



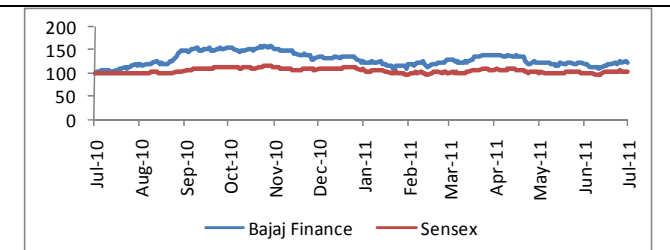
Stock Idea

Bajaj Finance Ltd

Recommendation	Not Rated
CMP (13/07/2011)	Rs. 686
Sector	NBFC

Stock Details	
BSE Code	500034
NSE Code	BAJFINANCE
Bloomberg Code	BAF IN
Market Cap (Rs. crs)	2,507
Free Float (%)	43.93
52- wk HI/Lo	839.1/493.6
Avg. volume BSE/ NSE (Monthly)	6505
Face Value	10
Dividend payout (FY 2011)	100%
Shares o/s (Crs)	3.65

Relative Performance	1Mth	3Mth	1Yr
Bajaj Finance	1.1%	-12.7%	17.9%
Sensex	0.8%	-6.5%	2.4%



Shareholding Pattern (31/03/2011)	
Promoters Holding	56.07%
Institutional (Incl. FII)	18.03%
Mutual Funds	6.84%
Public & others	19.06%

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Snapshot

Bajaj Finance Ltd (BFL), earlier known as Bajaj Auto Finance Ltd is a Bajaj group company and was incorporated in 1987. BFL started its operations as a captive financier for Bajaj Auto vehicles. However, over the past few years it has increased its presence in various segments and now caters to almost 8 major segments with auto financing contributing 23% of the total business.

➤ Diversified business player

BFL is a diversified player which is riding high on strong demand across its key business segments. It operates on a “**8 product portfolio**” and targets to grow its loan book at a higher pace.

➤ Sole player in consumer finance:

BFL is “**the sole player**” in consumer financing business and is well-positioned to capture a larger share in the opportunities arising from consumer finance business.

➤ High growth in business:

BFL has been growing its disbursement at a CAGR of 37% over FY06-FY11 which shows that it has been able to grow at a very higher rate. Moreover, going forward Management has indicated that the disbursement will grow at minimum 30% for FY12E and may even grow higher than that.

➤ Strong asset quality

BFL’s NPA has come down dramatically over last few years. Effective risk management strategy and improving collection efficiency has helped to bring down its net NPAs to 0.8% with a provision coverage ratio of 79% in FY2011.

Valuation & Recommendation

BFL is currently trading at a very attractive valuation amongst the NBFC business space. It is currently trading at a compelling valuation of 9.2 times PE and 1.5 times price to book value calculated post dilution on its annualized Q1FY12 earnings and book value respectively which we believe is at a discount to its peers. Going ahead, we believe BFL is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk as the company intends to focus on secured business lines. Given these factors we believe that the stock is available at an attractive value at current levels and offers potential upside from current levels. We recommend BUY on the stock with 20%-25% return in next 6 to 9 months.

Year	NII (Rs.crs)	Growth %	Profit before prov (Rs. crs)	Margin %	PAT (Rs. crs)	EPS (Rs)	P/E (x)	Adj BVPS	P/ABV (x)
FY 08A	239	12.50%	139	38.09%	21	5.62	122.0	291	2.36
FY 09A	345	44.3%	215	27.7%	34	9.26	74.1	297	2.31
FY 10A	608	76.1%	395	43.1%	89	24.40	28.1	315	2.18
FY 11A	906	49.0%	575	40.9%	247	67.42	10.2	372	1.84

Investment Rationale

➤ **Diversified business player**

BFL is a diversified player which is riding high on strong demand across its key business segments. Historically BFL had always focused on two wheeler and consumer durables loans. However, it has reduced its exposure from being auto finance company to diversified consumer franchise. It operates on a “**8 product portfolio**” and targets to grow its loan book at a higher pace. BFL operates in the following segments:

- Two-wheelers (23% of loan book)
- Consumer durables (12% of loan book)
- Personal and small business loans, (16% of loan book)
- Loans against property (LAP) or mortgages (31% of loan book)
- Loan against shares (LAS) (4% of loan book)
- Vendor financing (4% of loan book)
- Construction equipment (8% of loan book)
- Short term infrastructure lending (2% of loan book)

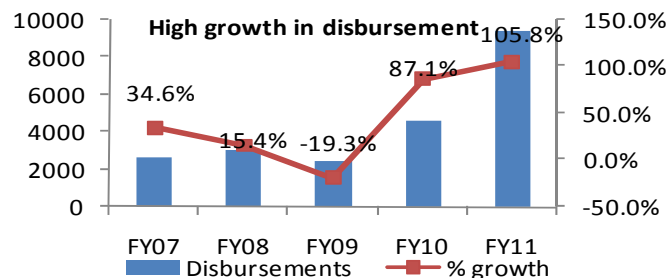
By being a diversified player BFL can have a stable business and on a blended average basis can have better consistency in its performance.

➤ **Sole player in consumer finance:**

BFL entered in consumer finance business towards the end of 2007, which coincided with the downtrend in the overall economic environment. However, BFL being a late entrant to consumer business was able to survive the downtrend as many other players exited the segment. The company has already worked hard on improving the fundamentals and has cleaned up its books, set up strong risk assessment and lending process and undertook a phase of consolidation. Now, it is witnessing sharp turnaround in the business on back of favorable environment and benign competition, which translates it into a pricing power. Currently BFL is literally “**the sole player**” in consumer financing business and is well-positioned to capture a larger share in the opportunities arising from consumer finance business.

➤ **High growth in business:**

BFL has grown its disbursement at a CAGR of 37% over FY06-FY11 which shows that it has been able to grow at a very higher rate. Moreover, going forward Management has indicated that the disbursement will grow at “**minimum 30%**” for FY12E and may even grow higher than that if the environment doesn’t deteriorate. We believe that the strong growth in the company’s loan book is possible due to the adequate capital funds available with the company and robust risk management system.



Source: Company data, Nirmal Bang Research

➤ **Strong asset quality: Unique business model**

Use of credit bureau

BFL has started placing strong emphasis to ensure that the asset quality of the company is on healthy tracks. As the company has major exposure in retail loans which falls in the high default category, cautious steps has been taken by the company across all business segments. BFL has implemented the usage of credit bureau over the last two years. Currently, BFL is **one of the largest users of Credit Information and Bureau India Ltd (CIBIL)**. BFL has access to the right credit history (especially for consumer durables and two wheelers) for its customers. Once the credit record of the consumer is approved, the loan is disbursed instantly. BFL has also reduced the time taken in the entire process. It has adopted a 3M (3 Minute) turnaround time (TAT) in FY 2011 from 3 day in FY 2007-2008. Moreover, it intends to reduce this to **“3S (3 Second) TAT”** by FY12.

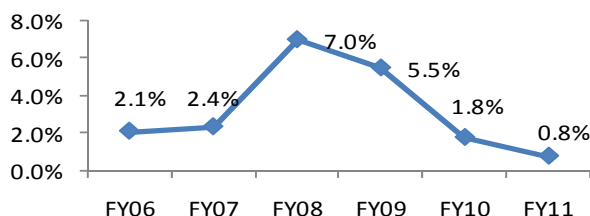
Better risk management framework

BFL involves dealers in the credit disbursement process by entering in a unique arrangement wherein if credit losses on loans disbursed through a specific dealer are below the initial estimation, BFL pays incentive to the dealers. This enables the dealers to ensure **“timely collection on goods sold”**. As a result this ensures lower credit losses and higher penetration for BFL.

Cash collection system for non bankers

Although BFL primarily uses cheques for collections, it has established a direct cash collection model to focus on semi-urban and rural customers who are not well versed and habituated with banking habits. BFL effectively uses dealers and authorized service centers (ASCs) to ensure cash collection from customers. As dealers have good relationships with customers and understand the local geography, BFL has entrusted the collection task to dealers in return of a small fee. This has significantly reduced collection costs for BFL and has **enhanced its collection efficiency**.

Movement in NPA



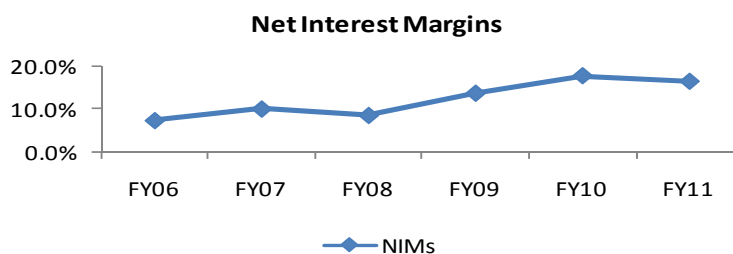
Source: Company data, Nirmal Bang Research

➤ **Go deep instead of go wide strategy:**

BFL intends to focus on affluent customers as its target segment. This has ensured better asset quality for BFL even in relatively riskier segments of the business and higher average ticket sizes. For its consumer durables financing business, BFL’s network has been reduced from 4500+ retail counters in FY09 to 2500 retail counters for consumer durables and 180 dealers for two-wheelers in top 79 cities. BFL has restricted its presence to top cities and does not intend to scale-up in these businesses. Over 20% of BFL’s business is derived from big stores such as Vijay Sales, Croma, e-zone, etc. The strategy which the company has adopted is to **“go deep”** and have a better asset quality instead of expanding in geographical terms.

➤ **Strong credit rating**

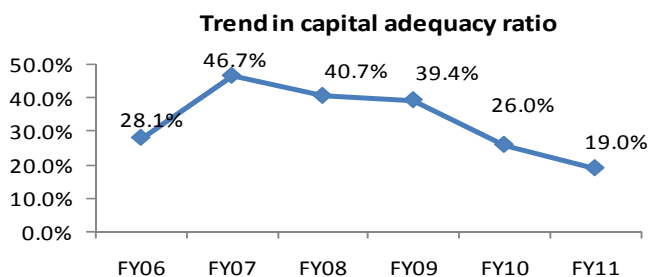
BFL enjoys strong credit ratings of LAA+ on its borrowings and FAAA on its fixed deposits. Improved financials, better and tighter risk assessment process, regular capitalization of the balance sheet has enabled BFL to sustain its credit rating at such levels. BFL also enjoys financial, managerial and operational support from its parent, Bajaj Finserv. Although an increase in wholesale borrowing costs is a key risk, we expect BFL's pricing power in key segments (consumer finance) and the group's backing will protect the company from a sharp decline in NIM.



Source: Company data, Nirmal Bang Research

➤ **Capital raising plans:**

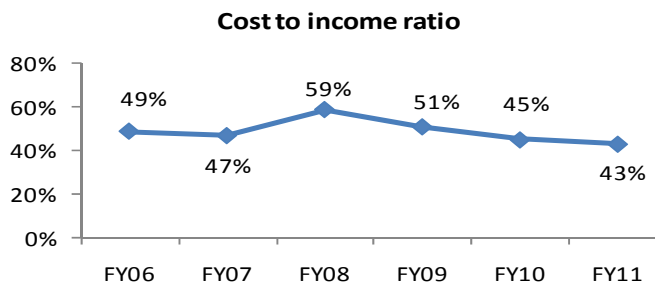
BFL has enjoyed higher capital adequacy which makes the company achieve higher growth. Before asset equity dilution plan the company had capital adequacy of 19% and has recently issued 60 lakh warrants on preferential basis to the promoter Bajaj Finserv Ltd. at an issue price of Rs. 651/- per warrant. Moreover, capital will also be raised via QIP of additional 60 lakh shares which will further boost the capital of the company. We believe that the higher capital adequacy as well as the capital infusion which the company is looking forward to will ensure that the company is well capitalized to support its growth trajectory.



Source: Company data, Nirmal Bang Research

➤ **Declining cost to income ratio**

BFL has had a higher cost to income ratio due to continuous investments in technology, strengthening of employee base and focus on small ticket costly loans. However, going forward the cost to income ratio of BFL is expected to decline as we believe that the investments made on technology and employees will start yielding results and will result in lower cost to income ratio.



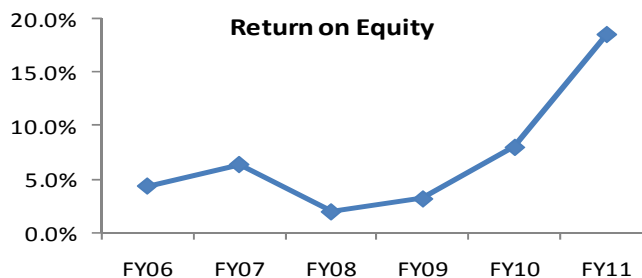
Source: Company data, Nirmal Bang Research

➤ **Highlights of Q1FY12 results:**

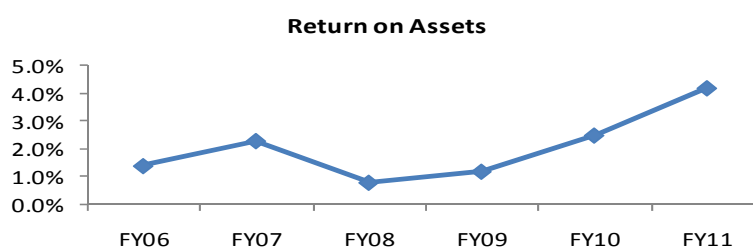
- Net interest income increased 16.1% on a QoQ basis and 38.8% YoY basis to Rs 274 crs in Q1FY12 reflecting strong growth in deployments.
- Deployments during Q1FY12 increased by 75.3% on a YoY basis to Rs3,588 crs from Rs 2,047 crs in Q1FY11.
- Total income increased 12.0% on a QoQ basis and 38.1% on a YoY basis to Rs 309.4 crs in Q1FY12.
- Profit before provisioning increased 17.7% on a QoQ basis and 28.9% on a YoY basis to Rs 169.1 crs in Q1FY12.
- The company reduced its provisioning significantly both on a QoQ and YoY basis to Rs 34.2 crs and intends to further reduce it down going forward.
- Consequently, PAT increased 28.8% on a QoQ basis and 94.6% on a YoY basis to Rs 91.03 crs in Q1FY12, exceeding market expectations.
- Provisioning coverage ratio stood at 78% in Q1FY12 against 63% in Q1FY11.
- Net NPA for Q1FY12 stood at 0.46% against 1.77% in Q1 FY11.
- Capital adequacy ratio of the company including Tier-II capital stood at comfortable 19%.

Quarterly performance	Q1 FY12A	Q1FY11A	YoY (%)	Q4FY11A	QoQ (%)
Interest earned	416	270	54.1%	354	17.5%
Interest expense	142	73	95.7%	118	20.3%
Net interest income	274	197	38.8%	236	16.1%
Other income	35	27	33.0%	40	(12.0%)
Total income	309	224	38.1%	276	12.0%
Total operating expenses	140	93	51.3%	133	5.9%
Profit before prov	169	131	28.8%	144	17.7%
Provisions	34	61	(43.5%)	38	(9.1%)
Profit before tax	135	71	90.9%	106	27.2%
Taxes	44	24	83.8%	35	24.2%
Net profit	91	47	94.5%	71	28.7%

Source: Company data, Nirmal Bang Research



Source: Company data, Nirmal Bang Research



Source: Company data, Nirmal Bang Research

Outlook:

BFL is currently trading at a very attractive valuation amongst the NBFC business space. It is currently trading at a compelling valuation of 9.2 times PE and 1.5 times price to book value calculated post dilution on its annualized Q1FY12 earnings and book value respectively which we believe is at a discount to its peers. Going ahead, we believe BFL is well-positioned to deliver sustainable and profitable growth which is scalable with lower risk as the company intends to focus on secured business lines. Given these factors we believe that the stock is available at an attractive value at current levels and offers potential upside from current levels. We recommend BUY on the stock with 20%-25% return in next 6 to 9 months.

	BFL (existing)	BFL (post dilution)	Mahindra Finance
P/BV	1.73x	1.5x	2.8x
P/E	6.9x	9.2x	14.1x
RoE	25.1%	16.3%	22.0%

Source: Company data, Nirmal Bang Research

Risks and Concerns

- BFL is venturing into relatively competitive areas of construction equipment and mortgages and recently into more risky business of infrastructure lending. While BFL has demonstrated a healthy record over the past two years, execution in new businesses remains a key risk.
- Being a wholesale funded company, any liquidity shock could impact spreads adversely and affect profitability.

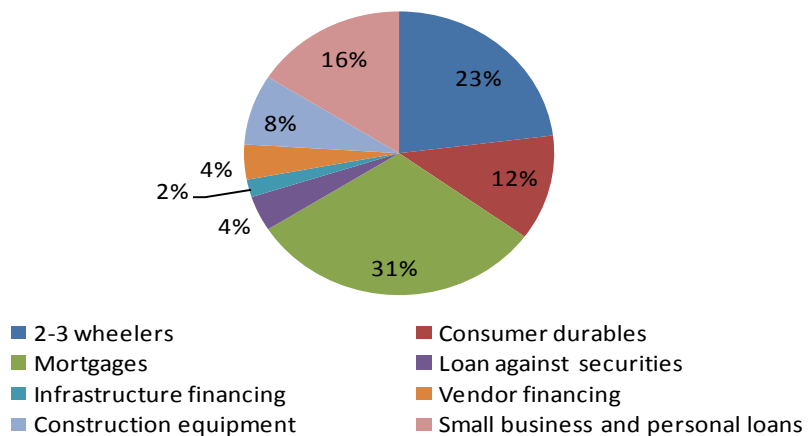
Company background

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However, over the past few years it has increased its presence in various segments and now caters:

- Two-wheelers
- consumer durables,
- personal and small business loans,
- Loans against property (LAP), mortgages
- Loan against shares (LAS),
- Vendor financing
- construction equipment

Break up of loan book



Source: Company data, Nirmal Bang Research

Stock Idea
Bajaj Finance Ltd
Financial Statements

Income Statement (Rs in crs)	FY 08A	FY 09A	FY 10A	FY 11A
Interest earned	410	510	810	1,284
Interest expense	170	164	202	378
Net interest income	239	345	608	906
Other income	93	90	106	122
Total income	332	435	714	1,028
Total operating expenses	193	220	320	454
Profit before prov	139	215	395	575
Provisions	109	164	261	205
Profit before tax	30	51	134	370
Taxes	9	17	45	123
Net profit	21	34	89	247
EPS	5.6	9.3	24.4	67.4
NIM (%)	8.6%	13.8%	17.9%	16.6%
RoE	2.0%	3.2%	8.0%	18.5%
RoA	0.8%	1.2%	2.5%	4.2%
CAR	40.7%	39.4%	26.0%	19.0%
Net NPA	7.0%	5.5%	1.8%	0.8%

Source: Company data, Nirmal Bang Research

Balance Sheet (Rs. Crs)	FY 08A	FY 09A	FY 10A	FY 11A
Equity capital	37	37	37	37
Reserves and surplus	1,027	1,052	1,116	1,321
Net worth	1,063	1,089	1,153	1,358
Secured	942	790	2,079	4,647
Unsecured	722	821	1,147	2,062
Total borrowings	1,664	1,611	3,227	6,709
Total liab and equity	2,727	2,700	4,379	8,067
Investments	327	274	302	445
Advances	2,893	2,370	4,026	7,270
Fixed assets	14	20	50	103
Total assets	2,727	2,700	4,379	8,067

Source: Company data, Nirmal Bang Research

Note

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