Stock Update

Result Update

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 30.81

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

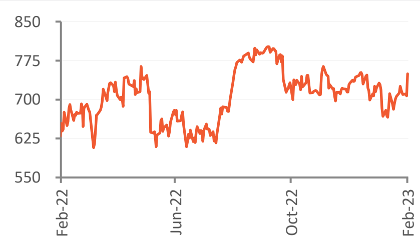
Company details

Market cap:	Rs. 61,625 cr
52-week high/low:	Rs. 818 / 594
NSE volume: (No of shares)	16.4 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.5 cr

Shareholding (%)

Promoters	51.5
FII	19.4
DII	21.2
Others	7.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.5	5.6	2.2	14.7
Relative to Sensex	4.8	6.1	-1.5	10.3

Sharekhan Research, Bloomberg

Cholamandalam Investment and Finance Company

Robust Q3, earnings beat driven by lower credit cost

NBFC	Sharekhan code: CHOLAFIN
Reco/View: Buy ↔	CMP: **Rs. 750** Price Target: **Rs. 900** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Cholamandalam Investment and Finance Company reported strong earnings growth of 31% y-o-y, led by a 36% y-o-y decline in provisions, significantly above consensus and our estimates. AUM growth also exceeded expectations with 31% y-o-y growth, about 3% higher than expectation, driven by strong disbursements growth of 68% y-o-y. New businesses segment – consumer and small business loans contributed 22% to the disbursement mix in Q3.
- NIM (calculated as a % of average AUM) was lower by 13 bps q-o-q at 6.5% on expected lines. On the positive side, Chola has significantly increased incremental lending rates in the vehicle finance book and the rest of the book is anyway floating rate book. However, we believe there would be further NIM pressure in the near term due to a higher share of floating rate liabilities and lower share of floating rate assets.
- Gross Stage-2 assets declined by ~115 bps q-o-q to 4.91%, while GS3/NS3 assets fell by 33bps/18bps q-o-q to 3.51%/2.07%, respectively. PCR on Stage-3 assets declined by ~52bps q-o-q to ~41%.
- At the CMP, the stock trades at 4.3x/3.6x/3.3x its FY2023E/FY2024E/FY2025E ABV estimates, respectively. We maintain Buy with an unchanged PT of Rs. 900.

Cholamandalam Investment Finance Company (CIFC) reported strong performance during Q3FY2023. Net interest income (NII) grew by ~17% y-o-y /~7% q-o-q, driven by strong AUM growth despite margin compression. NIM (calculated) contracted by ~13bps q-o-q at 6.5%. Core fee income grew by 46% y-o-y/16% q-o-q. Total operating expenses were up 41% y-o-y and 14% q-o-q, which translated into moderate operating profit growth of ~13% y-o-y/4% q-o-q. Provisions were down 36% y-o-y/43% q-o-q. PAT reported at Rs. 684 crore was higher by 31% y-o-y/21% q-o-q mainly due to lower credit cost. AUM grew by 31% y-o-y/13% q-o-q, led by strong disbursements growth at 68% y-o-y/20% q-o-q, driven by a strong demand environment. Vehicle book grew by 21% y-o-y/6% q-o-q; LAP book grew by 23% y-o-y/6% q-o-q and home loans grew by 39% y-o-y/13% q-o-q. Gross Stage-2 assets declined by ~115 bps q-o-q to 4.91%, while GS3/NS3 assets fell by 33bps/18bps q-o-q to 3.51%/2.07%. PCR on Stage-3 assets declined by ~52bps q-o-q to ~41%. GNPA and NNPA as per the Reserve Bank of India's (RBI) IRAC norms also declined by ~47bps/31bps q-o-q to 5.4% and 3.8%, respectively.

Key positives

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

Key negatives

- Higher opex growth (41% y-o-y/14% q-o-q).
- Margin compression, however, was on expected lines.

Management Commentary

- The company is confident of sustaining the strong business momentum and is guiding for 27-30% AUM growth in FY2023E.
- Delinquency in new business is lower compared to the industry level. The company has also guided that if the credit cost is incrementally higher going forward, then its impact would get offset by operating leverage due to moderation in opex. The company expects additional 40-50 bps rise in cost of funds from here on. However, management has guided that the target is to maintain overall RoA of ~3.5% (pre-tax).

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 900: The company is likely to deliver consistent sustainable RoE of 18-20%. NIM pressure is getting offset by strong acceleration in loan growth. Opex growth is expected to moderate in the medium term. Strong momentum is witnessed in the newer businesses segment and is expected to contribute ~10% to the total AUM mix by FY2024E. While this business is in a nascent stage with asset-quality performance untested, we take some comfort from the company's historic execution track record. We believe there would be some margin compression in the near term, as it has a higher fixed rate asset book (i.e., vehicle finance book) and has a lower share of fixed rate liabilities, but it has levers (AUM growth, opex growth, and credit costs) to deliver strong earnings growth and healthy return ratios going forward.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
NII	5,268	6,709	7,744	9,200
PAT	2,147	2,676	3,042	3,700
EPS (Rs.)	26.2	32.6	37.1	45.1
P/E (x)	28.6	23.0	20.2	16.5
P/BV (x)	5.3	4.3	3.6	3.3
RoE	20.2	19.4	19.4	20.2
RoA	2.7	2.8	3.0	2.7

Source: Company; Sharekhan estimates

Key result highlights

- **Strong momentum in disbursements:** Total disbursements grew by 68% y-o-y and 20% q-o-q in Q3FY2023, led by a strong demand environment. Vehicle finance disbursements were up 37% y-o-y and 23% q-o-q. Disbursement trends were healthy in other segments also. New lines of businesses contributed 22% to the disbursement mix. The company reiterated that the new product mix, strong demand environment, and geographic diversification are driving strong disbursement growth. The company is likely to sustain the momentum in the near term.
- **AUM growth ahead of expectation:** AUM growth exceeded expectations with 31% y-o-y growth, about 3% higher than expectation, driven by strong disbursements. Among key segments, the vehicle book grew by 21% y-o-y/ 6% q-o-q; LAP book grew by 23% y-o-y/6% q-o-q and home loans grew by 39% y-o-y/13% q-o-q. Strong demand in the vehicle finance segment is driven by robust replacement demand and strong uptick in infra projects. Higher AUM growth is expected to sustain in vehicle finance in the near to medium term. In the LAP & 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.
- **Higher opex growth:** Opex growth was higher due to – higher disbursement growth, investment in the new business segment, tech-led investment, geographical expansion, and manpower addition. The company guided that it should moderate in the near to medium term.
- **Strong liquidity position:** It continues to maintain liquidity of Rs. 7,396 crore vs. Rs. 6,573 crore q-o-q.
- **Asset quality stable:** Gross Stage-2 assets declined by ~115 bps q-o-q to 4.91%, while GS3/NS3 assets fell by 33bps/18bps q-o-q to 3.51%/2.07%, respectively. PCR on Stage-3 assets declined by ~52bps q-o-q to ~41%. GNPA and NNPA as per the RBI's IRAC norms also declined by ~47bps/31bps q-o-q to 5.4% and 3.8%, respectively.
- **Margin lever:** Improvement in yields would come from LAP, home loans, and new business segment (mostly floating rate book) due to repricing of the book. In the vehicle segment, the company would increase yields on fresh disbursements.
- **Borrowing mix:** The company does not foresee any major change in the current borrowing mix in the near term. However, the company would gradually increase securitization in the overall borrowing mix.
- **Guidance:** Delinquencies in the new business are lower compared to the industry level. The company also guided that if the credit cost is incrementally higher going forward, then its impact would get offset by operating leverage due to moderation in opex. The company expects additional 40-50 bps rise in cost of funds from here on. However, management has guided that the target is to maintain overall RoA of ~3.5% (pre-tax).

Result table (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY	Q2FY23	QoQ
Net Interest Income	**1598**	**1363**	**17%**	**1,489**	**7%**
Fee and Other Income	233	121	93%	209	12%
Net Total Income	**1832**	**1484**	**23%**	**1,697**	**8%**
Opex	752	532	41%	661	14%
Operating Profit	**1080**	**953**	**13%**	**1,036**	**4%**
Provisions	159	248	-36%	278	-43%
PBT	**921**	**704**	**31%**	**758**	**21%**
Tax	237	181	31%	195	21%
PAT	**684**	**524**	**31%**	**563**	**21%**

Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Strong outlook

Credit demand continues to remain robust, driven by a strong demand environment. Mortgages and auto volumes continue to see uptick. Urban demand has been robust and has recovered fully from pandemic-induced disruptions. There are some green shoots related to improvement in rural demand. Asset-quality trends are improving. NBFCs with a diverse product offering strategy, strong ALM management, robust liquidity buffers, strong risk management framework, and healthy liability franchise have ample growth opportunities and are well placed. However, there could be some margin pressure due to increased cost of funding for NBFCs.

Company Outlook – Attractive franchise

CIFC is an attractive franchise due to its demonstrated superior performance across economic cycles. A robust collection mechanism aided by a strong credit risk assessment framework will help it to navigate future cycles also. Newer businesses in the consumer, MSME, and SME ecosystem are likely to improve the business momentum and contribute ~10% to the AUM mix by FY2024E. Pristine asset quality has been the hallmark of the franchise. It is likely to deliver consistent sustainable RoE of 18-20%. We are confident about the longevity of the franchise and best-in-class management in terms of execution capabilities and strong governance.

Valuation – Maintain Buy rating on the stock with an unchanged PT of Rs. 900

The company is likely to deliver consistent sustainable RoE of 18-20%. NIM pressure is getting offset by strong acceleration in loan growth. Opex growth is expected to moderate in the medium term. Strong momentum is witnessed in the newer businesses segment and is expected to contribute ~10% to the total AUM mix by FY2024E. While this business is in a nascent stage with asset-quality performance untested, we take some comfort from the company's historic execution track record. We believe there would be some margin compression in the near term, as it has a higher fixed rate asset book (i.e., vehicle finance book) and has a lower share of fixed rate liabilities, but it has levers (AUM growth, opex growth, and credit costs) to deliver strong earnings growth and 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	750	61,625	23.0	20.2	4.3	3.6	19.4	19.4	2.8	3.0
M&M Finance	234	28,862	16.2	13.8	1.8	1.6	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. Strong parentage and rigorous risk-management practices provide comfort, 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. Higher-than-expected margin compression.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	CHOLAMANDALAM FINANCIAL HO	45.37
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.	2.09
6	VANGUARD GROUP INC.	1.63
7	BLACKROCK INC.	1.60
8	SBI FUNDS MANAGEMENT LTD.	1.53
9	ADITYA BIRLA SUN LIFE ASSET MANAGEMENT CO. LTD.	1.36
10	CANARA ROBECO ASSET MANAGEMENT CO. LTD.	1.22

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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