Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bajaj Finance

A long-term play

Banks & Finance	Sharekhan code: BAJFINANCE	Result Update

Stock Update

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 4,981**	
Price Target: **Rs. 6,000**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 5,479 cr
52-week high/low:	Rs. 5,373/1,783
NSE volume: (No of shares)	52.3 lakh
BSE code:	500034
NSE code:	BAJFINANCE
Free float: (No of shares)	26.4 cr

Shareholding (%)

Promoters	56.2
FII	24.7
DII	9.1
Others	10.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.2	54.1	51.3	20.0
Relative to Sensex	-10.5	31.7	20.0	0.1

Sharekhan Research, Bloomberg

Summary

- Bajaj Finance Limited's (BFL) Q3FY2021 results were mixed; operational numbers came largely in line with estimates.
- Asset quality improved on a q-o-q basis but continued elevated provisions (for Stage 1 and 2 loans) were dampeners.
- Management commentary on growth and asset-quality outlook are now more sure-footed; business transformation is encouraging for the long term.
- BFL is available at 6.9x/5.7x its FY2022E/FY2023E BVPS; We have fine tuned our estimates and target multiples. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 6,000.

Bajaj Finance Limited's (BFL) Q3FY2021 results were mixed. Operational numbers were largely in line with estimates but elevated provisions were dampeners. Asset quality improved on a sequential basis, which was along expected lines. Continued higher provisions (taken on prudent basis for Stage 1 and 2 loans) softened PAT performance. However, we believe it is positive, and frontloads provision is a burden. Management commentary on growth and asset-quality outlook for the near term is now more confident, which is a change since last quarter. Moreover, the company is now looking more sure-footed on growth and credit costs for the medium term, which is encouraging. On the operational front, BFL saw NII (Calculated) falling by 5% y-o-y, but up 3.2% q-o-q, while PPOP was down 3.2%% y-o-y and was below expectations. The company's assets under management (AUM) were flat. We believe there are several business transformation steps that are underway for BFL, which would not only be positive for business sustainability, scalability, but also position BFL to take advantage of a strong economic upturn expected in FY2022E. Business transformation, as well as relations with Banks such as DBS along with RBL Bank will help diversify business channels. The drag on margins due to liquidity buffers continued in Q3 as well, but it is now waning, which is a positive support for BFL's margins. Loan losses and provisions for Q3FY2021 were at Rs. 1,350 crore due to higher provision for Stage 1 and 2 assets due to prudence approach. BFL's subsidiary, Bajaj Housing Finance Limited's (BHFL) performance was weak with NII growth but PAT declined YoY due to higher loan losses and provisions. We believe armed with factors such as 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 have fine tuned our estimates and target multiples. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 6,000.

Key positives

- The provisioning coverage ratio as of 31 December 2020 was healthy at 65%. Provisioning coverage on stage 1 and 2 assets was 190 bps as of 31 December 2020 and provides comfort for investors.
- Healthy Capital adequacy ratio (including Tier-II capital) as of 31 December 2020 stood at 28.18% and the Tier-I capital stood at 24.73%.
- Liquidity surplus as of Q3 FY2021 stood at Rs 14,347 crore (at still elevated levels) but much lower from Rs 22,414 crores in Q2 FY2021, indicating lower cost of liquidity surplus.

Key negatives

- Elevated provisions, as during the quarter, the company has done one-time write-off of principal outstanding of Rs 1,970 crore and interest outstanding of Rs 365 crore on account of COVID-19 related stress.

Our Call

BFL is available at 6.9x/5.7x its FY2022E/FY2023E BVPS and premium valuations are likely to sustain as business transition and growth parameters stabilise. For BFL, the normalisation of business and improved stance on growth etc. indicate that management expects near-term headwinds to wane. We believe the long-term outlook has improved (liquidity drag to reduce, growth to return in H1FY2022E). Given BFL's strong balance sheet and business strengths, we believe the company is structurally a 20+% ROE business franchise in a normalised steady state basis. We believe BFL's stable leadership, well-capitalised balance sheet, robust risk management, and prudent management make it a strong franchise for the long term, which is well placed to ride over medium-term challenges. We have fine tuned our estimates and target multiples. We maintain our Buy rating on the stock with a revised PT of Rs. 6,000.

Key risk

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	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	11,762	16,901	18,409	21,455	26,318
Net profit	3,995	5,264	4,571	8,217	10,005
EPS (Rs.)	68.9	87.7	76.2	137.0	166.8
PE (x)	72.3	56.8	65.4	36.4	29.9
Book value (Rs./share)	342	499	606	727	874
P/BV (x)	14.6	9.2	8.2	6.9	5.7
RoE (%)	22.1	20.2	13.3	20.5	20.8
RoA (%)	3.7	3.6	2.6	3.9	3.7

Source: Company; Sharekhan estimates

Key Conference call takeaways

- **Growth outlook:** Company expects to have exit AUM growth of 8%-9% for Q4 FY2021. The company expects core AUM growth to resume to pre-COVID levels by Q4 FY21. AUM was structurally lower due to portfolio attrition and adverse pricing action. Most growth came in December.
- **Margin:** Margin profile in all business lines was steady at pre-COVID levels other than mortgages. Consolidated cost of funds would go down to 7.5% by March from 7.8% now. BFL now can generate natural liquidity of Rs. 5,500crore -7,000 crore each quarter.
- **New origination:** New origination looking better than pre-Covid origination
- **Opex:** Some of the business expenses will not revert to pre-Covid levels
- **Credit Costs:** Did a write off after various tests by risks of Rs. 1,970 crore. Still carrying Rs. 800 crore of overlay provisions. Loan loss provisions are frontloaded, lifetime provision done instead of requirement. The ccompany estimates residual credit costs in Q4 at Rs. 1,200 crore - Rs. 1,250 crore.
- **Guidance for FY2022E:** Credit cost is expected to go to 150 bps-160 bps average assets in FY2022E, which can be lower as well. If recoveries are better in FY2022, the company may experience lower net loan loss to average assets.
- **Collection Efficiency:** Bucket 0 and 1, 2 collection efficiency is better than pre-COVID levels. Even bucket 3 is encouraging but still assessing.
- **Credit Cost:** Management has guided Rs. 1,250 crore credit cost in Q4 expectations. Management expects recovery of Rs. 1,000 crore from next year. Most provisions are done on Stage 1 are 2.
- Proforma GNPA: Fundamentally, management expects GNPA for Q4 to revert to pre-COVID levels except auto, which is secured.
- **Structural transformation underway:** The company is changing operating processes and that would mean change in technology stack; this process will be completed by May 2021.
- **Omni-channel framework:** Omni-channel framework will start to play out going ahead. This change will require much lower headcount addition.
- **Business Transformation:** Developing omni-channel business so as to reduce risk and structurally change the operating process. That is underway and will get completed by May 2021. This will lead to creation of an app. This will lead to fundamental change in customer interaction. Management is focusing on reducing customer friction. All calls from march will be recorded calls from the company to customers.
- **DBS bank tie-up:** Just received an approval. DBS would be putting in technology structure and platform to launch credit card. Will launch in July 2021 and will give updates post then. Relation with RBL continues to be strong and strategic, and BFL has the capacity to serve both manufacturers at least for the medium term.
- **Loans stress in home loans:** The stress happened as there was COVID crisis, and the Instalment to income levels are very high. However, the loss given default (LGD) is very low.
- **Flexi Loans:** Flexi loans are not being converted to normal loans. From Q3 acquiring flexi as normal business, and the portfolio would have gone up since Q2. From provision and delinquency levels perspective, it is same in behaviour like rest of the loan book. Were doing flexi conversion during the lockdown phase as there was not much movement in market in terms of fresh loans. Now that situation has improved, the conversion is not focus anymore.

- **Write-off:** Were across auto finance, 3W finance, where receipts were not paid for the past three months, B2B not paid for 6-7 months. Such customers who were badly impacted by COVID and BFL expected them not to recover.
- **Digital Products:** Around 1,000 stores have closed. However, many of them were start-ups.
- **On bank transformation:** Management expects that RBI norms will seek to remove the NBFC versus bank arbitrage. Management believes the regulatory moves will be aimed to strengthen financial markets will be a long-term positive.
- **Restructuring pipeline:** The restructured pipeline is expected to be Rs. 2,040 crore. In Q3, there was recovery of Rs. 1,100 crore, which moved from Stage 2 to Stage 1; and if similar move happens in Q4, it will be positive.
- **New product:** Bajaj Pay to be launched between July 2021 to September 2021.
- **ECLGS Outstanding:** It is Rs. 600 crore-700 crore outstanding amount.
- **Slippages on Proforma:** Will be around Rs. 4,200 crore for Q3.

Results (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Interest Income & Fees	6653.8	7011.1	-5.1	6516.6	2.1
Interest and Other Charges	2362.7	2489.0	-5.1	2358.1	0.2
Net Interest Income	4291.1	4522.0	-5.1	4158.4	3.2
Other Income	2.4	14.9	-84.2	6.7	-65.1
Total Operating Income	4293.4	4536.9	-5.4	4165.2	3.1
Employee Expense	678.4	722.1	-6.0	514.4	31.9
Depreciation & Amortisation Expenses	79.6	75.6	5.3	71.5	11.4
Other Expenses	631.5	738.4	-14.5	573.4	10.1
PPoP	2903.8	3000.8	-3.2	3005.9	-3.4
Provisions and Loan losses	1351.7	830.8	62.7	1700.4	-20.5
PBT	1554.5	2170.1	-28.4	1305.5	19.1
Tax Expense	408.5	556.0	-26.5	340.6	19.9
Profit After Tax	1146.0	1614.1	-29.0	964.9	18.8
Key Items					
AUM	1,43,550	1,45,092	-1.1	1,37,090	4.7

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Green shoots in the economy are encouraging

We believe retail players have a large market to grow and recent credit growth of 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 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.

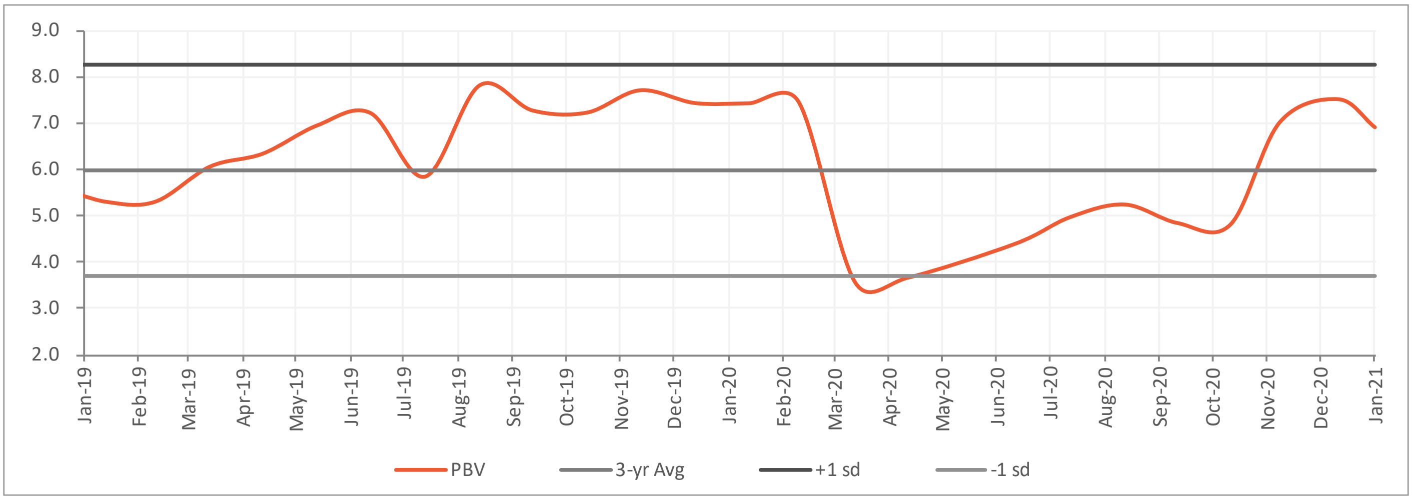
Company Outlook – Strong and prudent management, company getting ready for future growth

BFL continues to remain well capitalised with CRAR of 28.2% with Tier-1 capital at a healthy 24.7%. The drag on margins due to liquidity buffers continued in Q3 as well, but it is now waning, which offers positive support for BFL's margins. 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 result in a transformed customer experience model for it. We believe there are several business transformation steps that are underway for BFL, which would not only be positive for business sustainability and scalability, but would also position BFL 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 – Long-term outlook positive; Maintain Buy

BFL is available at 6.9x/5.7x its FY2022E/FY2023E BVPS and the premium valuation is likely to sustain as business transition and growth parameters stabilise. For BFL, business normalisation and improved stance on growth etc. indicate that management expects near-term headwinds to wane. We believe the long-term outlook has improved (liquidity drag to reduce and growth to return in H1FY2022E). Given BFL's strong balance sheet and business strengths, we believe the company is structurally a 20+% ROE business franchise in a normalised steady state basis. We believe BFL's stable leadership, well-capitalised balance sheet, robust risk management, and prudent management make it a strong franchise for the long term, which is well placed to ride over medium-term challenges. We have fine tuned our estimates and target multiples. We maintain our Buy rating on the stock with a revised PT of Rs. 6,000.

One-year forward P/BV (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Bajaj Finance	4,981	8.2	6.9	65.4	36.4	2.6	3.9	13.3	20.5
HDFC Ltd	2,689	4.7	4.4	44.9	38.8	1.9	2.0	11.5	12.1

Source: Company, Sharekhan Research

About company

BFL 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. BFL 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. BFL continues to be the largest consumer durables lenders in India. As a business entity, BFL continues to deliver steady performance with well-maintained margins and conservative asset-quality performance.

Investment theme

BFL enjoys a dominant position in the Indian consumer finance space with a 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 the past few years, BFL has been posting consistently strong growth with high but stable NIMs along with excellent asset quality. The stable 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 BFL 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

Prolonged or intermittent 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	4.3
2	Maharashtra Scooters Ltd	3.2
3	Axis Asset Management Co Ltd/India	2.6
4	SBI Funds Management Pvt Ltd	1.7
5	Capital Group Cos Inc/The	1.5
6	BlackRock Inc	1.3
7	LIC	1.3
8	Vanguard Group Inc/The	1.3
9	FMR LLC	0.9
10	UTI Asset Management Co Ltd	0.8

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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