

1 March 2011 (No. of pages: 12)

6-mth rating: **1**

Target price: Rs215.00 → Rs190.00

Share price: Rs145.20 (28 Feb)

Infrastructure Development Finance (IDFC IN)

Diversified financials: India

Sound business model at attractive valuations

Market concerns appear to be overplayed

- Recent concerns in the market about an expected slowdown in the number of new infrastructure projects, likely pressure on NIMs and unfavourable macro conditions have taken their toll on Infrastructure Development Finance's (IDFC) valuations. The share price has fallen by 32% from its peak (November 2010). As such, its lending business is now valued at a PBR of 1.5x and a PER of 11x on our FY12 forecasts, which we see as attractive.

Low leverage ratio an advantage in current environment

- We believe IDFC's low leverage ratio of less than 5x currently is an advantage amid the rising interest-rate scenario, and should support the company's current NIM, as more than 20% of the company's loans are funded by capital. We forecast the ROE for the company's core lending business to improve to 15.5% for FY12 and 17.3% for FY13, from a low of 14% for FY11.

Earnings growth likely to remain high for FY12-13

- We forecast an FY12-13 consolidated net-profit CAGR of 23%, and an EPS CAGR of 30% for the lending business. We have lowered our SOTP-based six-month target price to Rs190 (from Rs215) for which we assign Rs43/share for the value of IDFC's investments and Rs147/share for the value of its core lending business. We would see continued high interest rates as the key risk to our loan-growth assumption.

Reuters code IDFC.NS

Market data

SENSEX Index		17,823.40
Market cap	(US\$bn)	4.69
3-mth avg daily T/O	(US\$m)	28.31
Shares outstanding	(m)	1,461
Free float	(%)	70.0
Major shareholder	Government of India (17.9%)	
Exchange rate	Rs/US\$	45.271

Performance (%)*	1M	3M	6M
Absolute	(2.1)	(19.4)	(20.0)
Relative	1.0	(12.5)	(19.1)

Source: Daiwa

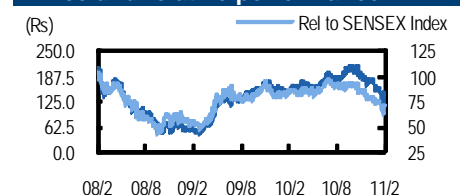
Note: *Relative to SENSEX Index

Investment indicators

		2011E	2012E	2013E
PER	(x)	15.5	13.5	10.8
PBR	(x)	2.0	1.8	1.6
Dividend yield	(%)	1.2	1.4	1.4
ROE	(%)	14.7	14.0	15.7
ROA	(%)	3.1	2.9	2.9

Source: Daiwa forecasts

Price and relative performance



Source: Bloomberg, Daiwa

Income summary

Year to 31 Mar	Operating profit		Pre-tax profit		Net profit		EPS		DPS (Rs)
	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	
2009	10,360	3.6	10,360	3.6	7,499	1.1	5.792	(5.5)	1.200
2010	14,284	37.9	14,284	37.9	10,620	41.6	8.183	41.3	1.500
2011E	17,128	19.9	17,128	19.9	12,955	22.0	9.383	14.7	1.800
2012E	20,979	22.5	20,979	22.5	15,764	21.7	10.792	15.0	2.000
2013E	26,275	25.2	26,275	25.2	19,683	24.9	13.475	24.9	2.000

Source: Company, Daiwa forecasts

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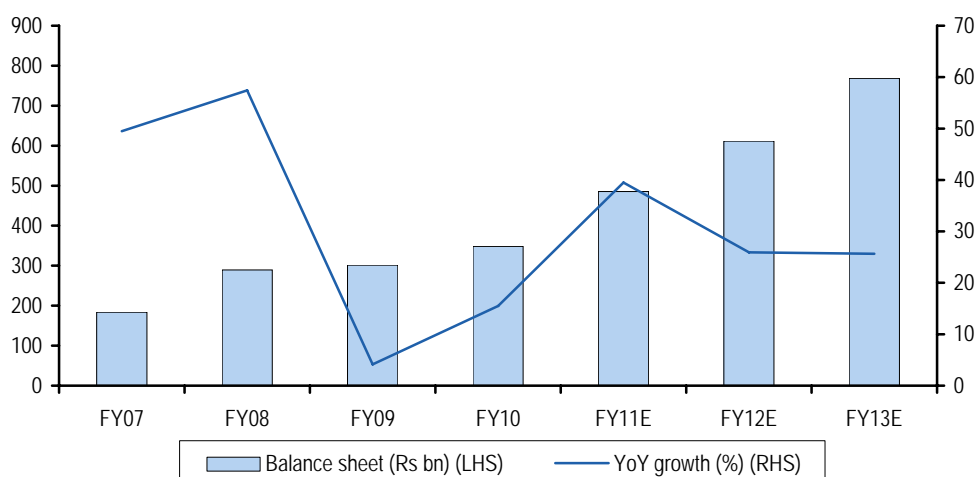
IMPORTANT DISCLOSURES, INCLUDING ANY REQUIRED RESEARCH CERTIFICATIONS, ARE PROVIDED ON THE LAST TWO PAGES OF THIS REPORT.

Global Equity Research

The three most important charts in this report ...

We forecast a balance-sheet CAGR of 30% for FY10-13

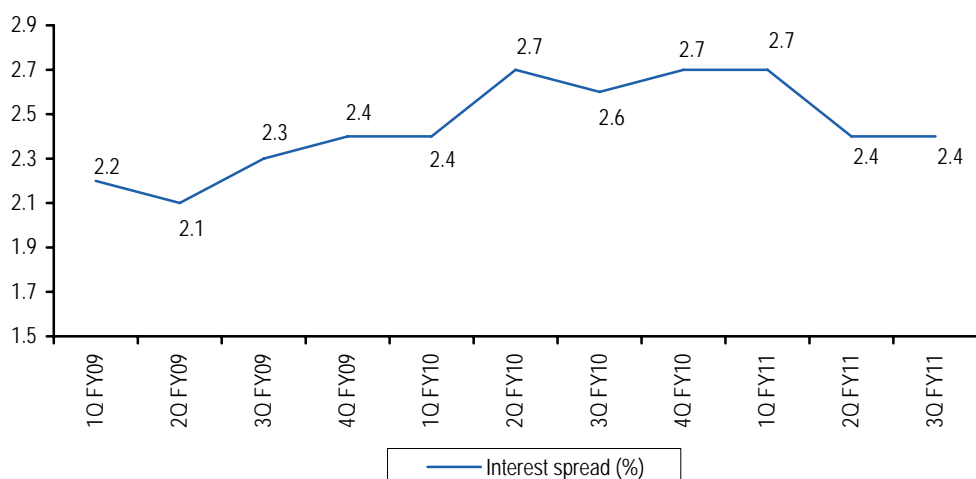
IDFC: balance sheet



Source: Company, Daiwa forecasts

We expect pressure on the interest spread to be marginal over the next two quarters

IDFC: interest spread (%)



Source: Company

IDFC: P&L for the lending business (reconstructed) (Rs m)

	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Interest earned	12,823	21,595	29,814	30,665	42,976	58,423	75,142
Interest expenses	8,555	14,802	20,795	19,502	26,957	37,287	47,664
NII	4,269	6,792	9,018	11,162	16,018	21,135	27,478
Fee income	904	1,600	1,573	2,080	2,289	2,647	3,016
Net income	5,173	8,392	10,592	13,242	18,307	23,782	30,495
Operating expenses	614	1,133	1,288	1,994	2,241	2,712	3,282
Operating income	4,559	7,259	9,304	11,248	16,066	21,070	27,212
Provisions	499	574	564	1,026	1,700	2,000	3,000
PBT	4,061	6,685	8,740	10,222	14,366	19,070	24,212
Tax	772	1,471	2,185	2,556	3,592	4,768	6,053
Net profit	3,289	5,214	6,555	7,667	10,775	14,303	18,159
Reported net worth	28,820	54,544	60,292	68,229	111,845	123,265	137,704
Leveraged net worth	22,488	41,517	37,304	43,815	86,943	97,864	111,796
Core ROE (%)	15.2	16.3	16.6	18.9	14.1	15.5	17.3
Leverage ratio (x)	3.7	6.2	6.3	6.7	5.3	5.2	6.0
Leveraged book value (Rs)	20	32	29	34	60	67	77
Core EPS (Rs)	2.9	4.0	5.1	5.9	7.38	9.8	12.4

Source: Company, Daiwa forecasts

Note: leverage ratio = average assets divided by average net worth

Company background

Infrastructure Development Finance (IDFC) is a leader in providing financing for long-term infrastructure projects, and also has interests in private-equity funds, asset management, and equity broking. The company was incorporated in Chennai by a consortium of public and private investors, and was listed in August 2005. It had a balance sheet of Rs480bn (US\$10.4bn) as at the end of Dec 2010.

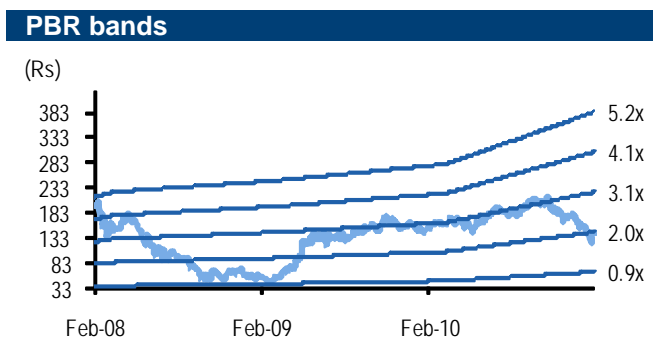
Infrastructure Development Finance – financial summary

Profit and loss (Rs m)						Balance sheet (Rs m)					
Year to 31 Mar	2009	2010	2011E	2012E	2013E	As at 31 Mar	2009	2010	2011E	2012E	2013E
Net-interest income	9,225	11,164	16,018	21,135	27,478	Cash & equivalent	8,255	2,715	3,665	4,398	5,277
Net fees & commission	1,110	1,440	2,160	2,376	2,614	Investment securities	64,999	46,417	62,341	66,775	71,652
Trading and other income	5,222	8,460	7,171	7,274	8,167	Net loans and advances	205,962	250,311	375,466	499,370	664,162
Net insurance income	0	0	0	0	0	Fixed assets	4,543	4,415	4,857	5,342	5,876
Total operating income	15,557	21,064	25,349	30,785	38,259	Goodwill	10,789	11,694	11,694	11,694	11,694
Personnel expenses	(1,773)	(3,072)	(3,380)	(4,056)	(4,867)	Other assets	6,820	32,533	27,516	23,890	9,627
Other expenses	(1,893)	(2,410)	(2,791)	(3,301)	(3,668)	Total assets	301,367	348,086	485,538	611,469	768,289
Total expenses	(3,666)	(5,482)	(6,171)	(7,356)	(8,534)	Customers deposits	0	0	0	0	0
Pre-provision operating profit	11,892	15,582	19,178	23,429	29,725	Borrowing	223,050	258,939	362,514	478,519	622,074
Total provision	(1,532)	(1,298)	(2,050)	(2,450)	(3,450)	Debentures/subordinated debt	6,500	6,500	6,500	6,500	6,500
Operating profit after prov.	10,360	14,284	17,128	20,979	26,275	Other liabilities	9,779	12,483	9,986	7,989	6,391
Non-operating income	0	0	0	0	0	Total liabilities	239,329	277,922	379,001	493,008	634,965
Profit before tax	10,360	14,284	17,128	20,979	26,275	Share capital	12,952	13,006	14,608	14,608	14,608
Tax	(2,782)	(3,666)	(4,103)	(5,154)	(6,531)	Reserves & others	48,806	57,095	91,767	103,590	118,352
Min. int./pref. div./other items	(79)	1	(70)	(60)	(60)	Shareholders' equity	61,758	70,101	106,374	118,198	132,960
Net profit	7,499	10,620	12,955	15,764	19,683	Minority interests	281	63	163	263	363
Adj. net profit	7,499	10,620	12,955	15,764	19,683	Total equity & liabilities	301,367	348,086	485,538	611,469	768,289
EPS (Rs)	5.792	8.183	9.383	10.792	13.475	Avg interest-earning assets	279,216	299,443	441,471	570,542	741,091
EPS (adjusted) (Rs)	5.792	8.183	9.383	10.792	13.475	Avg risk-weighted assets	n.a.	n.a.	n.a.	n.a.	n.a.
DPS (Rs)	1.200	1.500	1.800	2.000	2.000	BVPS (Rs)	47.68	53.90	72.82	80.91	91.02

Growth (YoY %)					
Year to 31 Mar	2009	2010	2011E	2012E	2013E
Net-interest income	32.9	21.0	43.5	31.9	30.0
Non-interest income	0.5	56.3	(5.7)	3.4	11.7
Total operating income	17.5	35.4	20.3	21.4	24.3
Total expenses	44.3	49.6	12.6	19.2	16.0
Pre-provision operating profit	11.1	31.0	23.1	22.2	26.9
Total provisions	118.7	(15.3)	58.0	19.5	40.8
Operating profit after provisions	3.6	37.9	19.9	22.5	25.2
Profit before tax	3.6	37.9	19.9	22.5	25.2
Net profit (reported)	1.1	41.6	22.0	21.7	24.9
Net profit (adjusted)	1.1	41.6	22.0	21.7	24.9
EPS (reported)	(5.5)	41.3	14.7	15.0	24.9
EPS (adjusted)	(5.5)	41.3	14.7	15.0	24.9
Gross loans	3.5	21.5	50.5	33.0	33.0
Deposits	n.a.	n.a.	n.a.	n.a.	n.a.
Total assets	4.1	15.5	39.5	25.9	25.6
Total liabilities	2.6	16.1	36.4	30.1	28.8
Shareholders' equity	10.4	13.5	51.7	11.1	12.5
Avg interest-earning assets	3.6	7.2	47.4	29.2	29.9
Avg risk-weighted assets	n.a.	n.a.	n.a.	n.a.	n.a.

Key assumptions					
Year to 31 Mar	2009	2010	2011E	2012E	2013E
Loan growth (%)	3.5%	21.5%	50.0%	33.0%	33.0%

Key ratios (%)					
Year to 31 Mar	2009	2010	2011E	2012E	2013E
Liquidity					
Loan/deposit	n.a.	n.a.	n.a.	n.a.	n.a.
Capital adequacy ratios (CAR)					
Tier-1 CAR	20.0	17.4	21.4	18.8	16.7
Total CAR	23.8	20.5	26.9	24.3	22.2
Asset quality					
NPLs/gross loans	0.4	0.3	0.5	0.5	0.5
Total loan-loss prov./NPLs	40.3	46.2	100.0	100.0	100.0
Profitability					
ROAA	2.5	3.3	3.1	2.9	2.9
ROAE	12.7	16.1	14.7	14.0	15.7
Efficiency					
Net-interest margin	3.3	3.7	3.6	3.7	3.7
Gross yield	10.8	10.3	9.7	10.2	10.1
Cost of funds	9.1	7.4	7.3	7.7	7.6
Net-interest spread	1.7	2.9	2.4	2.6	2.6
Total cost/total income	23.6	26.0	24.3	23.9	22.3
Others					
Effective tax	26.8	25.7	24.0	24.6	24.9
Dividend-payout ratio	20.7	18.3	19.2	18.5	14.8



Source: Company, Daiwa forecasts

ROE for the core lending business likely to expand

We forecast ROE for the lending business to improve to 17.3% for FY13, from 14.1% for FY11

We forecast IDFC's ROE from its core lending operation to expand to 17.3% for FY13, from 14.1% for FY11. We have built a profit and loss statement for the core lending business that excludes the profit on the sale of investments and income/gains on equity investments. We forecast an FY11-13 EPS CAGR of 30% for its core lending business, which we consider to be high.

The company's loan growth of 51% YoY as at the end of December 2010 was very high, and as such, we expect the loan-growth rate to slow to above 30% for the next two years. As we expect the leverage ratio to improve over the next two years, we forecast IDFC's core lending business to record a ROE of 15.5% for FY12 and 17.3% for FY13. We forecast a consolidated ROE of about 16% for FY13 from 13% for FY11.

We have factored into our model a moderate increase in the leverage ratio for FY11-13. However, if the company's balance sheet and leverage ratio should improve at a faster rate than we expect, this would provide upside potential to our current ROE forecast.

IDFC: P&L of the lending business (reconstructed) (Rs m)							
	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Interest earned	12,823	21,595	29,814	30,665	42,976	58,423	75,142
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Net Income	5,173	8,392	10,592	13,242	18,307	23,782	30,495
Operating expenses	614	1,133	1,288	1,994	2,241	2,712	3,282
Operating income	4,559	7,259	9,304	11,248	16,066	21,070	27,212
Provisions	499	574	564	1,026	1,700	2,000	3,000
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Net profit	3,289	5,214	6,555	7,667	10,775	14,303	18,159
Reported net worth	28,820	54,544	60,292	68,229	111,845	123,265	137,704
Leverage net worth	22,488	41,517	37,304	43,815	86,943	97,864	111,796
Core ROE (%)	15.2	16.3	16.6	18.9	14.1	15.5	17.3
Leverage ratio (x)	3.7	6.2	6.3	6.7	5.3	5.2	6.0
Leveraged book value (Rs)	20	32	29	34	60	67	77
Core EPS (Rs)	2.9	4.0	5.1	5.9	7.38	9.8	12.4

Source: Company, Daiwa forecasts

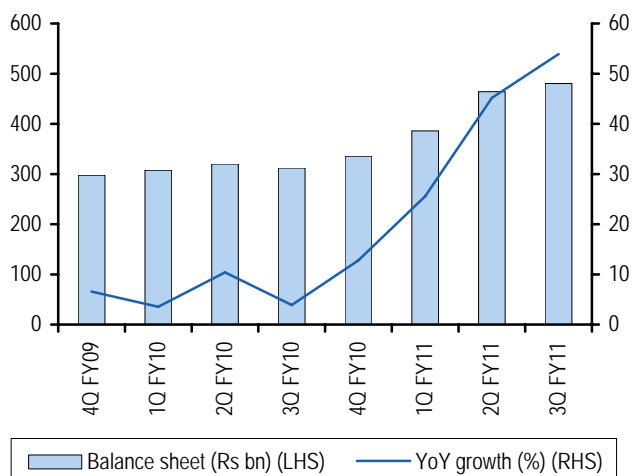
Note: leverage ratio = average assets divided by average net worth

Company's balance-sheet growth vision is intact

We forecast a loan CAGR of 33% for the next two years

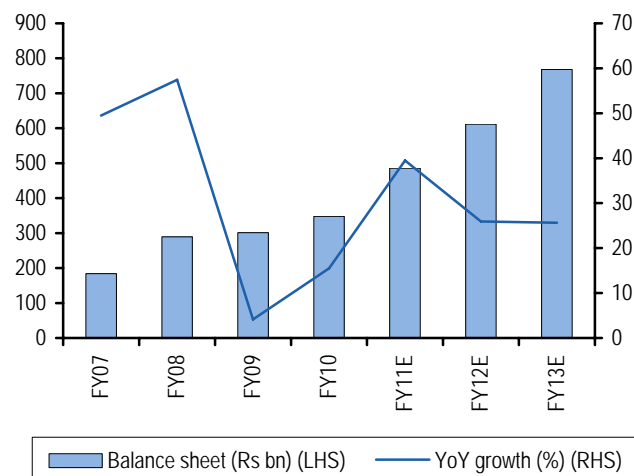
The size of IDFC's balance sheet has expanded rapidly over the past six months, rising by 54% YoY for December 2010. For 3Q FY11, balance-sheet-growth momentum was less impressive compared with that for 1H FY11, as balance-sheet growth this year has been front-end loaded, meaning that the numbers were higher for 1H FY11. As the company intends sell/securitise its loan portfolio and hence its loan book, we forecast a loan CAGR for the next two years of about 33%, at least. Management has also guided for a balance-sheet size of Rs1tn over the next three years, and we believe there is no lack of opportunities for IDFC to meet this target.

IDFC: balance-sheet growth on quarterly basis



Source: Company

IDFC: balance-sheet growth on annual basis



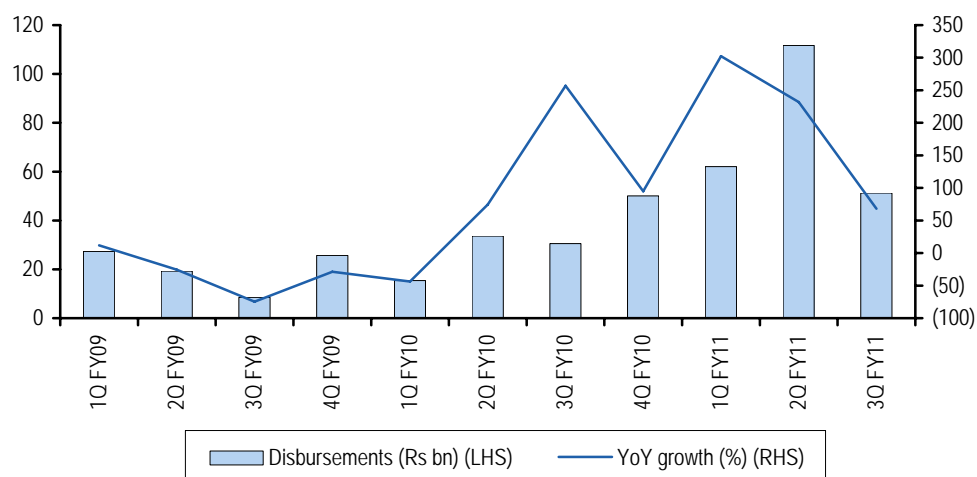
Source: Company, Daiwa forecasts

The company expects loan disbursements to pick up in FY12

3Q FY11 fall in loan-disbursement growth appears to be temporary

We believe the company capitalised well on the given opportunities for loan-disbursement growth during 1H FY11, which led to more than a three-fold year-on-year increase in disbursements over the period. However, loan disbursements for 3Q FY11 slowed, declining by 54% QoQ, and we expect 4Q FY11 disbursements to be marginally better compared with 3Q FY11. For the past three years, the company has achieved its highest loan-disbursement levels during the fourth quarter of the financial year. However, given the rising interest-rate environment, management is cautious about the company's 4Q FY11 loan-disbursement growth rate, but is confident that loan disbursements will pick up in FY12.

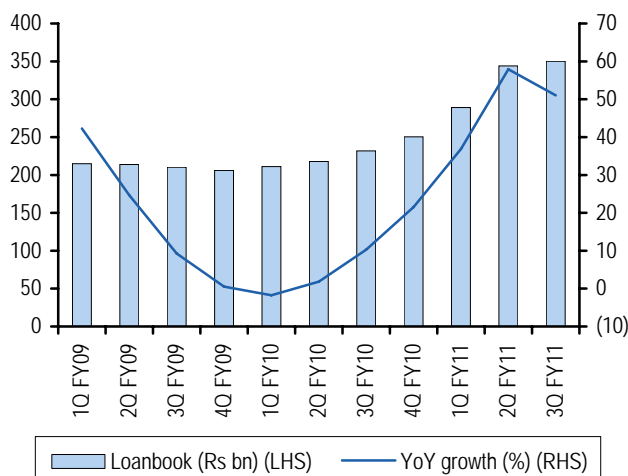
IDFC: loan-disbursement growth



Source: Company

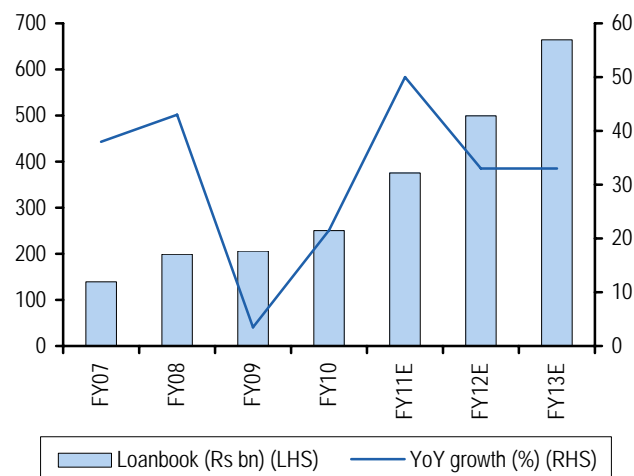
In the past during times of economic uncertainty, IDFC has cut back on its loan disbursement and loan growth. However, the current economic conditions are different to those seen in previous cycles, and management is confident of achieving its balance-sheet growth targets. We believe that as the India Government starts awarding power and road-sector contracts over the next few months, the company's loan-disbursement growth rate should pick up, and that any concerns in the market about the slowdown in disbursements are only likely to be temporary. For 3Q FY11, loan growth was mainly driven by an increase in project loans, and we believe that going forward over the next two years loan growth will be fuelled mainly by growth in project loans.

IDFC: loan-book growth (quarter-end)



Source: Company

IDFC: loan-book growth (year-end)



Source: Company, Daiwa forecasts

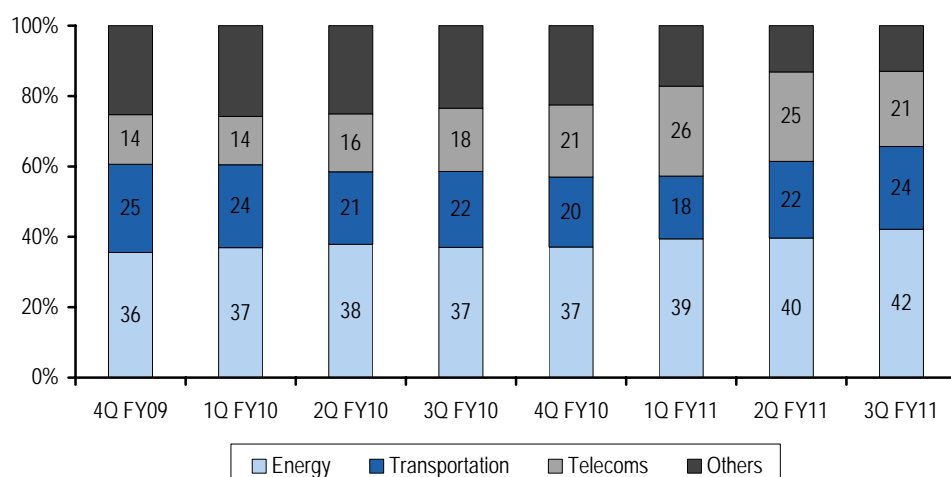
High proportion of operating assets should mean reduced asset-quality risk***Around 65% of its assets are operating assets***

About 65% of IDFC's assets are 'operating assets' that generate high cash flow, while its exposure to more sensitive assets, such as those 'under construction', is lower. This should reduce any risks associated with IDFC's loan book to a large extent. Also, the company's asset quality remains well under control, with gross and net NPLs accounting for 0.22% and 0.11% of total loans, respectively, as at the end of December 2010. The company's own assumptions relating to the projects to which it has lent are extremely conservative and the projects are performing better than IDFC's expectations. The company does not expect any pressure on its asset quality over the next two years. It has cumulative provisions of 1.7% of its total loans, which we think provides a sufficient cushion in case of pressure on asset quality.

Energy and transport segments have been the main drivers of loan growth, which should continue

The energy and transport segments account for almost two-thirds of the company's lending exposure and were the main loan-growth drivers for 9M FY11. The telecoms segment, for which IDFC saw very high loan growth for 1Q FY11, declined on a quarter-on-quarter basis for 3Q FY11, as some telecoms loans matured or were re-paid. However, IDFC is focusing on the energy and transport segments to drive future loan growth. For the past two quarters, loan growth for the transport segment has been higher than average and management believes that with new orders for road projects starting in 4Q FY11 and 1Q FY12, this segment could account for even more loan growth, as a percentage of total loans, from 2H FY11.

IDFC: loan exposure by segment



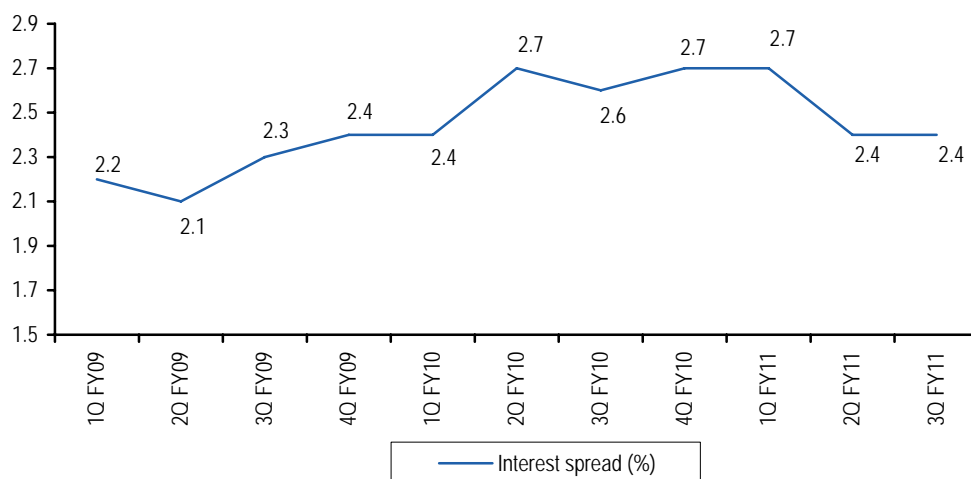
Source: Company

We expect only marginal pressure on the interest spread

Interest spread could see moderate pressure

We forecast a 10-20bp QoQ cut in the company's interest spread over the next two quarters. However, according to management, any compression in the interest spread is unlikely to be as pronounced as that for the previous rising-interest-rate cycle (in 2008). The spread declined by 30bps QoQ for 2Q FY11 as the cost of funds rose. Although the company is not facing a major asset-liability duration mismatch (when adjusted for reset periods the durations of loans for assets and liabilities are about 2.1 and 2.3 years, respectively), the loan book tends to be re-priced at a slower pace than the liabilities, which is likely to cause some pressure on the interest spread over the next few quarters.

IDFC: interest spread (%)



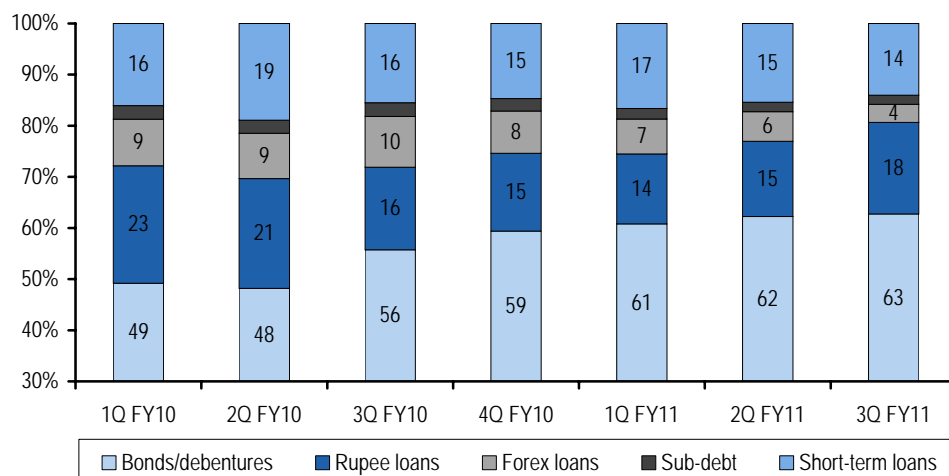
Source: Company

Infrastructure bonds and overseas borrowings are new avenues for raising funds

The company's overseas debt as a proportion of total debt has been declining over the past few quarters (4% of total debt as at 31 December 2010). As IDFC is classified by the Reserve Bank of India (RBI) as an 'infrastructure finance company (IFC)', it has the potential to raise up to US\$500m a year without getting approval from the RBI. While it is currently uneconomical to borrow from overseas, the company expects to tap this avenue in the future.

IDFC is also permitted to raise funds through tax-saving infrastructure bonds. The company has raised Rs12.5bn as at February 2011, and it could raise a further Rs5bn by end of March 2011. Over the next two years, we expect the company to increase the amount it borrows (to be raised through these bonds). Over the next three years, the company plans to increase the proportion of retail debt to account for 7% of its balance sheet from almost zero currently.

IDFC: debt mix



Source: Company

Earnings forecasts revised down, target price lowered

Valuations appear compelling; Buy rating maintained

We have revised down our FY11-12 consolidated net-profit forecasts by 6% and 7%, respectively, as we have revised down our non-interest income forecasts for the period, due mainly to the prevailing bearish sentiment in the market, which could have a negative effect on IDFC's securities-related business. As such, we have lowered our six-month target price to Rs190 (from Rs215), based on our SOTP methodology; we value the core lending business at a lower target PER of 15x (17x previously) on our FY12 EPS forecast, and IDFC's investments at Rs43 (formerly Rs49).

IDFC: Daiwa forecast revisions (Rs m)

Year to 31 March	FY11E	FY12E
Operating profit		
New	19,178	23,429
Previous	20,156	24,949
Change (%)	(4.9)	(6.1)
Net profit		
New	12,955	15,764
Previous	13,826	16,889
Change (%)	(6.3)	(6.7)

Source: Daiwa forecasts

We believe IDFC's FY12 PBR of 1.5x for the core lending BVPS and the FY12 PER of 11x for the core lending business (at its current share price and on our forecasts) are extremely attractive. As such, we maintain our **1 (Buy)** rating. For FY12, while we forecast a consolidated BVPS of Rs81, we also forecast a BVPS for the lending business of Rs67. Hence, after deducting the value of investments from the current market price, IDFC trades currently at a PBR of 1.5x on our FY12 BVPS forecast.

IDFC: SOTP valuation (Rs m)

	Est. value (Rs m)	Value/share (Rs)	Remarks
National Stock Exchange stake	9,250	7	Considering recent transaction valuations.
Value of private equity business	8,000	6	8% of assets under management (AUM)
Value of IDFC mutual fund	6,000	5	3% of AUM
Value of IDFC securities	8,619	7	10x FY12E earnings
Value of IDFC's investments in PE funds	6,000	5	At almost 2x its cost
Other investments (ARCIL, Athena, L&T Infra, STCI)	17,912	14	Valued at around double cost of investments
Total value	55,781	43	-
Value of the core business at 15x FY12E lending business EPS	214,542	147	-
Total value of IDFC	270,323	190	-

Source: Daiwa forecasts

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