

L&T Finance Holdings | BUY

Attractive risk reward opportunity

Over the past month, LTFH's stock price has corrected by 23% and we believe the CMP provides an attractive entry point due to: i) Improving RoE trends - profitability over the last 6 quarters has improved with reported ROE improving from 9.7% in to 15.2% despite the company providing for voluntary provisioning of INR 8.9bn and accelerated provisioning of INR 5.3bn; ii) While PSU banks' recap would increase competitive intensity in infrastructure/LAP, LTFH would benefit from the increase in down-selling opportunities; and iii) The company has hired senior staff from Bajaj Finance and Piramal Finance for its credit analytics and housing team. We believe LTFH is on track to achieve top quartile (18%+) ROE by FY19E, driven by i) increasing share of focused profitable business; ii) improving capital allocation by exiting/partial sell-down of its non-core assets/unprofitable businesses and redeploying it to RoE accretive businesses; iii) focus on fee income through sell-down and DCM operations; and iv) focus on cost efficiencies by streamlining businesses and digitising operations and increasing profitability contribution by the investment management business. We forecast earnings CAGR of 37% over FY17-20E with RoA/RoE improving from 1.35%/12% in FY17 to 2.1%/21% in FY20E. We value LTFH at 3.4x Mar'20, implying a Mar'19 TP of INR 235.

- **Continuous improvement in profitability over the last 6 quarters:** LTFH has seen improving profitability trends with its RoA/RoEs increasing from 1.3%/9.7% in 1Q17 to 1.9%/15.2% in 2Q18 driven by a combination of: a) strong 23% growth in its focus business and rundown of non-core business (declined from 7.6% in 3Q16 to 3.5% in 2Q18 of total portfolio); b) increase in fee income driven by higher sell-downs; and c) reduction in cost ratios, which declined from 2.4% in 3Q16 to 1.8% in 2Q18. Additionally, the company has strengthened its balance sheet by increasing its PCR from 22.5% in 3QFY16 (on 120DPD) to 43% in 2Q18 despite migrating to 90DPD. We expect return ratios to further improve and expect RoE to reach top quartile (18%+) by FY19E.
- **Best placed to capture down selling opportunities:** Given the larger ticket size of infra loans and the govt.'s focus towards infra, we believe PSBs would focus on this segment after the recap. However, we expect LTFH with excellent structuring capabilities and superior underwriting skills to benefit given a) opportunities for sell-downs would increase and will boost their fee income and b) increased availability of banks' credit.
- **Further upside can come from capital accretive dilutions and stake sale in AMC:** As of 1HFY18, tier I ratio stood at 13.3%, 14.1% and 9.7% for L&T Finance, L&T Infra finance and L&T Housing Finance respectively. We believe the company could raise capital over the next 12 months given strong growth outlook in each of the business. At CMP, the stock trades at 2.8x book FY19E. Any capital raise at the current multiple would be capital accretive and would provide further upside to the stock. Assuming 10% dilution, the implied multiple is 2.3x book FY19E (Exhibit 1). Additionally, any stake sale in the AMC business could provide further upside to the stock price – AUM is up from INR 225bn in FY15 to INR 527bn as of Sep'17.
- **Strong earnings CAGR of 37% over FY17-20E; RoA/RoE to witness significant improvement of 80/880 bps over FY17-20E:** We expect strong earnings (37% CAGR over FY17-20E) and expect RoA/RoE to improve to 2.1%/21%, respectively, in FY20E vs. 1.35%/12% in FY17. We value LTFH at 3.4x Mar'20, a implying Mar'19 TP of INR 235.



Karan Singh CFA FRM

karan.uberai@jmfll.com | Tel: (91 22) 66303082

Nikhil Walecha

nikhil.walecha@jmfll.com | Tel: (91 22) 66303027

Bunny Babjee

bunny.babjee@jmfll.com | Tel: (+91 22) 66303263

Sameer Bhise

sameer.bhise@jmfll.com | Tel: (91 22) 66303489

Jayant Kharote

jayant.kharote@jmfll.com | Tel: (91 22) 66303099

S Parameswaran

S.Parameswaran@jmfll.com | +91 22 66303075

Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	235
Upside/(Downside)	42.8%
Previous Price Target	190
Change	23.7%

Key Data – LTFH IN

Current Market Price	INR165
Market cap (bn)	INR300.1/US\$4.7
Free Float	28%
Shares in issue (mn)	1,755.7
Diluted share (mn)	
3-mon avg daily val (mn)	INR1,556.5/US\$24.2
52-week range	214/81
Sensex/Nifty	32,870/10,128
INR/US\$	64.4

Price Performance

%	1M	6M	12M
Absolute	-17.2	28.3	96.0
Relative*	-15.1	22.0	56.4

* To the BSE Sensex

Financial Summary

	(INR mn)				
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Profit	6,866	9,180	13,374	18,894	24,543
Net Profit (YoY) (%)	-4.4%	33.7%	45.7%	41.3%	29.9%
Assets (YoY) (%)	21.0%	13.7%	19.1%	20.9%	20.8%
ROA (%)	1.2%	1.3%	1.7%	2.0%	2.1%
ROE (%)	10.2%	12.2%	15.6%	18.8%	20.9%
EPS	3.9	5.2	7.4	10.4	13.5
EPS (YoY) (%)	-6.3%	32.9%	40.6%	41.3%	29.9%
P/E (x)	42.0	31.6	22.4	15.9	12.2
BV	41	45	51	59	70
BV (YoY) (%)	10.7%	9.6%	13.6%	15.9%	17.8%
P/BV (x)	4.02	3.67	3.23	2.79	2.37

Source: Company data, JM Financial, Note: Valuations as of 04/Dec/2017

JM Financial Institutional Securities Limited

JM Financial Research is also available on:
Bloomberg - JMFR <GO>,
Thomson Publisher & Reuters
S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1. Valuation table assuming 10% capital dilution

	Pre-Dilution	Post-Dilution
BPS (FY19e)	59.1	71.0
Implied P/B (FY19e)	2.8x	2.3x

Source: Company, JM Financial

Exhibit 2. LTFH: 2Q18 – Continuous improvement in ROE

ROE (%)	2Q'17	1Q'18	2Q'18	YoY (%)	QoQ (%)
Rural Business	23.9%	22.3%	25.3%	1.4%	3.0%
Housing Business	22.0%	30.4%	30.0%	8.1%	-0.4%
Wholesale Business	10.2%	10.2%	10.1%	-0.1%	-0.1%
Focus Business	14.5%	15.8%	16.2%	1.7%	0.4%
De-focused Business	-24.5%	-49.0%	1.6%	26.0%	50.5%
Lending Businesses	11.5%	13.5%	15.8%	4.2%	2.3%
Other Businesses	10.1%	10.4%	5.1%	-5.0%	-5.3%
LTFH Consol. (Reported)	11.4%	13.2%	14.7%	3.3%	1.5%
LTFH Consol. (To Equity Shareholders)	11.7%	13.6%	15.2%	3.4%	1.6%

Source: Company, JM Financial

Exhibit 3. LTFH: RoE for different business segments

LTFH - ROE (%)	FY17	FY18E	FY19E	FY20E
Focused business	15.3%	16.2%	17.0%	18.5%
- Rural	23.0%	24.1%	25.5%	26.7%
- Housing	23.4%	22.7%	21.1%	21.4%
- Wholesale	11.4%	12.2%	13.0%	14.6%
Lending	12.5%	15.0%	16.1%	17.7%
Consolidated business	12.2%	13.4%	16.0%	18.9%

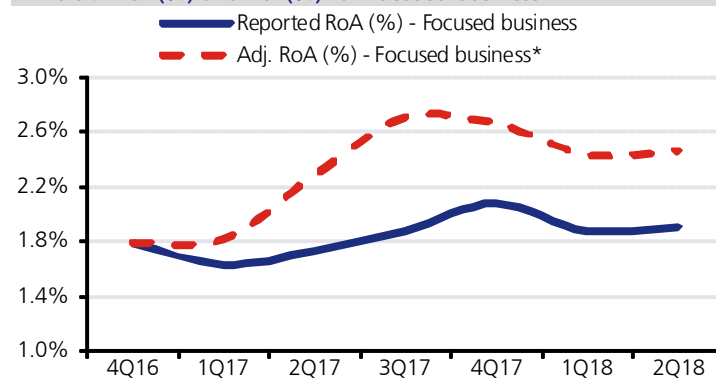
Source: Company, JM Financial

Exhibit 4. LTFH: Contribution by subsidiaries

LTFH - Contribution by subs	FY17	FY18E	FY19E	FY20E
Loans (Rs bn)	616	745	905	1,091
Rural Finance	15%	16%	17%	17%
Wholesale Finance	62%	62%	62%	61%
Housing Finance	19%	20%	21%	22%
PBT (Rs bn)	9.5	13.6	19.9	28.1
Rural Finance	46%	41%	38%	37%
Wholesale Finance	78%	69%	57%	52%
Housing Finance	44%	41%	35%	32%
Investment Management	5%	5%	7%	7%

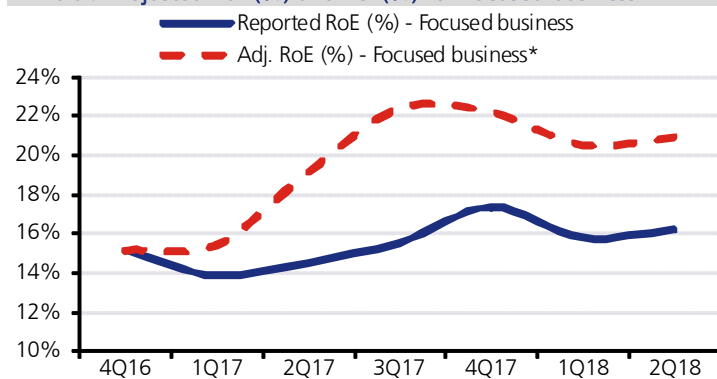
Source: Company, JM Financial

Exhibit 5. RoA(%) and RoE(%) for Focused business



Source: Company, JM Financial, *adjusted for voluntary provisions

Exhibit 6. Adjusted RoA(%) and RoE(%) for Focused business



Source: Company, JM Financial, *adjusted for voluntary provisions

Rural Finance: Financial summary

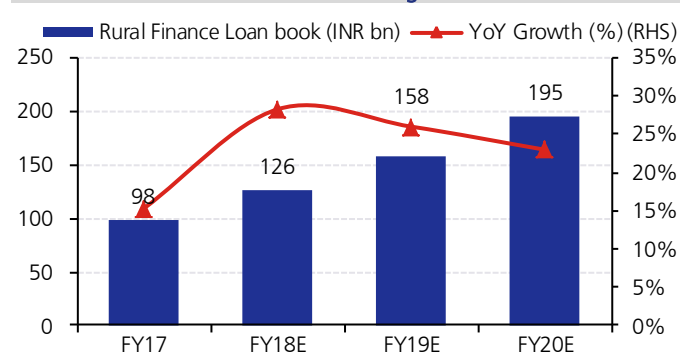
Exhibit 7. LTFH Rural finance – Financial Summary

INR. Mn	FY16	FY17	FY18E	FY19E	FY20E
NII	9,790	11,410	13,583	17,203	21,245
NII (YoY) (%)		16.5%	19.0%	26.7%	23.5%
Net Profit	2,120	2,900	3,654	4,969	6,754
Net Profit (YoY) (%)		36.8%	26.0%	36.0%	35.9%
Total Loans	85,090	98,100	125,790	158,448	194,807
Loans (YoY) (%)		15.3%	28.2%	26.0%	22.9%
ROA (%)	2.54%	2.96%	3.09%	3.35%	3.70%
ROE (%)	18.5%	23.0%	24.1%	25.5%	26.7%
Gross NPL (INR mn)	7,270	7,690	10,709	12,684	14,568
Gross NPL (%)	8.4%	7.7%	8.2%	7.7%	7.2%
Net NPL (INR mn)	5,920	5,380	6,425	6,976	7,575
Net NPL (%)	7.0%	5.5%	5.1%	4.4%	3.9%
Provision Coverage (%)	18.6%	30.0%	40.0%	45.0%	48.0%

Source: Company, JM Financial

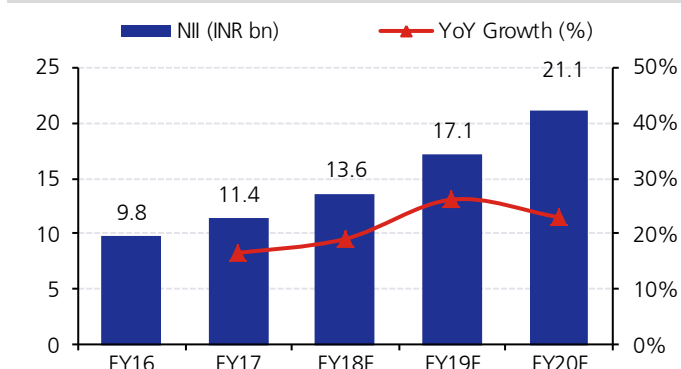
Rural Finance: Annual trends

Exhibit 8. Rural Finance: Trend in loan growth



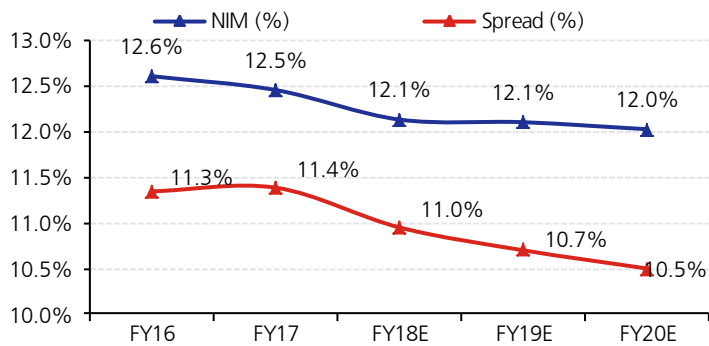
Source: Company, JM Financial

Exhibit 9. Rural Finance: Trend in NII



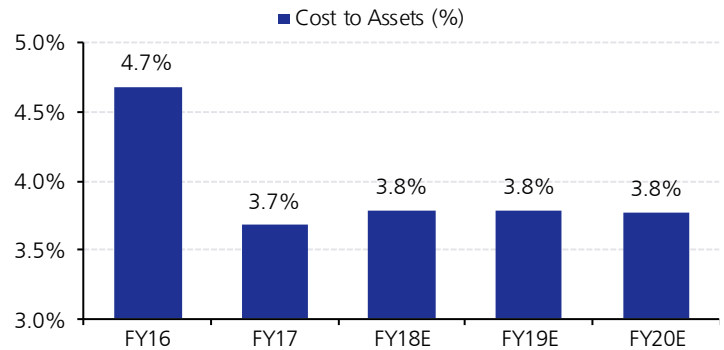
Source: Company, JM Financial

Exhibit 10. Rural Finance: Trend in margins



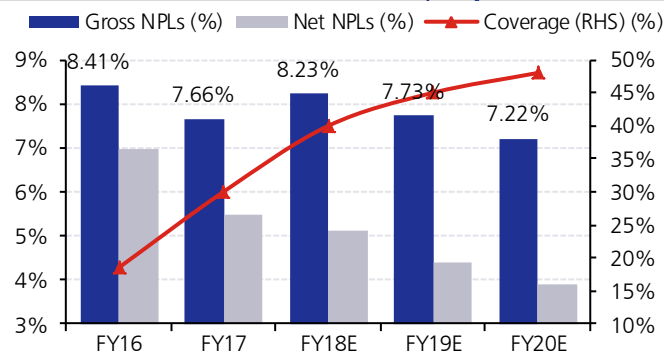
Source: Company, JM Financial

Exhibit 11. Rural Finance: Trends in Cost to Assets



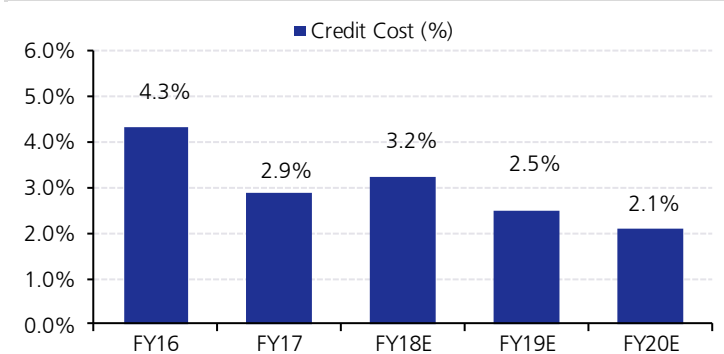
Source: Company, JM Financial

Exhibit 12. Rural Finance: Trends in asset quality



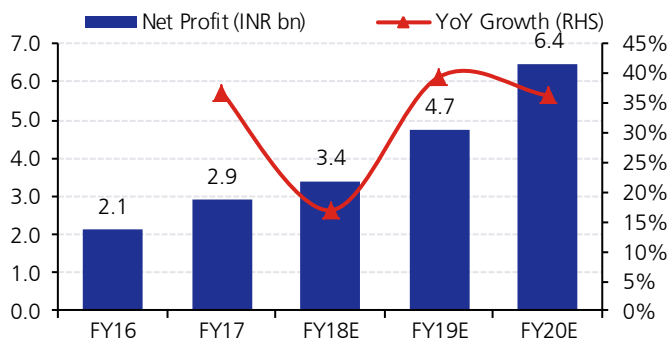
Source: Company, JM Financial

Exhibit 13. Rural Finance: Trends in credit costs



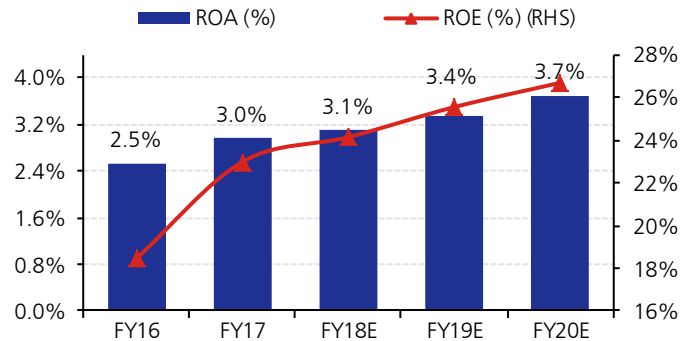
Source: Company, JM Financial

Exhibit 14. Retail Finance: Trend in earnings



Source: Company, JM Financial

Exhibit 15. Retail Finance: Trend in return ratios



Source: Company, JM Financial

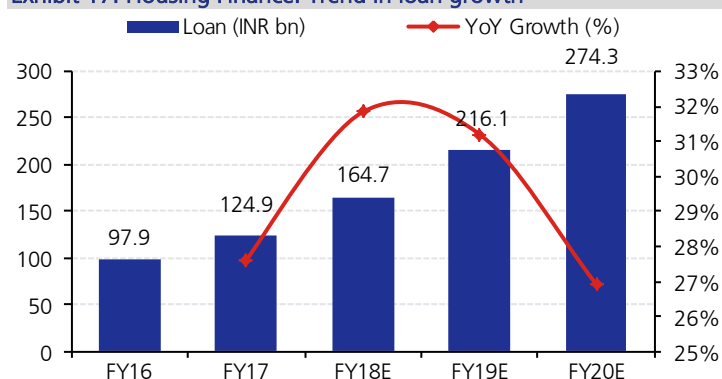
Housing Finance: Financial summary

Exhibit 16. Housing Finance – Financial Summary

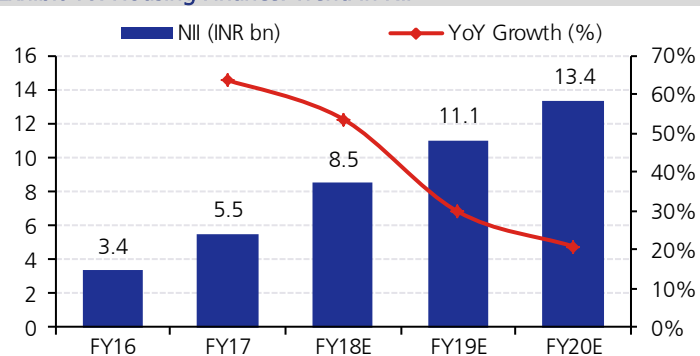
INR Mn	FY16	FY17	FY18E	FY19E	FY20E
NII	3,380	5,535	6,774	8,462	10,737
NII (YoY) (%)		63.8%	22.4%	24.9%	26.9%
Net Profit	1,270	2,750	3,678	4,619	5,961
Net Profit (YoY) (%)		116.5%	33.7%	25.6%	29.1%
Total Loans	97,900	124,940	159,883	202,079	253,934
Loans (YoY) (%)		27.6%	28.0%	26.4%	25.7%
ROA (%)	1.6%	2.3%	2.4%	2.4%	2.5%
ROE (%)	15.4%	23.4%	22.7%	21.1%	21.4%
Gross NPL (INR mn)	510	790	1,164	1,642	2,245
Gross NPL (%)	0.5%	0.6%	0.7%	0.8%	0.9%
Net NPL (INR mn)	300	390	582	788	1,010
Net NPL (%)	0.3%	0.3%	0.4%	0.4%	0.4%
Provision Coverage (%)	41.2%	50.6%	50.0%	52.0%	55.0%

Source: Company, JM Financial

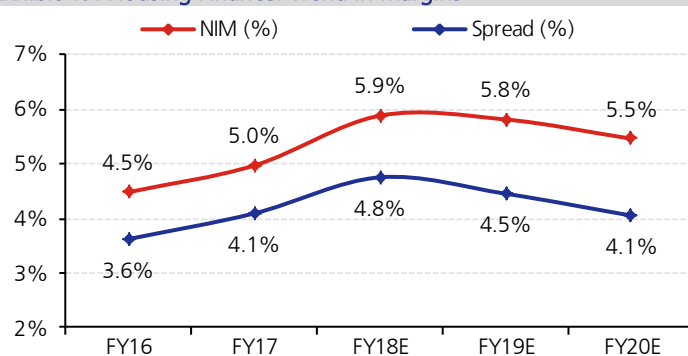
Housing Finance: Annual trends

Exhibit 17. Housing Finance: Trend in loan growth


Source: Company, JM Financial

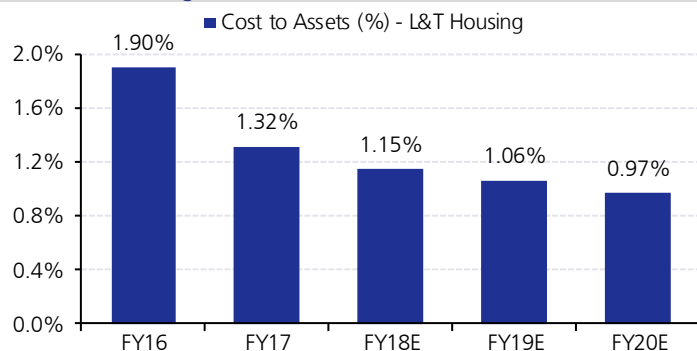
Exhibit 18. Housing Finance: Trend in NII


Source: Company, JM Financial

Exhibit 19. Housing Finance: Trend in margins


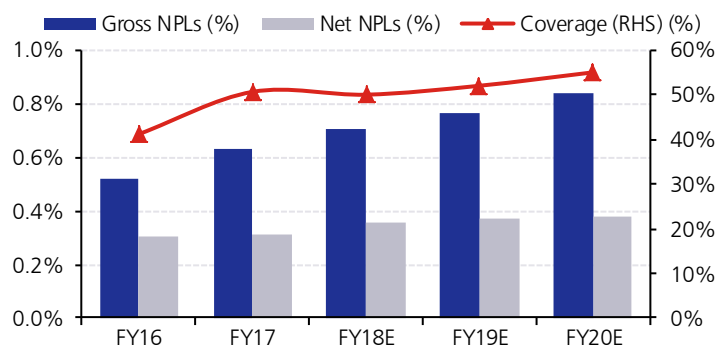
Source: Company, JM Financial

Exhibit 20. Housing Finance: Trend in cost-assets



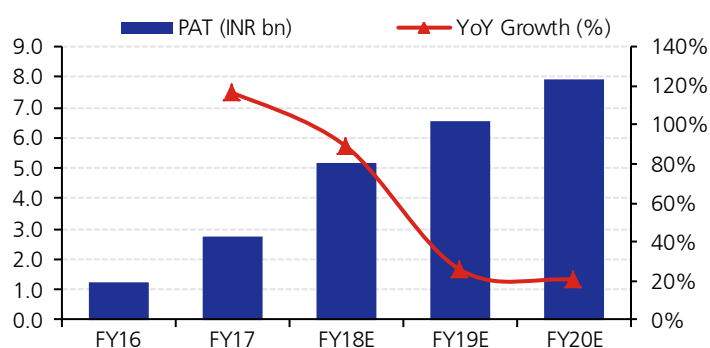
Source: Company, JM Financial

Exhibit 21. Housing Finance: Trend in asset quality



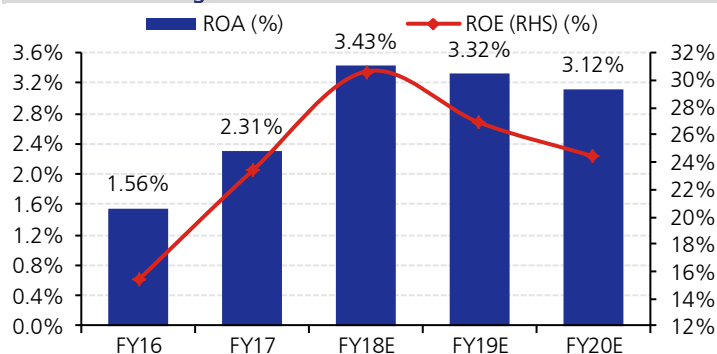
Source: Company, JM Financial

Exhibit 22. Housing Finance: Trend in earnings



Source: Company, JM Financial

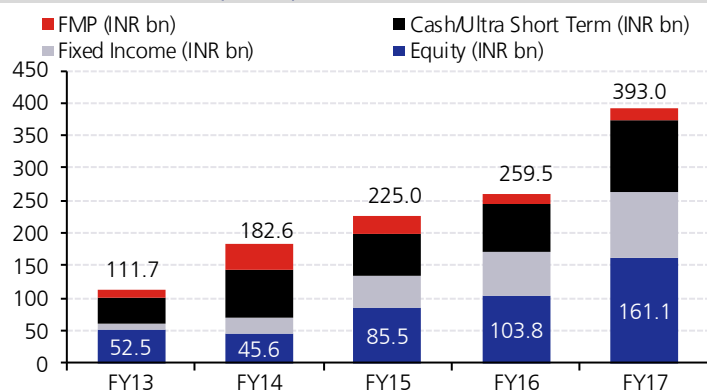
Exhibit 23. Housing Finance: Trend in return ratios



Source: Company, JM Financial

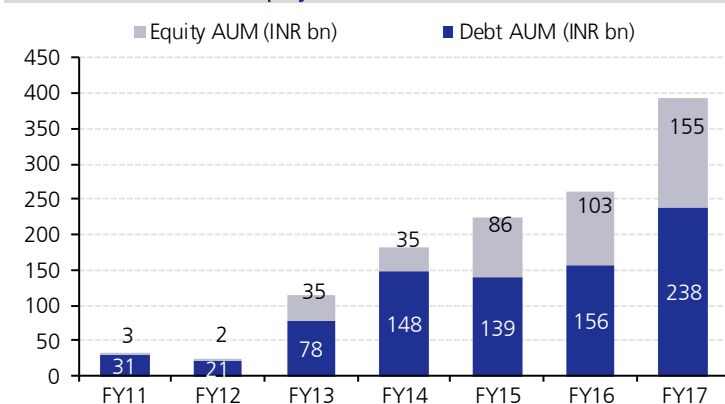
Investment Management: Key Charts

Exhibit 24. AUM Mix (INR bn)



Source: Company, JM Financial

Exhibit 25. AUM Mix – Equity and Debt



Source: Company, JM Financial

Wholesale Finance: Financial summary

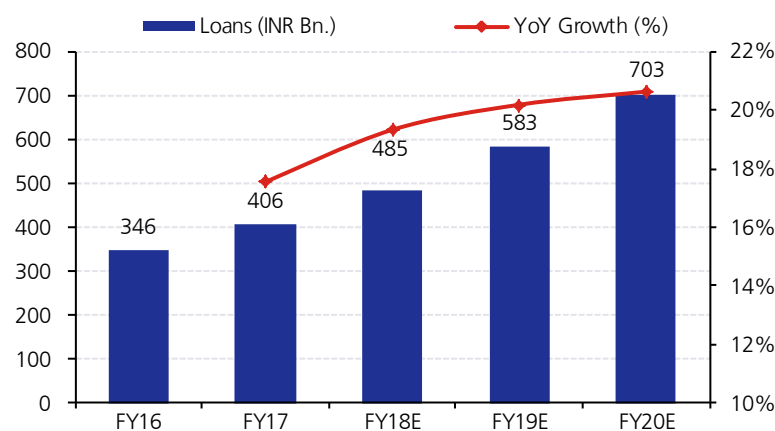
Exhibit 26. Wholesale Finance – Financial Summary

INR Mn	FY16	FY17	FY18E	FY19E	FY20E
NII	12,570	13,270	15,293	17,972	21,794
NII (YoY) (%)		5.6%	15.2%	17.5%	21.3%
Total Income	14,320	16,260	18,761	22,065	26,705
Total Income (YoY) (%)		13.5%	15.4%	17.6%	21.0%
Net Profit	5,460	5,600	6,906	8,355	10,784
Net Profit (YoY) (%)		2.6%	23.3%	21.0%	29.1%
Total Loans	3,45,800	4,06,450	4,93,113	5,94,166	7,05,547
Loans (YoY) (%)		17.5%	21.3%	20.5%	18.7%
ROA (%)	1.52%	1.38%	1.42%	1.43%	1.56%
ROE (%)		11.4%	12.2%	13.0%	14.6%
Gross NPL (Rs mn)	12,230	16,420	19,351	22,492	26,083
Gross NPL (%)	3.5%	4.0%	3.8%	3.7%	3.6%
Net NPL (Rs mn)	9,330	8,840	9,675	10,121	10,433
Net NPL (%)	2.7%	2.2%	2.0%	1.7%	1.5%
Provision Coverage (%)	23.7%	46.2%	50.0%	55.0%	60.0%

Source: Company, JM Financial

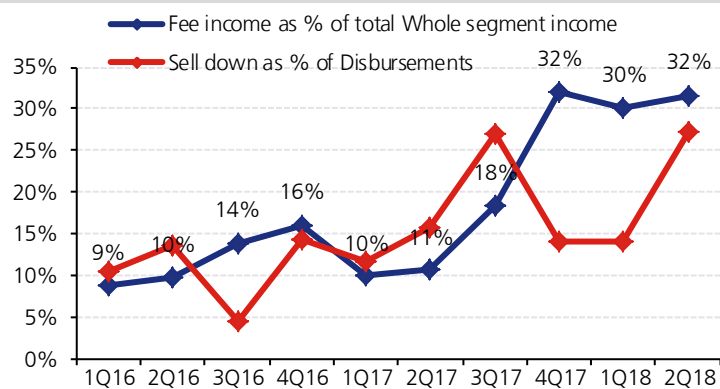
Wholesale Finance: Annual trends

Exhibit 27. Wholesale Finance: Trend in loans

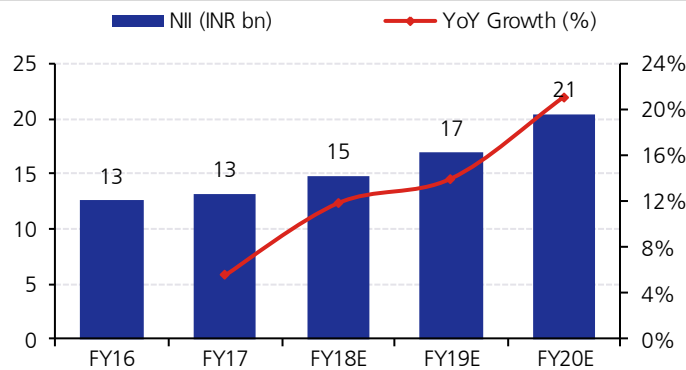


Source: Company, JM Financial

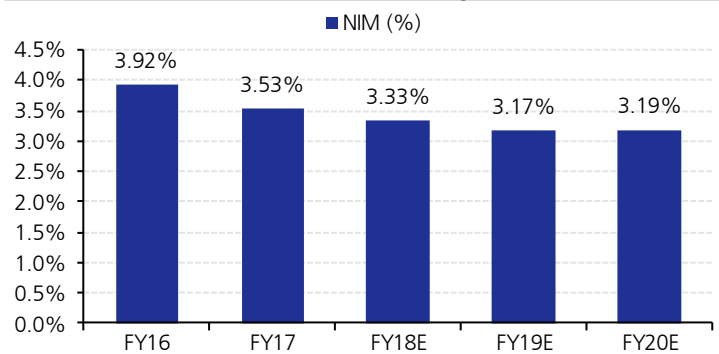
Exhibit 28. Wholesale Finance: Trend in Fee income



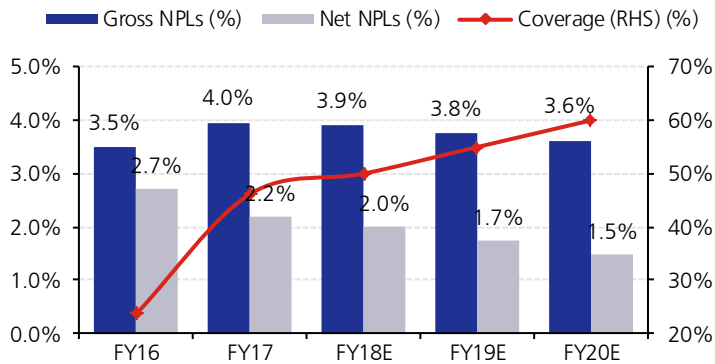
Source: Company, JM Financial

Exhibit 29. Wholesale Finance: Trend in NII

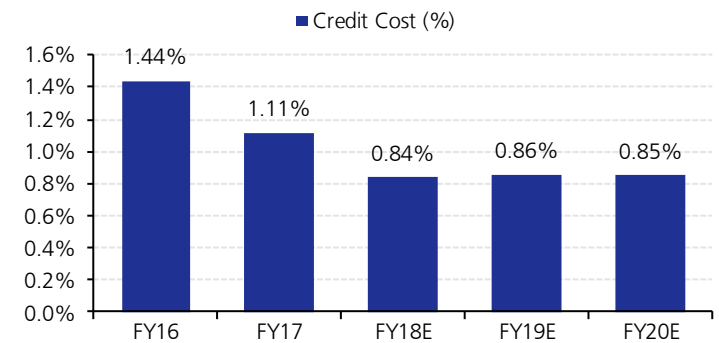
Source: Company, JM Financial

Exhibit 30. Wholesale Finance: Trend in margins

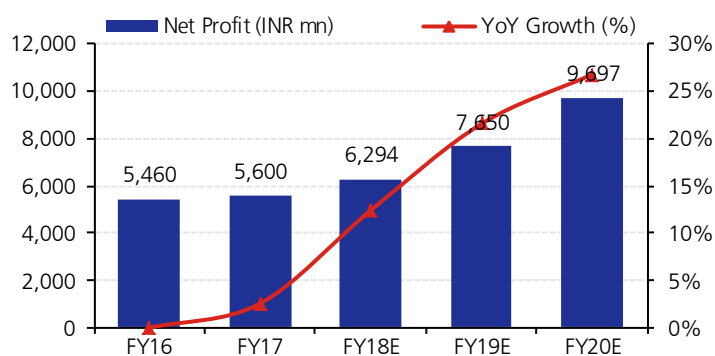
Source: Company, JM Financial

Exhibit 31. Wholesale Finance: Trend in asset quality

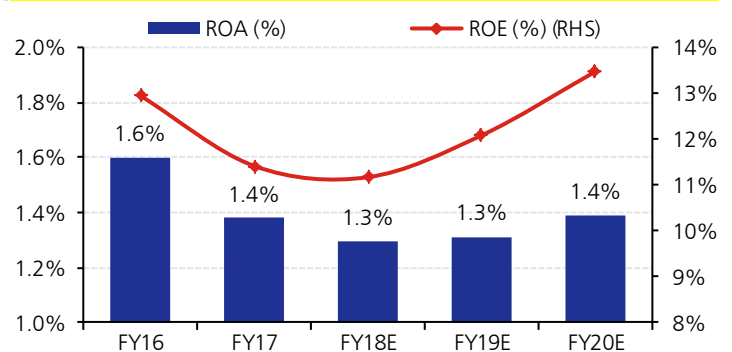
Source: Company, JM Financial

Exhibit 32. Wholesale Finance: Trend in credit costs

Source: Company, JM Financial

Exhibit 33. Wholesale Finance: Trend in earnings growth

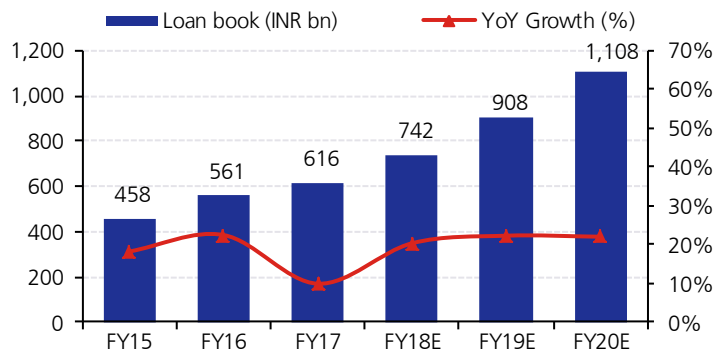
Source: Company, JM Financial

Exhibit 34. Wholesale Finance: Trend in return ratios

Source: Company, JM Financial

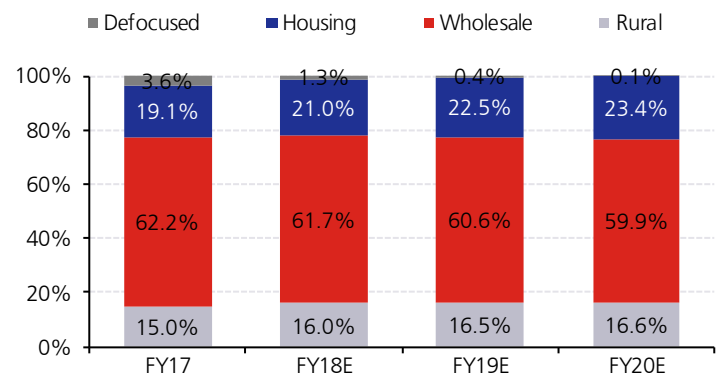
LTFH – Annual trends

Exhibit 35. LTFH: Trend in AUM (INR bn)



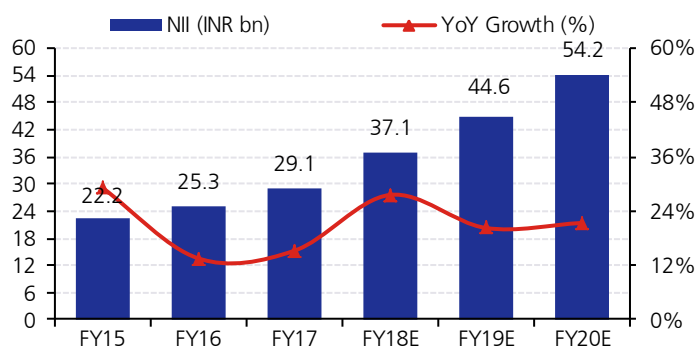
Source: Company, JM Financial

Exhibit 36. LTFH: Trend in AUM Mix



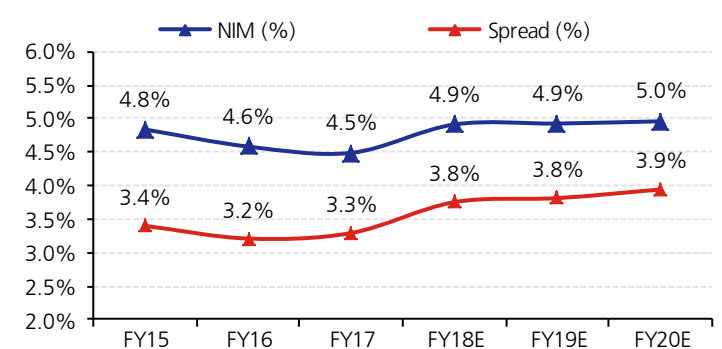
Source: Company, JM Financial

Exhibit 37. LTFH: Trends in NII



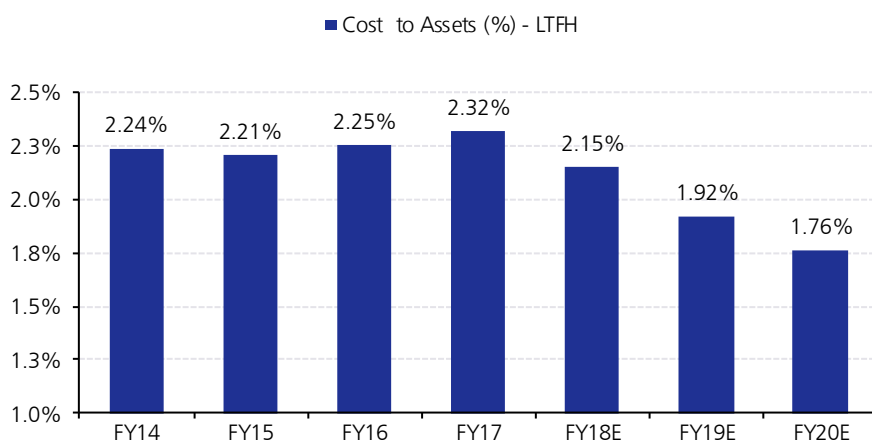
Source: Company, JM Financial

Exhibit 38. LTFH: Trends in Margins NII/AUM



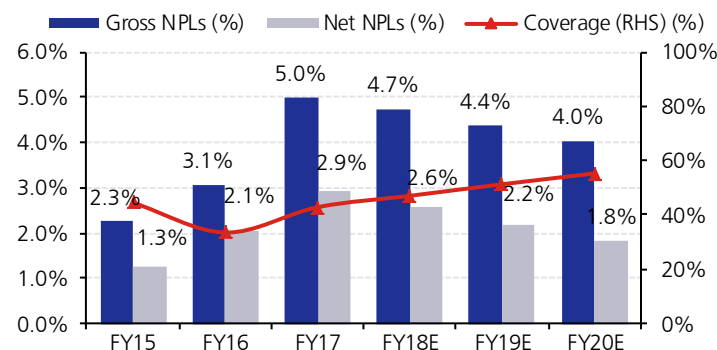
Source: Company, JM Financial

Exhibit 39. LTFH: Trends in Cost to assets



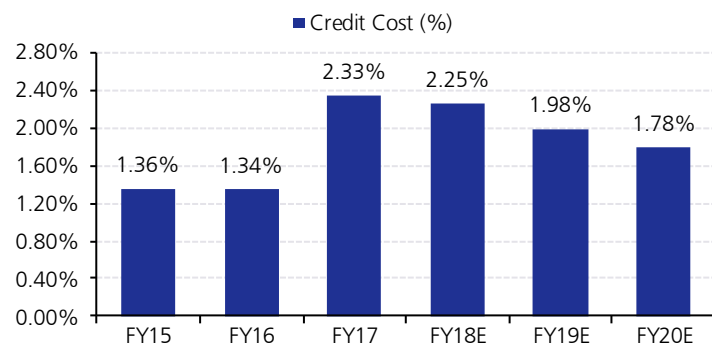
Source: Company, JM Financial

Exhibit 40. LTFH: Trend in asset quality



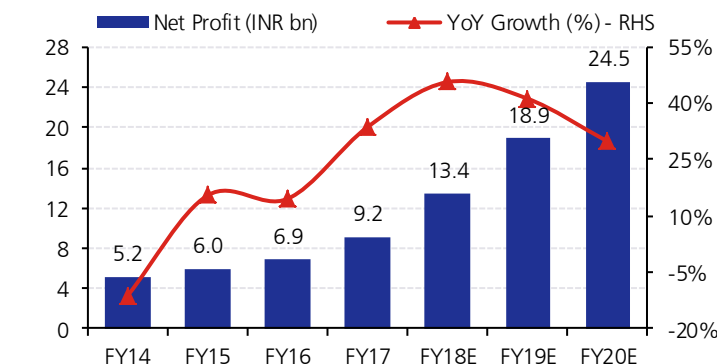
Source: Company, JM Financial

Exhibit 41. LTFH: Trend in credit costs



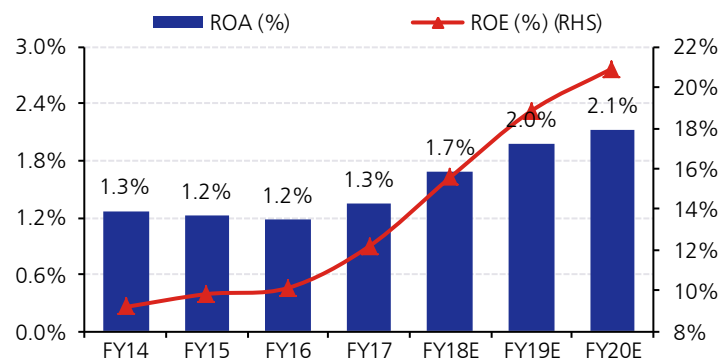
Source: Company, JM Financial

Exhibit 42. Trend in earning growth



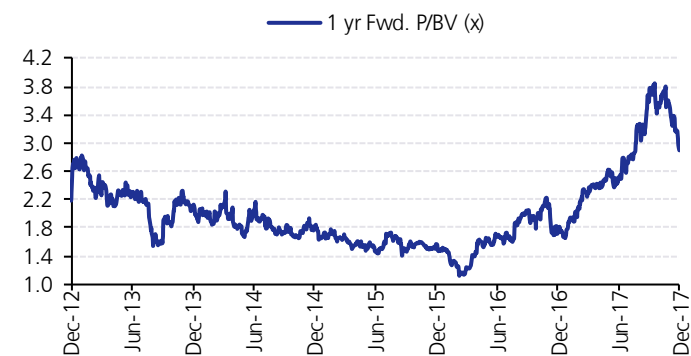
Source: Company, JM Financial

Exhibit 43. Trend in return ratios



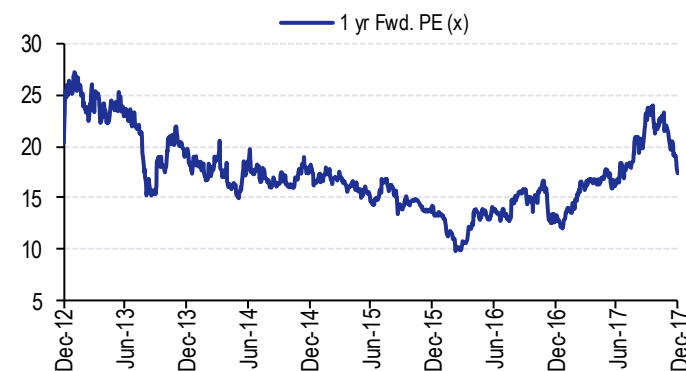
Source: Company, JM Financial

Exhibit 44. LTFH: One-year forward P/BV (x)



Source: Company, JM Financial

Exhibit 45. LTFH: One-year forward P/E (x)



Source: Company, JM Financial

Financial Tables (Consolidated)

Income Statement (INR mn)					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Net Interest Income (NII)	25,262	29,099	37,118	44,641	54,181
Non Interest Income	6,533	9,110	10,441	12,773	14,941
Total Income	31,795	38,208	47,559	57,414	69,123
Operating Expenses	13,129	12,765	14,516	16,386	18,939
Pre-provisioning Profits	18,666	25,444	33,044	41,028	50,184
Loan-Loss Provisions	7,266	15,497	0	0	0
Others Provisions	-5	9	17,873	18,902	20,527
Total Provisions	7,810	15,899	17,873	18,902	20,527
PBT	10,856	9,545	15,170	22,126	29,657
Tax	3,990	364	1,796	3,231	5,114
PAT (Pre-Extra ordinaries)	6,866	9,180	13,374	18,894	24,543
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	6,866	9,180	13,374	18,894	24,543
Dividend	2,027	706	2,942	4,157	5,399
Retained Profits	4,839	8,475	10,432	14,738	19,143

Source: Company, JM Financial

Balance Sheet (INR mn)					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Equity Capital	17,534	17,557	18,195	18,195	18,195
Reserves & Surplus	54,356	61,342	74,678	89,415	1,08,559
Stock option outstanding	62	40	42	44	46
Borrowed Funds	5,16,157	5,98,111	7,07,788	8,64,141	10,51,918
Deferred tax liabilities	17	24	0	0	0
Preference Shares	12,134	12,134	9,707	7,766	6,213
Current Liabilities & Provisions	37,751	35,928	53,222	64,246	75,638
Total Liabilities	6,38,011	7,25,136	8,63,633	10,43,808	12,60,569
Net Advances	5,60,654	6,16,485	7,42,106	9,07,844	11,08,205
Investments	35,633	60,115	66,127	69,433	72,905
Cash & Bank Balances	4,015	5,944	6,241	5,617	5,055
Loans and Advances	6,463	6,660	6,993	7,342	7,710
Other Current Assets	13,885	15,928	22,388	33,674	46,375
Fixed Assets	6,962	6,188	6,498	6,823	7,164
Miscellaneous Expenditure	6,389	6,389	5,111	4,089	3,271
Deferred Tax Assets	4,010	7,426	8,169	8,986	9,884
Total Assets	6,38,011	7,25,136	8,63,633	10,43,808	12,60,569

Source: Company, JM Financial

Key Ratios					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Growth (YoY) (%)					
Borrowed funds	22.6%	15.9%	18.3%	22.1%	21.7%
Advances	22.5%	10.0%	20.4%	22.3%	22.1%
Total Assets	21.0%	13.7%	19.1%	20.9%	20.8%
NII	13.6%	15.2%	27.6%	20.3%	21.4%
Non-interest Income	49.3%	39.4%	14.6%	22.3%	17.0%
Operating Expenses	21.9%	-2.8%	13.7%	12.9%	15.6%
Operating Profits	17.8%	36.3%	29.9%	24.2%	22.3%
Core Operating profit	19.4%	20.2%	24.5%	20.7%	20.4%
Provisions	18.0%	103.6%	12.4%	5.8%	8.6%
Reported PAT	-4.4%	33.7%	45.7%	41.3%	29.9%
Yields / Margins (%)					
Interest Spread	3.21%	3.29%	3.75%	3.81%	3.94%
NIM	4.58%	4.49%	4.91%	4.93%	4.96%
Profitability (%)					
ROA	1.18%	1.35%	1.68%	1.98%	2.13%
ROE	10.2%	12.2%	15.6%	18.8%	20.9%
Cost to Income	41.3%	33.4%	30.5%	28.5%	27.4%
Asset quality (%)					
Gross NPA	3.06%	4.99%	4.74%	4.36%	4.04%
LLP	0.35%	1.31%	0.60%	0.54%	0.53%
Capital Adequacy (%)					
Tier I	11.86%	11.45%	12.65%	12.13%	11.83%
CAR	15.07%	14.85%	16.50%	15.98%	15.69%

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
NII / Assets	4.34%	4.27%	4.67%	4.68%	4.70%
Other Income / Assets	1.12%	1.34%	1.31%	1.34%	1.30%
Total Income / Assets	5.46%	5.61%	5.99%	6.02%	6.00%
Cost / Assets	2.25%	1.87%	1.83%	1.72%	1.64%
PPP / Assets	3.20%	3.73%	4.16%	4.30%	4.36%
Provisions / Assets	1.34%	2.33%	2.25%	1.98%	1.78%
PBT / Assets	1.86%	1.40%	1.91%	2.32%	2.57%
Tax rate	36.8%	3.8%	27.0%	25.0%	25.0%
ROA	1.18%	1.35%	1.68%	1.98%	2.13%
Leverage	8.9	9.2	9.3	9.7	9.9
ROE	10.2%	12.2%	15.6%	18.8%	20.9%

Source: Company, JM Financial

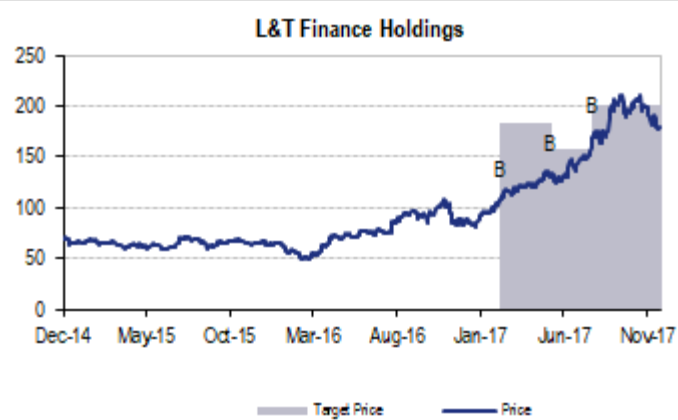
Valuations					
Y/E March	FY16A	FY17A	FY18E	FY19E	FY20E
Shares in Issue	1,753.4	1,755.7	1,819.5	1,819.5	1,819.5
EPS (INR)	3.9	5.2	7.4	10.4	13.5
EPS (YoY) (%)	-6.3%	32.9%	40.6%	41.3%	29.9%
P/E (x)	42.0	31.6	22.4	15.9	12.2
BV (INR)	41	45	51	59	70
BV (YoY) (%)	10.7%	9.6%	13.6%	15.9%	17.8%
P/BV (x)	4.02	3.67	3.23	2.79	2.37
DPS (INR)	1.2	0.4	1.6	2.3	3.0
Div. yield (%)	0.7%	0.2%	1.0%	1.4%	1.8%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	FY18E EPS (INR)	% Chg.	FY19E EPS (INR)	% Chg.	Target Price	% Chg.
9-Feb-17	6.9				183	
11-May-17	7.3	5.8	9.7		158	-13.7
28-Jul-17	2.8	-61.4	3.9	-60.1	200	26.6

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

Member of BSE Ltd. and National Stock Exchange of India Ltd. and Metropolitan Stock Exchange of India Ltd.

SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst – INH000000610

Registered Office: 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai 400 025, India.

Board: +9122 6630 3030 | Fax: +91 22 6630 3488 | Email: jmfinancial.research@jmfl.com | www.jmfl.com

Compliance Officer: Mr. Sunny Shah | Tel: +91 22 6630 3383 | Email: sunny.shah@jmfl.com

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Rating	Meaning
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Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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