

15 December 2011

# LIC Housing Finance

Reuters: **LICH.BO** Bloomberg: **LICHF IN** Exchange: **BSE** Ticker: **LICH**

## NIM pressure likely to be sustained in the near term

**Manish Shukla**Research Analyst  
(+91) 22 6658 4211  
manish.shukla@db.com**Manish Karwa**Research Analyst  
(+91) 22 6658 4212  
manish.karwa@db.com

### Near-term operating environment likely to remain challenging

We expect the near-term operating environment to remain challenging for LICHF, as NIM is likely to decline further. While retail loan momentum is stable, the company is cautious on lending to developers (we estimate loan growth of ~25% for FY12). Stable asset quality is a key positive, in our view, and a likely reason for strong outperformance of the stock. LICHF is currently trading at 1.8x FY13E P/B. Given near-term NIM concerns and a likely slower growth environment, we believe the stock is fairly valued at current levels. Maintaining Hold.

### Near-term pressure on NIM; no concerns yet on asset quality

2QFY12 NIM for LICHF dipped 33bps QoQ, to 2.45%. We expect NIMs to remain under pressure in the near term, as costs of funds have increased and are difficult to pass on fully to the lending side (50% of loan book fixed for next 9-12 months). Also, the declining share of high-yielding developer loans continues to keep overall yields under pressure. There are no concerns yet on asset quality – neither retail nor developer – but LICHF continues to monitor its developer loan book closely.

### FY12E loan growth likely to be ~25%, driven largely by retail

Individual loan growth is holding up well for LICHF. While there is some demand moderation in the larger cities like Mumbai and Delhi, demand in other centers like Chennai, Bangalore, Pune, Kolkata, etc., remains strong. Loans to developers are still shrinking, as management is not finding enough credible opportunities. Most developers are seeking term loans, while LICHF is comfortable only with project-based lending, where cash flows are escrowed. LICHF expects some uptick in developer loans in 4QFY12. We estimate FY12 loan growth of ~25%.

### Two-stage residual income valuation; risks

We lower our near-term FY12/FY13 net profit estimates by 27%/23% on account of our lower estimates for loan growth and NIM. Since we value LICHF on a two-stage residual income model (details on page 4), estimated over 10 years, we reduce our target price by ~5%, to INR195. Key upside risk: improving system liquidity, leading to lower cost of funds, and hence higher NIM. Key downside risk: high slippages from the developer loan book.

### Forecasts and ratios

Year End Mar 31	2010A	2011A	2012E	2013E	2014E
Pre-prov profit (INRm)	8,828.3	14,183.4	<b>14,821.7</b>	18,166.5	23,654.9
Net profit (INRm)	6,621.8	9,744.9	<b>8,527.0</b>	11,173.8	14,689.7
EPS (INR)	14.69	20.52	<b>17.95</b>	23.52	30.93
EPS growth	17.4	39.6	<b>-12.5</b>	31.0	31.5
PER (x)	9.2	10.4	<b>12.2</b>	9.3	7.1
Price/book (x)	2.3	2.6	<b>2.2</b>	1.8	1.5
Yield (net) (%)	2.2	1.6	<b>1.8</b>	2.3	3.0
ROE (%)	23.6	25.8	<b>19.0</b>	21.4	23.7

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

## Company Update

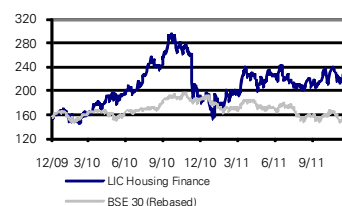
### Hold

Price at 15 Dec 2011 (INR)	<b>218.20</b>
Price target - 12mth (INR)	<b>195.00</b>
52-week range (INR)	<b>241.95 - 151.75</b>
BSE 30	<b>15,881</b>

### Key changes

Price target	205.00 to 195.00	↓	<b>-4.9%</b>
Provisioning (FYE)	995.1 to 3,452.3	↑	<b>246.9%</b>
Net int margin (FYE)	2.89 to 2.50	↓	<b>-13.6%</b>
Net profit (FYE)	11,712.5 to 8,527.0	↓	<b>-27.2%</b>

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	1.1	4.9	19.0
BSE 30	-5.9	-5.9	-19.2

### Stock data

Market cap (INRm)	<b>103,641</b>
Market cap (USDm)	<b>1,930</b>
Shares outstanding (m)	<b>475.0</b>
Major shareholders	<b>LIC (36.54%)</b>
Free float (%)	<b>63.5</b>
Avg daily value traded (USDm)	<b>13.8</b>

### Key indicators (FY1)

ROE (%)	<b>19.0</b>
Book value/share (INR)	<b>101.24</b>
Price/book (x)	<b>2.2</b>
NPL/total loans (%)	<b>0.6</b>
Net int margin (%)	<b>2.50</b>

### DB vs Consensus FY13E (INR/share)

	EPS	TP	
Mean	28.1	244	
High	32.0	299	
Low	24.1	180	
DB	18.1	195	
	BUYs	HOLDs	SELLs
	21	11	5

Source: Bloomberg Finance LP, DB

## Deutsche Bank AG/Hong Kong

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Model updated:15 December 2011

**Running the numbers****Asia****India****Other Financial Services****LIC Housing Finance**

Reuters: LICH.BO

Bloomberg: LICHF IN

**Hold**

Price (15 Dec 11) INR 218.20

Target price INR 195.00

52-week Range INR 151.75 - 241.95

Market Cap (m) INRm 103,641  
USDm 1,930**Company Profile**

LIC Housing Finance (LIC HF) was promoted by Life Insurance Corporation of India Ltd. (LIC) in 1989. LIC HF went public in 1994 and launched its maiden GDR in 2004. It is now the second largest housing finance company (HFC) in the country providing finance to individuals, corporates and developers for the purchase, construction, development and repair of houses, flats, commercial property and undeveloped areas of land.

Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
<b>Data Per Share</b>						
EPS (stated) (INR)	12.52	14.69	20.52	17.95	23.52	30.93
EPS FD (stated) (INR)	12.52	14.69	20.52	17.95	23.52	30.93
EPS FD (DB adj.) (INR)	17.11	20.22	18.35	23.94	32.23	42.37
Growth rate - EPS (stated) (%)	37.30	17.36	39.64	-12.50	31.04	31.47
DPS (INR)	2.60	3.00	3.50	3.84	5.03	6.61
BVPS (stated) (INR)	52.61	75.17	87.77	101.24	118.88	142.08
BVPS (DB adj.) (INR)	51.27	74.14	87.46	101.01	118.51	141.50
Average market cap	22,467	64,032	101,242	103,641	103,641	103,641
Shares in Issue (m)	425	475	475	475	475	475

**Valuation Ratios & Profitability Measures**

P/E (stated)	4.2	9.2	10.4	12.2	9.3	7.1
P/E FD (stated)	4.2	9.2	10.4	12.2	9.3	7.1
P/E FD (DB adj.)	3.1	6.7	11.6	9.1	6.8	5.2
P/B (stated)	0.9	2.3	2.6	2.2	1.8	1.5
P/B (DB adj.)	0.9	2.4	2.6	2.2	1.8	1.5
ROE (adj.) (%)	na	na	na	na	na	na
ROA (adj.) (%)	2.1	2.0	2.2	1.5	1.6	1.7
Dividend yield(%)	4.9	2.2	1.6	1.8	2.3	3.0
Dividend cover(x)	4.8	4.9	5.9	4.7	4.7	4.7
Payout ratio (%)	20.8	21.5	17.0	21.4	21.4	21.4

**Profit & Loss (INRm)**

Net interest revenue	7,384	8,897	13,770	14,418	17,812	23,410
Non interest income	1,475	1,847	2,576	2,698	2,968	3,264
Fees & Commissions	682	1,269	1,501	1,801	1,981	2,179
Trading Revenue	668	449	919	718	790	868
Insurance revenue	0	0	0	0	0	0
Dividend income	17	20	37	41	45	49
Other revenue	109	109	118	138	152	167
Total revenue	8,859	10,744	16,346	17,116	20,780	26,674
Total operating costs	1,542	1,916	2,162	2,294	2,613	3,019
Pre-provision profit/(loss)	7,317	8,828	14,183	14,822	18,167	23,655
Bad debt expense	53	-284	2,609	3,452	2,860	3,532
Operating Profit	7,264	9,113	11,575	11,369	15,307	20,123
Goodwill	0	0	0	0	0	0
Pre-tax associates	0	0	0	0	0	0
Extraordinary & Other Items	na	na	1,367	na	na	na
Pre-tax profit	999,999,990	999,999,990	12,942	999,999,990	999,999,990	999,999,990
Tax	1,948	2,491	3,197	2,842	4,133	5,433
Minorities	0	0	0	0	0	0
Preference dividends	0	0	0	0	0	0
Stated net profit	5,316	6,622	9,745	8,527	11,174	14,690
DB adj. core earnings	7,264	9,113	8,716	11,369	15,307	20,123

**Key Balance Sheet Items (INRm) & Capital Ratios**

Risk-weighted assets	231,945	313,420	456,259	577,178	714,162	883,390
Interest-earning assets	276,850	381,225	511,969	640,687	790,984	976,845
Total loans	279,196	382,982	513,168	643,614	795,452	982,920
Total deposits	1,618	3,262	2,458	3,195	4,154	5,400
Stated shareholders equity	22,341	33,877	41,691	48,086	56,467	67,484
Preference share capital	na	na	na	na	na	na
Tier 1 capital	22,341	33,877	41,691	48,086	56,467	67,484
Tier 1 ratio (%)	9	10	9	8	8	8
Tangible equity/ total assets (%)	8	9	8	8	7	7

**Credit Quality**

Gross NPLs / Total loans (%)	1.1	0.7	0.5	0.6	0.7	0.7
Provisions / NPLs (%)	80.9	82.4	93.8	97.2	96.8	96.3
Bad debt exp/ Avg loans (%)	0.0	-0.1	0.6	0.6	0.4	0.4

**Growth Rates & Key Ratios**

Growth in net interest income (%)	31.3	20.5	54.8	4.7	23.5	31.4
Growth in fee income (%)	29.6	86.2	18.3	20.0	10.0	10.0
Growth in non-interest income (%)	15.2	25.2	39.5	4.8	10.0	10.0
Growth in revenues (%)	28.3	21.3	52.1	4.7	21.4	28.4
Growth in costs (%)	15.3	24.2	12.9	6.1	13.9	15.5
Pre-provision earnings growth (%)	31.5	20.7	60.7	4.5	22.6	30.2
Growth in bad debts (%)	-78.4	-641.3	-1,017.3	32.3	-17.2	23.5
Growth in RWA (%)	38.2	35.1	45.6	26.5	23.7	23.7
Growth in loans (%)	25.9	37.2	34.0	25.4	23.6	23.6
Growth in deposits (%)	930.3	101.6	-24.6	30.0	30.0	30.0
Loan-to-deposits ratio (%)	17,257.9	11,740.9	20,878.1	20,142.5	19,149.6	18,202.1
Net int. margin (%)	3.0	2.7	3.1	2.5	2.5	2.6
Cost income ratio (%)	17.4	17.8	13.2	13.4	12.6	11.3
Cost asset ratio (%)	0.6	0.6	0.5	0.4	0.4	0.4
Trading income/ Total Rev (%)	7.5	4.2	5.6	4.2	3.8	3.3

**Manish Shukla**

+91 22 6658 4211

manish.shukla@db.com

Source: Company data, Deutsche Bank estimates

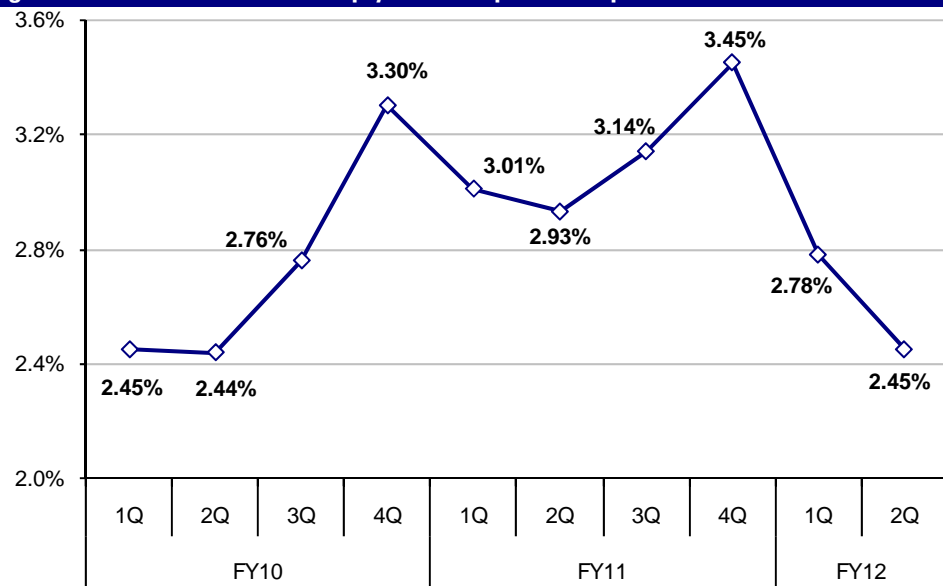
## Disbursements moderating; loan growth likely to be ~25% in FY12E

Disbursement growth has moderated to ~20% for individual loans, driven largely by loan demand from cities other than Mumbai and Delhi. Retail loan growth momentum continues to be strong, at ~30%; however, weak loan growth for the developer would result in overall loan growth of ~25% for FY12, on our estimates.

## NIM pressure near term; improvement likely from 2QFY13

Cost of funds continues to rise for LICHF, with current borrowing costs at ~10%. While the company raised its lending rates by 40bps in 3QFY12, the full benefit of this will come with a lag. A declining share of higher-yielding developer loans is pulling down the overall yield. Consequently, NIM is likely to be under pressure in the near term. Most of the retail loans for LICHF are under various fix-cum-floating schemes, where interest rates are fixed for the first few years. Under the "fix-o-floaty" scheme, interest rates are fixed at 8.9% for the first three years. These loans amount to ~INR120bn, and would start being converted into a floating rate from June 2012 onwards. The current floating rate is 11.5%. Even after factoring in some decline in interest rates over the next six months, the fix-o-floaty loans are likely to reset at a higher floating rate. This could lead to some improvement in NIM.

**Figure 1: NIM has come off sharply over the past two quarters**



Source: Company data, Deutsche Bank

## Regulatory provisions on outstanding book have been introduced

LICHF has already made various provisions for standard assets, teaser rates, etc. Incremental provisions would be required towards standard asset provisions on incremental individual loans at 40bps and on incremental developer loans at 90bps. The company has not made the 200bps standard asset provision required on teaser loans for its five-year fixed rate loans. LICHF believes that these are not teaser rate loans, and has written to the regulator (NHB) to convey this belief. It is awaiting further communication from NHB on the issue.

## Earnings, valuation and target price

### Change in our estimates

We are lowering our loan growth assumptions on account of weak growth in developer loans. In addition, we are lowering our NIM estimates due to continued pressure on yields and higher cost of funds, and are also now factoring in standard asset provisions on loans. Consequently, we reduce our net profit estimates for FY12/FY13 by 27%/23%. Figure 2 summarizes our key changes.

**Figure 2: Summary of key changes**

		Old	New	Change
<b>FY12E</b>				
Net interest income	INR m	16,973	14,418	-15.1%
PPOP	INR m	17,040	14,822	-13.0%
Provisions	INR m	995	3,452	246.9%
Net profit	INR m	11,713	8,527	-27.2%
EPS	INR	24.7	18.0	-27.2%
<b>FY13E</b>				
Net interest income	INR m	21,116	17,812	-15.6%
PPOP	INR m	21,100	18,167	-13.9%
Provisions	INR m	1,275	2,860	124.3%
Net profit	INR m	14,472	11,174	-22.8%
EPS	INR	30.5	23.5	-22.8%

Source: Deutsche Bank estimates

### Valuation and target price

We value LICHF on a two-stage residual income model. Our assumptions for the model are: an income CAGR of 11%; a dividend payout of 15%; cost of equity of 14.8% (our estimate); and a terminal growth rate of 5% (nominal growth rate for developed countries). This gives us a March 2013E-based target price of INR195, which results in a target P/BV of 1.6x on FY13E. We have reduced our target price to INR195 from INR205, as we factor in our earnings changes and our housekeeping changes to cost of equity.

**Figure 3: LICHF one-year forward P/B**



Source: Company data, Deutsche Bank

# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
LIC Housing Finance	LICH.BO	218.20 (INR) 15 Dec 11	NA

\*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

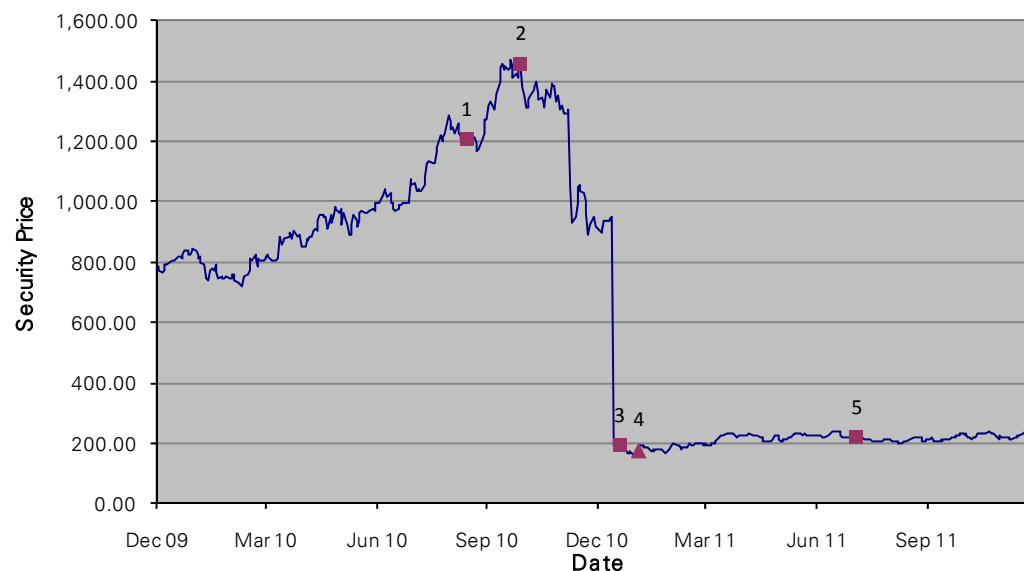
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### Historical recommendations and target price: LIC Housing Finance (LICH.BO)

(as of 12/15/2011)



#### Previous Recommendations

Strong Buy  
Buy  
Market Perform  
Underperform  
Not Rated  
Suspended Rating

#### Current Recommendations

Buy  
Hold  
Sell  
Not Rated  
Suspended Rating

\*New Recommendation Structure as of September 9, 2002

1.	30/8/2010:	Sell, Target Price Change INR1,040.00	4.	20/1/2011:	Upgrade to Hold, Target Price Change INR190.00
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## Equity rating dispersion and banking relationships

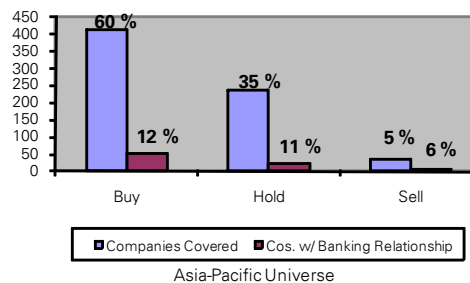
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## Deutsche Bank AG/Hong Kong

### Asia-Pacific locations

#### Deutsche Bank AG

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

#### Deutsche Bank AG

Filiale Hongkong  
International Commerce Centre,  
1 Austin Road West, Kowloon,  
Hong Kong  
Tel: (852) 2203 8888

#### Deutsche Equities India Pte Ltd

3rd Floor, Kodak House  
222, Dr D.N. Road  
Fort, Mumbai 400 001  
SEBI Nos: INB231196834  
INB011196830, INF231196834  
Tel: (91) 22 6658 4600

#### Deutsche Securities Inc.

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Japan  
Tel: (81) 3 5156 6770

#### Deutsche Bank (Malaysia) Berhad

Level 18-20  
Menara IMC  
8 Jalan Sultan Ismail  
Kuala Lumpur 50250  
Malaysia  
Tel: (60) 3 2053 6760

#### In association with Deutsche Regis Partners, Inc.

Level 23, Tower One  
Ayala Triangle, Ayala Avenue  
Makati City, Philippines  
Tel: (63) 2 894 6600

#### Deutsche Securities Korea Co.

17th Floor, YoungPoong Bldg.,  
33 SeoRin-Dong,  
Chongro-Ku, Seoul (110-752)  
Republic of Korea  
Tel: (82) 2 316 8888

#### Deutsche Bank AG Singapore

One Raffles Quay  
South Tower  
Singapore 048583  
Tel: (65) 6423 8001

#### Deutsche Securities Asia Ltd

Taiwan Branch  
Level 6  
296 Jen-Ai Road, Sec 4  
Taipei 106  
Taiwan  
Tel: (886) 2 2192 2888

#### In association with TISCO Securities Co., Ltd

TISCO Tower  
48/8 North Sathorn Road  
Bangkok 10500  
Thailand  
Tel: (66) 2 633 6470

#### In association with PT Deutsche Verdhana Indonesia

Deutsche Bank Building,  
6th Floor, Jl. Imam Bonjol No.80,  
Central Jakarta,  
Indonesia  
Tel: (62 21) 318 9541

### International locations

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60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250 2500

#### Deutsche Bank AG London

1 Great Winchester Street  
London EC2N 2EQ  
United Kingdom  
Tel: (44) 20 7545 8000

#### Deutsche Bank AG

Große Gallusstraße 10-14  
60272 Frankfurt am Main  
Germany  
Tel: (49) 69 910 00

#### Deutsche Bank AG

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

#### Deutsche Bank AG

Filiale Hongkong  
International Commerce Centre,  
1 Austin Road West, Kowloon,  
Hong Kong  
Tel: (852) 2203 8888

#### Deutsche Securities Inc.

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
Japan  
Tel: (81) 3 5156 6770

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