



Bajaj Finance

Carving its own path...

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Bajaj Finance Ltd

Rs 1,116

KRChoksey INSTITUTIONAL

Carving its own path....

BUY

We initiate Bajaj Finance with BUY rating and target price of Rs1314 (potential upside 17.8%). Unique business model, comprehensive product range, higher than industry growth outlook, decline in wholesale rates and sustainable return ratio are key investment arguments for the stock in our view. Higher-than-expected credit losses and tight liquidity condition are key risks to our recommendation.

Unique Business model in NBFC sector: Bajaj finance has successfully transformed from captive two / three wheelers finance company to a well diversified non banking finance company. We do believe diversification of product portfolio also de-risks earning's profile, as weakness in a particular business segment can be absorbed by other faster growing segments.

Strategy 2.0 to build scale with profitability: Bajaj Finance has formed differentiated 2.0 product line strategy which focuses on two levers – profit maximisers and scale builders. We believe strategy 2.0 create superior risk return trade off at aggregate portfolio level coupled with building scale through high ticket product & customer segments. Overall risk adjusted approach for building stronger balance sheet and in turn sustain superior return ratios are key qualitative differentiators in medium to long term for Bajaj Finance.

Loan book growth continues to outpace the banking & NBFC sector over FY12-15: Bajaj Finance witnessed strong growth in Loan book post the new management team induction and renewed strategic focus in lending business. The loan book grew 69.1% CAGR over FY09-FY12 significantly outpacing the banking sector (19.3% CAGR over FY09-FY12) and NBFC aggregates (39.3% CAGR over FY09-FY12). Loan book to grow 36.3% CAGR over FY12-FY15 supported by consumer finance & small business segments, continues to outpace banking & NBFC sector in our view.

Outlook & Recommendation: We believe unique business model, strategic focus on high growth business segments, continuous product development & innovative customer service and risk adjusted approach for product pricing are key value drivers for the stock. We expect Bajaj Finance continues to outpace industry growth and sustain superior return ratio for next three years. We expect Bajaj Finance to deliver 32.9% CAGR in net earnings over FY12-FY15 driven by 36.3% CAGR in loan book. We believe Bajaj Finance continue to deliver 3% plus RoA and 20% plus RoE on sustainable basis in medium term.

At Rs1,116 the stock trades 1.4x FY14 price to book and 7.3x FY14 earnings, further scope to re-rate on strong earning visibility and sustainable return ratio. We initiate Bajaj Finance with BUY rating and target price of Rs1,314 (potential upside 17.8%) with 12 month investment objective.

Key Financials

Rs in crore	FY11	FY12	FY13E	FY14E	FY15E
Net Interest Income	895	1230	1771	2486	3148
Pre-provisioning profit	574	757	1134	1600	2068
Net Profit	247	406	573	770	954
EPS	67.4	98	114	154	190
BVPS	370.8	492.2	666.2	801.0	970.2
RoA	3.7%	3.8%	3.6%	3.4%	3.3%
RoE	19.7%	24.0%	21.3%	20.9%	21.5%
P/E	16.6	11.3	9.8	7.3	5.9
P/BV	3.0	2.3	1.7	1.4	1.2

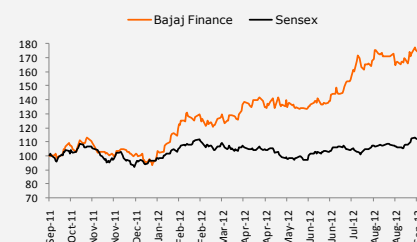
Source: Company, KRChoksey Research

Target Price (Rs): 1,314

Potential Upside : 17.8%

Market Data	
Shares outs (Cr)	4.13
Mkt Cap (Rs. Cr)	4,636
52 Wk H/L (Rs)	1147/585
Avg Vol (3m avg)	19530
Free float (%)	38.9
Face Value (Rs)	10
Bloomberg Code	BAF IN

Price performance:



Market Info:

SENSEX	18673
NIFTY	5669

Share Holding pattern (%)

Particulars	Jun-12	Mar-12	Chg %
Promoters	61.0	61.0	0.0
FIIs	5.5	4.9	0.6
Institutions	12.1	12.0	0.1
Others	21.3	22.0	-0.7
Total	100.0	100.0	

Source: BSE

Investment arguments

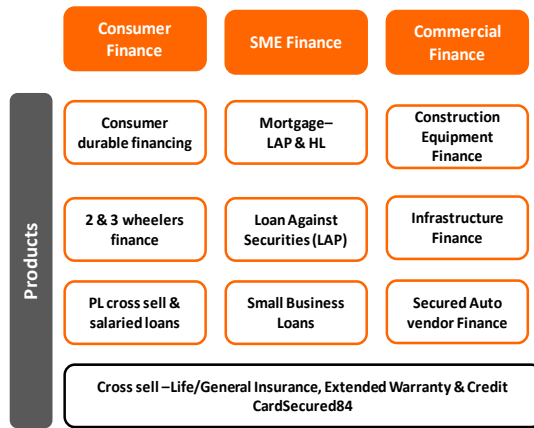
Unique Business model in NBFC sector: Bajaj finance has successfully transformed from a captive two / three wheelers finance company to a well diversified non banking finance company. The company has been continuously expanding product portfolio with superior product value proposition along with improving customer service levels. On strategic standpoint, the company has three key business segments focusing on consumer business, SME business loans & commercial finance business.

"BFL offers a bouquet of nine products under three business segments; as it effectively leverages its large customer base to cross sell various products to generate higher growth by gaining market share in certain sectors."

BFL offers a bouquet of nine products under three business segments; as it effectively leverages its large customer base to cross sell various products to generate higher growth by gaining market share in certain sectors.

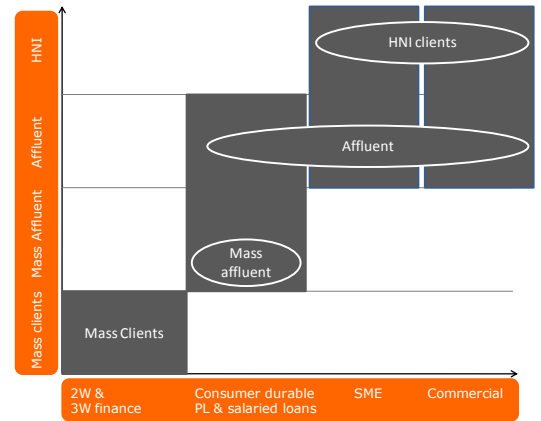
We believe Bajaj finance’s unique business model marks competitive edge over other NBFCs on two counts – firstly the company focuses on nine key products for business growth compared to single product focus in other NBFCs such as CV finance, gold finance, car finance, home finance or infrastructure finance and secondly the company has stronger customer focus on HNI & ultra HNI segments by offering innovative products & superior customer experience. We do believe diversification of product portfolio also de-risks earning’s profile as weakness in a particular business segment can be absorbed by other faster growing segments.

Exhibit 1: BFL’s Key Business segments & Products



Source: Company, KRChoksey Research

Exhibit 2: Customer segment & Targeted products



"We do believe diversification of product portfolio also de-risks earning’s profile due to weakness in a particular business segment can be absorbed by other faster growing segments"

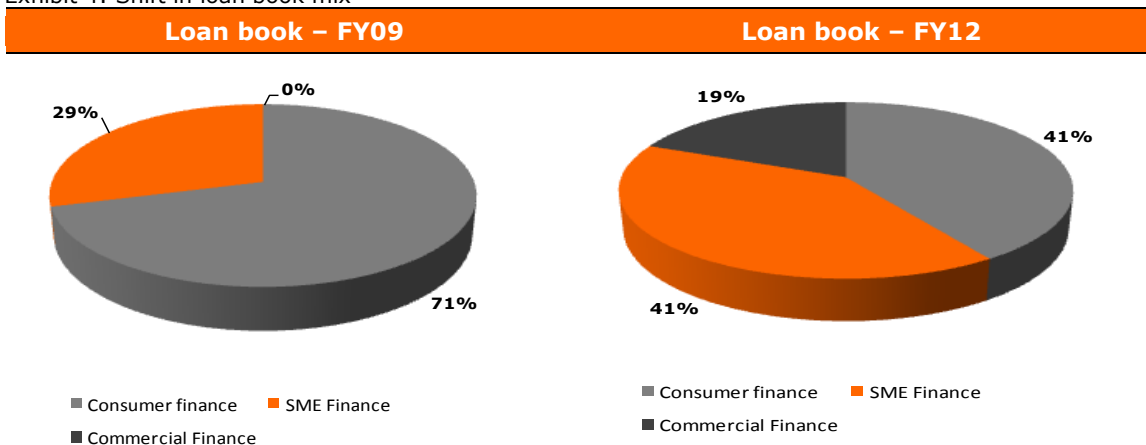
Exhibit 3: Business model & Product portfolio comparison

	Shriram Transport	M&M Finance	Muthoot Finance	Bajaj Finance
Business model play	Business trade and industrial activity	Agri sector & rural economy	Domain expertise, superior secured loan products & services to low income non banking habit group	Potent mix of urban & semi urban, rural market and small businesses' funding
Key Businesses	CV finance – Old & New	Vehicle finance/ car finance/ rural housing finance/ Insurance broking	Loans against household gold jewellery to low income group	Consumer finance SME finance Commercial Finance
Single Product & services Vs Multi Product & Services	Single product with stronger focus on old CV finance segments	Vehicle finance, pre owned vehicle finance, insurance broking, rural housing finance and MF distribution	Single product with distribution of financial products	Largest product portfolio catering to consumer, SME & commercial finance segments

"BFL focuses on nine key products for business growth compared to single product focus in other NBFCs such as CV finance, gold finance, car finance, home finance or infrastructure finance"

Source: KRChoksey Research

Exhibit 4: Shift in loan book mix



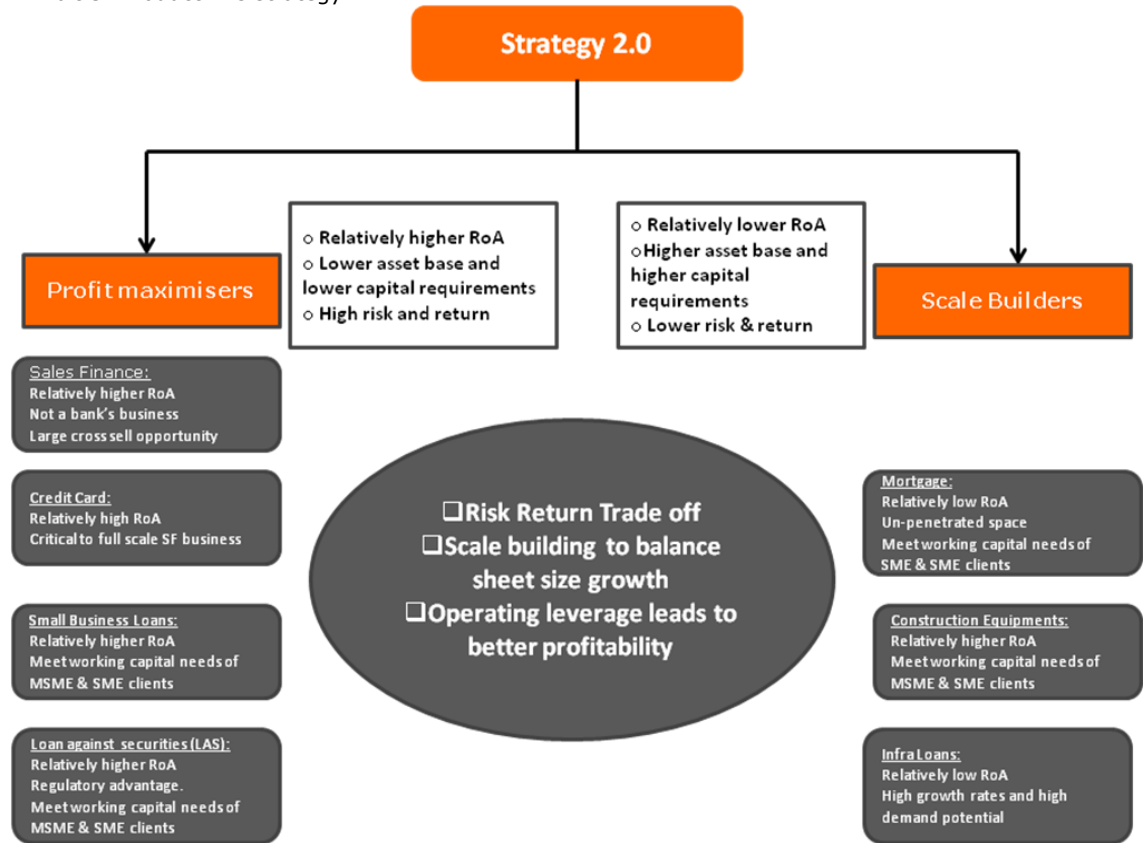
Source: Company, KRChoksey Research

Strategy 2.0 to build scale with profitability: Bajaj Finance has formed differentiated 2.0 product line strategy which focuses on two levers – profit maximisers and scale builders. The management is very clear in their thought process that car loans, gold & micro finance and commercial vehicle finance are non qualifier due to captive play, customer segmentation differential and specialized business respectively on strategic perspective.

"Bajaj Finance has formed differentiated 2.0 product line strategy which focuses on two levers – profit maximisers and scale builders"

We believe strategy 2.0 will create superior risk return trade off at aggregate portfolio level coupled with building scale through high ticket product & customer segments. Overall risk adjusted approach for building a stronger balance sheet and in turn sustain superior return ratios are key qualitative differentiators in medium to long term for Bajaj Finance. We also believe unique business model with differentiated product strategy should result into higher-than-industry business growth in relatively weaker macro & business environment.

Exhibit 5: Product line strategy



Source: Company, KRChoksey Research

Product innovation & improving customer service experience- Key competitive advantages:

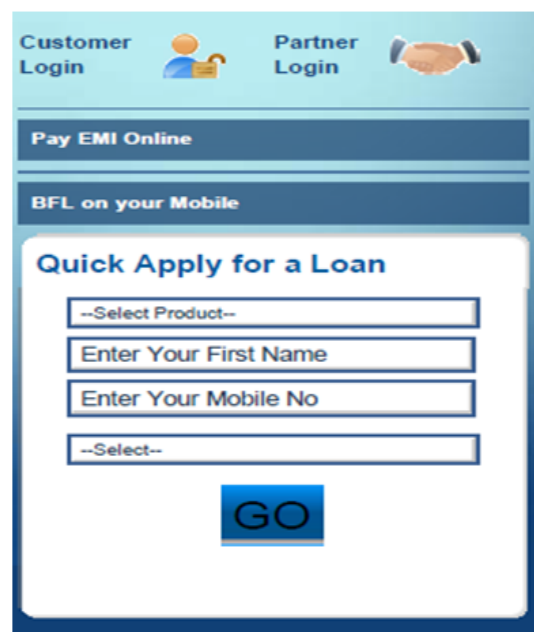
Bajaj Finance has demonstrated strong product innovation & development capabilities and expanding customer interface channels in last few years. The company has added many products and innovated different customer service channels to fulfill customer requirements. In order to maintain competitive positioning in consumer finance & small business loan segments, we believe superior product value proposition to customer and fast loan processing will play a critical role to deepen business potential with customers and accelerate customer acquisition.

BFL continued to focus on innovation of new products like the EMI card (existing member identification card) and the digital loan approval mechanism. The company maintains superior customer experience as its top priority. Services like the "Digital Grid" enhances the customer experience with faster loan processing over the web without any human interaction to fulfill all of the loan requirements in just over few clicks.

We believe aggressive product innovation and focus on superior customer service would enable the company to gain market share and augur well for the business to grow above the industry average.

"We believe aggressive product innovation and focus on superior customer service would enable the company to gain market share and augur well for the business to grow above the industry average"

Year	Product Launch
2007-08	Historical Business model 3 day TAT No cross sell
2008-09	100% POC link up 3 Min - TAT Started PL cross sell to existing customer Launched PLBL & Mortgages in 16 cities Unique sales & collect model
2009-10	Launched POS insurance cross sell Launched "no insurance no loan" Launched cutting edge underwriting platform
2010-11	Launched 3 Sec TAT Launched post sell insurance cross sell Expanded to 23 cities Portfolio seasoning for PLBL and mortgages Launched CE and home loan Launched partnership model
2011-12	Launch EMI card - 3 second TAT Launch cobranded credit card. Launch SBS cross sell to cross collateralize portfolios and Deepen wallet size
2012-13	Life style loan products



Consumer Finance – Competitive advantages

Data Mart and Cross sell capabilities
Customer Lifecycle Management
Low ticket - high volume transaction domain specialization

Small Business – Competitive advantages

Relationship model- Sales & Collect
Premium customer experience model
Cross sell to Small Business segment

Source: Company, KRChoksey Research

Superior return ratio to sustain in medium term: Bajaj Finance has shown marked improvement in return on asset ratio in last three years. Increase in asset utilization and falling credit costs were primary drivers for improvement in return ratio. Currently, loan book is witnessing lower-than-budgeted credit losses which result into supernormal return on asset ratio. We expect cost to income / cost to asset ratio to improve from 47%/ 6.2% in FY12 to 41% / 5.0% in FY15, driving profitability. Net interest income as % of average assets would see marginal decline from 11.5% to 10.9% due to higher growth in relatively lower yield loan book segments. We believe credit losses would revert to normalized levels in medium term which in turn will shave off supernormal ROAs. We also expect return on asset to normalize to 3.3% in FY15 from 3.8% in FY12 mainly due to uptick in credit losses. Overall, we believe Bajaj finance will sustain return on assets and return on equity above 3% & 20% in medium term.

"Overall, we believe Bajaj finance will sustain return on assets and return on equity above 3% & 20% in medium term"

"We also expect return on asset to normalize to 3.3% in FY15 from 3.8% in FY12"

"We believe recent decline in wholesale rates will result into better NIMs and begin operating environment for NBFCs and in turn re-rate valuation multiple of wholesale funded entities"

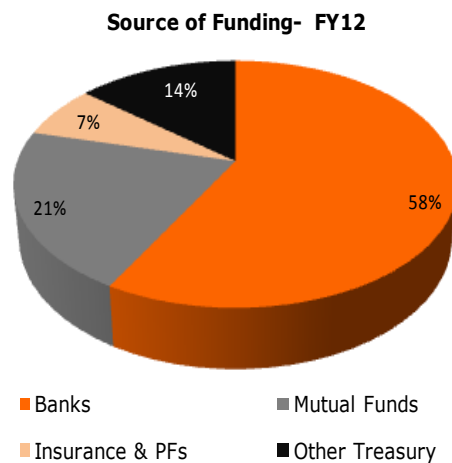
Exhibit 8: DuPont analysis

(As % avg assets)	FY10	FY11	FY12	FY13E	FY14E	FY15E
Net interest income	15.5%	13.4%	11.5%	11.1%	11.1%	10.9%
Non interest income	2.7%	2.1%	1.8%	1.6%	1.4%	1.3%
Operating revenues	18.2%	15.5%	13.3%	12.7%	12.5%	12.2%
Operating expenses	8.2%	6.9%	6.2%	5.6%	5.3%	5.0%
Pre-provision profits	10.1%	8.6%	7.1%	7.1%	7.2%	7.2%
Provisions	6.6%	3.1%	1.4%	1.8%	2.1%	2.3%
Profit before tax	3.4%	5.5%	5.6%	5.3%	5.1%	4.9%
Tax expense	1.1%	1.8%	1.8%	1.7%	1.7%	1.6%
Net profits	2.3%	3.7%	3.8%	3.6%	3.4%	3.3%

Source: Company, KRChoksey Research

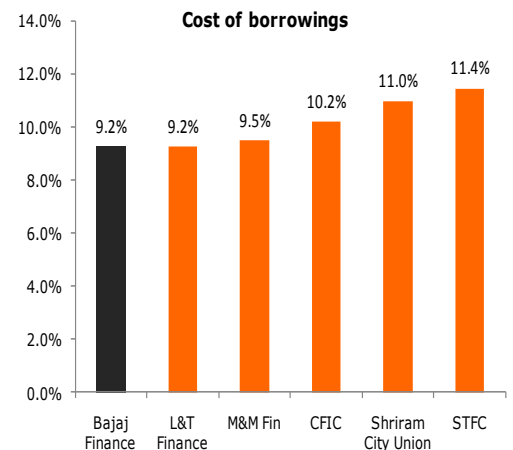
Diversified borrowing profile: Over the years, Bajaj Finance has strengthened borrowing profile through diversification of sources. In terms of cost of borrowings, Bajaj Finance borrows funds at competitive rates which help them to price loan products attractively in the market place. We believe diversified borrowing profile coupled with competitively borrowing play critical role for NBFC to sustain profitability in medium to long term. We expect Bajaj finance continues to enjoy diversified borrowing profile on the back group advantage and unique business model on NBFC platform. We believe recent decline in wholesale rates (over 100 bps in last three months) will result into better NIMs and begin operating environment for NBFCs and in turn re-rate valuation multiple of wholesale funded entities.

Exhibit 9: Borrowing Profile



Source: Company, KRChoksey Research

Exhibit 10: Cost of borrowings – Peer Group



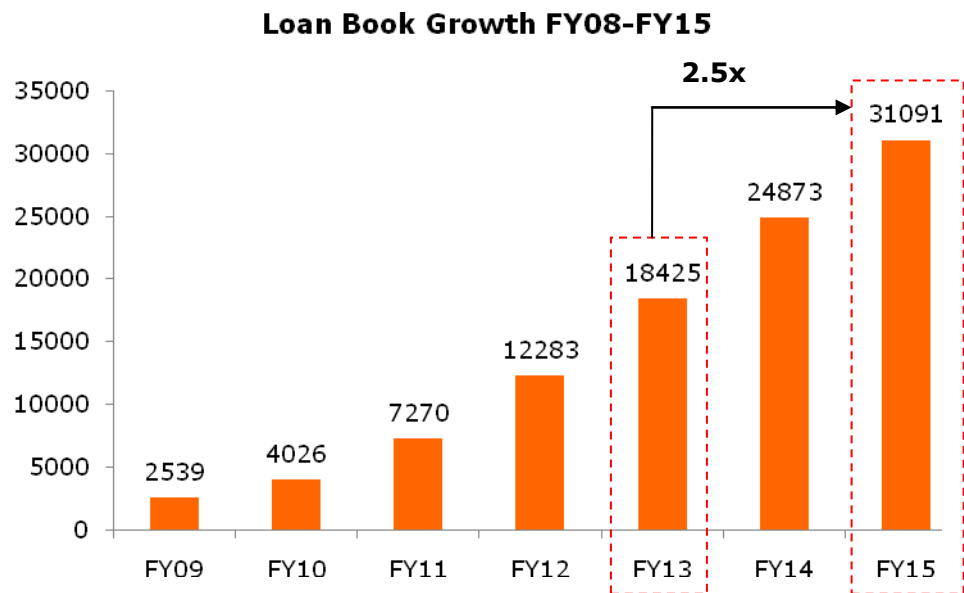
"Loan book to grow 36.3% CAGR over FY12-FY15 supported by consumer finance & small business segments, continues to outpace banking & NBFC sector in our view"

Loan book growth continues to outpace the banking & NBFC sector over FY12-15:

Bajaj Finance witnessed strong growth in Loan book post the new management team induction and renewed strategic focus in lending business. The loan book grew 69.1% CAGR over FY09-FY12 significantly outpacing the banking sector (19.3% CAGR over FY09-FY12) and NBFC aggregates (39.3% CAGR over FY09-FY12). Exponential growth in loan book was well supported by expanding product portfolio, deepening existing customer relationships and increased cross selling capabilities across business segments. Moreover, loan book mix has also seen significant change from FY09-FY12. Consumer finance mix declined from 71% in FY09 to 41% in FY12. Currently, consumer finance, small business finance and commercial finance contribute 39.1%, 44.6% and 16.3% respectively by end of Q1FY13. The management expects medium to long term perspective loan book mix would broadly be in line with current mix subject to intermediate adjustment to prevailing operating environment for particular business segment. We believe loan book growth would be driven by high growth in consumer durable financing and deepening existing corporate / vendor relationships for expanding small business loans and vendor finance segments. However, with increased macro risk in infrastructure and construction equipment finance, the company has taken cautious stance for growth in these segments.

Loan book to grow 36.3% CAGR over FY12-FY15 supported by consumer finance & small business segments, continues to outpace banking & NBFC sector in our view.

Exhibit 11: Loan book size growing strongly



Source: Company, KRChoksey Research

"We believe credit costs will see upward trend reflecting normalization of portfolio behavior and seasoning of loan book especially in mortgage loans, small business loans and consumer finance loans"

"We believe moderation in consumption, with deterioration in rural economy and sluggishness in working capital cycle of small businesses would affect negatively growth trajectory of Bajaj Finance."

Investments risks

- **Credit costs higher-than-expected:** Bajaj has delivered superior performance for containing credit losses below the normalized levels in last few quarters. Currently the company is witnessing ~ 60-70bps saving in credit costs from the budgeted level and in turn delivering supernormal RoAs. Credit costs have declined from 6.5% in FY09 to 1.4% in FY12. We believe credit costs will see upward trend reflecting normalization of portfolio behavior and seasoning of loan book especially in mortgage loans, small business loans and consumer finance loans. We are building higher credit costs 1.7%, 2.0% and 2.3% in FY13, FY14 and FY15 respectively factoring uptick overall NPAs and credit losses.

Exhibit 12: Gross NPAs, Net NPAs and coverage trend

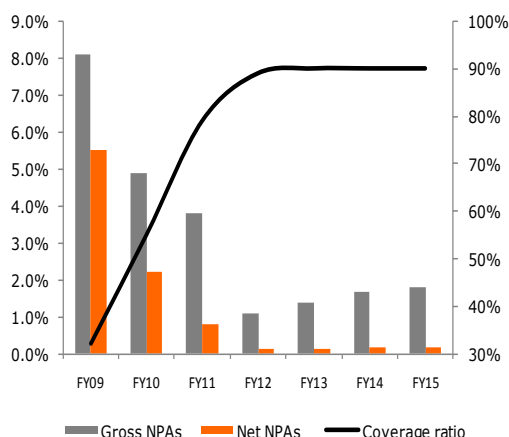
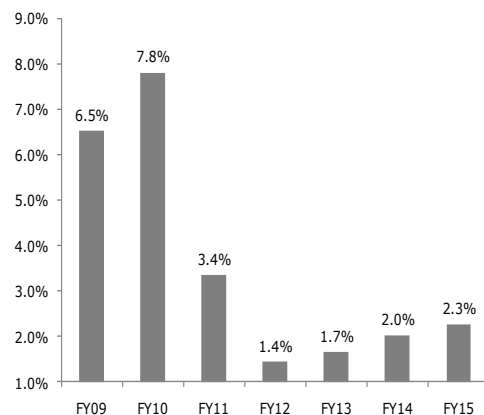


Exhibit 13: Credit costs are likely to see upturn



Source: Company, KRChoksey Research

- **Demand may slowdown due to moderation in consumption:** Business growth of Bajaj finance is driven by consumption growth trend, rural economy growth and operating environment for small business and vendors. We believe moderation in consumption, with deterioration in rural economy and sluggishness in working capital cycle of small businesses would affect negatively growth trajectory of Bajaj Finance.
- **Near-term RoE compression:** Bajaj finance has been growing faster than the industry in last two years. In order to support high balance sheet growth, Bajaj Finance is required to raise equity capital to maintain healthy capital adequacy ratio. According to the management, Bajaj Finance is seeking Rs750 crore of equity capital to balance sheet growth by 2015 and to maintain healthy capital adequacy ratio. We expect current equity capital raising plan would compress RoE in FY14 by 391bps.

Exhibit 14: Impact analysis of Rs750 crore equity raising on RoEs

	Capital Rising		Without capital raising		Impact
	FY13E	FY14E	FY13E	FY14E	
EPS	114	154	129	169	-9.1%
BVPS	666	801	605	755	6.1%
ROE	21.3%	20.9%	23.8%	24.8%	-391bps
Tier I	16.8%	15.1%	13.0%	12.1%	299bps

Source: KRChoksey Research

Financial analysis

AUM has grown 52% CAGR over the last five years

Bajaj Finance achieved a 52% CAGR in AUM over the last five years. The management’s renewed focus on the SME finance business helped the company show higher-than-industry growth. While the SME finance saw a 111% CAGR in the AUM over FY08-12, the company also saw opportunistic business in commercial lending space witnessing a 318% CAGR over the last three years. BFL has seen dramatic shift from concentrated consumer mix to diversified AUM in the last five years.

Exhibit 15: Assets under management trend

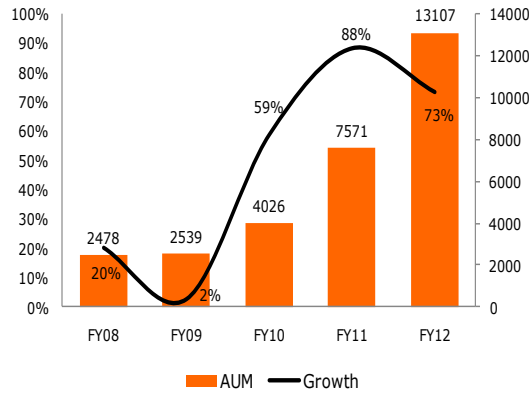
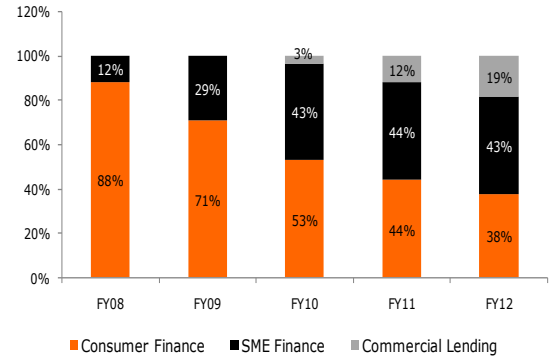


Exhibit 16: Shift in AUM mix



Source: Company, KRChoksey Research

Shift in Loan Book Mix

Bajaj Finance’s ability to model the core-satellite approach has led the loan book to grow at 75% CAGR in the last 2 years, where the core business verticals are used to achieve stability & satellite is viewed to target niche segments for an upside kicker. As BFL focused to grow the core business (Consumer Finance + Mortgages) at 66% CAGR over FY10-12, the company also participated in opportunistic businesses (Commercial Lending + Business Loans + LAS) which saw a 150% CAGR over FY10-12. We believe this model only adds to our confidence in BFL’s ability to sustain over the economic slowdown.

Exhibit 17: Loan book Rs4,026 FY10 - by Products

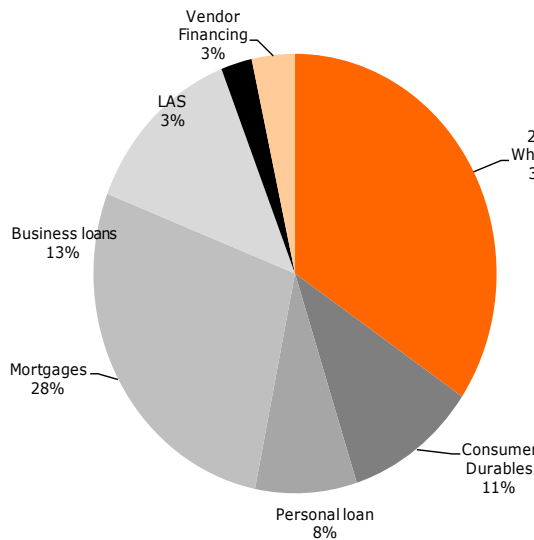
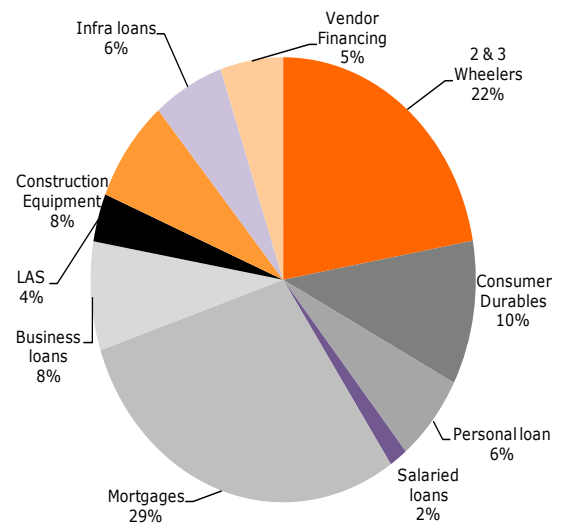


Exhibit 18: Loan book Rs12,283 FY12 - by Products



Source: Company, KRChoksey Research

"Marked improvement in asset quality supported by asset mix"

Marked improvement in asset quality supported by asset mix

Bajaj Finance’s proposition of aggressive loan growth without compromising the risk profile is clearly visible with 85% of the book being secured. BFL has seen a marked improvement in the asset quality over the years largely attributable to the loan book mix and risk adjusted pricing approach. GNPA & NNPA stands at 1.09% and 0.12% while the coverage gets stronger at 89% as of FY12. BFL’s strong credit origination practice has only added to the strength with credit cost falling from 7.9% to 1.6% in the past three years, however we believe we are building in higher credit cost going ahead

Exhibit 19: Falling credit costs

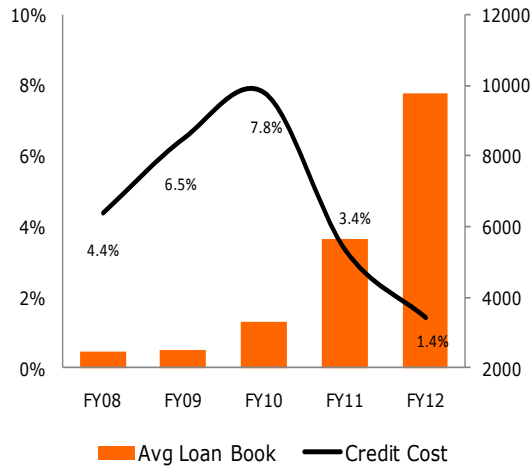
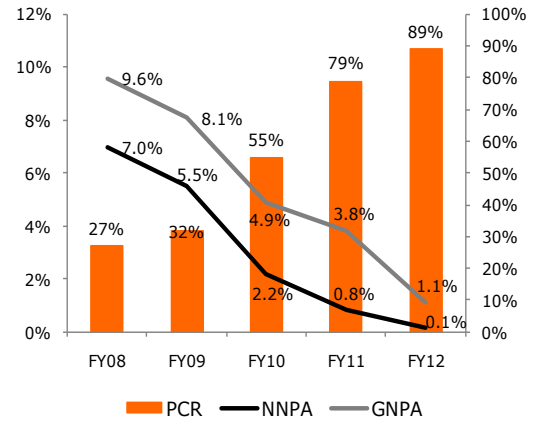


Exhibit 20: Gross NPAs, Net NPAs & coverage ratio



Source: Company, KRChoksey Research

Exhibit 21: Loan book mix – Secured Vs Unsecured

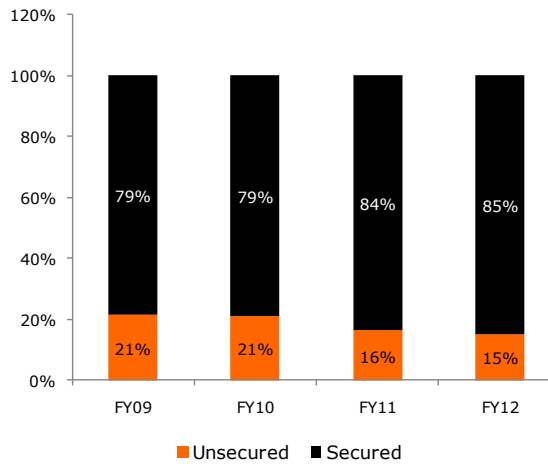
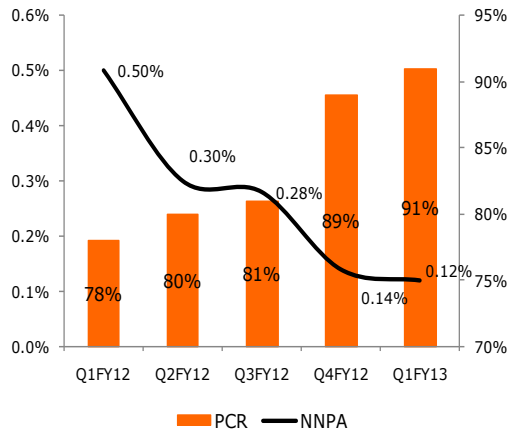


Exhibit 22: Quarterly trend in NPAs & Credit costs



Source: Company, KRChoksey Research

Healthy NIM's on back of efficient fund sourcing ability

Bajaj Finance has been delivering healthy NIM's on back of better risk pricing coupled with lower cost of funds. BFL's as a non deposit taking NBFC has to rely on banks, bonds and short term funds; however the company has time and again showed strength in the borrowing profile and maintains lower cost of funds while maintaining strong spreads.

Exhibit 23: Asset yield, cost of funds and Spread

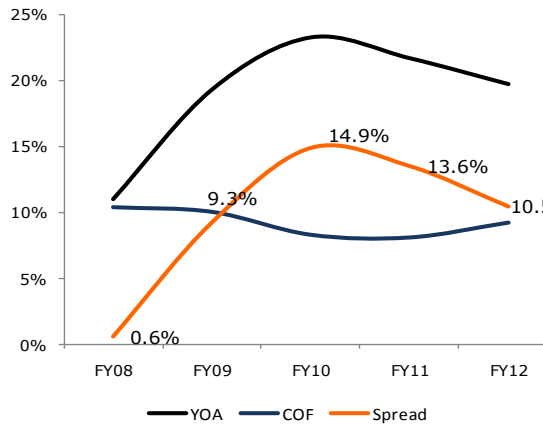
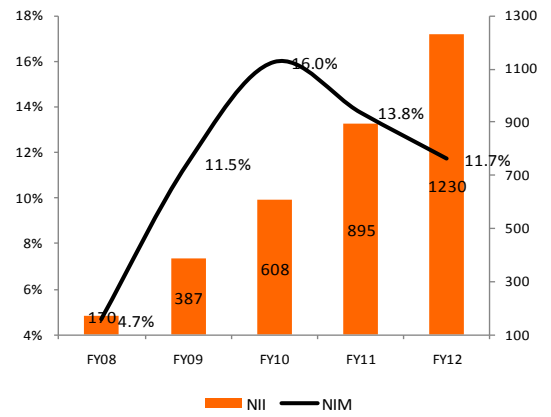


Exhibit 24: NII & net interest margin trend



Source: Company, KRChoksey Research

Superior Return Ratio

Bajaj Finance has shown a stellar performance with PAT CAGR of 112% on the back of 64% CAGR in NII. Return on asset ratio has shown marked improvement (moved up from 1.0% in FY09 to 3.8% in FY12) driven by increase in operating leverage and falling credit costs. Leverage ratio has also increased significantly from 3.2x in FY09 to 6.3x in FY12 driving RoE to 24%.

"Bajaj Finance has shown a stellar performance with PAT CAGR of 112%"

Exhibit 25: Improving return ratios

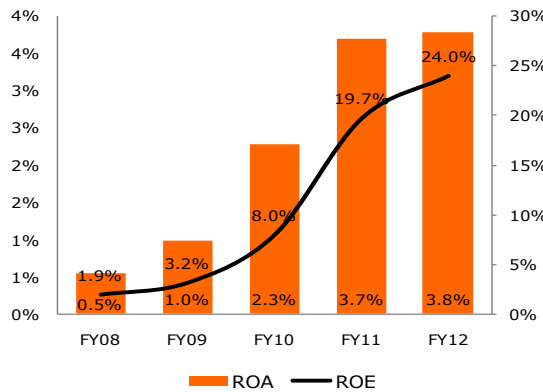
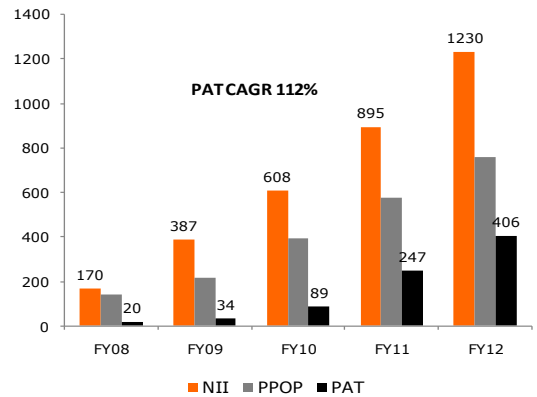


Exhibit 26: Earnings trend



Source: Company, KRChoksey Research

Exhibit 27: Quarterly earnings

Rs in crore	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13
Key operating metrics					
NII	274	284	348	340	403
OPEX	141	153	183	188	201
PPOP	169	173	213	202	238
PAT	91	87	120	108	139
AUM	9025	10071	11919	13107	14485
Deployment	3588	3352	4649	4208	4728
Y-o-Y growth					
NII	38.8%	31.2%	35.7%	44.0%	47.2%
OPEX	51.4%	48.1%	46.6%	41.6%	43.1%
PPOP	28.7%	23.7%	33.4%	40.3%	41.2%
PAT	94.1%	65.6%	57.1%	53.2%	52.7%
AUM	82.8%	74.5%	73.5%	73.1%	60.5%
Deployment	75.4%	57.5%	67.6%	69.2%	31.8%
Key ratios					
NII / Avg AUM	13.2%	11.9%	12.6%	10.9%	11.7%
Cost to income ratio	45.7%	47.2%	46.3%	48.8%	45.9%
Provisions / Avg AUM	1.65%	1.85%	1.30%	1.29%	0.93%
Effective tax rate	32.5%	32.2%	32.4%	32.9%	32.8%

Source: Company, KRChoksey Research

Peer Comparison & Valuation

Exhibit 28: Business size, operating metrics and return ratios comparison

FY12	STFC	M&M Fin	Muthoot Fin	Shriram City	Bajaj Finance
Avg AUM	38198	17866	20271	10715	10339
NII	3226	1316	2158	1109	1230
NII/AUM	8.4%	7.4%	10.6%	10.3%	11.9%
Cost to Income	21%	35%	37%	38%	47%
Credit Cost	2.0%	0.9%	0.2%	1.7%	1.5%
ROA	3.7%	3.9%	4.4%	3.1%	3.8%
ROE	22.8%	22.8%	41.9%	23.1%	24.0%

Source: Companies, KRChoksey Research

Exhibit 29: DuPont analysis

	Shriram Transport	Mahindra Finance	Muthoot Finance	Shriram City Union	Bajaj Finance
NII	9.59%	8.16%	11.64%	11.13%	11.47%
Non interest income	0.38%	2.22%	0.11%	0.19%	1.82%
Operating revenues	9.97%	10.38%	11.75%	11.32%	13.29%
Operating expenses	2.11%	3.67%	4.35%	4.27%	6.24%
Pre-provision profits	7.85%	6.71%	7.40%	7.05%	7.06%
Provisions	2.26%	0.97%	0.23%	1.79%	1.44%
Profit before tax	5.59%	5.74%	7.18%	5.26%	5.62%
Tax expense	1.85%	1.89%	2.37%	1.82%	1.83%
ROA	3.74%	3.85%	4.81%	3.44%	3.79%

Source: Companies, KRChoksey Research

Exhibit 30: Peer Valuation

	Shriram Transport	Mahindra Finance	Muthoot Finance	Shriram City Union	Bajaj Finance
EPS (Rs)					
FY12	58	63	24	68	98
FY13E	63	71	24	73	114
FY14E	74	85	27	86	154
FY15E	82	108	-	-	190
BV (Rs)					
FY12	267	291	79	330	492
FY13E	327	346	99	393	666
FY14E	384	412	123	477	801
FY15E	451	503	-	-	970
ROA (%)					
FY12	3.8	3.9	4.4	3.1	3.8
FY13E	3.3	3.6	3.4	2.9	3.6
FY14E	3.5	3.6	3.5	2.8	3.4
FY15E	3.3	3.7	-	-	3.3
ROE (%)					
FY12	22.8	22.8	41.9	23.1	24.0
FY13E	21.0	22.2	26.8	21.7	21.3
FY14E	21.2	22.4	24.3	20.6	20.9
FY15E	19.0	23.4	-	-	21.5
PE (x)					
FY12	10.8	13.7	6.8	11.4	11.4
FY13E	9.9	12.1	6.9	10.5	9.8
FY14E	8.4	10.1	6.1	8.9	7.3
FY15E	7.7	8.0	-	-	5.9
PB (x)					
FY12	2.3	3.0	2.1	2.3	2.3
FY13E	1.9	2.5	1.7	2.0	1.7
FY14E	1.6	2.1	1.3	1.6	1.4
FY15E	1.4	1.7	-	-	1.2

Source: KRChoksey Research, Bloomberg

Valuation & Recommendation

Bajaj Finance has delivered strong business and net earnings growth driven by expanding product portfolio and gaining market in key business segments. Return on assets has improved significantly from 2.3% in FY10 to 3.79% in FY12 primarily attributable to operating leverage and sharp fall in credit costs due to better-than-expected portfolio behavior & shift in loan book mix. The stock has given return 69% in last one year reflecting sustain improvement in company's fundamentals.

We believe unique business model, strategic focus on high growth business segments, continuous product development & innovative customer service, sustain superior return ratio and risk adjusted approach for product pricing are key value drivers for the stock.

We expect Bajaj Finance continues to outpace the sector growth and sustain superior return ratio for next three years. We also expect Bajaj Finance to deliver 32.9% CAGR in net earnings over FY12-FY15 driven by 36.3% CAGR in loan book. We believe Bajaj Finance continue to deliver 3% plus RoA and 20% plus on sustainable basis in medium term.

At Rs1,116 the stock trades 1.4x FY14 price to book and 7.3x FY14 earnings, further scope to re-rate on strong earning visibility and sustainable return ratio. We initiate Bajaj Finance with BUY rating and target price of Rs1314 (potential upside 17.8%) with 12 month investment objective.

Exhibit 31: Price to earning band

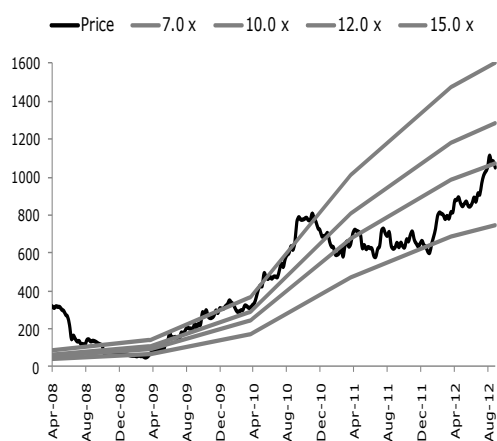
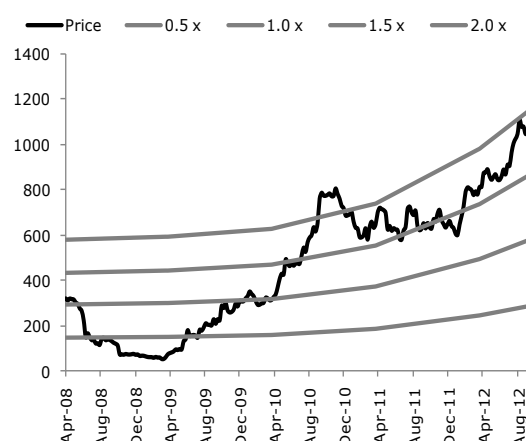


Exhibit 32: Price to book band



Source: KRChoksey Research, Bloomberg

	CMP (Rs)	Absolute Returns (%)					Relative Returns (%)				
		1M	3M	6M	12M	YTD	1M	3M	6M	12M	YTD
BFL	1116	1	25	34	69	80	-3	14	26	54	48
STFC	623	3	21	4	-3	48	-2	10	-3	-11	22
M&M Fin	837	11	32	24	22	37	6	20	16	11	13
Muthoot Fin	167	27	35	3	-3	7	21	23	-4	-11	-12
Shriram City	780	10	27	27	46	61	5	16	19	32	33

Source: Bloomberg

Exhibit 33: Target Price Derivation

Based on FY14 estimates	FY14E BV / EPS (Rs)	Target multiple	Value per share (Rs)	Weight (%)	Weighted Avg
Relative valuation Method					
Price to book basis	801	1.6X	1282	60%	769
Price to earnings basis	154	9.5X	1458	20%	292
Absolute valuation Method					
Residual Income valuation	-	-	1269	20%	254
Intrinsic value per share (Rs)					1314
CMP					1116
Potential upside (%)					17.8%

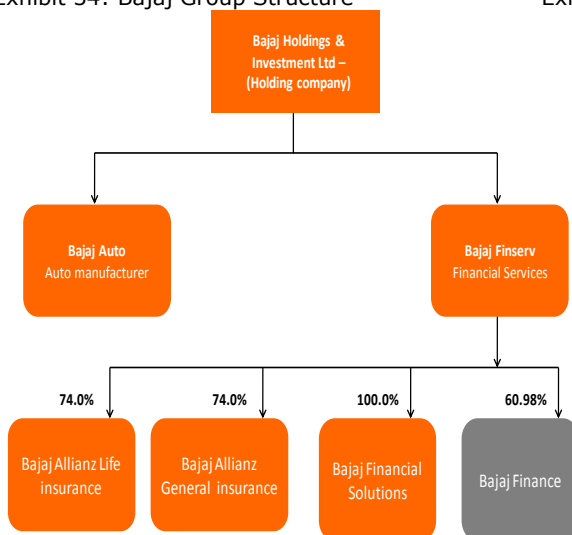
Source: KRChoksey Research

Company Background

Bajaj Finance (BFL) is a 25 year old non banking finance company with strong operating performance track record. Broadly the company operates in consumer finance, small business finance and commercial finance segments.

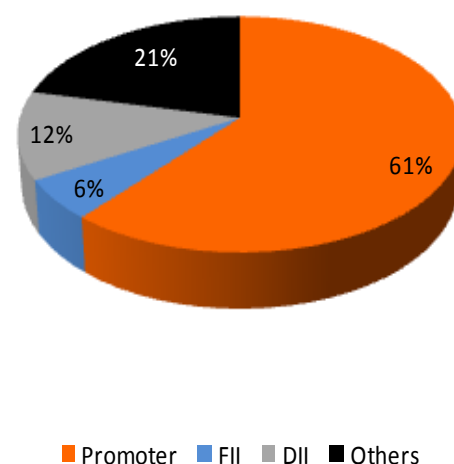
Initially, the company incorporated focused primarily on captive two wheeler finance business to support sales of Bajaj Auto (a group Company) in 1987. In 2007-08, the Bajaj group restructured manufacturing business (two wheelers & three wheelers) and finance business and formed new company Bajaj Finserv which in turn holds stake (61%) in the Bajaj Finance Ltd.

Exhibit 34: Bajaj Group Structure



Source: Company, KRChoksey Research

Exhibit 35: Shareholding pattern as on 30th June 2012



With the induction of professionals in the core management team; the company witnessed a transformation from captive finance company to a diversified non banking finance company. The company developed a diversified lending business model with nine product lines focusing on consumer finance, SME finance and commercial finance. Bajaj Finance expanded product lines and geographical presence with strong distribution reach with more than 225 points of presence and more than 4,000 distribution partners & dealers across India.

The company's strategic focus has been penetrating mass affluent' customer wallet in consumer businesses and affluent & HNI customers in small business and leveraging group relationships for vendor financing, construction equipment finance & infrastructure finance.

The company has stable and deep management structure with top 100 management team members having experience from leading multi national companies & transactional companies.

At end of Q1FY13, assets under management (AUM) stood at Rs14,485 crore which is well diversified into nine products. The company has seen marked improvement in growth trajectory, profitability and return ratios in the last three years. RoA increased significantly from 2.28% in FY10 to 3.79% in FY12 largely attributable to decline in credit costs and optimization of operating cost structure. AUM grew 51.6% CAGR outpacing the sector in the last four years.

Exhibit 36: Strong AUM growth

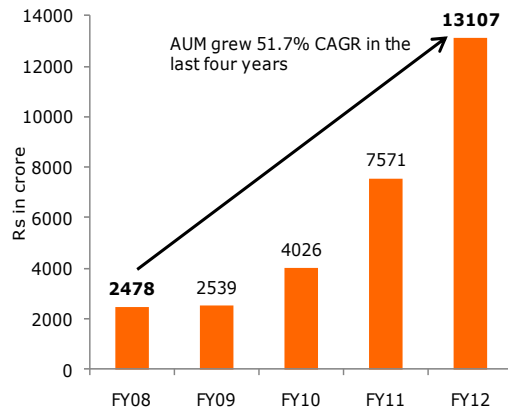
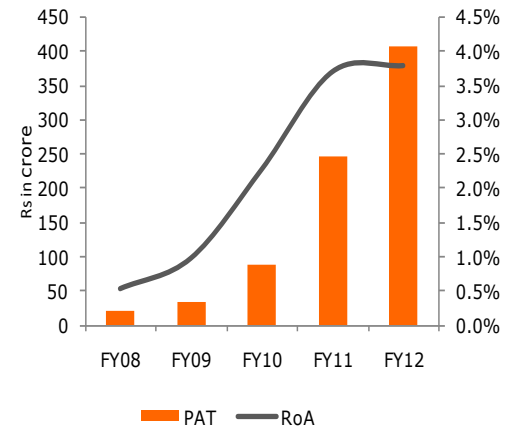


Exhibit 37: Marked improvement in profitability



Source: Company, KRChoksey Research

Exhibit 38: Top institutional holdings

	(%)
El Dorado Holding I Ltd	5.7
Reliance Capital Trustee Co Ltd	5.6
Maharashtra Scooters Ltd	4.0
Reliance Tax Saver Fund	3.4
Sundaram Asset Management Co Ltd	2.6
DSP Blackrock Investment Manager	2.3
IDFC Mutual Fund	0.9
Blackrock Investment Managers Hk	0.6
Morgan Stanley	0.2
FIM Fund Management Ltd	0.2
Vanguard Group Inc	0.1

Source: Bloomberg

Management team evaluation

Exhibit 39: Management team details

Core management team profile – Expanded management bandwidth

Rajeev Jain, CEO	<ul style="list-style-type: none"> He has been with the Company for 4 years and has worked towards steering the organization onto a path of fast-paced growth and defined an ambitious trajectory of building a diversified lending institution. He has earlier worked with AIG, GE money and American Express.
Amit Gaiinda- Business head mortgage	<ul style="list-style-type: none"> A Management graduate with 15 years of varied experience across Strategic Planning, Sales & Marketing, Product Design & Development, to Six Sigma, Collections, and Analytics. He has worked for GE & Citi.
Ashish Panchal – Business head credit cards	<ul style="list-style-type: none"> He has 13 years of rich and varied work experience across manufacturing, FMCG and Retail Banking in large multi-national organizations across credit cards, secured and unsecured assets as well as liabilities. He joined the Company from Barclays & would be responsible for launching credit card business.
Deepak Reddy – Business head Personal & small business loans	<ul style="list-style-type: none"> He has over 20 years of experience in distributing Financial Services & Consumer Durables. He joined the company from American Express, where he held various positions in their Personal Loans & Consumer Card businesses for over 9 years.
Devang Mody – Business head Sales Finance	<ul style="list-style-type: none"> He brings with him 15 years of experience in consulting and financial services. Joining Bajaj Finance from AIG, where he worked as Vice President – Business Development & CRM for the consumer finance business.
Sanjeev Vij- Business head Construction Equipment finance	<ul style="list-style-type: none"> 19 years of experience in Retail Consumer Finance, SME mid-markets, and Corporate Finance for sectors such as Infrastructure, Industrial, Healthcare, Transportation, Auto, and Securitization of Receivables He earlier worked with RBS and Citi
Diwakar Pundir – Chief credit officer	<ul style="list-style-type: none"> He has nearly 12 years of varied and rich work experience, with the last ten years in Risk Management. He joins the company from Citigroup, where his last assignment was managing risk and credit for West & South India regions for the Small & Medium Enterprises (SME) business.
Rajesh K – Chief risk officer	<ul style="list-style-type: none"> Rajesh is a management graduate with over 14 years of experience in financial services across consumer and commercial lending. Rajesh joins the company from HSBC where he was handling the portfolio risk management unit for HSBC's consumer credit risk function.
Pankaj Thadani - CFO	<ul style="list-style-type: none"> He joined Bajaj Finserv Lending in 2006, bringing with him a rich experience of 28 years in financing, financial accounting, cost accounting, tax, and systems He has provided invaluable advice and direction that has helped the Company grow from a single business company to a diversified NBFC.

Source: Company, KRChoksey Research

Financials

	FY11	FY12	FY13E	FY14E	FY15E
Income Statement					Rs in crs
Interest income	1266	1976	2969	4161	5370
Interest expense	371	746	1198	1675	2222
NII	895	1230	1771	2486	3148
Non interest income	140	195	257	311	364
Operating revenues	1035	1426	2028	2797	3511
Operating expenses	461	669	894	1196	1443
Pre-provision profits	574	757	1134	1600	2068
Provisions	205	154	285	460	655
Profit before tax	370	602	849	1140	1413
Tax expense	123	196	276	371	459
Net profits	247	406	573	770	954
Equity Dividend including taxes	43	58	82	94	106

	Rs in crs				
Balance Sheet					
Equity share capital	37	41	50	50	50
Reserve & Surplus	1321	1992	3290	3965	4813
Shareholders' fund	1358	2034	3340	4016	4864
Borrowings	6703	10226	14885	20494	25744
Current Liabilities	393	571	771	964	1109
Provisions	67	95	124	155	186
Total Liabilities	8522	12927	19120	25629	31902
Customer loans	7272	12283	18425	24873	31091
Investments	6	5	5	5	5
Cash & Bank banks	872	60	75	95	105
Fixed assets	103	139	139	139	139
Loans and advances	175	294	309	324	341
Other assets	96	145	167	192	221
Total assets	8522	12927	19120	25629	31902

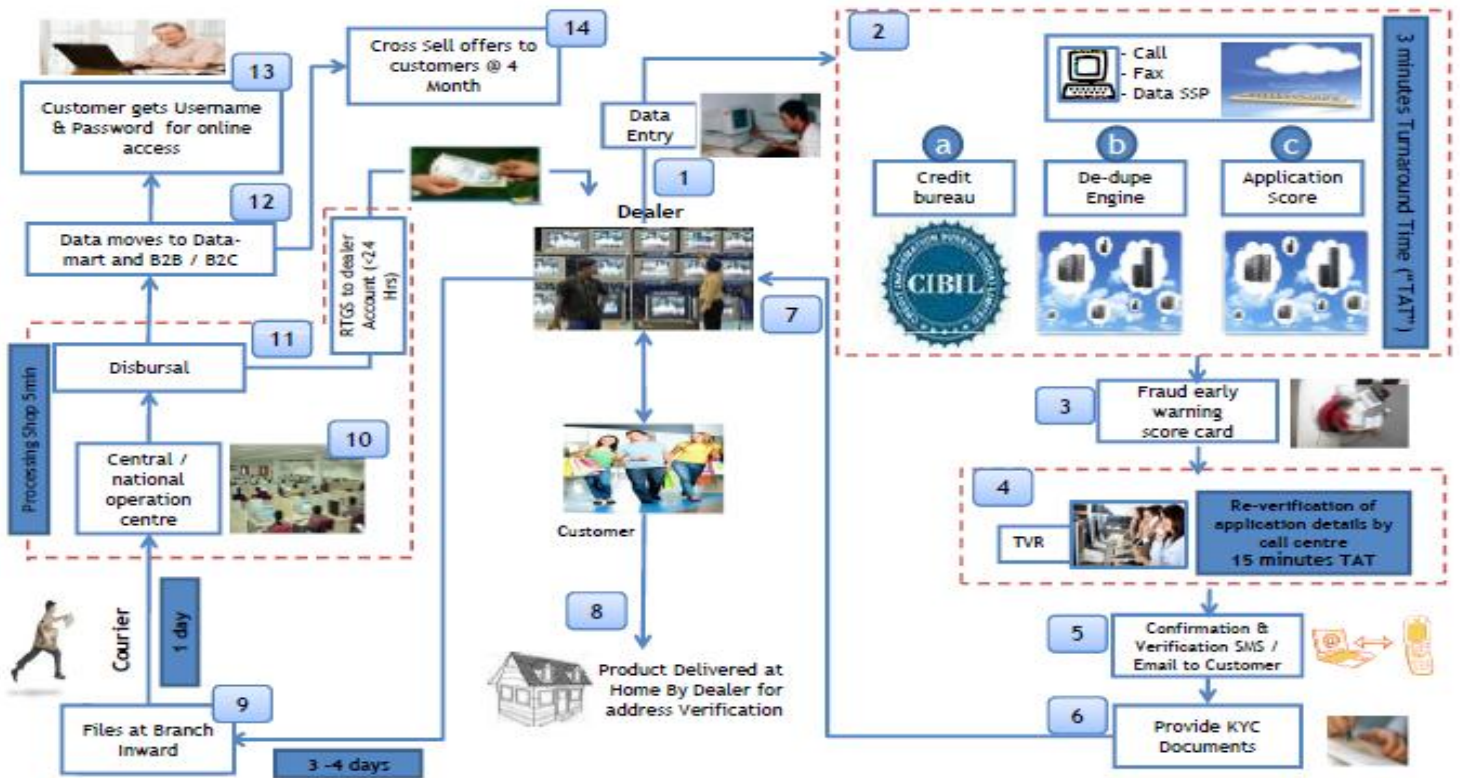
Spread Analysis					
Yield on loans	21.7%	19.7%	19.2%	19.1%	19.1%
Cost of borrowings	8.1%	9.2%	9.5%	9.5%	9.6%
Spread	13.6%	10.5%	9.7%	9.6%	9.4%
NIM	13.8%	11.7%	11.3%	11.4%	11.2%

DuPont Analysis					
NII	13.4%	11.5%	11.1%	11.1%	10.9%
Non interest income	2.1%	1.8%	1.6%	1.4%	1.3%
Operating revenues	15.5%	13.3%	12.7%	12.5%	12.2%
Operating expenses	6.9%	6.2%	5.6%	5.3%	5.0%
Pre-provision profits	8.6%	7.1%	7.1%	7.2%	7.2%
Provisions	3.1%	1.4%	1.8%	2.1%	2.3%
Profit before tax	5.5%	5.6%	5.3%	5.1%	4.9%
Tax expense	1.8%	1.8%	1.7%	1.7%	1.6%
Net profits	3.7%	3.8%	3.6%	3.4%	3.3%

	FY11	FY12	FY13E	FY14E	FY15E
Return ratio					
RoA	3.7%	3.8%	3.6%	3.4%	3.3%
RoE	19.7%	24.0%	21.3%	20.9%	21.5%
Other Key ratios					
Cost to income ratio	47%	47%	44%	43%	41%
Effective tax rate	33%	33%	33%	33%	33%
NII / Operating revenues	92%	86%	87%	89%	90%
Provisions / PPOP	36%	20%	25%	29%	32%
Asset Quality & Provisioning					
Gross NPAs	3.8%	1.1%	1.4%	1.7%	1.9%
Net NPAs	0.8%	0.1%	0.1%	0.2%	0.2%
Coverage ratio	79.0%	89.0%	90.0%	90.0%	90.0%
Credit costs	3.4%	1.4%	1.7%	2.0%	2.3%
Standard asset provisions / Std assets	-	0.31%	0.34%	0.34%	0.34%
Capital Adequacy					
Tier I	16.8%	15.0%	16.8%	15.1%	14.7%
CAR	20.0%	17.5%	18.5%	16.3%	15.7%
Leverage (x)	5.3	6.3	6.0	6.1	6.5
Value per share data					
EPS	67.4	98.4	114.3	153.5	190.2
DPS	10.0	12.0	14.0	16.0	18.0
PPOP	156.8	183.1	226.2	319.2	412.6
BVPS	370.8	492.2	666.2	801.0	970.2
Price to earnings (x)	16.6	11.3	9.8	7.3	5.9
Price to book ratio (x)	3.0	2.3	1.7	1.4	1.2
Price to PPOP (x)	7.1	6.1	4.9	3.5	2.7
Dividend yield (%)	0.9%	1.1%	1.3%	1.4%	1.6%
Growth ratios					
NII	47.3%	37.4%	43.9%	40.4%	26.6%
PPOP	45.5%	31.7%	49.9%	41.1%	29.2%
PAT	176.4%	64.6%	41.0%	34.3%	23.9%
Loan book	80.6%	69.0%	45.0%	35.0%	30.0%
Borrowings	82.6%	74.1%	45.1%	37.7%	25.6%
EPS	176.2%	45.9%	16.2%	34.3%	23.9%

Source:KRChoksey Research

Appendix: High technology orientation and robust risk management – An illustration



Source: Company, KRChoksey Research

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