MOTILAL OSWAL
FINANCIAL SERVICES

22 July 2024
1QFY25 Result Update | Sector: NBFCs

Poonawalla Fincorp

Estimate changes	↓
TP change	↓
Rating change	↔

Bloomberg	POONAWAL IN
Equity Shares (m)	775
M.Cap.(INRb)/(USDb)	313.1 / 3.7
52-Week Range (INR)	520 / 336
1, 6, 12 Rel. Per (%)	-8/-31/-16
12M Avg Val (INR M)	1136

Financials Snapshot (INR b)

Y/E MARCH	FY24	FY25E	FY26E
Net Income	22.0	29.1	38.6
PPOP	14.0	18.8	26.4
PAT	10.3	13.2	17.1
EPS (INR)	13.4	17.2	22.2
EPS Gr. (%)	73.3	28.2	29.0
BV/Share	106	121	140
Ratios			
NIM on AUM (%)	9.5	8.8	8.8
C/I ratio (%)	36.6	35.5	31.7
RoAA (%)	4.9	4.7	4.4
RoE (%)	14.2	15.1	17.0
Valuations			
P/E (X)	30.1	23.5	18.2
P/BV (X)	3.8	3.3	2.9

Shareholding pattern (%)

As On	Jun-24	Mar-24	Jun-23
Promoter	62.1	62.1	62.1
DII	6.8	5.8	8.0
FII	8.5	8.3	7.2
Others	22.6	23.8	22.7

FII Includes depository receipts

CMP: INR404 TP: INR465 (+15%) BUY

Earnings miss due to NIM compression; loan growth strong

Senior management rejig; articulation of strategy under the new MD/CEO

- Poonawalla Fincorp (PFL)'s 1QFY25 NII grew ~37% YoY to ~INR5.8b (5% miss), while its PPoP increased ~47% YoY to ~INR4.3b (9% miss). PFL's 1QFY25 PAT grew ~46% YoY and declined ~12% QoQ to ~INR2.9b (9% miss).
- Opex rose ~33% YoY to ~INR2.4b (~15% above estimate), with the C/I ratio broadly stable QoQ at ~36% (PY: ~38%). Provisions stood at INR425m (vs. estimated credit costs of ~INR500m).
- PFL articulated its strategy under the new MD & CEO Mr. Arvind Kapil (ex-HDFC Bank). The new management team will prioritize scalability by improving collections and distribution. It plans to double its product suite with new product offerings. Risk management will be a key focus area.
- We cut our FY25/FY26E earnings by 9%/13% to factor in NIM compression and elevated opex from investments in distribution, management team, and collections. We model a ~34%/29% AUM/PAT CAGR over FY24-FY26E and expect PFL to deliver an RoA/RoE of ~4.4%/~17% in FY26. **Reiterate BUY with a TP of INR465 (premised on 3.3x FY26E BVPS).**

Disbursements hit by a caution in the short-term personal loans (STPL)

- AUM grew ~52% YoY and ~8% QoQ to ~INR270b. Discontinued AUM (including legacy/DA) contributed ~4% to the AUM mix. The share of unsecured loans remained stable at ~51% of the AUM mix.
- PFL reported disbursements of ~INR74b, which grew ~5% YoY.
- Management guided ~30-35% AUM growth in FY25 and ~35-40% AUM CAGR over the next five years. We model an AUM CAGR of ~34% over FY24-26E.

NIM contracts ~85bp QoQ due to ~70bp decline in yields

- NIM (calc.) contracted ~85bp QoQ to ~10%, due to a decline in yields. Spreads (calc.) declined ~50bp QoQ despite ~20bp dip in CoB (calc.) to ~8%.
- Unlike the short-tenure loans, which were earlier disbursed under the co-lending model, the direct origination model features personal loans with an average tenure exceeding one year, resulting in a fee amortization over a longer period. Management guided stable borrowing costs. We model a NIM of ~8.8% over FY25-FY26E.

Highlights from the management commentary

- STPL (launched in 4QFY24) is not seasoned yet and will be monitored closely. The new management sensed that it needed to tweak credit policies and strengthen its collection capabilities in this segment. PFL will not accelerate STPL until the new management team gets a complete hold on it.
- PFL shared that investments in collections will be a key imperative for the company. Alongside, it will also be making investments in the new management team. **From the third year onwards, PAT growth will mirror AUM growth.**

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Asset quality continues to improve; credit costs still benign

- Asset quality improved with GS3/NS3 at 1.2%/0.6% and the PCR on S3 loans rose ~2pp QoQ to ~49%.
- We model credit costs at 0.6%/1.1% over FY25/FY26.

Senior management rejig under the leadership of the new MD & CEO

- With the appointment of Mr. Arvind Kapil (ex-HDFC Bank) as MD & CEO, PFL has seen a management rejig. A few more individuals from HDFC Bank will join PFL's senior management team.
- Mr. Kapil shared that PFL aims to achieve productivity, predictability, and sustainability through **higher investments, mainly in collections, technology, and launch of new businesses.** The company plans to launch consumer durable loans, PL prime, shopkeeper loans, and used-CV loans in FY25.

Valuation and view

- Strong leadership teams across functions, realignment of customer and product segments, and focus on leveraging technology and analytics position PFL well to build scale and deliver superior risk-adjusted returns. **Reiterate BUY with a TP of INR465 (premised on 3.3x FY26E BVPS).**
- **Key downside risks:** a) inability to execute its articulated strategy despite a new management team, and investments in technology, distribution, and collections; and b) aggressive competitive landscape leading to pressure on spreads and margins and/or deterioration in asset quality.

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

Y/E March	FY24				FY25E				FY24	FY25E	1QFY25E	v/s Est.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Interest Income	6,560	6,901	7,144	8,436	8,962	9,679	10,502	11,380	29,061	40,523	9,279	-3
Interest Expenses	2,348	2,155	2,237	2,811	3,201	3,569	3,837	4,276	9,503	14,883	3,204	0
Net Interest Income	**4,212**	**4,746**	**4,907**	**5,625**	**5,761**	**6,110**	**6,665**	**7,104**	**19,558**	**25,640**	**6,075**	**-5**
YoY Growth (%)	77.8	73.3	62.9	48.1	36.8	28.7	35.8	26.3	58.9	31.1	55.6	
Other Income	563	539	594	782	997	905	970	621	2,478	3,492	781	
Total Income	**4,775**	**5,285**	**5,501**	**6,407**	**6,758**	**7,015**	**7,635**	**7,725**	**22,036**	**29,132**	**6,856**	**-1**
YoY Growth (%)	70.3	57.1	52.8	57.0	46.9	32.7	38.8	20.6	54.7	32.2	54.1	
Operating Expenses	1,834	1,929	1,998	2,313	2,436	2,607	2,737	2,562	8,074	10,342	2,128	15
Operating Profit	**2,941**	**3,356**	**3,502**	**4,094**	**4,321**	**4,408**	**4,897**	**5,163**	**13,962**	**18,790**	**4,728**	**-9**
YoY Growth (%)	185.0	167.0	124.8	103.1	46.9	31.3	39.8	26.1	128.8	34.6	74.9	
Provisions & Loan Losses	266	281	-65	239	425	489	415	253	720	1,582	503	-15
Profit before Tax	**2,676**	**3,075**	**3,568**	**3,855**	**3,897**	**3,919**	**4,482**	**4,910**	**13,242**	**17,207**	**4,226**	**-8**
Exceptional items		6,560				0			6,560	**0**		
Tax Provisions	674	775	916	538	980	941	1,031	1,006	2,907	3,958	1,014	-3
PAT (excl. exceptional)	**2,002**	**2,300**	**2,651**	**3,317**	**2,916**	**2,979**	**3,451**	**3,904**	**10,335**	**13,250**	**3,211**	**-9**
PAT (incl. exceptional)	2,002	8,861	2,651	3,317	2,916	2,979	3,451	3,904	16,896	13,250	3211.48	**-9**
YoY Growth (%)	86.0	76.7	76.3	83.6	45.7	29.5	30.2	17.7	73.9	28.2	66.0	
Key Parameters (Calc., %)												
Yield on loans	16.3	15.8	15.3	16.3	15.5				15.6	15.4		
Cost of funds	8.0	7.2	7.5	8.2	8.0				7.2	8.0		
Spread	8.3	8.6	7.8	8.1	7.6				8.4	7.5		
NIM on loans	10.4	10.9	10.5	10.9	10.0				9.5	8.8		
C/I ratio	38.4	36.5	36.3	36.1	36.1				36.6	35.5		
Credit cost	0.6	0.6	-0.1	0.4	0.7				0.4	0.6		
Tax rate	25.2	17.7	25.7	13.9	25.2				21.9	23.0		
Balance Sheet Parameters												
Disbursements (INR b)	**70.6**	**78.1**	**87.3**	**96.9**	**74.0**				**199**	**246**		
Growth (%)	169.1	151.0	159.2	52.1	21.6				**111.3**	**10.4**		
AUM (INR b)	**178**	**202**	**219**	**250**	**270**				**178**	**202**		
Growth (%)	60.4	53.6	57.6	54.9	62.1				**60.4**	**53.6**		
AUM mix (%)												
Focused	96.3	89.0	91.7	94.1	96.0				96.3	89.0		
Discontinued (Legacy and DA)	3.7	11.0	8.3	5.9	4.0				3.7	11.0		
Asset Quality Parameters												
GS 3 (INR m)	2,450	2,660	2,750	2,680	1,660				2,450	2,660		
GS 3 (%)	1.4	1.4	1.3	1.2	0.7				1.4	1.4		
NS 3 (INR m)	1,310	1,400	1,450	1,360	790				1,310	1,400		
NS 3 (%)	0.8	0.7	0.7	0.6	0.3				0.8	0.7		
PCR (%	46.5	47.4	47.3	49.3	52.4				46.5	47.4		

E: MOFSL estimates

Highlights from the management commentary

Brief about Arvind Kapil, MD & CEO

- He had been associated with HDFC Bank for over 25 years and got the opportunity to launch various industry-first products. Prior to his exit, he was handling around INR7.5t of advances at HDFC Bank.

New management team

- Chief Credit & Analytics Officer - Sriram Iyer: Experience of over 25 years in credit and processes - which will add immense strength to the Poonawalla franchise
- Two Chief Business Officers - Vikas Pandey and Mr. Veeraraghavan Iyer - in-depth knowledge of building quality portfolio and cross-selling products
- Chief Human Resource Officer - Harsh Kumar - In his last assignment, he was the Chief Human Resource Officer of CSB Bank. Prior to that, he was associated with HDFC Bank as Vertical Head HR- Retail and Employee Engagement for ~13 years.
- Appointed seasoned professionals for Head of Compliance, Head of Internal Audit and CRO, who will be joining within the next 2-3 years

Guidance

- Guided a 30-35% AUM growth and 35-40% CAGR over the next five years. Aspires to get to 5-6x AUM within the next 5-6 years.
- PFL shared that investments in collections will be a key imperative for the company. Alongside, it will also be making investments in the new management team. From third year onwards, PAT growth will mirror AUM growth.

Margin compression

- 4Q was the first quarter where it started on-boarding customers outside the co-lending arrangement. Under the co-lending model, it used to do short-tenor loans but the average tenor of personal loans (being done now) is more than 1 year in the direct origination model. Amortization of fees also happens over a longer-tenor.

Strategy for the next 5-10 years

- The new management is in the process of taking over. Management acknowledged that for scalability, it needs to strengthen the collections and infrastructure framework of the company
- Doubling the product bouquet through the introduction of newer products
- Risk management in any finance business is going to be a key focus area
- Fundamental guiding philosophy for all its businesses - Predictable, Productive and Sustainable

Short-term Personal Loans (STPL)

- STPL is not seasoned yet, and will be monitored closely
- Closely review and measure - both and credit and collections - asked the team to review it intensively
- Management sensed that it needed to tweak credit policies and strengthen the collection capabilities in this product segment.
- Chief Credit Officer, Sriram, who has joined one month back, has started making changes in this product and it has seen some promising results already in the last two weeks.

- No concerns or red flags in this product segment - these are mere observations because this book is unseasoned
- Have asked the team to not accelerate STPL further until the time the new management team gets a complete hold on it

Consumer durables (CD)

- CD will open many doors to the middle-class India and will be used as a customer acquistion funnel.
- CD will create a strong high-yielding cross-sell model.
- Expects substantial strength from this business at the end of the second year

Shopkeeper loans

- Evaluating both physical and digital options of financing Kirana and Mom-Pop stores
- Arvind Kapil started this business in HDFC Bank - Veeraraghavan Iyer (CBO) has run it with his team in HDFC Bank

PL Prime

- Will be targeting employees of Top 100-200 Corporates - it will be looking to lift the quality of the unsecured book.

Used CVs

- Incubate for the first eight months and then start ramping it up
- Profit Maximiser, Enhancing MSME portfolio, and Secured businesses

Asset quality

- Legacy and discontinued book of ~INR3.5b and DA acquired loan-book of INR7.7b; ~80% of the write-offs pertain to this book

Risk management

- Unsecured lending also has various categories of risk tolerance. Certain categories of unsecured products show better asset quality and credit costs than secured products.

Liabilities and CoB

- Guided CoB to remain in a similar range
- 70% of its liabilities are variable and ~30% is fixed-rate borrowings. ~20% of the total borrowings are linked to external benchmark rates (EBLR). Well placed to take advantage of the expected cut in global and domestic interest rates.
- Fixed-rate liabilities are largely from capital markets and are shorter-term.

Financial Performance

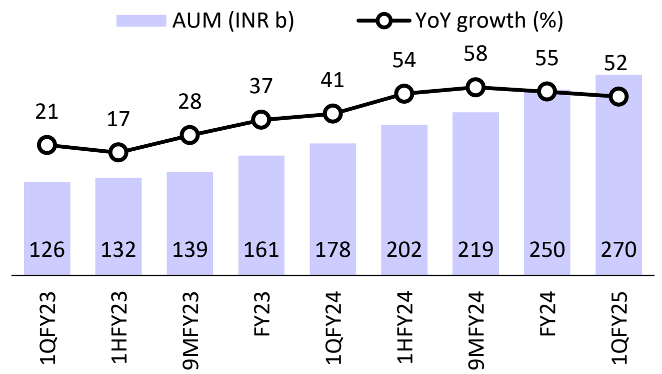
- AUM grew 52% YoY and 8% QoQ to INR270b
- MSME Finance contribution is at 35% followed by Personal and Consumer Finance at 28%
- Unsecured: Secured Mix – 51%:49%
- CoB remained flat QoQ at 8.16%. Debt-Equity ratio (D/E) rose from 1.9x to 2.1x QoQ - this resulted in an increase in the interest expense.
- Asset quality improved with GS3/NS3 at 0.7%/0.3% and the PCR on S3 loans rose ~3pp QoQ to ~52.5%

- Stopped co-lending from 4QFY24 onwards and is only doing direct originations now
- Technology stack is a major enabler to business. 40% of the new business is via straight-through-processing.

Others
- Plans to use physical and digital distributions extensively across all its product lines
- Endeavor will be to build the organization for scale, step-by-step and process by process
- Expects the market share of PFL growing, year over year, for the next 5-10 years
- Consumer durable is the fastest and surest way to enter middle-class India
- Almost doubling the range of businesses - will end up putting more investments over the next four quarters.
- LAP operates only out of 35 locations and it expects to roll it out to 2x-3x locations in the near-term
- Wants to consolidate for the next two quarters - optimize the existing strengths of PFL

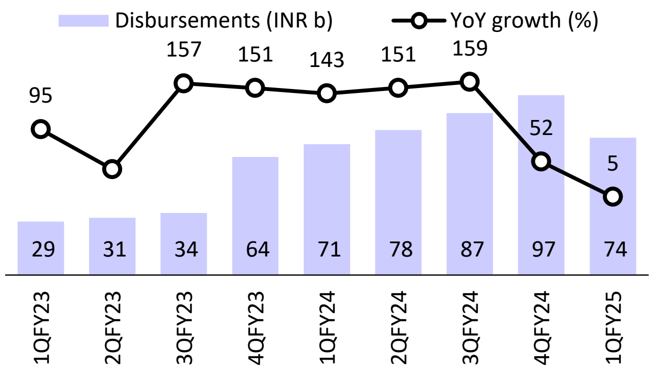
Story in charts

Exhibit 1: Healthy AUM growth at 52% YoY (%)



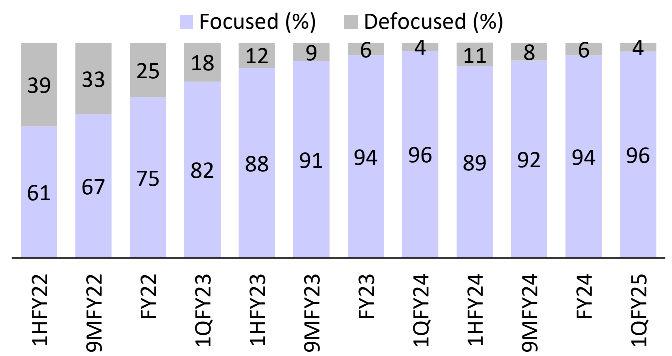
Source: MOFSL, Company

Exhibit 2: Disbursements grew ~5% YoY



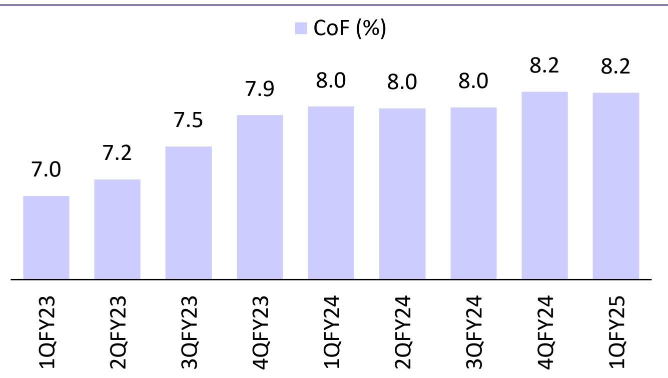
Source: MOFSL, Company

Exhibit 3: Focused products exhibiting healthy loan growth



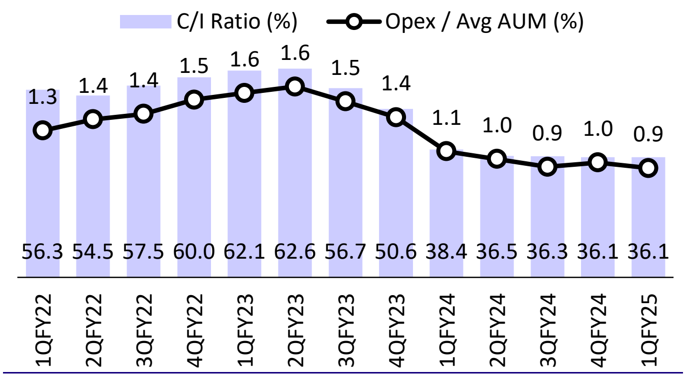
*Note: Change in classification from 2QFY24; Source: MOFSL, Company

Exhibit 4: CoF (reported) stable at 8.2% (%)



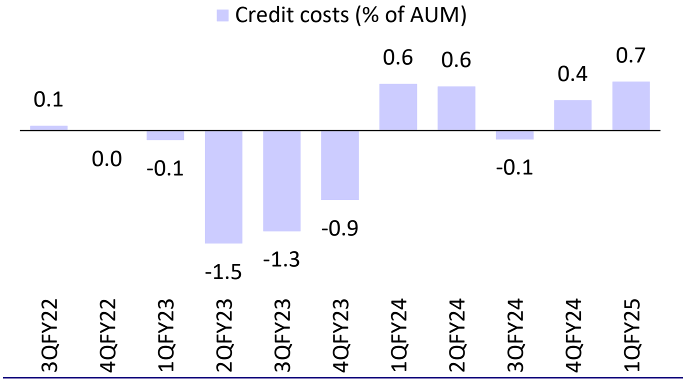
Source: MOFSL, Company

Exhibit 5: Cost ratios largely stable (%)



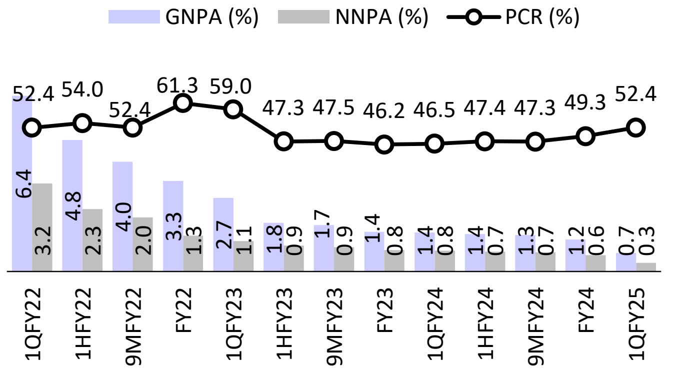
Source: MOFSL, Company

Exhibit 6: Credit costs stood at ~70bp in 1QFY25 (%)



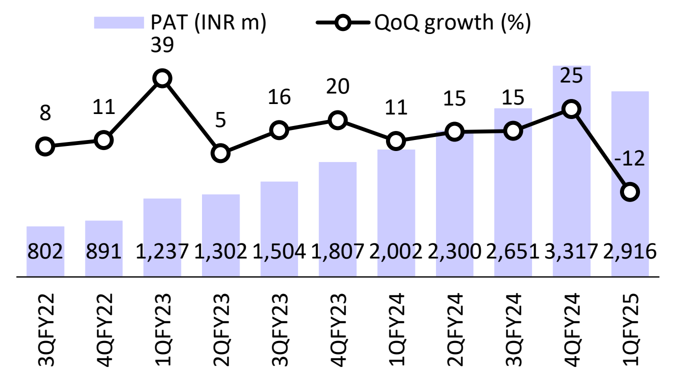
Source: MOFSL, Company

Exhibit 7: Asset quality improved sequentially (%)



Source: MOFSL, Company

Exhibit 8: 1QFY25 PAT declined ~12% QoQ (%)



Source: MOFSL, Company

Exhibit 9: Cut our FY25/FY26 estimates by 9%/13% to factor in NIM compression and elevated opex from investments in distribution, management team, and collections

INR B	Old Est.		New Est.		Change (%)	
	FY25	FY26	FY25	FY26	FY25	FY26
NII (incl. assignments)	27.5	36.0	25.6	34.3	-6.9	-4.8
Other Income	3.3	4.2	3.5	4.3	5.5	2.5
Total Income	**30.9**	**40.2**	**29.1**	**38.6**	**-5.6**	**-4.0**
Operating Expenses	9.3	10.5	10.3	12.2	11.7	16.6
Operating Profits	**21.6**	**29.7**	**18.8**	**26.4**	**-13.0**	**-11.3**
Provisions	2.7	3.9	1.6	4.2	-40.8	6.4
PBT	**18.9**	**25.8**	**17.2**	**22.2**	**-9.1**	**-14.0**
Tax	4.4	6.1	4.0	5.1	-11.0	-15.8
Normalized PAT	**14.5**	**19.7**	**13.2**	**17.1**	**-8.5**	**-13.4**
AUM	350	466	333	451	-5.0	-3.4
Loans	327	445	305	423	-6.9	-4.9
Borrowings	242	336	222	323	-8.2	-3.8
NIM	9.2	9.3	8.8	8.8		
Credit Cost	0.9	1.0	0.6	1.1		
RoA	4.9	4.9	4.7	4.4		
RoE	**16.4**	**19.2**	**15.1**	**17.0**		

Financials and Valuation

Income Statement								(INR M)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**
Interest Income	20,365	20,228	17,570	14,586	18,265	29,061	40,523	56,065
Interest Expenses	10,176	11,240	8,746	5,093	5,953	9,503	14,883	21,796
Net Interest Income	**10,189**	**8,988**	**8,824**	**9,493**	**12,312**	**19,558**	**25,640**	**34,269**
Change (%)	10.8	-11.8	-1.8	7.6	29.7	58.9	31.1	33.7
Non-interest income and Other Income	2,308	1,962	1,199	1,085	1,931	2,478	3,492	4,325
Net Total Income	**12,497**	**10,951**	**10,023**	**10,578**	**14,243**	**22,036**	**29,132**	**38,594**
Change (%)	15.1	-12.4	-8.5	5.5	34.6	54.7	32.2	32.5
Total Operating Expenses	**6,018**	**5,968**	**4,563**	**6,046**	**8,139**	**8,074**	**10,342**	**12,219**
Change (%)	9.0	-0.8	-23.5	32.5	34.6	-0.8	28.1	18.1
Employee Expenses	3,804	3,741	3,060	4,099	5,148	4,444	5,333	6,133
Depreciation	502	716	522	495	614	593	682	764
Other Operating Expenses	1,712	1,487	981	1,453	2,268	3,036	4,327	5,322
PPoP	**6,479**	**4,982**	**5,460**	**4,532**	**6,104**	**13,962**	**18,790**	**26,376**
Change (%)	21.4	-23.1	9.6	-17.0	34.7	128.8	34.6	40.4
Total Provisions	**2,450**	**4,640**	**13,186**	**686**	**-1,445**	**720**	**1,582**	**4,181**
PBT	**4,029**	**342**	**-7,727**	**3,846**	**7,761**	**13,242**	**17,207**	**22,195**
Exceptional items						6,560	0	0
Tax Provisions	1,278	442	-1,943	914	1,816	2,907	3,958	5,105
PAT (excl. exceptional)	**2,751**	**-100**	**-5,784**	**2,932**	**5,945**	**10,335**	**13,250**	**17,090**
PAT (incl. exceptional)	**2,751**	**-100**	**-5,784**	**2,932**	**5,945**	**16,896**	**13,250**	**17,090**

Balance Sheet								(INR M)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**
Equity Share Capital	539	539	539	1,530	1,536	1,541	1,541	1,541
Reserves & Surplus	25,019	24,614	18,881	55,615	62,711	80,130	91,838	1,06,617
Net Worth	**25,558**	**25,153**	**19,421**	**57,145**	**64,247**	**81,671**	**93,379**	**1,08,158**
Borrowings	**1,17,497**	**1,00,595**	**79,487**	**67,734**	**1,12,092**	**1,52,157**	**2,21,782**	**3,23,107**
Change (%)								
Other liabilities	6,820	3,803	4,512	3,217	3,880	7,041	11,970	17,955
Total Liabilities	**1,49,876**	**1,29,552**	**1,03,420**	**1,28,097**	**1,80,218**	**2,40,869**	**3,27,131**	**4,49,220**
Loans	**1,31,379**	**1,11,749**	**85,653**	**1,06,784**	**1,52,295**	**2,20,464**	**3,04,842**	**4,22,968**
Change (%)	8.1	-14.9	-23.4	24.7	42.6	44.8	38.3	38.7
Cash and Bank Balances	9,327	6,484	6,124	5,372	6,574	2,685	7,061	10,034
Fixed Assets	1,871	2,267	1,715	1,748	2,117	1,944	2,138	2,309
Investments	3,024	4,024	4,289	8,197	3,109	8,783	4,000	3,000
Other assets	4,275	5,028	5,638	5,996	16,123	6,992	9,090	10,908
Total Assets	**1,49,876**	**1,29,552**	**1,03,420**	**1,28,097**	**1,80,218**	**2,40,869**	**3,27,131**	**4,49,220**

E: MOFSL Estimates

Financials and Valuation

Ratios								
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Spreads Analysis (%)								
Avg. Yield on Loans	15.8	16.3	17.5	14.9	14.0	15.6	15.4	15.4
Avg Cost of Funds	8.9	10.3	9.7	6.9	6.6	7.2	8.0	8.0
Spread on loans	6.9	6.0	7.8	8.0	7.4	8.4	7.5	7.4
NIM (on AUM)	7.3	6.7	7.6	8.6	8.8	9.5	8.8	8.8
Profitability Ratios (%)								
RoE	12.6	-0.4	-26.0	7.7	9.8	14.2	15.1	17.0
RoA	1.9	-0.1	-5.0	2.5	3.9	4.9	4.7	4.4
Int. Expended / Int.Earned	50.0	55.6	49.8	34.9	32.6	32.7	36.7	38.9
Other Inc. / Net Income	18.5	17.9	12.0	10.3	13.6	11.2	12.0	11.2
Efficiency Ratios (%)								
Op. Exps. / Net Income	48.2	54.5	45.5	57.2	57.1	36.6	35.5	31.7
Opex/ Avg AUM	4.3	4.5	4.0	5.5	5.8	3.9	3.6	3.1
Empl. Cost/Op. Exps.	63.2	62.7	67.1	67.8	63.2	55.0	51.6	50.2
Asset-Liability Profile (%)								
Loans/Borrowings Ratio	1.1	1.1	1.1	1.6	1.4	1.4	1.4	1.3
Debt/Equity (x)	4.6	4.0	4.1	1.2	1.7	1.9	2.4	3.0
Assets/Equity (x)	5.9	5.2	5.3	2.2	2.8	2.9	3.5	4.2
Asset quality								
GNPA (INR m)			4,190	3,720	2,250	2,680	2,813	3,894
GNPA (%)			4.3	3.3	1.4	1.2	0.9	0.9
NNPA (INR m)			1,240	1,440	1,210	1,360	1,294	1,752
NNPA (%)			1.3	1.3	0.8	0.6	0.4	0.4
PCR (%)			70.4	61.3	46.2	49.3	54.0	55.0
Credit costs (%)	1.9	3.8	13.4	0.7	-1.1	0.4	0.6	1.1

Valuations	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Book Value (INR)	95	93	72	75	84	106	121	140
BV Growth (%)	24.2	-1.7	-22.8	3.7	12.0	26.7	14.3	15.8
Price-BV (x)	**4.3**	**4.3**	**5.6**	**5.4**	**4.8**	**3.8**	**3.3**	**2.9**
EPS (INR)	10.2	-0.4	-21.5	3.8	7.7	13.4	17.2	22.2
EPS Growth (%)	20.3	-103.6	5,675.2	-117.9	102.0	73.3	28.2	29.0
Price-Earnings (x)	**39.5**	**-1,087.7**	**-18.8**	**105.4**	**52.2**	**30.1**	**23.5**	**18.2**
Dividend per share	0.0	0.0	0.0	0.4	2.0	2.0	3.0	4.0
Dividend Yield (%)	**0.0**	**0.0**	**0.0**	**0.1**	**0.5**	**0.5**	**0.7**	**1.0**

E: MOFSL Estimates

NOTES

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