

# IndusInd Bank

## Strong synergies from merger in long run

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R Sreesankar

rsreesankar@plindia.com / +91-22-66322214

Pritesh Bumb

priteshbumb@plindia.com / +91-22-66322232

Vidhi Shah

vidhishah@plindia.com / +91-22-66322258

Rating	BUY
Price	Rs1,750
Target Price	Rs1,952
Implied Upside	11.5%
Sensex	32,433
Nifty	10,167

(Prices as on October 13, 2017)

### Trading data

Market Cap. (Rs bn)	1,046.8
Shares o/s (m)	598.1
3M Avg. Daily value (Rs m)	1872.2

### Major shareholders

Promoters	14.97%
Foreign	43.00%
Domestic Inst.	12.60%
Public & Other	29.43%

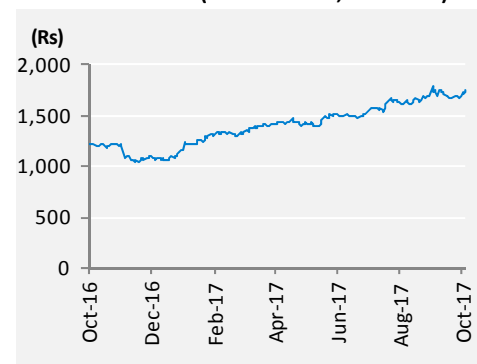
### Stock Performance

(%)	1M	6M	12M
Absolute	0.4	21.8	43.6
Relative	(0.3)	11.7	26.3

### How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2018	62.5	61.4	1.8
2019	82.3	77.7	5.8

### Price Performance (RIC: INBK.BO, BB: IIB IN)



Source: Bloomberg

*IIB concluded its much speculated merger with Bharat Financial Inclusion (BFIL) with deal consideration of 639 shares of IIB for every 1,000 shares of BFIL which implies a dilution of 14.7% for IIB shareholders at CMP and implies a premium of 12-13% for BFIL shareholders on CMP. The bank will continue existing operations of BFIL under a wholly owned subsidiary, though assets will move to IIB's balance sheet. We see the deal slightly expensive, though it has positive bearing on return ratios in near term. In the medium to long term we see positive outcome as strong penetration of BFIL in rural with robust technology platform will help IIB cross sell both liability & asset products. We have retained our estimates (pre-merger) and retain "BUY" with TP of Rs1,952 based on 3.9x Sep-19 ABV (pre-merger).*

■ **Synergies galore but also volatility:** BFIL provides livelihood loans which IIB believes is lucrative business given the higher yields and lower delinquencies. It also provides a full PSL compliant loan book and base to penetrate for liability franchise and cross sell other livelihood related products like 2W, home loans and fee based products. Given the fact BFIL caters to lower end segment which has its own business cycles and strong politically influenced segment, loan book risks and volatility will increase for IIB.

■ **Return ratios to improve immediately:** Upon merger, IIB's will see benefits flow though on return ratios with ROA of 2.0%, margin accretion of 30-40bps and improvement of Tier-I by 20bps. Although on dilution, we see slight impact on BV given the premium to acquire BFIL. On a back of the envelope calculation, merger synergies could help 3-4% improvement on PBT, post considering the negative impact of CRR/SLR impact (if book not refinanced) and positive impact of lower liquidity requirement for BFIL operations post-merger, benefit of lowered funding cost and fees from sale of PSLCs.

■ **Loan mix tilt higher towards MFI; deal to take 6-9 months:** Post merger, MFI segment will be highest at 9.2% from 2.2% in Q1FY18 followed by jewellery book at 5.2%. We believe, the share should continue to remain high given the growth in BFIL's MFI book historically and potential of the segment. The bank believes, the deal is likely to conclude in 6-9 months given the requirement of approval of various regulators and shareholders. Retain BUY with TP of Rs1,952.

Key financials ( Y/e March)	2016	2017	2018E	2019E
Net interest income	45,166	60,626	75,336	94,282
Growth (%)	32.1	34.2	24.3	25.1
Operating profit	41,414	54,510	69,191	86,058
PAT	22,865	28,679	37,370	49,200
EPS (Rs)	40.7	48.1	62.5	82.3
Growth (%)	19.6	18.2	30.0	31.7
Net DPS (Rs)	4.9	—	7.5	9.0

Profitability & Valuation	2016	2017	2018E	2019E
NIM (%)	3.55	3.77	3.77	3.84
RoAE (%)	16.2	15.0	16.8	18.9
RoAA (%)	1.80	1.78	1.87	2.00
P / BV (x)	6.0	5.2	4.5	3.8
P / ABV (x)	6.1	5.3	4.5	3.8
PE (x)	43.0	36.4	28.0	21.3
Net dividend yield (%)	0.3	—	0.4	0.5

Source: Company Data; PL Research

**Exhibit 1: Pro-forma Financials for IndusInd Bank – BFIL Merger – RoE accretive**

	IndusInd Bank			BFIL			IIB+BFIL (Pro-forma Merged)		Change for IIB	
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
NII	60,626	75,336	94,282	8,621	11,035	15,449	86,371	109,731	14.6%	16.4%
PBT	43,597	57,053	75,114	1,923	5,027	9,753	62,080	84,867	8.8%	13.0%
PAT	28,679	37,370	49,200	2,892	4,970	7,728	42,340	56,928	13.3%	15.7%
Shares O/s	598.1	598.1	598.1	138.0	138.0	138.0	686.3	686.3	14.7%	14.7%
Networth	206,309.2	238,279.5	280,999.8	24,470.0	29,440.0	37,168.0	267,719	318,168	12.4%	13.2%
Loans	1,130,805	1,430,468	1,823,847	71,750	90,951	114,014	1,521,419	1,937,861	6.4%	6.3%
Cash Equivalents	553,304	666,063	756,165	28,710	38,979	52,622	705,042	808,787	5.9%	7.0%
Total Assets	1,786,484	2,208,744	2,704,139	104,180	132,283	169,536	2,341,027	2,873,675	6.0%	6.3%
Loans as % of assets	63%	65%	67%	69%	69%	67%	65%	67%		
CE as % of assets	31%	30%	28%	28%	29%	31%	30%	28%		
Earning Assets	1,684,109	2,096,532	2,580,012	100,460	129,930	166,635	2,226,462	2,746,647		
NIMs	4.0%	4.0%	4.0%	10.2%	9.6%	10.4%	4.3%	4.4%	0.3%	0.4%
ROE	15.0%	16.8%	18.9%	15.1%	18.4%	23.2%	17.0%	19.4%	0.2%	0.5%
ROA	1.8%	1.9%	2.0%	3.3%	4.2%	5.1%	2.0%	2.2%	0.1%	0.2%
RORWAs	2.2%	2.4%	2.6%	4.8%	6.2%	7.6%	2.6%	2.9%	0.2%	0.3%
EPS	47.9	62.5	82.3	21.0	36.0	56.0	61.7	82.9	-1.3%	0.8%
BVPS	344.9	398.4	469.8	177.3	213.3	269.3	390.1	463.6	-2.1%	-1.3%
Tier I	14.7%	14.9%	14.9%	34.3%	32.6%	32.8%	15.1%	14.9%	0.2%	0.0%
P/E	36.5	28.0	21.3	83.5	48.6	31.3				
P/BV	5.1	4.4	3.7	5.7	4.7	3.7				

Source: Company Data, PL Research

**Exhibit 2: IIB will have 14-15% dilution to acquire BFIL**

Merger Impact	IIB	BFIL	Merged Entity
CMP	1746	1115	
Swap Ratio	639	1000	
No of O/s Shares	599	138	687
<b>Dilution for shareholders</b>			<b>14.7%</b>
<b>Dilution for existing promoters</b>			<b>2.5%</b>

Source: Company Data, PL Research

**Exhibit 3: Merged entity operational details – Strong presence points for IIB**

Parameters	IIB	BFIL	IIB+BFIL
Customers (mn)	9.5	6.8	16.3
Branches/Presence Points	2,209	1,408	3,617
Employees	25,071	15,284	40,355
Loans (Rs mn)	1,164,070	96,310	1,260,380
Networth (Rs mn)	215,010	24,200	239,210
Total Assets (Rs mn)	1,906,500	101,700	2,008,200

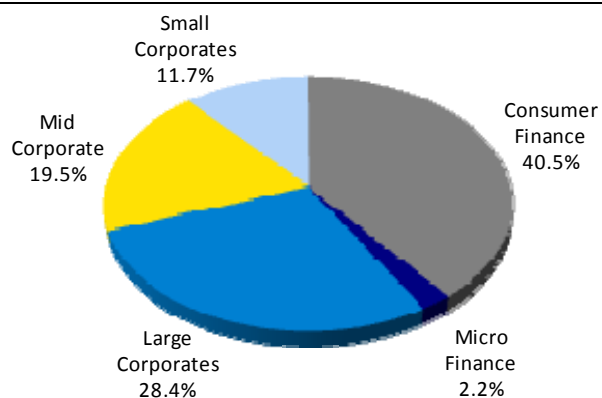
Source: Company Data, PL Research

**Note** – (i) IIB branches includes consumer fin outlets (ii) Data as on Q1FY18

**Exhibit 4: Merger synergies will be accretive in medium to long term**

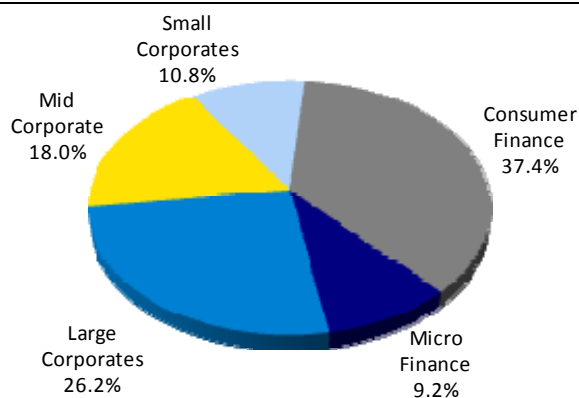
Merger Synergies	
Lower Cost of Funds	Overtime 300-400bps
PSL Benefit	100% PSL and PSLC fees of 1.0%-1.5%
Capital Release	75% Risk weighted v/s 100% in NBFC
Lower Cash Requirement	50% lower cash requirement in branches
Liabilities	Potential of penetrating +50% of existing customer base of 6.5mn
Cross Sell	2W financing, home improvement loans, micro insurance, fixed usage loans

Source: Company Data, PL Research

**Exhibit 5: Pre-merger loan book for IIB**


Source: Company Data, PL Research

**Note – Based on Q1FY18**

**Exhibit 6: Post-merger loan book for IIB**


Source: Company Data, PL Research

**Exhibit 7: MFI will be the highest amongst lending sectors for IIB**

Top Sectors (based on Q1FY18 loans)	Pre-merger	Post Merger
MFI	2.2%	9.2%
Gems & Jewellery	5.7%	5.2%
Lease Rental	3.6%	3.3%
Power Gen	2.6%	2.4%
Real Estate Developer	2.2%	2.0%
Telecom	2.1%	1.9%

Source: Company Data, PL Research

## IIB-BFIL Merger Concall Takeaways

- The share swap ratio for the merger is 639 share of IIB for 1000 shares of BFIL. Management expects the transaction to be completed in 6-9 months.
- Merged Balance Sheet will entirely move to the bank, while the infrastructure (people, branches) will be operate as a business correspondent under a wholly owned subsidiary. Bank will see no change in board composition, while post merger MFI advisory committee will be set for the subsidiary.

## Rationale of the merger

- Very strong potential of livelihood loans which have 2 characteristics a) very high yields and b) low delinquencies if managed properly.
- BhaFin has been a choice given the head start that they could provide, given dominant domain expertise and domain leadership in the rural business. BhaFin have been a business correspondent for last 5 years, which provides operational comfort.
- The network coverage will increase to 4000 branches over next 2 years (IIB standalone branches of 2000, Vehicle Finance branch of 1000 and BhaFin branches of ~1500).
- **(i)** Lower cost of funds (estimates 3%) – on Day 1, IIB can replace the entire bank borrowing for BhaFin. **(ii)** cross sell liability products with potential of >50% of BFIL customer base and cross sell asset products like 2W, home improvement loans and long tenure loans. Already running pilot in 99 bracnhes from earlier tie-up **(iii)** Fee income gains from PLSC sell down of 100-150bps as 100% loan book of BFIL is PSL compliant and **(iv)** capital release for IIB as RWA is 75% for bank v/s 100% for NBFC-MFI.
- 60% of BhaFin transaction is digitalised which has improved TAT and this will also help with adding new products to the bank

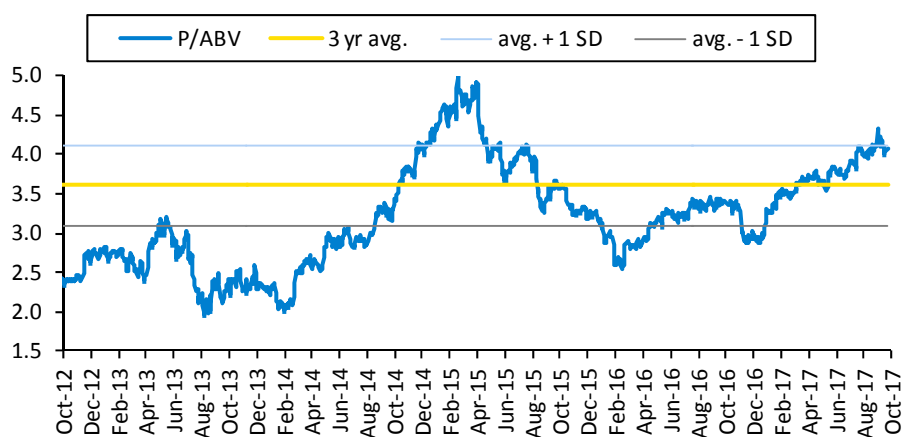
## Balance Sheet and P&L impact

- Bank could have a CRR/SLR hit but bank could refinance 100% of loan book. Refinance doesn't attract CRR/SLR and 100% of BhaFin's portfolio can be refinanced.
- MAT benefit available to BFIL will pass through to IIB (in form of Cash and not P&L benefit)
- The bank will issue warrants to promoters on preferential basis equal to the dilution from merger but pricing on SEBI driven formula.
- Some of the branches of BFIL will change to banking outlet; the bank will choose the conversion based on various facts such as liability attractiveness etc.
- No further spend is required on technology front for BhaFin.

**Exhibit 8: We revise our TP to Rs1,952 on 3.9x Sep'19 P/ABV**
**PT calculation and upside**

Fair price - EVA, Rs	1,949
Fair price - P/ABV, Rs	1,954
<b>Average of the two, Rs</b>	<b>1,952</b>
Target P/ABV (x)	<b>3.9</b>
Target P/E (x)	<b>20.9</b>
Current price, Rs	1,743
<b>Upside (%)</b>	<b>12%</b>
Dividend yield (%)	1%
<b>Total return (%)</b>	<b>13%</b>

Source: Company Data, PL Research

**Exhibit 9: Valuations continue to be at premium and above mean levels**


Source: Company Data, PL Research

### Income Statement (Rs m)

Y/e March	2016	2017	2018E	2019E
Int. Earned from Adv.	92,446	114,791	141,510	175,733
Int. Earned from Inv.	17,806	24,669	28,390	33,149
Others	5,555	4,597	5,691	6,492
Total Interest Income	115,807	144,057	175,591	215,374
Interest expense	70,641	83,431	100,255	121,092
<b>NII</b>	<b>45,166</b>	<b>60,626</b>	<b>75,336</b>	<b>94,282</b>
Growth (%)	32.1	34.2	24.3	25.1
Treasury Income	1,453	2,769	1,000	1,100
NTNII	31,517	38,946	51,144	64,080
Non Interest Income	32,969	41,715	52,144	65,180
Total Income	148,776	185,772	227,734	280,554
Growth (%)	23.0	24.9	22.6	23.2
Operating Expense	36,721	47,831	58,289	73,404
<b>Operating Profit</b>	<b>41,414</b>	<b>54,510</b>	<b>69,191</b>	<b>86,058</b>
Growth (%)	33.7	31.6	26.9	24.4
NPA Provisions	5,015	7,048	10,245	9,275
Investment Provisions	295	314	—	—
Total Provisions	6,722	10,913	12,138	10,944
<b>PBT</b>	<b>34,693</b>	<b>43,597</b>	<b>57,053</b>	<b>75,114</b>
Tax Provisions	11,828	14,918	19,683	25,914
Effective Tax Rate (%)	34.1	34.2	34.5	34.5
<b>PAT</b>	<b>22,865</b>	<b>28,679</b>	<b>37,370</b>	<b>49,200</b>
Growth (%)	27.5	25.4	30.3	31.7

### Balance Sheet (Rs m)

Y/e March	2016	2017	2018E	2019E
Par Value	10	10	10	10
No. of equity shares	595	598	598	598
Equity	5,950	5,981	5,981	5,981
Networth	176,822	206,309	238,279	281,000
Adj. Networth	173,606	201,921	235,581	276,126
Deposits	930,003	1,265,722	1,601,139	2,001,423
Growth (%)	25.4	36.1	26.5	25.0
Low Cost deposits	327,243	466,460	680,484	850,605
% of total deposits	35.2	36.9	42.5	42.5
<b>Total Liabilities</b>	<b>1,428,832</b>	<b>1,786,332</b>	<b>2,208,744</b>	<b>2,704,139</b>
Net Advances	884,193	1,130,805	1,430,468	1,823,847
Growth (%)	28.5	27.9	26.5	27.5
Investments	340,543	367,021	459,498	534,399
<b>Total Assets</b>	<b>1,428,970</b>	<b>1,786,484</b>	<b>2,208,744</b>	<b>2,704,139</b>

Source: Company Data, PL Research.

### Quarterly Financials (Rs m)

Y/e March	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Interest Income	36,993	38,300	41,355	42,084
Interest Expense	21,209	21,626	23,615	23,874
<b>Net Interest Income</b>	<b>15,784</b>	<b>16,675</b>	<b>17,741</b>	<b>18,210</b>
Non Interest Income	10,168	12,113	11,673	11,876
CEB	8,848	9,960	9,740	10,130
Treasury	1,320	2,150	1,930	1,750
<b>Net Total Income</b>	<b>25,952</b>	<b>28,788</b>	<b>29,413</b>	<b>30,086</b>
Operating Expenses	12,319	13,065	13,528	13,751
Employee Expenses	3,940	3,943	4,222	4,450
Other Expenses	8,378	9,122	9,306	9,300
<b>Operating Profit</b>	<b>13,633</b>	<b>15,722</b>	<b>15,885</b>	<b>16,335</b>
Core Operating Profit	12,314	13,572	13,955	14,585
Provisions	2,169	4,301	3,100	2,938
Loan loss provisions	1,524	2,560	—	—
Investment Depreciation	—	—	—	—
<b>Profit before tax</b>	<b>11,465</b>	<b>11,421</b>	<b>12,786</b>	<b>13,398</b>
Tax	3,959	3,905	4,420	4,597
<b>PAT before EO</b>	<b>7,506</b>	<b>7,516</b>	<b>8,365</b>	<b>8,801</b>
Extraordinary item	—	—	—	—
<b>PAT</b>	<b>7,506</b>	<b>7,516</b>	<b>8,365</b>	<b>8,801</b>

### Key Ratios

Y/e March	2016	2017	2018E	2019E
CMP (Rs)	1,750	1,750	1,750	1,750
Equity Shrs. Os. (m)	595	598	598	598
Market Cap (Rs m)	1,041,315	1,046,850	1,046,850	1,046,850
M/Cap to AUM (%)	72.9	58.6	47.4	38.7
EPS (Rs)	40.7	48.1	62.5	82.3
Book Value (Rs)	291	339	392	464
Adj. BV (100%) (Rs)	286	332	388	455
P/E (x)	43.0	36.4	28.0	21.3
P/BV (x)	6.0	5.2	4.5	3.8
P/ABV (x)	6.1	5.3	4.5	3.8
DPS (Rs)	4.9	—	7.5	9.0
Dividend Yield (%)	0.3	—	0.4	0.5

### Profitability (%)

Y/e March	2016	2017	2018E	2019E
NIM	3.5	3.8	3.8	3.8
RoAA	1.8	1.8	1.9	2.0
RoAE	16.2	15.0	16.8	18.9

### Efficiency

Y/e March	2016	2017	2018E	2019E
Cost-Income Ratio (%)	47.0	46.7	45.7	46.0
C-D Ratio (%)	95.1	89.3	89.3	91.1
Business per Emp. (Rs m)	88	101	111	122
Profit per Emp. (Rs lacs)	11.1	12.1	13.7	15.7
Business per Branch (Rs m)	2,134	2,397	3,032	3,821
Profit per Branch (Rs m)	27	29	37	49

### Asset Quality

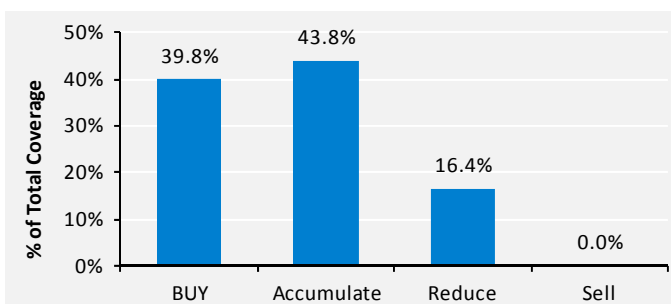
Y/e March	2016	2017	2018E	2019E
Gross NPAs (Rs m)	7,768	10,549	12,535	14,204
Net NPAs (Rs m)	3,216	4,388	2,698	4,874
Gr. NPAs to Gross Adv. (%)	0.9	0.9	0.9	0.8
Net NPAs to Net Adv. (%)	0.4	0.4	0.2	0.3
NPA Coverage (%)	58.6	58.4	78.5	65.7

Source: Company Data, PL Research.

**Prabhudas Lilladher Pvt. Ltd.**

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

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<b>Trading Buy</b>	: Over 10% absolute upside in 1-month
<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
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