

BSE Code: 533519
NSE Code: L&TFH
Reuters Code: LTFH.NS
Bloomberg Code: LTFH:IN
Strong growth momentum to sustain...

L&T Finance Holdings Ltd. (LTFH) is a financial holding company offering a diverse range of financial products and services across retail, corporate, housing and infrastructure finance sectors. It also has presence in asset management and investment management services.

Investment Rationale

➤ **Shift in focus on select business segments will drive profitable growth:** LTFH identified select focus segments which it believes offer strong long-term leading growth opportunities. It includes three key lending businesses (Rural, Housing and Wholesale), asset management and wealth management. Moreover, owing to difficult macro-environment and the challenges in large numbers of infrastructure projects, the company has decided to sell/run down less profitable/loss businesses includes CV, Cars, CE, Leases and SME Term Loans.

➤ **Asset quality to improve further despite shift to 90 dpd recognition:** Although LTFH moved to 90 days past due (dpd) non-performing assets (NPA) recognition across all business segments from Q1FY18, it reported significant improvement in asset quality. Gross NPA ratio improved by 140 bps QoQ to 5.7% on the back of higher recoveries in tractor portfolio along with sale of infra loans worth Rs350 cr to ARC. Net NPA ratio improved by 171 bps QoQ to 3.3% on account of aggressive provisioning policy of the company. we expect asset quality to further (Gross/Net NPA ratio to improve by 313/303 bps to 4%/2% by FY19E) on the back of strong risk management practices.

➤ **Robust improvement in earnings on the card:** LTFH's RoE is expected to touch 18% mark by FY20E from current level of 11.9% (FY17) mainly led by 1) sell/rundown of the defocused (less profitable) portfolio which includes cars, CE/CV, SME term loans and leases, 2) reducing the risk in wholesale/infra business by focusing more on operational projects which is likely to reduce provisioning 3) delivering industry leading growth in focus segments like micro-finance and housing finance, 4) improving cost to income ratio with increasing productivity, 5) reallocating capital towards more profitable businesses and 6) creating value in the asset management business and increasing fee income from wealth management.

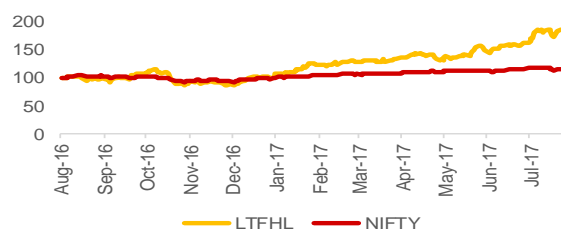
Valuation: The company reported steady performance across business segments in Q1FY18. Notably, LTFH has shown commendable progress on its well-articulated strategy since FY17. We believe that it is well on track to achieve top quartile RoE (16% by FY19E). Although the stock has seen strong runup in the last one year, the market will continue to re-rate it further given the company's focus on strengthening the balance sheet and improving operating efficiency along with rundown of non-core segments. Hence, we continue to maintain BUY rating on the stock with a target price (TP) of Rs200 valuing it using SOTP methodology. The valuation corresponds to P/ABV of 4.0x for FY19E for consolidated entity.

Market Data

Rating	BUY
CMP (Rs.)	175
Target (Rs.)	200
Potential Upside	14%
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	179/81
Adj. all time High (Rs.)	179
Decline from 52WH (%)	2.2
Rise from 52WL (%)	116.0
Beta	1.1
Mkt. Cap (Rs.Cr)	31,816

Fiscal Year Ended

Y/E		FY16	FY17	FY18E	FY19E
Net Interest Income (Rs. Cr)		2,481	2,866	3,559	4,247
Net Interest Margin (%)		4.7	4.6	4.9	4.9
Pre Pro Profit (Rs. Cr)		2,034	2,669	3,230	3,754
Net Profit (Rs. Cr)		854	1,042	1,335	1,674
EPS (Rs.)		4.9	5.9	7.3	9.2
P/E (x)		35.7	29.4	23.8	19.0
P/BV (x)		4.3	3.9	3.1	2.8
P/ABV (x)		6.1	6.4	4.1	3.3
ROE (%)		10.6	11.9	13.9	15.5

One-year Price Chart

Shareholding Pattern

Shareholding Pattern	Jun-17	Mar-17	Chg.
Promoters (%)	64.2	64.2	-
Public (%)	35.8	35.8	-

LTFH is a financial holding company offering a diverse range of financial products and services across retail, corporate, housing and infrastructure finance sectors.

L&T Finance Holdings Ltd. - Company Overview

L&T Finance Holdings Ltd. (LTFH) was incorporated in 2008 and is promoted by the construction major Larsen & Toubro (L&T). LTFH is a financial holding company offering a diverse range of financial products and services across retail, corporate, housing and infrastructure finance sectors. It also has presence in asset management and investment management services through its wholly owned subsidiaries. Further, the company has a strong parentage and a highly-qualified management team which has significant experience in evaluating long-gestation infrastructure projects.

The company has gradually built-up several businesses/product lines through both organic and inorganic route over the past few years. LTFH has identified select segments to grow its loan book— Housing finance, Tractor, Two-wheeler and Microfinance in the retail business and roads, renewable energy projects in the wholesale segment.

Shift in focus on select business segments will drive profitable growth

LTFH identified select focus segments which it believes offer strong long-term leading growth opportunities. It includes three key lending businesses (Rural, Housing and Wholesale), asset management and wealth management. Moreover, owing to difficult macro-environment and the challenges in large numbers of infrastructure projects, the company has decided to sell/run down less profitable/loss businesses includes CV, Cars, CE, Leases and SME Term Loans.

Reclassification of focused businesses and products

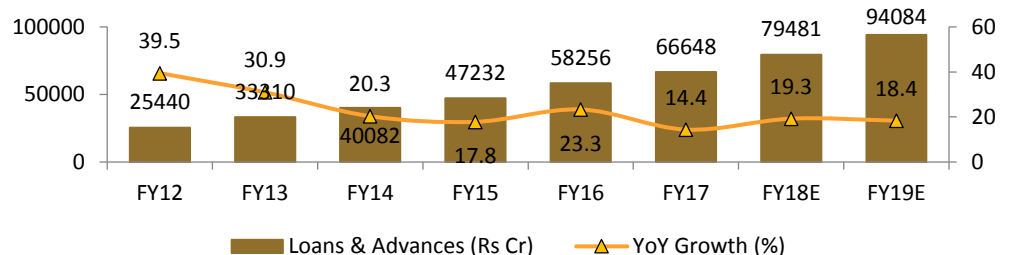
Rural Business	Housing Business	Wholesale Business
<ul style="list-style-type: none"> • Microfinance • Two Wheeler Finance • Farm Equipment 	<ul style="list-style-type: none"> • Home Loans • LAP • Real Estate Finance 	<ul style="list-style-type: none"> • Infra Finance • Structured Corporate Finance • Supply Chain Finance

Source: Company, In-house research

Loan growth to remain healthy led by focus businesses

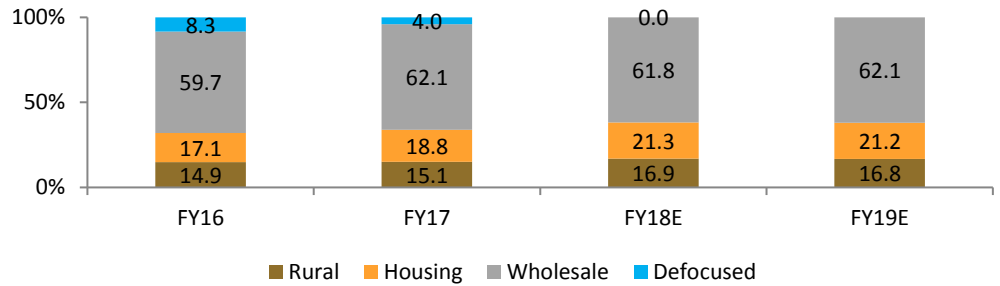
Consolidated advances grew at a healthy pace of 18% YoY driven by 22% YoY growth in focused businesses while defocused businesses which includes CV, Cars, CE, Leases and SME Term Loans) declined 46% YoY. Disbursement grew at a robust pace of 2.0x YoY on the back of 3.0x YoY increase in real estate financing followed by 2.5x and 1.7x YoY growth in infra and farm equipment financing, respectively. Notably, LTFH is looking to establish its dominance in farm equipment and infra financing segments in FY18. Going forward, we expect LTFH to deliver industry leading growth in microfinance and housing verticals while wholesale vertical is expected to report steady growth (impacted by rundown of defocused portfolio) leading to 19% CAGR in loans over FY17-19E.

Advances to grow at 19% CAGR over FY17-19E



Source: Company, In-house research

Changing business mix in favour of focused businesses

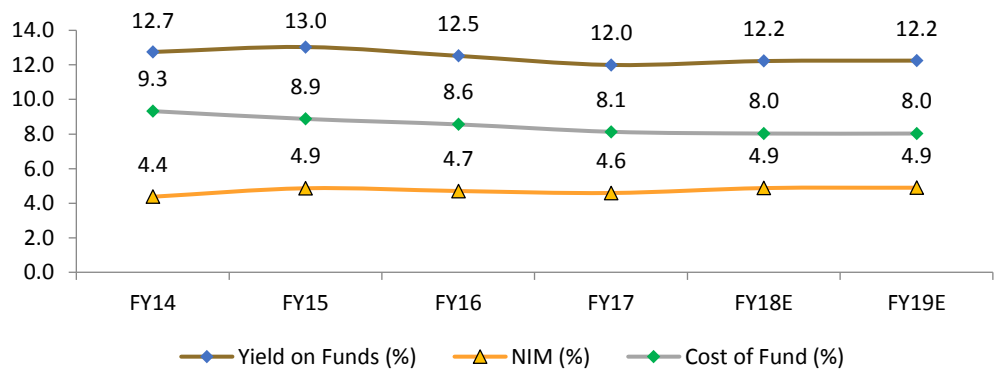


Source: Company, In-house research

Margins to improve further

We believe margins would exhibit a positive bias over FY17-19E on the back of decline in cost of funds. Notably, the company has 50% of borrowings via banks as of Q1FY18 where it is likely to get the benefit of reducing interest rate. Further, high margins in the rural business will compensate for the lower lending yields on low-risk loans that company has been focusing upon. Thus, we expect funding costs to ease by 15-20 bps over FY17-19E while lending yields to remain stable over the similar period. As a result, we expect LTFH's margin to improve further to 4.9% over FY17-19E.

Margins to improve further to 4.9% over FY17-19E

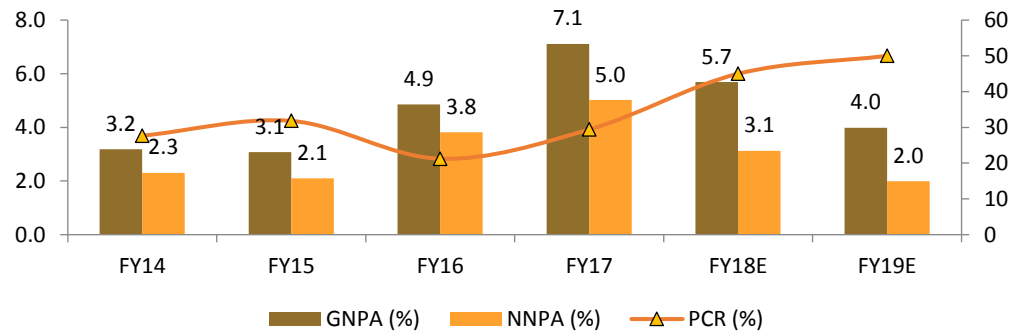


Source: Company, In-house research

Asset quality to improve further despite shift to 90 dpd recognition

Although LTFH moved to 90 days past due (dpd) non-performing assets (NPA) recognition across all business segments from Q1FY18, it reported significant improvement in asset quality. Gross NPA ratio improved by 140 bps QoQ to 5.7% on the back of higher recoveries in tractor portfolio along with sale of infra loans worth Rs350 cr to ARC. Net NPA ratio improved by 171 bps QoQ to 3.3% on account of aggressive provisioning policy of the company. As a result, provision coverage ratio (PCR) also improved by 1264 bps QoQ to 42%. Notably, LTFH hired McKinsey and Oliver Wyman to improve risk management system. This enables LTFH to establish strong risk management practices across verticals. Thus, we expect asset quality to further (Gross/Net NPA ratio to improve by 313/303 bps to 4%/2% by FY19E) on the back of strong risk management practices.

Asset quality ratios to improve over FY17-19E

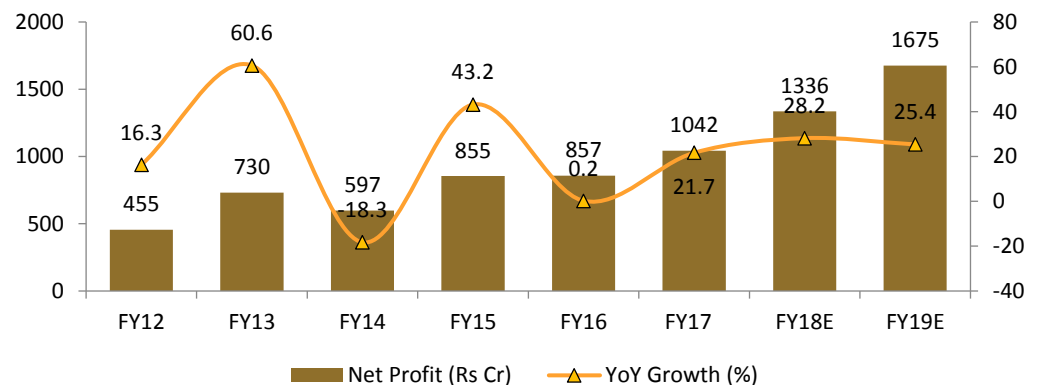


Source: Company, In-house research

Profitability to remain strong over despite accelerated provisions

Net interest income (NII) increased at a strong pace of 22% YoY (in line with our expectation) mainly driven by 29 bps YoY improvement in net interest margin (NIM) to 6.1% coupled with healthy loan growth. Other income witnessed robust growth of 213% YoY led by sharp surge in fee income on the back of high sell-down of loans. LTFH continued to improve its operating efficiency as cost to income (C/I) ratio declined by 790 bps YoY to 28.9%. Provisions increased by 81% YoY as the company made additional voluntary provisions of Rs95 cr and Rs49 cr in its rural and wholesale segment, respectively. Net profit came ahead of our expectation increasing by 49% YoY. We expect net profit to grow at a CAGR of 27% over FY17-19E supported by robust growth in other income coupled with decline in C/I ratio and credit cost.

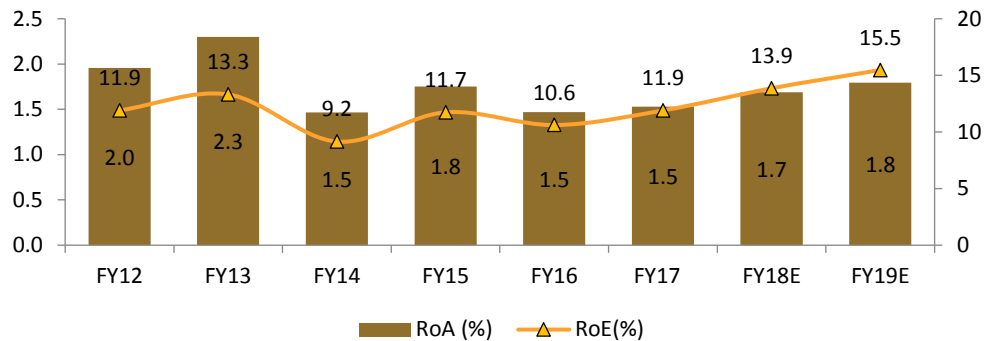
Earnings to grow at a CAGR of 27% over FY17-19E



Source: Company, In-house research

LTFH's RoE is expected to touch 18% mark by FY20E from current level of 11.9% (FY17) mainly led by 1) sell/rundown of the defocused (less profitable) portfolio which includes cars, CE/CV, SME term loans and leases, 2) reducing the risk in wholesale/infra business by focusing more on operational projects which is likely to reduce provisioning 3) delivering industry leading growth in focus segments like micro-finance and housing finance, 4) improving cost to income ratio with increasing productivity, 5) reallocating capital towards more profitable businesses and 6) creating value in the asset management business and increasing fee income from wealth management.

RoE to expand by 360 bps to 15.5% by FY19E



Source: Company, In-house research

Outlook and Valuation

The company reported steady performance across business segments in Q1FY18. Notably, LTFH has shown commendable progress on its well-articulated strategy since FY17. We believe that it is well on track to achieve top quartile RoE (16% by FY19E). Although the stock has seen strong runup in the last one year, the market will continue to rerate it further given the company's focus on strengthening the balance sheet and improving operating efficiency along with rundown of non-core segments. Hence, we continue to maintain BUY rating on the stock with a target price (TP) of Rs200 valuing it using SOTP methodology. The valuation corresponds to P/ABV of 4.0x for FY19E for consolidated entity.

Key Risks:

- **Asset quality risks in rural portfolio:** Higher-than-expected delinquencies in LTHF business, particularly the farm equipment portfolio which has so far shown strong resilience despite headwinds which the industry is facing, could impact earnings and our valuations.
- **Regulatory changes could impact profitability:** LTHF was impacted by regulatory changes in the microfinance segment and had to make significant provisions on its Andhra Pradesh portfolio. Any significant change in regulations (related to exposure, LTV, lending rates or capital requirements) could significantly impact the company's profitability.
- **Delays in scaling up business segment:** Inability to scale-up its microfinance and two wheelers portfolios, which are the key growth drivers in rural finance would cap the expected expansion in RoE.

Profit & Loss Account (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	6,605	7,493	8,931	10,629
Interest Expense	4,124	4,627	5,371	6,382
Net Interest Income	2,481	2,866	3,559	4,247
Non Interest Income	866	1,079	1,152	1,254
Net Income	3,347	3,945	4,712	5,501
Operating Expenses	1,313	1,276	1,482	1,748
Total Income	7,471	8,572	10,083	11,883
Total Expenditure	5,437	5,904	6,853	8,129
Pre Provisioning Profit	2,034	2,669	3,230	3,754
Provisions	781	1,590	1,848	2,021
Profit Before Tax	1,253	1,079	1,382	1,733
Tax	399	36	47	59
Net Profit	854	1,042	1,335	1,674

Balance Sheet (Consolidated)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Liabilities				
Capital	2,967	2,969	3,035	3,035
Reserves and Surplus	5,442	6,138	7,138	8,448
Minority Interest	100	119	119	119
Borrowings	51,616	59,811	71,112	83,923
Provisions	645	367	537	753
Other Liabilities and Provisions	3,032	3,110	3,802	4,610
Total Liabilities	63,801	72,514	85,741	100,887
Assets				
Fixed Assets	1,335	1,258	1,258	1,258
Investments	3,563	6,012	6,207	6,210
Advances	56,712	62,314	75,069	89,756
Other Assets	1,789	2,335	2,704	3,105
Cash And Balances	402	594	503	559
Total Assets	63,801	72,514	85,741	100,887

Key Ratios (Consolidated)

Y/E	FY16	FY17	FY18E	FY19E
Per share data (Rs.)				
EPS	4.9	5.9	7.3	9.2
DPS	0.8	0.0	0.8	0.8
BV	41.0	45.0	55.9	63.1
ABV	28.8	27.2	42.2	52.8
Valuation (%)				
P/E	35.7	29.4	23.8	19.0
P/BV	4.3	3.9	3.1	2.8
P/ABV	6.1	6.4	4.1	3.3
Div. Yield	0.5	0.0	0.5	0.5
Spreads (%)				
Yield on Funds	12.5	12.0	12.2	12.2
Cost of Funds	8.6	8.1	8.0	8.0
Asset (%)				
GNPA	4.9	7.1	5.7	4.0
NNPA	3.8	5.0	3.1	2.0
PCR	21.2	29.4	45.0	50.0
Management (%)				
Debt / Equity	6.1	6.6	7.0	7.3
Cost / Income	39.2	32.4	31.5	31.8
Earnings (%)				
NIM	4.7	4.6	4.9	4.9
ROE	10.6	11.9	13.9	15.5
ROA	1.5	1.5	1.7	1.8

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	Buy	More than equal to 15%
Hold	Upside or downside is less than 10%	Accumulate*	Upside between 10% & 15%
Reduce	Less than equal to -10%	Hold	Between 0% & 10%
		Reduce/sell	Less than 0%

* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

* L&TFH is a large-cap NBFC.

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