FINANCIAL APPRAISAL: The Study based upon the Financial Analysis of HDFC BANK LIMITED

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ABSTRACT
The Housing Development Finance Corporation Limited (HDFC) was amongst the first to receive an 'in principle' approval from the Reserve Bank of India (RBI) to set up a bank in the private sector, as part of RBI's liberalisation of the Indian Banking Industry in 1994. The bank was incorporated in August 1994 in the name of 'HDFC Bank Limited', with its registered office in Mumbai, India. HDFC Bank commenced operations as a Scheduled Commercial Bank in January 1995. The financial appraisal of a project helps to determine the financial viability and sustainability of the project. Since the financial appraisal begins with the financial analysis and then the economic analysis, the concepts and data ought to be organized in a consequential and consistent manner. This study examines the financial situation of the HDFC Banks using comparative analysis for the period 2005 to 2015. Profitability and leverage measures of the bank are analysed in the Indian financial market.

Keywords---- Financial Appraisal, Financial Viability, Cash Flow

I. INTRODUCTION
Financial appraisal is an objective evaluation of the profitability and financial strength of a Business unit. Many a times, the terms financial performance appraisal and financial statement analysis are used as synonymous. The techniques of financial statement analysis are used for the purpose of financial appraisal. Therefore, financial appraisal is the process of scientifically making a relevant, comparative and critical evaluation of the profitability and financial health of a given firm through the application of the techniques of financial statement analysis. The accounting system is concerned with the classification, recording, summarizing and presentation of financial data. This data is analysed for the purpose of evaluation and appraisal of the performance. Financial statement analysis attempts to unveil the meaning and significance of the items composed in profit and loss account and the balance sheet so as to assist the management in the formation of sound operating financial policies. The analysis and appraisal of financial statements reveal the significant facts relating to financial strength, profitability, corporate efficiency, weaknesses, managerial performance, solvency and other such factors relating to a company. The technique of appraisal is applied to the analysis and study of accounting data.

The first logical step towards financial analysis is the interpretation of financial statements. The basic data which are analyses are found in the financial statements. The ability to understand, analyze, interpret and use of information given in the financial statements depends upon the understanding of accounting and finance. With reference to this the definition of Accounting is worth noting: Accounting has identified wealth and performance as phenomena for which measurement and communication are warranted. Wealth is measured by direct attention to an entity's owners' equity and performance is measured by focusing on the effect of an entity's operating transactions on its owners' equity. The medium through which such information is communicated is known as financial statement. The American Institute of Certified Public Accountants defines accounting as the ‘art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character and in interpreting the results thereof.’

Financial statements are prepared for the purpose of presenting a periodical review or report by the management and deal with the status of investment in the business and the result achieved during the period under review. They reflect a combination of recorded facts, accounting conventions and personal judgment and conventions applied which affect them materially. The soundness of the judgment necessarily depends on the competence and integrity of those who make and on
their adherence to generally accepted accounting principles and conventions.

**Process of Financial Appraisal:**

The data for financial analysis and appraisal basically emerge from financial statements. Such analysis covers:

1. Segregating of individual components of financial statements and groups of specified elements duly defined so that the computation can be clearly ascertained for checking and accuracy. The data contained in the income statement and the balance sheet is to be completely recast and presented in a condensed and unified form.

2. To establish significant relationships between the individual components of income statement and balance sheet. This is done through application of the tools and techniques of financial analysis.

3. Evaluation and interpretation of the comparative data obtained by application of the tools of financial analysis.

II. **TECHNIQUES OF FINANCIAL APPRAISAL**

Various techniques of financial analysis which have been frequently used and have become popular are:

1. **Ratio analysis:** A ratio is an arithmetical relationship between two figures. Financial ratio analysis is a study of ratios between various items or groups of items in financial statements. Ratios can be worked out to verify the profitability, liquidity, solvency, leverage, valuation and turnover of the firm.

2. **Trend analysis, Common size statement analysis and comparative statement analysis:** Trend analysis is concerned with dividing the magnitudes of significant items or groups of items in each of a series of statements by their magnitudes in one year in the series selected as base, thus obtaining a series of trend percentages or relatives to the base year. By studying the variations from base year, a comprehensive view of the business can be obtained.

3. **Common size financial statements:** common size income statement and common size balance sheet. For this, all items of the statement are compared with one common item, which is significant. For instance, in the income statement, sales may be taken as 100 and all other items in the statement are compared as percentage of sales. Similarly, in case of balance sheet the relation of each item to total assets/total liabilities is computed. Such common size statements or 100 % statements give useful proportions of each component of the total. The study of proportions and trend in the composition of proportions of various item and the meaning as well as reasons of changes of proportions can be analysed for relevant study. Trend analysis and common size statements will help in inter firm comparison.

4. **Funds flow analysis:** Funds flow analysis or the statement of sources and uses of funds shows the sources of funds and applications of funds during the period. Funds flow analysis provides insight into the movement of funds and helps in understanding the changes in the structure of assets, liabilities and owner’s equity

5. **Cost - volume - profit analysis:** Cost volume profit analysis is an important tool of profit planning. It analyses the interrelationships of changes in profit when the volume of output is changing and ultimately the variable cost and fixed costs are also changing. It is a tool which analyses profitability under various situations having different volume of activity. This profit planning tool is also called break even analysis. It helps the management in taking relevant decisions under different levels of manufacturing activity, different prices and ultimate effect of the behavior of fixed and variable costs which make up the total cost at different levels of business activity. It helps in quantifying and understanding the various components of costs under different situations and hence become a guide for future planning of business and profit.

6. **Index Analysis:** In index analysis, the items in comparative financial statements (income statement and the balance sheet) are expressed as an index relative to the base year. All items in the base year assume a value of 100. This type of analysis facilitates comparison of progress or down trend of activities over a period, since various years’ figures/performance is compared with 100.

7. **Leverage Analysis:** As a general concept, leverage represents influence of power. In financial analysis leverage represents the influence of one financial variable over some other related financial variable. Financial leverage measures the effects in earning per share on account of changes in book profits. Operating leverage measures the effects in profit on account of changes in quantity produced and sold. Total leverage, that is, the combined effect of financial and operating leverage can also be analysed. This will help in understanding the cost behaviour and level of activity for profit planning and strategic decisions.

8. **Balanced Scorecard:** Now as a new development, most companies have a performance measurement system that includes financial measures as well as non financial measures. Financial measures are used primarily by senior management to monitor the performance of the firm as a whole. Non financial measures are employed mainly by operating managers to control short term operations. This integrated measurement framework is developed recently containing financial and non financial performance measures. The technique of Balance scorecard is strategy driven measure. In modern times, measurement focus of the scorecard is used to accomplish critical management processes. This tool of analysis focuses four important perspectives in a business, namely financial, customers, internal business and learning and growth. The technique of balanced scorecard links the objectives and measures thro cause and effect relationships existing in business. This way it is a comprehensive analytical tool of business activities measurement and performance appraisal.

III. **BANKS FINANCIAL RATIO**
1. Net interest margin (NIM): NIM is a measure of the difference between the interest income generated by banks or other financial institutions and the amount of interest paid out to their lenders (for example, deposits), relative to the amount of their (interest-earning) assets. It is similar to the gross margin (or gross profit margin) of non-financial companies. It is usually expressed as a percentage of what the financial institution earns on loans in a time period and other assets minus the interest paid on borrowed funds divided by the average amount of the assets on which it earned income in that time period (the average earning assets). Net interest margin is similar in concept to net interest spread, but the net interest spread is the nominal average difference between the borrowing and the lending rates, without compensating for the fact that the earning assets and the borrowed funds may be different instruments and differ in volume. The net interest margin can therefore be higher (or occasionally lower) than the net interest spread.

2. Loan to Deposit Ratio (LTD): The loan to deposit ratio is used to calculate a lending institution's ability to cover withdrawals made by its customers. A lending institution that accepts deposits must have a certain measure of liquidity to maintain its normal daily operations. Loans given to its customers are mostly not considered liquid meaning that they are investments over a longer period of time. Although a bank will keep a certain level of mandatory reserves, they may also choose to keep a percentage of their non-lending investing in short term securities to ensure that any monies needed can be accessed in the short term Loan-deposit ratio, also known as the LTD ratio, is a ratio between the banks total loans and total deposits. If the ratio is lower than 1, the bank relied on its own deposits to make loans to its customers, without any outside borrowing. If, on the other hand, the ratio is greater than 1, the bank borrowed money which it re-loaned at higher rates, rather than relying entirely on its own deposits. Banks may not be earning an optimal return if the ratio is too low. If the ratio is too high, the banks might not have enough liquidity to cover any unforeseen funding requirements or economic crises. It is a commonly used statistic for assessing a bank's liquidity.

3. Return on capital (ROC): ROC is a ratio used in finance, valuation, and accounting. The ratio is estimated by dividing the after-tax operating income (NOPAT) by the book value of both debt and equity capital less cash/equivalents. ROIC is a useful measure for comparing the relative profitability and value-creating potential of companies after taking into account the amount of initial capital invested Non-Performing Assets (NPAs): NPA is defined as a credit facility in respect of which the interest and/or instalment of Bond finance principal has remained ‘past due’ for a specified period of time. NPA is used by financial institutions that refer to loans that are in jeopardy of default. Once the borrower has failed to make interest or principle payments for 90 days the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. Troublesome pressure from the economy can lead to a sharp increase in non-performing loans and often results in massive write-downs.

4. Capital Adequacy Ratio (CAR): Capital Adequacy Ratio also known as Capital to Risk (Weighted) Assets Ratio (CRAR) is the ratio of a bank's capital to its risk. National regulators track a bank's CAR to ensure that it can absorb a reasonable amount of loss and complies with statutory Capital requirements. It is a measure of a bank's capital. It is expressed as a percentage of a bank's risk weighted credit exposures. This ratio is used to protect depositors and promote the stability and efficiency of financial systems around the world. Two types of capital are measured: tier one capital, which can absorb losses without a bank being required to cease trading, and tier two capital, which can absorb losses in the event of a winding-up and so provides a lesser degree of protection to depositors. Capital adequacy ratios (CARs) are a measure of the amount of a bank's core capital expressed as a percentage of its risk-weighted asset. Capital adequacy ratio is defined as:

$$\text{CAR} = \frac{\text{Tier 1 capital} + \text{Tier 2 capital}}{\text{Risk weighted assets}}$$

TIER 1 CAPITAL = (paid up capital + statutory reserves + disclosed free reserves) - (equity investments in subsidiary + intangible assets + current & b/f losses)
TIER 2 CAPITAL = A) Undisclosed Reserves + B) General Loss reserves + C) hybrid debt capital instruments and subordinated debts, where Risk can either be weighted assets or the respective national regulator's minimum total capital requirement.

IV. RESEARCH METHODOLOGY

The present study has been completed with the help of secondary data only. The Secondary data is collected from various sources like annual report of HDFC Bank, websites, journals and some financial books.

Objectives of the Study: Central part of this study is to analyse the financial statement with various ratios. However, detailed objectives have been outlined as under:

- To examine the impact of Net Interest Margin (NIM) on the banks performance
- To evaluate extent of impact of tax burden and tax efficiency ratio on the net profit
- To examine the capital adequacy ratio
- To evaluate return on capital

V. DATA ANALYSIS
1. Interest Income and Interest Expenses:

<table>
<thead>
<tr>
<th>Year</th>
<th>Interest Earned (Rs. In Crore)</th>
<th>Interest Expanded (Rs. In Crore)</th>
<th>Deposits (Rs. In Crore)</th>
<th>Loan (Rs. In Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>4547.26</td>
<td>1929.50</td>
<td>55796.86</td>
<td>35061.26</td>
</tr>
<tr>
<td>2006-07</td>
<td>7055.35</td>
<td>3179.45</td>
<td>68297.94</td>
<td>46944.78</td>
</tr>
<tr>
<td>2007-08</td>
<td>10530.43</td>
<td>4887.12</td>
<td>100768.60</td>
<td>63426.90</td>
</tr>
<tr>
<td>2008-09</td>
<td>16584.01</td>
<td>8911.10</td>
<td>142811.58</td>
<td>98883.05</td>
</tr>
<tr>
<td>2009-10</td>
<td>16467.92</td>
<td>7786.30</td>
<td>167404.44</td>
<td>125830.59</td>
</tr>
<tr>
<td>2010-11</td>
<td>20380.77</td>
<td>9385.08</td>
<td>208586.41</td>
<td>159982.67</td>
</tr>
<tr>
<td>2011-12</td>
<td>27874.19</td>
<td>14989.58</td>
<td>246706.45</td>
<td>195420.03</td>
</tr>
<tr>
<td>2012-13</td>
<td>35064.87</td>
<td>19253.75</td>
<td>296246.98</td>
<td>239720.64</td>
</tr>
<tr>
<td>2013-14</td>
<td>41135.53</td>
<td>22652.90</td>
<td>367337.48</td>
<td>303000.27</td>
</tr>
<tr>
<td>2014-15</td>
<td>48469.91</td>
<td>26074.23</td>
<td>450795.65</td>
<td>375495.04</td>
</tr>
<tr>
<td>Mean</td>
<td>22811.02</td>
<td>19253.75</td>
<td>210475.24</td>
<td>164376.52</td>
</tr>
<tr>
<td>SD</td>
<td>14860.441</td>
<td>8412.8</td>
<td>375495.04</td>
<td>113981.468</td>
</tr>
<tr>
<td>Skewness</td>
<td>0.5353696</td>
<td>0.559214</td>
<td>0.630959</td>
<td>0.69240328</td>
</tr>
<tr>
<td>Coefficient of Variation</td>
<td>65.145876</td>
<td>70.66669</td>
<td>62.077187</td>
<td>69.3416952</td>
</tr>
</tbody>
</table>

From the above figure it is inferred that bank has paid average interest of Rs. 11904.90 and received 22811.02 this shows that banks earn more interest marginally. But interest expenses shows more variation than the interest income (i.e. coefficient of variation) and same is happen with loans, it is shows more variation than the deposits.

2. Net Interest Margin:

![NIM Graph]

The above figure shows that bank was not able to improvise its net interest margin ratio there is no improvement from 2014 to 2015. It is still 4.4 percent.

3. EPS and DPS Ratios:

<table>
<thead>
<tr>
<th>Year</th>
<th>EPS</th>
<th>DPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005-06</td>
<td>5.58</td>
<td>1.10</td>
</tr>
</tbody>
</table>

The above figure shows that bank’s EPS and DPS consistently increased since 2005-06 to 2014-15. But it is also seen that bank believe in higher retention of the profit.

4. Tax Burden Ratio:

The above figure shows that tax burden ratio of the bank has an fluctuating trend in last 10 years. But if we compare 2005-06 to 2014-15 it is reduce to 0.67 from 0.69.
5. Non Performing Assets (NPAs) Comparison:

From the above figure it is inferred that bank efficiently able to reduce its Net NPAs to Net Advances and Gross NPAs to Gross Advances in present Year.

6. Return on Average Net Worth:

The above figure shows that return on average net worth of the bank has an increasing nature.
Return on Capital Ratio:

The above figure shows that ROE increased from 2012 (i.e. 20.1) to present (i.e. 20.4) but declined from 2013 (i.e. 20.9) to present (i.e. 20.4).

Capital Adequacy Ratio:

The above graph shows that the CAR is constant 16.8% if we compare present year to 2012 but when we compare it with 2013 it is increase in present year.

VI. FINDINGS

1. Bank has had a dividend policy that balances the dual objectives of appropriately rewarding shareholders through dividends and retaining capital in order to maintain a healthy capital adequacy ratio to support future growth. It has had a consistent track record of moderate but steady increase in dividend declarations over its history with the dividend payout ratio ranging between 20% and 25%. Consistent with this policy and in recognition of the overall performance during this financial year, bank directors are pleased to recommend a dividend of Rs.8.00 per equity share of Rs.2 for the year ended March 31, 2015 as against Rs.6.85 per equity share of Rs.2 for the previous year ended March 31, 2014. This dividend shall be subject to tax on dividend to be paid by the Bank.

2. Bank’s total Capital Adequacy Ratio (CAR) calculated in line with Basel III capital regulations stood at 16.8%, well above the regulatory minimum of 9.0%. Of this, Tier I CAR was 13.7%.

3. As of March 31, 2015, Bank’s ratio of gross non-performing assets (NPAs) to gross advances was 0.9%. Net non-performing assets (gross non-performing assets loss specific loan loss provisions) were 0.2% of net advances as of March 31, 2015. Net interest income grew by 21.2% due to acceleration in loan growth of 20.6% coupled with a net interest margin (NIM) of 4.4% for the year ending March 31, 2015.
5. Bank’s profit before tax was Rs.15, 328.7 crore, an increase of 20.0% over the year ended March 31, 2014. After providing for income tax of Rs.5, 112.8 crore, the net profit for year ended March 31, 2015 was Rs.10, 215.9 crore, up 20.5%, over the year ended March 31, 2014. Return on average net worth was 20.4%

6. Bank’s profit before tax was Rs.15, 328.7 crore, an increase of 20.0% over the year ended March 31, 2014. After providing for income tax of Rs. 5,112.8 crore, the net profit for year ended March 31, 2015 was Rs.10, 215.9 crore, up 20.5%, over the year ended March 31, 2014. Return on average net worth was 20.4% while the basic earnings per share increased from Rs.35.5 to Rs.42.2 per equity share.

VII. CONCLUSION

The financial performance of Bank during the financial year ended March 31, 2015 remained healthy with total net revenues (net interest income plus other income) increasing by 18.9% to Rs.31, 392.0 crore from Rs.26, 402.3 crore in the previous financial year. Revenue growth was driven by an increase in both, net interest income and other income. Net interest income grew by 21.2% due to acceleration in loan growth of 20.6% coupled with a net interest margin (NIM) of 4.4% for the year ending March 31, 2015. Other income grew 13.6% over that in the previous year to Rs.8, 996.3 crore during the financial year ended March 31, 2015. The largest component of other income was fees and commissions, which increased by 14.8% to Rs.6, 584.2 crore with the primary drivers being commissions on deposit accounts, fees on retail assets and commission on distribution of mutual funds and insurance products. Foreign exchange and derivatives revenues were Rs.1,028.0 crore, gain on revaluation / sale of investments Rs.581.6 crore and recoveries from written-off accounts were Rs.716.3 crore in the financial year ended March 31, 2015. The bank is efficiently able to reduce tax burden as well as its NPAs level which helps bank to generate higher EPS in the present year. The Bank has a structured management framework in the Internal Capital Adequacy Assessment Process (ICAAP) for the identification and evaluation of the significance of all risks that the Bank faces.

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