Sharekhan by BNP PARIBAS

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Cholamandalam Investment and Finance Company

Earnings weaker than expectations despite strong growth

NBFC	Sharekhan code: CHOLAFIN
Reco/View: Buy ⇔	CMP: Rs. 1,100 / 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 24.72

Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

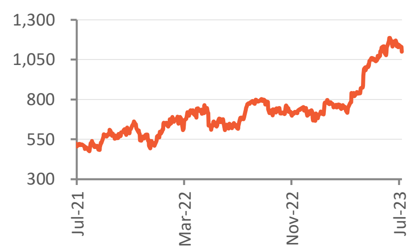
Company details

Market cap:	Rs. 90,425 cr
52-week high/low:	Rs. 1215 / 658
NSE volume: (No of shares)	16.5 lakh
BSE code:	511243
NSE code:	CHOLAFIN
Free float: (No of shares)	39.5 cr

Shareholding (%)

Promoters	51.5
FII	20.9
DII	20.4
Others	7.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.7	25.7	41.9	47.3
Relative to Sensex	-4.6	18.5	32.2	34.1

Sharekhan Research, Bloomberg

Summary

- Cholamandalam Investment and Finance Company (CIFC) reported PAT at Rs. 726 crore (up 28% y-o-y/down 15% q-o-q), below our estimates, mainly led by lower-than-expected NIM (down ~26 bps q-o-q at ~6.3% based on our calulations) and higher credit cost (at 126 bps annualised vs. estimate of 75 bps). Core PBT grew by 25% y-o-y/down 17% q-o-q.
- However, strong performance across its existing product lines and scaling up of the new business segment resulted in robust AUM growth of 42% y-o-y/9% q-o-q. Disbursements grew by 50% y-o-y/down 5% q-o-q. The new business segment – consumer, SME, and small business loans – contributed 23% to the disbursement mix in Q1.
- Headline asset-quality trends were broadly stable, with GS3/NS3 assets at 3.06%/1.67% vs. 3.01%/1.62% q-o-q. PCR on Stage-3 assets also remained stable q-o-q at ~45%; however, in absolute terms, GS2 and GS3 assets grew by 3% and 10% q-o-q, respectively, due to seasonality.
- The near-term outlook remains positive except for cost of funds. At the CMP, the stock trades at 4.5x/4.1x its FY2024E/FY2025E ABV estimates. We maintain our Buy rating with an unchanged PT of Rs. 1,350.

Cholamandalam Investment Finance Company (CIFC) reported weak performance despite strong growth in Q1FY2024. Net interest income (NII) grew at a slower pace, up ~24% y-o-y/~4% q-o-q despite strong AUM growth, as margins were under pressure due to the increase in cost of funds partly offset by higher disbursements yield. NIM (calculated) was at 6.3% vs. 6.5% q-o-q. Core fee income grew by 37% y-o-y/down 8% q-o-q. Total operating expenses grew by 36% y-o-y/flat q-o-q. Operating profit grew by 26% y-o-y/5% q-o-q. Total credit cost was at 126 bps annualised vs. 42 bps q-o-q and 141 bps y-o-y. Higher standard asset provisioning in the new business segment led to higher credit cost. Core PBT, excluding net gain on fair value change, grew by 25% y-o-y/down 17%. AUM grew by 42% y-o-y/9% q-o-q, led by robust disbursements growth capitalising on strong demand trends. Vehicle book grew by 28% y-o-y/6% q-o-q; LAP book grew by 29% y-o-y/6% q-o-q, while home loans grew by 60% y-o-y/13% q-o-q. The new business segment grew by 150% y-o-y/22% q-o-q on a low base. Headline asset-quality trends were broadly stable, with GS3/NS3 assets at 3.06%/1.67% vs. 3.01%/1.62% q-o-q. PCR on Stage-3 assets also remained stable q-o-q at ~45%; however, in absolute terms, GS2 and GS3 assets grew by 3% and 10% q-o-q, respectively, due to seasonality.

Key positives

- Robust business growth across product lines.
- Opex growth contained (flat q-o-q).
- Asset quality remained broadly stable.

Key negatives

- NIMs compression was higher than expected.
- Credit cost was higher, mainly led by rise in standard asset provisioning in the new business segment.

Management Commentary

- The company is confident of sustaining strong business momentum by penetrating deeper into geographies. Management also guided that it is cautious in some of the micro-market geographies in small, secured business loans/unsecured loans due to higher lending; but, the overall view remains optimistic for the new business segment and would continue to grow at a healthy pace for the company.
- Delinquencies in the new business segment (consumer and SME loans) increased on expected lines but were lower than the industry. Overall, credit cost was higher, mainly led by higher standard asset provisioning in the new business segment. Total credit cost is expected at ~1% or below for FY2024.
- NIMs were under pressure, as liabilities were repriced at higher rates, which led to increased cost of funding, partly offset by incrementally higher disbursement yields on the fixed book. The increase in marginal cost of funding is largely done. NIMs are expected to improve gradually.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 1,350

CIFC is likely to sustain its rich valuations on account of higher growth potential and steady return ratios. The company is likely to deliver a consistently sustainable RoE of 18-20%. Healthy AUM growth, bottoming-out of margins in the coming quarters, 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.

Key Risks

Economic slowdown can result in slower loan growth and higher-than-anticipated credit cost; and lower-than-expected margins.

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)	35.2	28.2	24.8	20.5
P/BV (x)	6.5	5.3	4.5	4.1
RoE	20.2	20.6	19.4	20.2
RoA	2.7	2.8	3.0	2.7

Source: Company; Sharekhan estimates

Key result highlights

- **Strong business momentum:** Total disbursements grew by 50% y-o-y/down 5% q-o-q in Q1FY2024. Vehicle finance disbursements were up 32% y-o-y. LAP and home loans disbursements grew by 32% y-o-y and 138% y-o-y, respectively. New product lines contributed 23% to the disbursement mix. AUM grew by 42% y-o-y/9% q-o-q, led by strong disbursements growth capitalising on robust demand trends. Vehicle book grew by 28% y-o-y/6% q-o-q; LAP book grew by 29% y-o-y/6% q-o-q, while home loans increased by 60% y-o-y/13% q-o-q. The new business segment grew by 150% y-o-y/22% q-o-q on a low base. The company reiterated that the new product line, strong demand environment, deeper penetration into the existing geography, and geographic diversification are driving robust disbursement growth. The company is confident of sustaining strong business momentum by penetrating deeper into geographies. Management also guided that it is cautious in some of the micro-market geographies in small, secured business loans/unsecured loans due to higher lending, but the overall view remains optimistic for the new business segment and would continue to grow at a healthy pace for the company.
- **Margin outlook:** NII grew at a slower pace, up ~24% y-o-y/~4% q-o-q, despite strong AUM growth as margins were under pressure due to increased cost of funds partly offset by higher disbursements yield. NIMs (calculated) were at 6.3% vs. 6.5% q-o-q. Management believes the increase in marginal cost of funding is largely done. NIMs are expected to improve gradually, led by higher disbursements yield in the fixed book. We believe NIMs would continue to be lower in at least the next two quarters, as liabilities get repriced at higher rates, partly offset by increased disbursements yield in the fixed book.
- **Opex growth moderated:** Opex growth moderated during the quarter despite higher disbursement growth and continued investments in the new business segment, which was a key positive. Opex to average assets was reported at 2.7% during the quarter vs. 2.9% in the last quarter.
- **Asset quality stable:** Headline asset-quality trends were broadly stable, with GS3/NS3 assets at 3.06%/1.67% vs. 3.01%/1.62% q-o-q. PCR on Stage-3 assets also remained stable q-o-q at ~45%; however, in absolute terms, GS2 and GS3 assets grew by 3% and 10% q-o-q, respectively, due to seasonality.
- **Credit cost guidance:** Total credit cost was at 126 bps annualised vs. 42 bps q-o-q and 141 bps y-o-y. Higher standard asset provisioning in the new business segment led to increased credit cost. Delinquencies in the new business segment (consumer and SME loans) increased on expected lines but were lower than the industry. Total credit cost is expected at ~1% or below for FY2024.
- **Capital raising:** The board has approved a proposal for equity capital raising worth Rs. 4,000 crore by way of QIP. Currently, the capital adequacy ratio is at 17.44%. Tier-I capital is at 15.14% and Tier-II Capital is at 2.30%.

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	Y-o-Y %	Q4FY23	Q-o-Q %
Net Interest Income	**1,842**	**1,481**	**24%**	**1,765**	**4%**
Fee and Other Income	284	159	79%	295	-4%
Net Total Income	**2,127**	**1,640**	**30%**	**2,060**	**3%**
Opex	787	580	36%	787	0%
Operating Profit	**1,340**	**1,060**	**26%**	**1,273**	**5%**
Provisions	372	299	25%	114	227%
PBT	**968**	**762**	**27%**	**1,159**	**-17%**
Tax	242	196	23%	306	-21%
PAT	**726**	**566**	**28%**	**853**	**-15%**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Growth looks encouraging

The growing importance of NBFCs is reflected in the consistent rise of their credit as a proportion to GDP as well as in relation to credit extended by SCBs to the NBFC sector. Retail credit demand continues to remain robust, driven by strong macro tailwinds. Volumes continue to see an uptick. Urban demand has been strong and recovered fully from pandemic-induced disruptions. There are some green shoots related to improvement in rural demand. Asset-quality trends are encouraging. NBFCs with a diverse product offering strategy, strong asset-liability management, robust liquidity buffers, strong risk management framework, and healthy liability franchise have ample growth opportunities and are well placed.

■ Company Outlook – Attractive franchise

CIFC has a strong business model, as demonstrated by 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 enable it to navigate in the future also. Pristine asset quality has been the hallmark of the franchise. The company 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. The company is confident of sustaining strong business momentum by penetrating deeper into geographies.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 1,350

CIFC is likely to sustain its rich valuations on account of higher growth potential and steady return ratios. The company is likely to deliver a consistently sustainable RoE of 18-20%. Healthy AUM growth, bottoming-out of margins in the coming quarters, 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.

Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Cholamandalam	1,100	90,425	24.8	20.5	4.5	4.1	19.4	20.2	3.0	2.7
M&M Finance	293	36,232	12.1	10.9	1.9	1.6	12.7	12.7	2.3	2.3

Source: Company, Sharekhan estimates

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 segments. 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 result in slower loan growth and higher-than-anticipated credit cost; and lower-than-expected margins.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	CHOLAMANDALAM FINANCIAL HOLDINGS	45.35
2	AXIS ASSET MANAGEMENT CO. LTD.	4.95
3	AMBADI INVESTMENTS LTD.	4.10
4	HDFC ASSET MANAGEMENT CO. LTD.	2.05
5	BLACKROCK INC.	1.77
6	VANGUARD GROUP INC.	1.65
7	SBI FUNDS MANAGEMENT LTD.	1.64
8	CAPITAL GROUP COS INC.	1.58
9	NORGES BANK	1.27
10	CANARA ROBECO ASSET MANAGEMENT CO. LTD.	1.14

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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