

26 November 2024

India | Equity Research | Company Update

L&T Finance

NBFCs

Project Cyclops – LTF’s AI-driven multi-dimensional underwriting engine – to hog the limelight

L&T Finance (LTF), during its Investor Digital Day 2024 ([Link](#)) (on 25 Nov'24), provided key insights into its project Cyclops – an AI-driven, multi-dimensional underwriting engine. The MD & CEO, as part of his opening address, highlighted LTF's transition from being a wholesale lender to diversifying retail and digital initiatives, making it future ready with digital at the core. Thereafter, LTF's Chief Digital Officer and Chief AI & Data Officer provided further insights into its futuristic digital architecture and how AI is driving growth. A brief overview of all its product verticals was provided by the respective business heads.

Project Cyclops will gradually be introduced for all LTF products except JLG

LTF launched its beta version for project Cyclops in Jun'24, which is an AI-driven multi-dimensional underwriting engine. It uses alternate data sources, namely trust signals, geo signals and account aggregator data apart from traditional bureau data from multiple bureaus. This is the next gen underwriting engine aimed at higher approval rates and delivering higher RoA, by way of operating leverage and rationalising credit cost.

For its two-wheeler business, it introduced Cyclops in Jun'24 and the results so far have been encouraging, as per the management. Cyclops has aided LTF in giving better customer offers and filtering out high-risk customers, which has resulted in a rise in prime share in disbursements to 64% in Oct'24 vs 54% in Jun'24. LTF expects this penetration to rise further in ensuing months.

Also, with successful pilot of Cyclops in two-wheeler financing business, it is looking to expand the usage of Cyclops in its other offerings as well, apart from JLG. This may help better its underwriting and open new avenues of growth. With usage of Cyclops, LTF now has various other data points to evaluate a customer profile, apart from the traditional bureau score and assess its capabilities. This would be extremely useful in assessing new-to-credit customer.

Financial Summary

Y/E March	FY23A	FY24A	FY25E	FY26E
Net Interest Income (INR mn)	67,679	75,367	89,563	1,14,070
PAT (INR mn)	19,583	23,171	28,400	37,077
EPS (INR)	6.2	9.3	11.4	14.9
% Chg YoY	43.2	50.2	22.6	30.6
P/E (x)	22.7	15.1	12.4	9.5
P/BV (x)	1.6	1.5	1.4	1.2
Gross Stage - 3 (%)	4.7	3.2	3.0	2.8
Dividend Yield (%)	1.4	1.8	2.1	2.4
RoA (%)	1.4	2.2	2.5	2.7
RoE (%)	7.4	10.3	11.6	13.7

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Market Data

Market Cap (INR)	351bn
Market Cap (USD)	4,170mn
Bloomberg Code	LTF IN
Reuters Code	LTFL.BO
52-week Range (INR)	194 /134
Free Float (%)	32.0
ADTV-3M (mn) (USD)	18.0

Price Performance (%)	3m	6m	12m
Absolute	(15.9)	(10.7)	0.7
Relative to Sensex	(14.7)	(16.9)	(20.7)

Earnings Revisions (%)	FY25E	FY26E
PAT	-	-

Previous Reports

21-10-2024: [Q2FY25 results review](#)

18-07-2024: [Q1FY25 results review](#)

Investments in project Cyclops to pave way for improving operating efficiencies and structural decline in credit cost

Overall, it has invested ~INR 3bn over a span of 2 years (FY24 and FY25) towards various digital initiatives and has done most of the heavy lifting on the cost front. Going ahead, this spend could moderate and would be more towards opex front. Moreover, operating leverage could kick in as project Cyclops is introduced for other LTF products, except MFI. Also, with the introduction of Nostradamus, LTF's automated risk management system, which is expected to be live by Q2FY26, could lead to a gradual and structural decline in credit cost with improved early warning signals.

Better credit guardrails result in contained DPD levels; however, sector headwinds and natural calamities pose risk to credit cost estimate

LTF has been relatively conservative while lending in MFI segment, and hence, has been conservatively following the guard rails, despite relaxation in Mar'22. Moreover, it saw some initial signs of over leveraging building up in early Jan'24, and hence, it further tightened its underwriting Jan'24 onwards, wherein it restricted lending to LTF + 2 customers. In order to better manage collections, it rationalised its field loan officer's APC from 540 to 490 to optimise the span of control and improve monitoring.

Bihar has seen unseasonal floods, which have impacted collections for Oct'24 in that state. However, management expects normalcy to prevail and CE in Bihar to improve in Dec'24. It has consciously adopted certain tight measures in microfinance.

Under MFI, it is driving efficiencies through data and technology. For MFI group meetings attendance, it is using advanced AI using CNN models for face recognition with KYC image, which seems quite interesting and unique. It has guided that growth will return for MFI industry, but not back to 30-40%; may be growth could restore to a reasonable rate of ~20%. Moreover, it has built a dedicated workforce of 500+ members to acquire lower leveraged customers in current environment and enter the untapped geographies with strong potential. Overall, it has built an MFI portfolio, which is differentiated, unique and relatively resilient.

Maintain BUY with revised TP of INR 200, valuing LTF at ~1.8x FY26E ABV

LTF continues to granularly track and execute its 5-pillar execution strategy towards reaching a consolidated RoA range of 2.8-3%, thereby, creating a sustainable and predictable retail franchise. However, MFI asset quality headwinds at sector level due to the current issue of over leveraging and tightening of MFI guard rails and natural calamities in specific geographies (larger for LTF), pose a risk to our credit cost estimate for LTF or could be offset by utilisation of macro prudential provisions. Moreover, since the industry is passing through a turmoil, it is unlikely that LTF would be unimpacted, given that it commands >6% market share in JLG loans. We, therefore, revise our target multiple to 1.8x FY26E ABV (vs. 2.0x earlier) and our TP stands revised to INR 200 vs INR 225 earlier. Maintain **BUY**.

Key Risks:

- Loan growth slower than expected
- Prolonged MFI asset quality cycle

Investor Digital Day 2024: Takeaways

Guidance

- Aiming to double loan book in next 3-4 years.
- AUM growth of 20-25% on sustained basis.
- **200-225bps credit cost on a steady-state basis.**
- **280-300bps RoA.**

Levers for RoA guidance

- It has launched micro-LAP which is a high-yielding business.
- Personal loan has legs to grow.
- Overall, there is immense focus on cost reduction.
- From FY26, India may start its downward rate cycle, which should also push NIM.
- If external environment improves, credit cost across the system would also improve.

Personal loans

- Prime customer loans and super prime customer loans continue to behave well.
- **Personal loans are showing stress only in loans below INR 75k. This comprises INR 1.25trn out of INR 13trn.**
- **Personal loans with ATS of less than INR 75k have loss rate of 6-7% vs ~2% loss rate in personal loans.**
- Personal loans' safe growth would be around 20%.

Microfinance

- **It has slowed down the MFI business by choice and has decided to do absolutely safe business, considering the external environment.**
- For MFI group meetings attendance, it is using advanced AI with CNN models for face recognition with KYC image.
- LTF is among the top 5 financiers in the country in JLG industry.
- In microfinance, it is driving efficiencies through data and technology.
- It currently has 100% paperless customer on-boarding and 25% digital collections.
- **It has built a microfinance portfolio which is differentiated, unique and resilient.**
- It has introduced mobile DIY journey through Planet app.
- By the end of CY23, it observed that its leverage was increasing in certain markets. Hence, **it has implemented customer leverage tracker for risk-based categorisation.**
- Collection efficiency at 99.5+% levels and ODD collection at 95%+ are driving '0' DPD culture- ~97%.
- It has 1 risk manager for every 3 branches, which provides with field-level intelligence for taking the right business decision.
- Typically, unsecured asset quality issues flow in 9-12 months.
- Moved to LTF + 2 from Jan'24 as it saw some signs of over leveraging.
- **Growth will return for MFI industry, but not back to 30-40%. May be growth could restore to reasonable growth rates of ~20%.**

Microfinance – business update

- Its MFI disbursements have reached INR 18bn, wherein it identified a crisis in the industry. Therefore, it set a criterion wherein if a branch achieves a certain threshold of CE, then it is eligible for new MFI business.
- **LTF has restricted sourcing to two external associations even for repeat customers; it is more stringent than MFIN norms.**
- It added over 1,000 employees to reduce the collection pressure per officer.
- **69% of portfolio has only 0/ 1 external association showcasing lower customer indebtedness.**
- **It is focusing on tapering off customers with high leverage (>=4 associations) in portfolio which has fallen from 7.0% in Jun'24 to 5.4% as of Sep'24 and 5.0% as of Oct'24.**

- Added 500 members in its team for fresh sourcing, so that its new business is also not impacted due to asset quality pressure in existing portfolio.
- **CE in Bihar is expected to improve in Dec'24.**
- **It does not expect overall MFI portfolio credit cost to exceed INR 10bn in FY25**
- It has seen improvement in CE in Maharashtra, post the *Ladli Behna* scheme.
- If the industry is going through a turmoil, then LTF cannot be unimpacted.
- **It sees an improvement in CE bias in many states. If the trend continues, it can expect peaking of industry in Dec-Jan'24 in terms of stress.**

SME/tractor/farm equipment

- It does cater to any case which is under sub-prime category in SME finance.
- It is looking to use satellite and meteorological data to improve delinquency prediction of tractor loans.
- It does not have a single customer with overdue in the 18 months of operation in warehouse receipt finance.

Two-wheeler financing

- **It is leveraging high speed compute for better underwriting and quicker TAT.**
- 170-180mn two wheelers are financed every year in India.
- It has a very strong dealer partnership and has also partnered with certain premium OEMs.
- Two-wheeler is not just a product, but is also used for cross-sell, data mining etc.
- Its goal is to improve Login to Disbursement ratio from 33-38% to 45%+ for two-wheeler loans.
- Entire legacy 2W portfolio would get renewed in the next 12 months.

Technology

- Technology is currently moving at a very fast pace.
- It has hired some of the best brains in the world and positions the organisation for a great leap forward.
- Account aggregator (AA) success rates currently stand at 91%, which means for every AA pull, it gets success of 91%.

Cyclops - state of the art credit underwriting system

- It is steadily scaling up Cyclops with encouraging results.
- Future is AI, especially in BFSI.
- **Right now, LTF lets go a lot of customers since its credit score is thin. Hence, analytics may help it further expand its customer base and increase penetration in NTC customers.**

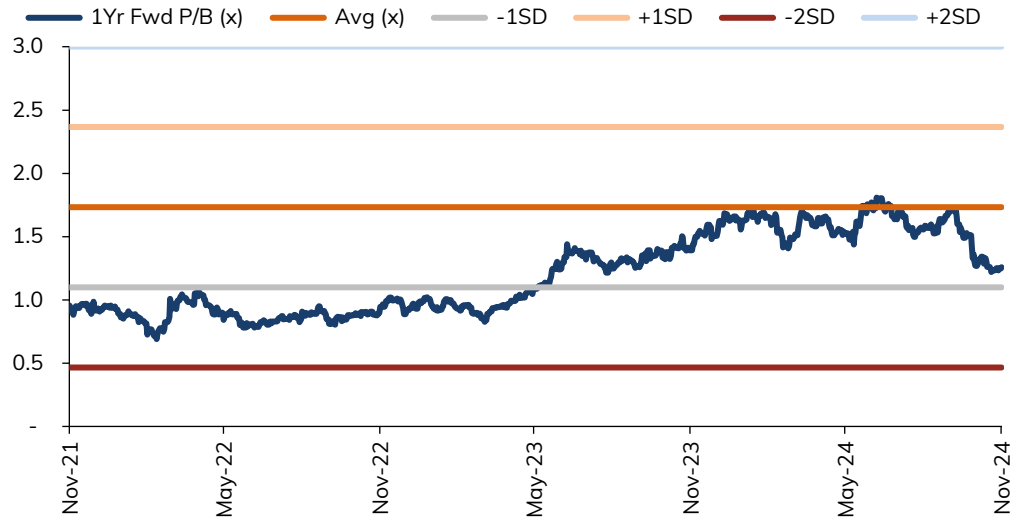
Cyclops investment

- INR 450mn for FY25 in opex.
- INR 1.75bn capex for FY25.

Planet app

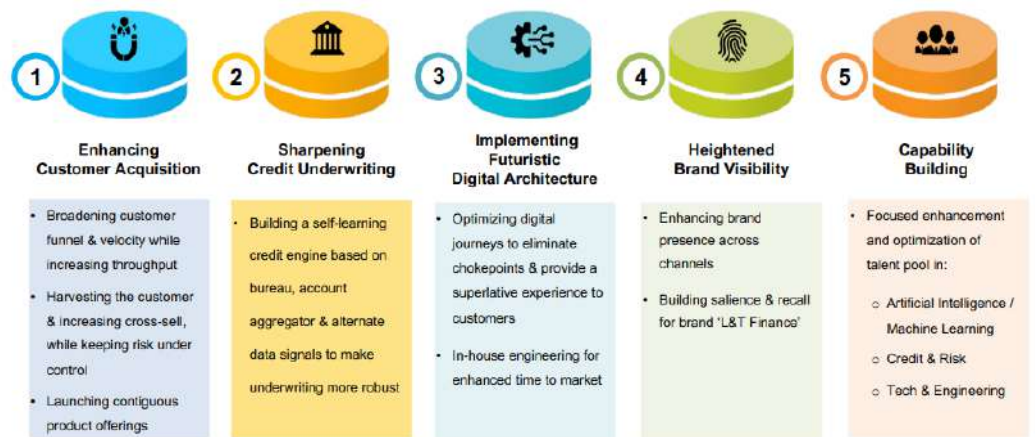
- Monthly active users on Planet app have almost doubled to 1.9mn vs 1.0mn a year ago.
- 2.4mn rural users are using Planet app

Exhibit 1: Risk:reward favourable at current valuations



Source: Bloomberg, Company data, I-Sec Research

Exhibit 2: Five-pillar execution strategy



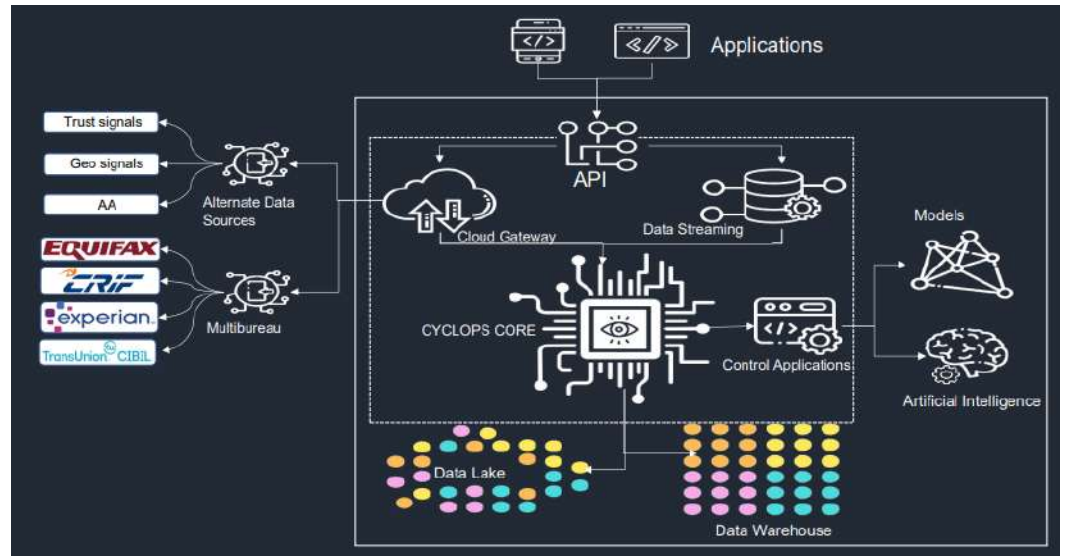
Source: Company data, I-Sec research

Exhibit 3: Aiming at sustainable RoA of 280-300bps



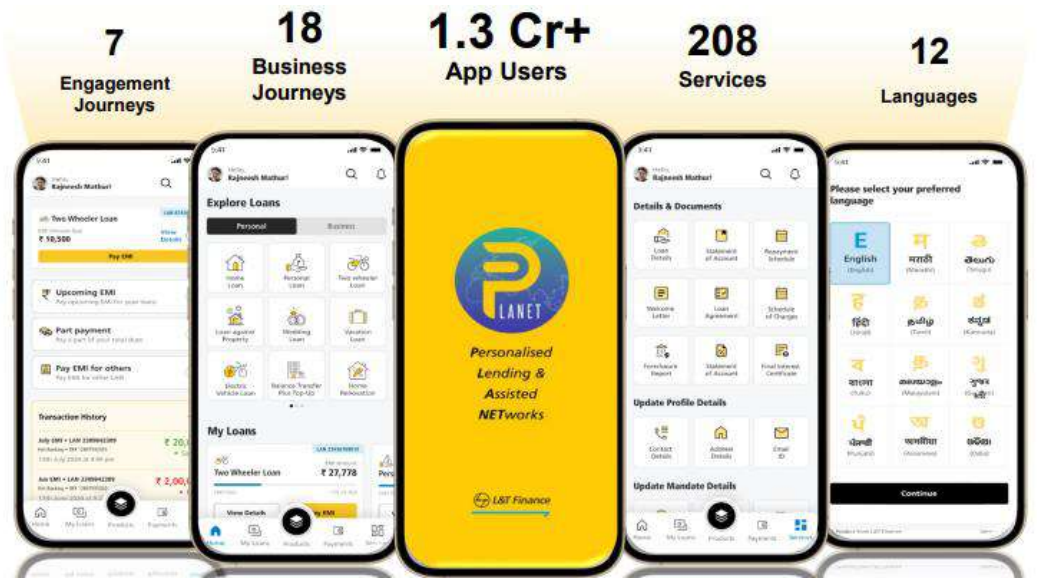
Source: Company data, I-Sec research

Exhibit 4: Project Cyclops - harnessing data from alternate sources, namely, trust signals, geo signals and account aggregator apart from bureau scores



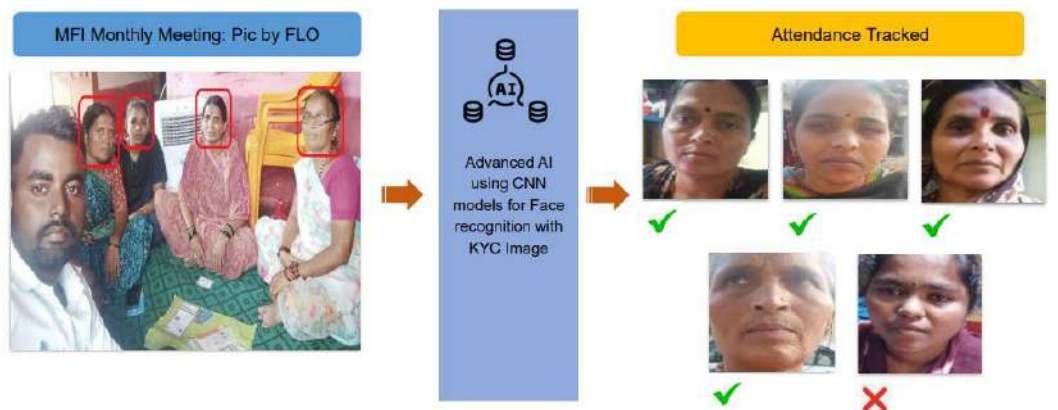
Source: Company data, I-Sec research

Exhibit 5: A glimpse of the PLANET App



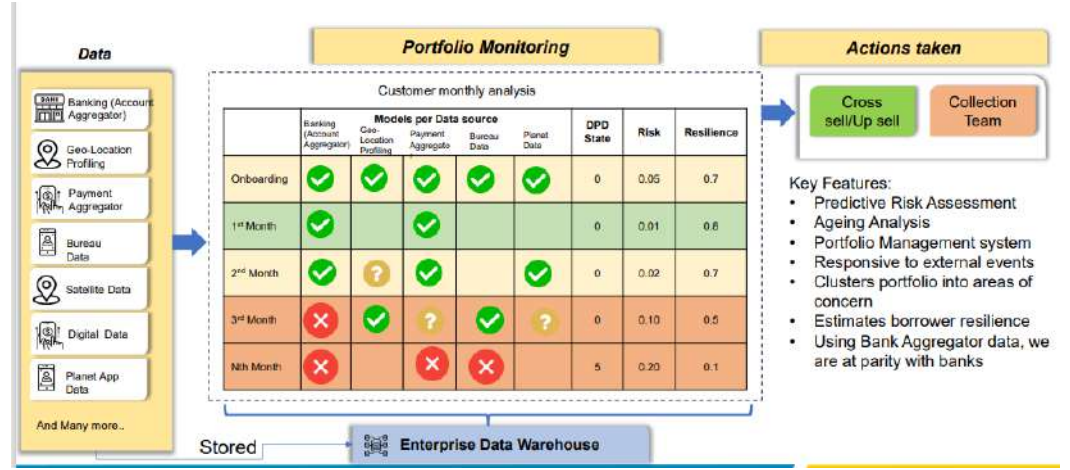
Source: Company data, I-Sec research

Exhibit 6: MFI – GenAI based auto attendance



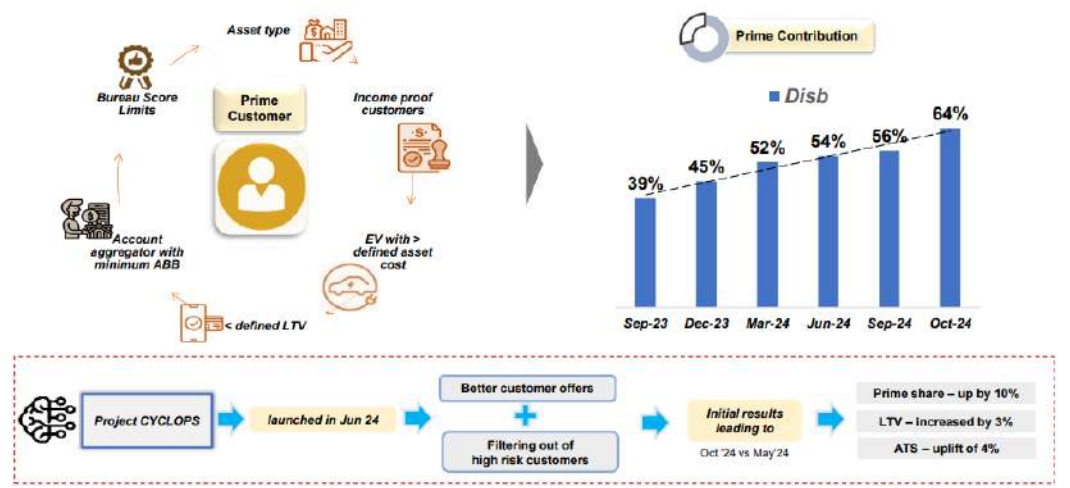
Source: Company data, I-Sec research

Exhibit 7: Nostradamus (Automated Risk Management System) in WIP stage



Source: Company data, I-Sec research

Exhibit 8: Pivoting towards prime portfolio in two-wheeler financing



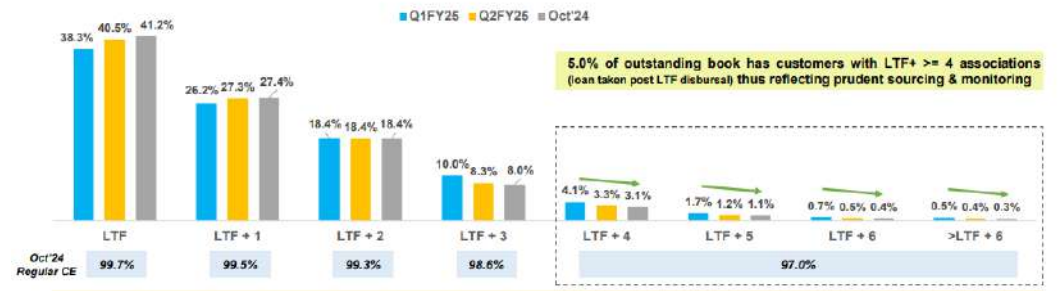
Source: Company data, I-Sec research

Exhibit 9: Association wise customer composition at sourcing

Association	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25	Q2 FY25	Oct'24
Only LTF	47%	48%	50%	48%	49%	53%
LTF + 1	28%	28%	28%	32%	31%	30%
LTF + 2	19%	19%	17%	19%	20%	17%
LTF + 3	6%	5%	5%	1%	0%	0%
Total	100%	100%	100%	100%	100%	100%

Source: Company data, I-Sec research

Exhibit 10: Continued reduction in leveraged customer base



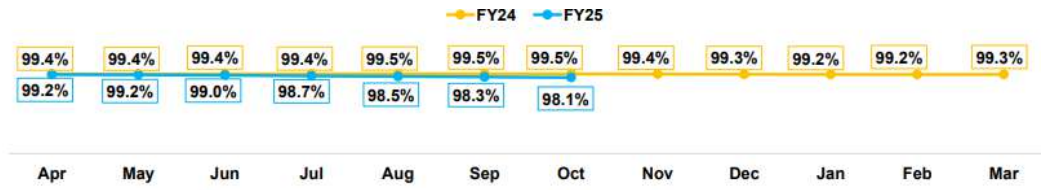
Source: Company data, I-Sec research

Exhibit 11: 0 DPD CE % for Rural business finance



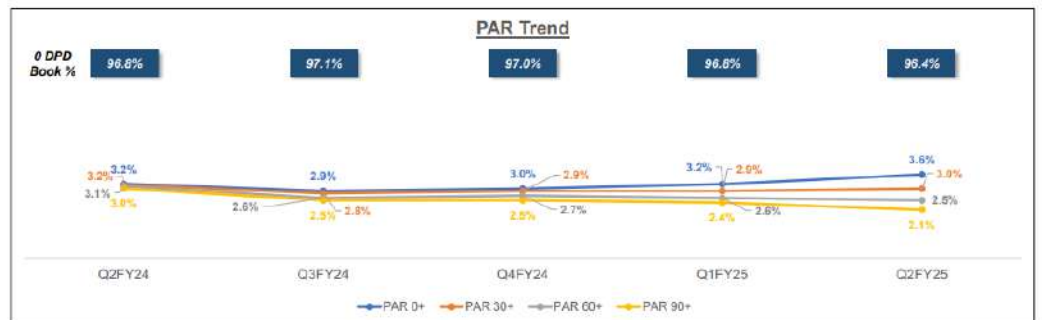
Source: Company data, I-Sec research

Exhibit 12: 0-90 DPD CE % for Rural business finance



Source: Company data, I-Sec research

Exhibit 13: Overall, PAR 1+ at 3.6%, relatively lower when compared to industry peers



Source: Company data, I-Sec research

Exhibit 14: Shareholding pattern

(%)	Mar'24	Jun'24	Sep'24
Promoters	65.9	66.4	66.3
Institutional investors	19.7	18.7	19.0
MFs and others	3.4	6.9	7.5
Insurance Cos	5.1	4.5	4.8
FIIIs	11.2	7.3	6.7
Others	14.4	14.9	14.7

Source: Bloomberg, I-Sec research

Exhibit 15: Price chart



Source: Bloomberg, I-Sec research

Financial Summary

Exhibit 16: Profit & Loss

(INR mn, year ending (March))

	FY23A	FY24A	FY25E	FY26E
Interest Income	1,25,651	1,29,139	1,49,107	1,87,511
Interest Expenses	(57,972)	(53,772)	(59,544)	(73,441)
Net Interest Income (NII)	67,679	75,367	89,563	1,14,070
Other Income	5,268	4,745	5,220	5,742
Total Income (net of interest expenses)	17,072	33,007	43,394	55,610
Employee benefit expenses	(14,059)	(18,064)	(21,531)	(26,838)
Depreciation and amortization	(1,112)	(1,148)	(1,203)	(1,270)
Other operating expenses	(13,162)	(15,867)	(17,481)	(20,893)
Total Operating Expense	(28,334)	(35,079)	(40,216)	(49,001)
Pre Provisioning Profits (PPoP)	46,711	51,701	62,723	80,050
Provisions and write offs	(25,404)	(21,410)	(24,770)	(30,501)
Profit before tax (PBT)	21,307	30,290	37,953	49,549
Total tax expenses	(1,724)	(7,119)	(9,553)	(12,471)
Profit after tax (PAT)	19,583	23,171	28,400	37,077

Source Company data, I-Sec research

Exhibit 17: Balance sheet

(INR mn, year ending (March))

	FY23A	FY24A	FY25E	FY26E
Share capital	24,797	24,889	24,889	24,889
Reserves & surplus	1,90,487	2,09,495	2,31,673	2,61,366
Shareholders' funds	2,15,284	2,34,384	2,56,562	2,86,256
Borrowings	8,30,435	7,65,409	9,50,809	11,96,909
Provisions & Other Liabilities	17,903	27,383	28,707	30,098
Total Liabilities and Stakeholder's Equity	10,63,621	10,27,176	12,36,078	15,13,262
Cash and balance with RBI	1,27,489	46,760	49,098	51,553
Fixed assets	5,573	5,550	5,827	6,119
Loans	7,51,546	8,13,594	10,08,331	12,82,924
Investments	1,43,662	1,23,849	1,36,234	1,43,045
Other Assets	35,352	37,423	36,588	29,620
Total Assets	10,63,621	10,27,176	12,36,078	15,13,262

Source Company data, I-Sec research

Exhibit 18: Key Ratios

(Year ending (March))

	FY23A	FY24A	FY25E	FY26E
AUM and Disbursements				
(Rs mn)				
AUM	8,08,930	8,55,640	10,60,441	13,49,225
Growth (%):				
Total AUM (%)	(8.4)	5.8	23.9	27.2
Loan book (on balance sheet) (%)	(8.9)	8.3	23.9	27.2
Total Assets (%)	(0.5)	(3.4)	20.3	22.4
Net Interest Income (NII) (%)	13.7	11.4	18.8	27.4
Non-interest income (%)	(26.2)	54.9	17.2	12.0
Total Income (net of interest expenses) (%)	41.9	93.3	31.5	28.1
Operating Expenses (%)	18.3	23.8	14.6	21.8
Employee Cost (%)	23.5	28.5	19.2	24.6
Non-Employee Cost (%)	14.2	20.6	10.2	19.5
Pre provisioning operating profits (PPoP) (%)	2.5	10.7	21.3	27.6
Provisions (%)	(17.6)	(15.7)	15.7	23.1
PBT (%)	44.5	42.2	25.3	30.6
PAT (%)	86.6	18.3	22.6	30.6
EPS (%)	43.2	50.2	22.6	30.6
Yields, interest costs and spreads (%)				
NIM on loan assets (%)	9.0	9.3	8.9	8.9
NIM on IEA (%)	7.1	8.2	8.9	9.1
NIM on AUM (%)	8.0	9.1	9.3	9.5
Yield on loan assets (%)	16.7	15.9	14.8	14.6
Yield on IEA (%)	13.2	14.0	14.8	14.9
Yield on AUM (%)	14.8	15.5	15.6	15.6
Cost of borrowings (%)	6.9	6.7	6.9	6.8
Interest Spreads (%)	9.8	9.1	7.8	7.8
Operating efficiencies				
Non interest income as % of total income	0.9	0.9	0.9	0.9
Cost to income ratio	37.8	40.4	39.1	38.0
Op.costs/avg assets (%)	2.7	3.4	3.6	3.6
Op.costs/avg AUM (%)	3.3	4.2	4.2	4.1
Salaries as % of non-interest costs (%)	49.6	51.5	53.5	54.8
NII /employee (Rs mn)	2.6	2.5	2.7	3.0
AUM/employee(Rs mn)	30.5	28.0	31.7	35.3
Capital Structure				
Average gearing ratio (x)	3.9	3.3	3.7	4.2
Leverage (x)	3.8	3.7	4.1	4.7

Source Company data, I-Sec research

	FY23A	FY24A	FY25E	FY26E
Asset quality and provisioning				
GNPA (%)	4.7	3.2	3.0	2.8
NNPA (%)	1.5	0.8	0.7	0.7
GNPA (Rs mn)	26,260	26,980	31,283	37,104
NNPA (Rs mn)	11,780	6,610	7,508	8,719
Coverage ratio (%)	69.3	75.5	76.0	76.5
Credit Costs as a % of avg AUM (bps)	300	257	259	253
Credit Costs as a % of avg on book loans (bps)	322	274	272	266
Return ratios				
RoAA (%)	1.4	2.2	2.5	2.7
RoAE (%)	7.4	10.3	11.6	13.7
ROAAUM (%)	1.8	2.8	3.0	3.1
Dividend Payout ratio (%)	32.3	26.9	26.0	22.5
Valuation Ratios				
No of shares	2,480	2,489	2,489	2,489
No of shares (fully diluted)	2,480	2,489	2,489	2,489
EPS (Rs)	6.2	9.3	11.4	14.9
EPS fully diluted (Rs)	6.2	9.3	11.4	14.9
Price to Earnings (x)	22.7	15.1	12.4	9.5
Price to Earnings (fully diluted) (x)	22.7	15.1	12.4	9.5
Book Value (fully diluted)	87	94	103	115
Adjusted book value	83	92	101	112
Price to Book	1.6	1.5	1.4	1.2
Price to Adjusted Book	1.6	1.5	1.4	1.2
DPS (Rs)	2.0	2.5	3.0	3.4

Source Company data, I-Sec research

Exhibit 19: Key Metrics

(Year ending (March))

	FY23A	FY24A	FY25E	FY26E
DuPont Analysis				
Average Assets (Rs mn)	10,66,322	10,45,399	11,31,627	13,74,670
Average Loans (Rs mn)	7,88,120	7,82,570	9,10,962	11,45,628
Average Equity (Rs mn)	2,07,380	2,24,834	2,45,473	2,71,409
Interest earned (%)	11.8	12.4	13.2	13.6
Interest expended (%)	5.4	5.1	5.3	5.3
Gross Interest Spread (%)	6.3	7.2	7.9	8.3
Credit cost (%)	2.4	2.0	2.2	2.2
Net Interest Spread (%)	4.0	5.2	5.7	6.1
Operating cost (%)	2.7	3.4	3.6	3.6
Lending spread (%)	1.3	1.8	2.2	2.5
Non interest income (%)	0.7	1.1	1.2	1.1
Operating Spread (%)	2.0	2.9	3.4	3.6
Tax rate (%)	(8.1)	(23.5)	(25.2)	(25.2)
ROAA (%)	1.4	2.2	2.5	2.7
Effective leverage (AA/ AE)	5.1	4.6	4.6	5.1
RoAE (%)	7.4	10.3	11.6	13.7

Source Company data, I-Sec research

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