Farm Equipment Finance

FINANCIAL SERVICES BUSINESS

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 Lending and Investment management businesses. Headquartered in Mumbai, LTFH has a strong network of branches and dealers across India catering to the business requirements of a 121 Lakh+ customer base across core businesses as given below:

- Rural Finance (farm equipment finance, two-wheeler finance, micro loans and consumer loans)
- Housing Finance (home loans, loans against property and real estate finance)
- Infrastructure Finance
- Investment Management

In continuation of the strategy of simplification of corporate structure, during the year, the wholly owned lending entities L&T Infrastructure Finance Company Ltd. and L&T Housing Finance Ltd. were merged with L&T Finance Ltd.

Business Environment

The unprecedented Covid-19 pandemic and the resultant nationwide lockdown brought economic activities to a near standstill. After witnessing technical recession during H1 FY21, the Indian economy showed partial recovery in Q3 FY21. With the adverse impact on the economy, the investment rate fell to a decade's low, primarily due to a drag in private investment. Consumer demand remained subdued, with severe stress on the household balance sheets due to high unemployment. In order to mitigate the short-term adversities that arose from the pandemic, Government spending was scaled up significantly.

On the sectoral front, the industrial and services sector were severely affected due to the disruptions caused by the lockdown. The agriculture and allied sector remained resilient and emerged as a silver lining, supported by a favourable monsoon in 2020. Robust kharif and rabi seasons, adequate reservoir levels, enhanced procurement by the Government and rich fiscal spending on schemes

Housing Finance

such as MGNREGA and PM Kisan aided agricultural growth. Conversely, despite a robust recovery witnessed in H2 FY21, the industrial sector is slated for a second successive annual contraction in FY21 dragged down by mining and quarrying, manufacturing and construction.

To address the adversities arising from the pandemic-led economic disruptions, calibrated and prudent fiscal and monetary support was extended by the policy-makers. The Central Government announced the 'Atmanirbhar Bharat' package to support the most affected segments of the economy. The RBI provided monetary support by slashing the policy rates to its record low levels along with both conventional and unconventional liquidity measures to support credit creation. As a part of the relief package, it also allowed borrowers to halt repayment of loans (moratorium) between March and August 2020, without impacting their credit history. In addition to the stress in asset quality across most lenders (banks as well as NBFCs), the moratorium also resulted in liquidity concerns for lenders, mostly for NBFCs. Well-governed NBFCs with strong parentage remained resilient throughout FY 2020-21 thanks to their strong capital buffers and also on the back of timely policy moves in the form of targeted longer-term refinancing operations (TLTRO) 2.0 and special liquidity scheme for NBFCs under the 'Atmanirbhar Bharat' package.

The financial markets faced another major setback on April 24th 2020, when a certain mutual fund closed six of its debt schemes citing a credit risk. The appetite for various debt securities further declined amid the thin volumes created by the Covid-19 pandemic. The RBI had to step in with a special liquidity facility of ₹ 500 billion for the mutual fund industry to control the crisis.

Agriculture and rural belts showed buoyancy in demand throughout FY 2020-21 amid favourable weather conditions and a record foodgrain production. The farm segment remained relatively resilient to the impact of Covid-19 and started to gain back traction from June '20 onwards.

Two-wheeler (TW) demand was impacted to a greater extent due to widespread Covid-19 cases and lockdowns in urban and semi-urban locations at the beginning of the financial year. The momentum in TW demand was gradual and picked-up from Q2 FY21 onwards with the rise in demand for personal vehicles as an alternative to public transport.

The Micro Loans business was impacted the most due to Covid-19 considering the 100% moratorium given to micro-loan customers till May '20, which severely affected the loan origination and collections, especially during the first few months. Disbursements were almost Nil during the first quarter and, with improvement in collections since Q2 FY21, disbursements resumed slowly, with focus on existing good customers.

Home loan growth, which declined in H1 FY21 owing to Covid-19, recovered towards the end of FY21 supported by the Government's push for the sector and attractive incentives given by the developers. LTFH restricted

Real Estate Finance

disbursements in the Loan Against Property business and focused on existing projects for disbursements in the real estate segment.

In the case of the renewables industry, overall energy consumption has turned positive since Q3 FY21, with renewables continuing to drive growth, helped by must-run status granted to operational renewable projects. Under the Discom package, more than ₹ 75,000 crore has been disbursed to Discoms out of over ₹ 1,36,000 crore sanctioned, which has improved the cashflows for these entities. In terms of LTFH's portfolio, operational projects are being paid on time and most of the Discoms have also remitted payments.

Significant Initiatives

During FY 2020-21, LTFH focused on addressing the challenges posed by the Covid-19 pandemic – with enhanced focus on liquidity and liability management and building a resilient balance sheet with focus on collections and building additional provisions on standard assets. Strong business fundamentals with businesses (Rural Finance, Housing Finance and Infrastructure Finance) aligned to sectors (agriculture and allied sector, construction sector and infrastructure sector) which are the key growth engines for the economy, have helped in strengthening LTFH's position and in facing the impact of the pandemic and the lockdown. The specific focus for the year was on the following areas:

a) **Capital Infusion:** During the year, LTFH raised ~₹ 3,000 crore in equity capital through issue of right shares which was oversubscribed by 15% and is well poised to take advantage of growth from economic rebound expected over next few years. The Capital adequacy ratio and Tier I Capital now stands at 23.80% and 18.79% respectively and the Company maintains a Debt / Equity ratio of less than 5x.

b) **Robust Liability Management:** LTFH weathered the market turbulence on the back of robust liability management practices and continues to remain resilient. At the onset of the pandemic, LTFH further shored up its liquidity buffers and maintained enhanced levels of liquid assets as a safeguard against any likely disruption in funding due to moratorium and the stretched market liquidity conditions in Q1 FY21.

   With easing of market liquidity since Q2 FY21, the Company focused on long-term borrowings as well as reduction in cost of borrowings through prepayment of high-cost borrowing and renegotiation of interest rates leading to reduction in Weighted Average Cost (WAC) for Q4 FY21 to 7.65% from 8.43% in Q4 FY20 (lowest in past 5 years). During the year, the company raised long-term funding of ₹ 15,629 crore through diversified sources such as Priority Sector Loans (PSL), Non-Convertible Debentures (NCD) through Private Placement, Bank loans, ECBs, etc.

Infrastructure Finance

The regulatory framework saw the Liquidity Coverage Ratio (LCR) guidelines come into effect from Dec '20. As of Mar '21, the applicable LTFH lending subsidiaries are compliant with LCR requirements. In order to strengthen the liquidity risk management at LTFH, early warning indicators under the Contingency Funding Plan (CFP) were adopted, which helps in timely tapping of resources during a liquidity crisis event. The early warning indicators monitor critical parameters not only at Company level but also macro-economic indicators.

c) **Resilient balance sheet with focus on collections and macroprudential provisions:** LTFH enhanced its focus on collections by leveraging the strong digital and analytics framework. Collection efficiencies reached pre-Covid-19 levels across businesses by Q4 FY21. Asset quality improved with reduction in Gross Stage III assets from 5.36% to 4.97% YoY (Provision Coverage Ratio up from 59% to 69%). Net Stage III assets reduced from 2.28% to 1.57% YoY, which is the lowest level of Net Stage III assets since FY16.

Major Achievements

'AAA' reaffirmed: Even under the stress scenario, LTFH maintained positive liquidity levels. LTFH's AAA rating was reaffirmed by all four rating agencies – CRISIL, ICRA, India Ratings and CARE post the onset of Covid-19, reflecting its resilient balance sheet.

Business Highlights

RURAL FINANCE

Farm

LTFH achieved No.1 position with increase in market share to 15%, leveraging analytics to gain counter share with identified dealers and data-analytics-driven geo-selection. The collection efficiency of LTFH continues to remain the highest in the industry. Since Jul '20, collection efficiency in FY 2020-21 is better than in every corresponding month of previous year, and regular CE in Mar '21 is at 91.5%.

Two-wheelers

LTFH improved ranking to amongst the top 3 financiers with increase in market share to 11% on the back of analytics capturing higher counter shares, a strong dealer network of 3700+ across India and an end-to-end digital proposition providing a best-in-class Turn Around Time (TAT) on Loan Sanction of 45 seconds.

Micro Loans

Starting with nearly Nil disbursements in Q1 FY21 and a moratorium till May, the Micro Loans business registered its highest-ever quarterly disbursement in Q4 FY21, up 54% QoQ and 44% YoY. LTFH increased focus on retaining customers with excellent repayment track record with a share of repeat customers at ~50% in Q4 FY21. LTFH further strengthened the digital payment framework, such as UPI, Wallet, NEFT, Direct Website, Payment Gateways, to drive collections through the digital mode.

Micro Loans

HOUSING FINANCE

Home Loans

A digital lending model leading to the paperless sanction of home loans to salaried customers is a unique offering that has helped in quick turnaround of proposals. The model has also enabled LTFH to reduce face-to-face meetings and frequent visits by customers to the branches. During the year, the contribution of Home Loans as a part of total retail housing disbursements has increased from 83% in H2 FY20 to 88% in H2 FY21.

LTFH continued to focus on increasing the share of its salaried customer base. The contribution of salaried customers to the total HL disbursements has also increased from 63% to 92% during the year. The share of salaried customers in the loan book has increased from ~38% in FY20 to ~43% in FY21.

Real Estate

LTFH continued its strategy of focus on project completion by lending only to existing projects. LTFH plans to start new underwriting in FY22.

INFRASTRUCTURE FINANCE

LTFH continues to be one of the leading players in the Infrastructure Finance business, with disbursements assisted by the continued momentum in sell-down. LTFH continues to focus on projects with strong sponsors and off-takers. LTFH enhanced its focus towards sell-down and pre-payments to create opportunities for disbursements without increasing capital allocation.

INVESTMENT MANAGEMENT

FY 2020-21 has been a moderate year for industry due to significant outflows coupled with stringent SEBI regulations. On an overall basis, the equity segment has seen a rise in redemptions on account of perceived higher valuations, while there was an uptick in the inflows in the debt segments and ETF / index funds.

Digital Initiatives

One of the biggest drivers of growth has been 'technology as an enabler' for LTFH. To ensure seamless customer service, LTFH took proactive measures and encouraged customers to prioritise the usage of digital facilities for services, payments and inquiry, and leveraged web portal and mobile app channels to establish direct connect with customers. LTFH focused on capacitating call centers for calling debtor customers for digital payments to strengthen the collection strategy. In the project finance business, LTFH also leveraged digital technology for real-time monitoring of infrastructure and real estate financed assets.

The Company looks to continue leveraging the power of data analytics, build strategic competitive advantage, improve productivity and enhance performance with its end-to-end digital proposition.


Mutual Funds

LTFH's flagship CSR programme, 'Digital Sakhi' (peer educators), focuses on financial literacy by cultivating and adopting digital modes of payments. The programme is currently being implemented in five states – Maharashtra, Madhya Pradesh, Tamil Nadu, Odisha and West Bengal, in a total of about 395 villages.

In FY 2020-21, LTFH's Digital Sakhis disseminated digital finance sessions to 8.70 lakh+ community members through door-to-door visits across the 5 states.

The flagship programme won the prestigious FICCI CSR awards in the category of women's empowerment and *Business Standard's* Social Excellence Award 2019 for the Most Socially Aware Corporate of the Year. In order to contain the spread of coronavirus in rural geographies, LTFH launched various awareness initiatives through Digital Sakhis reaching out to over 4.80 lakh community members.

Environment, Health and Safety

LTFH embarked upon the sustainability journey 3 years ago, and has taken various initiatives to steer 'Financing Sustainable Future' and for 'Growing Better Together'.

- LTFH introduced several technological solutions to save electricity and increase efficiency. LTFH complies with the E-Waste Management and Handling Rules and recycles 100% of generated e-waste through registered recyclers.
- LTFH's corporate headquarters in Mumbai has earned the recognition of being a LEED Gold-certified building. The structure has in place a Sewage Treatment Plant that allows the usage of wastewater for gardening and air-conditioning.

The nature of LTFH's business, which serves the rural populace and the base of the pyramid, as well as financing renewable energy projects, along with various sustainability initiatives, has enabled LTFH receive positive ratings on some of the global ESG indices such as FTSE4Good, Sustainalytics and MSCI.

Human Resources

As a financial services provider, people are one of LTFH's core strengths. LTFH is committed to the well-being and development of each of its employees and adapts its human resource practices to the changing needs and dynamics. With over 75% of people in frontline roles who are required to be out in the field for regular work, the focus on health and safety has been paramount, especially in a year such as this one.

1. **Enablement of WFH during lockdown, initiatives taken for safety of staff at workplace, travel etc.**

   Work from Home was immediately put into effect in the organisation as per the Government guidelines. To ensure a smooth transition, initiatives such as sanitising all branches and offices and connecting with employees daily to check on their health as well as the health of their families were introduced. In addition to the existing Mediclaim, Term Life and Personal Accident

Two-Wheeler Finance

policies, LTFH also launched a Covid-19 Domiciliary Policy for employees and their families for coverage of Covid-19 treatment expenses and an Online Health Care Facility (Doctor on Call Service, an app-based medical consultation) in association with Practo, for the safety and wellbeing of the employees and their families.

A daily tracker was instituted to check on the health of the employees who tested positive for Covid-19 to ensure that the necessary support is provided to them at the right time.

2. **Policies and programmes for employee growth and development, appreciation and satisfaction capability building:** LTFH's talent strategy is performance-oriented and in alignment with its organisational goals. LTFH encourages employees who have demonstrated the right capability, attitude and the desire to 'step up'. As a part of its strategy to groom future-ready talent, LTFH encourages cross-functional movements and up-skills them through 'education, exposure and experience'.

   To felicitate top performers, LTFH has established STAR Awards, one of the biggest annual recognition platforms which propagates its values and recognises those who live by it. Additionally, in recognition of the outstanding and exceptional contributions of the employees throughout the year, an online 'Wall of Fame', a reward and recognition platform, was instituted across the organisation.

   LTFH has a practice of periodic Town Halls conducted by senior business leaders. The frequency of these was ramped up in the past year, keeping in mind the need to have people aligned to organisation priorities as well as connected with their teams.

3. **Initiatives towards building future leaders, succession planning:** Succession planning is an important part of talent strategy, to de-risk any 'vacancy risk' associated with critical roles, for ensuring business continuity.

   From a high-potential talent pool, LTFH has identified successors to be developed in order to take up leadership roles in the future.

Risks and Concerns

Despite the optimism surrounding the ongoing vaccination drive, the recent resurgence in Covid-19 infections across the states has raised the spectre of fresh pandemic restrictions and thus poses a threat for smooth economic recovery.

On the fiscal front, both the Centre and the State Governments are expected to run higher fiscal deficits to fuel the economic recovery. In the absence of the imposition of fresh taxes by the Government, the revenue inflows will depend on an uptick in economic activities. A deluge of market borrowings by the Government could push up the cost of borrowing as well as impact the sovereign credit rating outlook, if growth does not pan out as expected. The business remains prepared to manage the concerns with help of strengths in market positioning, agile execution capabilities, robust early warning systems and the extensive use of analytics for risk mitigation and resource allocation.

Outlook

Around the globe, the support from the Governments and the central banks in the form of lowering of key policy rates, quantitative easing measures, loan guarantees and fiscal stimuli have brightened the global growth outlook for FY 2021-22. Various multilateral organisations and rating agencies have projected that the Indian economy will grow at a double-digit pace in FY 2021-22. With massive vaccination drives underway, risks to the recovery may abate and economic activity is expected to gain momentum in the second half of FY 2021-22. However, the emergence of newer variants of the virus has created some uncertainty.

The RBI expects gross NPAs of scheduled commercial banks to rise to 13.5% under the baseline stress scenario and further escalate to 14.8% under a severe stress scenario by September 2021. The banks will, thus, need to make higher provisions to cover the stressed assets, which could impair the credit available for investment spending. Similarly, the RBI expects asset quality of NBFCs to deteriorate further due to the disruption of business operations caused by the pandemic.

Retail inflation may be rearing its ugly head again in the coming months. Although the food inflation is likely to be moderate with expectations of bumper harvest, the core inflation has remained stubbornly elevated for the past few months. Recently, the commodity prices have started rising at a faster pace across the globe in response to the normalisation of economic activities. Broad-based escalation in cost-push pressures in services and manufacturing prices could further impart upward pressure. Expectations of demand normalisation, production cut by the OPEC+ and allies as well as higher taxes on petroleum products are likely to further exert an upward pressure on the fuel prices.

On the positive side, the Government has remained committed to providing further impetus to the economy through the Union Budget 2021. The Budget is expansionary with a focus on Health, Rural and Infrastructure related capex. The Budget has placed special emphasis on monetising operational public infrastructure assets, foreign participation through the InvITs and REITs route, and has proposed a sharp increase in capital expenditure of ₹ 5.54 trillion.

In FY 2021-22, supplemented by the capital raised, LTFH plans to build upon its strengths and learnings of FY 2020-21, to maintain leadership position in the focused segments – Rural, Housing & Infrastructure lending. It will continue tracking the developing macro conditions to manage risks while taking advantage of market growth opportunities.