

LIC Housing Finance

31 July 2021

Reuters: LICH.BO; Bloomberg: LICHFIN

Weak asset quality outweighs multiple other positives

LIC Housing Finance (LICHF) reported weak results for 1QFY22, with its PAT dropping by 81% YoY on account of NIM compression, one-off employee expenses (Rs1.25bn) and increase in provisioning. High stress levels continue to keep us uncomfortable. Along with sticky project level NPAs, we have also seen a sharp deterioration in the retail segment's asset quality. The management expects collections to improve going forward. Our discomfort around provisioning levels remains unchanged. Overall loan book growth was 10.8% YoY on the back of disbursements rising by 143% YoY. In view of the strong demand trends for housing finance, LIC HF's low cost of funds (CoF) positions the company competitively. However, consistently weak asset quality continues to be a key pain point, preventing us from being constructively positive on LIC HF, despite several positives such as growth, distribution and most importantly, lower CoF and undemanding valuation. Adjusting for the balance sheet gearing, a back-of-the-envelope calculation indicates that LIC HF's return ratios are lower. We maintain ACCUMULATE on the stock with a target price of Rs438, based on 1.2x FY23E ABVPS. HDFC Limited remains our preferred pick in the Housing Finance space.

Individual segment drives growth: Advances growth of 10.8% YoY was led by individual home loans (up 13.0% YoY and 0.7% QoQ). Lockdowns in April-May'21 affected the business (disbursements fell by 61.3% QoQ), but the trend has improved from June'21. Consequently, 2QFY22 disbursements are expected at 4QFY21 levels. In 1QFY22, 88% of the disbursements were towards individual housing loans, with this segment's share of the loan book increasing to 78.3% (up 150bps YoY and 40bps QoQ).

Weak asset quality further hit due to covid: The company's asset quality metrics were weak even pre-covid, primarily on the account of project loans and non-housing commercial loans. Despite multiple positives in the LIC HF story, its weak asset quality has been a major deterrent, preventing us from building a positive thesis on the stock, despite compelling valuation. Asset quality deterioration continued in 1QFY22, with stage 3 assets/GNPAs increasing sharply (up 151bps QoQ) to 5.93%. Individual home loans GNPAs increased from 1.9% in 4QFY21 to 2.6% in 1QFY22. NPAs in the developer segment have been sticky at elevated levels for a while now. In 1QFY22, developer GNPAs increased to 24.2% from 18% in 4QFY21 and 16% in 3QFY21. Stage 2 developer assets stood at 16%. Overall restructuring increased to 2.3% in 1QFY22 (from 1.3% in 4QFY21) with further restructuring expected in 2QFY22 under OTR-2.0. We expect the company's asset quality to remain weak.

Mismatch between earlier provisioning stance and run-rate: Provisioning trends for the last two quarters (up 13.7x YoY in 1QFY22 and up 34.9x in 4QFY21) have been in contrast to the management's earlier commentary when they had expressed confidence about asset quality outcomes and provisioning requirements. While we are all for conservative provisioning policies/excess provisions and guiding the market on the same ahead of time, we find it hard to associate LICHF with these qualities. In our last note, we had stated that a higher ECL coverage, at the cost of near-term profitability, will provide a lot more comfort to investors. For 1QFY22, credit cost stood at 1.4% (up 130bps YoY, down 30bps QoQ). In addition to ECL provisions, Rs3.5bn of impairment reserves are held against restructured assets. The management expects asset quality trends to improve. Collection efficiency for regular accounts stood at 98% (excluding arrears), in line with March 2021 levels. ~35% of the NPA accounts (volume-wise) are making some payments.

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ACCUMULATE

Sector: Banking

CMP: Rs410

Target Price: Rs438

Upside: 7%

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Key Data

Current Shares O/S (mn)	504.7
Mkt Cap (Rsbn/US\$bn)	207.1/2.8
52 Wk H / L (Rs)	542/255
Daily Vol. (3M NSE Avg.)	4,086,369

Price Performance (%)

	1 M	6 M	1 Yr
LIC Housing Finance	(12.7)	3.7	55.5
Nifty Index	0.3	15.6	42.0

Source: Bloomberg

Y/E Mar (Rsmn)	Q1FY22	Q1FY21	Q4FY21	YoY (%)	QoQ (%)
Interest Income	48,253	49,851	48,978	-3.2	-1.5
Interest Expense	35,500	37,645	33,929	-5.7	4.6
Net Interest Income	12,753	12,206	15,049	4.5	-15.3
NIM (%)	2.20	2.32	2.66	-12bps	-46bps
Fee & Other income	295	-98	590	-401.6	-49.9
Total Income	13,048	12,108	15,639	7.8	-16.6
Staff Cost	2,152	796	592	170.5	263.4
Other Op Exp	663	571	1,755	16.0	-62.2
Total Operating Expenses	2,815	1,367	2,347	105.9	19.9
Cost to Income (%)	21.6	11.3	15.0	1028bps	657bps
Cost to AUM (%)	0.5	0.3	0.4	22bps	7bps
Pre-Provisioning Operating profit	10,233	10,741	13,292	-4.7	-23.0
Provisions	8,304	565	9,772	1,371.1	(15.0)
PBT	1,929	10,177	3,520	-81.0	-45.2
Tax	395	2,002	-469	-80.3	-184.2
-effective tax rate	20.5	19.7	-13.3	80bps	3380bps
PAT	1,534	8,175	3,989	-81.2	-61.5
Other Comprehensive Income	33	-11	39	-410.5	-16.2
Total Comprehensive Income	1,567	8,164	4,028	-80.8	-61.1
EPS (Rs)	3.0	16.2	7.9	-81.2	-61.5
BV (Rs)	410	376	407	8.8	0.7
Advances	23,25,480	20,98,170	22,81,143	10.8	1.9

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Disappointing NIM performance: Interest income declined by 3.2% YoY despite strong advances growth, primarily on account of lower incremental yields even as interest reversals were small. Despite lower incremental CoF (down 12bps QoQ to 5.03%), interest cost increased by 4.6% QoQ. Consequently, NIM declined by 12bps YoY and 46bps QoQ to 2.2%. We have reduced our NIM estimates. Recently, LICHF has reduced home loan rates to 6.66% for specific salaried loans sanctioned till 31st Aug'21.

One-off employee costs: Sharp employee expenses growth in 1QFY22 (up 1.7x YoY and 2.6x QoQ) can be attributed to one-off salary hike arrears worth Rs1.3bn. Going forward, employee expenses would be higher by ~15% and the company would also provide some amount for future hikes.

Change in our numbers: We have (1) maintained loan growth estimates given the strong disbursements run-rate and a highly competitive position given the lower CoF (2) reduced our NIM estimates post 1QFY22 earnings – higher proportion of non-paying accounts, especially in high-yielding developer portfolio coupled with lower yields in core home loans (3) increased staff costs to account for the Rs1.3bn one-off in 1QFY22 (normalised average quarterly run-rate Rs850-900mn) (4) increased FY22E NPA estimates sharply, leading to higher credit cost. As a result, we have cut our FY22E/FY23E PAT by 19.4%/7.7% (see exhibit 13). Estimating asset quality and the consequent provisioning trends remains challenging and we would look to get more clarity on the same as we proceed through FY22. However, the overall risk-adjusted profitability remains weaker vis-a-vis HDFC.

Comprehensive Conference Call Takeaways

Asset Quality

- 1QFY22 asset quality was affected mainly due to second covid wave. In the near term, improving the asset quality will be a key priority area.
- In 1QFY22, there was one NCLT account recovery of >Rs1bn. There are 4 other accounts pending with NCLT.
- Retail restructuring is as follows:
 - 4QFY21: Rs12bn (OTR-1)
 - 1QFY22: Rs2.34bn (OTR-1), Rs0.45bn (OTR-2)
- For the company, the restructured assets sit mostly under Stage 1 assets. Current requests for restructuring under framework 2.0 are less, but are expected to pick up towards the end of 2QFY22. On the developer front, the company does not expect any further downside.
- To provide for the restructured loans, the company has created an impairment reserve, which currently stands at Rs3.5bn (Rs2.84bn in 4QFY21).
- Collection efficiency stood at 98% for June'21 (for regular accounts, excluding arrears).
- Stage 3 assets by segments:
 - Individual home loans: 2.6% (Rs47.27bn) – compared to 1.9% in 4QFY21 (Rs34-35bn)
 - Non-housing (individual): 10.99% (Rs22.53bn)
 - Non-housing (commercial): 18.91% (Rs27.07bn)
 - Project loans: 24.4% (Rs38.89bn) – compared to 18% in 4QFY21 (<Rs30bn).
 - Stage 2 developer loans stood at Rs24.9bn. Exposure to top 20 developers constitutes Rs20bn.
- Restructured LRD loans stood at Rs17bn in 4QFY21 and Rs20bn in 1QFY22.
- Segment-wise LTV:
 - Individual home loans: 44%
 - Non-housing (individual): 33%
 - Non-housing (commercial): 34%
 - Project loans: 38-39%
- 30-35% of the retail NPA customers are making some kind of payments.
- There were no write-offs in 1QFY22. Cumulative housing loan write-offs since inception stand at <Rs3bn compared to cumulative disbursements of >Rs4trn.

Business and Loan Growth

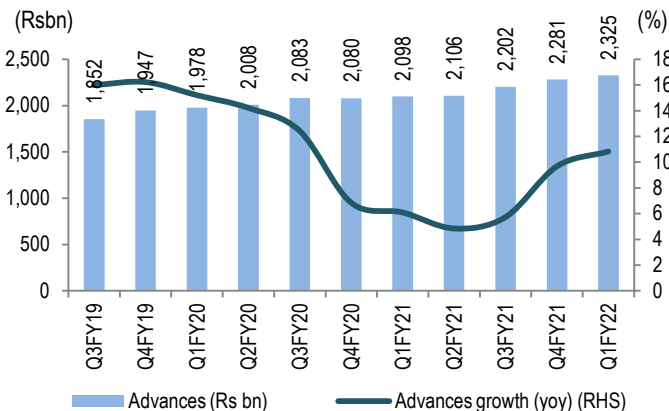
- Business environment has improved since June'21. While disbursements were affected in April-May'21, June'21 saw good growth, which has been geographically well spread. The management is confident of sustaining recovery in individual home loans. 2QFY22 disbursements are expected to be similar to 4QFY21.
- Overall LRD book stands at Rs90bn.
- Total ECLGS outstanding is Rs4.5bn.
- >50% business was done from tier 2 & 3 cities last year.

Margin, Liabilities and Liquidity

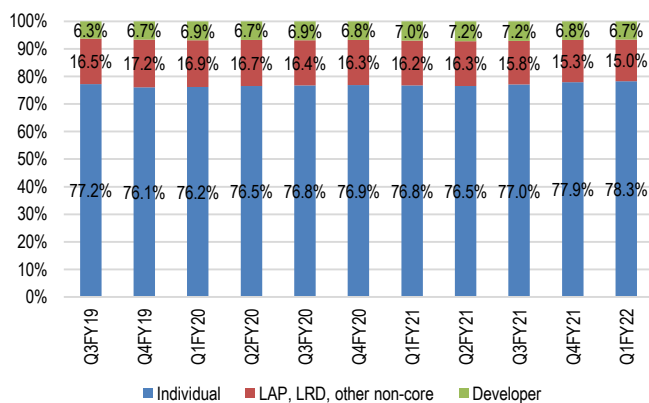
- Interest reversals were not large in 1QFY22.
- Interest income was majorly affected due to lower yields.
- Incremental spread stood at 250bps.

Operating Expenses

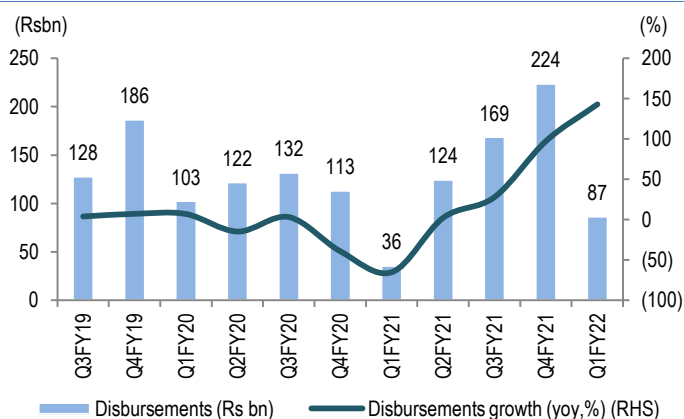
- Employee salaries are hiked once in 4 years. One-off employee expenses relating to arrears (Aug'2017 onwards) stood at Rs1.3bn. Employee expenses would increase by ~15% and the company would provide some amount for further salary hikes.

Exhibit 1: Advances (Rs bn) and Advances growth (YoY, %)


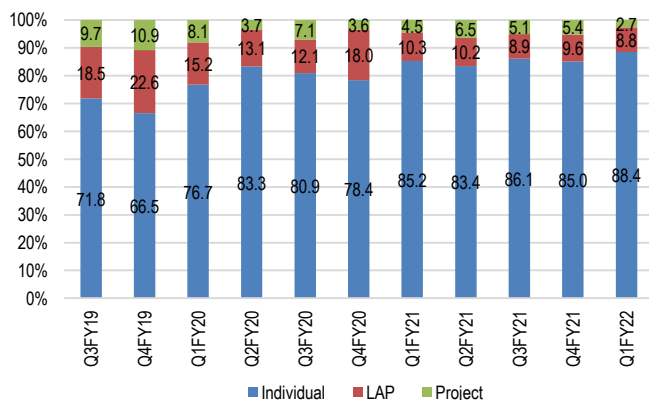
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Advances Mix (%)


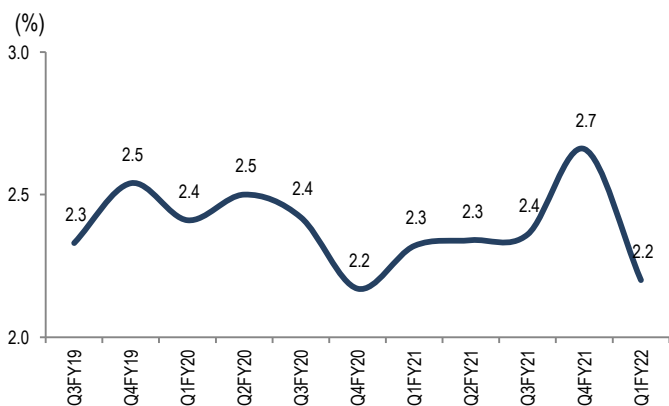
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Disbursements (Rs bn) and Disbursements growth (YoY, %)


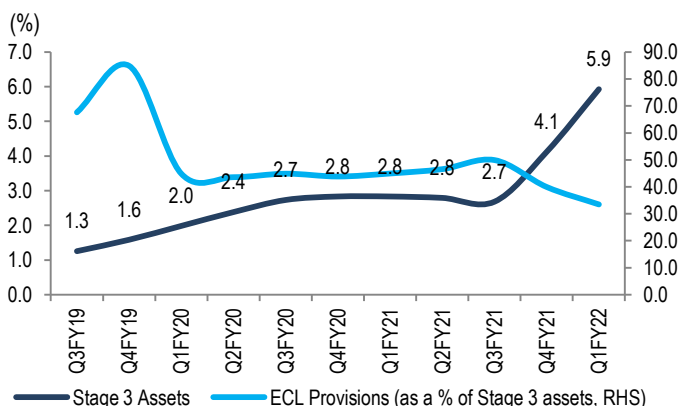
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Disbursements Mix (%)


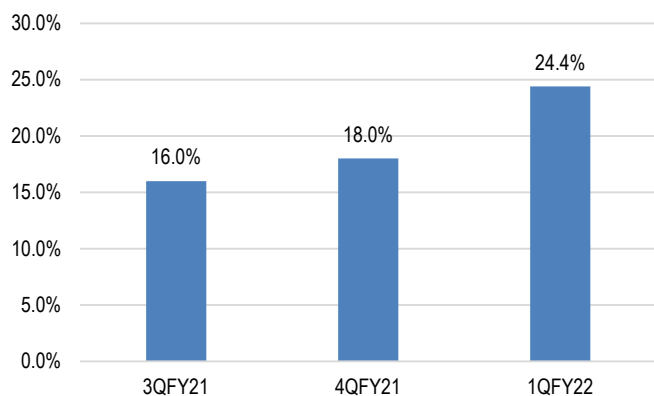
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: NIM (%) (reported)


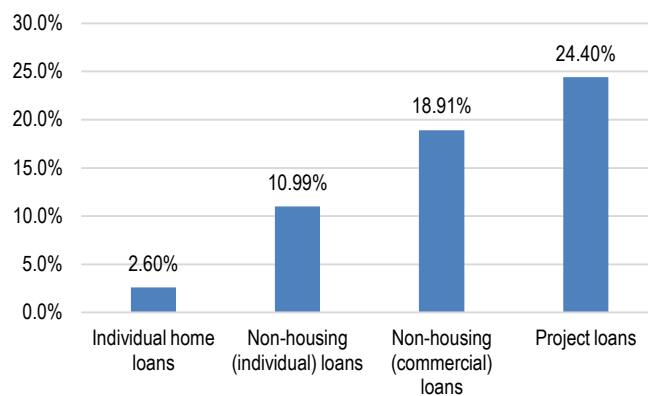
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Asset Quality metrics (%)


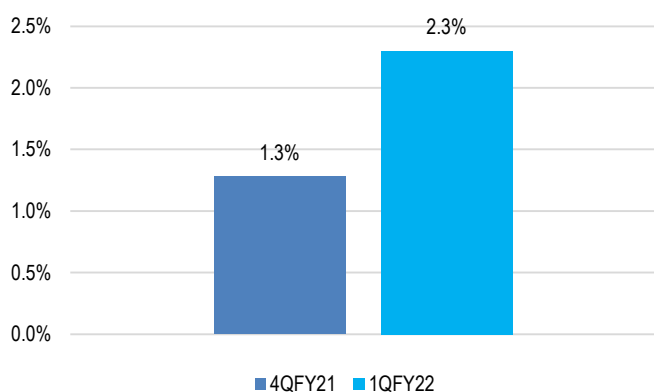
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Project level GNPA's (%)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: GNPA's across segments (%)


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Restructuring (%)


Source: Company, Nirmal Bang Institutional Equities Research

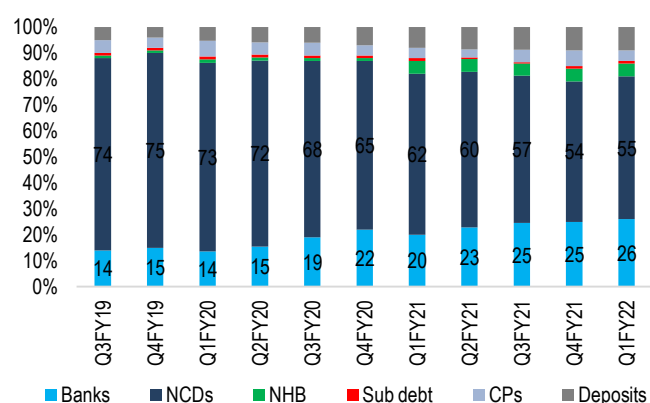
Exhibit 10: Borrowings Breakup (%)


Exhibit 11: Financial summary

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Net Interest Income	42,791	46,781	52,445	57,957	64,418
Pre-Provisioning Operating profit	37,421	42,221	46,662	49,824	56,656
PAT	24,344	24,022	27,343	27,142	36,097
EPS (Rs)	48.2	47.6	54.2	49.3	65.6
BV (Rs)	323.6	360.5	406.6	456.4	513.1
P/E (x)	8.5	8.6	7.6	8.3	6.2
P/BV (x)	1.3	1.1	1.0	0.9	0.8
ROA (%)	1.3	1.1	1.2	1.1	1.3
ROE (%)	15.9	13.9	14.1	11.9	13.5
Gross NPA (%)	1.5	2.7	4.1	5.0	4.6
Net NPA (%)	1.1	1.9	2.5	3.3	2.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Actual performance versus our estimates

(Rsmn)	Q1FY22	Q1FY21	Q4FY21	YoY (%)	QoQ (%)	Q1FY22E	Devi. (%)
Net interest income	12,753	12,206	15,049	4.5	(15.3)	15,070	(15.4)
Pre-provisioning operating profit	10,233	10,741	13,292	(4.7)	(23.0)	13,576	(24.6)
PAT	1,534	8,175	3,989	(81.2)	(61.5)	8,364	(81.7)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Change in our estimates

Earning Revision	Revised Estimate		Earlier Estimate		% Revision	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Net Interest Income (Rs mn)	57,957	64,418	61,392	68,365	-5.6	-5.8
Net Interest Margin (%)	2.4	2.3	2.5	2.5	-14 bps	-14 bps
Operating Profit (Rs mn)	49,824	56,656	54,520	60,745	-8.6	-6.7
Provisions (Rs mn)	13,634	8,527	9,596	8,599	42.1	-0.8
Profit after tax (Rs mn)	27,142	36,097	33,693	39,109	-19.4	-7.7
Loan Book (Rs bn)	2,610	2,919	2,610	2,919	0.0	0.0
ABVPS (Rs)	301	365	354	408	-14.9	-10.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: One-year forward P/ABV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 15: Income statement

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	1,71,701	1,94,620	1,96,971	2,04,406	2,29,080
Interest Expense	1,28,910	1,47,839	1,44,526	1,46,449	1,64,662
Net Interest Income	42,791	46,781	52,445	57,957	64,418
Non Interest Income	(421)	1,607	1,232	1,200	1,200
Net Revenue	42,369	48,388	53,677	59,157	65,618
Operating expenses	4,948	6,167	7,015	9,333	8,962
-Employee expenses	2,746	2,991	2,932	4,930	3,680
-Other expenses	2,203	3,176	4,083	4,403	5,282
Pre-Provisioning Operating profit	37,421	42,221	46,662	49,824	56,656
Provisions	3,504	9,527	13,176	13,634	8,527
PBT	33,918	32,693	33,486	36,190	48,129
Tax	9,574	8,672	6,142	9,047	12,032
PAT	24,344	24,022	27,343	27,142	36,097

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21	FY22E	FY23E
Share capital	1,009	1,009	1,009	1,100	1,100
Reserves & surplus	1,62,299	1,80,921	2,04,203	2,49,937	2,81,134
Shareholders' funds	1,63,308	1,81,930	2,05,213	2,51,037	2,82,234
Borrowings	17,06,670	19,13,317	20,78,615	23,59,228	26,30,539
Other liability & provisions	1,53,218	98,933	72,505	78,418	88,569
Total liabilities	20,23,196	21,94,180	23,56,333	26,88,684	30,01,342
Fixed Assets	1,359	1,475	1,362	1,431	1,502
Investments	35,951	55,055	46,356	47,283	48,229
Loans	19,46,522	21,06,004	22,81,143	26,10,020	29,19,393
Cash	29,949	19,790	13,467	14,545	15,272
Other assets	9,416	11,856	14,005	15,405	16,946
Total assets	20,23,196	21,94,180	23,56,333	26,88,684	30,01,342

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Key ratios

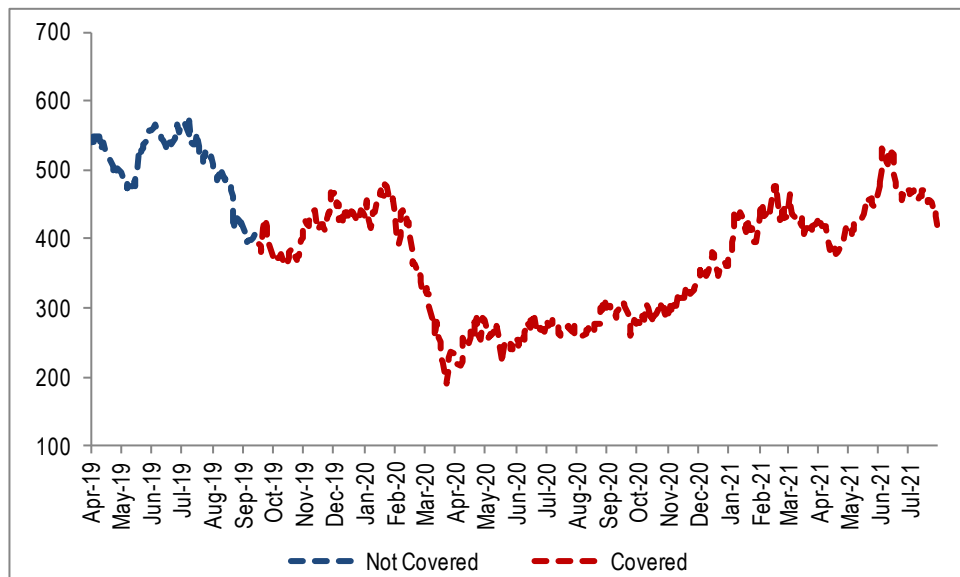
Y/E March- Ratios	FY19	FY20	FY21	FY22E	FY23E
Growth (%)					
Net Interest Income	21.2	9.3	12.1	10.5	11.1
Operating Profit	15.1	12.8	10.5	6.8	13.7
Profit After Tax	21.2	-1.3	13.8	-0.7	33.0
Business (%)					
Advance Growth	16.2	8.2	8.3	14.4	11.9
Spreads (%)					
Yield on loans	9.5	9.6	9.0	8.4	8.3
Cost of Borrowings	8.2	8.2	7.2	6.6	6.6
Spread	1.3	1.4	1.7	1.8	1.7
NIMs	2.4	2.3	2.4	2.4	2.3
Operational Efficiency (%)					
Cost to Income	11.7	12.7	13.1	15.8	13.7
Cost to AUM	0.3	0.3	0.3	0.4	0.3
CRAR (%)					
Tier I	12.3	12.2	12.7	12.7	12.4
Tier II	2.1	1.7	2.0	2.0	2.0
Total	14.4	13.9	14.7	14.7	14.4
Asset Quality (%)					
Gross NPA	1.5	2.7	4.1	5.0	4.6
Net NPA	1.1	1.9	2.5	3.3	2.8
Specific Provision Coverage	30.0	31.0	39.9	35.0	39.0
Credit Cost	0.2	0.5	0.6	0.6	0.3
Return Ratio (%)					
ROE	15.9	13.9	14.1	11.9	13.5
ROA	1.3	1.1	1.2	1.1	1.3
Per Share (%)					
EPS	48	48	54	49	66
BV	324	360	407	456	513
ABV	282	279	293	301	365
Valuation (x)					
P/E	8.5	8.6	7.6	8.3	6.2
P/BV	1.3	1.1	1.0	0.9	0.8
P/ABV	1.5	1.5	1.4	1.4	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
17 September 2019	Buy	394	517
7 October 2019	Buy	373	528
22 October 2019	Buy	375	518
8 January 2020	Buy	421	518
31 January 2020	Buy	437	512
27 March 2020	Buy	239	296
9 April 2020	Buy	224	296
23 June 2020	Accumulate	269	291
9 July 2020	Accumulate	282	291
25 August 2020	Accumulate	299	299
23 September 2020	Accumulate	287	328
7 October 2020	Accumulate	289	328
12 November 2020	Accumulate	313	331
26 November 2020	Accumulate	323	343
08 January 2021	Accumulate	435	401
31 January 2021	Accumulate	396	424
21 February 2021	Accumulate	449	490
16 June 2021	Accumulate	494	489
31 July 2021	Accumulate	410	438

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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