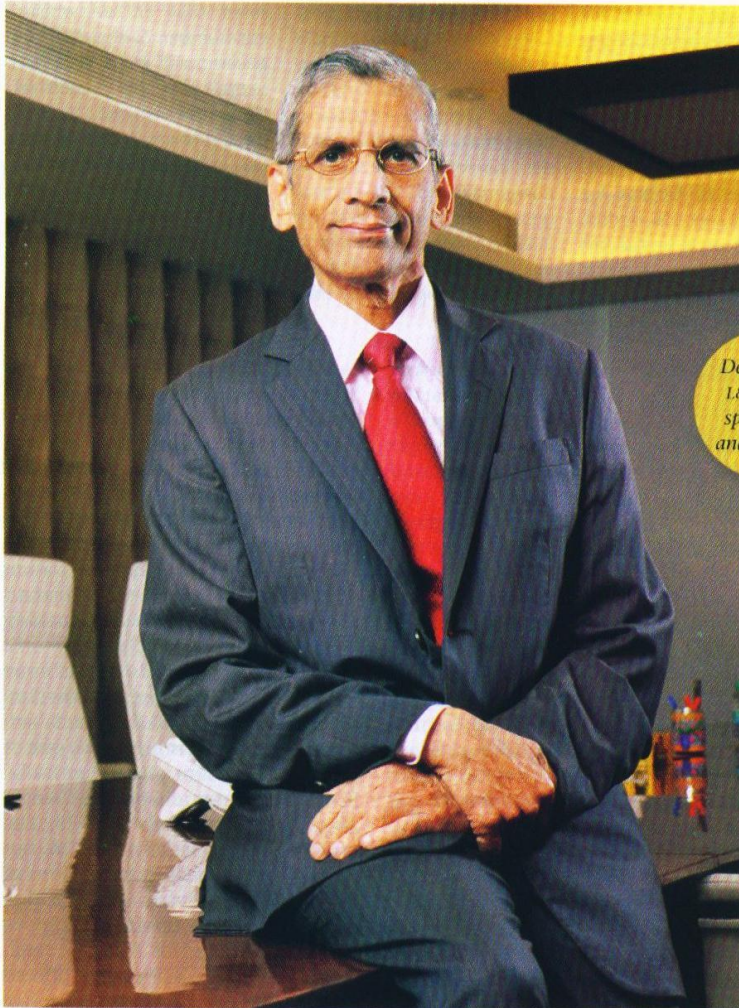


Betting on the bank



*Deosthalee:
L&T brand
spells trust
and integrity*

PHOTO: SANJAY BORADE

the granting of new banking licences was a major reason for re-rating the sector over the last few months. Besides adding respectability to the NBFC, a banking licence would also allow companies in the sector to access relatively low-cost funds, expand their lending business by giving guarantees and letters of credit and pursue other options, which NBFCs are currently not allowed.

The clearance of the bill permitting FDI in multi-retail format by the Central government in both houses of Parliament (despite being opposed by some key allies) in December has buoyed investor sentiment. They now hope that the Banking Laws Amendment Bill (2011), facilitating the issuance of new licences by the RBI, would likewise be passed in both the houses of the Parliament soon. Finance minister P.C. Chidambaram has already written a letter to the RBI to formalise application guidelines and seek applications ahead of the bill being passed.

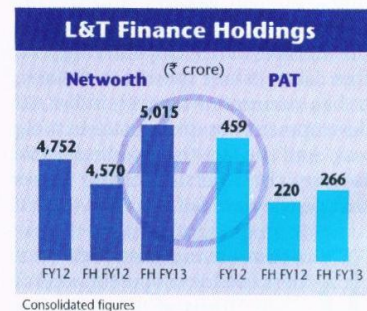
Among other things, the bill will empower the RBI by giving it powers to supersede boards of banks, inspect accounts of groups having a bank and regulate their shareholding pattern. The RBI had sought empowerment as one of the pre-conditions for the issue of new licences, which had been kept in abeyance for over a decade. In a bid to pave the way for a smoother transition, the RBI recently amended the NBFC guidelines, aligning the

L&T Finance Holdings is busy putting all its building blocks in place to take the next big leap

Investors in L&T Finance Holdings are a happy lot. The share price of the company, which is ranked amongst the top NBFCs by market cap (₹15,064 crore), recorded a 52-week high at ₹92.50 on 10 December. While the shares of other NBFCs have also rallied during the first fortnight of December, LTFH has surged the

fastest. Quoted at ₹43 in September (close to its 52-week low), the price in the subsequent 68 sessions appreciated by more than 100 per cent. This is much more than the share appreciation of Aditya Birla Nuvo, Bajaj Finserv and M&M Financial Services (see graph: Standing tall).

Expectations of the RBI formalising



provisions on the treatment of non-performing assets by NBFCs with those prescribed by banks. The message was clear – only well-capitalised NBFCs, with a demonstrated track record of 10 years, and are able to meet the stringent capital adequacy norms, would be eligible for a bank licence.

L&T to that extent is adequately capitalised. The net worth of its consolidated balance sheet stood at ₹5,015 crore as on 30 September 2012, while its loans and advances totalled ₹27,664 crore. Its PAT for the first half of 2012-13, at ₹271 crore, showed an improvement over the corresponding period of the previous year, which stood at ₹230 crore (see table). Taking cognisance of its size, pedigree and performance, the markets have valued LTFH at a little over ₹15,000 crore, placing it ahead of other NBFCs, which are also aspirants for the banking licence. "L&T is a symbol of professionalism and L&T Finance Holdings is growing at a scorching pace, capitalising on core competencies and focussed on value creation for its stakeholders," says Asit C. Mehta, chairman, Nucleus Financial group. "It is indeed among the best candidates for a banking licence."

To licence, or not

Bajaj Finserv, Aditya Birla Nuvo, Reliance Capital and Mahindras are the other companies with market caps of over ₹10,000 crore. Shriram Transport Capital is the only NBFC that has a larger market cap at ₹16,000 crore. However, Shriram Capital, the holding company of the Shriram group, which houses all the promoters' stake held in the various companies, is

Holding structure	
Subsidiaries of L&T Finance Holdings	
L&T Infra Finance	Project finance, corporate finance & advisory
L&T Finance	Retail & corporate finance
L&T Mutual Funds	Mutual fund, portfolio management, wealth management
L&T Fin.Corp	Non-asset back loans
Indo-Pacific Housing Finance	Home loans & builders finance



Sivaraman: comprehensive financial service

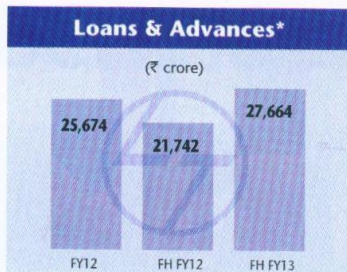
unlisted. IDFC, another aspirant with an impeccable track record in infrastructure financing, may not, according to an analyst, fit the bill, as its co-promoter, the HDFC group already has a bank under its umbrella.

Tata Capital, yet another aspirant qualifying for the licence, is also unlisted. If one were to exclude the specialised housing finance NBFCs, including LIC Housing Finance, the market cap of LTFH is more than that of several banks – both in the private and public sector. LTFH is valued over Union Bank (market cap: ₹14,072 crore), Central Bank and ING Vysya Bank (see box on market cap).

Dinesh Thakkar, chairman, Angel Broking, a Mumbai-based large retail broking house, says that they had identified L&T as the most likely corporate to get a licence almost two years ago, when the RBI had initially come out with a discussion paper on allowing corporations to get a banking licence. "Our understanding from the discussion paper was that going by global precedents, the RBI was not keen to give banking licences to promoter-driven corporate groups," says Thakkar. "We also reckoned that, logically, a banking licence could only be given to a corporate which had financially deep enough pockets

and a strong corporate reputation. Amongst companies with a market cap of over ₹10,000 crore, the only interested corporate, with a promoter holding of less than 25 per cent, was L&T – a completely professionally managed, highly reputed, cash-rich corporate, and was not driven by a single promoter. So, in our view, L&T (through L&T Finance) remains the most logical corporate to get a banking licence."

Incorporated in 1994 primarily for funding SMEs, LTFH did not play any meaningful role in the NBFC sector till a decade later. The financial sector was in a bad shape, reminisces Y.M. Deosthalee, the erstwhile finance director of the company, who is a chartered accountant by profession and widely acknowledged as one of the key architects who shaped L&T's fortune. According to him, LTFH played a sales-and-support function for its tractor division in the initial years. Despite its low operations, the company remained profitable all through, he points out. When A.M. Naik, a veteran at L&T, took charge of the company (first as MD and later as the chairman), a review of all business lines was done in a bid to restructure L&T's diverse product portfolio. Unrelated business



lines and those not making meaningful contributions to the top-line were identified for divestment (see Business India, 16 February 2004).

Holding on to finance

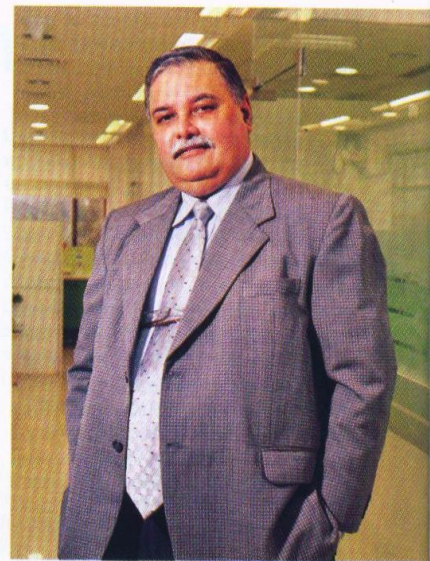
While L&T Finance was a natural choice for exiting, Deosthalee, who had been with L&T for over three decades, made a strong case before the board to retain the financial subsidiary. After the divestment of the cement division to the Aditya Birla group, Deosthalee argued that it made sense for L&T to broaden the portfolio of the finance company from the SME sector to infrastructure funding, equipment funding, as also consumer finance, by leveraging the existing platform. The sustainable and predictable income from the business would help in balancing the income flow from the cyclical, construction business, he reasoned.

He also pointed out that leveraging

the L&T brand, which spelt trust and integrity, would help create value for the stakeholders, which could be unlocked at a future date. A complete road-map was presented, which contemplated forays into equipment finance, project finance, housing finance and even general insurance, as also getting into the mutual fund business. "Our focus, even during the conceptualisation stage, envisaged the creation of a comprehensive financial service business," explains N. Sivaraman, president and whole-time director, who earlier played a key role in ensuring the smooth demerger of the cement business.

Convinced by his arguments, the board backed Deosthalee and gave him a free hand to grow the business. Over the last five years, LTFH has initiated the exercise of putting the building blocks in place. It has hired professionals with diverse backgrounds from various industries to set the ball rolling. Sunit K. Maheshwari, an MBA with 31 years experience in infrastructure financing and corporate funding, was given the mandate to build a specialised financial institution. He was given a free hand in selection of his team; he also helped to put in place a board of advisors for building L&T Infrastructure Finance Co, which was set up in 2007.

"We understand projects and project risk," explains Maheshwari, who has built a loan book of ₹12,000



Maheshwari: 'we are different'

crore as on 30 September 2012. "Our appraisal ability, risk mitigation processes and ability to handle sticky assets differentiates us from other infra funding companies." Being in the construction business, Maheshwari felt that LTFH could understand the issues involved in projects better. Besides providing project loans and corporate loans, the company also makes equity investments and offers advisory services and undertakes loan syndication.

The biggest of them all

Besides finance companies in the private sector, LTFH is more valuable than several banks including Union Bank, Syndicate Bank and Central Bank

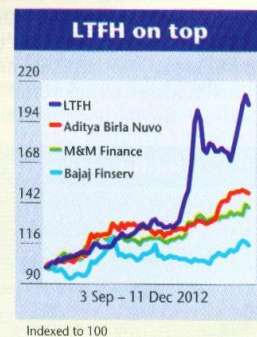
There are five NBFCs with market caps of over ₹10,000 crore: L&T Finance, Bajaj Finserv, Aditya Birla Nuvo, Mahindra & Mahindra Financial Services and Reliance Capital. Of these, LTFH is the largest, having a market cap of over ₹15,000 crore, while Reliance Cap is the lowest among the top

5 category (see table). Technically speaking, all five are holding companies, with several subsidiaries.

Bajaj Finserv has a separately listed arm – Bajaj Finance – which has a market cap of nearly ₹5,500 crore, which is higher than the market cap of Religare, India Info-line, Edelweiss or Motilal

Oswal. Aditya Birla Finance is a division of Aditya Birla Nuvo, which plans to spin it off when it reaches a large enough size. Shriram Capital, the holding company of the Shriram group, is unlisted, although its associate company – Shriram Transport – has a market cap of over ₹16,000 crore. Tata Capital, another strong contender for the banking licence, is also not listed.

LTFH is not just the biggest amongst private sector finance companies but also bigger than several private sector and public sector



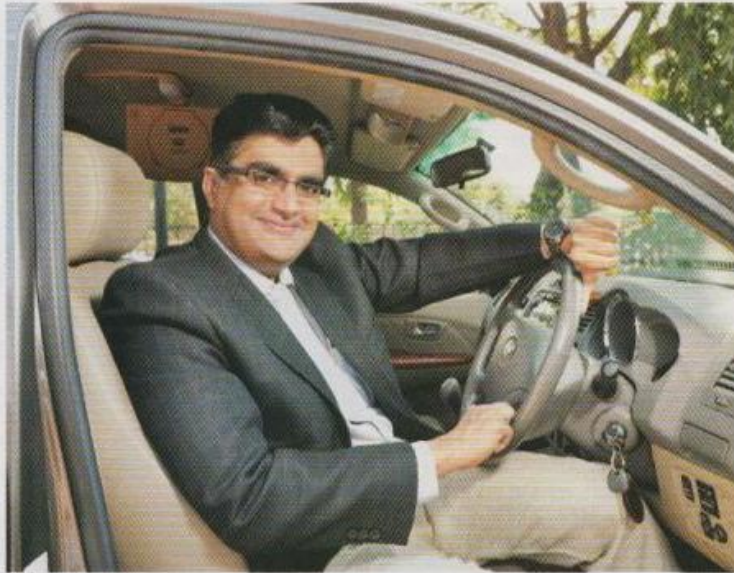
banks ranked by market cap. Amongst the leading PSU banks, Union Bank has a market cap of a little over ₹14,000

Dinanath Dubhashi, a mechanical engineer with an MBA from IIM Bangalore, was given charge of leading the company's foray into retail finance. The mandate was clear – provide loans against income-generating assets, which included farm and construction equipment, as also commercial vehicles, more so in Tier III and Tier IV towns. "Working with LTFH is like being an entrepreneur, with the safety of working under a big brand," he says.

Leveraging retail

Being in retail finance provides an opportunity for growth of retail loans and allows LTFH to build a diverse portfolio with different maturities – be they typical consumer loans, including housing and car finance or funding against shares or small ticket loans. It also helps LTFH provide loans ranging from 12 months to 10-15 years. Housing is a new area for LTFH after the acquisition of Indo-Pacific Housing Finance Co, which it acquired for ₹110 crore in 2012-13. It also acquired Family Credit Ltd, a Soc. Gen. group company primarily engaged in financing two-wheelers, for ₹120 crore in 2012-13. "We are putting the building blocks in place," says Dubhashi.

"L&T Finance Holdings is a good example of what you can build, with a defined vision set by Deosthalee and crisp execution by Sivaraman and his



Dubhashi: safe under a big brand

team," says Tarun Kataria, CEO, India, Religare Capital Markets Ltd. "Add to this a strong brand, good governance and a diversified asset portfolio and you have the makings of a financial services business, with a good long-term value story." Religare Capital Markets, a part of the Religare group of companies, is also a potential aspirant for securing a bank's licence.

Deosthalee, as the non-executive chairman, took complete charge in 2011 only after his retirement,

coinciding with the listing of the LTFH's IPO (see *Business India*, 7 August 2011). The day-to-day execution was left to Sivaraman, another L&Tite, who worked closely with Deosthalee in the finance division. Incidentally, the new business was initially housed in the same office in Bandra-Kurla Complex, Mumbai, which earlier housed the cement business.

With a full team in place, LTFH has put the two main building blocks in place and created a holding

crore, while Syndicate Bank comes a little under ₹7,900 crore and Central Bank, under ₹6,000 crore. One can argue that PSU banks' shares in the current environment are not fancied by the investors and have suffered fair erosion in market cap on fears of growing NPAs eating into their profit.

Even so, the value of LTFH is as much as the combined value of Vijaya Bank (₹3,064 crore), Dena Bank (₹4,095 crore), UCO Bank (₹5,275 crore) and Bank of Maharashtra (₹3,045 crore). Amongst the old private sector banks

too, LTFH's market cap is nearly twice that of ING Vysya (₹7,612 crore) and Federal Bank (₹8,553 crore).

It is no wonder that a few analysts have started benchmarking LTFH not just amongst its peers in the finance sector but also against banks both in the public and private sector. Some suggest caution, as they feel that the market, in its enthusiasm, has seen the share price run ahead of fundamentals on hopes. And if the bank's licence does not materialise, the market's disappointment may see a sharp erosion in share price. ♦

Standing tall

	Marketcap (₹ crore)	CMP* (₹)	52 week hi/low (₹)
L&T Finance Holdings	15,064	88	92/40
Bajaj Finserv	14,660	921	979/392
Aditya Birla Nuvo	12,485	1,100	1,143/710
M&M Financial Services	11,806	1,038	1,117/590
Reliance Capital	11,124	453	482/226
Indiabulls Finance	8,292	265	285/129
Sundaram Finance	6,021	1,084	1,118/420
Religare Enterprises	4,785	320	448/300
India Infoline	2,556	84	88/43
Edelweiss	2,589	34	46/22
Motilal Oswal Financial Services	1,854	128	137/75

Shriram Transport has a higher market cap but its holding company is unlisted. As is Tata Capital.
*Current market price as on 11 Dec 2012. Source: BSE

company that could take advantage of the investment and consumption story of India. "It is a well-crafted business model, articulated to bring quantum growth for the consumption and infrastructure areas under its respective arms of retail and infrastructure funding," says Deven Choksey, CEO, K.R. Choksey Financial Services, a Mumbai-based broking and research firm.

Ramping up

LTFH has also made some aggressive moves in a bid to widen its portfolio. It is also pursuing aggressive M&A initiatives to either ramp up its existing business or get a ready-made platform to take off from. After taking over DBS Cholamandalam AMC in 2009 to start a mutual fund business earlier this year, it paid an estimated ₹550 crore to take over main stream player Fidelity AMC with an AUM of under ₹9,000 crore – and, more importantly, managed to retain the top team headed by Ashu Suyash, who had built the Fidelity mandate in India.

The takeover of the assets, largely equity focussed, complements L&T's existing products, which were more debt-focussed. L&T now looks, for the first time, like a serious player in the mutual fund space. Schemes with similar focus were merged with the integration of the fund and merger of schemes taking place simultaneously. The takeover of Fidelity also saw the distribution franchise grow to 50 locations, pan India. "With a solid on-ground presence, we will take it to the next level," says Suyash, who is busy expanding on mandates from offshore and replicating Fidelity's research-driven structure in LTFH. The fund's AUM as on 30 September 2012 stood at over ₹13,000 crore.

Funding growth or operations has never been an issue, given the strong backing of its parent, L&T. In the case of wholesale funding for large infra projects, LTFH gets funds from banks, mutual funds and institutions, with interest rates of 9.5-9.75 per cent for both infra and finance. A tight check on operational expenses, which are amongst the lowest, makes L&T a partner of first choice in several of its businesses. Admitting that



Suyash: going to the next level

the finance sector is crowded and the landscape is getting competitive, "We do not look at year-on-year growth but believe in building businesses for perpetuity," says Deosthalee.

General insurance is the next big sector, where it plans to expand, albeit slowly. "There is no sense in pursuing growth at all costs and burning capital if you are making losses," is the well-enunciated policy of the company, which is followed even in this sector.

Of course, not all forays have gone well. Its earlier foray into micro-finance in the southern region did not meet with success. And the company, foreseeing adverse winds in the industry, has made additional provisions against its NPA portfolio, writing off ₹90 crore from its total provision of ₹140 crore. The management, however, feels that this is part

of the learning curve. It is not that LTFH has a unique business model. Several other companies are also trying to build an integrated full-service financial house.

Motilal Oswal, Edelweiss and India Infoline are some of the broking houses trying to build diverse income streams by getting into different verticals, including mutual funds, NBFC lending, insurance distribution and wealth management. Bajaj Finserv, through its subsidiary Bajaj Finance, is also trying to get into investment management, having built a strong franchise in vehicle finance and consumer equipment funding. Reliance Capital, through its division Reliance Money, had earlier built a retail investors' franchise. Reliance, Birla and Bajaj are also in Life & General Insurance, while Edelweiss too has made a start in Life.

However, unlike its other peers which are promoter-led, LTFH is professionally driven. And Deosthalee, a seasoned veteran in finance, is driving the team. "He is like super-man, exuding energy like a 21-year-old, extremely sharp and focussing on the macro- and micro-level equally well," says Suyash. "He encourages you to take decisions and plays the role of a mentor, ready to soak up tensions," adds Dubhashi. And while financial service is one more business line for other promoters, for LTFH, it is the only business. The plan is to ensure that it meets the internal target of a 25 per cent CAGR over the next five-to-seven years.

While investment demand is slow in India, like elsewhere in the world, it is likely to pick up in 2013-14. And with consumption demand also likely to gain traction in the years to come, LTFH, which is riding both growth planks of the economy, is in a sweet spot. The building blocks it has put in place will help it pursue growth aggressively in the coming years. With financial services being the precursor for growth in any economy, it may not be long before LTFH boasts a market cap equal to – or even higher than – its parent. A bank licence would be just the game-changer to ensure that this happens soon.

♦ DAKSHESH PARIKH

Growth through acquisition

Year		(₹ crore)
2009	DBS Cholamandalam AMC	45
2012	Fidelity AMC*	550
2012	Indo-Pacific Housing Finance	110
2012	Family Credit	120

*Industry sources