Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Cholamandalam Investment and Finance Company

On a strong growth path

Stock Update | Company Update

NBFC	Sharekhan code: CHOLAFIN
Reco/View: Buy ↔	CMP: Rs. 1,132 / Price Target: Rs. 1,350 ↑

↑ 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 24.83

Updated Jun 8, 2023

Medium Risk

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

Source: Morningstar

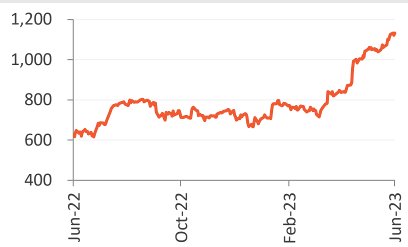
Company details

Market cap:	Rs. 93,062 cr
52-week high/low:	Rs. 1155 / 612
NSE volume: (No of shares)	16 lakh
BSE code:	511243
NSE code:	CHO4LAFIN
Free float: (No of shares)	39.5 cr

Shareholding (%)

Promoters	51.5
FII	19.6
DII	21.5
Others	7.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.0	51.1	54.5	82.0
Relative to Sensex	5.6	41.5	52.2	59.7

Sharekhan Research, Bloomberg

Summary

- We continue to see strong outperformance in Cholamandalam Finance, led by a robust show put up by existing businesses, while new businesses get scaled up. The company has guided for a 20-25% AUM growth in FY2024E, with the new businesses and home loans growing faster than the vehicle finance business.
- The company expects an additional 30-40 bps rise in cost of funds vs Q4FY23, however it would be fully offset by incrementally higher disbursement yields. Thus, the management endeavors to maintain NIMs at FY23 exit levels.
- We believe that the margin trajectory could surprise positively offsetting marginally higher COF led by higher yields on new fixed rate vehicle loans, mix shift to used/high-yielding vehicles from new HCVs funding and increase share of high-yielding small business loans.
- At CMP, the stock trades at 5.5x/5.0x its FY2024E/FY2025E ABV, respectively. We reiterate Buy with a revised PT of Rs. 1,350.

Cholamandalam Finance remains bullish on growth in the medium term as it does not have a high market share in some of the business segments and tier-II and -III cities are growing faster. Management has guided for 20-25% AUM growth in FY2024E, with new businesses and home loans growing at a faster pace than the vehicle finance business. Thus, the company expects its loan mix to be – vehicle at ~50% versus 63% currently, LAP and Home loans at 30-35%, and new product lines at ~15% by FY2026 vs 9% currently. New business segments are only served through 25% of vehicle finance branches. Thus, medium-term growth will be driven by market share gains in new businesses and home loans, besides incremental growth in tier-II and III cities. Overall, asset-quality outlook remains stable to positive.

- **Growth outlook stays positive:** New product lines are contributing 20-25% to the disbursement mix. New product volume, strong demand environment, deeper penetration and geographic diversification is driving robust disbursement growth. The company is confident of sustaining healthy momentum; however, growth would moderate to an extent after the strong rebound in FY2023. The management has guided for 20-25% AUM growth in FY2024E, with the new businesses and home loans growing at a faster pace than the vehicle finance business. Thus, it expects its loan mix to be – vehicle at ~50% versus 63% currently, LAP and Home loans at 30-35%, and new product lines at ~15% by FY2026 vs 9% currently.
- **Stable asset quality outlook:** New businesses are still in a nascent stage, with asset-quality performance untested; however, we take some comfort from the company's historic execution track record. In the past business cycles, the company has performed well, which provides comfort in the quality of its high growth. Currently, delinquencies in the new business segment (consumer and SME loans) are lower compared to the industry's level. The company guided that if the credit cost is incrementally higher in the new segment going forward, then its impact would get offset by moderation in opex growth, as investments in the new business would reduce gradually. Overall, asset quality outlook remains stable to positive in Vehicle, Home loans & loan against property (LAP) segment.
- **NIM outlook stable:** The company expects an additional 30-40 bps rise in cost of funds vs Q4FY23, however it would be fully offset by incrementally higher disbursement yields. Thus, management endeavors to maintain NIMs at FY23 exit levels. We believe that the margin trajectory could surprise positively offsetting marginally higher COF led by higher yields on new fixed-rate vehicle loans, mix shift to used/high-yielding vehicles from new HCVs funding and increase share of high yielding small business loans.

Our Call

Valuation: We maintain Buy on Cholamandalam with a revised PT of Rs. 1,350: Cholamandalam wany is likely to deliver a sustainable RoE of 18-20%. Strong AUM growth, stable margin outlook, moderation in opex growth, and lower credit cost should translate into a healthy earnings trajectory going ahead. The new business is still in a nascent stage, with asset-quality performance untested; however, we take some comfort from the company's historic execution track record. In the past business cycles, the company has performed well, which provides comfort in the quality of its high growth. The company has stated that its current focus is on strong collections and superior underwriting in the new business. An equity fund-raising in FY24 would be an additional catalyst.

Key Risks

Economic slowdown leading to slower AUM growth, higher-than-anticipated credit cost.

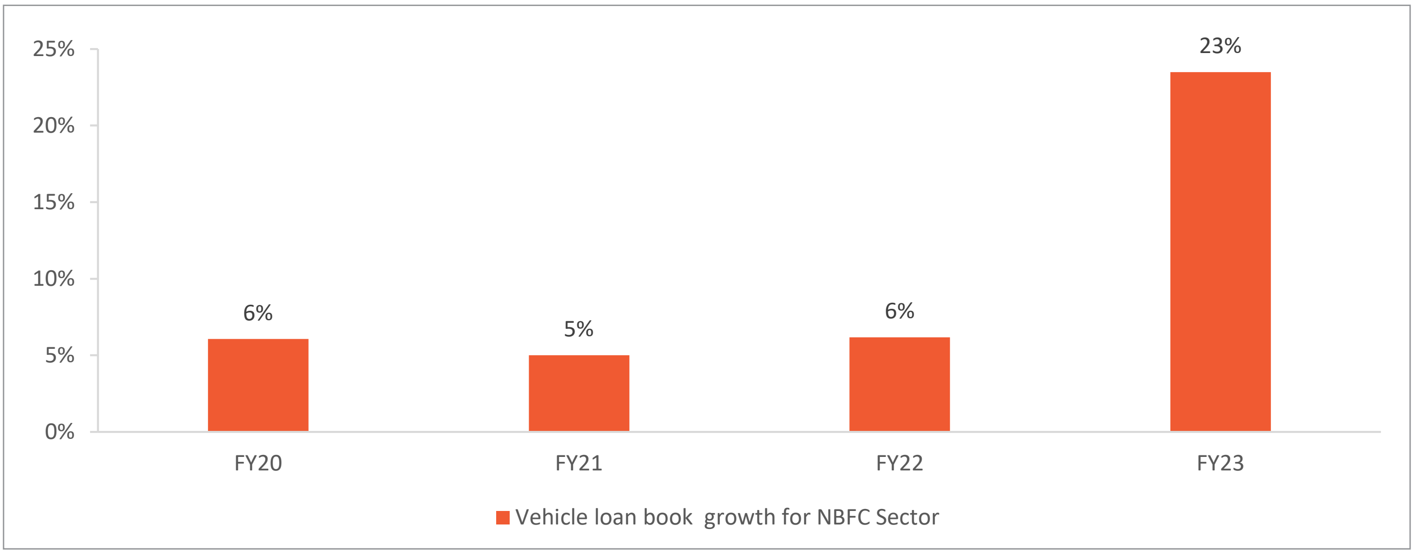
Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
NII	5,268	6,333	7.744	9,200
PAT	2,147	2,666	3,042	3,700
EPS (Rs.)	26.1	32.4	37.1	45.1
P/E (x)	43.2	34.8	30.4	25.0
P/BV (x)	7.9	6.5	5.5	5.0
RoE	20.2	20.6	19.4	20.2
RoA	2.7	2.8	3.0	2.7

Source: Company; Sharekhan estimates

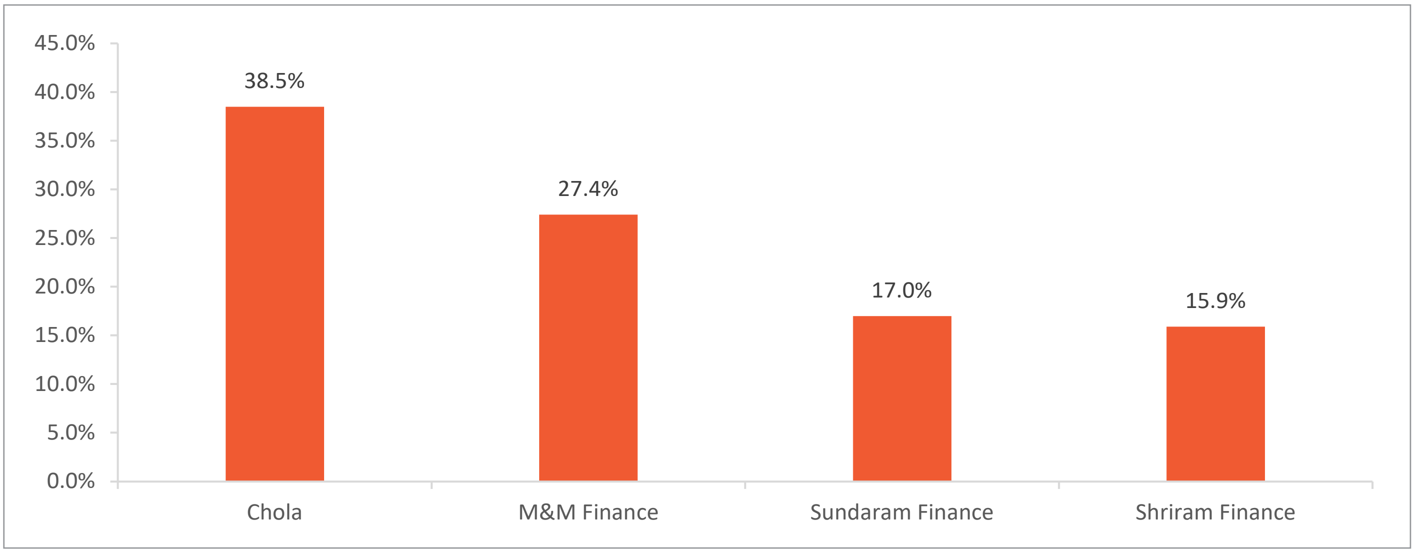
Vehicle financing segment best placed in lower interest rate cycle: The total vehicle financing loan book for the NBFC sector grew by 23% in FY23 vs 10% CAGR in FY19-23 led by strong volume demand driven by improved industrial activity, steady agricultural output, the government's focus on infrastructure, growing rural demand and increasing penetration in Tier 3 and 4 towns is expected to aid further growth. Healthy momentum is likely to sustain. However, growth could moderate to an extent after the strong rebound in FY2023. Interest rate cycle is close to its peak and this could act as tailwind for improvement in margins as Vehicle financing book is a fixed-rate book and a high yielding book. During the lower interest rate regime, liabilities gets repriced lower gradually, but the asset yield remains unchanged due to its fixed nature which helps vehicle financiers to boost NIMs. Overall, the asset quality outlook is also expected to be stable for the Vehicle Financier.

Trend in Vehicle Financing AUM growth for NBFC Sector



Source: Company, Sharekhan Research

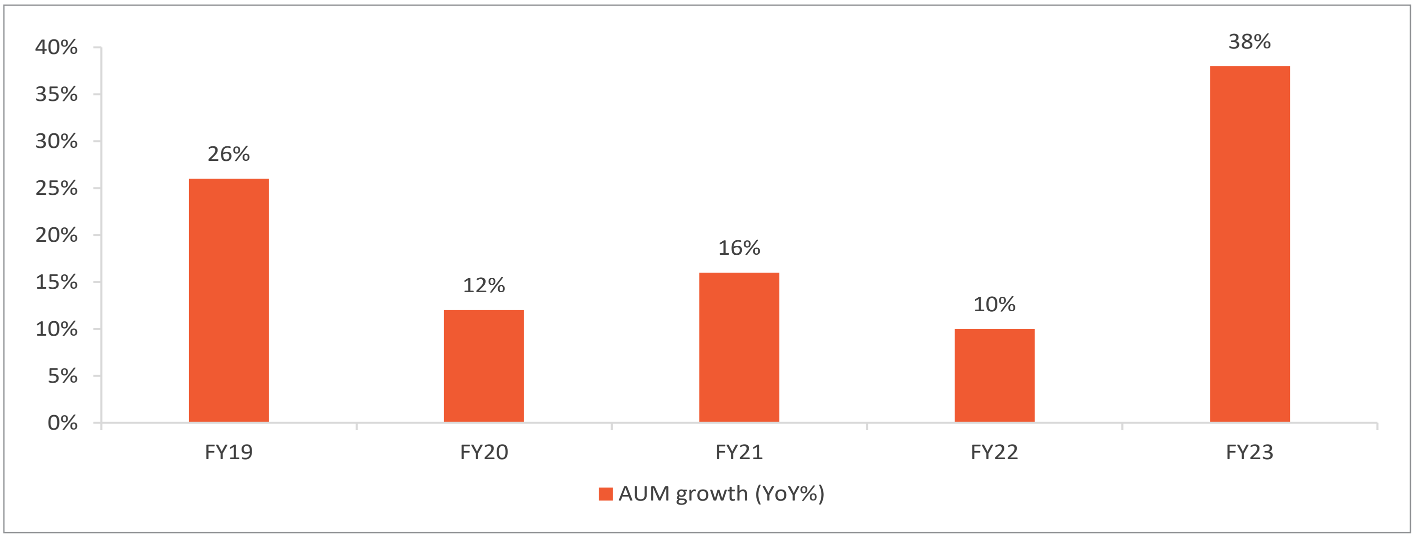
AUM Growth- Chola clearly outperforming the peers in FY23



Source: Company, Sharekhan Research

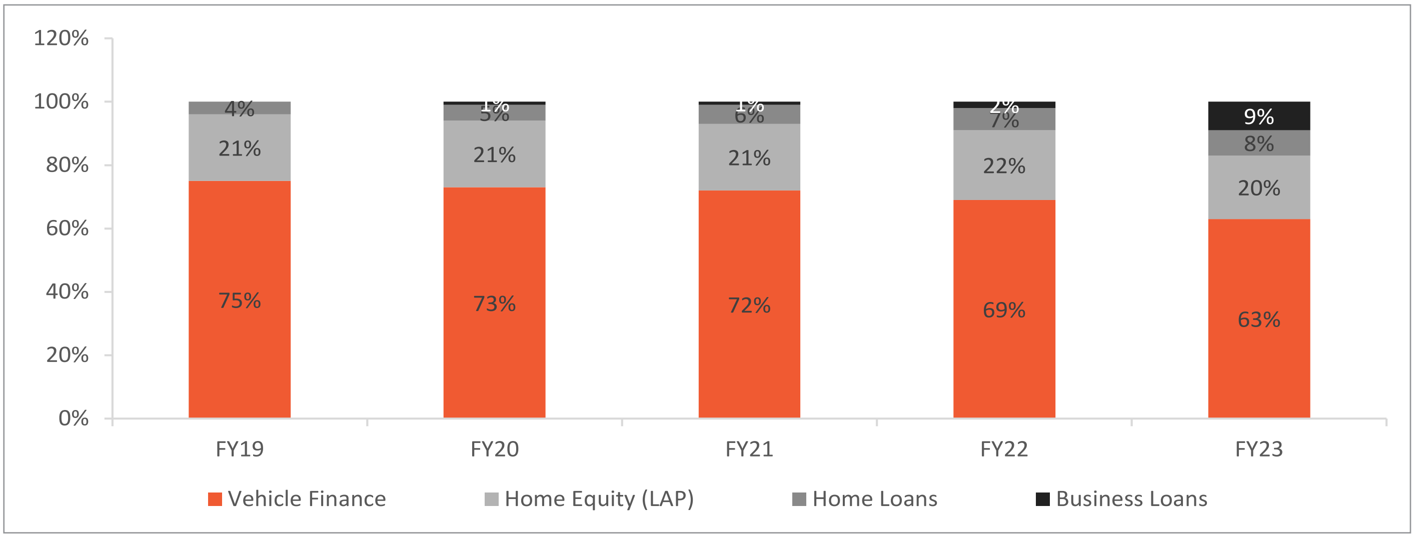
Growth outlook remains bullish for Chola despite moderation due to high base: New product lines are contributing 20-25% to the disbursement mix. New product volume, strong demand environment, deeper penetration and geographic diversification is driving robust disbursement growth. The company is confident of sustaining healthy momentum; however, growth would moderate to an extent after the strong rebound in FY2023. The management has guided for 20-25% AUM growth in FY2024E, with the new businesses and home loans growing at a faster pace than the vehicle finance business. Thus, it expects its loan mix to be – vehicle at ~50% versus 63% currently, LAP and Home loans at 30-35%, and new product lines at ~15% by FY2026 vs 9% currently.

Trend in AUM growth



Source: Company, Sharekhan Research

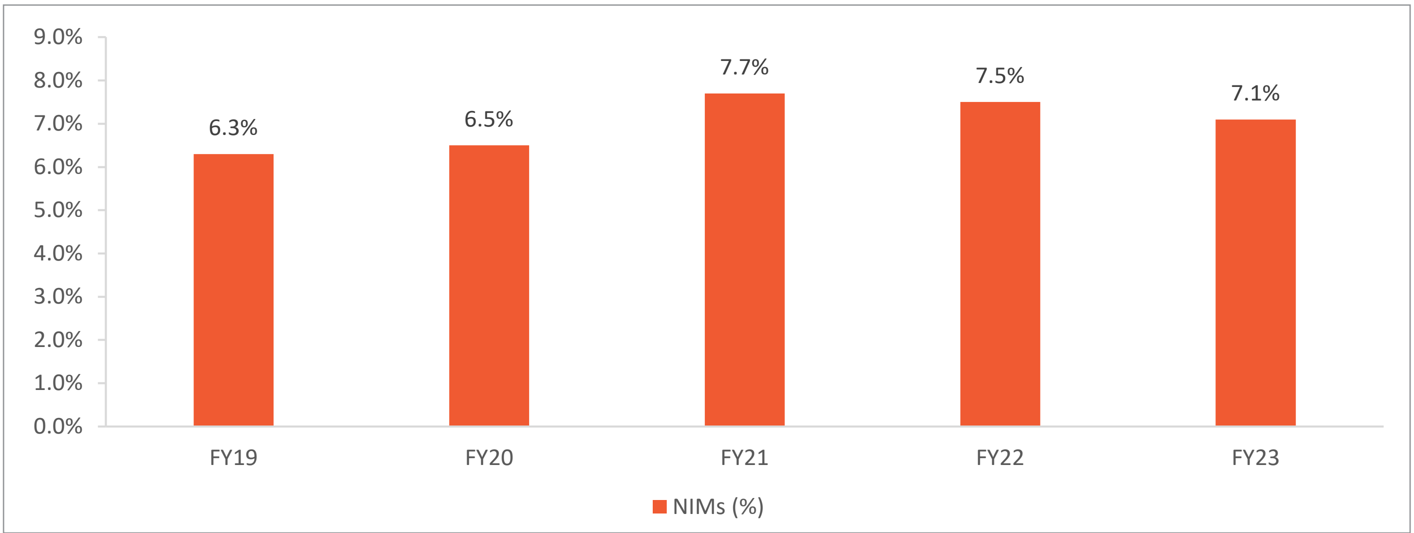
Trend in AUM Mix



Source: Company, Sharekhan Research

Margins outlook stable: The company expects an additional 30-40 bps rise in cost of funds vs Q4FY23, however it would be fully offset by incrementally higher disbursement yields. Thus, management endeavors to maintain NIMs at FY23 exit levels. We believe that the margin trajectory could surprise positively offsetting marginally higher COF led by higher yields on new fixed-rate vehicle loans, mix shift to used/high-yielding vehicles from new HCVs funding and increase share of high yielding small business loans.

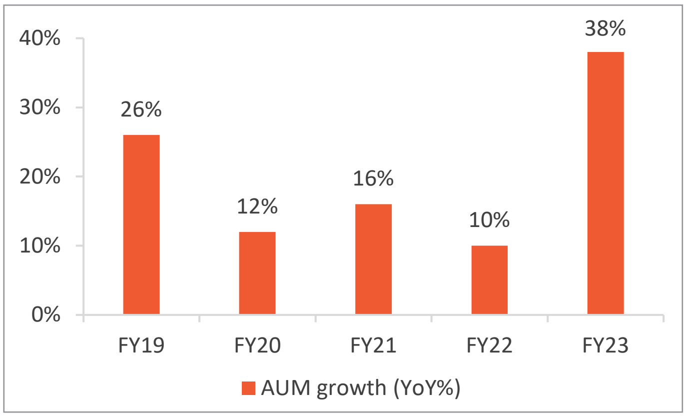
Trend in NIMs



Source: Company, Sharekhan Research

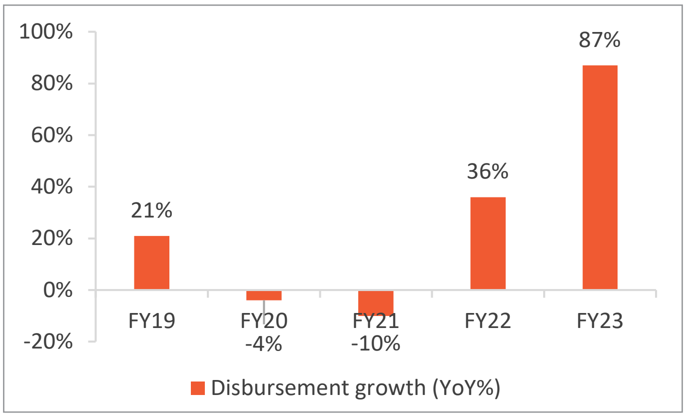
Financials in charts

Trend in AUM growth



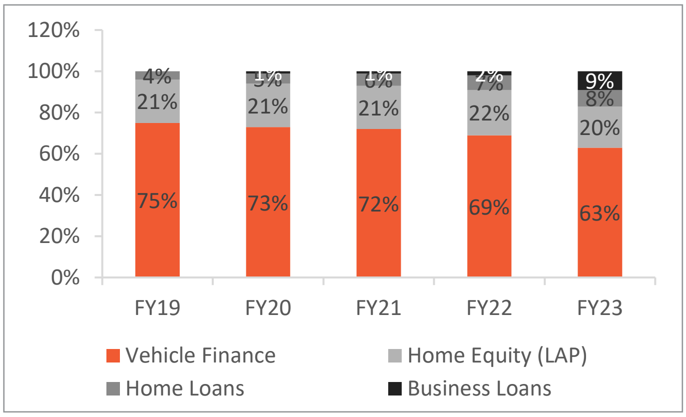
Source: Company, Sharekhan Research

Trend in Disbursement growth



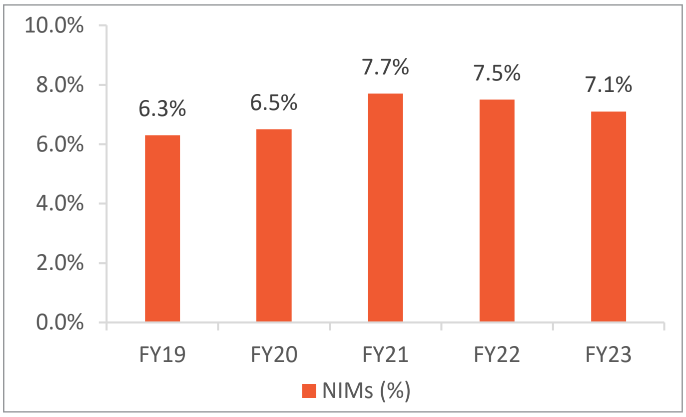
Source: Company, Sharekhan Research

Trend in AUM Mix



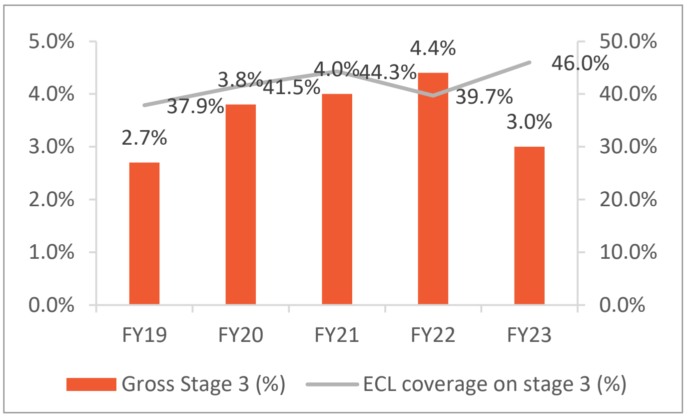
Source: Company, Sharekhan Research

Trend in NIMs



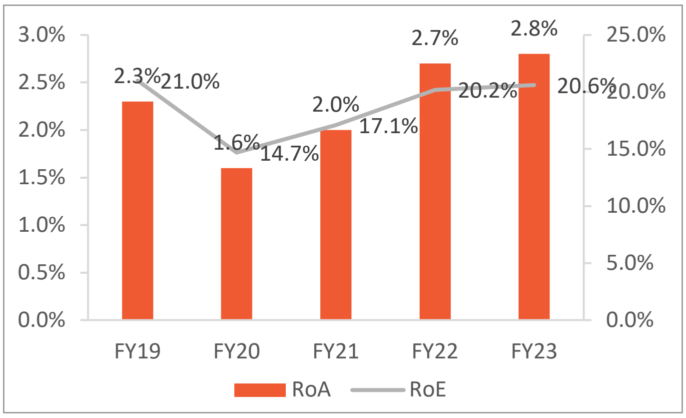
Source: Company, Sharekhan Research

Trend in Gross stage 3 assets



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Steady outlook

Retail credit demand remains robust, driven by strong demand. Mortgages and automobile volumes continue to see an uptick. Urban demand has been robust and has recovered fully from pandemic-induced disruptions. There are some green shoots related to an 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 a healthy liability franchise have ample growth opportunities and are well placed. The interest rate cycle is close to its peak and would act as a tailwind.

■ Company outlook - Attractive franchise

CIFC is an attractive franchise as it has demonstrated superior performance across economic cycles. A robust collection mechanism aided by a strong credit risk assessment framework has helped it to navigate past business cycles and would help it navigate in the future also. Newer businesses in the consumer, MSME, and SME ecosystems are likely to improve growth momentum and contribute ~15% to the AUM mix by FY2026E. Pristine asset quality has been the hallmark of the franchise. It is likely to deliver a consistently 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 - We maintain Buy on Cholamandalam with a revised PT of Rs. 1,350

Cholamandalam Finance is likely to sustain rich valuations on account of higher growth potential and steady return ratios. The company is likely to deliver a sustainable RoE of 18-20%. Strong AUM growth, stable margin outlook, moderation in opex growth, and lower credit cost should translate into a healthy earnings trajectory going ahead. The new business is still in a nascent stage, with asset-quality performance untested; however, we take some comfort from the company's historic execution track record. In the past business cycles, the company has performed well, which provides comfort in the quality of its high growth. The company has stated that its current focus is on strong collections and superior underwriting in the new business. An equity fund-raising in FY24 would be an additional catalyst.

Peer Comparison

Companies	CMP (Rs/ Share)	MCAP (Rs Cr)	P/E (x)		P/BV (x)		RoA (%)		RoE (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Cholamandalam Investment and Finance Company	1,132	93,062	30.4	25.0	5.5	5.0	3.0	2.7	19.4	20.2
Mahindra & Mahindra Finance	326	40,217	13.6	12.2	2.1	1.8	2.3	2.3	12.7	12.7

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, consumer loans, SME loans, wealth management, stock broking, and a variety of other financial services to customers.

Investment theme

CIFC is a leading vehicle financier diversifying its product segment. A strong collection mechanism and rigorous risk-management practices provide comfort, reflected in pristine asset quality. 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. The home loans segment 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 can lead to slower loan growth and higher-than-anticipated credit cost.

Additional Data

Key management personnel

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	CHOLAMANDALAM FINANCIAL HO	45.36
2	AXIS ASSET MANAGEMENT CO. LTD.	4.86
3	AMBADI INVESTMENTS LTD.	4.10
4	HDFC ASSET MANAGEMENT CO. LTD.	2.41
5	VANGUARD GROUP INC.	1.91
6	BLACKROCK INC.	1.70
7	SBI FUNDS MANAGEMENT LTD.	1.69
8	CAPITAL GROUP COS INC.	1.58
9	NORGES BANK	1.28
10	ADITYA BIRLA SUN LIFE 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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