

July 07, 2017

L&T Finance Holdings Ltd

Prudent downsizing for attractive business revival

L&T Finance Holdings Ltd (LTFH), promoted by L&T Ltd (64.2%) is a leading NBFC with a diversified lending portfolio. Over the last one year the management has restructured its business model and is focusing on selective segments where it has competitive advantage, simultaneously downsizing some products which were making losses.

Range of offerings across diversified book: LTFH's lending operations are focused on three primary segments viz. Rural 15% (Micro Finance, 2Wheeler & Tractors), Housing 19% (Home Loans, LAP & Builder loans) and Wholesale finance 62% (Renewable Energy, Operating Roads, etc.) of loan book. While the above segments will be the growth drivers, the management has started downsizing unattractive range of products.

Loan growth to remain fairly strong: We expect MFI, 2W and Tractor loans to report 25%/20%/10% CAGR over FY2017-20E respectively. LTFH has been gaining market share in the Tractor segment (9.5% in 2HFY2017 v/s. 4.5% in 1HFY2017) and expects to achieve double digit over next one year. The home loan segment is expected to grow at 30% CAGR, while wholesale loan book by 11% over the same period. The management intends to undertake sale down of assets post origination, which will release capital in addition to strong fee income.

Credit cost should moderate going ahead: LTFH has provided ₹1,150cr on its impaired assets and additional ₹650cr is to be provided. However, there is goodwill on consolidation of its subsidiaries, hence the company will claim tax benefit on amortization of the same, which will be used for making additional provisions, thus, overall credit cost will remain moderate.

Exiting of loss making business to revive ROE: LTFH has restructured some business segments and has been downsizing range of products which were loss making. However, as management intends to completely exit the defocused products, its impact is unlikely to be there from FY19 onwards, this together with favorable change in loan book and resultant NIM should propel the ROE to 17.9% by FY20 from 13.8% in FY17.

Ability to generate strong fee income will support earnings: LTFH has been a leader in lending to renewable energy sector and it intends to capitalize on its expertise of loan origination and subsequently selling it to other financial institutions for fee income. We expect fee income to grow by 30% CAGR over FY2017-20 and this should support a 24% PAT CAGR over the same period.

Outlook & Valuation: As LTFH operates in multiple segments, we have valued it based on SOTP. We have valued the rural finance segment at 2.5x, while the housing finance and wholesale finance has been valued at 3x and 2x its FY2020E BV each. LTFH's AMC arm, L&T MF has been valued at 5% of average AUM. **Accordingly, we have arrived at a fair value of ₹179 based on SOTP, and hence recommend BUY on the stock.**

Key financials (Consolidated)

Y/E March (₹ cr)	FY2016	FY2017	FY2018E	FY2019E	FY2020E
Nil	3,165	3,714	4,006	4,552	5,181
% chg	20.4	17.3	7.9	13.6	13.8
Net profit	854	1,043	1,210	1,520	2,006
% chg	20.8	22.1	16.1	25.6	32.0
NIM (%)	6.0	6.1	5.6	5.5	5.4
EPS (₹)	4.9	5.9	6.9	8.7	11.4
P/E (x)	30.4	24.9	21.5	17.1	12.9
P/BV (x)	3.6	3.3	2.8	2.5	2.2
RoA (%)	1.6	1.7	1.7	1.9	2.1
RoE (%)	11.9	13.8	14.1	15.5	17.9

Source: Company, Angel Research; Note: CMP as of July 06, 2017

BUY

CMP	₹149
Target Price	₹179

Investment Period 12 Months

Sector	NBFC
Market Cap (₹ cr)	27,181
Beta	1.8
52 Week High / Low	151/74
Avg. Daily Volume	37,68,991
Face Value (₹)	10
BSE Sensex	31,369
Nifty	9,675
Reuters Code	LTFH.NS
Bloomberg Code	LTFH.IN

Shareholding Pattern (%)

Promoters	64.2
MF / Banks / Indian FIs	8.3
FII / NRIs / OCBs	16.6
Indian Public / Others	10.9

Abs.(%)	3m	1yr	3yr
Sensex	4.2	16.2	15.0
L&T Fin	20.2	63.7	93.5

3-year price chart



Source: Company, Angel Research

Siddharth Purohit

022 - 3935 7800 Ext: 6872

siddharth.purohit@angelbroking.com

Company Background:

L&T Finance Holdings Ltd, promoted by L&T Ltd (holds 64.2%) is a leading NBFC with a diversified lending portfolio. The NBFC had built a line of multiple product portfolios, however some of the segments where it didn't have significant presence, and was facing severe competition started making losses, and hence, the management decided to restructure its business model by downsizing the low profit/ loss making segments. Going ahead, the management intends to focus only on three segments i.e. Rural Finance, Housing Finance and Wholesale Finance. The defocused loan book as % of total loan book has already been brought down to 4% from 8.5%, and we expect that by FY2018 it will be insignificant compared to the total loan book.

Exhibit 1: Transition towards a more focussed organisation

BEFORE STRATEGY – LTFH 1.0	AFTER STRATEGY – LTFH 2.0
Aspirations of Bank	Aspirations of becoming top quartile NBFC
No RoE focus	Sole objective is RoE focus -18%
Doing 21 products	Doing 7 products in a focused manner
Doing business through 7 lending entities	Doing business through 4 lending entities and shrinking further
Focused on growing book	Focused on increasing fees along with disbursements Down selling book
Falling short of provisions	Focused on insulating Balance sheet through proactive provisioning
Cost to Income highest at 33%	Cost to Income reduced to 26%

Source: Company, Angel Research

Key Management Personnel:

Mr Dinanath Dubhashi – Managing Director & CEO. He has over 26 years of experience in the BFSI space involving Corporate Banking, Cash Management, Credit Ratings, Retail Lending and Rural Finance. He has been associated with reputed organizations like BNP Paribas, SBI Caps and CARE.

Mr Kailash Kulkani – Chief Executive, Investment Management. He has over 26 years of experience having worked for organizations like Kotak Mahindra AMC, Met Life and ICICI.

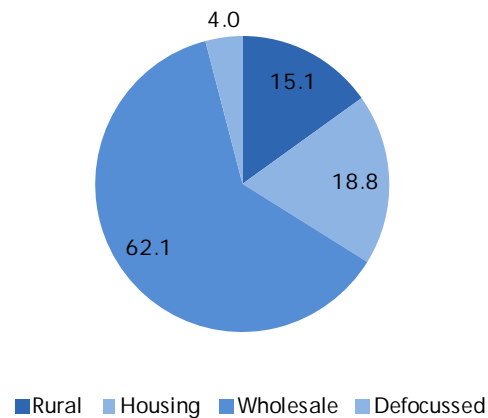
Mr Sunil Prabhune – Chief Executive, Rural and Consumer Lending. He has over 8 years of experience, having worked with ICICI Bank, GE and ICI.

Mr Virender Pankaj – Chief Executive, Wholesale. He has over 25 years of experience in the banking space and has worked with SBI.

Mr Srikant J – Chief Executive. He has over 20 years of experience and has worked with BNP Paribas and Commerz Bank AG.

Transition towards a more balanced portfolio of products and reducing exposure in loss making segments: LTFH had aspired to become a bank and accordingly had expanded to as high as 21 products. In some of the segments it was a marginal player, while the cost associated with those businesses was very high, and hence, those segments were losing money. However, as a change of strategy the organization has been focusing only on selective 7 products and the key parameters for getting into any business will be the ability to generate strong RoE.

Exhibit 2: Loan Book Composition FY2017 (%)



Source: Company, Angel Research

Exhibit 3: Loan Book Composition (` Cr)

Segmental Loan Book	FY16	FY17	FY18E	FY19E	FY20E
Rural	8,644	10,041	12,051	14,226	17,077
Housing	9,811	12,534	15,667	19,584	24,480
Wholesale	34,870	41,403	47,200	51,920	57,112
Defocused	4,931	2,671	1,335	668	334
Total	58,256	66,648	76,253	86,398	99,002
Segmental Contribution					
Rural	14.8	15.1	15.8	16.5	17.2
Housing	16.8	18.8	20.5	22.7	24.7
Wholesale	59.9	62.1	61.9	60.1	57.7
Defocused	8.5	4.0	1.8	0.8	0.3
Total	100	100	100	100	100

Source: Company, Angel Research

Investment Rationale

Knowledge of rural hinterland coupled with strong OEM and dealer relationship a key strength of LTFH

The rural finance of LTFH is largely focused on three segments viz. Microfinance (MFI), Two Wheeler (2W) & Tractors. Over the years LTFH has developed strong understanding of the rural hinterland, which helps in growing its MFI business. Further, it has developed excellent relationship with all major OEMs and dealers, which has been the key differentiator in market share gain in the 2W and Tractor financing segments. It has also strengthened the collection systems over the years, which is critical as far as long term sustainability of this business is concerned.

Exhibit 4: Rural loan growth product wise

Cr	FY16	FY17	FY18E	FY19E	FY20E
Micro Finance	2,234	3,551	4,439	5,548	6,936
% Change YoY	-	59	25	25	25
2W Finance	1,761	2,110	2,532	3,089	3,800
% Change YoY	-	20	20	22	23
Farm Equipment	4,649	4,379	5,080	5,588	6,342
% Change YoY	-	(6)	16	10	14
Total	8,644	10,041	12,051	14,226	17,077

Source: Company, Angel Research

Microfinance will continue to be a growth driver in rural segment: Microfinance business has been a growth driver for LTFH growing by 59% in FY2017. While there has been some moderation in the last two quarters, we expect MFI book to grow at 25% CAGR over FY2017-20 and account for 41% of the total rural loan book. The company has been quick in adapting to technology for the segment, and has now migrated to 100% cashless and 'Adhar' based disbursements.

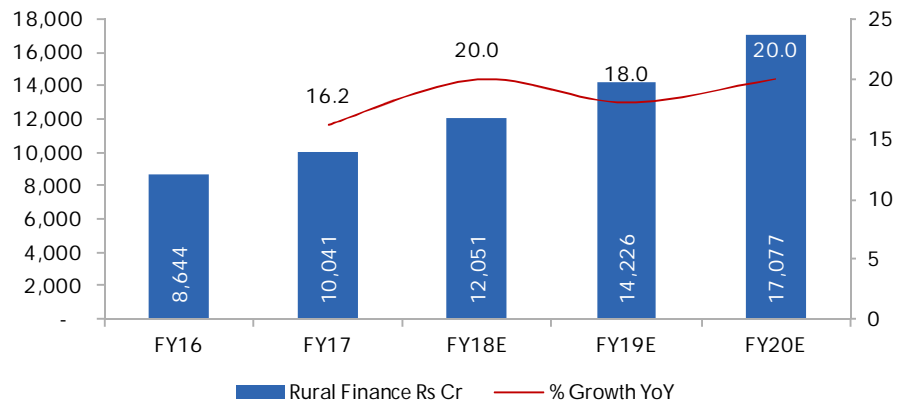
Two Wheelers segment leaves scope for further market share gain: LTFH has adopted technology and algorithm based database, which has resulted in sharp improvement in turnaround time. Ability to take credit call within 10 minutes vis-à-vis few hours has enabled it to grow this book and gain market share. We expect the 2W loans to grow by 20% CAGR over FY2017-20 and account for 23% of the total 2W loan book by FY2020.

Emerging as market leader in the tractor segment: The tractor segment depends a lot on factors like income levels in rural economy, monsoon and also on various program of Government addressing the rural masses. Despite lot of moving factors, LTFH has gained strong market share in tractor financing backed by increasing presence and relationship with dealers of top OEMs. The market share has doubled to 9.5% in 2HFY2017 v/s. 4.5% in 1HFY2017, and the management is confident of having double digit market share in next few quarters.

Rural Finance will continue to be a growth driver

Rural segment will continue to be a key area of focus for LTFH. In FY2017 the company reported 16.2% growth in the rural book. However, the steps taken with regards to adaptation of technology, faster turnaround time and higher presence across dealer network could help in growth rate accelerating in the years to come. We expect 19% CAGR in loan book over FY2017-20.

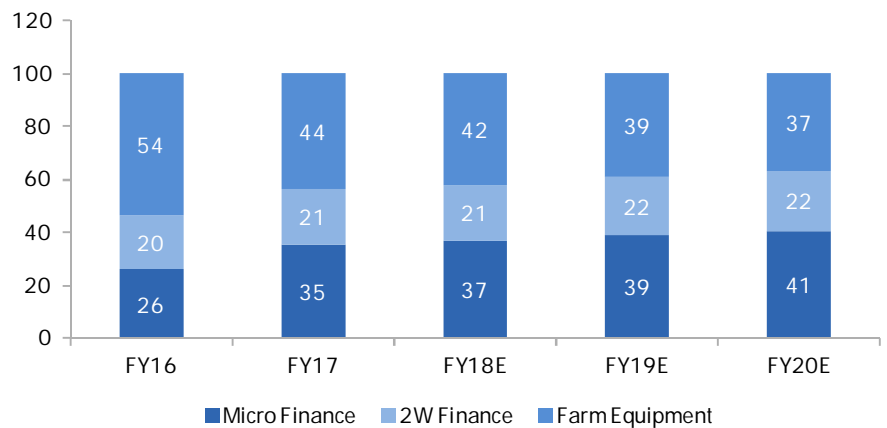
Exhibit 5: Loan Book growth Rural Business (₹ Cr)



Source: Company, Angel Research

The nature of rural business is of higher credit costs, and hence we have factored in 450 bps credit cost, similar to FY2017. However, the higher yield should take care of the credit cost, and despite this the higher operating leverage will ensure ~21% ROE in this business.

Exhibit 6: Rural Loans Composition (%)



Source: Company, Angel Research

Exhibit 7: Income Statement Rural Business

Cr	FY16	FY17	FY18E	FY19E	FY20E
Interest Income	1,589	1,823	2,164	2,521	2,964
Interest Cost	611	682	839	946	1,100
Net Interest Income	979	1,141	1,324	1,575	1,864
Fee Income & Other income	70	86	99	114	131
Total Income	1,049	1,227	1,423	1,689	1,995
Total Operating Expenses	390	359	370	400	440
PPP	658	867	1,053	1,289	1,555
Provisions, contingencies & w/off	336	425	497	591	704
PBT	323	443	556	698	851
Tax	112	154	189	237	289
PAT	211	289	367	461	562

Source: Company, Angel Research

Exhibit 8: Balance Sheet

Cr	FY16	FY17	FY18E	FY19E	FY20E
Closing Gross Loans & Advances	8,644	10,041	12,051	14,226	17,077
Total Assets	9,152	10,412	12,476	14,726	17,727
Closing Net worth	1,193	1,331	1,698	2,158	2,720
Closing Borrowing	7,329	8,686	10,162	11,890	13,911
Other Liabilities	630	396	616	678	1,096
Total Liabilities	9,152	10,412	12,476	14,726	17,727

Source: Company, Angel Research

Exhibit 9: Key Ratios Rural Business

Key Assumptions	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
Loans	-	16.2	20.0	18.0	20.0
Borrowings	-	18.5	17.0	17.0	17.0
NII	-	16.5	16.1	18.9	18.4
Provisions	-	26.5	17.0	18.9	19.1
PAT	-	37.0	27.2	25.4	22.0
Key Ratios (%)					
Yield on advances	20.3	19.8	19.6	19.2	18.9
Cost of funds	9.2	8.6	8.3	8.0	7.9
NIM%	12.5	12.4	12.0	12.0	11.9
Credit Cost	4.3	4.6	4.5	4.5	4.5
ROA	2.4	2.9	3.0	3.2	3.3
ROE	17.7	21.7	21.6	21.3	20.7

Source: Company, Angel Research

Growth has just begun for Housing Finance segment

LTFH has the potential to become a meaningful player in the housing finance segment in the years to come. Under this segment it lends to individual home loans, Loan Against Property (LAP) and also to developers. The segment grew by 27.8% YoY in FY2017 and accounted for 18.8% of the overall loan book. We expect the overall Housing Finance book to report 30% CAGR over FY2017-20.

Exhibit 10: Segmental Growth Housing Loans

Cr	FY16	FY17	FY18E	FY19E	FY20E
Retail Home Loans / LAP	6,313	7,643	9,936	13,413	17,840
% Change YoY		21.1	30.0	35.0	33.0
Real Estate Finance	3,498	4,891	7,092	8,865	9,929
% Change YoY		39.8	45.0	25.0	12.0
Total	9,811	12,534	17,028	22,278	27,769
% Growth YoY		27.8	35.9	30.8	24.6

Source: Company, Angel Research

Retail home loans/ LAP segment to see further improvement in traction: The retail home loan segment of LTFH caters to both salaried as well non salaried-self employed segments. However, as the margins in salaried segment are relatively lower, hence, in order to improve its overall NIMs, the company intends to increasingly focus more on the non salaried segment, which faces less competition as well as offers better yield. LAP accounts for ~33% of the individual home loans segment.

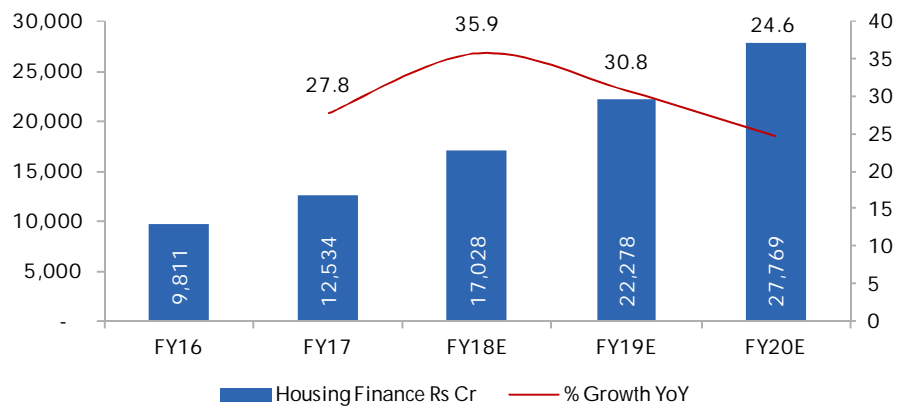
Builder's loan segment could aid higher margins in the Housing Finance segment: In FY2017, the loans book towards developers reported a strong growth of ~40%. In the developer loan segment LTFH will use parent L&T domain expertise, which will be used as the key mover for growing the housing finance space. Currently also, the company is lending only to the Tier 1 builders after doing lot of due diligence. While on one hand, it will lend to the developers, it will also generate leads from the same set of developers for its retail home loans, thus enhancing its cross selling capability.

Higher incremental business from developer loans and self employed segment should be RoE accretive: Generally, the fee income from developer loans are higher compared to other retail loans. Though developer loans will continue to grow at a healthy pace its share in total loans is expected to come down gradually. And as a result of better spread and higher fee income this is likely to result in a sustainable 20% ROE for the segment, despite increasing competition in the retail loans space. Further, in the home loans to the salaried segment, incrementally the company is relying more on its own origin rather than sourcing from DSA, which should result in lower cost.

AUM growth to be higher than industry growth in Housing Finance segment

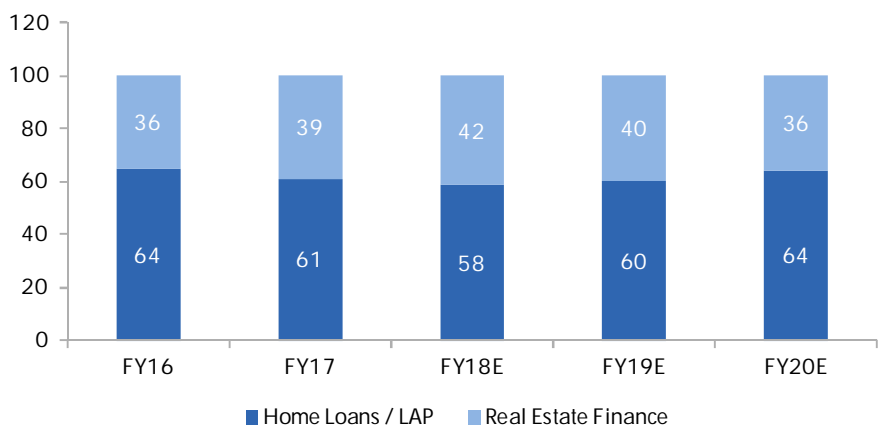
The Housing Finance segment reported a 27.8% growth in AUM in FY2017 and we expect it to report a 30% CAGR over FY2017-20, backed by 26% and 36% growth in Home Loans/ LAP and Developer loan segment respectively. We have factored in a marginally higher credit cost, as the share of loans from the non salaried segment goes up for the segment, and hence expect the PAT CAGR of 25% over the same period.

Exhibit 11: Growth in Housing Finance



Source: Company, Angel Research

Exhibit 12: Loan Bifurcation Housing Finance Segment (%)



Source: Company, Angel Research

Exhibit 13: Income statement Housing Loans

Cr	FY16	FY17	FY18E	FY19E	FY20E
Interest Income	941	1,386	1,733	2,122	2,597
Interest Cost	604	832	1,100	1,332	1,611
Net Interest Income	338	554	633	790	986
Fee Income & Other income	45	90	113	138	168
Total Income	383	644	746	928	1,154
Total Operating Expenses	156	157	173	190	209
PPP	227	487	573	738	945
Provisions, contingencies & w/off	26	68	78	109	143
PBT	201	420	495	628	802
Tax	73	146	168	214	273
PAT	128	274	327	415	529

Source: Company, Angel Research

Exhibit 14: Balance Sheet Housing Finance

Cr	FY16	FY17	FY18E	FY19E	FY20E
Closing Gross Loans & Advances	9,811	12,534	15,667	19,584	24,480
Total Assets	10,615	13,220	16,387	20,334	25,305
Closing Net worth	991	1,363	1,690	2,104	2,634
Closing Borrowing	8,829	11,115	13,782	17,227	21,534
Other Liabilities	1,786	2,106	2,605	3,107	3,771
Total Liabilities	10,615	13,220	16,387	20,334	25,305

Source: Company, Angel Research

Exhibit 15: Key Ratios Housing Finance Business

Key Assumptions	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
Loans	-	27.8	37.0	29.3	25.0
Borrowings	-	25.9	24.0	25.0	25.0
NII	-	64.0	14.2	24.8	24.8
Provisions	-	162.9	14.7	40.9	31.0
PAT	-	113.2	19.5	26.9	27.6
Key Ratios (%)					
Yield on advances	12.2	12.4	12.3	12.0	11.8
Cost of funds	8.8	8.4	8.0	7.7	7.5
NIM%	4.4	5.0	4.5	4.5	4.5
Credit Cost	0.3	0.6	0.6	0.6	0.7
ROA	1.3	2.2	2.1	2.1	2.2
ROE	12.9	20.1	19.3	19.7	20.1

Source: Company, Angel Research

Wholesale finance to generate high fee income

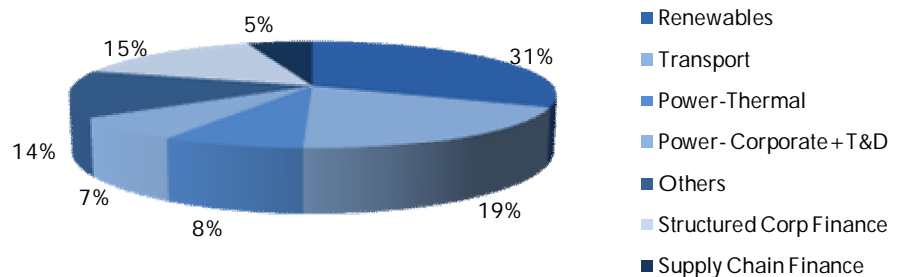
The wholesale finance segment reported a 18.7% growth in AUM in FY2017 and we expect it to report 11% CAGR over FY2017-20. The key strategy in wholesale finance will be to originate the deal and sell the assets to other financial institutions for some fees. LTFH is already a pioneer in lending to the renewable energy sector and intends to capitalize on the domain knowledge it has developed over the years in funding to the new sector where there is limited competition. Further, it also has been financing to operating roads and transmission sectors within the wholesale finance business.

Exhibit 16: Loan Bifurcation – Wholesale Finance

₹ Cr	FY16	FY17	FY18E	FY19E	FY20E
Infrastructure Finance	27,604	32,884	37,134	40,476	44,119
% Growth YoY	-	19.1	12.9	9.0	9.0
Structured Corp Finance	4,979	6,397	7,932	9,281	10,766
% Growth YoY	-	28.5	24.0	17.0	16.0
Supply Chain Finance	2,287	2,123	2,134	2,163	2,227
% Growth YoY	-	(7.2)	0.5	1.4	3.0
Total	34,870	41,404	47,200	51,920	57,112
% Growth YoY	-	18.7	14.0	10.0	10.0

Source: Company, Angel Research

Exhibit 17: Loan Composition of Wholesale Finance

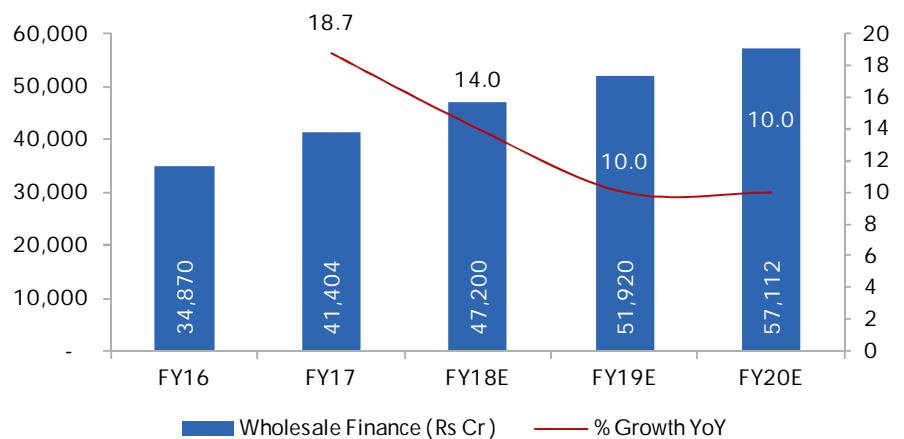


Source: Company, Angel Research

Sale down of assets will ensure higher bottom-line growth with low capital consumption

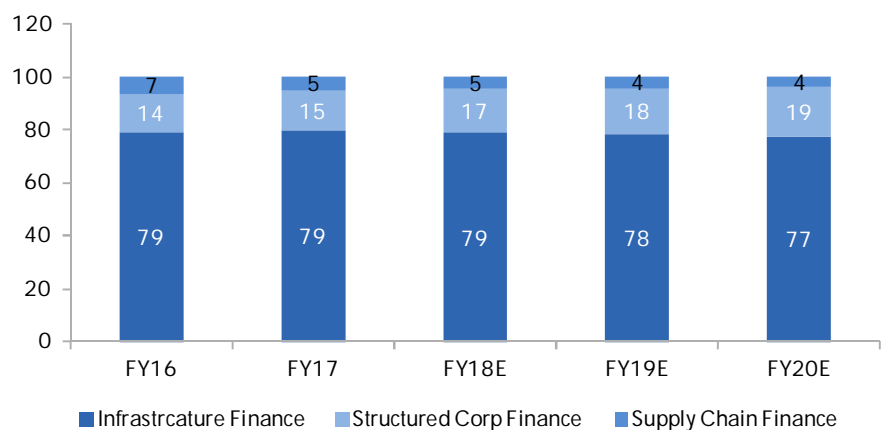
LTFH, on the back of its strong parentage has developed strong domain knowledge of financing the large and long gestation projects. While the assets financed before 2011 have lot of stress, those after 2011 have been strong in balance sheet. Going ahead, the management intends to sale down assets after strong underwriting process. Projects which are financed have a strong cash flow potential, and hence LTFH intends to generate strong fee income out of selling the loans. There is strong demand for this type of transactions both from Banks and other NBFCs.

Exhibit 18: Loan growth in Wholesale finance



Source: Company, Angel Research

Exhibit 19: Wholesale Finance Loan Composition (%)



Source: Company, Angel Research

Exhibit 20: Income Statement Wholesale Finance

Cr	FY16	FY17	FY18E	FY19E	FY20E
Interest Income	3,717	4,064	4,773	5,191	5,547
Interest Cost	2,429	2,736	3,372	3,663	3,953
Net Interest Income	1,288	1,328	1,401	1,528	1,593
Fee Income & Other income	144	299	404	485	582
Total Income	1,432	1,627	1,805	2,013	2,175
Total Operating Expenses	176	159	166	186	209
PPP	1,257	1,469	1,639	1,826	1,966
Provisions, contingencies & w/off	461	712	665	595	545
PBT	795	757	974	1,232	1,421
Tax	247	197	244	320	370
PAT	548	560	731	911	1,052

Source: Company, Angel Research

Exhibit 21: Balance Sheet Wholesale Finance

Cr	FY16	FY17	FY18E	FY19E	FY20E
Closing Business Assets	34,870	41,403	47,200	51,920	57,112
Total Assets	37,026	44,111	50,124	55,078	60,523
Closing Net worth	4,591	5,316	5,864	6,548	7,337
Closing Borrowing	30,593	37,164	41,996	46,195	50,815
Other Liabilities	1,841	1,630	2,264	2,335	2,371
Total Liabilities	37,026	44,111	50,124	55,078	60,523

Source: Company, Angel Research

Exhibit 22: Key Ratios Wholesale Finance

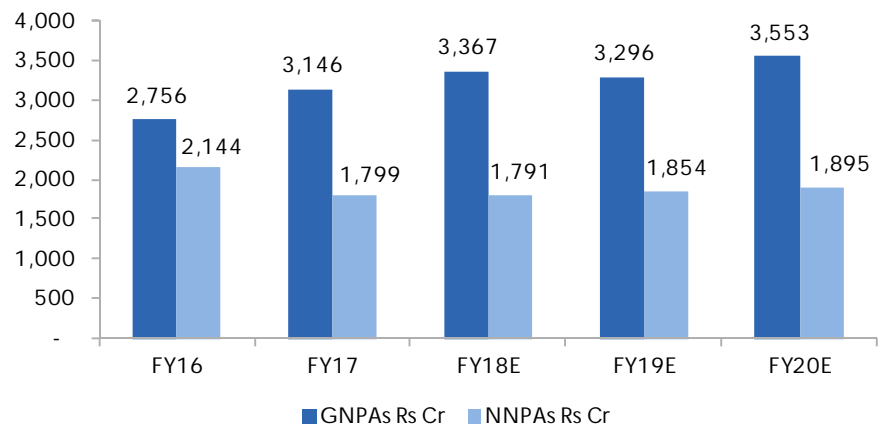
Key Assumptions	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
Loans	-	18.7	14.0	10.0	10.0
Borrowings	-	21.5	13.0	10.0	10.0
NII	-	3.1	5.5	9.1	4.3
Provisions	-	54.3	(6.7)	(10.5)	(8.3)
PAT	-	2.1	30.5	24.7	15.4
Key Ratios (%)					
Yield on advances	11.9	11.0	10.8	10.5	10.2
Cost of funds	8.8	8.4	8.0	7.9	7.8
NIM%	4.1	3.6	3.2	3.1	2.9
Credit Cost	1.5	1.9	1.5	1.2	1.0
ROA	1.6	1.5	1.5	1.8	1.8
ROE	10.7	10.5	11.7	13.3	13.7

Source: Company, Angel Research

Worst in terms of asset quality is over

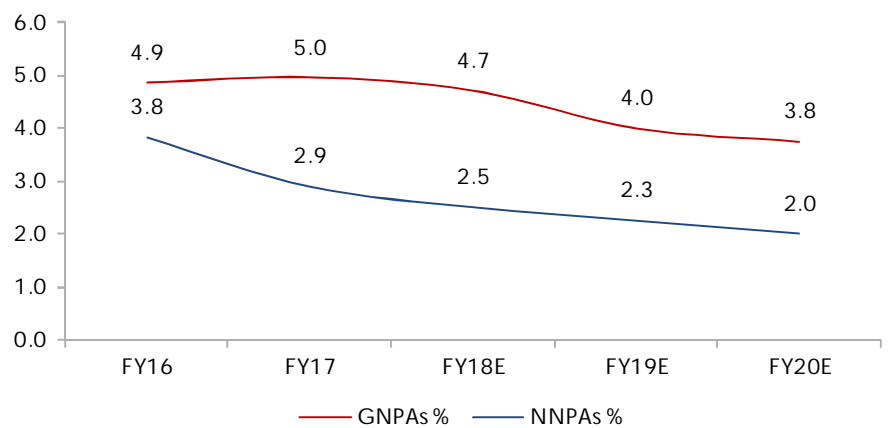
While the reported GNPA of LTFH is at 4.9%, including the restructured loans the gross impaired assets is at 9.8%. Large part of the stress is from the legacy assets financed prior to 2011, while the new assets financed in the wholesale financed segment have negligible NPAs. Further, incrementally the company's focus is on retail space and the granular nature of book will ensure lower slippages and NPAs in turn. We expect the GNPA and NNPA levels to gradually come down to 3.75% and 2% of the book by FY2020 respectively.

Exhibit 23: Asset Quality (₹ Cr)



Source: Company, Angel Research

Exhibit 24: Asset Quality Trend



Source: Company, Angel Research

Overall credit cost should moderate going ahead

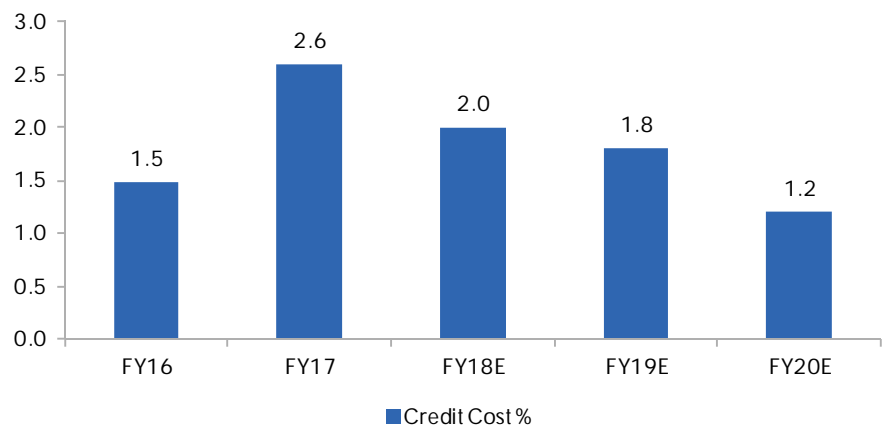
The nature of rural finances is of higher credit costs, which will remain high going ahead as well. Nonetheless, historically the credit cost for housing finance has always been lower and under control. The credit cost for the wholesale finance had been higher over the last two years and might remain higher in FY2018 as well, we expect the same to moderate going ahead. We expect the blended credit cost to decline to 1.8% by FY2020 from 2.4% in FY2017. Further, LTFH has increased its provision coverage ratio on the wholesale book and the blended PCR is likely to further improve going ahead.

Exhibit 25: Segmental Credit Cost (%)

	FY16	FY17	FY18E	FY19E	FY20E
Rural Finance	4.28	4.61	4.50	4.50	4.50
Housing Finance	0.33	0.61	0.55	0.62	0.65
Wholesale Finance	1.47	1.92	1.50	1.20	1.00
Blended Credit Cost	1.49	2.60	2.00	1.80	1.20

Source: Company, Angel Research

Exhibit 26: Credit Cost Trend (%)

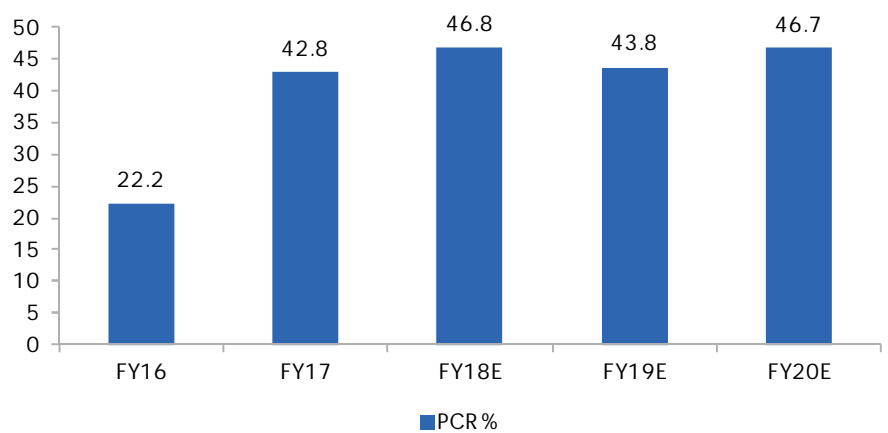


Source: Company, Angel Research

Increasing provision should take care of the impaired assets

While the company has already taken extra voluntary provisions with slippages remaining under control, overall asset quality trend should remain positive going ahead. LTFH merged two of its 100% subsidiaries with itself and since the companies were valued at a premium to their book value there was goodwill to the tune of ₹3000cr on account of this. Amortization of goodwill is tax deductible expenditure and the company intends to use this as an extra provision in its books. Lower PCR was one of the concerns for LTFH’s book, particularly on the wholesale finance side. However, it has already increased its PCR on the book and we expect the same to go up further.

Exhibit 27: PCR Trend (%)

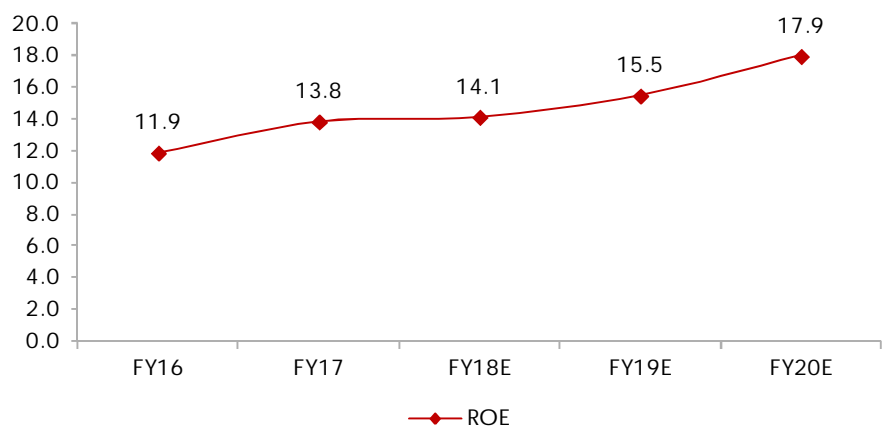


Source: Company, Angel Research

Shift towards higher yielding assets and lower credit cost to result in RoE improvement

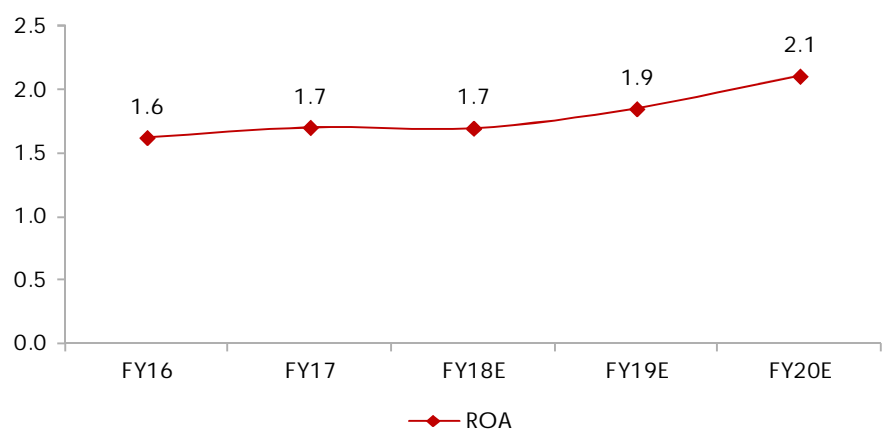
LTFH’s move to scale down its book on certain products which were making losses and the renewed focus on increasing share of high yielding assets like Rural Finance and Housing Finance segments have started paying off. Further, it has already taken voluntary provisions to cover the impaired assets from the wholesale book. Despite this, it ended FY2017 with a RoE of 13.8% v/s. 11.9% with 4QFY2017 hitting a high of 14.7%. With increasing sale down of assets in the wholesale book, the fee income will get a boost and this is likely to have positive impact on the RoE. We expect the blended RoE of LTFH to hit ~18% by FY2020.

Exhibit 28: ROE Trend (%)



Source: Company, Angel Research

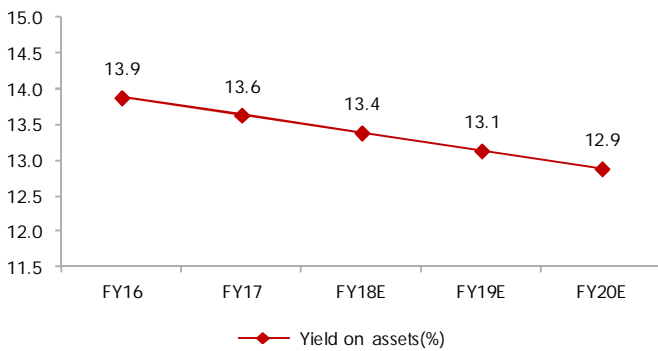
Exhibit 29: ROA Trend (%)



Source: Company, Angel Research

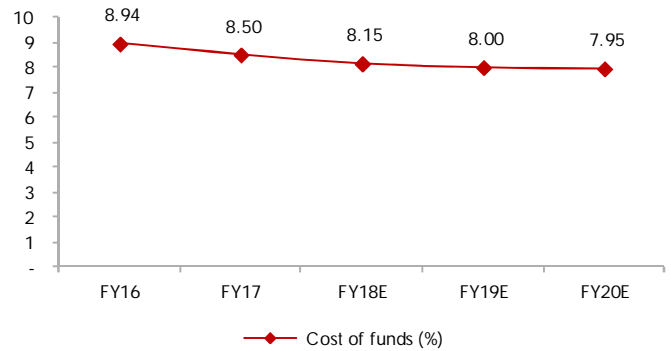
NIM to see marginal drop, still remain healthy: LTFH has historically enjoyed strong NIM due to its presence in the rural finance segment, which generates higher yield. While there has been a drop in the blended yield off late, it has also witnessed reduction in the cost of funds, and hence, NIM improved in FY2017. However, on conservative basis we have factored in further drop in yield due to competition in housing finance segment and rural finance segment, where other NBFCs and Small Finance Banks are also gearing up to scale up aggressively.

Exhibit 30: Yield (%)



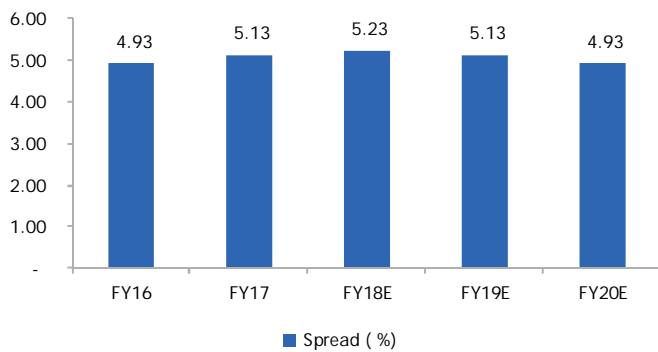
Source: Company, Angel Research

Exhibit 31: Cost of funds (%)



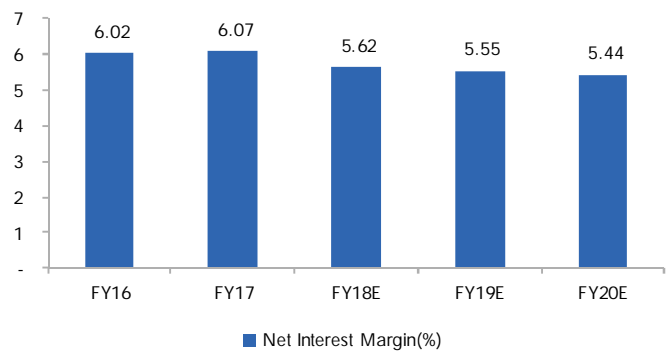
Source: Company, Angel Research

Exhibit 32: Spread (%)



Source: Company, Angel Research

Exhibit 33: NIM Trend (%)

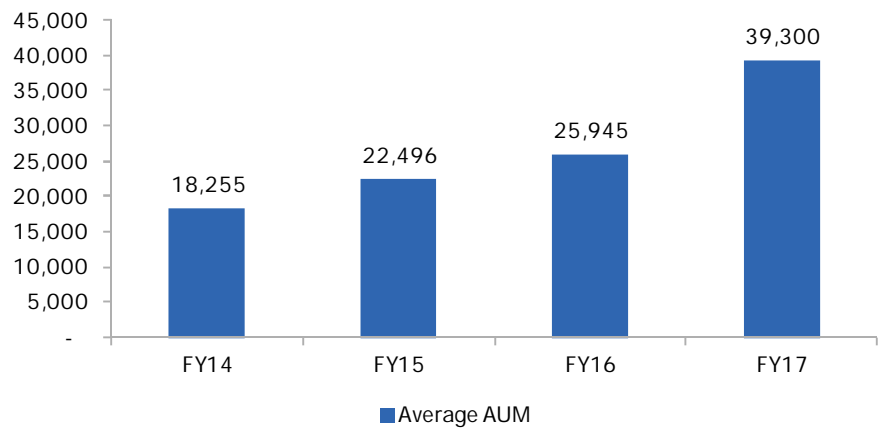


Source: Company, Angel Research

Investment management & wealth management, will aid to the profitability as well

In 2012, L&T Mutual Fund bought the Indian Operations of Fidelity Mutual Fund, which had an AUM of ~`8,881cr at that time. Nearly 38% Fidelity's total AUM was towards Equity and as a result today also L&T's overall Equity exposure in the total AUM at 39% stands higher than industry. In FY17, the average AUM of L&T AMC has gone up by 51%. While on one hand, it has been able to increase its AUM, simultaneously it has reduced the costs and hence, the cost/ income for the investment management business have come down to 66% by FY2017 from a high of 83% earlier. In FY17, the division posted PAT of `45cr v/s. `16cr in FY16. Further, the wealth management segment of the company has also been reporting improved numbers and reported a PAT of `5cr for FY17 compared to a loss of `24cr in FY16.

Exhibit 34: Increasing AUM (₹ Cr)



Source: Company, Angel Research

Outlook and valuation

As LTFH has multiple segments of operations, we have valued it based on SOTP. We have valued the rural finance segment at 2.5x while the housing finance and wholesale finance has been valued at 3x and 2x its FY20E BV each. LTFH's AMC arm, L&T MF has been valued at 5% of average AUM. **Accordingly, we have arrived at a fair value of ₹ 179 based on SOTP, and hence recommend BUY on the stock.**

Exhibit 35: SOTP Valuation

Based on FY20E (₹ Cr)	Net Worth	Multiple	Implied Mkt Cap
Rural	2,694	2.5	6,736
Housing	2,634	3.0	7,901
Whole sale	7,337	2.0	14,674
Combined Value of Lending Business			29,311
Value of MF @ 5% of AUM			1,965
Implied Market Cap			31,276
Implied Per Share			179
CMP			149
% Upside			20%

Source: Company, Angel Research

Exhibit 36: Comparative Valuation & Return ratio

	P/BV			RoE%			RoA%		
	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
L&T Fin	3.3	2.8	2.5	13.8	14.1	15.5	1.7	1.7	1.9
M&M Fin	2.9	2.6	2.3	7.6	14.7	17.4	1.0	2.0	2.2
Cholamandalam	4.2	3.6	3.1	16.9	18.3	18.9	2.3	2.5	2.6
Shriram City	3.2	2.9	2.5	11.8	15.6	16.6	2.4	3.0	3.0
Magma Fin	1.8	1.7	1.5	1.0	10.5	11.7	0.1	1.5	1.7
REPCO Home	4.6	3.8	3.2	17.6	19.5	20.6	2.4	2.5	2.6
Shriram Transport Fin	2.2	2.0	1.7	11.8	14.1	16.1	1.8	2.2	2.6
Sundaram Fin	3.7	3.5	3.1	15.2	15.6	16.7	2.3	2.4	2.6

Source: Company, Angel Research, Note: CMP as of July 06, 2017, * other NBFCs Consensus taken from Bloomberg,

Exhibit 37: Income Statement (Consolidated)

₹ Cr	FY16	FY17	FY18E	FY19E	FY20E
NII	3,165	3,714	4,006	4,552	5,181
- YoY Growth (%)	20.4	17.3	7.9	13.6	13.8
Other Income	182	232	324	422	548
- YoY Growth (%)	28.8	27.4	40.0	30.0	30.0
Operating Income	3,347	3,945	4,330	4,974	5,729
- YoY Growth (%)	20.8	17.9	9.8	14.9	15.2
Operating Expenses	1,313	1,277	1,404	1,545	1,699
- YoY Growth (%)	21.9	-2.8	10.0	10.0	10.0
Pre - Provision Profit	2,034	2,669	2,926	3,430	4,030
- YoY Growth (%)	20.2	31.2	9.7	17.2	17.5
Prov. & Cont.	781	1,590	1,526	1,587	1,492
- YoY Growth (%)	18.0	103.6	(4.0)	4.0	(6.0)
Profit Before Tax	1,253	1,079	1,400	1,843	2,538
- YoY Growth (%)	21.5	(13.9)	29.8	31.6	37.7
Prov. for Taxation	399	36	190	323	531
- as a % of PBT	23.1	(90.9)	422.0	69.9	64.6
PAT	854	1,043	1,210	1,520	2,006
- YoY Growth (%)	20.8	22.1	16.1	25.6	32.0

Source: Company, Angel Research

Exhibit 38: Balance Sheet (Consolidate)

Y/E March (₹ cr)	FY16	FY17	FY18E	FY19E	FY20E
Share Capital	1,754	1,756	1,820	1,820	1,820
Reserve & Surplus	5,324	6,020	7,433	8,583	10,138
Net Worth	7,195	7,894	9,253	10,403	11,958
Preference Shares	1,213	1,213	1,213	1,213	1,213
Minority Interest	100	119	119	119	119
Borrowings	51,616	59,811	67,935	77,786	89,065
- Growth (%)		15.9	13.6	14.5	14.5
Other Liabilities	2,961	3,035	3,131	3,444	3,789
Total Provisions	645	367	393	422	454
Others	70	75	75	75	75
Total Liabilities	63,801	72,514	82,120	93,463	1,06,672
Cash and Cash equivalents	402	594	654	719	791
Investments	3,563	6,012	6,072	6,375	6,694
Total Loans & Advances	56,065	61,649	71,314	82,058	95,187
- Growth (%)		10.0	15.7	15.1	16.0
Fixed Assets	696	619	631	644	657
Good Will on consolidation	639	639	639	639	639
Others	1,074	1,487	1,509	1,532	1,557
Other Assets	1,361	1,514	1,301	1,496	1,148
Total Assets	63,801	72,514	82,120	93,463	1,06,672

Source: Company, Angel Research

Exhibit 39: Key Ratios (Consolidated)

	FY16	FY17	FY18E	FY19E	FY20E
Profitability ratios (%)					
NIMs	6.0	6.1	5.6	5.5	5.4
RoA	1.6	1.7	1.7	1.9	2.1
RoE	11.9	13.8	14.1	15.5	17.9
Asset Quality (%)					
Gross NPAs	2,756	3,146	3,352	3,282	3,570
Gross NPAs %	4.9	4.9	4.7	4.0	3.8
Net NPAs	2,144	1,799	1,783	1,846	1,904
Net NPAs %	3.8	2.9	2.5	2.3	2.0
Credit Cost	1.5	2.6	2.0	1.8	1.2
PCR %	22.2	42.8	46.8	43.8	46.7
Per Share Data (₹)					
EPS	4.9	5.9	6.9	8.7	11.4
BVPS	41.0	45.0	52.7	59.3	68.1
Adj BV	28.8	34.7	42.6	48.8	57.3
DPS	0.8	0.8	1.0	1.8	2.2
Valuation Ratios					
PER (x)	30.4	24.9	21.5	17.1	12.9
P/BVPS (x)	3.6	3.3	2.8	2.5	2.2
P/ABVPS (x)	5.1	4.3	3.5	3.0	2.6
Dividend Yield (%)	0.5	0.5	0.7	1.2	1.5
DuPont Analysis					
Interest Income	13.9	13.6	13.4	13.1	12.9
Interest Expenses	7.9	7.6	7.8	7.6	7.4
NII	6.0	6.1	5.6	5.5	5.4
Other Inc.	0.3	0.4	0.5	0.5	0.6
Total Income	6.4	6.4	6.1	6.1	6.0
Opex	2.5	2.1	2.0	1.9	1.8
PPP	3.9	4.4	4.1	4.2	4.2
Provision	1.5	2.6	2.1	1.9	1.6
PBT	2.4	1.8	2.0	2.2	2.7
Taxes	0.8	0.1	0.3	0.4	0.6
RoA	1.6	1.7	1.7	1.9	2.1
Leverage	14.6	8.1	8.3	8.3	8.5
RoE	11.9	13.8	14.1	15.5	17.9

Source: Company, Angel Research

Research Team Tel: 022 - 39357800

 E-mail: research@angelbroking.com

 Website: www.angelbroking.com

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Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)