

## UBS Investment Research

### LIC Housing Finance

#### Margins surprise

##### ■ Revenues beat estimates on higher NIMs

LIC HF reported Net profit of Rs 2.13 bn slightly below our expectations of Rs 2.25 bn; however operating income of Rs 4.1 bn came in better than expected on back of 20 bps improvement in NIMs. The company also fully provided for Rs 2.3 bn general provisions on teaser rate (announced late December) while it booked income from sale of its stake in LIC MF to the tune of Rs 1.37 bn. Due to the capital gains booked and provisioning expensed, the tax rate during the quarter also came in lower than expected which too supported earnings.

##### ■ Loan book grew 36%, Capital raising is likely imminent

Driven by disbursement growth of 28% Y/Y, loan book grew by 7% QoQ with 8% growth in individual portfolio. Approvals too grew by 28%y/y with individual approvals up 90% y/y. Project/developer loans have stayed flat. We estimate 27% loan growth in FY12 following 30% growth in FY11; however with Tier-1 now at 8.5% we believe that capital raising will be required.

##### ■ NIMs expand by 20 bps; likely at peak

LICHF hiked PLR by 50 bps in October which with favourable ALM has led to NIM expansion of 20 bps QoQ to 3.1%. However the incremental spreads have been correcting (down 30bps QoQ) and now is at 1.65% which in our view will reflect in NIM with 2 quarter lag.

##### ■ Valuation: Peak profitability; Maintain Sell

We believe profitability will be impacted by declining margins; also slowdown in volumes (due to low affordability, high interest rates, competition) is a risk. Our price target is derived using a residual income model.

Highlights (Rsm)	03/09	03/10	03/11E	03/12E	03/13E
Revenues	8,760	10,739	14,700	18,041	22,064
Pre-tax profits	7,264	9,275	12,398	14,618	17,715
Net income	5,316	6,784	10,058	10,598	12,844
EPS (UBS, Rs)	12.51	14.28	21.17	22.31	27.04
Net DPS (UBS, Rs)	2.60	3.00	3.43	4.24	5.14
Profitability & Valuation	5-yr hist av.	03/10	03/11E	03/12E	03/13E
ROE %	9.7	23.9	23.9	23.0	23.3
P/Op x	4.4	7.1	6.4	5.1	4.2
P/BVPS x	1.1	1.8	1.9	1.6	1.3
PE (UBS) x	6.7	9.4	8.0	7.6	6.3
Net dividend yield %	3.9	2.2	2.0	2.5	3.0

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs170.40 on 19 Jan 2011 23:38 EST

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## Global Equity Research

India

Diversified Financial

12-month rating **Sell**  
**Unchanged**

12m price target **Rs160.00/US\$3.52**  
**Unchanged**

Price **Rs170.40/US\$3.75**

RIC: LIC.H.BO BBG: LICHF IB

19 January 2011

#### Trading data (local/US\$)

52-wk range	Rs293.74-144.56/US\$6.63-3.12
Market cap.	Rs80.9bn/US\$1.78bn
Shares o/s	475m (ORD)
Free float	98%
Avg. daily volume ('000)	3,225
Avg. daily value (m)	Rs651.4

#### Balance sheet data 03/11E

Common equity	Rs42.0bn
P/BVPS x	1.9
Tier one capital ratio	10.9%

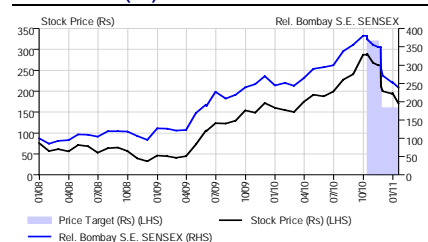
#### Forecast returns

Forecast price appreciation	-6.1%
Forecast dividend yield	2.4%
Forecast stock return	-3.7%
Market return assumption	13.0%
Forecast excess return	-16.7%

#### EPS (UBS, Rs)

	03/11E	03/10
	UBS	Cons. Actual
Q1	4.46	- 2.61
Q2	4.93	- 3.61
Q3E	4.74	- 3.23
Q4E	4.92	- 4.50
03/11E	21.17	21.18
03/12E	22.31	22.31

#### Performance (Rs)



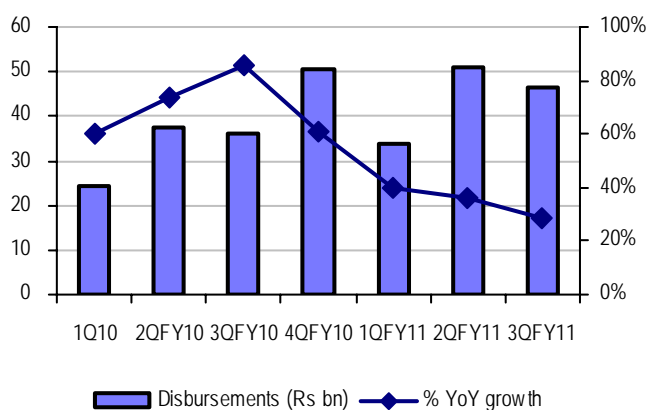
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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 9.

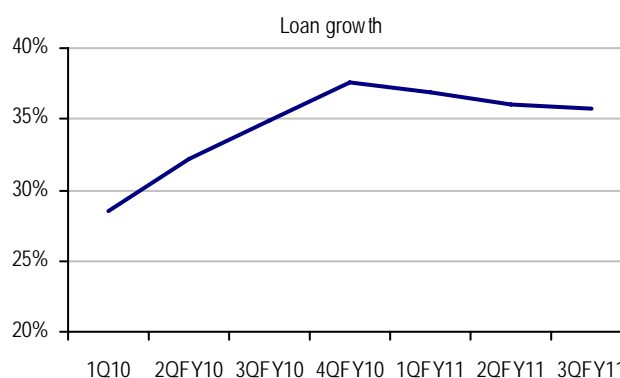
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Chart 1: Disbursements remain healthy



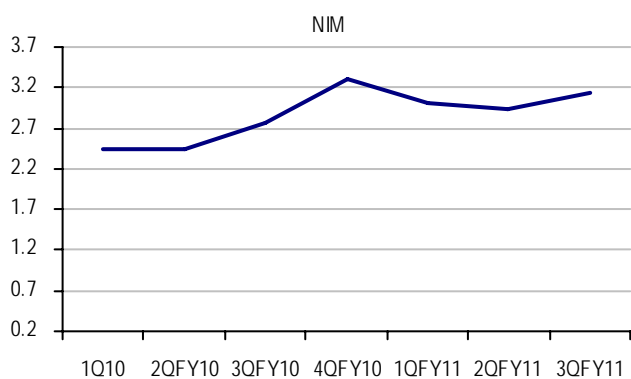
Source: Company

Chart 2: Loan growth was in line with expectations



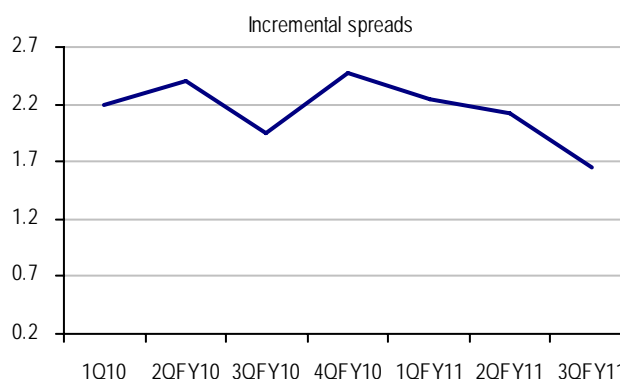
Source: Company

Chart 3: NIM expanded



Source: Company

Chart 4: But incremental spreads have been declining



Source: Company

Table 1: LIC Housing finance - Quarterly results (Rs mn)

	1Q10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	YoY (%)
Operating income	7,819	8,391	8,805	9,683	10,149	11,075	12,177	38
Interest on loans	7,451	7,847	8,336	9,193	9,716	10,429	11,615	39
Fees and other charges	225	502	446	436	300	423	397	(11)
Other income	143	42	22	53	134	222	166	641
Interest expenses	5,709	5,979	6,057	6,214	6,772	7,378	8,093	34
Net operating income	2,110	2,413	2,748	3,469	3,377	3,696	4,084	49
Other exp.	408	23	566	471	468	490	524	(7)
Establishment exp.	209	296	285	477	230	324	347	22
Staff expenses	99	144	123	120	149	165	198	61
Provisions	100	(417)	158	(126)	89	1	(21)	(113)
PBDT (inc. other income)	1,702	2,294	2,278	2,998	2,908	3,206	3,560	56
Depreciation	14	16	17	16	15	16	15	(12)
Extraordinary items							(980)	
Profit on sale of stake in LICMF							1,370	
General provisions on teaser loans							2,350	
PBT	1,688	2,278	2,261	2,982	2,893	3,190	2,565	13
Tax	450	566	629	847	773	848	428	(32)
PAT	1,238	1,712	1,632	2,135	2,120	2,342	2,138	31
Tax rate (%)	27	25	28	28	27	27	17	(40)

Source: Company

Table 2: Quarterly details

	1Q10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	YoY (%)
Approval for the quarter (Rs bn)	35	54	45	46	53	77	58	28
Individual	29	44	28	41	37	57	53	90
Project	7	9	17	6	17	20	5	(72)
Disbursements (Rs bn)	24	38	36	51	34	51	46	28
Individual (Rs bn)	23	34	30	38	30	38	42	41
Project	2	4	6	13	4	13	4	(33)
Outstanding portfolio (Rs bn)	293	319	342	381	400	434	464	36
Individual (Rs bn)	267	281	313	339	358	385	415	33
Project	25	27	29	41	42	49	49	68
NPLs								
Gross NPLs (Rs mn)	4,416	4,086	4,900	2,630	3,669	3,196	3,130	(36)
Gross NPL ratio (%)	1.51	1.28	1.44	0.69	0.92	0.74	0.67	
Net NPLs (Rs mn)	1,907	1,982	2,630	460	1,398	902	840	(68)
Net NPL ratio (%)	0.65	0.62	0.73	0.12	0.35	0.21	0.18	

Source: Company

Table 3: Recent publications

	Recent Reports	Analyst
19-Jan	First Read: CMB: 2011 GCC takeaways (Neutral)	Sarah Wu
19-Jan	First Read: BCOM: 2011 GCC takeaways (Neutral)	Sarah Wu
18-Jan	Busan Bank: Solid Q410 results despite lower earnings (Buy)	Scott Lee
18-Jan	Singapore Exchange: Q2 earnings in line with expectations (Buy)	Jaj Singh
17-Jan	First Read: India Banking & Finance Sector: RBI mandates standard asset provisioning	Ajitesh Nair
17-Jan	Power Finance: Spreads hold up: growth steady (Buy)	Ajitesh Nair
17-Jan	AXIS Bank: Strong show (Buy)	Vishal Goyal, CFA
17-Jan	First Read: GTJA International: 2011 GCC takeaways (Buy)	Noel Chan
14-Jan	Singapore Banks: Buyers in the face of property measures	Jaj Singh
13-Jan	China Minsheng Banking: Structure of capital raising disappointing (Neutral)	Sarah Wu
13-Jan	Chinatrust Financial Holding: Overhang removed; upgrade to Buy (Buy)	Pandora Lee
13-Jan	AMMB Holdings: NDR takeaway: upbeat outlook (Buy)	Khairul Rifaie
13-Jan	Malayan Banking: NDR takeaway: slightly positive on KimEng (Buy)	Khairul Rifaie
13-Jan	First Read: Korea Banks: View 25 bps rate hike as another catalyst	Scott Lee
13-Jan	First Read: Korea Banks: NPS will be allowed to buy more bank stocks - a catalyst	Scott Lee
12-Jan	Korea Banks: Q410 previews - solid with higher margins and improving asset quality	Scott Lee
12-Jan	Taiwan Financial: Nan Shan Life: Seemingly a good deal	Pandora Lee
12-Jan	First Read: Taiwan Financial: Nan Shan goes to Ruentex/Pou Chen JV?	Pandora Lee
11-Jan	India Banking & Finance Sector: Liquidity pangs	Ajitesh Nair
11-Jan	TISCO Financial Group: Record high ROE is hard to sustain (Buy)	Butsakon Khoosuan
11-Jan	Taiwan Financial Sector: Q4 mostly down QOQ; 2010 mostly up YoY	Pandora Lee
10-Jan	China Banks: How will differentiated reserves impact the banks?	Sarah Wu
10-Jan	First Read: Fubon FHC: Fubon announced to privatize Fubon HK (Neutral)	Pandora Lee
10-Jan	Hong Kong and Singapore Banks: A tale of two cities: HK and Singapore	Stephen Andrews, CFA/Jaj Singh
6-Jan	Malayan Banking: The tiger broadens its ASEAN footprint (Buy)	Khairul Rifaie
6-Jan	Chongqing Rural Commercial Bank: Right place, right time; initiate with Buy (Buy)	Steve Ho
6-Jan	First Read: Yuanfa FHC: More ammunition for M&As, but... (Buy)	Pandora Lee
6-Jan	First Read: Korea Banks: Troubled savings banks are hanging over	Scott Lee
5-Jan	Singapore Banks: Steeper yield curve	Jaj Singh
5-Jan	Taiwan Financial: Exposure to Powerchip	Pandora Lee
4-Jan	Taiwan Financial: NT dollar's relative strength implies higher hedging risk	Pandora Lee
3-Jan	Hong Kong Banks: IPO impact unwinds, loans & deposits fall	Stephen Andrews, CFA
3-Jan	First Read: Korea Banks: IBK and Hana are our 2011 top Buys	Scott Lee
15-Dec	Kasikornbank: Expanding Japanese customer base (Buy)	Butsakon Khoosuan
13-Dec	Bank Mandiri: Post-rights, post-placement view (Buy)	Joshua Tanja, CFA
10-Dec	China Banks: 7.5 trillion is in the bag	Sarah Wu
10-Dec	Key Call: Shriram Transport Finance: Weakness -- an opportunity to buy (Buy)	Ajitesh Nair
7-Dec	India Banking & Finance Sector: Rising deposit rates is not a big concern	Vishal Goyal, CFA
7-Dec	Korea Banks: We are bullish going into 2011	Scott Lee
6-Dec	Shinhan Financial Group: Upgrade to Buy on the first good news (Buy)	Scott Lee
2-Dec	AIA Group: Waking a sleeping Asian giant (Neutral)	Stephen Andrews, CFA
2-Dec	Asia Financials - Outlook 2011: Go long growth annuities	Andy Brown, CFA
1-Dec	Bank of Ayudhya: Multiple positive catalysts (Buy)	Butsakon Khoosuan
1-Dec	Hong Kong Banks: Mainland lending still in the driving seat	Stephen Andrews, CFA
1-Dec	Key Call: ICBC: Moving ICBC to a Key Call (Buy)	Sarah Wu
29-Nov	RHB Capital: Strong momentum continues (Buy)	Khairul Rifaie

Source: UBS

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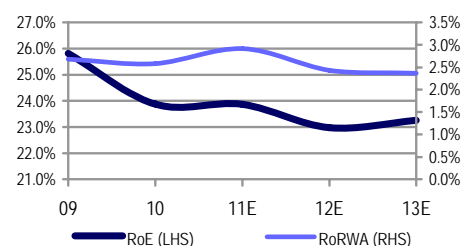
## LIC Housing Finance

Per share (Rs)	3/09	3/10	3/11E	3/12E	3/13E
EPS (stated)	12.51	14.28	21.17	22.31	27.04
EPS (UBS adjusted)	12.51	14.28	21.17	22.31	27.04
GOPS	16.98	18.70	26.71	33.10	40.73
DPS	2.60	3.00	3.43	4.24	5.14
BVPS (stated)	52.57	75.28	88.48	105.84	126.87
BVPS (adjusted)	52.57	75.28	88.48	105.84	126.87
<b>Profit &amp; Loss (Rsm)</b>					
Net interest income	8,078	9,464	13,096	16,196	19,851
Other income	682	1,275	1,604	1,845	2,214
Total revenues	8,760	10,739	14,700	18,041	22,064
Expenses	(1,542)	(1,857)	(2,011)	(2,321)	(2,720)
Operating profit	7,217	8,882	12,688	15,720	19,344
Provisions and other items	(53)	283	(291)	(1,102)	(1,629)
Profit before tax	7,264	9,275	12,398	14,618	17,715
Pre-exceptional net income	5,316	6,784	10,058	10,598	12,844
<b>Capital dynamics (Rsm)</b>					
Risk-weighted assets	222,322	303,652	385,587	485,092	600,714
Tier one capital	22,341	33,877	42,029	50,271	60,260
Total capital	22,341	33,877	42,029	50,271	60,260
Tier one ratio	10.0%	11.2%	10.9%	10.4%	10.0%
Total capital ratio	10.0%	11.2%	10.9%	10.4%	10.0%
Net profit after tax	5,316	6,784	10,058	10,598	12,844
Tier 1 requirement					
Less: Working capital requirement					
Less: Dividends	1,292	1,666	1,906	2,356	2,855
Surplus capital generated					
Surplus capital generation ratio					
<b>Balance sheet (Rsm)</b>					
Assets	293,820	402,416	511,555	644,566	799,121
Customer loans	276,790	380,814	490,502	621,898	774,577
Customer deposits	0	0	0	0	0
Funds under management					
Loans : assets	94.2%	94.6%	95.9%	96.5%	96.9%
Deposits : assets	0.0%	0.0%	0.0%	0.0%	0.0%
Loans : deposits					
Shareholders funds : assets	7.60%	8.42%	8.22%	7.80%	7.54%
<b>Asset quality (Rsm)</b>					
Non-performing assets	2,971	2,632	2,894	4,291	6,367
Total risk reserves	568	464	442	744	1,202
NPLs : loans	1.07%	0.69%	0.59%	0.69%	0.82%
NPL coverage	19%	18%	15%	17%	19%
Provision charge : average loans	0.02%	-0.09%	0.07%	0.20%	0.23%
Net NPLs : shareholders' funds	10.8%	6.4%	5.8%	7.1%	8.6%
<b>Profitability</b>					
Net interest margin (avg assets)	3.06%	2.72%	2.87%	2.80%	2.75%
Provisions : operating profit	0.7%	-3.2%	2.3%	7.0%	8.4%
RoE	25.8%	23.9%	23.9%	23.0%	23.3%
RoAdjE	0.0%	0.0%	0.0%	0.0%	0.0%
RoRWA	2.68%	2.58%	2.92%	2.43%	2.37%
RoA	0.00%	1.93%	1.98%	1.83%	1.78%
<b>Productivity</b>					
Cost : income ratio	17.6%	17.3%	13.7%	12.9%	12.3%
Costs : average assets	0.6%	0.5%	0.4%	0.4%	0.4%
Compensation expense ratio	5.9%	5.2%	4.4%	4.1%	3.8%
<b>Momentum</b>					
Revenue growth	+28.8%	+22.6%	+36.9%	+22.7%	+22.3%
Operating profit growth	+32.2%	+23.1%	+42.9%	+23.9%	+23.1%
Net profit growth	+37.3%	+27.6%	+48.2%	+5.4%	+21.2%
Dividend growth	+29.9%	+15.4%	+14.4%	+23.6%	+21.2%
<b>Value*</b>					
<b>UBS bank valuation</b>					
Leveraged P/E					
Risk tendency P/E					
Merger P/E					
Market capitalisation (Rsm)	22,331	62,824	73,810	73,810	73,810
<b>Conventional valuation</b>					
Market cap./Revenues	2.5x	5.9x	5.0x	4.1x	3.3x
Market cap./Operating profit	3.1x	7.1x	5.8x	4.7x	3.8x
P/E (stated)	4.2x	9.3x	8.0x	7.6x	6.3x
P/E (UBS adjusted)	4.2x	9.3x	8.0x	7.6x	6.3x
Dividend yield (net)	4.94%	2.25%	2.01%	2.49%	3.02%
P/BV (stated)	1.0x	1.8x	1.9x	1.6x	1.3x
P/BV (adjusted)	1.0x	1.8x	1.9x	1.6x	1.3x

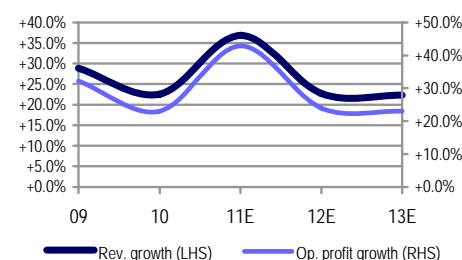
Source: UBS estimates, \* Historical valuations are based on an 'average for the year' share price. Current & future valuations are based on a share price of Rs170.40 on 19/01/2011

LIC Housing Finance Limited (LICHF) was established by LIC of India in June 1989 with the objective of providing long-term housing loans to individuals. It was listed on the NSE in 1994. As at March 2010, LICHF had 181 marketing offices and overseas representative offices in Dubai and Kuwait. It had 1,008 employees as of June 2010. During FY10, LICHF sanctioned loans amounting to Rs180bn and disbursements worth Rs149bn. Its outstanding loan book stood at Rs380bn in FY10. LIC holds 36.5% of shares outstanding and FILs holds 32% as at June 2010.

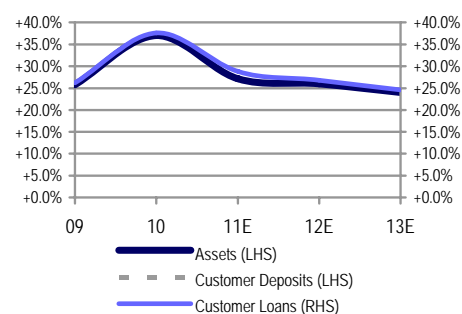
### Profitability (RoE & RoRWA)



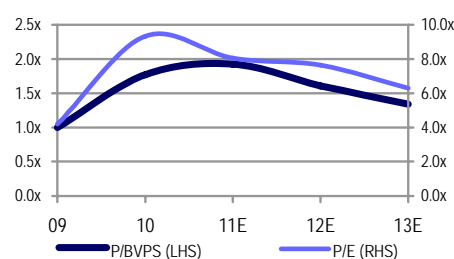
### Momentum (Revenue & Operating profit growth)



### Balance Sheet Growth



### Value (P/Adj. BVPS & P/Adj. EPS)





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## ■ LIC Housing Finance

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## ■ Statement of Risk

We believe a sustained economic slowdown could impact the banking and finance sector on several fronts: lead to a slowdown in credit; increase NPL risk; impact fee income; and exert pressure on NIMs. We believe a slowdown in real estate volumes and a spike in interest rates could impact mortgage demand. A spike in interest rates and irrational competition will impact NIMs. A change in management could lead to concerns on the continuity of LIC Housing Finance's strategy.

## ■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

## Required Disclosures

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### UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	49%	40%
Neutral	Hold/Neutral	42%	35%
Sell	Sell	8%	21%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	less than 1%	14%
Sell	Sell	less than 1%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2010.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

## KEY DEFINITIONS

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

**Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

**Equity Price Targets** have an investment horizon of 12 months.

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**UBS Securities India Private Ltd:** Ajitesh Nair; Vishal Goyal, CFA. **UBS Securities Asia Limited:** Andy Brown, CFA.

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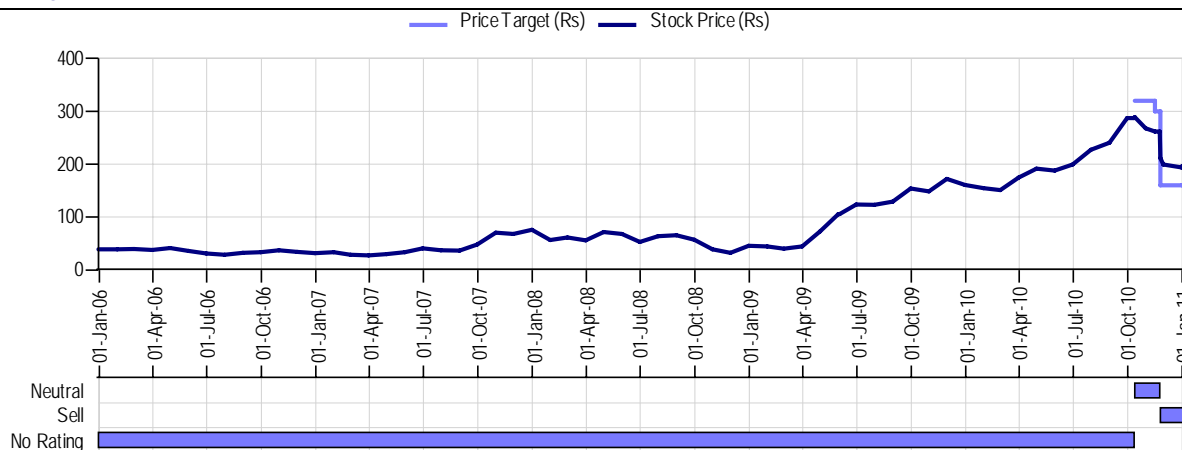
Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
LIC Housing Finance	LICH.BO	Sell	N/A	Rs170.40	19 Jan 2011

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

## LIC Housing Finance (Rs)



Source: UBS; as of 19 Jan 2011



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