ANANDRATHI

India I Equities

Banks

Result Update

1 November 2013

IDFC

Rating: **Buy**
Target Price: ₹148
Share Price: ₹106

Easing credit growth, but stable spreads and asset quality; Buy

Key takeaways

Lending business eases, spreads stable. IDFC's 2QFY14 loan growth was modest (3.4% yoy, -2.9% qoq), with disbursements falling 59% yoy. However, approvals spiked over 600% yoy, led by short-term corporate loans to the telecoms sector. Exposure to the energy and transportation sectors slipped to 58.7% (63.3% in 2QFY13). Spreads fell 10bps yoy to 2.5%, resulting in NII rising 6.7% yoy (flat qoq). Management maintains its focus on asset quality, and expects FY14 loan growth to be modest, driven primarily by re-financing.

Weak fees and Treasury income; productivity declines. Non-interest income fell 1% yoy (down 39.6% qoq) on account of modest Treasury income (14.7% yoy, -61.4% qoq). Asset-management fees were sturdy (50.7% yoy, 11.8% qoq), with weak traction in investment banking (-85% yoy) and institutional broking (-25% yoy). While IDFC has been able to keep operating costs in check (10.7% yoy), slower non-interest income growth led to cost-to-income rising 84bps yoy (190bps qoq) to 15.5%.

Asset quality stable, well-capitalized. Gross NPA fell 0.6% qoq to ₹1,805m (0.32% of loans). Hence, loan provisions declined 22.2% yoy. We expect IDFC's conservative underwriting standards and prudent provisioning policy to keep credit costs stable over FY14-15, at ~50bps. With capital adequacy of 23.9% (tier-1: 21.6%), the NBFC is adequately capitalized for growth.

Our take. With its strong domain expertise, we believe IDFC is poised to capitalize on long-term opportunities in infrastructure funding, and sustain a 2.8% RoA over FY14-15. Hence, we retain our Buy rating. Our sum-of-parts valuation gives us a fair value of ₹148. We astimate the lending business at ₹121 (1.2x FY14e BV) and the other businesses and investments at ₹27. **Risks:** Substantial slowdown in infrastructure spending and inability to mobilise resources for the AMC business.

Quarterly results (YE: Mar)	2QFY13	2QFY14	% yoy	1HFY13	1HFY14	% yoy
Net interest income (₹m)	6,420	6,850	6.7	12,620	13,710	8.6
Non-interest income (₹m)	2,070	2,040	(1.4)	3,600	5,390	49.7
Operating expenses (₹m)	1,241	1,375	10.7	2,401	2,759	14.9
Cost-to-income (%)	14.6	15.5	84bps	14.8	14.4	(36)bps
Pre-provisioning profit (₹m)	7,249	7,515	3.7	13,819	16,341	18.3
Provisions (₹m)	305	501	64.0	1,331	1,092	(17.9)
PBT (₹m)	6,943	7,015	1.0	12,488	15,249	22.1
Tax (₹m)	2,188	2,099	(4.0)	3,901	4,726	21.2
PAT (₹m)	4,757	4,868	2.3	8,554	10,441	22.1
EPS (₹)	3.1	3.2	2.2	5.6	6.9	21.8

Source: Company

Key data	IDFC IN / IDFC.BO
52-week high / low	₹185 / ₹76
Sensex / Nifty	21165 / 6299
3-m average volume	US$23.2m
Market cap	₹153bn / US$2.5bn
Shares outstanding	1516.1m

Shareholding pattern (%)	Sep '13	Jun '13	Mar '13
Promoters	-	-	-
- of which, Pledged	-	-	-
Free Float	100.0	100.0	100.0
- Foreign Institutions	49.5	52.2	53.2
- Domestic Institutions	30.8	30.6	31.9
- Public	19.7	17.2	14.9

Financials (YE Mar)	FY14e	FY15e
Net interest income (₹m)	29,547	34,704
Net profit (₹m)	21,275	25,014
EPS (₹)	14.0	16.4
Growth (%)	15.3	17.0
PE (x)	7.6	6.5
PBV (x)	1.1	0.9
RoE (%)	14.7	15.4
RoA (%)	2.8	2.9
Dividend yield (%)	2.9	3.4
Net NPA (%)	0.1	0.1

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
Net interest income	16,195	20,167	24,684	29,547	34,704
NII growth (%)	58.6	24.5	22.4	19.7	17.5
Non-interest inc	9,260	9,621	10,042	9,838	11,554
Total income	25,455	29,788	34,726	39,385	46,257
Total Inc growth (%)	20.4	21.5	18.2	13.4	17.4
Op. expenses	5,267	5,200	5,276	5,809	6,851
Operating profit	20,188	24,589	29,450	33,576	39,407
Op profit growth (%)	11.1	11.1	11.9	14.0	17.4
Provisions	2,400	2,862	3,514	3,183	3,672
PBT	17,788	21,727	25,936	30,393	35,735
Tax	4,998	6,219	7,511	9,118	10,720
PAT	12,817	15,540	18,362	21,275	25,014
PAT growth (%)	19.8	21.2	18.3	15.9	17.6
FDEPS (₹/share)	8.8	10.3	12.1	14.0	16.4
DPS (₹/share)	2.0	2.3	2.6	3.1	3.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
Share capital	14,609	15,124	15,147	15,223	15,299
Reserves & surplus	97,875	107,733	121,682	137,478	156,053
Deposits	356,539	457,855	535,773	635,009	747,383
Borrowings	6,500	6,500	6,500	6,500	6,500
Minority interests	17,643	22,818	31,491	12,439	15,421
Total liabilities	493,167	610,029	710,593	806,648	940,656
Advances	376,523	481,829	557,365	641,509	753,883
Investments	69,611	75,339	110,042	102,641	120,621
Cash & bank bal	11,049	7,002	2,658	4,394	4,669
Fixed & other assets	35,984	45,859	40,529	58,104	61,483
Total assets	493,167	610,029	710,593	806,648	940,656
No. of shares (m)	1,461	1,512	1,515	1,522	1,530
Deposits growth (%)	n/a	n/a	n/a	n/a	n/a
Advances growth (%)	49.6	27.9	15.8	15.1	17.5

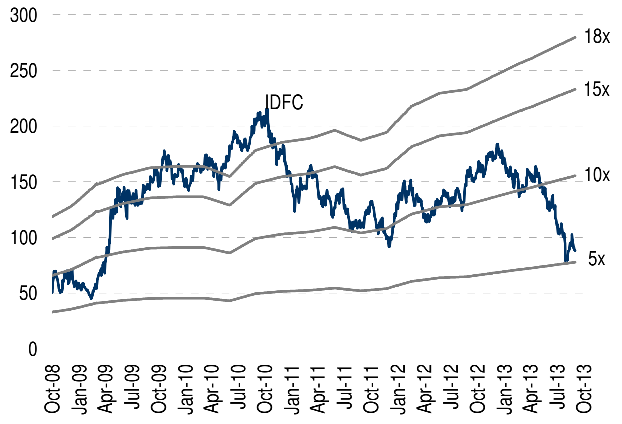
Source: Company, Anand Rathi Research

Fig 3 – Key ratios

Year-end: Mar	FY11	FY12	FY13	FY14e	FY15e
NIM (%)	4.0	3.8	3.8	4.0	4.1
Other inc / total inc (%)	36.4	32.3	28.9	25.0	25.0
Cost-income (%)	20.7	17.5	15.2	14.8	14.8
Provision coverage (%)	51.2	51.8	66.0	70.7	73.8
Dividend payout (%)	22.9	22.4	21.5	22.0	22.0
Credit-deposit (%)	n/a	n/a	n/a	n/a	n/a
Investment-deposit (%)	n/a	n/a	n/a	n/a	n/a
Gross NPA (%)	0.2	0.3	0.2	0.2	0.2
Net NPA (%)	0.1	0.1	0.1	0.1	0.1
BV (₹)	71.2	81.3	90.5	100.3	112.0
Adj BV (₹)	71.2	81.3	90.5	100.3	112.0
CAR (%)	24.5	20.9	22.1	20.9	20.3
- Tier 1 (%)	21.8	18.6	19.7	18.6	18.1
RoE (%)	14.0	13.2	14.1	14.7	15.4
RoA (%)	3.0	2.8	2.8	2.8	2.9

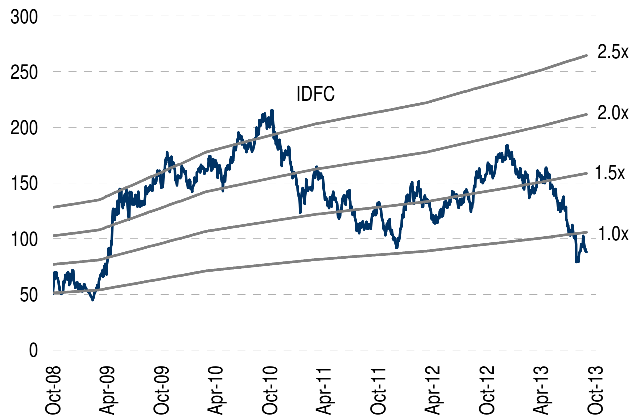
Source: Company, Anand Rathi Research

Fig 4 – PE band



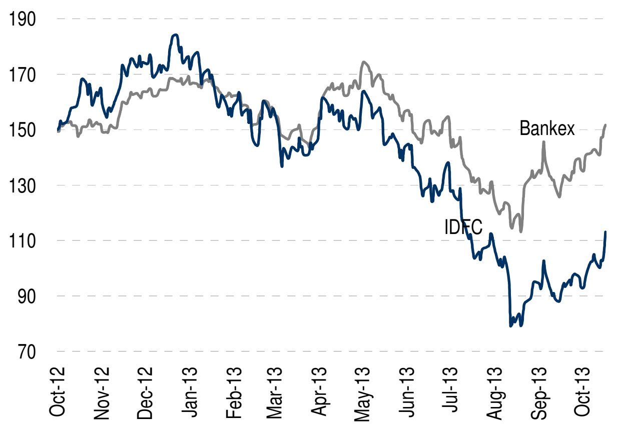
Source: Bloomberg, Anand Rathi Research

Fig 5 – Price-to-book band



Source: Bloomberg, Anand Rathi Research

Fig 6 – IDFC vs. Bankex



Source: Bloomberg

Result highlights

Fig 7 – 2QFY14 Results vs Expectations

(₹ m)	2QFY14	2QFY14e	Var %	2QFY13	YoY %	1QFY14	QoQ %
Net interest income	6,850	7,279	(5.9)	6,420	6.7	6,860	(0.1)
Non-interest income	2,000	2,361	(15.3)	2,020	(1.0)	3,310	(39.6)
Pre-provisioning profits	7,512	8,056	(6.8)	7,263	3.4	8,826	(14.9)
PAT	4,868	5,054	(3.7)	4,757	2.3	5,573	(12.7)

Source: Company, Anand Rathi Research

Fig 8 – 2QFY14 results

(₹ m)	2QFY14	2QFY13	YoY	1QFY14	QoQ
Credit	549,850	533,810	3.0	566,530	(2.9)
Borrowings	520,200	530,300	(1.9)	534,260	(2.6)
Gross NPA	1,805	1,503	20.1	1,817	(0.6)
Net NPA	1,113	727	53.1	1,125	(1.1)
Gross NPA %	0.3	0.3	4 bps	0.3	- bps
Net NPA %	0.2	0.1	7 bps	0.2	- bps
NPA coverage %	38.4	51.6	(1,329) bps	38.1	25 bps
Capital adequacy %	23.9	21.5	239 bps	23.0	85 bps
Tier-1 %	21.6	19.5	210 bps	20.7	90 bps

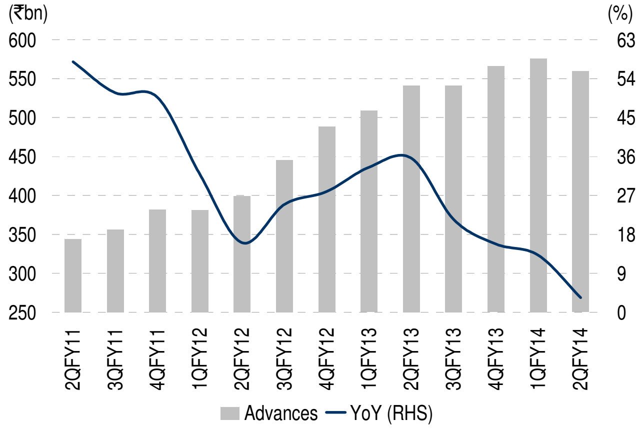
Source: Company, Anand Rathi Research

Modest credit growth, lower disbursements

At 3.4% yoy, IDFC's 2QFY14 credit growth was slower than the past four-quarter average of 21.5%. Business slowed down further in 1HFY14: disbursements dropped 46% yoy; approvals rose a mere 3% yoy. However, approvals spiked over 600% yoy, led by short-term corporate loans to the telecoms sector. Exposure to the energy and transportation sectors slipped to 58.7% (vs 63.3% in 2QFY13).

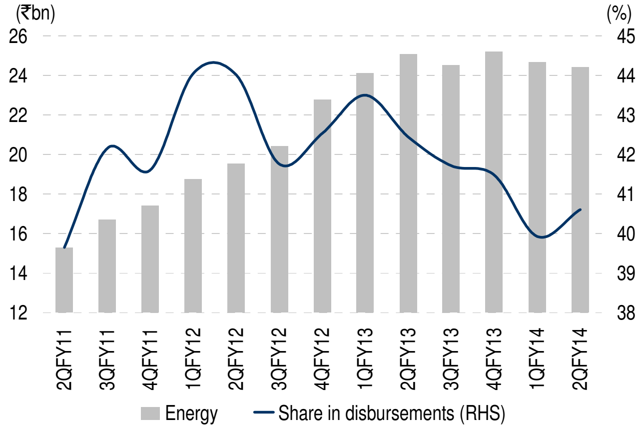
IDFC is poised to capitalise on the infrastructure-lending opportunities available in India - its loan pipeline (approvals less disbursements) in Sep'13 improved to ₹192.2bn (from ₹133.6bn in Sep'12). Ahead, management has guided to modest growth in infrastructure loans over FY13-15. A gradual upswing in India's investment capex cycle, along with opportunities in refinancing and non-infra loan segments, is likely to drive loan growth.

Fig 9 – Credit growth has steadily declined in 2QFY14



Source: Company, Anand Rathi Research

Fig 10 – Share of energy in loans has marginally increased

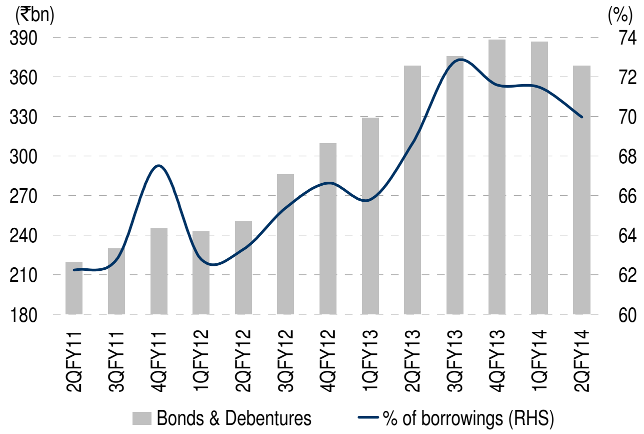


Source: Company, Anand Rathi Research

Lower spreads and modest loan growth constrain NII growth

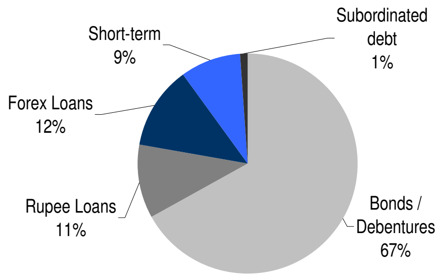
Interest spreads, on a rolling-12-month basis, fell 10bps qoq to 2.4%. The slower credit growth and the slightly lower spreads resulted in a 6.7% yoy rise in net-interest income. Although loan yields could decrease in FY14, we expect long-term spreads to be stable, if not improve, as wholesale borrowing costs are also expected to decrease over the same period. As IDFC's liabilities' duration (1.6 years) is longer than that of its assets (1.4 years), its liabilities would tend to re-price slower in a falling interest-rate scenario, hence, keeping spreads contained in the near-term. We expect NIM of 4% in FY14 and 4.1% in FY15.

Fig 11 – Share of bonds / debentures in borrowings remains high



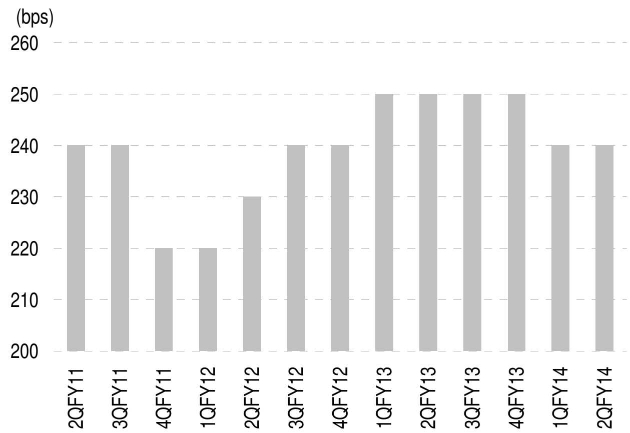
Source: Company

Fig 12 – Composition of borrowings (2QFY14)



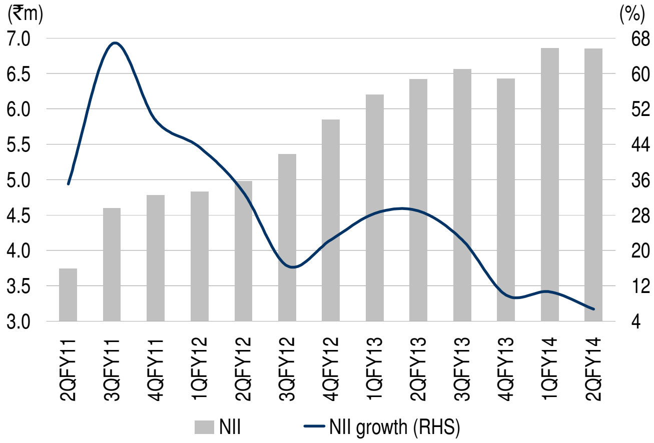
Source: Company, Anand Rathi research

Fig 13 – Spreads have been largely resilient



Source: Company

Fig 14 – With slowing credit growth, net interest income has eased



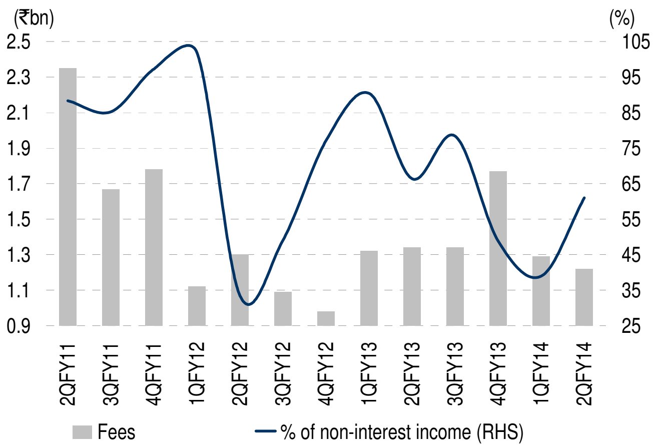
Source: Company

Robust AMC fees, weak capital-market revenues, lower productivity

The proportion of IDFC's non-interest income has risen from 1.3% of average assets in Mar'13 to 1.5% in Sep'13. Key drivers of this revenue stream are lending-related fees and income from its asset-management business. The capital-market-related businesses, broking and investment banking, registered weak fee income. In 2QFY14, non-interest income fell 1% yoy (down 39.6% qoq) on account of modest Treasury income (14.7% yoy, -61.4% qoq). Asset-management fees were sturdy (50.7% yoy, 11.8% qoq), with weak traction in investment banking (-85% yoy) and institutional broking (-25% yoy). While IDFC has been able to keep operating costs in check (10.7% yoy), slower non-interest income growth led to cost-to-income rising 84bps yoy (190bps qoq) to 15.5%.

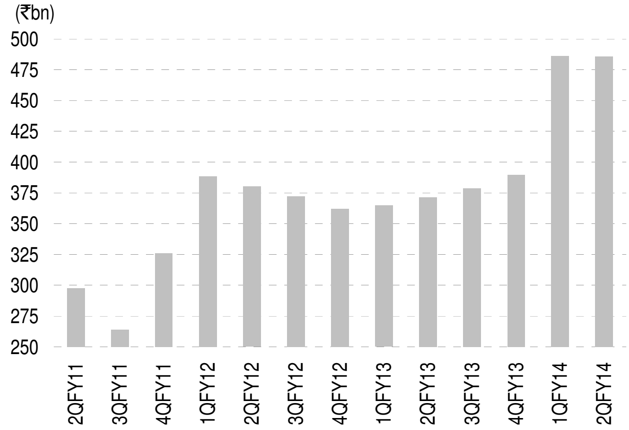
As a large chunk of non-interest income is linked to capital markets, it may not match the asset-growth pace at IDFC. We expect a 7.3% CAGR in non-interest income over FY13-15, comprising 1.2% of average assets over the same period. The key drivers of non-interest income would be lending-related fees, which contribute ~25% of non-interest revenues, and the asset-management-business-related fees. The increase in AUM of the mutual-fund business is market linked and we estimate ~10% growth over FY13-15.

Fig 15 – Robust fee-based income



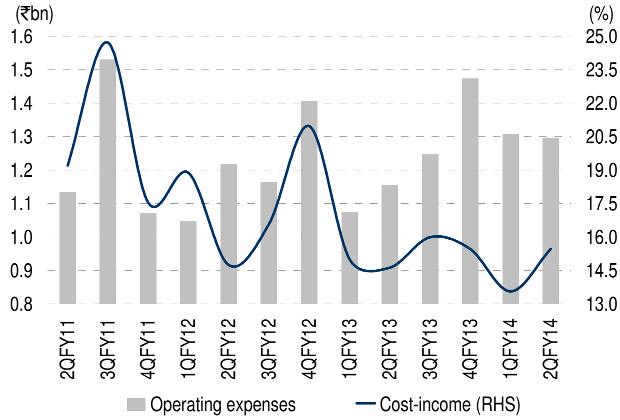
Source: Company

Fig 16 – AUM has risen sharply in 1HFY14



Source: Company

Fig 17 – Flat operating expenses qoq, but cost-to-income rises

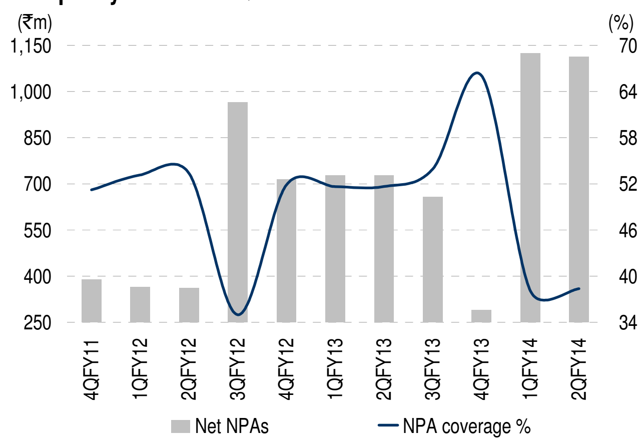


Source: Company

Asset quality stable, well-capitalised

Gross NPA fell 0.6% qoq to ₹1,805m (0.32% of loans). Hence, loan provisions declined 22.2% yoy. We expect IDFC's conservative underwriting standards and prudent provisioning policy to keep credit costs at a stable ~50bps over FY14-15,. With capital adequacy of 23.9% (tier-1: 21.6%), the NBFC is adequately capitalized for growth.

Fig 18 – Asset quality stable in 2QFY14



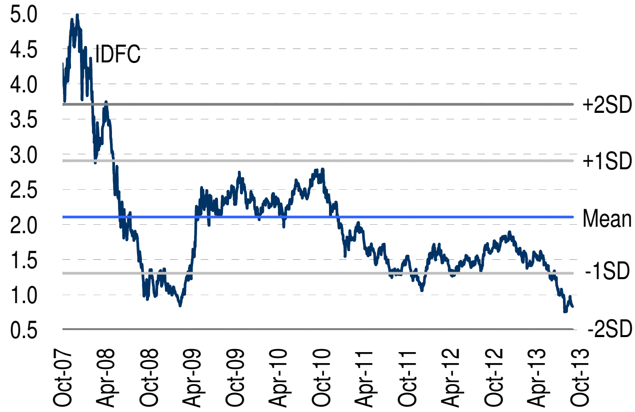
Source: Company

Valuations

We have arrived at our target price based on a sum-of-parts valuation.

- Core lending business – ₹121 a share at a PABV multiple of 1.2x FY14e BV. In our two-stage DDM, we assume cost of equity at 15.8%.
- Private equity – 15% of FY14e AUM of US$2bn, at ₹9.5 a share.
- Project equity – 10% of FY14e AUM of US$1.5bn, at ₹4.5 a share.
- IDFC AMC – based on 5% of 2QFY14 AUM, at ₹13 a share.

Fig 19 – Past-one-year forward-P/BV



Source: Bloomberg, Anand Rathi Research

Risks

- Slower-than-expected growth rate of the Indian economy.
- Aggressive monetary tightening and measures that could further slow down the economy.
- More-than-expected increase in bad loans.

Financials

We expect a 16.3% CAGR in the loan book over FY13-15 and a 16.7% earnings CAGR over the same period.

Fig 20 – Income Statement

Year-end: Mar (₹m)	FY11	FY12	FY13	FY14e	FY15e
Net Interest Income	**16,195**	**20,167**	**24,684**	**29,547**	**34,704**
Growth (%)	58.6	24.5	22.4	19.7	17.5
Non-interest Income	9,232	9,621	10,042	9,838	11,554
Total Income	**25,427**	**29,788**	**34,726**	**39,385**	**46,257**
Non-interest inc / Total Inc (%)	36.3	32.3	28.9	25.0	25.0
Operating Expenses	5,267	5,200	5,276	5,809	6,851
Pre-provisioning profit	**20,160**	**24,589**	**29,450**	**33,576**	**39,407**
Growth (%)	29.4	22.0	19.8	14.0	17.4
Provisions	2,400	2,862	3,514	3,183	3,672
Profit Before Tax	17,760	21,727	25,936	30,393	35,735
Taxes	4,998	6,219	7,511	9,118	10,720
Tax Rate (%)	28.1	28.6	29.0	30.0	30.0
Consolidated profit after tax	**12,789**	**15,540**	**18,362**	**21,275**	**25,014**
Growth (%)	20.4	21.5	18.2	15.9	17.6
Number of Shares (m)	1,461	1,512	1,515	1,522	1,530
Earnings Per Share (₹)	8.8	10.3	12.1	14.0	16.4

Source : Company, Anand Rathi Research

Fig 21 – Balance Sheet

Year-end: Mar (₹m)	FY11	FY12	FY13	FY14e	FY15e
Share Capital	14,609	15,124	15,147	15,223	15,299
Reserves and Surplus	97,875	107,733	121,682	137,478	156,053
Borrowings	356,539	457,855	535,773	635,009	747,383
Subordinated Debt	6,500	6,500	6,500	6,500	6,500
Other Liabilities & Provisions	17,643	22,818	31,491	12,439	15,421
Total Liabilities	**493,167**	**610,029**	**710,593**	**806,648**	**940,656**
Advances	376,523	481,829	557,365	641,509	753,883
Investments	69,611	75,339	110,042	102,641	120,621
Cash & Bank Balances	11,049	7,002	2,658	4,394	4,669
Fixed & Other Assets	4,469	4,165	3,445	5,647	6,585
Total Assets	31,515	41,694	37,084	52,458	54,898
No. of shares (m)	**493,167**	**610,029**	**710,593**	**806,648**	**940,656**

Source : Company, Anand Rathi Research

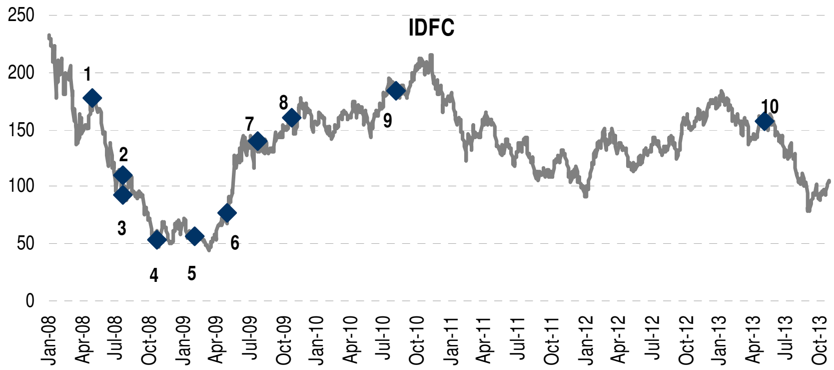
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 1 November 2013)



	Date	Rating	TP (₹)	Share Price (₹)
1	30-Apr-08	Buy	273	173
2	18-Jul-08	Buy	270	109
3	21-Jul-08	Buy	145	110
4	23-Oct-08	Buy	86	58
5	2-Feb-09	Buy	84	57
6	29-Apr-09	Buy	92	75
7	21-Jul-09	Buy	170	140
8	23-Oct-09	Buy	197	160
9	5-Aug-10	Buy	219	184
10	2-May-13	Buy	198	153
11	31-Jul-13	Buy	148	113

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Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Anand Rathi Research Ratings Distribution (as of 28 Feb 2013)

	Buy	Hold	Sell
Anand Rathi Research stock coverage (184)	65%	27%	8%
% who are investment banking clients	4%	2%	0%

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