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Business India

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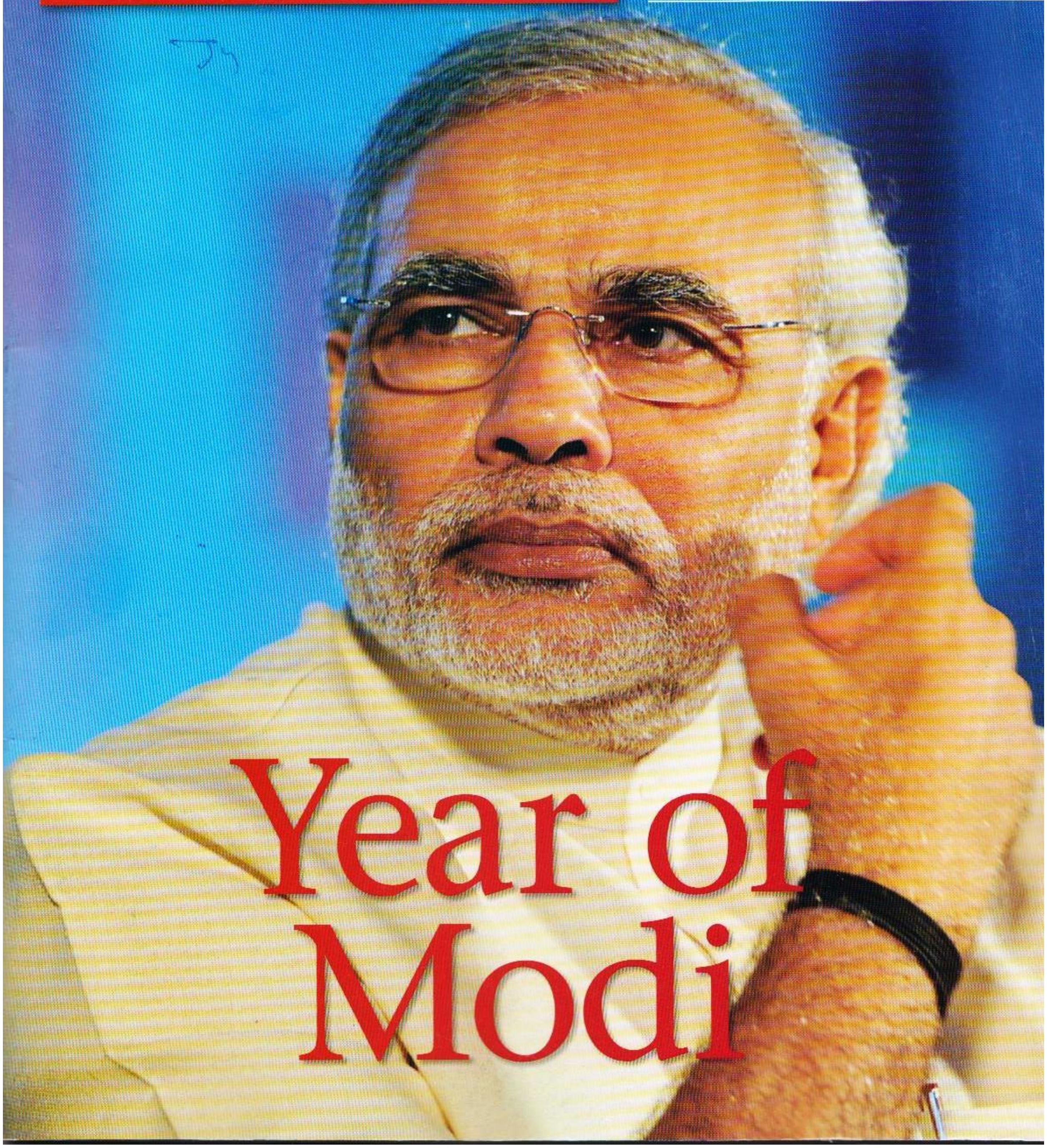

Year of Modi

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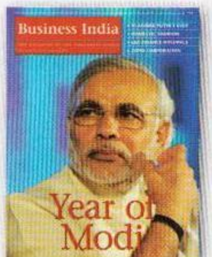
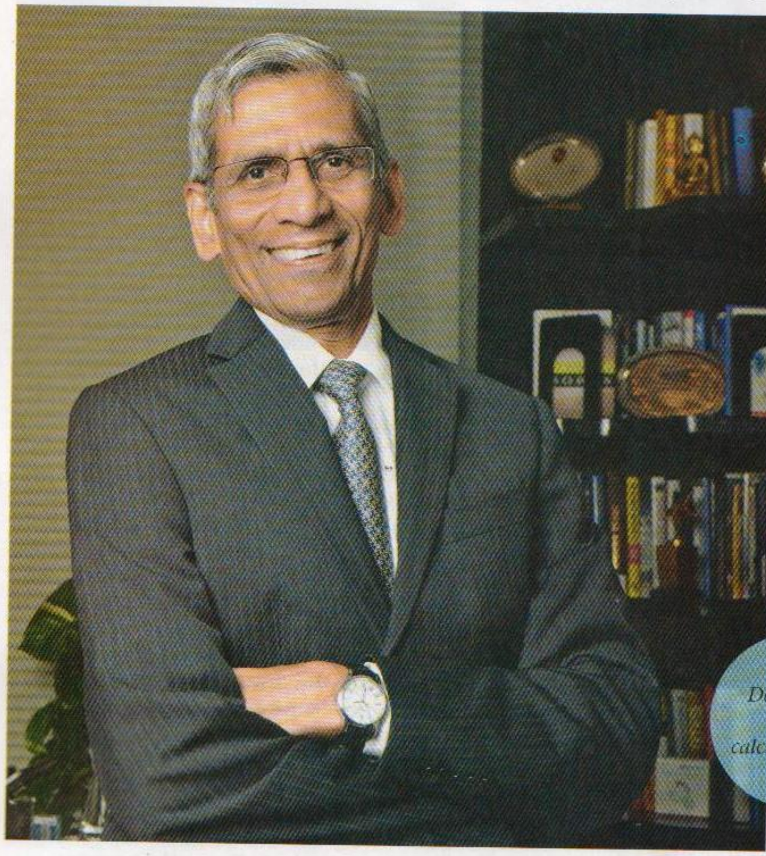


COVER PHOTOGRAPH BY SANJAY BORADE

Betting on second innings

L&T Finance Holdings is back on its growth trajectory



PALASHRANJAN BHAUMICK

Deosthalee: we take calculated risks

L&T Finance Holdings Limited (LTFHL) had evoked a good response when it came out with its maiden IPO in 2011. The issue was oversubscribed five times in a market still reeling from the aftermath of the global financial crisis. LTFHL had a strong pedigree and good governance practices. It was a professionally managed company, with no alignment with any business group. The top team was soon to be led by Y.M. Deosthalee, a veteran in the finance sector, who also played a key role in shaping Larsen & Toubro with A.M. Naik. Investors expected LTFHL to become one of the biggest lenders, and a name to reckon with in the NBFC segment, competing with the likes of Bajaj Finserv, M&M Financial, Sundaram Finance, Tata Capital and Reliance Capital.

Business India had last written about LTFHL in its issue dated 6 January, 2013, where it was stated that LTFHL was busy putting all its building blocks in place and readying itself to take the next big leap. A subsidiary of L&T, the NBFC had aggressively pursued an inorganic growth model, since its IPO. It had made four acquisitions, with a view to have a diversified portfolio – the biggest being Fidelity Mutual Fund, which it acquired for ₹550 crore. Earlier, in 2009, it had acquired DBS Cholamandalam Mutual Fund for ₹45 crore. It had also acquired Indo-Pacific Housing Finance for ₹110 crore, followed by Family Credit, a Societe Generale group company largely funding two-wheelers, for ₹120 crore.

After these acquisitions, the company had a well-laid out strategy of straddling all verticals in the finance sector. Through its four subsidiaries – L&T Infra Finance, L&T Finance, L&T Mutual Funds and L&T Housing Finance – it had taken exposure to project finance, corporate finance and advisory, retail finance, mutual funds, portfolio management, home loans and builders finance. The reasoning was that with the parent company L&T being in construction and engineering, LTFHL would be able to better appreciate and understand the nuances of projects and fund them in a meaningful manner.

The company had been studiously putting all the building blocks together and readying for the next leap, which was to acquire a banking licence, as and when RBI came out with the guidelines. On the hopes of it getting a bank licence, the share prices had run ahead of its fundamentals, soaring to an all-time high of ₹97 in December 2012, which, in turn, saw its market cap rise to a high of ₹15,000 crore.

The huge expectations built in the prices saw the markets value LTFHL higher than Bajaj Finserv, Aditya Birla

STEADY GROWTH

(₹ crore)

L&T Finance Holdings	H1 FY15	H1 FY14	% change
Loans & advance	42,760	35,459	21
Disbursements	14,163	11,405	24
NIM	1,190	937	27
NIM (%)	5.78	5.47	27
PAT	364	333	9
Gross NPA (%)	2.96	2.89	
Average AUM	20,673	15,079	37

Nuvo, M&M Financial Services, Reliance Capital, Indiabulls Finance and Sundaram Finance (see box: *Then and now*). Shriram Transport had a higher market cap, but its holding company was unlisted, as was Tata Capital. In terms of market cap LTFHL was also bigger than several of the PSU banks, including Union Bank, Syndicate Bank, Central Bank and even private sector banks like Federal Bank and ING Vysya, which was then valued at a little over ₹7,600 crore.

When RBI finally doled out the licences in April 2014, after a 10-year hiatus, LTFHL was given a miss. Of the 25 aspirants shortlisted, only IDFC, another strong lender in the infrastructure segment, and Bandhan, an NBFC specialising in providing micro-finance, were given the in-principle nod by RBI to set up banks. At that time, RBI had indicated that it would be putting in place a system to provide banking licences on tap. These could be for banks providing partial services, as against full banking services.

RBI took a few months before it finally came out with the guidelines for payment banks and small banks. Prior to the guidelines being released, there were unconfirmed reports about LTFHL making a bid for ING Vysya, which was eventually taken over by Kotak Mahindra. "This is a natural progression in a bank," says Y.M. Deosthalee, CMD, LTFHL. Without confirming or denying rumours about takeover bids, he adds: "When and how is another matter."

In the detailed guidelines for small finance banks, which the RBI released in the last week of November, 2014, it stated that there would be no restrictions on the area of operations for small finance banks. The banks would be allowed to offer basic banking services of accepting deposits and lending to farmers, small businesses and micro and small industries, besides other simple financial activities. The application for the banks had to be made before 15 January 2015.

While the guidelines *ipso facto* are not sufficient to incentivise NBFCs to make a bee-line for getting licences, the directives did give an option to an aspirant – that getting a small finance bank under its umbrella could be the first step towards becoming a universal bank.

Given its size and the wide scope of activities, it would make more sense for LTFHL to aggressively look at acquiring a large bank. Earlier it had pared its investments made in City Union Bank, albeit at a profit, ahead of applying for the bank's licence, the first time around. But, with opportunities of acquiring a decent pan-India size bank becoming scarcer, it is now left with the idea of applying for a licence and investing ₹100 crore plus towards meeting the net worth requirements. While the NBFC could well carry out almost all the functions of a bank, a universal bank, which is LTFHL's ultimate goal, would allow it to expand its activities to get into cash management business, provide guarantees and open letter of credit to its clients and also manage foreign exchange transactions in a more meaningful manner. It would not suit LTFHL to remain a niche player in the banking sector.

Noteworthy performance

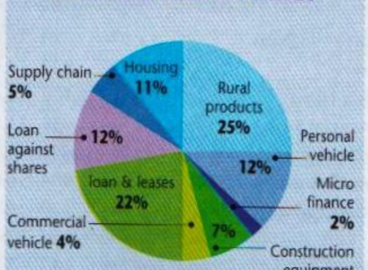
Currently, the company has a loan book of ₹42,750 crore (as on September 2014). Of this, the retail and mid-market division (comprising rural products, personal vehicle, micro-finance, construction equipment, commercial vehicles and housing finance) contributes ₹23,100 crore; housing finance accounts for ₹2,500 crore; and the infra loan book (comprising thermal power, renewable power, T&D, transportation & telecom) brings in the balance ₹19,660 crore (*see chart*). What is even more noteworthy is that managing assets with different maturities ranging from six months at the short end to five years in case of wholesale finance, the company has been able to have a diversified and balanced portfolio. It is funded through a judicious mix of borrowings from banks, mutual funds and institutions at competitive rates.

Besides this, the company has also grown its investment management business accounted by the mutual fund and wealth management business. Led by Ashu Suyash (who had been with Fidelity since inception), L&T Mutual Fund has been doing well – its total AUM more than doubling to ₹20,700 crore, since coming under the L&T banner in 2012. The company's equity assets account for about 32 per cent. It has also started a wealth management business, where it manages assets of ₹6,000 crore. The exposure to the large base of retail

DIVERSIFIED ASSET BOOK

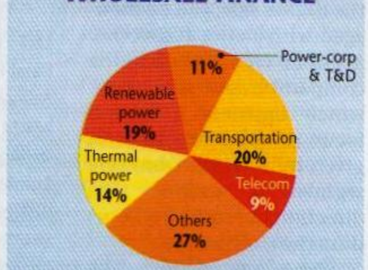
Total: ₹**42,760** crore

RETAIL & MID-MARKET



Total: ₹**23,100** crore

WHOLESALE FINANCE



Total: ₹**19,660** crore

Then and Now

The NBFC sector has been growing steadily over the last five year's. Care Ratings in its report on the NBFC Sector: *Trends, regulatory framework and way forward*, estimates that NBFC's assets have grown steadily from 10.7 per cent of banking assets in 2009 to 14.3 per cent of banking assets in 2014. However, the going has been tough for all NBFCs over the last couple of years. The slowdown in the economy, coupled with high interest rates, had deterred buyers from acquiring assets – both income-generating ones like tractors and commercial vehicles, as also cars. Home buyers were also deferred their purchases. This impacted new businesses, with the slowdown impacting cash flows on existing loans, giving rise to higher NPAs. The NPAs were marginally lower at about 3.4 per cent in 2014 due to the comfortable capital adequacy of the NBFC companies and also because of a marked shift towards secured lending.

The problems of NBFC have been compounded with banks entering their fiefdom. "Competition is becoming fiercer from both PSU banks and private sector banks, which are increasing their footprint in the rural markets," says Lakshmi Narasimhan, CFO, Magma Fincorp. NBFCs may soon lose their edge in funding new commercial vehicles and tractors because of these banks. A few NBFCs are sensing this trend ahead of the others and looking at building diversified

Thakkar: merge or perish

Narasimhan: fierce competition

income streams. Even in agri-finance, changes are taking place, says Narasimhan. For instance, "The tractor is no longer an agri-product but a haulage product," he adds, and so, companies have to change their financing strategies by widening its target audience.

The stringent guidelines prescribed by the RBI for NPA recognisation, capital adequacy and provisioning, which will be made applicable in the future will impact them even more. "Consolidation will happen in the NBFC sector; small NBFCs will have to merge or perish," prophesies Mahesh Thakkar, director general, Finance

investors has also allowed cross-selling of products through its 700 plus points of presence, which includes 150 branches, as also mobile loan vans plying in the rural areas.

It is true that, like other NBFCs, LTFHL has had its own share of problems. The gross NPAs largely from delayed recoveries in the commercial vehicle had seen the gross NPA levels in the lending business go up to 3.18 per cent of the total assets. This had been brought down to 2.96 per cent in the previous quarter ended September 2014 which, though on the higher side, can be managed with better recoveries. Another view was that the company is not sure about which business it should focus on and emphasis is given by rotation from one segment to another. The direction the company seeks is unclear, critics feel.

Some key people like Ved Prakash, who handled the wealth management business, have also left the company. One view is that the top team also requires to be reshuffled, with more young blood requiring to be inducted. After all, finance is all about taking risks, is the argument, and a young management team will be better suited for the job. However, some others feel that a balance between experience and fresh blood is the need of the hour. Also, given the deep pool of talent within the group, getting more committed professionals into the mid-tier or top tier management team, is hardly going to pose a serious problem.

"We are a conservative group, but we do take calculated risks," says Deosthale. Despite encountering problems in micro-finance in Andhra Pradesh earlier, the group has again built a franchise in that discipline across eight states – Tamil Nadu, Maharashtra, Gujarat, Odisha, Kerala, MP and Karnataka. Expanding footprint in the local area besides helping the company develop a local stand also complements its other business of tractor finance and affordable housing. The company, which has a loan book of ₹600 crore, maintains that micro-finance is not a losing business, with recovery being as high as 99.9 per cent. It is already scouting for takeovers in micro-business as in other businesses. However, the management is clear about its priorities and

PEER COMPARISON

(₹ crore)	12 Dec '14		11 Dec '12		
	CMP	Mkt cap	Mkt price	Mkt cap	% change
L&T Finance Holdings	88	12,074	70	15,064	-20
Bajaj Finserv	1,287	20,482	921	14,660	40
Aditya Birla Nuvo	1,666	21,672	1,100	12,485	74
M&M Financial Services	300*	8,524	1,038	11,806	-28
Reliance Capital	515	12,904	453	11,124	16
Sundaram Finance	1,278^	14,205	1,084	6,021	136
Religare Enterprises	312	5,569	320	4,785	16
IIFL**	180	5,440	84	2,556	112
Edelweiss	51	4,029	34	2,589	56
Motilal Oswal	259	3,600	128	1,854	94

*Post split ito 5 shares. ^Sundaram Finance bonus 1:1; ** India Infoline

SANJAY BORADE

Bagga: business will explode

Development Industry Council, an umbrella body of asset financial companies. Thakkar feels that RBI is meting out a step-motherly treatment and not allowing them to compete on an equal platform with banks for which it has a soft corner. However, for the big NBFCs, which are innovative, the future is bright. The SARFESI Act should also be made applicable to NBFCs to facilitate faster recoveries. An NBFC should be allowed to have asset-wise differential risk weightages, he feels.

Against this background, many of the NBFCs had shown a sedate growth in 2012-13. It was only in the current year that the prices of finance companies started moving up, in line with the overall change in the market sentiments, following the taking over of the new government at the Centre.

Many broking companies, which had also started building comprehensive businesses and ventured into housing finance (such as IIFL, Edelweiss, Motilal Oswal, Religare, etc) bounced back faster, following the healthy growth witnessed in the stock markets. IIFL notched a 112 per cent growth over a two-year period, while Sundaram Finance, one of the best managed finance companies (which had made its intention of not going in for a banking licence), saw the fastest appreciation at 136 per cent. L&T Finance Holdings, which had seen a lot of expectations built in the prices in 2012 (which were clearly running ahead of fundamentals), saw its price dip to a level of ₹70, where it has steadied itself. Aditya Birla Nuvo, a more diversified conglomerate, posted a 74 per cent growth, following improved returns on its telecom and other investments. M&M, largely into tractor finance, suffered a minor setback.

However, given that finance sector is a harbinger for change and runs ahead when the economy moves in the fast track, NBFCs are likely to perform better, ahead of actual changes being witnessed in the economy. "NBFC business will explode in the coming years," says Ajay Bagga, executive chairman, OPC Asset solution Private Ltd, an asset life cycle management company. Bagga, who was earlier with Deutsche Bank, feels that the NBFC fulfils the need of a segment that is not serviced by the banks or where banks take restricted exposure. In real estate, banks are wary of funding land purchase, but NBFC do so, he adds.

The much expected drop in the interest rates and higher consumption and investment demand is likely to see better days ahead for NBFCs. It will be a long time before banks can elbow out these companies. •

is emphatic about not going in for gold finance, despite it being lucrative.

New thrust

Sensing a slowdown in infrastructure, the company has pared its exposure to power plants much before others. In 2014-15, it has limited its exposure to only operational assets. Solar energy has now become a significant part of their assets in the wholesale funding business. The company is now gearing for the new thrust on infrastructure projects, which are expected to make a comeback in the coming months. N. Sivaraman, president & whole time director, L&T Finance Holdings, is optimistic about a revival sooner than later. "In the infrastructure segment, the government is trying to work on land purchase processes," he explains. "An accelerated implementation programme by NHAI could also help revive this sector. We are hopeful and should see action on the ground."

He feels the government should quickly re-allocate coal block as this will help "resolve issues for plans which are operational and under-construction." While this is not going to create any new projects, the uncertainty around the availability of coal for projects will disappear, he adds. The government is seriously trying to kick-start the investment climate in the country. One report says that over the last few months, nearly 322 projects entailing investments of ₹13 lakh crore have been cleared. The sharp drop in commodity prices could be another positive for companies to accelerate the project execution is one view.

With consumption also likely to get a boost from the various government initiatives, LTFHL can look forward to a bright future. Contrary to perceptions, "Our B2C segments, which are mainly rural products, personal vehicles and micro-finance, have grown by 18 per cent," says Dinanath Dubhashi, MD & chief executive, L&T Finance. He, however, admits, "In the mid-corporate segment – retail B2B products and SME – we have gone relatively cautious and, hence, our net growth in disbursements is actually about 19 per cent, lower compared to last year. This is one reason for the shift in the product mix with greater emphasis on B2C products."

Having multiple businesses allows LTFHL flexibility in changing their product mix and giving emphasis on the growth of different segments depending on the overall growth prospects. The goal is clearly to build a comprehensive financial services business, with a bank or otherwise.

The markets, which had shown its disappointment when LTFHL did not get the banking licence the first time around, is now hoping that the company will make a comeback and try to get a small finance bank's licence with the ultimate aim of becoming a universal bank. However, unlike the last time around, no expectations are being built in the share prices, which continue to stay at ₹70 levels. The rationale clearly is that, if the management does decide to make an application and secures a licence, it will be a bonus. Till then, the policy will be to 'wait and watch'.

• DAKSESH PARIKH