

L&T Finance Holdings Limited

August 28, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	1,000	1,000	[ICRA]AAA (stable); Upgraded from [ICRA]AA+ (Stable)
Commercial Paper Programme	2,000	2,000	[ICRA]A1+; Reaffirmed
Total	3,000	3,000	

Rating action

ICRA has upgraded the rating for the Rs. 1,000-crore non-convertible debenture programme of L&T Finance Holdings Limited (LTFHL)¹ from [ICRA]AA+ (pronounced ICRA double A plus) to [ICRA]AAA (pronounced ICRA triple A). ICRA has also reaffirmed the rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 2,000-crore commercial paper programme of LTFHL. The outlook on the long-term rating is Stable.

LTFHL is a non-operating holding company with a diversified business profile in the financial services space with its wholly-owned subsidiaries operating in rural, housing and wholesale finance and asset management. While arriving at the ratings, ICRA has considered the consolidated performance of LTFHL and its subsidiaries (referred to LTFHL group) given the strong operational and financial synergies between the companies.

Rationale

The ratings continue to draw significant strength from LTFHL's parentage, with Larsen & Toubro Ltd. (L&T, rated [ICRA]AAA/Stable) holding 64.01% (as on June 30, 2018) equity in the company, and LTFH group's increased strategic importance to the parent with financial services being a focus area for the L&T group and LTFHL being the holding company for L&T Group's financial services business.

The upgrade in the long-term rating factors in the group's ability to profitably grow the business volumes (the AUM grew by 26% in FY2018 and further to Rs. 86,571 crore as on June 30, 2018) while gradually improving the share of retail loans in the overall mix (26% from March 31, 2016 to 33% as on June 30, 2018) and improved capitalisation profile of the group supported by the sizeable capital infusion of Rs. 3,000 crore in March 2018. The ratings factor in ICRA's expectation of continued commitment from L&T in the form of management, liquidity and capital support (Rs. 2,000-crore equity infusion by L&T in Q4 FY2018) to LTFHL group and expects the group to maintain prudent leverage levels going forward as well. The ratings also factor in the group's experience in the appraisal of infrastructure projects, and its focus on underwriting with the subsequent down-selling of assets, provides scope for fee-based income, which is likely to support overall profitability. ICRA has also taken note of the higher share of the wholesale lending book and exposure to the infrastructure sector and real estate loans, and management's efforts to realign the portfolio towards the retail segments like micro loans and two-wheeler loans. While the focus is on sectors such as renewable, transportation and transmission in the wholesale segment, which are relatively less risky, the full benefit of this would only be visible over the medium term. While the group has provided for the legacy stressed assets, the ability of the group to continue to grow the business while controlling fresh

¹ For complete rating scale and definitions, please refer to ICRA's website (www.icra.in) or other ICRA rating publications.

slippages would be a key rating sensitivity. ICRA has also taken note of the Group's improving profitability indicators though these are expected to remain largely at current levels in FY2019 with the Group continuing to provide for the stressed assets in excess of regulatory requirements. In ICRA's opinion, accelerated provisioning, in addition to augmentation of capital through various avenues, would help the Group strengthen the consolidated balance sheet. Going forward, continued support from L&T and the sustained financial performance and asset quality indicators of LTFHL's subsidiaries will remain key rating sensitivities.

Outlook: Stable

ICRA believes that LTFHL group will continue to benefit from the capital support and board level supervision from L&T. The outlook may be revised to Negative in case of a deterioration in the group's asset quality indicators leading to an adverse impact on the financial and capitalisation profile. The outlook could also be revised to Negative if the parent's commitment to this group, and the ability to support it, in terms of capital support, reduces.

Key rating drivers

Credit strengths

Strong parentage and strategic importance to L&T Group; strong management team - L&T is the country's largest engineering and construction group and the market leader in infrastructure development, with expertise gained over seven decades of operations. The parent's demonstrated support in the form of capital, management, technical and operational pool considerably strengthens LTFHL group's credit profile. LTFHL group's access to other L&T Group companies also provides advantages in terms of business sourcing avenues, better assessment of risks, and availability of sector and industry expertise. L&T is also directly engaged in LTFHL's operations through board representation and deputation of senior management. ICRA believes that the strategic importance of the company to L&T and the presence of these synergies would ensure continued support to the company. LTFHL also has a strong management team in place with considerable experience across functions in retail and wholesale lending.

Diversified operations with consolidated entity offering multiple loan products as well as non-fund based services through investment and wealth management arms - LTFHL, through its subsidiaries, is present in a range of businesses in the financial services space. Through its subsidiary, L&T Infrastructure Finance Company Limited (LTIF), which is registered as an infrastructure finance company – non-banking finance company (IFC-NBFC), it offers wholesale lending products including infrastructure finance and structured corporate loans. L&T Housing Finance Limited (LTHFL) is a registered housing finance company (HFC) offering home loans, construction loans and loans against property. L&T Finance Limited (LTF, erstwhile Family Credit Limited), which is registered as an NBFC, offers retail products including farm equipment loans, micro loans, two-wheeler loans, supply chain finance, real estate finance, infrastructure finance and corporate finance loans. L&T Infra Debt Fund (LTIDF) is registered as an infrastructure debt fund – non-banking finance company (IDF-NBFC) offering wholesale financing to operational infrastructure projects. L&T Investment Management Limited (LTIML) is the investment manager of L&T Mutual Fund. On a consolidated level, LTFHL's lending book stood at Rs. 86,571 crore as on June 30, 2018 (compared to Rs. 69,635 crore as on June 30, 2017) while its average investment assets under management stood at Rs. 71,118 crore for the quarter ended June 30, 2018 (Rs. 44,484 crore for the quarter ended June 30, 2017).

Comfortable liquidity supported by strong financial flexibility in raising funds at competitive rates - LTFHL's primary revenue source is upstream dividends from its subsidiaries and interest income on financing extended to subsidiaries. Given its low standalone leverage levels, these cash flows are sufficient for meeting its financial obligations. Also, with the strong brand name of L&T and its track record of raising funds from banks and capital markets, LTFHL enjoys sufficient financial flexibility in raising funds at attractive rates. The company also has a significant liquid investment book, which can be monetised for meeting its obligations during contingencies.

CIC leverage ratio comfortably within stipulated limits – LTFHL’s standalone capitalisation remains adequately supported by its track record of raising funds (Rs. 3,000 crore in Q4 FY2018) and moderate internal capital generation (standalone return on equity of 6.27% in FY2018 compared to 6.15% in FY2017). LTFHL’s core investment company (CIC) leverage ratio as on March 31, 2018 was 0.2 times against the regulatory limit of 2.50 times. At a consolidated level, the Group’s leverage remains moderate (5.99 times as on March 31, 2018 and 6.46 times as on June 30, 2018) given that a significant proportion (~53%) of the lending book consists of the wholesale lending segment as reported by the company. ICRA expects the Group to maintain prudent capitalisation and expects that support from L&T would be forthcoming as and when required.

Credit challenges

Moderate portfolio vulnerability arising out of high share of wholesale lending book and relatively riskier retail asset classes – A significant portion of LTFHL’s portfolio constitutes wholesale loans (Rs. 57,193 crore², 66% of the overall book as on June 30, 2018 of which 59% was towards the infrastructure sector³). Wholesale loans are relatively chunkier and carry higher concentration risk with infrastructure lending representing additional construction and execution risk. The risk is, however, partially mitigated by the focus on lower risk operational projects in the power & energy sector book, and by LTFHL’s parentage and its long track record in infrastructure lending as well as its strategic shift towards the renewable energy sector (where gestation periods are shorter). The associated risks are further reduced by the Government-guaranteed nature of the majority of exposures in L&T Infra Debt Fund. On the retail book, a large proportion of incremental business is coming from relatively riskier asset classes such as micro loans, two-wheeler loans and real estate. While so far, the asset quality has been holding in these segments, the ability of the group to manage the asset quality through cycles would be a monitorable.

Moderation in asset quality indicators- On account of transition to IND AS, standard stressed assets have been included as part of Stage 3 over and above the Non-Performing Assets. This has resulted in Gross and Net Stage 3 Assets of 7.93% and 3.17% respectively as on June 30, 2018 as compared to Gross and Net NPA of 4.80% and 2.34% respectively as on March 31, 2018. The asset quality indicators are expected to remain stable given group is taking incremental exposure in sectors such as renewable, transportation and transmission in the wholesale segment, which are relatively less risky though, the full benefit of this would only be visible over the medium term. Overall, the Group’s ability to profitably grow business volumes while improving the asset quality would have a bearing on its overall financial profile and would be a key monitorable.

Moderate albeit improving consolidated profitability – LTFHL Group’s profitability, at a consolidated level, has been moderate. However, in FY2017, the company implemented a change in strategy which included the rationalisation of the products and streamlining of the Group’s structure. ICRA notes that with the implementation of the new strategy, the company’s profitability indicators improved in FY2018 vis-à-vis FY2017. The return on equity during FY2018 improved to 14.33% (as per IGAAP) from 13.81% (as per IGAAP) in FY2017 and further to 18.45% (as per IND AS) in Q1FY2019. Going forward, the company’s ability to maintain its margins and keep credit costs under control would have a bearing on its profitability and would be a monitorable.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Rating Methodology for Non-Banking Finance Companies](#)

² Includes the real estate finance segment

³ Includes the real estate finance segment

About the company

L&T Finance Holdings Limited (LTFHL) was originally incorporated as L&T Capital Holdings Ltd in May 2008 and its name was subsequently changed in September 2010. The company is registered as an NBFC-CIC with the RBI. It is promoted by Larsen & Toubro Limited (L&T) as the holding company of L&T Group's financial services companies. LTFHL has three wholly-owned subsidiaries, namely, L&T Infrastructure Finance Company Limited, L&T Finance Limited and L&T Housing Finance Limited, which undertake the Group's lending operations. L&T Infra Debt Fund, an NBFC-IDF, was incorporated in 2013, with LTFHL and its subsidiaries together holding a 100% stake in the company.

LTFHL, through its subsidiaries, offers a diverse range of financial products and services across rural, housing and wholesale finance businesses. It also offers fund management and other non-fund based services, such as insurance and mutual fund distribution and financial advisory services (project finance and pre-bid advisory), through its subsidiaries. Following an initial public offering in July 2011, L&T's shareholding in LTFHL declined to 82.64% from 99.99% earlier. Following some open market transactions, L&T's shareholding reduced further to 72.95% as on March 31, 2015. L&T currently holds a 64.01% stake in LTFHL.

For the quarter ending June 30, 2018, the company reported PAT (standalone) of Rs. 10.35 crore on total income of Rs. 53.35 crore against a loss of Rs. 19.05 crore on total income of Rs. 26.10 crore in Q1FY2018. Q1FY2018 results were restated as per Ind AS, which led to an increase in borrowing cost by Rs. 26.32 crore pursuant to application of effective interest method. As a result of this transition to Ind AS, Q1FY2018 profit of Rs. 8.2 crore was restated as a loss of Rs. 19.05 crore. On a consolidated basis, for Q1FY2018, LTFHL reported PAT of Rs. 538 crore on an asset base of Rs. 90,315 crore compared to PAT of Rs. 339 crore on an asset base of Rs. 73,256 crore as on June 30, 2017. The consolidated entity's net worth was Rs. 11,952 crore as on June 30, 2018.

Larsen & Toubro Limited

Larsen & Toubro Limited (L&T, rated [ICRA]AAA(Stable)) is a leading engineering and construction company in India with a global presence. Headquartered in Mumbai, it has interests in infrastructure, power, metallurgical & material handling, heavy engineering, shipbuilding, electrical & automation, machinery and industrial products, and realty. Apart from India, it has a significant presence in the Middle East. Through its subsidiaries, associate companies and joint ventures, the Group is engaged in the hydrocarbon business, IT services, financial services, and infrastructure development ventures. For Q1FY2019, L&T reported a standalone PAT of Rs. 912 crore compared to PAT of Rs. 558.74 crore for Q1FY2018.

Key financial indicators (consolidated) (audited)

	FY2017	FY2018
Total Income	8,572	10,500
Profit after tax (PAT)	1,042	1,459
Net Worth [^]	7,775	12,550
Loan Book	66,648	83,654
Total assets	72,514	89,231
Return on average total assets (PAT/ATA)	1.53%	1.81%
Return on average net worth (PAT/Avg. net worth)	13.81%	14.33%
Consolidated gearing	7.82	5.99
CIC Leverage ratio	0.27	0.20
Gross NPA%	4.94%	4.80%
Net NPA%	2.89%	2.34%
Net NPA/Net worth	22.6%	14.7%

Gross NPA recognised at 120+ dpd for FY2017 and 90+ dpd for FY2018

[^] Net worth does not include capital raised through preference shares

* annualised

Source: Company; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Type	Current Rating (FY2019)		FY2019		Chronology of Rating History for the past 3 years		
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Aug-18	July-18	FY2018 Oct-17	FY2017 Nov-16	FY2016 Jan-16
1	Commercial Paper Programme	2,000.00	1,150.00	[ICRA]A1+ ;	[I0043RA]A1+	[ICRA]A1+	-	-
2	Non-convertible Debenture Programme	1,000.00	-	[ICRA]AAA (stable);	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)	[ICRA]AA+ (stable)

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Commercial Paper Programme	-	-	7-365 days	2,000.00	[ICRA]A1+
-	Non-convertible Debenture Programme	Yet to be placed	-	-	1,000.00	[ICRA]AAA (stable)

Source: L&T Finance Holdings Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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