



LIC Housing Finance

STOCK INFO.	BLOOMBERG
BSE Sensex: 17,956	LICH IN
	REUTERS CODE
S&P CNX: 5,394	LICHF.BO

16 July 2010

Buy

Previous Recommendation: Buy

Rs1,057

Equity Shares (m)	95.0
52-Week Range	1,083/558
1,6,12 Rel.Perf.(%)	6/25/47
M.Cap. (Rs b)	100.4
M.Cap. (US\$ b)	2.1

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	ROE	ROA	PIABV
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	(X)
3/09A	8,867	5,316	62.5	37.3	16.9	4.0	26.2	2.0	4.0
3/10A	10,740	6,622	69.7	11.4	15.2	3.0	23.6	1.9	3.0
3/11E	14,751	8,828	92.9	33.3	11.4	2.4	23.4	1.9	2.4
3/12E	17,823	10,628	111.9	20.4	9.4	2.0	23.3	1.9	2.0

LIC Housing Finance (LICHF) reported net profit of 2.1b (71% YoY growth) in 1QFY11, which is higher than our estimate of Rs1.7b. Disbursals continue to be strong – the management maintains its guidance of 40% disbursement growth during FY11. Key highlights are:

- 1QFY11 disbursals grew 40% YoY and sanctions grew 51% YoY. In FY10, disbursals had grown 70% and sanctions had grown 66%.
- Robust NII growth of 60% YoY (on a lower base), led by loan growth of 37% and 56bp YoY improvement in NIM to 3.01%.
- On a QoQ basis, NIM declined 29bp, which was partially offset by loan growth of 5%. NII declined just 2% QoQ. Reported spreads shrank 12bp QoQ to 2.24%, led by 10bp decline in yield on loans to 10.05%. Cost of funds was stable QoQ at 7.81%.
- Management expects to keep its overall cost below its current average of 7.81% and aims to sustain NIM at ~3%.
- Asset quality deteriorated sequentially, with gross NPAs at Rs3.7b v/s Rs2.6b in 4QFY10 (seasonal phenomenon). In percentage terms, gross NPAs declined to 0.92% v/s 1.5% in 1QFY10, while net NPAs decreased to 0.35% v/s 0.65%.

Maintain Buy: We upgrade our earnings estimates on the back of expectations of strong disbursals. We are revising our EPS estimates upwards by 6% to Rs93 for FY11 and Rs112 for FY12. RoA and RoE would remain attractive at ~1.9% and ~23%+, respectively, over FY10-12. The stock trades at 2.4x FY11E and 2x FY12E BV. We maintain **Buy**, with a target price of Rs1,275 (2.4x FY12E BV).

QUARTERLY PERFORMANCE

Y/E MARCH	(RS MILLION)								FY10	FY11E
	FY10				FY11					
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Operating Income	7,802	8,349	8,782	9,629	10,125	10,837	12,144	14,348	34,562	47,454
Other Income	17	42	22	53	25	40	45	50	135	160
Total income	7,819	8,391	8,805	9,683	10,149	10,877	12,189	14,398	34,697	47,614
Y-o-Y Growth (%)	25.5	18.6	14.8	20.1	29.8	29.6	38.4	48.7	19.5	37.2
Interest expenses	5,709	5,979	6,057	6,214	6,772	7,450	8,343	10,297	23,957	32,862
Net Income	2,110	2,413	2,748	3,469	3,377	3,428	3,846	4,101	10,740	14,751
Operating Expenses	322	552	428	613	394	563	578	731	1,911	2,266
Operating Profit	1,788	1,861	2,320	2,856	2,983	2,865	3,268	3,370	8,829	12,485
Y-o-Y Growth (%)	17.4	4.5	26.8	30.8	66.8	53.9	40.9	18.0	20.7	41.4
Provisions and Cont.	100	-417	158	-126	89	100	120	41	-283	350
Profit before Tax	1,688	2,278	2,162	2,982	2,893	2,765	3,148	3,329	9,113	12,135
Tax Provisions	450	566	629	847	773	755	859	920	2,491	3,307
Net Profit	1,238	1,712	1,533	2,135	2,120	2,010	2,289	2,410	6,622	8,828
Y-o-Y Growth (%)	18.3	26.8	14.1	35.5	71.2	17.4	49.3	12.9	24.6	33.3
Int Exp/ Int Earned (%)	73.2	71.6	69.0	64.5	66.9	68.7	68.7	71.8	69.3	69.3
Other Income / Net Income (%)	0.8	1.8	0.8	1.5	0.7	1.2	1.2	1.2	1.3	1.1
Cost to Income Ratio (%)	15.3	22.9	15.6	17.7	11.7	16.4	15.0	17.8	17.8	15.4
Tax Rate (%)	26.6	24.8	29.1	28.4	26.7	27.3	27.3	27.6	27.3	27.3

E: MOST Estimates

Strong growth in sanctions and disbursements

Sanctions grew 51% YoY to Rs53.5b. Sanctions to builders increased to Rs16.9b (up 149% YoY on a lower base) and sanctions for individual loans were Rs36.5b (up 28% YoY). Disbursements grew 40% YoY to Rs33.9b. Disbursements for individual home loans grew 32% YoY to Rs30.2b. Disbursements for builder loans were Rs3.7b, up 148% YoY on a lower base.

Individual loan growth of 34% YoY

Loan book grew 37% YoY and 5% QoQ to Rs400b. Individual loans grew 34% YoY to Rs358b and builder loans grew 65% YoY to Rs41.8b. Share of project loans (financing to builders) increased to 10% v/s 9% in 1QFY10. The management has reiterated its intention to keep exposure to project loans (i.e. to builders) at ~10%. This is with the view to achieve long-term sustainability and stability in income, as this segment yields ~14%. We have modeled ~30% YoY growth in loans in FY11.

Introduction of new scheme

LICHF has introduced a new housing loan scheme, Advantage 5, wherein it would be disbursing loans at an interest rate of 9.25% fixed for five years. The scheme is currently on till 31 July 2010 and the company would take a call every month on whether to continue it. The management has indicated that borrowing for this scheme would be partially through back-to-back arrangements and partially through rolling arrangements.

Spreads declined 12bp QoQ, led by decline in yield on loans

Spreads for 1QFY11 declined 12bp QoQ to 2.24%. Yield on loans declined 10bp sequentially to 10.05% while cost of funds remained largely stable at 7.81%. Incremental cost of funds in 1QFY11 was 7.45% as compared to 7.03% in 4QFY10. NIM declined 29bp sequentially to 3.01%. LICHF expects to contain its incremental cost of borrowing below its current average of 7.81%, and sustain spreads at ~2% and NIM at ~3%.

Borrowings declined 9% QoQ

Total outstanding borrowings at the end of 1QFY11 declined 8.7% sequentially to Rs358b. Of this, 30% is from banks and 56.4% is from NCDs. With the implementation of the base rate, cost of borrowing from banks is likely to go up (current cost: 6.8%). The company intends to reduce the proportion of borrowings from banks gradually by increasing the share of NCDs and other borrowings.

Strong asset-liability management

For LIC HF, the average duration of assets is 8-9 years while the average duration of liabilities is 6-7 years. Of the total assets, 70-75% are on floating rates (excluding money granted under Fix-o-Floating scheme of 8.9% and recently launched scheme, Advantage 5, 9.25% fixed for five years). On the liability side, 60% are on fixed rates.

Cost to income ratio declines sharply

Operating expenses increased 22% YoY but healthy improvement in operational performance resulted in cost to income declining to ~12% v/s 18% in 4QFY10.

Asset quality shows seasonal deterioration

Asset quality deteriorated sequentially, with gross NPAs at Rs3.7b v/s Rs2.6b in 4QFY10. In percentage terms, gross NPAs increased to 0.92% v/s 0.69% in 4QFY10 while net NPAs increased to 0.35% v/s 0.12%. The accretion to NPAs is a yearly phenomenon; we expect asset quality to improve, going forward. Provision coverage ratio was at 62% v/s 57% in 1QFY10 and 82% in 4QFY10. The management expects gross NPAs to be contained below 0.5%.

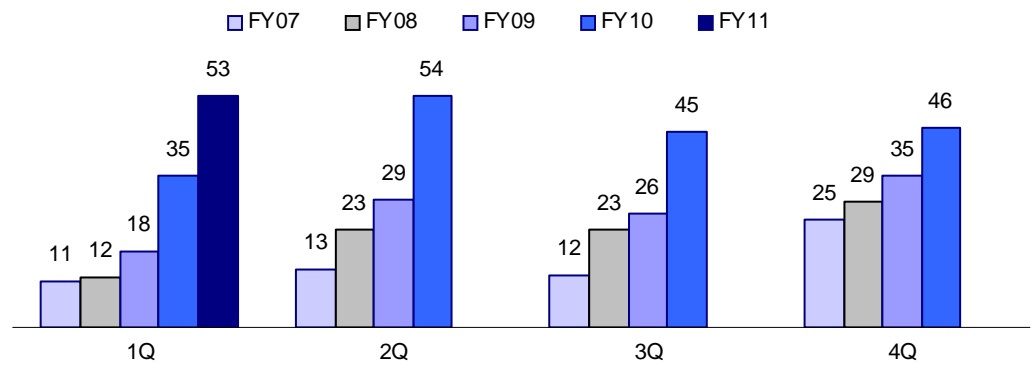
Valuation and view

We upgrade our earnings estimates for LICHF on the back of expectations of strong disbursements. The management plans to take outstanding loan portfolio to Rs500b (we have modeled for Rs490b). We are revising our EPS estimates upwards by 6% to Rs93 for FY11 and Rs112 for FY12. We have accounted for profits from stake sale in LIC Mutual Fund directly to reserves.

Stock trades at 2.4x FY11E and 2x FY12E BV. RoA and RoE would remain attractive at ~1.9% and ~23%+, respectively, over FY10-12. The stock has been re-rated given: (a) the consistent improvement across business parameters in the last several quarters, and (b) strong growth in business despite a challenging environment. We maintain **Buy**, with a target price of Rs1,275 (2.4x FY12E BV).

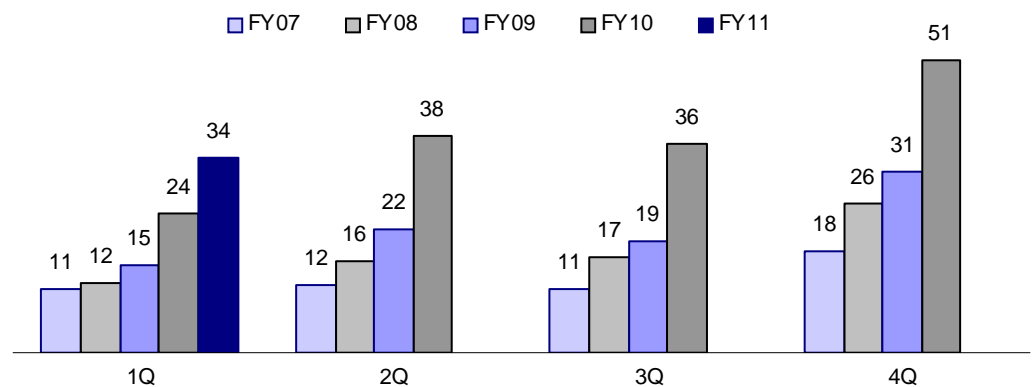
LOAN SANCTION TREND (RS B)

Approvals increase 51% YoY



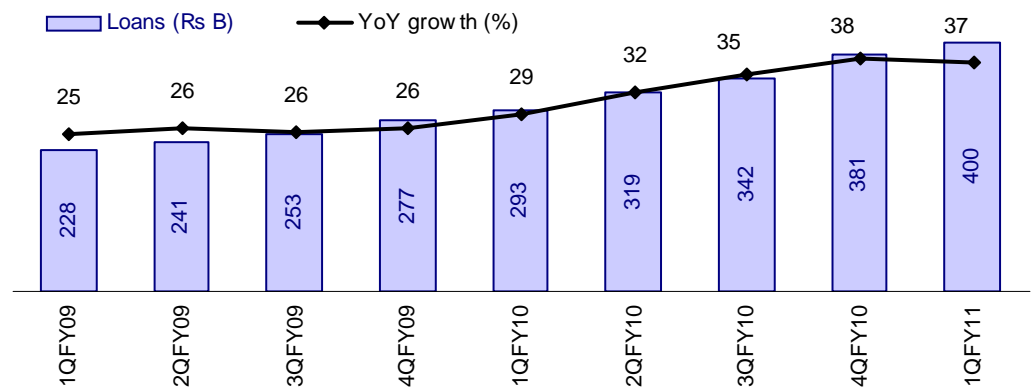
DISBURSAL TRENDS (RS B)

Disbursals up 40% YoY, led by higher disbursals to builders



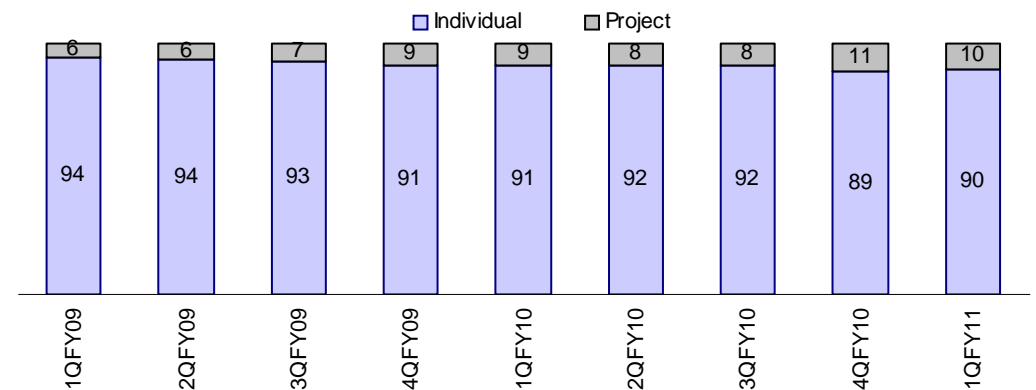
REPORTED LOAN GROWTH (RS B)

Loan book continues to be strong



LOAN MIX (%)

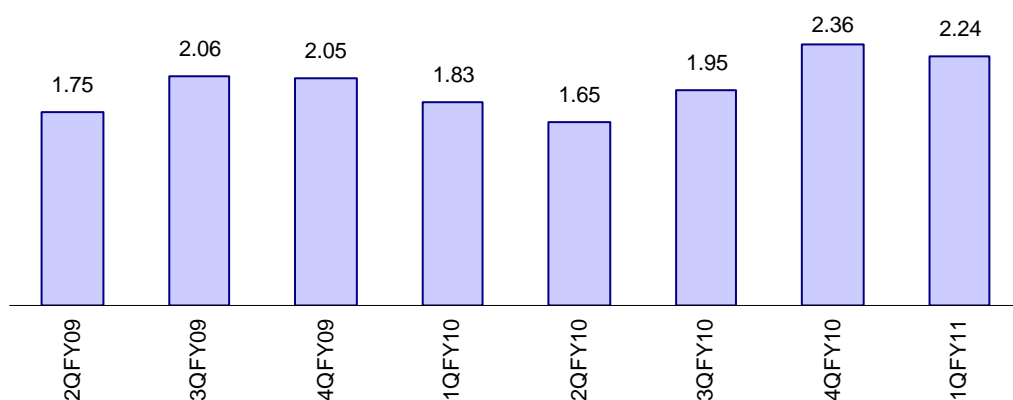
Loans to builders account for 10% of overall loan book



Source: Company/MOSL

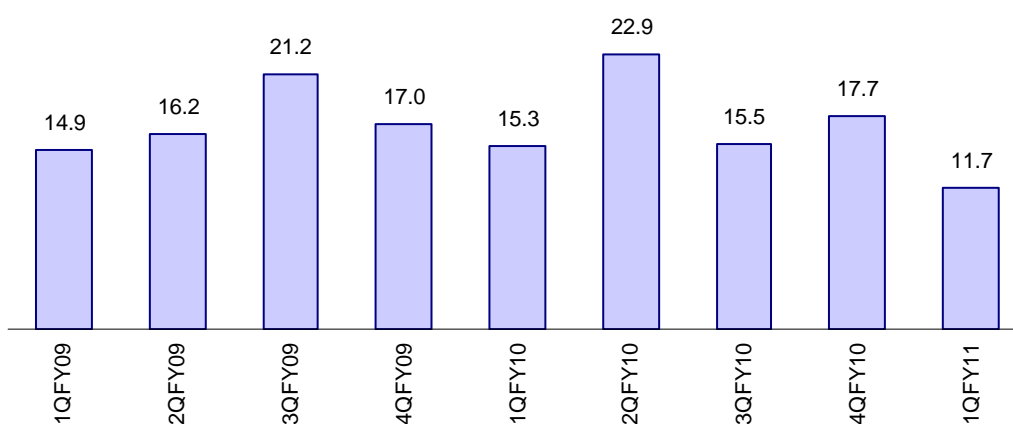
SPREAD MOVEMENT (%)

Spreads declined 12bp QoQ to 2.24%; likely to remain under pressure



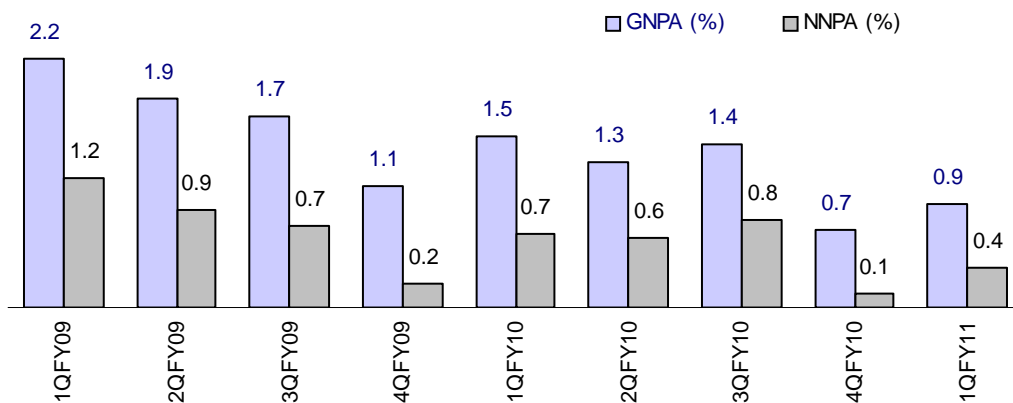
COST TO INCOME RATIO

Decline in cost to income ratio a positive



TREND IN ASSET QUALITY

Uptick in NPAs a seasonal phenomenon



Source: Company/MOSL

LIC Housing Finance: an investment profile

Company description

LIC Housing Finance (LICHF) was promoted by the LIC of India in 1989. LICHF provides loans for homes, construction activities, and corporate housing schemes. Based on the incremental disbursements, it is currently the 2nd largest housing finance company in India. LICHF came out with an IPO in 1994 and launched its maiden GDR in 2004 (US\$29.5m). LICHF holds 100% stake in LICHFL Care Homes and LICHFL Financial and Services, and ~20% stake in LIC Mutual Fund.

Key investment arguments

- Huge potential in the housing mortgage segment in India and LICHF is one of the largest players
- Strong parentage, high brand value, high RoE, and low net NPA levels are the key positives.
- Asset quality remains excellent, a testament to the systemic improvements in the company in the last five years.

Key investment risks

- Increasing competition from state-owned banks may lead to pressure on yields and spreads, going forward.

Recent developments

- LICHF has introduced a new housing loan scheme, Advantage 5, wherein it would be disbursing loans at an interest rate of 9.25% fixed for five years.

Valuation and view

- We upgrade our earnings estimates for LICHF by 6% for FY11 and FY12 on the back of expectations of strong disbursements. We expect EPS CAGR of 26% over FY10-12. We have adjusted the gain from stake sale in LIC MF directly to reserves.
- Stock trades at 2x FY12E BV and 9.6x FY12E EPS.
- We maintain **Buy**, with a target price of Rs1,275 (P/BV of 2.4x FY12E).

Sector view

- With the pick up in economic growth, housing loan growth is likely to accelerate.
- Increasing urbanization, rising disposable income, low interest rates and existing tax sops will keep the demand for mortgages buoyant.

COMPARATIVE VALUATIONS

		LICHF	HDFC*	ICICI BANK*
P/E (x)	FY11E	11.4	18.7	15.0
	FY12E	9.4	14.8	11.3
P/BV (x)	FY11E	2.4	4.7	1.8
	FY12E	2.0	3.8	1.6
Core RoE (%)	FY11E	23.4	25.5	11.7
	FY12E	23.3	25.8	13.7
RoA (%)	FY11E	1.9	2.8	1.4
	FY12E	1.9	2.8	1.5

* Valuation adjusted for investment in key subsidiaries

SHAREHOLDING PATTERN (%)

	JUN-10	MAR-10	JUN-09
Promoter	36.6	36.6	40.8
Domestic Inst	18.4	17.4	19.0
Foreign	32.3	34.1	23.7
Others	12.8	12.0	16.4

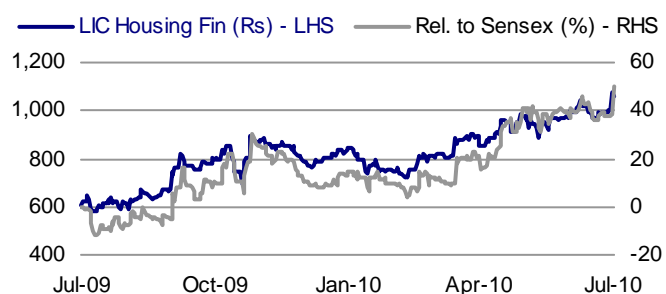
EPS: MOST FORECAST V/S CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY11	92.9	81.7	13.8
FY12	111.9	109.7	2.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,057	1,275	20.6	Buy

STOCK PERFORMANCE (1 YEAR)



Financials and Valuation

INCOME STATEMENT		(RS MILLION)					
Y/E MARCH	2007	2008	2009	2010	2011E	2012E	
Interest Income	14,990	20,368	27,477	32,827	45,163	58,435	
Interest Expended	11,015	14,829	20,166	23,957	32,862	43,383	
Net Interest Income	3,975	5,539	7,310	8,870	12,301	15,052	
<i>Change (%)</i>	18.7	39.3	32.0	21.3	38.7	22.4	
Fee Income	481	526	682	1,274	1,804	2,075	
Income from Investments	234	593	644	461	486	511	
Other Income	50	247	232	135	160	185	
Net Income	4,741	6,905	8,867	10,740	14,751	17,823	
<i>Change (%)</i>	14.5	45.6	28.4	21.1	37.3	20.8	
Operating Expenses	1,046	1,339	1,541	1,911	2,266	2,714	
Operating Income	3,695	5,566	7,326	8,829	12,485	15,109	
<i>Change (%)</i>	16.1	50.6	31.6	20.5	41.4	21.0	
Provisions/write offs	157	243	62	-283	350	500	
PBT	3,538	5,323	7,264	9,113	12,135	14,609	
Tax	746	1,451	1,948	2,491	3,307	3,981	
<i>Tax Rate (%)</i>	21.1	27.3	26.8	27.3	27.3	27.3	
PAT	2,791	3,872	5,316	6,622	8,828	10,628	
<i>Change (%)</i>	33.8	38.7	37.3	24.6	33.3	20.4	
Proposed Dividend	782	994	1,292	1,667	2,084	2,501	

BALANCE SHEET		(RS MILLION)					
Y/E MARCH	2007	2008	2009	2010	2011E	2012E	
Capital	850	850	850	950	950	950	
Reserves & Surplus	14,588	17,467	21,491	32,927	40,671	48,798	
Net Worth	15,438	18,317	22,341	33,877	41,621	49,748	
Secured Loans	146,770	191,134	235,240	326,550	421,906	525,959	
<i>Change (%)</i>	18.7	30.2	23.1	38.8	29.2	24.7	
Subordinated Debt	5,000	5,000	10,000	10,000	10,000	10,000	
Unsecured Loans	11,556	7,310	8,977	11,032	17,174	23,875	
Other Liabilities & Prov.	9,076	11,814	17,265	20,960	23,057	25,362	
Total Liabilities	187,841	233,575	293,823	402,419	513,757	634,945	
Cash and bank balance	7,790	3,639	1,353	2,670	2,091	3,450	
Investments	2,061	7,746	11,292	13,887	15,276	16,803	
<i>Change (%)</i>	-34.4	275.8	45.8	23.0	10.0	10.0	
Loans	175,635	219,364	276,793	380,814	490,797	608,516	
<i>Change (%)</i>	18.1	24.9	26.2	37.6	28.9	24.0	
Net Fixed Assets	236	300	345	356	433	499	
Other Assets	2,118	2,526	4,041	4,692	5,161	5,677	
Total Assets	187,841	233,575	293,823	402,419	513,757	634,945	

ASSUMPTIONS	(%)					
Loan Growth	18.1	24.9	26.2	37.6	28.9	24.0
Borrowings Growth	18.5	24.6	25.0	36.7	29.2	24.7
Investments Growth	-34.4	275.8	45.8	23.0	10.0	10.0
Dividend	79.9	99.9	130.0	150.0	187.5	225.0

E: MOST Estimates

Financials and Valuation

RATIOS

Y/E MARCH	2007	2008	2009	2010	2011E	2012E
Spreads Analysis (%)						
Avg. Yield on Earning Assets	8.7	9.7	10.4	9.4	9.9	10.2
Avg. Cost-Int. Bear. Liab.	7.3	8.1	8.8	8.0	8.3	8.6
Interest Spread	1.3	1.6	1.6	1.5	1.6	1.6
Net Interest Margin	2.3	2.6	2.8	2.6	2.7	2.6

Profitability Ratios (%)

RoAE	19.3	22.9	26.2	23.6	23.4	23.3
RoAA	1.6	1.8	2.0	1.9	1.9	1.9
Int. Expended/Int.Earned	73.5	72.8	73.4	73.0	72.8	74.2
Other Inc./Net Income	1.1	3.6	2.6	1.3	1.1	1.0

Efficiency Ratios (%)

Fees/Operating income	3.1	2.4	2.4	3.7	3.8	3.4
Op. Exps./Net Income	22.1	19.4	17.4	17.8	15.4	15.2
Empl. Cost/Op. Exps.	25.6	25.8	29.1	25.4	24.6	24.7

Asset-Liability Profile (%)

Loans/Borrowings Ratio	119.7	114.8	117.7	116.6	116.3	115.7
Debt/Equity (x)	10.6	11.1	11.4	10.3	10.8	11.3
Gross NPAs	4,523	3,730	2,970	3,662	4,614	5,841
Gross NPAs to Adv.	2.6	1.7	1.1	1.0	0.9	1.0
Net NPAs	2,209	1,410	568	1,208	1,615	2,044
Net NPAs to Adv.	1.3	0.6	0.2	0.3	0.3	0.3
CAR	13.0	14.0	12.5	15.0	14.0	14.0

VALUATION

Book Value (Rs)	181.6	215.5	262.8	356.6	438.1	523.7
Price-BV (x)	5.8	4.9	4.0	3.0	2.4	2.0
Adjusted BV (Rs)	164.7	204.7	258.5	348.3	427.1	509.7
Price-ABV (x)	5.8	4.9	4.0	3.0	2.4	2.0
EPS (Rs)	32.8	45.6	62.5	69.7	92.9	111.9
EPS Growth (%)	33.8	38.7	37.3	11.4	33.3	20.4
Price-Earnings (x)	32.2	23.2	16.9	15.2	11.4	9.4
OPS (Rs)	43.5	65.5	86.2	92.9	131.4	159.0
OPS Growth (%)	16.1	50.6	31.6	7.8	41.4	21.0
Price-OP (x)	24.3	16.1	12.3	11.4	8.0	6.6

E: MOST Estimates

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

LIC Housing Finance

- | | |
|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.