

## Execution of profitable retailization strategy holds the key

BFSI - NBFCs ▶ Result Update ▶ May 2, 2023

TARGET PRICE (Rs) : 125

**L&T Finance Holdings (LTFH) reported Q4FY23 PAT of ~Rs5bn (+10.4% QoQ/+46.4% YoY), in-line with consensus estimates. This was driven by sequentially lower credit costs and adding back loss attributable to minority interest with respect to a subsidiary. Overall, disbursements were weak off a high base in Q3. The rapid run-down of the wholesale book resulted in overall AUM falling 8.5% QoQ to ~Rs808bn. Credit costs declined ~40bps QoQ. Retail asset quality was broadly stable, while PCR on wholesale finance rose to 55.7% in Q4 from 36.1% in Q3, resulting in wholesale NS3 rising 52bps to 3.89%.**

**We assume coverage with a BUY rating and a Mar-24E TP of Rs125, using the excess return on equity (ERE) method. Our TP implies a Mar-25E P/BVPS of 1.2x for FY26E RoA of ~2.3% and RoE of ~12.4%. Key risks: Asset-quality shocks in wholesale finance.**

## L&amp;T Finance Holdings: Financial Snapshot (Consolidated)

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Net profit	10,701	16,232	22,948	28,251	34,128
AUM growth (%)	(6.0)	(8.5)	10.2	20.9	22.5
NII growth (%)	0.8	13.7	8.5	19.1	22.8
NIMs (%)	7.2	12.1	9.9	10.2	10.2
PPOP growth (%)	(12.2)	72.1	(31.4)	22.4	25.9
Adj. EPS (Rs)	4.3	6.5	9.2	11.4	13.7
Adj. EPS growth (%)	(3.5)	51.4	41.2	23.1	20.8
Adj. BV (Rs)	80.5	86.7	94.7	104.8	116.9
Adj. BVPS growth (%)	(7.0)	7.7	9.3	10.6	11.6
RoA (%)	1.0	1.5	2.1	2.3	2.3
RoE (%)	5.5	7.8	10.2	11.4	12.4
P/E (x)	21.9	14.5	10.3	8.3	6.9
P/ABV (x)	1.2	1.1	1.0	0.9	0.8

Source: Company, Emkay Research

## Result Highlights

Retail disbursements were moderately weak sequentially (-2.8% QoQ), owing to a high base in Q3. Retail AUM stood at ~Rs610.5bn (+7.1% QoQ/+35.4% YoY). Wholesale disbursements were sharply down -34% QoQ/-84% YoY, in line with management's strategy. Wholesale AUM stood at ~Rs195bn (-37% QoQ/-53% YoY) due to accelerated repayment and sell-down. Overall, disbursements stood at ~Rs123bn (-6% QoQ/-16% YoY), while AUM stood at ~Rs808bn (-8.5 QoQ/-8.4% YoY).

NII came in at ~Rs17.6bn (-3% QoQ/+15.7% YoY), as the sharp run-down of the high-yielding wholesale finance book on account of accelerated repayment and sell-downs resulted in lower interest income (-3% QoQ). Reported margins expanded by 22bps sequentially on a low base.

Operating expenses were elevated at ~Rs7.9bn (+6% QoQ/+30.4% YoY) on account of higher employee benefit expenses (+6.3% QoQ/+30.7% YoY) and other expenses (+6% QoQ/+32.9% YoY). Opex-to-AUM stood at ~3.7% (Q3: 3.3%). Operating expenses are expected to remain elevated with LTFH continuing to invest in technology to achieve its aim of being a fintech at scale.

Overall, credit costs (adjusted for one-time wholesale finance provision in Q3) declined by ~40bps QoQ to ~2.5%. Retail asset quality was broadly stable QoQ, with GS3 and NS3 down 6bps and 2bps, respectively, at 3.41% and 0.71%. PCR stood at 79.72%. On the wholesale front, the sharp run down resulted in GS3 rising by 319bps QoQ to 8.38%. PCR rose to 55.72% from 36.13% QoQ, as LTFH increased provisions on an asset in stage 3. As a result, NS3 rose 52bps QoQ to 3.89%. LTFH holds overlays of Rs11.7bn.

An AIF held by a subsidiary of LTFH (~55% share) suffered a loss during Q4FY23 on account of mark-to-market adjustment of investments held by it. As a result, a loss of ~Rs0.84bn was added back to LTFH's income statement for the quarter.

**Management guidance:** 1) Over 90% retail share in AUM by FY24. 2) CoF to rise by 30-40bps over the next few quarters. 3) FY24 AUM growth to be >25%. 4) Credit cost + opex (currently ~8%) is expected to moderate to ~7% over the next few years. 5) Retail RoA of 2.8-3% by FY26E. 6) Retail GS3 <3% and NS3 <1%. 7) Retail NIM + Fees.

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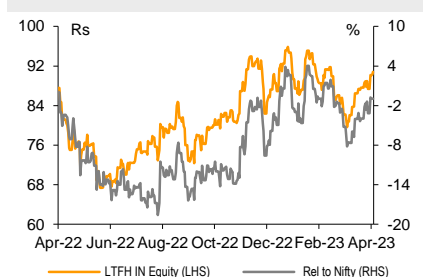
Target Price – 12M	Mar-24
Change in TP (%)	NA
Current Reco.	BUY
Previous Reco.	
Upside/(Downside) (%)	35.2
CMP (28-Apr-23) (Rs)	92.5

Stock Data	Ticker
52-week High (Rs)	98
52-week Low (Rs)	66
Shares outstanding (mn)	2,479.7
Market-cap (Rs bn)	229
Market-cap (USD mn)	2,800
Net-debt, FY24E (Rs mn)	10,986
ADTV-3M (mn shares)	4
ADTV-3M (Rs mn)	380.9
ADTV-3M (USD mn)	4.7
Free float (%)	33.9
Nifty-50	18,148
INR/USD	81.9
<b>Shareholding, Mar-23</b>	
Promoters (%)	66.1
FPIs/MFs (%)	11.4/6.6

## Price Performance

(%)	1M	3M	12M
Absolute	12.7	6.8	9.1
Rel. to Nifty	7.8	3.6	2.9

## 1-Year share price trend (Rs)



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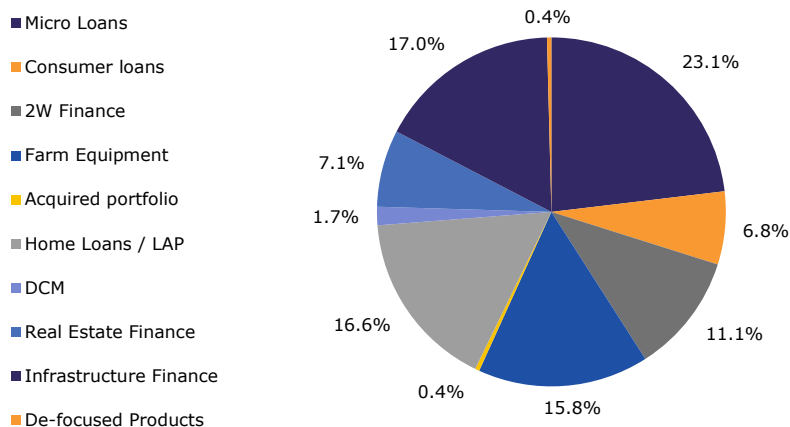
**Our forecasts:** We have built in an overall disbursement CAGR of ~23% over FY22-26E, with LTFH moving rapidly towards becoming a retail NBFC and given the accompanying sharp run-down of the wholesale finance portfolio to accomplish its 'Lakshya 2026' goals. We expect retail disbursements to post a ~35% CAGR over the same period. One of the key pillars of the 'Lakshya' strategy was to achieve >80% retailization by FY26. As of Q4FY23, LTFH has achieved ~76% retail share of AUM. Management expects the retail share to be >90% by FY24. We have built in overall AUM CAGR of ~11% over FY22-26E, with retail AUM registering a ~30% CAGR and its share at ~98% as of FY26.

We expect average calculated NIM + Fees of ~10.1% over FY24-26E, with the retailization journey well underway and LTFH expected to obtain a corporate agency license in Q1FY24, which would enable it to sell insurance products to non-customers, thereby boosting fee income. We expect opex-to-AUM to average ~3.8% over FY24-26E from ~3.3% in FY23, with LTFH expected to continue to have elevated operating expenses on account of one-time amnesty scheme and IT investments. As the share of retail loans increases, we expect overall stage-3 PCR to rise to ~76% by FY26E from ~69.3% in FY23E, with GS3 at ~3% and NS3 at ~0.8%. Post the elevated credit costs in FY23 on account of one-time provisions made in wholesale finance using gains from the sale of L&T Investment Management, we expect credit costs to rise ~30bps over FY24-26E from ~2.4% to ~2.7%. Thus, we expect a PAT CAGR of ~28% over FY23-26E for FY26E RoA of ~2.3% and RoE of ~12.4%.

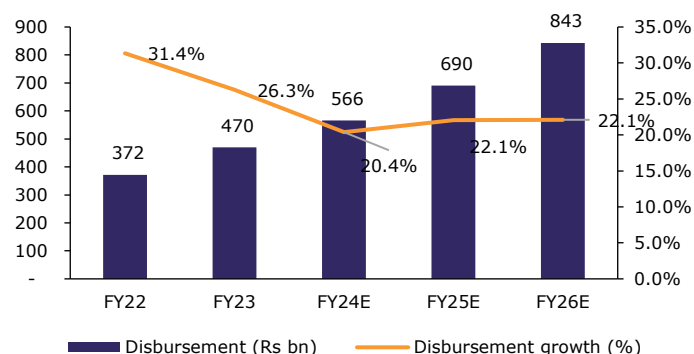
### Exhibit 1: Summary Financials

Particulars (Rs mn)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	% yoy	% qoq	FY23	FY24E	% yoy
Income from operations	29,188	29,466	30,862	33,216	32,107	10.0%	-3.3%	1,25,651	1,34,723	7.2%
Interest Expenses	13,923	14,132	14,385	15,007	14,449	3.8%	-3.7%	57,972	61,281	5.7%
Net Interest Income	15,265	15,334	16,477	18,209	17,658	15.7%	-3.0%	67,679	73,442	8.5%
Other Income	1,484	1,892	1,712	28,025	2,068	39.4%	NA	34,759	10,354	-70.2%
Total Income	16,749	17,226	18,189	46,234	19,726	17.8%	NA	1,02,438	83,795	-18.2%
Operating Expenses	6,034	6,169	6,868	7,427	7,870	30.4%	6.0%	28,334	32,950	16.3%
PPoP	10,715	11,057	11,321	38,807	11,857	10.7%	NA	74,104	50,845	-31.4%
Provisions	6,524	7,989	5,765	33,288	5,232	-19.8%	NA	52,276	20,228	-61.3%
Credit costs	3.0%	3.6%	2.6%	2.9%	2.5%	-53bps	-40bps	6.2%	2.4%	-380bps
PBT	4,191	3,068	5,556	5,519	6,624	58.1%	20.0%	21,828	30,617	40.3%
Tax	1,289	851	1,952	990	2,455	90.4%	148.0%	6,463	7,869	21.7%
Tax rate (%)	30.8%	27.7%	35.1%	17.9%	37.1%			29.6%	25.7%	
Profit after tax	2,902	2,217	3,603	4,529	4,169	43.7%	-7.9%	15,365	22,748	48.1%
Share of profit from associates/MI	521	405	461	8	842			868	200	
PAT adjusting for one offs	3,422	2,621	4,064	4,537	5,011	46.4%	10.4%	16,232	22,948	41.4%
AUM	8,83,410	8,80,780	9,00,980	8,84,270	8,08,930	3.4%	-1.9%	8,08,930	8,91,681	10.2%
Disbursement	1,47,320	1,04,630	1,10,490	1,31,570	1,23,100	32.8%	19.1%	4,69,790	5,65,580	20.4%
GS3 (%)	4.1%	4.1%	4.0%	4.2%	4.7%	66bps	53bps	4.7%	4.4%	-34bps
NS3 (%)	2.0%	1.9%	1.9%	1.7%	1.5%	-47bps	-21bps	1.5%	1.3%	-18bps
PCR (%)	52.6%	55.3%	55.0%	60.1%	69.3%	1662bps	920bps	69.3%	72.0%	274bps

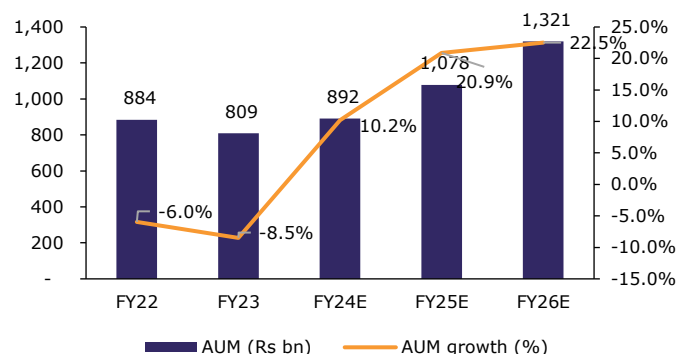
Source: Company, Emkay Research

**Exhibit 2: AUM mix at 76% retail and 24% wholesale**

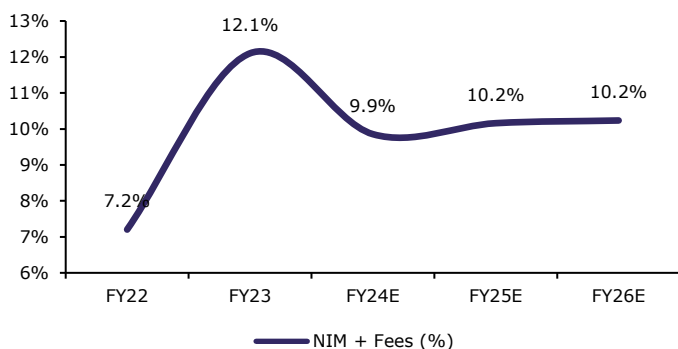
Source: Company, Emkay Research

**Exhibit 3: Retailization to drive disbursement CAGR of ~23% over FY22-26E...**

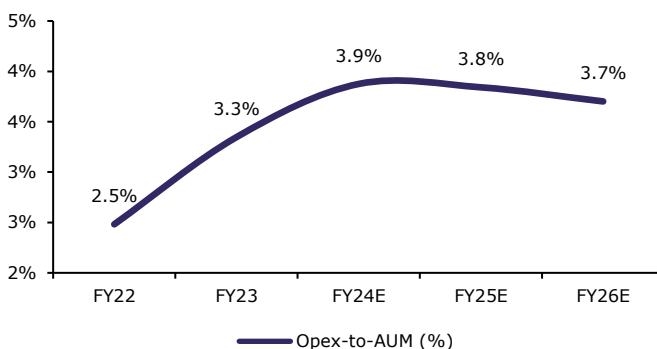
Source: Company, Emkay Research

**Exhibit 4: ....resulting in AUM CAGR of ~11% over the same period**

Source: Company, Emkay Research

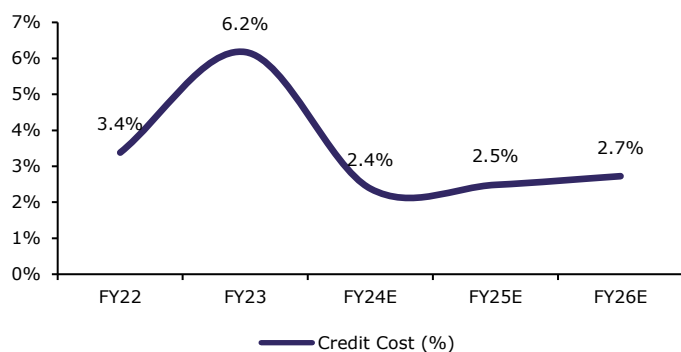
**Exhibit 5: Higher-yielding retail products to drive NIM + Fees of ~10.1% in FY24-26E post sharp wholesale book run down in FY23**

Source: Company, Emkay Research

**Exhibit 6: Continued investments in tech to keep opex-to-AUM elevated**

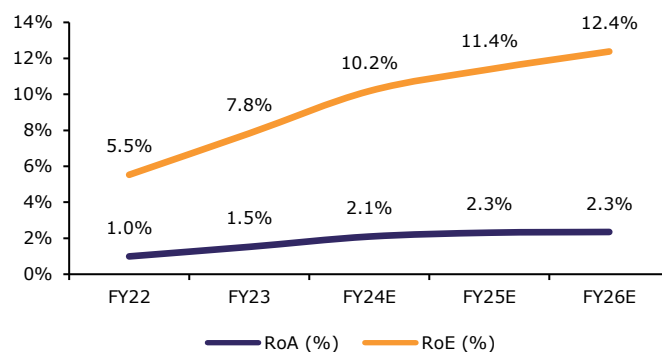
Source: Company, Emkay Research

**Exhibit 7: Post one-time impact of LTIM gain being taken as provisions in FY23, we expect average credit costs of ~2.5% in FY24-27E**



Source: Company, Emkay Research

**Exhibit 8: We, thus, expect ~2.3% RoA in FY26E, translating into RoE of ~12.4%**



Source: Company, Emkay Research

## Concall Highlights

- LTFH acquired >3mn customers in FY23 in the rural business finance segment.
- In urban finance, the focus is on the geographic expansion of existing products while increasing market share. The company wants to deepen its channel presence further and improve book quality.
- For real estate finance, the private equity seal for the sale of a part of the portfolio did not get regulatory approval.
- The share of retail by FY24 in the book should be >90%.
- No substantial provisions in wholesale finance are expected. Only some interest income reversals may be seen due to GS3 treatment under Ind AS.
- With respect to the proposal for the merger of LTFH and its subsidiaries into a single entity, the RBI and the stock exchanges have given final approval, whereas SEBI has given in-principal approval. The request has been filed with NCLT Mumbai and will soon be filed with NCLT Calcutta. The merger is expected to be completed by Q3FY24. The merger will reduce capital and liquidity constraints and allow LTFH to increase dividends.
- CoF is expected to rise by 30-40bps over the next couple of quarters.
- Some opex elevation will be seen due to one-time amnesty scheme and IT investments.
- One out of every three loans is given to existing customers. LTFH is already at four products per customer, where 1.4 are loan products and 2.6 are insurance products. A shift in loan products towards 1.7 would have a sizeable impact.
- LTFH is expected to obtain a corporate agency license in Q1FY24 and will then be able to sell insurance products to non-customers as well.
- 42% of servicing is done via the *planet* app and 71% of the overall servicing is done digitally. More of the D2C journey (such as two-wheeler that is already introduced on *planet* app) is on the way.
- In micro loans, >90 dpd loans are nearly 100% provided for.
- Credit cost + opex is 8% currently and will moderate to 7% over the next few years.
- Collections are entirely in-house, while repossessions are outsourced for certain products. Currently, 27,000 employees are on the field for collections.
- 20% of the disbursements in rural business finance qualify for microfinance (<Rs0.3mn annual family income).
- LTFH has not raised rates in microfinance and has just recently raised rates moderately in the two-wheeler segment.

## L&T Finance Holdings: Consolidated Financials and Valuations

### Profit and Loss

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	1,17,042	1,25,651	1,34,723	1,58,984	1,94,811
Interest Expense	57,538	57,972	61,281	71,491	87,401
<b>Net interest income</b>	<b>59,504</b>	<b>67,679</b>	<b>73,442</b>	<b>87,492</b>	<b>1,07,410</b>
NII growth (%)	0.8	13.7	8.5	19.1	22.8
Non-interest income	6,194	34,759	10,354	12,559	15,332
<b>Total income</b>	<b>65,698</b>	<b>1,02,438</b>	<b>83,795</b>	<b>1,00,051</b>	<b>1,22,742</b>
Operating expenses	22,636	28,334	32,950	37,832	44,393
<b>PPOP</b>	<b>43,061</b>	<b>74,104</b>	<b>50,845</b>	<b>62,220</b>	<b>78,349</b>
PPOP growth (%)	(12.2)	72.1	(31.4)	22.4	25.9
Provisions & contingencies	30,833	52,276	20,228	24,466	32,686
<b>PBT</b>	<b>12,229</b>	<b>21,828</b>	<b>30,617</b>	<b>37,754</b>	<b>45,663</b>
Extraordinary items	0	0	0	0	0
Tax expense	3,736	6,463	7,869	9,703	11,735
Minority interest	209	868	200	200	200
Income from JV/Associates	2,000	0	0	0	0
<b>Reported PAT</b>	<b>10,701</b>	<b>16,232</b>	<b>22,948</b>	<b>28,251</b>	<b>34,128</b>
PAT growth (%)	10.2	51.7	41.4	23.1	20.8
<b>Adjusted PAT</b>	<b>10,701</b>	<b>16,232</b>	<b>22,948</b>	<b>28,251</b>	<b>34,128</b>
<b>Diluted EPS (Rs)</b>	<b>4.3</b>	<b>6.5</b>	<b>9.3</b>	<b>11.4</b>	<b>13.7</b>
Diluted EPS growth (%)	(3.5)	51.4	41.2	23.1	20.8
<b>DPS (Rs)</b>	<b>0.5</b>	<b>0.8</b>	<b>1.1</b>	<b>1.3</b>	<b>1.6</b>
<b>Dividend payout (%)</b>	<b>11.6</b>	<b>11.6</b>	<b>11.6</b>	<b>11.6</b>	<b>11.6</b>
Effective tax rate (%)	30.6	29.6	25.7	25.7	25.7
Net interest margins (%)	7.2	12.1	9.9	10.2	10.2
Cost-income ratio (%)	34.5	27.7	39.3	37.8	36.2
PAT/PPOP (%)	24.9	21.9	45.1	45.4	43.6
Shares outstanding (mn)	2,474.0	2,479.7	2,479.7	2,479.7	2,479.7

Source: Company, Emkay Research

### Asset quality and other metrics

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
<b>Asset quality</b>					
GNPL - Stage 3	35,430	38,320	39,234	38,804	39,620
NNPL - Stage 3	16,780	11,780	10,986	10,089	9,509
GNPL ratio - Stage 3 (%)	4.1	4.7	4.4	3.6	3.0
NNPL ratio - Stage 3 (%)	2.0	1.5	1.3	1.0	0.8
ECL coverage - Stage 3 (%)	52.6	69.3	72.0	74.0	76.0
ECL coverage - 1 & 2 (%)	3.0	3.9	4.5	4.8	5.2
Gross slippage - Stage 3	NA	NA	NA	NA	NA
Gross slippage ratio (%)	NA	NA	NA	NA	NA
Write-off ratio (%)	0.3	0.4	0.7	0.8	0.8
Total credit costs (%)	3.4	6.2	2.4	2.5	2.7
NNPA to net-worth (%)	8.4	5.5	4.7	3.9	3.3
<b>Capital adequacy</b>					
Total CAR (%)	22.9	24.5	23.9	22.8	21.3
Tier-1 (%)	19.7	22.1	21.5	20.4	18.9
<b>Miscellaneous</b>					
Total income growth (%)	(4.5)	55.9	(18.2)	19.4	22.7
Opex growth (%)	14.6	25.2	16.3	14.8	17.3
PPOP margin (%)	4.7	8.8	6.0	6.3	6.5
Credit costs-to-PPOP (%)	71.6	70.5	39.8	39.3	41.7
Loan-to-Assets (%)	77.1	70.7	73.1	75.8	77.2
Yield on loans (%)	12.8	14.8	15.8	16.1	16.2
Cost of funds (%)	6.6	6.9	7.2	7.5	7.6
Spread (%)	6.2	8.0	8.7	8.7	8.7

Source: Company, Emkay Research

### Balance Sheet

Y/E March (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	24,740	24,797	24,797	24,797	24,797
Reserves & surplus	1,74,737	1,90,487	2,10,783	2,35,768	2,65,951
<b>Net worth</b>	<b>1,99,477</b>	<b>2,15,284</b>	<b>2,35,579</b>	<b>2,60,565</b>	<b>2,90,748</b>
<b>Borrowings</b>	<b>8,52,012</b>	<b>8,30,435</b>	<b>8,73,847</b>	<b>10,34,771</b>	<b>12,67,837</b>
<b>Other liabilities &amp; prov.</b>	<b>17,532</b>	<b>17,903</b>	<b>19,620</b>	<b>23,347</b>	<b>27,816</b>
<b>Total liabilities &amp; equity</b>	<b>10,69,022</b>	<b>10,63,621</b>	<b>11,29,047</b>	<b>13,18,682</b>	<b>15,86,400</b>
Net loans	8,24,694	7,51,546	8,25,072	9,99,295	12,23,938
Investments	1,22,411	1,46,777	1,44,185	1,44,868	1,52,140
Cash, other balances	79,704	1,27,489	1,18,283	1,28,289	1,58,371
<b>Interest earning assets</b>	<b>10,26,810</b>	<b>10,25,812</b>	<b>10,87,540</b>	<b>12,72,452</b>	<b>15,34,450</b>
Fixed assets	1,930	2,324	2,673	3,208	3,849
Other assets	40,282	35,486	38,834	43,023	48,102
<b>Total assets</b>	<b>10,69,022</b>	<b>10,63,621</b>	<b>11,29,047</b>	<b>13,18,682</b>	<b>15,86,400</b>
BVPS (Rs)	80.5	86.7	94.7	104.8	116.9
Adj. BVPS (INR)	80.5	86.7	94.7	104.8	116.9
Gross loans	8,84,020	8,08,930	8,91,681	10,77,886	13,20,664
<b>Total AUM</b>	<b>8,84,020</b>	<b>8,08,930</b>	<b>8,91,681</b>	<b>10,77,886</b>	<b>13,20,664</b>
On balance sheet	NA	NA	NA	NA	NA
Off balance sheet	NA	NA	NA	NA	NA
Disbursements	3,72,040	4,69,790	5,65,580	6,90,316	8,42,912
Disbursements growth (%)	31.4	26.3	20.4	22.1	22.1
Loan growth (%)	(5.2)	(8.9)	9.8	21.1	22.5
AUM growth (%)	(6.0)	(8.5)	10.2	20.9	22.5
Borrowings growth (%)	(3.8)	(2.5)	5.2	18.4	22.5
Book value growth (%)	(7.0)	7.7	9.3	10.6	11.6

Source: Company, Emkay Research

### Valuations and Key Ratios

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	21.9	14.5	10.3	8.3	6.9
P/B (x)	1.2	1.1	1.0	0.9	0.8
P/ABV (x)	1.2	1.1	1.0	0.9	0.8
P/PPOP (x)	5.4	3.2	4.6	3.8	3.0
Dividend yield (%)	0.5	0.8	1.2	1.4	1.7
<b>DuPont-RoE split (%)</b>					
NII/Avg AUM	6.5	8.0	8.6	8.9	9.0
Other income	0.7	4.1	1.2	1.3	1.3
Securitization income	0.0	0.0	0.0	0.0	0.0
Opex	1.3	1.7	1.9	1.9	1.8
Employee expense	1.2	1.7	2.0	1.9	1.9
<b>PPOP</b>	<b>4.7</b>	<b>8.8</b>	<b>6.0</b>	<b>6.3</b>	<b>6.5</b>
Provisions	3.4	6.2	2.4	2.5	2.7
Tax expense	0.4	0.8	0.9	1.0	1.0
<b>RoAUM (%)</b>	<b>1.2</b>	<b>1.9</b>	<b>2.7</b>	<b>2.9</b>	<b>2.8</b>
Leverage ratio (x)	4.7	4.1	3.8	4.0	4.4
<b>RoE (%)</b>	<b>5.5</b>	<b>7.8</b>	<b>10.2</b>	<b>11.4</b>	<b>12.4</b>

### Quarterly data

Rs mn, Y/E March	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
NII	15,265	15,334	16,477	18,209	17,658
NIM (%)	7.7	7.8	8.2	8.9	9.3
PPOP	10,715	11,057	11,321	38,807	11,857
PAT	3,422	2,621	4,064	4,537	5,011
EPS (Rs)	1.39	1.07	1.64	1.83	2.02

Source: Company, Emkay Research

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