FINANCIAL SERVICES BUSINESS

Micro Loans

Overview:

L&T Finance Holdings (LTFH) is the holding company for the financial services businesses of the Larsen & Toubro Group. It is one of India's most valued and diversified NBFCs, having a strong presence across the Lending & Investment management businesses. LTFH is a financial solutions provider catering to the diverse needs of its customers across various sectors, including:

- Rural Finance, comprising Farm Equipment Finance, Two-Wheeler Finance, Micro Loans and Consumer Loans
- Housing Finance, comprising Home Loans, Loan against Property and Real Estate Finance
- Infrastructure Finance
- Mutual Funds

The Wealth management business is being divested to IIFL wealth, the approval for which was received in April '20. With the aim of creating a single, unified lending entity with a wider and stronger capital and asset base, the process of amalgamating three lending entities – L&T Finance Ltd., L&T Infrastructure Finance Company Ltd. and L&T Housing Finance Ltd. – has been initiated.

Business Environment

The Indian economy in FY 2019-20 began on a downward trajectory, and continued to slow down further, weighed by structural stresses, such as sluggish private investment, a significant decline in savings rate and the highest unemployment rate ever recorded. A broad-based breakdown in consumption further accentuated the slowdown.

On the sectoral front, a bountiful monsoon supported the growth in agriculture and allied activities. The healthy water reservoirs augured well for rabi crops. Industrial growth, however, slowed down on the back of sluggish manufacturing activity. Growth in the services sector too was moderate due to subdued activity in the trade, hotel, transport and communication sectors.

India's fiscal deficit stood at 4.6% of GDP in 2019-20 as per the official report of the Department of Expenditure, Government of India. The financial markets remained jittery in FY20 due to the domestic economic slowdown, concerns on fiscal slippage and geo-political tensions. Weaknesses in overall economic activity also put pressure on the business growth of lenders, including NBFCs.

Government revenues have taken a significant hit due to the COVID-19 impact and the lockdown. On the other hand, expenditures have risen due to the various costs

Farm Equipment Finance

arising from the many virus containment efforts and the enforcement of the lockdown.

However, AAA rated, large-sized NBFCs were relatively better placed with liquidity, comprising liquid assets, undrawn lines from banks, and, in some cases, funding lines from group companies.

Overall, FY 2019-20 was a very challenging year, with funding markets seeing multiple periods of disruption and risk aversion from Mutual Funds and Banks especially towards NBFCs. However, in these difficult times, LTFH has been able to time the markets and has successfully raised highest annual long-term incremental borrowing (across various instruments) since FY 2016.

The business is comfortably placed with respect to both liquidity and interest rate risks, due to its robust Asset Liability Management (ALM) and strong risk management framework.

The average assets under Management for the Mutual Fund business had marginal Y-o-Y increase in FY20, the key focus areas being:

- Continued focus on retailisation of assets with diversified mix of distributors and customers
- Increase in market share through new customers
- Enhancing market share in high-quality fixed-income assets

Significant Initiatives

During FY 2019-20, the business continued to focus on sustainability of performance with steady margins, stable asset quality, focused growth and building a strong liability franchise. The specific focus for the year was on the following areas:

a) Diversification of sources of funds leading to stronger liability franchise

The business has a well-diversified borrowing mix in the form of Bank borrowings (including PSL), NCDs (retail and wholesale), Preference shares and ECBs. It has strengthened its liability profile with higher proportion of long-term borrowings through diversified sources of funding during the year.

b) Business realignment with focus on the 'Right to Win'

Some of the key business changes undertaken include:

- The business launched a pilot run of consumer loans in Q3 FY2019-20 and has disbursed the product to ~12,000 active customers with an excellent track record of repayment with the aid of data analytic tools

Infrastructure Finance

- In the Infrastructure Finance segment, the business is also evaluating diversification into new sectors including funding to City Gas Distribution (CGD) companies, ports and airports. In line with the strategy of investing in products with a 'Right to Win', the Structured Finance Group (SFG) and Debt Capital Markets (DCM) were classified as defocused business during the year and have been run down significantly over the last year (50% YoY reduction)

c) Maintained market share by leveraging on business strengths

LTFH increased its market share in the Farm and Two-wheeler sectors, while maintaining business strengths across the businesses, through investing in footprint expansion, team quality enhancement, technology infrastructure and data analytics framework.

Major Achievements

LTFH, through rigorous execution of digital proposition and domain expertise, has been able to capture a 9.3% market share in the Two-Wheeler Finance segment in FY 2019-20. A new scheme, 'Sabse Khaas Loan' was introduced to target the unfinanced sector with no hypothecation and a lower rate of interest as compared with credit cards. LTFH focussed on touch-free collections, which accounted for 32% of the total collection in FY20. LTFH has been able to maintain its market share of 14% in Farm Loans and strengthen its position as the #2 player in the Farm Equipment Finance industry. The rich customer base in Tractor Financing services, built over the years, is further strengthened by extending the refinancing facility to its prime customers with a good credit and payment history.

LTFH has strengthened its Right to Win in business by moving to a desired OEM and Asset mix and by de-risking over-dependencies. Disbursement from preferred OEMs now contributes 73% of the total disbursements in FY 2019-20.

LTFH disbursed ₹ 9,884 crore of micro loans in FY 2019-20, benefiting over 28 lakh women in rural and semi-urban areas who depend on dairy, grocery shops and similar allied activities for earning their daily livelihood.

LTFH introduced the 'Mid Term Renewal Product' (MTRP) scheme which aims to provide pre-approved early repeat loans for existing customers with an excellent repayment history, resulting in repeat business contributing 40% of the total business.

Despite the challenging environment witnessed in the housing market, direct sourcing initiatives have helped scale up home loans from 69% in FY 2018-19 to 72% in FY 2019-20.

Housing Finance

Mutual Funds

With the strategy to optimise its sectoral mix, the business scouted for disbursement opportunities in newer infra-related sectors and, during the year, has funded 2 projects of City Gas distribution (CGD) which are being executed by the AG&P group.

Asset origination with a clear perspective of 'Churn', the business achieved a key milestone of ₹ 25,000 crore of cumulative sell-down since FY'17. Further, while there was a reduction in overall sell-down volumes during the year due to the liquidity challenges being faced by NBFCs and the consolidation of PSU banks, it managed to sell down ₹ 780 crore of Hybrid Annuity Model (HAM) road projects to public sector banks.

FY 2019-20 was a year which also saw more rating downgrades than upgrades. In such a difficult operating environment, LTFH was successful in being assigned a AAA rating by CRISIL for the first time (October 2019). With this, all 4 rating agencies (viz., CRISIL, India Ratings, CARE and ICRA) have reaffirmed / rated LTFH as 'AAA' during FY 2019-20.

Environment, Health and Safety

LTFH recognises that the physical risks of climate change are very high, and thereby ensures that its operations and investments have a positive environmental impact in line with its Sustainability Policy. The policy has environmental objectives including:

- Products and services that contribute to the sustainable development of the Indian economy while ensuring application of environmentally friendly practices
- To reduce the adverse impact of climate change, and promote energy efficiency and environmentally friendly operations

The business is working towards lowering Greenhouse Gas (GHG) emissions through its operations. It believes that its operational efficiency can be enhanced by measuring, managing and mitigating GHG emissions. The business is also in the process of phasing out ozone-depleting substances (ODS) by reducing their usage and has installed inverters in place of DGs to reduce carbon emissions.

Investments in technology are a part of LTFH's commitment towards sustainability. The digital transformation efforts – e-communications and mobile apps across its business segments – have led to an impressive reduction in paper usage and, in turn, emission reduction. 100% E-waste is re-cycled through registered recyclers in accordance with the E-Waste Management and Handling Rules.


Real Estate Finance


Two-Wheeler Finance

Human Resources

The business believes that its people are its most important asset, and works with a clear plan for capitalizing and building upon their capabilities.

LTFH competes on the strength of its people; employees who are united by the core values of pride, integrity, discipline and ambition, and thrive in the climate of the 'Right People for the Right Culture'. A culture of entrepreneurship and empowerment has been built, with 'Results, Not Reasons' being at its core. Believing that knowledge is the differentiator, the business has modelled itself as a learning organisation by focusing on 'Stretch, Learn and Grow'.

The business talent strategy, aligned with its goals, is performance oriented. The business believes that building individual capabilities with focus and direction and leveraging them in a structured manner through job rotation builds up organisational capability. It encourages employees who have demonstrated the right capability, the right attitude and the desire to 'Step Up'. As part of its strategy to groom talent who are future-ready, cross-functional movements are encouraged and they are up-skilled through 'Education, Exposure and Experience'.

LTFH is an equal-opportunity employer, where meritocracy is the norm, and helps build a forward-looking organisation that can deal with the ever-changing business landscape.

Risks and Concerns

At this juncture, there are several uncertainties that cloud India's growth outlook and macroeconomic stability during FY 2020-21. The critical GDP contributors for India, comprising private consumption, investment and external trade, may get significantly impacted on the plausible scenario of a prolonged lockdown to contain the COVID-19 outbreak. The pandemic may have credit risk and liquidity implications for the NBFC sector. Despite steep monetary easing by the RBI, the cost of borrowing for NBFCs has witnessed an increase owing to fiscal slippage expectations and elevated risk premia for NBFCs. Furthermore, asymmetry in loan moratorium relief announced during the lockdown period (concessions from the asset side but not from the liability side) is likely to create liquidity stresses and ALM challenges for NBFCs.

The business of NBFCs is expected to experience a pressure on the NIMs owing to surplus liquidity in the banking system, coupled with a significant drop in new disbursements and fee income. Lower collections due to restrictive measures to counter the COVID-19 outbreak and the adverse impact on the earnings of the borrowers are likely to put additional pressures on asset quality and credit costs, which could be more pronounced in certain relatively more vulnerable segments, such as micro loans, loans against property (LAP), affordable housing and real estate segments.

With the onset of the pandemic in March 2020, the RBI has undertaken a series of radical policy measures to infuse liquidity into the banking system via Targeted Long Term Repo Operation (TLTRO), reduction in policy rate, widening the Liquidity Adjustment Facility (LAF) corridor, availability of funding for NBFC/HFC sector (TLTRO 2.0), etc. This has helped restore a degree of normalcy in short-term market rates. However, there has not been much effect on medium-long term rates which, at best, saw a marginal decline.

In April, following the Government's decision to hike its gross market borrowings for FY21 in the light of the economic package to mitigate the impact of the economic slowdown, there has been a rise in G-Sec yields reflecting market nervousness on account of anticipated higher fiscal deficit. Credit spreads have remained wide on account of heightened risk aversion from market participants, who see repayment stress affecting in particular, the NBFC sector, due to which interest rates for FY 2020-21 are anticipated to be elevated. This is despite the fact that the inflation rate is expected to remain benign due to the demand crunch both in the rural as well as the urban sectors and also due to likely low crude oil prices in the world market.

The business is confident of managing the hazards of adverse business conditions with the help of in-depth business knowledge, strong managerial capabilities, an agile execution engine, deep market penetration, risk mitigation through various market and credit checks, robust early warning systems and the extensive use of analytics.

Outlook

The global macroeconomic outlook is overcast with the adverse impact of the COVID-19 pandemic which has caused dislocations in global supply chains, among others. Several multilateral agencies have projected a recession for the global economy in 2020, with the International Monetary Fund (IMF) warning of the worst global recession in almost a century. Major nations, including India, have responded by expansionary monetary and fiscal policies to ensure liquidity and credit flow to their economies. Nevertheless, the pace of the containment of the pandemic will determine the depth of the recession while the policy responses announced in the meanwhile will support the pace of recovery in 2021.

Rating agencies and economic think-tanks have lowered India's growth projections for the year FY 2020-21 to a lowly positive growth print on the back of factory shutdowns, supply chain disruptions, travel restrictions, reduced discretionary spending and a recessionary outlook for the global economy. Many believe this decline as a cyclical event and that India's structural story is intact. However, a prolonged economic slowdown could adversely affect all credit intermediaries and financial markets. The asset quality of banks and NBFCs could further deteriorate amid the broad-based economic slowdown.

The outlook on inflation remains subdued during FY 2020-21 due to adequate buffer stocks in cereals, a good rabi harvest, record decline in global crude prices, low pricing power of firms and expectations of a normal monsoon in FY 2020-21.

LTFH expects that disbursements in retail will start gradually as the economy opens up, and in Infrastructure and Real Estate will be largely limited to tranche disbursements, while fresh disbursements are subject to higher risk controls.

LTFH remains resilient by continuing to focus on the strengths built over the past few years, viz. a strong ALM and enhanced liquidity on the back of well-established liability franchise, a strong balance sheet demonstrated through reduction in GS3 and comfortable capital adequacy.