Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cholamandalam Investment and Finance Company

Riding on improving outlook, recovery tailwinds

Banks & Finance	Sharekhan code: CHOLAFIN	Company 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

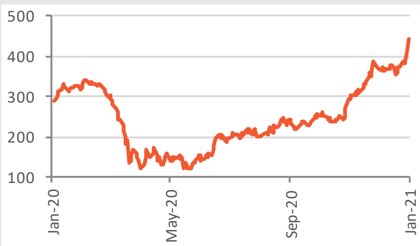
Company details

Market cap:	Rs. 28,926 cr
52-week high/low:	Rs. 363 / 117.4
NSE volume: (No of shares)	104.6 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.6 cr

Shareholding (%)

Promoters	51.7
FII	11.8
DII	29.1
Others	7.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.6	74.3	108.0	52.1
Relative to Sensex	15.6	53.5	76.6	33.6

Sharekhan Research, Bloomberg

Summary

- Cholamandalam Investment and Finance Company (CIFC) is well placed to benefit as macro factors turn favourable (lower borrowing costs, healthy offtake in auto sales); a combination of strong collections and high provisions for CIFC also provides comfort.
- Growth outlook is improving for vehicles finance NBFCs, along with lower credit cost (improving collections) fuelling improved earnings estimates.
- At the CMP, the stock is available at 4.1x/3.3x its FY2022E/FY2023E ABVPS, supported by improved growth outlook, backed by its superior performance throughout cycles, high medium-term RoEs, and strong management at the helm; we have fine-tuned our estimates accordingly.
- We maintain our Buy rating with a revised price target of Rs. 520.

Cholamandalam Investment and Finance Company (CIFC) is well placed to benefit as macro factors turn favourable (lower borrowing costs, healthy offtake in auto sales) along with a combination of strong collections and high ECL provisions for CIFC that offer comfort on asset quality going forward. We believe growth outlook is improving for vehicles finance NBFCs along with lower credit cost outlook which is reason for improved earnings estimates. We believe tailwinds benefits (a combination of improving disbursements and falling funding costs) for CIFC will help it deliver strong Operating performance (NII, PAT etc) over the next two years in terms of as well as margins cushion. Over the past few months, well-rated and large NBFCs have seen a sharp fall in funding costs, which has resulted in benefits of lower funding costs for them. Increased funding though NCDs and shifting benchmark to repo from MCLR have helped in reducing funding cost for these players. Hence, we expect overall funding costs to continue to fall, as weighted average funding cost catches up with about 100-150 lower incremental cost of funds. Lower funding cost (due to improved risk appetite of lenders) will be supportive to wean NBFCs from the excess liquidity on balance sheet and will provide further filip to margins. CIFC has been maintaining a highly liquid balance sheet (9.8% of total assets as of Q2FY2020, marginally lower than all-time high seen in FY2020), which is expected to come down with improved asset quality and borrowing scenario.

CIFC has a well-diversified vehicle financing business (both in terms of geographical and product mix), which has consistently exhibited robust growth, while maintaining asset quality over cycles. Factors such as improving asset-quality outlook (improving collections efficiency and high provision cover) are encouraging; management has also indicated that it expects less than 5% of portfolio likely to be restructured (consists mainly of borrowers such as bus operators), 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 have fine-tuned our estimates accordingly. We maintain our Buy rating with a revised price target (PT) of Rs. 520.

Our Call

Valuation: At the CMP, the stock is available at 4.1x/3.3x 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 to grow on a y-o-y basis in H2FY2021 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 augurs 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 a revised PT of Rs. 520.

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 economic recovery is delayed.

Valuations (Consolidated) 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)	30.6	34.5	25.4	16.6	12.6
P/ABVPS (x)	6.6	5.2	4.9	4.1	3.3
ROE (%)	19.2	12.9	15.1	19.0	20.3
ROA (%)	2.1	1.7	1.8	2.2	2.3

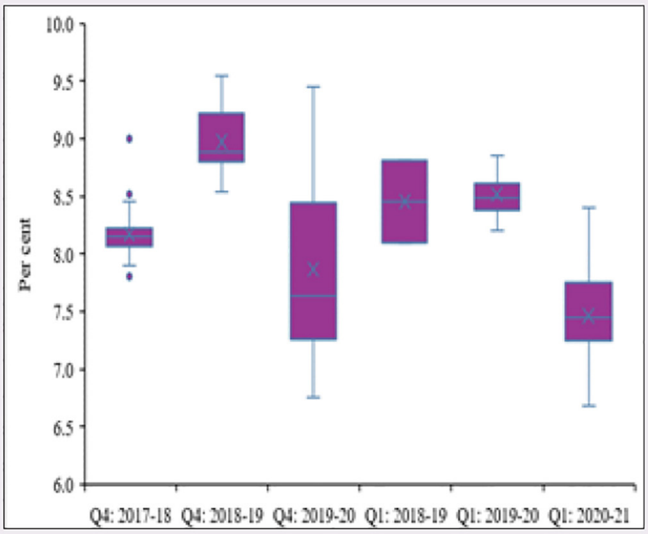
Source: Company; Sharekhan estimates

Liability pricing improves cost of funds for NBFCs

Against the backdrop of low investor confidence, resource mobilisation via issuance of non-convertible debenture private placements (NCD) declined marginally during Q4FY2020. However, this was reversed in Q1FY2021 with surplus liquidity in the system.

Funding costs for highly rated, well-functioning NBFCs have improved considerably since then. Coupon rates of AAA-rated NBFCs softened considerably during Q4FY2020. With regaining of market confidence in Q1FY2021, coupons and spreads softened as compared to their levels in Q4.

Three-year NCD coupon rates of AAA-rated private NBFCs

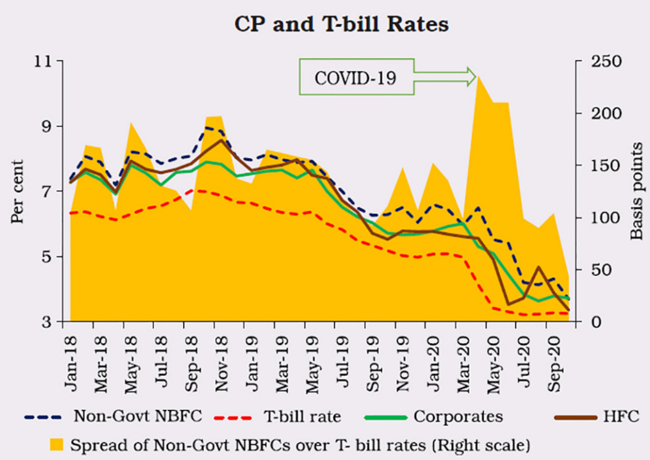


Sources: 1. Staff calculations.
2. Prime database.

Source: RBI

In the immediate aftermath of the lockdown imposed due to COVID-19, CP issuances by NBFCs had fallen drastically in April 2020, attributable partially to a few big companies raising lower amounts than in the corresponding period in 2019 but more so to a spike in borrowing rates due to risk aversion. April-May 2020 witnessed a widening of spreads between non-government NBFCs' CP rates and TBills. The scenario has since then improved significantly, which will also help to bring down borrowing costs for high-rated NBFCs, CIFC being among them.

Commercial Paper and T-Bill rates (Spread of Non-Government NBFC over T-Bill rates)

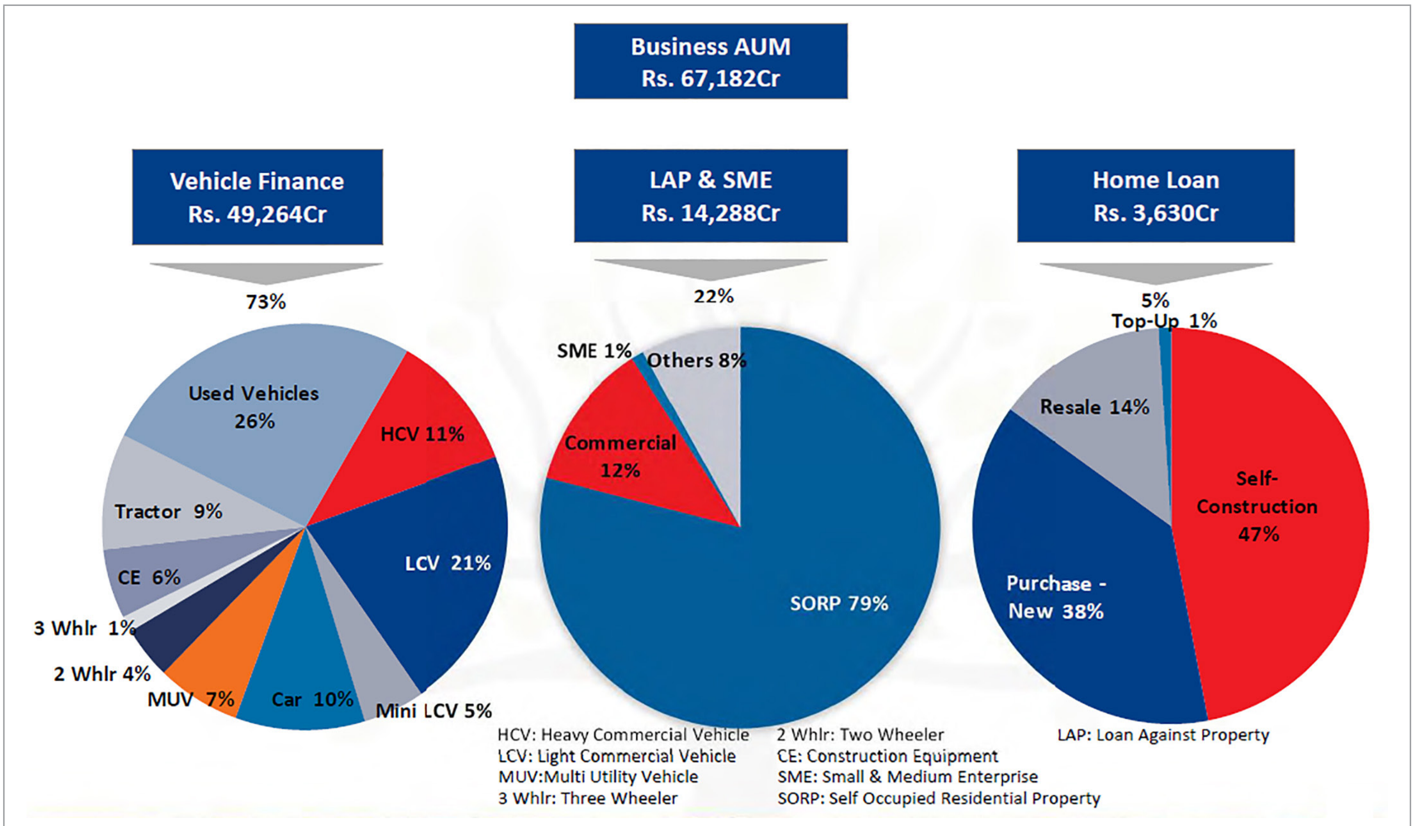


Source: RBI

Strong traction seen in auto sales – Positive for leaders in vehicle finance

Automobile OEMs reported strong numbers across segments in December 2020, driven by inventory restoration and robust demand emerging from rural, semi-urban, tier-2, and tier-3 cities. Moreover, sales were driven by low base due to BS-IV inventory de-stocking last year. Sales in tractor and passenger vehicles remained the key highlight for December 2020, registering 34.3% y-o-y and 25.3% y-o-y growth. Tractor sales continued to register robust volume numbers, driven by improved rural and farm sentiments. The commercial vehicle (CV) industry is showing strong sequential improvement, as the economy is getting back to normal. CV sales are improving sequentially, driven by recovery in economic activities, revival of the infrastructure sector, and improvement in consumption of petrol/diesel.

Business Profile and AUM as on 30th Sept 2020



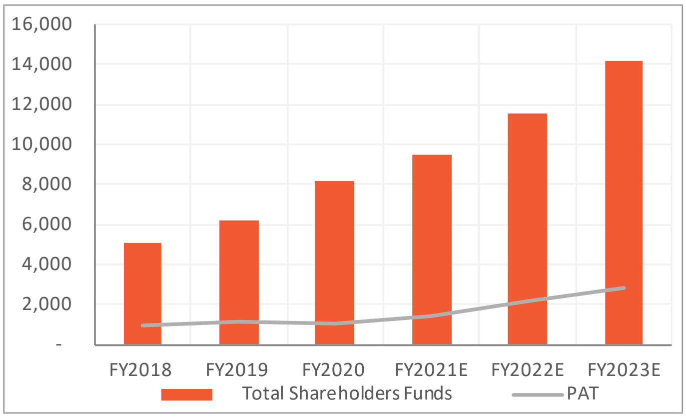
Source: Company, Sharekhan Research

Overall, we believe structural demand drivers remain intact and expect domestic sales volumes to regain momentum from Q4FY2021, helped by higher offtake from semi-urban, Tier-2, and Tier-3 cities.

Vehicle finance is the dominant constituent for Cholamandalam and forms 73% of the total book. Pick-up in auto sales augurs well for the disbursement and advances growth of financiers like Cholamandalam. Vehicle finance is generally fixed rate loans; a fall in cost of funds along with improved offtake augurs well for margins.

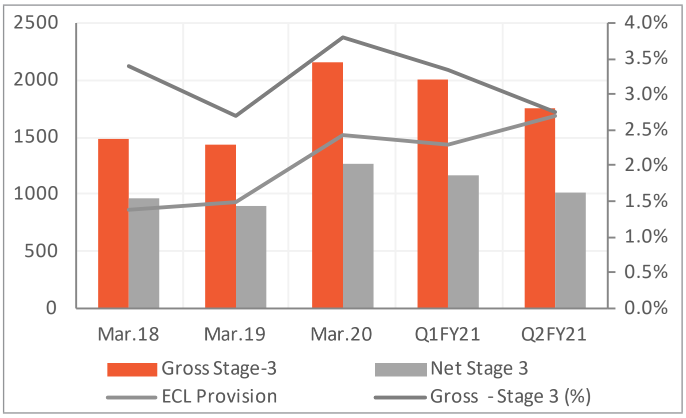
Financials in charts

Steady grwoth in PAT, Networth



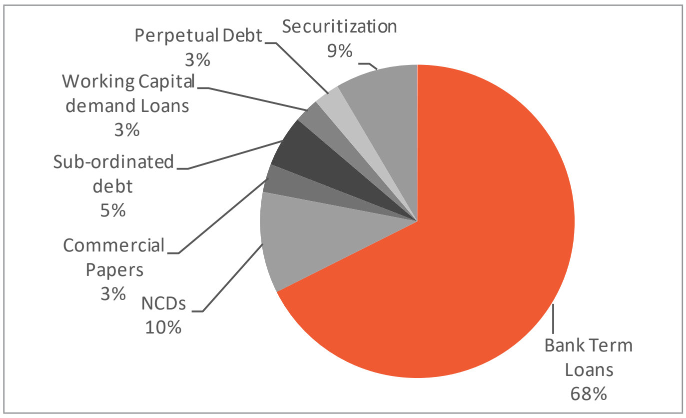
Source: Company, Sharekhan Research

Asset Quality, with ECL Buffer



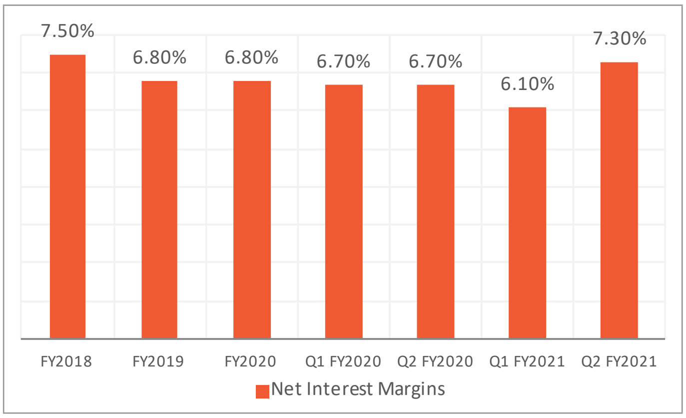
Source: Company, Sharekhan Research

Liability Profile



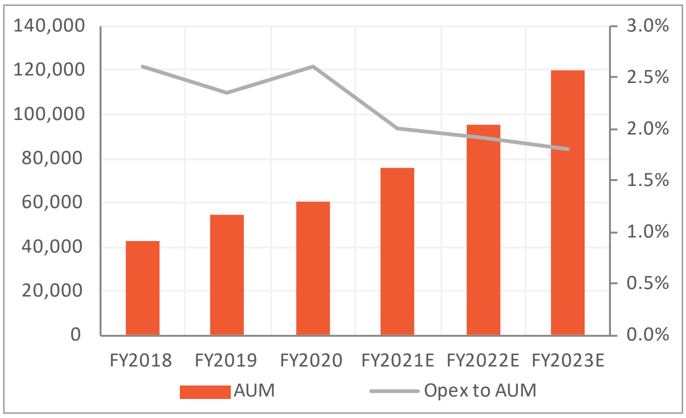
Source: Company, Sharekhan Research

Net Interest Margins



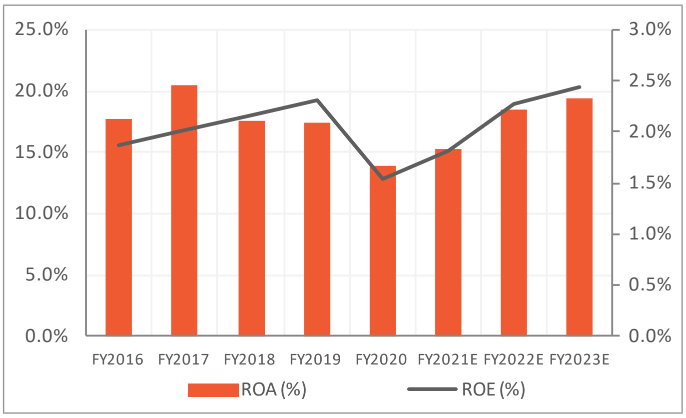
Source: Company, Sharekhan Research

AUM growth, efficiency



Source: Company, Sharekhan Research

Return Ratios



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 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 (~5% expected). 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.

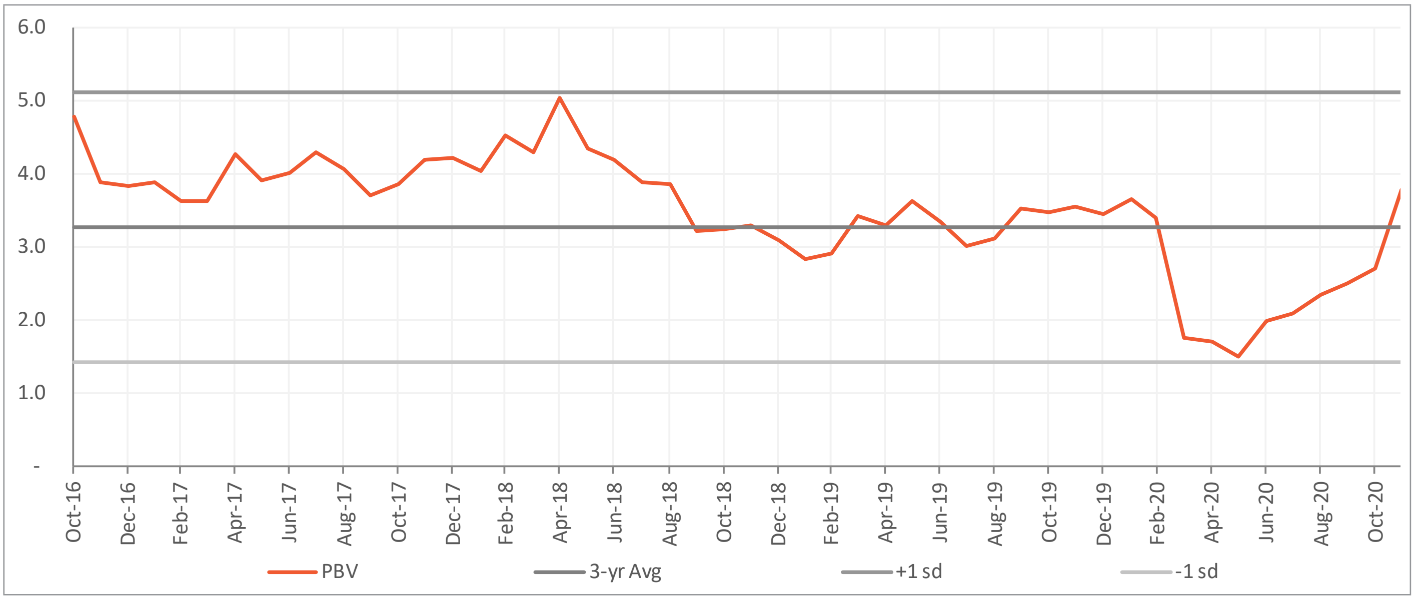
■ Company outlook - Strong fundamentals make it attractive

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 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 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 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 revised PT of Rs. 520

At the CMP, the stock is available at 4.1x/3.3x 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 adds to investor comfort. We expect disbursements to grow on a y-o-y basis in H2FY2021 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 ROEs to improve to 19% and 20%, respectively, for FY2022E and FY2023E. We believe buoyancy in rural markets augurs 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 a revised PT of Rs. 520.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
	Rs/Share	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY23E
Cholamandalam Investment & Finance	443	4.9	4.1	25.4	16.6	1.8	2.2	15.1	19.0
Sundaram Finance Ltd	1834	3.4	3.1	33.2	24.4	1.8	2.3	10.6	13.2
Shriram Transport	1076	1.3	1.1	12.7	9.2	1.8	2.3	10.6	13.0

Source: Company, 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 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 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	SBI Funds Management Pvt Ltd	4.1
5	Axis Asset Management Co Ltd/India	3.7
6	Aditya Birla Sun Life Asset Manage	2.9
7	DSP Investment Managers Pvt Ltd	2.1
8	HDFC Life Insurance Co Ltd	1.8
9	Mirae Asset Global Investments Co	1.8
10	Cartica Capital Ltd	1.2

Source: Bloomberg

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

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

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;