NIRMAL BANG
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Institutional Equities

Initiating Coverage

Bajaj Finance

12 June 2020

Reuters: BJFN.NS; Bloomberg: BAF IN

NPA pain temporary, focus on the long-term structural story

We initiate coverage on Bajaj Finance (BAJF) with a BUY rating and fair value estimate of Rs3,026, based on 4.5x FY22E ABV. We are cognizant of the near-term concerns that investors have regarding asset quality and loan growth challenges. While we concur with this view and build the same into our near/medium-term numbers, we also believe that these numbers would only be transient in nature. Structurally, we think that the company is on a solid footing with respect to steady-state profitability, balance sheet strength, underwriting capability and the larger macro opportunity in the consumer finance segment. Customer-reach is supported by an expansive distribution network. Keeping consumer finance as the cornerstone, the company has taken various initiatives to augment overall profitability, which only adds to management capability and credibility. We identify three key tenets that have kept the value-creation engine well-oiled at BAJF. These three principles – product innovation, cross-sell and focus on existing customers – also form the basis of our BUY thesis on the company. Besides, BAJF also enjoys a very favourable reputation and name in the capital markets, as indicated by its debt/equity-raising track record. In its latest round of equity infusion, the stock found enough appetite even at >7x BV. Debt market pricing for BAJF has been among the most favourable ones, standing out especially during times of crisis (as indicated in last 18 months). Lastly, BAJF ticks one of the most important pieces on our checklist, which is management longevity. We observe that more than 75% of the management team has been around since last 7-18 years, which is what partially explains the sustained business performance over the period. Our reading of the key management personnel indicates that most are well-experienced in multiple business lines (outside of their current profiles). Our channel checks suggest that BAJF enjoys preferred finance partner status among retailers due to its TAT (best in the industry), product-wise schemes, ability to deploy extra manpower (if/as/when required) and transparency in vendor dealings (see channel checks section). In our base case, we expect ROE to touch bottom in 2QFY21E and gradually revert to better-than-industry levels (~15%) by 4QFY21E as provisioning intensity subsides. We expect ROE recovery to >20% in by 3QFY22E. Prolonged stress and consequent provisioning requirements remain major risks to our estimate. Structurally, we think BAJF remains a 20%+ ROE story given the broader macro opportunity. The stock currently trades at 4.4x/3.6x FY21E/22E ABV. Over the last 8-10 years, the stock has traded at an average of 3.5-4x 1-year forward ABV. In more recent years, we have seen the ABV multiple getting re-rated to 5-7x. Two most important factors that explain such a stock price performance are strong balance sheet and visibility of >20% ROE on a steady-state basis. The impact of covid-19 is expected to be significant across lenders. However, we think that should not cloud our judgement of long-term structural trends and the companies that are best-placed to capture such opportunities.

Y/E March (Rsbn)	FY19	FY20	FY21E	FY22E
NII	111.8	162.1	161.9	200.6
PPOP	76.9	112.5	109.3	137.0
PAT	40.0	52.6	36.0	75.5
Loans	1,145.7	1,413.8	1,447.9	1,746.7
RoA (%)	*3.8*	*3.3*	*1.9*	*4.0*
RoE (%)	*23.1*	*18.7*	*8.6*	*18.5*
P/ABV	9.2	4.2	4.4	3.6

Source: Company, Nirmal Bang Institutional Equities Research

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BUY

Sector: NBFC

CMP: Rs2,448

Target Price: Rs3,026

Upside: 24%

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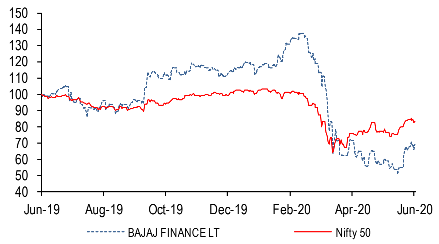
Key Data

Current Shares O/S (mn)	601.7
Mkt Cap (Rsbn/US$bn)	1,474.5/19.4
52 Wk H / L (Rs)	4,923/1,783
Daily Vol. (3M NSE Avg.)	10,223,850

Share holding (%)	4QFY20	3QFY20	1QFY20
Promoters	56.2	56.2	56.2
Public	43.5	43.6	43.5
Others	0.29	0.30	0.36

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Bajaj Finance	18.4	(39.6)	(30.1)
Nifty Index	8.2	(16.9)	(16.5)

Source: Bloomberg

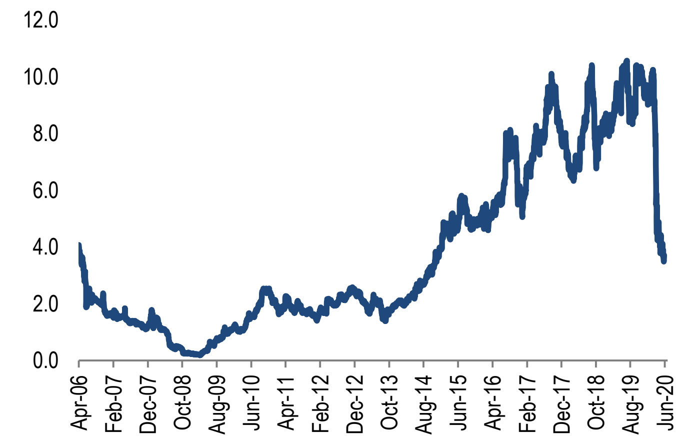
Outlook and valuation: One of the best placed to capture consumption trends; near-term headwinds are only transient, not structural

The near-term asset quality and growth impact is inevitable, not only for BAJF but for the whole lending space. At the current juncture, rising NPAs is a given. Therefore, we focus on the long-term structural growth story that BAJF presents as the basis of our thesis. BAJF enjoys a dominant market share in the consumer finance industry (60-65%). Despite attracting competition, owing to the segment's high margins and profitability, the company has been able to defend its market share in the manufacturers' subvention pool (as management claims as well as per our channel checks). Our consumer durables (CD) analyst, Chirag Muchhala, is positive on the long-term consumption patterns given the relatively small size of CD industry (Rs763bn) compared to India's GDP and large population size. Rising affordability and growing necessity are some of the structural demand drivers for the CD industry. At a more micro level, we think that easy repayment options such as no/low-cost EMIs should supplement affordability and ownership. We remain positive on BAJF's growth trajectory given their track record of product innovation, focus on customer convenience (which ensures stickiness) and early investments in setting up a enviable infra to cater to low-ticket size/high-volume business. The company's distribution strength remains unparalleled. A network of >114,400 touchpoints places the company well enough to gain from the consumption bounce back.

For FY21E, we expect AUM growth to be low (0.4%) followed by a 21% growth in FY22E on the back of a broader economic recovery. We also expect provisioning to consume 56% of operating profit in FY21E compared to an average of 20%, which will suppress ROE in the near term. Segment wise, auto finance, sales finance and SME business are likely to throw up higher NPA challenges and provisioning requirements. We are building in asset quality recovery only from 3QFY22E onwards. The company should get back to 20% ROE trajectory by 2HFY22E.

Over the last 8-10 years, the stock has traded at an average of 3.5-4x 1-year forward ABV. In more recent years, we have seen the ABV multiple getting re-rated to 5-7x. Two most important factors that explain such a stock price performance are strong balance sheet and average ROE of ~21% over last 10 years. What further adds to the premium valuation is the visibility on ROE sustainability and an overall 20-25% growth trajectory. We assign a 4.5x to our FY22E ABV estimate to arrive at a fair value estimate of Rs3026. Our target multiple is based on the lower-end of the average valuation the stock has commanded over the last 5-8 years. The stock is down 50% from its peak. In our worst case/most bearish scenario, we expect 67% downside for the stock, assuming it gets de-rated to 2x and there is a >20% impairment in BV. However, we think that the possibility of such a scenario is extremely remote. The company's equity capital raising track record is proof of its ability to attract investor interest even at high valuation. Based on our base case FY22E ABV, we think the risk-reward ratio is extremely favourable.

Exhibit 1: P/ABV (ttm)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: P/ABV (1-year forward)

Source: Company, Nirmal Bang Institutional Equities Research

Product innovation, cross-sell and focus on existing customers remain the key tenets of value creation

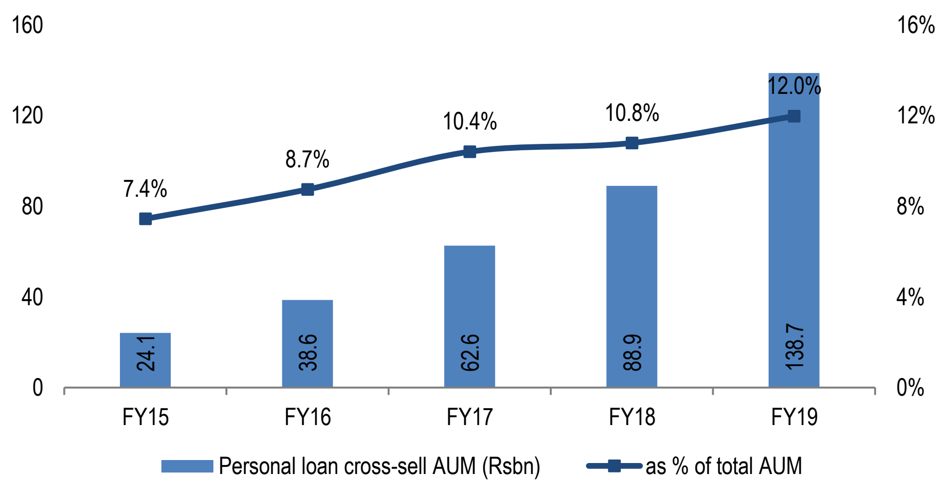
Based on our research, one of the key tenets that stands out for BAJF is product innovation. Time and again, the company has come to the market with new products, thus displaying its innovation-oriented mind-set. At the shop floor level, what differentiates BAJF from competition is its finance offerings, which are product-wise as opposed to plain vanilla/blanket finance offered by competitors. Exhibit 4 presents a timeline of product innovation by the company over the years. In addition, what establishes a strong moat for the company is the effort expended to understand and scale up a new segment. We understand that the company spends a considerable amount of time (often close to or more than two years) before scaling up. For example, lifestyle financing was launched in April 2013 and started turning into a full-fledged business only in its 3rd year of launch. Also note that at the time of launching lifestyle finance, BAJF was probably the only one offering such kind of a product and was thus responsible for market-making. In FY19, the company financed ~0.5mn lifestyle purchase transactions. What highlights the innovation bent of mind even more is that fact that the company had three separate verticals under retail alone by 3QFY15 (consumer durable, digital product finance, lifestyle finance). Since then, the company has added many new offerings such as e-commerce consumer finance, e-commerce seller finance and warehousing receipt finance (under rural). In FY18, the company launched a housing finance subsidiary, Bajaj Housing Finance Limited (BHFL), to cater to the housing finance opportunity.

A deeply embedded cross-sell culture has kept the innovation engine well-oiled. Alongside launching new credit products, the company has also focused on generating fee income. Many of the fee products launched/sold by the company aren't necessarily linked to the balance sheet, meaning they are not vulnerable to AUM growth. Focusing on cross-sell to existing customers has helped in 1) understanding the customer better, thus creating scope for improved service, and 2) better risk underwriting. As per the company, loan losses on existing customers are 1/3rd of that incurred on a new customer. Hence, adjusted for risk, cost of an existing customer is lower. This means that during bad times, limiting business only to existing customers should help cushion credit costs. As per the company's annual report (FY19) *"BFL's strategy of 'acquire and cross-sell' to manage cost and portfolio risk, based on the axiom that an existing customer poses significantly lower credit risk than a new customer, ensures lower risk across portfolios".*

We learn that 'focus on existing customer' is one of the central pieces of the company's go-to-market strategy. Usually, at first the company offers consumer durable loans (the entry point), followed by business loans, followed by home loans. In the true sense, the company seems to be following a life-cycle model which addresses growth at lower opex as well as lower credit costs. Over the years, the share of business coming from existing customers has increased from 40% towards end of FY13 to ~70% today. Over the medium-to-long term, the aspiration is to have existing customers contribute to 72-74% of the business.

A key factor behind shareholder value creation at BAJF is a close-knit combination of product innovation, cross-sell and focus on existing customers. Over the years (FY11-20), the company has delivered an average ROE of 20.9% and a PAT CAGR of 50%. Over the same period, GNPAs have averaged 1.7% while credit costs have averaged 1.8%.

Exhibit 3: Focus on existing customers and cross-sell is best reflected in the PLCS book build-up



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Business/product launch journey

Legacy	FY08	FY09&10	FY11	FY12	FY13	FY14	FY15	FY16
Consumer durable financing	Personal loan cross sell	Extended warranty cross sell	Construction equipment financing	EMI card	LRD	Consumer finance fitness report	MSME rural lending	Urban gold loans
2W & 3W financing	Life insurance distribution	Vendor financing	LAS - retail	Co-branded credit card	Home loans - salaried	CRISIL SME Rating	Property fitness report	Corporate finance business
-	-	LAP	Home loans - self-employed	Infra financing	Lifestyle product financing	General insurance distribution	Digital finance	Light engineering business
-	-	LAS - Promoter	-	Relationship management	-	Retailer finance	-	Financial institutional lending
-	-	Business loans	-	Professional loans	-	Consumer rural lending	-	SME financial fitness report
-	-		-	Salaried personal loans	-		-	E-commerce - seller finance

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Product suite (FY20)

Consumer	SME	Commercial	Rural	Deposits	Partnerships & services
Consumer durable loans	Unsecured WC loans	LAP	Consumer durable loans	Retail TDs	Life insurance distribution
Digital product loans	Loans to self-employed professionals	IPO financing	Digital product loans	Corporate TDs	General insurance distribution
Lifestyle product loans	Secured enterprise loan	ESOP financing	Lifestyle product loans	-	Health insurance distribution
Lifecare financing	Used-car financing	Vendor financing	Personal loan cross sell	-	Pocket insurance
EMI cards	LAP	Financial insti lending	Salaried personal loan	-	Co-branded credit card
Retail spend financing	Self-employed home loans	Light engineering lending	Gold loans	-	Co-branded wallet
2W & 3W financing	LRD	Specialty chemicals lending	Loans to professionals	-	Financial fitness report
Personal loan cross sell	-	Developer finance	LAP	-	Property search services
Salaried personal loan	-	-	Home loans	-	Property fitness report
E-commerce - consumer finance	-	-	Secured enterprise loans	-	-
Retailer finance	-	-	-	-	-
Salaried home loans	-	-	-	-	-
Salaried LAP	-	-	-	-	-

Source: Company, Nirmal Bang Institutional Equities Research

Consumer finance to remain the cornerstone

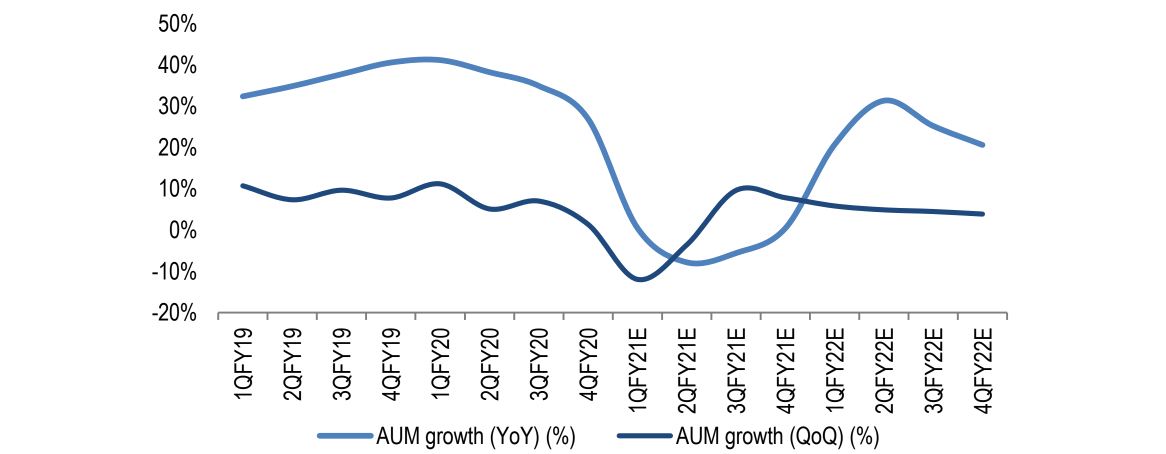
Given the possibility of a negative GDP growth in FY21 and a generally stressed economic environment due to the lockdown, we acknowledge that FY21 would be a year of negligible growth, at best. Our channel checks suggest that company-level activity has been muted for the first half of 1QFY21. Given the uncertainty in the economy, consumers going into cash conservation mode and consequent hold-back on discretionary spending, we expect AUM to decline in 1HFY21E.

Exhibit 6: AUM mix (%)

AUM mix (%)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20
Consumer B2B auto finance business	21.9%	7.4%	7.8%	7.6%	7.4%	7.5%	8.1%	8.4%	8.5%	8.8%	9.1%	8.9%
Consumer B2B sales finance business		13.2%	13.4%	11.2%	12.5%	11.7%	12.1%	10.6%	10.9%	10.1%	9.6%	8.6%
Consumer B2C businesses	17.1%	17.9%	18.3%	18.7%	18.5%	18.9%	19.1%	19.8%	19.3%	19.9%	20.2%	21.2%
Rural B2B sales finance business	5.5%	6.0%	1.8%	1.6%	1.8%	1.7%	2.1%	1.8%	1.8%	1.7%	1.9%	1.8%
Rural B2C business			4.8%	5.1%	5.3%	5.6%	5.8%	6.1%	6.2%	6.6%	6.9%	7.2%
SME business	12.4%	13.8%	13.1%	13.9%	13.2%	13.6%	13.1%	13.6%	12.7%	13.2%	12.9%	13.2%
Securities lending business		7.7%	7.5%	8.2%	7.7%	6.6%	5.8%	5.5%	7.0%	5.3%	4.5%	3.3%
Commercial lending business	13.2%	4.0%	4.4%	5.0%	5.5%	5.4%	5.3%	4.9%	4.6%	4.6%	4.5%	4.4%
Mortgages	29.8%	30.0%	29.0%	28.7%	28.3%	28.9%	28.6%	29.2%	29.0%	29.9%	30.5%	31.4%
Total (Rsbn)	**689**	**727**	**780**	**824**	**913**	**980**	**1,075**	**1,159**	**1,289**	**1,355**	**1,451**	**1,472**

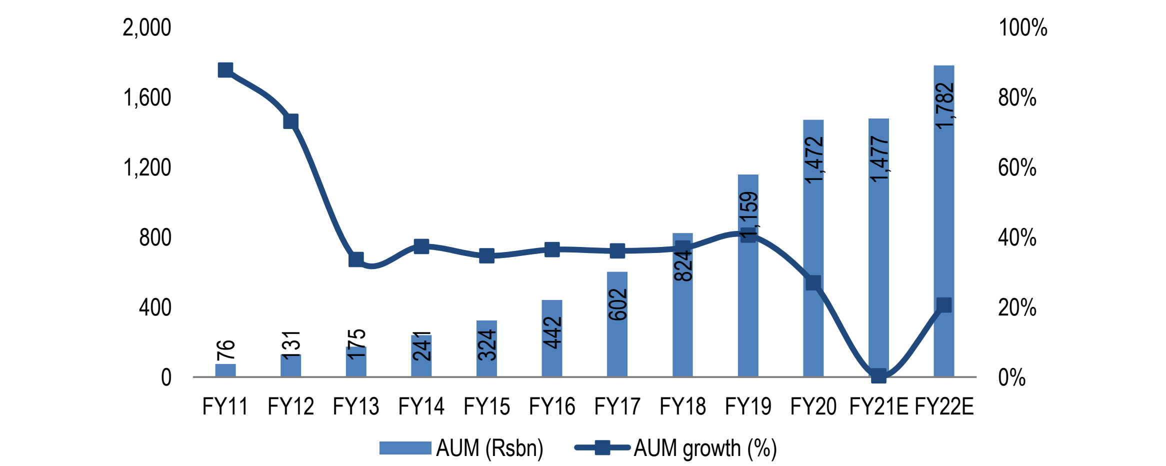
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: AUM growth trends (%) - near-term de-growth is inevitable due to high run-off and negligible activity in 1Q



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Expect AUM growth to pick up in FY22



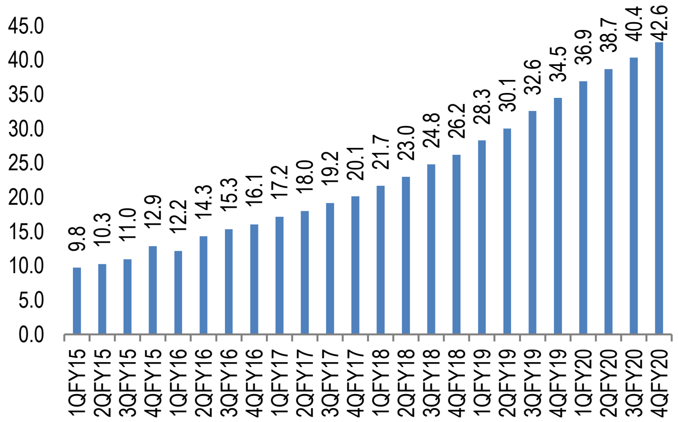
Source: Company, Nirmal Bang Institutional Equities Research

Overall franchise has grown ~3.5x in last 6 years; customer centricity remains the key

As of FY20, BAJF's overall customer franchise stood at 42.6mn. Though the customer franchise is up nearly 3.5x in last 6 years, existing customers still account for 65-70% of the new loans (see exhibit 13). This implies that majority of the growth comes from the existing customer base. On a steady-state basis, the company is committed to adding 7-8mn customers to the franchise every year.

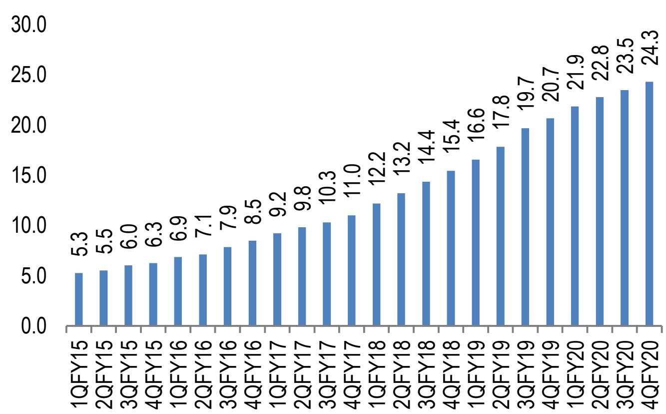
Since tightening underwriting criteria in 1HFY20, growth in new loans booked has decelerated quite sharply, from 54% in 4QFY19 to 3% in 4QFY20. At the same time, the share of business with existing customers has also gone up.

Exhibit 9: Total customer franchise (#mn)



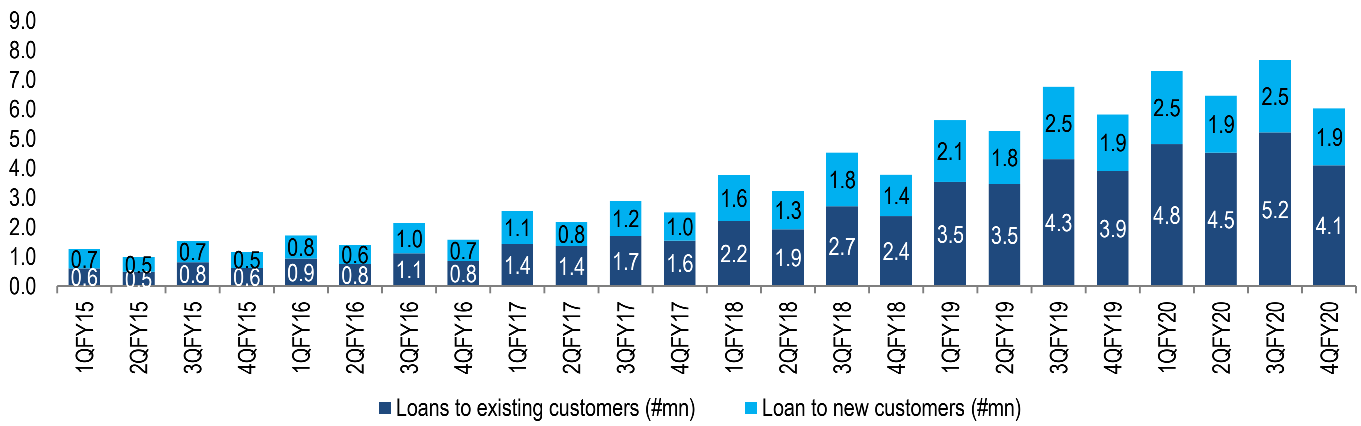
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Total cross-sell franchise (#mn)



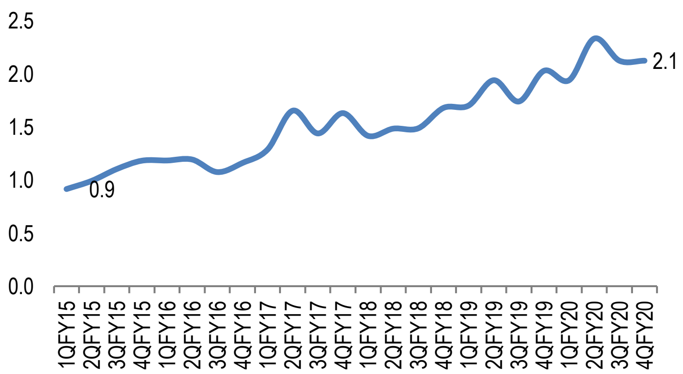
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Loan to existing vs. new customers (based on new loans booked)



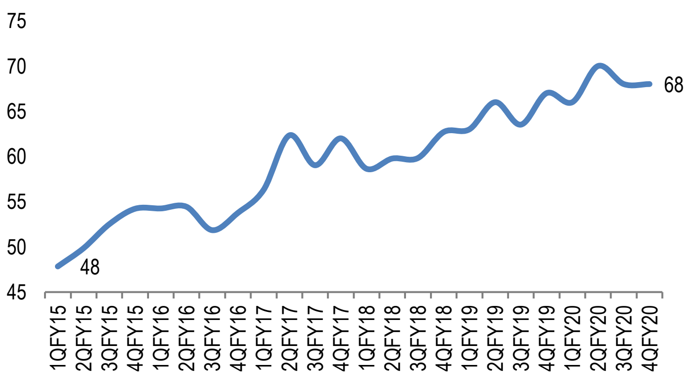
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Ratio of existing to new customers (x) (based on new loans booked)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Business from existing customers (% of new loans booked)



Source: Company, Nirmal Bang Institutional Equities Research

Sustained high growth an outcome of expansive distribution network

One of the key reasons behind the strong growth in AUM is the expansion in distribution channel. We understand that consumer businesses are difficult to scale up and generally have strong entry barriers as they require a significant support from a distribution standpoint. As a result of high upfront investments in distribution, technology and processes to compete in the relatively low-ticket size, high volume business, competition has remained benign for BAJF despite the company consistently delivering highly profitable growth (which should ideally attract competition). Our channel checks suggest that BAJF is a preferred finance partner across retailers (see section on channel checks).

As of 4QFY20, the overall distribution network stood at 114,400 touch points, nearly doubling over the last two years. Over FY13-FY19, the company expanded its distribution network at 34-63% annually. However, it slowed down to 25% in FY20.

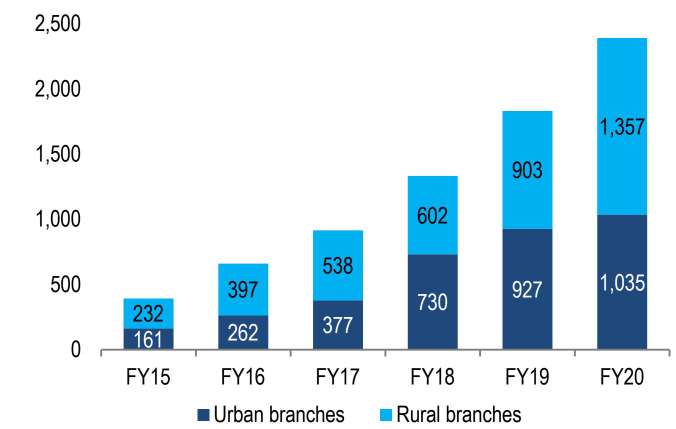
The rural-lending vertical was launched in 1QFY14 with 7 branches to start with in Maharashtra. Incrementally, the company has equally focused on scaling up the rural presence (see exhibit 17).

Exhibit 14: Distribution network

Active distribution - POS	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Consumer durable stores - Urban	2,800	3,500	4,900	7,000	9,400	14,000	15,500	20,400	24,200
Consumer durable stores - Rural	-	-	-	1,500	3,200	5,500	8,200	14,500	19,600
Digital product store	-	850	1,600	2,650	5,200	5,900	15,900	22,500	26,400
Lifestyle retail stores	-	-	-	1,150	3,200	3,900	6,000	7,700	9,500
EMI card - retail spends stores	-	-	-	-	-	5,600	12,100	19,100	24,300
Bajaj Auto dealers, sub-dealerships and ASSC	2,200	2,600	2,600	3,000	3,000	3,200	3,900	4,600	5,500
DSA	250	400	700	700	800	1,500	2,100	2,800	4,900
Overall active distribution network	**5,200**	**7,300**	**9,800**	**16,000**	**24,800**	**39,600**	**64,300**	**91,700**	**1,14,400**

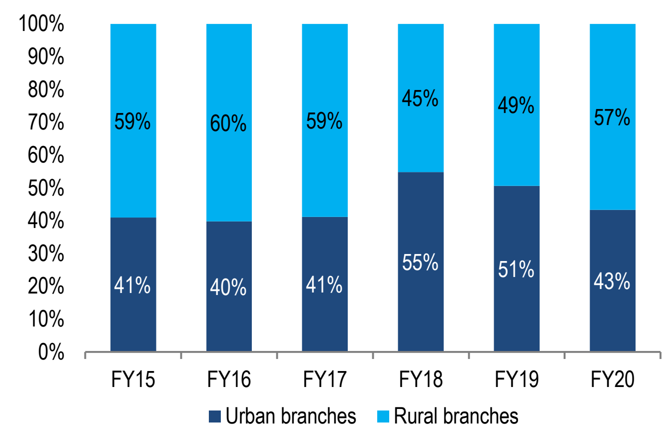
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Branch network



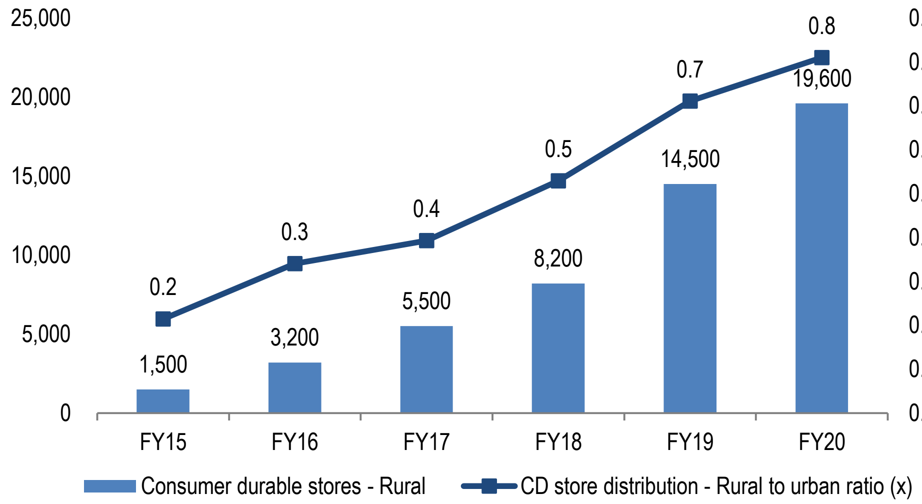
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Branch mix (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: Ramp up in rural presence has been very rapid

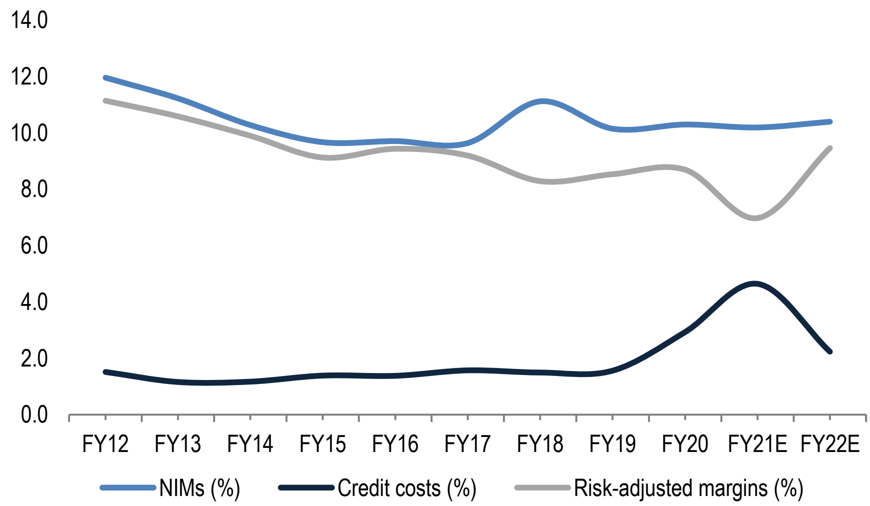


Source: Company, Nirmal Bang Institutional Equities Research

High NIMs + low credit costs have helped deliver superior risk-adjusted margins on a sustainable basis

Low-ticket, fast-churning consumer finance remains the cornerstone for superior profitability at BAJF. Total consumer finance + rural portfolio, stands at Rs703bn, forming 47.7% of the total AUM. Over the last ~3 years, this share has increased by 309bps (since 1QFY18). We estimate that the IRR and spreads on this book would be in the range of 15-24% and 6-15%, respectively. On a blended basis, spreads over 1QFY18-4QFY20 have averaged 9%. See exhibit 19 for product-wise IRR. Against an average credit cost of 2%, the company has delivered risk-adjusted spreads of 7%. Therefore, adjusted for loan losses, we think the spreads and profitability are of superior quality. Going forward, consumer finance is expected to remain the mainstay for the company. We estimate that excluding the mortgage piece, the remaining portfolio makes a NIM of 13.5-14%.

Exhibit 18: Margins and credit costs (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: IRR range* (%)

2W & 3W finance	22-26
Consumer durable finance	23-25
Digital product finance	23-25
Lifestyle product finance	23-25
Personal loans cross sell	16-26
Salaried personal loans	14-16
Business loans	17-20
Professional loans	14-17
Loan against property	10.5
Home loans (self-employed)	8.8-10.5
Home loans (Salaried)	8.5-9.5
Loan against securities	10-11.5
Rural lending	14-26
Vendor financing	10-12.5
Financial institutions group	9.5-12
Corporate finance	10-12

**as of FY17*

Source: Company, Nirmal Bang Institutional Equities Research

Hypothetical illustration of a purchase financed through Bajaj Finance

Retail price of the product (Rs)	40,000	
Bajaj Finance's commission (%)	7.50%	
Bajaj Finance's commission (Rs)	3,000	
Payment from Bajaj Finance to manufacturer (Rs)	37,000	<< initial capital outlay by Bajaj Finance
Processing fee (Rs)	1,000	<< assumed

IRR calculation (%)				
Scenario 1: zero down payment by the customer		Scenario 2: 3 months' down payment upfront		
Month	EMI (Rs)	Month	EMI (Rs)	
01-Apr-20	-37,000	01-Apr-20	-37,000	<< gross capital outlay by BAJF
30-Apr-20	3,333	01-Apr-20	10,000	<< down payment by customer
31-May-20	3,333	01-Apr-20	-27,000	<< net capital outlay
30-Jun-20	3,333	30-Apr-20	3,333	
31-Jul-20	3,333	31-May-20	3,333	
31-Aug-20	3,333	30-Jun-20	3,333	
30-Sep-20	3,333	31-Jul-20	3,333	
31-Oct-20	3,333	31-Aug-20	3,333	
30-Nov-20	3,333	30-Sep-20	3,333	
31-Dec-20	3,333	31-Oct-20	3,333	
31-Jan-21	3,333	30-Nov-20	3,333	
28-Feb-21	3,333	31-Dec-20	3,333	
31-Mar-21	3,333	IRR (%)	29.4%	
IRR (%)	15.7%			

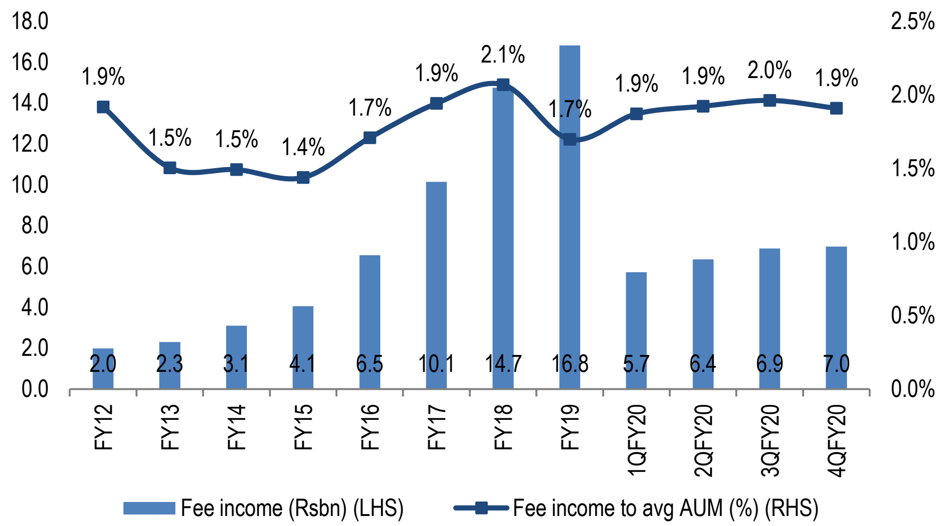
Source: Nirmal Bang Institutional Equities Research

Strong focus on fee income generation

Over FY12-20, the company's fee income has grown at a CAGR of 38%, forming 31-33% of the total PBT on average (was 54.5% in 4QFY20). Besides delivering industry-leading NIMs on a sustainable basis, the company has equally focused on enhancing profitability through fee income generation. Our reading across the top NBFCs suggests that for most players, the fee income is linked to the balance sheet growth, in some way or the other (loan processing charges, collections, etc.). However, for BAJF, a substantial part of the fee income is created off the balance sheet, through distribution income and other activities which are not correlated to the asset growth. Usually, a fee income stream which is de-linked with the balance sheet growth is more sustainable in nature and can cover up for poor asset growth during tough times. A comparison of fee income to average total assets across NBFCs suggests that BAJF has a superior fee income generation capability.

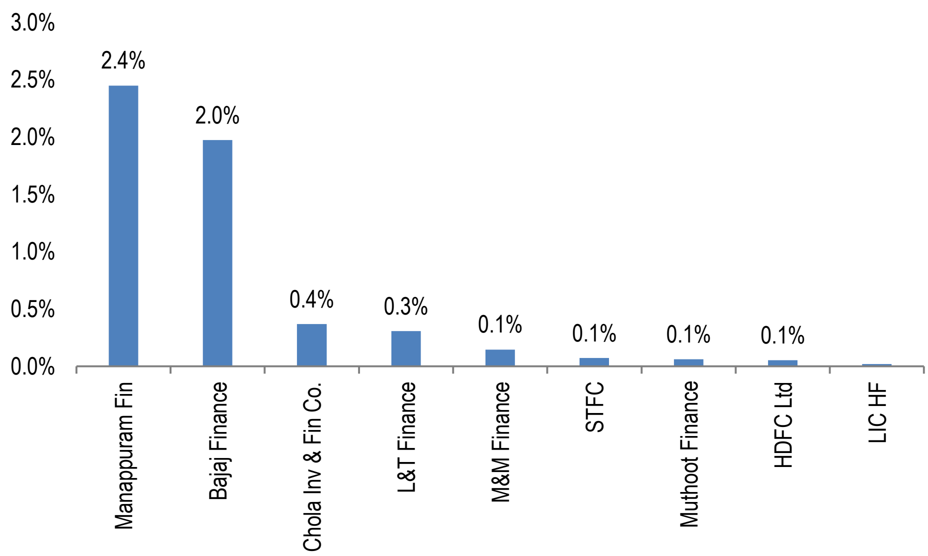
Apart from distribution of insurance and other financial products, EMI cards have also helped strengthen the fee income profile. As of 4QFY20, the EMI franchise stood at 22mn cards while EMI card retail store relationships stood at 24,300 (up nearly >3x since Mar'17). In FY19, EMI enabled BAJF to finance over 11.5mn purchases across consumer durables, digital products, lifestyle finance, lifecare, etc. compared to 6.75mn in FY18, which implies a growth of 70%. To further the healthcare finance business and facilitate hassle free processing of loans, the company has also launched 'Healthcare EMI card'.

Exhibit 20: Fee income



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Fee income to average total assets (%)



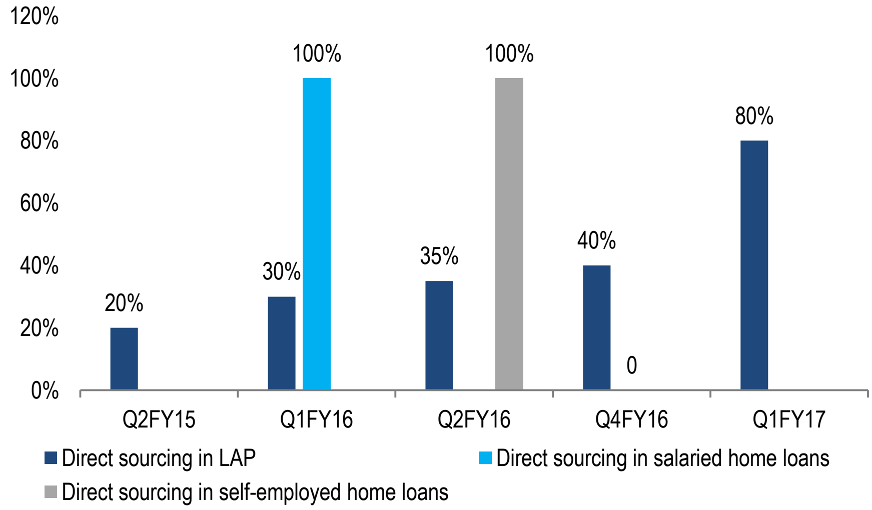
Source: Company, Nirmal Bang Institutional Equities Research

Superior handle on opex management

Considering the low-ticket size and short-tenor nature of the business and the essential requirement to generate gigantic number of volume to keep the growth engine intact, we think that the management has done a superior job in terms of reining in costs and maximizing output per unit (of cost). We note that opex-to-NII, a key cost performance measure, has improved from 50-53% in FY11/12 to <35% in FY20. Numbers suggest increasing asset generation per unit of cost has been complimented by improving fee income traction. Over FY12-20, total opex has grown at a CAGR of 30.9% compared to AUM CAGR of 35.3%, NII CAGR of ~38% and fee income CAGR of ~38%. Over this period, total income has grown at a CAGR of 36.5%.

It is important to note the various measures that the management has taken to keep costs under control and cut (or capture) third-party/distributor margins wherever possible. For instance, switching to direct sourcing in LAP, salaried & self-employed home loan was a key enabler to making reasonable ROEs in these businesses. Allocation of resources towards direct-to-consumer model was started back in early FY14 with meaningful results visible only from FY16 onwards (see exhibit 22). In FY16, the company transitioned its retail mortgage business to a 100% 'Direct to Customer' model, thereby lowering acquisition costs. Generally, the cost structure for the company is a highly variable one. PoS staff is temporary in nature and can be scaled up/down as per business requirements.

Exhibit 22: Share of direct sourcing across segments



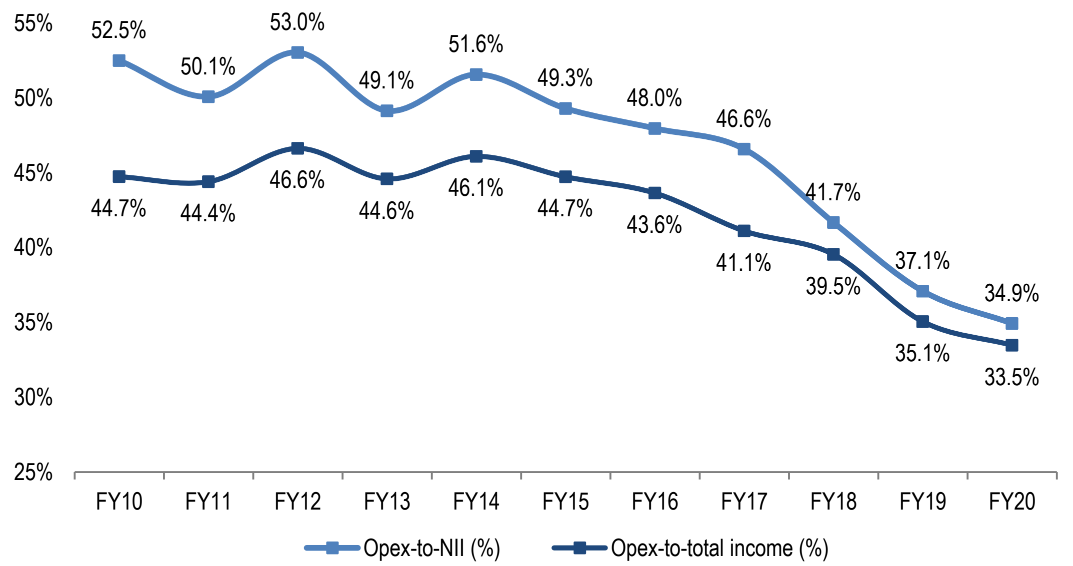
Source: Company, Nirmal Bang Institutional Equities Research

BAJF has also been at the forefront of technology adoption among the NBFCs and has continuously leveraged technology to launch new products, enhance customer acquisition and servicing processes along with simplifying back-offices. The company, for its flagship consumer finance business, has consolidated its front office, mid office and back office processes on a single cloud platform. This has brought more efficiency in the processes, increased front-end productivity, digitally.

Though there is still more scope for cost ratios to improve, we think that FY21E could see some deterioration due to covid-19's impact on business volume (especially in 1HFY21E). Our channel checks suggest that demand will be down by 20-25% in FY21. In light of the current situation, the company is already undertaking opex rationalization measures which include hiring-freeze, cut on travels and ads/promotion. As per the management's 4QFY20 commentary, fixed costs have been cut by 20-25% in the last 60 days. All branch expansion plans have also been suspended for now. Going by the management's worst case scenario guidance (6th April 2020), the opex cuts could be in the range of 15-20%. We expect collection costs to increase significantly as the company scales up its collections infra/capacity so as to contain NPAs.

On a steady state basis, we expect opex-to-NII to stabilize at 34-35% in the medium term. Our optimism about the company's ability to manage costs well relies on its track record so far. In the near term, limiting focus to existing customers should provide relief.

Exhibit 23: Cost ratios (%)



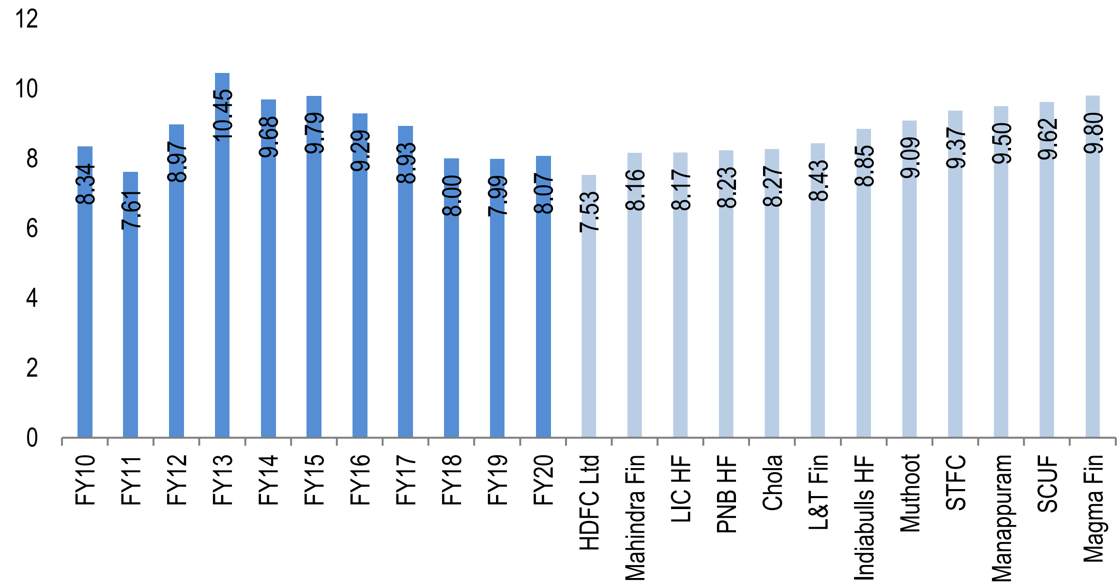
Source: Company, Nirmal Bang Institutional Equities Research

Well-managed funding profile with better cost of funds

As of 4QFY20, BAJF's liabilities comprised 41% from banks, 42% from money markets/NCDs and 17% from deposits. Despite maintaining a generally comfortable and balanced liability mix, the company has increased the share of deposits from 10% in 1QFY18 to 17% in 4QFY20. The company has been investing deeply in growing the retail fixed deposit channels. Of the total deposit book, 61% is retail in nature with an average size of Rs0.3mn and average tenor of 35 months. The strategy on the deposit front is to focus on the mass affluent and above clients.

A comparison across 13 large/mid-sized NBFCs (incl. HFCs) shows that BAJF has lower cost of borrowings than most others. Even on a standalone basis, the company has demonstrated meaningful reduction in cost of borrowings. Note that the company has continued to attract sizeable retail deposits in April 2020. In May 2020, it reduced rates by 25bps. As a measure to de-bulk the deposit profile, the company has reduced its rates on corporate deposits significantly.

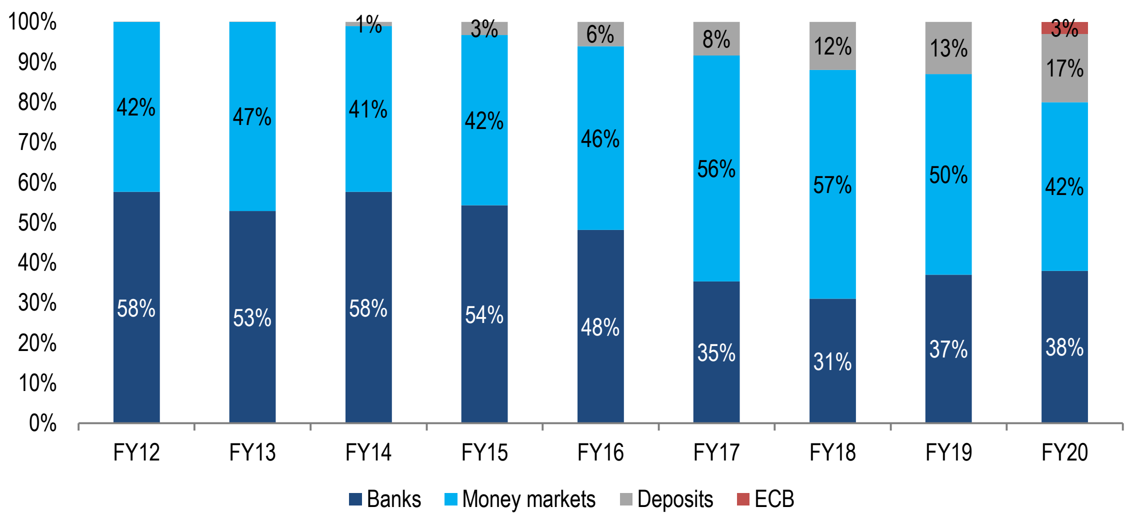
Exhibit 24: Cost of funds (%) - Peer comparison*



Source: Company, Nirmal Bang Institutional Equities Research

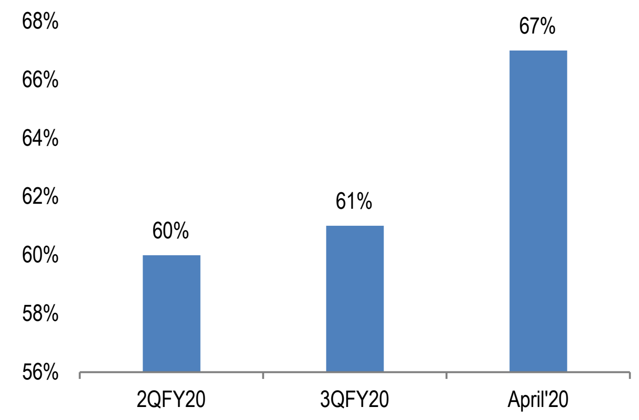
*Full year figures are for Bajaj Finance.

Exhibit 25: Liabilities mix (%)



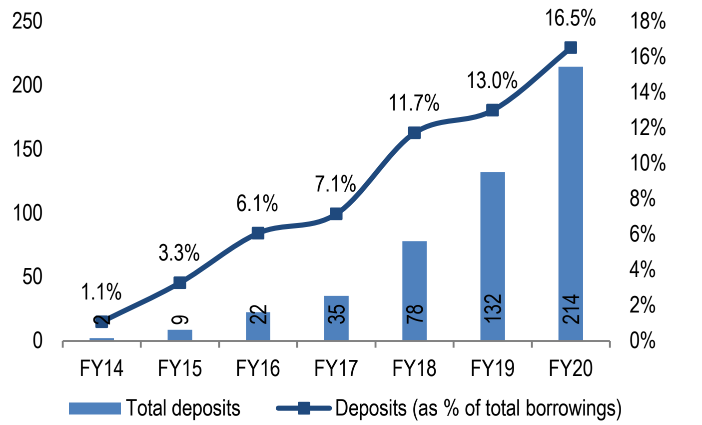
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 26: Retail share in total deposits (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 27: Deposit franchise build up



Source: Company, Nirmal Bang Institutional Equities Research

A safety haven for debt investors in times of crisis

Over the last 24 months, we have seen two full-blown liquidity crisis in the financial sector, first one being due to the collapse of IL&FS and the second one being covid-induced where banks virtually shut out lending to a section of the non-bank lenders. In both of these cases, the ‘relatively weaker’ players have either found it difficult to raise debt resources or have had to pay higher spreads.

Data shows that spreads even for some of the top-rated large non-bank lenders had expanded significantly during the peak of the liquidity squeeze. With respect to BAJF, we learn that the company has been able to raise resources from the markets without a hitch and at stable spreads. Our observation of the yields/spreads across 13 large and mid-size NBFCs (representing ~60% of the NBFC industry, ex-PFC/REC) indicates that yields for BAJF have only been higher than LIC HF and HDFC Ltd. At the peak of the IL&FS crisis (3QFY19), we estimate that BAJF’s average yields (9.12%) were only 11-19bps higher than that of LIC HF and HDFC Ltd. For comparison, for the ones that were able to raise money during this time, the yield exceeded LIC HF’s/HDFC Ltd’s by 27-99bps. Since peaking at 9.12%, we have seen yields ease for BAJF while for some of the others, they continue to remain elevated. Besides BAJF, Mahindra Finance has also seen comfortable spreads.

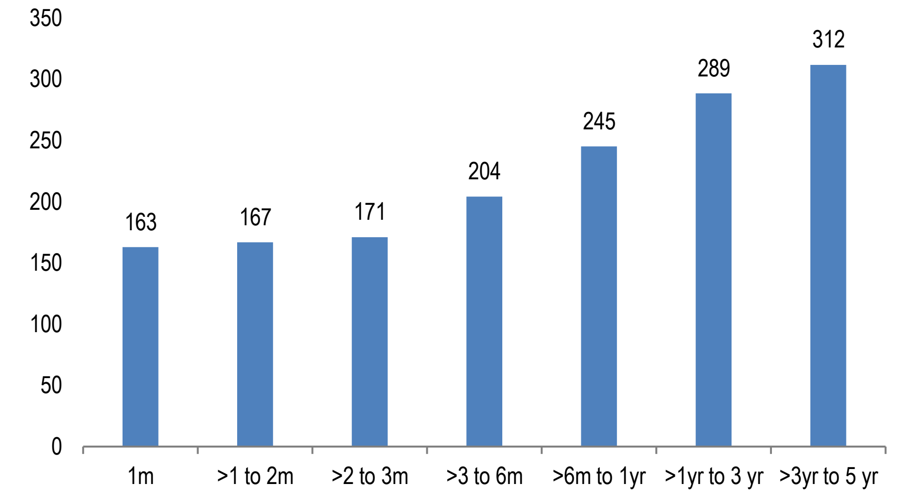
Even during the current crisis (covid-19), we believe BAJF is well-positioned from an overall liabilities standpoint. Our reading of the company and management’s earnings call interactions make us believe that the company has a conservative stance on liquidity management which makes it averse to taking liquidity risks. **A qualitative aspect that highlights the company’s focus on managing balance sheet risk is the fact that BAJF has been making ALM disclosures much before the IL&FS-led liquidity crunch (18-20 months ago) which resulted in a NBFC sector crisis.**

Exhibit 28: Bond issues and coupon rates

Coupon rate / Quarter	Bajaj Finance	CholaInv& Fin Co.	HDFC Ltd	Indiabulls HF	LIC HF	L&T Finance	Magma Fincorp	Manappuram Fin	Muthoot Finance	M&M Finance	PNB HF	SCUF	STFC
Q1FY09	-	10.35	9.92	-	9.79	-	10.90	-	-	8.64	-	10.25	10.18
Q2FY09	-	12.74	11.24	-	11.01	10.25	12.45	-	-	11.35	10.79	-	12.56
Q3FY09	11.45	-	10.96	-	10.87	-	14.00	-	-	12.13	-	-	12.94
Q4FY09	-	-	9.58	-	8.80	-	13.38	-	-	-	-	-	12.60
Q1FY10	8.62	-	6.84	-	7.23	-	-	-	-	-	-	-	10.31
Q2FY10	8.63	11.36	-	-	7.45	9.51	9.50	-	-	9.20	-	10.75	10.79
Q3FY10	8.02	11.08	7.25	-	6.93	-	9.88	-	-	9.85	8.70	10.75	9.95
Q4FY10	8.27	11.20	8.05	8.40	7.57	8.45	12.54	9.00	-	-	-	-	10.19
Q1FY11	8.57	8.64	7.94	7.60	7.70	7.45	11.50	-	-	-	-	7.82	10.10
Q2FY11	8.61	9.73	8.68	10.00	8.30	-	11.50	9.95	-	8.30	-	9.00	11.11
Q3FY11	9.19	12.05	9.11	-	9.13	-	12.00	-	-	9.21	-	10.55	11.05
Q4FY11	9.90	-	9.63	-	9.56	-	12.50	12.23	-	-	-	10.63	11.50
Q1FY12	10.14	11.46	9.76	-	9.91	-	-	12.30	-	10.47	-	-	10.65
Q2FY12	9.98	10.77	9.60	10.65	9.65	9.96	10.45	12.10	12.04	10.05	9.53	11.75	10.62
Q3FY12	10.28	11.39	9.78	9.73	9.79	10.23	11.30	12.50	-	10.16	-	-	10.32
Q4FY12	9.79	11.04	9.68	11.07	9.65	9.84	11.31	12.90	13.13	9.85	-	11.77	10.33
Q1FY13	9.80	11.02	9.76	10.59	9.81	10.03	10.95	-	13.17	10.15	9.25	10.65	10.55
Q2FY13	10.05	11.90	9.53	10.60	9.59	10.07	11.19	-	-	9.89	9.15	10.75	10.18
Q3FY13	9.64	11.00	9.17	10.30	9.22	9.53	10.47	12.51	11.75	9.57	9.05	10.83	10.07
Q4FY13	9.46	11.06	9.36	10.11	9.24	10.35	11.00	12.23	12.35	9.38	-	11.15	10.32
Q1FY14	9.22	9.56	8.69	9.85	8.60	8.93	10.32	-	-	9.33	8.58	-	10.05
Q2FY14	-	11.00	-	10.65	9.95	-	11.45	-	11.88	-	-	-	10.38
Q3FY14	9.80	12.35	9.74	10.59	9.59	10.10	10.48	-	11.13	10.05	-	-	10.72
Q4FY14	9.99	11.34	9.66	10.55	9.71	10.48	10.48	11.96	11.13	9.85	9.53	10.75	10.38
1QFY15	9.91	11.42	9.06	9.10	9.22	9.85	10.45	11.96	10.63	-	-	10.70	-
2QFY15	9.64	9.84	9.36	10.11	9.34	9.91	-	-	10.94	9.44	-	-	10.00
3QFY15	9.28	9.66	9.60	9.09	8.81	9.54	9.96	11.38	10.33	9.06	8.78	-	9.59
4QFY15	8.98	9.35	8.59	9.45	8.58	9.05	-	-	-	8.82	-	9.10	9.26
1QFY16	8.92	9.20	8.51	9.24	8.57	8.90	9.59	-	9.71	8.78	8.59	9.30	9.08
2QFY16	8.82	9.01	8.58	9.27	8.58	9.04	10.60	-	-	8.80	8.56	9.13	10.10
3QFY16	8.68	8.98	7.13	8.97	8.33	8.61	12.10	-	9.13	8.59	8.21	8.89	8.78
4QFY16	8.80	9.20	8.61	9.12	8.62	9.57	9.68	-	8.88	8.82	8.28	-	9.23
1QFY17	8.53	9.06	8.41	9.00	8.43	8.76	12.10	10.27	8.63	8.64	8.36	-	9.08
2QFY17	8.30	8.46	7.88	8.78	8.03	8.63	12.10	10.22	-	8.18	8.31	8.85	8.65
3QFY17	7.66	8.46	7.60	8.30	7.44	-	10.33	9.99	-	7.60	-	8.25	8.36
4QFY17	7.75	8.07	8.75	8.31	7.69	7.83	10.36	-	8.79	7.71	7.46	-	8.11
1QFY18	7.83	8.26	8.95	8.25	7.57	7.82	9.55	-	8.63	7.69	7.69	7.95	7.92
2QFY18	7.38	7.92	7.13	7.76	7.18	7.67	9.58	-	-	7.65	7.39	-	7.68
3QFY18	7.51	7.87	7.48	7.84	7.48	7.82	-	8.80	-	7.54	7.52	8.03	7.96
4QFY18	-	8.50	7.88	8.31	7.90	8.25	10.10	-	-	-	-	8.90	8.53
1QFY19	-	8.87	-	7.86	-	8.67	-	9.50	8.63	8.18	-	-	-
2QFY19	8.74	8.94	-	8.90	-	8.82	-	-	9.68	8.65	8.88	9.42	9.18
3QFY19	9.12	9.09	8.93	9.22	9.01	9.28	-	9.92	9.50	9.02	-	-	9.13
4QFY19	8.78	9.85	8.52	9.08	8.53	8.99	10.00	9.75	9.57	9.11	9.09	-	8.31
1QFY20	8.33	8.49	8.05	7.69	8.42	8.77	10.31	-	9.63	8.52	-	9.51	7.12
2QFY20	-	8.05	7.64	-	7.67	8.73	-	10.50	10.00	8.48	8.00	9.57	9.39
3QFY20	7.51	9.37	7.42	-	7.25	8.35	9.20	9.75	9.00	7.55	8.75	-	-
4QFY20	7.51	8.13	7.20	-	7.33	7.97	-	8.41	9.43	7.55	-	9.36	8.49

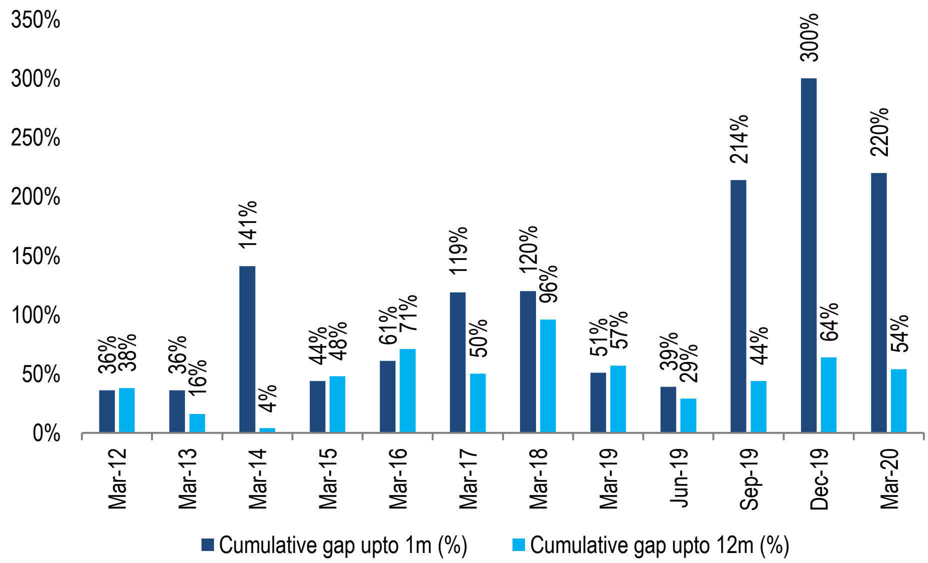
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 29: Cumulative mismatch (Rsbn) (4QFY20)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 30: ALM management

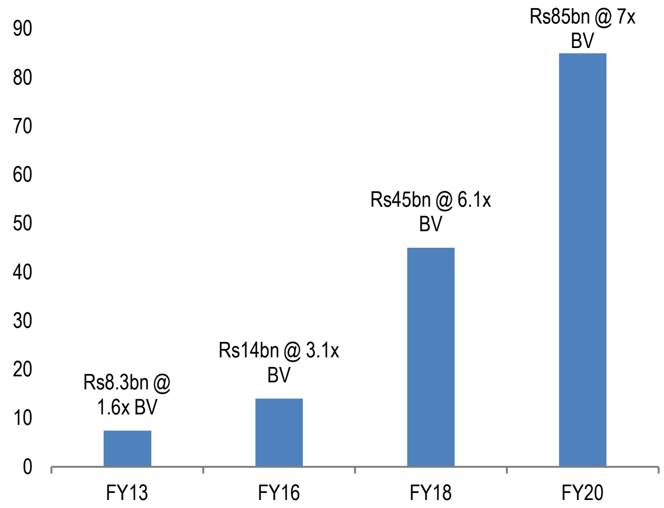


Source: Company, Nirmal Bang Institutional Equities Research

Equity raising track-record

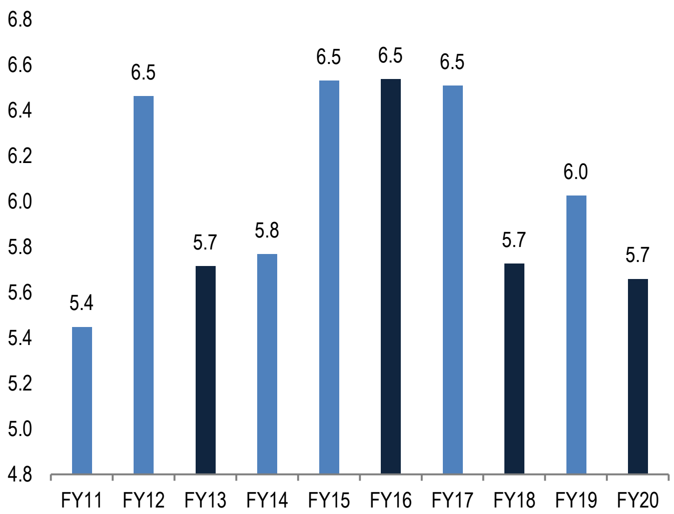
Considering the potential for consumerism and consumer finance in India, there has been no dearth of appetite for the stock. In its latest capital infusion round, the company raised Rs85bn (43% of FY19 net worth) at a valuation of >7x FY20 BV. We have seen that the company usually raises capital near 6.5-7x leverage. Over the last 10 years, the average leverage has been ~6x. Speaking about capital raising, it is also important to reflect on the valuation multiples the stock has commanded over the last decade.

Exhibit 31: Capital raising history



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Leverage (x)*



Source: Company, Nirmal Bang Institutional Equities Research
*The darker colored bars in 'leverage (x)' denote the year of capital raising

Exhibit 33: Capital raising history

Year	Amt (Rsbn)	Issue price (Rs)	BVPS (Rs)	Issue P/B (x)	Leverage (x)
FY13	8.3	1,100	676	1.6	5.7
FY14	-	-	-	-	5.8
FY15	-	-	-	-	6.5
FY16	14	4,275	1,368	3.1	6.5
FY17	-	-	-	-	6.5
FY18	45	1,692	275	6.1	5.7
FY19	-	-	-	-	6.0
FY20	85	3,900	537	7.3	5.7

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 34: Historical valuations

Average P/ABV	trailing	1-year forward
last 10 years	4.9	3.5
last 8 years	5.6	4.0
last 5 years	7.5	5.3
last 3 years	8.6	6.2
last 1 year	9.4	7.1
Current	4.7	4.3

Source: Company, Nirmal Bang Institutional Equities Research

Top quality balance sheet among peers

A comparison across NBFC peers shows that BAJF has one of the strongest balance sheets with reasonably lower NPAs and high capitalization ratios. The company is able to generate ROE of >20% with significantly lower leverage. We have seen that the company usually raises capital near 6.5-7x leverage. Over the last 10 years, the average leverage has been ~6x. Among a larger set of peers, it is one of the few to have been able to successfully scale up the deposit franchise. Share of deposits stands at 17% and is likely to inch higher going forward considering the management's liability strategy.

During the current crisis (covid-19), we believe BAJF is well-positioned from an overall liabilities standpoint. Our reading of the company and management's earnings call interactions make us believe that the company has a conservative stance on liquidity management which makes it averse to taking liquidity risks. The company's long-term rating is AAA, which is at par with HDFC Ltd and LIC Housing Finance. Also note that BAJF's bond issues have generally commanded lower spreads than most of its peers, implying the confidence debt investors have in the company.

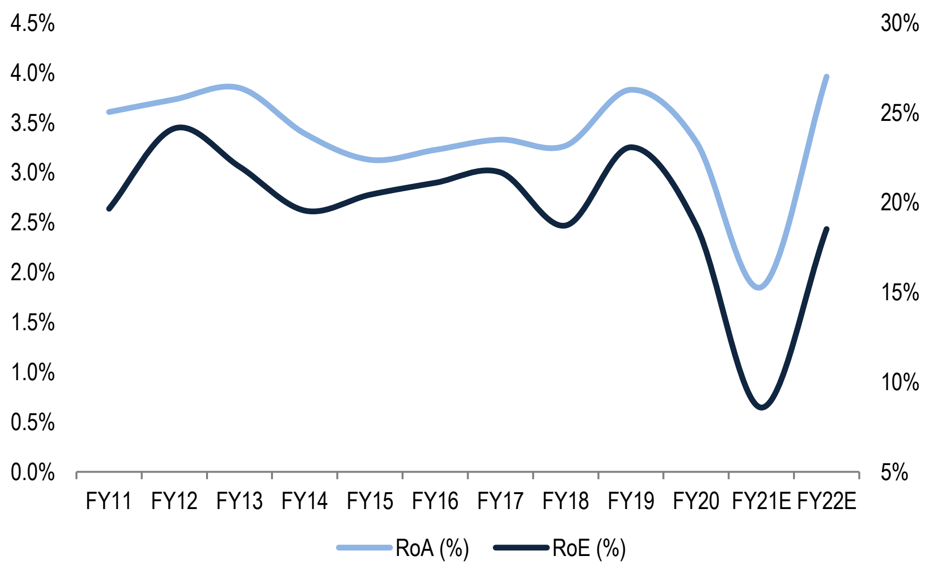
From covid-impact standpoint, the near-term focus would be on capital preservation and balance sheet protection. Recent equity capital raise of Rs85bn combined with subdued growth outlook in FY21 should keep the balance sheet strength intact. We build in higher liquidity on the balance sheet, modeling 10-17% of balance sheet as being held in cash and investments compared to a steady-state average of 6.6%.

Exhibit 35: Peer comparison

Balance sheet - peer comparison	Bajaj Finance	Chola Inv & Fin Co.	HDFC Ltd	Indiabulls HF	LIC HF	L&T Finance	Manappuram Fin	Muthoot Finance	M&M Finance	PNB HF	SCUF	STFC
Leverage (x) (total assets / s/hs' funds)	5.1	7.8	6.1	6.1	12.1	7.5	5.0	4.0	6.5	10.2	4.3	6.3
Cash + liquid investments (as % of total assets)	11.5%	11.0%	12.6%	19.4%	2.3%	7.7%	12.9%	12.8%	9.9%	7.6%	5.0%	8.9%
Deposits (as % of total borrowings)	17%	-	32%	-	6%	-	-	-	15%	19%	19%	12%
Tier-I (%)	21.3%	15.3%	16.6%	19.8%	12.5%	17.7%	22.9%	26.2%	15.4%	14.1%	25.3%	18%
GNPA (%)	1.6%	3.8%	2.0%	1.9%	2.7%	5.4%	0.9%	2.5%	8.4%	1.8%	8.5%	8.4%
NNPA (%)	0.7%	2.6%	1.0%	1.5%	1.5%	2.3%	0.4%	0.7%	6.0%	1.3%	5.0%	5.8%
PCR (%)	59.6%	31.1%	48.0%	1.1%	45.4%	57.5%	55.1%	73.5%	29.1%	28.4%	41.5%	30.7%
Credit rating	AAA/stable	AA+/stable	AAA/stable	AA/stable	AAA/stable	AAA/stable	AA/stable	AA/positive	AA+/stable	AA/negative	AA+ (CARE)	AA+/stable

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: Profitability ratios to dip in FY21 on back of high provisioning



Source: Company, Nirmal Bang Institutional Equities Research

Significant asset quality challenges in the near-to-medium term

With the lockdown having gone beyond the company's worst case scenario, which assumed lockdown till 15th May 2020, we think the asset quality challenges in FY21/22 will be quite significant. The earlier estimate was that credit costs (in absolute terms) would increase by 80-90% in FY21 (over FY20). Based on our current estimates, we expect a 55% increase in provisioning in FY21. Given the anticipated asset quality pain, we expect write-offs to be high. Our near-term view is that the management should be able to limit operating profit decline to 3% in FY21, given its ability to manage costs (collection costs will increase though). However, we expect PBT to decline on account of high provisioning. Particularly, we expect high NPA formation in auto finance (much more vulnerable to credit shocks) and SME (which is said to be in severe pain). Except for the 2-wheeler segment, the customer base (mass affluent) consists 65-67% of salaried class which should limit credit quality challenges unless there are widespread job losses. Further, ~65% of the customers have a bureau score of >750. In the B2C segment, the company has been avoiding the self-employed segment lately. During FY20, existing customers have contributed to 65-70% of the loans. Long-term view is that existing customers should form 72-74% of the business since they are better from a risk standpoint. For perspective – loan losses on an existing customer is 1/3rd of that in case of a new customer. By design, during times of slowdown/macro stress, the company reduces new customer acquisition, which should help limit NPA formation in the near-term to some extent. On a steady-state basis, we think that the management has been quite proactive in recognizing stress and providing for it upfront. Provisioning norms have always been more stringent than regulatory requirements and have been accelerated during early stage of delinquencies.

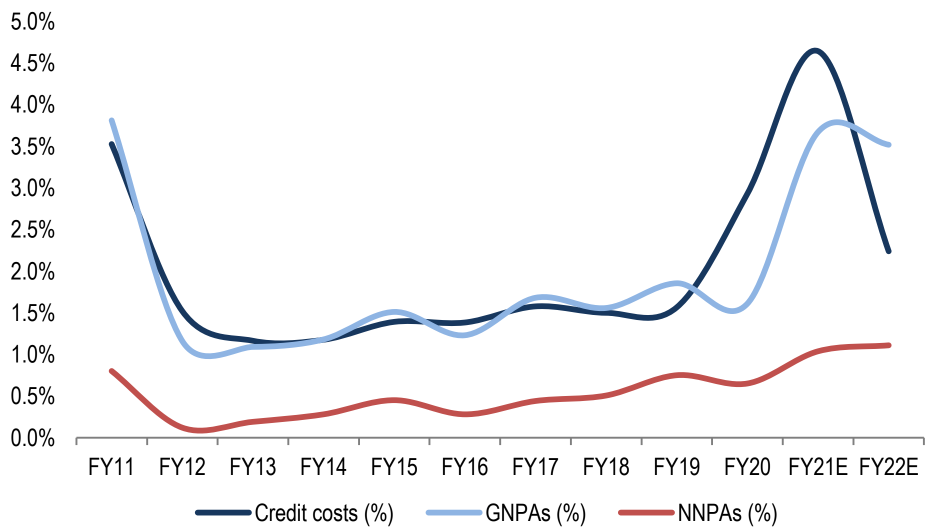
We also believe that the company's approach towards risk is a highly comprehensive one, which takes priority over growth.

4QFY20 management commentary on asset quality risks/challenges:

- Taking a cautious stance on lending in the current environment and tightening credit underwriting and LTV norms across all segments till July 2020.
- In B2C and SME segments, the company is taking a cautious stance to not lend till the lockdown is lifted.
- Mortgage business is mostly present in top 30 cities, most of which are in red zones – this could impact asset quality.
- Commercial lending is being restricted to only existing customers.
- Bounce rates are up significantly across segments (even in some of the safest ones such as loans to professionals). Post April, bounce rates haven't deteriorated further.
- Have refrained from giving moratorium to those who displayed higher likelihood of defaulting.
- Current focus will be on doing business with existing customers rather than new-to-Bajaj customers as the former have lower risk.
- Have beefed up the collections infra significantly; would go after collections and repayments as soon as the lockdown is lifted.
- Company has built multiple scenarios on potential Covid-19 credit cost impact which take into account various factors, including phasing of lockdown, behavior of moratorium customers, collection capacity management, changes in regulatory forbearances and response of the economy post lockdown.

We estimate credit costs to remain high in the near-term and gradually revert to normal 1QFY22 onwards.

Exhibit 37: Significant asset quality challenges in the near-to-medium term



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: Credit cost estimates

	1QFY21E	2QFY21E	3QFY21E	4QFY21E	1QFY22E	2QFY22E	3QFY22E	4QFY22E
Net slippages (%)								
Auto finance business	6.5	6.5	6.5	6.0	4.0	3.0	2.0	-1.0
Sales finance business	4.0	4.0	4.0	3.0	2.0	1.8	1.5	0.8
Consumer B2C business	2.0	2.0	2.0	1.0	1.0	0.5	-0.2	-0.2
Rural B2B business	2.0	2.0	2.0	1.0	0.5	0.2	0.2	-0.2
Rural B2C business	2.0	2.0	2.0	1.0	0.5	0.2	0.2	-0.2
SME business	3.0	3.0	3.0	3.0	1.8	1.5	0.5	-0.5
Securities lending business	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial lending business	2.0	2.0	2.0	2.0	0.8	0.5	0.5	0.3
Mortgages	1.3	1.3	1.3	1.0	0.8	0.5	-0.2	-0.2
Total	2.4	2.4	2.4	1.8	1.3	0.9	0.3	-0.2
NPA provisions (%)								
Auto finance business	4.0	4.6	4.9	4.5	2.9	2.1	1.4	-0.7
Sales finance business	3.2	3.2	3.2	2.4	1.6	1.5	1.2	0.6
Consumer B2C business	1.5	1.6	1.6	0.8	0.8	0.4	-0.2	-0.2
Rural B2B business	1.6	1.6	1.6	0.8	0.4	0.2	0.2	-0.2
Rural B2C business	1.4	1.4	1.4	0.7	0.4	0.1	0.1	-0.1
SME business	2.4	2.4	2.4	2.4	1.5	1.2	0.4	-0.4
Securities lending business	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial lending business	1.2	1.2	1.2	1.2	0.5	0.3	0.3	0.2
Mortgages	0.4	0.4	0.5	0.4	0.3	0.2	-0.1	-0.1
Overall credit costs (%)	**5.3**	**5.0**	**4.5**	**3.7**	**3.0**	**2.5**	**1.9**	**1.5**

Exhibit 39: Asset quality estimates/assumptions

	1QFY21E	2QFY21E	3QFY21E	4QFY21E	1QFY22E	2QFY22E	3QFY22E	4QFY22E
Gross stage 3 assets (GNPAs) (Rsbn)	32.3	39.8	47.0	53.1	57.7	61.1	62.2	61.4
Net stage 3 assets (NNPAs) (Rsbn)	10.9	12.2	13.2	15.0	16.7	18.3	19.1	19.4
Gross stage 3 assets (GNPAs) (%)	2.5	3.3	3.5	3.7	3.8	3.8	3.7	3.5
Net stage 3 assets (NNPAs) (%)	0.9	1.0	1.0	1.0	1.1	1.1	1.1	1.1
Stage 1 & 2 - ECL provisions o/s (Rsbn)	26.9	30.3	33.7	37.0	40.6	43.6	46.0	48.5
Stage 3 - ECL provisions o/s (Rsbn)	21.4	27.6	33.8	38.1	41.0	42.8	43.1	42.1
Net provisioning during the period	17.8	15.7	14.5	12.9	11.3	9.9	7.6	6.6
Write-offs during the period	6.7	6.2	4.8	5.2	4.8	5.1	4.9	5.1
Stage 1 & 2 ECL provisioning (%)	1.2	1.1	1.1	1.0	1.0	0.8	0.6	0.6
Stage 3 provisioning (%)	4.1	4.0	3.4	2.7	2.1	1.8	1.3	1.0
Stage 1 & 2 ECL coverage (%)	2.2	2.6	2.6	2.7	2.8	2.8	2.8	2.9
Stage 3 ECL coverage (%)	66.3	69.3	72.0	71.7	71.0	70.0	69.2	68.5
Write-offs as % of avg loans (%)	2.0	2.0	1.5	1.5	1.3	1.3	1.2	1.2

Exhibit 40: Segment wise asset quality - Stress in auto, consumer B2B and SME has increased meaningfully in 4QFY20

Segment-wise GNPA (%)	FY18	1QFY19	2QFY19	3QFY19	4QFY19	FY19	1QFY20	2QFY20	3QFY20	4QFY20	FY20
Auto finance business	5.70	5.70	5.76	5.42	5.12	5.12	5.19	5.57	5.68	6.47	6.47
Sales finance business	1.22	1.03	1.08	0.86	1.05	1.05	1.16	1.08	0.92	1.33	1.33
Consumer B2C business	1.69	1.67	1.66	1.49	1.40	1.40	1.63	1.49	1.34	1.62	1.62
Rural B2B business	0.87	0.82	0.77	0.60	0.93	0.93	0.97	1.15	0.59	0.55	0.55
Rural B2C business	1.24	1.31	1.42	1.42	1.53	1.53	1.63	1.41	1.33	1.53	1.53
SME business	1.85	1.87	1.86	1.75	1.49	1.49	1.64	1.49	1.41	1.70	1.70
Commercial lending business	0.00	0.00	0.00	0.00	0.64	0.64	0.61	0.58	0.60	0.03	0.03
Mortgages	0.46	0.55	0.81	1.38	1.23	1.23	1.19	1.20	1.36	0.53	0.53
Total	**1.41**	**1.39**	**1.49**	**1.55**	**1.54**	**1.54**	**1.60**	**1.61**	**1.61**	**1.61**	**1.61**

Segment-wise NNPA (%)	FY18	1QFY19	2QFY19	3QFY19	4QFY19	FY19	1QFY20	2QFY20	3QFY20	4QFY20	FY20
Auto finance business	2.25	2.27	2.24	2.11	2.06	2.06	2.14	2.36	2.61	3.08	3.08
Sales finance business	0.28	0.13	0.30	0.26	0.26	0.26	0.27	0.26	0.18	0.35	0.35
Consumer B2C business	0.42	0.47	0.46	0.38	0.38	0.38	0.45	0.41	0.38	0.49	0.49
Rural B2B business	0.52	0.47	0.41	0.32	0.36	0.36	0.31	0.36	0.12	0.10	0.10
Rural B2C business	0.59	0.62	0.72	0.63	0.61	0.61	0.61	0.45	0.44	0.51	0.51
SME business	0.38	0.43	0.44	0.34	0.32	0.32	0.35	0.34	0.36	0.56	0.56
Commercial lending business	0.00	0.00	0.00	0.00	0.29	0.29	0.26	0.23	0.25	0.03	0.03
Mortgages	0.17	0.23	0.47	0.96	0.89	0.89	0.86	0.87	0.99	0.34	0.34
Total	**0.43**	**0.44**	**0.53**	**0.62**	**0.63**	**0.63**	**0.64**	**0.65**	**0.70**	**0.65**	**0.65**

Segment-wise PCR (%)	FY18	1QFY19	2QFY19	3QFY19	4QFY19	FY19	1QFY20	2QFY20	3QFY20	4QFY20	FY20
Auto finance business	61	60	61	61	60	60	59	58	54	52	52
Sales finance business	77	87	72	70	75	75	77	76	80	74	74
Consumer B2C business	75	72	72	74	73	73	72	72	72	70	70
Rural B2B business	40	43	47	47	61	61	68	69	80	82	82
Rural B2C business	52	53	49	56	60	60	63	68	67	67	67
SME business	79	77	76	81	79	79	79	77	74	67	67
Commercial lending business					55	55	57	60	58	10	10
Mortgages	63	58	42	30	28	28	28	28	27	36	36
Total	**70**	**68**	**64**	**60**	**59**	**59**	**60**	**60**	**57**	**60**	**60**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 41: 0-dpd trends

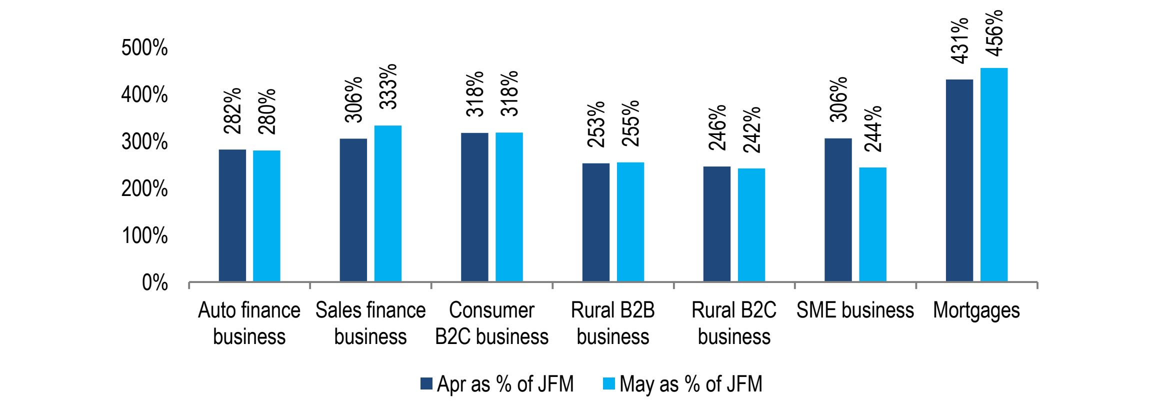
0-dpd trends										
Period	Consumer durable	Two/three wheeler	Lifestyle	Digital product	Personal loan cross sell	Salaried personal loan	Business & professional loan	LAP	Home loans	Rural (overall)
1QFY15	98.5%	88.4%	98.4%	98.1%	96.1%	99.8%	99.0%	98.9%	98.9%	98.8%
2QFY15	98.2%	88.0%	98.6%	97.7%	96.4%	99.6%	99.1%	98.8%	99.1%	98.7%
3QFY15	98.4%	88.8%	98.5%	97.8%	96.6%	99.6%	99.1%	98.8%	99.1%	98.8%
4QFY15	98.1%	89.2%	98.5%	97.0%	96.9%	99.6%	99.0%	98.4%	98.9%	98.6%
1QFY16	98.3%	88.5%	98.3%	96.4%	97.0%	99.6%	98.9%	98.5%	99.1%	98.8%
2QFY16	98.1%	88.8%	98.4%	96.7%	97.1%	99.6%	99.0%	98.7%	99.2%	98.7%
3QFY16	98.4%	89.8%	98.4%	97.2%	97.1%	99.5%	98.9%	99.3%	99.2%	98.9%
4QFY16	98.1%	89.9%	98.3%	96.9%	97.3%	99.5%	98.8%	99.2%	99.0%	98.9%
1QFY17	98.1%	89.3%	97.5%	96.5%	97.2%	99.5%	98.7%	99.2%	99.0%	98.4%
2QFY17	97.7%	89.2%	97.2%	96.1%	97.2%	99.4%	98.8%	99.3%	99.0%	98.5%
3QFY17	98.1%	83.9%	97.4%	96.8%	97.8%	99.5%	98.9%	99.1%	99.4%	98.8%
4QFY17	97.8%	85.7%	97.3%	97.3%	97.3%	99.5%	98.7%	99.2%	99.0%	99.2%
1QFY18	98.4%	85.9%	97.3%	97.9%	97.2%	99.5%	98.5%	99.1%	98.9%	99.2%
2QFY18	98.6%	85.8%	98.4%	98.7%	97.3%	99.6%	98.6%	98.6%	98.8%	99.2%
3QFY18	98.8%	87.9%	98.6%	98.9%	97.5%	99.6%	98.6%	98.3%	99.0%	99.2%
4QFY18	98.9%	88.8%	98.7%	98.5%	97.6%	99.7%	98.7%	99.2%	99.5%	98.9%
1QFY19	99.0%	87.6%	98.6%	98.5%	97.6%	99.7%	98.8%	99.3%	99.5%	98.9%
2QFY19	98.9%	88.3%	98.7%	98.7%	97.7%	99.7%	98.8%	99.2%	99.4%	98.7%
3QFY19	99.0%	89.7%	98.8%	98.8%	97.8%	99.7%	98.8%	97.0%	99.5%	99.0%
4QFY19	98.7%	90.2%	98.5%	98.3%	97.8%	99.7%	98.8%	97.7%	99.5%	98.9%
1QFY20	98.5%	88.7%	98.2%	97.7%	97.5%	99.7%	98.6%	97.7%	99.4%	98.7%
2QFY20	98.5%	87.6%	97.8%	97.9%	97.2%	99.6%	98.4%	97.3%	99.6%	98.6%
3QFY20	98.6%	85.8%	97.8%	98.2%	97.0%	99.6%	98.4%	97.1%	99.6%	98.5%
4QFY20	98.7%	86.0%	98.1%	98.5%	97.0%	99.6%	98.3%	97.1%	99.6%	98.5%

Exhibit 42: Covid-19 portfolio bounce performance

Business segment	AUM (April 30th) (Rsbn)	AUM under morat (Rsbn)	% of AUM under morat	Avg bounce rate for JFM	Bounce rate as of Apr'20	Bounce rate as of May'20	% of loans with no recent bounce	Covid provision (Rsbn)	Provisions as % of morat book
Auto finance business	137	96	70%	24.2%	68.2%	67.8%	69%	2.1	2.2%
Sales finance business	106	27	26%	9.0%	27.5%	30.0%	70%	0.6	2.3%
Consumer B2C business	305	88	29%	12.5%	39.7%	39.8%	67%	2.5	2.9%
Rural B2B business	23	7	30%	14.5%	36.7%	37.0%	64%	0.1	1.6%
Rural B2C business	107	30	28%	19.2%	47.3%	46.4%	56%	1.0	3.2%
SME business	190	57	30%	10.5%	32.1%	25.6%	65%	1.7	3.1%
Securities lending business	40	0	0.30%	-	-	-	-	0.0	-
Commercial lending business	62	15	25%	-	-	-	-	0.3	1.7%
Mortgages	460	65	14%	4.5%	19.4%	20.5%	74%	0.7	1.1%
Consolidated	**1,431**	**386**	**27%**	**12.0%**	**35.3%**	**36.9%**	**68%**	**9.0**	**2.3%**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 43: Bounce rate comparison (%)



Source: Company, Nirmal Bang Institutional Equities Research

Management longevity

Across the business landscape, one of the key tenets that helps organizations sustain and grow in size and (shareholder) value is management longevity; longer is better. We have seen such a trend play out from time to time, especially in case of some of the 'richly valued' stocks such as Bajaj Finance, HDFC Bank, Kotak Mahindra Bank.

At BAJF, we observe that more than 75% of the management team has been around since last 7-18 years, which partially explains the sustained business performance over the years. Our reading of the key management personnel indicates that most are well-experienced in multiple business lines (outside of their current profiles).

Board of directors	
Rahul Bajaj	Chairman, non-executive
Late NanooPamnani	Vice chairman, non-executive, independent
Sanjiv Bajaj	Vice Chairman, non-executive
Rajeev Jain	Managing Director, executive
Madhur Bajaj	Non-executive
Rajiv Bajaj	Non-executive
Dipak Poddar	Non-executive, independent
Ranjan Sanghi	Non-executive, independent
D J Balaji Rao	Non-executive, independent
Omkar Goswami	Non-executive, independent
Gita Piramal	Non-executive, independent

Management team	
Rajeev Jain	Managing Director (since Sep-07)
Sandeep Jain	Chief Financial Officer (since Aug-08)
Atul Jain	CEO, Bajaj Housing Finance Ltd (since Mar-02)
Anup Saha	President, Consumer business (since Oct-17)
Deepak Bagati	Chief risk officer (since Jul-08)
Ashish Panchal	President - Rural, insurance & liabilities and Chief of staff (since Jan-11)
MM Muralidharan	Treasurer
Sachin Sikka	Chief Business Officer (Fixed deposits) (since Apr-13)

Channel checks reinforce our thesis that BAJF is 'on top of the game' and poised to gain the most from economic recovery

Our interaction with a large multi-brand retailer is strong evidence of how BAJF has consistently approached business in a far more differentiated manner than competitors. One of the key takeaways from our interaction is that BAJF's capability to support high volumes on the shop floor, especially during festive periods, is a key differentiator (by a large margin). Strong vendor-level relationships with complete transparency since day one have been the hallmark of how BAJF conducts business with vendors. Another key inference that we make is that lowest TAT has been an outcome of being customer centric.

Following are the key takeaways from our interaction/channel check:

Sales are currently (in May/June'20) down 50% compared to Feb'20 levels. Cities with higher proportion of IT crowd should be less impacted as the IT industry itself isn't that much impacted because of covid. For the full year (FY21), sales/consumer demand is expected to be down 20-25%. Demand for low-cost mobiles is down 40% currently.

BAJF restarted operations/activated back around mid-May'20 and has restricted it to existing customers only. Discussions are currently underway on how to start entertaining new customers. Current sense is that BAJF wants to entertain new customers only at key partners which are large-format multi-brand stores (Croma, Reliance, etc.). Business in small standalone shops would be restricted to existing customers only.

Though BAJF has not cut down on PoS staff for key partners, but the staff itself has not reported back to work after the lifting of the lockdown. These staff are usually young boys/girls, who stay in PG/hostels and eat from canteens/mess. With everything shut, they have returned to their native places.

On a steady state basis, BAJF has a 60-65% market share in the consumer finance market and that has remained stable over time (in line with management commentary). BAJF's market share in tier2/3/lower towns is even higher as banks and most other financiers have not made in-roads because of perceivably higher risks and cost of operations. In many cases, BAJF is the sole financier.

A key differentiating factor is that BAJF offers product-wise schemes compared to other financiers which mostly offer a plain vanilla scheme (i.e., a blanket scheme applicable across product categories). For this reason, BAJF is a preferred finance partner among large number of retailers.

In terms of overall processes and ultimate TAT, BAJF is far ahead of others. This feature stands out and possibly matters the most during festive season sales when in-store traffic is high and customers are looking for smooth, seamless and quick transaction times and not for lower rate necessarily. Higher TAT help retailers push more volumes.

BAJF has the most bandwidth to deploy sales persons to handle unanticipated surge in volumes and in-store traffic, especially during rush hours or peak periods (during festival time). We believe that this highlights BAJF's flexibility and strength in terms of manpower on stand-by. We learn that on this same criteria, most other financiers struggle big time and lag BAJF by a wide margin. In a way, capacity is not a constraint for BAJF as in the case of competitors. Such preparedness makes BAJF a preferred financer partner among retailers.

EMI cards have been very popular in facilitating uninterrupted and smooth purchases/buying-transactions. As already known, a customer does not have to submit any documentation – he/she simply has to walk in, choose the product and swipe the EMI card at the counter.

Most importantly, BAJF's processes and workings with vendor partners have been very smooth and open with no discrimination between a large and a small retailer. We learnt that what vendors appreciate most about BAJF is its transparency since day one.

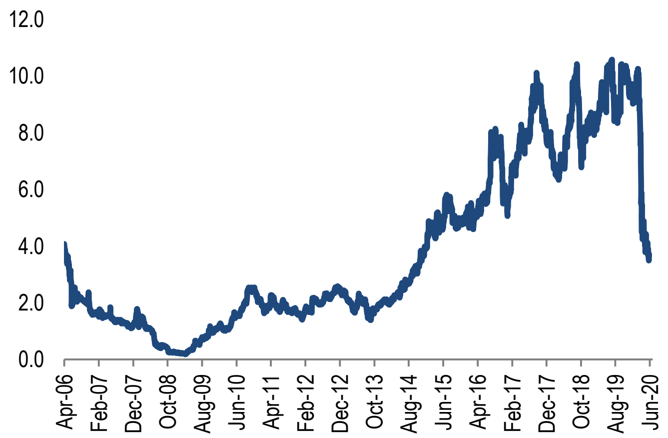
Outlook and valuation: One of best placed to capture consumption trends; near-term headwinds are only transient, not structural

The near-term asset quality and growth impact is inevitable, not only for BAJF but for the whole lending space. At the current juncture, rising NPAs is a given. Therefore, we focus on the long-term structural growth story that BAJF presents as the basis of our thesis. BAJF enjoys a dominant market share in the consumer finance industry (60-65%). Despite attracting competition, owing to the segment's high margins and profitability, the company has been able to defend its market share in the manufacturers' subvention pool (as management claims as well as per our channel checks). Our consumer durables (CD) analyst, Chirag Muchhala, is positive on the long-term consumption patterns given the relatively small size of CD industry (Rs763bn) compared to India's GDP and large population size. Rising affordability and growing necessity are some of the structural demand drivers for the CD industry. At a more micro level, we think that easy repayment options such as no/low-cost EMIs should supplement affordability and ownership. We remain positive on BAJF's growth trajectory given their track record of product innovation, focus on customer convenience (which ensures stickiness) and early investments in setting up a enviable infra to cater to low-ticket size/high-volume business. The company's distribution strength remains unparalleled. A network of >114,400 touchpoints places the company well enough to gain from the consumption bounce back.

For FY21E, we expect AUM growth to be low (0.4%) followed by a 21% growth in FY22E on the back of a broader economic recovery. We also expect provisioning to consume 56% of operating profit in FY21E compared to an average of 20%, which will suppress ROE in the near term. Segment wise, auto finance, sales finance and SME business are likely to throw up higher NPA challenges and provisioning requirements. We are building in asset quality recovery only from 3QFY22E onwards. The company should get back to 20% ROE trajectory by 2HFY22E.

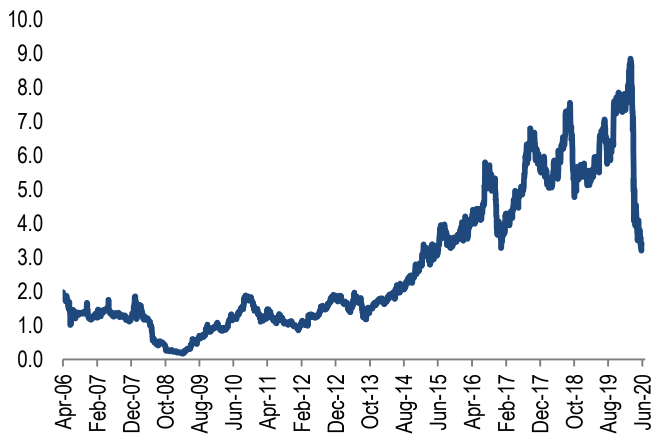
Over the last 8-10 years, the stock has traded at an average of 3.5-4x 1-year forward ABV. In more recent years, we have seen the ABV multiple getting re-rated to 5-7x. Two most important factors that explain such a stock price performance are strong balance sheet and average ROE of ~21% over last 10 years. What further adds to the premium valuation is the visibility on ROE sustainability and an overall 20-25% growth trajectory. We assign a 4.5x to our FY22E ABV estimate to arrive at a fair value estimate of Rs3026. Our target multiple is based on the lower-end of the average valuation the stock has commanded over the last 5-8 years. The stock is down 50% from its peak. In our worst case/most bearish scenario, we expect 67% downside for the stock, assuming it gets de-rated to 2x and there is a >20% impairment in BV. However, we think that the possibility of such a scenario is extremely remote. The company's equity capital raising track record is proof of its ability to attract investor interest even at high valuation. Based on our base case FY22E ABV, we think the risk-reward ratio is extremely favourable.

Exhibit 44: P/ABV (ttm)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 45: P/ABV (1-year forward)



Source: Company, Nirmal Bang Institutional Equities Research

Our worst-case scenario suggests >20% impairment in ABV from current levels and a 65-67% downside for the stock – but scenario probability remote

Exhibit 46: Scenario analysis

Book under morat (Rsbn)	386								
NPA slippage from morat book (%) (assumption)	25%			50%			75%		
NPA slippage from morat book (Rsbn)	96			193			289		
Provisions on incremental slippages (%) (assumption)	60%	70%	80%	60%	70%	80%	60%	70%	80%
Provisions on incremental slippages (Rsbn) (assumption)	58	68	77	116	135	154	174	203	232
Cumulative NNPA formation (FY21+22, Rsbn)	39	29	19	77	58	39	116	87	58
Cumulative PPOP (FY21+FY22)	246								
Incremental provisions as a % of PPOP (FY21+22)	24%	27%	31%	47%	55%	63%	71%	82%	94%
Cumulative PBT (FY21+22)	188	179	169	130	111	92	73	44	15
Cumulative PAT (FY21+22)	140	133	126	97	83	68	54	32	11
Cumulative dividend payout (FY21+22)	11								
Closing ABV (FY20)	314								
Closing ABV (FY22)	405	407	410	323	328	333	241	249	256
Closing ABVPS (FY22)	672	677	681	537	545	553	401	413	426

Exhibit 47: Stress scenario fair value estimates

				FY22E ABVPS (Rs)					
ABV multiple (x)	**672**	**677**	**681**	**537**	**545**	**553**	**401**	**413**	**426**
2	1,345	1,353	1,361	1,073	1,090	1,106	802	827	851
3	2,017	2,030	2,042	1,610	1,635	1,659	1,203	1,240	1,277
4	2,690	2,706	2,723	2,147	2,180	2,213	1,604	1,653	1,702
5	3,362	3,383	3,403	2,684	2,725	2,766	2,005	2,066	2,128

Exhibit 48: Stress scenario returns (%)

				FY22E ABVPS (Rs)					
ABV multiple (x)	**672**	**677**	**681**	**537**	**545**	**553**	**401**	**413**	**426**
2	-45%	-45%	-44%	-56%	-55%	-55%	-67%	-66%	-65%
3	-18%	-17%	-17%	-34%	-33%	-32%	-51%	-49%	-48%
4	10%	11%	11%	-12%	-11%	-10%	-34%	-32%	-30%
5	37%	38%	39%	10%	11%	13%	-18%	-16%	-13%

Source: Company, Nirmal Bang Institutional Equities Research

Key risks:

- Second-wave of covid-19 virus and a likely lockdown would impact business growth and asset quality severely.
- Lower growth, higher slippages (than expected) would hurt our profit and book value estimates.
- Deterioration in macros and company financials could result in higher cost of funds, impacting our margin/profit estimates.
- Severe deterioration in company fundamentals, including but not limited to all of the above, could resulting in valuation multiple de-rating.

Exhibit 49: Shareholding Information

Top 20 investors' shareholding	(%)
Bajaj Finserv Ltd. (promoter)	52.82
Government of Singapore	4.46
Maharashtra Scooters Ltd.	3.15
Steadview Capital Mauritius Ltd.	0.79
New Horizon Opportunities Master Fund	0.77
Axis Long term Equity Fund	0.76
ICICI Prudential Life Insurance Company Ltd.	0.68
SBI ETF Nifty 50	0.65
New World Fund Inc.	0.56
Small Cap World Fund Inc.	0.54
Vanguard Total International Stock Index Fund	0.52
SBI Life Insurance Co. Ltd.	0.48
Nomura India Investment Fund	0.48
SBI Equity Hybrid Fund	0.45
Vanguard Emerging Market Stock Index Fund	0.44
Axis Bluechip Fund	0.41
Axis Focused 25 Fund	0.36
Government Pension Fund Global	0.33
UTI – Equity Fund	0.32
People's Bank Of China	0.32

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 50: Income Statement

Y/E March (Rs Mn)	FY19	FY20	FY21E	FY22E
Operating income	1,79,074	2,56,856	2,58,115	3,11,723
Interest expense	67,227	94,732	96,247	1,11,169
Net interest income	**1,11,847**	**1,62,124**	**1,61,868**	**2,00,554**
Non-interest income	6,490	7,020	6,208	7,210
Net revenue	**1,18,337**	**1,69,144**	**1,68,076**	**2,07,764**
Operating expenses	41,483	56,628	58,781	70,810
Operating profit	**76,854**	**1,12,516**	**1,09,295**	**1,36,954**
Provisions	15,013	39,295	60,905	35,431
PBT	61,840	73,221	48,391	1,01,522
Tax	21,839	20,584	12,388	25,990
PAT	**40,002**	**52,638**	**36,003**	**75,533**

Exhibit 51: Balance Sheet

Y/E March (Rs Mn)	FY19	FY20	FY21E	FY22E
Share capital	1,154	1,203	1,203	1,203
Reserves & surplus	1,95,581	3,22,076	3,50,859	4,22,791
Shareholders' funds	**1,96,734**	**3,23,280**	**3,52,062**	**4,23,995**
Borrowings	10,15,879	12,98,060	12,91,411	14,72,481
Other liabilities & prov.	49,887	22,574	41,884	50,571
Total liabilities	**12,62,500**	**16,43,914**	**16,85,357**	**19,47,046**
Loans	11,45,704	14,13,761	14,47,896	17,46,660
Cash & investments	89,269	1,89,266	1,80,797	1,32,523
Fixed & other assets	27,065	40,887	56,663	67,863
Total assets	**12,62,038**	**16,43,914**	**16,85,357**	**19,47,046**

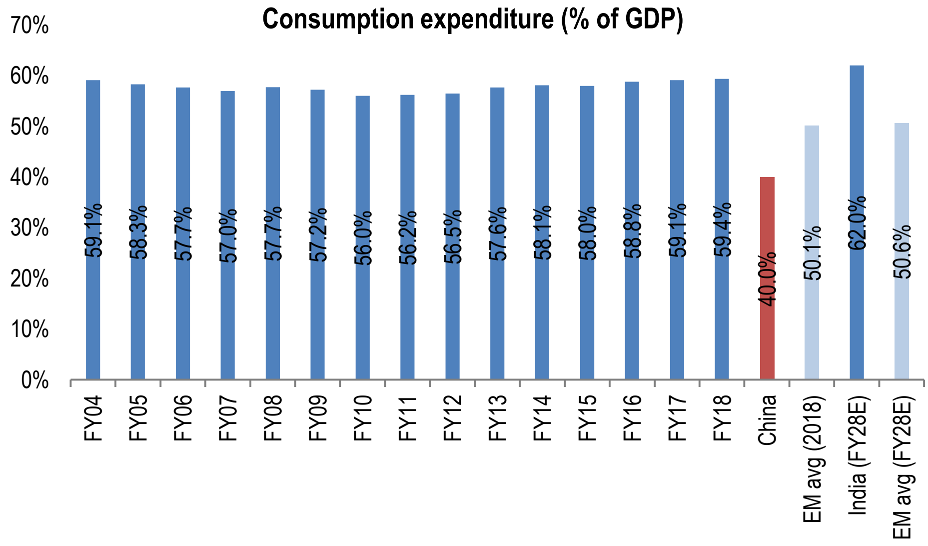
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 52: Ratios

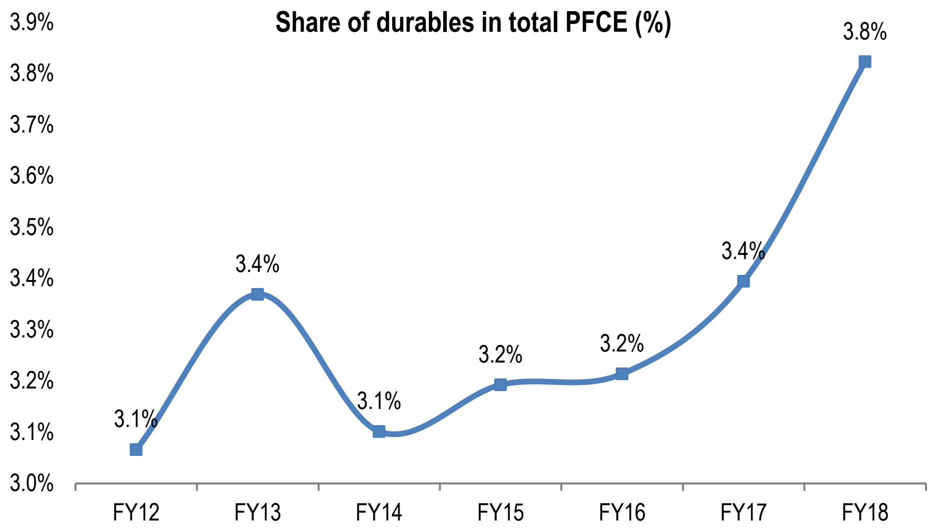
Y/E March	FY19	FY20	FY21E	FY22E
Growth (%)				
Net interest income	46.3	45.0	-0.2	23.9
Operating profit	57.8	46.4	-2.9	25.3
Profit after tax	60.5	31.6	-31.6	109.8
Loans	42.1	23.4	2.4	20.6
Spreads (%)				
Yield on loans	17.0	17.5	17.5	17.3
Cost of funds	8.0	8.1	8.1	8.1
Spread	9.1	9.5	9.4	9.2
NIMs	10.1	10.3	10.2	10.4
Operational efficiency (%)				
Cost-to-income	35.1	33.5	35.0	34.1
Cost to avg assets	3.9	3.9	3.5	3.9
CAR (%)				
Tier I	16.3	18.6	22.8	22.9
Tier II	4.4	3.9	3.9	3.9
Total	20.7	22.5	26.7	26.8
Asset quality (%)				
Gross NPA	1.9	1.6	3.7	3.5
Net NPA	0.7	0.7	1.0	1.1
PCR	59.6	59.6	71.7	68.5
Credit cost	1.6	2.9	4.6	2.2
Profitability (%)				
ROE	23.1	18.7	8.6	18.5
ROA	3.8	3.3	1.9	4.0
Per share (Rs)				
EPS	69	87	60	126
BVPS	341	537	585	705
ABVPS	329	522	560	672
Valuation (x)				
P/E	43.6	25.3	40.9	19.5
P/BV	8.9	4.1	4.2	3.5
P/ABV	9.2	4.2	4.4	3.6

Source: Company, Nirmal Bang Institutional Equities Research

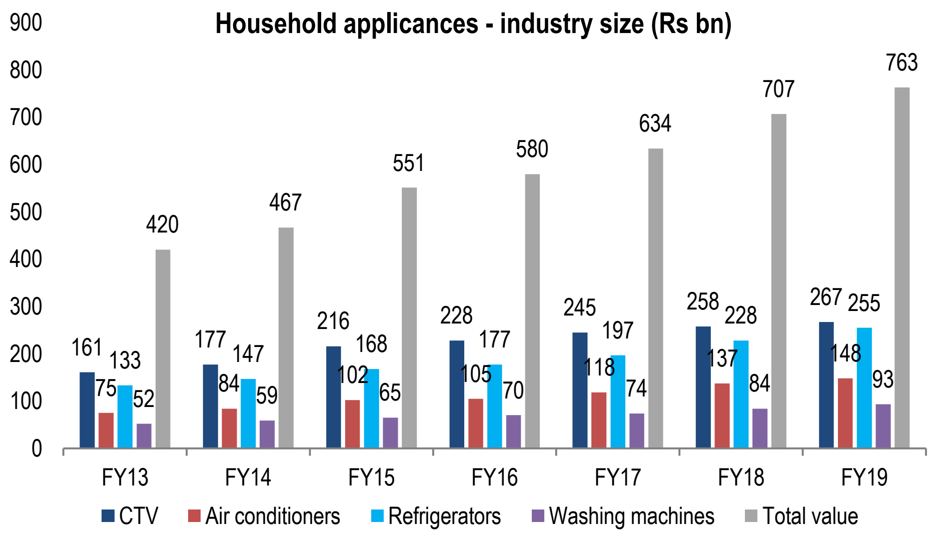
Consumerism in India…



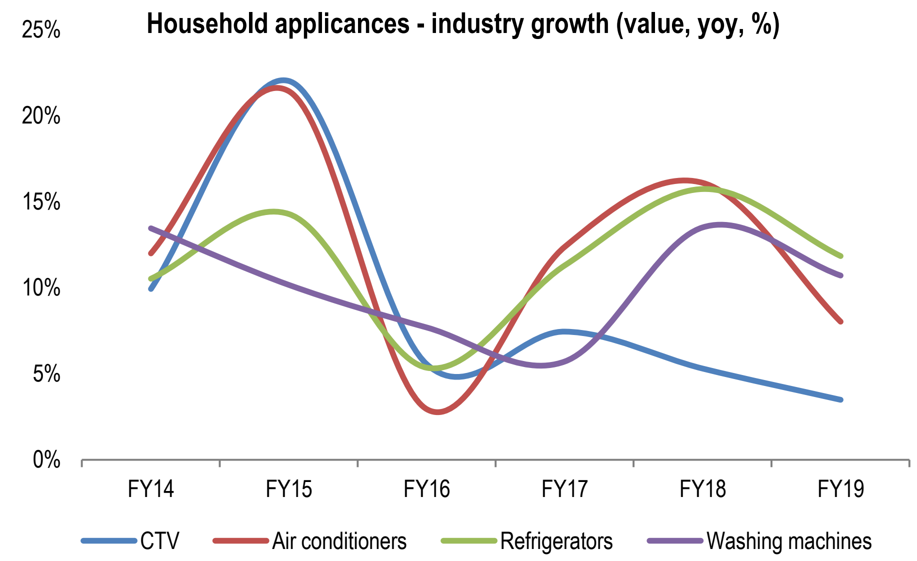
Source: IMF, WEF, BCG, Nirmal Bang Institutional Equities Research



Source: MOSPI, Nirmal Bang Institutional Equities Research



Source: CRISIL, Nirmal Bang Institutional Equities Research



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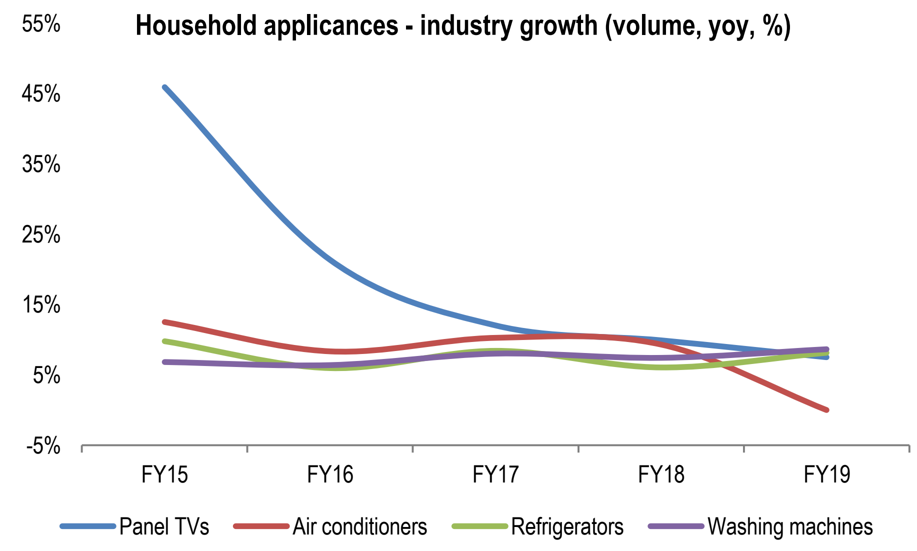

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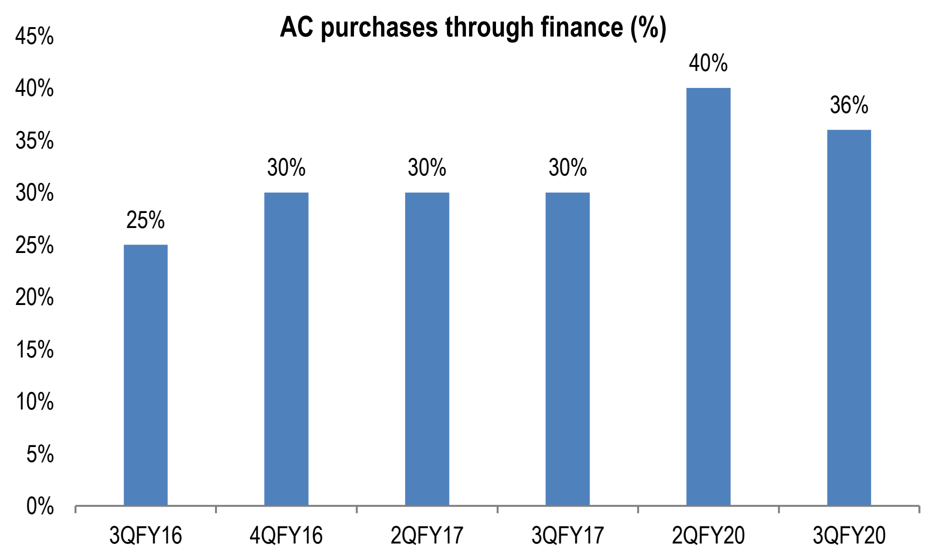
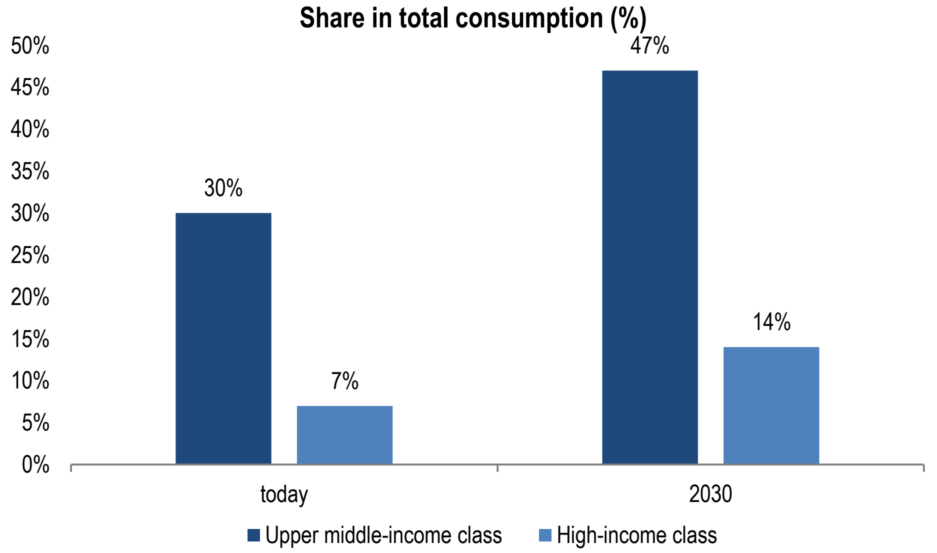
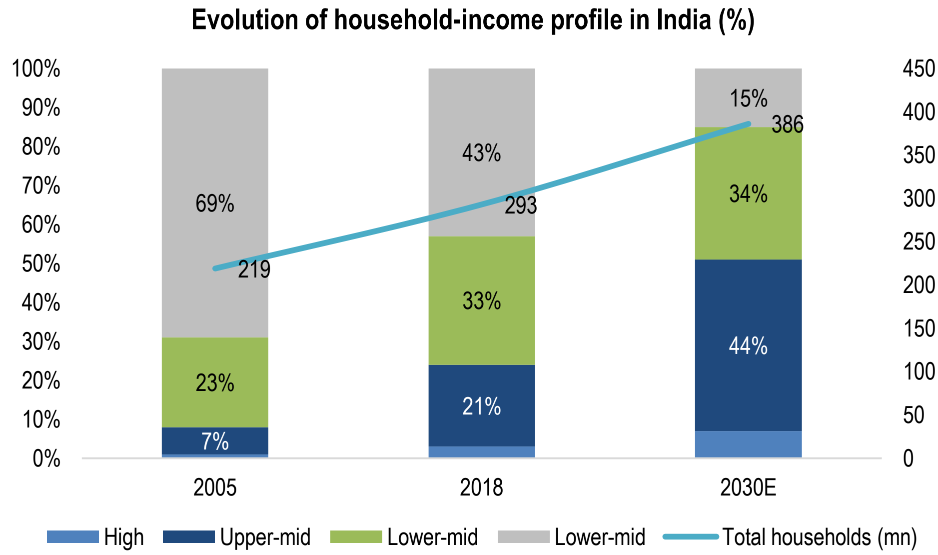


Source: Bluestar management commentary, Nirmal Bang Institutional Equities Research

…is expected to rise multifold on back of higher-spending by middle and high-income class and increasing urbanization



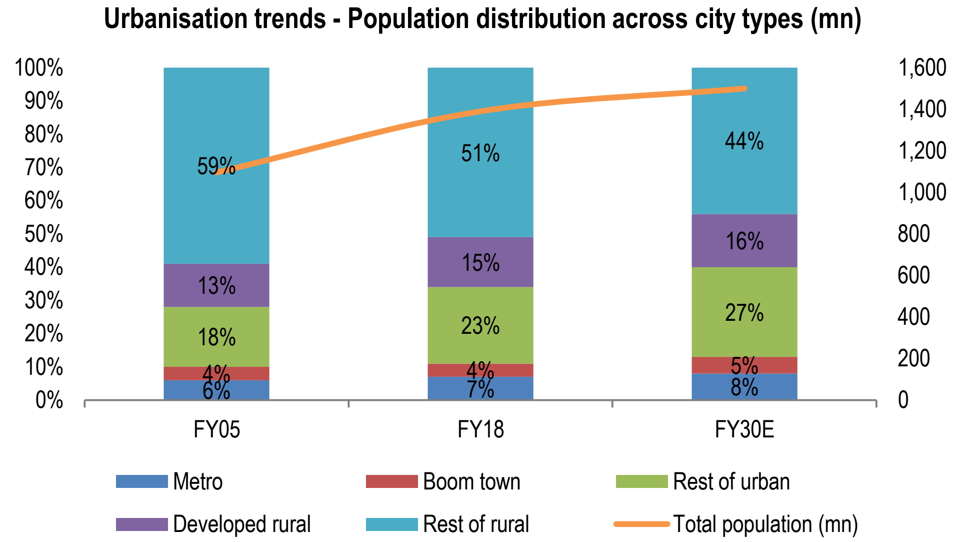
Source: WEF, Nirmal Bang Institutional Equities Research



Source: WEF, Nirmal Bang Institutional Equities Research

Category	No.of HHs (mn, 2018)	10-yr CAGR	Avg spend per HH (10-yr CAGR)
Elite and above >INR 20 lacs	9	13%	8.6%
Affluent INR 10-20 lacs	24	9%	8.6%
Aspirer INR 5-10 lacs	57	6%	8.5%
Next billion INR 1.5-5 lacs	129	2%	8.5%
Struggler <1.5 lacs	67	-2%	8.5%

Source: BCG, Nirmal Bang Institutional Equities Research



Source: WEF, Nirmal Bang Institutional Equities Research

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