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. 3,293**	
Price Target: **Rs. 3,800**	↑

↑ Upgrade ↔ No change ↓ Downgrade

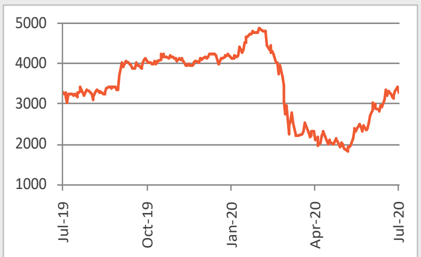
Company details

Market cap:	Rs. 198,426 cr
52-week high/low:	Rs. 4,923/1,783
NSE volume: (No of shares)	83.6 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	15.9	53.3	-20.5	1.4
Relative to Sensex	7.3	32.4	-12.8	1.7

Sharekhan Research, Bloomberg

Bajaj Finance Ltd (BFL) reported mixed Q1FY20 numbers, with tepid business growth, but a q-o-q improvement in asset quality and a decline in the moratorium to 15.7% of AUM from 27%, which is a positive. Assets under management (AUM) stood at Rs. 138,055 crore, down 6% q-o-q due to steps like more stringent loan-to-value ratios (LTVs), tightened credit filters, etc. which indicated a cautious outlook on growth by the management. However, growth guidance was moderated by 10-12% and a higher credit cost guidance of 100-110 bps (against ~80-100 BPS earlier) for FY21 were key notables. Net Interest Income (NII, calculated) stood at Rs 4150 crore, up by 12.5% y-o-y but was down by 11.3% on q-o-q basis. Understandably, AUM growth have been tepid (as expected) and there was also an Interest reversal of Rs. 220 crore. Customer franchise addition slowed down, and stood at 42.95 million (was 36.94 million in Q1FY20) and consequently the assets under management (AUM) stood at Rs 138,055 crore, down 6% q-o-q from Rs. 1,47,153 crore as of March end. AUM growth slowed, with new loans falling by 76% in Q1 due to stringent LTVs, tightened credit filters etc. Standard asset provisioning (ECL stage 1 and 2) stood at 273 bps including contingency provision for COVID-19 and 101 bps excluding contingency provision. Profitability was impacted by lower loan growth, interest income reversal of Rs Rs. 220 crore of and an additional Rs. 1,450 crore COVID-19 provisions (total COVID19 provisions stands at 1.7% of AUM as of June 2020). Operating performance was strong with a pre-provision operating profit (PPOP) growth of 26% y-o-y aided by cost control, which saw the cost-to-income ratio (C/I) to fall by 7 percentage points y-o-y to 28%.

The consolidated moratorium book reduced to Rs. 21,705 crore (15.7% of AUM) owing to a reduction in bounce rate coupled with improved collection efficiencies. Asset quality improved with gross NPA and net NPA as on Q1 FY21 stood at 1.40% and 0.50% respectively, from 1.61% and 0.65% from Q4 FY20. The provisioning coverage ratio was at 65% from 60% in previous quarter. Due to present situation, BFL is focusing on capital preservation, balance sheet protection and operating expense management. 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. 3,800.

Key positives

- As of July 20, 2020, BFL has commenced operations in 2,322 locations, forming 85% of company's business, which will help it scale back its business traction.
- The share of moratorium has declined to 15.7% of AUM from 27% which is a positive.
- Operating performance was strong with PPOP growth of 26% y-o-y aided by cost control, which dragged down C/I ratio by 7 percentage points y-o-y to 28%.

Key negatives

- The company had consolidated liquidity buffer of Rs 20,590 crore and SLR investments of Rs. 2,550 crore representing 19.2% of its total borrowings. Given the environment, the high liquidity buffer though is desirable, we believe will drag margins for the near term.
- Growth guidance was moderated by 10-12% and credit cost guidance was raised by 100-110 bps (against ~80-100 BPS earlier) for FY21 were key notables.

Our Call

Valuation - We believe that though risks continue to exist, and the pandemic impact is still unfolding, yet we believe that present decline in the moratorium book is encouraging and indicates the collection efficiency improving, which is a positive. Due to the encouraging outlook, we have tweaked our target multiples for the s tock. We believe that given BFL's strong balance sheet, and its business strengths, the company is structurally an over 20% ROE business franchise in a normalised steady state basis. We believe that its stable leadership, well-capitalised balance sheet, robust risk management and prudent management make BFL a strong franchise for the long term and is well placed to ride over medium-term challenges. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 3,800.

Key Risks

A prolonged or intermittent 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	8,050	11,762	16,901	19,151	21,406
Net profit	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

- **Q1 functional strategy:** Q1 was a pandemic-affected quarter. hence focus was on employee safety, capital preservation, liquidity management, business scenario planning, Opex management, collections capacity augmentation, customer propositions, business transformation framework and lastly but most importantly calibrated restart of business as the country started to reopen.
- **Unlocking scenario:** At this juncture, as per the company's assessment, over 75 cities should revert to pre-COVID volumes by October, 40-75 Cities by end November, 10-40 cities by January and top 10 cities by March. All this is of course is subject to the government not enforcing a second national lockdown. Based on this assessment, the company estimates AUM growth of 10-12% in FY21.
- **Flexi loans:** Given the lockdown, BFL decided to convert some of its existing customers with no overdue and good repayment track record from term loan to a flexi loan for a switch fee. BFL has been offering flexi loans to its customers for the last 5 years. As on March 31, 2020, the existing book under flexi stood at Rs 36,846 crore. The product provides the customers with flexibility to drawdown when they need and prepay when they want digitally. It also has an added feature of only interest servicing for first 1-2 years. In Q1FY21, the company has converted ~Rs 8,600 crore of term loans into flexi loans.
- **Liquidity:** As of July 20, 2020, the company had consolidated liquidity buffer of Rs 20,590 crore and SLR investments of Rs. 2,550 crore, constituting ~19.2% of its total borrowings. Given the environment, the BFL will continue to run a high liquidity buffer, despite an impact on cost of funds in the short term. The carry cost of excess liquidity in Q1 was Rs. 169 crore.
- **Opex cost:** Opex to NII improved to 27.9% in Q1 FY21 as against 35% in Q1 FY20. Opex for Q1 FY21 was lower by 11% y-o-y and 20% q-o-q to Rs 1,157 crore. Sequentially, operating expenses dropped by Rs 296 crore. Opex for Q1FY21 was lower by 11% y-o-y and 20% q-o-q to Rs 1,157 crore. Sequentially, opex dropped by Rs. 296 crore. The company has paused replacement and new hiring, branch expansion and deferred other discretionary costs till September 2020.
- **Credit cost:** Has now updated its credit cost scenario model for FY21 considering extended disruptions. It now estimates its credit costs to increase by 100-110% (Rs. 6,000-6,300 crore for FY21) over the pre-COVID credit cost of previous year. The Company has strong pre-provision profitability to absorb increased losses caused by COVID-19.
- **Strengthening Collection:** Has significantly augmented its collections infrastructure to mitigate its credit costs. It has added 2,800 collections officers and ~16,000 collection agency staff to manage the increased bounce volumes caused by COVID-19.
- **Moratorium:** Around 16% of loans are under moratorium, mainly due to a huge chunk being auto loans. Adjusted for the auto loans business, moratorium would be <50% of loans. Consolidated moratorium book reduced to Rs 21,705 crore (15.7% of AUM) as on June 30, 2020 from Rs 38,599 crore (27.1% of AUM) as of April 30, 2020 owing to a reduction in bounce rate coupled with improved collection efficiencies.
- **Provision:** During the quarter, the company has taken an additional contingency provision for COVID-19 of Rs 1,450 crore taking its contingency provision for COVID-19 to Rs 2,350 crore as of 30 June 2020. The contingency provisioning for COVID-19 is now at 10.8% of its moratorium book. This contingency provision together with existing ECL provision of Rs. 623 crore provides an overall provisioning coverage of 13.7% on the consolidated moratorium book.
- **Customer acquisition:** The company acquired 0.53 million new customers in the current quarter. Total customer franchise stood at 42.95 million as of June 30, 2020, a growth of 16% y-o-y. Existing customers contributed to 70% of new loans booked during Q1 FY21.

- **Deposits:** Deposits book stood at Rs 20,061 crore, a growth of 33% y-o-y. Its contribution to consolidated balance sheet was 17% as of June 30, 2020. The company continued to attract sizable retail deposits in Q1. The Company reduced rates for its retail deposit rates, twice in Q1 aggregating to a drop of 65 bps. The retail: corporate deposit mix stood at 70:30 as against 63:37 in Q4 FY20 in line with its strategy of reducing its reliance on corporate deposits.
- **Health Card:** Given the lockdown, the company increased focus on its 42.95 million customer franchise to increase penetration of fee products like health card, health insurance etc. The Company sold 5.33 lac health card to its existing EMI card customers in Q1 FY21. This product comes with higher limit, EMI financing tie ups at multi speciality hospitals and various other wellness benefits.
- **Guidance:** AUM growth at 25-27%, profit growth at 23-24%, GNPA in corridor of 1.4-1.7%, NNPA in corridor of 0.4-0.7%, RoA of 3.3%-3.5%, RoE at 19-21%.

Results (Consolidated) Rs cr

Particulars	Q1FY21	Q1FY20	y-o-y %	Q4FY20	q-o-q %
Interest Income & Fees	6648.2	5801.3	14.6	7226.6	-8.0
Interest and Other Charges	2497.6	2113.4	18.2	2547.4	-2.0
Net Interest Income	**4150.6**	**3687.9**	**12.5**	**4679.2**	**-11.3**
Other Income	1.5	7.0	-78.1	4.3	-63.8
Total Operating Income	**4152.1**	**3694.9**	**12.4**	**4683.4**	**-11.3**
Employee Expense	537.5	582.9	-7.8	618.1	-13.0
Depreciation & Amortisation Expenses	84.2	63.0	33.7	85.3	-1.3
Other Expenses	535.0	646.9	-17.3	748.1	-28.5
PPoP	**2995.4**	**2402.2**	**24.7**	**3231.9**	**-7.3**
Provisions and Loan losses	1685.7	550.7	206.1	1953.8	-13.7
PBT	**1309.7**	**1851.4**	**-29.3**	**1278.2**	**2.5**
Tax Expense	347.4	656.2	-47.1	330.1	5.2
Profit After Tax	**962.3**	**1195.3**	**-19.5**	**948.1**	**1.5**

Source: Company; Sharekhan Research

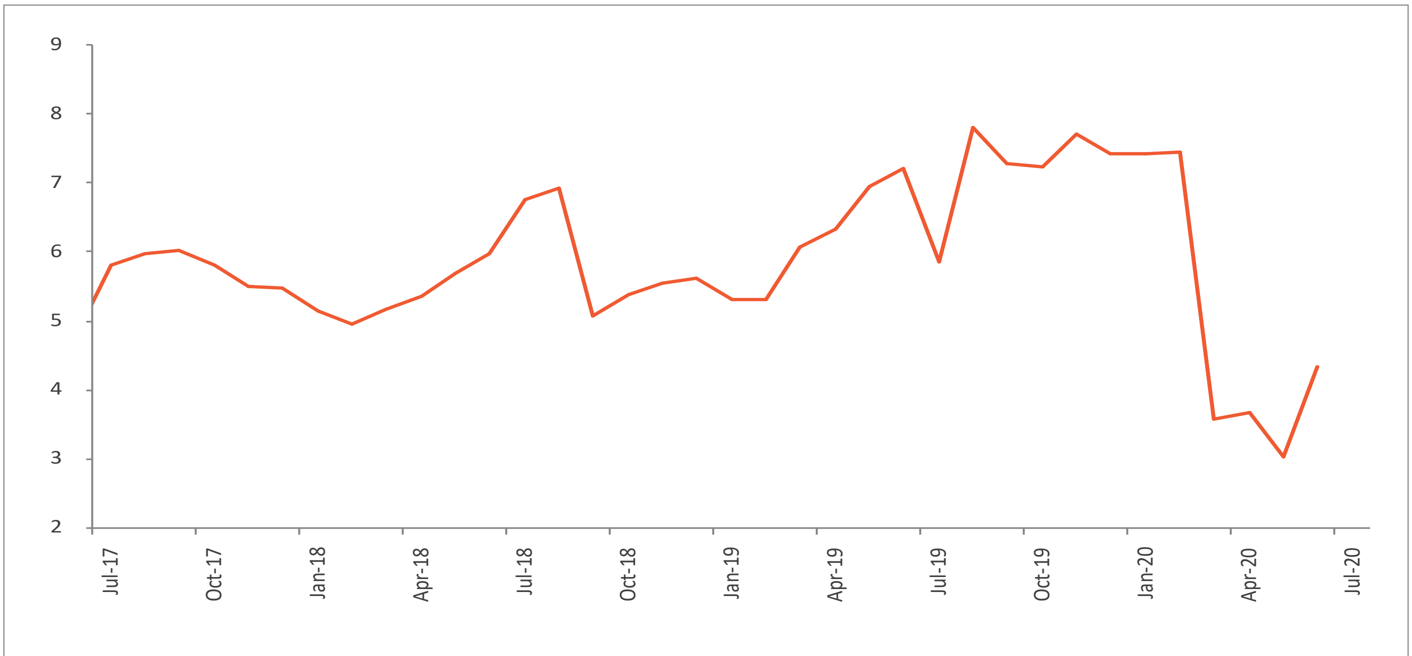
Outlook

The COVID-19 lockdown is a significant but unprecedented event, which is likely to weaken consumer demand and cause slowdown across sectors. Thus, it may result in higher delinquencies and lower credit offtake for NBFCs, including Bajaj Finance Limited (BFL). In case easing of the lockdown or an opening up is prolonged or intermittent, 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 behaviour 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. It is also well-capitalised as well and a strong provision buffer that will help it cushion impact on its Balance Sheet and profitability to a significant extent. BFL has modularity built across various cost items, including salary cost, which will provide BFL 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 the business environment normalises.

Valuation

We believe that though risks continue to exist, and the pandemic impact is still unfolding, yet we believe that present decline in the moratorium book is encouraging and indicates the collection efficiency improving, which is a positive. Due to the encouraging outlook, we have tweaked our target multiples for the s tock. We believe that given BFL's strong balance sheet, and its business strengths, the company is structurally an over 20% ROE business franchise in a normalised steady state basis. We believe that its stable leadership, well-capitalised balance sheet, robust risk management and prudent management make BFL a strong franchise for the long term and is well placed to ride over medium-term challenges. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 3,800.

One year forward P/BV (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Bajaj Finance	3,293	5.3	4.4	35.3	24.0	3.1	3.6	16.1	20.1
HDFC Ltd	1,883	3.6	3.4	34.2	27.0	1.7	2.0	11.8	13.0
Cholamandalam Investment & Finance	212	1.9	1.7	16.5	12.0	1.3	1.9	10.9	14.6

Source: Company, Sharekhan research, Bloomberg estimates

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. Rakesh Bhatt	Chief Operating Officer
Mr. Sandeep Jain	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Republic of Singapore	4.5
2	Maharashtra Scooters Ltd	3.2
3	Axis Asset Management Co Ltd/India	2.1
4	SBI Funds Management Pvt Ltd	2.0
5	AXIS MUTUAL FUND TRUSTEE L	1.8
6	Capital Group Cos Inc/The	1.4
7	Steadview Capital Mauritius Ltd	1.2
8	Vanguard Group Inc/The	1.1
9	BlackRock Inc	0.9
10	UTI Asset Management Co Ltd	0.8

Source: Bloomberg

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;