

Equities

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L&T Finance Holdings (LTFH.BO)

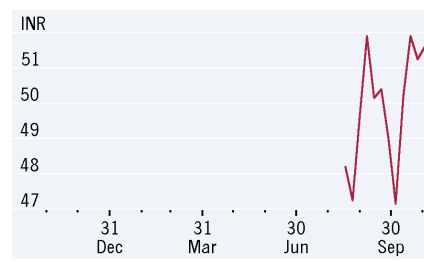
2Q12 Results: Strong Loan Growth but NIMs Moderate

- **1H12 profits up 9% yoy** — LTFH's 1H12 profits were up a modest 9% yoy, though up 29% yoy (excluding impact of microfinance). Key earnings drivers were: a) Strong loan growth (+53% yoy); b) Moderation in net interest margins; and c) Sharp asset quality deterioration in microfinance portfolio. Excluding microfinance - asset quality remained healthy, though continued rapid loan growth and macro challenges suggest caution.
- **Moderation in net interest margins** — LTFH's NIMs moderated by ~130bps (vs 1H11), largely on account of higher funding costs (average funding costs now at 8.5%). Management expects funding costs to largely remain stable and NIMs to improve slightly from current levels. NIMs for LTF were down 270bps (to 5.6%), however, this includes lower microfinance yields, excluding this NIMs were 6%, down 130bps yoy.
- **Cost-income ratio up slightly** — LTFH's operating costs expanded 28% yoy, well below asset expansion, however employee costs increased a sharp 46% yoy. Expense ratios are likely to improve gradually as near-term network expansion is largely done.
- **Rapid loan growth, especially infrastructure** — LTFH's YTD loan growth remained strong at 18% (+23% infra, +7% in retail, +50% in corporate) and well diversified across key segments (infra: 41% of loans, retail: 34%, corporate: 25%). Incremental loan sanctions have slowed down (especially in infra) and are likely to moderate loan growth ahead; however, should remain well ahead of industry levels.
- **Asset quality impacted by microfinance** — Overall asset quality saw significant deterioration – NPLs were up to 2.1% vs 1.1% in March 2011. However, excluding the AP microfinance portfolio (Rs1.9bn) – NPLs declined vs 1H11. LTFH's exposure to power is at 14% of total loans, thermal power is lower at 7.1% (of which 20% is in operational assets). Management sees low risks, remains comfortable on asset quality.
- **Operationally healthy, though macro remains challenging** — Operationally, LTFH remains healthy, however, given continued macro challenges, and its own rapid loan growth and wholesale funding dependence, we remain cautious. Maintain Neutral.

Company Update

Neutral	2
Price (03 Nov 11)	Rs52.20
Target price	Rs54.00
Expected share price return	3.4%
Expected dividend yield	0.0%
Expected total return	3.4%
Market Cap	Rs89,509M US\$1,820M

Price Performance (RIC: LTFH.BO, BB: LTFH IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	2,630	3.88	na	13.5	3.0	13.6	0.0
2011A	3,926	2.77	-28.7	18.9	2.6	15.0	0.0
2012E	5,220	3.14	13.5	16.6	1.8	13.4	0.0
2013E	7,178	4.32	37.5	12.1	1.5	13.6	0.0
2014E	8,857	5.33	23.4	9.8	1.3	14.6	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	13.5	18.9	16.6	12.1	9.8
P/E reported (x)	13.5	18.9	16.6	12.1	9.8
P/BV (x)	3.0	2.6	1.8	1.5	1.3
P/Adjusted BV diluted (x)	3.2	2.7	1.8	1.6	1.4
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	3.88	2.77	3.14	4.32	5.33
EPS reported	3.88	2.77	3.14	4.32	5.33
BVPS	17.34	20.38	29.56	33.88	39.21
Tangible BVPS	17.34	20.38	29.56	33.88	39.21
Adjusted BVPS diluted	16.26	19.56	28.83	33.12	38.29
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net interest income	7,258	10,386	12,948	17,082	21,143
Fees and commissions	98	243	304	395	513
Other operating Income	137	313	376	464	575
Total operating income	7,492	10,942	13,627	17,941	22,231
Total operating expenses	-1,998	-3,167	-3,881	-4,718	-5,711
Oper. profit bef. provisions	5,494	7,775	9,746	13,224	16,521
Bad debt provisions	-1,523	-1,716	-1,956	-2,510	-3,302
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	3,971	6,059	7,790	10,713	13,219
Tax	-1,341	-2,133	-2,571	-3,535	-4,362
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	2,630	3,926	5,220	7,178	8,857
Adjusted earnings	2,630	3,926	5,220	7,178	8,857
Growth Rates (%)					
EPS adjusted	nm	-28.7	13.5	37.5	23.4
Oper. profit bef. prov.	nm	41.5	25.4	35.7	24.9
Balance Sheet (RsM)					
Total assets	124,658	197,343	254,814	321,119	407,162
Avg interest earning assets	94,300	149,406	211,723	271,977	346,391
Customer loans	109,491	174,112	228,247	289,987	371,463
Gross NPLs	2,728	1,918	2,461	3,348	4,545
Liab. & shar. funds	124,658	197,343	254,814	321,119	407,162
Total customer deposits	1,600	750	863	992	1,141
Reserve for loan losses	1,268	750	1,246	2,086	3,019
Shareholders' equity	23,466	28,906	49,125	56,303	65,160
Profitability/Solvency Ratios (%)					
ROE adjusted	13.6	15.0	13.4	13.6	14.6
Net interest margin	7.70	6.95	6.12	6.28	6.10
Cost/income ratio	26.7	28.9	28.5	26.3	25.7
Cash cost/average assets	2.0	2.0	1.7	1.6	1.6
NPLs/customer loans	2.5	1.1	1.1	1.2	1.2
Reserve for loan losses/NPLs	46.5	39.1	50.6	62.3	66.4
Bad debt prov./avg. cust. loans	1.7	1.2	1.0	1.0	1.0
Loans/deposit ratio	6,843.2	23,215.0	26,463.5	29,236.2	32,565.7
Tier 1 capital ratio	20.8	15.9	20.7	18.8	17.0
Total capital ratio	20.8	15.9	21.4	19.8	18.2

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Figure 1. L&T Financial Holdings: 2Q12 Key Highlights (Rupees Million, Percent)

	1H12	1H11	YoY %	2H11	HoH %	2Q12	1Q12	QoQ %
Income from Operations	13,355	9,367	42.6	11,514	16.0	7,159	6,196	15.5
Interest Expense	(7,816)	(4,417)	77.0	(5,790)	35.0	(4,102)	(3,714)	10.4
Net Interest Income	5,539	4,950	11.9	5,724	-3.2	3,057	2,482	23.1
Non Interest Income	239	213	12.3	55	336.6	166	73	129.2
Operating Income	5,778	5,163	11.9	5,779	0.0	3,223	2,555	26.2
Employee Expenses	(633)	(434)	45.7	(528)	19.9	(357)	(276)	29.7
Other Expenses	(1,180)	(984)	20.0	(1,164)	1.4	(607)	(573)	5.8
Operating Expenses	(1,813)	(1,418)	27.9	(1,692)	7.2	(964)	(849)	13.6
Pre-Provision Profit	3,965	3,745	5.9	4,087	-3.0	2,259	1,706	32.4
Pre-Provision Profit (ex-trading gains)	3,965	3,745	5.9	4,087	-3.0	2,259	1,706	32.4
Charges for Bad Debts	(710)	(552)	28.8	(1,165)	-39.0	(461)	(250)	84.7
Pre-Tax Profit	3,255	3,193	1.9	2,923	11.4	1,798	1,456	23.5
Tax	(1,050)	(1,099)	-4.5	(1,034)	1.5	(556)	(494)	12.6
Minorities	0	(4)	NM	(7)	NM	0	0	NM
Extraordinary Items	0	(60)	NM	(0)	NM	0	0	NM
Net Profit	2,205	2,030	8.6	1,882	17.2	1,242	963	29.0
EPS	1.3	1.4	-10.2	1.3	-3.2	0.7	0.6	29.0
Customer Loans	210,020	136,385	54.0	177,647	18.2	210,020	N.A	NM
Borrowings	175,878	122,854	43.2	159,165	10.5	175,878	N.A	NM
AIEA	193,833	122,938	57.7	157,016	23.4	N.A	N.A	NM
AIBL	167,521	110,064	52.2	141,009	18.8	N.A	N.A	NM
Total Assets	221,581	149,935	47.8	188,077	17.8	221,581	N.A	NM
Avg Assets	204,829	137,297	49.2	169,006	21.2	N.A	N.A	NM
Non-Performing Loans (NPL)	4,322	2,748	57.3	1,918	125.4	4,322	N.A	NM
Loan Loss Reserves (LLR)	(1,719)	(1,191)	44.2	(750)	129.2	(1,719)	N.A	NM
Shareholders' Funds	45,703	27,017	69.2	28,912	58.1	45,703	N.A	NM
Book Value Per Share	27	19	39.8	20	30.6	27	N.A	NM
Key Ratios (%)	1H12	1H11	Bps Δ YoY	2H11	Bps Δ HoH	2Q12	1Q12	Bps Δ QoQ
ROAA (annualized)	2.15	2.96	-80	2.23	-7	N.A	N.A	NM
ROAE (annualized)	11.8	16.1	-426	13.5	-164	N.A	N.A	NM
Net Interest Margin (bps)	572	805	-234	729	-158	N.A	N.A	NM
Other Non-Interest Inc/Op Inc	4.1	4.1	1	0.9	319	5.2	2.8	232
Op. Cost/ Operating Income	31.4	27.5	391	29.3	211	29.9	33.2	-332
NPL/Loan Ratio	2.06	2.01	4	1.08	98	2.06	N.A	206
LLR/NPL Ratio	40	43	-359	39	66	40	N.A	NM

Source: Citi Investment Research and Analysis, Company Reports

L&T Finance Holdings

Company description

L&T Finance Holdings (LTFH), together with its subsidiaries is among India's largest non-bank finance companies with a presence in diversified lending businesses and is seeking to be a full-service financial services provider. The company is primarily engaged in infrastructure and retail lending through wholly owned subsidiaries – L&T Infrastructure Finance (LTIF) and L&T Finance (LTF), respectively. LTF was incorporated in 1994 with a focus on lending to SMEs. The company started financing rural assets in 2004 and since then has diversified into other retail, corporate, capital market and rural lending. LTIF started operations in 2007 and has received the Infrastructure Finance Company status from the Reserve Bank of India. It also has a wholly owned subsidiary, L&T Investment Management (LTIM), for carrying out its domestic asset-management business. L&T Finance Holdings also owns close to 5% stakes in two private-sector banks in India - Federal Bank and City Union Bank. The company has built a strong distribution network with 839 points of presence and has a predominantly in-house model for origination, underwriting and recovery.

Investment strategy

We rate L&T Finance Holdings shares as Neutral. L&T Finance Holdings is a diversified financial services provider with a presence in multiple asset financing segments – infrastructure, corporate, retail and rural; as well as financial services – asset management and third-party product distribution. We believe this reduces concentration and asset risks in any particular segment, and positions it well, benefiting from multiple growth drivers in India – infrastructure, rural and retail – each of which appears to have strong long-term underlying prospects. Also, Its strong parentage provides instant brand recognition, sector expertise, risk assessment skills and access to additional funding sources, besides management support. However, we believe there are near term challenges for the company, which are likely to cap valuation upsides, these are: a) Asset Quality - exposure to power is 12% of loans, though should be relatively lower risk than peers due to higher concentration of captive projects, also microfinance segment (2% of loans) is facing significant asset quality pressures; b) Loan Growth - some moderation expected, though it should still outpace the industry given its smaller base; and c) Regulatory changes - recent (draft) guidelines on non-banking finance companies can raise near term credit costs.

Valuation

We value L&T Finance Holdings at Rs54 per share. Our target price is based on our EVA model, which captures the long-term value of the business and is a standard valuation measure for the CIRA India banking coverage. Our EVA model assumes: a) a risk-free rate of 8% (in-line with the current secondary market yields); b) longer-term loan loss provisions of 100 bps given the company's higher asset risk profile; and c) loan spreads of 500 bps due to its higher-yielding asset profile. Our target price is also benchmarked off a 1.75x 1Yr Fwd P/BV, which is derived from a combination of 1.5x P/BV for its infrastructure segment (40% of loans, in-line with IDFC) and 2x P/BV for its other lending segments (60% of loans, in-line with Mahindra Finance).

Risks

Key upside and downside risks that can cause the stock to trade above or below our target price include: a) Reductions or increases in interest rates/easier or tighter liquidity, b) Improvement or deterioration in the growth outlook for the infrastructure segment, c) Better or worse than expected asset quality performance.

Appendix A-1 Analyst Certification

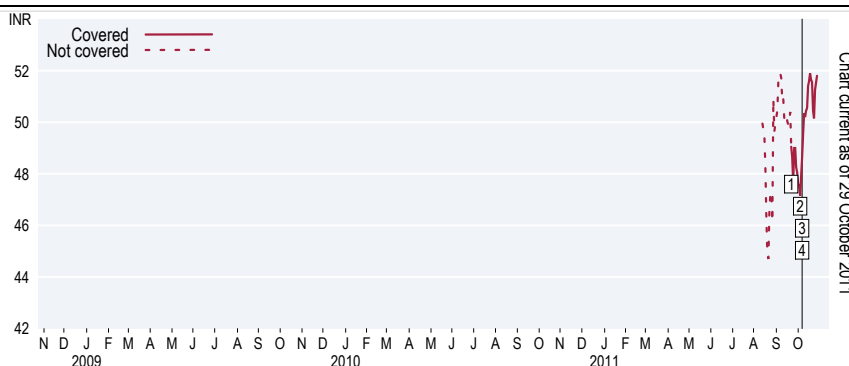
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L&T Finance Holdings (LTFH.BO)

Ratings and Target Price History Fundamental Research

Analyst: Manish Chowdhary, CFA
Covered since September 22 2011



Date	Rating	Target Price	Closing Price
1 22-Sep-11	*2L	*55.00	49.05
2 5-Oct-11	2L	*54.00	47.15

Date	Rating	Target Price	Closing Price
3 7-Oct-11	Stock rating system changed		
4 7-Oct-11	*2	54.00	48.65

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

L&T Finance Holdings (LTFH.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Manish Chowdhary, CFA
Covered since September 22 2011



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