KRChoksey INSTITUTIONAL

Bajaj Finserv Ltd.

RESULT UPDATE

5th February , 2018

Bajaj Finserv Ltd.

Continued strong profitability while driving India's financial inclusion theme

CMP	Target	Potential Upside	Market Cap (INR Mn)	Recommendation	Sector
INR 4882	**INR 5619**	**15.1%**	**785,674**	**BUY**	**BFSI**

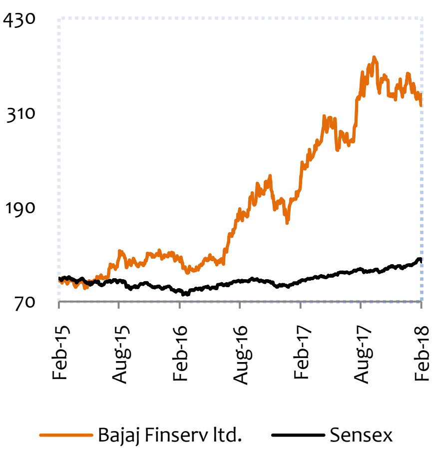
Result highlights

Bajaj Finserv recorded a PAT of INR 7.5 bn, up 22% yoy/14.8% qoq. The strong growth in PAT has come on back of superior performance of the lending arm (Bajaj Finance Ltd.) and general insurance (Bajaj Allianz General Insurance Company Ltd. /BAGIC) which recorded yoy PAT growth of 39%% and 30% respectively (for 9MFY18). For the life insurance arm (Bajaj Allianz Life Insurance Company/BALIC), GWP was up 24% yoy at INR 49.1 bn while the total insurance GWP was up 12.7%. While the management is confident about the performance of the lending business to continue along with synergistic additions in the form of Mobikwik, general insurance business of Bajaj Finserv is likely to stay one of the most efficient and profitable ones (combined ratio – 92.1% for Q3FY18 versus 99.6% for Q3FY17 and 96.8% for FY17). The company is also confident about transforming the life insurance business by focusing more on retail premium, diversifying distribution channel and restructuring product-mix balance, along with improving persistency and productivity.

MARKET DATA

Shares outs (Mn)	159
EquityCap (INR Mn)	796
Mkt Cap (INR Mn)	785674
52 Wk H/L (INR)	5835/3280
Volume Avg (3m K)	167
Face Value (INR)	5
Bloomberg Code	BJFIN IN

SHARE PRICE PERFORMANCE



MARKET INFO

SENSEX	35067
NIFTY	10761

SHARE HOLDING PATTERN (%)

Particulars	Dec- 17	Sep-17	Jun-17
Promoters	58.35	58.35	58.35
FIIs	7.89	8.22	8.08
DIIs	6.88	6.4	6.58
Others	26.88	27.04	26.99
Total	100	100	100

Strong consolidated earnings to continue going forward

Bajaj Finserv total consolidated revenue grew 22% yoy to INR 7.5 bn with surplus funds standing at INR 6.6 bn as of Q3FY18. The consolidated net worth stood at INR 201 bn with a BVPS of INR 1,261. Bajaj Finance remains the largest contributor with 56% share in the total consolidated PAT for Q3FY18.

We expect Bajaj Finserv to continue to deliver industry leading profitability with Bajaj Finance seeming more confident about the consumer finance business along with addition of a focused mortgage business and payments business (Mobikwik; in nascent stage), BAGIC sustaining its industry leading profitability and BALIC under-going transformation (changing product mix, diversifying distribution channel, re-focusing on segments; new business strain to persist till restructuring completes).

Bajaj Finance remains the outperformer; will continue to drive group earnings

AUM grew to INR 780 bn during the quarter, up 35.4% yoy. On back of such high growth, NII has grown 38% yoy to INR 23.7 bn with calculated NIMs coming at >11% against 10.9% for Q2FY18 and 11.9% for Q3FY17. Part of the improvement has also been on account of improved borrowings mix. Opex/NII came in at 40%, although the management expect this metric to deteriorate slightly as BFL accelerates its investments in technology along with 15-20% annual expansion rate. PAT has grown at 38% yoy to INR 7.7 bn. Annualized RoE stands at 20%, which has been achieved on back of various factors – reduction in cost of funds, stable asset quality and strong disbursements growth. On the asset quality front, the company has moved to 90-dpd recognition norm during the current FY as against 120-dpd followed until FY17. On comparable basis, asset quality has remained steady with GNPAs at 1.7% against 1.7% for Q2FY18. PCR stands at 68%.

Growth in AUM has been led by the consumer financing division which grew 38.5% yoy/10.5% qoq. The share of consumer business has increased to 48%, up 110 bps yoy and qoq. The company has continued to strengthen its leading position in low-ticket financing which is also corroborated by growth in EMI card franchise which now stands at more than 11.4 million cards.

SME portfolio has grown to INR 245 bn and now forms 31% of the total AUM, down 510 bps yoy/190 qoq. Currently, the company is taking a cautious stance on the SME lending segment due to its hyper-competitive nature and expects adverse impact of demonetisation and GST to prevail for a while. Against a figure of 53% as of Q4FY15, the company has scaled down its SME business to contribute 31% to the total AUM. The company continues to witness pressures in self employed segment, specifically LAP and SEHL.

Commercial portfolio stood at INR 105.5 bn, up 51.7% yoy/10% qoq. The segment now forms 14% of the total AUM, up 150 bps yoy/20 bps qoq.

Rural business stood at INR 54.97 bn, up 113% yoy/18.9% qoq, thus showing strong traction. As the company continues its 15-20% geographic expansion rate and penetrates deeper into rural areas, we expect contribution of rural portfolio to increase further. With the impact of demonetization gradually receding over the next few quarters, we believe this segment to keep posting strong growth rates as the management is keen on growing this portfolio. This is partly reflected in the company's rural presence which has increased from 232 points as of FY15 to 588 as of 9MFY18. The rural portfolio now forms 7% of the total AUM, against 4% for Q3FY17. Rural lending, which started in FY14, was only 0.3% at that time. Since then, it has grown at a CAGR of 268% upto FY17 (although partly because of a low base). Further, the company looks to rural as a part of consumer only and expects the combined share of the two segments to form a majority part of the portfolio.

Asset quality held stable

During the current FY, the company has moved to 90-dpd recognition norm as against 120-dpd followed until FY17. Gross NPAs stood at 1.67% against 1.68% for Q2FY18 while net NPAs stood at 0.53% versus 0.51% as of Q2FY18. PCR stands at 68.3%.

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Asset quality on the consumer business improved by 5 bps with GNPAs at 2.1% against 2.2% for Q2FY18 and 2.32% for FY17. On the SME business, GNPAS have improved to 1.6% against 1.7% for Q2FY18 and 1.65% for FY17. On the commercial business, GNPAs were 0.03%, down by 1 bp(s) qoq, whereas on the rural business, there was an uptick of 25 bps qoq in GNPAs which came in at 1.1%.

Segmental asset quality – GNPA (90-dpd)	Q3FY18	Q2FY18	Q-o-Q
Consumer	2.1%	2.2%	-5
SME	1.6%	1.7%	-8
Commercial	0.0%	0.0%	-1
Rural	1.1%	0.8%	25
Total	**1.7%**	**1.7%**	**-1**

Source: Company, KRChoksey Research

Particulars (INR Mn) Income Statement	Q3FY18	Q3FY17	Q2FY18	Y-o-Y	Q-o-Q
Income from operations	35,433	26,999	31,023	31.2%	14.2%
Interest expense	11,709	9,802	11,438	19.5%	2.4%
Net interest income	**23,724**	**17,197**	**19,586**	**38.0%**	**21.1%**
Total income	**23,724**	**17,197**	**19,586**	**38.0%**	**21.1%**
- Employee costs	3,695	2,525	3,362	46.3%	9.9%
- Other operating expenses	5,799	4,414	5,390	31.4%	7.6%
Operating expenses	**9,494**	**6,940**	**8,752**	**36.8%**	**8.5%**
Pre-provision profit	**14,230**	**10,258**	**10,833**	**38.7%**	**31.4%**
Provisions	2,468	1,758	2,278	40.4%	8.3%
Profit before tax	11,762	8,500	8,555	38.4%	37.5%
Tax expense	**4,094**	**2,944**	**2,986**	**39.1%**	**37.1%**
Net profit	7,668	5,557	5,569	38.0%	37.7%

Source: Company, KRChoksey Research

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AUM characteristics	Q3FY18	Q3FY17	Q2FY18	Y-o-Y	Q-o-Q
AUM - Business segment wise					
Consumer	3,73,820	2,69,970	3,38,150	38.5%	10.5%
SME	2,45,420	2,10,790	2,41,130	16.4%	1.8%
Commercial	1,05,490	69,540	95,890	51.7%	10.0%
Rural	54,970	25,750	46,220	113.5%	18.9%
Total	**7,79,700**	**5,76,050**	**7,21,390**	**35.4%**	**8.1%**
AUM - Business segment mix					
Consumer	48%	47%	47%	1.1%	1.1%
SME	31%	37%	33%	-5.1%	-1.9%
Commercial	14%	12%	13%	1.5%	0.2%
Rural	7%	4%	6%	2.6%	0.6%
Total	**100%**	**100%**	**100%**		
Operational efficiency	**Q3FY18**	**Q3FY17**	**Q2FY18**	**Y-o-Y**	**Q-o-Q**
Opex/NII	40.0%	40.4%	44.7%	-34	-467
Asset quality (90-dpd)	**Q3FY18**	**Q3FY17**	**Q2FY18**	**Y-o-Y**	**Q-o-Q**
GNPA (%)	1.67%		1.68%		-1
NNPA (%)	0.53%		0.51%		2
PCR (%)	68.3%		69.6%		-138
Asset quality (120-dpd)	**Q3FY18**	**Q3FY17**	**Q2FY18**	**Y-o-Y**	**Q-o-Q**
GNPA (%)	1.4%	1.5%	1.7%	-4	-27
NNPA (%)	0.4%	0.4%	0.5%	2	-9
PCR (%)	71.3%	73.5%	70.6%	-214	74

Source: Company, KRChoksey Research

Key Financials (INR Mn)	FY16	FY17	FY18E	FY19E	FY20E
Net Interest Income	36,211	49,030	73,567	1,00,237	1,33,813
Pre-provision profits	25,074	36,355	53,464	72,394	97,406
Net Profit	12,785	18,363	27,648	37,466	50,367
EPS (Rs.)	237	33	48	65	87
BVPS (Rs.)	1,360	175	291	353	437
P/E (x)	33.7	41.1	33.2	24.5	18.2
P/BV (x)	5.9	7.9	5.5	4.5	3.6

Source: Company, KRChoksey Research

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BAGIC's underwriting profitability continues to remain on a strong footing on back of improved claims ratio

•AUM at INR 133 bn grew 27% yoy. Orientation towards fixed income securities continues. GWP collected during the quarter was INR 18.92 bn, +10% yoy. Ex-crop, GWP stood at INR 18.2 bn, up 23% yoy.

•In terms of product mix, share of motor insurance came down by 200 bps while that of property increased by the same proportion. Share of agri/crop insurance increased by 100 bps as well. Overall business mix continues to be retail focused.

•Combined ratio stood at 92.1% versus 99.6% as of Q3FY17. Improvement in combined ratio came mainly on account of improved claims ratio. Consequently, PAT came in at 2.62 bn, +33% yoy.

•As part of its restructuring strategy, the company had decided to exit some of the loss making businesses. As a result, group health and motor OD/TP have witnessed much better loss ratios over time. Overall, the company has witnessed better loss ratio compared to last year.

•In terms of pricing, the company expects it to improve as the 3 PSU insurers (to be merged into one) get listed.

The company expects to grow the general insurance business on back of high quality underwriting, higher retention along with higher retail mix. The management sees crop insurance as a vast opportunity and will grow as they become more confident with respect to underwriting such risks. Further, the company plans to strengthen its selection (of customers) by investing in analytics to help the company select better customers which are likely to result in reduced claims. Solvency ratio for BAGIC stood at 313% as at the end of Q3FY18 against a regulatory minimum of 150%.

Particulars (INR Mn) Income Statement (BAGIC)	Q3FY18	Q3FY17	FY17	Y-o-Y
Gross written premium	**18,920**	**17,220**	**76,870**	**9.9%**
Net earned premium	14,860	12,590	49,370	18.0%
Underwriting result	**1,130**	**-**	**640**	**-**
Investment and other income	2,690	2,950	10,140	-8.8%
PBT	3,820	2,950	10,780	29.5%
PAT	**2,620**	**1,970**	**7,280**	**33.0%**
Claim ratio	**62.4%**	**70.8%**	**70.4%**	
Combined ratio	**92.1%**	**99.6%**	**96.8%**	
Business mix (%) (BAGIC)	**9MFY18**	**9MFY17**	**FY17**	**Y-o-Y**
Motor	44.0%	46.0%	46.0%	-200 bps
Retail health	5.0%	5.0%	6.0%	-
Group Health	9.0%	9.0%	7.0%	-
Property, Liability, Engg	15.0%	13.0%	13.0%	+200 bps
Agri (crop insurance)	19.0%	18.0%	19.0%	+100 bps
Others	8.0%	9.0%	9.0%	-100 bps
Total	**100.0%**	**100.0%**	**100.0%**	

Source: Company, KRChoksey Research

New business strain to continue at BALIC for a few quarters on account of high growth aspirations; cautious on ULIPs

•Individual rated new business stood at INR 3.65 bn during the quarter, up 28% yoy. Agency individual rated new business stood at INR 2.88 bn, up 13% yoy.

•Group new business at INR 5.69 bn is up 17%. Renewal premium at INR 7.95 bn is up 14%.

•The company continued to focus on growing regular premium as reflected in individual rated NB growth.

•In terms of product mix, the company lowered share of ULIPs to shed excessive concentration risks. As a result, focus was more on traditional products. On annual basis, share of ULIPs came down to 72% for the quarter as against 75% as of Q3FY17.

•AUM for the company stood at INR 524 bn, up 12% yoy, with 57% (INR 299 bn) under non-linked as against 48% as of Q3FY17. Of the total unit-linked funds of INR 266 bn, 66% is equity funds.

•BALIC continues to maintain strong solvency at 600% as of Q3FY18.

The management does not expect PAT to grow significant for a few quarters as the company pursues a high growth rate. Apart from this, the company is also investing in significant digital initiatives to transform the life insurance business.

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As per the management, the sole driver for the life insurance company will be improving NBV which will come on account of renewals catching up, improving persistency and productivity and by way of focusing on the retail segment.

Particulars (INR Mn) Income Statement (BALIC)	Q3FY18	Q3FY17	FY17	Y-o-Y
New business premium	**9,440**	**7,850**	**32,900**	20.3%
Rated individual NB premium	3,650	2,850	10,100	28.1%
Group NB premium	5,680	4,860	22,250	16.9%
Renewal premium	7,950	7,000	28,930	13.6%
Gross written premium	17,390	14,850	61,830	17.1%
Shareholders' profit	1,260	1,620	6,090	-22.2%
Total shareholders' PAT	1,630	1,920	8,360	-15.1%

Source: Company, KRChoksey Research

Particulars (INR Mn) Consolidated Financial Highlights (Bajaj Finserv Ltd.)	Q3FY18	Q3FY17	Y-o-Y
Total revenue	76,655	63,172	21%
PAT	7,486	6,138	22%
Net worth (consolidated)	200,614	152,625	19%

Source: Company, KRChoksey Research

Valuation and Recommendation

Given Bajaj group's years of experience in the financial services industry along with extensive distribution network, we believe the entity to continue to outpace the industry in terms of profitability. Prudent provisioning despite stable/improving asset quality has only made Bajaj Finance's balance sheet stronger and favorable macros (low insurance penetration) along with strong operational experience is only expected to work in favor of BAGIC and BALIC over the long term.

Strong outlook on the lending business as well as the insurance businesses should translate into strong earnings for the consolidated entity, ultimately resulting in high return ratios. Further, stake sales in the insurance arms could provide further unlocking for the consolidated entity.

We have value the stock on SOTP valuation methodology, arriving at a value per share of INR 5,619. Hence, we recommend to BUY.

JVs & subsidiaries	Valuation basis	Parent's stake	Business value	Stake value	Target price (INR)
BALIC	1.8x EV + 10x NBAP	74.0%	3,12,037	2,30,907	1,451
BAGIC	15x PAT	74.0%	2,09,194	1,54,803	973
Bajaj Finance	5x BVPS	57.8%	12,59,334	7,27,895	4,574
Windmill	INR 6.2 cr/MW	100.0%	4,042	4,042	25
Holding co. discount (%)					20%
Value per share (INR)					**5,619**
CMP (INR)					**4,882**
Potential upside (%)					**15.1%**

Source: Company, KRChoksey Research

Bajaj Finserv Ltd

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Date	CMP (INR)	TP (INR)	Recommendation
5-feb-18	4882	5619	BUY
18-Oct-17	5320	6109	ACCUMULATE
24-Jul-17	4,950	5,215	ACCUMULATE
01-Nov-16	3,458	3,700	ACCUMULATE
04-Aug-16	2,650	3,064	ACCUMULATE

Rating Legend	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% - 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than -5%

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