

COMBINED LOAN BOOK to have an advantage of larger spread across loan segments from big infrastructure projects down to micro enterprise lending

IDFC Bank's Valuations Likely to Improve Post Capital First Deal

ET ANALYSIS

Ranjit.Shinde@timesgroup.com

ET Intelligence Group: Long-term investors will benefit from the merger of Capital First and IDFC Bank. The deal, announced on Saturday and subject to regulatory approvals, will help IDFC Bank to reduce the valuation gap with private banks that have better exposure to the retail segment.

A focus on improving performance in terms of lowering bad debt, better return on equity, and higher retail disbursement is the common thread that joins the two institutions.

Historically, IDFC Bank has a greater proportion of infrastructure loans thanks to the parent, IDFC, which provides credit mainly to such projects. As a result, the corporate segment constitutes

over 73% of its loan book of ₹68,797 crore. In addition, the ratio of current account and savings account (CASA) deposits, the cheapest source of funding, form just over 8% of total funding. The proportion of gross nonperforming assets (GNPA) in total advances was also significantly higher at 3.9%.

Some of the larger peers have been able to control better asset quality by having a healthy mix of retail and corporate loans and a better CASA proportion. For instance, with a loan book of nearly ₹6.1 lakh crore, HDFC Bank has 46% exposure to the retail segment. Its GNPA was 1.3% and CASA ratio was nearly 50% at the end of September 2017. In another example, retail loans form 40% of IndusInd Bank's total advances of ₹1.2 lakh crore. Its CASA ratio was 40% and GNPA was 1.1% at the end of December 2017.

Continued on ►► MONEY MATTERS

Major Parameters

A Comparison

	IDFC Bank	Capital First
Loan book (Sep'18, ₹ crore)	68,797	22,974
Consumer loan share (%)	26.3	93
NNPA (Sep '18, %)	1.6	1
NII (1HY'18, ₹ crore)	917.3	880.8
Cost/income ratio (Sep '18, %)	49.4*	52
Net profit (1HY '18, ₹ crore)	671.2	145.3
RoE (Sep '18, %)	6.1	13.1
Book value per share (Sep '18, ₹)	44.3	247
Price/Book	1.5	3.4
Stock price (₹)**	67.7	835.9
Market cap (₹ crore)**	23,019	8,266.20

*Excluding loss on sale of equity; **As on January 12, 2018; 1HY'18- First half of FY18; NII- Net interest income; NNPA- Net nonperforming assets; RoE- Return on Equity; Source: Company data, BSE, ETIG



IDFC Bank's Valuations may Improve

►► From ET Markets Page 1

To improve performance, it's necessary for IDFC Bank to increase exposure to the retail segment. And, this is where its decision to merge with Capital First, which has 93% exposure to the retail lending, makes sense. The combined loan book will have an advantage of larger spread across loan segments from large infrastructure projects down to micro enterprise lending.

IDFC bank is valued at price-book (P/B) of 1.5, much lower than HDFC Bank's P/B of five and

IndusInd Bank's P/B of 4.5. The gap is expected to reduce in the future given the merger synergies.

Besides, investors may also want to consider the attractive share swap ratio. IDFC Bank will offer 139 shares for every 10 shares of Capital First. On Friday, the bank's stock was traded at ₹67.7 while the latter's was quoted at ₹835.9. At these prices, 10 shares of Capital First are worth ₹8,359, 12% cheaper than the 139 shares of the bank, which are worth ₹9,410. An investment in Capital First shares would therefore earn 12% return, though this gain may be wiped out once shares start trading on Monday.