Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# Bajaj Finance Ltd

## Steller performance with optimistic outlook

| NBFC | Sharekhan code: BAJFINANCE |
|---|---|
| Reco/View: Buy ↔ | CMP: **Rs. 6,396** | Price Target: **Rs. 7,600** ↓ |

↑ Upgrade ↔ Maintain ↓ Downgrade

| 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<br>Updated Jul 08, 2022 | | | | 19.46 |
|---|---|---|---|---|
| Low Risk | | | | |
| NEGL | LOW | MED | HIGH | SEVERE |
| 0-10 | 10-20 | 20-30 | 30-40 | 40+ |

*Source: Morningstar*

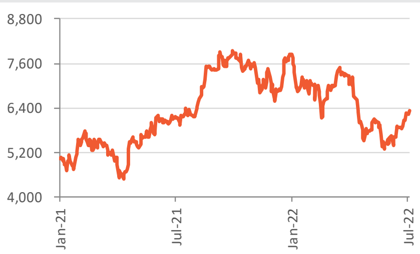
**Company details**

| | |
|---|---|
| Market cap: | Rs. 3,87,096 cr |
| 52-week high/low: | Rs. 8,044/ 5,236 |
| NSE volume: (No of shares) | 12.9 lakh |
| BSE code: | 500034 |
| NSE code: | BAJFINANCE |
| Free float: (No of shares) | 26.7 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 55.9 |
| FII | 21.4 |
| DII | 11.2 |
| Others | 11.5 |

**Price chart**




**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 13.4 | -4.7 | -6.9 | 2.6 |
| Relative to Sensex | 8.4 | -3.0 | -4.4 | -3.5 |

*Sharekhan Research, Bloomberg*


**Summary**

- Bajaj Finance reported another strong quarter with healthy operating performance. PAT stood at Rs. 2,596 crore (on consolidated basis), up ~159% y-o-y and ~7% q-o-q versus our estimate of Rs. 2,182 crore, on account of higher provision expectations.
- Asset quality continued to witness significant improvement with stage 3 assets at 1.25%, down ~35 bps q-o-q. The management expects the GNPA and NNPA ratios to trend lower going ahead.
- Consolidated AUM grew by 28% y-o-y and 3% q-o-q to Rs. 2.04 trillion in Q1FY2023. The company plans to grow its AUM to Rs. 4 lakh crore by FY2025. The company plans to be fully digital across all its products on application by March 2023.
- At the CMP, the company trades at 7.2x its FY2023E P/BV. We maintain our Buy rating on the stock with a revised PT of Rs. 7,600.


**Bajaj Finance (BAF) reported a stellar quarter reporting consolidated PAT of Rs. 2,596 crore versus our expectation of Rs. 2,182 crore, up ~159% y-o-y and ~7% q-o-q. This was primarily due to strong net interest income (NII) growth and lower provisions. NII grew by 48% y-o-y and ~10% q-o-q to Rs. 5,275 crore. Our estimated NII was at Rs. 5,102 crore. The company's other income rose by ~73% y-o-y and 8% q-o-q. Consolidated AUM stood at Rs. 2.04 trillion, up ~28% y-o-y/~3% q-o-q in Q1FY2023. Management plans to grow its AUM to Rs. 4 lakh crore by FY2025. AUM composition remained steady with all the segments registering double-digit growth except for auto finance business. The company continued to protect its margins with its NIM expanding by 38 bps, even though competitive intensity remained elevated across products for the company. The company has started increasing pricing of products from June 2022. GNPA and NNPA declined by ~35 bps q-o-q and ~18 bps q-o-q to 1.25% and 0.5%, respectively, in Q1FY2023. Provisions stood at Rs. 755 crore versus Rs. 702 crore in Q4FY2022 versus our estimate of Rs. 920 crore.**

**Key positives**

- Continued improvement in headline GNPA ratio by 35 bps q-o-q with auto finance business witnessing better asset quality.
- Consolidated AUM registered robust growth of ~31% y-o-y/~3% q-o-q in Q1FY2023.
- Deposits rose by 20% y-o-y and 9% q-o-q and contributed to 20% of consolidated borrowings.

**Key negatives**

- Operating expenses remained at elevated levels on a y-o-y basis as the company continues to invest in technology for business transformation.

**Management Commentary**

- With strong growth in consolidated AUM, management has further guided AUM growing to Rs. 4 lakh crore by FY2025.
- During the quarter, the company has revised up deposit rates by 55-70 bps, with increased system interest rates. The company plans to have deposits contribution of 25% in the long term through accelerating acquisition of retail deposits.
- GNPA and NNPA ratio witnessed significant improvement sequentially and management has guided for GNPA of 1.4% to 1.7% in the long term.

**Our Call**

**Valuation – We maintain our Buy rating on BAF with a revised PT of Rs. 7,600.** At the CMP, the company trades at 7.2x its FY2023E P/BV. The stock price has corrected 20% from the highs of Rs. 8,044 and offers an attractive buying opportunity. BAF stands poised to deliver robust AUM growth of 24% over FY2022E through FY2024E with RoE and RoA of 22-24% % and 4.7%-5% over FY2023E and FY2024E, respectively. Further, undergoing digital transformation is likely to bode well for its growth objectives going ahead along with operational efficiencies. BAF is one of the most diversified NBFCs with a wide range of product offerings with the management planning to go fully digital by 2023E. The company 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. Hence, we maintain our Buy rating on BAF with a revised price target (PT) of Rs. 7,600.

**Key Risks**

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

**Valuation (Consolidated)** Rs cr

| Particulars | FY21 | FY22 | FY23E | FY24E |
|---|---|---|---|---|
| PAT | 4,420 | 7,028 | 11,015 | 13,835 |
| EPS (Rs) | 72.9 | 115.6 | 181.2 | 227.6 |
| RoAA (%) | 2.6 | 3.7 | 4.7 | 4.8 |
| RoAE (%) | 12.8 | 17.4 | 22.6 | 23.0 |
| P/E (x) | 87.7 | 55.3 | 35.3 | 28.1 |
| P/B (x) | 10.5 | 8.9 | 7.2 | 5.9 |

*Source: Company; Sharekhan estimates*

## Key Concall highlights

- **Competition:** BAF foresees continued competition intensity across products. At the same time, it intends to protect its margin profile with product mix to remain stable.
- **Guidance for FY2025:** It plans to grow its AUM to Rs. 4 lakh crore by FY2025. NNPA at 0.4% to 0.7%. RoA and RoE are expected to be at 4% to 4.5% and 19% to 21%, respectively. The company intends to go fully digital across all its products and services by March 2023.
- **Strong AUM growth:** Overall AUM (consolidated) grew by 28% y-o-y and 3% q-o-q to Rs. 2.04 trillion. Except for auto finance, all businesses witnessed double-digit growth, thereby demonstrating broad-based growth across segments. Auto finance declined by 12% y-o-y and 2% q-o-q. AUM mix remained largely stable with B2C business accounting for 20% of consolidated AUM, while SME business constituted for 13% of AUM. It launched its non-captive two-wheeler (2W) financing business on July 6, 2022. The company plans to roll out new auto loans in FY2024.
- **Acceleration in deposits:** Deposits rose by 20% y-o-y and 9% q-o-q and contributed to 20% of consolidated borrowings. During the quarter, the company has revised up deposits rates by 55-70 bps, with increased system interest rates. It plans to have deposits contribution of 25% in the long term through accelerating the acquisition of retail deposits.
- **Higher opex ratio:** Opex to NII stood at 35.9% in Q1FY2023 versus 35.5% in Q4FY2022. The company continues to invest in people and technology for business transformation. Given these investments in its digital transformation, it expects opex to NII to remain elevated at 35%-36% in FY2023.
- **Other highlights:** Cost of funds (CoF) for the company stood at 6.64% in 1QFY2023 versus 6.71% in 4QFY2022. It foresees the impact of interest rate hike to be gradual given its strong ALM management. Provisions stood at Rs. 755 crore versus Rs. 702 crore in Q4FY2022. This included an impact of Rs. 190 crore as one large B2B commercial account was written off during the quarter. The company expects its loan losses to be 1.35% to 1.45% of average assets in FY2023.

**Results (Consolidated)** Rs cr

| Particulars | Q1FY23 | Q1FY22 | Q4FY22 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| Interest Income | 7,920 | 5,954 | 7,366 | 33.0 | 7.5 |
| Interest Expenses | 2,645 | 2,254 | 2,563 | 17.4 | 3.2 |
| **Net Interest Income** | **5,275** | **3,701** | **4,803** | **42.5** | **9.8** |
| Other Income | 1,363 | 789 | 1,264 | 72.8 | 7.8 |
| **Net OI (as reported by BAF)** | **6,638** | **4,489** | **6,068** | **47.8** | **9.4** |
| Employee Expenses | 1,183 | 617 | 1,020 | 91.9 | 16.0 |
| Non-employee expenses | 1,197 | 1,594 | 1,080 | (24.9) | 10.8 |
| **Operating Expenses** | **2,380** | **1,373** | **2,101** | **73.3** | **13.3** |
| **Pre-Provisioning Profit (PPoP)** | **4,257** | **3,116** | **3,967** | **36.6** | **7.3** |
| Provisions & Write-offs | 755 | 1,750 | 702 | (56.9) | 7.6 |
| **PBT** | **3,503** | **1,366** | **3,265** | **156.5** | **7.3** |
| Tax | 907 | 363 | 846 | 149.4 | 7.2 |
| Tax Rate (%) | 25.9 | 26.6 | 25.9 | | |
| Extraordinary Items | | | | | |
| **PAT** | **2,596** | **1,002** | **2,420** | **159.0** | **7.3** |
| **EPS (Rs)** | **43.0** | **16.7** | **40.2** | | |

*Source: Company; Sharekhan Research*

**Key Financials & Ratios**

| Particulars | Q1FY23 | Q1FY22 | Q4FY22 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| **Consolidated AUM** | | | | | |
| Consumer B2B -Auto Finance Business | 9,962 | 11,347 | 10,194 | (12) | (2) |
| Consumer B2B - Sales Finance Businesses | 16,475 | 11,175 | 14,977 | 47 | 10 |
| Consumer B2C Businesses | 41,207 | 31,399 | 38,772 | 31 | 6 |
| Rural B2B Business - Sales Finance Business | 4,564 | 2,914 | 4,129 | 57 | 11 |
| Rural B2C Business | 16,740 | 12,537 | 15,301 | 34 | 9 |
| SME Business | 26,564 | 20,335 | 24,979 | 31 | 6 |
| Securities Lending Business | 10,801 | 9,232 | 15,901 | 17 | (32) |
| Commercial Lending Business | 12,040 | 9,011 | 11,498 | 34 | 5 |
| Mortgages | 65,665 | 51,107 | 61,701 | 28 | 6 |
| **Total** | **204,018** | **159,057** | **197,452** | **28** | **3** |
| | | | | | |
| **Payments** | | | | | |
| Credit Card CIF (mn) | 3.0 | 2.1 | 2.8 | 39.0 | 7.6 |
| EMI Card CIF (mn) | 32.8 | 24.1 | 30.0 | 36.1 | 9.3 |
| Wallets (mn) | 22.3 | 20.9 | 22.1 | 6.7 | 0.9 |
| | | | | | |
| Customer Franchise (mn) | 60.3 | 50.5 | 57.6 | 19.5 | 4.7 |
| Cross sell Franchise (mn) | 34.7 | 27.4 | 32.8 | 26.4 | 5.8 |
| New Loans booked during quarter (mn) | 7.4 | 4.6 | 6.3 | 59.8 | 17.5 |
| | | | | **BPS** | **BPS** |
| Consol GNPA (%) [Reported] | 1.25 | 1.40 | 1.60 | -15 | -35 |
| Consol NNPA (%) [Reported] | 0.50 | 0.50 | 0.68 | 0 | -18 |
| PCR on Stage 3 (%) [Reported] | 59.91 | 65.0 | 58.4 | -510 | 150 |

*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 14.4 % y-o-y in the fortnight ending July 15, 2022, 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 – We maintain Buy rating on BAF with revised PT of Rs. 7,600.

At the CMP, the company trades at 7.2x its FY2023E P/BV. The stock price has corrected 20% from the highs of Rs. 8,044 and offers an attractive buying opportunity. BAF stands poised to deliver robust AUM growth of 24% over FY2022E through FY2024E with RoE and RoA of 22-24% % and 4.7%-5% over FY2023E and FY2024E, respectively. Further, undergoing digital transformation is likely to bode well for its growth objectives going ahead along with operational efficiencies. BAF is one of the most diversified NBFCs with a wide range of product offerings with the management planning to make it a digital company by FY2023E. The company 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. Hence, we maintain our Buy rating on BAF with a revised PT of Rs. 7,600.

**Peer valuation**

| Particulars | CMP (Rs / Share) | MCAP (Rs Cr) | P/E (x) | | P/BV(x) | | RoA (%) | | RoE (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E |
| Bajaj Finance | 6,396 | 3,87,096 | 35.3 | 28.1 | 7.2 | 5.9 | 3.7 | 4.7 | 17.4 | 23.0 |
| HDFC Ltd | 2,313 | 4,19,514 | 25.0 | 22.3 | 1.2 | 1.1 | 2.4 | 2.4 | 13.3 | 13.4 |
| Cholamandalam Investment and Finance Company | 677 | 55,648 | 17.9 | 20.3 | 4.1 | 3.2 | 3.3 | 3.0 | 24.5 | 20.9 |

*Source: Company, Sharekhan estimates*

## 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 is seen as a structural concern to higher RoE.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Mr. Sanjiv Bajaj | Chairman |
| Mr. Rajeev Jain | Managing Director |
| Mr. Atul Jain | Chief Executive Officer (BHFL) |
| Mr. Anup Saha | Deputy CEO |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Republic of Singapore | 3.3 |
| 2 | Maharashtra Scooters Ltd | 3.1 |
| 3 | Axis Asset Management Co Ltd/India | 2.7 |
| 4 | SBI Funds Management Pvt Ltd | 1.9 |
| 5 | Vanguard Group Inc/The | 1.5 |
| 6 | Capital Group Cos Inc/The | 1.3 |
| 7 | BlackRock Inc | 1.3 |
| 8 | St. Jame's Place PLC | 1.3 |
| 9 | UTI Asset Management Co Ltd | 0.9 |
| 10 | FMR LLC | 0.7 |

*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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