"Cholamandalam Financial Holdings Limited

Q3 FY'24 Earnings Conference Call"

February 06, 2024

MANAGEMENT: **MR. SRIDHARAN RANGARAJAN – NON-EXECUTIVE DIRECTOR – CHOLAMANDALAM FINANCIAL HOLDINGS LIMITED**
MR. GANESH – MANAGER & CHIEF FINANCIAL OFFICER – CHOLAMANDALAM FINANCIAL HOLDINGS LIMITED
MR. SURYANARAYANAN V – MANAGING DIRECTOR, CHOLAMANDALAM MS GENERAL INSURANCE –
MR. S. VENUGOPALAN – CHIEF FINANCIAL OFFICER, CHOLAMANDALAM MS GENERAL INSURANCE –

MODERATOR: **MR. SANKET CHHEDA – DAM CAPITAL**

Moderator: Ladies and gentlemen, good day. And welcome to the Cholamandalam Financial Holdings Q3 FY'24 Earnings Conference Call hosted by DAM Capital Advisors Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sanket Chheda from DAM Capital. Thank you and over to you, sir.

Sanket Chheda: Hello, everyone. Very good evening to all of you. We have with us the entire management team of Cholamandalam Financial Holdings to discuss their 3Q results. We have with us Mr. Sridharan Rangarajan, who is a Non-executive Director; Mr. Ganesh, who is the CFO; Mr. Suryanarayanan, who is MD, Chola MS General Insurance; and Mr. S. Venugopalan, who's the CFO of Cholamandalam MS General Insurance.

Without further ado, I will now hand over the call to management for their opening remarks. We'll follow that up with questions and answers. Over to you, sir.

Sridharan Rangarajan: Yes. Good afternoon to all of you and thanks for participating in the call. Since you all follow Chola Financial Holdings call, which consists of predominantly the insurance side of the business being well covered here, Chola Finance is well covered. And you have a separate earnings call which you have already attended. I request Mr. Suryanarayanan to give an overview and then we'll go ahead with the Q&A.

V. Suryanarayanan: Thanks, Sridhar. Good afternoon to each one of you for joining the earnings conference call of Chola Financial Holdings for Q3. We shall now proceed to give you a brief overview of the performance of Chola MS General Insurance for Q3.

In the quarter, Chola MS recorded a gross direct premium of INR1,855 crores with a growth rate of 14.2% as against a multiline insurers growth of 11.1%. The year-to-date December gross direct premium was at INR5,525 crores, with a growth rate of 25.8% as against the multiline insurers growth of 15.4%.

The company has grown across all its channels. In its captive channels, business from the sister company and the Insurance Express outlets grew by over 21% and growth of 27% from other channels, including crop. The addition of new channels has also helped attain this strong growth.

As an update, in the month of January, Chola MS has renewed its bancassurance agreement with IndusInd Bank for a period of 5 years. The tie-up has been a long-standing bancassurance relationship for Chola MS since 2006. Chola MS also renewed its agreement with Union Bank of India for a further period of 3 years. A new tie up has been signed with Federal Bank as well.

Moving on to other aspects of operations. The expense of management for Chola MS was 33.3% in Q3 as against 36.2% in corresponding quarter of previous year, which means a reduction of 2.9%. The claims ratio for the quarter was at 74.5% as against 69.7% in corresponding quarter.

Q3 claims also includes the impact from the cyclone that hit Chennai City and also the inundation in South Tamil Nadu. It also includes the claims provisioning for crop, which wasn't there in the previous period. The combined ratio for the quarter was at 110.3% and excluding the effect of the cyclone and inundation, this placed at 108.55%.

Chola MS investment portfolio corpus as at the end of December was at INR15,816 crores with an investment income of INR287 crores for the quarter. With no exposure to stressed assets, recoveries from the fully provided exposures will be recognized on cash basis as and when it happens.

The profit before tax in Q3 was INR134 crores as against INR58 crores in the corresponding quarter of the previous year. The year-to-date, in the 9 months ended profit before tax was at INR353 crores as against INR156 crores in the corresponding period. More importantly, the return on equity for the 9 months ended December has progressed to 15.3%.

We are now happy to take any questions that you may have.

Moderator: Thank you very much. We will now begin with the question-and-answer session. The first question is from the line of Swarnabh Mukherjee from B&K Securities. Please go ahead.

Swarnabh Mukherjee: I had about 3, 4 questions. So first one, as you mentioned in the opening remarks regarding the crop provisioning that has been included in the claims number in this quarter. So I just wanted to understand, last quarter, I think the segmental numbers which you have provided, we had a loss ratio around 103% in crop. This time around, 100%.

So last quarter's number, is it fair to assume that, that was the actual quantum of claims and no incremental provisioning was there and it has largely been done in this quarter? If you could maybe give us some breakup of that, how to think about it going ahead? That will be very useful. And also, if you could highlight on the nature of the crop tenders, what kind of excess of loss coverage if you might have in your tenders that you could highlight. That is the first question on crop. Maybe after that, I'll ask my remaining questions.

V. Suryanarayanan: Thanks, Swarnabh. As was mentioned last time around, Chola MS is operating the crop insurance in 4 districts of Maharashtra. We have excess of loss reinsurance arrangements for loss ratios of excess of 100%. So we are operating the 80% to 110% program. And for loss ratios exceeding 100%, we have the reinsurance protection. So the loss ratio that is reflected would more or less reflect the expected loss, plus the cost of the reinsurance program is what is reflected there. So any specific things, Venu, if you can add.

S. Venugopalan: Underlying loss ratio that we are assuming for crop has not changed and maybe the effect on the allocation of the XOL cost, which affects the loss ratio nominally, there is no fundamental change in the loss ratio that we are assuming between the previous quarter and the current quarter.

Swarnabh Mukherjee: Okay, sir. Got it. In terms of the loss ratios that we are seeing in fire and engineering in this particular quarter, which looks -- which is at a normal run rate, so how much of this is due to the NAT CATs that you mentioned? And how much is coming organically maybe because of price revision?

V. Suryanarayanan: We invite attention to Page 54 of the presentation deck, where we have given you in the last footnote, it shows the impact of NAT CAT events in fire LR for Q3, which is largely the effect of the cyclone and the flooding. For us, it was 36.6%. If overall loss ratio is reflected at 93.4%. 93.4% minus 36.6% is the effect of the normal fire loss for the quarter.

Swarnabh Mukherjee: Right. Any impact on engineering also because of this? Because the engineering loss ratio is also elevated.

V. Suryanarayanan: No engineering is a very small book. This is due to one single major loss there. But it's a very small book as compared to the fire.

S. Venugopalan: Even a single loss would trigger a higher loss ratio due to low NEP size in Q3. That is reflected in YTD LR which is normal.

V. Suryanarayanan: And the small book.

Swarnabh Mukherjee: Understood. Sir, now coming to the motor part of the business. So I think -- for this quarter, particularly, I think if I were to remove the impact of crop, given your overall loan book because it was not there, then our growth rate, what we are seeing is around 14%, would organically come down to a lower number in high single digits. I think from the numbers what I can make sense is that primarily because of the motor book, now I know your view on the two-wheeler side of the business.

But on the CV side, we are seeing a degrowth also and we are doing for the last couple of quarters, last 3 quarters a run rate of around between INR460 crores to INR530 crores. Is this where we should build the numbers going ahead? And some trends you can highlight, why you were maybe slightly more calibrated than where you were last year?

V. Suryanarayanan: So we have been far more prudent and tight with respect to a couple of aspects on the motor portfolio because the portfolio correction in terms of both payouts as well as discounts is something that we have been doing continuously even from Q2, which is where, if you look at Page 49, you can trace the growth of the motor line of business for Q3, we are at about 4.8% as against the industry growth of about 10%. So evidently here, we are punching below our weight, very clearly because of the choices that we are making and the portfolio correction that we are giving effect to.

Having said that, our portfolio continues to grow strongly in cars with the OEM and other channels and we are improving there. Commercial vehicles is also an area where we are seeing smaller drop in percentage that is evident in Page 56 of the deck, whereas compared to last year, we are almost about 4.5 percentage points higher in terms of cars. And commercial vehicles, we haven't dropped much. So it's actually about 2.3 percentage points, which, in my view, by the end of the year, it should be more or less closer to about 44% or so.

So two wheelers is something where -- while it may not dip further but it would more or less stay at around these levels, at about 16.8% to 17% is what it’s there. We believe that the effect of corrections that we have been making is showing up in the LR, which again, if you go back to the Page 54 and the footnote 3 in that presentation deck, you will see that the Motor OD LR, excluding the effect of the NAT CAT event has come down now to about 69.4%, which is almost a 5.5% reduction from where we were in Q1 and also almost about over 3% from Q2 level. So this directional journey towards a lower LR is becoming more prominent. So this will be the matter that will continue and we'll probably stay put around these levels.

Swarnabh Mukherjee: Understood, sir. Anything you are seeing since you are growing strongly in the private cars? So what is the industry trend that you are seeing? Is there a normalization in terms of the competition levels?

V. Suryanarayanan: We have always maintained that the competitive intensity has been high and motor is a business that is highly competed in the industry. But one trend that we have seen is, in Q3 almost all the larger frontline players, you would have seen them growing at more or less at about 4.5% to 5%.

So the established players, 4 of the 6 large players, you will find that it is more or less the growth in motor has been at that level. It is an effort from our side to prune down the loss ratios there and to make it more economically viable. So this is the step that many of the larger players are taking and we believe that we are doing the right thing.

Swarnabh Mukherjee: Got it, sir. One last one from my side. Your Banka channel growth has been slow. I just wanted to understand what products were getting sold there? And any -- should we expect this trend to remain?

V. Suryanarayanan: What we are mentioning is the PSU bank section there, which is there in Page 60 of the presentation deck. I suppose this is what you are referring to.

Swarnabh Mukherjee: Right, sir.

V. Suryanarayanan: So here, yes, exactly the growth has sort of tapered when you look at the corresponding 9 months, especially with the PSU banks where the property-related discounts are at greater play. But you will find that these volumes are still higher. But by the end of year, we do expect that things will improve to have a growth over the previous year.

Swarnabh Mukherjee: Okay. So just to clarify, this is primarily due to the property side of the business.

V. Suryanarayanan: Property side the high level of discounts is linked there.

Moderator: The next question is from the line of Ravi Purohit from Securities Investment Management. Please go ahead. Please go ahead.

Ravi Purohit: Congratulations on a good set of numbers. Sir, 3 questions. One is, if you look at our general insurance business between 2013 and '19, our average ROEs for the business were about 19-odd, 18-odd percent, right? In certain years, we were doing as much as 21%, 22%.

Subsequently, of course, there were some changes that we had to do because of IRDA not allowing expenditure and how we were kind of able to do that, plus we had various other issues. Now we are finally kind of inching back to around 13%, 14% kind of ROEs. What is in your view a long-term sustainable ROE that we aspire to kind of as a company achieve?

V. Suryanarayanan: Yes. As I said in my opening remarks, as of nine months, we have reached to 15.23%. And even at the beginning of the year, I had always said that it's quite possible to have anywhere upwards of 15.5%. So we have reached that. This is sustainable and as we go along, even without any change from any introduction of IFRS or any other external aspects coming into play, moving it from the present level of about 15.3% to about 16.5% to 17% is very much possible.

Ravi Purohit: Okay, okay. And sir, if I may ask, where do those incremental 200 basis-point improvement in ROEs will come from? Will it come from, let's say, higher yields on, let's say, our investment book or lower combined ratio? Do you have like some medium-term target on combined ratio, which we are like working with?

Because right now, we will kind of, of course, benefit from slightly higher yields on our investment book also. So it kind of takes care of higher combined ratios also. But is there -- if you can just break it up for us, over the medium term, where exactly is the improvement emanating from?

V. Suryanarayanan: See, given the fact that our investment-related multiples are high, whether it's in terms of the top line or in terms of network, investment obviously will be a much stronger play because the company has also been deploying in higher-yielding instruments, thanks to the interest rate cycle that we are in. And as the cycle changes, there must be other opportunities as well for the monetizing some gains. So certainly, investments will be a larger play, which will help in pushing the ROE. But the challenge always is relating to the combined ratio.

We've been having this climate change events impacting us. In fact, this year, we have had one event in each of the quarters. It has impacted the industry in a larger way. One does hope that we are saved from this impact, because even for the current year, the impact for us, Chola MS, for 9 months is about 1.5% on the COR. So these kind of changes have been digested to give you this 15.3%. If in a year, we don't have such kind of changes, I'm sure the ROE can get even better.

Ravi Purohit: Okay. And sir, on our investment book, on the debt side, can you share what's the duration of the book now? If let's say, we peaked out of our interest rate cycle and if interest rates actually come off, they were -- longer duration will probably help. So I just wanted to understand if you kind of can share what's the division of the investment book on the debt side?

S. Venugopalan: Definitely, we have been enhancing the tenure in respect of fresh investments. Definitely with the interest rate being higher, it gives us an opportunity of long-term high yield. So currently, we have moved from the earlier regime of low tenure to higher tenure, currently, we are around

3.8 years. So, the thing is, we will continue to invest in the long term debt. So long as the interest rates are higher, we continue our investment in long term and reap the benefit for long period.

Ravi Purohit: And sir, 2 last questions. I think one is something that lot of investors we historically while we have asked in terms of from shareholder value creation point of view, whether Chola MS Insurance will kind of get listed or get monetized in some form or the other. So any update that you can share on that? Is it at all like being thought about or discussed about? Obviously that would be helpful.

Sridharan Rangarajan: Yes. thanks for asking this question. So our immediate aim as well as the long-term view is to build a very good general insurance franchise and we have been doing this consistently. We are doing well and has been profitable. We have been growing consistently. And that's the single most aim we have at this point. The rest will follow based on how things develop in future. So our focus is to build a good insurance business that people would like to take.

Ravi Purohit: Okay. And sir, one last question on Chola Holdings, it has 2 businesses. There is CIFCL pace, there is MS insurance space and there is a small, called Chola Risk. Is holding -- the Chola Holding Company itself planning to do anything else under its umbrella? Or these will remain the 2 primary investments as of now?

Sridharan Rangarajan: I think whatever allied business relating to these 2 investments is what is the primary objective of the holding company.

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

Sanketh Godha: Sir, just wanted to understand this INR100 crores of additional [subject] what we intend to raise, the likely impact of the same on the solvency margin, today, we are at 1.79x. How much is expected to improve with that number? And just trying to read between the lines, you can correct me if my reading is incorrect, that given our solvency was coming down with the previous growth, is it that conscious decision also played a role for our growth moderation in the third quarter compared to what we delivered in 1H?

And now with this update, we can expect growth trends to be relatively better than what we have delivered in third quarter. As the previous participant highlighted, ex of crop, the growth looks muted, which was very strong at least till first quarter and second quarter. We just wanted to understand this part on growth, how you are looking at and related to solvency.

V. Suryanarayanan: Yes. Thanks, Sanketh. Certainly, solvency has not been the worry or the decision point behind degrowth aspect. This INR100 crores of Tier 2 infusion will at best improve the solvency about by 8 to 9 basis points. So to compare, 1.78x, shoot up to about 1.87x. So that is not that worrying element, still there is headroom for growth.

The solvency itself, the part of the impact was due to the way we measure it, which is on gross claims basis and which is where the inundation and flood claims has had some effect, which will wear out as we move on to the next year, I don't see it'll again goes up. So I don't think so long as we are profitable and we are having a strong PAT, there is enough room for growth to sustain the growth.

So certainly, that is not reason behind the lower growth at a non-crop level. It is our portfolio correction and then consolidation before we make our next leap for growth. It's been the front driver. I'm sure you will see us growing stronger anyway in Q4 even though we doesn't have much of crop as well. So you will find that growth.

Sanketh Godha: Sure, sir. And then my second question is, if I look at your loss ratio, ex of cat, I mean, last year, you were -- in 9 months you were at 111.4%, means if I exclude the cat event impact in the current 9 months, you are at 109%. And in the mix, you did little more crop, which was not there in the last year. And crop, as you highlighted, given there is no opex associated to it and the combined might be closer to 102%, 103%, which is lower than the company average at the combined level.

Sir, I just wanted to understand this delta improvement is largely crop-led, or you see this number to further improve given the current corrective measures you have taken probably with respect to motor or two-wheeler in that sense or even health portfolio in PSU banks, if you have taken any.

V. Suryanarayanan: Yes. See, it’s a combination of several factors. Motor is quite obvious. The portfolio correction which is showing up in the OD LR improvement, even as a quarterly trend. So that is quite obvious. The expense of management control, even adjusting for the crop element has been quite strong. 3.2% reduction, even adjusting for crop is quite strong. So we consider this 6 months as a period of consolidation before we move to the next phase of growth. So that is how we are looking at things.

And anyway, still we are not at 30% EOM level, while we are doing well in terms of our Board-approved plan that we have given to IRDAI and are ahead of what we have given at this point in time. We still have the distance to travel to converge the 30% EOM by FY26, ('25-'26). So, that correction will start reflecting continuously even on to the COR.

Sanketh Godha: Sir, that focus on expense bringing closer to 30%in year-end levels, is it also partially playing the role in moderation in the growth? Because maybe we are rationalizing the payouts and that is getting reflected in the growth also. I mean, is it a chick and egg problem kind of a thing, basically?

V. Suryanarayanan: No. But that is the direction that we have to take in any case. So it's also going about your business mix in a way, which brings in and gives that leeway. You would notice that Chola MS still does very little of employer-employee group health to the extent that we are having the lowest volumes in employer-employee group health in the industry.

There are some clear strategic calls that the Board makes on what to do at which point in time. So these will probably help us in taking us for the next round of the race, in terms of having the growth as well as the EOM. But fundamentally, we would look for businesses that are COR positive, even though the cost absorption initially could be high.

Sanketh Godha: Got it, sir. Sir, in simple words, if I want to put it in this way, given you have focus on EOM and given you have a focus on profitable portfolio and you want to go back to the path of 16%, 17% ROE, then the likely growth might be more of mid-teens going ahead compared to 20% plus what we delivered in the past. And that is the way I need to look at it, sir? Or you think you can still deliver 20% kind of a growth, given kind of solvency also you have?

V. Suryanarayanan: See, our aim is to improve market share rather than locking ourselves into a percentage, I would tend to think that we should grow at least at 1.4x of industry, 1.35x to 1.4x, which we are running even at this point in time on an overall basis. So I think that will help keep giving us the scale and which will help in better absorption of the operating expenses.

Sanketh Godha: Got you, sir. Sir, any -- if I ignore the cat events, you already have improved your COR by 2.5 or closer to 2.5 percentage points in 9 months. Assuming cat events don't repeat next year, most likely the number you can expect to improve going ahead. And second related question, immediately in the fourth quarter, given you have not reversed or your provisioning towards crop is very similar to what it was in second quarter, I mean, in ground whether the experience is better than what you have provided? And can we expect a likely reversal to happen and, therefore, fourth quarter COR to look better, given rains has been okay in Rabi and Kharif relatively in this part of the country or Maharashtra region.

V. Suryanarayanan: Generally, there are no NAT CAT events that happen in the country in Q4. To that extent, I'm sure we will be saved of that impact coming on to the P&L, generally, going by history. Crop, I think at this point in time, we will also look at how Rabi shapes before we really take a view on what to do because the entire program and structure is based on full, i.e. both Kharif and Rabi together.

That is how we would want to take a view rather than take a view on just 1 season. See, we do not want any huge fluctuations in what we report. So that is quite clear. So this is what underlines even the way we manage our motor third-party loss reserving and provisioning. So we would not have those quarter-to-quarter upheavals, which we can see in some of the quarterly results. We will never have that.

Sanketh Godha: Got it, sir. My question was more from FY'25, FY'26 perspective, that 109% is the number what you have now. Can you improve even by 100 basis points, no cat events for full year, 108%, then this likely improves.

Sridharan Rangarajan: Sanketh, let me put it this way. The Board will certainly want us to deliver better results from the current year performance.

Sanketh Godha: Okay, sir. Perfect, perfect. And lastly, one data keeping question -- sorry, sir. Last one data keeping question. Can you break down your health portfolio into benefit-based and indemnity?

V. Suryanarayanan: Yes. So our health actually, the benefits / indemnity benefits is without including the personal accident, health alone would be -- it will be about 45%-55%.

Sanketh Godha: So 55% is benefit based, right, sir?

V. Suryanarayanan: 55% would be indemnity now.

Moderator: As we have no further questions, I would now like to hand the conference over to the management for closing comments. Over to you, sir.

V. Suryanarayanan: Thanks, everyone, for joining the earnings call. At Chola MS, we believe that we are building a good strong franchise which emphasizes both the business growth as well as profitability. So we have been doing well and we expect to close the year as well on a higher note. Thank you.

Moderator: Thank you. On behalf of DAM Capital Advisors Limited, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.