

JULY 20, 2011

RESULT

Coverage view: **Attractive**

Price (Rs): **217**

Target price (Rs): **260**

BSE-30: **18,502**

**Moderate performance.** Lower disbursements and margin compression tamped LICHF's reported PAT (Rs2.56 bn) growth to 21% yoy, 4% above estimates. NPL increased sharply qoq though the trend is largely seasonal. While we believe that operating environment remains challenging due to high real estate prices driving down demand, lower competitive intensity, likely toping-off of interest rates are positive developments. We tweak estimates, retain ADD, with TP of Rs260 (from Rs270).

#### Company data and valuation summary

LIC Housing Finance

Stock data		Forecasts/Valuations			
		2011	2012E	2013E	
52-week range (Rs) (high,low)	299-150	EPS (Rs)	20.5	22.4	27.6
Market Cap. (Rs bn)	102.9	EPS growth (%)	47.2	9.0	23.3
Shareholding pattern (%)		P/E (X)	10.6	9.7	7.9
Promoters	36.5	NII (Rs bn)	14.5	17.6	21.4
FIs	41.3	Net profits (Rs bn)	9.7	10.6	13.1
MFs	2.3	BVPS	87.0	104.0	125.3
Price performance (%)		P/B (X)	2.5	2.1	1.7
Absolute	1M 3M 12M	ROE (%)	25.8	23.3	24.0
	(0.5) (5.8) 4.9	Div. Yield (%)	2.0	2.2	2.7
Rel. to BSE-30	(5.8) (0.9) 1.3				

#### Loan growth moderates

- ▶ **Lower disbursements in 1QFY12.** LICHF reported loan growth of 32% in 1QFY12 as compared to 34% in 4QFY11. Disbursements in the individual segments moved up by 15% yoy; LICHF made marginal disbursements to developers during the quarter.
- ▶ **Loan growth will likely remain strong.** We believe that high real estate prices, seasonal weakness in 1Q and withdrawal of 'Advantage 5' have affected growth traction. While high real estate prices will likely continue to affect demand, traction will likely pick up over the year. Management has highlighted that disbursements have picked up from June and is looking forward to accelerate growth rates from 2QFY12E despite a higher base. We are reducing our disbursements estimate for FY2012E to 15% from 20% earlier. Loan growth will likely be strong at 27% in FY2012E (as compared to 29% assumed earlier). We are modeling 22% and 20% loan growth in FY2013E and FY2014E, respectively. The traction of disbursements over the next few quarters will have a key sensitivity loan growth in the next two years.
- ▶ **Developer lending was lower than expected.** Lending to developers was lower than expected as the company maintained its cautious stance in this segment. In the past, management had highlighted that they propose to scale up in this segment; however, they remain cautious on the back of peaking real estate prices and the recent bribes-for-loan scam.
- ▶ **Withdrawal of Advantage 5 affected traction.** LICHF had a stated policy to cap 'Advantage 5' to 20% of its loan book since the company did not have long-term fixed rate resources to back this product. Interest rate risk on its balance sheet would have increased substantially, if the company has extended the product. Thus, timely withdrawal of this product is positive, in our view. However, this has affected business traction in 1QFY12. The product had driven almost 90% retail disbursements in 2HFY11. Fixed interest rate for next five years (as offered in this product) has likely appealed to borrowers and hence driven high volumes for LICHF.

#### QUICK NUMBERS

- **PAT up 21% yoy**
- **Retail disbursements up 15% yoy**

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### We expect NIM to be stable

LICHF reported NIM of 2.8% as compared to 3.45% in 4QFY11 and 3% in 1QFY11. Spreads declined to about 1.9% from 2.6% and 2.25% in 4QFY11 and 1QFY11, respectively. Sharp rise in borrowings cost, increase in slippages has pulled down margins. LICHF raised lending rate by 25 bps with effect from July 2011- this will cushion NIM in 2QFY12E. We expect NIM to remain in 2.7-2.9% in the next quarter and continue to model 2.8% NIM for 2012E.

In our discussion, management highlighted that they find comfort from the following:

- ▶ (Expectations of ) moderation in borrowings rates in 2HFY12
- ▶ Progressive increase in share of developer loans (though this was below expectations this quarter)
- ▶ Lower competitive intensity

### NPL rise sharply qoq, NPL ratio below 1%

LICHF reported gross NPL of 0.85% as compared to 0.5% in March 2011 and 0.9% in June 2011. In the past, the company has reported sharp qoq rise in NPLs in 1Q. The quantum of qoq rise is higher this year likely due to lower base of 4QFY11. We have not found macro signs of stress in retail home loans as real estate prices have remained stable; as such we expect these NPLs to be akin to delinquencies. We model a decline in NPLs from 2QFY12E though we believe that the extent of reduction will be crucial. Slippages in 1Q increased provisions for the quarter (about Rs200 mn of Rs330 mn), we expect some reversal in this over the next few quarters.

We are revising our provision estimates. Despite the rise in NPLs, we are reducing our estimates for provisions to 0.23% of assets from 0.3% expected earlier.

According to news reports, NHB will likely impose standard asset provision of 0.4% for housing finance companies. We are accordingly factoring 40 bps provisions for standard assets in our provision estimate for FY2012E. The company has Rs1 bn of excess provisions which can be utilized for these standard asset provisions. Notably, repayments from teaser loans (carrying standard provisions @ 2%) will offset some of the incremental provisions.

The company has not made standard asset provision (@2%) on loans disbursed in 4QFY11 under the 'Advantage 5' scheme. LICHF is not clear if this product is a 'teaser' and is awaiting regulatory clarification on the same. We are now not factoring any contingent provision on this account.

### Leverage at high levels, capital issuance likely in medium term

LICHF reported Tier-I capital adequacy ratio of 8.5% as of June 2011. LICHF's debt equity ratio will likely cross 11.5X by March 2012E. This is close to historic peaks and the company will need to raise equity capital to support medium-term growth. Management has acknowledged the need to raise capital though there is no such proposal to the board at the current juncture.

## LIC Housing Finance

Quarterly data, 1QFY10- 1QFY12 (Rs mn)

	1Q11	2Q11	3Q11	4Q11	1Q12	YoY(%)	1Q12E	Actual vs KS (%)
Operating income	10,149	11,074	13,544	13,919	14,182	40	13,374	6
Interest on loans	9,716	10,429	11,615	12,937	13,585	40	12,824	6
Fees and other charges	300	420	397	381	300	(0)	300	0
Other income	134	225	1,533	601	297	122	250	19
Interest expenses	6,772	7,378	8,093	8,733	9,971	47	9,278	7
<b>Net operating income</b>	<b>3,377</b>	<b>3,696</b>	<b>5,451</b>	<b>5,186</b>	<b>4,211</b>	<b>25</b>	<b>4,096</b>	<b>3</b>
Total Fund based income	9,849	10,654	13,148	13,538	13,882	41	13,074	6
Net interest income	2,943	3,051	3,522	4,203	3,614	23	3,546	2
Other exp.	468	490	2,873	874	739	58	700	6
Establishment exp.	230	322	348	517	245	6	280	(13)
Staff expenses	149	165	198	169	160	8	170	(6)
Provisions	89	3	2,328	189	334	274	250	34
<b>PBDT</b>	<b>2,909</b>	<b>3,206</b>	<b>2,578</b>	<b>4,312</b>	<b>3,471</b>	<b>19</b>	<b>3,396</b>	<b>2</b>
Depreciation	15	16	15	17	17	11	15	13
PBT	2,893	3,191	2,563	4,295	3,455	19	3,381	2
Tax	773	848	428	1,147	889	15	903	(2)
<b>PAT</b>	<b>2,120</b>	<b>2,342</b>	<b>2,135</b>	<b>3,148</b>	<b>2,565</b>	<b>21</b>	<b>2,478</b>	<b>4</b>
Tax rate (%)	27	27	17	27	26	(4)	27	0
PBT excl. extraordinary item	2,893	3,191	2,563	3,694	3,455	19	3,381	2
<b>Other business highlights</b>								
<b>Business growth</b>								
Disbursements (Rs bn)	34	51	46	68	35	4		
Individual (Rs bn)	30	38	42	65	35	15		
Others (Rs bn)	4	13	4	3	1	(82)		
Outstanding portfolio (Rs bn)	400	434	464	510	529	32	540	(2)
Individual (Rs bn)	360	385	415	467	489			
<b>Spreads/ margins (%)</b>								
NIM(reported -%)	3.01	2.93	3.14	3.45	2.78			
NIMs (KS estimate- %)	3.01	2.93	3.14	3.45	2.78			
Average lending rate (%)	9.95	10.00	10.35	10.62	10.52			
Average cost of funds (%)	7.68	7.88	7.97	8.01	8.66			
<b>Average spreads (%)</b>	<b>2.27</b>	<b>2.12</b>	<b>2.38</b>	<b>2.61</b>	<b>1.86</b>			
<b>NPLs</b>								
Gross NPLs (Rs mn)	3,670	3,196	3,127	2,420	4,440			
Gross NPL ratio (%)	0.9	0.7	0.7	0.5	0.9			
Net NPLs (Rs mn)	1,398	902	840	150	1,840			
Net NPL ratio (%)	0.4	0.2	0.2	0.0	0.4			
<b>Capital adequacy</b>								
CAR (%)	NA	14	15	15	15			
Tier I	NA	9.0	8.5	9.0	8.5			

Source: Company, Kotak Institutional Equities estimates

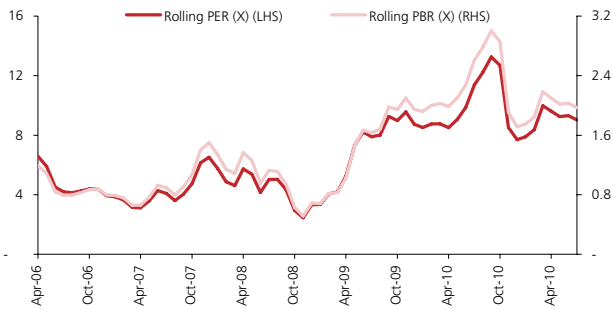
LICHF Detailed quarterly break-ups  
1QFY10-4QFY11 (Rs mn)

	1Q11	2Q11	3Q11	4Q11	1Q12
<b>Detailed break-ups (Rs mn)</b>					
<b>Income</b>	<b>9,716</b>	<b>10,428</b>	<b>11,615</b>	<b>12,936</b>	<b>13,580</b>
Individual loans	8,297	8,951	9,888	11,280	12,041
Project loans	1,419	1,477	1,727	1,656	1,539
<b>Yield on loans (%)</b>	<b>10.1</b>	<b>10.0</b>	<b>10.2</b>	<b>10.4</b>	<b>10.9</b>

Source: Company

Valuations moving up again...

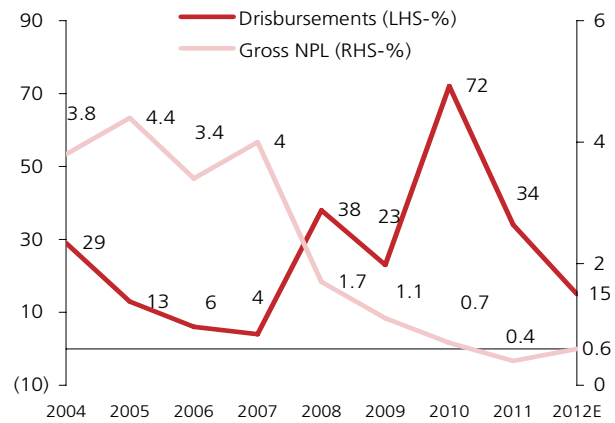
LICHF: Rolling PER and PBR, April 2004-April 2011 (X)



Source: Bloomberg, Company, Kotak Institutional Equities estimates

... as performance remains strong

Growth in disbursements (LHS) and gross NPL ratio (RHS), March fiscal year-ends, 2004-2012E (%)



Source: Company, Kotak Institutional Equities estimates

LIC Housing Finance- Old and new estimates  
March fiscal year-ends, 2012-2013E (Rs mn)

	Old estimates		New estimates		Old vs New (%)		YoY(%)	
	2012E	2013E	2012E	2013E	2012E	2013E	2012E	2013E
NIMs(%)	2.8	2.7	2.8	2.8	-	-	0.0	0.0
Loan growth (%)	28.8	25.8	26.8	22.6	-	-	0.0	0.0
Net interest income	16,396	20,440	15,993	19,992	(2)	(2)	17	25
Other income	2,393	2,585	2,606	2,452	9	(5)	(35)	(6)
Fee income	1,726	1,985	1,606	1,718	(7)	(13)	7	7
Other income	667	600	1,000	733	50	22	(60)	(27)
Total income	18,789	23,025	18,599	22,443	(1)	(3)	5	21
Loan loss provisions	1,753	1,857	1,333	1,659	(24)	(11)	(49)	24
Operating expenses	2,591	3,160	2,450	2,934	(5)	(7)	13	20
Employee expenses	851	996	817	980	(4)	(2)	20	20
Other expenses	1,740	2,165	1,633	1,953	(6)	(10)	10	20
PBT	14,444	18,008	14,816	17,851	3	(1)	14	20
Tax	3,968	4,867	3,956	4,780	(0)	(2)	24	21
<b>PAT</b>	<b>10,476</b>	<b>13,141</b>	<b>10,859</b>	<b>13,071</b>	<b>4</b>	<b>(1)</b>	<b>11</b>	<b>20</b>
<b>PBT bef. Prov, extraordinari</b>	<b>16,198</b>	<b>19,865</b>	<b>16,148</b>	<b>19,510</b>	<b>(0)</b>	<b>(2)</b>	<b>16</b>	<b>21</b>
<b>EPS (Rs per share)</b>	<b>22</b>	<b>28</b>	<b>23</b>	<b>28</b>	<b>-</b>	<b>-</b>	<b>11</b>	<b>20</b>

Source: Company, Kotak Institutional Equities estimates

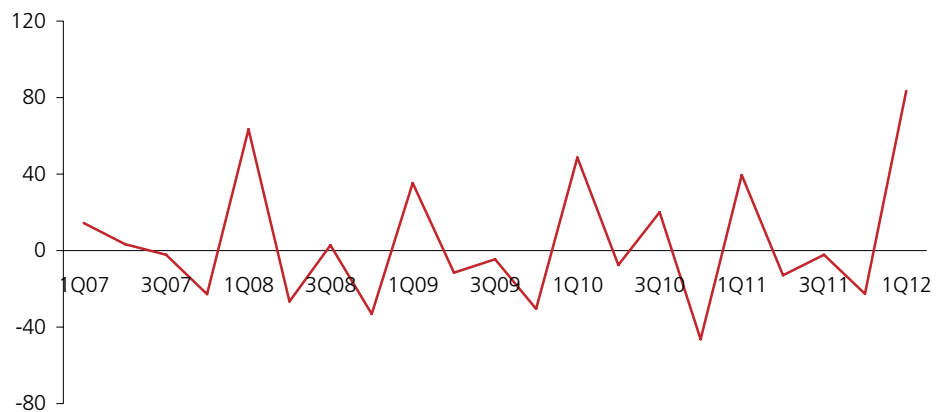
**Most companies offer loans at 10-10.5%**

Interest rates offered by HFCs and banks on home loans up to Rs3 mn

	Interest rate (%)
Bank of India	10.50%
Citibank (for high ticket loans)	10.00%
HDFC	10.25%
HSBC (for high ticket loans)	10.00%
ICICI Bank	10.25%
Indiabulls	10.00%
LICHF (new product)	10.15%
SBI	10.5% (base rate +1%)

Source: Company

NPLs typically rise in 1Q and decline in the later part of the year  
QoQ rise in NPLs for LICHF (%)



Source: Company

#### Affordability index at 2005- 2006 levels

Measurement of affordability of housing in India, March fiscal year-ends, 1999-2012E

	2000	2004	2005	2006	2007	2008	2009	2010	2011	2012E
Housing loan interest rates (%)	13.9	8.9	8.0	8.5	9.5	10.5	10.5	9.00	10.25	10.25
EMI per Rs100,000 on 20 yr loan (Rs)	1,240	895	836	868	932	998	998	900	982	982
Avg annual household income (for households with annual income > Rs200,000)	577,201	701,591	736,671	788,238	843,414	902,453	947,576	1,013,906	1,084,880	1,160,821
Income growth (%)		5%	5%	7%	7%	7%	5%	7.0%	7.0%	7.0%
Taxes	115,440	140,318	147,334	157,648	168,683	180,491	189,515	202,781	216,976	232,164
Post tax income	461,761	561,273	589,337	630,590	674,731	721,963	758,061	811,125	867,904	928,657
Selling prices rise by 5% FY2010E										
Capital price in Koramangala, Bangalore	1,900	2,350	2,800	4,500	4,750	4,750	3,600	4,320	4,968	5,465
Price of 1,500 sq. ft house (Rs mn)	2.9	3.5	4.2	6.8	7.1	7.1	5.4	6.5	7.5	8.2
EMI payable assuming 70% LTV	24,738	22,084	24,578	41,013	46,484	49,775	37,724	40,824	51,206	56,327
Price/income ratio (X)	4.9	5.0	5.7	8.6	8.4	7.9	5.7	6.4	6.9	7.1
<b>Affordability Index (assuming FY2000 as 100)</b>	<b>100</b>	<b>73</b>	<b>78</b>	<b>121</b>	<b>129</b>	<b>129</b>	<b>93</b>	<b>94</b>	<b>110</b>	<b>113</b>

Source: RBI, Kotak Institutional Equities estimates

LICHF: Key ratios, March fiscal year-ends, 2008-2014E (%)

	2008	2009	2010	2011	2012E	2013E	2014E
<b>Growth (%)</b>							
Total assets	24	24	37	33	26	22	19
<b>Housing loans</b>	<b>25</b>	<b>26</b>	<b>38</b>	<b>34</b>	<b>27</b>	<b>23</b>	<b>20</b>
Total borrowings	24	26	36	30	29	24	21
Net Income before provision	49	27	19	53	17	22	23
Fee income	9	55	56	18	7	7	10
Total expenses	19	16	24	12	13	20	20
PBT	50	37	25	42	14	20	23
<b>PAT</b>	<b>39</b>	<b>37</b>	<b>25</b>	<b>47</b>	<b>11</b>	<b>20</b>	<b>24</b>
<b>Spread calculation (%)</b>							
Average cost of funds	8.0	8.8	8.0	7.8	8.4	8.4	8.3
Average yield on assets	10.0	10.7	9.6	9.7	10.0	10.0	10.1
<b>Spreads</b>	<b>1.9</b>	<b>1.9</b>	<b>1.6</b>	<b>1.9</b>	<b>1.6</b>	<b>1.7</b>	<b>1.8</b>
Difference on housing loan	2.3	2.3	2.0	2.3	1.8	1.9	2.0
<b>NIM</b>	<b>3.0</b>	<b>3.0</b>	<b>2.7</b>	<b>3.1</b>	<b>2.8</b>	<b>2.8</b>	<b>2.8</b>
<b>Other ratios (%)</b>							
Tax rate	27	27	27	25	27	27	26
Debt/equity (X)	11	12	10	11	12	12	12
Total expenses/assets	0.6	0.5	0.5	0.4	0.4	0.4	0.4
Total expenses/total income	20	18	18	13	13	13	13
Divd payout ratio	22	22	22	22	22	22	22
<b>Du Pont analysis (% of average assets)</b>							
Net interest income	3.0	3.0	2.7	3.1	2.8	2.8	2.8
Loan loss provisions and Inv pro	0.1	—	(0.1)	0.6	0.2	0.2	0.2
Net other income	0.3	0.3	0.4	0.7	0.3	0.2	0.2
Operating expenses	0.6	0.6	0.6	0.5	0.4	0.4	0.4
(1- tax rate)	72.8	73.2	72.7	75.3	73.3	73.2	73.6
<b>ROA</b>	<b>1.8</b>	<b>2.0</b>	<b>1.9</b>	<b>2.1</b>	<b>1.8</b>	<b>1.8</b>	<b>1.8</b>
Average assets/average equity (X)	12.5	13.0	12.4	12.4	13.2	13.6	13.7
<b>ROE (%)</b>	<b>22.9</b>	<b>26.2</b>	<b>23.6</b>	<b>25.8</b>	<b>23.7</b>	<b>23.9</b>	<b>24.7</b>

Source: Company, Kotak Institutional Equities estimates

LICHF: Income statement and balance sheet, March fiscal year-ends, 2008- 2014E (Rs mn)

	2008	2009	2010	2011	2012E	2013E	2013E
<b>Income statement</b>							
Total income excluding fee income	20,365	27,476	32,827	44,697	59,390	74,292	90,078
Other operating income	127	634	597	802	1,000	733	800
Interest payable	14,744	20,155	23,957	30,977	43,397	54,301	65,463
Provision	243	53	-283	2,609	1,333	1,659	1,749
<b>Net total income</b>	<b>6,554</b>	<b>8,716</b>	<b>11,023</b>	<b>13,413</b>	<b>17,266</b>	<b>20,784</b>	<b>25,557</b>
<b>Total expenses</b>							
Staff expenses	345	447	485	681	817	980	1,176
Establishment expenses	182	166	131	134	154	185	222
Other expenses	774	890	1,241	1,282	1,410	1,693	2,031
Depreciation	37	49	64	62	69	76	83
Other income	105	100	10	1,688	0	0	0
<b>Profit before tax</b>	<b>5,321</b>	<b>7,264</b>	<b>9,112</b>	<b>12,942</b>	<b>14,816</b>	<b>17,851</b>	<b>22,044</b>
Tax	1,450	1,948	2,490	3,197	3,956	4,780	5,829
<b>Net profit</b>	<b>3,871</b>	<b>5,316</b>	<b>6,622</b>	<b>9,745</b>	<b>10,859</b>	<b>13,071</b>	<b>16,215</b>
EPS (Rs)	9	13	14	21	23	28	34
BVPS (Rs)	43.1	52.6	71.3	87.8	104.9	125.6	151.2
ABVPS (Rs)	184	233	68	83	98	119	0
<b>Balance sheet</b>							
<b>Disbursements</b>	<b>70,710</b>	<b>86,800</b>	<b>149,000</b>	<b>199,123</b>	<b>228,991</b>	<b>263,340</b>	<b>302,841</b>
YoY growth (%)	38	23	72	34	15	15	15
<b>Net loans</b>	<b>219,360</b>	<b>276,793</b>	<b>380,814</b>	<b>510,898</b>	<b>647,928</b>	<b>794,641</b>	<b>954,447</b>
<b>Total Investments</b>							
Cash & deposits	3,617	1,353	2,669	4,352	4,352	4,352	4,352
Loans and advances and other assets	1,597	3,093	3,803	4,845	4,845	4,845	4,845
Deferred tax assets	929	948	890	1,698	1,698	1,698	1,698
Fixed assets owned	300	324	356	474	408	410	410
<b>Total assets</b>	<b>233,549</b>	<b>293,804</b>	<b>402,418</b>	<b>536,299</b>	<b>673,263</b>	<b>819,978</b>	<b>979,784</b>
<b>Total liabilities</b>							
Share capital	850	850	950	950	950	950	950
Reserves	17,467	21,491	32,927	40,741	48,892	58,702	70,872
<b>Shareholders fund</b>	<b>18,317</b>	<b>22,341</b>	<b>33,877</b>	<b>41,691</b>	<b>49,841</b>	<b>59,653</b>	<b>71,824</b>

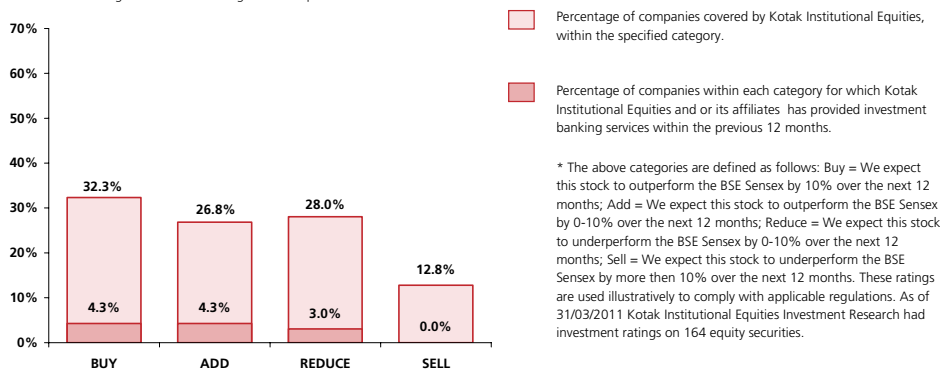
Source: Company, Kotak Institutional Equities estimates



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**Kotak Institutional Equities Research coverage universe**

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2011

**Ratings and other definitions/identifiers**

**Definitions of ratings**

**BUY.** We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

**REDUCE.** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

**SELL.** We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

**Other definitions**

**Coverage view.** The coverage view represents each analyst’s overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: **Attractive, Neutral, Cautious.**

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