



# IDFC Bank

BSE SENSEX	S&P CNX
30,133	9,352
Bloomberg	IDFCBK IN
Equity Shares (m)	3392.6
M.Cap.(INR b)/(USDb)	207.0 / 3.0
52-Week Range (INR)	83 / 44
1, 6, 12 Rel. Per (%)	-2/-29/0
Avg. Val, INR m	621
Free float (%)	47.1

CMP: INR61

TP: INR62 (2%)

Neutral

## Focus on inorganic opportunities; stressed assets stable

- n IDFC Bank's (IDFCBK) PAT rose 7% YoY to INR1.76b (12% beat), led by lower-than-estimated opex and provisioning.
- n Total income was largely stable YoY at INR5.6b (28% miss), driven by 21% YoY growth in NII to INR5b, offset by a 59% decline in non-interest income to INR563m. NII missed our estimate by 5% due to pressure on margins. The decline in non-interest income was on account of INR258m of trading losses, as against INR782m of trading gains in 4QFY16.
- n Operating expenses came in 20% below estimate at INR3.0b (1% YoY, -22% QoQ), driven by lower employee expenses (-30% YoY). Management has guided for average 2HFY17 employee cost as a run-rate (without considering new employee addition). C/I ratio remained largely stable YoY at 53%.
- n GNPL fell 57% QoQ to INR15.4b, resulting in GNPL ratio declining sequentially from 7% to 3%. This reduction is due to sale of INR40b NPLs to an ARC.
- n Loan book growth remains sluggish. Advances grew 8% YoY (+5% QoQ) to INR494b. Management targets to increase the share of retail loans from 25% to 55-60% in three years via both organic and inorganic opportunities.
- n Total deposits increased 49% QoQ to INR402b. CASA deposits more than doubled QoQ to INR20.9b. However, we suspect this could be on account of one-off float balances in current accounts.
- n **Other highlights:** (1) Tier-1 ratio remains healthy at 18.5%; (2) Core fee income increased significantly from INR595m in 4QFY16 to INR821m in 4QFY17.
- n **Valuation view:** Near-term earnings are likely to remain volatile due to transition cost, trading gains volatility and portfolio acquisitions (to fulfill PSL requirements). Stress loans too remain high. Over medium-to-long term, higher leverage, low cost-to-assets and higher share of infra bonds will lead to higher sustainable RoA/RoE. Near-term uncertainty remains high. We value the bank at 1.3x FY19 BV. Maintain **Neutral** with a revised TP (based on RI model) of INR62 (1.3x FY19E BV).

### Quarterly Performance

Quarterly Performance								(INR Million)	
	FY16			FY17E			2HFY16	FY17E	
	3Q	4Q	1Q	2Q	3Q	4Q			
Interest Income	17,891	18,155	19,755	20,830	22,509	22,234	36,046	85,327	
Interest Expense	14,028	13,987	14,766	15,874	17,301	17,213	28,015	65,154	
Net Interest Income	3,863	4,168	4,989	4,956	5,208	5,021	8,031	20,173	
% Change (Y-o-Y)					34.8	20.5		NA	
Other Income	2,179	1,377	2,128	4,101	3,350	563	3,556	10,131	
Net Income	6,042	5,545	7,117	9,057	8,558	5,584	11,587	30,304	
Operating Expenses	2,153	2,947	2,768	3,234	3,798	2,981	5,100	12,770	
Operating Profit	3,889	2,598	4,349	5,823	4,760	2,602	6,487	17,535	
% Change (Y-o-Y)					22.4	0.2		NA	
Other Provisions	123	119	236	223	2,318	48	242	2,825	
Profit before Tax	3,766	2,479	4,113	5,600	2,443	2,555	6,246	14,710	
Tax Provisions	1,345	829	1,465	1,722	530	795	2,173	4,512	
Net Profit	2,422	1,651	2,648	3,878	1,913	1,760	4,072	10,197	
% Change (Y-o-Y)	NA	NA	NA	NA	-21.0	6.6		NA	
Operating Parameters									
NIM (Reported,%)	2.0	2.1	2.4	2.2	2.1	2.0	2.1	2.2	
NIM (Cal, %)	2.1	2.3	2.4	2.0	2.0	1.9	2.2	2.1	
Tax Rate (%)	35.7	33.4	35.6	30.8	21.7	31.1	34.8	30.7	
Asset Quality									
Gross NPA (INR b)	14.6	30.6	30.3	32.2	35.9	15.4	30.6	15.4	
Gross NPA (on customer assets, %)	3.09	6.2	6.1	6.0	7.0	3.0	6.2	3.0	
E: MOSL Estimates									

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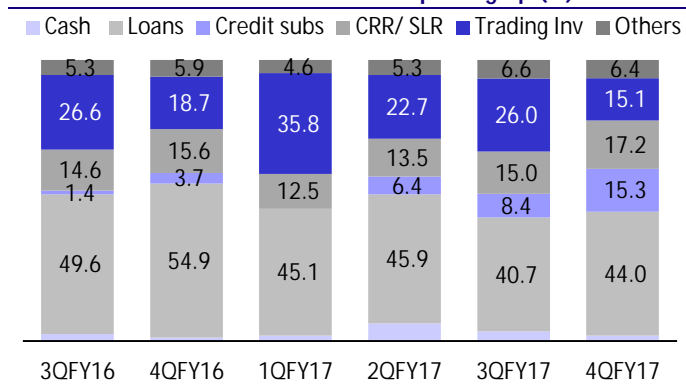
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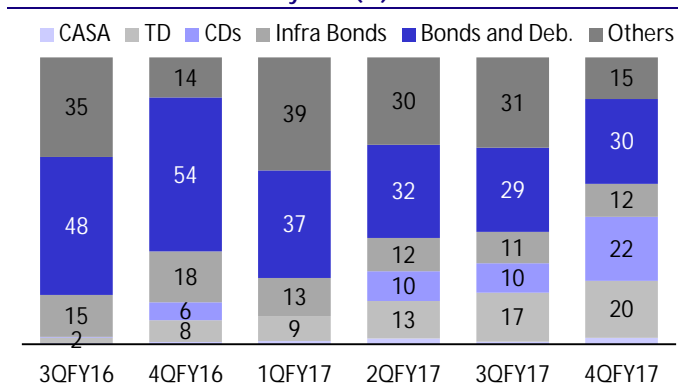
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**Exhibit 1: Quarterly Performance: Lower opex boosts PAT**

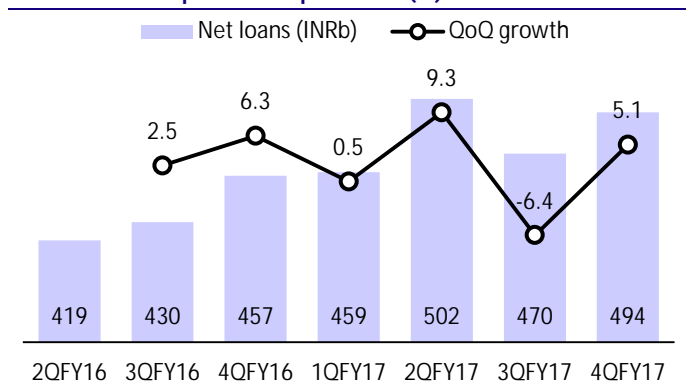
Y/E MARCH (INR m)	4QFY17A	4QFY17E	Var. (%)	Comments
Net Interest Income	5,021	5,264	-5	Pressure on margins
Other Income	563	2,520	-78	Trading losses
Net Income	5,584	7,784	-28	
Operating Expenses	2,981	3,727	-20	Lower employee expenses
Operating Profit	2,602	4,057	-36	
Other Provisions	48	1,701	-97	Lower provisioning
Profit before Tax	2,555	2,356	8	
Tax Provisions	795	781	2	
Net Profit	1,760	1,575	12	PAT beat due to lower provisions
% Change (Y-o-Y)	7	-5		

**Exhibit 2: Share of credit substitutes picking up (%)**

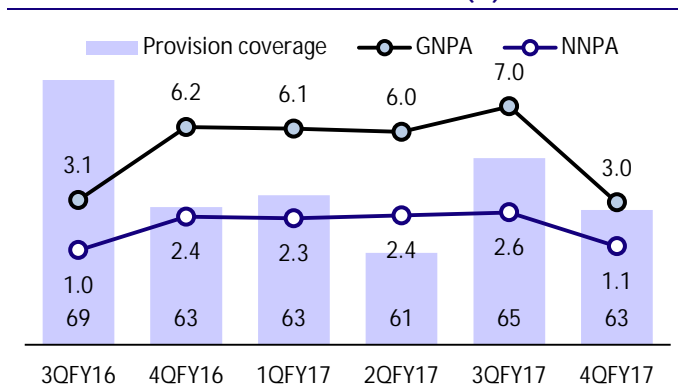
Source: MOSL, Company

**Exhibit 3: Trend in liability mix (%)**

Source: MOSL, Company

**Exhibit 4: Loan portfolio up 5% YoY (%)**

Source: MOSL, Company

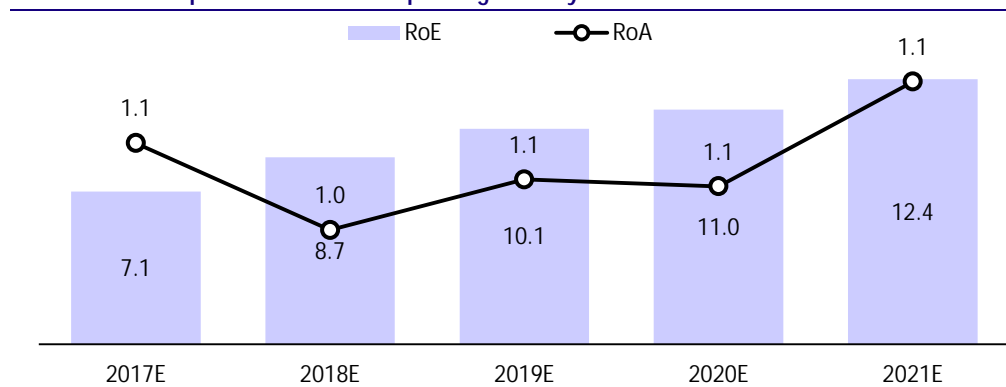
**Exhibit 5: GNPL down due to sale to ARC (%)**

Source: MOSL, Company

### Valuation and view

- n **Loan book CAGR of 26% over FY17-20:** Considering the low hanging fruits and less than 1% market share, we expect growth to be strong. Pick-up in the infrastructure segment and pick up macro-economic environment can push growth rates further. Near term growth in customer assets is likely to be driven by a) PSL and b) wholesale banking (non-infra corporate working capital as well as term loans).
- n **Gradual improvement in ROAs on cards:** Near term earnings are likely to be moderate as bank would focus on acquiring relationships (on cost of margins), Higher up-fronting of technology related cost, opening up of high street branches, higher marketing expenses, addition of top to middle management in the initial phase (high cost and lower productivity as new business lines are being set up). With the operating leverage kicking in, fee income starts contributing and stability in the business we expect ROAs to improve to ~1%. ROEs are likely to be function of growth.
- n **Near term remains highly uncertain:** The bank is going through a transitory phase which may lead to volatility in earnings and execution of retail strategy needs to be watched. Additionally, slippages from non-legacy book surprised negatively. While higher leverage, low cost to assets and higher share of infra bonds (less regulatory drag) will lead to higher sustainable ROE v/s infrastructure lending business, near term uncertainty remains high. We value the bank at 1.3x FY19 BV. Maintain Neutral with the revised target price (based on RI model) of INR62 (1.3x FY19E BV). Key assumptions in the RI model are a) Cost of equity 14.0% b) average growth FY17-35 - 16% and c) Terminal growth rate of 5%.

**Exhibit 6: We expect RoA/RoE to improve gradually**



Source: MOSL, Company



## Conference call highlights

### Target 2020

- n Customer to reach 10m customers (organically and inorganically) – Currently customer base is 1.4m
- n Doing INR5b of retail loan disbursements per month.
- n Retail to reach 50-60% of loans – SME to JLG entire spectrum (INR550b in next three years). Of the total loan book by FY20, acquired retail portfolio is likely to 20-25% from current level of 80%
- n Cost mitigating distribution architecture – Total Branches 200 (74 now), 1000 corporate BC (350 now), 0.1m payment point in micro ATM (8600 now)
- n Target to reach INR7b of fee based income by 2020

### Retail business

- n **Customer addition:** 60K customer a month and of which 20-22k are coming from urban locations
- n Savings account per customer is INR3k in rural area and INR27k in other areas
- n 25% of loans are retail. Organically adding INR5b of retail assets a month
- n Salaried customer average balance is INR35k. Large part of the urban customer base is salaried. Targeting to reach 40-45k/customer post on boarding of customer

### Corporate business

- n Total telecom sector exposure is INR115b. Large part of the portfolio is AA and above.
- n Have been focused on diversifying away from infra - Almost 25% of funded credit is 'retail' now, while the share of infra credit reduced from 72% to 54% in FY17.
- n Want to be the lender of choice for emerging large corporates (USD1b turnover). Also, targeting non-funded relationships with large corporates to generate fee income. Ok to scarifies margins to build relationships
- n CMS, Trade finance, business generation linked fees at INR3.5b

### Priority sector loans

- n PSL target of INR170b met
- n Of the INR170b of PSL loans – INR30b is organic and INR140b is inorganic. Effective drag on an average was 25bp (compared to COF). Negative drag will come down materially in the ensuing years. Buyout portfolio would remain constant.
- n It will take at-least 3 years to reach break-even in PSL

### Asset quality and sale to ARC

- n Sold INR20b net of provisions assets to ARC.
- n Asset sale: Gross amount INR40b; Net INR20b (14 accounts); 15:85 structure; Received SR is INR17b
- n Now the outstanding stress loans on balance sheet is INR50b on which company is carrying INR25b of provisions

**Others**

- n NIMs outlook – Pressure to continue. Challenges are a) acquired PSL b) movement of stress loans to ARC (accounting was happening on cash basis) c) legacy high cost liabilities. NIMs will take atleast 3-4 quarters to recover
- n Open for acquisition across spectrum and any acquisition should be EPS accretive from day one

**Exhibit 7: DuPont analysis**

	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17
<b>Net Interest Income</b>	<b>1.94</b>	<b>2.09</b>	<b>2.27</b>	<b>1.88</b>	<b>1.85</b>	<b>1.76</b>
Fee income	0.09	0.25	0.35	0.43	0.37	0.24
Fee to core Income	4.5	10.6	13.3	18.5	16.5	12.2
<b>Core Income</b>	<b>2.04</b>	<b>2.34</b>	<b>2.62</b>	<b>2.31</b>	<b>2.22</b>	<b>2.01</b>
<b>Operating Expenses</b>	<b>1.08</b>	<b>1.48</b>	<b>1.26</b>	<b>1.23</b>	<b>1.35</b>	<b>1.05</b>
Cost to Core Income	53.2	63.2	48.1	53.2	60.9	52.1
Employee cost	0.61	0.68	0.60	0.57	0.70	0.33
Emp to total exp (%)	55.9	46.2	47.5	46.3	52.0	31.8
Others	0.48	0.80	0.66	0.66	0.65	0.71
<b>Core Operating Profit</b>	<b>0.95</b>	<b>0.86</b>	<b>1.36</b>	<b>1.08</b>	<b>0.87</b>	<b>0.96</b>
<b>Non Interest income</b>	<b>1.10</b>	<b>0.69</b>	<b>0.97</b>	<b>1.56</b>	<b>1.19</b>	<b>0.20</b>
Trading and others	1.01	0.44	0.62	1.13	0.83	-0.05
<b>Operating Profit</b>	<b>1.96</b>	<b>1.30</b>	<b>1.98</b>	<b>2.21</b>	<b>1.69</b>	<b>0.91</b>
<b>Provisions</b>	<b>0.06</b>	<b>0.06</b>	<b>0.11</b>	<b>0.08</b>	<b>0.82</b>	<b>0.02</b>
NPA	0.05	0.00	0.00	0.00	0.00	0.00
Others	0.01	0.06	0.11	0.08	0.82	0.02
<b>PBT</b>	<b>1.90</b>	<b>1.24</b>	<b>1.87</b>	<b>2.12</b>	<b>0.87</b>	<b>0.90</b>
Tax	0.68	0.42	0.67	0.65	0.19	0.28
Tax Rate	35.7	33.4	35.6	30.8	21.7	31.1
<b>RoA</b>	<b>1.22</b>	<b>0.83</b>	<b>1.21</b>	<b>1.47</b>	<b>0.68</b>	<b>0.62</b>
Leverage (x)	5.9	5.9	6.4	7.5	7.8	7.8
<b>RoE</b>	<b>7.2</b>	<b>4.9</b>	<b>7.7</b>	<b>11.0</b>	<b>5.3</b>	<b>4.8</b>

Source: MOSL, Company

## Financials and Valuation

Income Statement		(INR Million)				
Y/E March	2H2016	2017	2018E	2019E	2020E	2021E
Interest Income	36,488	85,327	104,477	124,549	142,170	160,023
Interest Expense	28,015	65,154	81,508	94,730	105,204	116,962
<b>Net Interest Income</b>	<b>8,473</b>	<b>20,173</b>	<b>22,969</b>	<b>29,819</b>	<b>36,967</b>	<b>43,062</b>
Change (%)			13.9	29.8	24.0	16.5
<b>Non Interest Income</b>	<b>4,032</b>	<b>10,131</b>	<b>12,071</b>	<b>14,083</b>	<b>16,221</b>	<b>18,769</b>
Fee income	677	3,600	5,040	6,552	8,190	10,238
Change (%)			40.0	30.0	25.0	25.0
Other Income	3,355	6,531	7,031	7,531	8,031	8,531
<b>Net Income</b>	<b>12,505</b>	<b>30,304</b>	<b>35,040</b>	<b>43,903</b>	<b>53,188</b>	<b>61,830</b>
Change (%)		142.3	15.6	25.3	21.1	16.2
<b>Operating Expenses</b>	<b>5,106</b>	<b>12,770</b>	<b>16,703</b>	<b>19,902</b>	<b>24,135</b>	<b>28,833</b>
Change (%)		150.1	30.8	19.2	21.3	19.5
<b>Pre Provision Profits</b>	<b>7,399</b>	<b>17,535</b>	<b>18,338</b>	<b>24,001</b>	<b>29,053</b>	<b>32,997</b>
Change (%)			4.6	30.9	21.1	13.6
<b>Provisions (excl tax)</b>	<b>242</b>	<b>2,825</b>	<b>2,293</b>	<b>3,334</b>	<b>4,441</b>	<b>5,687</b>
Credit Cost (%)	0.0	0.4	0.3	0.3	0.4	0.4
<b>PBT</b>	<b>7,158</b>	<b>14,710</b>	<b>16,045</b>	<b>20,666</b>	<b>24,611</b>	<b>27,310</b>
Tax	2,489	4,512	4,813	6,200	7,383	8,193
Tax Rate (%)	34.8	30.7	30.0	30.0	30.0	30.0
<b>PAT</b>	<b>4,669</b>	<b>10,197</b>	<b>11,231</b>	<b>14,467</b>	<b>17,228</b>	<b>19,117</b>
Change (%)			10.1	28.8	19.1	11.0
Equity Dividend (Incl tax)	1,092	2,386	2,628	3,385	4,031	4,473

Balance Sheet		(INR Million)				
Y/E March	FY16	2017	2018E	2019E	2020E	2021E
Share Capital	33,926	33,990	33,990	33,990	33,990	33,990
Reserves & Surplus	102,399	112,790	121,394	132,475	145,672	160,315
<b>Net Worth</b>	<b>136,326</b>	<b>146,780</b>	<b>155,384</b>	<b>166,465</b>	<b>179,662</b>	<b>194,305</b>
<b>Deposits</b>	<b>82,190</b>	<b>402,082</b>	<b>652,632</b>	<b>840,831</b>	<b>1,025,501</b>	<b>1,215,574</b>
Change (%)		n.a.	62.3	28.8	22.0	18.5
CA	3,610	18,094	29,968	42,435	55,696	70,018
SA	800	2,368	7,296	19,712	37,248	58,406
<b>Borrowings</b>	<b>571,598</b>	<b>502,622</b>	<b>546,101</b>	<b>573,674</b>	<b>565,817</b>	<b>534,876</b>
Change (%)		-12.1	8.7	5.0	-1.4	-5.5
Infra Bonds	99,450	104,340	152,820	225,432	300,895	379,495
Other borrowings	472,148	398,282	393,281	348,242	264,922	155,381
<b>Other Liabilities &amp; Prov.</b>	<b>42,044</b>	<b>70,112</b>	<b>84,134</b>	<b>100,961</b>	<b>121,154</b>	<b>145,384</b>
<b>Total Liabilities</b>	<b>832,159</b>	<b>1,121,597</b>	<b>1,438,251</b>	<b>1,681,931</b>	<b>1,892,133</b>	<b>2,090,139</b>
Current Assets	29,039	51,020	63,870	76,989	87,086	86,577
<b>Investments</b>	<b>297,286</b>	<b>504,717</b>	<b>650,240</b>	<b>694,986</b>	<b>688,223</b>	<b>695,631</b>
Change (%)		69.8	28.8	6.9	-1.0	1.1
G Sec	110,570	192,640	260,064	306,876	337,563	354,441
RIDF and PTC	0	136,000	196,491	175,057	116,302	83,396
Other investments	186,716	176,077	193,685	213,053	234,358	257,794
<b>Loans</b>	<b>456,994</b>	<b>494,017</b>	<b>637,930</b>	<b>806,503</b>	<b>992,680</b>	<b>1,158,958</b>
Change (%)	n.a.	8.1	29.1	26.4	23.1	16.8
Other Assets	48,839	71,843	86,211	103,454	124,144	148,973
<b>Total Assets</b>	<b>832,159</b>	<b>1,121,597</b>	<b>1,438,251</b>	<b>1,681,931</b>	<b>1,892,133</b>	<b>2,090,139</b>

Asset quality						
GNPA (INR m)	30,583	35,891	41,063	45,609	52,618	61,948
NNPA (INR m)	11,390	12,562	14,372	15,963	18,416	21,682
GNPA Ratio	6.27	6.77	6.05	5.35	5.03	5.07
NNPA Ratio	2.49	2.54	2.25	1.98	1.86	1.87
PCR (Excl Tech. write off)	62.8	65.0	65.0	65.0	65.0	65.0
E: MOSL Estimates						

## Financials and Valuation

Ratios						
Y/E March	2H2016	2017	2018E	2019E	2020E	2021E
<b>Spreads Analysis (%)</b>						
Avg. Yield-Earning Assets		9.7	9.1	8.9	8.9	9.1
Avg. Yield on loans		10.7	10.3	10.0	10.0	10.0
Avg. Yield on Investments		8.2	7.8	7.5	7.3	7.3
Avg. Cost-Int. Bear. Liab.		8.4	7.8	7.3	7.0	7.0
Interest Spread		1.4	1.4	1.7	1.9	2.1
Net Interest Margin		2.3	2.0	2.1	2.3	2.4
<b>Profitability Ratios (%)</b>						
RoE		7.2	7.4	9.0	10.0	10.2
RoA		1.0	0.9	0.9	1.0	1.0
Int. Expense/Int. Income		76.4	78.0	76.1	74.0	73.1
Fee Income/Net Income		11.9	14.4	14.9	15.4	16.6
Non Int. Inc./Net Income		33.4	34.4	32.1	30.5	30.4
<b>Efficiency Ratios (%)</b>						
Cost/Income		42.1	47.7	45.3	45.4	46.6
Empl. Cost/Op. Exps.		44.9	41.7	40.7	39.3	38.8
Cost per Empl. (INR m)		1.8	1.6	1.6	1.7	1.7
of which for ex-Infra bus. INR M		93.9	94.6	89.9	89.9	94.4
NP per Empl. (INR Mn)		3.2	2.7	2.9	3.1	3.0
<b>Valuation</b>						
Book Value (INR)	40.2	43.2	45.7	49.0	52.9	57.2
Change (%)			5.9	7.1	7.9	8.2
Price-BV (x)	1.5	1.4	1.3	1.2	1.2	1.1
Adjusted BV (INR)	37.8	40.6	42.8	45.7	49.1	52.7
Change (%)			5.3	6.9	7.4	7.4
Price-ABV (x)	1.6	1.5	1.4	1.3	1.2	1.2
EPS (INR)	1.4	3.0	3.3	4.3	5.1	5.6
Change (%)			10.1	28.8	19.1	11.0
Price-Earnings (x)	44.3	20.3	18.5	14.3	12.0	10.8
Dividend Per Share (INR)		0.6	0.7	0.9	1.0	1.1
Dividend Yield (%)		1.0	1.1	1.4	1.7	1.8

E: MOSL Estimates



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