Sharekhan by BNP PARIBAS

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Stock Update

Cholamandalam Investment and Finance Company

Strong fundamentals, bright outlook

Banks & Finance	Sharekhan code: CHOLAFIN	Company 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. 528**	
Price Target: **Rs. 580**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

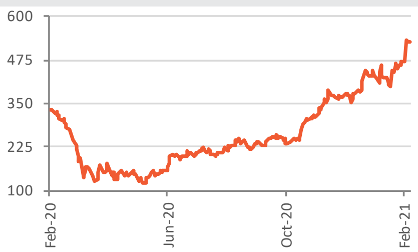
Company details

Market cap:	Rs. 43,244.07 cr
52-week high/low:	Rs. 537.9 / 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	20.5	58.9	133.0	60.2
Relative to Sensex	16.6	41.1	100.1	36.0

Sharekhan Research, Bloomberg

Summary

- Cholamandalam Investment Finance Corporation (CIFC) saw moderate rise in stressed loans; and as the economy picks up and recoveries improve, we expect NIM tailwinds and productivity improvement to drive earnings.
- CIFC's well-contained stressed loan is due to its favourable business mix; CIFC has a balanced portfolio with exposure to small CV operators and rural business (less impacted by the lockdown) and home equity segments, which were support factors.
- At the CMP, the stock is available at 4.9x/4.0x its FY2022E/FY2023E ABVPS, which is reasonable.
- We have revised our target multiples considering normalising growth and credit cost scenario; we maintain Buy with a revised PT of Rs. 580.

Cholamandalam Investment Finance Corporation (CIFC) saw a moderate increase in stressed loans (as moratorium ended) at 310 bps q-o-q. As the economy picks up and recoveries improve further, we expect NIM tailwinds and productivity improvement to drive near-term earnings. CIFC's well-contained stressed loan is also due to its favourable business mix. CIFC has a balanced portfolio with exposure to small CV operators and rural business (less impacted by the lockdown) and home equity segments, which were support factors. Going forward, we expect normalised disbursement for Q4 and H1FY2022, which will lead to improved loan growth outlook for the next year. Healthy business traction was seen with total AUMs up by 15% y-o-y. Increased funding though NCDs and shifting benchmark to repo from MCLR have helped in reducing funding cost for CIFC as well. Hence, net interest margin (NIM) improved to 7.8% for Q3FY2021 (up from 7% in Q3FY2020 and 7.3% in Q2FY2021). CIFC has a well-diversified vehicle financing business (both in terms of geographical and product mix). The company has witnessed consistently balanced robust growth, while maintaining its asset-quality range over cycles. We believe NIM tailwinds and lower credit costs for FY2022E will result in ROE of 20+% along with the possibility of ECL release, which will be further support to 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, 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 Buy with a revised price target (PT) of Rs. 580.

Our Call

Valuation: At the CMP, the stock is available at 4.9x/4.0x its FY2022E/FY2023E ABVPS, which is reasonable on account of 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 normalise 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 offer additional comfort. We have revised our target multiples considering the normalising growth and credit cost scenario. We maintain our Buy rating with a revised PT of Rs. 580.

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.

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)	36.5	41.1	30.2	19.8	15.1
P/ABVPS (x)	7.8	6.2	5.8	4.9	4.0
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

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 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.

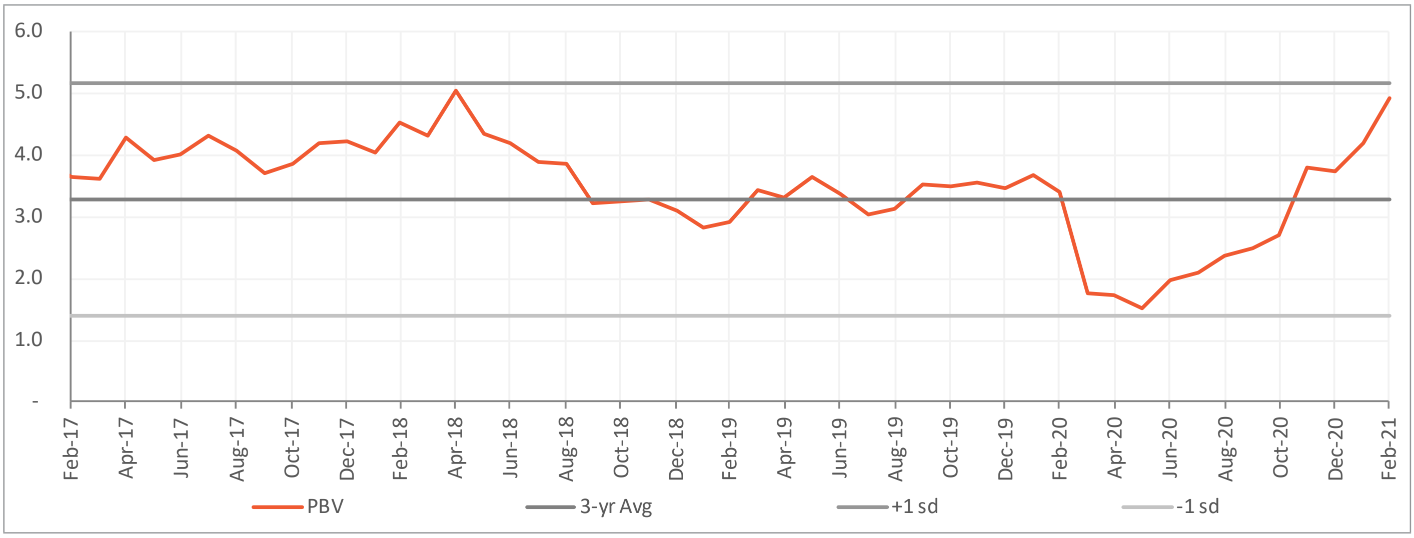
■ Company outlook - Strong fundamentals make it attractive

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), 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 an unchanged PT of Rs. 580

At the CMP, the stock is available at 4.9x/4.0x its FY2022E/FY2023E ABVPS, which is reasonable on account of 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 normalise 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 offer additional comfort. We have revised our target multiples considering normalising growth and credit cost scenario. We maintain Buy with a revised PT of Rs. 580.

One-year forward P/BV (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	528	5.8	4.9	30.2	19.8	1.8	2.2	15.1	19.0
Sundaram Finance Ltd	2284	4.5	4.0	30.9	26.9	2.4	2.7	14.1	14.5

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 (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, 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 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 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	Secretary/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

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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