

Bajaj Finserv Limited

Investment Rationale

Bajaj Finance—maintains strong growth momentum

Bajaj Finance a subsidiary of bajaj finserv, showed a strong growth in profit (up 29.8% YoY to Rs167.0 crore) in Q2FY2014. The growth in the profit was driven by a strong uptick in the net interest income (NII; up 31.5% YoY) and investment income of Rs27 crore. The deployments of the company grew by 20.0% YoY to Rs5,199 crore during the quarter while its AUMs expanded by 29.0% YoY.

Life insurance—premium flat, business momentum weak

The combined profit of the life insurance business declined by 18.2% YoY to Rs. 252 crore in Q2FY2014 led by a decline in the policyholders' surplus (down 34.1% YoY to Rs145 crore). The gross written premium (GWP) declined by 9.9% YoY contributed by a drop of 17.6% in the renewal premium. The company was able to arrest the decline in new business premium, which was flat yoy at Rs. 6.6 bn. Renewal premium increased 77% qoq (though down 18% yoy), improving the conservation ratio to 64% in 2QFY14 from 51% in 1QFY14 and 62% in 2QFY13. The assets under management (AUM) declined by 9.0% YoY (down 1.8% sequentially) to Rs36,961 crore in the quarter.

General insurance—operating metrics and profitability improves

The general insurance business reported a profit of Rs113 crore for Q2FY2014 as compared with a profit of Rs78.0 crore for Q2FY2013. The net premium increased by 37.9% YoY driven by 17.1% YoY increase in the GWP. The combined ratio (including motor pool losses) declined to 95.8% from 100.8% in Q2FY2013 (99.8% in Q1FY2014). The company reported an underwriting profit of Rs56 crore up 14% yoy despite a rise in the claims ratio to 66.7% from 59.2% in Q2FY2013. Motor pool losses were stable at Rs. 340 mn qoq. Combined ratio was stable at 96%.

In Rs. Cr.	FY12	FY13	FY14E	FY15E
Net interest Income (NII)	3161	4051	6147	7194
NIM (%)	13.8	12.5	11.9	11.6
Operating Profit	2226	2888	4610	5722
PAT	1338	1574	1620	1721
EPS (Rs)	90.9	103.0	107.0	87.0
Adjusted BV (Rs)	347	490	566	643
GNPA (%)	1.1	1.0	1.1	1.1

Consensus Estimate: Bloomberg

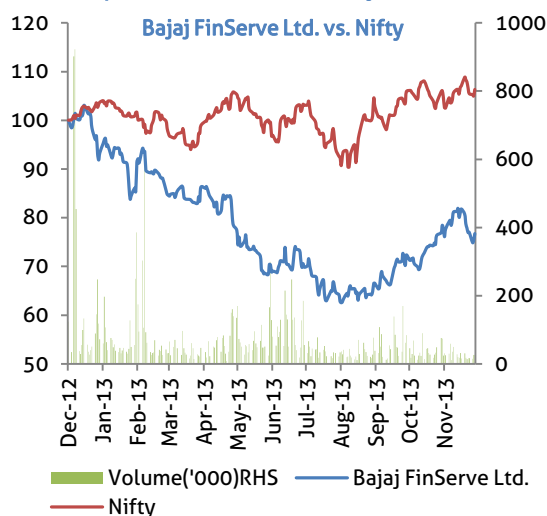
December 30, 2013

Recommendation	Buy
Target price	Rs. 850
Closing price	Rs. 726
Potential upside	17%

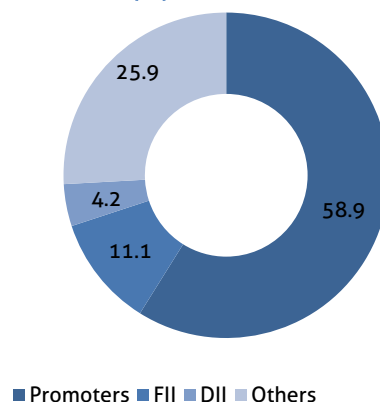
Company Information

BSE Code	532978
NSE Code	BAJAJFINSV
Bloomberg Code	BJFIN IN
ISIN	INE918101018
Market Cap (Rs. Cr)	11,555
Outstanding shares(Cr)	15.91
52-wk Hi/Lo (Rs.)	938.4 / 561
Avg. daily volume (1yr. on NSE)	70713
Face Value(Rs.)	5
Book Value	490

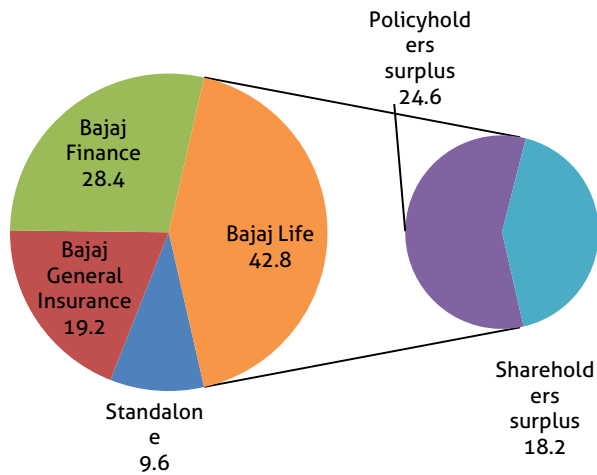
Relative performance chart (one year)



Share holding pattern as on 30.09.2013 (%)



Revenue Contribution (%)



Disbursements moderate from high levels, NIM stable yoy

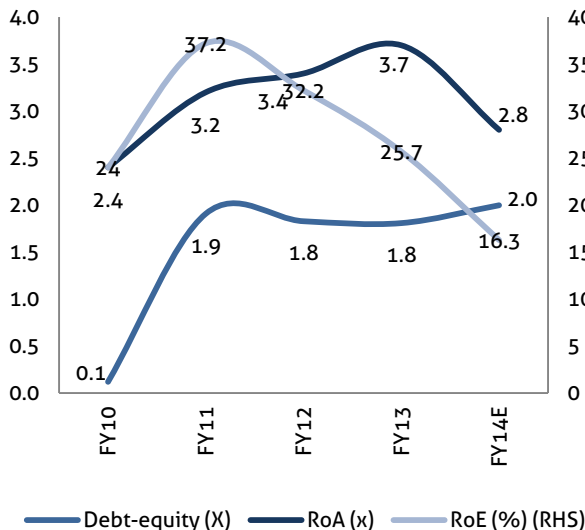
Bajaj Finance reported 32% growth in NII on the back of 29% growth in AUMs and almost stable NIM yoy. Growth in disbursements reduced to 20% yoy largely due to decline in commercial loans. Disbursements in the two focus segments, viz. consumer finance and small business loans, moderated to 30%—this was lowest in last two-and-a-half years (30-57% yoy growth in disbursements between 1Q12 and 2QFY14). Bajaj Finance’s calculated NIM was stable yoy at 11.8% (including fees) but lower than 13% in 1QFY13 (13%). Notably, 1Q is a strong quarter for consumer durable business and upfront booking of income in this quarter (on consumer durable loans) boosts calculated NIM for the period. Bajaj Finance’s calculated borrowing cost increased by about 15 bps qoq to 9.56% on the back of rise in marginal borrowing cost.

Asset quality on track

Bajaj Finances’ gross NPLs remain low at 1.14%; net NPLs were stable at 0.3%. Bajaj Finance increased its standard asset provisions of 40 bps (as compared 25 bps earlier) from 1QFY14. Asset quality performance in consumer durables and personal loans segments was steady; the company reported collection efficiency of 98% and 95% respectively in these segments. Collections in two-wheeler loans improved to 88.5% in 2QFY14 from 86.9% in 1QFY14. In the construction equipment finance business, collections declined to 84% from 88% in 1QFY14 and 94% in 2QFY13.

Bajaj Finance: Conference call

- **RoE to moderate over time.** Bajaj Finance’s management has guided for about 25% loan growth over the medium term. The share of consumer finance loans will over time decline to 30-35% (41% in June 2013), small business loans will be 50% (stable) and commercial loans will increase to 15- 20%; with the change in mix, RoE will moderate to about 18-20%. The company does not propose to scale up in commercial loans in the near term.
- **Not worried on RBI’s recent warning to banks.** Bajaj Finance is well-placed on its consumer durable products despite RBI’s recent warning to banks on zero interest finance schemes.
- Bajaj Finance was not an active player in financing products which offer differential prices for sales on cash and finance (like mobile phones). Consumer durable manufacturers do not offer a differentiated (lower) price on cash sales. Most large retailers do not offer any discount on cash purchase as compared to credit card or financing schemes.
- Bajaj Finance has modified its loan agreements from October 2013. The agreements now clearly mention that the company earns IRR of 23-25% on the loan, and interest component on this product is paid by the manufacturer.



Banking license for Bajaj Finance could be beneficial

Bajaj Finserv is one of the leading contenders for a new banking licence, given it has a good quality large NBFC, good management and there have been no governance issues around the promoters of the company. If the Reserve Bank of India (RBI) grant it a banking licence, then it will have to convert Bajaj Finance into a bank and any benefits emerging out of it in the form of larger reach and distribution will be also available to Bajaj Finserv. However the profitability will not decline substantially given the life insurance and general insurance business will help to support the profitability. So it is expected that this could be an excellent choice to play the banking licence theme.

Key Risk

- Asset quality issues from its two wheeler/CE book
- Tighter-than-expected liquidity.

Outlook & Valuation

Bajaj FinServ's overall earnings growth in the past few quarters was aided by a strong growth in the general insurance and lending businesses. However, the premium continues to decline in the life insurance business, though the investment income boosted shareholders' surplus. In view of the weak growth outlook for the life insurance sector, the top line and the margin are likely to contract for the life insurance business. The company's subsidiary, Bajaj Finance has applied for a banking licence which is a positive signal for the company. It is believed that the company is a better play in the insurance sector, as it is expected to maintain its growth and its valuation is attractive. At CMP Rs.726 Bajaj Finserv is trading at P/B multiple of 1.28x its FY14E BV of Rs. 566 and 1.13x its FY15E BV of Rs. 643. We value the NBFC at its P/BV multiple of 1.32x on its FY15E BV of Rs. 643 and with target price to Rs. 850. We recommended BUY on Bajaj Finserv with an upside potential of 17%.

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