Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

IndusInd Bank

Execution on the right path is key for sustainable performance ahead

Banks	Sharekhan code: INDUSINDBK

Reco/View: Buy	↔	CMP: **Rs. 1,077**	Price Target: **Rs. 1,270**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 35.76

Updated July 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 83,516 cr
52-week high/low:	Rs. 1242/ 764
NSE volume: (No of shares)	35.6 lakh
BSE code:	532187
NSE code:	INDUSINDBK
Free float: (No of shares)	65.1 cr

Shareholding (%)

Promoters	16.5
FII	45.8
DII	21.0
Others	16.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	25.5	16.7	9.7	3.5
Relative to Sensex	16.4	7.0	7.6	-5.4

Sharekhan Research, Bloomberg

Summary

- IndusInd Bank (IIB) expects to have recovered from the past challenges and has taken learnings from the past to improve and put adequate risk controls in place for future. The bank is guiding for strong loan growth momentum outlook across consumer and corporate book. The bank intends to achieve loan mix of 60:40 (retail-corporate) from the current mix of 54:46.
- However, the restructured book (2.1% of advances) is higher for the bank, given the higher share of CV and microfinance portfolio. The bank has guided that it is likely to see most of the restructured book run down by FY2023-end and the risk of higher slippages compared to the past quarter gone by looks unlikely.
- Management also indicated that it would continue to focus on strengthening its liability franchise. The bank has been improving the granularity of its deposit book. Retail LCR has gone up from ~26% in FY2019 to ~41% in FY2022.
- At the CMP, IIB trades at 1.5x and 1.3x its FY2023E/FY2024E BV. We maintain Buy with a revised TP of Rs. 1,270.

Our interaction with the management of IndusInd Bank (IIB) indicated that the bank has recovered from the past challenges and has taken learnings from the past to improve and put adequate risk controls in place for future. The company intends to restrict on taking any undue higher group-wide exposures in corporate banking. This has been one of the key learnings from the past that the bank faced due to chunky exposures in its corporate banking book. Further, the bank has been able to successfully reduce the share of high corporate fees, especially syndication-related fees. Now, the bank is guiding for strong loan growth momentum outlook across consumer and corporate book. The bank also indicated that it would continue to focus on strengthening its liability franchise. The bank has been improving the granularity of its deposit book. Retail LCR has gone up from ~26% in FY2019 to ~41% in FY2022. The main investors' concerns were on the restructured book as it is higher for the bank, given the higher share of CV and microfinance portfolio. The bank guided that it is likely to see most of the restructured book run down by FY2023-end and the risk of higher slippages compared to the past quarter gone by looks unlikely.

- **Shoring up the risk measures:** The bank has guided that there would be more focus on working capital loans in the corporate banking segment. The bank would be restricting exposure in individual sectors and in that granular exposure would be taken on individual borrower basis. The bank has also built systems, which throw early warning signals with the help of artificial intelligence based on data analytics.
- **Focus on domain expertise and scaling up new growth engines:** Management indicated that the bank is now well positioned to resume on the path of higher credit growth as asset quality has recovered. The bank possesses strong domain expertise in its focus segments - Vehicle and MFI business. Its underwriting practices have also been tested and enhanced in these segments as they have seen several credit cycles. The bank is aiming at 16-18% yoy growth in the vehicle business and 25-30% yoy growth in microfinance going forward. The SME/MSME business is likely to grow at 20-25% yoy growth. The large corporate book is expected to grow in line with the system growth. Thus, growth would be broad based. The bank would continue to invest in initiatives such as affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances.
- **Focus on strengthening its liability franchise:** Retail LCR has gone up from ~26% in FY2019 to ~41% in FY2022. Retailisation of deposits has been a key focus area for the bank, with 87% of incremental deposits over FY2020-FY2022 coming from retail deposits and CASA. The bank also acknowledges this learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings.

Our Call

Valuation – We maintain our Buy rating on the stock with a revised TP of Rs. 1,270: At the CMP, IIB trades at 1.5x and 1.3x its FY2023E/FY2024E BV. A well-capitalised balance sheet, with adequate internal risk control measures already placed in corporate and MFI business along with improvement in collection efficiencies across business segments, run down of restructured book without much flowing into NPA, steady asset-quality matrix and, in turn, lower credit cost would augur well for the bank's return ratio profile. We believe the shift back to growth, improvement in liability franchise, and recovery in return ratios would help valuations inch higher. However, restoring the full confidence in the franchise is a function of execution (walk the talk) and sustainable improved performance.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost especially could affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Interest Income	13,528	15,001	17,172	19,658
Net profit	2,836	4,611	6,559	7,997
EPS (Rs.)	38.7	59.5	84.7	103.2
P/E (x)	27.9	18.1	12.7	10.5
P/BV (x)	1.9	1.8	1.5	1.3
RoE	7.3	10.1	12.9	13.7
RoA	0.8	1.2	1.5	1.6

Source: Company; Sharekhan estimates

Key takeaways from management interaction

Improved loan growth outlook: Management indicated that the bank is now well positioned to resume on the path of higher credit growth as asset quality has recovered. The bank possesses strong domain expertise in its focus segments - Vehicle and MFI business. Its underwriting practices has also been tested and enhanced in these segments as they have seen several credit cycles. The bank is aiming at 16-18% yoy growth in the vehicle business and 25-30% yoy growth in microfinance going forward. The SME/ MSME business is likely to report 20-25% yoy growth. The large corporate book is expected to grow in line with the system's growth.

Sourcing new engines of growth: The bank would continue to invest in - affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances going forward.

Strengthening liability franchise: Retail LCR has gone up from ~26% in FY2019 to ~41% in FY2022. Retailisation of deposits has been a key focus area for the bank, with 87% of incremental deposits over FY2020-FY2022 coming from retail deposits and CASA. The bank also acknowledges this learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings.

Building strong digital capabilities: It would comprise enriching the digital value proposition for customers, building new digital business models, and transforming the existing business lines. Its digital 2.0 strategy focuses on driving significant amount of personalization of experience, transform existing line of businesses (processing, productivity, and TATs), and enable new business models. A sizeable proportion of the bank's new deposits (SA+TDs 96%), cards (90%), PLs (54%), and CA (70%) are sourced digitally currently.

Focus on strong risk management framework: The bank has moved away from high-ticket size loans towards more granular loans with a better rating profile. Moreover, risk profile has improved, with ~74% of the corporate book now rated 'A- and above' as of 1QFY2023, compared to ~63% as of FY2020. The bank has strict policies about group exposure limits and, within this, individual companies as well. Further, the bank has been able to successfully reduce the share of high corporate fees, especially syndication-related fees.

Guidance: The bank is likely to protect margins and NIMs are expected to be at 4.2-4.3%. Operating profitability is (PPoP/loans) > 5.5%. The bank would focus on branch expansion (2,500-3,000) and increasing customer base over the medium term. PCR stands at 72%. Total contingent provisions now stand at Rs. 3,003 crore (1.2% of advances). SMA 1 and 2 book are 10 bps and 40 bps, respectively. This should prevent higher credit cost. The bank has guided for credit cost in the range of 120 -150 bps.

Outlook and Valuation

Sector view - Credit growth sustains; Top private banks placed better

System-level credit offtake grew by ~15.1% y-o-y in the fortnight ending July 29, 2022, indicating loan growth has been sustaining, given the distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.1%, which also reflect a healthier economic scenario but are trailing advances growth. Bottom-up story is intact and we should see higher loan growth, while margins would likely expand in a higher interest rate cycle over the medium term. Asset quality is not a big issue from corporate loans end as only de-leveraging is being observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable except the MFI segment. Banks are in a sweet spot in terms of fundamentals and reasonable valuations. In the past two years, banks have been cautious on lending to BB and below, thus general risk, which they are carrying on corporate portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit cost. In terms of MSME, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

Company outlook - Operating performance to improve going ahead

We expect with IIB addressing the past challenges related to asset quality and internal control issues, the overhang has been done away. Additionally, factors such as the bank's willingness to recognise stress upfront in any loan segment before it becomes challenging to manage and its strategy to create adequate provisions or counter cyclical buffers if the business is risky will be cushions for the long term. Asset-quality matrix is expected to improve further, led by lower slippages from standard book. Opex is likely to moderate over the medium term. We expect loan growth acceleration and credit costs to normalise in FY2023E/FY2024E, given revival in demand environment. Key monitorable would be slippages from restructured book.

Valuation - We maintain our Buy rating on the stock with a revised TP of Rs. 1,270

At the CMP, IIB trades at 1.5x and 1.3x its FY2023E/FY2024E BV. A well-capitalised balance sheet, with adequate internal risk control measures already placed in corporate and MFI business along with improvement in collection efficiencies across business segments, run down of restructured book without much flowing into NPA, steady asset-quality matrix and, in turn, lower credit cost would augur well for the bank's return ratio profile. We believe the shift back to growth, improvement in liability franchise, and recovery in return ratios would help valuations inch higher. However, restoring the full confidence in the franchise is a function of execution (walk the talk) and sustainable improved performance.

Peer Comparison

Companies	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
IndusInd Bank	1077	83,516	12.7	10.5	1.5	1.3	12.9	13.7	1.5	1.6
Federal Bank	111	23,378	8.6	7.6	1.0	0.9	12.7	12.8	1.1	1.1

Source: Company, Sharekhan Research

About company

IIB is a private bank established in 1994, having a pan-India presence with 2,286 branches/banking outlets and 2,783 ATMs spread across 769 geographical locations of the country. The bank also has representative offices in London, Dubai, and Abu Dhabi. The bank has a strong retail loan franchise, along with its subsidiary in microfinance. The extended network of the bank includes branches of BFIL and outlets of IMFS. The bank is well placed with adequate capital levels.

Investment theme

IIB is addressing the past challenges related to asset quality and internal control issues. We believe the overhang has been done away. Additionally, factors such as the bank's willingness to recognise stress upfront in any loan segment before it becomes challenging to manage and its strategy to create adequate provisions or counter cyclical buffers if the business is risky will be cushions for the long term. Asset-quality matrix is expected to improve further, led by lower slippages from standard book. Opex likely to moderate over the medium term. We expect loan growth acceleration and credit costs over the medium term, given revival in demand environment.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost could affect earnings.

Additional Data

Key management personnel

Mr. Sumant Kathpalia	CEO and Managing Director
Mr. Arun Khurana	Deputy CEO
Mr. S V Zaregaonkar	Chief Financial Officer
Mr. A. G. Sriram	Head - Consumer Finance

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bank of New York Mellon Corp	8.2
2	LIC	4.9
3	BOFA Securities Europe SA	4.1
4	SFSPVI LTD	4.0
5	SBI Funds Management	3.1
6	Dragsa India	2.6
7	Route one Investment Co LP	2.5
8	Bridge India Fund	2.5
9	Morgan Stanley	1.9
10	ICICI Prudential	1.7

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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