Management discussion and analysis

Overview of the macro economy

Despite a global economic slowdown, the Indian economy reports a steady growth pace with positive indicators such as Gross Domestic Product (GDP) growth rate between 8-9 percent, increasing foreign exchange reserves, an active capital market and a rapid inflow of FDI. India continues to hold its place as the world's second fastest growing economy, next to China.

GDP growth

2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
4.4	5.8	4.0	8.5	6.9	8.4	9.4	8.7

(Source: Central Statistical Organisation)

The economy has been averaging an 8.35 percent growth rate in the last four fiscal years (2003-04 to 2006-07), with 9.4 percent (in 2006-07) being the highest in the last 18 years. The essence of a developing economy is reflected in its industrial and services growth. These two sectors have been responsible for this growth, suggesting a structural transformation of the Indian economy.

Optimism for the 9 percent growth rate during the Eleventh Plan is provided by the increasing savings and investment rate. While the gross saving rate as a proportion of GDP has increased from 23.5 percent in 2001-02 to 34.8 percent in 2006-07, the investment rate - reflected as the gross capital formation as a proportion of GDP - has increased from 22.8 percent in 2001-02 to 35.9 percent in 2006-07. Further, when compared with the Ninth Plan average, the savings rate is 8.8 percentage points higher for the Tenth Plan average, while the investment rate is 8.1 percentage points higher.

Overall industrial production grew by 8.7 percent during April-February 2007-08. Decline in growth is spread across most sectors except electricity, community services and the services category belonging to trade, hotels, transport and communications during 2007-08.

Agricultural growth was hit by the slackening of rabi crops and fell by 1.2 percentage points when compared to 2006-07 levels. Slow growth in consumer durables segment was the key factor behind manufacturing slowdown. Manufacturing and construction sectors decelerated by 2.5 percentage points in 2007-08, in comparison with a 12 percent growth in 2006-07. Cement and steel, the key inputs into construction, grew by 7.4 percent and 6.5 percent respectively, during April-November 2007-08, down from 10.8 percent and 11.2

percent in the previous year, dampening the growth in the construction sector.

Going forward, pressure on commodity prices is expected to reduce, due to lower resource utilisation in the U.S and corresponding moderation in demand from other major economies. Severity of the US recession remains somewhat uncertain and risks are slightly higher - being determined by the US consumer and fall out of sub-prime crisis. Europe and the UK are likely to follow accordingly. Increased pressure on China to slow the growth rate will also lead to moderation in the rest of Asia due to strong inter-linkages. But the Asia-Pacific region is expected to lead the global economy into another year of healthy growth in 2008.

The fiscal deficit is well under control (the combined deficit for the Centre and the states is inching towards 6% of GDP from 9.9% in 2001-02). As a result, the government draws less of bank credit, reducing the strain on interest rates produced by the surge in lending to industry (31.6%) and housing (38%) this year.

Exports reported growth of 23.02 percent during 2007-08, while imports increased by 27.01 percent during the same period. Reflecting the favourable growth prospect of the Indian economy, the orders received by Indian companies have increased by a whopping 68.6 percent to US$ 32.48 billion during January-October 2007 compared to US$ 19.26 billion in the same period last year. Fiscal and revenue deficit decreased by 13.5 percent and 33.3 percent, respectively, during April-February 2007-08 over the corresponding period last year.

A global demand-supply mismatch in terms of food and oil has led to a sharp increase in inflation to 7.6 percent in May 2008. To control inflation, the cash credit reserve has been raised to 8.25%. Coupled with high interest rates, credit growth moderated to 21.9 percent as of February 2008, as compared to nearly 30 percent in the corresponding period last year. Continued deceleration in non-food credit has been mirrored in the weak industrial production numbers.

With strong macroeconomic fundamentals the country continues to be a safe and stable investment destination, despite international financial turmoil. As the Indian market becomes more and more attractive, offering decent return, foreign direct investment (FDI) grows simultaneously. In 2007-08, the country received FDI of US$24.5 billion as against US$15.7 billion in 2006-07, showing a growth of 56%. In 2005-06, the growth was even sharper at 184%, up from U$5.5 billion in 2004-05. In light of the robust growth in FDI inflows in India, the commerce ministry expressed its estimates that India will receive US$35 billion FDI in the financial year 2008-09.

The financial health of the economy can be determined by the following highlights:

- India's National Stock Exchange (NSE) ranks first in the stock futures and second in index futures trade in the world.
- 20 Indian firms are on the list of Boston Consulting Group's '100 New Global Challenger Giants' list.
- The number of companies incorporated has increased at an annual average of 55,000 in the last two years.
- Four Indians and seven Indian microfinance companies have made it to the Forbes list of the top 10 world's wealthiest CEOs and world's top 50 microfinance institutions, respectively.
- India has the largest number of private equity (PE) funds operating among the BRIC markets.

Mumbai has been ranked tenth among the world's biggest centres of commerce in terms of financial flow volumes by a survey compiled by MasterCard worldwide.

Housing finance industry structure and development

Despite the global uncertainties stemming from the sub-prime meltdown and the potential slowdown in the United States, real estate demand in India across sectors remains strong, riding on the phenomenal economic performance - says a new Knight Frank report (Quarter 1, 2008). The report says that the office sector is driving the demand for retail, residential and hospitality segments, emerging as the most dynamic sectors of 2007, with increase in demand resulting in consistent rise in rental values.

Over the last couple of years, the rise in property prices has affected disbursements. Disbursements are estimated to grow by around 10 percent to reach Rs.1,119 billion in 2007-08 as compared with Rs.1,021 billion in 2006-07. This growth is mainly driven by the increase in value, that is, the average loan size at the higher loan slab has increased, while volumes have shown a drop due to the rise in property prices, affecting affordability.

At higher property prices, housing loans would witness a higher percentage increase in disbursements due to greater difference between the registered price and the market-indicated price. The potential increase in disbursements is estimated to be around 49 percent at loan slabs of above 50 lakh, as compared with around 10 percent at lower loan slabs of 10-25 lakh.

In the current market, housing loans are disbursed at LTV levels of 65-70 percent, as financiers draw comfort from the collateral value differentiation between the registered and the market value. Another fallout is the deferment of purchases due to the rise in the cash component. The deferment of purchase ranges from a few months at lower loan slabs to 2.5–3 years at loans slabs of above 25 lakh. This is due to the higher cash component needed for purchasing property of greater value in addition to the margin money, resulting in the deferment of purchases.

Thus the increase in the cash component, in addition to the rise in property prices, has reduced the affordability of salaried individuals, as they do not have large cash surpluses for the same. This is reflected in the significant slowdown in the housing finance market.

Competition

The housing finance industry is one of the most keenly competitive segments of the economy, with the banking sector having a significant presence. However, RBI through its credit policy announcements has amended its guidelines / norms, making it mandatory for banks to increase their provisioning required from 0.4 percent to 1.0 percent on housing loans above Rs.20. lakhs, real estate advances etc. This has resulted in banks going slow in housing finance lending. Further, NHB has reduced the risk weight on home loans from 75% to 50%. This means that the regulator feels home loans are less risky and has signalled that HFCs can be a little more aggressive in lending for housing to the individuals. The Company, through its competitive pricing, wide distribution network and good customer service, has not only been able to show a good growth in new business, but has shown improved retention rates, reflected in high growth of loan book.

Opportunities

The last census put India's households at 192 million in 2001, up 39 million from 1991 census and 69 million from 1981 census. This coupled with the drop in the average household size from 5.7 in 1971 to 5.5 in 1991 and 5.3 in 2001 indicates that apart from population growth, nuclear family structure is slowly finding ground in India. This has resulted in a housing stock shortfall of 24.71 million units, despite the strong inflow of supply over the past one decade. Supply needs to be accelerated at 3.4% to meet the shortage.

Aggregate housing shortage in the country increased by 134 percent during the last six years from 10.56 million units in 2001 to 24.71 million units in 2007. The number of urban households during this period has increased by 11.5 million, leading to a rise in slums. (Source: National Building Organisation)

And as the retail industry is growing, demand for property can also rise. Since the competition in the market is intense, builders are going out of the way to be different. Specialised malls have become the order of the day.

The easy availability of housing finance and likely stability in property prices are strong growth drivers. The investment in housing is prioritised in the national agenda as it contributes substantially to the country's GDP growth directly and indirectly. Most of the builders are trying to woo investors with interesting features, each more tempting than the other. Closed-circuit television and earthquake proofing are expected as standard features in most upmarket blocks. Some of the residential projects boast of air-conditioning, club house and recreational facilities, modular kitchens, etc.

Unlike other finances, the risk of non-repayments is minimal in housing finance due to emotional and social dimensions to house ownership, which induces the borrower to service the loan.

Tax incentives have increased and so have salaries. So for the first time, the salaried Indian has been able to leverage current earnings to buy a future asset. The average age of a new homeowner is now 32 years compared with 45 years a decade ago.

There is also an overall transparency in the sector which was hitherto missing as banks and financial institutions are lending aggressively both to investors and developers.

Relaxation of Foreign Direct Investment (FDI) ceiling has meant more foreign investment in the sector.

A large number of builders are lured by Special Economic Zones (SEZs) as these have become attractive due to 10-year tax holiday on their development.

In the IT and ITes centres, demand for housing will continue to be strong given the young age profile of employees and the nuclear family culture. A person who needs 100 square feet of office space to work will certainly require atleast 500 square feet of residential space to live and thus housing will remain the prime driver for developers.

Technology development has resulted in faster and better completion of projects, leading to higher return on investments (ROI).

Threats

However, there are a number of factors that can act as impediments. Land costs, which form a major constituent of housing costs in metros, have risen much faster than property prices. Developers are moving to smaller cities to offset this. But prices are rising there as well. This would affect some of the smaller players and experts feel that in time to come there would be a shakeout and may be some private equity deals and joint ventures.

High transaction costs namely stamp duty and registration fees will also have adverse effect on housing activities.

The risk weightage on mortgage loans has been increased to 125 percent in respect of loan to developers, which has additionally burdened the capital adequacy ratio of housing finance companies.

High cost of borrowings of housing finance companies coupled with high stamp duty dampens growth. Housing finance companies are not given universal banking status for offering wholesale and retail finances under one roof.

The hardening of interest rates could have an adverse impact; although a marginal hike will not trigger any sensitivity, a sustained increase could dampen incremental offtake.

At present, real estate developers are required to obtain as many as 33 clearances before putting up a township. It is felt that a single window clearance system would mitigate the problem to a greater extent.

Land is generally non-corporatised and is typically held by individuals or families. This restricts organised dealing and hinders transfer of titles. Moreover, legal process for property disputes is time consuming.

Stamp duties continue to be as high as 10-13 percent in certain states. Unless the government puts land reforms into place and addresses the challenges faced by the real estate sector it is difficult to the sector to contribute to the country's GDP though it has immense potential.

Segment-wise reporting

Segments has been identified in line with the Accounting Standard on segment reporting, taking into account the organisation structure as well as the differential risk and returns of these segments. The Company is exclusively engaged in the housing finance business and revenues are mainly derived from this activity.

Outlook

Property prices are continuing their upward movement, though stability is observed in some places with possibility of slight decline.

Residential demand continues to be robust, especially in mid-tier segment.

Commercial / office space demand is strong, though high lease rentals and huge supply can be dampeners.

– The high rates in retail are dampeners. Huge planned supply of space could force down prices.

Equity participation and viability gap funding to new ventures in infrastructure through India Infrastructure Finance Company Limited would lead to better prospects of financial closures and accelerate investments in such infrastructure projects.

Continued tax benefits to retail borrowers on housing loans and the decision to set up new cities revolving around industrial clusters is likely to give a strong boost to the housing sector.

For SEZs, land acquisition issues may imply a slower approach.

According to a CLSA report, while a decline in housing affordability and potential oversupply could weaken prices in the near term, the long-term outlook remains attractive. This is perhaps why developers remain sanguine. The fulcrum of activity will shift from mass markets in the metros to premium housing and development of satellite townships, commercial and retail property as well as tier-II cities.

Risks and concerns

The risks and concerns related to the business have been carried in a separate section of the annual report (for e.g. strategy risk, perception risk, business portfolio risk, profitability risk, industry cyclicality risk, geographic risk, client concentration risk, liquidity risk, receivable risk, interest risk, overheads risk, competition risk, political risk etc.).

The Company manages risks associated with the mortgage business. These risks include credit risk, liquidity risk and interest rate risk. The credit risk is managed through stringent credit norms, while liquidity risk and an interest rate risk arising out of a maturity mismatch of assets and liabilities are managed through the constant monitoring of maturity profiles.

Internal control systems and their adequacy

The Company has introduced a new internal audit system which is more effective and commensurate with the size of its operations. Adequate records and documents are maintained as required by the law from time to time. Internal audits and checks are regularly conducted and internal auditor's recommendations are seriously considered for improving systems and procedures. The Company's Audit Committee reviews the internal control system and looks into the observations of the statutory and internal auditors. During the year, various guidelines were issued on the operational side to ensure better credit appraisal, as a result of which quality of loans has improved during the year.

Discussion of financial performance with respect to operational performance

Fund management

There has been pressure on maintaining the Net Interest margin (NIM) because old low- cost loans were being replaced with loans at prevailing rates, and uncertainty in the market about interest rates. However, the Company through active liability management and better product mix would mitigate the pressure. During the year, various steps were taken to reduce the cost of funds including entering into interest rate swap, placement of idle funds in liquid funds of various mutual funds / band fixed deposit giving better returns.

During the year, the total sanctions and disbursements of loans were Rs.8615.17 cr and Rs.7068.38 cr respectively as against Rs.6101.86 cr and Rs.5118.17 cr in the previous year, registering growth in sanctions of 41.19% and growth in disbursements of 38.10%. The Company continued its focus on retail lending during the year and it constitutes 75.83% of the total sanctions and 83.46% of the total disbursements of the Company. The average loan size has increased to Rs.10.66 lakhs in the individual loan segment. The total loan portfolio has increased to Rs.21936.41 cr as against

Rs.17563.44 cr, an increase of 24.90% over the previous year.

The boom in housing construction due to a long-standing housing shortage in the country, coupled with improved standard of living, moderate interest rates and easy availability of finance, is expected to keep the housing finance disbursements growth steady.

Parking of funds

The Board of Directors of the Company had directed to park surplus funds available from time to time in money market instruments to avoid funds lying idle in the current account with the banks. This ensured adequate liquidity to support core activities, safety and optimum return.

Domestic borrowings

During the volatile and rising interest rate scenario, the Company has been able to contain its borrowing costs. As a policy, efforts were made to re-price the existing borrowings either by negotiation or through entering into derivatives. In F.Y. 2007-08, the Company has raised funds of Rs.4824 cr for operations from banks and Rs.2650 cr from non-convertible debentures (NCD). The Company also explored the option of public deposit and mobilised Rs.15.70 cr. The cumulative borrowing constitutes 92% of the total fund employed as on 31st March 2008. The composition of outstanding borrowings as on 31st March 2008 and the ratings assigned by rating agencies is as under:

Particulars	% to total borrowing	Rating
Term loans from scheduled banks	43.02%	"AAA/Stable"/ P1+ by CRISIL
Refinances from NHB	3.27%	
Term loans from LIC of India	8.17%	
External commercial borrowing	1.15%	
Non-convertible debentures	40.23%	"AAA/Stable" by CRISIL / "CAREAAA" by Care
Subordinated bonds	2.46%	"AAA/ Stable" by CRISIL
Public deposit	0.08%	"FAAA" by CRISIL
Others	1.63%	

During the year under review, the Company has utilised the provision for corporate undertaking to the extent of Rs.0.16 cr.

Marketing

The Company continues to serve customers at their door step through home loan agents, direct selling agents and customer relation associates. To enable the operating offices to serve maximum customers efficiently with minimum time limit, the concept of front and back office was introduced during 2004-05. New marketing units were opened and existing ones were upgraded. During the year, the Company also participated in property exhibitions in various parts of the country and abroad which have been proved successful marketing tool in modern days. The Company's website namely www.lichousing.com has also proved to be a good marketing tool for high-ticket and NRI customers.

The Company had also introduced a new scheme to cater to the demand of different kinds of customers namely the 'Reverse Mortgage for Senior Citizens'.

Recoveries and provisions

As per the revised norms prescribed by NHB for non-performing assets, loan becomes NPA if interest and / or installment are overdue for 90 days. The gross NPA as on 31st March 2008, stood at Rs.372.91 cr i.e. 1.70% of the outstanding portfolio as against Rs.452.31 cr, constituting 2.58% in the previous year and the net NPA stood at Rs.140.91 cr i.e. 0.64% of the outstanding portfolio as against Rs.234 cr constituting 1.26% in the previous year. The Company has written off loans totalling to Rs.38.99 cr during the year.

In terms of the revised norms for NPA prescribed by NHB, during the year, the Company has created provision of Rs.232 cr. As a prudent practice, the Company has taken a decision to make additional provisions as compared to the norms prescribed by NHB, to meet contingencies.

Subsidiaries

Though, providing housing finance continues to be the prime business activity of the Company, the Company promoted three new subsidiaries during the year under review, namely, LICHFL Financial Services Limited incorporated on 31st October 2007, LICHFL Asset Management Company Private Limited incorporated on 14th February 2008 and LICHFL Trustee Company Private Limited incorporated on 5th March 2008.

Human resources development

The Company has a dedicated team of 985 staff members who have been contributing to the progress and growth of the Company. The manpower requirement of the offices of the Company is assessed and recruitment is conducted accordingly. Personal skills of employees are fine tuned and knowledge is enhanced by providing them internal and external training, keeping in view the market requirement from time to time. Outstanding performers are rewarded by elevation to the higher cadre. Apart from fixed salary and perquisites, the employees are paid performance-linked incentives which motivate them to perform better. Uniform lay out of all the offices is being worked out which will help in strengthening the brand image of the Company and also provide a conducive working environment.

Loan assets per employee as at 31st March 2008 is Rs.22.27 cr and net profit per employee as at 31st March 2008 is Rs.39.30 lakh.

Conclusion with caution

Statements in this report, describing the Company's objectives, projections, estimations, expectations are 'forward-looking statements' within the meaning of applicable securities laws and regulations. These statements are based on certain assumptions in respect of future events and the Company assumes no responsibility in case the actual results differ materially due to change in internal or external factors.