17 Concall Highlights

Balance sheet & Outlook

- **Loan book – Outlook:** Will continue to outgrow systemic loan growth in FY17 and likely little more than average trends despite FCNR maturity in Q3FY17.
 - **Retail loans** –Auto/CV loans continue to robust growth and do not see any slowdown signs as yet taking cue from the OEM sales. Home loans growth remains strong on exercising full rights to buyback from HDFC Ltd. **Unsecured retail** - has been growing at strong pace but do not see risk especially on the proportion to book, as these loans are of small duration and in next 2 years, wholesale piece could improve on pick-up in capex which can bring unsecured mix down. Currently largely 60-70% sourcing is in-house and to internal customers.
- **Deposit** – Retail term deposits remained strong with growth of 19% YoY. **FCNR deposits** – Sept & Oct 2016 will see Rs3.4bn of NRI deposits mature, while would see \$2.4 bn assets/liabilities mature given from overseas branches which will have some impact on asset growth in Q3FY17.
- **Investment book** – Increase in investment book on back of **(i)** Had seen some build-up in short term assets in Q4FY16 and hence liquidity was sucked up, while **(ii)** built-up liquidity in investments to mitigate maturity in FCNR deposits in Q3FY17.

Margins/Pricing

- Margins improved 5-7bps QoQ mainly on back of improving asset mix towards retail. **Outlook** – Continue to maintain margin guidance of 4.1%-4.4% going ahead.

Fee income/Opex/Branches

- Fees saw slight weakness as sequentially TPPD was weak but decent YoY, Forex fees & gains were lower. **Outlook:** Continue to see growth in mid-teens in fees profile. Largely fee income rates have been stable and have not come off, but competitive pressure is intense.
- **Branch addition** – Will continue with run rate of adding 200-300 branches per year but continues to have flexibility in branch additions as now management believes branch presence have become meaningful.
- Opex will see some trending down as branch additions done in last few quarters continue to add to income, while much of the opex will depend on branch additions undertaken going ahead.

Asset Quality

- **Slippages** – The Bank witnessed Rs17.2bn of slippages in Q1FY17 mainly from SME/Agri, retail slippages were lower than expected while did not see any slippages in corporate book.
- **Punjab Govt food credit exposure** - Have made second part of provisions on food credit to Punjab govt and hence have utilized floating provisions by Rs1.5bn.

Exhibit 2: Retail loan book leads growth; share of retail increases slightly to 50.5%

Overall growth was slower comparatively on slower corporate book & business banking

Retail loans growth continues to be robust especially unsecured part. Auto loans also saw strong growth. Gold loans growth trends also saw improvement.

Corporate loan growth took backseat with 1.2% decline QoQ and comparatively weaker YoY.

Loan Composition (Rs m)	Q1FY17	Q1FY16	YoY gr. (%)	Q4FY16	QoQ gr. (%)
Car Loans	521,870	434,580	20.1	501,990	4.0
CV loans	153,290	133,890	14.5	146,880	4.4
2 wheeler loans	55,490	43,930	26.3	53,800	3.1
Sub-total - Auto Loans	730,650	612,400	19.3	702,670	4.0
Personal loans	404,930	288,300	40.5	372,000	8.9
Business banking	255,960	240,160	6.6	252,900	1.2
Loan against shares	12,060	9,800	23.1	12,400	(2.7)
Credit Cards	212,550	168,650	26.0	205,200	3.6
Home loans	335,900	268,880	24.9	318,440	5.5
Gold Loans	48,040	42,240	13.7	45,310	6.0
Other Retail	330,510	242,220	36.5	332,260	(0.5)
Retail Loans	2,330,600	1,872,650	24.5	2,241,180	4.0
Non Retail Loans	2,375,625	1,947,454	22.0	2,404,760	(1.2)
Total Advances	4,706,225	3,820,104	23.2	4,645,940	1.3

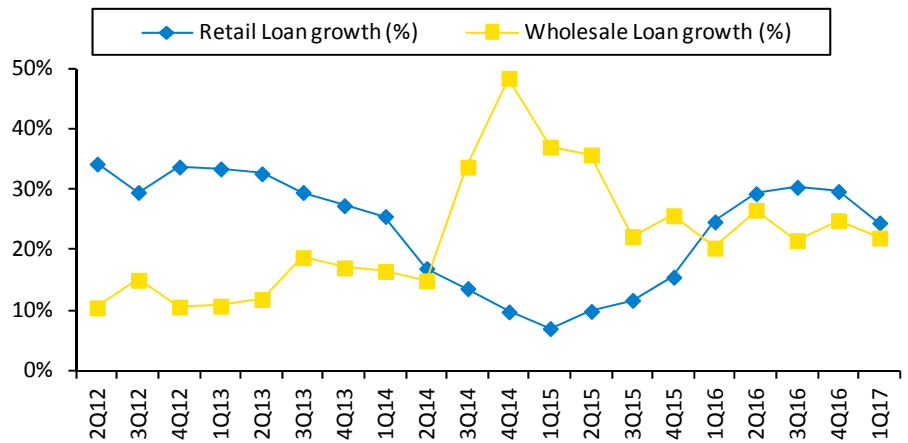
Source: Company Data, PL Research

Exhibit 3: Loan book composition as per internal classification

Loan Composition (Rs m)	Q1FY17	Q1FY16	YoY gr. (%)	Q4FY16	QoQ gr. (%)
Car Loans	5,95,610	5,01,000	18.9	5,72,810	4.0
CV loans	3,14,610	2,64,900	18.8	3,09,350	1.7
2 wheeler loans	66,140	52,810	25.2	63,830	3.6
Sub-total - Auto Loans	9,76,360	8,18,710	19.3	9,45,990	3.2
Personal loans	4,10,590	2,90,580	41.3	3,77,040	8.9
Business banking	6,04,440	5,09,550	18.6	6,10,890	(1.1)
Loan against shares	18,860	13,390	40.9	18,970	(0.6)
Credit Cards	2,12,550	1,68,650	26.0	2,05,200	3.6
Home loans	3,36,050	2,68,880	25.0	3,18,600	5.5
Gold loans	48,760	42,430	14.9	45,860	6.3
Other Retail	3,75,540	2,76,410	35.9	3,75,780	(0.1)
Retail Total	29,83,150	23,88,600	24.9	28,98,330	2.9

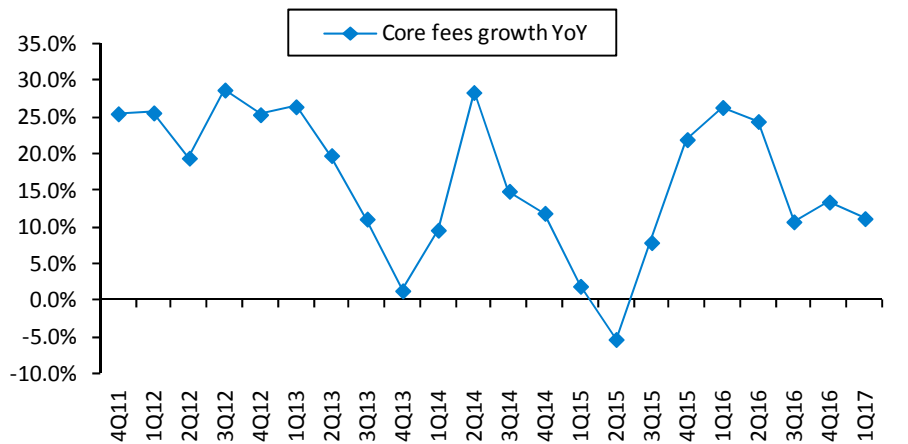
Source: Company Data, PL Research

Exhibit 4: Loan growth continues to be led by retail



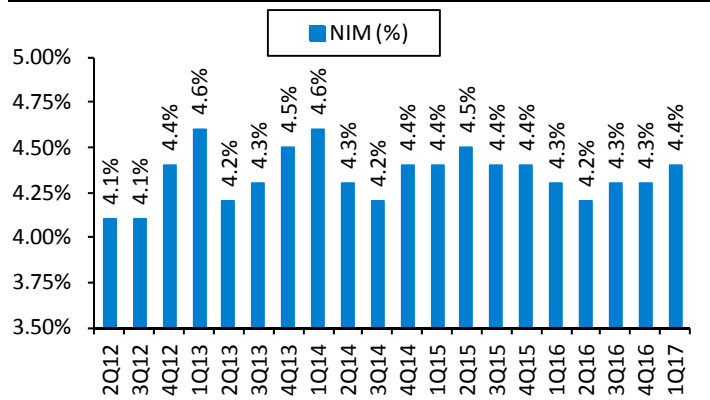
Source: Company Data, PL Research

Exhibit 5: Core fees growth was weak and remains below balance sheet growth



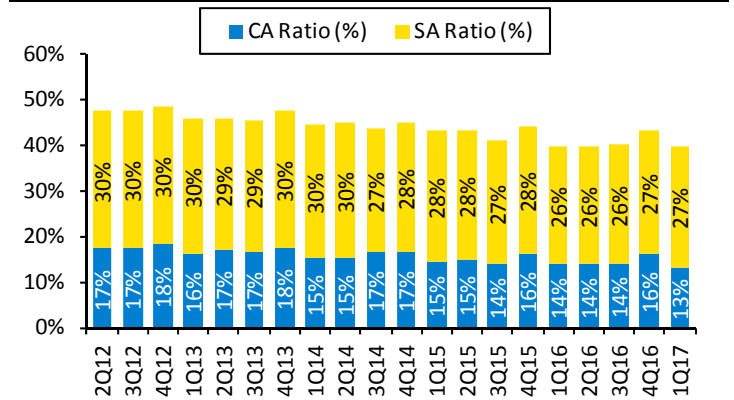
Source: Company Data, PL Research

Exhibit 6: Margins improved by 10bps QoQ, as fixed book growth continues to grow higher

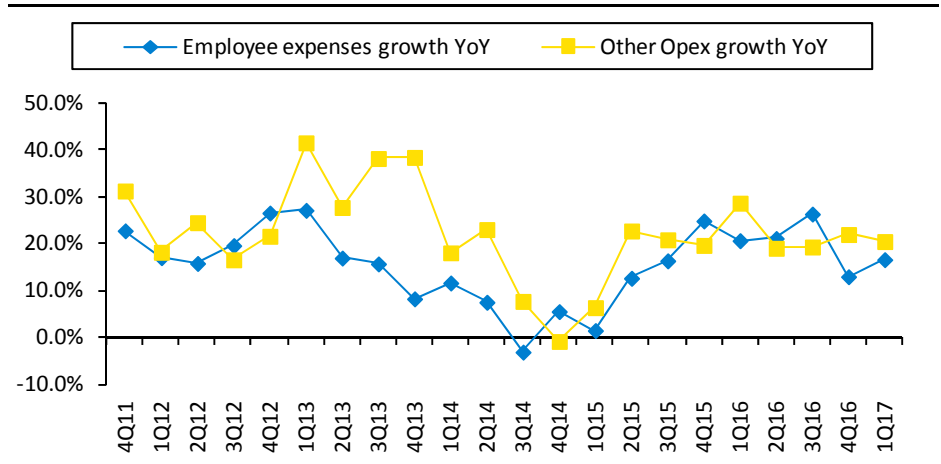


Source: Company Data, PL Research

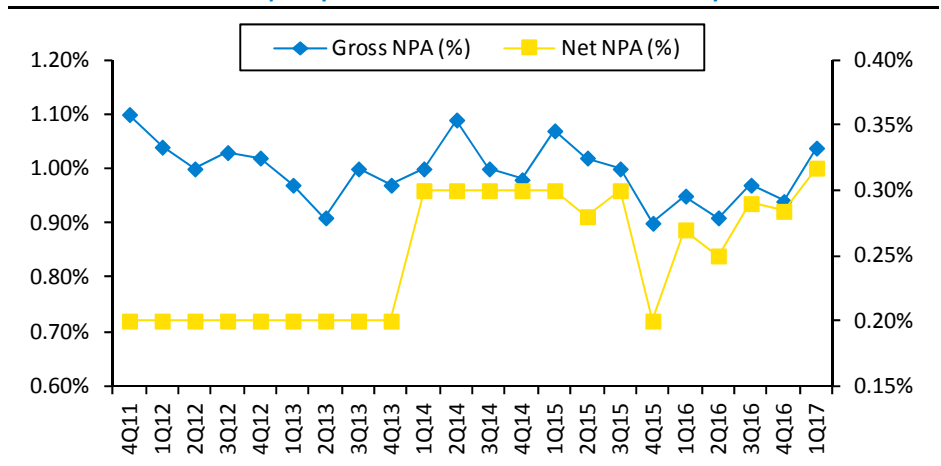
Exhibit 7: CASA saw some weakness as CA remains seasonally lower, while SA growth remained robust



Source: Company Data, PL Research

Exhibit 8: Opex growth relatively higher on some employee salary increments and general rental renewals from branches


Source: Company Data, PL Research

Exhibit 9: Overall asset quality saw some deterioration on seasonality


Source: Company Data, PL Research

Exhibit 10: Change in earnings estimates table – We slightly tweak our estimates to factor in higher opex & credit cost

Rs (mn)	Old estimates		Revised estimates		% change	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Net interest income	3,36,179	4,06,774	3,36,513	4,06,656	0.1	(0.0)
Operating profit	2,65,036	3,32,694	2,65,896	3,27,666	0.3	(1.5)
Net profit	1,51,689	1,90,250	1,49,220	1,84,437	(1.6)	(3.1)
EPS, Rs.	60.0	75.3	59.0	73.0	(1.6)	(3.1)
ABVPS, Rs.	313.7	371.1	318.2	373.4	1.4	0.6
Price target, Rs.	1,350		1,350		-	
Recommendation	BUY		BUY			

Source: Company Data, PL Research

Exhibit 11: We maintain our TP of Rs1,350 based on Mar-18 with a multiple of 3.6x on a robust ROE of 20% in FY18E.

PT calculation and upside	
Fair price – EVA	1,352
Fair price - P/ABV	1,348
Average of the two	1,350
Target P/ABV	3.6
Target P/E	18.5
Current price, Rs	1229
Upside (%)	9.9%
Dividend yield (%)	0.9%
Total return (%)	10.7%

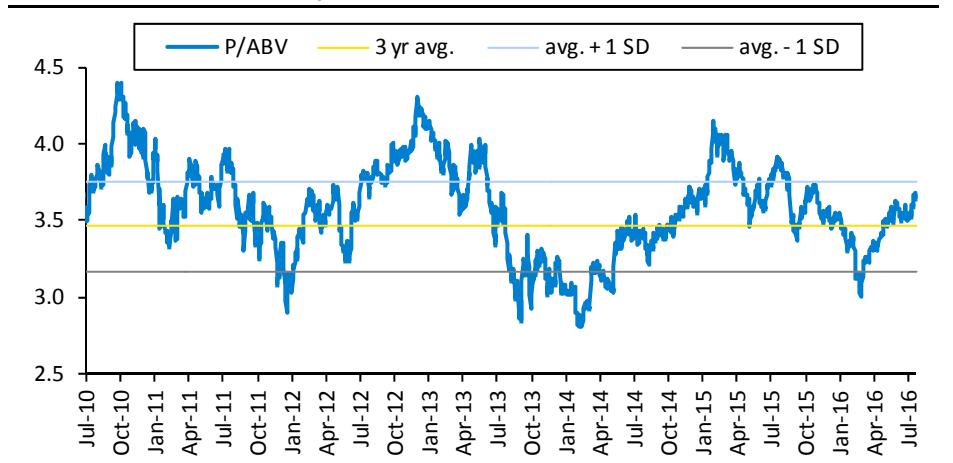
Source: Company Data, PL Research

Exhibit 12: Return ratios to improve on high loan growth with increasing market share, controlled credit cost and likely waning of opex cost

RoA decomposition	FY12	FY13	FY14	FY15	FY16	FY17E	FY18E
Interest income	9.06	9.50	9.22	8.96	9.27	9.07	8.89
Interest expenses	4.87	5.22	5.08	4.82	5.02	4.79	4.65
Net interest income	4.19	4.28	4.14	4.14	4.25	4.28	4.25
Treasury income	0.38	0.28	0.32	0.29	0.30	0.19	0.19
Other Inc. from operations	1.50	1.57	1.46	1.38	1.35	1.44	1.41
Total income	6.07	6.14	5.92	5.80	5.90	5.90	5.85
Employee expenses	1.11	1.07	0.94	0.88	0.88	0.84	0.80
Other operating expenses	1.91	1.97	1.76	1.71	1.74	1.68	1.62
Operating profit	3.05	3.10	3.22	3.22	3.29	3.38	3.42
Tax	0.76	0.82	0.96	0.94	0.98	0.98	0.99
Loan loss provisions	0.61	0.45	0.36	0.38	0.42	0.51	0.50
RoAA	1.68	1.82	1.90	1.89	1.89	1.90	1.93
RoAE	34.53	20.34	21.28	19.37	18.26	19.00	20.09

Source: Company Data, PL Research

Exhibit 13: HDFCB historical 1 year forward P/ABV trend



Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2015	2016	2017E	2018E
Int. Earned from Adv.	371,808	448,279	553,290	671,993
Int. Earned from Inv.	98,585	141,200	143,268	158,779
Others	14,306	12,736	16,999	20,658
Total Interest Income	484,699	602,214	713,557	851,431
Interest expense	260,742	326,299	377,044	444,775
NII	223,957	275,915	336,513	406,656
<i>Growth (%)</i>	21.2	23.2	22.0	20.8
Treasury Income	5,260	7,317	—	—
NTNII	84,704	100,200	127,946	152,895
Non Interest Income	89,964	107,517	127,946	152,895
Total Income	574,663	709,732	841,503	1,004,326
<i>Growth (%)</i>	17.1	23.5	18.6	19.3
Operating Expense	139,875	169,797	198,563	231,885
Operating Profit	174,045	213,635	265,896	327,666
<i>Growth (%)</i>	21.2	22.7	24.5	23.2
NPA Provisions	17,236	21,336	33,611	41,207
Investment Provisions	(38)	152	137	123
Total Provisions	20,758	27,256	39,804	48,216
PBT	153,287	186,379	226,092	279,450
Tax Provisions	51,128	63,417	76,871	95,014
<i>Effective Tax Rate (%)</i>	33.4	34.0	34.0	34.0
PAT	102,159	122,962	149,220	184,436
<i>Growth (%)</i>	20.5	20.4	21.4	23.6

Balance Sheet (Rs m)

Y/e March	2015	2016	2017E	2018E
Par Value	2	2	2	2
No. of equity shares	2,506	2,528	2,528	2,528
Equity	5,013	5,056	5,056	5,056
Networth	620,094	726,778	844,021	991,914
Adj. Networth	611,131	713,574	834,163	978,801
Deposits	4,507,956	5,464,242	6,737,410	8,246,590
<i>Growth (%)</i>	22.7	21.2	23.3	22.4
Low Cost deposits	1,984,921	2,363,108	3,139,633	3,884,144
<i>% of total deposits</i>	44.0	43.2	46.6	47.1
Total Liabilities	5,905,031	7,088,456	8,644,192	10,501,186
Net Advances	3,654,950	4,645,940	5,695,922	6,983,200
<i>Growth (%)</i>	20.6	27.1	22.6	22.6
Investments	1,664,599	1,638,858	1,752,125	2,050,203
Total Assets	5,905,031	7,088,456	8,644,192	10,501,186

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q2FY16	Q3FY16	Q4FY16	Q1FY17
Interest Income	147,725	154,111	159,968	165,160
Interest Expense	80,916	83,426	85,434	87,346
Net Interest Income	66,809	70,685	74,533	77,814
Non Interest Income	25,518	28,722	28,659	28,066
CEB	18,689	20,048	21,724	19,779
Treasury	1,624	3,279	1,155	2,769
Net Total Income	92,327	99,407	103,192	105,881
Operating Expenses	41,898	42,048	45,843	47,689
Employee Expenses	14,140	14,313	14,980	15,852
Other Expenses	27,758	27,736	30,863	31,837
Operating Profit	50,429	57,359	57,349	58,192
Core Operating Profit	48,805	54,080	56,194	55,423
Provisions	6,813	6,539	6,625	8,667
Loan loss provisions	4,844	6,015	4,903	8,323
Investment Depreciation	—	—	—	—
Profit before tax	43,616	50,820	50,725	49,525
Tax	14,922	17,251	16,982	17,136
PAT before EO	28,695	33,568	33,742	32,389
Extraordinary item	—	—	—	—
PAT	28,695	33,568	33,742	32,389

Key Ratios

Y/e March	2015	2016	2017E	2018E
CMP (Rs)	1,228	1,228	1,228	1,228
Equity Shrs. Os. (m)	2,506	2,528	2,528	2,528
Market Cap (Rs m)	3,079,104	3,105,751	3,105,751	3,105,751
<i>M/Cap to AUM (%)</i>	52.1	43.8	35.9	29.6
EPS (Rs)	41.7	48.8	59.0	73.0
Book Value (Rs)	247	287	334	392
Adj. BV (100%) (Rs)	233	271	318	373
P/E (x)	29.5	25.1	20.8	16.8
P/BV (x)	5.0	4.3	3.7	3.1
P/ABV (x)	5.3	4.5	3.9	3.3
DPS (Rs)	8.0	9.5	10.5	12.0
<i>Dividend Yield (%)</i>	0.7	0.8	0.9	1.0

Profitability (%)

Y/e March	2015	2016	2017E	2018E
NIM	4.1	4.2	4.3	4.2
RoAA	1.9	1.9	1.9	1.9
RoAE	19.4	18.3	19.0	20.1

Efficiency

Y/e March	2015	2016	2017E	2018E
<i>Cost-Income Ratio (%)</i>	44.6	44.3	42.8	41.4
<i>C-D Ratio (%)</i>	81.1	85.0	84.5	84.7
Business per Emp. (Rs m)	112	130	145	161
Profit per Emp. (Rs lacs)	14.0	15.8	17.4	19.5
Business per Branch (Rs m)	659	729	815	908
Profit per Branch (Rs m)	8	9	10	11

Asset Quality

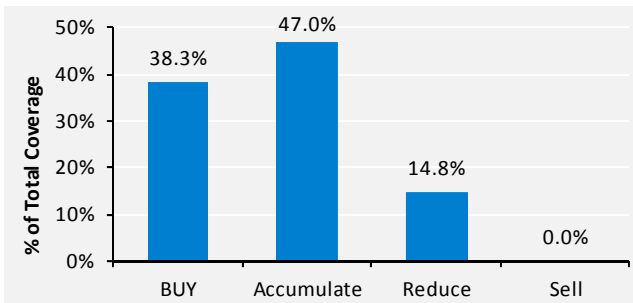
Y/e March	2015	2016	2017E	2018E
Gross NPAs (Rs m)	34,384	43,928	50,429	62,243
Net NPAs (Rs m)	8,963	13,204	9,858	13,112
<i>Gr. NPAs to Gross Adv. (%)</i>	0.9	0.9	0.9	0.9
<i>Net NPAs to Net Adv. (%)</i>	0.2	0.3	0.2	0.2
<i>NPA Coverage (%)</i>	73.9	69.9	80.5	78.9

Source: Company Data, PL Research.

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Rating Distribution of Research Coverage

PL's Recommendation Nomenclature

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Trading Sell	:	Over 10% absolute decline in 1-month
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