"Cholamandalam Finance Holdings Limited Q4 & FY '24 Earnings Conference Call"

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MODERATOR: **MR. PARTH JARIWALA - DAM CAPITAL ADVISORS**

Moderator: Ladies and gentlemen, good day, and welcome to Cholamandalam Finance Holdings Q4 and FY '24 Earnings Conference Call hosted by DAM Capital Advisors 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 this conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Parth Jariwala from DAM Capital Advisors. Thank you, and over to you, sir.

Parth Jariwala: Good morning, everyone, and welcome to Q4 FY '24 Earnings Call of Cholamandalam Financial Holdings Limited. From the management side, we have Mr. Sridharan Rangarajan, Non-Executive Director, Cholamandalam Financial Holdings Limited; Mr. N. Ganesh, Manager and Chief Financial Officer of Cholamandalam Financial Holdings, Mr. V. Suryanarayanan, Managing Director, Cholamandalam MS General Insurance, Mr. S. Venugopalan, Chief Financial Officer, Cholamandalam MS General Insurance.

I will now hand over the call to management to discuss FY '24 earnings call and give their brief comments post which we can open for question and answer. Over to you, sir.

Sridharan Rangarajan: Sure, thank you. Good morning and I hope all of you are doing well and your families in good health. I have pleasure to talk to you in the Q4 earnings call. Both the companies, Chola MS as well as Cholamandalam Finance have done exceeding the well. Today, I have with me Mr. Suryanarayanan, MD of Chola MS General Insurance; and Mr. Venugopalan, CFO for Chola MS General Insurance, and our CFO, Mr. Ganesh.

So since there is a wide coverage as far as Cholamandalam Investment and Finance Company, you would have already attended the calls as well, we will clearly focus this call to Chola MS General Insurance and I request Suryanarayanan to give you the opening comments, say about the business, and then we will open up for the Q&A. Thank you.

V. Suryanarayanan: Thank you, Sridhar. Good morning to all of you for joining the call and I shall now proceed to give you an overview of performance of Chola MS General for the quarter and the year. In quarter four, Chola MS recorded a gross direct premium of INR2,007 crores, with a growth rate of 13.6% as against the multi-line insurers growth of 10.9%. The full year premium was at INR7,533 crores, which is a growth rate of 22.4% as against the multi-line insurers growth of 14.2%. The company has grown across all its channels. For the quarter ended March in its Captive Channel's business from the sister company and the insurance express outlets GWP grew by about 21.5% apart from growth in other channels.

In the financial year, Chola MS recorded a crop insurance premium of INR465 crores, which constitutes about 6.2% of the topline, with growth in commercial and hat lines, the composition of motor in the overall premium has reduced to 65.9% from 70.6% in the previous year. In Motor Insurance, with a gross premium of INR4,964 crores for the year, Chola MS is getting stronger in the private car segments across both new and used vehicles.

The company underwrote over 100,000 electric vehicles in the year across categories. The company, excluding crop, has 26.5% of its premium from rural markets. The expense of management for Chola MS for the year was at 32.64% as against 35.79% in the previous year, a reduction of 3.15%. The claims ratio for the year was 73.7% against 71.2% in the previous year. The impact of the natural catastrophic events for the year in value terms was about INR55 crores which rendered the overall claims ratio higher by 1.08%. Besides the [0:05:08 NACAT] claims, also impacted the reinsurance commission earnings.

The company continues to be prudent in its reserving for motor third-party claims. The combined ratio for the year was at 109.9% which includes the impact of 1.08% by way of NACAT events. The Investment portfolio corpus as at the end of the year was at INR16,501 crores with an investment income of INR1,116 crores. With no exposure to stressed assets, recoveries from the fully provided exposures in Reliance Capital ILFS would be recognized on cash basis as and when it happens.

Profit before tax in quarter four was INR91 crores, and for the full year, it was at INR444 crores as against INR264 crores in the corresponding period. The return on equity for the year progressed to 14.25% as against 9.64% in the previous year. The company during the quarter was acknowledged as the best mid-sized non-life insurer by Mint Publication.

We'll now be happy to take any questions that you may have.

Moderator: The first question is from the line of Atul Mehra from Motilal Oswal Asset Management.

Atul Mehra: Yes. So basically, I was saying that recently, there was a SEBI discussion around investment holding companies for certain better price discovery of investment holding companies. They are proposing perhaps a call option mechanism and so on and so forth. So I just want to check is the board of the management are doing anything in terms of to make sure that there is better in terms of underlying value created for the entity which is Chola Financial Holdings and there is a better price discovery that is coming about. So any comments or anything that you can talk about either on behalf of the whole element?

Sridharan Rangarajan: So honestly, your line is not that audible, but I think I guess your question and probably answer. In case it is not, then please let me know. So as Cholamandalam Financial Holdings, probably you are looking at an option for it the underlying subsidiary to be listed or potential value creation is probably the underlying question that you're looking for. Is that correct?

Atul Mehra: Yes, sir.

Sridharan Rangarajan : Right. So I think we have been telling all the while is that we feel that at an appropriate time, either when the statute forces us or at an appropriate time, we will be more than happy to look at this. But for the capital required for the insurance business, both the partners have committed to provide and with continued support that initiative. That is a position that we are holding from the beginning, and we will continue to hold this.

Atul Mehra: Right. But is there any timeline to it, sir?

Sridharan Rangarajan : There is no timeline as such.

Moderator: Next question is from the line of Sanketh Godha from Avendus Spark.

Sanketh Godha: Sir, I just want to understand your growth strategy for next year. Sir, for the current year, we did cross INR470-odd crores, but we naturally slowed down a bit on -- in motor in the current year, especially in the second half of the year. So just wanted to how you will look at growth next year which line segments you will grow, whether we can see a growth in crop to grow better than INR470 crores what you have done in the current year?

And any revisiting of this strategy with respect to commercial lines, especially fire and marine given we are largely limited to our JV partner exposures there and not being other than the banca relationships. So just wanted to understand what is your growth aspiration next year? And which products will drive the growth, especially motor, crop, and commercial lines? That's my first question, sir.

V. Suryanarayanan: Thanks, Sanketh. All of you are perhaps aware that in the last two years, Chola MS has been growing faster than the industry, at 27.2% in '22 '23 and now 22.4% in '23 '24. So the company is committed to growing higher than the industry growth - multi-line players growth for '24 '25 as well. And then, yes, so to talk about crop, last year, marked our re-entry into the crop segment, where we had the cluster in Maharashtra, which gave us about INR465 crores. The company will continue to pursue opportunities in the other states. In fact, Tamil Nadu went down last week, and then we do have both Andhra and Telangana coming into the program this year into the crop program. Company will participate in some of these and seek to expand its crop business.

Coming to commercial lines, fire and marine, even last year, we grew higher than industry. And we have been stepping up our presence in the corporate business segment including the Japanese and Korean segment. We have secured higher reinsurance capacities during the year, and we should be stepping up growth even in the Indian commercial business. This is also towards diversifying on the lines and de-risk the concentration in the motor segment. I talked about earlier as to how the motor composition has shrunk to about just around 65%. Our medium-term goal would be to move it down to about 60%.

Having said that, we will continue to grow in motor. In Motor, our focus will continue to be in the cars and in the commercial vehicle segment. In quarter four, we did grow higher than the industry growth in motor. In H2 of last year we have balanced our expenses of management control with the growth. And we have been able to fairly ensure that we are able to grow while controlling the expenses of management -- a 3.15% reduction in expense of management is quite substantive given the size of the company.

So overall, if you are to broadly look at, we should be looking at least 1.35x of industry growth for next year and with at least a 1% shift away from motor into the other lines.

Sanketh Godha: Perfect, sir. Sir, basically, can I say if you say that a crop, which is INR465 crores or INR470-odd crores, can potentially become -- given you're okay to take exposure to three new states, maybe if you continue to hold these states in Maharashtra -- districts in Maharashtra, then is it safe to assume that we will be around INR600 crores, INR700 crores in the current year?

V. Suryanarayanan: See, Maharashtra will continue for two more years, '24-25 and '25-'26. So if there is no further insurance penetration, farmer coverage area and coverage, one can reasonably assume that the INR465 crores would be intact. But in terms of proportion, given the growth in other lines, I would tend to think that crop could come down to about 5% of the overall volumes.

Sanketh Godha: Okay. Got it. And my next question is on EOM. Naturally, you partially answered that question, but just wanted to understand that whether it will be largely product mix change, which will drive the EOM improvement? Or you believe there are internal operating efficiencies, which can still play out -- if you want to get a broader breakup how much operating efficiencies and how much product mix can contribute to the EOM improvement road map?

V. Suryanarayanan: Obviously, EOM reduction is a combination of the product mix, the channel mix and sometimes even geography mix. And of course, the efficiencies that the scale of business can bring in. So naturally, we are seeing the benefits of scale from where we were a couple of years back to the current level of INR7,500 crores, we have seen the benefits of scale from with respect to pure operating expenses. We expect that to continue.

On the product mix, definitely, yes. So having a higher level of commercial business can mean and contribute to a reduction of EOM as we go along. So that is something that we would want to look at.

Sanketh Godha: Got it, sir. And the third question which I had is that your CAR is 109.9%. Your loss ratio is 73.7%. So from a data keeping point of view, if cat events were not there or India was limited to one cat event, which is generally the case instead of three, then this CAR, how much you are expecting a normalized thing to play out? And then also you spoke about the initial remarks that reinsurance commissions also had a negative impact on the CAR in the current year. So if things normalize, especially in '24, this 109.9% combined improvement in loss ratio and along with the EOM roadmap, what you have, what is a more realistic number what we can expect it to be in '25 and '26, sir?

V. Suryanarayanan: Yes. So I did say that the cat events even without the impact of the reinsurance commission impact was about 1.08% on the combined ratio for the year ended March '24. I do agree that some cat event of some order and scale will happen even in the coming year, one can reasonably expect that. But with the EOM reduction and the other efficiencies that can come about, the business team is fairly confident that we should be looking at least 1% to 1.5% reduction in combined ratio from the current level. one can expect about 1.5% at least a reduction from that level.

Sanketh Godha: And can we expect a similar trend to continue from two years point of view, sir?

V. Suryanarayanan: See, the insurance industry is fast changing. So you have new regulations coming in. So one has to really understand the effect of the regulations and the changes that come about. So one can reasonably expect that given our track record, we will pursue both growth and efficiency when it comes to operating while staying conservative in our motor third-party reserving.

So we do know that our reserving levels are conservative as compared to other players in the market and which has an effect on combined ratio. Given the dominance of motor in our composition, actually if one were to take the reserving to market levels, our combined ratio would probably be 3% to 4% lower. But we want to stay prudent and conservative when it comes to motor third party.

Sanketh Godha: Got it, sir. And last one on health insurance, can you give the breakup or contribution of benefit-based -- long-term benefit base to the total premium?

Sridharan Rangarajan: Our long-term business in relation to total business still stays at about 8.8% of the total top line, and this would include the health benefit, the personal accident as well as the dwelling business that we write. So we continue to absorb the cost upfront, which is also baked into the combined ratios that we report. One can say that the regulator is considering the absorption of these costs over the tenure of the policy. The industry is awaiting a master circular from the regulator on this. If that materializes, you will find a substantive jump in the profitability per se -- the reported profits even from the current year. And when it comes to the health indemnity benefit, we are excluding personal accident, we have about 44% of the business coming in from the benefit segments with the balance coming in from the indemnity.

Moderator: Next question is from the line of Devansh Nigotia from Safe Enterprise.

Devansh Nigotia: Sir, in case of crop insurance, I think we have incurred a loss of almost INR20 crores, INR25 crores for this quarter. So if you look at auto in terms of its revenue contribution and what should be PPD contribution for FY '25. And we mentioned that we have some stop loss over year, we are reinsuring it. And I think we have some visibility of 5% underwriting profit. So if you can just reclarify on that as well. So that will be helpful.

V. Suryanarayanan: Venu, can you take that?

S. Venugopalan: Yes. Crop insurance for the financial year '23, '24, we did a premium of INR465 crores. The loss ratio has been estimated at 100%. You all know that the scheme itself is operating 80% to 110% corridor. So we are taking care of the 10% through XOL reinsurance (100% to 110%). That is why the maximum loss has been estimated at 100%. Naturally, if it is 100% loss ratio, there will be underwriting loss as there are XOL cost and other expenses are there. However, the LR is an estimation currently. We need to estimate the element of how the Rabi season LR will be and currently estimated to be very favourable. We expect that the loss ratios will come down from the 100% level when it finally estimated the benefit of which will flow subsequently.

The margin in crop is much lesser as you all know that depending on the LR, 23-24 was not good in kharif season due to shortfall in rain. Going forward in '24, '25, we can expect good results, if the monsoons are good. These are all purely dependent on the monsoon. There are two aspects which are favourable in this crop scheme, one is the 80:110 loss corridor framework due to which the losses are capped at 110% and the XOL reinsurance above 100% would also help.

Secondly, the crop though having low margin, it helps in EOM limit management as the expenses are lower. We are looking at additional states as Suri has said for 24-25 to increase the crop GWP. That may also help us in the EOM perspective. So as far as the solvency is concerned, impact on the same has been already built into that. FY 24-25 would not get affected in terms of RSM increase as the same is built in 23-24. The recoveries from government is also very fast and hence disallowance from solvency factors is unlikely to impact solvency. This is from the crop point of view.

V. Suryanarayanan: To add to what Venu has said, when it comes to the crop claims ratio provisioning, we have been conservative in providing at 100% of the earnings. And I can say now with confidence with the benefit of hindsight of almost 45 days into the next quarter, that the actual results are turning out better and we could well possibly see some reversal of provisioning in the coming quarter.

Devansh Nigotia: Sir, but I think we did mention that over here, we have a kind of reinsurance arrangement, which gives us visibility of underwriting profits of, I think, around 5%. So I'm just trying to understand what has changed here? Because what -- I think what you mentioned was that we were underwriting this business with an expected combined ratio of 105% and then the reinsurance arrangement allows us to, at the end, make a 5% underwriting profit. I mean has anything changed over there? Or because when we started underwriting, we had like a clear visibility on the profits over year.

And another thing is that for FY '24, the segment underwriting loss is INR63 crores for crop based on our -- so can you just reclarify on that number as well? And from underwriting profit -- from claims to underwriting, there should not be much different because this is just B2B, and you just participate in a tender with no employee cost or distribution expense. So why is there in between claim ratio to -- flowing from claims to underwriting profit and loss.

S. Venugopalan:

The loss ratio has been estimated at 100% which is likely to be lower than that, when finally the losses are assessed for both seasons. The LR is at 104.2% considering the XOL cost factored which covers the loss ratio between 100% to 110%.

Secondly, there are additional expenditures in the crop, which is normally very low, though 30% is allowed in EOM limits as per the regulation. The crop segment has got its own expenses in the form of managing the claim as well as from the point of view of enrolment of farmers and share of premium collection side. So all put together around 6.5% is the direct cost in the plan. That is also part of our COR. So when you talk about the 5% margin, I don't remember where we have said about that, clearly, it all depends on the ultimate LR for both seasons. This we have clearly explained earlier also.

It is to be noted that we have gone into that mainly because of the loss corridor of 80% to 110% formula that the government has given. Any LR below 80%, refund of premium to Government triggers and any LR above 110%, insurance companies are not covering the same. Margin of 5% level is possible only if the LR is lower than 85% level. That all depends on the monsoon and various other factors, which are beyond the control of insurers.

Devansh Nigotia: So to comply with EOM, then we will have to underwrite a business which -- where profitability historically hasn't been that great, which can impact our profits if we scale it up from here on? Any thoughts if you can share on that?

V. Suryanarayanan: See, crop business is also subject to vagaries of nature. And one would recall that the Kharif season operated in a very indifferent monsoon in July, August of last year. which also impacted the crop yields for the Kharif season. The Rabi season has turned out much better, bringing the balance to the overall loss ratio. One shouldn't tend to a conclusion that it is a loss-making business. But then the inherent risks of the business in as much as it's subject to vagaries of nature is very much there.

Devansh Nigotia: Sir, just last question. What would be your guidance for FY '25 and FY '26 in terms of revenue growth and combined ratios -- and LR?

V. Suryanarayanan: I thought I answered that when Sanketh asked that question in terms of what we would look for. Growth, yes, we would want to grow at least 1.3x to 1.35x of industry growth, which certainly would take us much higher in terms of size. And likewise, from the current level, we would be looking for at least a 1.5% improvement in the combined ratio.

Moderator: Next question is from the line of Mahek from Emkay Global.

Mahek: Sir, in the previous question, you mentioned that you would like to focus on the CV and PV segments in the motor business. So I just wanted to know that among these segments, which of these segments would you like to grow at a faster rate? And secondly, how do you see your channel mix shaping up in FY '25?

V. Suryanarayanan: Channel mix, let me take the second part first. So we would definitely see our agency business grow stronger. The bancassurance business will -- which is also with the addition of the new banks that we had in the previous year should help in the growth. The company is still in discussion with a couple of other banks and any positive turnout there can mean a further growth in volumes.

Besides the business growth of -- from our own sister company, Chola Finance, I think that will also better contribute to our growth in the motor side across products and of course, in the benefit business that we write. So overall, I don't think the growth is a challenge as far as in the next year.

Mahek: Okay. And then on the motor side, which segment would you like to grow faster?

V. Suryanarayanan: See, we have been growing if you see on the charts, we have been growing our proportion of cars. It's there in Page 57 where you can see that the motor is now 65.9%. And then within that, if one will have to look at the composition of motor in Page 56, you will find now that the cars and commercial vehicles are now almost getting equisized from 39.5% and 43.8%, respectively.

So you will see further growth in cars particularly from the agency segment. The company gets roughly about 30% of its total motor premium from new vehicles, which has been fairly consistent. So that should also help in the growth. The company, however, would look at the 2-wheeler segment a little cautiously and would clearly await the government signals and decision with respect to motor third-party premium revision.

Moderator: And next question is from the line of Anand Bhavnani from WhiteOak Capital.

Anand Bhavnani: Sir, both the businesses of the HoldCo are growing and expected to grow well. So from the capital release perspective, how do you see from, let's say, three-year perspective would we as a company as a HoldCo would have raise the capital to shareholding in both the businesses? Or we would be comfortable with shareholding going down? How are you thinking about it? You can comment a bit.

Sridharan Rangarajan : So as far as the Chola NBFC is concerned, I think the capital requirement will be far higher because of this growth appetite and the opportunity to grow. And in the last two fundraises Chola Financial Holding participated in the first one, and we could maintain the shareholding in the same ratio. The latest one, we did not participate and there was a dilution. As far as Chola Insurance is concerned, I think both the partners are committed to support the need of the growth as far as their insurance growth is concerned. So we would be able to find if there are any requirement on capital side.

Anand Bhavnani: Noted. If I were to summarize, Chola investments, is our shareholding over a few years due to more capital raise if we were to go down, we are comfortable with that. And for insurance, you have enough capability to continue maintaining our shareholding. Is that the right summary?

Sridharan Rangarajan : Yes. Fairly right. Yes.

Anand Bhavnani: Yes. So from the value unlock perspective, just wondering how's the Board is thinking. I think you must be ceased of the matter that a general insurance company coming from an IPO. They are not [0:35:48 indiscernible].

Sridharan Rangarajan: Sorry, sir, I think your line is not -- we can't hear you well.

Anand Bhavnani: My question is on value unlock. If I'm audible, the value unlock for the business, given that we are at a valuation which is left in the some of the two holdings.

Sridharan Rangarajan: We understand your question, and I think definitely, we will -- we are aware, and we will look into opportunities to unlock the values at an appropriate time.

Moderator: Next question is from the line of Atul Mehra from Motilal Oswal Management.

Atul Mehra: Just a follow-up on the previous question. So can a buyback be in terms of executed in order to unlock value in that interim that like listing will happen and then there is long-term plan around from the cash flows that you have. Can you execute buyback so that the underlying value for minority is realized?

Sridharan Rangarajan: Yes. So I think the Board would consider all options and take an appropriate action. And Board is aware of the market, the fund requirement of both the businesses and how the regulatory changes are evolving and would take a call at an appropriate time.

Atul Mehra: Got it. Sir, what is the current stance of the Board on this matter in the recently concluded meeting, it was discussed, what is the current stance of the board and what are the various options that are available to unlock value?

Sridharan Rangarajan: Yes. I think sure, you would appreciate that. I think we will be happy to discuss with you once a proper call is taken, then will be easier for us to come and present all the options why we took the options, etcetera. So we will definitely do that at an appropriate time.

Atul Mehra: Look forward to more clarification on this matter, maybe as an opportune time, maybe in the next conference call or ahead of that. So it will be very helpful if we have a proper communication from the Board on this matter so that minority, we are very clear of whatever expects could be in terms of follow to unlock value, so we look forward to that, sir.

Sridharan Rangarajan: Sure. Thank you.

Moderator: Ladies and gentlemen, as there are no further questions, on behalf of DAM Capital Advisors Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.