Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

L&T Finance Holding Ltd

Set to gain momentum

NBFC	Sharekhan code: L&TFH
Reco/View: Buy ↔	CMP: Rs. 77
	Price Target: Rs. 124 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 27.51

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 19,024 cr
52-week high/low:	Rs. 113/ 72
NSE volume: (No of shares)	312.0 lakh
BSE code:	533519
NSE code:	L&TFH
Free float: (No of shares)	90.2 cr

Shareholding (%)

Promoters	63.5
FII	8.3
DII	6.6
Others	21.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-2.5	-11.7	-12.3	-14.9
Relative to Sensex	-0.4	-6.7	-20.7	-36.5

Sharekhan Research, Bloomberg

Summary

- L&T Finance Holding Limited (LTFH) has proposed to hive off the mutual fund business, L&T Investment Management Limited for ~ Rs. 3,191 crore - Rs. 3,250 crore at 4.2% of QAAUM of L&T Mutual Fund as of September 2021, below the expectations of Rs. 5,000 crore. Apart from this, the LTFH would be entitled to excess cash in L&T Investment Management Limited.
- We believe, LTFH is a structural play on the credit growth story of India with rural credit displaying green shoots, recovery in housing sales, and continued government spending in infrastructure projects.
- On the asset-quality front, consolidated GNPA remained unchanged at 5.74% q-o-q in Q2FY2022, supported by collection efficiency reaching pre-Covid levels across retail products.
- LTFH trades at 1.0x/0.8x/0.5x its FY2022E/FY2023E/FY2024 book value, which is reasonable. The stock has corrected by 32% from its peak, which offers an attractive value buy from lower levels. We maintain Buy with a revised PT of Rs. 124.

L&T Finance Holding Limited (LTFH) and HSBC Asset Management (India) Pvt. Ltd. (HSBC AMC) entered into a definitive agreement, where by HSBC AMC will acquire 100% equity shares of L&T Investment Management Limited for~Rs. 3,191 crore - Rs. 3,250 crore. This is at 4.2% of the quarterly average assets under management (QAAUM) of L&T Mutual Fund as of September 2021. In addition, LTFH would be able to access the excess cash on the balance sheet of L&T Investment Management Limited. Divestment of the mutual fund business is in line with the strategic objective of LTFH of unlocking value from its subsidiaries to strengthen its balance sheet. LTFH's loan book continued to consolidate and stood at Rs. 896.4 billion, down 12% y-o-y and ~2% q-o-q in Q2FY2022. This was primarily due to a decline in infrastructure finance, housing, and de-focused businesses. Rural finance continued to provide support to the overall loan book with farm equipment growing by ~21% y-o-y and two wheeler increasing ~3% y-o-y. Collection efficiency (CE) reached to pre-Covid levels across retail products. Likewise, disbursement recovered q-o-q to Rs. 73.3 billion (up ~3% y-o-y and up ~41% q-o-q), aided by rural finance. Capital adequacy improved to 25.2% in September 2021 with Tier-1 at 20.1%.

- **Divestment of mutual fund business:** LTFH proposed to sell its L&T Investment Management Limited, which is the investment manager of L&T Mutual Fund. The AMC business is valued at ~Rs. 3,191 crore - Rs. 3,250 crore, which is at 4.2% of QAAUM of L&T Mutual Fund as on September 2021. In addition, LTFH would be able to access the excess cash on the balance sheet of L&T Investment Management Limited.QAAUM stood at Rs. 78,274 crore with over 2.4 million active folios ranked at 12 out of 45 mutual funds in the industry. Divestment of the mutual fund business is in line with the strategic objective of LTFH of unlocking value of its subsidiaries to strengthen its balance sheet. However, the valuation at 4.2% seems to be at a discount to its listed peers, which are currently trading at 8% to 11% its Mcap to AAUM. Further, earlier during this year, Principal AMC was valued at 4.5% to Rs. 339 crore, which was acquired by Sundaram Finance. This is likely to be sentimentally negative for LTFHin the short term, given its lower valuation. Additionally, this is despite pure equity plus hybrid AUM mix of 59% versus 47% for the industry. Nonetheless, we are positive on LTFH, given its on-track strategic objective and its long-term structural play in the credit growth story. We expect enhanced capital adequacy would support long-term growth of the company's lending business.
- **On track to drive credit growth:** LTFH is expected to reap the benefits of pick up in credit demand in the economy. As per industry estimates, housing sales have increased by 12% to 1,38,051 units during January-September 2021. Driven by pent-up demand and gradual recovery in the overall economy along with benign interest rates, housing sales are likely to increase by 15% to 20% going ahead. Likewise, continued government spending in infrastructure projects is expected to bode well for LTFH's lending business in the long term. Disbursement recovered q-o-q to Rs. 73.3 billion, (up ~3% y-o-y and up ~41% q-o-q), aided by rural finance, which constitutes 68% of the total disbursement.
- **Well capitalised:** With this divestment, LTFH would be able to strengthen its balance sheet to augur future growth in the lending business. The company is well capitalised to support its long-term growth. Its capital adequacy improved to 25.2% in September 2021 with Tier-1 at 20.1%.

Our Call

Valuation: We maintain our Buy rating on the stock with a revised PT of Rs. 124: The stock trades at 1.0x/0.8x/0.5x its FY2022E/FY2023E/FY2024 book value. We believe the company is a long-term opportunity on economic growth, revival in credit growth particularly the rural segment, recovery in housing sales, and infrastructure financing. We are sanguine on the company's long-term growth prospects due to business positives such as strong parentage, stable credit ratings, and well-managed asset quality, which are key long-term comfort factors. Its CE was near pre-Covid levels across retail segments,which augurs well for future growth. Its capital adequacy improved to 25.2% in September 2021 with Tier-1 at 20.1%. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 124.

Key Risks

Any prolonged economic slowdown may impact its loan book growth and deteriorate its asset quality.

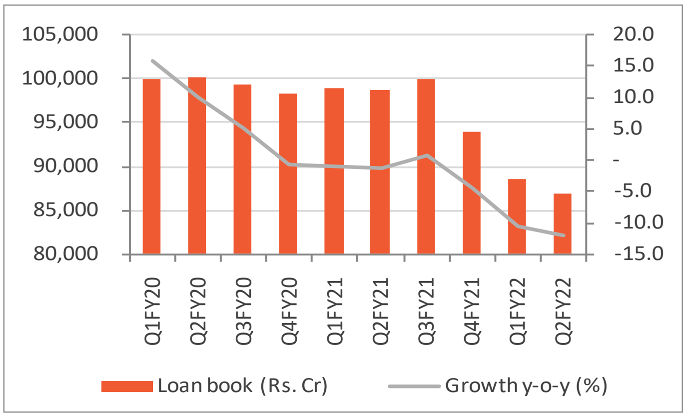
Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
NII	5,905	5,742	5,872	6,427
PAT	949	1,371	3,879	2,223
EPS (Rs)	3.8	5.5	15.7	9.0
P/E (x)	20.0	13.9	4.9	8.6
P/BV (x)	1.0	1.0	0.8	0.7
RoA (%)	0.9	1.3	3.4	3.0
RoE (%)	5.7	7.1	17.9	9.1

Source: Company; Sharekhan estimates

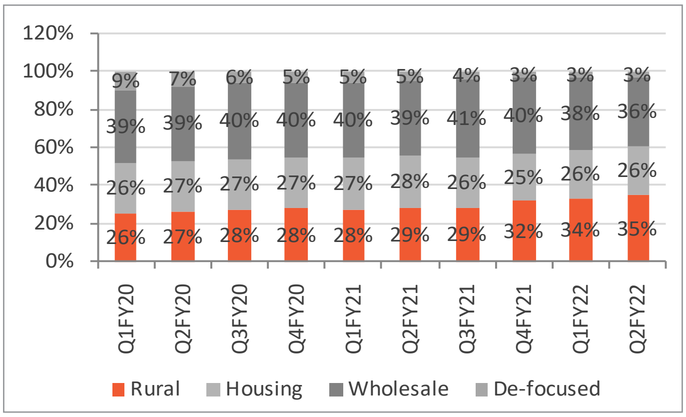
Financials in charts

AUM growth



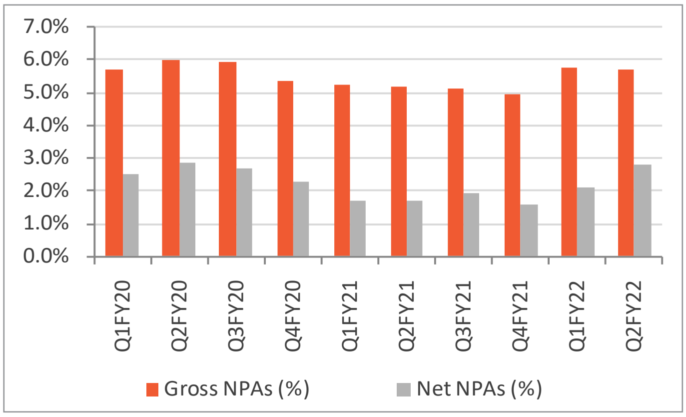
Source: Company, Sharekhan Research

AUM mix (%)



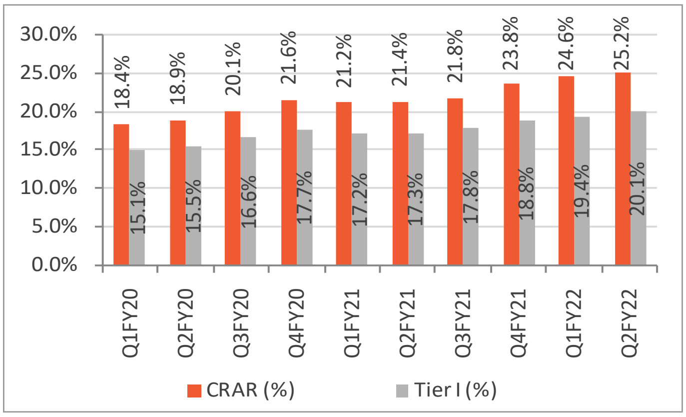
Source: Company, Sharekhan Research

Asset Quality



Source: Company, Sharekhan Research

Capital Adequacy (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Green shoots in the economy are encouraging; Rural segment a bright spot

The NBFC sector is witnessing an improved long-term outlook, helped by lower borrowing costs (supported by continued accommodative monetary policy stance). Financial services companies are reporting an incremental pick-up in credit demand, especially in retail and rural segments, post the removal of restrictions on movement. Leading indicators show recovery in economic activity, which will be positive. Increased MSPs, good monsoons, and adequate water storage position are leading to higher tractor demand and overall resilience of the rural economy and, therefore, the rural economy continues to be a bright spot in these times as well.

■ Company outlook - Strong fundamentals to drive growth ahead

Bolstered by a strong parentage, good liquidity (positive gaps in all buckets up to one-year), and high credit ratings (LTFH is rated AAA), LTFH enjoys long-term positives that allow it to access funds at competitive rates. Even though the pandemic has impacted the growth and credit costs of financial players', LTFH has responded well by prudent measures (by keeping high liquidity buffer, tightening of credit filters, and slowing disbursements), which indicate a cautious stance of a quality management team. A well-provided balance sheet and, hence, the NIM trajectory going forward would depend on growth and asset quality. We believe that notwithstanding medium-term challenges, factors such as well-capitalised balance sheet, stable ratings, and provision buffer indicate that LTFH is well placed to ride over medium-term challenges.

■ Valuation - We maintain our Buy rating on the stock with a revised PT of Rs. 124.

The stock trades at 1.0x/0.8x/0.5x its FY2022E/FY2023E/FY2024 book value. We believe the company is a long-term opportunity on economic growth, revival in credit growth particularly the rural segment, recovery in housing sales, and infrastructure financing. We are sanguine on the company's long-term growth prospects due to business positives such as strong parentage, stable credit ratings, and well-managed asset quality, which are key long-term comfort factors. Its CE was near pre-Covid levels across retail segments,which augurs well for future growth. Its capital adequacy improved to 25.2% in September 2021 with Tier-1 at 20.1%. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 124.

Peer valuation

Companies	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
L&T Finance Holdings Ltd	77	19,024	13.9	4.9	1.0	0.8	7.2	18.1	1.3	3.4
LIC Housing Finance Ltd	356	19,571	9.7	4.8	0.9	0.8	9.0	17.0	0.8	1.4
Mahindra & Mahindra Financial Services	145	17,921	8.4	10.7	1.1	1.0	7.3	13.0	1.4	2.0

Source: Company, Sharekhan Research

About company

LTFH offers a wide range of financial products and services across rural, housing, and wholesale finance sectors. LTFH is among the largest NBFCs in India with a loan book of ~Rs. 89,000 crore and with 700+ points of presence across 24 states. The company's parent is one of the leading infrastructure players in the country, which not only helps LTFH with access to pertinent industry information but also with the ability to leverage the parent's strength in business as well as ratings. The company operates in retail/wholesale lending, as well as across two-wheeler finance, tractor finance, microfinance, home loans/LAP, builder finance, infra finance, and structured finance among other product lines. LTFH is rated AAA by CARE and CRISIL.

Investment theme

LTFH has been strategically re-aligning its business mix, focusing on businesses where it has a clear competitive advantage and opportunity to scale. Benefitted by a strong parent and attractive credit ratings (LTFH is rated AAA), the company works at competitive rates, which are key support to its margins. Moreover, LTFH focuses on diversification of borrowings mix with the addition of new sources of borrowings, which are key for sustainability. LTFH has responded by keeping high liquidity buffer, tightening of credit filters, and slowing disbursements, indicating a cautious stance; but with improving outlook, we expect normalisation of business going forward. Factors such as well capitalised balance sheet, stable ratings, and provision buffer are positives. However, developments such as overhang of possible change in the regulatory stance (for NBFCs) and rights issue (book value dilutive) have added to medium-term uncertainty.

Key Risks

Any prolonged economic slowdown may impact its loan book growth and deteriorate its asset quality.

Additional Data

Key management personnel

Mr. Dinanath Dubhashi	Managing Director & Chief Executive Officer
Mr. Kailash Kulkarni	Chief Executive - Investment Management & Group Head - Marketing
Mr. Sachinn Joshi	Group - Chief Financial Officer
Mr. Sunil Prabhune	Chief Executive - Rural & Housing Finance & Group Head – Digital, IT and Analytics

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	ICICI Prudential Life Insurance Co	2.7
2	BC Asia Growth Investment	2.7
3	Citigroup Global Markets Mauritius	2.3
4	Life Insurance Corporation of India	1.8
5	Bc Investments Ltd	1.4
6	Vanguard Group Inc/The	1.1
7	Government Pension Fund Global	1.1
8	Dimensional Fund Advisors LP	0.5
9	BlackRock Inc	0.5
10	Kotak Mahindra Asset Management Co Ltd	0.3

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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