Company Focus

27 July 2008 | 9 pages

Indiabulls (IBUL.BO)

Rating change ☑
Target price change ☑
Estimate change ☑

Sell: 1Q09 Below Estimates; Risks to Growth, Valuations

- **1Q09 profits: 24% below estimates** — Ibulls 1Q09 profits were down 22% QoQ (+29% YoY). The sharp reduction in profits was largely due to lower IPO funding opportunities, higher cash on books (earning negative carry) and lower loan yields (change in loan mix).
- **Management softens growth estimates** — Management guides to a 50-60% loan growth (down from 100%+ earlier) due to the challenging environment.
- **Asset Quality: seeking to reduce risks —** Ibulls is reducing exposure to unsecured loans (15% of loans); increasing exposure to mortgages (50%), commercial credit (20%, backed by real estate/securities) and loans against securities (10%). While asset quality seems to be well under control (0.9% NPLs), we remain cautious (higher yield loans, aggressive historical growth).
- **Funding: wholesale** — Ibull's dependence on wholesale funding will increase funding costs in a rising rate environment. While it has significant cash (over US$1.0bn), which provides room for growth - it is currently earning negative carry on this, pending disbursals. IBull's balance sheet is however, currently underleveraged with debt: equity of 3.5x (2.4x net of surplus cash).
- **Adjusting target price to Rs230** — We lower earnings (23%-25%), TP (to Rs230) and raise risk rating (to High) post securities business demerger. Our target multiple (1.5x 1yr Fwd PBV) is at a discount to private banks due to a lack of retail deposit franchise, a slower growth environment and relatively higher environmental risks to asset quality. Maintain Sell (3H).

Sell/High Risk	**3H**
from Sell/Medium Risk	
Price (25 Jul 08)	Rs280.00
Target price	Rs230.00
from Rs550.00	
Expected share price return	-17.9%
Expected dividend yield	3.2%
Expected total return	**-14.6%**
Market Cap	Rs70,960M
	US$1,686M

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 (%)
2007A	3,806	19.81	29.3	14.1	3.4	26.8	1.1
2008A	3,311	14.26	-28.0	19.6	2.2	13.9	3.0
2009E	7,436	29.03	103.6	9.6	1.9	21.3	3.2
2010E	9,388	36.65	26.2	7.6	1.6	23.1	3.4
2011E	11,478	44.81	22.3	6.2	1.3	23.8	3.6

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	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	14.1	19.6	9.6	7.6	6.2
P/E reported (x)	14.1	19.6	9.6	7.6	6.2
P/BV (x)	3.4	2.2	1.9	1.6	1.3
P/Adjusted BV diluted (x)	3.9	2.2	1.9	1.6	1.4
Dividend yield (%)	1.1	3.0	3.2	3.4	3.6
Per Share Data (Rs)					
EPS adjusted	19.81	14.26	29.03	36.65	44.81
EPS reported	19.81	14.26	29.03	36.65	44.81
BVPS	82.56	128.40	147.72	174.20	208.40
Tangible BVPS	82.56	128.40	147.72	174.20	208.40
Adjusted BVPS diluted	72.62	126.60	145.64	171.75	205.47
DPS	3.02	8.50	9.00	9.50	10.00
Profit & Loss (RsM)					
Net interest income	6,449	7,518	13,615	17,944	22,738
Fees and commissions	2,333	3,180	0	0	0
Other operating Income	2,379	3,342	4,434	5,877	7,468
Total operating income	**11,161**	**14,040**	**18,049**	**23,821**	**30,206**
Total operating expenses	-3,809	-5,660	-4,566	-6,264	-8,440
Oper. profit bef. provisions	**7,352**	**8,380**	**13,483**	**17,557**	**21,766**
Bad debt provisions	-722	-1,096	-2,023	-3,154	-4,210
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**6,631**	**7,283**	**11,460**	**14,403**	**17,556**
Tax	-2,197	-3,801	-3,862	-4,854	-5,916
Extraord./Min. Int./Pref. Div.	-628	-171	-161	-161	-161
Attributable profit	**3,806**	**3,311**	**7,436**	**9,388**	**11,478**
Adjusted earnings	3,806	3,311	7,436	9,388	11,478
Growth Rates (%)					
EPS adjusted	29.3	-28.0	103.6	26.2	22.3
Oper. profit bef. prov.	90.8	14.0	60.9	30.2	24.0
Balance Sheet (RsM)					
Total assets	**40,611**	**156,869**	**170,014**	**238,061**	**332,155**
Avg interest earning assets	30,870	94,936	158,112	196,986	275,395
Customer loans	23,872	71,671	141,436	215,065	303,585
Gross NPLs	0	0	0	0	0
Liab. & shar. funds	**40,611**	**156,869**	**170,014**	**238,061**	**332,155**
Total customer deposits	0	0	0	0	0
Reserve for loan losses	0	0	0	0	0
Shareholders' equity	**15,131**	**32,430**	**37,309**	**43,997**	**52,634**
Profitability/Solvency Ratios (%)					
ROE adjusted	26.8	13.9	21.3	23.1	23.8
Net interest margin	20.89	7.92	8.61	9.11	8.26
Cost/income ratio	34.1	40.3	25.3	26.3	27.9
Cash cost/average assets	11.5	5.7	2.8	3.1	3.0
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	4.0	2.3	1.9	1.8	1.6
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: 1Q FY09 Results – Highlights (Rupees Million, Percent)

	1Q09	1Q08	YoY %	4Q08	QoQ%	Citi Investment Research Comments
Income from Operations	5,637	4,427	27.3	5,818	-3.1	Revenues QoQ impacted due to lower IPO financing activities - formed 10% of revenues in 4Q08
Other Income	9	1	689.9	1	953.2	
Gross Total Income	5,646	4,428	27.5	5,818	-3.0	Overall revenues (ex-securities business) up 74% YoY - largely led by a strong (180% YoY) growth in advances though offset by a decline in loan yields
Interest expense	(2,338)	(332)	603.5	(2,084)	12.2	Sharp growth due to surplus cash on the balance sheet during 1Q09 - management indicated over US$1bn
Total Income	**3,308**	**4,096**	**-19.2**	**3,735**	**-11.4**	
Operating Expenses	(1,302)	(1,615)	-19.4	(1,156)	12.6	A sharp 12% increase in costs QoQ - ahead of estimates and a relative surprise
Pre-Tax Profit	2,007	2,481	-19.1	2,579	-22.2	
Tax	(517)	(817)	-36.7	(685)	-24.5	
Minorities	(21)	0	NM	(7)	214.7	
Net Profit	**1,468**	**1,664**	**-11.7**	**1,887**	**-22.2**	**Profits up 28.8% YoY (ex-securities biz) but significantly below estimates**
EPS	5.79	7.21	-19.7	7.45	-22.2	

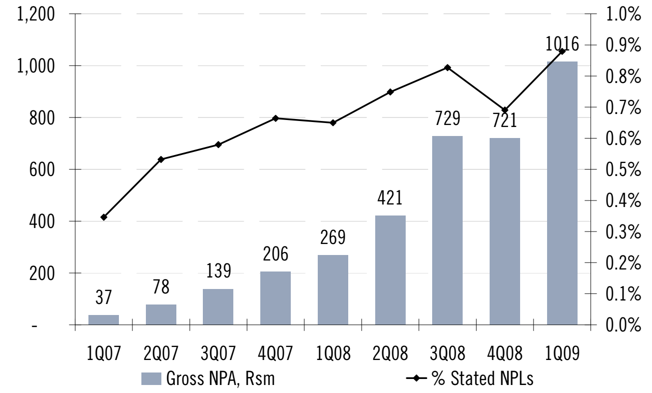
Source: Citi Investment Research

Figure 2. Indiabulls: Earnings Revision Summary

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
FY09E	9,901	7,436	-24.9	38.7	29.0	-24.9	4.5	9.0
FY10E	12,259	9,388	-23.4	47.9	36.6	-23.4	5.0	9.5
FY11E	NA	11,478	NA	NA	44.8	NA	NA	10.0

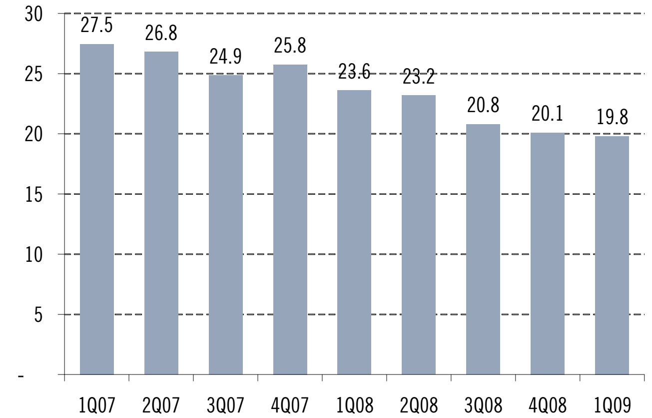
Source: Citi Investment Research

Figure 3. NPLs and NPL Ratio (Rupees Million, %)



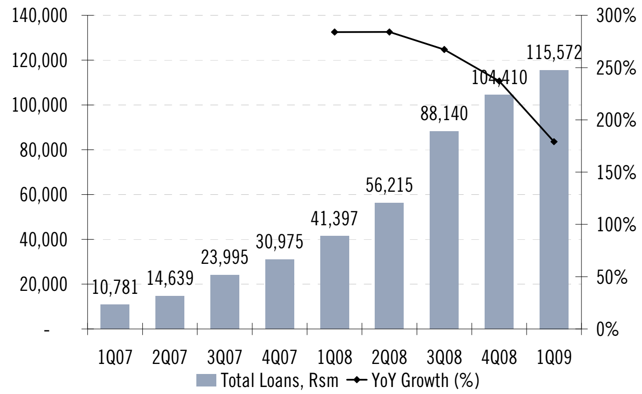
Source: Citi Investment Research

Figure 4. Tapering Yields on Assets (%)



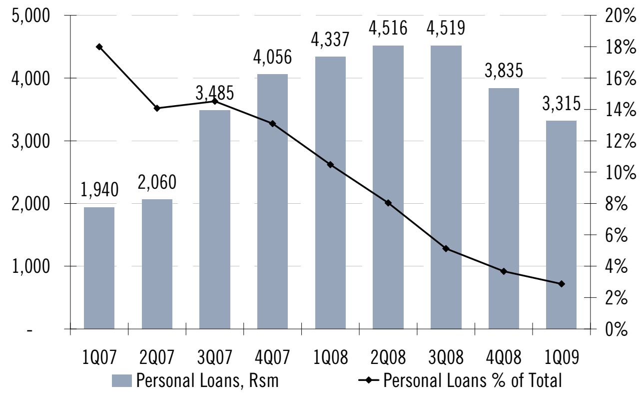
Source: Citi Investment Research

Figure 5. Total Loans and Growth (Rupees Million,%)



Source: Citi Investment Research

Figure 6. Reducing Personal Loan portfolio (Rupees Million, %)



Source: Citi Investment Research

Indiabulls

Company description

Sameer Gehlaut (CEO), Rajiv Rattan (CFO) and Saurabh Mittal (Director), founded Indiabulls (IBFSL) in 2000. The company and its subsidiaries are engaged in lending activities, offering personal loans, mortgages, commercial credit and loans against securities. It also undertakes third-party insurance product sales and distribution. Indiabulls is seeking to diversify into commodity exchanges, asset management and life insurance manufacturing. IBFSL listed on the Indian stock exchanges in Sep 2004.

Investment strategy

We rate Indiabulls shares as Sell/High Risk (3H). Indiabulls has aggressively entered new business areas: mid-market consumer financing, SME loans, 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 the stage of building up aggressively.

However, we see potential pressures in these businesses due to a) higher interest rates and tight liquidity environment, b) lower economic growth and c) increased environmental risks to asset quality. Indiabulls operates off a wholesale funding platform which suffers in a rising interest rate environment due to higher costs and availability. Indiabulls has been growing its asset portfolio very aggressively and a significant proportion of its loans are from SME, unsecured loans and loan against shares. Growth in this portfolio is highly leveraged to strong growth in the domestic economy and capital markets – current deceleration in growth would likely result in a sharp decline in its growth rates. Also, in a rising rate environment, there are significant risks to asset quality, especially in the SME and unsecured loans segments, which is another source of risk for Indiabulls.

Valuation

We revise our target price on Indiabulls to Rs230 (Rs550 earlier) post demerger of its securities business. Our new target price is based on 1.5x 1yr Fwd PBV (2x FY09E PBV earlier) for the financing businesses. Our target multiple is at a significant discount to other private sector banks (HDBK, Axis, Yes Bank) and best of breed non-banking finance companies (IDFC) due to its fully wholesale funded model, aggressive growth rates (raising asset quality risks) and its relatively higher yields and significant SME, unsecured and small businesses portfolio.

Risks

We rate Indiabulls High Risk (Medium) in-line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. We are raising our risk rating due to the demerger of its securities business (reduces revenue diversification), its dependence on wholesale funding (current rising interest rates are likely to raise funding costs, reduce availability) and increasing leverage. Moreover, Ibull's asset quality is also fundamentally under pressure due to a higher interest rate environment. Specific upside risks to our target price include a) decline in interest rates or easy liquidity environment, b) reversal in the asset quality environment, c) higher than expected margins on the lending portfolio, and d) faster than expected scale up / value accretion in announced new business ventures (life insurance, commodity exchange, asset management).

Appendix A-1

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Indiabulls (IBUL.BO)

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

Covered
Not covered

Rating/target price changes above reflect Eastern Standard Time

#	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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