

BSE SENSEX
33,627

S&P CNX
10,332

CMP: INR655 TP: INR960 (47%)

Buy



Stock Info

| | |
|-----------------------|------------|
| Bloomberg | CAFL IN |
| Equity Shares (m) | 97.4 |
| M.Cap.(INRb)/(USD\$b) | 63.8 / 1.0 |
| 52-Week Range (INR) | 902 / 610 |
| 1, 6, 12 Rel. Per (%) | 0/-19/-26 |
| Avg. Val, INRm | 680.0 |
| Free float (%) | 64.4 |

Capital First Financials (INR b)

| Y/E March | 2018E | 2019E | 2020E |
|--------------|-------|-------|-------|
| NII | 18.7 | 24.2 | 30.4 |
| PPP | 11.6 | 15.5 | 19.8 |
| PAT | 3.3 | 4.3 | 5.5 |
| EPS (INR) | 34.2 | 44.6 | 56.8 |
| EPS Gr. (%) | 38.9 | 30.2 | 27.5 |
| BV/Sh. (INR) | 264.9 | 305.2 | 357.3 |
| RoA on AUM% | 1.7 | 1.8 | 1.8 |
| RoE (%) | 13.7 | 15.6 | 17.2 |
| Payout (%) | 9.0 | 8.0 | 7.0 |

Valuations

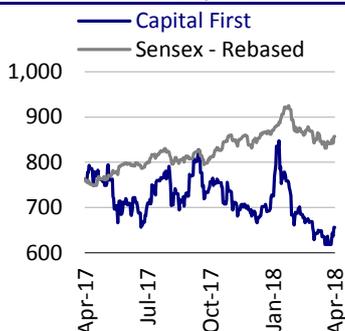
| | | | |
|----------------|------|------|------|
| P/E (x) | 19.1 | 14.7 | 11.5 |
| P/BV (x) | 2.5 | 2.1 | 1.8 |
| Div. Yield (%) | 0.5 | 0.5 | 0.6 |

Shareholding pattern (%)

| As On | Dec-17 | Sep-17 | Dec-16 |
|----------|--------|--------|--------|
| Promoter | 35.6 | 36.0 | 61.2 |
| DII | 12.4 | 13.1 | 5.8 |
| FII | 24.0 | 24.3 | 6.4 |
| Others | 28.0 | 26.6 | 26.6 |

FII Includes depository receipts

Stock Performance (1-year)



Second innings

INR37b PAT, 14%+ RoE for the combined entity in 5-6 years

- We recently met the management of Capital First (CAFL). The proposed merger of IDFC Bank (IDFCB) with CAFL is likely to fructify by mid-FY19, creating a financial services entity with total assets of ~INR1.5t.
- Over the next 5-6 years, the combined entity is likely to undergo a huge transformation – from a primarily wholesale-focused bank to a retail-focused bank with meaningful CASA deposit franchise.
- Currently, CASA deposits at IDFCB amount to merely INR43b – 4% of total liabilities. Bulk of the CASA has come in the past four quarters (post demonetization). The management’s priority post-merger will be scaling up the CASA franchise.
- Over the next six years (five years post-merger), we expect overall customer assets to reach INR1.9t and PAT to reach INR37b. This would imply 26% PAT CAGR for the consolidated entity over FY19-24. We believe the merged entity is well-capitalized to sustain such strong growth. We have a BUY rating on CAFL, with a TP of INR960.

600+ branch network to be built over the next 5-6 years...

Over the past two years, IDFCB has built a network of 127 branches. For a company with a balance sheet size of >INR1t, we believe the branch network is underpenetrated. Its closest two private sector competitors, IndusInd Bank and Yes Bank, both have more than 1,000 branches. Management expect to expand the network gradually to 600+ branches by FY24 compared to 127 branches currently. Note that CAFL has 67 branches currently, largely focused on assets and are not considered in the above numbers. We believe this will be the key not only in driving traction in CASA deposits but also help in building out the retail asset franchise of the company.

...to drive CASA ratio to 27% by FY24

Currently, CASA deposits at IDFCB amount to merely INR43b, implying 8% CASA ratio. More than half of these deposits were acquired in 9MFY18 itself. In our view, CASA deposit accretion has been sluggish – we attribute this to the small branch network of IDFCB. While the digital channel is very important for CASA acquisition, we believe a physical presence is equally important and should not be underestimated. In addition, IDFCB offers only 4% on its savings accounts, unlike 5-6% by some peers like KMB and YES.

Customer assets to approach INR2t by FY24

Since commencement of operations as a bank, IDFCB has grown its customer assets from INR439b in 3QFY16 to INR639b in 3QFY18, implying 21% CAGR. However, this is largely because of portfolio of INR130b purchased by the bank to meet PSL requirements and also includes INR30b from the acquisition of Grama Vidiyal MFI, which had a loan book of INR15b at the time of acquisition. As of 3QFY18, total customer assets of the combined entity stood at ~INR835b. We believe the combined loan book will grow at 14% CAGR to reach INR1.9t by FY24. This will be driven by continued traction in retail lending coupled with increasing penetration across the length and breadth of the country.

‘Retailization’ of the balance sheet underway

On a proforma basis, the retail loan book for the combined entity (ex-PSL buyout) currently amounts to ~INR250b, that is, 29% of total customer assets. Of this, CAFL contributes around INR190b. We believe retail assets will be the key loan growth driver over the foreseeable future, driven by the capabilities developed by CAFL’s management. We expect the proforma retail loan book to grow at 28% CAGR till FY24. With growing share of retail lending, we expect 58% of total customer assets from retail loans by FY24. This would not only help margins, but also asset quality.

~5x PAT by FY24E; RoE in low-to-mid teens

On a proforma basis, the combined entity is expected to deliver INR8b PAT in FY18E. With 14% customer assets growth, improvement in margins and declining C/I ratio, we expect PAT to grow at 27% CAGR over FY19-24E to reach INR37b. This would result in RoA/RoE of 1.3%/14% in FY24E. Upside to PAT could accrue from merger synergies coming in better than expected.

Valuation and view

CAFL is a niche play in the retail NBFC space, with a diversified loan portfolio. Its business model offers high growth potential with strong profitability. While the company has grown its AUM at 26% CAGR over FY12-17, it has not compromised on asset quality. With a GNPL ratio of ~1.5%, its asset quality remains pristine in comparison to peers. The company is entering the second phase of its journey – the banking journey. The merger with IDFCB provides CAFL a banking platform. We derive comfort from the fact that CAFL’s management will be heading the combined entity. We expect IDFCB to transform into a different avatar after five years – it will move from a slow-growing entity with low CASA deposits to an entity growing at ~15% CAGR with a strong CASA franchise coupled with respectable RoE of 14-15%. We factor in sharp rise in operating expenses due to change in strategy of branch expansion. We expect near-term earnings to be under pressure however, to rebound strongly from FY21. We have a Buy rating on CAFL, with a target price of INR960.

Second innings

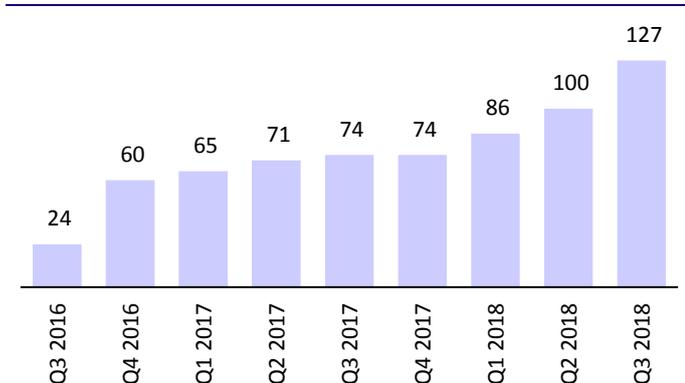
~INR2t customer assets, INR37b PAT by FY24E

Branch network of IDFCB to increase 5x to 600 branches by FY24E

127 branch network of IDFCB to grow to 600+ by FY24E

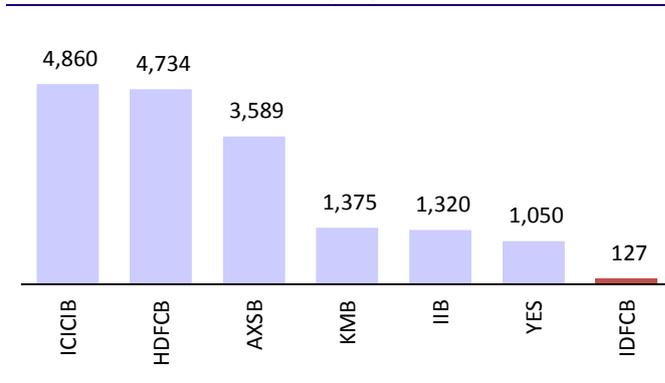
- Since commencement of banking operations in 3QFY18, IDFCB has grown its branch network from 24 branches then to 127 branches currently.
- We note that the branch count is much lower than peers like YES and IIB that have more than 1,000 branches each.
- The management's intention is to scale up the branch network to achieve higher share of CASA deposits as well as retail loans. We expect the branch count to increase from 127 currently to 600+ by FY24E.

Exhibit 1: Branch count trend of IDFCB



Source: MOSL, Company

Exhibit 2: Branch count of top-7 private sector banks



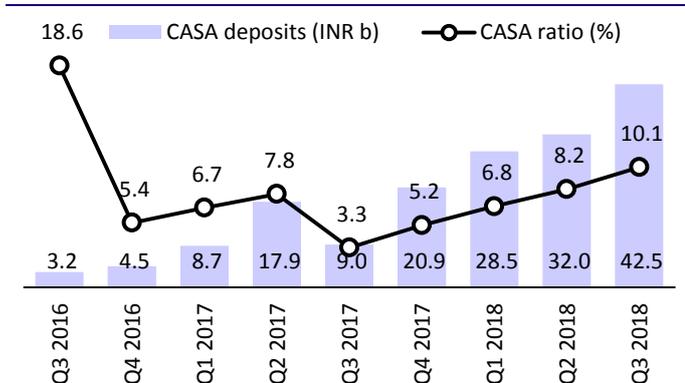
Source: MOSL, Company

CASA ratio to reach 27% by FY24E, in our view

Branch network expansion to drive CASA ratio to ~30% by FY24E

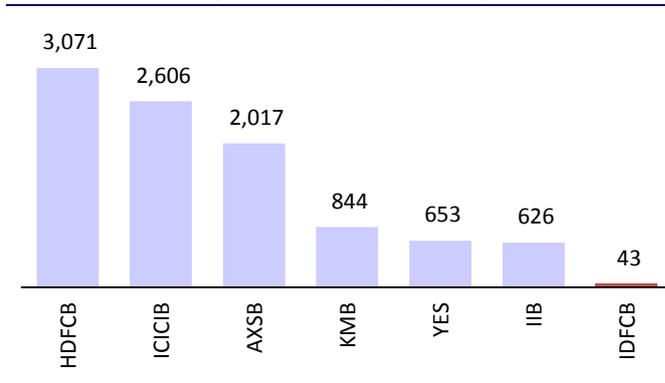
- Rapid scale-up of branches will enable IDFCB to garner more CASA and retail term deposits. We expect the CASA ratio to scale up from 8% currently to 27% by FY24E.
- CASA/branch is expected to cross INR700m by FY24E

Exhibit 3: CASA trend of IDFCB



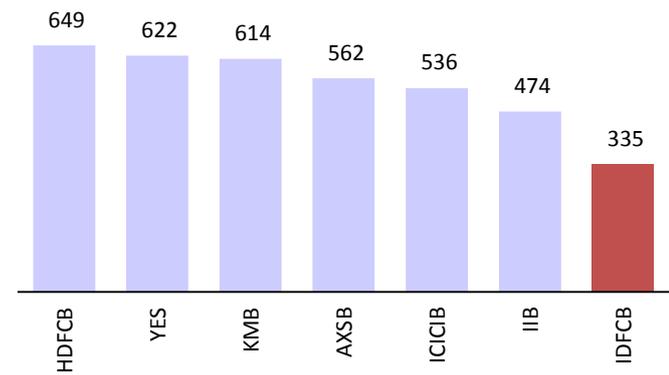
Source: MOSL, Company

Exhibit 4: CASA deposit base compared to peers (INR b)



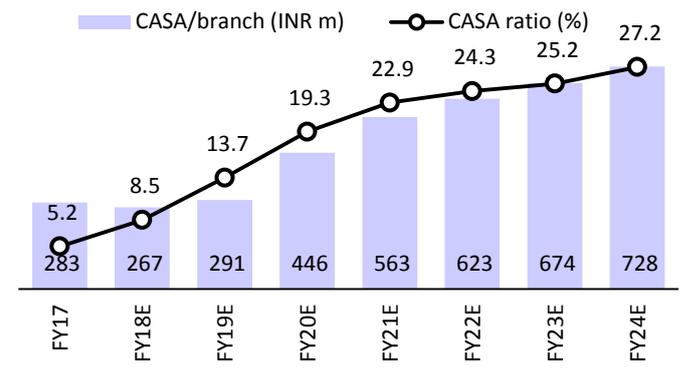
Source: MOSL, Company

Exhibit 5: IDFCB has lower CASA/branch than peers (INR m)



Source: MOSL, Company

Exhibit 6: CASA ratio trend, going forward



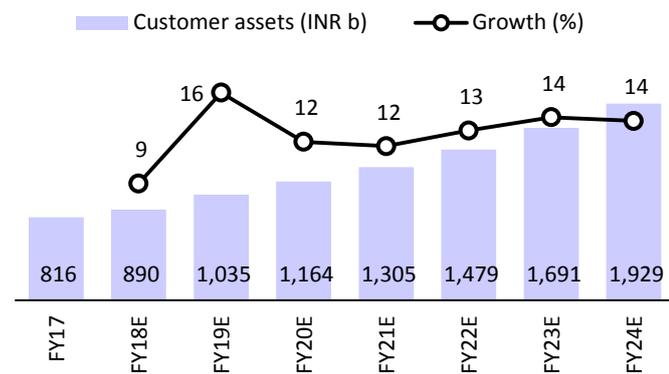
Source: MOSL, Company

Share of retail loans to reach 58% by FY24E

INR1t retail loans by FY24E; Share of retail loans to cross 50%

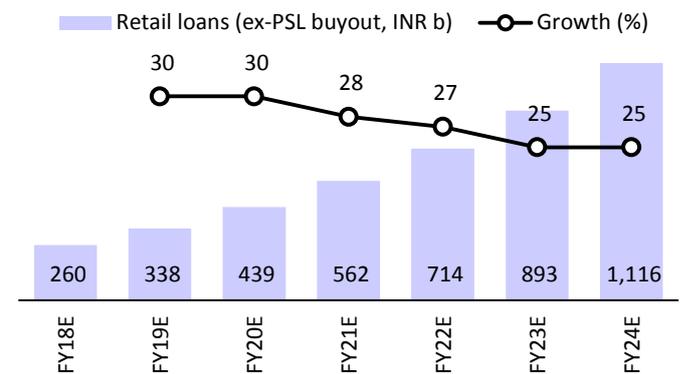
- Overall, we expect 14% CAGR in overall customer assets over FY18-24E, resulting in INR1.9t customer assets.
- We expect 27% CAGR in proforma retail loans over FY18-24E driven by increased geographical penetration.
- Consequently, share of retail loans (ex-PSL buyout) is expected to improve from 29% currently to 58% by FY24E.

Exhibit 7: Trend in total customer assets



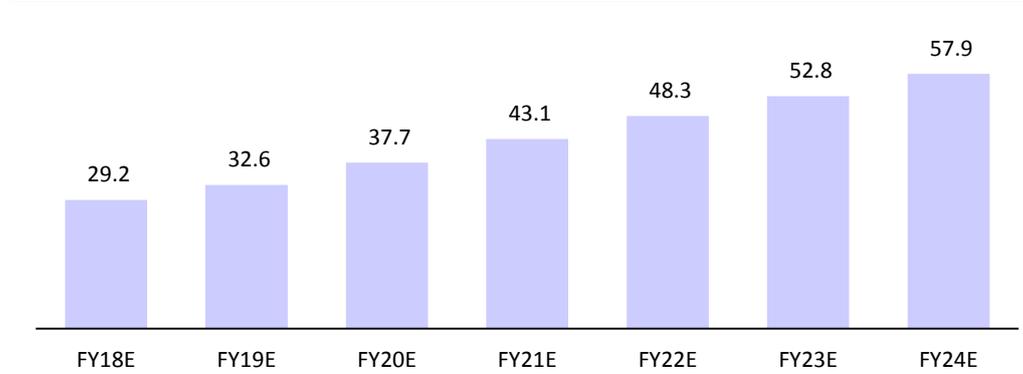
Source: MOSL, Company; FY17, FY18E data is proforma

Exhibit 8: Trend in retail loans



Source: MOSL, Company; FY18E data is proforma

Exhibit 9: Share of retail loans on the rise (%)



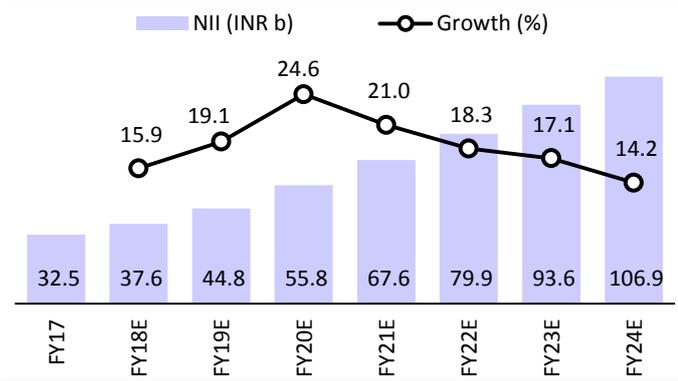
Source: MOSL, Company

Mid-teens RoE by FY24

INR37b PAT by FY24E manifesting in 14% RoE

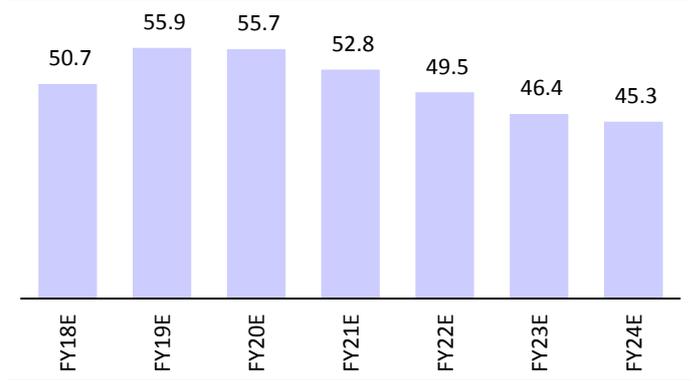
- While customer assets are expected to deliver 14% CAGR over FY18-24E, NII is expected to grow at a healthier pace (18% CAGR) driven by improvement in margins.
- While C/I ratio will increase in FY19 and FY20 due to branch expansion investments, it is expected to steadily decline as merger synergies kick in. We expect it to decline to ~45% by FY24.
- As a result, PAT should grow at 27% CAGR over FY19-24E, resulting in INR37b PAT for FY24. Correspondingly, RoA/RoE are expected to improve to 1.3%/14%.

Exhibit 10: NII growth trend



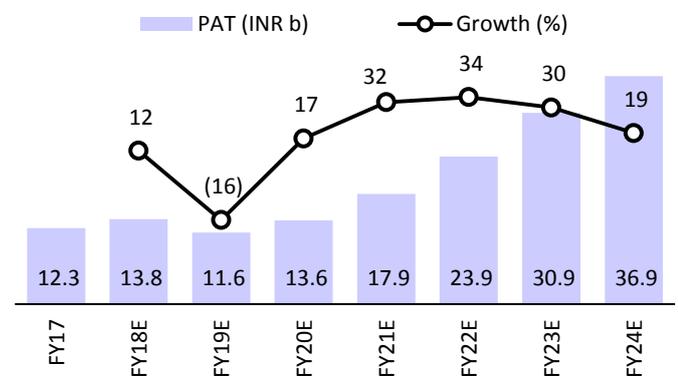
Source: MOSL, Company

Exhibit 11: C/I ratio to decline steadily over time



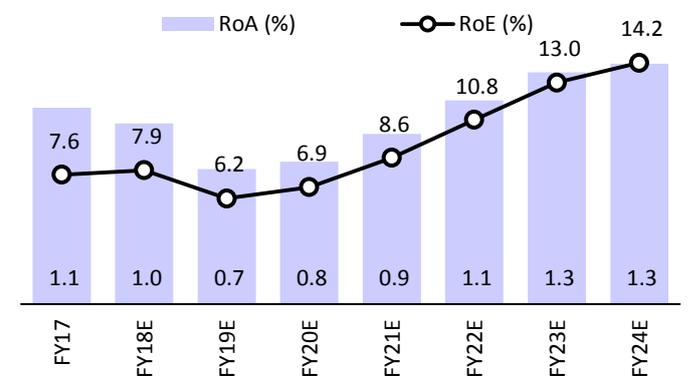
Source: MOSL, Company

Exhibit 12: PAT CAGR of 27% over FY19-24E



Source: MOSL, Company

Exhibit 13: RoA/RoE on an improving trend



Source: MOSL, Company

Financials – Proforma Combined Entity

| Income Statement | | | | | | | | (INR m) |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|----------------|----------------|----------------|
| Y/E March | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E |
| Interest Income | 109,215 | 122,718 | 137,660 | 159,077 | 178,325 | 203,596 | 234,741 | 269,756 |
| Interest Expense | 76,760 | 85,097 | 92,868 | 103,247 | 110,755 | 123,694 | 141,178 | 162,883 |
| Net Interest Income | 32,455 | 37,621 | 44,793 | 55,830 | 67,570 | 79,903 | 93,563 | 106,873 |
| Change (%) | | 15.9 | 19.1 | 24.6 | 21.0 | 18.3 | 17.1 | 14.2 |
| Non Interest Income | 14,252 | 18,094 | 22,915 | 24,075 | 28,798 | 36,278 | 45,941 | 58,432 |
| Net Income | 46,707 | 55,715 | 67,708 | 79,905 | 96,368 | 116,181 | 139,504 | 165,305 |
| Change (%) | | 19.3 | 21.5 | 18.0 | 20.6 | 20.6 | 20.1 | 18.5 |
| Operating Expenses | 21,068 | 28,262 | 37,849 | 44,525 | 50,888 | 57,562 | 64,765 | 74,928 |
| Pre Provision Profits | 25,639 | 27,453 | 29,859 | 35,380 | 45,480 | 58,619 | 74,739 | 90,377 |
| Change (%) | | 7.1 | 8.8 | 18.5 | 28.5 | 28.9 | 27.5 | 20.9 |
| Provisions (excl tax) | 7,355 | 6,914 | 10,759 | 14,524 | 18,012 | 21,875 | 27,127 | 33,586 |
| PBT | 18,284 | 20,539 | 19,101 | 20,856 | 27,469 | 36,744 | 47,612 | 56,791 |
| Tax | 5,988 | 6,756 | 7,519 | 7,300 | 9,614 | 12,860 | 16,664 | 19,877 |
| Tax Rate (%) | 32.8 | 32.9 | 39.4 | 35.0 | 35.0 | 35.0 | 35.0 | 35.0 |
| PAT | 12,296 | 13,783 | 11,582 | 13,556 | 17,855 | 23,883 | 30,948 | 36,914 |
| Change (%) | | 12.1 | -16.0 | 17.0 | 31.7 | 33.8 | 29.6 | 19.3 |
| Equity Dividend (Incl tax) | 813 | 2,419 | 2,033 | 2,379 | 3,133 | 4,192 | 5,431 | 6,478 |
| Core PPP* | 18,501 | 20,315 | 22,221 | 31,380 | 42,980 | 56,119 | 72,239 | 87,877 |
| Change (%) | | 9.8 | 9.4 | 41.2 | 37.0 | 30.6 | 28.7 | 21.6 |

*Core PPP is (NII+Fee income-Opex)

| Balance Sheet | | | | | | | | (INR m) |
|---------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Y/E March | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E |
| Net Worth | 169,616 | 180,426 | 192,222 | 201,771 | 212,948 | 227,669 | 247,361 | 272,877 |
| Deposits | 402,082 | 441,541 | 537,242 | 698,415 | 893,971 | 1,117,464 | 1,396,830 | 1,676,196 |
| Change (%) | 389.2 | 9.8 | 21.7 | 30.0 | 28.0 | 25.0 | 25.0 | 20.0 |
| of which CASA Dep | 20,944 | 37,440 | 73,441 | 134,837 | 204,369 | 271,362 | 351,972 | 456,528 |
| Change (%) | 370.6 | 78.8 | 96.2 | 83.6 | 51.6 | 32.8 | 29.7 | 29.7 |
| Borrowings | 643,703 | 776,653 | 823,698 | 808,617 | 763,432 | 759,239 | 760,134 | 820,639 |
| Other Liabilities & Prov. | 82,747 | 82,147 | 92,692 | 111,231 | 133,477 | 160,173 | 192,207 | 230,648 |
| Total Liabilities | 1,298,148 | 1,480,767 | 1,645,854 | 1,820,034 | 2,003,828 | 2,264,544 | 2,596,532 | 3,000,360 |
| Current Assets | 66,956 | 69,259 | 103,942 | 124,982 | 160,264 | 206,815 | 264,654 | 352,462 |
| Investments | 507,303 | 608,496 | 577,951 | 557,621 | 520,862 | 515,797 | 529,799 | 556,129 |
| Change (%) | 69.6 | 19.9 | -5.0 | -3.5 | -6.6 | -1.0 | 2.7 | 5.0 |
| Loans | 643,888 | 718,658 | 863,684 | 1,018,152 | 1,180,819 | 1,373,128 | 1,601,166 | 1,852,528 |
| Change (%) | 10.7 | 11.6 | 20.2 | 17.9 | 16.0 | 16.3 | 16.6 | 15.7 |
| Fixed Assets | 8,512 | 8,657 | 10,268 | 11,268 | 12,268 | 13,268 | 14,268 | 15,268 |
| Other Assets | 71,489 | 75,697 | 90,010 | 108,012 | 129,614 | 155,537 | 186,645 | 223,974 |
| Total Assets | 1,298,148 | 1,480,767 | 1,645,854 | 1,820,034 | 2,003,828 | 2,264,544 | 2,596,532 | 3,000,360 |

Financials – Proforma Combined Entity

Ratios

| Y/E March | 2017 | 2018E | 2019E | 2020E | 2021E | 2022E | 2023E | 2024E |
|-----------------------------------|-------------|------------|------------|-------------|-------------|-------------|-------------|-------------|
| Spreads Analysis (%) | | | | | | | | |
| Avg. Yield-Earning Assets | 10.4 | 9.5 | 9.6 | 10.3 | 10.7 | 11.1 | 11.4 | 11.6 |
| Avg. Yield on loans | 12.2 | 11.8 | 12.1 | 12.4 | 12.5 | 12.8 | 13.1 | 13.2 |
| Avg. Yield on Investments | 8.2 | 7.2 | 6.7 | 7.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| Avg. Cost-Int. Bear. Liab. | 8.4 | 7.5 | 7.2 | 7.2 | 7.0 | 7.0 | 7.0 | 7.0 |
| Interest Spread | 2.0 | 2.0 | 2.4 | 3.1 | 3.7 | 4.1 | 4.4 | 4.6 |
| Net Interest Margin | 3.1 | 2.9 | 3.1 | 3.6 | 4.0 | 4.4 | 4.6 | 4.6 |

Profitability Ratios (%)

| | | | | | | | | |
|--------------------------|------|------|------|------|------|------|------|------|
| RoE | 7.6 | 7.9 | 6.2 | 6.9 | 8.6 | 10.8 | 13.0 | 14.2 |
| RoA | 1.1 | 1.0 | 0.7 | 0.8 | 0.9 | 1.1 | 1.3 | 1.3 |
| Int. Expense/Int.Income | 70.3 | 69.3 | 67.5 | 64.9 | 62.1 | 60.8 | 60.1 | 60.4 |
| Non Int. Inc./Net Income | 30.5 | 32.5 | 33.8 | 30.1 | 29.9 | 31.2 | 32.9 | 35.3 |

Efficiency Ratios (%)

| | | | | | | | | |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Cost/Income | 45.1 | 50.7 | 55.9 | 55.7 | 52.8 | 49.5 | 46.4 | 45.3 |
| Empl. Cost/Op. Exps. | 38.6 | 35.3 | 31.4 | 31.7 | 32.6 | 32.5 | 32.4 | 32.8 |
| Busi. per Empl. (INR m) | 270.9 | 202.3 | 139.6 | 133.0 | 152.9 | 177.2 | 210.1 | 254.9 |
| NP per Empl. (INR lac) | 3.9 | 2.5 | 1.3 | 1.2 | 1.4 | 1.9 | 2.4 | 2.9 |

* ex treasury and Recoveries from written off accounts

Asset-Liability Profile (%)

| | | | | | | | | |
|--------------------------|-------|-------|-------|-------|-------|-------|-------|-------|
| Loans/Deposit Ratio | 160.1 | 162.8 | 160.8 | 145.8 | 132.1 | 122.9 | 114.6 | 110.5 |
| CASA Ratio | 5.2 | 8.5 | 13.7 | 19.3 | 22.9 | 24.3 | 25.2 | 27.2 |
| Investment/Deposit Ratio | 126.2 | 137.8 | 107.6 | 79.8 | 58.3 | 46.2 | 37.9 | 33.2 |
| G-Sec/Investment Ratio | 38.0 | 41.2 | 43.3 | 58.0 | 65.8 | 72.3 | 77.7 | 81.9 |

Valuation

| | | | | | | | | |
|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|------------|------------|
| Book Value (INR) | 35.7 | 38.0 | 40.4 | 42.4 | 44.8 | 47.9 | 52.0 | 57.4 |
| Change (%) | | 6.4 | 6.5 | 5.0 | 5.5 | 6.9 | 8.6 | 10.3 |
| Price-BV (x) | 1.4 | 1.3 | 1.2 | 1.2 | 1.1 | 1.0 | 1.0 | 0.9 |
| EPS (INR) | 2.6 | 2.9 | 2.4 | 2.9 | 3.8 | 5.0 | 6.5 | 7.8 |
| Change (%) | | 12.1 | -16.0 | 17.0 | 31.7 | 33.8 | 29.6 | 19.3 |
| Price-Earnings (x) | 19.3 | 17.2 | 20.5 | 17.5 | 13.3 | 10.0 | 7.7 | 6.4 |
| Dividend Per Share (INR) | 1.8 | 0.6 | 0.5 | 0.4 | 0.6 | 0.8 | 1.0 | 1.2 |
| Dividend Yield (%) | 3.6 | 1.2 | 1.0 | 0.9 | 1.1 | 1.5 | 2.0 | 2.3 |

E: MOSL Estimates

| Explanation of Investment Rating | Expected return (over 12-month) |
|----------------------------------|--|
| Investment Rating | |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | > - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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