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Cholamandalam Investment and Finance Company

Mixed quarter, strong fundamentals

Banks & Finance	Sharekhan code: CHOLAFIN	Result Update

Stock Update

3R MATRIX

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 443**	
Price Target: **Rs. 520**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

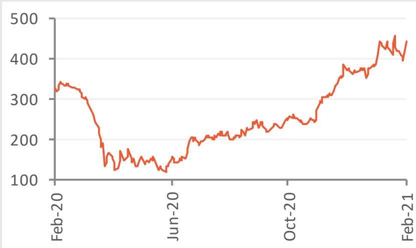
Company details

Market cap:	Rs. 36,352 cr
52-week high/low:	Rs. 464/117
NSE volume: (No of shares)	104.6 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.6 cr

Shareholding (%)

Promoters	51.6
FII	13.2
DII	23.9
Others	11.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.7	51.2	120.4	35.2
Relative to Sensex	6.2	28.9	88.8	17.2

Sharekhan Research, Bloomberg

Summary

- CIFC posted mixed results with a rise in proforma GNPA against reported GNPA levels, but improvement in margins was the bright spot.
- Healthy business traction seen with total AUM rising 15% y-o-y to Rs 75,813 crore; reported asset quality improved with Stage 3 assets at 2.57% (improved from 2.75% in Q2 FY2021).
- Buoyancy in rural markets augurs well, a well-capitalised balance sheet, and rigorous risk management practices provides long-term visibility; the stock is available at 4.1x/3.4x its FY2022E/FY2023E ABVPS
- Healthy traction in automobile demand, resilient rural economy brighten growth outlook; we maintain Buy rating with an unchanged price target (PT) of Rs. 520.

Cholamandalam Investment Finance Corporation (CIFC) posted mixed results with a rise in proforma GNPAs against reported GNPAs, but improvement in margins seen, which was a bright spot. Net interest income (NII) came in at Rs. 1,082 crore, up 26% y-o-y but down 7% q-o-q; and was below expectations. PAT came at Rs. 409 crore, up 5% y-o-y but down 5% q-o-q basis and was a tad below expectations. Reported asset quality improved (no new NPA recognised due to court directive) and hence Stage 3 assets at 2.57% improved from 2.75% in Q2 FY2021. However, on proforma basis, the Gross Stage 3 and Net Stage 3 would have been 3.75% and 2.12%, respectively, much higher than the reported GS3. Even on an absolute basis, GS3 and NS3 are higher by 46% and 49% as compared to the reported figures. Healthy business traction seen with total AUMs up at Rs 75,813 crore (Up by 15% y-o-y). PBT-ROA for Q3 FY21 was at 3.1% down from 3.4% in Q3 FY2020, but for YTD December 2020 it was at 3.4%, which is at the same level of 3.4% for the nine months ended December 2019. However, disbursements were muted with aggregate disbursements in Q3FY21 at Rs 7,926 crore (up by 6% y-o-y) while disbursements for 9MFY2021 were at Rs 17,972 crore registering a decline of 23% y-o-y. The vehicle finance (VF; 73% of total loans) business has clocked a volume of Rs 6,084 crore in Q3 FY21 has started registering growth of 2%, but Loan Against Property (LAP; 22% of total Loans) business disbursed Rs 1,265 crore in Q3 FY21, showing a good growth rate of 39% YoY. Home Loan (HL; 5% of total loans) business disbursed Rs 434 crore in Q3 FY21, registering a growth of 8% YoY. The impact of the lockdown and lifting of moratorium was witnessed in Q3. While we expect residual impact on Stage 3 in Q4 there are early indicators that suggest stabilization by Q1 FY22. Increased funding though NCDs and shifting benchmark to repo from MCLR have helped in reducing funding cost for CIFC as well. Hence, net interest margins improved to 7.8% for Q3 FY2021 (up from 7% in Q3 FY2020 and 7.3% in Q2 FY2021). CIFC has a well-diversified vehicle financing business (both in terms of geographical and product mix), which has consistently exhibited robust growth, while maintaining its asset quality range over cycles. Factors such as improving asset-quality outlook (improving collections efficiency and high provision cover) are encouraging; the management has also indicated that it expects less than 5% of portfolio likely to be restructured (consists mainly of borrowers such as bus operators etc which were impacted by COVID), which is a positive. A diversified product basket, parentage of the Murugappa group, strong historical underwriting and ample liquidity make CIFC among the best players in the vehicle financing space. We believe economic recovery and healthy traction seen in automobile demand along with resilient rural economy brighten the growth outlook. We maintain a Buy rating with an unchanged price target (PT) of Rs. 520.

Key positives

- Healthy business traction seen with total AUM up at Rs. 75,813 crore (Up by 15% YoY)
- Expense ratio remain unmoved at 2.1% q-o-q

Key negatives

- ROE fell to 17.6% a drop of 190 bps q-o-q

Our Call

Valuation: At CMP, the stock is available at 4.1x/3.4x its FY2022E/FY2023E ABVPS, which is reasonable, given improved growth and resumption of economic activity and support from a resilient rural segment. CIFC's valuations are supported by its superior performance throughout cycles, high medium-term RoEs and a strong management at the helm of the group, which add to investor comfort. We expect disbursements growth to normalize in FY2022 and expect AUM growth of ~25% for FY2022E and FY2023E. We expect operating expenses to AUM ratio to be at 2.1%-2.4% and ROE to improve to 19% and 20%, respectively, for FY2022E and FY2023E. We believe buoyancy in rural markets augur well for CV financiers this coupled with business benefits from a strong parentage, well-capitalised balance sheet, and rigorous risk management practices (provides long-term visibility) provides scope for improving operating leverage and return ratios, which offers additional comfort. We maintain our Buy rating with an unchanged PT of Rs. 520.

Key risk

Delayed recovery in economic activity will affect growth and profitability; further, it has exposure to the SME segment, which may be vulnerable if an economic recovery is delayed.

Valuation Rs cr

Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
NII	3,403	4,060	4,575	6,094	7,737
PPOP	2,526	3,067	3,490	4,830	6,269
PAT	1,186	1,052	1,432	2,184	2,873
EPS (Rs)	14.5	12.8	17.5	26.6	35.0
ABVPS (Rs)	67.4	84.6	91.1	108.4	132.5
P/E (x)	30.7	34.6	25.4	16.7	12.7
P/ABVPS (x)	6.6	5.2	4.9	4.1	3.4
ROE (%)	19.2	12.9	15.1	19.0	20.3
ROA (%)	2.1	1.7	1.8	2.2	2.3

Source: Company; Sharekhan estimates

Key Highlights

- Aggregate disbursements in Q3 were at Rs. 7,926 crore, as compared to Rs. 7,475 crore, rising 6%.
- The vehicle finance business clocked a volume of Rs 6,084 crore, against Rs 5,949 crore, up 2%. The loan against property business disbursed Rs 1,265 crore, against Rs 908 crore, with a growth rate of 39%.
- The home loan business grew at 8%, disbursing Rs 434 crore compared with Rs 400 crore.
- Assets under management at the end of December grew 15% to Rs. 75,813 crore, as compared to Rs. 65,992 crore a year ago.
- Cholamandalam in a statement said the company continues to hold strong liquidity position with Rs 6,228 crore as cash balance as of December 31, 2020, including Rs. 1,500 crore invested in G-Sec.
- The asset quality represented by Stage-3 assets stood at 2.57% with a provision coverage of 44.94%, as against 3.54% with a provision coverage of 32.95%. Chola continues to carry additional provision of Rs 751 crore for future contingencies.
- Chola intends to maintain a strong focus on financing of tractors given the positive industry trends. More than 80% of its branches are present in the rural areas, towns and semi-urban areas which gives it an advantage to capitalise on an uptick in rural demand.
- CIFC are one of the leading players in the rural segment. Any improvement in demand for Small commercial vehicles will help it augment greater market share due to its strong presence in rural and semi-urban markets. Its exposure in this segment is ~10% at a
- portfolio level. The company is closely monitoring this segment for further improvement in market conditions and fleet owner sentiments.
- The company intends to maintain a strong focus on two-wheeler funding, and are confident of increasing its market share in this segment considering its reach in rural and semi-urban areas.
- CIFC are one of the largest players in the used vehicle financing business with a disbursement mix of almost 30% in this space which will enable it to cater to this segment effectively and generate disbursement volumes.
- The company expects stronger demand from Consumption-driven sectors and E-commerce focused logistics companies will aid growth in the long term in the Auto Sector post the COVID-19 recovery. It expects demand for pick-ups will increase in long term due to higher flexibility in usage over sub-one tonne vehicles.
- With revival of MSME business activities pan-India, disbursements are expected to increase in Q4.
- Primary focus of CIFC will be on retail ticket size loans in tier 2/3/4 cities.
- Portfolio LTV at origination stands low at 52% which provides adequate security cover
- Collections remain a priority for the business with activities such as strengthening collections team, introduction of digital channels are in place. In addition, Chola has provided adequate provisions
- Chola does not have construction Finance exposure nor does it have material under construction exposure to developer supplied houses
- Chola's LTV at a portfolio level is ~60% at origination – indicates adequate security cover. Around ~87% of home loan assets are in tier 2,3,4 cities and suburbs of tier 1 cities.
- Average ticket size of ~15 lakh – predominantly in tier 2,3,4 cities indicate quality and marketability of portfolio assets.

Results

Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Interest earned	2427	2118	14.6	2358	2.9
Interest Expended	1140	1192	-4.4	1185.2	-3.8
Net interest income	**1286**	**925**	**39.0**	**1173**	**9.6**
Non-interest income	78.6	157.2	-50.0	81.8	-3.9
Net total income	1364.7	1082.5	26.1	1254.6	8.8
Operating expenses	**368.8**	**424.4**	**-13.1**	**355.1**	**3.9**
-Employee expenses	154.1	177.1	-13.0	170.1	-9.4
-Other operating expenses	214.7	247.3	-13.2	185	16.1
Pre-provisioning profit	**995.9**	**658.1**	**51.3**	**899.6**	**10.7**
Provisions	444.6	136	226.9	317.6	40.0
Profit before tax	**551.4**	**522.1**	**5.6**	**582**	**-5.3**
Tax	142.2	133.6	6.4	150.1	-5.3
Profit after tax	**409.2**	**388.5**	**5.3**	**431.9**	**-5.3**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Green shoots in the economy encouraging; Rural segment a bright spot

Post the unlocking of the economy, financial services companies are reporting an incremental pick-up in credit demand. Leading indicators specify recovery in economic activity, which will be a positive. Higher MSPs, increased Kharif sowing, good monsoons, and adequate water storage position are leading to increased tractor demand and overall resilience of the rural economy; therefore, the rural economy continues to be a bright spot at these times as well. Recovery in the vehicle finance (VF) sector over the past six months has been encouraging, with lower funding costs and improving traction (including sub-segments), among others. Asset-quality trends have also improved, driven by managements' assessment of low restructuring pipeline. While the sector is not completely out of the woods, we expect normalisation in H2CY2021. In this backdrop, aided by a strong parentage, highly rated and well-capitalised nimble NBFCs have ample growth opportunities as the market expands.

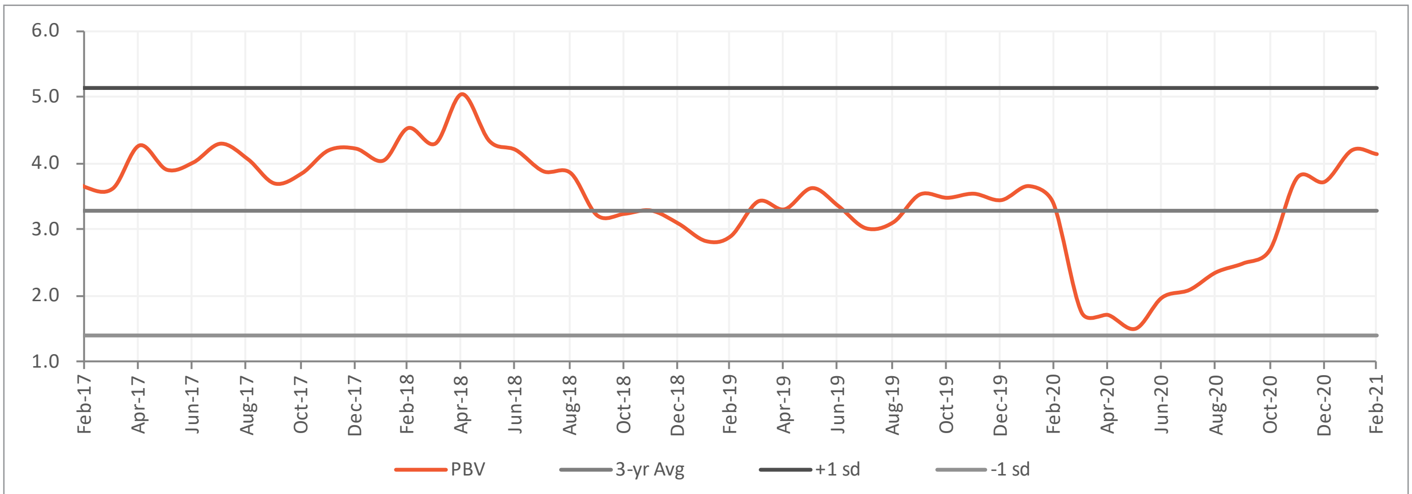
■ Company Outlook – Strong fundamentals make it attractive

CIFC has established itself as a strong and well-run vehicle financing (that forms 73% of AUM) NBFC with attractive return ratios, steady NIM, and strong operating metrics, which underline its high pedigree among peers. The company's other lending activities include home equity (LAP 22% of AUM) and home loans and MSME (5% of AUM). Business benefits from a strong parentage and rigorous risk management practices provide long-term visibility, while healthy capitalisation at 19.5% (Q2FY2021) and scope for improving operating leverage lends additional comfort. We believe while the vehicle financing business will continue to be the mainstay for the company, home equity (LAP) has also been a significant contributor to the company's growth and profitability. Home loan business is the rising star and has a great potential to be built into a solid portfolio, considering the expertise of the company in handling typical customer profiles. The company's robust collection mechanism aided by strong credit risk assessment framework will help it steer through the pandemic in FY2021. CIFC is an attractive pick due to its demonstrated superior performance on multiple business parameters.

■ Valuation – Maintain Buy rating with a unchanged PT of Rs. 520

At CMP, the stock is available at 4.1x/3.4x its FY2022E/FY2023E ABVPS, which is reasonable, given improved growth and resumption of economic activity and support from a resilient rural segment. CIFC's valuations are supported by its superior performance throughout cycles, high medium-term RoEs and a strong management at the helm of the group, which add to investor comfort. We expect disbursements growth to normalize in FY2022 and expect AUM growth of ~25% for FY2022E and FY2023E. We expect operating expenses to AUM ratio to be at 2.1%-2.4% and ROE to improve to 19% and 20%, respectively, for FY2022E and FY2023E. We believe buoyancy in rural markets augur well for CV financiers this coupled with business benefits from a strong parentage, well-capitalised balance sheet, and rigorous risk management practices (provides long-term visibility) provides scope for improving operating leverage and return ratios, which offers additional comfort. We maintain our Buy rating with an unchanged PT of Rs. 520.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

Particulars	CMP (Rs / Share)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Cholamandalam	444	4.9	4.1	25.4	16.7	1.8	2.2	15.1	19.0
Shriram Transport	1334	1.6	1.4	14.0	10.7	2.0	2.5	12.0	13.7

Source: Company, Sharekhan estimates

About company

CIFC was incorporated in 1978 as the financial services arm of the Murugappa Group. CIFC commenced business as an equipment financing company and today has emerged as a comprehensive financial services provider offering vehicle finance, home equity loans, home loans, SME loans, wealth management, stock broking, and a variety of other financial services to customers. CIFC operates from 1,091 branches across India with assets under management above Rs. 66,943 crore.

Investment theme

CIFC is a leading mid-cap vehicle financier expanding its presence into housing finance. The company has been gaining market share in the LCV/ SCV segment, while losing share in the HCV segment where it has consciously slowed down. Business benefits from a strong parentage and rigorous risk management practices provide long-term visibility, while healthy capitalisation at 19.5% (Q2FY2021) and scope for improving operating leverage lend additional comfort. We believe while the VF business will continue to be the mainstay for the company, home equity (LAP) has also been a significant contributor to the company's growth and profitability. Home loans are the rising star and have a great potential to be built into a solid portfolio considering the expertise of the company in handling typical customer profiles. The company's robust collection mechanism aided with a strong credit risk assessment framework will help it steer through the strong currents of the COVID-19 pandemic in FY2021. CIFC is an attractive pick due to its demonstrated superior performance on multiple business parameters.

Key Risks

Delayed recovery in economic activity will affect growth and profitability; further, it has exposure to the SME segment, which may be vulnerable if an economic recovery is delayed.

Additional Data

Key management personnel

Arun Alagappan	Managing Director
Arulselvan	Exec VP/CFO
Ravindra Kumar Kundu	Exec Dir/Pres
P Sujatha	Secreatary/Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Invesco Ltd	5.3
2	HDFC Asset Management Co Ltd	4.4
3	Ambadi Investments Ltd	4.1
4	Axis Asset Management CO Ltd	4.0
5	SBI Funds Management Pvt Ltd	3.4
6	Aditya Birla Sun Life Asset Manage	2.6
7	DSP Investment Managers Pvt Ltd	1.9
8	HDFC Life Insurance Co Ltd	1.8
9	Mirae Asset Global Investments Co	1.5
10	Vanguard Group Inc	1.3

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

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

Source: Sharekhan Research

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