

L&T Finance Holding

Broad horizons

Diversified loan mix

L&T Finance Holding's (L&TFH) well diversified loan book ranging from small ticket microfinance to big ticket infra loans, provides the company an opportunity to tap into various under penetrated segments and address a broader range of growth opportunities across cycles. In terms of reach, the L&T finance group has presence pan India (23 states, 837 Points of presence). Also, compared to specialised lending NBFCs, L&TFH's risk is much better spread out into the various segments it operates, which reduces the risks associated with any particular segment or customer concentration.

Strong growth track record

L&TFH's loan portfolio has grown at a CAGR of 56.6% over FY2009-FY2011, way ahead of its peers (35.2% for IDFC, 14.5% for Shriram transport). The company has its sights set on the two of the most rapid growing sectors – Infrastructure and rural development, which gives high visibility to its loan growth outlook, driven by higher government spending and substantial latent demand. The net profit of the holding company has grown by 53.4% over FY2010-11, although on a low base.

Strong parentage, but relatively expensive at the upper band

L&T Finance Holding looks well-positioned for growth considering its bolstered capital position post-IPO, diversified loan segments and healthy track record. The diversified loan book also reduces risk emanating from sectoral or customer concentration. That said, it remains to be seen if the company can match the ability of the niche NBFCs in profitably sourcing high-yielding loans, while managing credit risk effectively. At present, based on FY2011 numbers, the company's RoEs were on the lower side compared to peers. Also, there are near-term macro-headwinds for NBFCs from higher interest rates, slowing credit demand and asset quality concerns, due to which valuations of listed NBFCs have corrected. In the context of its lower RoEs relative to peers and considering the near-term macro-headwinds, the valuations at the upper band look a little expensive in our view at ~2.2x post-IPO Networth (~2.0x at the lower band).

Hence, we recommend Subscribe at the lower end of the price band.

Key financials (Consolidated)

Y/E March (₹ cr)	FY2010	FY2011
NII (Net interest income)	726	1,039
% chg	-	43
Net profit	242	398
% chg	-	65
NIM (%) (Net interest margin)	7.8	7.1
EPS (₹) (Earning per share)	1.8	2.8
P/E (x)*	26.5	18.1
P/ABV (x)*	3.6	2.6
RoA (%) (Return on asset)	2.5	2.5
RoE (%) (Return on equity)	21.1	16.3

Source: RHP, Angel Research. Note *: Valuations at the lower price band and at pre issue earnings and adjusted book value

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Issue Open: July 27, 2011

Issue Close: July 29, 2011

Issue Details

Face Value: ₹10

Present Eq. Paid-up Capital: ₹1,477cr

Offer Size#: 21.1cr – 24.4cr Shares

Post Eq. Paid-up Capital#: ₹ 1,688 – 1,721cr

Issue size (amount): ₹1,245cr

Price Band: ₹51-59

Post-issue implied mkt cap*: ₹ 8,778 - 9,959r

Promoters holding Pre-Issue: 95.9%

Promoters holding Post-Issue*: 82.3% - 83.9%

Note: # At the upper and lower price bands, respectively, * At the lower and upper price bands, respectively

Book Building

QIBs	Up to 50%
Non-Institutional	At least 15%
Retail	At least 35%

Post Issue Shareholding Pattern

Promoters Group	82.3% - 83.9%
MF/Banks/Indian Fls/Flls/Public & Others	16.1%-17.7%

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Company background

L&TFH offers a diverse range of financial products and services across the corporate, retail and infrastructure finance sectors, as well as mutual fund products and investment management services, through their direct and indirect wholly-owned subsidiaries.

L&T Finance's wholly owned subsidiary L&T Infrastructure Finance Company Limited (L&T Infra), conducts infrastructure finance business which provides financial products and services to customers engaged in infrastructure development and construction and is registered with the RBI as an NBFC-ND-SI and an IFC. L&T Finance Limited (L&T Finance), another wholly owned subsidiary, conducts retail finance business and corporate finance business and is registered with the RBI as an NBFC-ND-SI and an AFC.

Details of the issue

The IPO comprises an issue of ₹1,245cr, (21.1cr shares at upper band – 24.4cr shares at lower price band) equity shares of face value of ₹10 each, in the price band of ₹51–59 per share. The primary issue of shares would result in a dilution of the promoter's holding by 12.0% to 83.9% at the upper price band and by 13.6% to 82.3% at the lower price band.

The objects of the Issue are to repay the intercorporate deposit issued by Promoters to the Company, to augment the capital base of L&T Finance and L&T Infra to meet the capital requirements arising out of expected growth in their assets, primarily the loan portfolio, compliance with regulatory requirements and for other general corporate purposes including meeting the expenses of the Issue.

For the use of L&T brand and monogram, L&TFH will have to pay a consideration amounting to 0.15% of the assets, or 5% of the PAT, whichever is lower plus, service tax. The payment will commence from FY2012 onwards.

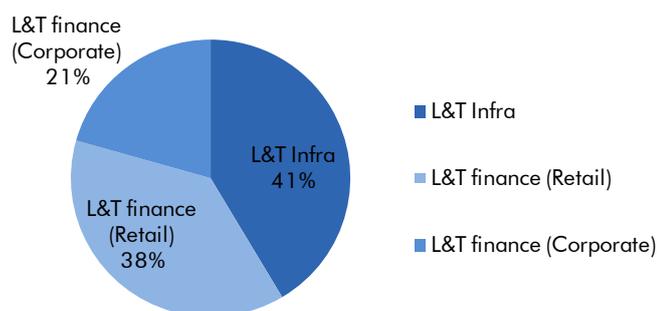
Investment arguments

Highly diversified business model with pan India presence

L&TFH's well diversified loan book ranging from small ticket microfinance to big ticket infra loans, provides the company an opportunity to tap into various under penetrated segments and address a broader range of growth opportunities across cycles. Compared to specialised lending NBFCs, L&TFH's risk is much better spread out into the various segments it operates, which reduces the risks associated with any particular segment or customer concentration.

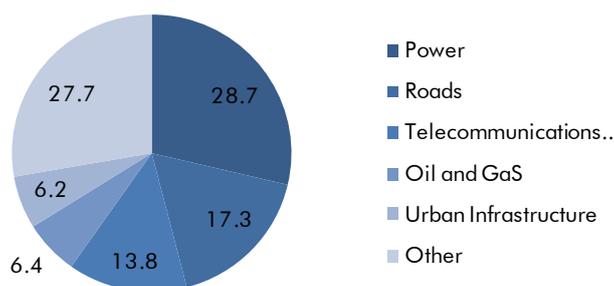
The strong parentage and brand equity of L&T has facilitated L&TFH's entry into various segments, allowed it to gain operational skills in a short frame of time and is likely to be an advantage with regards to attracting professional talent. Also, in terms of reach, the L&T finance group has presence pan India (23 states, 837 Points of presence).

Exhibit 1: L&TFH's loan structure – FY2011



Source: RHP, Angel Research

Exhibit 2: L&T Infra loan break up – FY2011



Source: RHP, Angel Research

As of FY2011, the L&T finance's loan book comprised 58.6% of the L&TFH's loan portfolio. The retail segment of L&T finance, which is mostly into construction equipment finance, transport finance and rural based lending, comprises 37.9% of the overall holding company's loan portfolio (64.8% of L&T Finance's loan book). The corporate segment which provides financial products and services to corporate customers comprises 20.6% of the overall holding company's loan portfolio (35.2% of L&T Finance's loan book).

L&T Infra offers loans to customers engaged in infrastructure development and construction. Conferred upon an IFC status by the RBI, the company's operations majorly comprises of lending to power and road projects. The exposure to power sector is ~ 2,060cr (11.9% of the holding company's loan book) with no exposure to any state electricity board.

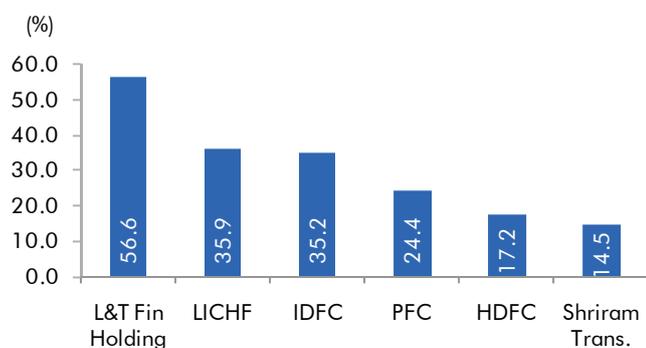
Exhibit 3: Product mix for L&TFH
L&TFH – Well diversified product mix

Corporate Finance	Retail Finance Group	Infra Group
Asset-backed loans	Construction equipment finance	Power
Term loans	Transportation equipment finance	Roads
Receivables discounting	Rural products finance	Telecommunications
Short-term working capital facilities	Microfinance	Oil and Gas
Operating and finance leases	Distribution of 3rd party fin. products	Urban Infrastructure
Supply chain finance		
Capital markets products		
Competitors	Competitors	Competitors
PSU and Pvt. Banks	Shriram Transport, SKS Microfinance, Magma Fincorp, M&M Fin Services	IDFC, PFC, REC

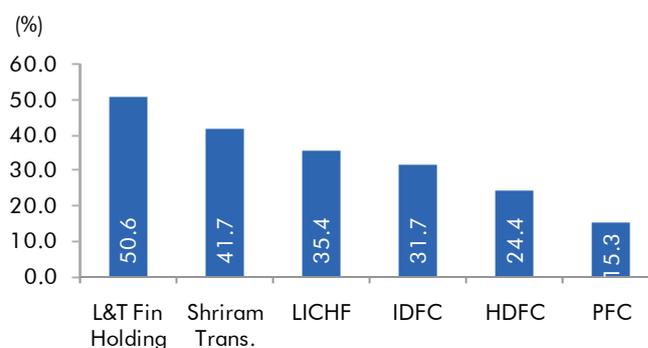
Source: Company, Angel Research

Strong growth track record

L&TFH's loan portfolio has grown at a CAGR of 56.6% over FY2009-FY2011, way ahead of its peers (35.2% for IDFC, 14.5% for Shriram transport). The company has its sights set on the two of the most rapid growing sectors – Infrastructure and rural development, which gives high visibility to its loan growth outlook, driven by higher government spending and substantial latent demand. The net profit of the holding company has grown by 53.4% over FY2010-11, although on low base.

Exhibit 4: Loan growth CAGR FY2009-11


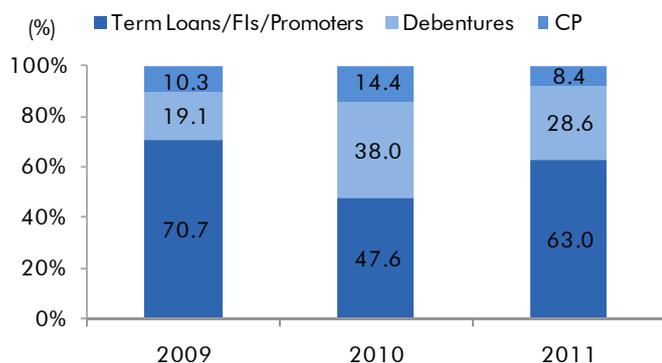
Source: RHP, Angel Research

Exhibit 5: PAT growth CAGR FY2009-11*


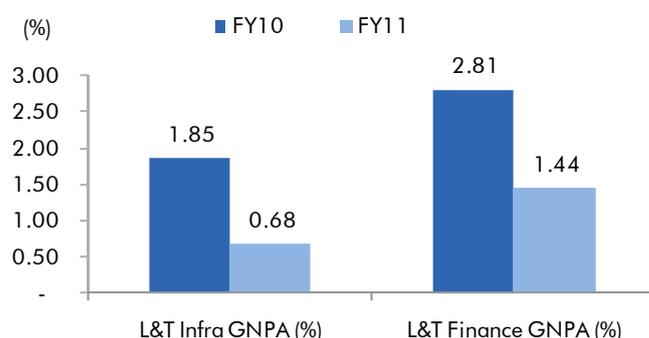
Source: RHP, Angel Research, *note; FY10-11 growth for L&T Fin Holding

L&TFH has seen robust growth in the last 2 years, while maintaining its asset quality. As of FY2011 the gross NPA ratios for L&T finance stood at 1.4% (2.8% in FY2010), while for L&T infra, the gross NPA ratio stood at 0.7% (1.9% in FY2010).

The overall funding mix comprises mostly of term loans (63.0% of total borrowings as of FY2011) and debentures (28.6% of total borrowings as of FY2011).

Exhibit 6: Funding Mix as of FY2011


Source: Company, Angel Research

Exhibit 7: Improvement in asset quality in FY2011


Source: Company, Angel Research

Strong credit rating with high capital adequacy

Both L&T finance and L&T Infra have strong credit ratings (AA+ from CARE and LAA+ from ICRA) allowing them access to various sources of funds. Moreover, L&T Infra is classified as an IFC, which allows raising low cost tax saving long term infrastructure bonds and also lowers the risk weightage for bank loans to the company. As of FY2011 both L&T Finance and L&T Infra had a capital adequacy ratio comfortably above the regulatory requirements. Also, L&T Infra has till now not raised any tier 2 capital (₹75cr tier 2 capital in L&T Finance also below regulatory limits), giving it the option of raising capital through tier 2 bonds in the future.

Exhibit 8: Strong credit rating

	CARE	ICRA	Status	CAR
L&T Infra	AA+	LAA+	IFC, PFI	16.5%
L&T Finance	AA+	LAA+	AFC	16.3%

Source: Company, Angel Research

Could be a contender for a banking license

With the RBI in the process of finalizing guidelines for issue of new banking license, we believe the L&T group (through L&TFH) could be a strong contender for receiving a license. In its discussion paper, the RBI had listed safeguards to address the downside risks of industrial and business houses promoting banks. One of the main criteria in our view was that industrial and business houses promoting banks must have diversified ownership and no connection with real estate.

Considering that any licensee would in our view need to have deep pockets and strong reputation, in our analysis we considered corporates with market capitalization exceeding ₹10,000cr. Amongst such corporates, L&T emerges as one of the very few where the promoter stake is less than 25% and is driven by a strong, professional management and board. Hence, we believe amongst various corporates who have evinced interest in a banking foray, the L&T group (through L&TFH) could emerge as a meaningful contender for receiving a banking license. However, it is important to note that there are several elements to this debate and at this stage, it would not be prudent to bank on any such development while evaluating L&TFH.

Investment risks

Both L&T finance and L&T infra have a wide mix of product offerings where they compete with a host of specialized players with already established asset appraisal skills. The product offerings by L&T finance range from working capital loans in the corporate space to rural based lending in retail space, on the one hand making its portfolio well diversified and shielded from slump in any particular sector i.e. it is a positive from a sectoral risk point-of-view.

But on the other hand, a diversified loan offering, however, also implies building asset appraisal skills (PFC in power lending, Shriram transport in vehicle loans) in every segment. It remains to be seen if the company can match the ability of the niche NBFCs in profitably sourcing high-yielding loans, while managing credit risk effectively. At present, based on FY2011 numbers, even at a reasonably high leverage, the company's RoEs were on the lower side compared to peers.

Also considering exposure to infra (above 40% of total loans outstanding; Nil to SEBs) and MFI (₹460cr exposure, with ₹200cr being in Andhra Pradesh), NPA and restructuring concerns surfacing in the short-to-medium term cannot be ruled out.

Outlook and valuation

L&TFH looks well-positioned for growth considering its bolstered capital position post-IPO, diversified loan segments and healthy track record. The diversified loan book also reduces risk emanating from sectoral or customer concentration. The company is also likely to benefit from L&T's strong corporate brand in attracting talent and capital. That said, it remains to be seen if the company can match the ability of the niche NBFCs in profitably sourcing high-yielding loans, while managing credit risk effectively. At present, based on FY2011 numbers, even at a reasonably high leverage, the company's RoEs were on the lower side compared to peers.

Also, there are near-term macro-headwinds for NBFCs from higher interest rates, slowing credit demand and asset quality concerns, due to which valuations of listed NBFCs have corrected. In the context of its lower RoEs relative to peers and considering the near-term macro-headwinds, the valuations at the upper band look a little expensive in our view at ~2.2x post-IPO Network (~2.0x at the lower band). **Hence, we recommend Subscribe at the lower end of the price band.**

Exhibit 9: DuPont Analysis L&TFH and competitors

FY11	IDFC	Bajaj Finance	M&M Finance	Shriram Transport	SKS Micro Finance	L&T FH*
Interest earned	10.5	22.0	19.9	22.9	30.6	13.4
Less: Prov	0.6	3.3	1.5	2.4	6.2	0.7
Adj interest earned	9.9	18.7	18.3	20.6	24.4	12.6
Int expense	5.9	6.1	6.5	9.6	9.1	6.6
Adj NII	4.0	12.7	11.9	10.9	15.3	6.0
Other income	1.7	0.6	0.3	0.1	2.5	0.3
Staff expenses	0.7	2.3	2.2	1.5	8.5	0.6
Other opex	0.6	5.0	2.7	1.7	4.9	1.8
PBT	4.4	5.9	7.3	7.9	4.5	4.0
Tax	1.2	2.0	2.5	2.6	1.6	1.4
ROA	3.2	4.0	4.8	5.2	2.9	2.6
PAT Equity	3.2	4.0	4.8	5.2	2.9	2.5
Leverage	4.4	5.0	4.8	5.4	2.8	5.9
ROE	14.0	19.7	22.9	28.1	8.1	15.0
Market Cap	20,709	2,670	7,428	15,800	3,859	8,778
P/BV	1.8	2.0	2.9	3.2	2.2	2.0
P/E	16.2	10.8	15.1	12.8	34.6	13.1

Source: Company, Angel Research, Note*: Post issue valuations

Income statement

Y/E March (₹ cr)	FY10	FY11
Net Interest Income	726	1,039
- YoY Growth (%)	NA	43.1
Other Income	23	56
- YoY Growth (%)	NA	137
Operating Income	749	1,094
- YoY Growth (%)	NA	46
Operating Expenses	260	372
- YoY Growth (%)	NA	43
Pre - Provision Profit	489	723
- YoY Growth (%)	NA	48
Prov. and Cont.	113	111
- YoY Growth (%)	NA	(2)
Profit Before Tax	376	612
- YoY Growth (%)	NA	63
Provision for Taxation	134	213
- as a % of PBT	36	35
PAT	242	398
- YoY Growth (%)	NA	65

Balance sheet

Y/E March (₹ cr)	FY10	FY11
Share Capital	1,354	1,417
Reserve & Surplus	672	1,431
Borrowings	9,727	15,916
- Growth (%)	56.4	63.6
Other Liabilities & Provisions	667	928
Total Liabilities	12,419	19,693
Investments	309	732
Advances	10,949	17,411
- Growth (%)	54.2	59.0
Fixed Assets	398	453
Other Assets	763	1,096
Total Assets	12,419	19,693

Ratio Analysis

Year end March	FY2010	FY2011
Per Share Data (₹)		
EPS	1.9	2.8
ABVPS (75% Coverage for NPAs)	14.1	19.6
Profitability ratios (%)		
NIMs	7.8	7.1
ROA	2.5	2.5
ROE	21.1	16.3
Asset Quality (%)		
Gross NPAs	2.49	1.10
Net NPAs	1.73	0.67
Valuation Ratios [§]		
PER (x)	26.5	18.1
P/ABVPS (x)	3.6	2.6
DuPont Analysis (%)		
NII	7.1	6.5
(-) Prov. Exp.	0.9	0.7
Adj NII	6.2	5.8
Other Inc.	0.2	0.3
Op. Inc.	6.4	6.1
Opex	2.6	2.3
PBT	3.9	3.8
Taxes	1.3	1.3
ROA	2.5	2.5
Leverage	8.3	6.6
ROE	21.1	16.3

Note: [§] Valuations at the lower price band and pre issue earnings and adjusted book value

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