

BUY

TP: Rs 280 | ▲ 38%

**CHOLAMANDALAM
INVESTMENT**

| NBFC

| 31 July 2020

Business activity picking up in pockets

Cholamandalam Investment (CIFIC) reported 10% YoY growth in AUM to Rs 635bn in Q1FY21, led by low repayment rates. Management expects the buoyant rural economy to keep disbursements upbeat in tractors and used vehicles. We believe opex levers have largely played out now that business activity is picking up. Stable spreads along with strong capital and liquidity buffers were other Q1 highlights. We increase FY21/FY22 earnings by 11%/10% and roll over to a revised Jun'21 TP of Rs 280 (earlier Rs 200). Maintain BUY.

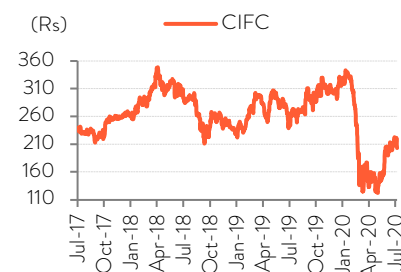
Shubhramshu Mishra
research@bobcaps.in

Low repayment rates, buoyant rural economy augur well: AUM grew 10% YoY to Rs 635bn in Q1FY21, largely driven by lower repayments as ~76% of the loan book was still under moratorium (unchanged sequentially). Disbursements declined 58% YoY to Rs 36bn – the biggest slide in the last 38 quarters. Management expects improvement in tractor and used vehicle disbursements amid strong growth in the rural economy.

Ticker/Price	CIFIC IN/Rs 203
Market cap	US\$ 2.2bn
Shares o/s	820mn
3M ADV	US\$ 37.5mn
52wk high/low	Rs 264/Rs 117
Promoter/FPI/DII	52%/12%/28%

Source: NSE

Spreads stable but opex levers played out: Stable spreads (calc.) at 6.8% led to mild 4% YoY growth in NII to Rs 9.8bn. With lower business activity, opex declined by 1%, which aided ~8% YoY growth in operating profit to Rs 6.4bn. We believe opex levers are largely played out and expenses will rise given the uptick in business activity.

STOCK PERFORMANCE

Source: NSE

Strong capital and liquidity buffers: CIFIC made an additional provision of Rs 2.4bn for macro events, taking total provisioning for the quarter to Rs 5.6bn. PAT grew 37% YoY to Rs 4.3bn. The company has bolstered its balance sheet with a provision cover of ~42%. Equipped with strong capital adequacy of 20.4% and liquidity from undrawn bank lines of Rs 116bn, the company can comfortably counter future tail risks from asset quality.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	28,972	32,495	34,729	36,853	40,032
NII growth (%)	14.7	12.2	6.9	6.1	8.6
Adj. net profit (Rs mn)	11,862	10,524	10,374	13,414	17,592
EPS (Rs)	15.2	12.8	12.7	16.4	21.5
P/E (x)	13.4	15.8	16.0	12.4	9.4
P/BV (x)	2.6	2.0	1.8	1.6	1.4
ROA (%)	2.4	1.7	1.5	1.8	2.1
ROE (%)	21.3	14.7	12.0	13.8	15.7

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.

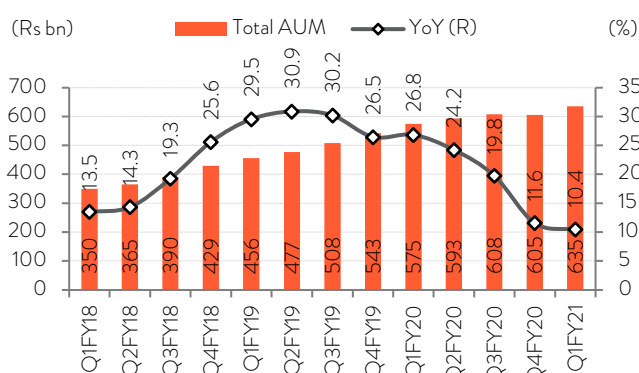


FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	YoY (%)
Income from Operations	21,136	20,295	4.1	21,513	(1.8)
Interest Expenses	11,307	10,870	4.0	11,359	(0.5)
Net Interest Income	9,830	9,425	4.3	10,154	(3.2)
YoY	4.3	16.3	-	13	-
Total Income	9,830	9,425	4.3	10,156	(3.2)
YoY	4.3	16.2	-	13	-
Operating Expenses	3,458	3,500	(1.2)	4,016	(13.9)
Operating Profit	6,372	5,925	7.5	6,140	3.8
YoY	7.5	11.9	-	19	-
Provisions & Loan Losses	562	1,095	(48.7)	5,567	(89.9)
Profit before Tax	5,810	4,830	20.3	573	913.6
Tax Provisions	1,501	1,688	(11.1)	147	923.7
Net Profit	4,309	3,142	37.1	427	910.2
YoY	37.1	10.2	-	(85)	-

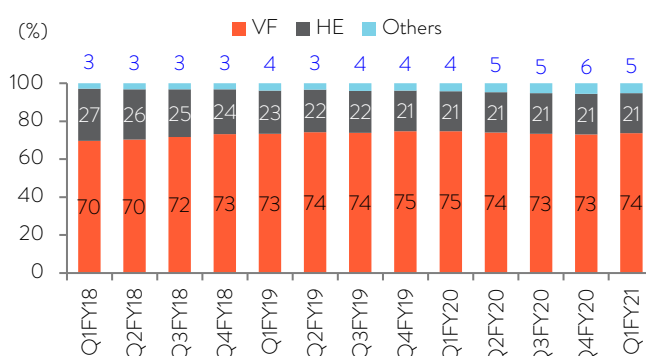
Source: Company, BOBCAPS Research

FIG 2 – AUM GREW 10% YOY TO RS 635BN...



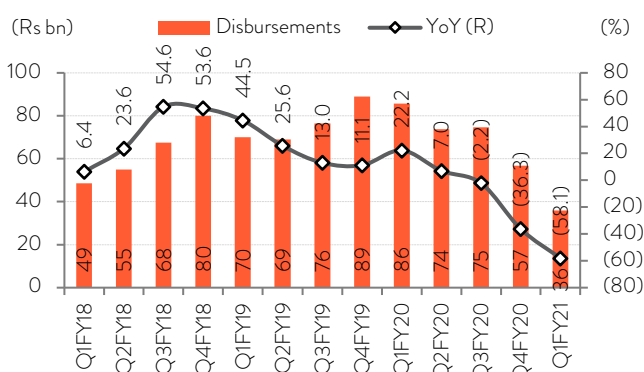
Source: Company, BOBCAPS Research

FIG 3 – ...LARGELY LED BY VEHICLE FINANCING (VF)



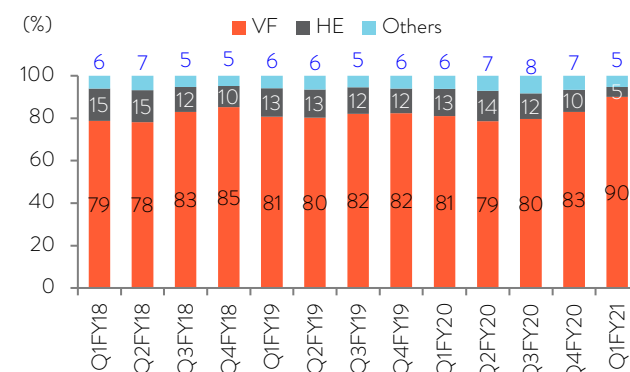
Source: Company, BOBCAPS Research

FIG 4 – DISBURSEMENTS CONTINUED TO DIP FOR FIFTH CONSECUTIVE QUARTER...



Source: Company, BOBCAPS Research

FIG 5 – ...WITH CONSIDERABLE SLOWDOWN IN LAP (HE)



Source: Company, BOBCAPS Research

FIG 6 – QUARTERLY PERFORMANCE

	FY19				FY20				FY21	Variation (%)	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	QoQ	YoY
Profit and Loss (Rs mn)											
Operating Income	16,057	16,751	18,261	18,851	20,295	21,970	22,749	21,513	21,136	(1.8)	4.1
Interest Expenses	7,950	8,565	9,508	9,864	10,870	11,769	11,924	11,359	11,307	(0.5)	4.0
Net Interest Income	8,107	8,185	8,753	8,987	9,425	10,200	10,825	10,154	9,830	(3.2)	4.3
Other income	2	1	1	3	1	1	0	1	0	(83.3)	(60.0)
Total Income	8,109	8,186	8,754	8,989	9,425	10,201	10,825	10,156	9,830	(3.2)	4.3
Operating Expenses	2,816	2,901	3,158	3,820	3,500	4,016	4,244	4,016	3,458	(13.9)	(1.2)
Employee	1,413	1,342	1,417	1,734	1,458	1,721	1,771	1,600	1,562	(2.4)	7.1
Others	1,404	1,559	1,742	2,086	2,042	2,295	2,473	2,416	1,897	(21.5)	(7.1)
Operating Profits	5,293	5,285	5,596	5,169	5,925	6,185	6,581	6,140	6,372	3.8	7.5
Provisions & Loan losses	905	690	961	556	1,095	952	1,360	5,567	562	(89.9)	(48.7)
PBT	4,388	4,595	4,635	4,614	4,830	5,233	5,221	573	5,810	913.6	20.3
Taxes	1,535	1,549	1,591	1,695	1,688	2,163	1,336	147	1,501	923.7	(11.1)
PAT	2,852	3,047	3,044	2,919	3,142	3,070	3,885	427	4,309	910.2	37.1
Asset Quality (%)											
Gross NPA (%)	3.6	3.4	3.3	2.7	3.0	2.7	3.5	3.8	3.3	(50bps)	30bps
Net NPA (%)	2.4	2.2	2.1	1.7	1.9	1.6	2.4	2.3	2.0	(29bps)	7bps
PCR (Calculated, %)	35.0	35.5	36.7	37.9	36.1	40.7	33.0	41.5	41.6	12bps	549bps
Ratios (%)											
Cost to Income	34.7	35.4	36.1	42.5	37.1	39.4	39.2	39.5	35.2	(436bps)	(195bps)
Provision to operating profit	17.1	13.1	17.2	10.8	18.5	15.4	20.7	90.7	8.8	(8,185bps)	(967bps)
Tax Rate	35.0	33.7	34.3	36.7	34.9	41.3	25.6	25.6	25.8	25bps	(911bps)
Total CAR	18.2	18.3	17.8	17.6	17.2	17.1	17.0	20.7	20.4	(26bps)	326bp
Cost of Funds	8.0	7.8	8.1	8.1	8.2	8.5	8.6	8.3	8.0	(30bps)	-26bps
NIMs	7.3	7.0	7.1	6.8	6.7	7.0	7.2	6.7	6.3	(36bps)	(41bps)
Business (Rs bn)											
On book Loans	443	468	493	526	555	562	567	561	583	4.0	5.1
Off book (Securitisation)	10	10	15	17	20	31	40	45	52	15.4	159.7
Total Borrowings	413	471	472	506	551	559	549	550	585	6.4	6.2
AUM Mix (%)											
Vehicle Finance	73	74	74	75	75	74	73	73	74	74bps	(101bps)
Home equity	23	22	22	21	21	21	21	21	21	(35bps)	(2bps)
Others	4	3	4	4	4	5	5	6	5	(39bps)	103bps
Disbursements (Rs bn)											
Total	70	69	76	89	86	74	75	57	36	(36.6)	(58.1)
Vehicle Finance	57	55	63	73	69	58	59	47	32	(31.3)	(53.4)
Home equity	9	9	10	10	11	11	9	6	2	(71.5)	(84.7)
Others	4	4	4	5	5	5	6	4	2	(48.8)	(64.2)
Total Borrowing Mix (%)											
Bank Loans	40	34	35	45	47	53	57	60	58	(200bps)	1,100bps
CP	11	10	10	7	10	10	7	3	7	400bps	(300bps)
Debentures	26	26	25	21	17	14	12	10	10	0bps	(700bps)
Sub Debt & PDI	9	8	8	8	7	7	7	8	7	(100bps)	0bps
Securitisation	14	12	12	11	10				7	700bps	(300bps)
Other Details											
Branches	883	885	891	900	999	1,029	1,073	1,105	1,098	(7)	99

Source: Company, BOBCAPS Research

Earnings call highlights

Business updates

- Jun'20 disbursements improved to 75% of levels achieved in same month last year; trend expected to continue
- Tied up with a top 3 tractor OEM recently and also expanded market share with the top 3, which supported strong tractor disbursements this quarter
- CIFIC gained market share YoY in Q1 as follows – overall auto: from 1.7% to 3.99%; CV: 13% to 23%; PV: 3% to 6%; 3W: 3% to 19%; 2W: 1% to 2%; Tractors: 6% to 11%; Construction Equipment: 8% to 21%
- Higher levels of economic activity in rural areas compared to urban areas enabling truck owners to find more opportunities for work
- Truck capacity utilisation increased significantly in June but declined in July due to lockdowns in tier-2/3 towns as well as seasonality
- Renegotiation of rental agreements led to one-time reduction in rent; lower business activity also reduced opex in Q1

Asset quality/Moratorium

- Moratorium rate high at 76% of loan book as customers face uncertainty in their businesses
- Some customers moved from non-moratorium to moratorium and vice-versa over phase-1 to phase-2
- Covid-19 provisions seen to be adequate but management to reevaluate them as needed
- Collection efficiency stable MoM in July
- GNPL ratio at 2.41% in vehicle finance, 6.9% in LAP, and 3.5% in home loans
- Some old overdues in vehicle finance written off during the quarter
- NRRB for the 1-2 bucket improved from 26.79% in May to 33.98% in June; similarly, that for HCVs improved from 17% in May to 30% in June
- Moratorium given to customers even in the 180dpd bucket, as per board resolution. No moratorium being offered on new contracts

Liquidity/Funding

- Liquidity on balance sheet to hover at ~Rs 60bn for remainder of the year
- Behavioral ALM in investor presentation reflects some conservatism in collections immediately after lifting of the moratorium
- Incremental cost of funds – 3-month money: 7%, banks: 7.5%

Others

- Business muted in April due to underlying pain in auto segment coupled with supply shortage both at dealer level and nationwide
- Loss given default (LGD) not expected to increase
- LGD in vehicle finance at 28-30% on average but lower for customers with higher vintage
- Margins down due to liquidity drag
- Customers able to service EMI when truck capacity utilisation at 65%+
- 90% of home loan branches located in tier-2/3/4 towns. Bulk of portfolio is towards self-construction. Disbursements in June at 50% of prior peak
- No top-up loans disbursed in the quarter
- For those who availed moratorium, tenor will get extended accordingly
- FY19 GNPL numbers restated in FY20 annual report due to migration from IGAAP to Ind-AS. Also, under Ind-AS, the Stage 3 number includes accrued interest as well

FIG 7 – STAGE-WISE PROVISIONS AS OF Q1FY21

June-20 DPD Freeze	Moratorium Status	Asset (Rs bn)	Normal (Rs bn)	Additional provision (Rs bn)		Total additional provision (Rs bn)	Total provision (Rs bn)	PCR (%)
				COVID19 provision	Macro provision			
Stage 1	Non-Moratorium	121	0.3	0.0	0.0	0.0	0.3	0.27
Stage 1 (0 overdues)	Moratorium	409	1.2	0.0	0.0	0.0	1.2	0.29
Stage 1 (No past history of flows)	Moratorium	20	0.1	1.2	0.0	1.2	1.3	6.65
Stage 1 (Past history of flow to Stage 2)	Moratorium	12	0.0	1.1	0.0	1.1	1.2	10.02
Stage 1 (Past history of flow to Stage 3)	Moratorium	0	0.0	0.1	0.0	0.1	0.1	33.33
Total Stage 1		561	1.6	2.5	0.0	2.5	4.1	0.74
Stage 2	Non-Moratorium	1	0.1	0.0	0.0	0.0	0.1	7.87
Stage 2 (No past history of flows)	Moratorium	14	1.1	0.3	0.0	0.3	1.5	10.57
Stage 2 (Past history of flow to Stage 3)	Moratorium	1	0.1	0.3	0.0	0.3	0.4	32.43
Total Stage 2		16	1.3	0.6	0.0	0.6	1.9	11.91
Stage 3	Non-Moratorium	14	3.1	2.0	0.0	2.0	5.2	35.85
Stage 3	Moratorium	3	0.7	0.4	0.0	0.4	1.0	33.33
Stage 3 - Legal	Non-Moratorium	2	2.1	0.0	0.0	0.0	2.1	85.77
Total Stage 3		20	5.9	2.4	0.0	2.4	8.3	41.61
Total		598	8.9	5.5	0.0	5.5	14.4	2.41

Source: Company, BOBCAPS Research

FIG 8 – MORATORIUM COLLECTION

Moratorium months	No. of agreements	No. of EMIs (%)					
		Part EMI	1 EMI	2 EMIs	3 EMIs	4+ EMIs	1+ EMIs
1 month	40,953	17	31	0	0	0	31
2 months	30,690	18	18	27	0	0	45
3 months	48,213	12	20	9	7	0	36
4 months	83,910	8	23	20	14	5	62
5 months	475,082	10	21	10	7	5	43
6 months	437,709	25	10	3	2	3	18
Total	1,116,557	16	17	8	5	4	34

Source: Company, BOBCAPS Research

Valuation methodology

Two aspects of CIFIC's vehicle finance business stand out compared to most peers: (i) diversification across product segments, and (ii) low state-level concentration – the largest state accounts for only 11% of the total portfolio. An early entry into LAP and focus on affordable housing are also likely to yield results in the medium term.

AUM has grown at >20% over FY19-FY20 though disbursements have slowed amid a tough economic environment. The near-to-medium-term outlook appears challenging due to Covid-19 disruptions – we expect back-ended recovery in H2FY22 given both supply and demand constraints. Hence, we model for slower AUM growth at ~12% CAGR during FY20-FY23. Strong asset quality has been a hallmark of CIFIC. Credit costs could remain elevated in FY21, but are likely to normalise in H2FY22. Thus, we expect ROA/ROE recovery in FY23.

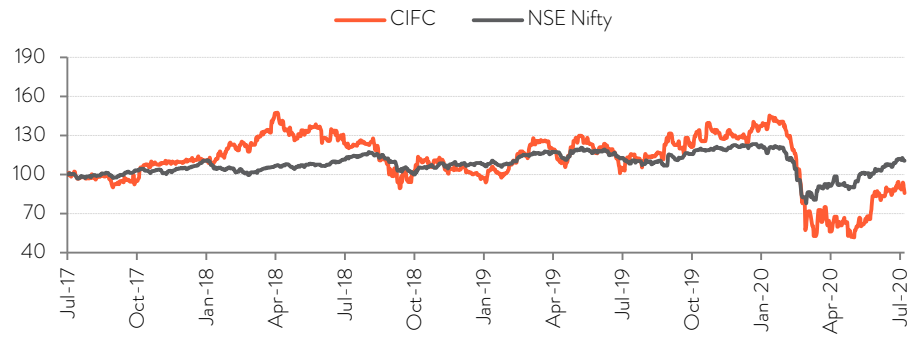
The stock currently trades at 1.8x Jun'22E BVPS, reflecting the steady performance post-lockdown and buoyant rural economy. We use a residual income model to arrive at our Jun'21 target price of Rs 280 (earlier Rs 200), which values the company at a risk-free rate of 7.75%, cost of equity of 13.7% (earlier 14%), and terminal growth of 5%. We increase our FY21/FY22 earnings estimates by 11%/10% and introduce FY23 estimates. In our view, the business will remain well capitalised and flush with liquidity through FY22. Maintain BUY.

FIG 9 – REVISED ESTIMATES

(Rs bn)	Old			New			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Total Income	41.5	42.7	49.6	43.2	45.9	49.6	4.1	7.6	0.0
Operating Expenses	16.8	17.7	20.3	16.9	18.6	20.3	0.3	5.5	0.0
Operating Profits	24.7	25.0	29.3	26.3	27.3	29.3	6.7	9.1	0.0
Provisions	12.2	8.7	5.7	12.4	9.3	5.7	2.2	7.2	0.0
PBT	12.5	16.3	23.5	13.9	17.9	23.5	11.0	10.0	0.0
Tax	3.1	4.1	5.9	3.5	4.5	5.9	11.0	10.0	0.0
PAT	9.3	12.2	17.6	10.4	13.4	17.6	11.0	10.0	0.0
RoA on AUM	1.4	1.7	2.1	1.5	1.8	2.1	-	-	-
RoE	10.9	12.7	15.7	12.0	13.8	15.7	-	-	-
AUM	633	658	785	658	719	785	3.9	9.3	0.0

Source: BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates are:

- reduced repayment discipline among customers seeking moratorium;
- longer-than-expected recovery in supply chains, affecting cash flows; and
- long drawn recoveries in the home equity business.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	28,972	32,495	34,729	36,853	40,032
NII growth (%)	14.7	12.2	6.9	6.1	8.6
Non-interest income	5,067	8,112	8,455	9,044	9,531
Total income	34,039	40,607	43,184	45,898	49,564
Operating expenses	12,695	15,776	16,886	18,647	20,309
Operating profit	21,344	24,831	26,298	27,251	29,255
Operating profit growth (%)	25.2	16.3	5.9	3.6	7.4
Provisions	3,112	8,973	12,429	9,318	5,736
PBT	18,232	15,857	13,869	17,933	23,519
Tax	6,370	5,334	3,495	4,519	5,927
Reported net profit	11,862	10,524	10,374	13,414	17,592
Adjustments	0	0	0	0	0
Adjusted net profit	11,862	10,524	10,374	13,414	17,592

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Equity capital	1,564	1,640	1,640	1,640	1,640
Reserves & surplus	60,193	80,079	89,469	101,899	118,311
Net worth	61,757	81,718	91,109	103,539	119,950
Deposits	0	0	0	0	0
Borrowings	505,667	550,054	610,560	686,880	755,568
Other liabilities & provisions	0	0	0	0	0
Total liabilities and equities	567,425	631,773	701,669	790,419	875,519
Cash & bank balance	36,749	69,591	87,871	112,568	130,293
Investments	729	729	3,053	3,434	1,889
Advances	526,223	554,027	601,315	662,874	729,551
Fixed & Other assets	1,754	2,837	3,405	4,086	4,903
Total assets	567,425	631,773	701,669	790,419	875,519
Deposit growth (%)	NA	NA	NA	NA	NA
Advances growth (%)	24.5	5.3	8.5	10.2	10.1

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS	15.2	12.8	12.7	16.4	21.5
Dividend per share	1.3	1.7	1.0	1.0	1.2
Book value per share	79.0	99.7	111.1	126.3	146.3

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
P/E	13.4	15.8	16.0	12.4	9.4
P/BV	2.6	2.0	1.8	1.6	1.4
Dividend yield (%)	0.6	0.8	0.5	0.5	0.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Net interest income	5.8	5.4	5.1	4.9	4.7
Non-interest income	1.0	1.3	1.3	1.2	1.1
Operating expenses	2.5	2.6	2.5	2.5	2.4
Pre-provisioning profit	4.2	4.1	3.9	3.6	3.5
Provisions	0.6	1.5	1.8	1.2	0.7
PBT	3.6	2.6	2.1	2.4	2.8
Tax	1.3	0.9	0.5	0.6	0.7
ROA	2.4	1.7	1.5	1.8	2.1
Leverage (x)	9.0	8.5	7.8	7.8	7.5
ROE	21.3	14.7	12.0	13.8	15.7

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Net interest income	14.7	12.2	6.9	6.1	8.6
Pre-provisioning profit	25.2	16.3	5.9	3.6	7.4
EPS	1516.5	1283.5	1265.3	1636.1	2145.7
Profitability & Return ratios (%)					
Net interest margin	6.1	6.1	5.9	5.7	5.7
Fees / Avg. assets	0.4	0.3	0.3	0.3	0.3
Cost-Income	37.3	38.9	39.1	40.6	41.0
ROE	21.3	14.7	12.0	13.8	15.7
ROA	2.4	1.7	1.5	1.8	2.1
Asset quality (%)					
GNPA	2.7	3.8	4.6	4.2	4.8
NNPA	1.7	2.3	1.1	1.2	1.5
Provision coverage	38.0	52.7	50.1	59.2	53.8
Ratios (%)					
Credit-Deposit	0.0	0.0	0.0	0.0	0.0
Investment-Deposit	0.0	0.0	0.0	0.0	0.0
CAR	17.4	20.7	19.4	19.2	19.6
Tier-1	12.4	15.3	14.4	14.6	15.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

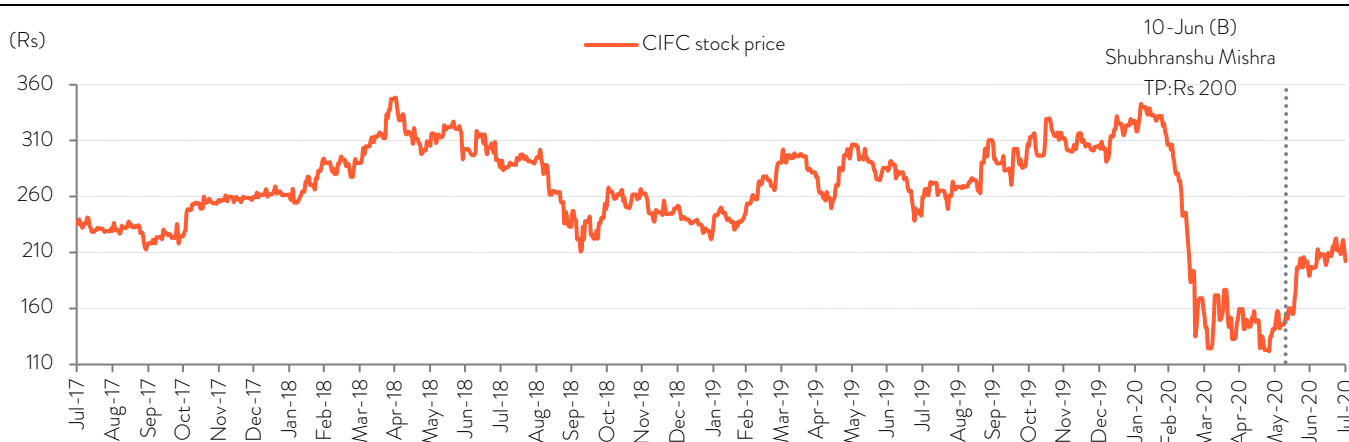
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): CHOLAMANDALAM INVESTMENT (CIFIC IN)



B – Buy, A – Add, R – Reduce, S – Sell

Rating distribution

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