

AUGUST 01, 2013
UPDATE

Coverage view: **Cautious**

Price (Rs): **168**

Target price (Rs): **300**

BSE-30: **19,317**

Stock correction sharp, factors depressed NIMs. We discuss key assumptions for LICHF's NIM for FY2014E—expect NIM to decline yoy by 20 bps if bulk borrowings rates remain at current levels and lending rates are unchanged. Medium-term NIM will be sensitive to LICHF's incremental business strategy and interest resets on existing portfolio. Liquidity constraints in debt markets for a prolonged period remain a risk. We will review our estimates and target price post the results.

Company data and valuation summary

LIC Housing Finance

Stock data		Forecasts/Valuations			
		2013	2014E	2015E	
52-week range (Rs) (high,low)	300-160	EPS (Rs)	20.3	25.4	30.8
Market Cap. (Rs bn)	84.8	EPS growth (%)	11.9	25.3	21.3
Shareholding pattern (%)		P/E (X)	8.3	6.6	5.5
Promoters	40.3	NII (Rs bn)	16.2	20.3	24.7
FIs	32.6	Net profits (Rs bn)	10.2	12.8	15.6
MFs	9.0	BVPS	124.5	144.1	167.9
Price performance (%)		P/B (X)	1.3	1.2	1.0
Absolute	1M (34.1) 3M (31.0) 12M (36.8)	ROE (%)	16.8	18.4	19.3
Rel. to BSE-30	(33.2) (30.3) (43.6)	Div. Yield (%)	2.4	3.0	3.6

Stock correction sharp, valuations inexpensive, NIM is key monitorable

LIC Housing Finance (LICHF) has corrected 34% in the last one month likely due to concerns on NIM of LICHF; the stock trades at 1.2X PBR and 6.6X PER FY2014E.

LICHF's marginal borrowings cost in debt markets declined by about 150 bps qoq in 1QFY14 but will clearly rise again over the next nine months. Trends in bulk borrowing rates are the key monitorable to drive its NIM over the next 2-3 quarters. Its asset-side strategy will be crucial in driving NIM in future years.

NIM may decline by 20 bps yoy in FY2014E (unless LICHF raises lending rates)

We expect LICHF's NIM to decline by 20 bps in FY2014E unless the company raises lending rates (PLR). In this note, we highlight earnings and profitability ratios of LICHF in various scenarios: (1) 20 bps NIM compression (looks most probable now), (2) 40 bps NIM compression (that's possibly what the market is factoring on juxtaposing current valuations against 14-15% RoE) and (3) stable NIM (assuming LICHF raises lending rates).

We will revisit our estimates post 1QFY14 earnings after taking cognizance of its business strategy (in the current environment) and analyzing the impact of interest resets in its portfolio for FY2015E and FY2016E.

LICHF's borrowings cost will rise to 9.75%. During FY2013, LICHF's average cost of borrowings (calculated) for the year was 9.53%. As of March 2013, the weighted average cost of borrowings moved up to 9.75%. We expect borrowing cost for FY2014 to remain at 9.75%, i.e. similar to the exit levels (March 2013) and about 20 bps higher than the average borrowing cost for FY2013.

- ▶ **Lower rates in 1Q.** LICHF raised bonds of about Rs70 bn (10% of outstanding borrowings) during 1QFY13; notably, bond yields for AAA-rated players declined to 8.3-8.5% in 1QFY13 thereby reducing marginal borrowing cost for LICHF.

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- ▶ **Higher cost in 2-4Q.** However, the decline in marginal borrowings cost (from bond markets) in 1QFY14 will offset higher cost of borrowings over the next nine months, in our view. We assume marginal borrowing cost for the next nine months at 10%—somewhat higher than 5-year bond yields for AAA-rated companies (9.5-9.75%) and marginally lower than bank base rates. Total borrowing plan for the year is Rs270-290 bn; LICHF will need to raise Rs20 bn over the next nine months.

Asset yield at 10.6%. LICHF's average yield on loans (calculated) was 10.6% for FY2013. With repricing of loans, the weighted average yield as of March 2013 increased to 10.8%. We expect average yield on loans for FY2014E to decline to 10.6% from the exit levels of 10.8%.

- ▶ **Lower yield on new loans.** New loans are disbursed currently at 10-10.25%. We model disbursements of Rs294 bn (up 21% yoy) in FY2014E, taking the total loan book to Rs955 bn. Loans disbursed during the year will be about 30% of total outstanding loans as of March 2014E.
- ▶ **Resets in 1Q.** About Rs30 bn of fixed rate loans are due for repricing in FY2014E. These loans will be repriced at 2% higher rate. The repricing will boost NIM by about 4-6 bps.

Resets, asset-side strategy will drive NIM in the future

Two drivers of medium-term NIM, in our view, are:

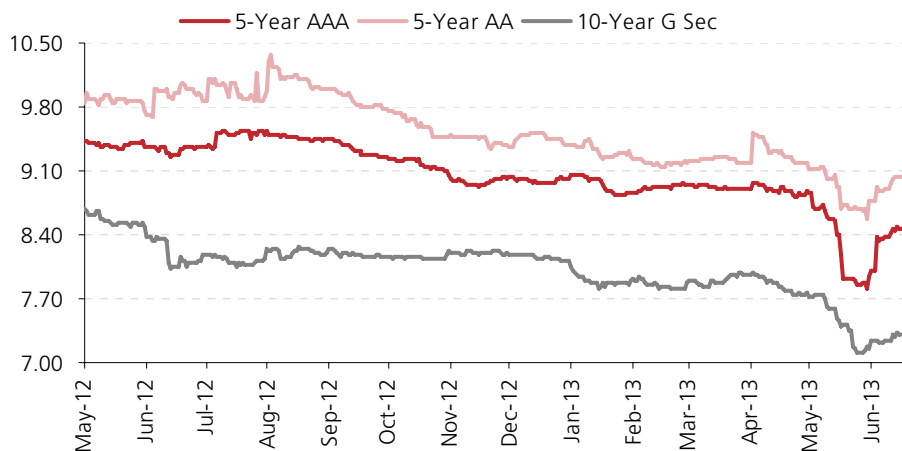
- ▶ **Business strategy.** LICHF's strategy to price home loans and focus on fixed-cum-floating products (fixed loans are 50% of loan book), which in turn will be determined by competition, interest rate in bulk borrowing markets and its growth appetite.
- ▶ **Loan resets.** About 50% of LICHF's loan book carries a fixed rate. Most loans (about 40% of total loan book) carry a fixed rate for 2-3 years. These loans will be repriced from FY2015E (at about 1.5-2% higher than current rates).

Rise in NPLs in 1QFY14

LICHF's management recently highlighted that they don't find any significant adverse trends in asset quality performance of non-retail loans. Developer loans were 4% of total loans as of March 2013. The company reported four slippages in this segment over 3QFY13 and 4QFY13, of which one of the loans was upgraded in 4QFY13. LICHF has issued a SARFAESI notice to one of the accounts—an Indore-based developer. We expect slippages to increase in 1QFY14 in the retail business—this is in line with seasonal trends.

Exhibit 1: Yields for AAA-rated and AA-rated bonds have declined

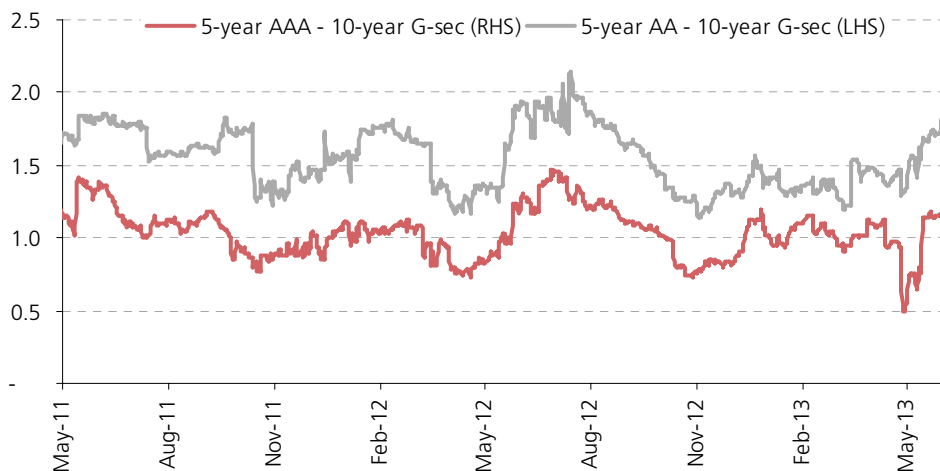
Yields on 5-year corporate bonds and 10-year G-Secs in India, May 2012- June 2013 (%)



Source: Kotak Institutional Equities, Company

Exhibit 2: Spreads between G-Sec and bonds has gone up recently

Spread between 5-year corporate bonds and 10-year G-Secs in India, May 2012- June 2013 (%)



Source: Kotak Institutional Equities, Company

Exhibit 3: Outstanding borrowings of LICHF

March fiscal year-ends, 2012-13

	2012		2013	
	(Rs mn)	(% of total)	(Rs mn)	(% of total)
Bank loans	178	32	205	30
Bonds	324	58	417	61
NHB loans	178	32	45	7
Deposits	3	0	8	1
Tier II bonds	30	5	9	1
Total borrowings	561	100	683	100

Source: Kotak Institutional Equities

Exhibit 4: LICHF: Scenario I: Assuming 20 bps NIM compression
March fiscal year-ends, 2013-16E

	2013	2014E	2015E	2016E
NII (Rs mn)	15,345	17,390	20,766	24,936
Loan growth (%)	23.3	22.8	20.3	19.6
PAT (Rs mn)	10,233	11,215	13,227	15,832
Yield on home loans (%)	10.59	10.60	10.60	10.60
Cost of funds(%)	9.53	9.75	9.77	9.78
Spread (%)	1.06	0.85	0.83	0.82
NIM (%)	2.2	2.0	2.0	2.0
RoA (%)	1.4	1.3	1.2	1.2
RoE (%)	17	16	17	18
EPS (Rs)	20	22	26	31
BVPS (Rs)	128	145	166	190
PER (X)	8.29	7.56	6.41	5.36
PBR (X)	1.31	1.16	1.01	0.89

Source: Kotak Institutional Equities estimates

Exhibit 5: LICHF: Scenario II: Assuming 40 bps NIM compression
March fiscal year-ends, 2013-16E

	2013	2014E	2015E	2016E
NII (Rs mn)	15,345	15,444	19,361	23,191
Loan growth (%)	23.3	22.8	20.3	19.6
PAT (Rs mn)	10,233	9,765	12,180	14,532
Yield on home loans (%)	10.59	10.60	10.70	10.70
Cost of funds(%)	9.53	10.00	10.02	10.03
Spread (%)	1.06	0.60	0.68	0.67
NIM (%)	2.2	1.8	1.9	1.9
RoA (%)	1.4	1.1	1.1	1.1
RoE (%)	17	14	16	17
EPS (Rs)	20	19	24	29
BVPS (Rs)	128	143	162	184
PER (X)	8.29	8.69	6.96	5.84
PBR (X)	1.31	1.17	1.04	0.91

Source: Kotak Institutional Equities estimates

Exhibit 6: LICHF: Scenario III: Assuming stable NIM
March fiscal year-ends, 2013-16E

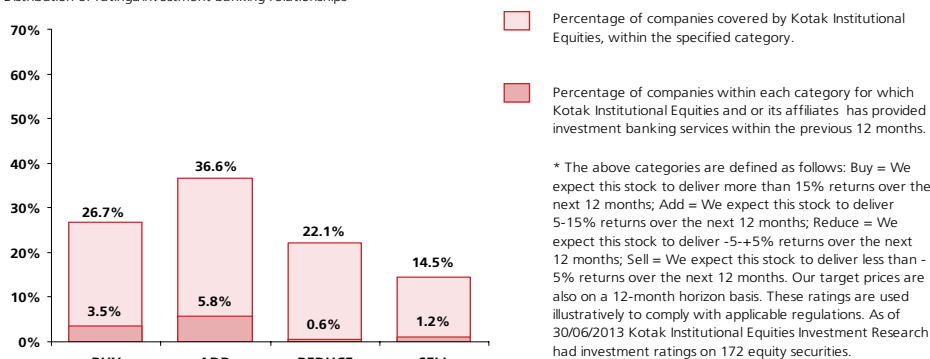
	2013	2014E	2015E	2016E
NII (Rs mn)	15,345	18,728	22,468	27,061
Loan growth (%)	23.3	22.8	20.3	19.6
PAT (Rs mn)	10,233	12,211	14,495	17,415
Yield on home loans (%)	10.59	10.75	10.75	10.75
Cost of funds(%)	9.53	9.75	9.77	9.78
Spread (%)	1.06	1.00	0.98	0.97
NIM (%)	2.2	2.2	2.1	2.2
RoA (%)	1.4	1.4	1.3	1.3
RoE (%)	17	18	18	19
EPS (Rs)	20	24	29	34
BVPS (Rs)	128	147	169	196
PER (X)	8.29	6.95	5.85	4.87
PBR (X)	1.31	1.14	0.99	0.86

Source: Kotak Institutional Equities estimates

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As of June 30, 2013

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