IndusInd Bank

31 March 2020

Reuters: INBK.BO; Bloomberg: IIB IN

Company Update

Mgmt commentary suggests a complete overhaul ahead

Our key takeaway from the bank's business update conference call last evening was that a major overhaul maybe underway at IndusInd Bank. This would include 'tweaks' at the management level and pivoting the business strategy in a direction such that asset growth is a function of liabilities (and not the other way). One of the elements of the overall plot includes de-focusing on bulk deposits. During the quarter, the bank lost about 10-11% of deposits, of which ~75% belonged to 1-2 state governments while rest were corporate in nature. Assuming the liabilities strategy plays out on expected lines, we think historical high loan growth rates would be challenged. Over FY20E/21E/22E, we expect advances to grow at nearly half the annual run-rate we were used to seeing before. Further, management sounded confident about managing covid-19 impact on asset quality across different portfolios. The confidence is attributed to the fact that the bank has been able to manage previous disruptions well. However, we would wait over the next few months to see how long the current health crisis lasts and what the underlying damage is to the economy and businesses. For now, we are building an uptick in NPAs in FY20E and FY21E for the bank. 4QFY20 will see overall credit costs of 200-210bps, which in absolute terms could turn out to be >Rs15bn (up 45% QoQ) (as per NBIE estimates) and could take PCR beyond 60%. Our sense is that we could witness a couple or more quarters of weak growth and profitability as the new MD/CEO implements new growth strategy, aims for a higher coverage ratio and a stronger balance sheet. We value the stock at Rs623, based on 1x FY22E ABV. Going forward, new MD/CEO delivering on stated guidance (*see business build-out philosophy on page 3*) may warrant upward revision of book value multiple.

Other key conference call highlights:

- Once the lockdown is over, service-oriented industry, including banking, will bounce back faster. RBI and the government are taking measures to ensure the economy resumes functioning as soon and smooth as possible. Though services will normalize in 3-4 months, demand should recover post 1QFY21.
- Given the current situation, bank's experience suggests that asset quality impact on the portfolio will be limited (*see business segment wise asset quality implications in exhibit 1*).
- The bank awaits clarifications from the RBI regarding freezing of DPD of clients. Meanwhile, the bank would continue to support its customers through various measures.
- In CVs, 70% of the business is from repeat customers, which have been in the business for more than two decades and have seen far worse times.
- Two-wheeler finance is mostly income-generation oriented since these include people such as carpenters who use the vehicle for earning their livelihood.
- The bank saw deposit outflow of 1-2 state government accounts (75% of the outflow) and some corporate deposits which constituted about 10-11% of the total deposits. Since then, the lost deposits have been made up for by tapping other resources such as 3-year refinance, FX borrowings, CDs, repos and call money instruments. A significant part of the advances book also qualifies for PSLC. Overall, the bank remains confident about its liquidity position.
- Retail deposits have been grown at 18-20% YoY.
- The bank has created an independent group to sharpen the corporate RoRWA. As per the MD/CEO, large/chunky corporate exposures are on their way out.
- The bank will maintain 15% as threshold for CRAR.
- Current management team's continuity is critical. There are likely to be some tweaks such as consolidation of profiles, addition of control and/or governance in some businesses and splitting of some business lines so as to gain more focus.
- Current health crisis could impact repayment inflows which should be made up for by the cut in CRR.
- In MFI, both disbursements and collection have been impacted since centre meetings have not been possible.
- Promoters have applied to the RBI for raising their stake to 26% and will continue to support the bank.

Valuation and outlook: We have retained our NII, PPOP and PAT estimates for FY20/FY21/FY22. We have retained Buy rating on IIB with a target price of Rs623, valuing the stock at 1.0x FY22E P/ABV.

BUY

Sector: Banking

CMP: Rs412

Target Price: Rs623

Upside: 51%

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Key Data

Current Shares O/S (mn)	693.5
Mkt Cap (Rsbn/US$bn)	286.7/3.8
52 Wk H / L (Rs)	1,824,/236
Daily Vol. (3M NSE Avg.)	12,292,030

Price Performance (%)

	1 M	6 M	1 Yr
IndusInd Bank	(62.6)	(70.1)	(76.8)
Nifty Index	(26.1)	(27.8)	(28.8)

Source: Bloomberg

Exhibit 1:Covid-19 implication on select loan portfolios

Business Segment	Who is our customer?	Why comfortable underwriting this ?	Actions taken to minimise Covid-19 disruption	Asset quality implication
Business Banking **(6% of loans)**	• SME/MSME across industries and geographies • Thrust area of Government of India being MSME class of borrowers. • Negligible capital market exposure	• Granular portfolio • Dispersed by industry and geography • Ticket size ~ 2.5 crores • Sole Banking • Cash Flow based. • Collateralised typically self-occupied marketable assets	• Sector based Portfolio / Policy review. • Relationship / collection model strengthened to monitor each and every account at ground level. • Covid-19 emergency lines to select borrowers & moratorium per RBI	• < 8 % portfolio in impacted sectors like Retail, Tour Travel, etc. • DSCR with sensitivity analysis so a limited shock is not disruptive. • Proven track record during earlier shocks GST, Demonetisation
Loan Against Property **(5% of Loans)**	• Small business owners, smaller than Business Banking - less complex and lending itself to program based lending	• Program based cash actual flow lending • 60-70 lac ticket size • Portfolio LTV 50%, mostly self occupied	• Advisory for collection resumption in 3 weeks • Pipeline loan re-assessment • Policy changes on select impacted sectors	• < 5% portfolio in impacted sectors like Retail, Tour Travel, Ent. • Portfolio is granular, very well secured and distributed.
Micro-finance **(10% of loans)**	• Women borrowers from low income households • Rural focussed with ticket size ~ 25K • Livestock, grocery / retail & weaving / tailoring account for 60% of loans	• Self employed livelihood loans • Conservative practices • Net producers to economy • Provide essential products to their immediate community	• Virtual Centre Meetings to engage 8 lac customers/day • Loan manager in touch by phone to offer advice on Health & Safety • Advisory for collections retained by Centre/Group leader & that operations re-commence in 3 weeks • Contact centre/helpline fully operational	• Negligible COVID in Rural / lower migration. • Government initiatives for rural poor • 3 months moratorium • No Centre Meetings till removal of lockdown. • History has shown strong collections on resumption: 98% for recent Kerala floods and 96% for demonetisation.
Cards & Personal Loans **(5% of loans)**	• Salaried individuals • Internal X-sell clients • Well spread client base • Focus on higher end of income & social pyramid	• Max PL/Card holding of 1 at time of acquisition • Must comply with min internal risk score A • Limits on analysis of disposable income • Regular portfolio churn	• Contact centre fully operational • Online channels in vogue for collections here • Portfolio reviews underway for any sign of stress	• Some elevation in delinquency likely • Moratorium applies • Sense that portfolio resumes normalcy soon after situation stabilises
Commercial Vehicles **(12% of loans)**	• >90% are Small Road Transport Operators with 3-10 vehicles • Serve every segment of the economy • Ticket size 6L (LCV), 12L (ICV), 30L (MHCV)	• 70% repeat customers • Granular portfolio • Credit Cycle management over 30 years by same team • Dispersed by application and geography	• Regular customer contact on Health & Safety and to enhance client experience • Digital repayment modes enabled obviating field visit • Contact centre/helpline fully operational	• Experienced client set able to withstand upto short term downturn • 3 months moratorium • Tends to bounce back rapidly from disruption as fully linked to economy
Passenger Vehicles & 2 Wheelers **(combined 6% of loan book)**	• Blend of self-employed, farmers and salaried • Semi urban and Rural focussed with ticket size 5L (Cars) and 0.5L (2W) • Large percent of self employed	• Typically livelihood loans • Net producers providing essentials to local communities • Expertise in business owner underwriting • Catering day-to-day essential services	• Teams in contact with their customers • Digital repayment modes enabled for cash paying customers (NACH adoption) • Contact centre / helpline fully operational	• Negligible Covid in Rural & Semi Urban so far • 3 month moratorium
Gems & Jewellery (3% of loans)	• Rough Diamond importers, manufacturers and exporters of polished diamonds • Jewelry manufacturer and exporters • Jewelry manufacturers for Domestic market. • Reputed Jewelry Retail chain for B2C	• A sustainable business across many decades in ABN AMRO / IBL with zero or negligible delinquencies • Risk weightage of 73% based on external ratings. • Strong backing by way of second way out like AIG Credit guarantee, mortgage of quality collateral like residential & commercial properties, factory set up and cash collateral to the extents of 54% of portfolio. • Excellent risk reward profile and sustained quality of assets is the key drivers for our underwriting.	• Continuous monitoring of loans and active discussion with customers for business impact • Re-assessing working capital requirements of individual customers on case to case basis • Sound tracking of situation basis insights from our global connects with miners, key industry players and financial institutions located across the globe. • With reduced business levels, we are reducing operating lines on our portfolio which is uncommitted and repayable on demand.	• Negligible impact as on date on portfolio with no SMA. • Sound realization of export bills is continuing till date • Currently envisaged 3 months lockdown of major markets is expected to delay the shipments and realization of already exported goods for payments. • RBI 3 months moratorium to help adjust supply lines • We expect markets in many parts of the world to open up post May 2020.
Real Estate Developer (4% of loans)	• RE: Developer Loans for under construction properties • Commercial and Residential • Ticket size 100-125 Cr	• Sector focused specialized and experienced team • Strong monitoring process	• Team working from home without any business impact	• Likely delay in some projects due to lockdown / labour migration • Continuous regulatory interventions to help the sector.
NBFCs (3% of loans)	• Large NBFCs	• Good sponsors • Several niche retail financiers e.g. Gold, Vehicle • Well capitalised entities	• Team working from home without any business impact • Portfolio reviews underway for any sign of stress	• Clients largely in secured lending space • 3 months moratorium to help them tide over • Some elevation in delinquencies likely if disruption > 3m

Source: Company, Nirmal Bang Institutional Equities Research

Key priorities include management continuity, inculcating accountability, employee incentivization, deposit retailisation, sharper focus on corporate RoRWA and strengthening the balance sheet.

Business Build-Out Philosophy

- Sustainability to underscore our 4D strategy !
- Management team largely intact, but some tweaks on structure and accountability.
- Employees to be incentivised appropriately but with mix of fixed/variable and malus/clawback provisions where applicable
- Deposit Retailization: Reduced Reliance on Bulk & Government deposits moving forward
- Sharper focus on Wholesale RORWA : Strengthening Risk Management, Disciplined Underwriting & Portfolio Management, Reduced Concentrations
- Strengthening the balance sheet by continuously raising PCR & maintaining a high threshold for CET1 capital.
- Moderated balance sheet during the COVID-19 period, and thereafter growth aligned with deposit and asset quality granularization
- Immediate priority to consolidate / build resilience

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net interest income	74,979	88,462	118,187	134,926	158,007
Pre-provisioning operating profit	66,570	80,882	104,438	117,285	136,936
PAT	36,066	33,011	49,054	58,674	73,033
EPS (Rs)	60.1	54.8	69.3	82.9	103.1
BV (Rs)	397.0	442.6	534.6	605.0	692.7
P/E (x)	6.8	7.5	5.9	5.0	4.0
P/BV (x)	1.0	0.9	0.8	0.7	0.6
GNPAs (%)	*1.2*	*2.1*	*2.6*	*3.1*	*3.1*
NNPAs (%)	*0.5*	*1.2*	*1.1*	*1.2*	*1.0*
RoA (%)	*1.8*	*1.3*	*1.6*	*1.7*	*1.9*
RoE (%)	*16.2*	*13.1*	*15.2*	*14.5*	*15.9*

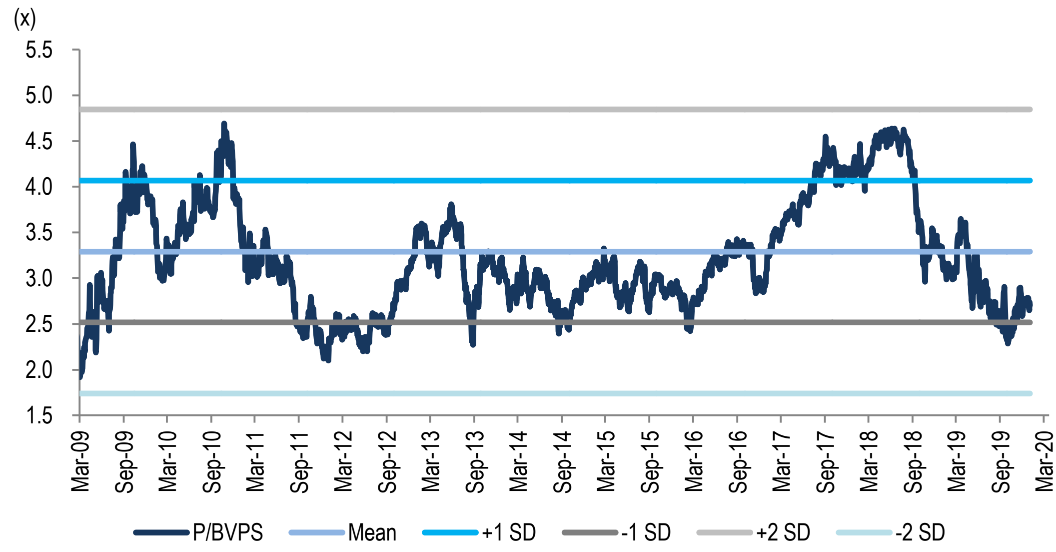
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	*FY20E*	*FY21E*	FY22E
Net interest income (Rsmn)	118,187	134,926	158,007	118,187	134,926	158,007	*0.0*	*0.0*	*0.0*
NIM (%)	*4.2*	*4.2*	*4.4*	*4.2*	*4.2*	*4.4*	*0 bps*	*0 bps*	*0 bps*
Operating profit (Rsmn)	104,438	117,285	136,936	104,438	117,285	136,936	*0.0*	*0.0*	*0.0*
Profit after tax (Rsmn)	49,054	58,674	73,033	49,054	58,674	73,033	*0.0*	*0.0*	*0.0*

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)	FY18	FY19	FY20E	FY21E	FY22E
Interest Income	172,808	222,612	281,877	309,662	351,278
Interest expense	97,829	134,150	163,690	174,736	193,271
Net interest income	**74,979**	**88,462**	**118,187**	**134,926**	**158,007**
Fees & Other Income	47,501	56,467	68,592	79,736	92,845
Net Revenue	122,479	144,929	186,779	214,662	250,852
Operating Expense	55,910	64,047	82,341	97,377	113,917
-Employee Exp	17,807	18,535	28,637	32,932	37,872
-Other Exp	38,103	45,512	53,704	64,445	76,045
Pre-Provisioning Operating Profit	**66,570**	**80,882**	**104,438**	**117,285**	**136,936**
Provisions	11,757	31,076	37,240	38,875	39,338
PBT	54,813	49,806	67,198	78,410	97,598
Taxes	18,747	16,795	18,143	19,736	24,565
PAT	**36,066**	**33,011**	**49,054**	**58,674**	**73,033**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Growth (%)					
NII growth	23.7	18.0	33.6	14.2	17.1
Pre-provision profit growth	22.1	21.5	29.1	12.3	16.8
PAT growth	25.7	-8.5	48.6	19.6	24.5
Business (%)					
Deposit growth	19.8	28.5	15.0	13.0	16.0
Advance growth	28.2	28.6	14.6	10.2	15.2
CD	95.6	95.7	95.3	92.9	92.3
CASA	44.0	43.1	43.7	46.0	47.9
Operating effeciency (%)					
Cost-to-income	45.6	44.2	44.1	45.4	45.4
Cost-to-assets	2.8	2.6	2.8	2.9	3.0
Spreads (%)					
Yield on advances	10.6	11.0	11.9	11.5	11.6
Yield on investments	7.1	6.7	6.4	6.5	6.5
Cost of deposits	5.8	6.1	6.2	5.9	5.7
Yield on assets	8.6	8.9	9.4	9.2	9.2
Cost of funds	5.8	6.2	6.3	6.0	5.9
NIMs	4.0	3.8	4.2	4.2	4.4
Capital adequacy (%)					
Tier I	14.6	13.7	15.2	14.8	14.4
Tier II	0.4	0.5	0.5	0.4	0.4
Total CAR	15.0	14.2	15.6	15.3	14.8
Asset Quality (%)					
Gross NPA	1.2	2.1	2.6	3.1	3.1
Net NPA	0.5	1.2	1.1	1.2	1.0
Provision coverage	56.3	43.0	56.3	62.8	69.5
Slippage	3.0	3.7	2.5	2.4	2.2
Credit-cost	0.7	1.4	1.4	1.3	1.2
Return (%)					
ROE	16.2	13.1	15.2	14.5	15.9
ROA	1.8	1.3	1.6	1.7	1.9
RORWA	2.3	1.7	2.1	2.2	2.3
Per share					
EPS	60.1	54.8	69.3	82.9	103.1
BV	397.0	442.6	534.6	605.0	692.7
ABV	384.5	405.3	500.0	565.4	655.5
Valuation					
P/E	6.8	7.5	5.9	5.0	4.0
P/BV	1.0	0.9	0.8	0.7	0.6
P/ABV	1.1	1.0	0.8	0.7	0.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

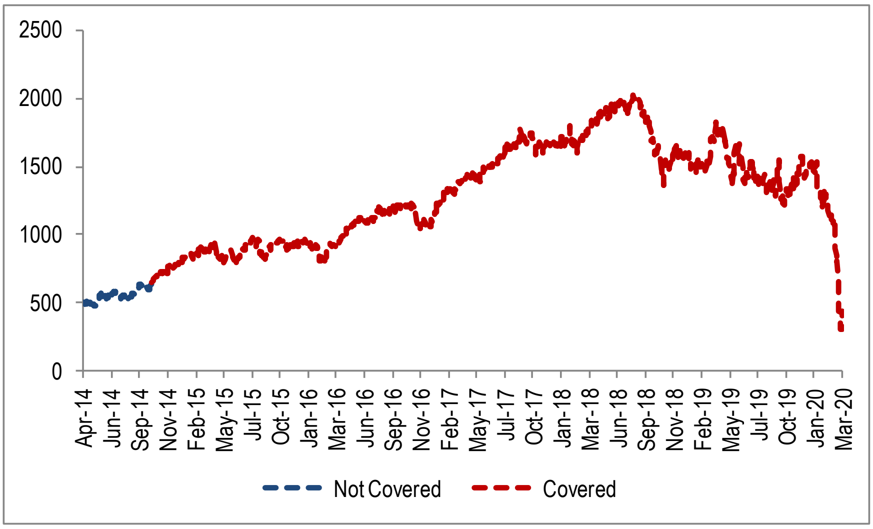
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Equity Capital	6,002	6,027	7,081	7,081	7,081
Reserves & Surplus	232,269	260,721	371,462	421,335	483,413
Shareholder's Funds	**238,271**	**266,748**	**378,543**	**428,416**	**490,494**
Deposits	**1,516,390**	**1,948,679**	**2,240,981**	**2,532,308**	**2,937,478**
Borrowings	382,890	473,211	496,872	506,809	567,626
Other liabilities	78,560	89,444	90,387	86,117	92,402
Total liabilities	**2,216,256**	**2,778,194**	**3,206,894**	**3,553,763**	**4,088,111**
Cash/Equivalent	132,154	147,834	203,525	226,977	262,179
Advances	1,449,537	1,863,935	2,136,210	2,353,742	2,711,097
Investments	500,767	592,662	672,294	759,693	881,243
Fixed Assets	13,386	17,099	19,402	20,342	21,282
Other assets	120,412	156,664	175,463	193,009	212,310
Total assets	**2,216,256**	**2,778,194**	**3,206,894**	**3,553,763**	**4,088,111**

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
8 April 2019	Buy	1,768	2,109
23 May 2019	Buy	1,519	2,066
8 July 2019	Buy	1,533	1,846
15 July 2019	Buy	1,510	1,880
7 October 2019	Buy	1,241	1,768
11 October 2019	Buy	1,229	1,733
1 November 2019	Buy	1,313	1,733
8 January 2020	Buy	1,459	1,729
15 January 2020	Buy	1,482	1,736
27 March 2020	Buy	413	623
31 March 2020	Buy	412	623

Rating track graph



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