HDFC Bank Ltd.

BP WEALTH

Management Meet Note

25th September 2023

We attended the HDFC Bank analyst meeting at HDFC House on 18th September 2023, where they shared particulars of the opening net worth of the merged entity (as of 1 July 2023) and insights into P&L accounting adjustments resulting from the merger. The analyst meeting was to brief about moving from IND-AS to I-GAAP accounting standard, where the significant transaction was to bring investments of HDFC Ltd. to cost from the fair value and certain transactions such as deferred acquisition costs, which will be amortized over the years. The deferred acquisition cost is around Rs. 11,800 crores, the credit policy harmonization comprises Rs. 7,600 crores (from a specific reserve point of view and contingent provision), and the third important item is deferred tax liability.

Following are the key takeaways from that interaction:

⇒ As HDFC Bank follows the I-GAAP accounting standard vis-à-vis IND-AS for HDFC Ltd., the realignment has reduced the merged entity's net worth by Rs 11,800 crores due to (a) upfronting Rs. 3,800 crores of loan acquisition costs, amortized earlier, (b) Rs. 2,800 crores of upfront gains (interest income spread earned on assignment of loans) recognized earlier but amortized now, and (c) Rs. 4,300 crores reduction as investments (around 70-80% listed equities) which were accounted for at fair value have now been taken at cost.

⇒ NIMs could see pressure over the next 2-3 quarters. This is mainly because excess liquidity is carried post-merger (around 25bps NIM impact for the merged entity). NIM could see pressure due to excess liquidity and accounting adjustments from IND-AS to I-GAAP and decline by 15-20 bps. Further, the I-GAAP-based accounting of HDFC Ltd's OPEX results in a sharp rise to its cost-to-income profile to 19% (from 10% under IndAS).

⇒ The bank gets a concessional tax rate when they set up a separate reserve from mortgage profits. One of the conditions for obtaining the concessional rate is that the amount should be from the appropriations or the general reserve. The second condition is that the reserve should continue and not be utilizing the reserve, and the year in which you utilize the reserve, the reserve gets taxed.

⇒ Sec 36(1)(8) of the Income Tax Act,1961 provides concessional rates to profits derived from funding for housing, infra; conditions - 1) lending tenure should be more than five years; 2) to claim the concession, it needs to be segregated from profit and loss or general reserve to a special reserve.

⇒ The RBI circular 2013 also says that the bank should set up a deferred tax liability as a special reserve for getting the concessional tax rates. Around Rs. 19,000 crores of the special reserve was set up by HDFC Ltd. The bank will continue to maintain the aforesaid special reserve.

⇒ Thus, HDFC Bank will get the above concessional rate going forward. However, sec 41 of the IT Act, 1961 says this particular tax benefit will reverse when you utilize the aforesaid special reserve. According to IND AS, HDFC Ltd. didn't have to account for this deferred tax liability. However, the RBI regulation circular 2013 says that the bank needs to segregate and keep DTL (not intended for the cash liability).

⇒ HDFC Ltd. followed the IND AS accounting method where the acquisition cost was amortized over the life, whereas in the I-GAAP accounting method, the cost will be taken upfront, and P&L will be charged with Rs. 3,800 crores. So, this is not a cash charge but a time charge.

⇒ In HDFC Ltd., the interest spread and assigned loans that are capitalized get amortized over time as per IND AS (Rs. 2,800 crores), and as per I-GAAP, it gets charged upfront to equity rather than coming through the life of the loan.

⇒ The bank highlighted that it will continue to carry this excess liquidity on its balance sheet for at least another 2-3 quarters. Hence, NIMs should continue to be in the declining trend in the forthcoming period.

⇒ In HDFC Ltd., as per IND AS, the specific provisions for NPAs, the losses are not realized in the books of accounts, i.e., future recoveries are not reckoned. The I-GAAP method and RBI regulation specify the minimum requirement for reserving. So, HDFC Ltd. has a 42% coverage ratio as day 0 comes. In the books of HDFC Bank, regarding the provision and reckoning of reserving, it takes specific PCR to about 74-75% (non-economic). Extra PCR from 42% in HDFC Ltd. to 74-75% in the merged entity, 40% was due to retail loans, and 60% was due to non-retail loans.

Sector Outlook	Neutral

Stock

CMP (Rs.)	1,529
NSE Symbol	HDFCBANK
BSE Code	500180
Bloomberg	HDFCB IN
Reuters	HDBK.BO

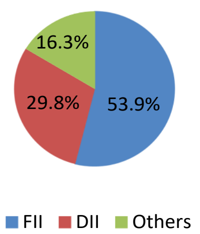
Key Data

Nifty	19,675
52WeekH/L(INR)	1,758/1,365
O/s Shares (Mn)	7,580
Market Cap (INR bn)	11,591
Face Value (INR)	1

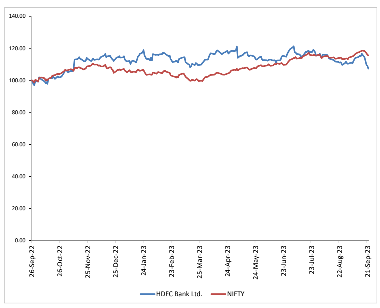
Average volume

3 months	2,10,36,280
6 months	1,87,97,940
1 year	1,30,56,870

Share Holding Pattern (%)



Relative Price Chart



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HDFC Bank Ltd.

- ⇒ HDFC Ltd. does not have a contingent provisioning policy, which HDFC Bank has. So, the bank has calculated it to be around Rs. 3,900 crores.
- ⇒ The GNPA of the merged entity has gone up to 6.7% mainly on account of 1) some accounts have gone into NPA (transferred from Stage 2 to Stage 3); thus, from P&L's point of view, it would not be much, but it is present in the NPA; 2) there are certain loan accounts in HDFC Ltd. which the HDFC bank would not prefer in their loan book and will force certain actions
- ⇒ Subsidies are not carried at fair value, and they are carried at cost, so there are no adjustments in the balance sheet item, Investments in Subsidiaries. Thus, there are no mark-to-market hits on Investments in Subsidiaries.
- ⇒ As per the new RBI circular (2023) on reclassification of investments, Investments in Subsidiaries will be held as AFS till 1 April 2024 and then determined that it will be held at an FVTPL or Fair value through equity.
- ⇒ There are certain non-individual loan accounts on which actions are to be taken, as the bank's risk assessment team is uncomfortable holding those accounts.
- ⇒ The major reason for RoAs to go down was that the dividend income that HDFC Ltd. received from the banks would get eliminated, and the other half would be on account of the upfront deferred acquisition costs and tax rate changes that would happen. Overall, ROAs will be in the range of 1.8%-1.9% vs earlier guidance of 1.9-2.1%.

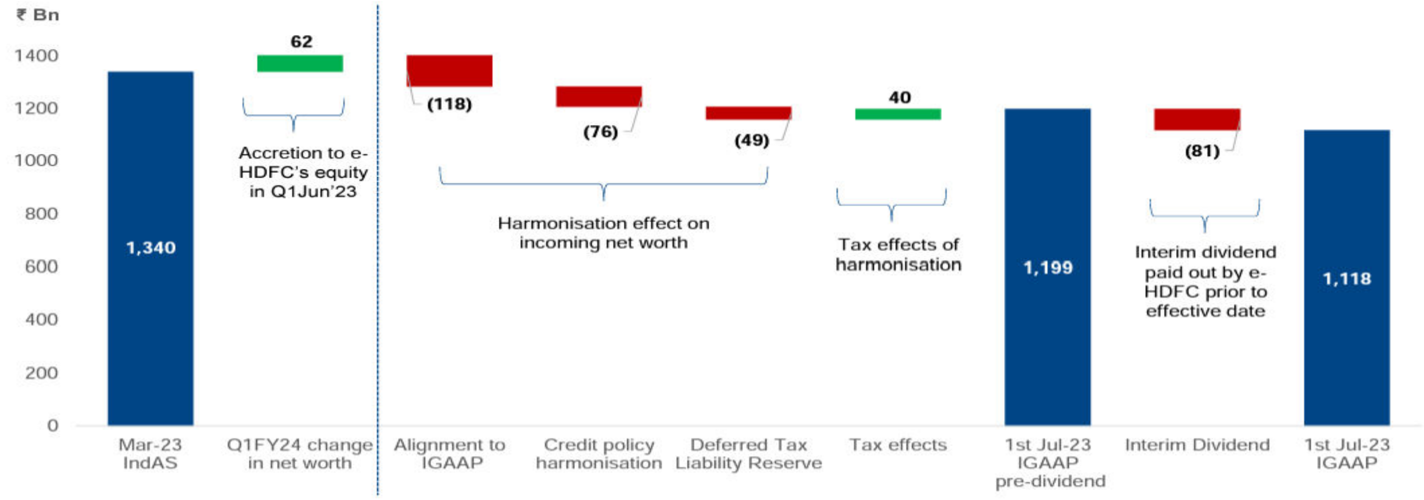
Key Ratios: Merged HDFC Bank

Particulars	HDFCB Mar-2023	HDFCB Jun-2023	HDFCB Merged Jul-2023
NIM (interest bearing assets)	**4.30%**	**4.30%**	**3.9% - 4.0%**
NIM (total assets)	4.10%	4.10%	3.7% - 3.8%
Cost to income	**40.00%**	**43.00%**	**~40%**
Credit costs as a % of advances	0.70%	0.70%	~0.6%
RoA	**2.10%**	**2.10%**	**1.9% - 2.0%**
RoE	17.40%	17.30%	~16%
EPS - standalone	**79**	**21**	**20**
EPS - consolidated	83	22	22
BVPS - standalone	**502**	**525**	**519**
BVPS - consolidated	519	543	536
Capital adequacy ratio	**19.30%**	**18.90%**	**19.20%**

Source : Sell side analyst meet Presentation

HDFC Bank Ltd.

e-HDFC Limited Net Worth Movement



Source : Sell side analyst meet Presentation

I-GAAP Alignment and Credit Policy Harmonization

I-GAAP Alignment	Rs. in bn
Deferred acquisition cost and fees	-38
Interest spread on assigned loans	-28
Fair value adjustments to bring investments to cost	-43
Others	-9
Total	-118
I-GAAP Alignment	**Rs. in bn**
General and contingent provisions	-38
Specific provisions for NPAs	-28
Total	-76

Asset Quality

Particulars	HDFCB Mar-2023	HDFCB Jun-2023	HDFCB Merged Jul-2023
Gross NPA (%)	**1.10%**	**1.20%**	**1.40%**
Retail GNPA (%)	1.00%	0.90%	0.90%
CRB GNPA (%)	1.60%	1.80%	1.80%
CRB ex-Agri GNPA (%)	1.10%	1.20%	1.20%
Wholesale GNPA (%)	0.50%	0.40%	0.40%
e-HDFCL Individual GNPA (%)			1.00%
e-HDFCL Non-Individual GNPA (%)			6.70%
Net NPA	**0.30%**	**0.30%**	**0.40%**
Specific provision coverage (%)	76%	75%	74%
Contingent and floating provisions as a % of advances	0.70%	0.70%	0.70%
Total provisions as a % of advances	2.00%	2.00%	2.20%
Total provisions (ex-specific) as a % of advances	1.10%	1.10%	1.10%

Source : Sell side analyst meet Presentation

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Key Financials						
YE March (Rs. crores)	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Net Interest Income	**40,095**	**48,243**	**56,186**	**64,880**	**72,010**	**86,840**
Growth %		*20.3%*	*16.5%*	*15.5%*	*11.0%*	*20.6%*
PPOP	**32,625**	**39,750**	**48,750**	**57,362**	**64,080**	**70,410**
Growth%		*21.8%*	*22.6%*	*17.7%*	*11.7%*	*9.9%*
Net Profit	**17,500**	**21,100**	**26,300**	**31,100**	**36,960**	**44,110**
Growth %		*20.6%*	*24.6%*	*18.3%*	*18.8%*	*19.3%*
EPS	**34.0**	**39.0**	**48.0**	**57.0**	**67.0**	**79.0**
Profitability & Valuation						
NIM (%)	4.30%	4.30%	4.30%	4.20%	4.10%	4.10%
RoA (%)	**1.90%**	**1.90%**	**2.00%**	**2.00%**	**2.00%**	**2.10%**
RoE (%)	18.20%	16.30%	16.80%	16.60%	16.90%	17.40%
BV per Share (Rs.)	**205.0**	**274.0**	**312.0**	**370.0**	**433.0**	**502.0**
P/E (x)	45.1	39.3	31.9	26.9	22.9	19.4
P/BV (x)	7.5	5.6	4.9	4.1	3.5	3.1
Cost to Income Ratio	41.00%	39.70%	38.60%	36.30%	36.90%	40.40%

Source: Company, BP Equities Research

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Disclaimer Appendix

Analyst (s) holding in the Stock : Nil

Analyst (s) Certification:

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