Equity Research

August 18, 2021

BSE Sensex: 55792

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Q1FY22 result review, TP & earnings change

Financials

Target price: Rs265

Earnings revision

(%)	FY22E	FY23E
PAT	↓ 7	↑ 2

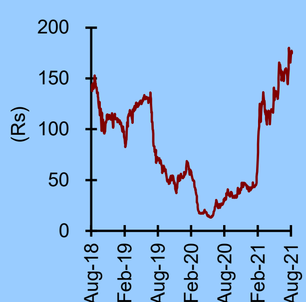
Target price revision

Rs265 from Rs173

Shareholding pattern

	Dec '20	Mar '21	Jun '21
Promoters	24.4	73.3	73.2
Institutional investors	55.1	15.2	15.0
MFs and other	8.9	4.1	4.0
FIs/Banks	5.4	2.3	2.3
Insurance co.	0.0	0.0	0.0
FIIs	40.8	8.8	8.7
Others	20.5	11.5	11.8

Price chart



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INDIA

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Poonawalla Fincorp

BUY

Maintain

Rs193

Business transformation on cards; a turnaround play

Poonawalla Fincorp (PFL), in its first quarter of transitioning to new promoter and management change, reported 1.8% RoA drawing support from normalised credit cost and reduction in borrowing cost. Accelerated write-offs and contingency buffer created in Q4FY21 helped contain credit cost at 1.4%. ECL provisioning at 7% of AUM seems adequate for existing stress pool (5.4% stage-3 + 5.9% restructuring). Company's *Vision 2025* is to be a diversified tech-enabled NBFC with focus on risk-calibrated growth in consumer and business financing. Business transformation is clearly underway with: 1) leadership team being strengthened; 2) product suite being realigned for better risk-adjusted returns; 3) credit policies being revised; and 4) risk management, data analytics and digital capabilities being scaled up. Incremental triggers will be in improved credit rating outlook due to well-capitalised balance sheet and strong parentage. High probability of enhanced operating metrics and return profile in the medium term can help the stock command 2.75x book value. We revise our 2-year target price to Rs265 (previously: Rs173). Maintain BUY.

- ***Vision 2025* of being a diversified tech-enabled NBFC:** Company has unveiled its vision to be a diversified tech-enabled NBFC focused on risk-calibrated growth, with customer-centric approach, providing a growth-oriented environment for its people and creating value for shareholders. By 2025 it endeavours to: 1) be amongst top-3 NBFCs for consumer and small business finance; 2) achieve risk-calibrated accelerated growth of ~3x current AUM; 3) command the lowest cost of funds with ~250bps reduction in the borrowing cost; 4) have the best-in-class asset quality with Net NPAs at <1%; and 5) accelerate the growth trajectory of Poonawalla Housing Finance (PHFL) followed by value unlocking through IPO.

- **Business transformation on cards post equity infusion:** Poonawalla group has infused equity of Rs34.6bn in PFL and Rs5bn in PHFL. Magma Fincorp has been rebranded as Poonawalla Fincorp, and Magma Housing Finance has been renamed Poonawalla Housing Finance. This rebranding and renaming was executed in record time. Business transformation is on cards with: 1) leadership team being strengthened across functions; 2) product suite being realigned for better risk-adjusted returns; 3) credit policies being revised with stringent parameters implemented across existing and new business lines; 4) data analytics being used for delivering targeted value proposition for customers and cross-sell opportunities; 5) Unified Loan Origination System (LOS), Loan Management System (LMS) and Customer Relationship Management (CRM) platforms being implemented. Also management change has facilitated majority of bank loans being repriced lower, and PFL now enjoys incremental borrowing cost below 7%.

Market Cap	Rs148bn/US$2.0n
Bloomberg	POONWAL IN
Shares Outstanding (mn)	763.9
52-week Range (Rs)	186/29
Free Float (%)	26.8
FII (%)	8.7
Daily Volume (US$/'000)	4,177
Absolute Return 3m (%)	44.7
Absolute Return 12m (%)	530.5
Sensex Return 3m (%)	13.2
Sensex Return 12m (%)	48.2

Year to March	FY20	FY21	FY22E	FY23E
NII (Rs mn)	11,226	10,652	12,225	14,876
Net Profit (Rs mn)	271	(5,590)	4,169	6,180
EPS (Rs)	1.0	(20.7)	5.5	8.1
% Chg YoY	(91.1)	(2,165.4)	(126.3)	48.2
P/E (x)	142.4	(6.9)	26.2	17.7
P/BV (x)	1.4	1.8	1.8	1.7
Net NPA (%)	4.1	1.2	3.6	3.0
Dividend Yield (%)	-	-	0.3	0.3
RoA (%)	0.2	(3.9)	3.0	3.9
RoE (%)	1.0	(22.6)	10.1	9.8

Core strategic pillars laying a focused direction:

- **New professional management to drive new vision:** Poonawalla Fincorp (PFL) will be a professionally-run organisation under a new and highly experienced leadership team with strong industry exposure. Mr. Adar Poonawalla has been appointed as the new chairman, Mr. Abhay Bhutada as the managing director, Mr. Vijay Deshwal as Group CEO, Mr. Sanjay Miranka as Group CFO. Also, other 10-12 senior management positions including CXOs, product heads, subject matter experts for risk analytics, digitisation, etc. are either appointed or will soon be appointed.
- **Product strategy to be realigned:** Company will realign its product and geographic strategy towards select (credit-tested) consumers and small/medium business segments with focus on healthy IRR, RaRoC, granularity and cross-sell opportunities. It has added personal loans, professional loans, SME LAP, non-affordable home loans to its existing product bouquet of pre-owned car financing, business loans, affordable loans and affordable LAP. By Mar'22, it will further look to introduce small-ticket LAP, co-branded credit card, merchant cash advances, supply chain financing, consumer durables, EMI card, medical equipment, and insurance cross-sell. Overall, management is of the view that PFL is on its way to build a diversified product franchise and aims to deliver 25-30% CAGR over the next 2-3 years.
- **Capital buffer, parentage and brand to improve credit rating outlook:** Equity infusion has led to sharp rise in tier-1 ratio to 57.8%, with leverage of mere 1.3x providing ample room for growth. Well capitalised balance sheet, strong parentage (Poonawalla group is one of the most respected and trusted business houses not only in India but globally too) and professional management will support the scope for improvement in credit rating outlook.
- **Efficient liability franchise to support competitive lending rates:** Leveraging the group's diversified relationships across banks, mutual funds, insurance companies and other capital market lenders, PFL will progressively increase its capital market borrowings to reach a steady-state range of 40-45% (from <20% currently). Also, repricing of high-cost debt and incremental borrowing at competitive rates (<7%) will support successive reduction in funding cost. It will become equally competitive on lending rates, which will enhance above-industry average growth prospects.
- **Scale up risk management, data analytics and digital capabilities**. PFL is looking to expand its tech capabilities through a dedicated technology centre in Pune, which will form the backbone for all the technology-related requirements and support for the company. It would also set up a strong analytics team, focused on delivering targeted value proposition to customers and generating cross-sell opportunities. Company will ensure customer retention and deeper penetration. It will invest heavily in building the direct acquisition channel via digital route to ensure that the customer ownership and connect is optimised. It will follow the 'digital first' approach across the organisation to get speed, control, scale and operational efficiency. PFL will also roll out a state-of-the-art contact centre to support the digital acquisition channel and bring in conversion efficiencies. It will launch complete online process for pre-disbursement activities like e-Agreement and e-Nach and complete API-based integration for information access, online checks, validations and credit rule engine.

Q1FY22 earning – Credit cost normalisation supports 1.8% RoA

Poonawalla Fincorp (PFL) reported PAT of Rs645mn (equivalent to 1.8% RoAs). Normalisation of credit cost and reduction in incremental borrowing cost were key triggers for better than expected operating performance.

- **Sequential rise in AUM even in a challenging quarter:** Disbursement growth of 20% QoQ to Rs17.3bn in Q1FY22 (Rs36.8bn in full-year FY21) supported sequential uptick of 1.4% in AUM and YoY decline was contained at <10%. This is despite discontinuation and run-down of a few product segments suggesting 6% YoY / 1% QoQ increase in AUM of focused product segments. Further pick-up in growth momentum in Jul'21 improves visibility on better growth trajectory through FY22E / FY23E. Pre-owned car financing, affordable housing, affordable LAP and business loans will be near-term growth drivers. Launch of several other products through FY22 will boost growth FY23E onwards. We are building-in AUM growth of 10% / 17% over FY22E / FY23E

- **More than 20% of stage-3 pool already rolled back in Jul'21:** In FY21, the company adopted a conservative policy of accelerated write-offs that resulted in stage-3 assets settling much lower at 3.7%. From that base amid covid disruption, stage-3 assets rose to 5.4%. Of this, more than 20% has already rolled back to <90dpd bucket and the company expects sharp improvement in stage-3 in the course of FY22 as normalcy returns. Collection efficiency that dipped to 84% in Apr'21 and <80% in May'21, recovered to 93% in Jun'21 and was encouraging in Jul'21 at 98% (higher than pre-covid levels).

- **Cumulative restructuring at 5.9% with 18% provisioning coverage:** PFL restructured Rs3.25bn under OTR 2.0 taking the cumulative restructuring pool to Rs8.5bn (5.9% of consolidated AUM). Out of the restructured assets, almost 60% is in 0-dpd bucket. However, for the purpose of asset classification and provisioning, ~83% of restructured assets was classified under stage 2 pool. It has created provisioning of 18% (Rs1.5bn) on the restructured portfolio

- **Credit cost normalised to 140bps; outstanding ECL provisions at 7% of AUM:** Post aggressive provisioning of ~9.5% in FY21, credit cost normalised to 140bps in Q1FY22 leading to beat in earnings. This was despite incremental accretion to stage-3 and restructuring pool. With this, it now carries coverage of 1.3% on stage-1 assets, 21% on stage-2 assets, and 51% on stage-3 assets. Outstanding ECL provisions of 7% of AUM seems adequate in the context of the existing stress pool (5.4% stage-3 + 5.9% restructuring). This will call for lower incremental credit cost and we model credit cost of 1.5%/1.1% for FY22E/FY23E.

- **Poonawalla Housing – equity infusion to shore up net worth for accelerated growth:** Magma Housing has now been renamed Poonawalla Housing Finance Limited (PHFL) post the capital infusion by Poonawalla group. PHFL reported a PAT of Rs90mn *vs* Rs70mn YoY and a loss of Rs200mn QoQ. Disbursements halved QoQ due to localised lockdowns, but were still up 86% YoY, which supported AUM growth of 2% QoQ / 19% YoY. After having grown at ~30% CAGR over FY18-FY21, recent capital infusion of Rs5bn should accelerate the growth further with lower funding cost benefit and expansion of customer base. Post equity infusion, leverage has fallen considerably to 2.1x from 5.1x QoQ. On asset quality front, rise in stage-3 was contained at 1.9% (1.6% in FY21). It rolled back coverage on stage-1 assets to 0.4% (1% in FY21), on stage-2 assets at 14.1% (21.8%) and on stage-3 at 36.5% (51.8%) and credit cost normalised to 110bps in Q1FY22 (360bps in FY21). As a result, PHFL now carries 2.8% provisioning coverage on its loanbook *vs* 3.6% QoQ.

- **Magma HDI General Insurance – stable combined ratio supports earnings:** Magma HDI General Insurance recently announced a fund raise transaction of Rs5.25bn at a pre-money valuation of Rs12bn. During Q1FY22, it registered PAT of Rs120mn *vs* Rs80mn YoY and loss of Rs50mn in Q4FY21. Combined ratio was stable at 121.5% with claims at 76% and opex at 46%.

Table 1: Quarterly profit and loss

(Rs mn)

	Q1FY21	Q4FY21	Q1FY22	QoQ (%)	YoY (%)
Interest Income	5,504	5,129	4,595	-10.4	-16.5
Interest Expense	2,954	2,505	1,995	-20.4	-32.5
Net Interest Income (NII)	**2,550**	**2,624**	**2,600**	**-0.9**	**2.0**
Other Income	195	742	237	-68.1	21.2
Total Income	**2,745**	**3,366**	**2,837**	**-15.7**	**3.3**
Employee Expenses	1,000	964	1,188	23.3	18.9
Other Operating Expenses (incl. depreciation)	393	533	389	-27.0	-1.0
Total Operating Expenses	**1,393**	**1,496**	**1,577**	**5.4**	**13.2**
Pre-Provisioning Operating Profit (PPoP)	**1,352**	**1,870**	**1,259**	**-32.7**	**-6.9**
Provisions and write offs	912	10,489	494	-95.3	-45.9
Profit Before Tax	**470**	**-8,636**	**810**	**-109.4**	**72.3**
Tax Expenses	93	-2,159	165	-107.6	77.2
Tax Rate	*19.8*	*25.0*	*20.4*	-18.6	2.8
Profit / (Loss) - after minority	**377**	**-6,477**	**645**	**-110.0**	**71.1**
EPS (Rs)	**1.4**	**-24.0**	**0.8**	-103.5	-39.7

Source: Company data, I-Sec research

Table 2: Key performance indicators

(Rs mn)

	Q1FY21	Q4FY21	Q1FY22	QoQ (%)	YoY (%)
Loan AUM	**1,59,220**	**1,42,250**	**1,44,240**	**1.4**	**-9.4**
Off-book as a % of loan AUM	11.5	10.9	11.0	12 bps	-47 bps
Loan disbursements	**2,160**	**14,260**	**17,320**	**21.5**	**701.9**
Yields on AUM (calculated) (%)	13.7	14.0	12.8	-121 bps	-90 bps
Cost of borrowings (calculated) (%)	10.0	9.4	8.7	-61 bps	-124 bps
NIM (calculated) (%)	**6.9**	**9.2**	**7.9**	**-129 bps**	**107 bps**
Gross NPA - on-book AUM (%)	**5.8**	**3.7**	**5.1**	**143 bps**	**-63 bps**
Net NPA - on-book AUM (%)	3.7	1.2	2.6	139 bps	-117 bps
Provision coverage ratio (%)	36.3	68.6	51.1	-1753 bps	1482 bps
Cost to Income (%)	50.7	44.4	55.6	1116 bps	486 bps
RoA (%) - annualised (reported)	**1.0**	**-18.8**	**1.9**	**2064 bps**	**89 bps**
RoE (%) - annualised (reported)	**5.4**	**-102.6**	**6.5**	**10909 bps**	**109 bps**
CRAR (%)	**26.0**	**20.3**	**57.8**	**3750 bps**	**3180 bps**
- Tier 1 (%)	23.8	17.4	0.0	-1740 bps	-2380 bps
- Tier 2 (%)	2.2	2.9	57.8	5490 bps	5560 bps

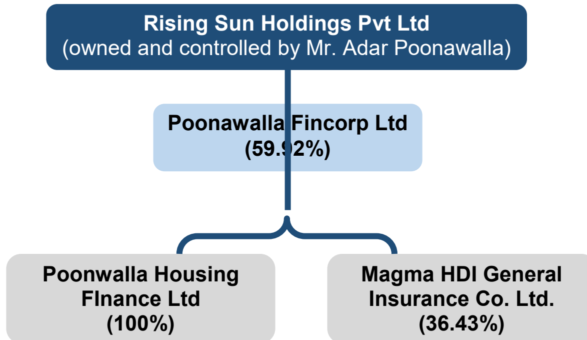
Source: Company data, I-Sec research

Table 3: Quarterly DuPont analysis (annualised, on average loan AUM)

	Q1FY21	Q4FY21	Q1FY22	QoQ (%)	YoY (%)
Average AUM (Rs mn)	**1,60,280**	**1,46,155**	**1,43,245**	**-2.0**	**-10.6**
Interest earned	13.7	14.0	12.8	-121 bps	-90 bps
Interest expended	7.4	6.9	5.6	-128 bps	-180 bps
Gross Interest Spread	**6.4**	**7.2**	**7.3**	**8 bps**	**90 bps**
Credit cost	2.3	28.7	1.4	-2733 bps	-90 bps
Net Interest Spread	**4.1**	**-21.5**	**5.9**	**2741 bps**	**179 bps**
Operating cost	3.5	4.1	4.4	31 bps	93 bps
Lending spread	**0.6**	**-25.6**	**1.5**	**2710 bps**	**87 bps**
Non-interest income	0.6	2.0	0.8	-120 bps	22 bps
Operating spread	**1.2**	**-23.6**	**2.3**	**2590 bps**	**109 bps**
Tax	0.2	-5.9	0.5	637 bps	23 bps
ROAAUM	**0.9**	**-17.7**	**1.8**	**1953 bps**	**86 bps**
Effective leverage (AAUM/ AE)	5.8	5.8	3.6	-216 bps	-216 bps
RoAE	**5.4**	**-102.6**	**6.5**	**10909 bps**	**109 bps**

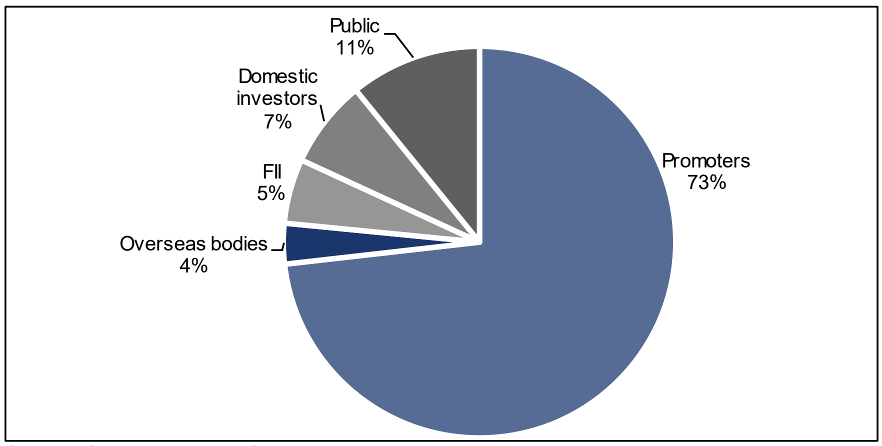
Source: Company data, I-Sec research

Chart 1: Group holding structure post equity infusion



Source: Company data, I-Sec research

Chart 2: Promoter shareholding at 73%



Source: Company data, I-Sec research

Chart 3: New management on board

Source: Company data, I-Sec research

Table 4: New professional management to drive new vision

Name	Designation	Previous Role
Abhay Bhutada	Managing Director	MD & CEO at Poonawalla Finance
Vijay Deshwal Group	Chief Executive Officer	Business Head, Service Sector Group at ICICI Bank
Sanjay Miranka Group	Chief Financial Officer	CFO at Aditya Birla Finance Limited
Manish Jaiswal	MD & CEO – HFC	Head, Risk Advisory, Research & SME Ratings, CRISIL
Rajive Kumaraswami	MD & CEO – MHDI	Chief Representative Officer - India Liaison office, SCOR Re, India
Girish Poddar	Chief Risk Officer	Head of Commercial at Bajaj Finance Limited
Manish Kumar Group	Chief Human Resources Officer	President and CHRO at Ziqitza Healthcare Limited
Mahender Bagrodia	Head Collections	Worked with Tijaya Enterprises Ltd
Rajendra Tathare	Chief Credit Officer	Head of Credit Underwriting Fullerton India
Kandarp Kant	Chief Technology Officer	Chief Technology Officer at Poonawalla Finance
Manoj Kutty Gujaran	Chief Compliance Officer (CCO)	CCO and Company Secretary at Poonawalla Finance
Anup Kumar Agarwal	Chief Internal Auditor	Risk and Audit Head at Poonawalla Finance

Source: Company data, I-Sec research

Chart 4: Phased strategy execution – Consolidate, Grow, Lead

Consolidate (1-9 months)	Grow (9-18 months)	Lead (18-36 months)
• People • Products • Branches • Digital • Data Analytics • Risk Management • Systems	• Introduce new products and expand cross sell • Build branch lite model • Enchange digital capabilities • Build D2C model • Enhanced Data-Analytics based origination • Robust risk management • Automation of process	• Leadership in chosen Products • Leadership in chosen geographies • Leadership in Process Automation • Leader in Risk Management • Leader in Data Analytics & Usage

Source: Company data, I-Sec research

Chart 5: Mutl-tiered customer proposition

PRICE - Competitive and Transparent	• Shall offer products at competitive and transparent pricing to ensure we are always in the top consideration set
TURNAROUND – Best in class	• Shall offer the best turnarounds with lean & agile backend operations by leveraging technology
CONVENIENCE – Product & Process	• Product & Process convenience will be integral part of the offering. From e2e digital to having completely transparent offerings. We will build a strong trust with transparency
SERVICE – Exceptional	• All customers will get exceptional service to ensure the experience brings them back to the Poonawalla brand every time they think of a financial services product

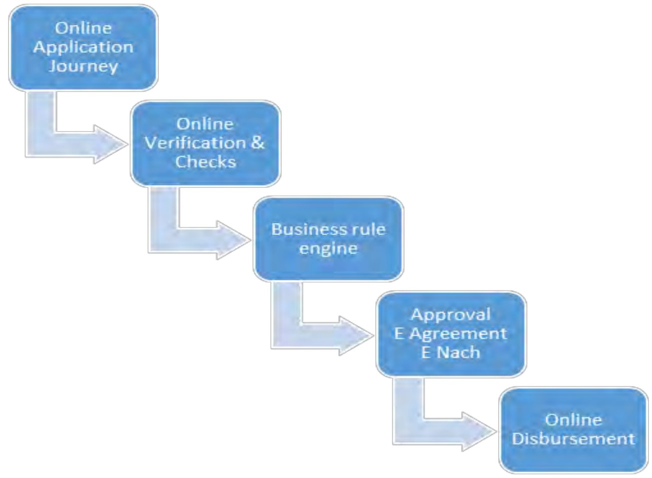
Source: Company data, I-Sec research

Table 5: Product strategy roadmap through FY22

Existing Products	Q2FY22	Q3FY22	Q4FY22
Pre-owned cars	Personal loan	Small ticket LAP	Consumer durables
Business loans	Loan to professionals	Merchant cash advance	EMI card
Affordable home loan	LAP	Co-branded credit card	Supply chain finance
Affordable LAP	Medical equipment loan	Machinery loan	Co-lending

Source: Company data, I-Sec research

Chart 6: E2E Digitized Process – Going Digital



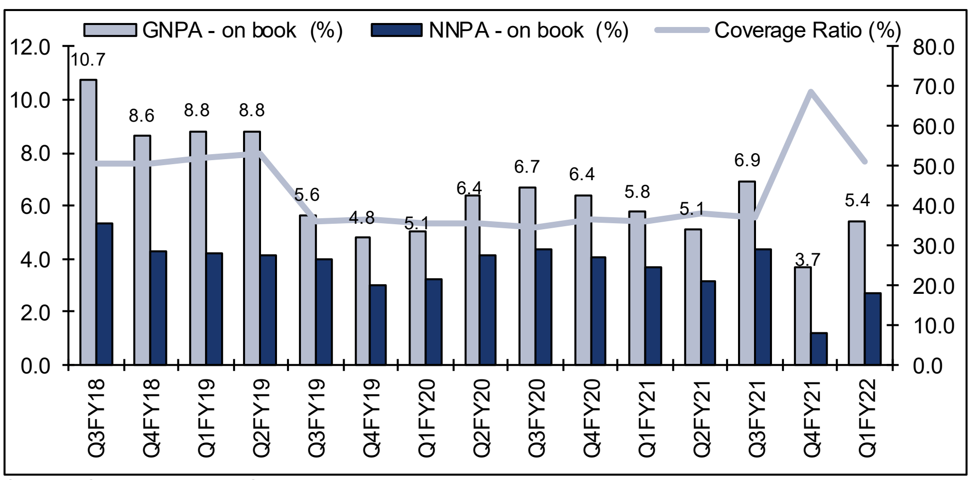
Source: Company data, I-Sec research

Table 6: More than 20% of stage-3 pool already rolled back in Jul'21

	PFL			PHFL			Consol		
	Jun-20	Mar-21	Jun-21	Jun-20	Mar-21	Jun-21	Jun-20	Mar-21	Jun-21
Stage 1 PCR (%)	1.4%	4.9%	1.6%	0.3%	1.0%	0.4%	1.2%	4.0%	1.3%
Stage 2 PCR (%)	15.4%	29.7%	22.3%	16.1%	21.8%	14.1%	15.4%	28.4%	20.8%
Stage 1 & 2 PCR (%)	**2.9%**	**8.5%**	**5.3%**	**0.8%**	**2.8%**	**2.2%**	**2.5%**	**7.2%**	**4.5%**
Gross Stage 3 (Rs mn)	7,710	4,190	6,380	400	460	590	8,110	4,650	6,970
Net Stage 3 (Rs mn)	4,930	1,240	3,040	240	220	380	5,170	1,460	3,410
Gross Stage 3 (%)	6.7%	4.3%	6.4%	1.6%	1.6%	1.9%	5.8%	3.7%	5.4%
Net Stage 3 (%)	4.4%	1.3%	3.2%	1.0%	0.8%	1.2%	3.7%	1.2%	2.7%
Stage 3 PCR (%)	**36.1%**	**70.4%**	**52.4%**	**39.8%**	**51.8%**	**36.5%**	**36.3%**	**68.6%**	**51.0%**
ECL Provision on Loan book	**5.1%**	**11.2%**	**8.3%**	**1.4%**	**3.6%**	**2.8%**	**4.5%**	**9.5%**	**7.0%**

Source: Company data, I-Sec research

Chart 7: Credit cost normalised to 140bps; outstanding ECL provisions at 7% of AUM



Source: Company data, I-Sec research

Q1FY22 earnings conference call takeaways

Management Vision 2025

- ***To be a diversified tech-enabled NBFC focused on risk calibrated growth, with customer centric approach, providing a growth-oriented environment for its people and creating value for the shareholders***
- To be amongst ***Top 3 NBFCs for consumer and small business finance***
- Risk-calibrated accelerated growth of **~3x of current AUM**
- Amongst the lowest COF in the industry ***~250bps reduction in borrowing cost***
- Best-in-class asset quality; ***Net NPA <1%***
- Accelerate the growth trajectory of PHFL followed by ***value unlocking through IPO***

Opening remarks

- Board reconstitution has been done and renaming as well as rebranding was done in a record time. Transformation journey has been spectacular.
- Strengthening management team across verticals – HR, risk, finance, collections, business etc. Continue to build a large talent pool which will drive risk culture
- Shifted company's focus to consumer and small business segment
- New product addition – started Personal loan to Super category A & category A employees, loans to professionals
- Company has implemented LOS/LM/CRM platform in a record time
- It has created new website with seamless integration to backend operations
- Strong in-house customer service centre powered by best people, processes and technology
- Over the next two quarters, it will do further alliances with corporates
- Started engaging with banks and undertaking aggressive repricing of liabilities
- New team has done 10-15 townhall and met employees to align them to the management vision. Internally, people are quite motivated post the acquisition.
- ***Expect incremental borrowing cost to be 250bps lower till March 2021***
- Rs 32bn liquidity available and Rs 60bn of sanctioned lines available and hence liquidity is ample
- ***Company believes that it is on way to build a very strong franchise***
- ***Consumer and small business would be the key FOCUS segments going forward. Picked up these business segments judiciously which should help deliver risk adjusted returns***
- ***Loan segments would include affordable HL, pre-owned cards, LAP, PL, Loans to Prof, co-branded credit cards, machine loans and heavy equipment loans***
- ***Aiming at 25-30% CAGR over the next 2-3 years***

5 guiding principles

- ***Brand & equity capital*** – backed by one of the most respected and trusted business house not only in India but globally
  Current capital is enough for growth over the next 5 years

- ***Cost of funds*** – company has seen gradual reduction in cost of funds and expect it to decline further in coming quarters which should help get aggressive on pricing and growth
  Liability mix would further be re-aligned with long term financing as well
- ***Distribution infrastructure*** – Erstwhile Magma strong distribution franchise should aid the company now to expand its footprints
- ***Digital*** – key to financing entire customer centricity
  Digitisation to help direct customer acquisition and help in bringing down cost of acquisition and cost of operations
- ***Operational leadership team*** - identified best talent in the market across business and partner functions. All these leaders have experience of atleast 20 years in their respective domain

<u>Q1FY22 performance</u>

- ***Q1FY22 has been a tough quarter for the entire sector. Despite that, company has put a very strong performance***
- AUM at Rs 144.2bn, consol PBT of Rs 810mn
- 6% AUM growth of continued and focus business
- NIMs improved 100bp QoQ
- ***RoA at 1.8% RoA which had doubled QoQ***
- Company has started seeing low cost benefit on incremental borrowings
- ***Fresh borrowing was done at sub 7%***
- Credit cost down 89bp lower YoY
- *Restructured portfolio at 5.9%*
- Cautiously optimistic on business opportunities going forward
- ***Higher margins, containment of credit cost, improvement in CE and sharp growth in profitability with PBT of Rs 810mn***
- ***As CE shows sign of improvement, it is looking at market with very cautious optimism. Implementation of best in class technology and providing growth oriented environment for people should enable the company create wealth for shareholders***

<u>Asset quality</u>

- ***Credit cost*** – Carried out a complete overhaul of credit and underwriting policies in the past 2 months. It does not mean only tightening, but
- Additionally, prudent measure taken in Q4FY21 and expected recoveries would aid company in future
- ***Normalised credit cost for the lines which company is expanding – 1.5% over the next 2-3 years***
- ***Access to best in class capital, optimum credit cost, gradual reduction in opex should ensure that company delivers risk adjusted return on capital***
- ***CE at 82% in April, 80% in May, 93% in June and 98% in July which is similar to pre-covid levels***
- ***CE calculation is in-line with industry (does not include foreclosure and part payments)***
- ***Coverage ratio of 21% on Stage 2 book, highest in the industry***
- ***Try to achieve Net NPA of <1.5% by FY22-end***

AUM growth drivers

- ***For Pre-owned car finance, business loans and affordable home loans - aspire to be in Top3***
- In terms of near-term growth drivers, company would focus primarily on pre-owned car finance, affordable HL, affordable LAP and business loans
- Affordable LAP is likely to start from Q2FY22
- ***It would be looking to launch consumer durable in Q3/Q4***
- ***FY22 would be a year of capital conservation wherein focus would be on credit cost, PAT and calibrated growth on identified products***
- Going forward, company would look towards unsecured lending

Customer profile

- Customer focus was more towards self-employed rural segment
- ***Planning to move focus towards customers with more formal income in urban and semi-urban which has now been included in new credit and underwriting policy***
- ***Company has one of the best cost of funds***
- ***Agile backend operations by leveraging tech***
- ***Loans to professionals including CA community – almost negligible cost of acquisition and near to zero credit cost (***Professional loans: 0+ DPD is hardly 1%)
- *Aim is to target right set of customers so that credit cost is contained within the target*

Pre-owned car segment growth potential

- In India, customers end up owing car for owing 6-7 years whereas in western world, car ownership is 3-4 years
- As trend shifts towards western culture, demand for used cars is likely to increase in coming years
- ***Currently only ~20% of used cars in India gets financed, which could increase to 30% over the next 3-4 years***
- It has huge presence across country, unique branch model, seasoned team
- Till now, it was restricted due to cost of funds, but now with lower cost of funds, it could scale up business rapidly
- Company is planning to get very aggressive in Maharashtra market
- ***Overall, Magma has complete understanding in this industry, seasoned team and backing of finest cost of funds***
- ***Currently, this space is dominated by large banks like HDFC, ICICI, AU and some NBFCs while Poonawalla Fincorp is currently at number 6 and aspires to be in top 3***
- Currently, it is into lending towards commercial usage vehicles due to limitation of CoF. But now with lower incremental CoF and strong collection infra, it is likely to move towards retail as well.
- Also, it is now shifting focus towards urban and semi-urban areas from rural areas

Poonawalla Finance

- For Erstwhile Poonawalla Finance – no further business would be done in Poonawalla finance
- Existing portfolio would gradually be transferred to Poonawalla Fincorp
- AA- rating for Poonawalla Finance by CARE
- Over next few months, large part of the book would see run-down
- Company would sell-down only if it sees a good deal, otherwise run-down would be gradual

Poonawalla Housing

- Has fantastic affordable housing franchise built over the past 3 years
- ***Value unlocking for Poonawalla Housing could be done by 2025 through IPO***

Erstwhile Magma Fincorp

- Despite digital presence, cross-sell of insurance, pre-owned car loans, business loans, affordable housing and LAP etc. needs physical branches which Magma had built over the years
- ***Key reason behind Magma acquisition was distribution infrastructure and employee strength***
- There would be some rationalisation of branches over due course
- Pre-owned car and VF business were doing very well for erstwhile Magma, as compared to peers

Q4FY21 earnings conference call takeaways

2025 vision

- Poonawalla Group has ambitious plan to foray into financial sector. It will be professionally run NBFC with new management team.
- ***Abhay Bhutada has been appointed as MD while new CEO Mr. Vishal Deshwal (ex-ICICI Bank) is expected to join in July 2021.***
- 10-12 leadership positions are expected to be filled up by end of Q2FY22 (either offers have been rolled out or they are in process). Besides few CXO, there will be subject matter experts in new product business heads, risk analytics, digital etc.
- Strong growth story from FY22 – customer centricity with product propositions – unique NBFC, esteemed Board, professional management team, robust risk framework, operating efficiencies, digitization etc
- Accelerated growth with calibrated underwriting approach – 3x current AUM to Rs450bn.
- Top 3 NBFCs for consumer and small/business finance.
- Cost of funds to reduce by 200-250 bps and net NPAs to be managed sub-1%

On New product launches

- Company will focus on housing loans, used cars, loans to professionals & consumer durables loans in the coming quarters

- Loans to professionals, Personal loans, Non-affordable housing loans & SME LAP will be launched once technology integration is completed with Poonawala group finance company (which has already been doing these type of loans)
- Before March 2022 looking to launch another 4 products which include consumer durables, medical equipment among others

On Cost of funds

- Currently because of lack of capital and strong parentage, cost of funds was higher.
- ***Magma is looking now at lower cost of funds because of higher capital adequacy, lower leverage, brand name and strong parentage***
- Magma current cost of funds is ~10%, while the best companies have cost of funds around ~7%
- With strong parentage, company is also looking now at a higher loan growth

On revised write-off policy (segment-wise)

- Company will provide 100% provision on DPD+ reaching certain threshold for various segments:
  - *90+ DPD from 450+DPD for Unsecured Loans*
  - *180+DPD from 730+DPD for Asset Backed Finance*
  - *730+ DPD for Affordable Housing from erstwhile case to case basis*
- ***All of the above changes in write-off policy resulted in a one-time impact of Rs 2.74bn***
- ***Rs 6.21bn management overlay provisions in Q4 to provide for impact of covid 2nd wave***
- ***Carrying total provision buffer of Rs 12bn, ~9.5% of total advances, which is amongst the highest in the industry***

On Collection efficiency (CE)

- CE at 101.8% in March 2021 vs. 84% in Sep 2020
- Q4 - CE at 99%, nearing normalization
- ***April 2021 CE at 84.3% and May 2021 is also trending lower compared to April 2021***

On Opex

- ***Almost 40-50% of 500k customers collection is done in cash. With digitisation, company is looking at 100% digital collection which will help contain cost***
- With digital picking up, company is not looking to expand employee/branch at a rapid pace

On Magma HDI Insurance

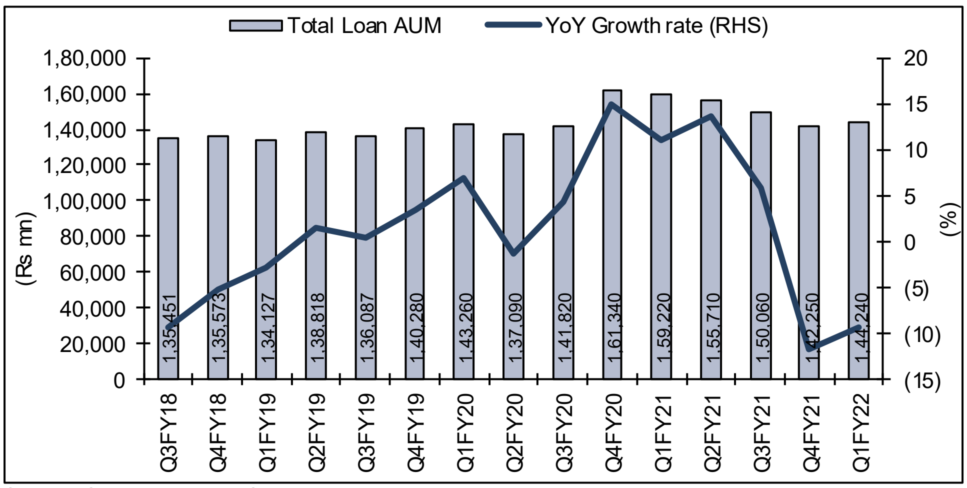
- ***Fresh capital issuance of Rs 2.5bn (subject to regulatory approval)***

- ***Secondary sale by existing promoters of Rs 2.75bn (subject to regulatory approval)***
- Investors are ICICI Ventures, Morgan Stanley, Poonawala group company and 2 family offices
- This will enable to comply with RBI regulations related to promoter stake and also provide growth capital

On Magma Housing

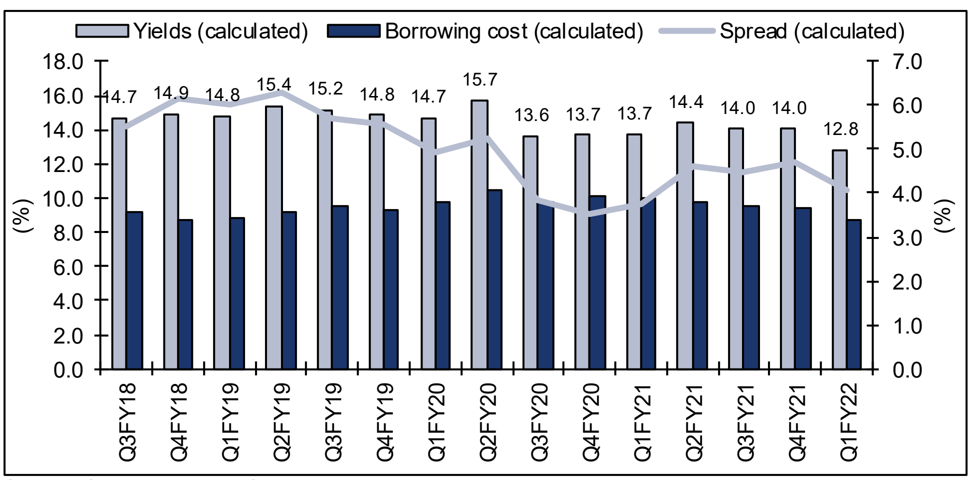
- Infused Rs 5bn by Magma Fincorp
- ***CAR at 58% as of 31st May 2021***
- With expected decline in cost of funds and deep credibility, company would be looking now to grow at a much more rapid pace

Chart 8: Sequential rise in AUM even in a challenging quarter



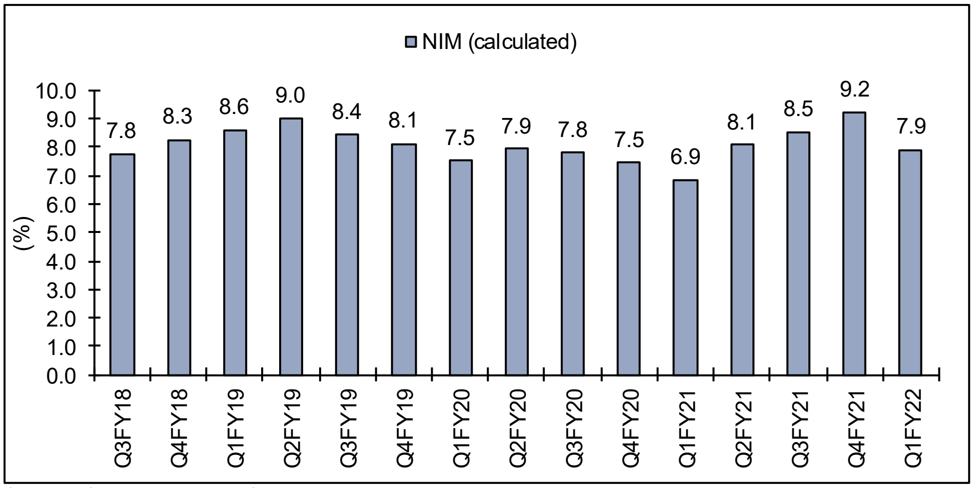
Source: Company data, I-Sec research

Chart 9: Spreads compress due to lower yields QoQ



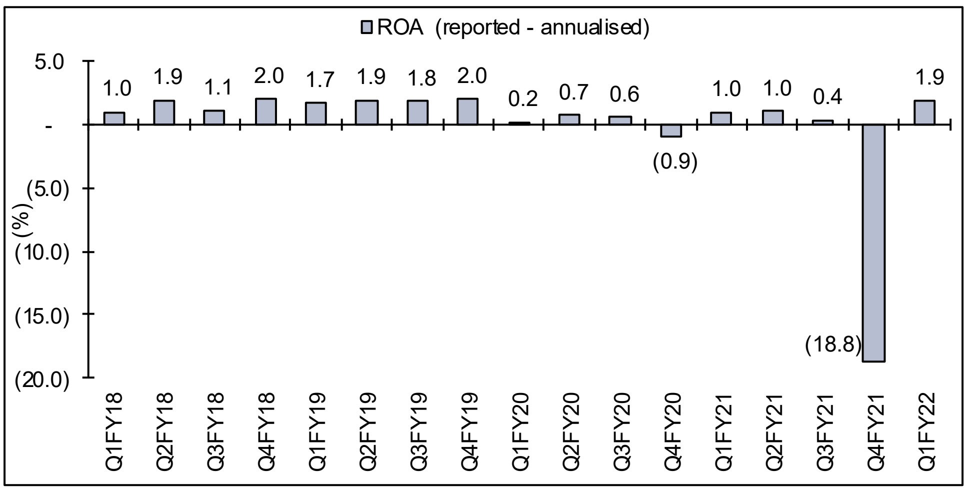
Source: Company data, I-Sec research

Chart 10: Margins volatile over the past few quarters



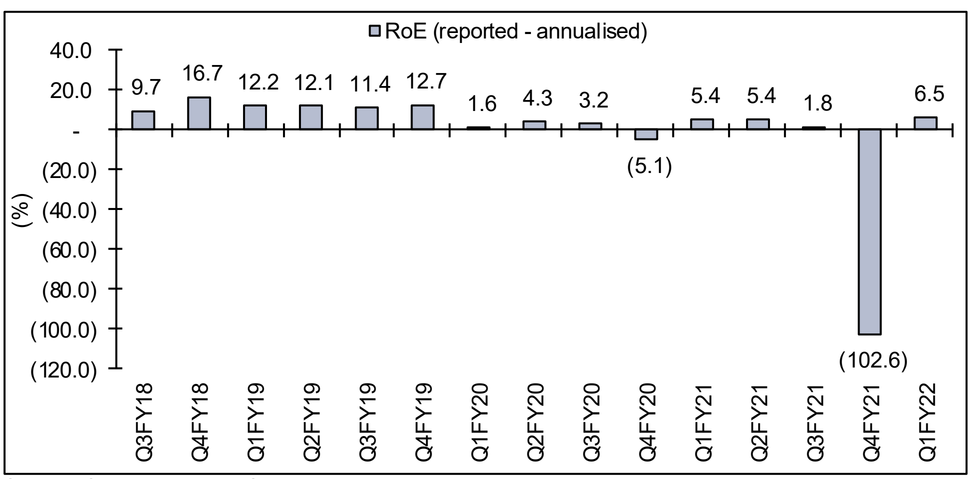
Source: Company data, I-Sec research

Chart 11: Credit cost normalisation supports 1.8% RoA



Source: Company data, I-Sec research

Chart 12: Business transformation to boost RoE



Source: Company data, I-Sec research

Financials

Table 7: Profit and Loss statement

(Rs mn, year ending March 31)

Particulars	FY19	FY20	FY21	FY22E	FY23E
Interest earned	24,552	24,164	21,657	19,165	21,858
Interest expended	11,216	12,938	11,005	6,940	6,982
Net interest income	**13,336**	**11,226**	**10,652**	**12,225**	**14,876**
Other income	**589**	**1,623**	**1,898**	**1,985**	**2,623**
Staff cost	**4,366**	**4,479**	**3,815**	**4,566**	**5,251**
Depreciation	**505**	**752**	**563**	**474**	**493**
Other operating expenses	**1,979**	**1,773**	**1,235**	**1,428**	**1,599**
Total operating cost	**6,850**	**7,005**	**5,613**	**6,468**	**7,343**
Pre-provisioning op profit	**7,075**	**5,844**	**6,937**	**7,742**	**10,155**
Provisions & contingencies	**2,658**	**5,016**	**14,480**	**2,265**	**1,894**
Share of profit of associates	7	(10)	55	45	-
Profit before tax	**4,424**	**818**	**(7,488)**	**5,521**	**8,262**
Income taxes	**1,384**	**547**	**(1,898)**	**1,352**	**2,082**
Minority	-	-	-	-	-
PAT	**3,040**	**271**	**(5,590)**	**4,169**	**6,180**

Source: Company data, I-Sec research

Table 8: Balance sheet

(Rs mn, year ending March 31)

Particulars	FY19	FY20	FY21	FY22E	FY23E
Capital	539	539	539	1,529	1,529
Reserves & surplus	26,900	26,941	21,404	58,839	64,713
Preference Capital	-	-			
Net worth	**27,439**	**27,480**	**21,943**	**60,368**	**66,242**
Minority Interest	-	-	-	-	-
Total borrowings	**1,34,010**	**1,19,870**	**1,04,331**	**80,170**	**98,924**
Other Liabilities & Provisions	6,441	5,050	5,848	6,623	7,873
Total liabilities & stockholders' equity	**1,67,890**	**1,52,400**	**1,32,122**	**1,47,160**	**1,73,040**
Loans & advances	**1,50,070**	**1,35,550**	**1,13,610**	**1,29,158**	**1,53,554**
Cash and Balance	9,570	7,080	7,750	6,401	6,929
Fixed Assets	1,890	1,930	4530	4855	5256
Current & other assets	6,360	7,840	6232	6746	7302
Total Assets	**1,67,890**	**1,52,400**	**1,32,122**	**1,47,160**	**1,73,040**

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending March 31)

Particulars	FY19	FY20	FY21	FY22E	FY23E
Growth (%):					
AUM	7.8	(5.3)	(11.8)	9.6	17.3
Disbursements	20	(27)	(43)	120	31
Loan book (on balance sheet)	1,50,070	1,35,550	1,13,610	1,29,158	1,53,554
Net Interest Income (NII)	8.9	(15.8)	(5.1)	14.8	21.7
Non-interest income	56.8	175.8	17.0	4.6	32.1
Pre provisioning operating profits (PPoP)	7.8	(17.4)	18.7	11.6	31.2
PAT	28.3	(91.1)	2,166.1)	(174.6)	48.2
EPS	12.9	(91.1)	2,165.4)	(126.3)	48.2
Yields, interest costs and spreads (%)					
NIM on AUM	8.1	6.8	7.0	8.2	8.8
Yield on loan assets (on -book)	15.0	14.6	14.3	12.9	12.9
Average cost of funds	8.7	10.2	9.8	7.5	7.8
Interest Spread on loan assets (on -book)	6.2	4.4	4.5	5.3	5.1
Operating efficiencies					
Non-interest income as % of net income	4.2	12.6	15.1	14.0	15.0
Cost to income ratio (%)	49.2	54.5	44.7	45.5	42.0
Op.costs/avg AUM (%)	4.2	4.2	3.7	4.3	4.3
No. of employees (including off rolls)	9,911	10,467	11,110	11,791	11,968
Average annual salary (Rs mn)	0.4	0.4	0.3	0.4	0.4
Annual inflation in average salary(%)	11.8	(2.9)	(19.7)	12.8	13.3
Salaries as % of non-int. costs (%)	63.7	63.9	68.0	70.6	71.5
NII /employee (Rs mn)	1.3	1.1	1.0	1.0	1.2
AUM/employee(Rs mn)	17.2	15.4	12.8	13.2	15.3
Capital Structure					
Debt-Equity ratio	4.9	4.4	4.8	1.3	1.5
Leverage (x)	6.1	5.5	6.0	2.4	2.6
CAR (%)	24.9	25.9	23.0	25.5	27.2
Tier 1 CAR (%)	20.7	23.0	20.3	23.0	24.7
Tier 2 CAR (%)	4.2	2.9	2.7	2.5	2.5
Asset quality and provisioning					
GNPA (% of AUM)	4.8	6.4	3.7	6.3	5.3
NNPA (% of AUM)	3.1	4.1	1.2	3.6	3.0
GNPA (Rs mn)	7,470	9,140	4,650	8,726	8,591
NNPA (Rs mn)	4,730	5,800	1,460	5,026	4,880
Coverage ratio (%)	36.7	36.5	68.6	42.4	43.2
Credit costs as % of average AUM (bps)	162	303	954	152	112
Return ratios & capital management					
RoAA (%)	1.9	0.2	(3.9)	3.0	3.9
RoAE (%)	12.9	1.0	(22.6)	10.1	9.8
Payout ratio (%)	7.1	-	-	7.3	4.9
Valuation Ratios					
EPS (Rs)	11.3	1.0	(20.7)	5.5	8.1
Price to Earnings	12.7	142.4	(6.9)	26.2	17.7
BVPS (Rs)	101.7	101.8	81.2	78.9	86.6
Price to Book	1.41	1.40	1.76	1.81	1.65
Dividend yield (%)	0.6	-	-	0.3	0.3

Source: Company data, I-Sec research

Table 10: DuPont analysis

Particulars	FY19	FY20	FY21	FY22E	FY23E
Interest earned	15.0	14.6	14.3	12.9	12.9
Interest expended	6.8	7.8	7.2	4.7	4.1
Gross Interest Spread	**8.1**	**6.8**	**7.0**	**8.2**	**8.8**
Credit cost	1.6	3.0	9.5	1.5	1.1
Net Interest Spread	**6.5**	**3.7**	**(2.5)**	**6.7**	**7.7**
Operating cost	4.2	4.2	3.7	4.3	4.3
Lending spread	**2.3**	**(0.5)**	**(6.2)**	**2.3**	**3.3**
Non-interest income	0.4	1.0	1.3	1.3	1.5
Minority	-	-	-	-	-
Final spread	**2.7**	**0.5**	**(5.0)**	**3.7**	**4.9**
Tax rate (%)	*31.3*	*66.9*	*25.3*	*24.5*	*25.2*
ROAAUM	**1.8**	**0.2**	**(3.7)**	**2.8**	**3.6**
Effective leverage (AAUM/ AE)	7.0	6.0	6.1	3.6	2.7
RoAE	**12.9**	**1.0**	**(22.8)**	**10.0**	**9.8**

Source: Company data, I-Sec research

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