

LIC HOUSING FINANCE



Delivering quarter after quarter

Consistently improving operating performance

In line with our estimates, LIC Housing Finance (LICHF) has consistently improved its operating performance quarter after quarter, bringing stability in growth, earnings and asset quality. In Q1FY11, PAT grew 71% Y-o-Y, to INR 2.12 bn (flat Q-o-Q). Margins improved 55bps Y-o-Y, to 3% levels (as expected, came off Q-o-Q - a seasonal impact). Gross NPLs were sustained below 1% and, disbursement growth, as guided by the management, was at 40% Y-o-Y.

Strong disbursement growth, as guided

Disbursement growth for LICHF was sustained at 40% in Q1FY11, at INR 34 bn (over a higher base set in FY10). It continued with average run-rate of INR 10-11 bn per month in individual loans (32% Y-o-Y growth). 'Fix-o-Floaty' scheme constituted ~85% of the disbursements and 25% of its loan book. The company has launched one more product 'Advantage 5' in July 2010, offering 9.25% fixed for five years. The response in the first few days was encouraging and it expects this scheme to constitute 30-50% of disbursements. The fact that its peers have reduced the fixed structure to one or two years, lends LICHF competitive edge. We are building in disbursement growth of 24% CAGR over FY10-12E.

Margins sustained at 3% levels

Despite the launch of various fixed rate special home loan schemes (for initial years), margins were sustained at 3% levels as there were back-to-back funding arrangements. As anticipated, the trend in margin was down Q-o-Q due to seasonal impact; however, it was 55bps higher Y-o-Y. Considering the rising interest rate environment, mix of back-to-back and rollover funding arrangements to be followed for 'Advantage 5' scheme and increasing competition, we have build in compression in margins to 2.6% by FY12E.

NPLs sustained below 1%

As was guided by the management, gross NPLs were sustained below 1%. Normally, in Q1 due to seasonal impact, gross NPLs inch up 50bps (INR 1.3-1.5 bn); however, NPL accretion (net) in Q1FY11 was lower at INR 1 bn and gross NPLs inched up merely 23bps, to 0.92%. Management sounded confident on improving gross NPLs further and bringing them below FY10 levels of 0.69% by end of this fiscal.

Outlook and valuations: Positive; maintain 'BUY'

Operating metrics are favourable for LICHF viz disbursement growth of 40%, 3% margins and NPLs below 1%. We are revising our EPS estimates upwards by 7% for FY11 and FY12 to INR 89.5 and INR 111.2 for FY12, respectively, to factor in higher disbursement growth and better asset quality. The stock is currently trading at 9.6x FY12E earnings and 2.1x FY12E adjusted book. We maintain 'BUY' on the stock and rate it 'Sector Performer' on relative returns.

Financials

Year to March	Q111	Q110	Growth (%)	Q410	Growth (%)	FY10	FY11E
Net int. inc. (INR mn)	2,943	1,742	69.0	2,980	(1.2)	8,871	11,975
Net profit (INR mn)	2,120	1,238	71.2	2,135	(0.7)	6,622	8,500
Diluted EPS (INR)	22.3	14.6	53.4	22.5	(0.7)	69.7	89.5
Price/ Book (x)						3.0	2.5
Price/ Earnings (x)						15.4	12.0

July 15, 2010

Reuters: LICH.BO Bloomberg: LICHF IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 1,074
52-week range (INR)	:	1,049 / 519
Share in issue (mn)	:	94.9
M cap (INR bn/USD mn)	:	101 / 2,187
Avg. Daily Vol. BSE/NSE ('000):	:	1,175.2

SHARE HOLDING PATTERN (%)

Promoters*	:	36.5
MFs, FIs & Banks	:	18.4
FIIIs	:	32.1
Others	:	13.0
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW BFSI Index
1 month	2.4	3.6	3.9
3 months	12.4	1.2	8.4
12 months	65.6	31.0	46.4

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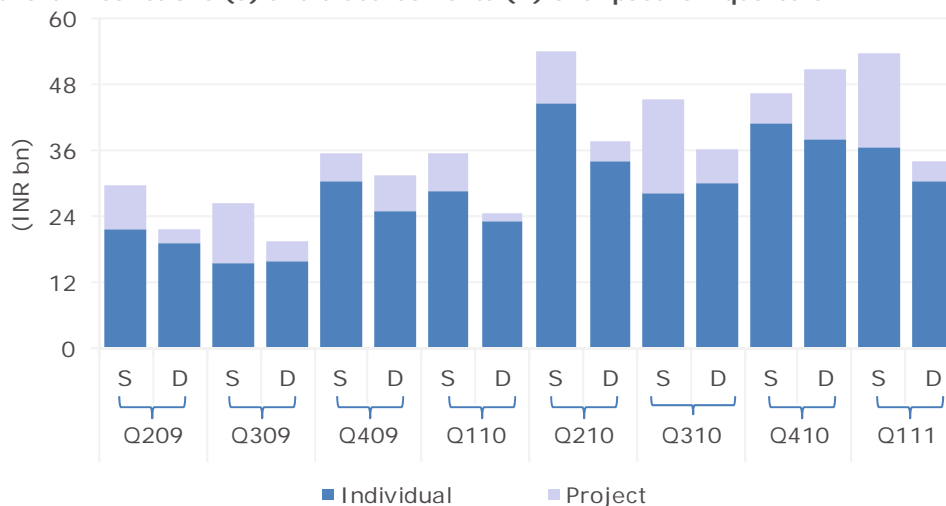
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■ Strong disbursement growth, as guided

- As was guided by the management, disbursement growth for LICHF was sustained at 40% in Q1FY11, at INR 34 bn (over a higher base set in FY10). It continued with average run-rate of INR 10-11 bn per month in individual loans and disbursements in this segment grew 32%.
- Following the historical trend, disbursements in the non-individual segment in Q1 were relatively lower and are expected to pick up in the coming quarters (also reflected in higher sanctions in this segment at INR 17 bn in Q1FY11 itself compared to INR 39 bn in full year FY10). Repayment in this category was higher at INR 3.2 bn and loan book in this segment remained flat Q-o-Q, at INR 41.8 bn (10% of the overall loan book).
- Disbursement under a 'Fix-o-Floaty' scheme (8.9% fixed rate up to March 2012) is estimated at 80-85% of the overall disbursements. The outstanding amount under this scheme stands at INR 10-11 bn. Besides raising the eligible limit under this scheme from INR 7.5 mn to INR 15 mn (earlier 9.9% was charged for this category), it has launched one more product 'Advantage 5' (9.25% fixed for five years). LICHF is amongst the few players offering fixed rate for five years. The fact that its peers have reduced the fixed structure to one or two years, lends LICHF competitive edge. The response in the first few days was encouraging and it expects this scheme to constitute 30-50% of disbursements in the coming months.
- Considering the ongoing run-rate of disbursements, competitive home loan schemes and improved outlook for mortgage demand, we expect disbursements to post 24% CAGR over FY10-12E.

Chart 1: Sanctions (S) and disbursements (D) over past few quarters

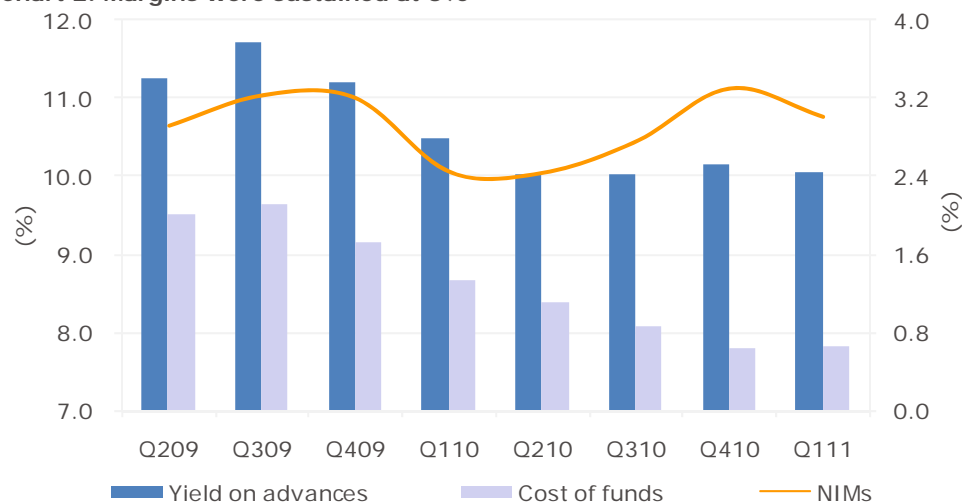


Source: Company

■ Margins sustained at 3%

- Despite the launch of various fixed rate special home loan schemes (for initial years), margins were sustained at 3%. This was because of back-to-back funding arrangements it had for disbursements in these special schemes. As was anticipated, the trend in margin was down Q-o-Q due to seasonal impact; however, it was 55bps higher Y-o-Y. Incremental cost of funds during the quarter was 7.45% against weighted average cost of funds of 7.8%.
- The tenure of fixed rate structure under 'Fix-o-Floaty' scheme has come off from three years to less than two years. For 'Advantage 5' scheme, the company is planning to follow a mix of both back-to-back and rollover funding arrangements in such a manner that the funding cost is capped at 7.8-8.0%.
- Considering rising interest rate environment and competition loan schemes, we have built in marginal compression in margins from the Q1FY11 levels, and expect margins to come off to 2.6% by FY12E.

Chart 2: Margins were sustained at 3%

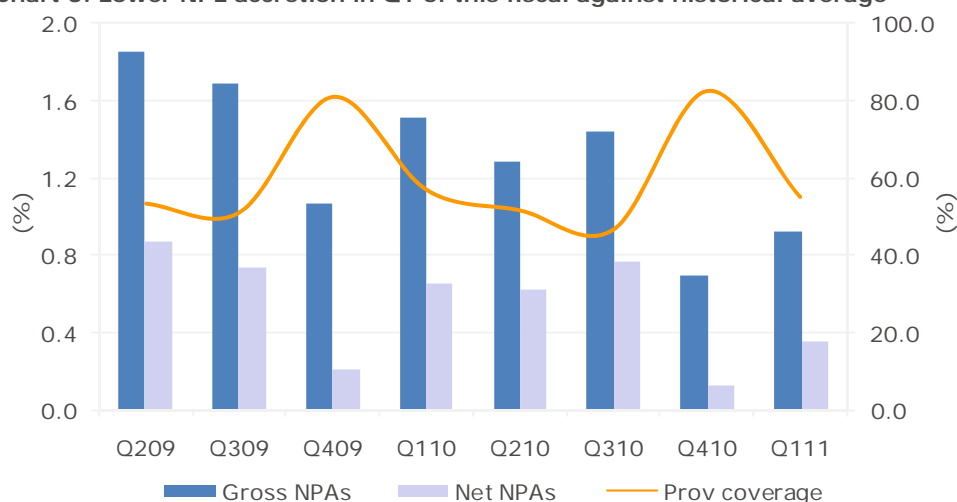


Source: Company

■ NPLs sustained below 1%

- As was guided by the management, gross NPLs were sustained below 1%. Normally, in Q1 due to seasonal impact, gross NPLs inch up 50bps (INR 1.3-1.5 bn); however, in FY11, NPL accretion (net) in Q1 was relatively lower at INR 1 bn and gross NPLs inched up 23bps to 0.92% (significantly lower compared with 1.5% in Q1FY10).
- NPLs in the non-individual segment came off from INR 50 mn in Q4FY10 to INR 40 mn in Q1FY11. Slippages in the individual loan segment in Q1FY11 were INR 1.3 bn, while upgradations/recoveries were at INR 280 mn. Provisioning coverage in Q1FY11 was also relatively higher (than historical average in Q1) at 62%.
- Management sounded confident on improving gross NPLs further and bringing them below FY10 levels of 0.69% by end of this fiscal.

Chart 3: Lower NPL accretion in Q1 of this fiscal against historical average



Source: Company

Financials snapshot

(INR mn)

Year to March	Q111	Q110	Growth (%)	Q410	Growth (%)	FY10	FY11E	FY12E
Interest income	9,716	7,451	30.4	9,193	5.7	32,828	44,205	58,131
Interest expenses	6,772	5,709	18.6	6,214	9.0	23,957	32,230	43,197
Net interest income	2,943	1,742	69.0	2,980	(1.2)	8,871	11,975	14,934
Non-interest income	434	368	17.8	489	(11.4)	1,870	2,344	2,663
Total revenue	3,377	2,110	60.0	3,469	(2.7)	10,741	14,319	17,597
Operating expenses	394	330	19.4	613	(35.7)	1,920	2,178	2,433
Operating profit	2,983	1,780	67.5	2,856	4.4	8,820	12,140	15,164
Provisions	89	92	(3.4)	-126	(170.8)	-293	411	561
Profit before tax	2,893	1,688	71.4	2,982	(3.0)	9,113	11,729	14,603
Provision for tax	773	450	72.0	847	(8.7)	2,491	3,229	4,034
Profit after tax	2,120	1,238	71.2	2,135	(0.7)	6,622	8,500	10,568
EPS (INR)	22.3	14.6	53.4	22.5	(0.7)	69.7	89.5	111.2

Ratios (%)

NII / GII	30.3	23.4		32.4		27.0	27.1	25.7
Cost - income	11.7	15.6		17.7		17.9	15.2	13.8
Tax rate	26.7	26.6		28.4		27.3	27.5	27.6

Balance sheet data

Loan book (INR mn)	400,296	292,540	36.8	380,813	5.1	380,814	504,709	645,268
Disbursements (INR mn)	33,918	24,301	39.6	50,616	(33.0)	148,530	188,633	226,360

Ratios (%)

Gross NPA	0.9	1.5		0.7		0.7	0.6	0.6
Net NPA	0.4	0.7		0.1		0.1	0.1	0.1

■ Company Description

LICHF is the fourth-largest mortgage finance company in India. It provides loans for homes, construction activities, and corporate housing schemes. Almost 90% of the company's loans are to retail customers and the balance 10% to large ticket commercial sector companies. It is fourth in terms of market share (including banks), with ~8-10% market share in home loan disbursements in FY08. The company has loan outstanding of INR 400 bn as at June 30, 2010. It has 130 offices and 100 camps across the country. The company has a marketing network of over 6,000 direct sales agents, home loan agents, and associates. LIC India is its majority shareholder with 36% equity holding, followed by FIIs at 32%.

■ Investment Theme

Internal restructuring and intense pricing war resulted in LICHF's disbursements growing a paltry 9% (below industry average of 36%) over FY04-06. Post internal restructuring, defying the concerns of slowdown in mortgages, and expectations of margin compression, LICHF reported robust disbursements in FY07-08. We expect the company to grow its disbursement at higher-than-historical growth rates. With the change in competitive landscape in favour of HFCs, we expect LICHF to gain market share and report margin improvement. Historically, asset quality for LICHF has not been highly impressive; however, with adoption of better and strict risk management process and concerted efforts on NPA recoveries, the company has reported significant improvement in its net NPAs.

■ Key Risks

Loss of market share to commercial banks and HFCs and pressure on spread due to inability to raise lending rates amidst stiff competition.

Real estate lending is becoming more challenging due to a high interest-rate background and weak property prices.

Deterioration of asset quality can increase NPA provisioning and affect profitability.

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Interest income	20,587	27,558	32,828	44,205	58,131
Interest expended	14,943	20,174	23,957	32,230	43,197
Net interest income	5,644	7,384	8,871	11,975	14,934
Non interest income	1,248	1,274	1,563	2,021	2,324
- Fee & forex income	655	697	898	1,320	1,585
- Misc. income	568	577	665	701	740
- Investment profits	24	-	-	-	-
Income from operations	6,892	8,659	10,434	13,996	17,258
Other income	299	292	307	322	338
Net revenues	7,190	8,951	10,741	14,319	17,597
Operating expense	1,467	1,541	1,920	2,178	2,433
- Employee exp	345	448	484	539	600
- Depreciation /amortisation	37	50	63	60	65
- Other opex	1,085	1,044	1,373	1,579	1,769
Preprovision profit	5,723	7,410	8,820	12,140	15,164
Provisions	400	146	(293)	411	561
Profit before tax	5,323	7,264	9,113	11,729	14,603
Provision for tax	1,451	1,948	2,491	3,229	4,034
Profit After Tax	3,872	5,316	6,622	8,500	10,568
Extraordinaries	-	-	-	(1,073)	-
Reported PAT	3,872	5,316	6,622	9,572	10,568
Basic shares outstanding (mn)	85	85	95	95	95
Basic EPS (INR)	45.6	62.5	69.7	89.5	111.2
Diluted equity shares (mn)	85	85	95	95	95
Diluted EPS (INR)	45.6	62.5	69.7	89.5	111.2
Dividend per share (INR)	10.0	13.0	15.0	18.1	21.6
Dividend payout (%)	25.7	24.3	25.2	21.0	22.7

Growth ratios (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	44.7	24.5	20.0	33.3	22.9
NII growth	42.0	30.8	20.1	35.0	24.7
Opex growth	17.9	5.0	24.6	13.4	11.7
PPP growth	53.6	29.5	19.0	37.6	24.9
Provisions growth	113.3	(63.6)	NA	NA	36.4
Net profit	38.7	37.3	24.6	28.4	24.3

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Yield on advances	10.3	11.1	10.0	10.0	10.1
Yield on assets	10.3	11.1	10.0	10.0	10.1
Net interest margins	2.8	3.0	2.7	2.7	2.6
Cost of funds	8.1	8.8	8.0	8.0	8.2
Spread	2.2	2.3	2.0	2.0	2.0
Cost-income	20.4	17.2	17.9	15.2	13.8
Tax rate	27.3	26.8	27.3	27.5	27.6

Balance sheet**(INR mn)**

As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	850	850	950	950	950
Share premium account	2,533	2,533	9,033	9,033	9,033
Reserves & surplus	14,934	18,958	23,915	31,478	39,648
Net worth	18,317	22,341	33,897	41,461	49,631
Deposits	157	1,618	3,132	5,193	6,635
Secured loans	191,134	235,240	322,568	430,617	555,219
Unsecured loans	12,153	17,359	21,856	27,446	33,968
Total liabilities	221,761	276,558	381,454	504,716	645,453
Loans	219,364	276,793	380,814	504,709	645,268
Investments	7,746	11,292	9,797	10,045	10,586
Total current assets	5,214	4,446	6,173	7,462	8,770
Total current liabilities & provisions	11,792	17,265	16,757	19,090	20,988
Net current assets	(6,578)	(12,819)	(10,584)	(11,628)	(12,219)
Fixed assets	300	345	330	300	285
Other Assets	929	948	1,097	1,291	1,533
Total assets	221,761	276,558	381,454	504,716	645,453
Loan growth	24.9	26.2	37.6	32.5	27.8
Deposit growth	24.5	24.3	36.4	33.0	28.6
EA growth	24.1	24.8	38.1	32.4	27.9
Gross NPA ratio	1.7	1.1	0.7	0.6	0.6
Net NPA ratio	0.6	0.2	0.1	0.1	0.1
Provision coverage	62.2	80.9	82.4	80.0	80.0
Capital adequacy	10.8	10.8	11.8	11.1	10.5

Sanctions and disbursements

Year to March	FY08	FY09	FY10	FY11E	FY12E
Sanctions (INR mn)	86,179	108,985	168,784	221,921	276,049
Disbursements (INR mn)	70,715	87,620	148,530	188,633	226,360
Disbursements to sanction ratio (%)	82.1	80.4	88.0	85.0	82.0
Disbursements growth (%)	38.1	23.9	69.5	27.0	20.0
Sanctions growth (%)	41.2	26.5	54.9	31.5	24.4

RoE decomposition (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net interest income/assets	2.8	3.0	2.7	2.7	2.6
Non interest income/assets	0.8	0.6	0.6	0.5	0.5
Net revenues/assets	3.6	3.6	3.3	3.2	3.1
Operating expense/assets	0.7	0.6	0.6	0.5	0.4
Provisions/assets	0.2	0.1	(0.1)	0.1	0.1
Taxes/assets	0.7	0.8	0.8	0.7	0.7
Total costs/assets	1.7	1.5	1.3	1.3	1.2
ROA	1.9	2.1	2.0	1.9	1.8
Equity/assets	8.5	8.2	8.6	8.5	7.9
ROAE %	22.9	26.2	23.6	22.6	23.2

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	45.6	62.5	69.7	89.5	111.2
<i>Y-o-Y growth (%)</i>	<i>38.7</i>	<i>37.2</i>	<i>11.5</i>	<i>28.4</i>	<i>24.3</i>
Book value per share (INR)	215.5	262.8	356.8	436.4	522.4
Adjusted book value per share (INR)	203.9	258.2	353.4	431.7	516.8
Diluted PE (x)	23.5	17.2	15.4	12.0	9.6
Price/BV (x)	5.0	4.1	3.0	2.5	2.1
Price/ Adj. BV (x)	5.3	4.2	3.0	2.5	2.1
Dividend yield (%)	0.9	1.2	1.4	1.7	2.0



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	BUY	SO	H	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SO	L	Federal Bank	BUY	SO	M
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	H
Infrastructure Development Finance Co Ltd	HOLD	SU	M	ING Vysya	BUY	SO	H
Karnataka Bank	BUY	SO	L	Kotak Mahindra Bank	BUY	SP	L
LIC Housing Finance	BUY	SP	M	Manappuram General Finance	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	H	Power Finance Corp	BUY	SP	L
Punjab National Bank	BUY	SO	L	Reliance Capital	HOLD	SP	M
Rural Electrification Corporation	BUY	SO	L	Shriram City Union Finance	BUY	SP	H
South Indian Bank	BUY	SP	H	State Bank of India	BUY	SP	L
Syndicate Bank	BUY	SP	H	Union Bank Of India	BUY	SO	L
Yes Bank	BUY	SO	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect



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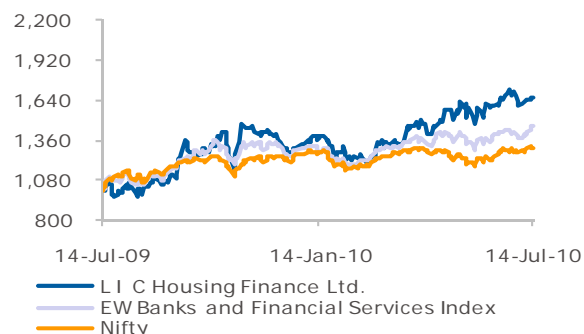
Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Manappuram General Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Syndicate Bank, Union Bank Of India, ING Vysya, Yes Bank

LIC Housing Finance



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	109	52	12	177
* 4 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	108	54	15	

Recent Research

Date	Company	Title	Price (INR)	Recos
14-Jul-10	HDFC	Quality performance; <i>Result Update</i>	3,077	Hold
09-Jul-10	Banking	Liquidity blues = deposit rates set to move = Positive for margins; <i>Sector Update</i>		
30-Jun-10	United Bank of India	Moving in the right direction; <i>Visit Note</i>	81	Not Rated

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