

Wheels set rolling

We retain Buy on Sundaram Finance (SUF) with SOTP based TP at Rs2,030. Q2'18 results beat our estimates on all fronts – higher than expected earnings; strong disbursement / AuM growth and stable asset quality. Housing business too saw growth accelerate with Q2'18 disbursements up 18.4% YoY. Other subsidiaries remain profitable. Strong capital position, best-in-class asset quality and superior returns profile remain key strengths for SUF. Value un-locking through demerger of non-financial investments into a separate entity could lead to further upside. Prefer Sundaram Finance in the NBFC space.

- **Q2'18 results: Asset financing business - Beat on all fronts:** - Nil at Rs3.3bn (+22% YoY) beat our estimates and was led by strong 16.1% YoY growth in AuMs and 27bps QoQ / 41bps YoY improvement in spreads to 5.7%. Disbursements grew 20% YoY, strongest in past 8-quarters; for H1, disbursements have grown 13% YoY. PPOP came in at Rs2.6bn, +31% YoY. Asset quality continues to remain healthy with GNPA / NNPA at 2%/1% on 90-dpd NPA recognition policy. Net profit for the quarter came in at Rs1.6bn (+25% YoY) vs. our estimates of Rs1.3bn.
- **Housing business – early signs of revival; AMC, Insurance businesses remain profitable:** After a sustained period of lower growth / consolidation, Q2'18 saw housing finance business report growth in its disbursements. Q2'18 disbursements grew 18.4% YoY / 41.6% QoQ, strongest ever; AuM stood at Rs79bn (2.5% YoY). Trend in asset quality has stabilized with GNPA at 3.66% (vs. 3.7% QoQ). H1 RoE stood at ~16%. Chola Home Equity Q2'18 GNPA stood at 5.98% (vs. 6.03% QoQ); disbursements grew 12.2% QoQ / declined 7.9% YoY. General insurance business has seen improvement in its gross-written premium / profitability over the past few quarters. Combined ratio was at 111%. AMC reported PAT at Rs200mn for H1'18.
- **Business overview; Earnings Outlook:** We expect SUF to report healthy 17.5% / 17.1% CAGR in disbursements / AuM over FY17-19E. The same follows greater focus at non-CV business (Cars, tractors and CE segment) in addition to continued thrust at market share gains in the core-CV lending business. Better product mix and reduction in cost of borrowings saw Q2'18 report improvement in spreads. We expect overall spreads to remain at ~5% levels. Asset quality related issues remain limited and adequately provided. We expect the AFC business to generate 2.9% RoA / core RoE in excess of 17% by end-FY19E. On the housing business, we are building in 8% / 11% CAGR in loans / PAT over FY17-19E.
- **Valuation and view:** Q2'18 result beat our estimates on all fronts; we expect momentum therein to continue and have tweaked our estimates to that extent for FY18E/FY19E. In our [recent note](#) we had argued for premium valuations for Sundaram Finance, we see that continuing. Retain Buy with SOTP based TP at Rs2,030 (vs. earlier Rs2,000). Value un-locking in the non-financial investments through the demerger process into a separate entity (and subsequently listing of the entity) could add ~10% to our existing SOTP. Key risks: Lower than expected growth or inability to contain NPA's at current level.

Rs mn	Q2FY18	Q2FY17	% yoy	Q1FY18	% QoQ	Q2FY18E	% Var
Net interest income	3,303	2,702	22.2	3,032	8.9	3,225	2.4
Pre-provisioning profit	2,590	1,972	31.4	1,941	33.5	2,189	18.3
PAT	1,600	1,277	25.3	1,173	36.3	1,337	19.7
Disbursement	37,970	31,770	19.5	34,200	11.0	35,265	7.7
AuM	2,24,690	1,93,480	16.1	2,13,200	5.4	2,19,683	2.3

Source: Company, Centrum Research

Y/E Mar (Rsmn)	Net income#	PPOP	Reported PAT	YoY (%)	EPS (Rs)	P/E (x)	ABVPS (Rs)	P/ABV (x)	RoA (%)	Core-RoE (%)
FY15	12,007	7,479	4,542	2.6	40.9	26.5	261.6	4.4	2.8	17.6
FY16	12,573	7,643	4,773	5.1	43.0	32.5	286.7	5.0	2.8	15.8
FY17	12,938	7,817	4,953	3.8	44.6	32.9	329.4	4.4	2.7	16.7
FY18E	15,109	9,368	5,707	15.2	51.4	31.7	373.9	4.4	2.8	16.5
FY19E	17,761	11,310	6,955	21.9	62.6	29.4	431.1	4.3	2.9	17.3

Source: Company, Centrum Research Estimates. Standalone nos. # Net income denotes Nil + other income. FY15-18E YTD have been valued on average market cap basis.

In the interest of timeliness, this document is not edited

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Target Price	Rs2,030	Key Data	
CMP*	Rs1,842	Bloomberg Code	SUF IN
Upside	10.2%	Curr Shares O/S (mn)	111.1
Previous Target	Rs2,000	Diluted Shares O/S(mn)	111.1
Previous Rating	Buy	Mkt Cap (Rsbn/USDbn)	205.4/3.2
Price Performance (%)*		52 Wk H / L (Rs)	1899/1089
	1M	6M	1Yr
SUF IN	10.1	18.0	37.9
Nifty	4.6	12.5	23.8
	5 Year H / L (Rs)		1899/453.5
	Daily Vol. (3M NSE Avg.)		37679.1

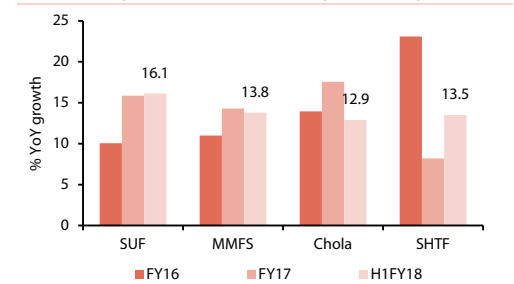
*as on 3 November 2017; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Sep-17	Jun-17	Mar-17	Dec-16
Promoter	36.0	36.0	36.1	36.1
FIs	6.1	5.9	5.6	5.4
DIs	11.2	11.3	11.3	11.1
Others	46.7	46.9	47.0	47.3

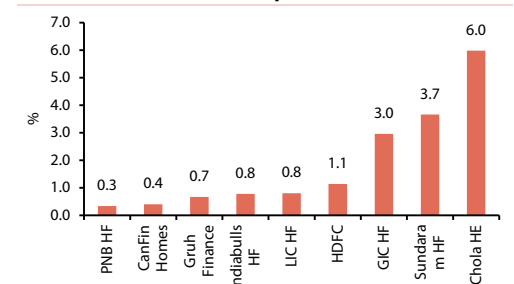
Source: BSE, *as on 3 November 2017

H1'18 AuM grew 16.1% YoY, strongest amongst peers



Source: Companies, Centrum Research. Pertains to AFC business.

HFC- Trend in GNPA across peers (H1FY18)



Source: Companies, Centrum Research

Bloomberg Consensus*				Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)		
5	0	1	1,895	2,030	7.1

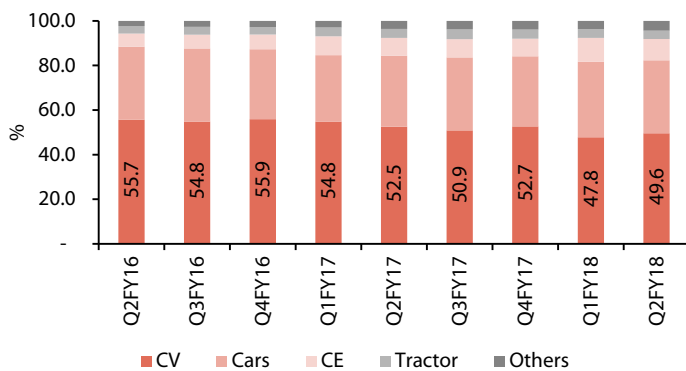
Source: Bloomberg, Centrum Research Estimates

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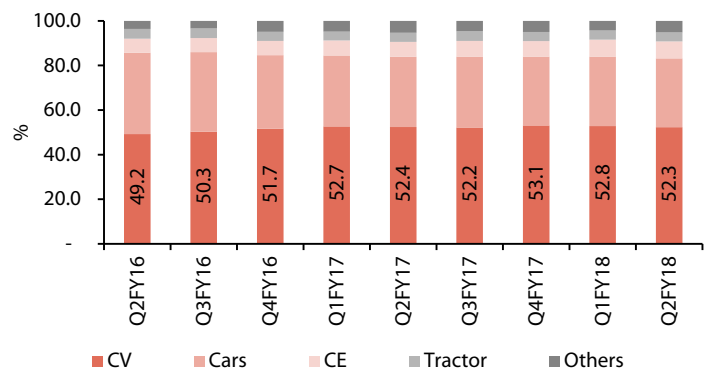
Sundaram Finance – Asset financing business

Exhibit 1: Disbursement trend - Diversified product mix



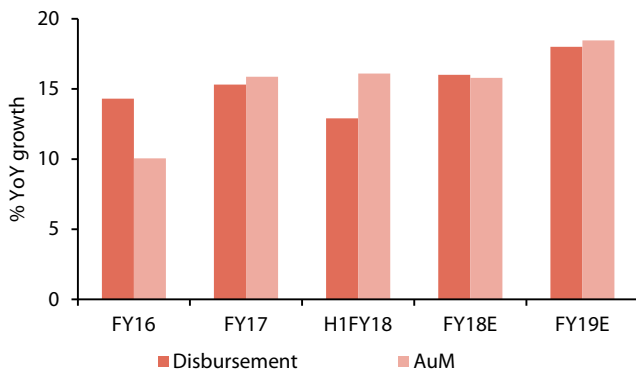
Source: Company, Centrum Research.

Exhibit 2: Q2'18 AuM grew 16.1% YoY led by 15.9% YoY / 16.4% YoY growth in CV / non-CV portfolio

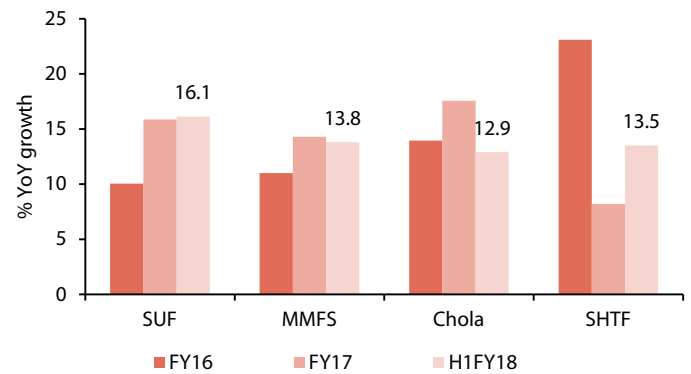


Source: Company, Centrum Research.

Exhibit 3: SUF – SUF – Factoring in 17% CAGR in AuM / Exhibit 4: SUF – AuM growth vis-a-vis peers disbursements each over FY17-19E

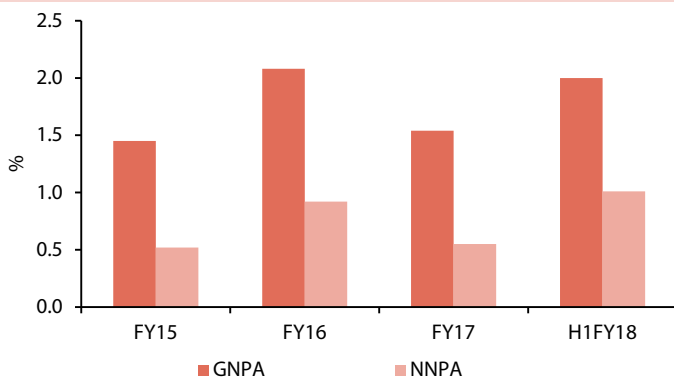


Source: Company, Centrum Research.



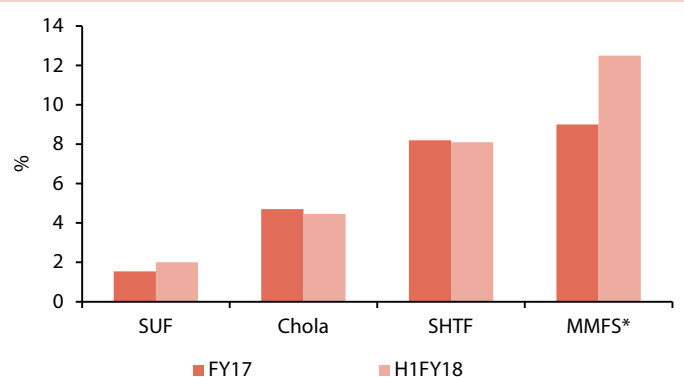
Source: Companies, Centrum Research. AuM growth is for AFC business.

Exhibit 5: Asset quality remains stable for SUF...



Source: Company, Centrum Research.

Exhibit 6: ... and best amongst its peer set players



Source: Companies, Centrum Research. MMFS H1FY18 is on 90-dpd NPA recognition. SHTF is still on 120-dpd NPA norms

Other comments

Asset financing business

Q2'18 disbursements grew 20% YoY, strongest in past 8-quarters. H1 disbursements have grown 13% YoY. On an incremental basis, the 19.5% YoY growth in disbursement was in the nature of 22% YoY growth in CV and 17% YoY growth in non-CV portfolio.

The 16.1% YoY growth in AuM during the quarter was led by 15.9% YoY growth in CV and 16.4% YoY growth in non-CV portfolio. Management have guided for continued focus at segments of Tractors, CE and Car segment for growth.

On the spreads front, the intense competition in M&HCV space has seen overall spreads compress. Adjusted for credit loss, the management however has guided at retaining a respectable level of spreads on the CV portfolio. The loss in spreads from CV portfolio is expected to be off-set by non-CV portfolio especially tractor and CE segment. We are building in spreads at 470bps over FY18-19E.

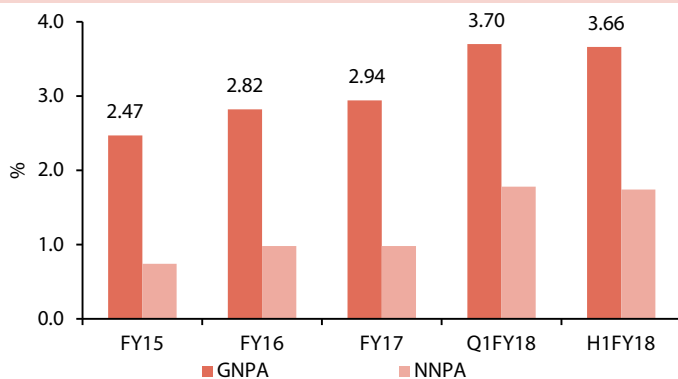
Sundaram Finance recognizes GNPA on 90-dpd basis. As at Q2'18 GNPA came in at 2%; NNPA was at 1.01%. This compares with 12.5% for MMFS.

Home finance business

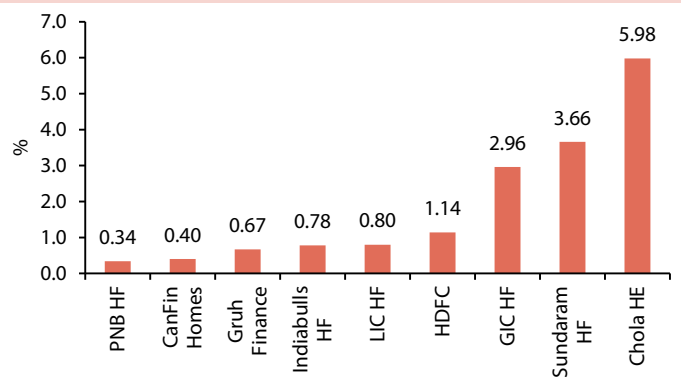
H1'18 disbursements grew 10.3% YoY; Q2'18 disbursements have grown 18% YoY, strongest in recent past and compares with 12.5% QoQ growth in disbursement for Chola. AuM have grown 2.5% YoY. Management have guided for continued focus at growth in non-LAP segment.

On the profitability front, H1 profits stood at Rs830mn (vs. Rs819mn YoY). Asset quality has remained largely stable with GNPA / NNPA at 3.66% / 1.74% respectively and compares with GNPA / NNPA at 3.7% / 1.78% QoQ.

Exhibit 7: Sundaram Home Finance – efforts at curtailing NPA levels underway ... **Exhibit 8: Trend in GNPA across other HFC's (H1FY18)**



Source: Company, Centrum Research.



Source: Companies, Centrum Research

AMC and General insurance business

Subsidiaries continue to remain profitable and adequately capitalised. AuM grew 28% YoY to Rs344.8bn; H1FY18 PAT stood at Rs200mn (vs. Rs141mn YoY).

General insurance business saw GWP at Rs12.8bn (+18.8% YoY); PAT stood at Rs340mn (vs. Rs180mn YoY). Its combined ratio stood at 111% during Q2'18. Management has pointed that the segment has achieved break-even in Q1'18 and expects profitability therein to improve in ensuing quarters.

Valuation, view and recommendations

Q2'18 results beat our estimates on all fronts; we have tweaked our estimates accordingly. We see SUF asset financing business to gain further traction including market share gain in segments of CE, tractor and LCV. Housing finance space after a phase of consolidation is started witnessing growth. On the housing business, we are building in 8% / 11% CAGR in loans / PAT over FY17-19E. AMC business continues to remain profitable; general insurance business has seen break-even; the combined ratio (now at 111%) is set to improve.

We expect valuation premium for SUF over its peers to continue. Retain Buy with SOTP based TP at Rs2,030 (vs. Rs2,000 earlier) Slower pace of growth, asset quality headwinds remain key risks.

Exhibit 9: SOTP based fair valuation FY19E

Co_Name	Stake (%)	Per share (Rs)	(%) of total	Networth / AuM / net profit / business valuation	Multiple	Period / Comments
Sundaram Finance	100.0	1,364	67.2	37,928	4.0	Mar'19E ABV
Sundaram BNP Paribas Home Finance	50.0	182	9.0	13,480	3.0	Mar'19E ABV
Sundaram AMC	100.0	180	8.9	4,00,898	5.0%	Mar'19E AuM
Royal Insurance	75.9	225	11.1	22,000		Valued at 1.5x FY17 GWP
Other investments	100.0	64	3.1	8,825	0.8x	20% holding co discount
Total		2,030				

Source: Centrum Research Estimates

Our SOTP valuation does not include potential upside following the [demerger of non-financial investments](#) into a separate entity. Assuming a 50% holding co discount, the value of the investment based on certain assumptions could well be at ~Rs200 per share (10% upside from our existing TP).

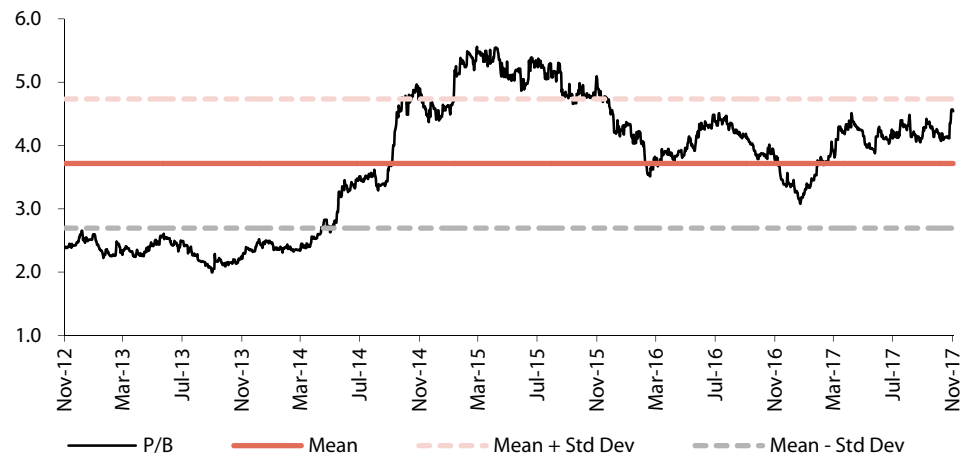
Sensitivity analysis, peer comparison

Exhibit 10: Sensitivity Analysis – impact of change in credit cost and NIM on FY18E PBT

%		Credit cost				
		-10%	-5%	current levels	+5%	+10%
NIM	+2%	(3.2)	(5.3)	(1.2)	0.9	3.0
	+1%	(4.4)	(6.5)	(2.3)	(0.2)	1.9
	current levels	(2.1)	(4.2)	-	2.1	4.2
	-1%	(0.9)	(3.0)	1.2	3.2	5.3
	-2%	0.2	(1.9)	2.3	4.4	4.4

Source: Centrum Research Estimates

Exhibit 11: Rolling forward P/B chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 12: Comparative Valuations – asset financing companies

Co Name	Mkt Cap (Rs mn)	CAGR FY17-FY19E (%)			PE (x)			RoA (%)			RoE (%)			P/BVPS(x)		
		Rev.	EBITDA	PAT	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E	FY17	FY18E	FY19E
Sundaram Finance*	2,05,448	17.2	20.3	18.5	32.9	31.7	29.4	2.7	2.8	2.9	14.0	14.3	15.2	4.3	4.3	4.2
Mahindra Finance*	2,47,043	17.4	23.1	56.2	47.4	29.0	25.1	0.9	1.4	1.6	6.4	11.0	13.4	2.9	3.1	3.2
Shriram Transport	2,95,027	10.3	8.6	28.6	17.2	13.6	12.9	2.0	2.2	2.6	12.9	14.3	16.6	2.1	1.85	2.03
Cholamandalam	1,94,034	20.2	19.8	26.7	23.1	19.1	17.4	2.3	2.6	2.7	17.6	19.3	19.8	3.9	3.4	3.1
Magma Fincorp	42,762	6.0	8.3	303.5	134.9	17.1	13.0	1.1	1.5	2.0	7.8	9.7	13.1	1.3	1.6	1.6

Source: Bloomberg, * denotes Centrum Research Estimates. FY16-18EYTD have been valued on average market cap basis.

Exhibit 13: Quarterly financials – (Standalone)

(Rs mn)	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Income Statement								
Interest earned	5,909	5,823	5,577	5,732	5,981	6,091	5,938	6,352
Interest expended	3,242	2,999	2,907	3,030	2,876	2,833	2,906	3,049
Net interest income	2,667	2,824	2,669	2,702	3,106	3,259	3,032	3,303
Non-interest income	220	371	39	337	335	304	121	546
Total income	2,887	3,195	2,709	3,039	3,441	3,563	3,153	3,849
Operating expenses	1,239	1,218	1,239	1,067	1,294	1,335	1,212	1,258
PPOP	1,648	1,977	1,470	1,972	2,147	2,228	1,941	2,590
Provisions	176	263	145	128	137	205	169	175
PBT	1,472	1,715	1,325	1,843	2,011	2,022	1,771	2,415
Tax	451	494	424	567	628	630	598	815
PAT	1,022	1,221	902	1,277	1,382	1,393	1,173	1,600
Balance Sheet								
Disbursements	28,360	29,100	32,170	31,770	33,370	34,650	34,200	37,970
AuM	1,74,490	1,78,950	1,86,030	1,93,480	2,00,110	2,07,350	2,13,200	2,24,690
Borrowings	1,59,730	1,66,000	1,74,910	1,79,670	1,83,250	1,93,730	1,99,760	2,14,130
Ratios								
Growth YoY (%)								
<i>NII</i>	(3.4)	2.4	0.2	(3.3)	16.4	15.4	13.6	22.2
<i>Opex</i>	7.4	5.9	3.3	(16.2)	4.4	9.6	(2.1)	17.9
<i>PPOP</i>	(7.5)	15.6	(9.4)	(17.7)	30.3	12.6	32.0	31.4
<i>PAT</i>	(7.9)	34.6	(8.9)	(17.1)	35.3	14.0	30.1	25.3
<i>AuM</i>	8.9	10.0	13.1	12.9	14.7	15.9	14.6	16.1
<i>Borrowing</i>	9.1	10.4	19.5	14.6	14.7	16.7	14.2	19.2
Asset quality								
<i>GNPA (%)</i>	2.1	2.1	2.2	2.2	2.2	1.5	2.0	2.0
<i>NNPA (%)</i>	1.1	0.9	1.0	1.0	1.0	0.6	0.9	1.0

Source: Company, Centrum Research

Financials – Sundaram Finance (Standalone)

Exhibit 14: Income Statement

Y/E March (Rsmn)	FY15	FY16	FY17	FY18E	FY19E
Interest Income	21,725	22,338	22,672	25,899	30,323
Interest Expense	11,676	12,177	11,645	13,158	15,519
Net Interest Income	10,049	10,161	11,026	12,741	14,805
Non Interest Income	1,957	2,412	1,911	2,368	2,956
Total Net Income	12,007	12,573	12,938	15,109	17,761
Total Operating Expenses	4,527	4,930	5,121	5,740	6,451
Employee Expenses	3,614	4,088	4,301	4,876	5,540
Other Operating	913	842	820	864	911
Pre-provision Profit	7,479	7,643	7,817	9,368	11,310
Provisions & Contingencies	967	811	615	1,070	1,198
Profit Before Tax	6,512	6,832	7,202	8,298	10,112
Taxes	1,971	2,060	2,249	2,591	3,157
Profit after Tax	4,542	4,773	4,953	5,707	6,955

Source: Company, Centrum Research Estimates

Exhibit 15: Key Ratios

Y/E March	FY15	FY16	FY17	FY18E	FY19E
Growth Ratios (%)					
Loans	10.1	3.4	10.8	17.8	18.5
AuM	3.6	10.0	15.9	15.8	18.5
Borrowings	6.4	(1.1)	11.9	17.5	18.5
NII	2.8	1.1	8.5	15.5	16.2
Opex	(0.5)	8.9	3.9	12.1	12.4
PPOP	7.6	2.2	2.3	19.8	20.7
Provisions	99.8	(16.2)	(24.1)	74.0	12.0
PAT	2.6	5.1	3.8	15.2	21.9
Operating ratios (%)					
Yield on advances	15.1	14.4	13.4	13.4	13.4
Cost of borrowings	9.6	9.8	8.9	8.7	8.7
NIM	6.8	6.4	6.5	6.6	6.6
Non-int inc / Total income	16.3	19.2	14.8	15.7	16.6
Opex / Avg assets	2.8	2.9	2.8	2.8	2.7
Effective tax rate (%)	30.3	30.1	31.2	31.2	31.2
RoA	2.8	2.8	2.7	2.8	2.9
RoE	16.9	15.2	14.0	14.3	15.2
Credit Quality Ratios (%)					
Gross NPA	1.5	2.1	1.5	1.5	1.4
Net NPA	0.5	0.9	0.5	0.5	0.4
NPA coverage ratio	64.1	56.4	64.5	65.2	69.5
Per Share (Rs)					
BVPS	268.0	298.2	337.1	382.6	439.3
Adjusted BVPS	261.6	286.7	329.4	373.9	431.1
Core ABV	214.0	198.6	239.4	283.9	341.0
EPS - wt avg	40.9	43.0	44.6	51.4	62.6
Valuations Ratios					
Price/BV (x)	4.3	4.8	4.3	4.3	4.2
Price/Adj. BV (x)	4.4	5.0	4.4	4.4	4.3
P/E (x)	26.5	32.5	32.9	31.7	29.4

Source: Company, Centrum Research Estimates. FY15-18E YTD have been valued on average market cap basis.

Exhibit 16: Balance Sheet

Y/E March (Rs mn)	FY15	FY16	FY17	FY18E	FY19E
Current assets	9,045	8,038	9,902	11,081	12,432
Loans & Advances	1,38,778	1,43,525	1,59,005	1,87,260	2,21,824
Investments	15,215	18,362	18,832	19,714	20,685
Total Int Earning Assets	1,63,037	1,69,926	1,87,739	2,18,055	2,54,941
Other assets	3,466	2,784	2,767	2,893	3,027
Total assets	1,66,504	1,72,710	1,90,505	2,20,948	2,57,967
Borrowings	1,25,354	1,23,918	1,38,702	1,62,974	1,93,201
Interest Bearing Liabilities	1,25,354	1,23,918	1,38,702	1,62,974	1,93,201
Other non int bearing Liab.	11,369	15,666	14,348	15,463	15,953
Total Liabilities	1,36,723	1,39,584	1,53,049	1,78,437	2,09,154
Equity	29,781	33,126	37,456	42,511	48,813
Total Liabilities	1,66,504	1,72,711	1,90,505	2,20,948	2,57,967

Source: Company, Centrum Research Estimates

Exhibit 17: DuPont analysis

% Average Assets	FY15	FY16	FY17	FY18E	FY19E
Yield on assets	13.6	13.2	12.5	12.6	12.7
Cost of funds	7.3	7.2	6.4	6.4	6.5
Spreads	5.5	4.6	4.6	4.7	4.7
NIM	6.8	6.4	6.5	6.6	6.6
Other income	1.2	1.4	1.1	1.2	1.2
Total income	7.5	7.4	7.1	7.3	7.4
Operating expenses	2.8	2.9	2.8	2.8	2.7
Provisions	0.6	0.5	0.3	0.5	0.5
PBT	4.1	4.0	4.0	4.0	4.2
Tax	1.2	1.2	1.2	1.3	1.3
RoA	2.8	2.8	2.7	2.8	2.9
Leverage	5.9	5.4	5.1	5.1	5.2
RoE	16.9	15.2	14.0	14.3	15.2
Core RoE	17.6	15.8	16.7	16.5	17.3

Source: Company, Centrum Research Estimates.

Appendix A

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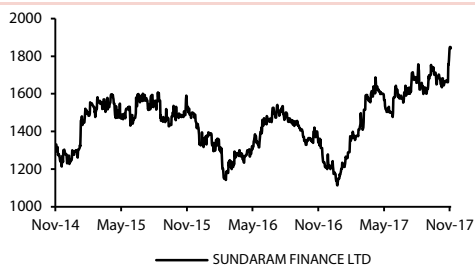
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Sundaram Finance price chart



Source: Bloomberg, Centrum Research

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