LIC Housing Finance Ltd.

EQUITY REPORT

May 16, 2014

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LIC Housing Finance Ltd (LICHFL), one of the country's largest housing finance company, was incorporated in 1989. The company is engaged in the business of providing loans for purchase, construction, repairs and renovation of houses to individuals, corporate bodies, builders and co-operative housing societies. The company possesses one of the industry's most extensive marketing network in India, with registered and corporate Office in Mumbai, 7 Regional Offices, 15 Back Offices and 194 marketing units across India. LICHFL enjoys the highest rating from CRISIL & CARE indicating highest safety with regard to the ability to service interest and repay principal on its outstanding borrowings.

Investor's Rationale

Impressive performance in FY'14 augurs well for LICHFL – LICHFL witnessed a healthy performance in FY'14, with 22% YoY growth in total income at ₹93,350 mn. Net profit showed a sharp increase of 29% in FY14 and stood at ₹13,171 mn. The outstanding mortgage portfolio of the company as on 31st March 2014 stood at ₹91,341 mn as against ₹77,813 mn on 31st March 2013, recording a growth of 17%. Individual Loan Portfolio (contributes ~97% of the total loan portfolio) went up by 18% and stood at ₹88,559 mn as on 31st March 2014. The overall results have been impressive so far and counting on a few major developments, we are positive about an increase of ~40% in NII by FY16.

Hopeful for achieving ~20% growth in the loan book in FY15E - Widespread geographic presence and diversified product offering enabled LICHFL to witness 17% YoY healthy growth in its loan portfolio at ₹91,341 mn during Q4FY14. Further, on account of continued emphasis on the individual loan book and strong sanction pipeline, we believe that the company will continue to see above ~20% growth in its loan book in FY15E.

Well positioned to deliver consistent growth in profitability - Notwithstanding tough macroeconomic factors, LICHFL has consistently improved its profitability, maintained its net interest margin (NIM) above 2% and has increased focus on high yielding products, which would help improve the margins. Over the past few years, the company also been able to maintain its asset quality & keep NPL's (non-performing loans) below 1%. Thus, we believe that on the back of rising retail spreads, adequate borrowing mix and abating asset quality concerns, LICHF is well positioned to take advantage of the underlying opportunity present in the Indian housing finance industry.

NIM margin recovery assured - LICHFL posted 17% QoQ growth in interest income in FY14 due to healthy growth in core interest income and widening of margins. Net Interest Income (NII) growth of 16% was achieved despite the high interest rate scenario for most of the fiscal in FY14, firming our belief of sustained margins in the coming quarters. We believe the NIM to grow by 39.78% YoY in FY16.

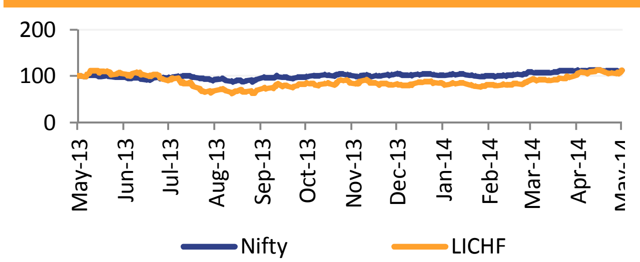
Market Data

Rating	**BUY**
CMP (₹)	310.5
Target (₹)	**370**
Potential Upside	~19.2%
Duration	Long Term
Face Value (₹)	2.0
52 week H/L (₹)	326.9/152.8
Adj. all time High (₹)	1,446
Decline from 52WH (%)	5.1
Rise from 52WL (%)	103.2
Beta	1.4
Mkt. Cap (₹bn)	156.8
Enterprise Value (₹bn)	803.2

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Int. Income (₹bn)	76.6	92.1	110.6	132.7
Net Profit (₹bn)	10.5	13.2	15.8	18.9
Share Cap. (₹bn)	1.0	1.0	1.0	1.0
EPS (₹)	20.7	26.1	31.4	37.5
PE (x)	15.0	11.9	9.9	8.3
P/BV (x)	2.4	2.1	1.8	1.5
RoA (%)	1.3	1.4	1.4	1.4
RoE (%)	16.1	17.4	17.9	18.1

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	40.3	40.3	-
FII	37.4	35.7	1.7
DII	6.9	8.1	(1.2)
Others	15.4	15.9	(0.5)

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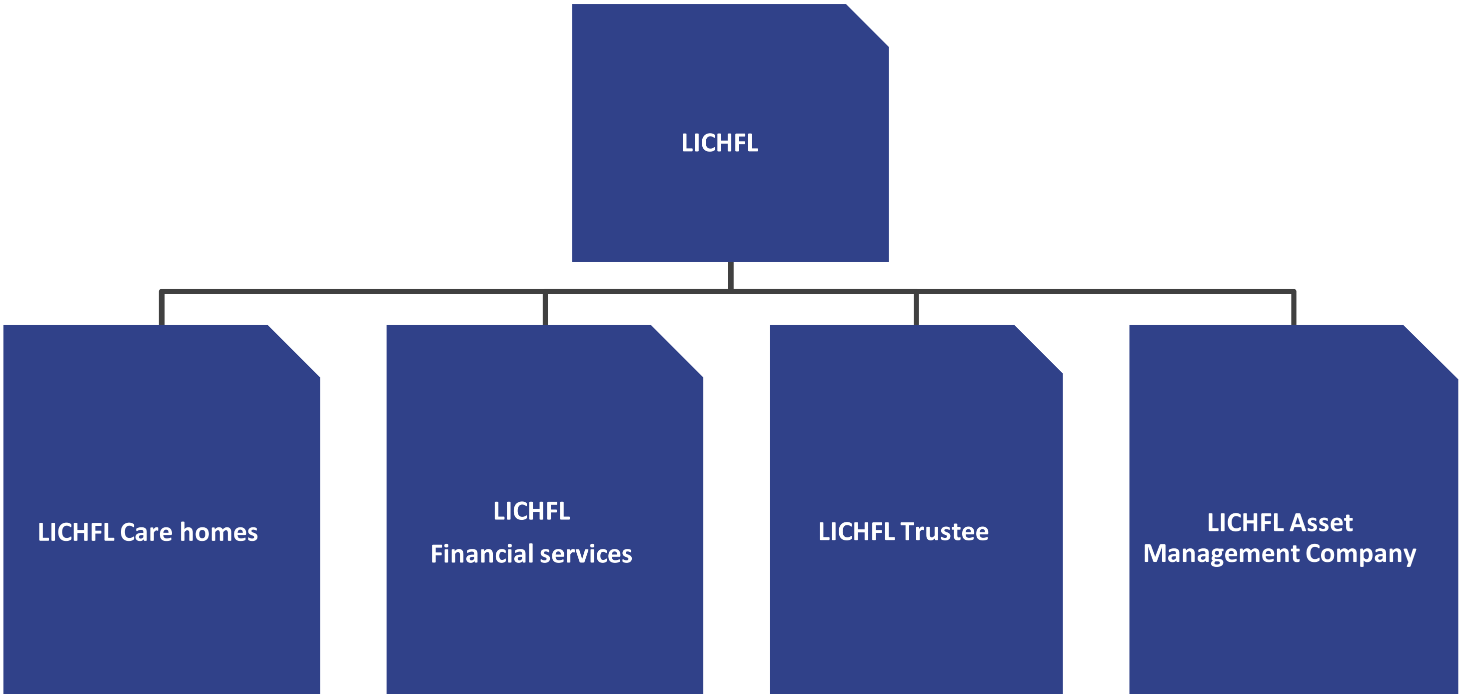
Today, the company has a proud group of over 10, 00,000 prudent house owners who have enjoyed the company's financial assistance.

LIC Housing Finance Ltd. (LICHFL) – one of the largest housing finance companies in India

LICHFL, the second largest player in the Indian mortgage market, was founded in June 1989. The company is engaged in the business of providing loans for purchase, construction, repairs and renovation of houses to individuals, corporate bodies, builders and co-operative housing societies and has its operations within India. It provides loans for homes, construction activities, and its corporate housing schemes. The company has one of the widest networks of offices across the country and representative offices at Dubai & Kuwait. In addition, the company also distributes its products through branches of its subsidiary LICHFL Financial Services Ltd. LICHFL was promoted by Life Insurance Corporation in 1989 and a public issue was made in 1994. It launched its maiden GDR offering in 2004. The company enjoys the highest rating from CRISIL & CARE indicating highest safety with regard to the ability to service interest and repay principal on its outstanding borrowings. The Authorized Capital of the company is ₹1,500 mn and its paid up capital is ₹850mn. The main objective of the company is providing long term finance to individuals for purchase / construction / repair and renovation of new / existing flats / houses.

The company possesses one of the industry's most extensive marketing network in India, with registered and corporate Office in Mumbai, 7 Regional Offices, 15 Back Offices and 194 marketing units across India. In addition, the company has appointed over 1,241 Direct Sales Agents (DSAs), 6,535 Home Loan Agents (HLAs) and 782 Customer Relationship Associates (CRAs) to extend its marketing reach. Back Offices spread across the country conduct the credit appraisal and administrative functions. The company has set up a Representative Office in Dubai and Kuwait to cater to the Non-Resident Indians in the GLCC countries covering Bahrain, Dubai, Kuwait, Qatar and Saudi Arabia. Today, the company has a proud group of over 10,00,000 prudent house owners who have enjoyed the company's financial assistance.

LICHF's subsidiaries and associates

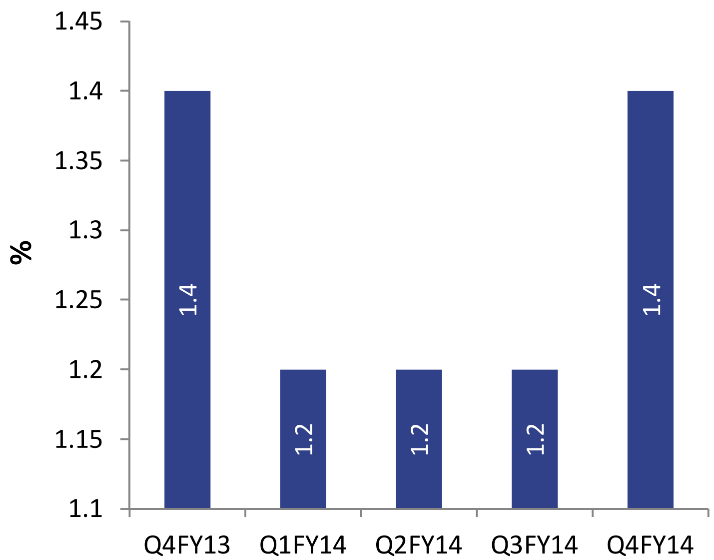


Showcased impressive performance in Q4FY14 and FY14

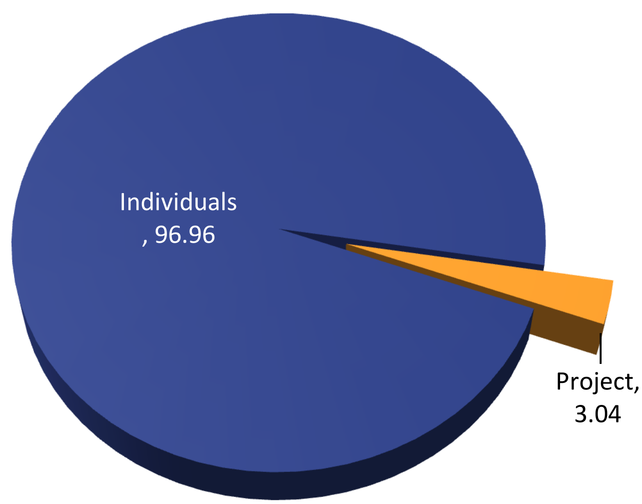
During the quarter, total income as well as revenue from operations grew by 19% YoY.

LICHFL witnessed a robust performance in the fourth quarter of FY14 with strong growth in total income by 19% YoY to ₹24,780 mn as against ₹20,750 mn in the same period a year ago. Revenue from operations also grew by 19% YoY to ₹24,071 mn in Q4FY14 from ₹20,280 mn in Q4FY13. Further, Net Interest Income (NII) went up by 16% to ₹5,330 mn in Q4FY14 over the same period of last year due to increase in loan disbursement. However, its NIM stood at 2.40% in Q4FY14 against 2.45% in Q4FY13. NIM decreased marginally during the quarter due to an increase in finance cost of the company, which came up to 76.7% of total income from 76.3% in Q4FY13. However, the net profit of the company during the quarter witnessed a strong growth of 17% at ₹3,700 mn in Q4FY14 as against ₹3,161 mn in Q4FY13.

Quarterly trend of overall spread



Q4FY14 loan book break-up (%)



NIM decreased marginally in Q4FY14 due to an increase in finance cost of the company, which came up to 76.7% of total income from 76.3% in Q4FY'13.

During FY14, LICHFL witnessed a 22% increase in total income and in revenue from operations at ₹93,350 mn and ₹90,732 mn, respectively, while net profit grew by 29% YoY to ₹13,171 mn.

During FY14, LICHF's registered an impressive growth of 22% YoY in its total income at ₹93,350 mn as against ₹76,591 mn in FY13. The company's revenue from operations grew significantly by 22% to ₹90,732 mn during the said year. Net profit of the company recorded a growth of 29% in FY14 and stood at ₹13,171 mn as compared to ₹10,232 mn in the previous year. The outstanding mortgage portfolio of the company as on 31st March 2014 stood at ₹91,341 mn as against ₹77,813 mn on 31st March 2013, recording a growth of 17%. Individual Loan Portfolio (contributes ~ 97% of the total loan portfolio) went up by 18% and stood at ₹88,559 mn as on 31st March 2014. On assets quality front, the company witnessed marginal deterioration. Gross NPAs of the company as on 31st March 2014 stood at 0.67% as against 0.61% as on 31st March 2013 while its net NPAs came up to 0.39% as on 31st March 2014 as compared with 0.36% of the same period last year.

Overall, the results have been impressive so far and counting on a few major developments, we are positive about an increase of 40% in the NII by FY16.

Lower borrowing cost to boost NII

Fund-raising is the biggest problem for all housing finance companies. The companies seek different avenues of fund raising as a means of risk distribution. The Reserve Bank relaxed external commercial borrowings (ECBs) norms for affordable housing projects by withdrawing

Until now, the company has been operating in the mid-income segment and targeting end-users and there hasn't been any challenge with respect to demand in this segment.

But now, LICHFL is shifting its focus to the salaried group, majority of them being from the PSU sector, as the outside economy doesn't impact them.

In a very challenging business environment, the company has been able to maintain good asset quality and improved profitability and is likely to increase the loan book growth to 20%.

the minimum capital requirement and lowering total experience to three years, while extending the scheme till the next financial year. RBI also withdrew the condition of minimum paid-up capital requirement of not less than ₹500 mn for the housing finance companies (HFCs) to avail ECBs.

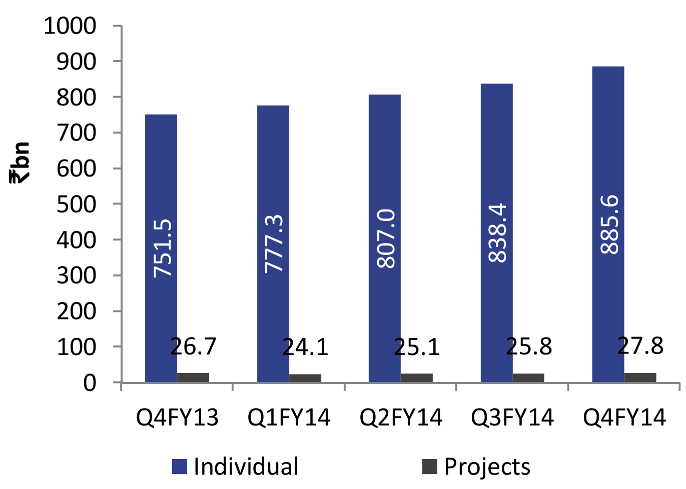
LICHFL recently got approval from the RBI to raise USD300 mn (over ₹18,000 mn) from overseas markets through external commercial borrowings (ECBs). It plans to deploy these funds as loans to home buyers in the affordable housing segment. Under this arrangement the average loan dispersal would be in the range of ₹1.4 mn and ₹1.5 mn. The current loan disbursal is ₹1.9 mn. Until now, the company has been operating in the mid-income segment and targeting end-users and there hasn't been any challenge with respect to demand in this segment, but it is now shifting focus to the salaried group, majority of them being from the PSU sector as the outside economy doesn't impact them. Thus, making us positive about the growth of loans and NII of the company.

Eyes ~20% increase in loan book growth in FY15

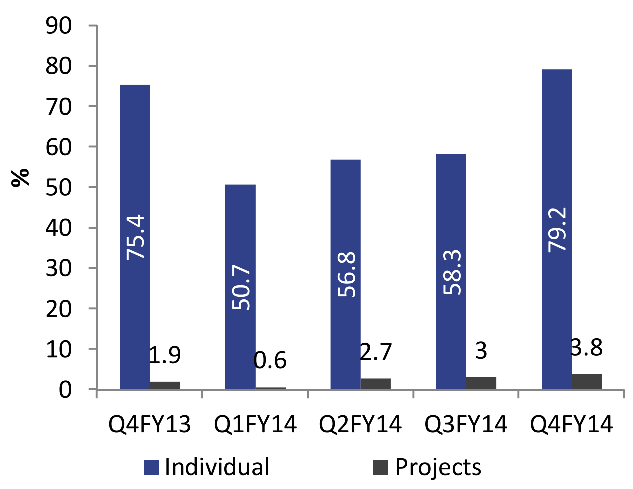
The company's overall loan book growth narrowed to 17% in Q4FY14 against a growth of 19% YoY in Q3FY13 as there was not much improvement in loan disbursals despite of aggressive lending against property in Q4FY14. Loan disbursements to individuals (contributing ~97% to loan book) grew by 7% in Q4FY14, just above the 6% growth seen in Q4FY13. The outstanding mortgage portfolio as on Q4FY14 was ₹91,341 mn as against ₹77,813 mn on Q4FY13, thus registering a growth of 17%. Individual loan portfolio stood at ₹88,559 mn in Q4FY14, a growth of 18%.

LICHFL increased its lending rates on existing portfolio by 10bps effective 1st October, 2013. 50% of its loan portfolio is floating in nature and will get re-priced immediately. In a very challenging business environment, the company has been able to maintain good asset quality and improved profitability and is likely to increase the loan book growth to 20%.

Loan book grew at ~17% QoQ in last five quarters



Growth in Disbursements (%)



We believe persistently high borrowing costs act as a deterrent for homebuyers. The increase in yields also depends on how much LICHFL is able to sustain the growth in loans against property. But, there is a good pipeline of loan sanctions and growth in the individual portfolio should be better in FY15. Retail disbursements should start reviving after a couple

The company's Gross NPAs stood at 0.67% in Q4FY14 as against 0.61% in Q4FY13. Net NPAs were 0.39% in Q4FY14 as against 0.36% in Q4FY13.

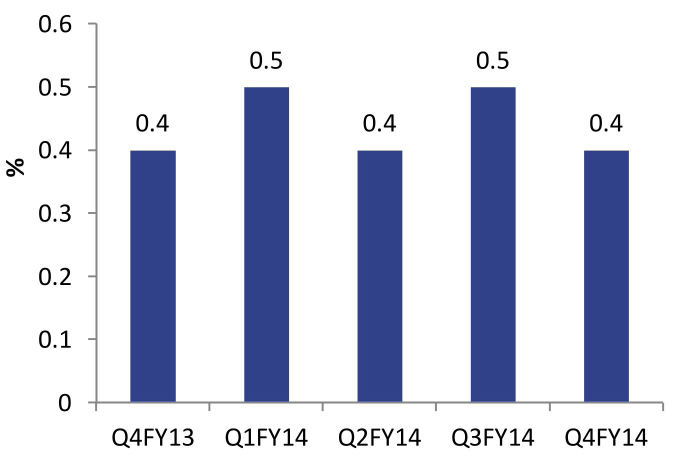
Asset quality woes will no longer surface in the company as it is expected to stabilize in coming quarters with macroeconomic improvements.

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. These factors will be key catalysts, which will drive the loan book growth in the near term.

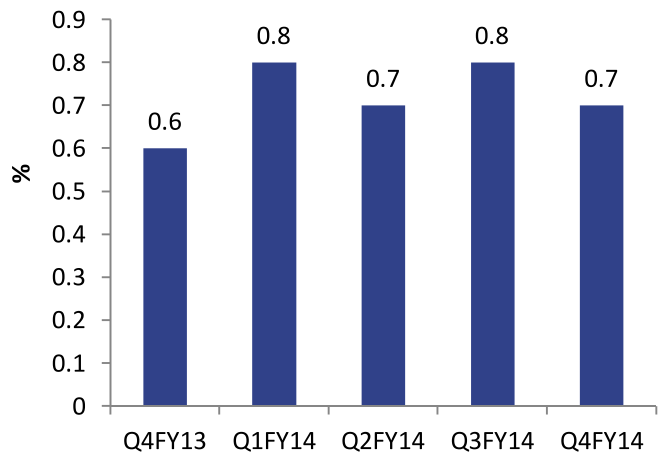
Asset quality woes no longer surface in LICHFL

LICHFL showcased significant improvement on asset quality front. It was reported that the company's Gross NPAs stood at 0.67% in Q4FY14 as against 0.61% in Q4FY13. Net NPAs were 0.39% in Q4FY14 as against 0.36% in Q4FY13. Gross NPAs in the individual loan segment stood at 0.27% as on March 31, 2014 as against 0.32% as on March 31, 2013. Asset quality woes will no longer surface in the company as it is expected to stabilize in coming quarters with macroeconomic improvements. As per the management guidance, most of the problem accounts in the developer segment have been identified and therefore further large slippages are unlikely. Delinquencies in the retail mortgages segment are expected to remain benign. Credit cost is estimated to remain low due to expected recoveries from defaulted developers. With no major delinquencies in its developer loan book, the company expects no negative surprises on asset quality in the near future.

Improvement in Net NPA



Gross NPA trend



RBI's governor has suggested new banking license aspirants to consider applying for a differentiated license instead of a full license. A differentiated license will allow a bank to offer products only in select verticals, such as project financing, or focus only on a certain banking service, like in the case of payment banks

LICHFL positive on banking license re-application

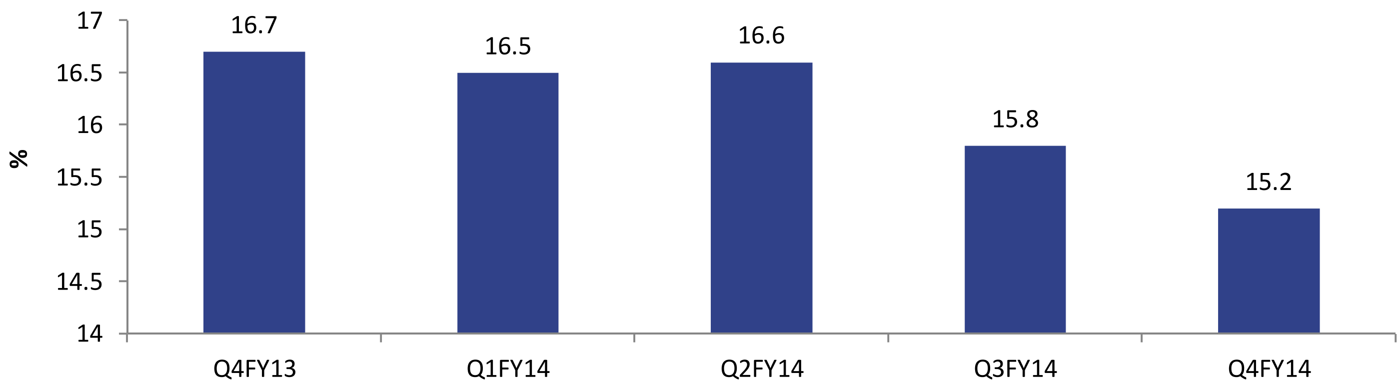
Despite of having a robust balance sheet, adequate sourcing of funds of the entities' promoter groups, income tax records, LICHFL was unable to obtain the banking license. The major reason attributed to this being the absence of the company in the backward regions of India. Nonetheless, the company has its chances of obtaining a banking license in a different vertical on an on-tap basis. RBI's governor Raghuram Rajan has suggested new banking license aspirants to consider applying for a differentiated license instead of a full license. A differentiated license will allow a bank to offer products only in select verticals, such as project financing, or focus only on a certain banking service, like in the case of payment banks. This would be a rather favorable development for LICHFL as the company will not have to undergo an entire process change to set shop but can continue to manage its own vertical.

LICHFL's tier-I capital adequacy ratio (CAR) improved to 12.1% at the end of FY14 as compared to 11.5% in FY13.

Adequate CAR to sustain better return

Regulatory body NHB (National housing board) has recently relaxed norms towards lower risk weights and provisioning on select individual loans, which are above ₹7.5 mn and residential projects under corporate real estate category. As a result, LICHFL's tier-I capital adequacy ratio (CAR) improved to 12.1% at the end of FY14 as compared to 11.5% in FY13. In view of the comfortable capital adequacy ratio as a result of preferential allotment of equity shares to the promoters and development related to issue of new banking license by RBI, the company decided to defer the raising of equity capital through Qualified Institutional Placement. However, after rejection of the banking license application, it plans to raise at least ₹2 mn (USD32.65 mn) via dual tranche bonds. The company will sell one-year one-day bonds at 9.50% and 3-year bonds at 9.69%. This move is in line with the company's strategy to increase its Tier II capital (as the company is in favor of raising equity only if it gets into a capital-intensive business like retail banking) and maintain adequate levels of CAR.

CAR Trend (%)



Margins bounced back in the last quarter; recovery in the margins will be the key growth driver.

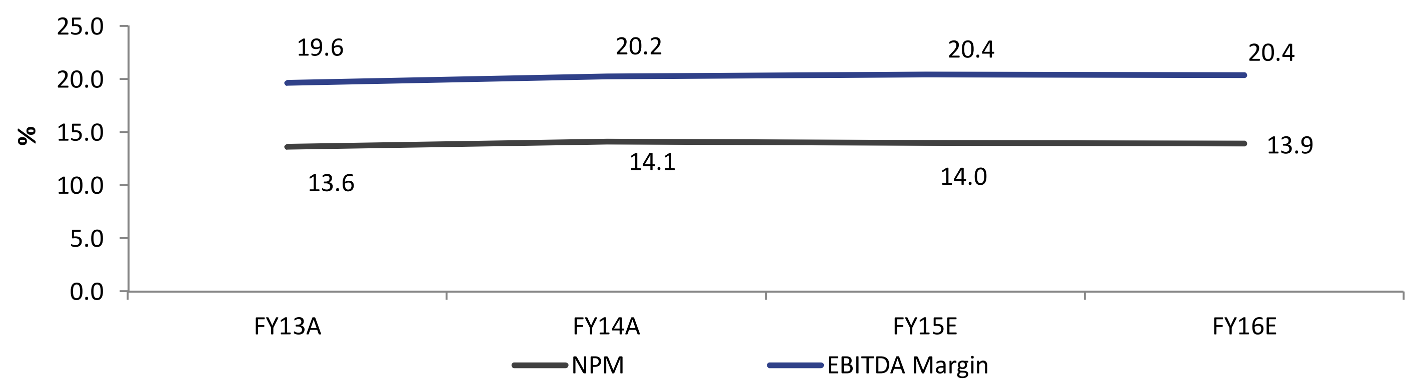
Key issues needs to be addressed

Asset quality in the developer category: The outlook on performance in developer portfolio will be a vital determinant of performance in the coming quarters.

Margin trends: LICHF has been disappointing on the margin front for the past few quarters. Margins bounced back in the last quarter; recovery in the margins will be the key growth driver.

Overall asset quality trends: Decline in the GNPA and NNPA levels ensure no unlikely slippages.

Margin trend



Balance Sheet (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	1,010	1,010	1,010	1,010
Reserve and surplus	64,324	74,849	87,599	103,492
Net Worth	65,334	75,859	88,609	104,502
Minority Interest	8	11	11	11
Long-term borrowings	562,679	677,123	799,005	942,826
Deferred tax liabilities	1	1	1	1
Other long-term liabilities	554	981	981	981
Long-term provisions	6,874	7,063	8,123	9,341
Current liability	171,037	197,564	237,076	283,929
Total Liability	**806,487**	**958,601**	**1,133,806**	**1,341,591**
Goodwill	2	2	2	2
Fixed assets	732	864	950	998
Long-term loans and advances	1,681	1,463	1,492	1,566
Deferred tax assets (Net)	2,489	2,566	2,566	2,566
Other non-current assets	55	129	129	129
Non-current investments	1,804	1,922	1,922	1,922
Customer Loans	778,127	913,409	1,077,822	1,271,831
Current Assets	21,597	38,248	48,923	62,579
Total Assets	**806,487**	**958,601**	**1,133,806**	**1,341,591**

Profit & Loss Account (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Interest Income	76,596	92,147	110,577	132,692
Interest Expended	59,246	71,744	86,811	104,173
NII	17,350	20,403	23,766	28,519
Other Income	868	1,583	2,850	3,363
Operating Income	**18,218**	**21,986**	**26,616**	**31,882**
Operating Expenses	3,170	3,355	4,026	4,831
EBITDA	**15,048**	**18,631**	**22,590**	**27,051**
Depreciation	77	78	86	94
Provisions	790	215	1,073	1,610
Taxes	3,640	5,124	5,586	6,423
Sh. Of associate	(58)	(29)	0	0
Sh. Of Minority Interest	7	3	0	0
Net Profit	**10,475**	**13,182**	**15,845**	**18,923**

Key Ratios (Standalone)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA margin (%)	19.6	20.2	20.4	20.4
NPM (%)	13.5	14.1	14.0	13.9
ROE (%)	16.1	17.4	17.9	18.1
ROA (%)	1.3	1.4	1.4	1.4
Interest Exp/ Interest Inc. (%)	77.3	77.9	78.5	78.5
Cost-Income Ratio (%)	17.4	15.3	15.1	15.2
BVPS (₹)	129.4	150.2	175.5	206.9
P/BV (x)	2.4	2.1	1.8	1.5
EPS (₹)	20.7	26.1	31.4	37.5
P/E (x)	15.0	11.9	9.9	8.3

Valuation and view

Despite the challenging business environment, the company is well positioned to deliver sustainable and profitable growth backed by strong disbursement in the mid and small housing segment. However, on QoQ basis, loan disbursements remained weak. In this respect, the company aims to increase the disbursements to developer loans going forward, which is likely to keep the margins intact.

Considering these factors, we recommend BUY on the stock at the current market price of ₹310.5 with a target price of ₹370, with a potential upside of ~19.2%, based on P/BV of ~1.8x FY15E book value of ₹175.5 and 1.5x on FY16E book value of ₹206.9.

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