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Will HDFC Bank remain the Arnold Schwarzenegger of banks for next 10-20 years? Devina Mehra explains

Synopsis

"I do not expect a big stumbling block in the HDFC merger. Obviously, some of HDFC Bank's ratios will get diluted at least in the short term whether it is the return ratios or even the growth percentage that would come down from where it has been with the merger of HDFC. Other than that, I do not see any big glitches coming up."



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Devina Mehra, Chairperson & MD, First Global, says "I doubt whether [HDFC](#) will be in a situation where it will never get its act together in technology as it is so critical. I do not know exactly what they are doing in the sense that I have not met the management of late or anything, but I am sure that would not be a permanent stumbling block."

I am looking at one of your first reports that you published on [HDFC Bank](#). The buy report said that at one, he is good, at five he will be awesome; from the baby it was a teen with a six-pack ab. Devina what is your sense then at 29 years, what is this teen with a six-pack abs going to look like? Is the opportunity still as large for shareholders?

Yes, it is not a teen with the six-pack abs, it is [Arnold Schwarzenegger](#), who was the reigning world champion then.

I could not tell.

At one it is a baby, at five it will be Arnold Schwarzenegger, the world champion. Even on a global scale, it is a huge bank; the fourth largest in the world in [market cap](#). That report was just one year out of IPO and is relatively well known and one of the reasons why I made that call at that time of course, there was this whole fundamental thing that PSU banks had a large market share and therefore there was a good case to be made that a well-run private bank will take away some share.

[HDFC](#) itself was already a brand name even for the retail consumer and their deposits and debentures, etc, used to do well. They were already a known name and that was another advantage.

I always say that this call had a plus-plus factor because in banking, one ultimately banks on the people because it is a business where if the credits go wrong, there are always negative surprises.

In this case, because a lot of the people who set up HDFC Bank were my ex-colleagues from Citibank – right from Aditya to a lot of his team – I was quite positive that they would manage the risk tightly, which as they showed in subsequent years, they did.

But this report is well known. What is not so well known is that just a couple of years after that, we actually had a dramatically opposite view on HDFC and let me just give you a bit of background of HDFC.

In '93-94, when the Indian market was opened to FIIs. HDFC was the Number One FII stock, fund managers just loved it. It was obviously a well-run business, very articulate management who could talk numbers which was a rarity at that time and so every time the FII limit regulatorily was increased, HDFC was the first stock to touch the limit on whatever was the limit at that time for FIIs.

FIIs would just jump in and buy and ours was the first negative view on HDFC in the late 90s, in 1998 or '99. We did a piece and the reason had nothing to do with the business but because there was this much demand for the stock, they were raising equity practically every year via what now are called QIPs. They were doing a lot of institutional equity placements at that time and at that time, the managements in India were maturing, people were primarily focussed on profits, earnings, growth and nobody was really focussed on the balance sheet side and we said that this is a company which is seeing a decline in return on equity every year and this stock cannot perform and people were like, shocked.

They said this is the most loved FII stock and how can you say that it would not perform, but actually thereafter for five years, the HDFC stock did nothing. It was a time correction. It did not crack and go down but for five

years, when the market was going up, it did not go up. So we have been on both sides you can say on this trade even in the 90s.

But from the 90s to now that it is a combined entity, one of the largest in the world, what lies ahead? What are the next 10 or 20 years going to look like?

It is difficult to say. It is a reasonable start. In most mergers, you are thinking about how the two cultures would mesh or whether they would be able to make it work and what are the potential glitches. Those concerns are much less in these two entities because they have been in a sense parent and child and I doubt whether there will be a big conflict in terms of the management side also. All those things are taken care of.

Therefore one can make a case that the synergies would come through in terms of cross-selling, in terms of accessing each other's consumers and the logic for being in an NBFC structure no longer held once all the regulatory changes have come about which have made NBFCs fairly tightly regulated.

What about growth projections because HDFC Bank wishes to grow its deposit base at 20%. In the current environment, can it consistently grow deposits in a big way?

It should be able to grow higher than the market because at least in the beginning, there will be some synergistic benefits of tying up with HDFC because in terms of branches, in terms of consumers, there is not a 100% overlap. I think it would give a boost and obviously for HDFC it would bring down their funding cost.

What are some of the hiccups that could be there given it has been a very differentiated institution? Could that emerge as a stumbling block?

I think the merger will go through smoothly. I do not expect any big stumbling block. Obviously, some of HDFC Bank's ratios will get diluted at least in the short term whether it is the return ratios or even the growth percentage that would come down from where it has been with the merger of HDFC. Other than that, I do not see any big glitches coming up.

What about flows? This was one of the key parameters when you came out with those reports on HDFC-HDFC Bank back in the day. Do you believe that the worst in terms of flows and all the MSCI adjustments are now over for the combined entity of HDFC Bank?

In fact it was a reverse in terms of anyone betting on flows would have said that HDFC would never underperform because all the FIIs absolutely loved it. Domestic mutual funds did not really exist in any meaningful form and you would say that the money is coming in and how can the stock not perform?

I have never been a believer in flows; on an aggregate basis from 1994, when the FIIs started coming to India, despite billions of dollars coming in, 1994 to 2003 is the only nine-year period in the Indian equity markets with zero returns. So just money coming in does not drive up the market. It sounds strange but if you look at the correlation, it does not work that way. It is not something I track anymore. We tracked FIIs flows for a long time and saw that there is no causation or correlation with the market movement.

Many say that or at least there are a few critics out there who believe that HDFC Bank would not quite be able to catch up with the times banking of the future will be based on technology right besides of course many other parameters and technology or going digital is one thing that HDFC Bank has sort of hiccuped on?

Yes, they have. Just see all the consumer complaints floating around everywhere but I do not think this is going to be a permanent state of affairs. It is a smart management and sometimes they do not do things in time but it is unlikely that they will never do it. I doubt whether HDFC will be in a situation where it will never get its act together in technology as it is so critical. I do not know exactly what they are doing in the sense that I have not met the management of late or anything, but I am sure that would not be a permanent stumbling block.

The other thing which you also briefly alluded to is that HDFC Limited's leadership has largely not participated in [HDFC Bank](#). Do you think that at some point, that could become a challenge although it is a very seasoned top brass?

I do not think so. I am sure all these things have been thought of and many of the old time HDFC Limited management is now at a stage where they would be retiring not that much later. So the transition can be managed. I am sure all this would have been thought through in the merger itself because they are the guys negotiating the merger.