Q4FY10 Result Update

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LIC Housing Finance Ltd. (LICHFL) recently came out with its Q4FY10 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 Q4FY10 increased by 21.8% to Rs. 9629.4 mn [Q4FY09: Rs. 7904.8 mn]. The Net Interest Income grew by 40.9% to Rs. 2979.7 mn [Q4FY09: Rs. 2114.9 mn]. LICHFL recorded higher net interest margins of 3.3% in Q4FY10 as compared to 3.2% in Q4FY09, mainly due to significant decline in the cost of funds from 9.15% in Q4FY09 to 7.8% in Q4FY10. The yield on advances reduced from 11.2% in Q4FY09 to 10.15% in Q4FY10. The interest spread was 2.35% in Q4FY10 vs. 2.05% in Q4FY09. Even the incremental spreads improved from 2.06% in Q4FY09 to 3.12% in Q4FY10 due to lower re-pricing of liabilities and higher proportion of project loans at 25.2% in incremental disbursements (in Q4FY09, project loans proportion to the total disbursement stood at 21.2%). Yield on Project loans is normally higher at ~14%.
- However, the operating profit grew by 30.8%, lower than in line with NII growth. This was on the back of decline in the other income (down 5.3% due to lower miscellaneous income) and higher staff cost (up 60.8%). The staff cost increased due to performance-linked incentives provided by LICHFL in Q4FY10. The other operating expenses increased by 32.1%. Amongst the other operating expenses, the commission & brokerage expenses rose 65.6%, while the advertisement expenses rose 36.3%. The processing fees received during the quarter increased by 50.5%.
- Strong recovery efforts and rectification of technical factors that caused sharp slippages in Q3FY10 pulled down gross NPAs, which declined by 11% Y-o-Y. Consequently, the company reported a net provision write-back of Rs. 125.6 mn in Q4FY10 (Rs. 13.3 provision write-off in Q4FY09), which boosted the earnings. PBT increased by 37.4% to Rs. 2981.8 mn [Q4FY09: Rs. 2170.5 mn]. However, the effective tax rate on PBT rose from 27.4% in Q4FY09 to 28.4% in Q4FY10. PAT rose 35.5% to Rs. 2135.1 mn [Q4FY09: Rs. 1575.6 mn]. The EPS for the quarter stood at Rs. 22.5 (calculated on fully diluted equity of Rs. 949.3 mn) vs Rs. 18.6 in Q4FY09 (calculated on original equity of Rs. 849.3 mn).
- Disbursements grew by 61% to Rs. 50615.9 mn in Q4FY10 as compared to Rs. 31430 mn during Q4FY09. Sanctions grew by 30.8% to Rs. 46294.9 mn [Q4FY09: Rs. 35390 mn]. Retail disbursements constituted 74.8% in Q4FY10 & the rest went to developers. The retail disbursements rose 52.8%, while the retail sanctions grew by 35.2% (Y-o-Y). The disbursements to developers rose 91.8% during the quarter.

➢ **Quarterly Review on Q-o-Q basis**

- Sequentially, Net Interest income rose 30.7%, while the NIMs improved from 2.76% in Q3FY10 to 3.3%. While the cost of funds reduced by 29 bps from 8.08% in Q3FY10, the yield on advances improved by 12 bps from 10.03%. Even the incremental spreads have moved up from 3% in Q3FY10 to 3.1% in Q4FY10.
- Asset quality improved significantly as the Gross NPAs in absolute terms declined sharply by 46.4% from Rs. 4908 mn in Q3FY10 to Rs. 2631.5 mn in Q4FY10 (in % terms from 1.44% in Q3FY10 to 0.69% in Q4FY10), while the Net NPAs reduced by 82.4% from Rs. 2636 mn in Q3FY10 to Rs. 463.6 mn (in % terms from 0.77% in Q3FY10 to 0.12% in Q4FY10). Gross NPAs had increased in Q3FY10 mainly due to a technology problem faced in November while upgrading the IT systems. However, strong recovery efforts and rectification of technical factors pulled down the gross NPAs significantly.
- The disbursements increased by 40.4% from Rs. 36042 mn in Q3FY10, while the sanctions rose marginally by 2.5% from Rs. 45155.7 mn in Q3FY10. While the Sanctions in the individual loan segment rose 45.7% (Q-o-Q), in the project loan segment, they declined by 67.7%. However, the disbursements in both individual & project loan segments rose 26.4% & 109.3% respectively.
- The operating profit rose 22.9%, lower than in line with the NII growth rate. This was due to higher other operating expenses (up 63.4%) and lower processing fees received (down 7%). However, staff cost reduced by 2.7% Q-o-Q. Provision write backs of Rs. 125.6 mn during the quarter (as compared to write-off of Rs. 158.4 mn in Q3FY10) & decline in the effective tax rate (reduction of 66 bps from 29.1% in Q3FY10) boosted the net profits, which grew by 39%.

➢ **Full Year comparison**

- LICHFL surpassed our estimations of Net Interest Income & PAT for FY10. NII & PAT grew by 21.3% & 24.6% to Rs. 8869.4 mn & Rs. 6621.8 mn respectively over FY09 as compared to the estimated NII & PAT of Rs. 8598.8 mn & Rs. 6233.9 mn respectively. EPS for FY10 stood at Rs. 69.8 [Rs. 56 in FY09] vs. the estimated EPS of Rs. 65.7.
- However, the NIMs (annualized) declined from 2.95% in FY09 to 2.7% in FY10 mainly due to aggressive pricing of loans during the year, which resulted in NIMs falling in the first three quarters of FY10. By the end of FY11, the company expects NIMs to settle at around 3%.
- For FY10, LICHFL sanctioned loans worth Rs. 180.4 bn, an increase of 65.6% over FY09. It disbursed Rs. 148.5 bn, a growth of 69.5 % over FY09. The management has targeted 30-40% growth in disbursement.
- The Outstanding Mortgage Portfolio as on March 31, 2010 was Rs. 380.8 bn as against Rs. 276.8 bn as on March 31, 2009, thus registering a growth of 37.6%. Of this, the project loans (loans to builders & developers) amounted to Rs. 41.3 bn, an

increase of almost 70.3% over FY09. Of the total outstanding asset portfolio, around 85% of the loans (assets) were on floating rate basis in FY10.

- LICHFL's asset quality improved significantly as the Gross NPAs stood at Rs. 2631.5 mn (0.69%) in FY10 vs. Rs. 2970.8 mn (1.07%). The Net NPAs also declined significantly to Rs. 463.6 mn (0.1%) in FY10 from Rs. 568.3 mn (0.2%) in FY09. The management expects the Gross NPAs to be 0.5% or lower in FY11.
- The provision cover on the NPAs stood at 82.4% for FY10, which increased from 81% in FY09.
- The company has changed its accounting policy with effect from Q2FY10 resulting into lower provisioning on Housing policy categorized as standard asset for retail & project loans. Earlier the company used to provide for higher provisioning though not required by National Housing Bank directions 2001. Had this practice been followed for Q4FY09 and FY09, the PBT for Q4FY09 and FY09 would have been Rs. 2,219 mn and Rs. 7,635 mn respectively. Accordingly PBT would have been higher by 34.3% for Q4FY10 and 19.4% for FY10 (instead of growth of 37.4% & 25.4% respectively).
- LICHFL's borrowings as on March 31, 2010 stood at Rs. 347.6 bn vs. Rs. 254.1 bn as on March 31, 2009. The sources of borrowings include banks (33%), NCDs (52%), LIC (4%), National Housing Bank (5-6%) & others (incl. public deposits, commercial papers, etc.). Around 48% of the sourcing of funds is done on a floating rate basis.
- As on March 31, 2010 the loan to value ratio was 58% and installment to income ratio was 34.5% [As on March 31, 2009: Loan to value ratio was 48% & Installment to income ratio was 38.2%].

Other Key Highlights:

- LICHFL's number of active agents as on March 31, 2010 were ~5000.
- LICHFL's CAR at the end of Q4FY10 stood at 15.2% (as against the regulatory requirement of 10%). The sale of its partial stake in LIC Mutual Fund (17.3% amounting to Rs. 1380 mn) to Nomura is yet to take place since the regulatory clearances are pending from RBI & SEBI. The same is expected to reflect in Q1FY11. That could increase the CAR further.
- LICHFL has plans to foray into banking business. The company is planning to apply for a banking licence, if it qualifies after the RBI issues guidelines on issue of fresh licences for private sector companies. Even if its parent company, LIC, is not able to partner the venture, then LICHFL will go ahead with its plans of starting a bank if the company finds itself eligible under the proposed RBI guidelines.
- LICHFL will also start operations of its real estate venture capital fund in the next six months with an initial seed capital of Rs. 5 bn. About 20% of the capital will be from LIC and LICHFL and the remaining would be mobilised from HNIs (high net worth individuals) and institutions. The company had plans of roping in a joint venture partner for this, but decided against it. Now, it will be a subsidiary where LIC & LICHFL would be majority shareholders. It will invest in real estate projects in residential and commercial areas.
- In March 2010, LICHFL decided to take over the entire staff home loan portfolio of LIC, which has resulted in transfer of 35,000 accounts estimated at about Rs. 13 bn to the company from April 01, 2010. For LICHFL, it will mean a new market and addition to its total loan portfolio. All the new loans will be handled by LICHFL. With LIC raising employees' home loan limit (almost doubling the cadre limit) and granting loan for a second home, LICHFL expects substantial fresh business from this deal.
- LICHFL also has plans to raise Rs. 200 bn during FY10 through non-convertible debentures and public deposits.

Conclusion & Recommendation:

LICHFL continues to report robust growth in sanctions & disbursements. In FY10, the sanctions & disbursements increased by 65.6% & 69.5% respectively on the back of traction in both individual & project segment. The management is confident of achieving Y-o-Y growth of 30-40% in its disbursement in FY11. The company has also witnessed a sharp improvement in its asset quality. With strong recovery efforts, it has managed to reduce its Gross NPAs from 1.07% in FY09 to 0.69% in FY10. Even with the aggressive growth targets, the management expects the Gross NPAs to be 0.5% or lower in FY11.

LICHFL's annualized NIMs for FY10 declined by 25 bps to 2.7% mainly because of the aggressive pricing of its loans during the year, which resulted in the NIMs falling in the first three quarters of FY10 (Y-o-Y). However, sequentially there has been a market improvement in the NIMs in Q3FY10 & Q4FY10 on the back of re-pricing of high cost borrowings. Also the QIP issue of Rs. 6.6 bn in Q2FY10 partly contributed towards the improvement in NIMs. The management expects the NIMs to improve to 3% in FY11 on the back of lower cost of funds and higher proportion of project loans (up from 8.8% in FY09 to 10.9% in FY10). Also, the partial stake sale of LIC Mutual Fund (17.3%), which is expected to be reflected in Q1FY11 could take care of the incremental borrowings & support the NIMs. However, it is to be noted that the increasing proportion of project loans also increases the risk of rise in NPAs during the market downturn.

LICHFL's liability profile seems to be well positioned. Around 48% of its liabilities are on floating rate basis, while on the asset side, 85% of the home loans carry a floating rate. Hence, in the event of rate hikes, LICHFL would actually benefit in terms of improvement in its NIMs (however the demand for fresh loans could get impacted).

LICHFL surpassed our estimations of Net Interest Income & PAT for FY10. NII & PAT grew by 21.3% & 24.6% to Rs. 8869.4 mn & Rs. 6621.8 mn respectively over FY09 as compared to the estimated NII & PAT of Rs. 8598.8 mn & Rs. 6233.9 mn respectively. EPS for FY10 stood at Rs. 69.8 [Rs. 56 in FY09] vs. the estimated EPS of Rs. 65.7. We feel that the company would be able to achieve FY11 NII growth in line with our estimates while it could surpass our PAT estimates. However, we are maintaining our FY11 projections and would review the same post the Q1FY11 results.

LICHFL has witnessed a re-rating in its share price since March 2009 on the back of sharp improvement in its asset quality & more visibility on future business growth. While the Sensex has increased ~108% during March 2009 - April 2010, the stock has risen almost 375% during that period. At the CMP of Rs. 957.7, the stock trades at 11.7xFY11E EPS and 2.2xFY11E P/ABV. In our Q3FY10 results review, we recommended 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. Thereafter the stock touched a low of Rs. 710 on Feb 23, 2010 and subsequently made a high of Rs. 969.9 on May 03, 2010. Though the future prospects of the company continue to look bright, we feel that the scope for further upside from the current levels is limited. Hence for more margin of safety, one should enter the scrip at lower levels in the price band of Rs. 830-870 for a price target of Rs. 1022 (2.4xFY11E P/AVB) over the next quarter.

Quarterly Details:

(Rs. In Million)

Particulars	Q4FY10	Q4FY09	VAR [%]	Q3FY10	VAR [%] (Q-o-Q)	Q3FY09	VAR [%] (Y-o-Y)	Q2FY10	Q1FY10
Interest Income	9193.3	7544.3	21.9	8336.1	10.3	7343.3	13.5	7846.8	7450.5
Interest Expenses	6213.6	5429.4	14.4	6056.6	2.6	5344.6	13.3	5978.5	5708.6
Net Interest Income	2979.7	2114.9	40.9	2279.5	30.7	1998.7	14.0	1868.3	1741.9
Other Income	489.4	516.6	-5.3	468.5	4.5	323.3	44.9	544.1	368.4
Processing Fees	343	227.9	50.5	368.7	-7.0	163.3	125.8	337	225
Miscellaneous Income	146.4	288.7	-49.3	99.8	46.7	160.0	-37.6	207.1	143.4
Operating Income	3469.1	2631.5	31.8	2748.0	26.2	2322.0	18.3	2412.4	2110.3
Operating Expenses	612.9	447.7	36.9	424.7	44.3	492.3	-13.7	551.4	322.3
Staff cost	119.5	74.3	60.8	122.8	-2.7	206.3	-40.5	143.6	99.0
Other Operating Expenses	493.4	373.4	32.1	301.9	63.4	286.0	5.6	407.8	223.3
Operating Profit	2856.2	2183.8	30.8	2323.3	22.9	1829.7	27.0	1861.0	1788.0
Provisions & Write offs	-125.6	13.3	-	158.4	-	7.5	2020.5	-417	100
Profit before taxes	2981.8	2170.5	37.4	2164.9	37.7	1822.3	18.8	2278.0	1688.0
Taxes	846.7	594.9	42.3	629.1	34.6	479.0	31.3	565.5	449.6
PAT	2135.1	1575.6	35.5	1535.8	39.0	1343.3	14.3	1712.5	1238.4
EPS	22.5	18.6	21.2	16.2	39.0	15.8	2.3	18.0	14.6
Equity	949.3	849.3	11.8	949.3	0.0	849.3	11.8	949.3	849.3
Face Value	10	10	0.0	10	0.0	10.0	0.0	10.0	10.0

(Source: Company, HDFC Sec)

Financial Estimations:

(Rs. In Million)

Particulars	FY08	FY09	FY10 (OE)	FY10 (Act)	FY11E
Net Interest Income	5539.4	7310.4	8598.5	8869.4	10920.2
Operating Profit	5565.9	7316.7	8396.2	8829.3	10701.7
PAT (Adjusted)	3871.9	5316.1	6233.9	6621.8	7753.3
EPS (Rs.)	40.8	56.0	65.7	69.8	81.7
Equity (Fully Diluted)	949.3	949.3	949.3	949.3	949.3
Book Value (per share)	214.8	262.0	356.8	357.0	432.2
Adj. BV [ABV] (per share)	198.2	255.3	346.3	352.1	425.9
Price / ABV (x)	4.8	3.8	2.8	2.7	2.2

* OE - Original Estimates

(Source: Company, HDFC Sec Estimates)

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