

HDFC Ltd.

30 August, 2021

Reuters: HDFC.BO; Bloomberg: HDFC IN

Best bet in a steady growth sector

As we look back over the last several quarters, especially through the pandemic period, HDFC Ltd has emerged as the strongest player among the large HFCs, with leading asset quality performance - an area where most large peers have struggled. However, as we speak, recoveries and collections are improving. Retail NPAs are expected to reach <1% in the near term, although non-individual NPAs may take some time to recover. We understand that non-individual NPAs peaked out in 1QFY22. Credit costs would be brought down to 25-35bps. Besides being sanguine about the retail growth prospects, we expect to see better growth traction in the non-individual segment than the trend seen in the recent past. At an industry level, over the last several months, some of the stressed projects, which were earlier unable to obtain NBFC/bank funding, have been supported through private equity and other non-conventional sources of funding. A strong and well-managed ALM versus peers is one of the key differentiators for HDFC. We retain HDFC as our top pick in NBFC/HFC category, given its leading market position (14-15% market share) and top-notch balance sheet strength (tier-1: 21.3%). We retain BUY on the stock with a target price (TP) of Rs3,154, valuing it at 2.2x FY23E ABVPS + Rs1,660 for its subsidiaries.

Key takeaways from our recent interaction:

On asset quality

- **NPA deterioration led by retail segment:** Collections were severely impacted in April-May'21, but picked up in June'21. Collections improved further in July'21. Collection efficiency was 98.3% in June'21 compared to 98% in March'21.
 - Retail recoveries improved in July'21 as lockdowns eased out. The company is hopeful of achieving <1% retail GNPA levels soon (but has refrained from giving a timeline).
 - Retail slippages in 1QFY22 were higher and were primarily from borderline accounts (30+/60+dpd).
 - The share of under-construction properties in the retail portfolio is 55%.
 - As part of its underwriting practice, the management stated that in several cases (under retail loans), loans are disbursed only after the customer has paid his equity contribution.
- **Wholesale book NPAs have peaked out (1QFY22: 4.87%):** The resolutions/recoveries in the non-individual segments will take place over time and we are unlikely to see any kind of bunched-up recoveries. Overall effort will be to reduce non-individual NPAs (not that it is a worry even now).
 - In 1QFY22, the non-individual account, which got resolved, was in NCLT for 3 years. Keeping the timelines in mind, the resolutions in the non-individual segment may happen with some delays.
 - The management stated that realty developers have become much more aware about the pros/cons of servicing debt on time. Behaviour-wise, we think there might be a positive change in the developer segment from the debt-servicing standpoint.
- **Better access to project funding than before:** One of the key reasons why NPA projects were not able to secure funding till 12-24 months ago is that fresh loans to such projects (by banks/NBFCs) would be classified as NPA from day one. This was posing procedural/regulatory challenges on part of the lenders. However, with ample liquidity in the system and with the emergence of mezzanine & private equity funding (which are not bound by such regulatory hurdles), project-funding has become easier. The overall environment today is much better for new projects due to the availability of funding as well as the strong sales momentum. SWAMIH has also been helpful.
- LRD segment has performed well for HDFC, but in the last few quarters, the portfolio has declined due to repayments on REITS issuance.
- **Credit costs** have averaged at ~55-60bps over the last 2-3 years and the management intends to bring it down to 25-35bps.

On business and loan growth

- A key reason why HDFC has been able to cater to demand and deliver strong disbursements growth is the acceleration in utilisation of its digital platforms.
- **HDFC Reach:** 35-40% of HDFC's business is towards affordable housing. HDFC Reach product constitutes a very small proportion of the book and has higher yields and higher credit costs.
- **Self-employed/salaried mix** has stabilised at 20%/80%. The self-employed category has grown due to large amount of professionals (like CAs, investment advisors, etc.) working independently. HDFC is more comfortable with self-employed customers now due to better compliance in income disclosures.
- **Prepayments:** 1QFY22 retail pre-payment rate was lower at 8% due to branch closures. Usually, it is 11%.
- **Industry growth 15%:** Housing finance industry growth for FY21 was ~15% (annualised after excluding 1Q and 2Q). Going forward, sector growth is expected at similar levels.
- **Segment profitability:** RoA is higher for non-individual loans due to higher spreads and lower opex despite higher credit costs. However, RoE is similar to individual loans when adjusted for capital requirements.

BUY

Sector: NBFC

CMP: Rs2,718

Target Price: Rs3,154

Upside: 16%

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Key Data

Current Shares O/S (mn)	1,806.7
Mkt Cap (Rsbn/US\$bn)	4,954.6/67.6
52 Wk H / L (Rs)	2,938/1,623
Daily Vol. (3M NSE Avg.)	3,155,036

Price Performance (%)

	1 M	6 M	1 Yr
HDFC Ltd	12.3	8.0	45.6
Nifty Index	7.1	16.2	45.0

Source: Bloomberg

On liabilities and ALM

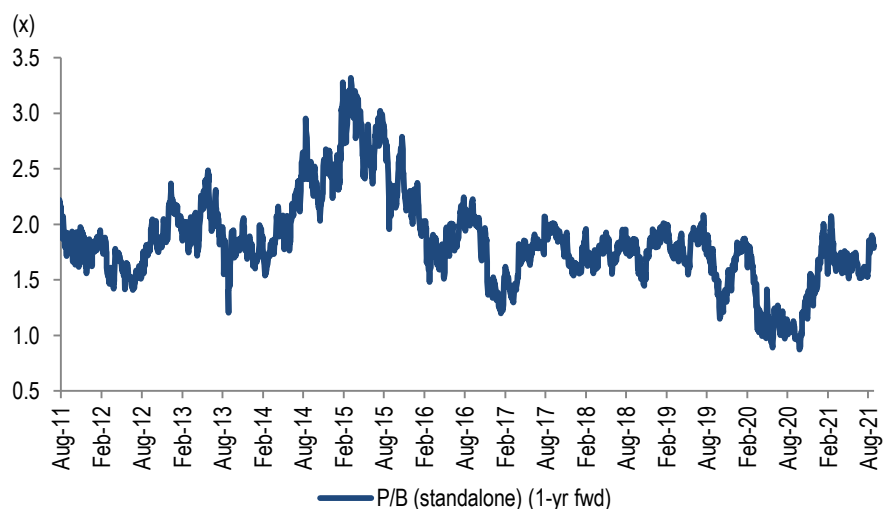
- HDFC is running positive ALM mismatch across all/most of the buckets and also uses swaps to hedge interest rates risks. If rates were to rise, HFCs running negative ALM would be affected.
 - Liability mix would depend on the cost of borrowing from each funding source.
- Public deposits have grown at a steady rate, but HDFC has had to offer higher rates vis-à-vis banks to attract inflows. Wholesale deposits, majorly from IT companies, are unlikely to pose any risk since the maturities of these are well-spread out and the relationships with such corporates are long-term in nature.
 - In FY21, many corporates shifted out of debt funds to deposits.
 - While top 20 deposits constitute 25% of total deposits, it is not opportunistic money and maturities are well spread out. Corporate deposits' tenure is ~1-year; shorter tenure deposits are not encouraged.

Exhibit 1: SOTP valuation

Entity	Valuation Methodology	Holding (%)	Value per share (INR)
			FY23E
HDFC Bank	3.6x FY23E ABV	21.1%	1,172
HDFC Life Insurance	4.5x FY23E EV	50.0%	449
HDFC AMC	39x FY23E EPS	52.7%	194
HDFC ERGO General Insurance	Latest Transaction	45.0%	95
Bandhan Bank	2.5x FY23E ABV	9.9%	30
HDFC Credila	2x latest BV	100.0%	13
Holding co. discount (%)			15%
Value of total (INR per share)			1,660
Standalone entity	2.2 FY23E ABV		1,494
Value of total (INR per share)			3,154

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: One-year forward P/BV (standalone)



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 3: Income statement

Y/E March (RsMn)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	3,91,564	4,40,040	4,41,640	4,66,776	5,29,585
Interest Expense	2,78,377	3,10,014	2,86,148	2,78,634	3,19,127
Net Interest Income	1,13,188	1,30,027	1,55,492	1,88,142	2,10,458
Non Interest Income	42,216	1,51,484	42,137	33,814	22,338
Net Revenue	1,55,403	2,81,510	1,97,629	2,21,956	2,32,796
Operating expenses	14,866	15,113	19,998	21,996	22,581
-Employee expenses	5,054	5,929	9,141	12,098	12,105
-Other expenses	7,701	9,047	10,857	9,898	10,476
Pre-Provisioning Operating profit	1,40,538	2,66,397	1,77,631	1,99,960	2,10,215
Provisions	9,350	59,131	29,480	18,405	12,469
PBT	1,31,188	2,07,266	1,48,151	1,81,555	1,97,746
Tax	34,863	25,813	27,878	39,502	43,504
PAT	96,325	1,81,453	1,20,273	1,42,053	1,54,242

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Balance sheet

Y/E March (RsMn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	3,443	3,464	3,608	3,608	3,608
Reserves & surplus	7,70,593	8,58,117	10,84,219	11,84,256	12,92,225
Networth	7,74,036	8,61,581	10,87,826	11,87,864	12,95,833
Borrowings	36,52,657	41,91,016	44,13,650	50,31,561	57,86,296
Other liability & provisions	2,20,368	2,98,316	3,04,759	3,14,739	3,63,277
Total liabilities	46,47,060	53,50,913	58,06,236	65,34,164	74,45,406
Fixed Assets	6,562	13,490	13,559	13,694	13,831
Investments	4,65,622	6,58,348	6,94,773	7,79,723	8,67,944
Loans	40,66,071	45,09,035	49,82,980	55,93,970	64,05,680
Cash	15,963	34,257	11,448	38,350	44,102
Other assets	92,844	1,35,784	1,03,476	1,08,427	1,13,848
Total assets	46,47,060	53,50,913	58,06,236	65,34,164	74,45,406

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Key ratios

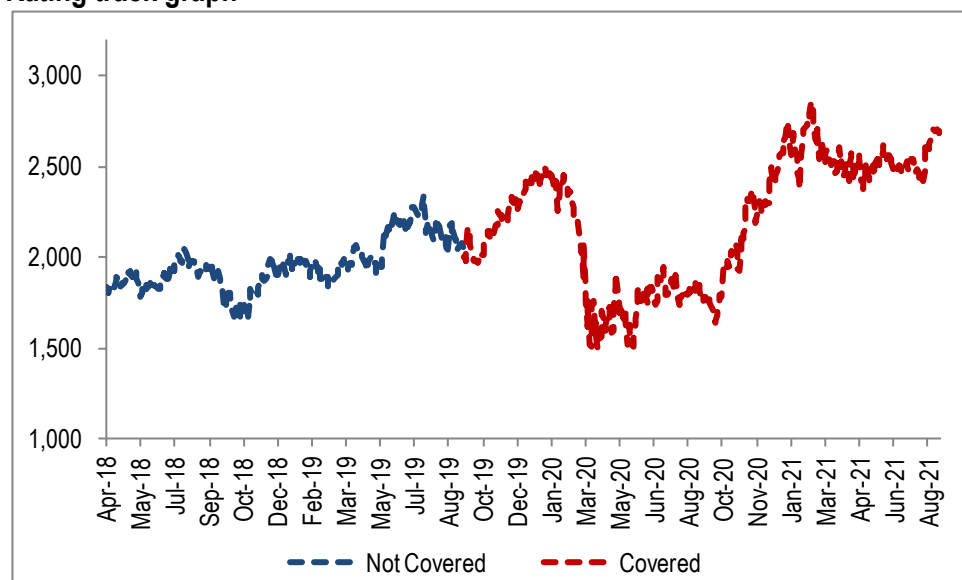
Y/E March- Ratios	FY19	FY20	FY21	FY22E	FY23E
Growth (%)					
Net Interest Income	16.3	14.9	19.6	21.0	11.9
Operating Profit	-8.2	89.6	-33.3	12.6	5.1
Profit After Tax	-12.1	88.4	-33.7	18.1	8.6
Advance Growth	12.1	10.9	10.5	12.3	14.5
Spreads (%)					
Yield on loans	9.7	9.7	8.8	8.3	8.3
Cost of Borrowings	8.1	7.9	6.7	5.9	5.9
Spread	1.6	1.8	2.1	2.4	2.4
NIMs	2.7	2.8	3.0	3.3	3.3
Operational Efficiency (%)					
Cost to Income	9.6	5.4	10.1	9.9	9.7
Cost to AUM	0.4	0.4	0.4	0.4	0.4
CRAR (%)					
Tier I	17.5	16.4	21.5	21.5	21.1
Tier II	1.5	1.2	0.7	0.7	0.7
Total	19.1	17.6	22.2	22.2	21.8
Asset Quality (%)					
Gross NPA	1.4	2.3	2.3	2.1	1.9
Net NPA	0.8	1.2	1.1	1.0	0.9
PCR	43.3	47.5	52.1	52.0	52.0
Credit Cost	0.2	0.5	0.6	0.3	0.2
Return Ratio (%)					
ROE	13.5	22.2	12.3	12.5	12.4
ROA	2.2	3.6	2.2	2.3	2.2
Per Share (%)					
EPS	48.9	53.6	58.9	77.6	85.5
BV (consol.)	685.3	772.7	918.1	990.4	1104.1
ABV (consol.)	665.4	734.3	887.2	959.5	1071.0
Valuation (x)					
P/E	55.6	50.7	46.1	35.0	31.8
P/BV (consol.)	2.9	3.5	3.0	2.7	2.5
P/ABV (consol.)	3.0	3.7	3.1	2.8	2.5

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
17 September 2019	Buy	1,985	2,527
7 October 2019	Buy	1,978	2,528
5 November 2019	Buy	2,180	2,655
8 January 2020	Buy	2,406	2,760
28 January 2020	Buy	2,396	2,771
27 March 2020	Buy	1,755	2,519
9 April 2020	Buy	1,559	2,519
26 May 2020	Buy	1,515	2,062
9 July 2020	Buy	1,886	2,204
31 July 2020	Buy	1,811	2,101
23 September 2020	Buy	1,676	2,469
7 October 2020	Buy	1,934	2,488
3 November 2020	Buy	2,022	2,483
26 November 2020	Buy	2,190	2,620
08 January 2021	Buy	2,661	3,067
03 February 2021	Buy	2,653	3,128
21 February 2021	Buy	2,745	3,195
7 May 2021	Buy	2,496	3,142
2 August 2021	Buy	2,462	3,120
30 August 2021	Buy	2,718	3,154

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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