

Investing Ideas Podcast by Stanley



By Ser Jing

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Reasoning from 1st principles: What is the stock market?

- Place to buy and sell pieces of actual businesses (shares)
- So what makes the price of a share increase? --> If the underlying business grows!
- From 1965 to 2018, Berkshire Hathaway's book value (assets less liabilities) grew by 18.7% per year; its share price grew by 20.5% per year. **Input of 18.7%, output of 20.5%.**

Reasoning from 1st principles: So what are the signs of a business that could grow?

- Revenues that are small in relation to a large and/or growing market, or revenues that are large in a fast-growing market.
- A strong balance sheet with minimal or reasonable levels of debt.
- Management with integrity, capability, and an innovative mindset.
- Revenue streams that are recurring in nature, either through contracts or customer-behaviour.
- A proven ability to grow.
- A high likelihood of generating a strong and growing stream of free cash flow in the future.

Introducing HDFC Bank (NYSE: HDB)

- One of India's largest private-sector banks with an array of both commercial and investment banking services, with more than 5,000 branches throughout the country serving ~50million customers.
- Headquartered in India and listed on the country's major stock exchanges, the National Stock Exchange of India and Mumbai Stock Exchange. Unfortunately, individuals who are not citizens of India do not have easy access to the country's listed stocks.
- Good thing is HDFC is also listed in the US under the ticker symbol NYSE:HDB. The US-listing is under a American Depository Receipt (ADR) programme established by HDFC and JP Morgan. 1 ADR share is backed by 3 actual HDFC shares.

HDFC Bank's (NYSE: HDB) thesis

- Founded in 1995 and has grown earnings per share and book value per share in every fiscal year since fiscal 1996 (year ended 31 March 1996). Growth has been really impressive too:

Time period	Book value per share annual growth	Earnings per share annual growth
Fiscal 1996 to fiscal 2019	27.1%	29.4%
Fiscal 2009 to fiscal 2019	23.0%	22.2%
Fiscal 2014 to fiscal 2019	24.8%	17.3%

HDFC Bank's (NYSE: HDB) thesis

- Managed to grow while being run very conservatively with low leverage ratio (ratio of total assets to shareholders' equity) and low non-performing assets ratio.
- HDFC's leverage ratio averaged just 11.5 from fiscal 1996 to fiscal 2019, and was just 8.5 as of 30 September 2019.
- HDFC's non-performing assets ratio averaged just 1.36% from fiscal 1996 to fiscal 2019. Non-performing assets ratio was just 1.38% as of 30 September 2019. India's public-sector banks had non-performing assets ratio of 14.6% in 2018.

HDFC Bank's (NYSE: HDB) thesis

- India's working-age group (15 to 64 year-olds) is projected to increase by 30% from 860 million in 2015 to 1.12 billion in 2050. That's a strong tailwind for long-term economic growth. For context, China's working-age population is expected to shrink by 20% over same period.
- India is underbanked. Only about 40% of the adult population of India currently have a bank account, and just 13% have a debit card and only 2% have credit cards.

HDFC Bank's (NYSE: HDB) thesis

- At the end of 2018, HDFC had 7% of the total banking deposits market in India, and less than 10% of the total loans and advances market.
- HDFC is growing faster than other Indian banks. From fiscal 2013 to fiscal 2018, growth rate of India's loan market was 16% at most in each of those years, while HDFC's growth rate in loans ranged from 18.7% to 26.4% in the same period. Overall Indian deposit growth never exceeded 16% in any of those years, while HDFC's deposit growth was never less than 17.8%.

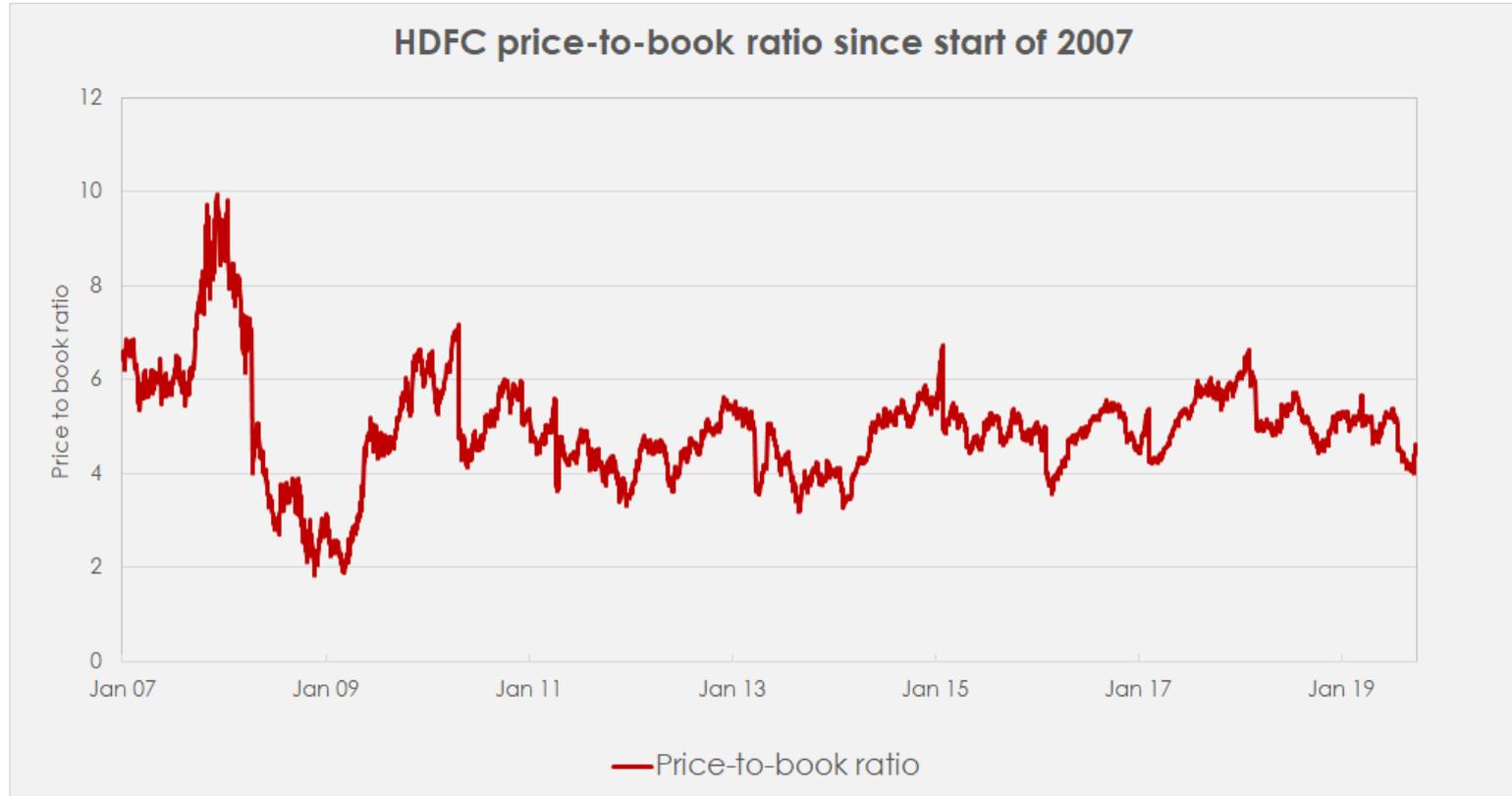
HDFC Bank's (NYSE: HDB) thesis

- HDFC has strong history of innovation:
 - Launched internet banking and mobile banking services back in 1999 and 2000, respectively (first bank in India to launch mobile banking).
 - Customer-initiated transactions in HDFC through internet & mobile channels account for 92% of all such transactions today, up from 29% in 2009.
 - MSMEs (micro, small, and medium enterprises) can get approved for loans of less than ₹50 million (about S\$1 million) in less than three hours - first in India.
 - Retail customers can get approved for a personal loan in as little as 10 seconds.
 - HDFC first bank in India to allow banking customers to apply online for loans that are backed by shares and mutual funds they own.

HDFC Bank's (NYSE: HDB) thesis

- Compensation for HDFC's founder and long-time leader, Aditya Puri, is reasonable: ₹136.7 million (S\$2.6 million) in FY2019. For context, HDFC's market cap is around S\$130 billion, which is twice that of DBS in Singapore (S\$68 billion); DBS CEO, Piyush Gupta, was paid S\$11.9 million in 2018.
- HDFC's management team has sensible compensation policy: Part of management's fixed as well as variable pay depend on HDFC's non-performing assets (NPA). This incentive structure increases the chance that HDFC's leaders will run the bank's lending operations with prudence.

HDFC Bank's (NYSE: HDB) valuation



HDFC Bank's (NYSE: HDB) risks

- Key risk is planned departure of founder and long-time leader Aditya Puri.
- Bankers must retire at 70 under India law and Puri is 68. He is scheduled to retire in October 2020.
- Succession planning already in place. Long-tenured senior executive of HDFC
 - Sashidhar Jagdishan, 54 (joined in 1996) - became head of most of the important portfolios in HDFC in August this year. Most of Puri's current leadership team is also relatively young and have been at HDFC for years, if not decades.

Disclosure

- I own shares of Berkshire Hathaway. For work and personal reasons, I don't own shares of HDFC yet.