February 15, 2013

IndusInd Bank Limited

*"Best is yet to come…
IndusInd Bank has a long way to go"*

Nirmal Bang Research (Division of Nirmal Bang Securities Pvt. Ltd.)
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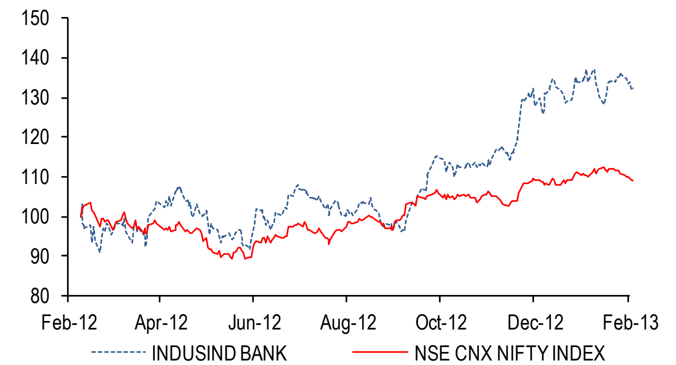
Conviction getting stronger — IndusInd Bank Ltd.

Recommendation			BUY
CMP (Rs.)			Rs.436
Target			Rs.625
Stock Details			
BSE Code			532187
Bloomberg Code			IIB IN
Market Cap (Rs. cr)			22611
Free Float (%)			84.7
52- wk HI/Lo (Rs)			438/242
Avg. Volume BSE (Monthly)			321733
Face Value (Rs)			10.0
Dividend (FY 12)			22%
Shares o/s (Crs)			52.1
Relative Performance	1Mth	6Mth	1Yr
IIB(%)	(0.9)	31.5	32.0
NIFTY(%)	(3.0)	9.2	6.2



Shareholding Pattern as of 31 Dec 2012	
Promoters Holding	15.3%
Institutional (Incl. FII)	61.3%
Corporate Bodies	14.9%
Public & others	8.4%

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IndusInd Bank is placed on strong trajectory to reap the gains from a falling interest-rate regime. With half of the loan book being fixed in nature, the Bank should register a significant improvement in margins and also maintain strong asset quality.

Investment rationale

- **NIMs set to improve from here**: The NIM expansion in the previous two quarters (3bps and 21 bps respectively) is the beginning and we expect a much more stronger and sustainable growth in the NIM segment, going forward.

- **Strong growth in the fee-income segment:** The growth in the fee income segment is expected to be robust going forward. The complete product portfolio coupled with enhanced branch network and more than half of this income de-linked to the Balance Sheet, we expect this segment to grow higher than the Balance Sheet.

- **Adequately funded for the next three years:** With the recent Qualified Institutional Placement (QIP), the Bank is adequately funded for the next three years.

- **Disciplined approach to help keep a tab on asset quality:** The management's disciplined approach should help to keep a tab on the asset quality. Inspite of having more than 25 per cent exposure to the CV segment and 49 per cent to the vehicle portfolio, we are quite confident that the asset quality should remain quite robust.

Valuation & Recommendation

We expect IndusInd Bank to post a net profit of Rs.1044.1 crore on Net Interest Income of Rs.2230 crore in FY'13E. We expect the Bank to clock a net profit of Rs.1340 crore on Net Interest Income of Rs.2862 crore for FY'14E. This translates into an EPS of Rs.25.7 for FY'14E. We expect significant traction in FY'15E and expect the Bank to post a PAT of Rs.1745 crore, translating into an EPS of Rs.33.2 and an adj. book value of Rs.192. We expect the valuation to improve going forward and looking at the consistency in earnings, we assign a value of 3.25x FY'15E adj. book value (of Rs.192) to arrive at a price target of Rs.625 over the next 15-18 months.

Particulars (Rs Cr)	Net interest Income	*Growth (%)*	PAT	*Growth (%)*	P/E (x)	P/ABV (x)	*RoE (%)*
FY'11E	1,376	*23.8*	577	*39.2*	35.3	7.8	*18.0*
FY'12E	1,704	*23.8*	803	*39.2*	25.4	5.1	*18.0*
FY'13E	2,230	*30.9*	1,044	*30.0*	21.8	4.6	*18.3*
FY'14E	2,862	*28.3*	1,340	*28.4*	16.9	3.0	*16.9*
FY'15E	3,605	*28.4*	1,732	*28.0*	13.1	2.7	*16.6*

(*Source: Company, Nirmal Bang Research)*

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Management meet takeaways

NIM expansion: The Bank is strategically placed to reap the benefits of the downward interest rate cycle. Over the last two quarters, the NIMs have expanded by 3 bps and 21 bps respectively. The Bank's loan book is exposed to the automobile segment (~47 per cent) and more than half of the book (51 per cent) has an exposure to the consumer finance segment. With the loan book being fixed in nature, the reduction in interest rates is expected to lead to an improvement in overall NIMs.

It is to be noted that the Bank shall not only be able to manage the increase in NIMs going forward but also maintain the asset quality.

The largest portion of the loan book is the CV segment contributing more than 25 per cent to the loan book.

In general, the CV segment can be classified into three different categories depending on their fleet size.

1. Fleet Operator – More than 15 vehicles
2. Small Road Transport Operator (SRTO) – 3 to 15 vehicles and
3. First Time User (FTU)

IndusInd Bank, as a policy, lends only to the SRTO segment and has a minimscule exposure to the Fleet Operator (~5%) FTU category. Therefore, the Bank has been able to cope up with various cycles in the CV industry, keeping the asset quality intact.

For example, with the mining ban in certain territories, a number of finance entities having large exposure to the fleet operators in that particular belt were severely impacted. It is difficult for a large fleet operator to deploy the fleet into some other territory in a short span of time or in the same territory but some other segments. Both these events ultimately led to a strain on the cashflows of the operator, leading to chances of a default. However, the Bank was able to manage the asset quality since the exposure is to a SRTO, having a relatively small fleet size, thereby making it possible for the SRTO to shift from one territory to another.

One of the incentives to various finance entities to cater to this category is the Priority Sector Lending (PSL) tag but the FTU segment continues to be on shaky ground and therefore, it would be difficult for this segment to meet their obligations when things turn shaky in the overall economy.

In the used-CV segment, IndusInd Bank as a policy, does not engage in financing 8-year plus old vehicle. The management is of the opinion that the revenue generating characteristics of a 3-8 year-old vehicle (near-new vehicle) camouflages that of a new vehicle. Therefore, the risk factors in case of an old vehicle are much higher and therefore, the company does not finances the same.

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Robust asset quality: In the corporate segment, the Bank caters only to the working capital requirements of the corporates and the overall duration of this loan book is around seven months. During Q3FY'13, the Bank has written off the Deccan Chronicle account as well. The loan book of the Bank is much more diversified with no exposure to the aviation sector and marginal exposure to high-risk segments like real estate (1.5 per cent of the loan book).

The Bank's exposure towards Lavasa is less than Rs.50 crore and the same is not due in the near-term. This asset is well collaterised.

The bank's experience in the CV segment has come as a legacy and that has helped it scale through various cycles. It has been the experience of the management that the credit costs associated with this segment varies between 50-80 bps across business cycles.

Strong growth in the fee-income segment: The growth in the core-fee income segment has been robust and the same is expected to continue in future as well. IndusInd Bank is on target in meeting the guidance of 500 branches by the end of this financial year. With this, the ratio of newly opened branches to already opened branches should get skewed in favour of the latter.

At present, the Bank's cross-selling ratio is a 3:1 i.e the Bank is selling three products to every single customer and therefore with a complete array of products in its portfolio coupled with an increase in the branch network, the distribution channel continues to remain strong.

Adequately funded for the next three years: With the recent Qualified Institutional Placement (QIP), the Bank is adequately funded for the next three years. We do not expect any equity dilution during this period.

Competitive scenario: There have been rounds of discussion with regard to new bank licenses being issued. We believe that since those licenses would be issued to already existing NBFCs, they shall not impact the present banks as far as the loan-book goes because these entities are already providing competition but as NBFCs. However, there could be some amount of competition heating up as far as the liabilities of various banks are concerned.

The chase to shore-up CASA can become a bit tougher with new banks foraying into this space. We do not rule out talent acquisition to gather steam going forward. However, we believe that IndusInd Bank has more than doubled the CASA ratio from ~14 per cent in 2008 to the present figure of ~28 per cent. We expect that management's target to scale up the same to ~35 per cent is achievable.

Secondly, if the focus in the new banking licenses is more towards rural areas, then the considering the maintenance cost incurred on an average of around Rs.800 per account per annum and limited opportunities to cross-sell third-party products, this proposition may not be financially viable for quite some time.

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Disciplined approach: We like the disciplined approach of the management with prudent principles in place. These are as follows:

- The management completed the entire suite of product portfolio in the initial phase. Considering the requirement of the housing finance segment, the Bank chose to to become a distributor of the product of HDFC Limited rather than launching its own product in the segment and engaging the capital.
- Similarly in the CV segment, the exposure of the Bank to the fleet segment is just ~5 per cent of the portfolio and that too in case of relationships existing beyond a couple of decades. This could be the cases where the operator would have had grown with the Bank and has emerged as a player with a strong fleet of vehicles.
- Considering the high delinquencies in the credit card segment, the Bank chose to distribute the card to a selected set of clients only and therefore, the Bank had been able to turn around the business in less than a year of acquisition

Innovations in place: The Bank has taken various pro-active steps at the right time and has come up with a number of novel ideas. A few of them have been mentioned below:

- IndusInd Bank's ATMs provide the customers a choice to get the currency of their denomination. As a result, more than 75 per cent of the users of ATM network of IndusInd Bank are non-account holders providing the Bank an opportunity to hook them as clients
- The monthly account statement of the clients have scanned copies of the cheques issued by the customer, providing significant ease to the customer to reconcile the statement
- With the latest IT version (Finacle 10.2), IndusInd Bank should be rightly placed in effectively improving upon the cross-selling opportunities

VALUATION AND RECOMMENDATION

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Conviction getting stronger

IndusInd Bank Ltd.

Profitability (Rs. Cr.)	FY'11	FY'12	FY'13E	FY'14E	FY'15E
Interest earned	3,589	5,359	7,050	8,742	10,316
Interest expended	2,213	3,655	4,820	5,880	6,711
Net interest Income	1,376	1,704	2,230	2,862	3,605
Core Fee Income	629	913	1,295	1,650	1,980
Non Interest income	714	1,012	1,360	1,760	2,077
Operating income	2,090	2,716	3,590	4,622	5,682
Operating expenses	1,009	1,343	1,780	2,200	2,640
Staff costs	383	485	650	850	1,020
Other Operating expenses	626	858	1,130	1,350	1,620
Operating profit	1,081	1,373	1,810	2,422	3,042
Provisions	202	180	270	440	480
Profit before tax	879	1,193	1,540	1,982	2,562
Taxes	302	390	496	641	830
Extra-ordinary items	-	-	-	-	-
Net Profit	577	803	1,044	1,340	1,732

Quarterly	Dec.11	Mar.12	Jun.12	Sep.12	Dec.12
Net interest income	431	464	484	510	577
Non interest income	265	292	319	320	356
Total Income	696	756	803	830	933
Operating expenses	347	377	399	410	1,684
Operating profit	349	379	404	420	472
Provisions	43	46	54	49	79
Profit before tax	306	333	350	371	393
Taxes	100	110	114	121	126
Net Profit	206	223	236	250	267

Profitability Ratios	FY'11	FY'12	FY'13E	FY'14E	FY'15E
RoE	18.0%	18.0%	18.3%	16.9%	16.6%
RoA	1.5%	1.6%	1.6%	1.7%	1.7%

Growth Ratios	FY'11	FY'12	FY'13E	FY'14E	FY'15E
NII growth	55.3%	23.8%	23.8%	30.9%	28.3%
PAT growth	65.3%	39.2%	39.2%	30.0%	28.4%
Pre-prov profit growth	53.8%	27.0%	27.0%	31.8%	33.8%

Ratios	FY'11	FY'12	FY'13E	FY'14E	FY'15E
P/BV	7.4	4.3	3.0	2.7	2.3
P/ABV	7.8	5.1	4.6	3.0	2.7
P/E	51.1	25.4	21.8	16.9	13.1

Balance Sheet (Rs. Cr.)	FY'11	FY'12	FY'13E	FY'14E	FY'15E
Equity Capital	466	468	521	521	522
Reserves & Surplus	3,584	4,274	7,120	8,020	9,465
Networth	4,050	4,742	7,641	8,541	9,987
Deposits	34,365	42,363	53,850	67,520	84,730
Borrowings	5,525	8,682	9,090	10,940	12,960
Total loan funds	39,890	51,045	62,940	78,460	97,690
Total liability and equity	43,940	55,787	70,581	87,001	107,677
Advances	26,166	35,064	43,890	55,050	70,500
Investments	13,551	14,572	18,230	22,850	27,875
Cash	2,456	2,904	5,641	6,738	7,100
Balances with RBI	1,569	2,636	2,157	1,650	1,850
Fixed Assets	596	657	850	1,020	1,050
other assets	1,298	1,764	2,050	2,480	2,450
Less: Provisions	1,695	1,811	2,290	2,910	3,150
	43,941	55,786	70,528	86,878	107,675

Spread Analysis

Key Ratios	FY'11	FY'12	FY'13E	FY'14E	Fy'15E
Average Yield on Interest bearing assets	9.1%	9.3%	10.8%	10.3%	9.70%
Average Yield on Advances	11.6%	12.10%	13.8%	12.9%	12.0%
Average Yield on Investments	6.0%	6.10%	7.7%	7.0%	6.4%
Average cost of deposits	6.4%	6.3%	8.2%	6.9%	6.0%
Average cost of funds	6.4%	6.20%	8.0%	7.2%	6.4%
Spread	2.7%	3.1%	2.8%	3.1%	3.3%

Asset quality ratios					
Gross NPA (%)	1.2%	1.0%	1.0%	1.3%	1.3%
Net NPA (%)	0.5%	0.3%	0.3%	0.4%	0.4%

Valuation Ratios	FY'11	FY'12	FY'13E	FY'14E	FY'15E
EPS	12.3	17.2	20.0	25.7	33.2
BVPS	86.6	101.4	146.7	163.9	191.3
Adjusted BVPS	85.2	95.0	143.7	161.5	192.0

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Note

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