# IndiaBulls Financial Services

**Price Objective Change** **BUY**

Equity | India | Securities Broker/Dealer
16 October 2006

# Enhanced Visibility on Unlocking of Value


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## Raising PO on back of Enhanced Visibility on De-Merger

We are raising our price target from Rs315 to Rs490 owing to the rising value of its businesses, estimated at 49% higher than our earlier forecasts (see our report titled *'Unlocking of Realty Value'*, dated 26th July 2006), principally owing to much stronger than expected equity markets, a revised macro outlook, likely ramp up in the real estate business and expected de-merger by Nov.15th. Based on our *new* sum of parts, we get a value of Rs491/share, implying about 20% potential upside, underpinning our new PO of Rs490. Delays in de-merger; weakness in equity markets key risks to PO.

- Real estate business valued at Rs189/share (FY08E) factoring in possible upside to future real estate acquisition which IFSL is planning.
- Consumer finance business is valued at 1.7x FY07E book given its forecast ROE of 24%, 1.7x higher than the CoE at 14%. The valuations are reflective of our revised macro outlook (lower bond yields; strong visibility of growth) and the sustained rapid growth in business.
- The securities business is valued at 15x FY08E earnings (15% discount to market) capturing the strong equity markets and the 7%-8% upside to earnings in brokerage business.

## 2QFY07 Results Better Than Expected

While IFSL's reported net profit for the 2QFY07 at Rs951, up 59% yoy, was 11% ahead of our estimates, it was driven by lower taxes. Operating earnings were in line. Factoring in the lower tax rates (owing to writeoffs) we have raised our earnings estimates by 6%-7% for FY07-08.

### Estimates (Mar)

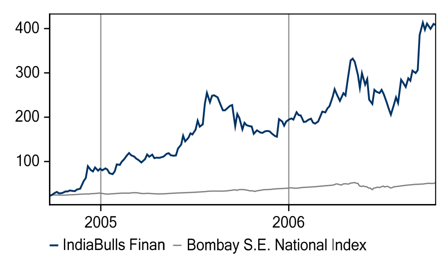
| (Rs) | 2005A | 2006A | 2007E | 2008E | 2009 |
|---|---|---|---|---|---|
| Net Income (Adjusted - mn) | 498.90 | 2,369 | 3,155 | 4,292 | NA |
| EPS | 3.74 | 14.78 | 17.68 | 22.59 | NA |
| EPS Change (YoY) | 63.8% | 294.9% | 19.6% | 27.8% | NA |
| Dividend / Share | 0 | 1.80 | 2.50 | 3.50 | NA |
| Free Cash Flow / Share | NA | NA | NA | NA | NA |
| GDR EPS (US$) | 0.086 | 0.332 | 0.389 | 0.497 | NA |
| GDR Dividend / Share (US$) | 0 | 0.040 | 0.055 | 0.077 | NA |

### Valuation (Mar)

| | 2005A | 2006A | 2007E | 2008E | 2009 |
|---|---|---|---|---|---|
| P/E | 109.27x | 27.67x | 23.14x | 18.11x | NA |
| Dividend Yield | 0% | 0.440% | 0.611% | 0.855% | NA |

### Stock Data

| | |
|---|---|
| Price (Common / GDR) | Rs409.15 / US$6.50 |
| Price Objective | Rs490.00 / US$11.00 |
| Date Established | 16-Oct-2006 / 16-Oct-2006 |
| Investment Opinion | C-1-7 / C-1-7 |
| Volatility Risk | HIGH / HIGH |
| 52-Week Range | Rs135.00-Rs446.40 |
| Market Value (mn) | US$1,454 |
| Shares Outstanding (mn) | 161.5 / 161.5 |
| Average Daily Volume | 1,704,316 |
| ML Symbol / Exchange | XPZMF / BSE |
| ML Symbol / Exchange | XVZXF / LUX |
| Bloomberg / Reuters | IBULL IN / IBUL.BO |
| ROE (2007E) | 18.8% |
| Leverage (2006A) | NA |
| Est. 5-Yr EPS / DPS Growth | 35.0% / 20.0% |
| Free Float | NA |

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Refer to important disclosures on page 13 to 14. Analyst Certification on page 11. Price Objective Basis/Risk on page 11.


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# iQprofile[SM] IndiaBulls Financial Services

| Key Income Statement Data (Mar) | 2005A | 2006A | 2007E | 2008E | 2009 |
|---|---|---|---|---|---|
| (Rs Millions) | | | | | |
| Net Interest Income | 363.39 | 1,921 | 2,162 | 1,997 | NA |
| Net Fee Income | 0 | 0 | 0 | 0 | NA |
| Securities Gains / (Losses) | NA | NA | NA | NA | NA |
| Other Income | 1,187 | 3,896 | 8,250 | 15,358 | NA |
| Total Non-Interest Income | 1,187 | 3,896 | 8,250 | 15,358 | NA |
| Total Operating Income | 1,551 | 5,817 | 10,412 | 17,355 | NA |
| Operating Expenses | (650.24) | (1,998) | (4,078) | (7,310) | NA |
| Pre-Provision Profit | 900.30 | 3,819 | 6,334 | 10,045 | NA |
| Provisions Expense | 0 | (85.00) | (950.00) | (2,100) | NA |
| Operating Profit | 900.30 | 3,734 | 5,384 | 7,945 | NA |
| Non-Operating Income | NA | NA | NA | NA | NA |
| Pre-Tax Income | 900.30 | 3,734 | 5,384 | 7,945 | NA |
| Net Income to Comm S/Hold. | 498.90 | 2,369 | 3,155 | 4,292 | NA |
| Adjusted Net Income (Operating) | 498.90 | 2,369 | 3,155 | 4,292 | NA |

| Key Balance Sheet Data | | | | | |
|---|---|---|---|---|---|
| Total Assets | 12,215 | 25,556 | 47,027 | 71,095 | NA |
| Average Interest Earning Assets | NA | NA | NA | NA | NA |
| Weighted Risk Assets | NA | NA | NA | NA | NA |
| Total Gross Customer Loans | 8,464 | 13,202 | 34,031 | 57,426 | NA |
| Total Customer Deposits | NA | NA | NA | NA | NA |
| Tier 1 Capital | NA | NA | NA | NA | NA |
| Tangible Equity | NA | NA | NA | NA | NA |
| Common Shareholders' Equity | 4,484 | 13,114 | 20,474 | 27,485 | NA |

| Key Metrics | | | | | |
|---|---|---|---|---|---|
| Net Interest Margin | NA | NA | NA | NA | NA |
| Tier 1 Ratio | 0% | 0% | 0% | 0% | NA |
| Effective Tax Rate | 37.0% | 32.1% | 30.0% | 30.0% | NA |
| Loan / Assets Ratio | 69.3% | 51.7% | 72.4% | 80.8% | NA |
| Loan / Deposit Ratio | NA | NA | NA | NA | NA |
| Oper Leverage (Inc Growth - Cost Growth) | 52.0% | 67.9% | -25.1% | -12.6% | NA |
| Gearing (Assets / Equity) | 2.7x | 1.9x | 2.3x | 2.6x | NA |
| Tangible Common Equity / Assets | 0% | 0% | 0% | 0% | NA |
| Tangible Common Equity / WRAs | NA | NA | NA | NA | NA |
| Revenue Growth | 130.0% | 275.2% | 79.0% | 66.7% | NA |
| Operating Expense Growth | 78.0% | 207.3% | 104.1% | 79.3% | NA |
| Provisions Expense Growth | NA | NA | 1,017.6% | 121.1% | NA |
| Operating Revenue / Average Assets | NA | NA | NA | NA | NA |
| Operating Expenses / Average Assets | NA | NA | NA | NA | NA |
| Pre-Provision ROA | NA | NA | NA | NA | NA |
| ROA | NA | NA | NA | NA | NA |
| Pre-Provision ROE | NA | NA | NA | NA | NA |
| ROE | 19.8% | 26.9% | 18.8% | 17.9% | NA |
| RoTE | NA | NA | NA | NA | NA |
| RoWRAs | NA | NA | NA | NA | NA |
| Dividend Payout Ratio | 0% | 12.2% | 14.1% | 15.5% | NA |
| Efficiency Ratio (Cost / Income Ratio) | 41.9% | 34.3% | 39.2% | 42.1% | NA |
| Total Non-Interest Inc / Operating Inc | 77% | 67% | 79% | 88% | NA |
| Market-Related Revenue / Total Revenues | 0% | 0% | 0% | 0% | NA |
| Provisioning Burden as % of PPP | 0% | 2.2% | 15.0% | 20.9% | NA |
| NPLs plus Foreclosed Real Estate / Loans | 0% | 0% | 0% | 0% | NA |
| Loan Loss Reserves / NPLs | NA | NA | NA | NA | NA |
| Loan Loss Reserves / Total Loans | NA | NA | NA | NA | NA |
| Provisions Expense / Average Loans | 0% | 0.8% | 4.0% | 4.6% | NA |

| Other Metrics | | | | | |
|---|---|---|---|---|---|
| Income / Employee | 0.934 | 1.23 | 1.30 | 1.74 | NA |
| (Operating Expenses) / Employee | 0.392 | 0.422 | 0.510 | 0.733 | NA |
| Pre-Provision Profit / Employee | 0.542 | 0.788 | 0.673 | 0.796 | NA |
| Net Profit / Employee | 0.301 | 0.500 | 0.394 | 0.430 | NA |

## Company Description

Indiabulls is a leading equity brokerage, set up in the mid-1990s, provides equity and derivative brokerage services to the retail segment, which accounts for 60-65% of the total market volumes in India. It also provides consumer finance to the lower middle income segments of the society, a high-risk, high-return business. Through another JV, it has also diversified into real estate and property development.

## Table 1: Sum of Parts Valuation

| On IFSL's Per Share Basis | FY08 - Old | FY08 - New | Chg |
|---|---|---|---|
| Real Estate | 156 | 189 | 21% |
| Consumer Finance | 33 | 45 | 38% |
| Brokerage | 156 | 272 | 74% |
| Less: BV of Invst in IFSL | -15 | -15 | 0% |
| Per Share of IBL | 330 | 491 | 49% |

Source: Merrill Lynch Research Estimates

## Stock Data

| | |
|---|---|
| Shares / GDR | 1.00 |
| Price to Book Value | 3.2x |

## 2QFY07 Results Review

IFSL's 2QFY07 net income was up 59%yoy to Rs951mn, higher than our estimate of Rs861mn mainly due to lower tax rates. While revenues were also up 11% yoy, that was offset by higher operating expenses, resulting in operating profit being in line with estimates and pre-tax (up 48% yoy) being up only 2% higher than our estimates.

The growth was led by robust brokerage business and increasing traction on the consumer financing business. In the margin financing business, despite relatively moderate top line growth (21%yoy), net income grew 59%yoy to Rs306mn on account of a sharp decline in interest expenses as the company used its recent capital raising (issuing preference share) of Rs6.4bn to repay its borrowings.

Key Results highlights are mentioned below division-wise.

### Securities business

- Securities business (comprising brokerage, margin financing, IPO financing and distribution of third party products) top line grew 25%yoy as the company maintained its market share at around 7%, adding around 56,000 clients in the 2QFY07, taking its total client base to around 387,000.

- Net income (PAT) growth from securities business was, however, higher due to lower interest expenses, despite a sharp rise in lending book, due to the Rs6.4bn preference share issue done by IFSL, which was utilised to repay high-cost borrowings.

### Consumer financing business

- The consumer financing business is the fastest growing segment for the company and is operated through a separate subsidiary in which IFSL holds a 53% stake. The business is run through a separate distribution network with over 158 offices and an employee base of over 5000. It's headed by a senior banker, Mr Suresh Gurmani (from Standard Chartered Bank).

- The consumer financing business continued to be on a strong growth trajectory with the O/S loans growing 8-fold yoy to Rs5.0bn and, more importantly, more than doubling over their Jun-06 levels. It contributed around 23% of the top line in 2QFY07 v/s 15% in 1QFY07. Loan yields have, however, declined from an average of 31%yoy in the 1QFY07 to 29% in 2QFY07 owing to an increasing proportion of low risk-low yield loans like mortgages. A corresponding effect is, however, expected in the cost of funding also as the company increases the proportion of secured funding in its total loan book.

### Consolidated Financials

- Top line grew 74%yoy to Rs2.7bn, led by a four-fold rise in other income (12% of total income) i.e. mainly fees, and 113%yoy growth in financing business, largely consumer financing. Brokerage (and related income) revenues have grown 27%yoy.

- While the net profit growth was 59%yoy, EPS growth was subdued (up 22%yoy) owing to the capital raising done by the bank in the last year and rising proportion of minority interest (on the consumer financing business).

- EBITDA growth was relatively lower at 45% due to a 129%yoy increase in operating expenses due to a) most recruitments happen in the month of

May and June while the scale-up happens gradually throughout the year, b) the opex line includes floating NPL provisions @11% of the consumer financing book. PBT growth was marginally higher (48%yoy) due to marginal rise in interest expenses due to the preference share issue done by IFSL (discussed earlier)

- The higher than estimated growth in earnings was primarily on account of lower tax rates (28% in 2QFY07 v/s average tax rate of 32-33%) due to aggressive writeoffs done by the bank.

Table 2: 2QFY07 Income Statement

| (Rs mn) | Q2FY06 | Q2FY07 | yoy growth |
|---|---|---|---|
| Income from Operations | 1,550 | 2,704 | 74% |
| - Brokerage and Capital market related income | 865 | 1,096 | 27% |
| - Financing income | 599 | 1,277 | 113% |
| -Other income | 86 | 331 | 283% |
| Opex | 540 | 1,239 | 129% |
| EBIDTA | 1,010 | 1,465 | 45% |
| Interest and Finance charges | 102 | 112 | 10% |
| Depreciation | 17 | 38 | 124% |
| PBT | 892 | 1,315 | 47% |
| Provision for Tax | 292 | 364 | 25% |
| PAT | 599 | 951 | 59% |

Source: Company Reports

## Looking Ahead – FY07 and Beyond

We briefly outline the key earnings drivers for IFSL, going forward, and more importantly, the expected change in its business model which in our view will be driving its earnings and also have significant impact on its valuations.

### Securities business momentum linked to equity markets buoyancy

The brokerage business (comprising brokerage of equity and derivative products, margin financing and IPO financing business), in our view, will continue to be the mainstay of IFSL's revenue streams over the next few years, although its share in overall revenues is likely to fall from 80% in FY06 to 50% by FY08E.

IBL has been managing to hold onto its market share of around 7% in the brokerage business. However, we believe the key challenge for IBL will be to ensure that it can sustain this in the future and possibly expand it further. In the past IBL had been rapidly gaining market share, which appears to be plateauing. Incrementally the growth is likely to be driven by the volumes in equity markets and the underlying buoyancy in equity markets. To that extent, we reckon the volatility in earnings may also be the most for this business.

Hence, we are factoring in a deceleration in both revenues and earnings, going forward, owing to volume growth being more moderate overall for the equity markets and greater price competition. We expect commission rates for IFSL, estimated at around 8bps, to contract further to about 6bps by FY08.

However, we do expect IFSL to keep adding customers at a very rapid pace and gain marginal market share from current levels of 7% to close to 7.3% by FY08.

### Consumer finance business to be key growth driver

The consumer finance business will, in our view be the principal growth driver for IFSL's future earnings streams (excluding real estate). IFSL has already grown its consumer loan book almost 5x in just 6 months (since April'06) to Rs5bn as of Sep'06. The consumer finance subsidiary is now offering the entire range of products to sub-prime borrowers such a small shopkeepers, car drivers, peons, clerical staff of companies etc.

The average yield on its loans is currently at 29%. With rates expected to rise, we expect IFSL to be in a position to raise lending rates by 100-150bps over the next 2 years. We have, however, factored in some fresh competition within the segment and are forecasting some contraction in net interest margins from an estimated 26% in FY07 to 24% by FY08. Many of the NBFCs including players such as DBC Chola and also a few private banks are beginning to contemplate entry strategies for this segment as a nice product.

Margins are still significantly higher than spread (estimated at 19-20%) owing to a higher proportion of funding coming from equity sources. While increasing leverage would result in contraction of net interest margins, the same would also result in expansion of ROE.

Given the aggressive plans of IFSL, we expect the consumer finance book to grow almost 2.5-fold from Sep'06 levels to about Rs12.5bn in FY07, rising to about Rs30bn by FY08.

The main challenge, in our view, in IFSL's consumer finance business would be managing the delinquency, especially in rising rate environment. While NPLs are currently only at 5% they are not reflective of the underlying trends as IFSL's loan portfolio is not seasoned given the very early stage of the cycle at which the company is. IFSL, however, is providing about 10% of its loans as general provisions to help offset any future NPLs.

Factoring in rising NPL provisions and a 5-fold jump in its operating expenses, we still expect the consumer finance business earnings to grow by over four-fold in FY07 and then more than double in FY08.

## Raised Earnings by 6-7%; EPS <0.5%

We have raised our earnings estimates by 6% for FY07 and 7% in FY08 factoring in a) lower tax rates and b) lower interest outgo due to the fresh capital raising of Rs3bn though preferential allotment of 7.25mn equity shares. We now expect net profit (PAT after minority interest but before preference dividend) to grow 43% in FY07 and 36% in FY08 driven by

- +300% annualized growth in the consumer financing business; the growth, though coming from a low base, is expected to be the key driver of earnings for the company, estimated to contribute around 36% of total revenues in FY08 (v/s 6% in FY06)

- +50% growth in brokerage revenues in FY07 as IFSL gains some market share with aggressive expansion of distribution network driving strong client additions. The fall in average volume per client (due to market condition) should be more than offset by volume growth due to new client additions.

### EPS growth to be marginal owing to equity dilution

EPS growth is, however, expected to be more moderate at 20% in FY07 and 28% in FY08 owing to the equity dilution due to the a) recent preferential allotment of 7.25mn shares, b) conversion of 11mn warrants issued to the promoters and c) conversion of preference shares. Earnings per share for IFSL's brokerage business, in our estimate, will begin to show much sharper deceleration, growing only 10-12% in FY07/FY08 owing to overall slowdown in growth as many other players are aggressively venturing into this business and looking to up the scale, including the likes of Indiainfoline, IL&FS Investmart etc.

### Factored in higher NPL provisions

We have also factored in higher NPL provisioning, assuming a delinquency rate of 8-10% in the consumer financing business. While the current delinquency rates are much lower at 5%, the company, in our view, is still in the early stage of the credit cycle and the delinquency rates are estimated to rise over the next few quarters, especially given our view of an uptick in the asset quality cycle.

## Real Estate Business

IFSL's real estate business is, in our view, likely to be the largest value generator for the company from both a valuation perspective and also the scalability of the business model that it is seeking to build.

IFSL has a 40% stake in the real estate company called Indiabulls Real Estate Private limited. The balance is held by Farallon. IFSL plans to set up each real estate venture through a separate SPV. Additionally, according to IBL, it plans to raise the stake in each of the real estate ventures to 51%.

The realty company which would be the holding company for all the real estate ventures is likely to be de-merged from IFSL into a separate company, according to IFSL. The de-merger is awaiting court approvals and would in our view take about 3 months. The swap ratio has already been finalized at 1:1; i.e., for every one share of IFSL, investors will get one share of the realty company.

We show below the key details of the properties that Indiabulls real estate company already has:

Table 3: Real Estate Valuation

| Project | Ibulls Holding (%) | Area (mn sqft.) | Rental in Rs./sf/mth | Other Income/ Maintenance | Yield rate | Property wise Sale Value in Rs.mn | Net value Rs.mn | Developer Profit in Rs.mn | Land Valuation Rs.mn |
|---|---|---|---|---|---|---|---|---|---|
| Delhi Project (Residential) | 26% | 1.3 | | | | 22,500 | 4,714 | 943 | 3,771 |
| Mumbai Project (IT Park) | 40% | 3.5 | 175 | 10 | 10% | 77,700 | 27,784 | 5,557 | 22,228 |
| Sonepat | 40% | 1.6 | | | | 1,168 | 581 | 116 | 465 |

Source: Company Reports, ML Research Estimates

The above are broad estimates for the possible value of these properties. However, the Mumbai properties have been valued by Knight Frank. According to IFSL, Knight Frank has assigned a value of Rs26,427mn for the 2 Mumbai properties as of Jan1, 2008.

This, as per our estimate (after factoring in the equity dilution) and time discount works out to Rs156/share in FY08E, as detailed in our earlier report.

The key challenge, in our view, would be to successfully implement these projects, especially the Mumbai projects by developing these properties on time and ensuring a high occupancy at the earliest. This is especially important given that IFSL has no past track record in this field.

### Likely to expand realty business very rapidly; could add 30-40%

Going forward, we expect Indiabulls to continue to expand its realty business very rapidly. The company is actively seeking to acquire more properties and we reckon it could add 4-5 properties over then next 6 months. While it is hard to quantify the same, we reckon the aggregate value of future properties could be 30-40% of its existing properties.

## Valuation

As detailed in our earlier research report titled *'Unlocking of Realty Value'*, dated 26$^{th}$ July 2006, we have adopted a "sum of parts" approach to value the company given the enhanced significance and growth of its real estate and consumer finance business. Hence, we seek to value the company by valuing each of the 3 businesses separately.

### Capturing revised value of businesses

We discuss below the key drivers resulting in a much higher value for each of the 3 businesses.

#### Real estate business

In the real estate business, we have not changed our earlier estimates, which factored in the Knight Frank value for Mumbai properties at the NAV. However, given the lack of a track record and the uncertainty with regard to real estate prices, we have maintained a 15% discount to NAV. Also, the value assigned by Knight Frank is as of Jan'08 which we have discounted on an NPV basis to arrive at FY07 levels. Further, we have factored in the impending equity dilutions. Additionally, the value of other two properties has been maintained as forecast in our earlier estimates.

As discussed earlier, we believe Indiabulls is looking to rapidly scale up its operations and could, in our view, be announcing new real estate deals over the next 3-6 months. While details of the same are not known, we reckon the value of these new ventures is likely to be at least around 25% of the existing value, given the company's plans to rapidly scale up its real estate business. Hence, we have factored in a 33% rise in the possible real estate value while determining the possible value of its real estate business.

#### Consumer Finance

The consumer finance business is likely to scale up very rapidly, with ROE forecast at almost 24%. Assuming cost of equity at 14%, it implies the stock could arguably trade up to 1.7x FY08E book value. This is without assigning any premium for the exceptionally strong growth trajectory that the business could be expected to deliver given it is in the early stage of the cycle (when banks usually trade at >3x book multiples in the same stage of the cycle).

Also, our revised macro outlook would, in our view, help further sustain a re-rating for many of the consumer finance businesses as growth remains ahead of expectations.

Our key concern remains the possibility of sharper uptick in the NPL cycle as we are expecting a cyclical NPL uptick at the banking sector level. However, the company is providing >10% of its loans as provisions, enhancing the comfort level of the businesses valuations.

### Brokerage Business

For the brokerage business, we have valued it on a PE basis relative to the benchmark market multiples, given the vulnerability and dependence of the brokerage business to the markets. We had earlier assigned a PE of 10x in FY07E and 9x in FY08E, equivalent to a 30-35% discount to the market multiples. Given the buoyancy in equity markets we have now lowered the discount to 15% and believe it could potentially trade up to even 15x FY08E earnings.

Table 4: Target valuation multiples

| Valuation Multiples | FY07E - Old | FY08E - Old | FY07E - New | FY08E - New |
|---|---|---|---|---|
| Brokerage | | | | |
| EPS growth | 10 | 8 | 14 | 12 |
| Market PER | 15.1 | 13.4 | 19.3 | 17.1 |
| PER for IFSL | 10.0 | 9.0 | 16.0 | 15.0 |
| Discount to mkt PER | 34% | 33% | 17% | 12% |
| Consumer Finance Business | | | | |
| EPS | 3.8 | 9.6 | 3.8 | 9.8 |
| EPS Growth | 151% | 155% | 155% | 156% |
| Imputed market price of cons. biz. | 48 | 55 | 66 | 78 |
| P/Adj. BV | 1.3 | 1.2 | 1.8 | 1.7 |
| Real Estate business | | | | |
| Discount to NAV | 15% | 10% | 15% | 10% |
| Time discounting | 12% | 12% | 12% | 12% |

Source: ML Research Estimates

### "Sum of Parts" +49% higher than earlier

The sum of parts approach, also, in our view, helps show which businesses are likely to be contributing the most relative to others. We show below the valuations for each of the 3 businesses on a per share of IFSL.

We show below the valuation ascribed to each of its 3 businesses by us in July'06 and our current estimates of the value of these businesses, capturing the higher growth trajectory and the changed operating environment as also the stronger than expected buoyancy in equity markets. It also captures the subsequent equity dilution done recently when IFSL issued an additional 7.25mn shares @ Rs417/share. We briefly discuss the reasons for the much higher value of the businesses. Based on our revised sum of parts, the theoretical fair value of the business appears to be pegged at around Rs491.

Table 5: Sum of Parts - New V/s Old

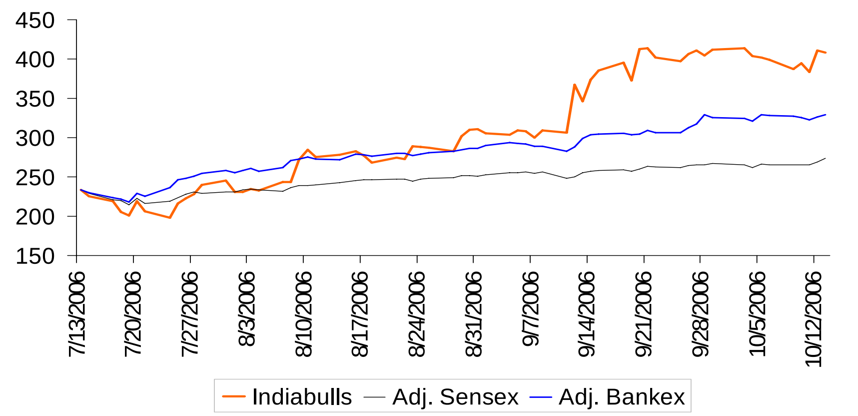
| Market Value (Rs mn) | FY07E - Old | FY08E - Old | FY07E - New | FY08E - New | Chg |
|---|---|---|---|---|---|
| Real Estate | 22,424 | 28,549 | 24,424 | 35,817 | 25% |
| Consumer Finance | 9,887 | 11,883 | 14,258 | 16,923 | 42% |
| Brokerage | 27,582 | 28,538 | 47,073 | 51,648 | 81% |
| Total | 59,893 | 68,970 | 85,755 | 104,389 | 51% |
| On IFSL's Per Share Basis | | | | | |
| Real Estate | 131 | 156 | 137 | 189 | 21% |
| Consumer Finance | 29 | 33 | 41 | 45 | 37% |
| Brokerage | 161 | 156 | 264 | 272 | 74% |
| Less: BV of Invst in IFSL | -16 | -15 | -16 | -15 | 0% |
| Per Share of IBL | 305 | 330 | 425 | 491 | 49% |

Source: ML Research Estimates

## Raising PO by only 20% as valuations partly discounting rising value of businesses

While we estimate the value of the 3 businesses to be almost +49% higher than our earlier estimates (in July'06), the stock in that period has risen by 83%.

Chart 1: Indiabulls stock price performance relative to market and bankex




Source: Bloomberg

The upside potential from current levels is closer to only 20% factoring in our revised sum of parts value of Rs490, underpinning our new PO.

Other possible catalysts for the stock could include consistent newsflow on future real estate market transactions, successful de-merger (high court decision expected on November 15$^{th}$), and sustained buoyancy in equity volumes.

Key risks to our PO stem from a sharp fall in equity volumes and delays in de-merger.

Table 6: Income Statement

| Year to Mar (Rs mn) | FY04A | FY05A | FY06 | FY07E | FY08E |
|---|---|---|---|---|---|
| Revenue | 698 | 1,677 | 6,104 | 11,086 | 19,351 |
| - Brokerage | 532 | 996 | 2,609 | 3,935 | 5,594 |
| - Trade Financing Revenues | 149 | 497 | 2,236 | 2,862 | 4,043 |
| - Consumer Financing | - | 10 | 368 | 2,480 | 7,013 |
| - Others | 17 | 173 | 891 | 1,810 | 2,702 |
| Operating Expenses | 354 | 628 | 1,925 | 3,913 | 7,083 |
| EBITDA | 343 | 1,048 | 4,179 | 7,173 | 12,268 |
| Interest | 45 | 134 | 315 | 699 | 2,046 |
| Depreciation | 11 | 22 | 73 | 156 | 218 |
| Operating profit | 287 | 892 | 3,791 | 6,309 | 9,995 |
| Other Income | 22 | 8 | 28 | 25 | 50 |
| Provision for NPL | - | - | 85 | 950 | 2,100 |
| PBT | 309 | 900 | 3,734 | 5,384 | 7,945 |
| Provision for Tax | 115 | 333 | 1,200 | 1,615 | 2,384 |
| PAT | 193 | 567 | 2,534 | 3,769 | 5,562 |
| Profit from Realty Associates | - | - | - | - | - |
| Minority Interest | 0 | 7 | 159 | 372 | 953 |
| PAT after Minority Interest | 193 | 560 | 2,375 | 3,397 | 4,608 |
| Less Preferred dividends | 7 | 61 | 6 | 242 | 316 |
| Net Income | 186 | 499 | 2,369 | 3,155 | 4,292 |

Source: Company Reports, ML Research Estimates

Table 7: Balance Sheet

| As at March | FY04A | FY05A | FY06E | FY07E | FY08E |
|---|---|---|---|---|---|
| Total Net Fixed Assets | 68 | 212 | 725 | 1,128 | 1,554 |
| Consolidation Goodwill | 76 | 193 | - | - | - |
| Total Current Assets | 2,628 | 11,803 | 22,157 | 43,225 | 66,866 |
| - Interest accrued | 2 | 13 | 45 | 8 | 8 |
| - Receivables | 1,347 | 12 | 819 | 1,531 | 2,366 |
| - Cash etc | 873 | 3,326 | 8,910 | 9,161 | 9,407 |
| - Other CA | 12 | - | 0 | 25 | 25 |
| - Loans & advances | 395 | 8,452 | 12,383 | 32,500 | 55,060 |
| Total current liabilities | 526 | 1,645 | 5,416 | 8,473 | 10,695 |
| - Sundry liabilities | 389 | 1,186 | 3,711 | 5,295 | 6,467 |
| - Provisions | 137 | 458 | 1,705 | 3,177 | 4,228 |
| Net Current Assets | 2,102 | 10,158 | 16,741 | 34,752 | 56,171 |
| Total Assets | 2,246 | 10,570 | 20,140 | 38,554 | 60,399 |
| Equity Capital | 163 | 266 | 320 | 357 | 380 |
| Reserves & Surplus | 401 | 4,218 | 12,794 | 20,117 | 27,105 |
| Net Worth | 564 | 4,484 | 13,114 | 20,474 | 27,485 |
| Net deferred tax liability | 6 | 19 | 132 | 132 | 132 |
| Total Loans | 1,217 | 4,954 | 3,030 | 2,000 | 2,750 |
| Total Liabilities | 2,246 | 10,570 | 20,140 | 38,554 | 60,399 |

Source: Company Reports, ML Research Estimates

Table 8: Key Ratios

| Year to March | FY04A | FY05A | FY06E | FY07E | FY08E |
|---|---|---|---|---|---|
| EPS | 2.3 | 3.7 | 14.8 | 17.7 | 22.6 |
| EPS growth | | 64% | 295% | 20% | 28% |
| CEPS | 2.5 | 4.4 | 15.3 | 19.9 | 25.4 |
| ROAE | 44.6 | 22.2 | 27.0 | 20.2 | 19.2 |
| ROAA | 14.2 | 8.7 | 15.5 | 11.6 | 9.3 |
| BV/ Share (Rs) | 6.9 | 33.7 | 81.8 | 114.7 | 144.7 |
| Interest Coverage (x) | 7.8 | 7.7 | 12.9 | 8.7 | 4.9 |
| Leverage | 2.2 | 1.1 | 0.2 | 0.1 | 0.1 |
| EBITDA Margin | 0.5 | 62.5 | 68.5 | 64.7 | 63.4 |
| Net Margin | 0.3 | 33.4 | 38.9 | 30.6 | 23.8 |
| P/E | 178.5 | 109.0 | 27.6 | 23.1 | 18.1 |
| P/ CEPS | 162.7 | 93.4 | 26.7 | 20.5 | 16.1 |
| P/ Book Value | 59.0 | 12.1 | 5.0 | 3.6 | 2.8 |
| Dividend Per Share | - | - | 1.80 | 2.50 | 3.50 |
| Dividend Pay Out Ratio | 0% | 0% | 12% | 13% | 14% |
| Dividend Yield | 0.0% | 0.0% | 0.4% | 0.6% | 0.9% |

Source: Company Reports, ML Research Estimates

## Price Objective Basis & Risk

Based on our *new* sum of parts, we get a theoretical fair value of Rs491/share, implying about 20% potential upside, underpinning our new PO of Rs490. Delays in de-merger; weakness in equity markets key risks to PO.

- Real estate business valued at Rs189/share (FY08E) factoring in possible upside to future real estate acquisition which IFSL is planning.
- Consumer finance business is valued at 1.7x FY07E book given its forecast ROE of 24%, 1.7x higher than the CoE at 14%. The valuations are reflective of our revised macro outlook (lower bond yields; strong visibility of growth) and the sustained rapid growth in business.
- The securities business is valued at 15x FY08E earnings (15% discount to market) capturing the strong equity markets and the 7-8% upside to earnings in brokerage business.

## Analyst Certification

I, Rajeev Varma, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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## *iQmethod* SM Measures Definitions

| Business Performance | Numerator | Denominator |
| --- | --- | --- |
| Return On Capital Employed | NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization | Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization |
| 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 | EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities | Sales |
| EV / EBITDA | Enterprise Value | Basic EBIT + Depreciation + Amortization |

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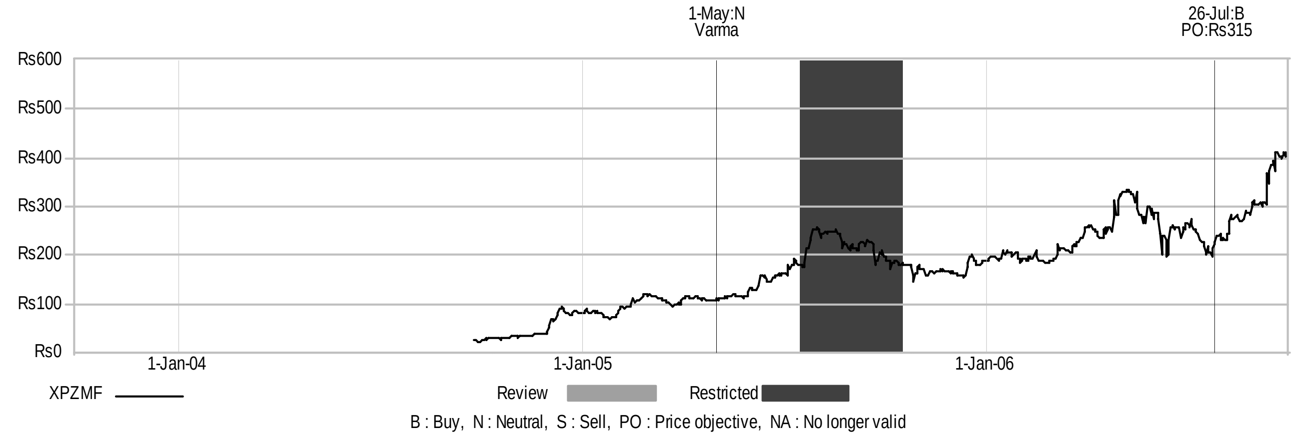
*iQdatabase* ® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

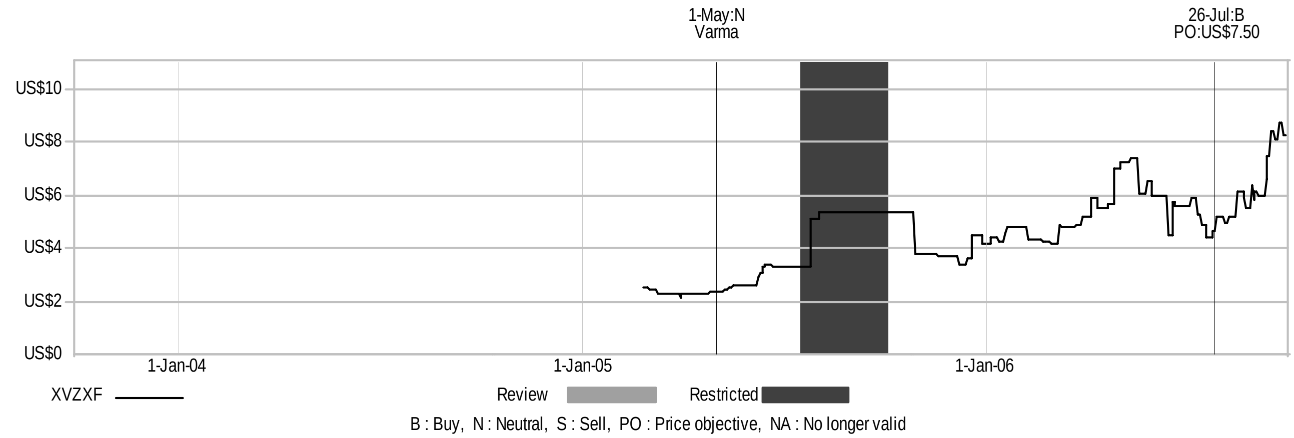
# Important Disclosures

## XPZMF Price Chart




The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of September 30, 2006 or such later date as indicated.

## XVZXF Price Chart

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| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 110 | 46.41% | Buy | 57 | 51.82% |
| Neutral | 120 | 50.63% | Neutral | 60 | 50.00% |
| Sell | 7 | 2.95% | Sell | 3 | 42.86% |

## Investment Rating Distribution: Global Group (as of 30 Sep 2006)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 1325 | 44.76% | Buy | 434 | 32.75% |
| Neutral | 1420 | 47.97% | Neutral | 412 | 29.01% |
| Sell | 215 | 7.26% | Sell | 48 | 22.33% |

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