Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

IDBI Bank Ltd.

EQUITY REPORT

May 23, 2014

BSE Code:	500116	NSE Code:	IDBI	Reuters Code:	IDBI.NS	Bloomberg Code:	IDBI:IN

IDBI Bank Ltd (IDBI), one of the country's largest commercial banks, offers personalized banking and financial solutions to its clients in the retail and corporate banking arena through its network of branches. Headquartered in Mumbai, the bank has operations in three segments, namely, wholesale banking, retail banking and treasury services. The bank, besides its core banking and project finance domain, has a presence in associated financial sector businesses like capital market, investment banking and mutual fund business. The lender also provides infrastructure financing for structuring and financing of infrastructure projects in the areas of power, telecom, roads, airports, seaports, railways and logistics, as well as special economic zones (SEZs).

Investor's Rationale

Loan book to grow by ~15% in FY15E - The bank's balance sheet continued to grow at a moderate pace during FY14. Its loan book grew by 4.4% YoY, while deposits witnessed a growth of 4% YoY. Going forward, the bank has guided moderate loan book growth of ~15%, with primary focus on increasing the share of priority sector lending (PSL) in the overall loan book by acquiring and expanding its priority sector business, which includes the MSME and Agri business, to broaden its asset portfolio.

Asset quality risk continues but at manageable level - Despite rising NPAs in a challenging economic environment, IDBI Bank's overall asset quality remain at a manageable level, with gross NPAs ratio and net NPAs declining on QoQ basis to 4.9% and 2.48% as on 31 March 2014 as against 5.44% and 2.93% respectively as on 31 December 2013. We believe that the bank's decent recovery of ₹14 billion would help the bank to stay away from significant asset quality risk that is faced by the rest of the banking space. Further, with higher recoveries and upgrades, the bank guided of improving asset quality in FY15E.

NIM to remain stable in FY15E - We believe that the bank's near term and long term margin outlook will remain stable on expectation that substantial CASA expansion and improving asset mix would be the structural levers, benign wholesale rates and planned capital raising would be cyclical factors driving NIM improvement.

Aims to keep its capital ratio sustained above regulatory requirements - At the end of FY14, the bank's capital adequacy ratio (CAR) stood at 11.68% as per Basel III. Tier I capital of IDBI Bank as on 31 March 2014 stood at 7.78%, below the RBI's stipulated level of 8%. On capital raising plans, IDBI Bank will raise additional tier-I capital aggregating about ₹20 billion from the overseas markets to shore up its common equity tier-I capital to over 8%. With this capital infusion, IDBI Bank is now in a position to grow its business above the industry average.

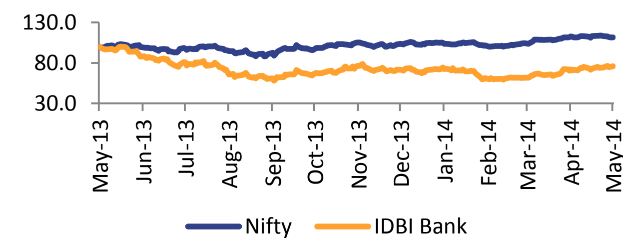
Market Data

Rating	BUY
CMP (₹)	95
Target (₹)	110
Potential Upside	~16%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	96.8/52.3
Adj. all time High (₹)	195.7
Decline from 52WH (%)	1.9
Rise from 52WL (%)	81.6
Beta	1.3
Mkt. Cap (₹bn)	152.4
BV/share per share (₹)	147.4

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
NII (₹bn)	53.7	60.2	68.5	82.6
Net Profit (₹bn)	18.8	11.2	12.8	16.0
ShareCap (₹bn)	13.3	16.0	16.0	16.0
EPS (₹)	14.1	7.0	8.0	10.0
PE (x)	6.7	13.6	11.9	9.5
P/BV (x)	0.6	0.6	0.6	0.5
C/I Ratio (%)	36.5	36.9	36.9	36.3
RoA (%)	0.6	0.3	0.4	0.4
RoE (%)	9.3	5.0	5.2	5.9

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	76.5	76.5	-
FII	2.9	2.8	0.1
DII	11.2	11.3	(0.1)
Others	9.4	9.4	-

IDBI Bank Ltd – one of the country's largest commercial banks

IDBI Bank offers personalized banking and financial solutions to its clients in the retail and corporate banking arena through its large network of branches and ATMs.

The bank's total business (deposits and advances) as of March 31, 2014 stood at ₹4,334.6 billion as against ₹4,234.2 billion as of March 31, 2013, registering a growth of 2%.

With an aim to provide credit and other facilities for the development of the fledgling Indian industry, IDBI Bank was established in 1964 by an Act of Parliament. For over 40 years, IDBI Bank has essayed a key nation-building role, first as the apex Development Financial Institution (DFI) (July 1, 1964 to September 30, 2004) in the realm of industry and thereafter as a full-service commercial Bank (October 1, 2004 onwards).

The bank offers an array of wholesale and retail banking products, apart from providing long-term finance for industrial development. The bank offers personalized banking and financial solutions to its clients in the retail and corporate banking arena through its large network of branches and ATMs, spread across the length and breadth of India. The bank has also set up an overseas branch at Dubai and has plans to open representative offices in various other parts of the Globe, for encashing emerging global opportunities. Its experience of financial markets will help it to effectively cope with challenges and capitalize on the emerging opportunities.

IDBI Bank is the youngest, new generation, public sector universal bank that rides on a cutting edge core banking information technology platform. This enables the bank to offer personalized banking and financial solutions to its clients. The bank's total business (deposits and advances) as of March 31, 2014 stood at ₹4,334.6 billion as against ₹4,234.2 billion as of March 31, 2013, registering a growth of 2%. While, the bank's aggregate assets as of March 31, 2014, stood at ₹3,290.0 billion as against ₹3,227.7 billion as of March 31, 2013.

Key milestones of IDBI Bank

1964-76

- Set up by an Act of Parliament in 1964 as a subsidiary of the Central Bank (RBI).
- Ownership transferred to Govt. in 1976.
- IDBI had been a policy bank in the area of industrial financing and development.

1994-00

- IDBI Act amended to permit private ownership up to 49%.
- Domestic IPO in 1995 reduces Govt. stake to 72%.
- Post capital restructuring in 2000, Govt. stake reduced to 58.5%.

2003-06

- IDBI Repeal Act passed in December 2003 for conversion to a banking company.
- Govt. ownership to be not below 51%.
- Amalgamation of IDBI Bank Ltd. with IDBI Ltd. w.e.f. April 2, 2005.
- Oct. 2006 amalgamated erstwhile UWB.

2007-14

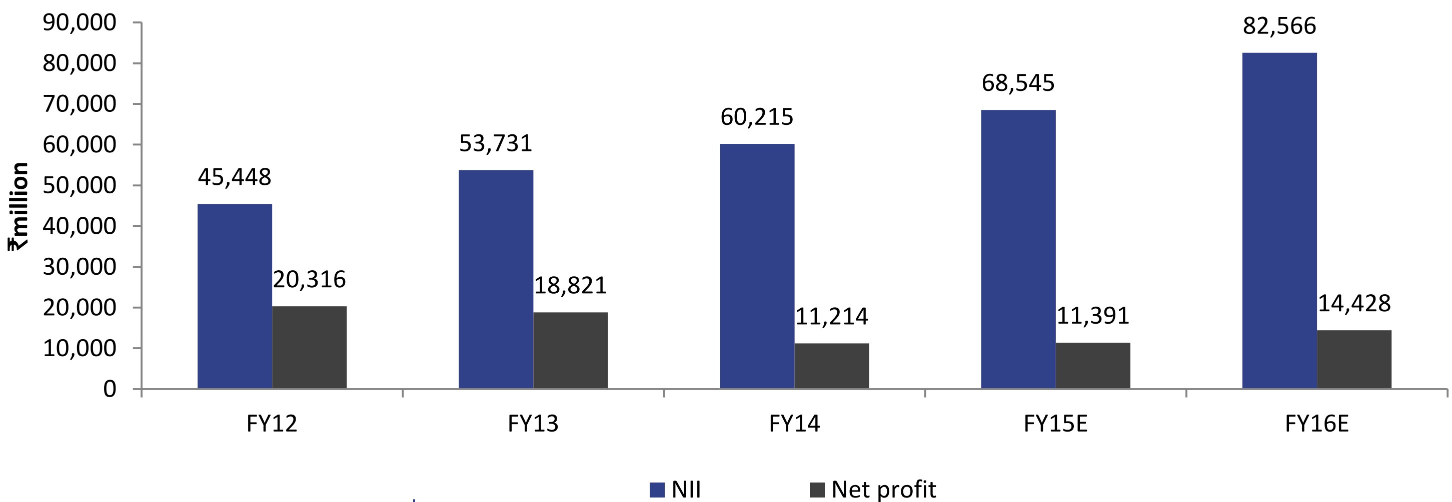
- Complete Networking (100% Core Banking).
- Name changed to IDBI Bank Ltd.
- Achieved regulatory norms of SLR, CME.
- Merged erstwhile subsidiaries IHFL & IGL with the Bank.
- Govt. stake increased from 52.67% to 65.14% by equity infusion.
- Govt. stake increased from 65.14% to 70.52% (equity infusion & conversion of Tier I bonds into equity).

During FY14, higher provisioning coupled with subdued loan growth resulted in steep decline in net profit.

Performance remained subdued in FY14

The lender witnessed a sharp decline in its net profit by 40.4% YoY to ₹11.2 billion in FY14 from ₹18.8 billion in the corresponding period a year ago mainly led by increased provisioning for non-performing loans and investments. The bank's overall provision for FY14 rose to ₹45.60 billion from ₹35.8 billion. Weak loan growth weighed on net interest income. The growth in non-interest income remained flat. Net interest income (NII) of the bank grew by 12% YoY to ₹60.2 billion on the back of subdued loan growth, while net interest margin (NIM) improved to 2.2% in Q4FY14 from 2.19% in Q4FY13.

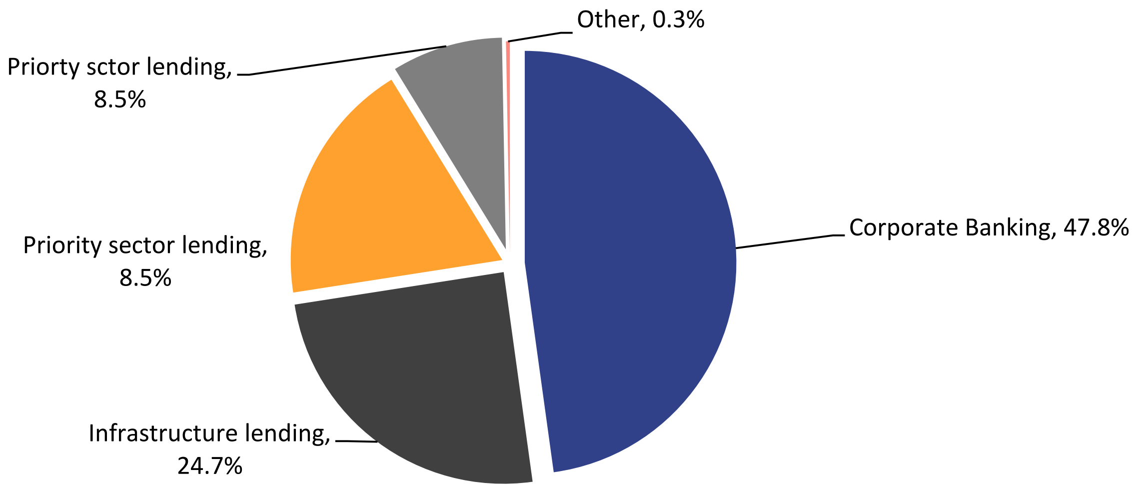
Optimistic for a better performance in FY15E-FY16E



During Q4FY'14, both advances as well as deposits grew merely by 1% and 4%, respectively, significantly below the industry average of 13-14%.

The slowing economy has also made it difficult for IDBI Bank to grow loans as advances grew by 1% to ₹1,976.86 billion at the end of March quarter, the slowest pace in four years, and deposit growth was weak at 4% to ₹2,357.7 billion. Both advances and deposit growth are significantly below the industry average of 13-14%. The bank has been cautious in lending to infrastructure firms and large corporations. The share of low cost deposits - Current Account and Savings Account (CASA) stood at 22.63% at the end of March 2014, against 25.12% in the year-ago period.

Loan book mix in FY14



We believe that without a branch expansion network, it is very difficult for the bank to get CASA and meet priority-sector lending.

IDBI Bank holds a ₹50 billion portfolio of stress assets stabilisation fund, which is a zero-coupon bond (the fund was created to hold the stressed and non-performing assets of the erstwhile IDBI). Secondly, the bank failed to meet priority-sector lending of 40% mandated by the RBI that made it to deposit ₹20 billion in RIDF (Rural Infrastructure Development Fund), which fetches 4% or so. Third, the bank's CASA (current and savings account) ratio is very less, now 22% on an average. These three factors resulted in lower returns and, thus, the bank's earnings capacity is limited to that extent. Therefore, we believe that without a branch expansion network, it is very difficult for the bank to get CASA and meet priority-sector lending.

The per-branch CASA is highest in IDBI, but the constraints of limited branches put a serious drag on the bank's profitability.

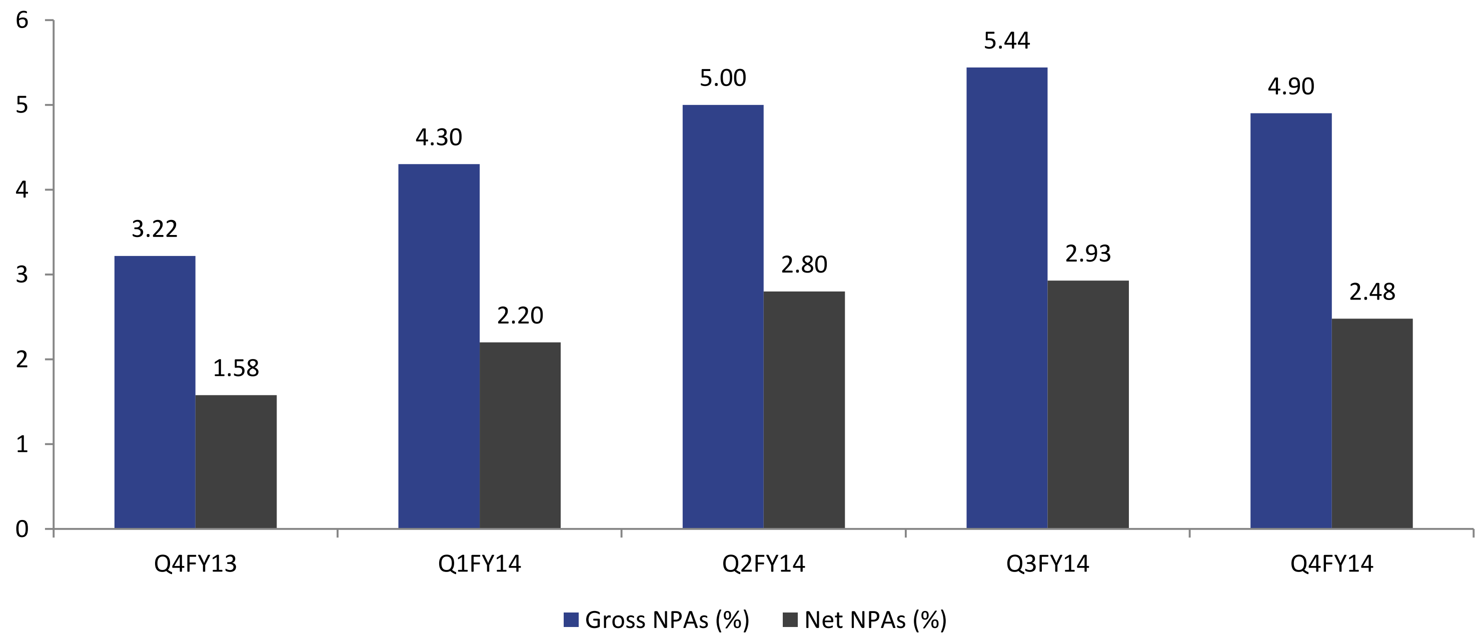
Eyes an improvement in asset quality in FY15

With a recovery of ₹14.0 billion of bad loans, the bank managed to exhibit improved performance on the asset quality front, with gross NPAs ratio and net NPAs declining to 4.9% and 2.48% as on 31 March 2014 as against 5.44% and 2.93% respectively as on 31 December 2013.

Grappling with asset quality issues, IDBI Bank witnessed some respite with gross non-performing assets (NPAs) as they declined to ₹99,601.6 million as on 31 March 2014 from ₹100,124.4 million as on 31 December 2013. With a recovery of ₹14.0 billion of bad loans, the bank managed to exhibit improved performance on the asset quality front, with gross NPAs ratio and net NPAs declining to 4.9% and 2.48% as on 31 March 2014 as against 5.44% and 2.93% respectively as on 31 December 2013. Restructured book came down for the first time in past three years due to higher upgrades. Q4FY14 saw a fresh restructuring of around ₹13.0 billion. Total slippages in FY14 stood at ₹19.0 billion in Q4FY14.

However, on a YoY basis, asset quality indicators of IDBI bank have weakened with Gross NPA and Net NPA increasing from 3.22% and 1.58% in FY13 on the back of challenging operating conditions. We believe that the bad-assets stress is showing signs of cooling off but heavy restructuring continues to remain the norm. But, with some respite in asset quality woes, the bank is confident of improving asset quality in FY15E.

Witnessing stability on asset quality font



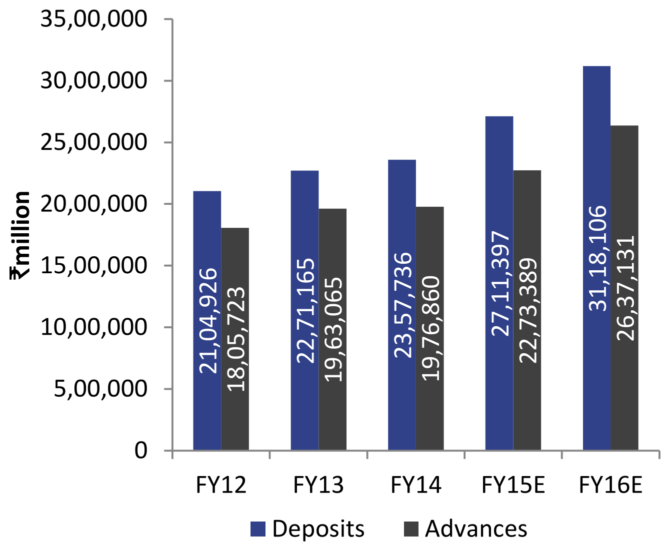
Expects ~15% growth in loan book in FY15E

IDBI Bank loan book substantially consists of corporate lending and we expect IDBI to continue to focus on corporate segment with infrastructure lending as a major growth driver.

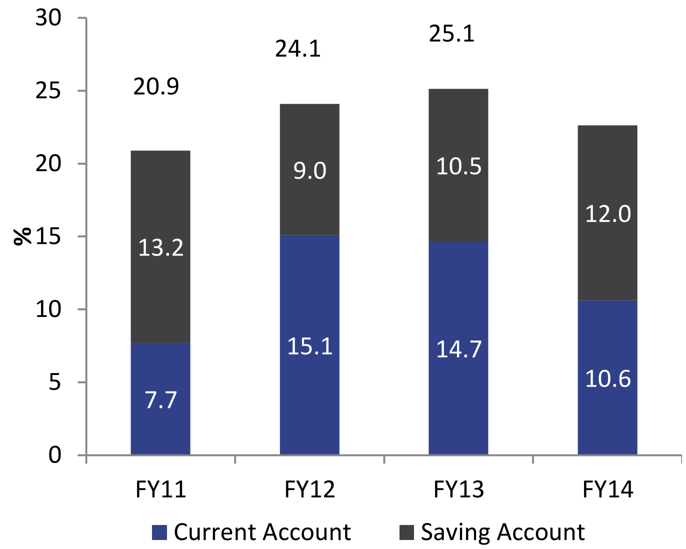
With focus on increasing the share of priority sector lending, the bank aims to grow its loan book by 15% in FY15E.

We expect strong growth prospects in the infrastructure sector supported by the government spending of ₹1 tn over FY17E. IDBI Bank loan book substantially consists of corporate lending and we expect IDBI to continue to focus on corporate segment with infrastructure lending as a major growth driver. IDBI Bank is also focusing more on agriculture, micro small and medium enterprises (MSME) and retail segment to exploit potential of these high yielding segments. Due to inadequate branch network, the bank's priority sector advances had been tremendously low at 8.5% against 40% the regulatory prescription. Therefore, the bank thought to restructure its book from moving away from the predominance of corporate sector. In the last one quarter to one and a half quarters, the bank reduced the corporate book exposure from 51% to 48% while at the same time improving retail book from 17% to now 19%. Also IDBI Bank will continue to invest in retail business which would begin to gain traction over the medium to long term and further diversify the fee based revenue streams. IDBI Bank's business model of tapping wholesale banking has potential to generate revenues, while continuing to invest in long gestation retail liability franchisee is remarkable. This has enabled the bank to scale up its balance sheet and infrastructure and at the same time deliver impressive return ratios. Thus, with focus on increasing the share of priority sector lending, the bank aims to grow its loan book by 15% in FY15E.

Moderate business growth



CASA trend



Lowest cost ratio to provide competitive edge over its peer

Cost to income (C/I) ratio stood at 32.10% in Q4FY14 and 36.88% in FY14, arguably the lowest in its peer set in the banking space.

The lean operational infrastructure along with state-of-the-art technology platform enabled the bank to post commendable control over cost with cost to income (C/I) ratio stood at 32.10% in Q4FY14 and 36.88% in FY14, arguably the lowest in its peer set in the banking space. The bank's overhead efficiency ratio during the reporting period stood at 131.55% in Q4FY14 and 89.75% in FY14, ahead of its peer set, comprising both private and public sector constituents, evidence of its robust mobilisation under 'other income', which more than covered operating expenses.

In the retail liability product segment, the bank continues to design new products aligned to emerging customer needs. The bank rationalised existing products and also unveiled another customer-friendly initiatives to, inter alia, increase the complement of low-cost funds.

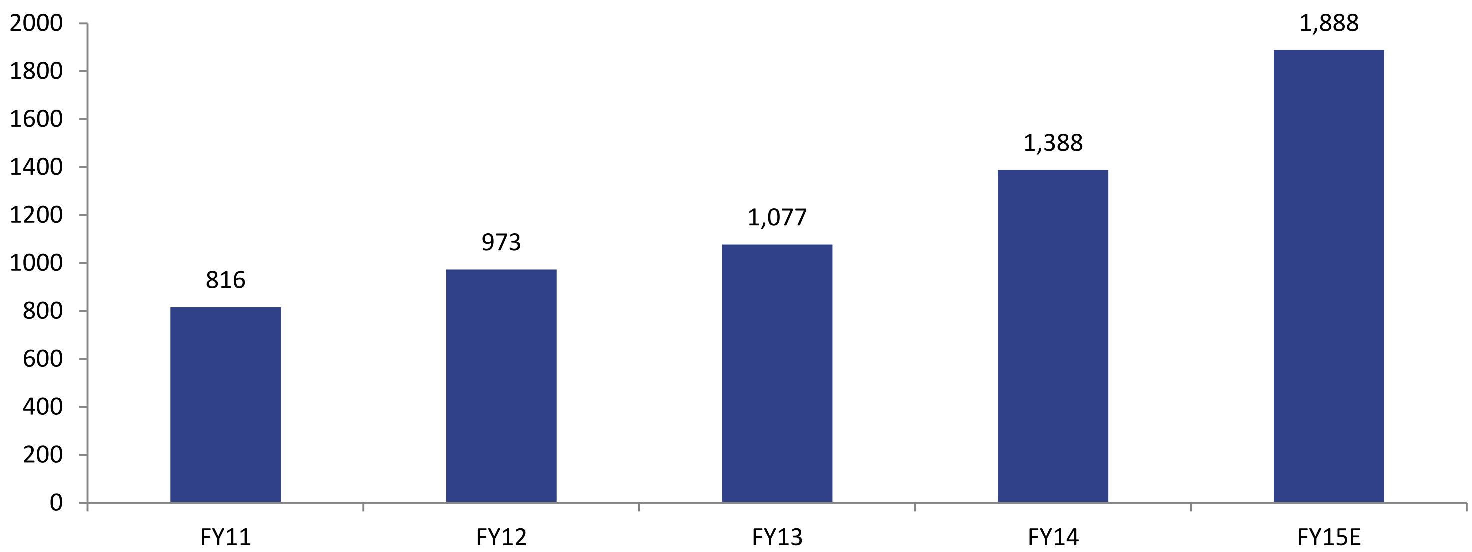
With a retail customer base of more than 6.5 million, the bank has expanded its domestic branch network to 1,388 branches, as on March 31, 2014, as many as 319 are located in metropolitan centres, 426 in urban centres, 372 in semi-urban centres and 270 in rural centres.

Robust branch expansion to drive strong growth in CASA ratio

To execute its strategy of building a robust customer base, facilitate CASA growth, improve customer service and further the cause of inclusive banking, the bank embarked on a calibrated branch-category wise expansion drive. The bank added 312 new branches during FY14. With a retail customer base of more than 6.5 million, the bank has expanded its domestic branch network to 1,388 branches, as on March 31, 2014, as many as 319 are located in metropolitan centres, 426 in urban centres, 372 in semi-urban centres and 270 in rural centres; besides, that the bank has one fully operational overseas branch at DIFC, Dubai. Further, in its global expansion plans, the bank has initiated the process for setting up branch offices in Singapore and representative office in Shanghai.

Thus, we believe that steady branch expansion plans of the bank should continue to increase the contribution of retail deposits in the bank's funding mix and drive strong CASA market share gains going forward. Therefore, the bank plans to expand its branch network by 500 in FY15E. The bank's CASA deposits posted a 31.5% CAGR over FY07-13; we have factored in an 11.5% CAGR over FY13-15E.

IDBI Bank aims to expand its branch network by 500 by the end of FY15



We believe that the bank's near term and longer term margin outlook are positive on the expectation that substantial CASA expansion and improving asset mix would be structural levers, benign wholesale rates and planned capital raising would be cyclical factors driving NIM improvement.

NIM to remain steady in the coming year

Despite flat advance growth, the net interest margin (NIM) of the bank improved by 5bps YoY to 2.17% in FY14 on lower cost of fund and higher spread. However, cost of fund also reduced by 44bps YoY to 7.87% in FY14. We believe that the bank's near term and longer term margin outlook are positive on the expectation that substantial CASA expansion and improving asset mix would be structural levers, benign wholesale rates and planned capital raising would be cyclical factors driving NIM improvement.

The bank expects to maintain its NIM at 2.2% in FY15E. Thus, with planned capital raising (up to ₹20 billion) and softening of bulk deposits rates and sustained improvement in the CASA ratio should lower overall cost of funds, which will help to sustain its NIM at the current level on the back of reduction in leverage.

Balance Sheet (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Paid up capital	13,328	16,039	16,039	16,039
Employees stock options outstanding	9	8	5	5
Total Reserve & Surplus	181,487	199,025	220,349	242,384
Deposits	2,104,926	2,271,165	2,357,736	2,711,397
Borrowings	534,776	658,089	601,463	589,434
Other Liabilities & Provisions	69,182	86,071	94,374	108,530
Total equity & liabilities	**2,903,163**	**3,227,685**	**3,289,966**	**3,667,789**
Cash & balance with RBI	150,902	105,440	127,111	134,473
Bank balance & money at call & short notice	29,674	73,806	41,068	42,300
Investment	831,754	988,009	1,037,735	1,105,969
Advances	1,805,723	1,963,065	1,976,860	2,273,389
Fixed assets	30,188	29,253	29,832	30,429
Other assets	54,922	68,113	77,360	81,228
Total assets	**2,903,163**	**3,227,685**	**3,289,966**	**3,667,789**

Profit & Loss Account (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Interest Income	250,643	265,975	284,593	315,899
Interest Expended	196,912	205,760	216,048	233,332
Net Interest Income	**53,731**	**60,215**	**68,545**	**82,566**
Other interest income	32,195	29,788	30,383	30,991
Total income	**85,926**	**90,002**	**98,928**	**113,557**
Operating Expenses	31,344	33,188	36,507	41,253
Provisions	28,365	39,403	44,131	49,427
Profit Before Tax	**26,218**	**17,411**	**18,290**	**22,878**
Tax	7,397	6,197	5,524	6,909
Net Profit	**18,821**	**11,214**	**12,767**	**15,969**

Key Ratios (Standalone)

Y/E	FY13A	FY14A	FY15E	FY16E
Avg. Cost of deposits (%)	18.7	18.1	18.3	17.2
ROA	0.6	0.3	0.4	0.4
ROE	9.3	5.0	5.2	5.9
Interest Expense/ Interest Income	78.6	77.4	75.9	73.9
Investment/Deposit	41.6	43.8	42.3	39.0
Cost-Income Ratio (%)	36.5	36.9	36.9	36.3
C-D Ratio (%)	86.4	83.8	83.8	84.6
Adj.BVPS	159.3	147.4	161.1	176.2
P/Adj.BV	0.6	0.6	0.6	0.5
Adj.EPS	14.1	7.0	8.0	10.0
P/E	6.7	13.6	11.9	9.5

Valuation and view

The bank has been among the fastest-growing banks in terms of CASA deposits over the past few years (CAGR of ~32% over FY07-13) even when compared to private banks. Given the challenging macro environment, IDBI Bank delivered a weak operating performance with subdued business growth. However, the asset quality pressures have moderated sequentially for the bank during FY14. Thus, we believe that improving asset quality, superior cost efficiency and sustainable NIM provide higher upside for the IDBI Bank.

Considering these factors, we recommend 'BUY' on the stock with a target price of ₹110, based on 0.5x P/BV for FY16E at book value per share (BVPS) of ₹176.2, providing a potential upside of ~16%. The current market price of ₹95 implies a P/BV of ~0.6x FY'15E BVPS of ₹161.1.

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