

3Q: Topline miss, but set to improve; Return ratios healthy

Raise PO; Longer-term return ratios to remain healthy; Buy

We raise our PO on LIC HFC (trades at 2.5x FY12 book) to Rs285 pegging it at +2.3x FY13 book, which is also an average PB of last 3 years trading history. The PO raise factors in 3Q surprise; recent rate cuts (lower CoE); robust earnings growth of +35% in FY13. Moreover, we believe the risk-return is positive (RoEs at ~24%, pre dilution) and with likely capital raising (~Rs15bn) in FY13, risk-return should remain positive (trade at ~1.7x 1-yr fwd; RoEs of +21%), with Tier 1 rising by ~180bps.

3Q: Earnings beat driven by write-back of provisions

LIC HFC reported earnings of Rs3.1bn up 43% yoy; +25% ahead led by write-back of excess provisions (~Rs800mn) and now falling in-line with prescribed norms. PPOP earnings were ~12% below estimates, as topline contracted 7% yoy (~10% below est) on margins (down 87/18bps yoy/qoq) owing to declining share of non-retail loans (~6% now), but loan growth at 27% yoy (~33% retail). Disbursement growth (retail) weak (only 8% yoy), but per mgmt. there has been a sharp pick-up since Dec'11. Asset quality is manageable, with gross NPLs at 63bps, but net NPLs rise by 19bps qoq to 31bps owing to write-back of provisions.

Earnings growth at +35% in FY13 on rebound in margins

We raise our FY12 earnings by ~2-3% factoring in strong 3Q and rebound in margins in 4Q12. For FY13, we estimate earnings growth at +35%, partly base driven, and led by 1) jump in margins on softening of funding costs / re-pricing of 'Fixed-O-Floaty' (~16% of loans) by at least +250-300bps upwards and; 2) write-back of excess provisions related to 'Fixed-O-Floaty' scheme (~Rs1.4bn) in FY13. Moreover, margins may get a further fillip on rising share of non-retail loans (LIC guiding for +10%). FY12/13 estimates build in +21/20% loan growth.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	6,622	9,745	9,513	12,999	15,742
EPS	14.69	20.53	20.03	27.37	33.14
EPS Change (YoY)	17.5%	39.7%	-2.4%	36.6%	21.1%
Dividend / Share	3.00	3.50	3.50	5.00	6.00
Pre-exceptional EPS	14.69	20.53	20.03	27.37	33.14
Pre-exceptional EPS Change (YoY)	17.5%	39.7%	-2.4%	36.6%	21.1%
Book Value / Share	71.32	87.77	103.73	125.29	151.46

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	17.1x	12.2x	12.5x	9.2x	7.6x
Dividend Yield	1.19%	1.39%	1.39%	1.99%	2.39%
Pre-exceptional PE	17.08x	12.23x	12.53x	9.17x	7.57x
Price / Book	3.52x	2.86x	2.42x	2.00x	1.66x
RoE / PB	6.69x	9.02x	8.64x	11.93x	14.45x
Price / Pre-Provision Profit	13.52x	7.67x	8.21x	6.18x	5.06x

Bank of America Merrill Lynch

Veekesh Gandhi >>

+91 22 6632 8677

Research Analyst
DSP Merrill Lynch (India)
veekesh.gandhi@baml.com

Rajeev Varma >>

+91 22 6632 8666

Research Analyst
DSP Merrill Lynch (India)
rajeev.varma@baml.com

Stock Data

Price	Rs251.00
Price Objective	Rs285.00
Date Established	1-Feb-2012
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs163.20-Rs264.40
Mrkt Val / Shares Out (mn)	US\$2,411 / 475.0
Market Value (mn)	Rs119,220
Average Daily Volume	2,584,993
BofAML Ticker / Exchange	LHFLF / BSE
Bloomberg / Reuters	LICHF IN / LICH.BO
ROE (2012E)	20.9%
Total Dbt to Cap (Mar-2011A)	11.4%
Est. 5-Yr EPS / DPS Growth	17.3% / 19.7%
Free Float	63.5%

Key Changes

(Rs)	Previous	Current
Price Obj.	260.00	285.00
2012E EPS	19.56	20.03
2013E EPS	27.88	27.37
2014E EPS	33.94	33.14

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*iQprofile*SM LIC Housing Finance, Ltd.

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Net Interest Income	8,847	13,815	14,101	18,759	22,889
Net Fee Income	1,274	1,501	1,726	1,985	2,283
Securities Gains / (Losses)	448.74	2,286	785.52	783.56	781.60
Other Income	170.24	107.59	166.35	191.30	220.00
Total Non-Interest Income	1,893	3,895	2,678	2,960	3,284
Total Operating Income	10,740	17,710	16,779	21,719	26,173
Operating Expenses	(1,920)	(2,162)	(2,263)	(2,423)	(2,595)
Pre-Provision Profit	8,820	15,548	14,516	19,296	23,578
Provisions Expense	283.44	(40.69)	(1,197)	(1,150)	(1,650)
Operating Profit	9,103	12,939	12,769	17,566	21,273
Non-Operating Income	NA	NA	NA	NA	NA
Pre-Tax Income	9,113	12,942	12,769	17,566	21,273
Net Income to Comm S/Hold.	6,622	9,745	9,513	12,999	15,742
Adjusted Net Income (Operating)	6,622	9,745	9,513	12,999	15,742

Key Balance Sheet Data

Total Assets	402,419	536,300	645,366	771,110	908,272
Average Interest Earning Assets	331,091	450,102	570,018	685,671	815,184
Weighted Risk Assets	327,400	471,292	568,374	755,010	979,095
Total Gross Customer Loans	380,814	510,898	617,541	741,201	876,301
Total Customer Deposits	3,262	2,458	4,424	5,309	6,371
Tier 1 Capital	33,877	41,691	49,272	59,511	71,941
Tangible Equity	33,877	41,691	49,272	59,511	71,941
Common Shareholders' Equity	33,877	41,691	49,272	59,511	71,941

Key Metrics

Net Interest Margin	2.67%	3.07%	2.47%	2.74%	2.81%
Tier 1 Ratio	10.3%	8.8%	8.7%	7.9%	7.3%
Effective Tax Rate	27.3%	24.7%	25.5%	26.0%	26.0%
Loan / Assets Ratio	94.1%	94.8%	95.1%	95.5%	95.8%
Loan / Deposit Ratio	11,608.0%	20,693.5%	13,878.2%	13,871.7%	13,653.7%
Oper Leverage (Inc Growth - Cost Growth)	-3.4%	52.3%	-9.9%	22.4%	13.4%
Gearing (Assets / Equity)	11.9x	12.9x	13.1x	13.0x	12.6x
Tangible Common Equity / Assets	8.4%	7.8%	7.6%	7.7%	7.9%
Tangible Common Equity / WRAs	10.3%	8.8%	8.7%	7.9%	7.3%
Revenue Growth	21.1%	64.9%	-5.3%	29.4%	20.5%
Operating Expense Growth	24.5%	12.6%	4.7%	7.1%	7.1%
Provisions Expense Growth	-639.5%	-114.4%	2,841.0%	-3.9%	43.5%
Operating Revenue / Average Assets	3.1%	3.8%	2.8%	3.1%	3.1%
Operating Expenses / Average Assets	0.6%	0.5%	0.4%	0.3%	0.3%
Pre-Provision ROA	2.5%	3.3%	2.5%	2.7%	2.8%
ROA	1.9%	2.1%	1.6%	1.8%	1.9%
Pre-Provision ROE	31.4%	41.1%	31.9%	35.5%	35.9%
ROE	23.6%	25.8%	20.9%	23.9%	24.0%
RoTE	19.5%	23.4%	19.3%	21.8%	21.9%
RoWRAs	2.0%	2.1%	1.7%	1.7%	1.6%
Dividend Payout Ratio	20.4%	17.0%	17.5%	18.3%	18.1%
Efficiency Ratio (Cost / Income Ratio)	18.7%	14.0%	14.2%	11.6%	10.2%
Total Non-Interest Inc / Operating Inc	18%	22%	16%	14%	13%
Market-Related Revenue / Total Revenues	4.2%	12.9%	4.7%	3.6%	3.0%
Provisioning Burden as % of PPP	-3.2%	0.3%	8.2%	6.0%	7.0%
NPLs plus Foreclosed Real Estate / Loans	0.7%	0.5%	0.7%	0.9%	1.0%
Loan Loss Reserves / NPLs	82.4%	93.8%	81.2%	72.5%	73.0%
Loan Loss Reserves / Total Loans	0.6%	0.4%	0.6%	0.6%	0.7%
Provisions Expense / Average Loans	-0.1%	0%	0.2%	0.2%	0.2%

Other Metrics

Income / Employee	9.45	13.75	11.84	13.94	15.27
(Operating Expenses) / Employee	1.69	1.68	1.60	1.55	1.51
Pre-Provision Profit / Employee	7.76	12.07	10.25	12.38	13.75
Net Profit / Employee	5.83	7.57	6.72	8.34	9.18

Company Description

LIC Housing is the second-largest independent mortgage financier, with a wide distribution network spread throughout the country. It was promoted as an independent mortgage financing company by the Life Insurance Company of India (LIC, which holds 36.5% stake currently) in 1989.

Investment Thesis

LIC HF has had a strong earnings trajectory driven by rapid market-share gains. This enabled the company to also generate strong return ratios (RoEs of 24-26% over FY09-11). We expect RoEs to settle at +24-25% in FY12-13 driven by RoAs normalizing to 1.8%.

Stock Data

Price to Book Value 2.4x

3QFY12 Results Summary

Table 1: 3QFY12 Results Summary

Rs mn	3QFY11	3QFY12	yoy	Remarks
Interest Income	11,615	15,387	32%	Loan growth by 27% yoy, Retail book growth at 33%, Non retail continues declining (27% yoy)
Interest expenses	8,093	12,129	50%	
NII	3,522	3,258	-7%	10% miss. Margins declining +85bps yoy and 18bps qoq to 2.3% on declining Non retail loans and sharp rise in funding costs
Non Int. income	1,929	539	-72%	
Total Income	5,451	3,796	-30%	
Operating exp	560	534	-5%	
Operating profit	4,891	3,263	-33%	12% lower than estimates on lower topline
Provisions	2,328	(797)	-134%	Provisioning policy aligned with NHB norms. Excess provisions (net of provisions required in 3QFY12) written back of Rs789mn. AQ remains manageable with gross NPLs at 63bps and net at 31bps.
PBT	2,563	4,060	58%	Adj. for write-back, PBT earnings would have missed by 11%
Provisions for tax	428	1,003	134%	
PAT	2,135	3,057	43%	Reported earnings +25% higher than estimates on provisions write-back.

Source: Bof A Merrill Lynch Global Research Estimates

Price objective basis & risk

LIC Housing Finance, Ltd. (LHFLF)

We have a PO for LIC Housing Finance of Rs285, including Rs3.4/shr. for its 20% stake in LIC Mutual Fund. We like LIC HFC owing to 1) inherent structural mortgage demand and LIC HFC is still gaining market share, 2) strong earnings trajectory (+35% in FY13, led by margin uptick on re-pricing of fixed rate stock and, 3) rebound in return ratios (RoAs of 1.8% and RoEs of +24%). Hence, we believe the stock, trading at 2.5x FY12 book can trade at least at 2.3x FY13 book, implying a PO of Rs285. Our PO is based on Gordon model theory of RoE / CoE, wherein we see RoE at +24pct and CoE at 14pct. Hence, we still assign a 25-30pct premium to this theoretical model for strong growth and return ratios. Our PO is at a target PE of 10.4 (trades at 12.5x FY12 earnings). Downside risks are a spike in wholesale rates leading to margin pressure and NPL spiking.

Link to Definitions

Financials

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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SEBI Regn no. : BSE - INB/INF 011348134 NSE – INB/INF 231348138

Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

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BUY				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDFF	HDFC IN	Rajeev Varma
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICBC IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XMJIF	MAX IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
UNDERPERFORM				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

01 February 2012

***iQmethod*SM Measures Definitions**

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

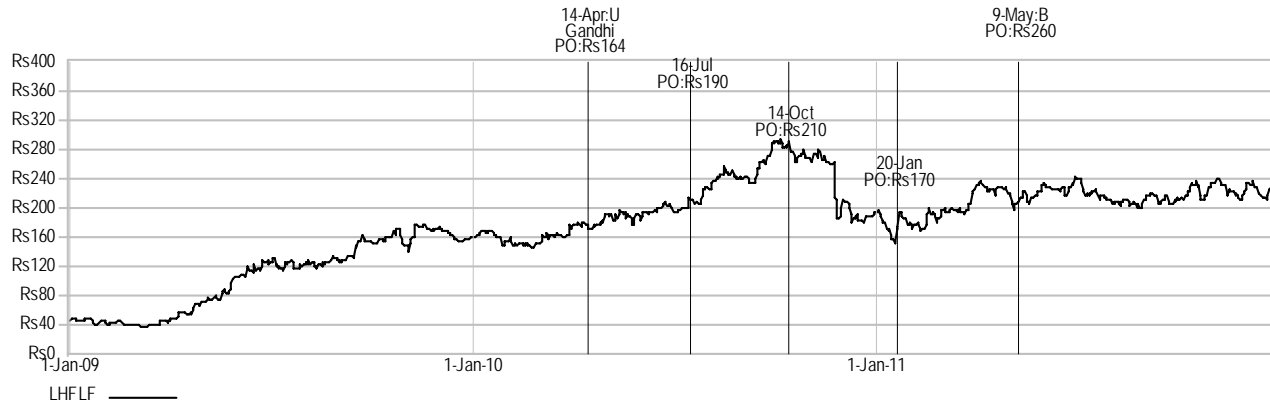
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LHFLF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

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Investment Rating Distribution: Banks Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	120	48.00%	Buy	85	89.47%
Neutral	76	30.40%	Neutral	53	82.81%
Sell	54	21.60%	Sell	37	71.15%

Investment Rating Distribution: Global Group (as of 01 Jan 2012)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2029	52.00%	Buy	1337	72.11%
Neutral	1009	25.86%	Neutral	657	71.34%
Sell	864	22.14%	Sell	487	60.20%

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