

Equities

10 January 2011 | 9 pages

LIC Housing Finance (LICH.BO)

Risks Increasing at the Margin

- Maintain Sell (3M) on increasing risks to NIMs** — We are reducing our target price on LIC Housing to Rs170 per share (from Rs262) as we believe the increasing risks to its NIMs, reducing mortgage profitability, and recent adverse developments at the company will likely result in a contraction of its valuation multiples. We expect the continuing rise in cost of wholesale funds to pressure NIMs for wholesale borrowers and especially for LIC Housing due to the higher competitive intensity in the mortgage segment. Our revised target is based on 1.6x FY12E P/BV (from 2.5x earlier) and is at ~10% premium, to its 3yr average P/BV multiple of 1.5x.
- Tight liquidity is impacting cost of funds** — India's banking system liquidity has continued to remain tight and has significantly raised wholesale funding costs over recent months – 1 year commercial paper rates have increased by 150bps to 9.8% since Oct 2010. LICHF's incremental cost of funding has also gone up and it recently raised Rs7.5bn through 3-year non-convertible debentures at 9.4%.
- Higher fixed rate lending, competition likely increases NIM risks** — LICHF's incremental lending is mostly under its fixed rate schemes - 9.5% fixed for 5 years and floating thereafter – and over 10% of its total loans are now at fixed rates. While it has raised its PLR in October 2010 (50bps, raises rates on outstanding floating book), we believe, sustaining margins at current levels will be a challenge as proportion of fixed rate loans is rising fast and also due to the high competition in the segment, which is likely to keep lending rates under pressure.
- Minimal impact on loan growth, quality; raise earnings 2%-3%** — LICHF's new management believes that there has been minimal impact of the recent unforeseen developments on its business fundamentals – loan growth has remained strong and so has asset quality (even on the loans allegedly provided on graft by the previous CEO). We are raising our loan growth estimates to 35% for FY11E (31% earlier) and our earnings estimates by 2%-3% over FY11-13E.

- Company Update
- Target Price Change
- Estimate Change

Sell/Medium Risk	3M
Price (07 Jan 11)	Rs180.15
Target price	Rs170.00
	from Rs262.00
Expected share price return	-5.6%
Expected dividend yield	1.8%
Expected total return	-3.9%
Market Cap	Rs85,511M
	US\$1,885M

Price Performance (RIC: LICH.BO, BB: LICHF IN)



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	5,316	12.51	37.3	14.4	3.4	26.2	1.4
2010A	6,622	14.72	17.6	12.2	2.5	23.6	1.7
2011E	9,585	20.18	37.1	8.9	2.0	25.3	1.8
2012E	10,391	21.88	8.4	8.2	1.7	22.6	1.9
2013E	12,562	26.45	20.9	6.8	1.4	22.6	2.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	14.4	12.2	8.9	8.2	6.8
P/E reported (x)	14.4	12.2	8.9	8.2	6.8
P/BV (x)	3.4	2.5	2.0	1.7	1.4
P/Adjusted BV diluted (x)	3.5	2.6	2.1	1.7	1.4
Dividend yield (%)	1.4	1.7	1.8	1.9	2.0
Per Share Data (Rs)					
EPS adjusted	12.51	14.72	20.18	21.88	26.45
EPS reported	12.51	14.72	20.18	21.88	26.45
BVPS	52.57	71.32	87.90	105.95	128.35
Tangible BVPS	52.57	71.32	87.90	105.95	128.35
Adjusted BVPS diluted	51.23	70.35	86.36	103.33	124.37
DPS	2.60	3.00	3.20	3.40	3.60
Profit & Loss (RsM)					
Net interest income	7,400	8,906	12,618	15,064	18,254
Fees and commissions	682	1,274	1,579	1,927	2,351
Other operating Income	678	560	1,935	696	671
Total operating income	8,760	10,739	16,133	17,687	21,275
Total operating expenses	-1,542	-1,920	-2,164	-2,502	-2,899
Oper. profit bef. provisions	7,217	8,819	13,969	15,186	18,376
Bad debt provisions	-53	283	-275	-341	-430
Non-operating/exceptionals	99	10	0	0	0
Pre-tax profit	7,264	9,113	13,694	14,844	17,946
Tax	-1,948	-2,491	-4,108	-4,453	-5,384
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	5,316	6,622	9,585	10,391	12,562
Adjusted earnings	5,316	6,622	9,585	10,391	12,562
Growth Rates (%)					
EPS adjusted	37.3	17.6	37.1	8.4	20.9
Oper. profit bef. prov.	32.2	22.2	58.4	8.7	21.0
Balance Sheet (RsM)					
Total assets	293,823	402,419	519,311	642,035	773,086
Avg interest earning assets	262,331	345,537	457,714	577,284	703,896
Customer loans	279,193	382,985	518,480	645,984	782,334
Gross NPLs	2,970	2,632	3,090	3,796	4,623
Liab. & shar. funds	293,823	402,419	519,311	642,035	773,086
Total customer deposits	1,618	3,262	3,914	4,697	5,167
Reserve for loan losses	2,400	2,172	2,355	2,549	2,730
Shareholders' equity	22,341	33,877	41,752	50,327	60,965
Profitability/Solvency Ratios (%)					
ROE adjusted	26.2	23.6	25.3	22.6	22.6
Net interest margin	2.82	2.58	2.76	2.61	2.59
Cost/income ratio	17.6	17.9	13.4	14.1	13.6
Cash cost/average assets	0.6	0.6	0.5	0.4	0.4
NPLs/customer loans	1.1	0.7	0.6	0.6	0.6
Reserve for loan losses/NPLs	80.8	82.5	76.2	67.1	59.1
Bad debt prov./avg. cust. loans	0.0	-0.1	0.1	0.1	0.1
Loans/deposit ratio	17,257.7	11,741.0	13,245.7	13,752.6	15,141.2
Tier 1 capital ratio	9.2	11.2	10.3	10.1	10.1
Total capital ratio	13.5	15.9	13.8	12.9	12.5

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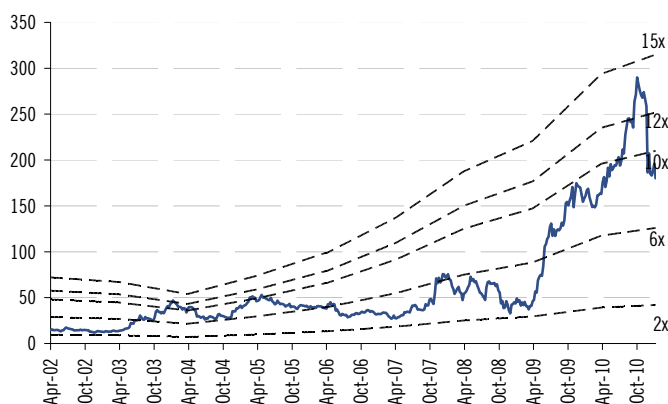


Figure 1. LICHF — Earnings Revision Summary

	Net Profit (RsM)			EPS (Rs)			DPS (Rs)	
	Old	New	% change	Old	New	% change	Old	New
FY11E	9,303	9,585	3.0	19.59	20.18	3.0	3.2	3.2
FY12E	10,148	10,391	2.4	21.36	21.88	2.4	3.4	3.4
FY13E	12,288	12,562	2.2	25.87	26.45	2.2	3.6	3.6

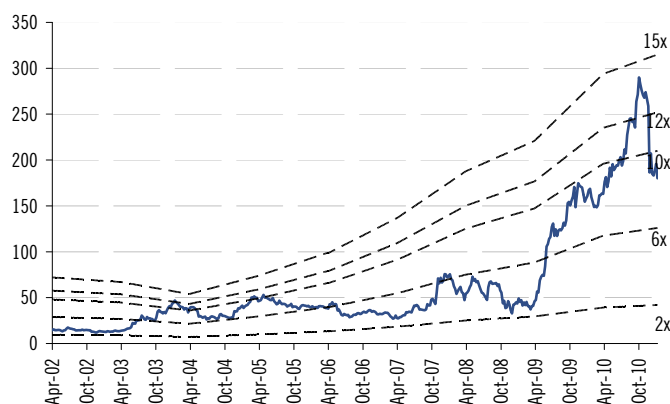
Source: Citi Investment Research and Analysis estimates

Figure 2. LICHF — P/E Band Chart



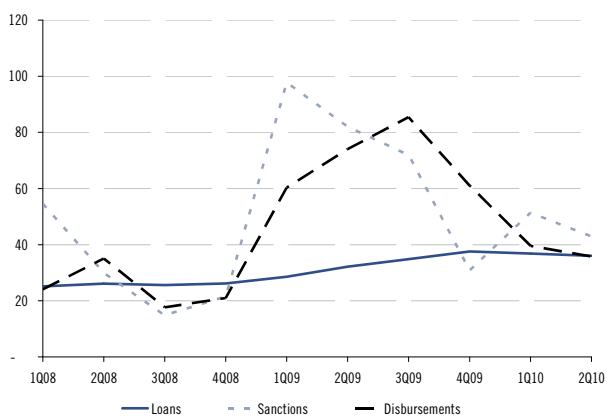
Source: Company Reports and CIRA Estimates

Figure 3. LICHF — P/B Band Chart



Source: Company Reports and CIRA Estimates

Figure 4. LICHF — Loans, Sanctions and Disbursements Growth (% YoY)



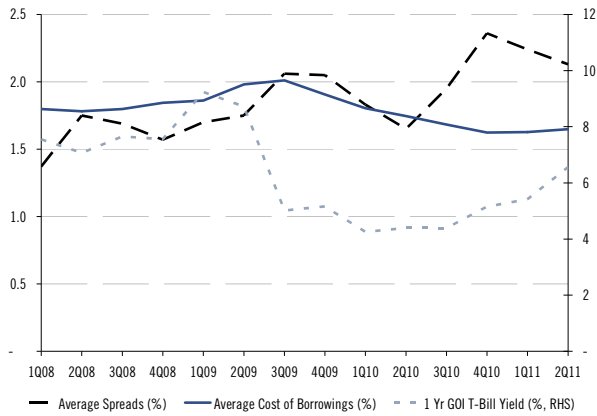
Source: Company Reports

Figure 5. LICHF — 1Yr GOI T-Bill and Incremental Spreads (%)



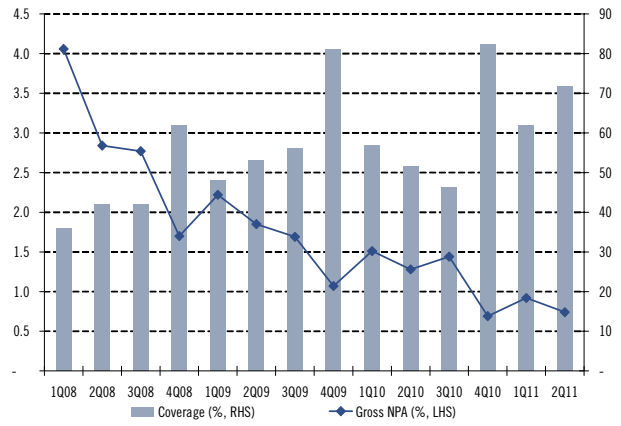
Source: Company Reports

Figure 6. LICHF — Average Spreads, Cost of Borrowing and 1Yr GOI T-Bill (%)



Source: Company Reports

Figure 7. LICHF — Gross NPLs and Coverage Ratios (%)



Source: Company Reports

LIC Housing Finance

Valuation

We value LIC Housing shares at Rs170 per share based on 1.6x one-year forward P/BV (FY12E). LIC Housing's historical trading range is 0.5x - 1.5x one-year forward P/BV and the stock is trading at a premium to its own history. We believe part of this is warranted going forward given the company's significant improvements in its market position, asset quality and return profile. However, we also benchmark LIC Housing to other non-banking finance companies in India and believe that it should trade at a discount to peers due to its lower return profile, weaker and inconsistent track record on asset quality and significantly higher competition levels in the mortgage segment. Our target price is also at a discount to our target multiples for private sector banks (2.0x – 3.0x one-year forward P/BV).

We also see a fair value basis for LIC Housing shares at Rs179 based on CIRA's EVA model, which captures the long-term value of the business, and is a standard valuation measure for the CIRA India Banking coverage. Our EVA model assumes: a) risk-free rate of 8.0% in line with our assumptions for other banks; b) longer-term loan loss provisions of 20bps given its low asset risk profile, c) loan spreads of 170bps which is slightly lower than banking industry averages of 200bps, and d) long-term fee income growth of 10%.

Risks

We rate LIC Housing shares Medium Risk, in-line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks that could cause the stock to continue to trade above our target price include: a) Stronger-than-expected economic and more specifically mortgage financing growth, b) Reversal towards a lower interest rate / easy liquidity environment which could support its net interest margins, c) Continued robust asset quality environment in the mortgage segment, d) Any decrease in competitive intensity, and e) Any regulatory changes.

Appendix A-1

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Ratings and Target Price History Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since November 9 2009

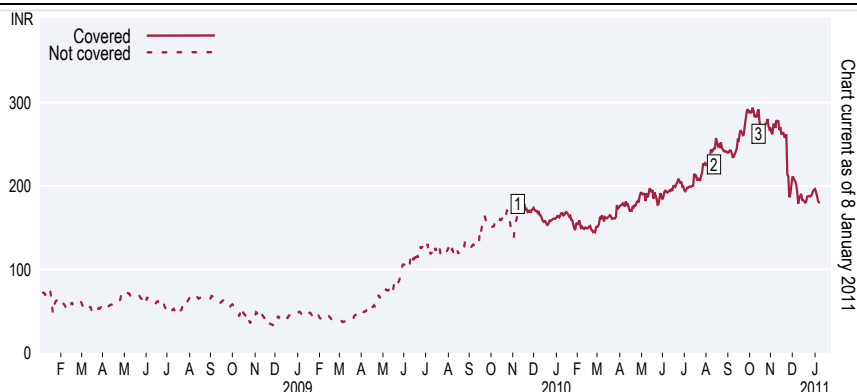


Chart current as of 8 January 2011

	Date	Rating	Target Price	Closing Price
1	9-Nov-09	*3M	*148.00	178.47

	Date	Rating	Target Price	Closing Price
2	12-Aug-10	3M	*210.80	244.94

	Date	Rating	Target Price	Closing Price
3	14-Oct-10	3M	*262.00	291.61

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

LIC Housing Finance (LICH.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since November 9 2009

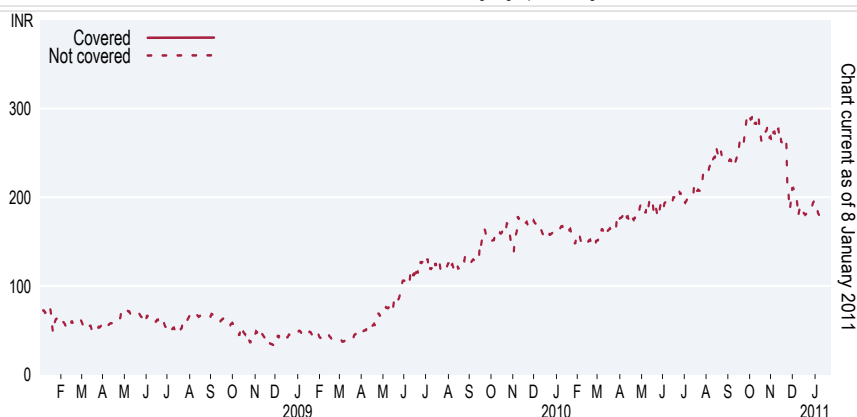


Chart current as of 8 January 2011

* Indicates change

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