

# L&T Finance on buyout spree

With five acquisitions in recent years, the company wants to quickly move into the big league

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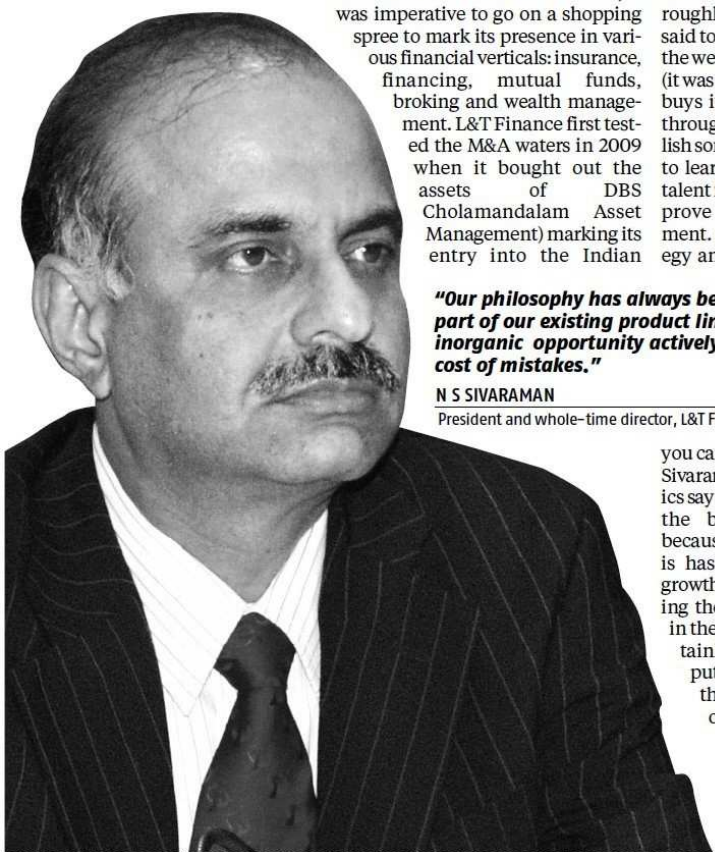
L&T Finance Holdings is all set to acquire Future Group's 50 per cent stake in Future Generali, the general insurer, for roughly ₹600 crore, and is being considered one of the top contenders for a new banking licence. With five acquisitions worth almost ₹900 crore in the last three years, the company is attempting to catapult itself to a sizeable player in this industry in a short period.

In contrast, its parent, Larsen & Toubro, or L&T, the engineering-to-construction conglomerate, took over six decades of painstaking efforts to reach the size it is today.

Barring a handful of buyouts, including that by its software arm, L&T Infotech, more recently, L&T has grown the conventional way.

Interestingly, L&T Finance's growth strategy has been scripted and is being implemented by two group veterans: YM Deosthalee, chairman and managing director, and N S Sivaraman, president and whole-time director.

For Deosthalee, 66, and Sivaraman, 54, who have served the parent company for almost four and three decades, respectively, the philosophy



## GEARING UP FOR THE FUTURE

Acquisitions by L&T Finance in the last three years

| Target       | DBS Cholamandalam AMC | Fidelity Mutual Fund India | Indo Pacific Housing Finance | Family Credit | JV with Future and Generali groups* |
|--------------|-----------------------|----------------------------|------------------------------|---------------|-------------------------------------|
| Value (₹ cr) | 45                    | 550                        | 118                          | 127           | 600**                               |
| Stake (%)    | 100                   | 100                        | 100                          | 100           | 51 in Combined Entity               |
| Year         | 2009                  | 2012                       | 2012                         | 2012          | 2013                                |

\*Merger of L&T General Insurance and Future Generali India Insurance; \*\*As per news reports

Source: Industry estimates and news reports

to acquire and grow had been relatively alien till almost three years back. But, it did not take much time for them to realise that there is little time to build an organisation of size in the ultra-competitive world of finance the conventional slow and steady way, like L&T. "Our philosophy has always been that if something is not part of our existing product lines, we would look at an inorganic opportunity very actively because it reduces the cost of mistakes," says Sivaraman, sitting in his office in Kalina, a Mumbai suburb.

### Quick growth

For a company which started as the finance arm of L&T in 1994 to help meet the working capital requirements of its dealers and vendors, it was imperative to go on a shopping spree to mark its presence in various financial verticals: insurance, financing, mutual funds, broking and wealth management. L&T Finance first tested the M&A waters in 2009 when it bought out the assets of DBS Cholamandalam Asset Management marking its entry into the Indian

mutual fund industry. In 2012, it acquired Indo Pacific Housing Finance and Family Credit, which provides auto loans.

The big one came in the same year (2012) when it bought out the Indian assets of Fidelity Mutual Fund. It is said L&T Finance paid ₹530-550 crore to buy Fidelity's assets under management worth around ₹8,800 crore (at the time of the acquisition). The acquisition was important for L&T Finance as a sizeable portion of Fidelity's assets were equities, which fetch fund houses higher profit margins than debt.

The company has now set its sights to expand in the insurance business as it is set to buy Future Group's 50 per cent stake in Future Generali for roughly ₹600 crore. L&T Finance is said to be considering acquisitions in the wealth management business too (it was in talks with Morgan Stanley to buy its local unit but the talks fell through). "When you want to establish something on your own, you have to learn. Even if you recruit all the talent from the industry, it still has to prove itself in a different environment. So if you have a business strategy and a management team, then

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President and whole-time director, L&T Finance Holdings

you can hit the ground running," says Sivaraman. Industry insiders and critics say the company has embarked on the buyout-driven growth plan because the top management feels it is has lost out on many years of growth. "The key people who are driving the strategy are among the best in the world of finance but age is certainly not by their side. They are putting their best to leave behind their imprint," says a top official of a rival financial services firm. Sivaraman, on his part, denies that the management is in a hurry. "When you are a player who is going to be here perpetually, timing doesn't

matter. There is no feeling of losing out. We started now and 50 years later, we'll still be there. So there is no hurry," says Sivaraman. A chartered accountant by training, Sivaraman started his career in the company's internal audit, which he considers the "least glamorous activity" around. He had stints in accounts and treasury later. Sivaraman says he never planned his career and took up whatever came his way. "I've never known my next job," he says. This philosophy has helped him move seamlessly into the financial services space.

### The L&T connect

Even as it looks to grow aggressively, L&T Finance is retaining part of the parent's conservative streak. This was evident when the management stepped in to temper the market's expectations about the company's prospects after a surge in its stock price in late 2012. The stock had more than doubled from about ₹42 in early September to a high of ₹97.35 in the second week of December. The buzz was that an operator, who was pulled up by the Securities Exchange Board of India in 2007 for alleged involvement in rigging up shares of a small construction company, was active in the stock. Confused by the rapid jump, analysts rushed to the company's management to understand the reasons behind the heightened activity. Sivaraman's experience in handling investors in L&T for almost seven years came handy in this situation. "We stepped in to communicate that there was unusual activity in the stock," says Sivaraman. The stock is currently at about ₹77.

Part of the optimism in the stock has been because investors and analysts believe L&T Finance could secure the coveted banking licence for which Reserve Bank of India has invited applications till July 1. "The market considers L&T Finance to be a contender because it has an independent promoter group which is not controlled by any family," says Amit Jain, a banking analyst at Sunidhi Institutional Research. "This is a big advantage for the company." L&T, which holds 82.57 per cent in L&T

Finance, is widely held by institutional investors such as LIC and SUUTI, and L&T Employees Welfare Foundation. A banking licence will help the company boost its lending capabilities and image compared to what a non-banking finance company (NBFC) enjoys, says Sivaraman. "Today, as an NBFC, it is very difficult to provide a loan to an AAA-rated company," he says. "Not because of higher cost of funds but that the leverage that a bank can enjoy on AAA lending is extremely high."

Also, being a non-deposit taking NBFC, the cost of funds has been higher for L&T Finance; banks are doing one-third of its funding which is hurting its margins. "It has hurt us over the last one-and-a-half years. The margins dropped because banks consistently increased rates and there haven't been too many sources available to borrow in the rising interest rate environment," says Sivaraman.

Analysts remain cautious about the company's prospects as losses from microfinance lending and in the mutual fund business will weigh down its return on equity (RoE), which could be lower than its cost of equity this year. The company is in the process of rectifying this. "The RoE would start looking up soon because the mutual fund business would break even next year, microfinance losses have been 'more or less' fully provided and credit cost will decline," says Sivaraman "In addition, we are raising preference share capital at the moment in order to put equity capital into various subsidiaries. This will help us in our capital requirement which is less than the cost of equity."

Analysts do not share Sivaraman's optimism about an immediate turnaround in the mutual fund business, which incurred a net loss to of ₹25 crore for the financial year ended March 31, 2012. Industry sources say L&T Mutual Fund would have to pay a higher cost to retain clients and large distributors who are not pushing its products yet. Fidelity Mutual Fund's equity schemes attracted a lot of investors partly because foreign banks, among the country's top distributors, pushed its products. "The empanelment procedure is taking place. Some of the large distributors should be able to do it by March end. Hopefully by this March we should be able to achieve key empanelment requirement for the business," says Sivaraman.

Also, as L&T Finance attempts to grow into a financial bigwig with diversified revenue streams, analysts say a business focus would help. "The company's well-diversified earnings structure is its strength and weakness too. Unlike many other players, there does not seem to be a focus," says Sunidhi's Jain.