

**BSE Code: 500034**
**NSE Code: BAJFINANCE**
**Reuters Code: BJFN.NS**
**Bloomberg Code: BAF:IN**

### Consistent performer...

Bajaj Finance Limited (BFL) is one of the leading non-banking financial companies (NBFC) in India and is part of the illustrious Bajaj group. Though BFL started as the captive financier to two and three wheelers manufactured by Bajaj Auto, the company entered various other lending segments and became one of the significant players in the retail asset-financing industry. BFL's diversified product suite now comprises >19 product lines divided broadly into four categories like consumer, SME, commercial and rural. The company is the largest financier of two-wheelers and consumer durables in India.

### Investment Rationale

🔗 **Unique and innovative product offerings:** The unique selling point (USP) of BFL is its stronghold in the consumer durable (CD), digital & lifestyle product financing business (~13% of the AUM) wherein it does not have any major competition. Moreover, it has capitalised strongly on its "0% financing" product which has enabled it to gain popularity among customer. Further, the large number of customers acquired through the CD financing business allows BFL to cross-sell various other products to customers with a healthy credit history. These products include personal loans (16%+ of the AUM), life/general insurance, etc. In addition, BFL's strategy of maintaining a well-diversified product portfolio and its focus on the affluent and mass affluent customer segments augurs well during times of uncertainty. Hence, the concentration risks also remain limited.

🔗 **Pan-India distribution network:** BFL has an extensive pan-India distribution network of 318 consumer branches and 538 rural locations with over 38,000 distribution points across India as of FY17. Further, BFL has tie-ups with all major manufacturers and dealers in consumer durables, lifestyle financing, digital products, etc for various product lines. To tap the rural lending opportunities, BFL has presence across 538 towns and villages with retail presence across 5,500+ stores. In addition, BFL sources business directly online via its website. BFL plans to continue expanding its reach in terms of number of branches and points of sale and we believe that this expansion along with product diversification will drive AUM growth for BFL.

🔗 **Considerable investments in analytics gives an edge over peers:** BFL has proactively invested heavily in technology and automation to streamline operations, maintain large database and understand behavioral pattern of the customers. These helped the company to reduce operating and delivery cost over time. Further, it reduced turnaround time for disbursement of consumer loans to just 3 minutes. As a result, it enjoys near monopoly status in businesses like CD, digital and lifestyle financing.

**Valuation:** BFL has delivered healthy operating performance with steady asset quality over the last five years. Going ahead, we expect 32% CAGR in earnings over FY17–19E driven by robust AUM growth (34% CAGR) coupled with stable asset quality. Moreover, we expect BFL to continue to deliver ~3%+ RoA and ~20%+ RoE on sustainable basis in the medium term. Given the strong growth rate, unbeatable asset quality and superior return ratios, its premium valuations within the NBFC space is justified. Thus, we initiate coverage on BFL with a BUY rating and assign a TP of Rs1,541 (P/ABV of 6.0x for FY19E).

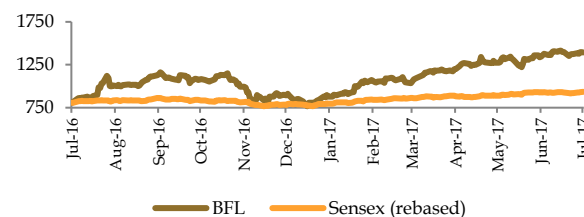
### Market Data

<b>Rating</b>	<b>BUY</b>
<b>CMP (Rs.)</b>	1,393
<b>Target (Rs.)</b>	1,541
<b>Potential Upside</b>	11%
<b>Duration</b>	Long Term
Face Value (Rs.)	1
52 week H/L (Rs.)	1,431/762
Adj. all time High (Rs.)	1,431
Decline from 52WH (%)	2.7
Rise from 52WL (%)	82.8
Beta	1.7
Mkt. Cap (Rs.Cr)	76,603

### Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Interest Income (Rs.Cr)	7,304	9,977	13,306	17,844
Interest Expense (Rs.Cr)	2,927	3,803	4,974	6,703
Net Interest Income (Rs. Cr)	4,377	6,174	8,331	11,141
Pre Pro Profit (Rs. Cr)	2,507	3,636	4,911	6,548
EPS	47.8	33.6	44.8	58.9
P/E (x)	29.2	41.5	31.1	23.6
P/BV (x)	10.0	7.9	6.5	5.2
P/ABV (x)	10.2	8.2	6.7	5.4
ROE (%)	20.9	21.6	23.0	24.5
ROA (%)	3.2	3.3	3.3	3.3

### One year Price Chart



Shareholding Pattern	Mar-17	Dec-17	Chg.
Promoters (%)	57.9	58.1	(0.2)
Public (%)	42.1	41.9	0.2

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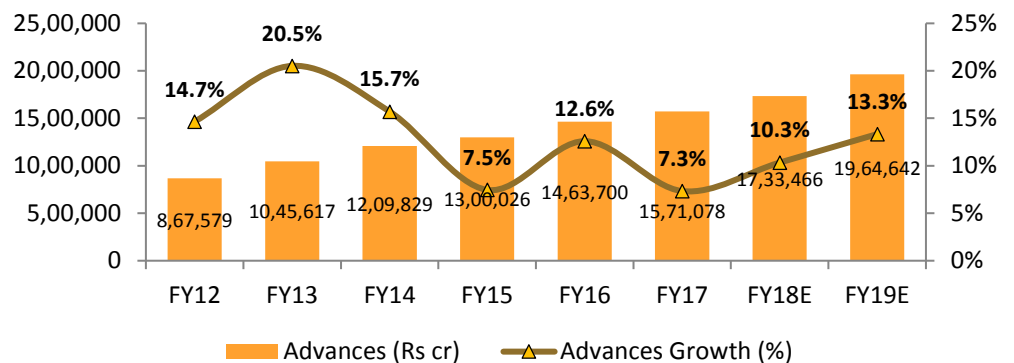
### Bajaj Finance Limited - Company Overview

Bajaj Finance Limited (BFL) is one of the leading non-banking financial companies (NBFC) in India and is part of the illustrious Bajaj group. Though BFL started as the captive financier to two and three wheelers manufactured by Bajaj Auto, the company entered various other lending segments and became one of the significant players in the retail asset-financing industry. BFL's diversified product suite now comprises >19 product lines divided broadly into four categories like consumer, SME, commercial and rural. The company is the largest financier of two-wheelers and consumer durables in India.

### AUM to grow at 34% CAGR over FY17-19E led by consumer financing

BFL continues to perform well on overall business metrics with AUM growth of 36% CAGR over FY12-17. As a result, AUM has grown 4.6x since FY12 which remains best in the industry. This growth is mainly due to company's presence in segments which continues to remain unaffected by recent slowdown in the economy. Penetration level in consumer financing specially consumer durables financing, digital product financing and two-wheeler financing continues to increase. Further, cross selling of other products and SME financing (Mortgage and LAP) are the other key growth drivers. Going ahead, we expect AUM to grow at 34% CAGR over FY17-19E led by the consumer financing segment (43% CAGR).

**AUM to grow at a CAGR of 34% over FY17-19E**



Source: Company, In-house research

### Borrowing mix shifting towards market borrowing

BFL has a diversified borrowing mix across banks, bonds, short-term commercial papers (CPs) and fixed deposits (FDs). This helps it to keep borrowing cost under check. BFL has been replacing bank borrowing with market borrowing over the last three years as former is more expensive as compared to raising money through bonds. As a result, the proportion of bank loans declined to 35% of total borrowings as of FY17 as compared to 58% as of FY14. Notably, share of fixed deposits (FDs) has been gradually rising and constitutes 8% of liabilities as of FY17 as compared with only 1% as of FY14. BFL is planning to increase the share of FDs to 15% of liabilities over the next 3-5 years.

### Margins to broadly remain stable

BFL enjoys one of the highest net interest margin (NIM) among its peers. It has successfully maintained its NIM trajectory over 10% during the last five years. Such high margins were on the back of strong blended yields on AUM along with competitive cost of fund. Going forward, change in loan mix skewed towards more secured loans will pressurize yield on funds. However, this will get offset by lower cost of funds due to change in borrowing mix in favor of non-convertible debentures (NCDs). Hence, we expect BFL's margin to remain largely stable at current level of 11.8% over FY17-19E.

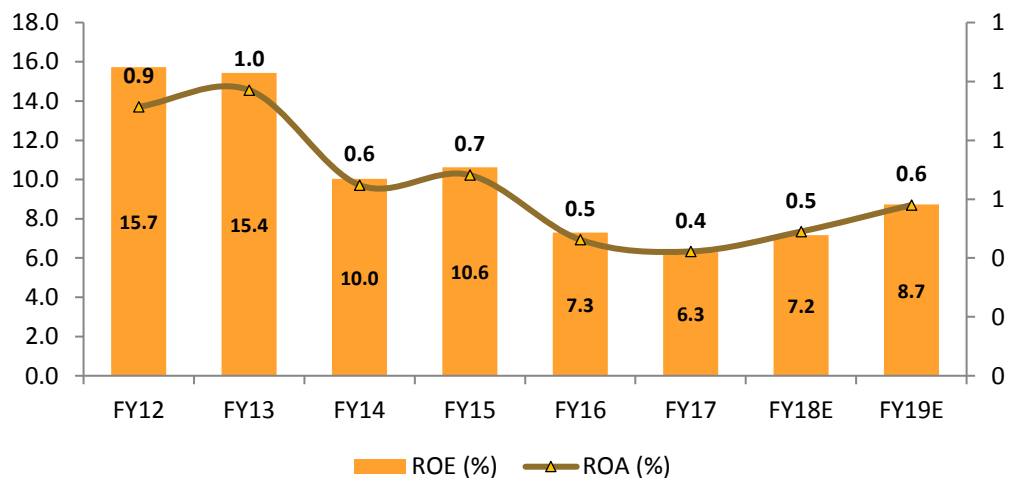
### Earnings growth to remain sturdy

Net interest income (NII) witnessed robust traction in the past on the back of strong margins coupled with healthy AUM growth. Hence, NII grew by 34% CAGR over FY12-17. Going forward, we expect NII to grow at a similar pace of 34% CAGR over FY17-19E led by superior credit growth coupled with stable NIM. BFL reported robust CAGR of 35% in net profit over FY12-17 supported by improving operating efficiency. Cost to Income (C/I) ratio declined to 41.4% in FY17 as compared to 46.9% in FY12. However, we don't expect any further operating efficiency to flow and project C/I ratio to remain stable at current levels over next two years. Moreover, we factor in a slightly higher credit cost over FY17-19E. Hence, we expect earnings to grow at a CAGR of 32% over FY17-19E. However, despite some moderation in earning growth, it will be one of the best among its peers.

### Impressive execution, superior return ratios

BFL has delivered strong business and earnings growth driven by expanding product portfolio and increase in market share in key business segments. Moreover, return ratios (RoA – 3.0%+ and RoE – 20%+) have consistently remained strong over the last five years on the back of better-than-expected portfolio behavior and shift in loan book mix. We expect BFL to continue to outpace the sector growth and sustain superior return ratios over the next two years and estimate the company to deliver 3.0%+ RoA and 24%+ RoE by FY19E.

Return ratios to improve gradually over FY17-19E



Source: Company, In-house research

### Well managed asset quality

BFL continues to enjoy one of the best asset quality among the peer group. The company's Gross/Net non-performing assets (NPA) stood at 1.7%/0.4% as of FY17. Besides, BFL's provision coverage Ratio (PCR) stood at 74% as of FY17 which provides further comfort. Focus on affluent segment, enhanced usage of credit bureau, product rationalization and strong risk management framework have ensured best-in-class asset quality, even in the riskier segments. Notably, there is no impact on BFL due to change in regulations by the RBI related to higher standard asset provisioning and early recognition of NPAs. BFL already follows substantially stringent policy on provisioning which was higher than RBI norms applicable for NBFCs. BFL continues to provide 0.40% on all standard assets as against earlier regulatory requirement of 0.25% and in line with current regulatory requirement of 0.40%. BFL also recognizes NPAs on 90 days overdue as against earlier regulatory requirement of 180 days and current requirement of 90 days. Going forward, we estimate marginal increase in asset quality stress and project Gross/Net NPA to stand at 1.9%/0.5% by FY19E.

## Outlook and Valuation

BFL is one of the best placed NBFCs with a diversified product mix across segments and has witnessed an impressive growth rate in AUM backed by healthy disbursements. BFL has also continuously delivered best performance in terms of operating metrics and return profile. Further, despite strong growth in AUM, the asset quality and provision coverage ratio (PCR) remain among the best in the system. One of the key strengths that the company has built over time is a quick turnaround time in consumer financing segment which is difficult to attain by most other retail financiers. We believe that its unique business model, strategic focus on high growth segments, continuous product development and innovative customer service will help the company to maintain premium valuations within the NBFC space. Hence, we initiate coverage on BFL with a BUY rating and assign a target price (TP) of Rs1,541 (P/ABV of 6.0x for FY19E).

## Key Risks:

- **Prolonged economic slowdown:** A prolonged economic slowdown is a key risk and could lead to slower growth and impact BFL's earnings adversely. Further, it may result in deterioration of asset quality and could adversely affect its profitability.
- **Increasing competition in consumer financing segment:** BFL's key strength against its peers is in its stronghold in the consumer durable financing business and lifestyle product financing business. Currently no major player except Capital First Ltd (CFL) is in this business who can pose a challenge to BFL but there are no entry barriers too. Other NBFCs may look towards this under penetrated financing business. This may reduce BFL's strong positioning and lead to a reduction in the premium multiple it gets currently.
- **Any major impact on Asset quality:** We are not expecting any major deterioration in asset quality, however expect Net NPA to go up slightly by ~5 bps over FY17-19E. Accordingly we are building in the credit cost of 1.6% and 1.7% for FY18E and FY19E, respectively.

**Profit & Loss Account (Standalone)**

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	7,304	9,977	13,306	17,844
Interest Expense	2,927	3,803	4,974	6,703
<b>Net Interest Income</b>	<b>4,377</b>	<b>6,174</b>	<b>8,331</b>	<b>11,141</b>
Non Interest Income	79	26	51	89
<b>Net Income</b>	<b>4,457</b>	<b>6,200</b>	<b>8,382</b>	<b>11,231</b>
Operating Expenses	1,949	2,564	3,471	4,683
<b>Total Income</b>	<b>7,383</b>	<b>10,003</b>	<b>13,356</b>	<b>17,934</b>
<b>Total Expenditure</b>	<b>4,876</b>	<b>6,368</b>	<b>8,446</b>	<b>11,386</b>
Pre Provisioning Profit	2,507	3,636	4,911	6,548
Provisions	543	818	1,148	1,601
<b>Profit Before Tax</b>	<b>1,965</b>	<b>2,818</b>	<b>3,762</b>	<b>4,946</b>
Tax	686	981	1,312	1,725
<b>Net Profit</b>	<b>1,279</b>	<b>1,837</b>	<b>2,450</b>	<b>3,222</b>

**Balance Sheet (Standalone)**

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
<b>Liabilities</b>				
Capital	54	109	109	109
Reserves and Surplus	7,373	9,491	11,629	14,441
Deposits	37,025	49,250	66,208	89,373
Borrowings	368	1,295	1,733	2,328
Other Liabilities and Provisions	1,637	3,580	4,529	5,735
<b>Total Liabilities</b>	<b>46,457</b>	<b>63,725</b>	<b>84,208</b>	<b>111,986</b>
<b>Assets</b>				
Cash and Balances	287	361	426	504
Investments	1,034	4,075	4,095	3,679
Advances	42,756	57,683	77,366	104,197
Fixed Assets	1,051	1,249	1,762	2,489
Other Assets	1,329	357	559	1,118
<b>Total Assets</b>	<b>46,457</b>	<b>63,725</b>	<b>84,208</b>	<b>111,986</b>

**Key Ratios (Standalone)**

Y/E	FY16	FY17	FY18E	FY19E
<b>Per share data (Rs.)</b>				
EPS	47.8	33.6	44.8	58.9
DPS	5.0	3.6	4.7	6.2
BV	138.7	175.6	214.7	266.1
ABV	136.4	170.9	208.1	256.7
<b>Valuation (%)</b>				
P/E	29.2	41.5	31.1	23.6
P/BV	10.0	7.9	6.5	5.2
P/ABV	10.2	8.2	6.7	5.4
Div. Yield	0.4	0.3	0.3	0.4
<b>Capital (%)</b>				
CAR	19.5	20.3	17.2	16.1
Tier I	16.1	14.6	13.2	12.1
Tier II	3.4	5.7	4.0	4.0
<b>Asset (%)</b>				
GNPA	1.2	1.7	1.8	1.9
NNPA	0.3	0.4	0.4	0.5
PCR	77.0	74.0	75.0	75.0
<b>Management (%)</b>				
Credit/ Deposit	5.0	5.1	5.6	6.1
Cost/ Income	43.7	41.4	41.4	41.7
<b>Earnings (%)</b>				
NIM	11.4	11.8	11.8	11.8
ROE	20.9	21.6	23.0	24.5
ROA	3.2	3.3	3.3	3.3

#### Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
<b>Buy</b>	More than equal to 10%	<b>Buy</b>	More than equal to 15%
<b>Hold</b>	Upside or downside is less than 10%	<b>Accumulate*</b>	Upside between 10% & 15%
<b>Reduce</b>	Less than equal to -10%	<b>Hold</b>	Between 0% & 10%
		<b>Reduce/sell</b>	Less than 0%

\* To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

\* BFL is a large-cap bank

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