2 November 2007 | 10 pages

Indiabulls (IBUL.BO)

Sell: Presenting Blue-Sky; Maintaining Base Case

- **Estimating valuations including new initiatives** — We attempt here to estimate the best case valuations for Indiabulls, attributing aggressive values for its recently announced initiatives. However, we maintain our base case estimates, valuation (target price Rs550) and recommendation (Sell, 3M) as it is still too early to ascribe any definite values to these businesses pending execution.
- **Blue-sky scenario implies Rs930 per share** — Under best case assumptions, Indiabulls can potentially be valued at Rs930 per share, with new initiatives at Rs152 per share on FY09 estimates and a value of Rs778 per share for existing brokerage and finance businesses (assuming aggressive and higher than base case valuation multiples).
- **What are the assumptions?** — For starters, in each planned business line, we assume a) rapid market share gains, b) industry level profitability, and c) high industry growth. Specifically, we assume for the following businesses: a) Life insurance: Rs4.6bn in FY09E premiums (1% market share on new premium among the private players); b) AMC: Rs50bn of AUM (1% of market); c) US$500mn in private equity; d) Institutional broking: 2% market share (FY09E); e) Commodity exchange: 5% market share (FY09E). We highlight these assumptions in greater detail later in the report.
- **Value accretion to depend on execution success** — Indiabulls is seeking to leverage its large capital and distribution network. Though we believe value accretion could be gradual, it will depend on execution success.

Sell/Medium Risk	3M
Price (02 Nov 07)	Rs697.85
Target price	Rs550.00
Expected share price return	-21.2%
Expected dividend yield	0.6%
Expected total return	**-20.6%**
Market Cap	Rs155,444M US$3,962M

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	45.6	8.4	26.7	0.3
2007A	4,107	21.37	39.5	32.7	8.5	28.9	0.4
2008E	7,308	31.46	47.2	22.2	4.4	26.6	0.6
2009E	9,901	38.65	22.9	18.1	3.6	22.4	0.6
2010E	12,259	47.86	23.8	14.6	3.0	22.7	0.7

Source: Powered by dataCentral

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

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	45.6	32.7	22.2	18.1	14.6
P/E reported (x)	45.6	32.7	22.2	18.1	14.6
P/BV (x)	8.4	8.5	4.4	3.6	3.0
P/Adjusted BV diluted (x)	9.2	9.6	4.5	3.7	3.0
Dividend yield (%)	0.3	0.4	0.6	0.6	0.7
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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Figure 1. Indiabulls – Summary Valuation Table, Rupees

			Base Case		Bull Case	
Business/ Segment	**Parameter**	**Valuation**	**Value, Rsbn**	**Per share, Rs**	**Value, Rsbn**	**Per share, Rs**
Retail Broking / Distribution	Net Profits - estimated Rs2.7bn in FY09E	18 - 22x PE	48.1	192	59.4	238
Asset Financing	Book Value - estimated. Rs45bn in FY09E	2-3x PBV	89.5	358	135.0	540
Life Insurance	Assuming First Year Premium of Rs4.65bn in FY09E NBAP margins of 16-20%(50% of Reliance Capital's first full year's FYP)	18-22x NBAP			18.4	74
Asset Management	Assuming AUM of Rs50bn by end Mar09E	5-8% of AUM			4.0	16
Institutional Broking	Assuming 2% institutional market share and 30% Net Profit Margins in FY09E - translating to net profit of Rs0.5bn	18 - 22x PE			11.0	44
Private Equity Management	Assuming AUM of US$500mn in FY09E i.e. Rs20bn AUM	10-15% of AUM			3.0	12
Commodity Exchange	Assuming 5% market share in commodity volumes and 40% Net Profit Margins in FY09E - translating to a net profit of Rs60mn	22 - 28x PE			1.7	7
Total Value			**137.6**	**550**	**232.5**	**930**

Source: Citi Investment Research

Our bull case assumptions in more detail...

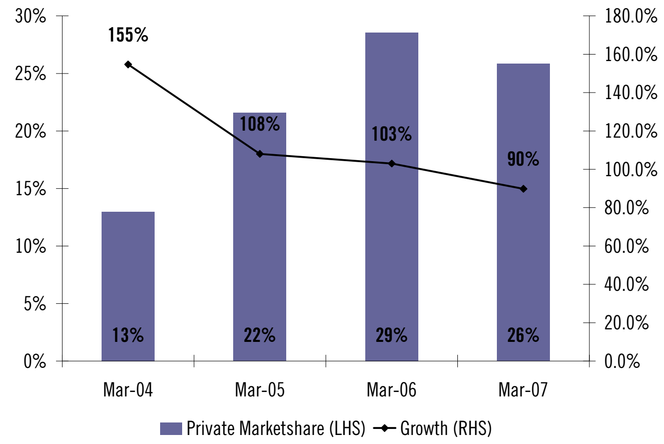
Life Insurance: Approvals pending, but building distribution capability. Has large capital base to invest in the business; management estimates Rs3bn over first 2 yrs of business.

Strong industry growth especially in the private sector; presence of large and dominant incumbents raises competitive intensity. Ibulls' third-party insurance distribution experience suggests it can hit the ground running. We assume 1% market share among the private sector banks on aggressive marketing and large existing distribution network and capability. As a comparative, Reliance Capital had written a FY premium of Rs9.3bn in its first full year of operations. We also assume an NBP margin of 20%, slightly higher than industry averages of about 19%

Figure 2. New Premiums (Rs Bn) and Split between Private and LIC

Source: Citi Investment Research, IRDA

Figure 3. Private Sector Market Share and Growth



Source: Citi Investment Research, IRDA

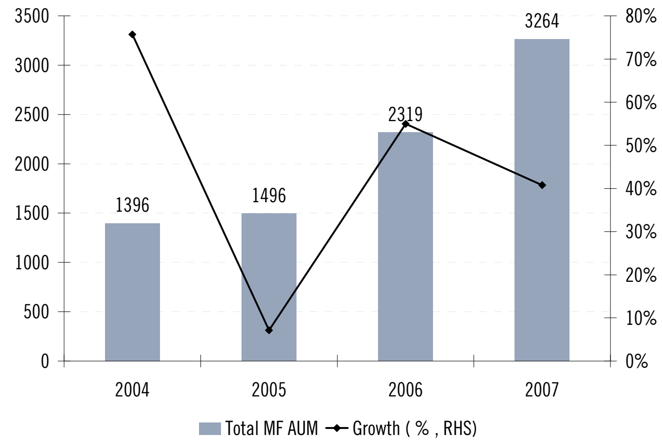
Asset Management: No significant regulatory hurdle. Approvals should be relatively easier with lower capital requirements.

Expect stronger growth in equity AUMs as large share of current AUMs in debt. Relatively fragmented market though has a few large and established players. Assuming AUMs of Rs50bn by FY09E, close to 1% of estimated industry AUMs

Institutional Broking: No approvals required; does not have a team on ground. Inorganic route can reduce time to market, and management suggests it is open to acquisitions. Institutional equity volumes have grown rapidly over the last four years.

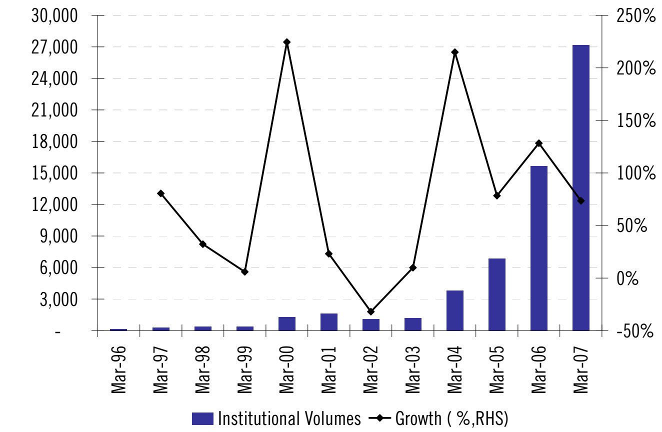
Foreign brokers have dominant market share; some domestic brokers have also built significant market shares. We assume Indiabulls will gain 2% market share in this growing pie by FY09E.

Figure 4. MF AUM and Growth (Rs Bn, %)



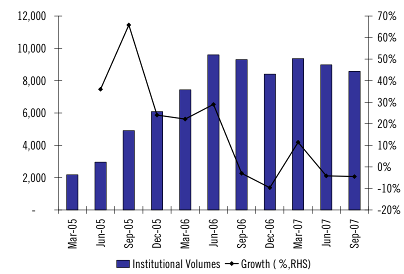
Source: Citi Investment Research, AMFI

Figure 5. Institutional Volumes Cash & F&O Both Sides (Rs Bn , %)



Source: Citi Investment Research, NSE

Figure 6. Quarterly Commodity Exchange Volumes – Single Side (Rs Billion,%)



Source: Citi Investment Research, FMC

Private Equity Fund Management: Initial targets of raising US$500mn – though still early days.

Commodity Exchange: Partnership with MMTC, a large domestic commodity trading house (Indiabulls has 76% stake). It has received government approvals. Cash surplus business with relatively low initial capex. It has to compete with two dominant national exchanges with over 90% market share between them.

We assume Indiabulls' venture to carve a 5% volume market share by FY09E with a normalized 40% net profit margin.

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

Our target price is Rs550 based on a sum-of-the-parts calculation. We apply an 18x FY09E earnings multiple based on the Sensex FY09E multiple of 19x. We do not apply a 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 FY09E PBV for the asset finance businesses on sustained high growth in the portfolio and factor 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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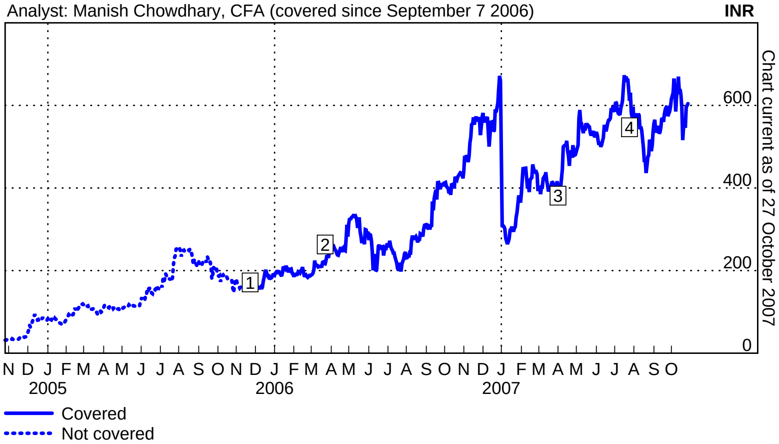
Indiabulls (IBUL.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Manish Chowdhary, CFA (covered since September 7 2006)



#	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
4:	25 Jul 07	3M	*550.00	611.40

*Indicates change.

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