Poonawalla Fincorp

NBFCs

Steady quarter; aspires for 5–6x AUM over next 5–6 years

Poonawalla Fincorp's (Poonawalla) new MD & CEO – Arvind Kapil – revealed that its guiding philosophy across businesses would be productivity, predictability and sustainability. This would be achieved via higher investments initially in collection infra, tech and launch of new products. These investments would be made with a long-term horizon and an aspiration of scaling AUM by 5–6x over the next 5–6 years. We believe RoA shall remain in the range of 3.5% - 4% over the next two years due to higher investments in the initial phase and normalisation of credit cost. We resume coverage with **HOLD** rating and a TP of INR 390, valuing the stock at 3.0x FY26E P/B (vs. 5-year average of ~2.2x). A favourable blend of high growth aspiration and the current MD's track record at HDFC Bank justifies the premium multiple, in our view, which, in turn, instils confidence on execution and Poonawalla's ability to deliver steady/sustainable return ratios.

New MD&CEO – Abhay Bhutada passes baton to Arvind Kapil

Arvind Kapil has joined Poonawalla as its new MD&CEO, effective 10 Jun'24 for a period of five years, succeeding Abhay Bhutada. Previously, Mr Kapil has served as HDFC Bank's Group Head, overseeing the mortgage banking business with a book size of ~INR 7.5trn and has also led the bank's retail lending franchise. With >25 years under his belt at HDFC Bank, he has several feathers in his cap, including developing a plethora of digital solutions for the bank's retail lending products.

Poonawalla believes that getting across new businesses and expanding existing ones for the next phase of growth will need significant investments. Hence, the company aims to solidify its business by investing in back-end and front-end operations in the areas such as collections, technology, businesses, and manpower over the next 4–6 quarters. Poonawalla is building a long-term franchise, which has manifested in a rejig in senior management. The exercise seeks to instate a seasoned management team that has extensive experience and comes with a proven track record of scaling up business. In senior management, it has appointed accomplished professionals for Chief Compliance Officer, Chief Internal Auditor and Chief Risk Officer. The company has also approved the early retirement of Head Retail Assets and Head HR.

Along with solidification, further action shall entail expanding new product lines and the phygital model by engaging with new customers across touchpoints. With building a solid base, the company would subsequently sharpen its focus on the customer acquisition funnel and pushing the pedal on cross-selling to customer cohorts at lower acquisition costs. On balance, market share gains being the desired outcome.

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Interest Income (NII)	12,199	19,493	26,240	33,217
PAT (INR mn)	5,624	8,350	10,379	13,532
EPS (INR)	7.3	10.8	13.5	17.6
% Chg YoY	91	48	24	30
P/E (x)	55	37	30	23
P/BV (x)	4.8	3.8	3.5	3.1
Gross Stage - 3 (%)	1.4	1.2	1.0	0.9
Dividend Yield (%)	0.5	0.5	0.7	1.0
RoA (%)	3.6	4.0	3.7	3.6
RoE (%)	9.3	11.4	12.1	14.2

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Market Data

Market Cap (INR)	313bn
Market Cap (USD)	3,743mn
Bloomberg Code	POONAWAL IN
Reuters Code	POON BO
52-week Range (INR)	520 /336
Free Float (%)	37.0
ADTV-3M (mn) (USD)	14.4

Price Performance (%)	3m	6m	12m
Absolute	(18.2)	(17.6)	7.7
Relative to Sensex	(27.5)	(30.3)	(13.0)

Overall, the company's aim is to grow its AUM by 5–6x over the next 5–6 years with a clear focus on scaling retail lending via its mantra of solidify, expand and scale. In terms of guidance, it aims to see around 30–35% AUM growth in the first year, wherein the next two quarters could mark some AUM optimisation. Thereafter, with bulk of the heavy lifting on the opex front, it is aiming to grow AUM at 35–40% CAGR over the next couple of years.

Q1FY25 results: Steady quarter – robust AUM growth; improving asset quality

Poonawalla reported PAT of INR 2.92bn, up 46% YoY but down 12% QoQ due to a one-time tax benefit of INR 0.4bn in Q4FY24. This translated into RoA of 4.62% and AUM growth has been healthy at INR 269.7bn, up 52% YoY/8% QoQ. Moreover, AUM has grown at 46% CAGR over the past two years. Asset quality has also been improving with sustained decline in gross as well we net Stage-3 since the past 4–5 quarters. Poonawalla continues to see steady growth in AUM and profitability coupled with superior asset quality metrics. Arvind Kapil has taken over the reigns as MD&CEO during the quarter.

Well-diversified AUM; limited uptick in margins hereon

Poonawalla has more than doubled its AUM over the past two years with improving metrics on asset quality as well as margins, which has boded well for the company's profitability. It has a well-diversified portfolio with a balance of secured and unsecured mix at 49:51. As of Q1FY25-end, 35% of its portfolio is towards MSME, followed by 28% towards personal and consumer loans, 17% towards LAP, 14% towards pre-owned cars and 6% towards other loans.

Going ahead, new management has guided that it will look to optimise AUM growth over the next two quarters. It aims to grow AUM at 30–35% for the first year and thereafter at a consistent CAGR of 35–40%. We are building in AUM growth of 30%/ 36% for FY25E/FY26E.

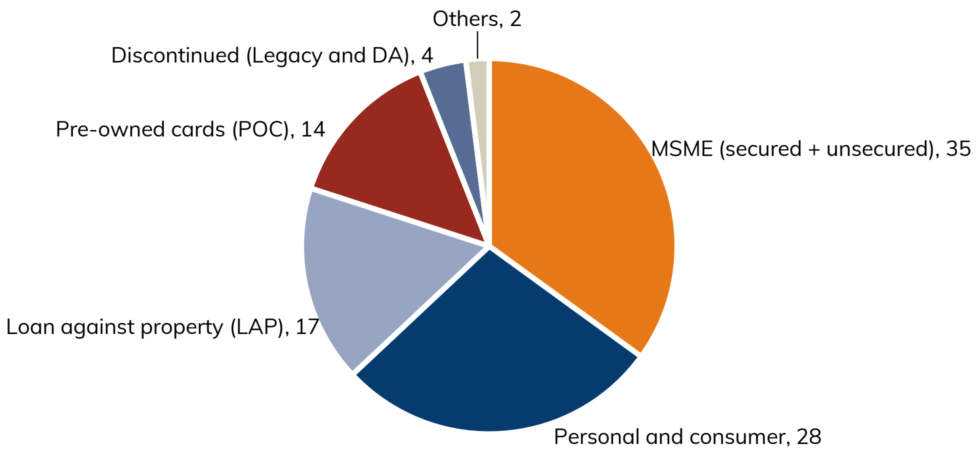
With expectations of rapid expansion in AUM, we believe yields are unlikely to inch-up further. Moreover, as leverage builds up and with the steep rise in loan book and caution on short term personal loans (STPL), we believe margins could contract by 40–50bps in the next two years.

Gross Stage-3 below 1%; Net Stage-3 below 0.5%

Poonawalla has consistently improved its asset quality from >3% Gross Stage-3 in FY22-end to 0.67%, as of Q1FY25-end. Similarly, net stage-3 has also fallen to 0.32% vs. >1%, as of FY22-end. However, the company has alluded that STPL is an unseasoned book and would be monitored closely going ahead. We believe that with ~50% of unsecured book, there could be normalisation in credit cost post sub-50bps credit cost in FY24 and a provision write-back in FY23. We are building in credit cost of 1.7%/1.9% for FY25E/FY26E.

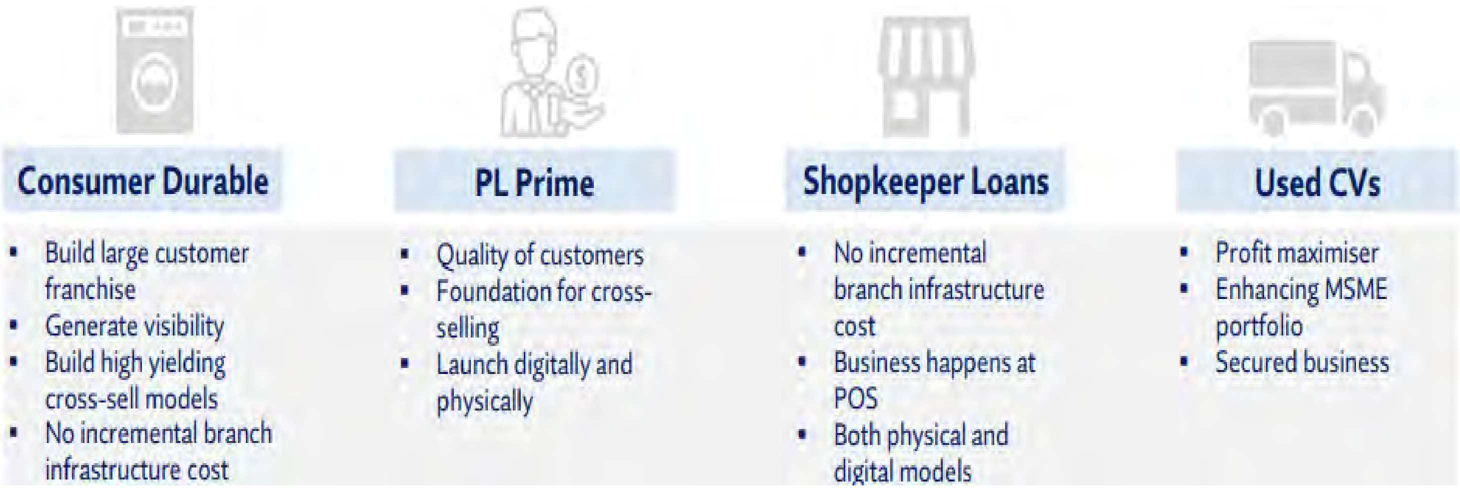
Key risks: No significant rise in credit cost; Elongated investment phase eating into growth phase.

Exhibit 1: Well-diversified AUM; equal share of secured and unsecured



Source: Company data, I-Sec research

Exhibit 2: Planned launches in FY25

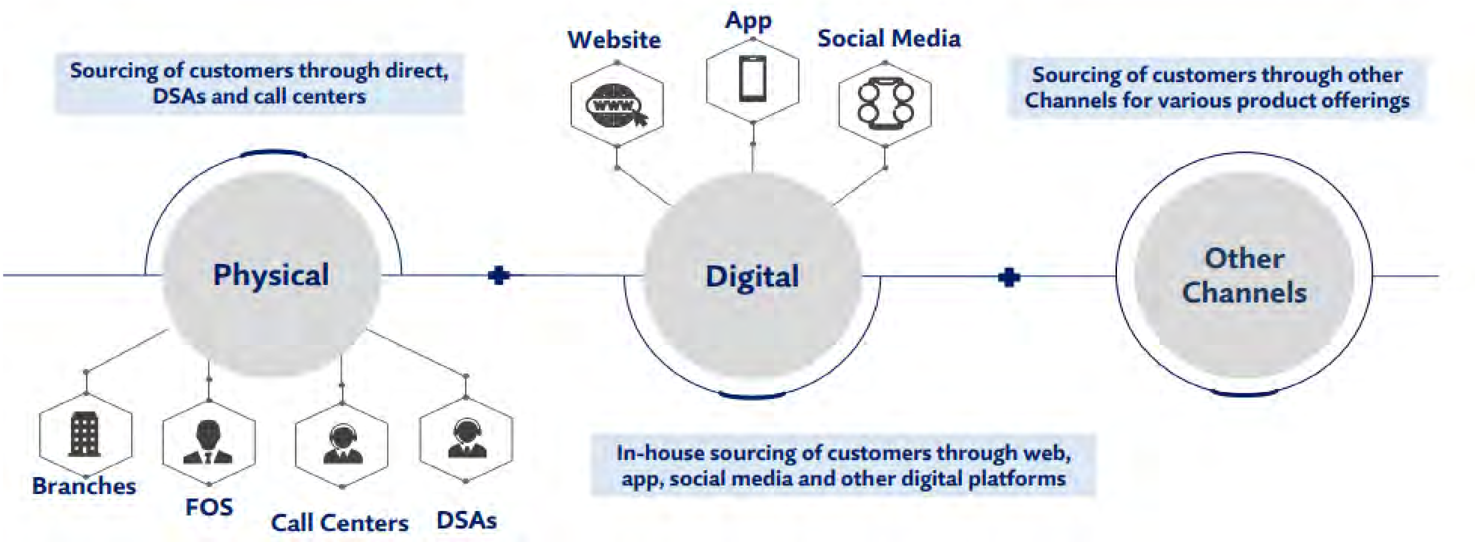


Source: Company data, I-Sec research

Exhibit 3: Overview of its product offerings

Source: Company data, I-Sec research

Exhibit 4: Phygital sourcing model



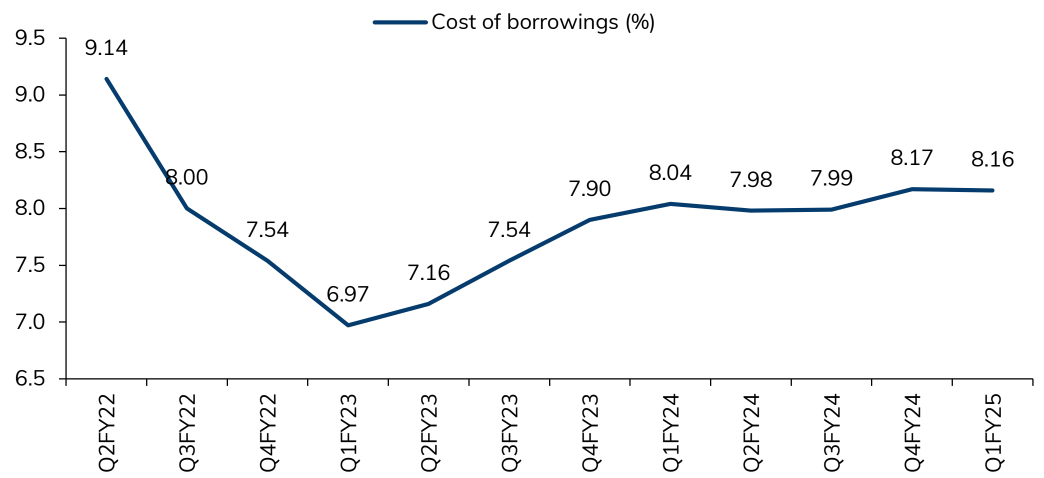
Source: Company data, I-Sec research

Exhibit 5: Improvement in asset quality over the quarters

Stage-wise assets (INR mn)	Q1FY24	Q2FY24	Q3FY24	Q4FY24	Q1FY25
Stage 1	1,64,210	1,86,570	1,97,060	2,22,040	2,39,030
Stage 2	6,620	6,040	7,450	6,150	7,130
Stage 3	2,450	2,660	2,750	2,680	1,660
Total	**1,73,280**	**1,95,270**	**2,07,260**	**2,30,870**	**2,47,820**
PCR (%)	**Q1FY24**	**Q2FY24**	**Q3FY24**	**Q4FY24**	**Q1FY25**
Stage 1	0.5%	6.7%	5.0%	3.4%	2.0%
Stage 2	6.4%	23.6%	18.9%	19.3%	14.4%
Stage 1 and 2	0.7%	7.2%	5.5%	3.9%	2.3%
Stage 3	46.4%	47.2%	47.3%	49.4%	52.5%
Gross Stage 3 (%)	1.42%	1.36%	1.33%	1.16%	0.67%
Net Stage 3 (%)	0.76%	0.72%	0.70%	0.59%	0.32%

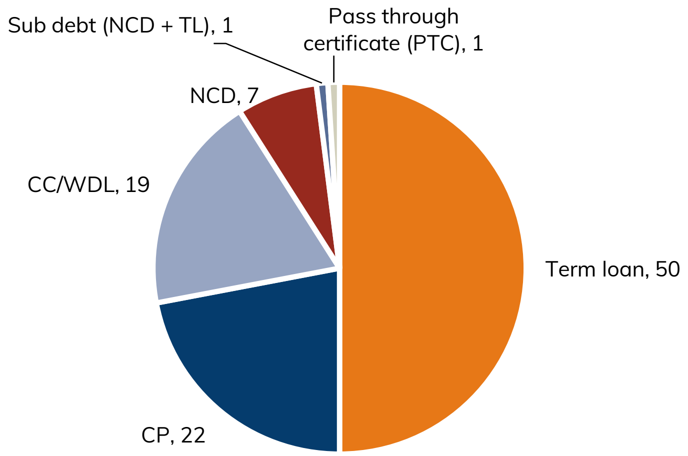
Source: Company data, I-Sec research

Exhibit 6: Cost of borrowings stabilising around current levels



Source: Company data, I-Sec research

Exhibit 7: Well-diversified borrowing base



Source: Company data, I-Sec research

Exhibit 8: New MD&CEO – Arvind Kapil (ex-HDFC Bank); responsible for steering Poonawalla into next growth phase

Source: Company data, I-Sec research

Q1FY25 earnings conference call takeaways

Outlook

- ***New MD&CEO will set up the foundation in the next 1–1.5 years for predictable and sustainable future growth.*** It should be far easier to build building blocks thereafter.
- ***Plan is to build a business model that is predictable, sustainable and productive***
- ***Guidance is 30–35% AUM growth in the first year (over the first two quarters, it will look to optimise). 35–40% AUM growth over the next five years thereafter, by building retail business.***
- ***Aspire to scale AUM by 5–6x in the next five years.***
- ***Poonawalla's market share should continue growing on a YoY-basis over the next 5–10 years.***
- *It aims to become the customer's preferred choice.*
- ***Digital capabilities, management depth, agile technology and AI are its key strengths.***
- Believes that this is a good time to walk digitally and physically for prime salaried customers at top 100 corporates in the country where Poonawalla is currently broadly not present.

Management

- ***Arvind Kapil comes with ~25 years of experience with HDFC Bank where he was heading retail assets worth INR 7.5trn.***
- ***Poonawalla is building a long-term franchise, and hence, has rejigged its senior management team with the aim of having seasoned management that has extensive experience and comes with a background of scaling business.***
- Recently appointed seasoned professionals for Head of Compliance, Head of Internal Audit and Chief Internal Audit Officer.

Asset quality

- ***Poonawalla plans to invest in building a robust collection framework.***
- ***The company is looking to make investments in collections, since it is looking at building a 5–10 years franchise.***
- As per management, ~3–4% improvement in resolution rates eventually makes 15–20% difference in accumulated losses.

Future investments

- ***Getting across new business and expanding existing ones will need significant investments.***
- ***Investments in Artificial Intelligence (AI) will aid:***
  - Personalised targeting for credit
  - Building a robust data pipeline that is near-real-time

AUM and Disbursements

- AUM up 52% YoY/8% QoQ for Q1.
- Continue to maintain a balance of secured and unsecured mix.
- ***DA book of INR 7.7bn.***

- ***Legacy book outstanding of INR 3.15bn as of Q1.***
- ***The company is keen on shopkeeper loans and used commercial vehicles. They will start incubating it and gradually work on the building blocks before a full-fledged launch.***
- *Shopkeeper loans are a very high margin business and target market is the entire country. New MD&CEO has already done this business in the past at HDFC Bank.*

Margins

- NII at INR 6.8bn, up 42% YoY/5% QoQ.
- Cost of borrowings is expected to be in a similar range for future quarters.
- Cost of borrowings remained flat at 8.16%. ***But D/E at 2.1x QoQ vs. 1.9x which resulted in a rise in interest expenses.***
- Despite the high interest rate scenario, cost of borrowings was flat due to dynamic treasury management with one eye on cost of borrowings and another on liquidity.
- ***INR 52bn surplus liquidity, as of Q1FY24-end.***
- ***INR 171.21bn borrowings, of which 70% is variable and the remaining 30% is fixed that are of short tenure and largely pertaining to capital markets.***

Miscellaneous

- PAT, at INR 2.9bn, is up 46% YoY/down 12% QoQ. One-time tax benefit recorded in Q4.
- CRAR, at ~35%, is well-above regulatory requirements.
- ***There was a complete UI, UX revamp of web and mobile app during Q1FY25.***
- NPS, a leading indicator of customer brand royalty is at an all-time high of 72%.
- Certified as great place to work in the NBFC sector in 2024.

Economy

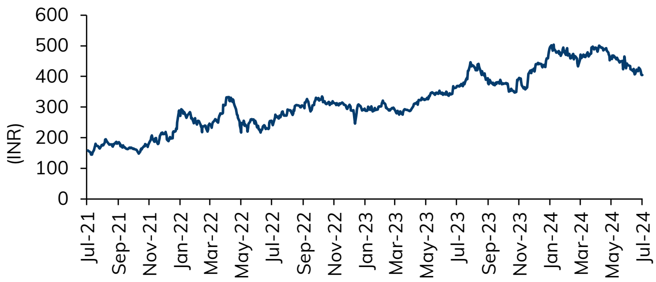
- India recorded its highest-ever GST collections.
- UPI transactions are showing strong traction.
- India will continue to outperform global economy at large driven by growth and consumption expenditure and increasing multiplier benefits; all these indicators are positive for retail lending.
- ***Sees high co-relation between GDP growth and retail lending.***
- ***Despite high growth for retail lending over the past decade, the company sees strong growth for the retail lending industry as a whole.***

Exhibit 9: Shareholding pattern

%	Dec'23	Mar'24	Jun'24
Promoters	62.1	62.1	62.1
Institutional investors	13.3	14.3	15.3
MFs and others	4.9	4.5	4.4
FIs/Banks	0.1	0.6	0.7
Insurance	0.5	1.3	2.3
FIIs	7.8	7.9	7.9
Others	24.6	23.6	22.6

Source: Bloomberg

Exhibit 10: Price chart



Source: Bloomberg

Financial Summary

Exhibit 11: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Interest Income	18,152	28,996	39,933	53,648
Interest Expenses	5,953	9,503	13,693	20,431
Net Interest Income (NII)	**12,199**	**19,493**	**26,240**	**33,217**
Other Income	1,931	2,478	2,935	3,541
Total Income (net of interest expenses)	**14,130**	**21,970**	**29,175**	**36,758**
Employee benefit expenses	5,148	4,444	5,555	6,389
Depreciation and amortization	614	593	652	718
Other operating expenses	2,377	3,036	4,554	5,238
Total Operating Expense	**8,139**	**8,074**	**10,762**	**12,344**
Pre Provisioning Profits (PPoP)	**5,991**	**13,897**	**18,413**	**24,414**
Provisions and write offs	-1,445	720	4,575	6,726
Profit before tax (PBT)	**7,436**	**13,177**	**13,838**	**17,688**
Total tax expenses	1,812	4,827	3,460	4,157
Profit after tax (PAT)	**5,624**	**8,350**	**10,379**	**13,532**

Source Company data, I-Sec research

Note: FY24 PAT is pre-exceptional and from continuing operations

Exhibit 12: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Share capital	1,536	1,541	1,541	1,541
Reserves & surplus	62,711	80,130	88,197	98,646
Shareholders' funds	**64,247**	**81,671**	**89,738**	**100,187**
Borrowings	112,092	152,157	218,302	319,897
Provisions & Other Liabilities	3,880	7,041	11,970	17,955
Total Liabilities and Stakeholder's Equity	**180,218**	**240,869**	**320,009**	**438,039**
Cash and balance with RBI	6,574	2,685	4,199	4,751
Fixed assets	2,117	1,944	2,138	2,309
Loans	**152,295**	**220,464**	**296,230**	**411,653**
Investments	3,109	8,783	10,101	11,616
Other Assets	16,123	6,992	7,342	7,709
Total Assets	**180,218**	**240,869**	**320,009**	**438,039**

Source Company data, I-Sec research

Exhibit 13: Key Ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
AUM and Disbursements (Rs mn)				
AUM	161,430	250,030	325,824	444,301
On-book Loans	152,295	220,464	296,230	411,653
Off-book Loans	9,136	29,566	29,594	32,648
Disbursements	157,510	332,890	432,332	583,096
Repayments	113,730	244,290	356,538	464,619
Growth (%):				
Total AUM (%)	37	55	30	36
Disbursements (%)	109	111	30	35
Repayments (%)	89	115	46	30
Loan book (on balance sheet) (%)	43	45	34	39
Total Assets (%)	41	34	33	37
Net Interest Income (NII) (%)	29	60	35	27
Non-interest income (%)	78	28	18	21
Total Income (net of interest expenses) (%)	34	55	33	26
Operating Expenses (%)	35	-1	33	15
Employee Cost (%)	26	-14	25	15
Non-Employee Cost (%)	54	21	43	14
Pre provisioning operating profits (PPoP) (%)	32	132	33	33
Provisions (%)	-311	-150	535	47
PBT (%)	93	77	5	28
PAT (%)	92	48	24	30
EPS (%)	91	48	24	30
Yields, interest costs and spreads (%)				
NIM on on-book loans (%)	7.9	9.3	9.4	8.8
NIM on IEA (%)	8.6	9.9	9.7	9.0
NIM on AUM (%)	8.7	9.5	9.1	8.6
Yield on on-book loans (%)	14.0	15.6	15.5	15.2
Yield on IEA (%)	12.9	14.7	14.7	14.5
Yield on AUM (%)	13.0	14.1	13.9	13.9
Cost of borrowings (%)	6.6	7.2	7.4	7.6
Interest Spreads (%)	7.4	8.4	8.1	7.6
Operating efficiencies				
Non interest income as % of total income	13.7	11.3	10.1	9.6
Cost to income ratio	57.6	36.7	36.9	33.6
Op.costs/avg assets (%)	5.3	3.8	3.8	3.3
Op.costs/avg AUM (%)	5.8	3.9	3.7	3.2
No of branches (x)	85	102	127	152
Salaries as % of non-interest costs (%)	63	55	52	52
AUM/ branch (Rs mn)	1,899	2,451	2,566	2,923
Capital Structure				
Average gearing ratio (x)	1.5	1.8	2.2	2.8
Leverage (x)	2.5	2.9	3.3	4.0
CAR (%)	38.9	33.9	30.3	26.5
Tier 1 CAR (%)	37.7	32.4	28.7	24.9
Tier 2 CAR (%)	1.2	1.5	1.6	1.6

Source Company data, I-Sec research

	FY23A	FY24A	FY25E	FY26E
Asset quality and provisioning				
GNPA (%)	1.4	1.2	1.0	0.9
NNPA (%)	0.8	0.6	0.5	0.4
GNPA (Rs mn)	2,250	2,680	3,137	3,935
NNPA (Rs mn)	1,210	1,360	1,498	1,761
Coverage ratio (%)	46.2	49.3	52.3	55.3
Credit Costs as a % of avg AUM (bps)	-112	39	177	190
Credit Costs as a % of avg on book loans (bps)	-104	35	159	175
Return ratios				
RoAA (%)	3.6	4.0	3.7	3.6
RoAE (%)	9.3	11.4	12.1	14.2
ROAAUM (%)	4.0	4.1	3.6	3.5
Valuation Ratios	768	771	771	771
No of shares	768	771	771	771
ESOP Outstanding	7.3	10.8	13.5	17.6
EPS (Rs)	7.3	10.8	13.5	17.6
EPS fully diluted (Rs)	55	37	30	23
Price to Earnings (x)	55	37	30	23
Price to Earnings (fully diluted) (x)	84	106	116	130
Adjusted book value	4.8	3.8	3.5	3.1

Source Company data, I-Sec research

Exhibit 14: Key Metrics

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
DuPont Analysis				
Average Assets (Rs mn)	154,157	210,544	280,439	379,024
Average Loans (Rs mn)	129,539	186,379	258,347	353,942
Average Equity (Rs mn)	60,696	72,959	85,704	94,963
Interest earned (%)	11.8	13.8	14.2	14.2
Interest expended (%)	3.9	4.5	4.9	5.4
Gross Interest Spread (%)	**7.9**	**9.3**	**9.4**	**8.8**
Credit cost (%)	-0.9	0.3	1.6	1.8
Net Interest Spread (%)	**8.9**	**8.9**	**7.7**	**7.0**
Operating cost (%)	5.3	3.8	3.8	3.3
Lending spread (%)	**3.6**	**5.1**	**3.9**	**3.7**
Non interest income (%)	1.3	1.2	1.0	0.9
Operating Spread (%)	**4.8**	**6.3**	**4.9**	**4.7**
Tax rate (%)	1.2	2.3	1.2	1.1
ROAA (%)	**3.6**	**4.0**	**3.7**	**3.6**
Effective leverage (AA/ AE)	2.5	2.9	3.3	4.0
RoAE (%)	**9.3**	**11.4**	**12.1**	**14.2**

Source Company data, I-Sec research

Note: FY24 PAT is pre-exceptional and from continuing operations

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