YES SECURITIES
INSTITUTIONAL EQUITIES

September 19, 2023

EVENT REPORT | Sector: Banks

HDFC Bank

Erstwhile HDFC Limited under the spotlight

We participated in the Analyst Day Meet held by HDFC Bank (HDFCB) and gleaned the following key takeaways (1) The networth of the erstwhile HDFC Limited would be reduced by a gross quantum of Rs 324bn as of 1st July due to various adjustments (2) For HDFC Limited, the IGAAP RoA for FY23 would have been about 1.9%, which is about 75% of IndAS RoA of 2.4% for FY23 (3) Management explained that the excess liquidity being held would be unwound in 2-4 quarters (4) The return on assets for the merged bank in 1QFY24 on pro forma basis is 1.9-2% compared with 2.1% for the standalone bank.

The networth of the erstwhile HDFC Limited would be reduced by a gross quantum of Rs 324bn as of 1st July due to various adjustments

The reduction in networth is (1) Rs 118bn due to alignment of IGAAP (2) Rs 76bn due to credit policy harmonization in order to adhere to RBI standards as well as bank standards (3) Rs 49bn due to deferred tax liability reserve as per RBI's 2013 circular (4) Rs 81bn due to dividend payout before 1st July 2023. On the other hand, (1) there was an accretion to networth over 1QFY24 due to income, warrants, ESOPs, etc amounting to Rs 62bn and (2) there was also a positive impact of Rs 40bn due to tax effects of harmonization. As a result, the net negative impact on the erstwhile HDFC Limited's networth is Rs 222bn as of 1st July compared with March 2023. The opening networth of unmerged HDFC Bank for July 2023 is Rs 2938bn, which translated to a standalone BVPS of Rs 525. The negative impact due to share swap and elimination of stake amounts to Rs 142bn. After adding the adjusted HDFC Limited networth, the networth of the merged entity amounts to Rs 3914bn as of 1st July 2023, which translates to a standalone BVPS of Rs 519.

For HDFC Limited, the IGAAP RoA for FY23 would have been about 1.9%, which is about 75% of IndAS RoA of 2.4% for FY23

Half of this reduction is the bank dividend that HDFC Limited used to get but is now eliminated. The remaining half is equally due to deferred acquisition cost being taken upfront and the tax rate change.

Management explained that the excess liquidity being held would be unwound in 2-4 quarters

The incoming Day 0 margin for HDFC Limited is 2.0% due to the additional liquidity that HDFC Limited is carrying. This is 70 bps lower than its 1QFY24 IGAAP margin of 2.7%. The total impact on merged entity 1QFY24 NIM (based on total assets) is 4.1% declining to a pro forma NIM of 3.7-3.8% due to the additional liquidity being carried. It will take 2-4 quarters to run down the excess liquidity. Longer-term, loan mix change will also aid margin. Share of retail, which used to be 54% even before a fully-fledged mortgage business, had dipped to 45% but has recovered to 47%.

The return on assets for the merged bank in 1QFY24 on pro forma basis is 1.9-2% compared with 2.1% for the standalone bank

The impact from decline in margin would be partly offset by a decline in cost to income ratio and a marginal decline in credit cost. The cost to income ratio of the standalone bank for 1QFY24 was 43%, which would be ~40% on pro forma basis for the merged entity. The credit cost would be marginally lower at ~0.6% compared with 0.7%. There are certain pockets such as small-ticket unsecured and MSME which are under stress at the system level but not necessarily for the bank. Pre-merger, the mean credit cost was 90-100 bps whereas, post-merger, it is about 10 bps lower.

We maintain a less-than-outright bullish ADD rating with a revised price target of Rs 1950

We value the standalone bank at 2.5x FY25 P/BV for an FY24E/25E/26E RoE profile of 16.4/17.1/17.0%. We assign a value of Rs 207 per share to the subsidiaries, on SOTP. We had begun with an ADD rating for HDFCB in our in our Sector Initiation Report dated June 2021 before we upgraded it to BUY in our Sector Report dated May 2022 and then downgraded the stock back to ADD in our 4QFY23 result report.

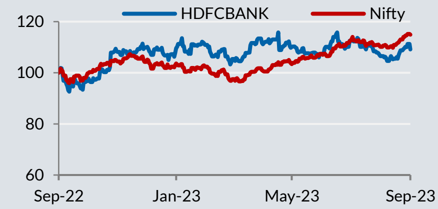
(*See Comprehensive analyst meet takeaways on page 2 for significant incremental colour*.)

Recommendation	:	ADD
Current Price	:	Rs 1,629
Target Price	:	Rs 1,950
Potential Return	:	19.5%

Stock data (as on September 18, 2023)

Nifty	20,133
52 Week h/l (Rs)	1758 / 1365
Market cap (Rs/USD mn)	12588760 / 151180
Outstanding Shares (mn)	7,576
6m Avg t/o (Rs mn):	23,724
Div yield (%):	0.9
Bloomberg code:	HDFCB IN
NSE code:	HDFCBANK

Stock performance



	1M	3M	1Y
Absolute return	2.4%	1.6%	9.1%

Shareholding pattern (As of Jul'23 end)

Promoter	0.0%
FII+DII	72.5%
Others	13.9%

Δ in stance

(1-Yr)	New	Old
Rating	ADD	ADD
Target Price	1950	1925

Financial Summary

(Rs mn)	FY24E	FY25E	FY26E
NII	1,102,144	1,480,489	1,780,332
PPOP	973,291	1,329,856	1,604,199
Net Profit	577,290	817,232	966,013
Growth (%)	30.9	41.6	18.2
EPS (Rs)	77.3	109.5	129.4
BVPS (Rs)	568.7	709.6	814.0
P/E (x)	18.4	13.0	11.0
P/BV (x)	2.5	2.0	1.8
ROE (%)	16.4	17.1	17.0
ROA (%)	1.8	2.0	2.0
Tier-1 (%)	16.0	16.9	16.4

Δ in earnings estimates

Rs.	FY24E	FY25E	FY26E
EPS (New)	77.3	109.5	129.4
EPS (Old)	77.3	106.6	124.5
% change	0.0%	2.7%	4.0%

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COMPREHENSIVE ANALYST MEET TAKEAWAYS

Networth movement for HDFC Limited – March 2023 to 1st July 2023

- ✓ The closing networth for HDFC Limited as of March 2023 is Rs 1340bn on IndAS basis.
- ✓ The accretion to networth over 1QFY24 amounted to Rs 62bn and pertained to income, warrants, ESOPs, etc.
- ✓ IGAAP alignment
  - The reduction due to alignment of IGAAP is Rs 118bn.
  - **Deferred acquisition cost and fees**
    - In IndAS, the acquisition cost was amortised over the life of the asset but now, it has to be taken upfront and hence, a Rs 38bn charge-off.
    - This is not a cash charge-off but only an impact due to timing differential.
  - **Interest spread on assigned loans**
    - Under IndAS, for the interest spread on assigned loans, there is a gain recognised and the interest spread capitalized gets amortised.
    - This is not available under IGAAP and hence, a Rs 28bn charge-off which is, again, not having any cash impact.
  - **Fair value adjustment to bring investments to cost**
    - The fair value adjustment to bring investments to cost amounts to Rs 43bn.
    - This is mainly (about 75-80% of the impact) due to bringing listed equity investments from fair value to cost.
    - Again, there is no economic loss due to this adjustment.
    - This adjustment is not pertaining to the subsidiaries.
    - The bank has time till 1st April 2024 to reckon as to which category these investments will be classified as on that date.
- ✓ Credit policy harmonization
  - The reduction due to credit policy harmonization is Rs 76bn in order to adhere to RBI standards as well as bank standards.
  - **General and contingent provisions**
    - HDFC Limited did not have the same contingent provisions policy as the bank.
    - The impact due to harmonising to the bank policy is Rs 39bn, which is about 70 bps.
    - The standalone bank also has 69-70 bps of floating and contingent provisions on its balance sheet (which is indicative of the harmonization).
  - **Specific provisions on NPA**
    - HDFC Limited reserving was carried out based on expected loss and its PCR was 42%.
    - The bank has taken this specific PCR to 74%, which leads to an impact of Rs 38bn.
    - This is also non-economic and mainly to do with timing.
- ✓ Deferred Tax Liability Reserve
  - The reduction due to deferred tax liability reserve is Rs 49bn as per RBI's 2013 circular.
  - This is only a balance sheet segregation from Equity to DTL.
  - There is a concessional tax rate for profit derived from housing loans due to which HDFC Limited's tax rate is 19-20%.
  - The tax benefit is reversed when the reserve will be utilised but HDFC Limited decided not to reverse and hence, did not set up DTL. However, the bank has to set it up.

(Con call takeaways continue on the next page)

- **Other aspects**
  - There is a positive impact of Rs 40bn due to tax effects of harmonization.
  - The reduction due to dividend payout amounted to Rs 81bn before 1st July 2023.
- The closing networth for HDFC Limited as of 1st July 2023 is Rs 1118bn.

Credila

- The Credila deal has not yet happened and is still in the works and hence, its pro forma gains are not yet factored in.

Merged Networth

- The opening networth of unmerged HDFC Bank for July 2023 is Rs 2938bn, which translated to a standalone BVPS of Rs 525.
- The networth of erstwhile HDFC Limited worth Rs 1199bn gets added.
- The negative impact due to share swap and elimination of stake amounts to Rs 142bn.
- The negative impact of interim dividend payout amounts to Rs 81bn.
- Consequently, the networth of the merged entity amounts to Rs 3914bn as of 1st July 2023, which amounts to a standalone BVPS of Rs 519.

Asset quality – Unmerged bank at June 2023 vs Merged bank on 1st July 2023

- GNPA ratio rises from 1.2% to 1.4%.
- NNPA ratio rises from 0.3% to 0.4% (0.37%).
- Specific PCR moves from 75% to 74%.
- Contingent and floating provisions has remained stable at about 0.7%.
- Total provisions have risen from 2.0% to 2.2% of advances.
- **HDFC Limited**
  - **Non-individual GNPA**
    - The non-individual GNPA has gone up from ~4% as of March to 6.7%.
    - Some amount of accounts have gone into the NPA bucket.
    - Also, the bank would not do certain accounts and action has been taken.
  - **Stage 1 and 2 provisions**
    - This amounted to about 45 bps.
    - This happens to be similar to the 44 bps general provisions on the standalone bank.

HDFC Limited – Key numbers – IndAS vs IGAAP

- **Return on assets**
  - 75% of the IndAS RoA is sustainable under IGAAP and the FY23 RoA gets reduced from 2.4% to 1.9%.
  - Half of this reduction is the bank dividend that HDFC Limited used to get but is now eliminated.
  - The remaining half is equally due to deferred acquisition cost being taken upfront and the tax rate change.
- **Net interest margin**
  - The FY23 NIM has remained stable at 2.9%.

(Con call takeaways continue on the next page)

- The 1QFY24 NIM is 2.7% under IGAAP.
- The incoming Day 0 margin is 2.0% due to the additional liquidity that HDFC Limited is carrying.
- It may be noted that the NIM being mentioned here is based on Du Pont (i.e. with total assets in the denominator).

✓ **Cost to income ratio**

- The FY23 cost to income ratio rises from 10% to 19%.

✓ **Credit cost**

- The FY23 credit cost remains stable at 0.3%.

Standalone bank vs Merged – 1QFY24

✓ **Net interest margin**

- NIM (total assets) – 4.1% to 3.7-3.8% due to the additional liquidity being carried.
- It will take 2-4 quarters to run down the excess liquidity.
- **Loan mix**
  - Longer-term, loan mix change will aid margin.
  - Share of retail, which used to be 54% even before a fully-fledged mortgage business, had dipped to 45% but has recovered to 47%.

✓ **Cost to income ratio**

- 43% to ~40%

✓ **Credit cost**

- 0.7% to ~0.6%.
- There are certain pockets such as small-ticket unsecured and MSME at the system level which are under stress but not necessarily for the bank.
- Pre-merger, the mean credit cost was 90-100 bps whereas, post-merger, it is about 10 bps lower.

✓ **Return on Assets**

- 2.1% to 1.9-2.0%

✓ **Return on Equity**

- 17.3% to ~16%

✓ **Capital adequacy**

- 18.9% to 19.2%, including 1Q profit in both numbers.
- RWA density has remained at about 65-66%.

Deposits profile

✓ **Outflows in LCR**

- Wholesale deposits outflow ranges between 40-100% from an LCR perspective.
- For retail deposits, the outflow ranges from 5-10% and hence, the focus is on retail deposits.

✓ **Share of retail**

- Share of retail deposits is slightly above 80%.
- The bank does wholesale deposits but not at any cost.
- **Example of shunned wholesale depositor**
  - There was a 100% LCR wholesale deposit customer available at 7.8-7.85%, whose fully loaded cost was 8.1% but was turned down.
  - Even a bond could be cheaper than such a wholesale deposit customer.

(Con call takeaways continue on the next page)

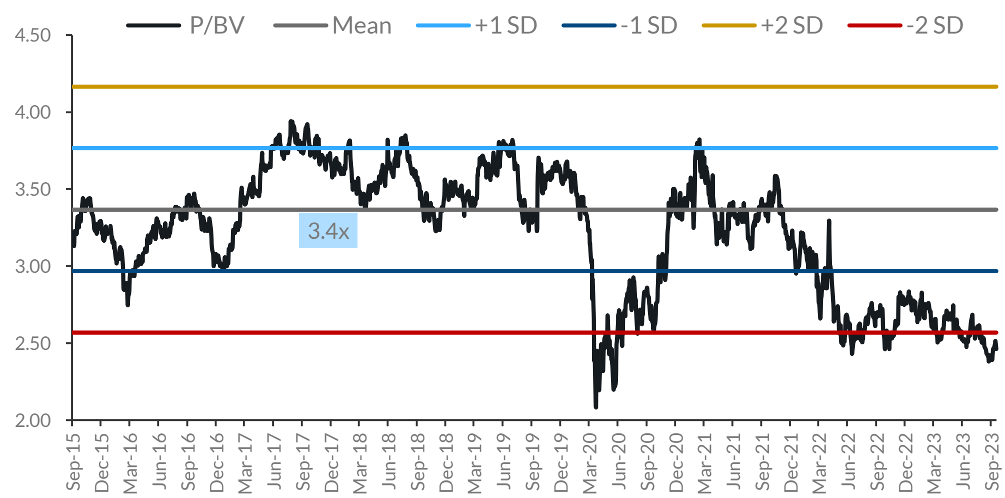
HDFC Limited non-individual book growth

- Some more rundown of non-individual book will happen.
- As such, the bank will continue to do the HDFC Limited non-individual business including all 3 segments viz. Developer book, LRD book and other corporates.

Exhibit 1: 1-year rolling P/BV band

Source: Company, YES Sec – Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

Exhibit 2: 1-yr rolling P/BV vis-a-vis the mean and standard deviations



Source: Company, YES Sec – Research, N.B. Valuations in this chart are not adjusted / netted out for subsidiaries' value

ANNUAL FINANCIALS

Exhibit 3: Balance sheet

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Total cash & equivalents	1,523,269	1,937,651	2,799,099	3,302,937	3,897,466
Investments	4,555,357	5,170,014	7,666,832	8,903,525	10,362,822
Advances	13,688,209	16,005,859	25,446,355	30,026,699	35,431,505
Fixed assets	60,837	80,165	88,182	97,000	106,700
Other assets	857,678	1,467,125	1,760,550	2,112,660	2,535,192
Total assets	**20,685,351**	**24,660,815**	**37,761,018**	**44,442,821**	**52,333,685**
Net worth	2,400,929	2,801,990	4,245,171	5,297,218	6,075,824
Deposits	15,592,174	18,833,946	28,746,467	33,326,811	38,731,617
Borrowings	1,848,172	2,067,656	3,200,515	3,750,156	4,398,733
Other liabilities	844,075	957,222	1,568,865	2,068,635	3,127,510
Total liabilities incl. Equity	**20,685,351**	**24,660,815**	**37,761,018**	**44,442,821**	**52,333,685**

Source: Company, YES Sec – Research

Exhibit 4: Income statement

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	1,277,531	1,615,855	2,168,346	2,930,919	3,465,963
Interest expense	(557,435)	(747,433)	(1,066,202)	(1,450,430)	(1,685,630)
Net interest income	**720,096**	**868,422**	**1,102,144**	**1,480,489**	**1,780,332**
Non-interest income	295,099	312,148	487,810	650,387	767,724
Total income	**1,015,195**	**1,180,570**	**1,589,954**	**2,130,876**	**2,548,057**
Operating expenses	(374,422)	(476,521)	(616,663)	(801,020)	(943,858)
PPoP	**640,773**	**704,050**	**973,291**	**1,329,856**	**1,604,199**
Provisions	(150,618)	(119,197)	(203,571)	(240,214)	(316,181)
Profit before tax	**490,155**	**584,853**	**769,720**	**1,089,642**	**1,288,018**
Taxes	(120,541)	(143,766)	(192,430)	(272,411)	(322,004)
Net profit	**369,614**	**441,087**	**577,290**	**817,232**	**966,013**

Source: Company, YES Sec – Research

Exhibit 5: Du Pont Analysis (RoA tree)

Y/e 31 Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest income	6.7	7.1	6.9	7.1	7.2
Interest expense	-2.9	-3.3	-3.4	-3.5	-3.5
Net interest income	**3.8**	**3.8**	**3.5**	**3.6**	**3.7**
Non-interest income	1.5	1.4	1.6	1.6	1.6
Total income	**5.3**	**5.2**	**5.1**	**5.2**	**5.3**
Operating expenses	-2.0	-2.1	-2.0	-1.9	-2.0
PPoP	**3.4**	3.1	3.1	3.2	3.3
Provisions	-0.8	-0.5	-0.7	-0.6	-0.7
Profit before tax	**2.6**	**2.6**	**2.5**	**2.7**	**2.7**
Taxes	-0.6	-0.6	-0.6	-0.7	-0.7
Net profit	**1.9**	**1.9**	**1.8**	**2.0**	**2.0**

Source: Company, YES Sec – Research

Exhibit 6: Sum of the Parts (SOTP) - Subsidiaries

Subsidiary	Market Cap / Assigned value (Rs mn)	Valuation metric	Metric value (Rs mn)	Trailing multiple (Implied / Assigned)	Stake (%)	Stake value (Rs mn)	Per share (Rs)
HDB Financial Services	400,295	BV	114370	3.5x	95.0%	380,120	50.9
HDFC Securities	53,914	BV	17,971	3.0x	96.3%	51,941	7.0
HDFC AMC	565,410	QAAUM	4,497,663	12.6%	52.6%	297,179	39.8
HDFC Life	1,418,930	EV	395,260	3.6x	50.3%	714,147	95.7
HDFC ERGO	163,165	PE	6,527	25.0x	50.5%	82,398	11.0
Bandhan Bank	397,240	MCap	346,576	1.0x	5.0%	19,663	2.6
Value of Subsidiaries						**432,061**	**207.0**

Source: Company, YES Sec – Research

Exhibit 7: Change in Annual Estimates

Y/e 31 Mar (Rs. mn)	Revised Estimate			Earlier Estimate			*% Revision*		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Net Interest Income	1,102,144	1,480,489	1,780,332	1,102,156	1,451,576	1,731,060	*(0.0)*	*2.0*	*2.8*
Pre-Prov. Operating Profit	973,291	1,329,856	1,604,199	973,289	1,301,643	1,554,867	*0.0*	*2.2*	*3.2*
Profit after tax	577,290	817,232	966,013	577,289	796,072	929,014	*0.0*	*2.7*	*4.0*

Source: Company, YES Sec – Research

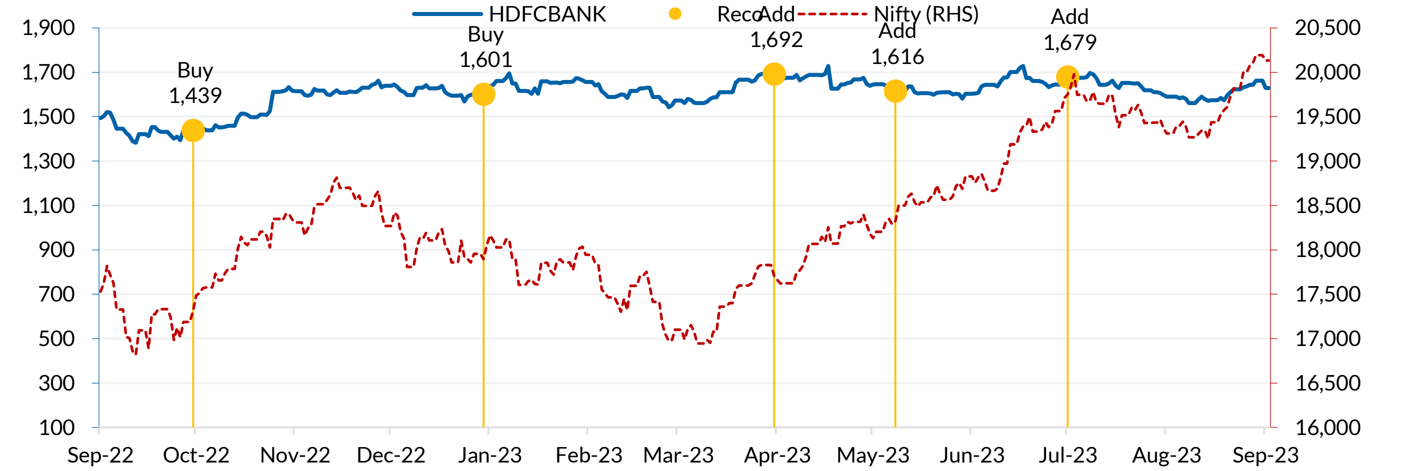
Exhibit 8: Ratio analysis

Y/e 31 Mar	FY22	FY23	FY24E	FY25E	FY26E
Growth matrix (%)					
Net interest income	11.0	20.6	26.9	34.3	20.3
PPoP	11.7	9.9	38.2	36.6	20.6
Net profit	18.8	19.3	30.9	41.6	18.2
Loans	20.8	16.9	59.0	18.0	18.0
Deposits	16.8	20.8	52.6	15.9	16.2
Profitability Ratios (%)					
Net interest margin	4.0	4.1	3.8	3.9	4.0
Return on Average Equity	16.7	17.0	16.4	17.1	17.0
Return on Average Assets	1.9	1.9	1.8	1.99	2.00
Per share figures (Rs)					
EPS	66.7	79.1	77.3	109.5	129.4
BVPS	433	502	569	710	814
ABVPS	425	494	556	690	792
Valuation multiples					
P/E	21.4	18.0	18.4	13.0	11.0
P/BV	3.3	2.8	2.5	2.0	1.8
P/ABV	3.4	2.9	2.6	2.1	1.8
NIM internals (%)					
Yield on loans	7.9	8.6	8.2	8.4	8.5
Cost of deposits	3.4	3.6	4.0	4.1	4.1
Loan-deposit ratio	87.8	85.0	88.5	90.1	91.5
CASA ratio	48.2	44.4	37.0	37.0	37.0
Opex control (%)					
Cost/Income ratio	36.9	40.4	38.8	37.6	37.0
Cost to average assets	2.0	2.1	2.0	1.9	2.0
Capital adequacy (%)					
Tier 1 capital ratio	17.9	17.1	16.0	16.9	16.4
Asset quality (%)					
Slippage ratio	2.1	1.7	1.2	1.2	1.2
Gross NPL ratio	1.2	1.1	1.2	1.5	1.6
Credit cost	0.8	0.8	0.8	0.8	0.9
Net NPL ratio	0.3	0.3	0.4	0.5	0.5

Source: Company, YES Sec – Research; Valuations are the implied valuation of standalone entity net of subsidiaries

HDFC Bank Ltd

Recommendation Tracker



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DISCLOSURE OF INTEREST

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BUY: Upside greater than 20% over 12 months

ADD: Upside between 10% to 20% over 12 months

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