

**BUY**

TP: INR 310.00

▲ 13.2%

## LIC Housing Finance

LICHF IN

### Loan growth healthy but NIM expansion limited

We recently interacted with the management of LICHF. Disbursements have remained strong in the retail segment despite rising competitive intensity. However, growth in the developer portfolio is likely to be muted in FY13. NIM expansion (from Q1FY13 levels) will also be limited as the rising cost of funds will offset re-pricing benefits on fixed loans. We expect FY13 NIMs to decline by 10bps and improve only marginally in FY14. Earnings growth, however, would be driven by business growth and healthy asset quality.

- ➔ **Retail disbursements to grow 20% in FY13:** Retail disbursement growth was strong at 29% YoY in Q1FY13 and the management expects a robust 15-20% uptick in Q2FY13 as well. However, project disbursements will remain low at ~Rs 3-3.5bn. Consequently, the proportion of developer loans could decline further to 4.4% by September'12 (as against 5% in Mar'12 and 4.6% in Jun'12).
- ➔ **NIM disappointment likely to continue:** Yield on advances could increase by 25bps YoY in FY13 due to re-pricing of three-year fixed-rate loans; however, the higher cost of funds would still lead to ~10bps NIM compression in FY13 to ~2.4%. FY14 NIMs would improve only marginally (to 2.45-2.5%) as asset re-pricing benefits will largely play out by Q1FY14. A sharp increase in competition and PLR cuts could put further pressure on NIMs. However, upside risks to NIMs could emanate from a sharp pick-up in the developer loan portfolio and equity dilution.
- ➔ **Valuations reasonable at 1.9x FY14E BV but near-term re-rating potential limited:** LICHF has done well YTD due to strong business growth and low risks on asset quality. While we like the stock due to its presence in the mortgage segment, we believe that subdued NIMs and increasing competitive intensity would restrict any re-rating from current levels in the near term. We note that ROEs have declined from an average of 25% over FY08-FY11 to ~19% in FY12-FY13. We roll forward to a September'13 TP of Rs 310/sh, where the stock would trade at 2.0x FY14E BV and 11x FY14E EPS.

### Financial Highlights

Y/E 31 Mar	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income (INR mln)	13,719	13,916	16,661	21,276	26,011
Net revenues (INR mln)	17,710	16,241	19,348	24,277	29,545
Pre-provision profits (INR mln)	15,550	13,870	16,634	20,989	25,683
Adj. PAT (INR mln)	9,745	9,142	11,618	14,552	17,867
Adj. EPS (INR)	20.5	18.1	23.0	28.8	35.4
ROE (%)	25.8	18.6	19.0	20.5	21.5
ROA (%)	2.2	1.6	1.7	1.7	1.7
Gross NPA (%)	0.5	0.4	0.5	0.6	0.6
CAR (%)	14.9	16.7	16.0	15.2	14.7
P/BV (x)	2.6	2.3	2.1	1.8	1.5
P/E (x)	11.0	14.5	11.9	9.5	7.7

Source: Company, Bloomberg, RCML Research

26 September 2012



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PRICE CLOSE (26 Sep 12)

INR 273.75

MARKET CAP

INR 138,151 mln

USD 2,580 mln

SHARES O/S

504.7 mln

FREE FLOAT

59.7%

3M AVG DAILY VOLUME./VALUE

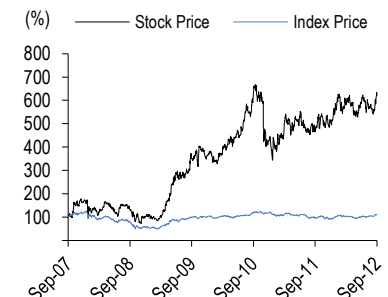
1.9 mln/ USD 9.1 mln

52 WK HIGH

INR 279.30

52 WK LOW

INR 208.50





## Near-term margin disappointment likely to continue

### NIMs could decline further in FY13

LICHF has reported sharp compression in interest spread and NIMs in FY12 due to a rise in cost of funds, an increase in proportion of fixed-rate loans in individual loan portfolios and a decline in loans to developers. Yield on advances increased by 46bps in FY12; however, the cost of funds increased by 130bps during the same period. As a result, NIMs declined from 3.14% in FY11 to 2.51% in FY12. NIMs have further fallen to 2.18% in Q1FY13 as the cost of funds increased by 36bps QoQ to 9.58%.

**Fig 1 - NIMs have declined significantly in FY12**

(%)	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Yield on advances	9.3	10.3	11.1	10.0	10.0	10.5	10.8	10.8	10.8
Cost of funds	7.4	8.1	8.8	8.0	7.7	9.1	9.4	9.3	9.2
Interest spread	1.9	2.2	2.3	2.0	2.3	1.4	1.4	1.5	1.6
NIMs	2.4	2.8	2.9	2.7	3.1	2.5	2.4	2.5	2.5

Source: RCML Research, Company

We expect NIMs to improve from Q1FY13 levels as the company would benefit from the re-pricing of its teaser-rate loan portfolio. We note that LICHF currently has a three-year fixed-rate home loan portfolio of ~Rs 125bn which will be re-priced at a floating rate over Q2FY13 to Q1FY14 (current yield on these loans is ~8.9%; re-pricing could increase yields by 250-300bps). It also has a five-year fixed-rate loan portfolio of ~Rs 100bn which is generating yields of 9.25%. However, this will be re-priced only from FY16 onwards. The other fixed-rate home loan portfolio is worth ~Rs 80bn. Overall, ~48% of the total individual loan portfolio was fixed in nature at the end of June'12.

The market was earlier expecting significant NIM improvement in FY13 due to re-pricing of the company's three-year teaser-rate loan portfolio. However, we believe that NIM improvement is unlikely in FY13 (although it is likely to improve from Q1FY13 levels) due to the higher cost of funds.

**Fig 2 - Quarterly trend in NIMs**

(%)	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13	Q2FY13	Q3FY13	Q4FY13
Yield on advances	10.35	10.62	10.45	10.70	10.72	10.69	10.68	10.84	10.95	11.18
Cost of funds	7.99	8.01	8.66	9.25	9.40	9.22	9.58	9.65	9.65	9.60
Interest spread	2.36	2.61	1.79	1.45	1.32	1.47	1.10	1.19	1.30	1.58
NIMs	3.14	3.45	2.78	2.45	2.27	2.44	2.18	2.25	2.43	2.58

Source: RCML Research, Company

As per our calculations, the overall yield on advances could rise by 25bps in FY13 with asset re-pricing contributing 12-15bps of this growth. However, we believe that the higher yields would be offset by a higher cost of borrowings. We note that LICHF's reported cost of funds stood at 9.58% in Q1FY13 (as against ~9.1% in FY12). The incremental cost of funds was ~9.9% in Q1FY13. While wholesale rates have softened in H1FY13 and 12-month CP rates have fallen by ~200bps, the impact on LICHF would be limited as AAA bonds & debentures and bank loans (constituting ~90% of the company's total borrowings) have fallen by only 20-30bps.

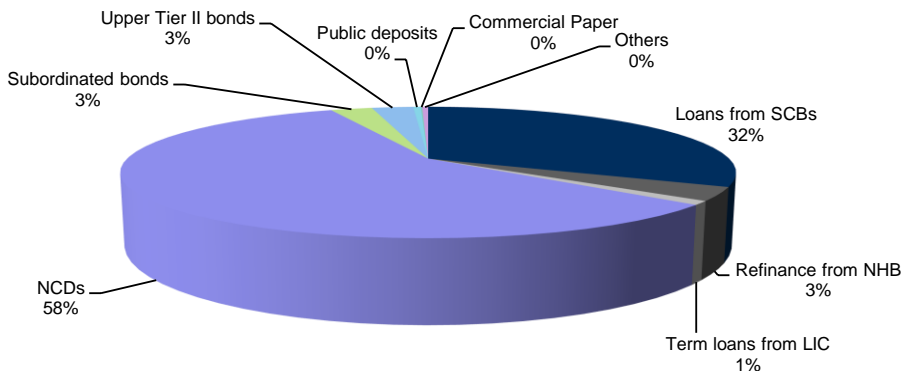
**NIMs fell from 3.14% in FY11 to 2.18% in Q1FY13 as cost of funds increased**

**Rising cost of funds to cap benefits from fixed rate loan re-pricing**

**Borrowing cost on AAA bonds, debentures and bank loans remains high**

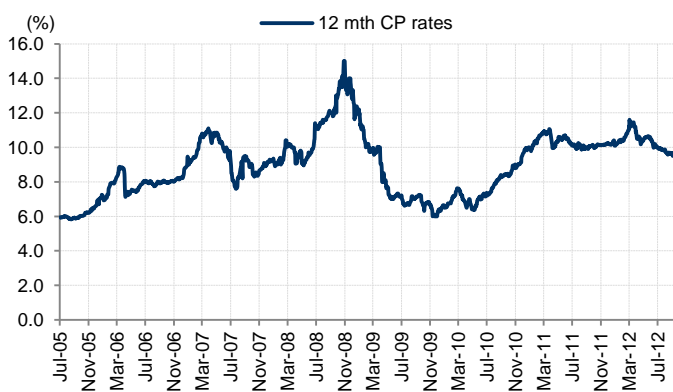


**Fig 3 - Borrowing profile – FY12**



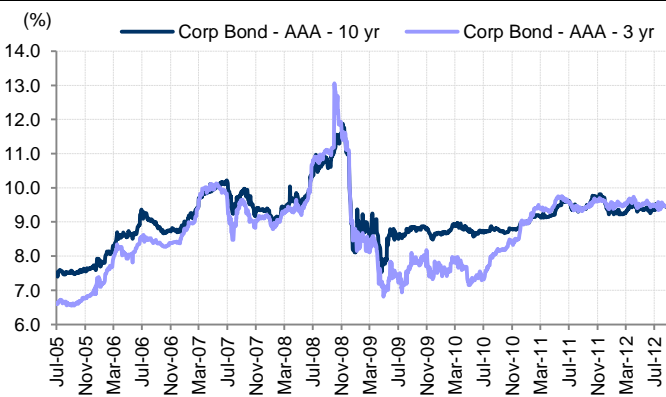
Source: RCML Research, Company

**Fig 4 - CP rates lower by ~200bps from peak in Mar'12...**



Source: RCML Research, Bloomberg

**Fig 5 - ...however, AAA bonds declined by only ~20-30bps**



Source: RCML Research, Bloomberg

LICHF would also be adversely affected by higher re-pricing of NCDs. Over Q2FY13-Q4FY13, ~Rs 42bn of NCD borrowings are likely to be re-priced upward (currently priced at 7.9-8.9%). We are factoring in a 32bps increase in cost of funds in FY13. Consequently, NIMs are likely to decline by ~10bps to 2.4%.

**We factor in 32bps increase in cost of funds in FY13**

**Fig 6 - NCD borrowings of ~Rs 42bn to be re-priced upwards in next three quarters**

	Amount maturing (Rs mn)	Blended rate of interest (%)	% of total NCD borrowings
Q1FY13	20,400	8.3%	6.4
Q2FY13	19,150	7.9%	6.0
Q3FY13	14,610	8.9%	4.6
Q4FY13	8,150	8.6%	2.5
Q1FY14	17,560	8.7%	5.5
Q2FY14	33,450	9.1%	10.4
Q3FY14	9,750	9.5%	3.0
Q4FY14	9,500	9.8%	3.0
FY15	31,850	9.8%	9.9

Source: RCML Research, Company



### NIMs to improve marginally in FY14 but higher competition key risks

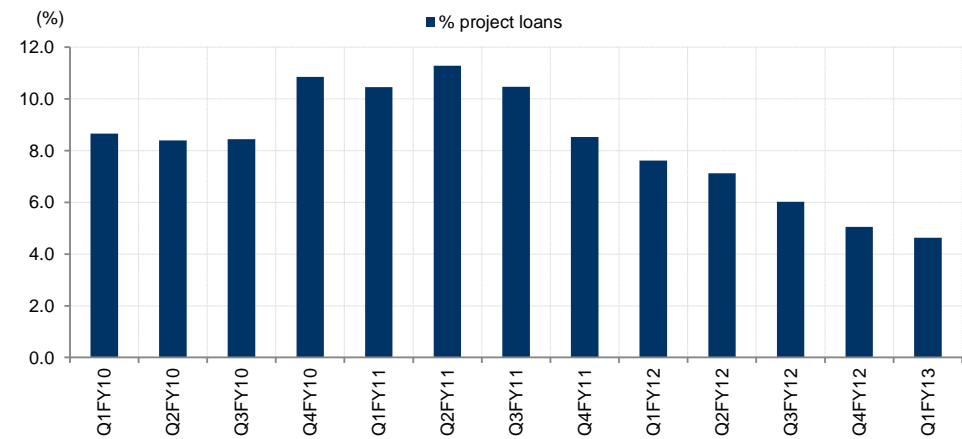
We expect NIMs to improve marginally by ~8bps in FY14. Re-pricing of the three-year fixed-rate loan portfolio and a likely decline in cost of funds could support interest spreads and NIMs in FY14. However, a sharp increase in competition, high inflation and tight liquidity (which would keep wholesale rates high) could put further pressure on NIMs. We note that SBIN has reduced its home loan rates in the last three months and is offering loans at 10-10.15% (as against 10.5-11.0% for HDFC and LICHF).

Competition from banks a key risk to margins

### Pick-up in developer loans would be positive for margins... but unlikely

A sharp decline in the developer loan portfolio (from 11.3% in Q2FY11 to 4.6% in Q1FY13) was also one of the reasons for NIM compression. Average spreads on this portfolio are 5.0-5.5% higher than the retail loan book. Consequently, any sharp pick-up here would be positive for NIMs. In our view, however, an improvement in project disbursements appears unlikely in the near term due to muted new project announcements. As per the management, LICHF is not aggressive in opportunities available in refinancing space. We expect project loans to remain stable at ~4.4% of the loan book.

Fig 7 - Proportion of developer portfolio has declined



Developer loan portfolio down from 11.3% in Q2FY11 to 4.6% in Q1FY13

Source: RCML Research, Company

### Loan growth to be driven by retail segment

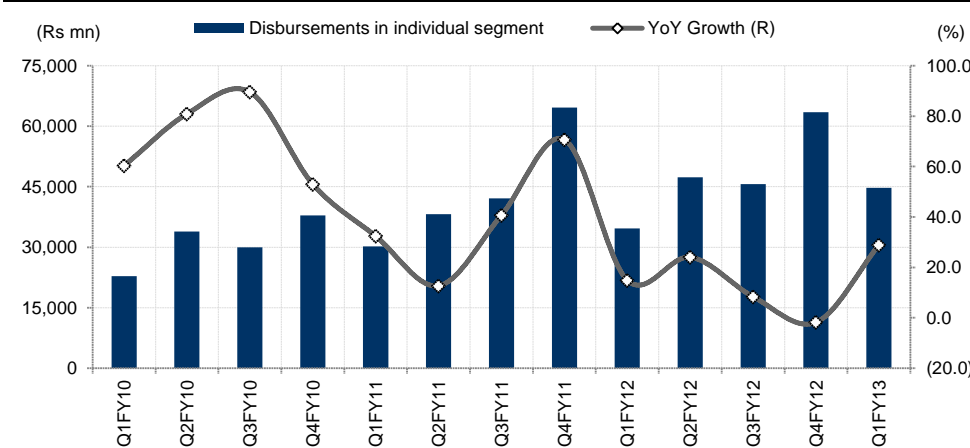
#### Retail disbursements likely to grow by 20% YoY in FY13

LICHF reported muted disbursement growth in the individual loan segment in H2FY12. However, growth picked up in Q1FY13. The management is seeing healthy traction in Q2FY13 as well and expects 20% YoY growth in retail disbursements and ~25% YoY growth in the individual loan portfolio in FY13. However, project disbursements are likely to be muted; we are factoring in only 8% YoY growth in project loans in FY13.

Healthy traction in individual loan segment



**Fig 8 - Retail disbursements picked up in Q1FY13**



Source: RCML Research, Company

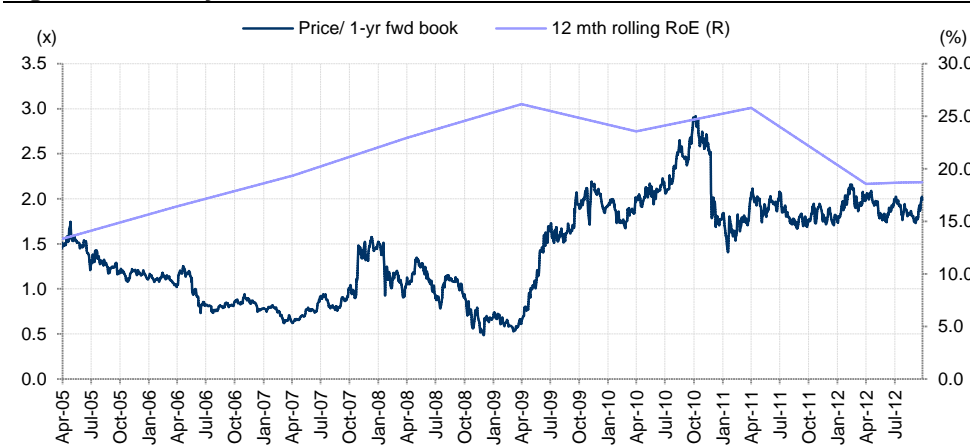
**Valuations reasonable but near-term re-rating potential limited**

LICHF has significantly outperformed the BSE Bankex in the last one year (the stock is up 30% against 19% for Bankex) despite disappointment on NIMs and earnings downgrades. We believe this was largely driven by healthy loan book growth and high comfort on asset quality (asset quality risks are the lowest on mortgages).

While we remain bullish on the mortgage financing space and expect LICHF to perform well in the long term due to its strong distribution network and leadership position in the individual loans segment, we believe that rising competitive intensity (from banks) and subdued NIMs would restrict any near-term re-rating from current levels. We note that LICHF's ROEs have declined from an average of 25% over FY08-FY11 to ~19% in FY12-FY13 due to sharp compression in spreads in the individual loan segment and a decline in the proportion of developer loans.

**Rising competition and subdued NIMs would restrict stock re-rating**

**Fig 9 - Price to 1-yr fwd BV**



Source: RCML Research, Bloomberg



## Disbursements

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Disbursements	199,124	200,271	246,447	297,888	348,282
Growth (%)	34.1	0.6	23.1	20.9	16.9
AUM/Sanctions	226,029	220,345	274,876	328,708	384,245
Growth (%)	25.3	(2.5)	24.7	19.6	16.9

## Per Share Data

Y/E 31 Mar (INR)	FY11A	FY12A	FY13E	FY14E	FY15E
Reported EPS	20.5	18.1	23.0	28.8	35.4
Adjusted EPS	20.5	18.1	23.0	28.8	35.4
DPS	3.5	3.6	4.9	6.1	7.5
Book value	87.8	112.6	129.9	151.7	178.4
Adjusted book value	87.6	111.3	127.2	148.0	173.5

## Valuation Ratios

Y/E 31 Mar (x)	FY11A	FY12A	FY13E	FY14E	FY15E
P/E	11.0	14.5	11.9	9.5	7.7
P/BV	2.6	2.3	2.1	1.8	1.5
P/ABV	2.6	2.4	2.2	1.8	1.6

## Financial Ratios

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
<b>Spread Analysis</b>					
Interest spreads	2.5	1.7	1.6	1.7	1.8
Yield on advances	10.0	10.5	10.8	10.8	10.8
Yield on assets	10.2	10.8	11.0	11.0	11.0
Cost of funds	7.7	9.1	9.4	9.3	9.2
NIMs	3.1	2.5	2.4	2.5	2.5
<b>Operating Ratios</b>					
Operating cost to income	12.2	14.6	14.0	13.5	13.1
Operating expenses / Avg assets	0.5	0.4	0.4	0.4	0.4
<b>Asset Quality and Capital</b>					
Gross NPA	0.5	0.4	0.5	0.6	0.6
Net NPA	0.0	0.1	0.2	0.3	0.3
CAR	14.9	16.7	16.0	15.2	14.7
<b>Growth Ratios</b>					
Net interest income	54.7	1.4	19.7	27.7	22.3
Non-interest income	113.4	(41.8)	15.6	11.7	17.7
Pre-provisioning profit	76.3	(10.8)	19.9	26.2	22.4
Net profit	47.4	(6.2)	27.1	25.3	22.8
Assets	33.3	22.6	22.7	22.5	20.8
Advances	34.2	23.5	23.8	22.6	20.9
Book value	23.1	28.2	15.4	16.7	17.6
EPS	47.3	(11.8)	27.1	25.3	22.8

## DuPont Analysis

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income / Assets	3.1	2.5	2.4	2.5	2.5
Non-interest income / Assets	0.9	0.4	0.4	0.4	0.3
Operating expenses / Assets	0.5	0.4	0.4	0.4	0.4
Provisions / Assets	0.6	0.3	0.1	0.2	0.1
Taxes / Assets	0.7	0.6	0.6	0.6	0.6
ROA	2.2	1.6	1.7	1.7	1.7
Equity / Assets	8.6	8.9	8.8	8.3	8.0
<b>ROAE</b>	<b>25.8</b>	<b>18.6</b>	<b>19.0</b>	<b>20.5</b>	<b>21.5</b>

**BUY**

TP: INR 310.00

▲ 13.2%

# LIC Housing Finance

LICHF IN



Company Update

INDIA

FINANCIALS

## Income Statement

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Interest income	44,697	59,827	75,919	93,799	114,129
Interest expense	(30,977)	(45,911)	(59,258)	(72,522)	(88,118)
Net interest income	13,719	13,916	16,661	21,276	26,011
Non-interest income	3,991	2,324	2,687	3,001	3,533
Net revenue	17,710	16,241	19,348	24,277	29,545
Operating expenses	(2,160)	(2,371)	(2,713)	(3,288)	(3,861)
Pre-provisioning profits	15,550	13,870	16,634	20,989	25,683
Provisions & contingencies	(2,608)	(1,560)	(935)	(1,324)	(1,539)
PBT	12,942	12,309	15,699	19,665	24,144
Extraordinaries	0	0	0	0	0
Income tax	(3,197)	(3,167)	(4,082)	(5,113)	(6,278)
Reported PAT	9,745	9,142	11,618	14,552	17,867
<b>Adj. net profit</b>	<b>9,745</b>	<b>9,142</b>	<b>11,618</b>	<b>14,552</b>	<b>17,867</b>

## Balance Sheet

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Advances	510,898	630,802	781,052	957,877	1,157,687
Investments	14,032	13,751	11,001	13,201	15,841
Current assets	9,197	9,968	11,620	14,228	17,291
Net block (inc CWIP)	474	768	682	683	677
Goodwill	0	0	0	0	0
Other assets	1,698	2,208	2,208	2,208	2,208
<b>Total Assets</b>	<b>536,299</b>	<b>657,496</b>	<b>806,563</b>	<b>988,196</b>	<b>1,193,704</b>
Share capital	950	1,010	1,010	1,010	1,010
Options/warrants/others	0	0	0	0	0
Reserves & surplus	40,741	55,812	64,568	75,536	89,002
Net worth	41,691	56,822	65,578	76,546	90,012
Total borrowings	451,887	561,154	701,148	864,546	1,048,157
Current liabilities	35,626	30,599	34,934	40,823	47,642
Provisions	7,095	8,921	4,903	6,281	7,893
Deferred tax liabilities	0	0	0	0	0
Other liabilities	0	0	0	0	0
<b>Total Equity &amp; Liabilities</b>	<b>536,300</b>	<b>657,496</b>	<b>806,563</b>	<b>988,196</b>	<b>1,193,704</b>

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Hold	Between 15% and -5%
Sell	Less than -5%

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