Bajaj Finance | BAF IN

Price: ₹632
BUY
Target: ₹990 (Mar'12)

JM FINANCIAL

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Ready to cruise in its new Avatar

- **Restructuring has set the base for sustainable growth:** Post induction of new management team led by Mr. Rajeev Jain, Bajaj Finance (BAF) underwent significant restructuring during FY08-10 which included **a)** shift in focus towards the affluent and HNI segment in the consumer business, **b)** transformation from primarily being a captive business model (Bajaj Auto's finance arm) focused on 2-wheeler and consumer durable business to a diversified NBFC with full suite of lending products, **c)** Significant improvement in origination and underwriting processes by investing in technology, using information from CIBIL and creating a dedicated risk analytics unit which has enhanced its risk management capabilities. Going ahead, we believe BAF is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk, as it intends to focus on secured business lines.

- **Secured business lines to drive loan book CAGR of 32% over FY11-13E:** We expect secured loan products (loan against property, construction equipment finance and infrastructure finance) to drive loan book CAGR of 32% over FY11-13E, while unsecured business lines would be in consolidation phase after witnessing strong growth during FY09-11. Consequently, we expect secured assets to account for c.55-60% of the book by FY13E vs c.30% in FY10.

- **Healthy NII CAGR of 26% despite margin pressure due to change in loan-mix and higher borrowing costs:** We factor-in significant margin decline of c.440bps over FY10-13E due to **a)** lower asset yields on account of higher proportion of secured business going ahead, **b)** increase in cost of borrowings. We still expect a healthy 26% CAGR in NII over FY11-13E.

- **Credit costs to decline by 135bps over FY11-13E; coverage ratio now at healthy 71% level:** We expect credit costs for BAF to decline by 135bps over FY11-13E given **a)** change in loan mix towards secured assets; **b)** BAF has improved its coverage ratio from 28% in FY08 to a healthy 71% currently. We forecast gross and net NPLs of 4% and 1% respectively in FY13E.

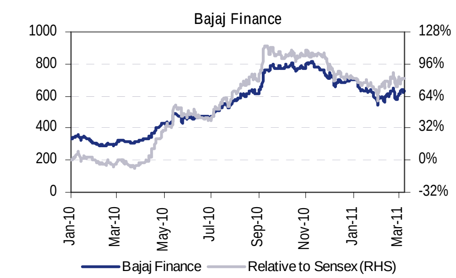
- **Earnings CAGR of 27% with healthy ROE of c.22%:** We expect earnings CAGR of c.27% over FY11-13E on strong loan growth, lower credit costs and improving cost ratios. We expect BAF to report healthy return ratios with ROA of 3.1% and ROE of 22% by FY13.

- **Solid business available at compelling valuation; initiate with BUY and TP of ₹990:** BAF is currently trading at a compelling valuation of 5.7x/1.2x based on FY13E earnings and book value respectively. We value BAF at 9x Mar'13 EPS (implied P/B of 1.8x), implying Mar'12 target price of ₹990, upside of c.57%. **Key risks:** Spike in interest rates and higher than expected delinquencies.

Key Data

Market cap (bn)	₹ 23.2 / US$ 0.5
Shares in issue (mn)	36.6
Diluted share (mn)	36.6
3-mon avg daily val (mn)	₹ 29.2/US$ 0.6
52-week range	₹ 839.1/295.0
Sensex/Nifty	18,440/5,521
Rs/US$	45.1

Daily Performance



	1M	3M	12M
Absolute	7.3	-5.7	97.0
Relative*	3.6	0.7	89.2

** To the BSE Sensex*

Shareholding Pattern (%)

	3Q FY10	3Q FY11
Promoters	49.11	55.51
FII	20.18	6.05
DII	5.59	12.94
Public/others	25.12	25.50

Exhibit 1. Financial Summary (₹ mn)

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Net Profit	339	894	2,476	3,154	4,038
Net Profit (YoY %)	64.8%	163.6%	177.0%	27.4%	28.0%
Assets (YoY %)	-21.6%	59.9%	74.4%	35.0%	30.0%
ROA (%)	0.99%	2.28%	3.74%	3.19%	3.09%
ROE (%)	3.2%	8.0%	19.7%	21.0%	22.3%
EPS (₹)	9.3	24.4	67.7	86.2	110.3
EPS (YoY %)	64.8%	163.6%	177.0%	27.4%	28.0%
PE (x)	**68.2**	**25.9**	**9.3**	**7.3**	**5.7**
BV (₹)	297	315	373	447	542
BV (YoY %)	2%	6%	18%	20%	21%
P/BV (x)	**2.12**	**2.01**	**1.70**	**1.41**	**1.17**

Source: Company data, JM Financial. Note: Valuations as of 08/03/2011

Exhibit 2. Key Financials

Key Parameters	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E	CAGR (05-10)*	CAGR (10-13)E*
Balance sheet											
Borrowings (₹ bn)	7	10	16	17	16	32	63	87	115	36.5%	52.8%
Loans (₹ bn)	11	19	27	28	24	40	72	97	126	29.1%	46.2%
Total Assets (₹ bn)	14	22	35	38	30	48	84	114	148	27.7%	45.2%
Assets Growth (%)	51.2%	56.4%	59.6%	8.6%	-21.6%	59.9%	74.4%	35.0%	30.0%		
Income statement											
NII (₹ bn)	0.6	0.9	1.2	1.7	3.9	6.1	9.4	11.9	14.8	57.3%	34.5%
Operating profits (₹ bn)	0.8	0.9	1.5	1.4	2.1	3.9	6.0	7.3	9.0	37.3%	31.6%
PAT (₹ bn)	0.4	0.4	0.5	0.2	0.3	0.9	2.5	3.2	4.0	16.6%	65.3%
Profitability											
Interest Spread (%)	1.56%	0.95%	-0.55%	-1.01%	6.45%	12.98%	12.42%	10.29%	9.72%	11.43%	-3.27%
NIM (%)	5.39%	4.99%	4.27%	4.70%	11.59%	16.02%	14.54%	12.32%	11.63%	10.63%	-4.38%
ROA (%)	3.52%	2.07%	1.64%	0.56%	0.99%	2.28%	3.74%	3.19%	3.09%	-1.24%	0.81%
ROE (%)	16.9%	10.0%	6.3%	2.0%	3.2%	8.0%	19.7%	21.0%	22.3%	-8.88%	14.34%
Asset Quality											
Gross NPL (₹ mn)	237	573	1,034	2,529	4,164	3,185	3,184	4,356	5,239	68.2%	18.0%
Gross NPL (%)	2.09%	3.06%	3.77%	8.70%	16.63%	7.58%	4.30%	4.36%	4.04%	5.49%	-3.54%
Net NPL (₹ mn)	159	396	640	1,806	2,829	1,432	796	1,089	1,310	55.2%	-2.9%
Net NPL (%)	1.42%	2.13%	2.37%	6.37%	11.93%	3.56%	1.11%	1.13%	1.04%	2.14%	-2.52%
Loan Loss Charge (₹ mn)	168	380	809	1,092	1,636	662	2,228	2,471	2,840	31.5%	62.5%
Coverage (%)	32.7%	30.8%	38.1%	28.6%	32.1%	55.0%	75.0%	75.0%	75.0%	22.3%	20.0%

Source: Company, JM Financial, Note: * Figures for ratios signify change over the specified period.

Bajaj Finance (BAF)

Restructuring has set the base for sustainable growth

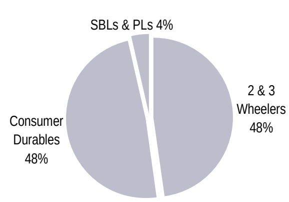
- **Transformed from finance arm of Bajaj Auto to a diversified consumer finance player**

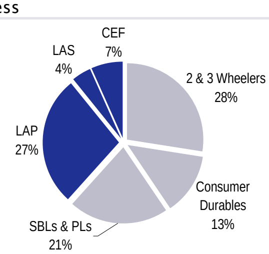
Post induction of new management team led by Mr. Rajeev Jain, Bajaj Finance underwent significant business and organisational restructuring during FY08-10 which included **a)** shift in focus towards the affluent and HNI segment in the consumer business, **b)** transformation from primarily being a captive business model (Bajaj Auto's finance arm) focused on 2-wheeler and consumer durable business to a diversified NBFC with full suite of lending products, **c)** Significant improvement in origination and underwriting processes by investing in technology, using information from credit bureau (CIBIL) and creating a dedicated risk analytics unit which has enhanced its risk management capabilities. Going ahead, we believe Bajaj Finance is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk, as it intends to focus on secured business lines.

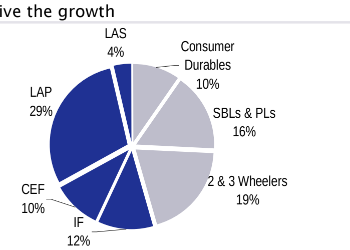
Exhibit 3. BAF: Business and Organisational restructuring set the base for sustainable growth

Business and Organizational restructuring set the base for sustainable growth			
	FY04-FY07	Now	FY10-FY13E
	Surviving and Fixing	Building and Transforming	Going deep and leveraging investments
Customer	Mass & Sub-prime	Affluent & HNI	- Lower operating costs - Improved risk performance - Better asset quality performance with improved net NPLs of 1.1% in 3Q11 vs 11.93% in FY09
Strategy	Captive and very small ticket size business i.e. two wheeler and consumer durable	Full of suite lending portfolio with ticket size of ₹25,000 to ₹500mn	- Diversified and stable loan book - Scalable and consistent growth; Expect 32% CAGR in loans over FY11-13E period vs tepid 9% CAGR in FY06-09
People	Home grown talent; horizontal organisation structure, absence of variable pay	Excellent mix of homegrown and outside talent; verticle organisation structure, Introduction ESOPs and variable pay	- Quick decision making resulting in lowering turn-around-time - Improved employee efficiency
Technology	Legacy technology platform	Continuous increased investments in technology up-grades	- Better risk management system, control and supervision - Improved cross-selling of PLs and LAP
Operations	Decentralized and fixed cost model	Centralized and flexible operating cost model	- Productivity improvement to lead to decline in cost ratios (cost to assets) from 8.1% in FY10 to 5.8% in FY13E
Underwriting	Physical underwriting, separate sales and collections	Automation of underwriting platform and integrated sales and collection model	- Better control over delinquencies which are expected to halve by FY13E
Risk Management	Limited	Integrated risk analytics framework, Significant lateral investment in risk management	- Improved operational and credit quality control
Loan Book	Concentrated, unsecured and higher proportion of riskier loans	Diversifying loan book by investing in new business	- Secured and sustainable loan book composition to drive the growth

Loan Book Composition







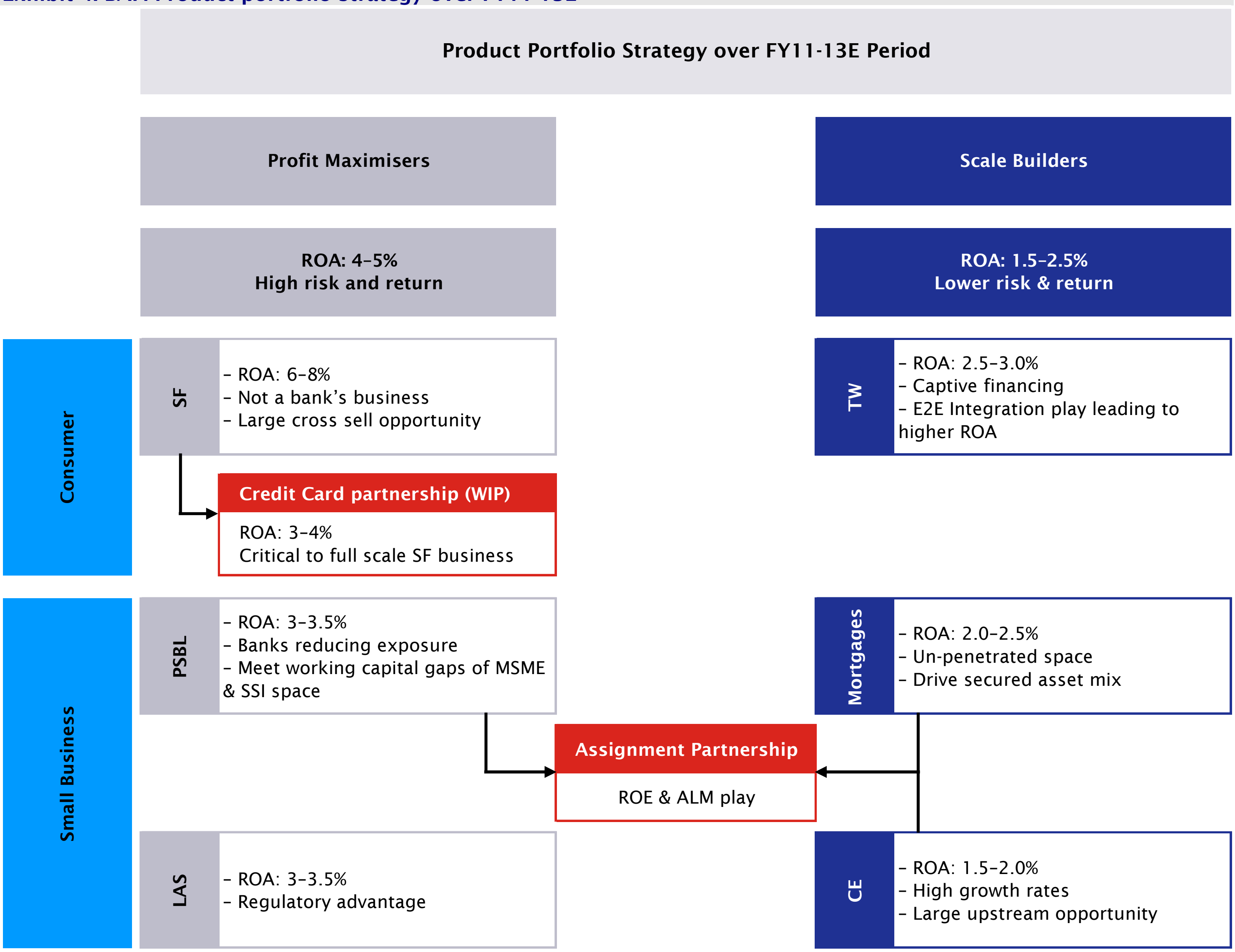
Secured Loans Unsecured Loans

Source: Company, JM Financial. CEF: Construction Equipment Finance, SBL: Small Business Loans, IF: Infrastructure Finance.

Business Model

Product strategy shown in Exhibit 4 highlights BAF's business model going ahead. The model would focus on consumer and small business segments. It would comprise profit maximisers like loan against consumer durable, personal / small business loans and loan against shares which would help generate high profitability with ROA in the range of 4-5%. On the other hand, to ensure stability and achieve scale, the company would focus on scale builders like loan against property, construction equipment and infrastructure finance which would generate ROA of 2-2.5%. As scale builders are expected to constitute c.60% of the loan book going forward, this model should result in healthy return ratios with ROA in the range of c.3-3.2%. In our opinion, this scalable and stable business model should lead to significant re-rating of the stock going ahead.

Exhibit 4. BAF: Product portfolio strategy over FY11-13E



Source: Company, JM Financial.

Product Offering

BAF transformed from primarily being a captive business model (Bajaj Auto's finance arm) focused on 2-wheeler and consumer durable business to a diversified NBFC with full suite of lending products. It currently focuses on the following products:

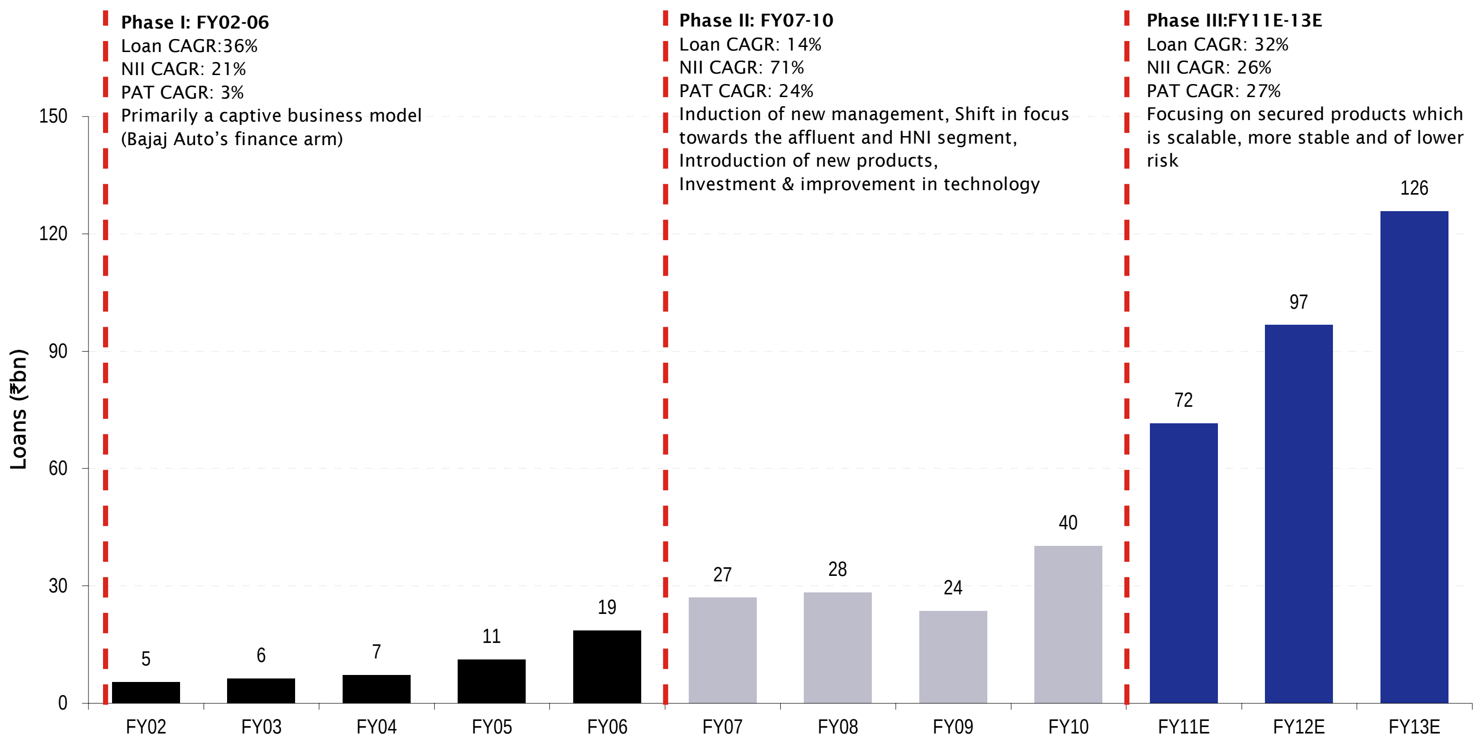
Exhibit 5. BAF: Product suite

	Main Product Features					
	Scale Builders			Profit Maximizers		
	ROA: 1.5 –2.5% Lower risk & return			ROA: 4 –5% High risk and return		
	LAP & Mortgages	**Construction Equipment**	**2 & 3 Wheelers**	**Consumer Durables**	**Small Business Loans & PLs**	**Other Assets**
Product Profile	Residential, commercial, Plot/land, lease rental discounting, Residential property purchase	New and used Equipment refinance, Balance transfer	2-3 Wheelers	Electronics like white goods, TV, LED, Music System	Business requirement, medical expense, Holiday, marriage etc.	Shares, Mututal funds and any other security
Distribution Network	Present across 17 locations	Present across 14 locations	448 dealers & 1,004 sub dealers	2,500 retail counters in 56 cities, 600 dealers	Cross sell through consumer durables	Present across 17 locations
Loan size range	₹2 mn - ₹200 mn	Upto ₹500mn	c.₹30,000	₹7,500-500,000	SBL:₹0.3-3.0mn PLC:₹0.2-2.0mn	₹5.0mn- ₹100mn
Yield (%)	11.5%	11.0%	25.0%	25.0%	18-26%	11.5%
Gross NPLs (%)						
Duration (in months)	Upto 8 years	Upto 4 years	Upto 24 months	10-15 months	12-36 months	6-24months
% of Loan book (3Q11)	27%	7%	28%	13%	21%	5%

Source: Company, JM Financial.

Journey since FY02

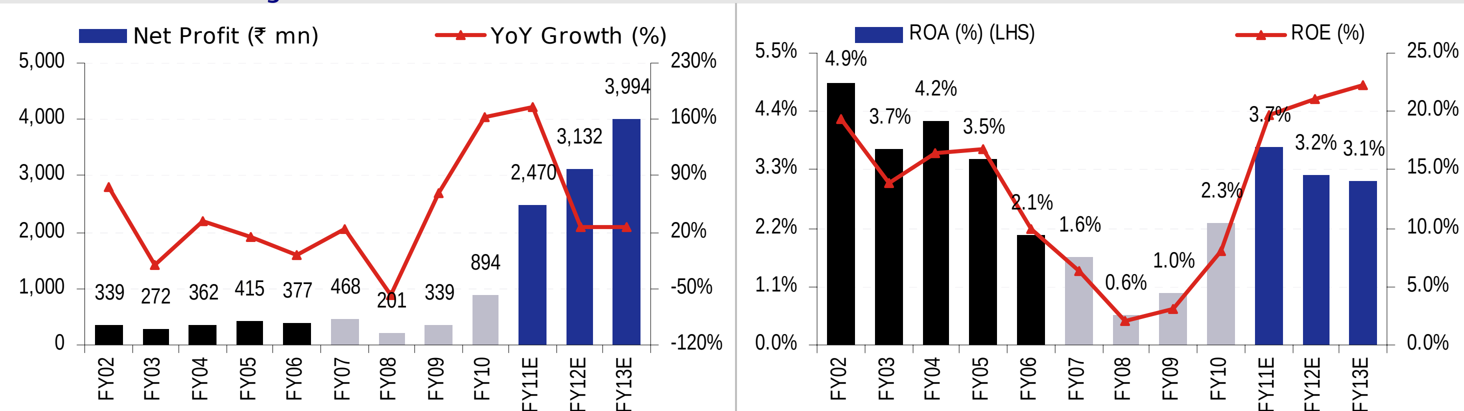
Exhibit 6. BAF: Journey since FY02



Source: Company, JM Financial.

Going ahead, we believe Bajaj Finance is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk, as it intends to focus on secured business lines. We expect earnings CAGR of c.27% CAGR over FY11E-13E period driven by strong loan growth, lower credit costs and improvement in operating efficiency. Consequently, we expect BAF to report healthy return ratios with ROA and ROE of c.3.1% and c.22% respectively by FY13E

Exhibit 7. BAF: Earnings and return ratios over FY02-FY13E



Source: Company, JM Financial.

Sustainable business model of secured loans to drive 32% CAGR in loans over FY11-13E

BAF till FY09 was focusing on financing of 2 and 3-wheelers, consumer durables, personal loans, and small business loans which are unsecured in nature. However, in order to build a stable and scalable book, the company introduced secured products like loan against property (LAP), loan against shares (LAS) and construction equipment finance. We expect secured products like loan against property, construction equipment finance and infrastructure finance to drive loan book CAR of 32% over FY11-13E, while unsecured business lines would be in consolidation phase after witnessing strong growth during FY09-11.Consequently, we expect secured assets to constitute c.55-60% of the book by FY13E from c.30% in FY10.

Exhibit 8. BAF: Product timeline

Year	Product Introduced
Pre 1999	Two Wheeler Financier
FY99-00	Consumer Durables
FY08-09	
June 08	Personal and Small Business Loans
Aug 08	Insurance Distribution Business
Dec 08	Loan against Property
FY09-10	Construction Equipment
	Loan agianst Shares

Source: Company, JM Financial.

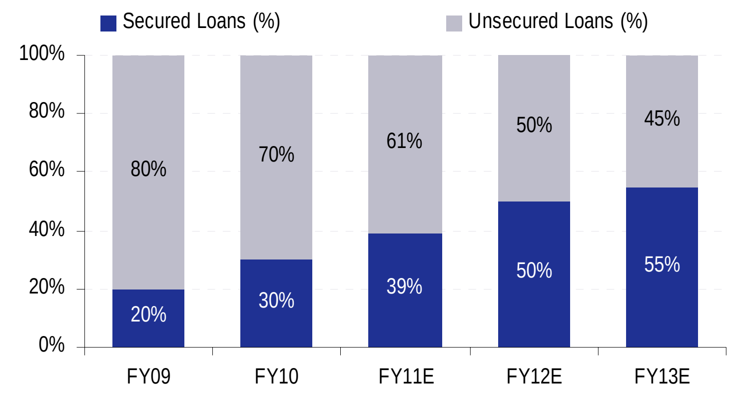
- **Tie-up with Central Bank of India to co-finance retail and SME loans**

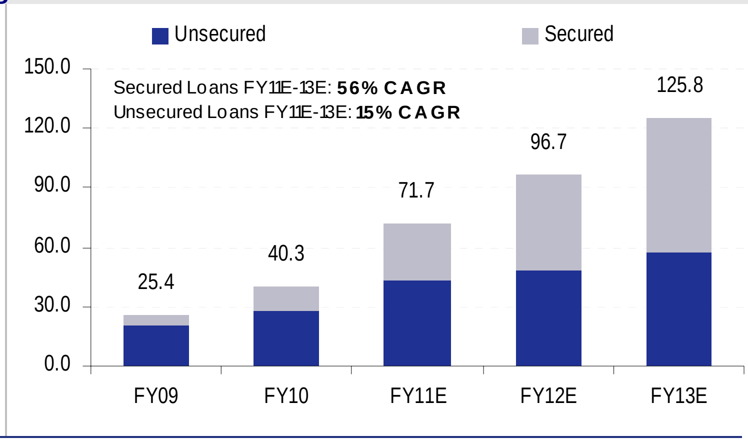
  The company has forged a unique alliance with Central Bank of India (CBI) to co-finance retail and SME loans in which these loans would be partially assigned to CBI on a periodic basis. The administration and servicing of these loans will be managed by BAF. The company intends to assign c.₹10.0bn of co-financing loans over the next 18 months. 30% of SME loans and 35% of mortgages will be assigned to Central Bank on which BAF will also earn upfront fees (0.50%-1.25%) and service charges (0.75%-1.00%).

- **Unsecured product lines to be in consolidation phase after witnessing strong growth during FY09-11**

  After strong growth during FY09-11, we expect unsecured product lines to be in consolidation phase for the next 2 years. We expect c.13% CAGR in 2 and 3-wheelers, c.17% CAGR in consumer durables and c.16% CAGR in small business and personal loans over FY11-13E.

Exhibit 9. BAF: Trend in secured and unsecured loan book growth



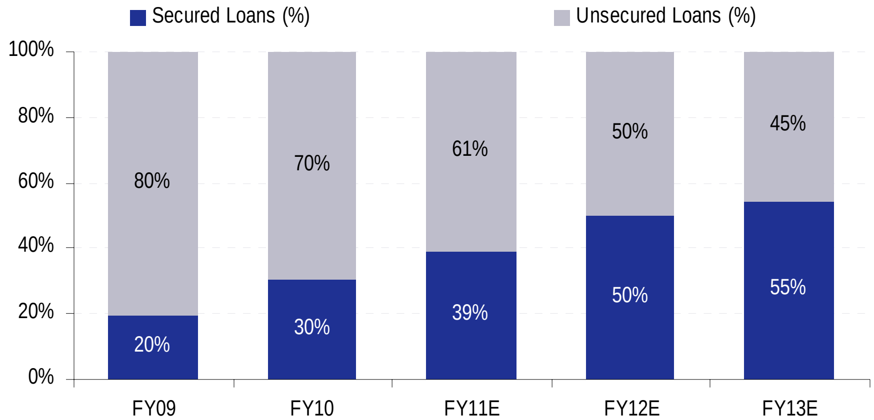


Source: Company, JM Financial.

Loan composition – Focus on secured book

We expect secured loan products like loan against property, construction equipment finance and infrastructure finance to drive loan book CAGR of 32% over FY11-13E, while unsecured business lines would be in consolidation phase after witnessing strong growth during FY09-11. Consequently, we expect secured assets to constitute c.55-60% of the book by FY13E vs c.30% in FY10.

Exhibit 10. BAF: Trend in secured and unsecured loan book



Source: Company, JM Financial.

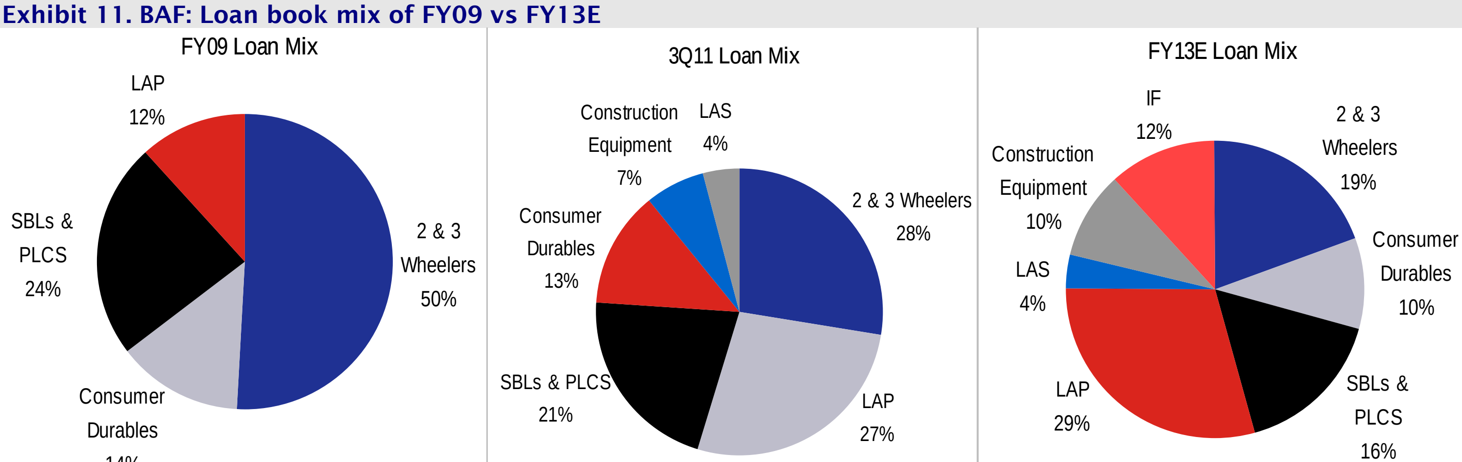
- **Bajaj Auto's 2/3-wheelers account for 27% of loan book**

  The company continues to leverage on the distribution network of Bajaj Auto to build its 2/3 wheeler loan book. Currently, the company is present in 448 dealerships and has access to over 1,000 sub-dealers across India. In FY10, BAF's penetration as a % of domestic sales of Bajaj two-wheelers was at 23% (FY09: 20%). 2/3 wheeler loans currently account for 27% of the loan book and going ahead, we expect this proportion to decline to c.20% by FY13E.

- **LAP to constitute c.30% of the book by FY13E**

  BAF started offering this product, which targets HNIs, in FY09. The share of LAP in the loan book has increased significantly from 12% in FY09 to 27% as of 3Q11. We expect LAP to constitute c.30% of the book by FY13E.

Exhibit 11. BAF: Loan book mix of FY09 vs FY13E



Source: Company, JM Financial.

Diversified borrowing mix

BAF raises funds from diversified sources which include term loans from banks (constituted c.43% of FY10 borrowings), non-convertible debentures (40%), fixed deposits and money market borrowings such as commercial paper. BAF has one of the lowest borrowings cost amongst peers, highlighting its ability to raise funds at competitive rates from financial institutions (Exhibit 13). It enjoys credit rating of AA+ from CRISIL and LAA+ from ICRA.

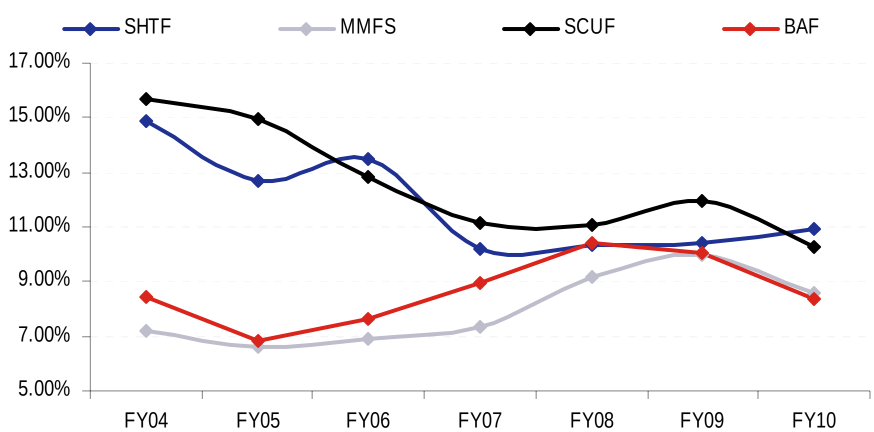
Currently average duration of borrowings is c.18 months while assets have average duration of c.14 months (excluding LAP). Hence, BAF enjoys positive ALM and is adequately geared for rising interest rate environment.

Exhibit 12. BAF: Trend in composition of borrowings

Borrowings – Break-up (₹ mn)	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E	CAGR FY05-10	CAGR FY10-13E
Banks & Others	4,646	7,753	9,940	9,542	8,550	13,800	31,461	42,671	55,310		
Growth (%)	*144%*	*67%*	*28%*	*-4%*	*-10%*	*61%*	*128%*	*36%*	*30%*	*39%*	*59%*
Share (%)	68%	76%	61%	57%	53%	43%	50%	49%	48%		
Fixed Loans	357	184	87	1,319	1,537	26	5,663	7,838	10,371		
Growth (%)	*-17%*	*-48%*	*-53%*	*1420%*	*17%*	*-98%*	*21967%*	*38%*	*32%*	*-38%*	*639%*
Share (%)	5%	2%	1%	8%	10%	0%	9%	9%	9%		
NCD	0	1,000	3,606	2,524	2,628	13,042	14,472	21,771	29,960		
Growth (%)	NA	NA	261%	-30%	4%	396%	11%	50%	38%	NA	32%
Share (%)	0%	10%	22%	15%	16%	40%	23%	25%	26%		
Commercial Paper	1,800	1,250	2,550	3,250	3,400	5,400	11,326	14,804	19,589		
Growth (%)	64%	-31%	104%	27%	5%	59%	110%	31%	32%	30%	54%
Share (%)	26%	12%	16%	20%	21%	17%	18%	17%	17%		
Total	6,803	10,188	16,183	16,635	16,114	32,268	62,922	87,084	115,229		
Growth (%)	98%	50%	59%	3%	-3%	100%	95%	38%	32%	45%	53%

Source: Company, JM Financial.

Exhibit 13. BAF: Trend in borrowings cost vs peers



Source: Company, JM Financial.

Robust 26% CAGR in NII over FY11E-13E despite margin compression

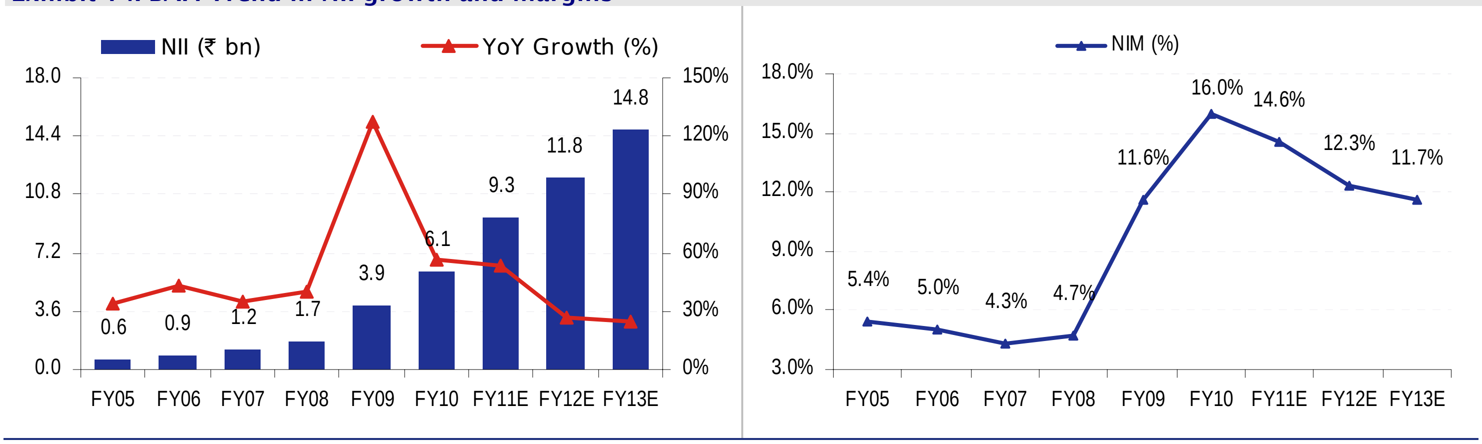
- **Yield to moderate as loan mix changes in favour of secured lending**

  Going forward, we expect yield on advances to moderate as BAF changes the loan mix in favour of secured but lower yielding lending such as construction equipment finance (CEF), infrastructure financing and loan against property (LAP). Further, BAF was a beneficiary of benign interest rate environment in the last 2 years which helped it reduce its cost of borrowings by c.200bps. We expect borrowing cost to go up during FY11-13E. Consequently, we expect change in loan mix and higher borrowing costs to adversely impact margins. We factor-in significant margin decline of c.440bps over FY10-13E

- **Margins to decline by c.440bps over FY10E–13E**

  We expect margins to decline during FY11E–13E due to **a)** moderation in yield on advances due to change in loan mix in favour of lower yielding but secured lending of CEF, LAP and infra finance, **b)** increase in cost of borrowings by c.115bps over FY11E-13E given higher interest rates. Hence, we expect margins to decline by c.440bps over FY10-13E. However, despite factoring in margin pressure, we expect healthy 26% CAGR in NII over FY11-13E.

Exhibit 14. BAF: Trend in NII growth and margins



Source: Company, JM Financial.

Cost ratios to improve by 100 bps over next 2 years

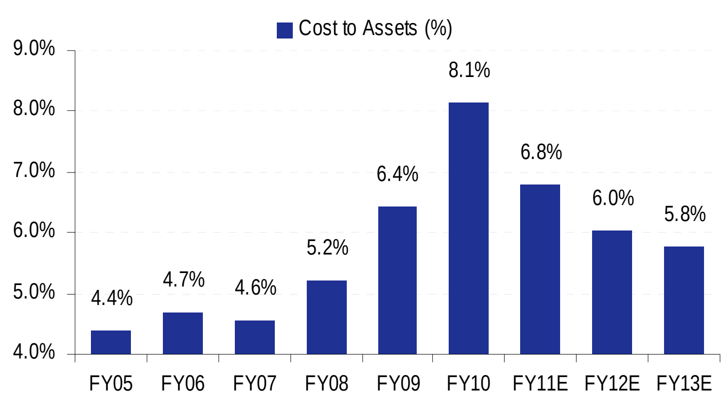
- **Opex remained at elevated levels due to technology upgrade, strengthening of employee base and focus on small ticket costly loans**

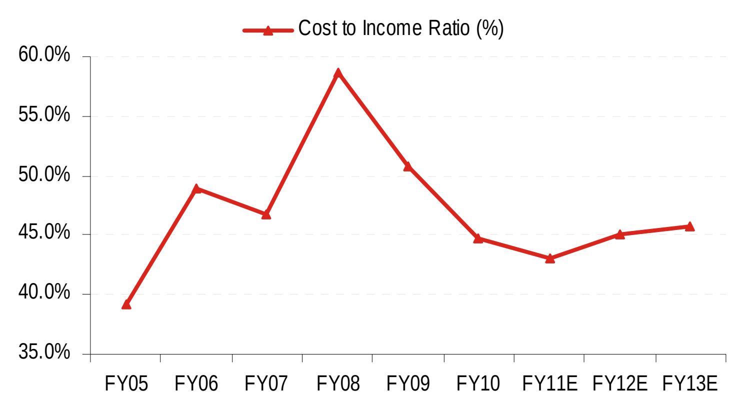
  During FY07-10, operating expenses witnessed 34% CAGR as cost to assets jumped to 8.1% in FY10 from 4.6% in FY07 on **a)** massive investment in technology up-gradation - Company implemented a fully integrated state-of-the-art lending platform to streamline processing, deliver lower unit cost and minimise operational risks, **b)** strengthening of employee and sales force - During FY07-10, company strengthened its sales force by almost doubling its employee base which led to 45% CAGR in employee costs.

- **Operational efficiencies, restructuring of distribution network and higher ticket loans to bring cost to assets down by 100bps over next 2 years**

  We expect cost to assets to decline by 100bps to 5.8% over the next 2 years due **a) benefits of operating efficiencies** - We expect investment made for technology up-gradation and human resource to start yielding benefits as most of the fixed cost investments are done with. **b) Restructuring of distribution network** - The company restructured its distribution network and currently operates through 63 branches vs 113 in FY07. Similarly, cross-selling is gaining prominence and generates c.20% of loan book (small business loans and personal loans) and is very cost effective **c) Focusing on high ticket secured loans** -The company has also changed its strategy and focuses on high ticket secured loans (e.g. CEF, LAP) which reduces business origination and administration cost significantly.

Exhibit 15. BAF: Trend in cost ratios





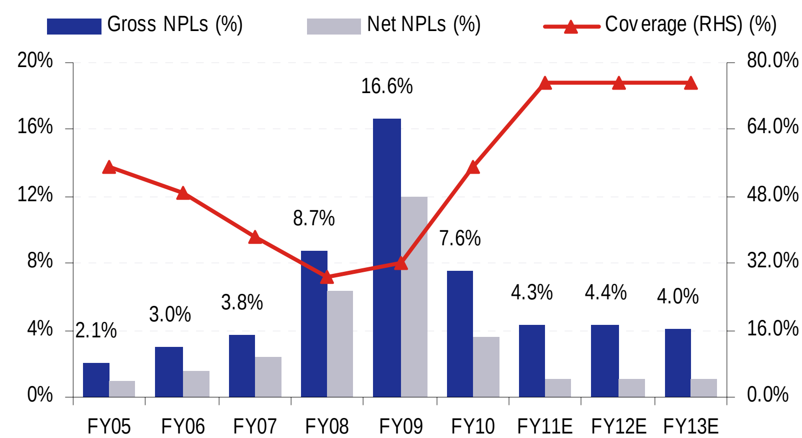
Source: Company, JM Financial.

Credit costs to decline by 135bps over FY11-13E

- **Expect stable asset quality trends over next 2 years**

Given the economic slowdown and concentrated unsecured loan book, BAF faced asset quality issues during FY07-09. Gross NPLs increased from 3.8% in FY07 to 16.6% in FY09 while credit costs increased from 355bps to 815bps during the period. However, since then apart from the change in loan mix towards secured assets, significant improvement in origination and underwriting processes by investing in technology, using information from credit bureau (CIBIL) and creating a dedicated risk analytics unit has enhanced risk management capabilities. Consequently, asset quality improved with gross NPLs down to 3.6% and net NPLs to 1.1% in 3Q11 vs gross and net NPL of 16.6% and 11.9% in FY09. Going ahead, we expect gross NPAs of c.4.1% in FY13E for BAF with net NPA at c.1.1%.

Exhibit 16. BAF: Trend in asset quality and coverage ratio



Source: Company, JM Financial.

- **Credit Costs have peaked in FY10**

Credit costs in our opinion have peaked at c.815bps in FY10 and are expected to decline to 260bps in FY13E (vs 398bps in FY11E) due to:

a) **Shift in portfolio mix towards secured assets:** Given the increasing proportion of secured assets, we expect delinquencies to be lower for BAF which should lead to a decline in credit costs.

b) **Tightening in credit origination by using in-house credit managers at dealerships:** Earlier, business origination for 2 and 3-wheelers was done by dealers themselves which resulted in higher delinquencies. However, now the company has tightened credit origination by deploying in-house credit managers, resulting in improved asset quality.

c) **Use of CIBIL and cross selling:** BAF has made CIBIL check compulsory before loan sanction which is leading to substantial reduction in loan losses. Similarly, it is also emphasising on cross selling where in it targets customers with good repayment history for its two-wheeler/consumer durables loans.

d) **<u>Focus on 'premium' (affluent and HNI) customers:</u>** BAF earlier focused on mass customers in rural and semi urban areas with poor asset quality However, BAF's strategy to focus on 'mass affluent' customers has led to substantial improvement in the credit quality from fresh originations.

e) Improvement in collections and IT Infrastructure.

f) BAF has also tightened its fresh origination norms by making loan-to-value (LTV) ratio more stringent.

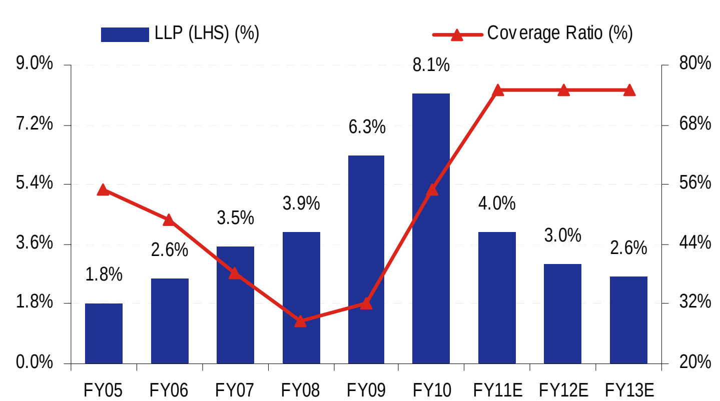
g) BAF has also moved out of loss making dealer locations and high loss-making personal computer business.

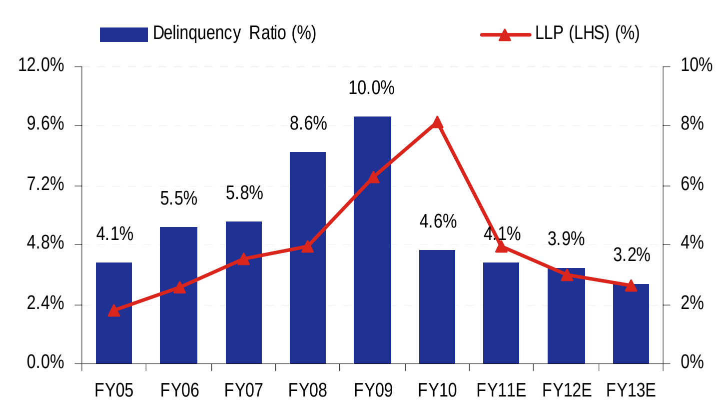
h) Introduction of trailing dealer commission, direct cash collection mechanism and elimination of channel risk should lead to better asset quality.

- **Credit costs to decline by 135bps over FY11-13E, coverage ratio at healthy 77% level:**

Apart from higher delinquencies, credit costs remained at elevated levels during FY08-10 as BAF created provisions to increase its coverage ratio from 28% to 55% during the period. Currently, the coverage ratio is at healthy level of 71%. This coupled with lower delinquencies due to reasons mentioned above should lead to 135bps decline in credit cost for BAF over FY11-13E to c.260bps in FY13E with coverage ratio at 75%.

Exhibit 17. BAF: Trend in LLP, coverage ratio and delinquency (%)





Source: Company, JM Financial.

Highly experienced management team

- **Outside talent, variable pay and ESOPs to spearhead the restructuring process**

  Management team led by Mr. Rajeev Jain is well-supported by highly experienced professionals (**exhibit 18**). Post streamlining of businesses, the company hired business heads from MNCs and private banks with experience of at least ten years in niche consumer lending business. The company also introduced performance linked pay (only fixed pay earlier) and an Employee Stock Option scheme to further lower the turnover rate and foster loyalty. Current management team is responsible for turning the company into diversified asset financier from mere consumer financier earlier. With management bandwidth in place, we believe that BAF is well-positioned to deliver sustainable and profitable growth going ahead.

Exhibit 18. BAF: Management Profile

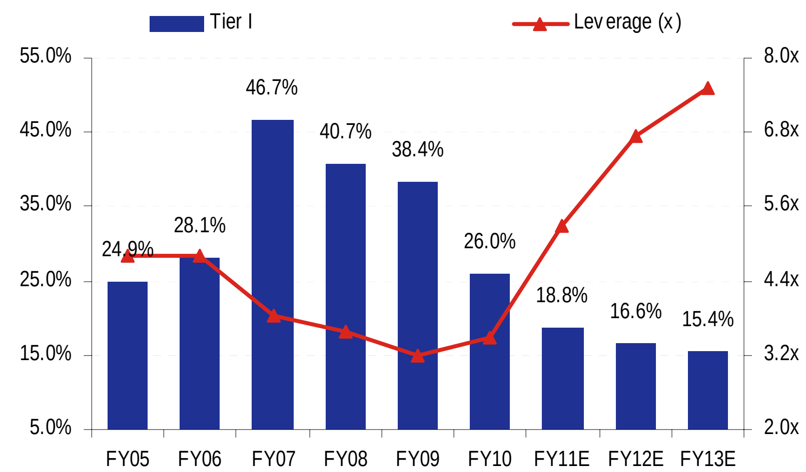
Name	Designation	Profile
Mr. Rajeev Jain	Chief Executive Officer	– Has more than 18 years of experience in auto loans, durable loans, personal loans and credit cards – Earlier he worked for over four years with GE and eight years with American Express respectively and joined the company from AIG, where he was the Deputy CEO of the consumer finance business – Instrumental in transforming BAF from a mere consumer finance business to one of the most diversified NBFCs
Mr. Pankaj Thadani	Chief Financial Officer	– Has experience of 28 years in financing, financial accounting, cost accounting, tax, and systems – His previous assignments were with Bajaj Auto Limited, Eicher and Mico Bosch – Helped the company grow from a single business company to a diversified NBFC
Mr. Rajesh K	Chief Risk Officer	– Over 13 years of experience in risk management domain of consumer and commercial lending – Earlier worked with HSBC, First Leasing (handled commercial asset financing), GE Money (unsecured personal loan, portfolio securitization and auto lease) and Prime Financial (Head of Risk Policy and Analytics
Mr. Amit Gainda	Head - Loan Against Properties	– Joined from GE Money, where he held the position of National Sales Manager - Mortgages – With over 13 years of varied experience, he manages the Loan Against Property business which is a high growth business for the company
Mr. Sanjeev Vij	Head - Construction Equipment Finance	– 19 years of experience in Retail Consumer Finance, SME mid-markets, and Corporate Finance – Will be responsible for profitably setting up and growing Construction Equipment Finance business that would be a highly strategic revenue driver for BAF
Mr. Devang Mody	Head - Sales Finance	– Worked with GE Money, AIG and E&Y on various assignments in Six Sigma, Sales Finance, Cross-Sell, and Personal Loans – Turned around the sales finance business of BAF with substantial gaining of market share

Source: Company, JM Financial.

Could require capital in FY13E to support growth

BAF may require equity capital in FY13E to support growth going forward. We estimate BAF to have tier 1 capital of c.15.4% in FY13E. So far BAF has not utilised tier 2 capital, hence there is an opportunity for BAF to raise tire 2 capital as well and leverage on its capital more effectively. We do not factor-in any dilution in our estimates.

Exhibit 19. BAF: Trend in Tier I and leverage ratio (%)



Source: Company, JM Financial.

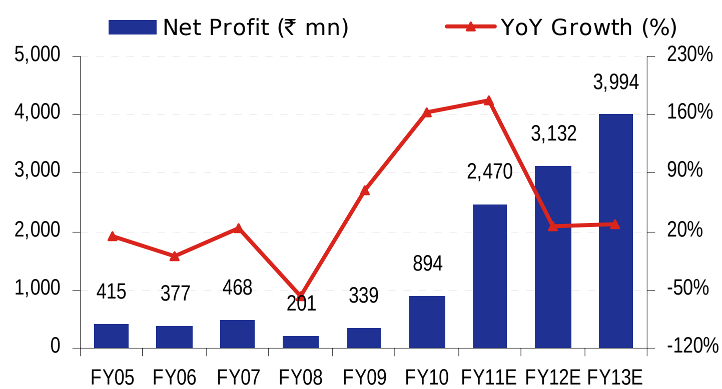
Earnings CAGR of 27% over FY11-13E

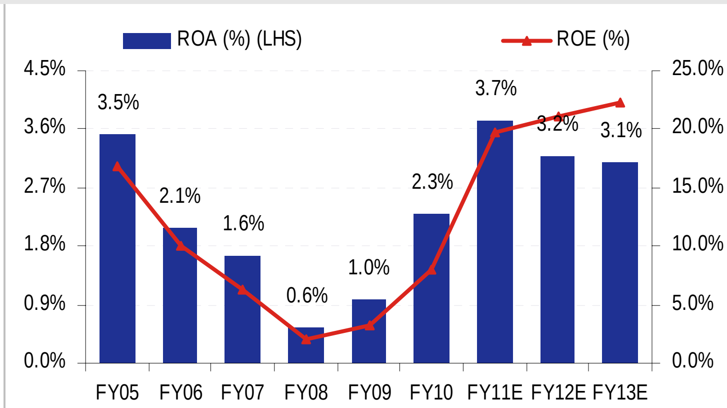
- **Earnings CAGR of c.27% over FY11-13E driven by strong loan growth, lower credit cost and improved operating efficiency**

  We forecast net profit to witness c.27% CAGR over FY11E–13E driven by strong loan growth (32% CAGR over FY11E-13E), lower credit costs (FY13E credit costs of 260bps vs 815bps in FY10) and improvement in operating efficiency (cost to assets to improve by 100bps to 5.8% over FY11E-13E). However, we have factored in margin decline of 300bps over FY11E-13E change in loan mix and increase in borrowing costs.

  Consequently, we expect BAF to report healthy return ratios with ROA and ROE of c.3.1% and c.22% respectively by FY13E.

Exhibit 20. BAF: Trend in return ratios





Source: Company, JM Financial.

Solid business available at compelling valuation

- **Stock is available at 5.7x and 1.2x FY13E earnings and book value**

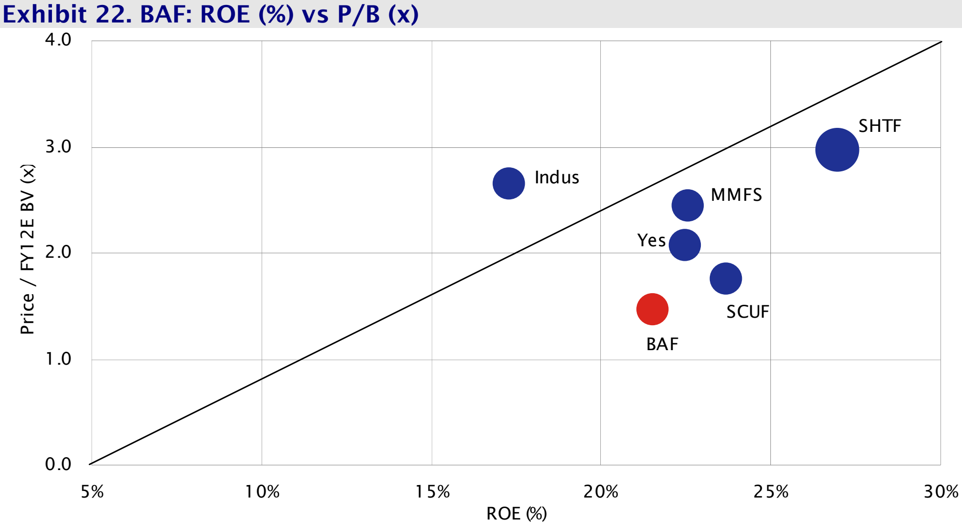
  Bajaj Finance is the cheapest NBFC in consumer finance business space. It is currently trading at a compelling valuation of 5.8x/1.2x based on FY13E earnings and book value respectively which is a discount to its peers. Going ahead, we believe BAF is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk as the company intends to focus on secured business lines, which should lead to significant re-rating of the stock.

Exhibit 21. BAF: Peer valuation comparables

Peer Comparables : Valuation	Book Value		EPS		ROE		P/B		P/E	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
BAF	373	447	67.7	86.2	19.7%	21.0%	1.7	1.4	9.3	7.3
SCUF	238	291	45.7	62.6	21.0%	23.7%	2.1	1.7	11.1	8.1
SHTF	213	263	53.1	64.3	27.7%	27.0%	3.7	3.0	14.7	12.1
MMFS	245	291	45.6	60.6	22.0%	22.6%	2.9	2.4	15.6	11.7
Manappuram Finance	46	58	6.7	11.0	23.3%	21.1%	2.6	2.1	18.0	11.0

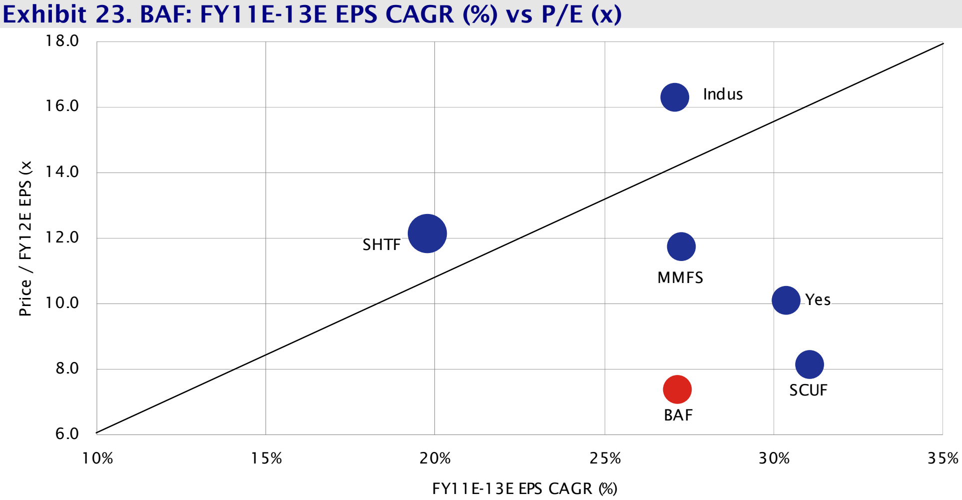
Source: Company, JM Financial.

Exhibit 22. BAF: ROE (%) vs P/B (x)



Source: Company, JM Financial.

Exhibit 23. BAF: FY11E-13E EPS CAGR (%) vs P/E (x)



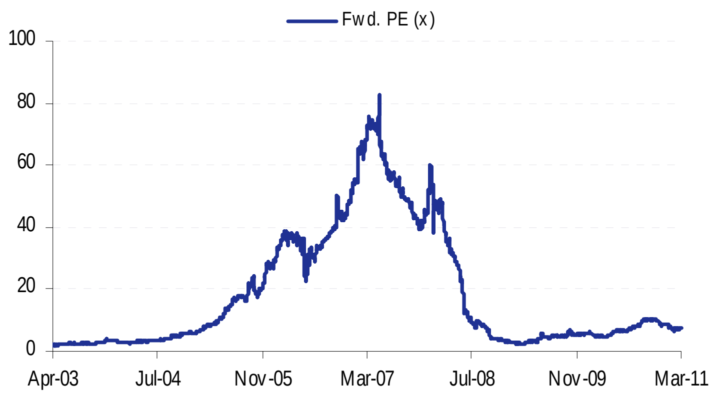
Source: Company, JM Financial.

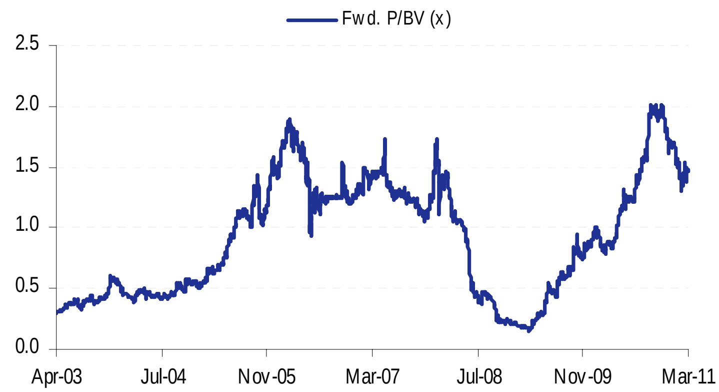
Initiate coverage with BUY and TP of ₹990

- **Initiate coverage with BUY and TP of ₹990**

  We value BAF at 9x Mar'13 EPS (implied P/B of 1.9x), implying Mar'12 target price of ₹990, upside of c.57%.

Exhibit 24. BAF: One-year forward PE (x) and One-year forward P/BV (x)





Source: Bloomberg, Company, JM Financial.

BAF: ROE Tree

- **Healthy return ratios:** We expect BAF to generate healthy ROA of c.3.1% and ROE of c.22.0% by FY13E driven by strong loan growth, lower credit costs and improvement in cost ratios.

Exhibit 25. BAF - Normalised earnings (%)

	FY07	FY08	FY09	FY10	FY11E	FY12E	FY13E
Net Margin (as % of avg. IEA)	**4.27%**	**4.70%**	**11.59%**	**16.02%**	**14.54%**	**12.32%**	**11.63%**
NIM (as % of avg. Assets)	4.24%	4.64%	11.34%	15.53%	14.14%	12.01%	11.35%
Core Non-IR/Asset	5.54%	4.12%	1.29%	2.17%	1.61%	1.35%	1.26%
Core Non-IR/Revenues	**56.7%**	**47.0%**	**10.2%**	**12.3%**	**10.2%**	**10.1%**	**10.0%**
Core Revenue / Assets	**9.78%**	**8.76%**	**12.63%**	**17.70%**	**15.75%**	**13.36%**	**12.61%**
Cost/ Core Income	46.7%	59.7%	51.4%	46.3%	43.0%	45.0%	45.5%
Cost/Assets	**4.57%**	**5.23%**	**6.49%**	**8.20%**	**6.78%**	**6.02%**	**5.74%**
Core operating Profits	**5.21%**	**3.53%**	**6.14%**	**9.50%**	**8.98%**	**7.35%**	**6.87%**
LLP/Loans	**3.55%**	**3.94%**	**6.29%**	**8.15%**	**3.98%**	**3.01%**	**2.62%**
Loans/Assets	79.1%	74.9%	75.9%	81.6%	84.6%	85.2%	85.2%
Profits/Provisions on Sect.	-0.05%	-0.24%	-0.06%	-0.53%	-0.02%	-0.02%	-0.01%
Pre-Tax	2.46%	0.81%	1.43%	3.39%	5.63%	4.80%	4.65%
Effective Tax Rate	33.9%	32.9%	33.5%	33.4%	33.5%	33.5%	33.5%
ROA	**1.63%**	**0.54%**	**0.95%**	**2.25%**	**3.74%**	**3.19%**	**3.09%**
Equity / Assets	25.97%	27.94%	31.36%	28.59%	19.01%	15.17%	13.86%
RoE	**6.3%**	**2.0%**	**3.0%**	**7.9%**	**19.7%**	**21.0%**	**22.3%**

Source: Company, JM Financial

Key risks

- **Significant economic slowdown:** Significant economic slowdown is a key risk and could lead to slower growth and impact BAF's earnings adversely. Further, it may result in deterioration in asset quality and could adversely affect the company's profitability.

- **Spike in interest rates:** Being a wholesale funded institution, any sustained liquidity shock could impact spreads adversely and affect profitability.

- **Higher than expected credit costs:** Although we have been conservative in our credit cost assumptions, higher than expected delinquencies due unseasoned loan book (construction equipment, LAP and infra finance) remain a risk to our estimates.

- **Significant increase in competitive intensity:** Any significant increase in competition in the 2/3-wheeler and consumer durable space could impact BAF adversely.

Company background

Bajaj Finance Ltd was promoted by erstwhile Bajaj Auto Limited and Bajaj Auto Holdings Limited. Bajaj Auto Limited is a manufacturer of two and three-wheelers and Bajaj Auto Holdings Limited is an investment company that is a wholly owned subsidiary company of Bajaj Holdings & Investment Limited. As per the Scheme of Demerger of erstwhile Bajaj Auto Limited, the shareholding of Bajaj Auto Limited in BAF has now been vested with Bajaj FinServ Limited. Bajaj Finance is engaged primarily in the business of financing of two-wheelers, consumer durables, personal loans, small business loans, mortgages, and loan against securities. It recently also ventured into construction equipment and infrastructure finance and intends to build the scale gradually. It operates through a network of c.2,500 Bajaj auto and consumer durable dealerships and 63 branch offices.

Timeline of equity dilution

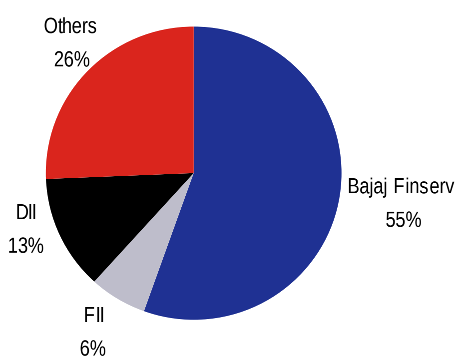
Exhibit 26. BAF: Timeline of capital/equity dilution

Year of Issue	No. of Shares Issued (in mn)	Mode	Price per share	Amount raised ₹. Mn	Issue as % of O/s shares	Investor
Jan 2006	1.0	Preferential Allotment	410.0	411.3	6.1%	Promoters
Jan 2006	3.5	Preferential Allotment	450.0	1,575.0	21.2%	Foreign Investors
Feb 2007	12.6	Rights Issue of 6:10	325.0	4,093.7	60.0%	Shareholders
Mar 2007	1.8	Conversion of Preferential Warrants	410.0	721.0	5.2%	Promoters
July 2007	1.2	Conversion of Preferential Warrants	410.0	511.7	3.5%	Promoters

Source: Bloomberg, Company, JM Financial.

Shareholding Pattern

Exhibit 27. BAF: 3Q11 Shareholding pattern



Source: Company, JM Financial.

Financial Tables (Standalone)

Profit & Loss (₹ mn)

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Net Interest Income (NII)	**3,890**	**6,087**	**9,360**	**11,870**	**14,820**
Non-Interest Income	**458**	**1,046**	**1,077**	**1,352**	**1,660**
Total Income	**4,348**	**7,133**	**10,437**	**13,222**	**16,480**
Operating Expenses	2,204	3,192	4,485	5,946	7,495
Pre-provisioning Profits	**2,144**	**3,942**	**5,952**	**7,276**	**8,985**
Loan Loss Provisions	1,636	2,606	2,228	2,533	2,913
Other Provisions	-2	-7	0	0	0
Total Provisions	**1,634**	**2,599**	**2,228**	**2,533**	**2,913**
PBT	**510**	**1,343**	**3,724**	**4,743**	**6,072**
Tax	171	449	1,247	1,589	2,034
PAT (Pre-Extra ordinaries)	**339**	**894**	**2,476**	**3,154**	**4,038**
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	**339**	**894**	**2,476**	**3,154**	**4,038**

Source: Company, JM Financial

Balance Sheet (₹ mn)

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Equity Capital	366	366	366	366	366
Reserves and Surplus	10,521	11,159	13,270	15,985	19,474
Warrant Application Money	0	0	0	0	0
Share holders equity	**10,887**	**11,525**	**13,636**	**16,351**	**19,840**
Preference Share Capital	0	0	0	0	0
Stock Option O/s	0	0	0	0	0
Borrowed Funds	16,114	32,268	62,922	87,084	115,229
Deferred tax liabilities	0	0	0	0	0
Current Liabilities	3,162	4,433	7,572	10,105	12,547
Total Liabilities	**30,164**	**48,226**	**84,129**	**113,539**	**147,616**
Loans & Advances	23,704	40,258	71,659	96,740	125,762
Investments	2,739	3,018	4,765	6,433	8,489
Loans & Advances - CA	2,370	3,281	5,088	6,965	9,118
Cash & Bank Balances	418	225	430	580	755
Other Current Assets - CA	224	247	309	400	494
Fixed Assets	202	505	796	1,017	1,249
Misc. expenditure	0	0	0	0	0
Deferred Tax Asset	506	692	1,081	1,403	1,750
Total Assets	**30,164**	**48,226**	**84,129**	**113,539**	**147,616**

Source: Company, JM Financial

Key ratios (%)

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Borrowed Funds	-3.1%	100.2%	95.0%	38.4%	32.3%
Advances	-16.4%	69.8%	78.0%	35.0%	30.0%
Total Assets	-21.6%	59.9%	74.4%	35.0%	30.0%
NII	127.0%	56.5%	53.8%	26.8%	24.9%
Non-Interest Income	-71.0%	128.4%	2.9%	25.5%	22.7%
Operating Expenses	14.1%	44.8%	40.5%	32.6%	26.1%
Operating Profits	57.4%	83.8%	51.0%	22.3%	23.5%
Core Operating Profits	60.0%	77.6%	60.5%	22.2%	23.5%
Provisions	53.8%	59.1%	-14.3%	13.7%	15.0%
Reported PAT	64.8%	163.6%	177.0%	27.4%	28.0%
Yields / Margins (%)					
Interest Spread (%)	6.45%	12.98%	12.42%	10.29%	9.72%
NIM (%)	11.59%	16.02%	14.54%	12.32%	11.63%
Profitability (%)					
ROA (%)	0.99%	2.28%	3.74%	3.19%	3.09%
ROE (%)	3.2%	8.0%	19.7%	21.0%	22.3%
Cost to Income (%)	50.7%	44.7%	43.0%	45.0%	45.5%
Assets Quality (%)					
Gross NPAs (%)	16.63%	7.58%	4.30%	4.36%	4.04%
Specific LLP (%)	6.29%	7.38%	3.98%	2.93%	2.55%
Capital Adequacy (%)					
Tier I (%)	38.41%	26.00%	19.14%	17.17%	16.16%
CAR (%)	39.37%	26.00%	19.14%	17.17%	16.16%

Source: Company, JM Financial

DuPont Analysis (%)

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
NII / Assets (%)	11.34%	15.53%	14.14%	12.01%	11.35%
Other income / Assets (%)	1.34%	2.67%	1.63%	1.37%	1.27%
Total Income / Assets (%)	12.67%	18.20%	15.77%	13.38%	12.62%
Cost to Assets (%)	6.42%	8.14%	6.78%	6.02%	5.74%
PPP / Assets (%)	6.25%	10.06%	8.99%	7.36%	6.88%
Provisions / Assets (%)	4.76%	6.63%	3.37%	2.56%	2.23%
PBT / Assets (%)	1.49%	3.43%	5.63%	4.80%	4.65%
Tax Rate (%)	33.55%	33.43%	33.50%	33.50%	33.50%
ROA (%)	0.99%	2.28%	3.74%	3.19%	3.09%
Leverage (%)	3.2	3.5	5.3	6.6	7.2
ROE (%)	3.15%	7.98%	19.68%	21.04%	22.31%

Source: Company, JM Financial

Valuations

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Shares in issue (mn)	36.6	36.6	36.6	36.6	36.6
EPS (₹.)	9.3	24.4	67.7	86.2	110.3
EPS (YoY) (%)	64.8%	163.6%	177.0%	27.4%	28.0%
PE (x)	68.2	25.9	9.3	7.3	5.7
BV (₹)	297	315	373	447	542
BV (YoY) (%)	2%	6%	18%	20%	21%
P/BV (x)	2.12	2.01	1.70	1.41	1.17
DPS (₹)	2.3	7.0	10.0	12.0	15.0
Div. yield (%)	0.4%	1.1%	1.6%	1.9%	2.4%

Source: Company, JM Financial

JM Financial Institutional Securities Private Limited

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