IDFC

Maintain BUY

Price: Rs. 104 | **BSE Index: 14218** | **26th April 2007**

4QFY07 Result - Strong growth in fee income

IDFC has reported a net profit growth of 15.7% y-o-y to Rs 851 mn for the quarter ended March 2007. The result were inline with our estimates at the top line but was below our estimates at bottom line mainly due to higher than expected operating and provisioning expenditure. Total income grew by 60% y-o-y to Rs. 4.1 bn backed by improved yield on infrastructure assets and rise in fee based income. Rise in staff expenses and provision against standard assets pushed operating and provisioning expenditure higher during the quarter. We maintain our positive outlook on the stock & reiterate our Buy rating based on strong business growth, better return ratios and superior asset quality.

Highlights

- IDFC has posted a strong balance sheet growth of 50% y-o-y to Rs 179.8 bn. During FY07, incremental gross approvals & disbursements increased by 23% & 19% to Rs 130.5 bn and Rs 72.1 bn, respectively. Over the last one year, IDFC has identified energy, commercial & industrial segments as its key areas of financing. The exposure to these segments now account for 38.6% & 14.4%, respectively.
- Average yield on infrastructure assets increased marginally by 30 bps y-o-y to 9.2% during FY07 while yield on treasury assets improved by 150 bps y-o-y to 7.6% during the same period. As a result overall yield on its interest earning assets has improved by 50 bps to 9%. However NIM has fallen by 20 bps y-o-y to 2.8% for FY07 with a steep rise in cost of funds. Going forward we believe the company will face more pressure on interest margins due to its inability to pass on the increasing cost of funds.
- Profit from sale of equity investments remained flat at Rs 1.2 bn during FY07. IDFC is sitting on unrealized gains of Rs 2.2 bn in its equity book which excludes over 2.2% stake in NSE as unquoted investments. Based on recently concluded deal, NSE's stake can fetch IDFC Rs. 2.3 bn or Rs. 2.05 per share net of acquisition cost (at around $2.5 bn valuation of NSE). However management has indicated to carry it on as strategic investment rather than selling it to other investors.

Share Data

Reuters code	IDFC.BO
Bloomberg code	IDFC IN
Market cap. (US$ mn)	2,839
Issued Shares (mn)	1,126

Performance (%)	1m	3m	12m
Absolute	20	(1)	42
Relative	12	(1)	16

Valuation Ratios

Year to	2008E	2009E
EPS (Rs.)	5.0	5.7
+/- (%)	21.5	13.2
ABV (Rs.)	29.1	33.1
+/- (%)	13.5	13.8
PER (x)	20.6	18.2
PABV (x)	3.6	3.1
Dividend/Yield (%)	1.3	1.5

Major shareholders (%)	
Promoters	23
FIIs	18
MFs	1
ADRs/GDRs/Other Foreign	25
Institutions	18
Public & Others	15

Financial highlights

Rs Mn	Q4FY06	Q4FY07	y-o-y (%)	FY06	FY07	y-o-y (%)	FY08E	y-o-y (%)	FY09E	y-o-y (%)
Operating Income	2,553	4,058	59.0	10,138	15,006	48.0	19,102	27.3	24,930	30.5
Other Income	14	45	215.3	19	52	171.6	72	39.7	101	39.2
Total Income	**2,567**	**4,104**	**59.8**	**10,157**	**15,057**	**48.2**	**19,175**	**27.3**	**25,031**	**30.5**
Interest & Other Charges	1,415	2,660	88.0	5,008	8,555	70.8	10,885	27.2	15,225	39.9
Depreciation & other expenses	170	194	13.9	440	614	39.3	831	35.3	1,109	33.5
Total expenditure	1,586	2,855	80.0	5,448	9,168	68.3	11,716	27.8	16,334	39.4
Operating Profits	**982**	**1,249**	**27.2**	**4,709**	**5,889**	**25.1**	**7,459**	**26.7**	**8,697**	**16.6**
Provision & Contingencies	132	158	19.4	516	174	(66.3)	480	176.0	696	45.0
Provision for tax	114	240	110.9	437	1,087	148.9	1,326	22.0	1,600	20.7
Reported Profit	**736**	**851**	**15.7**	**3,756**	**4,629**	**23.2**	**5,653**	**22.1**	**6,401**	**13.2**

- IDFC is able to maintain a very healthy asset quality with gross NPA ratio at 0.20% and zero net NPAs. Gross NPA ratio has improved by 30bps over the last one year. However, the loan loss reserve ratio of the company has dropped from 2.36%, a year ago to current 1.57% during FY07. Hence provisioning expenditure may rise substantially going forward.

Outlook

IDFC has maintained its focus towards financing infrastructure projects and all other activities revolve around this business. IDFC is likely to be the biggest beneficiary of the rising infrastructure spending in the country. We maintain our positive outlook on the stock due to its lean and mean cost structure, changing revenue mix with focus on fee income, strong and experienced management team with deep domain knowledge and its strong asset quality. Moreover IDFC's recent foray in to Private equity, asset management and tie up with other private players for infrastructure development initiatives will also add value to the existing business. The company is directed towards increasing its leverage ratios, which will help it in improving the return ratios and positively impact the valuations.

Valuation

At the current market price of Rs 104, the stock is trading at 20.6x FY08E and 18.2x FY09E earnings. On P/AB, the stock is trading at 3.6x FY08E and 3.1x FY09E adjusted book value. We reiterate our "Buy" recommendation based on FY09E adjusted book value.

Result analysis

- IDFC has posted a strong balance sheet growth of 50% y-o-y to Rs 179.8 bn. During FY07, incremental gross approvals & disbursements increased by 23% & 19% to Rs 130.5 bn and Rs 72.1 bn, respectively. The company has a large pool of sanctioned loans which will take care of its business growth going forward.
- IDFC is leveraging its domain expertise in various segments and is financing projects, which it thinks are viable and are likely to have steady cash flows. It has maintained its focus towards financing infrastructure projects and all other activities revolve around this business. Over the last one year, IDFC has identified energy, commercial & industrial segments as its key areas of financing. The exposure to these segments now account for 38.6% & 14.4%, respectively. Due to the large ticket size of the loan, 42% of its exposure is restricted to top 20 companies.
- During FY07 gross borrowings increased by 90% y-o-y to Rs. 79.6 bn as IDFC continued to increase its leverage which now stands at 5.4% up from 4.5% a year ago.
- Average yield on infrastructure assets increased marginally by 30 bps y-o-y to 9.2% during FY07 while yield on treasury assets improved by 150 bps y-o-y to 7.6% during the same period. However NIM has fallen by 20 bps y-o-y to 2.8% for FY07 with a steep rise in cost of funds. Going forward we believe the company will face more pressure on interest margins due to its inability to pass on the increasing cost of funds.
- During FY07, Net interest income from infrastructure loans increased by 33% to Rs 3.9 bn whereas net interest income from treasury operations increased by 185% to Rs. 370 mn. Net operating income increased by 48% y-o-y to Rs. 15 bn during the same period.

Exposure

(%)	FY06	FY07
Energy	36.8	38.6
Transportation	28.4	27.0
Telecom & IT	17.9	17.3
Commercial & Industrial	12.1	14.4
Others	4.8	2.7

- The company is focusing on diversifying its revenue stream with focus on creating a sustainable source of fee income. Fee income increased by 41% y-o-y during FY07 to Rs 1.3 bn primarily backed by 84% y-o-y rise in fees from asset management in addition to fees from debt syndication. The share of fee income in non-interest income increased from 42% to 50% whereas the share of fee income in operating income remained stagnant at 19% over the same period. However, the share of non-interest income in operating income has decreased from 43% to 37% during FY07.
- IDFC has two PE funds managing worth USD 700 mn currently. IDFC intends to increase the size of the funds under management to USD 3-3.5 bn from current level over next three years. The proposed capital raising will take care of the seed capital of IDFC in the targeted fund size.
- Profit from sale of equity investments remained flat at Rs 1.2 bn during FY07. IDFC is sitting on unrealized gains of Rs 2.2 bn in its equity book which excludes over 2.2% stake in NSE as unquoted investments. Based on recently concluded deal, NSE's stake can fetch IDFC Rs. 2.3 bn or Rs. 2.05 per share net of acquisition cost (at around $2.5 bn valuation of NSE). However management has indicated to carry it on as strategic investment rather than selling it to other investors.
- IDFC is able to maintain a very healthy asset quality with gross NPAs at 0.20% and zero net NPAs. Gross NPA ratio has improved by 30bps over the last one year. However, the loan loss reserve ratio of the company has dropped from 2.36% a quarter ago to current 1.57% during FY07. Hence provisioning expenditure may rise substantially going forward.
- IDFC maintains a capital adequacy ratio of 20.3%, which is sufficient to meet its business growth needs & regulatory norms. Currently, the company has a Tier-I ratio in excess of 16%. Going forward, the company has enough scope to raise additional Tier II capital to support its business growth. Moreover, it intends to increase the leverage ratio from current 5.4x to 7-8x over a period of time, which will lead to a sharp improvement in return ratios. It plans to raise part of the additional capital to the tune of $500 mn in current fiscal.

New Developments

- The Board has recommended 10% dividend i.e. Rs 1 per equity share for FY07.
- The Board has approved a plan to raise capital through issue of equity or quasi-equity instruments upto USD 500 mn equivalent INR over next 18 months period to fund balance sheet growth, meet regulatory norms and to increase its seed capital in the asset management business.
- The Board has also approved an increase in FII shareholding limit in IDFC from current 49% to 74% subject to the approval of the shareholders.

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Analyst Certification

We, Praveen Agarwal and Sandeep Chopra, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

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