FINANCIAL SERVICES BUSINESS

Farm Equipment Finance

Overview:

L&T Finance Holdings (LTFH) is one of the leading private non-banking financial services companies in India. The businesses are Rural Finance, Housing Finance, Wholesale Finance, Investment Management and Wealth Management. L&T Finance Holdings Ltd. is a NSE and BSE listed company and is also registered with RBI as an NBFC and a Core Investment Company (CIC). It conducts its financial services businesses through various subsidiaries. L&T Financial Services (LTFS) is the brand name of L&T Finance Holdings Ltd.

Functionally, the structure of the Financial Services business is as follows:

- Rural Finance comprising Farm Equipment Finance, Two-wheeler Finance and Micro Loans
- Wholesale Finance comprising Infrastructure Finance, Structured Corporate Finance and Debt & Capital Market
- Housing Finance comprising Home Loans & LAP and Real Estate Finance
- Mutual Funds
- Wealth Management

Business Environment

India's GDP is estimated to have grown by 7% in FY 2018-19 on the back of lower growth in agriculture and mining sectors, lower Government spending on public administration and weaknesses in domestic and external demand conditions. However, the gross fixed capital formation rate improved from 31.4% in FY18 to 32.3% in FY19, reflecting a good pick up in investment spending, and bodes well for the financial services industry.

The Indian economy faced a slew of challenges around mid-FY19 from the external front triggered by a sharp increase in global Brent price, which led to a sharp depreciation in the Rupee, along with other emerging market currencies. Around the same time, the debt defaults by the IL&FS group triggered a crisis of confidence for the NBFC sector – a critical source of finance for the real estate sector. The AAA rated NBFCs with a strong promoter and shareholder backing and proactive economic intelligence and risk management units withstood volatile market conditions without hurting core operations – L&T Finance being one of them.

During the year, the various segments of business performed under the stated business environment:

Farm equipment finance growth was led by record growth in the tractor industry. Increased urbanisation, sustained

Two-wheeler finance

Providing micro-loans to small-scale entrepreneurs

focus on road infrastructure development and increasing fuel prices pushed consumers towards two-wheelers during the year, resulting in an increase in two-wheeler finance. Increase in micro loans on the back of increasing penetration in existing geographies and opening of new geographies.

In the Wholesale Finance segment, the disbursements were focused on Infrastructure Financing, especially in Renewables and Roads and kept in line with the opportunities available for Sell-down. This enabled the Company to maintain the wholesale book around the same level and move towards increased retailisation of the balance sheet.

Disbursement registered a growth in home loans while de-growth in the Real Estate sector. The real estate sector stabilised based on the implementation of regulatory frameworks (RERA, GST reforms) leading to price stabilisation.

FY19 remained a challenging year for the Wealth Management industry. Market volatility coupled with a reduction in MF fees on account of regulatory measures impacted the business in the short term.

Significant Initiatives

FY19 has been a landmark year for the business, marked by the effective execution of the strategy put in place. The specific focus for the year was on the following areas:

a) **Improved competitive position across all products**

Being in the 'Right Businesses' forms an important part of the strategy, in which 5 core businesses were identified by the Company. The core businesses were identified based on a 3-filtered approach – industry attractiveness, company profitability and our ability to extract value from it.

b) **Established fees as a second line of income to counter interest rate cycle**

As a hedge against interest rate cycles, the Company has established 'fees' as a second line of income. Fee income generation happens through various modes such as processing fees, subvention income, cross selling income, advisory fees and underwriting fees among others.

c) **Increased 'Retailisation' of balance sheet**

The Company is focusing on building a well-diversified book. Strong sell-down capabilities have helped the Company to limit the wholesale book growth without slowing down the business.

d) **Digital initiatives and data analytics used to unlock RoE**

In the field of digital and data analytics, the Company primarily concentrates on optimising credit cost, collection cost and productivity rather than just focusing

Housing Finance

Real Estate Finance

on more commonly talked about areas like cross-selling or customer acquisition. The Company believes in using the power of data to provide a strategic competitive advantage, improve productivity and enhance performance.

e) Strengthening balance sheet with improved asset quality, increase in provision coverage ratio (PCR) and maintaining macro-prudential provisions

We believe that true greatness is achieved by a Company only by having a low Sigma, which means minimising the variability of returns, along with earnings and growth. A strong risk management framework, improving portfolio quality and continuously improving PCR are important contributors to achieve a low Sigma.

f) Robust ALM Framework

The Company is comfortably placed with respect to both liquidity and interest rate risks, due to its robust ALM and strong risk management framework. The Company enjoys positive gaps in both Structural Liquidity and Interest Rate Sensitivity. In addition to this, a positive gap was maintained consistently even under '1 in 10' stress scenario in the 1-month bucket.

Major Achievements

LTFH increased its market share in Farm Equipment Finance from 12.5% to 14% in FY19. Through rigorous execution of digital propositions on the ground and domain expertise, LTFH has been able to increase its market share in Two-Wheeler Finance from 8.2% to 11%. With the implementation of 100% automated credit decision, LTFH has been able to improve collection efficiencies and reduce NPAs. With this clear strategy in place, LTFH has enhanced the disbursements in Farm Equipment and Two-Wheeler Finance by 19% and 67% respectively. Similarly, the Farm Equipment and Two-Wheeler Finance book has grown by 27% and 68% respectively through increased penetration in the identified branches.

In Micro Loans, LTFH has been able to increase disbursements by 51% and book by 60% during the year. This was on the back of increasing penetration in existing geographies and opening of new geographies in existing states and new states such as Jharkhand and Tripura. New states entered in the previous year and this year have contributed 28% to the business during the last quarter. An increase in business has been achieved with improved collection efforts and a reduction in debtors YOY. This has resulted in regular collection efficiency being brought back to pre-demonetisation levels.

Wholesale Finance

A wide range of Mutual Funds to suit every investment need

With tightening of liquidity, the business saw lower growth in the Order Book for Infrastructure Financing and a decline in the Asset Book for Structured Corporate Finance. During the year, the Company started building a Government Securities (G-Sec) book which will also act as a low-cost liquidity reservoir in adverse market conditions.

The Company focuses on the Home Loan market with an emphasis on direct sourcing of salaried customers through developer relations and an analytics led sourcing model. Our digital lending model of paperless sanction of home loans to salaried customers is a unique offering that has helped in quick turnaround of proposals. During the NBFC crisis in FY19, the Company has continued to support real estate projects funded by us, while selectively sourcing new business. In the Mutual Fund business, the AUM of the Company increased by 13% to ₹ 69,689 crore during FY19 as against ₹ 61,603 crore in FY18. The Wealth management business increased its focus on Dubai, where the yield on the assets is higher and serves as a natural hedge to the India business.

Human Resources

In its journey to create value sustainably by delivering top quartile ROE, the Human Resources function of L&T Financial Services has ensured that employees at all levels are aligned to this objective through effective performance management and a two-way communication processes. Our culture of 'results and not reasons' is instrumental in driving accountability and clarity across the organisation. The focus is to simultaneously build the capability of employees so that they can be held accountable. Building capability of employees will enable the organisation to achieve sustainable and long-lasting success.

Environment, Health and Safety

LTFH aligns its social responsibility theme and commitment with the United Nation's global development agenda of Sustainable Development Goals (SDG). The core areas of Integrated Water Resource Management (IWRM) and Digital Financial Inclusion are designed to ensure sustainable livelihood opportunities with the intent to bring the deserving but vulnerable population into the mainstream economy. IWRM programme engages with the communities and more specifically farmers and implement interventions which address their core needs in water and soil health management. Climate change is leading to increasing incidents of natural disasters in India. The business supports disaster recovery efforts through a number of practical methods. These include prompt affected area assessments and a provision for immediate relief. The business considers safety as an integral part of its business operations and due importance has been given to maintaining safety standards.

Wealth Management

LTFS' 'Digital Sakhi' programme aims at digital financial inclusion of rural women

Risks and Concerns

Restrictive regulatory prescriptions for the NBFC sector not accompanied with the reforms of the long-term bond market may adversely impact the profitability of a set of mid-sized NBFCs and HFCs (housing finance companies) with possible negative implications for India's financial sector's stability.

However, with the help of in-depth business knowledge and strong managerial capabilities, deep market penetration, risk mitigation through various market and credit checks, robust early warning systems, extensive use of analytics and best in class turnaround time proposition, the business is confident of managing the hazards of adverse business conditions.

At this juncture, there are several uncertainties that cloud India's growth outlook and macroeconomic stability during FY20. The investment spend may get impacted due to faltering growth impacting India's trade balance, political uncertainties due to upcoming general elections, in case of Brent crude price resurging, fiscal slippages, etc.

Outlook

Several global forecasters including the International Monetary Fund have lowered their projections for global economic growth in 2019 from a year earlier on the back of ongoing trade frictions, tightening of financial conditions and the Brexit related uncertainties. Global slowdown, tight financial conditions and political uncertainty in the election year may impact India's GDP growth during FY20. Past experience shows that India's growth mix remains skewed towards consumption and away from investment during the General Election year. Financial markets and capital inflows too may witness heightened volatility during FY20. Moreover, the new political regime is likely to follow fiscal prudence in H2, FY20, which may adversely impact public investments and growth in the latter part of the year.

On the positive side, retail (CPI) inflation is projected by Reserve Bank of India (RBI) to remain below 4% up to December, 2019. This should enable the Monetary Policy Committee of RBI to implement an easy monetary policy during a major part of FY20. Additionally, the RBI's continued purchase of Government bonds (open market operations), recent recapitalisation of Public Sector Banks (PSBs), release of five PSBs from the Prompt Corrective Action Framework (PCA) and the ongoing resolution of chronic stressed asset cases through IBC should remain supportive of the lending environment.