Company Focus

23 October 2007 | 11 pages

Indiabulls (IBUL.BO)

2Q08 Results: Slightly Below, but Focus Shifting to New Initiatives

- **Net profits up 82% yoy** — Ibull's 2Q08 profits grew strongly to Rs1.73bn (+82% yoy), though about 5% below expectations. Growth in the asset finance business remained strong, fee businesses increased traction, though brokerage revenues were below expectations despite a strong capital market environment.
- **Asset financing: Reducing risk** — Asset growth remains aggressive at 43% qoq (+664% yoy); though loan mix suggests a reduction in risk appetite (unsecured personal loans now 11% of consumer loans against 36% a year ago). Management targets Rs100bn of loans by end-FY08E; suggests stronger focus on relatively lower risk loans against property/mortgages and commercial loans.
- **Brokerage: Some growth, but lagging market** — Brokerage revenues rose +24% qoq (+10% yoy) but lags market volume growth of +30% qoq (+100% yoy). Fee incomes though gained traction (+350%) with insurance distribution key focus.
- **New business updates** — Management suggested a slew of initiatives – some near term – institutional broking and portfolio management services; others over the medium to longer term – insurance, asset management, credit cards and private equity management. De-merger of the securities businesses remains on track to be completed before end-FY08E. We believe these initiatives can be stock and value drivers going forward though still early days.
- **We await further clarity on these ventures** — before attributing values. Stock has underperformed SENSEX (-21%) over last 6 months. Maintain Sell (3M).

Sell/Medium Risk	3M
Price (22 Oct 07)	Rs567.50
Target price	Rs550.00
Expected share price return	-3.1%
Expected dividend yield	0.7%
Expected total return	**-2.4%**
Market Cap	Rs126,409M US$3,184M

Price Performance (RIC: IBUL.BO, BB: IBULL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	2,368	15.32	230.0	37.0	6.8	26.7	0.3
2007A	4,107	21.37	39.5	26.6	6.9	28.9	0.5
2008E	7,308	31.46	47.2	18.0	3.6	26.6	0.7
2009E	9,901	38.65	22.9	14.7	2.9	22.4	0.8
2010E	12,259	47.86	23.8	11.9	2.4	22.7	0.9

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	37.0	26.6	18.0	14.7	11.9
P/E reported (x)	37.0	26.6	18.0	14.7	11.9
P/BV (x)	6.8	6.9	3.6	2.9	2.4
P/Adjusted BV diluted (x)	7.5	7.8	3.6	3.0	2.4
Dividend yield (%)	0.3	0.5	0.7	0.8	0.9
Per Share Data (Rs)					
EPS adjusted	15.32	21.37	31.46	38.65	47.86
EPS reported	15.32	21.37	31.46	38.65	47.86
BVPS	82.89	82.56	157.72	192.42	235.96
Tangible BVPS	82.89	82.56	157.72	192.42	235.96
Adjusted BVPS diluted	75.50	72.62	155.50	189.72	232.65
DPS	1.81	3.02	4.00	4.50	5.00
Profit & Loss (RsM)					
Net interest income	2,422	6,750	11,514	16,331	20,232
Fees and commissions	2,101	2,333	3,180	3,783	4,738
Other operating Income	823	2,379	3,342	4,372	5,413
Total operating income	**5,347**	**11,462**	**18,036**	**24,487**	**30,383**
Total operating expenses	-1,495	-3,809	-5,660	-8,005	-10,249
Oper. profit bef. provisions	**3,853**	**7,653**	**12,376**	**16,482**	**20,134**
Bad debt provisions	-119	-722	-1,096	-1,304	-1,400
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**3,734**	**6,931**	**11,280**	**15,178**	**18,734**
Tax	-1,200	-2,197	-3,801	-5,115	-6,313
Extraord./Min. Int./Pref. Div.	-166	-628	-171	-161	-161
Attributable profit	**2,368**	**4,107**	**7,308**	**9,901**	**12,259**
Adjusted earnings	2,368	4,107	7,308	9,901	12,259
Growth Rates (%)					
EPS adjusted	230.0	39.5	47.2	22.9	23.8
Oper. profit bef. prov.	320.8	98.6	61.7	33.2	22.2
Balance Sheet (RsM)					
Total assets	**25,556**	**40,611**	**62,386**	**89,268**	**113,425**
Avg interest earning assets	17,876	30,870	47,241	69,441	93,363
Customer loans	12,383	23,872	45,089	69,240	90,734
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	**25,556**	**40,611**	**62,386**	**89,268**	**113,425**
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	**13,282**	**15,131**	**39,835**	**48,600**	**59,596**
Profitability/Solvency Ratios (%)					
ROE adjusted	26.7	28.9	26.6	22.4	22.7
Net interest margin	13.55	21.87	24.37	23.52	21.67
Cost/income ratio	28.0	33.2	31.4	32.7	33.7
Cash cost/average assets	7.9	11.5	11.0	10.6	10.1
NPLs/customer loans	0.0	0.0	0.0	0.0	0.0
Reserve for loan losses/NPLs	na	na	na	na	na
Bad debt prov./avg. cust. loans	1.1	4.0	3.2	2.3	1.7
Loans/deposit ratio	na	na	na	na	na
Tier 1 capital ratio	na	na	na	na	na
Total capital ratio	na	na	na	na	na

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Powered by: dataCentral

Figure 1. Indiabulls – 2Q08 Results: Key Highlights (Rupees Million, Percent)

	2Q08	2Q07	YoY %	1Q08	QoQ%	Citi Investment Research Comments
Income from Operations	4,929	2,704	82.3	4,427	11.3	
Other Income	25	0	12250.0	1	1958.3	
Gross Total Income	**4,953**	**2,704**	**83.2**	**4,428**	**11.9**	**Largely in line with expectations and driven by the financing incomes - now contributing about 65% of total revenues against 54% a year ago**
Interest expense	(531)	(112)	376.0	(332)	59.7	
Total Income	4,423	2,592	70.6	4,096	8.0	
Operating Expenses	(1,802)	(1,277)	41.1	(1,615)	11.6	Costs are slightly ahead of expectations - though explained by the continued expansion in distribution and employee costs. Expect cost additions to remain high
Operating Income	**2,621**	**1,315**	**99.3**	**2,481**	**5.6**	
Pre-Tax Profit	2,621	1,315	99.3	2,481	5.6	
Tax	(889)	(364)	144.1	(817)	8.7	
Net Profit	**1,732**	**951**	**82.1**	**1,664**	**4.1**	**Slightly below expectations - though growth remains impressive and high**
Segmental Revenues	**2Q08**	**2Q07**	**YoY %**	**1Q08**	**QoQ%**	
Broking	1,270	1,149	10.5	1,024	24.0	Growth market volumes and suggests a declining market share - challenges of being the incumbent in a buoyant market environment
Financing	3,204	1,453	120.5	3,087	3.8	Strong, driven by asset growth - though yields have declined slightly - expect more pressures on yields as loan mix to shift to relatively lower yielding assets
Fee and Others	480	101	375.2	317	51.4	Strong traction and momentum - especially on insurance distribution - which a key focus of the management and is fast gaining momentum
Total	**4,954**	**2,703**	**83.3**	**4,428**	**11.9**	**About 5% below expectations as broking growth continues to disappoint slightly**

Source: Company Reports and Citi Investment Research

An update on the new initiatives...

Management suggested a wide spectrum of new initiatives that are in the pipeline – some more near term than others – though potentially value drivers all. We believe these are still early days for these initiatives and await further clarity and fructification of these ventures before attributing values. The broad outlines of these businesses are:

- **Institutional Broking:** management suggests in advanced stages and likely to be culminated over the near term; management open to inorganic route for building scale in the business.
- **Portfolio Management Services:** Focus on mass affluent, will precede the asset management business.
- **Insurance:** Approvals pending but building distribution capability; third-party insurance distribution focus suggests can hit the ground running. More of a medium-term focus. Has large capital base to invest in the business, management estimates Rs3bn over first 2 years of business.
- **Asset Management:** Pending approvals, will be a step up from the portfolio management services planned.
- **Credit Cards:** Likely to tie-up with existing players –target existing group customers with strong credit record. Not a large focus.
- **Private Equity Fund Management:** initial targets of raising US$500mn – though still early days.

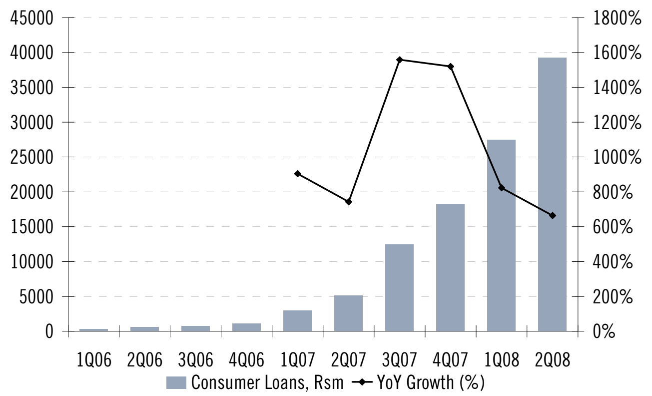
... And on the existing businesses

Asset financing

Growth with bias shifting to secured loans...

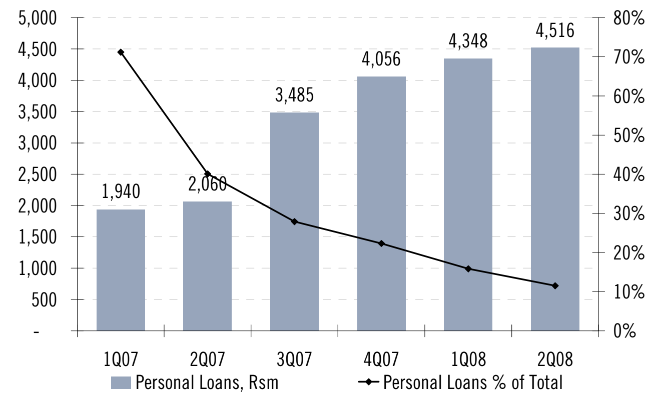
Asset growth remains impressive with a bias toward secured than unsecured loans. Secured loans now represent about 61% of total loans against 46% in March 2007. Growth in the small ticket personal loan segment has decidedly slowed down to a trickle – compared to own history as management shifts focus to relatively lower risk segments – loans against property, mortgages and loans to commercial businesses. Personal loans now comprise just 11% of consumer loans against 36% a year ago (though on a much smaller absolute base). We expect strong growth to continue with management targeting Rs100bn of outstanding loans by end-FY08E.

Figure 2. Consumer Loans - High growth (Rsm, %)



Source: Company Reports

Figure 3. Personal Loans – Declining proportions (Rsm, %)



Source: Company Reports

...Will continue to pressure yields

Figure 4. Indiabulls – Indicative Product Yields

Product / Segment	(%)
Personal Loans	Over 30%
Loans against shares	22-25%
Commercial/ Business Loans	19-25%
Used CVs	23%
Loans against property	18%
Mortgages against new homes	13-14%

Source: Company Reports and CIR Estimates

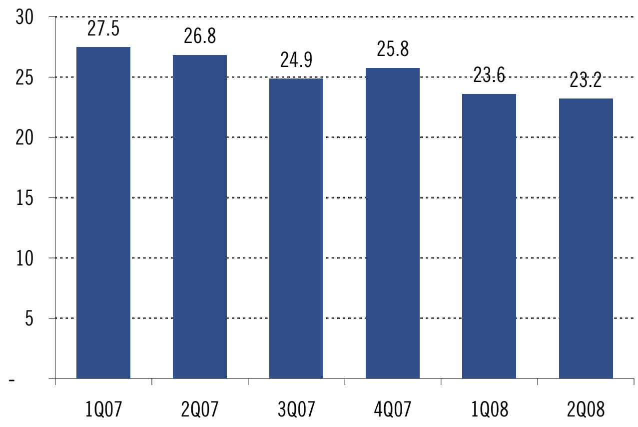
Changes in mix towards relatively lower yield assets will pressure yields downwards as will increasing competition in this segment – both from existing players seeking growth (private sector banks have recently raised capital) and newer entrants (likes of Reliance Capital). Though we believe there are enough opportunities for growth, yields will continue to be under pressure. We expect a lower interest rate environment as a potential risk to sustaining its relatively higher yields relative to competition.

Asset Quality: Provisioning appears adequate though portfolio is not seasoned yet

Recent increase in NPLs does suggest some pressure on the asset quality – especially on the unsecured portion of the portfolio. Current provisions appear adequate – though we believe, high portfolio growth and lack of adequate seasoning make it difficult to judge normalized loan losses. Though stated

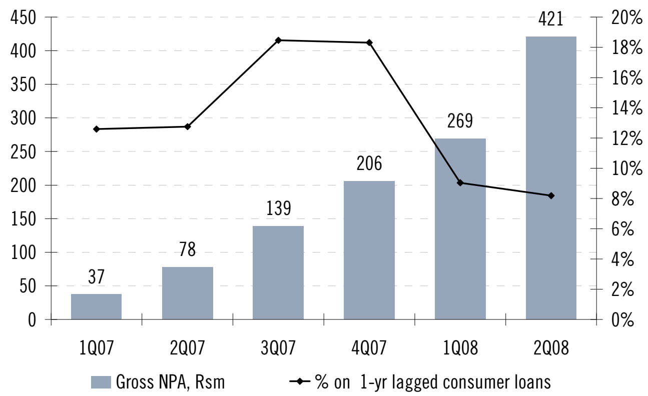
NPLs remain low at 1.1% of total loans – lagged NPLs are substantially higher at over 8% levels.

Figure 5. Average Loan Yields are declining... (%)



Source: Company Reports

Figure 6. ...And NPLs are rising (Rsm, %)



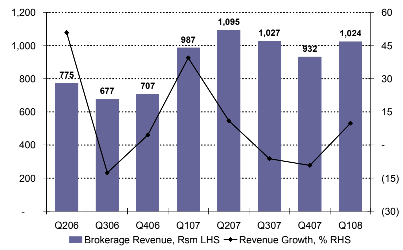
Source: Company Reports and Citi Investment Research

Retail broking: Pressure from new entrants

Growth lagging industry volumes

Brokerage revenues have grown 10% yoy (+24% qoq) this quarter after a flat revenue performance over the last 4 quarters – though growth is still lagging industry volume growth (+100% yoy; +30% qoq). Among the larger incumbents, Ibulls appears to be losing market shares to the newer and possibly more aggressive competition. We expect pressure on retail broking margins to continue on increased competitive intensity.

Figure 7. Brokerage Revenues, Growth - Rsm %



Source: Company Reports

Fee incomes gain momentum: focus on distribution

Key highlight for the second consecutive quarter – fee incomes rose over 50% qoq and 350% yoy. The key focus here is on distribution on third-party mutual fund insurance products. We believe this increases Ibulls' revenue diversification and reduces capital market related revenue volatility in its broking segment.

Indiabulls

Company description

Sameer Gehlaut (CEO), Rajiv Rattan (CFO) and Saurabh Mittal (Director), founded Indiabulls (IBFSL) in 2000. The company and its subsidiaries provide a variety of financial services, including equity, debt and derivatives brokerages, depositary services, equity-research services, third-party mutual funds and insurance product sales, commodities trading through on-line and off-line distribution channels, and loans. The company recently started offering unsecured personal loans through a JV company (with Farallon Capital), and has formed a JV for IPO financing (with Amaranth Capital). IBFSL listed on the Indian stock exchanges in Sep 2004, and issued GDRs in Feb and July 2005. IBFSL has entered into JVs with financial investors. IBFSL largely maintains management control and a controlling shareholding. IBFSL and its subsidiaries have built up their customer base rapidly with more than 450,000 clients as of December 2006. The group operates through its head office in New Delhi and 640 offices in 180 cities in India.

Investment strategy

We rate Indiabulls shares as Sell/Medium Risk (3M). Recent strong stock performance has run ahead of our fair value estimate and implies downside to our target price. Indiabulls continues its strong momentum in the broking business, and is well positioned at the top end of the market. The company is also restructuring its businesses into separate broking and lending businesses; we believe these should provide greater management focus, improve capital allocation, and potentially support higher valuations. We believe that Indiabulls could continue to post healthy growth in volumes and gain market share from the fringe players. Indiabulls' margin finance portfolio is a source of competitive advantage for the company as it helps to attract and retain potential clients. It is also backed by a strong technology-based risk management system that reduces risks of default significantly. Indiabulls has aggressively entered new business areas: mid-market consumer financing, IPO financing and loans against property. Growth in the consumer finance businesses has been strong. Potentially high-return, high-risk ventures, these businesses are in their infancy. Although these businesses could generate a substantial portion of incremental value, they do not come without risks.

Valuation

We are increasing our target price to Rs550 (Rs350 earlier). Our target price is based on a sum-of-the-parts calculation. We apply an 18x FY09E earnings multiple (17.1x FY08E earnings earlier) based on the Sensex FY09E multiple of 19x. We are removing the discount to market multiple as Indiabulls continues to retain its market share despite increasing competitive pressures. This values the broking business at Rs192.

We maintain a target multiple of 2.0x PBV but are rolling forward to FY09E PBV (2x FY08E P/B earlier) for the asset finance businesses on sustained high growth in the portfolio and factoring in additional capital raised. This values the asset finance business at Rs358.

Risks

Although our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a High Risk rating to Indiabulls shares, we use a Medium Risk rating because we believe revenue is well diversified as the company builds out into new business areas. We think this lowers its high-earnings, value-risk profile. Specific risks to our target price include a slowdown in capital markets and aggressive entry into the mid-market consumer finance segment. Upside risks, which could cause the shares to continue to trade above our target price include strong markets and continued market share gains, and better-than-expected scale and profitability in the consumer-finance business.

Appendix A-1

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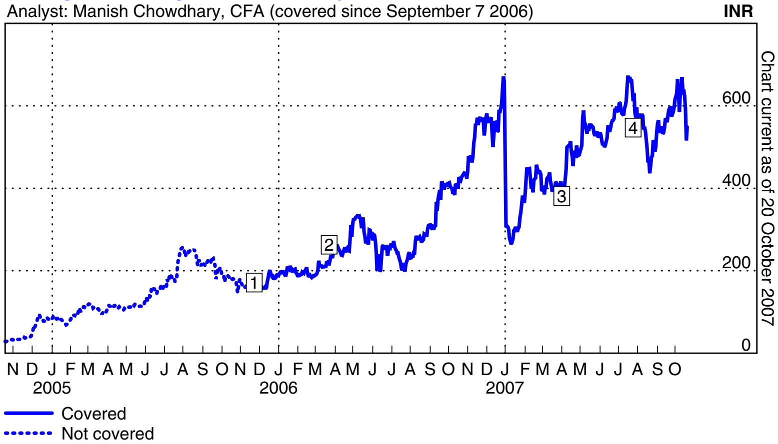
Indiabulls (IBUL.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Manish Chowdhary, CFA (covered since September 7 2006)



#	Date	Rating	Target Price	Closing Price
1:	23 Nov 05	3H	167.00	171.35
2:	23 Mar 06	*3M	*212.00	216.45
3:	2 Apr 07	3M	*350.00	400.45
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*Indicates change.

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