

BUY

TP: Rs 1,700 | ▲ 15%

INDUSIND BANK

| Banking

| 14 January 2020

Asset quality amiss

IndusInd Bank's (IIB) Q3FY20 PAT grew 33% YoY to Rs 13bn, largely due to 34% YoY growth in NII and 5bps QoQ NIM expansion to 4.15%. Asset quality was a miss as slippages rose to ~Rs 19bn driven by three large corporate accounts worth Rs 7bn while SMA-2 loans stood at Rs 14bn (0.5% of loans). Exposure to three stressed groups declined to 0.5% of loans given recoveries and repayments. IIB made accelerated provisions worth Rs 2.5bn and raised its coverage on IL&FS exposure to 73% in Q3. We raise our TP to Rs 1,700 on roll over to Mar'21.

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Slippages mount: Two accounts in the HFC (investment book) and travel sectors were proactively termed as NPAs post detection of fraud. IIB routed Rs 2.4bn (25%) provisions on these accounts via P&L in Q3 and the balance (75%) were drawn down from the reserves which shall be later debited to P&L equally over the next 3 quarters. This apart a paper/diversified group (subsequently recovered) account worth Rs 1.8bn/Rs 2.5bn too slipped into NPA.

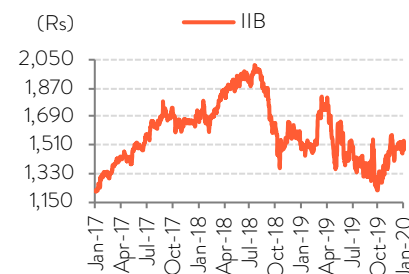
Ticker/Price	IIB IN/Rs 1,482
Market cap	US\$ 12.6bn
Shares o/s	603mn
3M ADV	US\$ 82.4mn
52wk high/low	Rs 1,834/Rs 1,188
Promoter/FPI/DII	17%/52%/31%

Source: NSE

IIB raised its coverage on IL&FS exposure to 73% and expects its exposures in tunnel/road project SPVs to be resolved in Q4. SMA-2 exposure stands at Rs 14bn (0.5% of loans) vs Rs 11bn (0.6%) in Q2.

Loan growth moderates further: IIB's loan growth at <20% YoY continues to moderate largely due to subdued 8% corporate loan growth. The bank received repayments/recoveries worth Rs 70bn in the last three quarters and sold corporate loans Rs 15bn in Q3.

STOCK PERFORMANCE



Source: NSE

Maintain BUY with revised TP of Rs 1,700: We continue to value the stock at 2.3x FY22E P/BV as merger synergies are expected to raise ROE to ~19% by FY22E but raise our TP to Rs 1,700 (revised from Rs 1,550 earlier) on roll over to Mar'21.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Net interest income	74,974	88,462	121,131	141,941	177,991
NII growth (%)	23.7	18.0	36.9	17.2	25.4
Adj. net profit (Rs mn)	36,060	33,011	54,079	69,042	89,751
EPS (Rs)	60.2	54.9	82.5	97.5	126.8
P/E (x)	24.6	27.0	18.0	15.2	11.7
P/BV (x)	3.8	3.4	2.9	2.4	2.0
ROA (%)	1.8	1.3	1.7	1.7	1.8
ROE (%)	16.2	13.1	17.2	17.2	18.7

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY19	Q2FY20	Q3FY20	YoY (%)	QoQ (%)
Net interest income	22,881	29,094	30,742	34	6
Non-interest income	14,689	17,272	17,900	22	4
Net total income	37,569	46,365	48,642	29	5
Staff expenses	4,521	7,165	7,404	64	3
Other expenses	11,879	12,966	13,661	15	5
Total operating expenses	16,400	20,131	21,065	28	5
Pre-provisioning profit	21,170	26,234	27,577	30	5
Provisions	6,067	7,377	10,435	72	41
Profit before tax	15,103	18,857	17,143	14	(9)
Tax	5,253	4,848	4,050	(23)	(16)
Profit after tax	9,850	14,010	13,092	33	(7)
Balance Sheet					
Loans	1,731,690	1,971,126	2,074,130	20	5
Deposits	1,757,010	2,071,934	2,167,130	23	5
CASA ratio (%)	43.6	41.4	42.4	(118bps)	96bps
Yields and margins (%)					
Yield on advances	11.5	12.0	12.0	45bps	(7bps)
Yield on assets	9.6	10.0	9.9	24bps	(12bps)
Cost of deposits	6.7	6.7	6.5	(25bps)	(21bps)
Cost of funds	5.8	5.9	5.7	(8bps)	(17bps)
Net interest margin	3.8	4.1	4.2	32bps	5bps
Key ratios (%)					
Cost / income ratio	43.7	43.4	43.3	(35bps)	(11bps)
Tax rate	34.8	25.7	23.6	(1,115bps)	(208bps)
Loan to deposit ratio	98.6	95.1	95.7	(285bps)	57bps
Capital adequacy (%)					
Tier I	13.8	14.3	13.5	(29bps)	(78bps)
Total CAR	14.2	14.7	13.9	(27bps)	(78bps)
Asset Quality					
Gross NPAs	19,682	43,702	45,784	133	5
Net NPAs	10,293	22,026	21,733	111	(1)
Coverage ratio (%)	47.7	49.6	52.5	483bps	293bps
Gross NPA Ratio (%)	1.1	2.2	2.2	105bps	(1bps)
Net NPA Ratio (%)	0.6	1.1	1.1	46bps	(7bps)

Source: Company, BOBCAPS Research

Valuation methodology

We expect IIB to continue growing much higher than the industry for the next few years and hence use the two-stage Gordon growth model to set our target price as it captures valuations in a high-growth stage.

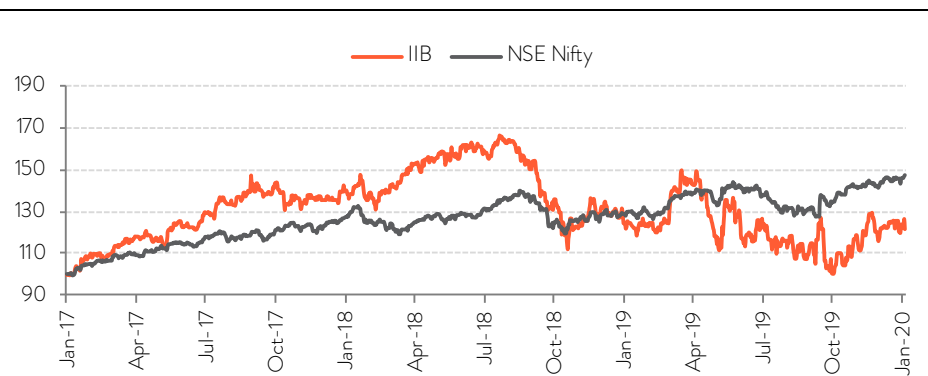
We continue to value the stock at 2.3x FY22E P/BV as we believe our credit costs estimates reflect the uncertainty surrounding IIB's asset quality. Using the two-stage Gordon growth model, we arrive at a revised Mar'21 target price of Rs 1,700 (vs. Rs 1,550 earlier). Maintain BUY.

FIG 2 – VALUATION SNAPSHOT

Components of Gordon growth model	Assumptions (%)
Risk-free rate (%)	7.0
Equity risk premium (%)	5.0
Beta	1.4
Cost of equity (%)	14.1
Blended ROE (%)	19.6
Initial high growth period (yrs)	10.0
Payout ratio of high-growth phase (%)	20.0
Long-term growth (%)	5
Long term dividend payout ratio (%)	75
Justified P/BV Multiple (x)	2
Adj. BVPS (Rs)	723
Value per share (Rs)	1,700

Source: Company, BOBCAPS Research

FIG 3 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Romesh Sobti's term as MD and CEO will end on 23 Mar 2020 as he reaches the upper age limit of ~70 years. While the board has indicated that succession planning is in place, any hiccups or senior management exits that may take place during this transition period could negatively impact the stock.
- BHAFIN may open the door to unexpected surprises, especially on the asset quality front, given the nature of its business.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Net interest income	74,974	88,462	121,131	141,941	177,991
NII growth (%)	23.7	18.0	36.9	17.2	25.4
Non-interest income	47,501	56,467	67,794	82,027	101,316
Total income	122,475	144,929	188,925	223,969	279,307
Operating expenses	(55,914)	(64,047)	(85,996)	(101,835)	(123,929)
Operating profit	66,561	80,882	102,928	122,133	155,378
Operating profit growth (%)	22.1	21.5	27.3	18.7	27.2
Provisions	(11,754)	(31,077)	(27,654)	(29,335)	(34,746)
PBT	54,807	49,806	75,274	92,798	120,633
Tax	(18,747)	(16,795)	(21,195)	(23,756)	(30,882)
Reported net profit	36,060	33,011	54,079	69,042	89,751
Adjustments	0	0	0	0	0
Adjusted net profit	36,060	33,011	54,079	69,042	89,751

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19P	FY20E	FY21E	FY22E
Equity capital	6,002	6,027	7,081	7,081	7,081
Reserves & surplus	232,414	260,833	354,897	434,342	511,493
Net worth	238,416	266,860	361,977	441,423	518,574
Deposits	1,516,392	1,948,679	2,451,497	3,082,464	3,878,127
Borrowings	382,891	473,211	686,752	798,931	926,746
Other liabilities & provisions	78,563	89,444	94,489	99,823	105,463
Total liabilities and equities	2,216,262	2,778,194	3,594,715	4,422,641	5,428,909
Cash & bank balance	132,159	147,834	158,267	169,636	182,033
Investments	500,767	592,662	736,843	924,040	1,136,435
Advances	1,449,537	1,863,935	2,292,640	2,865,872	3,582,431
Fixed & Other assets	133,799	173,764	406,965	463,093	528,010
Total assets	2,216,262	2,778,194	3,594,715	4,422,641	5,428,909
Deposit growth (%)	19.8	28.5	25.8	25.7	25.8
Advances growth (%)	28.2	28.6	23.0	25.0	25.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19P	FY20E	FY21E	FY22E
EPS	60.2	54.9	82.5	97.5	126.8
Dividend per share	7.2	9.0	9.2	11.7	15.2
Book value per share	391.2	437.4	506.6	618.8	727.8

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19P	FY20E	FY21E	FY22E
P/E	24.6	27.0	18.0	15.2	11.7
P/BV	3.8	3.4	2.9	2.4	2.0
Dividend yield (%)	0.5	0.6	0.6	0.8	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19P	FY20E	FY21E	FY22E
Net interest income	3.7	3.5	3.8	3.5	3.6
Non-interest income	2.4	2.3	2.1	2.0	2.1
Operating expenses	2.8	2.6	2.7	2.5	2.5
Pre-provisioning profit	3.3	3.2	3.2	3.0	3.2
Provisions	0.6	1.2	0.9	0.7	0.7
PBT	2.7	2.0	2.4	2.3	2.4
Tax	0.9	0.7	0.7	0.6	0.6
ROA	1.8	1.3	1.7	1.7	1.8
Leverage (x)	9.0	9.9	10.1	10.0	10.3
ROE	16.2	13.1	17.2	17.2	18.7

Ratio Analysis

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	23.7	18.0	36.9	17.2	25.4
Pre-provisioning profit	22.1	21.5	27.3	18.7	27.2
EPS	25.2	(8.8)	50.3	18.2	30.0
Profitability & Return ratios (%)					
Net interest margin	4.0	3.8	4.2	4.0	4.0
Fees / Avg. assets	1.7	1.6	1.5	1.5	1.5
Cost-Income	45.7	44.2	45.5	45.5	44.4
ROE	16.2	13.1	17.2	17.2	18.7
ROA	1.8	1.3	1.7	1.7	1.8
Asset quality (%)					
GNPA	1.2	2.1	2.3	2.1	2.0
NNPA	0.5	1.2	1.0	0.8	0.7
Provision coverage	56.3	43.0	56.2	62.1	65.9
Ratios (%)					
Credit-Deposit	95.6	95.7	93.5	93.0	92.4
Investment-Deposit	33.0	30.4	30.1	30.0	29.3
CAR	15.0	14.2	14.3	14.1	13.4
Tier-1	14.6	13.7	13.9	13.6	12.9

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: INDUSIND BANK (IIB IN)



B – Buy, A – Add, R – Reduce, S – Sell

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