Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cholamandalam Investment and Finance Company

Poised to scale new heights

NBFC	Sharekhan code: CHOLAFIN
Reco/View: Buy ↔	CMP: **Rs. 606**
	Price Target: **Rs. 720** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 26.52

Updated Jan 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 49,353 cr
52-week high/low:	Rs. 702/470
NSE volume: (No of shares)	36.8 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	51.6
FII	17.7
DII	22.8
Others	8.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-6.7	7.8	5.1	13.5
Relative to Sensex	1.6	16.1	14.4	8.8

Sharekhan Research, Bloomberg

Summary

- We believe that Cholamandalam Investment Finance Company (CIFC) is a strong vehicle finance player and outdoes its peers in terms of loan book growth; non-auto segments are likely to drive growth going ahead, even as outlook for auto loans improves. New businesses would aid growth momentum as well though near-term challenges on the supply front may hit growth.
- The company has demonstrated stable asset quality through cycles and we expect it to improve further given CIFC's ability to tide over credit cycles with relative ease and its lower credit cost versus peers.
- Stock has corrected by 14% from the highs of Rs. 702 as compared to 14% and 20% correction in the NIFTY and NIFTY Bank indices respectively. Such correction in the stock price offers a good buying opportunity for investment with risk and reward ratio turning favorable. Additionally, it has given returns of 8% in the past three months and outperformed its peers. The stock is available at 5x/4.1x its FY2023E/FY2024E BVPS.
- We re-iterate our Buy rating with price target (PT) of Rs. 720.

Auto financiers are expected to see loan growth improve and asset quality pressures ease as business activities normalise. After weathering multiple challenges in the past three fiscals, overall assets under management (AUM) of NBFCs is likely to grow by 8-10% in FY23E (industry estimates) driven by an improvement in the economic activities, sufficient capital buffers, sizeable on-balance sheet provisioning and adequate system liquidity which would aid funding. Better economic activity, pick-up in auto sales and revival of used commercial vehicles segment would drive auto loan growth for financiers under our coverage. We expect their AUMs to clock a CAGR of ~13% over FY22E through FY24E for our coverage. However, near-term challenges remain for auto financiers due to supply disruptions. Cholamandalam Investment Finance Company (CIFC) is better placed in terms of the loan book growth with a strong vehicle financing franchise. Its newly-launched businesses is also likely to add on to drive growth. Further, the asset quality is also expected to improve going ahead given its record to manage its asset quality through the cycles.

- **Improving loan growth and cyclical recovery:** With the normalization of economic activities, pick up in auto sales and revival in the used commercial vehicle segment, we believe auto financiers' loan book is expected to gain momentum while asset quality pressures ease as well. We believe that CIFC is set to benefit from the expected up cycle (FY22E to FY25E). Its AUM grew at a CAGR of ~19% over FY16 to FY21 and reached Rs. 700 billion. While its vehicle AUM grew at a CAGR of ~20% over FY16 to FY21. With a strong parentage (Murugappa Group) and credit rating of AA+, the company has built in strong liability franchise with a well-diversified loan book with LAP, SME and housing loans along with vehicle portfolio. As of December 2021, LAP, SME, home loans and vehicle finance portfolio was 70%, 22%, 1% and 7%, respectively of the book, thereby non vehicle book constituting to ~30% of the total book. Hence, we believe that the acceleration in the non auto segment is likely to drive the AUM growth and the vehicle loan book.
- **Asset quality pressures to ease:** CIFC has managed successfully in navigating through the different credit cycles as compared to its peers despite having ~22% of its business assets in LAP which is considered a more vulnerable segment. Its focus on mid-market customers makes it better placed with strong underwriting polices. While the RBI norms have driven up GNPA and NNPA ratios to 8.53% and 5.76%, respectively, we believe this is below the threshold of 6% NPA to avoid PCA. Although the company plans to bring its NPA ratio to 4%, a decline of 200 bps going ahead. We expect the company's NPA to reduce further given the improvement in collection efficiency and disbursements. The non-delinquent book's collection efficiency stood at 99% in December as compared to 98.5% in November.
- **Strong capital position:** CIFC has the strong parentage of the Murugappa group and enjoys a credit rating of AA+. It is well-capitalised with a CRAR of ~19.8% (Tier-I capital of 16.8%).

Our Call

Valuation: The stock trades at 4x/3.3x its FY2023E/FY2024E BVPS. The premium valuation as compared to its peers is due to its high earnings growth prospects with better management of the pandemic. The company has witnessed sharp recovery in disbursements and collections, which we believe would improve further going ahead. Assets under management (AUM) growth is likely to be in single digits in FY2022E, followed by pickup up FY2023-FY2024E and can see double-digit growth. CIFC, with a parentage, is well diversified across product segments – vehicle finance, small business finance, and housing finance, which will enable it to deliver in terms of growth, risk and returns. However, short term supply challenges may prove to be a dampener in the near term. of the company. We reiterate a Buy rating with a PT of Rs. 720.

Key Risks

Decline in margin and risks of asset quality deterioration in the loan against property (LAP) segment.

Valuation Rs cr

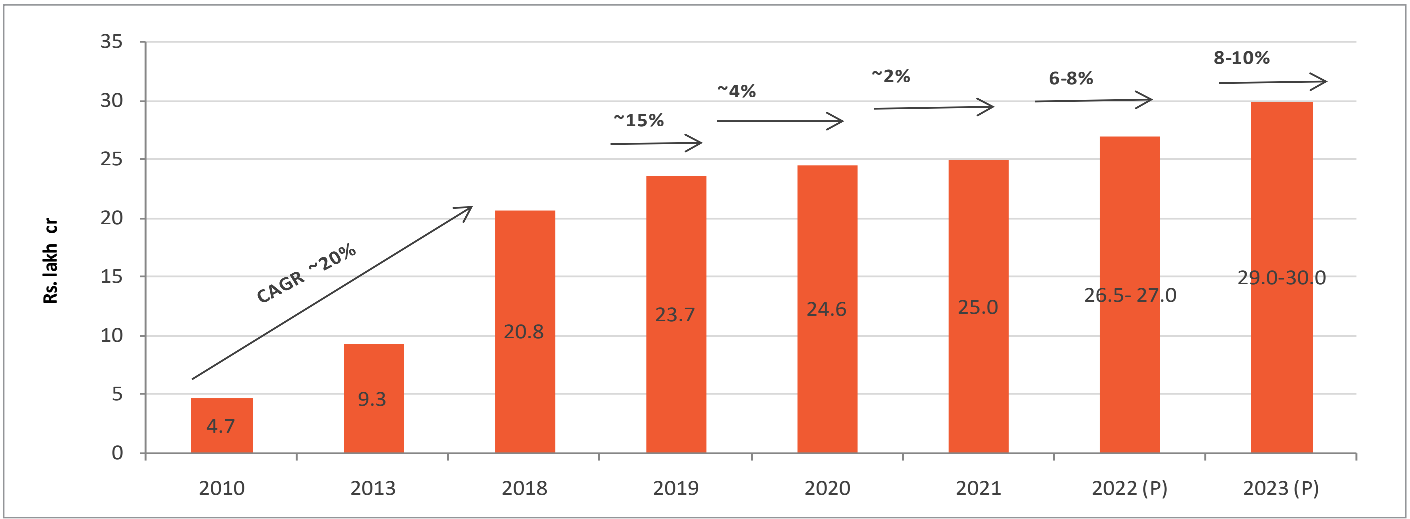
Particulars	FY21	FY22E	FY23E	FY24E
PAT	1,515	1,965	2,605	3,157
EPS (Rs.)	18.5	24.0	31.8	38.5
BVPS (Rs.)	116.6	140.1	162.6	200.1
P/E (x)	33.5	34.2	25.8	21.3
P/BVPS (x)	5.3	5.9	5.0	4.1
ROE (%)	17.1	18.8	20.6	20.5
ROA (%)	2.2	2.6	3.0	3.1

Source: Company; Sharekhan estimates

Asset quality improvement to fuel growth

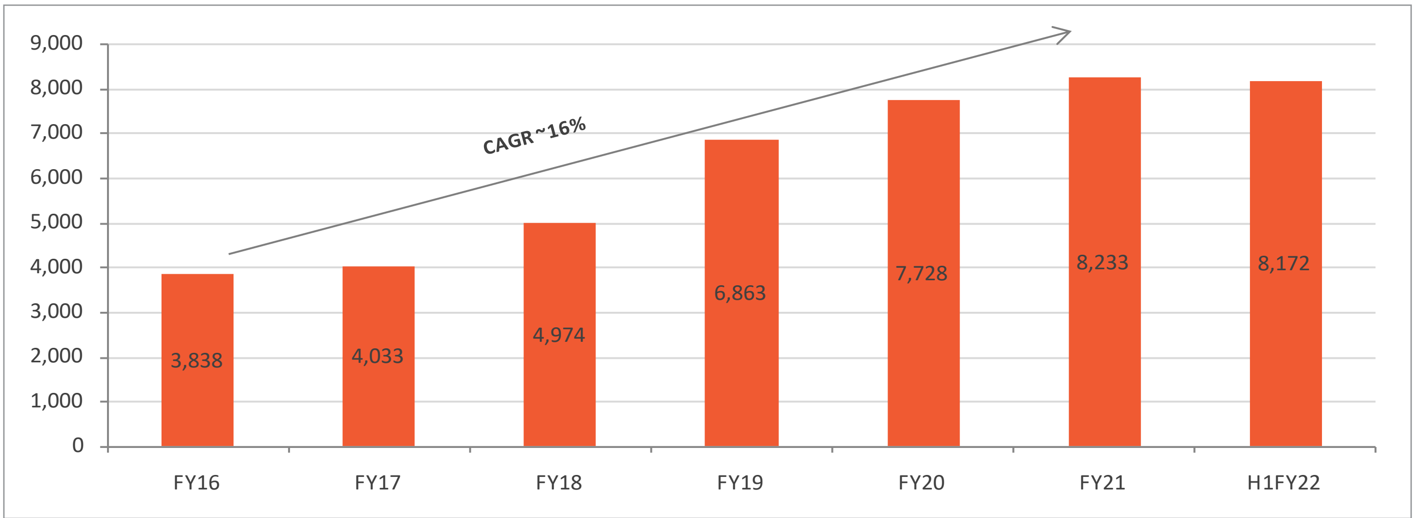
Auto financiers are expected to see loan book growth improve and asset quality pressures ease as business activities normalise. After weathering multiple challenges in the past three fiscals, the overall assets under management (AUMs) of NBFCs is likely to grow by 8-10% in FY23E (industry estimates) driven by improvement in economic activities, sufficient capital buffers, sizeable on-balance sheet provisioning along with adequate system liquidity which is likely to aid funding. Growth in the vehicle finance segment would also depend on the availability of the vehicles which are currently undergoing component shortage issues. However, the segments such as two-wheelers, passenger vehicles and heavy commercial vehicles may still be vulnerable. The credit cost for the auto financiers are expected to normalise as there is sizeable on-balance sheet provisioning. as per the industry estimates the stage-3 assets of NBFCs is expected to remain elevated at ~6% in FY23E versus 6.8% in Q3FY22, primarily on account of slippages in the restructured book and emergency credit line guarantee scheme (ESLGS) portfolio. This was also on account of adherence to the revised norms of NPA recognition by RBI. However, with the postponement of the timeline for adhering to upgraded non-performing assets norms and tailwinds for the sector such as improved economic activity, the gross NPA ratio may decline by 150-200 bps. Vehicle finance segment too saw a ~500 bps decline in gross NPAs. Within vehicle segment, two-wheelers, three-wheelers and commercial passenger vehicles saw more slippages due to greater volatility in the cash flows of borrowers. However, the credit cost is expected to be moderate as the NBFCs have adequate provisioning buffers. We believe that disbursements may normalise in FY23E with segments such as loan against property (LAP), home loans and vehicle finance may witness higher demand. Additionally, tractor finance segment is likely to remain stable given the agriculture sector growth and government spending the rural areas.

AUM growth trajectory of NBFCs



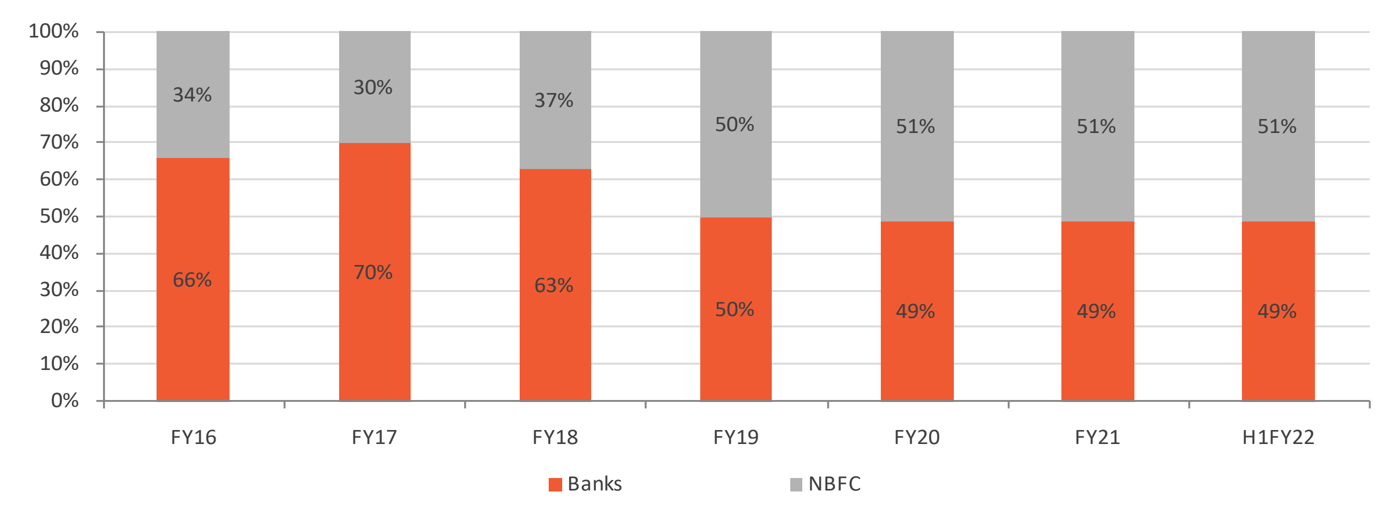
Source: Industry; Sharekhan Research

Vehicle Finance Industry AUM (Rs. billion)



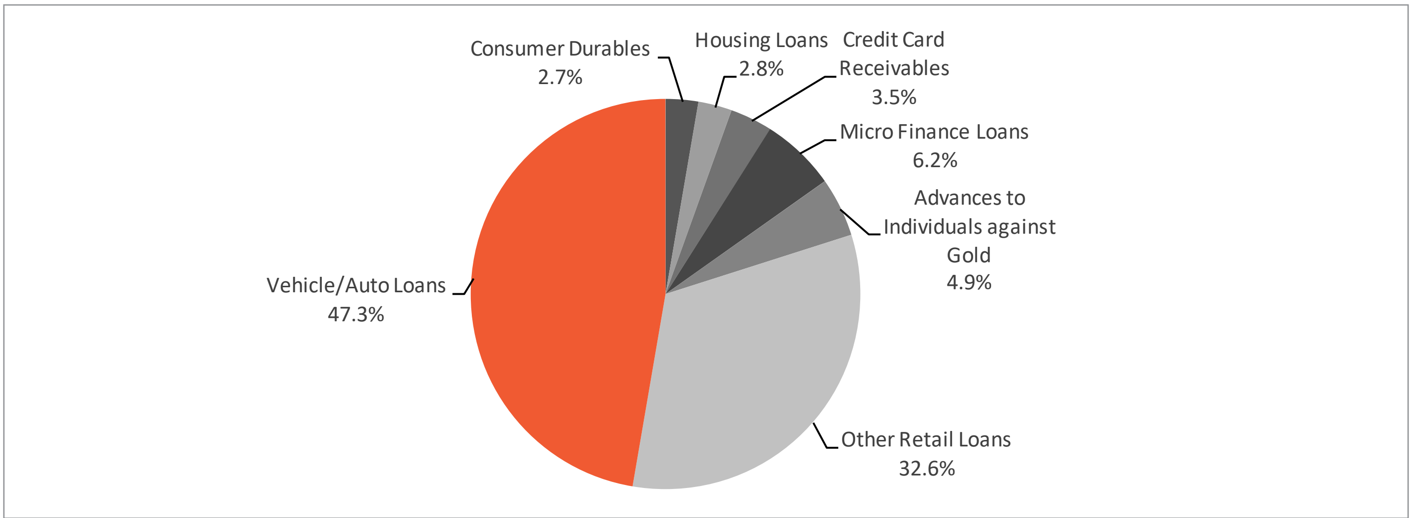
Source: Industry; Sharekhan Research

Banks and NBFCs share in vehicle financing



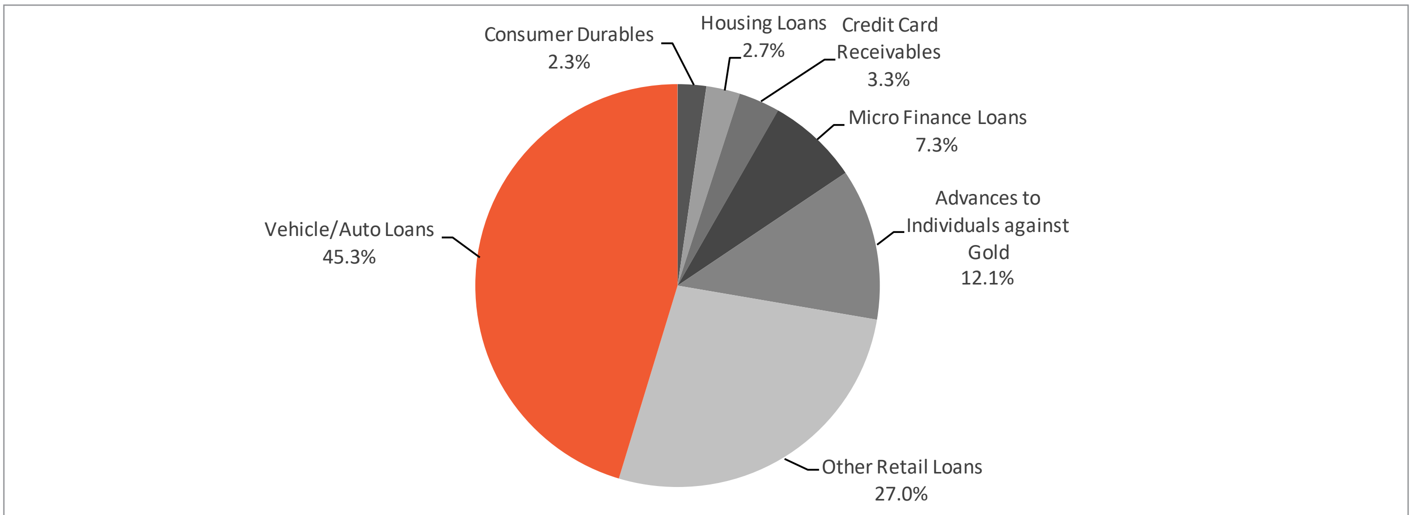
Source: RBI; Sharekhan Research

Distribution of Retail Loans of NBFCs (%) - FY20



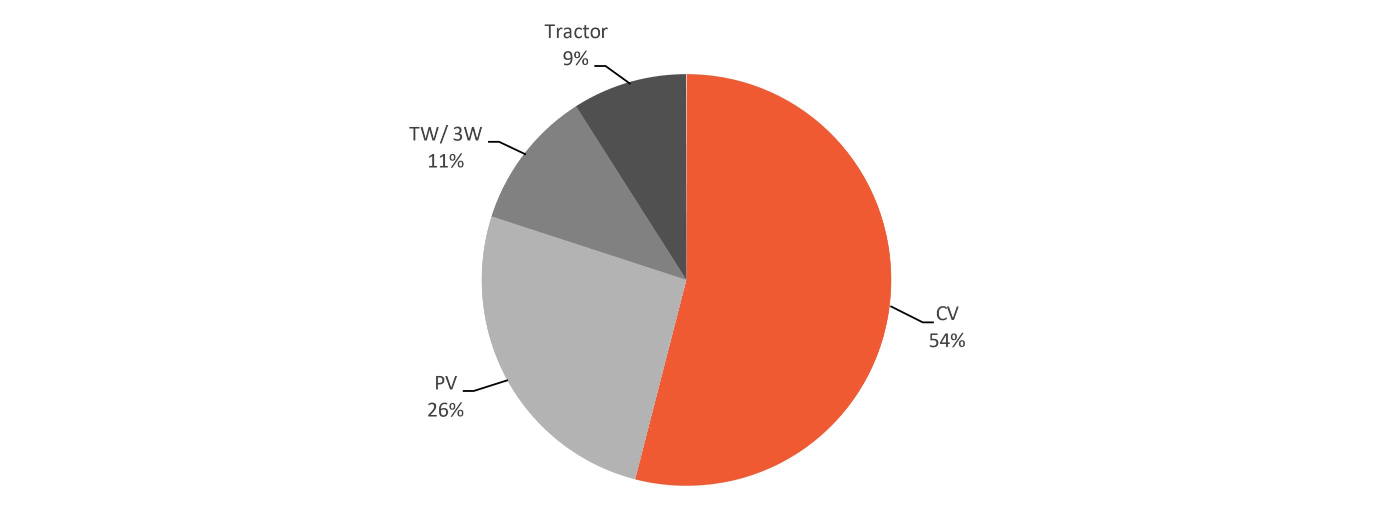
Source: RBI; Sharekhan Research

Distribution of Retail Loans of NBFCs (%) - FY21



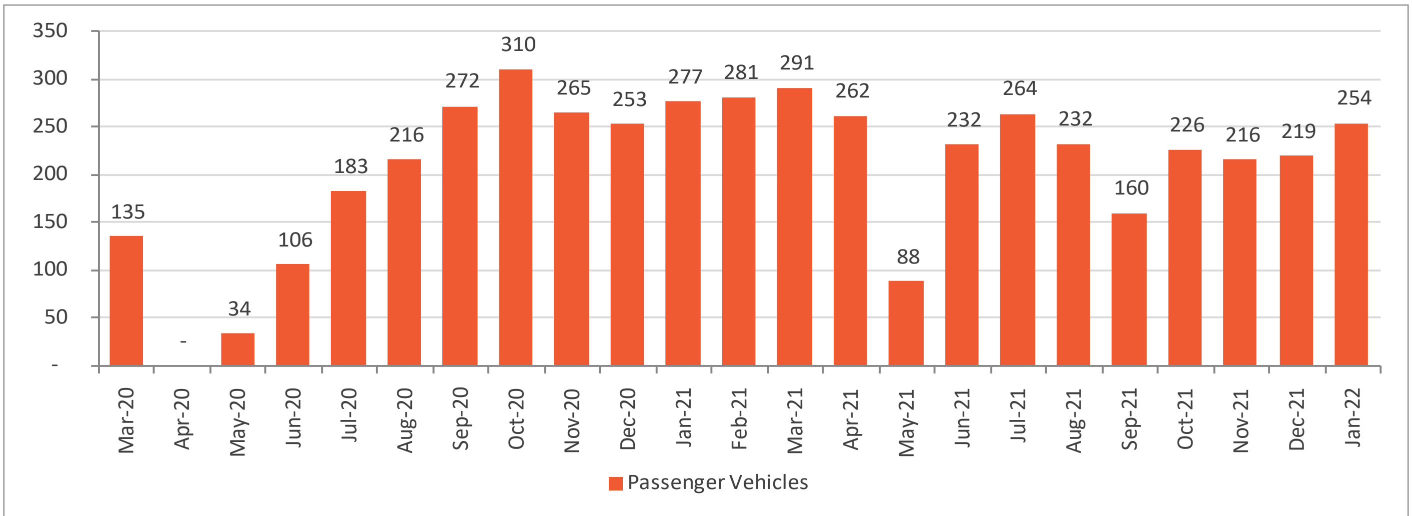
Source: RBI; Sharekhan Research

Vehicle Finance AUM Mix - FY21



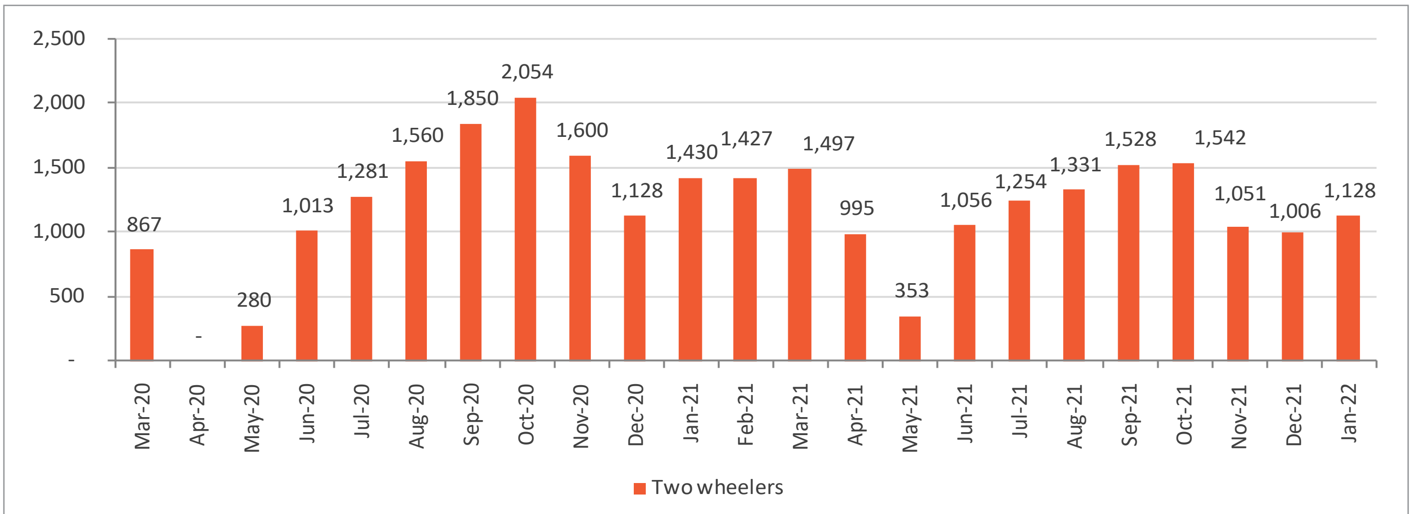
Source: Industry; RBI; Sharekhan Research

Passenger Vehicles sales (in 000)



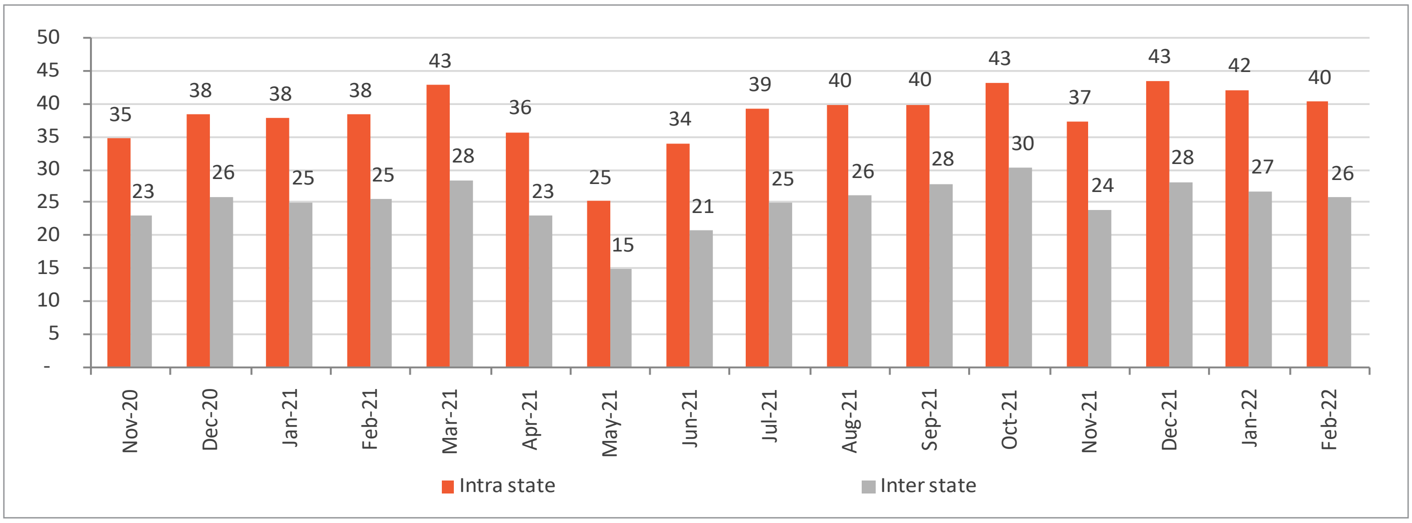
Source: SIAM; Sharekhan Research

Two wheelers sales (in 000)



Source: SIAM; Sharekhan Research

Number of e way bills issued took breather in Feb 2022



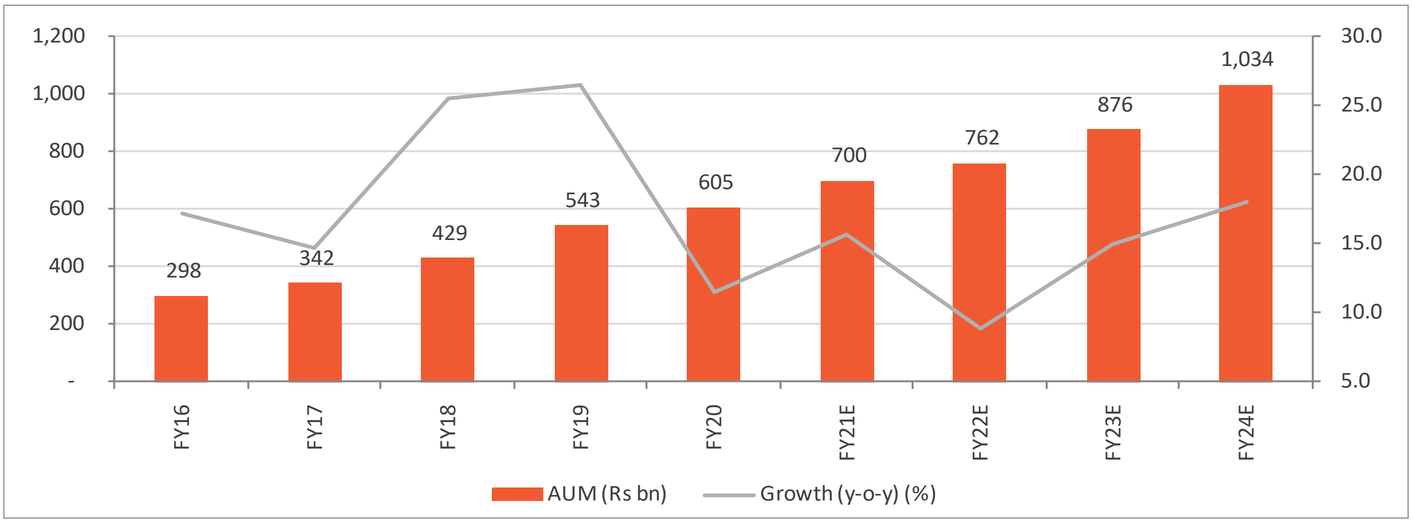
Source: GSTN; Sharekhan Research

CIFC poised to outperform on growth and asset quality

With normalisation of business activities, pick-up in auto sales and revival in the used commercial segment, we expect the vehicle finance book of CIFC to record robust loan book growth going ahead. Additionally, the acceleration in the non auto book is also likely to drive growth going ahead. We expect CIFC's AUM to clock ~23% over FY22E through FY24E, primarily driven by its non-auto loan book growth. We expect its vehicle book to grow at a CAGR of ~14% over FY22E through FY24E. As of December 2021, LAP, SME, home loans and vehicle finance portfolio was 70%, 22%, 1% and 7% respectively of the book, thereby non vehicle book constituting to ~30% of the total book. With respect to its commercial vehicle portfolio, the company focuses on the small road & transport operators (SRTOs) and medium truck operators which makes it less risky segment with lower competition from large banks. Additionally, over the years, the company has diversified its portfolio into other segments as well which makes it less skewed towards the vehicle segment. Recently, CIFC launched three new businesses: Consumer and Small Enterprise Loan, Secured Business and Personal Loan, and SME loan in order to diversify its business and to boost medium term growth. The company intends to disburse additionally Rs. 600 to 700 crore in Q4FY22 and increasing it to Rs. 1,000 crore per quarter in the next 3 to 6 months going ahead. We believe, the new businesses could boost the growth in the medium term if executed well.

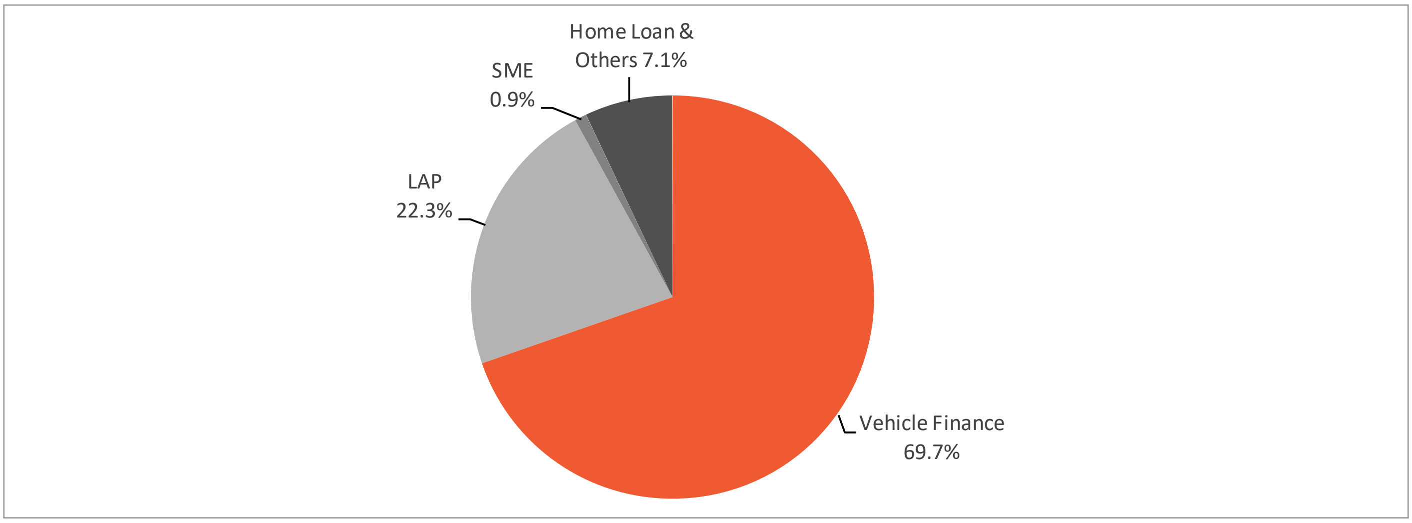
Asset quality pressures to ease: The company has managed successfully in navigating through the different credit cycles as compared to its peers despite having ~22% of its business assets in LAP, which is considered a more vulnerable segment. Its focus on the mid market customer segment makes it better placed with strong underwriting polices. GNPA and NNPA deteriorated as per the revised RBI norms for NPA recognition and stood at 8.53% and 5.76%, respectively. However, the company has managed its asset quality metrics well across business cycles. The company plans to bring its net NPA ratio to 4% going ahead. We expect the company's NPA to reduce further given the improvement in collection efficiency and disbursements. The non-delinquent book's collection efficiency stood at 99% in December as compared to 98.5% in November.

AUM growth (%)



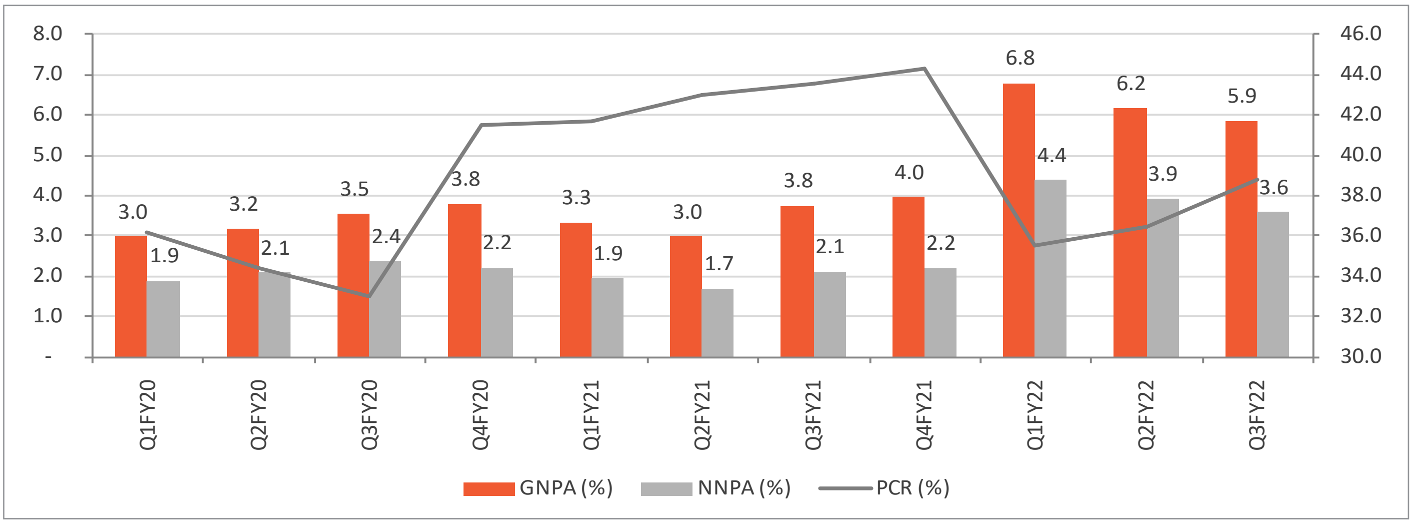
Source: Company; Sharekhan Research

AUM mix (%) - Q3FY22



Source: Company; Sharekhan Research

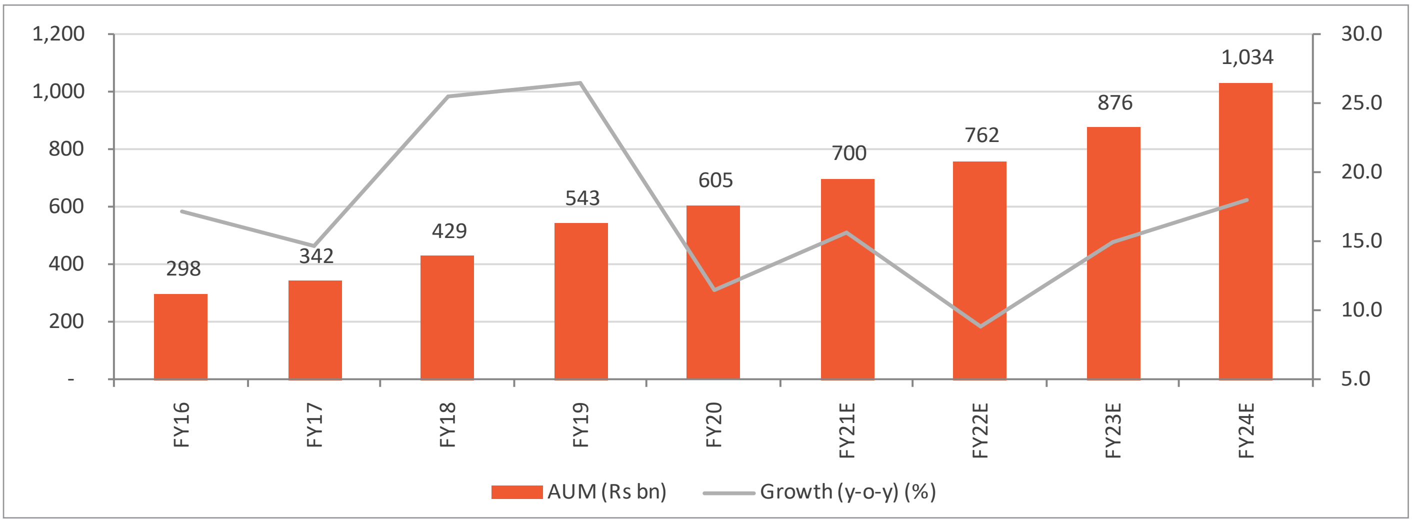
Asset quality



Source: Company; Sharekhan Research

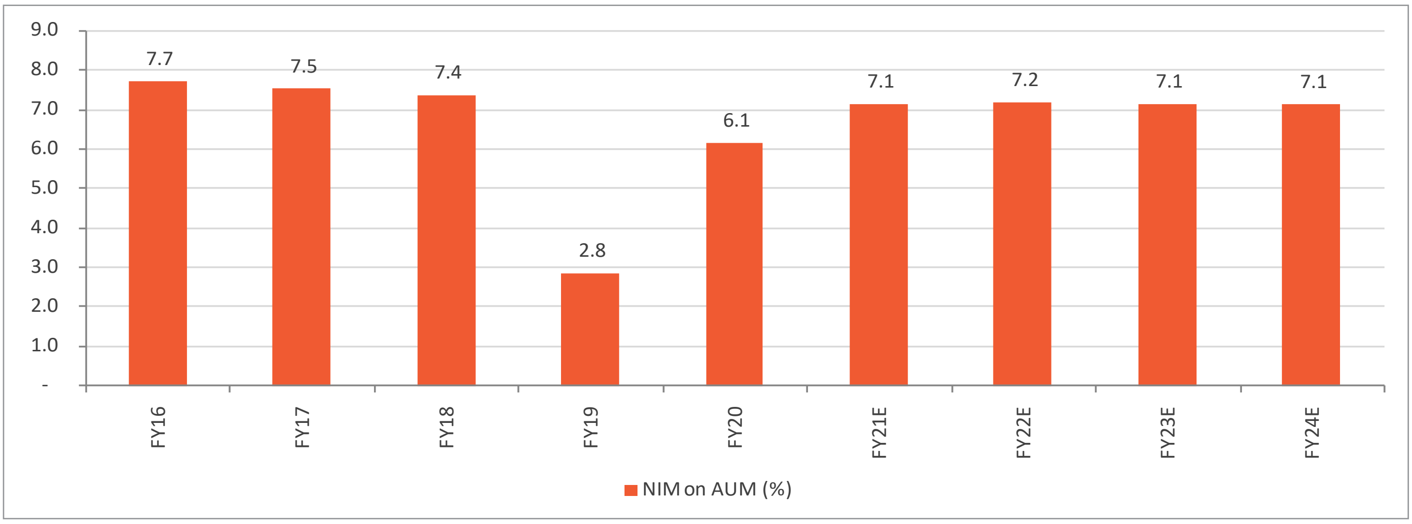
Financials in charts

AUM growth



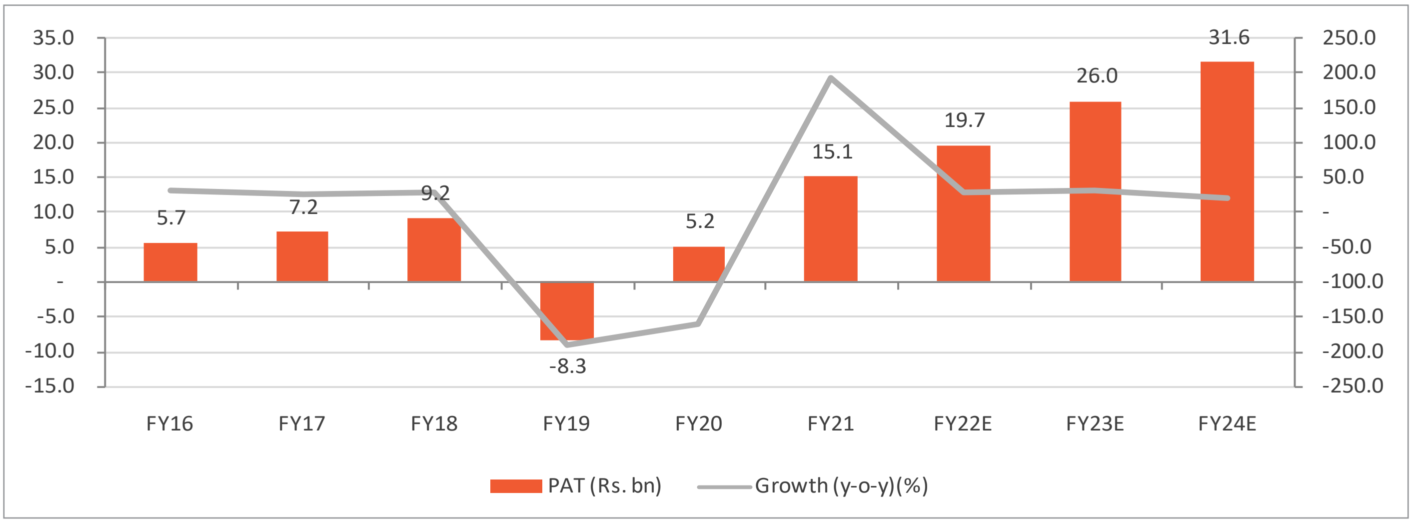
Source: Company; Sharekhan Research

NIM on average AUM (%)



Source: Company; Sharekhan Research

PAT trend



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Notwithstanding near-term challenges, the rural segment is a bright spot

The NBFC sector is witnessing an improved long-term outlook, helped by lower borrowing costs (supported by continued accommodative monetary policy stance). Financial services companies are reporting an incremental pickup in credit demand, especially in retail and rural segments, post the revival in the economy. After weathering multiple challenges in the past three fiscals, the overall assets under management (AUM) of NBFCs is likely to grow by 8-10% in FY23E (industry estimates) driven by improvement in the economic activities, sufficient capital buffers, sizeable on-balance sheet provisioning along with adequate system liquidity which is likely to aid funding. Growth in the vehicle finance segment would also depend on the availability of the vehicles which are currently undergoing component shortage issues.

■ Company outlook - Strong fundamentals make it attractive

CIFC has established itself as a strong and well-run vehicle financing (that forms 70% of AUM) NBFC with attractive return ratios, steady net interest margin (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 (8% of AUM). Business benefits from a strong parentage and rigorous risk management practices provide long-term visibility, while healthy capitalisation at 19.8% (Q3FY2022) 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. A robust collection mechanism and strong credit risk assessment framework will help it drive growth. CIFC is an attractive pick due to its demonstrated superior performance on multiple business parameters.

■ Valuation

The stock trades at 4x/3.3x its FY2023E/FY2024E BVPS. The premium valuation as compared to its peers is due to its high earnings growth prospects with better management of the pandemic. The company has witnessed sharp recovery in disbursements and collections, which we believe would improve further going ahead. Assets under management (AUM) growth is likely to be in single digits in FY2022E, followed by pickup up FY2023-FY2024E and can see double-digit growth. CIFC, with a parentage, is well diversified across product segments – vehicle finance, small business finance, and housing finance, which will enable it to deliver in terms of growth, risk and returns. However, short term supply challenges may impact the earnings of the company. We reiterate a Buy rating with a PT of Rs. 720.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/BVPS		P/EPS		ROE (%)		ROA (%)	
			FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Cholamandalam Investment Finance Co.	601	49,353	4.3	3.7	25.1	18.9	18.8	20.6	2.6	3.0
Mahindra Finance	129	15,815	1.1	1.0	17.2	8.3	6.2	12.5	1.1	2.2

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 1,140 branches across India with AUM above Rs. 72,724 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 19.8% (Q3FY2022) 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 loans segment is also attractive and has a great potential to be built into a solid portfolio considering the expertise of the company in handling typical customer profiles.

Key Risks

Decline in margin and risks of asset quality deterioration in the LAP segment.

Additional Data

Key management personnel

Mr. Vellayan Subbiah	Chairman and Non- Executive Director
Mr. Arul Selvan	Chief Financial Officer
Mr. Ravindra Kumar Kundu	Executive Director
Ms. P Sujatha	Secreatary/Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Axis Equity Advantage Fund	4.16
2	Ambadi Investments Ltd	4.11
3	Axis Asset Management CO Ltd	4.05
4	HDFC Asset Management Co Ltd	3.62
5	Capital Group Cos Inc	2.14
6	Aditya Birla Sun Life Asset Management	1.78
7	HDFC Life Insurance Co Ltd	1.54
8	BlackRock Inc	1.49
9	Vanguard Group Inc	1.47
10	SBI Funds Management Pvt Ltd	1.38

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

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