May 20, 2009

Visit Note

CMP : INR 430
Target : INR 512

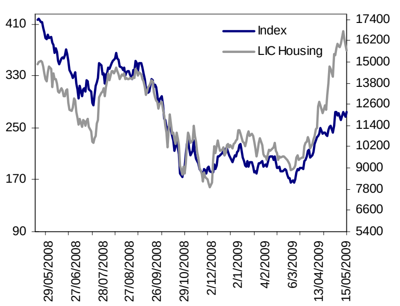
LIC Housing Finance Ltd.

KEY DATA	
Market Cap (Rs bn)	36.5
Market Cap (US$ mn)	761.4
52 WK High / Low	420/151
Avg Daily Volume (BSE)	303308
Face Value (Rs)	10

BSE Sensex	14302
Nifty	4318
BSE Code	500253
NSE Code	LICHSGFIN
Reuters Code	LICH.BO
Bloomberg Code	LICHF IN

Shareholding %	2Q	3Q	4Q
Promoters	41.0	41.0	41.0
MF/Banks/Indian FIs	8.0	14.0	19.0
FII/ NRIs/ OCBs	33.0	27.0	22.0
Indian Public	18.0	18.0	18.0

Performance Chart



Financials (INR Mn.)	FY09	FY10E	FY11E
NII	7,310	9,128	10,976
PPP	7,317	8,780	10,478
PAT	5,316	6,342	7,576
EPS	62.6	74.7	89.2

We interacted with the management of LIC housing Finance. Key takeaways of the meetings are as under:

Demand for Housing Loan is picking up.

Post interest rate cuts and correction in property prices (especially in big cities), the demand for housing loans is picking up. Last two months (March and April) the disbursements grew by 42% and 34% respectively for the company which indicates strong trend. Further correction in property prices coupled with easing of interest rates will boost the demand. We expect disbursemnts to grow at a CAGR of 22% for the company over FY09-11E.

Expanding geographical presence

LIC has ramped up its distribution network with increase in the number of branches and agent force. The company has opened 20 branches in the current fiscal which has increased the total branch count to 150 (targets 160 branches by FY10). Despite branch additions the employee numbers have remained almost same due to effective utilization of manpower.

Decline in interest rates to cushion margins

Management expects to maintain margins at the current levels (i-e 2.95%) despite offering loans at the competitive rates. With decline in overall interest rates, the incremental cost of funds will decline and the company expects to maintain spread of ~2% on incremental loans. The special rate of 8.75% offered by the company would not have any significant impact on margins as the offer is for limited period and would constitute small part (~10%) of the overall loan book.

Customer mix dominated by PSU/govt employees

LICHFL's customers mainly consist of salaried employees and self employed people. Among the salaried customers about 50% are government/PSU employees resulting in lower risk on loans. The company will continue to expand its customer base (PSU & govt.) which will benefit from the implementation of sixth pay commission.

Asset quality set to improve

Asset quality has shown marked improvement as gross NPAs and Net NPA have declined to 1.07% and 0.21% respectively at the end of FY09. Management targets to reduce net NPA to zero by the end of current fiscal.

Valuations attractive despite run up

We expect company's loan book to grow at CAGR% of 22% over FY09-FY11E led by drop in the interest rates and correction in property prices. Net interest margins are expected to remain stable at 3% despite lending rate cuts. Current valuations of 1.1x FY11 BV is attractive considering higher RoE's (26% & 27% for FY10, FY11), better asset quality and huge growth potential in the housing finance segment. We have a target price of INR 512 for the stock which is 1.3xFY11 BV. We recommend Buy on the stock.

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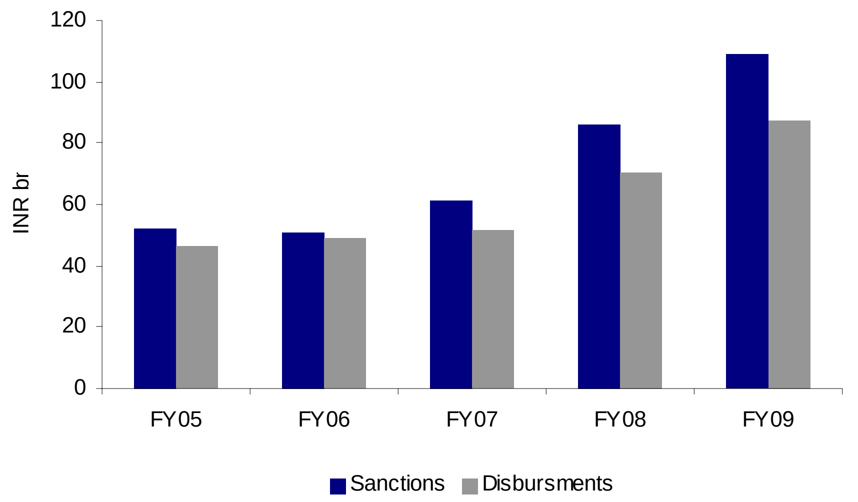
KEY HIGHLIGHTS

Disbursments are expected to grow at 25% for FY10; Average Loan size to increase by 10-15%

Business Growth

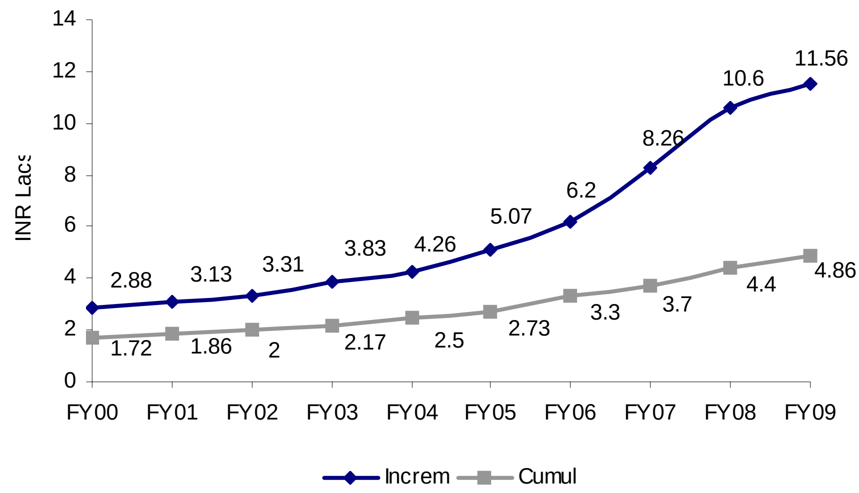
LICHFL's sanctions and disbursements have grown at a CAGR of 18% over FY05-09 led by favorable economic environment and expansion of the branch and agent network. Resultantly the market share of the company increased to ~8% in FY09 compared to 6% in FY05. The average loan size almost doubled to INR 0.486 mn in FY09 from INR 0.273 mn in FY05. Correction in property prices by ~25% across the cities and ~ 300 bps declines in the home loan rates will increase demand in the housing segment. Disbursement growth has already picked up as it grew by 42% and 34% in the last two months (March and April). Management has guided a growth of 25% in disbursements over FY10 and 10-15% increase in the average loan size.

Chart : Sanctions and Disbursments



Source : Company, FQ Research

Chart: Average Loan size



Source : Company, FQ Research

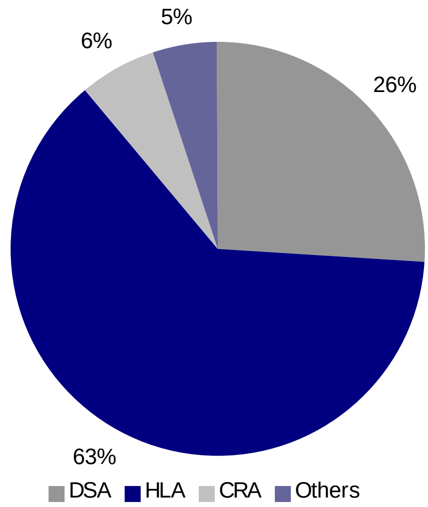
Leveraging of branch network & agent force would increase business volumes

Vast distribution network

LICHF has built up a strong distribution network covering major parts of the country. About 58% of the company's revenue is derived from the top ten cities. At the end of FY09 the company had 130 marketing offices covering 450 centers. During April'09, 20 new branches were opened increasing the total branch tally to 150. Further the company has been has been leveraging the LIC agents (6810 LIC agents) for sourcing home loans. In addition to that the company has 1292 direct sales agents and 535 customer relationship associates to source the business.

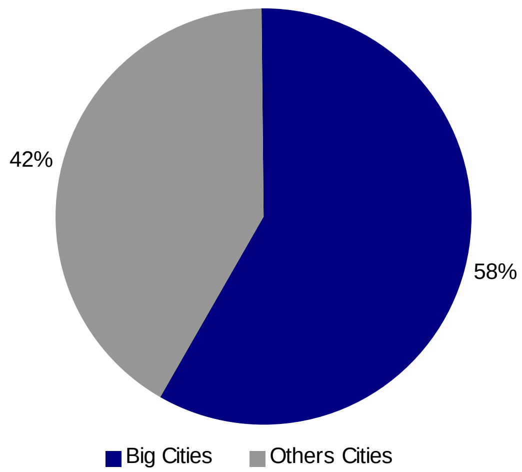
The company also has relationship with top corporates for providing the home loan products to their employees. These tie-ups have contributed to 35% of the total retail sanctions in FY09. Management plans to leverage its distribution network to achieve higher business volumes.

Chart : Loan Origination



Source : Company, FQ Research

Chart : City wise distribution of Business



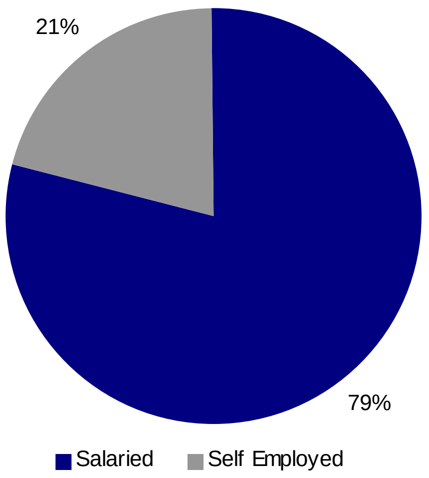
Source : Company, FQ Research

Implementation of 6th pay commission will further improve risk profile of customers

Low risk customer base Customer Profile

LICHFL's customers mainly consist of salaried employees and self employed people. Among the salaried customers about 50% are government/PSU employees having lower risk profile. In additional to that, 92% of the loan book is towards individuals and ~8% to project finance. The Company will continue to expand its customer base (salaried PSU & govt.) which will benefit from the implementation of sixth pay commission. Moreover the loans in the project finance segment would be capped within 10% of the loan book.

Chart : Customer Profile



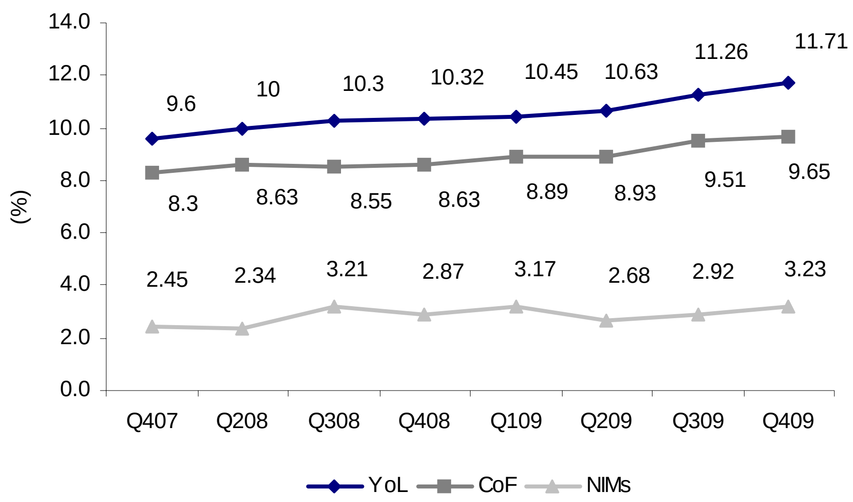
Source : Company, FQ Research

Operational Parameters to sustain

Special schemes will not have significant impact on margins

Net interest margins of the company increased by 15bps YoY to 2.95% in FY09. Management expects to maintain margins and other operational parameters (RoE, RoA) despite sharp reduction the lending rates. The company had offered special rate of 8.75% for home loans on which the rate would be revised every quarter. However the offer is for limited period and will form a small part (>10%) of the total loan and hence would not impact margins significantly. Further the company has taken measures like centralization of offices, effective utilization of manpower which would improve efficiency.

Chart : Yields and Costs



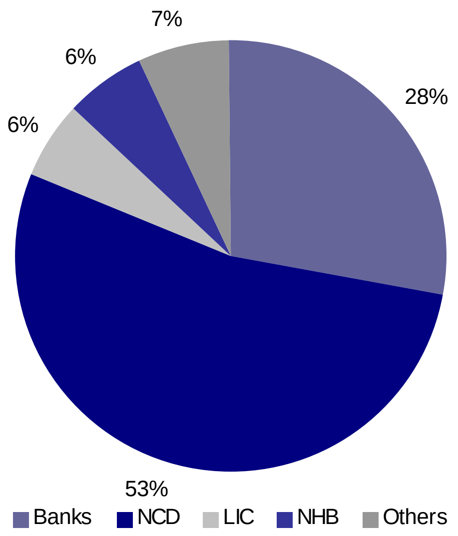
Source : Company, FQ Research

Improved funding profile

NCD's & Bank term loans constitute majority of funds

Funding profile of the company has improved significantly as majority of the funds have been mobilized by way of NCDs and bank loans at competitive rates. This contributed to significant reduction in the funding expenses and improvement in margins. With decline in overall interest rates, the incremental cost of funds has come down to ~7%(for NCD's) in April'09 from ~9.8% in Dec08. The company also plans to mop up deposits to the tune of INR 5bn as retail deposit rates have declined significantly.

Chart: Funding Mix



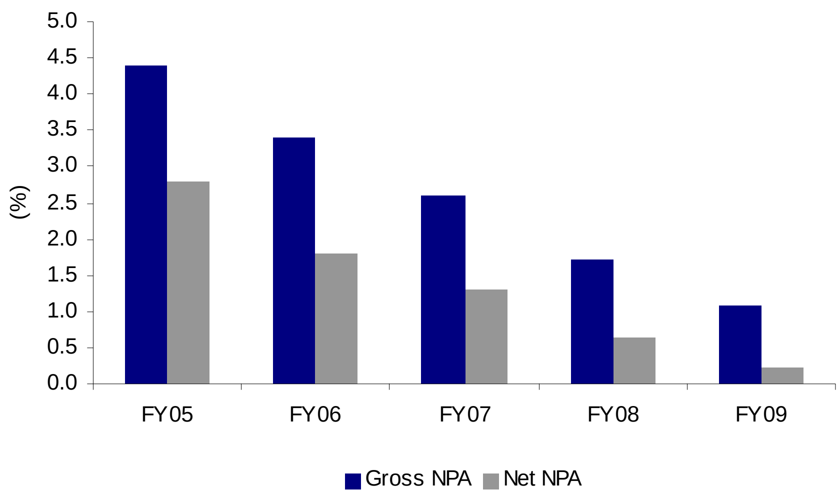
Source : Company, FQ Research

Asset Quality

Gross & Net NPA's declined to 1.07% & 0.21% respectively in FY09

Asset quality has shown considerable improvement despite adverse economic environment. Gross and Net NPAs has declined 1.07% and 0.21% resp. in FY09 from 1.7% and 0.64% resp. during FY08. Provision coverage has increased to 81% from 62% during the same period. The company has set up strong credit appraisal systems, risk management systems and recovery mechanism resulting in lower defaults. Loan to value ratio at the end of FY09 stands at 56% (57% in FY08) and hence comfortably placed against fall in property prices. Management aims to reduce net NPAs to zero by the end of current fiscal.

Chart : NPA



Source : Company, FQ Research

New Subsidiary to contribute in long term

LICHFL has floated a new subsidiary LICHFL Financial Services Limited (LICHFFSL) to distribute products like insurance, credit cards, personal loans and mutual funds. However the management has not set any target for the subsidiary in terms of revenues or PAT. In our view the company would make material contribution to the consolidated revenues in long term only.

Q4FY09 Results

During Q4FY09, the net interest income grew 26.6% YoY to INR 2.1bn led by a 21% increase in disbursements. Net profits increased by 31% YoY, to INR 1.57bn despite 10% YoY decline in the other income. Gross NPA and net NPA declined by 62bps and 52bps sequentially to 1.07% and 0.21% respectively. Yield on loans and cost of funds declined by 50 bps to 11.2% and 9.15% respectively. Net interest margin was stable at 3.19% for the quarter whereas it increased by 15bps YoY for FY09. Outstanding loan book increased 26% to INR 277bn while disbursements during the quarter grew 21% to INR 3.4 bn against 18% in the previous quarter.

Valuation & Outlook

Housing Finance segment has immense potential to grow on back of low penetration of mortgage loans, rising income levels and demand supply gap. LICHFL being the key players in the segment having ~8% (banks ~60%, HDFC 30 %) market share is set to capitalize on the opportunities emanating from correction in property prices and fall in interest rates. Further, large distribution network coupled with strong relationship with corporate will aid business growth.

We expect company's loan book to grow at CAGR% of 22% over FY09-FY11E led by drop in the interest rates and correction in property prices. Net interest margins are expected to remain stable at 3% despite lending rate cuts. Considering strong growth outlook for the company in medium to long term and higher ROE's, the stock is relatively undervalued. We have a target price of INR 512 for the stock which is 1.3x FY11 BV. Currently the stock is trading at 1.3x FY10 and 1.1x FY11 book value. We recommend buy rating on the stock.

Key Concerns

Extension of special schemes may hurt margins

LICHFL has offered special schemes offering home loan rates at 8.75% for loans upto 3mn. Extension of such schemes coupled with further rate cuts will impact margins negatively.

Competition from Banks

Banks are dominant players in the housing finance segment having ~60% market share. In the last 2-3 months banks have increased focus on housing loans and have offered attractive rates. LICHFL may loose market share in case banks become more aggressive in the home loan segment.

Standalone Financials

Income Statement

Particulars (INR mn)	FY08	FY09	FY10E	FY11E
Net interest income	5,539	7,310	9,128	10,976
Other income	1,365	1,557	1,723	1,944
Total Income	6,905	8,867	10,851	12,920
Operating expenses	1,339	1,551	2,071	2,442
Preprovision profit	5,566	7,317	8,780	10,478
Provisions	243	53	74	76
Profit before tax	5,323	7,264	8,706	10,402
Tax	1,451	1,948	2,364	2,826
Net Profit	3,872	5,316	6,342	7,576

Balance Sheet

Particulars (INR mn)	FY08	FY09E	FY10E	FY11E
Equity share capital	850	850	850	850
Reserves And Surplus	17,467	21,491	26,441	32,578
Net worth	18,317	22,341	27,291	33,428
Borrowings	203,444	253,572	307,357	375,825
Secured	191,134	233,618	286,955	356,112
Unsecured	12,310	19,954	20,402	19,713
Current Liabilities	11,792	12,183	13,173	14,711
Total liabilities	233,552	288,097	347,821	423,963
Net block	230	257	255	243
CWIP	70	50	35	35
Investments	7,746	4,868	6,208	7,654
Loans	219,364	276,790	334,366	408,629
Current assets	5,214	5,203	6,029	6,473
Deferred Tax assets	929	929	929	929
Total assets	233,552	288,097	347,821	423,964

Ratios

Particulars	FY08	FY09E	FY10E	FY11E
Per Share Data				
EPS	46.6	62.6	74.7	89.2
BV	215.7	256.1	321.3	393.6
DPS	10.0	13.0	14.0	14.5
Valuation Ratios				
P/E	9.2	6.9	5.8	4.8
P/BV	2.0	1.7	1.3	1.1
Performance ratios (%)				
Avg yield on assets	10.2	11.2	10.4	10.0
Avg Cost of borrowings	8.0	9.0	8.1	7.6
Net interest margins	2.8	3.0	2.9	2.9
ROE	23.2	25.0	26.0	27.0
ROA	2.0	2.2	2.1	2.0
Growth (%)				
Net interest Income	41.5	32.0	24.9	20.3
Other Income	78.3	14.0	10.7	12.8
Total Income	47.4	28.4	22.4	19.1
Operating Profit	52.9	31.5	2.0	1.9
PAT	41.7	37.3	19.3	19.5
Disbursements	24.9	26.2	23.0	22.2
Asset Quality (%)				
Gross NPA/Loan Assets %	2.6	1.1	1.0	1.0
Net NPA/Loan Assets%	1.2	0.2	0.1	0.1

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Outperformer	Marketperformer	Underperformer
More than 10% to Index	Within 0-10% to Index	Less than 0-10% to Index