CMP:Rs. 1160 Weight: 5%

28/03/2017

STOCK DATA

Market Cap(Rs. cr)	19,214
EPS (Diluted) – FY2017	31.51
P/E	36.8
P/B	3.4
Promoters Holding	39.08%
52 week high/low	1189.70/775
Shares outstanding	16.5

KEY FINANCIALS(Rs in Cr.)

Y/E March	2014	2015	2016	Dec 2016
Loan Assets* (Rs in Cr.)	9400	15300	24300	34300
NII (Rs in Cr.)	275	442	708	702
Gross NPA (%)	0.32	0.20	0.22	0.37
ROE (%)	16.71	15.45	17.6	17.03
ROA (%)	1.35	1.27	1.35	1.49
NIM (%)	3.17	2.98	3.08	2.82
Cost to Income	30.14	31.39	25.69	23.20

***As on 31st December**

VALUATION- We expect PNB to do a Net Profit of 520 Cr. for FY2017 and 730-770 Cr. in FY2018. It trades at 3.4x FY2017 book and PE Ratio of 37x FY17 which is a little on the expensive side but we have longevity of growth on our side as the capital adequacy is 24% post IPO and AUM growth is expected to be more than 40% CAGR for the next 3 years.

PNB Housing Finance

Thesis –

We at Stallion Asset have a consistent Strategy of buying companies which have serious tailwinds and can grow at more than 20% sustainably. We are extremely bullish on the NBFC space and we certainly believe that 2015-2019 will be marked in history as period of upsurge of NBFC in India. Housing Finance is a well discovered story in the capital market with expected sustainable growth of about 20% for the next decade. Housing Finance Companies are set to create massive wealth for shareholders and may be the leader of the NBFC pack for next 1-2 years.

We have Chosen PNB housing because PNB Housing is the fastest growing Housing Finance Company and we believe that this growth is sustainable for next 3 years. We will exit PNB housing if one of the 2 things happens

1) Gross NPA's More than 1%
2) AUM Growth Less than 30%

PNB Housing is a little expensive on PE Parameters but it will stay expensive till it's the fastest growing HFC in the country. We expect a repeat of Can-Fin homes in PNB Housing Finance. We believe they can Increase their ROA with consistent growth. We have given a Smaller Weight of 5% today as the stock has given a breakout, we may add more if there is a correction.

Since you already understand the housing finance sector from our previous report on DHFL and our blog http://www.stallionasset.com/blog/vijay-kedia-joins-basant-in-housing-finance/

We will keep this report concentrated on the PNB Housing Finance prospects.

History- PNB Housing Finance started its business operations in 1988 as a subsidiary of Punjab National Bank. The Fortunes of PNB Housing changed when it sold 26% stake to destimoney in 2009, the company then got a new management team in 2010 with Sanjaya Gupta as the CEO, he increased the asset size of PNB Housing Finance from 4436 crores in 2012 to 29,724 by FY2016 Growing at a CAGR of 51%. He made sure that the asset quality was intact with Gross NPA of 0.22% by end of FY2016.

The launch of "Project Kshitij" post 2010 which concluded in 2016, aimed at up gradation of technology, change in organisational structure and improving operational efficiency. In last 5 years the company has managed to grow its loan book at more than 50%+ keeping the growth momentum intact.

2009
- PNB sold 26% of its stake to DEL

2010
- Launched the business process re-engineering project "Kshitij"

2012
- DEL increased its shareholding to 49% in the company, pursuant to the conversion of CCDs issued to DEL in 2009.
- Gross and Net NPAs were bought lower than 0.5% of our asset portfolio

2016
- Crossed Rs. 27 billion loan portfolio and Rs. 7 billion deposits.

Destimoney was sold to Carlyle Group in 2015 and now Quality Investments, a subsidiary of Carlyle owns PNB housing finance.

PNB Housing Finance –Today

PNB Housing Finance is the fifth largest Housing Finance Company (HFC) in the country in terms of the loan book (37745 Cr). Its product portfolio includes Housing Loans, loan against Property, Corporate term loans, construction finance and lease rental discounting. It conducts operations from a network of 58 branches and 9600 channel partners with 18 zonal processing units and across North (40%), West (30%) and South India (30%).

(%)	2016	2015	2014
Salaried	40	37	37
Self- employed	45	50	54
Loan to corporates	15	13	9

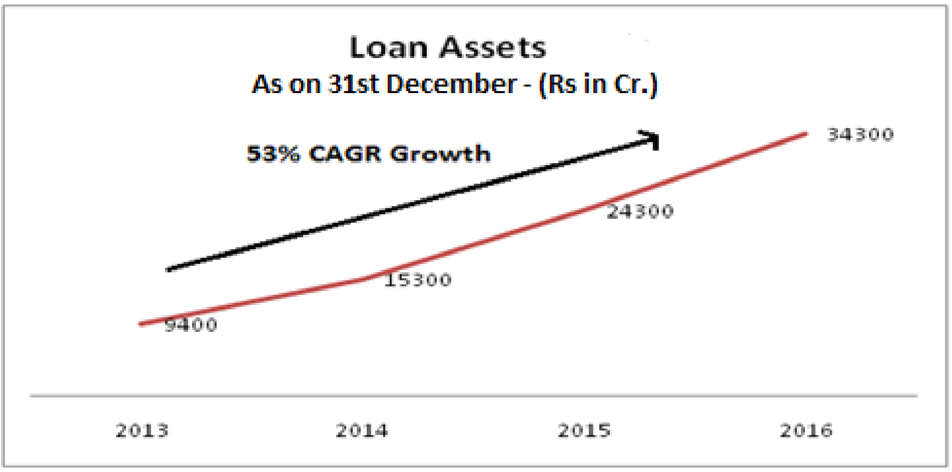
Loan Segment	2016	2015	2014
Housing Loans (%)	72	70	71
Total Retail Housing	87	87	92
Construction Finance	13	13	8
Non Housing (%)	28	30	29
LAP	61	70	70
Lease Rental Discounting	15	12	9
Corporate Term Loans	11	6	9
Non Residential Premises loan	13	12	12

Let us understand the various valuation aspects of the company:

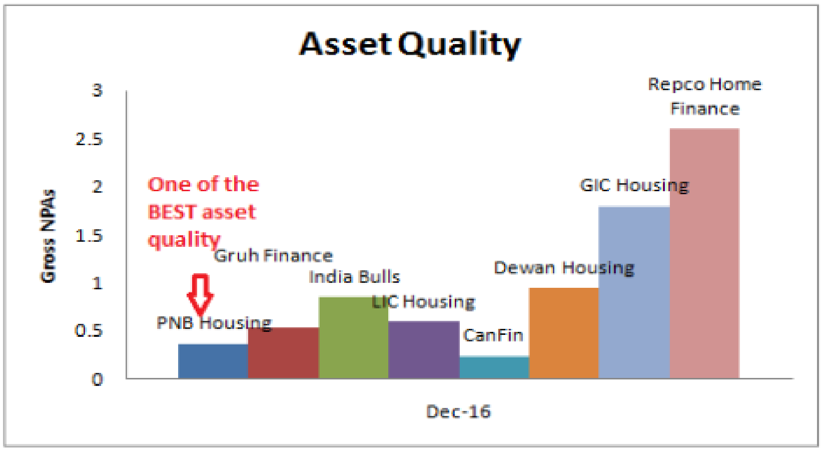
- Factor1: Loan Asset Growth
- Factor 2:Asset Quality
- Factor 3: ROE/ ROA
- Factor 4: Cost to Income
- Factor 5: NIMs

Factor 1: Loan Asset Growth

PNB Housing Finance has grown its loan assets at 53% cagr for last 3 years. This makes the company the fastest growing Housing Finance Company in the country which is trading at 3.4 times book as compared to CanFin Homes trading at 5.7 times book with a growth of 30%. We believe that the company will maintain its momentum on the back of huge opportunity size and geographical diversification. It can maintain a 30%+ long term growth rate.



Factor 2: Asset Quality – The Good thing about a fast growing NBFC is that profits are front ended whereas credit cost are back ended. For next 2-3 years we expect massive profit growth with Gross NPA below 1%. PNB has one of the best asset quality in the Industry



Asset Quality is one of the important indicator. Asset quality of the company directly depends on the proportion of the lending exposure to salaried and self-employed. PNB's loan book has only 40% exposure to salaried but it has set a benchmark on how it maintains high asset quality in self-employed space.

Company has the best asset quality in the industry after CanFin Homes with Gross NPAs of 0.37%.

	2014	2015	2016	Dec-16
Gross NPAs	0.32%	0.20%	0.22%	0.37%

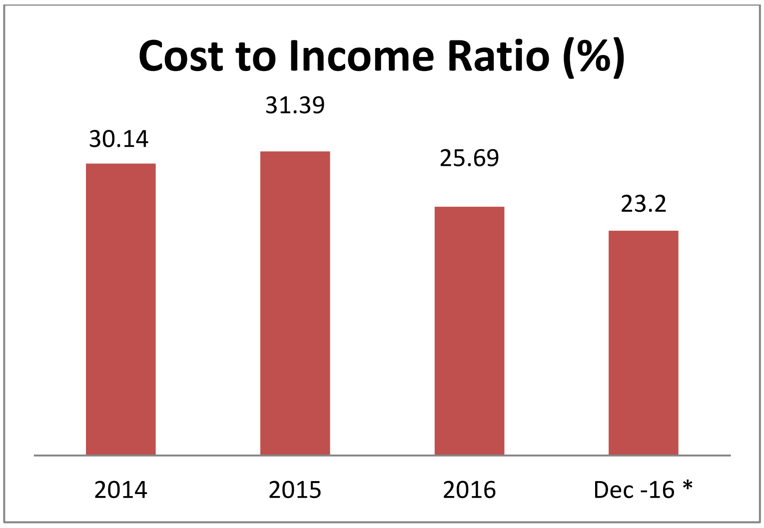
Company has maintained its Asset Quality, the company understands the lenders and the growth isnt a compromise to the Quality.

Factor 3: ROE/ ROA

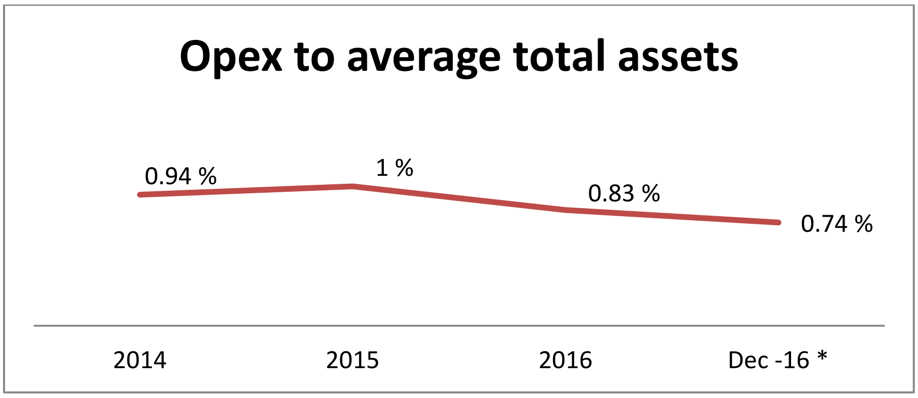
PNB has a ROE of 17% as compared to Industry average of 19%. Company's operating expenses had risen post the restructuring scheme due to aggressive expansion. As the profitability will improve, the ROEs and ROA are expected to rise going forward.

	2014	2015	2016	Dec -16
Return on Equity	16.71	15.45	17.6	17.03
Return on Average Assets	1.35	1.27	1.35	1.49

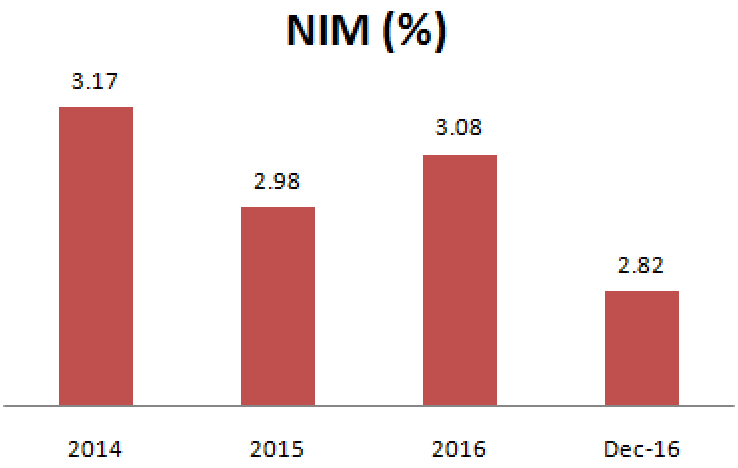
Factor 4: Cost to Income Ratio



Lower the cost to income better it is. PNB has a very high cost to income ratio of 23.2% as on 31st December, 2016 as compared to Industry average of 17%. The company rebranded itself post 2010 and was aggressively expanding its loan book hence increasing the operating expenses of the company. We believe that as the company will reach a scale (total asset will increase more in proportion of expenses), the cost to income ratio will come down. The declining trend is evident in 2016 number.



Factor 5: NIMs

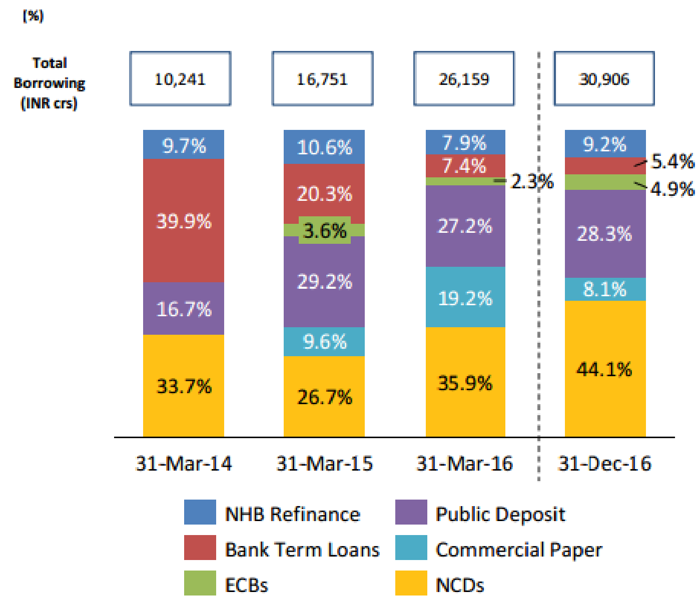


We are experiencing a falling NIM scenario in the country which is bad for business as margins will squeeze. We believe the pressure on margins will ease in next 6 months as excess money from with banks demonetization is lend out and NIM will remain at closer to 3% for next 2-3 years.

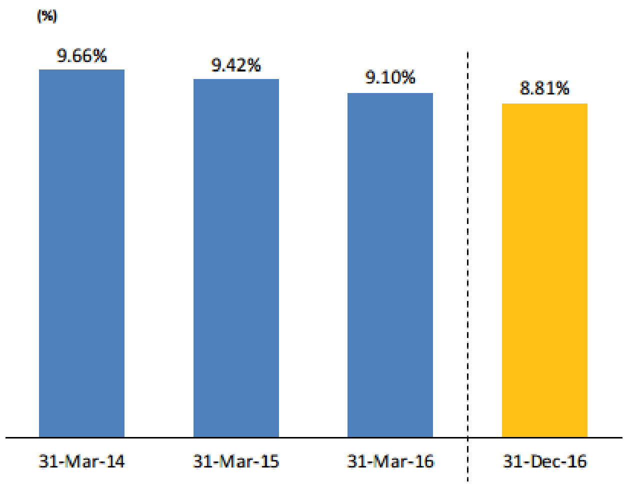
PNB has reduced its cost of borrowing from 9.66% in 2014 to 8.81% in December2016.

Company has reduced its borrowing from Banks as the cost of borrowing is higher as compared to other sources and diversified it by borrowing via NCDs, Public Deposits and other short term instruments. NCD is the cheapest source of capital and we believe NCD and Public deposits will remain at higher levels for PNBHF.

Access to a Diverse Base of Funding...



...leading to decline in Cost of Borrowings



Valuations – We expect PNB to do a Net Profit of 520 for FY2017 and 730-770 Crores in FY2018. It trades at 3.4x FY2017 book and PE Ratio of 37x FY2017 which is a little on the expensive side but we have longevity of growth on our side as the capital adequacy is 24% post IPO and AUM growth is expected to be more than 40% CAGR for the next 3 years. **Can the valuations correct?** As much as we understand growth Investing, till the AUM growth is more than 35-40%, there is no way the stock can correct more than 10-20%. The company will keep getting re-rated till the time growth is more than 40%. We believe that PNB Housing finance can double its AUM to 75,000crores in two years without any dilution.

Risks

- Company has an exposure to construction Finance (3900 Cr. loan size) which typically has higher NPAs. It is more riskier lending as the ticket size is larger and the chances of default is more as compared to LAP and Retail Housing Loans. The company has managed it well till now, we will be consistently tracking NPA levels.
- Falling Average Yields due to competitive market with increasing competition from the bigger banks and HFC can hamper the future growth of the company. The Average Ticket size of 32 Lakhs is one of the highest in the HFC space, it targets mass housing where competition and yield pressures will be very high.

Conclusion – We have entered India's fastest growing HFC, with superb credit Quality. Housing finance is set to lead this bull market and my experience of bull markets tells me that the company with the fastest growth will give the highest return. We have allocated a small weight of 5% in PNBHF but may add more if it declines 10-15%. We understand that profits of HFC's are front ending, whereas problem are backended, they growth for next 2-3 years will consistently help the stock price. We will exit PNBHF if NPA's rise more than 1%, or AUM Growth Slow to less than 30%.

Note – This report is shorter report and should be read with our DHFL report and our blog on housing finance. http://www.stallionasset.com/blog/vijay-kedia-joins-basant-in-housing-finance/

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