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Post-mega merger, HDFC Bank sees consolidation
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HDFC BANK WILL take four-five years to fully digest its merger with its parent last July, but expects to restore a key financial metric to pre-merger levels at the end of that period, two sources familiar with the bank's thinking said.

The lender's quarterly earnings last week prompted a sharp 15% decline in the stock, even as its profit beat expectations, as analysts raised concerns about lending margins and sluggish deposit growth in its second quarterly report since merging with Housing Development Finance Co.

"We will see a period of consolidation for four-five years during which growth rates and trajectory of some of the metrics will differ from what we were used to in the bank, but this is a different institution now after the merger," said one of the sources quoted above.

TIGHTROPE WALKING

- Before merger, the bank's return on equity was above **17%**, but it declined to **15.8%** as of December-end
- After Q3 numbers, investors and analysts criticised the bank for over-promising and under-delivering on certain metrics
- Stock slumped **15%** last week, as analysts raised concerns about lending margins and sluggish deposit growth
- During consolidation, growth rates and trajectory of some of the metrics will differ from what they used to be

Before the merger, the bank's return on equity was above 17%, but it has since declined to 15.8% as of December-end. "We are very focused on profitable growth and we will see the return on equity move back to the levels we saw before the merger over this period," this person said.

Other metrics, including the net interest margin, deposit and loan growth will be contingent on the economic environment and the strategic decisions the bank makes to adapt to the environment, the person said.

Following the earnings, investors and analysts criticised the bank for over-promising and under-delivering on certain metrics, particularly margins.

Over the past two quarters, the bank's management, during road shows and investor meetings, has guided towards an improvement in margins that has not materialised, said a fund manager invested in the stock.

"We believe it will take another couple of quarters before one can see NIM improvement," Macquarie Securities' analyst Suresh Ganapathy wrote in a note on Thursday.

The bank expects deposit growth to be influenced by the environment, where banking system liquidity is in a significant deficit, resulting in higher rates.

"In some cases, we have let deposits go because it doesn't make sense to us," said the second person quoted above.

Incrementally, the bank aims to maintain a loan-to-deposit ratio of around 80%, this person said, which will help reduce the overall LDR ratio. The loan-to-deposit ratio reflects the share of deposits loaned out by a bank.

The liquidity buffer, known in banking terms as the liquidity coverage ratio, is expected to rise to the 115-120% range, up from the current 110%, this person said.

Loan growth, however, could see some slowdown on a net basis as the bank sells off assets, likely from its wholesale loan book, as high-cost liabilities of HDFC mature. The mix of loans may shift slightly more towards retail, which constituted 55% of the bank's book a few years ago, compared with near 45% now. "It's a tightrope walk," said one of the sources. "We have to be balanced from a risk management, growth and profitability perspective." — **REUTERS**