

THE POWER OF ONE



Annual Report
2003-2004



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THE POWER OF

AWARDS FOR THE YEAR



Outlook Money-Best Bank
in the Private Sector 2003

Business Today-India's
Best Managed Company 2003

Business Today-India's
Best Bank 2003

economictimes.com and NASSCOM-
Best IT User in Banking 2003



Highlights

- ☒ Profit after tax up by 31.4% to Rs. 509.5 crores
- ☒ Earnings per share increases from Rs. 13.75 to Rs. 17.95
- ☒ Dividend per share increases from Rs. 3.00 to Rs. 3.50 (proposed)
- ☒ Branch Network up from 231 to 312 outlets
- ☒ ATM network up from 732 to 910
- ☒ PhoneBanking coverage in 99 cities
- ☒ Point-of-Sale (POS) Terminals at merchant outlets up from 21800 to 26400
- ☒ Geographic reach expanded from 122 cities to 163 cities
- ☒ Balance Sheet size up from Rs. 30,424 crores to Rs. 42,307 crores
- ☒ Savings deposits up from Rs. 4,663 crores to Rs.7,804 crores
- ☒ Retail assets up by 112.9% to 7,325 crores

financial highlights

Rs. in lacs

	1999-2000	2000-2001	2001-2002	2002-2003	2003-2004
Interest Income	679,87	1,259,46	1,702,99	2,013,61	2,548,93
Interest Expense	374,28	753,75	1,073,74	1,191,96	1,211,05
Net Interest Income	305,59	505,71	629,25	821,65	1,337,88
Other Income	119,54	176,57	335,90	465,55	480,03
Net Revenues	425,13	682,28	965,15	1,287,20	1,817,91
Operating costs	171,39	309,59	417,95	577,05	810,00
Operating Result	253,74	372,69	547,20	710,15	1,007,91
Provisions and Contingencies	58,89	57,63	121,82	139,30	288,95
Profit before tax	194,85	315,06	425,38	570,85	718,96
Provision for taxation	74,81	104,94	128,34	183,25	209,46
Profit after tax	120,04	210,12	297,04	387,60	509,50
Funds :					
Deposits	8,427,72	11,658,11	17,653,81	22,376,07	30,408,86
Subordinated debt	150,00	200,00	200,00	200,00	600,00
Stockholders' Equity	751,52	913,09	1,942,28	2,244,83	2,691,88
Working Funds	11,731,03	15,617,33	23,787,38	30,424,08	42,306,99
Loans	3,462,34	4,636,66	6,813,72	11,754,86	17,744,51
Investments	5,748,28	7,145,14	12,004,02	13,388,08	19,256,79
Key Ratios :					
Earnings per share (Rs.)	5.93	8.64	11.01	13.75	17.95
Return on Average Networkth	29.00%	24.53%	18.30%	18.10%	20.14%
Tier 1 Capital Ratio	9.56%	8.69%	10.81%	9.49%	8.03%
Total Capital Ratio	12.19%	11.09%	13.93%	11.12%	11.66%
Dividend per share (Rs.)	1.60	2.00	2.50	3.00	3.50**
Dividend payout ratio	29.96%	25.55%	23.68%	24.72%	22.15%
Book value per share as at March 31 (Rs.)	30.90	37.50	69.00	79.60	94.52
Market price per share as at March 31 (Rs.)*	257.20	228.35	236.60	234.55	378.75
Price to Earnings Ratio	43.37	26.43	21.50	17.06	21.10
Rs. 10 Lac = Rs. 1 Million	Rs. 1 Crore = Rs. 10 Million	**Proposed	*Source : NSE		

10TH ANNUAL GENERAL MEETING

Date : May 26, 2004
 Day : Wednesday
 Time : 3.30 p.m.
 Place : Birla Matushri Sabhagar,
 19, New Marine Lines,
 Mumbai 400 020
 Book Closure: May 8, 2004 to May 26, 2004
 Dates (both days inclusive)

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BOARD OF DIRECTORS

Mr. Jagdish Capoor, *Chairman*
Mr. Aditya Puri, *Managing Director*
Mr. Keki Mistry
Dr. (Mrs.) Amla Samanta
Mr. Anil Ahuja
Dr. Venkat Rao Gadwal
Mr. Vineet Jain
Mrs. Renu Karnad
Mr. Arvind Pande
Mr. Ranjan Kapur (w.e.f. January 9, 2004)
Mr. Bobby Parikh (w.e.f. January 9, 2004)

VICE PRESIDENT (LEGAL) & COMPANY SECRETARY

Mr. Sanjay Dongre

AUDITORS

M/s. P. C. Hansotia & Co.
Chartered Accountants

REGISTRARS & TRANSFER AGENTS**MCS LIMITED**

Sri Venkatesh Bhavan,
 Plot No. 27, Road No. 11,
 MIDC Area, Andheri (East),
 Mumbai 400 093.
 Tel. No. 2821 5235 / 6 / 7
 Fax No. 28350456
 E-mail : mcsvb@eth.net

REGISTERED OFFICE

HDFC Bank House,
 Senapati Bapat Marg,
 Lower Parel,
 Mumbai 400 013.
 Tel. No. 5652 1000
 Fax No. 2496 0739
 Web-site : www.hdfcbank.com

Directors' Report

To the Members,

Your Directors have great pleasure in presenting the Tenth Annual Report on the business and operations of your Bank together with the audited accounts for the year ended March 31, 2004.

FINANCIAL PERFORMANCE

	(Rs. in crores) For the year ended	
	March 31, 2004	March 31, 2003
Deposits and other borrowings	32717	24461
Advances	17744	11755
Total income	3029.0	2479.2
Profit before depreciation and tax	844.7	677.0
Net profit	509.5	387.6
Profit brought forward	356.1	190.4
Transfer from debenture redemption reserve	-	9.7
Total profit available for appropriation	865.6	587.7
Appropriations :		
Transfer to statutory reserve	127.4	96.9
Transfer to general reserve	51.0	38.8
Transfer to investment fluctuation reserve	169.1	-
Proposed dividend	100.0	84.9
Tax on dividend	12.8	10.9
Dividend paid	-	0.1
Balance carried over to Balance Sheet	405.3	356.1

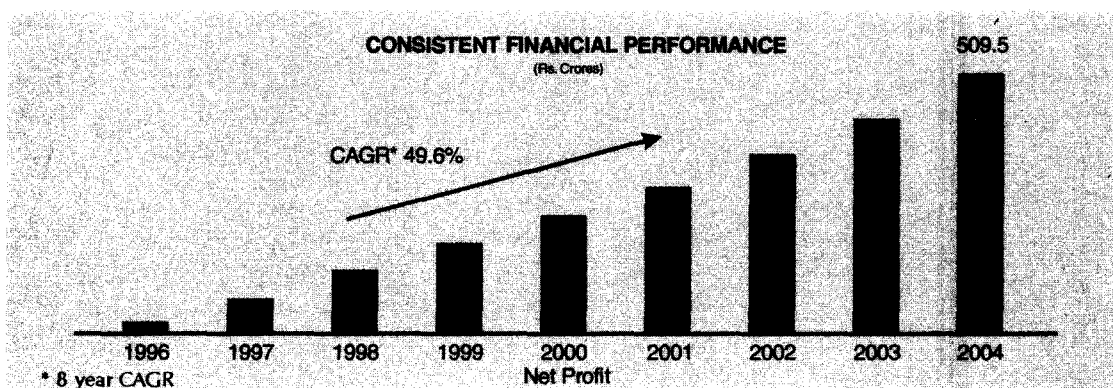
The Bank posted total income and net profit of Rs. 3029.0 crores and Rs. 509.5 crores respectively for the financial year 2003-04 as against Rs. 2479.2 crores and Rs. 387.6 crores respectively in the previous year. Appropriations from the net profit have been effected as per the table given above.

DIVIDEND :

Keeping in mind the need to balance the twin objectives of appropriately rewarding shareholders with cash dividends, of retaining capital to meet the Bank's investment needs and to maintain a healthy capital adequacy ratio to support future growth, your Directors are pleased to recommend a dividend of 35% for the year ended March 31, 2004, as against 30% for the year ended March 31, 2003. The dividend for financial year 2003-04 shall be subject to tax on dividend to be paid by the Bank but will be tax-free in the hands of the members. In line with regulatory requirements, the dividend declared is subject to approval by the Reserve Bank of India (RBI).

AWARDS :

Your Bank continued to receive awards and gain recognition from various leading domestic and international publications during 2003-04. It was selected as "Best Local Bank in India - 2003" by



Directors' Report – (Contd.)

Finance Asia and "Best Domestic Bank in India Region" in The Asset Triple A Country Awards 2003. The Bank was also rated as the "Best Bank in India" in 2003 by Business Today, "Best Bank in the Private Sector" for the year 2003 in the Outlook Money Awards and "Best New Private Sector Bank 2003" by the Financial Express in the FE-Ernst & Young Best Bank's survey 2003. It was also named in the list of "Best Under a Billion, 200 Best Small Companies for 2003" by Forbes Global. For its use of information technology, the Bank was awarded the "Best IT User in Banking" award at the IT User Awards 2003 conferred by Economicstimes.com & Nasscom.

ADDITIONAL CAPITAL :

During the year under review 27.5 lac shares were allotted to the employees of the Bank pursuant to the exercise of options under the Employees Stock Option Scheme of the Bank.

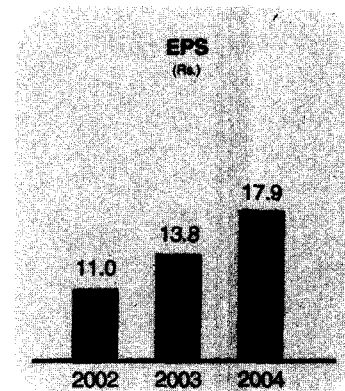
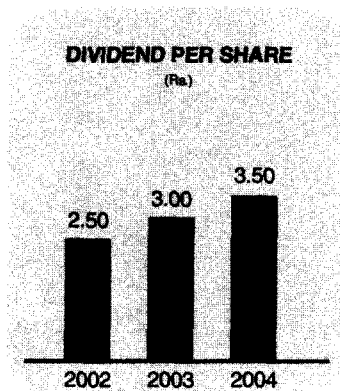
In February 2004, the Bank issued Unsecured Redeemable Non-Convertible Subordinated Bonds of Rs.250 crores with an option to retain oversubscription of Rs.150 crores to augment the Tier-II Capital for strengthening Capital Adequacy and enhancing long term resources of the Bank. The issue was oversubscribed and the Bank raised subordinated debt of Rs.395 crores with maturity of

10 years 3 months at an interest rate of 5.9% p.a. and Rs.5 crores with maturity of 13 year 3 months at rate of 6% p.a.

Employee Stock Options :

During the year, the Bank granted 68 lac options under ESOS 4, 24 lac options under ESOS 5 and 17 lac options under ESOS 6 (aggregating to 110 lac options) at price of Rs.358.60, Rs.366.30 and Rs.362.90 per option respectively. The prices for the options under ESOS 4 & 6 are based on the market price of the shares of the Bank on the immediately preceding business day (of National Stock Exchange of India Limited) on the date of grant of option. These options are governed by the shareholders' resolution passed at the 9th Annual General Meeting of the Bank held on June 2, 2003. The price for the options under ESOS 5 is based on the average daily closing price of the shares of the Bank quoted on The Stock Exchange, Mumbai for a period of sixty days preceding the date of grant of option. These options are governed by the shareholders' resolution passed at the Extra-ordinary General Meeting of the Bank held on January 1, 2000. The options would vest over a period of 3 years on the expiry of minimum period of one year from the date of grant.

The Securities Exchange Board of India (SEBI) has prescribed two methods to account for stock grants; (i) the intrinsic value method (ii) the fair value method.



Directors' Report – (Contd.)

The Bank has adopted the intrinsic value method to account for the stock grants during the year.

The Bank has also calculated the fair value using internally developed and tested model with the following assumptions: the risk free interest rate will remain between 4.4% to 4.5%, expected volatility will be in the range of 45% and dividend will be around Rs.4.0 per share during tenor of the ESOSs. The market price on the date of grant ranged from Rs.357 to Rs.362.9. Had the fair value method been used, the stock option compensation expense would have been higher by Rs.18.4 crores. Consequently the profit after tax would have been lower by Rs.11.8 crores and the basic and diluted earnings per share would have been lower by Rs.0.65 and by Rs.0.58 respectively.

Out of the options granted under the Employees Stock Option Scheme in January, 2001 (ESOS 2) and February, 2002 (ESOS 3), 14.6 lac and 4.2 lac options, respectively, have been vested in the employees.

During the year under review, 27.5 lac options were exercised and allotted by the Bank resulting in an increase in the paid-up capital of Rs.275 lac and share premium by Rs.4768 lac. The allotment of 10.5 lac shares in respect of options exercised in the quarter ended March 2004 has been made on April 5, 2004. The new shares issued under ESOS would rank pari-passu with the existing shares in all respects.

During the year 5.3 lac options lapsed on account of staff resignations.

After considering the exercised and lapsed options, 143.2 lac options are still outstanding as at March 31, 2004. The earning per share (EPS) for the year under review after considering all options outstanding under ESOS, works out to Rs.16.55.

Shares issued to senior managerial personnel :

The Bank has not granted options aggregating to 5% or more of the options granted or issued shares more than 1% of the outstanding share capital to any employee during the fiscal year ended March 31, 2004.

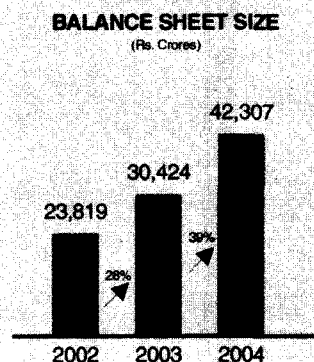
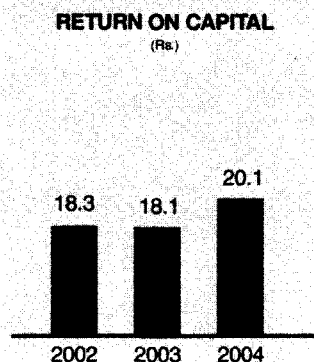
Capital Adequacy Ratio:

The Bank's total capital adequacy ratio (CAR) stood at a healthy 11.66%, well above the regulatory minimum of 9%. Of this, Tier 1 CAR was 8.03%.

MANAGEMENT'S DISCUSSIONS AND ANALYSIS:

Macro-economic and Industry Developments:

The advance estimates of GDP growth for the year 2003-04 is 8.1% over the previous year. This places



Directors' Report – (Contd.)

India firmly amongst the fastest growing economies in the world during the current year. The buoyancy has been spread across most sectors of the economy and is not confined merely to agriculture. Whilst the agriculture sector is estimated to grow at 9.1% this year, manufacturing sector and service sector is likely to grow at 6.5% and 8.4% respectively. The buoyancy in the industrial sector can be linked to a pick-up in demand that has been facilitated by a rebound in agriculture, a sharp pick-up in exports and the wealth effect emanating from a vibrant stock market. A noteworthy development in this fiscal has been the pick-up in the machinery and equipment segment of manufacturing. This signals a pick-up in investment activity which has been languishing for quite some time.

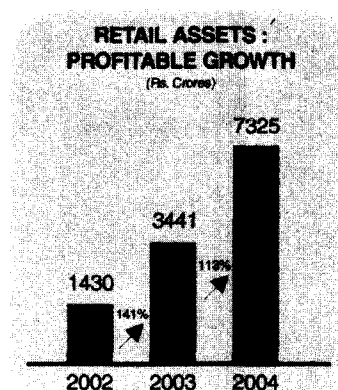
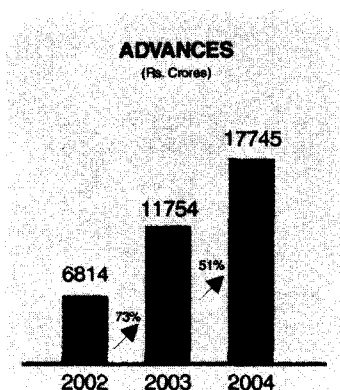
The inflationary situation has been benign in 2003-04. The inflation rate for all commodities has steeply declined whilst the manufactured product inflation continues to rise, the key contributor to the latter being steel prices. With expectation of excise cuts, the year-on-year estimate of inflation in March is expected to be between 4.5 and 5.0 per cent.

On the commercial credit front, there have been some signs of pick-up in credit off-take in recent months. The growth has been in non-food credit whilst food credit witnessed a fall of around 30%. The growth in non-food credit is principally because of surge in retail lending, particularly in housing. However, credit to industry declined despite the industrial recovery probably due to large internal accruals and

increasing disintermediation. The growth in non-food credit has not led to a rise in interest rates due to matching growth in bank deposits that has kept liquidity easy. Bank deposits have grown over 15% this fiscal.

The financial markets continue to remain generally stable. The average call money rate moved down by a little over 20 basis points. The yield on treasury bills of different maturities has declined, while the yield on Government securities with 10-year residual maturity has marginally firmed up. In fact, a slight steepening of the yield curve is noticeable with shifts in yield at the very long-end. By and large, the behaviour of the fixed income market has been in consonance with the monetary policy stance.

The uncertainties relating to the currency movements of major currencies have increased. Continuing forex inflows both on the current and capital account has seen upward pressure on the rupee. The RBI has kept a constant check on the appreciating rupee and continuously intervened by way of regular dollar purchases. Notwithstanding the appreciation of the rupee against the US dollar, exports still grew over 8 per cent over the last fiscal. This was achieved because while the rupee appreciated against the US dollar, it depreciated against its competitor currencies, especially with that of Asian and Latin American countries, giving India the relative advantage in merchandise exports.



Directors' Report – (Contd.)

Imports too have accelerated this year on the back of revival of domestic economy. Oil imports in US dollar terms are higher by 12.4 per cent. Non-oil imports have increased at a high rate of 26.5 per cent. The trade deficit in the current financial year so far has widened, in fact is double of last year. The current account, however, remains in surplus on account of robust invisible earnings.

All in all the Indian economy has demonstrated considerable resilience to exogenous shocks in the last fiscal and is poised for growth.

(Source: statistics from CSO, Reserve Bank of India and CRISINFAC)

Mission and Business Strategy:

Our mission is to be “a world class Indian Bank” which is benchmarked against international standards and best practices in terms of product offerings, technology, service levels, risk management and audit & compliance. The objective is to build sound customer franchises across distinct businesses so as to be a preferred provider of banking services for target retail and wholesale customer segments and to achieve a healthy growth in profitability, consistent with the Bank's risk appetite. We are committed to do this while ensuring the highest levels of ethical standards, professional integrity and regulatory compliance.

Our business strategy emphasizes the following:

- Increase our market share in India's expanding banking and financial services industry by following a disciplined growth strategy and delivering high quality customer service;
- Leverage our technology platform and open, scalable systems to deliver more products to more customers and to control operating costs;
- Maintain our current high standards for asset quality through disciplined credit risk management;
- Develop innovative products and services that attract our targeted customers and address inefficiencies in the Indian financial sector;
- Continue to develop products and services that reduce our cost of funds; and
- Focus on healthy earnings growth with low volatility.

Financial Performance:

The overall performance during the financial year 2003-04 remained healthy with total net revenues (net interest income plus other income) increasing by 41.2% to Rs.1817.9 crores from Rs.1287.2 crores in 2002-03. The revenue growth was driven principally by an increase of 62.8% in net interest income. The

