India Ratings Affirms HDFC Bank at ‘IND AAA’/Stable; Rates Additional CDs

Dec 05, 2023 | Private Sector Bank

India Ratings and Research (Ind-Ra) has affirmed HDFC Bank Limited’s (HDFC) Long-Term Issuer Rating at ‘IND AAA’ with a Stable Outlook. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Certificates of deposit (CD)	-	-	7-365 days	INR750	IND A1+	Affirmed
CDs	-	-	7-365 days	INR200	IND A1+	Assigned
Term deposit programme	-	-	-	-	IND AAA/Stable	Affirmed
Infrastructure bonds@	-	-	-	INR200	IND AAA/Stable	Affirmed
Basel-III compliant Tier 2 bonds@	-	-	-	INR250	IND AAA/Stable	Affirmed
Basel-III compliant Tier 1 bonds*	-	-	-	INR150	IND AA+/Stable	Affirmed

* Details in Annexure
@ Yet to be issued

Analytical Approach: Ind-Ra continues to take a consolidated view of HDFC and its subsidiaries - HDB Financial Services Limited (holds 94.8%), HDFC Life (50.4%), HDFC AMC (52.5%), HDFC Ergo (50.5%) and HDFC Securities Limited (95.5%) while arriving at the ratings, owing to the strategic, operational and legal linkages among them.

The ratings continue to reflect HDFC’s financial strength, diverse earning profile, and sustained strong through-the-cycle performance in the Indian banking system. The systemic importance of HDFC continues to be reflected in its pole position among private banks and second-largest position after State Bank of India (‘IND AAA’/Stable), even as the Reserve Bank of India (RBI) has classified it as a domestic systemically important bank since 2017. The bank’s retail focus on both the asset and liability sides has resulted in a high-yielding granular asset book, and a stable and strong funding profile. Furthermore, in Ind-Ra's opinion, the bank's strong capital buffers and market access to raise capital provide support to its consistently higher-than-system advances growth. The successful amalgamation with its promoter HDFC Limited (HDFCL) in 1 July 2023 has further strengthened its retail franchise on the asset side and is likely to assist in providing a runway for increasing the customer wallet share by deepening the relationships.

For AT1 instruments, the agency considers the discretionary component, coupon omission risk and the write-down/conversion risk as the key parameters to arrive at the ratings. Ind-Ra recognises the unique going-concern loss absorption features that these bonds carry and differentiates them from the bank's senior debt, factoring in a higher probability of an ultimate loss for investors in these bonds.

Key Rating Drivers

Systemic Importance Reinforced with Amalgamation: As of 2QFY24, HDFC continues to be the second-largest bank and the largest private sector bank with an increase to 11.4% and 15.5% market share in deposits and net advances on a post amalgamated basis. The market share gap with the third-largest bank in the Indian banking system has also widened significantly with the completion of the amalgamation recently. The systemic importance of HDFC is also reflected in RBI classifying it as a domestic systematically important bank. A widespread network of 7,945 branches with a target to increase the same on an ongoing basis and an increasing presence in the rural and semi-urban geographies also reflect the bank's ever-growing appetite to expand its customer base.

New Subsidiaries Create a Strong Presence across Financial Services Value Chain: Post the completion of the amalgamation, HDFC now has a strong presence across the financial services value chain, spanning banking, brokerage, asset management, life and general insurance. However, the contribution of the bank's subsidiaries to the consolidated profitability of the group is limited with profit after tax contribution of 4.9% in 2QFY24. Among the subsidiaries, the life insurance business had a 15.7% market share for individual weighted received premium among private life insurance players in India in 1HFY24, while the general insurance business also has gross direct premium market share of 6.1% position basis 1HFY24 premiums. The asset management business also had a market share of 11.2% with a 20% penetration in the mutual fund industry.

Stable Through-the-cycle Performance; Amalgamation Enhances Retail Franchise Further: HDFC's strength lies in its strong credit underwriting skills and risk management as reflected in its low credit costs, widespread reach in terms of both geographic presence and customer base, wide product offering creating an opportunity for deep entrenchment in customer ecosystem and strong liability franchise. The agency opines that the bank's focus on the adoption and upgradation of technology, analytics and digital initiatives for both asset and liability products will further improve its process efficiency, customer traction ability and operating costs (as a percentage of total assets), which would also drive its incremental profitability buffers over the near-to-medium term. Among the peer group, HDFC has witnessed one of the most stable profitability profiles over the years with a stable return on assets of 1.8%-2.1% over FY14-FY23 (FY23: 2.1%, FY22: 2.0%, FY21: 2.0%).

The amalgamation of HDFCL with HDFC is now effective; and the agency believes that it will benefit from the former's portfolio with a lower cost of funds, resulting from the latter's strong and growing low-cost liability franchise. The benefit is likely to come in gradually and would be limited in the initial period as HDFC fulfils all the regulatory requirements for the transition. The addition of HDFCL's loan book has also changed HDFC bank's loan mix, thereby increasing the share of long-tenor products in the overall advances mix, along with increasing the share of retail products. Amid the highly competitive home financing segment among banks, while margins on home loans could be lower than that for other retail products, a higher share of long-tenor products would provide HDFC a greater opportunity to cross sell other products and increase its customer wallet share.

Strong Capital Buffers Supported by Resilient Internal Accruals; Markets Access Remains Robust for Capital Raising: HDFC had a standalone CET 1 ratio of 17.3% in 2QFY24 (FY23:16.4%, FY22: 16.7%, FY21: 16.9%) at the higher end of the range of peer-rated banks. The bank had last raised equity in July-August 2018 of about INR240 billion from its promoters and other investors. The agency believes despite the significant picking up of loan growth in the banking system, the capital levels still provide HDFC enough cushion for the next two-to-three years. The bank's strong profitability also aids the capital buffers. The agency believes the stable through-the-cycle performance track record gives the bank a strong ability to raise funds from equity markets on an ongoing basis. HDFC also has board approvals in place to raise funds through bonds. Ind-Ra also believes that the impact of RBI's recent circular on increasing risk weight requirements for unsecured consumer credit and for lending to the non-bank segment is going to be limited and easily absorbable, given its capital buffers.

Strong Focus on Deposit Growth and CASA Franchise Build-up to Continue: HDFC's deposit grew 5.3% qoq in 2QFY24, strongly outpacing the system-level deposit growth at 4.0%, on a consolidated basis. With the aim to significantly grow the branch network by FY26 and deepening of franchise in rural and semi-urban areas, the agency believes that the tailwinds for HDFC on deposit growth are likely to continue in the near-to-medium term. HDFC's current account (CA) and saving account (SA) deposit ratio came in at 37.6% in 2QFY24 (1QFY24: 39%) and down in comparison to the pre-amalgamated basis of 44.4% in FY23. The concentration in deposits remains low in comparison to comparable peers with the top depositors constituting 4.5% of the total deposits in FY23 and an increasing share of retail deposits constituting 83.0% of the overall deposits in 2QFY24 (1QFY24: 83.0%).

Liquidity Indicator - Superior: HDFC had an overall funding deficit of 0.4% in the cumulative one-year bucket (excluding foreign currency exposure on assets and liabilities) as a percentage of the total assets in FY23. The bank also maintained about 22.0% of total assets in balances with the RBI and in government securities in FY23, which provides Ind-Ra the comfort that HDFC is more than adequately placed to meet its short-term funding requirements. Moreover, HDFC maintained a liquidity coverage ratio of 121% at 2QFY24 (FY23: 114.85%, FY22: 112%, FY21: 138%), against the regulatory requirement of 100%.

High Provision Coverage Ratio, Additional Provisions and Strong Profitability Buffers Provide Comfort: Compared to most peer-rated private banks who have seen volatility in gross non-performing assets (NPAs) over FY16-FY22, HDFC's efficient risk management practices have helped it in maintaining gross NPAs at 0.9%-1.5%, well below that of the rated peers. The bank reported gross NPAs of 1.34% in 2QFY24 (FY23: 1.12%, FY22: 1.17%; FY21: 1.32%). It had a provision coverage ratio (excluding prudential write-offs) of 74.4% in 2QFY24 (FY23: 75.8%, FY22: 72.7%, FY21: 69.8%), slightly above the median of comparable private peer banks. HDFC also maintains floating and contingency provisions of INR156 billion, about 1.9x of net NPAs as of 2QFY24. The net NPA to CET 1 capital stood at 2.1% in 2QFY24 (FY23: 1.7%, FY22: 1.9%, FY21: 2.3%). Furthermore, with the strong operating buffers (pre-provisioning operating profit/provisions) of 7.8x in 2QFY24 (FY23: 5.9x, FY22: 4.3x, FY21: 3.7x) already in place, the agency believes HDFC is better positioned than most of its peer group to face any elevated asset quality stress.

While Ind-Ra derives significant comfort from the granular book of the bank, a significant exposure to micro small and medium enterprises and unsecured retail segments is a key monitorable as the agency holds a cautious view on asset quality in these segments.

Rating Sensitivities

Negative: The Outlook could be revised to Negative if the asset quality starts deteriorating sharply and the credit costs are high on a sustained basis. The ratings could be downgraded if there is a material impact to Tier I capitalisation levels with CET I falling below 11.5% on a sustained basis, net non-performing asset to CET I capital rising sharply higher than that of its peer group, a significant erosion of franchise – a reduction of deposits or advances market share, all on a sustained basis, or a weakening of the relative competitiveness in the banking space. Weakened liquidity or the funding profile may also result in a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on HDFC, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

Company Profile

HDFC is the largest private sector bank in terms of advances as well as deposits. At end-2QFY24, its net advances stood at INR23,312 billion. The bank has a large retail footprint, with a leading market share across multiple product lines. At end-2QFY24, HDFC had a network of 7,945 branches and 1,97,899 employees.

FINANCIAL SUMMARY

Particulars	FY23	FY22
Total assets (INR billion)	24,660.81	20,685.4
Total equity (INR billion)	2,802.0	2,400.9
Net income (INR billion)	441.1	369.6
Return on assets (%)	2.1	2.0
CET1 (%)	16.4	16.7
Capital adequacy ratio (%)	19.3	18.9
Source: HDFC, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Financial Institutions Rating Criteria

Evaluating Corporate Governance

The Rating Process

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (billion)	Rating	8 February 2023	22 March 2022	2 June 2021	3 June 2020
Issuer rating	Long-term	-	IND AAA/Stable	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+	IND AAA/Stable/IND A1+
Lower Tier-2 subordinated debt	Long-term	-	WD	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
CDs	Short-term	INR950	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+
Term deposit programme	Long-term	-	IND AAA/Stable	IND tAAA/Stable	IND tAAA/Stable	IND tAAA/Stable	IND tAAA/Stable
Basel III AT1 bonds	Long-term	INR150	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable	IND AA+/Stable
Infrastructure bonds	Long-term	INR200	IND AAA/Stable	-	-	-	-
Basel-III compliant Tier 2 bonds	Long-term	INR250	IND AAA/Stable	-	-	-	-

Annexure

ISIN	Instrument	Date of Issue	Coupon Rate (%)	Maturity Date	Issue Size (billion)	Rating/Outlook
INE040A08419	Basel III AT1	8 September 2022	7.84	Perpetual	INR30	IND AA+/Stable
	Total unutilised				INR120	

Complexity Level of Instruments

Complexity Indicator	Complexity Indicator
Lower Tier-2 subordinated debt	Low
CDs	Low
Term deposit programme	Low
Basel III AT1 bonds	High
Infrastructure bonds	Low
Basel-III compliant Tier 2 bonds	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

Contact

Primary Analyst
Ankit Jain
Senior Analyst
India Ratings and Research Pvt Ltd
Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
+91 22 40356160
For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Karan Gupta
Director
+91 22 40001744

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

About India Ratings and Research: India Ratings and Research (Ind-Ra) is committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

India Ratings is a 100% owned subsidiary of the Fitch Group.

For more information, visit www.indiaratings.co.in.