



IDFC

STOCK INFO. BLOOMBERG
BSE Sensex: 9,772 IDFC IN
REUTERS CODE
S&P CNX: 2,943 IDFC.BO

23 October 2008

Buy

Rs54

Previous Recommendation: Neutral

		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)	1,294.3	3/07A	7,158	5,042	4.4	25.6	12.3	2.1	21.5	18.3	3.3	2.1
52-Week Range	235/47	3/08A	13,236	7,423	5.8	32.9	9.3	1.2	20.0	17.4	3.1	1.3
1,6,12 Rel.Perf.(%)	-4/-27/-22	3/09E	15,229	8,352	6.5	11.8	8.3	1.1	20.0	14.1	2.7	1.1
M.Cap. (Rs b)	69.9	3/10E	18,311	10,121	7.9	21.2	6.9	1.0	20.0	15.2	2.7	1.0
M.Cap. (US\$ b)	1.4											

Strong performance: IDFC's consolidated earnings grew 19% YoY in 2QFY09 to Rs2.3b. Despite slower NII growth due to losses on treasury investments, sustained high capital gains and stronger traction in fees led to earnings growth.

Balance sheet grew 28% to Rs290b (QoQ flat), driven by 25% growth in loans to Rs214b (QoQ flat). Gross disbursements decreased 26% YoY and 30% QoQ to Rs19b in 2QFY09. Disbursements are down 7% YoY in 1HFY09 to Rs47b. Approvals decreased by 30% YoY to Rs29b in 2QFY09 and 12% YoY to Rs74b in 1HFY09.

Management maintained its conscious risk aversion attitude towards asset book growth considering the increasing macro risks and liquidity uncertainties. The management highlighted that its priorities would be (1) liquidity, (2) profitability, and (3) balance sheet growth. Non-interest income increased significantly by 72% YoY to Rs2.2b in 2QFY09 due to 60% growth in fees and 93% growth in capital gains. Asset management fees grew 4.6x to Rs600m in 2QFY09. We expect alternative asset management fees to grow 2.5x in FY09 to Rs1.42b.

IDFC's capital adequacy is strong at 22.2% and Tier I at 18.9%. It said that it has no plans to raise capital in the foreseeable future. Management maintained that it would like to sustain leverage at current level of ~5x.

Upgrade to Buy: We are upgrading FY09 earnings estimates by 2% and cutting FY10 earnings estimates by 3%. The stock trades at 1.1x FY09E BV and 8.3x FY09E EPS and 1x FY10E BV and 6.9x FY10E EPS. The current valuations are attractive and offer favorable risk reward ratio. Upgrade to **Buy** with a target price of Rs76; an upside of 41%.

Y/E MARCH	(RS MILLION)							
	FY08				FY09		FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q		
Operating Income	6,096	6,551	7,634	7,670	8,686	9,397	28,045	35,736
Other Income	0	16	33	63	19	68	20	40
Total income	6,096	6,567	7,667	7,734	8,705	9,465	28,065	35,776
Y-o-Y Growth (%)	79.6	63.3	90.6	80.8	42.8	44.1	78.6	27.5
Interest Expenses	3,112	3,306	3,960	4,451	4,867	5,219	14,829	20,548
Net Income	2,985	3,261	3,707	3,283	3,839	4,246	13,236	15,229
Operating Expenses	486	486	629	858	720	871	2,459	2,709
Operating Profit	2,499	2,775	3,077	2,425	3,119	3,374	10,777	12,519
Depreciation	12	13	13	35	49	58	73	77
Provisions	63	164	73	400	199	148	700	1,080
Profit before Tax	2,424	2,598	2,991	1,991	2,871	3,169	10,004	11,362
Tax Provisions	582	621	774	503	685	833	2,480	2,954
Net Profit	1,842	1,977	2,216	1,487	2,186	2,336	7,523	8,408
Share of Ass / Minority Int	-33	-32	-41	6	-19	-13	-100	-57
Consolidated Net Profit	1,809	1,945	2,176	1,494	2,167	2,323	7,423	8,352
Y-o-Y Growth (%)	38.0	25.6	74.1	60.7	19.8	19.4	47.3	12.5
Int Exp/ Operating Income (%)	51.0	50.5	51.9	58.0	56.0	55.5	52.9	57.5
Tax Rate (%)	24.0	23.9	25.9	25.3	23.9	26.3	24.8	26.0
Cost to Income Ratio (%)	16.7	15.3	17.3	27.2	20.0	20.5	19.1	18.3

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

Key highlights

Management maintains cautious outlook on asset growth: Balance sheet grew 28% to Rs290b (QoQ flat), driven by 25% growth in loans to Rs214b (QoQ flat). Management divested the treasury portfolio (fixed income securities) during the quarter at a loss. The treasury portfolio decreased by Rs6b QoQ to Rs44b. Gross disbursements decreased 26% YoY and 30% QoQ to Rs19b in 2QFY09. Disbursements are down 7% YoY in 1HFY09 to Rs47b. Approvals decreased by 30% YoY to Rs29b in 2QFY09 and 12% YoY to Rs74b in 1HFY09. Outstanding disbursements grew 22% to Rs234b (down 4% QoQ) and outstanding total exposure grew 26% to Rs350b (down 4% QoQ). Loan pipeline remains strong at ~Rs100b (~50% of outstanding loans). Management maintained its conscious risk aversion attitude going forward towards asset book growth considering the increasing macro risks and liquidity uncertainties. Management highlighted that its priorities would be (1) liquidity, (2) profitability, and (3) balance sheet growth. We have lowered our loan book growth estimates for FY09 to 18% from 30% earlier.

More focus on quality of loan book than spreads: NII on infrastructure loans grew 23% YoY in 2QFY09 to Rs1.79b (flat QoQ), while NII from treasury portfolio dropped 60% YoY and 45% QoQ to Rs200m. The treasury book has suffered MTM losses due to widening of credit spreads on corporate bonds. IDFC exited part of the treasury portfolio at loss during 1HFY09. Overall NII grew by merely 1% YoY in 2QFY09. During 1HFY09, NII growth has been 25%. Spreads improved YoY from 2.0% to 2.1% but were down QoQ by ~10bp on a 12M rolling basis. The management highlighted that it would prefer higher quality loans assets in current environment and would focus on quality rather than higher yields/spreads.

Other Income growth – accelerating: Non interest income increased significantly by 72% YoY to Rs2.2b in 2QFY09 due to 60% growth in fees and 93% growth in capital gains. Capital gains were Rs890m during 2QFY09 as against Rs460m in 2QFY08. Capital gains during 1HFY09 have been significantly (Rs1.5b vs Rs2.2b in FY08) better than expectations. Management highlighted that there is no carry income booked in 1HFY09. Asset management fees grew 4.6x to Rs600m in 2QFY09 - due to 1) accrual of fees for PE-III of USD700m (for 5 months), 2) accrual of fees for project equity fund of USD900m (for 3 months) and 3) consolidation of Standard Chartered MF. We expect alternative asset management fees to grow 2.5x in FY09 to Rs1.42b.

Investment banking fees including loan syndication fees and broking decreased by 10% YoY to Rs370m in 2QFY09 and 20% YoY in 1HFY09 to Rs730m. Fees from project related advisory and structuring grew 32% YoY in 2QFY09 to Rs330m and 61% YoY in 1HFY09 to Rs790m. We expect these fees to slow down as the business volumes remain muted in 2HFY09.

RoAs decline: IDFC reported RoA of 2.8% in 2QFY09 (12m rolling), lower than September 2007 level of 3.2% and June 2008 level of 2.9%. Margins have declined by

10bp QoQ and 30bp from September 2007 level on 12m rolling basis. Strong traction in fees has however helped mitigate the falling margins partially (as a % to assets, fees increased from 1.3% in September 2007 and 1.4% in June 2008 to 1.6% in September 2008). Provisions decreased by mere 10% in 2QFY09 despite 26% decline in disbursements. The management has stepped up its loan loss provisions in FY09 considering the increased risks. The management reiterated that it aims to progressively increase its loan loss reserve ratio from current 1.2% of loan book to 1.5%.

No capital raising in foreseeable future: IDFC's capital adequacy is strong at 22.2% and Tier I at 18.9%. Required CAR for IDFC as per RBI regulations is 12% currently and 15% from FY10 - half of which can be made by Tier II. This implies IDFC's regulatory leverage can be 7-8x on a sustainable basis. However, a credit rating agency has turned very cautious on leverage limits for IDFC post the global financial turmoil. This means that IDFC would be required to maintain CAR at current levels to maintain its ratings. The management aims to preserve its AAA rating and thus plans to grow assets at a moderate pace. While management has taken a blanket shareholder approval for raising US\$750m of capital (debt and equity), it said that it has no plans to raise capital in foreseeable future. The management maintained that it would like to sustain leverage at current level of ~5x. Thus, IDFC would not be able to achieve its 18-20% RoE target over the next 2-3 years without a significant contribution from capital gains and carry income. In our view, its RoE would hover around 15-16% over next couple of years, given the constraints on leveraging of balance sheet.

Upgrade to Buy: We remain positive on the growth prospects of IDFC and its strengths to earn significant higher fee income. However, revenue and earnings growth during FY09 would remain subdued due to lackluster capital markets as ~40% of its FY08 consolidated net revenue was derived from capital gains, investment banking and broking businesses - all of which are expected to decline. We are upgrading FY09 earnings estimates by 2% and cutting FY10 earnings estimates by 3%.

We expect IDFC to report an EPS of Rs6.5 in FY09E and Rs7.9 in FY10E. Book value would be Rs48 in FY09 and Rs55 in FY10. Stronger capital gains (including carry income) and improvement in capital market activities can lead to positive surprises to our earnings estimates.

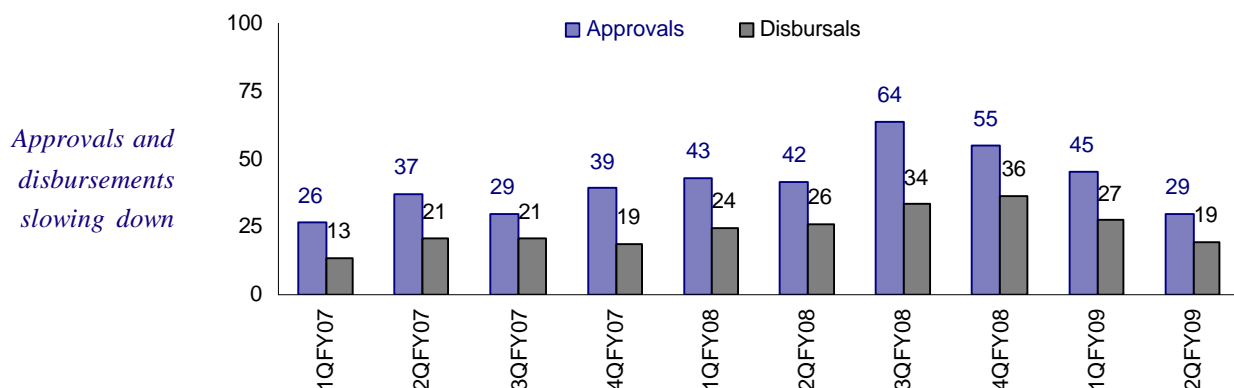
SOTP FY10 BASED

	(Rs b)	US\$ B	Per Share (Rs)	Valuation Rationale
Financing/Investment business	63.9	1.3	49.3	1x FY10E stand alone adjusted BV
Alternative assets management	14.7	0.3	11.4	13% of AUM of USD2.35b
NSE Stake	10.0	0.2	7.7	8% stake, base price of last deal
AMC	6.7	0.1	5.2	20% discount to acquisition price
IDFC SSKI	3.0	0.1	2.3	10x FY10E earnings, 80% stake of IDFC
Total Value	98.2	2.0	75.9	
CMP (Rs)	69.9	1.5	54.0	
Upside (%)	40.6	40.6	40.6	

Source: Motilal Oswal Securities

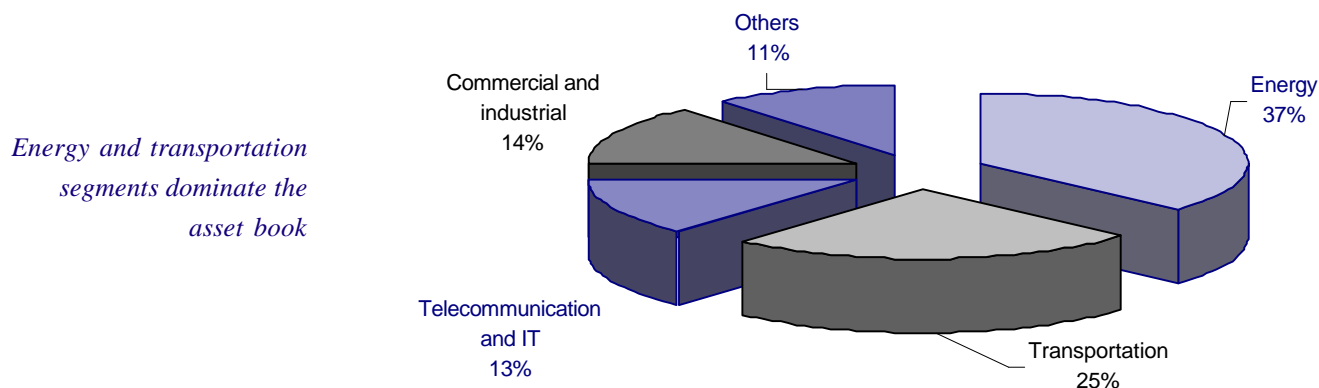
The stock trades at 1.1x FY09E BV and 8.3x FY09E EPS and 1x FY10E BV and 6.9x FY10E EPS. The current valuations are attractive and offer favourable risk reward ratio. Upgrade to **Buy** with a target price of Rs76; an upside of 41%.

APPROVALS AND DISBURSALS (%)



Source: Company/Motilal Oswal Securities

OUTSTANDING DISBURSEMENTS UP 23% TO RS234B



Source: Company/Motilal Oswal Securities

PRODUCT-WISE BREAK-UP (RS B)

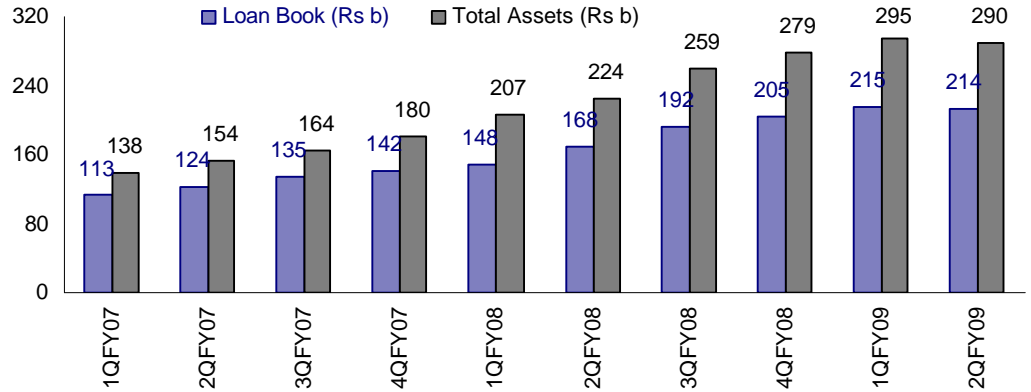
Asset book pipeline continues to be encouraging

	TOTAL EXPOSURE	OUTSTANDING	PIPELINE
Loans and Debentures	310.7	211.9	98.8
Project Loans	178.3	99.2	79.1
Corporate Loans	95.1	85.1	10.0
LAS	37.3	27.6	9.7
Mezzanine Products	6.3	4.7	1.7
Sub debt	2.7	1.1	1.6
Pref shares	3.7	3.7	0.0
Equity	27.1	13.0	14.1
Non Funded	6.1	4.7	1.4
Total	350.3	234.3	116.0

Source: Company/Motilal Oswal Securities

BALANCE SHEET GROWTH SLOWING DOWN

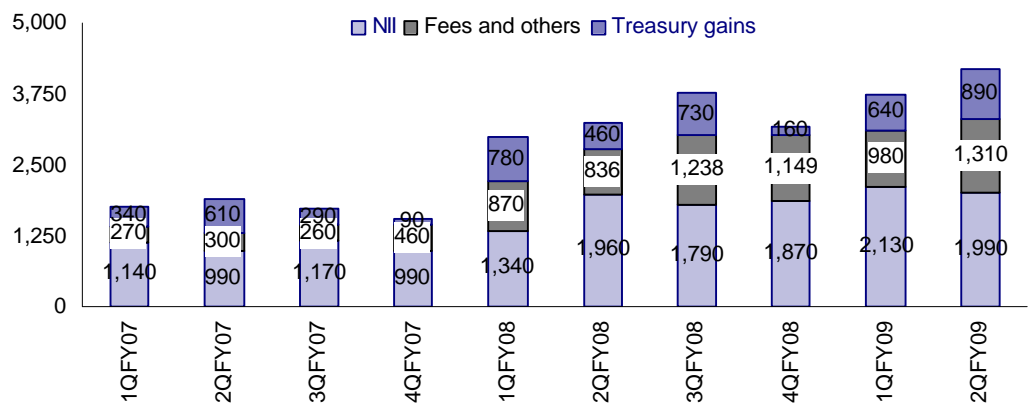
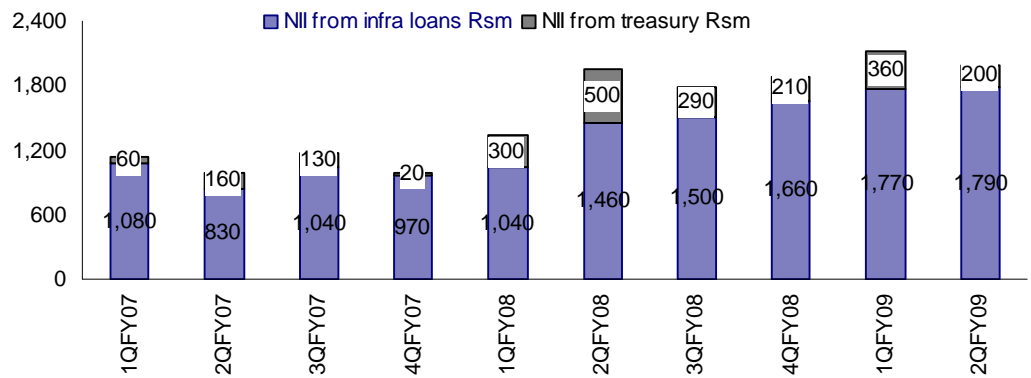
Management cautions that growth would slowdown going forward due to risk aversion



Source: Company/Motilal Oswal Securities

NII GROWTH AFFECTED DUE TO TREASURY OPERATIONS AND LOWER LOAN BOOK GROWTH

Fee share in total revenue increasing but capital gains continue to play a deciding role in earnings growth



Source: Company/Motilal Oswal Securities

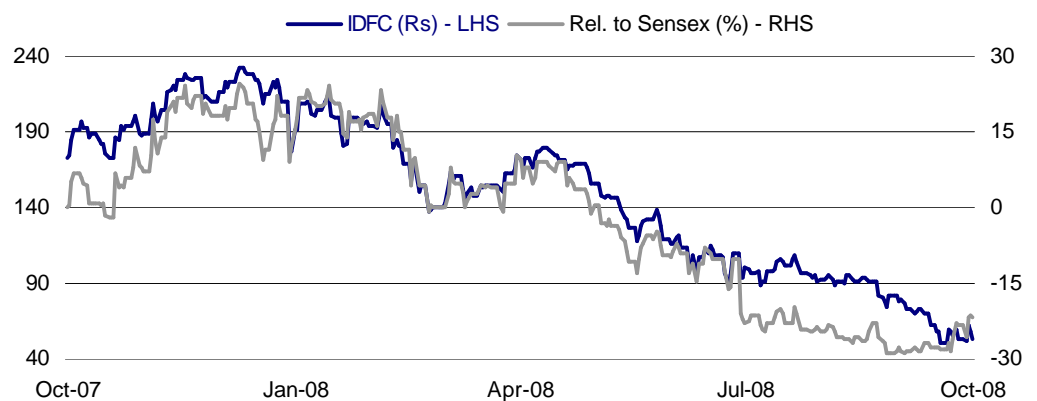
*Lower spreads put
pressure on RoAs*

ROA ANALYSIS (ROLLING TWELVE MONTHS BASIS)

	JUN-07	SEP-07	DEC-07	MAR-08	JUN-08	SEP-08
Net Interest Income	2.7	3.0	2.9	2.9	2.9	2.7
Infrastructure	2.4	2.5	2.3	2.4	2.4	2.3
Treasury	0.4	0.5	0.5	0.5	0.5	0.4
Non Interest Income	2.3	2.2	2.6	2.6	2.3	2.5
Fees income	1.2	1.3	1.6	1.7	1.4	1.6
Capital gains	1.0	0.8	1.0	0.9	0.8	0.8
Miscellaneous Income	0.0	0.0	0.0	0.1	0.1	0.1
Operating Income	5.0	5.1	5.5	5.6	5.3	5.3
Operating Expenses	0.7	0.8	0.9	1.1	1.1	1.1
Operating Profit	4.3	4.3	4.6	4.5	4.2	4.2
Provisions	0.1	0.2	0.2	0.3	0.3	0.3
PBT	4.1	4.1	4.3	4.2	3.9	3.8
Tax, Minority Interest	0.9	1.0	1.1	1.1	1.0	1.0
Share of associate companies	0.1	0.0	0.0	0.0	0.0	0.0
PAT	3.3	3.2	3.2	3.1	2.9	2.8

Source: Company/Motilal Oswal Securities

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(RS MILLION)
Y/E MARCH	2006	2007	2008	2009E	2010E	
Interest Income	7,848	12,762	20,810	28,384	34,549	
Interest Expended	5,008	8,555	14,829	20,548	25,155	
Net Interest Income	2,839	4,208	5,981	7,837	9,394	
Change (%)	20.2	48.2	42.1	31.0	19.9	
Other Income	2,520	2,951	7,255	7,392	8,917	
- Fees	959	1,346	2,170	3,473	4,475	
- Brokerage and Investment banking		0	1,863	1,069	1,442	
- Profit on sale of investments	1,561	1,605	3,223	2,850	3,000	
Net Income	5,359	7,158	13,236	15,229	18,311	
Change (%)	28.9	33.6	84.9	15.1	20.2	
Operating Expenses	546	818	2,532	2,786	3,317	
Operating Income	4,814	6,340	10,704	12,443	14,994	
Change (%)	24.1	31.7	68.8	16.2	20.5	
Other Provisions	387	175	700	1,080	1,225	
PBT	4,426	6,165	10,004	11,362	13,768	
Tax	517	1,241	2,480	2,954	3,580	
Tax Rate (%)	11.7	20.1	24.8	26.0	26.0	
PAT	3,909	4,924	7,523	8,408	10,189	
Change (%)	28.6	26.0	52.8	11.8	21.2	
(Minority Interest)/Associate profit	0	118	-100	-57	-68	
Consolidated PAT	3,909	5,042	7,423	8,352	10,121	
Change (%)	28.6	29.0	47.2	12.5	21.2	
Proposed Dividend	1,283	1,129	1,556	1,359	1,631	

BALANCE SHEET						(RS MILLION)
Y/E MARCH	2006	2007	2008	2009E	2010E	
Capital	11,225	11,259	12,943	12,943	12,943	
Reserves & Surplus	14,460	18,217	42,990	49,752	57,964	
Net Worth	25,685	29,476	55,933	62,695	70,907	
Borrowings	87,302	142,528	216,540	251,186	308,959	
Change (%)	48.1	63.3	51.9	16.0	23.0	
Sub-ordinated Debt	6,500	6,500	6,500	6,500	6,500	
Other Liabilities & Prov.	3,491	5,335	10,442	13,153	16,501	
Total Liabilities	122,977	183,840	289,415	333,534	402,867	
Cash and bank balance	3,530	10,800	18,081	11,225	11,856	
Investments	12,927	23,903	52,257	61,663	72,763	
Change (%)	68.2	84.9	118.6	18.0	18.0	
Advances	100,871	139,184	199,051	234,880	291,252	
Change (%)	43.1	38.0	43.0	18.0	24.0	
Net Fixed Assets	508	489	3,850	465	435	
Deferred Tax Assets	794	857	972	875	787	
Other Assets	4,347	7,637	12,257	13,483	14,831	
Total Assets	122,977	183,840	289,415	333,534	402,867	

ASSUMPTIONS	(%)				
Borrowings Growth	48.1	63.3	51.9	16.0	23.0
Advances Growth	43.1	38.0	43.0	18.0	24.0
Investments Growth	68.2	84.9	118.6	18.0	18.0
Leverage (x)	10.0	4.7	3.6	3.7	4.1
Dividend	10.0	10.0	10.0	10.5	12.6

E: M O S t Estimates

RATIOS

Y/E MARCH	2006	2007	2008	2009E	2010E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.2	8.9	9.7	10.6	11.2
Avg. Cost-Int. Bear. Liab.	6.3	7.0	8.0	8.5	8.8
Interest Spread	19	19	17	2.1	2.5
Net Interest Margin	3.0	2.9	2.8	2.9	3.1
Profitability Ratios (%)					
RoE	17.5	18.3	17.4	14.1	15.2
RoA	3.7	3.3	3.1	2.7	2.7
Int. Expended/Int.Earned	63.8	67.0	71.3	72.4	72.8
Fee Income./Net Income	17.9	18.8	16.4	22.8	24.4
Efficiency Ratios (%)					
Op. Exps./Net Income	10.2	11.4	19.1	18.3	18.1
Empl. Cost/Op. Exps.	57.6	58.7	66.2	66.4	70.4
Busi. per Empl. (Rs m)	1,260	1,224	950	1,127	1,207
NP per Empl. (Rs m)	310	25.6	20.5	210	22.6
Asset-Liability Profile (%)					
Debt/Equity Ratio (x)	3.7	5.1	4.0	4.1	4.4
Loans/Equity (x)		4.7	3.6	3.7	4.1
Total assets/Equity (x)		6.2	5.2	5.3	5.7
Gross NPAs to Adv.	0.5	0.6	0.2	0.4	0.5
Net NPAs to Adv.	0.0	0.0	0.0	0.3	0.4
VALUATION					
Book Value (Rs)	22.9	26.2	43.2	48.4	54.8
Price-BV (x)	2.4	2.1	1.2	1.1	1.0
Adjusted BV (Rs)	22.9	26.2	43.2	48.1	54.1
Price-ABV (x)	2.4	2.1	1.3	1.1	1.0
EPS (Rs)	3.5	4.4	5.8	6.5	7.9
EPS Growth (%)	14.6	25.6	32.9	11.8	21.2
Price-Earnings (x)	15.5	12.3	9.3	8.3	6.9
OPS (Rs)	4.3	5.6	8.3	9.6	11.6
OPS Growth (%)	10.6	31.3	46.9	16.2	20.5
Price-OP (x)	12.6	9.6	6.5	5.6	4.7

E: Most Estimates

N O T E S



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

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