

INDIA

IDFC

BUY
Maintained
Rs58

Financials

Earnings revision

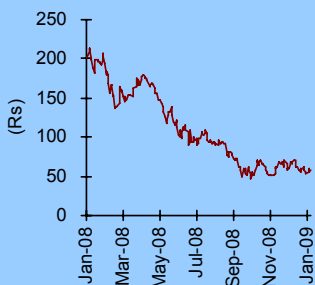
(%)	FY09E	FY10E
NII	↓ 3.3	↓ 5.9
PPP	↓ 6.4	↓ 15.5
Net profit	↓ 8.6	↓ 19.1

Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	-	-	-
Institutional investors	86.7	86.6	83.7
MFs and UTI	36.0	36.0	34.0
Insurance Cos.	6.7	6.7	8.1
FIs	44.0	44.0	41.5
Others	13.4	13.4	16.3

Source: BSE

Price chart



Capital market pressure visible

Reason for report: Q3FY09 results review & earnings revision

IDFC's Q3FY09 net profits declined 15% YoY, driven by sharp fall in non-interest income (down 61% YoY), primarily on account of slowdown in capital market-related businesses and lower gains booked on equity, even as NII growth remained strong (up 44% YoY in Q3FY09). Despite sharp moderation in loan growth to 7% YoY, NII grew a robust 44% YoY, driven by 20bps increase in spreads to 2.3% for rolling 12 months sequentially. Asset quality remained robust with nil NNPLs & no incremental slippages – loan-against-shares (LAS) fell to 6.7% QoQ of outstanding (o/s) book. We reduce FY09E & FY10E earnings estimates 8.6% & 19.1% respectively to reflect lower loan growth and pressure on capital market-related income. Maintain BUY with target price of Rs90/share.

- ▶ **Loan growth moderated further; spreads rose.** Gross disbursements decreased 34% YoY to Rs55.2bn, while o/s loan book grew 7% YoY to Rs213bn during nine months ended December '08. On a rolling 12-month basis, spreads expanded ~20bps QoQ to 2.3%. LAS comprised 6.7% of o/s advances (versus 10.7% in Q2FY09). NII growth at 44% was robust despite tepid loan growth, driven by sharp increase in spreads.
- ▶ **Non-interest income subdued due to impact on capital markets.** Other income growth was subdued in Q3FY09 (down 61% YoY) as income from principal investments, IDFC-SSKI and advisory/processing fees fell 99%, 80% & 74% respectively. Asset management fee remained robust (up 243% YoY) to Rs480mn during the quarter.
- ▶ **Asset quality robust, but expect acceleration in provisions.** Asset quality remained robust, with nil NNPLs and no incremental slippages. There has been a rundown of loan against share portfolio, which comprised 6.7% of o/s loans as against 10.7% in September '08. While provisions stood at Rs30mn in Q3FY09, we expect provisioning build-up to accelerate going forward.
- ▶ **Earnings & target price downgrade.** We lower FY09E & FY10E earnings estimates 8.6% & 19.1% respectively to reflect moderation in loan growth and lower income on capital market-related businesses. We estimate sustainable RoE from the core lending business at 14%, driven by constraint on leverage that could be ~5x. We marginally reduce our estimates for capital market-related businesses, leading to sum-of-the-parts (SOTP) based target price at Rs90/share. Maintain BUY. Sharp rise in NPLs is the key risk.

Market Cap	Rs75bn/US\$1.5bn
Reuters/Bloomberg	IDFC.BO/IDFC IN
Shares Outstanding (mn)	1,294.3
52-week Range (Rs)	235/45
Free Float (%)	100.0
FII (%)	41.5
Daily Volume (US\$/'000)	19,200
Absolute Return 3m (%)	0.0
Absolute Return 12m (%)	(71.8)
Sensex Return 3m (%)	(3.7)
Sensex Return 12m (%)	(48.3)

Year to March	2008	2009E	2010E	2011E
NII (Rs mn)	5,811	7,256	8,611	10,174
Net Income (Rs mn)	7,426	7,809	8,754	10,364
EPS (Rs)	5.8	6.2	6.9	8.2
% Chg YoY	33.2	6.1	12.3	18.4
P/E (x)	10.0	9.4	8.4	7.1
P/BV (x)	1.3	1.2	1.1	1.0
Net NPA (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	2.1	2.1	2.4	2.8
RoA (%)	3.3	2.6	2.5	2.5
RoE (%)	17.6	13.5	13.7	14.5

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Loan growth moderated further; spreads rose

Gross disbursements decreased 34% YoY to Rs55.2bn, while o/s loan book grew 7% YoY to Rs213bn during nine months ended December '08. We note that even on a QoQ basis, there has been a slight reduction in o/s loans (down 2% QoQ). While the lumpy nature of wholesale lending business makes it difficult to track loan growth on a quarterly basis, we are now factoring in a lower loan growth of 18% for IDFC given the tough market environment. NII growth at 44% was robust despite tepid loan growth driven by sharp increase in spreads (which rose 20bps QoQ to 2.3% on a rolling 12-month basis). The sharp increase in spreads was driven by improved pricing power during Q3FY09 and a fall in cost of wholesale deposits towards the end of the quarter.

Non interest income subdued due to impact on capital markets

Other income growth was subdued during the quarter (down 61% YoY); however, this was primarily on account of sharp fall in investment banking business and profits from principal investments. While profits from principal investments during the quarter stood at just Rs10mn, IDFC-SSKI (investment banking and brokerage) revenues fell 80% YoY to Rs130mn. Asset management fee remained robust (up 243% YoY) at Rs480mn during the quarter even as AUMs (ex-IDFC mutual fund) stood at US\$2bn.

Table 1: Non-interest income break-up

(Rs mn)

Non-interest income	Q3FY09	Q3FY08	YoY growth (%)
Principal investment	10.0	740.0	(99)
Asset management	480.0	140.0	243
IDFC SSKI	130.0	640.0	(80)
Loans related and other fees	110.0	430.0	(74)
Other income	30.0	30.0	0

Source: Company data, I-Sec Research

Asset quality robust, but expect acceleration in provisions

Asset quality remained robust, with nil NNPA's and no incremental slippages. However, we expect some stress on ~Rs30bn real estate portfolio of IDFC on account of liquidity crisis faced by some borrowers. There has been a rundown of loan against share portfolio, which comprised 6.7% of o/s loans as against 10.7% in September '08. While provisions stood at Rs30mn in Q3FY09, we expect provisioning build-up to accelerate going forward as cases for re-structuring rise on account of tough operating environment.

Earnings & target price downgrade

We lower FY09E & FY10E earnings estimates 8.6% & 19.1% respectively to reflect moderation in loan growth and lower income on capital market-related businesses. We estimate sustainable RoE from the core lending business at 14%, driven by constraint on leverage that could be ~5x. We marginally reduce our estimates for the capital market-related businesses, leading to SOTP-based target price of Rs90/share. Maintain BUY. Sharp rise in NPLs is the key risk.

Table 2: Q3FY09 results review*(Rs mn, year ending March 31)*

	Q3FY09	Q3FY08	% chg (YoY)	9MFY09	9MFY08	% chg (YoY)
Net interest income	2,570	1,780	44	6,690	5,070	32
Other income	770	1,970	(61)	4,720	4,920	(4)
Total income	3,340	3,750	(11)	11,410	9,990	14
Staff cost	328	451	(27)	1,284	1,142	12
Other op expenses	188	194	(3)	912	498	83
Total operating expenses	670	684	(2)	2,350	1,680	40
Gross profit	2,670	3,066	(13)	9,060	8,310	9
Other provisions and contingencies (net)	30	70	(57)	380	300	27
PBT	2,640	2,996	(12)	8,680	8,010	8
Provisions for taxes	800	820	(2)	2350	2090	12
Share of associate company PAT	1,840	2,176	(15)	6,330	5,920	7
NII (infrastructure)	2,070	1,490	39	5630	3990	41
NII (treasury)	510	280	82	1070	1080	(1)

Source: Company data, I-Sec Research

Table 3: Sum-of-the-parts valuations

	Rs/share	Methodology
IDFC Lending Business	67.6	FY10E BV of 1.5x
SSKI	3.1	FY10 PE of 10x
StanChart AMC	3.2	50% Discount to acquisition price
NSE	5.3	FY10 PE of 12x
Private/Project Equity business	10.4	DCF
	90	

Note: Value of lending business after stripping investments in SSKI and StanChart AMC

Source: Company data, I-Sec Research

Table 4: Earnings revision*(Rs bn)*

	FY09E			FY10E		
	New	Old	% chg	New	Old	% chg
NII	7.3	7.5	(3.3)	8.6	9.2	(5.9)
PPP	11.8	12.6	(6.4)	13.4	15.8	(15.5)
Net profit	7.8	8.5	(8.6)	8.8	10.8	(19.1)

Source: I-Sec Research

Financial Summary

Table 5: Profit and Loss Statement
(Rs bn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Interest earned	20.6	26.9	31.5	37.6
Interest expended	14.8	19.6	22.9	27.4
Net interest income	5.8	7.3	8.6	10.2
Other income	7.4	7.8	8.7	10.2
Trading gains	3.2	1.8	1.5	1.8
Fee income	0.6	1.8	2.5	2.7
Operating expenses	2.5	3.2	3.9	4.7
Employee costs	1.7	1.9	2.5	3.0
Pre-provisioning profit	10.7	11.8	13.4	15.6
Loan and investment loss provisions	0.7	0.9	1.1	1.3
Profit before tax	10.0	10.9	12.3	14.3
Income taxes	2.5	3.0	3.3	3.7
Minority Interest	(0.1)	(0.2)	(0.2)	(0.2)
Net profit	7.4	7.8	8.8	10.4

Source: Company data, I-Sec Research

Table 6: Balance Sheet
(Rs bn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Share Capital	12.9	12.9	12.9	12.9
Reserves and surplus	43.0	49.2	56.2	64.5
Borrowings	223.0	269.9	318.4	375.8
Other liabilities and provisions	0.2	-	-	-
Total liabilities & stockholders' equity	279.2	332.1	387.6	453.2
Cash and balances with RBI	18.1	7.0	8.0	7.0
Investments	52.3	71.6	83.2	99.2
Infrastructure Loans	199.1	236.9	279.5	329.8
Fixed Assets, net	3.9	4.0	4.1	4.2
Other Assets	6.0	12.5	12.8	13.0
Total assets	279.2	332.1	387.6	453.2

Source: Company data, I-Sec Research

Table 7: Key Ratios
(Year ending March 31)

	FY08	FY09E	FY10E	FY11E
Per share data (Rs)				
Period end shares outstanding (mn)	1,294.3	1,294.3	1,294.3	1,294.3
Basic EPS	5.8	6.2	6.9	8.2
Diluted EPS	5.8	6.2	6.9	8.2
Book value per share	43.2	48.0	53.5	59.9
Adjusted book value per share	43.2	48.0	53.5	59.9
Growth ratios (%)				
Total assets	56.4	18.9	16.7	16.9
Advances	43.0	19.0	18.0	18.0
Borrowings	56.5	21.0	18.0	18.0
Book value	65.1	11.2	11.3	12.0
EPS	33.2	6.1	12.3	18.4
Valuation ratios (x)				
P/PPP (pre-provisioning profit)	7.0	6.3	5.6	4.8
P/E	10.0	9.4	8.4	7.1
P/BV	1.3	1.2	1.1	1.0
P/ABV	1.3	1.2	1.1	1.0
Dividend yield (%)	2.1	2.1	2.4	2.8

Operating ratios (%)

Operating cost to income	19.1	21.4	22.7	23.3
Operating expenses/ Avg. assets	1.1	1.1	1.1	1.1

Profitability ratios (%)

Spread	1.3	1.2	1.4	1.4
Net interest margin	2.6	2.5	2.5	2.5
Return on avg. assets	3.3	2.6	2.5	2.5
Return on avg net worth	17.6	13.5	13.7	14.5

Asset quality and capital (%)

Gross NPA	0.20	0.25	0.32	0.41
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Source: Company data, I-Sec Research

Table 8: Quarterly trends
(Rs mn, year ending March 31)

	Mar-08	Jun-08	Sep-08	Dec-08
Net interest income	1,870	2,140	1,980	2,570
% growth (YoY)	88.9	60.9	1.0	44.4
Other income	1,380	1,680	2,270	770
Pre-provision profit	2,390	3,040	3,350	2,670
Net profit	1,490	2,180	2,310	1,840
% growth (YoY)	60.2	21.1	19.1	(15.6)

Source: Company data, I-Sec Research

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