Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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. 564**	
Price Target: **Rs. 630**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

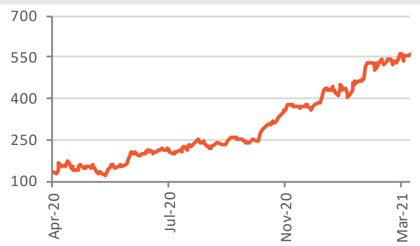
Company details

Market cap:	Rs. 46,208 cr
52-week high/low:	Rs. 580 / 117.4
NSE volume: (No of shares)	63.0 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.6 cr

Shareholding (%)

Promoters	51.6
FII	13.7
DII	28.1
Others	6.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.3	27.1	119.0	293.2
Relative to Sensex	6.9	23.3	89.7	216.2

Sharekhan Research, Bloomberg

Cholamandalam Investment and Finance Company

Improving outlook, strong fundamentals

Banks & Finance | Sharekhan code: CHOLAFIN | Company Update

Stock Update

Summary

- Cholamandalam Investment & Finance (CIFC) is well placed to benefit from tailwinds for the vehicle financing business, improving CV traction, and economic recovery.
- Strong rural demand (aided by good Rabi harvest, expectation of normal monsoon for 2021, and higher cropping among others) will be beneficial for CIFC (80+% branches in the rural and semi urban areas); lower liquidity held on the balance sheet indicates strong growth and margin outlook.
- Available at 5.2x/4.2x its FY2022E/FY2023E ABVPS, supported by ROEs improving to 19%/20% for FY2022E/FY2023E and improving growth prospects (+25+% AUM growth for the next two years) and lower credit costs.
- We maintain our Buy rating with a revised price target (PT) of Rs. 630.

Cholamandalam Investment & Finance (CIFC) is well placed to benefit from tailwinds for the vehicle financing business, improving CV traction (better fleet utilisation) spurred by improved economic activity led by consumption-driven sectors, e-commerce focused logistics companies, and strong rural demand, which will aid growth in the long-term post COVID-19 recovery. Rise in fuel price has been largely compensated by increasing freight rates (as per media reports). Management commentary indicates that disbursements are at ~80% of pre-COVID levels for vehicle loans; and collection efficiencies have also started picking up as well, which is encouraging. Moreover, we expect strong rural economy and demand to be seen (aided by a good Rabi harvest, expectations of normal monsoon for 2021, and higher cropping among others), which will be supportive for tractor demand in particular and vehicle demand in general. With 80+% branches in rural areas, towns, and semi urban areas for Chola, its business mix gives a clear advantage to capitalise on the uptick in rural demand. An important benefit of the strong demand and improved economic scenario will be that it will help lower liquidity maintenance by NBFCs. As NBFCs dial down on the liquidity held on the balance sheet, not only the same will lead to better yields, but will also help provide positive support to margins. CIFC had ~6.9% of its balance sheet in liquid assets; and hence, a decline in liquidity levels will be positive support for margins. Along with growth, asset-quality wise, CIFC is relatively better placed compared to peers. We believe a low burden on profitability going forward would enable faster revert to the company's growth. The company has consistently balanced robust growth, while maintaining its asset-quality range over cycles, which indicates the quality of business and management. We believe NIM tailwinds and lower credit costs for FY2023E will result in ROE of 20+% along with the possibility of ECL release, which will further support earnings. Factors such as improving asset-quality outlook (improving collections efficiency and high provision cover) are encouraging. A diversified product basket, parentage of the Murugappa Group, and strong historical underwriting make CIFC among the best players in the vehicle financing space. We maintain Buy with a revised price target (PT) of Rs. 630.

Our Call

Valuation: The stock is available at 5.2x/4.2x its FY2022E/FY2023E ABVPS. Valuations are supported by ROEs improving to 19%/20% for FY2022E/FY2023E and improving growth prospects. We expect incremental new business asset quality to be strong and the stress in seasoned book to be well contained. We believe economic recovery and healthy traction seen in automobile demand along with resilient rural economy brightens the growth outlook. We expect 25+% AUM growth for the next two years, with a decline in credit costs. We have revised our target multiples, considering improving growth and credit cost scenario. We maintain our Buy rating with a revised PT of Rs. 630.

Key Risks

Delayed recovery in economic activity will affect growth and profitability; further, it has exposure to the SME segment, which may be vulnerable to pandemic-related risks.

Valuation Rs cr

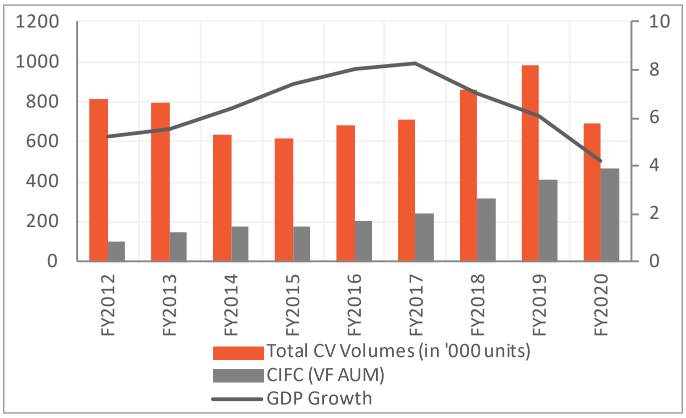
Particulars	FY2019	FY2020	FY2021E	FY2022E	FY2023E
NII	3,403	4,060	4,575	6,094	7,737
PPOP	2,526	3,067	3,490	4,830	6,269
PAT	1,186	1,052	1,432	2,184	2,873
EPS (Rs.)	14.5	12.8	17.5	26.6	35.0
ABVPS (Rs.)	67.4	84.6	91.1	108.4	132.5
P/E (x)	38.9	43.9	32.2	21.1	16.1
P/ABVPS (x)	8.3	6.7	6.2	5.2	4.2
ROE (%)	19.2	12.9	15.1	19.0	20.3
ROA (%)	2.1	1.7	1.8	2.2	2.3

Source: Company; Sharekhan estimates

Recovery in vehicle financing, CV business traction expected with positive tailwinds

The CV financing business is witnessing tailwind benefits with improved fleet utilisation (spurred by improved economic activity) and rise in fuel price, which have been largely compensated by increasing freight rates (as per media reports). Going froward, we believe the strong rural economy and demand are likely to be seen, indicated by bumper Rabi crop and expectations of normal monsoon, which are positives. Moreover, management commentary indicates that disbursements are at ~80% of pre-COVID levels for vehicle loans, and the encouraging thing is that collections have also started picking up.

GDP versus CV Volumes



Source: RBI, Company, Industry reports, Sharekhan Research

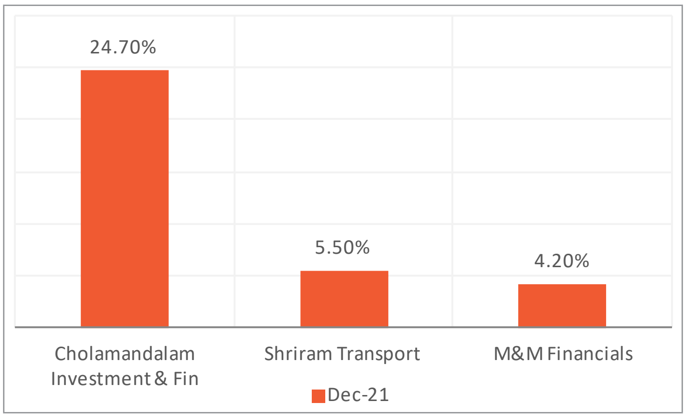
GDP growth has a strong bearing on vehicle finance. With the outlook of GDP growth for FY2022E expected to be strong, we expect gradual pick-up in vehicle sales volumes and, therefore, improved credit offtake. We expect CIFC to be a major beneficiary of the CV cycle uptick.

Introduction of scrappage policy will also help in churning and improving the eventual demand for vehicles. The policy will spur consumers with older vehicles to move for a vehicle with lesser vintage, thereby increasing the demand in credit as well as improving the used vehicle space.

Hence, the commercial vehicle (CV) finance business is expected to accelerate because of healthy demand conditions, anticipated improvement in supply chain, and resilient balance sheets of financiers.

The recent decision of the government for the ECLGS scheme extension is positive and will provide further boost to the sector. CIFC has a high ECLGS disbursement levels as compared to peers and will benefit from it. Moreover, with regulatory support, we believe CV financiers' balance sheets remain resilient.

ECLGS disbursement by vehicle financiers



Source: Company, Sharekhan Research

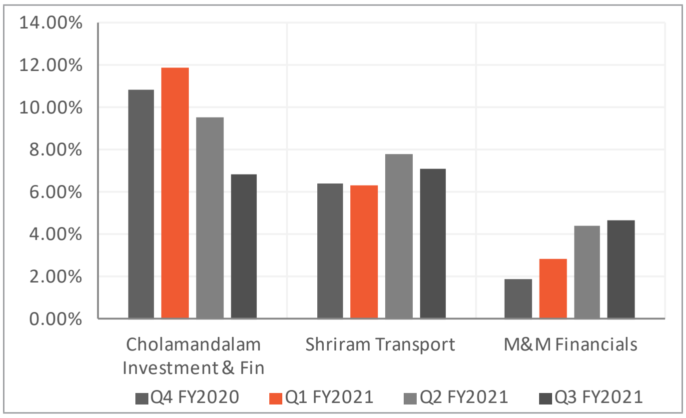
Improved economic outlook leading to lower liquidity drag, positive support on margins

An important benefit of strong demand and improved economic scenario will be that it will help lower liquidity maintenance by NBFCs. As NBFCs dial down on the liquidity held on the balance sheet, not only the same will lead to better yields, but will also help provide positive support to margins.

As seen above, balance sheet liquidity has been coming down for NBFCs. Not only this will lead to better yields, but will also help provide support to margins.

Further, the decline in CoF and disbursements pick-up have aided spreads. CIFC has witnessed as high as 50bps+ reduction in CoF with lowest cost at 7.44% at the end of Q3FY2021, while net interest margin (NIM) has risen by ~100 bps y-o-y to 8.0% in Q3FY2021.

Balance Sheet Liquidity of Vehicle Financiers

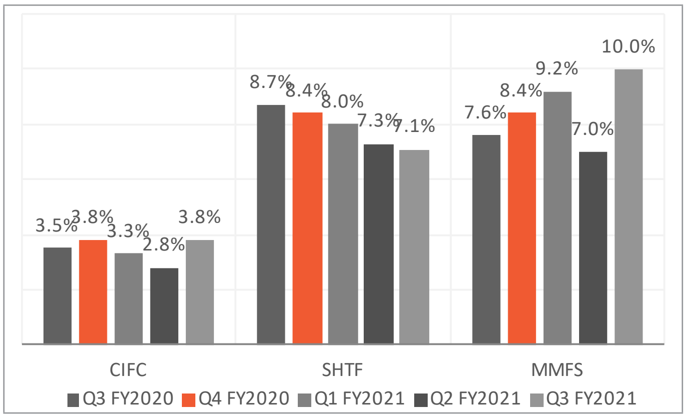


Source: Company, Sharekhan Research

Asset quality to improve from FY2022E; CIFC well placed asset quality wise

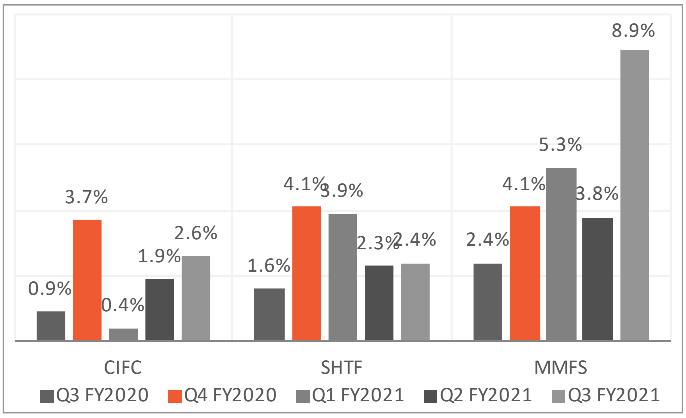
CIFC has front-loaded provisions in 9MFY2021, and management has indicated it expects significance reduction in NPA next year, as SARFAESI resolutions pace. Restructured book also stands under control across players.

CIFC well placed in terms of GNPAs compared to peers



Source: Company, Sharekhan Research

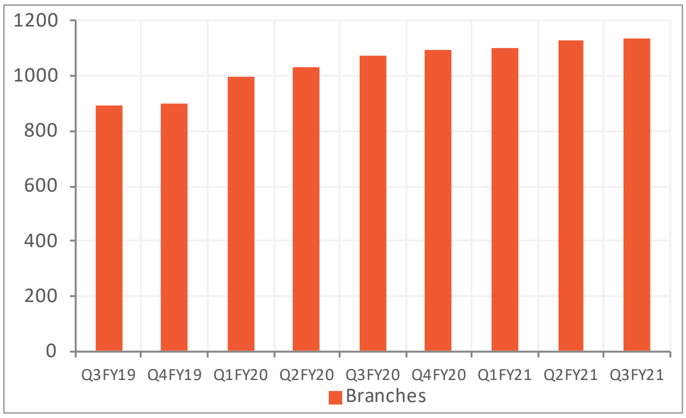
CIFC well placed in terms of credit costs compared to peers



Source: Company, Sharekhan Research

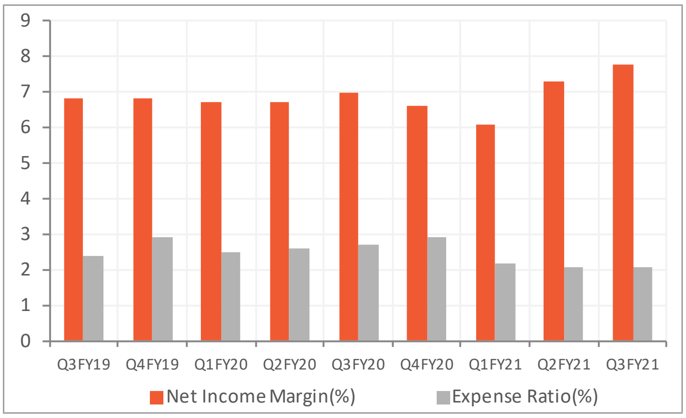
Financials in charts

Branches



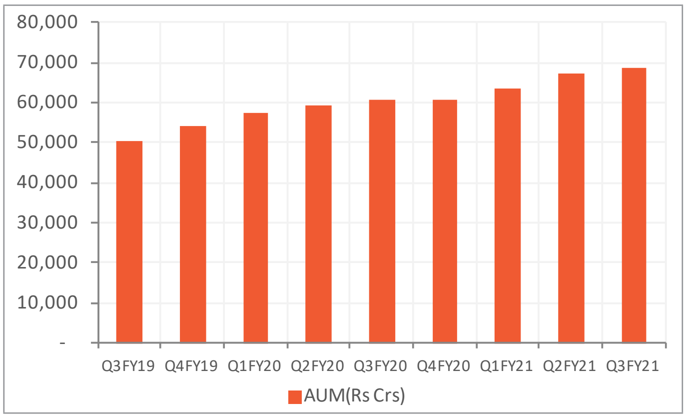
Source: Company, Sharekhan Research

Net Interest Margns (NIMs; %) & Expense Ratio



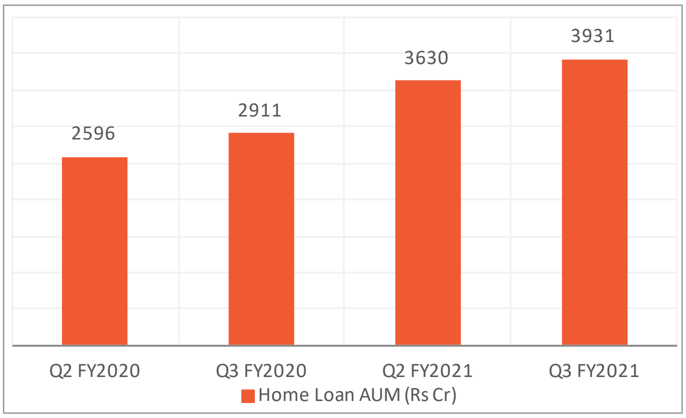
Source: Company, Sharekhan Research

AUM (Rs Cr)



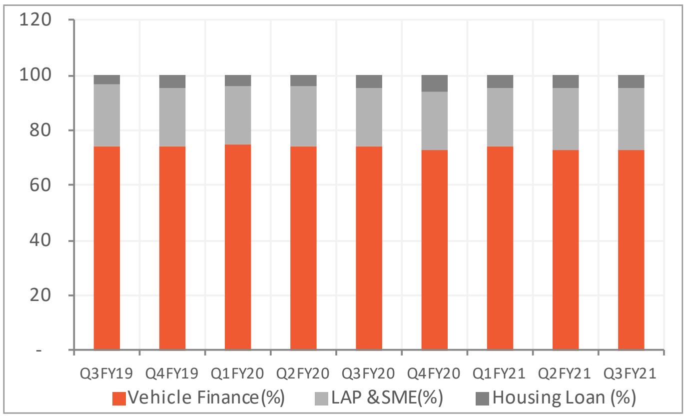
Source: Company, Sharekhan Research

Home Loan AUM (Rs Cr)



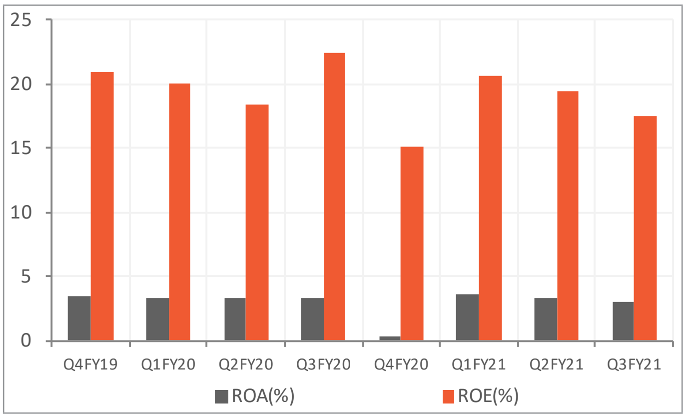
Source: Company, Sharekhan Research

Loan book breakup (%)



Source: Company, Sharekhan Research

ROA, ROE (%)



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 point to a recovery in economic activity, which is positive. Higher MSPs, increased Kharif sowing, expectations of a normal monsoon, 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 management's 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.

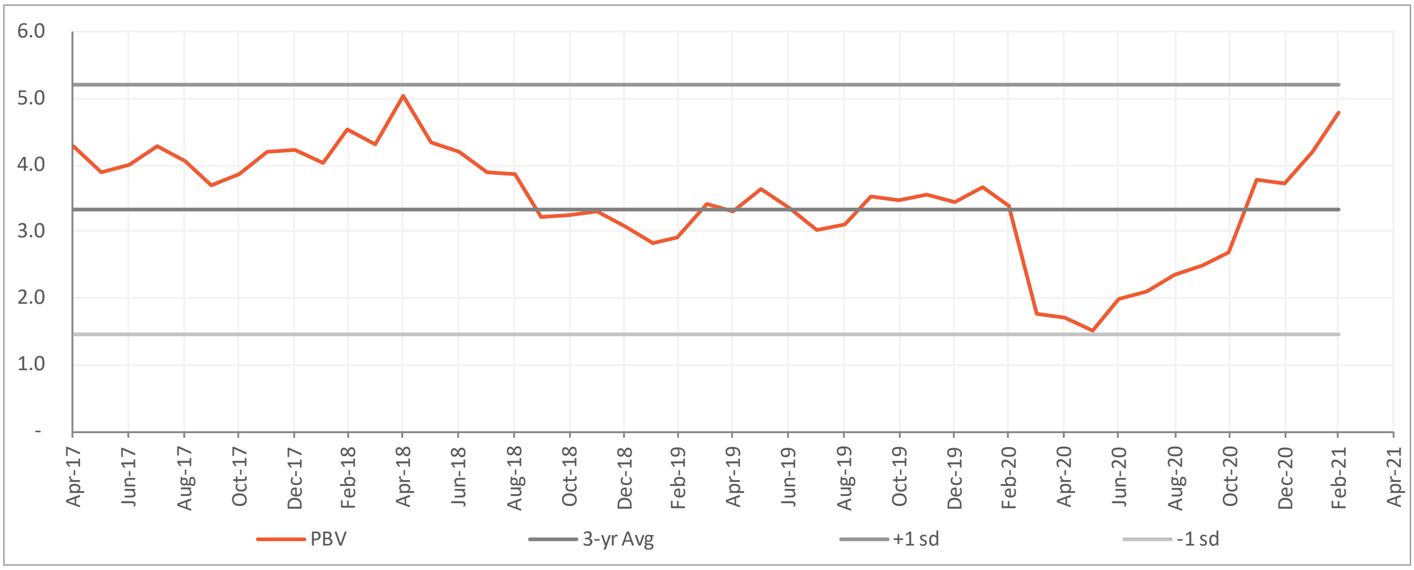
■ Company outlook - Strong fundamentals make it attractive

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), 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 19.3% (Q3FY2021) and scope for improving operating leverage lend 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. The home loan business is the rising star and has a great potential to be built into a solid portfolio, considering the company's expertise 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 revised PT of Rs. 630

The stock is available at 5.2x/4.2x its FY2022E/FY2023E ABVPS. Valuations are supported by ROEs improving to 19%/20% for FY2022E/FY2023E and improving growth prospects. We expect incremental new business asset quality to be strong, and stress in seasoned book to be well contained. We believe economic recovery and healthy traction seen in automobile demand along with resilient rural economy brighten the growth outlook. We expect 25+% AUM growth for the next two years, with a decline in credit costs. We have revised our target multiples, considering improving growth and credit cost scenario. We maintain our Buy rating with a revised PT of Rs. 630.

One-year forward P/E (x) band



Source: Bloomberg, Sharekhan Research

Peer Comparison

Particulars	CMP	P/BVPS		P/EPS		RoE (%)		RoEA(%)	
	Rs/Share	FY2022E	FY2023E	FY2022E	FY2023E	FY2022E	FY2023E	FY2022E	FY2023E
Cholamandalam Investment	564	3.9	3.2	20.1	17.1	21.2	20.9	3.0	3.0
M&M Financial	204	1.6	1.4	20.0	14.0	7.8	10.3	1.5	1.8
Sundaram Finance	2,619	4.2	3.7	30.8	24.4	14.5	16.2	2.7	3.1

Source: Bloomberg, Sharekhan Research

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 (AUM) 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, which it views attractive. Business benefits from a strong parentage and rigorous risk management practices provide long-term visibility, while healthy capitalisation at 19.3% (Q3FY2021) and scope for improving operating leverage lend 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 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 to pandemic-related risks.

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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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