Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

L&T Finance Holdings Ltd

Retail continues to grow strongly

NBFC	Sharekhan code: L&TFH
Reco/View: Buy ↔	CMP: Rs. 131 / Price Target: Rs. 155 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- LTFH's legacy wholesale book has been running down faster, and a favourable cycle is helping its retail business to grow rapidly.
- The wholesale book declined by 65% y-o-y and 28% q-o-q due to a larger sell-down/prepayment. The retail book grew by 34% y-o-y/5% q-o-q. Share of retail assets rose to 82% of loan book vs. 75% q-o-q.
- The company is looking to run down a majority of the wholesale book by the end of FY2024E. Thus, the diminishing wholesale book will constrain net loan growth and RoE in FY2024; however, from FY2025, growth in retail franchise would uplift loan growth and RoE.
- We maintain our Buy rating with a revised PT of Rs. 155. At the CMP, the stock trades at 1.4x/1.2x its FY2024E/FY2025E BV.

L&T Finance Holdings Limited's (LTFH) core retail business performance remained strong capitalising on strong macro, driven by healthy retail assets growth, better margins, and lower credit cost, which translated into RoA for the retail segment over ~3% vs. 2.5% in FY2023; however, the wholesale book's performance continued to overshadow the overall performance. Net interest income (NII) grew by 14% y-o-y/down 1% q-o-q. Net interest margin (NIM) (calculated) improved by 47 bps q-o-q to 8.81% vs. 8.34%. Although funding cost was marginally higher by 6 bps q-o-q, the increasing share of retail assets led to NIM expansion. Total operating expenses were up 18% y-o-y/down 1% q-o-q, mainly led by continued investments in technology. Thus, operating profit grew by ~7% y-o-y/down 3% q-o-q. Annualised credit cost (as a percentage of average loans) was reported at 2.6% vs. 2.5% q-o-q. Provisions fell by 35% y-o-y/flat q-o-q. PBT grew strongly by 100% y-o-y/down 4% q-o-q mainly led by lower credit cost. PAT was reported at Rs. 531 crore, up 103% y-o-y/6% q-o-q. Overall, loan book declined by 11% y-o-y/3% q-o-q. Gross stage-3 assets improved to 4.04% vs. 4.74% q-o-q. Net stage-3 assets were also lower at 1.19% vs. 1.51% q-o-q. PCR on Stage-3 assets improved to 71% vs. 69% q-o-q. The securities receipt book currently stands at ~Rs. 6,500 crore and the company expects to recover approximately ~Rs. 2,000 crore by the end of FY2024.

Key positives

- Strong retail assets growth translating into segmental RoA of over ~3%.
- Margins improved sequentially due to a higher retail mix.
- Stable asset-quality trends.

Key negatives

- Diminishing wholesale book is constraining overall loan growth and RoE.

Management Commentary

- The company reiterated its plans to accelerate reduction in the wholesale book through sell downs, repayments, and prepayments. The company also plans to increase the retail mix to ~90% by March 2024 and is confident of sustaining post-tax retail RoA of ~3%.
- The company is focusing on cross-sell/up-sell. The share of cross-sell in disbursement for Q1FY2024 stood at 34%. The company is planning to increase the share to cross-sell/upsell gradually to 40% and then to 50% as acquisition cost and credit cost are significantly lower.
- The corporate agency business lines license is expected to be received in the coming quarter, which is expected to support fee income.

Our Call

Valuation – We maintain our Buy rating with a revised PT of Rs. 155: LTFH is set to primarily transform itself into a retail franchise, which could lead to improvement in overall profitability and return ratio. Management targets to improve the retail mix to ~90% by March 2024, which is expected to be achieved in the next few quarters. We believe the current trend suggests that a majority of the wholesale book would get run down by the end of FY2024 and the market may look through one-time book value adjustment related to estimated write-offs and at the same time some recoveries in the wholesale book for the remaining wholesale book. We estimate a PAT CAGR of 40% over FY2023-FY2025, with consolidated RoA/RoE of ~2.6%/~13% in FY2025.

Key Risks

Slower retail growth and higher-than-anticipated write-off in the wholesale and retail NPL cycle.

Valuation Rs cr

Particulars	FY22	FY23	FY24E	FY25E
NII	5,955	6,768	8,131	9,834
PAT	1,070	1,623	2,680	3,178
EPS (Rs.)	4.3	6.5	10.9	12.9
P/E (x)	30.5	20.2	12.1	10.2
P/BV (x)	1.6	1.5	1.4	1.2
ROA	1.0	1.5	2.3	2.6
ROE (%)	5.4	7.8	11.9	12.6

Source: Company; Sharekhan estimates

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 19.22

Updated Jul 08, 2023

Low Risk

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

Source: Morningstar

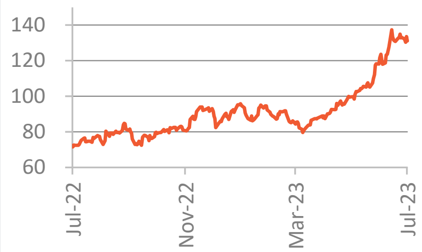
Company details

Market cap:	Rs. 32,553 cr
52-week high/low:	Rs. 140 / 71
NSE volume: (No of shares)	82.7 lakh
BSE code:	533519
NSE code:	L&TFH
Free float: (No of shares)	74.5 cr

Shareholding (%)

Promoters	66.1
FII	13.9
DII	5.3
Others	14.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.4	47.2	37.9	81.9
Relative to Sensex	0.8	34.4	26.5	56.3

Sharekhan Research, Bloomberg

Key result highlights

- **NIM outlook:** NII grew by 14% y-o-y/down 1% q-o-q. NIM (calculated) improved by 47 bps q-o-q to 8.81% vs. 8.34%. Although funding cost was marginally higher by 6 bps q-o-q, increasing share of retail assets led to NIM expansion. The increasing share of retail assets could further support NIM, even if funding cost inches higher marginally from here on. The company is guiding for overall (NIM + fee income) ~11.5% vs. ~11% of earlier guidance for the retail business going forward.
- **Asset quality and credit cost:** Overall, gross stage-3 assets were lower at 4.04% vs. 4.74% q-o-q. Net stage-3 assets were also lower at 1.19% vs. 1.51% q-o-q. PCR on stage-3 assets improved to 71% vs. 69% q-o-q. In the retail business, GS-3/NS-3 stood at 3.21%/0.7% vs. 3.41%/0.71% q-o-q, with PCR at 79% vs. 80% q-o-q. The company is guiding for (opex + credit cost) ~7% for the retail business in the near to medium term. Annualised credit cost (as a percentage of average loans) was reported at 2.6% vs. 2.5% q-o-q. Overall asset-quality outlook continues to remain stable to positive for the retail asset portfolio.
- **Overall performance muted driven by wholesale; however, retail grows strongly:** Retail disbursements grew by 25% y-o-y/down 1% q-o-q, capitalising on the strong macros. Overall disbursements grew at a slower pace at 18% y-o-y/flat q-o-q, led by the decline in wholesale disbursements. The company has realigned its strategy by repositioning the portfolio growth from product-based to customer-centric and using deep analytics to understand various nuances like business selection, dealer selection, sale volumes, market positioning in various segments, portfolio vintage including customer behaviour, counter share performance, distribution network, which is positive for the franchise from a medium to long-term perspective. The company is also focusing on cross-sell/ upsell and the share of cross-sell in disbursement for Q1FY2024 stood at 34%. It is planning to increase the share to cross-sell/upsell gradually to 40% and then to 50% as acquisition cost and credit cost are significantly lower. The company reiterated its plans to accelerate reduction in the wholesale book through sell-downs, repayments, and prepayments. The company also plans to increase the retail mix to ~90% by March 2024 and is confident of sustaining post-tax retail RoA of ~3%.
- **Return guidance:** Overall RoA for the whole entity is expected to converge with retail RoA in FY2025.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Q4FY23	YoY	QoQ
Net Interest Income	**1,753**	**1,533**	**1,766**	**14**	**-1**
Fee and Other Income	261	280	291	-7	-10
Total Income	**2,013**	**1,814**	**2,057**	**11**	**-2**
Operating Expenses	778	658	787	18	-1
Operating Profit	**1,235**	**1,156**	**1,270**	**7**	**-3**
Provisions	521	799	523	-35	-0
PBT	**714**	**357**	**747**	**100**	**-4**
Tax	183	95	246	93	-25
PAT	**531**	**262**	**501**	**103**	**6**
AUM	**78,566**	**88,078**	**80,893**	**-11**	**-3**
Disbursements					
Retail	11,193	8,938	11,282	25	-1
Wholesale	1,172	1,522	1,028	-23	14
Total	12,365	10,460	12,310	18	0
Retail book	64,274	47,794	61,053	34	5
Wholesale book	14,035	39,795	19,512	-65	-28
Total Focused Book	**78,309**	**87,589**	**80,565**	**-11**	**-3**
Defocused book	257	489	328	-47	-22
Total book	**78,566**	**88,078**	**80,893**	**-11**	**-3**
Mix					
Retail book	82%	55%	76%		
Wholesale book	18%	45%	24%		
Asset Quality Metrics					
Gross Stage 3 Assets	3,172	3,559	3,832		
Net Stage 3 Assets	907	1,591	1,178		
Gross Stage 3 Assets	4.04%	4.08%	4.74%		
Net Stage 3 Assets	1.19%	1.87%	1.51%		
PCR	71%	55%	69%		
Retail asset quality metrics					
Gross Stage 3 Assets	2,063	1,727	2,081		
Net Stage 3 Assets	437	433	421		
Gross Stage 3 Assets	3.21%	3.61%	3.41%		
Net Stage 3 Assets	0.70%	0.93%	0.71%		
PCR	79%	75%	80%		
Wholesale asset quality metrics					
Gross Stage 3 Assets	1,065	1,825	1,635		
Net Stage 3 Assets	469	1,157	724		
Gross Stage 3 Assets	7.58%	4.69%	8.38%		
Net Stage 3 Assets	3.49%	3.03%	3.89%		
PCR	56%	37%	56%		

Source: Company data, Sharekhan Research

Outlook and Valuation

■ Sector View – Retail credit demand continues to exhibit strong trends

Retail credit growth continues to remain robust. Demand across retail assets has accelerated and asset-quality trends are also stable, given the favourable cycle. NBFCs having a diverse product offering, strong ALM management, robust liquidity buffers, strong risk management framework, healthy liability franchise, and well-capitalised balance sheet are well poised for growth.

■ Company Outlook – Improving business outlook

LTFH is set to primarily transform itself into a retail franchise, which could lead to improvement in overall profitability and return ratio. The company is realigning its strategy by repositioning its portfolio growth from product-based to customer-centric, focusing on cross-selling, up-selling along with using deep analytics to understand various nuances like business selection, dealer selection, sale volumes, market positioning in various segments, portfolio vintage including customer behaviour, counter share performance, and distribution network, which are key positives. The current collection trends are appearing strong; and overall, the retail asset-quality outlook continues to remain stable to positive.

■ Valuation – We maintain our Buy rating with a revised PT of Rs. 155

LTFH is set to primarily transform itself into a retail franchise, which could lead to improvement in overall profitability and return ratio. Management targets to improve the retail mix to ~90% by March 2024, which is expected to be achieved in the next few quarters. We believe the current trend suggests that a majority of the wholesale book would get run down by the end of FY2024 and the market may look through one-time book value adjustment related to estimated write-offs and at the same time some recoveries in the wholesale book for the remaining wholesale book. We estimate a PAT CAGR of 40% over FY2023-FY2025, with consolidated RoA/RoE of ~2.6%/~13% in FY2025.Peer valuation

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
L&T Finance Holdings	131	32,553	12.1	10.2	1.4	1.2	11.9	12.6	2.3	2.6
M&M Finance	321	39,661	13.3	12.0	2.1	1.8	12.7	12.7	2.3	2.3

Source: Company, Sharekhan Research

About the company

LTFH is one of the leading non-banking financial companies (NBFCs) in India. LTFH has strategically re-aligned its business mix towards retail. The company lends across 2W finance, tractor finance, microfinance, home loans/LAP, farm equipment, consumer loans, SME loans etc. The company is rated AAA by CARE, ICRA, CRISIL, and India Ratings.

Investment theme

LTFH has strategically re-aligned its business mix towards retail. Benefitting from a strong parentage, the company has access to funds at competitive rates. Accelerating retail growth will support earnings going forward.

Key Risks

Slower retail growth and higher-than-anticipated write-off in wholesale and retail NPL cycle.

Additional Data

Key management personnel

Mr. Dinanath Dubhashi	Managing Director and Chief Executive Officer
Mr. Sudipta Roy	Chief Operating Officer
Mr. Sachinn Joshi	Group - Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Larsen & Toubro Ltd.	66.0
2	Citigroup Global Markets Mauritius	3.9
3	BC ASIA GROWTH INVESTMENTS	2.7
4	BC ASIA GROWTH INV	2.7
5	BNP Paribas SA	2.3
6	Aryaman Capital Markets Ltd.	2.3
7	ICICI Prudential Life Insurance Co	2.0
8	Life Insurance Corp of India	2.0
9	BC INVESTMENTS LTD.	1.4
10	BC Asia Investments VII Ltd.	1.4

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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