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PRIME STOCKS

Stock recommendations
for quality, long-term pay-offs



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Prime Stocks is a research-backed list of fundamentally sound, quality stocks that you can invest in as part of your long-term stock portfolio.

To us, quality, growth and right price for the business are all important. We apply a quantitative stock-selection model on the Nifty 500 index. This comprehensive model uses over 20 different metrics to measure quality and growth of a company. A different set of metrics helps understand stock risks, volatility, and valuations.

To the companies shortlisted through our model, we layer on qualitative analysis to dig deeper into the company, sector, growth and profit drivers, valuations, and more. Our quantitative and qualitative analysis ensures that we have no market-cap or sector bias.

Our analysis is distilled into a 'Buy' stock list, which are quality stocks that you can add to your portfolio. Each recommendation comes with an investment thesis, risk level involved, and suitability for you to understand each stock. If valuations of these stocks or their growth prospects no longer align, we'll issue 'Hold' or 'Sell' alerts. We regularly run our models to add good opportunities to the Buy list.

This research report contains recommendation and analysis of Bajaj Holdings & Investment, a stock in our Buy list in Prime Stocks.



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STOCK RECOMMENDATION

BAJAJ

BAJAJ HOLDINGS & INVESTMENT LTD

5th SEPTEMBER 2021

CMP: ₹ 4,315.20

N V Chandrachoodamani



Own many great businesses through this one stock

In bull markets, expensive valuations often make it necessary for investors to look for offbeat opportunities to acquire wealth generating companies. The investment arms of leading promoter groups in India offer such opportunities to buy sound companies, at a discount to prevailing valuations.

SWOT ANALYSIS



S

- It is the company through which the Bajaj group holds majority stakes in their flagship Bajaj Auto and Bajaj FinServ
- Underlying companies are well established in their respective business and are part of Nifty 50 Index
- Bajaj Auto is a mature high cash flow business paying high dividends
- High growth scope in financial services comprising consumer lending (Bajaj Finance) and insurance (Bajaj Allianz)

W

- Being a holding company, it tends to trade at lower valuations.
- Discount will continue to exist because large institutions generally prefer to buy operating companies
- Stock can spend a long time with sedate returns until market picks up on discounted valuations.

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- Attractive entry opportunity to buy two sound companies at a discount
- Lower-risk route to play the high-volatile financial services opportunity

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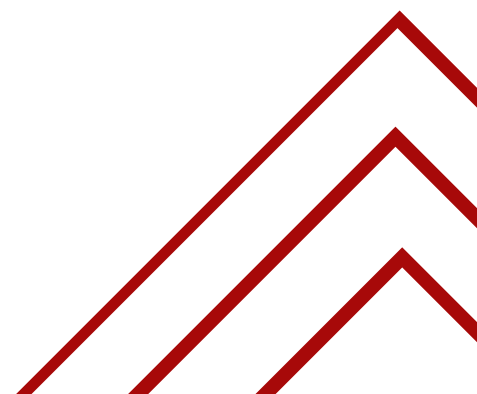
- Wealth creation influenced by capital allocation and dividend policies of the company as well as underlying companies

One such holding company that's available at a steep discount in valuations is Bajaj Holdings & Investment. This company is the main route through which the Bajaj Group holds stake in its two flagship companies – Bajaj Auto and Bajaj FinServ.

Valuations for Bajaj Holdings look attractive at this time. The two underlying businesses complement each other with one being a mature, dividend-paying business while the other offers opportunities in the high-growing financial services space.

Why Buy

- Bajaj Auto and Bajaj FinServ are two flagship companies of Bajaj Group with significant size and scale in their businesses. While the auto business is a mature high cash flow business, the financial services business comprising consumer lending and insurance is a play on the low penetration and high growth potential in the retail financial services space.
- Bajaj Auto is an established 2 and 3-wheeler manufacturer with leadership in premium bikes, significant export business, robust earnings profile and financial strength
- Bajaj FinServ holds stakes in Bajaj Finance, Bajaj Allianz General Insurance and Bajaj Allianz Life Insurance which have each built a significant retail franchise in consumer lending, general and life insurance, respectively. The company also has plans for a significant scale up in the fintech space through the significant use of technology
- In terms of valuation and stock price volatility, these two companies are very different—



Key Metrics

| Company | 5Yr PAT CAGR | PE ratio | Dividend Yield | Price to Book | Beta |
|---------------|--------------|----------|----------------|---------------|------|
| Bajaj Auto | 6.5% | 23 | 3.65% | 4.4 | 0.77 |
| Bajaj FinServ | 19.0% | 38 | 0.03% | 4.6 | 1.48 |

Table: PrimeInvestor.in • Source: Capitaline Database • Created with [Datawrapper](#)

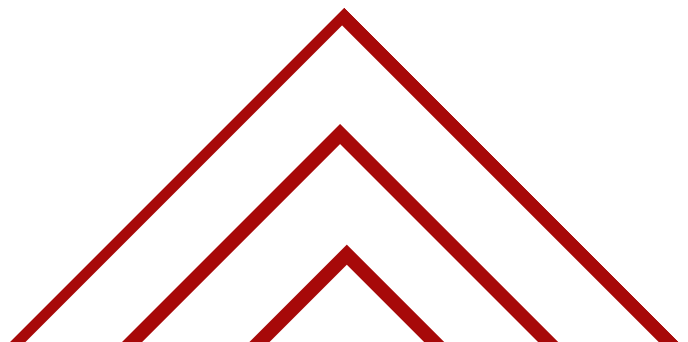
- The Bajaj Group owns the majority of its stake in these companies only through Bajaj Holdings and Investments. The significant discount at which the stock trades even after applying a holding company discount, provides an attractive opportunity to buy two sound companies at a discount to market valuations and play the financial services opportunity with less risk and volatility

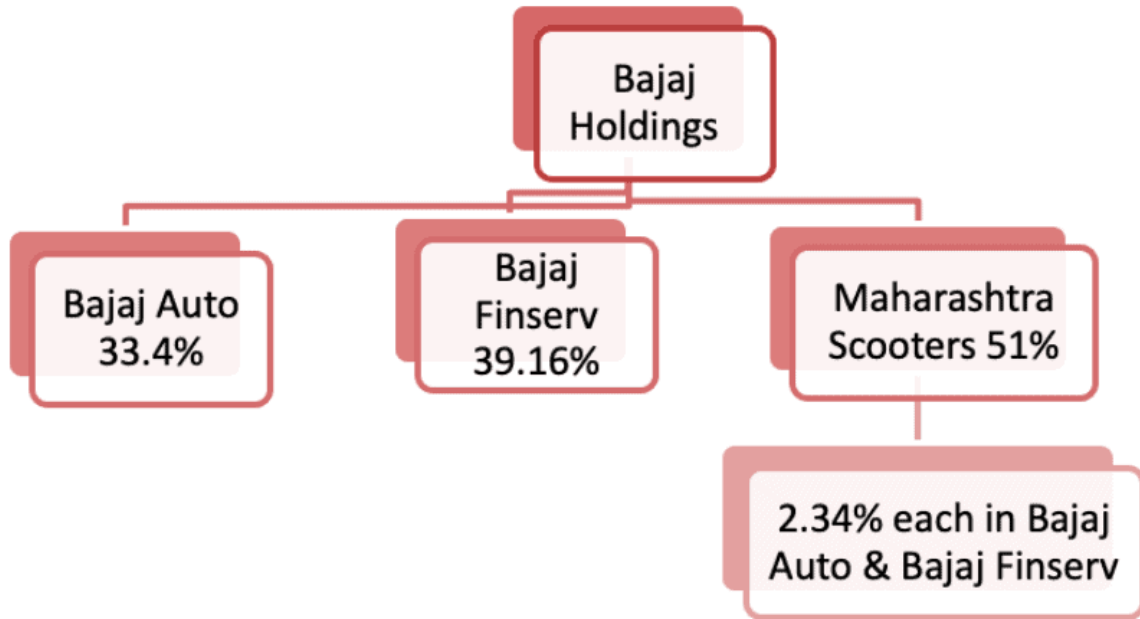
Business

Bajaj Auto had initiated business diversifications into automotive finance and insurance in the early 2000. Later in FY08, Bajaj Auto separated its manufacturing and financial services businesses into two separate entities through a scheme of demerger. Following it, the two companies got listed with a clear focus on each line of business. Each of these businesses has grown strongly over last decade to achieve market value in excess of Rs. 1 trillion.

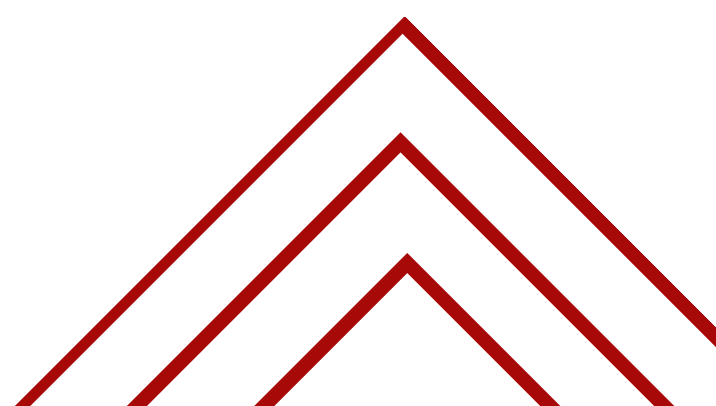
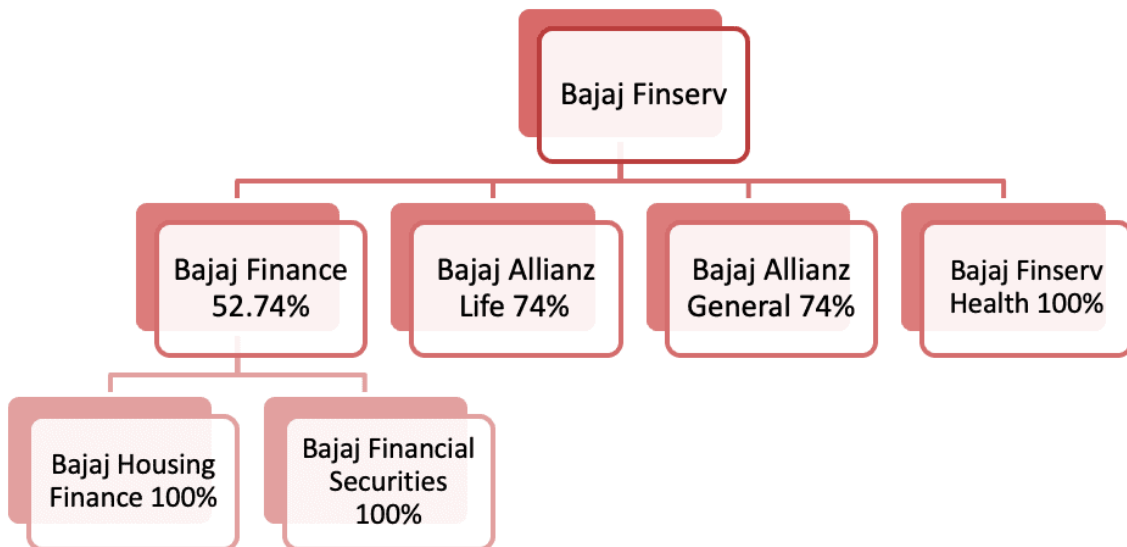
The Bajaj Group owns the bulk of its equity stake in these companies through Bajaj Holdings. The other major entity housing its equity stakes – Jamnalal Sons Pvt Ltd – owns just a 10% stake.

Consequently, Bajaj Holdings captures the lion's share of market capitalization of the Bajaj group.





Bajaj FinServ, the holding company for the Bajaj group's financial services houses stakes in its consumer lending business, general insurance business and life insurance business. It has also applied for a mutual fund AMC license in H2 FY2021.



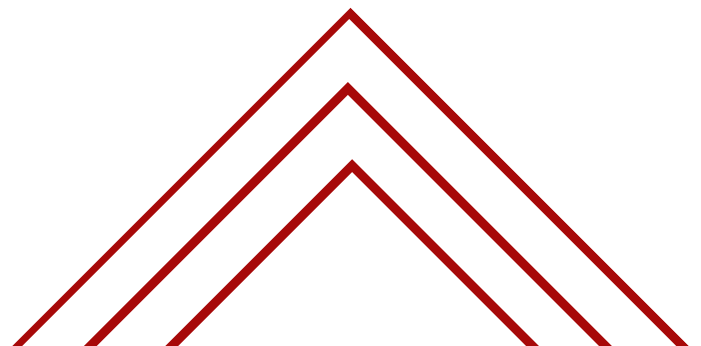
• Consumer Lending - Bajaj Finance

Retail finance penetration in India is at the nascent stages still. Bajaj Finance, as a leader in consumer electronics lending in India with tie-ups with all leading OEMs in the consumer appliances and electronics space, represents a direct proxy for discretionary consumption spending. This has helped it grow its assets at a 28% CAGR between FY15 and FY21. The company has a significant book in MSME lending and housing loans too.

However, the onset of Covid last year represented a speedbump to growth, with apprehensions of a spike in defaults and delayed repayments due to a spike in job losses and income hits for salary earners as well as the self-employed. The grant of loan moratoriums fanned fears of an impaired credit culture, while risk aversion led to a spike in funding costs for NBFCs.

Bajaj Finance responded to these challenges by slowing down loan growth, proactive provisioning to deal with likely defaults/delays and shoring up its capital base. For FY21 the company reported an AUM growth of 4%, with new loan origination back to pre-covid levels by the Q4 of FY21. Strong deposit growth of 20%, a liquidity buffer equal to 12.5% of total borrowings as of March 2021 provide adequate liquidity buffers.

While net NPAs saw a mild increase from 0.65% in Q4 FY20 to 0.75% in Q4 FY21, secured loans against mortgages and autos accounted for the bulk of these. Against restructured loans of Rs 1739 crore as of March 2021 the company held expected credit loss provisions of 19%.



While the company is well capitalized with total CAR at 28% and has a diversified funding mix spread across wholesale, banks, and retail deposits, a second speedbump in the form of the Covid second wave may present a challenge to a quick rebound from this crisis.

Loan offtake in the year ahead may continue to be sluggish on the back of consumer and lender risk aversion, with a spike in defaults and delays quite likely. The stock's high valuation at 8.75 times on a price to book basis offers limited margin of safety against these risks, though the impact on the holding company may be cushioned by the significant discount to underlying market prices.

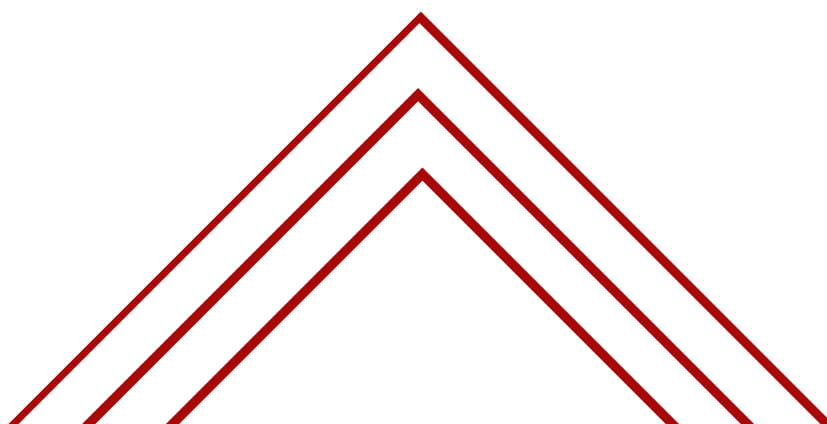
Bajaj Finance Financial Performance (Consolidated)

All figures in Rs crore except where specified

| | FY2021 | FY2020 | FY2019 | FY2018 | FY2017 |
|---------------------------|-----------|-----------|-----------|----------|----------|
| AUM* | 152,947.0 | 147,153.0 | 115,888.0 | 82,422.0 | 60,196.0 |
| Net Interest Income | 17,269.0 | 16,913.0 | 11,877.0 | 8,143.0 | 6,186.0 |
| PBT | 5,992.0 | 7,322.0 | 6,179.0 | 3,843.0 | 2,818.0 |
| PAT | 4,420.0 | 5,264.0 | 3,995.0 | 2,496.0 | 1,837.0 |
| RoA (%) | 3.1 | 4.1 | 4.2 | 3.7 | 3.7 |
| RoE (%) | 12.8 | 20.2 | 22.5 | 20.1 | 21.6 |
| Book Value Rs. per share) | 597.0 | 530.0 | 337.0 | 274.0 | 176.0 |
| GNPA (%) \$ | 1.8 | 1.6 | | | |
| NNPA (%) \$ | 0.8 | 0.7 | | | |

*AUM of Bajaj Housing Finance, a 100% subsidiary, is Rs 38,871 crore as of March 31, 2021. \$ Standalone GNPA and NNPA are at 2.21% and 0.91% respectively.

Table: PrimeInvestor.in • Source: Company presentations, Capitaline Database • Created with [Datawrapper](#)



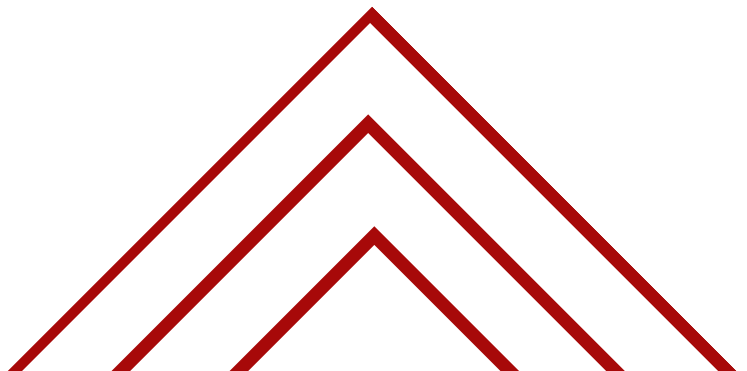
- **Insurance - Bajaj Allianz**

If the consumer lending business is pro-cyclical and piggybacks on robust consumer sentiment, Bajaj's insurance business offers complementary strengths by playing on risk aversion and providing protection to retail consumers against crises. Bajaj in tie-up with the German Allianz SE has made significant headway in insurance and is among the leading players in the private sector.

In India, insurance is a high growth opportunity in both life and general categories due to the low levels of penetration. Various reports point to penetration levels at <3% for life insurance and <1% for general insurance (as a % of GDP). The General Insurance (GI) Council is targeting a 2.5% non-life insurance penetration by 2030 (Asia is 1.85% and global level is 2.8%).

Bajaj Allianz General Insurance: It is among the top two private sector general insurance companies in India with a balanced product mix. General insurance is one space where private players have been able to dislodge entrenched PSUs in market share unlike in life insurance.

While health insurance in India is at the takeoff stage, motor insurance is seeing gradual de-tariffing and de-control. Recent consolidation of PSU banks may also work to the company's advantage in bancassurance channel. Bajaj Allianz has reported strong premium growth and has good combined ratios with high solvency creating headroom for expansion.





Bajaj Allianz General Insurance Financial Performance (Standalone)

Claims ratio: 68.5%, Solvency ratio: 345%, Combined ratio: 96.9%.

| | FY2021 | FY2020 | FY2019 | FY2018 | FY2017 |
|--------------------|--------|--------|--------|--------|--------|
| Net earned premium | 7,436 | 8,206 | 7,010 | 6,059 | 4,937 |
| PBT | 2,392 | 1,376 | 1,151 | 1,353 | 1,078 |
| PAT | 1,330 | 999 | 780 | 921 | 727 |
| EPS (Rs.) | 121 | 91 | 71 | 84 | 66 |
| RoE (%) | 20 | 18 | 16 | 23 | 23 |

All figures in Rs crore except where specified.

Table: PrimelInvestor.in • Source: Company presentations, Capitaline Database, PrimelInvestor research • Created with [Datawrapper](#)

Bajaj Allianz Life Insurance: Among the top five private life insurers Bajaj Allianz has carved out a strong market share by offering innovative products with competitive premiums. While the industry is still dominated by LIC with a 66% market share, private players are making inroads via pure term, guaranteed return and ULIP products.

Like others Bajaj Allianz Life is also shifting the mix towards non-par products, which offer better margins to the insurer. Its top-of-the-shelf solvency creates room for strong expansion. Higher FDI limits could lead to better value unlocking and price discovery in this industry in future.

Bajaj Allianz Life Insurance Financial Performance (Standalone)

Persistence Ratios: 13th Month – 80%, 37th month – 63%, 61st month – 42%.

Solvency Ratio: 666%

| Rs. Cr | FY2021 | FY2020 | FY2019 | FY2018 | FY2017 |
|-----------------------|--------|--------|--------|--------|--------|
| Gross written premium | 12,024 | 9,753 | 8,857 | 7,053 | 7,468 |
| PBT | 1,383 | 524 | 662 | 822 | 1,006 |
| PAT | 580 | 450 | 502 | 716 | 836 |
| EPS (Rs.) | 38 | 30 | 33 | 48 | 55 |
| RoE (%) | 6 | 5 | 5 | 8 | 10 |

Notes: The embedded value of Bajaj Life insurance was at Rs. 15,534 crore at the end of FY2021. Solvency ratio at 666%. Bajaj FinServ has a consolidated book value of Rs. 2,252 per share as at 31st March 2021 as per its Q4 FY2021 earnings presentation.

• Automobiles - Bajaj Auto

Bajaj Auto is a mature high cash flow business with high dividend pay-out. It is a market leader in premium bikes in domestic market and in 3 Wheelers. Two-wheeler companies are perceived to be less cyclical in the automotive space and Bajaj Auto's performance, market positioning, significant export business, and robust earnings profile ensure a less cyclical stream of dividend income.

Bajaj Auto also owns 48% in KTM AG, which it acquired at the time of global financial crisis. It has since then turned it profitable, earned dividends and made India the largest market for KTM apart from exporting KTM bikes to all major global markets. Now it has finalized plans to enter classic premium segment with Triumph with the first product roll out in FY2023. Its leadership in premium bikes (>150CC) will make it less vulnerable to EV disruption as well considering the target market for EVs.

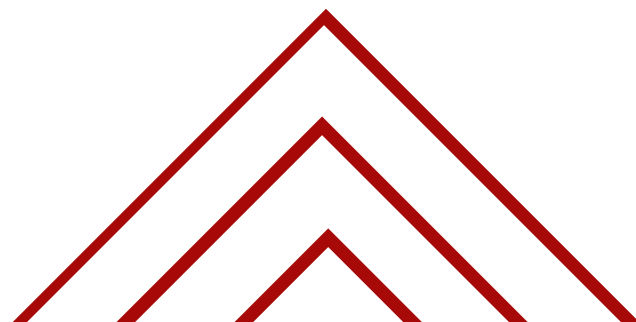
Bajaj Auto Financial Performance - Consolidated

Figures in Rs crore except where specified.

| | FY2021 | FY2020 | FY2019 | FY2018 | FY2017 |
|--------------------|--------|--------|--------|--------|--------|
| Net Sales | 27,741 | 29,918 | 30,358 | 25,219 | 21,767 |
| PBIDT | 6,507 | 6,942 | 7,225 | 6,249 | 5,896 |
| PAT | 4,857 | 5,212 | 4,928 | 4,219 | 4,079 |
| EPS (Rs per share) | 168 | 180 | 170 | 146 | 141 |
| RoE (%) | 20 | 23 | 23 | 22 | 26 |
| Dividend per share | 140 | 120 | 60 | 60 | 55 |

Table: PrimeInvestor.in • Source: Capitaline database, PrimeInvestor research • Created with [Datawrapper](#)

Note: Impact of Bajaj Auto's dividend policy amendment:



The steady cash flows at Bajaj Auto translate into regular dividend incomes for Bajaj Holdings. The dividends from Bajaj Auto in FY2021 translate to a yield of 3.6% to Bajaj Holdings on its investments.

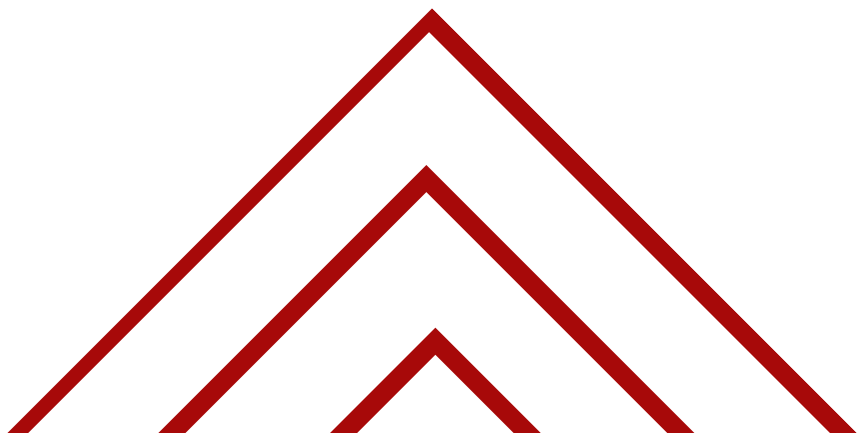
Bajaj Auto has recently revised its dividend policy so that dividend distribution would be raised to 90% when the surplus cash is over Rs 15,000 crore. If the surplus is between Rs 7,500 crore and Rs 15,000 crore, it would be up to 70% and if surplus is below Rs 7,500 crore, it would be up to 50%.

Margin of Safety

Having established that its subsidiaries are attractive to own, it is good to assess the extent to which their valuations are captured in the Bajaj Holdings stock. Investment companies are prone to trading at a discount to their underlying. We therefore apply a conservative holding company discount of 50% to value Bajaj Holdings' stakes in Bajaj Auto and Bajaj FinServ to arrive at a fair value for the stock.

In addition, given the immediate risks to Bajaj FinServ's business, a further margin of safety of 10% to market price is taken into account for Bajaj FinServ considering the volatile nature of financial stocks.

Based on the current market cap, we find the Bajaj Holdings stock is trading at a ~44% discount to its underlying even after applying these margins of safety. This discount appears high considering the high dividend pay-outs from Bajaj Auto and high growth potential of Bajaj FinServ.





Valuation

| Company | % Stake | Market Cap Rs.Crores | Margin of Safety | Holding Value Rs. Crores |
|-----------------------------------|---------|----------------------|------------------|--------------------------|
| Bajaj Auto | 33.40 | 110,869 | - | 37,030 |
| Bajaj Finserv | 39.16 | 175,630 | 10% | 61,899 |
| Maharashtra Scooters | 51.00 | 3,606 | - | 1,839 |
| Total | | | | 100,769 |
| Other Investments in shares & MF | | | | 9,129 |
| Total Market Value of Investments | | | | 109,898 |
| Market Value of Bajaj Holdings | | | | 38,076 |
| Discount to total value (%) | | | | 65 |

| Valuation at appropriate discount | Discount % | |
|--|------------|--------|
| Value of holdings in Bajaj Auto | 50 | 18,515 |
| Value of holdings in Bajaj FinServ | 50 | 30,950 |
| Value of holding in Maharashtra Scooter | 50 | 920 |
| Value of other investments | 50 | 4,565 |
| Total value @50% discount for both | | 54,949 |
| Fair price for Bajaj Holdings (Rs.Per share) | | 4,937 |
| Upside on valuation gap (%) | | 44 |

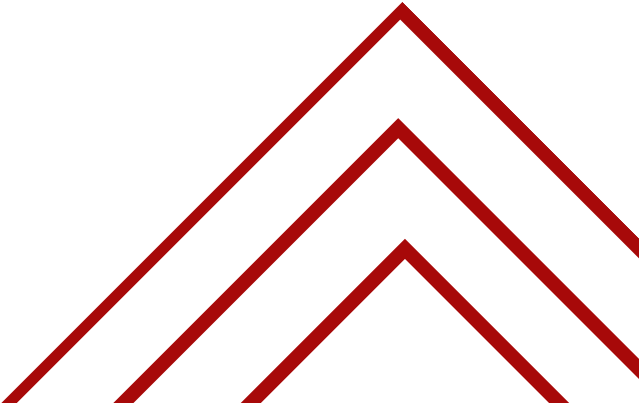
Fintech Opportunity

Beyond this upside on account of its deep holding company discount, Bajaj Holdings also offers a less risky way to play the fast growing financial services opportunity led by Bajaj FinServ's forays in savings, insurance and investments with the significant use of technology.

In its FY2021 earnings presentation, Bajaj Finance has also laid out plans for further business transformation leveraging on fintech solutions. It is in the process of launching "Bajaj Pay", an integrated payment solution comprising of UPI, PPI, EMI Card and Credit card to its customers and is also building "Bajaj Pay" merchant App. There will be 5 market places (Apps by Bajaj Fin & FinServ) for eStore, Insurance, Investment, Broking and Health as well and plans to roll out first phase by July 2021 and complete the entire roll out by September 2021

The first phase of eStore has already gone live in February 2021 with onboarding of 40000 customers. With its launch customers can now search, compare and select from +25K SKUs of consumer durables, order online and make a single-click checkout through Bajaj FinServ EMI card. Insurance and investments marketplace apps will go live between July and August 2021.

Investors who are interested in this space, but reluctant to buy Bajaj FinServ and Bajaj Finance at this valuation can look to play it through Bajaj Holdings with less risk and volatility. Other potential re-rating triggers include increase in dividend pay-out, IPOs of insurance subsidiaries and further consolidation in corporate structure.





Risks to the recommendation

Holding companies do not get much investor attention other than at the time of major corporate actions. Large institutions generally prefer to buy operating companies and so the discount will continue to exist.

Holding company discounts can widen during bearish phases leading to downside to investors, that is higher than in underlying stocks.

Suitability

This company is suitable for patient long term investors as holding companies are generally boring investments and perform with a lag.



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