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Company update, TP and
earnings revision

Banking

Target price Rs2,000

Earnings revision

(%)	FY24E	FY25E
PAT	↓ 4	↓ 2

Target price revision:

Rs2,000 from Rs1,990

Shareholding pattern

	Sep '22	Dec '22	Mar '23
Promoters	25.6	25.6	25.6
Institutional investors	59.9	60.5	60.6
MFs and others	18.0	18.4	18.5
FIs/Banks	0.0	1.5	1.6
Insurance Cos.	7.9	8.1	8.0
FPI	34.0	32.5	34.0
Others	14.5	13.9	13.8

Source: BSE

ESG disclosure score

Year	2021	2022	Chg
ESG score	58.2	63.1	4.9
Environment	43.2	40.1	(3.1)
Social	51.6	56.7	5.1
Governance	79.8	92.4	12.5

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

HDFC Bank

BUY
Maintained

RBI grants dispensation on PSL / Insurance businesses stake

Rs1,675

With clarity on regulatory dispensations, HDFC Bank, in our view, has crossed a major milestone in its journey towards big-bang merger with parent HDFC Limited. RBI has granted some leeway pertaining to PSL compliance, holding stake in the insurance businesses and LAS business of HDFC Limited though there is no relaxation on CRR, SLR and LCR front. Bank has got 6 months (sufficient time, in our view) to link all the retail, MSME and floating-rate loans of HDFC Limited with appropriate benchmark. RBI seems to be silent on the proposed grandfathering of the parent's liabilities and the bank would approach RBI with the crystallized amount in due course. There are a few areas (loans regarding land acquisition, core investment companies, projects under implementation, etc.) where clarity is yet to come in, but these are not of much consequence, in our view.

Our back-of-the-envelope calculations suggest that the relaxed dispensation on PSL timeline should ease RoA drag by <5bps but, more importantly, should give better manoeuvrability to the bank in its journey towards PSL compliance while pursuing its strong growth ambitions. The merger remains on track and should be consummated within the earlier-envisaged timeline (Jul'23), in our view. Overall, we believe the developments should largely ease the overhang surrounding merger uncertainties. We revise our earnings for standalone bank to reflect our current estimates. We tweak our target price to Rs2,000 (vs Rs1,990 earlier), valuing the standalone bank at ~3.0x FY25 ABV. Maintain BUY.

Key parameters:

► **Some leeway on PSL compliance as only one-third of HDFC Limited's loans to be used for 'adjusted net bank credit' (ANBC) in year-1:** Bank has got some leeway in its PSL compliance for the merged entity. ANBC may be calculated considering one-third of the outstanding loans of HDFC Limited as on the effective date of the amalgamation for the first year. The remaining two-thirds of HDFC Limited's portfolio shall be considered over a period of next two years equally. We believe this would be a key positive for the bank as it is likely to make PSL compliance easier for the merged entity.

Bank has clarified that on the date of merger, only ANBC would increase while PSL requirements would come-in only after 12 months (as usual). Incremental loans for HDFC Limited will follow business-as-usual PSL requirements. It seems the qualified bonds issued by HDFC Limited may not be eligible for deduction from the PSL perspective though further clarity is awaited.

On PSL mechanism, the bank mentioned it would endeavour to be PSL-compliant via the organic route. Hence, it is rapidly expanding its presence in semi-urban / rural locations. It also mentioned there are multiple alternatives for complying with PSL – namely IBPC, co-lending, PSLC, PTC and RIDF and that it would take a calculated call while evaluating these options.

Market Cap	Rs9344bn/US\$113.7bn	Year to Mar	FY22	FY23	FY24E	FY25E
Reuters/Bloomberg	HDBK.BO/HDFCB IN	NII (Rs bn)	720	868	989	1,170
Shares Outstanding (mn)	5,579.7	Net Profit (Rs bn)	370	441	501	591
52-week Range (Rs)	1696/1281	EPS (Rs)	66.8	79.3	89.8	106.0
Free Float (%)	74.4	% Change YoY	18.1	18.6	13.2	18.1
FII (%)	34.0	P/E (x)	25.1	21.1	18.6	15.8
Daily Volume (US\$'000)	1,76,002	P/BV (x)	3.9	3.3	2.9	2.6
Absolute Return 3m (%)	0.8	P/ABV (x)	3.9	3.4	3.0	2.6
Absolute Return 12m (%)	23.3	GNPA (%)	1.2	1.1	1.3	1.6
Sensex Return 3m (%)	(1.4)	RoA (%)	1.9	1.9	1.9	1.9
Sensex Return 12m (%)	4.3	RoE (%)	16.2	16.5	16.3	16.8

Please refer to important disclosures at the end of this report

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- ▶ **No disruption with respect to stake in the insurance businesses:** Investments including subsidiaries and associates of HDFC Limited will be allowed to continue as investments of HDFC Bank. The RBI has permitted HDFC Bank / HDFC Limited to increase its shareholding to more than 50% in HDFC Life Insurance and HDFC ERGO General Insurance prior to the effective date of amalgamation. This appears to be the least disruptive way to continue with the stake in insurance businesses, in our view.

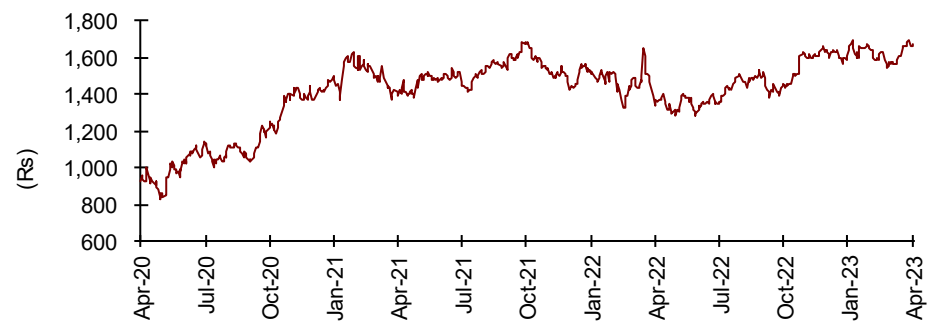
Moreover, in terms of HDFC Limited's holdings in other banks (Yes / Bandhan), they are already within the normal threshold and thus can maintain status-quo from the regulatory perspective.

The RBI has also permitted HDFC Bank to continue holding HDFC Limited's stake in: (a) HDFC Education and Development Services Private Limited, and (b) HDFC Credila Financial Services Limited, subject to its shareholding being brought down to 10% within 2 years from the effective date and not on boarding new customers. The required change in the said two entities is not material in the overall scheme of things, in our view.

- ▶ **CRR, SLR and LCR norms applicable from day-1 without any relief:** The merged entity shall continue to comply with extant requirements of CRR, SLR and LCR from the effective date without exception. There is no dispensation given by RBI here, but it is in line with our / consensus expectations. Statutory requirement for SLR is 18% and CRR is 4.5%, while the bank is carrying ~25% SLR and 116% LCR as of Mar'23. Management did not specify if it would need additional liquidity to maintain sufficient buffer to comply with LCR norms for the merged entity.
- ▶ **HDFC Bank's interest rate won't be detrimental for HDFC Limited customers:** Bank will have to do one-time mapping of all borrowers of HDFC Limited for benchmark and spreads. All retail, MSME and other floating-rate loans sanctioned by HDFC Limited would be linked to appropriate benchmark (EBLR or MCLR) within 6 months from the effective date. The benchmark applicable here would be either EBLR or MCLR. However, we are not sure if the bank can offer MCLR option to the existing HDFC Limited home loan customers upon transition. Bank has clarified that the effective rate to the customers would not be detrimental and the transition should be seamless. It remains confident that the associated costs too should not be material. Bank would aim to maintain / deepen the existing relationship with customers and further improve upon it.
- ▶ **LAS above Rs2mn to be permitted in bank till maturity:** RBI has permitted that the merged entity can continue to keep loan against shares (LAS) for either promoter contribution or in excess of Rs2mn to the individuals, for the existing duration/maturity. This is in line with our as well as consensus expectations of not allowing bulk LAS business within the bank.
- ▶ **Harmonisation of IRAC norms:** The asset classification of accounts from HDFC Limited post-merger would be harmonised with banking norms. Given the strong asset quality at HDFC Limited, we believe the transition should be least disruptive.
- ▶ **No explicit mention on grandfathering of liabilities:** RBI seems to be silent on the proposed grandfathering of the parent's liabilities and the bank would approach RBI with the crystalized amount in due course.

- **Clarification related to certain issues pending with RBI:** Apart from the above parameters, there are a few areas (loans regarding land acquisition, core investment companies, projects under implementation, etc.) where clarity is yet to come, but these are not of much consequence, in our view.

Price chart



Source: Bloomberg

Financial summary (standalone)

Table 1: Profit and Loss statement

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Interest income	802,414	989,721	1,148,127	1,208,582	1,277,531	1,615,856	2,004,077	2,456,116
Interest expense	-401,465	-507,288	-586,264	-559,787	-557,435	-747,433	-1,015,427	-1,285,951
Net interest income	400,949	482,432	561,863	648,796	720,096	868,422	988,649	1,170,165
growth (%)	21.0	20.3	16.5	15.5	11.0	20.6	13.8	18.4
Non-interest income	152,203	176,259	232,608	252,049	295,099	312,148	396,641	474,909
Operating income	553,152	658,691	794,471	900,845	1,015,195	1,180,571	1,385,290	1,645,074
Operating expenses	-226,904	-261,194	-306,975	-327,226	-374,422	-476,521	-582,259	-693,010
- Staff expenses	-68,057	-77,618	-95,257	-103,648	-120,317	-155,124	-193,953	-232,667
Pre-provisions profit	326,248	397,497	487,495	573,618	640,773	704,050	803,031	952,064
Core operating profit	317,002	393,629	468,152	549,802	617,947	717,462	797,730	946,763
growth (%)	28.9	24.2	18.9	17.4	12.4	16.1	11.2	18.7
Provisions & Contingencies	-59,275	-75,501	-121,424	-157,029	-150,618	-119,197	-133,212	-161,334
Pre-tax profit (before non-recurring items)	266,973	321,997	366,072	416,590	490,155	584,853	669,819	790,730
Non-recurring items	0	0	0	0	0	0	0	0
Tax on non-recurring items	0	0	0	0	0	0	0	0
Pre-tax profit (after non-recurring items)	266,973	321,997	366,072	416,590	490,155	584,853	669,819	790,730
Tax (current + deferred)	-92,106	-111,215	-103,498	-105,425	-120,541	-143,766	-168,794	-199,264
Net profit	174,868	210,782	262,573	311,165	369,614	441,087	501,024	591,466
Adjusted net profit	174,868	210,782	262,573	311,165	369,614	441,087	501,024	591,466
growth (%)	20.2	20.5	24.6	18.5	18.8	19.3	13.6	18.1
Minority interests	0	0	0	0	0	0	0	0
Net income	174,868	210,782	262,573	311,165	369,614	441,087	501,024	591,466

Source: Company data, I-Sec research

Table 2: Balance Sheet

(Rs mn, year ending Mar 31)

	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Cash and balance with RBI/Banks	1,229,151	813,476	866,187	1,194,704	1,523,269	1,937,651	2,476,251	3,178,203
Investments	2,422,002	2,905,879	3,918,267	4,437,283	4,555,357	5,170,014	6,042,575	6,992,007
Advances	6,583,331	8,194,012	9,937,029	11,328,366	13,688,209	16,005,859	18,803,048	22,070,469
Interest earning assets	10,234,484	11,913,367	14,721,483	16,960,353	19,766,835	23,113,524	27,321,874	32,240,679
Fixed assets (Net block)	36,072	40,300	44,319	49,093	60,837	80,166	89,699	112,123
Other assets	368,787	491,740	539,311	459,259	857,678	1,467,125	1,631,655	1,812,127
Total assets	10,639,343	12,445,407	15,305,113	17,468,705	20,685,351	24,660,815	29,043,228	34,164,929
Deposits	7,887,706	9,231,409	11,475,023	13,350,602	15,592,174	18,833,947	22,706,444	27,290,742
Other interest bearing liabilities	1,231,050	1,170,851	1,446,285	1,354,873	1,848,172	2,067,656	2,056,061	2,137,061
Total Interest bearing liabilities	9,617,064	11,002,590	13,595,252	15,431,497	18,284,421	21,858,825	25,855,449	30,521,721
Other liabilities and provisions	498,308	600,329	673,944	726,022	844,075	957,223	1,092,944	1,093,918
Share capital	5,190	5,447	5,483	5,513	5,546	5,580	5,580	5,580
Reserves & surplus	1,017,089	1,437,371	1,704,377	2,031,696	2,395,384	2,796,411	3,182,199	3,637,628
Less: Misc. expenditure	0	0	0	0	0	0	0	0
Shareholders' funds	1,022,279	1,442,817	1,709,860	2,037,208	2,400,929	2,801,990	3,187,779	3,643,207
Minorities interests	0	0	0	0	0	0	0	0
Total equity & liabilities	10,639,343	12,445,407	15,305,113	17,468,705	20,685,351	24,660,815	29,043,228	34,164,929

Source: Company data, I-Sec research

Table 3: Key ratios

(Year ending Mar 31)

	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Valuation ratios								
Adjusted EPS (Rs)	33.9	39.6	48.0	56.6	66.8	79.3	89.8	106.0
BVPS (Rs)	197.0	264.9	311.8	369.5	432.9	502.2	571.3	652.9
Adjusted Book NAV/share (Rs)	193.7	261.0	307.6	363.4	427.0	496.3	562.4	640.3
PER (x)	49.4	42.3	34.9	29.6	25.1	21.1	18.6	15.8
Price/Book (x)	8.5	6.3	5.4	4.5	3.9	3.3	2.9	2.6
Price/Adjusted book (x)	8.6	6.4	5.4	4.6	3.9	3.4	3.0	2.6
Dividend Yield (%)	0.4	0.5	0.2	0.4	0.9	1.1	1.2	1.5
Du-Pont ratios								
NII/Avg. Assets (%)	4.2	4.2	4.0	4.0	3.8	3.8	3.7	3.7
Non-interest income/Avg Assets	1.6	1.5	1.7	1.5	1.5	1.4	1.5	1.5
- Fee income / Avg Assets	1.5	1.5	1.5	1.4	1.4	1.4	1.5	1.5
- Trading gains / Avg Assets	0.1	0.0	0.1	0.1	0.1	-0.1	0.0	0.0
Cost / Avg Assets	2.4	2.3	2.2	2.0	2.0	2.1	2.2	2.2
Non-tax Provisions / Avg Assets	0.6	0.7	0.9	1.0	0.8	0.5	0.5	0.5
Tax Provisions / Avg Assets	1.0	1.0	0.7	0.6	0.6	0.6	0.6	0.6
ROA (%)	1.8	1.8	1.9	1.9	1.9	1.9	1.9	1.9
Leverage	10.2	9.4	8.8	8.7	8.6	8.7	9.0	9.3
ROE (%)	18.1	16.7	16.2	16.2	16.2	16.5	16.3	16.8
Balance Sheet ratios								
Loan growth (%)	18.7	24.5	21.3	14.0	20.8	16.9	17.5	17.4
Deposit growth (%)	22.5	17.0	24.3	16.3	16.8	20.8	20.6	20.2
Loans/Deposits (%)	83.5	88.8	86.6	84.9	87.8	85.0	82.8	80.9
Investments/Deposits (%)	30.7	31.5	34.1	33.2	29.2	27.5	26.6	25.6
CASA ratio (%)	43.5	42.4	42.2	46.1	48.2	44.4	42.3	40.5
Profitability ratios								
NIMs (%)	4.4	4.4	4.2	4.1	3.93	4.06	3.93	3.94
Interest spread (%)	3.8	3.8	3.6	3.6	3.5	3.7	3.5	3.5
Yield on advances (%)	10.4	10.5	10.2	9.0	7.9	8.6	9.2	9.8
Cost of deposits (%)	4.6	4.8	4.9	4.0	3.4	3.9	4.5	4.7
Efficiency/other P/L ratios								
Non-interest income/Net income (%)	27.5	26.8	29.3	28.0	29.1	26.4	28.6	28.9
Trading income/Net income (%)	1.7	0.6	2.4	2.6	2.2	-1.1	0.4	0.3
Cost/Income (%)	41.0	39.7	38.6	36.3	36.9	40.4	42.0	42.1
Asset quality ratios								
Gross NPLs (%)	1.3	1.4	1.3	1.3	1.2	1.1	1.3	1.6
Net NPLs (%)	0.4	0.4	0.4	0.4	0.3	0.3	0.4	0.4
Net NPLs/Net worth (%)	2.5	2.2	2.0	2.2	1.8	1.5	2.0	2.5
Loan provisions/Avg loans (%)	0.9	0.9	1.1	1.1	0.9	0.79	0.8	0.8
Provisions cover (%)	69.8	71.4	72.0	69.8	72.7	75.8	73.0	73.0
Capitalisation ratios								
Tier I cap.adequacy (%)	13.2	15.8	17.2	17.6	17.9	17.1	15.9	15.4
Total cap.adequacy (%)	14.8	17.1	18.5	18.8	18.9	19.3	17.8	17.2

Source: Company data, I-Sec research

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