25 July 2023

1QFY24 Results Update | Sector: Financials

Poonawalla Fincorp

Estimate change	↑
TP change	↑
Rating change	↔

Bloomberg	POONAWAL IN
Equity Shares (m)	768
M.Cap.(INRb)/(USDb)	282.8 / 3.5
52-Week Range (INR)	385 / 244
1, 6, 12 Rel. Per (%)	3/13/19
12M Avg Val (INR M)	1005

Financials & Valuations (INR b)

Y/E March	FY23	FY24E	FY25E
Net Total Income	14.1	21.7	29.8
PPOP	6.0	14.2	21.2
PAT	5.8	9.7	13.8
EPS (INR)	7.6	12.7	17.9
EPS Gr. (%)	98.7	66.4	41.3
Standalone BV (INR)	84	135	150
Valuations			
NIM (%)	8.8	9.9	10.0
C/I ratio (%)	57.5	34.7	28.9
RoAA (%)	3.8	4.6	4.8
RoE (%)	9.6	11.6	12.5
Payout (%)	26.2	23.7	22.3
Valuations			
P/E (x)	48.3	29.0	20.6
P/BV (x)	4.4	2.7	2.4
Div. Yield (%)	0.5	0.8	1.1

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	62.1	62.1	61.5
DII	8.0	6.1	5.7
FIIFIIFII	7.2	7.1	7.4
Others	22.7	24.6	25.4

FII Includes depository receipts

CMP: INR368 TP: INR425 (+15%) Buy

Operating efficiencies playing out; asset quality healthy

- Poonawalla Fincorp (PFL)'s 1QFY24 standalone PAT grew 95% YoY to ~INR2b. The healthy operational performance was driven by: a) ~10bp QoQ margin expansion, and b) improved efficiency driving moderation in cost ratios.
- NII grew 58% YoY to INR4.2b, while PPOP jumped 150% YoY to INR2.9b. PFL is focused on improving productivity, supported by digitization, and is confident of scaling up without investing in additional manpower or branches. The cost-income ratio (CIR) fell ~12pp QoQ to ~38% (PQ: 50%), including lower ESOP expenses.
- The company has strong moats on the liability front, supported by its strong parentage. At its current size (one-fifth to one-tenth of peers in similar segments), PFL has a huge opportunity in its target product segments. With a healthy capital position, we believe the company has a long runway of strong loan growth ahead.
- PFL has laid down a robust foundation for sustainable profitability through initiatives that will lead to lower operating costs (as a % of AUM), higher business volumes and robust asset quality. We model a standalone AUM/PAT CAGR of ~38%/53% over FY23-FY25E and expect PFL to deliver a RoA/RoE of 4.8%/12.5% in FY25. **Reiterate BUY with a TP of INR425 (premised on 2.8x FY25E BVPS).**

Business momentum strong; rise in DDP will lower acquisition cost

- Standalone AUM rose 41% YoY/10% QoQ to ~INR178b. Focused AUM grew 66% YoY and contributed ~96% to the AUM mix (PY: 82%). Unsecured loans contributed ~55% to the AUM mix.
- Standalone disbursements grew 143% YoY to INR70.6b.
- The company continued to focus on accelerated customer acquisitions with improving proportion of Direct, Digital and Partnerships (DDP) in the sourcing mix to ~86% (PQ: 81%). This has been driving down the customer acquisition costs (CAC).

Asset quality healthy in the newly originated loan book

- Asset quality remained pristine, with GS3/NS3 at 1.42%/0.76% and the PCR on S3 loans increasing ~25bp QoQ to ~46.4%. Restructured book in 1QFY24 declined to 0.6% of AUM (PQ: 0.8%), and ~51% of the restructured book was in the 0 dpd bucket.
- Legacy discontinued book (GS3: 22.7%) contributed a large part of non-performing loans, while the newly originated book had GS3 of 0.4%. This, we believe, can help sustain healthy asset quality and benign credit costs going forward as well.
- Net credit costs of INR60m included a gain of INR200m from the sale of the legacy portfolio and an impairment of INR260m on financial instruments. We model credit costs of 0.7%/1.2% in FY24/FY25.

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Highlights from the management commentary

- For FY24, the company has guided for Opex/AUM of ~4%, including an ESOP charge of INR880m. The ESOP charges are expected to decline further in FY25.
- Outstanding borrowing under legacy book stands at INR8.3b as of Jun'23 and it carries interest rate of ~9.7%. The company is working towards pre-closing legacy borrowings (by using receipts from sale of housing subsidiary), which should benefit CoF by ~10bp.
- The sourcing mix consists of DDP accounting for 86%, while the remaining ~14% is sourced through branches and Direct Selling Agents (DSAs) originating Loan Against Property (LAP) and pre-owned cars.

Valuation and view

- Consumer and small business finance – the segments targeted by PFL – have a huge market opportunity. We believe that the company has levers to maintain NIMs of ~10% over FY24-FY25E. We model benign credit costs of 0.7% in FY24.
- Strong leadership teams across functions, realignment of customer and product segments, and focus on leveraging technology/analytics position PFL well to build scale and deliver superior risk-adjusted returns. **Reiterate BUY with a TP of INR425 (premised on 2.8x FY25E BVPS).**
- **Key downside risks:** a) Inability to execute its articulated strategy despite a new management team and investments in technology and processes, and b) aggressive competitive landscape leading to pressure on spreads/margins and/or deterioration in asset quality.

Quarterly Performance (Standalone) **(INR M)**

Y/E March	FY23				FY24E				FY23	FY24E	1Q FY24E	v/s Est.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Interest Income	3,857	4,179	4,605	5,529	6,560	7,085	7,652	7,617	18,169	28,914	6,138	7
Interest Expenses	1,187	1,441	1,593	1,732	2,348	2,442	2,589	2,415	5,953	9,794	2,009	17
Net Interest Income	**2,670**	**2,738**	**3,012**	**3,798**	**4,212**	**4,643**	**5,063**	**5,202**	**12,217**	**19,120**	**4,129**	**2**
YoY Growth (%)	*26.3*	*12.0*	*23.6*	*52.0*	*57.8*	*69.6*	*68.1*	*37.0*	*28.7*	*56.5*	*54.7*	
Other Income	434	627	588	282	563	596	629	813	1,931	2,601	490	
Total Income	**3,103**	**3,365**	**3,600**	**4,080**	**4,775**	**5,239**	**5,692**	**6,015**	**14,148**	**21,721**	**4,619**	**3**
YoY Growth (%)	*34.6*	*25.1*	*33.2*	*41.7*	*53.9*	*55.7*	*58.1*	*47.4*	*33.7*	*53.5*	*48.8*	
Operating Expenses	1,926	2,107	2,043	2,064	1,834	1,907	1,926	1,874	8,139	7,540	2,022	-9
Operating Profit	**1,178**	**1,257**	**1,558**	**2,016**	**2,941**	**3,332**	**3,766**	**4,141**	**6,008**	**14,180**	**2,597**	**13**
YoY Growth (%)	*16.8*	*2.8*	*35.6*	*75.0*	*149.8*	*165.0*	*141.8*	*105.4*	*32.6*	*136.0*	*120.5*	
Provisions & Loan Losses	-164	-482	-452	-347	266	300	387	470	-1,445	1,423	-50	-631
Profit before Tax	**1,550**	**1,740**	**2,010**	**2,367**	**2,676**	**3,032**	**3,379**	**3,671**	**7,666**	**12,757**	**2,647**	**1**
Tax Provisions	313	438	506	560	674	728	811	811	1,816	3,023	622	8
Net Profit	**1,237**	**1,302**	**1,504**	**1,807**	**2,002**	**2,304**	**2,568**	**2,859**	**5,849**	**9,734**	**2,025**	**-1**
YoY Growth (%)	*148.2*	*75.8*	*87.5*	*102.7*	*61.9*	*77.0*	*70.7*	*58.2*	*99.5*	*66.4*	*63.8*	
Key Parameters (Calc., %)												
Yield on loans	13.9	14.1	14.6	15.7	16.3				14.0	15.3		
Cost of funds	7.0	7.2	7.5	7.9	8.0				6.6	7.9		
Spread	6.9	6.9	7.1	7.8	8.3				7.4	7.4		
NIM on loans	9.7	9.2	9.6	10.8	10.4				8.8	9.9		
C/I ratio	62.1	62.6	56.7	50.6	38.4				57.5	34.7		
Credit cost	-0.1	-0.4	-0.3	-0.2	0.2				-1.1	0.7		
Tax rate	20.2	25.2	25.2	23.6	25.2				23.7	23.7		
Balance Sheet Parameters												
Disbursements (INR b)	**29.0**	**31.1**	**33.7**	**63.7**	**70.6**				**158**	**199**		
Growth (%)	95.5	42.0	157.2	150.9	143.5				109.4	**95.0**		
AUM (INR b)	**126**	**132**	**139**	**161**	**178**				**161**	**178**		
Growth (%)	21.5	16.8	27.6	37.2	41.0				37.2	**41.0**		
AUM mix (%)												
Focused	81.9	88.3	91.4	94.1	96.3				94.1	96.3		
Discontinued	18.1	11.7	8.6	5.9	3.7				5.9	3.7		
Asset Quality Parameters												
GS 3 (INR m)	3,270	2,240	2,230	2,250	2,450				2,250	2,450		
GS 3 (%)	2.7	1.8	1.7	1.4	1.4				1.4	1.4		
NS 3 (INR m)	1,340	1,180	1,170	1,210	1,310				1,210	1,310		
NS 3 (%)	1.1	0.9	0.9	0.8	0.8				0.8	0.8		
PCR (%	59.0	47.3	47.5	46.2	46.5				46.2	46.5		

E: MOFSL estimates

CONFERENCE CALL

Highlights from the management commentary

Business Strategy

- PFL continues to focus on building a consumer and MSME-oriented retail lending franchise. The healthy growth is supported by the contributions from LAP and unsecured business, as well as Supply Chain finance.
- The portion of short-term products in the loan mix currently stands at 26% and is projected to remain within the range of 20-25%.
- Regarding the sale of the Housing Finance subsidiary, the company has obtained all necessary approvals, and the transaction is anticipated to be finalized within the next one week.
- The company is leveraging its existing customer database to facilitate cross-selling. There has been a notable improvement in cross-selling activities, with the company even initiating the sale of third-party products.
- The company has already finalized a partner bank for a co-branded credit card and applied before the RBI. Expects to launch co-branded credit card and EMI card before the end of Dec'23.
- Over the quarter, the company achieved a 5% reduction in manpower by effectively leveraging technology.

Asset Quality and Credit costs

- Out of the total INR2.45b of GS3 assets, the discontinued book amounts to INR1.04b, the legacy book is ~INR0.4b, and new originations account for ~INR1.01b.
- GS3 under new originations of INR1.01b can be further categorized into partnerships (INR260m), acquired assets (INR520m), and internal originations (INR230m).
- The company has initiated a cleanup process for the legacy book, which involved scaling down Magma employees from 8,000 at the time of acquisition to 3,000 as of the current date. Additionally, the number of branches has been reduced from 300 to 100 as part of the cleanup efforts.
- The management has guided for credit cost of 0.8-1.2% across economic cycles.
- The company further stated that short-term personal loans (STPL) will be facilitated through the company's D2C model utilizing its own app. It has guided for credit costs of 2% in the STPL segment.
- Net credit costs amounted to INR60m, which included a gain of INR200m from the sale of the legacy portfolio and an impairment of INR260m on financial instruments.
- ECL/EAD stood at 1.36% as of Jun'23.

Guidance

- The company has provided guidance for strong growth, with AUM growth of 35-40% and earnings growth of 30-35% on a YoY basis.
- On a steady state basis, the company expects RoA of above 4% and NIM of over 10%.
- Regarding credit costs, the company expects them to stabilize in the range of 0.8%-1.2% in the steady state.

- For FY24, the company has guided for Opex/AUM of ~4%, including an ESOP charge of INR880m. ESOP charges are expected to decline in the subsequent years.

CoF and borrowing

- The outstanding borrowing under legacy book stands at INR8.3b as of Jun'23 and it carries interest rate of ~9.7%. The company is working towards pre-closing legacy borrowings (by using receipts from sale of housing subsidiary), which should provide advantage of ~10bp to the CoF.
- The company foresees further ~10bp benefit in CoF over the next two quarters, driven by its plans to raise short-term funding in the form of CPs.

MSME Loans:

- Business Loans have an ATS of less than INR2m, while Professional Loans have an ATS of less than INR1.5m, and Personal Loans less than INR0.5m.
- The maximum turnaround time for processing these loans is two days.
- For loans that are more than 90 days overdue, the rate is 0.15%.
- Unsecured MSME Business Loans carry an interest rate of 18.7% and additional fees of 1% for insurance and 1.8% for processing. The ATS for these loans is INR1.7m, with a tenor of 36 months, and an average tenor of 30 months. These loans are entirely digital and follow a cash-flow lending approach.

Sourcing mix

- The sourcing mix consists of DDP accounting for 86%, while the remaining 14% is sourced through branches and DSAs for LAP and pre-owned car book.
- Within the DDP category, 61% is sourced from partnerships and digital sourcing, while the remaining 25% is sourced directly from non-partnership digital channels like SMS, chat-bot, etc.

Super-app

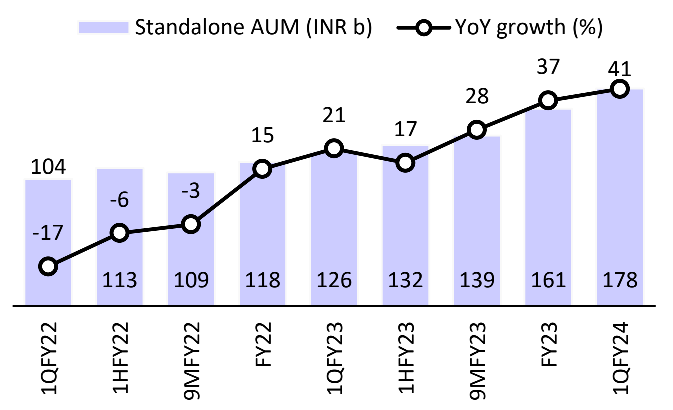
- The company plans to launch the Super app on 15 Aug'23. The app would help the company penetrate further into the unsecured digital lending ecosystem and short-term loans segment.
- It is focused on maintaining a strong product proportion and is building straight-through processing (STP) on its D2C app, ensuring no manual intervention until ticket size of INR300k.
- The company offers zero prepayment charges and ensures there are no hidden fees for its customers.
- The company earns blended yields of 13% from the Fintech originations.

Collections

- The company has established a dedicated call center and increased manpower for collections.
- The acquisition of Magma was primarily driven by the desire to strengthen the collection infrastructure. As a result, the company now possesses an extensive collections infrastructure across India, with a workforce of over 500 individuals dedicated to collections.

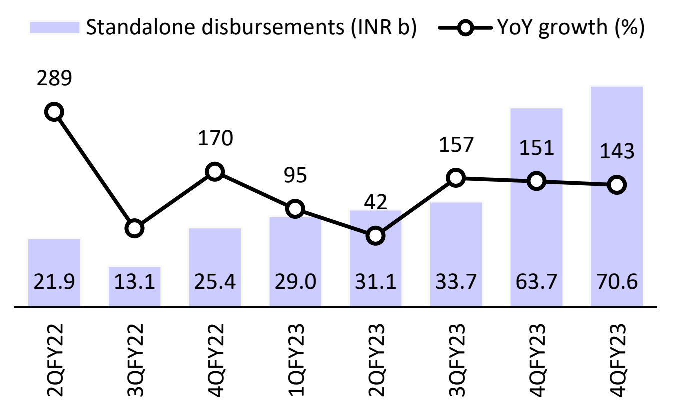
Story in charts

Exhibit 1: AUM growth healthy at 41% YoY (%)



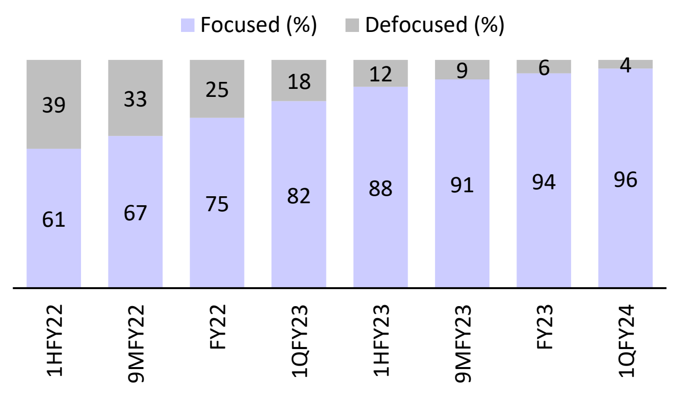
Source: MOFSL, Company

Exhibit 2: PFL recorded the highest-ever quarterly disbursements



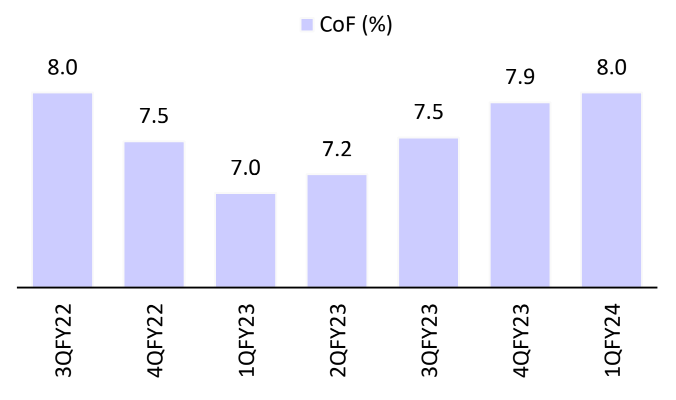
Source: MOFSL, Company

Exhibit 3: Contribution of focused book improving gradually



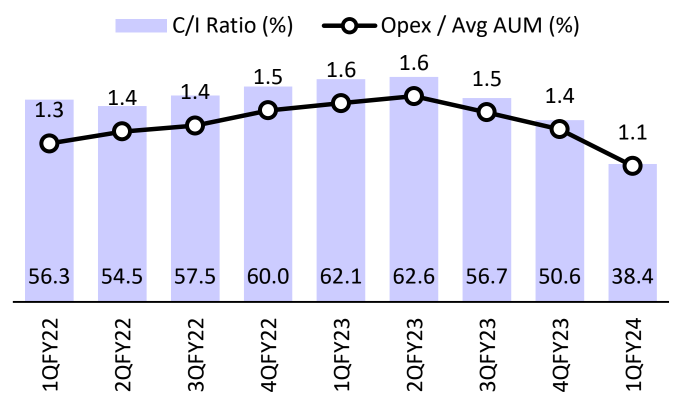
Source: MOFSL, Company

Exhibit 4: CoF increased ~10bp sequentially (%)



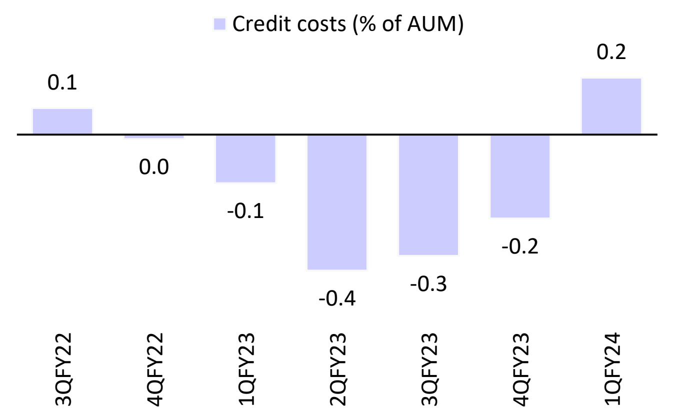
Source: MOFSL, Company

Exhibit 5: Improvement in cost ratios driven by operating efficiencies (%)



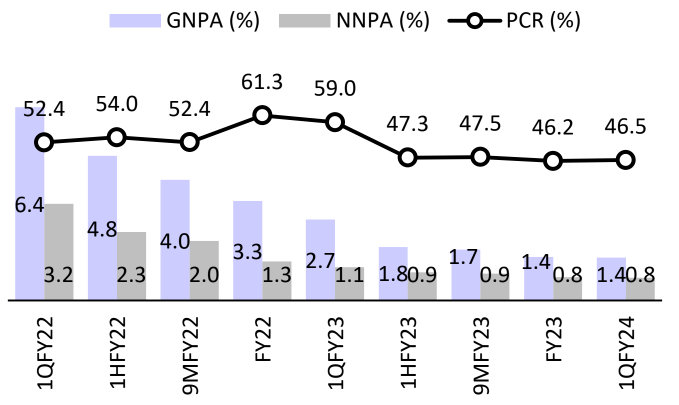
Source: MOFSL, Company

Exhibit 6: Credit costs of 0.2% in 1QFY24



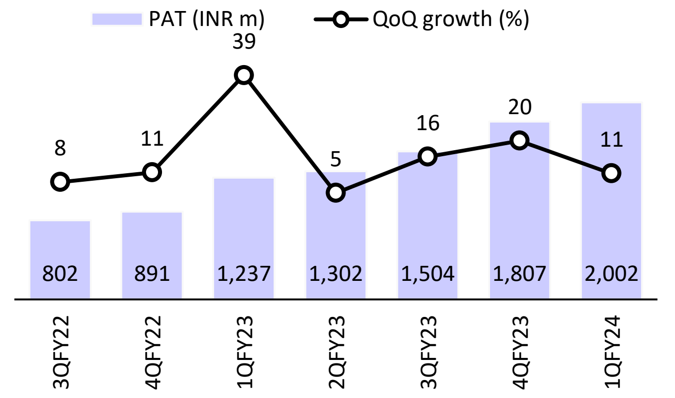
Source: MOFSL, Company

Exhibit 7: Asset quality stable sequentially (%)



Source: MOFSL, Company

Exhibit 8: 1QFY24 PAT grew ~62% YoY (%)



Source: MOFSL, Company

Exhibit 9: Increase our FY24/FY25E EPS by 5%/ 4% to factor in higher loan growth, better NIM and cost efficiencies

INR B	Old Est.		New Est.		% change	
	FY24	FY25	FY24	FY25	FY24	FY25
NII (incl. assignments)	18.8	26.5	19.1	26.7	1.7	0.8
Other Income	2.2	2.8	2.6	3.1	18.5	12.9
Total Income	**21.0**	**29.2**	**21.7**	**29.8**	**3.5**	**2.0**
Operating Expenses	7.9	8.7	7.5	8.6	-4.3	-1.3
Operating Profits	**13.1**	**20.5**	**14.2**	**21.2**	**8.2**	**3.3**
Provisions	1.0	3.2	1.4	3.2	42.7	-1.5
PBT	**12.1**	**17.3**	**12.8**	**18.0**	**5.4**	**4.2**
Tax	2.9	4.1	3.0	4.3	5.4	4.2
PAT	**9.2**	**13.2**	**9.7**	**13.8**	**5.4**	**4.2**
AUM	226	306	226	309	0.4	0.8
Loans	222	301	223	303	0.3	0.8
Borrowings	135	202	136	204	0.4	0.8
NIM	9.7	10.0	9.9	10.0		
Credit Cost	0.5	1.2	0.7	1.2		
RoA	4.4	4.7	4.6	4.8		
RoE	**11.0**	**12.1**	**11.6**	**12.5**		

Source: MOFSL, Company

Financials and valuations

Income Statement								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Interest Income	19,319	20,365	20,228	17,570	14,586	18,169	28,914	40,111
Interest Expenses	10,126	10,176	11,240	8,746	5,093	5,953	9,794	13,415
Net Interest Income	**9,193**	**10,189**	**8,988**	**8,824**	**9,493**	**12,217**	**19,120**	**26,697**
Change (%)		10.8	-11.8	-1.8	7.6	28.7	56.5	39.6
Non-interest income and Other Income	1,666	2,308	1,962	1,199	1,085	1,931	2,601	3,111
Net Total Income	**10,859**	**12,497**	**10,951**	**10,023**	**10,578**	**14,148**	**21,721**	**29,807**
Change (%)		15.1	-12.4	-8.5	5.5	33.7	53.5	37.2
Total Operating Expenses	**5,522**	**6,018**	**5,968**	**4,563**	**6,046**	**8,139**	**7,540**	**8,603**
Change (%)		9.0	-0.8	-23.5	32.5	34.6	-7.4	14.1
Employee Expenses	3,306	3,804	3,741	3,060	4,099	5,148	4,221	4,728
Depreciation	490	502	716	522	495	614	688	770
Other Operating Expenses	1,726	1,712	1,487	981	1,453	2,268	2,631	3,105
PPoP	**5,337**	**6,479**	**4,982**	**5,460**	**4,532**	**6,008**	**14,180**	**21,204**
Change (%)		21.4	-23.1	9.6	-17.0	32.6	136.0	49.5
Total Provisions	**2,966**	**2,450**	**4,640**	**13,186**	**686**	**-1,445**	**1,423**	**3,182**
PBT	**2,371**	**4,029**	**342**	**-7,727**	**3,846**	**7,666**	**12,757**	**18,022**
Tax Provisions	359	1,278	442	-1,943	914	1,816	3,023	4,271
Tax Rate (%)	15.1	31.7	129.3	25.1	23.8	23.7	23.7	23.7
PAT	**2,012**	**2,751**	**-100**	**-5,784**	**2,932**	**5,849**	**9,734**	**13,751**
Change (%)						99.5	66.4	41.3

Balance Sheet								(INR m)
Y/E March	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**
Equity Share Capital	474	539	539	539	1,530	1,536	1,536	1,536
Reserves & Surplus	17,634	25,019	24,614	18,881	55,615	62,711	1,02,509	1,13,957
Net Worth	**18,108**	**25,558**	**25,153**	**19,421**	**57,145**	**64,247**	**1,04,045**	**1,15,493**
Borrowings	**1,10,980**	**1,17,497**	**1,00,595**	**79,487**	**67,734**	**1,12,092**	**1,35,858**	**2,03,753**
Change (%)								
Other liabilities	6,593	6,820	3,803	4,512	3,217	3,880	5,043	6,304
Total Liabilities	**1,35,681**	**1,49,876**	**1,29,552**	**1,03,420**	**1,28,097**	**1,80,218**	**2,44,947**	**3,25,550**
Loans	**1,21,544**	**1,31,379**	**1,11,749**	**85,653**	**1,06,784**	**1,52,295**	**2,22,664**	**3,03,354**
Change (%)	0.03	8.1	-14.9	-23.4	24.7	42.6	46.2	36.2
Cash and Bank Balances	3,978	9,327	6,484	6,124	5,372	6,574	2,905	1,564
Fixed Assets	1,921	1,871	2,267	1,715	1,748	2,117	2,286	2,515
Investments	3,056	3,024	4,024	4,289	8,197	3,109	0	0
Other assets	5,182	4,275	5,028	5,638	5,996	16,123	17,091	18,116
Total Assets	**1,35,681**	**1,49,876**	**1,29,552**	**1,03,420**	**1,28,097**	**1,80,218**	**2,44,947**	**3,25,550**

E: MOFSL Estimates

Financials and valuations

AUM

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
AUM (INR b)	139.9	138.7	128.5	102.5	117.7	161.4	226.4	308.7
YoY growth (%)	**-5**	**-1**	**-7**	**-20**	**15**	**37**	**40**	**36**
Disbursements (INR b)	67.5	76.7	50.5	24.2	75.2	157.5	307.1	399.3
YoY growth (%)		**14**	**-34**	**-52**	**210**	**109**	**95**	**30**

E: MOFSL Estimates

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Spreads Analysis (%)								
Avg. Yield on Loans	15.7	15.8	16.3	17.5	14.9	14.0	15.3	15.2
Avg Cost of Funds	9.5	8.9	10.3	9.7	6.9	6.6	7.9	7.9
Spread on loans	6.1	6.9	6.0	7.8	8.0	7.4	7.4	7.3
NIM (on loans)	6.4	7.3	6.7	7.6	8.6	8.8	9.9	10.0
Profitability Ratios (%)								
RoE	11.7	12.6	-0.4	-26.0	7.7	9.6	11.6	12.5
RoA	1.5	1.9	-0.1	-5.0	2.5	3.8	4.6	4.8
Int. Expended / Int. Earned	52.4	50.0	55.6	49.8	34.9	32.8	33.9	33.4
Other Inc. / Net Income	15.3	18.5	17.9	12.0	10.3	13.6	12.0	10.4
Efficiency Ratios (%)								
Op. Exps. / Net Income	50.9	48.2	54.5	45.5	57.2	57.5	34.7	28.9
Opex/ Avg AUM	3.9	4.3	4.5	4.0	5.5	5.8	3.9	3.2
Empl. Cost/Op. Exps.	59.9	63.2	62.7	67.1	67.8	63.2	56.0	55.0
Asset-Liability Profile (%)								
Loans/Borrowings Ratio	1.1	1.1	1.1	1.1	1.6	1.4	1.6	1.5
Debt/Equity (x)	6.1	4.6	4.0	4.1	1.2	1.7	1.3	1.8
Assets/Equity (x)	7.5	5.9	5.2	5.3	2.2	2.8	2.4	2.8
Asset quality								
GNPA (INR m)				4,190	3,720	2,250	2,717	3,396
GNPA (%)				4.3	3.3	1.4	1.2	1.1
NNPA (INR m)				1,240	1,440	1,210	1,413	1,698
NNPA (%)				1.3	1.3	0.8	0.6	0.6
PCR (%)				70.4	61.3	46.2	48.0	50.0
Credit costs (%)	2.4	1.9	3.8	13.4	0.7	-1.1	0.7	1.2

Valuations	FY18	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Book Value (INR)	76	95	93	72	75	84	135	150
BV Growth (%)	11.0	24.2	-1.7	-22.8	3.7	12.0	61.9	11.0
Price-BV (x)	**4.8**	**3.9**	**3.9**	**5.1**	**4.9**	**4.4**	**2.7**	**2.4**
EPS (INR)	8.5	10.2	-0.4	-21.5	3.8	7.6	12.7	17.9
EPS Growth (%)		20.3	-103.6	5,675.2	-117.9	98.7	66.4	41.3
Price-Earnings (x)	**43.3**	**36.0**	**-990.7**	**-17.2**	**96.0**	**48.3**	**29.0**	**20.6**
Dividend per share	0.0	0.0	0.0	0.0	0.4	2.0	3.0	4.0
Dividend Yield (%)	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.5**	**0.8**	**1.1**

E: MOFSL Estimates

NOTES

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Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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