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20 YEARS

Initiating Coverage

L&T Finance Holdings Ltd.

01-February-2021

RETAIL RESEARCH

L&T Finance Holdings Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
BFSI – NBFC	Rs 86	Buy at LTP and add on dips to Rs 73-76 band	Rs 99.5	Rs 107.5	2 quarters

HDFC Scrip Code	LTFINH
BSE Code	533519
NSE Code	L&TFH
Bloomberg	LTFH IN
CMP Jan 29, 2021	86.0
Equity Capital (cr)	2469.4
Face Value (Rs)	10
Eq- Share O/S (cr)	246.9
Market Cap (Rs cr)	21237
Adj. Book Value (Rs)	62.9
Avg.52 Wk Volume	1,81,30,000
52 Week High	124.6
52 Week Low	42.8

Share holding Pattern % (Dec, 2020)	
Promoters	63.65
Institutions	14.63
Non Institutions	21.72
Total	100.0

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Our Take:

L&T Finance Holdings (LTFH) has shown commendable growth on all fronts post implementation of its strategy in FY17. It is on path to become a dominant player in infrastructure and tractor businesses. Focus on branch rationalization, cost efficiency and use of digital and data analytics platform to source loans and collections could lead to further improvement in return ratios. The company had been focusing on reducing its product lines which were low margin and substandard ROE businesses. Improving capital allocation by exiting/partial sell-down of its non-core assets/unprofitable businesses and redeploying it to RoE accretive businesses (Rural and Housing Finance) with higher focus on fee income through sell-down and DCM (Debt and Capital Markets) operations would also support RoE expansion.

Disbursement growth has turned positive in Q3FY21 after 9 quarters of de-growth as LTFH rationalized its operations. Collection volumes have picked up and asset quality has been gradually improving. The company has made accelerated provisioning towards Covid, cushioning the balance sheet from future uncertainities. Reduction in cost of funding aided by easing liquidity, strong capability to earn fee income and pickup in rural disbursements should aid in margin expansion.

Valuations & Recommendation:

LTFH, over the years has been constantly reducing its dependence on the wholesale lending business by aggressively expanding its well diversified rural financing business which has grown at CAGR of 40% over FY17-20. The company's rural financing segment share of revenues expanded by 1100 bps over last 4 years from 17% to 28% as on FY20. It has established itself as one of the prominent players in the tractor financing business. LTFH has witnessed improving trends across its business in the past few months and with pick up in disbursements, return ratios are likely to improve. The stock is available at cheap valuations for a reason of possible asset quality hiccups in wholesale lending though the focus on this business has been falling. We feel investors can buy the stock at CMP (1.04xFY23E ABV) and add further on dips to Rs 73-76 band (0.90x FY23E ABV) for sequential targets of Rs 99.5 (1.2x FY23E ABV) and Rs 107.5 (1.3x FY23E ABV) in 2 quarters.

Financial Summary

Particulars (Rs cr)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY20	FY21E	FY22E	FY23E
NII	1581	1468	*7.7*	1393	*13.5*	5731	5683	6220	6768
PPoP	1275	1206	*5.7*	934	*36.5*	4674	4498	4964	5506
PAT	291	592	*-50.9*	265	*9.6*	1700	961	1830	2442
EPS (Rs)	1.4	3.0	*-51.1*	1.3	*9.6*	8.5	3.9	7.4	9.9
P/E (x)						10.1	21.5	11.5	8.6
P/ABV (x)						1.4	1.3	1.2	1.0
RoAA (%)						1.6	0.9	1.6	1.9

(Source: Company, HDFC sec)

Q3FY21 Financials

Net Interest Income (NII) grew by 7.7% yoy to Rs 1581cr as the focused loan book grew by 2.7% to Rs 96,458cr while NIMs expanded by 39bps to 6.02% on back of reduction in cost of borrowing and lesser liquidity buffer. However, total advances increase by 0.7% yoy to Rs 100,098cr mainly because of 34% yoy de-growth in de-focused book. Net profit fell by 51% yoy to Rs 288cr. Provision increased by 92% yoy to Rs 926cr. The company took additional Covid-19 related provision of Rs 483cr during the quarter.

Disbursements grew 12.7% yoy to Rs 10,773cr after a continuous de-growth in last 9 quarters. Higher disbursements were driven by infrastructure finance (+207%) in wholesale finance segment and farm equipment (+13%) and 2W finance (+11%) in rural finance segment. Management continued to remain cautious on micro loans which de-grew 19%.

Asset quality improved sequentially with GNPA ratio down by 7 bps qoq to 5.12%, while NNPA was up by 25 bps qoq to 1.92% due to ~500 bps qoq decline in PCR ratio to 64%. The company is carrying additional provision of Rs 1739cr (1.9% of standard book) over and above PCR and standard asset provision. During the quarter, LTFH restructured assets worth Rs 213cr (10% provision held). Additionally, assets worth Rs 1225cr are expected to be restructured in Q4FY21.

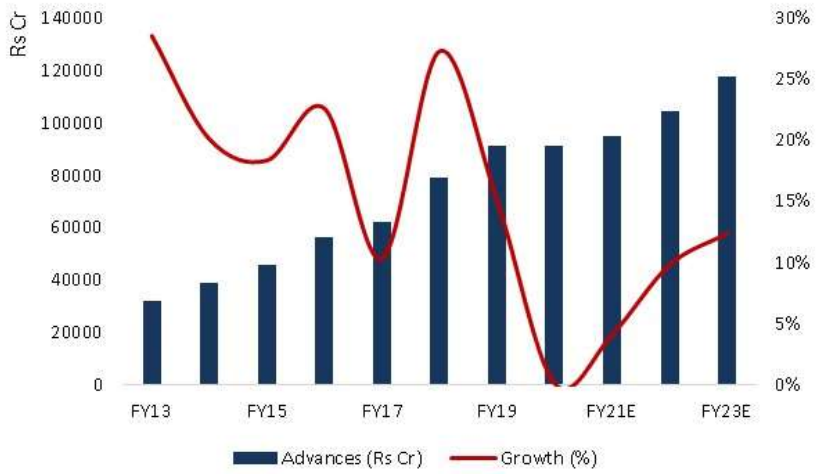
Average AUM in L&T AMC improved sharply QoQ to Rs 68976cr (down 3.6% YoY) in Q3 primarily on income and equity book. Income book contributes 31% to AUM, while equity contributes 55%.

Long term Triggers

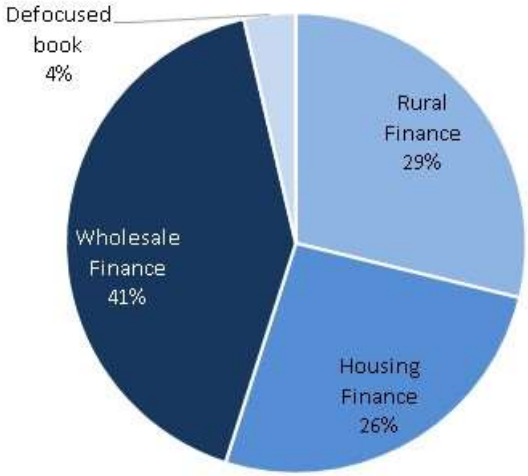
Sustained growth in loan book

Loan book growth of LTFH has remained strong, growing at a CAGR of 22.4% over FY17-FY20 as the company ramped up its housing and rural portfolio. Housing finance book grew by ~28% CAGR driven by 45% increase in real estate finance. Rural portfolio also witnessed ~40% CAGR over the same period as 2W finance grew by 46% and microfinance lending was up by 52%. However in FY20 loan book de-grew by 1% on back of fall in disbursement by 37% YoY as the company remained cautious due to slowdown in business activity. Slower off-take in real estate (down 26% YoY) and micro finance (down 9% YoY), and no disbursements in the de-focused book, led to the de-growth. The Covid pandemic resulted is further slowdown in disbursements as the company became cautious in lending. Consequently loan book has grown by 0.7% as of Q3FY21.

Loan book growth to pick up



Segmental Loan book breakup



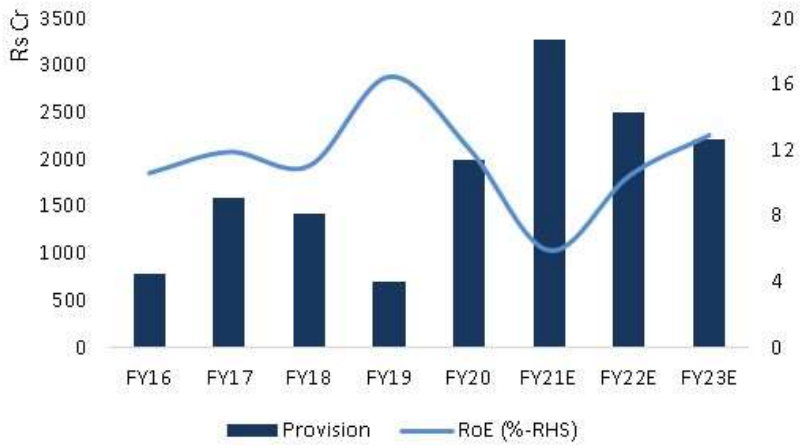
(Source: Company, HDFC sec)

We expect outstanding loan book to grow at a muted 4% in FY21 and 11% CAGR over FY21E-FY23E as the lock down eases, people get vaccinated and operations of the company normalise. LTFH continues to maintain its market share by leveraging on its business strengths. It continues to strengthen its core businesses by investing in footprint expansion, team quality enhancement, technology infrastructure and data analytics framework.

Lower provisioning, pick up in lending to drive RoE

RoE has been improving consistently since the management has redefined its business strategy in FY17 despite an increase in provisioning. However due to the Covid impact RoE declined to 12% in FY20 from 17% in FY19 as the company took higher provisioning. RoE is expected to decline to ~6% in FY21 due to higher Covid provisioning and cautious lending by the management. Pick up in higher margin rural/housing segments, run-down in defocused products, selective growth in wholesale segment, lower provisioning requirement and use of analytics for direct sourcing and cross selling resulting in better cost efficiencies are the primary drivers for RoE expansion which are likely to continue going forward.

Higher provisioning impacted RoE



(Source: Company, HDFC sec)

Robust fee income growth

Fee income consisting of processing fees, subvention income, cross selling income, advisory, underwriting fees etc. has been growing consistently with LTFH now regularly hitting the 2% mark of loan book. Over FY17-FY20 Non-Interest income has increased more than 5x from Rs. 232Cr in FY17 to Rs. 1303Cr as on FY20. This was mainly driven by higher contribution from rural and housing before slowing down in FY20. In FY20 fee and other income remained flat due to lower disbursements and higher liquidity maintained by the company. The fee Income is getting more broad based across all focused businesses. LTFH with a large infrastructure financing book and with excellent structuring capabilities and superior underwriting skills would benefit from opportunities for sell-downs boosting their fee income further.

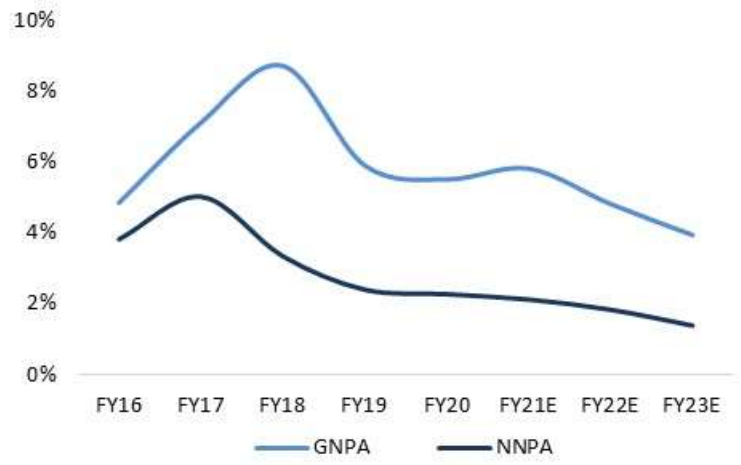
Asset quality on improvement track

Asset quality of the company has been strengthening gradually. Its GNPA/NNPA has been progressively improving from 7.9%/3.2% in Q1FY19 to 5.1%/1.9% respectively in Q3FY21. Post adoption of ECL (Expected Credit Losses) at the beginning of FY18, LTFH had provided additional Rs 1,800cr in its wholesale book for stressed loans by adjusting its reserves. While the absolute levels of NPA has remained steady in the rural book, it has come down in the wholesale. Housing NPA have witnessed an uptick in recent times. In addition to standard asset provisioning, the company is carrying additional provisioning of Rs 1739cr which is 1.9% on standard book.

LTFH is now focusing on lower risk borrowers by restricting real estate loans to grade 'A' developers, tractor loans mostly to top three OEMs, analytics-based expansion strategy in microfinance, estimating default risk up to borrower levels, mechanisms to detect early warning signals across businesses and having large extra provisions on the balance sheet.

The immediate impact of moratorium exit has been moderate in Q3FY21, although trends in recovery will have to monitored especially – microfinance book, two-wheelers, Infra and real estate loan book.

Asset quality improving gradually



(Source: Company, HDFC sec)

Adequate capitalisation levels and comfortable liquidity position

At the consolidated level, LTFH's capitalisation remains adequately supported by its track record of raising funds and good internal capital generation. Post capital raising in FY2018 and muted business growth in FY2020, the gearing level of the group declined to a moderate level of 6.4 times in FY20 as compared to 6.8 times at the end of FY19. Consolidated CRAR as on Dec 31, 2020 stood at 21.8% (Tier 1: 17.8%). On the liquidity front LTFH has comfortable liquidity buffers, cash flow from its short-term assets and policy of maintaining adequate unutilised bank facilities as a liquidity backup. The liquidity profile is also supported by 2,000cr credit line from L&T.

LTFH will raise Rs 2,999 crore via a rights issue in the entitlement ratio of 17:74 at Rs 65 per equity share. The rights issue will open on February 1 and close on February 15. The rights issue price includes a premium of Rs 55 per equity share. This raise will further enhance the capital adequacy and provide flexibility to grow its advances book aggressively. It will also provide a buffer in case of any unexpected trends in the loan book.

What could go wrong

Asset Quality could worsen

Due to the stress in LAP and Infrastructure loans, the company's asset quality could worsen going forward. Infrastructure loans account for ~32% of the focused loan book as on FY20. Any prolonged weakness in Indian macros could result in elevated slippages from the existing book.

Cancellation of PPAs in renewable energy

The falling power prices in the renewable segment has led to SEBs demanding revision in PPAs. If SEBs renege on PPAs signed earlier, it could impact the financials of power producers and thus, LTFH. Also the Government has imposed duty on import of solar panels which would increase the cost for developers and without a corresponding increase in sale price, the project could turn into NPA. LTFH has an exposure of ~Rs 22,274cr (54% of infra book) in renewable power.

Concentration on account of high share of wholesale lending book

A significant portion of LTFH's portfolio constitutes wholesale loans. The company has classified Debt Capital market and Structured Finance as defocussed book. Wholesale and defocussed book still form a significant chunk (43%) of the outstanding loan book of which 78% is towards the infrastructure sector. Wholesale loans are chunkier and carry higher concentration risk with further construction and execution risk associated with infrastructure lending.

The RBI has recently proposed stricter regulation for non-banking financial companies (NBFCs) and proposed classifying them into four categories based on their size and risk perception. The proposed regulations would vary according to the size of the NBFC. To what extent the enhanced regulations on NBFCs including LTFH will impact their lending and cashflows needs to be seen. On the optimistic side, the reforms may preserve non-banking financial institutions' (NBFIs) niche business models and could improve the funding environment for some entities by strengthening investor confidence in the sector

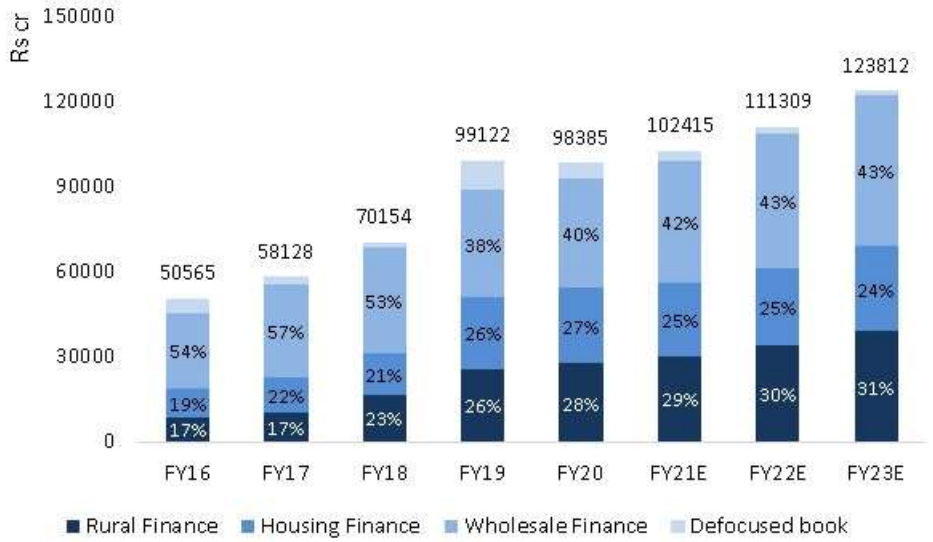
About the company

L&T Finance Holdings Ltd. (LTFH) is a financial holdings company offering a diverse range of financial products and services across retail, corporate, housing and infrastructure finance sectors as well as mutual fund products and investment management services through its wholly owned subsidiaries. Promoted by Larsen & Toubro, it was incorporated in 1994 and headquartered in Mumbai. With a total loan

book size exceeding Rs 1 lakh crore and pan-India reach with ~200 branches across 21 states and 1 union territory of India, it has built a strong position in the Indian financial services industry.

In FY17, LTFH launched a four year strategy roadmap in order to maximise shareholder returns. The single most important metric chosen to deliver this was Return on Equity (RoE). The roadmap was designed to deliver a top quartile RoE by the year 2020 or earlier. In the backdrop of this strategy LTFH has been transforming from a company doing a little bit in lots of businesses to a company building distinctive positions in chosen businesses. It is gradually moving out of non-core business and merged others within clearly defined verticals. It has been able to achieve this objective by FY19, a full year before the targeted timeframe.

AUM growth and breakup

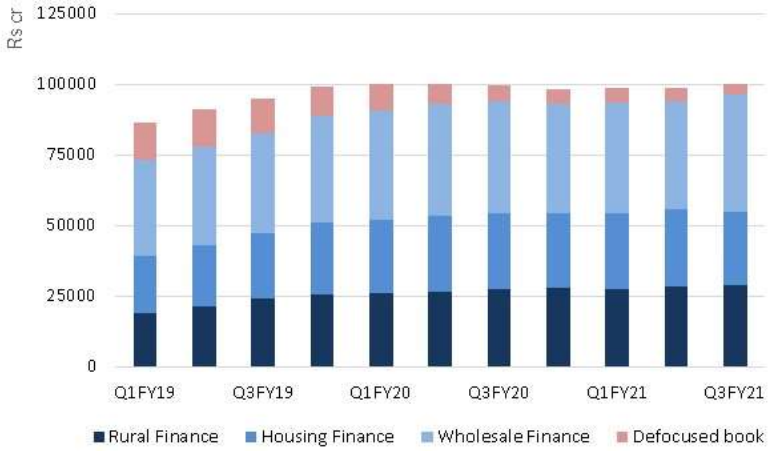


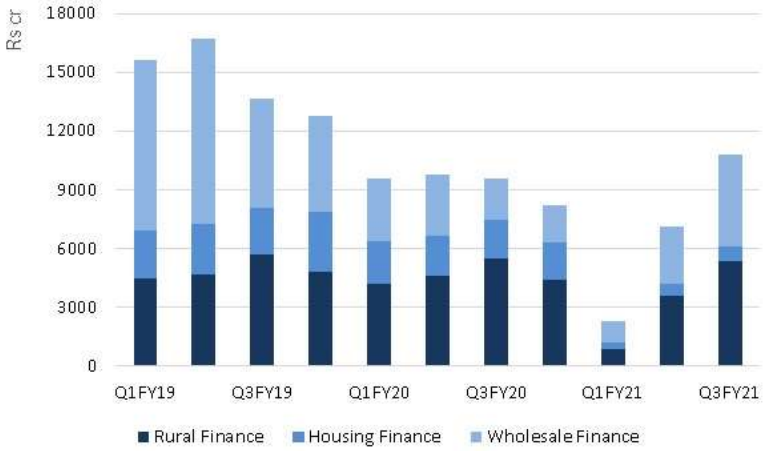
(Source: Company, HDFC sec)

Company Structure

(Source: Company, HDFC sec)

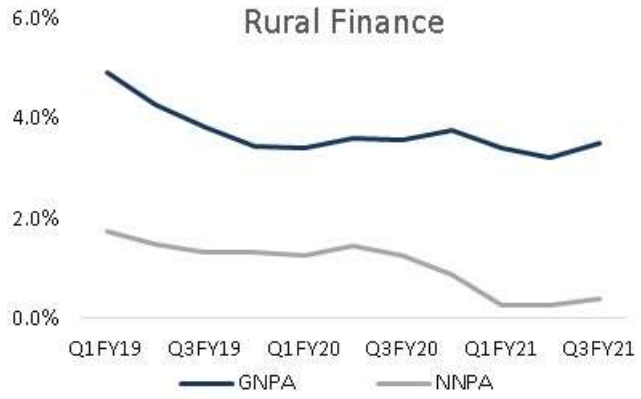
Segmentwise AUM and Disbursement trend

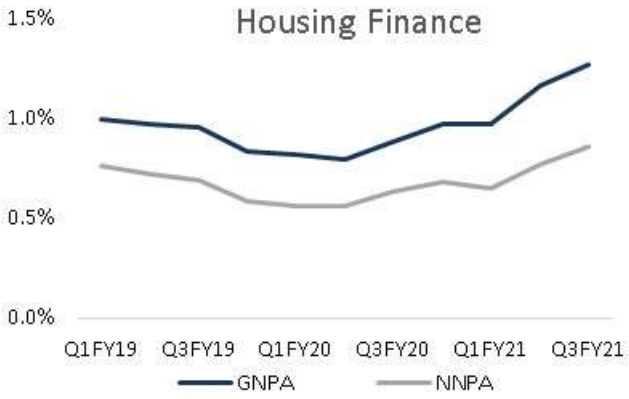


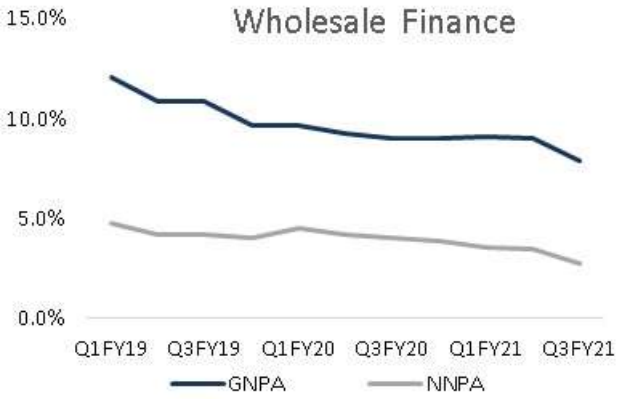


(Source: Company, HDFC sec)

Segmentwise asset quality trend







(Source: Company, HDFC sec)

Peer Comparison

(Rs cr)	CMP	Mcap	NII				PPoP				PAT				RoE (%)				P/E (x)				P/B (x)			
			FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
Chola Fin	493.9	9270	3532	4196	4447	4898	2483	2996	3149	3412	1052	1593	1701	1930	13.8	17.9	16.3	16	40.8	25.5	23.9	21.0	5.9	5.1	4.1	3.5
STFC	1291.7	32687	7997	7996	8205	8665	6234	6182	6210	6482	2502	2172	2831	3296	14.8	11	12.4	12.9	11.7	15.1	11.5	9.9	2.4	2.2	1.7	1.4
M & M Fin	154.9	19138	5113	5676	6212	7021	3398	3918	4356	4959	906	787	1426	1811	8.1	5.9	9	10.5	10.5	24.2	13.4	10.5	1.3	1.8	1.4	1.2
L&T Fin	86.0	21237	5731	5683	6220	6768	4674	4498	4964	5506	1700	961	1830	2442	12.1	5.8	9.5	11.6	10.1	21.5	11.5	8.6	1.4	1.3	1.2	1.0

Financials

INCOME STATEMENT

(Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Interest Income	11638	13245	13058	13867	15229
Interest Expenses	6860	7514	7375	7648	8461
Net Interest Income	**4778**	**5731**	**5683**	**6220**	**6768**
Non interest income	1664	1303	1400	1499	1667
Operating Income	**6441**	**7035**	**7083**	**7719**	**8435**
Operating Expenses	2689	2360	2585	2755	2929
PPP	3753	4674	4498	4964	5506
Prov & Cont	701	1994	3267	2498	2223
Profit Before Tax	3052	2680	1230	2465	3283
Tax	820	980	246	621	826
PAT	**2232**	**1700**	**984**	**1845**	**2457**
Adj. PAT	**2226**	**1700**	**961**	**1830**	**2442**

BALANCE SHEET

(Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Eq. Share Capital	1999	2005	2466	2466	2466
Reserves & Surplus	11450	12688	15962	17511	19598
Shareholder funds	**13449**	**14692**	**18429**	**19977**	**22064**
Minority Interest	222	220	243	258	273
Borrowings	91507	93894	90484	98352	110564
Other Liab & Prov.	877	722	798	985	838
SOURCES OF FUNDS	**106055**	**109529**	**109954**	**119573**	**133740**
Fixed Assets	174	198	213	233	250
Goodwill on Cons.	639	637	637	637	637
Investment	9008	5979	6667	6801	7057
Cash & Bank Balance	1874	7804	3810	3662	4117
Advances	91325	91463	95246	104630	117622
Other Assets	3035	3448	3381	3610	4058
TOTAL ASSETS	**106055**	**109529**	**109954**	**119573**	**133740**

RATIO ANALYSIS

As at March (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Return Ratios (%)					
Calc. Yield on adv	13.6	14.5	14.0	13.9	13.7
Calc. Cost of borr	8.4	8.1	8.0	8.1	8.1
Calc. NIM	5.6	6.3	6.1	6.2	6.1
RoAE	17.1	12.1	5.8	9.5	11.6
RoAA	2.3	1.6	0.9	1.6	1.9
Asset Quality Ratios (%)					
GNPA	5.9	5.5	5.8	4.8	3.9
NNPA	2.4	2.3	2.1	1.8	1.4
PCR	60.8	58.7	63.5	61.9	64.8
Growth (%)					
Advances	15.1	0.2	4.1	9.9	12.4
Borrowings	27.8	2.6	-3.6	8.7	12.4
NII	39.7	20.0	-0.8	9.4	8.8
PPoP	31.0	24.6	-3.8	10.4	10.9
PAT	77.4	-23.6	-43.5	90.4	33.4
Valuation Ratios					
EPS (Rs)	11.2	8.5	4.0	7.5	10.0
P/E (x)	7.7	10.1	21.5	11.5	8.6
Adj. BVPS (Rs)	56.4	62.9	66.5	73.2	82.9
P/ABV (x)	1.5	1.4	1.3	1.2	1.0
Dividend per share (Rs)	1.0	0.9	1.0	1.2	1.5
Dividend Yield (%)	1.2	1.0	1.2	1.4	1.7
Other Ratios					
Cost-Income (%)	41.7	33.6	36.5	35.7	34.7
Leverage (x)	6.8	6.2	5.2	5.2	5.3

(Source: Company, HDFC sec)

Price Chart


140
120
100
80
60
40
55000
49000
43000
37000
31000
25000
Sep-19
Feb-20
Jul-20
Dec-20
L&T Fin
BSE Sensex

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