L&T Mutual Fund

Credit Insights

A quarterly perspective on credit environment in India

Credit Insights

January 2018

Accrual funds: Resilient in 2017, to benefit from better macros and favorable risk-reward dynamics in 2018

Global economy witnessed steady improvement in CY17[1]

- GDP growth rate[2] is estimated to improve to 3.6% for CY 17 vis-à-vis 3.2% for CY 16 and is expected to further improve to 3.7% in CY 18
- Firmer domestic demand growth in advanced economies & China, and improved performance in emerging economies drove overall optimism
- Partial unwinding of stimulus measures adopted earlier by central banks worldwide in response to the Lehman crisis have not caused major disruptions in the market

(1: CY: Calendar year: Jan-Dec; 2: Source: IMF)

....While the domestic economy went through a turbulent phase

- Measures/regulations like GST, demonetization, RERA, and higher provisioning requirements for banks had short term disruptive impact on the economy. No historical reaction function to gauge the impact of such events.
- GDP growth for FY 2018[1] is estimated at 6.5% as against 7.1% in FY 2017 and 8.0% in FY 2016
- However, these measures are expected to structurally strengthen the economy over the longer term

(1: FY: fiscal year: Apr-Mar; Source: CSO)

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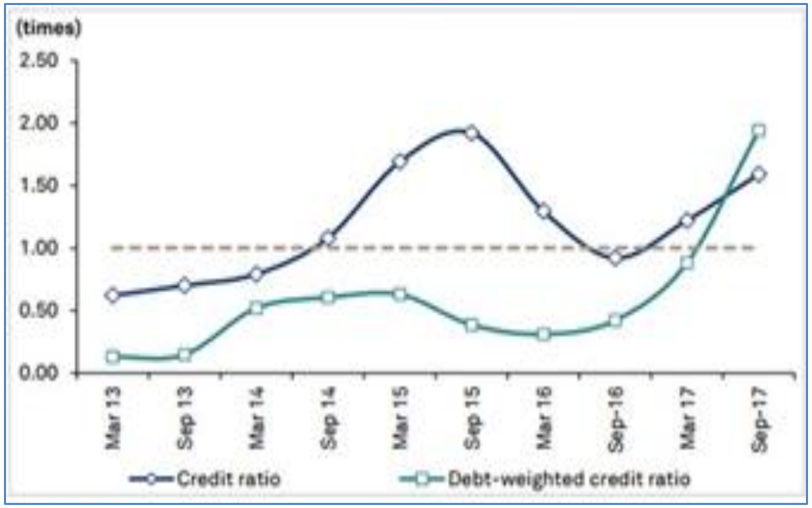
Notwithstanding domestic hiccups, corporate credit quality picked up in 2017 with mutual funds' exposure witnessing stronger improvement



Upgraded / downgraded debt quantum across debt Mutual funds						
		1H FY 16	2H FY 16	1H FY 17	2H FY 17	1H FY 18
Mutual Fund Industry	Upgrades (Rs cr)	14,993	3,882	6,320	32,733	62,214
	Downgrades (Rs cr)	12,252	11,051	512	11,174	29,744
	Credit ratio	1.22	0.35	12.34	2.93	2.09
L&T MF	Upgrades (Rs cr)	138	82	266	804	1,562
	Downgrades (Rs cr)	0	0	0	199	371
	Credit ratio	NM	NM	NM	4.04	4.21

(Source: CRISIL, ICRA, Factsheets; Credit ratio: Ratio of number of upgrades to that of downgrades)

- As per CRISIL's analysis – for the first time in 5 years – both the risk environment barometers a) Credit Ratio as well as b) Debt Weighted Credit Ratio inched up above 1 in 2017 on a rolling 12 month basis.
- Leveraged sectors such as metals, engineering & construction, cement, sugar etc. benefitted from improving commodity prices, higher govt. infrastructure spend and steady consumption
- Buoyant equity markets, benign interest rates and deferment of heavy capex supported the deleveraging and strengthening of credit metrics
- However, sectors such as real estate, public sector banks, mining and microfinance institutions witnessed pressure primarily on back of regulatory reforms

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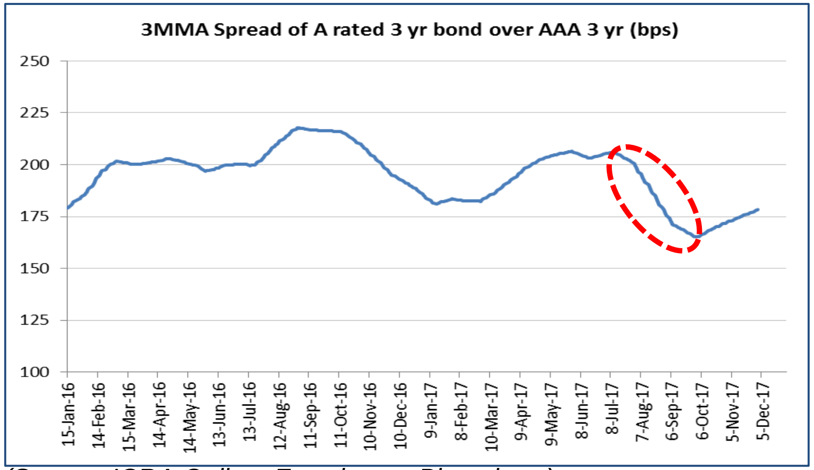
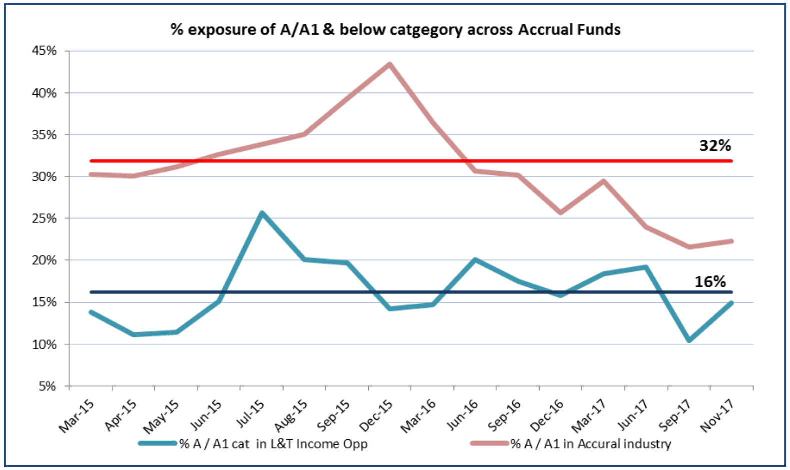
Liquidity driven credit spread compression and macro uncertainty prompted reduction in credit risk exposure across accrual funds in CY 17





(Source: ICRA Online, Factsheets, Bloomberg)

Sustenance of credit quality improvement and attractive risk reward dynamics to provide favorable backdrop for accrual funds in CY 18

Macro economic recovery to be more pronounced from 2nd half of CY 18

- Favorable leading indicators - *near normal monsoon, healthy growth in auto sales & air traffic, up-tick in manufacturing PMI print, improving growth in bank's credit* – indicate fading impact of disruptions as witnessed in the last year
- Public sector banks – the economy's critical growth engine – will witness gradual improvement
  1. Capital infusion through recently announced recapitalization bonds will not only alleviate concerns on viability, but also enable kick starting of lending activity
  2. Incremental asset quality slippages to moderate
  3. Possible resolution of large NPAs under the IBC to strengthen balance sheets
- However, factors such as political landscape running into 2019 general elections, rising crude prices and direction of fiscal and current account deficit will determine extent of improvement

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<u>Other key sectors relevant for mutual funds are also expected to remain upbeat</u>

Sector	Key Positives
Metals	• Steady global prices and supply side reforms in China
Engineering & Construction Cement & Property	• Govt's thrust on infrastructure spend, especially in sectors such as roads, affordable housing etc. • Stabilization post gradual RERA adoption
Auto ancillaries	• Steady domestic demand along with improving global demand
NBFC	• Steady asset quality with pick up in rural economy / CV sales, although spreads may compress.
MFIs converted into SFBs	• Higher loan book diversification and retail liability base

Risk reward ratio to turn favorable

- Normalization of credit spreads witnessed in Nov-Dec 2017 driven by reduction of excess systemic liquidity
- Ample investment opportunities supported by healthy pipeline of issuers across the rating curve
- Prudent credit selection to remain the theme in CY 18.

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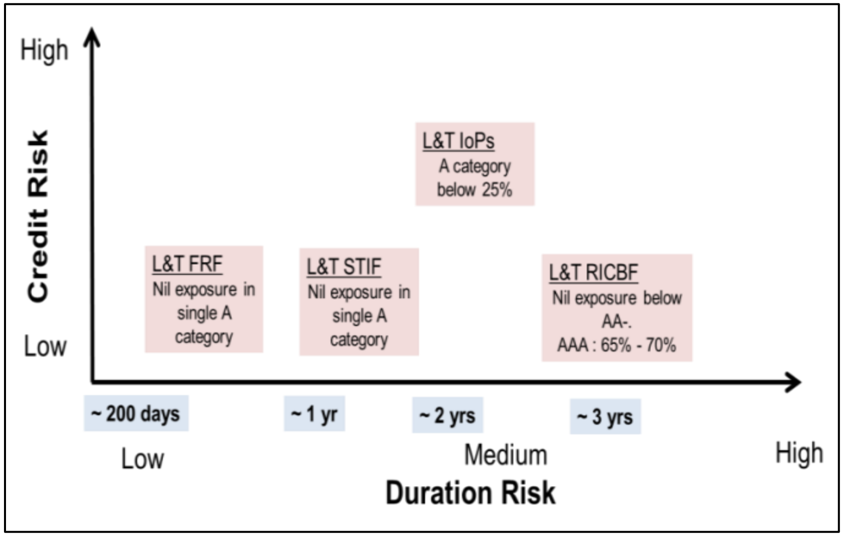
L&T's accrual funds are well positioned to benefit from the improving environment



Fund Statistics- Dec 2017	AUM (Rs cr)	YTM	Modified Duration (yrs)	Cash / CBLO
L&T Floating Rate Fund	641	7.86%	0.44	9.11%
L&T Short Term Income Fund	1,156	8.55%	1.21	11.68%
L&T Income Opportunities fund	3,378	8.92%	1.94	11.42%
L&T Resurgent India Corporate Bond fund	2,504	8.54%	2.75	11.41%

- L&T's accrual funds are positioned across the credit risk/tenor curve to suit investor requirements
- Factoring in heightened bond market volatility across Nov-Dec 2017, we have maintained high cash component / liquid exposure across funds
  - It will be incrementally deployed at attractive yields as credit spreads become more favorable in January to March 2018 period
- Ample cushion available across funds to add credit risk exposure
- Proprietary bottom-up analytical framework to enable identification of credits with rating upgrade potential

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Recent highlights in the credit universe : Sept – Dec 2017

Key events

- In Oct 2017, Govt. of India announced recapitalization of public sector banks through infusion of an aggregate amount of Rs 2.11 lakh crore
    - This move is a significant positive for public sector banks as it will address the critical issue of capital availability and will help them kick start lending activity
- In Dec 2017, Reliance Communications Ltd (R-Com) as a part of its monetization exercise entered into a binding agreement with Reliance Jio Infocomm Ltd for the sale of its wireless business
- Announcement is a positive for banks having exposure to R-Com as the proceeds would be used solely for reducing debt

Key rating movements in the mutual fund universe	
Rating upgrades	**Rating downgrades**
Indiabulls Housing Finance Ltd	Corporation Bank Ltd
Sundaram Finance Ltd	Janalakshmi Financial Services Ltd
Aditya Birla Finance Ltd	Oriental Bank of Commerce
RBL Bank Ltd	Religare group
KEC International Ltd	Steel Authority of India Ltd

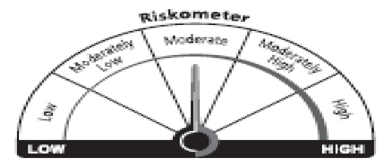
Source: ICRA Online, Factsheets, Rating agency Reports

- L&T MF was able to capture the upgrades in Indiabulls Housing Finance Ltd, Sundaram Finance Ltd and Aditya Birla Finance Ltd across various schemes.
- At the same time, L&T MF avoided all the above downgrades across any open ended scheme.

Product Labelling

L&T Resurgent India Corporate Bond Fund
An open-ended income scheme

This product is suitable for investors who are seeking*
• Generation of income over medium to long term
• Investment primarily in debt and money market securities of fundamentally strong corporates/companies in growth sectors which are closely associated with the resurgence of domestic economy
*Investors should consult their financial advisers if in doubt about whether the product is suitable for them

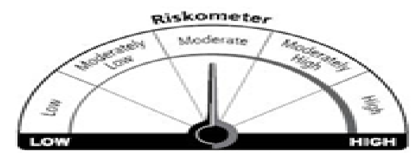


Investors understand that their principal will be at moderate risk

L&T Short Term Income Fund
An open-ended income scheme

This product is suitable for investors who are seeking*
• Generation of reasonable returns over short to medium term
• Investment in fixed income securities and money market instruments

*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.



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L&T Income Opportunities Fund
An open-ended income scheme

This product is suitable for investors who are seeking*
• Generation of regular returns and capital appreciation over medium to long term
• Investment in debt instruments(including securitized debt), government and money market securities

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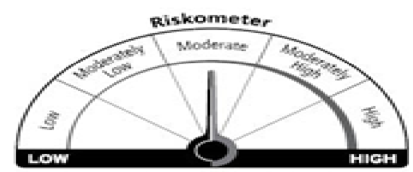

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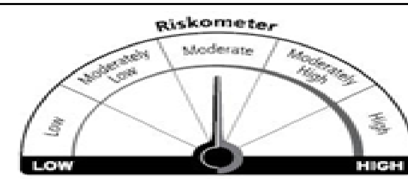
L&T Floating Rate Fund
An open-ended income scheme
This product is suitable for investors who are seeking*
• Generation of regular income over short to medium term
• Investment substantially in floating rate debt/money market instruments, fixed rate debt/money market instruments swapped for floating rate returns, and fixed rated debt securities, government securities and money market instruments
*Investors should consult their financial advisers if in doubt about whether the product is suitable for them.



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