May 14, 2018

Buy

Indusind Bank

Industry: BFSI

Stock Idea

In a sweet spot!!!

Indusind Bank finds itself in the sweet spot currently in the wake of CV cycle recovery & surge in market share in the corporate loans. We expect strong credit growth of 30% CAGR over FY18-20E, which shall be nearly >2x of industry growth. Also, sizeable synergies of merger will start accruing within next 2 yrs strengthening its rural franchise – which will be long term ROA/ROE accretive. More importantly, the bank has strengthened its balance sheet by acquiring core banking relationships with the large corporates & by adding better rated borrowers. Also, margin could potentially surprise positively given the rising interest rates & potential for SA rates to move down

Valuations - Return profile is likely to improve for better – we estimate ROE to improve to 18% in FY20E from 16% in FY18. We expect net profit to grow at strong CAGR of 26% over FY18-20E. Since, bank has strengthened its balance-sheet by adding better rated borrowers to its assets, we are comfortable according better valuation multiples to the bank. We assign a BUY rating on the stock with a target price of ₹2270, giving upside potential of 20% from the current levels

Strong visibility of asset growth - We expect CV cycle recovery to sustain for the next 2 yrs led by recovery in macros, ban on the overloading of CVs in the states like UP, Haryana, Rajasthan, good monsoon and introduction of BSVI emission norms beginning FY2020. Banks like Indusind & Yes Bank are lapping up this opportunistic demand to increase their market share in good quality rated corporate loans. Its share of AAA rated borrowers has improved considerably over the last 2 yrs from 30% to 36% of the total book. All these factors put together would result in credit to grow at strong rate of 30% CAGR over FY18-20E.

Upbeat on margin outlook - We are upbeat on the margin outlook of the bank – margins could surprise positively than management guidance of 3.95-4% for FY19 driven by - rising interest rates, change in the portfolio mix more in the favour of high yielding retail assets, higher corporate credit demand (which earlier had got shifted to bond market), opportunistic demand coming from better yielding refinancing options in NCLT cases, potential for SA rates moving down – all these factors would work in the favour of margins trajectory moving up.

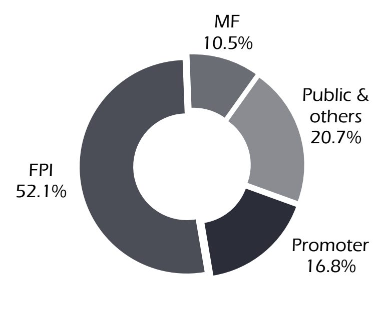
Merger would be best fit into the bank's product suite - Merger to give the bank direct access to 1 lac villages in 342 districts with a customer base of 7.3 mn. This low cost rural focused unique distribution model will leapfrog the rural strategy of the bank by multiple years. Other benefits could be better cross-sell opportunities, lower cost of funds & lesser requirement of capital boosting return profile of the bank. In our view, within 2 years itself sizeable benefits of synergies will start accruing & further strengthen the retail & rural inheritance of the bank. Branch network of merged entity would surge by >100% @2967 branches.

Sustained strength in the asset quality will continue - Asset quality profile of the bank has largely remained unscathed despite market-wide chaos of ballooning NPAs. RBI divergence report on asset classification done in Q4FY18 was minimal at 0.9% of advances (Rs13.5 bn). Also, barring one-offs, gross slippages for Q4FY18 were similar to last quarter levels. As per mgmt, its exposure to sensitive sector like power, real estate & gems & jewellry doesn't has much asset quality risks. On the whole, strong asset quality profile of the bank is likely to continue going forward as well – we estimate credit cost of 65 bps in FY19 vs, mgmt. guidance of 55-60 bps.

Stock Data

Current Market Price (₹)	1,898
1 year Target Price (₹)	2,270
Potential upside (%)	20
Full Market Cap (₹ bn)	1,139
52-Week Range (₹)	1,905 / 1,375
Face Value (₹)	10
Reuters	INBK.BO
Bloomberg	IIB:IN
BSE / NSE Code	532187 / INDUSINDBK

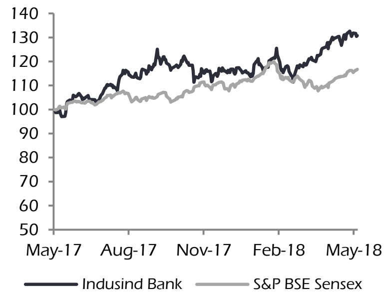
Shareholding Pattern



Financial Snapshot

YE Mar	FY16	FY17	FY18	FY19E	FY20E
PAT (₹.bn)	22.9	28.7	36.1	45.1	57.1
yoy (%)	27.5	25.4	25.7	24.9	26.8
BV (₹)	291.0	338.9	391.0	474.4	569.6
ABV (₹)	285.6	331.6	378.5	456.8	540.4
P/ABV (x)	3.2	4.3	4.7	4.2	3.5
ROE (%)	16.1	15.0	16.2	17.1	18.0
ROA (%)	1.8	1.8	1.8	1.8	1.8
Gr.NPA (%)	0.9	0.9	1.2	1.3	1.5
PCR (%)	58.6	58.4	56.3	58.5	52.3

Relative Price Performance



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Key Investment Arguments

Strong visibility of asset growth

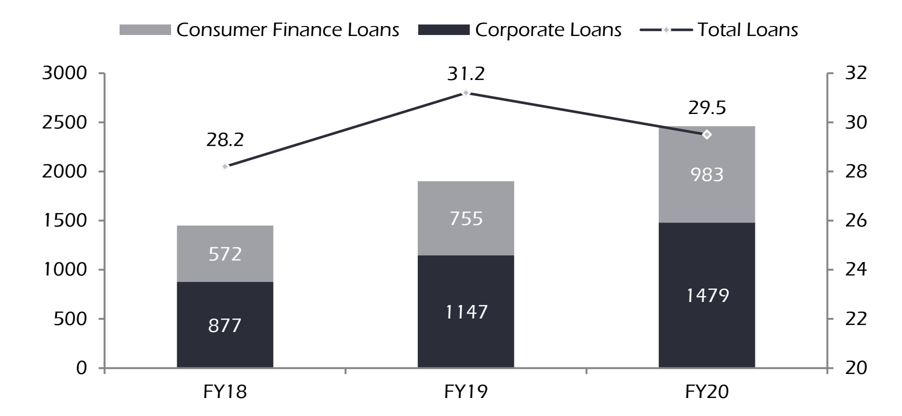
Large private sector banks like ICICI Bank & Axis Bank are facing untiring asset quality problems. While PSU banks are not growing as many are facing capital constraints or also because they have been placed under Prompt Corrective Action (PCA) plan. Banks with relatively cleaner balance sheet & strong capital position like Indusind & Yes Bank are sizeably increasing their market share in the good quality corporate loans. CV cycle recovery, good monsoon, better refinancing opportunities coming in NCLT cases, revival in corporate credit demand – all these factors put together would lead to strong credit demand. Management is aiming for 25-30% credit growth for FY19. While we estimate credit to grow by 30% CAGR over FY18-20E – there is strong possibility the bank to surpass our estimate as well.

Strong asset growth expected led by both corporate & consumer finance loans

(₹.bn)	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Total Loans	**551**	**688**	**884**	**1131**	**1450**	**1901**	**2462**
Corporate Loans	303	404	519	676	877	1147	1479
Consumer Finance Loans	248	284	365	455	572	755	983
Growth yoy (%)							
Total Loans	24.3	24.8	28.5	27.9	28.2	31.2	29.5
Corporate Loans	38.3	33.2	28.5	30.2	29.8	30.7	29.0
Consumer Finance Loans	10.6	14.6	28.6	24.6	25.7	31.8	30.3
% Share							
Corporate Loans	55.0	58.7	58.7	59.7	60.5	60.3	60.1
Consumer Finance Loans	45.0	41.3	41.3	40.3	39.5	39.7	39.9

Source: Company, LKP Research

Loans to grow at 30% CAGR over FY18-20E



Source: Company, LKP Research

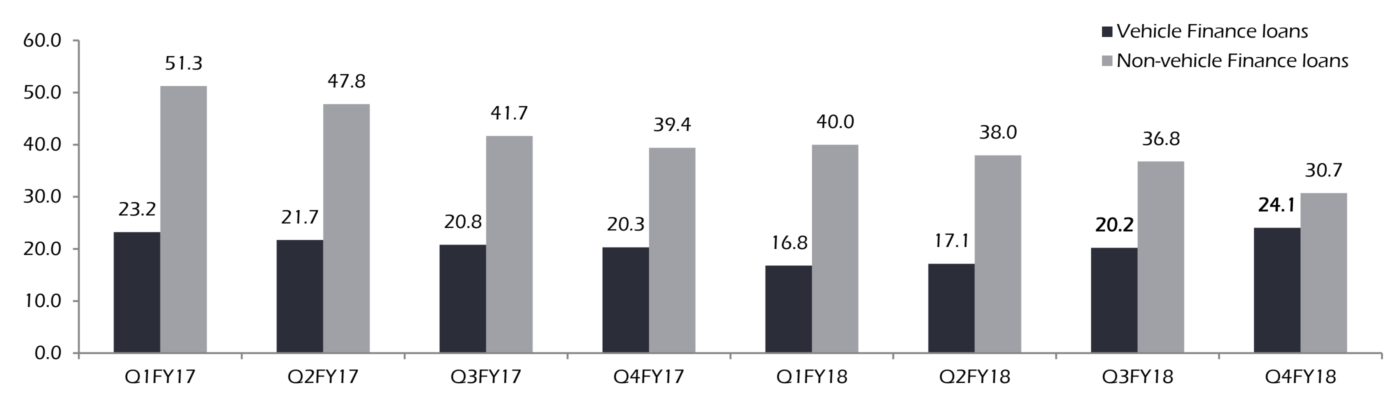
- **Recovery in CV cycle beneficial for the bank**

Last 2 quarters, bank has witnessed strong traction in CV loans (which form nearly 20% of total loan book including small CVs & equipment financing) led by improvement in economic activity, ban on the overloading of CVs in the states like UP, Haryana, Rajasthan. Also, with the waning effects of demonization & GST, demand for CVs has come back. Strong pickup in the CV cycle, which was last seen in FY11, is likely to sustain for atleast next 2-3 yrs. Among the CVs, healthy growth is witnessed in the LCVs as compared to HCVs & MHCVs, where Indusind Bank has strong foothold. Good monsoon that would further fuel rural demand, introduction of BSVI emission norms beginning FY2020, recovery in macros – all these factors put together would lead to sustained long term good demand in CVs beneficial for Indusind Bank in big way. CV portfolio of the bank, which is widely spread across all the states, consists largely of small road transporters (90-95% of CV book). It has swaying loyalty in this segment indicative from the fact that 70% of its customers are repeat customers. Additionally, it lends largely for new vehicles or where the vintage age of vehicle is relatively <3-4 yrs. It doesn't lends to large fleet operators (HDFC Bank, Kotak Bank are bigger players in this segment) or to HCV & MHCV where the demand currently is uneven and more opportunistic & less secular. Higher growth in the retail CV portfolio yield better margins and add more granularity to the book.

Vehicle finance portfolio is gaining traction

(₹.mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Total Consumer Finance Loans	**385,910**	**405,580**	**428,650**	**455,290**	**470,950**	**494,650**	**532,140**	**572,390**
Vehicle Finance loans	298,930	311,540	327,190	341,820	349,190	364,920	393,360	424,050
Non-vehicle Finance loans	86,980	94,040	101,460	113,470	121,760	129,730	138,780	148,340
Share (%)								
Vehicle Finance loans	77.5	76.8	76.3	75.1	74.1	73.8	73.9	74.1
Non-vehicle Finance loans	22.5	23.2	23.7	24.9	25.9	26.2	26.1	25.9
growth (% yoy)								
Vehicle Finance loans	23.2	21.7	20.8	20.3	16.8	17.1	20.2	24.1
Non-vehicle Finance loans	51.3	47.8	41.7	39.4	40	38	36.8	30.7

Growth is improving in vehicle finance loans



Source: Company, LKP Research

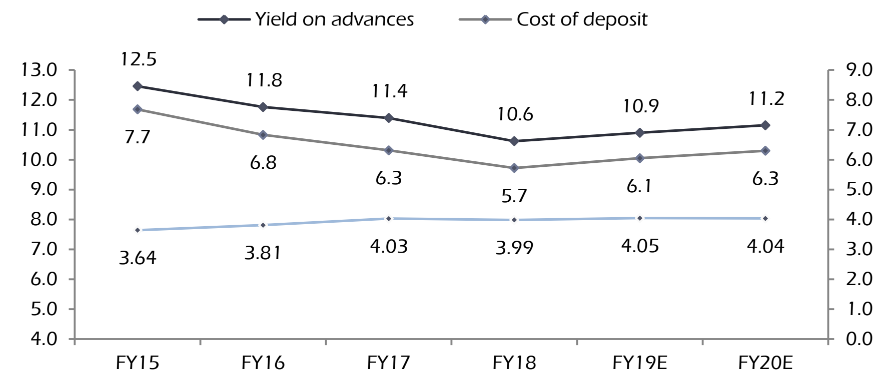
- **Gaining market share in good quality corporates**

Indusind Bank has reported accelerated credit growth, led by growth in large corporate lending in the last 2 quarters. The bank is lapping up the transient opportunity that has come in the market to grow good quality rated portfolio. Large private sector banks like ICICI Bank & Axis Bank are facing untiring asset quality problems. While PSU banks are not growing as many are facing capital issues or also because they have been placed under Prompt Corrective Action (PCA) plan. Banks with relatively cleaner balance sheet & strong capital position like Indusind & Yes Bank are sizeably increasing their market share in the good quality corporate loans. For indusind, share of AAA rated borrowers has improved considerably over the last 2 yrs from 30% to 36% of the total book. Also, the bank is leveraging on good refinancing opportunities coming from NCLT resolutions cases. It is acquiring core banking relationships with the large corporates. Also, it is doing lot more government business as govt. is now open for all the banks to give tenders which were earlier restricted to only PSU banks. In the near term, surge in high rated corporate book would dent the margins & profitability of the bank. However, in the longer run, such relationships would add to the fees, provide cross-sell opportunities of retail liabilities & third party products improving the return profile of the bank.

Upbeat on margin outlook

Margins have improved by 20 bps from 3.8% to 4% over the last 2 yrs driven by faster downward repricing of deposits than assets. The bank had utilized lower deposit cost to build better rated corporate asset book which have lesser quality concerns – implying quality of balance sheet has improved relatively. Management has guided to retain margins at 3.95-4% levels for FY19E while, in our view, it can improve further from these levels. Rising interest rates, change in the portfolio mix more in the favour of high yielding retail assets, higher corporate credit demand (which earlier had got shifted to bond market), opportunistic demand coming from better yielding refinancing options in NCLT cases, potential for SA rates moving down – all these factors would work in the favour of margins trajectory moving up.

Margin outlook is positive



Source: Company, LKP Research

Margin comparison of peer banks – cost of deposits of Yes & Indusind Bank has come down by 200 bps in the last 2 yrs – partially the benefit has flowed into margins while majorily its used to build high rated corporate portfolio

(%)	FY15	FY16	FY17	FY18
Indusind Bank	3.6	3.8	4.0	4.0
Yes Bank	3.2	3.4	3.4	3.5
HDFC Bank	4.4	4.3	4.3	4.3
ICICI Bank	3.5	3.5	3.3	3.2

Note: Indusind Bank margins are calculated, while for others are reported margins
Source: Company, LKP Research

All the banks have hiked their MCLR including Indusind Bank which would be margin positive for them. Down trending of interest rate cycle seems to be over – banks with higher proportion of floating based loans & lower share of term deposits will have better edge over others. Secondly, better yielding retail loans of the bank viz. vehicle finance book is seeing good traction. There is visibility of strong growth in vehicle finance loans over the next 2-3 years. Additionally, banks like Yes & Indusind are also lapping up opportunistic demand coming from refinancing of NCLT cases which are undoubtedly high yielding assets. The bank has strategically stayed away from assets that are not margin/ROA accretive viz. home loans. In home loan space, the bank offers HDFC home loans products for which it gets fee income (1-1.5%). So far, the bank has generated $1 bn worth of home loan assets for HDFC. The bank doesn't carry any balance sheet risk in these assets as they are low yielding & less ROA accretive.

MCLR rates have started rising after a gap of 2 yrs

(%)	Apr'16	Dec'16	Jun'17	Dec'17	Apr'18
Overnight	9.20	8.75	8.40	8.20	8.60
1 month	9.25	8.80	8.45	8.25	8.65
3 month	9.45	9.10	8.75	8.55	8.95
6 month	9.70	9.35	9.00	8.80	9.20
1 yr	10.00	9.45	9.10	8.85	9.25
2 yr	-	-	9.30	8.90	9.30
3 yr	-	-	-	8.95	9.35

Source: Company

On the liability side, cost of deposits of the bank has fallen by 200 bps over the last 4 yrs led by faster growth in the CASA deposits & retail term deposits. However, drop in the cost of deposits of Yes Bank & Indusind is much faster as compared to large private banks like ICICI & HDFC Bank. For e.g. differential in cost of deposits between Indusind & HDFC Bank which was 1.9% in FY15 has now come down to only 0.7% in FY18. Undoubtedly, this has led to increase in their competitiveness position to garner share of better rated corporate borrowers. Hence, without foregoing of margins, their quality of balance sheet has improved considerably. Share of AAA rated corporate borrowers has surged from 30% to 36% in the last 2 yrs. As per management, there is further room for deposit cost to come down led by drop in SA rates (asthe differential interest rate of SA between large banks & Indusind is still above 150 bps). In our view, there is systemic challenge for the banks to grow deposits – deposit growth is at multi year low at 6.7%. In such scenarios, bringing down the deposit rates looks very unlikely in the near term.

Cost of deposits for Yes & Indusind Bank has come down substantially

(%)	FY15	FY16	FY17	FY18	Diff in FY18 over FY15
Yes Bank	7.9	7.1	6.4	5.9	**-2.0**
Indusind Bank	7.7	6.8	6.3	5.7	**-2.0**
ICICI Bank	6.2	5.9	5.4	4.9	**-1.3**
HDFC Bank	5.7	5.9	5.3	5.1	**-0.7**
Difference btwn Indusind Bank & HDFC Bank	**1.9**	**1.0**	**1.0**	**0.7**	
Difference btwn Indusind Bank & ICICI Bank	**1.5**	**1.0**	**0.9**	**0.9**	

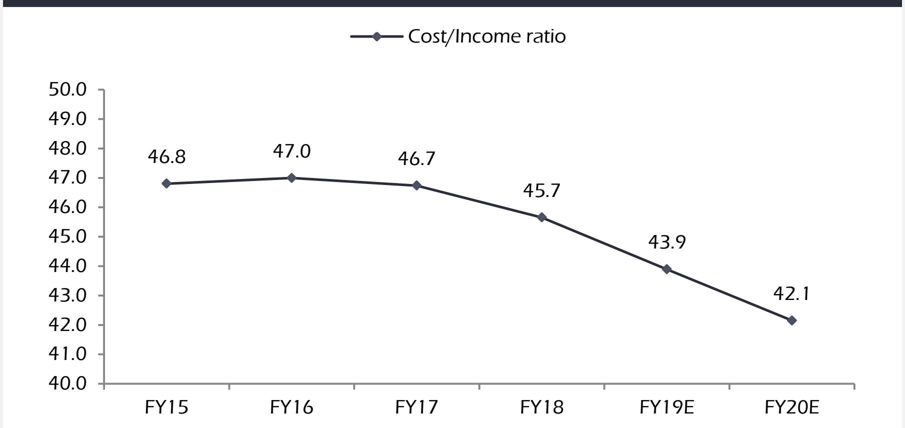
Source: Company, LKP Research

Note: Yes & Indusind Bank numbers are calculated, while for HDFC & ICICI Bank, numbers are reported ones

Productivity improvements likely on cards

Cost ratios of the bank have been slightly on the higher end at 46-47% for the last 3-4 yrs triggered by higher additions of the branches & employees & productivity gains which are yet to flow through in newer branches. However, as per the management, improvement in cost ratios is very much on the cards - it can came down by >200 bps over the next 2 yrs for the reasons like –a) the new branches are relatively smaller in size b) for newer branches, the bank has brought down the average number of employees per branch from 25 to 12 now. This has resulted in average employees per branch ratio coming down from 24 in FY14 to 18 in FY18 c) nearly 43% of branches of the bank have avg. age of <3 yrs which are yet to contribute meaningfully in terms of generating volumes of retail assets & liabilities. We can expect paybacks from these branches to start accruing over the next 1-2 yrs d) sizeable digital & technology investments would also bring down the costs in the long run. It nearly spends 5.5-6% of operating expenditure for digital initiatives.

We expect cost/income ratio to come down



Source: Company, LKP Research

Merger would be best fit into the bank's product suite.

In our view, within 2 years itself sizeable benefits of synergies will start accruing & further strengthen the retail & rural inheritance of the bank. Branch network of merged entity would surge by >100% @2967 branches, just behind HDFC Bank & ICICI Bank. There would be no other bank except for Bandhan Bank (be it private or PSU bank), having micro finance portfolio of size ₹185 bn which is equally highly profitable. Other banks have agri or farm related loan book which is more burdened with NPA and hence have lower return profile on this book. The bank would generate excess PSL which can be sold in the market, aiding its bottom-line.

Although, on immediate basis, merger is not likely to change the return profile of the bank much, but the long term synergies are many. And the benefits are -1) BFIL is one of the largest micro-finance company in India with gross disbursements at ~₹185 bn. Unlike other MFIs, it has pan-India presence with more of rural focus. Merger to give the bank direct access to 1 lac villages in 342 districts with a customer base of 7.3 mn. This low cost rural focused unique distribution model will leapfrog the rural strategy of the bank by multiple years. 2) huge cross-sell opportunities to offer both retail assets & liability products to BFIL customers viz. two-wheeler financing, home improvement loans, fixed usage loans, micro insurance, etc. As per management, on the liability side, there is potential to penetrate to more than 50% of the customer base of BFIL 3) BFIL will have the benefit of lower cost of funds as differential rate of borrowings cost between the two entities is currently ~3.5%. This shall be big positive for the NBFC to keep rates competitive and the same time remain profitable 3) there would be lesser requirement of capital at the bank level as compared to NBFC 4) opportunity to sell BFIL's loan (enjoying PSL status) in the market, which could generate additional fee income for the bank.

Post-merger, Bharat Financial Inclusion (BFIL) would work as wholly owned subsidiary (act as Business Correspondent) of the Indusind Bank. There will be continuity of all BFIL management & employees in the current assignments & there will not be any change in the board of Indusind Bank. Additionally, MFI advisory committee would be set up for the subsidiary. The scheme of arrangement of merger would be – BFIL assets & liabilities to merge into bank's assets & liabilities and former's operations would be part of subsidiary. The bank has got RBI & CCI approval in the Q4FY18, while approval of SEBI, stock exchanges, respective shareholders, creditors is pending which is most likely to come by Aug 2018 (appointed date of merger is 1st Jan 2018 while effective date is 1st October 2018)

How the broad numbers look like for the merged entity

₹.mn, FY18	BFIL	Indusind Bank	Combined Entity	Inc %
NII	10,350	74,975	85,325	13.8
Total Income	13,920	122,476	136,396	11.4
Operating Profit	6,900	66,561	73,461	10.4
PBT	4,550	54,807	59,357	8.3
PAT	4,540	36,060	40,600	12.6
Networth	29,990	238,416	268,406	12.6
CAR	33.2	16		
Total Assets	115,310	2,216,262	2,331,572	5.2
Disbursements	184,720	1,449,537	1,634,257	12.7
Branches	1,567	1,400	2,967	111.9
Employees	16,021	26,000	42,021	61.6
Efficiency & Profitability (calculated)				
Avg. ROA	4.1	1.8	1.9	
Avg. ROE	16.7	16.2	16.3	

Source: Company, LKP Research

Relative reach & size of private banks

₹.bn	Branches	Asset Size (FY18)
HDFC Bank	4,787	10,639
ICICI Bank	4,867	8,135
Kotak Bank	1,388	2,649
Yes Bank	1,100	3,124
Indusind Bank*	2,967	2,216

Source: Company, LKP Research

Sustained strength in the asset quality will continue

Asset quality profile of the bank has largely remained unscathed despite market-wide chaos of ballooning NPAs. Total slippages in Q4FY18 were higher at ₹8.6 bn vs. ₹4.1 bn qoq largely due to rise in corporate NPLs (₹5.4 bn vs. ₹1.4 bn qoq). There were many one-offs in the corporate NPLs viz. it included ₹1.86 bn of divergence amount, loans sold to ARC amounting to ₹1.2 bn, exposure to Gitanjali Gems recognized as NPA which was in 2 digits. Excluding these one-offs, gross corporate slippages were at ~₹1.48 bn similar to last quarter numbers. Going forward, bank expects credit cost to be 55-60 bps in FY19 similar to FY18 levels, however, we have estimated conservative number of 65 bps. On the whole, strong asset quality profile of the bank is likely to continue going forward as well. This also gets reflected from low levels of SMA 2 accounts which stand at just 13 bps currently. With respect to NCLT cases, the bank's exposure amounts to ₹3.85 bn to 40 accounts, where it has made provisioning to the tune of 65% and no further provisioning will be required on the same.

RBI divergence report on asset classification done in Q4FY18 was minimal at 0.9% of advances (₹13.5 bn). The net impact of divergence that flowed into NPLs was just ₹1.86 bn. Bank's exposure (in 2 digits) to Gitanjali Gems was recgonised as NPAs in Q4FY18, while, the provisioning on the same will be spread over the next 4 quarters as per RBI norms. Bank's exposure to some of the sensitive sectors like power, real estate, gems & jewellry doesn't have much asset quality risks. Power sector exposure at 4.1% of total book includes lending to all AAA PSUs rated borrowers & to non-thermal based projects i.e. conventional & solar energy projects. Real estate exposure at 2.8% of total book includes loans given to builders who are into development of both residential & commercial projects spread across geographies, where the mgmt. doesn't perceives any material risk. Gems & jewellry sector (6% of total book), where it has deep & domain expertise in lending, has seen better pricing & relatively lower delinquency levels. In this segment, it lends to selected few reputed names in the market.

Exposure to sensitive sectors

(%)	Q4FY18	Q3FY18	Q2FY18	Q1FY18
Real Estate	2.8	3.0	3.9	2.2
Power Generation	4.1	3.4	2.0	2.6
Gems & Jewellry	5.2	5.4	5.8	5.7

Source: Company, LKP Research

Divergence details

	₹.mn	(Share %)
Divergence in NPAs	**13502.0**	**100.0**
of which,		
Large standard cement M&A "bridge loan" provided for as per IRAC norms in March 2017 and fully paid repaid in June 2017	5185.2	38.4
Loans fully repaid	2578	19.1
Loans classified as NPA prior to divergence report and already included in GNPA	2360	17.5
Loans sold to ARC	1188	8.8
Accounts under divergence upgraded to Standard	0	0.0
Loans written off	331.8	2.5
Loans to a toll road project classified as NPA by the bank, currently being considered by consortium banks as "Standard"	1042	7.7
Balance of divergence recognized as GNPA as of 31 March 2018	817	6.1
Total impact on GNPA	**1859**	**13.8**

Source: Company, LKP Research

Quarterly trends of asset quality profile

(₹.mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Opening Balance	7,770	8,610	8,990	9,710	10,550	12,720	13,460	14,990
Add: Slippages	2,530	2,610	2,810	6,340	6,080	4,980	4,080	8,600
Less: Reductions	1,690	2,230	2,090	5,500	3,910	4,240	2,550	6,540
Cl. Gross NPAs (₹)	8,610	8,990	9,710	10,550	12,720	13,460	14,990	17,050
Net NPAs (₹)	3,560	3,690	4,010	4,390	5,080	5,370	5,920	7,460
Provisions (₹)	5,050	5,300	5,700	6,160	7,640	8,090	9,070	9,590
Gross NPAs (%)	0.9	0.9	0.9	0.9	1.1	1.1	0.0	1.2
Net NPAs (%)	0.38	0.37	0.39	0.39	0.44	0.44	0.46	0.51
PCR (%)	58.7	58.9	58.8	58.4	60.0	60.1	60.5	56.3

Source: Company, LKP Research

Yearly asset quality trends

(₹.mn)	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Opening Balance	4,578	6,208	5,629	7,768	10,549	17,049	25,448
Add: Slippages	6,242	8,873	8,487	14,293	23,740	31,890	43,725
Less: Reductions	4,612	9,452	6,348	11,512	17,240	23,490	32,511
Cl. Gross NPAs (₹)	6,208	5,629	7,768	10,549	17,049	25,448	36,662
Net NPAs (₹)	1,841	2,105	3,218	4,389	7,460	10,573	17,498
Provisions (₹)	4,367	3,524	4,551	6,160	9,590	14,875	19,164
Gross NPAs (%)	1.1	0.8	0.9	0.9	1.2	1.3	1.5
Net NPAs (%)	0.3	0.3	0.4	0.4	0.5	0.6	0.7
PCR (%)	70.4	62.6	58.6	58.4	56.3	58.5	52.3

Source: Company, LKP Research

Bank considering inorganic growth opportunities in adjacent financial service space

Large banks offer complete gamut of financial services from savings to investments including life and non-life insurance, mutual funds, broking services. Opportunity size in non-banking financial service space is massive & since the markets are under-penetrated growth rates are humongous. While Yes Bank is growing organically in asset management, broking businesses, Indusind Bank has aiming to grow via inorganic route. Mgmt has indicated it is scouting for opportunities in non-life & life insurance, mutual fund & securities businesses. In our view, this is long term positive for the bank as it would only make the company one stop shop for all financial service needs

Valuations

Indusind Bank finds itself in the sweet spot currently in the wake of CV cycle recovery & surge in market share in the corporate loans. We expect strong credit growth of 30% CAGR over FY18-20E, which shall be nearly >2x of industry growth. Also, sizeable synergies of merger will start accruing within next 2 yrs strengthening its rural franchise – which will be long term ROA/ROE accretive. More importantly, the bank has strengthened its balance sheet by acquiring core banking relationships with the large corporates & by adding better rated borrowers. Also, margin could potentially surprise positively given the rising interest rates & potential for SA rates to move down

Return profile is likely to improve for better – we estimate ROE to improve to 18% in FY20E from 16% in FY18. We expect net profit to grow at strong CAGR of 26% over FY18-20E. Since, bank has strengthened its balance-sheet by adding better rated borrowers to its assets, we are comfortable according better valuation multiples to the bank. We assign a BUY rating on the stock with a target price of ₹2270, giving upside potential of 20% from the current levels (giving target multiple of 4.2x on FY20E ABV). Currently, it is trading at 4.2x FY19E and 3.5x FY20E ABV.

ROA Tree

E) Breakdown of ROA (%)	FY16	FY17	FY18	FY19E	FY20E
Interest Income	9.4	9.0	8.6	9.0	9.3
Interest expenses	5.8	5.2	4.9	5.2	5.5
NII/avg assets	3.6	3.8	3.7	3.8	3.8
Non-NII/avg. assets	2.6	2.6	2.4	2.1	1.9
Total Income	6.2	6.4	6.1	5.9	5.7
Operating exp/avg. assets	2.9	3.0	2.8	2.6	2.4
Operating profit/avg assets	3.3	3.4	3.3	3.3	3.3
Provisions/avg. assets	0.5	0.7	0.6	0.6	0.6
PBT/avg. assets	2.8	2.7	2.7	2.7	2.7
Tax/avg. assets	0.9	0.9	0.9	0.9	0.9
PAT/avg. assets	1.8	1.8	1.8	1.8	1.8
Leverage	8.3	8.8	9.4	10.1	10.6

Source: Company, LKP Research

Profit & Loss Statement

(₹. Mn)	FY16	FY17	FY18	FY19E	FY20E
INTEREST EARNED	**118,717**	**144,057**	**172,808**	**229,922**	**301,369**
Interest/Discount on advances/Bills	92,446	114,791	136,999	182,610	243,231
Income from Investment	20,670	24,669	30,744	43,297	52,572
Interest on Balances with RBI & Others	4,132	3,308	3,215	2,115	3,566
Others	1,470	1,288	1,850	1,900	2,000
INTEREST EXPENDED	**73,552**	**83,431**	**97,833**	**133,419**	**178,255**
Net Interest Income (NII)	**45,166**	**60,626**	**74,975**	**96,503**	**123,114**
OTHER INCOME	32,969	41,715	47,501	53,795	61,924
TOTAL INCOME	**78,135**	**102,341**	**122,476**	**150,298**	**185,038**
Employee Expenses	12,361	15,210	17,807	21,058	25,072
Other operating expenses	24,360	32,621	38,108	44,909	52,919
Total Opex	**36,721**	**47,831**	**55,914**	**65,967**	**77,992**
OPERATING PROFIT	**41,414**	**54,510**	**66,561**	**84,331**	**107,046**
PROVISIONS	6,722	10,913	11,754	15,856	20,207
Provision for Non-Performing Assets	5,015	7,048	9,010	12,357	16,002
Profit Before Tax (PBT)	**34,693**	**43,597**	**54,807**	**68,475**	**86,839**
Tax Provisions	11,828	14,918	18,747	23,418	29,699
PAT	**22,864**	**28,679**	**36,060**	**45,057**	**57,140**
(% change)	27	25	26	25	27
EPS	38	48	60	75	95
Total Paid-Up Capital	5,950	5,981	6,002	6,002	6,002

Balance Sheet

(₹.mn)	FY16	FY17	FY18	FY19E	FY20E
Application of funds					
Cash & bank balances	45,210	77,487	109,624	133,466	156,862
Bal. with banks and money at call & short notice	55,908	108,795	22,535	62,078	80,571
Advances	884,193	1,130,805	1,449,537	1,901,100	2,461,784
Investments	340,543	367,021	500,767	601,349	720,158
Fixed Assets	12,553	13,352	13,388	23,978	28,991
Other Assets	90,561	89,023	120,412	154,247	185,405
TOTAL ASSETS	**1,428,970**	**1,786,484**	**2,216,262**	**2,876,218**	**3,633,771**
Sources of funds					
Total Paid-Up Capital	5,950	5,981	6,002	6,002	6,002
ESoPs	138	152	146	146	146
Reserves & Surplus	170,872	200,328	232,269	282,330	339,470
Deposits	930,003	1,265,722	1,516,392	1,980,312	2,564,358
Borrowings	249,959	224,537	382,891	508,832	605,381
Other Liabilities & Provisions	72,048	89,764	78,563	98,596	118,414
TOTAL LIABILITIES	**1,428,970**	**1,786,484**	**2,216,262**	**2,876,218**	**3,633,771**

Ratios

(A) Efficiency Ratios (%)	FY16	FY17	FY18	FY19E	FY20E
Int. exp/Int. earned	62.0	57.9	56.6	58.0	59.1
NII / Total Income	57.8	59.2	61.2	64.2	66.5
Other income / Total Income	42.2	40.8	38.8	35.8	33.5
Fee income / Other income	67.7	69.4	71.5	76.8	79.2
Fee income / Total Income	28.6	28.3	27.7	27.5	26.5
Cost / Income	47.0	46.7	45.7	43.9	42.1
Cost/Income (exluding trading gains)	47.9	48.0	47.9	44.9	42.8
C-D ratio	95.1	89.3	95.6	96.0	96.0
I-D ratio	36.6	29.0	33.0	30.4	28.1
Loan / Assets ratio	61.9	63.3	65.4	66.1	67.7
Deposits / Assets ratio	65.1	70.8	68.4	68.9	70.6
CASA / Total Deposits	35.2	36.9	44.0	43.9	43.1

B) Spreads (%)	FY16	FY17	FY18	FY19E	FY20E
Yield on Assets	10.0	9.6	9.2	9.6	9.9
Yield on Advances	11.8	11.4	10.6	10.9	11.2
Yield on Investments	7.0	7.0	7.1	7.9	8.0
Cost of Funds	6.9	6.2	5.8	6.1	6.3
Cost of Deposits	6.8	6.3	5.7	6.1	6.3
Cost of Earning Assets	6.2	5.5	5.2	5.6	5.8
Net Interest Spread	3.1	3.3	3.4	3.6	3.6
Net Interest Margin	3.81	4.03	3.99	4.05	4.04

C) Solvency	FY16	FY17	FY18	FY19E	FY20E
Gross NPAs (₹)	7,768	10,549	17,049	25,448	36,662
Net NPAs (₹	3,218	4,389	7,460	10,573	17,498
Provisions (₹ mn)	4,551	6,160	9,590	14,875	19,164
Gross NPAs / Gross Advances (%)	0.9	0.9	1.2	1.3	1.5
Net NPAs / Net Advances (%)	0.4	0.4	0.5	0.6	0.7
Provision Coverage Ratio (%)	58.6	58.4	56.3	58.5	52.3
Delinquency rate(%)	1.2	1.6	2.1	2.2	2.3
Credit Cost (%)	0.57	0.62	0.62	0.65	0.65
Credit Cost (%) (NPA Prov + SA / Gross Advances)	0.69	0.93	0.81	0.83	0.82

D) Measures of Investment	FY16	FY17	FY18	FY19E	FY20E
EPS (₹)	38.4	47.9	60.1	75.1	95.2
BV (₹) (adjusted for revaluation reserve)	291.0	338.9	391.0	474.4	569.6
Adjusted BV (₹) (adjusted for revaluation reserve)	285.6	331.6	378.5	456.8	540.4
DPS (₹)	4.0	6.0	7.5	8.5	9.5
Avg. ROE (%)	16.1	15.0	16.2	17.1	18.0
Avg. ROA (%)	1.8	1.78	1.80	1.77	1.76
Pre-tax ROA (%)	2.8	2.7	2.7	2.7	2.7
Pre-provisioning operating ROA (%)	3.3	3.4	3.3	3.3	3.3
Pre-provisioning operating ROE (%)	29.2	28.4	29.9	32.0	33.8
P/E (x)	24.1	29.4	29.9	25.0	19.7
P/BV (x)	3.2	4.2	4.6	4.0	3.3
P/ABV (x)	3.3	4.3	4.7	4.2	3.5
Dividend yield (x)	0.4	0.4	0.4	0.5	0.5
Dividend Payout ratio (%)	10.4	12.5	12.5	11.3	10.0
Effective tax rate (%)	34.1	34.2	34.2	34.2	34.2

E) Breakdown of ROA (%)	FY16	FY17	FY18	FY19E	FY20E
Interest Income	9.4	9.0	8.6	9.0	9.3
Interest expenses	5.8	5.2	4.9	5.2	5.5
NII/avg assets	3.6	3.8	3.7	3.8	3.8
Non-NII/avg. assets	2.6	2.6	2.4	2.1	1.9
Total Income	6.2	6.4	6.1	5.9	5.7
Operating exp/avg. assets	2.9	3.0	2.8	2.6	2.4
Operating profit/avg assets	3.3	3.4	3.3	3.3	3.3
Provisions/avg. assets	0.5	0.7	0.6	0.6	0.6
PBT/avg. assets	2.8	2.7	2.7	2.7	2.7
Tax/avg. assets	0.9	0.9	0.9	0.9	0.9
PAT/avg. assets	1.8	1.8	1.8	1.8	1.8
Leverage	8.3	8.8	9.4	10.1	10.6

F) Growth Rates (%)	FY16	FY17	FY18	FY19E	FY20E
Interest Income	22.5	21.3	20.0	33.1	31.1
Interest Expenses	17.3	13.4	17.3	36.4	33.6
NII	32.1	34.2	23.7	28.7	27.6
Other Income	37.2	26.5	13.9	13.2	15.1
Total Income	34.2	31.0	19.7	22.7	23.1
Operating Income	33.7	31.6	22.1	26.7	26.9
Net Profit	27.5	25.4	25.7	24.9	26.8
Deposits	25.4	36.1	19.8	30.6	29.5
Advances	28.5	27.9	28.2	31.2	29.5

H) Other performance parameters	FY16	FY17	FY18	FY19e	FY20e
No. of branches (No.)	1,000	1,200	1,400	1,650	1,900
No. of employees (No.)	23,060	25,314	26,000	27,750	29,500
Business per branch (₹)	1,814	1,997	2,119	2,352	2,645
Profit per branch (₹)	22.9	23.9	25.8	27.3	30.1
Business per employee (₹)	78.7	94.7	114.1	139.9	170.4
Profit per employee (₹)	1.0	1.1	1.4	1.6	1.9

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