IDBI BANK

IDBI Bank Ltd-

Scrip Code: **500116 ;** Holding: **1 Month Plus**
Buy Price Rec: **102.00**
Price target: **Rs115/???/???/???**

Rec Date: 15/06/2009

Company background

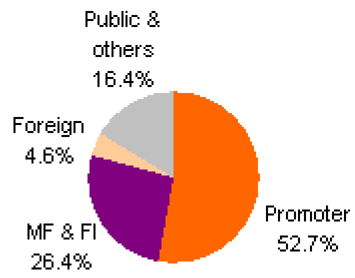
IDBI Bank is one of leading public sector banks of India. It was set up as the private banking arm of erstwhile Industrial Development Bank of India (IDBI) in 1994. IDBI itself was established in 1964, by an act of the Parliament, as a wholly owned subsidiary of the Reserve Bank of India to catalyse the development of a diversified and efficient industrial structure in the country based on national priorities. IDBI played a significant role in the industrial and economic development of the country for over 40 years as a development financial institution (DFI). In 2005, IDBI transformed itself into a full-service commercial bank after merging its commercial banking arm, IDBI Bank, into itself. More recently, the amalgamation of United Western Bank (UWB) with IDBI Bank gave the latter the much needed branch network to enhance its retail presence.

Company details

Market cap: Rs7,679 cr
52-week high/low: Rs113/40
NSE volume: 31.6 lakh (No of shares)

BSE code: 500116
NSE code: IDBI
Free float: 34.3 cr(No of shares)

Shareholding pattern



Key points

Operating performance to get a boost: IDBI Bank, which had been operating on a wafer thin net interest margin (NIM) of around 1% in the past, is expected to see some improvement on the margin front, as ~69% of its deposits are likely to get re-priced at lower rates in the current fiscal. The bank is also substituting its high-cost borrowings with deposits in order to contain its cost of funds. Not only that, it has also stepped up efforts to increase the share of its high-yielding retail loans. Thus, the bank's operating performance is expected to improve in FY2010 even in the face of challenges like low CASA and weak margins.

More impetus from capital infusion: At 11.6% IDBI Bank's capital adequacy ratio is above the regulatory requirement but lower than the preferred level of 12%. Since the bank evidently has little room to grow its balance sheet without raising capital, the government proposes to infuse capital into it. A capital infusion will be a major catalyst for the bank as it would facilitate the bank's efforts to achieve higher growth and profitability, and thus lead to the re-rating of the stock.

Investments, the hidden wealth: What's more, the bank's huge portfolio of quoted and unquoted investments could be another major source of funds when needed. The bank could unlock value from these investments and boost its profitability. Some of the companies in which IDBI Bank holds a significant stake include NSE, LIC, IDFC, IFCI, NSDL, CARE, ARCIL and SIDBI. These major investments collectively contribute about Rs42 to our SOTP valuation of the bank.

Attractive valuations: IDBI Bank is expected to improve its core business gradually as its NIM expands from 1.06% in FY2009 to 1.3% in FY2010 on a conservative basis. We expect the bank's RoE (excluding revaluation reserves) to increase from 12.1% in FY2009 to 13.8% in FY2010 and to 14.3% in FY2011. At the current market price of Rs106, the stock is trading at 5.8x its FY2011E EPS, 0.8x its FY2011E BV and 1.0x its FY2011E ABV. We have valued IDBI Bank using the SOTP valuation method as per which its core business of banking is valued at Rs118 per share (at 1.1x its FY2011E ABV). Considering this along with the value of the bank's investment portfolio and subsidiaries we arrive at a price target of Rs169 over a period of 12-18 months. This implies an upside of ~60% from the current levels. We initiate coverage on IDBI Bank with a Buy recommendation.

Key financials

Key financials

Particulars	FY2007	FY2008	FY2009	FY2010E	FY2011E
Net profit (Rs cr)	630.3	729.5	859.0	1121.4	1330.9
Shares in issue (cr)	72.4	72.5	72.5	72.5	72.5
EPS (Rs)	8.7	10.1	11.9	15.5	18.4
EPS growth (%)	12.3	15.7	17.8	30.5	18.7
PE (x)	12.2	10.5	8.9	6.9	5.8
P/PPP (x)	8.5	5.8	5.6	3.8	2.8
Book value (Rs/share)	86.1	93.8	102.7	121.1	136.3
P/BV (x)	1.2	1.1	1.0	0.9	0.8
Adj. book value (Rs/share)	76.1	78.9	89.6	100.4	104.2
P/ABV (x)	1.4	1.3	1.2	1.1	1.0
RoNW (%)	10.0	11.2	12.1	13.8	14.3

Investment arguments

Core business to turn around

IDBI Bank has over the years successfully transformed itself from a DFI into a full-service commercial bank. During this period, the bank has undergone radical changes at various operational and financial levels to suit the different business segments it caters to. We believe the consolidation of IDBI Bank with IDBI and the recent merger of UWB with IDBI Bank have positioned the bank favourably in the commercial banking space. Thanks to these efforts, IDBI Bank now has the platform required to achieve the next phase of growth and is well poised to capitalise on the emerging opportunities in the banking and financial services space.

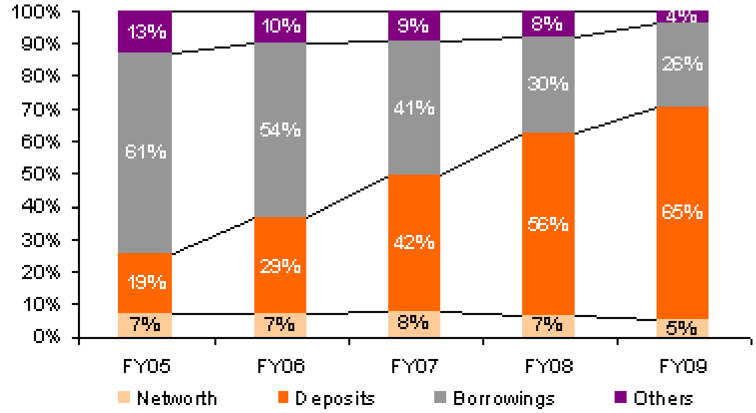
Capital raising crucial for turnaround

It is believed that IDBI Bank has approached the government for an infusion of Rs8,000 crore to recapitalise itself and fund its growth in the next two to three years. However, considering that the government is facing challenges on the fiscal front and has plans to recapitalise many other banks as well, the proposal may not be accepted fully. On the other hand, even if the government is ready to infuse 50% of the amount sought, the same would translate into Rs4,000 crore. Moreover, if the bank leverages this capital by six times (an acceptable level for the industry), it would be able to raise Rs28,000 crore (Rs4,000 capital + Rs24,000 debt). Clearly, fund mobilisation of such a magnitude would provide enough gunpowder to the bank to fund the growth of its loan book, expand its retail franchisee and reduce its reliance on wholesale deposits.

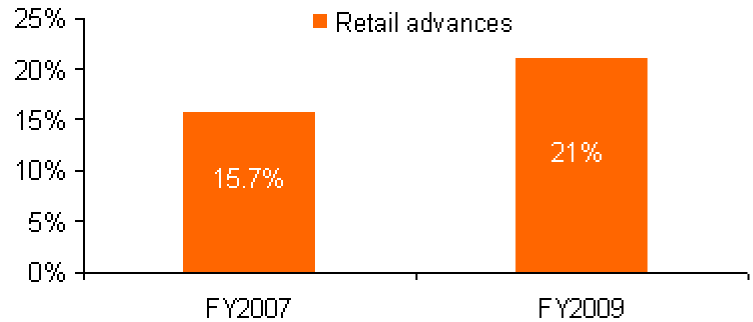
A potential fillip to NIM

IDBI Bank's efforts towards altering its resource mix and re-balancing its loan book would receive a major support from this capital raising exercise. On the resource mix front, the bank is running down its old high-cost borrowings and boosting its deposit mobilisation. This move is expected to reduce its cost of funds significantly. Further, the efforts to re-balance its loan book by increasing the share of its retail loans assumes great significance in the sense that it would improve the bank's yield on overall assets since retail loans typically carry better yields. As evident in the chart below, the share of the bank's retail advances has gone up from 15.7% in FY2007 to 21% in FY2009. We believe that the confluence of these efforts would provide a fillip to the bank's NIM.

Share of deposits as % of resources



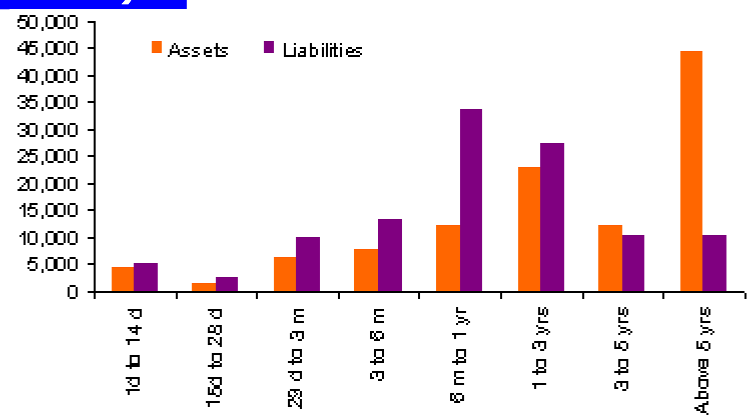
Share of retail loans on the rise



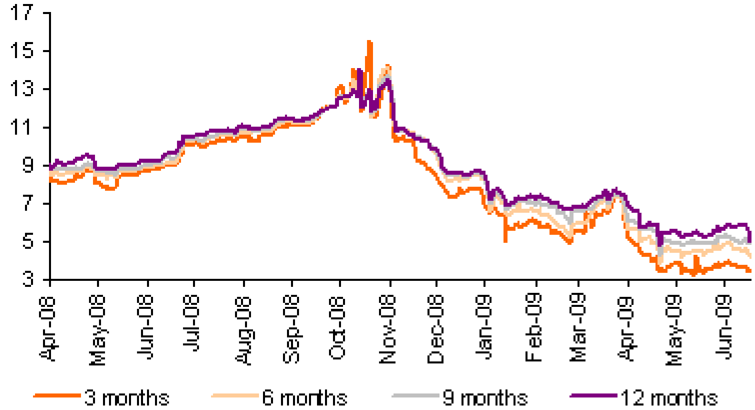
Re-pricing of high-cost deposits to lower cost of funds

In recent months, the domestic yield curve has steepened substantially as a result of the sharp cuts in the short-term rates and ample liquidity infusion by the government. Consequently, the wholesale deposit costs have come down substantially. IDBI Bank has benefited significantly from this development as about 57% of its liabilities came up for re-pricing during FY2009. With the cost of the wholesale deposits well off its peak, the bank was able to register a significant improvement in its NIM (refer chart below) in the last fiscal. In FY2010 too the bank is expecting 69% of its deposits to get re-priced at lower rates, which, in turn, would aid the bank's efforts to improve its margins.

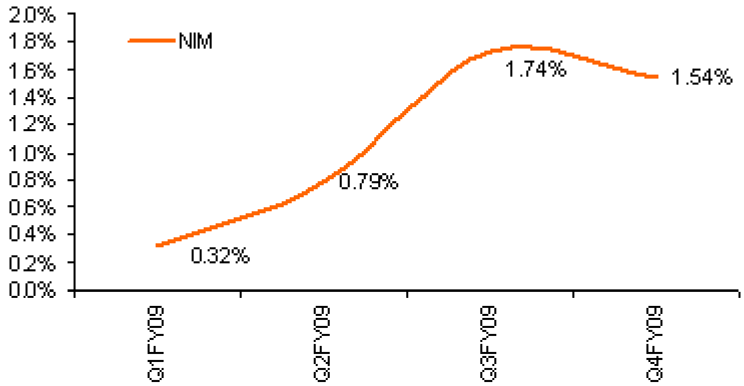
Maturity profile (FY2008)



Trend in wholesale deposit rates



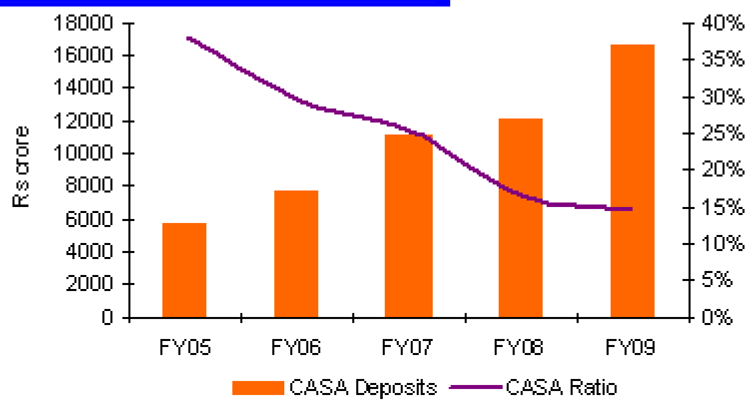
Trend in NIM



CASA balance growing but ratio weaker vs peers

The low cost deposits as a percentage of the bank's overall deposits is lesser than that of the other government owned banks, mainly due to the different focus of the entity in its role as a DFI. The peers (the other public sector banks [PSBs]) have a current account and savings account (CASA) ratio in the range of 25-40% while IDBI Bank's CASA ratio is much lower at ~15%. However, it is important to note that in absolute terms the bank's CASA balance has been on the rise in recent years, especially after IDBI's transformation into a commercial bank. This implies that the declining CASA ratio of the bank is the result of a faster growth in its term deposits compared with its CASA deposits due to the shift in its resource profile away from borrowings.

Trend in CASA balance and CASA ratio



Investments, a hidden jewel box

IDBI, in its DFI avatar, had played a significant role in fathering/promoting many institutions (viz National Stock Exchange [NSE], Life Insurance Corporation [LIC], National Securities Depositories Ltd [NSDL], Small Industries Development Bank of India [SIDBI], Industrial Financial Corporation of India [IFCI] and Infrastructure Development Finance Corporation [IDFC]). Many of these institutions have grown into national giants. Hence, the value of IDBI's investments have increased in tandem with the stature of these institutions. In fact, the total cost of these investments is pegged at around Rs600 crore, which has gone up to ~Rs3,000 crore. Clearly, IDBI Bank can utilise this huge investment portfolio of quoted and unquoted equity stocks for raising much needed capital. Collectively, these major investments contribute about Rs42 to our sum-of-the-parts (SOTP) valuation of the bank.

Value unlocking from subsidiaries too

Besides the strategic investments, IDBI Bank has four wholly owned subsidiaries: IDBI Capital Market Services (ICMS), IDBI Home Finance, IDBI Gilts and IDBI Intech. The bank is planning to sell its stake in IDBI Home Finance. In fact, the deal was almost struck earlier in CY2009 but it failed to take off due to adverse market conditions. However, with the macro picture improving in recent times, the idea of the stake sale may gather steam again in the days ahead. Collectively, these subsidiaries (except IDBI Intech) contribute around Rs9 to our SOTP valuation.

Risks and concerns

Economic downturn to increase NPAs

Any disappointment on the economic recovery front may lead to a surge in the bank's non-performing assets (NPAs) as the bank has exposure to most industrial sectors and hence needs to make higher provisions. This, in turn, could affect the bank's future profitability.

High restructuring of loans

During FY2009, IDBI Bank restructured loans worth Rs3,131 crore and currently has applications for restructuring of loans worth over Rs5,500. These together constitute over 8% of the bank's total outstanding advances. The rate is significantly higher compared with that of the other PSBs who have restructured loans to the tune of ~1.5-4.5% of their total loans. Though we have factored in higher delinquencies in our estimates for FY2010 and FY2011, a higher than expected increase in the bank's delinquencies would pose a downside risk to our estimates.

Investment portfolio gains linked to market volatility

IDBI Bank's quoted and unquoted equity investments are exposed to the vagaries of the capital market. Hence, any adverse movement in the capital markets may affect the expected valuation and earnings from the investment portfolio.

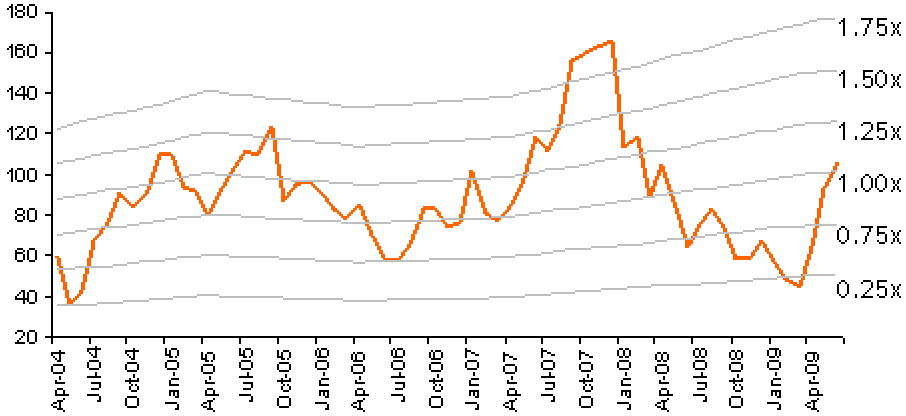
Hardening of interest rates

Due to the government's huge borrowing programme to fund the ballooning fiscal deficit of the country and a possible surge in inflation during H2FY2010 interest rates may harden again. Such an event would have a significant impact on the bank's profitability as the bank relies heavily on wholesale deposits of shorter maturities.

Valuation—numerous re-rating triggers ahead

IDBI Bank is expected to improve its core business gradually as its NIM expands from 1.06% in FY2009 to 1.3% in FY2010 on a conservative basis. We expect the bank's return on equity (RoE; excluding revaluation reserves) to increase from 12.1% in FY2009 to 13.8% in FY2010 and to 14.3% in FY2011. At the current market price of Rs106, the stock is trading at 5.8x its FY2011E earnings per share (EPS), 0.8x its FY2011E book value (BV) and 1.0x its FY2011E adjusted book value (ABV). We have valued IDBI Bank using the SOTP valuation method as per which its core business of banking is valued at Rs118 per share (at 1.1x its FY2011E ABV). This along with the value of the bank's investment portfolio and subsidiaries implies a price target of Rs169 to be achieved over a period of 12-18 months. That amounts to an upside of 60% from the current levels. We initiate coverage on IDBI Bank with a Buy recommendation.

One-year forward P/ABV



Financials

Profit & Loss account Rs (cr)

Particulars	FY2007	FY2008	FY2009	FY2010E	FY2011E
Net interest income	**657.9**	**656.4**	**1,326.0**	**2,493.2**	**3,641.1**
Other income	1,027.2	1,635.5	1,390.0	1,518.1	1,669.9
Net total income	1,685.1	2,291.9	2,716.0	4,011.3	5,311.0
Operating expenses	778.5	958.8	1,338.0	1,965.5	2,549.3
Pre-provisioning profit (PPP)	**906.6**	**1,333.1**	**1,378.0**	**2,045.7**	**2,761.7**
Provision & Contingency	224.0	510.4	392.0	644.0	860.5
Profit before tax	682.6	822.7	986.0	1,401.7	1,901.2
Tax	52.3	93.3	127.0	280.3	570.4
Profit after tax	**630.3**	**729.5**	**859.0**	**1,121.4**	**1,330.9**

Balance sheet Rs (cr)

Particulars	FY2007	FY2008	FY2009	FY2010E	FY2011E
Liabilities					
Equity capital	724.4	724.8	724.8	724.8	724.8
Reserves total	7,575.1	8,095.5	8,697.0	9,548.7	10,621.7
Net worth	**8,299.5**	**8,820.3**	**9,421.8**	**10,273.5**	**11,346.4**
Deposits	43,354.0	72,998.0	112,401.0	157,361.4	212,437.9
Borrowings	42,404.4	38,612.6	44,417.0	32,777.1	17,680.6
Other liabilities & Provisions	9,781.0	10,261.9	6,162.0	6,470.1	6,793.6
Total liabilities	**103,839.3**	**130,694.4**	**172,401.8**	**206,882.1**	**248,258.5**
Assets					
Cash & balances with RBI	5,406.5	6,694.8	8,591.0	19,465.9	18,995.4
Balances with banks & Money at call	1,504.6	2,063.9	2,629.0	5,644.7	5,697.2
Investments	25,675.3	32,802.9	50,048.0	51,147.0	67,630.9
Advances	62,470.8	82,212.7	103,428.0	122,045.0	146,454.0
Fixed assets	2,778.4	2,766.0	2,824.0	2,965.2	3,024.5
Other assets	6,003.7	4,154.0	4,882.0	5,614.3	6,456.4
Total assets	**103,839.3**	**130,694.4**	**172,401.8**	**206,882.1**	**248,258.5**

Key ratios

Particulars	FY2007	FY2008	FY2009	FY2010E	FY2011E
Net interest margins (%)	0.7	0.6	0.9	1.3	1.6
% GNPA	2.0	1.9	1.4	1.9	2.6
% NNPA	1.2	1.3	0.9	1.2	1.6
RoE (%)	10.0	11.2	12.1	13.8	14.3
EPS (Rs)	8.7	10.1	11.9	15.5	18.4
P/E (x)	12.2	10.5	8.9	6.9	5.8
Book value (Rs)	86.1	93.8	102.7	121.1	136.3
P/BV (x)	1.2	1.1	1.0	0.9	0.8
Adj. book value (Rs)	76.1	78.9	89.6	100.4	104.2
P/ABV (x)	1.4	1.3	1.2	1.1	1.0

The author doesn't hold any investment in any of the companies mentioned in the article.

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