

INFRASTRUCTURE DEVELOPMENT FINANCE CO INR 224



Delivering on high expectations

BUY

IDFC's robust loan growth of over 40%, along with strong support from investment banking, and treasury activities helped PAT grow 75% Y-o-Y and 10% Q-o-Q, to INR 2.2 bn. It also increased its stake in IDFC-SSKI to 80% from 67% and announced the expected first closure of the Citi, Blackstone, and IIFCL fund.

Key highlights

1) Strong growth in disbursements witnessed with loan book growing 44% Y-o-Y and 11% Q-o-Q, to INR 192 bn, while balance sheet is at INR 259 bn as against INR 164 bn in Q3FY07, 2) net interest margin remained muted at 2.8% Q-o-Q, 3) non-interest income grew 42%, supported by investment banking, and 4) assets under management estimated to grow Q4FY08 onwards.

* Balance sheet growth remains robust; net interest margins stay unchanged

IDFC's balance sheet grew 58% Y-o-Y and 15% Q-o-Q, to INR 259 bn. The current quarter saw disbursements mainly to the loan book, which grew 44% Y-o-Y, to INR 198 bn. Net interest income, grew 53%, to INR 1.8 bn. On the margins front, Q3FY08 remained unchanged Q-o-Q at 2.8%.

* Non-interest income contribution exceeds 50%; AUM business set to grow

Contribution from non-interest income has increased to 52% for Q3FY08 from 40% in Q2FY08, mainly from IDFC-SSKI (INR 550 mn for Q3FY08) and "carry share" which is included in treasury gains. IDFC has increased its stake in IDFC-SSKI to 79.8% from 66% in Q1FY08 (value undisclosed). IDFC expects to raise at least USD 500 mn in the Citi, Blackstone, and IIFCL funds in the next three weeks and will also raise another USD 500 mn for its third fund by Q2FY09.

* Outlook and valuations: Consistent performance : upgrade to 'BUY'

We have valued IDFC on SOTP basis, which gives INR 276 per share as the fair value based on FY10E and INR 217/share on FY09E. We have valued the core infrastructure book (includes IDFC-SSKI), valued at 25x FY10E adjusted earnings, at INR 242/share and INR 188/share for FY09E, mainly because of our confidence in the management to deliver over 30% CAGR in EPS for FY07-10E. NSE has been valued separately at INR 20/share for FY10 based on earnings multiple; we have assigned a multiple of 15% to USD 3 bn of AUMs expected to be managed by FY10. We upgrade IDFC from "ACCUMULATE" to 'BUY'.

SOTP

Business	Basis	Multiple	FY09E			FY10E		
			Base Value (INR mn)	Value (INR mn)	Per share	Base Value (INR mn)	Value (INR mn)	Per share
Core business	PE	25	9,706	242,645	188	12,496	312,393	242
NSE	PE	35	280,000	22,960	18	315,000	25,830	20
PE funds	AUM	15%	100,000	15,000	12	120,000	18,000	14
					217			276

January 16, 2008

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Reuters : IDFC.BO
Bloomberg : IDFC IN

Market Data

52-week range (INR) : 235 / 74
Share in issue (mn) : 1,290
M cap (INR bn/USD mn) : 289.9 / 7,372.9
Avg. Daily Vol. BSE ('000) : 9,029.5

Share Holding Pattern (%)

Promoters : 0.0
MFs, Fls & Banks : 36.3
Fls : 53.8
Others : 9.9

*** Loan book growth of over 40% Y-o-Y indicates strength in the infrastructure story**

IDFC's balance sheet grew 58% Y-o-Y and 15% Q-o-Q, to INR 259 bn. The current quarter saw disbursements mainly to the loan book, which grew 44% Y-o-Y and 12% Q-o-Q, to INR 198 bn. Disbursements continue to focus on energy, transportation, telecommunications, and IT accounting for ~80% of the loan book. Disbursements/approvals continue to remain at 55% indicating healthy pipeline.

We expect loan book to grow by ~35% CAGR from current levels to INR 385 bn while balance sheet will grow by 30% CAGR to INR 460 bn by FY10 from current levels making it one of strongest player in the infrastructure segment.

Table 1: Pipe lines continue to remain strong

(INR mn)	Q2FY07	Q3FY07	Q4FY07	Q1 FY08	Q2FY08	Q3FY08
Disbursements / Approvals (Qtr)	57	68	47	59	56	55
Disbursement/Approvals (Year)	55	59	55	59	57	57

Source: Company

IDFC resorted to market borrowings for the current quarter, as the equity raised (INR 21 bn in Q2FY08) was fully utilised. During Q3FY08, it raised a net of ~INR 32 bn (19% Q-o-Q increase) of its total outstanding of INR 203 bn. Two thirds of this borrowing book is in the form of rupee loans and debentures.

Table 2: Consistent growth in disbursements

(INR bn)	Q2FY07	Q3FY07	Q4FY07	Q1 FY08	Q2FY08	Q3FY08
Loans (incl. mezzanine)	124	135	141	148	174	198
Q-o-Q growth (loan %)		8.9	4.8	4.3	17.9	13.9
Equity	6.1	5.1	3.9	10.5	11.1	11.5
Non-funded	8.1	8.2	8.7	8.5	6.5	4.2

(%)	Q2FY07	Q3FY07	Q4FY07	Q1 FY08	Q2FY08	Q3FY08
Energy	38	40	38	37	36	34
Transportation	27	27	26	28	28	28
Tele & IT	18	18	17	16	13	17
Others	17	15	19	19	24	21

Source: Company

*** Net-interest margin remained stable at 2.8%**

IDFC maintained its margins at 2.8% on a trailing four quarter basis, as: 1) Cost of funds increased 23bps Q-o-Q, to 7.4%, 2) equity raised in the previous quarter was fully deployed and IDFC borrowed INR 32 bn to fund growth, 3) yield on infrastructure loans improved 36bps, to 11%.

Net-interest income increased 53% Y-o-Y, to INR 1.8 bn, compared with INR 1.16 bn for Q3FY07. We expect net interest margins (infrastructure) to be at 2.2%, inline with the management expectations.

Table 3: Rolling quarterly analysis of RoA

(%)	Q2FY07	Q3FY07	Q4FY07	Q1 FY08	Q2FY08	Q3FY08
Net Interest Margin	2.8	2.8	2.7	2.6	2.8	2.8
Fee and other income	0.9	0.9	0.9	1.2	1.3	1.6
Investment Gains	0.0	1.1	0.9	1.0	0.8	0.9
Total Income	3.7	4.7	4.5	4.8	5.0	5.3
Operating Expenses	0.5	0.5	0.5	0.7	0.8	0.9
Provisions	0.1	0.1	0.1	0.1	0.2	0.2
Tax	0.8	0.8	0.8	0.9	0.9	1.1
RoA	3.5	3.4	3.1	3.1	3.0	3.1
Equity/Assets	0.2	0.2	0.2	0.2	0.2	0.2
RoE	17.1	17.5	17.2	18.2	16.3	16.1

Source: Company

*** Non-interest income contributes to 52% of total income for Q3FY08**

Contribution from non-interest income has increased to 52% for Q3FY08 from 40% in Q2FY08 and 32% in Q3FY07 (not strictly comparable, as SSKI merged with SSKI in Q1FY08).

♦ Investment banking practice getting stronger; SSKI stake increased to 80%

IDFC has increased its stake in IDFC-SSKI to 79.8% from 66% in Q1FY08 (value not disclosed for the incremental purchase). IDFC-SSKI will house the entire investment banking activity, including the activities in debt capital markets, which was earlier with IDFC.

Contribution from IDFC-SSKI increased to INR 550 mn for Q3FY08 compared with INR 680 mn for H1FY08. We expect contribution from IB business and advisory services to contribute to ~9% of FY10E total income from 5% in FY07.

♦ Some of the key highlights of the quarter were:

- ♦ IDFC emerged as the ninth largest player in the QIP segment, co-raising INR 16 bn
- ♦ Lead manager for Mundra Port and Special Economic Zone (total fee for all lead managers INR 440 mn)
- ♦ 2% market share in raising debt funds (raised USD 450 mn for Q3FY08)

♦ Asset management book to grow from Q4FY08 by another USD 1 bn

In our previous call, IDFC had indicated that it would see the first closure of its USD 2 bn Citi, Blackstone and IIFCL Fund. The management has now further indicated that it would see the first closure raising ~USD 500 mn in the next three weeks and would focus on raising another round a few months later. IDFC currently has invested INR 2.1 bn from its treasury books, which will be transferred to this fund.

IDFC Private Equity Fund II is expected to be fully invested by Q4FY08 before raising for its third fund (first closure AUM's of USD 500 mn) by Q1FY09.

♦ Treasury gains boost bottom-line; 'carry' starts to accrue

Despite equity investments remaining flat Q-o-Q, at INR 11 bn, IDFC booked INR 730 mn for the current quarter, taking the total gains booked to INR 2 bn compared to INR 1.2 bn for FY07. These gains include 'carry' share from the first fund "India Development Fund" (USD 190 mn fund that has been completely been withdrawn). We have factored INR 900 mn as carry fees for FY08.

Table 4: Building a strong principal investments book

(INR mn)	Q2FY07	Q3FY07	Q4FY07	Q1 FY08	Q2FY08	Q3FY08
Investment book	6,130	5,070	3,900	10,510	11,120	11,490
Realised during the quarter	610	290	0	780	490	730
Unrealised gains	1580	2200	2190	2440	3240	NA

Source: Company

IDFC has indicated that it will most likely dilute a part of its stake in NSE (~8.2% valued at INR 20/share for FY10E) in Q2FY09 to comply with regulations.

- ◆ **Advisory fees focus on capturing business opportunities**

IDFC reported INR 1.23 bn for 9MFY08 and INR 510 mn for Q3FY08 as advisory fees that capture fee income from core business of IDFC which includes structuring, advisory, guarantee fee, and syndication.

- * **Operating expenses jump 36% Q-o-Q, while tax rate (at 27%) continues to climb upwards**

Operating expenses have jumped to INR 680 mn, increasing the cost to income ratio to 23% in Q3FY08 from 14% in Q3FY07. We believe that we would see a gradual increase in this operating metrics mainly due to continued expansion in employee base for IDFC-SSKI.

The tax provided for the quarter was at 27% for Q3FY08 and on rolling four quarters, this has increased to 26% for Q3FY08 compared to 24% in Q2FY08 and 19% in Q3FY07. We have assumed a gradual increase to 27% for FY07-10E.

- * **Valuation**

We have valued IDFC at INR 271 for FY10 on an SOTP basis to bring the fair value in the core infrastructure book, investment book as well as in the asset management business.

- ◆ **Core infrastructure book valued at INR 242/share on FY10 earnings**

We have valued the core business, including IDFC-SSKI, at 25x FY10E earnings (adjusted earnings for asset management fees and any related expenditure) of INR 10 bn, which translates into INR 242/share. We continue to remain positive on the infrastructure story with IDFC being a key beneficiary of having the expertise in financing this segment. We expect loan growth of ~40% CAGR for FY07-10E to INR 385 bn and believe that the balance sheet growth of over 36% is sustainable. We believe that this growth will boost EPS to grow by over 30% CAGR for FY07-10E.

We see other key benefits, including the following, to sustain IDFC's rapid growth:

- ◆ IDFC continues to enjoy a preferential status, implying a much lower cost of borrowing for an NBFC.
- ◆ Strongest operating leverage in the entire industry (including banks) at less than 1% of average assets on a sustainable basis in its infrastructure business.
- ◆ Fees from advisory practice to continue to grow ahead of balance sheet growth, mainly due to opportunities to capture fees at almost every link before actual disbursements (advisory, structuring, guarantee, and syndication).
- ◆ We expect IDFC-SSKI to leverage its relationship with IDFC (infrastructure book as well as AUM practice)
- ◆ Continued strong performance in the principal investment book.

- ◆ **NSE valued at INR 20/share for its 8.2% stake**

Our fair value for NSE comes to INR 18/share for FY09E, based on 35x FY09 expected earnings of INR 80 bn, and INR 20/share for FY10E based on 35x FY10 expected earnings of INR 90 bn.

- ◆ **Asset management business valued on DCF at 15% AUM**

The asset management business is valued at 15% (based on DCF) of FY10E AUM of USD 3 bn, which translates into INR 20/share for FY10E and INR 18/share on FY09E AUM of USD 2.5 bn.

Financials snapshot								(INR mn)
Year to March	Q3FY08	Q3FY07	Growth (%)	Q2FY08	Growth (%)	9M FY08	9M FY07	FY08E
Interest income	5,740	3,451	66.3	5,258	9.2	15,435	9,184	21,916
Interest expenses	3,960	2,291	72.9	3,298	20.1	10,364	5,894	14,906
Net interest income	1,780	1,160	53.4	1,960	(9.2)	5,070	3,290	7,009
Fee income	1,210	260	365.4	850	42.4	2,930	840	4,642
Net income	2,990	1,420	110.6	2,810	6.4	8,000	4,130	11,651
Operating expenses	680	190	257.9	500	36.0	1,680	523	2,474
Pre prov Op profit (PPOP)	2,310	1,230	87.8	2,310	(0.0)	6,320	3,607	9,178
Investment gains	730	290	151.7	490	49.0	2,000	1,240	1,969
Provisions	70	30	NA	170	(58.8)	300	5	630
Profit before tax	2,970	1,490	99.3	2,630	12.9	8,020	4,842	10,517
Provision for tax	800	270	196.3	660	21.2	2,070	972	2,644
Profit after tax	2,170	1,220	77.9	1,970	10.1	5,950	3,870	7,873
Profit of associate cos	0	20		0		0	0	0
Profit after tax (conso)	2,170	1,240	75.0	1,970	10.1	5,950	3,870	7,873
EPS (INR)	1.7	1.1	52.6	1.5	10.1	4.6	3.6	5.8
Ratios (%)								
NII / GII	31.0	33.6		37.3		32.9	35.8	32.0
Non-interest income/ income	52.2	32.2		40.6		49.3	38.7	48.5
Investment gains/income	24.4	20.4		17.4		25.0	30.0	16.9
Cost - income	22.7	13.4		17.8		21.0	12.7	21.2
Provisions / PPOP	3.0	2.4		7.4		4.7	0.1	6.9
Tax rate	26.9	18.1		25.1		25.8	20.1	25.1
Balance sheet (INR bn)	259.0	163.8	58.2	224.4	15.4	259.0	163.8	259.0
Loans (INR bn)	192.4	134.8	42.7	168.2	14.4	192.4	134.8	192.4
Unrealised gains(INR mn)	NA	2,200		3,240		NA	2,200	
Net interest margins (%)	2.9	2.9		3.6				2.9
Yield on loans (%)	11.1	10.3		12.1				11.1
Cost of funds (%)	8.4	7.1		7.6				8.4
Leverage (x)	5.1	5.2		5.4				5.1

Company Description

IDFC was established in 1997 as a private sector enterprise by a consortium of public and private investors to provide infrastructure financing. It was mainly started as a government initiative, but the structure of ownership changed in 2005-06 with its IPO.

IDFC generates its business in four business segments

In the lending business, it has a balance sheet size of INR 259 bn as on Q3FY08 and has been growing its balance sheet in excess of 40% CAGR. Of its INR 191 bn loan book (net NPA is 0%), energy, transportation, and telecom sectors constitute 80% of the outstanding.

It has sponsored IDFC Private Equity that manages two funds - India Development Fund and IDFC Private Equity Fund. The total corpus of the two funds as on Q3FY08 was USD 680 mn. It generates fee income for managing the assets and also participates on upsides over the respective hurdle rates

It has 80% stake in IDFC where it houses the investment banking and institutional broking business.

As of Q3FY08 it had a strong principal investment book of INR 11 bn which is invested through listed and unlisted entities.

Key Risks

There are risks of margin compression, as the infrastructure financing space is keenly contested. Being an NBFC, IDFC is dependent on wholesale funding. Hence, high interest rates will remain a risk.

Large ticket lending makes IDFC's loan book riskier than other banks. NPA occurrence, due to large ticket size, can dent its future earnings.

As it now generates more than 50% of non interest income, revenue can be a lumpy in nature (especially in investment banking and principal investment book)

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Interest earned	8,067	12,976	21,916	30,970	40,585
Interest expended	5,008	8,555	14,903	21,470	28,879
Net interest income	3,058	4,421	7,013	9,499	11,705
Other income	2,301	2,737	6,611	9,938	12,801
Operating income	5,359	7,158	13,624	19,437	24,507
Operating expenses	546	821	2,474	3,500	4,612
Operating profit	4,814	6,337	11,150	15,937	19,895
Provisions and contingencies	387	175	630	775	1,126
PBT	4,426	6,162	10,520	15,162	18,769
Provision for tax	517	1,241	2,645	3,963	5,000
PAT	3,909	4,921	7,876	11,199	13,769
Share in associate companies	0	118	0	0	0
Minority interest		0	323	365	548
Consolidated PAT	3,909	5,039	7,553	10,834	13,221
EPS (INR)	3.5	4.5	5.9	8.4	10.2
Dividend per share (INR)	1.0	1.0	1.5	2.5	3.6
Dividend pay out (%)	29	22	25	30	35

Common size metrics (as a % of gross interest earned)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net interest income	37.9	34.1	32.0	30.7	28.8
Other income	28.5	21.1	30.2	32.1	31.5
Operating profit	59.7	48.8	50.9	51.5	49.0
PBT	54.9	47.5	48.0	49.0	46.2
PAT	48.5	37.9	35.9	36.2	33.9

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Interest earned	42.4	60.9	68.9	41.3	31.0
Interest expended	60.6	70.8	74.2	44.1	34.5
Net interest income	20.2	44.6	58.6	35.4	23.2
Other income	35.9	18.9	141.5	50.3	28.8
Operating profit	23.0	31.6	76.0	42.9	24.8
PAT	27.1	25.9	60.0	42.2	23.0

ROE decomposition

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net interest income	2.9	2.9	3.1	3.0	2.9
Other income	1.0	1.0	2.1	2.5	2.4
Capital gains	1.2	0.8	0.9	0.7	0.7
Net revenue	5.1	4.7	6.0	6.2	6.0
Operating expenses	(0.5)	(0.5)	(1.1)	(1.1)	(1.1)
Operating profit	4.5	4.1	4.9	5.1	4.9
Provisions	(0.4)	(0.1)	(0.3)	(0.2)	(0.3)
PBT	4.2	4.0	4.7	4.8	4.6
Tax	(0.5)	(0.8)	(1.2)	(1.3)	(1.2)
ROA	3.7	3.2	3.5	3.6	3.4
Equity	0.2	0.2	0.2	0.2	0.2
ROE	17.5	17.8	18.5	18.9	20.6

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Share capital	11,225	11,259	12,909	12,909	12,909
Reserves & surplus	14,460	18,217	42,808	49,898	57,874
Shareholders funds	25,685	29,476	55,717	62,807	70,783
Other loans	6,500	6,500	6,500	3,250	0
Unsecured loans	87,302	142,528	200,509	289,824	379,191
Loan funds	93,802	149,028	207,009	293,074	379,191
Sources of funds	119,487	178,505	262,727	355,882	449,974
Net fixed assets (net of CWP)	508	489	1,602	1,779	1,872
Investments	12,928	23,903	29,971	37,664	42,420
Current assets, loans & advances	109,542	159,448	237,556	324,698	415,858
Less: Current liabilities & provisions	3,491	5,335	6,402	8,260	10,175
Net current assets	106,051	154,113	231,154	316,439	405,683
Application of funds	119,487	178,505	262,727	355,882	449,974

Ratios (%)					
Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROE	17.5	17.8	18.5	18.9	20.6
ROA	3.7	3.2	3.5	3.6	3.4
Yield on assets	7.6	8.5	9.7	9.8	9.9
Yield on advances	8.4	9.4	10.7	10.7	10.7
Cost of liabilities	6.0	6.8	8.1	8.3	8.4
NIM	2.9	2.9	3.1	3.0	2.9
Gross NPA (% of total assets)	0.5	0.2	0.1	0.1	0.1

Valuation parameters					
Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR)	3.5	4.5	5.8	8.5	10.5
<i>Y-o-Y growth (%)</i>	<i>13.2</i>	<i>28.5</i>	<i>29.3</i>	<i>46.2</i>	<i>23.6</i>
Book value per share (INR)	22.9	26.2	43.2	48.7	54.8
ROE (%)	1,754.1	1,784.2	1,848.2	1,889.4	2,063.0
ROA (%)	368.7	321.8	349.2	355.5	335.8
P/E (x)	64.1	49.9	38.6	26.4	21.3
Price/ Book value (x)	9.8	8.5	5.2	4.6	4.1

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Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services:

Allahabad Bank, Axis Bank, Centurion Bank of Punjab, Federal Bank, HDFC Bank, ICICI Bank, IOB, Karnataka Bank, Kotak Mahindra Bank, OBC, SBI, Yes Bank, IDFC, HDFC, LIC Housing Finance, PNB, Power Finance Corporation, Reliance Capital, SREI Infrastructure Finance, Shriram City Union, Syndicate Bank and Union Bank.

IDFC



Recent Research

Date	Company	Title	Price (INR)	Reco
11-Jan-08	Geojit Fin. Services	Partnering growth; Result Update	105	Not Rated
10-Jan-08	Future Capital	Future lies in execution; IPO Note	700-765	Subscribe
9-Jan-08	Axis Bank	Fast and the furious, discovering value Visit Note	1,096	Buy
09-Jan-08	ICICI Bank	Bank on non-banking; Visit Note	1,310	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	108	44	16	3	188

* 12 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	66	19

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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