

BUY

TP: Rs 5,000 | ▲ 21%

BAJAJ FINANCE

| NBFC

| 24 January 2020

BAF 2.0 – Revamped growth engine; initiate with BUY

We initiate coverage on Bajaj Finance (BAF) with BUY and a Mar'21 TP of Rs 5,000. Strong traction in consumer finance (~40% of loans) underpins a high-yield, high-churn book that aids faster repricing, while the SME and commercial lending businesses form sustainable scale builders. We estimate a 30% CAGR in NII over FY19-FY22, alongside non-linear fee income growth form a refined cross-sales engine. Higher fixed-rate borrowings and a prudent ALM strategy are expected to sustain spreads at ~9% and fuel a 37% earnings CAGR through FY22.

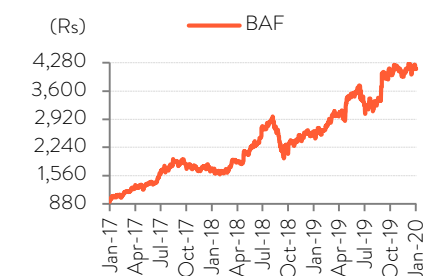
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Consumer finance, cross-sell to remain key moats: Consumer finance will remain the customer acquisition engine for BAF, driving cross-sales of credit and fee-based products to vetted clients. We expect non-linear fee income growth (~3x over FY19-FY22) from the cross-sell franchise to largely cover for operating cost (~2x). A bulk of NII will thus flow into operating profit which is estimated to log a 33% CAGR through to FY22 vs. a 27% CAGR in AUM.

Ticker/Price	BAF IN/Rs 4,126
Market cap	US\$ 34.8bn
Shares o/s	602mn
3M ADV	US\$ 66.2mn
52wk high/low	Rs 4,253/Rs 3,950
Promoter/FPI/DII	56%/22%/10%

Source: NSE

Sustainable scale builders and stable spreads: SME and commercial lending (together 24% of AUM) offer profitable and opportunistic credit plays that mitigate BAF's concentration in the top-10 cities. We expect a prudent liability mix and rural lending to help sustain spreads at ~9% over FY19-FY22 and model for a 150bps decline in C/I ratio over this period led by technology investments.

STOCK PERFORMANCE

Source: NSE

Well managed asset quality to drive return ratios: The use of technology and data analytics for prudent product positioning and cross-sales has kept credit risk at bay. Credit cost is expected to remain stable at ~200bps over the next three years, thus driving healthy ROE of 22%+.

Initiate with BUY: We have a Mar'21 TP of Rs 5,000 for BAF using a residual income model, assuming 12.8% CoE, 7.75% risk-free rate and 5% terminal growth.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	69,716	97,252	135,172	171,485	213,464
NII growth (%)	42.2	39.5	39.0	26.9	24.5
Adj. net profit (Rs mn)	24,964	39,950	61,728	82,232	102,432
EPS (Rs)	43.4	69.3	102.6	136.7	170.2
P/E (x)	95.1	59.6	40.2	30.2	24.2
P/BV (x)	15.0	12.1	7.4	6.1	5.0
ROA (%)	3.4	3.8	4.2	4.3	4.4
ROE (%)	20.1	22.5	23.2	22.1	22.6

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.

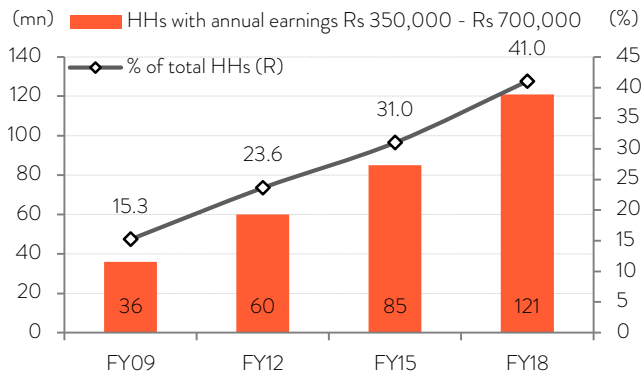


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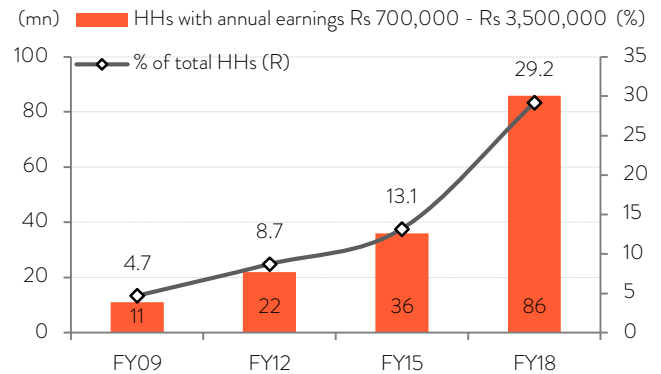
Focus charts

FIG 1 – GROWING MIDDLE CLASS...



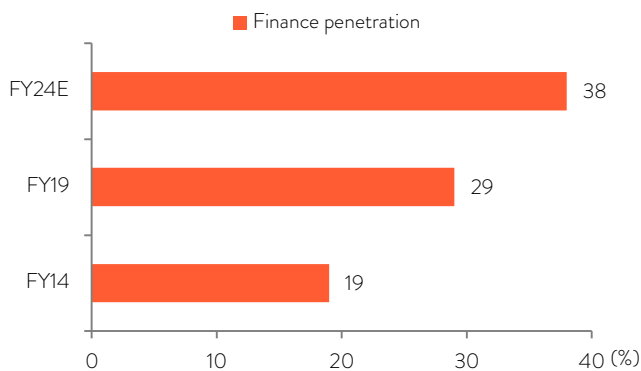
Source: Burger King RHP, BOBCAPS Research | HH – Households

FIG 2 – ...TO DRIVE DISCRETIONARY SPENDING



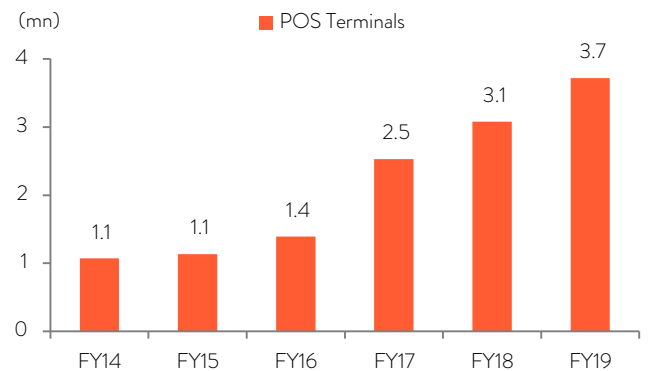
Source: Burger King RHP, BOBCAPS Research

FIG 3 – FINANCE PENETRATION IN CONSUMER DURABLE PRODUCTS TO INCREASE...



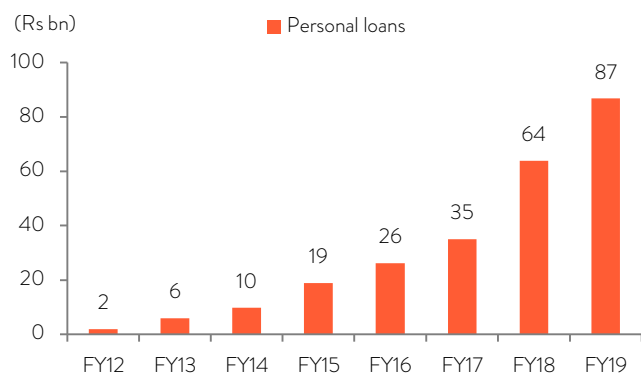
Source: CRISIL, RBI, BOBCAPS Research

FIG 4 – ...DUE TO GROWING INFRASTRUCTURE FOR DIGITAL PAYMENTS & GEOGRAPHICAL EXPANSION



Source: CRISIL, RBI, BOBCAPS Research

FIG 5 – BAF'S PERSONAL LOANS OUTSTANDING UP ~46X DURING FY12-FY19



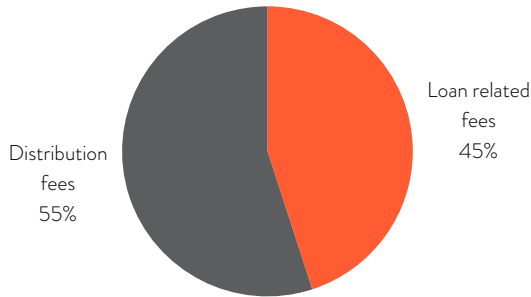
Source: Company, BOBCAPS Research

FIG 6 – PERSONAL LOANS PORTFOLIO OF NBFCs COMPARES WELL TO THAT OF PRIVATE BANKS



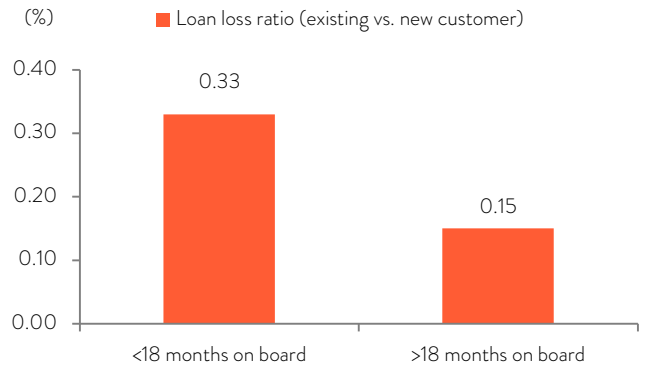
Source: Company, BOBCAPS Research

FIG 7 – BAF’S FEE INCOME EVENLY DIVIDED BETWEEN DISTRIBUTION AND LOAN-RELATED FEES



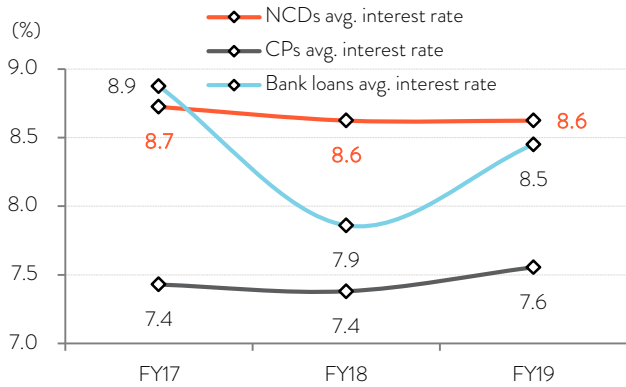
Source: Company, BOBCAPS Research

FIG 8 – BAF TARGETS 75% OF NEW LOAN ORIENTATION FROM EXISTING CUSTOMERS, LOWERING RISK



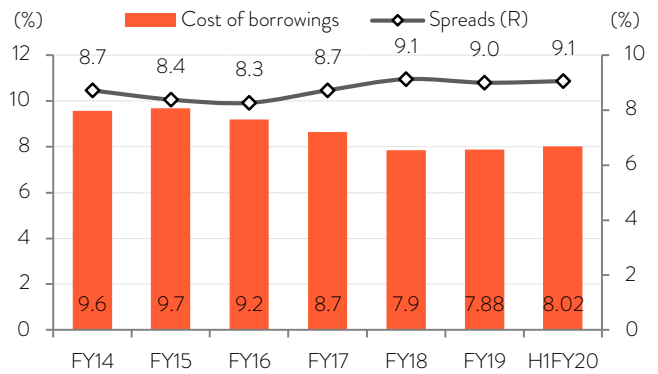
Source: Company, BOBCAPS Research

FIG 9 – PRICING OF DEBT THROUGH FY17-FY19 HAS BEEN LARGELY STABLE...



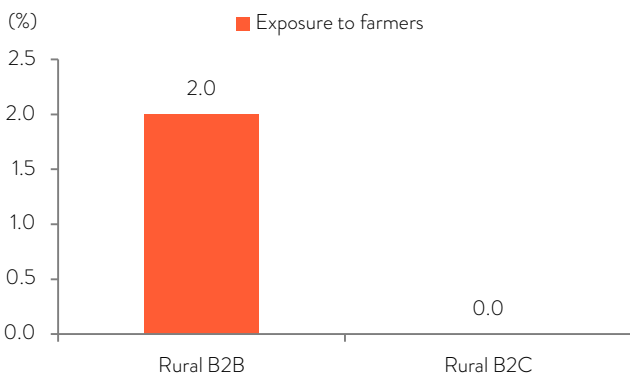
Source: Company, BOBCAPS Research

FIG 10 – ...LEADING TO LOWER BORROWING COST AND HIGHER SPREADS



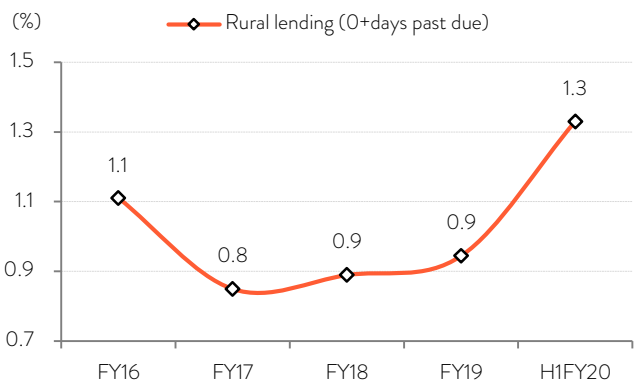
Source: Company, BOBCAPS Research

FIG 11 – MINISCULE EXPOSURE TO FARMERS IN RURAL FINANCE PORTFOLIO



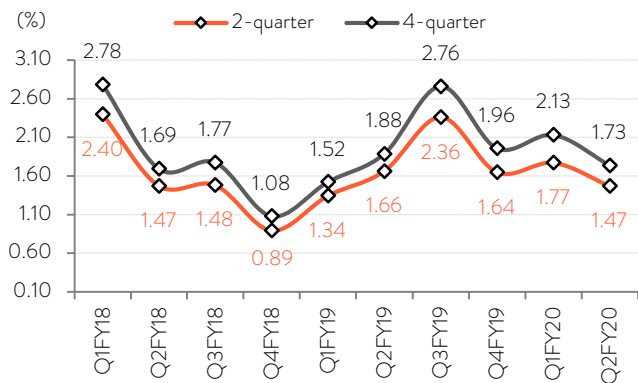
Source: Company, BOBCAPS Research

FIG 12 – RURAL DELINQUENCIES LOOK BENIGN



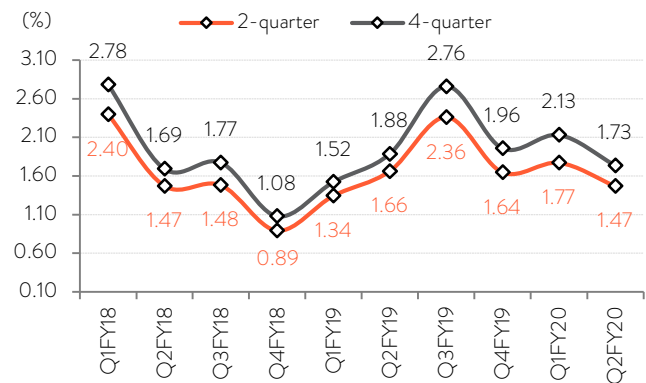
Source: Company, BOBCAPS Research

FIG 13 – NET SLIPPAGES DIPPING...



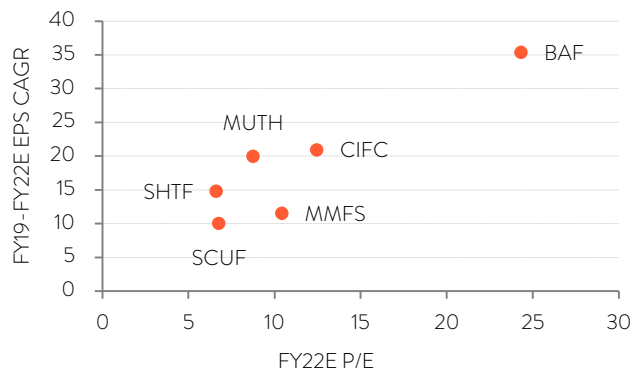
Source: Company, BOBCAPS Research

FIG 14 – ...AND TREND IN WRITE-OFFS (WITH LAG EFFECT) CLEARLY SHOWS COLLECTION EFFICACY



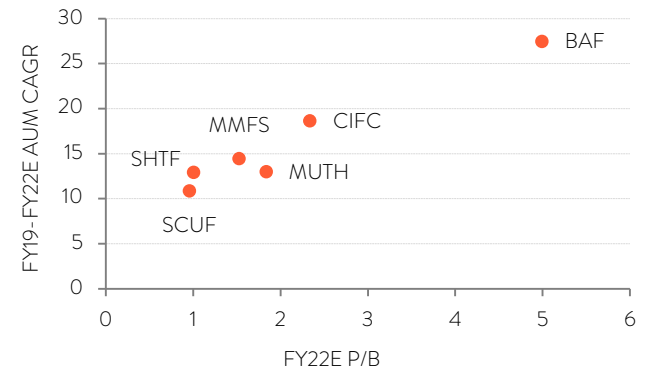
Source: Company, BOBCAPS Research

FIG 15 – BAF LEADS SELECT PEERS ON P/E...



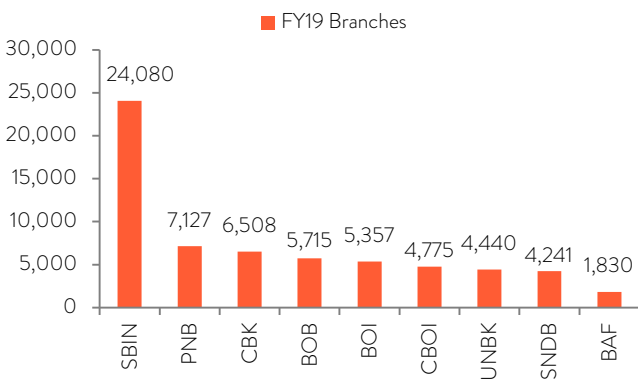
Source: Bloomberg, BOBCAPS Research | Note: Bloomberg consensus data for SHTF, MMFS, CIFIC and SCUF | Price as of 23 Jan 2020

FIG 16 – ...AND P/B VALUATIONS



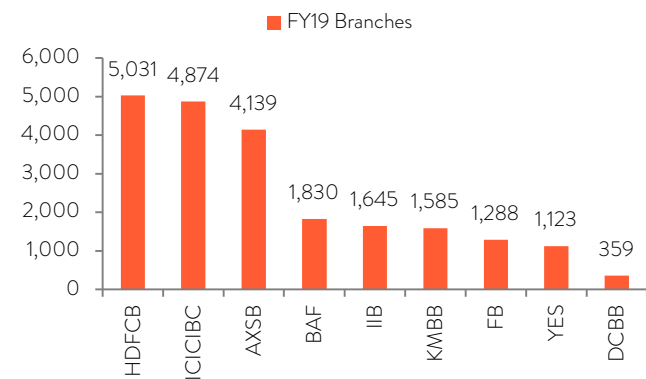
Source: Bloomberg, BOBCAPS Research | Note: Bloomberg consensus data for SHTF, MMFS, CIFIC and SCUF | Price as of 23 Jan 2020

FIG 17 – BRANCH COMPARISON WITH PSU BANKS...



Source: Company, BOBCAPS Research

FIG 18 – ...AND PRIVATE BANKS



Source: Company, BOBCAPS Research

Investment summary

Consumer financing and cross-sell to remain key moats

Consumer financing business will remain the key moat for BAF, given the prospects arising from younger demographics and innovative credit outreach. This business will act as the funnel for customer acquisition, of which vetted customers will be cross-sold credit and fee-based products. The non-linear fee income growth (~3x over FY19-22E) will largely cover for opex (~2x during same period), thereby large proportion of NII (~30% FY19-22E CAGR) will flow into operating profit (~33% FY19-22E CAGR). This will augment the return ratios at similar levels of leverage.

SME and commercial financing form sustainable scale builders

SME financing and commercial lending offer high velocity, profitable and opportunistic credit plays, which mitigate top-10 cities concentration. Also, both portfolios are fairly granular, so that gives the company the flexibility to go slow on one segment or region, if either is not performing well on risk parameters.

Well protected spreads and astute focus on opex

Prudent liability mix strategy, positive ALM mismatch in one-year bucket and rural lending will meaningfully help sustain spreads (~9% over FY19-22E). Operating profits will grow faster than AUM growth (~27% FY19-22E CAGR) due to the higher contribution from cross-sell and fee-based products and the ~150bp decline (FY19-22E) in C/I ratio led by technology investments over the years.

Mortgage business to add scale

In-house loan sourcing, cross-sell opportunity to existing customers (they have ~Rs 5tn of mortgages as per management) and operating in sweet spot of ticket size at ~Rs 3.5-4mn are key growth drivers for BHFL near to medium term growth.

Well-managed asset quality to drive return ratios

Using technology and data analytics, for prudent product positioning and cross-sell has kept credit risk at bay. A well-oiled collection machinery ensures keeping credit costs ~200bp, thus driving healthy RoEs of 22%+.

Characteristics of the Bajaj Finance customer

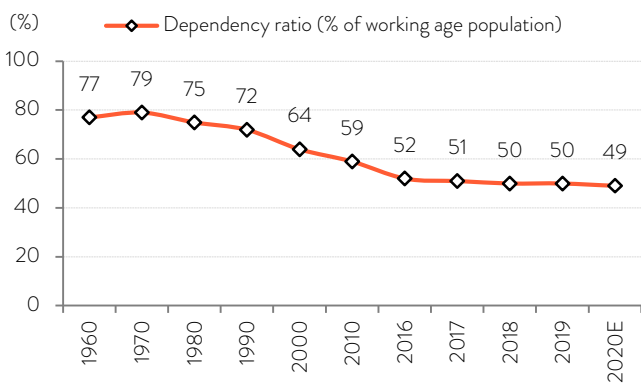
BAF’s management has frequently highlighted that it focuses on the mass affluent segment. We set out to understand who this customer is and how this target market will shape up in the medium term.

The 7 consumption desires of Millennials and Gen Z

BAF defines mass affluent as incomes above Rs 350,000 in rural areas and Rs 500,000 in urban areas. With ~440mn millennials and ~390mn Gen Z (born after 2000) teens and children, the sheer size of India’s youth paves the way for its consumer story to be one of the world’s most compelling in the next 20 years.

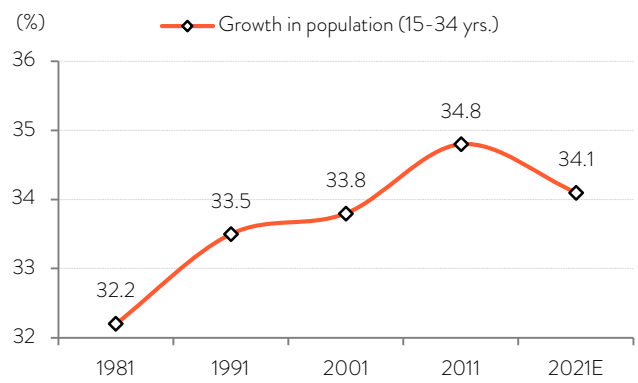
The size of India’s young population is contributing to a decline in dependency ratio – defined as the ratio of dependent population size to working-age population size (15 to 64 years of age). The country’s working age population has increased from 36% in FY00 to 49.8% in FY18.

FIG 19 – DEPENDENCY RATIO DECLINING...



Source: MOSPI, Census of 2011, BOBCAPS Research

FIG 20 – ...DUE TO SUSTAINED GROWTH IN YOUNG POPULATION

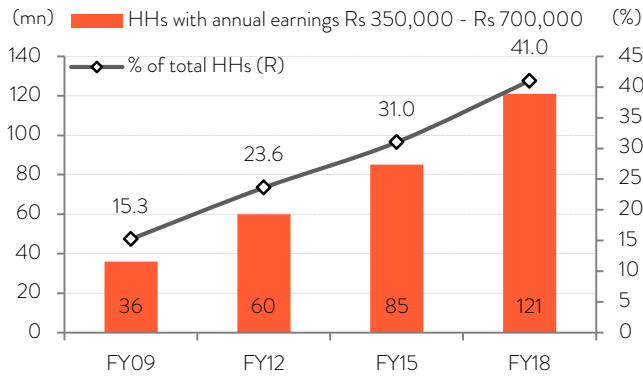


Source: MOSPI, Census of 2011, BOBCAPS Research

This trend is expected to fuel rising income levels per household as well as higher levels of discretionary expenditure. Consequently, spends on premium products will rise, leading to higher expenditure in various categories, including food and beverages, apparel and accessories, luxury products and consumer durables.

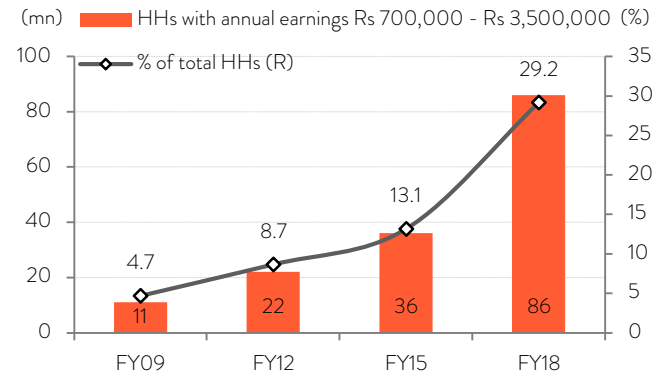
As per industry sources, the seven consumption desires of millennials and Gen Z Indians can be encapsulated as follows: (1) looking better, (2) eating better, (3) better home, (4) mobility/connectivity, (5) travelling, (6) wellbeing (health/ education), and (7) luxury.

FIG 21 – GROWING MIDDLE CLASS...



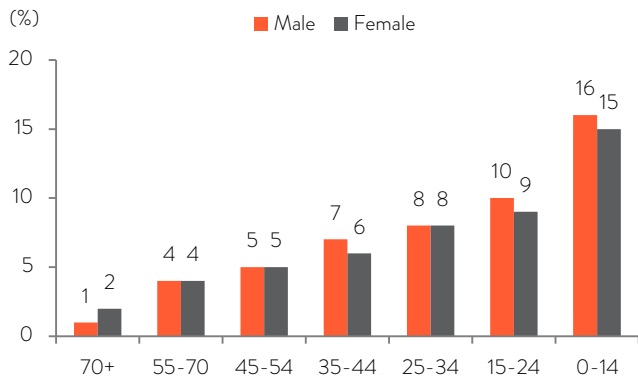
Source: Burger King RHP, BOBCAPS Research

FIG 22 – ...TO DRIVE UP DISCRETIONARY SPENDING



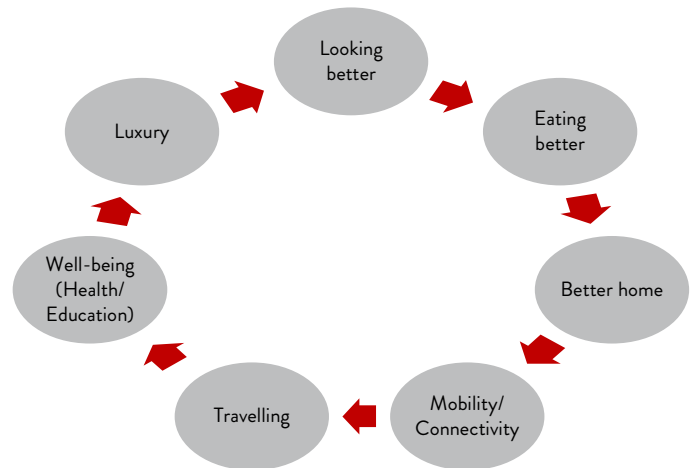
Source: Burger King RHP, BOBCAPS Research

FIG 23 – RISING WORKFORCE PARTICIPATION OF MILLENNIALS AND GEN Z...



Source: Census of 2011, MOSPI, BOBCAPS Research

FIG 24 – ...AND THEIR 7 KEY DESIRES FOR CONSUMPTION



Source: Industry, BOBCAPS Research

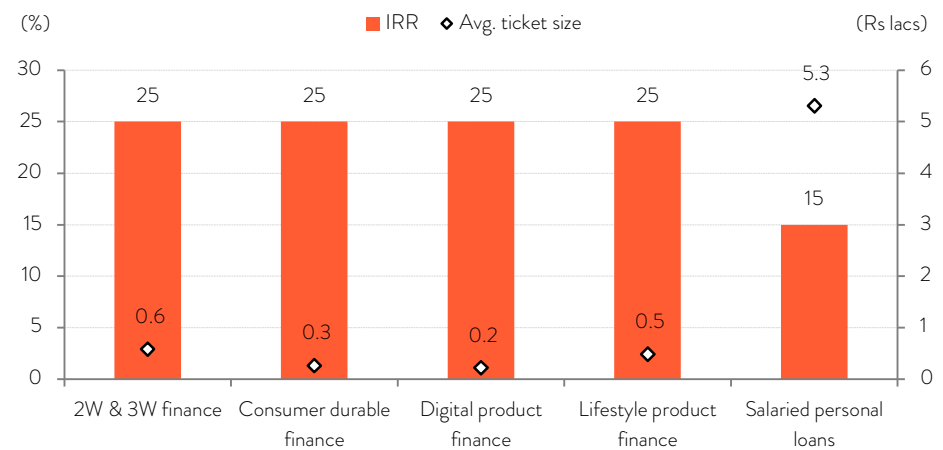
Investment rationale

Continued traction in consumer financing

BAF’s consumer financing business registered a healthy 38% CAGR over FY11-FY19 to reach an AUM of Rs 450bn and currently contributes 40% of the loan book. The company offers high-churn, short-tenor and high-IRR products – a mix that facilitates faster repricing of the back book, especially amid rising interest rates.

Although opex for credit acquisition is higher in granular consumer loans, this is offset by robust product IRR of 24-25% and scale-led operating leverage. We expect consumer financing to be a primary growth driver for BAF, aiding a 27% CAGR in the company’s overall loan book over FY19-FY22.

FIG 25 – CONSUMER FINANCING LOANS ARE GRANULAR WITH HIGH IRRs



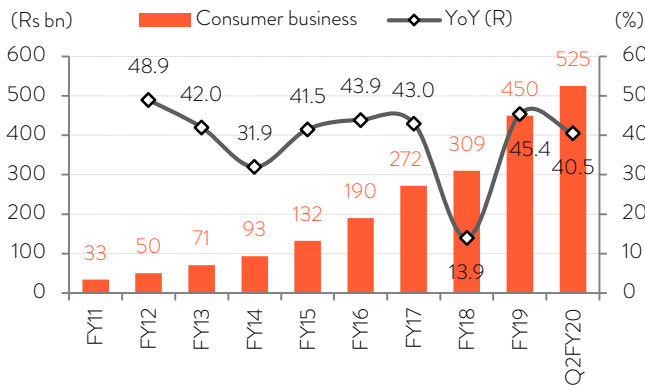
Source: Company, BOBCAPS Research

Strong growth trajectory

Over the past decade, BAF has established a strong position in the under-penetrated consumer financing segment by strategically adding product lines, targeting affluent customers and underwriting risk via technology platforms. Banks were vacating this space post-GFC, which gave the company an opportunity to make a mark. During FY11-FY19, the business registered a healthy 38% CAGR to reach an AUM of Rs 450bn. FY18 was an aberration with 14% YoY growth due to the after-effects of demonetisation and GST rollout.

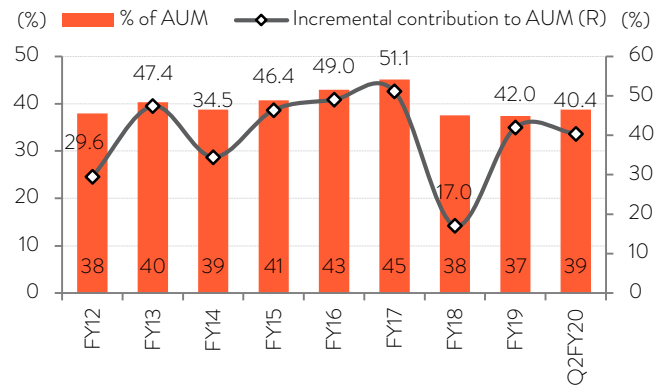
Consumer financing AUM at Rs 450bn as of FY19 from Rs 33bn in FY11

FIG 26 – CONSUMER FINANCING GREW ~13X DURING FY11-FY19...



Source: Company, BOBCAPS Research

FIG 27 – ...CONTRIBUTING ~40% OF INCREMENTAL AUM IN FY19



Source: Company, BOBCAPS Research

BAF currently caters to ~40mn customers and offers vehicle (two- & three-wheelers), consumer durable, digital/lifestyle product and salaried personal loans. Notably, two-third of new customers have a strong credit history (CIBIL scores of >750), implying significantly low credit loss probability, while a third are new to credit entirely. Consumer financing thus serves as a robust funnel for customer acquisition, facilitating cross-sales of the company’s credit and fee-based products.

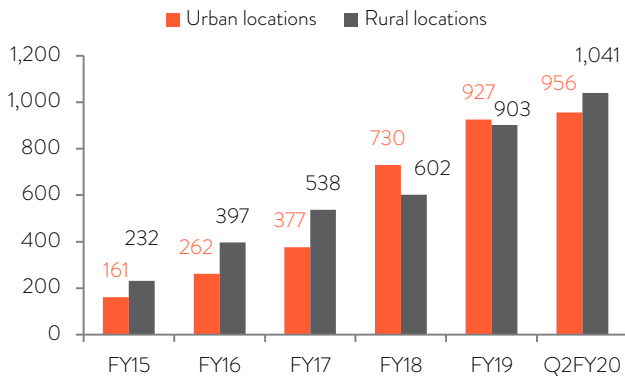
We estimate a near doubling in customer base to 75mn over 3-4 years aided by (a) favourable demographics and increasing finance penetration, (b) high-value sales of consumer durables, and (c) the company’s innovative credit outreach in the form of affordable EMI schemes and technology-led client mining. We thus forecast a robust 27% AUM CAGR in the business over FY19-FY22.

Firm focus on consumer durable, digital & lifestyle product financing

BAF’s strategy is to ensure deeper penetration in its well-performing product categories. Consequently, its in-store presence in consumer durables (~2x), digital products (~4x) and lifestyle retail points-of-sale (~2x) increased considerably over FY17-FY19. The number of consumer durable loan contracts doubled to 12.7mn over this period, underlining a clear thrust on volumes over value.

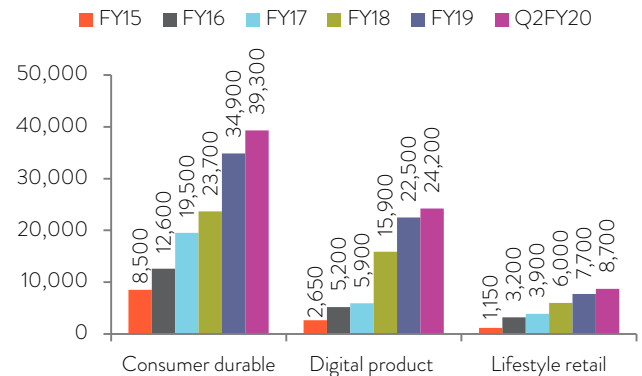
Focus on volume over value paying off

FIG 28 – URBAN BRANCHES GREW ~6X AND RURAL BRANCHES ~4X DURING FY15-FY19



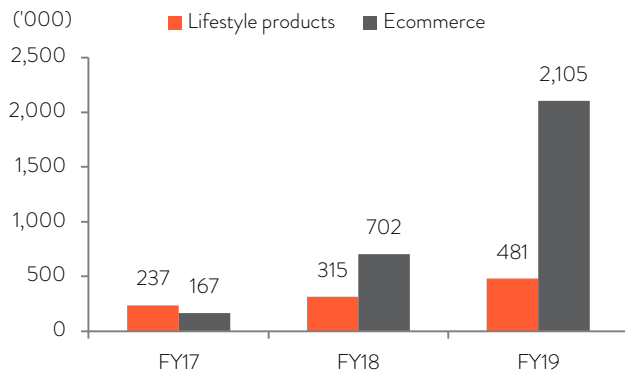
Source: Company, BOBCAPS Research

FIG 29 – WIDER IN-STORE PRESENCE INDICATES CLEAR FOCUS ON VOLUME GROWTH



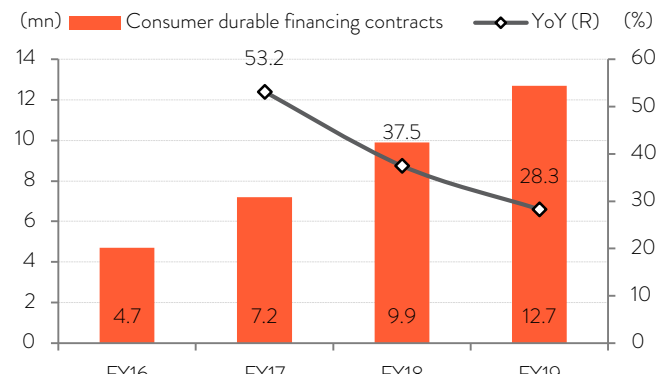
Source: Company, BOBCAPS Research

FIG 30 – LIFESTYLE/ECOMMERCE LOAN TRANSACTIONS GREW ~2X/~13X DURING FY17-FY19...



Source: Company, BOBCAPS Research

FIG 31 – ...AND CONSUMER DURABLE LOAN CONTRACTS GREW ~2X IN THE SAME PERIOD



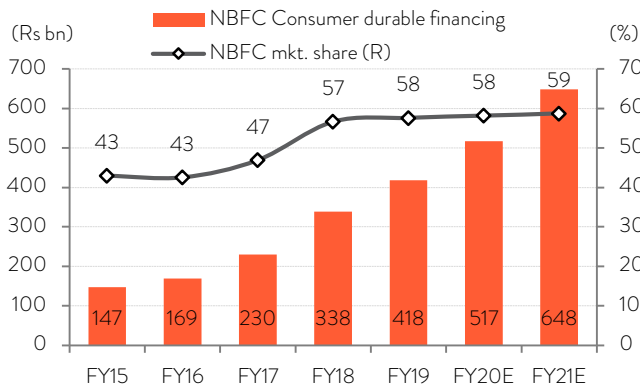
Source: Company, BOBCAPS Research

Consumer durables to be a key growth driver

With ~60% market share, NBFCs continue to dominate consumer durable disbursements as these largely involve point-of-sale (POS) financing, i.e., loans are normally processed at the retail outlet or showroom (for televisions, kitchen appliances, etc.). Customers prefer the convenience of on-the-spot EMI schemes while making a purchase rather than approaching banks for a loan.

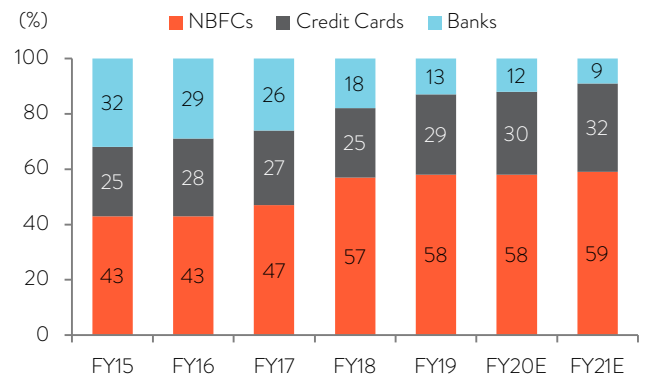
Loan disbursal by NBFCs towards consumer durables is estimated at Rs 517bn as of FY20 and has clocked a brisk ~29% CAGR over FY15-FY20. BAF has ~70% market share among NBFCs in this space.

FIG 32 – EASE OF TRANSACTIONS...



Source: CRISIL, Company, BOBCAPS Research

FIG 33 – ...TO HELP NBFCs MAINTAIN MARKET SHARE IN CONSUMER DURABLE FINANCING



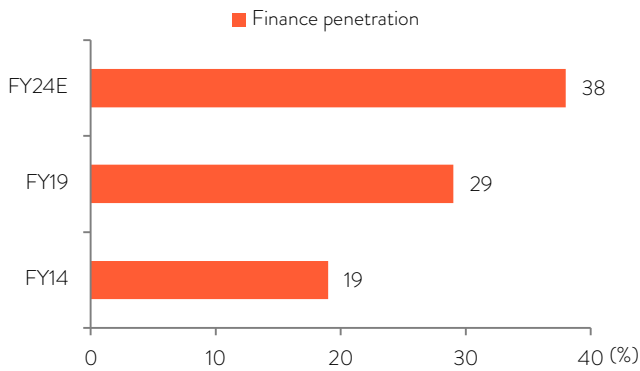
Source: CRISIL, Company, BOBCAPS Research

Finance penetration in India’s consumer durables industry is estimated to increase from 29% in FY19 to 38% in the next five years, as per a CRISIL study. Currently, easy finance schemes available at interest-free EMI help push up durable category sales and entice customers into buying aspirational premium products. As all consumer durable financiers including banks offer such schemes, we believe aggressive expansion by lenders in terms of point-of-sale (POS) infrastructure and a presence in more product segments are among the primary drivers that will increase finance penetration.

NBFCs offer zero-interest finance by charging interest to the manufacturer or dealer. Interest cost on loans is distributed across three levels – manufacturer, dealer and customer. The charge varies depending on the product, EMI financing option and the sourcing dealer. A majority of the interest cost is typically borne by the manufacturer (subvention of close to 5% of the product price).

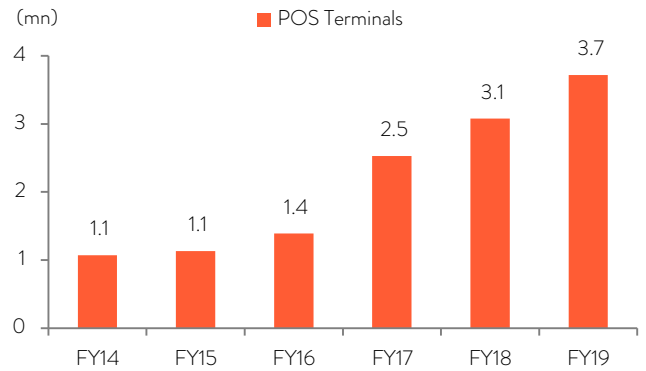
Existing member identification (EMI) card is another offering by NBFCs that has supported the consumer durable financing business by creating customer stickiness. These cards come with a credit limit and offer zero down-payment options and other promotional offers to customers.

FIG 34 – FINANCE PENETRATION IN CONSUMER DURABLE PRODUCTS TO INCREASE...



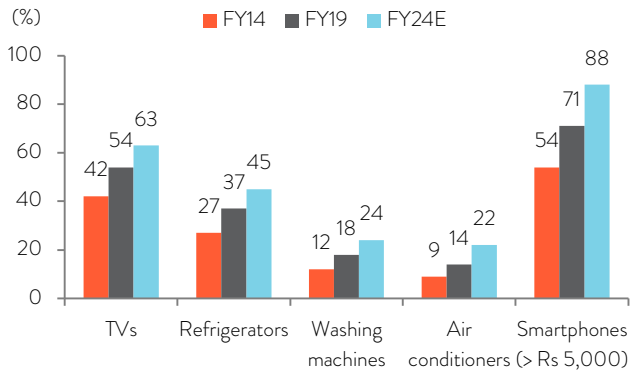
Source: CRISIL, RBI, BOBCAPS Research

FIG 35 – ...DUE TO GROWING INFRASTRUCTURE FOR DIGITAL PAYMENTS & GEOGRAPHICAL EXPANSION



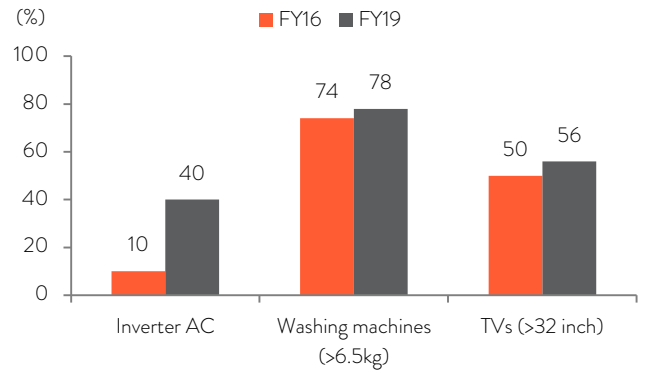
Source: CRISIL, RBI, BOBCAPS Research

FIG 36 – PENETRATION TO IMPROVE ACROSS PRODUCTS...



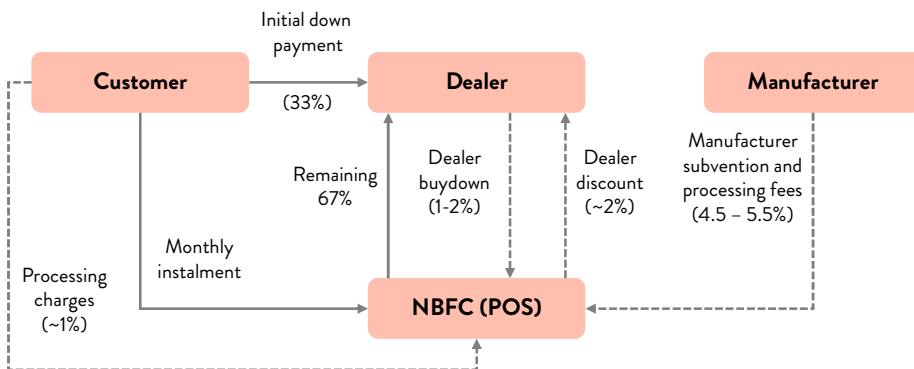
Source: CRISIL, RBI, BOBCAPS Research

FIG 37 – ...AS BUYER PREFERENCE FOR HIGH-VALUE PRODUCTS MOVES UP



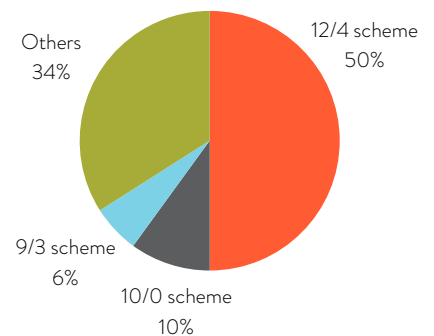
Source: CRISIL, RBI, BOBCAPS Research

FIG 38 – POS FINANCING THROUGH NBFCs



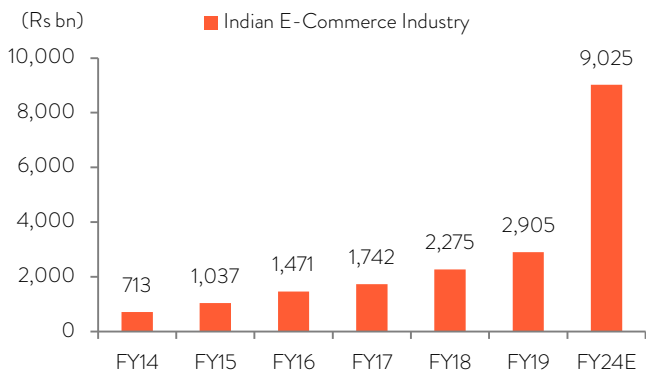
Source: Company, BOBCAPS Research

FIG 39 – SPLIT OF SCHEMES OFFERED BY NBFCs



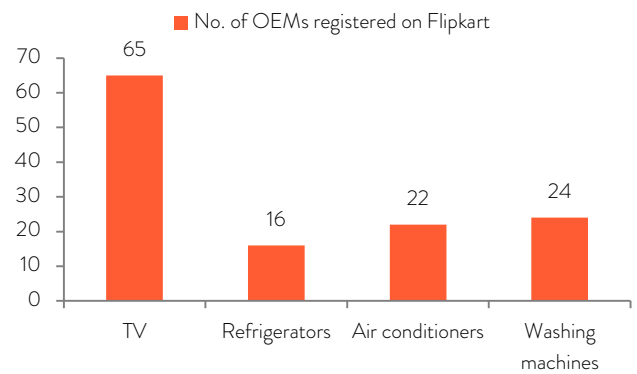
Source: Company, BOBCAPS Research

FIG 40 – GEOGRAPHICAL DIVERSIFICATION OF E-COMMERCE TO FUEL 23-28% CAGR OVER FY19-FY24E



Source: CRISIL, Company, BOBCAPS Research

FIG 41 – OEMs CONTINUE TO OFFER SUBVENTION ON CONSUMER DURABLES TO STAVE OFF RIVALS



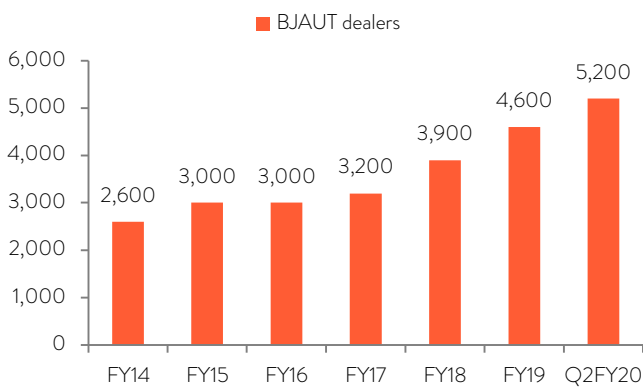
Source: Flipkart, BOBCAPS Research

Sensible slowdown in 2W and 3W financing

Slowed auto loan channel expansion due to defaults and risk concentration

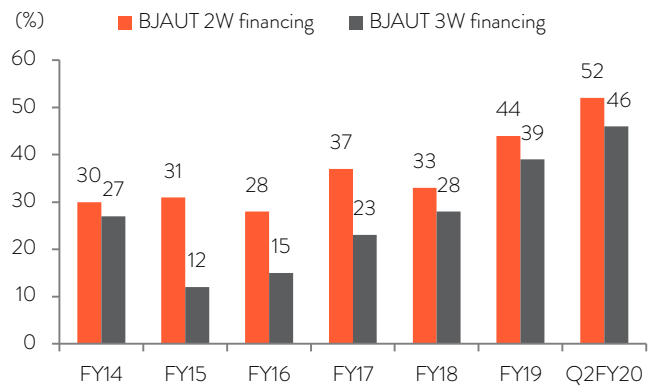
Though BAF started as a captive auto financier for Bajaj Auto’s (BJAUT) two-wheelers (2W) and three-wheelers (3W), management deliberately slowed down channel expansion during FY14-FY17 due to the higher delinquencies during the period. Thereafter, BAF increased the tally of BJAUT dealer relationships by 60% to 5,200 in Q2FY20, along with financing 52% of the company’s 2Ws and 46% of 3Ws, thus gaining market share in the latter’s financing pie. Risk concentration in 2W and 3W financing has reduced to 9% of AUM in Q2FY20 from 15% in FY14.

FIG 42 – SLOWER GROWTH IN BJAUT DEALERSHIPS...



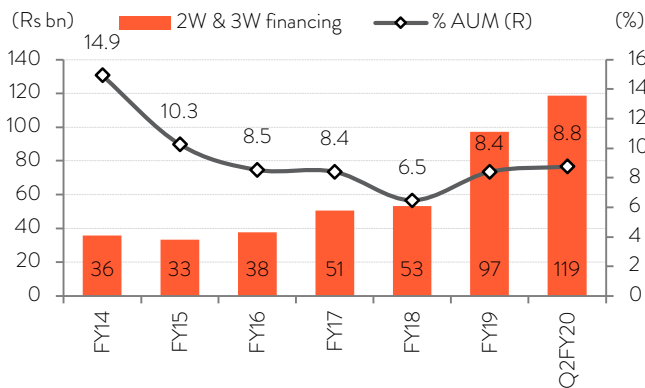
Source: Company, BOBCAPS Research

FIG 43 – ...BUT MARKET SHARE GAINS IN BJAUT FINANCING PIE



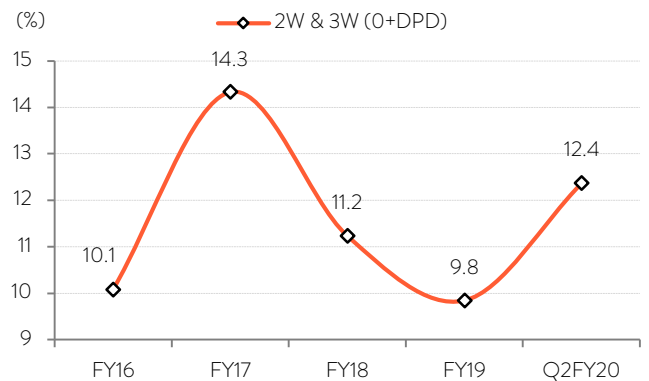
Source: Company, BOBCAPS Research

FIG 44 – 2W AND 3W FINANCING CONTRIBUTED ONLY ~9% OF AUM IN Q2FY20



Source: Company, BOBCAPS Research

FIG 45 – UPTICK IN DELINQUENCIES DUE TO SECULAR ECONOMIC SLOWDOWN



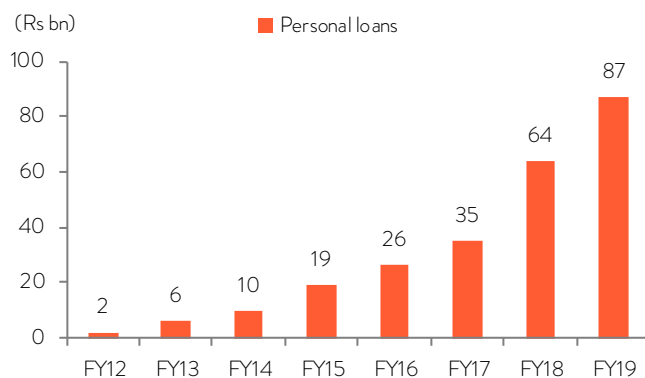
Source: Company, BOBCAPS Research

Personal loans – reliable customer acquisition engine

To diversify its consumer finance offerings, BAF launched personal loans for the salaried class in FY12. The business targets affluent salaried employees above a threshold income range and has logged a 46-fold rise in outstanding personal loans over FY12-FY19, from Rs 2bn to Rs 87bn.

BAF sources customers via direct selling agents (DSA), an in-house sales team and through the online portal of group company Bajaj Finserv Direct (BFDL). It was among the early entrants into online loans and offers eligible customers loan approvals for sums up to Rs 1.5mn within 15 minutes. We expect personal loans to remain a strong credit funnel for BAF in the near term.

FIG 46 – BAF’s PERSONAL LOANS O/S HAS GROWN ~46X DURING FY12-FY19



Source: Company, BOBCAPS Research

FIG 47 – PERSONAL LOAN PORTFOLIO OF NBFCs COMPARES WELL TO THAT OF PRIVATE BANKS



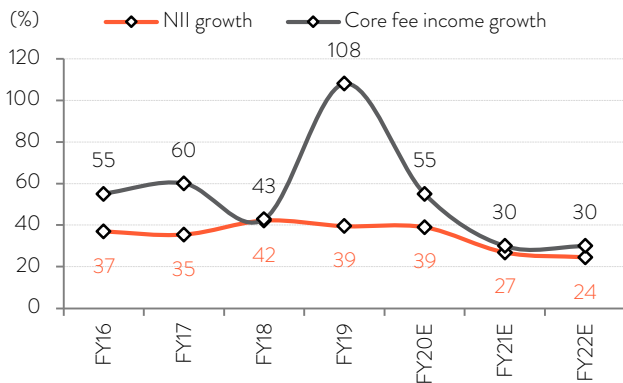
Source: Company, BOBCAPS Research

Cross-sell franchise to drive fee income

BAF has a successful cross-sales franchise that increases customer engagement, drives high-velocity, small-ticket lending and generates granular fee income. Over FY16-FY19, the company has seen a three-fold rise in cross-sell customer pool to ~21mn, aiding ~5x fee income growth over this period.

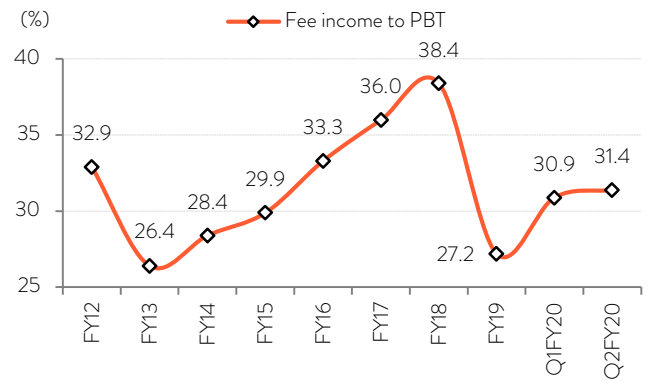
Opex is negligible to sell to existing customers and credit loss is one-third that of new customers. Management thus expects the fee income-to-PBT ratio to increase to 38-40% in the near term from 31% at present. This non-linear growth will largely cover operating costs, allowing a large proportion of NII to flow into operating profit.

FIG 48 – CORE FEE INCOME GROWTH



Source: Company, BOBCAPS Research

FIG 49 – MANAGEMENT EXPECTS TO INCREASE FEE INCOME-TO-PBT RATIO TO ~38% IN NEAR TERM

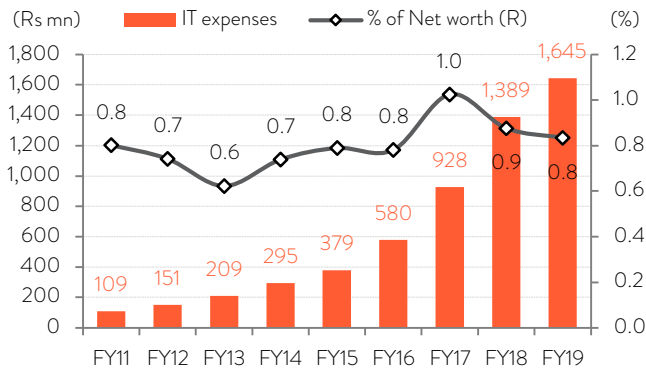


Source: Company, BOBCAPS Research

Technology supporting cross-sell franchise

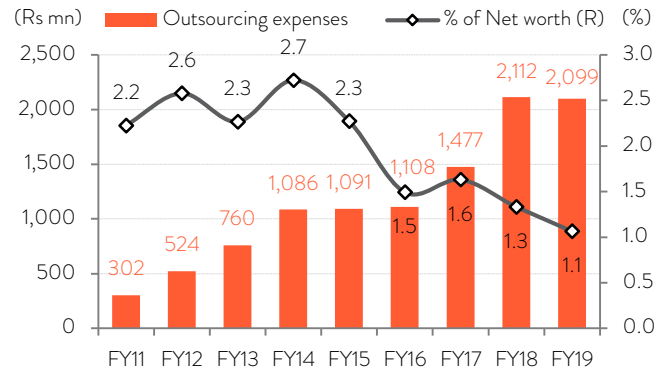
BAF has invested ~Rs 13bn on technology and processes over FY15-FY19. Domain specialist teams within each business vertical and the use of data analytics help churn the franchise effectively and deepen engagements with existing customers. Simultaneously, geographical and product expansion has led to a tripling of the cross-sell customer pool to ~21mn over FY16-FY19.

FIG 50 – TECHNOLOGY INVESTMENT OF ~RS 6BN OVER FY11-FY19



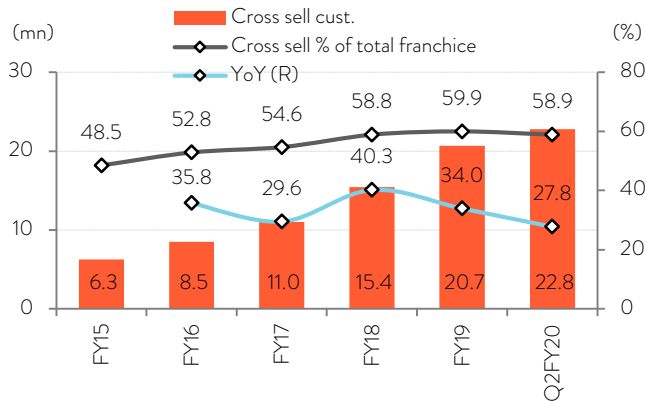
Source: Company, BOBCAPS Research

FIG 51 – MID- AND BACK-OFFICE FUNCTIONS OUTSOURCED TO SAVE COSTS



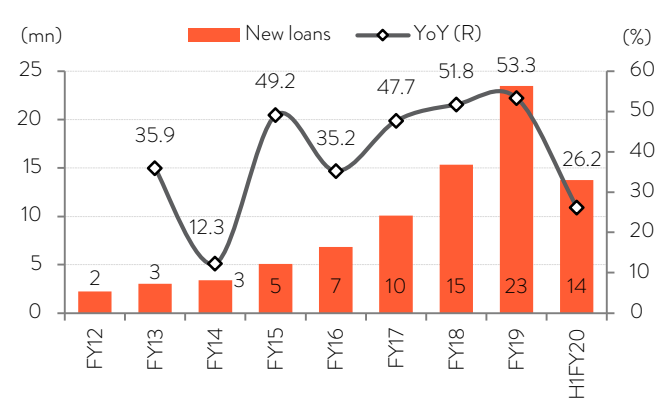
Source: Company, BOBCAPS Research

FIG 52 – TECH. AND PROCESS INVESTMENTS HAVE EXPANDED THE CROSS-SELL FRANCHISE...



Source: Company, BOBCAPS Research

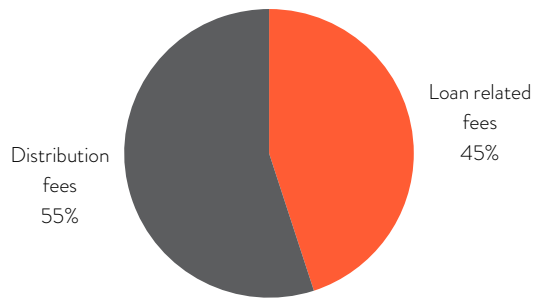
FIG 53 – ...THOUGH NEW LOAN ACQUISITION HAS SLOWED DURING CURRENT SECULAR SLOWDOWN



Source: Company, BOBCAPS Research

The company markets personal loans, EMI cards and co-branded credit cards to its consumer finance clientele and aims to have ~75% of new loan originations from existing customers in near term. As most credit products offered by BAF are for consumer products, we believe the acquisition of new customers is also paramount – the company has done well on this front, logging a robust customer acquisition CAGR of 47% over FY15-FY19.

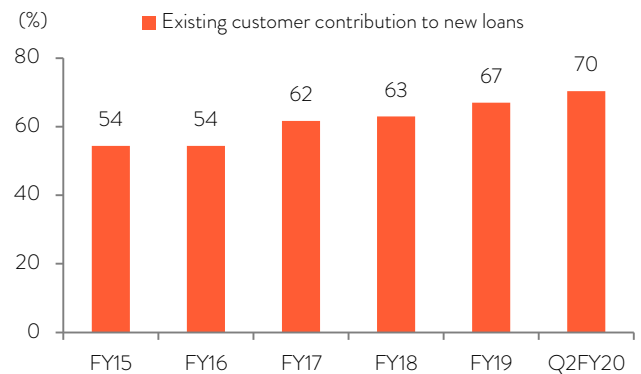
FIG 54 – BAF’S FEE INCOME IS EVENLY DIVIDED BETWEEN DISTRIBUTION AND LOAN-RELATED FEES



Z

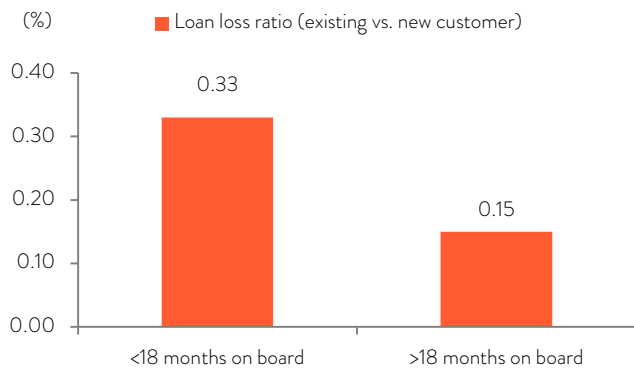
Source: Company, BOBCAPS Research

FIG 55 – BAF AIMS TO HAVE ~75% OF NEW LOAN ORIGINATIONS FROM EXISTING CUSTOMERS



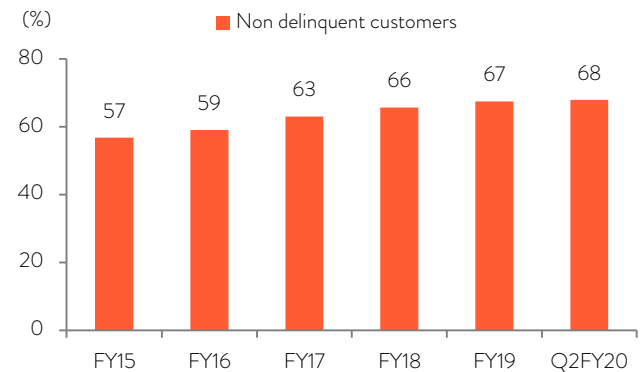
Source: Company, BOBCAPS Research

FIG 56 – LOAN LOSSES LOWER ON EXISTING VETTED CUSTOMERS...



Source: Company, BOBCAPS Research

FIG 57 – ...AS NON-DELINQUENT POOL HAS INCREASED DRIVEN BY TECH INVESTMENTS



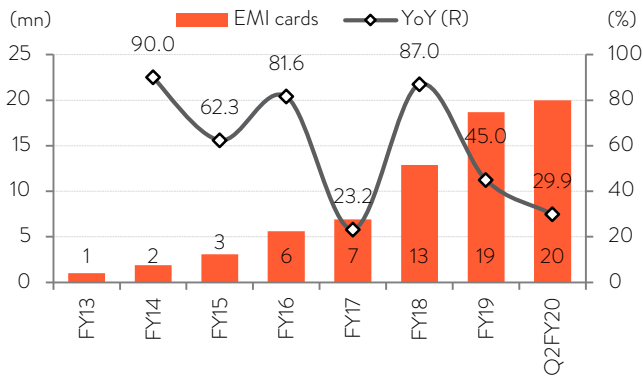
Source: Company, BOBCAPS Research

EMI card spends – emerging component of fee income

EMI cards offer easy instalment options for small-ticket purchases

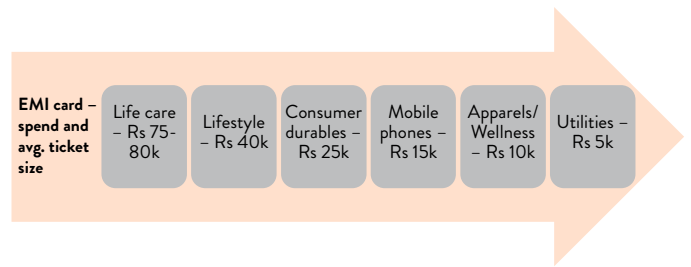
BAF started offering existing member identification (EMI) cards ranging from Rs 5,000 to Rs 80,000 for a variety of purchases to vetted customers in FY11. Active EMI card volumes grew ~6x during FY15- FY19. Given that these cards offer easy instalment options to customers for small-ticket purchases such as fashion, travel, insurance and small appliances, the business is driving granular fee income. In FY18, the company extended its loan offerings in the healthcare segment to both elective and non-elective procedures, following this up with the recent launch of a healthcare EMI card.

FIG 58 – EMI CARDS GREW ~6X DURING FY15-FY19



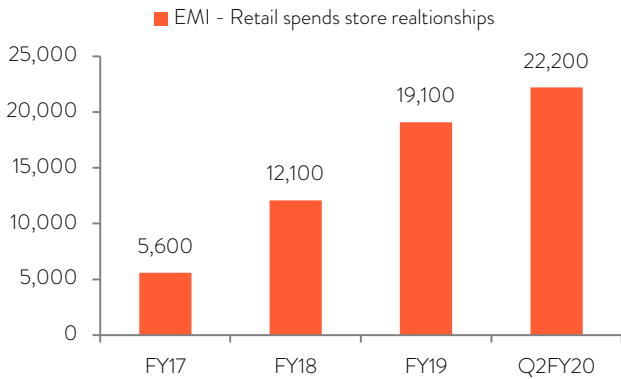
Source: Company, BOBCAPS Research

FIG 59 – PRODUCT AND TICKET SIZE HIERARCHY FOR EMI CARDS



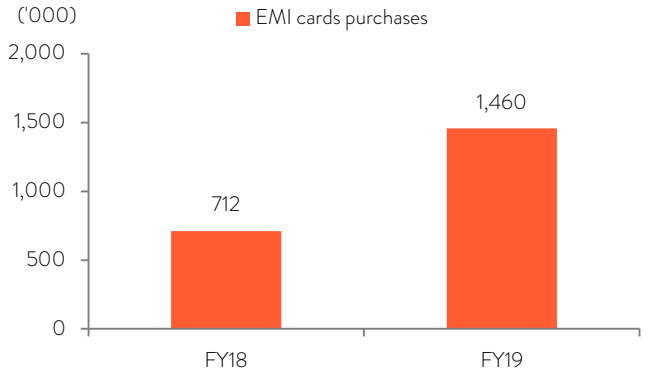
Source: Company, BOBCAPS Research

FIG 60 – EMI RETAIL STORE RELATIONSHIPS GREW ~3X DURING FY17-FY19



Source: Company, BOBCAPS Research

FIG 61 – NUMBER OF PURCHASES USING EMI CARD INCREASED ~2X DURING FY18-FY19



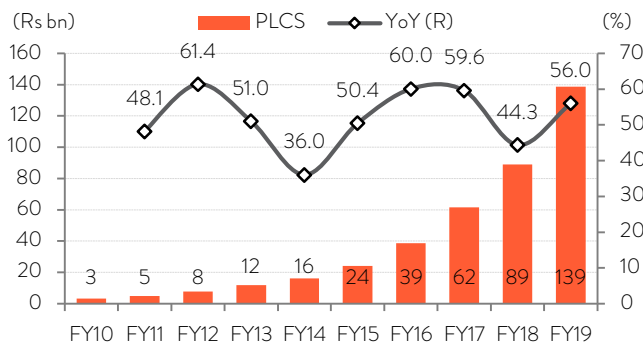
Source: Company, BOBCAPS Research

Personal loans cross-sell – promising risk-reward

Opex on PLCS negligible and credit loss low

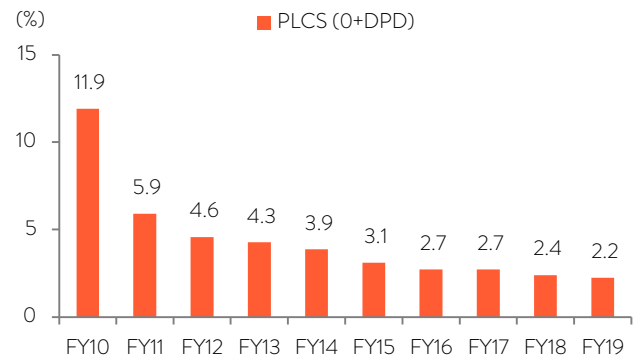
Personal loans cross-sell (PLCS) is offered to existing salaried and self-employed customers with timely repayment track records. Opex to offer the PLCS product is negligible and the credit loss is a third of that incurred for new customers. This points to a sustainable risk-reward equation.

FIG 62 – PERSONAL LOANS CROSS-SELL GREW ~6X OVER FY15-FY19...



Source: Company, BOBCAPS Research

FIG 63 – ...AND INCREASED USE OF DATA ANALYTICS LED TO LOWER DELINQUENCY

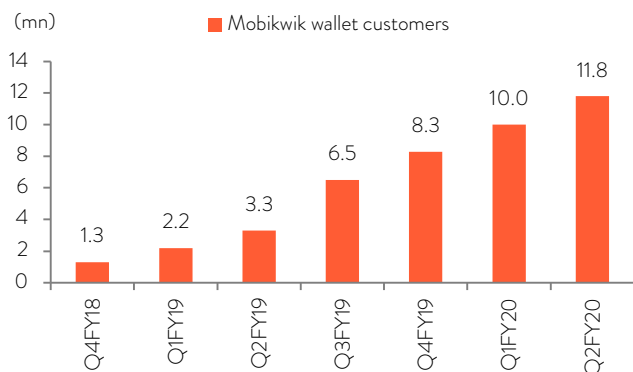


Source: Company, BOBCAPS Research

Mobikwik wallet – gateway to high velocity transactions

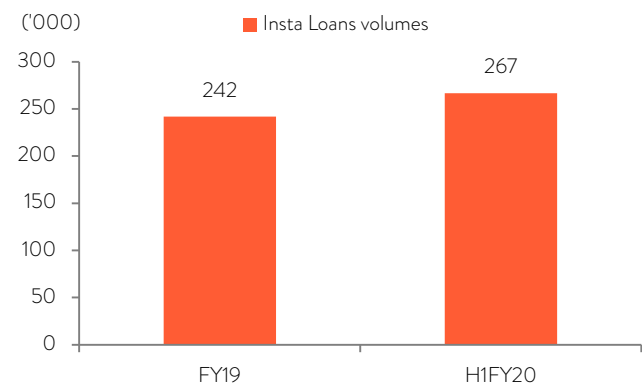
BAF made a strategic investment in Mobikwik in Q2FY18, enabling it to offer small-ticket, high velocity credit products. It also launched digitised EMI cards for existing and new wallet customers, decreasing issuance costs. In FY19, the company started a pilot project of “insta” pre-approved loans worth Rs 5,000 and Rs 10,000 to wallet customers. We believe this will create a pool of sticky, granular fee income as users can now conveniently fund their small-ticket purchases.

FIG 64 – DIGITISED EMI CARDS ADDING TO WALLET CUSTOMER VOLUMES



Source: Company, BOBCAPS Research

FIG 65 – SMALL INSTA LOANS TO RAISE CUSTOMER STICKINESS AND GROW GRANULAR FEE INCOME



Source: Company, BOBCAPS Research

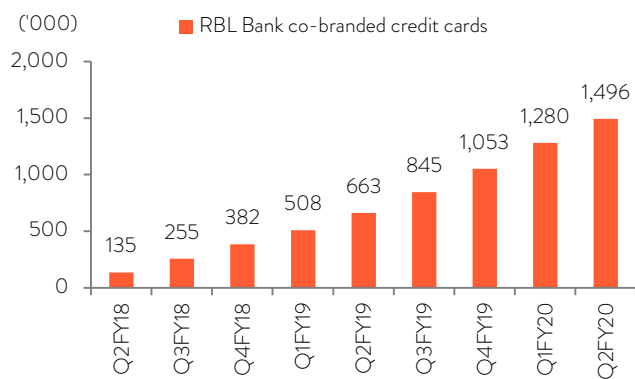
Co-branded credit cards – large source of fee income

As regulations do not permit BAF to offer standalone credit cards, it has a co-branded offering with RBL Bank for existing customers. Under this arrangement, BAF earns 100% of the sourcing fee. This book is now maturing and has a vintage of ~2.5 years.

BAF works closely with credit bureaus to understand how the portfolio behaves and consequently has credit losses lower than the top-4 credit card originators, as per management. The company has a run-rate of ~100,000 new card acquisitions per month and aims to be among the top-3 card issuers by FY24.

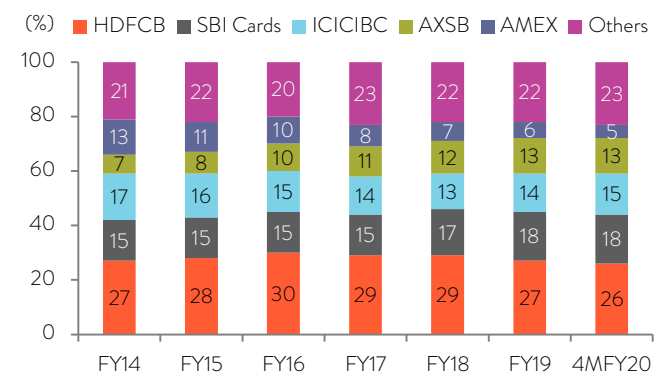
We believe risk-reward will be favourable for BAF-sourced RBL credit cards as these are targeted solely at vetted customers with a strong repayment history, wherein BAF only retains the fee income.

FIG 66 – NUMBER OF CREDIT CARDS UP ~11X IN TWO YEARS



Source: Company, BOBCAPS Research

FIG 67 – TOP-5 CREDIT CARD ORIGINATORS HAVE ~80% MARKET SHARE



Source: Company, BOBCAPS Research

SME, commercial loans – sustainable scale builders

BAF derives ~40% of its business in the top-10 cities and anticipates higher risk here due to the migratory population and heightened competition from banks and fintech companies. SME financing (13% of consolidated AUM) and commercial lending (10%) offer high-volume, profitable and opportunistic credit plays with a wide footprint, mitigating the geographic concentration. Also, both portfolios are fairly granular, giving the company the flexibility to go slow on one segment or region, depending on risk parameters.

SME lending has doubled over Q1FY18 to FY19 to Rs 158bn after BAF hived off the secured lending business to Bajaj Housing (BHFL). Commercial lending has clocked a healthy 23% CAGR during FY17-FY19, though the company has gone slow in some segments during the present credit slowdown.

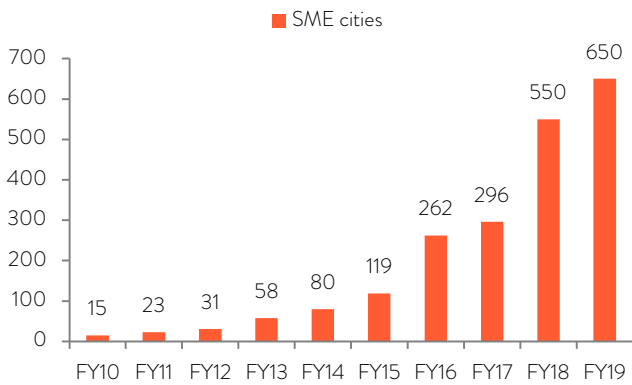
SME financing – judicious diversification

BAF’s longstanding strategy has been to focus on affluent SME customers with an average turnover of Rs 120mn, established financials and a robust borrowing track record. The SME lending business offers secured loans (average Rs 1mn ticket size) and unsecured loans (Rs 1.2mn) to customers, and has grown 2x to Rs 158bn over the past two years.

Offers business loans to SMEs and professional loans through unsecured lending

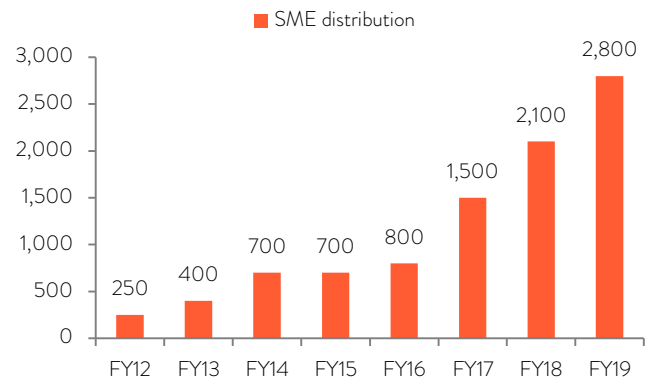
Till Jan'18, secured lending was through three product offerings: (a) loans against property (LAP), (b) lease rental discounting, and (c) home loans for the self-employed. Thereafter, incremental loan sourcing in these three categories as well as developer financing was taken over by mortgage arm Bajaj Housing Finance (BHFL). Unsecured lending is via two product offerings: (a) business loans to SMEs & to the self-employed, and (b) professional loans.

FIG 68 – RAPID SME BRANCH EXPANSION IN RECENT YEARS



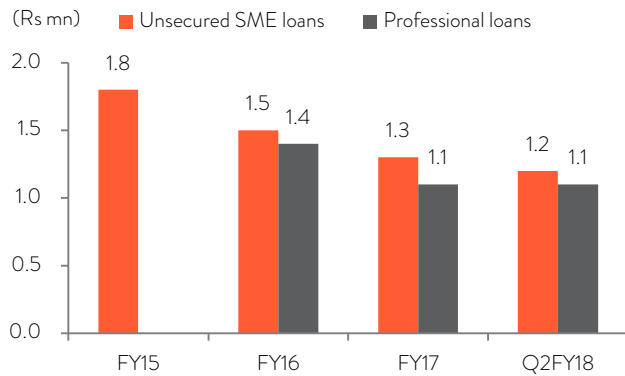
Source: Company, BOBCAPS Research

FIG 69 – DSA OUTREACH FOR SME LENDING UP 11X SINCE FY12



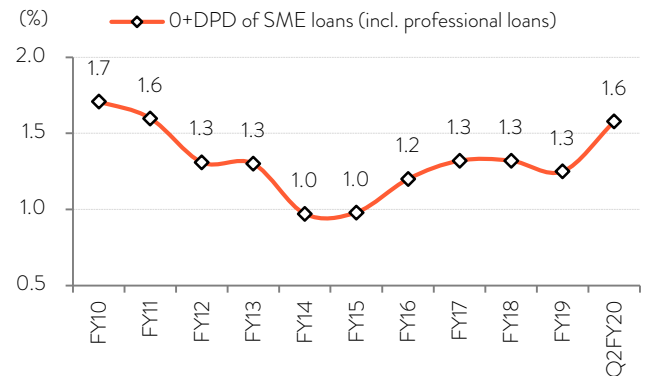
Source: Company, BOBCAPS Research

FIG 70 – INCREASING GRANULARITY IN TICKET SIZE



Source: Company, BOBCAPS Research

FIG 71 – DELINQUENCIES FOR SME LENDING INCHING UP, BUT STILL MANAGEABLE

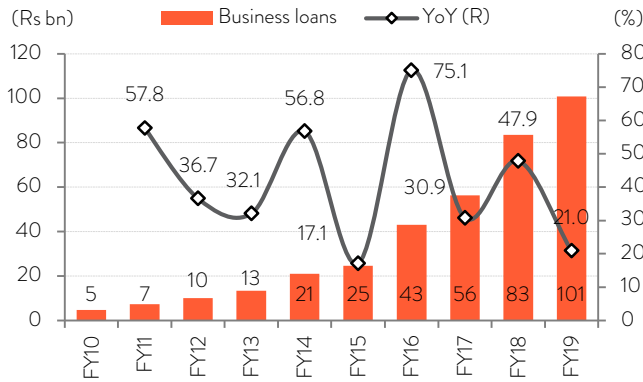


Source: Company, BOBCAPS Research

- Business loans help spread portfolio concentration risk:** Business loan AUM has grown ~4x to Rs 101bn over FY15-FY19 as BAF expanded its SME lending footprint from 119 cities to 650 over this period. This segment helps diversify portfolio concentration risk beyond the intensely competitive top-40 markets and deliver a lower cost of loan acquisition.
- Professional loans help ease macro risks with low opex:** BAF carved out professional loans targeted at chartered accountants, doctors and engineers as a separate business structure in Q4FY15. Segmental AUM has grown ~9x to Rs 53bn over FY15-FY19 aided by geographic expansion and analytics-

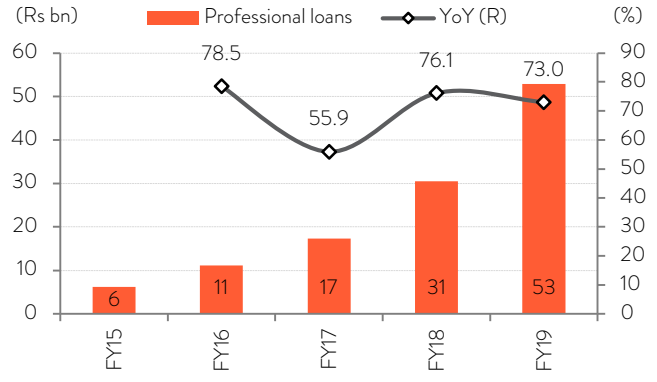
based credit outreach. Loans are directly disbursed to eligible customers and hence entail low cost of customer acquisition. This client segment is largely independent of macro events, limiting the probability of credit loss.

FIG 72 – BUSINESS LOANS HAVE GROWN 20X DURING FY10-FY19



Source: Company, BOBCAPS Research

FIG 73 – PROFESSIONAL LOANS GREW ~9X OVER FY15-FY19



Source: Company, BOBCAPS Research

Commercial financing – high growth, profitable business

Commercial loan offerings

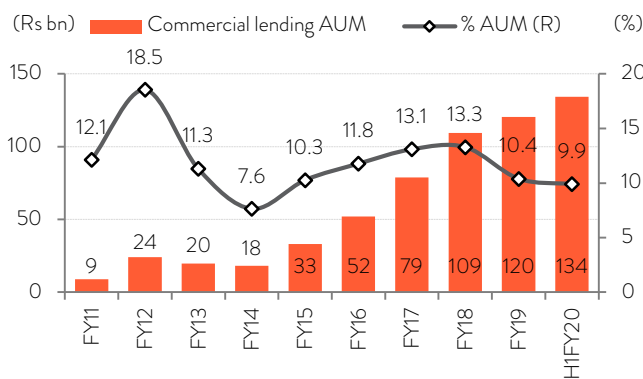
- (i) loan against securities (LAS)
- (ii) financial institution group (FIG) lending
- (iii) warehouse receipt financing
- (iv) working and growth capital to auto component manufacturers
- (v) loans to the light engineering industry
- (vi) loans to specialty chemical industry verticals

Source: Company, BOBCaps

Commercial lending AUM grew ~4x to Rs 120bn during FY15-FY19 and now forms ~10% of consolidated AUM. The product offerings are short-, medium- and long-term financing to mid-market corporates. BAF also offers structured collateralised products against marketable securities or mortgages.

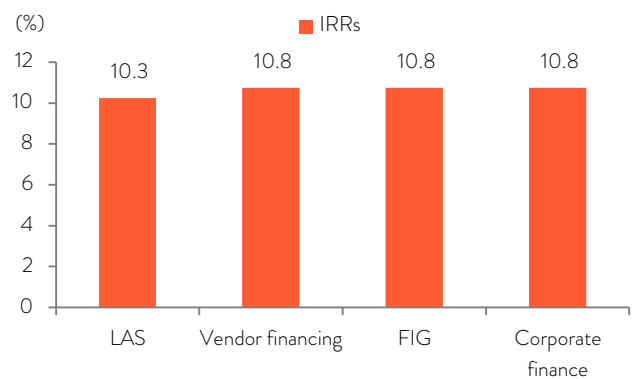
The company ensures that commercial lending is an opportunistic, profitable business (average ~11% IRR) that avoids concentration risks. For instance, loans to auto-component manufacturers only have ~40% share from BJAUT vendors. BAF also decided to wind down its warehouse receipt financing business from Apr'19, attributing this to stress witnessed in the agrarian sector and the lack of a sustainable profit model.

FIG 74 – COMMERCIAL LENDING GREW ~15X DURING FY10-H1FY20



Source: Company, BOBCAPS Research

FIG 75 – HEALTHY IRR ACROSS PRODUCT OFFERINGS



Source: Company, BOBCAPS Research

Rural financing to generate higher yields

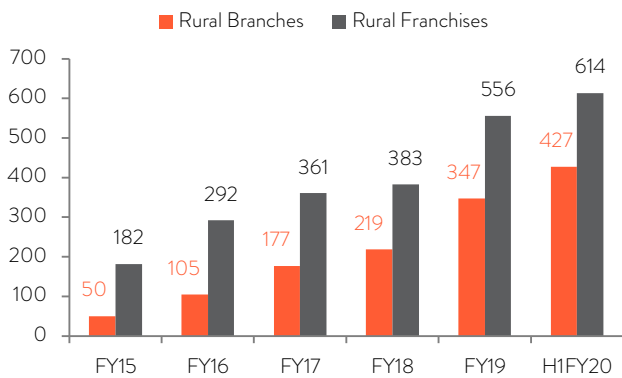
Rural lending forms 8% of consolidated AUM

BAF launched the rural lending business in FY14, offering consumer durable, lifestyle and personal loans, SME and gold loans, and fixed deposits. Rural lending has grown ~7x during FY16-FY19 to reach an AUM of Rs 92bn and now contributes 8% of consolidated AUM vs. 3% in FY15. Although consumer durable ticket sizes are 10% lower than urban branches, the yields are 100-150bps higher. This offsets the impact of high customer acquisition cost and credit losses.

Expanding hub-and-spoke model

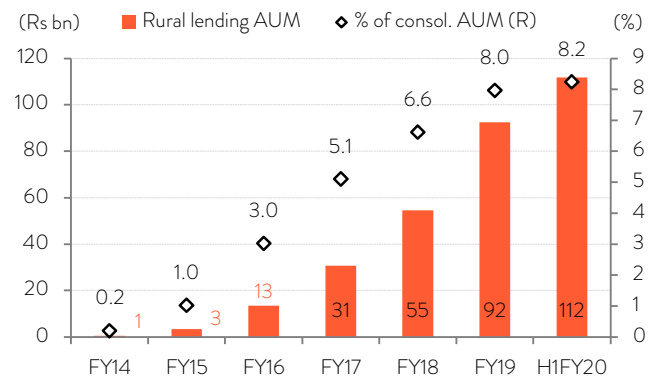
BAF uses a hub-and-spoke model to source customers. As of H1FY20, its rural business is spread in over 1,000 locations across 13 states and union territories in India through 16,400+ store relationships. Management expects to increase the rural presence to 2,500 locations in 4-5 years and extend its distribution reach to 16-17 states in a calibrated manner.

FIG 76 – RAPID GROWTH IN RURAL HUBS (LENDING BRANCHES) & SPOKES (FRANCHISES)



Source: Company, BOBCAPS Research

FIG 77 – RURAL LENDING HAS GROWN ~8X SINCE FY16

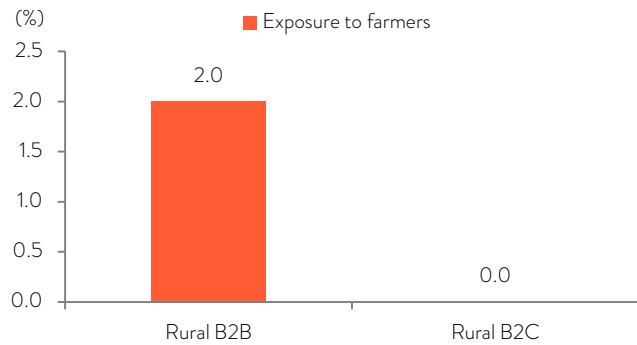


Source: Company, BOBCAPS Research

Prudent approach curbs delinquencies

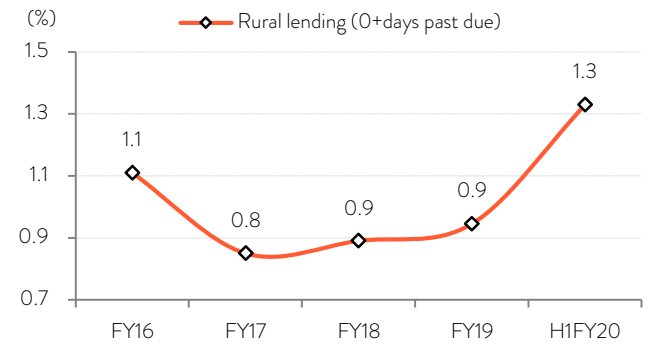
Management has prudently chosen to stay away from farmer loans while judiciously selecting rural locations to build its presence. Though the EMI bounce rates are higher, collection efficiency is better than in urban locations – reflected in benign delinquencies in the rural business (0+dpd 1.3% as of H1FY20).

FIG 78 – EXPOSURE TO FARMERS IS MINISCULE



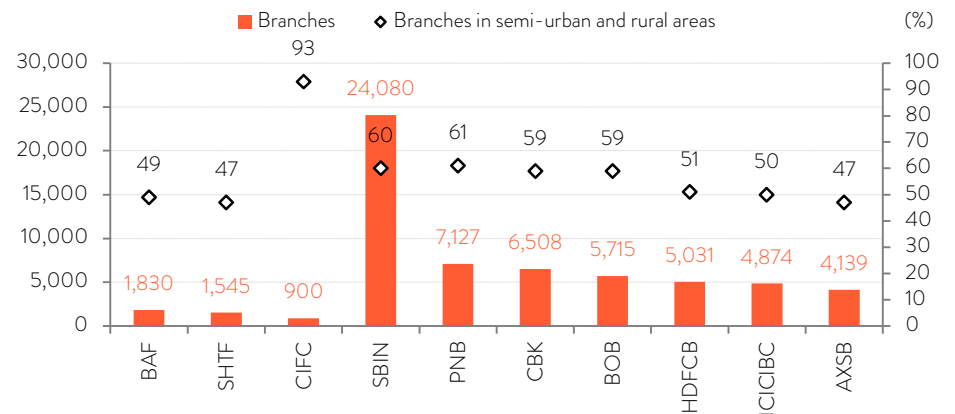
Source: Company, BOBCAPS Research

FIG 79 – DELINQUENCIES LOOK BENIGN



Source: Company, BOBCAPS Research

FIG 80 – PROPORTION OF SEMI-URBAN AND RURAL BRANCHES, FY19



Source: Company, BOBCAPS Research

Judicious borrowing approach to support margins

Stable credit rating, positive asset-liability mismatch (ALM) in the less than one-year bucket and a favourable borrowing mix have helped cut borrowing cost by ~120bps over FY16-FY19. This in turn has kept spreads stable at 8.5-9%. The rural financing foray also augurs well for margins as yields are 100-150bps higher than urban branches. We expect spreads to remain at ~9% levels during FY19-FY22 backed by benign debt market pricing of BAF’s papers and the company’s ability to increase its deposit profile.

Higher fixed-rate borrowing led to steady spreads

BAF has incrementally replaced its debt mix with fixed-rate instruments, taking advantage of the falling rate environment and its stable credit rating profile over FY16-FY19. Cost of borrowings has declined ~120bps over FY16-FY19. With an incremental focus on financing high-yield, high-churn digital and lifestyle products, the back-book repricing has been faster than liability repricing – this has manifested in stable-to-improving spreads over FY16-FY19, ranging from 8.5-9.0%.

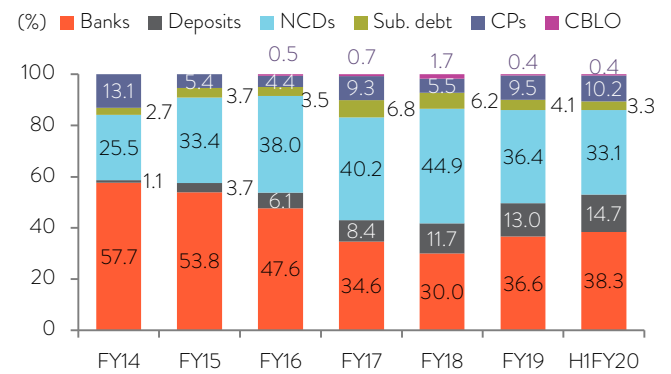
Cost of borrowings has fallen ~120bps over FY16-FY19

FIG 81 – CREDIT RATINGS STABLE THROUGH FY16-FY19

	FY16	FY17	FY18	FY19
NCD	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
Sub. Debt	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
LT Bank Rating	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable	IND AAA/Stable
ST Bank Rating	IND A1+	IND A1+	IND A1+	IND A1+

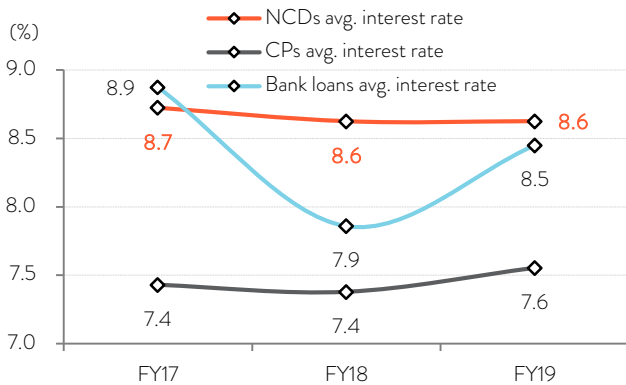
Source: India Ratings, Company, BOBCAPS Research

FIG 82 – FUNDING MIX MOVING TOWARDS FIXED RATE INSTRUMENTS



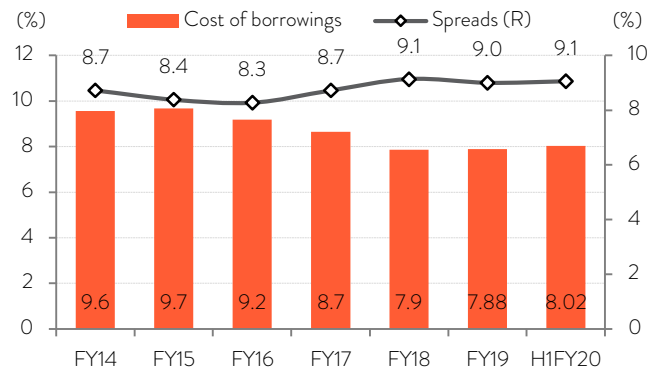
Source: Company, BOBCAPS Research

FIG 83 – PRICING OF DEBT THROUGH FY17-FY19 HAS BEEN LARGELY STABLE...



Source: Company, BOBCAPS Research

FIG 84 – ...LEADING TO LOWER COST OF BORROWINGS AND HIGHER SPREADS



Source: Company, BOBCAPS Research

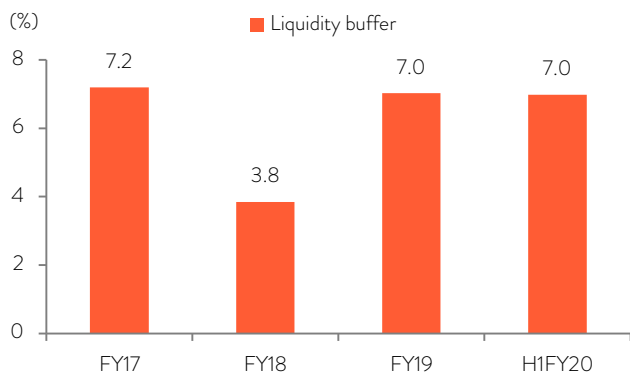
Astute asset-liability management

Liquidity buffer of 7% helped manage liquidity risk

BAF has a prudent asset-liability management (ALM) strategy of raising long-term debt and maintaining a judicious mix of borrowings between banks, money markets and deposits. The company maintained a liquidity buffer of 7% in H1FY20, which helped it to manage liquidity risk. Consequently, the increase in cost of funds over FY19 was only 14bps on a calculated basis. We define liquidity buffer as cash & equivalents plus investments (excl. investment in subsidiaries) divided by total assets.

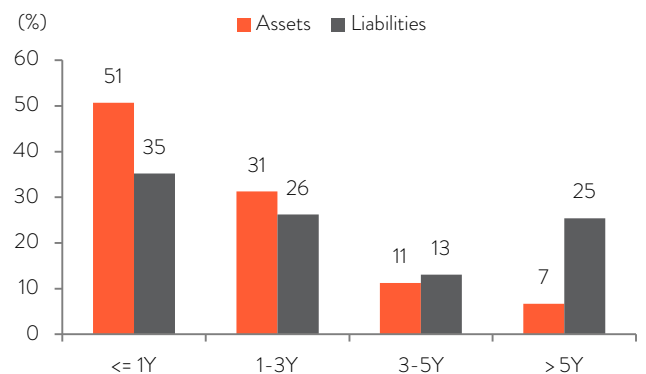
BAF’s assets maturing in H2FY20 are worth Rs 214bn, more than its liabilities maturing during the same period, thus exhibiting a positive gap in ALM for the next one year. We believe this will lead to stable-to-improving spreads and return ratios in FY20, with spreads projected to hold at ~9% levels over FY19-FY22.

FIG 85 – LIQUIDITY BUFFER OF 7% IN FY19



Source: Company, BOBCAPS Research

FIG 86 – POSITIVE MISMATCH IN ONE-YEAR MATURITY BUCKET (AS OF H1FY20)



Source: Company, BOBCAPS Research

Mortgage business to gain scale in medium term

Post hive-off into a separate entity in FY18, Bajaj Housing Finance (BHFL) will have (a) access to a lower cost of funds, (b) a dedicated team to focus on the large Rs 20tn market (which is likely to expand at 15% p.a.), and (c) the opportunity to lever the business 9-10x. We expect BHFL to achieve a book size of Rs 1.2tn (CAGR of 22%) and market share of 3% by FY24.

Return ratios set to improve

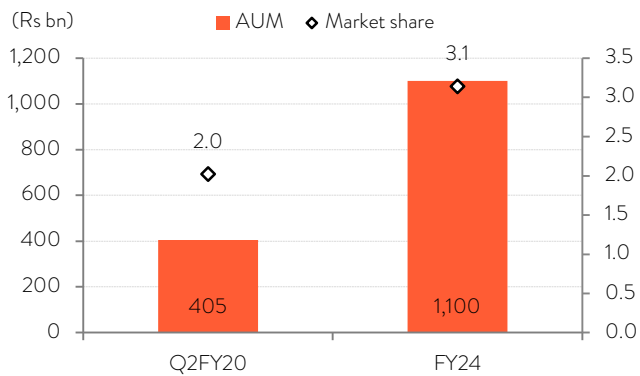
BAF launched the mortgage product in FY09 with LAP products. In subsequent years, it entered into home loans for self-employed and salaried customers, lease rental discounting loans and construction financing. BAF now also offers fee-based products such as ‘property fitness reports’ and ‘property search’.

In FY16, the company changed its home loan origination strategy from a DSA basis to in-house origination. This has resulted in lower cost of customer acquisition, higher retention, and better credit quality. Management expects BHFL to deliver 14-15% ROE in the near term. With scale, operating leverage will also play out in this business (though a few years away), thereby meaningfully contributing to return ratios.

Strong growth outlook

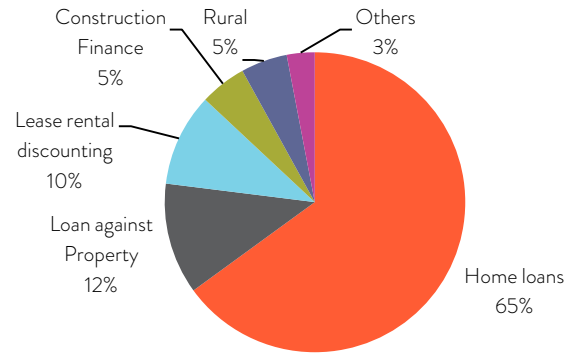
Atul Jain, who had set up the successful rural lending business, heads BHFL. As of H1FY20, mortgages contribute 30% of BAF’s consolidated AUM, which we estimate will grow to 35% by FY24 on a conservative basis. In-house loan sourcing, cross-sell opportunity to existing customers (who have ~Rs 5tn of mortgages as per management) and popular ticket-size loans of Rs 3.5mn-4mn will act as key growth drivers for BHFL in the near-to-medium term.

FIG 87 – ~3% MARKET SHARE BY FY24 DOES NOT SEEM A BIG ASK FOR BHFL



Source: Company, BOBCAPS Research

FIG 88 – AUM SPLIT, H1FY20



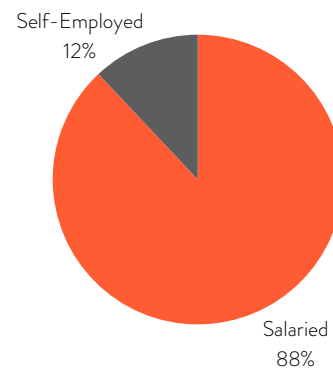
Source: Company, BOBCAPS Research

FIG 89 – BHFL PRODUCT LANDSCAPE AS OF H1FY20

	HL	LAP	LRD	CF
Avg. ticket size (Rs mn)	3.9	2.8	250	200
Yield (%)	9.5	11.5	NA	12
LTV (%)	70	~50	NA	NA
Locations	Top-40	Top-30	Top-8	Top-8

Source: Company, BOBCAPS Research

FIG 90 – CLEAR FOCUS ON SALARIED CUSTOMERS



Source: Company, BOBCAPS Research

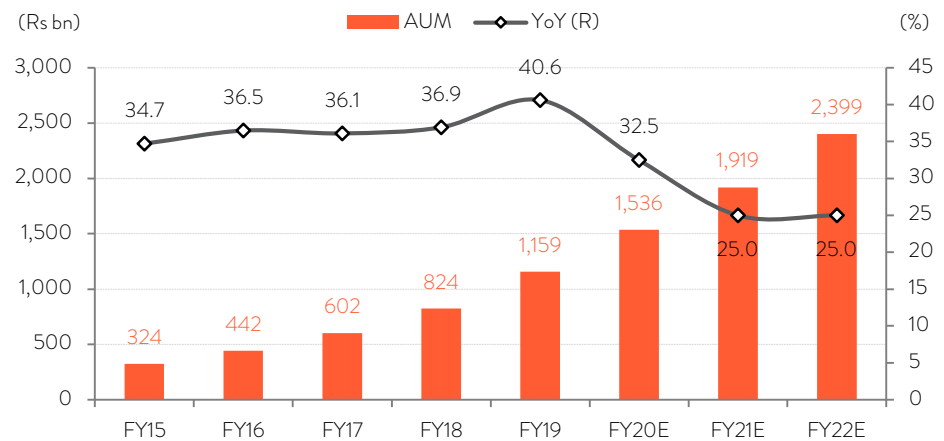
Financial review

Expect 27% AUM CAGR over FY19-FY22

We expect higher finance penetration across consumer products coupled with geographical expansion to drive value and volume growth for BAF’s consumer financing division. Further, technology-led throughput should help the business scale up rapidly, with scorecard-based decision-making now possible within minutes.

Commercial and SME lending offer both secured and unsecured credit products, which can be scaled up or down depending on risk metrics for end users and regions. Rural financing offers a cushion against any renegotiations by OEMs on loan subvention schemes, as yields are 100-150bps higher than urban areas. Lastly, mortgages offer the opportunity to build scale, led by in-house sourcing and favourable ticket size. Given these factors we forecast a 27% AUM CAGR for BAF during FY19-FY22.

FIG 91 – WE EXPECT ~27% CAGR IN AUM OVER FY19-FY22E

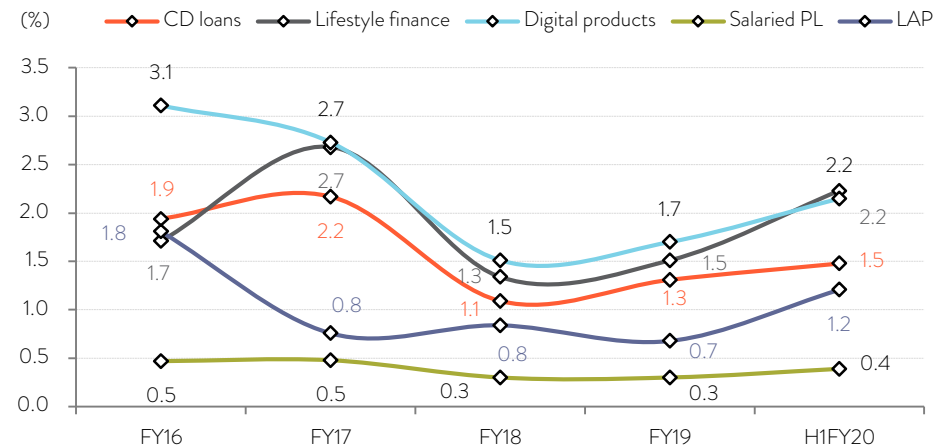


Source: Company, BOBCAPS Research

Asset quality to remain healthy

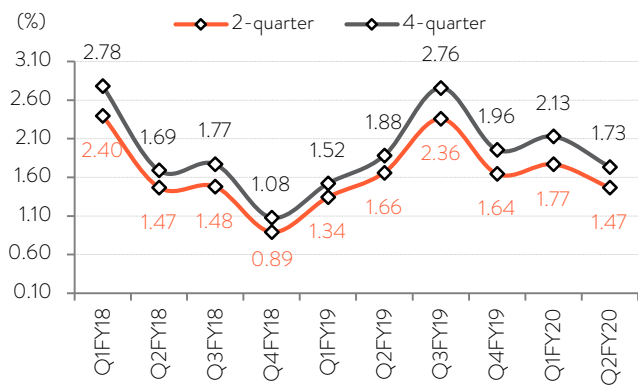
BAF’s credit costs have been range-bound at 130-160bps over the past seven years, thus driving healthy ROE of 22%+. Net slippages ratio (with a four-quarter lag) has averaged at ~200bps over the last 10 quarters, reflecting the efficacy of collections. Strict monitoring of asset quality metrics, a diversified product suite that allows for flexibility in loan exposure, and use of technology & data analytics for prudent product positioning lowers credit loss probability. We expect asset quality to remain benign, with credit cost (incl. Karvy exposure) of ~200bps over FY20-FY22 vs. the average of ~230bps during FY10-FY19.

FIG 92 – DATA ANALYTICS EVIDENT IN BENIGN 0+ DPD ACROSS SEGMENTS



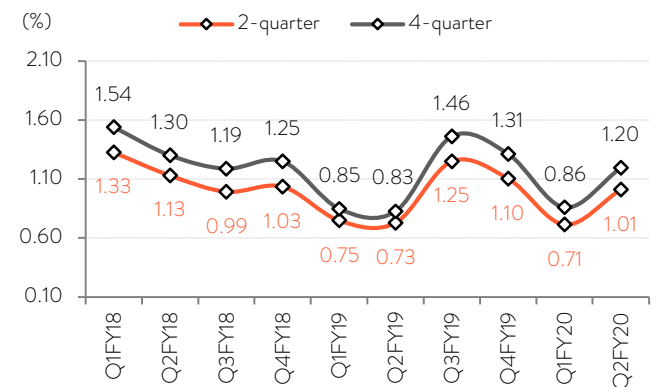
Source: Company, BOBCAPS Research

FIG 93 – NET SLIPPAGES LOW...



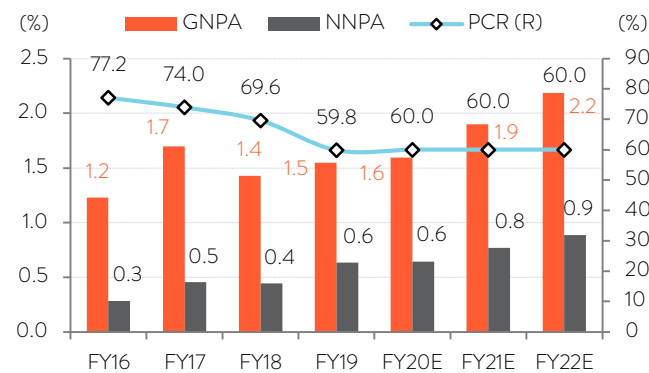
Source: Company, BOBCAPS Research

FIG 94 – ...AND LOW WRITE-OFFS (WITH LAG EFFECT) SHOW THE EFFICACY OF COLLECTIONS



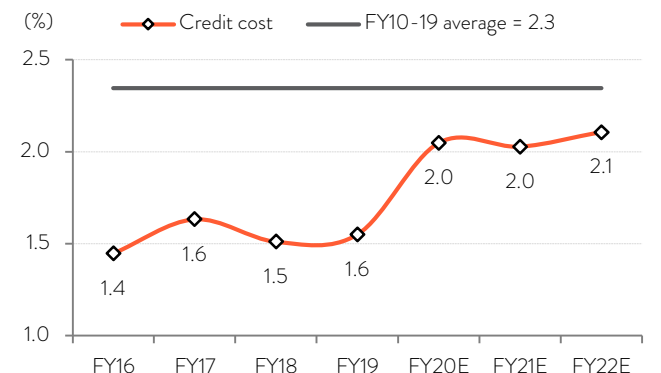
Source: Company, BOBCAPS Research

FIG 95 – WE EXPECT ASSET QUALITY TO REMAIN BENIGN



Source: Company, BOBCAPS Research

FIG 96 – DESPITE BEING CONSERVATIVE ON CREDIT COST, IT IS STILL BELOW THE 10Y AVERAGE



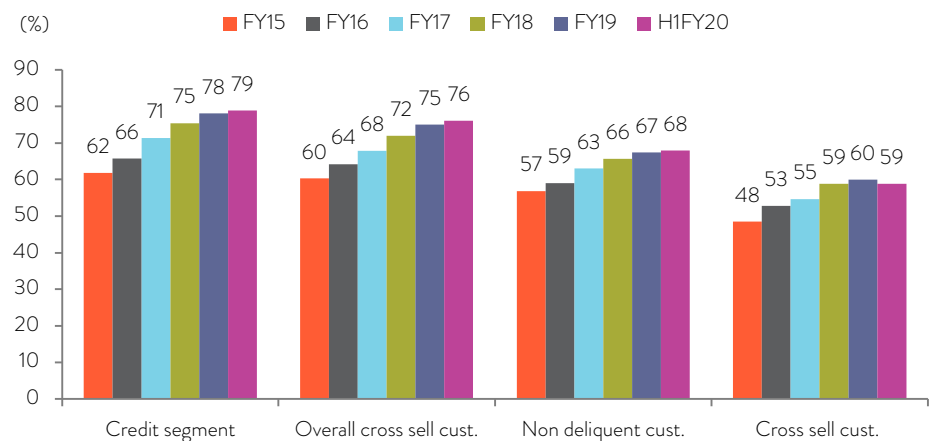
Source: Company, BOBCAPS Research

Low opex and credit cost to drive earnings

BAF caters to ~40mn customers, which we expect will nearly double to 75mn over 3-4 years. Leveraging this large customer base, the company deploys in-depth data analytics, bureau scrubs and database provider alliances to cross-sell personal loans, EMI cards and co-branded credit cards. The company’s cross-sell franchise earns high fee income at negligible operating cost, with limited credit loss (~0.33% that of new customers).

We think the street is underestimating BAF’s cross-sell franchise and thereby fee income potential. We highlight our expectations of non-linear fee income growth vs. AUM growth, which we believe will largely offset operating expense and allow a large part of NII (~30% CAGR FY19-FY22) to flow into operating profit (~33% CAGR).

FIG 97 – CROSS-SELL OPPORTUNITIES AUGMENTS OPERATING LEVERAGE

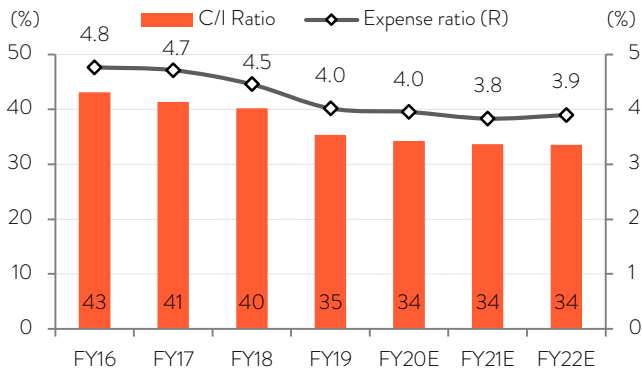


Source: Company, BOBCAPS Research

About 70% of BAF’s technology runs on cloud infrastructure, POS staff are temporary, the mid- and back-office are outsourced to BPOs, and a dedicated financial planning analysis (FPA) wing works to rein in costs. The FPA team has a target of achieving cost savings of Rs 2.5bn in FY20. Given the large technology investments over the years, we are optimistic of a further decline in Cost/Income ratio from 35% currently to 34% by FY22.

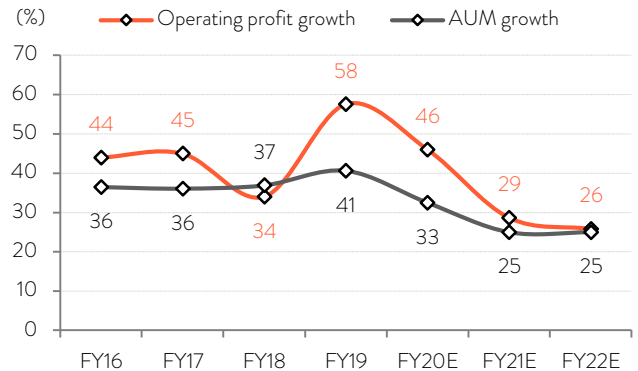
We expect operating leverage to play out as the business has attained scale in the top-10 cities. Technology-led throughput and increasing reliance on existing customers for new loan originations will have a salutary effect on both opex and credit costs. Though we forecast a ~150bps decline in C/I ratio, we think this metric holds the potential to surprise positively.

FIG 98 – WE BELIEVE OPEX CAN FALL FURTHER DUE TO TECHNOLOGY INVESTMENTS OVER THE YEARS



Source: Company, BOBCAPS Research

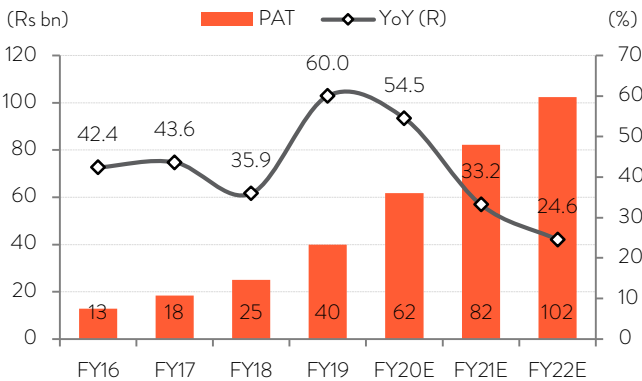
FIG 99 – OPERATING PROFIT GROWTH TO BE IN SYNC WITH AUM GROWTH



Source: Company, BOBCAPS Research

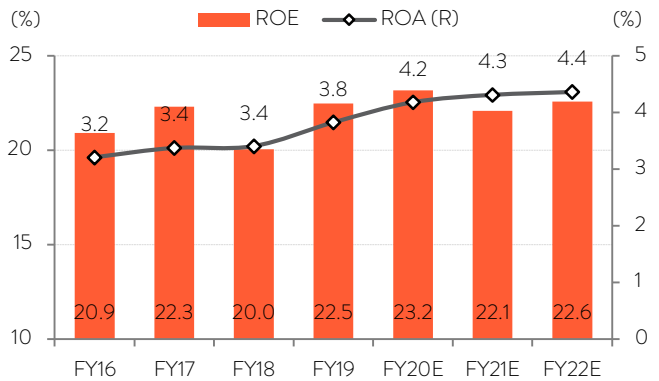
With credit cost of ~200bps expected during FY19-FY22, we forecast a 37% earnings CAGR for the company. Given the non-linearity of fee income, we argue for a case of ROE improving at current levels (i.e. 5-5.5x) of leverage.

FIG 100 – WE EXPECT PAT CAGR OF 37% IN FY19-FY22E



Source: Company, BOBCAPS Research

FIG 101 – BAF REMAINS A LOW-LEVERED PLAY



Source: Company, BOBCAPS Research

Management profile

FIG 102 – BAF'S MANAGEMENT

Name	Profile
Nanoo Pamnani Vice-Chairman	<p>Nanoo Pamnani was earlier associated with Citibank, where he began his career, from 1967 to 2006 and held various leadership positions. Prior to joining BAF, he was the Director for Citibank, N.A., Asia Pacific Group, based in Singapore. He has over 42 years of experience in the banking, auto and financial services sectors. He holds a Bachelor's degree in Arts (Honors) and a Bachelor's degree in Economics from London School of Economics.</p>
Rajeev Jain Managing Director	<p>Rajeev Jain was earlier associated with American International Group (AIG) as Deputy CEO of its Consumer Finance business. Before that, he was with American Express for over eight years and ended his stint as Head of Personal and Small Business Lending in India. He is a Management graduate from T A Pai Management Institute, Manipal, with a Bachelor's degree in Commerce.</p>
Atul Jain CEO, BHFL	<p>Atul Jain holds an MBA in Finance and has over 19 years of work experience in the financial sector. He started his career in investment banking and thereafter practiced as an independent financial consultant, engaged in debt syndication and capital structuring. He has been associated with BAF for nine years and has been the key driver in the collections vertical for the last five years.</p>
Sandeep Jain Chief Financial Officer	<p>Sandeep Jain joined BAF in 2008 and has been an integral part of the company's growth and evolution journey from a mono-line auto finance company to a diversified financial services business. He joined BAF in the management accounting unit and since then has served various roles in the company that include FP&A, Strategic Planning, Executive Assistant to CEO, Investor Engagement and Head of Management accounting unit. Sandeep is a rank holder Chartered Accountant from ICAI with a Bachelor's degree in Commerce.</p>
Anup Saha President – Consumer Business	<p>Anup Saha has worked with ICICI Bank for 14 years in different roles, the last being Senior General Manager and Group Product Head – Retail Home Loan, Vehicle Loans, Developer Funding, Retail and Rural Collections. Anup has also served on the board of ICICI Bank HFC and TU CIBIL and has spearheaded the bank's sales CRM and Big Data transformation projects. Prior to ICICI Bank, Anup worked with GE Capital International Services (GECIS). An alumnus of IIT Kharagpur and IIM Lucknow, Anup brings with him more than 24 years of diverse management experience.</p>
Deepak Bagati Executive Vice President & Group Business Head – SME	<p>Deepak Bagati is responsible for managing and growing SME business verticals such as Business Loans, Loans against Property, Professional Business, Self-employed Home Loans, Developer Finance, and Relationship Management Business. He has extensive work experience in the services industry, spread across printing solutions, reprographics, rating firms, supply chain management and lending. He was associated with Yes Bank as Zonal Head for the unsecured business before joining BAF. He has also worked with HDFC Bank, ONICRA, Mahindra & Mahindra and Modi Xerox. He is an Engineering graduate with a degree in Industrial Electronics.</p>
Ashish Panchal President – Rural, Insurance & Liabilities and Chief of Staff	<p>Ashish Panchal is responsible for managing and growing the Rural Lending and Insurance business and as Chief of Staff, is also responsible for driving corporate strategy, as well as managing retail and corporate liabilities. He has rich and diverse work experience across manufacturing, FMCG and retail banking. Within retail banking, he has worked with marquee international firms such as Citi, SCB and Barclays across a range of functions, at times in start-up situations. Previous to joining BAF, Ashish was with Barclays Bank as the Head of Acquisition and Portfolio Actions, Credit Cards. Ashish is a Mechanical Engineering graduate from Walchand Institute of Technology and has completed his Management education from the Jamnalal Bajaj Institute of Management Studies.</p>

Peer comparison

FIG 103 – AUM AND PAT COMPARISON

Company	FY19 AUM (Rs bn)	FY15-19 AUM CAGR (%)	FY19 PAT (Rs bn)	FY15-19 PAT CAGR (%)	FY19 net worth (Rs bn)
Bajaj Finance	1,159	38	39.9	44	197
Shriram Transport Finance	1,045	15	25.6	20	158
Mahindra Finance	671	16	15.6	17	104
Cholamandalam Investment & Fin	543	21	11.9	29	62
Aditya Birla Finance	517	31	8.7	34	73
Shriram City Union Finance	296	15	10.0	15	63
Muthoot Finance	349	14	19.7	26	98

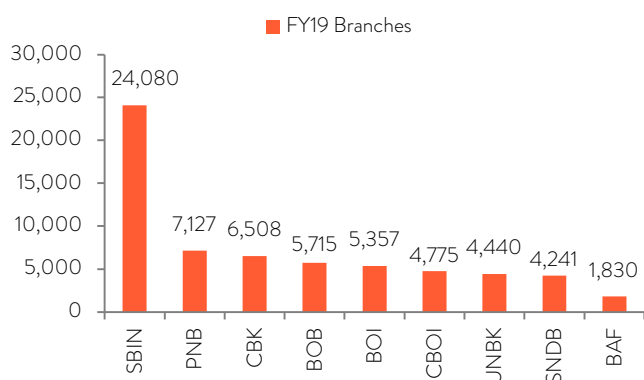
Source: Company, BOBCAPS Research

FIG 104 – DUPONT ANALYSIS AS OF FY19

Company	Yield on advances	Cost of funds	NIMs	Non-interest income	Opex	Credit cost	RoA	Leverage	RoE
Bajaj Finance	16.9	7.9	10.0	2.0	4.0	1.4	3.8	5.9	22.5
Shriram Transport Finance	16.0	8.8	7.8	0.0	1.9	2.4	2.5	6.8	17.0
Mahindra Finance	16.0	8.9	8.5	0.1	3.1	1.1	2.6	6.1	15.8
Cholamandalam Investment & Fin	13.4	8.1	5.9	1.3	2.5	0.6	2.4	8.8	21.1
Aditya Birla Finance	11.8	8.2	4.9	0.5	1.7	0.4	1.8	7.1	12.9
Shriram City Union Finance	21.5	9.0	12.7	0.4	5.6	2.6	3.5	4.8	16.9
Muthoot Finance	21.0	9.3	14.0	0.4	4.5	0.1	5.7	3.9	22.4

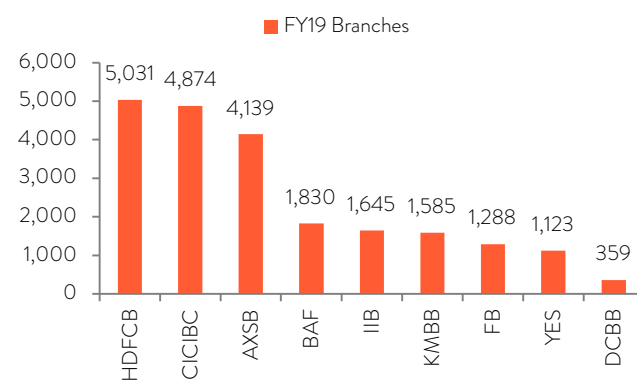
Source: Company, BOBCAPS Research

FIG 105 – BRANCH COMPARISON WITH PSU BANKS...



Source: Company, BOBCAPS Research

FIG 106 – ...AND PRIVATE BANKS



Source: Company, BOBCAPS Research

Valuation methodology

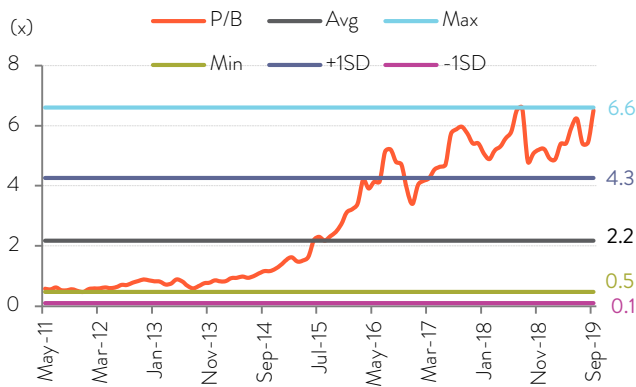
BAF is trading at 7.4x/6.1x FY20E/FY21E BV for an estimated ROE of 23.2%/22.1%. We value the stock based on a residual income model that yields a Mar'21 target price of Rs 5,000. Our assumptions include: cost of equity of 12.8%, risk-free rate of 7.75%, risk premium of 5%, and long-term growth rate of 5%. Initiate coverage with BUY.

FIG 107 – VALUATION ASSUMPTIONS

Valuations assumptions	
Cost of Equity (%)	12.8
Risk-free rate (%)	7.75
Risk premium (%)	5.0
Long-term growth rate (%)	5.0

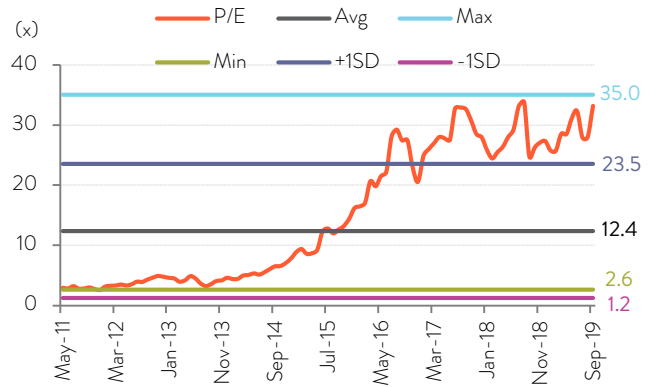
Source: BOBCAPS Research

FIG 108 – ONE YEAR FORWARD P/B



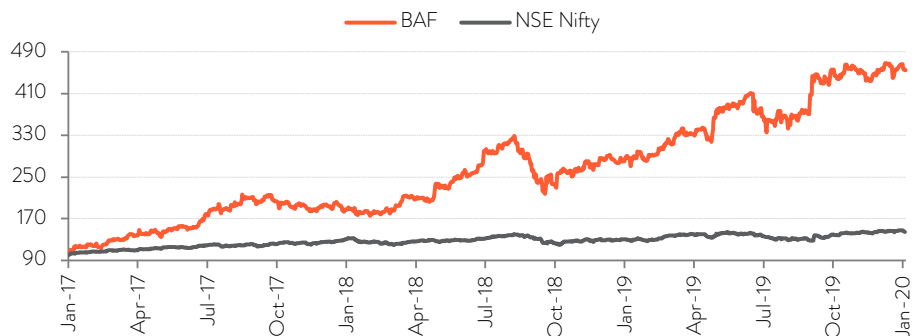
Source: Bloomberg, BOBCAPS Research

FIG 109 – ONE YEAR FORWARD P/E



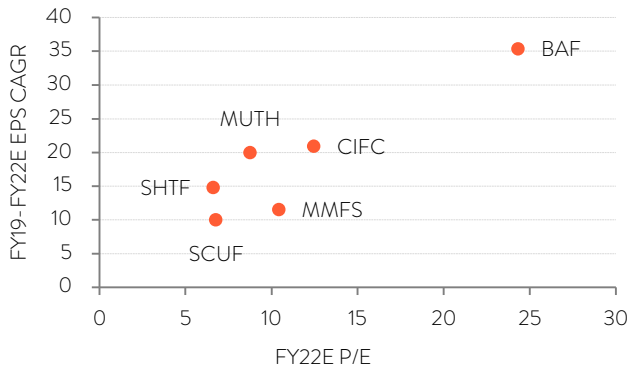
Source: Bloomberg, BOBCAPS Research

FIG 110 – RELATIVE STOCK PERFORMANCE



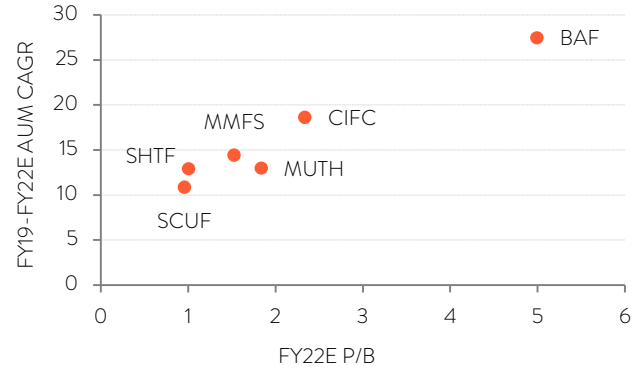
Source: NSE

FIG 111 – BAF LEADS SELECT PEERS ON P/E...



Source: Bloomberg, BOBCAPS Research | Note: Bloomberg consensus data for SHTF, MMFS, CIFIC and SCUF | Price as of 23 Jan 2020

FIG 112 – ...AND P/B VALUATION METRICS



Source: Bloomberg, BOBCAPS Research | Note: Bloomberg consensus data for SHTF, MMFS, CIFIC and SCUF | Price as of 23 Jan 2020

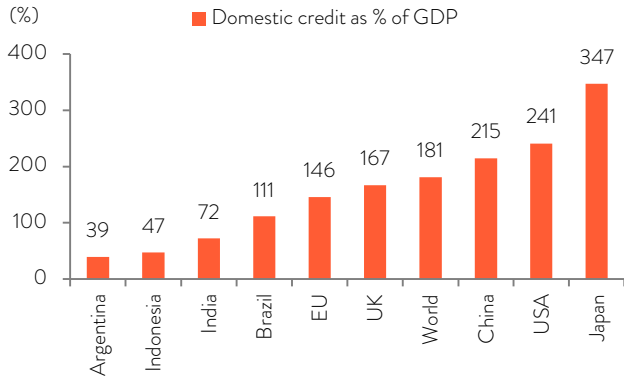
Key risks

- Moving into smaller geographic locations could expose BAF to a high proportion of new-to-credit customers, who may not have disciplined banking behaviour.
- Risk of renegotiations by OEMs could hamper subvention income and thereby the high IRRs enjoyed in consumer financing.
- Growing competition from banks and financial technology players in the retail lending space is another key risk.

Annexure

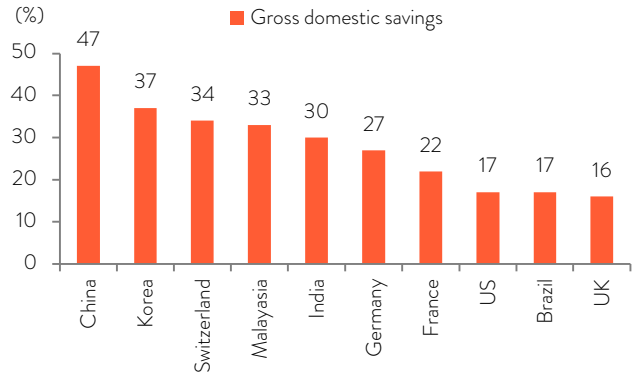
Retail industry landscape and drivers

FIG 1 – INDIA’S DOMESTIC CREDIT (AS % OF GDP) TO INCREASE



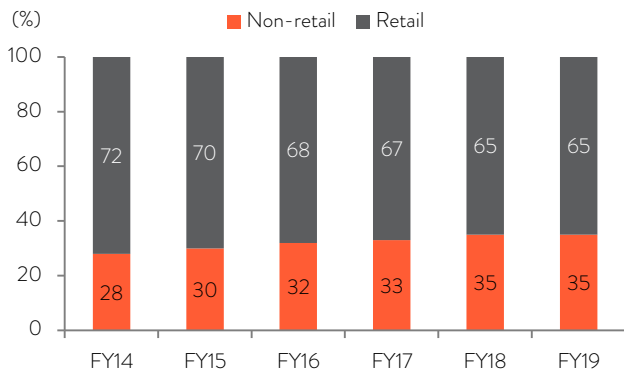
Source: Company, BOBCAPS Research | Note: US and Japan data for 2016, Other countries data for 2017

FIG 2 – GROSS DOMESTIC SAVINGS COMPARISON



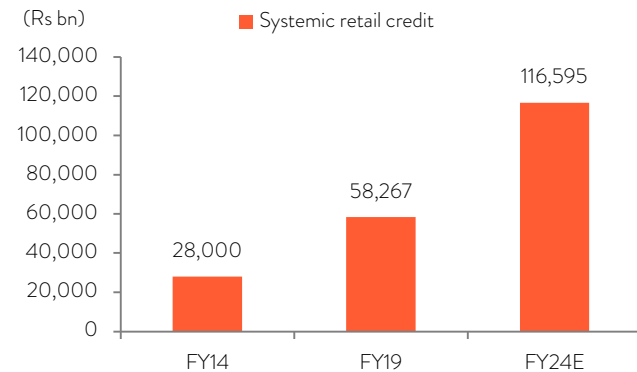
Source: Company, BOBCAPS Research | Note: Data as of 2017

FIG 3 – SYSTEMIC RETAIL CREDIT GROWING (RS 161TN AS OF FY19)



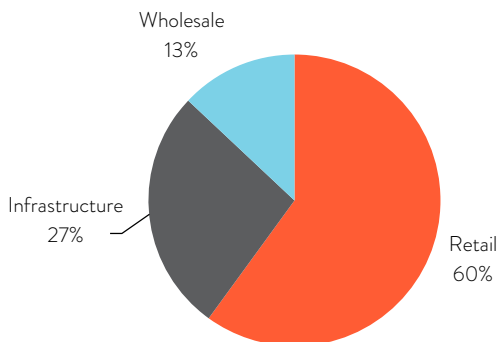
Source: Company, BOBCAPS Research

FIG 4 – SYSTEMIC RETAIL CREDIT TO GROW AT 15% CAGR OVER FY19-FY24E (CRISIL)



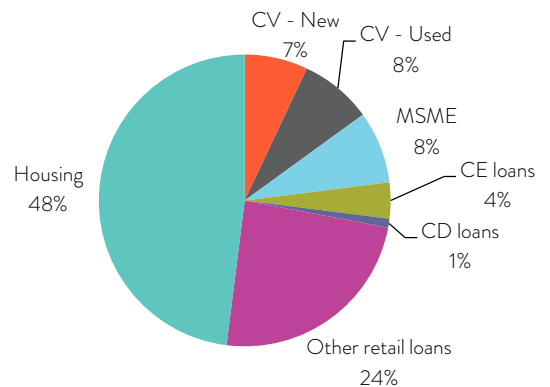
Source: CRISIL

FIG 5 – OVERALL NBFC CREDIT AT RS 29.3TN AS OF FY19...



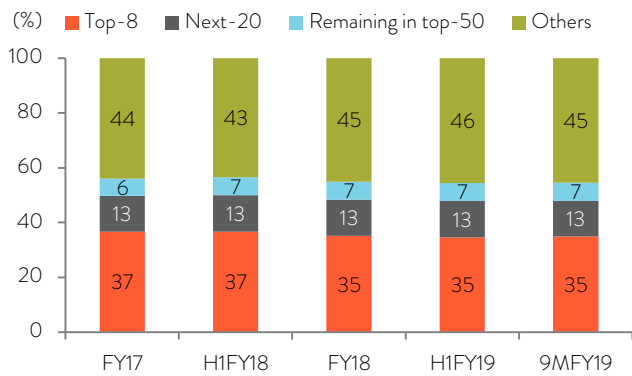
Source: Company, BOBCAPS Research

FIG 6 – ...OF WHICH RETAIL LOANS COMPRISE RS 17.6TN (~60%)



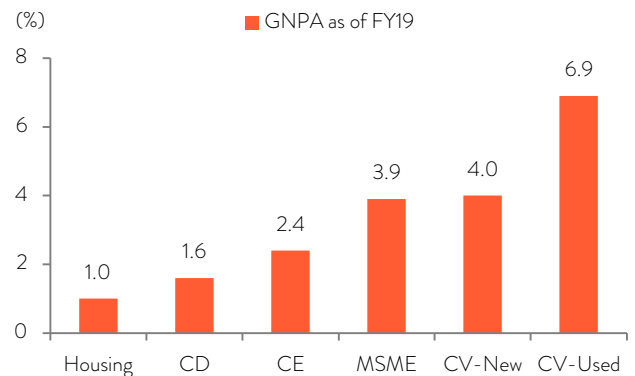
Source: Company, BOBCAPS Research

FIG 7 – RETAIL CREDIT LANDSCAPE ACROSS CITIES IN INDIA



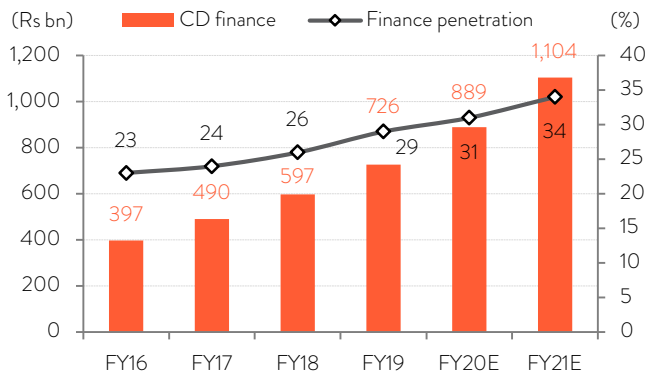
Source: Experian, Company, BOBCAPS Research

FIG 8 – DESPITE HIGH GROWTH IN RETAIL, ASSET QUALITY HAS BEEN STABLE



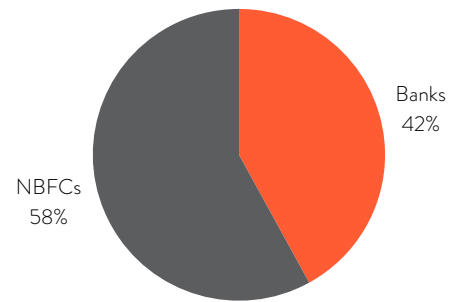
Source: CRISIL

FIG 9 – CONSUMER DURABLE FINANCE AND FINANCE PENETRATION GROWING RAPIDLY



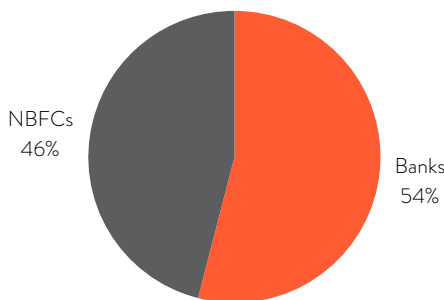
Source: CRISIL

FIG 10 – 2W FINANCING DISBURSEMENT TO GROW AT ~12% CAGR TO RS 552BN (FY19-FY24E: CRISIL)



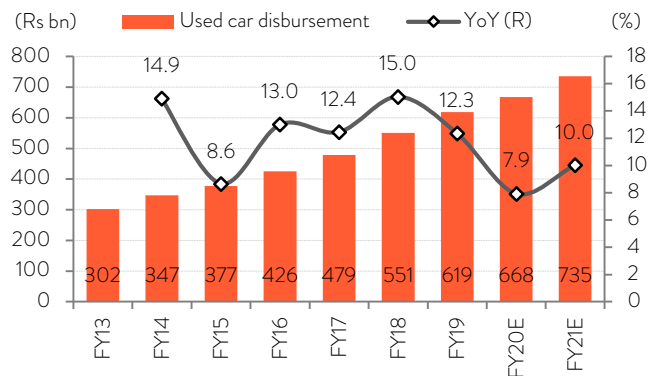
Source: CRISIL | Note: Data as of FY19

FIG 11 – 3W FINANCING DISBURSEMENT TO GROW AT ~6% CAGR TO RS 148BN (FY19-FY24E: CRISIL)



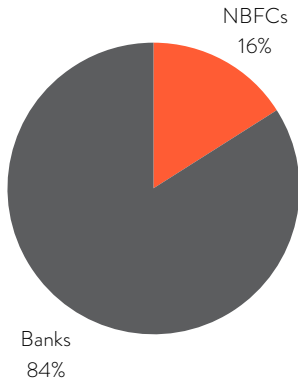
Source: CRISIL | Note: Data as of FY19

FIG 12 – USED CAR FINANCING MARKET TO GROW STEADILY



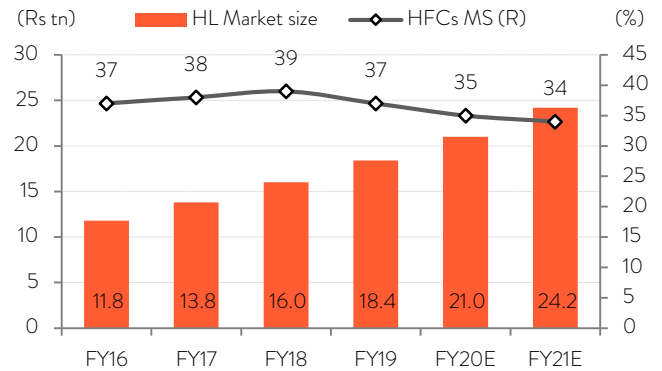
Source: CRISIL

FIG 13 – PERSONAL LOAN BOOK TO GROW AT 22% CAGR TO RS 11.2TN (FY19-FY24E: CRISIL)



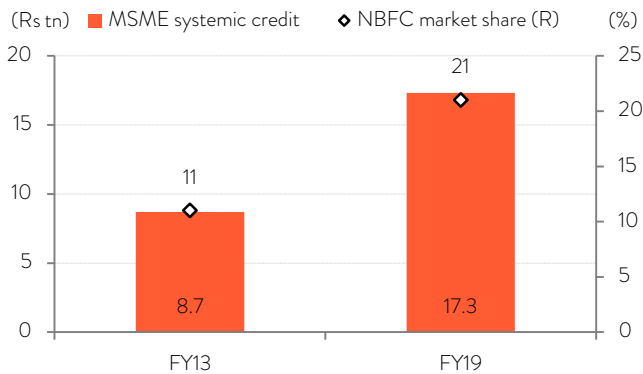
Source: CRISIL

FIG 14 – BANKS TO GAIN MARKET SHARE OVER FY19-FY21E (CRISIL)



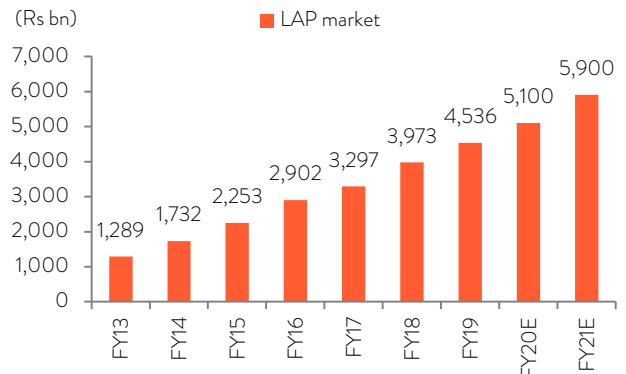
Source: CRISIL

FIG 15 – NBFC MARKET SHARE INCREASING IN MSME FINANCING



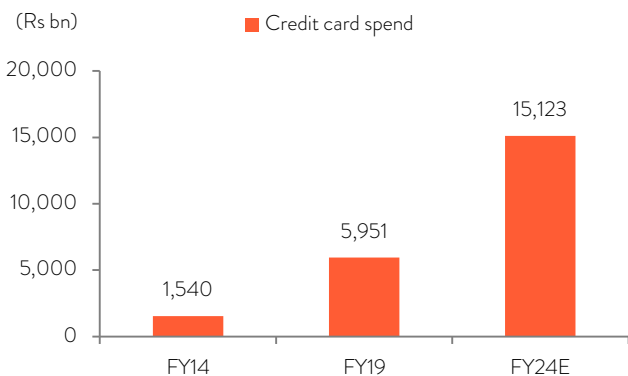
Source: CRISIL

FIG 16 – LAP MARKET TO GROW AT ~14% CAGR DUE TO TEPID NBFC PARTICIPATION (FY19-FY21E: CRISIL)



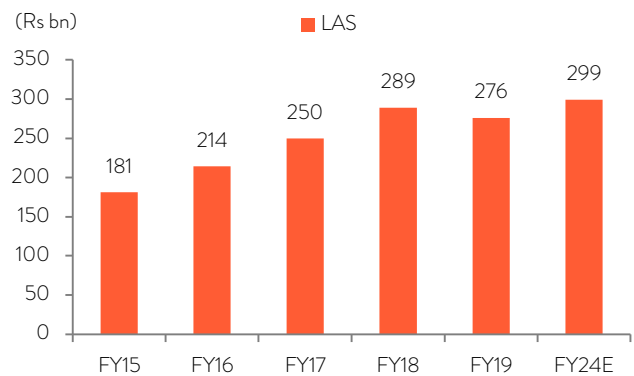
Source: CRISIL

FIG 17 – CREDIT CARD SPEND TO GROW AT ~20% CAGR (FY19-FY24E: CRISIL)



Source: CRISIL

FIG 18 – LOAN AGAINST SHARES (LAS) TO REMAIN STATIC OVER FY19-FY24E (CRISIL)



Source: CRISIL

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	69,716	97,252	135,172	171,485	213,464
NII growth (%)	42.2	39.5	39.0	26.9	24.5
Non-interest income	11,713	21,530	35,358	45,955	59,728
Total income	81,429	118,782	170,530	217,440	273,192
Operating expenses	32,690	41,977	58,391	73,136	91,612
Operating profit	48,739	76,805	112,139	144,303	181,580
Operating profit growth (%)	34.1	57.6	46.0	28.7	25.8
Provisions	10,305	15,014	27,075	34,367	44,639
PBT	38,434	61,792	85,064	109,936	136,941
Tax	13,471	21,842	23,336	27,704	34,509
Reported net profit	24,964	39,950	61,728	82,232	102,432
Adjustments	0	0	0	0	0
Adjusted net profit	24,964	39,950	61,728	82,232	102,432

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	1,150	1,154	1,203	1,203	1,203
Reserves & surplus	157,328	195,817	335,094	407,458	497,598
Net worth	158,478	196,970	336,297	408,662	498,801
Deposits	0	0	0	0	0
Borrowings	665,573	1,015,879	1,340,966	1,657,374	2,048,175
Other liabilities & provisions	23,932	29,476	33,897	38,981	44,829
Total liabilities and equities	847,983	1,242,325	1,711,160	2,105,017	2,591,805
Cash & bank balance	3,397	3,487	88,520	89,336	86,462
Investments	31,394	85,990	98,889	113,722	130,780
Advances	800,001	1,137,135	1,506,703	1,883,379	2,354,224
Fixed & Other assets	4,703	6,948	6,968	6,988	7,008
Total assets	847,983	1,242,325	1,711,160	2,105,017	2,591,805
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	41.8	42.1	32.5	25.0	25.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	43.4	69.3	102.6	136.7	170.2
Dividend per share	4.0	6.0	10.3	13.7	17.0
Book value per share	275.7	341.4	558.9	679.2	829.0

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	95.1	59.6	40.2	30.2	24.2
P/BV	15.0	12.1	7.4	6.1	5.0
Dividend yield (%)	0.1	0.1	0.2	0.3	0.4

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	9.5	9.3	9.2	9.0	9.1
Non-interest income	1.6	2.1	2.4	2.4	2.5
Operating expenses	4.5	4.0	4.0	3.8	3.9
Pre-provisioning profit	6.6	7.3	7.6	7.6	7.7
Provisions	1.4	1.4	1.8	1.8	1.9
PBT	5.2	5.9	5.8	5.8	5.8
Tax	1.8	2.1	1.6	1.5	1.5
ROA	3.4	3.8	4.2	4.3	4.4
Leverage (x)	5.9	5.9	5.5	5.1	5.2
ROE	20.1	22.5	23.2	22.1	22.6

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	42.2	39.5	39.0	26.9	24.5
Pre-provisioning profit	34.1	57.6	46.0	28.7	25.8
EPS	29.2	59.6	48.1	33.2	24.6
Profitability & Return ratios (%)					
Net interest margin	10.2	10.0	10.2	10.1	10.1
Fees / Avg. assets	1.1	1.6	1.8	1.8	1.9
Cost-Income	40.1	35.3	34.2	33.6	33.5
ROE	20.1	22.5	23.2	22.1	22.6
ROA	3.4	3.8	4.2	4.3	4.4
Asset quality (%)					
GNPA	1.4	1.5	1.6	1.8	2.1
NNPA	0.4	0.6	0.6	0.7	0.9
Provision coverage	69.6	59.8	60.0	60.0	60.0
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	24.0	20.7	18.7	18.9	19.1
Tier-1	18.4	16.3	15.7	16.6	17.3

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

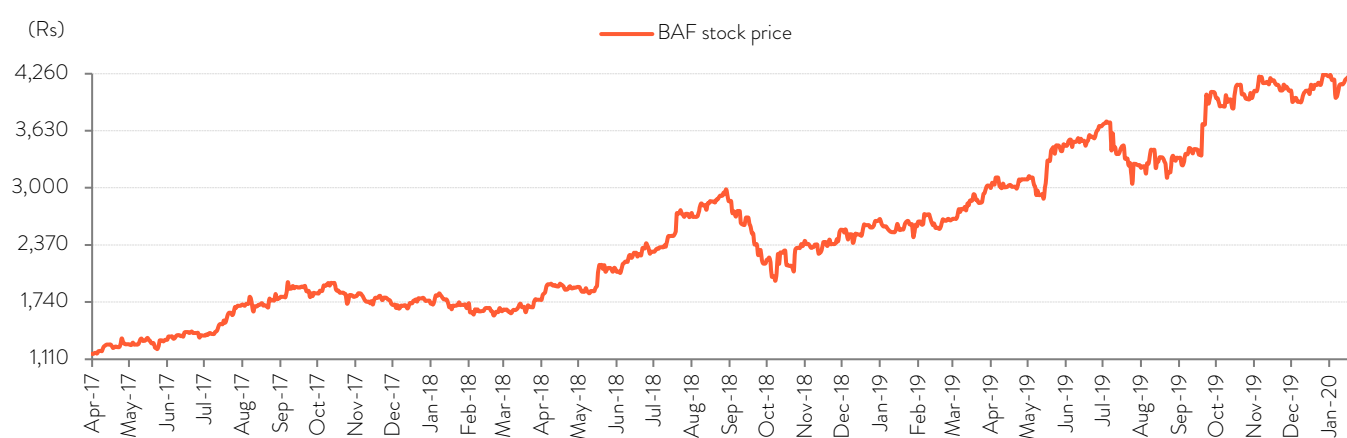
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: BAJAJ FINANCE (BAF IN)



B – Buy, A – Add, R – Reduce, S – Sell

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