

7 march 2018

Bajaj Finance – BUY

CMP : 1,621
Target Price : 2,019
Upside : 24%+
Stop Loss : 1,428 (closing basis)

Investment Thesis

Recently, the stock price of Bajaj Finance Ltd. (Bajaj Finance) corrected by ~17% from 52-week high of Rs.1,986 despite reporting good set of numbers in the recent quarters.

Bajaj Finance has a diversified loan portfolio and a leadership position in under penetrated and growing segments like consumer durables (CD) financing, lifestyle product financing, two-wheeler financing, LAP, etc., which account for its ~50% of its portfolio. Despite a weak economic environment in the past few years, these segments have helped Bajaj Finance to clock strong AUM CAGR of over 40% during FY11-17 to Rs.602bn. Of the total AUM, it places about 4-5% for securitization for better asset-liability management. As on FY17, Rs.25bn was securitized amount and the balance Rs.577bn is advances outstanding in the balance sheet. Strong AUM growth was mainly driven by the SME category, which increasing at 45% CAGR followed by the consumer finance (CF) category, which rose at 40% CAGR. Going ahead, we expect AUM growth at over 25% CAGR in FY18-20E, led by the CF segment that will be driven by CD financing business.

Bajaj Finance's borrowings are well diversified with NCDs proportion being the highest at 48% followed by banks at 35% and CPs/FDs at 17% of total borrowing of Rs.493bn as on FY17. This is owing to strong parentage and stable credit rating from Crisil and ICRA over the last seven years, with a positive outlook. As a result, Bajaj Finance is able to raise funds at competitive rates from various sources. At regular intervals, Bajaj Finance was able to raise funds via QIP, which also helps in reducing its cost of borrowings. In 2015, it raised ~Rs.18bn via allotment of warrants to promoters and equity to QIBs. It also raised Rs.45bn through QIP recently. Going ahead, the mix of borrowings is expected to shift towards non-bank avenues owing to downward trajectory of market rates.

Financials

- During the past 5 years, Interest Income of Bajaj Finance grew at CAGR of 33.0% while PAT grew at CAGR of 35.2% in the same period.

Standal. (INR Mn)	FY15	FY16	FY17	FY18E	FY19E
NII	28,141	38,447	52,008	59,809	68,780
% growth	35.5	36.6	35.3	15.0	15.0
PAT	8,979	12,785	18,366	22,039	26,446
ABV (INR)	86.1	131.3	170.9	200.9	230.8
P/ABV (x)	19.2	12.6	9.7	8.2	7.2
EPS (INR)	16.4	23.4	33.6	40.3	48.4
P/E (x)	100.9	70.9	49.3	41.1	34.3
RoE (%)	18.5%	17.3%	19.1%	20.0%	20.9%

- Bajaj Finance's NII for Q3FY18 increased strongly by 38.4% YoY to Rs.21,090mn led by healthy growth in AUM and strong margins.

Stock Data

Market Cap (INR MN)	955,232
Market Cap (\$ MN)	14,741
Shares O/S (in MN)	546.9
Avg. Volume (3 month)	1,014,000
52-Week Range (Rs.)	1,986 / 886

Shareholding Pattern

Promoters	55.28%
FIIIs	20.41%
Institutions	8.13%
Others (incl. body corporate)	16.18%

Performance (%)	1M	6M	1Yr
Absolute	-2.4%	-8.5%	53.4%
BSE Bankex	-7.7%	4.1%	23.1%

Key Ratios

Div Yield	0.2%
TTM PE	40.2x
ROE	20.4%
TTM EPS (INR)	41.2/-

- AUM of Bajaj Finance witnessed growth of 33% YoY to Rs.764bn in Q3FY18 largely led by consumer finance and commercial business segments.
- Bajaj Finance's NIM has also improved by 14bps YoY to 10.7% in Q3FY18 owing to faster traction in high yielding consumer finance segment.

Key Business Highlights

- Bajaj Finance is a non-banking finance company (NBFC), engaged in lending and allied activities. It focuses on consumer lending, SMEs lending, commercial lending, rural lending, fixed deposits, etc.
- Bajaj Finance's consumer lending products include two-wheelers and three-wheelers finance, consumer durables finance, digital products finance, retailer finance, salaried personal loans, e-commerce consumer finance and home loan while its SME lending products include loan against property and business loans.
- Bajaj Finance's commercial lending products include loan against securities and financial institutions group lending business while its rural lending products include personal loans cross-sell, salaried personal loans and gold loans.

Valuation

- Bajaj Finance's gross NPA ratio at 1.7% (Rs.9.5bn) as on FY17, is relatively better than some of its peers, considering the weak economic environment of the past two or three years. The asset quality has improved sharply over the last five or six years as GNPA ratio was at 16.6% in FY09. This low asset quality was owing to high stress witnessed in the two-wheeler financing and computer financing business. Bajaj Finance started focusing on improving its risk management process and framework, which included product rationalization like exiting the computer financing business, focusing on safer products like LAP and mortgages during the weak economy of FY11-14, increased use of Cibil scores, focusing on repeat customers with good repayment pattern and on affluent & mass affluent customers. These efforts yielded large gains with improvement in asset quality by FY17.
- Bajaj Finance's margin at ~10% during FY17 is one of the highest among its peers. Such high margins is on the back of strong blended yields of over 17% and competitive cost of fund, which helped Bajaj Finance to earn overall spread of ~10%. In the past few years, margins witnessed a slide owing to a change in loan mix towards lower yielding segments as its strategy was to go for scale and secured products like in the SME category (like LAP), which impacted the yield to some extent, but also helped maintain steady asset quality. We expect margins of Bajaj Finance to stay at healthy levels of about 10% going ahead.
- With diversified loan portfolio and a leadership position in CD financing, Strong AUM growth, well diversified borrowings, strong asset quality and margins to stay at healthy levels, we value Bajaj Finance at 8.75x FY19E ABV of Rs.230.80 to arrive at target price of Rs.2,019, an upside of ~24%.

Risk & Concern

- Any changes in the regulatory framework affecting NBFCs, including provisioning norms for NPAs and capital adequacy requirements may adversely affect Bajaj Finance.
- Any significant steps taken to gain market share by the players in the banking industry will impact the business of Bajaj Finance.
- Any unstable interest rate environment may adversely impact cost of fund of Bajaj Finance.

Graphs & Charts

Figure 1: Interest Income Trend

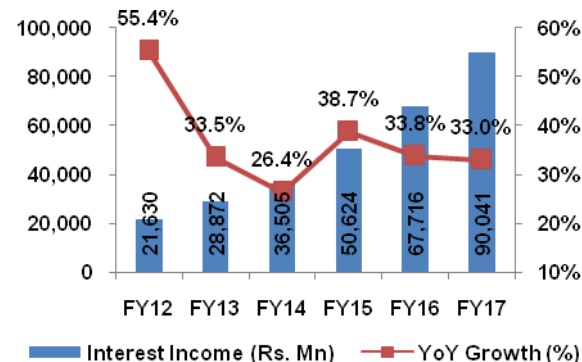


Figure 2: NII Trend

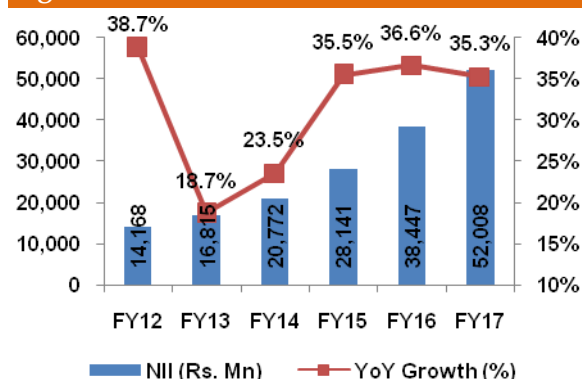


Figure 3: PAT Trend

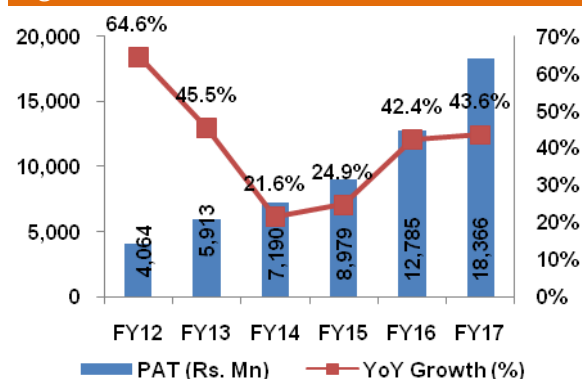
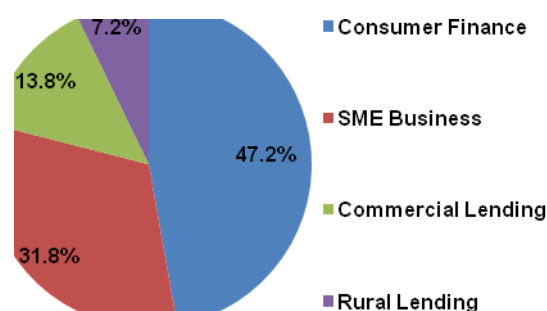


Figure 4: AUM Distribution (Q3FY18)



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