

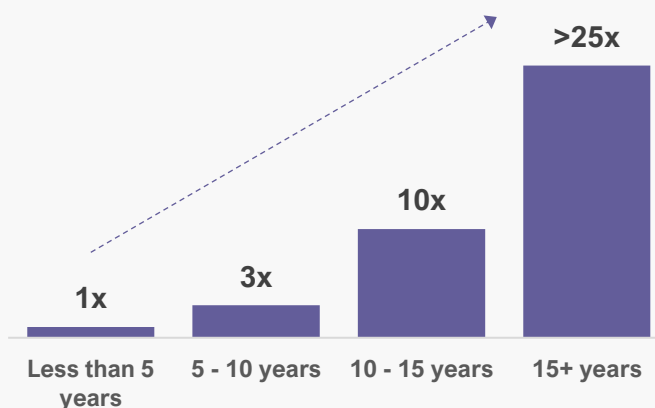
During Q2 2024, LBA established a new position in HDFC Bank, one of the premiere Indian banking institutions. Our analysis suggests the company can grow EPS by more than 11% CAGR for the next 5 years.

HDFC Bank announced a merger with its parent entity HDFC Limited in April 2022, which was finalized in 2023. The market did not favorably view the terms of the transaction and punished the stock. The merger brought in assets from HDFC Limited which negatively impacted the funding mix of the bank in the near term. The key concern for investors was whether HDFC Bank could maintain the profitable growth rate that had been generated in the past.

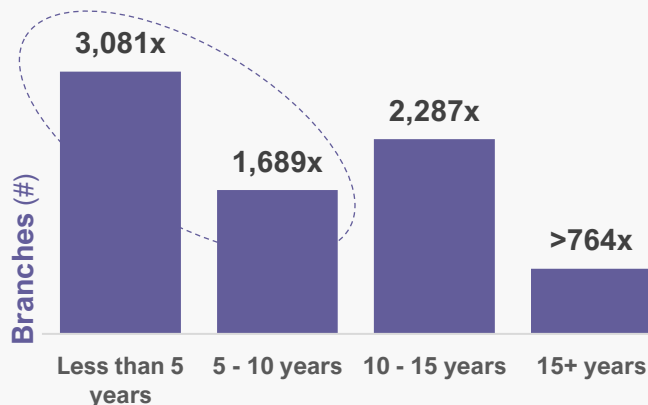
LBA Investment Thesis: Next 3-5 Years

- LBA's proprietary research suggests that HDFC Bank will continue to deliver on its profitable growth by regaining its superior funding mix over the medium term. HDFC Bank has accelerated its push to expand its physical presence by opening more than 3,000 branches in the last 5 years.
- Approximately 60% of HDFC Bank's branch network is less than 10 years old. With the help of its expanded branch footprint, HDFC Bank is now adding almost 1 million clients per month. As these branches and customer relationships mature, they bring in stable and low-cost deposits. For instance, branches with 5-to-10-year vintage grow by ~3x vis-à-vis the branches with less than 5-year vintage, which will be used to replace higher cost wholesale funding, helping HDFC Bank regain its superior funding mix and hence its peer leading profitable growth.

Branch Deposits Compound with Time



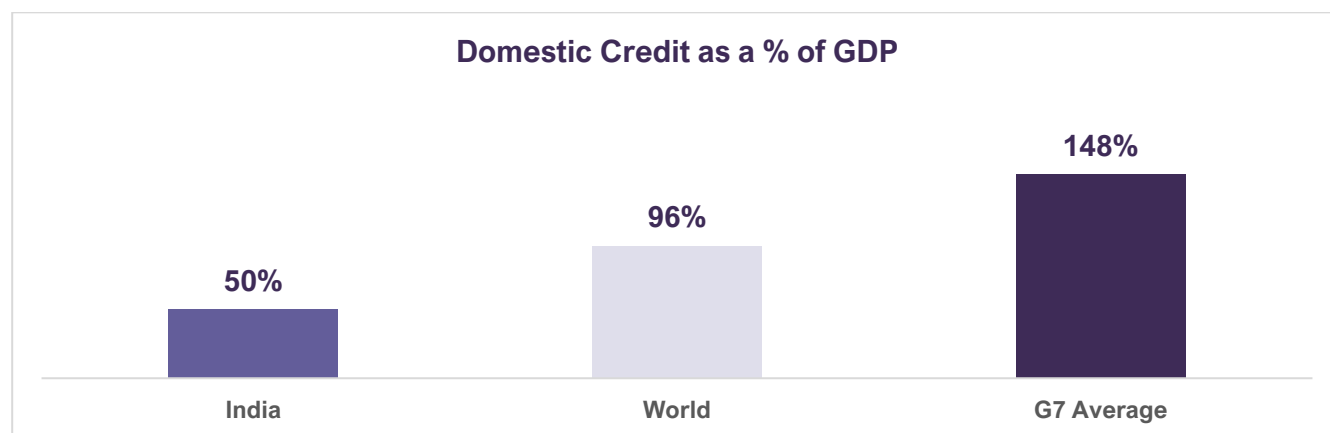
>60% Branches Less than 10 Years Old – at an Inflection Point



Source – HDFC Bank presentation

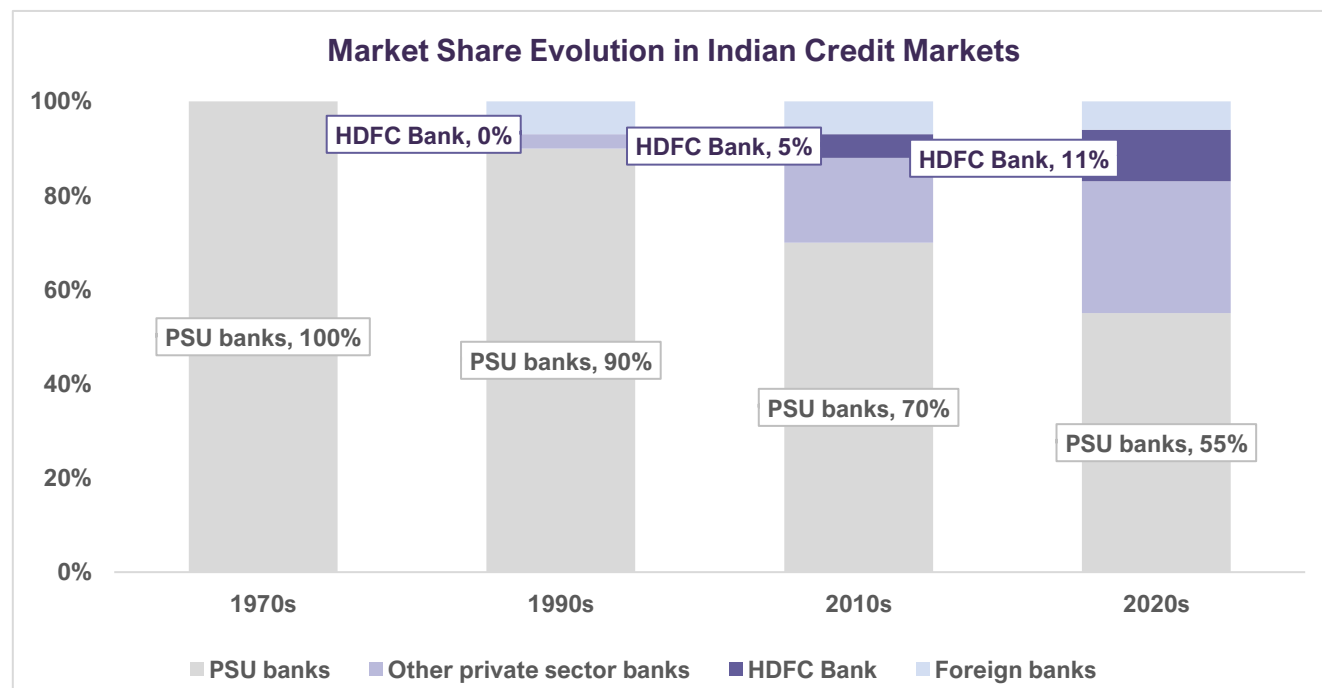


- The current low penetration of banking and credit markets in India; domestic credit relative to private sector as a % of GDP for India is at 50%, roughly half of the world average at 96% and a third of the developed country average of 148%.



Source – World bank, St Louis Fed, LBA analysis

- Another important tailwind is the long-term market share gain from Government-owned (PSU) banks which came into being after the nationalization in in the late 60's. In the early 90's, a few private owned banks were given licenses including HDFC Bank. Since then, the market share shift from PSU banks to private owned banks has been impressive.



Source – Reserve Bank of India, LBA analysis

- Our analysis also suggests the merger offers potential for revenue synergies as ~70% of HDFC Limited's customers (~ 5 million customers) were not banking with HDFC Bank. The merger brings along significant stakes in other industry-leading and profitable financial services such as life insurance, general insurance, mutual funds etc.



- HDFC has typically traded at a lofty valuation around 4-5x book value. We recently met with their management team, and thoroughly understood their business model and plans, When the opportunity presented itself earlier this year as the valuation came under duress due to systematic market volatility, we were able to add it at only 2.5x book, or about half its historical valuation.



Source – FactSet, LBA Analysis

Conclusion:

Our analysis suggests HDFC Bank is a suitable addition to our portfolio since we believe it offers the combination of quality and growth without materially increasing the risk profile of the portfolio. LBA is highly price sensitive, and we try to maximize the margin of safety in our portfolio by acquiring companies at reasonable valuations.

All dollar references in the text are U.S. dollars unless otherwise indicated.

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