PNB Housing Finance Ltd. – Robust play in Indian HFC sector "SUBSCRIBE"

24th Oct, 2016

Issue date	25 -27th October, 2016
Type of issue	Fresh Issue – Rs. 30 bn.
Face Value	Rs. 10
Price Band	Rs. 750 – 775 per equity share
Lot size	19 shares
Post issue Market Cap.	Rs. 128 bn at upper end of Price band
Issue structure	QIB – 50%, Non institutional – 15% Retail – 35%
BRLM	Kotak Mahindra, DSP Merrill Lynch, JM Financial, JP Morgan and Morgan Stanley India
Registrar to the issue	Link Intime
Shareholding Pattern (%)	PNB – 39.1 Destimoney (Carlyle) - 37.6 Others – 23.4

Y/e 31 Mar (Rs. mn)	FY16	FY15	FY14
NII	7,080	4,416	2,753
NIM (%)	2.98	2.94	2.93
C/I ratio (%)	25.69	31.39	30.14
PCR (%)	36.25	66.82	51.47
PAT	3,276	1,941	1,297
EPS (Rs.)	25.8	18.7	19.7
Book Value (Rs.)	169	152	142
Share Capital	1,269.23	1,269.23	1,269.23
Gross NPAs (%)	0.22	0.20	0.32
RoA (%)	1.35	1.27	1.35
RoE (%)	17.60	15.45	16.71

PNB Housing Finance Ltd (PNBHFL) is the fifth largest housing finance company (in terms of loan portfolio) and the second largest (in terms of deposits). Punjab National Bank (PNB) holds a 51% stake in its housing finance unit, which was founded in 1988 as a non-banking financial company. Private equity firm Carlyle Group owns the rest. Carlyle acquired the stake from financial services firm Destimoney Enterprises Pvt. Ltd in February 2015. PNBHFL offers its customers "housing loans" for the purchase, construction, extension or improvement of residential properties or for the purchase of residential plots, and "non-housing loans" in the form of loans against property ("LAP") to property-owning customers through mortgages over their existing property and any additional security, if required; non-residential premises loans ("NRPL") for the purchase or construction of non-residential premises; lease rental discounting ("LRD") loans offered against rental receipts derived from lease contracts with commercial tenants; and corporate term loans ("CTL"), which are general purpose loans to developers and/or corporates for purposes of on-going projects or business needs. PNB Housing has 48 branches and around 800 employees across northern, western and southern regions. Forty percent of its business comes from north India, with south and west both contributing 30% each.

As on June 16, housing loans accounted 70.31% of total loans and its retail home loans constituted 86.52% of housing loans (60% of total loan portfolio) and construction finance comprising the rest. Within non-housing loans, LAP comprises ~60% (18% of total loan portfolio); lease rental discounting and corporate term loans accounted for the balance. The average loan size (at origination) of retail housing loans as of June 30, 2016 was Rs. 3.18 million, with a weighted average loan-to-value ratio ("LTV ratio") (at origination) of 66.10%. As of June 30, 2016, non-housing loans constituted 29.69% of its total loan portfolio and its retail non-housing loans accounted for 78.27% of its total non-housing loan portfolio. The average loan size (at origination) of our retail non-housing loans as of June 30, 2016 was Rs. 5.68 million, with an weighted average LTV ratio (at origination) of 46.49%.

Investment highlights

1) Fifth largest HFC in India and the fastest growing HFC among leading HFCs in India
   a) PNBHFL has over 25 years of experience in the Indian Housing Finance industry.
   b) 5th largest HFC in India by loan portfolio as of Sep. 2015 with the second largest amount of deposits in an HFC IN India as of Mar. 31, 2015 according to IMaCS report.
   c) Loan portfolio growing at a CAGR of 61.81% from Rs. 39,696.63 mn as on Mar. 31, 2012 to Rs. 168193.17 mn as of March 2015. As of June 30, 2016, its loan portfolio had grown to Rs. 309006.44 mn.
   d) As of June 30, 2016, our housing loans constituted 70.31% of our total loan portfolio and our retail housing loans constituted 86.52% of our total housing loan portfolio.
2) Scalable operating model, centralized and streamlined operational structure which has resulted in improved turnaround time for processing a loan application until loan sanction.
3) Access to diversified and cost effective funding sources, such as term loans (7.03%), NCDs and other debt instruments (30.19%), Deposits (24.75%), ECBs (5.37%), Commercial Paper (19.64%), NHB (10.04%), subordinated debt (3%).

Investment Rationale and Recommendation

With due consideration to factors like a) Indian Housing Finance Sector Poised For Strong Growth, b) Indian Mortgage Market is significantly under-penetrated, c) 5th largest by loan portfolio and 2nd largest by deposits, d) strong parentage, independent professional management and an autonomous board, e) fastest growing HFC amongst the Top 5 HFCs in India, f) strong growth in loan portfolio across segments over the last 5 years, g) robust and scalable technology-enabled target operating model, h) wide product offering with ~70% of the loan portfolio as housing loans with an average ticket size of Rs. 3.2 mn catering to affordable segment which has a higher demand, i) strong distribution network with pan India presence and over 7,110 channel partners across India, j) diverse and cost effective funding mix with average cost of borrowing at 8.65%, j) lowest GNPAs amongst peers in India at 0.27%, k) efficient capital utilization and delivering healthy RoEs consistently, l) fairly valued on post issue basis (2.5x – P/BV) considering its credentials against existing listed peers, we recommend to "SUBSCRIBE" the issue.

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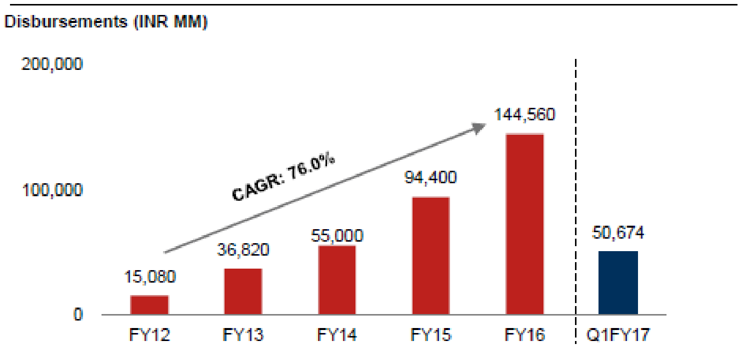
Objects of the issue

1) Achieve the benefits of listing the Equity Shares on stock exchanges
2) IPO proceeds would be used purely for "growth" and expansion of distribution channels to take on its rivals.
3) The mortgage lender will use the proceeds to bolster its tier-I capital base in order to meet its capital requirements.
4) The money garnered through IPO would also help the firm comply with National Housing Board directions on minimum capital adequacy ratio, which consists of tier-I and tier-II capital.

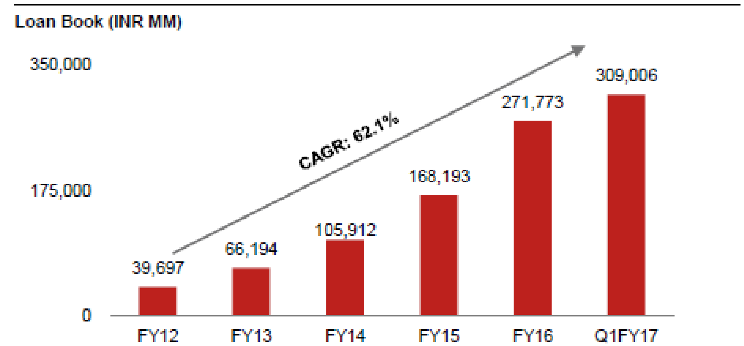
Post-IPO, PNB will hold approximately 38-39% of the issued and paid-up share capital, while Carlyle's holding will be around 37%.

Strong growth in loan portfolio across segments over the last 5 years

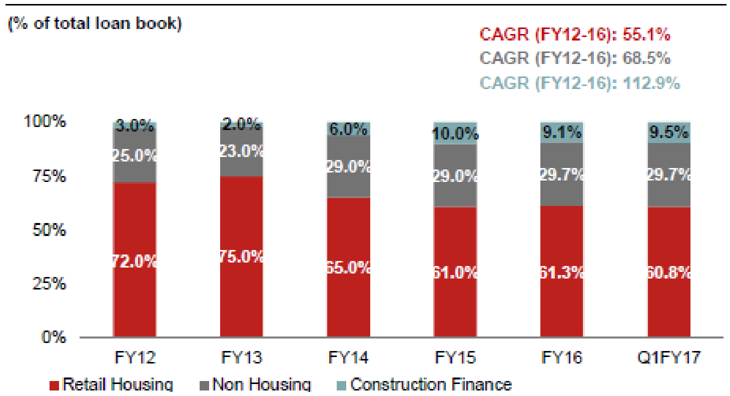
Disbursements have Grown at a CAGR of 76% Annually for the Last 5 Years



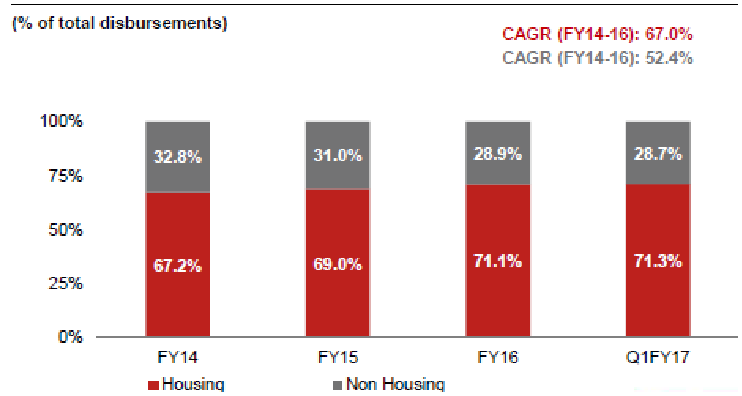
Loan Portfolio has Grown at a CAGR of ~62% Annually for Last 5 Years



Wide Product Offering



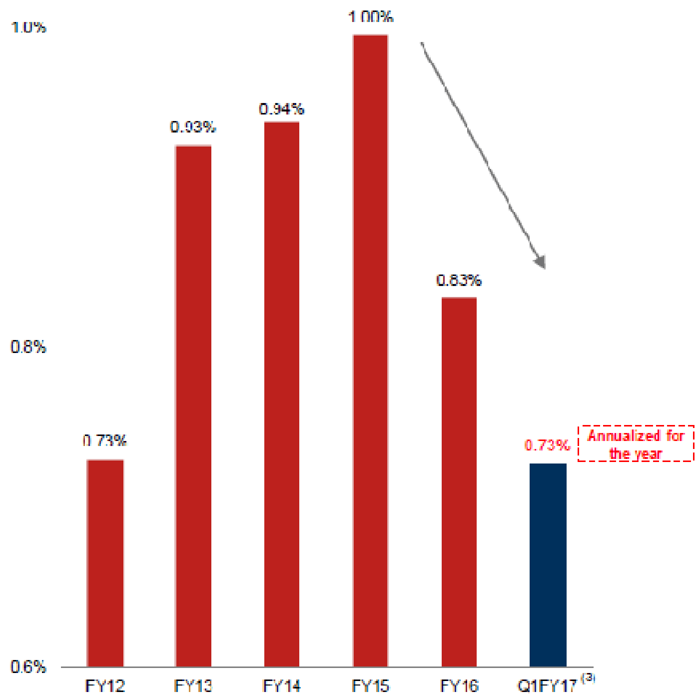
....With Stable Share of Housing Loans



Driving operating leverage

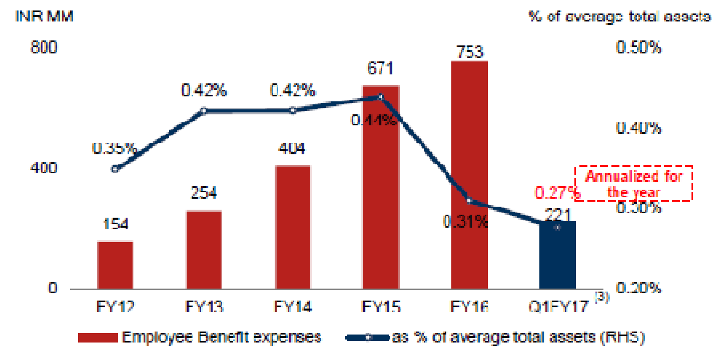
Operating Leverage Kicking-in...

Opex to average total assets ratio (%) (1)

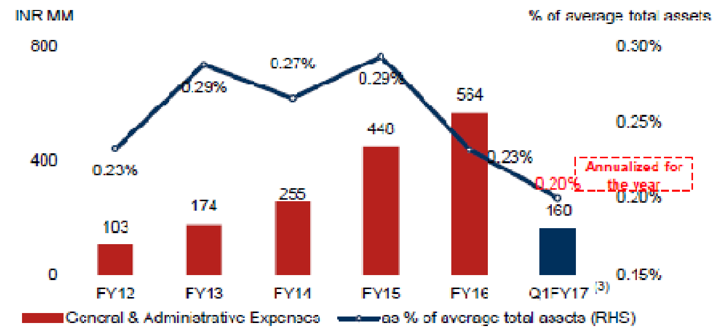


...as Productivity of Employees and Branches Improve

Employee Benefit Expenses

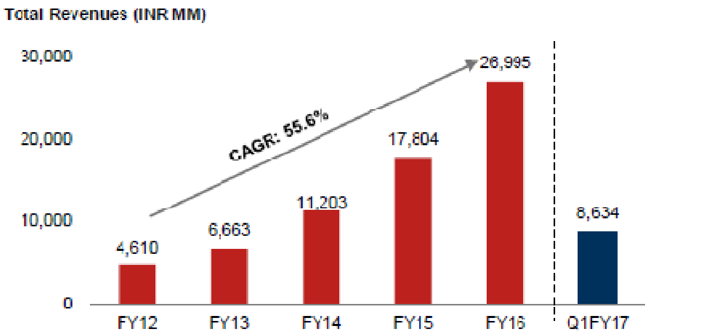


General and Administrative Expenses (2)

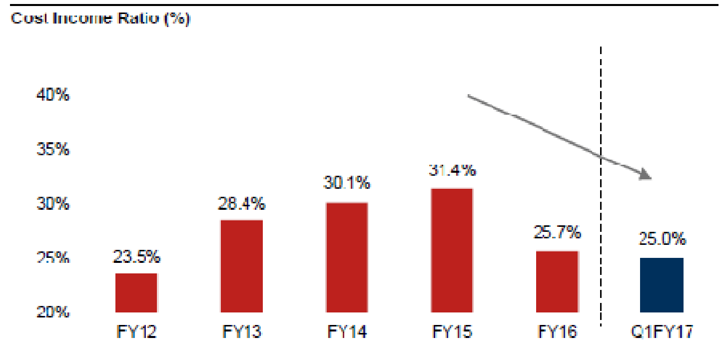


Strong operating and financial performance

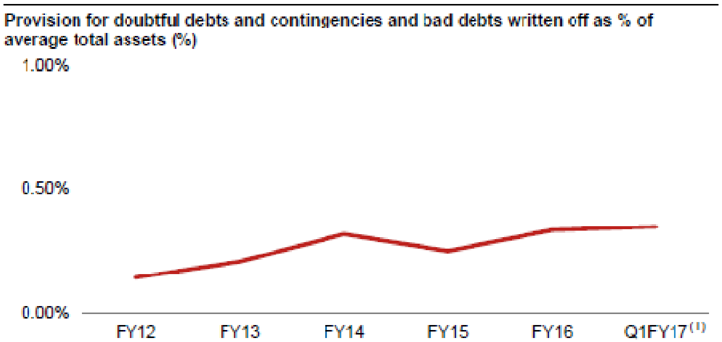
Strong Growth in Revenues...



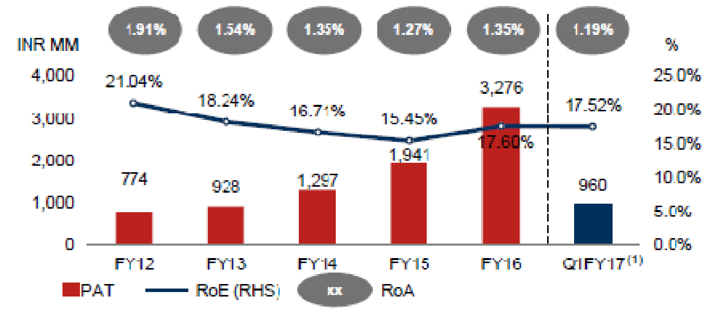
...And Reducing Operating Costs



...while Maintaining Stable Credit Costs



...Leading to Strong Profitability



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