Q3FY10 Result Update

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LIC Housing Finance Ltd. (LICHFL) recently came out with its Q3FY10 results. Given below is a brief overview of the financial performance & some key highlights that we came across while reviewing the results.

Results Update:

Quarterly Review on Y-o-Y basis

- LICHFL's total income for Q3FY10 increased by 14.8% to Rs. 8782.2 mn [Q3FY09: Rs. 7650.8 mn]. The Net Interest Income grew by 14% to Rs. 2279.5 mn [Q3FY09: Rs. 1998.7 mn]. LICHFL recorded lower net interest margins of 2.76% in Q3FY10 as compared to 3.23% in Q3FY09, mainly due to aggressive pricing of loans. LICHFL had reduced its PLR rate by 50 bps on its existing loan portfolio w.e.f July 2009. The yield on advances reduced from 11.71% in Q3FY09 to 10.03% in Q3FY10, while the cost of funds in Q3FY10 stood at 8.08%, down from 9.65% in Q3FY09. The interest spread was 1.95% in Q3FY10 vs 2.06% in Q3FY09. However, the incremental spreads improved from 1.4% in Q3FY09 to 3% in Q3FY10 mainly because of substantial reduction in the borrowing cost.
- Increase in other income & lower operating expenses led to higher growth in the operating profit, which increased by 27% to Rs. 2323.3 mn in Q3FY10 vs Rs. 1829.7 mn in Q3FY09. The operating expenses decreased by 13.7% in Q3FY10 over Q3FY09, mainly on account of 40.5% decline in the staff cost. In Q3FY09, LICHFL had incurred a one-time expense of Rs. 90 mn towards wage related arrears of the past two years. The other operating expenses increased by 5.6%. Amongst the other operating expenses, the commission & brokerage expenses rose 125.9%, while the advertisement expenses reduced significantly by 80%.
- Increase in Provision & write offs (up from Rs. 7.5 mn in Q3FY09 to Rs. 158.4 mn in Q3FY10) & higher tax expense (up 31.3% to Rs. 629.1 mn vs Rs. 479 mn in Q3FY09) led to lower PAT growth of 14.3% in Q3FY10 (as compared to operating profit growth). The higher provisioning was despite the change in provisioning policy by reducing the provisions on standard non-retail assets to 0.9% from 1.4% earlier and provisions on retail assets to 0.1% from 0.2% earlier. The effective tax rate on PBT rose from 26.3% in Q3FY09 to 29.1% in Q3FY10. The company has a system of following tax provision as per the internal budget up to Q3 and then in Q4 it will be on the basis of revenue. Because of the robust growth in business, LICHFL has revised the budget upward and so tax liability provision has been increased. The EPS for the quarter stood at Rs. 16.2 (calculated on fully diluted equity of Rs. 949.3 mn) vs Rs. 15.8 in Q3FY09 (calculated on original equity of Rs. 849.3 mn).
- Disbursements grew by 86% to Rs. 36042 mn in Q3FY10 as compared to Rs. 19380 mn during Q3FY09. Sanctions grew significantly by 72% to Rs. 45156 mn [Q3FY09: Rs. 26210 mn]. Retail disbursement constituted 83.1% in Q3FY10 & the rest went to developers. The retail disbursements rose 90%, while the retail sanctions grew by 82% during the quarter (Y-o-Y).
- The Outstanding Mortgage Portfolio as on December 31, 2009 was Rs. 341.7 bn as against Rs. 253.4 bn as on December 31, 2008, thus registering a growth of 34.8%. Of this, the project loans (loans to builders & developers) amounted to Rs. 28.8 bn, an increase of almost 58.2% over Q3FY09. Of the total outstanding asset portfolio, around 85-90% of the loans (assets) were on floating rate basis in Q3FY10.
- LICHFL's asset quality deteriorated as the Gross NPAs stood at Rs. 4908 mn (1.44%) in Q3FY10 vs Rs. 4273 mn (1.69%). The rise was mainly due to a technology issue faced in November while upgrading the IT systems. The Net NPAs increased to Rs. 2636 mn (0.77%) in Q3FY10 [Q3FY09: Rs. 1860.5 mn (0.73%)].
- The provision cover on the NPAs stood at 46.3% as on December 31 2009, which fell from 56.5% as on December 31, 2008. The management has indicated that it will increase provisioning coverage to 60-65% by FY10.

Quarterly Review on Q-o-Q basis

- Sequentially, Net Interest income rose 22%. Incremental cost of funds declined from 7.1% in Q2FY10 to 6.98% in Q3FY10. Around Rs. 15-20 bn of borrowings have been re-priced lower by 300 bps. This has resulted in decline in the cost of funds by 30 bps & improvement in the Net Interest margins from 2.45% in Q2FY10 to 2.76% in Q3FY10. Further, ~Rs. 30 bn of borrowings are due for re-pricing lower, which could further improve the margins. By the end of FY10, the company expects NIMs to settle at around 3%.
- Asset quality deteriorated as the Gross NPAs in absolute terms increased by 20.1% from Rs. 4085.5 mn in Q2FY10 to Rs. 4908 mn in Q3FY10 (in % terms from 1.28% in Q2FY10 to 1.44% in Q3FY10), while the Net NPAs increased by 33% from Rs. 1982.5 mn in Q2FY10 to Rs. 2636 mn (in % terms from 0.62% in Q2FY10 to 0.77% in Q3FY10). Gross NPAs rose mainly due to a technology problem faced in November while upgrading the IT systems. This is temporary in nature and the company has said that it is confident of bringing the Gross NPAs below 1% by the end of this fiscal.
- The disbursements reduced by 4.1% from Rs. 37570 bn in Q2FY10 due to lower disbursements in November, while the sanctions fell by 15.8% from Rs. 53648 mn in Q2FY10. Sanctions in the individual loan segment fell by 36.8% (Q-o-Q). There was an IT problem, which the company faced while trying to adopt a new IT system. It was unsuccessful and hence LICHFL had to go back to the old system. So during November, the company could not sanction loans at normal pace because of this process problem.
- The operating profit rose 24.8%, supported by lower operating expenses, which fell by 23% due to absence of one-time expenditures related to QIP issue expenses & revision in wages. The staff cost reduced by 14.5%, while the other operating expenses fell by 26%. However, provision / write off and higher effective tax rate during the quarter led to decline in the PAT growth. PAT fell by 10.3% over Q2FY10. The provision write-off (net) stood at Rs. 158.4 mn in Q3FY10 vs provision write back of Rs. 417 mn created in Q2FY10. The effective tax rate on PBT increased sharply by 425 bps from 24.8%.

- The loan book increased by 7.1% in Q3FY10 from Rs. 318.9 bn in Q2FY10.

Other Key Highlights:

- During Q3FY10, the number of agents increased by around 0.9% over Q2FY10 to 11,500. This includes 8,800 home loan agents (HLAs), 1,600 Direct Sales Agents (DSAs) & 1100 Customer Relation Associates (CRAs). Around 90% of LICHFL's business is generated through agents, of which the HLAs contribute 60%, while DSAs & CRAs contribute 25% & 15% respectively.
- As on December 31, 2009 the loan to value ratio was 54% and installment to income ratio was 35% [As on December 31, 2008: Loan to value ratio was 56.2% & Installment to income ratio was 38.1%].
- LICHFL's borrowings as on December 31, 2009 stood at Rs. 308.2 bn vs Rs. 291.1 bn as on September 30 2009. The sources of borrowings include banks (34%), NCDs (49%), LIC (3.6%), National Housing Bank (4%) & others (incl. public deposits, commercial papers, etc.). Around 50% of the sourcing of funds is done on a floating rate basis.
- LICHFL's financial services subsidiary has opened 30 branches till now & is expected to open some more branches by the end of this fiscal. The company's product suite would include home loans, insurance products and mutual funds and going forward it would add on credit cards and other third-party products.
- LICHFL's CAR at the end of Q3FY10 stood at 15.2% (as against the regulatory requirement of 12%). The sale of its partial stake in LIC Mutual Fund (17.3% amounting to Rs. 1380 mn) is yet to take place since the regulatory clearances are pending from RBI & SEBI. The same is expected to reflect in Q4FY10. That could increase the CAR further. This coupled with Rs. 6.6 bn raised through QIP in Q2FY10 are expected to improve the NIMs in the coming quarters.

Conclusion & Recommendation:

Though LICHFL's Net Interest Margins reduced by 47 bps Y-o-Y to 2.76% on account of aggressive pricing of loans in the previous months, improvement was witnessed sequentially, as NIMs improved by 31 bps due to re-pricing of high cost borrowings in Q3FY10. Further, ~Rs. 30 bn of borrowings are due for re-pricing lower. Also, the expected partial stake sale of LIC Mutual Fund (17.3%), which would be reflected in Q4FY10 could take care of the incremental borrowings & could improve the NIMs. Moreover, the project sanctions & disbursements increased by 83% & 65.1% respectively on a Q-o-Q basis. This is expected to improve the NIMs further since in projects, the spread is 6%, while in retail it is around 3%. However, it should be noted that the increasing proportion of project loans to the total loan book (up from 8.4% in Q2FY10 to 9.2% in Q3FY10) also increases the risk of rise in NPAs during the market downturn. As per the management, NIMs are expected to settle at around 3% by FY10.

The company continues to report robust growth in sanctions & disbursements. In 9MFY10, the sanctions & disbursements increased by 83% & 75% respectively on the back of traction in both individual & project segment. A sequential fall in the sanctions & disbursements in Q3FY10 seems to be temporary since it occurred on account of some technology upgradation issue. The management is confident of achieving Y-o-Y growth of 25%+ in its sanctions & disbursement in FY11.

In 9MFY10, LICHFL's Net Interest Income (NII) & PAT increased by 13.4% & 19.9% respectively. We feel that LICHFL could achieve FY10 NII in line with our estimates. However, the company could surpass our PAT estimates. Hence we are enhancing our FY10 PAT estimates by 4.2%. EPS is expected to be Rs. 65.7 vs Rs. 63 estimated earlier. We have kept our FY11 projections unchanged (though they seem a bit aggressive at this point), with the NIMs & PAT expected to grow by 27% & 24.4% respectively & EPS is likely to be Rs. 81.7. The management explanation about Q-o-Q decline in the sanctions & disbursements (being only due to some technology problem) needs to be confirmed in Q4FY10.

At CMP of Rs. 743.8, the stock trades at 11.3xFY10E & 9.1xFY11E EPS and 2.1xFY10E & 1.8xFY11E P/ABV. Following the recent QIP placements, LICHF is well capitalised to leverage its strength & exploit the opportunities arising in the underpenetrated housing finance market, which has witnessed a sharp surge in demand for mortgage finance in the past 4-5 months. Also it is to be noted that with the inflation continuing to rise, there is a high probability of RBI hiking the interest rates in the coming months. If that happens & NBFCs follow the same, then it could actually benefit LICHFL in terms of improvement in its NIMs, since 85-90% of the company's outstanding asset portfolio is on floating rate basis, while only 50% of total sourcing is on floating rate basis (however demand for fresh loans could get impacted in a rising interest rate scenario).

A sharp improvement in the asset quality & more visibility on future business growth has recently led to a re-rating in the stock. The stock has risen almost 272% since the beginning of March 2009). From the current levels, the scope of upside looks limited. Also, the current negative market sentiments could pull the stock further lower, though it has already corrected 19% from its 52-week high of Rs. 915.4 made on November 10, 2009. Taking into account the margin of safety, we advise investors to enter the scrip at lower levels in the price band of Rs. 680-720 for a price target of Rs. 782 (1.9xFY11E P/AVB) over the next one to two quarters.

Quarterly Details:

(Rs. In Million)

Particulars	Q3FY10	Q3FY09	VAR [%]	Q2FY10	VAR [%] (Q-o-Q)	Q2FY09	VAR [%] (Y-o-Y)	Q1FY10	Q4FY09
Interest Income	8336.1	7343.3	13.5	7846.8	6.2	6661.4	17.8	7450.5	7544.3
Interest Expenses	6056.6	5344.6	13.3	5978.5	1.3	4950.6	20.8	5708.6	5429.4
Net Interest Income	2279.5	1998.7	14.0	1868.3	22.0	1710.8	9.2	1741.9	2114.9
Other Income	468.5	323.3	44.9	544.1	-13.9	413.6	31.6	368.4	516.6
Processing Fees	368.7	163.3	125.8	337	9.4	163.9	105.6	225	227.9
Miscellaneous Income	99.8	160.0	-37.6	207.1	-51.8	249.7	-17.1	143.4	288.7
Operating Income	2748.0	2322.0	18.3	2412.4	13.9	2124.4	13.6	2110.3	2631.5
Operating Expenses	424.7	492.3	-13.7	551.4	-23.0	342.9	60.8	322.3	448.4
Staff cost	122.8	206.3	-40.5	143.6	-14.5	83.5	72.0	99.0	74.3
Other Operating Expenses	301.9	286.0	5.6	407.8	-26.0	259.4	57.2	223.3	374.1
Operating Profit	2323.3	1829.7	27.0	1861.0	24.8	1781.5	4.5	1788.0	2183.1
Provisions & Write offs	158.4	7.5	2020.5	-417	-138.0	-64.2	549.5	100	12.6
Profit before taxes	2164.9	1822.3	18.8	2278.0	-5.0	1845.7	23.4	1688.0	2170.5
Taxes	629.1	479.0	31.3	565.5	11.2	495.0	14.3	449.6	594.9
PAT	1535.8	1343.3	14.3	1712.5	-10.3	1350.7	26.8	1238.4	1575.6
EPS	16.2	15.8	2.3	18.0	-10.3	15.9	13.4	14.6	18.6
Equity	949.3	849.3	11.8	949.3	0.0	849.3	11.8	849.3	849.3
Face Value	10.0	10.0	0.0	10.0	0.0	10.0	0.0	10.0	10

(Source: Company, HDFC Sec)

Financial Estimations:

(Rs. In Million)

Particulars	FY08	FY09	*FY10 (OE)	*FY10 (RE)	FY11E
Net Interest Income	5539.4	7310.4	8598.5	8598.5	10920.2
Operating Profit	5565.9	7316.7	8396.2	8707.4	10701.8
PAT (Adjusted)	3871.9	5316.1	5983.3	6233.9	7753.3
EPS (Rs.)	40.8	56.0	63.0	65.7	81.7
Equity (Fully Diluted)	949.3	949.3	949.3	949.3	949.3
Book Value (per share)	214.8	262.0	354.2	356.8	420.9
Adj. BV [ABV] (per share)	198.2	255.3	343.6	346.3	411.5
Price / ABV (x)	3.8	2.9	2.2	2.1	1.8

* OE - Original Estimates; RE - Revised Estimates

(Source: Company, HDFC Sec Estimates)

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