ArihantCapital
Generating Wealth

Initiating Coverage
20th Dec 2018

Sundaram Finance Ltd

Sundaram to clock 11% PAT CAGR over FY-18-20E, initiate coverage with HOLD and TP of Rs 1601.

CMP : Rs 1430

Rating : HOLD

Target : Rs 1601

STOCK INFO	
INDEX	
BSE	590071
NSE	SUNDARMFIN
Bloomberg	SUF IN
Reuters	SNFN.BO
Sector	BFSI
Face Value (Rs)	10
Equity Capital (Rs cr)	111
Mkt Cap (Rs cr)	15,890
52w H/L (Rs)	2100 / 1340
Avg Yearly Vol (BSE+NSE)	48,480

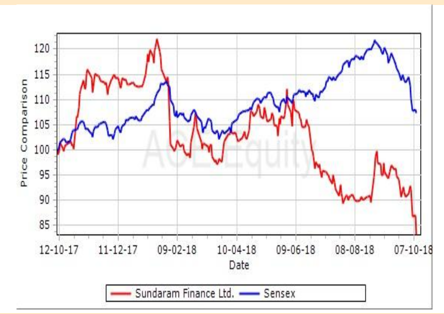
SHAREHOLDING PATTERN	%
(As of Sept, 2018)	
Promoters	36.5
DII	11.4
FII	6.5
Public & Others	45.6

Source: ACE Equity, Arihant Research

STOCK PERFORMANCE(%)	3m	6m	12m
SUNDARMFIN	-9.7	-16.6	-23.5
SENSEX	-5.6	0.96	7.47

Source: ACE Equity, Arihant Research

SUNDARMFIN v/s NIFTY



Source: ACE Equity, Arihant Research

Investment Rationale

- **Well diversified product portfolio**

Subsidiaries, i.e. housing finance, AMC and general insurance remain profitable and contribute meaningfully to the overall earnings.

SUF Standalone
Asset Financing
AUM Rs 24,734 cr
FY18 PAT Rs 533cr

Sundaram AMC
AAUM Rs 35982 cr
Equity51% Debt 49%
FY18 PAT – Rs 38 cr

Sundaram BNP Paribas Home Finance
AUM Rs 8358 cr
PAT FY18 Rs 136cr

Royal Sundaram General Insurance
GWP Rs 2643 cr
FY18 PAT Rs 83 cr

- **Superior Assets Quality in the industry**

GNPA at 1.29% / NNPA at 0.50% remain industry best and is an outcome of superior controls, adequate monitoring and effective recovery mechanism. SUFs FY18 GNPA at 1.29% compares with 2.9% for Chola; 8.5% for MMFS and 9.15% for SHTF.

- **Double digit AUM growth without deterioration in the assets quality**

SUF's AUM stands at Rs 24,734 cr, having grown at CAGR of 15% over FY15-FY18 led primarily by growth in the CV segment.

SOTP based fair valuation

Deeper product understanding, diversified product portfolio, consistently higher RoAs and best in class asset quality remain key strengths for SUF.

We have a 12% upside for SUF based on SOTP based target price at Rs 1601. Our SOTP valuation does not factor in any potential upside following the demerger of non-financial investments into a separate entity.

Key risks: Lower than expected AUM growth, pressure on NIMs and NPAs.

Financial Performance - SUF (Standalone)

YE March (Rs Cr)	Net Interest Income	Operating Profit	PAT	EPS (Rs)	EPS Growth	NIMs	RoE	RoA	Yield Earned
FY18	1336	869	533	48	8%	5.91%	13.8%	2.27%	12.29%
FY19E	1425	915	554	50	4%	5.90%	13.3%	1.92%	12.27%
FY20E	1671	1074	657	59	19%	5.83%	14.2%	2.02%	12.14%

Source: Company, Arihant Research

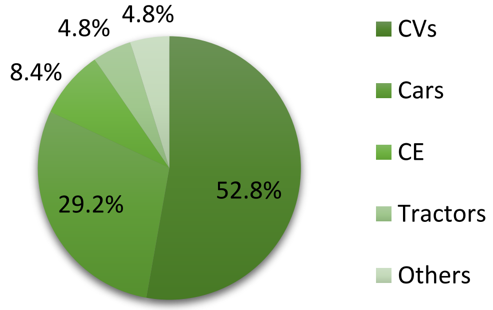
Company Background

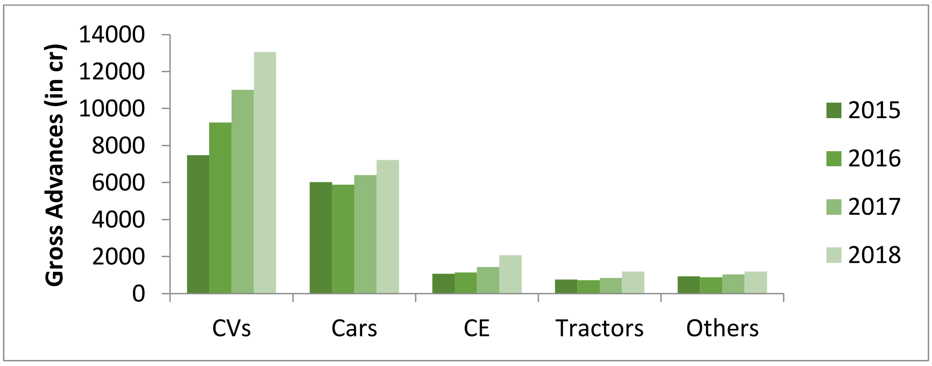
Sundaram Finance is one of the most stable retail asset financing NBFCs with a presence across diverse products. Through its various subsidiaries it has its presence across multiple facet of the financial services industry including housing finance, asset management and general insurance.

Product Details

Asset financing

SUFs AUM stands at Rs 24,734cr, having grown at CAGR of 15% over FY15-FY18 led primarily by growth in the CV segment. The disbursements for FY18 stood at Rs 15,632 cr registering a healthy growth of 18% over the previous year, notwithstanding the various disruptions faced by the automotive sector in the first half of the financial year. The company also increased its market share in the rapidly growing construction equipment and tractor segments.





The company's major contribution to its AUM comes from South (65%), followed by North (19%), West (13%) and East (3%).

Disbursements over FY15-FY18 were led primarily by the growth in the CV segment. However in the last 2 years the pace of growth has slightly slowed down. Traction in growth was visible in CE and Tractor segment at 45.2%/39.7% YoY as of FY18.
Over FY15-FY18, the share of car loans in overall AUM has declined to 29% (37% in FY15) following competitive intensity. CV share in the overall AUM has been sustained over the last 2 years (~53%). Construction Equipment segment has witnessed higher growth in FY18 increasing its AUM share to 8.4% from 6.6% in FY15.

The borrowing profile of SUF includes Debentures (36%), Securitisation (25%), Bank Loans (20%), Deposits (11%) and Commercial Paper (8%). Debentures constituted 48% in FY15 and have come down to 36% in FY18. SUF's ALM profile is optimally managed whereby it has access to long term borrowings consisting of NCDs, securitisation and term loans (~81%). SUFs cost of funds stood at 9.3% as of FY18 and we expect an increase of ~50-120bps over FY19-FY20E.

GNPA at 1.29%/ NNPA at 0.5%, on 90-dpd recognition remain the best in the industry. The lower NPA levels have also enabled SUF to keep its provisioning low. FY18 provisioning stood at 21bps (average AUM) which is the lowest amongst its peers.

Home Finance – Sundaram BNP Paribas Home Finance

Over FY15-FY18, its AUM have grown marginally by 4% CAGR. The slower pace of growth is following management's greater focus at asset quality. This is evident as Q4'FY18 saw GNPA at 3.27% (decline from 3.65% as of Dec 17).
While asset quality headwinds of housing finance prevail in the market and may impact near-term profitability, we draw comfort in SUFs Home Finance subsidiary given its strong business management and increased focus at housing portfolio. As of FY18, AUM registered a growth of 9% which is the highest growth achieved in the last 5 years.

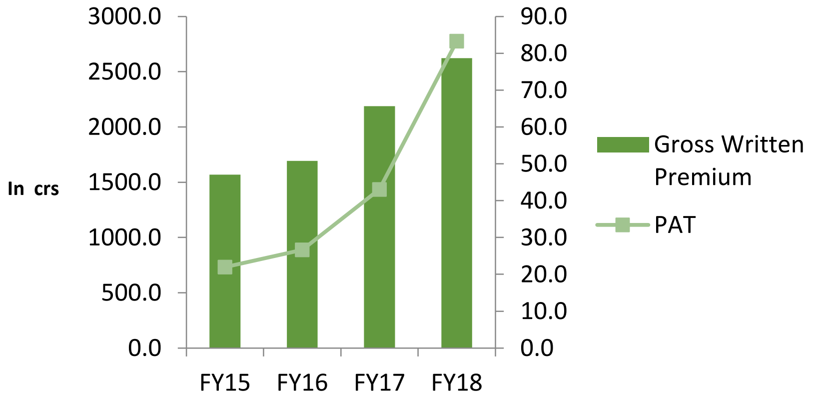
NIMs during FY18 came in at 4.14% lower by 21 bps YoY. The housing loan consists of 69% and non-housing 31% of the AUM.

Borrowing portfolio was funded by NCDs (25%), term loans (48%), fixed deposits (13%), commercial paper (9%) and others (5%).

The company stands at 112 branches and 746 employees as on FY18. The CAR ratio stood at 24.28%

General Insurance - Royal Sundaram

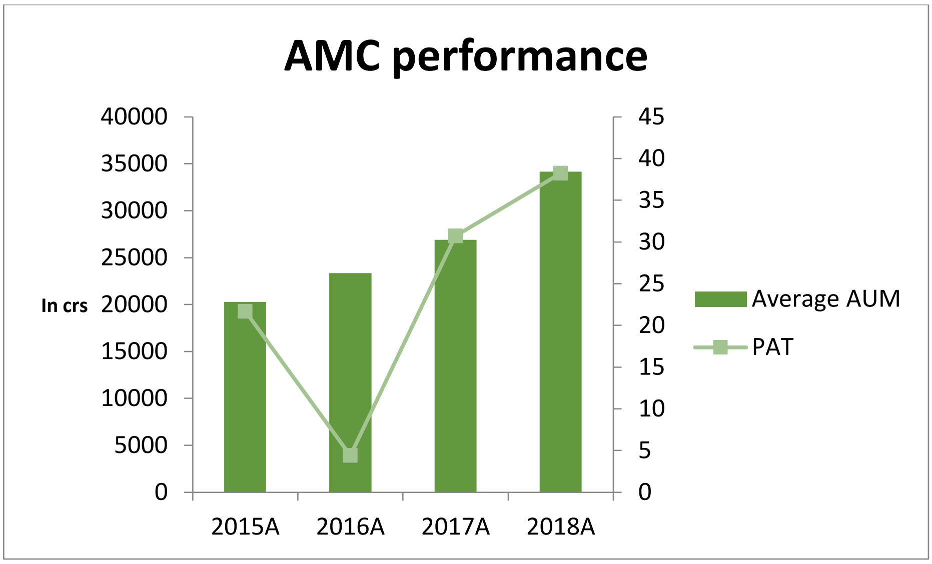
Royal Sundaram is a non-life insurer with a 1.74% market share as of FY18. The company has managed to improve its combined operating ratio from 113% as of FY15 to 109% in FY18. In the next 2 years we expect the combined ratio to reduce to 105% on strongly improving profitability.



Gross Written Premium was up 20% YoY to Rs 2643cr while profitability doubled to Rs 83cr in FY18.

AMC – Sundaram Asset Management

The company's average AUM grew by 27% over FY18 to Rs 34,164cr from Rs 26,896cr. Of the average AUM of Rs 34,164cr, 49% constituted Debt while 51% constituted Equity.
Retail investors in FY18 grew by 13% compared to earlier growth of 5-6%.



Demerger of non financial services

Under SUFs restructuring plan, it has demerged its non Financial Services (non-FS) investments into a separate listed entity Sundaram Finance Holdings Ltd during Q4FY18. This restrucuting was intended to ring-fence the financial services assets and businesses of the group. It will also reduce the complexity of the SUF balance sheet with all non-FS businesses merged into one entity. The demerged entities are a mix of manufacturing and automotive investments sitting inside an NBFC balance sheet. Separating them and moving these entities into a separate balance sheet will result in better evaluation of these entities and lead to value discovery.

Key risks

1. Regional concentration – While asset quality risks have been low, a sudden shock in any of the southern states (~65% of business) could result in an increase in GNPAs.
2. Portfolio concentration – While the company has diversifed its business profile to some extent, it still maintains market share in the CV finance segment in southern India.

Industry Overview

Asset financing

Sales of Medium & Heavy commercial vehicles (M&HCV) registered a fall during the first half of the financial year compared to the previous year. Considering the fact that industrial activity remained muted, M&HCV demand in several states, especially in Southern and Western India were markedly lower than in FY17. However, a turnaround in the second half of the year, driven predominatly by the continuing focus of the government on infrastructure, robust demand in Northern India and thr substantial discounts that were on offer, ensured that M&HCV sales registered a growth of 12.5% for the year.

The reduced turnaround times on account of inter-state check posts being dismantled, stricter implementation of overloading norms in several states and vastly improved highways, resulted in a significant shift towards higher tonnage vehicles

New CV: Higher infrastrcuture spend, stable freight demand, regulatory changes (overloading **& BS VI** transition), goods and services (GST) implementation, rising prices due to BS VI transition and increasing preference for higher tonnage vehicles would be key drivers for the CV industry. BS VI transition could entail pre-buying in FY20.

Used CV: GST implementation, BS VI transition, discounting and preference for higher tonnage vehciles have made financing for new CV more attractive than used CV.

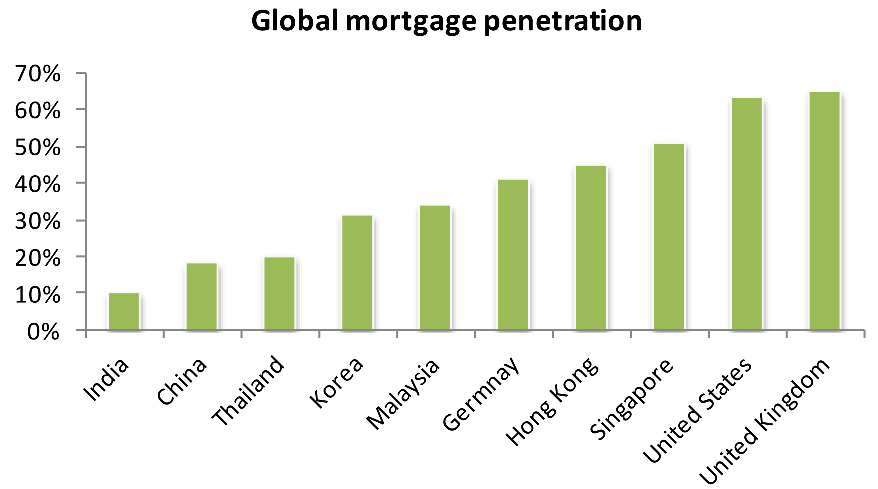
Tractors: The tractor industry witnessed another year of strong growth. Multiple factors ranging from subsidy support for tractor purchase by several states, a bountiful harvest on account of a good monsoon and the availabilty of retail finance saw the industry register a robust growth of 22% during the year.
Rural sentiments remain strong, bolstered by improved crop production and forecast of a normal monsoon. This combined with improving haulage demand from infrastructure activities continues to bode well for tractor demand

Passenger Vehicle: Replacement demand will rise on the back of higher affordability, competitively priced launches and easy availability of finance.

Home finance

High government support and increasing demand/penetration in Tier II/ smaller towns to fuel loan growth over the medium to long term. Despite mortgage penetration improving by 300-400 bps over the last six years (now at 10%), the same is still low when compared to other developed countries like USA, Denmark, etc.

The following chart sets forth global mortgage penetration trends:



The Indian housing finance market has grown at a CAGR of 18% over the last 5 years and is expected to grow at CAGR of 18 to 20% over the next 5 years, as per ICRA's Research report.

Impact of RERA: The RERA brings unprecedented levels of transparency into real estate projects and promises to eliminate delays in projects, and, in the process, weed out unscrupulous developers and provide home buyers with detailed information on the specifications and progress of the projects in which they invest.
Overall, both RERA and GST are expected to bring more transparency in the sector, as the builders would be forced to maintain project-wise books of account to pass on input tax credit to the customers.

General Insurance (Non-life)

The non-life insurance sector offers different products such as motor, health, crop, fire, marine, travel, aviation and home insurance aimed at meeting different protection needs of retail customers, government as well as corporate customers.

Motor insurance: The motor market in India is expected to see rapid growth. An improvement in motor sales will result in stronger growth in third party motor insurance premiums as the new vehicles will have to mandatorily be insured.

The sales for higher tonnage vehicles have been growing in the light of the infrastructure developments. With the new emission standards likely to be implemented in April 2020, it is expected that many fleet owners will go for replacement of their vehicles. These developments are expected to augur well for the future growth of the automobile sector and the insurance industry as well.

Valuation

Compay	Stake (%)	Valuation Basis	Value/Share
SUF	100%	Base case, derived from residual income (RI) valuation model	1,004
Sundaram B Paribas Home Finance	50%	Base case, justified P/B of 1.6x FY20E	215
Sundaram AMC	100%	5% FY20E AUM	216
Royal Insurance	50%	P/B of 2x FY20E - Market multiple	117
Other Investments	100.00%	P/B of 2.1x of share in net worth	49
Target Price			**1,601**

Upside Case (Target – Rs 2220)

We assume (1) SUF's CAGR of 16% over FY18-FY20E, driven by strong growth in CV, CE and tractor segments, (2) Spreads, NIMs an RoA are better than base case.

Downside Case (Target – Rs 1142)

Weak economy and weak CV demand.

We assume (1) AUM CAGR of of 2% over FY18-20E (2) weaker spreads owing to an unfaviourable environment and intense competition (3) decrease in market share across all asset finance segments

Peer Comparision (TTM)

Company	Market Cap (cr)	PAT (cr)	GNPA (%)	RoA (%)	RoE(%)	BVPS	P/BV
SUF	15,890	551	1.79	2.7	13.8	385.0	3.71
Cholamandalam	20,038	1,139	2.80	2.9	20.7	363.3	3.53
Shriram Transport	28,928	1,823	8.77	1.9	12.4	641.7	1.99
M&M Finance	28,933	1,417	9.00	1.9	11.3	161.6	2.90

Source: Company, Arihant Research

Financials – Standalone

Particulars	2018A	2019E	2020E
Interest Income	2618.29	3312.17	3678.89
(-) Interest Expense	-1282.60	-1887.02	-2007.33
Total Net Interest Income	1335.69	1425.15	1671.56
Other Income	78.05	87.43	97.80
Total Income	1413.74	1512.58	1769.36
Operating Expenses	544.35	597.65	695.46
Provisions and Write Off	62.60	88.32	93.80
Profit before Tax	806.79	826.62	980.10
Provision for Tax	273.84	272.78	323.43
Profit after Tax	532.95	553.83	656.67
Earnings per share	47.97	49.85	59.10

Particulars	2018A	2019E	2020E
Assets			
Cash and Balances	981.36	1261.62	1427.97
Deferred Tax Assets	116.41	121.07	134.06
Investments	2258.25	5127.93	5856.94
Advances	19617.27	21858.59	24451.03
Fixed Assets	222.85	242.15	268.13
Other Assets	250.77	302.79	342.79
Total Assets	23446.90	28914.14	32480.91
Liabilities			
Capital	111.10	111.10	111.10
Reserves and Surplus	3859.74	4275.03	4767.43
Borrowings	17735.83	18023.11	20399.56
Trade Payables	97.83	121.07	134.06
Other Liabilities	1349.56	6053.63	6703.13
Provisions	292.83	330.20	365.63
Total Liabilities	23446.90	28914.14	32480.91

	2018A	2019E	2020E
Basic Ratio			
EPS	47.97	49.85	59.10
BVPS	357.40	394.78	439.10
Adjusted BVPS	261.72	240.19	304.58
Dividend per share			
Asset Quality			
Gross NPAs	1.29%	1.40%	1.47%
Net NPAs	0.50%	0.57%	0.45%
PCR	61.8%	60.0%	70.0%
Profitability Ratio			
RoAE	13.81%	13.25%	14.18%
RoAA	2.27%	1.92%	2.02%
NIMs	5.91%	5.90%	5.83%

	2018A	2019E	2020E
Spread Analysis			
Yield Earned	12.29%	12.27%	12.14%
Cost of funds	9.33%	9.47%	9.47%
Spread	2.96%	2.80%	2.67%
Growth			
Advances growth	19.3%	11.2%	10.7%
Deposit growth	9.7%	15.2%	13.2%
Net Profit growth	7.6%	3.9%	18.6%
Liquidity			
CET 1 Ratio	12.20%	13.95%	11.57%
Efficiency			
Cost-to-Income	38.5%	39.5%	39.3%

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Stock Rating Scale

	Absolute Return
Buy	> 20%
Accumulate	12% to 20%
Hold	5% to 12%
Neutral	-5% to 5%
Reduce	< -5%

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