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India Bulls Housing Finance

BUY

Target Price Rs1,010	CMP Rs.628	Q2FY19E P/BV X 3x

Index Details

Nifty	7,908
BSE 100	8,094
Sensex	25,807
Industry	Housing finance

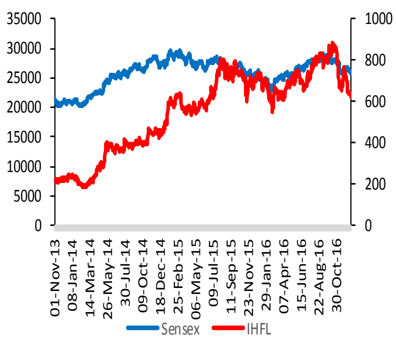
Scrip Details

Mkt Cap (Cr)	27,245
BVPS (Rs)	254
O/s Shares (Cr)	42.1
Av Vol (Lacs)	1.4
52 Week H/L	551/895
Div. Yield (%)	5.7
FVPS (Rs)	2

Shareholding Pattern

Shareholder	%
Promoters	24.3
Public	75.7
Total	100.0

IHFL Vs Sensex



Indiabulls Housing Finance (IHFL) is now focused on the housing loan segment. It has executed consistently on its strategy of expansion by

- **focusing on the affordable housing segment,**
- **growing its loan book using better technology,**
- **leveraging its financial strength and improving its ratings to increase competitiveness**
- **and diversifying its funding mix to reduce funding costs.**

In its quest for growth, it has continued to maintain adequate liquidity and adhere to prudent risk management policies for assets under management. We initiate coverage on IHFL with buy rating and price target of Rs1010.

IHFL should be part of a long-term investors' portfolio for the following reasons:

- **IHFL grew its loan book at a CAGR of 31.0%, from Rs355bn in FY14 to Rs608bn in FY16. We believe that its focus on the affordable housing segment will help IHFL as the segment has a nice tailwind from various government and policy initiatives.**
- **IHFL has access to diversified and cost effective funding sources. Long-term loans, non-convertible debentures, global bonds issued in Rupees and international currency will help IHFL keep its NII around 3.8% in FY18E.**
- **It has a presence in the higher yield LAP segment and has kept its credit costs in check by focusing on residential properties. Its corporate loan segment is focussed on the high yield-low risk lease rent discounting segment.**
- **We expect IHFL to deliver a PAT CAGR of ~19% over FY16-18E. At CMP of Rs.628, the stock is trading at 2.3x and 2.0x its estimated adjusted book value for FY17 and FY18, which is attractive in relation to growth.**

Key Financials (Rs in Cr)

Year	Interest Income	NII	PAT	EPS (Rs)	ROE (%)	P/E (X)	ROA (%)	P/B (X)	Adjusted P/B (X)
2016	7,841.8	2,711.0	2,344.7	58.0	27.1	10.8	3.5	2.5	2.5
2017E	9,880.8	3,072.2	2,707.3	63.5	23.7	9.9	3.1	2.2	2.3
2018E	12,514.5	4,087.9	3,361.3	78.8	25.8	8.0	3.1	1.9	2.0
2019E	15,306.7	5,061.2	3,949.1	92.6	26.6	6.8	3.0	1.7	1.7

STOCK POINTER

Tuesday,27th December 2016

CONTENTS

A] Indiabulls Housing Finance

B] Housing Finance Sector Overview

❖ Company Background:

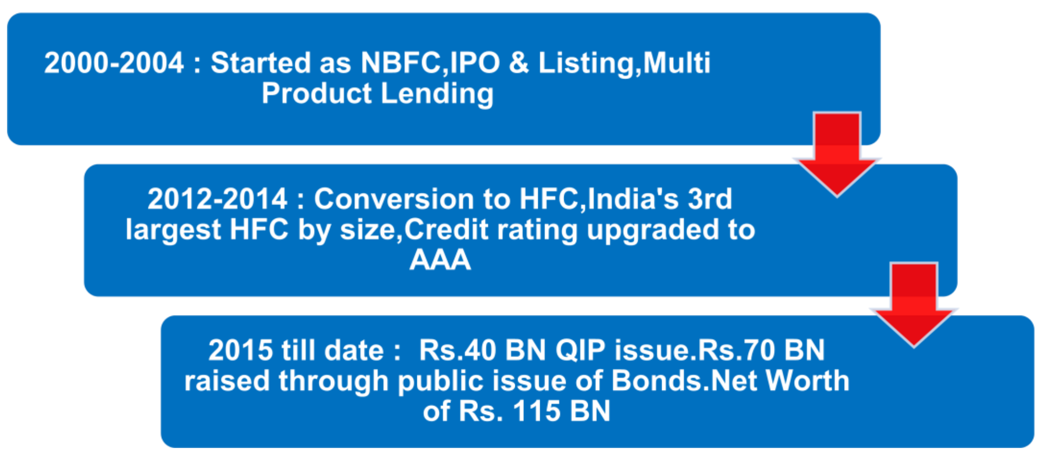
Indiabulls Housing Finance Company started operations in 2000 as an NBFC (Non-Banking Financial Company). In early 2013, in keeping with the group's long-term commitment to the housing finance business, the company was reverse-merged into its housing finance subsidiary, IHFL. It was in the lending business and had many products. Over time, IHFL has increased its housing loan portfolio to 53% of the total loans given at the end of FY16.

IHFL is one of the leading home lending institutions in India. It is the second largest Housing Finance Company by market capitalization. It has a presence all over India, including TIER II and TIER III cities. IHFL has presence on all digital and social platforms through its website and mobile apps. It recently launched E Home Loans – the first of its kind in the home loan industry.

IHFL lends against commercial and residential property. In addition, it lends money to large corporates as vendor financing. Together, these constituted around 45% of the total loan book, as at end FY16.

IHFL is a housing finance institution approved by National Housing Bank (NHB), the apex authority of housing in India. It has credit rating of AAA from CARE and AA+ from CRISIL. In Q1 FY17, IHFL's subordinate debt credit rating was upgraded to the highest AAA rating. IHFL is now amongst the select few financial services companies that enjoys AAA on both senior and subordinate debt.

IHFL History



Source: IHFL, Ventura Research

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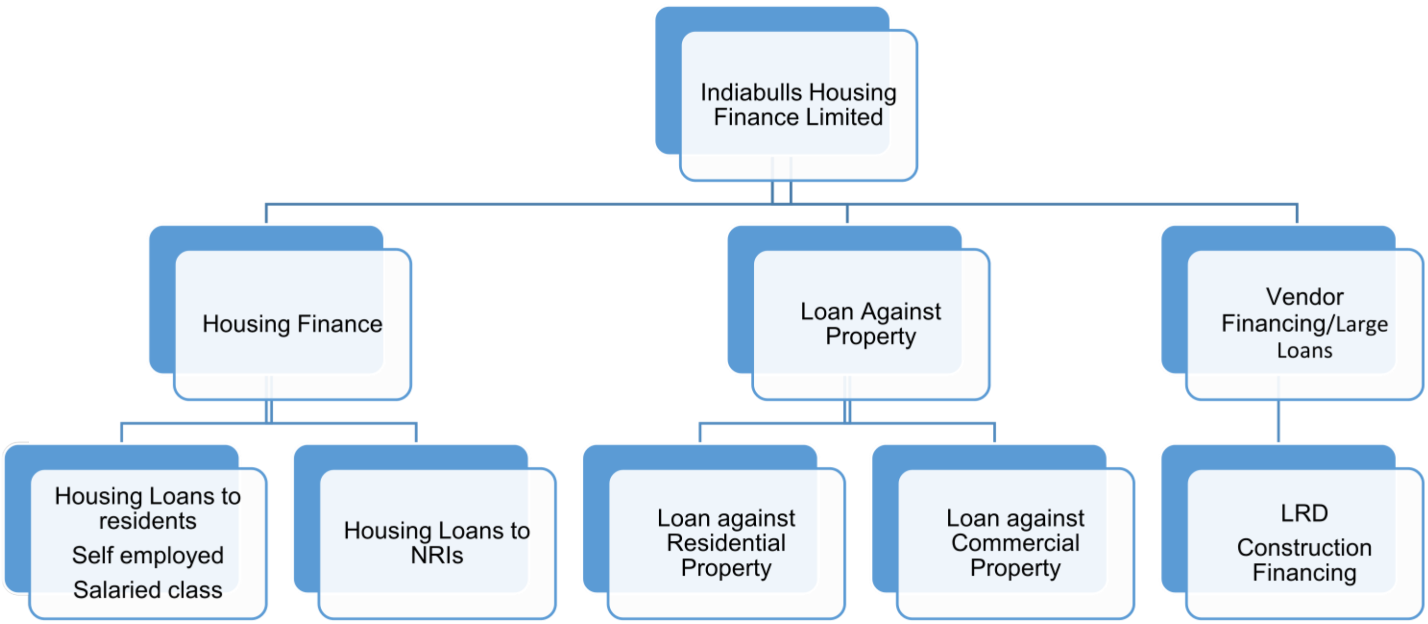
Products Offered by IHFL



Source: Ventura Research

Product Specifications			
	Housing		LAP
Particulars	**Smart City Home loans**	**Affordable Housing**	**LAP**
Average Loan to size	Rs.1.5 Mn	Rs.2.5 Mn	Rs.7.3 Mn
Maximum/Average Loan to value	80%	80%	65%
Average Loan Term	20 years	15 years	7 Years
Primary Security	Mortgage of property financed	Mortgage of property financed	Mortgage of property financed

Source: Ventura Research

SWOT

Strengths

- High Growth ratios in the recent history
- All over India Presence
- Great digital presence
- More than 15 years of experience in lending
- AA A rating of loans

Weaknesses

- Default risk high in corporate loans and LAP segment
- Too much diversification will lose concentration from profitable business
- Internal generation of capital low due to high dividend payouts

SWOT

Threats

- Major Corporate Vendor Default
- Stiff competition from Banks

Opportunities

- Scalability possible due to high CRAR
- Smart Cities, Affordable Housing and Housing for all by GOI can give very good demand for loans
- High NCD'S will reduce cost of Borrowings

Source: Ventura Research

❖ Key Investment Highlights:

Management strategy and long term approach towards business

- **Profitability**
  - Focus on profitability in each business segment
  - Internal cost structures aligned along product lines
  - Regions and branches evaluated on profitability and asset quality, not market share
  - Stable margins despite continuous reduction in risk levels within each asset class
- **Sustainability**
  - Stable senior and mid-manager levels Senior personnel in key business functions unchanged since inception 10 years ago-
  - Focus on affordable housing segment-Vast urban housing shortage of 19 Mn units
  - Only mortgage backed lending Historically low NPA levels
- **Scalability**
  - Efficient Capital Deployment Focus on loan sell downs Home Loan segments with lowest risk weights
  - Focus on Operating Efficiencies Declining Cost To Inocme Ratio
  - Lowest credit costs from expanding Housing loan portfolio IT enabled work flow for sales, creidt and collections.
  - Digital Platforms and Technology Customer Engagement throgh social media Net connecting all branches

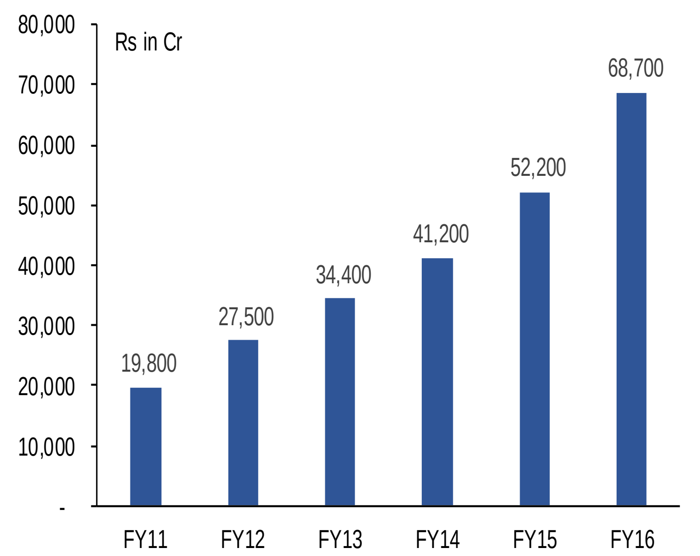
Source: Ventura Research

IHFL management's strategy is focused on consistency in operating metrics, a fundamental cornerstone which it seeks to maintain at the current optimal mix across business segments. It aims to achieve the twin and sometimes contrasting objectives of high yield with stable quality of its loan portfolio.

➢ High Growth ratios likely to continue

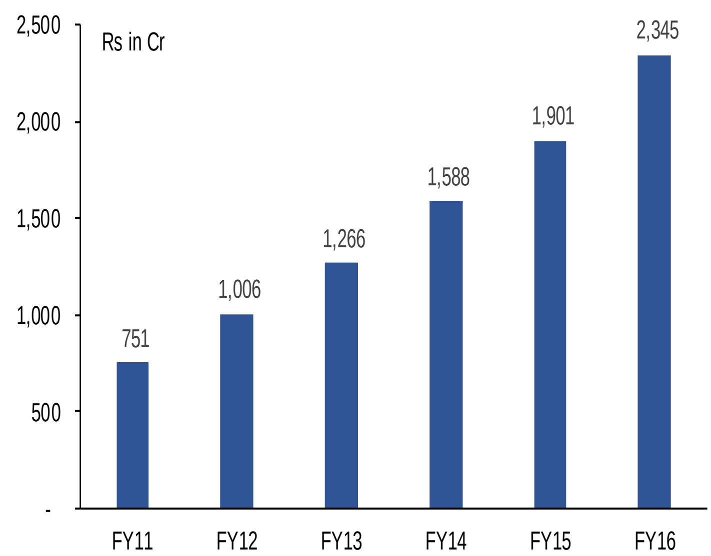
IHFL has delivered consistently high growth, with a CAGR of 28% in Loans, 30% in revenue, 23% in NII and 26% in PAT for the last 5 years. All income parameters are showing a consistent up move, clearly indicating signs of a good and progressive management.

Total Loan Assets Growth CAGR of 20%



Source: IHFL Annual Report, Ventura Research

PAT Growth – 26% CAGR

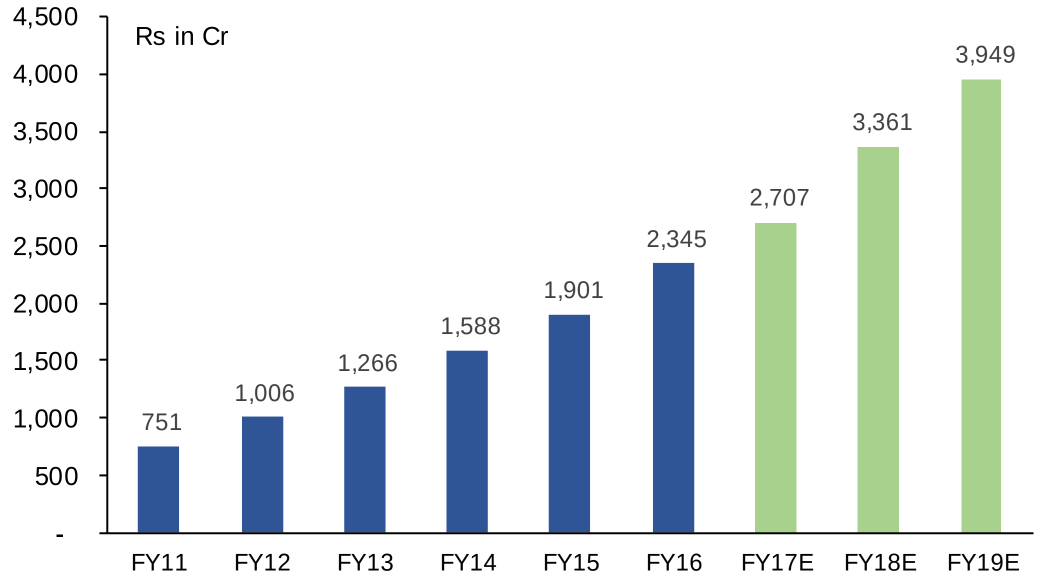


Source: IHFL Annual Report, Ventura Research

Reasons for strong performance in FY11-16

- Focused strategy on mortgages and exit from unsecured loans & other financing products like auto loans has led to consistent CAGR of 28% in loans.
- Decrease in cost to income ratio to 14.6% in 2016 has aided its growth in PAT.
- Shift of borrowings from bank sources to bonds has resulted in a reduction in financing costs to 9.16% in 2016, resulting in a margin improvement over the years.
- IHFL has exited all other lending businesses like vehicle loans and personal loans, which enables it to concentrate more on its core mortgage business, leading to specialization.
- Unique business strategy of selling down of mortgages has reduced the capital requirement for the short term and reduced risks of defaults, indirectly reducing costs of funds.

Sustainable PAT growth for the next 3 years exceeds 18%



Source: Ventura Research

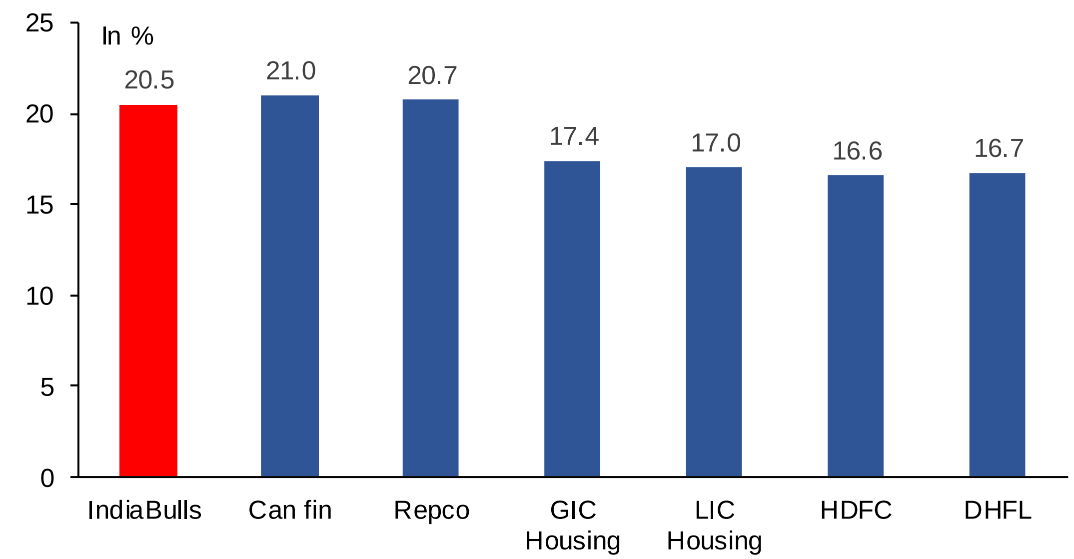
- Government is now focused on the affordable housing segment. We expect the growth rate of construction of houses to increase further. IHFL has a presence in 110 locations all over India to benefit from this increased demand.
- 'Smart cities' and 'Housing for All by 2020' are some major steps the government has taken to form new and well planned cities for all.
- Consistent high growth ratios are a sign of good profitability and growing business. We expect the same to continue in the near future. We expect the PAT CAGR for next 3 years to be more than 20%.

➢ High CAR signifies scalability in lending

- The Housing Finance Industry is regulated by NHB. To make owners of capital responsible, NHB requires lending in proportion to capital. Currently, NHB requires a Capital Adequacy Ratio (CAR) of 12% for all housing companies.
- IHFL is one of the best capitalized HFCs with a CAR of 20.5% at the end of FY16. Healthy capitalization has added IHFL's fund raising capability. A high CAR compared to regulatory requirements clearly gives IHFL flexibility in terms of lending and borrowing. However, a high CAR for a long time is a sign of idle funds.

Therefore, with lending picking up in housing finance, we expect the CAR to come down in the coming years.

CAR at the end of FY16 for IHFL and peers



Source: Ventura Research

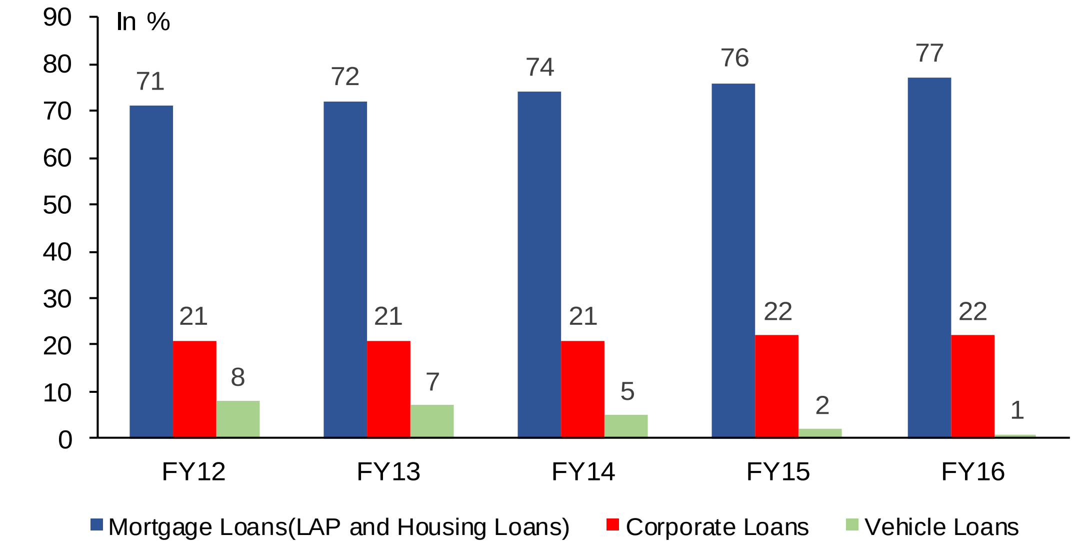
- IHFL's management believes that they do not need to raise equity capital for the next 5 years. Thus, there will be dilution free growth for shareholders. This is important as finance companies normally grow by raising equity capital every few years. Repeated equity issuance reduces EPS growth and valuations.

➢ Lending and Borrowing mix give IHFL an edge over peers:

- At the end of FY16, IHFL had the following asset composition: 53% of the total was in housing loans, 24% was in LAP and 23% was in corporate loans. This mix is a good natural hedge to manage yield and stability. IHFL has been streamlining its assets composition over the last few years. It has completely cut out vehicle financing and is now focusing on home loans.

- IHFL has guided that by FY20 more than 65% of its total loan portfolio will consist of housing loans. This will render a stable income stream with lower risk of default. LAP and corporate loans increase the yield for IHFL but come with a higher risk of default.

Mortgage Loans become more important in FY12-16



Source: Ventura Research

Difference between Mortgage loans and Corporate Loans is explained below:

Difference between mortgage and Corporate loans

Parameter	Housing Loan	LAP	Corporate finance
NIIM	9-11.5%	12.5-14%	14-15%
Risk	Low	Moderate	High
growth	High	High	High
Perpetuity	High	Low	Low
Ticket size	2.5mn	7.3mn	More than LAP
Loan to value	71%	49%	N.A.
Average Loan Term	15yrs	7yrs	N.A.

Source: Ventura Research

- Housing Loans carry the least risk amongst all, with high growth rates in the near future in India. Housing loans have a high tenure hence a high percentage of housing loans ensures a steady flow of income over a longer period. At the same time, the yield remains low in case housing loans. IHFL compensates for this by LAP and vendor financing, which yield higher margins.

➢ Target 60-60-60 strategy:

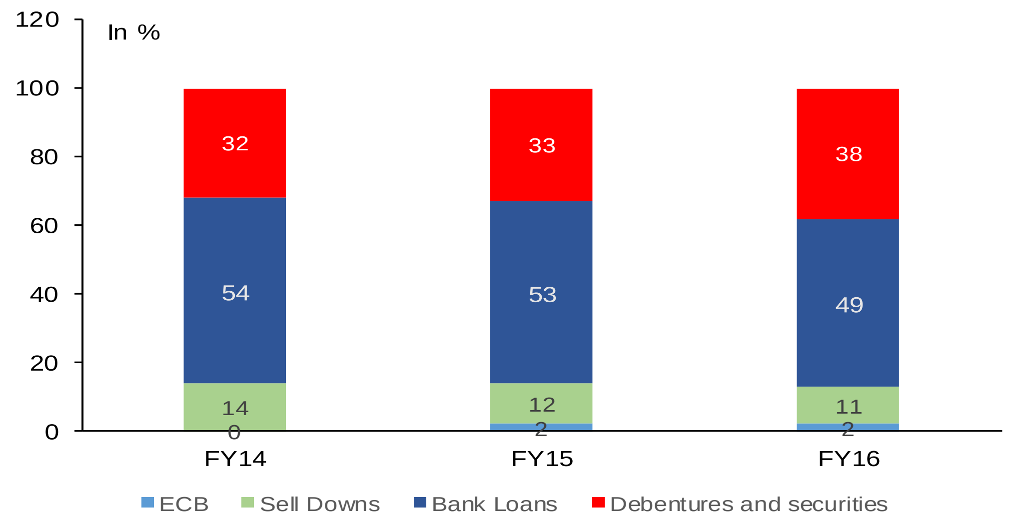
- Management plans to increase Housing loans to 60% of total assets; at the same time, NCDs (Non-convertible Debentures) will form 60% of the borrowings and 60% of the LAP loans to be sourced in-house by FY18.
- This will result in less risky loan assets in the form of increased housing loans. Housing Loans will lend more sustainability and a stable income stream in the longer run.
- Increased percentage of bonds in the borrowings profile can result in a lower cost of funds and more profitability. The latest issue of NCDs supports the strategy.
- LAP (Loans against Property) formed 24% of the total loans at the end of FY16 for IHFL. In-house sourcing will give more control to IHFL over the lending process and improve its profile of borrowers. This is likely to lead to better decisions and lower costs in the form of defaults.
- We think the target strategy is good for IHFL in the long term.

➢ Shift to low costs borrowings:

- At end of FY16, the borrowing mix of IHFL consisted of 49% in bank loans. IHFL has been attempting to reduce bank loans and increase the percentage of NCDs as a percent of bank loans has been reduced from 54%.
- Bank loans cost more for IHFL than NCDs. NCDs costs less than 10% and give more stability and profitability as the tenures of NCDs are longer. In Q1FY17, bank loans have reduced to 47%. IHFL issued NCDs worth Rs7,000 crore in September.
- This shift in the borrowing profile will result in lower costs of funds in future as well as stability. The company has set a target to reduce Bank Term Loan Borrowings to less than 30% of the overall Borrowings by 2020.
- IHFL's recent Rs7000 crore NCD issue with coupon rate ranging from 8.65% to 9.30% is a step in the same direction. The company has raised Rs1,300 crore through masala bonds which mature after 3 years and have a coupon of 8.57%.

Low costs and longer term loans can enhance IHFL's profitability and sustainability.

Changing Loan Profile: Shift from Bank Loans towards NCDs

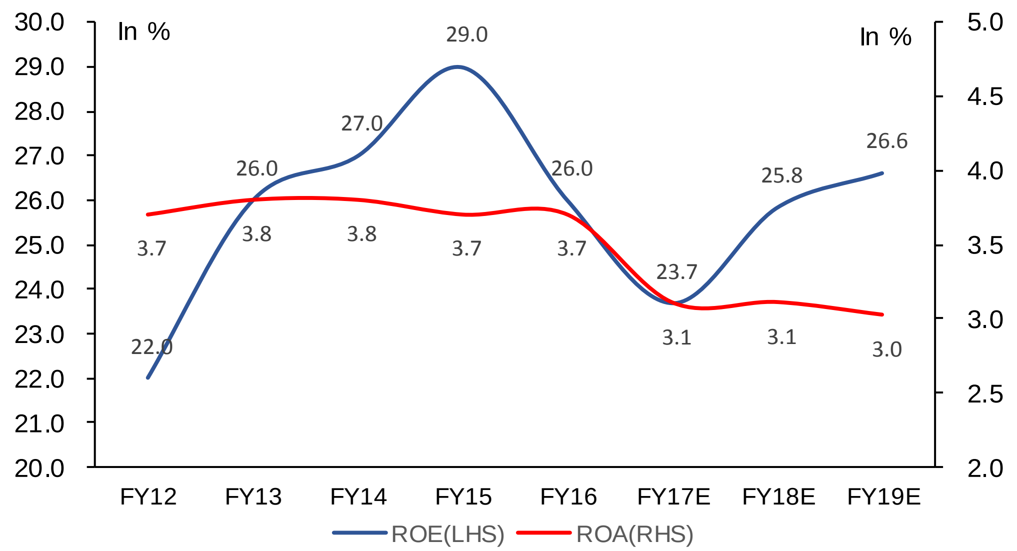


Source: Ventura Research

➢ Consistently high and industry beating ROE and ROA

IHFL delivered an expansion in RoE from 22% in FY12 to 29% in FY15 but it declined to 26% in FY16, following an equity issue. It will bottom out in FY17 at 23.7% as IHFL continues to deploy capital raised in FY16 and FY17.

Consistent ROE above 25% and ROA above 3%



Source: Ventura Research

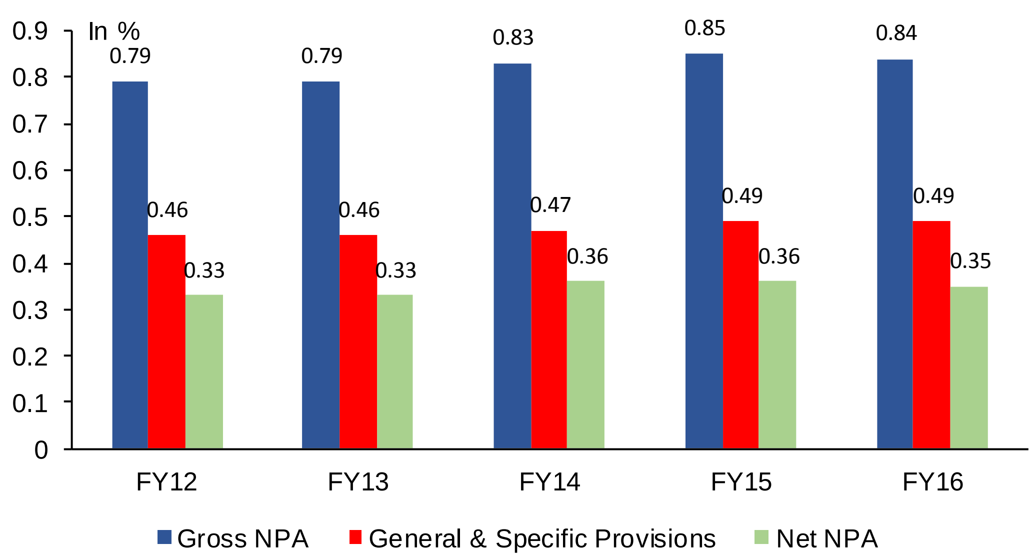
Decomposition Of ROA						
(As % of Average Assets)	FY14	FY15	FY16	FY17 E	FY18 E	FY19 E
NII	4.0	3.9	4.1	3.5	3.8	3.9
Operating Income and Other Income	2.4	2.6	2.3	2.2	1.9	1.7
Other Operating Expense	1.0	1.1	0.9	0.8	0.8	0.8
Provisions	0.7	0.6	0.8	0.7	0.7	0.7
Net Income pre tax	4.8	4.9	4.7	4.2	4.2	4.0
Tax To Total Assets	1.0	1.1	1.2	1.1	1.0	1.0
Loss of associtės	-	-	-0.0	-0.0	-0.0	-0.0
ROA	3.8	3.7	3.5	3.1	3.1	3.0
Average assets/average equity	7.7	8.2	7.7	7.6	8.3	8.8

Source: Ventura Research

- IHFL reported consistent ROA above 3.5% till FY16. We expect it to moderate in FY17-18 due to fundraising by the company in FY16 and FY17. Capital raised from equity and debt issuances will be utilized in the coming years. As the funds get utilized for the purpose of lending, we expect the ROA to stabilize at around 3.10%.

➢ Stable Asset Quality

Low NPA levels



Source: Ventura Research

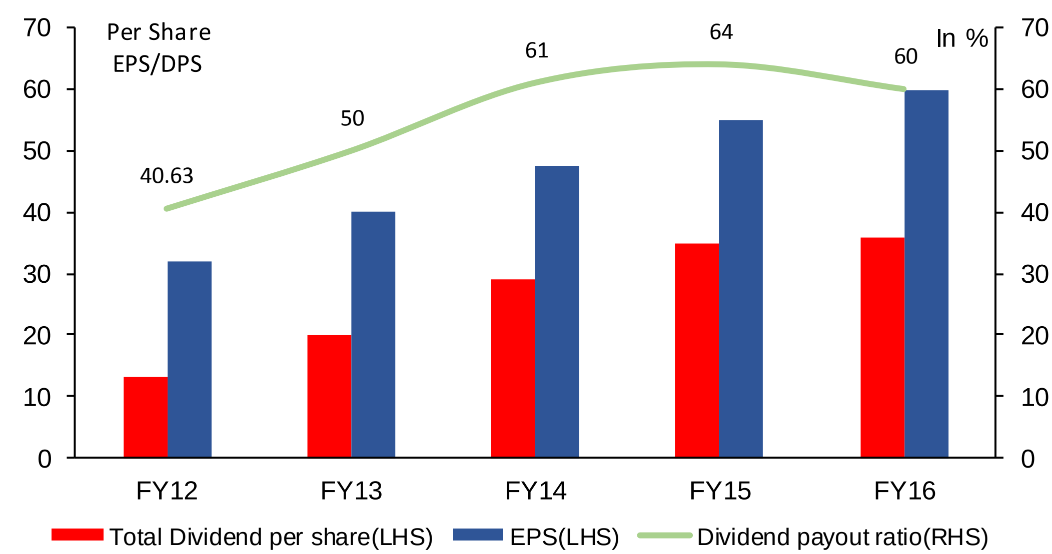
- IHFL has consistently had very low NPA levels from FY12. This is despite 47% of assets being other than housing loans. IHFL sells mortgages to SPV. With Sell downs, it manages the risks well. Sell down of loans makes available cash whenever required as well as it reduces the loans from the books in a short period. An experienced underwriting team and the in-house sourcing and collection teams ensure control over loan sourcing, credit appraisal and portfolio management.

- We believe that consistent low NPA level can lead to higher sustainability of financial enterprise.

- IHFL's default rate may rise in Q3FY17 due to demonetisation. IHFL has made counter cyclical provisions in previous quarters hence any unexpected increase in NPA can be set off against counter cyclical provisions. These provisions currently stood at Rs336cr at the end of Q2FY17.

➢ Consistent Dividend Payment History for the last 3 years

High Dividend pay-out ratio



Source: IHFL Presentation, Ventura Research

- IHFL consistently distributed profits in the form of dividends to shareholders. Its dividend pay-out ratio has been higher than 50% for the last 4 years. This indicates a shareholder-friendly management and financial stability. At the same time, it reduces the available funds for operations for IHFL.

➢ Digital initiatives to drive revenue growth:

- IHFL has a digital presence across various platforms. The recently launched Indiabulls e-Home Loans provides an end-to-end home loan experience to customers. With the usage of digital devices, customers are at their ease while applying for loans. It can increase the reach to customer and can lead to fast processing of loans. We expect this new initiative will give IHFL an advantage over its peers in the long run and increase their sustainability and profitability.

- IHFL is giving home loans to customers by digitally completing many steps required for obtaining home loans. New e-home loans will reduce the loan processing time and save the cost of visits by sales executives. It will expand IHFL's reach to Tier I, II and III towns as well as in NRI customers.

- IHFL has tied up with UIDAI Aadhar for e-Signatures and e-KYC, thus eliminating several formalities (repeated signatures, documents). Verified information, photograph, etc. are taken automatically from the UIDAI database. Thus, manual error-prone data entry is eliminated, allowing the credit team to focus on underwriting.

- Recently launched 'Smart City Home Loans' in tier II and tier III towns with an average ticket size of Rs15 lakh is expected to result in good growth in the Affordable Housing segment.

Expected Positive Impact of Digital Initiatives		
Digital Initiatives can give faster growth in revenues which in turn will lead to increase in profitability	More reach to customers as well as falling costs will lead to sustainability	Digital presence can increase customer base which will give more opportunities which lead to scalability

Source: IHFL presentation, Ventura Research

❖ Segment wise Business Outlook:

➢ Focus on Housing Finance segment:

- The housing finance segment contributed 4% of the total loan assets at the end of FY16. Management strategy involves increasing the share of the housing loan segment to 60% by FY18. We think IHFL is likely to achieve this objective.

- Housing loans carry lower risk but margins are lower than other segments. The growth drivers for housing can come from newly launched affordable housing and smart city projects. The housing finance segment has comparatively less chances of defaults as well as continuity of income compared to LAP.

- Apart from traditional housing loans, IHFL has affordable housing loans as well as smart city loans as two newly launched segments under housing loans. The company's new initiative e-home loans can become the driver of growth.

➢ LAP Segment's risk-return balance

- IHFL has 24% of its loans financed under LAP. We expect them remain in the ratio of 20-24% in the years to come.

- LAP loans are NIM accretive, which increases profitability for IHFL. In the last few years, the LAP loan segment in all financials is increasing rapidly. Concerns are starting to arise over the increasing Loan to Value as well as the decreasing share of collateral and funding against non-residential property. This is one reason why we think IHFL is not trading at a premium multiple like Gruh Finance.

- Some of the investors' concerns are mitigated by IHFL's agreement with CRISIL Ratings to grade its incremental LAP loans from FY16. In Q2 FY 2015-16, IHFL tied up with rating agency ICRA to grade all of its incremental LAP loans.

- CRISIL grades LAP loans to small business owners based on four key factors: 1) financial strength, 2) business management, 3) collateral quality and 4) underwriting process adherence. Given rising concerns about the increase in LAP loans to SMEs, verification of the portfolio performance from external agencies is expected to offer some support. Detailed assessment of the following key factors determines the credit worthiness of the borrower:

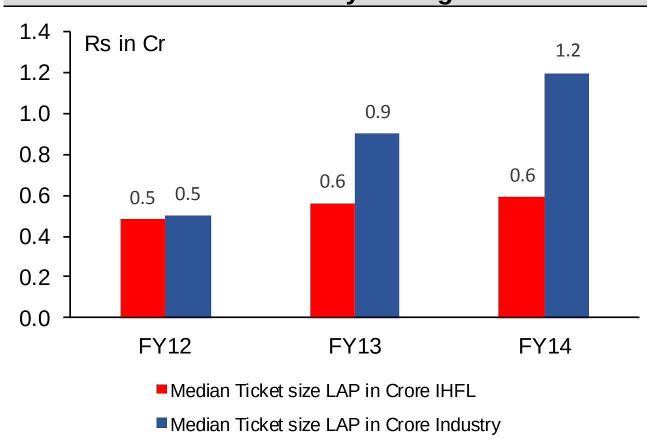
Key factors for LAP Assessment

Financial Strength	Business Management
•Interest and debt service cover	•Business sector and sectoral prospects
•Revenues, margin and profitability	•Business duration and track record
•Net worth and leverage	•Debt service track record
•Growth track of key financial parameters	•Experience and qualification of promoters and proprietors
	•Management strength and experience
Collateral Quality	**Underwriting Process Adherence**
•Property type and location	•Independent verification and valuation
•Valuation of property	•Third party database checks
•Ownership and title chain of property	–CERSAI (Central Registry of Securitization, Asset Reconstruction and Security Interest of India
•Adherence to local zoning and planning permissions	–Registrar of companies
	–Credit bureau checks
	–CIBIL mortgage checks
	–RBI wilful defaulter list
	–Experian Hunter fraud check

Source: IHFL Presentation, Ventura Research

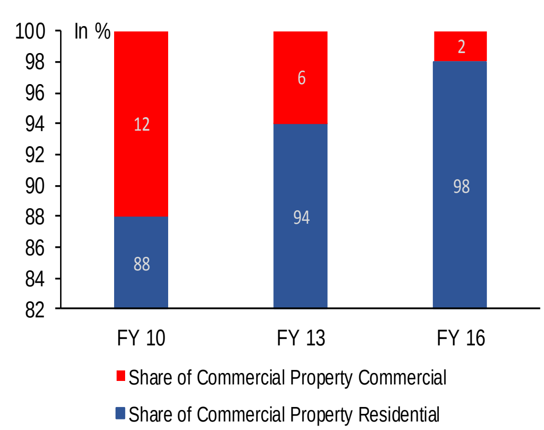
- The Exercise OF LAP grading by rating agencies will address some investor concerns about the LAP book. It may give sustainability to valuations in the long run.

LAP Median ticket size comparatively smaller than industry average



Source: IHFL, Ventura Research

Decreasing % of Commercial LAP



Source: IHFL, Ventura Research

Corporate Loans segment:

- The corporate loans segment is another high growth segment for IHFL where the main concentration is on Lease rent discounting and residential construction financing. Corporate Loans constituted 22% of the total loan book at the end of FY16.

- IHFL provides finance to real estate developers through corporate mortgage loans. Corporate mortgage loans are made available through two main types of structures: (i) residential construction finance and (ii) lease rental discounting loans for commercial properties.

- Lease rental discounting loans are loans provided against hypothecation of the rental receivables (which are routed through an escrow account) of an operational commercial property, which is the primary source of repayment/payment of the loan and the other dues. The commercial property is also mortgaged to secure the loan and other dues. Additionally, the shares of the mortgagor may be pledged to further secure the loan and other dues. Due consideration is given to the credit appraisal process.

- IHFL has lent Rs5bn to Shree Ram Urban Infrastructure limited for the Palais Royale project in Worli, Mumbai. The borrower violated certain BMC regulations and now the project is under litigation. IHFL's Funds recoverability is dependent, in this case, on many complex factors. IHFL hopes that problems relating to this loan may be resolved before the end of FY17.

- We believe that IHFL needs to improve disclosures relating to large corporate loans, which are 23% of the total loans. Such exposures to large projects increase IHFL's portfolio risks. We believe this impacts share valuation.

Investment in Oak North Bank in UK

- OakNorth Bank Limited is a specialist bank in the UK that lends between £1m to £20m to mid-sized growth businesses and entrepreneurs. The bank, set up in 2013 by Rishi Khosla, a startup investor, specializes in lending to small businesses. IHFL has bought a 40% stake in OakNorth Bank in November 2015 for $100mn.

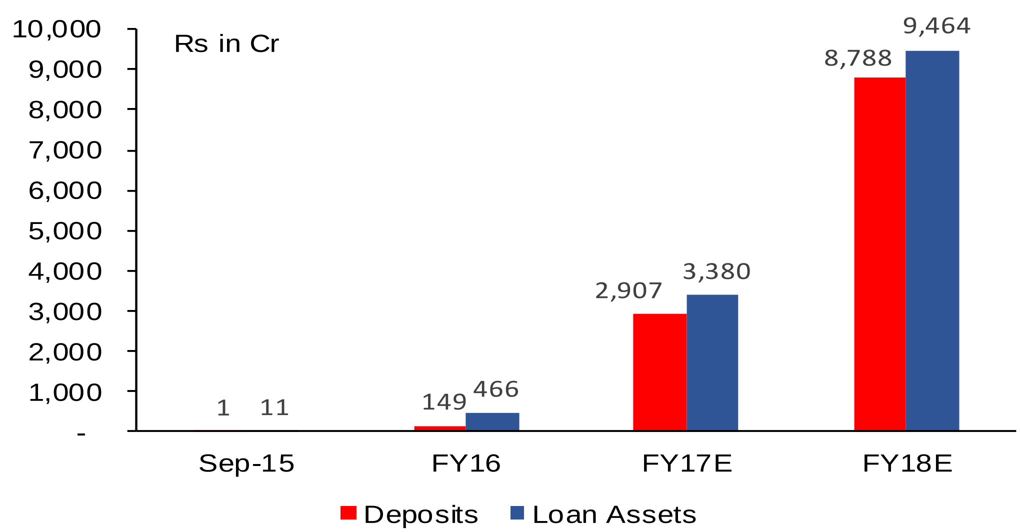
- OakNorth Bank secured a full banking license from the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) in FY15 and began deposit taking and lending six months later in September.

- OakNorth Bank provides business loans of between £1m to £20m in addition to property development finance, property investment loans and savings accounts. The bank considers stock, debtors, fixtures and fittings, plant and machinery, intellectual property, and real estate as collateral.

- IHFL acquired a stake in this bank with an intent to help build experience and a track record of managing a deposit-taking franchise in a tightly regulated market such as the UK's. Such credentials of overseeing a large franchise that accepts public deposits will stand IHFL in good stead on its long-term growth path.

As per OakNorth Bank estimates, deposits and loans are expected to grow in the future as given in the chart.

Oak North Bank Expected growth in future promising



Source: Ventura Research

Conservative Valuation compared to peers					
Challenger Bank	**Valuation**	**Investment**	**Valuation Period**	**Mode of transaction**	**Transaction Highlights**
Metro Bank	US$ 2.3 Bn	US$ 571 Mn	Mar'16	IPO	IPO at a P/B multiple of 2.0x
Shawbrook Bank	US$ 1.0 Bn	US$ 129 Mn	Mar'15	IPO	IPO at a P/B multiple of 3.5x
Aldermore Bank	US$ 1.0 Bn	US$ 129 Mn	Mar'15	IPO	IPO at a P/B multiple of 2.4x
Atom Bank	US$ 230 Mn	US$ 128 Mn	Nov'15	Stake purchase by BBVA & others	•Valuation for minority stake
					•Licensing conditions not met at

Source: IHFL Presentation, Ventura Research

- For a controlling stake, IHFL invested US$100mn in OakNorth Bank at a valuation of US$250Mn at a price-to-book of 1.9x in Nov

- As IHFL has a 40% of stake in OakNorth Bank, it is treated as an associate for financial reporting purposes. In the last two quarters, IHFL has reported Rs.6.6 cr as losses from associates.

- In September 2016, OakNorth Bank announced it has broken even. We have continued with conservative estimates, taking minor losses from the bank in the financials and reducing the book value.

➢ Demonetization: short term negative but long term positive

For IHFL, which derives a major part of its business in Housing Finance and LAP, demonetization will have a short as well as a long-term impact.

- **Short Run Impact – Negative for Q3 and Q4 FY17**

  Less liquidity in the economy may impact IHFL's revenues for the next quarter or two. IHFL housing loans repayments may be postponed for the next two quarters. New loans growth may be low or even negative for these two quarters. In case of LAP, the short run impact will be the same as it is for housing loans. In the case of corporate loans, the LRD may be impacted less than large loans. We have factored this in our earnings model by reducing the loan growth rate in the next quarter. Post demonetization, the RBI has relaxed norms related to provisioning for the next quarter. Our estimates for provisions and GNPA and NNPA have not changed.

- **Long term: Business outlook does not change**

  Real estate activity growth may see a slowdown till end March 2017. In turn, it will affect the growth of housing finance companies. We expect this to impact more high value houses (exceeding Rs10mn) than those in the Affordable Housing Segment. Since IHFL is concentrating more on Affordable Housing, the impact on IHFL may not be significant. Elimination or reduction of the unaccounted cash component may increase transaction values and average borrowing sizes may increase.

The LAP segment may see a rise in default rates as well as a slowdown in business. With falling property prices, the mortgage value is going to fall. This in turn increases the default risks. This risk is unavoidable for the financial sector. Since IHFL has disbursed LAP using residential property as collateral, it may be less exposed than companies giving loans against commercial properties.

For corporate loans, we may see a slowdown in loans growth as well as rising defaults. IHFL has not been expanding its corporate book but it is 1/5th of the total book. There may be an increased default risk from corporate loans.

❖ Key Risks:

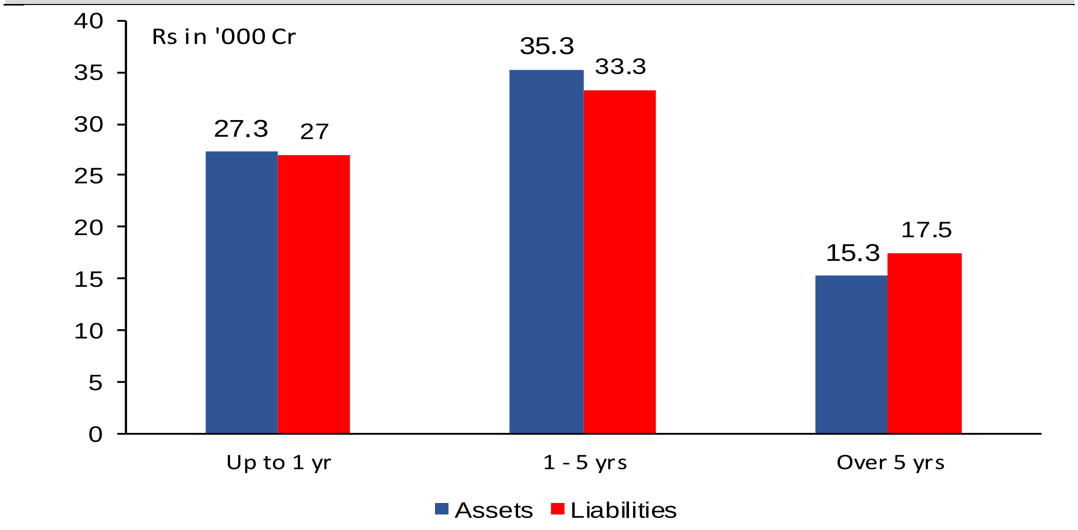
- Credit risks: A credit risk is the risk of default on a debt that may arise from a borrower failing to make required payments.
  The Risk Management Committee (RMC) of IHFL comprises of members of its senior management team, who have many years of experience in the industry and have put in place preventive mechanisms to contain various risks.

- Interest rate risks: This is the risk that an investment value will change due to a change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve, or in any other interest rate relationship. Asset Liability Management reviews management of Interest Risks.

- Currency risks: Currency risks are risks that arise from changes in the relative valuation of currencies. IHFL business is mainly India driven. It has no foreign exposure in terms of revenue. The company has ECB loans in the books but ECB loans are only 2% of total loans.

- Liquidity risks: Liquidity risk is the risk that a company or bank may be unable to meet short term financial demands. This usually occurs due to the inability to convert a security or hard asset to cash without a loss of capital and/or income in the process.
  IHFL's Liability profile is optimally matched as we can see from the chart. The company has an Asset-Liability management committee to look into liquidity risks.

Maturity profile (As of March 31, 2016)



Source: IHFL, Ventura Research

Operational risks: Operational risk is the prospect of loss resulting from inadequate or failed procedures, systems or policies. These risks arise from employee errors, systems failures, fraud or other criminal activity or any event that disrupts business processes.

To enhance the control, the RMC put in place measures to contain these risks. IHFL has a robust mechanism to ensure an ongoing review of systems, policies, processes and procedures to contain and mitigate risk that arise from time to time.

❖ Financial Performance

Consolidated Quarterly Financial Performance				
Particulars(Rs in Cr)	**Q1FY17**	**Q2FY16**	**FY16**	**FY15**
Revenue	2,394.6	1,877.0	7,841.8	6,120.9
Growth%	27.6%		28.1%	
Finance Costs	1,627.9	1,245.0	4,971.4	3,944.2
NII	766.6	631.9	2,870.4	2,176.7
Growth%	21.3%		31.9%	
Operating Expenses	244.1	146.3	618.4	553.3
Provisions	81.7	113.1	506.9	300.3
Other Income	480.4	368.8	1,383.7	1,149.4
Net Profit Before Tax	921.2	741.3	3,128.9	2,472.5
Tax	235.2	185.8	776.0	571.3
Net Profit After Tax	686.1	555.5	2,352.9	1,901.2
Growth%	23.5%		23.8%	
Share of profit/(Loss)of as	-1.8	-	-8.2	-
Net Profit After Tax	684.3	555.5	2,344.7	1,901.2

Source: IHFL, Ventura Research

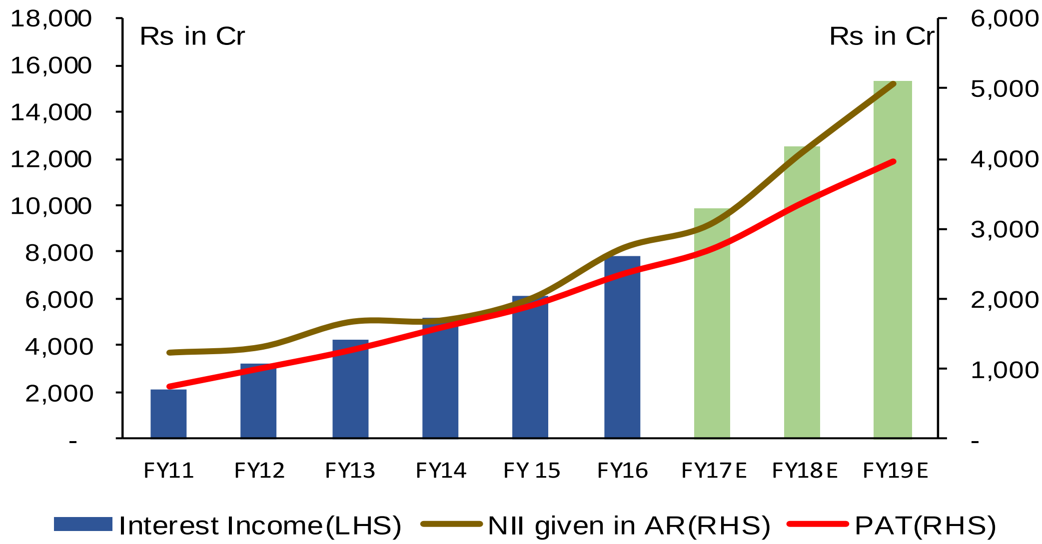
- Consolidated financial performance for Q2FY17 vindicates growth visibility for IHFL. Robust topline and bottom-line growth is visible from the numbers. Revenue grew by 27.6% to Rs 2,394.6cr. NII showed growth of 21.3% due to a change in the borrowings mix and a fall in policy rates. PAT growth was 23.5%, which was due to higher NII and higher other income. We expect loan growth to gain more momentum in FY18 due to the availability of funds for lending and a supportive external environment.

- As a part of the demonetisation, we expect IHFL's loan growth to reduce in Q3 and Q4 FY17 due to lower economic activity.

❖ Financial Outlook positive:

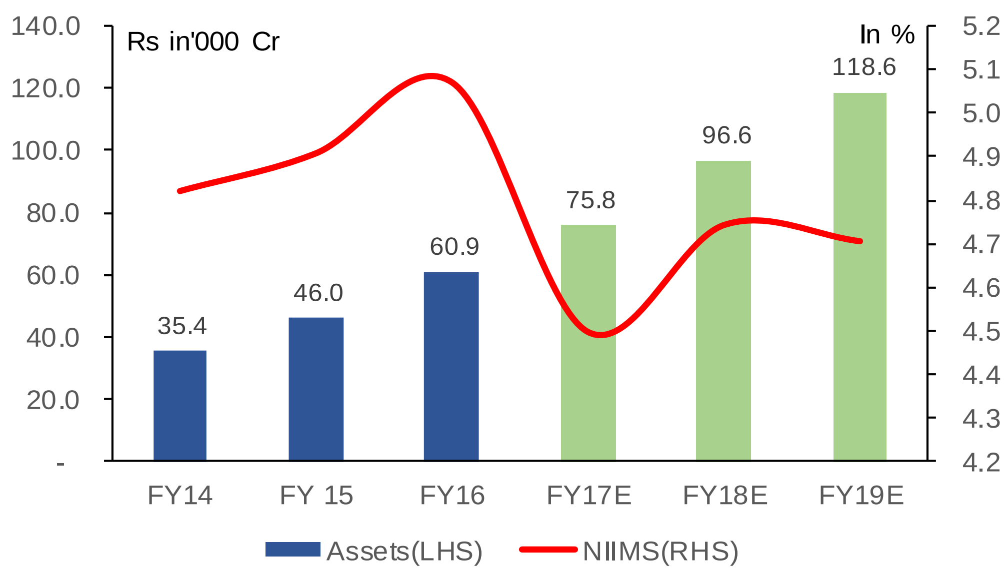
- New e-home loans, smart city loans project, digital initiatives and existing branch networks with a presence in over 110 locations across India give support to revenue growth. Availability of funds, which we can see from a high CAR can provide basic raw materials for more housing loans. IHFL's efforts to reduce high cost bank borrowings and switch to low cost NCDs/bonds borrowings will reduce the cost of funds for IHFL. We expect finance costs to fall further and remain in the range of 8.75% to 9.25% in the future. We expect the loan assets to grow by at least 25% as well as Interest Income to grow in the range of 20-25% per annum.

Strong Business Growth Visible



Source: Ventura Research

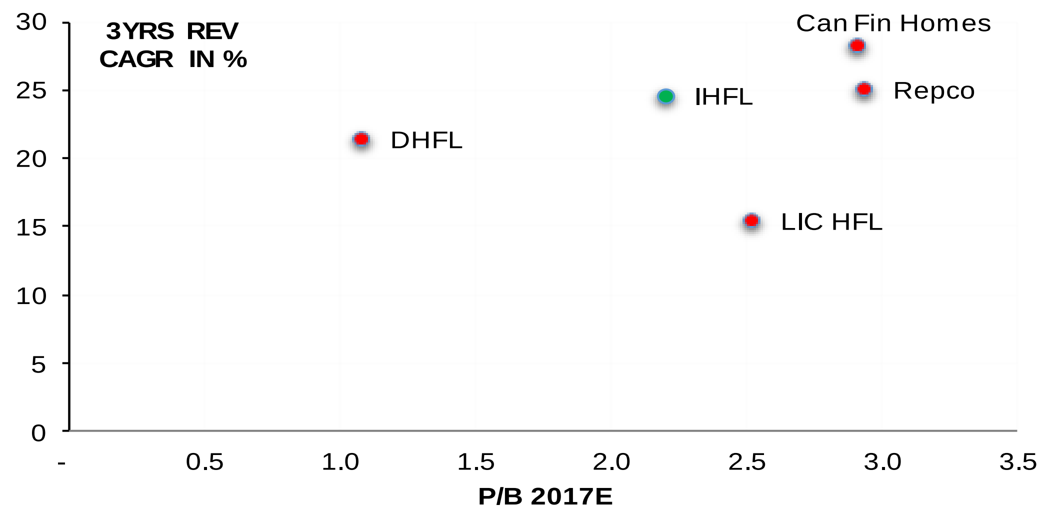
High NIMS with sustainable Home Loan growth



Source: Ventura Research

❖ Attractive valuation considering revenue growth

Attractive Valuation along with high growth



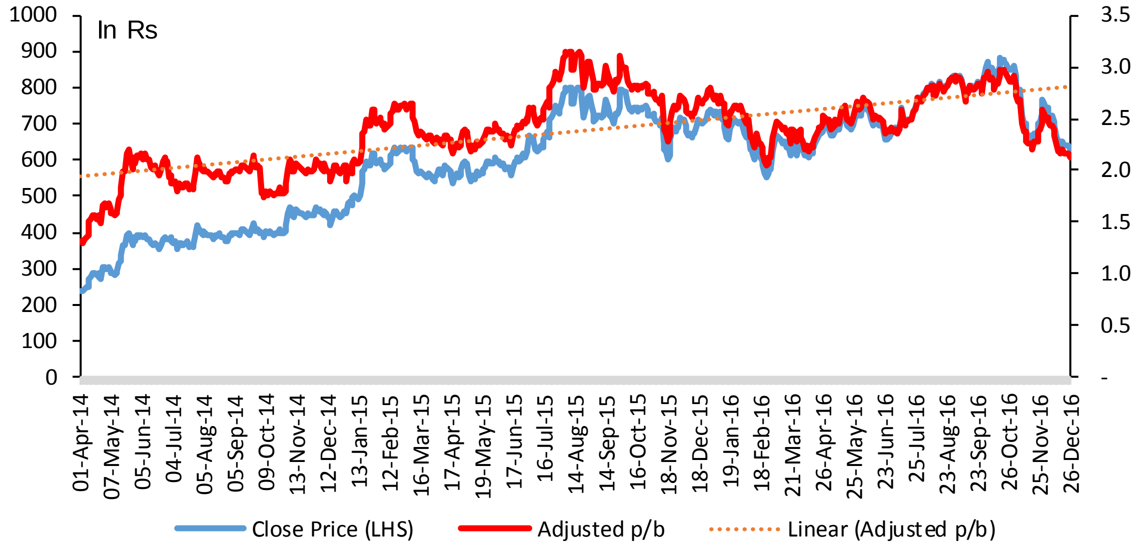
Source: Ventura Research

IHFL is trading at a P/B multiple of 2.5 times the FY2016 book. It is expected to deliver revenue CAGR of 25% and PAT CAGR of 19% for the next 3 years but still have cheap valuations compared to its peers. It is valued at 2.3 times the FY2017 adjusted book, which is cheaper than that of its peers.

We are positive on IHFL for the following reasons:
1. Growth in interest income to continue at 25% for FY17-18.
2. Housing Loans will increase as a percentage of total loans, adding stability to revenues.
3. Major default from any large corporate loan is not likely to disrupt profits in the future.
4. IHFL will reduce its bank borrowings and improve profitability.
5. IHFL is not likely to foray into completely unrelated lines of business
6. Oak North Bank valuation will remain stable and losses in the bank will not cross estimated levels.

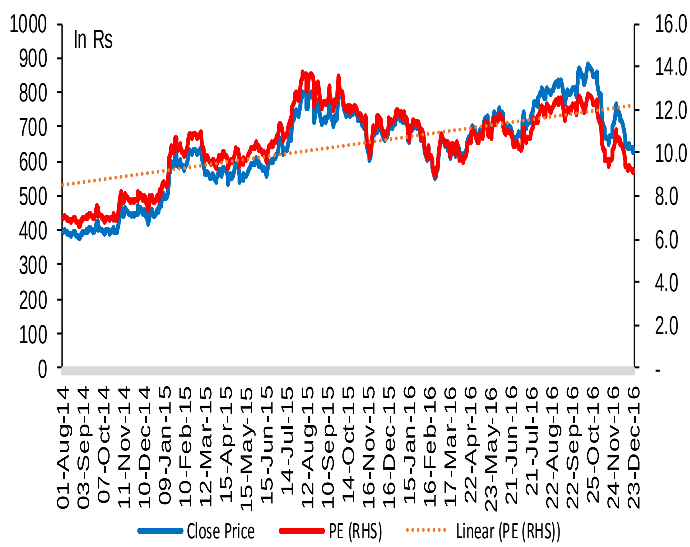
We note that IHFL has traded at lower P/B multiples compared to its peers for long. We value the company at 3 times 8 qtrs. forward adjusted Book of Rs337 to arrive at a price target of Rs1010.

Adjusted PB Chart

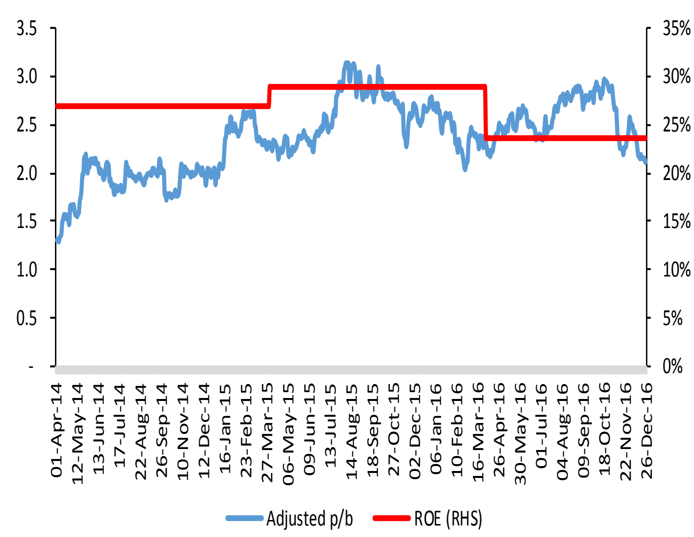


Source: Ventura Research

PE Chart



Adjusted PB to ROE Chart



Source: Ventura Research

Peer Comparison

Year	Interest Income (Rs in Cr)	NII (Rs in Cr)	PAT (Rs in Cr)	EPS	NIIM (%)	P/E (X)	P/BV (X)
IBHFL							
2016	7,842	2,711	2,345	58.0	5.1%	10.8	2.5
2017E	9,881	3,072	2,707	63.5	4.5%	9.9	2.2
2018E	12,515	4,088	3,361	78.8	4.7%	8.0	1.9
Can Fin Homes							
2016	816	300	157	59.0	3.2%	24.7	3.2
2017E	1,083	428	226	85.1	3.5%	17.1	2.9
2018E	1,381	558	285	107.2	3.6%	13.6	2.3
DHFL							
2016	5,010	1,822	743	25.5	3.2%	9.1	1.3
2017E	5,984	2,208	956	31.2	3.3%	7.4	1.1
2018E	7,312	3,014	1,383	39.8	3.7%	5.8	0.9
LIC HFC							
2016	12,251	2,944	1,661	32.9	2.4%	16.3	3.0
2017E	14,068	3,588	1,890	37.4	2.5%	14.3	2.5
2018E	16,243	4,181	2,259	44.8	2.5%	12.0	2.1
Repco							
2016	852	303	154	24.6	4.3%	20.7	3.3
2017E	1,012	334	147	23.6	4.2%	21.7	2.9
2018E	1,336	485	222	35.5	4.4%	14.4	2.5

Source: Ventura Research

Kyon ki bhaiya, sabse bada rupaiya.

❖ Financials and Projections

Y/E March,Rs in Cr	FY16	FY17E	FY18E	FY19E
Income Statement				
Interest Income(incl.int on bonds)	**7,841.8**	**9,880.8**	**12,514.5**	**15,306.7**
Interest Expense	4,971.4	6,512.1	8,051.2	9,786.3
Net Interest Income(incl.int on bonds)	**2,870.4**	**3,368.6**	**4,463.3**	**5,520.4**
YoY change (%)	*31.9*	*17.4*	*32.5*	*23.7*
Non Interest Income	1,383.7	1,586.9	1,631.3	1,757.7
Total Net Income	4,254.1	4,955.5	6,094.6	7,278.2
Total Operating Expenses	618.4	715.9	890.3	1,070.8
Pre Provision profit	**3,635.7**	**4,239.6**	**5,204.3**	**6,207.4**
YoY change (%)	*31.1*	*16.6*	*22.8*	*19.3*
Provisions for expenses	506.9	578.0	706.6	925.9
Profit Before Tax	**3,128.9**	**3,661.5**	**4,497.7**	**5,281.4**
YoY change (%)	*26.5*	*17.0*	*22.8*	*17.4*
Taxes	776.0	941.6	1,124.4	1,320.4
Net profit	**2,352.9**	**2,719.9**	**3,373.3**	**3,961.1**
YoY change (%)	*23.8*	*15.6*	*24.0*	*17.4*
Loss from Associates	-8.15	-12.62	-12.00	-12.00
PAT To Equity ShareHolders	**2,344.7**	**2,707.3**	**3,361.3**	**3,949.1**
Balance Sheet				
Assets				
Cash and Bank balances	2,902	3,032	3,864	4,149
Investments	10,693	14,396	15,242	16,755
Loans Given	60,880	75,810	96,611	1,18,553
Housing	32,266	43,212	59,899	77,059
Corporate Loans	13,394	15,920	19,805	24,303
Other Loans	14,611	16,678	16,907	17,190
Vehicle loans	609	-	-	-
Other assets	1,961	4,714	2,670	3,501
Total	**76,436**	**97,953**	**1,18,388**	**1,42,958**
Liabilities				
Shareholders Funds	10,694	12,170	13,851	15,825
Borrowings	61,090	81,234	98,740	1,20,019
Other Liabilities	4,652	4,549	5,797	7,113
Total	**76,436**	**97,953**	**1,18,388**	**1,42,958**
Dupont Analysis				
(As % of Average Assets)				
NII	4.1	3.5	3.8	3.9
Operating Income and Other Income	2.3	2.2	1.9	1.7
Other Operating Expense	0.9	0.8	0.8	0.8
Provisions	0.8	0.7	0.7	0.7
Net Income pre tax	4.7	4.2	4.2	4.0
Tax To Total Assets	1.2	1.1	1.0	1.0
Loss of assocites	0.0	0.0	0.0	0.0
ROA	3.5	3.1	3.1	3.0
Average Assets to Average Equity	7.7	7.6	8.3	8.8

Y/E March,Rs in Cr	FY16	FY17E	FY18E	FY19E
Ratio Analysis				
Efficiency Ratio				
Int Expended / Int Earned	63.4%	65.9%	64.3%	63.9%
NII / Total Income	31.1%	29.4%	31.6%	32.4%
Other Inc. / Total Income	15.0%	13.8%	11.5%	10.3%
Ope. Exp. / Total Income	6.7%	6.2%	6.3%	6.3%
Loans To Borrowed Funds	1.0	0.9	1.0	1.0
NIM	5.1%	4.5%	4.7%	4.7%
(Int Income on loans-Int expense on loans)/Average Loans				
Solvency Ratios				
Gross NPA (%)	0.84	0.85	0.85	0.85
Net NPA (%)	0.49	0.35	0.35	0.35
Per Share Data (Rs)				
EPS Rs	58.0	63.5	78.8	92.6
Dividend Per Share Rs	36.0	33.3	39.4	41.2
Book Value Rs	253.8	285.3	324.7	371.0
Adjusted Book Value of Share Rs	248.1	278.3	315.7	359.9
Valuation Ratios (x)				
Price/Earnings (x)	10.8	9.9	8.0	6.8
Price/Book Value (x)	2.5	2.2	1.9	1.7
Price/Adj.Book Value (x)	2.5	2.3	2.0	1.7
Return Ratios				
RoAA (%)	3.5	3.1	3.1	3.0
RoAE (%)	27.1	23.7	25.8	26.6
Growth Ratio (%)				
Interest Income	28.1	26.0	26.7	22.3
Interest Expenses	26.0	31.0	23.6	21.6
Other Income	20.4	14.7	2.8	7.8
Total Income	27.9	16.5	23.0	19.4
Net profit	23.3	15.5	24.2	17.5
Borrowings	28.6	33.0	21.6	21.6
Loans	32.2	24.5	27.4	22.7

❖ Housing Finance Sector Overview

Key Growth Drivers for the Housing Industry in India	
Favourable Demographics	66% of India's population is below 35 years of age. Urban housing requirement estimated to grow to 45 million units by 2022
Accelerating Urbanization	Urbanisation to rise to 40% of the population by 2030 from the present 31%
Improving Affordability	Rising disposable income, affordable housing loan interest rates and tepid property price inflation to result in rapidly increasing affordability
Government Policy Thrust	Housing for all by 2022; Smart cities plan; Atal Mission for Rejuvenation and Urban Transformation. Smart city project
Funding Drivers	RBI focus on long-term liquidity; Distribution tax on securitization abolished; Insurance companies, provident & pension funds to invest 15% of corpus in affordable housing and infra

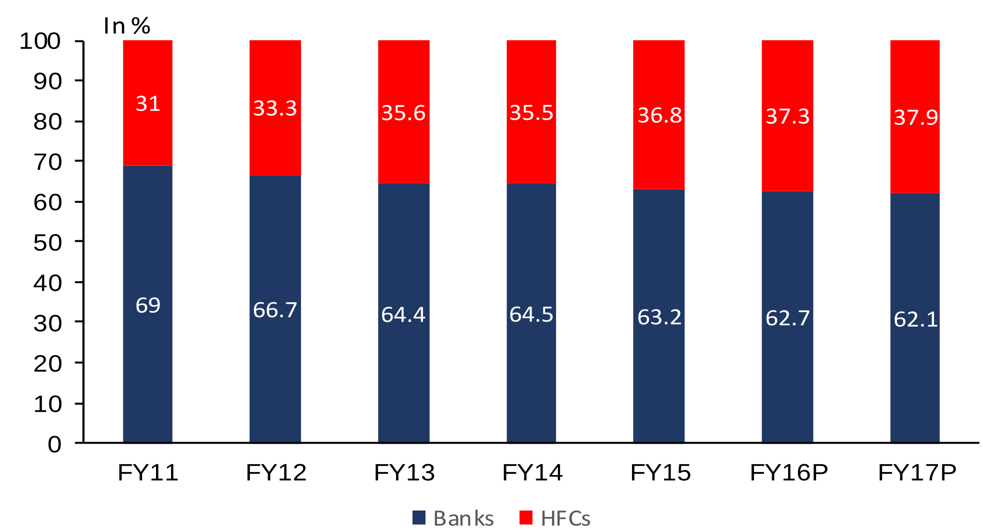
Source: IHFL Performance Update, Ventura Research

- **Housing Finance Industry to enter high growth phase**
  With a total population of more than 1.25 billion, India is one of the most densely populated countries. Out of the total population, 65% is below 65 years of age. A young and growing population can easily think of purchasing a house financed by a housing loan. With an increasing number of young people moving out of rural areas in search of jobs, housing will be in demand in semi-urban and urban areas.

Recent boost to Housing Sector	
Regulator	Real Estate (Regulatory & Development) Act, 2016 will lead to a structured, transparent and disciplined sector
Tax Incentives	Increased tax incentive reduces effective housing loan yields to 4.0% for a 9.4% housing loan for first-time home buyers buying affordable houses
Budget 2016-17	100% tax exemption on profits from building affordable housing will attract organized developers and increase supply
Fiscal Incentives	Service tax exemption on construction of affordable housing will lead to a reduction in prices, increasing affordability
7th Pay Commission	Annual payout to 10 Mn government employees to go up by Rs1 Tn per annum. Increased disposable income will have a positive impact on the housing sector

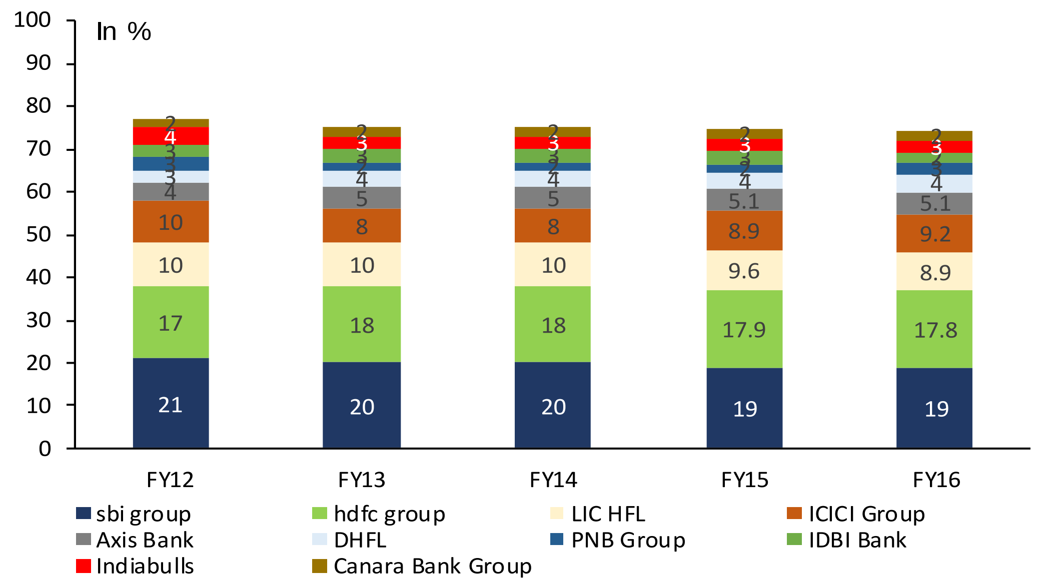
Source: Indiabulls Performance Update, Ventura Research

Increasing Market share of HFC



Source: PNB Housing DRHP, Ventura Research

Stable Market Share of IHFL over the year



Source: IHFL Draft prospectus, Ventura Research

- The sector remains concentrated with the top five players – SBI Group (SBI along with associate banks), HDFC Group (HDFC Limited, HDFC Bank and Gruh Finance), LIC Housing Finance Limited, ICICI Group, and Axis Bank – clearly dominating the domestic mortgage market. These five cumulatively accounted for 60% of the total housing credit in India as of FY16, (61% as on FY15).

Out of the total listed players in the housing finance market, IHFL has the 3rd largest asset base. With a favorable environment for growth for the sector as a whole, IHFL can benefit from the growing industry. IHFL is planning to raise the share of Housing Loans in the total loans to 60% by FY18 and 65% by FY20.

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