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Institutional Equities

IndusInd Bank

10 January 2019

3QFY19 Result Update

Reuters: INBK.BO; Bloomberg: IIB IN

Provisions To Give Way To Synergies

IndusInd Bank (IBL) reported its 3QFY19 results with the key takeaways being: (1) IBL took provision cover to IL&FS parent exposure to ~30% and expects a cumulative provision requirement of 40-50% on this exposure to IL&FS parent (2) NIM was largely flat, contracting 1 bp QoQ with management guiding for stable to improving margin (3) Corporate loan growth (ex MFI) at 34% YoY continued to outpace consumer finance growth at 28% YoY. (See detailed conference call takeaways from page 2) Per se, on the key P&L items, IBL delivered NII, PPOP and PAT growth of 21%, 27% and 5% YoY to Rs22,881mn, Rs21,170mn and Rs9,850mn, respectively. We have retained Buy rating on IBL and revised our target price to Rs2,107 (from Rs2,139 earlier).

IBL took provision cover to IL&FS parent exposure to ~30% and expects a cumulative provision requirement of 40-50% on this exposure to IL&FS parent: The provision requirement on IL&FS parent is in consonance with our prior assumption of 50% requirement (See page 81 of Re-initiation report). We consider exposure to IL&FS group a one-off incidence of sub-optimal corporate credit appraisal. Stress pipeline remains limited with a restructured book of 11 bps and security receipts worth 34 bps of loan book. There was no untoward trend observed in the Weighted Average Risk Score for vehicle finance book with the metric staying within a band at 1.82.

NIM was largely flat, contracting 1 bp QoQ with management guiding for stable to improving margin: NIM registered during 3QFY19 stood at 3.83% as rise in cost of funds at 17bps QoQ outpaced rise in yield on assets at 16bps QoQ. Management confidence on prospective margin is predicated on (a) MCLR-linked re-pricing of loan book (b) return of pricing power. Rise in cost of funds was the result, among other reasons, of a dependence on wholesale funding, with bulk deposits (defined by IBL as having ticket size >Rs50mn) forming ~33% of total deposits as of 2QFY19. Even so, rise in cost of funds was controlled below rise in cost of deposits (20 bps) by raising cost-effective borrowings including foreign currency borrowings at rates which have been 35-45bps lower than rates prevailing in the certificate of deposits (CD) market. Refinance was also raised at rates similar to deposit rates, implying even lower cost when factoring in the former's lack of CRR/SLR requirement.

Corporate loan growth (ex MFI) at 34% YoY continued to outpace consumer finance growth at 28% YoY: Corporate loan growth (excluding Microfinance) of 34% YoY continued to outpace consumer finance growth of 28% YoY. Hence, lack of planned loan book retailisation meant the expected cushion to NIM was absent. Some of this is deliberate with caution being exercised on the loan against property business (which grew 2.8% QoQ). However, traction on the vehicle finance business continues to be encouraging with vehicle book (incl. CE) up 7.0% YoY, within which CV book was up 6.0% YoY.

Valuation and outlook: We have revised our NII, PPOP and PAT estimates, retained Buy rating on IBL and revised our target price to Rs2,107 (from Rs2,139 earlier), valuing the stock at 3.4x 1HFY21E P/BV.

BUY

Sector: Banking

CMP: Rs1,601

Target Price: Rs2,107

Upside: 32%

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Key Data

Current Shares O/S (mn)	602.1
Mkt Cap (Rsbn/US$bn)	964.4/13.7
52 Wk H / L (Rs)	2,038/1,331
Daily Vol. (3M NSE Avg.)	2,611,361

Price Performance (%)

	1 M	6 M	1 Yr
IndusInd Bank	3.0	(17.2)	(7.6)
Nifty Index	3.5	(0.8)	2.1

Source: Bloomberg

Y/E March (Rsmn)	3QFY19	3QFY18	2QFY19	*YoY (%)*	*QoQ (%)*
Interest income	57,635	42,868	54,381	***34.4***	***6.0***
Interest expenses	34,754	23,920	32,348	***45.3***	***7.4***
Net interest income	**22,881**	**18,948**	**22,033**	***20.8***	***3.8***
NIM (%)	***3.8***	***4.0***	***3.8***	***-16 bps***	***-1 bps***
Non-interest income	14,689	11,868	13,173	***23.8***	***11.5***
Operating income	**37,569**	**30,816**	**35,206**	***21.9***	***6.7***
Staff costs	4,521	4,600	4,582	***(1.7)***	***(1.3)***
Other operating expenses	11,879	9,569	10,699	***24.1***	***11.0***
Total operating expenses	**16,400**	**14,169**	**15,281**	***15.7***	***7.3***
Cost- to-income (%)	*43.7*	*46.0*	*43.4*	***-233 bps***	***25 bps***
Operating profit	**21,170**	**16,647**	**19,924**	***27.2***	***6.2***
Provisions	6,067	2,362	5,903	***156.9***	***2.8***
PBT	**15,103**	**14,285**	**14,022**	***5.7***	***7.7***
Tax	5253	4923	4819	***6.7***	***9.0***
-Effective tax rate	34.8	34.5	34.4	***32 bps***	***41 bps***
PAT	**9,850**	**9,362**	**9,203**	***5.2***	***7.0***
EPS (Rs)	16.4	15.6	15.3	***4.8***	***6.9***
BV (Rs)	438.5	382.3	421.6	***14.7***	***4.0***
Deposits	17,57,010	14,60,860	16,82,193	***20.3***	***4.4***
Advances	17,31,690	12,85,420	16,31,443	***34.7***	***6.1***

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Asset Quality

The bank continues to guide for 60 bps for full year FY19.

With respect to ILFS, the bank has made provisioning of Rs. 2,550 mn (Rs. 2,750 mn in Q2FY19). Total PCR on ILFS exposure stands at 30% (Rs. 6 bn) and the bank senses it would need to take it to 40-50%. Regarding exposure to SPVs, the bank does not expect any haircut as per its analysis of the operating assets.

Further, in terms of ILFS exposure, the bank is of the view that they've got a good handle as to which all assets are attributable to the holding company. The bank has also done its assessment of what the realizable values of these assets are. As per the bank, they have a full list of assets based on which they will be doing further deep-dive analysis. The bank would be taking further provisioning in Q4FY19.

On annual NPA divergence - RBI has completed its audit and as per the report, there is no divergence to report as of March 2018.

During the quarter, the bank wrote off Rs. 3.5 bn worth of exposures (several accounts, fully provided for over the years), which has resulted in a reduced PCR. However, the write-off gives the bank tax benefit as write-offs are tax deductible. Against their current PCR of 48%, the bank would eventually like to move to 60% over time.

There was slight uptick in corporate NPAs due to slipping of 2-3 accounts in the segment. But none of this is of any large significant value (they are "2-digit exposures, presumably from a Rs cr perspective)., 2 accounts are from the EPC construction sector.

In terms of IL&FS exposure, the bank believes that the operating assets are strong which could be sold to recover money if they became NPAs.

The bank does not expect any haircuts on the SPVs however it is of the view that all of these will turn NPA sooner than later and will attract provisioning as per IRAC norms. However, the bank expects to recover these accounts without any haircut.

As per the bank, lot of banks are holding cash in escrow accounts with IL&FS which were meant to service their debt. Since the NCLAT has put a stay order on all proceedings against ILFS, the bank has moved a petition to relax a certain part of the moratorium which is that the money held in these accounts before 1st October 2018 should be allowed to service the debt.

As per the bank, if there is a provisioning requirement on SPVs (which is another Rs 10bn worth of exposure) in case of a haircut to the tune of 10%, the bank will be able to absorb it within the 60 bps credit cost guidance. However the bank remains confident of zero haircut on its exposure to the SPVs.

Business and Loan Growth

The bank is of the view that certain sectors like manufacturing and mining could add to the credit growth going forward.

The bank added 1 mn customers in Q2FY19 and another 1 mn in Q3FY19, taking total customer base to 14 mn.

The bank is seeing strong underlying growth across the board. Steel exposure saw sharp decline as the bank had financed an NCLT steel company acquisition which has been repaid. Power exposure has gone up due to drawn down by some PSU companies.

Entire loan growth was organic, there were no buy outs from NBFCs.

Market share shift in vehicle finance segment has been happening since a period of time. As per the bank management, about a decade ago, market share of NBFCs in vehicle finance used to be 70% while banks now have about 60-70% only got accelerated recently due to liquidity crisis in NBFC space. The bank sees a very positive trend in private sector banks, including Indusind, in terms of getting higher and higher market share.

On the savings side, the bank lost a little bit of govt deposits. On CA side, the bank saw a short term spike (added Rs. 43.3 bn qoq) while the bank has guided for normal accretion rate of Rs. 6-10 bn. Some of the higher growth in CA deposits is transitory and it will come down.

Gems/Jewelry book is in USD. Oct-Dec'18 saw INR appreciate which on converting makes the exposure seems lesser than before. Also, the bank's customers in gems/jewelry had witnessed a good December month due to Thanksgiving. Overall, the portfolio remains robust and the bank does not sense any delinquencies.

In terms of MFI exposure (which is classified as under small corporate), the bank is currently at ~Rs. 80 bn. The bank eventually would like to take this figure to Rs. 100 bn by March 2019, excluding Bharat Financial's book. The bank does not see any constraint in this segment.

Margin, Liabilities and Liquidity

Though market rates/bond yields have corrected in the last quarter, liquidity is still in a deficit mode.

Lending rates have moved mildly higher due to some lagged effect of MCLR hikes.

Interest on IL&FS is still being accrued since the account is still classified as standard.

Corporate yields have moved up clearly while retail yields are slower to move up as the fixed-rate proportion is higher. Fresh disbursements in retail in last few quarters are going at a higher rate though and the older book which is at a lower rate is decaying. The bank expects to see better yields on non-vehicle retail book in coming quarters.

Absolute amount of loans linked external benchmark is very small.A significant part of retail book is fixed rate. The part that is floating will require some adjusting of spread or converting the loans to fixed rate loans.

NIM outlook is stable, with an upward tendency as re-pricing happens. Furthermore, pricing power is returning due to reasons including NBFC crisis. Besides, leadership in certain products is also helping on the pricing front.

In terms of funding profile, the bank is working on retailising its fixed deposits book. The bank has also chosen to have a certain percentage of funding coming from foreign currency borrowings which are at better prices, have better tenor and are more stable behaviourally. The bank believes there is scope for managing cost of funds by having the right balance of funding sources as the rate differential across FDs, corporate deposits and foreign borrowings is substantial.

Operating expenses

Instead of opening branches in rural areas, the bank is now re-nominating some of the BC branches as rural banking outlets which complies with RBI requirement of opening 25% branches in rural areas, incrementally.

Based on actuarial valuation discount rate and the mortality and attrition rate, which keep varying qoq, past one year has worked in favour of the bank as bond yields have moved up ,which has helped on the staff expenses front. However, bond yields have moved lower of late. But the bank believes it could also see some uptick going forward as they have been adding 350-400 people every quarter. Total headcount stands at 26,800.

Fee income

Distribution fee has been impacted partially by the SEBI regulation however it is only a deferment of income recognition in real sense which would catch up in later quarters. On the whole, core fee income is showing steady growth except distribution income.

Investment banking fee run rate of Rs 2 bn is something that can be attained on a broadly recurring basis.

Processing fees is 40% retail and 60% corporate.

In terms of new initiatives, the bank has continued to carry out innovations. The bank launched its wealth vertical under which it is targeting Rs. 160 bn in AUM and Rs. 3 bn fee income by FY21.

Others

As per the bank, the merger has been supported well and good by shareholders on both the sides with 99% voting in favour of the merger.

On Mr. Ramesh Sobti's term extension/retirement – Taking retirement age from 70 to 75 is only speculation. The Companies Act earlier used to require a special resolution to be passed for amending the retirement age but that now has been changed to ordinary resolutions which is what has caused the speculation. The board had fixed a succession plan 4 years ago and is committed to creating an orderly and a non-disruptive plan of succession.

The bank expects consolidation of Bharat Financial to happen in this quarter (Q4FY19). The bank is awaiting the NCLT tribunal for giving the final date followed by some procedural exercises, which are usually quick to do. Consolidation should be completed sometime in February. The intimation of the final hearing date is awaited.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	60,626	74,974	91,382	1,18,901	1,53,478
Pre-provision profit	54,511	66,561	84,417	1,05,638	1,37,715
PAT	28,679	36,060	38,396	53,942	72,488
EPS (Rs)	48.0	60.1	64.0	89.9	116.1
BV (Rs)	345.2	397.2	453.7	533.9	705.2
P/E (x)	33.4	26.7	25.0	17.8	13.8
P/BV (x)	4.6	4.0	3.5	3.0	2.3
GNPAs (%)	*0.9*	*1.2*	*1.2*	*1.3*	*1.1*
NNPAs (%)	*0.4*	*0.5*	*0.5*	*0.4*	*0.3*
RoA (%)	*1.8*	*1.8*	*1.5*	*1.7*	*1.8*
RoE (%)	*15.0*	*16.2*	*15.0*	*18.2*	*19.1*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	3QFY19	3QFY18	2QFY19	*YoY (%)*	*QoQ (%)*	3QFY19E	*Devi. (%)*
Net interest income	22,881	18,948	22,033	*20.8*	*3.8*	23,053	*(0.7)*
Pre-provision profit	21,170	16,647	19,924	*27.2*	*6.2*	21,216	*(0.2)*
PAT	9,850	9,362	9,203	*5.2*	*7.0*	9,410	*4.7*

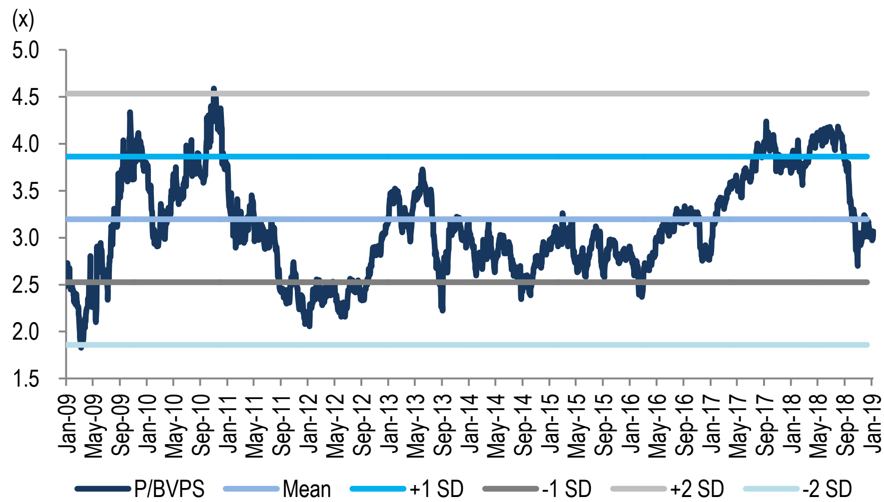
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	91,382	1,18,901	1,53,478	94,995	122,296	158,987	*(3.8)*	*(2.8)*	*(3.5)*
NIM (%)	*4.00*	*4.06*	*4.14*	*4.14*	*4.15*	*4.21*	*-14 bps*	*-9 bps*	*-7 bps*
Operating profit (Rsmn)	84,417	1,05,638	1,37,715	87,379	113,562	150,037	*(3.4)*	*(7.0)*	*(8.2)*
Profit after tax (Rsmn)	38,396	53,942	72,488	45,610	63,326	84,995	*(15.8)*	*(14.8)*	*(14.7)*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	1,44,057	1,72,807	2,24,368	2,85,448	3,62,022
Interest expenses	83,431	97,833	1,32,985	1,66,547	2,08,545
Net interest income	**60,626**	**74,974**	**91,382**	**1,18,901**	**1,53,478**
Fee income	38,914	43,783	51,676	74,858	95,069
Other income	2,801	3,718	4,390	3,401	4,284
Net revenues	1,02,341	1,22,475	1,47,448	1,97,160	2,52,831
Operating expenses	47,831	55,914	63,032	91,522	1,15,116
-Employee expenses	15,210	17,807	18,857	23,508	29,553
-Other expenses	32,621	38,108	44,175	68,014	85,562
Operating profit	**54,511**	**66,561**	**84,417**	**1,05,638**	**1,37,715**
Provisions	10,913	11,754	26,242	23,908	27,885
-Loan loss provision	10,506	9,009	25,808	22,811	26,525
-Provision for investment	314	1,209	434	1,098	1,360
-Other provisions	94	1,537	0	0	0
PBT	43,597	54,807	58,175	81,730	1,09,830
Tax	14,918	18,747	19,780	27,788	37,342
PAT	**28,679**	**36,060**	**38,396**	**53,942**	**72,488**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity Capital	5,981	6,002	6,002	6,002	6,242
Reserves & surplus	2,00,477	2,32,414	2,66,308	3,14,465	4,33,991
Shareholder's funds	**2,06,458**	**2,38,416**	**2,72,310**	**3,20,467**	**4,40,233**
Deposits	**12,65,722**	**15,16,392**	**19,72,996**	**25,07,222**	**31,85,690**
Borrowings	2,24,537	3,82,891	4,89,660	6,31,990	7,31,280
Other liabilities	89,764	78,563	1,00,656	1,22,312	1,44,428
Total liabilities	**17,86,481**	**22,16,262**	**28,35,622**	**35,81,992**	**45,01,632**
Cash/equivalent	1,86,282	1,32,159	2,07,284	2,63,250	3,34,328
Advances	11,30,805	14,49,537	18,84,398	23,93,185	30,39,345
Investments	3,67,021	5,00,767	5,96,761	7,63,660	9,49,873
Fixed assets	13,352	13,388	14,726	16,199	17,819
Other assets	89,023	1,20,412	1,32,453	1,45,698	1,60,268
Total assets	**17,86,483**	**22,16,262**	**28,35,622**	**35,81,992**	**45,01,632**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

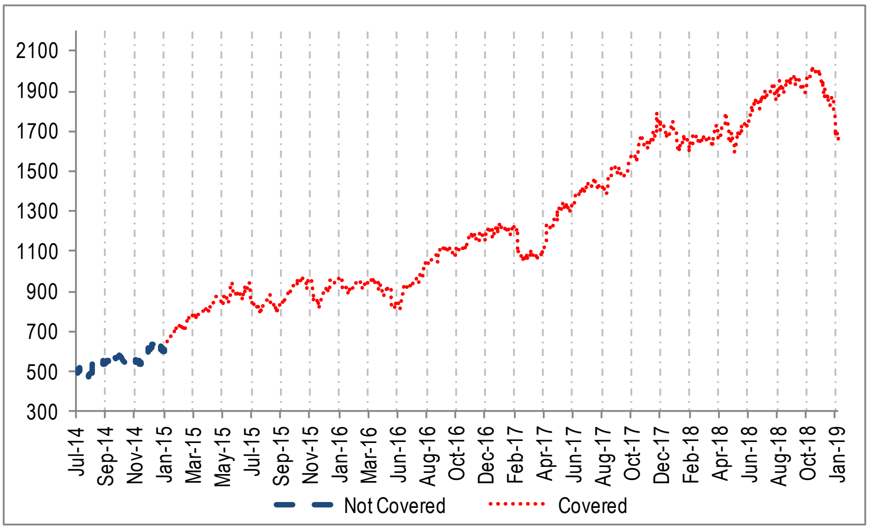
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	34.2	23.7	21.9	30.1	29.1
Pre-provision profit growth	31.6	22.1	26.8	25.1	30.4
PAT growth	25.4	25.7	6.5	40.5	34.4
Business (%)					
Deposit growth	36.1	19.8	30.1	27.1	27.1
Advances growth	27.9	28.2	30.0	27.0	27.0
Business growth	32.1	23.8	30.1	27.0	27.0
CD	89.3	95.6	95.5	95.5	95.4
CASA deposits	36.9	44.0	45.0	46.0	46.7
Operating efficiency (%)					
Cost-to-income	46.7	45.7	42.7	46.4	45.5
Cost-to-assets	3.0	2.8	2.5	2.9	2.8
Productivity (Rsmn)					
Business per branch	1,980.6	2,118.5	2,571.6	2,800.2	3,112.5
Business per employee	94.7	117.3	146.9	164.7	183.1
Profit per branch	23.7	25.8	25.6	30.8	36.2
Profit per employee	1.1	1.4	1.5	1.8	2.1
Spread (%)					
Yield on advances	11.4	10.6	11.0	10.9	10.9
Yield on investments	7.0	7.1	6.9	7.0	7.0
Cost of deposits	6.3	5.8	6.1	6.0	5.9
Yield on assets	10.0	9.6	9.8	9.8	9.8
Cost of funds	5.9	5.5	5.9	5.7	5.7
NIM	4.2	4.2	4.00	4.06	4.14
Capital adequacy (%)					
Tier I	14.7	14.6	12.8	11.6	12.6
Tier II	0.6	0.4	0.5	0.5	0.4
Total CAR	15.3	15.0	13.3	12.1	13.0
Asset quality (%)					
Gross NPAs	0.9	1.2	1.2	1.3	1.1
Net NPAs	0.4	0.5	0.5	0.4	0.3
Provision coverage	58.4	56.3	62.9	68.9	70.3
Slippage	1.4	2.6	1.3	1.3	1.0
Credit-cost	0.7	0.7	1.2	0.9	0.8
Return ratios (%)					
RoE	15.0	16.2	15.0	18.2	19.1
RoA	1.8	1.8	1.5	1.7	1.8
RoRWA	2.2	2.3	2.0	2.2	2.3
Per share (Rs)					
EPS	48.0	60.1	64.0	89.9	116.1
BV	345.2	397.2	453.7	533.9	705.2
ABV	337.9	384.8	440.7	519.3	690.3
Valuation (x)					
P/E	33.4	26.7	25.0	17.8	13.8
P/BV	4.6	4.0	3.5	3.0	2.3
P/ABV	4.7	4.2	3.6	3.1	2.3

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
14 October 2014	Buy	636	800
14 January 2015	Buy	821	975
17 April 2015	Buy	933	1,075
14 July 2015	Buy	927	1,150
12 October 2015	Buy	937	1,150
13 January 2016	Buy	908	1,335
22 April 2016	Buy	971	1,335
12 July 2016	Buy	1,124	1,340
13 October 2016	Buy	1,220	1,470
10 January 2017	Buy	1,162	1,470
14 February 2017	Buy	1,340	1,600
20 April 2017	Buy	1,420	1,700
12 July 2017	Buy	1,560	1,790
13 October 2017	Buy	1,747	2,065
12 January 2018	Buy	1,700	2,018
20 April 2018	Buy	1,834	2,165
11 July 2018	Buy	1,934	2,288
9 October 2018	Buy	1,600	2,274
16 October 2018	Buy	1,627	2,235
13 December 2018	Buy	1,582	2,139
10 January 2019	Buy	1,599	2,107

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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