LIC Housing Finance

SELL

COMPANY INSIGHT | LICHF IN EQUITY | December 18, 2014

Déjà Vu

Wholesale rates in India have been falling faster than banks' base rates over the last couple of months. This is incrementally positive for LICHF since it lowers LICHF's funding cost without pressurising its yields. However, this situation is unlikely to sustain and we expect base rates to follow bond rates soon. The impact of lower bond costs on LICHF's funding costs would be gradual but its assets could re-price faster (since ~40% LICHF's assets are floating rate assets). Hence, margin expansion could remain elusive for LICHF. We retain our SELL stance.

Competitive position: Medium   Changes to this position: POSITIVE

Falling wholesale rates offer respite

After an elevated interest rate environment over the last three years, bond rates have declined sharply (75bps) over the last two months, offering a respite to wholesale-funded institutions like LICHF. Moreover, wholesale rates had declined faster than the banks' base rates over the last four months and are now quoting ~160bps below base rates. This has resulted in incremental spreads widening for LICHF from ~70bps in August 2014 to 160bps in December 2014, leading to a 40% rally in the stock price over the last four months.

NIMs would not expand barring a blip in 2HFY15

Besides bond yields, LICHF's NIMs are also driven by factors like competition, regulatory changes and composition of the asset-liability mix. If the current scenario persists for the next two years, LICHF's NIMs could expand by 20bps over that time period. However, looking at the historical correlation between bond rates, base rates and mortgage rates, the current scenario is unlikely to persist and we expect base rates and mortgage rates to catch up with bond rates soon. Hence, we do not expect LICHF's margins to structurally improve over the next two years. However, as mortgage rates would decrease with a lag, LICHF's 2HFY15 NIMs look better than consensus' expectations.

Growth could be a challenge

Whilst LICHF's loan growth has been robust over the last four years, it has moderated over the last three years, with growth coming down to ~15% in YTD FY15 vs 28% growth in FY12. This growth slowdown seems to be a factor of the overall slowdown in mortgage loans in India and banks gaining some market share from HFCs over the last two years. With overall growth in mortgages slowing down due to a higher base effect and softening real estate prices and greater competition from banks in the future, we expect loan growth to moderate for LICHF at 16% CAGR in FY14-17 vs 21% CAGR in FY11-14.

Valuations expensive

At a valuation of 2.1x one-year forward P/B, the stock is trading at a 33% premium to its cross-cycle valuations and is trading close to its peak valuations due to consensus expectations of NIM expansion. Whilst better NIMs could support valuations in 2HFY15, NIMs are unlikely to expand in FY16, missing consensus expectations. We retain SELL but we increase our one-year TP by 6% to ₹330/share (vs ₹311 earlier) due to the roll over from September 2015 to December 2015 (~4% increase) and 2% increase in our earnings estimates.

Key Financials

	FY13	FY14	FY15E	FY16E	FY17E
Net Revenues (₹ mn)	17,343	21,602	24,571	27,779	31,623
Net Profits (₹ mn)	10,233	13,172	14,563	16,190	18,483
Diluted adjusted EPS	20.2	26.1	28.9	32.1	36.6
RoA (%)	1.5	1.6	1.5	1.4	1.4
RoE (%)	16.8	18.8	17.9	17.3	17.2
P/B (x)	3.1	2.7	2.3	2.0	1.8

Source: Company, Ambit Capital research

BFSI

Recommendation

Mcap (bn):	₹203/US$3.2
3M ADV (mn):	₹1,239/US$19.5
CMP:	₹402
TP (12 mths):	₹330
Previous TP	₹311
Downside (%):	18%

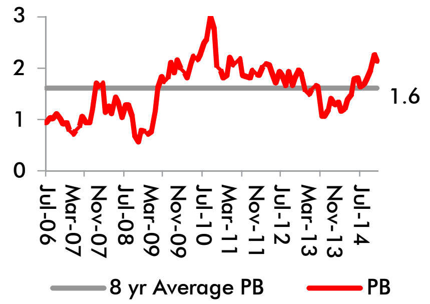
Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	GREEN

Catalysts

- NIM disappointment in FY16
- Lower loan growth in FY16

Cross-cycle P/B



Source: Bloomberg, Ambit Capital research

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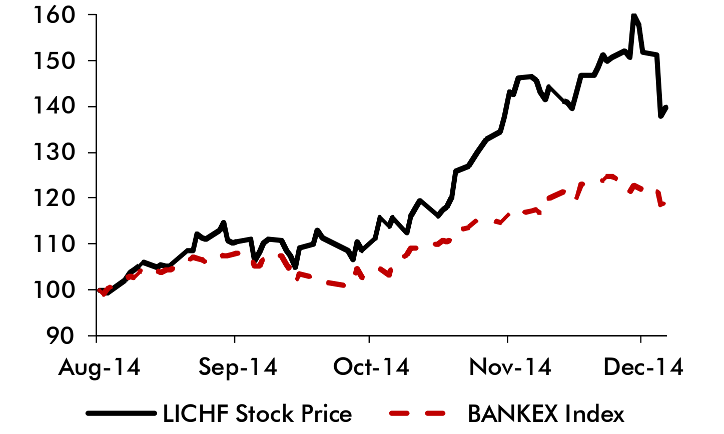
Stock price rally due to falling bond yields

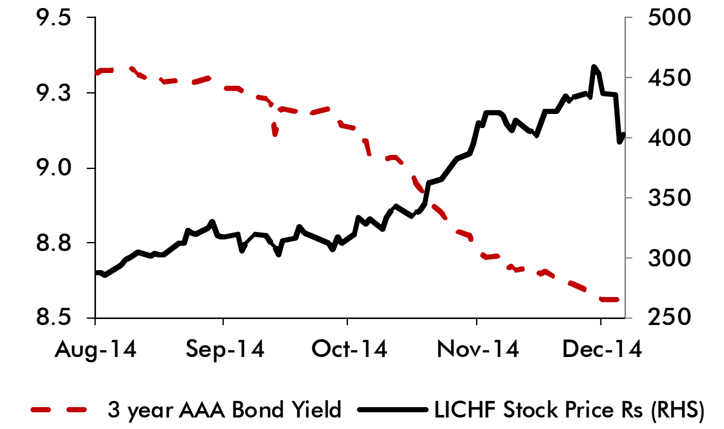
LIC Housing Finance's stock has rallied 40% over the last four months and has outperformed the Bankex by 21% during this period. Barring the overall liquidity-fuelled rally in the Indian markets, the around 75bps fall in AAA bond yields (three-year maturity bonds) seems to be a major reason behind this sharp rally.

Exhibit 1: Significant outperformance of LIHCF



Source: Bloomberg, Ambit Capital research

Exhibit 2: ...driven by falling bond yields



Source: Bloomberg, Ambit Capital research

Why falling bond yields are considered good for LICHF?

Given that ~68% of the total liabilities of LICHF are bond market borrowings, falling bond yields improve the funding costs of LICHF. Bonds have been a cheaper source of money for LICHF, as on average AAA rated NBFCs like LICHF could get money from this source 100-150bps cheaper than bank borrowings.

Exhibit 3: LICHF's borrowing as at September 2014 - Bonds are a major and cheaper source of funds

Source	Annualised Borrowing rates*	% of total borrowings
Banks	10.64%	22%
Debentures and bonds	9.41%	68%
Deposits and others	9.17%	10%
Total	**9.68%**	**100%**

Source: Company, Ambit Capital research. Note: Banks' headline lending rates are monthly compounding rates and hence effective annualised rates for borrowers are ~50bps higher.

Moreover, with major banks pricing their home loans at ~10.15% (10.65% annualised rates), which is also the borrowing rate of LICHF from banks, the only way LICHF could compete in home loans with banks is by borrowing funds from the bond markets. Hence, a liquid and large bond market is very essential for LICHF, as it allows LICHF to borrow more and cheaper from the bond market to compete with banks.

Exhibit 4: Competitive rates on home loans by banks

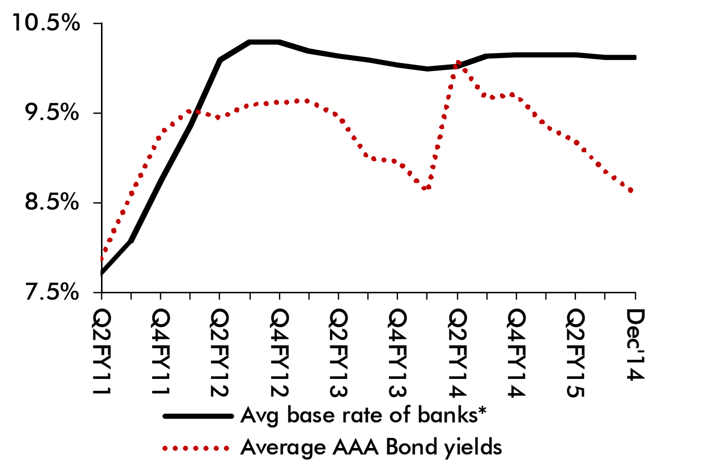
Bank	Market share in home loans	Base Rate	Mortgage rates	Annualised mortgage rates*
State Bank of India	~18%	10.00%	10.15%	10.65%
ICICI bank	~9%	10.00%	10.15%%	10.65%
Axis Bank	~5%	10.15%	10.15%%	10.65%
Average	**11%**	**10.05%**	**10.15%**	**10.65%**

Source: Company, RBI, Ambit Capital research. Note: Banks' headline lending rates are monthly compounding rates and hence effective annualised rates for borrowers are ~50bps higher.

Moreover, as banks' base rate puts a floor on the lending yields of LICHF (as banks cannot lend below the base rate), a falling bond yield environment coupled with banks' base rate remaining stable is the best possible combination for LICHF. Hence, wider the difference between banks' base rate and bond yields, better the spread for LICHF.

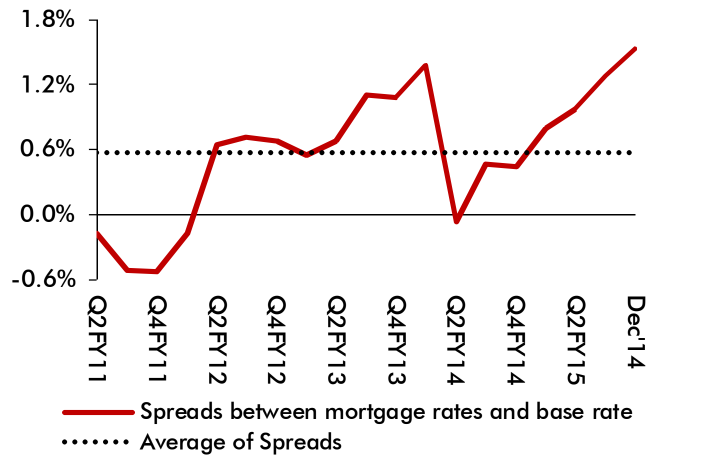
In fact, this is what has happened over the last four months, where the difference between these two rates has widened to ~160bps vs historical average of ~60bps.

Exhibit 5: Bond yields falling faster than banks' base rate



*Source: Company, Ambit Capital research. Note: * Average base rate of SBI, ICICI, Axis, PNB and BOB.*

Exhibit 6: Difference between banks' base rate and AAA bond yields has increased



Source: Company, Ambit Capital research

No correlation between bond yields and NIMs

Whilst falling bond yields definitely help LICHF decrease its cost of funds, in the last decade, there has not been a direct correlation between LICHF's NIMs and bond yields. Barring the current cycle over FY11-14 when LICHF's NIM declined in line with the increase in bond yields, in previous interest rate cycles in fact LICHF has benefitted in a rising rate cycle and suffered in a declining rate cycle.

Exhibit 7: Not much correlation between interest rate spreads and bond yields

Period	Change in 10 year Govt bond yield	Change in LICHF's net interest spreads during the cycle
FY05-08- Rising Rate Cycle	+247bps	+19bps
FY08-10 declining rate cycle	-68bps	-45bps
FY11-14 rising rate cycle	+140bps	-58bps

Source: Company, Bloomberg, Ambit Capital research

A high floating rate loan portfolio coupled with sizeable fixed rate liabilities meant that historically LICHF's assets re-priced faster than liabilities and hence margins 1expanded in a rising rate cycle and contracted in a declining rate cycle.

However, this positive correlation between bond rates and LICHF's NIMs broke during the FY11-14 increasing rate cycle, due to:

Banks moving to base rate increased the funding cost for LICHF: Banks moving to the base rate mechanism from FY11 meant that LICHF's funding cost structurally increased from banks vs the earlier regime whereby LICHF was able to borrow from banks at much cheaper rates.

Exhibit 8: Bank borrowings have structurally become more costly for LICHF after FY11

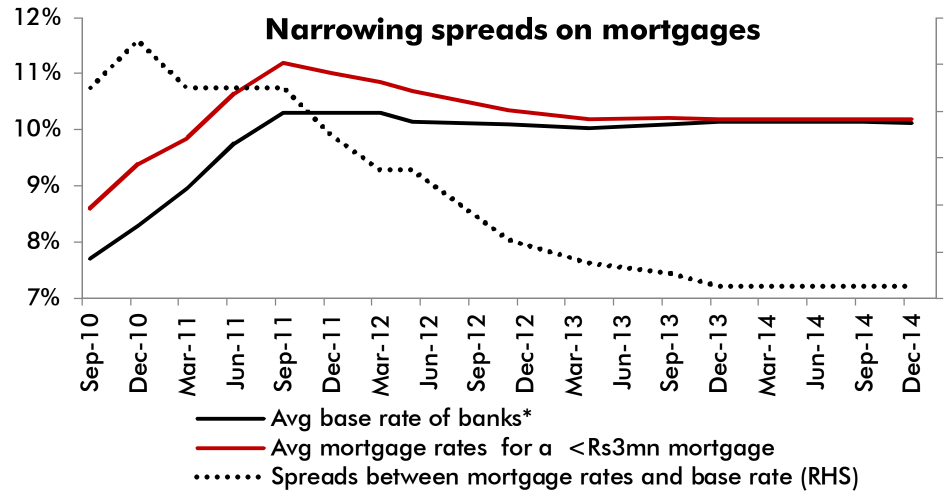
Borrowing rates	FY04	FY08	FY09	FY11	FY13	FY14
Borrowings rates from banks	9.19%	8.48%	9.43%	9.07%	10.63%	10.70%
Borrowing rates from bonds	8.91%	8.30%	9.27%	8.54%	9.43%	9.26%
Premium for bank borrowings	**0.28%**	**0.18%**	**0.16%**	**0.53%**	**1.20%**	**1.24%**

Source: Company, Ambit Capital research

Inability to pass on increased rate to old borrowers due to competition and regulations: Whilst the structural increase in funding costs from banks and the elevated interest rate environment led to a ~170bps increase in funding costs for LICHF between FY11 and 1HFY15, it could not pass on this to its borrowers due to increased competition and change in regulations:

- **Banks became more competitive in home loans:** Whilst banks kept their base rates elevated over FY11-14, they kept the pricing on their home loans at competitive rates and reduced the premium for home loans (over base rates) from ~100bps in FY11 to ~5bps in 1HFY15. Given that LICHF is a price taker, it had to price its loans in line with banks and hence incremental yields on home loans remained under pressure, leading to incremental spreads remaining under pressure at ~60bps during FY12-1HFY15 (vs a portfolio spread of 195bps in FY11).

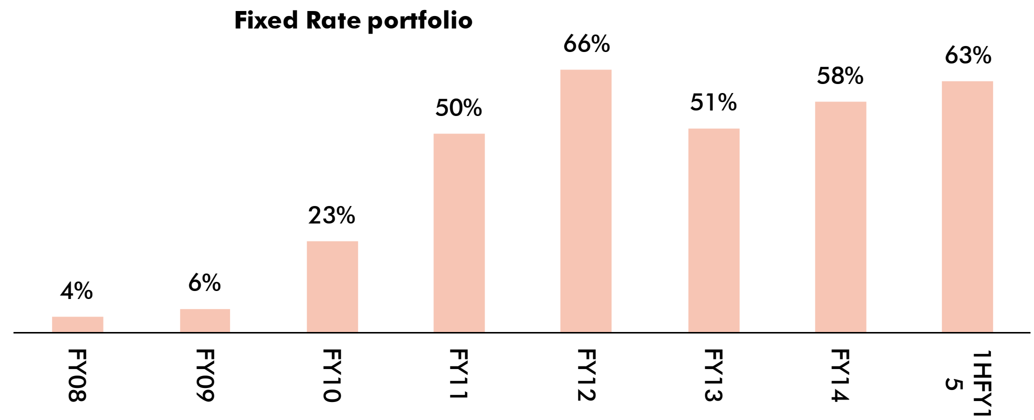
Exhibit 9: Increasing competitive pricing by banks on mortgages



*Source: Company filings, Ambit Capital research. Note: * Average base rate of ICICI, Axis, SBI, BoB and PNB*

- **Fixed rate portfolio in a rising rate environment:** Unlike the earlier years when LICHF had a high proportion of floating rate portfolio, LICHF's ~50-60% portfolio was at a fixed rate in rising rate environment of FY11-14, impacting its yields.

Exhibit 10: High proportion of floating rate loans in a rising rate environment



Source: Company filings, Ambit Capital research

- **Removal of pre-payment penalty on floating rate loans:** LICHF did pass on its increased cost of funds to its old floating rate customers by increasing its prime lending rate (PLR). However, the regulator removing pre-payment penalty on floating rate loans in October 2011 and decreasing rates on new mortgages (giving an attractive option to borrowers to switch) meant that LICHF saw higher pre-payments on this high-yield floating rate portfolio, somehow mitigating the increase in rates for the old customers.

Hence, the relationship between bond rates and LICHF's margins is not straight forward and it would be impractical to consider falling bond yields as a panacea for LICHF's margins. This is not to say that falling bond yields are not good for LICHF but the point we are trying to make here is that LICHF's NIMs are driven by various factors and not by bond yields alone.

Would NIMs improve in the future?

Will LICHF's NIMs improve as we enter into a declining rate cycle over the next 2-3 years? Based on our estimates, we do not envisage a material increase in LICHF's NIMs between 1HFY15 and FY17, barring some improvement in 2HFY15.

What happens if the current scenario persists?

As explained earlier, keeping all other things constant, higher the difference between banks' base rates and AAA bond yields, higher would be the incremental spreads for LICHF and higher would be its overall spreads and NIMs. The current spread of ~160bps between base rates and bond rates is the highest over the last four years and to some extent signals a future cut in base rates.

If the current spread of ~160bps between base rates and bond rates persist going forward, LICHF' net interest spreads could increase by 20-25bps over the next two years.

However, if we assume that the current scenario persists in the future till FY17 (which we believe is the best-case scenario), LICHF's spreads should improve by ~20bps-25bps over the next two years. The key assumptions in this scenario are:

- LICHF's incremental borrowing costs from bonds remain at 8.6%
- Percentage of bond borrowings increase from 68% at present to 75% by FY17
- LICHF continues to originate new loans at current mortgage rates of 10.10%
- ~40% of LICHF's current loan portfolio re-prices at ~80bps higher rates over 2HFY15-FY17
- Proportion of developer loan/LAP for LICHF increases from the current 6% to 10% by FY17
- LICHF does not decrease its PLR (to which its floating rates are linked) in line with reduction in its funding cost.

Exhibit 11: Spread movement for LICHF in the best case scenario

	FY14	FY15E	FY16E	FY1517E
Yield on advances (%)	10.85%	10.77%	10.74%	10.69%
Cost of funds (%)	9.60%	9.55%	9.38%	9.22%
Spread (%)	**1.25%**	**1.22%**	**1.36%**	**1.47%**

Source: Company, Ambit Capital research.

But such a blue-sky scenario unlikely to persist

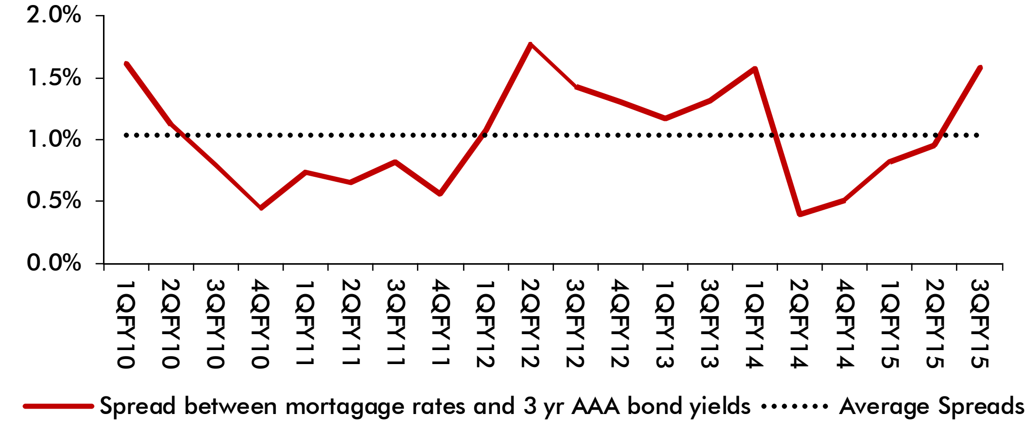
Historical high difference between base rates and bond rates: However, looking at the historical levels, it is unlikely that the difference between bond rates and base rates would remain at these levels, as the current difference is at the peak in the last four years (~100bps, above historical average of ~60bps). We expect base rates and hence mortgage to soon catch up bond rates (see Exhibits 5 and 6)

Current difference of ~160bps between base rates and bond rates is ~100bps higher than historical average of ~60bps.

Historical high difference between mortgage rates and bond rates: Even if we look at the historical difference between mortgage rates and bond yields which has a much longer history, the difference has averaged around 100bps over the last six years and the current difference is towards higher range and 60bps above the historical average. With banks getting additional funding benefits from SLR/CRR/PSL-exempt infra bonds, the pricing on home loans should remain competitive in the future.

Current difference of ~160bps between mortgage rates and bond rates is ~60bps higher than historical average of ~100bps.

Exhibit 12: Difference between bond yields and mortgage rates*



*Source: Bloomberg, Company filings, Ambit Capital research. Note: *Average mortgage rates of major banks*

Hence, we expect mortgages rates to come down in the future and expect incremental spreads to come down its historical average as the rate cycle progresses.

Re-pricing of floating rate loan portfolio: Moreover, LICHF's floating rate individual portfolio (40% of the loan book) is priced at ~11.5% (vs the ongoing mortgage rates of ~10.15%). As LICHF's borrowing rates come down by 40bps over the next two years, we expect this to reflect in LICHF's PLR as well, bringing down overall yields.

Exhibit 13: Floating rate portfolio could re-price faster as PLR comes down

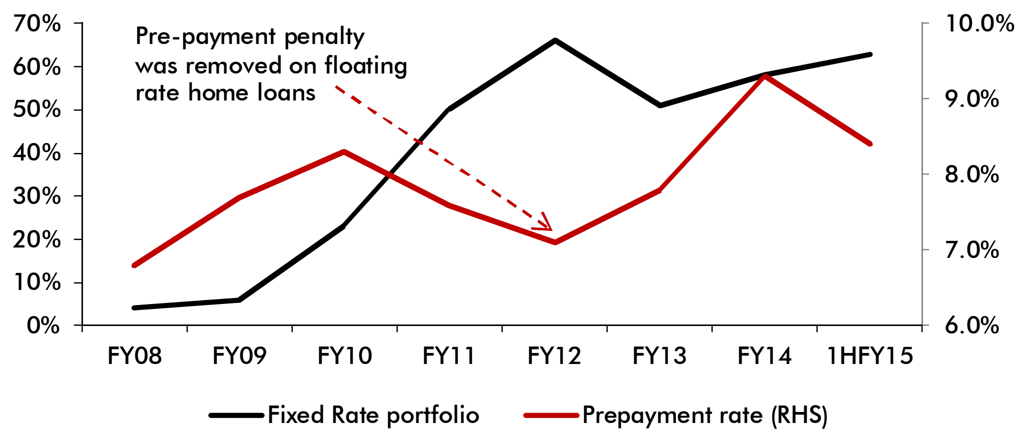
Yields of LICHF	(%)
Current floating rate home loans offered by banks/NBFCs	10.15%
On existing individual floating rate home loans	~11.5%%

Source: Company, Ambit Capital research

Pre-payment rates should go up in in LICHF's floating rate loan portfolio if it does not decrease rates for old borrowers in a declining rate environment.

If LICHF does not decrease its PLR, we expect this to reflect in the higher pre-payments on floating rate loan portfolio. Overall pre-payments rates have not increased for LICHF since pre-payment penalty was removed on floating rate loans in October 2011. However, given that on average 50% of LICHF's portfolio has been at fixed rate over the last three years where the borrower had no incentive to prepay due to lower rates and higher pre-payment charges, it would be wrong to conclude that pre-payment rates have not gone up since the removal of penalty on floating rate loans. On the contrary, we believe that overall prepayments rates have increased for LICHF in its floating rate portfolio which is also reflected in yields remaining under pressure.

Exhibit 14: Pre-payments rates have inched up despite higher proportion of fixed rate portfolio



Source: Company filings, Ambit Capital research

Moreover, the RBI is incrementally pushing lenders to transparent and fair pricing on all floating rate loans with removing pre-payment penalty on floating rate loans. The RBI also came out with draft guidelines on transparent and fair pricing of credit where it talked about all floating rate being either linked to base rates or an external benchmark. Whilst banks are already on base rate, given that HFCs still link their floating rate loans to PLR, it's highly probable that base rate regime would be implemented on HFCs as well.

HFCs like LICHF not passing on decrease in their funding costs to their old floating rate customers could result in regulators implementing base rate mechanism on HFCs as well.

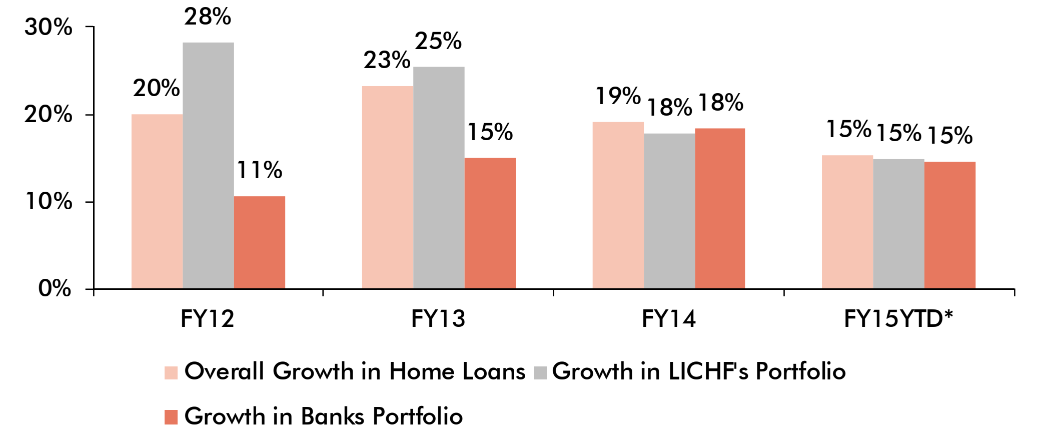
Once base rate is implemented for HFCs, LICHF would have less headroom to sustain the yields on its old portfolio. For example, Axis Bank had to reduce its base rate by ~10bps to remain competitive in home loans, which re-priced downward its old portfolio as well. However, HFCs like LICHF could reduce rates for new borrowers without affecting the rates for old borrowers.

Hence, in our base-case scenario, we believe that incremental and hence blended spreads of LICHF would remain at ~100bps in its individual home loan portfolio in the future.

Pressure on growth likely

Whilst LICHF's loan growth has been robust over the last 3-4 years, it has been moderating over the last three years, with growth coming down to ~15% in YTD FY15 vs 28% growth in FY12. This slowdown in growth seems to be a factor of the overall slowdown in mortgage loans in India and banks gaining some market share from HFCs over the last two years.

Exhibit 15: Overall growth of mortgages, LICHF's growth and banking system's growth



*Source: RBI, Company filings, Ambit Capital research. Note: *YTD data annualised*

In the future, there could be more pressure on LICHF's growth due to:

More banks jumping into home loans: Given the regulatory requirement of CRR/SLR/PSL on their borrowings, only banks with a high share of low-cost CASA deposits (SBI, Axis, ICICI and other PSU banks) were able to compete with HFCs in this segment. Banks like Kotak Mahindra Bank, Yes, Bank, IndusInd Bank, ING Vysya Bank were not active in home loans despite having a distribution platform to disburse home loans.

"With the new infrastructure bonds, one can effectively work like a housing finance company. Even if you give the loan at the base rate, you still have a margin to play as 30% of it will qualify for priority-sector lending. It is a strategic product for us and it makes immense sense to get into it right now."

- Pralay Mondal, senior group president (retail and business banking) of Yes Bank

With the RBI allowing banks to long-term bonds with exemptions on CRR/SLR/PSL, we could see the likes of Kotak Mahindra Bank, IndusInd Bank and Yes Bank jumping into the fray, impacting growth for HFCs.

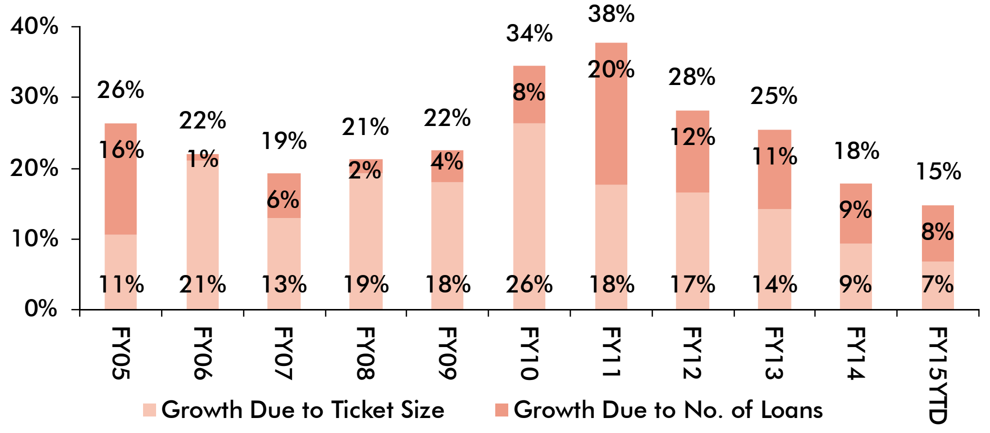
Exhibit 16: Change in economics of home loans for mid-sized banks

	HFCs	Mid-sized banks*	
		Before exemption	**After exemption**
Cost of 7year+ bonds	9.00%	9.00%	9.00%
Add regulatory cost:			
Cost of carry on CRR	-	0.38%	-
Cost of carry on SLR	-	0.21%	-
Cost of carry on PSL	-	1.01%	-
Cost of bonds (%) - A	**9.00%**	**10.6%**	**9.00%**
Yields (%) – B	10.65%	10.60%	10.65%
Spreads (%) - (B-A)	**1.65%**	**0.5%**	**1.65%**

Source: Company, RBI, Ambit Capital research

Slowdown in real estate could impact growth: In the last decade, real estate prices have expanded by ~15% CAGR which has been a major driver of home loan portfolios for LICHF and other banks. Over the last 2-3 years, growth rates are coming down in both ticket sizes and number of loans which is affecting company's growth. If real estate prices stagnate going forward, the overall growth in mortgage loans in India and hence LICHF's loan growth could come under further pressure.

Exhibit 17: Slowing growth in both volumes and ticket sizes for LICHF



Source: Company filings, Ambit Capital research

Key estimates and forecasts

Exhibit 18: Key changes in assumptions and estimates (₹ mn unless specified)

	New Estimates			Old Estimates			Change			Comments
Assumptions*	**FY15E**	**FY16E**	**FY17E**	**FY15E**	**FY16E**	**FY17E**	**FY15E**	**FY16E**	**FY17E**	
YoY loan growth (%)	16%	16%	15%	16%	14%	NA	0bps	200bps	NA	We marginally increase our growth expectations, as LICHF has shown better traction in home loans in recent quarters vs our estimates.
Net interest margins (%)	2.19%	2.12%	2.08%	2.12%	2.09%	NA	+7bps	+3bps	NA	We increased our FY15 NIM estimates on the back of falling bond yields but we would retain our FY16 and FY17 NIM estimates, as we expect mortgage rates to catch up with a lag.
Opex/avg loan book ratio (%)	0.38%	0.38%	0.37%	0.35%	0.34%	NA	+4bps	+3bps	NA	We increase our opex/avg loan book ratio is expense growth trends are higher than our expectations.
Provisions as a % of average loan book	0.07%	0.11%	0.10%	0.07%	0.11%	NA	0bps	0bps	NA	We have broadly retained our credit cost estimates in line with the experience in FY13-14.
Outputs (₹ mn)										
Total income	24,571	27,779	31,623	23,693	26,580	NA	4%	5%	NA	
Operating profit	20,765	23,410	26,658	20,256	22,764	NA	3%	3%	NA	
Adjusted Net Profit	14,563	16,190	18,483	14,299	15,703	NA	2%	3%	NA	
Diluted EPS (₹)	28.9	32.1	36.6	28.3	31.1	NA	2%	3%	NA	
ROE (%)	17.94%	17.32%	17.22%	17.67%	16.96%	NA	+27bps	+36bps	NA	
Target Price		**330**			**311**			**6%**		We upgrade our FY15-16 PAT estimates by ~2%-3%% and with a 4% rollover from September 2015 to December 2015, we increase our target price by 6%.

Source: Company, Ambit Capital research

We upgrade our PAT estimates by 2-3% for FY15-16 primarily to factor in slightly higher growth and higher NIMs given due to slightly better trends on funding side for LICHF due to ease in wholesale funding. Our FY16/17 estimates are 10%/15% below consensus estimates primarily driven by the fact that we are factoring in lower NIMs and to some extent lower growth in FY16-17E.

Exhibit 19: Ambit vs consensus (standalone)

	Ambit			Consensus			Divergence		
Outputs (₹ mn)	**FY15E**	**FY16E**	**FY17E**	**FY15E**	**FY16E**	**FY17E**	**FY15E**	**FY16E**	**FY17E**
Total income	24,571	27,779	31,623	25,613	31,098	37,898	-4%	-11%	-17%
Operating profit	20,765	23,410	26,658	21,839	26,318	31,684	-5%	-11%	-16%
Net Profit	14,563	16,190	18,483	14,814	17,819	21,667	-2%	-9%	-15%
Diluted EPS (₹)	28.9	32.1	36.6	29.3	35.3	43.6	-1%	-9%	-16%

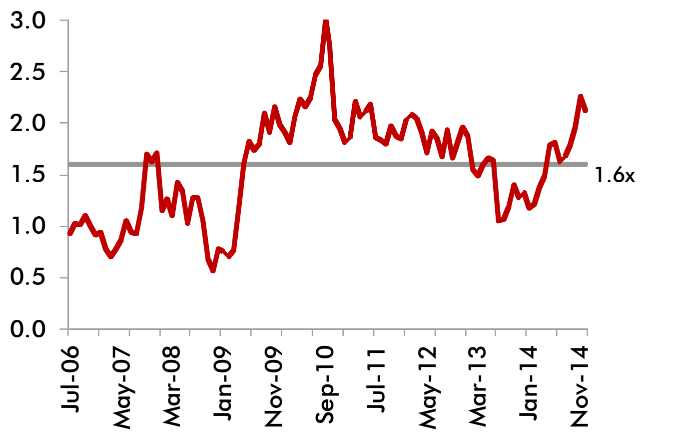
Source: Bloomberg, Ambit Capital research

Expensive valuation relative to earnings potential

On consensus estimates, LICHF's current 12-month forward P/B of 2.1x is at a 33% premium to its cross-cycle average P/B, and its 12-month forward P/E of 11.9X is at a 45% premium to its cross-cycle 12-month average forward P/E and the stock is trading close to its peak valuations. Clearly, consensus expectations of better earnings growth on the back of higher loan growth and higher margin expectations are driving these valuations.

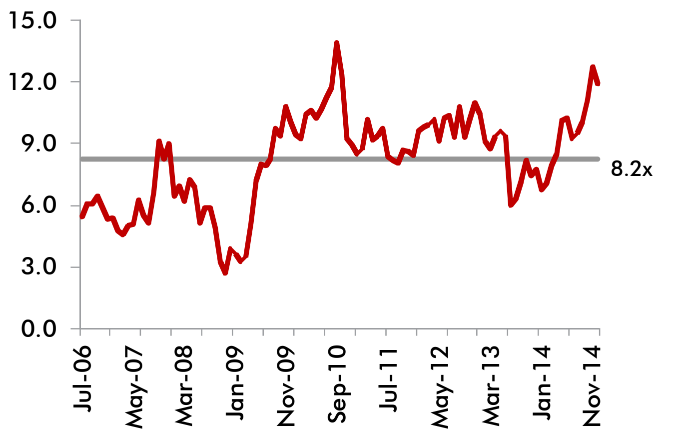
However, as explained earlier, we believe that the market is overestimating the future earnings growth of the company and as the company misses earnings estimates in FY16, we expect LICHF's valuation multiples to contract over the next couple of years.

Exhibit 20: One-year forward P/B at a ~33% premium to cross-cycle averages



Source: Bloomberg, Ambit Capital research

Exhibit 21: One-year forward P/E at a ~45% premium to cross-cycle averages



Source: Bloomberg Ambit Capital research

In absolute terms, we have valued LICHF using the excess return to equity model, which is 'net profit – (cost of equity x average net worth)' for all the future years discounted back to December 2015 using cost of equity, and we have added this to net worth at December 2015.

- We have explicitly forecast the net profit for FY15-17 based on the assumptions in Exhibit 18.
- Our assumptions for other stages of valuation models are shown in Exhibit 22.
- We have assumed a cost of equity of 15% and terminal growth of 5%. Our 15% cost of equity assumption is based on risk free rate of 8% (30-year G-sec yield at 8.2%) and market risk premium of 7%.

Exhibit 22: Key assumptions in our 'excess return to equity' valuation model

Valuation driver	FY18-29E	Comments
Period of high growth	12 years	
Loans CAGR	16.0%	We expect LICHF to gradually lose market share in home loans and hence we expect its growth rate to be slower than the overall growth in home loans in India.
RoAs	~1.45%	With higher competition in home loans, we expect sustainable RoAs for LICHF to come down going forward to 1.45%.
Leverage	Averaging at 12.5x	Assuming tier-1 capital requirement of 10%.

Source: Ambit Capital research estimates

Based on these assumptions our 'excess return model' gives a one-year forward target price of ₹330/share. Our target price implies one-year forward P/B of 1.7x and one-year forward P/E of 10.3x, implying a 18% downside from current levels.

However, our valuation for the company is highly sensitive to our assumptions on Net Interest spreads and to some extent growth assumptions.

Exhibit 23: Sensitivity of target price to key assumptions

Key Assumptions	Base Case	Bull Case
Average Sustainable NIMs	2.2%	2.5%
Average Sustainable growth	15%	18%
RoE (%)	17%	19.5%
Target Price (₹)	**₹330** (implied P/B multiple of 1.5x Dec'16 BVSP	**₹494** (Implied P/B multiple of 2.3x Dec'16 BVPS

Source: Ambit Capital research estimates

Relative valuations at a discount to its peers

Based on consensus estimates, LICHF is trading at a ~15% discount to similar size NBFCs like MMFS and SHTF. However, we believe that MMFS and SHTF have more differentiated business models and are less prone to competition and hence they deserve to trade at a premium to LICHF. LICHF is trading at a discount of ~60% to other housing finance companies. However, other HFCs deserve some premium to LICHF given their differentiation on the asset side. For example, 30% of HDFC's loan book is the higher-yielding corporate loan book whilst Gruh Finance and Repco Home Finance are operating in a segment where growth is higher but competition is lower from banks. Moreover, given that the entire sector is massively overvalued, relative valuation would not be a right metric to look at.

Exhibit 24: Relatively cheap vs its peers

Name	Mkt Cap (US$ bn)	P/B		P/E		RoA (%)		RoE (%)	
		15Y	16Y	15Y	16Y	15Y	16Y	15Y	16Y
HFCs									
HDFC*	26.88	5.52	5.02	30.3	27.9	2.08	1.91	23.9	22.4
Gruh Finance Ltd	1.44	11.9	9.78	43.2	35.4	3.1	2.55	30.7	29.6
Dewan Housing Finance Corp	0.79	1.26	1.09	7.89	6.12	1.34	1.38	16.6	17.9
Repco Home Finance	0.59	4.49	3.76	27.5	21.6	2.51	2.48	17.7	18.9
Other NBFCs									
M&M Finance*	2.57	2.75	2.4	19.0	14.4	2.28	2.63	14.5	17.0
Shriram Transport*	3.87	2.6	2.25	17.7	14.5	2.15	2.3	15.6	16.6
Cholamandalam	1.02	2.33	1.99	15.7	12.4	1.85	2.1	14.9	16.9
Magma Fincorp*	0.29	1.04	0.95	12.4	8.8	0.86	1.04	9.89	11.3
Sundaram Finance	2.18	4.97	4.28	28.0	24.0	3.03	3.13	18.7	18.8
HFCs Average		**5.8**	**4.91**	**27.2**	**22.8**	**2.26**	**2.08**	**22.2**	**22.2**
Other NBFCs average		**2.74**	**2.37**	**18.6**	**14.8**	**2.03**	**2.24**	**14.7**	**16.1**
LIC Housing Finance*	**3.2**	**2.34**	**2.04**	**14**	**12.6**	**1.5**	**1.42**	**17.9**	**17.3**
Premium / Discount to HFCs peer-set		-60%	-59%	-49%	-45%	-34%	-32%	-19%	-22%
Premium / Discount to Other NBFCs		-15%	-14%	-25%	-15%	-26%	-37%	22%	7%

Source: Bloomberg; Ambit Capital research; Note: Ambit estimates*

Key risks to our investment thesis

Our SELL stance on the stock revolves around our assumption that the competitive pressure from banks in home loans would remain high in the future, leading to incremental spreads of LICHF remaining under pressure despite its funding costs coming down. However, banks pulling away from the home loan segment and becoming less competitive on pricing is a major risk to our SELL stance on the stock.

Forensic accounting scores

Exhibit 25: Explanation for our forensic accounting scores

Segment	Score	Comments
Accounting	GREEN	Based on disclosures made by the company in its annual report and comparing it with its peers, we believe that the company's reported profitability is a true reflection of the actual profitability.
Predictability	AMBER	Exposure to a single segment coupled with the fact that we are in the midst of a changing regulatory regime for NBFCs, the uncertainty on the future earnings growth is very high.
Earnings momentum	GREEN	Consensus has upgraded its earnings estimates and the next two quarter's numbers could lead to further upgrades.

Source: Bloomberg, Ambit Capital research

Balance sheet

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Networth	56,822	64,938	75,329	86,979	99,931	114,717
Borrowings	560,920	687,660	820,400	964,320	1,130,792	1,310,197
Total Sources of funds	**617,742**	**752,598**	**895,729**	**1,051,299**	**1,230,723**	**1,424,914**
Loan Book	630,802	778,120	913,409	1,072,050	1,255,015	1,453,039
- Individual	598,946	751,470	885,580	1,046,743	1,227,832	1,422,329
- Developer	31,855	26,650	27,830	25,307	27,184	30,710
Other Assets	(13,059)	(25,522)	(17,680)	(20,751)	(24,292)	(28,125)
Total Application of funds	**617,742**	**752,598**	**895,729**	**1,051,299**	**1,230,723**	**1,424,914**

Source: Company, Ambit Capital research

Income statement

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net Interest Income	**13,916**	**15,345**	**18,989**	**21,685**	**24,619**	**28,198**
Interest Income	59,827	74,591	90,733	106,906	123,089	139,873
Interest Expense	45,911	59,246	71,744	85,220	98,470	111,675
Non-Interest Income	2,336	1,998	2,613	2,886	3,160	3,425
Total Income	**16,252**	**17,343**	**21,602**	**24,571**	**27,779**	**31,623**
Operating expenses	2,372	2,818	3,132	3,806	4,369	4,965
Pre Provisioning Profit	**13,880**	**14,525**	**18,470**	**20,765**	**23,410**	**26,658**
Provisions	(160)	789	215	816	1,232	1,339
PBT	**14,040**	**13,736**	**18,255**	**19,949**	**22,178**	**25,319**
Less:Tax	3,632	3,503	5,083	5,386	5,988	6,836
Net Profit	**10,408**	**10,233**	**13,172**	**14,563**	**16,190**	**18,483**

Source: Company, Ambit Capital research

Ratio analysis

	FY12	FY13	FY14	FY15E	FY16E	FY17E
AUM growth (%)	23.5	23.4	17.4	17.4	17.1	15.8
Dil Consol EPS growth (%)	(6.3)	5.1	29.1	10.6	11.2	14.2
Net interest margin (NIM) (%)	2.5	2.2	2.3	2.2	2.1	2.1
Cost to income (%)	14.6	16.2	14.5	15.5	15.7	15.7
Opex (% of AAUM)	0.42	0.41	0.37	0.38	0.38	0.37
Gross NPAs (%)	0.4	0.6	0.7	0.6	0.6	0.6
Credit costs (% of AAUM)	0.19	0.11	0.03	0.08	0.11	0.10
Provisioning Coverage	68.0	42.6	41.8	45.0	45.0	45.0
Capital adequacy (%)	16.7	16.5	16.1	15.8	15.5	15.3
Tier-1 (%)	11.0	11.5	11.2	11.0	10.8	10.7
Leverage (x)	11.3	11.3	11.8	12.0	12.2	12.4

Source: Company, Ambit Capital research

Valuation parameters

	FY12	FY13	FY14	FY15E	FY16E	FY17E
BVPS (₹)	120	129	149	172	198	227
Diluted EPS (₹)	19.2	20.2	26.1	28.9	32.1	36.6
ROA (%)	1.6	1.5	1.6	1.5	1.4	1.4
ROE (%)	18.5	16.8	18.8	17.9	17.3	17.2
P/E	20.9	19.9	15.4	14.0	12.6	11.0
P/BV	3.4	3.1	2.7	2.3	2.0	1.8
Dividend yield (%)	0.9	0.9	1.1	1.2	1.4	1.6

Source: Company, Ambit Capital research

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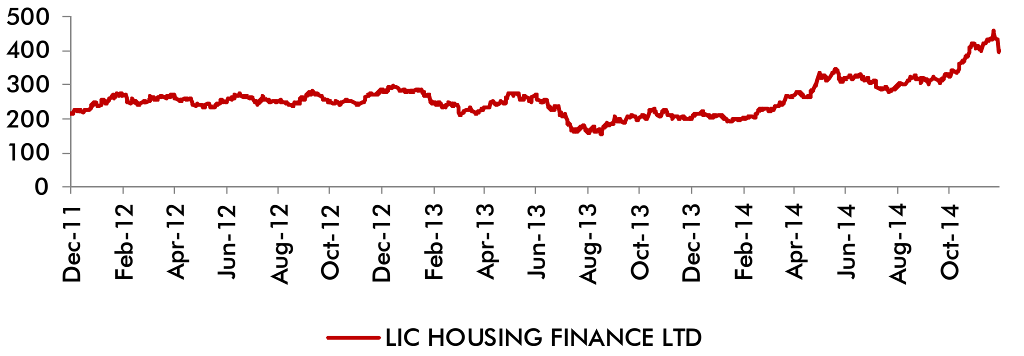
LIC Housing Finance (LICHF IN, BUY) - Stock price performance



Source: Bloomberg, Ambit Capital research

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BUY	>5%
SELL	<5%
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UNDER REVIEW	We will revisit our recommendation, valuation and estimates on the stock following recent events
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21. NIL

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