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Banking

Q2FY20 results review and earnings revision

Target price Rs1,818

Earnings revision

(%)	FY20E	FY21E
PAT	↓ 7	↓ 15

Target price revision

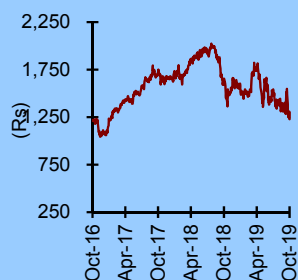
Rs1,818 from Rs2,530

Shareholding pattern

	Mar '19	Jun '19	Jul '19
Promoters	16.8	16.8	14.4
Institutional investors	63.3	62.3	64.9
MFs and UTI	8.3	9.5	11.2
FIs/Banks	0.3	0.2	0.3
Insurance Cos.	0.9	1.0	0.9
FII	53.8	51.5	52.5
Others	19.9	20.9	20.7

Source: CMIE

Price chart



INDIA

ICICI Securities

IndusInd Bank

BUY

Maintained

Q2FY20: A turnaround quarter, potentially

Rs1,229

IndusInd Bank (IIB) has reported 14% lower-than-estimated PAT, almost entirely due to accelerated provisions even as operating profits came in line. Loan growth slowed to 13% YoY dragged by the corporate book. Most profitability parameters came in strong with RoA coming in at a healthy 1.9%. With due emphasis being given to how the management plans to tackle the watchlist (which has declined) as well as the SMA1&2 assets, we believe the worst could be behind us even as the bank took a precautionary accelerated provisioning to increase coverage ratio to 50%. After cutting our earnings and target price, we believe the bank has a potential to trade at its 12-year average multiples since Mr Sobti took charge. We retain our BUY rating on the stock.

- **Q2 summary – slower growth but robust profitability:** While the non-retail book declined 10% (partly due to a reclassification of small business loans), retail growth remained healthy at 44%. Margins improved sequentially by 5bps as IIB stands to benefit from falling rates as almost half of its loan book is fixed rate lending even as deposit rates fall. CASA mix came off marginally – not out of line with industry trends – to 41%. Cost ratios continue to exhibit broad downward trends.
- **Asset quality:** Large gross slippages, mainly technical (non-timely submission of adequate disclosures by companies) were reversed during the quarter itself resulting in net slippages coming in lower, sequentially. Even their watchlist of their exposure to three stressed groups came off to 1.1% of loans vs 1.7% in the previous quarter due to repayments. Additionally, the bank's credit cost at ~75bps was supplemented with another 76bps of accelerated provisions to enable a more comfortable coverage ratio of 50%, even as the bank targets 60%.
- **Earnings outlook:** We cut our PAT estimates by 7%/15% for FY20E/21E, introduce FY22E estimates and look for 30% PAT CAGR from FY20-22E with RoA estimated at 2.2% over this period.
- **Valuations and target price:** IIB trades at 2.2x P/ABV and 12x P/E 1-year forward. The opportunity of expanding profitability and robust growth is factored into our DDM-based target price of Rs1,818, implying a 48% upside and meriting a **BUY** rating on the stock. We have adjusted our target multiple down to IIB's 12-year average of 2.6x representing the period presided over by the current CEO, Mr Sobti.

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Market Cap	Rs851bn/US\$12bn	Year to Mar	FY19	FY20E	FY21E	FY22E
Reuters/Bloomberg	INBK.BO / IIB IN	NII (Rs bn)	114	126	154	193
Shares Outstanding (mn)	692.9	Net Profit (Rs bn)	50	68	86	111
52-week Range (Rs)	1821/1229	EPS (Rs)	72.6	98.4	124.7	159.6
Free Float (%)	85.6	% Change YoY	18.9	35.5	26.8	28.0
FII (%)	52.5	P/E (x)	16.9	12.5	9.9	7.7
Daily Volume (US\$'000)	102,122	P/BV (x)	2.8	2.3	1.9	1.6
Absolute Return 3m (%)	(17.0)	P/ABV (x)	3.0	2.5	2.0	1.7
Absolute Return 12m (%)	(24.6)	GNPA (%)	2.1	2.8	2.3	2.1
Sensex Return 3m (%)	(1.4)	RoA (%)	1.9	2.2	2.3	2.3
Sensex Return 12m (%)	10.3	RoE (%)	17.5	20.3	21.4	22.5

Note: numbers represent the merged entity from FY18 onwards

Please refer to important disclosures at the end of this report

Table 1: Q2FY20 result review*(Rs mn, year ending March 31)*

Particulars	Q2FY20	Q2FY19	% Change YoY	Q1FY20	% Change QoQ
Net Interest Income	29,094	25,603	14	28,440	2
% Growth	14	187,686		1,237,397	
Fee income	14,680	14,090	4	14,220	3
Add: Other income	2,592	1,053	146	2,410	8
Total Net Income	46,365	40,746	14	45,070	3
% Growth	14	22		17	
Less: Operating Expenses	(20,131)	(17,511)	15	(19,163)	5
Pre-provision operating profit	26,234	23,235	13	25,907	1
NPA Provisions	(3,630)	(2,190)	66	(3,040)	19
Other provisions	(3,740)	(3,973)	(6)	(1,266)	195
PBT	18,864	17,072	10	21,601	(13)
Less: taxes	(4,848)	(5,539)	(12)	(7,278)	(33)
PAT	14,017	11,533	22	14,323	(2)
% Growth	22	15		22	
Balance sheet (Rs mn)					
Advances	1,971,126	1,740,583	13	1,935,200	2
Deposits	2,071,934	1,682,193	23	2,005,860	3
Asset quality					
Gross NPL	43,702	18,223	139.8	41,997	4.1
Net NPL	22,026	7,999	175.4	23,805	(7.5)
Gross NPL ratio (Change bps)	2.2	1.0	115	2.2	4
Net NPL ratio (Change bps)	1.1	0.5	66	1.2	(11)
Credit cost (Change bps)	0.7	0.5	22	0.6	
Coverage ratio (Change bps)	50	56	(651)	43	628
Business ratio					
RoA	1.9	1.9	6	2.0	(7)
RoE	17.1	18.3	(126)	19.5	(242)
CASA	41.4	43.6	(219)	43.1	(171)
Credit/Deposit ratio	96.2	104.1	(790)	97.4	(120)
Cost/Income ratio	43.4	43.0	44	42.5	90
Earning ratios					
Yield on advances	12.18	11.96	22	11.88	31
Cost of deposits	6.84	6.92	(8)	6.85	(1)
NIM	4.22	4.37	(15)	4.18	4

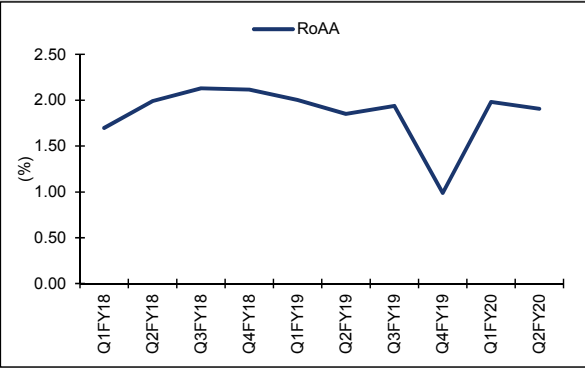
Source: Company data

Growth and profitability

(Note: All charts and outlook data represents IIB merged numbers)

The picture	The story	The outlook			
		FY19	FY20E	FY21E	FY22E
Growth					
Loan growth					
	<ul style="list-style-type: none"> Advances growth declined to 13% YoY and 2% on QoQ basis on merged basis with BHAFIN. 				
	Loan growth	25.7	12.7	24.8	25.6
Deposit growth, CASA mix					
	<ul style="list-style-type: none"> Deposits grew by 23% YoY / 3% QoQ. CASA mix declined by ~170bps QoQ to 41.4%. 				
	Deposit growth	28.5	18.3	27.0	27.0
	CASA ratio	43.1	41.0	41.0	41.0
Profitability					
Margins					
	<ul style="list-style-type: none"> Margins improved by 4bps QoQ to 422bps. As per management, full synergy of merger is yet to play out w.r.t. margins as all liabilities are yet to be repriced. The Bank has guided margin of 425bps for FY20. 				
	YoA	12.0	12.1	12.4	12.4
	CoD	6.1	6.2	6.3	6.3
	Margin	4.6	4.4	4.5	4.5

The picture	The story	The outlook			
		FY19	FY20E	FY21E	FY22E
Costs					
	<ul style="list-style-type: none"> Cost-Assets ratio increased by 9bps QoQ to 2.74%. 				
	<p>Cost/assets ratio</p> <p>Cost/income ratio</p>	2.8	2.6	2.5	2.3
		41.8	41.8	40.8	38.7
Credit cost, GNPA and coverage ratio					
	<p>GNPAs increased marginally by 4bps QoQ to 2.19%.</p> <p>Slippages were higher at Rs.11bn, however most of the slippages were technical in nature. Net Slippages were Rs.1.7bn. Stressed book declined to 1.1% from 1.7% in Q1FY20 on the back of cash repayments. The bank guided that this will further decline to 0.8% owing to upcoming cash payment in next quarter. During the quarter, the Bank had provided accelerated provisions of Rs.3.6bn.</p>				
	<p>Gross NPL ratio</p> <p>Credit cost</p> <p>Coverage ratio</p>	2.1	2.8	2.3	2.1
		1.5	1.5	0.7	0.7
		45.8	59.6	63.9	64.7
Break up of provisioning					

The picture	The story	The outlook			
		FY19	FY20E	FY21E	FY22E
RoA 	RoA	1.9	2.2	2.3	2.3

Source: Company data, I-Sec research

Valuations, stock performance and target price

We value the stock using a 3-period DDM model with the following key assumptions:

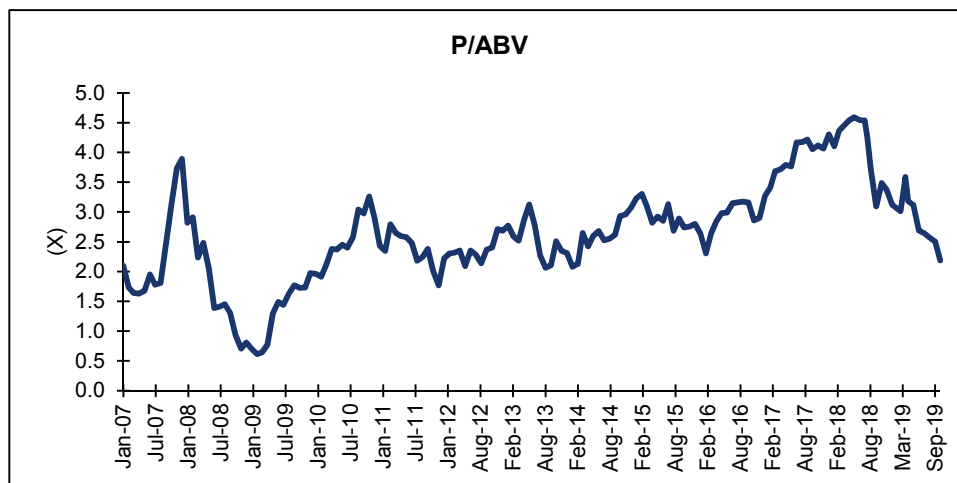
Sustainable RoE: 17.6% (cycle average)
 Cost of equity: 12.5%

Three growth periods for earnings:

- High growth FY20-FY25: 15% with dividend payout at 12%
- Stable growth FY26-FY30: 8% with dividend payout increasing to 40%
- Terminal growth: 4.5% with dividend payout at 40%

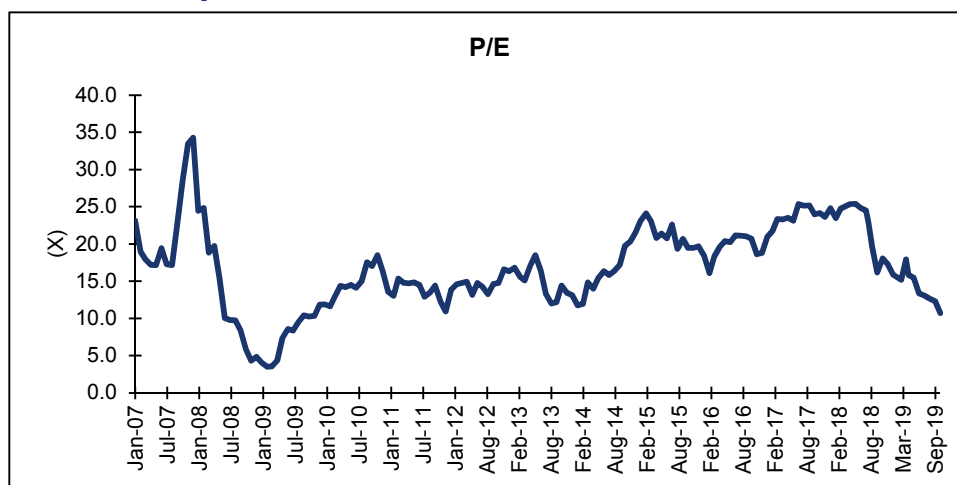
Finally, we make an adjustment to our thus derived fair value by adjusting it down to the 12-year average multiple that the stock has traded at during the period that the current CEO – Mr Sobti – has presided over. This implies a target P/B multiple of 2.6x and a target price of Rs1,818 representing an upside of 48%.

Chart 1: IIB: 1-year forward P/ABV



Source: Bloomberg, Company data, I-Sec research

Chart 2: IIB: 1-year forward P/E



Source: Bloomberg, Company data, I-Sec research

Financial summary

Table 2: Profit and Loss statement
(Rs mn, year ending Mar 31)

	FY16	FY17	FY17 (Merged)	FY18	FY19	FY20E	FY21E	FY22E
Net Interest Income	45,166	60,626	68,401	85,325	1,13,882	1,26,267	1,54,005	1,93,419
% Growth	32	34	51	25	33	11	22	26
Fee income	22,315	28,953	30,195	35,549	44,728	46,545	53,526	63,161
Add: Other income	10,655	12,762	14,800	15,522	15,831	23,861	25,967	28,772
Total Net Income	78,136	1,02,342	1,13,396	1,36,396	1,74,441	1,96,672	2,33,499	2,85,352
% Growth	31	31	45	20	28	13	19	22
Less: Operating Expenses	(36,721)	(47,831)	(53,363)	(62,924)	(72,843)	(82,145)	(95,279)	(1,10,460)
Pre-provision operating profit	41,415	54,511	60,033	73,471	1,01,598	1,14,526	1,38,220	1,74,893
NPA Provisions	(5,015)	(7,048)	(7,048)	(9,010)	(27,050)	(15,378)	(18,659)	(21,874)
Other provisions	(1,707)	(3,866)	(7,459)	(5,094)	(4,747)	(7,000)	(4,172)	(5,250)
PBT	34,693	43,598	45,526	59,367	69,801	92,148	1,15,389	1,47,769
Less: taxes	(11,828)	(14,918)	(13,949)	(18,764)	(19,929)	(23,987)	(28,993)	(37,143)
PAT	22,865	28,680	31,577	40,603	49,873	68,161	86,396	1,10,626
% Growth	27	25	38	28.6	22.8	36.7	26.8	28.0

Source: Company data, I-Sec research

Table 3: Balance sheet
(Rs mn, year ending Mar 31)

	FY16	FY17	FY17 (Merged)	FY18	FY19	FY20E	FY21E	FY22E
Capital	5,950	5,981	5,981	6,869	6,869	6,930	6,930	6,930
Reserve & Surplus	1,71,010	2,00,480	2,23,567	2,61,004	3,01,673	3,62,105	4,38,049	5,35,163
Deposits	9,30,003	12,65,722	12,65,722	15,16,392	19,48,679	23,06,063	29,28,700	37,19,448
Borrowings	2,21,559	2,24,537	2,57,860	4,69,061	5,20,991	5,10,321	6,35,401	8,41,546
Other liabilities	72,048	89,764	1,36,149	77,723	1,01,714	1,37,453	1,82,032	2,00,304
Total liabilities	14,00,570	17,86,484	18,89,280	23,31,049	28,79,927	33,22,871	41,91,111	53,03,391
Cash & Bank Balances	1,01,119	1,86,283	2,14,346	1,53,758	1,67,914	2,02,068	2,36,332	2,89,859
Investment	3,12,143	3,67,021	3,67,023	5,00,769	5,92,664	6,40,077	8,00,095	10,40,123
Advances	8,84,193	11,30,805	12,01,635	15,44,727	19,41,015	21,87,096	27,30,442	34,29,605
Fixed Assets	12,553	13,352	13,573	14,183	15,279	16,408	17,639	18,980
Other Assets	90,561	89,023	92,702	1,17,613	1,63,056	2,77,222	4,06,604	5,24,825
Total Assets	14,00,570	17,86,484	18,89,280	23,31,049	28,79,927	33,22,871	41,91,111	53,03,391
% Growth	25.3	27.6	34.9	23.4	23.5	15.4	26.1	26.5

Source: Company data, I-Sec research

Table 4: Dupont analysis
(%, year ending Mar 31)

	FY16	FY17	FY17 (Merged)	FY18	FY19	FY20E	FY21E	FY22E
Interest income	9.4	9.0	9.6	9.0	9.8	9.6	9.6	9.6
Interest expense	(5.8)	(5.2)	(5.5)	(5.0)	(5.5)	(5.6)	(5.5)	(5.5)
NII	3.6	3.8	4.2	4.0	4.4	4.1	4.1	4.1
Other income	0.8	0.8	0.9	0.7	0.6	0.8	0.7	0.6
Fee income	1.8	1.8	1.8	1.7	1.7	1.5	1.4	1.3
Total income	6.2	6.4	6.9	6.5	6.7	6.3	6.2	6.0
Operating expenses	(2.9)	(3.0)	(3.2)	(3.0)	(2.8)	(2.6)	(2.5)	(2.3)
Operating profit	3.3	3.4	3.6	3.5	3.9	3.7	3.7	3.7
NPA provision	(0.4)	(0.4)	(0.4)	(0.4)	(1.0)	(0.5)	(0.5)	(0.5)
Total provisions	(0.5)	(0.7)	(0.9)	(0.7)	(1.2)	(0.7)	(0.6)	(0.6)
PBT	2.4	2.3	2.3	2.4	1.6	2.5	2.6	2.7
Tax	(0.9)	(0.9)	(0.8)	(0.9)	(0.8)	(0.8)	(0.8)	(0.8)
PAT	1.8	1.8	1.9	1.9	1.9	2.2	2.3	2.3

Source: Company data, I-Sec research

Note: All numbers represent the merged entity from FY18 onwards

Table 5: Key ratios

(Year ending Mar 31)

	FY16	FY17	FY17 (Merged)	FY18	FY19	FY20E	FY21E	FY22E
EPS – Diluted (Rs)	38.4	47.9	52.8	61.1	72.6	98.4	124.7	159.6
% Growth	13.4	24.8	37.4	15.7	18.9	35.5	26.8	28.0
DPS (Rs)	4.5	6.0	6.0	7.5	7.5	11.8	15.0	19.2
Book Value per share (BVPS) (Rs)	291	339	377	398	445	528	638	778
% Growth	50.4	16.5	29.7	5.5	11.7	18.8	20.8	22.0
Adjusted BVPS (Rs)	285	331	367	387	412	492	604	742
% Growth	50.7	16.1	28.5	5.4	6.5	19.4	22.9	22.7
Valuations								
Price / Earnings (x)	32.0	25.6	23.3	20.1	16.9	12.5	9.9	7.7
Price / Book (x)	4.2	3.6	3.3	3.1	2.8	2.3	1.9	1.6
Price / Adjusted BV (x)	4.3	3.7	3.4	3.2	3.0	2.5	2.0	1.7
Asset Quality								
Gross NPA (Rs mn)	7,810	10,590	14,871	19,199	41,583	62,640	64,640	71,640
Gross NPA (%)	0.9	0.9	1.2	1.2	2.1	2.8	2.3	2.1
Net NPA (Rs mn)	3,236	4,408	6,261	7,537	22,533	25,313	23,313	25,313
Net NPA (%)	0.4	0.39	0.5	0.5	1.2	1.2	0.9	0.7
NPA Coverage ratio (%)	59	58	58	60.7	45.8	59.6	63.9	64.7
Gross Slippages (%)	1.3	1.6	1.6	2.0	3.5	3.1	1.3	1.3
Credit Cost (%)	0.63	0.70	0.67	0.65	1.5	0.7	0.7	0.7
Net NPL/Networth	1.8	2.1	2.7	2.8	7.3	6.9	5.2	4.7
Business ratios (%)								
ROAA	1.8	1.8	1.9	1.9	1.9	2.2	2.3	2.3
ROAE	16.6	15.3	15.8	16.6	17.5	20.3	21.4	22.5
Credit Growth	28.5	27.9	35.9	28.6	25.7	12.7	24.8	25.6
Deposits Growth	25.4	36.1	36.1	19.8	28.5	18.3	27.0	27.0
CASA	35.2	36.9	36.9	44.0	43.1	41.0	41.0	41.0
Credit / Deposit Ratio	95.1	89.3	94.9	101.9	99.6	94.8	93.2	92.2
Cost-Income ratio	47.0	46.7	47.1	46.1	41.8	41.8	40.8	38.7
Operating Cost / Avg. Assets	2.9	3.0	3.2	3.0	2.8	2.6	2.5	2.3
Fee Income / Total Income	1.8	1.8	1.8	1.7	1.7	1.5	1.4	1.3
Earning ratios								
Yield on Advances	11.8	11.4	12.2	11.1	12.0	12.1	12.4	12.4
Yield on Earning Assets	10.2	9.7	10.3	9.6	10.4	10.4	10.6	10.6
Cost of Deposits	6.8	6.3	6.3	5.8	6.1	6.2	6.3	6.3
Cost of Funds	7.0	6.3	6.7	6.0	6.4	6.5	6.4	6.4
NIM	3.9	4.1	4.4	4.29	4.6	4.4	4.5	4.5
Capital Adequacy (%)								
RWA (Rs)	11,62,875	14,35,288	14,28,355	18,59,290	23,41,297	29,39,323	37,32,861	48,78,523
Tier I	14.9	14.7	16.1	14.4	13.2	12.6	11.9	11.1
CAR	15.5	15.3	17.0	15.2	14.0	13.2	12.6	11.6

Source: Company data, I-Sec research

Note: All numbers represent the merged entity from FY18 onwards
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