Bajaj Finserv

Some hits, some misses in Q3

Banks & Finance	Sharekhan code: BAJAJFINSV	Result Update

Summary

- Bajaj Finserv (BFS, holding company) clocked mixed numbers for Q3FY2021, where operational performance marginally beat expectations; however, higher provisions of Bajaj Finance dampened BFS' PAT.
- Insurance subsidiaries BALIC and BAGIC performed well, helped by a net positive impact on PAT on account of post-tax MTM gains from BAGIC & BALIC's investments of Rs. 384 crore.
- Bajaj Finance is well capitalised with conservative leverage and both BALIC and BAGIC have healthy solvency ratios and strong operating metrics, with structural tailwinds to benefit them for the long term.
- We maintain a Buy on Bajaj Finserv with a revised SOTP-based price target (PT) of Rs. 10,860.

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 9,048**	
Price Target: **Rs. 10,860**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

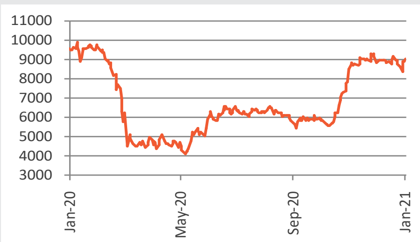
Company details

Market cap:	Rs. 143,995 cr
52-week high/low:	Rs. 9970/3985
NSE volume: (No of shares)	8.1 lakh
BSE code:	532978
NSE code:	BAJAJFINSV
Free float: (No of shares)	6.2 cr

Shareholding (%)

Promoters	60.8
FII	9.5
DII	6.1
Others	23.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.2	54.1	42.5	-5.2
Relative to Sensex	-6.6	31.7	11.5	-25.9

Sharekhan Research, Bloomberg

Bajaj Finserv (BFS, holding company) reported mixed numbers for Q3FY2021, where operational performance marginally beat expectations, but higher provisions of Bajaj Finance dampened BFS's PAT. The insurance subsidiaries BALIC and BAGIC performed well, helped by a net positive impact on PAT on account of MTM gains on BAGIC and BALIC Investments of Rs. 384 crore (post-tax). Bajaj Finance (BFL) saw Q3FY2021 marked by a granular business recovery, significant improvement in risk metrics and tracking implementation on business transformation plan. Loan losses and provisions stood at Rs. 1,352 crore versus Rs. 831 crore in Q3FY20 and during Q3, BFL carried out one-time principal write-offs of Rs. 1,970 crore on account of COVID-19 related stress. We find that the growth outlook for BFL is stable from FY22 onwards and the company guided to keep loan losses and provisions at pre-COVID-19 levels of 160-170 bps of average assets. BAGIC's gross written premiums (GWP) grew by 11% in Q3FY21 versus industry growth of 2% (private players growth of 8.6%) and a 3% decline in 9MFY21 versus flat industry growth (private players saw a growth of 1.7%). Q3 has seen a turnaround in four-wheeler and two-wheeler segments, which grew by 9.6% & 13.1%, respectively. Combined ratio (COR) improved and stood at 96.1% in Q3 FY21 versus 103.6% in Q3 FY20 on account of lower claims (loss ratio in Q3 FY21 stood at 66.6% as against 72.6% in Q3 FY20) and expense saves. Solvency ratio stood at 330% as against the regulatory requirement of 150% as on December 31, 2020. Despite COVID-19, BALIC had a market-beating individual rated new premium (IRNB) growth of 14% in Q3 FY21 (industry reporting a decline of 9%; private sector grew by 3%). Institutional Business have been a growth driver with 75% growth in IRNB for Q3 FY21 as new partnership like Axis Bank, IDFC First Bank, RBL Bank and India Post Payments Bank (IPPB) are delivering well. The regulator has proposed norms, which (if accepted) would allow conversion of NBFCs to banks, is sentimentally positive for players like BFL, as they may open opportunity of possible conversion to a bank for them. While BFL has yet to evince active interest in acquiring a banking license, a change of course is possible. While near-term challenges remain, sound fundamentals of BFL's business franchise are likely to sustain. Bajaj Finance Limited (BFL) is well capitalized with a conservative leverage, and both BALIC and BAGIC have healthy solvency ratios and strong operating metrics, with structural tailwinds to benefit them for the long term. We maintain our Buy recommendation on Bajaj Finserv with a revised SOTP-based price target (PT) of Rs. 10,860.

Key positives

- Strong capital metrics across all subsidiaries, with BAGIC's solvency ratio robust at 330% and BALIC's solvency ratio at healthy 708%, with BFL Tier-1 capital ratio at 24.7%.
- A lower claim ratio was seen in the motor, crop, and health segments, which partly were benefitted by the pandemic.

Key negatives

- Provisions remained elevated for BFL, with the company doing a one-time write-off of principal outstanding of Rs 1,970 crore and interest outstanding of Rs. 365 crore on account of COVID-19 related stress. Front ending of provisions, however, presents BFL with a clean slate for FY22E.

Our Call

Valuation: As BFL had taken upfront provisions in FY2021, we expect it to enter FY2022E with a clean slate, high capitalisation, and strong balance sheet as growth facilitators going forward. Notwithstanding near-term headwinds, sound fundamentals of BFL's business franchise and strategic long term business transformation steps are likely to be long term positives. BFL is well-capitalised with conservative leverage and both BALIC and BAGIC have healthy solvency ratios and strong operating metrics, along with strong structural tailwinds to provide growth opportunities for them for the long term. We maintain our Buy rating on the stock with a revised SOTP-based PT of Rs. 10,860.

Key Risks

Slowdown in consumer finance growth and worsening of economic parameters may pose a risk to earnings growth and profitability.

SOTP Valuation

Particulars	Holding	Value per share	Rationale
Life Insurance	74.0%	1,317	1.6x FY23E EV
General Insurance	74.0%	1,130	16.5x FY23E PAT
Bajaj Finance	52.7%	12,060	6.9x FY23E BVPS
Less: Holding Co Discount	25%	3,647	
Total		**10,860**	

Source: Company; Sharekhan estimates

Key Concall Highlights

Business update: Business conditions have improved q-o-q. BFS is focused on growth recovery and managing risk.

BAGIC Update: BAGIC is taking a calibrated approach to growth by preferred areas (private cars, two-wheelers, commercial lines like fire & property, retail health, etc) to grow and cautious on group health. Most of retail health is Indemnity based retail business.

In CV insurance, BAGIC had a minor presence, but business has reached to pre-COVID levels. BAGIC has been conservative in claims in the motor segment, etc. Motor two-wheeler and four-wheelers registered a 13.1% and 9.6% growth, while in the CV segment, there was a 19% decline y-o-y; q-o-q growth improved.

Retail health demand has normalised, and price increase in Q3 has dampened the growth. BAGIC is conservative on the employee-employer group health business due to a high loss ratio.

Pricing: Average rate increases are lower for BAGIC but risk is also lower. Since property price rate increase in Q4FY20 hence growth may slow due to base effect.

Motor business: There is an uncertainty on final claims and hence taking conservative stance of the claims. On pricing and discounting, BAGIC is a strong player and have strong infrastructure and channels which build a sustainable business.

Reserving is challenge, since there is 1 year delay on claims and there is interest charge on the claim. This lag will need to be considered for reserving calculations. OD part the frequency claim had earlier during the year declined but has now normalised.

BALIC update: Demand for ULIPs is increasing due to mkt performance.

Distribution: BALIC 77% of business via digital line in December.

Life persistency: The Life Insurnace business have made transition to mass affluent customer segment, but so far the migration impact on persistency levels is visible on ULIPs. Moreover, BALIC has partnerships with small-finance banks, which cater to lower-ticket size business as well.

Technology: Conceiving, creating and executing products are important for BAGIC and BALIC. They have been investing on analytics as well as customer experience for on-spot claims, etc. The company earlier started the concept of a virtual sales officer (VSO) across the country. It had also begun on-the-spot claim resolution in 2014-15, an industry first at that time. So both companies have a long-term focus on technology.

TP loss ratio are likely to be elevated levels from Q1 due to higher claims. It is dependent on the pricing charged. Due to lockdown there were lower claims and as economy opens and there are more normalised claims, there will be higher claims and loss ratio. Hence pricing change for temporary phenomenon is not done. Q4 will be keenly watched for the loss ratio plays out.

BALIC channels has diversified: Strong growth on institutional business, and BALIC has diversified from 4-5 years ago being dependent on agency.

A hike in prices of general insurance in next year will be decided by market forces. India is unique for having a combined ratio of over 100% in the world for a long term. BAGIC is sharpening analytics, data mix, propensity models, etc to collect better customer, and profitable.

Motor OD: In April and May, vehicle usage was low and hence the claim ratio was also low. Now the vehicle population on road has normalized and hence the quantum of loss and frequency will be stable.

Life insurance term protection: Life insurance protection has been volatile for BALIC. The monthly fluctuations have been higher due to product mix. Also depend on speed of issue etc which has impacted business during FY2021.

Pricing in group health segment: Annual contract, and due to Covid and related claims, the company has realised that pricing is difficult. Hence decided to go slow on this segment.

Crop pricing: Since 2015 when Fasal Bima was launched, BAGIC has maintained the crop insurance. This is not a float business, and works on combined ratio, supported by strong re-insurance partner.

Retail health, pricing hike and impact on combined ratio: As per regulations, the company can't increase the prices for three years. Hence, medical inflation may be higher due to COVID-19. In the retail health book, loss ratios are 30-40% till 1-3 years, and in the fourth year it will be 100%. Hence if company writes more newer business, the overall combined ratio will come lower. Retail health is a strong growth business, and size wise too, it is an attractive business.

Reserving: Company believes that is reserving has been cautious.

Busines mix to diversify for BALIC: For BALIC, the mix is well diversified but would be looking to broad base further as situation permits. The credit protection outlook is likely to improve, but co would be focusing more on retail business.

Views on banking licence: There is a discussion paper as well as final guidelines which is awaited. Becoming a bank has some positives, but the company will analyse the terms of the same when it is finalised.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Income from operations	15958.5	14558.9	9.6	15049.6	6.0
Other income	2.2	1.8	20.3	2.0	9.0
Total Income from operations	15960.7	14560.7	9.6	15051.6	6.0
Expenses	13181.5	11933.8	10.5	12894.9	2.2
Employee Expenses	1230.4	1293.3	-4.9	1013.9	-
Finance Costs	2258.4	2419.4	-6.7	2340.2	-3.5
Fees and comission expense	719.4	557.3	29.1	613.9	17.2
Claims paid	3094.5	3198.4	-3.2	2802.9	10.4
Reinsurance ceded	1274.3	1163.5	9.5	1715.2	-25.7
Net Change in Insurance / Investment Liabilities	2307.0	1378.3	67.4	1884.7	22.4
Depreciation & Amtzn.	123.8	116.2	6.6	114.0	8.6
Other Expenses	797.5	978.4	-18.5	750.0	6.3
Provisions	1376.3	828.9	66.0	1660.1	-17.1
Profit before tax	2779.2	2627.0	5.8	2156.7	28.9
Share in PAT of invst in associates	0.0	0.2	-110.5	-0.1	-77.8
Tax	697.3	649.1	7.4	538.3	29.5
PAT	2081.9	1978.1	5.2	1618.3	28.6

Source: Company; Sharekhan Research

Bajaj Allianz Life Insurance Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Gross written premium	3,147	2,552	23.3	2,677.0	17.6
New business premium	1,706	1,411	20.9	1,372.0	24.3
Renewal premium	1,441	1,141	26.3	1,305.0	10.4
Shareholders Profit	148	133	11.3	131.0	13.0
Transfer from policyholder account	-30	10	-400.0	-33.0	-9.1
Profit / (Loss) after tax	118	143	-17.5	98.0	20.4

Source: Company; Sharekhan Research

Bajaj Allianz General Insurance Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Gross written premium	3,392	3,055	11.0	4,156.0	-18.4
New earned premium	1,838	2,156	-14.7	1,986.0	-7.5
Underwriting Result	27	-87	-131.0	29.0	-6.9
Investment and other income (net)	413	359	15.0	414.0	-0.2
Profit before tax	440	272	61.8	443.0	-0.7
Profit after tax	330	191	72.8	332.0	-0.6

Source: Company; Sharekhan Research

Bajaj Finance (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Interest Income & Fees	6659	7024	-5.2	6516.6	2.2
Interest and Other Charges	2363	2489	-5.1	2358.1	0.2
Net Interest Income	4296	4535	-5.3	4158.4	3.3
Operating Expenses	1389	1534	-9.5	1159.27	19.8
Provisions and Loan losses	1352	831	62.7	1700.4	-20.5
PBT	1,555	2,170	-28.3	1305.5	19.1
Tax Expense	409	556	-26.4	340.6	20.1
Profit After Tax	1,146	1,614	-29.0	964.9	18.8

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Green shoots in the economy are encouraging

Retail players have a large market to grow post unlocking of the economy. Banks are reporting an incremental pickup in credit demand, especially in retail and consumer segments. Leading indicators indicate recovery in economic activity, which will be a positive. So far, risk metrics of new volumes originated across businesses are tracking better than pre-COVID-19 origination. We believe retail and consumer lending segments have a long structural growth runway available to them, as India's credit delivery diversifies and penetration increases. In this backdrop, aided by a strong demographic advantage, we believe nimble NBFCs and private banks can co-exist and grow for the foreseeable future as the market expands. We believe the insurance sector has a huge growth potential in India with a large protection gap, expanding per capita income, retiral needs, as well as greater awareness/ acceptance of financial security products (accelerated by the pandemic) etc., which are key long-term growth drivers for the sector. In this backdrop, we believe strong players such as BALIC and BAGIC, armed with the right mix of products, services, and distribution (augmented by stable Bancassurance partnerships) are likely to gain disproportionally from the opportunity.

■ Company outlook - Subsidiaries' sound fundamentals will allow play on long-term opportunities

We believe that structurally, all of BFS subsidiaries are well placed. BFL stands out with its strong balance sheet, comfortable liquidity, high credit ratings, and well-matched asset-liability management position. It is also well-capitalised as well and has a strong provision buffer that will help it cushion the impact on its balance sheet and profitability. BFL has modularity built across various cost items, including salary costs, which will provide BFL a reasonable control over costs.

BFL has a diversified financial services strategy seeking to optimise risk and profit, and deliver a sustainable and superior ROE and ROA on the long term. It is focused on continuous innovation to transform customer experience to create growth opportunities. The insurance subsidiaries have well-diversified product portfolio and multi-channel distribution supported by prudent underwriting, which augurs well for long term sustainability and profits. The premium trajectory is encouraging, reflecting a rapid normalization aided by operational tweaks and agility in technology adoption. While near-term headwinds persist, the sound fundamentals of business franchises are likely to sustain during these tough times.

■ Valuation - Maintain Buy with a PT of Rs. 10,860

As BFL had taken upfront provisions in FY2021, we expect it to enter FY2022E with a clean slate, high capitalisation, and strong balance sheet as growth facilitators going forward. Notwithstanding near-term headwinds, sound fundamentals of BFL's business franchise and strategic long term business transformation steps are likely to be long term positives. BFL is well-capitalised with conservative leverage and both BALIC and BAGIC have healthy solvency ratios and strong operating metrics, along with strong structural tailwinds to provide growth opportunities for them for the long term. We maintain our Buy rating on the stock with a revised SOTP-based PT of Rs. 10,860.

About company

Bajaj Finserv (BFS) is a diversified financial services group with a pan-India presence in life insurance, general insurance, and lending. It is the holding company for Bajaj Finance Ltd (BFL) and BFS' shareholding in BFL (Bajaj Finance Ltd.) was 52.74%. It also holds 74% each in Bajaj Allianz General Insurance (BAGIC) and Bajaj Allianz Life Insurance (BALIC, among top 5 Pvt sector Life insurers in India on new business in FY20). Set up in 1987, BFL is a diversified company across lending (consumer, rural, SME, commercial & mortgage space) and payments. BAGIC established in 2001 is the 2nd largest private General insurer in India in terms of Gross Premium and has Consistently most profitable amongst the private players. BALIC, established in 2001 has a deep, pan India distribution reach.

Investment theme

Bajaj Finserv is a financial conglomerate having presence in the financing business (vehicle finance, consumer finance and distribution) via Bajaj Finance (BFL) and in the Insurance space via its life insurance arms Bajaj Allianze Life (BALIC) and Non Life subsidiary Bajaj Allianz General insurance (BAGIC). BFL is a dominant player in the Consumer finance space. We expect BFL to maintain its loan book trajectory as well as profitability and margins in the long term, augmented by its unique business model and strong infrastructure, though near term may be a recovery phase in terms of growth. Despite challenges, we believe lending business is on a strong and improved footing. We view Insurance is an attractive space with a long term growth potential. The insurance subsidiaries are strong entities in their own domain. Both BAGIC and BALIC, have healthy operating metrics, high capital and profitability ratios which are long term positives. The insurance arms are focusing on strengthening distribution channel and profitability and are likely to emerge as attractive businesses over time providing valuation support to BFS.

Key Risks

Slowdown in consumer finance growth and worsening of economic parameters may pose risk to earnings growth and profitability.

Additional Data

Key management personnel

Mr. Sanjiv Bajaj	Managing Director & CEO
S Sreenivasan	CFO
V. Rajagopalan	President - Legal
Mr. Ganesh Mohan	Group Head – Strategy
Mr. Ajay Sathe	Head – Group Risk Management
Rajeev Jain	Managing Director – Bajaj Finance Limited

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Jamnalal Sons Pvt Ltd	9.6
2	Jaya Hind Industries Ltd	3.9
3	Maharashtra Scooters Ltd	2.3
4	Bajaj Niraj Ramkrishna	1.7
5	Bajaj Sevashram Pvt Ltd	1.5
6	Life Insurance Corp of India	1.4
7	Capital Group Cos Inc	1.3
8	Bachhraj& Co Pvt Ltd	1.3
9	Vanguard Group Inc/The	0.9
10	SBI Funds Management Pvt Ltd	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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