Sharekhan
by BNP PARIBAS

Bajaj Finance

Mixed Quarter, but strong franchise for the long term

Sector: Banks & Finance
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 1,978**	
Price Target: **Rs. 2,700**	↓

↑ Upgrade ↔ No change ↓ Downgrade

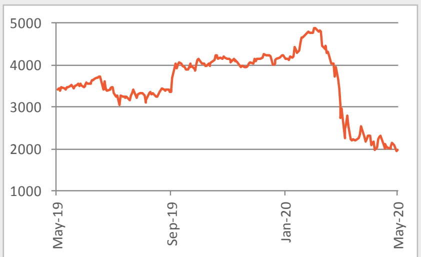
Company details

Market cap:	Rs. 118,367 cr
52-week high/low:	Rs. 4,923/1,916
NSE volume: (No of shares)	15.9 lakh
BSE code:	500034
NSE code:	BAJFINANCE
Sharekhan code:	BAJFINANCE
Free float: (No of shares)	26.4 cr

Shareholding (%)

Promoters	56.2
FII	21.2
DII	10.6
Others	12.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14.3	-59.5	-52.2	-42.0
Relative to Sensex	-9.7	-32.8	-26.5	-18.7

Sharekhan Research, Bloomberg

Bajaj Finance Ltd (BFL) reported mixed Q4FY20 numbers, wherein operational numbers were better than expectations. However, a spike in provisions (mainly due to COVID-19 related provisions and one-offs) resulted in PAT coming below expectations. Consolidated net interest income (NII) grew to Rs. 4,684 crore (up 37.8% y-o-y, better than expectations) but PAT came at Rs. 948 crore (down 19.4% y-o-y), below expectations due to higher provisions. During Q4, provisions jumped to Rs. 1,953 crore (up by 135% from Q3) mainly due to one-time provision of Rs 1,419 crore (COVID-19-19 provision Rs 900 crore, Rs 390 crore for two large accounts now written-off, and Rs 129 crore for ECL re-calibration). At present overall coverage ratio of 2.54% (from 1.9% in December 2019) and is a significant cushion. Overall NIM remains strong in Q4 as well, with NIM (Calc.) at 11.2%. The management guided its FY21E credit cost to be ~80% higher than the normalized credit cost due to the uncertain economic situation. Due to present situation, BFL is focusing on capital preservation, balance sheet protection and operating expenses management. Its healthy capital adequacy (CRAR at 25%), strong liquidity position, low gross and net NPA, attractive credit ratings, large mass affluent customer franchise, diversified portfolio mix and strong risk management orientation present key long-term positives. However, while a consolidated buffer of Rs 20,900 crore (18.6% of its total borrowing) lends comfort on the liquidity front, this is likely to impinge on margins in the medium term. Given the environment, BFL indicated it will continue to run high liquidity buffer around till H1. While the lockdown is being eased gradually, business normalisation and demand recovery may take time, and hence we believe medium-term growth is likely to be slower than normal. We have fine-tuned our estimates (factoring in growth adjustments and higher provisions burden) and accordingly the target multiples (in light of dynamic business environment). However, we believe that due to a strong balance sheet, robust risk management and prudent management, BFL is a strong franchise for the long term and is well placed to ride over medium term challenges. We maintain a Buy rating on Bajaj Finance with a revised price target of Rs. 2,700.

Key positives

- Healthy AUM growth of 27% despite lockdown, indicating BFL strong traction and recovery in demand till lockdown happened. Adjusted for the impact of the lockdown, AUM growth would have been 31%.
- Stable asset quality with Gross Stage 3 (GS3) at 1.61%, with Coverage ratio of 60% which is significant given the present business scenario.

Key negatives

- Spike in Provisions cost to Rs 1953 crore (due to one-time provision of Rs 1,419 crore (COVID-19-19 provisions, write-offs, etc) dragged down PAT.
- Bounce rates have jumped across board in all categories indicating near-term vulnerabilities, with 27% of total book under moratorium.

Our Call

Valuation - We believe that though risks have increased due to the lockdown, the same are largely priced in post the recent correction in the stock. We have fine-tuned our estimates and the target multiples (in light of revised business environment). We opine that further weakness in the stock may be an opportunity for investors to add it to their portfolio for the long term. We maintain a Buy rating on Bajaj Finance with a revised price target of Rs. 2,700.

Key Risks

Prolonged lockdown may result in slower growth and operational challenges, which along with worsening of economic parameters will pose a challenge.

Valuation Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Net interest income (Rs cr)	8,050	11,762	16,901	19,151	21,406
Net profit (Rs cr)	2,496	3,995	5,264	5,590	8,239
EPS (Rs)	43.3	68.9	87.7	93.2	137.3
PE (x)	45.7	28.7	22.5	21.2	14.4
Book value (Rs/share)	283	342	499	621	742
P/BV (x)	7.0	5.8	3.7	3.2	2.7
RoAE (%)	19.3	22.1	20.2	16.1	20.1
RoAA (%)	3.3	3.7	3.6	3.1	3.6

Source: Company; Sharekhan estimates

Key Concall highlights –

- **COVID-19 Impact:** The economy was on the mend in Q4 but COVID-19 has changed everything. Hence, BFL had good 81 days in Q4 but lost fag end due to the lockdown. AUM growth would have been 31% if not for COVID-19 lockdown.
- **Strategy post COVID-19:** Building business with a 10-year view, so for a few months will look to preserve capital and protect balance sheet. Tailwinds of entering next fiscal at cleaner book, and (other than two wheeler book) a diversified portfolio will help. Amid COVID-19, the company has turned cautious and tightened underwriting and loan-to-value (LTV) norms across all businesses. It is currently open for business in 1,926 urban and rural locations. To augment collections, it is adding around 2,800 officers.
- **B2B:** The Company is currently open for its B2B businesses in 1,583 urban and rural locations and is originating 22,000-25,000 applications per day. The company expects the rural segment to pick-up the fastest. Gold loan products are being developed and will be a key focus area.
- **B2C and unsecured loans:** BFL didn't lend in April and will resume once the lockdown lifts.
- **Liquidity:** BFL has Have liquidity of Rs 21000 crore, and have Rs 3300 crore of SLR, 19% of borrowing is in cash & cash equivalents. At least till H1FY2020, BFL will run on a high liquidity mode. It will continue to focus on deposit accretion; even during lockdown, it has raised sizeable retail deposits.
- **Opex cost:** The Company has frozen all hiring. It has modular salary costs, so it will see reasonable dip in employee cost. On a fixed opex basis, have knocked off ~24% of the fixed opex, and suspended all new branch expansion. Introduced zero based budgeting model across company and expected to see that initiative to bring down cost further in 9-12 months time.
- **Credit cost:** Entered COVID-19 on a clean slate with less legacy NPAs. Except lifestyle and two wheeler segment, rest all business had lower y-o-y credit cost till February. The company has sufficient profit and buffer to withstand COVID-19. Two large identified stress accounts have been charged off. Have total 160 BPS of standard asset provision available (Rs. 2,354 crore). Credit cost may go up by 80% on the normalized provision (which was around Rs 2,900 crore in FY2020).
- **Moratorium:** Around 27% of loans are under moratorium, mainly due to a huge chunk being auto loans. Adjusted for the auto loans business, moratorium would be <22% of loans. However, as a matter of prudence, BFL decided that a set of customers with 60-das overdue and high likelihood of moving into NPA should not be offered moratorium. Had the company chosen to offer moratorium to all such customers as well, GNPA and NNPA would have been 1.38% and 0.51%, respectively. Around 60% of the clients which have bounced have never defaulted so far. Have around 233 bps coverage on the moratorium portfolio.
- **Customer acquisition:** Will focus on mining existing customers for some time since that segment historically is cheaper to acquire and usually has better quality.
- **Salaried versus self employed:** The salaried class bounce rate is lesser than self-employed.
- **Asset quality consumer B2C business:** Most businesses having an increased bounce rate not merely due to higher credit stress but also inability to collect. B2C will usually have highest bounce rate, just like Mortgage generally has the lowest rate.
- **Re-starting business:** The company is focused on re-starting business, and is getting back to feet slowly. Business growth not priority at present, but gold loans will be a focus area. BFL's collection model tracks each default via geography zones based on which BFL decides on collection staffing plan. Ready for opening of collections post lockdown.
- **Write-offs:** BFL had written off exposures to a beleaguered Infrastructure finance conglomerate and a broker account, of Rs. 587 crore. The write-off in the former was because already there was ~19 months delay in recovery (have collateral 2x of exposure), while in the broker account the exposure was unsecured. If there is recovery from these accounts, it will add to balance sheet.
- **Deposits:** Systematic deposit plan is still on and BFL hopes to build a large business going forward. It has cut retail deposit rates.
- **Fee Income:** Fees have high correlation with incremental disbursements, but right now BFL is eyeing RBI/ government steps and response of economy once lockdown lifts and hence at present stance cautious.

- **Ability to withstand shocks:** Profitability and balance sheet strength of company is strong enough to withstand shocks, including COVID-19 and remain solid.
- **IBC process suspension:** There is no impact, but there may be corporate slippages going forward as well in the normal course of business.
- **Life care fees:** BFL has 20 million EMI card customers. In the last 18 months, BFL has been investing in "Lifecare financing" which is financing for medical needs. The company is now present under the Lifecare financing with many multi-speciality hospitals. Clients can now have multiple cards, which was made feasible technologically only in January. BFL has sold 300,000 Health Card so far which may see increased limits for customers. Clients pay some level of fees (~Rs. 700) for higher limits in a Lifecare card.
- **Customer behavior change post lockdown:** There will be better visibility and greater clarity by July-August. BFL will focus on managing risk rather than growth, and worry about disbursals later.
- **Probability of recovery on moratorium impact:** BFL is unclear whether the moratorium would be extended. More impact depends on recovery of economy rather than just moral hazard only. Even under the bounce ratio, historically ~90+ % have paid experience over last three years.
- **Auto loans:** The auto loans segment has a provision coverage ratio (PCR) of 50%. For two- and three-wheeler where cases had high delinquency, long overdue have been written off and hence is not carrying NPA burden on balance sheet. The auto finance portfolio is marked red, but co expects to see improvement in portfolio quality in 2-3 quarters.
- **Cost of Funds:** This now stands at 8.76% and would have been at 8.35% if not due to Liquidity drag. In the last few days, BFL raised commercial papers, as it wanted to match ALM in line with business. The borrowing tenor for ECBs is three years, fully hedged, and total size of ECBs is Rs. 5,300 crore. The cost is ~7.2% (at fully hedged price).
- **Experience post-lockdown:** Every market is structurally being run by non-market forces which are expected to normalise once the lockdown ends. Consumption pattern change and pent-up demand is too early to see. The longer the lockdown, the more time the economy will take to bounce back.
- **Strengths:** BFL has sufficient capital, liquidity, talent, low GNPA/NNPA as support factors. The franchise is strong to bounce back. It will continue to be a growth company in the medium term.

Results Consolidated — Rs cr

Particulars	Q4FY20	Q4FY19	YoY%	Q3FY20	QoQ%
Interest Income & Fees	7226.6	5307.7	36.2	7011.1	3.1
Interest and Other Charges	2547.4	1913.2	33.2	2489.0	2.3
Net Interest Income	**4679.2**	**3394.5**	**37.8**	**4522.0**	**3.5**
Other Income	4.3	0.8	424.7	14.9	-71.4
Total Operating Income	**4683.4**	**3395.3**	**37.9**	**4536.9**	**3.2**
Employee Expense	618.1	531.8	16.2	722.1	-14.4
Depreciation & Amortisation Expenses	85.3	40.8	109.0	75.6	12.8
Other Expenses	748.1	601.8	24.3	738.4	1.3
PPoP	**3231.9**	**2220.9**	**45.5**	**3000.8**	**7.7**
Provisions and Loan losses	1953.8	409.3	377.4	830.8	135.2
PBT	**1278.2**	**1811.6**	**-29.4**	**2170.1**	**-41.1**
Tax Expense	330.1	635.6	-48.1	556.0	-40.6
Profit After Tax	**948.1**	**1176.1**	**-19.4**	**1614.1**	**-41.3**

Source: Company; Sharekhan Research

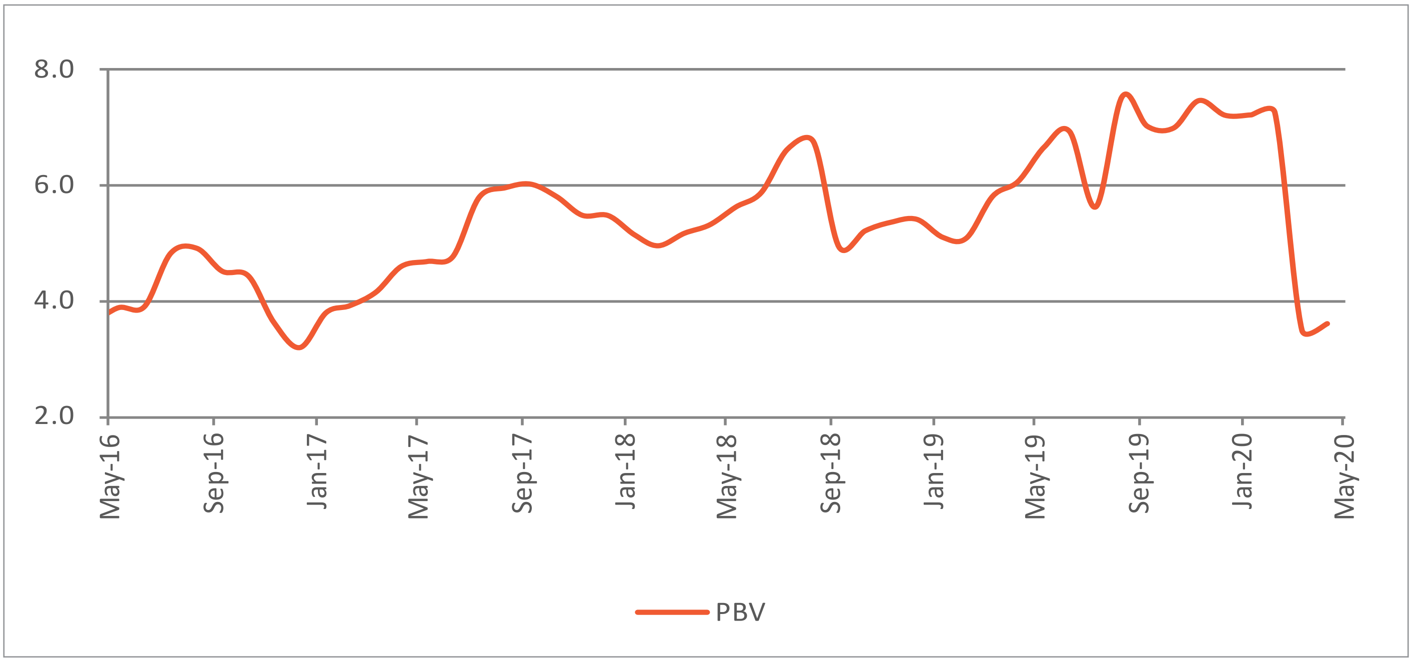
Outlook

The COVID-19 lockdown is a significant but unprecedented event, which weaken consumer demand and slowdown across sectors. Thus, it may result in higher delinquencies and lower credit offtake for NBFCs, including Bajaj Finance Limited (BFL). In case the lockdown is prolonged, then business growth and credit cost for FY21E is likely to be significantly impacted. Also, we believe that the uncertainly on the lockdown may impact the spending behavior and affect collections which may prompt BFL to slow down loan disbursements. That said, BFL stands out with its strong balance sheet position, comfortable liquidity position, high credit ratings and well matched asset-liability management position and is well capitalised as well. BFL has modularity built across various cost line items, including salary cost, which will provide it with reasonable control over cost management. New lines of business, like healthcare cards, retail deposits are additional positives. Hence we believe the company is well diversified (across segments and sees advantage in lower cost of funds), which will help it sustain and bounce back once business environment normalizes.

Valuation

We believe that though risks have increased due to the lockdown, the same are largely priced in post the recent correction in the stock. We have fine-tuned our estimates and the target multiples (in light of revised business environment). We opine that further weakness in the stock may be an opportunity for investors to add it to their portfolio for the long term. We maintain a Buy rating on Bajaj Finance with a revised price target of Rs. 2,700.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Bajaj Finance	1,978	3.2	2.7	21.2	14.4	3.1	3.6	16.1	20.1
HDFC Ltd	1,540	2.6	2.3	16.5	12.3	2.2	2.3	13.0	13.9

Source: Sharekhan Research

About company

Bajaj Finance is one of India's largest NBFCs for consumer finance and provides loans 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 Company operates through 944 urban locations and 951 rural locations, with over 91,700 distribution points. BFL continues to be the largest consumer durables lenders 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, BFL 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. Despite the medium term impact of the pandemic, 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 in the long term.

Key Risks

Prolonged lockdown may result in slower growth and operational challenges, which along with worsening of economic parameters will pose a 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	Republic of Singapore	3.61
2	Maharashtra Scooters Ltd	3.15
3	SBI Funds Management Pvt Ltd	2.13
4	Axis Asset Management Co Ltd/India	2.1
5	AXIS MUTUAL FUND TRUSTEE L	1.87
6	Capital Group Cos Inc/The	1.42
7	Steadview Capital Mauritius Ltd	1.21
8	BlackRock Inc	0.98
9	UTI Asset Management Co Ltd	0.83
10	Vanguard Group Inc/The	0.83

Source: Bloomberg

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