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## Prakhar Sharma

prakhar.sharma@cls.com  
+91 22 6650 5058

## Aashish Agarwal

+91 22 6650 5075

3 August 2018

## India

### Financial services

Reuters INBF.NS  
Bloomberg IHFL IS

Priced on 2 August 2018  
CNX Nifty @ 11,244.7

12M hi/lo Rs1,421.15/1,108.35

12M price target Rs1,700.00  
±% potential +31%

Shares in issue 426.6m  
Free float (est.) 78.4%

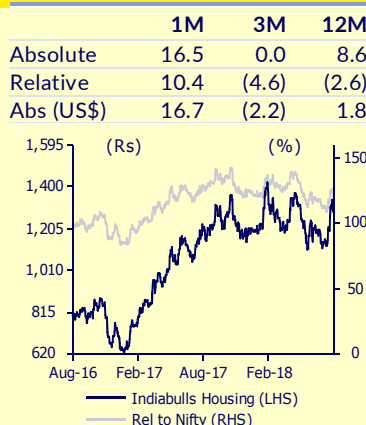
Market cap US\$8,084m

3M ADV US\$35.1m

Foreign s'holding 54.6%

Major shareholders  
Promoters 21.6%  
Foreign holding 54.6%

### Stock performance (%)



Source: Bloomberg

## Steady core; IndAS accretive

### Healthy growth to drive compounding-led returns; BUY stays

For 1QFY19, Indiabulls Housing Finance (IHFL) reported IndAS profit of Rs11bn, up 30% YoY. The key positive was the healthy growth in AUMs (up 33% YoY) and QoQ expansion in spreads despite increase in funding costs. While rise in share of housing loans and cautious growth in LAP help to derisk book, higher growth in corp loans with rising share of developer loans (vs LRD) will offset some of that. Transition to IndAS can lift net worth by ~18%, as it includes MTM gains on stake in OakNorth and DTL reversal; even earnings should be higher. IHFL's stress loans per IndAS (stage 3) are in line with gross NPLs at 0.8% of AUM (this is a different from the case with HDFC Ltd) and mgmt has retained ad-hoc provisions of Rs10.5bn (0.8% of AUM). We raise earnings estimates by 3-4% to factor in the changes per IndAS and see 23% Cagr in profit over FY18-21CL and retain BUY with a TP of Rs1,700 (was Rs1,650).

### Healthy growth and spreads stable; high growth in construction financing

The key positive in IHFL's result was 33% growth in AUMs, led by a 41% rise in housing loans whose share has risen from 57% one year back to 60% now. While the rise in share of home loans and cautious growth in LAP (18% YoY) are derisking the book, some of this is getting offset by high growth in corporate segment and rising share of construction finance vis-à-vis low risk segments (like LRD); although mgmt believes quality of developers is strong. Encouragingly, the spreads expanded 12bp QoQ to 3.2% (flat YoY) aided by rate hikes and access to lower cost of funds like ECBs/CPs etc.

### IndAS transition lifts net worth by 18% and accretive to earnings

IHFL's transition to IndAS is accretive to net worth and earnings: (1) IndAS based net worth is ~18% higher than Indian GAAP aided by MTM gain on investment in OakNorth and reversal of Deferred Tax Liability (DTL), (2) earnings should be a tad higher, as lower tax rate and credit costs will offset lower NII and higher costs (as cost of zero coupon bonds and Esops is amortised). IHFL's stress loans per IndAS (stage 3) at 0.8% of AUM are largely in line with gross NPLs and credit costs will be lower, as it will be based on actual loss experience; it is also carrying Rs10.5bn of ad-hoc provisions (0.8% of loans).

### Retain BUY

We raise earnings estimates by 3-4% to factor in the changes per IndAS and see 23% Cagr in profit over FY18-21CL (but not fully like to like). We retain BUY with a 12-month TP of Rs1,700 (earlier Rs1,650) based on 3.2x Jun-20CL adjusted PB.

### Financials

Year to 31 March	17A	18A	19CL	20CL	21CL
Operating profit (Rsm)	45,547	60,969	66,016	84,376	105,716
Net profit (Rsm)	29,064	38,474	45,699	57,990	72,403
NP forecast change (%)	-	-	3.0	4.2	4.4
EPS (Rs)	69	90	107	136	170
CL/consensus (10) (EPS%)	-	-	102	105	106
EPS growth (% YoY)	14	32	18	27	25
Core ROA (%)	2.9	3.0	3.0	3.0	3.0
Core ROE (%)	23	28	29	29	31
PE (x)	19	14	12	10	8
Adjusted PB (x)*	4.5	4.0	3.0	2.6	2.2
Dividend yield (%)	2.1	3.2	3.1	3.7	4.4

\*Adjusted for 100% NPL coverage. Source: Company, CLSA

We would like to thank Evalueserve for its help in preparing our research reports. Bhavik Mehta (Autos, IT); Kamal Verma (Banking & Financial Services); Kushal Shah (Midcaps), Mihir Manohar (Capital Goods, Utilities, Power); and Suraj Yadav (Cement, Oil & Gas) provide research support services to CLSA.

Figure 1

Summary of 1QFY19 results under IndAS			
(Rsm)	1QFY18	1QFY19	(% YoY)
Net interest income	13,840	16,900	22%
Other income (includes securitisation gains)	635	462	(27%)
<b>Total income</b>	<b>14,475</b>	<b>17,362</b>	<b>20%</b>
Costs	1,871	2,689	44%
<b>Operating profit</b>	<b>12,604</b>	<b>14,673</b>	<b>16%</b>
Provisions	1,985	648	(67%)
<b>Profit before tax</b>	<b>10,619</b>	<b>14,024</b>	<b>32%</b>
Tax	2,571	3,538	38%
<b>Profit after tax</b>	<b>8,049</b>	<b>10,487</b>	<b>30%</b>
Share of profit (loss) of associate	46	60	31%
<b>Profit after minority interest</b>	<b>8,095</b>	<b>10,547</b>	<b>30%</b>
<b>Total comprehensive income</b>	<b>7,778</b>	<b>10,380</b>	<b>33%</b>
<b>AUM (Rsm)</b>	<b>944,510</b>	<b>1,259,630</b>	<b>33%</b>
- Mortgages	739,030	998,050	35%
- Home loans	535,027	757,040	41%
- LAP	204,003	241,010	18%
- Corporate	204,110	260,480	28%
<b>Borrowings (Rsm)</b>	<b>884,700</b>	<b>1,159,900</b>	<b>31%</b>
- Bank loans	346,000	417,100	21%
- Bonds, NCDs	509,600	695,500	36%
- Others	29,100	47,300	63%
<b>Asset quality</b>			
Gross NPL/stage 3 loans (Rsm)	7,570	9,800	29%
Net NPL/stage 3 loans (Rsm)	5,745	7,350	28%
Gross NPL (% of AUM)	0.8%	0.8%	-2bps
Net NPL (% of AUM)	0.6%	0.6%	-3bps
Coverage (% of gross NPL)	24%	25%	89bps
Total provisions (% of AUM)^	Na	1.3%	

^Includes excess provisions held in excess of what is required under ECL model. Source: Company, CLSA

Figure 2

Trend in spreads					
	1QFY18	4QFY18	1QFY19	(% YoY)	(% QoQ)
Yield on AUMs (%)	11.5%	10.9%	11.2%	-34bps	29bps
Cost of funds (%)	8.3%	7.8%	7.9%	-33bps	17bps
<b>Spreads (%)</b>	<b>3.2%</b>	<b>3.1%</b>	<b>3.2%</b>	<b>-1bps</b>	<b>12bps</b>
<b>Incremental Spreads (%)</b>	<b>3.0%</b>	<b>2.8%</b>	<b>2.8%</b>	<b>-16bps</b>	<b>4bps</b>

Source: Company, CLSA

NII growth lagged AUM growth – spreads were stable, but margins were down

Lower provisions aided strong growth in earnings

AUM growth is led by home loan growth

Gross stage 3 loans are similar to gross NPLs for Indiabulls Housing

Total provisions (including floating) are 1.3% of total AUM

Spreads expanded QoQ but stable YoY

IHFL classifies only NPLs (90d DPD) under stage 3

Figure 3

Asset quality classification under Ind AS				
AUM	Jun-17		Jun-18	
	Rsbn	% AUM	Rsbn	% loans
Stage 1 & 2 (standard)	937	99%	1,250	99%
Stage 3 (NPL)	7.6	0.8%	9.8	0.8%
<b>Total</b>	<b>944</b>		<b>1,260</b>	

Source: Company, CLSA

Figure 4

Provisions held against loans		
	Jun-18	
	Rsbn	% of gross NPL (stage 3 loans)
<b>Total AUM</b>	<b>1,260</b>	
<b>Stage 3 AUM (NPL)</b>	<b>9.8</b>	
<b>Provisions</b>		
- Direct provisions against stage 3 loans	2.5	25%
- Other provisions required under ECL norms	3.2	
- Floating provisions	10.5	
<b>Total provisions</b>	<b>16.2</b>	

Source: Company, CLSA

Figure 5

Reconciliation of 1QFY18 profit as per Ind AS and Indian GAAP	
<b>Rsbn</b>	<b>1QFY18</b>
Net profit after tax as per Indian GAAP	7.88
<b>Net profit after tax as per Ind AS</b>	<b>8.09</b>
<b>% of Indian GAAP profit</b>	<b>103%</b>
<b>Adjustments</b>	
On account of effective interest rate method for financial assets and liabilities recognised at amortised cost	(0.72)
On account of net gain on excess interest spread on assignment transactions for the quarter	0.64
On account of Expected Credit Loss	0.09
On account of fair valuation of employee stock options	(0.04)
Tax Impact on above including reversal of Deferred Tax Liability on 36 (1) (viii) for the quarter	0.19
<b>Total</b>	<b>0.21</b>

Source: Company, CLSA

Figure 6

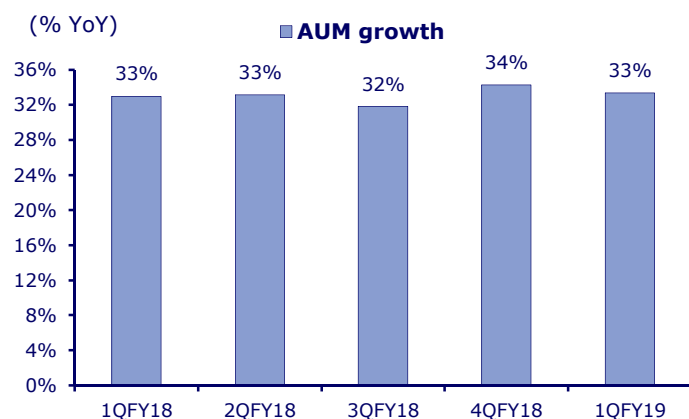
Reconciliation of March 2018 net worth under Ind AS	
<b>Rsbn</b>	<b>Mar 18</b>
<b>Net worth under IGAAP</b>	<b>134</b>
MTM gains on stake held in Oak North	19
Reversal of DTL	5
<b>Net worth under Ind AS (Indicative)</b>	<b>158</b>
<b>% of net worth under Indian GAAP</b>	<b>118%</b>

Source: CLSA

Net worth as per Ind AS can be 18% higher than in Indian GAAP...

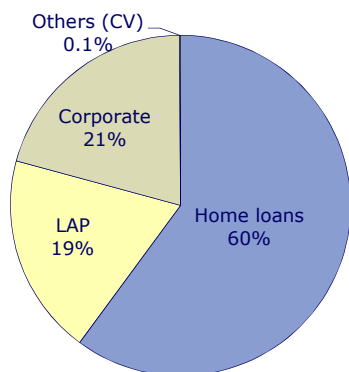
...due to MTM gains on stake held in Oak North and reversal of DTL

Figure 7

**AUM grew by 33% YoY...**

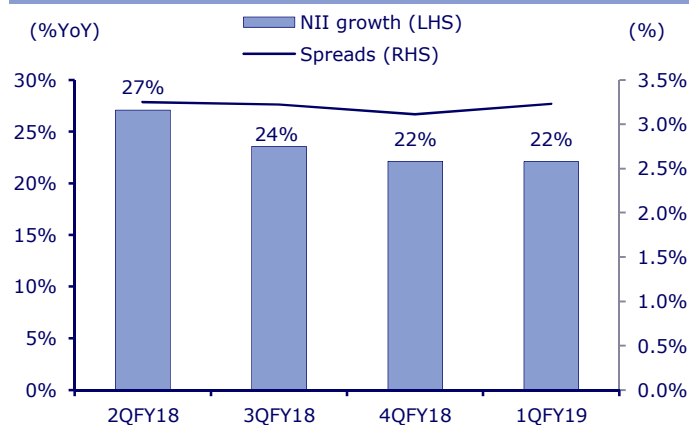
Source: Company, CLSA

Figure 9

**Home loans form ~60% of AUMs****Distribution of AUMs, Jun-18**

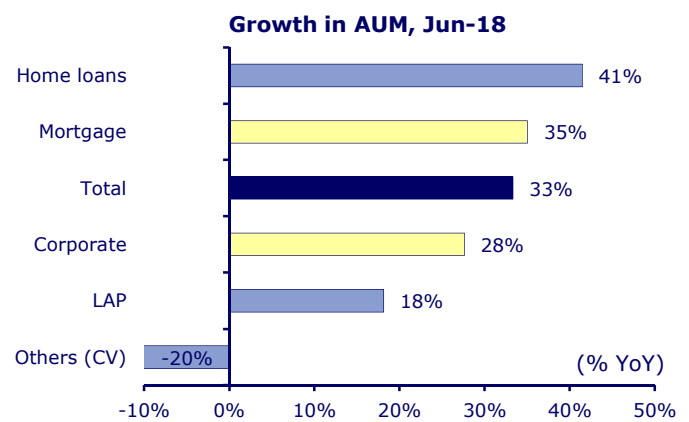
Source: Company, CLSA

Figure 11

**NII growth lagged AUM growth due to compression in margins (spreads stable)**

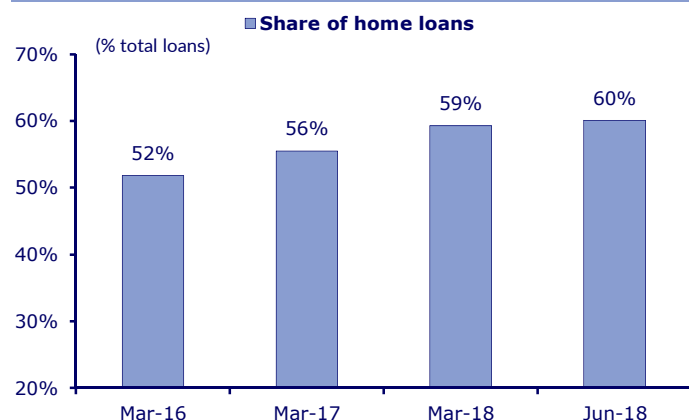
Source: Company, CLSA

Figure 8

**...led by growth in home loans**

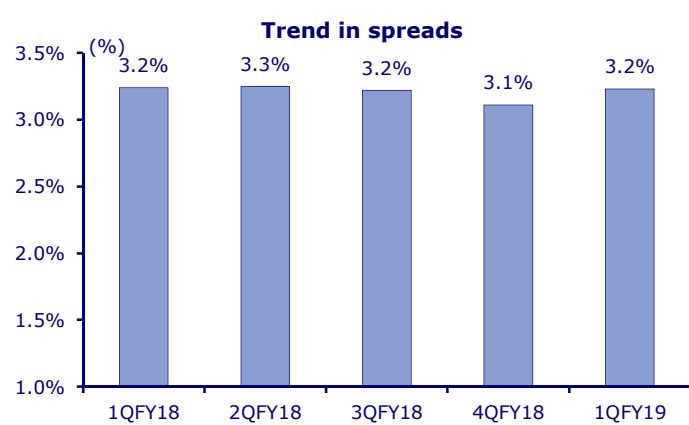
Source: Company, CLSA

Figure 10

**Share of home loans has been rising and company targets to increase it to 66% by FY20**

Source: Company, CLSA

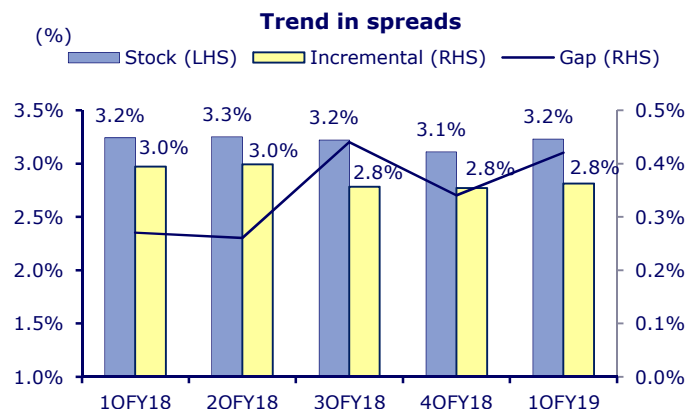
Figure 12

**Spreads have improved post rate hike in April 2018**

Source: Company, CLSA

Figure 13

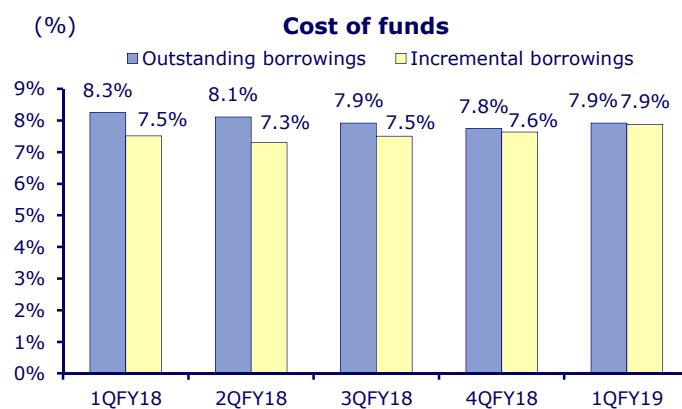
**Incremental spreads are lower than the spread on stock but the gap has been in a narrow range**



Source: Company, CLSA

Figure 14

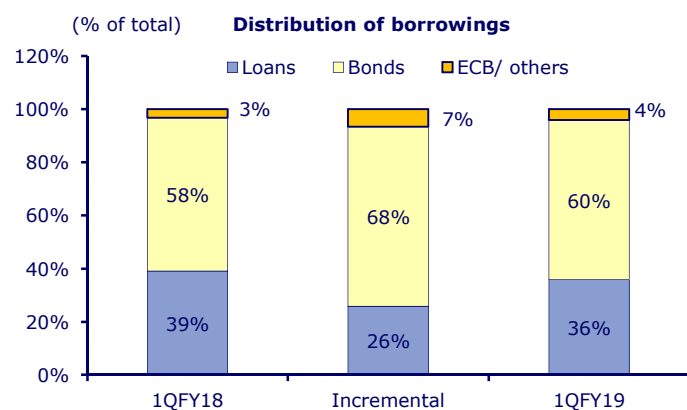
**The gap between incremental cost of borrowings has narrowed**



Source: Company, CLSA

Figure 15

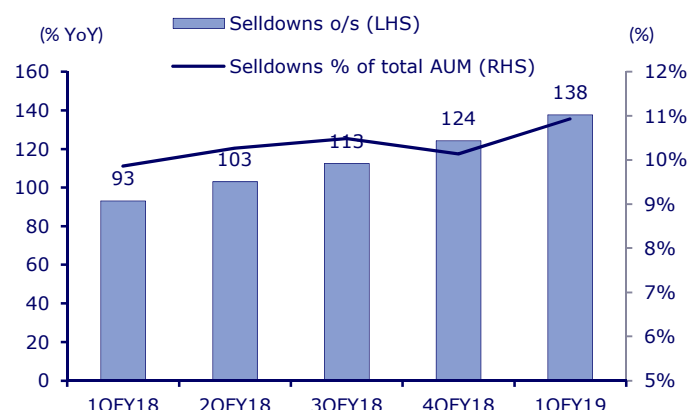
**Bonds dominate, but share of ECB in incremental funding has increased**



Note: Does not include sell-downs. Source: Company, CLSA

Figure 16

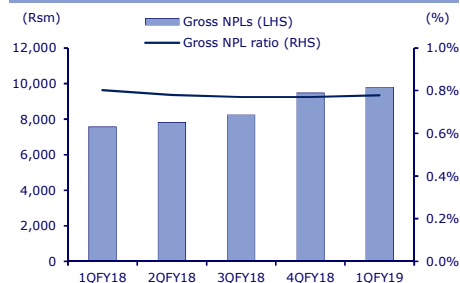
**Securitised book grew by 48% YoY to 11% of AUM**



Source: Company, CLSA

Figure 17

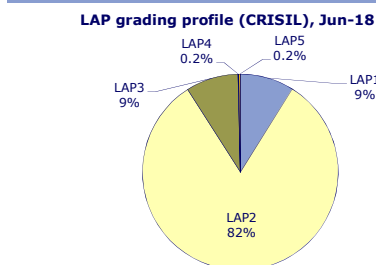
**Gross NPL ratio was stable at 0.8% of AUM**



Represents stage 3 loans under Ind AS. Source: Company, CLSA

Figure 18

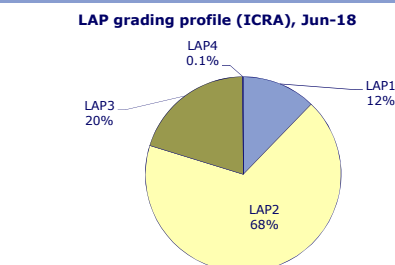
**LAP credit rating is comfortable: Top-3 grades formed bulk of the incremental lending**



Source: Company, CLSA

Figure 19

**LAP credit rating is comfortable: Top-3 grades formed bulk of the incremental lending**



We expect 26% Cagr in NII over FY18-21...

Profits to expand at 23% Cagr; FY18 profits also include some income from stake sale in OakNorth

Expect AUM growth of 29% Cagr over FY18-21

Figure 20

Summary income statement					
Year to March (Rsm)	FY17	FY18A/CL	FY19CL	FY20CL	FY21CL
Interest income	107,082	130,619	173,645	227,424	288,678
Interest expense	64,108	76,539	107,895	142,539	181,773
<b>Net interest income</b>	<b>42,975</b>	<b>54,081</b>	<b>65,750</b>	<b>84,885</b>	<b>106,905</b>
Other income	9,935	15,785	11,741	13,443	15,507
- Fee income	2,918	2,918	3,210	3,852	4,622
- Profit on investments	4,701	9,420	4,395	4,835	5,415
Total income	52,910	69,865	77,491	98,328	122,412
Operating expenses	7,363	8,896	11,475	13,951	16,697
<b>Pre-provision profit</b>	<b>45,547</b>	<b>60,969</b>	<b>66,016</b>	<b>84,376</b>	<b>105,716</b>
Provisions	7,829	11,213	4,801	6,195	7,934
<b>PBT</b>	<b>37,718</b>	<b>49,756</b>	<b>61,215</b>	<b>78,181</b>	<b>97,782</b>
Tax	8,633	11,501	15,757	20,456	25,670
<b>Net Profit</b>	<b>29,086</b>	<b>38,255</b>	<b>45,458</b>	<b>57,725</b>	<b>72,112</b>
Less: minority / associates	22	(219)	(241)	(265)	(291)
<b>Net profit post minority</b>	<b>29,064</b>	<b>38,474</b>	<b>45,699</b>	<b>57,990</b>	<b>72,403</b>

Source: Company, CLSA

Figure 21

Summary balance sheet					
As at March (Rsm)	FY17	FY18A/CL	FY19CL	FY20CL	FY21CL
Loans	830,877	1,101,800	1,428,776	1,832,634	2,330,511
Investments	136,166	148,709	155,856	163,360	171,240
Current assets/others	11,496	19,352	21,171	23,288	25,617
Cash	56,825	47,478	92,601	119,707	146,668
Net fixed assets	1,011	1,110	1,166	1,224	1,285
Goodwill	678	578	578	578	578
<b>Total assets</b>	<b>1,037,054</b>	<b>1,319,028</b>	<b>1,700,148</b>	<b>2,140,792</b>	<b>2,675,898</b>
Share Capital	848	853	853	853	853
Reserves & Surplus	120,373	133,382	181,341	214,466	257,057
<b>Shareholders' Funds</b>	<b>121,221</b>	<b>134,235</b>	<b>182,194</b>	<b>215,319</b>	<b>257,911</b>
Borrowings	719,206	922,940	1,209,412	1,568,469	2,001,515
Other Loans	133,805	179,660	220,075	259,690	309,428
Current liabilities & prov.	62,822	82,193	88,467	97,314	107,045
<b>Total liabilities</b>	<b>1,037,054</b>	<b>1,319,028</b>	<b>1,700,148</b>	<b>2,140,792</b>	<b>2,675,898</b>
<b>Total AUM</b>	<b>913,010</b>	<b>1,226,000</b>	<b>1,600,208</b>	<b>2,065,131</b>	<b>2,644,681</b>

Source: Company, CLSA

Figure 22

Key ratios					
Year to March	FY17	FY18A/CL	FY19CL	FY20CL	FY21CL
EPS (Rs)	69	90	107	136	170
EPS growth (% YoY)	14%	32%	18%	27%	25%
BVPS (Rs)	286	315	427	505	605
Adj. BVPS (Rs)	287	325	432	503	595
ROA (%)	3.2%	3.3%	3.0%	3.0%	3.0%
<b>Core ROA (%)</b>	<b>2.9%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>3.0%</b>
ROE (%)	25%	30%	29%	29%	31%
<b>Core ROE (%)</b>	<b>23%</b>	<b>28%</b>	<b>29%</b>	<b>29%</b>	<b>31%</b>
Spreads (%)	4.4%	4.2%	3.9%	3.8%	3.8%
NIM (%)	5.4%	5.0%	4.7%	4.7%	4.7%
Gross NPLs (% of loans)	0.9%	0.9%	0.9%	0.9%	0.9%
Net NPLs (% of loans)	0.4%	0.4%	0.6%	0.6%	0.6%
Coverage (% of gross NPLs)	58%	56%	30%	30%	30%
Capital Adequacy Ratio (% RWA)	18.3%	18.4%	16.9%	15.7%	15.0%
- Tier I CAR (% RWA)	15.1%	13.3%	14.5%	13.6%	13.2%
Cost/ Income ratio (%)	14%	13%	15%	14%	14%
Fee income growth (% YoY)	(8%)	0%	10%	20%	20%
Fee (% total revenue)	5.5%	4.2%	4.1%	3.9%	3.8%
Cost Asset Ratio (%)	0.8%	0.8%	0.8%	0.7%	0.7%
Loan Growth (% YoY)	36%	33%	30%	28%	27%
Equity / Assets (%)	12%	10%	11%	10%	10%
Equity / Loans (%)	15%	12%	13%	12%	11%
Provision/ avg. loans (%)	1.1%	1.2%	0.4%	0.4%	0.4%
Tax rates (% of PBT)	23%	23%	26%	26%	26%
Yield on Loans (%)	13.2%	12.0%	12.4%	12.6%	12.6%
Cost of funds (%)	8.7%	7.8%	8.6%	8.8%	8.8%
Dividend per share (Rs)	27	41	40	48	58
Dividend payout (% of profit)	39%	45%	37%	35%	34%
Dividend yield (%)	2.1%	3.2%	3.1%	3.7%	4.4%
<b>P/E (x)</b>	<b>19</b>	<b>14</b>	<b>12</b>	<b>10</b>	<b>8</b>
P/PPP (x)	12	9	8	7	5
<b>P/B (x)</b>	<b>4.5</b>	<b>4.1</b>	<b>3.0</b>	<b>2.6</b>	<b>2.1</b>
<b>Adjusted P/B (x)</b>	<b>4.5</b>	<b>4.0</b>	<b>3.0</b>	<b>2.6</b>	<b>2.2</b>

Source: Company, CLSA

**Valuation details**

We value Indiabulls Housing Finance based on an adjusted PB multiple, which we prefer over reported BVPS as it normalises provisioning by building in 100% coverage on NPLs. Our target price is based on 3.2x Jun-20CL adjusted PB, which in turn is based on the Gordon Growth Model.

**Investment risks**

The key risk to our view is a sharp rise in interest rates that can put pressure on earnings especially as Indiabulls Housing Finance depends on wholesale sources of funding. We also believe that the company will continue to see an improvement in its funding profile (with credit rating upgrades) over one or two years; any delay on that front would be disappointing. On the business side, slower growth in demand for mortgages can also put our earnings estimates at risk.





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## Companies mentioned

Indiabulls Housing (IHFL IS - RS1,298.55 - BUY)

HDFC (HDFC IB - RS1,932.7 - BUY)

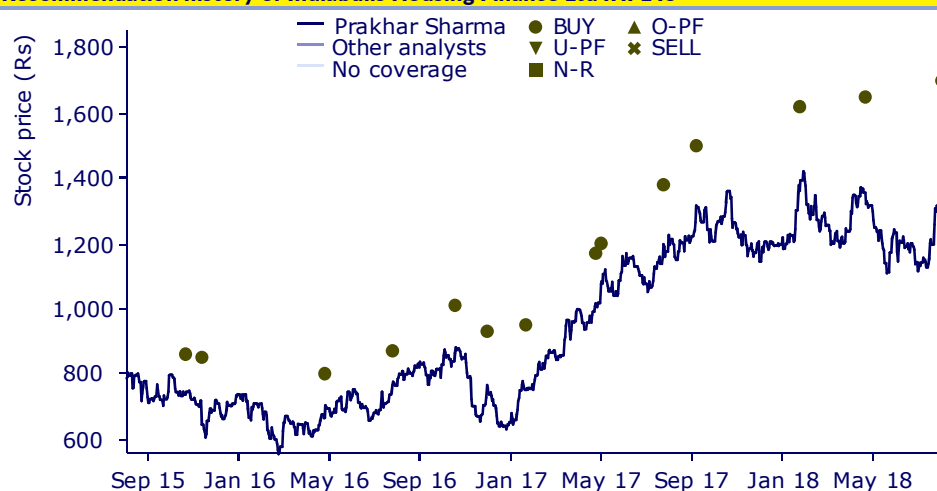
OakNorth (N-R)

## Analyst certification

The analyst(s) of this report hereby certify that the views expressed in this research report accurately reflect my/our own personal views about the securities and/or the issuers and that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

## Important disclosures

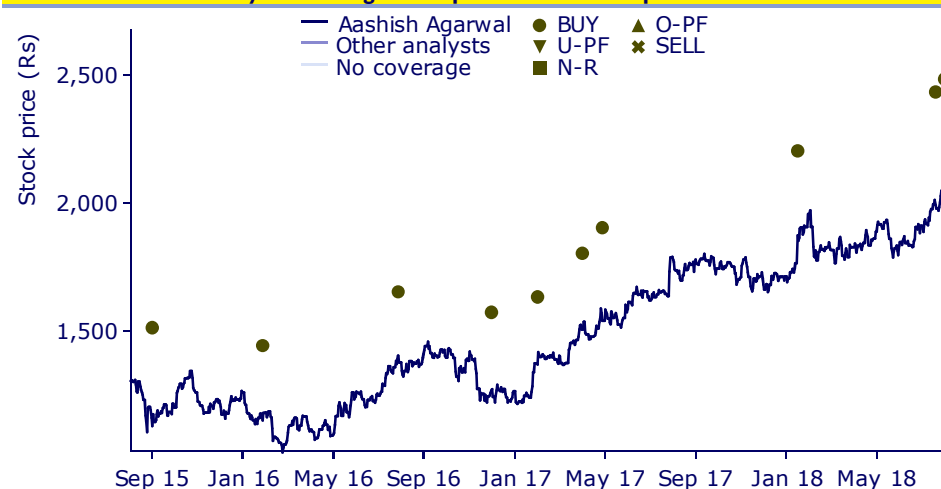
### Recommendation history of Indiabulls Housing Finance Ltd IHFL IS



Date	Rec	Target	Date	Rec	Target
LATEST	BUY	1,700.00	21 Jan 2017	BUY	950.00
22 Apr 2018	BUY	1,650.00	30 Nov 2016	BUY	930.00
24 Jan 2018	BUY	1,620.00	18 Oct 2016	BUY	1,010.00
07 Sep 2017	BUY	1,500.00	26 Jul 2016	BUY	870.00
25 Jul 2017	BUY	1,380.00	26 Apr 2016	BUY	800.00
02 May 2017	BUY	1,200.00	13 Nov 2015	BUY	850.00
25 Apr 2017	BUY	1,170.00	22 Oct 2015	BUY	860.00

Source: CLSA

## Recommendation history of Housing Development Finance Corp Ltd HDFC IB



Date	Rec	Target	Date	Rec	Target
31 Jul 2018	BUY	2,480.00	31 Jan 2017	BUY	1,630.00
19 Jul 2018	BUY	2,430.00	30 Nov 2016	BUY	1,570.00
15 Jan 2018	BUY	2,200.00	28 Jul 2016	BUY	1,650.00
28 Apr 2017	BUY	1,900.00	28 Jan 2016	BUY	1,440.00
01 Apr 2017	BUY	1,800.00	02 Sep 2015	BUY	1,510.00

Source: CLSA

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