

BUY

TP: Rs 5,200 | ▲ 18%

BAJAJ FINANCE

| NBFC

| 30 January 2020

Healthy performance in secular slowdown

Bajaj Finance (BAF) reported healthy 35% YoY growth in AUM in Q3FY20. With opex (+37% YoY) growing slower than NII (+42% YoY), operating profit grew 44% YoY to Rs 30bn. We note an uptick in provisions to Rs 8.3bn (vs. Rs 6bn in Q2FY20) and remain cautious with a credit cost forecast of ~210bps in FY20. PAT grew 52% YoY to Rs 16.1bn as a lower tax rate offset higher provisions. We think BAF is well capitalised to weather the secular slowdown. We revise our Mar'21 TP to Rs 5,200 (vs. Rs 5,000).

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Healthy loan growth despite secular slowdown: AUM grew 35% YoY to Rs 1.45tn largely driven by mortgages (+44% YoY) and consumer finance (+34% YoY). Loan volumes also increased due to geographic expansion (+443 branches YoY) and growth in customer franchise to 40mn (+24% YoY). Management expects to increase the customer base by 7-8mn every year.

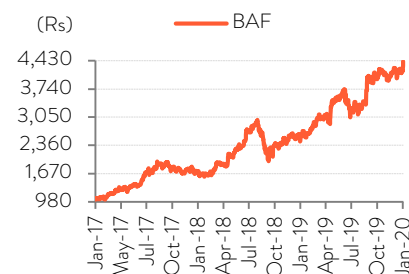
Strong operating profit growth: NII grew 42% YoY to Rs 45.4bn driven by growth in AUM and the recent capital raise of Rs 85bn. Spreads on loans (calc.) were largely stable at 9.4%. Opex grew slower than NII at 37% YoY, resulting in 44% YoY growth in operating profit to Rs 30bn.

Well capitalised to absorb asset quality concerns: BAF reported provisions of Rs 8.3bn, of which Rs 850mn was for Karvy exposure. The sharp increase in provisions was largely offset by a lower tax rate, aiding 52% YoY growth in net profit to Rs 16.1bn. Management has indicated some chunky resolutions in the near term. With the recent capital raise, the company remains well capitalised (23.2% tier-1 ratio) to absorb asset quality concerns. (see our Jan'20 initiation report for details: [BAF 2.0 – Revamped growth engine; initiate with BUY](#)).

Ticker/Price	BAF IN/Rs 4,419
Market cap	US\$ 37.3bn
Shares o/s	602mn
3M ADV	US\$ 75.8mn
52wk high/low	Rs 4,444/Rs 3,950
Promoter/FPI/DII	56%/22%/10%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	69,716	97,252	135,172	171,485	213,464
NII growth (%)	42.2	39.5	39.0	26.9	24.5
Adj. net profit (Rs mn)	24,964	39,950	60,969	81,853	101,928
EPS (Rs)	43.4	69.3	101.3	136.0	169.4
P/E (x)	101.8	63.8	43.6	32.5	26.1
P/BV (x)	16.0	12.9	7.9	6.5	5.3
ROA (%)	3.4	3.8	4.1	4.3	4.3
ROE (%)	20.1	22.5	22.9	22.0	22.5

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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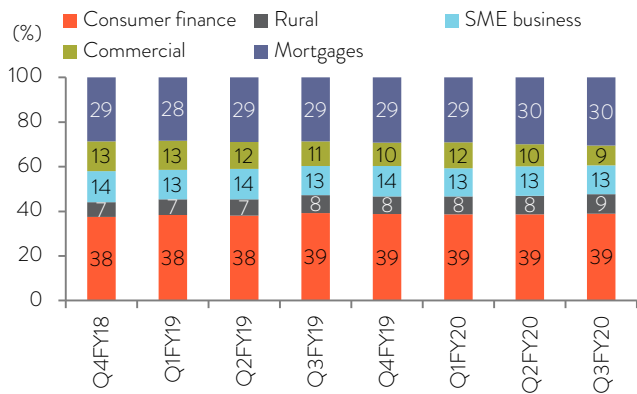


FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Interest Income	70,111	49,854	41	63,215	11	191,338	131,830	45
Interest expenses	24,890	17,857	39	23,234	7	69,258	47,102	47
Other Operating Income	149	67	123	11	1,253	230	202	14
Net Interest Income	45,369	32,064	41	39,991	13	122,310	84,929	44
Operating Expenses	15,361	11,199	37	13,825	11	42,113	30,333	39
Operating Profit	30,008	20,864	44	26,167	15	80,196	54,596	47
Provisions and Cont.	8,308	4,508	84	5,942	40	19,757	10,921	81
Profit before Tax	21,701	16,357	33	20,224	7	60,439	43,675	38
Tax Provisions	5,560	5,761	(3)	5,161	8	17,283	15,486	12
Net Profit	16,141	10,596	52	15,063	7	43,157	28,189	53

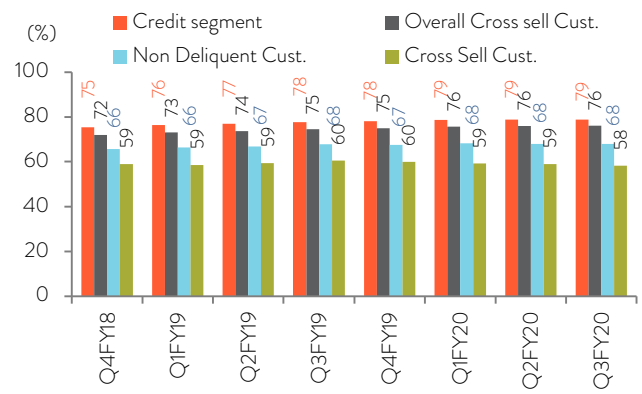
Source: Company, BOBCAPS Research

FIG 2 – STEADY GROWTH ACROSS BUSINESSES



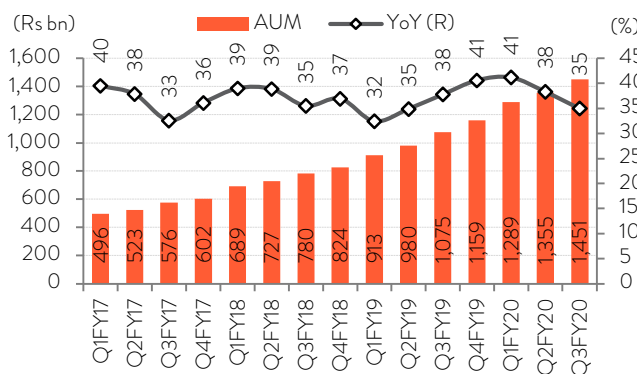
Source: Company, BOBCAPS Research

FIG 3 – CROSS-SELL FRANCHISE IS RANGE-BOUND AT ~60% OF TOTAL FRANCHISE



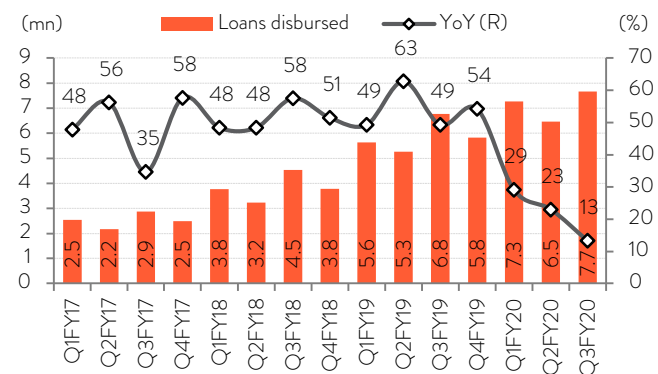
Source: Company, BOBCAPS Research

FIG 4 – AUM GROWTH STEADY



Source: Company, BOBCAPS Research

FIG 5 – LOAN DISBURSAL VOLUMES HAVE SLOWED



Source: Company, BOBCAPS Research

FIG 6 – DETAILED QUARTERLY COMPARISON

Particulars	FY18			FY19				FY20			Variation (%)	
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	QoQ	YoY
Profit and Loss (Rs mn)												
Total Income	30,507	33,714	34,877	39,362	42,614	49,854	53,077	58,013	63,215	70,111	11	41
Interest Expenses	11,414	11,788	12,273	13,591	15,654	17,857	19,132	21,134	23,234	24,890	7	39
Net Income	19,093	21,927	22,604	25,772	26,959	31,997	33,945	36,879	39,980	45,220	13	41
Other Income	153	27	39	15	119	67	8	70	11	149	1,253	123
Operating Expenses	7,812	8,534	8,929	9,546	9,588	11,199	11,744	12,928	13,825	15,361	11	37
Employee	3,483	3,878	3,903	4,438	4,554	50,990	5,318	5,829	6,283	7,221	15	(86)
Others	4,329	4,656	5,026	5,108	5,034	(39,791)	6,426	7,099	7,542	8,140	8	(120)
Operating Profits	11,434	13,420	13,714	16,241	17,491	20,864	22,209	24,022	26,167	30,008	15	44
Provisions	2,205	2,782	2,272	3,268	3,146	4,508	4,093	5,507	5,942	8,308	40	84
PBT	9,229	10,638	11,442	12,973	14,345	16,357	18,116	18,514	20,224	21,701	7	33
Taxes	3,250	3,737	3,966	4,615	5,110	5,761	6,356	6,562	5,161	5,560	8	(3)
Reported PAT	5,979	6,900	7,476	8,359	9,235	10,596	11,761	11,953	15,063	16,141	7	52
Asset Quality												
GNPA (Rs mn)	11,527	12,478	11,707	12,497	14,077	16,140	17,327	20,018	21,057	22,469	7	39
NNPA (Rs mn)	3,499	3,960	3,006	3,326	5,007	6,456	7,088	8,007	8,501	9,769	15	51
GNPA (%)	1.7	1.7	1.5	1.4	1.5	1.6	1.5	1.6	1.6	1.6	0	8
NNPA (%)	0.5	0.5	0.4	0.4	0.5	0.6	0.6	0.6	0.7	0.7	8	13
PCR (%)	69.6	68.3	74.3	73.4	64.4	60.0	59.1	60.0	60.0	57.0	(5)	(5)
Ratios (%)											(bps)	(bps)
Cost to Income	40.6	38.9	39.4	37.0	35.4	34.9	34.6	35.0	34.6	33.9	(2)	(3)
Tax Rate	35.2	35.1	34.7	35.6	35.6	35.2	35.1	35.4	25.5	25.6	0	(27)
CAR	25.4	24.8	24.7	23.0	22.1	21.4	20.7	19.5	19.7	26.9	37	26
Tier I	19.9	19.6	19.7	17.9	17.2	16.8	16.3	15.5	15.9	23.2	46	38
RoA (not annualised)	0.8	1.1	1.0	1.2	1.0	1.0	1.1	1.0	1.2	1.2	0	20
RoE (not annualised)	4.4	4.7	4.8	6.0	5.4	5.9	6.2	5.9	7.0	5.9	(16)	0
AUM Profile (Rs bn)												
AUM	727	780	824	913	980	1,075	1,159	1,289	1,355	1,451	7	35
On book Loans	686	747	791	899	945	1,041	1,125	1,251	1,308	1,396	7	34
Off book Loans	41	33	33	14	35	34	34	38	47	55	17	64
AUM Mix (%)											(bps)	(bps)
Consumer Finance	38	39	38	38	38	39	39	39	39	39	0	(1)
SME Business	14	13	14	13	14	13	14	13	13	13	(2)	(2)
Commercial	12	12	13	13	12	11	10	12	10	9	(9)	(19)
Rural	6	7	7	7	7	8	8	8	8	9	6	10
Mortgages	30	29	29	28	29	29	29	29	30	30	2	7

Source: Company, BOBCAPS Research

Earnings call highlights

Business update

- Search trends on large keyword portfolios across loan and consumption categories (electronics, mobile, furniture, apparel) reflected a significant demand slowdown in Q3FY20. However, BAF has seen some uptick in consumption categories since December, which has continued into January. Republic Day sale momentum was strong, per management, but data needs to be watched for a longer period to have a definitive view on demand.
- BAF's portfolio granularity strategy continued in Q3 across products/locations.
- The company has been winding down broker relationships, so the loans against securities (LAS) book has come off.
- BAF moves 30% of electronics retailer Vijay Sales volumes. The sales B2B business is steady as the share of manufacturer subvention has been stable in the last three years and penetration rates are stable across ~2,000 locations.
- Average yields for the auto business are 23-24%.
- The company plans to add 7-8mn customers per annum overall and 3-4mn to the cross-sell franchise. There is a wider pool of 60-70mn customers to whom BAF can offer credit products.
- Management expects to open 200 new geographic locations in FY21.

Asset quality

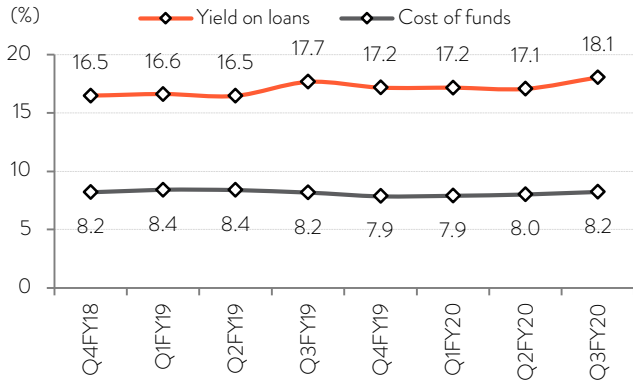
- The company has taken corrective measures in the auto finance business and expects asset quality to improve in 2-3 quarters. Loss given default (LGD) is at 45-50%, so provision coverage remains volatile at 55-63%.
- Self-employed customers continue to show stretched asset quality on all asset classes. Salaried customers fare better on delinquencies.
- Personal loan cross-sell comprises 36-month loans and takes 9-12 months for provisions to hit the P&L.
- BAF has a Rs 600mn provision for IL&FS exposure (Rs 300mn in escrow).
- Credit cost has peaked excluding one-offs.

Liquidity

- Due to the large capital raise, the company saw its CP borrowing go down dramatically from 8% to 2% sequentially. The CP book is down to Rs 20bn.

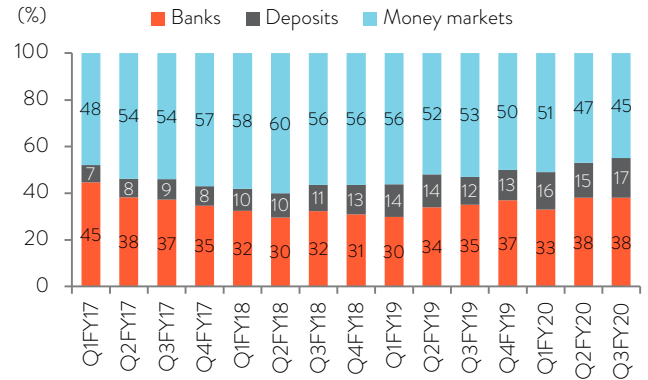
Story in charts

FIG 7 – SPREADS IMPROVED DUE TO CAPITAL RAISE



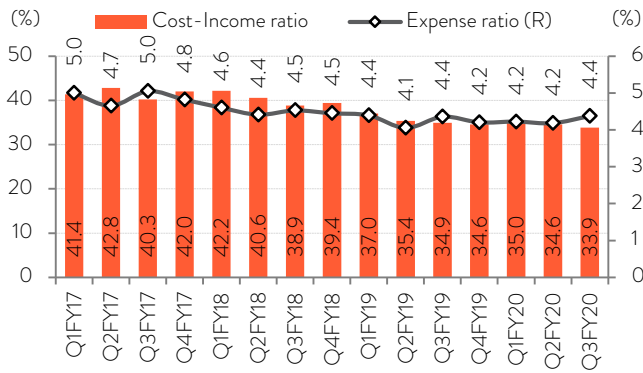
Source: Company, BOBCAPS Research

FIG 8 – DEPOSITS INCREASING IN BORROWING MIX



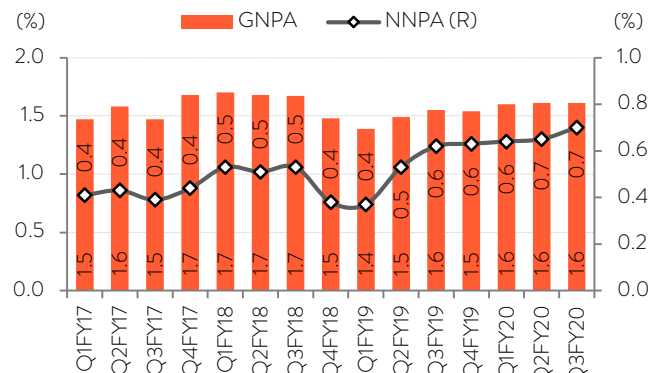
Source: Company, BOBCAPS Research

FIG 9 – COST TO INCOME & EXPENSE RATIOS STABLE



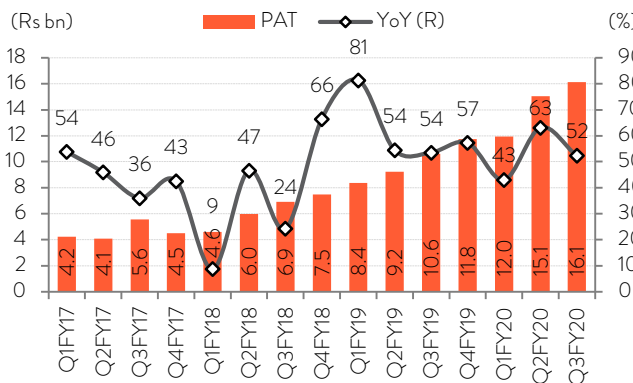
Source: Company, BOBCAPS Research

FIG 10 – ASSET QUALITY LOOKS BENIGN



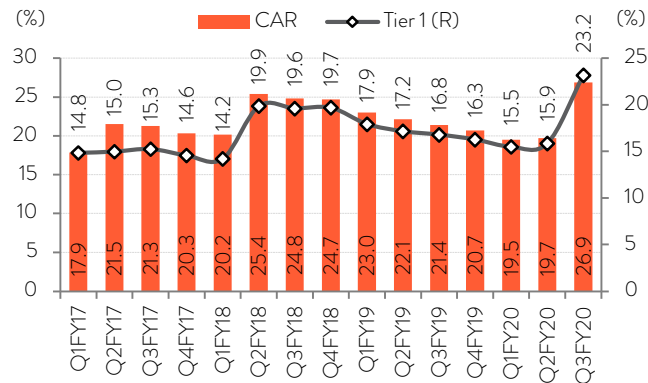
Source: Company, BOBCAPS Research

FIG 11 – STRONG PAT GROWTH



Source: Company, BOBCAPS Research

FIG 12 – WELL CAPITALISED



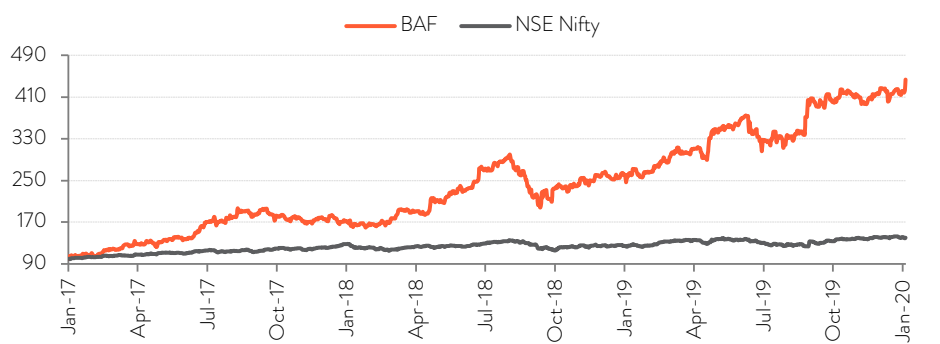
Source: Company, BOBCAPS Research

Valuation methodology

BAF is trading at 7.9x/6.5x FY20E/FY21E BV for an estimated ROE of 22.9%/22.0%. We value the stock based on a residual income model and increase our Mar'21 target price to Rs 5,200 (vs. Rs 5,000). Our assumptions include: cost of equity of 12.8%, risk-free rate of 7.75%, risk premium of 5%, and a long-term growth rate of 5%.

We keep our estimates unchanged and maintain BUY given that we expect (1) consumer financing and cross-sell to remain key moats, (2) SME and commercial financing to form sustainable scale builders, (3) well protected spreads and astute focus on opex to drive profits, (4) mortgage business to add scale, and (5) well-managed asset quality to drive return ratios (see our Jan'20 initiation report for details: [BAF 2.0 – Revamped growth engine; initiate with BUY](#)).

FIG 13 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Moving into smaller geographic locations could expose BAF to a high proportion of new-to-credit customers, who may not have disciplined banking behaviour.
- Risk of renegotiations by OEMs could hamper subvention income and thereby the high IRRs enjoyed in consumer financing.
- Growing competition from banks and financial technology players in the retail lending space is another key risk.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	69,716	97,252	135,172	171,485	213,464
NII growth (%)	42.2	39.5	39.0	26.9	24.5
Non-interest income	11,713	21,530	35,500	46,125	59,932
Total income	81,429	118,782	170,671	217,610	273,396
Operating expenses	32,690	41,977	58,391	73,136	91,612
Operating profit	48,739	76,805	112,281	144,473	181,784
Operating profit growth (%)	34.1	57.6	46.2	28.7	25.8
Provisions	10,305	15,014	28,232	35,045	45,516
PBT	38,434	61,792	84,049	109,429	136,268
Tax	13,471	21,842	23,080	27,576	34,339
Reported net profit	24,964	39,950	60,969	81,853	101,928
Adjustments	0	0	0	0	0
Adjusted net profit	24,964	39,950	60,969	81,853	101,928

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	1,150	1,154	1,203	1,203	1,203
Reserves & surplus	157,328	195,817	334,425	406,455	496,152
Net worth	158,478	196,970	335,629	407,659	497,356
Deposits	0	0	0	0	0
Borrowings	665,573	1,015,879	1,340,966	1,657,374	2,048,175
Other liabilities & provisions	23,932	29,476	33,897	38,981	44,829
Total liabilities and equities	847,983	1,242,325	1,710,492	2,104,014	2,590,359
Cash & bank balance	3,397	3,487	87,852	88,333	85,017
Investments	31,394	85,990	98,889	113,722	130,780
Advances	800,001	1,137,135	1,506,703	1,883,379	2,354,224
Fixed & Other assets	4,703	6,948	6,968	6,988	7,008
Total assets	847,983	1,242,325	1,710,492	2,104,014	2,590,359
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	41.8	42.1	32.5	25.0	25.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	43.4	69.3	101.3	136.0	169.4
Dividend per share	4.0	6.0	10.1	13.6	16.9
Book value per share	275.7	341.4	557.8	677.5	826.6

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	101.8	63.8	43.6	32.5	26.1
P/BV	16.0	12.9	7.9	6.5	5.3
Dividend yield (%)	0.1	0.1	0.2	0.3	0.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	9.5	9.3	9.2	9.0	9.1
Non-interest income	1.6	2.1	2.4	2.4	2.6
Operating expenses	4.5	4.0	4.0	3.8	3.9
Pre-provisioning profit	6.6	7.3	7.6	7.6	7.7
Provisions	1.4	1.4	1.9	1.8	1.9
PBT	5.2	5.9	5.7	5.7	5.8
Tax	1.8	2.1	1.6	1.4	1.5
ROA	3.4	3.8	4.1	4.3	4.3
Leverage (x)	5.9	5.9	5.5	5.1	5.2
ROE	20.1	22.5	22.9	22.0	22.5

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	42.2	39.5	39.0	26.9	24.5
Pre-provisioning profit	34.1	57.6	46.2	28.7	25.8
EPS	29.2	59.6	46.3	34.3	24.5
Profitability & Return ratios (%)					
Net interest margin	10.2	10.0	10.2	10.1	10.1
Fees / Avg. assets	1.1	1.6	1.8	1.8	1.9
Cost-Income	40.1	35.3	34.2	33.6	33.5
ROE	20.1	22.5	22.9	22.0	22.5
ROA	3.4	3.8	4.1	4.3	4.3
Asset quality (%)					
GNPA	1.4	1.5	1.5	1.7	2.0
NNPA	0.4	0.6	0.6	0.7	0.8
Provision coverage	69.6	59.8	60.0	60.0	60.0
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	24.0	20.7	18.7	18.9	19.0
Tier-1	18.4	16.3	15.6	16.5	17.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

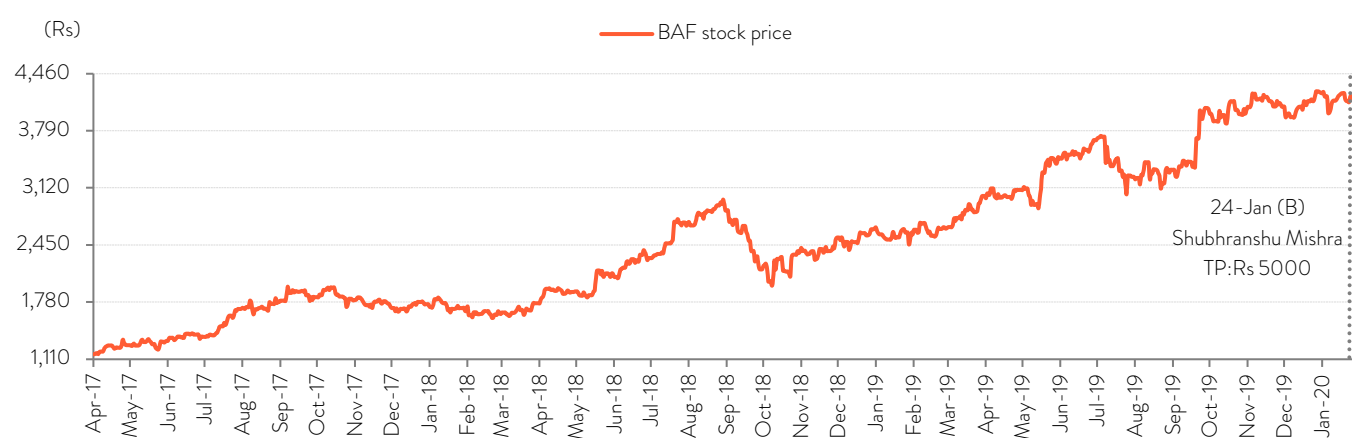
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: BAJAJ FINANCE (BAF IN)



B – Buy, A – Add, R – Reduce, S – Sell

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