

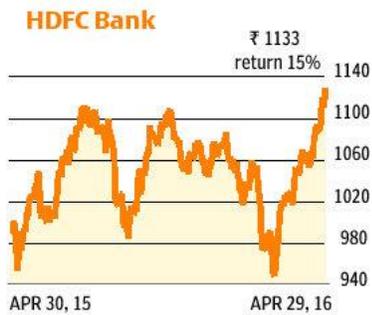
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HDFC Bank: It's business as usual

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The bank has shrugged off industry blues and shown steady performance

April 30, 2016:

The past year has been challenging for the banking sector, to say the least. While weak economic growth led to slower credit offtake and rising bad loans, the RBI's asset quality review left a few private banks in the lurch as well. But for HDFC Bank, it was business as usual.

It continued to deliver steady performance across all parameters, thanks to healthy growth in loans, stable margins and low delinquency. The bank has also been more or less untouched by the RBI's assessment of the stressed accounts in the banking system.

The stock's 15-odd per cent return over the past year is noteworthy, given that its peers ICICI Bank and Axis Bank have lost about 20-25 per cent, owing to asset quality pressure.

HDFC Bank has always commanded a premium to its peers for predictability and consistency in earnings. Investors with a two-to-three year horizon can buy the stock.

For one, HDFC Bank, while commanding twice the multiple of its peers — ICICI Bank and Axis Bank — still trades at attractive valuations. At 3.3 times its one-year forward book value, its valuation is still lower than its long-term (since 2009) historical average of 3.4 times and peak levels of four times. Given a steady 20-22 per cent growth in earnings, the stock offers scope for appreciation at the current levels.

What blues?

The bank has shrugged off industry blues and grown its loan book by a healthy 27 per cent in 2015-16. Through the 2016 fiscal, when bank credit growth was languishing at 8-9 per cent levels, HDFC Bank's loan book grew steadily by 22-27 per cent year-on-year, each quarter.

A pick-up in retail loans in 2015-16 has helped the bank deliver higher loan growth than the 20 per cent in fiscal 2014-15.

All segments within retail did well during the year. Lending to the commercial vehicles (CV) segment, which was impacted by the slowdown in industry volumes, has been picking up steadily over the last four quarters. From contraction of 11 per cent in 2014-15, the commercial vehicle/construction equipment (CV/CE) segment bounced back to grow at 14.8 per cent in 2015-16.

On the corporate side, a large portion of the bank's lending has always been for working capital financing. Hence, this segment continues to deliver healthy growth, in spite of weak investment activity.

New lending rates

HDFC Bank also sports strong profitability — among the best in the private bank space — with return on assets at about 1.9 per cent. Aside from healthy pace of growth in loans, the bank's industry leading margins have led to enviable returns.

The bank maintained its net interest margin (NIM) within a narrow 4.2-4.3 per cent range through 2015-16.

While the full year margin at 4.3 per cent is lower than the 4.4 per cent recorded last year, it is nonetheless healthy, given the substantial cut in lending rates during the year.

HDFC Bank's healthy share of low-cost current and savings account (CASA) deposits at 43 per cent (though a tad lower than last year), has aided margins.

The bank's overall deposits grew a healthy 21 per cent in 2015-16, at a time when there have been concerns on the anaemic 9-10 per cent deposit growth in the banking system.

HDFC Bank is also well placed to safeguard its margins under the new marginal cost of funds based lending rate (MCLR) which came into effect from April 2016.

A chunk of its loans — about 70 per cent — are fixed rate loans, which reduce the interest rate risk. For now, the bank continues to offer the best rates; its one-year MCLR is among the lowest at 9.2 per cent. This will help it compete well, as competition intensifies with more rate cuts by various banks.

The bank is also well-capitalised to fund growth when the economy revives. Its total capital adequacy ratio as of the March 2016 quarter stood at 15.5 per cent, well above the regulatory requirement of 9 per cent.

Low delinquency

HDFC Bank's asset quality has also not thrown any nasty surprises. When large PSBs are reeling under pressure from higher delinquencies, HDFC Bank's low levels of bad loans are a key positive. Its gross non-performing assets (GNPAs) stood at 0.94 per cent of loans in the March quarter, within its past range of 0.9-1 per cent. This is lower than that of its peers, such as Axis Bank (1.6 per cent) and ICICI Bank (5.8 per cent). HDFC Bank's restructured book is also very small at just 0.1 per cent of loans.

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