Bajaj Finance | BUY

JM FINANCIAL

Stellar quarter; well positioned on ALM and liquidity

Bajaj Finance (BAF) reported 2QFY19 net profit of INR 9.24bn (up 55% YoY) as per IndAS. As per IGAAP, net profit was up 83% YoY at INR 10.2bn. Key highlights: i) AUM growth remained strong at 38% YoY driven by all the segments. As per company, consumer demand remained strong, however given the current environment, company would be slightly cautious for quarter or so in the lumpy exposure in SME, LAS and commercial lending. ii) Customer acquisition remained healthy, with the company acquiring 1.8 million new customers (up 34% YoY) in 2QFY19. iii) Margins increased 33bps YoY to 11.1% on a 47bps YoY decline in funding costs. iv) Asset quality trends improved, with the gross NPL ratio improving 22bps YoY to 1.49% YoY with coverage ratio at 65%. v) Company has maintained strong ALM across cycles with positive ALM gap of 65% (upto 12m) as of Sep'18. Further BAF continue to maintain 4-6% of borrowing in cash and cash equivalents. In the current situation, we believe strong promoter backed NBFCs will get disproportionate share of funding going forward. Moreover, competition from new, small and PE backed NBFCs will come down massively further helping these strong promoter backed NBFCs. BAF remains well-positioned to deliver sustainable profitable growth going forward. We value BAF at 6.0x Mar'20 BV (implied PE 30x), implying a Mar'19 TP of INR 2,500. Maintain BUY.

- **Strong AUM growth; near-term approach to moderate SME/LAS/Commercial lending growth:** AUM growth remained strong at 38% YoY driven by all segments - rural (71% YoY), SME (33% YoY), consumer (39% YoY), commercial segment (38% YoY) while mortgages grew 32% YoY. As per company, consumer demand remained strong, however given the current environment, company would be slightly cautious for a quarter or so in the lumpy exposure in SME, LAS and commercial lending. We expect AUM CAGR of 28% over FY18-21E.
- **Margins rose 33bps YoY to 11.1%; proportion of deposits increased 450bps YoY to 15%:** Margins (NII/AUM) increased 33bps YoY to 11.1%, on a 33bps YoY drop in funding costs to 8.1%. Company expects cost of funds to remain below 9% for next 4-5 quarters. Further, 45% of its balance sheet could be repriced. The company has increased lending rates by 10-15 bps on existing portfolio and 20-50 bps for new acquisitions in the last 45 days including mortgage portfolio. BAF continues to diversify its liability mix as the proportion of deposits increased to 15% vs. 10% YoY; BAF expects it to increase further to 25-30%. We expect NII CAGR of 29% over FY18-21E.
- **Well positioned on ALM and liquidity:** Company has maintained strong ALM across cycles with positive ALM gap of 65% (upto 12m) as of Sep'18. Further BAF continue to maintain 4-6% of borrowing in cash and cash equivalents. Management believes that the current situation is better than 2013 when there was a complete freeze.
- **Forecast earnings CAGR of 31% YoY, Maintain BUY with TP of INR 2,500:** We expect earnings CAGR of 31% over FY18-21E, driven by robust AUM growth (28% CAGR) and improvement in opex and credit costs. We expect healthy return ratios with RoA/RoE of 3.8%/23% by FY21E; we value BAF at 6.0x Mar'20 BV (implied PE of 30x), implying a Mar'19 TP of INR 2,500.

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Recommendation and Price Target	
Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	2,500
Upside/(Downside)	20.0%
Previous Price Target	2,700
Change	-7.4%

Key Data – BAF IN	
Current Market Price	INR2,084
Market cap (bn)	INR1,204.4/US$16.4
Free Float	37%
Shares in issue (mn)	535.5
Diluted share (mn)	
3-mon avg daily val (mn)	INR6,639.4/US$90.2
52-week range	2,995/1,511
Sensex/Nifty	33,847/10,147
INR/US$	73.6

Price Performance

%	1M	6M	12M
Absolute	-12.4	9.7	13.6
Relative*	-4.7	11.7	9.1

* To the BSE Sensex

Financial Summary (INR mn)

Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Profit	18,366	26,741	37,309	47,214	60,519
Net Profit (YoY) (%)	43.6%	45.6%	39.5%	26.5%	28.2%
Assets (YoY) (%)	37.2%	36.3%	28.1%	27.3%	26.4%
ROA (%)	3.3%	3.6%	3.8%	3.7%	3.8%
ROE (%)	21.6%	21.1%	21.4%	22.2%	23.2%
EPS	33.6	46.5	64.9	82.1	105.2
EPS (YoY) (%)	40.7%	38.4%	39.5%	26.5%	28.2%
P/E (x)	**62.1**	**44.8**	**32.1**	**25.4**	**19.8**
BV	176	274	332	406	501
BV (YoY) (%)	26.6%	55.9%	21.3%	22.2%	23.3%
P/BV (x)	**11.87**	**7.61**	**6.27**	**5.13**	**4.16**

Source: Company data, JM Financial. Note: Valuations as of 23/Oct/2018

JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

- **Strong asset quality trends across product categories:** Asset quality trends improved, with the GNPL ratio improving 22bps YoY to 1.49% in 2QFY19. BAF is very comfortable with credit quality of all lines of business; this quarter the company saw improvement in consumer durable/LAP/2W/home loans' 30+DPD portfolio declining 83/141/714/93bps YoY to 0.62%/0.81%/5.68%/0.43%, respectively. Company has over INR 2.25bn exposure in IL&FS against loan against commercial real estate in GIFT city. It has an exclusive charge on these assets with LTV of 62%. BAF has prudently made 10% provision on this account. Credit costs remained stable YoY at 136bps. Coverage stood at 65% vs. 71% YoY. We have factored credit costs (provisions/AUM) of 130bps over FY18-21E.
- **Operating leverage and cost saving in mortgage business led to a decline in Opex/NII to 37%:** Cost/Asset declined to 3.94% from 4.22% primarily due to benefits of operating leverage and restructuring in mortgage business. We expect cost/assets of 4.8% by FY21E.
- Bajaj Finance (BAF) reported 2QFY19 net profit of INR 9.24bn as per IndAS, up 55% YoY. As per IGAAP, net profit was up 83% YoY at INR 10.22bn. We have shown reconciliation of IGAAP to IndAS in Exhibit 2.

Exhibit 1. BAF: Actual vs. estimates

P/L Rs mn	2Q19E	2Q19A	A/E (%)
Net Interest Income	**27,504**	**26,886**	**-2.2%**
Total Income	**27,554**	**27,290**	**-1.0%**
Total Operating Expenses	11,000	9,799	-10.9%
Operating Profit (PPP)	**16,554**	**17,491**	**5.7%**
Provisions	3,440	3,146	-8.6%
Reported Profit	**8,537**	**9,235**	**8.2%**

Source: Company, JM Financial

Exhibit 2. Reconciliation of IGAAP to IndAS

INRm	1Q18	2Q18	1Q19	2Q19	YoY change	QoQ change
PBT - IGAAP	**9,250**	**8,560**	**15,620**	**15,720**	84%	1%
EIR for financial assets at amortised costs	(1,860)	710	(2,210)	(1,150)		
EIR for financial liabilities at amortised costs	50	30	80	90	200%	13%
Expected Credit Loss	(130)	(10)	(370)	(170)		
Fair value of stock options as per Ind AS 102	(90)	(120)	(170)	(220)		
Actuarial loss on employee defined benefit plan recognised in OCI IndAS 19	-	-	-	-		
Gain/ (losses) on fair valuation of financial assets at FVTPL	(90)	10	20	-		
Recognition of Servicing Assets on assignment transactions		-		80		
PBT - IndAS	**7,130**	**9,180**	**12,970**	**14,350**	56%	11%
Less: Tax	(2,520)	(3,240)	(4,610)	(5,120)		
PAT - IndAS	**4,610**	**5,940**	**8,360**	**9,230**	55%	10%
PAT - IGAAP	**6,020**	**5,570**	**10,180**	**10,220**	83%	0%
Total IndAS impact	**(2,120)**	**620**	**(2,650)**	**(1,370)**		
% PBT IndAS	-29.73%	6.75%	-20.43%	-9.55%		
% PBT IGAAP	-22.92%	7.24%	-16.97%	-8.72%		

Source: Company, JM Financial

BAF – 2QFY19 trends

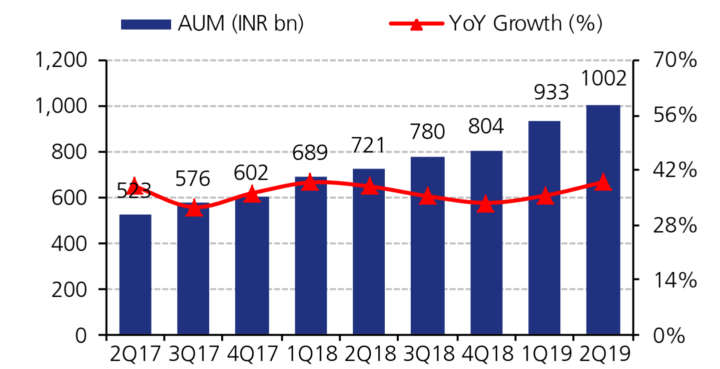
Exhibit 3. BAF quarterly highlights

Earnings Table (INR mn)	2Q'18	1Q'19	2Q'19	YoY (%)	QoQ(%)
Net Interest Income	**19,093**	**25,728**	**26,886**	**40.8%**	**4.5%**
Total Non-interest Income	153	49	404	163.6%	733.6%
Total Income	**19,246**	**25,777**	**27,290**	**41.8%**	**5.9%**
Employees Cost	3,483	4,471	4,600	32.1%	2.9%
Other Expenditure	4,329	5,065	5,200	20.1%	2.7%
Total Operating Expenses	**7,812**	**9,536**	**9,799**	**25.4%**	**2.8%**
Operating Profit (PPP)	**11,434**	**16,241**	**17,491**	**53.0%**	**7.7%**
Provisions & Write Offs	2,205	3,268	3,146	42.6%	-3.7%
PBT	**9,229**	**12,973**	**14,345**	**55.4%**	**10.6%**
Tax	3,250	4,615	5,110	57.2%	10.7%
Reported Profit	**5,979**	**8,359**	**9,235**	54.5%	10.5%
AUM (INR mn)	7,26,690	9,33,140	10,02,170	37.9%	7.4%
Ratios Analysis (%)					
Cost to Income (%)	40.6%	37.0%	35.9%	-4.7%	-1.1%
Effective Tax Rate (%)	35.2%	35.6%	35.6%	0.4%	0.1%
Credit Quality					
Gross NPAs (90 days overdue) (INR Mn.)	11,870	12,800	14,710	23.9%	14.9%
Net NPAs (90 days overdue) (INR Mn.)	3,500	4,000	5,220	49.1%	30.5%
Gross NPA (90 days overdue) (%)	1.71%	1.39%	1.49%	-12.8%	7.2%
Net NPA (90 days overdue) (%)	0.51%	0.44%	0.53%	3.9%	0.1%
Coverage Ratio (90 days overdue) (%)	70.5%	68.8%	65.0%	-7.8%	-3.8%
Capital Adequacy (%)					
Tier I (%)	19.9%	17.9%	17.2%	-2.7%	-0.8%
CAR (%)	25.4%	23.0%	22.1%	-3.3%	-0.9%
Du-pont Analysis (%)					
NII / Avg. Assets (%)	10.3%	11.2%	10.8%	0.5%	-0.4%
Non-Interest Inc. / Assets (%)	0.2%	0.0%	0.3%	0.2%	0.3%
Op. Cost / Assets (%)	4.2%	4.2%	3.9%	-0.3%	-0.2%
PPP / Assets (%)	6.2%	7.1%	7.0%	0.9%	-0.1%
Provisions / Assets (%)	1.2%	1.4%	1.3%	0.1%	-0.2%
Reported ROA (%)	3.2%	3.6%	3.7%	0.5%	0.1%

Source: Company, JM Financial

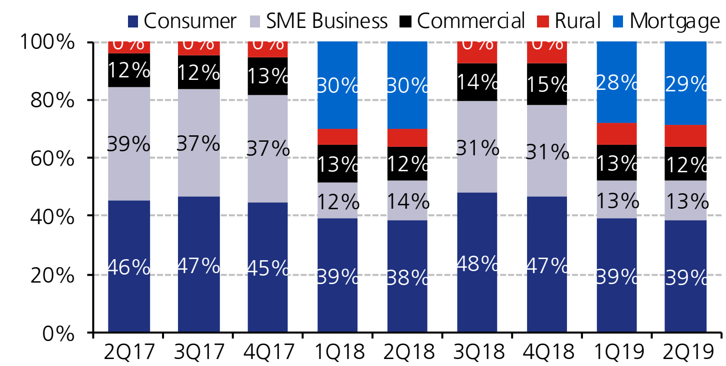
- AUM growth was robust at 38% YoY driven by all segments - rural segment grew 71% YoY, SME segment grew 33% YoY, consumer grew 39%, commercial segment grew 38% YoY while mortgages grew 32%. Customer acquisition remained strong as the company acquired 1.8 mn customers (34% YoY) in 2QFY19 and booked 5.26mn new loans (63% YoY) during the quarter.

Exhibit 4. BAF: Trend in AUM growth



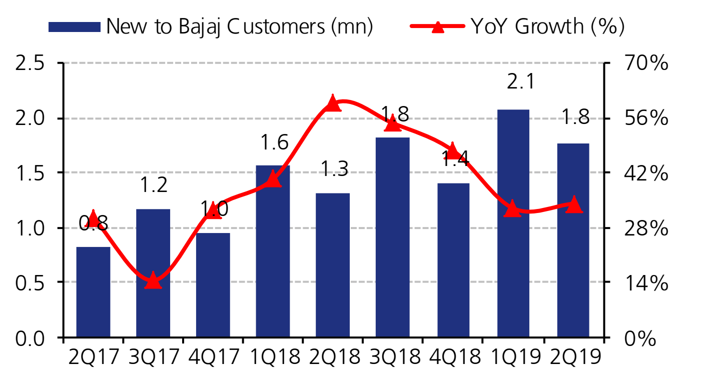
Source: Company, JM Financial

Exhibit 5. BAF: Trend in AUM composition



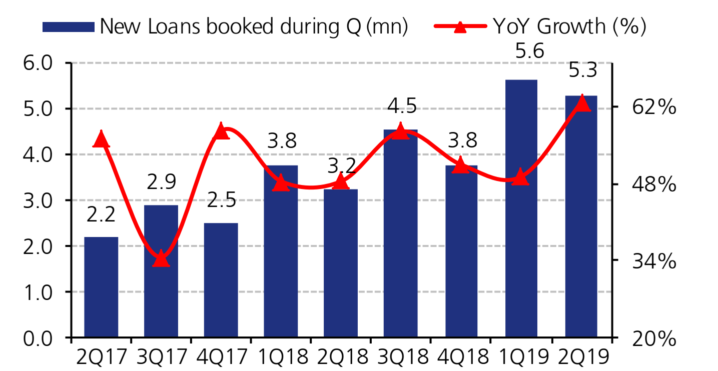
Source: Company, JM Financial, breakup for Mortgage is provided for 1Q18, 2Q18, 1Q19 and 2Q19

Exhibit 6. New to Bajaj customers



Source: Company, JM Financial

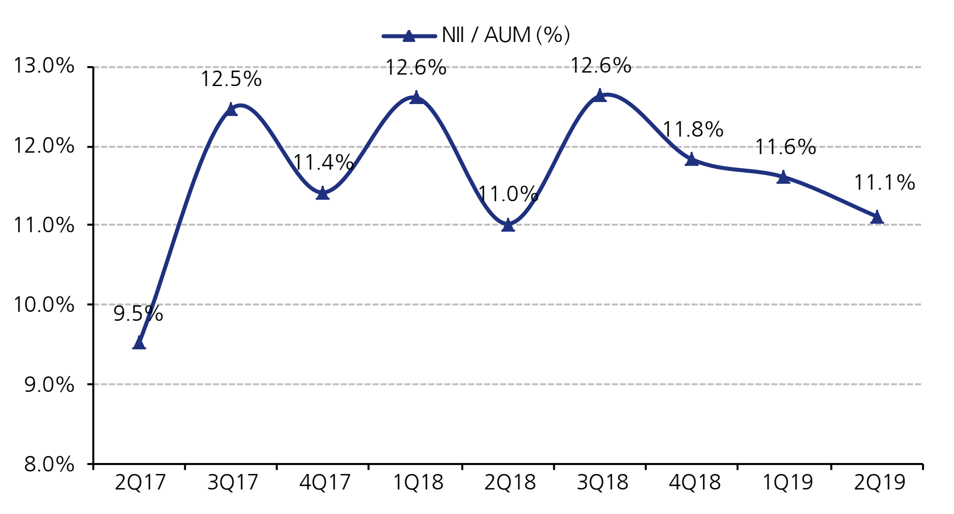
Exhibit 7. New loans booked



Source: Company, JM Financial

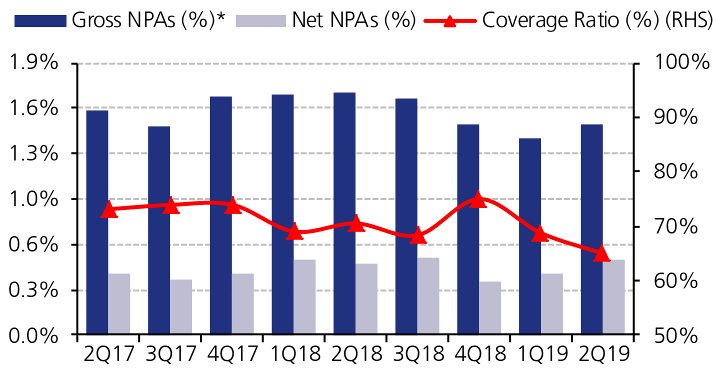
- Margins (NII/AUM) increased 33bps YoY to 11.1%, on a 47bps YoY drop in funding costs.

Exhibit 8. BAF: Trend in calculated margins (%)



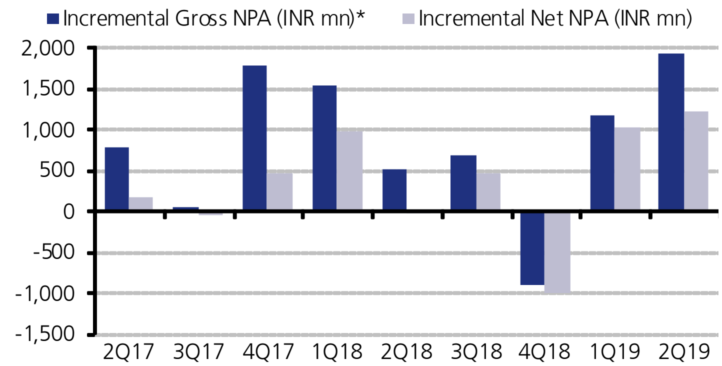
Source: Company, JM Financial

Exhibit 9. BAF: Trend in asset quality (%)



Source: Company, JM Financial, * NPL numbers are based on 120DPD in 2Q17-4Q17; 90DPD from 1Q18 and Stage 3 from 1Q19 onwards

Exhibit 10. BAF: Trend in asset quality (%)



Source: Company, JM Financial

Exhibit 11. Asset quality segment wise

Rs mn	GNPL (%)			NNPL (%)			Coverage ratio (%)		
Segments	2Q18	1Q19	2Q19	2Q18	1Q19	2Q19	2Q18	1Q19	2Q19
Consumer Business	2.1%	2.3%	2.4%	0.6%	0.7%	0.8%	73.0%	69.5%	67.6%
SME Business	1.9%	2.9%	1.9%	0.7%	0.8%	0.3%	65.0%	71.8%	76.6%
Commercial Business	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	NM	NM	NM
Mortgage	1.29%	0.56%	0.79%	0.25%	0.61%	0.17%	69.2%	51.6%	48.9%
Rural Business	0.9%	1.3%	1.3%	0.3%	0.6%	0.2%	69.2%	51.6%	48.9%
Total	**1.7%**	**1.4%**	**1.5%**	**0.5%**	**0.4%**	**0.5%**	**70.0%**	**68.8%**	**64.5%**

Source: Company, JM Financial

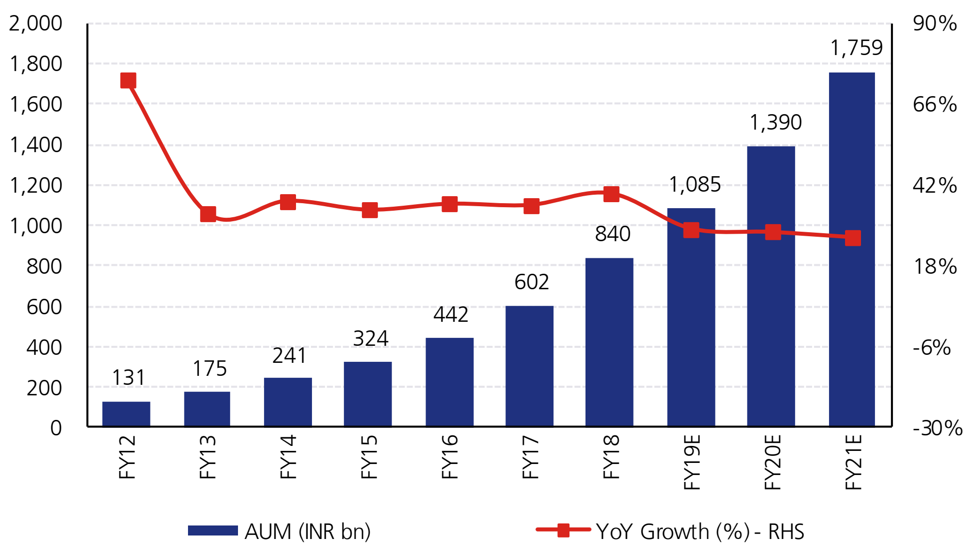
Exhibit 12. Credit quality – 30+DPD

Credit Quality -30+dpd	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	YoY%	QoQ%
Consumer durable	1.2%	1.4%	1.0%	0.8%	0.7%	0.7%	0.5%	0.6%	-0.2%	0.1%
Digital product finance	2.2%	1.7%	1.3%	0.7%	0.6%	0.9%	0.9%	0.7%	0.0%	-0.2%
Lifestyle Finance	1.7%	1.7%	1.7%	0.9%	0.8%	0.8%	0.8%	0.7%	-0.3%	-0.1%
Two wheeler	7.0%	6.8%	7.0%	7.1%	6.2%	5.6%	6.0%	5.7%	-1.5%	-0.3%
Personal loan cross sell	1.2%	1.4%	1.5%	1.5%	1.4%	1.3%	1.3%	1.2%	-0.2%	0.0%
Small Business loan	0.5%	0.9%	1.0%	0.9%	1.0%	1.0%	0.8%	0.9%	-0.1%	0.0%
Home loan	0.5%	0.9%	0.9%	0.9%	0.8%	0.2%	0.5%	0.4%	-0.5%	0.0%
Loan against property	0.6%	0.7%	0.9%	1.4%	1.6%	0.8%	0.7%	0.8%	-0.6%	0.2%
Rural Lending	0.8%	0.7%	0.6%	0.5%	0.6%	0.6%	0.6%	0.7%	0.1%	0.1%

Source: Company, JM Financial

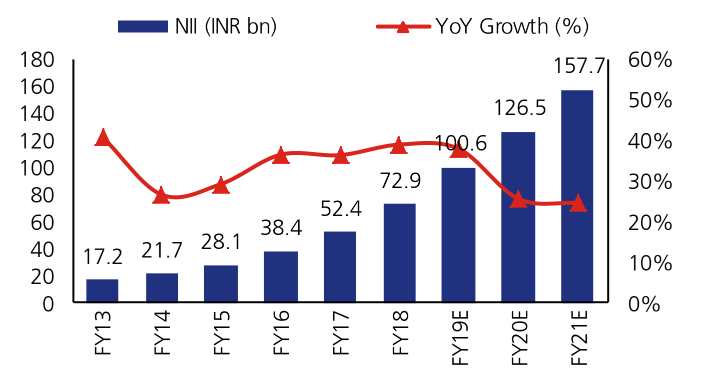
BAF – Annual trends

Exhibit 13. BAF: Trend in loans (INR bn)



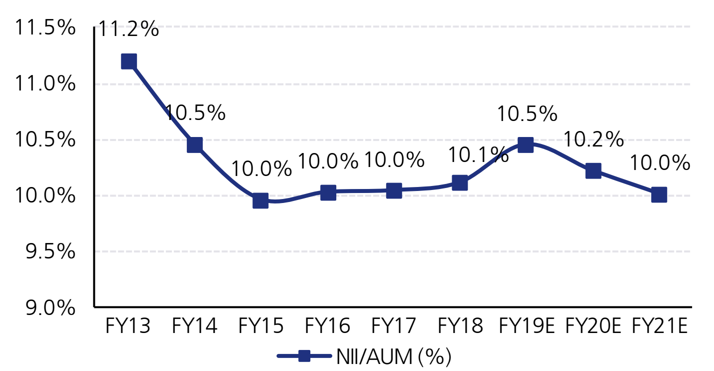
Source: Company, JM Financial

Exhibit 14. BAF: Trend in NII



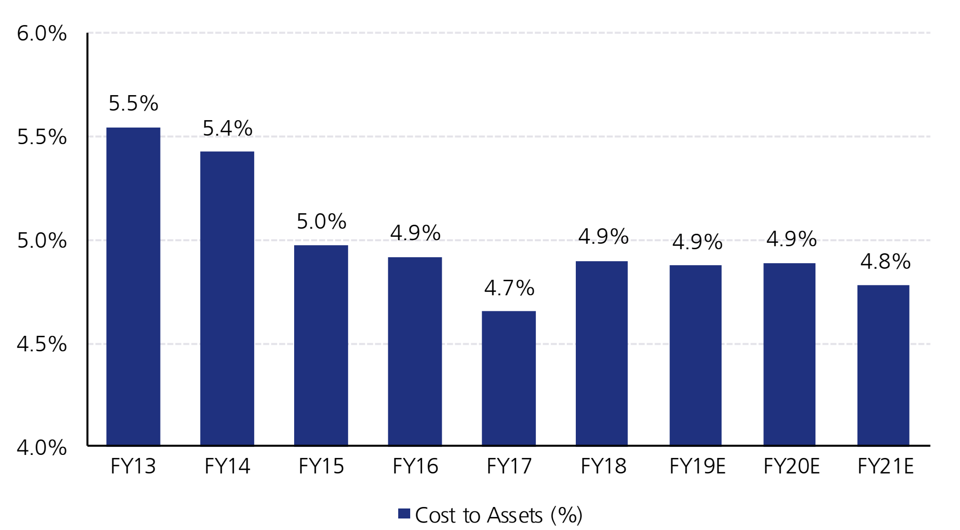
Source: Company, JM Financial

Exhibit 15. BAF: Trend in margins



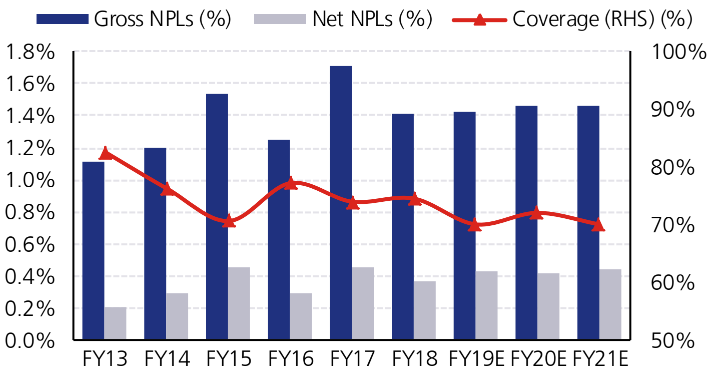
Source: Company, JM Financial

Exhibit 16. BAF: Trend in cost-to-assets (%)



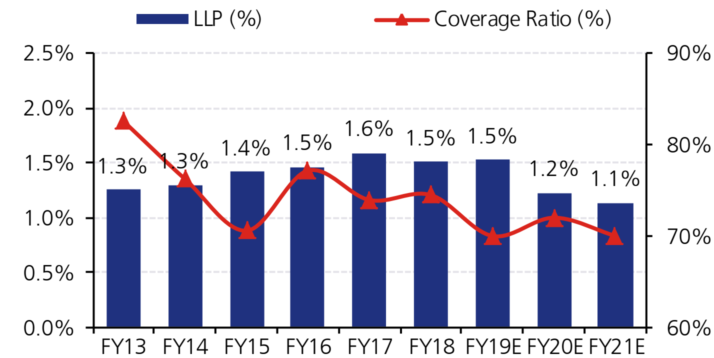
Source: Company, JM Financial

Exhibit 17. BAF: Trend in asset quality



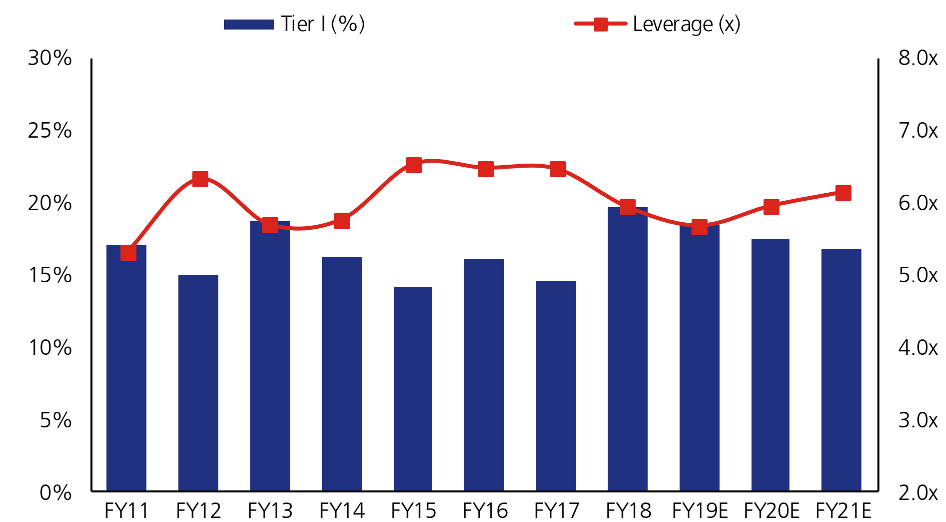
Source: Company, JM Financial

Exhibit 18. BAF: Trend in credit costs



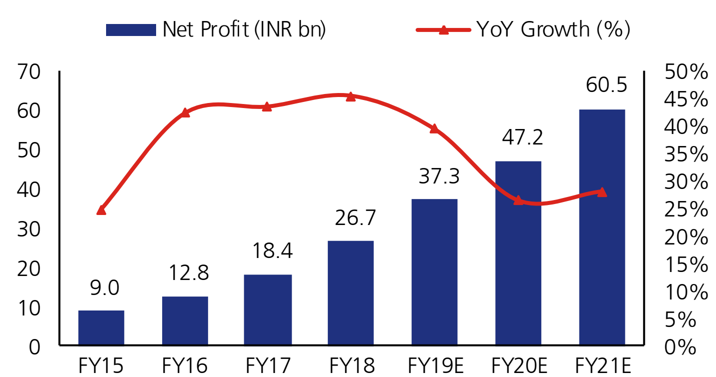
Source: Company, JM Financial

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



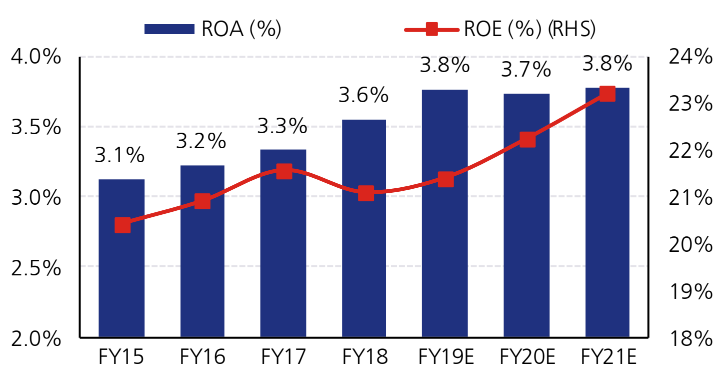
Source: Company, JM Financial

Exhibit 20. BAF: Trend in earnings growth



Source: Company, JM Financial

Exhibit 21. BAF: Trend in return ratios



Source: Company, JM Financial

Financial Tables (Standalone)

Income Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Interest Income (NII)	52,435	72,924	1,00,636	1,26,504	1,57,696
Non Interest Income	9,440	15,265	18,446	22,614	28,046
Total Income	**61,875**	**88,189**	**1,19,082**	**1,49,117**	**1,85,742**
Operating Expenses	25,642	36,902	48,287	61,815	76,600
Pre-provisioning Profits	**36,233**	**51,287**	**70,795**	**87,303**	**1,09,141**
Loan-Loss Provisions	3,908	3,252	14,265	14,766	17,446
Others Provisions	3,908	7,073	0	0	0
Total Provisions	**8,058**	**10,325**	**14,265**	**15,766**	**17,446**
PBT	**28,175**	**40,962**	**56,529**	**71,536**	**91,695**
Tax	9,810	14,221	19,220	24,322	31,176
PAT (Pre-Extra ordinaries)	**18,366**	**26,741**	**37,309**	**47,214**	**60,519**
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	**18,366**	**26,741**	**37,309**	**47,214**	**60,519**
Dividend	2,383	2,787	3,731	4,721	6,052
Retained Profits	**15,983**	**23,954**	**33,578**	**42,493**	**54,467**

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Equity Capital	1,094	1,150	1,150	1,150	1,150
Reserves & Surplus	94,909	1,56,306	1,89,885	2,32,377	2,86,844
Stock option outstanding	0	0	0	0	0
Borrowed Funds	4,92,497	6,44,813	8,43,415	10,85,896	13,84,518
Deferred tax liabilities	0	0	0	0	0
Preference Shares	0	0	0	0	0
Current Liabilities & Provisions	48,746	65,974	77,862	96,267	1,16,271
Total Liabilities	**6,37,246**	**8,68,243**	**11,12,311**	**14,15,691**	**17,88,783**
Net Advances	5,68,320	8,16,001	10,53,581	13,49,522	17,07,883
Investments	40,747	31,460	34,768	39,136	47,821
Cash & Bank Balances	3,799	3,395	4,214	5,398	6,832
Loans and Advances	5,333	3,432	4,214	5,398	5,978
Other Current Assets	11,712	5,389	5,713	5,153	6,266
Fixed Assets	3,611	4,670	5,426	6,199	7,832
Miscellaneous Expenditure	0	0	0	0	0
Deferred Tax Assets	3,691	3,864	4,394	4,885	6,172
Total Assets	**6,37,213**	**8,68,211**	**11,12,311**	**14,15,691**	**17,88,783**

Source: Company, JM Financial

Key Ratios					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Growth (YoY) (%)					
Borrowed funds	33.0%	30.9%	30.8%	28.8%	27.5%
Advances	32.9%	43.6%	29.1%	28.1%	26.6%
Total Assets	37.2%	36.3%	28.1%	27.3%	26.4%
NII	36.5%	39.1%	38.0%	25.7%	24.7%
Non-interest Income	62.0%	61.7%	20.8%	22.6%	24.0%
Operating Expenses	31.6%	43.9%	30.9%	28.0%	23.9%
Operating Profits	46.4%	41.5%	38.0%	23.3%	25.0%
Core Operating profit	44.3%	40.8%	42.8%	24.0%	25.1%
Provisions	57.7%	28.1%	38.2%	10.5%	10.7%
Reported PAT	43.6%	45.6%	39.5%	26.5%	28.2%
Yields / Margins (%)					
Interest Spread	8.01%	8.05%	8.28%	8.10%	7.94%
NIM	9.76%	9.90%	10.32%	10.14%	9.96%
Profitability (%)					
ROA	3.33%	3.55%	3.77%	3.74%	3.78%
ROE	21.6%	21.1%	21.4%	22.2%	23.2%
Cost to Income	41.4%	41.8%	40.5%	41.5%	41.2%
Asset quality (%)					
Gross NPA	1.71%	1.41%	1.42%	1.47%	1.46%
LLP	1.41%	1.38%	1.53%	1.23%	1.14%
Capital Adequacy (%)					
Tier I	14.56%	19.68%	18.38%	17.44%	16.85%
CAR	20.30%	24.71%	23.09%	21.89%	21.07%

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
NII / Assets	9.52%	9.69%	10.16%	10.01%	9.84%
Other Income / Assets	1.71%	2.03%	1.86%	1.79%	1.75%
Total Income / Assets	11.23%	11.72%	12.03%	11.80%	11.59%
Cost / Assets	1.69%	1.89%	2.01%	2.10%	2.08%
PPP / Assets	6.58%	6.81%	7.15%	6.91%	6.81%
Provisions / Assets	1.46%	1.37%	1.44%	1.25%	1.09%
PBT / Assets	5.11%	5.44%	5.71%	5.66%	5.72%
Tax rate	34.8%	34.7%	34.0%	34.0%	34.0%
ROA	3.33%	3.55%	3.77%	3.74%	3.78%
Leverage	6.6	5.5	5.8	6.1	6.2
ROE	21.6%	21.1%	21.4%	22.2%	23.2%

Source: Company, JM Financial

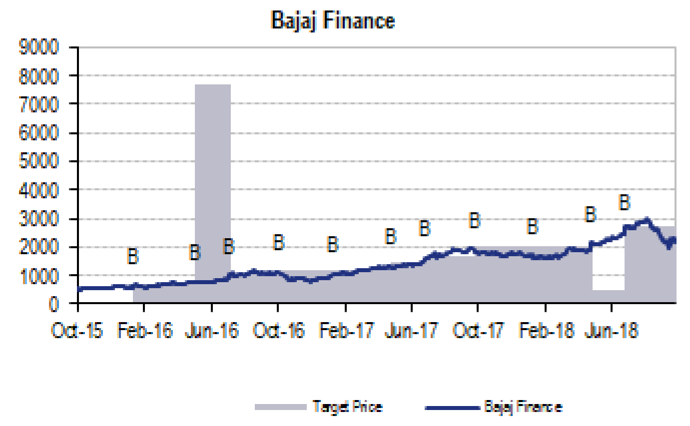
Valuations					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Shares in Issue	546.9	575.2	575.2	575.2	575.2
EPS (INR)	33.6	46.5	64.9	82.1	105.2
EPS (YoY) (%)	40.7%	38.4%	39.5%	26.5%	28.2%
P/E (x)	62.1	44.8	32.1	25.4	19.8
BV (INR)	176	274	332	406	501
BV (YoY) (%)	26.6%	55.9%	21.3%	22.2%	23.3%
P/BV (x)	11.87	7.61	6.27	5.13	4.16
DPS (INR)	4.4	4.8	6.5	8.2	10.5
Div. yield (%)	0.2%	0.2%	0.3%	0.4%	0.5%

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
3-Feb-16	Buy	720	
25-May-16	Buy	7,700	969.4
26-Jul-16	Buy	1,030	-86.6
27-Oct-16	Buy	1,150	11.7
31-Jan-17	Buy	1,150	0.0
18-May-17	Buy	1,460	27.0
20-Jul-17	Buy	1,650	13.0
17-Oct-17	Buy	2,050	24.2
2-Feb-18	Buy	2,050	0.0
17-May-18	Buy	UR	
17-May-18	Buy	510	
19-Jul-18	Buy	2,700	429.4

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

(formerly known as JM Financial Securities Limited)

Corporate Identity Number: U67100MH2017PLC296081
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Rating	Meaning
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Hold	Price expected to move in the range of 10% downside to 15% upside from the current market price.
Sell	Price expected to move downwards by more than 10%

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