

## Decent show, all eyes on digital strategy execution

**About the stock:** Bajaj Finance is a dominant player in the consumer finance space while it also has made a foray into various lending segments wherein housing has grown to a significant size.

- Consumer business forms ~35% of overall consolidated AUM
- Bajaj Finance maintained strong operating metrics over various credit and rate cycles leading to >18% RoE and >3% RoA consistently

**Q2FY22 Results:** Earnings recovery as expected, expect cost pressures to stabilise.

- Strong net interest income (NII) growth at 28% YoY above expectations at ₹ 5335 crore up 19% QoQ
- C/I ratio rose to 38% from 30.6% QoQ rising sharply higher due to higher salary and opex denting overall PAT growth
- GNPA, NNPA ratio moderated to 2.45% and 1.10%, respectively, in Q2FY22
- PAT grew 53% YoY to ₹ 1,481 crore from ₹ 965 crore

**What should investors do?** Bajaj Finance's share price in the last quarter has zoomed by 31% to ~₹ 7856 levels in October 2021). Factoring in management agility towards product development and execution strength, we remain positive.

- Recommend BUY rating on the stock

**Target Price and Valuation:** We believe with NNPA guidance of <1% and strong credit growth with payments foray we continue to value the stock at ~10x P/ABV on FY23E and maintain target price of ₹ 8950. Premium valuations stay as BFSI fintechs with low profits/ losses are still getting significant valuations.

**Key triggers for future price performance:**

- Transition towards fin-tech from being a pure lender to propel valuations
- RoE is seen returning to ~15% and RoA at >3%
- A leaner operating model and robust growth guidance
- Expect 20% advances growth and PAT growth at 33% CAGR

**Alternate Stock Idea:** Apart from BAF, in our BFSI coverage we also like HDFC Ltd.

- HDFC Ltd is the largest housing finance company in India with a loan size of ~₹ 4.98 lakh crore. It has a presence in other financial services segments like life insurance, banking, AMC, etc, via its subsidiaries
- We have a BUY rating with a target price of ₹ 3100

### Key Financial Summary

₹ Crore	FY19	FY20	FY21	4 year CAGR (FY17-FY21)	FY22E	FY23E	2 year CAGR (FY21-23E)
NII (₹ crore)	11864	16901	17254	33%	19787	23572	17%
PPP (₹ crore)	7681	11252	11961	35%	12597	15225	13%
PAT (₹ crore)	3995	5264	4420	25%	5963	7795	33%
ABV (₹)	313	534	597		653	877	
P/E	112	87	106		78	61	
P/ABV	24.8	14.6	13.0		11.9	8.9	
RoA	3.0	2.8	2.4		3.4	3.6	
RoE	22.4	20.2	12.8		15.0	15.7	



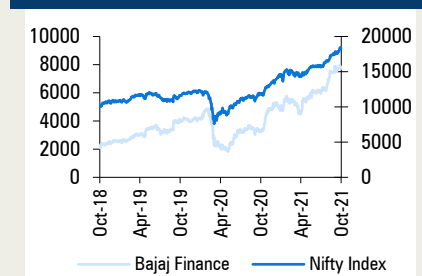
#### Particulars

Particulars	Amount
Market Capitalisation	₹ 473770 crore
52 week H/L	8020/ 3239
Face Value	₹ 2
Net worth	₹ 38999 Crore
DII Holding (%)	9.7
FII Holding (%)	23.6

#### Shareholding pattern

(in %)	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Promoter	56.1	56.1	56.1	56.0	56.0
FII	21.3	23.9	24.1	24.0	23.6
DII	10.7	9.1	9.1	9.3	9.7
Others	11.9	10.9	10.7	10.6	10.6

#### Price Chart



#### Recent Event & Key risks

- Strong NII growth,
- Key Risk:** i) Pressure on NIMs to impact operating profit. ii) Probability of third wave of pandemic could impact asset quality

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## Key takeaways of recent quarter & conference call highlights

### Q2FY22 Results: stable results, all eyes on digital execution

- Strong net interest income (NII) growth at 28% YoY above expectations at ₹ 5335 crore up 19% QoQ (₹ 4484 crore in Q1FY22) stole the show. Interest reversal for the quarter was ₹ 322 crore compared to ₹ 215 crore YoY and ₹ 450 crore QoQ
- Consolidated AUM grew to ₹ 1,69,370 crore against ₹ 1,59,057 crore, up 5%QoQ and 22% YoY. Core AUM growth in Q2FY22 was ~₹ 11000 crore vs. ₹ 4100 crore QoQ. AUM witnessed growth from rural business (37% YoY), consumer sales finance (58% YoY) and mortgages (18% YoY)
- C/I ratio rose to 38% from 30.6% QoQ rising sharply higher denting overall PAT growth. This is on account of elevated debt management cost owing to second wave and salary cost. In Q2FY22, the company increased its employee strength by over 2,000 to support its growth stance. With normalisation of debt management cost and increase in NII as a result of balance sheet growth, opex to NII metric should normalise in the range of 33-34% by Q4FY22
- Consolidated post tax profit in Q2FY22 was ₹ 1,481 crore compared to ₹ 965 crore in Q2FY21, growth of 53% YoY
- GNPA/NNPA ratio moderated to 2.45% and 1.10%, respectively, in Q2FY22 from Q1FY22 levels of 2.96% / 1.46%. Loan losses and provisions still elevated for Q2FY22 was ₹ 1300 crore against ₹ 1,750 crore in Q1FY22. The company is holding a management overlay and macro provision of ~₹ 832 crore again similar to March 31, 2021 and rising from ₹ 486 crore in Q1FY22. The management has mentioned in presentation that in absence of a severe third wave, the company is committed to bring down its GNPA to 1.7-1.8% & NNPA to 0.7-0.8% by March 31, 2022
- Non overdue one-time restructuring (OTR) book was at ₹1512 crore vs. ₹ 1,287 crore (0.8% of book) QoQ. ECL provision was at ₹ 289 crore (19%)
- Capital adequacy remained strong at 27.68% with Tier I at 24.9%
- Customer franchise was at 52.80 mn as of September 30, 2021, growth of 20% YoY. Cross sell franchise was at 29.37 mn, growth of 23% YoY. During the quarter, customer franchise grew by 2.35 mn

### Few highlights

- The company digitally acquired 372,000 new EMI card customers in Q2FY22 using an integrated digital ecosystem

#### Payments

1. The company has 3.1 mn customers on its wallet as of October 24, 2021. For the festival season, the company has integrated the wallet feature for seamless fulfilment. It should significantly improve wallet engagement, stickiness and cashback/reimbursement process
  2. Merchant app is on track to go live by February 2022. It will enable P2P and P2M onboarding, transactions, promotions, rewards and settlements
  3. Post receiving board approval to apply for payment aggregator (PA) & Bharat Bill Pay Operating Unit (BBPOU), the company has initiated various approvals
  4. The company is in the process of significantly expanding payment talent pool
- Opex to NII is likely to normalise to 33-34% by Q4FY22
  - In the absence of a third wave, AUM growth is expected to at pre-Covid levels for the rest of the year

## Comparison

### Exhibit 1: Peer Comparison

Sector / Company	CMP			M Cap (₹ bn)	EPS (₹)			P/E (x)			P/ABV (x)			RoE (%)		
	(₹)	TP(₹)	Rating		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
LIC Housing Finance (LICHF)	406	400	Hold	223	54.2	35.9	51.3	7.5	11.3	7.9	1.4	1.3	1.1	14.1	8.9	11.5
HDFC (HDFC)	2,912	3,100	Buy	5,265	59.8	75.6	87.8	48.7	38.5	33.2	4.8	4.6	4.4	11.1	12.3	13.5
Bajaj Finserv (BAFINS)	18,349	20,200	Buy	2,920	235.6	300.1	440.5	77.9	61.1	41.7	8.1	7.2	6.1	11.0	12.5	15.9
Bajaj Finance (BAJFI)	7,800	8,950	Buy	4,738	73.6	99.1	127.4	106.0	78.7	61.2	13.1	11.9	8.9	12.8	15.0	15.7
Mahindra & Mahindra Finance	188	160	Reduce	232	2.7	3.4	12.5	69.1	55.5	15.0	1.9	2.1	1.7	2.6	2.8	9.7

Source: Company, ICICI Direct Research

We believe Bajaj Finance foraying into the fintech arena has captured investors' interest. The company has 3.1 million customers on its wallet as of October 24, 2021 and aims to reach 25 million customers by FY23. The company digitally acquired 3.7 lakh new EMI card customers in Q2FY22 using an integrated digital ecosystem. The management has a proven historical track record of launching various products like lifestyle financing, digital product loans, EMI cards, etc. We believe that with the lending business firmly in place along with a strong customer base, the payments business should get a boost and better credit assessment could be an advantage compared to other fintechs. The current consumer app already has 12.9 million active customers. Bajaj Finance can evolve as a twin play on e-commerce and conventional lending with the potential to capture the best of both worlds. Management has guided on better festive growth and higher RoA guidance for future. The buzz about fin-tech players and their expected valuations have provided room for future valuations to expand to 10x networth (BV) for proven business models that already generate >3% RoA.

Exhibit 2: Variance Analysis

	Q2FY22	Q2FY22E	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	Comments
NII	5,334	4,952	4,158	28.3	4,488	18.8	Surprised positively, led by strong credit growth and benefits of liquidity unwind
NIM (%) (calc)	14.6	13.3	11.1	355 bps	12.1	259 bps	
Other Income	1	3	7	-89.6	1	-36.4	
Staff cost	937	669	514	82.2	617	52.0	Higher employee strength for digital business segments impacted staff cost
Other Operating Expenses	1,093	830	645	69.4	757	44.4	
Opex to NII(%)	38.1	30.3	27.9	36.5	30.6	24.4	
PPP	3,305	3,457	3,006	9.9	3,116	6.1	
Provision	1,300	1,230	1,700	-23.5	1,750	-25.7	Lower provisions as incremental stress under control, boosted PAT
PBT	2,004	2,227	1,305	53.5	1,366	46.8	
Tax Outgo	523	557	341	53.7	363	44.0	
PAT	1,481	1,670	965	53.5	1,002	47.7	

Key Metrics

GNPA	4,103	4,974	1,873	119.1	4,737	-13.4	W/offes and provisions bought lowers
NNPA	1,826	2,492	771	136.8	2,307	-20.8	
AUM	166,937	166,900	137,090	21.8	159,057	5.0	Ex IPO financing of ₹1.7bn, growth was 6.8% sequentially

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

₹ Crore)	FY22E			FY23E		
	Old	New	% Change	Old	New	% Change
Net Interest Income	19202	19,787	3.0	23,425.2	23,572	0.6
Pre Provision Profit	12204	12,597	3.2	15,276.8	15,225	-0.3
NIM(%) (calculated)	10	11.1	76 bps	10.3	11.1	77 bps
PAT	5740	5,963	3.9	8,359.1	7,795	-6.8
ABV per share (₹)	673	653.1	-3.0	887.4	877.3	-1.1

Source: Company, ICICI Direct Research

Exhibit 4: Assumption

	Current				Earlier	
	FY20	FY21	FY22E	FY23E	FY22E	FY23E
Credit growth (%)	25.7	3.8	19.1	21.5	18.0	21.7
Borrowings Growth (%)	23.7	-2.7	23.0	20.0	20.0	20.0
NIM Calculated (%)	13.3	10.5	11.1	11.1	10.3	10.3
Cost to income ratio (%)	33.5	30.7	36.4	35.5	36.5	34.8
GNPA (₹ crore)	2,276.2	2,530.6	4,575.9	6,236.1	4,747.5	6,387.6
NNPA (₹ crore)	918.9	1,060.3	3,087.8	3,973.9	1,638.3	2,740.9

Source: Company, ICICI Direct Research

Exhibit 5: Asset quality data

Assets Under Management	Consolidated AUM Sept'21	GNPA	NNPA	PCR (%)	3/31/2021	06/30/2021	09/30/2021	3/31/2021	06/30/2021	09/30/2021
					(GNPA)	(GNPA)	(GNPA)	(NNPA)	(NNPA)	(NNPA)
Auto Finance Business	10738	1919	1027	46.0%	9.31%	19.15%	16.00%	4.84%	12.18%	9.25%
Sales Finance Business	12555	91	18	80.0%	1.11%	1.05%	0.64%	0.26%	0.24%	0.13%
Consumer B2C Business	33679	709	177	75.0%	1.70%	2.84%	2.11%	0.44%	0.95%	0.54%
Rural Sales Finance Business	3258	36	7	81.0%	1.11%	1.35%	1.09%	0.26%	0.29%	0.21%
Rural B2C Business	13376	429	175	59.0%	1.65%	2.85%	3.09%	0.39%	0.92%	1.28%
SME Lending Business	21871	379	96	75.0%	0.94%	2.15%	1.69%	0.23%	0.70%	0.43%
Securities Lending Business	7463	2	1	18.0%	-	-	0.02%	-	-	0.02%
Commercial Lending Business	9801	44	29	34.0%	-	-	0.45%	-	-	0.29%
Mortgages	54196	494	296	40.0%	0.92%	0.88%	0.97%	0.58%	0.61%	0.59%
Total	166937	4103	1826	55.0%	1.79%	2.96%	2.45%	0.75%	1.46%	1.10%

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 6: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Interest Earned	26373.8	26668.1	29325.0	35716.8
Interest Expended	9473.2	9414.0	9538.1	12144.4
Net Interest Income	16900.6	17254.1	19786.9	23572.4
Growth (%)	42.5	2.1	14.7	19.1
Non Interest Income	11.8	15.0	18.4	22.6
Operating Income	16912.4	17269.1	19805.3	23595.0
Employee cost	2290.9	2165.8	2749.1	3353.9
Other operating Exp.	3369.9	3142.4	4459.1	5016.0
Operating Profit	11251.6	11960.8	12597.1	15225.2
Provisions	3929.5	5968.6	4539.1	4691.7
PBT	7322.1	5992.3	8058.0	10533.4
Taxes	2058.4	1572.4	2095.1	2738.7
Net Profit	5,263.8	4,419.8	5,962.9	7,794.7
Growth (%)	31.8	-16.0	34.9	30.7
EPS (₹)	89.5	73.6	99.1	127.4

Source: Company, ICICI Direct Research

Exhibit 7: Key Ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Valuation</b>				
No. of shares (crore)	60.0	60.2	60.2	61.2
EPS (₹)	89.5	73.6	99.1	127.4
BV (₹)	549	615	704	942
ABV (₹)	534	597	653	877
P/E	87	106	78	61
P/BV	14.2	12.7	11.0	8.3
P/ABV	14.6	13.0	11.9	8.9
<b>Yields &amp; Margins (%)</b>				
Net Interest Margins	12.0	10.5	11.1	11.1
Yield on assets	18.7	16.3	16.4	16.8
Avg. cost on funds	8.3	7.6	7.0	7.3
Yield on average advances	20.8	18.5	18.2	18.5
<b>Quality and Efficiency (%)</b>				
Cost to income ratio	33.5	30.7	36.4	35.5
Cost to assets ratio	3.0	2.8	4.1	3.9
GNPA	1.6	1.7	2.6	2.9
NNPA	0.7	0.7	1.8	1.9
ROE	20.2	12.8	15.0	15.7
ROA	2.8	2.4	3.4	3.6

Source: Company, ICICI Direct Research

Exhibit 8: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
<b>Sources of Funds</b>				
Capital	120.0	120.3	120.3	122.3
Reserves and Surplus	32207.6	36798.1	42255.7	57036.7
Networth	32327.6	36918.4	42376.0	57159.0
Borrowings	125664.6	122278.1	150402.1	180482.5
Other Liabilities & Provisions	6399.2	1562.5	1871.2	2284.0
Total	164,391.4	160,759.0	194,649.3	239,925.5
<b>Application of Funds</b>				
Fixed Assets	1097.3	3288.9	3321.8	3653.9
Investments	17543.9	18396.9	15637.4	15168.3
Advances	141376.1	146687.0	174738.6	212322.6
Other Assets	4374.2	2911.6	951.5	8780.7
Total	164,391.4	171,284.4	194,649.3	239,925.5

Source: Company, ICICI Direct Research

Exhibit 9: Growth ratios				
	(%)			
(Year-end March)	FY20	FY21	FY22E	FY23E
Total assets	29.9	4.2	21.1	23.3
Advances	25.7	3.8	19.1	21.5
Borrowings	23.7	-2.7	23.0	20.0
Net interest income	42.5	2.1	14.7	19.1
Operating Income	42.4	2.1	14.7	19.1
Operating expenses	34.9	-6.8	35.8	16.1
Operating profit	46.5	6.3	5.3	20.9
Net profit	31.8	-16.0	34.9	30.7
Net worth	64.1	14.2	14.8	34.9
EPS	29.0	-17.8	34.7	28.6

Source: Company, ICICI Direct Research

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Buy: >15%

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Sell: <-15%



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