Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

IndusInd Bank

Earnings growth to outperform sector growth

Banks	Sharekhan code: INDUSINDBK
Reco/View: Buy ↔	CMP: Rs. 1,409 / Price Target: Rs. 1,650 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

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 30.24

Updated Aug 08, 2023

High Risk

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

Source: Morningstar

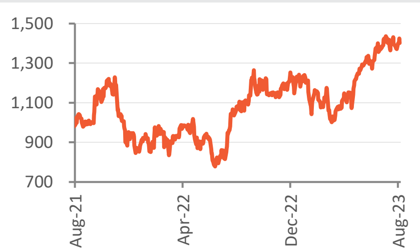
Company details

Market cap:	Rs. 1,09,428 cr
52-week high/low:	Rs. 1,446 / 990
NSE volume: (No of shares)	34.7 lakh
BSE code:	532187
NSE code:	INDUSINDBK
Free float: (No of shares)	65.2 cr

Shareholding (%)

Promoters	16.5
FII	42.3
DII	27.9
Others	13.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.4	11.1	30.2	31.7
Relative to Sensex	1.5	7.1	20.6	21.2

Sharekhan Research, Bloomberg

Summary

- IndusInd Bank is likely to outperform the sector in terms of earnings growth, led by stable NIMs, strong loan growth and lower credit cost, which could translate into higher RoA.
- Near-term business growth outlook looks comfortable, led by a benign corporate credit cycle, stable CV and MFI cycle, which should support operating profit growth.
- We believe there is still headroom for reduction in credit cost and it augurs well in case there is higher-than-expected growth in operating cost in FY2024, as the bank continues to invest in the franchise for future growth.
- The stock trades at 1.7x/1.5x its BV estimates for FY2024E/FY2025E vs. average RoA trajectory expected at ~1.9% over the next two years. We believe re-rating is expected given sustained earnings progression and strengthening of liability franchise. We reiterate Buy with an unchanged TP of Rs. 1,650.

IndusInd Bank (IIB) has been progressing well on guided lines. Overall loan growth is expected to be broad-based with the retail and wholesale mix broadly at 55:45. The bank is targeting loan growth of 18-23% y-o-y in FY2024. Net interest margin (NIM) is expected to be stable at 4.2-4.3% despite rise in cost of funds fully offset by increased yields. The bank is also speeding up its efforts to improve the retail liability franchise, which is a key positive. 87% of incremental deposits in the past three years have come from retail term deposits and CASA. Retail deposits as per LCR are now at 43% vs. 26% in FY2019. Increasing share of retail deposits has been a key focus area for the bank. 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 re-rating is expected given sustained earnings progression and strengthening of liability franchise.

- **Stable NIM trajectory expected:** Despite a sharp rise in the cost of deposits, the bank has managed to report stable NIM, led by improvement in yields. The cost of deposits is expected to peak in H1FY2024 and, thereby, stabilise from Q3FY2024. Going by this rationale, NIMs may have levers for improvement in H2FY2024 through better loan mix towards high-yielding retail assets. However, the bank has guided that there could be some moderation in yields in the corporate book, which is expected to fully offset the benefit. Thus, the bank is guiding for stable margins in the target range of 4.2-4.3% for FY2024. Overall, the sector is reporting lower margins vs. stable margins trajectory at the bank, thereby outperforming peers on net Interest income (NII) growth.
- **Strong loan growth likely to sustain and is expected to be broad based:** Loan growth is higher than the industry's average for the bank and has been broad based. Strong growth outlook from a well-diversified loan book with a rising share of retail loans along with healthy capital ratios gives strong visibility. 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's growth and the bank is aiming for higher growth in the small corporate book. Additionally, the bank is investing in new growth engines such as affluent banking, NRI banking, tractor finance, affordable housing, and merchant advances. Overall, loan growth is expected to be broad-based with the retail and wholesale mix broadly at 55:45.
- **Credit cost to undershoot further, which should improve ROA:** Collection efficiencies continue to improve across its core portfolio, led by continued benign credit cycle. Total credit cost stood at 134 bps (as of average advances) in Q1FY2024, and the bank has guided for further improvement in credit cost (in the range of 110-130 bps) in the coming quarters. Accelerated provisions made in the past few quarters (in turn maintaining healthy PCR at ~71%), lower slippages due to a benign credit cycle, and additional non-NPA provision buffer (0.55% of advances) along with unwinding of the restructured book will enable further drop in credit cost and would drive strong earnings growth.

Our Call

Valuation – We maintain our Buy rating on the stock with an unchanged TP of Rs. 1,650: At the CMP, IIB trades at 1.7x/1.5x its FY2024E/FY2025E BV estimates. Strong loan growth momentum, stable NIMs, and lower credit cost are likely to support earnings growth, and this should keep RoEs at ~15% in the near term. Near-term business growth outlook looks comfortable, led by benign corporate credit cycle, stable CV, and MFI cycle, which should support operating metrics. The bank is likely to outperform the sector in terms of earnings growth, led by stable NIMs, strong loan growth, and lower credit cost, which could translate into higher RoA. Key monitorable: Mobilisation of retail and granular deposits and RBI approval on higher promoter stake.

Key Risks

Economic slowdown that can lead to slower loan growth, higher-than-anticipated credit costs, slow growth in the retail liability franchise.

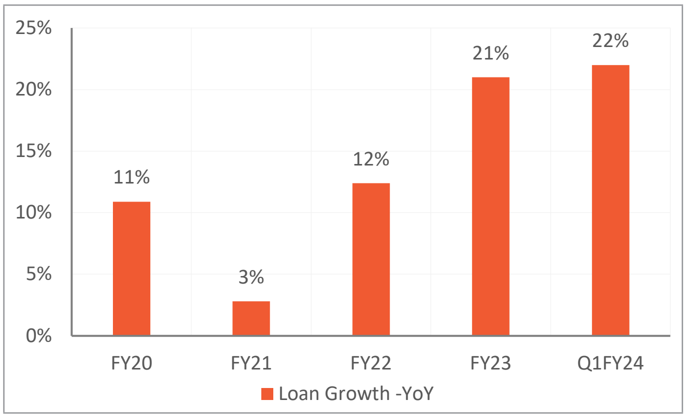
Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Interest Income	15,001	17,592	19,770	23,946
Net profit	4,611	7,390	9,102	10,606
EPS (Rs.)	59.5	95.2	116.7	136.0
P/E (x)	23.7	14.8	12.1	10.4
P/BV (x)	2.3	2.0	1.7	1.5
RoE (%)	10.1	14.4	15.4	15.4
RoA (%)	1.2	1.7	1.9	1.9

Source: Company; Sharekhan estimates

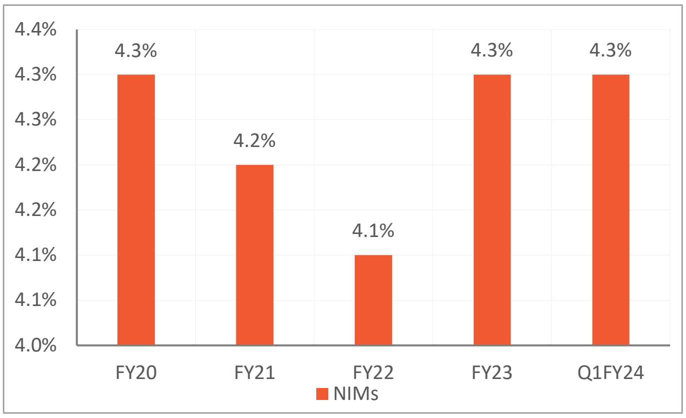
Financials in charts

Trend in Loan Growth



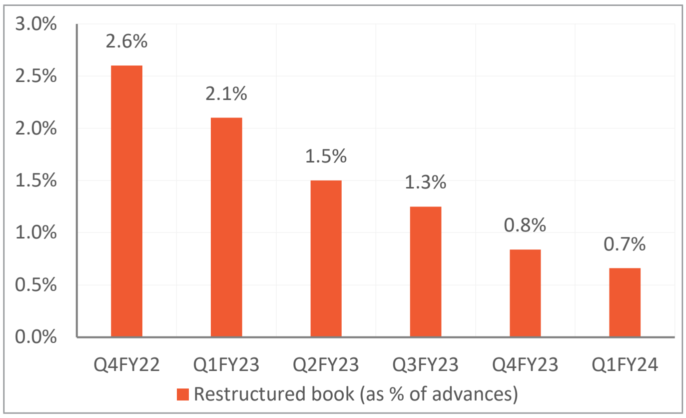
Source: Company, Sharekhan Research

Trend in NIMs



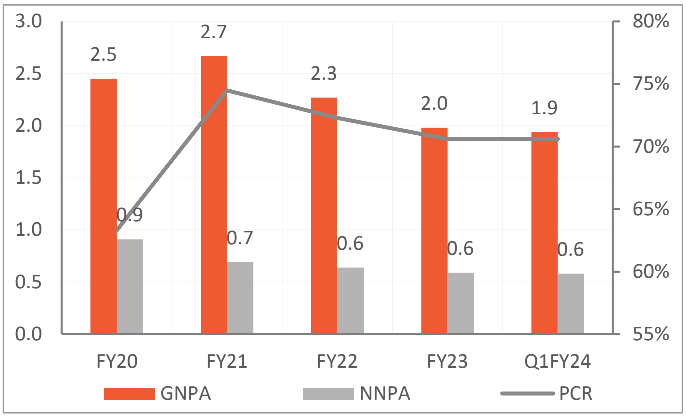
Source: Company, Sharekhan Research

Restructured book likely to run down by H1FY24



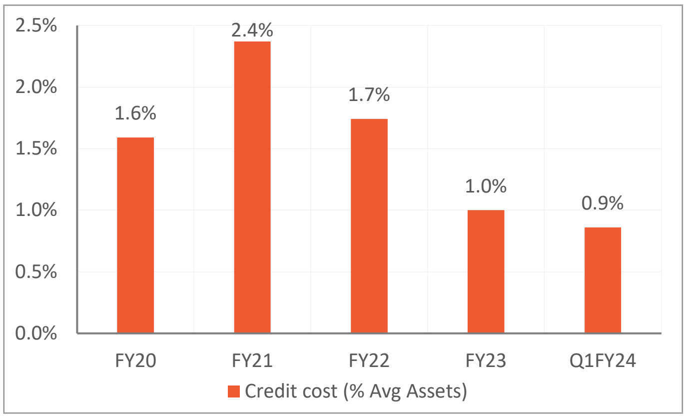
Source: Company, Sharekhan Research

Trend in Asset Quality



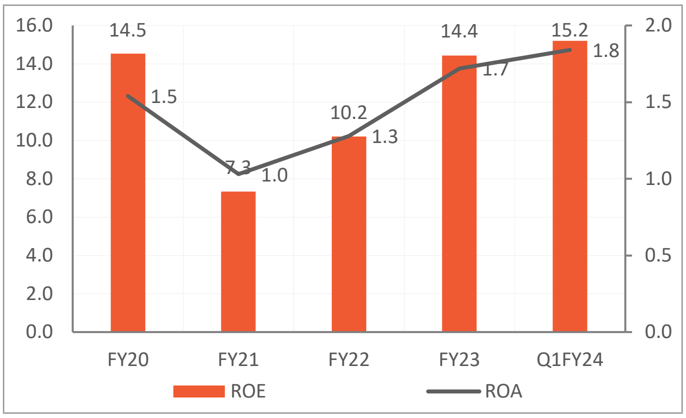
Source: Company, Sharekhan Research

Trend in Credit Cost



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Deposit mobilisation to be in focus; banks with a superior liability franchise placed better

System-level credit offtake grew by ~19.7% y-o-y in the fortnight ending August 11, 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 ~13.5%. The gap between advances and deposits growth is narrowing and is expected to further narrow as real deposit rates increase gradually. We should see some moderation in loan growth due to a higher base in FY2024, but loan growth is expected to remain healthy. Margins have likely peaked out in Q4FY2023. The overall asset-quality outlook continues to remain stable to positive for the sector. 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 – Improving with each passing quarter and the franchise is looking towards a more predictable performance

The bank has navigated the past challenges and is progressing well on expected lines. Overall asset-quality outlook is expected to remain stable in the near to medium term, which should lead to lower slippages and, in turn, reduced credit cost. Near-term business trends look comfortable for the bank and the franchise is looking towards a more predictable performance. Strong loan growth momentum, stable NIMs, and lower credit cost in the near to medium term augur well for earnings growth.

■ Valuation – We maintain our Buy rating on the stock with an unchanged TP of Rs. 1,650

At the CMP, IIB trades at 1.7x/1.5x its FY2024E/FY2025E BV estimates. Strong loan growth momentum, stable NIMs, and lower credit cost are likely to support earnings growth, and this should keep RoEs at ~15% in the near term. Near-term business growth outlook looks comfortable, led by benign corporate credit cycle, stable CV, and MFI cycle, which should support operating metrics. The bank is likely to outperform the sector in terms of earnings growth, led by stable NIMs, strong loan growth, and lower credit cost, which could translate into higher RoA. Key monitorable: Mobilisation of retail and granular deposits and RBI approval on higher promoter stake.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
IndusInd Bank	1,409	1,09,428	12.1	10.4	1.7	1.5	15.4	15.4	1.9	1.9
Federal Bank	144	33,830	8.4	7.3	1.2	1.0	15.6	15.3	1.3	1.3

Source: Company, Sharekhan estimates

About company

IIB is the fifth largest private bank promoted by Hinduja Group in India. The bank has a strong pan-India presence with 2,606 branches as of June 2023. The bank is a market leader in most of the product categories in the vehicle finance segment, which forms around 26% of overall loans. Overall, the retail-to-wholesale mix stands at 54:46. The bank is well-placed with adequate capital levels. Capital adequacy ratio (CAR) stands at 18.4%.

Investment theme

IIB has addressed the past challenges and is now focusing on strong granular growth, robust risk management framework, and its strategy to create counter-cyclical buffers, which will act as cushions. Asset-quality outlook is expected to be stable over the medium term, which should lead to lower slippages and, in turn, reduced credit cost. Near-term business trends look comfortable for the bank and the franchise is looking towards a more predictable performance. Strong loan growth momentum and lower credit cost in the near to medium term augur well for earnings growth.

Key Risks

Economic slowdown that can lead to slower loan growth, higher-than-anticipated credit costs, and slow growth in the retail liability franchise.

Additional Data

Key management personnel

Mr. Sumant Kathpalia	CEO and Managing Director
Mr. Arun Khurana	Deputy CEO
Mr. AG Shriram	Head – Consumer Finance
Mr. Sanjeev Anand	Head – Corporate, Commercial, Rural, and Inclusive Banking
Mr. Gobind Jain	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	IndusInd International Holdings Ltd.	11.53
2	AIA Co Ltd.	8.18
3	INDUSIND Ltd.	3.60
4	Route One Offshore Master Fund	3.27
5	SBI FUNDS MANAGEMENT LTD.	3.13
6	DF International Partners	2.78
7	LIFE INSURANCE CORP OF INDIA	2.76
8	BRIDGE INDIA FUND	2.46
9	DRAGSA INDIA EQUITIES III LP	2.12
10	SFSPVI Ltd.	2.07

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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