

IDFC Ltd

Rs 129

Steady core performance in challenging macro environment

BUY



IDFC reported consolidated PAT of Rs 314 cr against our estimate of Rs 315 cr growing 9% q-o-q, but however declined 6% q-o-q. Approval and disbursement were down 50% each respectively indicating sharp slowdown in infrastructure financing space especially in power sector. NII increased 43% y-o-y and 2% q-o-q to Rs 483 cr driven by Infrastructure NII and Treasury NII which grew 41% y-o-y and 61% y-o-y respectively. Slower growth in loan related fee income, sharp fall in fee income from investment banking & institutional broking and trading loss dragged non-interest income during the quarter. Non-interest income's share has declined 56% y-o-y and 35% q-o-q due to weaker income from capital market linked businesses. However, core operating profit registered 34% y-o-y reflecting underlying strong growth momentum in lending business. Maintain buy with revised TP Rs167.

Operating income up 21% y-o-y and 5% q-o-q: Net interest income grew strongly by 43% y-o-y mainly driven by strong loan growth at 30% y-o-y, stable spreads and sequential sharp uptick in NII from treasury. Lending business contributed ~ 80% of operating income during the quarter, whereas the share for non-interest income's has declined from 24% in Q4FY11 to 20% on the back of lower capital gains, subdued fee income from asset management, investment banking and institutional brokerage. Non-interest income decreased 56% y-o-y & 20% q-o-q to Rs 122 crore. We expect net interest income to grow 20% CAGR over FY11-13E driven by steady loan growth.

Stable lending spread q-o-q: Core lending spread remained stable at 2.2% indicating return of reasonable pricing power. With diversification of liability franchise and targeting better yield on asset side, we expect IDFC to sustain core lending spread at 2.3-2.4% going forward.

Loan book growth at 30% y-o-y; loan growth guidance scale down: Gross approvals and gross disbursement declined by ~50% y-o-y due to the challenging macro environment. Loan book grew 30% y-o-y to Rs 37,527 cr driven by power and transportation sector. The management has scale down growth target from 30% to 15% for FY12 due to rising interest rate environment and slowdown in infrastructure projects. We believe 3x balance sheet growth target are likely to extend in medium term. We believe that IDFC's strategy to slowdown balance sheet growth and focus on profit growth is better proposition in current macro environment.

Valuation & Recommendation: IDFC has performed relatively better on lending operation front however showed subdued performance in capital market linked businesses due to adverse market conditions. We have cut FY12 and FY13 earnings estimate by 5% & 9% respectively factoring lower loan growth, moderate growth in fee income and margin pressure. However, we expect earnings to grow 17% CAGR over FY11-13 driven by core operation. At Rs129, the stock is trading at 1.5x FY13 book and 10.8x FY12 earnings, below than the 5 year mean valuation. We believe integrated business model, strong management capabilities, superior return ratios, healthy asset quality attractive risk-reward are key investment ratio for IDFC. We also believe policy rate hike cycle is closer to its peak and IDFC would be the most beneficiary when the cycle reverses. Hence, we maintain our BUY rating on the stock with TP of Rs169.

Key Financials

Rs in crore	FY10	FY11	FY12E	FY13E
Net Interest Income	938	1,560	2,019	2,247
Operating Profit	1,558	2,014	2,481	2,801
Net Profit	1,064	1,280	1,588	1,754
EPS	8.2	8.7	10.8	12.0
BVPS	53.9	71.0	79.0	87.6
P/E	15.8	14.7	11.9	10.8
P/BV	2.4	1.8	1.6	1.5

Source: Company, KRChoksey Research

Target Price (Rs): 169

Potential Upside : 31%

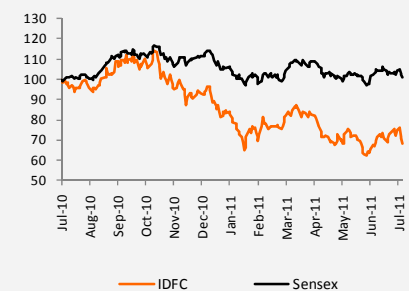
Previous TP (Rs): 192

Market Data	
Eq.shares O/S (Cr)	146.3
MCAP (Rs crs)	18,449
52 Wk H/L (Rs)	218/111
Avg Vol (3m avg)	7480898
Fee float (%)	85%
Face Value (Rs)	10
Bloomberg Code	IDFC IN

Market Info:

SENSEX	18,199
NIFTY	5,478

Price Performance



Share Holding pattern (%)

Particulars	Jun-11	Mar-11	Chg %
Promoters	-	-	-
FIs	46.8	51.1	-4.3
Institutions	36.9	35.8	1.1
Others	16.3	13.1	3.2
Total	100	100	-

Source: BSE

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Strong NII growth led by steady loan growth

Net interest income showed a robust growth of 43% y-o-y driven by the strong growth in Infrastructure NII (41% y-o-y) and treasury NII (67% y-o-y). Steady loan growth, sharp jump in treasury book and stable spreads helped to show strong NII. Infrastructure loan book grew 29.8% y-o-y and flat on q-o-q driven by power and transportation sector which contribute 67.7% to outstanding disbursements. In terms of RoA contribution, Net interest income's contribution was stable to 3.9% on pre tax basis. Management has guided that spreads on infra loans are likely to improve on the back of slower & selective loan growth and focus on better asset yield. However, we are factoring 10bps spread contraction in FY12 to reflect margin pressure in rising interest rate environment. We expect net interest income to grow 20% CAGR over FY11-13E driven by steady loan growth.

Exhibit :1 Loan and NII growth Trend y-o-y

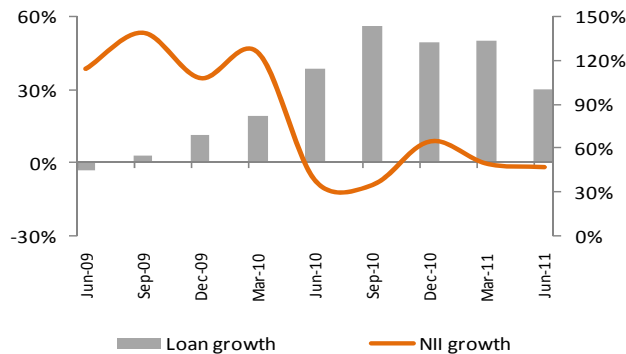
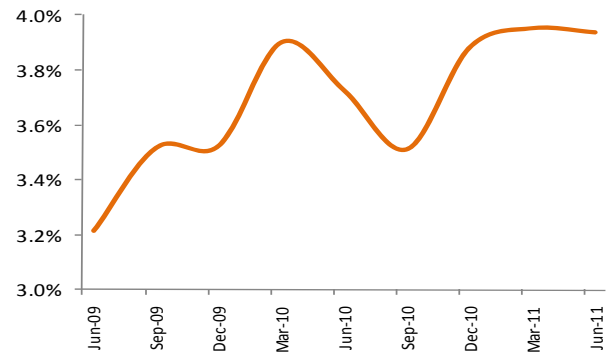


Exhibit : 2 NII / Avg asset Rolling Basis - Calculated



Source: Company, KRChoksey Research

Subdued non-interest income led by decline in fee income and trading losses

Lending business contributed ~ 80% of operating income during the quarter; however non-interest income's share has declined from 24% in Q4FY11 to 20%. Sharp slowdown in sanction and disbursement led to decline in loan related fee by 15% y-o-y (adjusting IDFC foundation). Lower cash market volumes, falling brokerage yields and subdued capital raising environment resulted into 50% q-o-q drop in income from investment banking and institutional brokerages. Principle investment reported Rs2 crore losses against Rs120 crore profits in Q1FY11. However, management plans to monetize certain investment to profit growth momentum during the quarter. We are building in 11% CAGR in non-interest income over FY11-FY13e driven by capital gains, asset management fees and brokerage and investment banking fees.

Exhibit :3 Operating income trend

Rs in crore	Q1FY12	Q1FY11	Q4FY11	y-o-y	q-o-q
Net interest income	483	337	478	43.3%	1.0%
- Infrastructure	428	304	426	40.8%	0.5%
- Treasury	55	33	52	66.7%	5.8%
Non-interest income	110	266	183	-58.6%	-39.9%
Principal Investment	-2	120	5	-101.7%	-140.0%
Asset management	62	65	113	-4.6%	-45.1%
- Mutual Fund	33	28	34	17.9%	-2.9%
- Alternatives	29	38	54	-23.7%	-46.3%
- Capital gains & Carry	0	0	24	-	-100.0%
Investment Banking & Broking	19	36	38	-47.2%	-50.0%
- Investment Banking	8	22	28	-63.6%	-71.4%
- Institutional Broking	11	14	10	-21.4%	10.0%
Loan related & other fees	31	44	27	-29.5%	14.8%
Misc income	11	11	7	0.0%	57.1%
Operating income	604	613	667	-1.5%	-9.4%

Source: Company, KRChoksey Research Note: certain portion of loan related fee income which related to subsidiaries was transferred to IDFC foundation, after adjusting this fee income would have been Rs31 crore in Q1FY12 vs Rs37 crore in Q1FY11, down 15% y-o-y. Similarly, operating expenses were adjusted to Rs114 crore in Q1FY12 vs Rs117 crore in Q1FY11.

Borrowings increased 23.7% y-o-y; short term loan up 121% q-o-q

Borrowings increased 23.6% y-o-y and 6.5% q-o-q, supporting infrastructure loan growth and treasury book which grew 41% y-o-y & 36% y-o-y respectively. Long term loans constitute 90.4% of total borrowings and the remaining is the short term borrowings. Foreign borrowings increased 44.8% y-o-y. Asset duration and liability duration stood at 2 yrs and 2.55 yrs respectively. Short term loan increased sharply by 121% q-o-q which largely invested in treasury book.

Exhibit :5 Asset Liability Trend

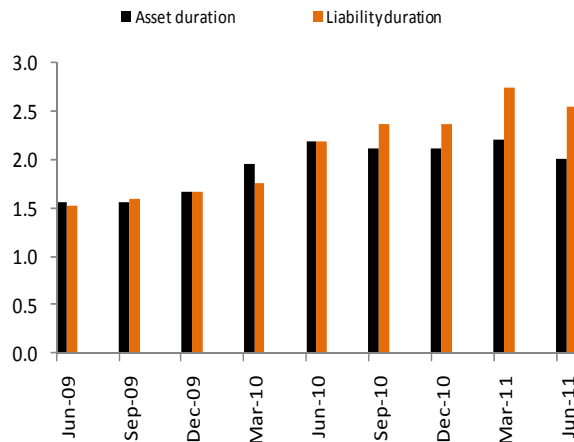
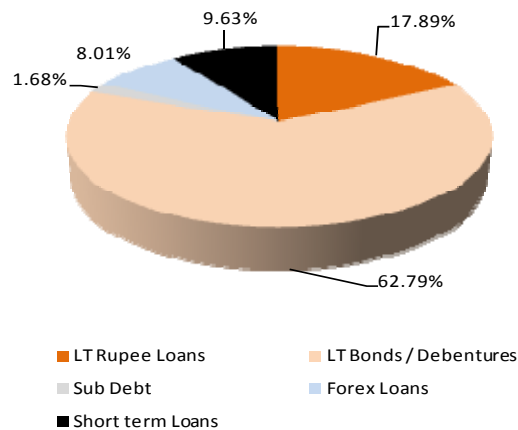


Exhibit :6 Diversified Liability Franchise



Source: Company, KRChoksey Research

Loan book growth at 30% y-o-y; loan growth guidance scale down

Gross approvals and gross disbursement declined by ~50% y-o-y due to the challenging macro environment, policy paralysis on reforms front, rising concerns in power sector and this led to subdued growth in loan book on q-o-q basis. Loan book grew 30% y-o-y to Rs 37,527 cr driven by power and transportation sector which contributes 68% of total outstanding disbursement. In terms of product based distribution, project loans and corporate contribute 89% of outstanding disbursement. The management has scale down growth target from 30% to 15% for FY12 due to rising interest rate environment and slowdown in infrastructure projects. We believe 3x balance sheet growth target are likely to extend in medium term. We believe that IDFC's strategy to slowdown balance sheet growth and focus on profit growth is better proposition in current macro environment. We expect infra loan book to grow 18% CAGR over FY11-FY13e.

Exhibit :7 Product based O/S disbursement Break up - Q1FY12

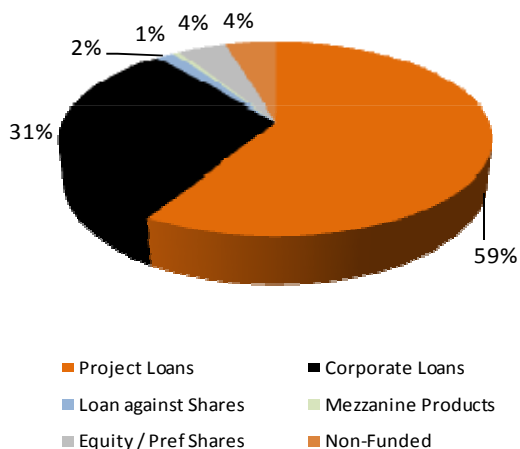
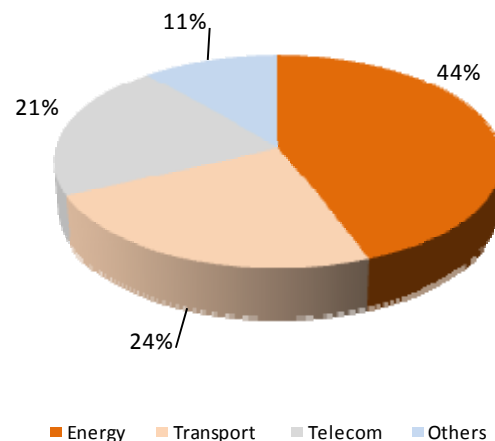


Exhibit :8 O/S Disbursement Mix - Q1FY12



Source: Company, KRChoksey Research

Asset under management ~\$8.7bn (Mutual fund and Alternative Assets)

Asset under management stood at Rs38,830 crore at end of Q1FY12, comprising mutual fund assets, alternative assets, project equity. Fee income from mutual funds and alternative assets decreased 17.9% y-o-y and 23.7% respectively. The management has indicated that alternative assets are likely to raise fund in H2FY12. We believe income from asset management continue to support profitability going forward.

Exhibit :7 AUM and Asset Management Fee income Trend

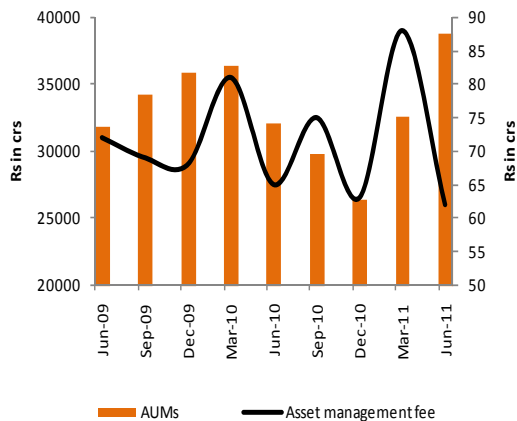


Exhibit :8 Asset under management composition - Q1FY12

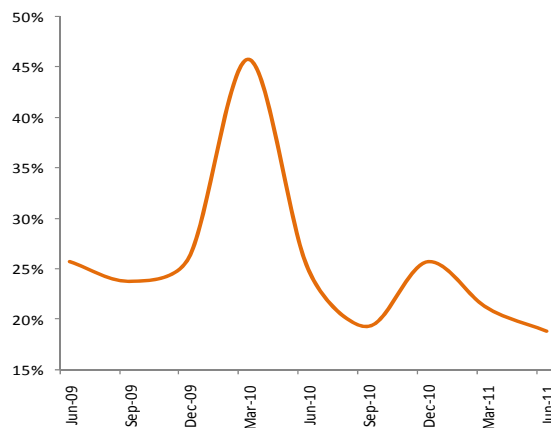
	Rs Crore	USD Bn
IDFC Private Equity	4457	1.0
Fund I	285	0.1
Fund II	1269	0.3
Fund III	2903	0.7
IDFC Project Equity Fund	3837	0.9
IDFC Mutual Fund	30536	6.8
Investment Advisor	682	0.2
Equity	5506	1.2
Debt	24349	5.5
Total	38830	8.7

Source: Company, KRChoksey Research

Cost to Income remains stable

Operating expenses declined 10% q-o-q, which led to the decline in cost to income ratio by 100bps q-o-q to 19%. However, the management has guided us that cost to income ratio is likely to remain 18-20% going forward.

Exhibit :8 Cost to income ratio



Source: Company, KRChoksey Research

Other Key Highlights

- Capital Adequacy ratio is healthy at 24.01% (Tier I 21.46%) against the regulatory requirement of 15%, giving enough room to leverage the balance sheet going forward.
- Gross NPAs and Net NPAs stood at 0.2% and 0.10% respectively.
- Stake sale of 25% in AMC business to Natixis received from SEBI and FIPB.



Earnings Revision

(Rs in crores)	FY12E			FY13E		
	Old	New	% change	Old	New	% change
NII	2,162	2,019	-7%	2,599	2,247	-14%
Non-interest income	1,105	1,100	0%	1,249	1,232	-1%
Opex	680	638	-6%	779	678	-13%
PPP	2,587	2,481	-4%	3,070	2,801	-9%
Provision	261	245	-6%	339	295	-13%
PAT	1,651	1,588	-4%	1,912	1,754	-8%

Source: Company, KRChoksey Research

SOTP Valuation

We have downgrade valuation multiple for IDFC's lending business from 2.2x to 1.6x to factor in macro headwind such as prolong rate hike cycle, slowdown in infrastructure finance and deterioration in pricing power near term.

Based on FY13 Estimate	Rs	Basis of Valuation
Core Lending Business	125	1.6x of Book value
Investment banking & brokerage	6	12x of Earnings
Private Equity	16	15% of AUM
Mutual fund	15	5% of AUM
NSE investment value	7	Based on recent market deal
Intrinsic value per share (Rs.)	169	

Source: Company, KRChoksey Research

Quarterly Result analysis

Rs in crore	Q1FY12	Q1FY11	Q4FY11	y-o-y	q-o-q
Income Statement					
Net Interest Income	483	337	474	43%	2%
Infrastructure	428	304	425	41%	1%
Treasury	55	33	49	67%	12%
Non Interest Income	122	276	152	-56%	-20%
Principal Investment	-2	120	29	-102%	-107%
Asset management	62	65	88	-5%	-30%
Investment Banking & Broking	19	36	38	-47%	-50%
Loan related & other fees	31	44	-9	-30%	-444%
Miscellaneous income	12	11	6	9%	100%
Operating Income	605	613	626	-1%	-3%
Operating Expenses	114	123	126	-7%	-10%
Pre-Provisioning Profits	491	490	500	0%	-2%
Provisions & Losses	40	45	89	-11%	-55%
PBT	451	445	411	1%	10%
Tax	137	110	124	25%	10%
PAT	314	335	287	-6%	9%
Core operating profits	493	370	471	33%	5%
Balance Sheet					
Net Worth	11551	7322	11248	57.8%	2.7%
Loan Funds	38669	31283	36304	23.6%	6.5%
Infrastructure Loans (net)	37527	28901	37552	29.8%	-0.1%
Investments	10608	7800	8303	36.0%	27.8%
Total Assets	50221	38612	47554	30.1%	5.6%
Gross Approvals	6523	13046	6213	-50.0%	5.0%
Gross Disbursements	3102	6204	4207	-50.0%	-26.3%
Key Ratios					
Net interest income / Avg assets	4.0%	4.0%	3.7%	8 bps	31 bps
Infrastructure	3.5%	3.6%	3.4%	-6 bps	13 bps
Treasury	0.5%	0.4%	0.4%	4 bps	8 bps
RoA (reported)	2.8%	3.4%	3.0%	-60 bps	-20 bps
Spread on lending - Reported	2.2%	2.7%	2.2%	-50 bps	0 bps
Cost to income ratio - (calculated)	18.8%	21.1%	24.9%	-232 bps	-617 bps
Effective tax rate -(calculated)	30.4%	30.2%	24.7%	21 bps	566 bps
Loan loss reserve - Reported	1.7%	1.7%	1.6%	0 bps	10 bps
RoE - (calculated)	12.0%	10.8%	19.6%	122 bps	-754 bps

Source: Company, KRChoksey Research

Financials

Income Statement

Rs in crore	FY10	FY11	FY12E	FY13E
Interest income	2,892	3,948	5,229	6,086
Interest expense	1,953	2,388	3,209	3,838
Net interest income	938	1,560	2,019	2,247
Non interest income	1,169	985	1,100	1,232
Operating income	2,107	2,546	3,119	3,480
Operating expenses	548	531	638	678
Pre-provisioning profit	1,558	2,014	2,481	2,801
Provision	128	235	245	295
Profit before tax	1,430	1,779	2,236	2,506
Tax expense	367	500	648	752
Net profit	1,064	1,280	1,588	1,754
PAT after MI	1,065	1,282	1,588	1,754
Proposed dividend	228	333	429	492

Key Ratios

	FY10	FY11	FY12E	FY13E
Spread	2.9%	3.5%	3.4%	3.5%
Net interest margin	2.9%	3.8%	4.0%	3.8%
RoA	3.2%	3.1%	3.1%	3.0%
RoE	16.1%	14.0%	13.9%	14.4%
Leverage (x)	4.96	4.51	4.47	4.84
Cost to income ratio	26.0%	20.9%	20.5%	19.5%
CAR	20.1%	24.4%	21.9%	21.2%

Balance Profile

	FY10	FY11	FY12E	FY13E
Infra Loan / TA	71.9%	79.2%	80.8%	83.3%
Investments / TA	13.3%	17.6%	15.8%	14.0%
Infra Loans / Loans	94.3%	103.7%	102.6%	97.5%
NII / OI	44.5%	61.3%	64.7%	64.6%
Non int. income / OI	55.5%	38.7%	35.3%	35.4%

Per Share Data

Valuation	FY10	FY11	FY12E	FY13E
EPS (Rs)	8.2	8.7	10.8	12.0
DPS (RS)	1.7	2.3	2.9	3.4
BVPS (Rs.)	53.9	71.0	79.0	87.6
Adj. BVPS (Rs)	43.2	61.5	69.4	78.0
PE (x)	16.5	15.4	12.5	11.3
Price to book (x)	2.5	1.9	1.7	1.5
Dividend yield (%)	1.4%	1.8%	2.3%	2.6%

Source: KRChoksey Research

Balance Sheet

Rs in crore	FY10	FY11	FY12E	FY13E
Net worth	7010	10408	11567	12831
MI	6	2	2	2
Borrowings	26,544	36,304	42,941	54,235
Total Liabilities	34,810	47,554	54,510	63,477
Infra Loans	25,031	37,652	44,053	52,861
Investments	4,642	8,364	8,614	8,864
Goodwill	1,169	1,164	1,164	1,164
Fixed assets & other assets	3,791	125	430	336
Total Assets	34,810	47,554	54,510	63,477

Dupont Analysis

	FY10	FY11	FY12E	FY13E
Interest income	8.8%	9.6%	10.2%	10.3%
Interest expense	6.0%	5.8%	6.3%	6.5%
Net interest income	2.9%	3.8%	4.0%	3.8%
Non interest income	3.6%	2.4%	2.2%	2.1%
Operating income	6.4%	6.2%	6.1%	5.9%
Operating expenses	1.7%	1.3%	1.3%	1.2%
Pre-provisioning profit	4.8%	4.9%	4.9%	4.7%
Provision	0.4%	0.6%	0.5%	0.5%
Profit before tax	4.4%	4.3%	4.4%	4.2%
Tax expense	1.1%	1.2%	1.3%	1.3%
Net profit	3.2%	3.1%	3.1%	3.0%
Leverage	5.0	4.5	4.5	4.8
RoE	16.1%	14.0%	13.9%	14.4%

Growth ratios

	FY10	FY11	FY12E	FY13E
Net interest income	22.7%	66.3%	29.4%	11.3%
Non interest income	47.7%	-15.7%	11.6%	12.1%
Operating income	35.4%	20.8%	22.5%	11.6%
Pre-provision profits	31.1%	29.2%	23.2%	12.9%
Net profits	40.4%	20.3%	24.1%	10.5%
Infra Loans	21.5%	50.4%	17.0%	20.0%
Borrowings	12.5%	36.8%	18.3%	26.3%



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IDFC			
Date	CMP	Target	Recommendation
29-Jul-11	129	169	BUY
3-May-11	140	192	BUY
3-Feb-11	141	206	BUY
10-Nov-10	207	254	BUY
6-Aug-10	183	209	BUY

Rating Legend	
Our Rating	Upside
Buy	More than 15%
Hold	5% - 15%
Reduce	0 - 5%
Sell	Less than 0%

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