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THE COMPASS

HDFC Bank: Gradually rising asset quality stress

The bank is about 20 bps away from the upper limit of its 10-year average NPA comfort zone

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Three quarters back, when HDFC Bank's gross non-performing asset (NPA) ratio climbed over a per cent, the hope was that it would only be a one-off blip. But, the bank hasn't been able to regain its sub one per cent level since then. Provisioning and gross NPA ratios have only been climbing up sequentially and the December quarter (Q3) results were no exception.

The focus this quarter was on the outcome of the Reserve Bank of India's audit observation on HDFC Bank's bad loans. According to the audit report, a divergence in gross NPA of ₹20.5 billion was reported for FY17. The good thing is: An account (Jindal Steel and Power) which was classified as NPA in the September quarter was mutually decided by banks at the joint lenders forum to now be classified as a standard asset, resulting in a reversal in provisioning of ₹17 billion. The net impact of divergence provided for in Q3 was around ₹3 billion.

This partly explains why provisioning cost for Q3 went up by 78 per cent to ₹13.5 billion. Impact of weak asset quality seen in agriculture loans is still lingering and has resulted in higher provisions in Q3 as well. "We haven't seen the end of tail on agri loans," explains Paresh Sukthankar, deputy managing director, HDFC Bank. The comforting fact is that the provisioning reversal hasn't been used to boost Q3 profit but the bank has set aside some buffer out of it. Therefore, should the need arise for high provisioning, HDFC Bank is reasonably insulated.

Nonetheless, the quarter did witness 24 basis points (bps) year-on-year (y-o-y) increase in gross NPA ratio, taking the number to 1.3 per cent in Q3. At this level, it is just shy of 20 bps from its upper limit of 10-year average gross NPA ratio of 1.5 per cent.

STEADILY INCREASING NPAs

	NPA ratio (%)	
	Gross	Net
Dec '16	1.05	0.30
Mar '17	1.05	0.30
Jun '17	1.24	0.44
Sep '17	1.26	0.43
Dec '17	1.29	0.44

Source: HDFC Bank

Not just this, on an absolute basis, gross NPAs rose 58 per cent year-on year to ₹82.35 billion in Q3, as a further indication of increasing asset quality stress.

But, for now, analysts are hopeful that as much of the recognition is already through, HDFC Bank should not see further elevation in loan losses. Asutosh Mishra of Reliance Securities says unless the ratio goes above two per cent, he wouldn't worry much.

Barring this, for a bank which has been consistent with 20–25 per cent growth on key parameters, Q3 was no different. Net interest income at ₹103.14 billion (up 24 per cent y-o-y) was in-line with expectations, though net profit at ₹46.4 billion (up 20 per cent year-on-year) was a shade below estimates of ₹47 billion. Loan growth at 27.5 per cent taking the loan book to ₹6,312 billion was well supported by retail and wholesale assets.

However, to see the share of low-cost CASA (current account–savings account) deposits fall to 44 per cent, from 45 per cent a year-ago (a quarter helped by demonetisation) is tough to accept, especially for a strong retail-oriented bank. While this is not eating into net interest margin (4.3 per cent in Q3; up by 20 bps y-o-y), in an increasing bond yield scenario a stable CASA ratio could help more. Overall, there isn't much to complain about with HDFC Bank's Q3 numbers and it justifies its expensive valuations of over five times its FY19 price-to-book.