

India Financials

Bajaj Finance Ltd

Rating

Underperform

 (Outperform *OLD*)

Target Price

 **BAF.IN**
1,740.00 INR (4,820.00 *OLD*)

Bajaj Finance: From growth to risk management; Downgrade to underperform

We are downgrading Bajaj Finance to Underperform. This is in line with our view, that unsecured consumer finance business models would become challenging in the current pandemic environment. At the current early stage of COVID19 outbreak in India, it is uncertain to project how long the physical restrictions from the government would last beyond the 21-days imposed lockdown. At this stage, it would be conservative to assume that first quarter of FY2021 would be a near complete economic freeze and a crawling recovery post that.

We believe Bajaj is a risk conscious organization, which will react by refocusing on collections, risk containment and liquidity management. We expect FY2021 to be a year of consolidation with loan growth recovering marginally only in the second half of FY2021. As things stand now, we estimate the loan growth to be 8% YoY for the FY2021 vs. 35% YoY run rate.

As Bajaj loan growth comes to a grinding halt, we expect credit costs to escalate by 100 bps (2.7% for FY2021W vs. 1.7% for FY'20). We expect SME loans (13% of the loan book) and Consumer B2C loans (27% of total loans) to be at risk of delayed collections. Within B2C consumer loans, self-employed personal loans could be vulnerable.

Bajaj is adequately capitalized (tier 1 of 23.2%) and it has always maintained conservative leverage of ~6x (currently 4.9x post fund raise). We expect Bajaj to manage its ALM well given its short tenured asset book except in the worst case of a sustained economic freeze.


We expect FY'21E EPS to contract by 8% vs. FY'20. We expect ROE to compress to 15% in FY2021 and recover slowly to 17% in FY2022. We compress the valuation multiple to 15x earnings (~52% contraction from its 5-year average of 28.5x), given the growth shock, escalation of risk costs and expected slow recovery to its historical long-term growth profile.

Investment Implications

We rate Bajaj Underperform with a target price of INR1740, implying 38% downside.

EPS Reported	F19A	F20E	F21E	Financials	F19A	F20E	F21E	CAGR	Valuation Metrics	F19A	F20E	F21E
BAF.IN (INR)	68.75	99.29	91.09	Credit Cost (%)	1.57	1.80	2.65		P/E Reported (x)	40.64	28.14	30.67
<i>OLD</i>		98.53	129.46	Net Revenue Yield (%)	11.98	11.98	11.00		Div Yield (%)	0.21	0.31	0.28
MXAPJ	34.13	38.44	43.54	ROA (%)	3.82	4.12	3.21					
				ROE (%)	22.48	22.06	14.97					
				AUM (M)				(55.8)%				

Close Date	26-Mar-2020			
BAF.IN Close Price (INR)	2,793.70			
Target Price (INR)	1,740.00			
Upside/(Downside)	(38)%			
52-Week Low	2,104.65			
52-Week High	4,923.40			
MXAPJ	427.22			
FYE	Mar			
Indicated Div Yield	0.4%			
Market Cap (INR) (B)	1,681			
EV (INR) (B)	2,696			
Performance	YTD	1M	6M	12M
Absolute (%)	(34.0)	(41.9)	(30.2)	(4.8)
MXAPJ (%)	(22.7)	(18.6)	(15.3)	(18.4)
Relative (%)	(11.3)	(23.3)	(14.8)	13.6

 Analyst Page

 Bernstein Events

 Company Page

DETAILS

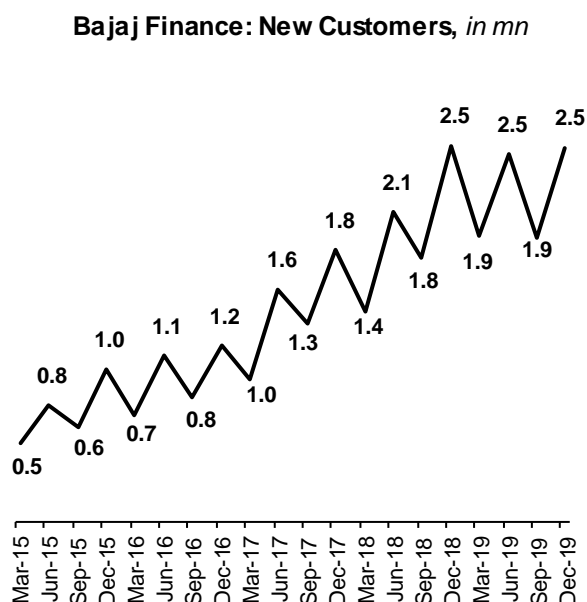
Bajaj's business model is retail driven:

Bajaj's business model was driven by its retail point of sale credit network. This allows Bajaj to acquire close to 2-2.5 million customers a quarter (refer Exhibit 1). This customer acquisition base of 23.5 million core customers (refer Exhibit 2) forms the base for Bajaj to cross sell its retail loan products such as personal loans and home loans.

A sudden 21-day lockdown not only leads to immediate retail demand shock, but it would be reasonable to assume a slowdown beyond the 21 days, as the government is unlikely to be complacent, given the experience with other countries. Even well managed countries such as Singapore, are now having to deal with a second surge of cases and are reacting by shutting down retail & entertainment outlets.

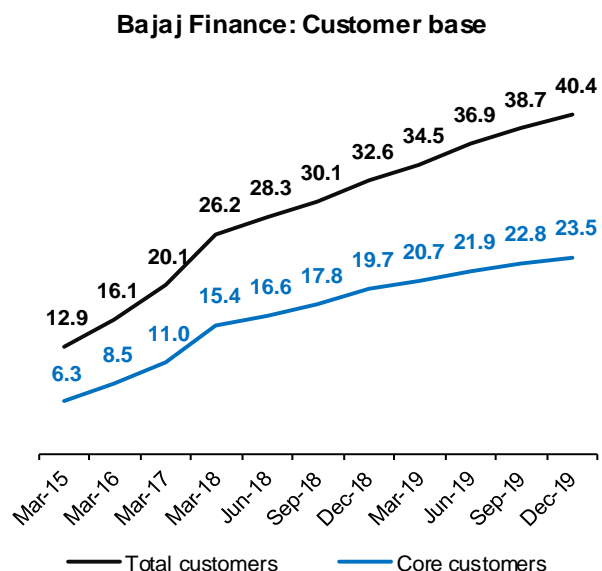
Further, pre-shutdown announcement, modern retail store footfalls were down 40-50% (based on channel checks). It would be again reasonable to assume post shut down, retail footfalls are likely to grind to a halt for most of Q1'FY21 and even remain slow paced in Q2' FY21.

EXHIBIT 1: **Bajan Finance: New customers**



Source: Company disclosures, Bernstein analysis

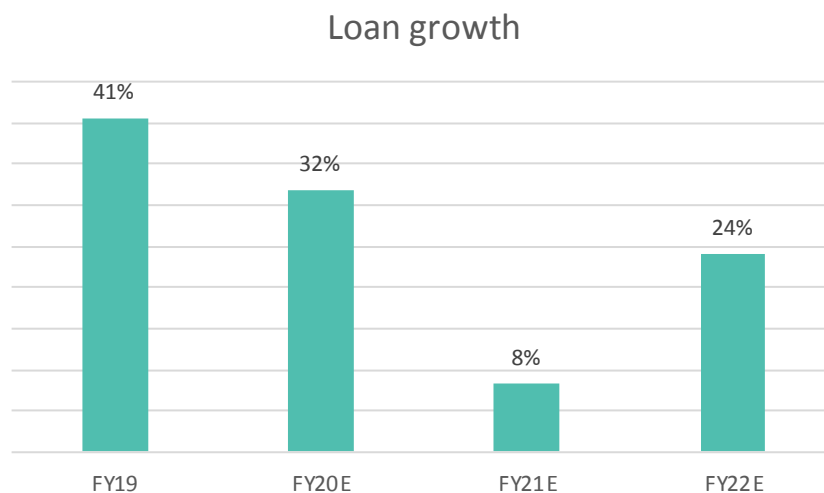
EXHIBIT 2: **Bajaj Finance: Customers**



Source: Company disclosures, Bernstein analysis

Impact on loan growth:

With the sudden withdrawal of lending activity, Bajaj is likely to refocus the organization towards collections, and risk management for first half of the next financial (FY'21). Bajaj's loan book growth is diversified broadly across SME and consumer, both of which are likely to be adversely impacted. We expect disbursements to stall during first half of FY'2021 and slowly recover in the second half, assuming a gradual improving COVID-19 scenario (something that still remains uncertain).

EXHIBIT 3: We expected Bajaj's loan growth to compress for FY'21 before recovering...

Source: Company disclosures, Bernstein analysis and estimates

EXHIBIT 4: Bajaj Finance loan segment wise growth – Actual & estimated

Business segments	Q3 FY'19	FY' 21E	FY' 22E
Consumer Lending B2B	25%	5%	20%
Consumer Lending B2C	43%	10%	30%
SME Lending	32%	0%	10%
Commercial Lending	10%	0%	10%
Rural Lending	49%	10%	30%
Mortgage	44%	15%	30%
Total	35%	8%	24%

Source: Company disclosures, Bernstein analysis and estimates

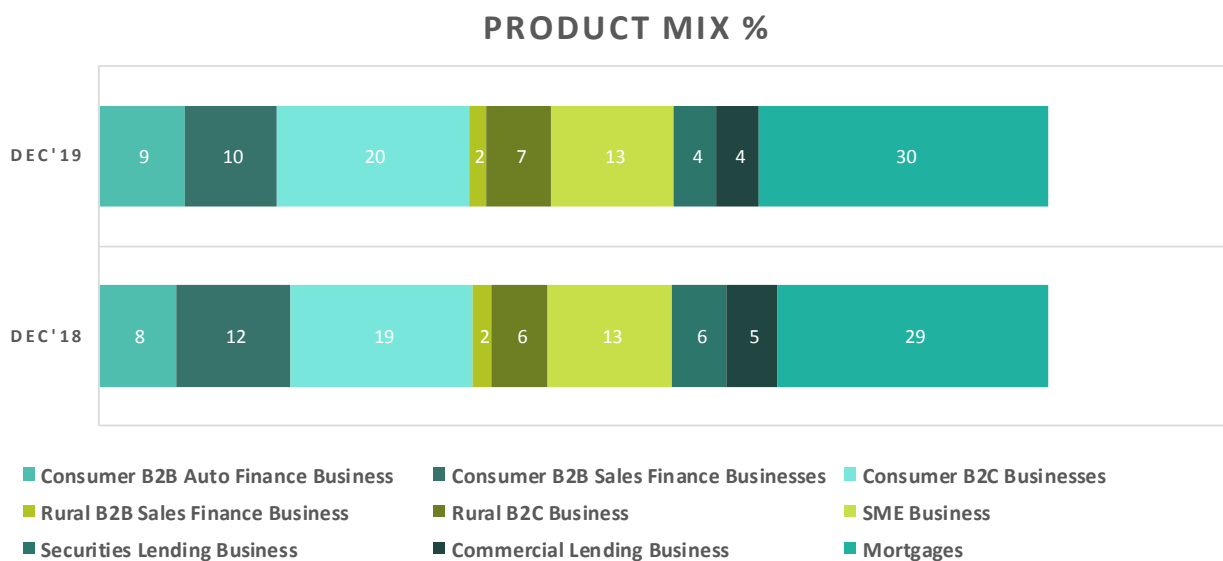
Risks to book quality:

Bajaj's portfolio has last seen elevated crisis level NPAs during the 2008-09 retail NPA crisis post GFC. However, Bajaj's consumer finance business was built post that period and thus, 2008-09 is not very representative of the current business model.

Bajaj discloses 30+ days past due across multiple products (refer Exhibits 6 to 11). Bajaj has been highly proactive and nimble in discontinuing product lines that have flashed warnings on delinquency trends (e.g. Loans against property, digital product loans). We believe, across all segments, the non-salaried personal loan segment is most vulnerable for Bajaj Finance. Further, products such as digital loans and lifestyle loans have reflected relatively higher delinquency trends in recent times (refer Exhibits 7 & 8).

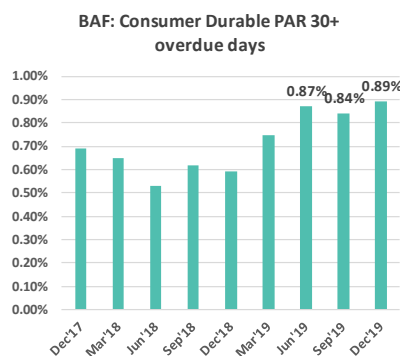
We believe, Bajaj management will completely refocus the organization on collections, risk management and liquidity management.

EXHIBIT 5: SME segments & self-employed segments within consumer loans look vulnerable to the environment



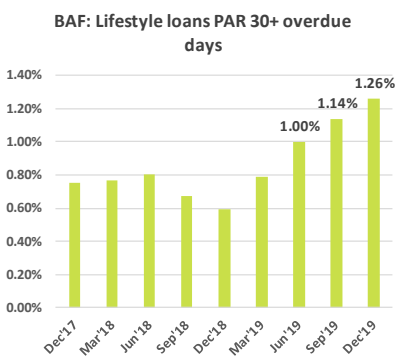
Source: Company disclosures, Bernstein analysis

EXHIBIT 6: Consumer durable 30+ DPD



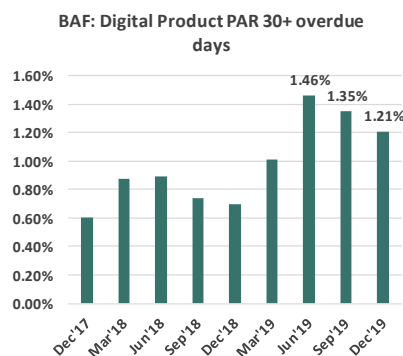
Source: Company disclosures, Bernstein analysis

EXHIBIT 7: Lifestyle loans 30+ DPD



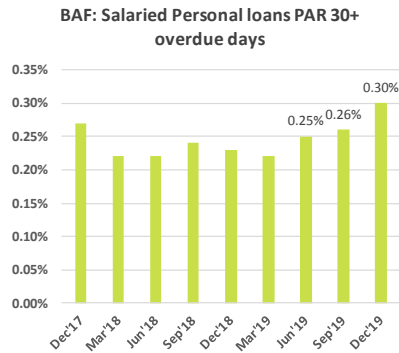
Source: Company disclosures, Bernstein analysis

EXHIBIT 8: Digital product 30+ DPD



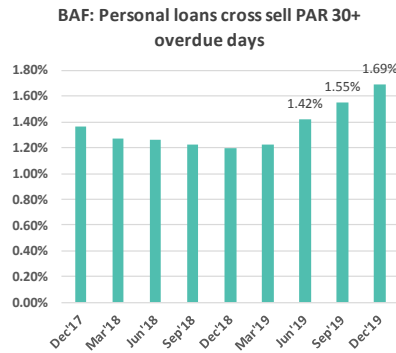
Source: Company disclosures, Bernstein analysis

EXHIBIT 9: Salaried personal loans 30+ DPD



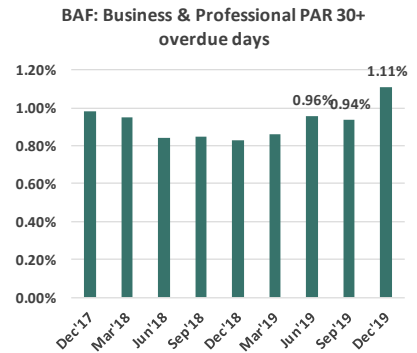
Source: Company disclosures, Bernstein analysis

EXHIBIT 10: Personal loans cross sell 30+ DPD



Source: Company disclosures, Bernstein analysis

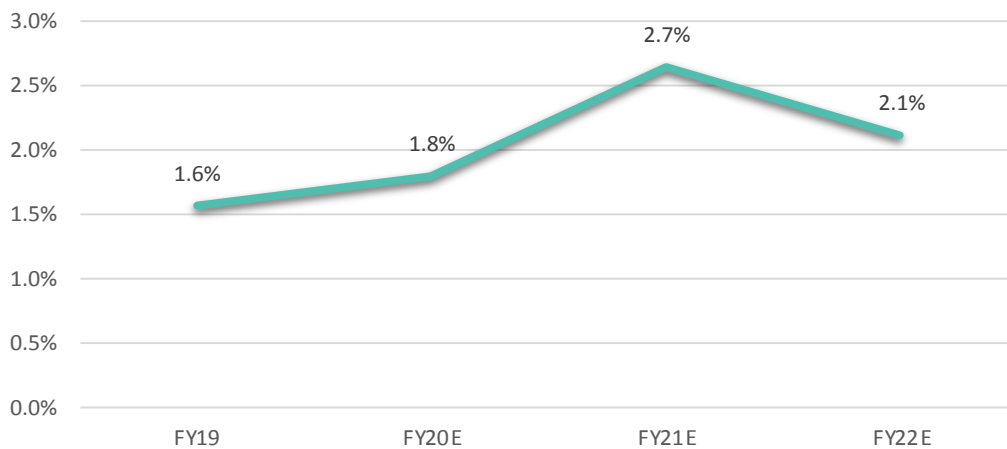
EXHIBIT 11: Business and professional 30+ DPD



Source: Company disclosures, Bernstein analysis

EXHIBIT 12: We expect elevated credit cost for FY'21 given slowdown in growth and stress in select segments such as non-salaried personal loans and SMEs

Credit Cost to average loans



Source: Company disclosures, Bernstein analysis and estimates

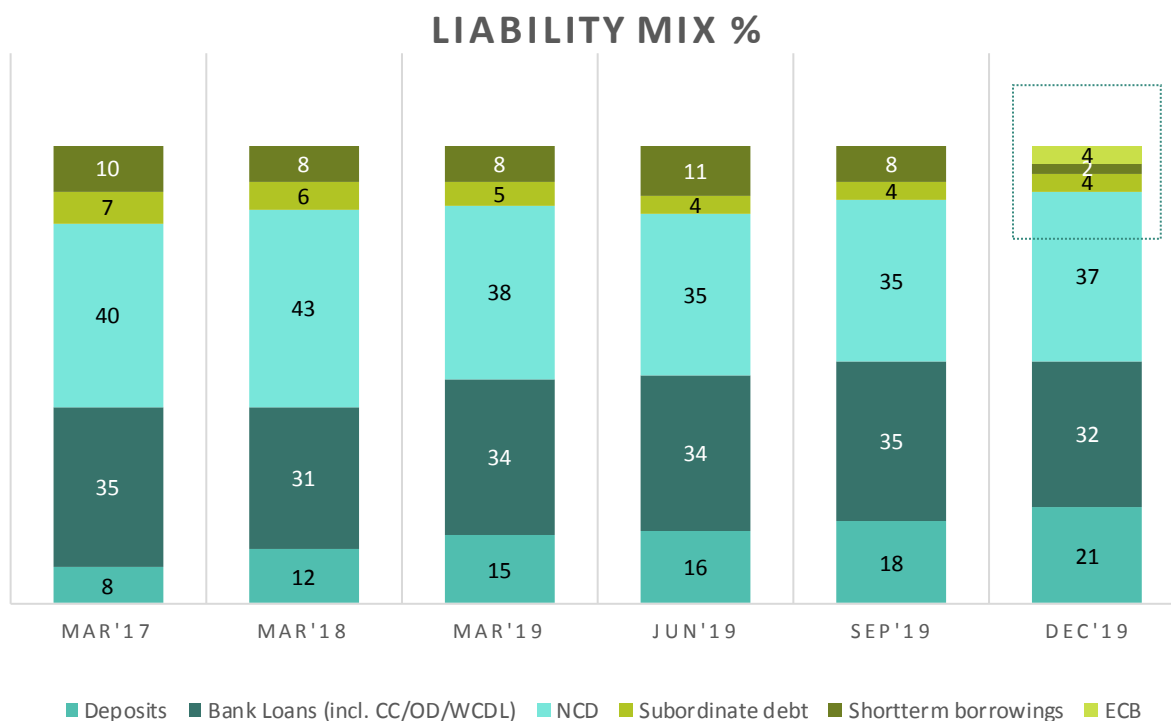
Bajaj's asset liability management would be critical

Bajaj's ALM over the next two quarters will be critical to manage its liquidity and maintain its margins. In the scenario of Bajaj consolidating its loan book with focus on collections, Bajaj will have to renew its liabilities with banks, NCDs and deposits. We believe, given the Bajaj group strength, banks are likely to continue supporting with credit lines.

Bajaj has survived NBFC funding crisis in the past with short tenured assets and long tenured liabilities (refer Exhibit 14). However, that works well during periods of fast growth. In the scenario, that Bajaj starts consolidating in the coming year and economic contraction environment sustains longer than planned, Bajaj will have to incur interest costs on its long-term liabilities, without earning corresponding interest income causing margins to contract. However, we don't project a major margin risk as we await more data on the length of this slowdown.

32% of Bajaj's liability mix is contributed by market NCDs. Similarly, recently Bajaj raised external foreign currency loans equivalent to 4% of its liabilities (refer Exhibit 13). Given the domestic and global liquidity crunch in debt markets, Bajaj will have to change direction towards consolidation and liquidity management instead of growth.

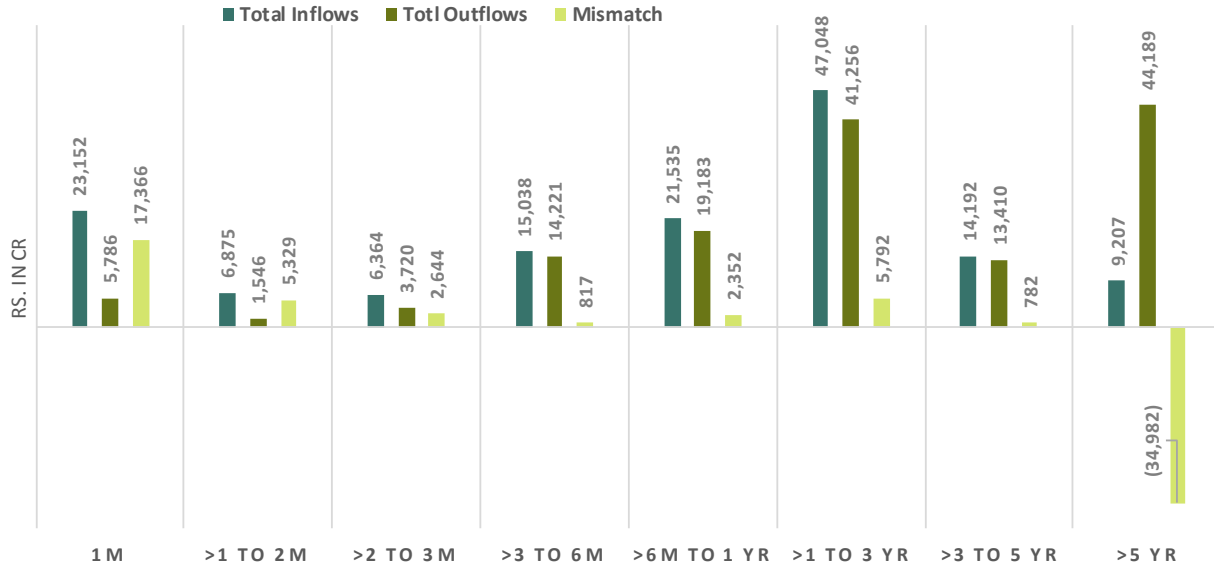
EXHIBIT 13: Bajaj Finance: Liability Mix



Source: Company disclosures, Bernstein analysis

EXHIBIT 14: **ALM snapshot - Bajaj's ALM is driven by short tenured assets and long tenured liabilities - works well in periods of growth but challenging during periods of consolidation**

ALM SNAPSHOT AS ON 31/12/2019



Source: Company disclosures, Bernstein analysis

Valuation:

Historically, Bajaj has traded at a 5-year average LTM valuation of 28.5x earnings, and a forward Price earnings growth of greater than 1, given the continuous earnings compounding nature of the business.

We expect ROE to compress from a 22% historical level to 15% in FY'21 (refer Exhibit 16) before gradually recovering.

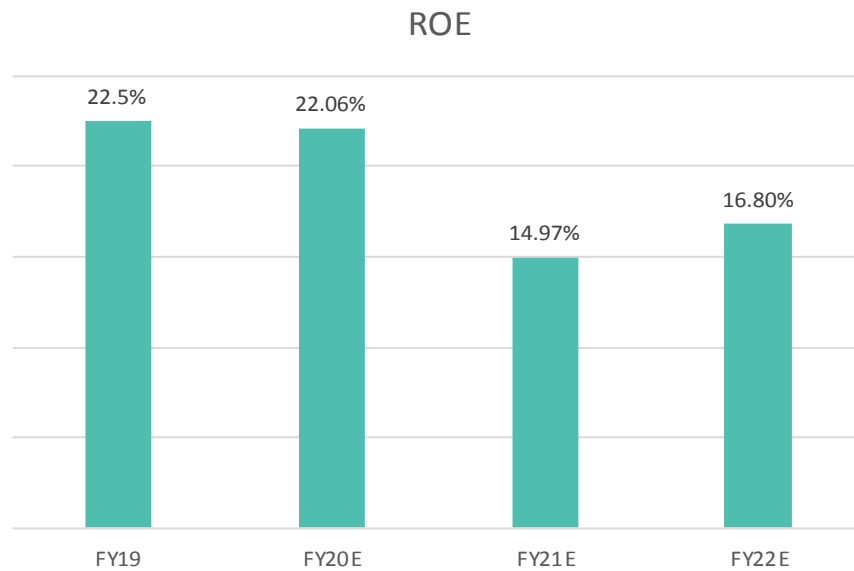
We value Bajaj at 15x target earnings multiple (52% compression of its 5-year LTM), to factor a year of growth shock and consolidation before we consider Bajaj back on its long-term growth trajectory.

EXHIBIT 15: Bajaj Finance is trading at lower than its historical average on NTM PE Basis (18.71x vs. 5-year avg. 28.73)



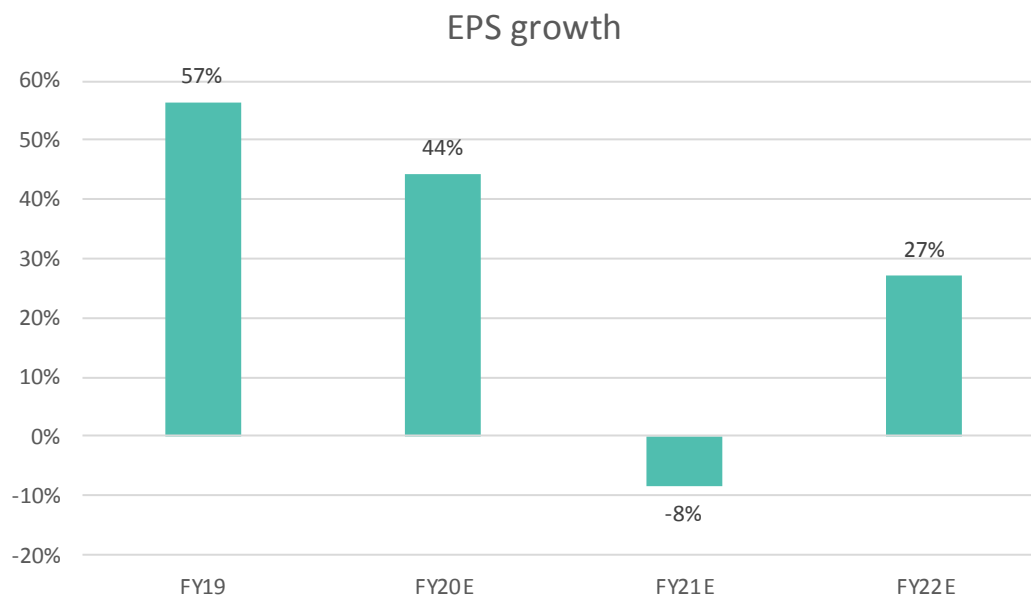
Note: Data till 25th March 2020
 Source: Bloomberg, Bernstein analysis

EXHIBIT 16: **Bajaj Finance: ROE**



Source: Company disclosures, Bernstein analysis and estimates

EXHIBIT 17: **Bajaj Finance: EPS growth**



Source: Company disclosures, Bernstein analysis and estimates

EXHIBIT 18: Bajaj Finance: Key financials and estimates

BAJAJ FINANCE						
<i>All figures in ₹ million</i>						
	FY'18	FY'19	FY'20E	FY'21E	FY'22E	FY'23E
INCOME STATEMENT						
Net Revenues	81,429	118,782	160,933	175,114	204,161	254,774
Operating expenses	(32,690)	(41,977)	(56,326)	(61,290)	(71,456)	(89,171)
PPOP	48,739	76,805	104,606	113,824	132,704	165,603
Credit Cost	(10,305)	(15,014)	(23,438)	(40,870)	(38,169)	(47,653)
Exceptional Item	-	-	-	-	-	-
PBT	38,434	61,792	81,169	72,955	94,535	117,950
Income tax	(13,471)	(21,842)	(22,321)	(18,968)	(24,579)	(30,667)
PAT	24,964	39,950	58,847	53,987	69,956	87,283
Consol Diluted EPS	43.92	68.75	99.29	91.09	115.90	144.60
Consol Diluted EPS g	30%	57%	44%	-8%	27%	25%
Consol DPS	4.0	6.0	8.7	7.9	10.1	12.6
Consol. Payout ratio	9%	9%	9%	9%	9%	9%
BALANCE SHEET						
<u>Consolidated</u>						
Loans	791,025	1,125,128	1,479,044	1,605,454	1,995,397	2,500,209
Borrowings	587,644	883,948	1,335,429	1,449,565	1,801,645	2,257,440
Total Assets	847,982	1,242,325	1,611,111	1,754,872	2,165,558	2,695,363
AUM	824,220	1,158,880	1,527,938	1,655,961	2,056,051	2,576,208
Shareholder's equity	158,479	196,970	336,648	384,385	448,608	528,597
Consol BVPS	276	341	562	642	749	883
Shares o/s, Closing (mn)	575	577	599	599	599	599
KEY RATIOS						
GNPA %	1.5%	1.6%	1.8%	1.9%	2.0%	2.1%
AUM g	37%	41%	32%	8%	24%	25%
Net Revenues / Avg AuM	11.4%	12.0%	12.0%	11.0%	11.0%	11.0%
Cost to income	40%	35%	35%	35%	35%	35%
Credit cost / Avg AuM	1.4%	1.5%	1.7%	2.6%	2.1%	2.1%
Effective income tax rate	35%	35%	28%	26%	26%	26%
RoAA	3.5%	4.0%	4.4%	3.4%	3.8%	3.8%
RoAE	19.6%	22.5%	22.1%	15.0%	16.8%	17.9%
Tier I Capital %	18.4%	16.3%	21.1%	22.2%	20.9%	19.6%

Source: Company disclosures, Bernstein analysis and estimates

EXHIBIT 19: **New vs Old**

Particulars	New estimates			Old estimates			Variance		
	FY'20E	FY'21E	FY'22E	FY'20E	FY'21E	FY'22E	FY'20E	FY'21E	FY'22E
AuM	1,527,952	1,655,975	2,056,069	1,507,237	1,921,491	2,423,621	1%	-14%	-15%
Net Revenue	160,933	175,114	204,161	159,693	203,657	255,915	1%	-14%	-20%
Operating Expenses	(56,326)	(61,290)	(71,456)	(55,892)	(69,243)	(85,603)	1%	-11%	-17%
Operating income	104,606	113,824	132,704	103,800	134,413	170,311	1%	-15%	-22%
Credit Cost	(23,438)	(40,870)	(38,169)	(23,257)	(30,727)	(39,410)	1%	33%	-3%
PBT	81,169	72,955	94,535	80,543	103,686	130,901	1%	-30%	-28%
Income tax	(22,321)	(18,968)	(24,579)	(22,149)	(26,958)	(34,034)	1%	-30%	-28%
Consol PAT	58,847	53,987	69,956	58,394	76,728	96,867	1%	-30%	-28%
Consol Dil. EPS	99	91	116	99	129	160	1%	-30%	-28%
Book value / share	562	642	749	561	679	827	0%	-5%	-9%
Tier 1 % ratio	21.1%	22.2%	20.9%	21.4%	20.3%	19.6%	-1%	10%	7%

Source: Company disclosures, Bernstein analysis and estimates

EXHIBIT 20: **Bernstein vs Consensus**

Particulars	FY20E			FY21E			FY22E		
	BERN	Consensus	Variance	BERN	Consensus	Variance	BERN	Consensus	Variance
P&L									
Net revenues	160,933	167,640	-4%	175,114	220,495	-21%	204,161	279,146	-27%
Operating expenses	(56,326)	(57,700)	-2%	(61,290)	(77,063)	-20%	(71,456)	(94,214)	-24%
Gross operating income	104,606	109,940	-5%	113,824	143,432	-21%	132,704	184,932	-28%
Credit costs	(23,438)	(25,852)	-9%	(40,870)	(32,743)	25%	(38,169)	(41,183)	-7%
Net operating income	81,169	84,089	-3%	72,955	110,689	-34%	94,535	143,749	-34%
Pre-tax profit	81,169	83,321	-3%	72,955	112,028	-35%	94,535	143,908	-34%
Net income	58,847	60,252	-2%	53,987	83,606	-35%	69,956	108,272	-35%
BS									
AuM	1,527,952	1,539,159	-1%	1,655,975	2,010,148	-18%	2,056,069	2,461,597	-16%
Per share									
EPS	100	101	-1%	92	139	-34%	117	184	-36%
DPS	9	9	-5%	8	11	-31%	10	15	-33%
BVPS	562	531	6%	642	663	-3%	749	854	-12%
Key ratios									
Tier 1 capital %	21.1%	17.1%	4%	22.2%	17.3%	5%	20.9%	18.9%	2%
AuM g	32%	33%	-1%	8%	31%	-22%	34%	49%	-15%
Net revenue as a % of AuM	12%	12%	0%	11%	12%	-1%	11.4%	13.6%	-2%
C/I	35%	34%	1%	35%	35%	0%	35%	34%	1%
Credit costs %	1.7%	1.9%	0%	2.6%	1.8%	1%	2.1%	2.0%	0%
RoE	22%	23%	-1%	15%	25%	-10%	17%	25%	-8%
RoA	4.1%	4.1%	0%	3.2%	4.3%	-1%	3.6%	4.4%	-1%
Dividend Payout Ratio	9%	9%	0%	9%	8%	0%	9%	8%	0%

Source: Bloomberg, Company disclosures, Bernstein analysis

DISCLOSURE APPENDIX

BERNSTEIN TICKER TABLE

Ticker	Rating	26 Mar 2020 Closing Price	Target Price	TTM Rel. Perf.	EPS Reported			P/E Reported		
					2019A	2020E	2021E	2019A	2020E	2021E
BAF.IN	U	INR 2,793.70	1,740.00	13.6%	INR 68.75	99.29	91.09	40.64	28.14	30.67
<i>OLD</i>	O		4,820.00			98.53	129.46			
MXAPJ		427.22			34.13	38.44	43.54	12.52	11.11	9.81

RATING CHANGE / TARGET PRICE CHANGE / ESTIMATE CHANGE IN BOLD

O - Outperform, M - Market-Perform, U - Underperform, N - Not Rated

VALUATION METHODOLOGY

India Financials

India is a growth market and investors generally seek growth-based returns in India. We believe all banks in India trade on what market believes as the sustainable earnings growth momentum. Banks that have sustained cross-cycle earnings growth despite sector asset quality concerns trade at a premium. On the other hand banks that have been inconsistent in earnings growth get penalized by the market until they build investor confidence again. We value our coverage on a target P/E multiple based on one year forward earnings calibrated by trading history and our expectation of three year sustainable earnings growth. We use a one-year forward multiple based on FY'21 earnings to arrive at FY'20 end target price. We corroborate our target price earnings multiples with a P/BV based multiple as a secondary check. We also believe the market can be brutal with growth stocks if the growth story shows any structural weakness and thus we constantly stress-test for structural growth weakness across our industry and company investment thesis.

RISKS

Bajaj Finance Ltd

Upside risks include

- More than expected improvement in Indian Covid 19 situation
- Bajaj is able to manage asset quality better than its peers

REQUIRED REGULATORY DISCLOSURES

- References to "Bernstein" relate to Sanford C. Bernstein & Co., LLC, Sanford C. Bernstein Limited, Sanford C. Bernstein (Hong Kong) Limited 盛博香港有限公司, Sanford C. Bernstein (Canada) Limited, Sanford C. Bernstein (India) Private Limited (SEBI registration no. INH000006378) and Sanford C. Bernstein (business registration number 53193989L), a unit of AllianceBernstein (Singapore) Ltd. which is a licensed entity under the Securities and Futures Act and registered with Company Registration No. 199703364C, collectively. On and as of April 1, 2019, AllianceBernstein L.P. acquired Autonomous Research. As a result of the acquisition, the research activities formerly conducted by Autonomous Research US LP have been assumed by Sanford C. Bernstein & Co., LLC, which will continue to publish research under the Autonomous Research US brand and the research activities formerly conducted by Autonomous Research Asia Limited have been assumed by Sanford C. Bernstein (Hong Kong) Limited 盛博香港有限公司, which will continue to publish research under the Autonomous Research Asia brand.
- References to "Autonomous" in these disclosures relate to Autonomous Research LLP and, with reference to dates prior to April 1, 2019, to Autonomous Research US LP and Autonomous Research Asia Limited, and, with reference to April 1, 2019 onwards, the Autonomous Research US unit and separate brand of Sanford C. Bernstein & Co., LLC and the Autonomous Research Asia unit and separate brand of Sanford C. Bernstein (Hong Kong) Limited 盛博香港有限公司, collectively.
- References to "Bernstein" or the "Firm" in these disclosures relate to Sanford C. Bernstein & Co., LLC, Sanford C. Bernstein Limited, Sanford C. Bernstein (Hong Kong) Limited 盛博香港有限公司, Sanford C. Bernstein (Canada) Limited, Sanford C. Bernstein (India) Private Limited (SEBI registration no. INH000006378), Sanford C. Bernstein (business registration number 53193989L), a unit of AllianceBernstein (Singapore) Ltd. which is a licensed entity under the Securities and Futures Act and registered with Company Registration No. 199703364C and, with reference to April 1, 2019 onwards, Autonomous Research LLP, collectively.
- Bernstein and Autonomous analysts are compensated based on aggregate contributions to the research franchise as measured by account penetration, productivity and proactivity of investment ideas. No analysts are compensated based on performance in, or contributions to, generating investment banking revenues.
- Bernstein rates stocks based on forecasts of relative performance for the next 6-12 months versus the S&P 500 for stocks listed on the U.S. and Canadian exchanges, versus the MSCI Pan Europe Index for stocks listed on the European exchanges (except for Russian companies), versus the MSCI Emerging Markets Index for Russian companies and stocks listed on emerging markets exchanges outside of the Asia Pacific region, and versus the MSCI Asia Pacific ex-Japan Index for stocks listed on the Asian (ex-Japan) exchanges - unless otherwise specified. We have three categories of ratings:
 - Outperform: Stock will outpace the market index by more than 15 pp in the year ahead.
 - Market-Perform: Stock will perform in line with the market index to within +/- 15 pp in the year ahead.
 - Underperform: Stock will trail the performance of the market index by more than 15 pp in the year ahead.
 - Not Rated: The stock Rating, Target Price and/or estimates (if any) have been suspended temporarily.
- For purposes of the Market Abuse Regulation (MAR) and the FINRA Rule 2241, 'Outperform' is classified as a Buy, 'Market-Perform' is classified as a Hold, and 'Underperform' is classified as a Sell
- As of 03/25/2020, Bernstein's ratings were distributed as follows: 279 Outperform - 45.5% (0.0% banking clients); 269 Market-Perform - 43.9% (0.0% banking clients); 65 Underperform - 10.6% (0.0% banking clients); 0 Not Rated - 0.0% (0.0% banking clients). The numbers in parentheses represent the percentage of companies in each category to whom Bernstein provided investment banking services. All figures are updated quarterly and represent the cumulative ratings over the previous 12 months. These ratings relate solely to the investment research ratings for companies covered under the Bernstein brand and do not include the investment research ratings for companies covered under the Autonomous brand. This information is provided in order to comply with Article 6 of the Commission Delegated Regulation (EU) 2016/958.
- Accounts over which Bernstein and/or their affiliates exercise investment discretion own more than 1% of the outstanding common stock of the following companies BAF.IN / Bajaj Finance Ltd.

12-Month Bernstein Rating History as of 03/25/2020

Ticker Rating Changes

BAF.IN O (IC) 10/11/18

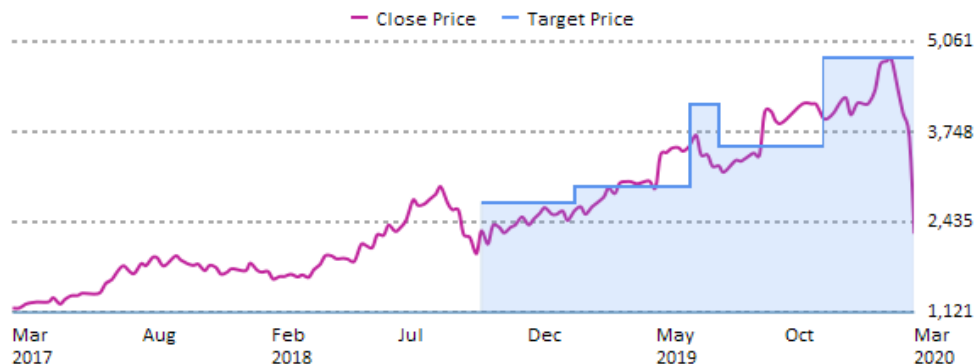
Rating Guide: O - Outperform, M - Market-Perform, U - Underperform, N - Not Rated

Rating Actions: IC - Initiated Coverage, DC - Dropped Coverage, RC - Rating Change

BAF.IN / Bajaj Finance Ltd (INR)

Date	Rating	Target
11-Oct-2018	O(IC)	2,720.00
30-Jan-2019	O	2,960.00
18-Jun-2019	O	4,150.00
26-Jul-2019	O	3,530.00
27-Nov-2019	O	4,820.00

O - Outperform
M - Market-Perform
U - Underperform
N - Not Rated
IC - Initiated Coverage



Source: Bernstein - As of 25-Mar-2020

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