8 November 2012

Update | Sector: Financials

LIC Housing Finance

BSE SENSEX	S&P CNX
18,902	5,760

CMP: INR255 **TP: INR300** **Buy**

Bloomberg	LICHF IN
Equity Shares (m)	505.0
52-Week Range (INR)	290/208
1,6,12 Rel.Perf.(%)	-6/-14/-1
M.Cap. (INR b)	128.1
M.Cap. (USD b)	2.4

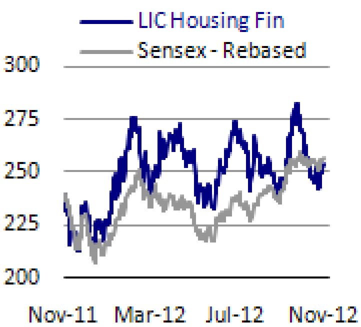
Valuation summary (INR b)

Y/E March	2012	2013E	2014E
NII	13.9	15.2	20.2
OP	13.9	14.7	19.6
NP	9.1	10.0	14.5
EPS (INR)	18.1	19.8	28.7
EPS Gr. (%)	-11.7	9.6	44.7
BV/Sh. (INR)	112.5	127.7	149.7
P/E (x)	12.8	12.8	9.6
P/BV (x)	2.3	2.0	1.7
ABV (INR)	112.1	127.1	149.0
P/ABV (x)	2.3	2.0	1.7
RoA (%)	1.8	1.4	1.5

Shareholding pattern %

As on	Sep-12	Jun-12	Sep-11
Promoter	40.3	40.3	36.6
Dom. Inst	9.6	9.1	8.9
Foreign	37.8	37.5	38.6
Others	12.3	13.1	15.9

Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

Spreads bottom out, improvement in 2H imminent

Asset quality, growth complement strong show; Buy

- **LIC Housing Finance (LICHF) delivered strong performance both on growth and asset quality fronts. However, it has consistently disappointed on spreads, a key RoA driver, leading to underperformance v/s the sector. We believe that spreads have bottomed out and would now improve as the benefits from cost of funds start to accrue.**
- **Growth is expected to remain healthy at 20%+ levels in the medium term, driven by structural growth drivers in the housing finance industry, coupled with LICHF's strong positioning in Tier II and Tier III centers, which provides it with an edge over larger peers. We assume CAGR in loans of ~25% during FY12-14E.**
- **The stock corrected by ~14% in October 2012, thus underperforming the broader indices by a wide margin (~2% decline in Bankex and Sensex). However, in our view, margins should improve and loan growth should remain healthy in 2HFY13. At 1.7x FY14E BV, the stock is attractively valued and largely discounts concerns. We maintain a Buy, with a target price of INR300.**

Spreads bottom out, should improve from current levels: During 1HFY13, company continued to disappoint on margin front as it contracted to 2.1% in 2QFY13, lowest in past 25 quarters. However, we expect margins to improve from the current levels led by (1) higher spreads on incremental business (165bp in 1HFY13 v/s 75bp in 1HFY12), (2) declining cost of funds, (3) expected improvement in share of builder loans and (4) re-pricing of teaser loan portfolio. We estimate ~30bp decline in margins for FY13E based on the assumption of builder loan portfolio staying at ~4% levels in FY13.

Structural drivers, strong positioning in Tier II/III centers to sustain growth momentum: During FY07-12, LICHF's loan book clocked a staggering 29% CAGR. Notably, similar healthy growth momentum continued in 1HFY13 as the loan book expanded by 23% YoY to INR691b and 27% YoY growth in individual loans. Going forward, we expect the loan book to grow at a healthy 20%+ levels in the medium term. As structural growth drivers remain intact, the strong positioning in Tier II and Tier III centers provides the company an edge over larger peers as demand in non-urban centers was fairly healthy in the current environment. We assume CAGR in loans of ~25% during FY12-14E.

Asset quality, growth healthy; spreads bottom out; Buy: LICHF continues to deliver well on growth and asset quality fronts. Despite the high interest rates and property prices, healthy volume growth in the individual loan segment remains encouraging. Improvement in spreads would lead to better return ratios. We assume 25% loan CAGR, ~30bp decline in margins assumption for FY13 and 15bp improvement in FY14; average adjusted RoA of ~1.5% and RoE of ~18% over FY12-14E. At 1.7x FY14E BV, the stock is attractively valued and largely discounts the concerns. We maintain **Buy** with a target price of INR300 (with an upside of 18%).

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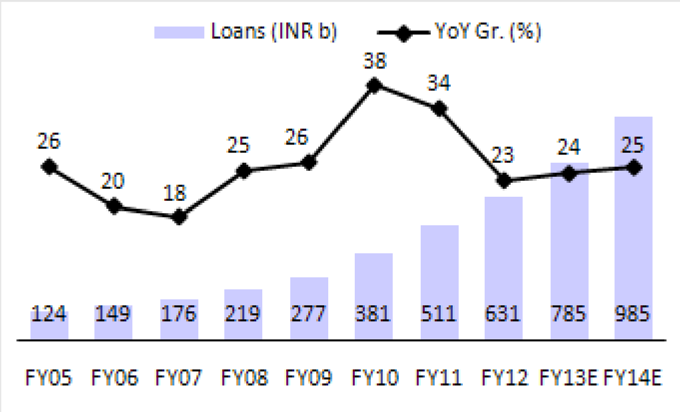
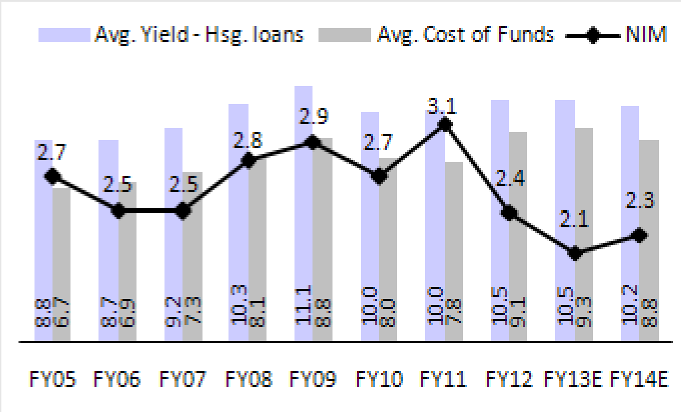
Story in charts Spreads to improve; Healthy growth, asset quality to sustain

1. Loan growth expected to remain healthy on the back of strong demand in individual segment
2. Margins estimated to look up due to declining cost of funds, higher incremental spreads and re-pricing of teaser rate loans
3. We model in builder loan portfolio at 4-5% of loans; higher growth in this segment could be an upside risk to our margin assumptions
4. Asset quality remains healthy and no major negative surprises expected
5. Increasing share of salaried customers in the overall mix led to stable asset quality
6. Improvement in margins would lead to better return ratios

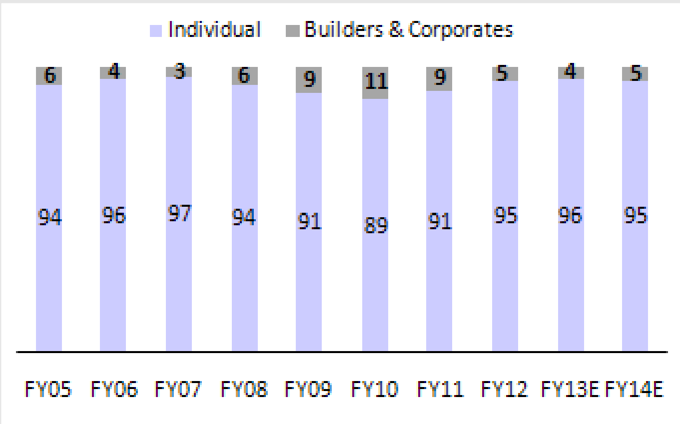
❶ We expect loan CAGR of ~25%



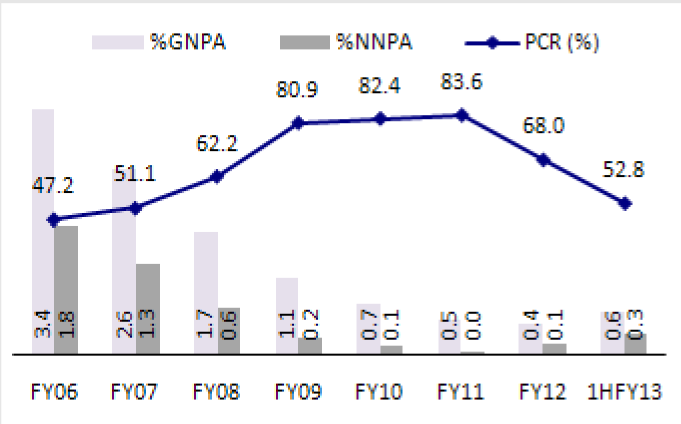
❷ Margins to improve mainly led by decline in cost of funds (%)



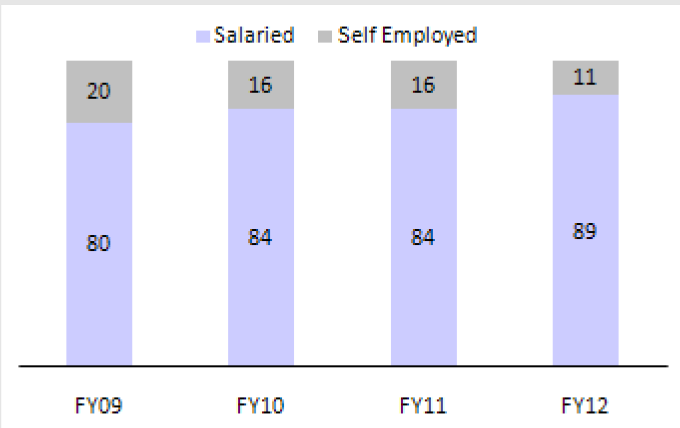
❸ Share of developer loans crucial for margin improvement



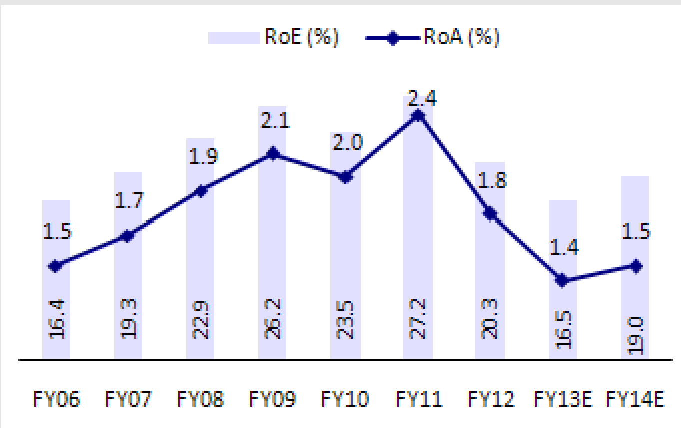
❹ Asset quality remains stable



❺ Focus on salaried class provides stability to asset quality



❻ Improvement in margins to lead to better return ratios (adj.)



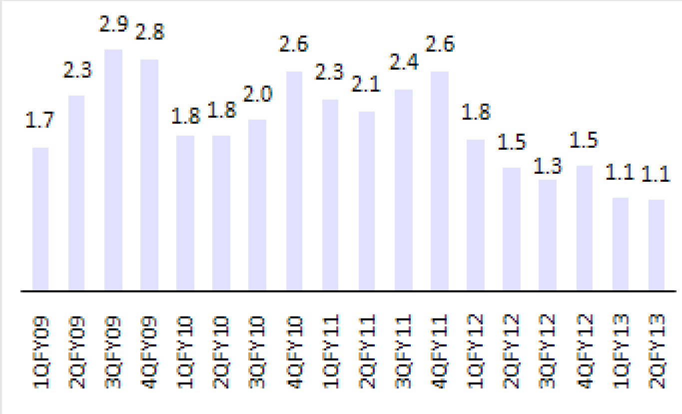
Source: Company, MOSL

Spreads bottom out, likely to improve from current levels

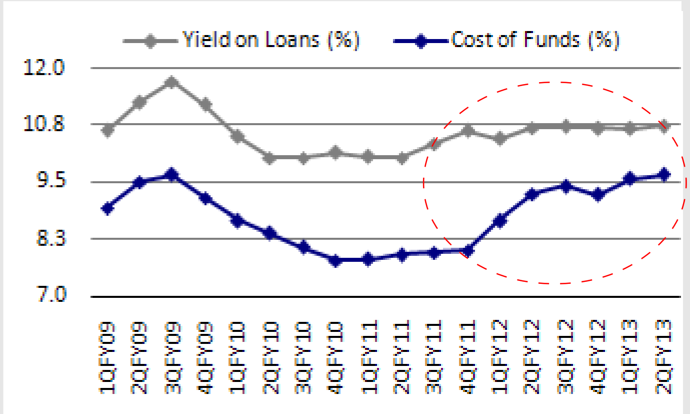
Disappointing margin performance continued in 1HFY13...

In 2QFY13, LICHF disappointed again on the margins front, a decline of 8bp QoQ to 2.1% and the lowest in past 25 quarters. After it reported peak margins of 3.45% in 4QFY11, there was a steady decline in later periods. Spreads during 2QFY13 contracted to 1.07% and exerted pressure on top line growth, despite a healthy asset growth.

Spreads at the lowest level since past 25 quarters



Unable to pass on rising costs due to higher fixed rate loans

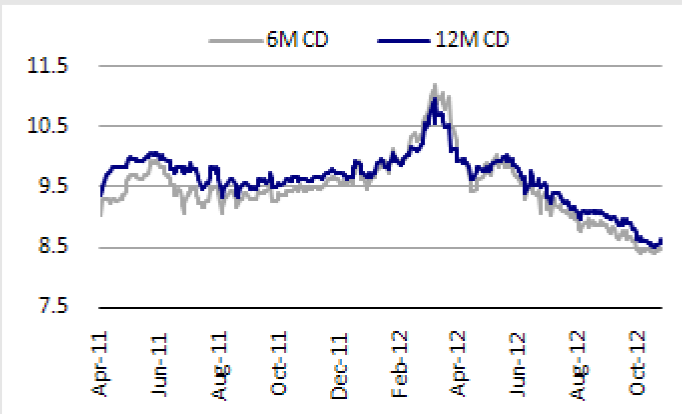


Source: Company, MOSL

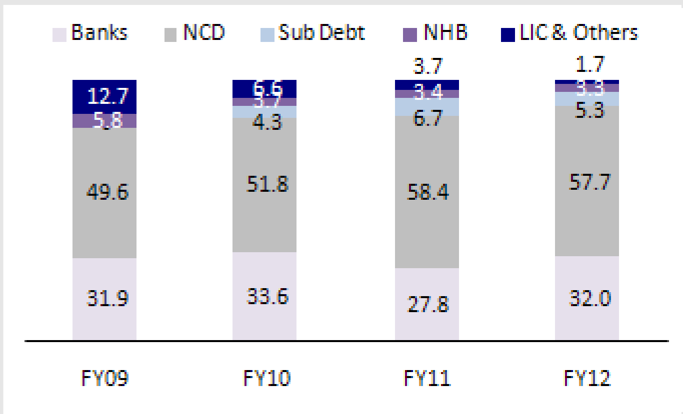
...Spreads bottom out, to improve in 2HFY13

In our view, spreads have bottomed out and shall improve from the current levels led by (1) higher spreads on incremental business (165bp in 1HFY13 v/s 75bp in 1HFY12), (2) declining cost of funds, (3) expected improvement in share of builder loans and (4) re-pricing of teaser loan portfolio. Company is incrementally borrowing through the wholesale route (where rates are down sharply) and thus is replacing the relatively high cost bank borrowings, which provides a cost saving of ~100-150bp. Also, the expected reduction in bank base rates over the next two quarters would reduce the cost of borrowings. Currently, ~30% of LICHF's borrowings are through banks.

Wholesale rates fell sharply during YTD period



Movement in borrowing mix (%)



Source: Company, MOSL

Fixed-o-Floaty Loans		
Quarterly Re-Pricing Schedule		
Already Re-priced	INR b	%
1QFY13	8	1.1
2QFY13	15	2.2
To be re-priced		
3QFY13	~22	3.2
4QFY13	~30	4.3
1QFY14	25-30	~4.0

Fixed-o-Floaty teaser loan portfolio's re-pricing

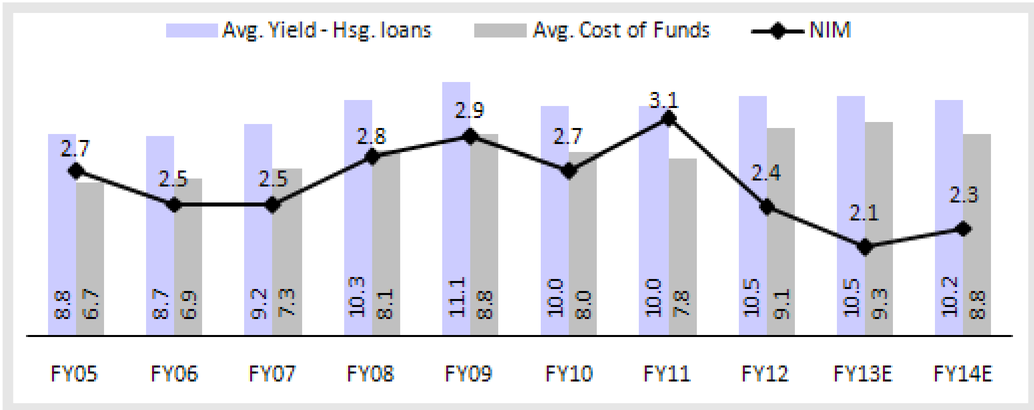
Of the total Fixed-o-Floaty teaser loan portfolio, loans worth ~INR23b have already got re-priced during 1HFY13 and another ~INR50b loans are expected to be re-priced in 2HFY13. After deducting the repayments/prepayments, the balance Fixed-o-Floaty portfolio would be re-priced in 1QFY14. Besides, LICHF has ~INR100b worth fixed rate loans in Advantage 5 (a five-year fixed rate product) and their re-pricing shall happen over FY15E-16E.

Every 1%age point increase in builder loans will lead to 4-5bp improvement in margins

We assume ~30bp decline in margins for FY13, based on the assumption of builder loan portfolio remaining at ~4% levels. However, better-than-expected traction in this segment and faster-than-expected decline in cost of funds can be upside risks to our assumptions.

We believe margins have bottomed out and expected to improve from here on

Spreads to improve mainly led by sharp decline in CoF (calc.)

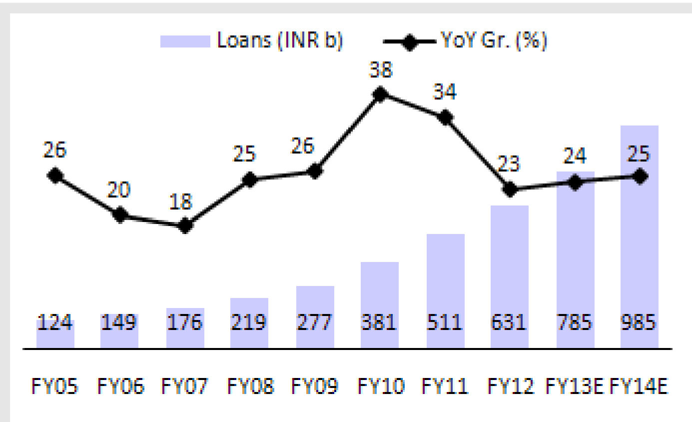


Source: Company, MOSL

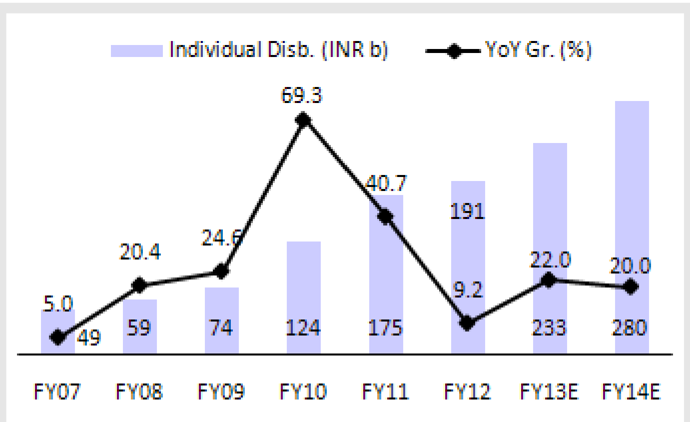
Structural drivers, strong positioning in Tier II/III centers to sustain growth momentum

During FY07-12, LICHF's loan book grew at a CAGR of staggering 29%. Notably, similar growth momentum continues during the first half of current fiscal as the book expanded by 23% YoY to INR691b and individual loans by 27% YoY. LICHF capitalized on the strong demand for housing finance in the country led by structural growth drivers, which coupled with strong presence in Tier II and III regions and startegy to target the middle income segment, led to healthy growth in the loan book.

Loan growth to remain healthy led by...



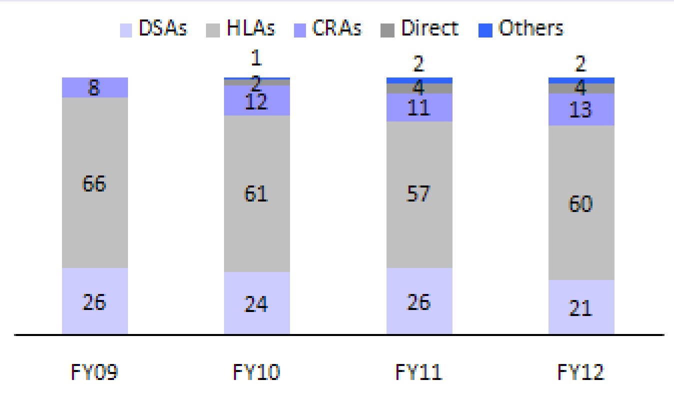
...strong demand in individual home loan segment



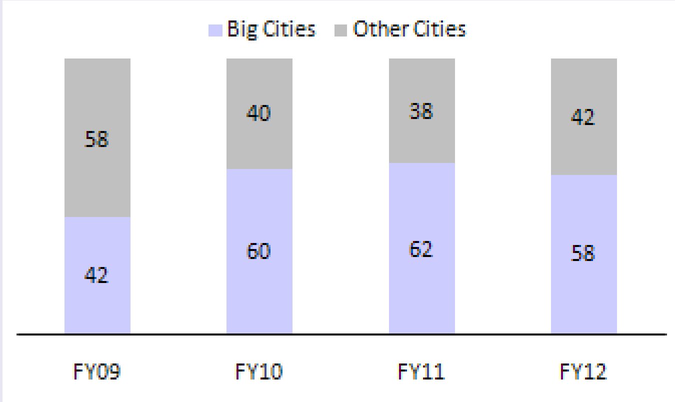
Source: Company, MOSL

LICHF's individual disbursements growth was fairly strong driven by a greater presence in Tier II and III centers. A large chunk of its business (~60%) is originated by its home loan agents (HLAs), followed by DSAs (slightly over 20%). Moreover, as in FY12, big cities contribute ~58% of LICHF's new business originations; importantly, company includes cities like Bangalore, Pune and Hyderabad in the definition of large cities. While Mumbai and Delhi-NCR (among large cities) witnessed slowdown in growth, LICHF's growth has been driven by other cities. Notably, the share of smaller cities in new originations mix increased to 42% from 38% in FY11.

Large part of originations done by HLAs (%)



Share of smaller cities in originations has increased (%)

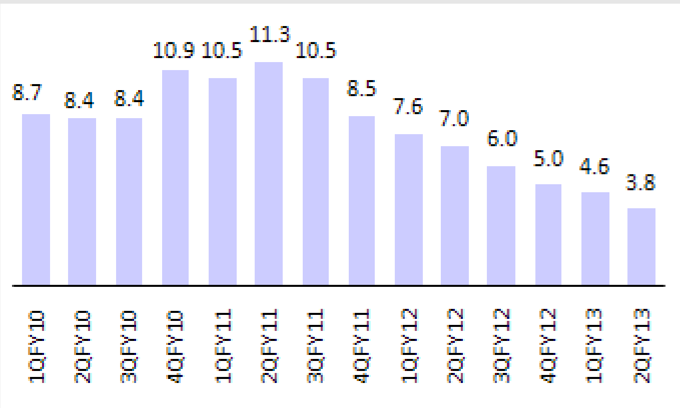


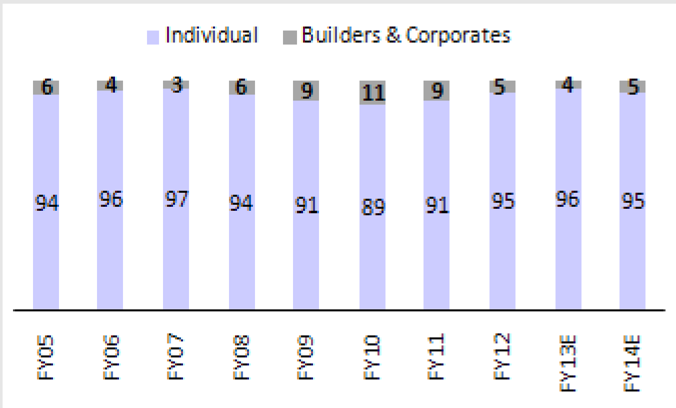
Note: DSA - Direct Selling Agents; HLA - Home Loan Agent; CRA - LICHF Agents

Source: Company, MOSL

While the company's growth decelerated in the builder segment (given the uncertain macro environment), which helped to maintain the healthy asset quality, overall loan growth was strong led by a robust demand in the individual loan segment. Going forward, we expect LICHF to increase the loan book at a healthy 20%+ levels in the medium term, as the structural drivers remain intact in the housing finance industry. Also, the strong positioning in Tier II and III centers provides an edge over larger peers, as demand in non-urban centers remains fairly healthy in the current environment. Thus, we assume loans CAGR of ~25% during FY12-14E.

Share of developer loans declined steadily since its peak in 2QFY11. We expect it to improve gradually from here on (%)



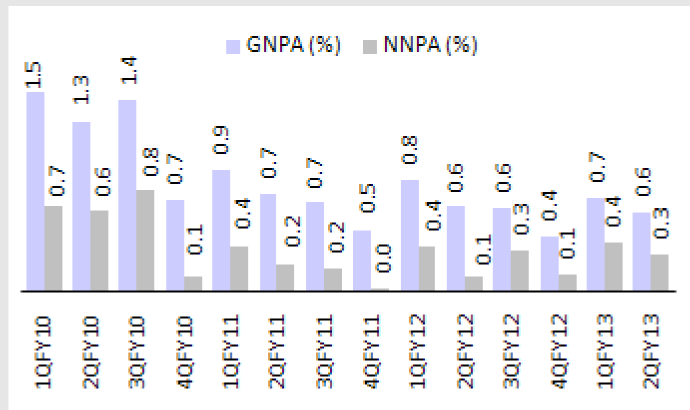


Source: Company, MOSL

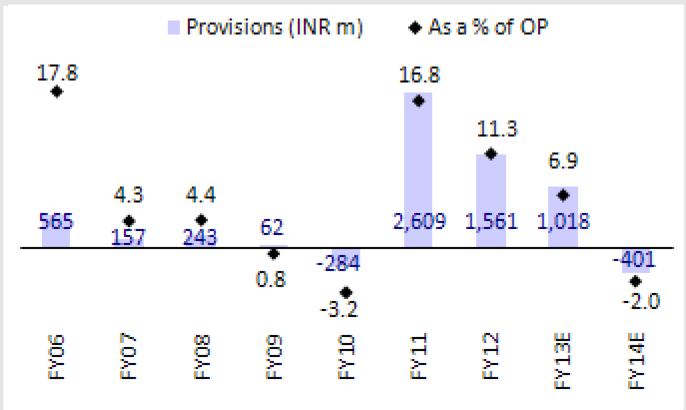
Asset quality to remain healthy; no negative surprises expected

LICHF's asset quality was healthy, with GNPAs at 0.6% in 1HFY13. While the inherent risk in the mortgage business remains low due to highly secured lending and strong collateral in place, company also reduced risk by lowering the exposure to the builder segment in an uncertain environment. Moreover, retail asset quality in the current credit cycle was healthy for most lenders, which too is reflected from LICHF's asset quality performance. With a portfolio LTV of ~57%, instalment to net income ratio of ~39% and share of non-salaried customers at ~11%, the risk to company's asset quality is restricted to a great extent.

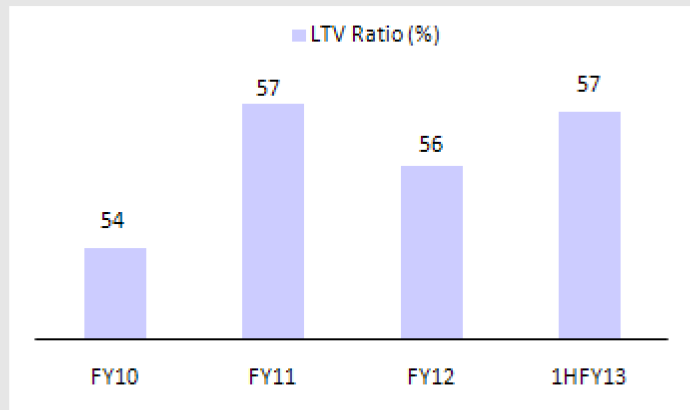
Asset quality remains healthy

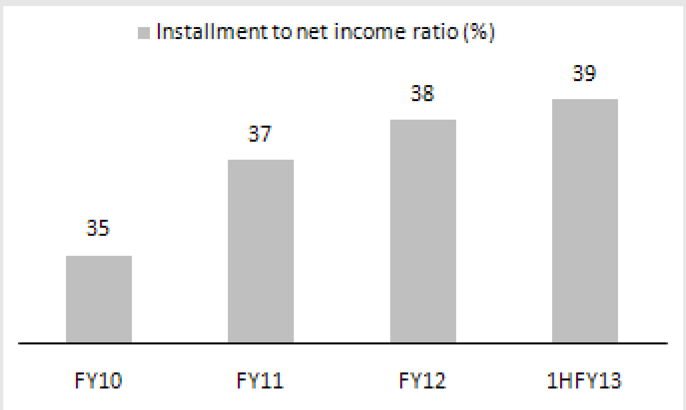


Prov. write-back (on teaser loans) in FY14E to boost rep. PAT

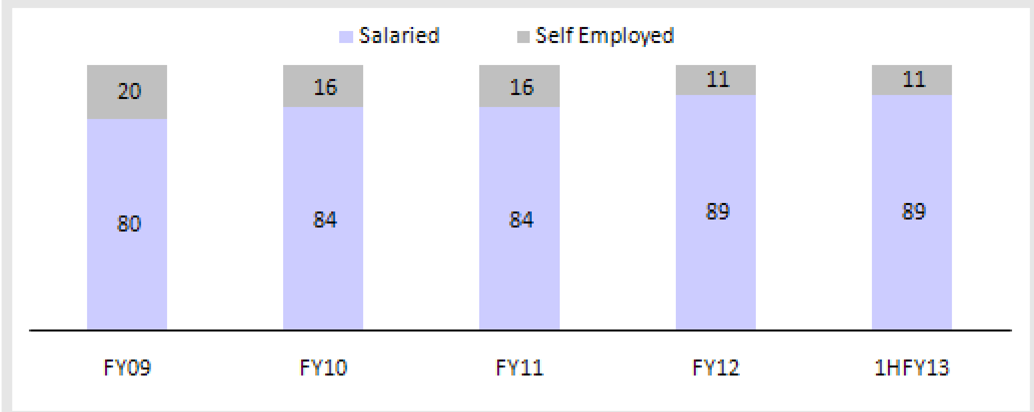


Lower LTV ratio (at the time of origination, %) and instalment-to-income ratio (%) provide adequate cushion to asset quality





Share of salaried customers (among new originations) has risen steadily in the customer mix (%)



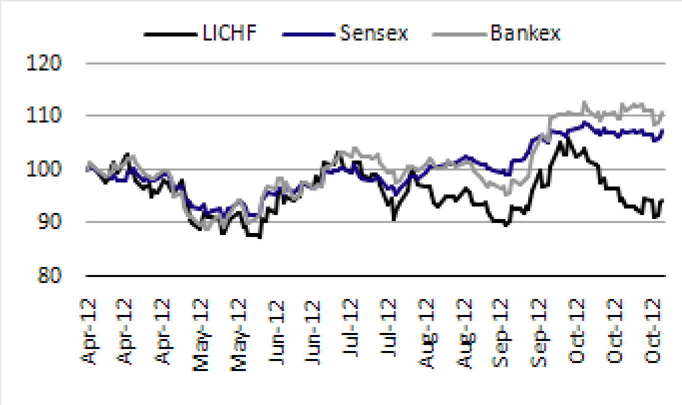
Source: Company, MOSL

Healthy growth and asset quality; spreads bottom out; Buy

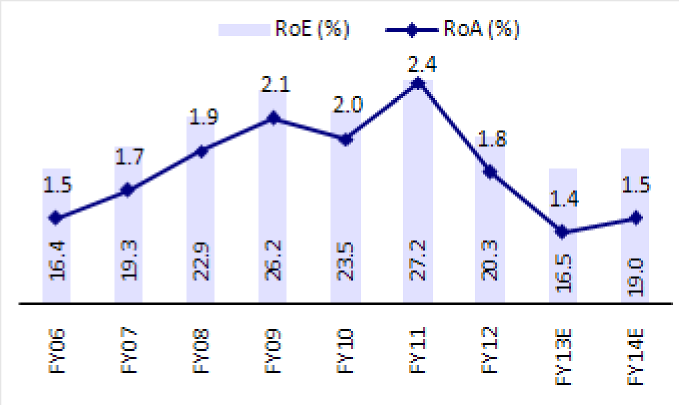
LICHF continues to deliver well on growth and asset quality fronts. It is well-positioned to make the most of the strong growth opportunities in the housing finance industry. Despite high interest rates and property prices, healthy volume growth in the individual loan segment remains encouraging. Improvement in spreads would lead to better return ratios.

The stock corrected by ~14% in October 2012, thus underperforming the broader indices by a wide margin (~2% decline in Bankex and Sensex). We believe margins improvement and healthy loan growth would remain intact in 2HFY13. At 1.7x FY14E BV, it is attractively valued and largely discounts the concerns. Maintain a **Buy** with a target price of INR300.

LICHF underperformed broader indices during the YTD period

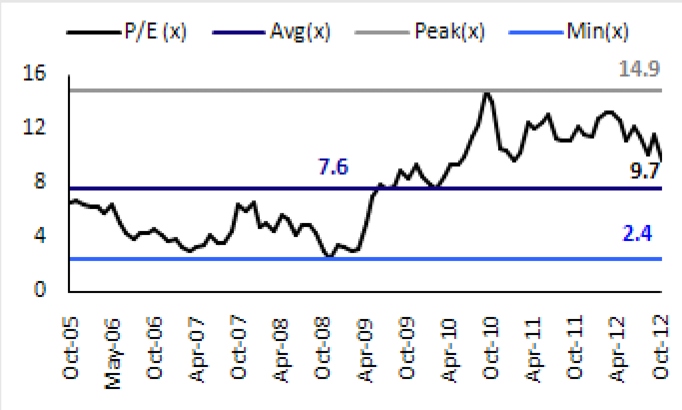


Return ratios expected to improve in FY14 (adjusted)

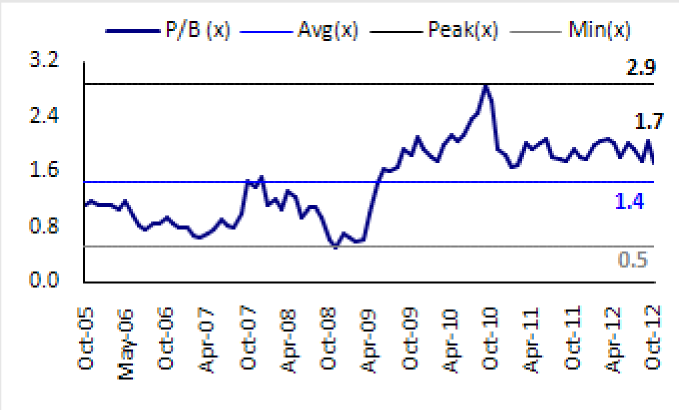


Source: Company, MOSL

LICHF: 1 year forward PE band



LICHF: 1 year forward PB band



LIC Housing Finance: DUPONT Analysis

	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Interest Income	10.17	11.03	9.98	10.22	10.77	10.67	10.35
Interest Expended	7.40	8.09	7.28	7.08	8.26	8.49	8.05
Net Interest Income	**2.77**	**2.93**	**2.70**	**3.14**	**2.51**	**2.18**	**2.30**
Non interest Income	**0.68**	**0.62**	**0.57**	**0.91**	**0.42**	**0.34**	**0.32**
Fee Income	0.26	0.27	0.39	0.34	0.24	0.20	0.20
Treasury Income	0.30	0.26	0.14	0.14	0.14	0.11	0.10
Other Income	0.12	0.09	0.04	0.43	0.04	0.03	0.03
Net Income	**3.45**	**3.56**	**3.26**	**4.05**	**2.92**	**2.52**	**2.63**
Operating Expenses	**0.67**	**0.62**	**0.58**	**0.49**	**0.43**	**0.40**	**0.39**
Cost to income (%)	19.39	17.29	17.85	12.21	14.60	16.04	14.85
Operating Profits	**2.78**	**2.94**	**2.68**	**3.55**	**2.50**	**2.12**	**2.24**
Provisions/write offs	0.12	0.02	-0.09	0.60	0.28	0.15	-0.05
PBT	**2.66**	**2.92**	**2.77**	**2.96**	**2.22**	**1.97**	**2.28**
Tax	0.72	0.78	0.76	0.73	0.57	0.53	0.63
Tax Rate (%)	27.26	26.79	27.36	24.71	25.73	27.00	27.50
PAT	**1.93**	**2.14**	**2.01**	**2.23**	**1.65**	**1.44**	**1.66**
Extra-ordinary Items	0.00	0.00	0.00	0.12	0.16	0.00	-0.13
Adjusted PAT	**1.93**	**2.14**	**2.01**	**2.35**	**1.80**	**1.44**	**1.52**
Leverage	11.87	12.26	11.70	11.58	11.28	11.48	12.50
RoE	**22.94**	**26.19**	**23.52**	**27.22**	**20.32**	**16.52**	**19.04**

Source: Company, MOSL

Spreads have bottomed out, expected to improve from here on

Pressure on fees likely to continue

Will continue to reap benefits of operating leverage

We have not considered dilution in our estimates

Capital raising in the offing to fund future growth

LICHF plans to raise INR12b through QIP route to fund its future growth plans. We have not yet factored it into our estimates. Notably, capital infusion will be one of the drivers for margin expansion in FY14.

Below we present a snapshot of change in financials post the QIP. We have assumed dilution of ~9.5% (on pre-dilution equity capital) based on capital raise of ~INR12b at a price of INR250 per share to assess its impact on margins and other key ratios.

Impact of capital infusion

	Pre-Dilution			Post-Dilution		
	FY12	FY13E	FY14E	FY12	FY13E	FY14E
NIM (%)	2.44	2.15	2.28	2.44	2.15	2.40
EPS (INR)	18.1	19.8	28.7	18.1	18.1	27.7
BV (INR)	112.5	127.7	149.7	112.5	138.3	159.5
RoA (%)	1.8	1.4	1.5	1.8	1.4	1.6
RoE (%)	20.3	16.5	19.0	20.3	15.0	17.2
P/E (x)	**14.0**	**12.8**	**8.8**	**14.0**	**14.0**	**9.2**
P/B (x)	**2.3**	**2.0**	**1.7**	**2.3**	**1.8**	**1.6**

Source: Company, MOSL

Financials and Valuation

Income Statement (INR Million)

Y/E March	2009	2010	2011	2012	2013E	2014E
Interest Income	27,477	32,827	44,697	59,827	74,336	90,700
Interest Expense	20,166	23,957	30,977	45,911	59,126	70,518
Net Interest Income	**7,310**	**8,870**	**13,719**	**13,916**	**15,210**	**20,182**
Change (%)	32.0	21.3	54.7	1.4	9.3	32.7
Fee Income	682	1,269	1,501	1,322	1,383	1,739
Income from Investments	644	462	603	804	750	850
Other Income	232	134	1,886	198	218	243
Net Income	**8,867**	**10,735**	**17,710**	**16,240**	**17,561**	**23,015**
Change (%)	28.4	21.1	65.0	-8.3	8.1	31.1
Operating Expenses	1,533	1,916	2,162	2,371	2,816	3,418
Operating Income	**7,334**	**8,819**	**15,548**	**13,870**	**14,745**	**19,597**
Change (%)	31.8	20.2	76.3	-10.8	6.3	32.9
Provisions/write offs	62	-284	2,609	1,561	1,018	-401
PBT	**7,272**	**9,103**	**12,939**	**12,309**	**13,727**	**19,998**
Tax	1,948	2,491	3,197	3,167	3,706	5,499
Tax Rate (%)	26.8	27.4	24.7	25.7	27.0	27.5
PAT	**5,324**	**6,612**	**9,743**	**9,142**	**10,021**	**14,499**
Change (%)	37.5	24.2	47.3	-6.2	9.6	44.7
Adjusted PAT*	**5,324**	**6,612**	**10,285**	**10,011**	**10,021**	**13,339**
Change (%)	37.5	24.2	55.5	-2.7	0.1	33.1
Proposed Dividend	1,293	1,666	1,932	2,112	2,345	3,393

*Adjusted for extra ordinary and one-off items

Balance Sheet

Y/E March	2009	2010	2011	2012	2013E	2014E
Capital	850	950	950	1,010	1,010	1,010
Reserves & Surplus	21,491	32,927	40,741	55,812	63,488	74,594
Net Worth	**22,341**	**33,877**	**41,691**	**56,822**	**64,498**	**75,604**
Borrowings	**254,217**	**347,582**	**451,628**	**560,873**	**710,653**	**901,178**
Change (%)	25.0	36.7	29.9	24.2	26.7	26.8
Total Liabilities	**276,558**	**381,458**	**493,319**	**617,695**	**775,151**	**976,782**
Investments	11,292	13,887	14,032	13,750	15,125	16,638
Change (%)	45.8	23.0	1.0	-2.0	10.0	10.0
Loans	**276,793**	**380,814**	**510,898**	**630,802**	**785,252**	**984,894**
Change (%)	26.2	37.6	34.2	23.5	24.5	25.4
Net Fixed Assets	345	356	339	623	739	795
Net Current Assets	-11,872	-13,599	-31,949	-27,481	-25,966	-25,545
Total Assets	**276,558**	**381,458**	**493,319**	**617,695**	**775,151**	**976,782**

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E March	2009	2010	2011	2012	2013E	2014E
Spreads Analysis (%)						
Avg. Yield on loans	11.1	10.0	10.0	10.5	10.5	10.2
Avg. Yield on Earning Assets	10.8	9.7	9.8	10.3	10.4	10.1
Avg. Cost-Int. Bear. Liab.	8.8	8.0	7.8	9.1	9.3	8.8
Int. Spread on Hsg. Loans	2.3	2.0	2.3	1.4	1.2	1.5
Net Int. Margin on Hsg. Loans	2.9	2.7	3.1	2.4	2.1	2.3
Profitability Ratios (%)						
Adj RoAE	26.2	23.5	27.2	20.3	16.5	19.0
Adj RoAA	2.1	2.0	2.4	1.8	1.4	1.5
Int. Expended/Int.Earned	73.4	73.0	69.3	76.7	79.5	77.7
Other Inc./Net Income	2.6	1.2	10.7	1.2	1.2	1.1
Efficiency Ratios (%)						
Fees/Operating income	2.4	3.7	3.2	2.1	1.8	1.9
Op. Exps./Net Income	17.3	17.8	12.2	14.6	16.0	14.9
Empl. Cost/Op. Exps.	29.3	25.3	31.5	30.6	32.8	33.8

Valuation

Book Value (INR)	52.6	71.3	87.8	112.5	127.7	149.7
Growth (%)	22.0	35.7	23.1	28.2	13.5	17.2
Price-BV (x)				**2.3**	**2.0**	**1.7**
Adjusted BV (INR)	52.2	71.1	87.5	112.1	127.1	149.0
Price-ABV (x)				**2.3**	**2.0**	**1.7**
EPS (INR)	12.5	13.9	20.5	18.1	19.8	28.7
Growth (%)	37.5	11.1	47.3	-11.7	9.6	44.7
Price-Earnings (x)				**14.0**	**12.8**	**8.8**
Adj. EPS (INR)	12.5	13.9	21.7	19.8	19.8	26.4
Growth (%)	37.5	11.1	55.5	-8.4	0.1	33.1
Price-Earnings (x)				**12.8**	**12.8**	**9.6**
Dividend Per Share	2.6	3.0	3.5	3.6	4.0	5.7
Dividend Yield (%)				**1.4**	**1.6**	**2.3**

E: MOSL Estimates

N O T E S

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