Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cholamandalam Investment and Finance Company

Steady Performance

NBFC	Sharekhan code: CHOLAFIN
Reco/View: Buy ↔	CMP: Rs. 745 / Price Target: Rs. 900 ↑

↑ 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 Oct 08, 2022

Medium Risk

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

Source: Morningstar

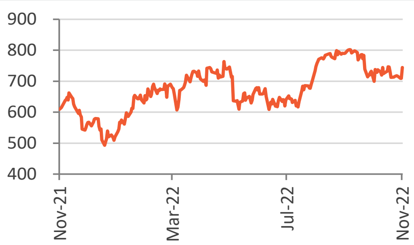
Company details

Market cap:	Rs. 61,185 cr
52-week high/low:	Rs. 818 / 470
NSE volume: (No of shares)	16.6 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.8 cr

Shareholding (%)

Promoters	51.5
FII	20.8
DII	21.9
Others	5.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.4	-0.3	-0.3	22.1
Relative to Sensex	5.5	-14.3	-4.7	22.8

Sharekhan Research, Bloomberg

Summary

- Cholamandalam Investment and Finance Company reported steady performance in Q2FY2023 in terms of AUM, disbursement growth, and asset quality. Gross Stage-2 and Stage-3 assets declined by ~129 bps QoQ to 9.9%, while GS3/NS3 improved by 32bps/22bps QoQ to 3.8%/2.2%, respectively. PCR on Stage-3 assets improved by ~78bps QoQ to ~42%.
- Its business AUM grew by 25% YoY/7% QoQ to Rs. 87,668 crore in Q2FY2023. Among key segments, vehicle finance book grew by 17% YoY/4% QoQ; Home Equity/ LAP grew by 22% YoY/4% QoQ, and Home Loans grew by 35% YoY/17% QoQ. Disbursements were also healthy at Rs. 14,623 crore and grew by 68% YoY/10% QoQ. New businesses in consumer, MSME, and SME ecosystem contributed 21% to the disbursement mix.
- NII grew by 17% YoY/1% QoQ. NIM contracted by ~35bps YoY and ~45bps QoQ in Q2FY2023, led by a sharp ~70bps QoQ increase in CoF. PPoP grew by 18% YoY/down 2% QoQ, driven by moderate NII growth offsetting higher opex.
- At the CMP, the stock trades at 4.3x and 3.6x its FY2023E and FY2024E ABV, respectively. We maintain Buy with a revised PT of Rs. 900.

Cholamandalam Investment Finance Company (CIFC) reported strong business momentum during Q2FY2023, leading to 25% YoY/7% QoQ AUM growth. However, NII growth was moderate at ~17% y-o-y /~1% q-o-q, despite healthy AUM growth as margins (NIMs) contracted by ~35bps YoY and ~45bps QoQ in Q2FY2023, led by a sharp ~70bps QoQ increase in CoF. Total operating expenses were up by 28% y-o-y and 14% q-o-q, which translated into PPoP growth of ~18% y-o-y and down by ~2% q-o-q. Provisions were down by 7% QoQ; however, they were higher by 376% YoY due to minimal provisions done in Q2FY2022, as accelerated provisions were already done in Q1FY2022 due to the second wave of Covid-19. However, provisions were still lower during the quarter. Thus, PAT reported at Rs. 563 crore was down 7% YoY/flat QoQ. Gross Stage-2 and Stage-3 assets declined by ~129bps QoQ to 9.9% during the quarter. GS3/NS3 improved by 32bps/22bps QoQ to 3.8%/2.2%, respectively, while PCR on Stage-3 assets improved by ~78bps QoQ to ~42%. GNPA and NNPA as per the Reserve Bank of India's (RBI) IRAC norms also declined by ~45bps each QoQ to 5.8% and 4.0%, respectively. The company carries management overlay of Rs. 528 crore (60 bps of AUM) as of September 2022.

Key positives

- Strong disbursement growth leading to heathy AUM growth
- Improvement in Gross stage-2 and stage-3 assets sequentially along with lower credit cost

Key negatives

- Higher opex growth (28% YoY/ 14% QoQ).
- Margin compression; however, it was on expected lines

Management Commentary

- New product mix, strong demand environment, and geographic diversification are driving strong disbursement growth and the company is likely to sustain the momentum going forward.
- Management has guided that the target is to maintain overall ROA of ~3.5% (pre-tax). The company continues to deliver that despite some NIM compression and higher opex offset by benign credit cost cycle. Opex is expected to be ~3% of average assets for FY2023E.

Our Call

Valuation – Maintain Buy rating on the stock with a revised PT of Rs. 900: We believe pristine asset quality has been the hallmark for the franchise. It is likely to deliver strong earnings growth, driven by healthy AUM growth and benign credit costs, translating into a sustainable RoE of 18-20%. Newer businesses in the consumer, MSME, and SME ecosystem are likely to improve the business momentum, contribute ~10% to the AUM mix by FY2024E, and further aid RoA improvement. We believe there would be some margin compression going ahead, as it has higher fixed rate book (i.e., vehicle finance book), but it has levers (AUM growth, opex growth, and credit costs) to deliver healthy return ratios going forward.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
NII	4,648	5,268	6,709	7,744
PAT	1,515	2,147	2,676	3,042
EPS	18.5	26.2	32.6	37.1
P/E (x)	40.3	28.5	22.8	20.1
P/BV (x)	6.4	5.2	4.3	3.6
RoE	17.1	20.2	20.6	19.4
RoA	2.2	2.7	2.8	3.0

Source: Company; Sharekhan estimates

Key result highlights

Strong disbursements: Total disbursements grew by 68% y-o-y and 10% q-o-q in Q2FY2023, led by strong demand environment. Vehicle finance disbursements were up 38% y-o-y and flat q-o-q. Disbursement trends were healthy in other segments also. Newer lines of businesses contributed 21% to the disbursement mix. The company reiterated that new product mix, strong demand environment, and geographic diversification are driving strong disbursement growth. The company is likely to sustain the momentum going forward.

Healthy AUM growth: Business AUM grew by 25% YoY/7% QoQ to Rs. 87,668 crore in Q2FY2023. Among key segments, the vehicle finance book grew by 17% YoY/4% QoQ; Home Equity/LAP grew by 22% YoY/4% QoQ; and Home Loans grew by 35% YoY/17% QoQ. October has been very strong in terms of vehicle finance. Higher AUM growth is expected to sustain in vehicle finance in H2FY2023 also. Focus is on retail customers, especially in smaller towns and rural areas. Company will continue to focus on this segment, in line with market trends. In the home loans segment, the company has significantly expanded its geographical footprint, especially in the North, East, and West Zones while continuing to deepen its footprint in the South.

Strong liquidity position: It continues to maintain liquidity of Rs. 6,573 crore (7.5% of AUM)

Asset quality stable: Gross Stage-2 and Stage-3 assets declined by ~129 bps QoQ to 9.9% during the quarter. GS3/NS3 improved by 32bps/22bps QoQ to 3.8%/2.2%, respectively, while PCR on Stage-3 assets improved by ~78bps QoQ to ~42%. GNPA and NNPA as per the RBI's IRAC norms also declined by ~45bps each QoQ to 5.8% and 4.0%, respectively. The company carries management overlay of Rs. 528 crore (60 bps of AUM) as of September 2022. Management does not see increasing management overlay provision and will not use it in the near term.

Margin lever: Improvement in yields would come from LAP and home loans (floating rate book) due to repricing of book . In the vehicle segment, the company would increase yields on fresh disbursements. In LAP, it has already taken a 40-bps increase in June, 40-bps in September, and 40-bps in November. Full impact would be seen in Q4FY2023.

Borrowing Mix: The company does not forsee any major change in the current borrowing mix in the near term. The company continues to remain dependent on banks largely for funding, followed by market borrowings.

Guidance: Management has guided that the target is to maintain overall ROA of ~3.5% (pre-tax); it continues to deliver that despite some NIM compression and higher opex offset by the benign credit cost cycle. Opex is expected to be ~3% of average assets for FY2023E.

Others: The company has been adding manpower in new business verticals in the existing vehicle finance branch, thus opex growth is inching higher and most of the collection activity is done in-house.

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY %	Q1FY23	QoQ %
Net Interest Income	**1,489**	**1,269**	**17%**	**1,481**	**1%**
Other income	209	124	68%	159	31%
Net Income	**1,697**	**1,393**	**22%**	**1,640**	**3%**
Opex	661	518	28%	580	14%
Operating Profit	**1,036**	**875**	**18%**	**1,060**	**-2%**
Provisions	278	58	376%	299	-7%
PAT	**563**	**607**	**-7%**	**566**	**-**

Source: Company, Sharekhan Research

Key Parameters Rs cr

Particulars	Q2FY22	Q1FY23	Q2FY23	YoY %	QoQ %
Disbursement	**8,706**	**13,329**	**14,623**	**68.0**	**9.7**
Total AUM	**70,023**	**81,925**	**87,668**	**25.2**	**7.0**
-Vehicle	49,285	55,376	57,606	16.9	4.0
-Home Equity	15,421	18,116	18,843	22.2	4.0
-Home Loans	4,765	5,497	6,454	35.4	17.4
-Others	552	2,936	4,765	763.2	62.3
NIM (Reported) (YTD)	7.7	8.0	7.8		
Tier I	16.7	16.3	15.8		
Tier II	3.0	2.9	2.6		
CAR (%)	19.6	19.2	18.4		
GNPA (%)	6.2	4.2	3.8		
NNPA (%)	3.9	2.5	2.2		
Provisioning Coverage	36.5	40.7	41.5		

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Strong outlook

The NBFC sector is witnessing an improved long-term outlook. Financial services companies are reporting incremental pick-up in credit demand, especially in retail and rural segments, post the unlocking of the economy. Leading indicators show recovery in economic activity, which will be positive. Auto volumes continue to see uptick. Increased MSPs, good monsoon season, and adequate water storage position are positive for the rural economy. Therefore, rural economy continues to be a bright spot at these times as well.

■ 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 and strong operating metrics, which underline its high pedigree among peers. The company's other lending activities include home equity, home loans, and MSME lending. We believe while the vehicle financing business will remain 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 aided by strong credit risk assessment framework will help it to drive growth. Newer businesses in consumer, MSME, and SME ecosystem are likely to improve the business momentum, contribute ~10% to the AUM mix by FY2024E, and further aid RoA improvement. CIFC is an attractive pick due to its demonstrated superior performance across economic cycles.

■ Valuation - Maintain Buy rating on the stock with a revised PT of Rs. 900

We believe pristine asset quality has been the hallmark for the franchise. It is likely to deliver strong earnings growth, driven by healthy AUM growth and benign credit costs, translating into a sustainable RoE of 18-20%. Newer businesses in the consumer, MSME, and SME ecosystem are likely to improve the business momentum, contribute ~10% to the AUM mix by FY2024E, and further aid RoA improvement. We believe there would be some margin compression going ahead, as it has higher fixed rate book (i.e., vehicle finance book), but it has levers (AUM growth, opex growth, and credit costs) to deliver healthy return ratios going forward.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Cholamandalam	745	61,185	22.8	20.1	4.3	3.6	20.6	19.4	2.8	3.0
M&M Finance	194	23,920	13.7	11.2	1.5	1.3	11.2	12.7	2.1	2.3

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.

Investment theme

CIFC is a leading vehicle financier expanding its presence into other segments. Business benefits from a strong parentage and rigorous risk management practices provide long-term visibility, while healthy capitalisation 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 great potential to be built into a solid portfolio considering the expertise of the company in handling typical customer profiles along with new consumer and SME business.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost

Additional Data

Key management personnel

Mr. Vellayan Subbiah	Chairman
Mr. Arul Selvan	CFO
Mr. Ravindra Kumar Kundu	ED

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	CHOLAMANDALAM FINANCE HO	45.39
2	AXIS ASSET MANAGEMENT CO LTD	4.96
3	AMBADI INVESTMENTS LTD	4.10
4	HDFC ASSET MANAGEMENT CO LTD	2.46
5	CAPITAL GROUP COS INC	2.14
6	SBI FUNDS MANAGEMENT LTD	2.05
7	VANGUARD GROUP INC	1.87
8	BLACKROCK INC	1.62
9	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO LTD	1.53
10	CANARA ROBECO ASSET MANAGEMENT CO LTD	1.19

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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