



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

Updated Feb 08, 2023

28.24

High Risk

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

Source: Morningstar

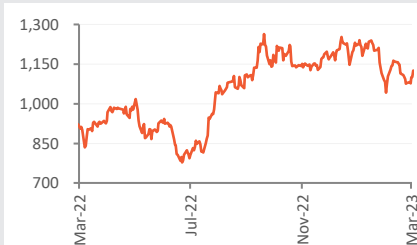
Company details

Market cap:	Rs. 82,239 cr
52-week high/low:	Rs. 1275 / 764
NSE volume: (No of shares)	36.1 lakh
BSE code:	532187
NSE code:	INDUSINDBK
Free float: (No of shares)	65.2 cr

Shareholding (%)

Promoters	16.5
FII	44.8
DII	25.1
Others	13.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.7	-11.9	-6.8	17.5
Relative to Sensex	-5.1	-5.0	-2.9	12.7

Sharekhan Research, Bloomberg

IndusInd Bank

Re-Rating contingent upon improvement in core franchise

Banks	Sharekhan code: INDUSINDBK		
Reco/View: Buy	↔	CMP: Rs. 1,060	Price Target: Rs. 1,400
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- IndusInd Bank (IIB) has informed that the RBI has approved the re-appointment of Mr. Sumant Kathpalia as MD and CEO for a further period of 2 years instead of 3 years, as was proposed by the bank.
- Neither the RBI nor the bank has provided reasons behind the lower tenure approved. We believe the focus now shifts to improving the core franchise and re-rating would depend upon the sustained earnings progression on guided lines.
- There had been instances in the past (in case of Federal Bank) where the tenure extension has been lower, but subsequently extension has been given by the RBI for higher tenure depending upon the performance.
- IIB remains our tactical buy as valuations are cheap at 1.3x/1.1x its BV estimates for FY2024E/FY2025E versus average RoA trajectory expected at ~1.9% over the next two years. Risk to reward is attractive. We maintain Buy with a revised TP of Rs. 1,400.

IndusInd Bank (IIB) has recovered from its past challenges and has been progressing well on guided lines. Strong growth potential from a well-diversified loan book with a rising share of retail loans along with healthy capital ratios (Tier-I capital at 16.5% as of Q3FY2023) gives loan growth visibility. In the retail loan segment, vehicle finance and micro finance book are expected to be growth boosters. Moreover, its underwriting practices have been tested in this segment as these portfolios have seen a downcycle. The bank is also speeding up its efforts to improve the retail liability franchise, which is a key positive. Retail deposits have gone up from ~26% in FY2019 to ~42% in 9MFY2023. Increasing share of retail deposits has been a key focus area for the bank, with 87% of incremental deposits over FY2020-9MFY2023 coming from retail deposits and CASA. The bank has acknowledged the learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings. We believe the focus would now shift back to business performance from hereon and re-rating would depend upon sustained earnings progression on guided lines.

- Taking instances from the past:** The bank informed that the RBI has given approval for re-appointment of Mr. Sumant Kathpalia as MD and CEO for a further period of 2 years instead of 3 years, as was proposed by the bank. Neither the RBI nor the bank has provided reasons behind the lower tenure approved. There had been instances in the past (in case of Federal Bank) where the tenure extension has been lower but subsequently extension has been given by the RBI for a higher tenure, depending upon the performance. It does not appear to be a material negative outcome; however, at the same time, we would await clarity on any changes in the business guidance going forward due to this event.
- Focus remains on accelerating the loan growth led by rising retail mix and strengthening the liability franchise:** Loan growth has started to accelerate (19% in 9MFY2023 vs. 8% over FY2020-FY2022), driven by strong SME and vehicle finance portfolio. Strong growth potential from a well-diversified loan book with a rising share of retail loans along with healthy capital ratios (Tier-I capital at 16.5% as of Q3FY2023) gives loan growth visibility. In the retail loan segment, vehicle finance and micro finance book are expected to be the growth boosters. The bank possesses strong domain expertise in its focus segments – vehicle and MFI business. Moreover, its underwriting practices have been tested in this segment as these portfolios have seen a downcycle. The large corporate book is expected to grow in line with the system growth. Moreover, the bank is investing in new growth engines such as affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances. The bank is also speeding up its efforts to improve the retail liability franchise, which is a key positive. Retail deposits have gone up from ~26% in FY2019 to ~42% in 9MFY2023. Increasing share of retail deposits has been a key focus area for the bank, with 87% of incremental deposits over FY2020-9MFY2023 coming from retail deposits and CASA. The bank has acknowledged the learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings.
- Credit cost to undershoot further, which should lead to higher ROA from here on:** Collection efficiencies continue to improve across its core portfolio, led by continued benign credit cycle. The bank reported higher credit cost at 3.8%/3.0% during FY2021-FY2022. While in 9MFY2023, credit cost has sharply fallen to 1.8% of average advances. Accelerated provisions made in the past few quarters (in turn maintaining healthy PCR at ~71%), lower slippages, and additional non-NPA provision buffer towards the restructured book (1.25% against which 0.8% provisions are already made) will enable further drop in credit cost and would drive strong earnings recovery. Its credit cost is expected to fall below ~150 bps over FY2024FY2025E, which is expected to lead to improved return ratios.

Our Call

Valuation – We maintain our Buy rating on the stock with a revised TP of Rs. 1,400: At the CMP, IIB trades at 1.3x and 1.1x its FY2024E/FY2025E BV estimates. A well-capitalised balance sheet, adequate internal risk-control measures placed, improvement in collection efficiencies across business segments, run down of the restructured book without much flowing into NPAs by Q1FY2024, steady asset-quality matrix and, in turn, lower credit costs would augur well for the bank's return ratio profile. We believe the strong recovery in earnings, improvement in liability franchise, and recovery in return ratios would help valuations inch higher.

Key Risks

Economic slowdown due to which slower loan growth, higher-than-anticipated credit costs, slow growth in retail liability franchise, and lower-than-expected margins.

Valuation (Standalone)

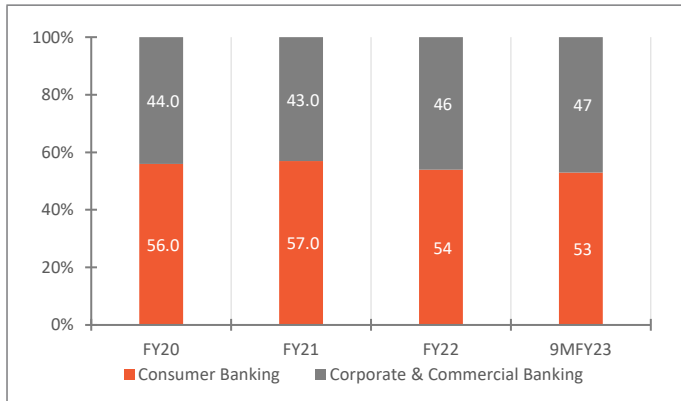
Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	15,001	17,750	21,423	26,098
Net profit	4,611	7,539	9,402	11,075
EPS (Rs.)	59.5	97.3	121.4	143.0
P/E (x)	18.1	11.1	8.9	7.5
P/BV (x)	1.8	1.5	1.3	1.1
RoE (%)	10.1	14.6	15.7	15.8
RoA (%)	1.2	1.7	1.9	1.9

Source: Company; Sharekhan estimates

- ♦ **Focus on strengthening liability franchise:** Retail deposits have gone up from ~26% in FY2019 to ~42% in 9MFY2023. Increasing share of retail deposits has been a key focus area for the bank, with 87% of incremental deposits over FY2020-9MFY2023 coming from retail deposits and CASA. The bank has acknowledged the learning due to the challenges it faced in the past due to higher reliance on wholesale deposits and borrowings.
- ♦ **Focus on increasing the retail mix:** In the retail loan segment, vehicle finance and micro finance book are expected to be the growth boosters. The bank possesses a strong domain expertise in its focus segments – vehicle and MFI business. Moreover, its underwriting practices have been tested in this segment as these portfolios have seen a downcycle. The large corporate book is expected to grow in line with the system growth. 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 Q3FY2023 as compared with ~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.
- ♦ **Sharp recovery in earnings led by lower credit cost:** Collection efficiencies continue to improve across its core portfolio, led by continued benign credit cycle. The bank reported higher credit cost at 3.8%/3.0% during FY2021-FY2022. While in 9MFY2023, credit cost has sharply fallen to 1.8% of average advances. Accelerated provisions made in the past few quarters (in turn maintaining healthy PCR at ~71%), lower slippages, and additional non-NPA provision buffer towards the restructured book (1.25% against which 0.8% provisions are already made) will enable further drop in credit cost and would drive strong earnings recovery. Its credit cost is expected to fall below ~150 bps over FY2024-FY2025E, which is expected to lead to improved return ratios.

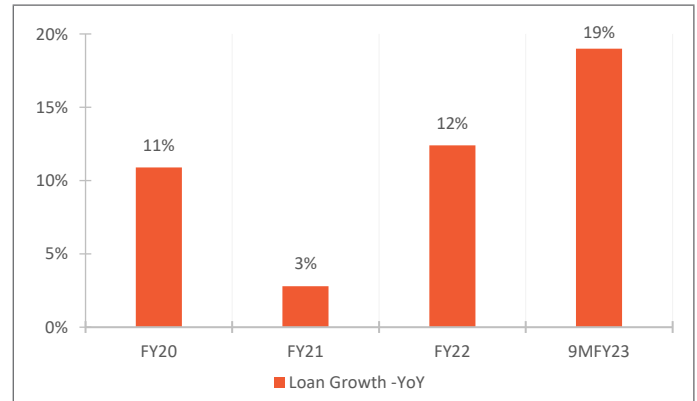
Financials in charts

Trend in Loan mix



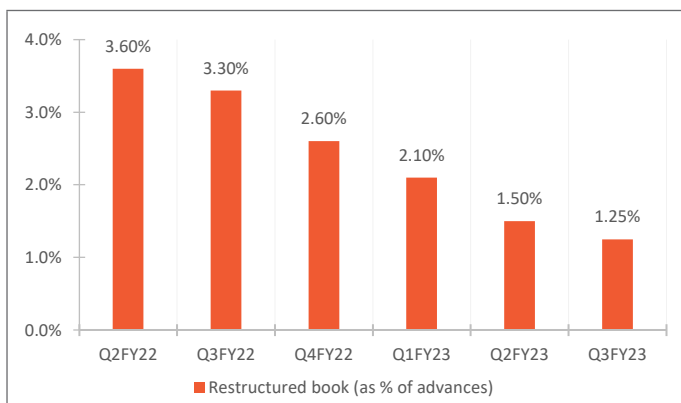
Source: Company, Sharekhan Research

Trend in Loan Growth



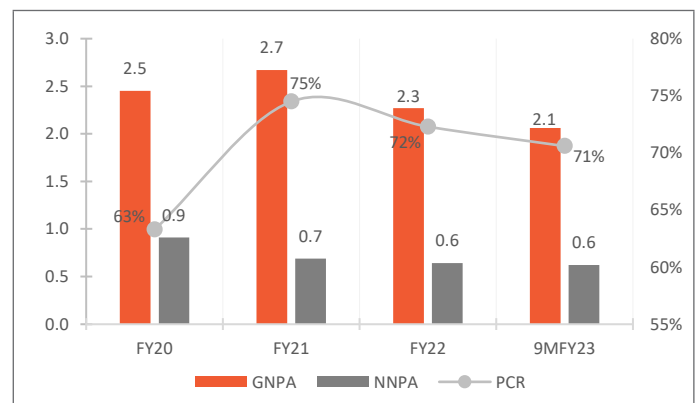
Source: Company, Sharekhan Research

Restructured book likely to run down by Q1FY24



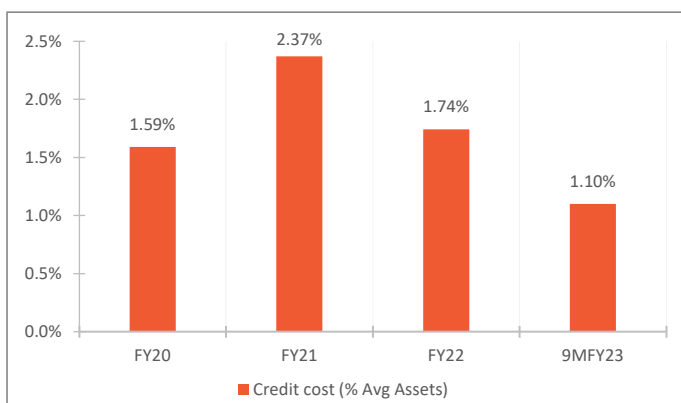
Source: Company, Sharekhan Research

Trend in Asset Quality



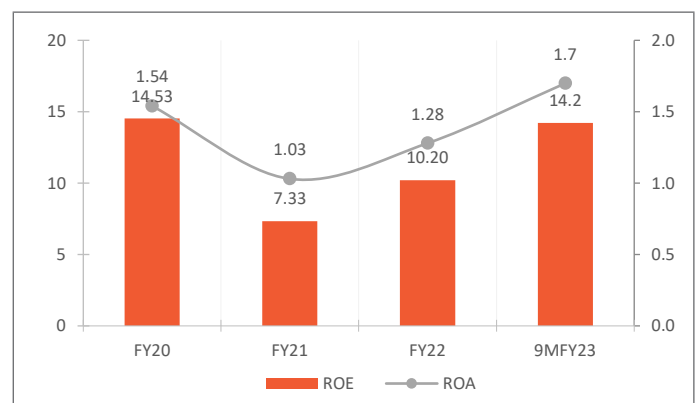
Source: Company, Sharekhan Research

Trend in Credit Cost



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Deposits mobilisation to be in focus; Banks with superior liability franchise placed better

System-level credit offtake grew by ~15.5% y-o-y in the fortnight ending February 24, 2023, indicating loan growth has been sustaining, given distinct signs of an improving economy, revival of investments, and strong demand. On the other hand, deposits rose by ~10.1%, but still trails advances growth. We should see some moderation in loan growth due to a higher base in FY2024, but loan growth is expected to remain healthy. Margins are likely to improve, but momentum is expected to moderate and margins are expected to peak out by the end of FY2024. Asset quality is not a big issue on the corporate lending end due to muted growth in the past few years. From the retail side, there could be some pressure due to adverse macro situation, but nothing is significant. Asset quality is likely to remain stable in the near to medium term. In the past few years, lenders have been cautious about lending to the 'BB & 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 banks with a robust capital base, strong deposit franchise, 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

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 the standard book. Opex is likely to moderate over the medium term. We expect loan growth acceleration, margins to remain stable, and credit costs to normalise in FY2024-FY2025E, which should drive a sharp recovery in earnings going forward.

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

At the CMP, IIB trades at 1.3x and 1.1x its FY2024E/FY2025E BV estimates. A well-capitalised balance sheet, adequate internal risk-control measures placed, improvement in collection efficiencies across business segments, run down of the restructured book without much flowing into NPAs by Q1FY2024, steady asset-quality matrix and, in turn, lower credit costs would augur well for the bank's return ratio profile. We believe the strong recovery in earnings, 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 (%)	
			F24E	FY25E	F24E	FY25E	F24E	FY25E	F24E	FY25E
IndusInd Bank	1060	82,239	8.7	7.4	1.3	1.1	15.7	15.8	1.9	1.9
Federal Bank	129	27,378	7.5	6.5	1.1	0.9	15.3	15.2	1.4	1.4

Source: Company, Sharekhan Research

About company

IIB is a private bank established in 1994. Promoted by Hinduja Group, the bank is the fifth largest private bank in India. The bank has a strong pan-India presence with 6,352 touch points as of December 2022. The bank is a market leader in most product categories in the vehicle finance segment, which forms around 26% of overall loans. Overall, the retail to wholesale mix stands at 53:47. The bank is well placed with adequate capital levels. Capital adequacy ratio (CAR) stands at 18.01%.

Investment theme

IIB has addressed its past challenges related to asset quality and internal control issues. Additionally, its strategy to create counter-cyclical buffers would act as a cushion in future. Asset-quality outlook is expected to be stable over the medium term, which should lead to lower slippages. Loan growth acceleration (shifting to growth pedal again) and credit costs normalisation over the medium term, given the revival in macro environment augurs well for earnings growth going forward.

Key Risks

Economic slowdown due to which slower loan growth, higher-than-anticipated credit costs, slow growth in retail liability franchise, and lower-than-expected margins.

Additional Data

Key management personnel

Mr. Sumant Kathpalia	CEO and Managing Director
Mr. Arun Khurana	Deputy CEO
Mr. S V Zaregaonkar	Chief Operating Officer
Mr. Gobind Jain	Chief Financial Officer
Mr. Ramaswamy Meyyappan	Chief Risk Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	IndusInd International Holdings Ltd.	11.55
2	Bank of New York MELLON CORP	8.19
3	BofA Securities Europe SA	3.93
4	LIFE INSURANCE CORP OF INDIA	3.74
5	INDUSIND LTD.	3.61
6	SBI FUNDS MANAGEMENT LTD.	2.99
7	SFSPVI LTD.	2.57
8	Route One Investment Co.	2.53
9	BRIDGE INDIA FUND	2.46
10	DRAGSA INDIA EQUITIES III LP	2.05

Source: Bloomberg

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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 deteriorating 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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