Bajaj Finance

Long-term story intact despite FY21 glitch

We initiate coverage on Bajaj Finance (BAF) with an ADD rating and a target price of Rs 3,643, 4.7xSept-22E ABV. It is one of the largest NBFCs and perhaps the most diversified one in the country. It has consistently delivered strong performance across fronts. Over FY13-20, its AUM grew at a CAGR of ~35%, RoAEs averaged ~19.6%, and GNPAs did not exceed 1.7%. However, its near-term performance is likely to be a stark contrast to that seen in recent times due to the overarching impact of COVID-19. FY21E is likely to be an aberration in terms of growth, asset quality, and return ratios, but we expect a significant recovery in FY22E. While our near-term outlook may seem lacklustre, we believe that BAF's long-term prospects remain reasonably intact, despite COVID-19. Further, we believe that current valuations do not adequately price in BAF's potential to sustainably deliver superior return ratios in the long term. This underpins our positive stance.

- **Near-term outlook:** In FY21E, we expect AUMs to de-grow by 1.9%, as sustained disruption to real economic activity would result in muted credit demand and some degree of risk aversion; we expect AUM growth to revive to ~23% YoY over FY22-23E. Furthermore, we expect GNPAs to rise to 3.89% in FY21E (the highest in the past 10 years). Consequently, we believe there would be a sharp rise in LLPs to 4.12% in FY21E, followed by a reduction to ~2.35% over FY22-23E. Other income traction is likely to slow down due to lower business volumes, which would also result in a fall in cost ratios (we estimate a C-AA ratio of 3.6% over FY21-22E vs. 4.1% over FY18-19). As a result, we believe the RoAE may fall to 12.5% in FY21E and recover to 17.4/18.8% in FY22/23E.
- **Valuation:** BAF is currently trading at 4.07xFY23E ABV. The current valuation does not appear to fully factor in the company's potential to sustainably deliver superior return ratios. We believe that BAF can deliver an RoAE of 19%+ in the long term. Our view is supported by (1) BAF's RoAE track record, and (2) significant potential for AUM growth. Further, COVID-19 is likely to dent return ratios only temporarily, with the impact mostly limited to FY21E.
- **Risks and scenario analysis:** The uncontrolled spread of COVID-19 could result in sustained disruption to economic activity beyond FY21E, and this poses downside risks to our estimates. In an attempt to measure the impact of such outcomes on our estimates, we have examined them under three scenarios. In our most extreme scenario, (1) FY21/22/23E RoAEs could fall to 8.1/12.8/15.2%, (2) FY22/23E ABVs could be 10.5/9.6% lower (vs. our base case), at Rs 623/760, and (3) our assigned multiple would fall to 3.7x.

Financial Summary

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	36,211	49,033	69,716	97,252	134,972	138,833	163,216	198,786
PPOP	25,074	36,357	48,739	76,805	112,516	115,111	133,871	158,380
PAT	12,785	18,366	24,964	39,950	52,638	42,991	69,470	89,270
EPS (Rs)	23.9	33.6	43.1	69.3	87.7	71.7	115.8	148.8
EPS growth (%)	61.7	40.7	28.3	60.7	26.7	(18.3)	61.6	28.5
ROAE (%)	20.9	21.6	19.5	22.5	20.2	12.5	17.4	18.8
ROAA (%)	3.23	3.33	3.36	3.82	3.65	2.55	3.68	3.93
ABVPS (Rs)	136.4	170.9	269.4	329.0	523.5	570.9	698.2	840.5
P/ABV (x)	25.06	20.01	12.69	10.39	6.53	5.99	4.90	4.07
P/E (x)	143.2	101.8	79.3	49.4	39.0	47.7	29.5	23.0

Source: Company, HSIE Research

ADD

CMP *(as on 12 Aug 2020)*	Rs 3,419
Target Price	Rs 3,643
NIFTY	11,308

KEY STOCK DATA	
Bloomberg code	BAF IN
No. of Shares (mn)	603
MCap (Rs bn) / ($ mn)	2,059/27,525
6m avg traded value (Rs mn)	26,109
52 Week high / low	Rs 4,923/1,783

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	65.2	(28.3)	0.0
Relative (%)	42.8	(20.6)	(2.1)

SHAREHOLDING PATTERN (%)

	Mar-20	Jun-20
Promoters	56.2	56.2
FIs & Local MFs	10.7	9.9
FPIs	21.2	21.2
Public & Others	11.9	12.7
Pledged Shares	0.0	0.0

Source : BSE

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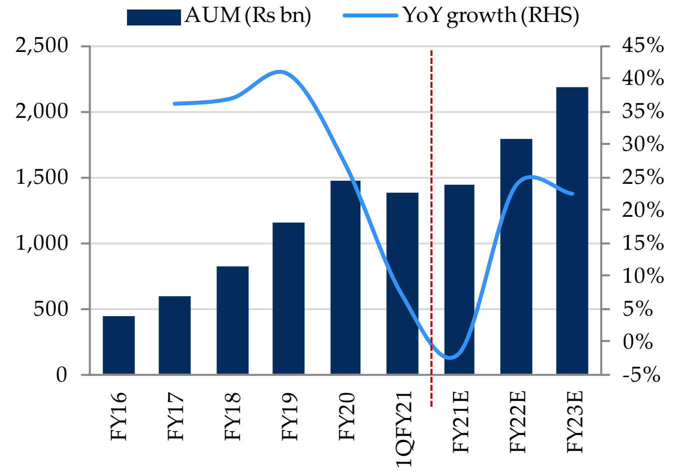
Outlook

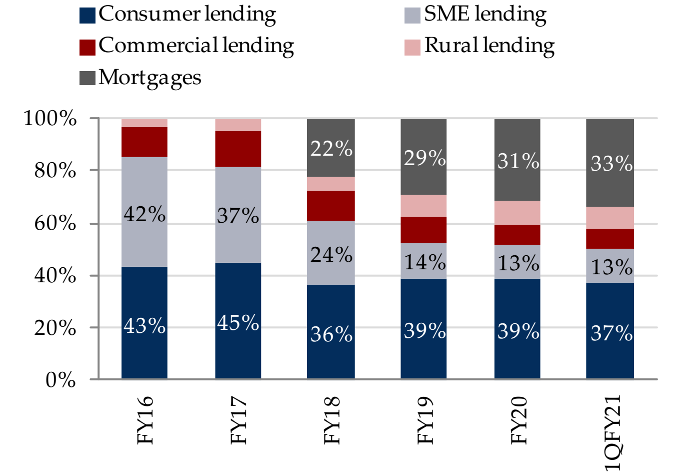
- **Growth:** Over FY13-20, BAF registered an AUM CAGR of ~35%. Its portfolio has grown much faster than bank credit, and several major private banks and NBFCs over this period. Further, growth has been broad-based across product segments. BAF's superior growth has been supported by product diversification, increasing geographical penetration (2,408 locations, distribution network consisting of 1,14,000+ points), customer acquisition, product innovation (flexi loans, EMI cards) and focus on cross-selling.
- COVID-19 will impact portfolio growth over FY21E. The impact of the pandemic on growth is already visible, with AUM growth slowing to 27% YoY in 4QFY20 (the management said that AUM could have grown ~31% YoY, if not for COVID-19), and to 7.1% YoY (-6.2% QoQ) in 1QFY21. Although the company restarted operations in May, they have been limited to select products and geographies. As of June, the company had resumed operations in 2,322 locations, which represented 85% of its business.
- The management believes that business in 75+ cities should revert to pre-COVID-19 volumes by October, another 40-75 cities by November, another 10-40 cities by January, and finally in the top-10 cities by March 2021. Further, the management has guided for an AUM growth of 10-12% for FY21E.
- Given, the fluidity of the COVID-19 situation, sporadic local lockdowns across the country, risk aversion, and the fact that credit demand is likely to remain muted, we expect AUMs to de-grow 1.9% over FY21E, followed by a recovery in growth to 23.6% YoY in FY22E. Our FY21E growth estimates may seem overly conservative, but we believe that ongoing disruptions to real economic activity and the short tenure of a significant proportion of the portfolio will limit growth.
- BAF's inherent strengths (strong execution track record, superior ability to access funds, etc.), which have supported superior growth until FY20, will continue to support superior growth in the post-COVID world as well.

Exhibit 1: AUM growth trends and estimates



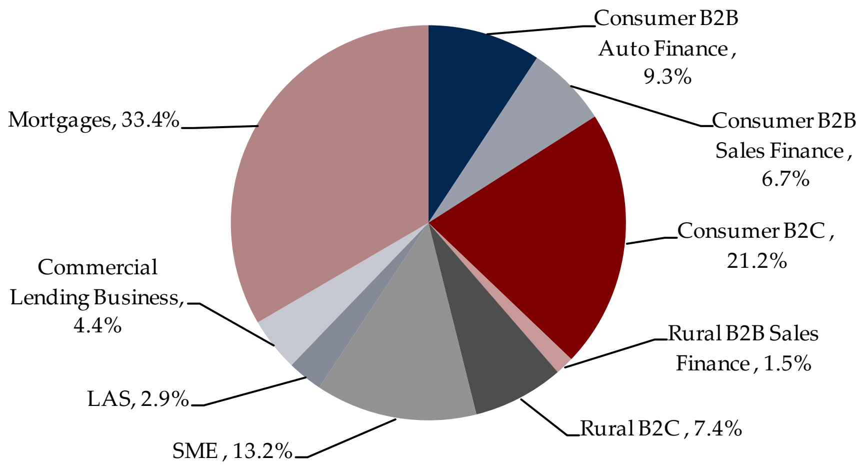
Source: Company and HSIE Research

Exhibit 2: AUM mix trends



Source: Company and HSIE Research

Exhibit 3: AUM mix at present



Source: Company and HSIE Research

Exhibit 4: BAF's diversified product offering

Consumer lending	SME lending	Commercial lending	Rural lending	Mortgages and related products	Securities services	Partnerships and other services
Consumer durable loans	Unsecured working capital loans	Loans against securities	Consumer durable loans	Salaried home loans	Depository services	Life insurance distribution
Digital product loans	Loans to self-employed and professionals	IPO financing	Digital product loans	Salaried LAP	Margin trading facility	General insurance distribution
Lifestyle product loans	Secured enterprise loans	ESOP financing	Lifestyle product loans	LAP	Spread financing	Health insurance distribution
Lifecare financing	Used car financing	Vendor financing to auto component manufacturers	Personal loans and cross-sell	Self-employed home loans	Brokerage account	Pocket insurance
EMI cards		Financial institutions financing	Salaried personal loans	LRD		Co-branded credit card
Retail spend financing		Light engineering financing	Gold loans	Developer finance		Co-branded wallet
2-wheeler and 3-wheeler loans		Specialty chemicals lending	Loans to professionals	Secured enterprise loans		
Personal loans and cross-sell						
Salaried personal loans						
E-commerce consumer finance						
Retailer finance						
Healthcare EMI card						

Source: Company and HSIE Research

Exhibit 5: BAF's distribution network

Particulars	FY15	FY16	FY17	FY18	FY19	FY20	1QFY21
CD stores- urban	7,000+	9,400+	14,000+	15,000+	20,400+	24,200+	24,200+
CD stores- rural	1,500+	3,200+	5,500+	8,200+	14,500+	19,600+	19,600+
Digital product stores	2,650+	5,200+	5,900+	15,900+	22,500+	26,400+	26,400+
Lifestyle retail stores	1,150+	3,200+	3,900+	6,000+	7,700+	9,500+	9,500+
EMI card- retail spend stores	-	-	5,600+	12,100+	19,100+	24,300+	24,300+
Auto dealers	3,000+	3,000+	3,200+	3,900+	4,600+	5,500+	5,500+
DSAs	700+	800+	1,500+	2,100+	2,800+	4,900+	4,900+
Total active distribution network	**16,000+**	**24,800+**	**39,600+**	**64,300+**	**91,700+**	**1,14,000+**	**1,14,400+**

Source: Company and HSIE Research

Exhibit 6: Branch count

Particulars	FY17	FY18	FY19	FY20	1QFY21
Urban	377	730	927	1,035	1,049
Rural	538	602	903	1,357	1,359
rural lending branches	*177*	*219*	*347*	*527*	*527*
rural lending franchise	*361*	*383*	*556*	*830*	*832*
Total	**915**	**1,332**	**1,830**	**2,392**	**2,408**

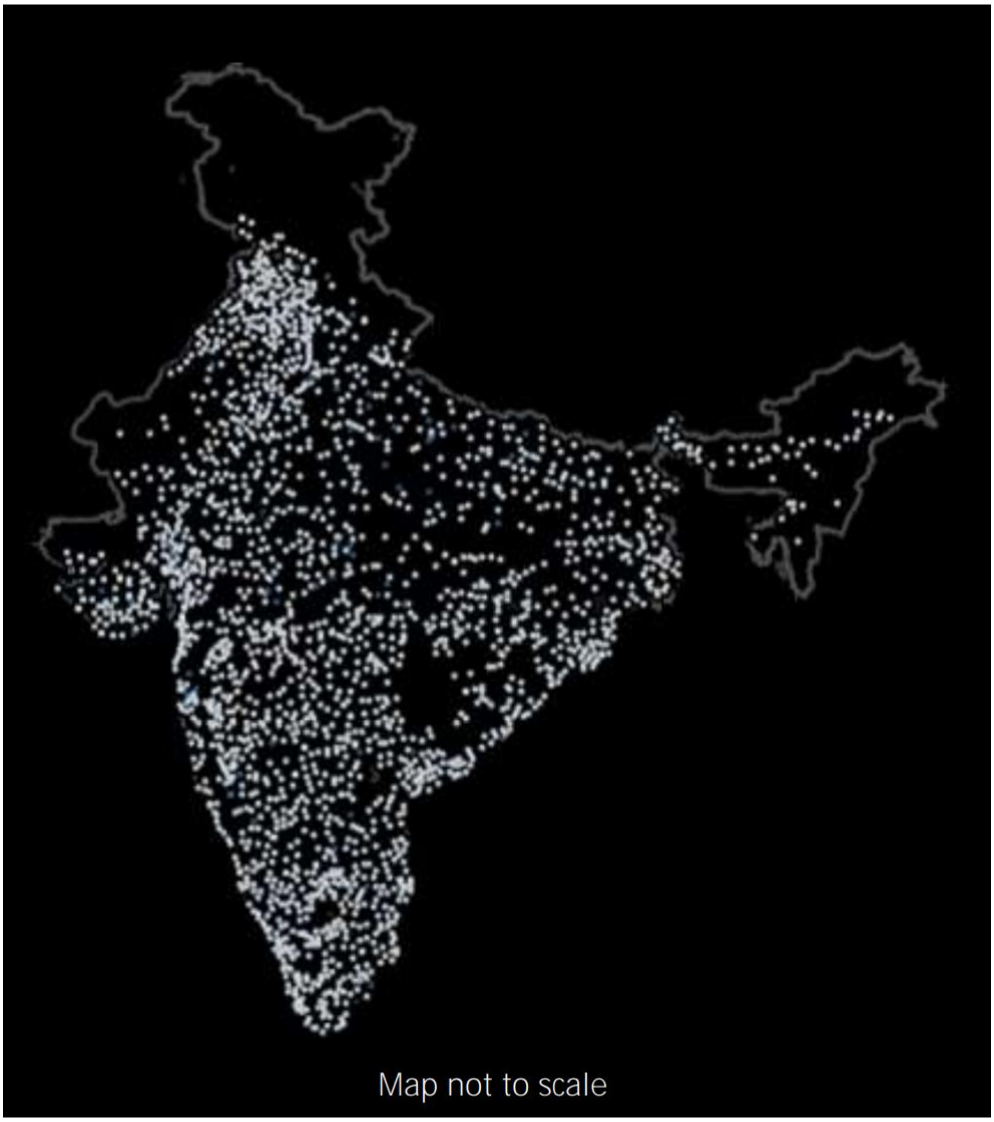
Source: Company and HSIE Research

Exhibit 7: BAF's customer franchise

Particulars (mn)	FY15	FY16	FY17	FY18	FY19	FY20	1QFY21*
Total franchise	**12.89**	**16.07**	**20.13**	**26.22**	**34.48**	**42.60**	**42.95**
Credit segment filter	7.97	10.57	14.38	19.77	26.93	33.47	33.47
Overall cross-sell franchise	7.77	10.32	13.67	18.88	25.89	32.32	32.32
Non-delinquent customers	7.32	9.48	12.69	17.22	23.26	28.48	28.48
Cross-sell franchise	6.25	8.49	11.00	15.43	20.67	24.13	24.13

Source: Company and HSIE Research; Note: * - Customer franchise has been kept static due to moratorium

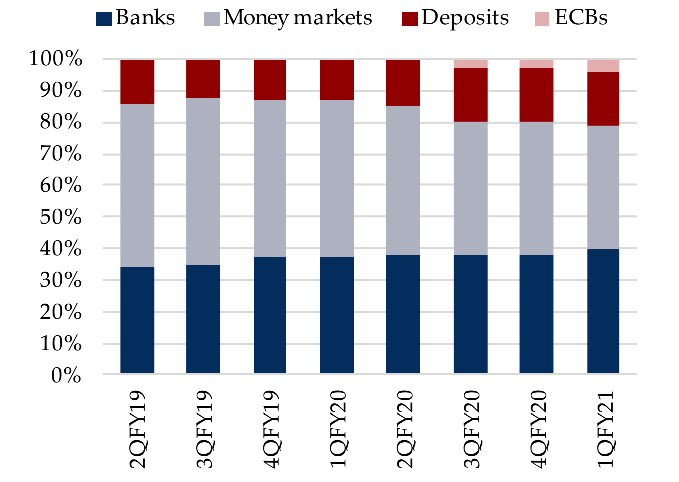
Exhibit 8: BAF's locations across the country



Source: Company and HSIE Research

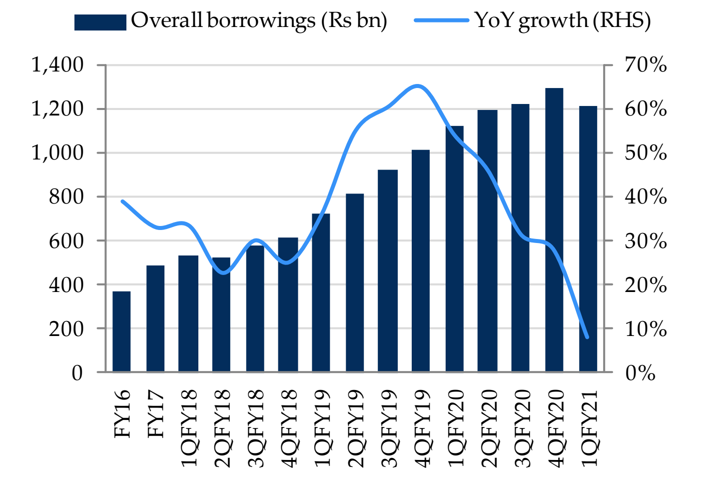
- **Funding and liquidity:** BAF is perhaps one of the best-placed NBFCs on these fronts. Its borrowing mix is well-diversified, with bank borrowings constituting the largest source of funds, at ~40% of overall borrowings as of 1QFY21. The share of capital market borrowings has declined to 39%, from 50% in FY19. Deposits constitute 17% of overall borrowings, vs. 13% in FY19. Further, the ratio of retail to wholesale deposits is ~70:30. In 2QFY20, the company availed of ECBs, which now constitute ~4% of overall borrowings as of 1QFY21. Borrowings growth trends indicate that the company has been able to raise funds with ease, especially after September 2018 (IL&FS and DHFL). As of 20th July, the company had liquid assets of Rs 205.9bn, which constituted 19.2% of borrowings. On the ALM front, too, the company is well-placed (as suggested by historical surpluses in near-term buckets). BAF also enjoys a healthy CRAR of 26.4% (one of the highest in the NBFC space, bolstered by a Rs 85bn equity raise in FY20).

Exhibit 9: Borrowing mix trends



Source: Company and HSIE Research

Exhibit 10: Borrowing growth trends



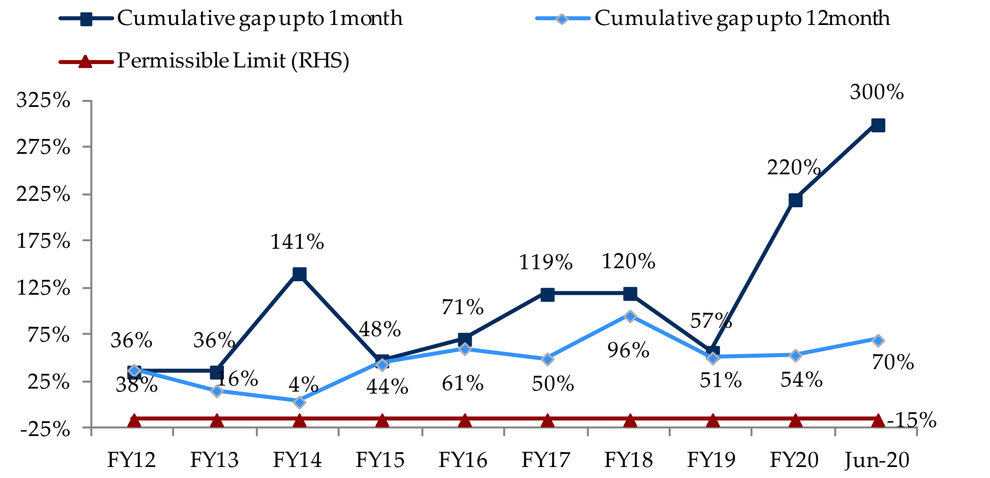
Source: Company and HSIE Research

Exhibit 11: Behavioral ALM statement as of 1QFY21

Particulars (Rs bn)	1 month	1 to 2 months	2 to 3 months	3 to 6 months	6 months to 1 year	1 to 3 years	3 to 5 years	Beyond 5 years	Total
Cash and investments	148.4	5.0	0.0	0.0	3.1	17.4	4.4	55.7	234.1
Advances	60.7	49.3	47.4	115.0	173.3	391.4	182.9	65.9	1,085.8
Other assets/ inflows	38.3	0.4	3.3	9.5	2.1	21.3	-	44.9	119.9
Total inflows	**247.4**	**54.7**	**50.6**	**124.5**	**178.6**	**430.1**	**187.2**	**166.6**	**1,439.8**
Borrowings	21.1	63.1	29.5	72.8	133.8	435.2	125.7	114.0	995.2
Capital and reserves	-	-	-	-	-	-	-	335.9	335.9
Other outflows	40.7	1.3	2.0	13.6	6.7	10.8	5.3	28.1	108.6
Total outflows	**61.8**	**64.4**	**31.5**	**86.5**	**140.5**	**446.1**	**131.0**	**478.0**	**1,439.8**
Gap	***185.6***	***(9.7)***	***19.1***	***38.1***	***38.1***	***(16.0)***	***56.3***	***(311.4)***	
Cumulative gap	***185.6***	***175.9***	***195.0***	***233.1***	***271.1***	***255.2***	***311.4***	***0.0***	

Source: Company and HSIE Research

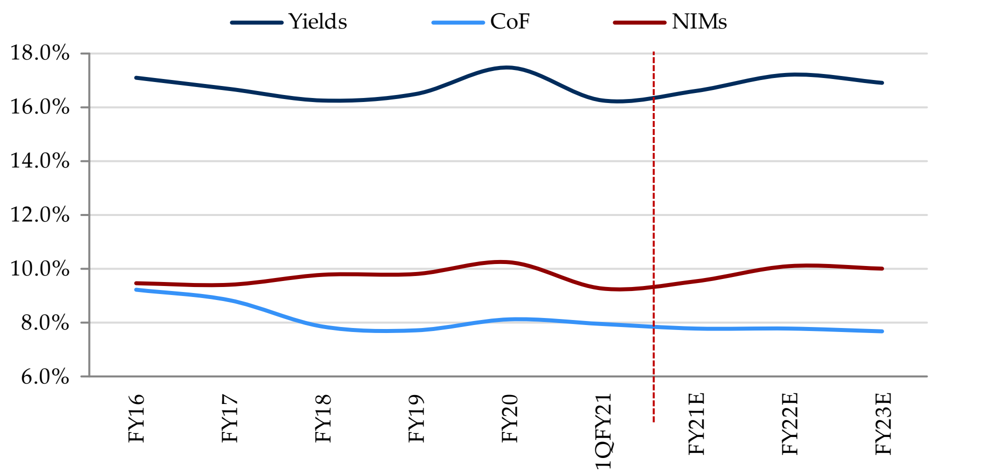
Exhibit 12: Historical trend of near-term bucket surpluses



Source: Company and HSIE Research; Note – RBI revised permissible limit for cumulative gap up to 1-M to -20% from June, 2020.

- **Margins:** BAF has enjoyed a healthy margin of ~9.7% over FY16-20. It has been aided by the fact that a large chunk of the company's portfolio is relatively high yielding, and that it has one of the lowest CoF in the industry.
- We expect NIMs to dip slightly in FY21E to 9.5%, as BAF continues to maintain high liquidity (as stated above, the management intends to maintain more than adequate liquidity, at least over 1HFY21)**.**

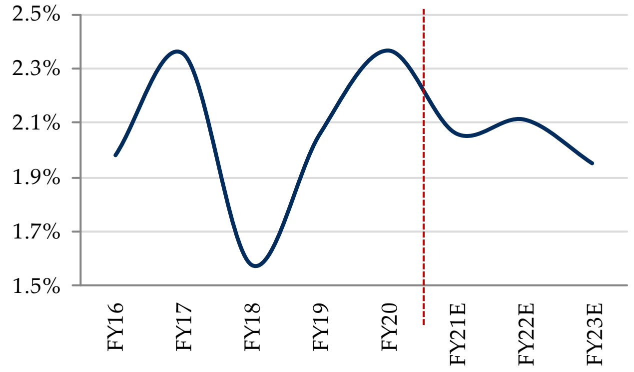
Exhibit 13: Margin profile



Source: Company and HSIE Research

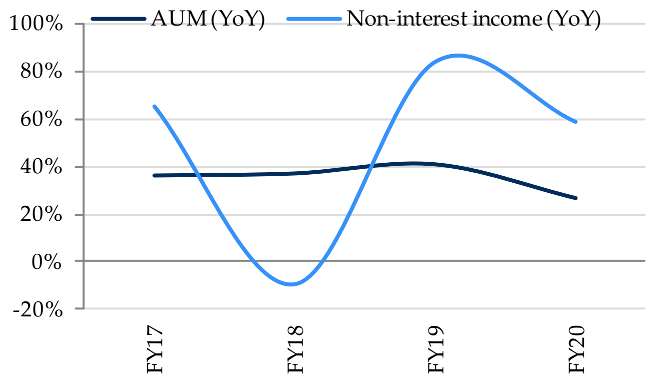
- **Non-interest income:** In recent years, BAF has seen strong non-interest income growth, which registered a CAGR of 44.4% over FY16-20, while AUMs registered a CAGR of 35.4% over the same period. Consequently, the ratio of non-interest income to average assets increased from 1.98% in FY16 to 2.37% in FY20.

Exhibit 14: Non-interest income/ average assets



Source: Company and HSIE Research

Exhibit 15: Non-interest income vs. AUM growth



Source: Company and HSIE Research

Exhibit 16: Split of non-interest income

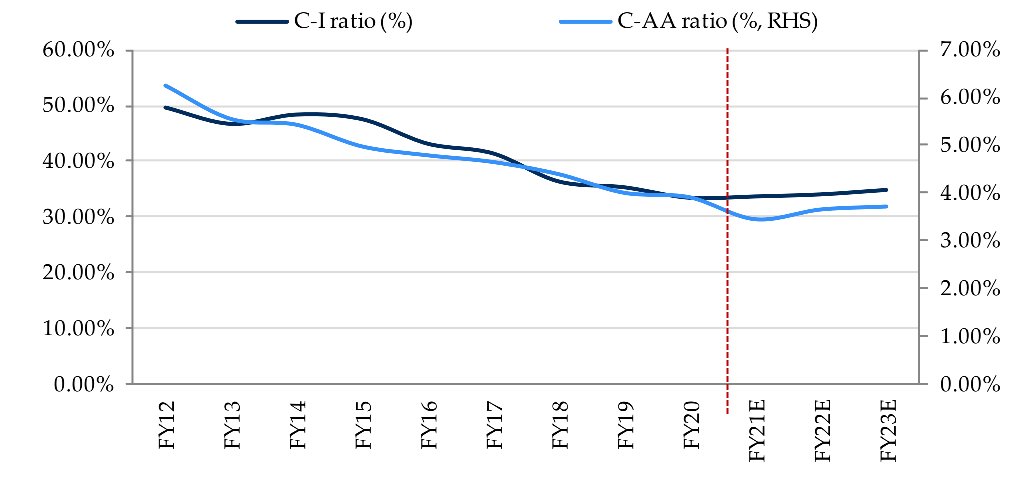
Particulars	FY18	FY19	FY20	*2-year CAGR*
Fees and commission income				
Service and administration charges	3,434	5,806	8,996	*61.9%*
Fees on value added services and products	1,972	3,285	4,137	*44.8%*
Foreclosure income	247	1,052	1,574	*152.4%*
Distribution income	2,428	6,676	11,153	*114.3%*
Brokerage income			49	
Total	**8,082**	**16,819**	**25,910**	***79.1%***
Net gain/ loss on fair value changes	2,146	2,979	5,375	*58.2%*
Sale of services				
Fees for management of assigned loan portfolios	677	638	1,243	*35.5%*
Other service fees		50		
Total	**677**	**688**	**1,243**	***35.5%***
Other operating income				
Recoveries against financial assets	584	852	1,409	*55.3%*
Net realisation on sale of written-off loans	101	47	98	
Total	**685**	**899**	**1,507**	***48.4%***
Other income				
Interest on income tax refund	19		10	
Net gain on disposal of P,P&E		34		
Forex gain/ loss	0	1	1	
Dividend income			**6**	
Miscellaneous income	106	96	101	
Total	**124**	**130**	**118**	
Total non-interest income	**11,713**	**21,514**	**34,152**	***70.8%***

Source: Company and HSIE Research

- Core fee income (service and administration charges, and fees on value-added products) accounts for ~38% of BAF's non-interest income. Of these, service and administration charges have grown at an average of ~62% over the past two years. BAF's distribution income has grown at an average of ~114% over the past two years. Together, these constitute ~71% of non-interest income.
- On account of lower business (disbursal and distribution) volumes, we believe fee momentum is likely to slow considerably in FY21E and bounce back in FY22E, as the company returns to normal operations. However, higher treasury income could provide some cushion in the interim, as seen in 1QFY21.
- We project non-interest income at ~2.1% of average assets over FY21-22E.

- **Operating expenses:** BAF has seen a sustained improvement in cost ratios. The C-AA ratio declined almost steadily from 6.2% in FY12 to 3.9% in FY20. The improvement has been aided by a combination of improvement in staff cost and other operating cost-related efficiencies.

Exhibit 17: Cost ratio trends and estimates



Source: Company and HSIE Research

- Apart from staff expenses, recovery costs, outsourcing costs, travelling expenses, and IT expenses constitute a significant portion of the company's operating costs.

Exhibit 18: Split of other operating expenditure

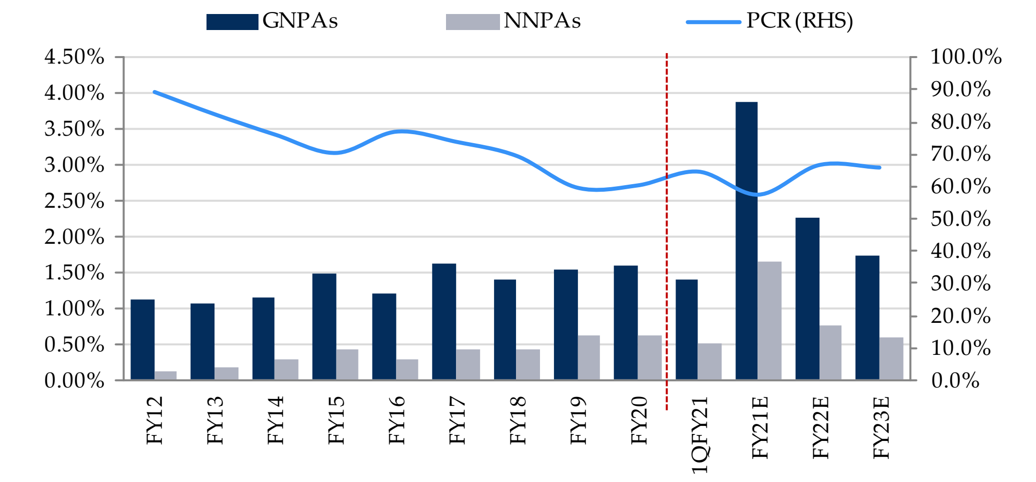
Particulars	FY18	FY19	FY20	2-year CAGR
Operating expenses				
Insurance	29	32	32	4.6%
Rent taxes and energy	627	914	433	-16.9%
Director's fees, commission, and expenses	35	42	57	28.1%
Communication expenses	640	707	1,241	39.2%
Outsourcing/ back office expenses	2,112	2,099	2,428	7.2%
Travelling expenses	1,602	2,026	2,124	15.1%
Information technology expenses	1,389	1,640	2,109	23.2%
Bank charges	822	991	1,345	27.9%
Net loss on disposal of P,P & E	4	-	23	148.8%
Auditors fees and expenses	7	7	11	22.8%
Advertisement, branding, and promotion expenses	1,669	1,832	2,219	15.3%
CSR	396	568	828	44.6%
Repairs and maintenance	384	565	858	49.4%
Printing and stationery	110	168	181	28.5%
Legal and professional expenses	153	169	250	27.7%
Customer experience	439	673	963	48.2%
Miscellaneous expenses	1,581	1,573	2,508	25.9%
Total	**11,999**	**14,006**	**17,607**	**21.1%**
Fees and commission expenses				
Commission and incentives	420	616	628	22.2%
Recovery costs	4,914	6,469	9,594	39.7%
Credit guarantee charges	-	-	297	NA
Loan portfolio management service charges	-	44	45	NA
Total	**5,335**	**7,129**	**10,564**	**40.7%**
Depreciation and amortization costs	1,021	1,442	2,946	69.9%
Total other operating expenses	**18,354**	**22,576**	**31,117**	**30.2%**

Source: Company and HSIE Research

- In the face of COVID-19, BAF has undertaken several cost control measures: (1) fixed pay cuts ranging from 5% to 17.5%, (2) restrictions on incentives in 1QFY21, (3) call centre optimisation, (4) freeze on travel and advertising & promotion, and (5) deferral of physical training, to name a few. These measures, along with reduced business volumes, will curtail operating expenditure, to an extent. However, recovery-related costs are likely to see a significant rise.
- We expect C-AA and C-I ratios of 3.57/33.9% over FY21-22E.

Asset quality and provisioning: So far, BAF has had nothing short of a dream run on the asset quality front, and this is almost difficult to comprehend. Since FY11, GNPAs have not exceeded 1.7%.

Exhibit 19: Asset quality and coverage trends and estimates



Source: Company and HSIE Research

- Given BAF's rapid balance sheet growth, even if one tests GNPAs on a lagged basis, no adverse trends are evident. Moreover, asset quality trends have been healthy across most sub-portfolios, except auto finance.

Exhibit 20: Segment-wise asset quality trends

Particulars	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21
Auto finance	5.70%	5.76%	5.42%	5.12%	5.19%	5.57%	5.68%	6.47%	5.80%
Sales finance	1.03%	1.08%	0.86%	1.05%	1.16%	1.08%	0.92%	1.33%	1.03%
Consumer B2C	1.67%	1.66%	1.49%	1.40%	1.63%	1.49%	1.34%	1.62%	1.36%
Rural B2B	0.82%	0.77%	0.60%	0.93%	0.97%	1.15%	0.59%	0.55%	0.16%
Rural B2C	1.31%	1.42%	1.42%	1.53%	1.63%	1.41%	1.33%	1.53%	1.30%
SME finance	1.87%	1.86%	1.75%	1.49%	1.64%	1.49%	1.41%	1.70%	0.89%
Securities lending	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Commercial B2C	0.00%	0.00%	0.00%	0.64%	0.61%	0.58%	0.60%	0.03%	0.04%
Mortgages	0.55%	0.81%	1.38%	1.23%	1.19%	1.20%	1.36%	0.53%	0.69%
Overall	**1.39%**	**1.49%**	**1.55%**	**1.54%**	**1.60%**	**1.61%**	**1.61%**	**1.61%**	**1.40%**

Source: Company and HSIE Research

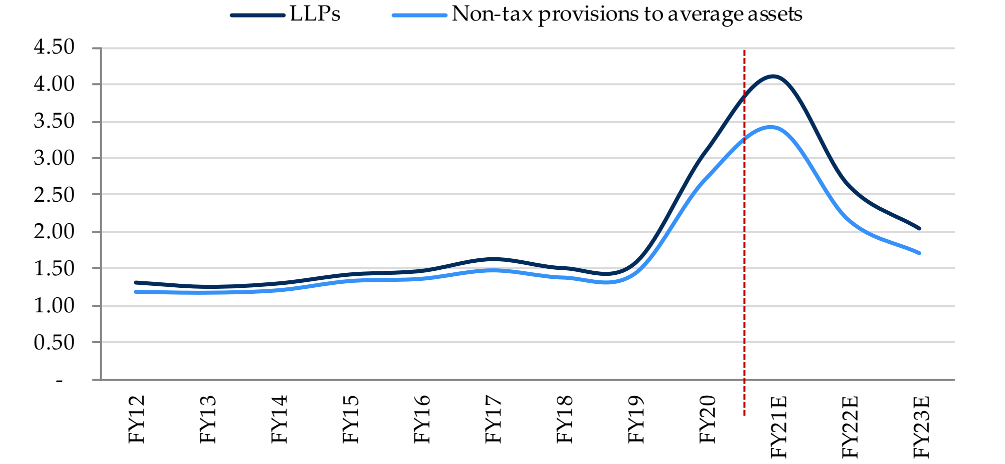
Exhibit 21: Segment-wise portfolio quality disclosures

Particulars	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QYF20	3QYF20	4QFY20
CD financing												
Bucket 0	98.4	98.6	98.8	98.9	99.0	98.9	99.0	99.0	98.5	98.5	98.6	98.7
30+	1.0	0.8	0.7	0.7	0.5	0.6	0.6	0.8	0.9	0.8	0.9	0.8
Two and three wheeler financing												
Bucket 0	85.9	85.8	87.9	88.8	87.6	88.3	89.7	90.2	88.7	87.6	85.8	86.0
30+	7.0	7.1	6.2	5.6	6.0	5.7	5.0	4.7	5.3	6.0	6.8	7.3
Lifestyle finance												
Bucket 0	97.3	98.4	98.6	98.7	95.6	98.7	98.8	98.5	98.2	97.8	97.8	98.1
30+	1.7	0.9	0.8	0.8	0.8	0.7	0.6	0.8	1.0	1.1	1.3	1.1
Digital product finance												
Bucket 0	97.9	98.7	98.9	98.5	98.5	98.7	98.8	98.3	97.7	97.9	98.2	98.5
30+	1.3	0.7	0.6	0.9	0.9	0.7	0.7	1.0	1.5	1.4	1.2	1.0
Personal loans cross-sell												
Bucket 0	97.2	97.3	97.5	97.6	97.6	98.0	97.8	97.8	97.5	97.2	97.0	97.0
30+	1.5	1.5	1.4	1.3	1.3	1.2	1.2	1.2	1.4	1.6	1.7	1.7
Salaried personal loans												
Bucket 0	99.5	99.6	99.6	99.7	99.7	99.7	99.7	99.7	99.7	99.6	99.6	99.6
30+	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3
Business and professional loans												
Bucket 0	98.5	98.6	98.6	98.7	98.8	98.8	98.8	98.8	98.6	98.4	98.4	98.3
30+	1.0	0.9	1.0	1.0	0.8	0.9	0.8	0.9	1.0	0.9	1.1	1.2
LAP												
Bucket 0	99.1	98.6	98.3	99.2	99.3	99.2	97.0	97.7	97.7	97.3	97.1	97.1
30+	0.9	1.4	1.6	0.8	0.7	0.8	3.0	2.3	2.2	2.3	2.8	2.8
Home loans												
Bucket 0	98.9	98.8	99.0	99.5	99.5	99.4	99.5	99.5	99.4	99.6	99.6	99.6
30+	0.9	0.9	0.8	0.2	0.5	0.4	0.3	0.4	0.4	0.4	0.3	0.4
Rural lending B2B												
Bucket 0	99.2	99.2	99.2	99.1	99.1	99.0	99.1	99.3	98.9	98.9	99.2	99.3
30+	0.6	0.5	0.6	0.6	0.6	0.7	0.7	0.5	0.7	0.8	0.6	0.5
Rural lending B2C												
Bucket 0				98.8	98.7	98.5	98.8	98.9	98.7	98.5	98.3	98.3
30+				0.7	0.7	0.9	0.8	0.8	0.9	1.0	1.2	1.2

Source: Company and HSIE Research, Colour coding is as reported, and is indicative of expected stress: red-high, yellow-medium, & green-low; no data is available for the rural lending B2C segment, prior to 4QFY18, and colour coding information is available only after 3QFY19

- Recently, the company has had to write off certain large exposures: CCD (Rs 910mn), IL&FS (Rs 2.34bn), and Karvy (Rs 3.21bn). This has been unusual, given the company's focus on granular lending.
- Non-tax provisions have ranged between 1.2% and 1.4% of average assets over FY12-19 but spiked to 2.7% in FY20. This spike was led by a sharp rise in provisions in 2HFY20. These provisions were towards on account of/ pertained to the LAS portfolio, ECL recalibration, and certain large stressed exposures.

Exhibit 22: Provisioning trends and estimates



Source: Company and HSIE Research

- **COVID-19 impact (so far):** As of April, ~27% of BAF's portfolio was under a moratorium. At that time, notably, 70% of the auto finance book and 14.2% of the mortgage book were under the moratorium. The portfolio under moratorium shrank by 43.8% to form 15.7% of the book. BAF's rural portfolio under moratorium saw a ~67% dip to ~10%. However, BAF converted outstanding term loans under moratorium worth Rs 36bn into flexi loans, while ~18% of the portfolio was under the moratorium, adjusted for such conversion. The stock of such converted loans vis-à-vis the moratorium portfolio should be monitored.

Exhibit 23: Segment-wise moratorium trends

Particulars	As of 30th April 2020			As of 30th June 2020		
	AUM	Moratorium	%	AUM	Moratorium	%
Auto finance	13,726	9,611	70.02%	12,802	6,446	50.35%
Sales finance	10,600	2,742	25.87%	9,231	1,813	19.64%
Consumer B2C	30,505	8,771	28.75%	29,219	4,454	15.24%
Rural sales finance	2,326	688	29.58%	2,089	214	10.24%
Rural finance B2C	10,650	3,020	28.36%	10,281	1,015	9.87%
SME lending	19,048	5,708	29.97%	18,277	2,245	12.28%
Securities lending	4,037	13	0.32%	3,957		0.00%
Commercial	6,215	1,527	24.57%	6,075	1,168	19.23%
Mortgages	45,960	6,518	14.18%	46,124	4,350	9.43%
Total	**143,067**	**38,598**	**26.98%**	**138,055**	**21,705**	**15.72%**

Source: Company and HSIE Research

- BAF had made additional COVID-related provisions of ~Rs 30bn (2.17% of AUMs and 13.8% of the portfolio under moratorium).

Exhibit 24: Details of extraordinary provisions held

Particulars	Rs mn
3QFY20 LAS portfolio provision	850
4QFY20 ECL recalibration	1,290
4QFY20 COVID-19 contingency provision	9,000
Charge-off related to two stress accounts	3,900
Total extra-ordinary provisions	**15,040**

Source: Company and HSIE Research

- We believe that FY21E is likely to be an aberration for BAF in terms of asset quality. Despite the company's impeccable performance on this front, we expect GNPA to rise considerably to reach 3.89% by FY21E and to 2.26% by FY22E. Our stance on asset quality is premised upon BAF's significant exposure to SME and unsecured retail loans (we believe that these sectors are likely to see a disproportionate rise in stress vs. other credit segments).

- The management guides for a 100-110% rise in credit costs in FY21E (vs. FY20E). We expect credit costs to rise, and build non-tax provisions of 2.8% of average assets over FY21-22E and LLPs of 3.4%. Even though we expect BAF to see a substantial rise in credit costs, its strong PPOP profile is capable of absorbing elevated loan losses.
- The extensive utilisation of the COVID-19 related stress resolution framework/ MSME restructuring scheme by BAF would result in upside risks to our estimates.

How do we value BAF?

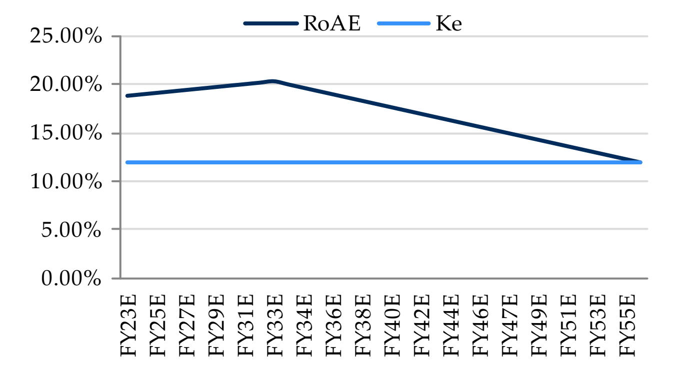
- Based on our RI model, we assign a target multiple of 4.3xSept-22E ABV.

Exhibit 25: RI model assumptions

Rf	5.90%
Rm	4.50%
Beta	1.346
Ke	11.96%

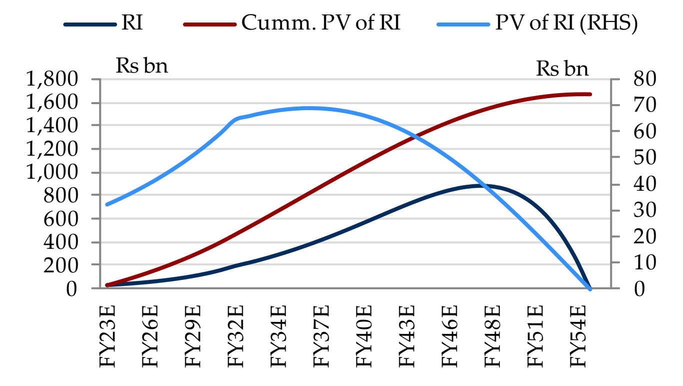
Source: HSIE Research

Exhibit 26: RoAE vs. Ke estimates



Source: HSIE Research

Exhibit 27: RI accumulation



Source: HSIE Research

- At first, our high target multiple may appear to contradict our near-term earnings outlook, but it reflects our confidence in the company's long-term ability to (1) generate high sustainable residual income and (2) grow ahead of the industry. Our target multiple also reflects other inherent strengths, such as management and promoter pedigree.
- **Ability to generate high residual income:** BAF's RoAEs have averaged 19.6% over FY12-20 and always exceeded 16%. The management guides for RoAEs of 19-21% over the long term. The company's margins (including other income) can sustain or decline slightly over the long term. However, such a decline could be compensated by an improvement in operating efficiencies.
- **Significant growth runway:** A combination of factors, including those that have enabled BAF to grow rapidly thus far, should provide it with a significant growth runway under normal circumstances. These include (1) unique product/service offerings, (2) a diversified product mix, (3) significant investments in technology that allow better sourcing, underwriting and customer experience, (4) deepening penetration, (5) first-mover advantage in certain segments, which continue to present significant potential for growth, and (6) a strong funding base (as evidenced by the company's ability to raise funds post-September 2018).
- For now, we believe COVID-19 does not change any of this for the worse. In fact, the pandemic may end up benefiting large players such as BAF, as smaller NBFCs would get disproportionately impacted.

Downside scenario analysis

- Our base case estimates for BAF factor in (1) slight AUM de-growth in FY21E, followed by a sharp increase in growth (albeit below pre-COVID-19 levels) and (2) significant rise in GNPAs in FY21E, followed by a gradual reduction therein. However, given the continuing uncertainty around the spread of the virus and the resultant economic fallout, we believe that the risks to our estimates are mostly to the downside. We have attempted to evaluate the impact of (1) higher-than-expected stress, and (2) slower-than-expected growth on our estimates.

Our estimates under various scenarios

Exhibit 28: Scenario analysis assumptions

Particulars	Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Increase in GNPA %	+1%	+0.5%		+1.5%	1%		+2%	1.50%	
Decrease in AUM growth %		-5%	-3%		-9%	-7%		-12%	-9%

Source: HSIE Research

- GNPAs in FY21E/22E could be 25.9-51.2%/18.8-50.3% higher than our base case estimates.
- FY22/23E AUM growth could be range from 18.6 to 11.6%/19.4 to 12.4%.
- FY22/23E NII could be 2.3-5.5%/ 5.3-13.8% lower than our base case estimates.
- FY21/22/23E earnings could be 18.3-36.5%/ 13.8-31.4%/ 10.5-27.4% below our base case estimates.
- Under scenario 3 (our worst case), BAF continues to report RoAA/RoAEs of 3.3/15.2%. However, given the fall in returns and delayed improvement, our assigned multiple falls to 3.71 from 4.33.
- Despite the significant fall in earnings, across scenarios, due to higher provisions, we expect BAF's RoAEs to dip at most to 8.1/12.8/15.2% under scenario 3.

Exhibit 29 & 30: Scenario analysis results

Particulars	Base case			Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPAs (Rs mn)	56,106	40,357	37,713	70,609	47,948	35,700	77,829	53,943	33,867	85,049	60,587	32,514
GNPA (%)	3.9	2.3	1.7	4.9	2.8	1.7	5.4	3.3	1.8	5.9	3.8	1.8
AUM growth (YoY, %)	(1.9)	23.6	22.4	(1.9)	18.6	19.4	(1.9)	14.6	15.4	(1.9)	11.6	12.4
NII (Rs mn)	138,833	163,216	198,786	138,833	159,512	188,182	138,833	156,548	178,533	138,833	154,326	171,405
PPOP (Rs mn)	115,111	133,871	158,380	115,111	130,434	148,643	115,111	127,684	139,783	115,111	125,622	133,239
Provisions (Rs mn)	57,637	40,997	39,035	68,152	50,387	41,824	73,386	56,003	43,905	78,620	61,895	46,550
Provisions (%)	4.1	2.6	2.0	4.9	3.3	2.3	5.2	3.8	2.6	5.6	4.2	2.8
PAT	42,991	69,470	89,270	35,125	59,875	79,901	31,210	53,618	71,717	27,295	47,668	64,843
ABV Rs	571	698	841	542	667	805	528	646	781	514	625	760
RoAA (%)	2.5	3.7	3.9	2.1	3.3	3.7	1.9	3.0	3.5	1.6	2.7	3.3
RoAE (%)	12.5	17.4	18.8	10.3	15.5	17.6	9.2	14.1	16.3	8.1	12.8	15.2
Assigned multiple		4.7			4.1			3.9			3.7	
TP		**3,643**			**3,315**			**3,046**			**2,823**	

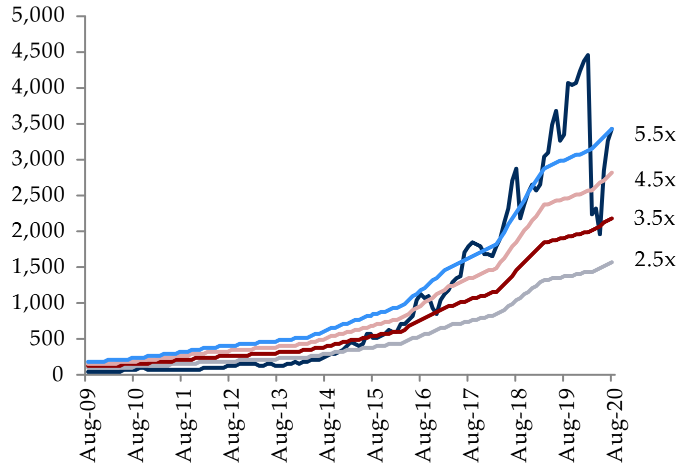
Change in (vs. base)	Scenario 1			Scenario 2			Scenario 3		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
GNPAs (Rs mn)	+25.85%	+18.81%	-5.34%	+38.72%	+33.66%	-10.20%	+51.59%	+50.13%	-13.79%
GNPA (%)	+100bps	+50bps	+2bps	+150bps	+100bps	+5bps	+200bps	+150bps	+7bps
NII (Rs mn)	0.00%	-2.27%	-5.33%	0.00%	-4.09%	-10.19%	0.00%	-5.45%	-13.77%
PPOP (Rs mn)	0.00%	-2.57%	-6.15%	0.00%	-4.62%	-11.74%	0.00%	-6.16%	-15.87%
Provisions (Rs mn)	+18.24%	+22.90%	+7.14%	+27.33%	+36.60%	+12.48%	+36.41%	+50.98%	+19.25%
LLP (%)	+75bps	+68bps	+27bps	+112bps	+112bps	+52bps	+150bps	+157bps	+78bps
PAT (Rs mn)	-18.30%	-13.81%	-10.50%	-27.40%	-22.82%	-19.66%	-36.51%	-31.38%	-27.36%
ABV (Rs)	-5.00%	-4.49%	-4.23%	-7.48%	-7.48%	-7.02%	-9.97%	-10.53%	-9.55%
RoAA (%)	-46bps	-43bps	-22bps	-69bps	-72bps	-44bps	-92bps	-101bps	-65bps
RoAE (%)	-216bps	-192bps	-118bps	-326bps	-329bps	-249bps	-437bps	-463bps	-361bps
Assigned multiple		4.12			3.9			3.71	
TP		**-9.00%**			**-16.39%**			**-22.51%**	

Source: HSIE Research

Risks

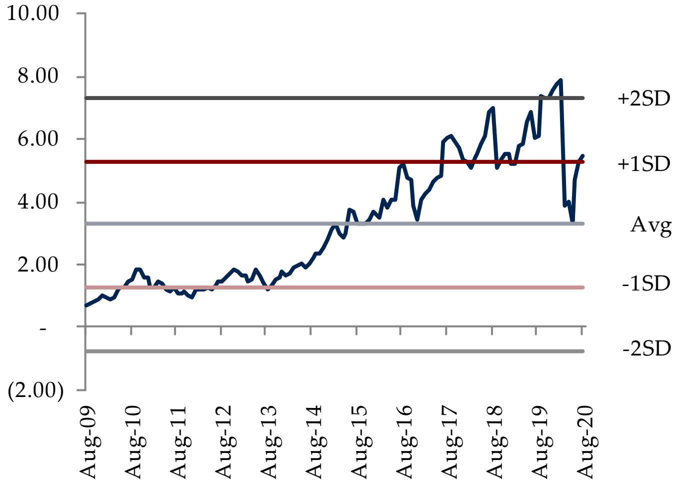
- Given our add rating on BAF, the risks to our call would mostly include factors/ considerations resulting in (1) slower-than-expected growth and (2) worse-than-expected asset quality outcomes. These include:
- **COVID-19-linked macroeconomic outcomes:** Our estimates on growth and credit costs are more conservative than the management's. We expect BAF's book to de-grow slightly in FY21E and GNPAs to peak at that time, followed by a gradual recovery in FY22/23E. Further, our RI model-derived target multiple assumes a gradual improvement in RoAEs, post FY23E. If COVID-19 is to spread unabated, possible lockdowns and the resulting disruptions to economic activity would lead to (1) slower-than-expected growth, (2) higher-than-expected GNPAs and credit costs, and (3) a prolonged recovery to potential return ratios, reducing our assigned multiple. This is the primary risk to our call, we believe, and we have attempted to capture it in our scenario analyses (refer the previous page).
- **Inability to raise sufficient funds:** Our long-term RoAE assumption within our RI model, based on which we assign a target multiple, would require BAF to grow its balance sheet rapidly or make high dividend payouts. We believe that the former is more desirable/probable. To sustain such growth, BAF would require funds (from various sources), almost 'on-tap'. While the company has not faced problems on this front so far, even as other NBFCs did, post-September 2018, as its balance sheet grows beyond a certain size, this may become an increasingly important consideration.

Exhibit 31: P/ABV



Source: HSIE Research

Exhibit 32: P/ABV



Source: HSIE Research

Exhibit 33: Peer set comparison

	MCap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
BAF	**2,059**	**3,419**	**ADD**	**3,643**	**523**	**571**	**698**	**39.0**	**47.7**	**29.5**	**6.53**	**5.99**	**4.90**	**20.2**	**12.5**	**17.4**	**3.65**	**2.55**	**3.68**
CIFC	172	209	BUY	249	84	93	114	17.4	13.9	12.2	2.49	2.25	1.84	13.8	14.1	14.1	1.63	1.90	2.03
SHTF	151	665	ADD	861	530	568	754	6.0	6.9	5.4	1.25	1.17	0.88	14.8	11.5	13.0	2.28	1.90	2.28
INDOSTAR	34	256	REDUCE	266	226	247	276	-7.3	30.2	16.1	1.13	1.04	0.93	-11.4	4.0	5.2	- 2.96	1.15	2.00
LICHF	135	267	REDUCE	272	294	269	298	5.6	8.4	5.8	0.91	0.99	0.90	13.9	8.5	11.3	1.15	0.72	0.99
REPCO	8	132	ADD	207	233	245	287	2.9	3.5	3.4	0.57	0.54	0.46	16.9	12.3	11.4	2.44	1.90	1.88

Source: Company, HSIE Research

Financials

Income statement

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Interest earned	65,479	87,067	115,855	163,488	229,704	241,985	277,659	335,445
Interest expended	29,269	38,034	46,139	66,236	94,732	103,152	114,443	136,658
Net interest income	**36,211**	**49,033**	**69,716**	**97,252**	**134,972**	**138,833**	**163,216**	**198,786**
Other income	7,854	12,966	11,713	21,530	34,152	34,812	39,861	44,375
Total income	**44,065**	**61,999**	**81,429**	**118,782**	**169,124**	**173,645**	**203,077**	**243,161**
Total operating expenditure	18,991	25,642	32,690	41,977	56,608	58,534	69,205	84,781
PPOP	**25,074**	**36,357**	**48,739**	**76,805**	**112,516**	**115,111**	**133,871**	**158,380**
Provisions & contingencies	5,429	8,182	10,305	15,014	39,295	57,637	40,997	39,035
PBT	19,646	28,175	38,434	61,792	73,221	57,474	92,875	119,345
Tax expenses	6,861	9,810	13,471	21,842	20,584	14,484	23,404	30,075
PAT	**12,785**	**18,366**	**24,964**	**39,950**	**52,638**	**42,991**	**69,470**	**89,270**

Source: Bank, HSIE Research

Statement of assets and liabilities

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
SOURCES OF FUNDS								
Share capital	536	1,094	1,150	1,154	1,200	1,200	1,200	1,200
Reserves	73,731	94,909	157,328	195,817	322,076	365,067	431,064	515,870
Net worth	74,266	96,003	158,478	196,970	323,276	366,267	432,264	517,070
Borrowings	370,247	492,497	679,802	1,032,595	1,298,064	1,346,862	1,587,568	1,962,003
Other liabilities	20,052	48,746	9,702	12,760	22,574	18,465	20,442	25,007
Total liabilities	**464,565**	**637,246**	**847,983**	**1,242,325**	**1,643,914**	**1,731,594**	**2,040,273**	**2,504,080**
APPLICATION OF FUNDS								
Cash balance	13,292	3,565	3,397	3,487	13,827	121,155	115,368	190,364
Advances	427,558	576,827	791,025	1,125,128	1,413,761	1,387,268	1,714,573	2,099,343
Investments	10,341	40,747	31,394	85,990	175,439	175,092	158,757	156,960
Fixed assets	2,870	3,611	4,670	6,916	13,177	14,495	15,944	17,539
Other assets	10,505	12,495	17,497	20,804	27,710	33,585	35,631	39,874
Total Assets	**464,565**	**637,246**	**847,983**	**1,242,325**	**1,643,914**	**1,731,594**	**2,040,273**	**2,504,080**

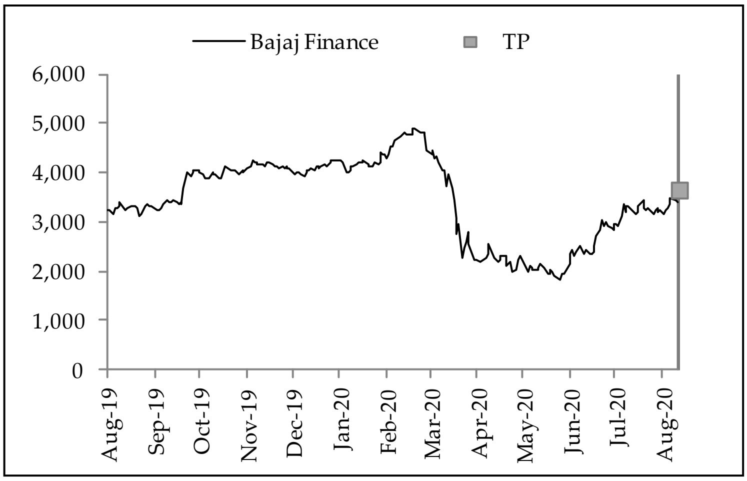
Source: Bank, HSIE Research

Key ratios

	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Valuation ratios								
EPS (Rs)	23.9	33.6	43.1	69.3	87.7	71.7	115.8	148.8
Earnings growth (%)	62%	41%	28%	61%	27%	-18%	62%	29%
BVPS (Rs)	139	176	276	341	539	610	720	862
Adj. BVPS (Rs)	136	171	269	329	523	571	698	841
ROAA (%)	3.23	3.33	3.36	3.82	3.65	2.55	3.68	3.93
ROAE (%)	20.9	21.6	19.5	22.5	20.2	12.5	17.4	18.8
P/E (x)	143.2	101.8	79.3	49.4	39.0	47.7	29.5	23.0
P/BV (x)	24.6	19.5	12.4	10.0	6.3	5.6	4.7	4.0
P/ABV (x)	25.1	20.0	12.7	10.4	6.5	6.0	4.9	4.1
P/PPOP (x)	73.0	51.4	40.3	25.7	18.2	17.8	15.3	12.9
Dividend yield (%)	0.1	0.1	0.1	0.2	0.3	-	0.2	0.2
Profitability (%)								
Yield on advances (%)	17.1	16.7	16.2	16.5	17.5	16.6	17.2	16.9
Cost of funds (%)	9.2	8.8	7.9	7.7	8.1	7.8	7.8	7.7
Core spread (%)	7.9	7.9	8.4	8.8	9.3	8.8	9.4	9.2
NIM (%)	9.4	9.4	9.8	9.8	10.3	9.5	10.1	10.0
Operating efficiency (%)								
Cost/avg. asset ratio	4.8	4.7	4.4	4.0	3.9	3.5	3.7	3.7
Cost-income ratio	43.1	41.4	40.1	35.3	33.5	33.7	34.1	34.9
Balance sheet structure ratios (%)								
Loan growth	36.5	36.1	36.9	40.6	27.0	(1.9)	23.6	22.4
Borrowing growth	38.9	33.0	38.0	51.9	25.7	3.8	17.9	23.6
Equity/assets	16.0	15.1	18.7	15.9	19.7	21.2	21.2	20.6
Equity/loans	17.4	16.6	20.0	17.5	22.9	26.4	25.2	24.6
Total capital adequacy ratio (CAR)	19.5	20.3	24.0	20.7	25.0	24.9	24.3	23.4
Tier I CAR	16.1	14.6	18.4	16.3	21.3	21.2	20.6	19.7
Asset quality								
Gross NPLs (Rs mn)	5,386	9,824	11,638	17,941	23,393	56,106	40,357	37,713
Net NPLs (Rs mn)	1,229	2,554	3,535	7,207	9,231	23,747	13,387	12,801
Gross NPLs (%)	1.22	1.63	1.41	1.55	1.59	3.89	2.26	1.73
Net NPLs (%)	0.28	0.42	0.43	0.62	0.63	1.64	0.75	0.59
Coverage ratio (%)	77.2	74.0	69.6	59.8	60.5	57.7	66.8	66.1
Provision/avg. loans (%)	1.47	1.63	1.51	1.57	3.10	4.12	2.64	2.05
RoAE tree								
Net interest income	9.14%	8.90%	9.39%	9.31%	9.35%	8.23%	8.65%	8.75%
Non-interest income	1.98%	2.35%	1.58%	2.06%	2.37%	2.06%	2.11%	1.95%
Operating cost	4.79%	4.65%	4.40%	4.02%	3.92%	3.47%	3.67%	3.73%
Provisions	1.37%	1.49%	1.39%	1.44%	2.72%	3.41%	2.17%	1.72%
Tax expense	1.73%	1.78%	1.81%	2.09%	1.43%	0.86%	1.24%	1.32%
ROAA	3.23%	3.33%	3.36%	3.82%	3.65%	2.55%	3.68%	3.93%
Leverage (x)	6.5	6.5	5.8	5.9	5.5	4.9	4.7	4.8
ROAE	20.91%	21.57%	19.48%	22.48%	20.24%	12.47%	17.40%	18.81%

Source: Company and HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
12-Aug-20	3,419	ADD	3,643

From 2nd March 2020, we have moved to new rating system

Rating Criteria

BUY: >+15% return potential
ADD: +5% to +15% return potential
REDUCE: -10% to +5% return potential
SELL: >10% Downside return potential

Disclosure:
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