MOTILAL OSWAL

19 March 2021

Update | Sector: Financials - NBFC

Cholamandalam Inv & Fin

BSE SENSEX	S&P CNX
49,858	14,744

CMP: INR553 **TP: INR640 (+16%)** **Buy**

The momentum continues

Growth trajectory healthy; asset quality performance impressive

- **Contrary to our expectations, CIFC has seen a quick turnaround in terms of both growth and asset quality. Disbursement performance has been superior v/s peers, while collection efficiency (CE) has consistently been 100%+ for the past few months. Macro indicators, such as e-way bills, also point to a strong recovery.**
- **The company's strategy to focus less on low-yielding products (such as HCV Financing) compared with high-yielding ones (such as Tractor Finance) has been fruitful. With the cost of funds continuing to decline, coupled with the trimming of excess balance sheet liquidity, margins are poised to expand further going forward.**
- **Over the past five years, CIFC's AUM has grown at a 19% CAGR, while RoE has improved from 16% to 20% (adjusted for one-off COVID provisions in FY20). The company is well-diversified across product segments as well as geographies. Asset quality is the best among peers under our coverage. The impact of COVID-19 is now behind us, and the provisions made by the company would suffice for any reasonable increase in GNPLs. While the stock has re-rated over the past few months, it trades close to its five-year average. Given CIFC's strong RoE and growth potential, we believe there is scope for a further re-rating. Buy, with TP of INR640 (3.6x FY23E BVPS).**

Growth back at pre-COVID levels

Compared with peers, CIFC was the quickest to get back on its feet in terms of disbursements post the pandemic. **Despite the washout in the first quarter, disbursements were down only 25% YoY in 9MFY21 (in the Vehicle Finance segment) vis-à-vis 45–50% for peers.** With OEM sales continuing to recover in 4QFY21, coupled with the low base effect, the company would continue to deliver above-average disbursement growth over the foreseeable future. While we expect AUM growth to decline to 10% YoY in FY22 (due to a higher repayment rate), it should improve to the mid-teen levels FY23 onwards.

Product diversification margin-accretive

A clear strategy the company has followed, even before the COVID outbreak, is to diversify away from the new HCV Financing segment (given elevated competition from banks and low yields) and to other segments such as Used CVs and Tractors. **The share of HCVs in the AUM mix has declined from ~20% to 10% over the past two years, while that in disbursements has declined from ~15% to 2–3% over this period.** While this has led to slower growth for CIFC, it has helped improve overall yields and return ratios. On the other hand, it has become a meaningful player in Tractor Financing. **With disbursements more than doubling over the past three years, CIFC's disbursements in 9MFY21 were 15–20% below that of MMFS and ~30% below that of LTFH.** Note that yields in Tractor Finance are 500–600bp higher than in HCV Finance.

Chola
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Stock Info

Bloomberg	CIFC IN
Equity Shares (m)	820
M.Cap.(INRb)/(USDb)	453.1 / 6.2
52-Week Range (INR)	559 / 117
1, 6, 12 Rel. Per (%)	6/101/122
12M Avg Val (INR M)	2317
Free float (%)	48.4

Financials Snapshot (INR b)

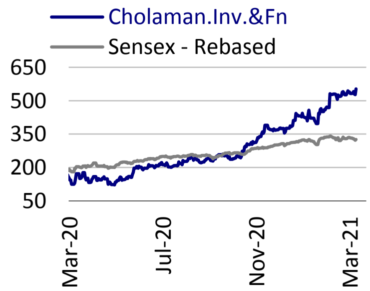
Y/E March	2020	2021E	2022E
Total Income	40.6	49.9	57.8
PPP	24.8	35.1	40.2
PAT	10.5	18.1	23.6
EPS (INR)	12.8	22.1	28.7
EPS Gr. (%)	-15.4	71.8	30.3
BV (INR)	100	120	146
Ratio			
NIM (%)	6.0	7.2	7.5
C/I ratio (%)	38.9	29.7	30.5
RoAA (%)	1.7	2.7	3.2
RoE (%)	14.7	20.1	21.7
Payout (%)	15.8	8.2	7.0
Valuations			
P/E (x)	43.1	25.1	19.2
P/BV (x)	5.5	4.6	3.8
Div. Yield (%)	0.3	0.3	0.4

Shareholding pattern (%)

As On	Dec-20	Sep-20	Dec-19
Promoter	51.6	51.6	52.9
DII	27.4	29.1	21.5
FII	13.2	11.3	16.6
Others	7.8	7.9	9.0

FII Includes depository receipts

Stock Performance (1-year)



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Healthy e-way bills trend bodes well for asset quality

Consistent improvement is seen in collection trends post the lifting of the moratorium in Sep'20. **While CE was 85–90% in Sep'20 (the first month post the lifting of the moratorium), it has consistently ranged above 100% over the ensuing months**. Our analysis of e-way bill data further corroborates this trend – **the number of e-way bills issued reached pre-COVID levels in Sep'20 and has since been on an uptrend (up 10–12% YoY in Jan and Feb'21).**

Provisions adequate; expect run-rate credit costs hereafter

Since the pandemic, CIFC's 'stressed' pool (Stage 2 + Stage 3 loans) has increased only 80bp to 9%, better than our initial expectations. In light of this, the company has increased its total provision buffer by 120bp to 3.1%. Hence, the incremental provisions made amount to 1.5x of incremental stress. Given that LGDs in this segment would typically be 30–35%, the incremental provisions made could withstand an additional 200bp+ of stress (which we do not foresee). Hence, we believe the company is well-provisioned for any foreseeable future stress, and credit costs should normalize to run-rate levels (sub-1%) going forward.

Lower CoF and reduction in excess liquidity to drive margin improvement

CIFC's NCD borrowing book, which had reduced more than half since the IL&FS crisis, has grown meaningfully over the past two quarters. **Over 60% of its incremental borrowings over the past two quarters came from NCDs, the cost of which has plummeted over the past year (refer to Exhibit 9).** On the other hand, yields have been stable given the pricing power the company enjoys. While the weighted-average cost of funds would continue to decline, another trigger for margin expansion would be a reduction in excess liquidity – if CIFC were to reduce liquidity from current levels of 11% to normalized levels of 7–8%, it would improve margins by 30–40bp ceteris paribus. Hence, we expect margins to improve 40bp to 7.6% over FY21–24E.

All eyes on new management initiatives

With Mr Vellayan Subbiah back at the helm of affairs as Chairman, investors' expectations are quite high, and justifiably so. He is credited with the turnaround of the company post the Global Financial Crisis. In our view, the following areas would see a renewed focus from the management: a) Affordable Housing Finance – given 1,100+ branches in total (with 235 in LAP), there is huge scope to grow the affordable housing finance book; b) Digitization – the past two years have seen increased digitization across processes and functions, which should continue.

Growth and RoE higher v/s peers; reiterate Buy

The company's recovery in the past nine months, across disbursements as well as collections, has been encouraging. CIFC is likely to continue to grow faster than peers over the medium term, in our opinion. Its asset quality performance is significantly better v/s the other two vehicle financiers under our coverage. **With RoE of 20%+, its return ratios are among the best.** The company is well-capitalized and would not need any dilution for growth. While the stock has re-rated sharply in the past three months, its valuation is only marginally higher than its five-year average of 3x PB. Strong RoE, coupled with above-average growth, warrants a higher multiple. Maintain Buy, with TP of INR640 (3.6x FY23E BVPS).

Provisions adequate; credit costs to normalize

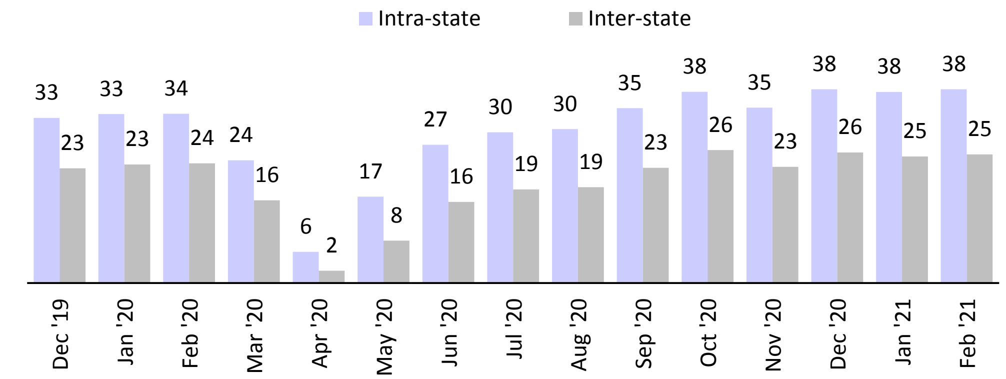
- **Since the lifting of the moratorium in Sep'20, CE has been on an uptrend. It improved to 108% in Dec'20 (from 87% in Sep'20). Our interaction with the management suggests CE has been healthy in 4QFY21 as well.**
- **An analysis of the e-way bills trend corroborates the same. The number of e-way bills issued improved to pre-COVID levels in Sep'20 and has since been on an uptrend. Typically, when freight demand is strong, truck operators are able to pass on fuel cost hikes to their customers. Hence, we are not too concerned about the recent rise in diesel prices.**
- **Over the past year, the company increased its provisions by 120bp v/s an 80bp increase in stressed loans. Given average LGD of 30–35%, we believe the incremental provisions made are adequate for another 200bp+ rise in stressed loans.**

Number of e-way bills up 10–12% YoY

Robust e-way bill data gives comfort on freight operator cash flows

- The uptick in the number of e-way bills issued has sustained over the past 5–6 months. **At 63m, the number of e-way bills issued in Jan and Feb was up 10–12% YoY, highlighting that freight demand is back at pre-COVID levels**.

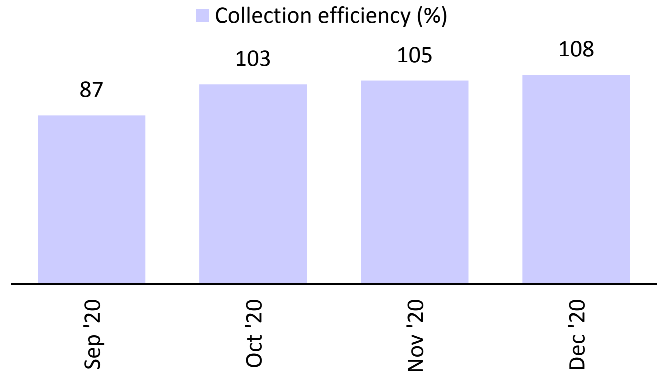
Exhibit 1: Number of e-way bills issued (m)



Source: MOFSL, Company

- Consequently, CIFC's CE has been on an uptrend – it improved to 108% in Dec from 87% in Sep. Our interaction with the management suggests the healthy CE trend has sustained in 4QFY21 as well. Hence, we do not foresee any meaningful increase in the proforma GNPL ratio in the coming quarter.
- **More importantly, against an 80bp YoY increase in 'stressed' loans, total provisions have increased 120bp YoY.** This implies that CIFC is more than adequately provided – even if the GNPL ratio were to increase 200bp going forward. This gives us the comfort that credit costs would now return to normal levels.

Exhibit 2: Collection efficiency improving



Source: MOFSL, Company

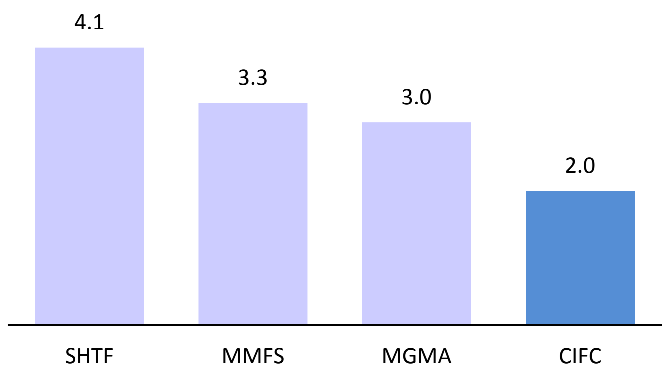
Exhibit 3: Trend in stressed loans

%	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21
GS 2	4.6	3.5	2.7	2.9	5.2
GS 3	3.5	3.8	3.3	2.8	3.8
Total stressed loans	**8.2**	**7.3**	**6.1**	**5.7**	**9.0**
Total provisions	1.9	2.7	2.4	2.6	3.1

Source: MOFSL, Company

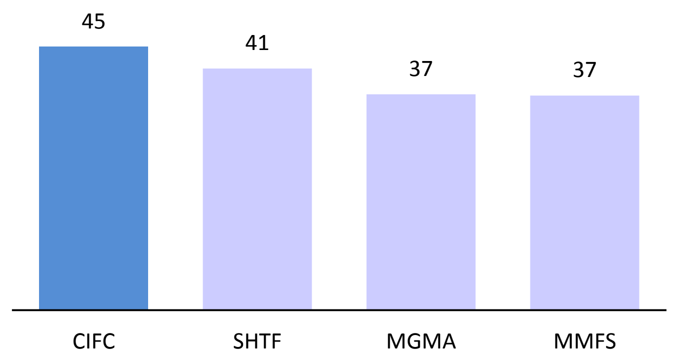
- Given the build-up of provisions over the past few quarters, CIFC's Stage 3 provisions are higher than that of peers. However, while its standard asset provisions are lower than that of peers, this is justified by its lower slippage ratio.

Exhibit 4: CIFC has the lowest Stage 1, 2 provisions (%)…



Source: MOFSL, Company

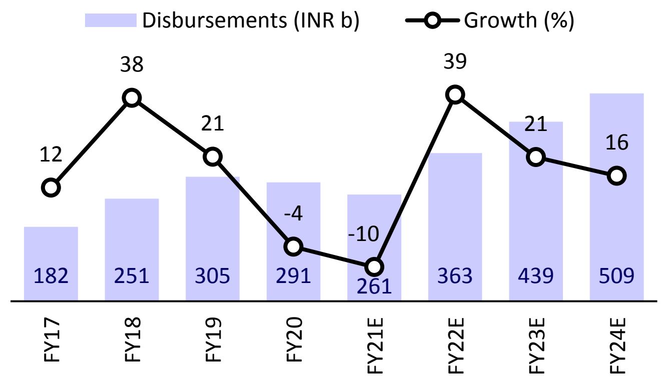
Exhibit 5: …but the highest Stage 3 provisions (%)



Source: MOFSL, Company

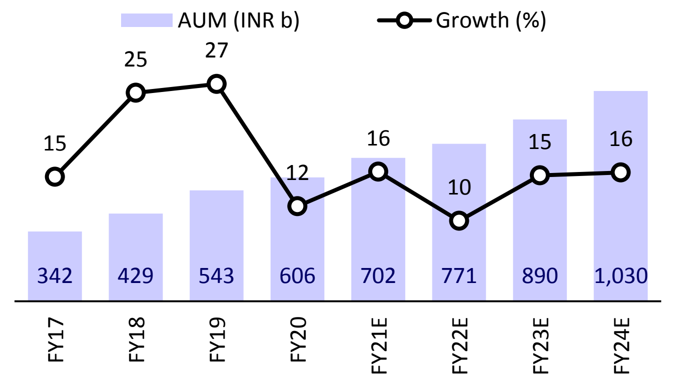
Story in charts

Exhibit 6: 25% disbursement CAGR off low base in FY21E



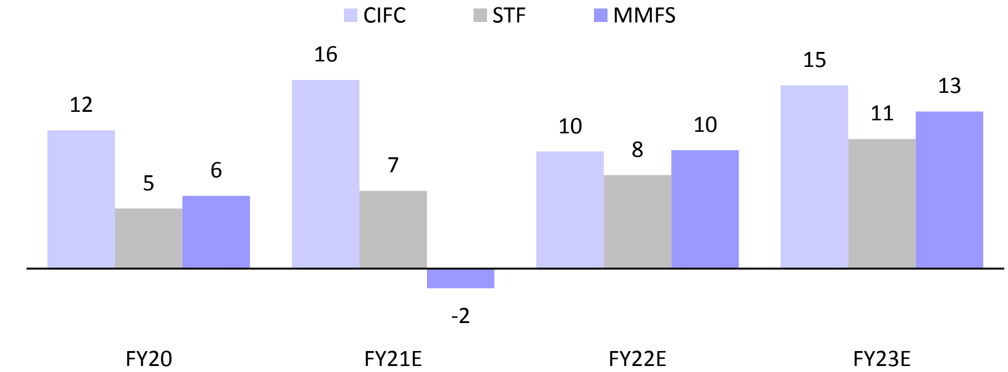
Source: MOFSL, Company

Exhibit 7: Growth slow in FY22 due to high repayment rate



Source: MOFSL, Company

Exhibit 8: CIFC poised to deliver stronger AUM growth in all years (%)



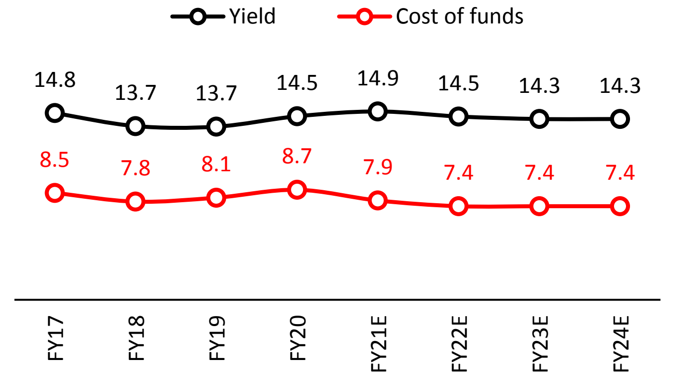
Source: MOFSL, Company

Exhibit 9: Recent NCD issuances

Month of issue	Tenure of instrument	Interest rate (%)
JAN'21	4Y	ZCB
JAN'21	1Y	5.48
DEC'20	3Y	6.10
DEC'20	3Y	5.68
NOV'20	2Y	5.45
NOV'20	3Y	5.70
OCT'20	4Y	6.80
OCT'20	3Y	5.85
AUG'20	5Y	7.92
JUN'20	2Y	7.20
APR'20	1Y	6.90

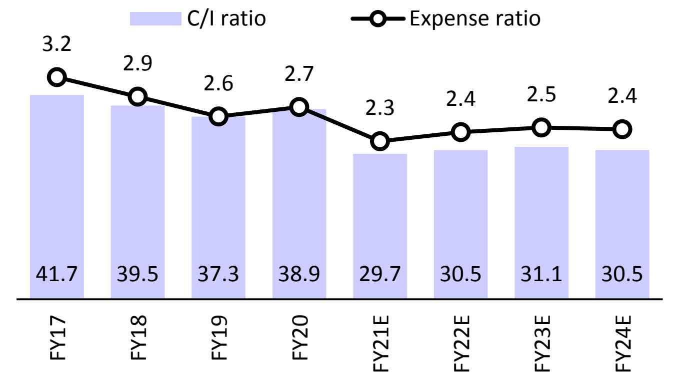
Source: MOFSL, NSE, BSE

Exhibit 10: Expect CoF to decline to 7.4% in FY22E (%)



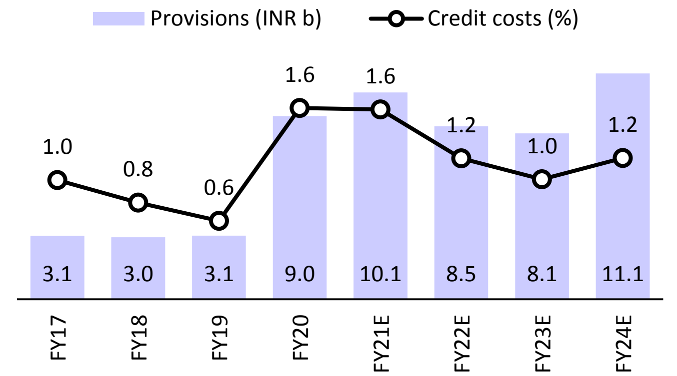
Source: MOFSL, Company

Exhibit 11: C/I expense ratio to remain stable



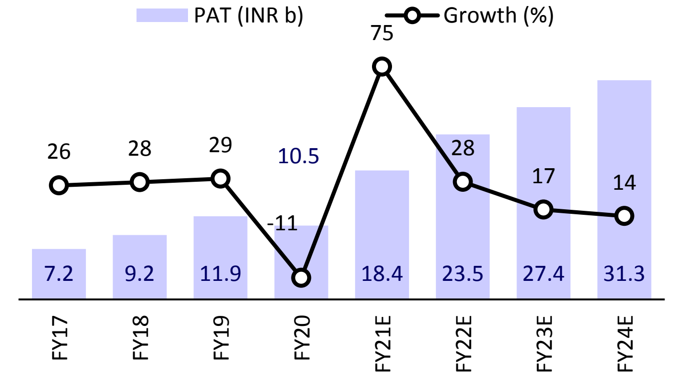
Source: MOFSL, Company

Exhibit 12: Credit costs to normalize



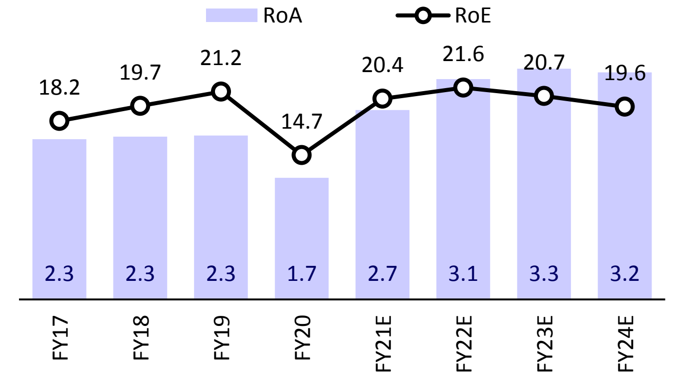
Source: MOFSL, Company

Exhibit 13: 19% PAT CAGR over FY21–24E



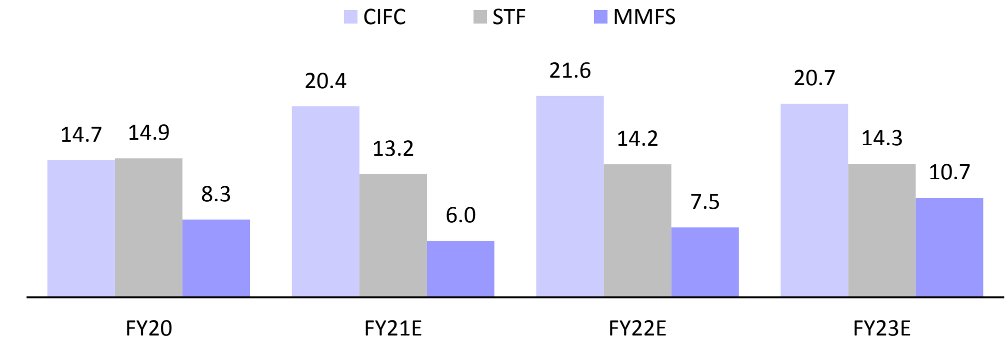
Source: MOFSL, Company

Exhibit 14: RoE north of 20% consistently



Source: MOFSL, Company

Exhibit 15: RoE far higher than that of peers (%)



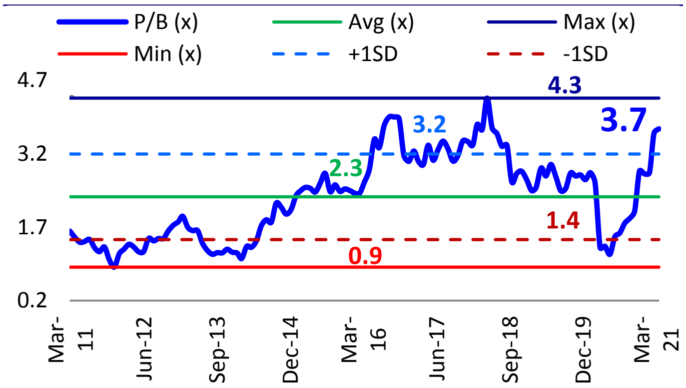
Source: MOFSL, Company

Exhibit 16: DuPont Analysis

%	2015	2016	2017	2018	2019	2020	2021E	2022E	2023E
Interest Income	15.2	15.1	13.9	13.1	12.8	12.9	13.1	13.1	13.2
Interest Expended	8.6	7.9	7.1	6.7	7.1	7.6	6.8	6.3	6.2
Net Interest Income	**6.6**	**7.2**	**6.8**	**6.4**	**5.7**	**5.4**	**6.4**	**6.8**	**7.0**
Other Operating Income	1.0	1.1	0.9	0.7	1.0	1.3	0.9	0.9	0.9
Net Income	**7.6**	**8.3**	**7.7**	**7.1**	**6.7**	**6.7**	**7.3**	**7.7**	**7.9**
Operating Expenses	3.3	3.3	3.2	2.8	2.5	2.6	2.2	2.3	2.4
Operating Income	**4.3**	**5.0**	**4.5**	**4.3**	**4.2**	**4.1**	**5.1**	**5.4**	**5.4**
Provisions/write offs	1.4	1.7	1.0	0.8	0.6	1.5	1.5	1.1	1.0
PBT	**2.9**	**3.4**	**3.5**	**3.5**	**3.6**	**2.6**	**3.6**	**4.2**	**4.4**
Tax	1.0	1.2	1.2	1.2	1.3	0.9	0.9	1.1	1.1
Reported PAT	**1.9**	**2.2**	**2.3**	**2.3**	**2.3**	**1.7**	**2.7**	**3.1**	**3.3**
Leverage	8.3	7.6	8.0	8.5	9.1	8.5	7.6	6.9	6.3
RoE	**15.9**	**16.6**	**18.2**	**19.7**	**21.2**	**14.7**	**20.4**	**21.6**	**20.7**

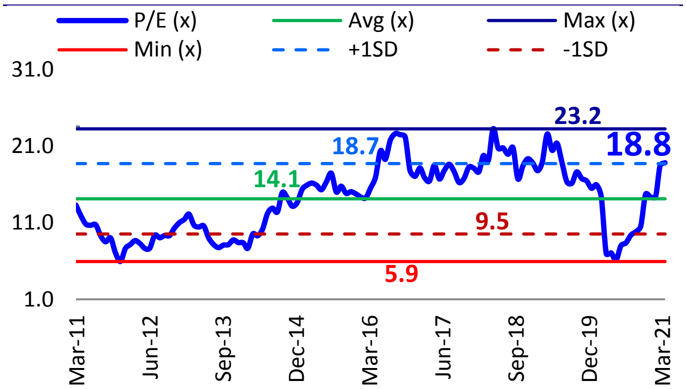
Source: MOFSL, Company

Exhibit 17: PB trend (1yr forward)



Source: MOFSL, Company

Exhibit 18: PE trend (1yr forward)



Source: MOFSL, Company

Financials and valuation

Income Statement								(INR m)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**	**2024E**
Interest Income	43,717	51,862	64,962	78,417	89,390	98,336	1,09,898	1,27,949
Interest Expenses	22,308	26,593	35,887	45,922	46,107	47,356	51,894	59,654
Net Interest Income	**21,409**	**25,268**	**29,075**	**32,495**	**43,283**	**50,980**	**58,004**	**68,295**
Change (%)	14.8	18.0	15.1	11.8	33.2	17.8	13.8	17.7
Other Operating Income	776	2,931	4,090	5,637	6,378	6,763	7,439	8,183
Total Income	**24,295**	**28,203**	**34,039**	**40,607**	**49,696**	**57,778**	**65,478**	**76,513**
Change (%)	13.4	16.1	20.7	19.3	22.4	16.3	13.3	16.9
Total Operating Expenses	**10,133**	**11,153**	**12,696**	**15,776**	**14,765**	**17,594**	**20,389**	**23,325**
Change (%)	19.9	10.1	13.8	24.3	-6.4	19.2	15.9	14.4
Operating Profit	**14,162**	**17,051**	**21,344**	**24,831**	**34,930**	**40,185**	**45,089**	**53,188**
Change (%)	9.1	20.4	25.2	16.3	40.7	15.0	12.2	18.0
Total Provisions	**3,106**	**3,037**	**3,112**	**8,973**	**10,135**	**8,477**	**8,134**	**11,067**
% of Operating Profit	21.9	17.8	14.6	36.1	29.0	21.1	18.0	20.8
PBT	**11,056**	**14,014**	**18,232**	**15,857**	**24,795**	**31,708**	**36,955**	**42,121**
Tax Provisions	3,868	4,831	6,370	5,334	6,397	8,181	9,534	10,867
Tax Rate (%)	35.0	34.5	34.9	33.6	25.8	25.8	25.8	25.8
PAT	**7,187**	**9,183**	**11,862**	**10,524**	**18,398**	**23,527**	**27,420**	**31,253**
Change (%)	26.4	27.8	29.2	-11.3	74.8	27.9	16.5	14.0
Proposed Dividend	547	1,016	1,016	1,662	1,476	1,640	2,050	2,050

Balance Sheet								(INR m)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**	**2024E**
Share Capital	1,564	1,564	1,564	1,640	1,640	1,640	1,640	1,640
Reserves & Surplus	40,971	49,105	59,880	80,079	96,697	1,18,248	1,43,197	1,71,979
Net worth	**42,535**	**50,669**	**61,445**	**81,718**	**98,337**	**1,19,887**	**1,44,837**	**1,73,619**
Borrowings	**3,02,001**	**3,83,303**	**5,05,667**	**5,50,054**	**6,24,639**	**6,55,243**	**7,47,294**	**8,64,968**
Change (%)	33.8	26.9	31.9	8.8	13.6	4.9	14.0	15.7
Total Liabilities	**3,50,372**	**4,40,897**	**5,74,263**	**6,39,930**	**7,22,977**	**7,75,130**	**8,92,131**	**10,38,587**
Investments	697	729	729	729	625	655	747	865
Change (%)	4.6	4.7	0.0	0.0	-14.3	4.9	14.0	15.7
Loans	**3,32,244**	**4,22,532**	**5,26,223**	**5,54,027**	**6,45,833**	**7,10,527**	**8,26,501**	**9,62,989**
Change (%)	27.9	27.2	24.5	5.3	16.6	10.0	16.3	16.5
Net Fixed Assets	1,417	1,646	1,759	2,839	1,356	1,032	596	36
Total Assets	**3,50,372**	**4,40,897**	**5,74,263**	**6,39,930**	**7,22,977**	**7,75,130**	**8,92,131**	**10,38,587**

E: MOFSL Estimates

Financials and valuation

Ratios								(%)
Y/E March	**2017**	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**	**2024E**
Spreads Analysis (%)								
Avg. Yield on Loans	14.8	13.7	13.7	14.5	14.9	14.5	14.3	14.3
Avg Cost of Funds	8.5	7.8	8.1	8.7	7.9	7.4	7.4	7.4
Spread of loans	6.3	6.0	5.6	5.8	7.1	7.1	6.9	6.9
NIM (on loans)	7.2	6.7	6.1	6.0	7.2	7.5	7.5	7.6
Profitability Ratios (%)								
RoE	18.2	19.7	21.2	14.7	20.4	21.6	20.7	19.6
RoA	2.3	2.3	2.3	1.7	2.7	3.1	3.3	3.2
Int. Expended / Int.Earned	51.0	51.3	55.2	58.6	51.6	48.2	47.2	46.6
Other Inc. / Net Income	3.2	10.4	12.0	13.9	12.9	11.8	11.4	10.7
Efficiency Ratios (%)								
Op. Exps. / Net Income	41.7	39.5	37.3	38.9	29.7	30.5	31.1	30.5
Empl. Cost/Op. Exps.	39.7	48.1	46.5	41.5	44.4	43.9	43.6	42.7
Asset-Liability Profile (%)								
Loans/Borrowings Ratio	110.0	110.2	104.1	100.7	103.4	108.4	110.6	111.3
Net NPAs to Net Adv.	3.2	2.3	1.6	2.2	2.9	2.6	2.2	1.8
Assets/Equity	8.2	8.7	9.3	7.8	7.4	6.5	6.2	6.0

Valuations	**2017**	**2018**	**2019**	**2020**	**2021E**	**2022E**	**2023E**	**2024E**
Book Value (INR)	54.4	64.8	78.6	99.7	119.9	146.2	176.7	211.8
BV Growth (%)	16.2	19.1	21.2	26.9	20.3	21.9	20.8	19.9
Price-BV (x)				**5.5**	**4.6**	**3.8**	**3.2**	**2.6**
EPS (INR)	9.2	11.7	15.2	12.8	22.4	28.7	33.4	38.1
EPS Growth (%)	26.3	27.7	29.1	-15.4	74.8	27.9	16.5	14.0
Price-Earnings (x)				**43.1**	**25.1**	**19.2**	**17.0**	**14.5**
Dividend per share	1.1	1.3	1.3	1.7	1.8	2.0	2.5	2.5
Dividend Yield (%)				**0.3**	**0.3**	**0.4**	**0.5**	**0.5**

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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