HSBC Global Research

Financial Institutions Group
Commercial Banks
Equity – India

IndusInd Bank (IIB)

Overweight

Target price (INR)	362.00
Share price (INR)	248.95
Potential return (%)	45.4

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-13.2	1.0	-14.8
Relative^ (%)	-4.6	4.4	3.1

Index^	BOMBAY SE SENSITIVE INDEX
RIC	INBK.BO
Bloomberg	IIB IN
Market cap (USDm)	2,225
Market cap (INRm)	116,182
Free float (%)	83

2 December 2011

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OW: Interesting takeaways on CV cycle and savings rate

- **CV segment still going strong, mainly due to IIB's gaining market share and rural economy's doing well**
- **Savings rate increase should have a small short-term impact but long-term neutral; asset quality remains stable**
- **Reiterate Overweight rating with target price of INR362, which implies a potential return of 45.4%**

We met with IndusInd Bank management to pick up key trends in the CV market and their initial experience on savings rate deregulation.

Commercial vehicle business still going strong: The CV segment for IIB has been growing at 37% YoY in the current fiscal year, despite moderation in CV cycle. Management has guided that the growth is likely to remain robust in the current fiscal year, the key reasons being: (a) PSU banks and marginal NBFCs are exiting the market, helping incumbents to grow market share, (b) while CV sales usually have had a high correlation with IIP, incrementally increasing rural prosperity, driven by NREGA* and higher MSPs** and supporting CV demand; (c) ongoing rural infrastructure projects also have contributed to CV demand; (d) ongoing shift of market share from railways to roadways is due to improving road infrastructure; (e) LCV growth remains strong at 20-25% due to last-mile connectivity's building up in rural areas; and (f) freight rates have remained firm and appear likely to remain so, implying continued profitability for truck operators.

Asset quality remains robust: IIB has not seen any major concerns building up on its loan book. Vehicle portfolio continues to do well with low delinquencies, while corporate segment is largely working-capital finance, where the book is behaving well. The bank is looking to build up floating provision buffer over the next few quarters as a counter-cyclical measure.

Savings rate increase – small short-term impact, long-term neutral: IIB is one of the few banks that increased its savings rate to 6%. While it expects a near-term impact on NIM of ~3-4bps, expected improvement in CASA traction and the recent base-rate hike should help them remain margin-neutral over 2-3 quarters. Interestingly, bulk SA in the system is likely to be interest rate-sensitive; however, retail SA should largely be rate-agnostic.

Valuation: IIB is trading at 12-month forward multiples of 12.6x PE and 2.4x PB. We value IIB at 19x PE and 2.7x PB, thereby retaining our 12-month target price of INR362, implying a potential return of 45.4%. We reiterate our Overweight rating. We continue to see a structural growth story unfolding with new drivers emerging over the next few years as it gains size. Key risks: further policy tightening by RBI and higher-than-expected loan slippages.

** National Rural Employment Guarantee Scheme. ** Minimum support price.*

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
P&L summary (INRm)				
Net interest income	13,765	17,293	22,534	28,990
Net fees/commissions	4,111	6,092	8,128	10,700
Trading profits	404	525	578	636
Other income	2,621	3,436	4,459	5,699
Total income	20,902	27,347	35,698	46,025
Operating expense	-10,085	-13,265	-17,140	-21,918
Bad debt charge	-1,612	-1,799	-2,315	-2,968
Other	-407	-324	-474	-559
HSBC PBT	8,798	11,959	15,768	20,580
Exceptionals	0	0	0	0
PBT	8,798	11,959	15,768	20,580
Taxation	-3,025	-4,006	-5,282	-6,894
Minorities + preferences	0	0	0	0
Attributable profit	5,773	7,953	10,486	13,686
HSBC attributable profit	5,773	7,953	10,486	13,686
Balance sheet summary (INRm)				
Ordinary equity	38,169	44,650	53,173	64,297
HSBC ordinary equity	38,169	44,650	53,173	64,297
Customer loans	261,656	334,509	428,068	547,916
Debt securities holdings	159,694	194,874	243,960	304,345
Customer deposits	327,874	408,511	530,192	683,113
Interest earning assets	385,637	491,181	619,509	786,659
Total assets	456,358	567,668	718,189	907,529
Capital (%)				
RWA (INRm)	307,160	404,034	528,573	697,454
Core tier 1	12.3	11.1	10.1	9.2
Total tier 1	12.3	11.1	10.1	9.2
Total capital	15.9	14.5	13.2	12.1

Ratio, growth & per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Year-on-year % change				
Total income	45.2	30.8	30.5	28.9
Operating expense	37.0	31.5	29.2	27.9
Pre-provision profit	53.7	30.2	31.8	29.9
EPS	44.0	29.6	31.8	30.5
HSBC EPS	44.0	29.6	31.8	30.5
DPS	11.2	34.9	33.3	30.6
NAV (including goodwill)	55.5	17.0	19.1	20.9
Ratios (%)				
Cost/income ratio	48.2	48.5	48.0	47.6
Bad debt charge	0.7	0.6	0.6	0.6
Customer loans/deposits	79.8	81.9	80.7	80.2
NPL/loan	1.0	1.2	1.2	1.2
NPL/RWA	0.9	1.0	1.0	1.0
Provision to risk assets/RWA	0.6	0.7	0.7	0.7
Net write-off/RWA	0.0	0.0	0.0	0.0
Coverage	72.6	72.0	72.0	72.0
ROE (including goodwill)	19.3	19.2	21.4	23.3
Per share data (INR)				
EPS reported (fully diluted)	13.17	17.07	22.50	29.37
HSBC EPS (fully diluted)	13.17	17.07	22.50	29.37
DPS	2.00	2.70	3.60	4.70
NAV	81.91	95.82	114.11	137.99
NAV (including goodwill)	81.91	95.82	114.11	137.99

Core profitability (% RWAs) and leverage

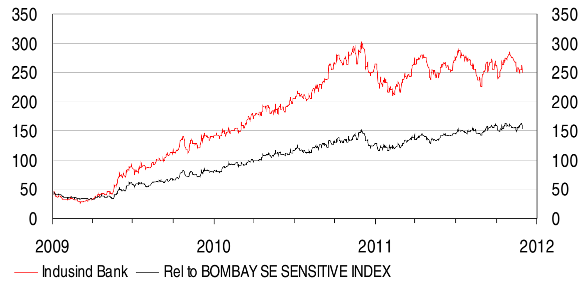
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Net interest income	5.2	4.9	4.8	4.7
Trading profits	0.2	0.1	0.1	0.1
Other income	1.0	1.0	1.0	0.9
Operating expense	-3.8	-3.7	-3.7	-3.6
Pre-provision profit	4.1	4.0	4.0	3.9
Bad debt charge	-0.6	-0.5	-0.5	-0.5
HSBC attributable profit	2.2	2.2	2.2	2.2
Leverage (x)	8.8	8.6	9.5	10.4
Return on average tier 1	15.3	17.8	19.7	21.3

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
PE*	18.9	14.6	11.1	8.5
Pre-provision multiple	10.1	8.2	6.3	4.8
P/NAV	3.0	2.6	2.2	1.8
Equity cash flow yield (%)	-0.2	1.0	1.5	1.6
Dividend yield (%)	0.8	1.1	1.4	1.9

Note: * = Based on HSBC EPS (fully diluted)

Price relative

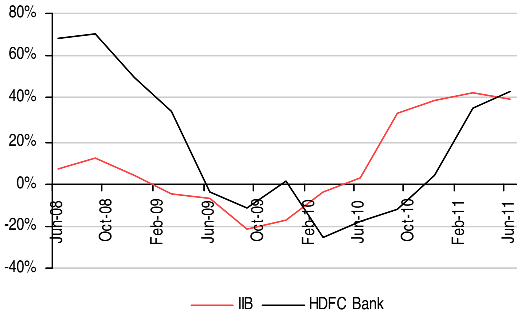


Source: HSBC

Note: price at close of 30 Nov 2011

Commercial vehicle trends

Chart 1: IIB and HDFC Bank growing strongly due to improving market share

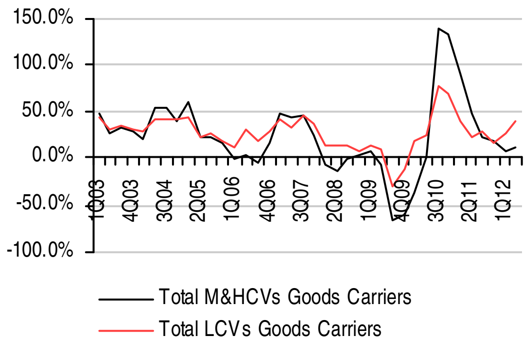


Source: Company reports, HSBC

Remarks

- IIB and HDFC Bank had robust growth in their CV loan books in the past few quarters, with both increasing in the range of 35-40% in 1HFY12.
- This is despite a slowdown in the M&HCV market; however, the LCV market has been holding up well.
- Key reasons for such growth is mainly the ability to increase market share; discussions with some large players show that PSU Banks and marginal NBFCs have been exiting the market. Smaller NBFCs, particularly, are facing a funding and capital crunch.
- Roughly half the growth for IIB and HDFC Bank appears to be coming from market growth, and the balance is market-share acquisition.

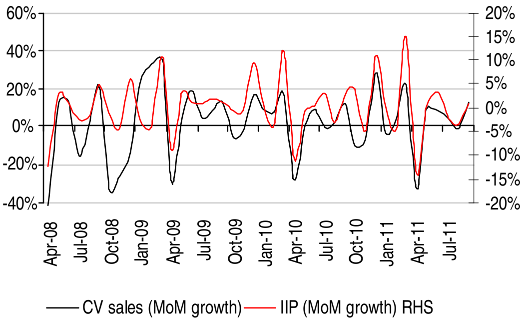
Chart 2: Long-term CV growth trend



Source: CEIC, HSBC

- Long-term demand trend suggests that M&HCV and LCVs have grown in 20s on an average over the past nine years.
- Particularly, LCV growth has been higher than M&HCV growth due to their need for last-mile connectivity. Also, LCVs usually have a shorter life span, implying higher replacement demand than M&HCVs.
- In the current fiscal year, M&HCV's growth has moderated to 8% YoY, while LCV is still growing at a strong 32% YoY.

Chart 3: CV sales have a high correlation with IIP

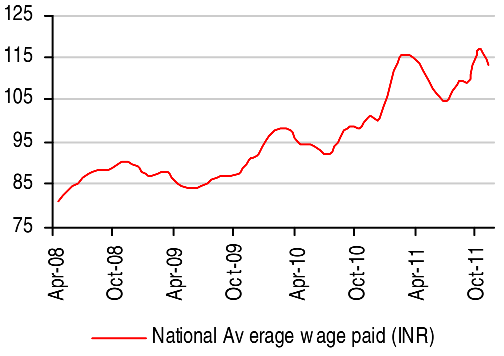


Source: CEIC, HSBC

- CVs usually have had a high correlation with IIP trends.
- While this still is a dominant driver, increasing rural prosperity and infrastructure growth in rural areas are incrementally supporting CV demand.

Commercial vehicle trends, continued

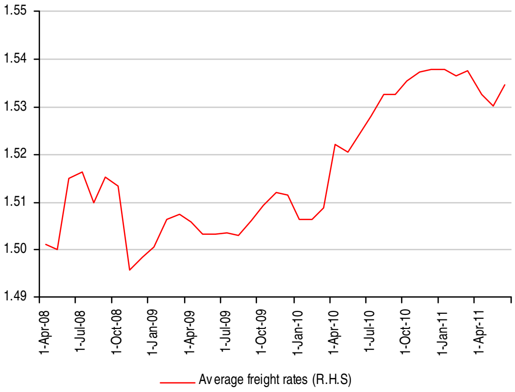
Chart 4: NREGA improving rural incomes and therefore rural consumption



Source: www.nrega.nic.in

- NREGA scheme over the past three years has been a big factor in improving incomes in rural areas.
- Wages in rural areas have increased at a CAGR of 12% during this period.
- Also, the Indian government India has continuously increased minimum support prices (MSP) for farm produce, which has also increased rural incomes.
- Overall with this increasing prosperity, rural demand for goods has remained healthy, increasing transportation needs.
- This has mainly boosted LCV growth for transportation to smaller villages and within villages.

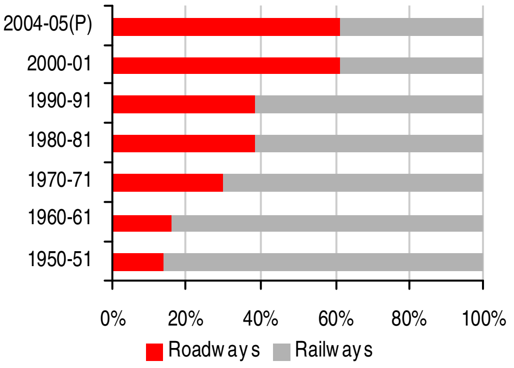
Chart 5: Freight rates remain firm



Source: TCI, Crisil Research

- While one may argue that with the economy slowing, freight rates have remained high in the past year.
- Higher freight rates have helped truck operators maintain their profitability, which has supported CV growth.

Chart 6: Roadways gaining market share from railways



Source: Planning Commission Report

- Since independence, roadways have consistently gained market share from railways due to the improving road network.
- While we have data only to 2005, the ongoing improvement of road infrastructure in terms of expanding national highways and building of industrial corridors must have given further impetus to road transportation.

Valuation and risks

Overweight rating, INR362 target price

We maintain our 12-month target price of INR362. We base our weightings for PE, PB, and EPM on macro factors influencing the industry. Historically, PE holds sway above PB in valuing banking stocks during a recovering credit cycle. As economic growth peaks, focus is likely to shift from earnings growth potential towards asset quality and the risk to book. While we had uniform 50%, 20%, and 30% weightings, respectively, we are changing the weightings for the PSU banks' segment to 20%, 50% and 30%, given the relative lack of clarity on the earnings outlook, higher volatility on bond yields, and asset quality. However, we maintain our earlier weightings for private banks, justified by greater earnings clarity and lower expected volatility of the above-mentioned factors. We thus assign 50%, 20%, and 30% weighting each to the PE, PB, and EPM components respectively, of IndusInd Bank.

Our three-stage EPM uses explicit forecasts until FY14e, followed by 10 years of semi-explicit forecasts. The final stage of 12 years (fade period) assumes convergence of ROE and COE. EPM is based on the assumptions in the following table:

IndusInd Bank: EPM assumptions

Semi-explicit forecasts for 10 yrs	
Loan CAGR	8%
Dividend payout	20%
Fade period of 12 yrs	
Risk-free rate	8%
Beta	1.0
Equity risk premium	6%
Cost of equity	14%
EPM value	**157**

Source: HSBC

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppt above and below our hurdle rate for Indian stocks of 11%, or 6-16% around the current share price. Our target price of INR362 suggests a potential return, including dividend yield, of 39%, which is above the Neutral band. We therefore reiterate our Overweight rating on the stock. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

IndusInd Bank: Valuation and risks summary (INR)

	PE multiple	Weighting 50% PE-based TP	PB multiple	Weighting 20% PB-based TP	Weighting 30% DCF value	Weighted target price	Downside risks
Valuation methodology	19x	493	2.7x	340	157	362	Further policy tightening by RBI, and higher-than-expected loan slippages

Source: HSBC

Disclosure appendix

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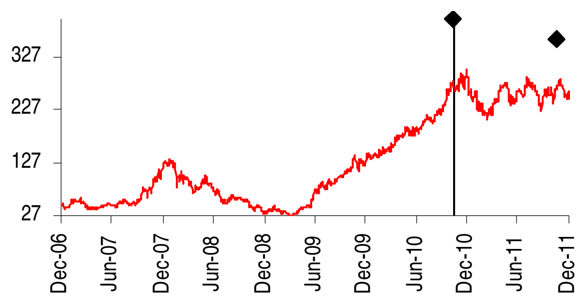
Overweight (Buy)	54%	(27% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(22% of these provided with Investment Banking Services)
Underweight (Sell)	11%	(13% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Indusind Bank (INBK.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	08 October 2010
Target Price	**Value**	**Date**
Price 1	400.00	08 October 2010
Price 2	362.00	18 October 2011

Source: HSBC

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Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
INDUSIND BANK	INBK.BO	248.95	30-Nov-2011	4, 7

Source: HSBC

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