

Journey towards retailisation at attractive valuation

About the stock: L&T Finance Holding (LTFH) is a leading NBFC catering to the diverse financing needs of underserved customers in urban and rural areas. LTFH is engaged in consumer loans, 2wheeler loans, home loans, MFI, farm & SME loans.

- Backed by a strong parent, LTFH has been assigned "AAA" rating
- Distribution network remains strong with substantial dealer penetration (2500+ dealers in farm equipment & 6500+ tie-ups in 2 wheeler segment), 2 crore customers (database) spread across 21 states & one union territory.

Investment Rationale

- **Re-orientation of balance sheet towards retailisation:** In April 2022, LTFH announced "Lakshya 2026", which was targeted towards retailisation with customised products in mature markets [farm equipment, rural group loans (MFI) and two wheeler finance] and focus on newer retail segment (consumer loans, home loans, LAP and SME loans). Accordingly, in the last quarters, the share of retail loans has increased from 51% to ~82% while the proportion of wholesale book has declined from 49% to ~18%.
- **Leaner business structure and change in leadership:** LTFH's transformation process includes a leaner, simpler organisation structure and hierarchy to enable improved focus on performance. LTFH has exited unfocused business lines, stopped growing real estate vertical and is in the process of consolidating L&T Finance and L&T Infra Credit wherein NCLT approval is awaited. LTFH has announced superannuation of current MD & CEO and appointment of Mr Sudipta Roy as new MD & CEO from Jan 2024; which remains in-line with focus on retailisation target articulated earlier.
- **RoAUM trajectory to improve to ~2.7-2.8% in FY25E:** Increase in retail proportion will continue to aid NIMs trajectory (calculated NIMs at 7.5% in FY23), and is expected to improve to ~8-9% levels. Sustainable retail AUM growth (31%/ 24% YoY in FY24E/ 25E) to aid gradual improvement in efficiency, though CI ratio could remain elevated at ~40-41% in the initial phase. Provision buffer of ~2% is expected to keep credit cost largely steady, thus aiding earnings momentum. We expect return on AUM (RoAUM) to improve from ~2% in FY23 to ~2.7-2.8% by FY25E.

Rating and Target price

- With retail loan book gaining traction to almost >90% of outstanding AUM by FY24E, valuation multiple should witness a re-rating. Further, contained GNPA, NNPA guidance of <3%, <1%, respectively, provide comfort.
- At the CMP, LTFH currently trades at ~1.2x ABV offering room for further expansions as RoE, RoA are expected to reach ~10%, ~2.1%, respectively, in FY23-25E. Hence, we assign a target price of ₹ 160/share, valuing at ~1.6x FY25E ABV and recommend **BUY** rating on the stock.



L&T Finance Holdings

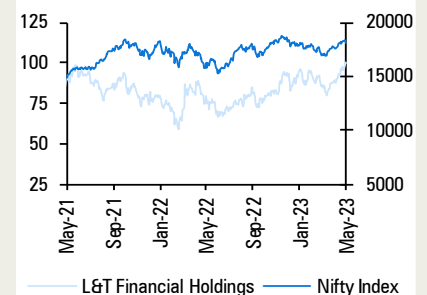
Particulars

| Particulars | Amount |
|-----------------------|---------------|
| Market Capitalisation | ₹ 31537 crore |
| 52 week H/L | 140 / 71 |
| Net Worth | 21,528 |
| Face value | ₹ 10 |
| FII Holdings (%) | 14.7 |
| DII Holdings (%) | 5.3 |

Risks to our call

- 1) Elevated incremental cost while downsizing wholesale book
- 2) Higher slippages from unsecured portfolio in case of macro volatility

Price performance



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Key Financial Summary

| | FY21 | FY22 | FY23 | 2 year CAGR (FY24-FY25E) | FY24E | FY25E | 2 year CAGR (FY24-FY25E) |
|----------------------|--------|--------|--------|--------------------------|--------|--------|--------------------------|
| NII (₹ crore) | 5616.0 | 5589.0 | 6368.0 | 6% | 6805.4 | 8335.1 | 14% |
| Net Profit (₹ crore) | 971.0 | 1070.0 | 1623.0 | 29% | 1934.6 | 2656.2 | 28% |
| EPS (₹) | 4.5 | 4.3 | 6.5 | 21% | 7.8 | 10.7 | 28% |
| P/E (x) | 28.5 | 29.6 | 19.6 | | 16.4 | 11.9 | |
| P/BV (x) | 2 | 2 | 1 | | 1 | 1 | |
| P/ABV (x) | 1.70 | 1.71 | 1.60 | | 1.44 | 1.32 | |
| RoE (%) | 6.2 | 5.4 | 7.5 | | 8.4 | 10.6 | |
| RoA (%) | 1.1 | 1.0 | 1.5 | | 1.8 | 2.1 | |

Company Background

&T Finance Holding (LTFH) is a leading NBFC catering to the diverse financing needs of served and underserved customers in urban as well as rural areas. LTFH offers financial assistance in various segments including consumer loans, two-wheeler loans, home loans, micro loans, farm loans and SME loans. Backed by a strong parent, the lender has been assigned "AAA" rating by rating agencies. Its distribution network remains strong with substantial dealer penetration (2500+ dealers in farm equipment and 6500+ tie-ups in two-wheeler segment), 2.1 crore customers (database) spread across 21 states and one union territory.

Exhibit 1: LTFH product mix

| As of March 2023 | Loan book (₹ crore) | Disbursement (₹ crore) | Yields (%) | Tenure (Yrs) | ATS (₹) |
|--------------------|------------------------|---------------------------|------------|--------------|-----------------------|
| Rural Finance | 18,693 | 16,910 | 24% | 2 | 1-2.5 lakhs |
| Farmer Finance | 12,819 | 6,450 | 16-18% | 4-5 | 1-2.5 lakhs |
| 2W segment | 8,960 | 7,110 | 22% | 2 | 1-2.5 lakhs |
| HL / LAP | 13,410 | 4,730 | 9.9.5% | 20-25 | 20 lakhs to 7.5 crore |
| Consumer Finance | 5,471 | 4,886 | 13-17% | 1-2 | 1-2.5 lakhs |
| SME portfolio | 1,378 | 1,473 | 13-16% | 5 | 5-30 lakhs |
| Acquired | 322 | 506 | - | - | - |
| Retail | 61,053 | 42,065 | 16% | - | - |
| Wholesale | 19,512 | 4,910 | 10% | - | - |
| De-focussed | 328 | - | - | - | - |
| Total | 80,893 | 46,975 | 14% | - | - |

Source: Company, ICICI Direct Research

Investment Rationale

Re-orientation of balance sheet towards retailisation

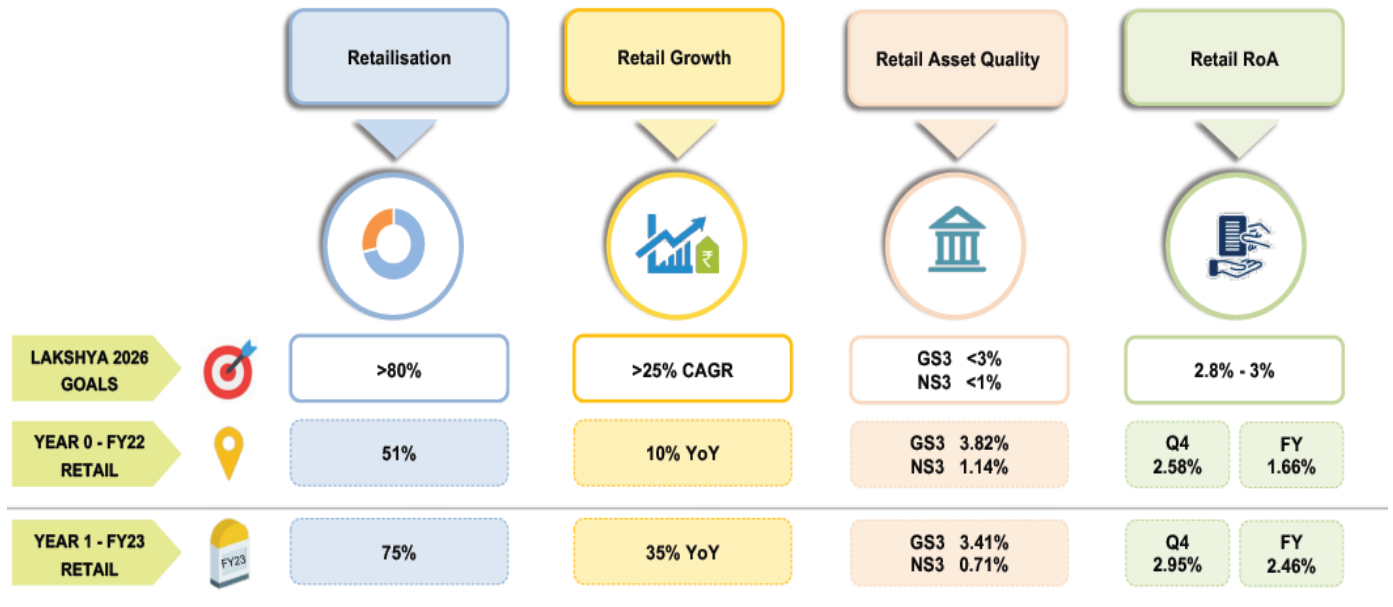
In April 2022, LTFH announced "Lakshya 2026", which was targeted towards retailisation and a shift from product based approach to customer focused approach to pedal business growth as well as improve return ratios. As per the plan, the recalibrated product growth strategy was adopted with customised products in mature markets [farm equipment, rural group loans (MFI) and two wheeler finance] with focus on newer retail segment (consumer loans, home loans, LAP and SME loans) with substantial growth potential.

The management aimed to run down the wholesale book and increase retail share in total loans. Accordingly, in the last four quarters, the share of retail loans has increased from 51% to 75% (~82% in June 2023) while the proportion of wholesale book has declined from 49% to ~18% (from ₹ 43257 crore to ₹ 114035 crore). Induction of new Chairman SN Subrahmanyam in February 2022 hastened the process of restructuring further.

Going ahead, AUM growth is expected to be driven by the retail segment – newer segments seen driving faster traction while existing mature segments are expected to witness steady growth with a gradual gain in market share. Increase in retail proportion will continue to aid NIMs trajectory (calculated NIMs at 7.5% in FY23 vs. 6.3% in FY22), which is expected to improve to ~8-9% levels.

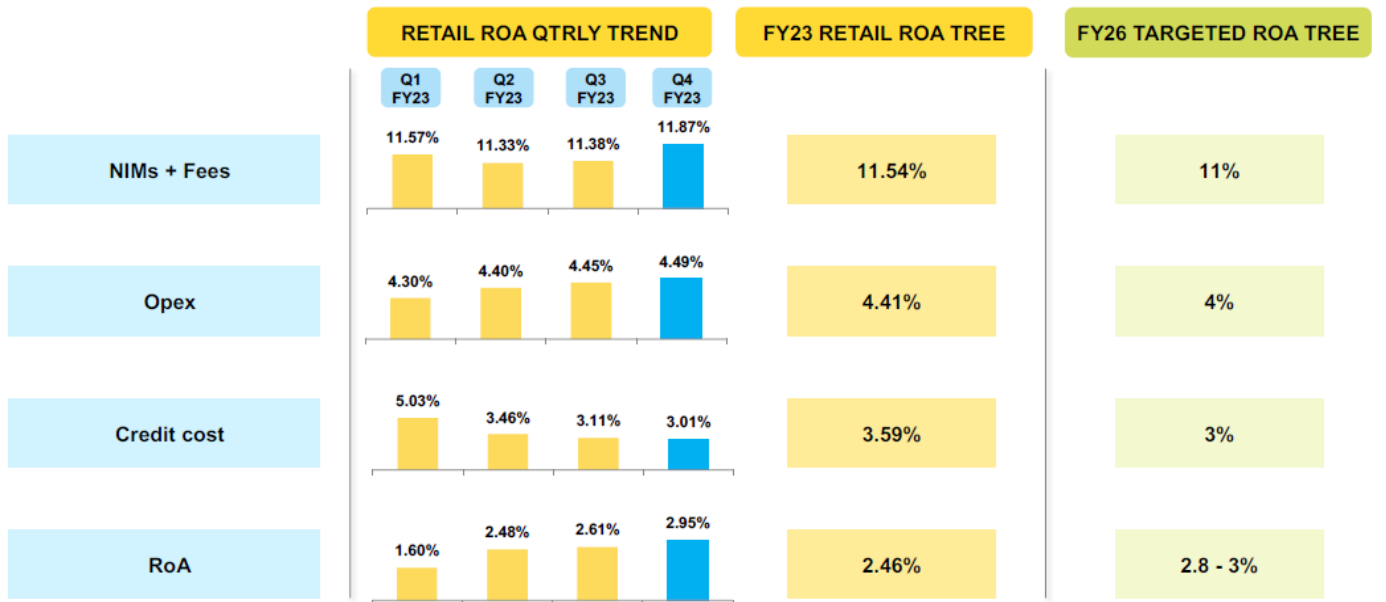
LTFH has been focusing on accelerating retailisation and, thus, leveraging fintech capabilities through automation in order to make the customer journey hassle free and quick. All this should aid sustainable retail AUM growth (31% YoY in FY24E and 24% YoY in FY25E) and gradual improvement in efficiency. However, CI ratio could remain elevated at ~40-41% in the initial phase and subsequently witness improvement at ~38-39% level.

Exhibit 2: Lakshya 2026 vs. FY23 performance



Source: Company, ICICI Direct Research

Exhibit 3: On track performance towards targeted RoA...



Source: Company, ICICI Direct Research

We expect robust AUM growth ahead of 25% in FY24-25E given shift to newer segment of retail lending coupled with increasing dominance in existing segments. Further, traction in retail segment is expected to aid earnings trajectory amid improving margins and moderation in credit cost ahead.

Leaner business structure for improved focus

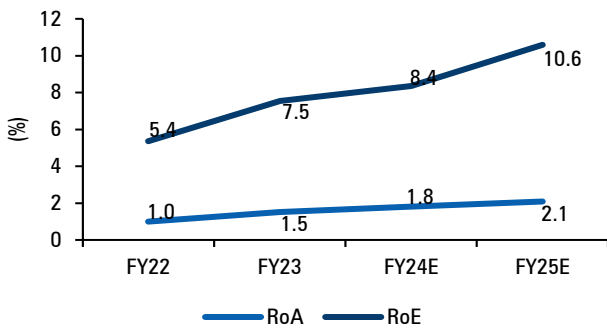
LTFH’s transformation process includes a leaner, simpler organisation structure and hierarchy. LTFH, in its second cycle, has simplified its corporate structure as well as business model. It has exited unfocused business lines (sold its L&T AMC business segment for ₹ 4249 crore), stopped growing in the real estate vertical and is in the process of consolidating L&T Finance and L&T Infra Credit wherein NCLT approval is

awaited. A leaner structure will enable improved focus thereby resulting in healthy growth and improved performance.

RoAUM trajectory to improve to ~2.7-2.8% in FY25E

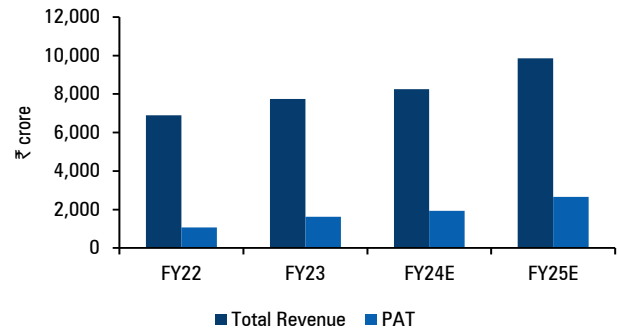
Focus on new business segments will aid yields and, thus, expansion of NIMs. With continued investment in tech, people and branch addition, efficiency is seen improving gradually. Focus on accelerating business growth & provision buffer of ~2% is expected to keep credit cost largely steady, thus aiding earnings momentum. We expect return on AUM (RoAUM) to improve from ~2% in FY23 to ~2.7-2.8% by FY25E.

Exhibit 2: Improvement seen in RoA in FY24-25E



Source: Company, ICICI Direct Research

Exhibit 3: Borrowing profile (FY23)



Source: Company, ICICI Direct Research

Valuation and outlook

With the retail loan book gaining traction to almost >90% of outstanding AUM by FY24E, valuation multiple should witness a re-rating. Further, contained GNPA, NNPA guidance of <3%, <1%, respectively, provide comfort. At the CMP, LTFH currently trades at ~1.2x ABV offering room for further expansions as RoE, RoA are expected to reach ~10%, ~2.1%, respectively, in FY23-25E. Hence, we ascribe a target price of ₹ 160/share, valuing at ~1.6x FY25E ABV and recommend **BUY** rating on the stock.

Key risks and concerns

Elevated incremental cost while downsizing wholesale book

As per "Lakshya 2026", LTFH has undertaken shift to retail assets. Accordingly, in the last four quarters, the share of retail loans has increased from 51% to ~82% while the proportion of wholesale book has declined from 49% to ~18% (from ₹ 43257 crore to ₹ 14035 crore). Going ahead, further downsizing of wholesale book is slated to increase share of retail book more than 80%. Though, LTFH has adequate buffer, selling of wholesale at a discount could lead to incremental cost which remains a risk

Higher slippages from unsecured portfolio in case of macro volatility

LTFH is engaging in retail segment including micro finance, two wheeler finance, personal loans and small business loans which are unsecured in nature. Though the book remains granular with smaller ticket size loans, any slowdown in economy could lead to higher delinquencies which could impact profitability.

Financial Summary

| Exhibit 4: Profit & Loss statement (₹ crore) | | | | |
|--|----------|----------|----------|----------|
| (Year-end March) | FY22 | FY23 | FY24E | FY25E |
| Interest Earned | 11,356.0 | 12,165.0 | 12,751.6 | 14,677.5 |
| Interest Expended | 5,767.0 | 5,797.0 | 5,946.2 | 6,342.4 |
| Net Interest Income | 5,589.0 | 6,368.0 | 6,805.4 | 8,335.1 |
| growth (%) | | 13.9% | 6.9% | 22.5% |
| Non Interest Income | 1,307.0 | 1,382.0 | 1,451.1 | 1,523.7 |
| Net Income | 6,896.0 | 7,750.0 | 8,256.5 | 9,858.8 |
| Opex | 1,275.2 | 1,523.1 | 1,766.8 | 2,049.4 |
| Operating Profit | 5,620.8 | 6,226.9 | 6,489.8 | 7,809.3 |
| Provisions | 3,030.0 | 2,473.0 | 2,363.7 | 2,566.6 |
| PBT | 1,496.0 | 2,348.0 | 2,579.5 | 3,541.6 |
| Taxes | 426.0 | 725.0 | 644.9 | 885.4 |
| Net Profit | 1,070.0 | 1,623.0 | 1,934.6 | 2,656.2 |
| growth (%) | | 51.7% | 19.2% | 37.3% |
| EPS (₹) | 4.3 | 6.5 | 7.8 | 10.7 |

Source: Company, ICICI Direct Research

| Exhibit 5: Key ratios | | | | |
|-------------------------------|-------|-------|-------|-------|
| (Year-end March) | FY22 | FY23 | FY24E | FY25E |
| Valuation | | | | |
| No. of Equity Shares (Crores) | 247.4 | 248.0 | 248.0 | 248.0 |
| EPS (₹) | 4.3 | 6.5 | 7.8 | 10.7 |
| BV (₹) | 80.6 | 86.8 | 93.4 | 101.2 |
| ABV (₹) | 75.1 | 80.1 | 88.6 | 97.1 |
| P/E | 29.4 | 19.4 | 16.3 | 11.9 |
| P/BV | 1.6 | 1.5 | 1.4 | 1.3 |
| P/ABV | 1.7 | 1.6 | 1.4 | 1.3 |
| Yields & Margins (%) | | | | |
| Net Interest Margins | 6.3 | 7.6 | 8.2 | 8.9 |
| Yield on assets | 12.8 | 14.5 | 15.4 | 15.7 |
| Avg. cost on borrowings | 6.6 | 6.9 | 7.2 | 7.0 |
| Quality and Efficiency (%) | | | | |
| Cost to income ratio | 34.4 | 37.8 | 40.1 | 38.0 |
| Loan to borrowing (%) | 96.8 | 90.5 | 95.9 | 95.4 |
| GNPA | 4.1 | 4.7 | 3.9 | 3.7 |
| NNPA | 2.0 | 1.5 | 1.2 | 1.1 |
| RoE | 5.4 | 7.5 | 8.4 | 10.6 |
| RoA | 1.0 | 1.5 | 1.8 | 2.1 |
| RoAUM | 1.2 | 1.9 | 2.3 | 2.9 |

Source: Company, ICICI Direct Research

| Exhibit 6: Balance Sheet Statement (₹ crore) | | | | |
|--|--------|--------|--------|--------|
| (Year-end March) | FY22 | FY23 | FY24E | FY25E |
| Sources of Funds | | | | |
| Capital | 2474 | 2480 | 2480 | 2480 |
| Reserves and Surplus | 17474 | 19049 | 20672 | 22606 |
| Networth | 19948 | 21528 | 23151 | 25086 |
| Borrowings | 85201 | 83043 | 82128 | 99084 |
| Other Liabilities & Provisions | 21701 | 23319 | 24615 | 27678 |
| Total | 106902 | 106362 | 106742 | 126762 |
| Application of Funds | | | | |
| Fixed Assets | 24 | 57 | 63 | 69 |
| Investments | 11917 | 14366 | 11854 | 13211 |
| Advances | 82469 | 75155 | 78741 | 94510 |
| Other assets | 24433 | 31208 | 28001 | 32251 |
| Total | 106902 | 106362 | 106742 | 126762 |

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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