

IDFC

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,311	IDFC IN
	REUTERS CODE
S&P CNX: 3,634	IDFC.BO

3 May 2006
Buy
Previous Recommendation: Buy
Rs72

		YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
Equity Shares (m)	1,120.0	3/06A	5,148	3,756	3.4	10.3	21.5	3.2	25.6	16.9	3.6	3.2
52-Week Range	78/50	3/07E	6,298	4,227	3.8	12.6	19.1	2.8	21.5	15.7	3.0	2.9
1,6,12 Rel.Perf.(%)	0/-44/-	3/08E	7,646	4,900	4.4	15.9	16.5	2.5	18.0	16.3	2.6	2.6
M.Cap. (Rs b)	80.7											
M.Cap. (US\$ b)	1.8											

IDFC has posted a 25% decline in earnings YoY to Rs736m in 4QFY06, as margin pressure resulted in slowing down net interest income (NII) growth. Business momentum has remained robust with approvals up 66% and disbursements up 62% in FY06. IDFC continues to maintain its asset quality, with nil net NPLs.

- ✍ NII growth slows on the back of margins pressure
- ✍ Maintains strong growth in disbursals
- ✍ Treasury profits decline
- ✍ Declining margins lead to RoA declining to 2.8% in 4QFY06

The current performance demonstrates strong loan growth and we expect the trend to continue in future. However, we expect IDFC to continue to face margin pressure, as competitive pressure from banks increase. IDFC currently trades at 2.5x FY08E BV. We maintain our **Buy** recommendation on our target price of Rs84 (valuing IDFC at 3x FY08E BV).

Y/E MARCH	QUARTERLY PERFORMANCE										(RS MILLION)	
	FY05				FY06				FY05	FY06*		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Operating Income	1,386	1,581	1,725	2,494	2,562	2,577	2,446	2,553	7,186	10,138		
Other Income	0	25	50	15	1	0	3	14	90	19		
Total income	1,386	1,606	1,775	2,510	2,564	2,577	2,449	2,567	7,276	10,157		
Y-o-Y Growth (%)					85.0	60.5	37.9	2.3	28.7	39.6		
Interest expenses	665	722	792	940	1,117	1,163	1,314	1,415	3,119	5,008		
Net Income	720	884	983	1,570	1,447	1,415	1,135	1,152	4,157	5,149		
Operating Expenses	143	36	87	626	273	260	97	293	891	922		
Operating Profit	578	849	896	944	1,175	1,155	1,039	859	3,266	4,227		
Y-o-Y Growth (%)					103.4	36.0	15.9	-8.9	-52.4	29.4		
Depreciation	9	9	9	9	8	8	9	10	36	34		
Profit before Tax	568	839	887	935	1,167	1,147	1,030	850	3,230	4,193		
Tax Provisions	60	91	84	-46	84	103	136	114	190	437		
Net Profit	508	748	803	981	1,083	1,044	894	736	3,040	3,756		
Y-o-Y Growth (%)					113.0	39.5	11.4	-25.0	9.2	23.6		
Int Exp/ Int Earned (%)	48.0	45.6	45.9	37.7	43.6	45.1	53.7	55.4	43.4	49.4		
Other Income / Net Income (%)	0.0	2.8	5.1	1.0	0.1	0.0	0.3	1.2	2.2	0.4		
Cost to Income Ratio (%)	19.8	4.0	8.9	39.9	18.8	18.4	8.5	25.4	21.4	17.9		

E: M0St Estimates * Quaterly nos and full year nos will not tally due to different way of reporting financial nos

IDFC has posted a 25% decline in earnings YoY to Rs736m in 4QFY06, as margin pressure resulted in net interest income (NII) growth slowing down. Business momentum has remained robust with approvals up by 66% and disbursements up by 62% in FY06. IDFC continues to maintain its asset quality, with zero net NPLs.

NII growth slows on back of margin pressure

NII has increased by 7% YoY to Rs750m in 4QFY06, as margins were under pressure. However, for FY06 as a whole, NII has grown by 15% to Rs2.94b despite yield on assets declining by 50bp to 8.9% in FY06.

Infrastructure NIIs' share in total income has also come down to 55% in FY06 from 60% in FY05. However, share of infrastructure NII to total income in 4QFY06 compared with 4QFY05 has gone up by 16% to 59%.

Overall, spreads have come down by 70bp to 1.7% in FY06, as borrowing cost moved up to 6.7% from 6.5% in FY05 and yield on assets came down to 8.4% from 8.9% in FY05.

Maintains strong growth in disbursements

Gross disbursements have increased 62% during FY06 to Rs60.5b. Loan book has expanded by 44% to Rs102b. Gross approvals have also increased 66% to Rs106b, indicating a strong pipeline over the next few quarters.

Treasury profits decline

IDFC has booked equity gains out of its proprietary equity book to the tune of Rs160m during the quarter compared with Rs780m witnessed during 4QFY05. Compared with previous quarters, treasury gains have slowed. We believe that any concern on these gains is unwarranted as IDFC continues to have substantial treasury gains on its books. As of March 2006, IDFC had unrealized gains valued at Rs2.8b on its books.

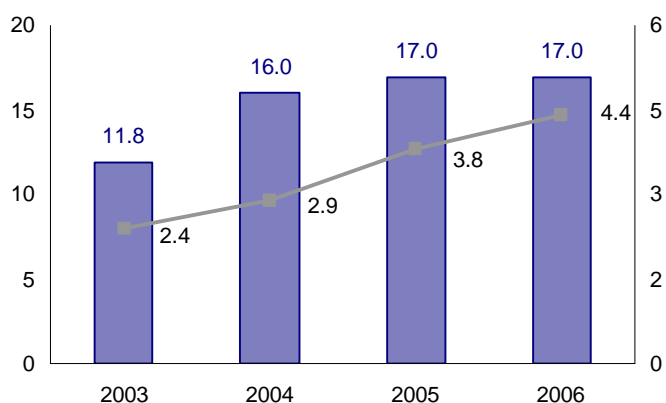
Declining margins lead to RoA decline to 2.8% during 4QFY06

In line with expectation, RoA has declined during the quarter as well as during the year on the back of its increasing leverage and absence of high treasury gains. IDFC has been able to deliver RoA of 2.8% during the quarter (3.8% during FY06 from 4.5% in FY05). As leverage has increased to 4.4x from 3.8x, RoE has been maintained at 17%.

Going forward, we expect RoA to decline on the back of lower margins (as IDFC increases leverage) coupled with lower contribution from treasury. However RoE will tend to increase as IDFC improves its leverage.

The current capital adequacy ratio (CAR) for IDFC is 25.6%, of which Tier 1 is 19.2%, indicating that it can support strong 35%-40% growth in loans over the next couple of years. Further, management has indicated that with leverage at only 4.4x, it can go up to 7x before requiring another tranche of capital.

TREND IN INCREASING LEVERAGE AND IMPROVING ROE (%)



Source: Company/Motilal Oswal Securities

PAT growth at 24% in FY06

On the back of steady growth in NII and strong treasury profits, IDFC has posted PAT growth of 24% for FY06 at

Rs3.76b. Net NPAs continued to be nil, with gross NPAs at 0.5%. However for 4QFY06, PAT declined by 25% on back of lower NII growth and sharply reduced treasury gains.

Tax rate to move up significantly ahead

Owing to its current status as an infrastructure financier, IDFC has been receiving certain tax benefits. However, recently the government made certain amendments to the section 10(23)G, wherein income from infrastructure lending and investments were exempt from tax. Going forward, we can see IDFC's effective tax rate going up. Further, a higher proportion of fee-based income (which are charged at marginal tax rates) will also result in higher tax rates. We expect tax rates on IDFC to move up over the next couple of years. We have assumed tax rates to increase to 17% in FY07 and 20% in FY08.

Subsidiaries could drive future non-interest income

IDFC has been diversifying its income streams for some time now, with more thrust on fee based income. With its subsidiaries (IDFC AMC and IDFC Private Equity) growing bigger, we expect fee-based income to be a larger chunk of the total income pie.

IDFC Private Equity has commitments up to US\$650m from various global investors to invest in infrastructure projects in India over a period of time. IDFC would be earning 2% management fee and also 20% share in profits over the hurdle rate set by IDFC and investors. We expect that going forward this business could contribute significantly to the company's non-interest income.

Recently IDFC has also acquired a 33.3% stake in S.S. Kantilal Ishwarlal Securities Pvt. Ltd. (SSKI), a privately held leading domestic corporate finance and institutional securities company. IDFC and SSKI propose to work together by pooling their relationships and expertise to provide investment banking and capital market solutions to clients. This could also add to IDFC's vision of growing its non-interest income share in total income.

We maintain Buy

The current performance demonstrates strong loan growth and we expect the trend to continue in future. However, we expect IDFC to continue to face margin pressure, as competitive pressure from banks increase. IDFC currently trades at 2.5x FY08E BV. We maintain our **Buy** recommendation on our target price of Rs84 (valuing IDFC at 3x FY08E BV).

IDFC: an investment profile

Company description

IDFC was established in 1997 as a specialized financial intermediary to catalyze private sector investments to commercially viable infrastructure projects. Apart from infrastructure funding, IDFC works closely with the GoI and other state governments on conceptualizing and formulating policies that inculcate a conducive environment for private sector participation in the infrastructure sector. IDFC's main focus areas are power, roads, ports and telecom. Since the time IDFC began operations in 1997, it has rapidly grown on all business parameters. While its total assets, total income and profit after tax have recorded a CAGR of 33%, 21% and 22% respectively, its total infrastructure loans have grown at an impressive CAGR of 54% from the year FY01 to FY06.

Key investment arguments

- ✍ Explosive infrastructure growth will enable robust loan book expansion and fee income growth
- ✍ The company has a sterling pedigree in quality lending, and hence is able to maintain a zero Net NPA status
- ✍ Enjoys the highest RoA in the sector; high CAR gives enough room to grow loan book and boost RoE
- ✍ Is one of the few US\$1b stocks in the financial sector available to the FIIs

Key investment risks

- ✍ Is dependent on government policies
- ✍ Rising interest rates may pressurize margins
- ✍ Has an unseasoned loan book
- ✍ Faces competitive pressures from the banks

Recent developments

- ✍ IDFC Board approved acquisition of a 33.33% equity interest in S.S. Kantilal Ishwarlal Securities Pvt. Ltd. (SSKI), a privately held leading domestic corporate finance and institutional securities.

Valuation and view

- ✍ With the growth in infrastructure development activities, the loan book is expected to expand by 35% in FY07 and FY08. The borrowings will also grow at 40% FY07 and FY08 respectively.
- ✍ IDFC rules firm on all other business parameters as well. It enjoys the highest CAR and RoA and the lowest cost/ income ratio in the sector. Superior asset quality negates the need of excessive provisions and IDFC also enjoys tax breaks on infrastructure lending
- ✍ PAT is expected to grow by 13% in FY07 and 16% in FY08. The stock trades at P/BV of 2.5x FY08E. We recommend **Buy** with the price target of Rs84.

COMPARATIVE VALUATIONS

		IDFC	HDFC	HDFC BANK
P/E (x)	FY07E	19.1	21.3	23.7
	FY08E	16.5	17.6	18.1
P/ABV (x)	FY07E	2.9	6.0	4.4
	FY08E	2.6	4.9	3.6
RoE (%)	FY07E	15.7	30.7	19.7
	FY08E	16.3	30.4	21.6
RoA (%)	FY07E	3.0	2.6	1.4
	FY08E	2.6	2.6	1.4

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	23.3	23.3	34.9
Domestic Institutions	19.4	19.3	24.9
FIIs/FDIs	44.7	42.9	39.9
Others	12.6	14.5	0.2

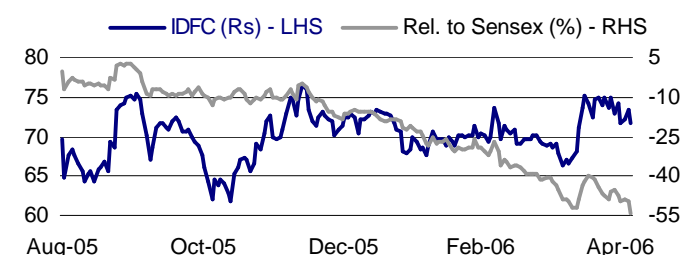
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	3.8	4.1	-7.5
FY08	4.4	4.8	-8.5

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
72	84	16.7	Buy

STOCK PERFORMANCE (FROM 12 AUGUST 2005)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Interest Income	4,195	5,481	8,098	11,594	15,763
Interest Expended	2,260	3,119	5,008	7,623	10,739
Net Interest Income	1,935	2,362	3,090	3,971	5,024
Change (%)	18.5	22.1	30.8	28.5	26.5
Other Income	2,176	1,795	2,058	2,327	2,621
Net Income	4,111	4,157	5,148	6,298	7,646
Change (%)	51.2	1.1	23.8	22.3	21.4
Operating Expenses	308	280	440	555	670
Operating Income	3,803	3,878	4,707	5,743	6,975
Change (%)	68.8	2.0	21.4	22.0	21.5
Other Provisions	1,084	648	515	650	850
PBT	2,719	3,230	4,192	5,093	6,125
Tax	128	190	437	866	1,225
Tax Rate (%)	4.7	5.9	10.4	17.0	20.0
PAT	2,591	3,040	3,756	4,227	4,900
Change (%)	44.0	17.3	23.5	12.6	15.9
Proposed Dividend	1,128	1,143	1,232	1,400	1,568

BALANCE SHEET (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Capital	10,000	10,000	11,200	11,200	11,200
Reserves & Surplus	6,991	8,889	14,287	17,115	20,447
Net Worth	16,991	18,889	25,487	28,315	31,647
Borrowings	33,250	58,951	87,170	122,038	170,853
Change (%)	118.0	77.3	47.9	40.0	40.0
Sub-ordinated Debt	6,500	6,500	6,500	6,500	6,500
Other Liabilities & Prov.	2,519	2,975	3,383	4,228	5,286
Total Liabilities	59,260	87,315	122,540	161,081	214,286
Cash and bank balance	43	4,270	3,415	4,403	7,287
Investments	11,640	7,688	12,950	14,893	17,126
Change (%)	27.2	-34.0	68.4	15.0	15.0
Advances	44,189	70,504	101,830	137,471	185,585
Change (%)	66.2	59.6	44.4	35.0	35.0
Net Fixed Assets	551	505	505	534	546
Deferred Tax Assets	532	662	790	711	640
Other Assets	2,306	3,687	3,040	3,070	3,101
Total Assets	59,260	87,315	122,540	161,081	214,286

ASSUMPTIONS (%)

Borrowings Growth	118.0	77.3	47.9	40.0	40.0
Advances Growth	66.2	59.6	44.4	35.0	35.0
Investments Growth	27.2	-34.0	68.4	15.0	15.0
Dividend	10.0	10.0	11.0	12.5	14.0

E: Most Estimates

RATIOS

Y/E MARCH	2004	2005	2006	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Asset:	8.8	7.7	8.0	8.4	8.6
Avg. Cost-Int. Bear. Liab.	7.3	5.9	6.3	6.9	7.0
Interest Spread	15	18	17	16	16
Net Interest Margin	4.1	3.3	3.0	2.9	2.7

Profitability Ratios (%)

RoE	15.9	16.9	16.9	15.7	16.3
RoA	5.2	4.1	3.6	3.0	2.6
Int. Expended/Int. Earned	53.9	56.9	61.8	65.8	68.1
Other Inc./Net Income	52.9	43.2	40.0	36.9	34.3

Efficiency Ratios (%)

Op. Exps./Net Income	7.5	6.7	8.6	8.8	8.8
Empl. Cost/Op. Exps.	43.5	52.7	59.6	62.5	63.5
Busi. per Empl. (Rs m)	473.4	994.6	1,273.8	1,661.1	2,080.9
NP per Empl. (Rs m)	20.6	29.2	30.0	31.3	33.1

Asset-Liability Profile (%)

Adv./Deposit Ratio	132.9	119.6	116.8	112.6	108.6
Invest./Deposit Ratio	35.0	13.0	14.9	12.2	10.0
Gross NPAs to Adv.	0.6	0.7	0.5	1.1	1.2
Net NPAs to Adv.	0.0	0.0	0.0	0.0	0.0
CAR	37.0	28.6	25.6	21.5	18.0
Tier 1	25.6	20.1	19.2	15.0	12.0

VALUATION

Book Value (Rs)	17.0	18.9	22.8	25.3	28.3
Price-BV (x)	4.2	3.8	3.2	2.8	2.5
Adjusted BV (Rs)	17.0	18.9	22.8	25.3	28.2
Price-ABV (x)	4.2	3.8	3.2	2.9	2.6
EPS (Rs)	2.6	3.0	3.4	3.8	4.4
EPS Growth (%)	44.0	17.3	10.3	12.6	15.9
Price-Earnings (x)	27.8	23.7	21.5	19.1	16.5
OPS (Rs)	3.8	3.9	4.2	5.1	6.2
OPS Growth (%)	68.8	2.0	8.4	22.0	21.5
Price-OP (x)	18.9	18.6	17.1	14.1	11.6

E: Most Estimates



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Disclosure of Interest Statement

	IDFC
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	Yes
3. Broking relationship with company covered	No

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