Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

IndusInd Bank

Emerging stronger

Banks	Sharekhan code: INDUSINDBK
Reco/View: **Buy** ↔	CMP: **Rs. 1,164**
	Price Target: **Rs. 1,400** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We believe IndusInd Bank is coming out of a tough cycle and concerns about asset quality, liquidity amid COVID-19 pandemic for bank is fading away, as collection efficiencies (due to recovery in core portfolio CV/MFIs) and liquidity position (LCR ~124%) is improving over the past few quarters.
- Bank reported credit cost at 3.8%/3.0% during FY21-22, but accelerated provisions made in past few quarters (in turn maintaining healthy provisioning on stressed assets) and additional non-NPA provision buffer of 1.2% of loans will enable a sharp drop in credit cost and would drive strong earnings recovery. Its credit cost is expected to fall sharply to ~150 bps annually over FY23-25E.
- With a view to strengthen its liability franchise, bank has been improving the granularity of its deposit book. Retail deposits' share rose from ~26% in FY2019 to ~41% in FY2022.
- At CMP, IIB trades at 1.6x and 1.4x its FY2023E/FY2024E BV. We maintain Buy with a revised TP of Rs. 1,400.

IndusInd Bank appears well positioned over the medium term due to strong capital ratios (Tier I capital at 16.6% as at Q1FY23), growth potential from a well-diversified loan book with a rising share of retail loans. Also, bank has speed up its efforts to improve the retail funding franchise, which is a key positive. Loan growth acceleration is seen in Q1FY23 (18% YoY/4% QoQ vs 8% over FY20-22) on the back of a strong SME and vehicle finance portfolio. Moreover, Vehicle finance disbursals are currently running at its highest-quarterly levels. Bank is also guiding for strong loan growth momentum outlook across consumer and corporate book. Deposit growth has also been stable (13% y-o-y/3% q-o-q) but funding costs is expected to increase going forward. We expect margins to remain stable at current levels ~4.2% as higher growth in higher yield portfolio (Vehicle + MFI) is going to offset higher funding costs and a sharp drop in credit cost should drive strong recovery in earnings and its return ratio profile.

- **Focus on domain expertise and scaling up new growth engines:** We believe that the bank is now well positioned to resume on the path of higher credit growth as it has recovered from past asset quality challenges. 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. Loan growth acceleration is seen in Q1FY23 (18% YoY/4% q-o-q versus 8% over FY20-22) on the back of strong SME and vehicle finance portfolio. Moreover, Vehicle finance disbursals are currently running at its highest quarterly levels. The bank is eyeing a 16-18% y-o-y growth in the vehicle business and 25-30% y-o-y growth in microfinance going forward. The SME/MSME business is likely to grow at 20-25% y-o-y growth. The large corporate book is expected to grow in line with the system growth. Thus, growth would be broad based. Also bank is investing in new growth engines such as affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances.
- **Sharp recovery in earnings led by lower credit cost:** We believe bank is coming out of tough cycle. Concerns about asset quality amid COVID-19 pandemic and past internal control challenges for bank is fading away, as collection efficiencies (due to recovery in core portfolio CV/MFI), liquidity position (LCR ~124%) and internal control measures are improving over the past few quarters. The bank reported credit cost of 3.8%/3.0% in FY21/22, however, accelerated provisions made in past few quarters (in turn maintaining healthy provisioning on stressed assets) and additional non NPA provision buffer of 1.2% of loans will enable a sharp drop in credit cost, driving a sharp recovery in earnings. Its credit cost is expected to fall sharply to ~150 bps annually over FY23-25E.

Revision in estimates – We have increased our FY2023E/FY2024E earnings estimates, factoring in lower credit cost. Moreover, we have introduced FY2025E numbers in this note.

Our Call

We maintain our Buy rating on the stock with a revised TP of Rs. 1,400: At CMP, IIB trades at 1.6x and 1.4x its FY2023E/FY2024E BV. A well-capitalised balance sheet, with adequate internal risk control measures already placed in the corporate and MFI business along with improvement in collection efficiencies across business segments, run down of restructured book without much flowing into NPAs, steady asset-quality matrix and, in turn, lower credit costs 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.

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	FY22	FY23E	FY24E	FY25E
Net Interest Income	15,001	17,172	19,658	23,142
Net profit	4,611	7,142	8,547	10,002
EPS (Rs.)	59.5	92.2	110.3	129.1
P/E (x)	19.6	12.6	10.6	9.0
P/BV (x)	1.9	1.6	1.4	1.2
RoE (%)	10.1	13.9	14.5	14.6
RoA (%)	1.2	1.7	1.7	1.8

Source: Company; Sharekhan estimates

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 8, 2022

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 90,267 cr
52-week high/low:	Rs. 1275/ 764
NSE volume: (No of shares)	35.0 lakh
BSE code:	532187
NSE code:	INDUSINDBK
Free float: (No of shares)	63.6 cr

Shareholding (%)

Promoters	16.5
FII	45.8
DII	21.0
Others	16.6

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	8.8	41.3	25.7	1.1
Relative to Sensex	11.7	33.8	26.5	6.1

Sharekhan Research, Bloomberg

Focus on strengthening liability franchise: Retail deposits have gone up from ~26% in FY2019 to ~41% in FY2022. Increasing share of retail 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 the learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings.

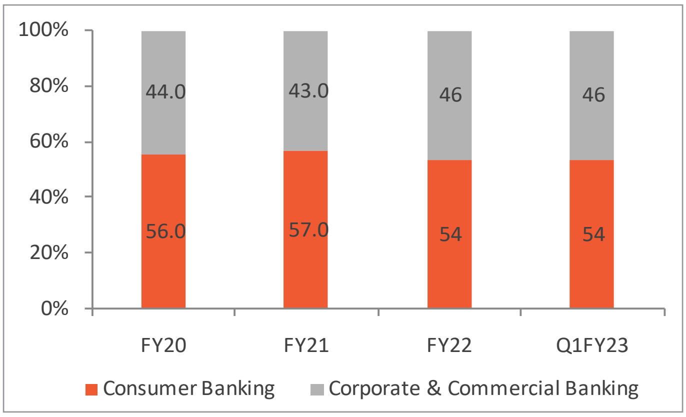
Focus on strong risk management framework: The bank has moved away from high-ticket size loans towards more granular loans with a better rating profile. Moreover, risk profile has improved, with ~74% of the corporate book now rated 'A- and above' as of Q1FY2023, as compared to ~63% as of FY2020. The bank intends to focus on working capital loans in the corporate banking segment. It has built strict policies about group exposure limits and, within this, individual companies as well. The bank also intends to restrict its exposure in individual sectors and in that granular exposure would be taken on individual borrower basis. Further, the bank has been able to successfully reduce the share of high corporate fees, especially syndication-related fees.

Building strong digital capabilities & sourcing new engines of growth: 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. The bank would be investing in - affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances going forward.

Sharp recovery in earnings led by lower credit cost: We believe bank is coming out of tough cycle. Concerns about asset quality amid COVID-19 pandemic and past internal control challenges for bank is fading away, as collection efficiencies (due to recovery in core portfolio CV/MFI), liquidity position (LCR ~124%) and internal control measures are improving over the past few quarters. The bank reported credit cost of 3.8%/3.0% in FY21/22, however, accelerated provisions made in past few quarters (in turn maintaining healthy provisioning on stressed assets) and additional non NPA provision buffer of 1.2% of loans will enable a sharp drop in credit cost, driving a sharp recovery in earnings. Its credit cost is expected to fall sharply to ~150 bps annually over FY23-25E.

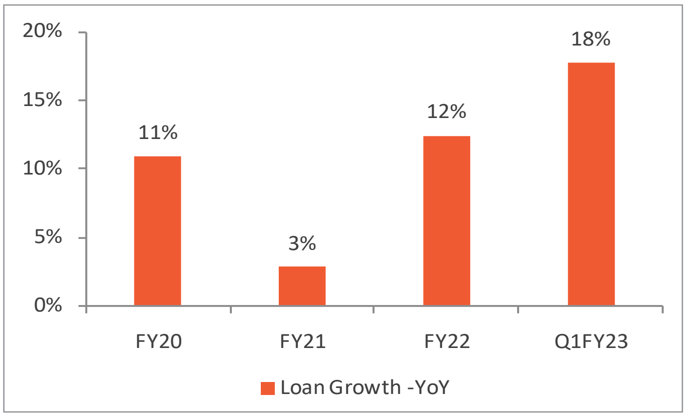
Financials in charts

Retail mix expected to improve going forward



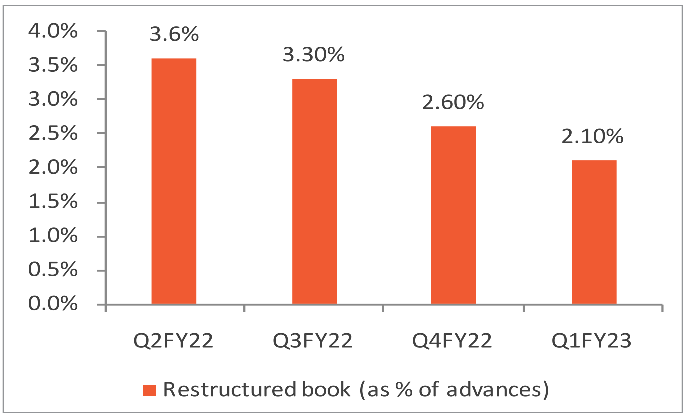
Source: Company, Sharekhan Research

Higher loan growth likely to sustain going forward



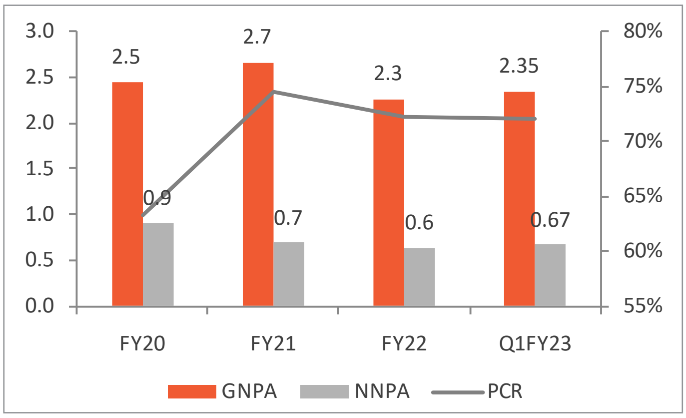
Source: Company, Sharekhan Research

Restructured book likely to run down by Q4FY23



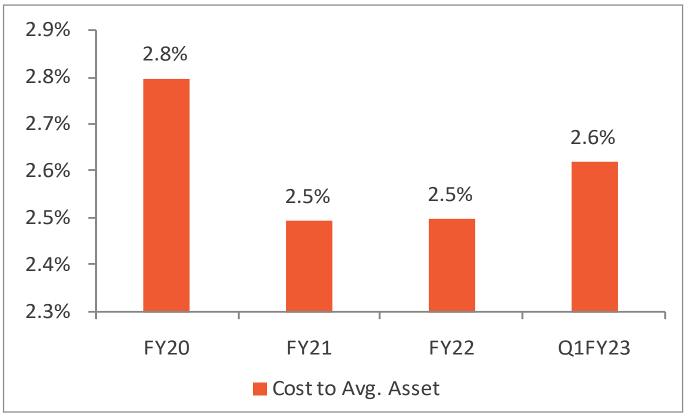
Source: Company, Sharekhan Research

Asset quality likely to improve further along with higher PCR augurs well



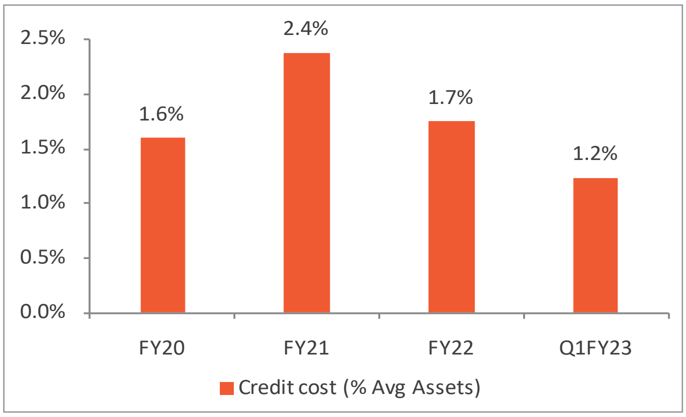
Source: Company, Sharekhan Research

Cost increase reflects accelerated investments



Source: Company, Sharekhan Research

Credit cost is expected to normalize & sustain



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Credit growth is sustaining; Top private banks placed better**

System-level credit offtake grew by ~16.2% y-o-y in the fortnight ending Sep 9, 2022, indicating loan growth has been sustaining, given distinct signs of improving economy and revival of investments and loan demand. While, deposits growth remined steady at ~9.5% y-o-y, which also reflects a healthier economic scenario but are trailing advances growth. The bottom-up story is intact, and we should see loan growth acceleration sustaining, while margins are likely to improve in a higher interest-rate cycle. Asset quality is not a big issue on the corporate lending 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 for 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 the 'BB and below' category, thus the general risk, which they are carrying on the 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 costs. In terms of the MSME book, 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 - Sharp recovery in earnings is expected going ahead**

We believe bank is coming out of tough cycle and concerns about asset quality, liquidity amid COVID-19 pandemic for bank is fading away, as collection efficiencies and liquidity position are improving notably over the past few quarters. Focus on strong risk management framework and its strategy to create adequate provisions/ counter cyclical buffers will act as cushions in future. Asset-quality matrix is expected to improve, led by lower slippages from standard book. Opex is likely to moderate over the medium term. We expect loan growth acceleration, margins to remain stable and credit costs to normalize in FY23-25E that should drive a sharp recovery in earnings going forward. Key monitorable would-be slippages from restructured book.

■ **Valuation - We maintain a Buy on the stock with a revised TP of Rs. 1,400.**

At CMP, IIB trades at 1.6x and 1.4x 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.

Peer Comparison

Companies	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			F23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
IndusInd Bank	1,164	90,267	12.6	10.6	1.6	1.4	13.9	14.5	1.7	1.7
Federal Bank	114	24,129	9.4	8.3	1.1	1.0	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 has addressed 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/ counter cyclical buffers would act as cushion in future. Asset-quality matrix is expected to improve further, led by lower slippages from standard book. Opex likely to moderate over the medium term. We also expect loan growth acceleration and credit costs normalization over the medium term, given revival in macro 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

Sharekhan

by BNP PARIBAS

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