

L&T Finance Holdings

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Balance sheet strengthened; retailization above Lakshya goals

- LTFH reported Q3FY23 PAT of ~Rs4.5bn, around 3% above our estimates, primarily driven by higher than expected interest income due to change in the asset mix towards retail products. In the seasonally-strong festive quarter, disbursements grew 19.1%QoQ/32.8% YoY, led by the highest-ever quarterly disbursements in the 2W and farm-equipment segments as well as sustained healthy disbursements in home loans and LAP. Overall AUM, however, declined 1.9%QoQ/grew 3.4%YoY, due to accelerated repayments/pre-payments (Rs42.2bn) and sell-downs (Rs29.5bn) in the wholesale finance segment. Retail disbursements grew 13.4% QoQ/52% YoY, resulting in retail AUM growth of 9.5% QoQ/33.8% YoY to ~Rs570bn. The retail AUM now accounts for 64% of the overall book (Q3FY22: 50%); Management expects this share to touch ~90% by FY24-end. Wholesale disbursements grew 90.8% QoQ (on a low base)/declined 32.8% YoY. However, the aforementioned repayment/prepayment & sell-downs resulted in the wholesale AUM declining 17.5%QoQ/24% YoY to ~Rs310bn.
- NII witnessed healthy growth of 10.5% QoQ/24.1% YoY. Calc NIM came in at ~8.2% (+76bps QoQ), driven by higher yields (+103bps QoQ) due to strong growth in 2Ws, consumer loans, micro-finance and farm equipment. Calc CoFs rose 11bps QoQ due to re-pricing of variable rate loans and higher incremental CoFs. Operating expenses grew 8.1% QoQ/27.7% YoY, in line with our estimates, on account of elevated employee benefit expenses (+8.7% QoQ/+41.2% YoY) as well as higher other expenses (+7.9% QoQ/+16.5% YoY) that we believe could be attributed to higher business activity in Q3.
- The key highlight of the quarter was the one-time gain from the sale of the mutual-fund business (L&T Investment Managers), at ~Rs21.6bn (post-tax), being utilized to shore up provisions on the wholesale portfolio. In order to aid the accelerated reduction in the wholesale portfolio, LTFH conducted a fair-value assessment. While the fair value was close to the held-to-maturity value largely due to earlier provisions taken, Management, in order to aid the accelerated run down, decided to shift from the amortized cost method for valuing wholesale loans to the fair-value method, resulting in a one-time provision of ~Rs26.9bn. The provision is primarily for any illiquidity discount that may arise during the run-down. As per the management, this exercise should adequately cover downside risks from future sell-downs as well as protect retail profitability.
- Asset quality for the retail segment witnessed modest improvement QoQ, with GS3 and NS3 declining 8bps and 15bps QoQ to 3.47% and 0.73%, respectively. For the wholesale portfolio, GS3 and NS3 rose by 47bps and 15bps QoQ to 5.19% and 3.37%, respectively. However, in absolute terms, the wholesale GS3 declined 7% QoQ to Rs16.1bn. Overall Credit costs (excl. impact of one-time provision) rose by 29bps QoQ to 2.9%. LTFH still continues to retain macro prudential provisions of Rs10.39bn (Q2: Rs10.96bn), corresponding to 1.89% of the standard book. This can be utilized in case of any escalations emanating in the future, in its retail portfolio.

Financial Snapshot (Consolidated)

(Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net income	68,801	65,698	1,01,818	91,610	1,11,582
Net profit	9,709	10,701	16,721	21,769	27,935
EPS (Rs)	4.5	4.3	6.7	8.8	11.3
BV (Rs)	86.5	80.5	86.3	94.1	104.1
RoA (%)	0.9	1.0	1.5	1.9	2.3
RoE (%)	5.8	5.5	8.1	9.7	11.4
P/E (x)	21.3	22.0	14.1	10.8	8.5
P/BV	1.1	1.2	1.1	1.0	0.9

Source: Company, Emkay Research

CMP	Target Price
Rs 95 as of (January 16, 2023)	Rs 116 (▲) 12 months
Rating	Upside
BUY (■)	21.9 %

Change in Estimates

EPS Chg FY23E/FY24E (%)	-/
Target Price change (%)	16.0
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY23E	FY24E
Emkay	6.7	8.8
Consensus	6.9	8.4
Mean Consensus TP (12M)	Rs 95	

Stock Details

Bloomberg Code	LTFH IN
Face Value (Rs)	10
Shares outstanding (mn)	2,480
52 Week H/L	98 / 59
M Cap (Rs bn/USD bn)	236 / 2.89
Daily Avg Volume (nos.)	8,989,248
Daily Avg Turnover (USD mn)	9.6

Shareholding Pattern Sep '22

Promoters	66.2%
FIIIs	6.8%
DIIIs	5.4%
Public and Others	21.7%

Price Performance

(%)	1M	3M	6M	12M
Absolute	4	25	36	20
Rel. to Nifty	6	20	22	22

Relative price trend



Source: Bloomberg

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- We roll over our forecasts to Mar-24 and retain our BUY rating on the stock, with a Mar-24E TP of Rs116 (earlier Rs100), valuing the lending business based on the 'Excess return on Equity' (ERE) method. Our TP implies Mar-25E P/BVPS of 1.3x of its lending book BVPS of Rs87, for FY25E RoE of 13.7%. Leverage estimates are expected to increase from FY25. **Key downside risks:** Additional provisions in the wholesale portfolio during the sell-down, weakness in consumer balance sheets affecting retail credit.
- **What we liked:** Sustained high disbursements in retail products such as consumer loans, 2Ws, farm equipment and micro finance. Utilization of one-off gains for fast-tracking the retailization of the balance sheet with guidance of no additional provisions required during the actual rundown process. Lakshya 2026 goals were: 1) retailization at >80%, retail CAGR at >25%, GS3 at <3% & NS3 at <1%, and RoA at 2.8-3%. As per Management, the retailization target should be met by FY24-end, and retail CAGR is expected to exceed 25%. **What we did not like:** Excluding the one-off provisions, credit costs for the quarter came in higher than the normalized run-rate.
- **Management guidance:** Management expects retail NIM + Fees of at least 11% (which is currently at 11.4%) and opex + credit cost at ~7% in the near term, resulting in post-tax RoA of ~3%. It also expects to exceed the earlier retail book CAGR guidance, logging at least 25% till FY26, on account of higher retailization during the last 3 quarters. Good momentum in established products, rapid scale-up in recently-launched products and the expected launch of new products over the next few quarters will aid in achieving the growth target. The expected rapid run-down of the wholesale book will lead to lower leverage in FY24, but leverage is expected to go up FY25 onwards.
- **Change in estimates:** Considering the increasing retailization within the portfolio, we revise our disbursement estimates upwards for FY23-25 and the expected avg. disbursement growth of ~24% over the period. Higher retail disbursements are expected to drive NII growth of ~9% over the forecast period, resulting from higher NIMs. We revise upwards our credit cost estimates to account for the higher share of retail loans, and expect average credit costs of ~4.1% over the forecast period (Exhibit 3).

Exhibit 1: Quarterly Financials

Particulars (Rs mn)	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	YoY	QoQ	FY22	FY23E	YoY
Income from operations	28,744	29,188	29,466	30,862	33,216	15.6%	7.6%	1,17,042	1,27,085	8.6%
Interest Expenses	14,066	13,923	14,132	14,385	15,007	6.7%	4.3%	57,538	58,732	2.1%
Net Interest Income	14,678	15,265	15,334	16,477	18,209	24.1%	10.5%	59,504	68,352	14.9%
Other Income	2,248	1,484	1,892	1,712	28,025	NA	NA	6,194	33,465	440.3%
Total Income	16,925	16,749	17,226	18,189	46,234	173.2%	154.2%	65,698	1,01,818	55.0%
Operating Expenses	5,817	6,034	6,169	6,868	7,427	27.7%	8.1%	22,636	28,071	24.0%
PPoP	11,109	10,715	11,057	11,321	38,807	249.3%	242.8%	43,061	73,747	71.3%
Provisions	7,418	6,524	7,989	5,765	33,288	NA	NA	30,833	53,656	74.0%
Credit costs	3.4%	3.0%	3.6%	2.6%	14.9%			3.6%	6.6%	
PBT	3,691	4,191	3,068	5,556	5,519	NA	NA	12,229	20,091	64.3%
Tax	1,126	1,289	851	1,952	990	NA	NA	3,736	5,143	37.7%
Tax rate (%)	30.5%	30.8%	27.7%	35.1%	17.9%			30.6%	25.6%	
Profit after tax	2,565	2,902	2,217	3,603	4,529	NA	NA	8,492	14,948	76.0%
Share of profit from associates/MI	695	521	405	461	8			2,209	1,773	
PAT adjusting for one offs	3,260	3,422	2,621	4,064	4,537	39.2%	11.6%	10,701	16,721	56.3%
AUM	8,55,520	8,83,410	8,80,780	9,00,980	8,84,270	3.4%	-1.9%	8,84,020	8,95,834	1.3%
Disbursement	99,080	1,47,320	1,04,630	1,10,490	1,31,570	32.8%	19.1%	3,72,020	4,77,690	28.4%
GS3	5.9%	3.8%	4.1%	4.0%	4.2%			3.4%	3.0%	
NS3	3.0%	2.0%	1.9%	1.9%	1.7%			1.2%	1.0%	
PCR	48.7%	47.4%	54.2%	54.0%	59.1%			65.9%	65.9%	

Source: Company, Emkay Research

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Exhibit 2: Actuals vs. Estimates (Q3FY23)

(Rs mn)	Actual	Estimates (Emkay)	Variation vs. Emkay	Comments
Disbursement	131,570	133,700	-2%	
AUM	884,270	910,172	-3%	Higher-than-expected repayments/prepayments and sell down in wholesale portfolio
NII	18,209	16,684	9%	Higher-than-expected yields (retail shift) driving higher interest income
PPOP	38,807	37,020	5%	
PAT (ex minority interest)	4,537	4,416	3%	

Source: Company, Emkay Research

Exhibit 3: Revision to earnings estimates of lending business

Y/E Mar (Rs m)	FY23E			FY24E			FY25E		
	Earlier	Revised	% change	Earlier	Revised	% change	Earlier	Revised	% change
Disbursement	4,48,860	4,77,690	6.4%	5,25,708	5,81,093	10.5%	6,17,633	7,07,097	14.5%
AUM	9,28,051	8,95,834	-3.5%	10,22,837	9,20,880	-10.0%	11,53,486	11,01,932	-4.5%
Net interest income	61,111	65,800	7.7%	71,932	79,774	10.9%	84,597	98,220	16.1%
PPOP	73,178	77,663	6.1%	56,611	58,432	3.2%	66,051	69,591	5.4%
PAT	12,623	10,085	-20.1%	23,597	21,785	-7.7%	27,606	27,749	0.5%
NIM (%)	6.7%	7.4%	65bps	7.4%	8.8%	141bps	7.8%	9.7%	194bps
Cost-to-income ratio (%)	25.0%	24.8%	-24bps	33.1%	36.1%	295bps	33.5%	37.6%	417bps
Disbursement growth (%)	20.7%	28.4%	775bps	17.1%	21.6%	453bps	17.5%	21.7%	420bps
AUM Growth (%)	5.1%	1.3%	-372bps	10.2%	2.8%	-742bps	12.8%	19.7%	689bps
Credit Costs (%)	5.2%	6.0%	78bps	2.5%	3.2%	67bps	2.6%	3.2%	57bps

Source: Company, Emkay Research

Exhibit 4: AUM to be dominated by retail going ahead

	FY22	FY23E	FY24E	FY25E
Lending business AUM (Rs mn)	884,020	895,834	920,880	1,101,932
Retail AUM	450,840	617,128	822,181	1,047,103
- Micro Loans	132,780	193,377	267,219	340,399
- Consumer loans	23,010	54,902	88,908	121,367
- 2W Finance	74,620	89,471	105,879	122,537
- Farm Equipment	113,170	128,778	147,348	169,042
- Acquired portfolio	0	4,024	10,317	17,222
- Home Loans / LAP	106,650	132,282	164,505	2,04,933
- DCM	610	14,293	38,005	71,604
Wholesale AUM	417,310	274,585	95,609	52,511
- Real Estate	112,100	63,577	16,895	7,559
- Infrastructure	305,210	211,008	78,714	44,952
Defocused AUM	15,870	4,120	3,090	2,318
AUM Growth				
Lending business AUM	-6.0%	1.3%	2.8%	19.7%
Retail AUM	10.4%	36.9%	33.2%	27.4%
- Micro Loans	8.8%	45.6%	38.2%	27.4%
- Consumer loans	369.6%	138.6%	61.9%	36.5%
- 2W Finance	4.8%	19.9%	18.3%	15.7%
- Farm Equipment	10.3%	13.8%	14.4%	14.7%
- Acquired portfolio	NA	NA	156.4%	66.9%
- Home Loans / LAP	-0.7%	24.0%	24.4%	24.6%
- DCM	NA	NA	165.9%	88.4%
Wholesale AUM	-17.3%	-34.2%	-65.2%	-45.1%
- Real Estate	-13.4%	-43.3%	-73.4%	-55.3%
- Infrastructure	-18.7%	-30.9%	-62.7%	-42.9%
Defocused AUM	-41.3%	-74.0%	-25.0%	-25.0%

Source: Company, Emkay Research

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Exhibit 5: Lending business Income statement and key ratios

Lending business financials (Rs mn)	FY22	FY23E	FY24E	FY25E
Net interest income	56,107	65,800	79,774	98,220
Fee & Other Income	8,880	37,464	11,622	13,361
Net operating Income	64,987	1,03,264	91,396	1,11,581
Operating Expenses	21,651	25,601	32,963	41,990
Pre-Provision operating profit	43,336	77,663	58,432	69,591
Provisions	29,584	53,656	29,009	32,325
Profit before tax	13,752	24,008	29,424	37,265
Tax	3,639	13,923	7,638	9,517
Profit after tax	10,113	10,085	21,785	27,749
Key ratios				
NIM + Fees	7.1%	11.6%	10.1%	11.0%
Opex-to-AUM	2.4%	2.9%	3.6%	4.2%
Credit costs	3.2%	6.0%	3.2%	3.2%
RoAUM	1.1%	1.1%	2.4%	2.7%
Leverage	5.2	5.1	5.0	5.0
RoE	5.8%	5.8%	12.0%	13.7%
EPS (Rs)	4.1	4.1	8.8	11.2
BVPS (Rs)	71.9	69.3	77.0	86.8

Source: Company, Emkay Research

Con-call highlights

- Management expects retail NIM + Fees of ~11% (which is currently at 11.4%) and opex + credit cost of ~7% in the near term, resulting in post-tax RoA of ~3%. It also expects to exceed the earlier guidance of retail book CAGR of at least 25% till FY26, on account of higher retailisation during the last 3 quarters. Good momentum in established products, rapid scale-up in recently-launched products and the expected launch of new products over the next few quarters will aid in achieving the growth target.
- Integrated with over 100 fintech partners to date.
- Customer retention of >30% on loan products is helping to cross-sell and upsell.
- D2C app 'PLANET' launched in Mar-22 has already crossed the 1.7mn download mark and Rs9.7bn in terms of disbursements and Rs1.2bn collections (incl. web-based app). New features launched during Q3 include Mandi price and wellness insurance. An end-to-end digital journey for two-wheelers is also expected to be launched. The aim is to convert the app from its fintech nature to an entire marketplace app.
- LTFH aims to rapidly run down its wholesale book by way of repayment/prepayment and sell-downs. Valuation of wholesale loans resulted in the fair value derived being largely close to the held-to-maturity value. However, in order to aid an accelerated run-down, a shift to the fair value method of accounting involved giving an illiquidity discount to some wholesale assets that may be requested for by potential buyers during the sale process. To give effect to this, a one-time provision of Rs26.87bn was taken. This should adequately cover any future sell-down and ensure that any sell-down does not adversely impact retail profitability.
- Merger of subsidiary lending-entities L&T Finance and L&T Infra Credit with the listed entity L&T Finance Holdings is expected to be completed by nearly end-FY24.
- Rural demand in H2FY23 and H1FY24 should remain reasonably buoyant. Good progression is witnessed in the Rabi sowing season and water reservoir levels have been strong.
- Rural disbursements' monthly run rate is ~Rs14bn, with a 52:48 mix of fresh and repeat customers.
- In microfinance, Company expects the good momentum to be maintained by introduction of new products like Rural LAP.
- Repeat customer disbursements have grown to Rs2.7bn for farm equipment.

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- For 2W finance, LTFH achieved the highest-ever monthly disbursement in Oct-22, at ~Rs10bn.
- Digital aggregator partnership disbursements crossed ~Rs1bn in Q3.
- Share of self-employed disbursements in home loans increased to 31% in Q3FY23 vs. 13% Q3FY22.
- The SME pilot launched in Q3FY22 has witnessed steady pick up. Q3 saw monthly disbursement crossing the Rs2bn mark. The book stood at Rs8.38bn. A significant geographic & channel expansion has aided this growth. During the quarter, LTFH launched the drop line overdraft facility for this segment. The SME book is expected to significantly scale up going ahead.
- The rise in CoF during the quarter has been due to repricing of floating rate loans and higher incremental CoF for the quarter. LTFH raised long-term funds to the tune of Rs65bn in Q3, Rs82bn in Q2 and Rs20bn in Q3FY22. This should aid in a rising interest rate environment. The ALM should work in favor of the company, as wholesale assets are phased out.
- Market share (and market position): Tractors ~15% (No. 1); 2Ws: ~11% (No. 4); Micro loans: ~5.7% (No. 4).
- While the capital may seem to be in excess in FY24, the Board has yet to decide on providing a special dividend, etc. The expected rapid run-down of the wholesale book will lead to lower leverage in FY24, but leverage is expected to go up in FY25 & onwards.
- The one-time provisions are more with respect to the real estate book than for the infrastructure book.
- Will apply for a corporate agent for insurance which will help achieve the full extent of fees.
- Higher yields QoQ have been due to 4 products: microloans, consumer loans, farm equipment and 2Ws, all of which saw good growth sequentially. In terms of passing on costs, the maximum pass-on happened in Home loans and infrastructure financing, where yields are so low that the company has no choice but to pass-on costs. Micro loans, which are by nature higher yielding, have however absorbed most of the of 225bps rate hikes to date.
- Management believes that the earlier the shift to retail, the better will be the value creation for shareholders.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net interest income	59,049	59,504	68,352	81,987	98,220
Other income	9,752	6,194	33,465	9,623	13,362
Net income	68,801	65,698	1,01,818	91,610	1,11,582
Operating expenses	19,749	22,636	28,071	33,622	41,990
Pre provision profit	49,052	43,061	73,747	57,988	69,592
PPP excl treasury	49,052	43,061	73,747	57,988	69,592
Provisions	36,357	30,833	53,656	29,009	32,325
Profit before tax	14,951	12,229	20,091	28,979	37,266
Tax	5,463	3,736	5,143	7,419	9,540
Tax rate (%)	37	31	26	26	26
Profit after tax and MI	9,709	10,701	16,721	21,769	27,935

Balance Sheet

Y/E Year End (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity	24,695	24,740	24,740	24,740	24,740
Reserves	1,63,038	1,74,737	1,89,525	2,08,778	2,33,483
Net worth	1,87,732	1,99,477	2,14,265	2,33,518	2,58,224
Other Liabilities and provisions	16,426	17,532	20,627	24,343	28,851
Borrowings	8,85,558	8,52,012	8,65,582	8,81,078	10,40,255
Total liabilities	10,89,717	10,69,022	11,00,474	11,38,939	13,27,329
Cash and bank	84,270	79,704	1,21,526	1,31,475	1,22,052
Investments	91,994	1,22,411	1,24,361	1,26,587	1,49,457
Loans	8,70,303	8,24,694	8,08,845	8,30,938	10,00,817
Others	43,150	42,212	45,742	49,940	55,004
Total assets	10,89,717	10,69,022	11,00,474	11,38,939	13,27,329

Key Ratios (%)

Y/E Year End	FY21	FY22	FY23E	FY24E	FY25E
NIM	6.1	6.5	7.7	9.0	9.7
RoA	0.9	1.0	1.5	1.9	2.3
RoAE	5.8	5.5	8.1	9.7	11.4
GNPA (%)	7.7	3.4	3.0	2.6	2.6
NNPA (%)	2.2	1.2	1.0	0.9	0.9

Per Share Data (Rs)	FY21	FY22	FY23E	FY24E	FY25E
EPS	4.5	4.3	6.7	8.8	11.3
BVPS	86.5	80.5	86.3	94.1	104.1
DPS	0.0	0.5	0.8	1.0	1.3

Valuations (x)	FY21	FY22	FY23E	FY24E	FY25E
PER	21.3	22.0	14.1	10.8	8.5
P/BV	1.1	1.2	1.1	1.0	0.9
Dividend Yield (%)	0.0	0.5	0.8	1.1	1.4

Source: Company, Emkay Research

Growth (%)	FY21	FY22	FY23E	FY24E	FY25E
NII	3.0	0.8	14.9	19.9	19.8
PPOP	(1.6)	(12.2)	71.3	(21.4)	20.0
PAT	(42.9)	10.2	56.3	30.2	28.3
Loans	(4.8)	(5.2)	(1.9)	2.7	20.4

Quarterly (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
NII	14,678	15,265	15,334	16,477	18,209
NIM(%)	6.8	7.0	7.0	7.4	8.2
PPOP	11,109	10,715	11,057	11,321	38,807
PAT	3,260	3,422	2,621	4,064	4,537
EPS (Rs)	1.32	1.39	1.07	1.64	1.83

Source: Company, Emkay Research

Shareholding Pattern (%)	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	63.5	63.5	66.3	66.2	66.2
FIIIs	8.3	7.9	6.9	6.6	6.8
DIIIs	6.6	6.1	4.6	5.3	5.4
Public and Others	21.7	22.5	22.3	21.8	21.7

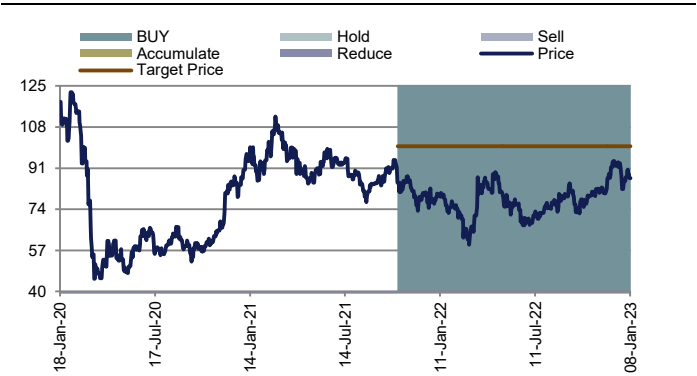
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
02-Dec-22	91	100	12m	Buy	Manjith Nair
24-Oct-22	80	100	12m	Buy	Manjith Nair
20-Jul-22	71	100	12m	Buy	Manjith Nair
20-Jun-22	67	100	12m	Buy	Manjith Nair
04-May-22	81	100	12m	Buy	Manjith Nair
24-Jan-22	73	100	12m	Buy	Manjith Nair
22-Oct-21	85	100	12m	Buy	Manjith Nair

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 17 Jan 2023 01:34:06 (SGT)
Dissemination Date: 17 Jan 2023 01:35:06 (SGT)

Sources for all charts and tables are Emkay Research unless otherwise specified.

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