LIC Housing Finance

INDIA PRIVATE CLIENTS

Improvement in RoA to drive valuation re-rating

Loan book to witness healthy CAGR of 18%

LIC Housing Finance (LICHF), 3rd largest player in the mortgage market with ~13% share, is witnessing growth moderation as disbursement growth in retail mortgages has come off while it remains weak in the developer segment. We expect portfolio growth to further moderate to 16% in FY15 but recover strongly in FY16 to 19%. In our view, retail disbursements should start reviving after a couple of quarters supported by improvement in underlying demand and a stable-to-increasing property prices. Growth in developer segment is also expected to pick-up as asset quality risks abate and construction activity improve.

NIM to see a gradual recovery; incremental spreads improving

Incremental spread after hitting a low of 1.1-1.2% has improved 1.4% in recent quarters. This trend of gradual recovery would continue in the medium term translating into improved NIM in FY15. Cost of funding is expected to decline materially over FY14-16 on account of improved liquidity conditions, easing of policy rates and shift in funding mix away from relatively costlier bank borrowings. On the other side, blended portfolio yield is likely to display some resilience as 50%+ of the portfolio is at fixed rate, share of LAP and developer loans is estimated to increase and it is likely that market would hold pricing in the initial phase of easing cycle.

Asset quality to stabilize; RoA to improve

After witnessing significant deterioration, asset quality is expected to stabilize in coming quarters as macro environment improves. As per company, most of the problem accounts in developer segment have been identified and therefore further large slippages are unlikely. Delinquencies in retail mortgages segment are expected to remain benign. Credit cost is estimated to remain low due to reversal of teaser loan provisioning and expected recoveries from defaulted developers. This along with NIM recovery will drive RoA expansion to 1.7%. In this context, LICHF's valuation at 1-yr rolling fwd 1.4x P/ABV (~20% discount to 5-year mean) is attractive. The key risk to our case for near-term valuation re-rating would be the award of banking license.

Financial summary

Y/e 31 Mar (Rs m)	FY13	FY14E	FY15E	FY16E
Total operating income	17,343	22,024	26,733	31,556
Yoy growth (%)	6.8	27.0	21.4	18.0
Operating profit (pre-provisions)	14,524	18,867	23,072	27,271
Net profit	10,232	13,187	16,227	18,631
yoy growth (%)	11.9	28.9	23.1	14.8
EPS (Rs)	20.3	26.1	32.1	36.9
Adj. BVPS (Rs)	122.8	139.8	162.5	188.7
P/E (x)	11.7	9.1	7.4	6.5
P/Adj.BV (x)	1.9	1.7	1.5	1.3
ROE (%)	16.8	18.8	19.8	19.5
ROA (%)	1.5	1.6	1.7	1.7
CAR (%)	14.8	17.0	15.8	14.5

Source: Company, India Infoline Research

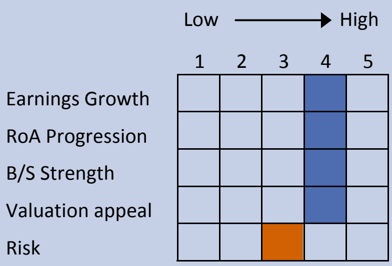
March 31, 2014

Rating:	**BUY**
Target (9-12 months):	**Rs285**
CMP:	**Rs238**
Upside:	**19.7%**

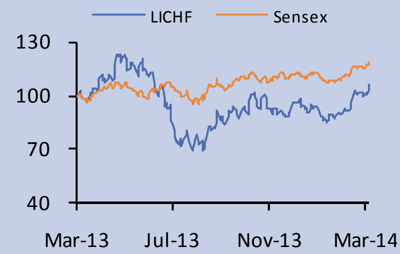
Sector:	**Financials**
Sector view:	**Positive**
Sensex:	22340
52 Week h/l (Rs):	281/152
Market cap (Rscr) :	12,003
6m Avg vol ('000Nos):	3,106
Bloomberg code:	LICHF IN
BSE code:	500253
NSE code:	LICHSGFIN
FV (Rs):	2

Price as on Mar 28, 2014

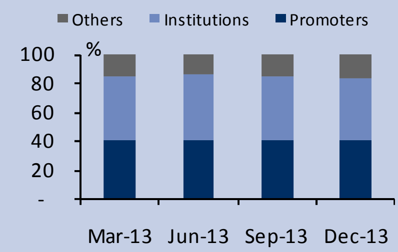
Company rating grid



Share price trend



Share holding pattern



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Company Report

Loan book to witness healthy CAGR of 18%

Aided by widened distribution and property price inflation, LIC Housing Finance (LICHF) witnessed a robust 32% CAGR in its mortgage book over FY09-12 increasing its market share from 7% to 13%. Currently, it is the third largest retail mortgage lender in the country after HDFC and SBI. However, over the past many quarters there has been sustained moderation in loan growth which has come-off to 19% yoy. The slowdown has been driven by general decline in transaction volume in the retail segment, muted growth in real estate prices, company's averseness to grow developer portfolio and an increasing base effect.

32% CAGR in Loan book over FY09-12; market share increased to 13%

Recently portfolio growth has come-off to 19% yoy due to multiple factors

Having witnessed heightened stress in the developer segment, LICHF has substantially run-down this portfolio since the start of FY12. The share of developer loans in the overall book has declined to 3% from a peak of 11%+ during FY11. Quarterly disbursements in this segment have averaged modest Rs2.5bn over the past three years. Though the company now has intentions of gradually increasing the share of developer loans, the pace of incremental growth is likely to be a function of quality of the underlying asset and availability of good opportunities.

Developer loans' share in overall book has declined to 3% from peak of 11%+

Company now has intentions of gradually increasing its share

In the retail mortgages segment, the disbursement growth has weakened materially to mid-single digits from 20%+ just a few quarters back for the aforesaid reasons. Within the segment, loan against property (LAP) product has been witnessing strong disbursement growth of 20%+ yoy and its contribution in the outstanding retail mortgages has increased to 3.5%. LICHF is confident about this further increasing to 5% over the next few quarters. We expect retail disbursement growth to start reviving after a couple of quarters aided by improvement in underlying volumes and a stable-to-increasing property prices. However, the recent sharp moderation in disbursement growth is likely to hurt portfolio folio growth in the near term.

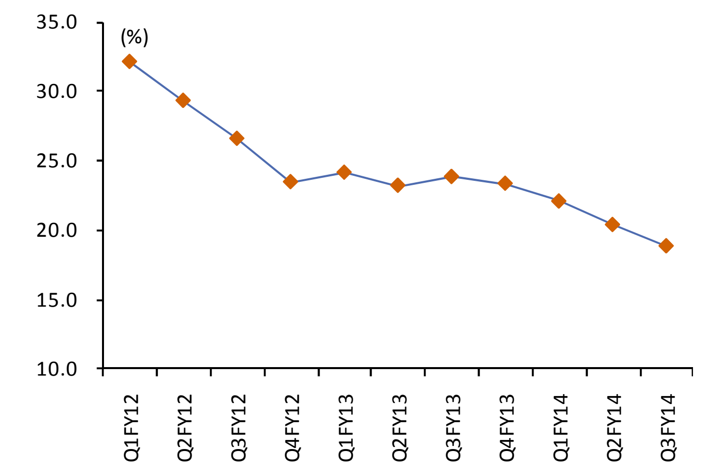
Disbursements of retail mortgages has slowed down

LAP continues to grow ahead of the overall book; share to increase to 5%

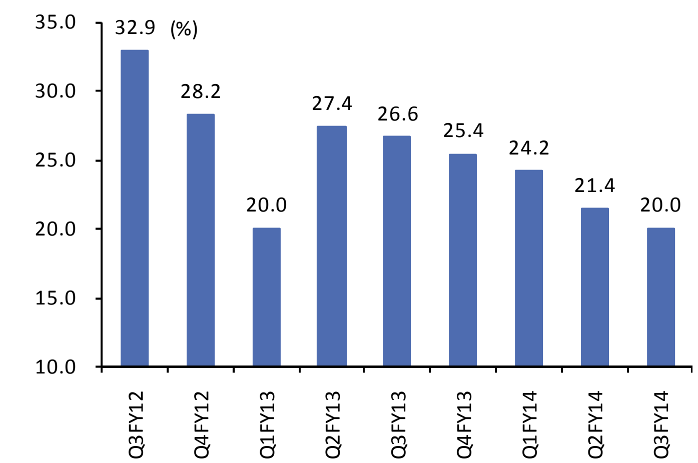
Overall, we expect LICHF loan book to witness a healthy CAGR of 18% over FY14-16 with the share of LAP and developer loans improving.

Expect retail disbursement growth to start reviving after a couple of quarters

Loan growth has been moderating

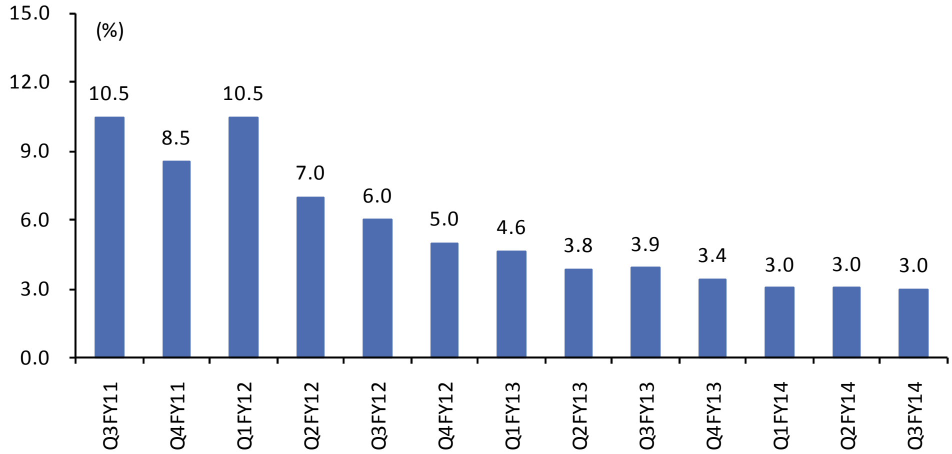


Retail mortgages growth has been on decline



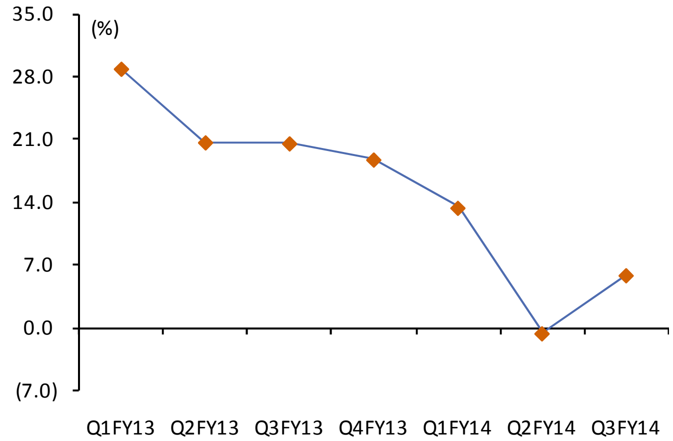
Source: Company, India Infoline Research

Share of developer loans has dipped significantly

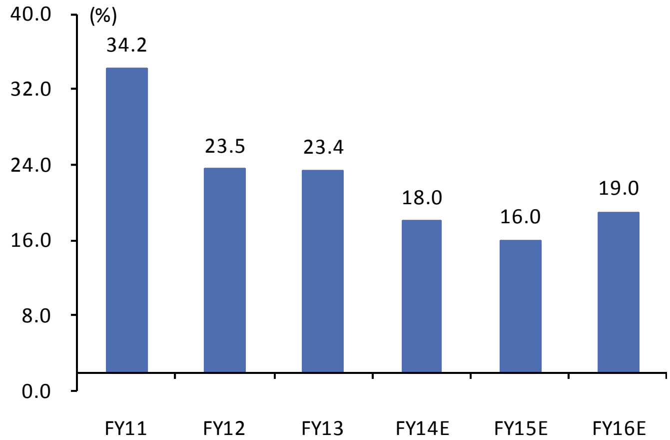


Source: Company, India Infoline Research

Retail loan disbursements growth has come-off sharply



Loan growth to bounce-back to 19% in FY16



Source: Company, India Infoline Research

NIM to see a gradual recovery; incremental spreads improving

Over FY11-13, LICHF’s NIM saw a steep correction of 90bps with the shift in portfolio mix, intense price competition and deterioration in developer portfolio restricting the uptick in portfolio yield in an increasing funding cost environment. On the resources side, company’s reliance on NCDs/Bonds is high at 63% with bank term loans forming majority of the balance. LICHF has been working towards reducing the share of relatively high-cost bank borrowings (10.7% v/s 9.4% for NCDs) in the funding mix to improve the overall cost.

NIM corrected by 90bps over FY11-13

On the liability side, company’s reliance on NCDs is high

During Q1 FY14 when liquidity was available in the market, company pulled down bank funding from 30% in the previous quarter to 25%. However, due to exceptional liquidity tightness during Q2 FY14, company had to resort to substantial bank borrowings to fund loan growth. With the liquidity situation having eased in recent months and expected to remain benign over the medium term, the cost of institutional funding (NCDs) should moderate. This would allow the company to replace relatively higher cost bank borrowings. Already in Q3 FY13, bank loans formed only 10% of the incremental borrowings. We envisage the contribution of bank borrowings in the funding mix declining to 24-25% by H2 FY15. This along with policy rate easing by the RBI should drive a material decline in funding cost during FY15/16.

Share of bank funding to decline as liquidity eases and the cost of institutional funding falls

On the asset side, the blended portfolio yield is likely to display some resilience as 1) more than 50% of the portfolio is fixed rate loans (counting hybrid loans currently at fixed rate) 2) the share of LAP and developer loans is estimated to increase (both are priced much higher at 13.5% than 10.5-11% for retail home loans) and 3) it is likely that market would hold pricing in the initial part of easing cycle. Incremental spread after hitting a low of 1.1-1.2% has improved 1.4% in recent quarters. This trend of gradual recovery would continue in the medium term therefore translating into improved NIM in FY15.

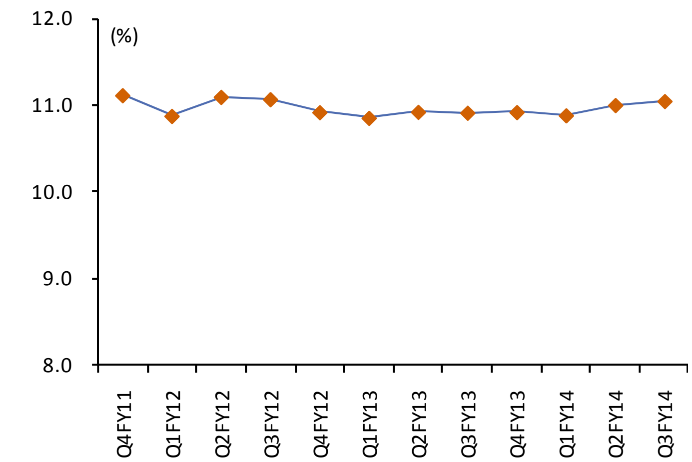
Portfolio yield to display resilience over the next two years

Trend of improvement in incremental spread is likely to continue

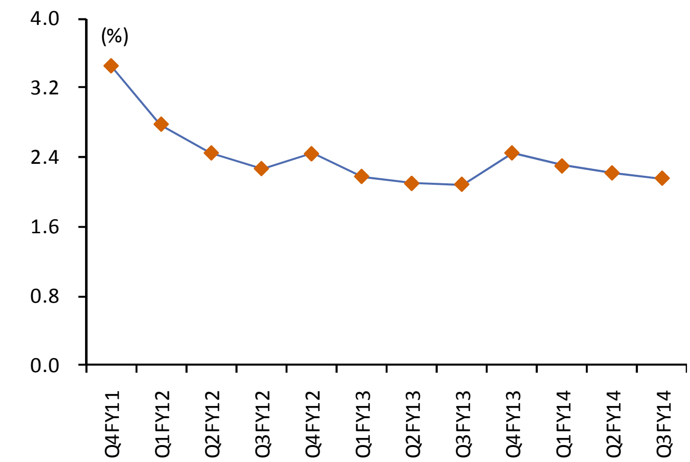
The cost income ratio is also anticipated to decline as the opex growth has moderated in recent quarters and is expected to remain lower than income growth. We estimate cost/income ratio to improve to 13.6% in FY16 from 16.3% in FY13.

Cost/income ratio to decline as income growth beats opex growth

Portfolio yield has been stable though interest rates have increased in general

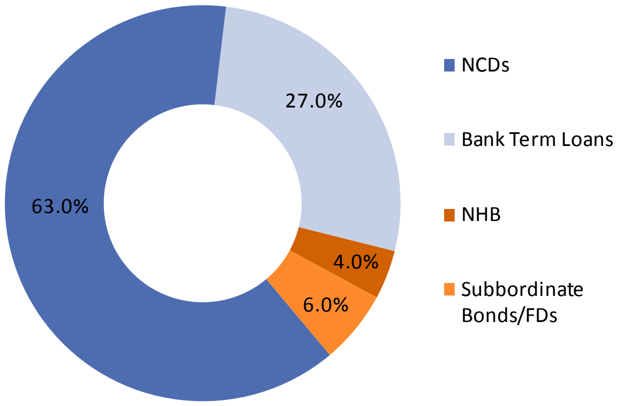


NIM has declined quite sharply but has bottomed out

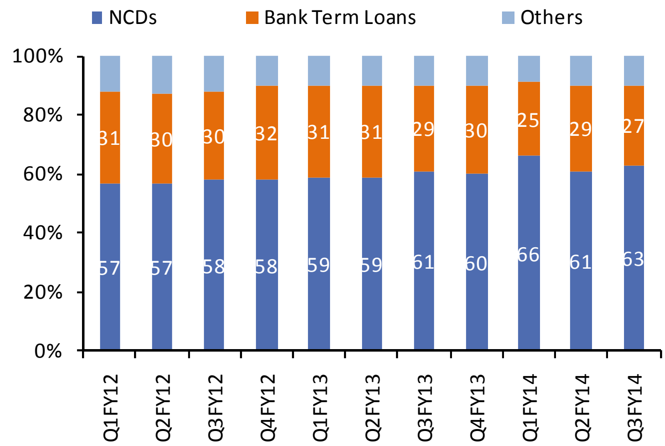


Source: Company, India Infoline Research

NCDs/Bonds is the major source of funding

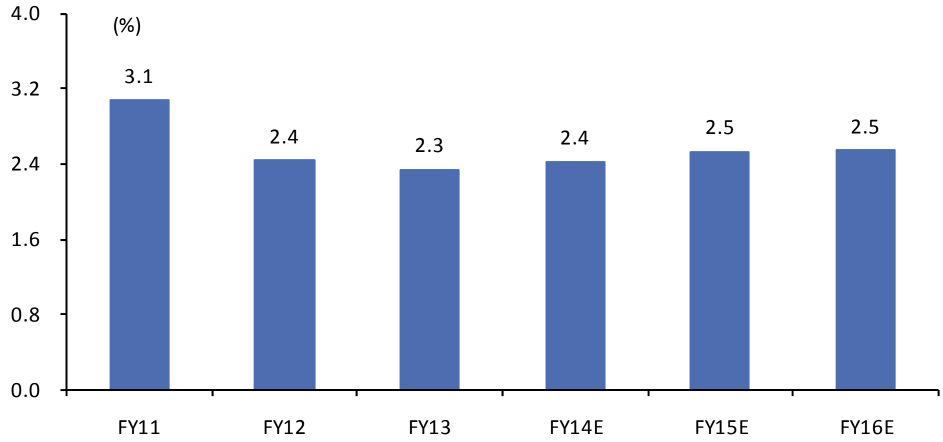


Shift away from bank funding to continue



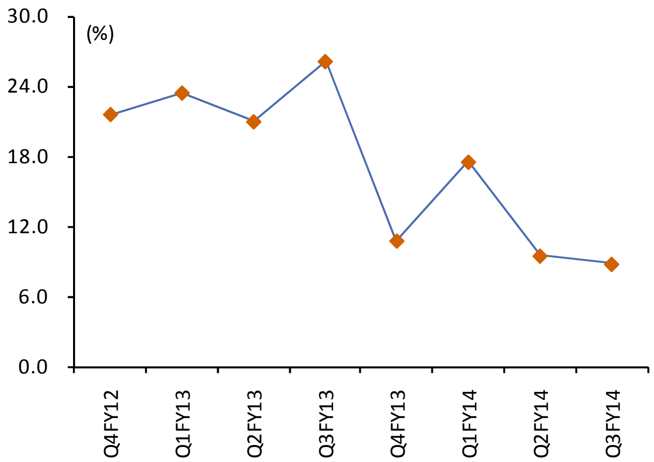
Source: Company, India Infoline Research

NIM (calculated) to witness a mild recovery over FY14-16

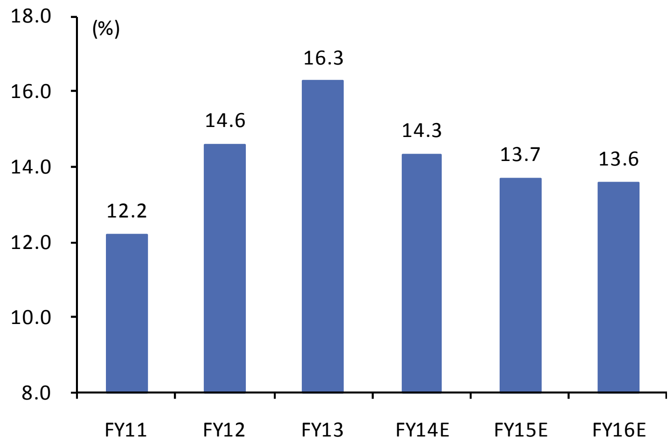


Source: Company, India Infoline Research

Opex growth has come-off sharply



Cost/income to decline as income grows faster than cost



Source: Company, India Infoline Research

Asset quality to stabilize; credit cost to be modest

LICHF's asset quality has seen a material deterioration during FY13 and YTD FY14. Absolute Gross NPLs has jumped 2.7x and as a ratio to advances has increased from 0.4% to 0.8%. A large part of the NPL accretion has happened in the developer loan portfolio where the Gross NPLs have reached a high level of ~14%. Asset quality in retail mortgage segment has remained benign with Gross NPLs currently at ~0.4%.

Gross NPLs has jumped 2.7x since the start of FY13 driven by large influx in developer portfolio

About four accounts in the developer loan segment constitute the outstanding bad loans. LICHF holds more than 2-2.5x collateral in all these NPL accounts. It has already commenced legal action and in a couple of cases have repossessed the properties. Company expects the defaulting developers to pay-up once it starts proceedings to liquidate the securities. As per the management, most of the problem accounts have been identified and therefore further large slippages in this segment is unlikely. We are also of the view that resilient pricing, demand revival (especially in the commercial segment) and easing of rate cycle could provide relief to stressed developers thereby stabilizing the assets quality in this segment. Delinquencies in the retail mortgages segment is expected to remain low. Blended LTV of the book is also very comfortable at 54-55%. Overall, we estimate the pace of NPL accretion to slow down over the next two years and therefore Gross NPL level should remain at sub 1%.

Legal and recovery proceedings initiated against defaulting developers; security cover is 2-2.5x

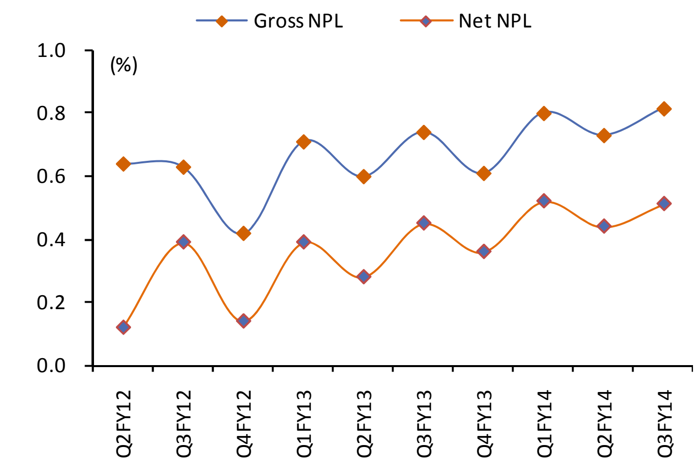
Further large slippages in this segment unlikely as per company

Assets quality in retail mortgage segment has remained benign

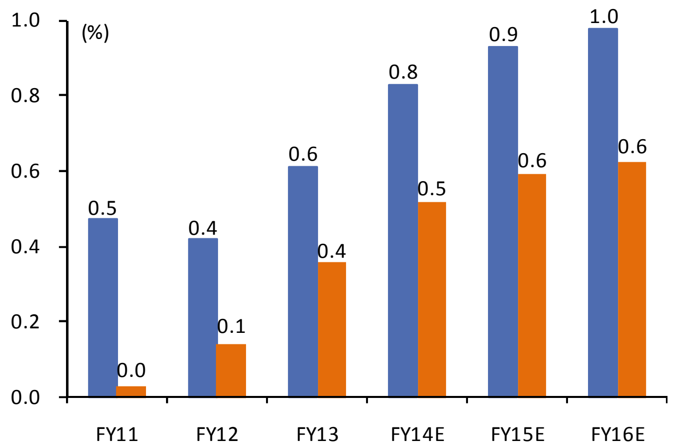
Credit cost is also expected to remain low in FY15 (9bps) and then normalize in FY16 (15 bps). FY15 credit cost would be suppressed by reversal of provisioning on the teaser loan portfolio; ~Rs1.4bn expected to be released over Q4 FY14-Q2 FY15. Recoveries from the defaulting developers would also lead to release of provisions. In FY16, we expect improved operating environment to drive modest credit cost.

FY15 credit cost to be suppressed by reversal of teaser loan provisioning

NPLs have risen sharply since the start of FY13

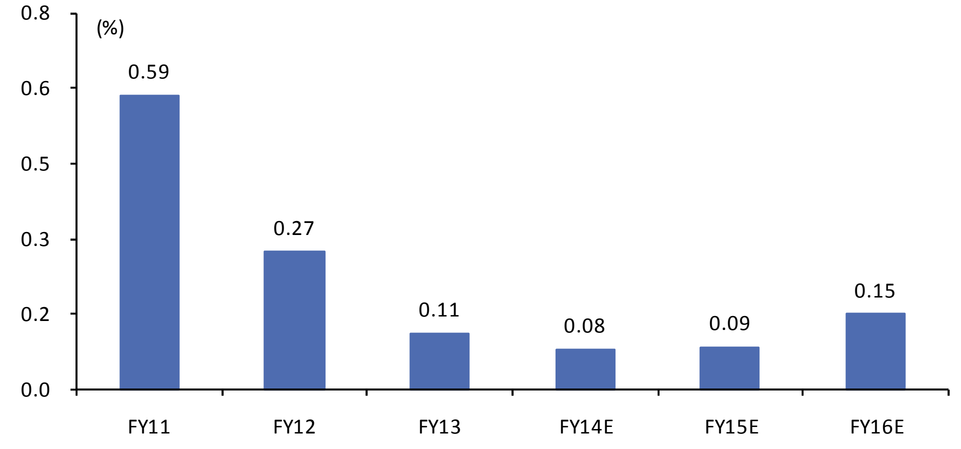


Accretion to slowdown; marginal uptick in NPL levels from hereon



Source: Company, India Infoline Research

Credit cost to remain modest through FY15-16



Source: Company, India Infoline Research

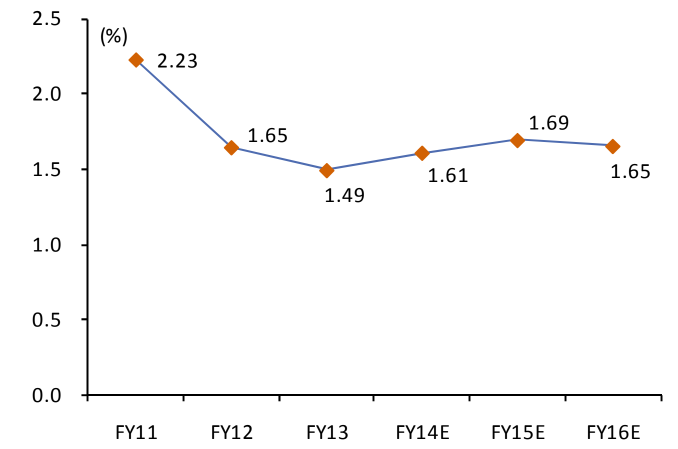
RoA has bottomed out but long-term sustainable level near 1.7%

The significant compression in NIM during FY11-13 lowered RoA to 1.5%. However, as incremental spreads are improving, RoA has also recovered slightly in YTD FY14. With NIM likely to expand marginally in FY15 and credit cost to remain low, the RoA is expected to bounce to 1.7%. We believe that sustainable RoAs for the industry would reset at much lower level as compared to the previous cycle with intensification of competition leading to aggression on pricing front. So for LIC improving RoA beyond 1.7% would a difficult task unless the market adheres to some pricing discipline or institutional funding cost declines sharply. Tier-1 capital adequacy ratio is at modest 12.5% (v/s 10% minimum regulatory requirement) but is unlikely to act as a constraint to the estimated growth due to strong growth in internal accruals.

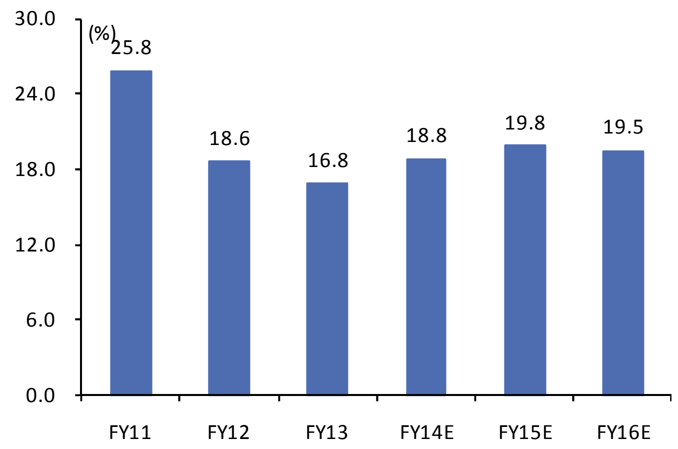
RoAs hit a low of 1.5% during FY13; on course to reach 1.7% in FY15 driven by NIM improvement and low credit cost

Tier-1 capital adequacy at modest 12.5% but is unlikely to act as a growth constraint

RoA on the mend; in longer-term to be around 1.7%

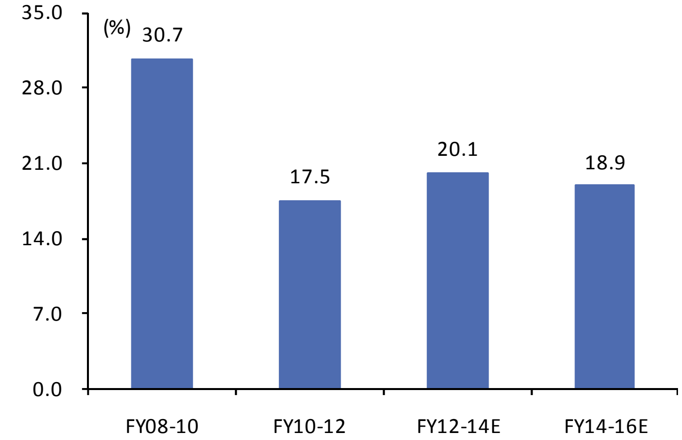


RoE to be in the impressive band of 18-20%

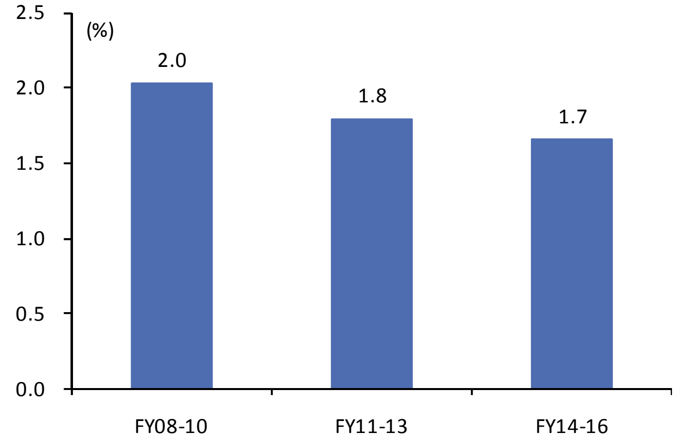


Source: Company, India Infoline Research

Earnings growth to be reasonably healthy



Average RoA over FY14-16 will not be significantly lower than during FY11-13



Source: Company, India Infoline Research

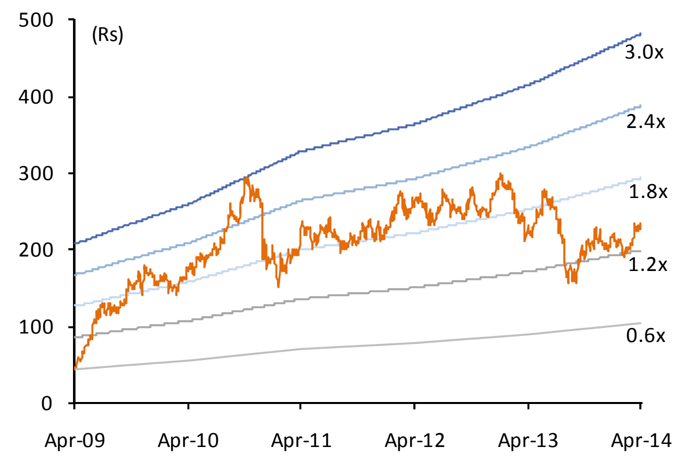
Valuation attractive vis-à-vis improved RoA delivery

LICHF's valuation has de-rated significantly over the past 18-20 months on the back of RoA decline which was driven by NIM contraction and deterioration in asset quality. From trading near 2x 1-year fwd rolling P/ABV (~10% above 5-year mean, valuation has come-off to 1.4x (~20% below the mean). In another context, valuation has traded below the 1-year fwd RoA since June 2013 while it has always remained above it in the preceding 3.5 years. We therefore believe that LICHF's current absolute valaution is attractive especially when the operating environment is turning for better and RoA is on the mend. The key risk to our case for valuation re-rating would be the award of the banking license to the company which will involve a painful transition and add an element of uncertainty. We recommend buying LICHF with a 9-12 month target of Rs285.

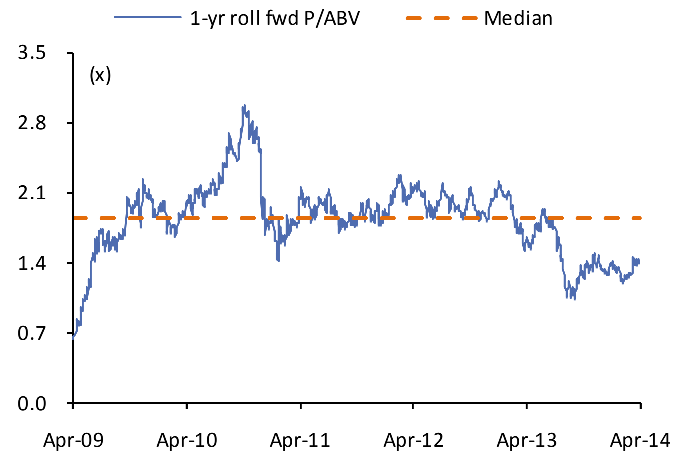
Valuation has de-rated from 2x 1-year fwd rolling P/ABV to 1.4x; currently at 20% discount to 5-year mean

It looks attractive in context of improving operating environment and RoA

1-year rolling forward P/ABV at 1.4x

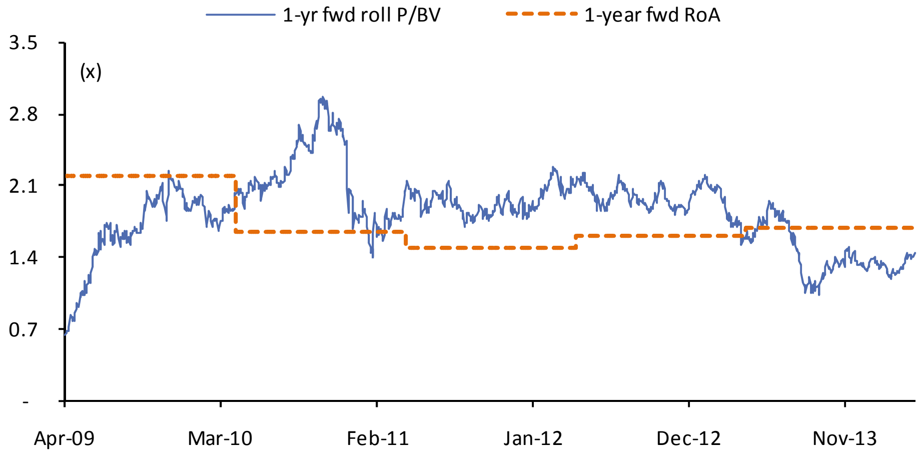


… at ~20% discount to five-year mean



Source: Bloomberg, India Infoline Research

Trading below 1-year forward RoA



Source: Bloomberg, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs mn)	FY13	FY14E	FY15E	FY16E
Income from Operatns	75,759	91,891	105,453	119,359
Interest expense	(59,246)	(71,319)	(80,317)	(89,720)
Net interest income	**16,513**	**20,572**	**25,136**	**29,639**
Non-interest income	830	1,452	1,597	1,916
Total op income	**17,343**	**22,024**	**26,733**	**31,556**
Total op expenses	(2,818)	(3,157)	(3,662)	(4,284)
Op profit (pre-prov)	**14,524**	**18,867**	**23,072**	**27,271**
Provisions	(789)	(679)	(843)	(1,749)
Profit before tax	**13,736**	**18,189**	**22,229**	**25,522**
Taxes	(3,504)	(5,002)	(6,002)	(6,891)
Net profit	**10,232**	**13,187**	**16,227**	**18,631**

Balance sheet

Y/e 31 Mar (Rs mn)	FY13	FY14E	FY15E	FY16E
Investments	1,846	2,031	2,234	2,457
Advances	778,127	918,189	1,065,100	1,267,469
Net current assets	(28,143)	(34,132)	(38,489)	(47,506)
Fixed assets	624	686	755	830
Total assets	**752,454**	**886,775**	**1,029,599**	**1,223,251**
Net worth	**64,813**	**75,358**	**88,356**	**103,172**
Secured loans	649,926	766,913	889,619	1,058,647
Unsecured loans	37,715	44,503	51,624	61,432
Total int-bear liab	**687,641**	**811,416**	**941,243**	**1,120,079**
Equity + Total liab	**752,454**	**886,774**	**1,029,599**	**1,223,251**

Key ratios

Y/e 31 Mar	FY13	FY14E	FY15E	FY16E
Growth matrix (%)				
Net interest income	18.7	24.6	22.2	17.9
Total op income	6.8	27.0	21.4	18.0
Op profit (pre-provision)	4.7	29.9	22.3	18.2
Net profit	11.9	28.9	23.1	14.8
Loans	23.4	18.0	16.0	19.0
Borrowings	22.6	18.0	16.0	19.0
Total assets	21.8	17.9	16.1	18.8
Profitability Ratios (%)				
NIM	2.3	2.4	2.5	2.5
Non-int inc/Total inc	4.8	6.6	6.0	6.1
Return on Avg Equity	16.8	18.8	19.8	19.5
Return on Avg Assets	1.5	1.6	1.7	1.7
Per share ratios (Rs)				
EPS	20.3	26.1	32.1	36.9
Adj.BVPS	122.8	139.8	162.5	188.7
DPS	3.6	4.5	5.5	6.5
Valuation ratios (x)				
P/E	11.7	9.1	7.4	6.5
P/Adj.BVPS	1.9	1.7	1.5	1.3
Other key ratios (%)				
Loans/Borrowings	113.2	113.2	113.2	113.2
Cost/Income	16.3	14.3	13.7	13.6
CAR	14.8	17.0	15.8	14.5
Tier-I capital	10.3	12.0	11.3	10.5
Gross NPLs/Loans	0.6	0.8	0.9	1.0
Total prov/Avg loans	0.1	0.1	0.1	0.2
Net NPLs/Net loans	0.4	0.5	0.6	0.6
Tax rate	25.5	27.5	27.0	27.0
Dividend yield	1.5	1.9	2.3	2.7

IIFL Research won 3 awards at India's Best Market Analyst Awards 2013 by Zee Business for Banking, Oil & Gas and Pharma.

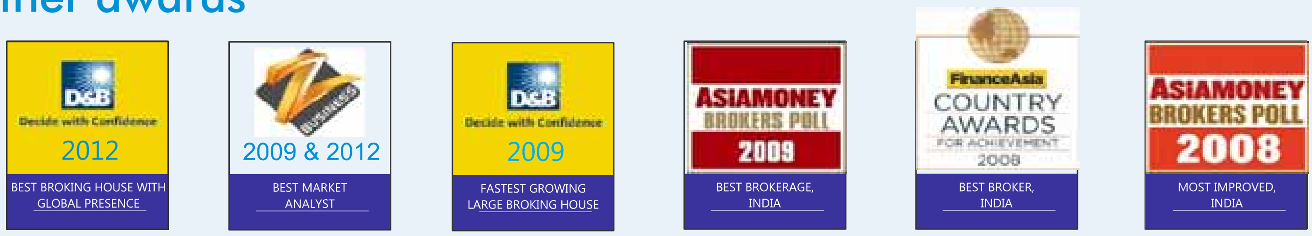
'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards



Recommendation parameters for fundamental reports:

BUY – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

SELL – Absolute return below -10%

Call Failure - In case of a Buy report, if the stock falls 20% below the recommended price on a closing basis, unless otherwise specified by the analyst; or, in case of a Sell report, if the stock rises 20% above the recommended price on a closing basis, unless otherwise specified by the analyst

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