HDFC

What it does

HDFC is major provider of finance for housing in India. Recently, HDFC have been granted approval to merge with HDFC Bank.

Why we own it

- Management are operationally excellent and entrepreneurial but also prudent.
- Loan book has > $55bn of assets.
- The Indian mortgage market offers the potential for decades of rapid growth at attractive rates of return.
- Excellent underwriting record over the last 40 years. Non-performing loans <1.5% in contrast to the broader market.
- Merger with HDFC Bank will strengthen competitive position and accelerate growth.

How it could be worth many times more

HDFC stands to be worth many multiples more thanks to the following:

- Mortgage Business: penetration grows to c.20% of Indian GDP by 2030. Core mortgage business delivers mid-teens loan book growth for another ten years, with HDFC holding its 20% market share.
- HDFC Bank: can grow ahead of the industry by winning customers from the smaller public banks with inferior customer service. Structural tailwind of young population seeking credit to realise their growing aspirations.
- HDFC Asset Management: can continue to take share from subscale competitors, growing AUM slightly ahead of the industry.
- HDFC Life: Life insurance is still underpenetrated in India. HDFC has ~20% market share with strong solvency ratios. Mid-teens growth in embedded value.
- The merger of HDFC and HDFC Bank: harnessing the Bank's physical presence in India would be a significant unlock to HDFC's mortgage growth (>3x more branches to distribute mortgages), while also providing cross-selling synergies for the Bank.

Where we might be wrong

- Cultural disruption follows the merger.
- Market opportunity smaller than it appears.
- Competition squeezes margins.
- Credit quality declines; write offs increase.

Short 10 questions

Can sales double in the next five years? 1

Yes, the overall loan book continues to grow healthily and the merger (if approved) could unlock additional growth.

Ten years and beyond? 2

Secular trends of urbanization and home ownership continue.

Competitive advantage? 3

Greater efficiency than large state-run competition, while a shake out of smaller players continues. If merger approved, HDFC stands to provide improved value proposition to customers, taking even more market share.

Is the business culture different? 4

Pragmatic approach to growth, married with a strong willingness to experiment with new technologies and opportunities.

Customers like you? Contribute to society? 5

Providing relatively quick and cost competitive funding for a life-changing purchase. Extensive financial education programme.

Are returns worthwhile? 6

Operating margin very dependable over time.

Will they rise or fall? 7

Margins stable. Diversifying its lending sources over the last decade to leave it less exposed to short-term rises in lending costs.

How is capital allocated? 8

New opportunities within the financial sector with more emphasis on returns to shareholders over the next decade.

Could it be worth 5x as much? 9

Yes, particularly when factoring in the merger, if approved.

What doesn't the market understand? 10

Longevity of the opportunity and culture.

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