

Sector: Banks & Finance
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 4,032	
Price Target: Rs. 4,400	↓

↑ Upgrade ↔ No change ↓ Downgrade

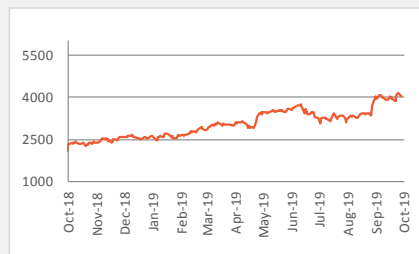
Company details

Market cap:	Rs. 2,33,795 cr
52-week high/low:	Rs. 4219/2001
NSE volume: (No of shares)	18.2 lakh
BSE code:	500034
NSE code:	BAJFINANCE
Sharekhan code:	BAJFINANCE
Free float: (No of shares)	24.2 cr

Shareholding (%)

Promoters	58.3
FII	20.7
DII	7.1
Others	14.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.2	19.3	37.5	92.7
Relative to Sensex	12.8	17.7	35.8	68.4

Sharekhan Research, Bloomberg

Bajaj Finance (BFL) has posted steady results for Q2FY20 with the net interest income (NII) rose by 48.3% YOY to Rs3998 crore (we expected growth of 41.5% YOY) while the Net profit jumped by 63.1% YoY to Rs1506 crore (we expected growth of 40.8% YOY). The performance was benefitted by lower corporate tax rate. Asset under management grew smartly by 38% YoY while new loans booked during the quarter increased by 23% YoY. Asset quality during the quarter remained stable as GNPA ratio stood at 1.61% versus 1.60% in the previous quarter. However, the management's guidance of credit cost to be 170-180 BPS for FY20E (compared to 150 bps last year) is a negative. While Management believes credit cost may come down end of Q4 FY20E as growth comes back to the system. While we believe that the long term business strengths remain, and the management indicated for a demand revival for rural & semi-urban India buoyed by strong monsoons, in the near term there may be challenges. However, for the near term the higher credit cost guidance is a concern. We have accordingly revised our estimates for FY20E/FY21E. We maintain our Buy rating with a revised price target of Rs 4400.

Key positives

- Asset under management (AUM) grew smartly by 38% YoY while new loans booked during the quarter increased by 23% YoY.
- Asset quality during the quarter remained stable as GNPA ratio stood at 1.61% versus 1.60% in the previous quarter.

Key negatives

- The management's revised guidance of credit cost to be 170-180 BPS for FY20E (compared to 150 bps last year) is a negative.

Valuations

Valued at 5.8x FY21E BVPS, BFL posted stable performance on headline parameters. However, cautious outlook and the weak demand environment are manifesting challenges. While the strong franchise, impressive operating metrics and strong return ratios work in its favour. Asset quality and growth are key monitorables in the near term. We maintain our Buy rating on the stock with an revised price target (PT) of Rs. 4400.

Key Risks

Slowdown in Consumer Finance growth and worsening of economic parameters may pose challenge.

Valuation

Particulars	FY18	FY19	FY20E	FY21E
Net interest income (Rs cr)	7,567	11,146	12,852	14,698
Net profit (Rs cr)	2,539	3,922	5,368	6,082
EPS (Rs)	44.0	68.0	92.6	104.9
EPS growth (%)	31.1	54.5	25.3	13.3
PE (x)	68.6	48.0	42.8	37.8
Book value (Rs/share)	283	344	419	517
P/BV (x)	10.7	8.8	7.2	5.8
RoAE (%)	19.6	21.7	22.4	23.7
RoAA (%)	3.3	3.8	3.6	3.5

Source: Company; Sharekhan estimates

Bajaj Finance – Q2 FY20 Concall highlights

- ◆ Bajaj Finance is looking to manage risk by reduce / calibrating new customer acquisition, so it's more by design than by anything else that 70% of the loans in Q2 were existing customers and 30% to new customers.
- ◆ The company added 102 locations, taking them to just a tad below 2000 locations. BFL will add another ~200 locations in the next year and between 160 to 200 locations in balance second half of the year as well.
- ◆ **Cost of Funds:** Cost of funds continue to go down for the company given surplus liquidity in the banking system in general. The COF has come off from 8.49 in Q1 to 8.38 in Q2 FY20. It could fundamentally still be lower if not for the overhang that BFL is continuing to carry in the balance sheet cash and equivalents of around Rs 8,000 - 10,000 crores which is a cost of carry, but given the environment that's probably the prudential thing to do.
- ◆ **Higher Loan losses:** Loan losses were higher than earlier quarter, as the company is seeing Credit cost (plus ECL impact of 12-14 BPS per quarter) rising to almost the Demonetization era. Hence, see credit cost of 175-178 BPS on FY20E (from 150BPS in FY19). The concern is mostly from Auto etc segments. However, management expects improvement from Q4 FY20.
- ◆ Bajaj Finance generally prefers to sell down the portfolio to ARCs rather than trying to recover.
- ◆ Fully hedged cost of ECB is lower than bank financing, the ECB cost is around 7.90-7.95% all in (interest payable + hedging) vs Bank money which is at ~8.55%. It also helps diversify the funding base.
- ◆ **Deeper customer reach:** BFL has on an average added ~12 million new customers and the company is now in ~2000 towns in india. However, most of the competitive activities is in top 25- 30 towns in India and in point of sale businesses.
- ◆ In consumer durable finance, Bajaj Finance has a competitive advantage and can manage risk better. As per the management, in consumer finance business it is its important to have strong risk management, provide value in terms of reduced friction and have own customer base (whose financial history is available with the lender). Hence, Bajaj Finance has been able to create In Q2 ~6mn sales from Point of sale (POS) terminals and out of the same ~70% was from its existing business. This is adding value.
- ◆ Was able to create heft at the Point of Sale, BFL finances ~15% of mobile smartphone business in India, 8-10% of organized furniture in India which is financed by BFL.
- ◆ **Competition from online payment channels from technology cos:** The mgmt. believes that the digital lending and Wallet gives customer ease of business, and has data etc but doesn't have Risk based info of customers, hence Payment business have lesser insight on Customer risk assessment and hence BFL has an upside. Hence, BFL can choose to sell liability or asset business to a client based on the risk profile of the customer and thereby manage its own risk.
- ◆ Further credit tightening: Don't know if bottom has formed as of yet.
- ◆ Festive season, till Navratri wasn't good, but post that it has improved dramatically. Expect slump after Diwali, but will see some pickup again in Christmas.
- ◆ **Fee Income:** Penal fees, insurance distribution, EMI Card fees are not linked to Balance sheet growth.
- ◆ **Cash back offers:** OEM are not bearing the cost and the cost is Partly being borne by retailer and the rest by the Financier. Promotion is being done to attract customer.
- ◆ Tax cut benefit was used by increasing ~5% of salary. Medium term for ROA/ROE target 18-20% will increase to 20-22% guidance for FY20E/FY21E
- ◆ Changed the guidance for ROE for the medium term to be 20-22% range from 18% - 20% earlier.
- ◆ Semi-urban and rural demand will emerge by Q4 due to good monsoons, demand pickup. Urban demand will be difficult to say.
- ◆ **Collections Infrastructure:** 4500 out of 20K employees work for collection. In sync will 16,000 agencies in 2000 centers in India. ~40% of business comes from top 10 cities.
- ◆ **70% business from existing customer:** Existing customer is lower risk, but new customer has performed much worse. New customer loss is 1x, then existing will be 0.45x loss.
- ◆ Commercial lending to Bajaj's Auto Ancillaries: Risk management to that book: Don't only do for Bajaj. Auto ancillary today do biz with 2-3 clients. Slippages is very complicated. Capex is slow. Incremental capex is also not there.
- ◆ Exposure to one NBFC of ~Rs50 crores which is stressed. Been very slow in lending to NBFCs post last year.
- ◆ Under the ECL method the provisions made for even standard asset is higher, where earlier only required to do 40 bps of provisioning, but now they make 16% -24% of provisioning on that 30 to 90-day bucket depending on the asset class.
- ◆ Around 40% of BFL's business comes out of top 10 cities
- ◆ Big jump in Other receivable due to MF sell down at the end of the quarter, and the money came on next day or 1st OCT so they are sitting as receivable on the balance sheet.
- ◆ **Loss Given default (LGD) in digital products:** If customer crosses 5-6 instalment, LGD is ~80% with BFL.

Results (Consolidated)

Particulars	Rs cr				
	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %
Interest Income & Fees	6321.5	4261.4	48.3	5801.2	9.0
Interest and Other Charges	2323.4	1565.4	48.4	2113.4	9.9
Net Interest Income	3998.0	2695.9	48.3	3687.9	8.4
Other Income	1.1	11.9	-90.8	7.0	-84.4
Total Income	3999.1	2707.9	47.7	3694.9	8.2
Employee Expense	628.3	455.4	38.0	582.9	7.8
Depreciation & Amortisation Expenses	70.7	33.4	111.9	63.0	12.3
Other Expenses	683.5	470.0	45.4	646.9	5.6
PPoP	2616.7	1749.1	49.6	2402.1	8.9
Provisions and Loan losses	594.2	314.6	88.9	550.7	7.9
PBT	2022.4	1434.5	41.0	1851.4	9.2
Tax Expense	516.1	511.0	1.0	656.2	-21.3
Profit After Tax	1506.3	923.5	63.1	1195.2	26.0

Source: Company; Sharekhan Research

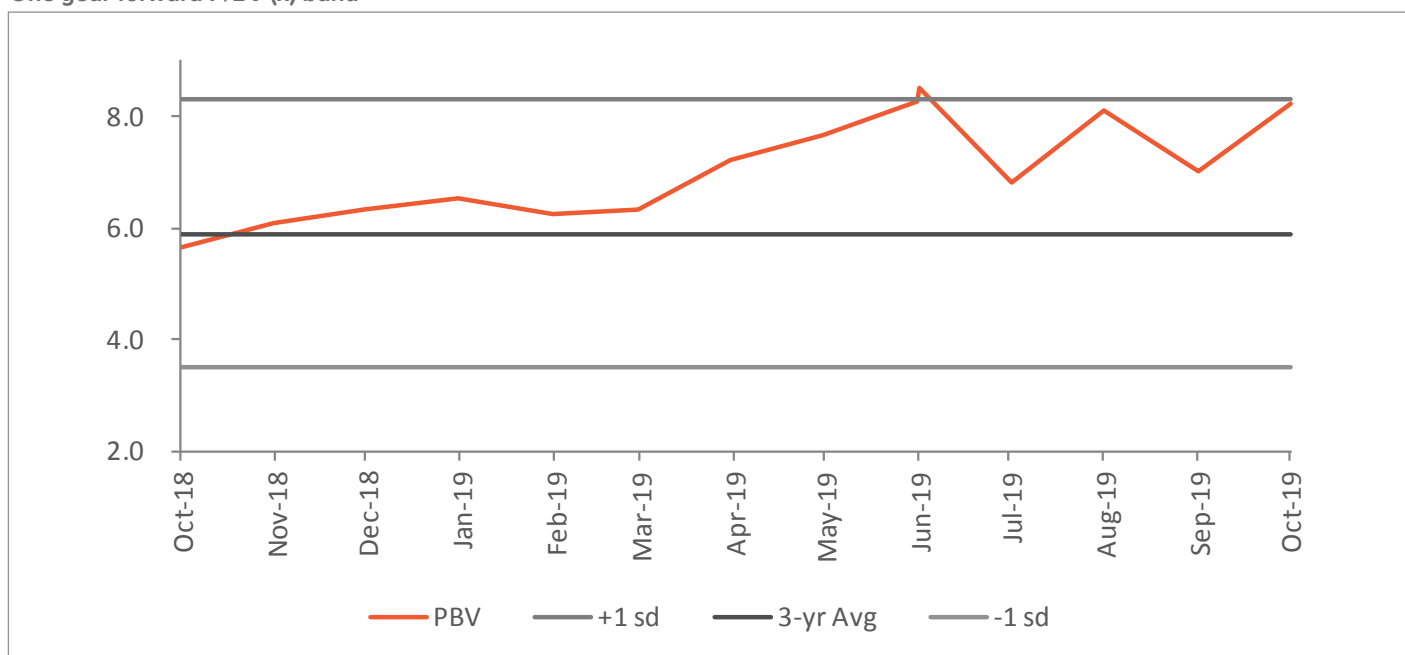
Outlook

BFL posted largely in line with expectations Q2 FY20 results, but caution on loans growth and credit cost indicates that the consumption demand remains weak and stress is visible with even the best of players. While most business parameters indicate that asset quality is not in immediate danger, we believe that any increase in slippages in the current environment would raise concern. However, in the present scenario, the Auto and consumption segment is looking at its own challenges, and the growth is likely to be tentative in near term. Its strong data driven customer portfolio has attained size which presents opportunities. While the yields are likely to come off a bit in the near term on face of competition, change in business mix, and slower credit demand. The fall in Cost of Funds has helped sustain the NIMs. We believe that over a longer term, the company looks well placed to clock AUM growth of over 35+%. The company is well capitalized (Tier 1 at 15.86%) which places it on a stronger position. The ability of BFL to create new product categories, leveraging its large customer base and proactive risk management track-record are key positives to support valuations. The Board has already approved issue Rs 8,500 cr through Qualified Institutional Placement (QIP) which at current valuations will be book value accretive.

Valuation

Valued at 5.8x FY21E BVPS, BFL posted stable performance on headline parameters. However, cautious outlook and the weak demand environment are manifesting challenges. While the strong franchise, impressive operating metrics and strong return ratios work in its favour. Asset quality and growth are key monitorables in the near term. We maintain our Buy rating on the stock with an revised price target (PT) of Rs. 4400.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Bajaj Finance	4032	9.6	7.8	43.6	38.4	3.6	3.5	22.4	23.7
Cholamandalam	455	4.8	4.1	26.8	22.2	2.2	2.3	19.9	19.9

Source: Company, Sharekhan research

About company

Bajaj Finance is a large (BFL is present in 1,895 locations across the country, including 951 locations in rural/smaller towns and village) with an AUM of Rs 1,28,898 which makes it one of the largest NBFCs for consumer finance in India. Bajaj Finance (BFL), erstwhile Bajaj Auto Finance, provides financing for two-wheelers, consumer durables, housing, small businesses, construction equipment and infrastructure finance. BFL undertook business and organizational restructuring in FY08 and re-defined small business and consumer financing as its key niches. The new initiatives have been delivering tangible results since FY09, with 41% and 61% CAGR in AUM and net profit respectively, over FY09-19. The Company operates through 944 urban locations and 951 rural locations, with 91,700+ distribution points as of June 19. BFL continues to be the largest consumer durables lender in India. As a business entity, Bajaj Finance continues to deliver steady performance with well-maintained margins and conservative asset-quality performance.

Investment theme

Bajaj Finance (BFL) enjoys a dominant position in the Indian Consumer finance space with strong presence in retail assets and liabilities. BFL's dominance in the market is seen in the consistent growth and margin performance maintained by the company across credit cycles and rate cycles. During last few years, Bajaj Finance has been posting consistent strong growth with high but stable NIMs and very good asset quality. The stable asset quality is indicative of the high focus on the risk management and robust credit underwriting capability of the company. We expect BFL to maintain its loan book trajectory as well as profitability and margin on back of healthy franchise expansion and increasing customer base. We opine Bajaj Finance's strong operational capabilities and efficiencies, with consistency are clear differentiators for the stock at present times.

Key Risks

Slowdown in Consumer Finance growth and worsening of economic parameters (especially rural) may pose challenge

Additional Data

Key management personnel

Mr. Rahul Bajaj	Chairman
Mr. Rajeev Jain	Managing Director
Mr. Atul Jain	Chief Executive Officer (BHFL)
Mr. Anup Saha	President – Consumer Business

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bajaj Finserv Ltd	54.81
2	Republic of Singapore	3.67
3	Maharashtra Scooters Ltd	3.27
4	Axis Asset Management Co Ltd/India	1.96
5	SBI Funds Management Pvt Ltd	1.39
6	Steadview Capital Mauritius Ltd	1.26
7	BlackRock Inc	1.23
8	Capital Group Cos Inc/The	1.19
9	Vanguard Group Inc/The	1.11
10	UTI Asset Management Co Ltd	0.91

Source: Bloomberg

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