

IDFC

Upgrade to Neutral: Valuations undemanding but near-term risks remain

- IDFC reported 3Q FY11 net profit of Rs3.2B, up 19% y/y, which was ~10% lower than our estimate. NII was higher due to one-off treasury gains, but fee income growth continued to disappoint with a >20% q/q fall. We upgrade IDFC to Neutral as valuations at ~1.8 FY12E book now look undemanding, but we see risks on margins from tight liquidity and on growth from delayed execution.
- **3Q FY11: Trade off between margins and growth:** 12-month rolling spreads were flat sequentially, but loan growth is moderating with just 2% q/q growth. Loan growth has been strong YTD at 40%, and we see limited risks to management's target of 3x loan book over FY10-14E. However, we expect tight liquidity to have an impact on near-term growth as management is likely to consciously moderate near-term growth as incremental spreads are under pressure.
- **Fees continued to disappoint:** Fee income contracted ~23% q/q and ~13% y/y due to low gains from principal investment, a slowdown in disbursements impacting loan fees, and lower flow business income. We believe fee income will continue to lag overall profit growth with just 12% growth vs 35% balance sheet growth over FY10-13E.
- **Valuations undemanding, but near-term risks remain:** With the ~20% underperformance over the past three months, valuations look undemanding at 1.8x FY12E book, and the gap with PFC/REC has narrowed to almost nil. But tight liquidity will affect margins over the next 2-3 quarters, and near-term growth could moderate given pressure on incremental spreads.
- **Upgrade to Neutral; better liquidity and budget could be catalysts:** We adjust our earnings by 0-2% over FY11-13E. We cut our Sep-11 PT to Rs170 from Rs200 as we lower our target multiple to 13.5x Sep12E EPS (~16x earlier) as we see increasing risks to growth and margins. But valuations look undemanding after the ~30% correction; hence our upgrade to Neutral. We would wait for better system liquidity before turning more positive. Higher Infra spending in the budget could also be an upside catalyst.

▲ Neutral

Previous: Underweight

IDFC.BO, IDFC IN

Price: Rs177.95

▼ Price Target: Rs170.00

Previous: Rs200.00

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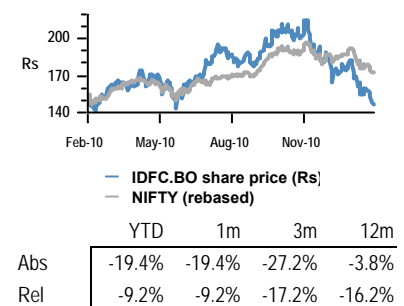
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Price Performance



Infrastructure Development Finance Company (Reuters: IDFC.BO, Bloomberg: IDFC IN)

Year-end Mar (Rs in mn)	FY09A	FY10A	FY11E	FY12E	FY13E	52-wk range (Rs)	218.25 - 141.10
Operating Profit	11,891	15,585	20,171	25,588	31,735	Market cap (Rs mn)	259,943
Net Profit	7,577	10,620	13,482	17,111	21,212	Market cap (\$ mn)	5,681
Cash EPS (Rs)	5.85	8.17	8.95	11.36	14.08	Shares outstanding (mn)	1,461
Fully Diluted EPS (Rs)	5.85	8.17	8.95	11.36	14.08	Fiscal Year End	Mar
DPS (Rs)	1.20	1.39	1.85	2.27	2.82	Price (Rs)	177.95
EPS growth (%)	2.0%	39.6%	9.6%	26.9%	24.0%	Date Of Price	22 Dec 10
ROE	12.9%	16.1%	15.2%	14.5%	15.5%	Avg daily value (Rs mn)	
P/E	25.2	18.0	15.9	13.0	10.5	Avg daily value (\$ mn)	
BVPS (Rs)	47.68	53.90	73.47	85.58	96.56	Avg daily vol (mn)	
P/BV	3.1	2.7	2.0	1.7	1.5	NIFTY	5,506
Div. Yield	0.8%	0.9%	1.3%	1.5%	1.9%	Exchange Rate	45.76

Source: Company data, Bloomberg, J.P. Morgan estimates.

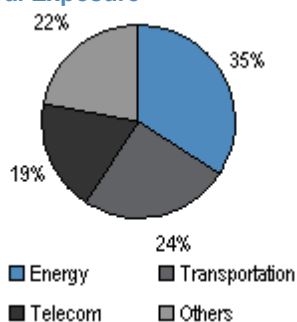
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Company Description

IDFC is NBFC dedicated to infrastructure lending to private companies. It has a loan portfolio of ~US\$6B and Energy, transportation, and telecom are the sectors with largest exposure. It also runs ~US\$2.2B in project and private equity

Sectoral Exposure



Source: Company

EPS: J.P. Morgan vs consensus

	J. P. Morgan	Consensus
FY11E	9.2	9.1
FY12E	11.4	11.2
FY13E	14.1	

Source: Bloomberg, J.P.Morgan.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
NIMs		
Impact of each 10bps	1.80%	1.90%
Cost to Income		
Impact of each 100bps	1.35%	1.43%
Provisions/Assets		
Impact of each 10bps	0.0%	1.9%

Source: J.P.Morgan estimates

Price target and valuation analysis

Our Sep-11 PT of Rs170 is based on 13.5x Sep-12E EPS. Our PT implies 1.9x Sep-12E book. Our P/E multiple for IDFC is lower than the multiple we use for private banks (17.3x) due to the capital market contribution to profits and dependence on wholesale funding.

Sep-12 EPS	12.7
Multiple	13.5
Fair value	172
Sep-12 PT	170
Risk free rate:	7.8%
Market risk premium:	6.0%
Beta:	1.2
Cost of Equity	15.0%
Terminal "g":	5%
Stage 2 earnings growth	~38%
Target P/B	1.87

Source: J.P.Morgan estimates

Current valuations look undemanding at ~1.8x FY12E book. But we would wait for system liquidity to improve before we turn more positive. Higher Infra spending in the budget could also be an upside catalyst. Longer-than-expected tightness remains a downside risk for both margins and growth.

Figure 1: IDFC: 3Q FY11 Financials

Rs MM, YE Mar.	3Q10	2Q11	3Q11	YoY	QoQ
Net interest income	2,790	3,740	4,690	68%	25%
Non-interest income	2,370	2,680	2,060	-13%	-23%
Operating income	5,180	6,470	6,600	27%	2%
Operating expense	1,080	1,210	1,620	50%	34%
Pre-provision profits	4,100	5,260	4,980	21%	-5%
Provisions and losses	420	490	510	N/A	4%
Profit before tax	3,680	4,770	4,470	21%	-6%
Tax	980	1,360	1,260	29%	-7%
PAT	2,700	3,410	3,210	19%	-6%
Spreads (12 mnt rolling)	2.60	2.40	2.40	-20%	0%
Prov/PPOP	10.2%	9.3%	10.2%	0.0%	0.9%
Cost/Income	20.8%	18.7%	24.5%	3.7%	5.8%
Tax rate	26.6%	28.5%	28.2%	1.6%	-0.3%
Loans (Rs mn)	234,500	343,970	350,210	49%	2%
Borrowings (Rs mn)	241,910	353,000	366,330	51%	4%
Non Interest Income					
Principal Investment	1,050	120	300	-71%	150%
Asset management	680	750	630	-7%	-16%
IB & Broking	340	740	510	50%	-31%
Loan related & other fees	310	1,070	520	68%	-51%

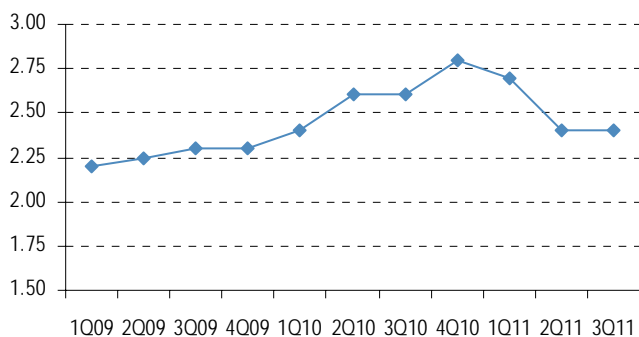
Source: Company

Quarterly highlights

Moderation in growth: Loan growth moderated in 3Q FY11 at 2% q/q with the slowing trend for sanctions. Sanctions were down y/y as management trades off near-term growth to protect margins. Disbursements also slowed with q/q drop. We do not see risks to management's longer-term target of 3x loan book over FY10-14E but near-term growth could be at risk given the trade margin-growth trade-off.

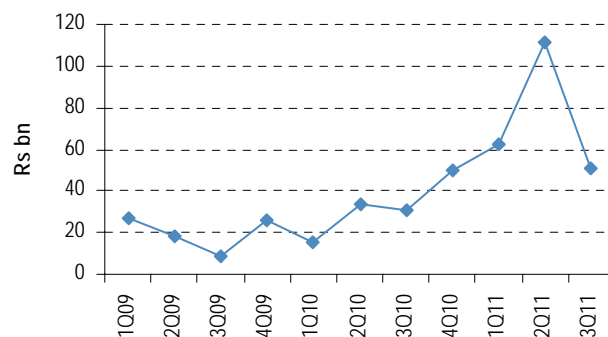
Spreads stable: 12-month rolling spreads were stable in 3Q FY11 at 2.4% but we expect marginal moderation in the near future given the tight liquidity and high wholesale funding costs. NII growth was very strong in this quarter as a large part of the loan growth was back-ended in 2Q FY11, leading to strong average loan growth in 3Q FY11.

Figure 2: IDFC: Spreads remain stable (nine-month rolling spreads)



Source: Company

Figure 3: IDFC: Disbursements moderate



Source: Company

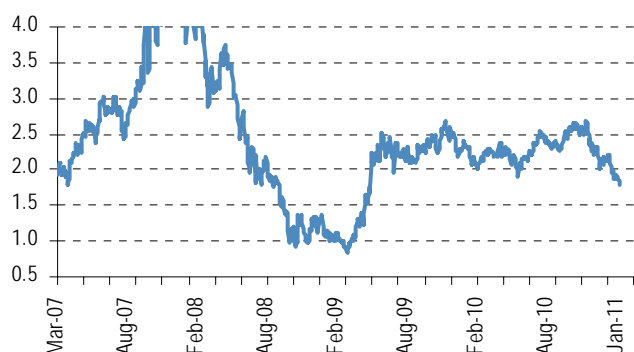
Fee income continued to disappoint: Fee income contracted ~23% q/q and ~13% y/y due to low gains from principal investment, a slowdown in disbursements impacting loan fees, and lower flow business income. AMC revenues were down 16% q/q and IB and broking revenues were down 31% q/q. We believe fee income will continue to lag overall profit growth with just 12% growth vs 35% balance sheet growth over FY10-13E.

Valuations undemanding - Upgrade to Neutral, but wait for macro to improve

With the ~30% correction over the past three months, valuations look undemanding at 1.8x FY12E book, and the gap with PFC/REC has narrowed to almost nil. IDFC has underperformed broader markets by ~20% over the past three months, and we see limited downside from current levels. **We thus upgrade IDFC to Neutral.**

We adjust our earnings by 0-2% over FY11-13E. We reduce our Sep-11 PT to Rs170 from Rs200 as we cut our target multiple to 13.5x Sep12 EPS (~16x earlier) as we see increasing risks to growth and margins. But current valuations look undemanding after the ~30% correction; hence our upgrade to Neutral. But we would wait for system liquidity to improve before we turn more positive. Higher Infra spending in the budget could also be an upside catalyst.

Figure 4: IDFC: One-year forward P/BV valuation now undemanding



Source: Company, J.P.Morgan estimates

Figure 5: IDFC: Valuation premium over REVC/PFC is almost nil now



Source: Company, Bloomberg, J.P.Morgan estimates

Figure 6: IDFC: Adjust earnings by 0-2%

Rs MM, YE Mar.	FY11E	FY12	FY13
PPOP			
Revised	20,171	25,588	31,735
Earlier	19,312	25,188	30,956
% change	4.5%	1.6%	2.5%
Net Profit			
Revised	13,482	17,111	21,212
Earlier	13,175	17,381	20,970
% change	2.3%	-1.6%	1.2%

Source: J.P.Morgan estimates.

IDFC: Summary of Financials

Income Statement						Growth Rates					
Rs in millions, year end Mar	FY09	FY10	FY11E	FY12E	FY13E		FY09	FY10	FY11E	FY12E	FY13E
NIM (as % of avg. assets)	3.1%	3.8%	4.0%	3.9%	3.8%	Loans	3.5%	21.5%	43.0%	33.0%	35.0%
Earning assets/assets	94.0%	100.7%	103.8%	103.7%	100.7%	Deposits	-	-	-	-	-
Margins (% of earning assets)	2.9%	3.9%	4.1%	4.0%	3.8%	Assets	6.4%	13.1%	28.4%	29.2%	31.5%
						Equity	9.9%	13.5%	52.9%	20.3%	12.8%
Net Interest Income	7,866	10,178	15,011	19,444	25,487	RWA	10.1%	14.3%	43.0%	33.0%	35.0%
Total Non-Interest Income	7,821	11,246	13,222	14,619	9,434	Net Interest Income	33.8%	29.4%	47.5%	29.5%	31.1%
Fee Income	-	-	-	-	-	Non-Interest Income	-8.7%	43.8%	17.6%	10.6%	-35.5%
						of which Fee Grth	-	-	-	-	-
Other Operating Income	0	0	0	0	0	Revenues	-	-	-	-	-
Total operating revenues	-	-	-	-	-	Costs	45.1%	49.6%	6.1%	22.3%	24.6%
						Pre-Provision Profits	11.0%	31.1%	29.4%	26.9%	24.0%
Operating costs	-3,665	-5,482	-5,817	-7,112	-8,861	Loan Loss Provisions	117.0%	-15.3%	31.2%	26.2%	24.7%
						Pre-Tax	3.6%	37.9%	29.3%	26.9%	24.0%
Pre-Prov. Profits	11,891	15,585	20,171	25,588	31,735	Attributable Income	2.1%	40.1%	27.0%	26.9%	24.0%
Provisions	-1,532	-1,298	-1,702	-2,148	-2,678	EPS	2.0%	39.6%	13.2%	22.9%	24.0%
Other Inc/Exp. (treasury Income)	-	-	-	-	-	DPS	-0.1%	15.6%	33.2%	22.9%	24.0%
Exceptionals	0	0	0	0	0						
						Balance Sheet Gearing					
Pre-tax	10,359	14,287	18,469	23,440	29,057	Loan/deposit	-	-	-	-	-
Tax	-2,782	-3,668	-4,987	-6,329	-7,845	Investment/assets	19.4%	9.8%	9.0%	8.3%	7.4%
Minorities	-	-	-	-	-	Loan/Assets	66.9%	71.9%	80.1%	82.5%	84.7%
Other Distbn.	-	-	-	-	-	Customer deposits/liab.	0.0%	0.0%	0.0%	0.0%	0.0%
Attributable Income	7,577	10,620	13,482	17,111	21,212	LT debt/liabilities	76.7%	76.3%	73.0%	75.1%	78.7%
Per Share Data Rs						Asset Quality/Capital					
EPS	5.85	8.17	9.24	11.36	14.08	Loan loss reserves/loans	0.0%	0.0%	0.0%	0.0%	0.0%
DPS	1.20	1.39	1.85	2.27	2.82	NPLs/loans	0.2%	0.3%	0.4%	0.5%	0.5%
Payout	-	-	-	-	-	Specific loan loss reserves/NPLs	0.0%	0.0%	0.0%	0.0%	0.0%
Book value	47.68	53.90	73.47	85.58	96.56	Growth in NPLs	31.9%	105.1%	61.6%	68.4%	52.2%
Fully Diluted Shares	-	-	-	-	-	Tier 1 Ratio	20.0%	17.4%	21.2%	19.3%	15.5%
						Total CAR	23.8%	20.5%	23.9%	21.7%	17.7%
Key Balance sheet Rs in millions						Du-Pont Analysis					
Net Loans	205,962	250,311	357,944	476,066	642,689	NIM (as % of avg. assets)	3.1%	3.8%	4.0%	3.9%	3.8%
LLR	-	-	-	-	-	Earning assets/assets	94.0%	100.7%	103.8%	103.7%	100.7%
Gross Loans	205,962	250,311	357,944	476,066	642,689	Margins (as % of Avg. Assets)	2.9%	3.9%	4.1%	4.0%	3.8%
NPLs	396	811	1,311	2,208	3,360	Non-Int. Rev./ Revenues	-	-	-	-	-
Investments	59,611	34,264	40,329	47,633	56,453	Non IR/Avg. Assets	2.6%	3.4%	3.3%	2.9%	1.4%
Other earning assets	22,680	44,241	25,773	26,324	27,894	Revenue/Assets	-	-	-	-	-
Avg. IEA	251,495	266,174	377,614	500,457	672,933	Cost/Income	23.6%	26.0%	22.4%	21.8%	21.8%
Goodwill	-	-	-	-	-	Cost/Assets	-1.2%	-1.7%	-1.5%	-1.4%	-1.3%
Assets	307,864	348,099	446,813	577,247	758,935	Pre-Provision ROA	-	-	-	-	-
						LLP/Loans	-0.7%	-0.5%	-0.5%	-0.5%	-0.4%
Deposits	0	0	0	0	0	Loan/Assets	67.8%	69.6%	76.5%	81.4%	83.7%
Long-term bond funding	236,046	265,441	325,967	433,415	597,203	Other Prov. Income/ Assets	0.0%	0.0%	0.0%	0.0%	0.0%
Other Borrowings	-	-	-	-	-	Operating ROA	4.0%	4.8%	5.1%	5.0%	4.8%
Avg. IBL	-	-	-	-	-	Pre-Tax ROA	-	-	-	-	-
Avg. Assets	298,638	327,982	397,456	512,030	668,091	Tax rate	26.9%	25.7%	27.0%	27.0%	27.0%
Common Equity	61,759	70,101	107,153	128,893	145,430	Minorities & Outside Distbn.	0.0%	0.0%	0.0%	0.0%	0.0%
RWA	290,786	332,351	475,262	632,099	853,334	ROA	2.5%	3.2%	3.4%	3.3%	3.2%
Avg. RWA	277,401	311,569	403,807	553,681	742,716	RORWA	2.7%	3.4%	3.3%	3.1%	2.9%
						Equity/Assets	19.7%	20.1%	22.3%	23.1%	20.5%
						ROE	12.9%	16.1%	15.2%	14.5%	15.5%

Source: Company reports and J.P. Morgan estimates.

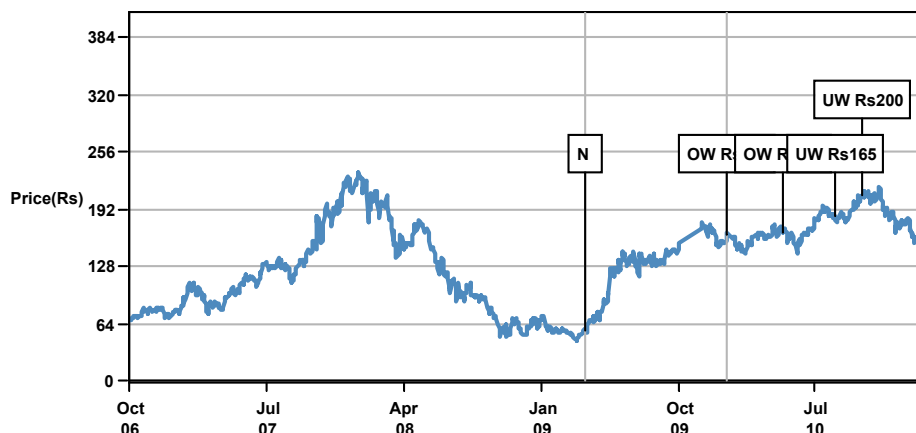
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IDFC (IDFC.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
27-Mar-09	N	55.35	--
06-Jan-10	OW	162.20	190.00
28-Apr-10	OW	165.95	195.00
11-Aug-10	UW	182.85	165.00
02-Oct-10	UW	206.85	200.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage Mar 27, 2009 - Jan 06, 2010. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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