

3Q beat; Rising return ratios to drive re-rating, Buy

3Q: 2% beat; Growth strong, with rising share of home

IHFL reported 3Q earnings of ~Rs4.0bn, yoy growth of 22% (2% ahead) driven by strong growth sustaining and stable asset quality leading to lower provisions. AUM growth healthy at 20%, but disbursement growth down 17% yoy. However, weak disbursement growth is owing to no CV lending, excluding this growth down ~8% yoy. Spreads down 10bps qoq to ~340bps (book) on changing loan mix to home loans (lower spreads), but better quality vs. CV and commercial credit.

Stable asset quality in 3Q mirroring past trends; To sustain

Asset quality remains largely stable, with ~7/11% qoq rise in headline gross/net NPLs, but gross only at 88bps. With higher share of home / LAP loans and risks mitigated by in-house sourcing model (~75% in-house), with focus on cash-flow linked lending for non-home loans and more than adequate collateral (2x) for non-mortgage loans, asset quality to be stable. However, given headwinds in the sector, we are, nevertheless, still estimating gross NPLs at ~1.3/1.5% in FY14/15.

20%+ AUM growth to sustain; Spreads may improve ahead

Strong capitalization (CAR at ~18.5%) will allow IHFL to sustain 20%+ AUM growth through FY16+. Spreads, in our view, will improve driven by changing liability mix towards lower cost bonds vs. bank funding (cost differential of ~40bps) and also as IHFL does higher securitization (~70/30bps lower cost vs. banks/bonds, resp.) and raises ECB funding. We estimate net profit growth at 18-20% in FY15/16, atop 22%+ in FY14 (after raising FY14 earnings by ~2%, post 3Q14).

Rising return ratios to drive re-rating (target P/B about 1.7x)

IHFL trades at 1.3x FY15E adj. book. Our PO of Rs305 is based on target P/B of 1.7x 1-year forward adjusted book and based on Gordon theoretical multiples. We are positive on IHFL's ability to grow its core 'mortgage' book, gain share, and hence, deliver above average RoA/RoE. Improvements in financial / operating leverage should complement, boosting ROEs. As a combine, these should drive a continued re-rating of the stock, in our view. Reiterate Buy.

Estimates (Mar)

(Rs)	2012A	2013A	2014E	2015E	2016E
Net Income (Adjusted - mn)	9,961	12,543	15,331	18,069	21,670
EPS	32.00	40.19	47.78	54.58	65.47
EPS Change (YoY)	34.1%	25.6%	18.9%	14.2%	20.0%
Dividend / Share	13.00	20.00	27.00	27.50	33.00
Free Cash Flow / Share	NA	NA	NA	NA	NA

Valuation (Mar)

	2012A	2013A	2014E	2015E	2016E
P/E	7.40x	5.89x	4.96x	4.34x	3.62x
Dividend Yield	5.49%	8.44%	11.40%	11.61%	13.93%

Equity | India | Financial Services-Consumer/Commercial
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Bank of America Merrill Lynch

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Stock Data

Price	Rs236.85
Price Objective	Rs305.00
Date Established	31-Oct-2013
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs165.25-Rs290.00
Mrkt Val / Shares Out (mn)	US\$1,276 / 333.2
Market Value (mn)	Rs78,921
Average Daily Volume	377,513
BofAML Ticker / Exchange	XFQGF / NSI
Bloomberg / Reuters	IHFL IN / INBF.NS
ROE (2014E)	28.1%
Leverage (2013A)	NA
Est. 5-Yr EPS / DPS Growth	20.0% / 15.0%
Free Float	61.8%

Key Changes

(Rs)	Previous	Current
2014E EPS	46.68	47.78
2015E EPS	54.44	54.58
2016E EPS	65.16	65.47

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11351228

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iQprofileSM Indiabulls Housing Finance Ltd.

Key Income Statement Data (Mar)	2012A	2013A	2014E	2015E	2016E
(Rs Millions)					
Net Interest Income	12,528	15,597	19,548	24,518	29,742
Net Fee Income	0	0	0	0	0
Securities Gains / (Losses)	NA	NA	NA	NA	NA
Other Income	6,089	5,706	6,966	6,811	7,594
Total Non-Interest Income	6,089	5,706	6,966	6,811	7,594
Total Operating Income	18,617	21,303	26,514	31,329	37,337
Operating Expenses	(3,802)	(4,275)	(4,287)	(4,993)	(5,903)
Pre-Provision Profit	14,815	17,028	22,227	26,336	31,434
Provisions Expense	(2,240)	(1,332)	(1,836)	(2,269)	(2,521)
Operating Profit	12,575	16,066	20,391	24,067	28,912
Non-Operating Income	645.40	484.57	581.48	668.71	769.01
Pre-Tax Income	13,221	16,550	20,972	24,736	29,681
Net Income to Comm S/Hold.	9,982	12,584	15,425	18,186	21,817
Adjusted Net Income (Operating)	9,961	12,543	15,331	18,069	21,670

Key Balance Sheet Data

Total Assets	322,274	391,288	450,885	523,131	613,929
Average Interest Earning Assets	281,769	347,194	408,064	468,944	541,674
Weighted Risk Assets	268,416	318,844	391,258	476,520	599,848
Total Gross Customer Loans	255,944	309,402	372,058	447,237	532,959
Total Customer Deposits	NA	NA	NA	NA	NA
Tier 1 Capital	49,055	50,558	58,229	63,968	73,007
Tangible Equity	49,055	50,558	58,229	63,968	73,007
Common Shareholders' Equity	49,055	51,686	58,229	63,968	73,007

Key Metrics

Net Interest Margin	4.45%	4.49%	4.79%	5.23%	5.49%
Tier 1 Ratio	18.3%	15.9%	14.9%	13.4%	12.2%
Effective Tax Rate	23.9%	23.5%	26.0%	26.0%	26.0%
Loan / Assets Ratio	79.0%	78.7%	81.9%	84.7%	85.9%
Loan / Deposit Ratio	NA	NA	NA	NA	NA
Oper Leverage (Inc Growth - Cost Growth)	13.6%	2.0%	24.2%	1.7%	0.9%
Gearing (Assets / Equity)	6.6x	7.6x	7.7x	8.2x	8.4x
Tangible Common Equity / Assets	15.2%	12.9%	12.9%	12.2%	11.9%
Tangible Common Equity / WRAs	18.3%	15.9%	14.9%	13.4%	12.2%
Revenue Growth	18.3%	14.4%	24.5%	18.2%	19.2%
Operating Expense Growth	4.8%	12.4%	0.3%	16.5%	18.2%
Provisions Expense Growth	-12.5%	-40.5%	37.8%	23.6%	11.1%
Operating Revenue / Average Assets	6.5%	6.0%	6.3%	6.4%	6.6%
Operating Expenses / Average Assets	1.3%	1.2%	1.0%	1.0%	1.0%
Pre-Provision ROA	5.2%	4.8%	5.3%	5.4%	5.5%
ROA	3.5%	3.5%	3.6%	3.7%	3.8%
Pre-Provision ROE	31.4%	34.2%	40.9%	43.1%	45.9%
ROE	21.1%	25.0%	28.1%	29.8%	31.9%
RoTE	20.3%	24.8%	26.3%	28.2%	29.7%
RoWRAs	3.7%	3.9%	3.9%	3.8%	3.6%
Dividend Payout Ratio	40.5%	49.6%	56.5%	50.4%	50.4%
Efficiency Ratio	20.4%	20.1%	16.2%	15.9%	15.8%
Headline Cost/Income Ratio	20.4%	20.1%	16.2%	15.9%	15.8%
Total Non-Interest Inc / Operating Inc	33%	27%	26%	22%	20%
Market-Related Revenue / Total Revenues	0%	0%	0%	0%	0%
Provisioning Burden as % of PPP	15.1%	7.8%	8.3%	8.6%	8.0%
NPLs plus Foreclosed Real Estate / Loans	0.9%	0.9%	1.3%	1.5%	1.7%
Loan Loss Reserves / NPLs	58.0%	58.1%	54.6%	58.1%	61.6%
Loan Loss Reserves / Total Loans	0.5%	0.5%	0.7%	0.9%	1.0%
Provisions Expense / Average Loans	1.0%	0.5%	0.5%	0.6%	0.5%

Other Metrics

Income / Employee	4.39	5.23	6.47	7.37	8.30
(Operating Expenses) / Employee	(0.896)	(1.05)	(1.05)	(1.17)	(1.31)
Pre-Provision Profit / Employee	2.96	3.85	4.97	5.66	6.42
Net Profit / Employee	2.35	3.09	3.76	4.28	4.85

Company Description

Indiabulls Housing Finance Ltd. (IHFL) is a third largest housing financial companies, with total loan assets on a managed basis of \$6.3bn as on H1FY14. IHFL offers a broad suite of lending and other financial products to target client base of middle and upper-middle income individuals and small- and medium-sized enterprises, or SMEs. It has presence across 200+ locations across India and in house sales team of sourcing agents .

Investment Thesis

We rate IHFL as a Buy on improving its B/S through maintaining adequate liquidity, high Tier I and high NPL coverage. Growth focus will be secondary. Given low market share in home loans (2%), we believe IHFL can continue to grow its volume above market average for next 3 years and also maintain its asset quality.

Stock Data

Price to Book Value 1.4x

3QFY14 Results Summary

Table 1: 3QFY4 Results Summary

Rsmn	3QFY14	3QFY13	YoY	Remarks
Interest income	15,058	11,431	32%	
Interest Expenses	9,068	6,653	36%	
Net Interest Income	5,990	4,778	25%	6% below estimates on higher cost of funds. Spreads (book basis) declined by 10bps qoq to 3.4% on shift in mix towards home loans vs. CV / commercial credit. AUM growth strong at 20% yoy. Share of Home loan up 300bps yoy to 48% in total AUM.
Other income	688	720	-5%	
-Fee income	600	621	-3%	Fee was weak. Disbursement declined 17% yoy to Rs31bn. Home loan forms the largest (58%) part of disbursement followed by LAP (26%) and rest to Corporate loans
Total Income	6,678	5,498	21%	
Total expenses	997	1,074	-7%	Improving operating efficiencies. Cost Income ratio down 460/100bps yoy / qoq to 15%
Pre Provision Profit	5,681	4,424	28%	3% below estimate on lower top-line and fee income
Provisions	319	95	235%	Asset quality comfortable. Gross NPLs up 7% qoq and Net NPLs up 11%. Gross now at 88bps and net at 48bps
Profit before tax	5,362	4,329	24%	
Tax expense + Minority	1,411	1,094	29%	
Net Profit	3,951	3,236	22%	Earnings 2% above estimates on and stable asset quality leading to lower provisions.

Source: BofA Merrill Lynch Global Research Estimates

Price objective basis & risk

Indiabulls Housing Finance Ltd. (XFQGF)

IHFL trades at 1.2x FY14 adj. book. Our PO of Rs305 is based on target P/B of 1.7x one-year forward adjusted book. We remain positive on IHFL's ability to grow its core 'mortgage' book, gain share, and hence, deliver above-average RoA/RoE. Improvements in financial / operating leverage should complement, boosting ROE. As a combine, these should drive a continued re-rating of the stock, in our view. We value IHFL using growth-adjusted P/BV method (Gordon Model), with the following key assumptions: ROE: 27% (adjusted RoEs for zero-coupon bonds, in our view) and Cost of equity at 15.5% (Risk free rate of 8%, Beta of 1.4, ERP of 5.5%). Risks are a very strong business growth leading to a spike in NPLs, which could hurt earnings momentum, and a sharp rise in wholesale borrowing costs can lead to spread compression.

Link to Definitions

Financials

Click [here](#) for definitions of commonly used terms.

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India - Financials Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
	Credit Analysis & Research Ltd (CARE)	XSEIF	CARE IN	Veekesh Gandhi
	HDFC	HGDFF	HDFC IN	Rajeev Varma
	HDFC Bank	XHDFE	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	Indiabulls Housing Finance Ltd.	XFOGF	IHFL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Veekesh Gandhi
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Mahindra and Mahindra Financial Services	XGDAF	MMFS IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XXMIF	MAX IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Veekesh Gandhi
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Indusind Bank	IDUBF	IIB IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma
RVW				
	Bajaj Finserv Limited	XBVJF	BJFIN IN	Rajeev Varma

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iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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XFQGF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

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Investment Rating Distribution: Financial Services Group (as of 31 Dec 2013)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	111	48.05%	Buy	97	87.39%
Neutral	72	31.17%	Neutral	57	79.17%
Sell	48	20.78%	Sell	30	62.50%

Investment Rating Distribution: Global Group (as of 31 Dec 2013)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1713	49.48%	Buy	1270	74.14%
Neutral	890	25.71%	Neutral	674	75.73%
Sell	859	24.81%	Sell	539	62.75%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
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23 January 2014

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