

Poonawalla Fincorp

Refer to important disclosures at the end of this report

Sale of housing finance subsidiary to TPG

CMP

Rs 302

as of (December 14, 2022)

Rating

HOLD (■)

Target Price

Rs 270 (■)

12 months

Upside

(10.6) %

- **Sale of the housing finance subsidiary:** Poonawalla Fincorp (PFL), in its board meeting held on 14-Dec-2022, approved the sale of its housing finance subsidiary – Poonawalla Housing Finance (PHFL) – to TPG (Perseus SG Pte., an entity affiliated with TPG Global, LLC). The deal has been struck at Rs39bn, which values PHFL at a trailing Sep-22 P/BVPS of 3.4x. This is broadly in line with our TP implied trailing Sep-22 valuation of 3.3x for the consolidated entity. As per our interactions with the management, post the approval from the respective regulatory authorities, shareholders and lenders, the deal is expected to be completed within 3-6 months. As of Sep-22, PFL (standalone) had an AUM of ~Rs129bn and reported RoA of 4%, while PHFL's AUM stood at ~Rs56bn and RoA at 2.4%.
- **Stated rationale for the transaction:** The sale is in line with one of Poonawalla Fincorp's stated 'Vision 2025' objectives – of value unlocking of the housing finance subsidiary. Management believes the transaction will help them focus on maximizing value creation by optimizing resource allocation and increasing Management focus on the business needs of the standalone entity. With rapid growth in the digital ecosystem, Management believes that the growth opportunities for PFL are aplenty. PFL is expected to continue building a strong retail franchise in consumer and MSME financing.
- **Management guidance on the way forward:** PFL has laid out a six-fold future roadmap for the standalone business which includes:
 - focus on tech-led growth by leveraging technology and digital capabilities. PFL targets **AUM growth of 35-40% YoY over the next 3 years**;
 - risk-calibrated growth and operational efficiencies to aid in achieving **constant RoAs of 4-4.5%**;
 - **net NPAs expected to remain below 1%**, on the back of prudent underwriting and collection capabilities;
 - branch and manpower rationalization to **reduce operating expenses**;
 - with PFL already being well-capitalized and having one of the lowest CoFs, the sale is expected to grant further strength for **exponential growth over the next 5-7 years**,
 - deep capital base to enable PFL to explore deep investments in technology and analytics through both, the **organic and inorganic routes**.
- **Our view:** Poonawalla Fincorp's existing consolidated portfolio is a dichotomy – of the old world legacy-acquired Magma Fincorp portfolio comprising of CV/CE/Agri/affordable housing loans that resides beside the digital-first-technology-led, mainly urban, consumer/SME loans that originated post the acquisition of Magma. As of Q2FY23, the PFL portfolio comprises of housing loans (incl. PHFL DSA acquired) at ~30%, unsecured PL/BL and loans to professionals at ~27%, pre-owned car loans at ~12%, legacy magma book at ~8%, other acquired loans at ~14%, with auto lease and LAP constituting the rest. The legacy CV loans in the standalone entity were expected to run down by Q1FY24. Now, with the sale of Poonawalla Housing Finance expected to be culminated during H1FY24, the business will become a purely technology-led, asset-light retail consumer/SME play.
- PFL's consolidated portfolio excluding the legacy CV/CE loans and mortgage portfolio will primarily be composed of LAP (11%), pre-owned car loans (20%), unsecured personal/business loans (44%), DA acquired portfolio of 23% and the rest in auto lease. In our assessment, almost two-thirds of the portfolio would be unsecured loans, while the rest would be quasi secured, like LAP and pre-owed car loans.

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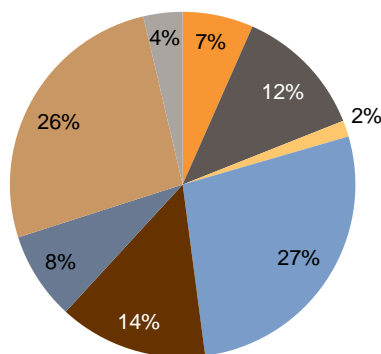
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- Based on our interactions with the management, the contractual duration of LAP is 9-10 years, of pre-owned car loans is ~4 years, while that of unsecured personal loans is 3-5 years. In the behavioral perspective, we expect the portfolio to have a tenure of <5 years.
- Management guidance points to strong growth of 35-40% YoY and RoA of 4.0-4.5% over the next three years. Taking into account earlier guidance of tripling the FY21 loan book by FY25, Management expects the loan book to be in excess of Rs300bn by FY25 (FY21 portfolio excluding PHFL was ~Rs100bn). In our view, while the affordable housing business provided limited scope for cross selling the technology-led consumer products that PFL envisaged, the presence of the mortgage book, nevertheless, gave the much needed stability and longevity to the overall portfolio. **Our key concern** regarding the transaction pertains to the shorter duration of the portfolio, post the sale of the housing finance business. The post-sale loan book, primarily comprising of unsecured loans, pre-owned car loans and LAP, is vulnerable to a higher degree of churn, given its relatively lower duration vis-à-vis home loans. This would imply a significantly-higher disbursement rate than currently envisaged. While the firm is more than adequately capitalized (Q2FY23 standalone CAR: 44.9%), we remain cautious of the impact of prolonged high interest rates on the consumer loans segment.
- Considering the ambiguity around operational plans, in terms of composition of product segments, and cost structure/credit costs associated with these, we retain our HOLD rating with unchanged Sep-23E TP of Rs270. We will revisit our estimates post further clarification from the management.

Please see our sector model portfolio (Emkay Alpha Portfolio): [BFSI-NBFCs](#)

Exhibit 1: Loan book composition – Pre-Sale

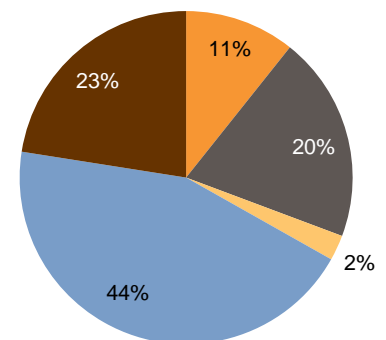
- LAP
- Pre-owned car
- auto lease
- Unsecured PL/ BL/ Loan to professionals
- DA (acquired)
- Legacy book
- Housing
- PHFL DA



Source: Company, Emkay Research' Note: *based on Sep-22 data

Exhibit 2: Loan book composition – Post-sale

- LAP
- Pre-owned car
- auto lease
- Unsecured PL/ BL/ Loan to professionals
- DA (acquired)



Source: Company, Emkay Research; Note: *based on Sep-22 data

Exhibit 3: We estimate BVPS accretion of 32% post-sale of the housing finance subsidiary

Standalone Net worth - Sep'22 (Rs mn)	60,180
Profit from sale* (Rs mn)	24,139
Standalone Net worth Post-sale (Rs mn)	84,320
No. of shares (mn)	765
Consolidated BVPS Pre-sale (Rs) (A)	84
Standalone BVPS Pre-sale (Rs)	79
Standalone BVPS Post-sale (Rs) (B)	110
BVPS accretion (Rs) (B-A)	27
BVPS accretion (%)	32%

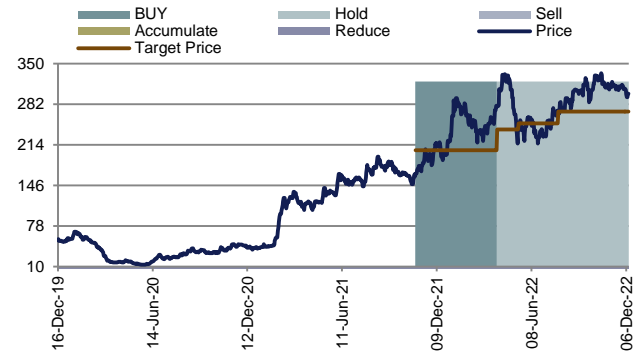
Source: Company, Emkay Research, Note: *Profit has been derived as: Consideration amount - Book value of investment IN PHFL as of Mar'22 - Profit of PHFL for H1FY23, post applying capital gains tax of 20% on the transaction

RECOMMENDATION HISTORY (Rs/share)

Date	Closing Price	TP	Period	Rating	Analyst
02-Dec-22	308	270	12m	Hold	Manjith Nair
24-Oct-22	319	270	12m	Hold	Manjith Nair
29-Jul-22	267	270	12m	Hold	Manjith Nair
14-May-22	248	250	12m	Hold	Manjith Nair
03-Apr-22	280	240	12m	Hold	Manjith Nair
29-Oct-21	166	205	12m	Buy	Manjith Nair

Source: Company, Emkay Research

RECOMMENDATION HISTORY (Rs/share)



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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