

Initiating Coverage Cholamandalam Financial Holdings Ltd

19-July-2021



Cholamandalam Financial Holdings Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Holding Co.	Rs.646.5	Buy at LTP and add more at Rs.568	Rs.711	Rs.785	2 quarters

HDFC Scrip Code	CHOFINEQNR
BSE Code	504973
NSE Code	CHOLAHLDNG
Bloomberg	CHOLAHLD IN
CMP July 16, 2021	646.5
Equity Capital (RsCr)	18.8
Face Value (Rs)	1
Equity Share O/S (Cr)	18.8
Market Cap (Rs Cr)	12047.6
Book Value (Rs)	287
Avg. 52 Wk Volumes	142963
52 Week High	711.0
52 Week Low	315.3

Share holding Pattern % (Mar, 2021)	
Promoters	48.8
Institutions	37.8
Non Institutions	13.4
Total	100.0

Fundamental Research Analyst

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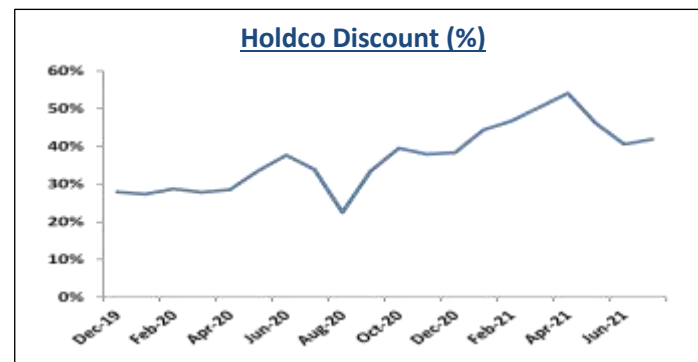
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Our take

Cholamandalam Financial Holdings Limited (CFHL) (formerly known as TI Financial Holdings Limited) is a part of the Murugappa Group and registered with RBI as a Non-Deposit taking Systemically Important - Core Investment Company. The company has shareholding in group companies viz., Cholamandalam Investment and Finance Company Limited (45.5%), Cholamandalam MS General Insurance Company Limited (60%) and Cholamandalam MS Risk Services Limited (49.5%). Being a holding company, it trades at a significant discount to its asset value which may contract going forward. Listing of subsidiaries of associate companies and/or stake sale in them could further enhance its value. Going forward, we expect steady compounding of both its NBFC and general insurance businesses on the back of vast and scalable opportunity in the highly underpenetrated retail oriented market. Cholamandalam Investment and Finance is the third largest asset finance company (AFC) in India and Chola MS is the eighth largest private general insurer in terms of Gross written premium (GWP). We expect growth in investments and reduction in holdco discount to be key drivers for re-rating of the stock.

Valuation and recommendation

We have given a holding company discount to its equity investments in its listed associate companies. The holdco discount since Dec 2019 has ranged from 24% to 54% (average 37%). We believe investors can buy the stock at LTP and add on dips to Rs.568 for a base case target of Rs.711 and bull case target of Rs.785 as per SOTP method listed below.



Financial Summary (Consolidated)

Particulars (RsCr)	Q4FY21	Q4FY20	YoY-%	Q3FY21	QoQ-%	FY20	FY21	FY22E	FY23E
Total Income	3523	3287	7	3645	-3	13137	13905	15296	16978
EBITDA	1479	1288	15	1798	-18	6549	7154	7854	8700
RPAT	84	40	110	213	-61	1165	1764	2118	2480
EPS						29.3	43.9	59.6	68.2
RoE						12.9	16.5	18.8	18.0
RoCE						11.1	11.2	11.4	11.8
P/E						22.0	14.7	10.8	9.5
P/BV						2.6	2.3	1.9	1.6

(Source: Company, HDFC sec)

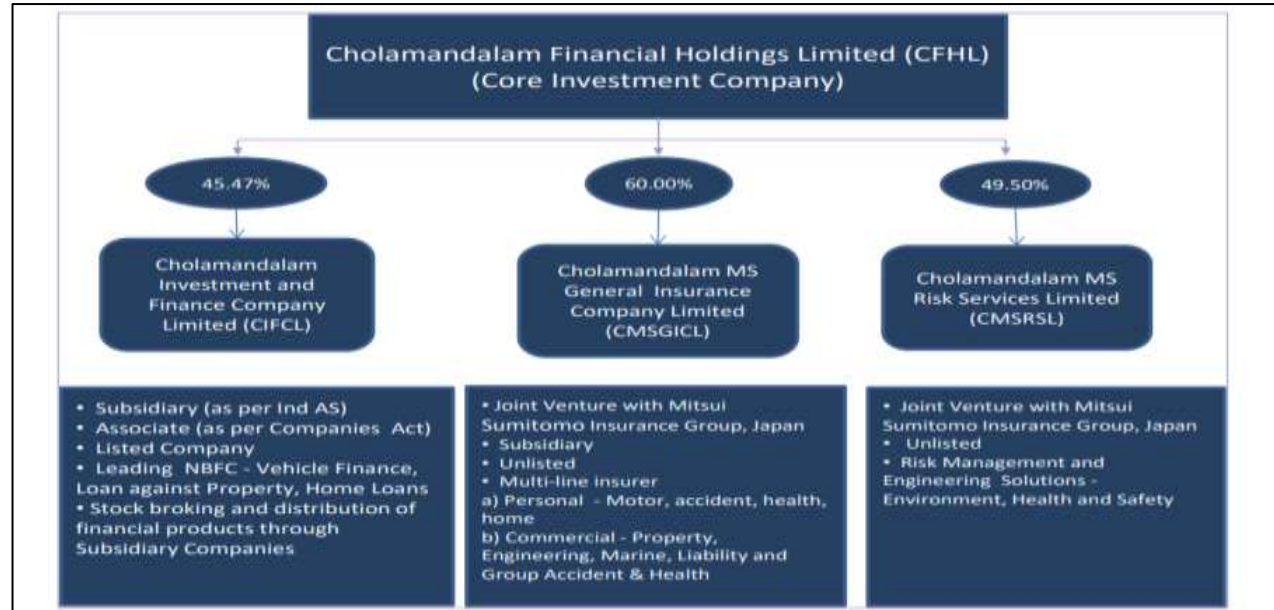
CIFCL Q4FY21 result update

CIFCL reported 37.2% YoY growth in Net Interest Income (NII). NIM during the quarter remained steady at 7.6%, with continued cost of funds tailwinds (~120bps sequentially), offset by interest income reversals. Employee expenses (68% YOY) witnessed a steep increase on account of deferred incentives/salary increases, along with headcount additions in the collections team. Operating profit grew by 35% YoY, while Net profit came at Rs.243.2 cr (470% YoY) compared to Rs.408.9 cr in last quarter. The asset quality witnessed marginal deterioration (GNPL at 3.96%) with vehicle finance GNPA inching up from 2.7% to 3% sequentially, while GNPA for home equity segment remained elevated at 7.3%. the company has adequately provided for its Gross Stage-II/III assets at 16.8/44.3% PCR. Disbursement growth was only 2% sequentially. Slowdown was evident, particularly in used vehicles (-25% QoQ), tractors (-13% QoQ) and home equity segment (-2% QoQ). The second wave of the pandemic is likely to further impact the disbursements. We expect AUM growth of 14.2% CAGR during FY20-FY23E.

Long-term triggers

Strategic holdings in group companies

CFHL earns revenue predominantly by way of dividend income from investments held in subsidiary and other group companies. Additionally, the Company has invested its surplus funds in fixed income securities or instruments of similar nature thereby ensuring safety of capital and availability of liquidity as and when required. Since CFHL does not have operations of its own, it does not have major operating expenses with majorly being towards its two employees and director fees.



Strong Parentage

Founded in 1900, the ~Rs. 369 Bn, Murugappa Group is one of India's leading business conglomerates with base in south India. The Group has 28 businesses. These companies are market leaders in served segments including Abrasives, Auto Components, Transmission Systems, Cycles, Sugar, Farm Inputs, Fertilizers, Plantations, Bio-products and Nutraceuticals. Murugappa Group has forged strong alliances with leading international companies such as Groupe Chimique Tunisien, Foskor, Mitsui Sumitomo, Morgan Advanced Materials, Sociedad Química y Minera de Chile (SQM), Yanmar & Co. and Compagnie Des Phosphat De Gafsa (CPG). It has a wide geographical presence all over India and spanning 6 continents.

Renowned brands like BSA, Hercules, Montra, Mach City, Ballmaster, Ajax, Parry's, Chola, Gromor, Shanthi Gears and Paramfos are from the Murugappa stable. The Group fosters an environment of professionalism and has a workforce of over 50,000 employees.

Cholamandalam Investment and Finance Company Ltd (CIFCL)

CIFCL, an NBFC incorporated in 1978, is one of the leading, comprehensive financial service providers. It has diversified product portfolio such as vehicle finance (72% of AUM), SME & home equity loans (22% of AUM) and Home loans (6% of AUM). It is one of the leaders in the commercial vehicle finance segment. As of Q4FY21 the AUM stood at Rs. 69,996 cr. It has 1137 branches across 29 states/Union territories (80% locations are in rural, 13% in semi-urban and rest 7% in urban area).

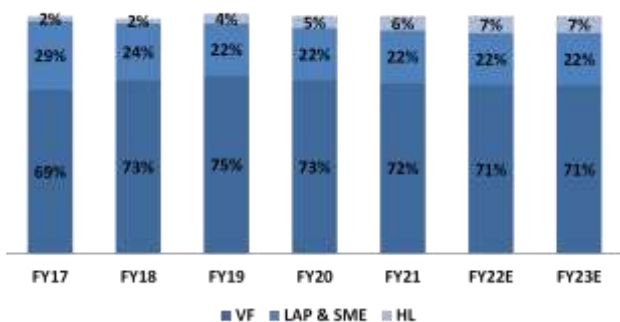
During the last five years, the company has established a credible operational and financial track record as manifested by superior growth in both AUM and Net profit at 20% CAGR. Despite the industry facing many challenges in past couple of years, CIFCL has been able to maintain stable asset quality. It has the lowest non-performing assets ratio in the industry. It has been constantly giving dividend since more than last ten years.

The rural segment has been resilient and rising government spends, increased sowing and ample reservoir levels augur well for rural-focused players such as CIFCL. To combat the problem of slowdown in new vehicles sales, the company has started focusing on used vehicle segment. This will help it in the time of post corona recovery phase as the demand for used vehicles will emerge first (due to lower cost). Improved industrial activity, steady agricultural output, and the government's focus on infrastructure will aid growth in the long-term considering a lower base currently. An improvement in demand and better availability of funds could further improve the growth prospects. The Company has a comprehensive Risk Management Policy in place and has laid down a well-defined risk management framework to identify, assess and monitor risks and strengthen controls to mitigate risks.

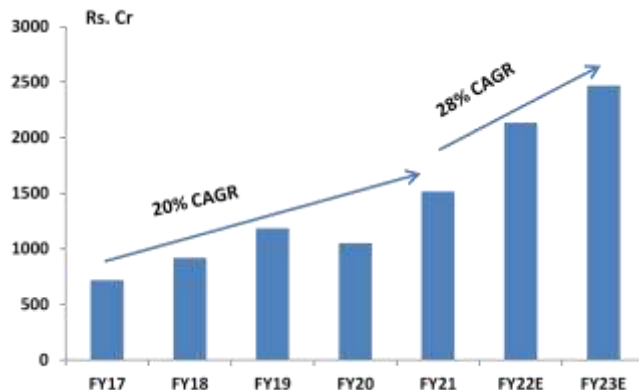
The Home Equity (HE) business continues to focus on a systematic approach to build a healthy portfolio mix, with more than 80% of the portfolio as Self-Occupied Residential Properties (SORP) and an average loan ticket size of less than Rs.50 Lakh. Adequate Loan-to-Value (LTV) ratio in their portfolio will help it manage risk of downward revision in property prices.

Home Loans (HL) business offers loans for self-construction, purchase of new and resale flats/ independent houses, balance transfer from other financiers, top-up loans for existing customers. Since the past five years, the residential real estate sales have been almost stagnant. COVID-19 pandemic has further created a sharp price cut. Early economic indicators are encouraging. The government's constant aids to the sector along with lowest interest rates are key triggers for us to believe that the real estate and housing finance sectors have bottomed out.

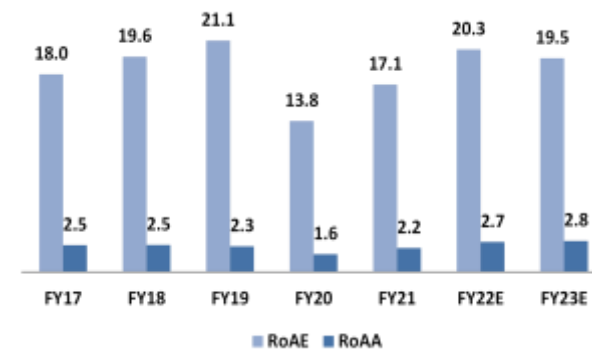
AUM contribution trend (%)



PAT is expected to grow at 28% CAGR



Return ratios (%)



Cholamandalam MS General Insurance Company Ltd (MSGICL)

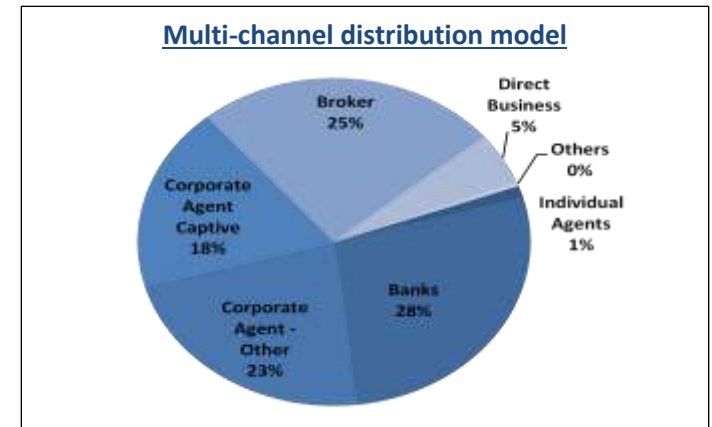
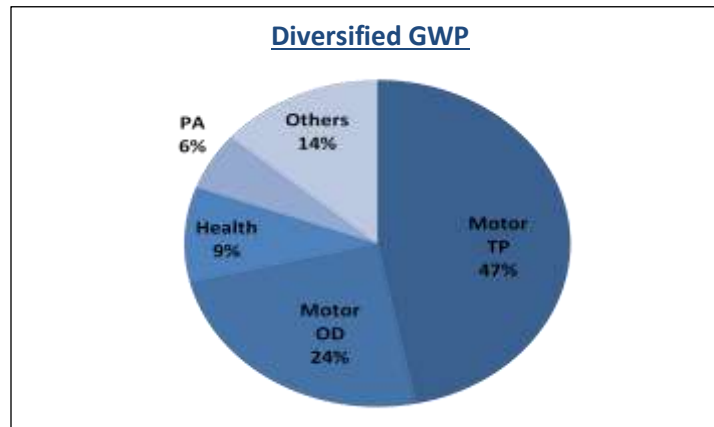
The Company holds 60% in the paid-up equity share capital of MSGICL - a joint venture with Mitsui Sumitomo Insurance Company Ltd., Japan and is a material subsidiary of CFHL.

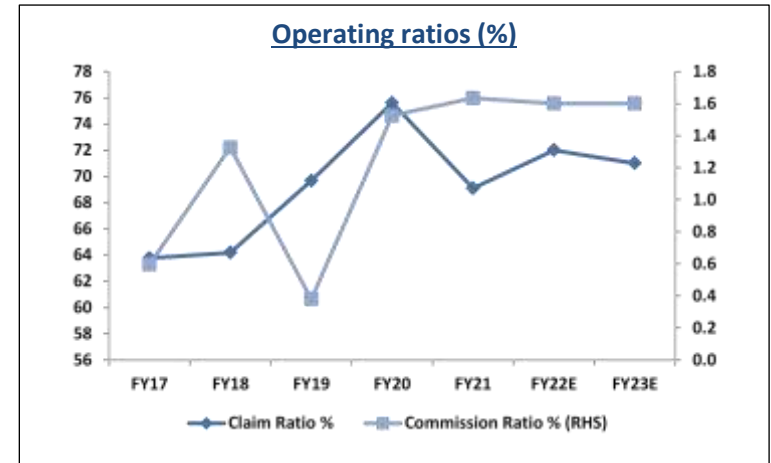
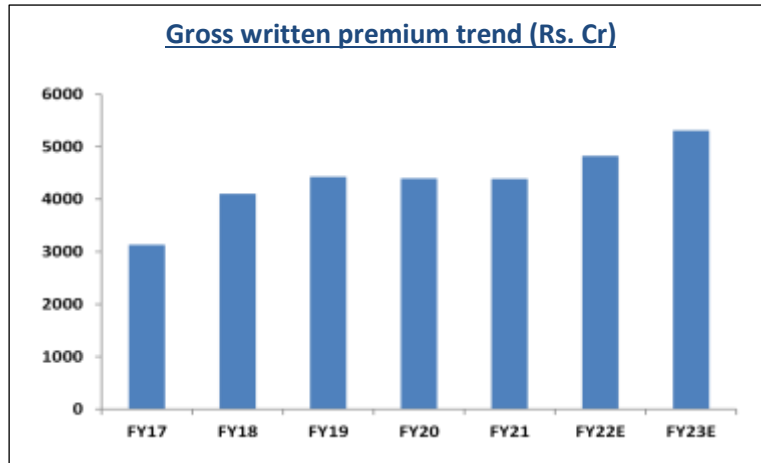
MSGICL, the insurance business division of CFHL, is registered with Insurance Regulatory and Development Authority of India (IRDA) to carry on general insurance business. MSGICL offers a wide range of insurance including motor, travel, health, accident, home and other types of insurance for corporate customers. Given the low solvency and high underwriting losses of state-owned insurers who collectively have over a 50% market share, we expect a structural shift towards stronger private players. MSGICL with a strong JV partner, credible management, and controlled combined ratio will be a key beneficiary.

MSGICL has retail (87% in business mix) focused diversified revenue streams. Motor third party contributes 46.8% in Gross Written Premium (GWP), Motor OD (Own Damage) contributes 24.4%, health 9.4%, personal accident 5.7% and 13.7% by others. It has multi-channel model which ensures lesser concentration. Further, no state constitutes >25% of the GWP, which ensures geographic

diversification. The company is 8th largest private insurer by GWP, 7th largest private motor insurer by GWP with 7.0% market share among private players. The company has a strong Pan India Multi-channel distribution network which comprises of 141 Chola MS branches across India has a total of 50k+ agents. On the Bancassurance side, Chola MS is No 1 in GI Bancassurance Space (Non Captive) – FY20. Mitsui Sumitomo Insurance Company Limited (MSI) Japan, the joint venture partner continues to provide support in areas of overall business improvement measures, reinsurance, business development with Japanese and Korean clients in India, claims processes and training.

Global comparison of general insurance premium as percentage of GDP across countries indicates that at 0.94% of GDP, penetration in India is low. Developed economies such as the US and UK have a penetration of 8.5% and 2.3% respectively. Every 0.25% increase in penetration can increase industry GWP by Rs.350 Bn. This presents immense opportunities to expand the insurance business given the favorable demographics, rising urbanization, growing household income and the increasing awareness of the need for financial protection. Further, PSU insurers have been consistently losing market share (despite lowering prices), however the intensity of market share loss has further increased in last 2-3 years as PSUs lack adequate capital to write incremental business. Private insurers have gained 1,000bps market share over last 10 years, by improving underwriting quality. Though the government is talking about a merger and capital infusion in the 3 bleeding PSU insurers, we foresee little improvement in their market share as private insurers will continue gaining market share with their sales aggression, better products and customer service.





Cholamandalam MS Risk Services Ltd (CMSRSL)

The Company holds 49.5% in the paid-up equity share capital of CMSRSL, a joint venture with Mitsui Sumitomo Insurance Company Ltd., Japan and has a technical collaboration with Inter Risk, a group company of Mitsui Sumitomo Insurance Group.

CMSRSL, is engaged in providing risk management and engineering solutions in the field of safety, health and environment, in association with CMSGICL. It has partnered with organizations in implementation of their CSR projects in the areas of Health, Safety & Environment (HSE) programs, and Road Safety programs. It has also partnered with digital developers to introduce HSE digital products and explore introduction of AI integrated studies into the market. The joint venture partner, Mitsui Sumitomo Insurance Company Ltd., Japan, continues to support it by introducing Japanese companies entering the Indian market for risk management services.

Risks and concerns

Holding company discount

Since the company is a holding company it does not get full valuations of its investments in associates as it does not directly run these businesses. This discount keeps widening and narrowing based on the market sentiments.

Lower returns from investments

The profit earned by the company is invested in various listed/unlisted financial products to earn income. With the contraction in interest rates, the returns earned by the company on its investments could reduce.

Economic slowdown

The company's performance depends on the performance of the companies discussed above. Any downturn in these is going to adversely affect the profitability of these companies and indirectly the value of Cholamandalam Finance Holdings.

The prospects of Commercial Vehicle industry are largely linked to economic activity, so any prolonged slowdown in the economy will impact the sale of Commercial Vehicles and ultimately to the vehicle financing companies both in terms of loan growth and asset quality. Further, CIFCL has exposure to the SME segments which may be vulnerable if economic recovery is delayed.

In the case of insurance business, the slow economic growth might also impact the business both in terms of new business growth and persistency.

CIFCL's over dependence on semi-urban and rural areas

The company has large dependence on rural and semi-urban areas. Over 90% of the branches are located in semi-urban and rural areas. Poor rainfall could lead to slowdown in rural areas compounding problems for the company. Further, it has high-risk customer base as it offers loan to economically lower placed people, who have no credit ratings.

High competition in general insurance business

Insurance business is highly competitive business. There has been intense competition from other private as well as public general insurance companies. This price war has created a high loss ratios and underwriting losses for most of them. Rising competition especially via digital disruptors poses pricing risk.

Government's announcement regarding merger of three large public sector general insurance companies (National Insurance, United India Insurance and Oriental India Insurance) could create a giant and an almost monopolistic situation.

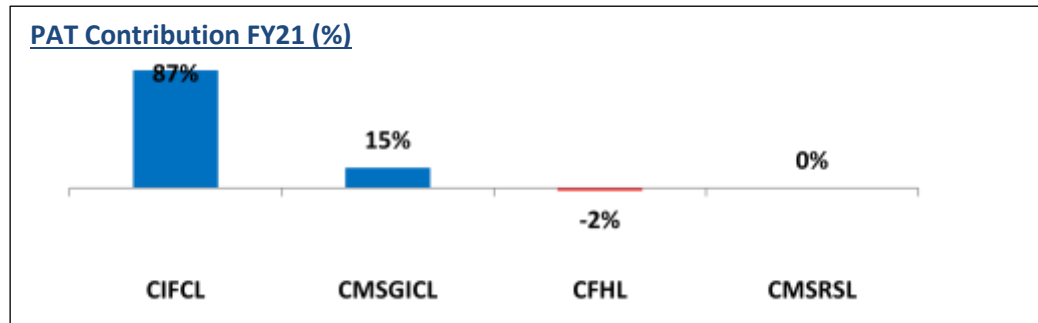
Regulatory changes and catastrophe risk

Change in Motor TP Regulation, inability to diversify away from Motor TP, higher claims in Motor TP or Crop Insurance, any adverse development with key distribution partners along with any unforeseen catastrophe are the key risks for the general insurance business.

Company background

Cholamandalam Financial Holdings Limited (CFHL) (formerly known as TI Financial Holdings Limited) was incorporated in 1949 and is a part of the Murugappa Group, one of the most diversified business conglomerates of India. Consequent to the scheme of arrangement (demerger) sanctioned by the National Company Law Tribunal, the manufacturing business of the Company was transferred to a separate company and the company retained its finance business.

CFHL is registered with the Reserve Bank of India as a Non-Deposit taking Systemically Important - Core Investment Company (CIC-ND-SI) pursuant to the receipt of Certificate of Registration from the Reserve Bank of India (RBI) dated January 6, 2020, under Section 45-IA of the Reserve Bank of India Act, 1934. After the demerger, the company has significant shareholding in companies viz., Cholamandalam Investment and Finance Company Ltd, Cholamandalam MS General Insurance Company Ltd and Cholamandalam MS Risk Services Ltd.



SOTP Valuation:

	Metrics	Base Case	Bull Case
CIFCL	on the basis of our report's target of Rs.613 (45.5% holding)	1218.0	1218.0
Holding Co. Discount	50%/45%	609.0	548.1
Total		609.0	669.9
CMSGICL	2.0/2.25 ABV FY23 Rs.85.4 (60% holding)	102.5	115.3
Value per share		711	785

Subsidiaries

Particulars	Cholamandalam Investment and Finance Company Ltd. (CIFCL)	Subsidiaries of CIFCL		Cholamandalam MS General Insurance Company Ltd.
		Cholamandalam Securities Ltd.	Cholamandalam Home Finance Ltd.	
Share capital	164.07	22.5	42.4	298.81
Reserves & surplus	9396.24	11.87	11.36	1546.71
Total assets	74548.42	86.7	61.72	14085.14
Total Liabilities	64988.11	52.33	7.96	12239.62
Investments	1618.82	3.71	9.63	10262.49
Turnover	9519.62	30.14	37.15	4370.46
Profit / (Loss) Before Tax	2038.44	6.84	2.62	366.82
Provision for taxation	523.53	1.92	0.84	91.11
Profit / (Loss) After Tax	1514.91	4.92	1.78	275.71
Proposed Dividend	35%	Nil	Nil	Nil
% of shareholding	45%	100%	100%	60%

Associates and Joint Ventures

Particulars	Cholamandalam MS Risk Services Limited (JV)	Associates of CIFCL	
		White Data Systems Private Limited	Vishvakarma Payments Private Limited
No. of Shares	989979	1275917	2100
Amount of Investment (in Rs. Cr.)	0.99	8	0.0021
Extent of Holding (%)	49.50%	30.87%	21.00%
Net worth (in Rs. Cr)	26.04	10.65	0
Profit / (Loss) for the year (in Rs. Cr)	1.95	-2.3	0

Financial Snapshot of CIFCL

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
NII	2986.8	3531.9	4648.3	5104.0	5763.8
PPOP	2134.4	2483.1	3360.4	3793.9	4380.4
PAT	1186.2	1052.4	1515.1	2136.3	2467.9
EPS	15.2	12.1	18.5	26.0	30.1
ROAE (%)	21.1	13.8	17.1	20.3	19.5
ROAA (%)	2.3	1.6	2.2	2.7	2.8
ABVPS	68.1	84.2	94.9	123.4	150.7
P/ABV	7.5	6.1	5.4	4.1	3.4
P/E	33.6	42.4	27.7	19.7	17.0

Financial Snapshot of CMSGICL

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Premium from Direct Business Written (Gross)	4428.2	4398.5	4388.2	4827.0	5309.7
Premium Earned (Net)	3352.3	3409.2	3357.6	3693.3	4062.7
Operating Profit	258.1	538.4	580.4	532.3	626.2
PAT	178.9	149.4	281.7	314.8	352.6
Claim Ratio %	69.7	75.6	69.1	72.0	71.0
Commission Ratio %	0.4	1.5	1.6	1.6	1.6
EPS	6.0	5.0	9.4	10.5	11.8
BV	48.6	52.7	63.1	73.6	85.4
RoE (%)	12.3	9.5	14.9	14.3	13.8

Financials

Income Statement (Standalone)

(Rs Cr)	FY18	FY19	FY20	FY21
Total Revenue from operations	64.7	73.5	90.9	58.1
Other Income	0.0	0.0	0.0	0.1
Total Income	64.7	73.5	90.9	58.1
Finance cost	0.0	0.0	1.5	21.7
Employee Benefits Expense	0.6	0.9	1.0	1.1
Depreciation and amortisation expense	0.0	0.0	0.0	0.0
Other Expenses	2.6	1.7	1.5	1.5
Total Expense	3.2	2.6	4.0	24.2
Profit Before Tax	61.4	70.9	86.9	33.9
Tax	2.1	4.4	3.6	12.2
Profit After Tax	59.4	66.5	83.3	21.7
Other comprehensive income	0.6	-0.7	-0.6	0.5
APAT	60.0	65.9	82.7	22.2
EPS	3.2	3.6	4.4	1.2

Balance Sheet

(Rs Cr)	FY18	FY19	FY20	FY21
SOURCE OF FUNDS				
Share Capital	18.8	18.8	18.8	18.8
Reserves	1000.8	1045.8	1099.5	1122.0
Shareholders' Funds	1019.5	1064.5	1118.3	1140.8
Long-Term Borrowings	0.0	0.0	200.6	0.0
Other Non-Current liabilities	2.2	2.3	1.9	9.8
Total Source of Funds	1021.8	1066.8	1320.8	1150.5
APPLICATION OF FUNDS				
Investments	939.8	955.7	1278.4	1279.2
Deferred Tax Assets (net)	0.2	0.3	0.3	0.0
Total Non Current Assets	939.9	956.0	1278.7	1279.2
Cash & Equivalents	82.5	111.8	43.3	23.5
Other Current Assets	0.1	0.1	0.0	0.1
Total Current Assets	82.6	111.8	43.3	23.6
Short-Term Borrowings	0.0	0.0	0.0	150.0
Trade Payables	0.4	0.3	0.6	0.6
Other Current Liab & Provisions	0.5	0.7	0.7	1.8
Total Current Liabilities	0.8	1.0	1.3	152.4
Net Current Assets	81.7	110.8	42.0	-128.8
Total Application of Funds	1021.8	1066.8	1320.8	1150.5

Cholamandalam Financial Holdings Ltd

Income Statement (Consolidated)

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
Total Income	10948	13137	13905	15296	16978
Growth (%)	22.9	20.0	5.8	10.0	11.0
Operating Expenses	5147	6588	6751	7442	8278
EBITDA	5801	6549	7154	7854	8700
Growth (%)	31.2	12.9	9.2	9.8	10.8
EBITDA Margin (%)	53.1	49.9	51.5	51.4	51.3
Depreciation	77.9	149.8	145.5	157.1	169.7
EBIT	5723	6399	7008	7697	8531
Interest	3586.9	4592.4	4607.8	4873.3	5224.2
PBT	2136	1807	2401	2824	3306
Tax	721.0	641.8	636.4	705.9	826.6
PAT	1415	1165	1764	2118	2480
APAT	697	551	825	1118	1280
EPS	37.1	29.3	43.9	59.6	68.2

Balance Sheet

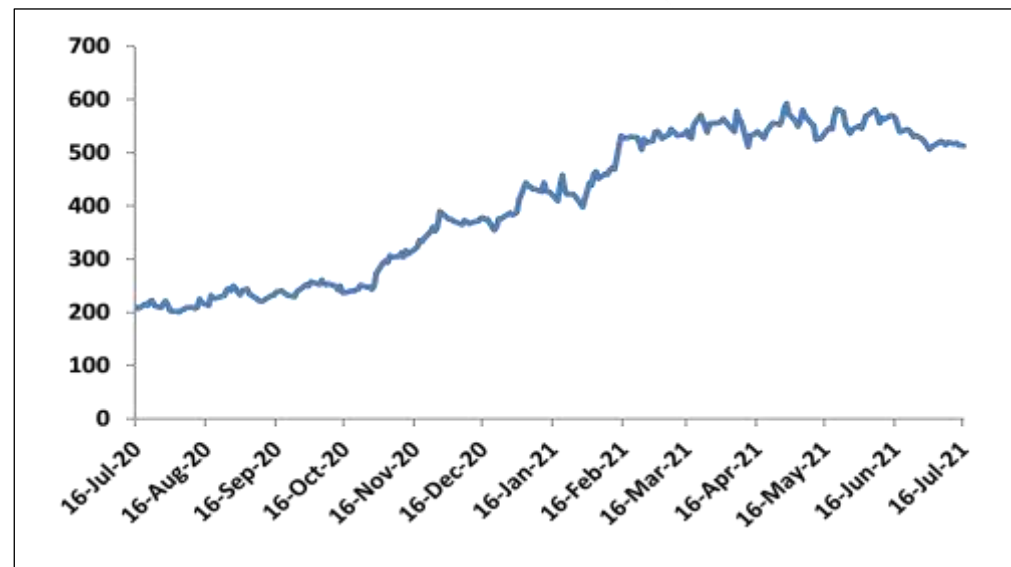
(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E
SOURCE OF FUNDS					
Share Capital	18.8	18.8	18.8	18.8	18.8
Reserves	3925	4572	5367	6466	7727
Shareholders' Funds	3944	4591	5386	6485	7746
Minority Interest	3921	5111	5973	5973	5973
Long-Term Borrowings	36485	47983	51310	54902	58745
Total Source of Funds	44350	57684	62669	67359	72464
APPLICATION OF FUNDS					
Net Block	263	437	404	393	304
Capital Work-in-Progress	14	11	10	11	12
Investments	7552	8893	11678	12761	11678
Goodwill	43	43	43	43	43
Deferred Tax Assets (net)	608	687	973	1022	1073
Long Term Loans & Advances	52611	55396	65839	71106	78217
Other Non-Current Assets	997	2065	2309	2471	2718
Total Non Current Assets	62088	67531	81256	87807	94044
Trade Receivables	1903	1010	1155	1271	1436
Cash & Equivalents	3945	7314	6204	5591	5553
Total Current Assets	5849	8324	7359	6862	6989
Short-Term Borrowings	13962	7135	12487	13736	14835
Trade Payables	856	703	1076	1184	1337
Other Current Liab & Provisions	8770	10332	12384	12390	12397
Total Current Liabilities	23588	18170	25947	27310	28569
Total Application of Funds	44350	57684	62669	67359	72464

Cholamandalam Financial Holdings Ltd

Key Ratios

	FY19	FY20	FY21	FY22E	FY23E
Profitability (%)					
EBITDA Margin	53.1	49.9	51.5	51.4	51.3
EBIT Margin	52.4	48.7	50.4	50.3	50.3
APAT Margin	13.0	8.9	12.7	13.9	14.6
RoE	19.2	12.9	16.5	18.8	18.0
RoCE	12.9	11.1	11.2	11.4	11.8
PER SHARE DATA (Rs.)					
EPS	37.1	29.3	43.9	59.6	68.2
BV	210	245	287	345	413
Dividend	1.3	0.7	0.7	1.0	1.0
VALUATION (x)					
P/E	17.4	22.0	14.7	10.8	9.5
Dividend Yield	0.2	0.1	0.1	0.2	0.2
P/BV	3.1	2.6	2.3	1.9	1.6
EV/EBITDA	12.0	10.6	9.7	8.9	8.0

One Year Price Chart



Disclosure:

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Any holding in stock –No

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