

## Bajaj Finserv

### Life insurance surprise positively

**Bajaj Finserv remains our preferred mid-cap idea in the neglected general insurance sector given its best-quality general insurance franchise, strong lending business and decent life insurance franchise. Q3 results were in line with our expectations, underpinned by good underwriting margin, strong performance in financing and stability in Life Insurance. In our view, Bajaj Allianz General remains the best general insurance franchise in India and the best play on the improved fundamentals of the industry. Its Life Insurance arm is expected to deliver growth both in new business premiums and AUM from FY15. We re-iterate Buy on Bajaj Finserv, our Silver Bullet idea for the quarter.**

#### Q3 results in-line

Q3 results were in line with our expectations, with consolidated PAT growing 13% YoY to Rs2.8bn.

#### Bajaj Allianz General – the best general insurance franchise in India

In Q3FY14, its general insurance arm reported 13%YoY growth in gross premiums and 4%YoY growth in PAT (last year Q3 was exceptionally strong) as it returned to a more sustainable claims ratio (excluding Motor TP) of 67% in Q3 vs. 60% last year, in line with our expectation. The erratic bond yields also hurt investment income. However, with the improved fundamentals of the sector, discussed in our thematic ([LINK](#)), we remain upbeat on the prospects of general insurance entity. We expect the company to be a more than 20% RoE generating company with 15% premium growth in the next three years.

#### Life Insurance business stabilizing: growth imminent

Bajaj Life, the largest contributor to our valuation (44%) of Bajaj Finserv, has been experiencing a decline in both AUM and new business premiums since 2012 and 2009 respectively. New business premium has stabilized (1% YoY in Q3FY13) and we were positively surprised to see AUM growing by c.4% on a QoQ basis (albeit most of the growth could be due to +8% movement in NIFTY during Q3). We expect AUM to start growing from FY15 onwards on a sustainable basis given a) the decline in the proportion of ULIP policies (68% of AUM in H1FY14 vs. 89% in FY11), b) incremental money coming in via long-term traditional policies (85% of new business premium in H1FY14) and c) majority of ULIP surrenders should be done by FY14.

#### Bajaj Finance is going strong

Bajaj Finance continued its strong performance despite the slowdown in consumer discretionary spending. The company delivered 33% AUM growth, mainly driven by loan against property (LAP) and consumer financing where disbursements grew by 102%YoY and 30%YoY respectively. PAT growth of 21% lags balance sheet growth as the company continues to invest in increasing its reach (opex grew 35% YoY) and has accelerated provisioning (provisioning up 55%YoY) despite strong credit quality (GNPA of 1.15% vs. 1.14% last quarter).

#### Valuation

Our SOTP valuation for Bajaj Finserv is Rs868 per share and this assumes 49% FDI in the insurance sector. We have valued the Life Insurance, General Insurance and Financing business at Rs120bn, Rs65.9bn and Rs69.6bn respectively.

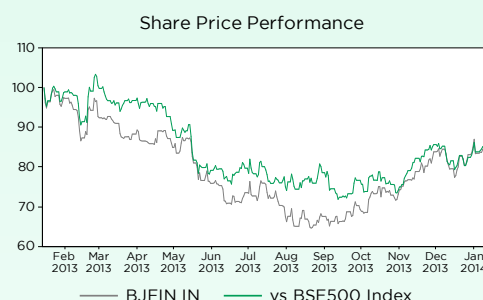
Accounting & corporate governance	GREEN
Franchise Strength	GREEN
Earnings Momentum	AMBER

**BUY** 20% upside  
Fair Value Rs868.00

Bloomberg ticker	BJFIN IN
Share Price	Rs721.55
Market Capitalisation	Rs114,814.77m
Free Float	41%

INR m Y/E 31-Mar	2012A	2013A	2014E	2015E
Total Income	39,048	50,749	61,965	73,245
Total expenses	16,786	23,668	30,547	37,112
Profit before tax	22,262	27,081	31,418	36,133
Profit for the year	13,378	15,736	16,814	19,077
EPS	92	99	106	120
Embedded Value	67,758	76,529	85,777	96,223

Y/E 31-Mar	2012A	2013A	2014E	2015E
RoEV (Life Insurance)	6%	12%	11%	11%
NBAP Margin (Life Insurance)	11%	9%	12%	12%
P/E	7.8	7.3	6.8	6.0
P/B	2.0	1.5	1.2	1.0
Debt/Equity	1.8	1.7	1.7	1.8
RoA	6%	4%	3%	3%
RoE	30%	24%	19%	18%



Source: Espirito Santo Investment Bank Research, Company Data, Bloomberg

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# Bajaj Finserv

Recommendation:

Fair Value:

BUY

INR 868

Share Price:

INR 722

Upside / Downside

20%

3 Month ADV (\$m)

2

Free Float

41%

52 Week High / Low

391-954

Bloomberg:

BJFIN IN

Model Published On:

16 January 2014

Shares In Issue (mm)

159

Market Cap (\$bn / Rs bn)

\$1.9bn/Rs. 116 bn

## Forthcoming Catalysts

Q4 results

Monthly premium numbers

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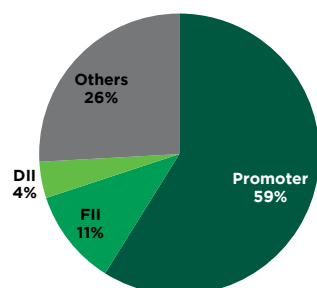
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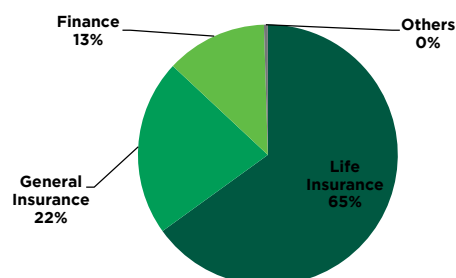
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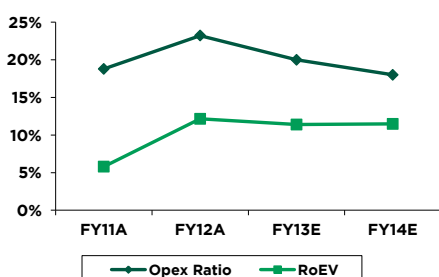
## Shareholding Pattern



## Revenue Breakdown - FY13



## Margin Trends



Valuation Metrics	2012	2013	2014E	2015E	2016E
Equity Value					
P/E	7.8	7.3	6.8	6.0	5.2
P/B	2.0	1.5	1.2	1.0	0.8
Leverage (x)					
Debt/Equity	1.8	1.7	1.7	1.8	1.8
RoA	6%	4%	3%	3%	3%
RoE	30%	24%	19%	18%	18%

Life Insurance	2012	2013	2014E	2015E	2016E
APE	19,382	20,736	22,861	26,290	28,919
NBAP	2,148	1,910	2,743	3,155	3,470
NBAP Margin	11%	9%	12%	12%	12%
Return on Net worth/Unwind	5,115	5,421	6,505	7,291	8,179
PAT	3,820	8,771	9,248	10,446	11,649
ROEV	6%	12%	11%	11%	11%
Embedded Value (Balance Sheet)	67,758	76,529	85,777	96,223	107,872
EV per Share	468	481	539	604	678

P&L Summary	2012	2013	2014E	2015E	2016E
Transfer from Policyholders' account	10,691	9,175	9,001	8,927	10,356
Operating profit from General Insurance	1,193	3,339	5,661	7,317	9,223
Interest income from financing	19,963	29,248	37,408	45,439	54,743
Wind Mill	844	734	785	840	899
Investment & other	6,357	8,254	9,109	10,722	11,509
<b>Total Income</b>	<b>39,048</b>	<b>50,749</b>	<b>61,965</b>	<b>73,245</b>	<b>86,731</b>
Contribution to shareholders' account	28	24	-	-	-
Employee expenses	2,647	3,343	4,136	4,903	5,789
Loan loss provisions	1,544	1,818	2,580	3,115	3,814
Financing cost	7,441	12,036	15,628	19,124	22,729
Depreciation	141	173	173	173	173
Other expenses	4,984	6,276	8,030	9,796	11,839
Total expenses	16,786	23,668	30,547	37,112	44,344
Profit before tax before exceptionals	22,262	27,081	31,418	36,133	42,387
Exceptionals	-	-	-	-	-
Profit before tax	22,262	27,081	31,418	36,133	42,387
Taxes	3,365	4,939	7,760	9,179	10,803
<b>Profit after tax</b>	<b>18,897</b>	<b>22,142</b>	<b>23,658</b>	<b>26,954</b>	<b>31,584</b>
Minority Interest and profit from associates	5,520	6,405	6,844	7,878	9,315
Profit for the year	13,378	15,736	16,814	19,077	22,269
EPS	92	99	106	120	140

Growth YoY	2012	2013	2014E	2015E	2016E
Revenues		30%	22%	18%	18%
PBT		22%	16%	15%	17%
EPS		7%	7%	13%	17%

Life Insurance (Growth YoY)	2012	2013	2014E	2015E	2016E
New premium	-22%	10%	12%	15%	10%
Renewal Premiums	-22%	-18%	0%	5%	18%
Total Premiums	-22%	-8%	5%	10%	14%
Commissions	-37%	-26%	39%	14%	11%
Operating Expenses	-12%	14%	-10%	-1%	14%
Commissions as % of Premium	8%	7%	7%	7%	7%
Opex as % of Total Premium	19%	23%	20%	18%	18%

Balance Sheet Summary	2012	2013	2014E	2015E	2016E
Shareholders' fund	50,990	78,015	94,829	113,905	136,174
Minority Interest	19,828	28,989	35,833	43,711	53,026
Funds for future appropriation	2,291	1,741	1,741	1,741	1,741
Borrowings	91,774	129,907	163,540	204,238	250,340
Deferred Tax Liabilities	80	88	88	88	88
Other Liabilities	74,436	333,490	340,050	359,754	385,167
<b>Total Liabilities</b>	<b>239,398</b>	<b>572,230</b>	<b>636,080</b>	<b>723,437</b>	<b>826,536</b>
Fixed assets	6,407	7,806	7,459	7,756	7,844
Goodwill on consolidation	1,951	4,290	4,290	4,290	4,290
Investments	435,056	432,479	460,670	505,200	559,199
Deferred tax assets	1,068	1,312	1,312	1,312	1,312
Loan book (financing)	122,831	167,436	206,643	254,668	309,693
Net current assets	-333,512	-51,958	-55,158	-60,654	-66,667
Other assets	5,598	10,864	10,864	10,864	10,864
<b>Total assets</b>	<b>239,398</b>	<b>572,230</b>	<b>636,080</b>	<b>723,437</b>	<b>826,536</b>

Source: Espirito Santo Investment Bank Research, Bloomberg, Company Data; Shareholding pattern as of Sep 2013



**Figure 1 Q3FY14 snapshot**

Bajaj Allianz Life	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	YoY	QoQ
Gross written premium	15,920	15,080	25,810	8,840	14,340	13,850	-8%	-3%
New business premium	6,510	6,690	11,840	4,380	6,590	6,780	1%	3%
Renewal premium	9,410	8,390	13,970	4,460	7,750	7,070	-16%	-9%
Policyholders' Surplus	2,200	2,310	1,980	1,810	1,450	1,830	-21%	26%
Shareholders' Profit	880	1,000	9,180	1,150	1,070	1,150	15%	7%
Total Profit (Shareholders + Policyholders')	3,080	3,310	11,160	2,960	2,520	2,980	-10%	18%

Bajaj Allianz General	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	YoY	QoQ
Gross Written Premium	9,760	9,500	11,970	10,980	11,430	10,730	13%	-6%
Net Earned Premium	6,390	6,940	7,750	8,160	8,810	8,990	30%	2%
Underwriting Profit (excluding MP)	490	620	80	360	560	300	-52%	-46%
Provision for Motor Pool losses	(540)	(530)	(590)	(340)	(340)	(420)	-21%	24%
Investment Income	1,170	1,220	1,380	1,390	1,440	1,490	22%	3%
Profit before tax	1,120	1,310	870	1,410	1,660	1,370	5%	-17%
Profit after tax	780	910	620	1,000	1,130	950	4%	-16%
Claims Ratio	59.2%	60.5%	69.7%	66.8%	66.7%	67.4%	11%	1%
Combined ratio (excluding MP)	92.3%	91.1%	98.9%	95.5%	92.2%	96.4%	6%	5%
Combined Ratio (including MP)	100.8%	98.7%	105.2%	99.8%	95.8%	100.9%	2%	5%

Bajaj Finance	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	YoY	QoQ
Total Income	7,370	8,280	8,430	9,320	9,640	10,820	31%	12%
Interest expense	2,950	3,210	3,260	3,310	3,820	4,100	28%	7%
NII	4,420	5,070	5,170	6,010	5,820	6,720	33%	15%
Opex	1,990	2,190	2,340	2,700	2,770	2,980	36%	8%
Provisions	530	510	450	640	520	790	55%	52%
PBT	1,900	2,370	2,380	2,670	2,530	2,950	24%	17%
PAT	1,290	1,600	1,640	1,760	1,670	1,940	21%	16%
AUM	153,700	168,440	175,170	192,290	198,290	224,610	33%	13%
Consumer	59,700	68,950	70,700	80,020	81,080	89,250	29%	10%
SME	69,770	77,380	84,670	93,710	99,240	116,500	51%	17%
Commercial	24,230	22,110	19,800	18,560	17,970	18,860	-15%	5%
Deployments	43,340	52,000	51,060	62,500	51,990	75,320	45%	45%
Net NPA	0.2%	0.2%	0.2%	0.3%	0.3%	0.2%	15%	-12%
CAR	17.7%	17.5%	22.0%	21.5%	20.9%	19.5%	12%	-7%

Consolidated	Q2FY13	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	YoY	QoQ
PAT	2,168	2,487	9,129	2,788	2,765	2,810	13%	2%

Source: Espirito Santo Investment Bank Research, Company Data

**Table 1 SOTP for Bajaj Finserv**

Valuation @ 51%	Valuation	Stake	Value of stake	Per Share Value
Life Insurance	120,480	51%	61,445	386
General Insurance	65,882	51%	33,600	211
Bajaj Finance	69,580	62%	43,139	271
				868

Source: Espirito Santo Investment Bank Research, Company Data

## Valuation Methodology

We have valued Bajaj Finserv on a SOTP basis. The life insurance business is valued using the appraisal value method. The appraisal value is calculated as the sum of one-year forward embedded value and a multiple times two year forward new business profit (FY14E EV + 9x FY15E NBAP). For Bajaj Allianz Life Insurance we have taken a multiple of 9x, which is lower than its peers due to embedded value calculation based on a market consistent basis and we expect its embedded value growth to be lower than its peers.

We have valued the general insurance business on discounted cash flow methodology on a single stage ten year horizon, a cost of equity of 14% and a terminal growth rate of 5%. Bajaj Finance is valued using excess return model with a two stage twenty year time horizon (ten years each) and cost of equity of 15%.

**Figure 2 Bajaj Allianz General DCF disclosures**

Bajaj Allianz General DCF Valuation											
Cost of Equity	14%										
Terminal growth rate	5%										
	Rs. Mn										
Valuation	65,882										
Rs. Mn	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	
FCFE	2,411	3,545	3,993	4,377	5,197	6,346	7,462	8,760	10,258	11,986	
Discount Factor	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3	
Present Value	2,115	2,728	2,695	2,592	2,699	2,891	2,982	3,071	3,154	3,233	
Terminal Value											37,721

Source: Espirito Santo Investment Bank Research, Company Data

**Figure 3 Bajaj Finance valuation methodology disclosures**

Bajaj Finance Limited																				
Cost of Equity	15%																			
Shares in Issue	50																			
	Rs. Mn										Rs./share									
Free cash flow to equity NPV	69,580										1,400									
Rs. Mn	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	Mar-28	Mar-29	Mar-30	Mar-31	Mar-32	Mar-33
Beginning book Value	33,670	39,807	47,135	56,057	66,756	79,434	94,435	112,074	132,468	156,319	188,721	221,464	####	301,143	348,935	402,592	462,515	529,077	602,609	683,389
Net Profit	7,131	8,516	10,368	12,432	14,732	17,433	20,497	23,699	27,717	32,402	38,037	43,368	49,196	55,521	62,334	69,613	77,325	85,423	93,843	102,508
Cost of Equity	5,051	5,971	7,070	8,409	10,013	11,915	14,165	16,811	19,870	23,448	28,308	33,220	38,819	45,171	52,340	60,389	69,377	79,362	90,391	102,508
ROAE	21%	21%	22%	22%	22%	22%	22%	21%	21%	21%	20%	20%	19%	18%	18%	17%	17%	16%	16%	15%
Excess Return	2,080	2,545	3,298	4,024	4,719	5,518	6,332	6,888	7,847	8,954	9,729	10,148	10,377	10,350	9,994	9,224	7,948	6,061	3,452	-
Discount Factor	0.9	0.7	0.6	0.6	0.5	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	1.0
Present Value	1,978	2,105	2,372	2,516	2,566	2,609	2,603	2,463	2,440	2,421	2,287	2,075	1,845	1,600	1,343	1,078	808	536	265	-

Source: Espirito Santo Investment Bank Research, Company Data

## Risks to Fair Value

We have assumed a 51% economic interest in Life Insurance and General Insurance which is contingent on an increase in FDI limit to 49% in insurance by 2016. Allianz has a call option, which expires in 2016, to increase its stake to 74% in both Life insurance and General insurance. If the FDI limits were not to increase to 49%, then the stock would appreciate further from here; however this is too long a period to take risk on. Also, if the insurance industry improves significantly in the current year then we can see the stock continuing to outperform.





Report date	Recommendation	Fair value	Share price
2013	November 22	Buy	Rs868.00
	July 2	Buy	Rs859.00
2012	September 24	Sell	Rs768.94
	August 22	Sell	Rs767.56
2011	June 1	Buy	Rs614.00

Source: Bloomberg, Espirito Santo Investment Bank Research

Please visit our website at [www.EspiritoSantoIB.co.uk](http://www.EspiritoSantoIB.co.uk) for up to date recommendation charts.



## IMPORTANT DISCLOSURES

150114

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<b>BUY</b>	Analyst expects at least 10% upside potential to fair value, which should be realized in the next 12 months
<b>NEUTRAL</b>	Analyst expects upside/downside potential of between +10% and -10% to fair value, which should be realized in the next 12 months
<b>SELL</b>	Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months
TRADING RATING	DEFINITION
<b>TRADING BUY</b>	Analyst expects a positive short-term movement in the share price (max duration 2 months from the time Trading Buy is announced) and may move out of line with the fair value estimate during that period
<b>TRADING SELL</b>	Analyst expects a negative short-term movement in the share price (max duration 2 months from time Trading Sell is announced) and may move out of line with the fair value estimate during that period

#### Ratings Distribution

As at end December 2013	Total ESIB Research		Total Investment Banking Clients (IBC)		
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12 Month Rating:					
<b>Buy</b>	204	47.9%	26	72.2%	6.1%
<b>Neutral</b>	127	29.8%	7	19.4%	1.6%
<b>Sell</b>	92	21.6%	1	2.8%	0.2%
<b>Restricted</b>	2	0.5%	2	5.6%	0.5%
<b>Under Review</b>	1	0.2%	0	0.0%	0.0%
Trading Rating:					
<b>Trading Buy</b>	0	0.0%	0	0.0%	0.0%
<b>Trading Sell</b>	0	0.0%	0	0.0%	0.0%
<b>Total recommendations</b>	426	100%	36	100%	8.5%

For further information on Rating System please see "Definitions and distribution of ratings" on: <http://www.espiritosantoib-research.com>.

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