"Cholamandalam Financial Holdings Limited Q4 FY2022 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Cholamandalam Financial Holdings Q4 FY2022 Results Conference Call, hosted by Axis Capital Limited. As a reminder all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Praveen Agarwal from Axis Capital Limited. Thank you, and over to you, Sir!

Praveen Agarwal: Thank you Aman. Good morning everyone. From the management team we have Mr. Sridharan Rangarajan – Director of Cholamandalam Financial Holdings; Mr. N Ganesh - Manager & CFO of Cholamandalam Financial Holdings; Mr. V Suryanarayanan – MD of Chola MS General Insurance; and Mr. S Venugopalan - CFO at Chola MS General Insurance.

I would request Mr. Sridharan to give us his initial remarks post which we will open the floor for Q&A. Over to you Mr. Sridharan!

Sridharan Rangarajan: Thank you. Good morning to all, and hope all are doing well and your family also is doing well. Though the pandemic is slowly coming down kindly take care of yourself. To start with I think we have the entire team to answer and discuss with you to our questions. Our MD, Mr. Suryanarayanan and Venugopalan, CFO, Chola MS General Insurance is there, Ganesh is also there, our CFO for Chola Financial Holdings.

We have posted the presentation, so you have an opportunity to go through this and I will just quickly walk through a few of the highlights. We are as usual consolidating NBFC Chola Finance as subsidiary and Joint Venture Chola MS Risk continue to report under Ind AS, as per the regulatory requirement.

I will come straight away to the standalone financial performance. Chola financial holdings income consists of income by way of dividend, interest and royalty for brand use. Total income for the quarter ending March 2022 is about 50.85 Crores against 50.74 Crores in the corresponding quarter of the previous year. Profit after tax is about 36.3 Crores against 31.9 Crores against the corresponding quarter last year.

The consolidated result for the company consists of the results of Cholamandalam Investment and Finance Company and Chola MS General Insurance, as well as the Chola MS Risk, which is a joint venture. Total revenue for the current quarter ended March 2022 increased by 6% to 3743 Crores while the profit after tax increased by 220% to 687 Crores primarily due to reduction in impairment charge on loans.

I think there is quite a lot covered in detail on Cholamandalam Investment Finance Company. So, I will go straight away into Chola MS General Insurance. Chola MS General Insurance registered a GDPI of 4854 Crores in FY2022 an increase of 10.3% over the previous year driven by increased contribution from new channels and growth in commercial and SME segment offsetting the drop in financial channel. The growth excluding financial channel was 14.5%. The company continued well in changing the mix of products within the motor insurance.

The share of two-wheeler has grown from 16% to 23% and private car share has grown from 25% to 29% resulting in a reduction in commercial vehicle share from 58% to 48%. The company maintained its leadership position in motor LOB in Tamil Nadu, Chhattisgarh and targeting to reach number one in Andhra Pradesh and Telangana. The company absorbed 262 Crores of opening balance of deferred acquisition cost as per IRDA advice.

The company continues its good effort in making the compromise settlement, the solvency as at March 2022 is 1.95 times after considering the disallowance of 165 Crores of taxes paid towards contingent liabilities as per IRDA circular. This has an impact of 0.19 times in solvency which means the solvency needs to be 1.95 plus 0.19 in the normal course. The major concern I would say that Indian economy is inflation driven by crude oil as well as by the commodity price.

The global yield on debt is increasing and along with that higher Indian government borrowing plan putting pressure on Indian debt market interest rate though such interest rate is beneficial for fresh investment in terms of the yield. The MTM value of the existing book would have negative impact on profit booking. In summary the company has addressed all the issues starting from provisional investment absorption of DAC and COVID claims. The company has invested in digitizing the process, customer interfaces and analytics. It has strengthened the team and would grow from strength-to-strength from here. So, I would now open up for Q&A. Thank you once again to all.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Devansh Nigotia from SIMPL. Please go ahead.

Devansh Nigotia: Sir thanks for the opportunity. Just couple of questions; one is in the asset quality we are seeing 0.5% improvement, so GNPA will improve from 0.8% to 0.3%, but no write-backs have flown in the P&L, so if you can help us understand what exactly has happened over there.

Sridharan Rangarajan: Could you please repeat your question, we cannot hear you well.

Devansh Nigotia: Asset quality GNPA has improved from 0.8% to 0.3% QoQ, but we are not seeing any write-backs that have come for us. So, if you can help us understand.

Sridharan Rangarajan: You are talking NPA of the NBFC business is that correct?

Devansh Nigotia: No, the investment book of the general insurance.

Sridharan Rangarajan: Can you please go ahead with your next question? We will take note on that.

Devansh Nigotia: Regarding investment book only if you can help us understand the fixed on floating bond mix. So we can assess the incremental impact on the increasing is on our fixed bond, which can come. So this was regarding the investment book, I mean, in our operating expense we are continuously seeing this step up especially in advertisement and publicity expense even if I adjusted for the one-off, the amortization, which is happening. This amount has almost increased by 50% YoY, and the kind of benefit we are now seeing in the business growth, the only benefit is probably the mix change that has happened in the motor business, but other than that we are probably growing in line with the industry or probably around that. So, when this growth can be higher than the industry and where exactly these investments and ad expense are, are these the ads that you see on the television or these are variable in nature for the distribution, so that is one. In fire business also we are lagging growth compared to our peers when these are highly profitable segments. So what exactly is happening there? In our prepaid expenses, the amortization was 36 Crores and 80 Crores was expected, so while lower amortization has happened and what is the current balance of prepaid expense, which is yet to be amortized.

Suryanarayanan : I will take the last one first. On the prepaid expenses there is nothing that is left to be absorbed as at March 2022. IRDA had advised us to absorb the complete portion of prepared expenses relating to sourcing costs by the year end that is March 2022. So whatever you are seeing on the balance sheet as prepaid expenses are normal prepaid expenses and there is nothing to do with sourcing cost. On the investment book, in the presentation deck in page #53 , we can see that the change in portfolio is also happening where the gradual shift away from the G-sec book into the housing , infrastructure book. On the question about investment portfolio write backs, our stressed assets are mainly in Reliance Capital as also in IL&FS where the level of provisioning is high. We may have only about 12 Crores of exposure that is open with respect to IL&FS, but then we know that recovery is certainly on the cards both in the case of IL&FS as well as in Reliance Capital, and recovery should get recognized on cash basis hopefully in 2022-2023. I think one of the questions asked is that how much is locked as a fixed interest and how much is locked as variable interest. Everything is fixed interest, but we have bank deposits constituting 8.7% of the entire investment book which can be redeployed as interest rates move up.

Now I will move on to the other question which is relating to Opex. This year certainly was a year of transition where it is not just the opening prepaid expenditure that had to be absorbed, but also the costs on the long-term business that we procure had to be absorbed. The presentation reflects the combine of operating costs and the commission costs. As mentioned even in our earlier calls, our long-term business proportion is roughly about 8% to 10% of our topline. These relate essentially to the dwelling businesses that we write where the typical business goes up to 10 years and then on the credit linked personal accident businesses ranging upto five years and in some of the benefit-health policies that we write which goes up to three years. So these are the long-term businesses that we write and to the extent that we have growth in the volumes of these businesses, the P&L takes the hit upfront by way of acquisition cost even though the earnings from the premium would flow over the period. As the growth in these products stabilizes it will reach an equilibrium where you will not have any incremental impact. As can be noticed from the presentation deck, our health, PA volumes did go up rather sharply in Q4 both in the health as well as in the PA. In page # 48 on the presentation deck you would have noticed that our health growth was robust at about 46% and likewise the return-back to reasonable growth in personal accident in Q4. So all this is also going to mean that the cost gets absorbed upfront.

Devansh Nigotia: But when we look at our Opex the percentage of net written premium it is at 36% and that is almost 7%, 8% higher than our peer. So I am still not able to understand where are we at such a big division.

Suryanarayanan: Let me explain that, I do not know whom you are looking at peers, but to give you a perspective on the costs in the industry, those companies which have a fairly large complement of government business namely the crop business or any other government health business are likely to have a lower Opex because in both government businesses there is no sourcing cost or if at all it is there, it is very, very marginal more to do with the banking related cost by way of enrollment cost that they incur in the crop business. Otherwise there are no intermediaries as these are tender businesses. Therefore companies that have a high proportion of crop business will have their cost structure lower, companies which do not have any crop business implies their business is largely intermediary driven and therefore to that extent you will find that the cost structure is at a different level. Going by numbers that we have seen with respect to competition we believe that amongst companies that do not have crop business we compare reasonably well. So that probably would explain why there is such difference of 6%, 7%, 8% whatever is there.

Devansh Nigotia: So as a percentage of net return premium these are 36% as of now. What would be our outlook for next two to three years, how much should Opex be as a percentage of net return premium.

Suryanarayanan: As I said earlier, the upfront absorption will get bigger as we grow. I would tend to think that it can come down by about 1%, 2% at that level. Given that we are unlikely to have any large government business on our GWP, we may not be able to see a very substantial change because the sourcing costs would continue to exist. But then the efficiency certainly will creep in on a larger base and the Opex related absorption over a larger base would definitely flow into our P&L. So from the current level, about a 2% change is something that we can certainly look forward.

Moderator: Thank you. The next question is from the line of Sanketh Godha from Spark Capital. Please go ahead.

Sanketh Godha: Thank you for the opportunity. Sir, if you look at fourth quarter exit motor OD loss ratio seems to be reported at 83%. So it is definitely very elevated compared to what we have reported in nine months of the current year FY2022. So just wanted to understand if you want to extrapolate it to FY2023 will you see this 83% as a new normal or 70% plus I think more normalized number to get into FY2023 and if you believe it is 70% to be kind of a number then what could be the levers to achieve that kind of a figure that is question on motor OD. Similarly on motor third-party exit has marginally increased at 67% so we had a big lockdown exit in the entire year especially in the first quarter. So just wondering whether we will go back to that 80s, 90s kind of a number in 2023 if things normalize as we enter into it. So that is on motor business means if you can answer this then maybe I have a couple of questions on health and investment book.

Sridharan Rangarajan: First on the Motor OD business, yes 82.8% is one of the highest ever. We certainly see that, ratio around the mid 70s in motor OD given the current competitive intensity in the market. What would bring it from the 82.8 are the changing portfolio mix to reflect in the earnings. Our proportion of two wheelers has been going up continuously and should start reflecting in the earnings in the current year. Second element is that the pricing certainly on the new vehicles is far better, the portfolio is also seeing an improving change in mix of new vehicles which is coming in. Last year the proportion of older vehicles was much, much higher, but then the earnings impact arising from the new vehicles is certainly likely to be better as we have done better in terms of new vehicles in Q3 and Q4 of the previous year So these two would be very clear factors besides the efficiency factors. But then we also have to understand that there is also inflation push that will come in by way of both the hike parts prices as well as the labor charges. So while efficiency will take care of that these two factors the increasing proportion of new vehicles and the portfolio mix effect is what is likely to bring our OD loss ratios down to the mid 70s. Can I go ahead with the motor TP.

Sanketh Godha: Yes, go ahead Sir.

Sridharan Rangarajan: On motor TP, in the two years 2020-2021 and 2021-2022, we did see benefits coming out of the lockdown which is reflected in the P&L of not just Chola MS but also across other insurers as well. This year all of us are likely to see an increase from the reported levels of motor TP loss ratios. While the anticipated price increase can be some relief, but it is still awaited. We expect the final notification to be at not just at the draft exposure level, but at a slightly higher level as well. We certainly see our motor TP loss ratios going up definitely from FY2021 and FY2022 level I would tend to think that we are more likely to go closer to about at our FY2021 levels.

Sanketh Godha: And in motor TP given two-wheeler component is increasing so that acting as a buffer should play a role or even factoring does not think 80 is most likely the numbers to be reported in motor TP.

Sridharan Rangarajan: Motor vehicle act impact is something that while notified we will have to wait to see how the courts react to and the effect of faster reporting. but I am not too sure if companies would start even start to see the benefits out of the MV act straight away by way of faster reporting. But then some other benefits that were there in the MV act by way of pay and recovery orders can start showing some benefits.

Sanketh Godha: Sir given MVA got implemented now. So do you think any, because investment leverage has been the one of the biggest brownie points of our business model. So though it can improve potentially the loss ratio now the negative impact which assumes that six months clause gets potentially fully implemented on face value any thought you have made or internal working we have made which could have a potential impact on the investment leverage or float on motor TP business.

Sridharan Rangarajan: See given the larger proportion of the motor business as such and the fact that we have been doing fairly well on the long-term premium addition, our book size of long-term premium has really been growing and as at March 2022 I think the number is at about 1200 Crores.

Sanketh Godha: Yes.

Suryanarayanan: At that level , the beneficial effect of investment income is going to continue, yes, to an extent with faster reporting, the payments are also made earlier but I think I would see that more as a possible impact challenge for 2023-2024 and not necessarily for 2022-2023. So we have to first experience the faster reporting trend.

Sanketh Godha: My broader question was that the benefit of our cost ratios should be overwhelming the negative impact of lower deleverage and therefore net, net it is ROA accretive that is the way you look at it.

Sridharan Rangarajan: Yes, very clearly yes. Definitely our augmented investment corpus and therefore the investment income and to that extent, the effect will be on PBT, PAT and the ROE. That much is certain and not in doubt at all.

Sanketh Godha: Last two questions, on is on, see again even on health given we did not have largely anything with respect to Covid in the fourth quarter, we usually are in health and PA is less than 50% combined our loss ratio company in the historical past. I know the indemnity part has gone up and all those things, but still at 79% kind of a loss ratio in the fourth quarter in health and PA put together looks little on the higher side. Again wanted to understand why it led to that deterioration and finally if you can disclose the average duration of the bond what we hold that will be useful.

Suryanarayanan Yes, as compared to the past, the proportion of indemnity and benefit product mix was different for the current year especially with the financial channels and the consequent attachment businesses of PA and benefit health products not just really going up to the optimal level. We did see the change in trend in Q4 wherein we have seen a larger proportion of benefit products coming back and the PA products coming back. This should help reduce the and PA loss ratios further from the q4 level of about 78.9%, but it may not go back to our historical levels of 40% or 42%. As there is an indemnity business which cannot be run at that kind of loss ratio, we would only tend to think that this 78.9% can definitely go down to about 70% as we go along.

Sanketh Godha: Just the current mix of health into indemnity and benefit if you can disclose.

Sridharan Rangarajan: Presently, our indemnity benefit mix is at about 38% of indemnity and 62% was the bundled benefit products. While we would want them to be 50-50 by the growth of indemnity over a period of time, the higher proportion of benefit is actually beneficial in terms of balancing the loss ratio.

Sanketh Godha: Sir this 38%, 62% what you have given is only health right it is not health and PA put together right.

Sridharan Rangarajan: No, it is actually health and PA put together.

Sanketh Godha: And last if you can speak about the duration of the bonds.

Suryanarayanan: Duration, Venu correct me if I am wrong, our duration is at about 3.5 years. As was mentioned earlier in the call we have a fairly large component in the bank deposits which can be redeployed to our advantage. Of course it is factored in the duration workings, but then that is the flexibility that we have without losing anything on the interest rate.

Sanketh Godha: Got it Sir, perfect. Thank you. That is it from my side.

Moderator: Thank you. The next question is on the line of Kashyap from Broadview Research. Please go ahead.

Kashyap Kirit Pujara: Hi! Good morning. Actually I have joined in a bit late. I have a few basic questions. First is on the provisions and all cost absorption that you mentioned that the company has taken from here. So the right reflection of the current your FY2022 PBT is what 350 Crores in your view, what is the base from which we can build growth from here.

Sridharan Rangarajan: I think base level is about 300 Crores.

Kashyap Kirit Pujara: And just one broader question was that if you look at the investment book which is around 12500 Crores now which was 9300 Crores couple of years back and that is growing from here. So if one were to look at a close to 7% or 6.5%, 7% growth, I mean, investment return on that book which is growing are kind of with a 900 Crores of investment income and even if the GWP were to grow at 12% to 14% from here and you kind of more a 107% core at the overall level unlikely that we lose anything more than 350, 400 Crores. So is it fair to say that 500 Crores PBT of the business is more or less a fair reflection maybe a year or two out for the business if not this year then next but at some point we should logically arrive at that number is it a fair way of understanding the way that or the direction in which we are headed.

Suryanarayanan: Yes, assumptions relating to the investment book and income are quite logical and we will tend to concur with that. On the core business side yes last year 2021-2022 we returned back to the growth path of 10% plus growth. The numbers for April 2022 are out and I can say we have begun the new year well. As growth rate increases you will find that there will always be the pressure of absorbing cost upfront. So definitely yes over a two-year period we certainly see very clearly the business stabilizing down to a good level of profitability.

Kashyap Kirit Pujara: Thank you so much and all the best.

Moderator: Thank you. The next question is from n the line of Yash Mehta from Steinberg Asset Management. Please go ahead.

Yash Mehta: Thanks for the opportunity. I just wanted to first juxtapose your comment on competitive intensity with the changing composition of our business. Now as you can see over the past three, four years we have increased the share of passenger vehicles two-wheelers and private cars both at the same time reducing the share of CV. My question is what is allowing us, how are we able to kind of gain share in these favorable segments especially when there has been a rising competitive intensity in the industry. So that is my first question.

Suryanarayanan Let me proceed to answer. We have grown fairly strongly in the two-wheeler space. As I have mentioned in the earlier calls, the growth driver has been the entry into several OEM programs which has actually helped us gain a market share of about 15% in new two-wheelers that are sold in the country. We are present in almost all OEM programs in two-wheelers likewise in cars we have added to our OEM partnerships for example last year 2021-2022 we entered the Renault Nissan partnership where we are one of three players in the program. So that has helped us grow. As I have said in earlier calls our presence in tier three towns has helped us to leverage the motor business pretty well not just in the older vehicles but also in new vehicles, we are able to reach out to the dealerships in these markets better because of our market presence. This has helped us grow in both cars and two-wheelers over the last couple of years or last three years fairly significantly.

Yash Mehta: And would it be a fair assumption to say that given that since many other players the competitors would want to enter into and get share of the OEM business the higher expense ratio that we see in our shareholders account, this is a profit and loss account is that reflection of lower margins on OEM because you were having to pay to these OEMs effectively to get share from them.

Sridharan Rangarajan: We do see the competitive intensity is not just on the payout but it is also on the level of premium discounts that are offered. There was an earlier question on motor OD loss ratios heading north not just for us but for almost the entire industry. The driver is essentially the discounts that are provided for various categories. As discounts go to higher levels in the new vehicles, it operates as a benchmark for the immediate succeeding years as customer having bought a premium for a new vehicle at a certain discount, in the next year he is not going to pay anything more. This therefore leaves some sort of a cascading effect. Competition intensity in newer vehicles is higher. I also talked about that in the newer vehicles earned premium is higher and therefore will help the loss ratio down. So that is what causes the competitive intensity.

Yash Mehta: And you have mentioned that the financier channel has been declining now sorry if this is a basic question, just want to understand in general we have seen a recovery in this cost introduced, expect it to grow along or there are some structural reasons for the decline in the financier channel.

Suryanarayanan: No, we are seeing the revival in that channel. In the last two years since the financier channels had their own problems to contend with in terms of portfolio management and otherwise. In Q4 we did see some change and even in the month of April we have seen some change. We are adding partners and therefore we certainly expect that the volumes to improve and therefore in the composition that was mentioned earlier we would tend to think that our CVs would still more or less be continued around the mid 40s in terms of the motor composition.

Yash Mehta: Mid 40s.

Sridharan Rangarajan: Mid 40s right.

Yash Mehta: Motor composition of what.

Sridharan Rangarajan: The proportion of commercial vehicles in the motor business.

Yash Mehta: And my last question is in the last quarter you mentioned 350 Crores as a baseline PBT in the current call if I heard it correctly it was around 300 Crores my only question what is that divergence here and from in a quarter's time and as far as the resumption the profitability is concerned when would that be visible.

Suryanarayanan: So generally we do not give out any estimates of profit. The only point that I really keep saying is that definitely next year we are poised for much better growth and as growth comes in, we will have an effect by way of upfront absorption. And then definitely some tailwinds from possibly the higher yields on the investment book side which can always come in that is a beneficial factor that we see. So what we are indicating is more a ballpark number at those levels.

Yash Mehta: There is no incremental regulator from last quarter to this quarter.

Sridharan Rangarajan: Venu can you take this.

Yash Mehta: There is no negative development so from Q3 to Q4.

S Venugopalan: So far I tend to think that there is no negative development there in fact that some of the lockdown benefits that we was mentioned earlier that will not obviously reflect. So to that extent things are back to normal.

Yash Mehta: Fair enough. Thank you very much for the opportunity.

Moderator: Thank you. The next question is from the line of Deepak Sonawane from Haitong. Please go ahead.

Deepak Sonawane: Thank you for the opportunity. I am asking for motor OD like other players; order leading players have we taken any price hike in motor OD especially in Q4 FY2022.

Suryanarayanan: We get a fair chunk of business from the financiers as well as our own insurance express e outlets across the 460 outlets that we have which essentially deals with older vehicles. In the older vehicle we have made some corrections on the price on the CVs as well as in the used cars ie the older cars business. On the new cars, yes, we are still tracking the situation and we will need to make those corrections.

Deepak Sonawane: All right Sir, thank you so much and my second question is regarding our motor book mix. So if you can give us any differentiation, I mean, a contribution of new and used vehicle overall motor book for FY2022.

Suryanarayanan: Roughly we would have about 40% of the premium coming in from the new vehicles. Somewhere between 40% to 42% would be the new and then the balance would be the, it could be even a one year or two year, but then it is not more, so the 58% to 60% would be the older vehicles.

Deepak Sonawane: And my last question is regarding our electric vehicle, so what is the contribution of electric vehicle to our overall motor book.

Suryanarayanan: We do have a fairly reasonable presence in the electric two-wheelers where our market share is at about 8% now. We are not so much present in electric cars. we also have a small presence more a kind of an R&D type of presence in the electric three-wheeler which is there. But in electric two-wheelers, we have a decent presence and over the last six to eight months it has been growing well.

Deepak Sonawane: All right, thank you so much.

Moderator: Thank you. The next question is a follow-up question from the line of f Devansh Nigotia from SIMPL. Please go ahead.

Devansh Nigotia: Thanks for the follow-up. Just wanted to understand in our investment book we are seeing a step up in equity. So what is our overall strategy there, I mean, are you looking to increase this mix to increase the yield on the overall book. If you can just get some perspective.

Sridharan Rangarajan: Sorry I could not hear the question clearly.

Devansh Nigotia: I wanted to understand what is our overall strategy in terms of increasing our equity exposure in our overall investment book. So as of now it is very negligible but considering the duration of our investment book are you looking to increase this exposure over there or what is our overall strategy.

Sridharan Rangarajan: Definitely we would step up our exposures of equity in our investment book. Yes, we would like in the medium-term , to go upto 5%.

Devansh Nigotia: If you could just help us understand the team size of the equity investment book the fund manager or are we looking for some recruitments or…

Sridharan Rangarajan: We have a CIO and we have two research analysts backed up by him and we also have links to other research firms to support our investment activity.

Devansh Nigotia: Yes, my question has been answered. Thank you.

Moderator: Thank you. Ladies and gentlemen, that would be our last question for today. I now hand the conference over to the management for their closing remarks. Thank you and over to you!

Sridharan Rangarajan: I think thanks a lot for the participation and we feel that Chola MS General Insurance has weathered quite a lot of challenge in the last couple of years. It is a very solid franchise that we have built. We have also invested heavily in the digitization process we feel that I think the growth is here to stay for us and then we will go from strength-to-strength from here and that would be our message at this point in time. Thanks a lot again for your participation.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Axis Capital Limited we conclude today's call. Thank you all for joining us and you may now disconnect your lines. Thank you.