Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING Updated Oct 08, 2021				23.66
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

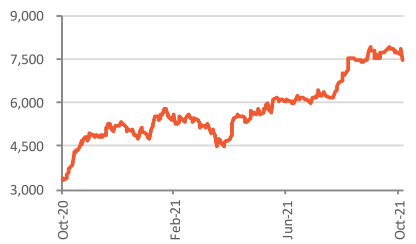
Company details

Market cap:	Rs. 4,51,510 cr
52-week high/low:	Rs. 8,020 / 3,255
NSE volume: (No of shares)	86.9 lakh
BSE code:	540767
NSE code:	BAJFINANCE
Free float: (No of shares)	26.5 cr

Shareholding (%)

Promoters	56.0
FII	23.6
DII	9.7
Others	10.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.0	16.9	37.2	116.7
Relative to Sensex	-5.8	0.8	11.9	65.8

Sharekhan Research, Bloomberg

Bajaj Finance Ltd

Strong levers in place to drive earnings growth

NBFC	Sharekhan code: BAJFINANCE

Reco/View	Reco: **Buy**	↔	CMP: **Rs. 7,482**	Price Target: **Rs. 9,097**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2FY2022 PAT saw robust growth of 53% y-o-y and 48% q-o-q, aided by strong consolidated AUM growth of ~22% y-o-y/ ~5% q-o-q. NII grew by 26% y-o-y (up by 16% q-o-q).
- Auto finance GNPA witnessed significant improvement (19.15% in Q1FY2022 versus. 16% in Q2FY2022). GNPA declined by 51 bps q-o-q to 2.45% in Q2FY2022.
- PCR on GS3 stood at 55.5% versus 51.3% in Q1FY2022.
- We maintain our Buy rating on the stock with revised PT of Rs. 9,097.

Bajaj Finance (BAF) missed our Q2FY2022 earnings estimates due to higher operating expenses. The company's consolidated PAT was at Rs. 1,481 crore versus our expectation of Rs. 1,517 crore (up 53% y-o-y and 48% q-o-q). The company reported a sharp increase in operating expenses (up by 76% y-o-y and 48% q-o-q) on account of high debt management cost and employee expenses. The company's cost-to-income ratio stood at 38.9% versus 30.8% in Q1FY2022. NII grew by 26% y-o-y (up by 16% q-o-q) to Rs. 4,290 crore and NIM was at 13.1%, expanded by 100 bps y-o-y/ 160 bps q-o-q, aided by aided lower CoF (down by 27 bps q-o-q). GNPA and NNPA stood at 2.45% (declined by 51 bps q-o-q) and 1.09% (down 36 bps q-o-q), respectively. Auto finance GNPA witnessed significant improvement (19.15% in Q1FY2022 versus 16% in Q2FY2022). PCR on GS3 stood at 55.5% versus 51.3% in Q1FY2022. Total provisions on S1 and S2 assets stood at Rs. 2,277 crore in Q2FY2022 (including a management overlay of Rs. 315 crore).

Key positives

- Significant improvement in absolute headline GNPA (consolidated) by 13% q-o-q.
- Strong NII growth of 16% q-o-q with NIM increasing by 160 bps q-o-q.

Key negatives

- Operating expenses rose sharply by 48% q-o-q.

Management Commentary

- With the normalisation of debt management cost and increased NII as a result of balance sheet growth, opex to NII metric should normalise and is likely to be in the range of 33-34% by Q4 FY2022.
- In the absence of a severe third wave, the company expects its GNPA at 1.7-1.8% and NNPA at 0.7%-0.8% by March 2022.
- Consequently, it estimates its overall credit cost for FY2022 to be approximately Rs. 4,300 crore.

Our Call

Valuation – BAF stands poised to deliver robust AUM growth of 23-25% over FY22E through FY24E with RoE and RoA of 27% and 6% over FY23E and FY24E, respectively. This is likely on the back of improving auto financing cycle, pick up in mortgage lending business and lower estimates of credit cost supported by strong balance sheet. Further, operating efficiencies in terms of lower employee costs and collection is also expected to aid profitability. BAF is one of the most diversified NBFCs with a wide range of product offerings and is one of the early movers from Physical' to 'Phygital'. It has the ability to demonstrate high credit growth in the new credit cycle, aided by its strong cross-sell franchise and robust risk management framework. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 9,097.

Key Risks

Any sharp deterioration in asset quality and high credit cost seen as a structural concern to higher RoE.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
NII	13,899	19,106	26,529	33,315
y-o-y growth (%)		37.5	38.9	25.6
PPoP	11,932	15,544	21,975	28,059
PAT	4,414	7,781	14,027	18,005
EPS (Rs)	73.6	118.6	173.6	226.3
RoAA (%)	2.6	4.2	6.1	6.4
RoAE (%)	12.9	19.6	28.3	27.9
P/E (x)	106.8	65.3	44.9	35.2
P/B (x)	12.7	10.3	8.9	7.5

Source: Company; Sharekhan estimates

Key result highlights

- **Operating performance:** BAF reported PAT of Rs. 1,481 crore, up ~53% y-o-y/48% q-o-q. NII stood at Rs. 4,290 crore, up ~16% q-o-q , led by strong growth in AUM. The company's NIM was at 13.1%, expanded by 100 bps y-o-y/160 bps q-o-q, aided by lower CoF (down by 27 bps q-o-q). The company has reversed interest income of Rs. 322 crore in Q2FY2022 (versus Rs. 216 crore in Q2FY2021). In the absence of a third wave, the company expects quarterly interest reversals to normalise to Rs. 180 crore to Rs. 200 crore by Q3FY2022. The company reported a sharp increase in operating expenses (up by 76% y-o-y and 48% q-o-q) on account of high debt management cost and employee expenses. The company's cost-to-income ratio stood at 38.9% versus 30.8% in Q1FY2022. Opex to NII for Q1FY2022 was 30.6% versus 27.9% in Q1FY2021.
- **AUM growth:** Consolidated AUM at Rs. 1.67 trillion, was up ~22% y-o-y/ ~5% q-o-q. BHFL AUM at Rs. 444 billion, was up 33% y-o-y. The company expects quarterly AUM growth rate for balance of the year to be at pre-COVID levels. The company reported healthy customer franchise growth of 5% q-o-q and 20% y-o-y to 52.8 million. Barring auto finance (decline of 5% q-o-q), all the other business segments reported steady growth during the quarter. With a geographic footprint stood at 3,113 locations, it expanded its presence in 216 new locations.
- **Asset quality:** GNPA and NNPA stood at 2.45% (declined by 51 bps q-o-q) and 1.09% (down by 36 bps q-o-q, respectively. Auto finance GNPA witnessed significant improvement (19.15% in Q1FY2022 versus 16% in Q2FY2022). PCR on GS3 stood at 55.5% versus 51.3% in Q1FY2022. Total provisions on S1 and S2 assets stood at Rs. 2,537 crore in Q2FY2022. The company increased management overlay provision by Rs. 350 crore to Rs. 832 crore in September 2021. The company estimates its GNPA at 1.7%-1.8% and NNPA at 0.7%-0.8% by March 31, 2022. Consequently, the company expects its overall credit cost to be approximately Rs. 4,300 crore in FY2022.
- **Others:** Its business transformation programme, the launch of new application got delayed by 45 days because of delay in tech deliveries and code freeze for the festival season. However, it is expected to go live by mid December. Its merchant application is on track and is expected to go live by February 2022. The company would also enable P2P and P2M on-boarding, transactions, promotions, rewards, and settlements. BAF's capital adequacy stood at 27.7% as of September 2021 and the company expects its excess liquidity to normalise to pre-COVID levels by Q4FY2022.

Results (consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	Q1FY22	Y-o-Y %	Q-o-Q %
Interest Income	6,687	5,763	5,954	16.0	12.3
Interest Expenses	2,398	2,358	2,254	1.7	6.4
Net Interest Income	**4,290**	**3,405**	**3,701**	**26.0**	**15.9**
Other Income	1,045	760	789	37.4	32.4
Net Operating Income					
(NII as reported by BAF)	5,334	4,165	4,489	28.1	18.8
Employee Expenses	937	514	617	82.2	52.0
Non-employee expenses	1,093	1,453	1,594	(24.8)	(31.5)
Operating Expenses	**2,030**	**1,157**	**1,373**	**75.5**	**47.8**
Pre-Provisioning Profit (PPoP)	**3,305**	**3,008**	**3,116**	**9.8**	**6.1**
Provisions & Write offs	1,300	1,700	1,750	(23.5)	(25.7)
PBT	**2,004**	**1,308**	**1,366**	**53.2**	**46.8**
Tax	523	341	363	53.7	44.0
Tax Rate (%)	26.1	26.0	26.6	7 bps	-50 bps
Extraordinary Items					
PAT	**1,481**	**967**	**1,002**	**53.1**	**47.7**
EPS (Rs.)	**24.6**	**16.1**	**16.7**	**53.2**	**47.7**

Source: Company; Sharekhan Research

Rs cr

Key Financials & Ratios	Q2FY22	Q2FY21	Q1FY22	Y-o-Y %	Q-o-Q %
AUM Mix					
Bajaj Finance	1,23,281	1,04,986	1,19,567	17.4	3.1
Housing	44,429	33,463	40,941	32.8	8.5
Consolidated AUM	**1,66,900**	**1,37,090**	**1,59,057**	**21.7**	**4.9**
				bps	**bps**
Consol GNPA (%) [Reported]	2.45	1.34	2.96	110	-52
Consol NNPA (%) [Reported]	1.09	0.55	1.44	53	-36
PCR on Stage 3 (%) [Reported]	55.5	58.8	51.3	-335	419

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Structural tailwinds to support

We believe retail players have a large market to grow and recent credit growth of over 6% indicates pickup in credit offtake, especially in retail and consumer segments. Leading indicators depict recovery in economic activity, which will be a positive. So far, risk metrics of new volumes originated across businesses are tracking better than pre-COVID-19 origination. We believe the retail and consumer lending segments have a long structural growth runway available to them, as India's credit delivery diversifies and penetration increases. In this backdrop, aided by a strong demographic advantage, we believe nimble NBFCs and private banks can co-exist and grow for the foreseeable future as the market expands.

■ Company outlook – Strong and prudent management, company getting ready for future growth

The company is in the middle of a business transformation, which aims to significantly strengthen its technology, data science, app design, and content design to transform the customer experience model. We believe there are several business transformation steps that are underway for BAF, which would not only be positive for business sustainability and scalability, but would also position BAF to take advantage of a strong economic upturn expected in FY2022E. Once implemented, this transformation should lead to significantly higher velocity at a much lower cost.

■ Valuation – Maintain our Buy rating on the stock with a revised PT of Rs. 9,097

BAF stands poised to deliver robust AUM growth of 23-25% over FY22E through FY24E with RoE and RoA of 27% and 6% over FY23E and FY24E, respectively. This is likely on the back of improving auto financing cycle, pick up in mortgage lending business and lower estimates of credit cost supported by strong balance sheet. Further, operating efficiencies in terms of lower employee costs and collection is also expected to aid profitability. BAF is one of the most diversified NBFCs with a wide range of product offerings and is one of the early movers from Physical' to 'Phygital'. It has the ability to demonstrate high credit growth in the new credit cycle, aided by its strong cross-sell franchise and robust risk management framework. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 9,097.

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY22E	FY23E	FY22E	FY22E	FY22E	FY22E	FY22E	FY22E
Bajaj Finance	7,478	10.3	8.9	65.3	65.3	4.2	4.2	19.6	19.6
L & T Finance Holdings	84	1.0	1.0	13.7	9.9	1.4	1.9	7.9	10.1

Source: Company, Sharekhan research

About company

BAF is one of India's largest NBFCs for consumer finance. The company provides loans for two-wheelers, consumer durables, housing, small businesses, construction equipment, and infrastructure finance. BAF undertook business and organisational restructuring in FY2008 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. BAF continues to be the largest consumer durables lenders in India. As a business entity, BAF continues to deliver steady performance with well-maintained margins and conservative asset-quality performance.

Investment theme

BAF enjoys a dominant position in the Indian consumer finance space with a strong presence in retail assets and liabilities. BAF'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 the past few years, BAF has been posting consistently strong growth with high but stable NIMs along with excellent asset quality. The sequential improvement in asset quality is indicative of the company's high focus on risk management and robust credit underwriting capability. Despite the medium-term impact of the pandemic, we expect BAF to maintain its loan book trajectory as well as profitability and margin because of healthy franchise expansion and increasing customer base in the long term.

Key Risks

Any sharp deterioration in asset quality and high credit cost seen as a structural concern to higher RoE.

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	4.2
2	Maharashtra Scooters Ltd	3.1
3	Axis Asset Management Co Ltd/India	2.5
4	SBI Funds Management Pvt Ltd	1.7
5	Vanguard Group Inc/The	1.5
6	BlackRock Inc	1.4
7	Capital Group Cos Inc/The	1.3
8	UTI Asset Management Co Ltd	0.8
9	FMR LLC	0.7
10	Baron Capital Inc	0.6

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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