

INDUSIND BANK

BANKS & FINANCIAL SERVICES

BUY

Target Price: Rs 1,630

Q4 in line; unveils 3-year strategy to grow 2x

Indusind Bank (IIB's) Q4FY17 PAT (adjusted for one-offs) of ~Rs 8.3 bn (up 34% YoY) was broadly in line with our expectations on the back of higher other income. Provisions included one-off provision of ~Rs 1.2 bn as per RBI's directives against a standard account in cement sector. Q4FY17 was strong operationally – loans up 28%, deposits up ~36%, NIM stable at 4% and terminal CASA(%) at ~37%.

IIB unveiled its 4th 3-year Planning Cycle (PC4) where it targets to double its loan book, profits and client base again. Core strategies are centered on gaining market share profitably and digitizing to differentiate via 7 strategic themes (detailed below). It will target a 50:50 corporate-to-retail loan mix and further 50:50 vehicle-to-non-vehicle retail loan mix. Roll forward to FY19 P/ABV. **Maintain BUY with new TP of Rs 1,630.**

CMP : Rs 1,423
Potential Upside : 15%

MARKET DATA

No. of Shares : 598 mn
Free Float : 85%
Market Cap : Rs 851 bn
52-week High / Low : Rs 1,445 / Rs 966
Avg. Daily vol. (6mth) : 1.4 mn shares
Bloomberg Code : IIB IB Equity
Promoters Holding : 15%
FII / DII : 43% / 12%

Q4FY17 highlights: (a) Provisions for Q4FY17 doubled YoY led by a one-time provision (~Rs 1.2 bn) on a standard account following RBI's directives. Management expects this to reverse in Q1FY18; (b) Asset quality remained pristine with GNPA's at 0.9% (flat QoQ); (c) Loan book grew 28% YoY backed by 30% YoY growth in corporate loans. Retail loans grew ~25% YoY; (d) Other income grew ~33% YoY driven by ~74% YoY growth in 3rd party product distribution commissions (largely explained by flow of idle cash deposited during demonetization); (e) IIB sold loans worth ~Rs 1.9 bn to ARCs; (f) branch footprint expanded by 125 branches to touch 1,200.

Maintain BUY with rolled-forward TP of Rs 1,630 (3.7x FY19 P/ABV): We are enthused by IIB's aggressive 3-year targets for FY20, as management has proven its caliber by meeting targets set in previous 3 planning cycles. With growing retail franchise and increasing market share in large corporate segment, IIB is one of few banks reporting robust growth when industry growth is down to single digit. We roll forward our estimates to FY19, valuing IIB at 3.7x FY19 P/ABV to arrive at TP of Rs 1,630 (15% upside from CMP).

Financial summary (Standalone)

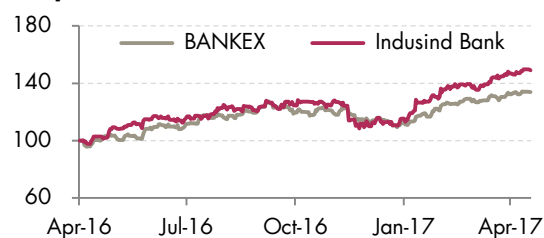
Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs mn)	22,864	28,678	35,717	44,097
EPS (Rs)	38	47	58	72
EPS chg (%)	13.8	24.5	24.5	23.5
Book value (Rs)	285	331	381	444
Adj. BV (Rs)	281	326	376	437
PE (x)	37.9	30.4	24.4	19.8
P/ABV (x)	5.1	4.4	3.8	3.3
RoE (%)	16.6	15.2	16.4	17.4
RoA (%)	1.8	1.8	1.8	1.8
Net NPA (%)	0.4	0.4	0.4	0.4

Source: Company, Axis Capital

Key drivers

	Q1'17	Q2'17	Q3'17	Q4'17
Loan growth (% YoY)	30	26	25	28
NIM (%)	4.0	4.0	4.0	4.0
CASA (%)	34	37	37	37
GNPA ratio (%)	0.9	0.9	0.9	0.9

Price performance



Planning Cycle 4 (PC4) FY18-20

IIB unveiled its fourth 3-year Planning Cycle (PC4) where it targets to double itself yet again (in terms of loan book, profits and client base)

Core strategies include

- ◆ Digitize to differentiate, diversify and create domain Leadership and
- ◆ Gain market share profitably

IIB highlighted 7 strategic themes (detailed below) to achieve the following broad targets over FY17-20.

Exhibit 1: PC 4 targets

Parameter	PC3 Target	PC3 Actual	Result	PC4 Target
Loan Growth	25-30%	27.0%	Achieved	25-30%
CASA Ratio	35%+	36.9%	Achieved	40%
Branch Network	2x to 1,200	1,200	Achieved	2,000
Customer Base	2x to 9 mn	9.5 mn	Achieved	20mn+
Revenue Growth		Na		Exceed Balance Sheet Growth
RoRWA (Return on Risk Weighted Assets)		Na		2.4%+

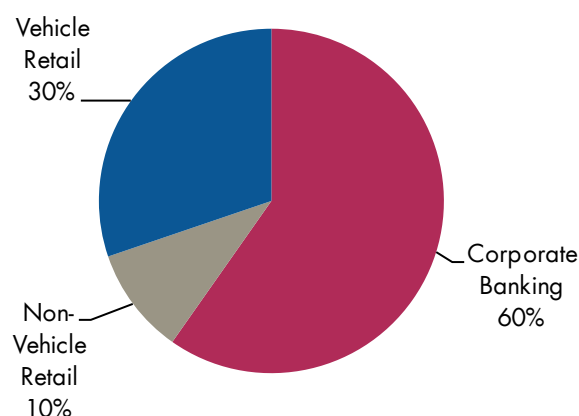
Source: Company, Axis Capital

7 strategic themes

1) Rebalancing of loan book

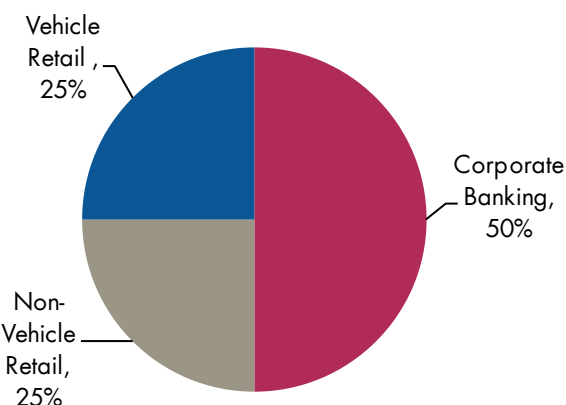
- ◆ IIB targets a 50:50 corporate-to-retail loan mix and further 50:50 vehicle-to-non-vehicle retail loan mix by FY20
- ◆ This would help the bank achieve a more diversified, granular mix of assets reducing concentration risk while increasing NIM
- ◆ Management expects NIM to increase ~35 bps by FY20 if it succeeds in achieving this mix

Exhibit 2: Book mix Q4FY17 (current)

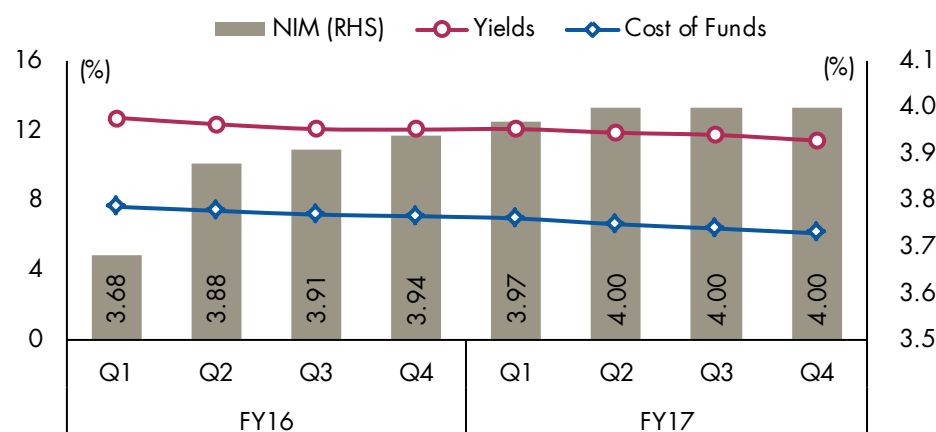


Source: Company, Axis Capital

Exhibit 3: Book target mix FY20E



Source: Company, Axis Capital

Exhibit 4: Yield, margins and cost of funds


Source: Company, Axis Capital

2) Focus on rural banking and microfinance

- ♦ Rural Banking to contribute more than 10% of PAT by FY20
- ♦ To be achieved through three focus segments: (a) inclusive banking (2) agri business and (3) achieving profitability of rural branches

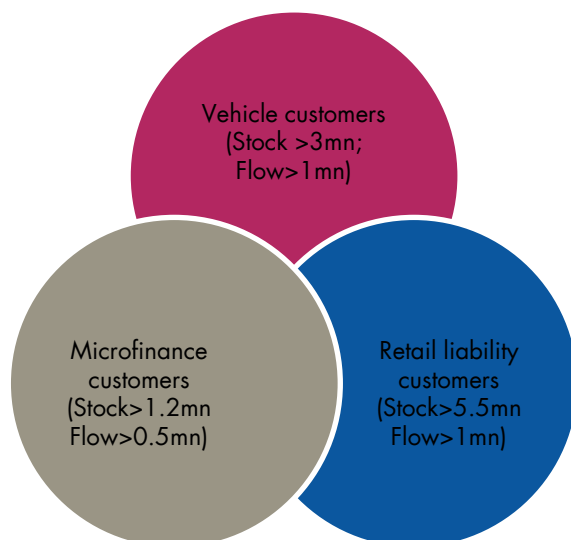
3) Digital strategy

- ♦ Digital to contribute ~14% of PAT by FY20
- ♦ To be achieved through enhanced revenue generation and low cost customer acquisition or through process re-engineering, reducing back-end and mid-end costs
- ♦ Management stated that it is working with an external consultant (McKinsey) to digitize front-, mid- and back-end operations, and believes that the gains of digitization are largest in the back office

4) Increasing cross sells

- ♦ IIB has developed a significant retail customer base comprising (1) ~3 mn vehicle finance customers, (2) 1.2 mn microfinance customers and (3) ~5.5 mn retail customers (there may be overlap between these segments)
- ♦ Aims to increase cross-sells upto 6x higher than the current levels

Exhibit 5: Large customer base

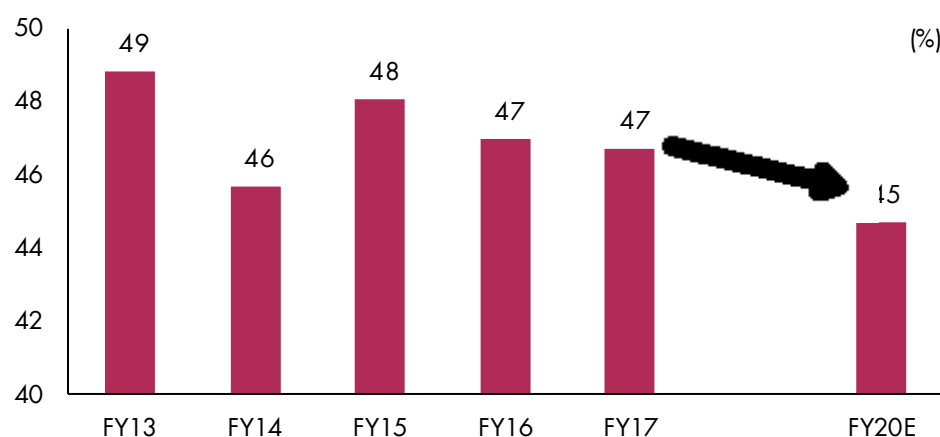


Source: Company, Axis Capital

5) Focus on productivity

- ◆ Main aim is to reduce the cost to income ratio by 200 bps from ~47% in FY17 to ~45% by FY20 though decline in physical transactions and growth in mobile transactions
- ◆ To reduce size of incremental branches by ~50% and cost of running incremental branches by ~35%

Exhibit 6: Cost to income ratio expected to decline 200bps



Source: Company, Axis Capital

6) Goal-based improvement in customer experience

- ◆ Aim is to retain and deepen relationships with customers, garnering additional wallet share in terms of financial transactions (higher cross-sells etc.) and CASA balances (~Rs 100 bn of additional CASA by FY20)

7) Sustainable banking: Taking cognizance of regulatory compliance and environmental/social factors and higher governance

Conference call highlights

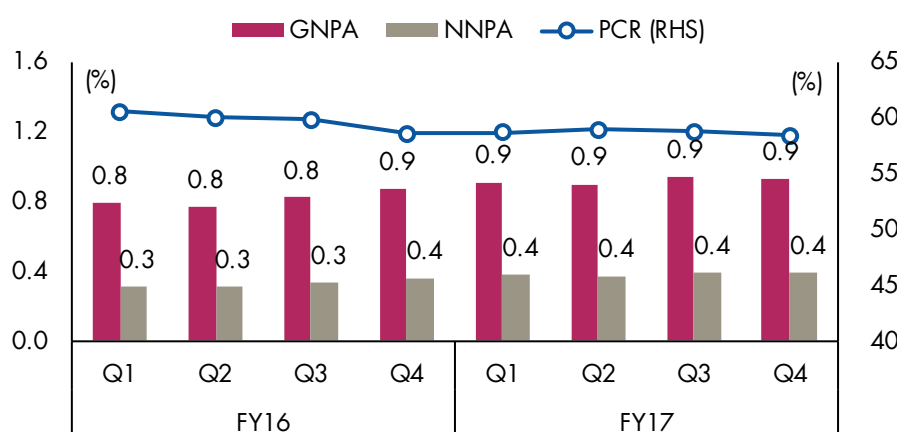
Inorganic opportunities and view on microfinance

- ◆ IIB is not interested in pursuing any inorganic opportunities in mutual fund, life insurance or general insurance business because of the long payback period on investments
- ◆ It prefers brokerage and microfinance businesses and remains open to acquisitions in these spaces
- ◆ On microfinance, the management believes that although the industry has its own challenges, the intensity of these challenges is coming down. In particular, credit bureaus have helped bring down systemic overleveraging dramatically
- ◆ Management highlighted that RoE accretion (from day 1) and domain leadership to be the key criteria for acquisition

Asset quality

- ◆ Provisions in Q4FY17 include a one-off provision of Rs 1.2 bn pursuant to specific RBI's directives against a standard account (bridge loan for M&A acquisition in cement sector; with repayment due in Q1FY18). The management expects this provision to reverse in Q1FY18
- ◆ On telecom exposures, IIB stated that any additional provisions required to be made would only pertain to on funded exposures (no provisions on non-funded exposures). Management is comfortable with its current exposures (IIB's exposure to telecom sector is 4.8% on total basis and 2.6% on funded basis)
- ◆ IIB sold ~Rs 1.9 bn worth of loans to ARCs during the quarter at a loss of Rs 1.25 bn (taken to income statement without any amortization)

Exhibit 7: Trend in asset quality performance

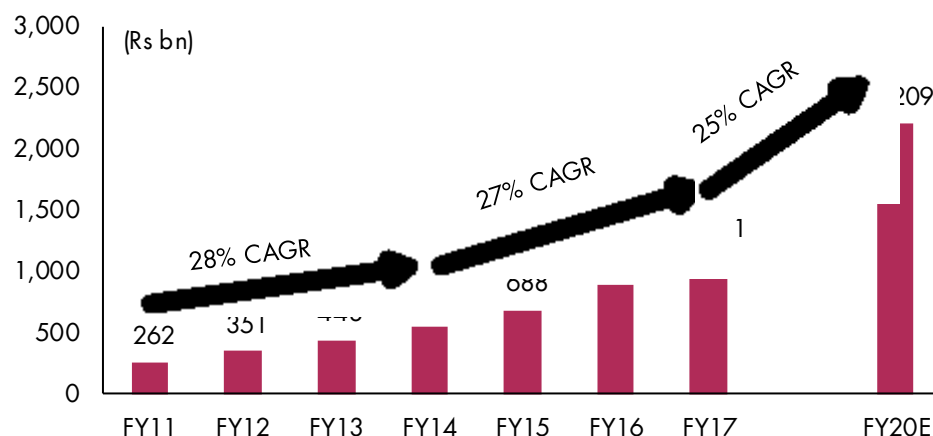


Source: Company, Axis Capital

Loan growth

- Corporate loan growth (30% YoY) outpaced retail loan growth (25%) on the back of increased competitiveness on working capital loans
- Management attributed the same to the MCLR regime, which allows differential pricing on various tenors. It stated that it is competitive on the 90-day MCLR where most working capital loans are structured

Exhibit 8: Loans posted ~27% CAGR over FY11-17; loan book to double even at lower-end of guidance

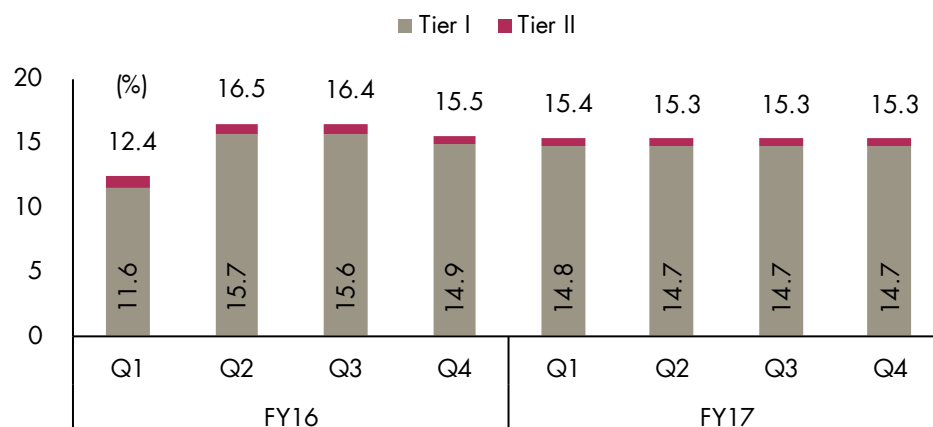


Source: Company, Axis Capital

Capital consumption

- ILB raised ~Rs 10 bn worth of Additional Tier 1 capital via bonds in Q4, pumping up Tier 1 capital
- However, due to roll forward of base year coupled with high growth rates over FY14-17, capital consumption spiked in Q4 (seasonal factor – RBI mandates 3 years' weighted average loan book for calculation of operational risk weights, with base year shifts in Q4)

Exhibit 9: Capital position remains healthy post Rs 10 bn of AT-1 bond raise during quarter

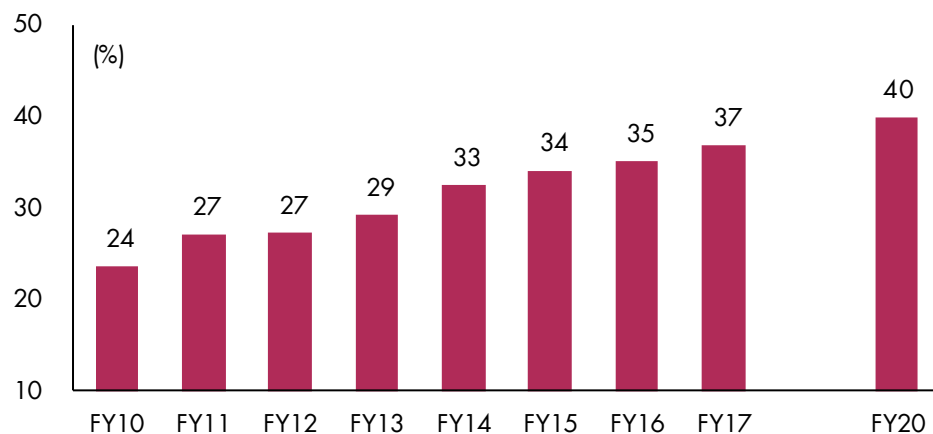


Source: Company, Axis Capital

CASA/Deposits

- ◆ IIB stated that it has retained ~35% of demonetization-led deposits – a sizeable chunk which it feels may now remain in the system
- ◆ It targets CASA of 40% by FY20

Exhibit 10: Trend in CASA ratio



Source: Company, Axis Capital

Operating costs/ branches

- ◆ IIB opened ~125 branches in Q4, taking the count to 1200 as of end-FY17
- ◆ Management stated that it is working with an external consultant (McKinsey) to digitize front-/mid-/back-end operations, and believes that gains of digitization are largest in the back office

Exhibit 11: Branch footprint has kept doubling every 3 years since FY14



Source: Company, Axis Capital

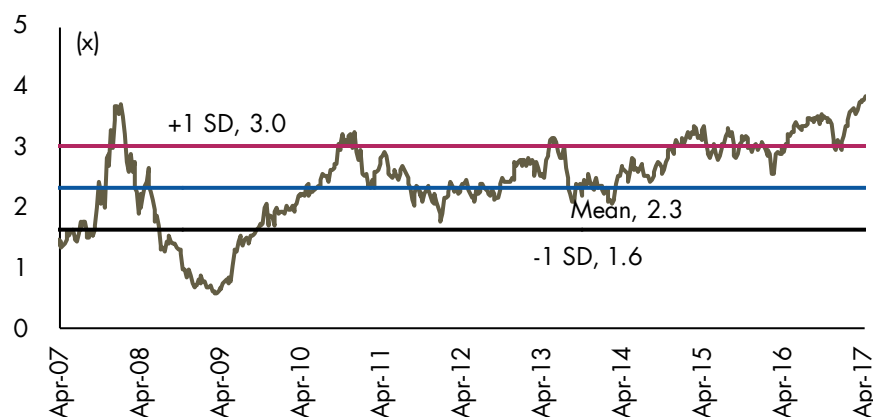
Exhibit 12: Results update

(Rs mn)	Quarter ended					12 month ended		
	Mar-17	Mar-16	% Chg	Dec-16	% Chg	Mar-18E	Mar-17	% Chg
Interest income	38,300	32,074	19	36,993	4	176,594	144,057	23
Interest expended	21,626	19,392	12	21,209	2	101,644	83,431	22
Net interest income	16,675	12,682	31	15,784	6	74,950	60,626	24
Non-interest income	12,113	9,128	33	10,168	19	50,116	41,715	20
Net income	28,788	21,810	32	25,952	11	125,066	102,341	22
Operating expenses	13,065	10,298	27	12,319	6	57,253	47,831	20
Operating profit	15,722	11,512	37	13,633	15	67,813	54,510	24
Provision & contingencies	4,301	2,137	101	2,169	98	13,696	10,915	25
PBT	11,421	9,375	22	11,465	(0)	54,117	43,595	24
Tax	3,905	3,172	23	3,959	(1)	18,400	14,917	23
Net profit	7,516	6,204	21	7,506	0	35,717	28,678	25
Asset quality								
Gross NPAs (Rs mn)	10,549	7,768	36	9,716	9	14,528	10,549	38
Gross NPAs (%)	0.93	0.87	6 bps	0.94	(1)bps	1.01	0.93	9 bps
Net NPAs (Rs mn)	4,389	3,218	36	4,007	10	5,375	4,389	22
Net NPAs (%)	0.39	0.36	3 bps	0.39	0 bps	0.38	0.39	(1)bps
Provisioning coverage (%)	58	59	(19)bps	59	(37)bps	63	58	460 bps
Capital (%)								
Tier-I	14.7	14.9	(20)bps	14.7	(2)bps	13.2	14.7	(149)bps
CAR	15.3	15.5	(19)bps	15.3	0 bps	13.8	15.3	(151)bps
Balance sheet (Rs bn)								
Advances	1,131	884	28	1,028	10	1,423	1,131	26
Deposits	1,266	930	36	1,192	6	1,593	1,266	26
CASA (%)	37	35	167 bps	37	(19)bps	38	37	144 bps

Source: Company, Axis Capital

Note: Full year yields and margin are on calculated basis

Exhibit 13: 10 years P/ABV movement



Source: Bloomberg, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	118,717	144,057	176,594	216,345
Interest expended	(73,552)	(83,431)	(101,644)	(122,788)
Net interest income	45,166	60,626	74,950	93,557
Non interest income	32,969	41,715	50,116	59,519
Net income	78,135	102,341	125,066	153,076
Operating expenses	(36,721)	(47,831)	(57,253)	(68,126)
Staff expenses	(12,361)	(15,210)	(17,922)	(21,065)
Other operating expenses	(24,360)	(32,621)	(39,332)	(47,062)
Operating profit	41,414	54,510	67,813	84,950
Provisions & contingencies	(6,722)	(10,915)	(13,696)	(18,136)
Pre-tax profit	34,692	43,595	54,117	66,813
Tax expense	(11,828)	(14,917)	(18,400)	(22,716)
Profit after tax	22,864	28,678	35,717	44,097
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	22,864	28,678	35,717	44,097

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	1,428,970	1,786,483	2,175,312	2,664,762
Cash & Balances with RBI	101,119	186,283	183,939	216,285
Investments	340,543	367,021	456,992	549,034
Advances	884,193	1,130,804	1,423,422	1,778,249
Fixed assets	12,553	13,352	13,595	14,128
Other assets	90,561	89,023	97,364	107,066
Total liabilities	1,428,970	1,786,484	2,175,312	2,664,762
Equity capital	5,950	5,982	5,982	5,982
Preference capital	-	-	-	-
Reserves & surplus	167,202	196,733	227,594	266,140
Networth	173,290	202,867	233,727	272,273
Borrowings	249,959	224,537	246,182	289,038
Deposits	930,003	1,265,722	1,593,205	1,987,643
Other liabilities & prov.	72,048	89,764	98,605	112,214

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	38	47	58	72
BV (Rs.)	285	331	381	444
Adj. BV (Rs.)	281	326	376	437
DPS (Rs.)	5	6	7	8
Dividend payout (%)	13	13	12	11
Yields & Margins (%)				
Yield on advances	11.8	11.4	11.2	11.1
Cost of deposit	7.2	6.8	6.6	6.4
Net interest margin	3.8	4.0	4.0	4.1
Asset quality (%)				
Gross NPAs	0.9	0.9	1.0	1.1
Net NPAs	0.4	0.4	0.4	0.4
Credit cost	0.8	0.7	0.7	0.7
Provisioning coverage	58.6	58.4	63.0	65.0
Capital (%)				
Tier-I	14.9	14.7	13.2	12.4
CAR	15.5	15.3	13.8	13.0
Efficiency (%)				
ROA	1.8	1.8	1.8	1.8
ROE	16.6	15.2	16.4	17.4
Cost to income	47	47	46	45
CASA	35	37	38	39
Effective tax rate	34	34	34	34
Growth (%)				
Net interest income	32	34	24	25
Fee income	27	27	21	19
Operating expenses	28	30	20	19
Profit after tax	27	25	25	23
Advances	29	28	26	25
Deposits	25	36	26	25
Total assets	28	25	22	23

Source: Company, Axis Capital

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