Sharekhan by BNP PARIBAS

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Bajaj Finance

Earnings in line, digital transformation expected to aid momentum

NBFC	Sharekhan code: BAJFINANCE
Reco/View: Buy ↔	CMP: Rs. 5,756
	Price Target: Rs. 7,500 ↓

↑ 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 19.49

Updated Dec 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

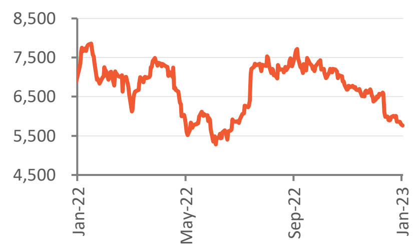
Company details

Market cap:	Rs. 3,48,486 cr
52-week high/low:	Rs. 7,777 / 5,236
NSE volume: (No of shares)	11.5 lakh
BSE code:	500034
NSE code:	BAJFINANCE
Free float: (No of shares)	26.6 cr

Shareholding (%)

Promoters	55.9
FII	19.9
DII	12.4
Others	11.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.5	-17.9	-20.2	-16.2
Relative to Sensex	-8.6	-16.8	-23.2	-19.9

Sharekhan Research, Bloomberg

Summary

- BAF's reported solid earnings growth of 40% y-o-y in Q3FY2023, driven by 24% y-o-y growth in operating profit and a 20% y-o-y decline in provisions. Customer franchise expanded to 66 mn (up 19% y-o-y) with cross-sell franchise at 38.6 mn (up 23% y-o-y).
- NIM (calculated as a percentage of average AUM) was stable q-o-q at 10.5% despite cost of funds increasing by 23 bps q-o-q. Opex growth has started to moderate, which is expected to aid operating leverage going forward. Opex to average AUM stands at 4.6% vs. 4.8% q-o-q. Asset quality was remarkable, as GS3 ratio sequentially declined to 1.14% (vs. 1.17% in Q2FY2023) and GS2 ratio (including OTR) dipped to 1.2% (vs. 1.4% in Q2FY2023).
- AUM growth is moderating to 25-30% vs. earlier at 35-40% owing to a higher base and competitive intensity, which continues to remain elevated across the portfolio that is leading to some market share loss in the near term. This has led to de-rating in the valuation multiples. However, we believe the impact of digital transformation is yet to be visible fully, which should uplift AUM growth gradually.
- The company continues to focus on protecting the profit pool instead of merely chasing growth. Thus, BAF is poised to deliver sector-leading ROA/ROE of 4.7%/22% over FY2022-FY2025E. At the CMP, the stock trades at 6.5x/5.3x/4.3x its FY2023E/FY2024E/FY2025E BV estimates. We are confident about the company's strong earnings growth and longevity of the franchise, thus we reiterate Buy on BAF with a revised PT of Rs. 7,500, tweaking the multiple lower due to moderation in AUM growth.

Bajaj Finance (BAF) reported steady performance in Q3FY2023, in line with consensus and our estimates. Net interest income (NII) grew robustly by 25% y-o-y and 7% q-o-q, broadly in line with AUM growth. NIM (calculated as a percentage of average AUM) remained stable q-o-q at 10.5%. New customer acquisitions and the new loan booked trajectory have been strong. Fee and other income grew by 19% y-o-y/3% q-o-q. Total operating expenses were up 24% y-o-y/3% q-o-q. Opex growth has started to moderate, which should aid operating leverage going forward, as the company guided that incremental tech-led investments have peaked out. Total provisions were down by 20% y-o-y. Credit cost (calculated as a percentage of average AUM) for the quarter stood at 150 bps within the guided range of 140-150 bps. PBT grew by 40% y-o-y and 7% q-o-q, led by lower credit cost and strong operational performance. PAT reported at Rs. 2,973 crore was up by 40% y-o-y/7% q-o-q. AUM growth was at 27% y-o-y/6% q-o-q. AUM growth is moderating to 25-30% vs. earlier at 35-40% owing to a higher base and competitive intensity, which continues to remain elevated across the portfolio, which is leading to some market share loss in the near term. Growth moderation was seen in the B2B segment due to lower disbursements owing to muted festive demand and in the mortgages segment due to intense pricing pressure. Asset quality was remarkable, as GS3 ratio sequentially declined to 1.14% (vs. 1.17% in Q2FY2023) and the GS-2 ratio (including OTR) dipped to 1.2% (vs. 1.4% in Q2FY2023). PCR on GS3 assets was 64% vs. 62% in the past quarter. BAF continues to hold contingent provisions of Rs. 1,000 crore (40 bps of AUM).

Key positives

- Strong growth in customer acquisition and cross-sell franchise.
- Margins remained stable sequentially.
- Operating leverage has started to kick in.

Key negatives

- AUM growth moderated both on a y-o-y/q-o-q basis, mainly led by the B2B segment and mortgages.

Management Commentary

- The company articulated that its new customer additions are expected to be higher than 11 mn in FY2023 vs. earlier guided at 10-11 mn. The company guided that competitive intensity remained elevated across all products. It continues to protect its margin profile across businesses, while it is gradually passing on the impact of higher interest rates to customers across businesses. The company expects operating leverage to start reflecting as tech-led investments have peaked out.
- The company also discussed about its long-range strategy framework (an annual five-year rolling strategy planning process with an execution plan of 12-24 months) to catch the mega-industry trends and build strong building blocks for future sustainability and growth of the franchise.

Our Call

Valuation – We reiterate a Buy on Bajaj Finance with a revised PT of Rs. 7,500: Stock has witnessed significant correction from its high, and at CMP, the company trades at 6.5x/5.3x/ 4.3x its FY2023E/FY2024E BV. We believe the company is poised to deliver sector-leading ROA/ ROE of ~4.7%/ 22% over FY22-FY25E. Diverse product offerings through omni channel presence along with focus on new customer addition and ability to cross-sell different products is likely to support healthy AUM growth. Digital transformation, omnichannel strategy is likely to bode well for its growth objectives along with operational efficiencies going ahead and its full impact is yet to be visible. The company has exhibited its strong ability to navigate through economic down cycle, led by a prudent and agile management team and robust risk management framework. Stock offers reasonable risk reward for long term investors, we maintain our BUY recommendation on the stock with a revised target price of Rs7500.

Key Risks

Economic slowdown due to which slower AUM growth and higher-than-anticipated credit cost; Increased competitive intensity could lead to higher market share loss and further moderation in AUM growth.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
NII	17,522	22,847	28,155	33,697
PAT	7,028	11,377	13,514	15,855
EPS (Rs)	115.6	187.1	222.3	263.0
RoA (%)	3.7	4.8	4.7	4.7
RoE (%)	17.4	23.3	22.4	22.0
P/E (x)	49.8	30.8	25.9	21.9
P/BV (x)	8.0	6.5	5.3	4.3

Source: Company; Sharekhan estimates

Key result highlights

- **Strong NII growth in line with AUM growth:** NII grew robustly by 25% y-o-y and 7% q-o-q, driven by healthy AUM growth of 27% y-o-y/6% q-o-q. NIM (calculated as a percentage of average AUM) remained stable at 10.5% despite a 23-bps q-o-q increase in cost of funds. The company guided that the impact of the recent interest rate hikes on cost of funds will remain gradual due to strong ALM management. The company continues to protect its margin profile across businesses, while it is gradually passing on the impact of higher interest rates to customers across businesses.
- **Credit cost guidance maintained:** Credit cost reported for the quarter was 150 bps annualised. The company has guided for 140 -150 bps credit cost going forward. BAF continues to maintain contingent provisions of Rs. 1,000 crore (40 bps of AUM).
- **Pristine asset quality:** Asset quality was remarkable, as GS3 ratio sequentially declined to 1.14% (vs. 1.17% in Q2FY2023) and GS2 ratio (including OTR) dipped to 1.2% (vs. 1.4% in Q2FY2023). PCR on GS3 assets was 64% vs. 62% in the last quarter.
- **Diverse product offerings, new customer addition, new geographies, and ability to cross-sell to support AUM growth:** Customer franchise stood at 66 mn (up 19% y-o-y) and cross-sell franchise stood at 38.6 mn (up 23% y-o-y) in Q3FY2023. New loans booked were 7.8 mn, the highest-ever quarterly run rate. AUM grew by 27% y-o-y/6% q-o-q. AUM growth is moderating to 25-30% vs. earlier at 35-40%, owing to a higher base and competitive intensity, which continues to remain elevated across the portfolio, which is leading to some market share loss in the near term. Growth moderation was seen in the B2B segment due to lower disbursements owing to muted festive demand, and in the mortgages segment due to intense pricing pressure. The company articulated that its customer acquisitions run rate is likely to improve further from here on and, thus, AUM growth is expected to improve. The company articulated that its new customer additions are expected to be higher than 11 mn in FY2023 vs. earlier guided at 10-11 mn.
- **Strong growth in deposits:** Deposits rose by 41% y-o-y and contributed to 21% of consolidated borrowings. The company is on track to deliver its long-term goal of 25% of consolidated borrowings from deposits in the medium term.
- **Opex growth moderated:** Total operating expenses were up 24% y-o-y/3% q-o-q. Opex growth has started to moderate, which should aid operating leverage going forward, as the company guided that incremental tech-led investments have peaked out. Opex to NII ratio stood at 34.7% in Q3FY2023 vs. 35.9% in the last quarter. The company expects to sustain operating efficiencies.
- **Long-range strategy:** The company discussed about their long-range strategy framework (an annual five-year rolling strategy planning process with an execution plan of 12-24 months) to catch the mega-industry trends and build strong building blocks for future sustainability and growth of the franchise. It has launched the LAP business in BFL for MSME customers from January 2023, which was earlier done in BHFL. It is expected to launch new auto loans in Q2FY2024, micro finance loans in Q4FY2024, tractor financing in Q1FY2025, and emerging corporate business in Q3FY2024. Moreover, it is launching B2B on QR and EDC in Q4FY2024, Flexi on QR in Q4FY2024, and Insta PL card in Q4FY2024. It intends to open 100 locations in UP, Bihar, and Northeast in FY2024 and another 100 locations in FY2025. It would continue to invest in horizontal capabilities for operational excellence and deliver robust controls and compliance.
- **Others:** The company has guided that dependence on the B2B sales finance segment for customer acquisition will reduce if it is able to execute its digital transformation programme.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	Y-o-Y %	Q-o-Q %
Net Interest Income	**5,922**	**4,728**	**5,538**	**25%**	**7%**
Fee & Other Income	1,513	1,273	1,464	19%	3%
Total Income	**7,435**	**6,001**	**7,001**	**24%**	**6%**
Operating Expenses	2,582	2,081	2,525	24%	3%
Pre-Provisioning Profit (PPoP)	**4,853**	**3,919**	**4,487**	**24%**	**8%**
Provisions	841	1,051	734	-20%	15%
PBT	**4,012**	**2,868**	**3752**	**40%**	**7%**
Tax	1,039	743	972	40%	7%
PAT	**2,973**	**2,125**	**2,781**	**40%**	**7%**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Structural drivers to support growth

We believe retail players have a large market to grow and recent credit growth of ~17 % y-o-y in the fortnight ending December 2022 indicates healthy credit offtake, especially in retail and consumer segments. High-frequency indicators are signifying a strong revival in economic activity, which is 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 SME 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 NBFCs and private banks can co-exist and grow for the foreseeable future as the market expands.

■ Company Outlook – On a strong footing

The company has been into business transformation developing omnichannel to serve customers. BAF has significantly strengthened its technology, digital platforms, and product strategy to improve customer experiences. We believe business transformation would enhance business sustainability, improve its scalability, and would give competitive advantage among peers. Once these business-transformation initiatives are fully implemented, this should lead to operating leverage to kick in, which would also provide cost efficiencies. Its full impact is yet to be visible. We are confident on strong earnings growth and longevity of the franchise.

■ Valuation – We reiterate a Buy on Bajaj Finance with a revised PT of Rs. 7,500

Stock has witnessed significant correction from its high, and at CMP, the company trades at 6.5x/5.3x/ 4.3x its FY2023E/FY2024E BV. We believe the company is poised to deliver sector-leading ROA/ ROE of ~4.7%/ 22% over FY22-FY25E. Diverse product offerings through omni channel presence along with focus on new customer addition and ability to cross-sell different products is likely to support healthy AUM growth. Digital transformation, omnichannel strategy is likely to bode well for its growth objectives along with operational efficiencies going ahead and its full impact is yet to be visible. The company has exhibited its strong ability to navigate through economic down cycle, led by a prudent and agile management team and robust risk management framework. Stock offers reasonable risk reward for long term investors, we maintain our BUY recommendation on the stock with a revised target price of Rs.7500.

Peer Comparison

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	5,756	3,48,486	30.8	25.9	6.5	5.3	4.8	4.7	23.3	22.4
Cholamandalam Investment and Finance Company	710	58,361	21.8	19.1	4.1	3.4	2.8	3.0	20.6	19.4

Source: Company, Sharekhan estimates

About company

BAF is one of India's largest and well-diversified NBFC. 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 1,392 urban locations and 2,322 rural locations, with over 143,900 distribution points. BAF continues to be the largest consumer durables lenders in India. As a business entity, BAF continues to deliver steady performance and superior asset-quality performance.

Investment theme

BAF enjoys a dominant position in the Indian consumer finance space. BAF's dominance in the market is seen in its consistent growth and steady operational performance has been maintained by the company across cycles. Superior asset quality is indicative of the company's high focus on risk management and robust credit underwriting capability and collections. The company's business model continues to generate healthy pre-impairment operating profit, enabling it to withstand higher credit costs in times of stress.

Key Risks

Economic slowdown due to which slower AUM growth and higher-than-anticipated credit cost; Increased competitive intensity could lead to higher market share loss and further moderation in AUM growth.

Additional Data

Key management personnel

Mr. Sanjiv Bajaj	Chairman
Mr. Rajeev Jain	Managing Director
Mr. Sandeep Jain	Chief Financial Officer
Mr. Atul Jain	Chief Executive Officer (BHFL)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BAJAJ FINSERV LTD.	52.49
2	REPUBLIC OF SINGAPORE	3.42
3	MAHARASHTRA SCOOTERS LTD.	3.13
4	AXIS ASSET MANAGEMENT CO. LTD.	2.62
5	SBI FUNDS MANAGEMENT LTD.	2.44
6	BLACKROCK INC.	1.39
7	VANGUARD GROUP INC.	1.31
8	CAPITAL GROUP COS INC.	1.23
9	UTI ASSET MANAGEMENT CO. LTD.	0.99
10	FMR LLC	0.71

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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