

With the RBI giving regulatory dispensation, HDFC Bank is now ready for the one of biggest merger with parent HDFC. RBI has given PSL dispensation and allowed transfer of promoter status to the bank in insurance subsidiaries and additionally stake can be increased in the companies.

In our view, one of the major hangover on the stock is now behind. As per our calculations, the combined entity ROA should be 1.9% vs. >2% of the bank currently. With merger blues likely to get over, we expect stock to outperform. Retain positive view on the stock with TP of INR 2075, upside of 24% from current levels

1) Priority Sector Lending (Impact - Positive) –The bank has got some leeway in terms of PSL compliance for the merged entity. Adjusted Net Bank Credit (ANBC) will be calculated as 1/3 of outstanding loans of HDFC in the first year of amalgamation, 2/3rd by second year and all ANBC by the end of third year. For the first year, the bank has time of one full year time to comply with the norms. In our view, this is sizeably positive development for the bank, which was one of the concern of the street.

Mgmt highlighted that it would be their endeavour to comply with PSL norms organically, hence, there has been sizeable rapid branch expansion in the rural/semi-urban areas. If not organic route, it can also opt for inorganic route via co-lending, PTC, RIDF etc.

2) CRR/SLR, LCR and certain other regulatory requirements – HDFC Bank will have to comply with the extant requirements of the CRR, SLR, LCR from the effective date of the merger without any exceptions. The statutory requirement currently for SLR is 18%, CRR is 4.5% while bank is carrying excess SLR of >25% and 116% LCR.

Financial Summary

Y/E Mar (Rs Bn)	FY21	FY22	FY23e	FY24e	FY25e
NII	649	720	868	1017	1212
Net profit	311	370	441	522	631
Networth	2,037	2,401	2,802	3,203	3,707
Adj BVPS	361	425	494	561	648
EPS (Rs)	56	67	79	93	113
P/ABV (x)	4.6	3.9	3.4	3.0	2.6
P/E (x)	30	25	21	18	15
RoA (%)	1.9	1.9	1.9	2.0	2.1
RoE (%)	16.6	16.7	17.0	17.4	18.3

Source: Company

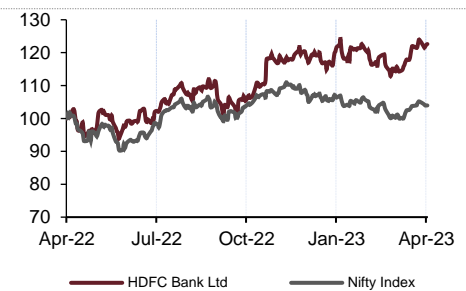
Rating	TP (Rs)	Up/Dn (%)
BUY	2,075	24

Market data

Current price	Rs	1,675
Market Cap (Rs.Bn)	(Rs Bn)	9,344
Market Cap (US\$ Mn)	(US\$ Mn)	1,13,734
Face Value	Rs	1
52 Weeks High/Low	Rs	1720 / 1271.6
Average Daily Volume	('000)	16,659
BSE Code		500180
Bloomberg		HDFCB.IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Mar-23	Dec-22
Promoters	25.59	25.60
Public	74.41	74.4
Total	100	100

Source: Bloomberg

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- 3) **Interest Rate Benchmarks** – The bank will have to do one-time mapping of all the borrowers of HDFC for benchmarks and spreads. The bank will get six-month time frame for benchmarking all retail, MSME and other floating rate loans sanctioned by HDFC. The bank mentioned that customers will be given an option to choose from current various benchmarking of loans.
- 4) **Investments in insurance subsidiaries (Impact – positive)**
 - RBI allowed investments including subsidiaries and associates of HDFC to continue as investments of HDFC Bank. Also, RBI has permitted HDFC Bank or HDFC to increase the shareholding to more than 50% in HDFC Life Insurance and HDFC Ergo prior to effective date. Current HDFC holding in HDFC Life is 50.3% and 49.98% in HDFC Ergo, it will need to take it to atleast 51% to make their subsidiaries. Management did not clarified whether increase of stake in HDFC Life would be via open offer or fresh issuance of shares.

Also, RBI has permitted to continue holding HDFC stake in
a) HDFC Education & Development for 2 years from the effective date
b) HDFC Credila Financial Services, subject to the shareholding being brought down to 10% within 2 years from effective date and not on-boarding new customers.
- 5) **Loan against shares** – On the basis of list submitted by HDFC, RBI has permitted loan against shares for promoter contribution/in excess of INR 20 lacs to the individuals, to continue for its existing duration / maturity.
- 6) **Income recognition and asset classification** – Subsequent to effective date, asset classification of accounts in the books of HDFC Bank will be as per the norms applicable to banks.

Post-merger, HDFC Bank will become second largest bank with loan book size of INR 21 trillion after SBI with ROA of ~2%. Despite being the large in size, combined entity loan book is expected to grow higher than the industry average @17.5% CAGR over FY23-25e. Merger is likely to get completed by July 2023.

- **Loans to grow higher than industry average** - Based on our calculations, HDFC Bank's credit is likely to grow by 17.5% CAGR over FY23-25 period and combined entity loan book is estimated to grow by 16.4% CAGR vs. 13-15% systemic growth seen for the same period
- Post-merger, it will continue to 1.9% ROA levels. The focus of the bank to continue to generate return matrix which it draws currently while there may be some internal P&L adjustments.
- **Branch expansion plans** – With the current branch network of 7183, bank wants to increase branch count to 12000 over the next 5 years' time. Currently, nearly 30% of the branch network has vintage of <3 years which are likely to contribute

meaningfully in terms of business. Business per branch for the bank is ~2.2 bn which is one of the best in the industry. Assuming with the increased productivity of INR 250 business per branch, the bank can support loan book of ~30 trillion.

- **Change in the loan mix** - The loan mix of HDFC Bank will undergo change - retail home loans will have 27% share in the combined entity loan book (vs. 6% at bank level now). Also, retail assets share in the total loan book will increase to 51% vs. 40% now. The combined entity will have loan book size of INR 21.2 trillion (balance-sheet size of INR ~30 trillion) vs. SBI loan book of ~INR25.8 trillion. While the ICICI Bank will be nearly half the size of the HDFC Bank in terms of loans book at INR 9.7 trillion and Axis Bank at INR 7.6 trillion. Being large in size, it can actually disrupt the market and gain market share by offering competitive rates on its various loan products.
- **How the home loans landscape might change post-merger** - Currently, the total housing loan market has size of ~26 trillion as on Q2FY23 (this includes both affordable and other home loans) wherein the HFCs have 33% market share, public sector banks 42.8% share and private banks 24% share. Post-merger, HDFC Bank alone will have 22.6% share in total home loan market next only to SBI which will have 23.6% share. The HDFC Bank will be significant market player in the home loan market going forward.
- **Other important parameters** - Post-merger, cost/income ratio is anticipated to come down to 300-400 bps. However, it is anticipated to increase by ~100 bps as the bank is on the branch expansion spree. Also, margins of combined entity will get impacted by 35-40 bps as the HDFC draws 3% margins vs. 4%+ of bank. On the asset quality side, gross NPLs are likely to remain similar.

Outlook & Valuations

As per our calculations, post-merger, ROA is expected to remain stable at 1.9% levels which is in-line with the management guidance as well. HDFC Bank will become second largest bank after SBI and largest private sector bank. Secondly, it is one of the few banks having strong deposit growth trajectory (@20.8% yoy in Q4FY23 vs. ~10% for industry) which can fund higher credit growth comfortably. Additionally, visibility of deposit growth is strong going forward as it has aggressively rolled out branches vis-à-vis other private banks. With merger blues likely to get over, stock should outperform. It is currently, trading at 3.0x/2.6x FY24e/FY25e ABV on ROE/ROA of 16%/2%. We believe it is one of best bet in the large cap banking stocks – **retain BUY with TP of INR 2075, upside of 24% from the current levels.**

HDFC Bank - SOTP

	Stake (%)	Valuation Methodology	Multiple (FY25e)	Value Per Share INR For HDFC
HDFC Bank - Parent		3.1 FY25e ABV	3.1	2008
HDB Financial Services	94.8%	2.25x FY25e ABV	2.25	58
HDFC Securities	95.6%	1.5x FY25e BV	1.5	9
Total Value				2075
CMP				1675
Upside				24%

Source: Dalal & Broacha Research, Company

Quarterly Financials (Q4FY23)

(Rs in Cr)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ(%)	FY23	FY22	YoY (%)
Interest earned	45,119.4	33,448.7	34.9	42,707.8	5.6	1,61,585.6	1,27,753.1	26.5
-Interest/discount on advances/bills	35,642.8	25,908.9	37.6	33,641.4	5.9	1,27,095.9	98,512.0	29.0
-Income on investments	8,376.4	6,576.5	27.4	8,039.2	4.2	31,311.2	26,046.1	20.2
-Interest on bal. with RBI	308.7	695.5	-55.6	231.7	33.2	996.8	2,552.4	-60.9
-Others	791.5	267.9	195.5	795.5	-0.5	2,181.7	642.6	239.5
Interest expenses	21,767.5	14,576.0	49.3	19,719.9	10.4	74,743.3	55,743.5	34.1
Net Interest Income (NII)	23,351.8	18,872.7	23.7	22,987.8	1.6	86,842.2	72,009.6	20.6
Other Income	8,731.2	7,637.1	14.3	8,499.8	2.7	31,214.8	29,509.9	5.8
Total income	32,083.0	26,509.8	21.0	31,487.7	1.9	1,18,057.1	1,01,519.5	16.3
Operating expenses	13,462.1	10,152.8	32.6	12,463.6	8.0	47,652.1	37,442.2	27.3
-Employee cost	4,362.1	3,144.6	38.7	4,126.2	5.7	15,512.4	12,031.7	28.9
-Other operating expenses	9,100.1	7,008.2	29.8	8,337.4	9.1	32,139.7	25,410.5	26.5
Operating profit	18,620.9	16,357.0	13.8	19,024.1	-2.1	70,405.0	64,077.3	9.9
Provision for contingencies	2,685.4	3,312.4	-18.9	2,806.4	-4.3	11,919.7	15,061.8	-20.9
PBT	15,935.5	13,044.7	22.2	16,217.6	-1.7	58,485.3	49,015.5	19.3
Provision for taxes	3,888.1	2,989.5	30.1	3,958.1	-1.8	14,376.6	12,054.1	19.3
Net profit	12,047.5	10,055.2	19.8	12,259.5	-1.7	44,108.7	36,961.3	19.3
Equity	558.0	554.6	0.6	557.7	0.1	558.0	554.6	0.6
EPS	215.9	181.3	19.1	219.8	-1.8	790.5	666.5	18.6
Ratios (%)								
Int. exp/Int earned (%)	48.2	43.6	-	46.2	-	46.3	43.6	-
Cost/Income ratio (%)	42.0	38.3	-	39.6	-	40.4	36.9	-
Gross NPAs (Rs)	18,019.0	16,141.0	11.6	18,763.9	-4.0	18,019.0	16,141.0	11.6
Net NPAs (Rs)	4,368.4	4,407.7	-0.9	5,024.3	-13.1	4,368.4	4,407.7	-0.9
Gross NPAs (%)	1.1	1.2	-	1.2	-	1.1	1.2	-
Net NPAs (%)	0.3	0.3	-	0.3	-	0.3	0.3	-
ROA (%)	0.5	0.5	-	0.6	-	1.5	1.5	-
CAR (%)	19.3	18.9	-	17.7	-	19.3	18.9	-
Balance Sheet (Rs.mn)								
Sources of Funds								
Capital	558.0	554.6	0.6	557.7	0.1	558.0	554.6	0.6
Reserves and Surplus	2,79,641.1	2,39,538.4	16.7	2,66,984.7	4.7	2,79,641.1	2,39,538.4	16.7
Shareholders Funds	1,45,369.0	1,22,397.0	18.8	1,37,866.0	5.4			
Deposits	18,83,394.7	15,59,217.4	20.8	17,33,204.0	8.7	18,83,394.7	15,59,217.4	20.8
Borrowing	2,06,765.6	1,84,817.2	11.9			2,06,765.6	1,84,817.2	11.9
Other Liabilities and Provision	95,722.3	84,407.5	13.4			95,722.3	84,407.5	13.4
TOTAL	17,72,289.0	13,90,371.0	27.5	16,52,634.0		24,66,081.5	20,68,535.1	19.2
Applications of funds	0.0	0.0				0.0	0.0	
Cash and Balances with Reserve Bank of India	1,17,160.8	1,29,995.6	-9.9			1,17,160.8	1,29,995.6	-9.9
Balances with Banks and Money at Call and Sh	76,604.3	22,331.3	243.0			76,604.3	22,331.3	243.0
Investments	5,17,001.4	4,55,535.7	13.5			5,17,001.4	4,55,535.7	13.5
Advances	16,00,585.9	13,68,820.9	16.9	15,06,809.3	6.2	16,00,585.9	13,68,820.9	16.9

Source: Dalal & Broacha Research, Company

Financials

Profit & Loss Account					
Rs in Bn	FY21	FY22	FY23e	FY24e	FY25e
Interest Earned	1,209	1,278	1,616	1,944	2,320
Interest expended	560	557	747	927	1108
NII	649	720	868	1017	1212
Other Income	252	295	312	399	475
Net Income	901	1015	1181	1416	1687
Operating Exp	327	374	477	567	666
PPOP	574	641	704	849	1021
Provisions	157	151	119	157	184
PBT	417	490	585	692	837
Tax	105	121	144	170	206
PAT	311	370	441	522	631

Balance Sheet					
Rs in Bn	FY21	FY22	FY23e	FY24e	FY25e
CAPITAL & LIABILITIES					
Capital	5.5	5.5	5.6	5.6	5.6
Reserves & Surplu	2,032	2,395	2,796	3,198	3,701
Deposits	13,351	15,592	18,834	21,874	25,474
Borrowings	1,355	1,848	2,068	2,316	2,640
Other Liabilities	726	844	957	1,093	1,230
TOTAL	17,469	20,685	24,661	28,486	33,051
ASSETS					
Cash & Balances	1194.7	1523.3	1937.7	1956.8	2072.8
Investments	4,437	4,555	5,170	5,767	6,633
Advances	11,328	13,688	16,006	18,887	22,098
Fixed Assets	49	61	80	100	113
Other Assets	459	858	1,467	1,775	2,134
TOTAL	17,469	20,685	24,661	28,486	33,051

Ratios

Ratios (%)	FY21	FY22	FY23e	FY24e	FY25e
Growth					
NII	5.3	5.7	26.5	20.3	19.4
PPOP	17.7	11.7	9.9	20.6	20.3
Net profit	18.5	18.8	19.3	18.3	21.0
Deposits	16.3	16.8	20.8	16.1	16.5
Advances	14.0	20.8	16.9	18.0	17.0
Returns					
ROA	1.9	1.9	1.9	2.0	2.1
ROE	16.6	16.7	17.0	17.4	18.3
Efficiency					
C/I Ratio	36.3	36.9	40.4	40.1	39.5
CASA	46.1	48.2	44.4	42.5	40.8
Margins	4.1	3.9	4.1	4.1	4.2
CD ratio	85	88	85	86	87
Per Share					
No. of shares	5.5	5.5	5.6	5.6	5.6
FV	1	1	1	1	1
BV (Rs)	370	433	502	574	664
ABV (Rs)	361	425	494	561	648
EPS (Rs)	56	67	79	93	113
Valuation					
P/BV (x)	4.5	3.9	3.3	2.9	2.5
P/ABV (x)	4.6	3.9	3.4	3.0	2.6
P/EPS (x)	29.7	25.1	21.2	17.9	14.8
Asset quality					
GNPAs (Rs)	151	161	180	261	285
NNPAs (Rs)	46	44	44	74	93
PCR (Rs)	105	117	137	187	192
GNPA (%)	1.3	1.2	1.1	1.4	1.3
NNPA (%)		0.3	0.3	0.4	0.4
PCR	69.8	72.7	78.6	71.6	67.4

Source: Dalal & Broacha Research, Company

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