

Outperformance to continue

We retain Buy on Sundaram Finance (SUF) and revise our SOTP based TP upwards to Rs2,240. The upward revision to TP follows a) second successive year of 15%+ YoY growth in AuM b) improved profitability (adjusted PAT grew 16% YoY) and c) superior asset quality (GNPA at 1.29%, industry best). Subsidiaries - housing finance, AMC and general insurance remain profitable and contribute meaningful to overall earnings. Commentaries on growth, earnings and asset quality remain encouraging and we have factored the same into our estimates. Valuations continue to remain attractive. BUY, prefer Sundaram Finance in the NBFC space.

- **Asset financing business** – FY18 AuM grew 19.3% YoY (highest ever since FY13) and was led by strong traction in CV (up 18.6% YoY) and non-CV portfolio (20% YoY). Disbursements were up 18.5% YoY with 20% YoY growth in non-CV business. Q4'18 NII at Rs3.4bn grew 8% YoY; NIM at 5.6% (calc) declined 34bps QoQ and follows intense pricing pressure. Asset quality remains healthy with GNPA / NNPA at 1.29%/0.5% (vs. 1.5% / 0.55% YoY). SUF has reported material improvement in its segmental GNPA as well. Net profit for the quarter came in at Rs1.3bn. FY18 net profit at Rs5.3bn grew 7.6% YoY; adjusted for the income of the demerged entity (non-financial investments have been demerged into a separate entity – Sundaram Finance Holdings Limited), net profit at Rs5.3bn grew 16% YoY.
- **Housing business – AuM grew 9.1% YoY; AMC, General Insurance remain profitable:** FY18 saw housing finance business report robust 43.4% YoY / 9.1% YoY growth in disbursement / AuM. The improved growth follows three consecutive years of balance sheet consolidation and management's greater focus at asset quality. This is also evident as Q4'18 saw GNPA at 3.27% decline from 3.65% QoQ (4.1% in Dec'16) and compares with 5.4% for Chola Home Equity. General insurance business gross-written premium / profitability grew 19.9% YoY / 93% YoY. Combined ratio has improved to 109% (vs 111% in FY17). AMC reported PAT at Rs380mn for FY18. Networth stood at Rs2.1bn.
- **Earnings outlook:** We expect SUF to report 18.5% YoY growth in AuM. The same follows favorable sector dynamics, improved focus at shoring non-CV business (especially the CE and tractor segment) in addition to market share gains in the core-CV lending business, particularly LCV portfolio. While we expect near term margins to remain under pressure, an improved product mix and well contained borrowing cost (SUF long term credit ratings has been upgraded to AAA from AA+ earlier) will see margins improve over H2FY19-20E. We are building in NIM on AuM at 5.9% levels. We expect the AFC business to generate 2.7% RoA / core RoE in excess of 18% by end-FY20E. On the housing business, we are building in 14.8% / 23.5% CAGR in loans / PAT over FY18-20E (vs. 8.1% CAGR in loans / 5.4% decline in PAT over FY16-18).
- **Valuation and view:** We have revised our FY19E / FY20E estimates to factor in higher growth and improved efficiency. Our numbers are also revised for the non-interest income following demerger of the non-financial investments into separate entity. We continue to like SUF for its business model, asset quality and risk-adjusted RoE's. Valuations at 2.7x FY20E core ABV remain attractive. Retain Buy with SOTP based TP at Rs2,240 (vs. earlier Rs2,030). Key risks: Lower than expected growth, margin pressures or NPA's risk.

Rs mn	Q4FY18	Q4FY17	% yoy	Q3FY18	% QoQ	Q4FY18E	% Var
Net interest income	3,430	3,175	8.0	3,468	(1.1)	3,648	(6.0)
Pre-provisioning profit	2,092	2,228	(6.1)	2,489	(16.0)	2,609	(19.8)
PAT	1,297	1,393	(6.9)	1,537	(15.6)	1,578	(17.8)
Disbursement	35,400	34,650	2.2	48,750	(27.4)	43,313	(18.3)
AuM	2,47,340	2,07,350	19.3	2,43,380	1.6	2,53,836	(2.6)

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 (%)
FY16	12,573	7,643	4,773	5.1	43.0	32.5	286.7	5.0	2.8	15.8
FY17	12,617	7,817	4,953	3.8	44.6	30.8	329.4	4.2	2.7	16.7
FY18P	14,138	8,694	5,330	7.6	48.0	35.4	348.6	4.9	2.5	16.0
FY19E	16,675	10,429	6,430	20.7	57.9	30.1	398.9	4.4	2.6	17.3
FY20E	19,795	12,733	7,915	23.1	71.2	24.3	462.9	3.7	2.7	18.1

Source: Company, Centrum Research Estimates. Standalone nos. # Net income denotes NII + other income. FY16-19E 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	Rs2,240	Key Data	
CMP*	Rs1,733	Bloomberg Code	SUF IN
Upside	29.2%	Curr Shares O/S (mn)	111.1
Previous Target	Rs2,030	Diluted Shares O/S(mn)	111.1
Previous Rating	Buy	Mkt Cap (Rsbn/USDbn)	192.6/2.9
Price Performance (%)*	52 Wk H / L (Rs)	1896.8/1344.9	
	1M	6M	1Yr
	5 Year H / L (Rs)	1896.8/417.4	
SUF IN	(0.9)	3.0	18.1
Daily Vol. (3M NSE Avg.)			40557
Nifty	(0.2)	4.7	9.5

*as on 5 June 2018, Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Mar-18	Dec-17	Sep-17	Jun-17
Promoter	36.0	36.0	36.0	36.0
FIs	5.8	6.0	6.1	5.9
DIs	11.7	11.8	11.2	11.3
Others	46.5	46.3	46.7	46.9

Source: BSE, *as on 5 June 2018

Bloomberg Consensus*				Target Price (Rs)	Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD	Target Price (Rs)			
6	0	1	1,931	2,240	16.0	

Source: Bloomberg, Centrum Research, *as on 5 June 2018

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Other comments

Asset financing business

FY18 disbursements grew 18.5% YoY (vs. 15.3% YoY growth in FY17) and was driven by strong 20% YoY growth in non-CV portfolio. Management had guided for strong traction in CE and tractor portfolio. Disbursements to these segments grew 49.9% YoY and 24.2% YoY during FY18. Q4'18 disbursements however grew a mere 2.2% YoY and follows a) front-ending of disbursement in Q3'18 and b) greater focus at profitability over growth.

AuM growth at 19.3% YoY for FY18 was the strongest ever (FY17 AuM grew 15.9% YoY) and was led by strong traction in CE – 45.2% YoY; tractor – 39.7% YoY and CV portfolio – 18.6% YoY. Share of CE + tractor loans have increased to 13.2% vs. 11% YoY. Management has guided for continued focus at segments of Tractors, CE and LCV segment for growth.

Asset quality remains best in class with FY18 GNPA / NNPA at 1.29% / 0.5%. Provision coverage ratio remains comfortable at 61%. On the segmental front, SUF reported all round improvement with truck operator GNPA at 1.18% (vs. 1.35% in FY17); auto loans GNPA at 1.06% (vs. 1.13%); infrastructure loans at 0.87% (vs. 2.02% YoY) and others at 1.3% (vs. 2.4% YoY).

Our interaction with management has highlighted for greater focus at growth and profitability. Capital position remains comfortable with CAR / tier-I at 17.6% / 12.2%. Management does not foresee any need for fund raise and believe that the internal accruals will suffice the growth requirement.

Home finance business

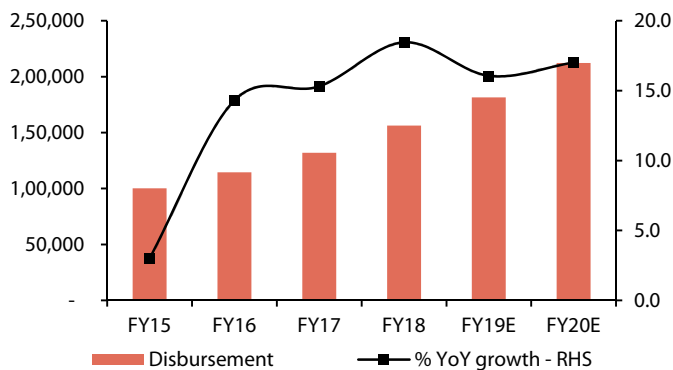
FY18 saw Sundaram Home Finance witness robust 43.4% YoY growth in disbursements / 9.1% YoY growth in loans. Management has guided for growth momentum to continue in FY19 and follows a) three years of consolidated with greater focus at asset quality b) defined target segment coupled with favorable sector dynamics (implementation of GST and RERA has helped growth) c) vacating of space by some other regional players and d) leveraging on parentage.

On asset quality – even as FY18 saw GNPA at 3.3% decline from 3.7% as at Q1'18 – the pace of NPA resolution is slower than expected. Management has referred certain cases for resolution under SARFAESI. It expects overall GNPA to reduce to comfortable levels in FY19E.

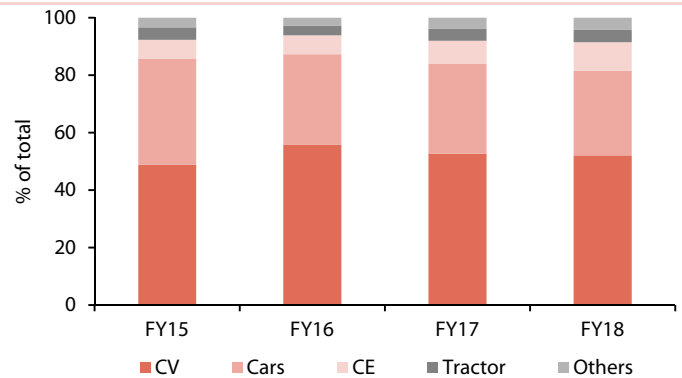
After three years of loans / earnings consolidation, we expect the momentum to accelerate. We thus are factoring in 14.8% / 23.5% CAGR in loans / net profit over FY18-20E and compares with 8.1% CAGR in loans / 5.4% decline in profit over FY16-18. We expect HFC business to generate 2% RoA / ~15% RoE by end-FY20E.

Sundaram Finance – Asset financing business

Exhibit 1: Disbursements have been on a rise; factoring in 16.5% CAGR over FY18-20E (vs. 18.5% for FY18)

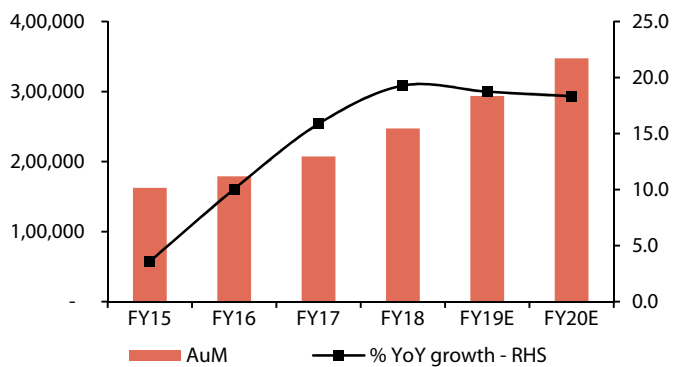


Source: Company, Centrum Research.

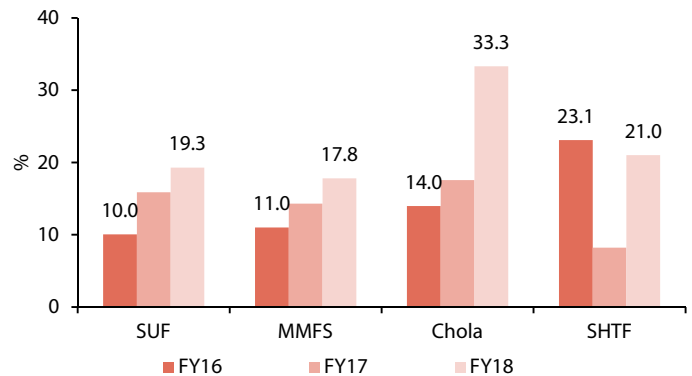


Source: Company, Centrum Research.

Exhibit 3: AuM grew 19.3% YoY, strongest since FY13; Exhibit 4: SUF – AuM growth vis-a-vis peers factoring in 18.5% CAGR in AuM over FY18-20E

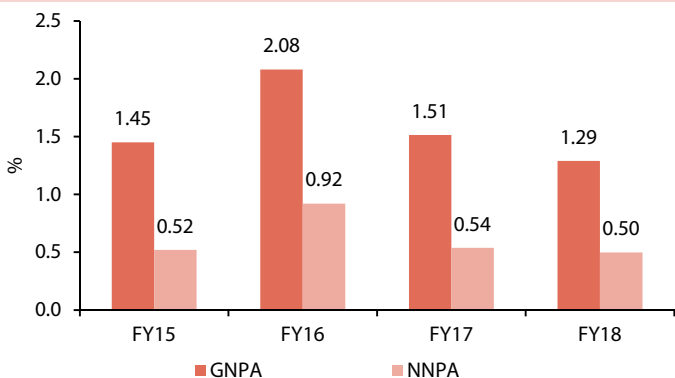


Source: Company, Centrum Research.



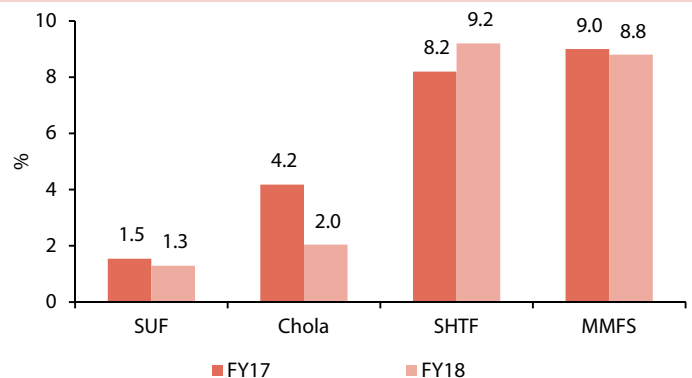
Source: Companies, Centrum Research. AuM growth pertains to AFC business.

Exhibit 5: Asset quality has improved



Source: Company, Centrum Research.

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



Source: Companies, Centrum Research.

Valuation, view and recommendations

We retain BUY on Sundaram Finance and revise our TP upwards to Rs2,240.

We see SUF asset financing business to gain further traction including market share gain in segments of CE, tractor and LCV. Asset quality, capital position remains comfortable. We have valued the core business at 4x FY20E ABV. On the housing business, we are building in loan / earnings acceleration. We expect the housing finance business to report 2% RoA / ~15% RoE by end-FY20E.

AMC business continues to remain profitable; general insurance business has seen break-even; the combined ratio (now at 109%) is set to improve. We have valued those businesses accordingly.

Exhibit 7: SOTP based fair valuation- FY20E

Co_Name	Stake (%)	Per share (Rs)	(%) of total	Networth / AuM / business valuation	Multiple	Period / Comments
Sundaram Finance	100.0	1,491	66.6	41,422	4.00	Mar'20E core ABV
Sundaram BNP Paribas Home Finance	50.0	189	8.5	14,002	3.00	Mar'20E ABV
Sundaram AMC	100.0	216	9.6	4,80,000	5.0%	Mar'20E AuM
Royal Insurance	75.9	271	12.1	26,430	1.5	Valued at 1.5x FY18 GWP
Other investments *	-	70	3.1		0.7x	30% holding co discount
Total		2,240				

Source: Centrum Research Estimates * includes value of investments in Sundaram Finance Holdings Limited (demerged entity of Sundaram Finance) and other investments

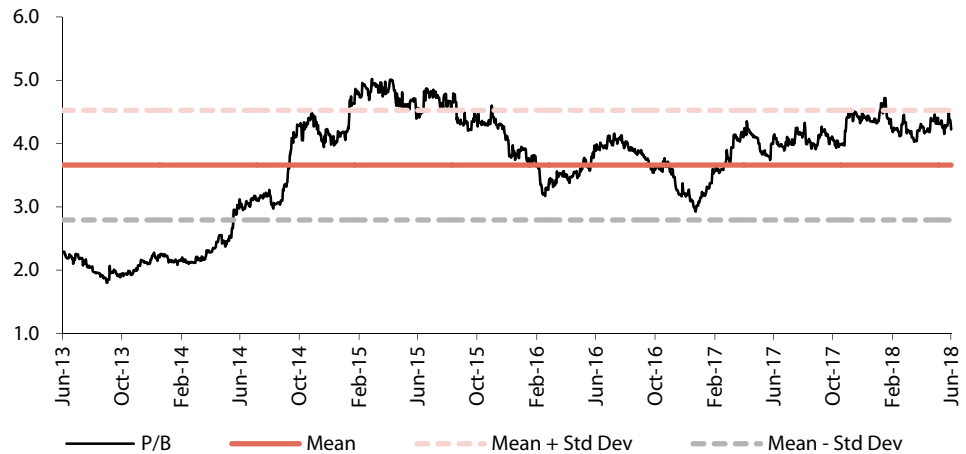
Sensitivity analysis, peer comparison

Exhibit 8: Sensitivity Analysis – impact of change in credit cost and NIM on FY19E PBT

%	Credit cost				
	-10%	-5%	current levels	+5%	+10%
+2%	(3.4)	(5.6)	(1.2)	1.0	3.2
+1%	(4.6)	(6.8)	(2.4)	(0.2)	2.0
NIM					
current levels	(2.2)	(4.4)	-	2.2	4.4
-1%	(1.0)	(3.2)	1.2	3.4	5.6
-2%	0.2	(2.0)	2.4	4.6	4.6

Source: Centrum Research Estimates

Exhibit 9: Rolling forward P/B chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 10: Comparative Valuations – asset financing companies

Co Name	Mkt Cap (Rs mn)	CAGR FY18-FY20E (%)			PE (x)			RoA (%)			RoE (%)			P/BVPS(x)		
		Rev.	EBITDA	PAT	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Sundaram Finance*	1,92,582	18.3	21.0	21.9	35.4	30.1	24.3	2.5	2.6	2.7	13.8	15.1	16.1	4.8	4.3	3.7
Mahindra Finance*	2,88,249	19.1	21.8	41.1	28.1	21.8	16.2	1.7	2.2	2.4	11.3	14.1	16.1	2.7	2.9	2.5
Shriram Transport	3,13,291	17.0	23.1	30.1	15.3	14.5	10.6	2.2	2.5	2.6	14.5	17.7	18.7	2.1	2.4	1.8
Cholamandalam	2,40,816	23.1	25.0	27.1	19.5	19.8	15.5	2.7	2.8	2.9	20.0	21.9	22.2	3.6	4.0	3.2
Magma Fincorp	42,655	13.5	13.5	32.8	16.5	14.4	10.6	1.6	2.1	2.3	10.2	11.7	12.3	1.6	1.5	1.2

Source: Bloomberg, * denotes Centrum Research Estimates. FY17-19EYTD have been valued on average market cap basis.

Exhibit 11: Quarterly financials – (Standalone)

(Rs mn)	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Income Statement								
Interest earned	5,577	5,732	5,981	6,008	5,938	6,352	6,772	6,997
Interest expended	2,907	3,030	2,876	2,833	2,906	3,049	3,304	3,567
Net interest income	2,669	2,702	3,106	3,175	3,032	3,303	3,468	3,430
Non-interest income	39	337	335	304	121	546	331	202
Total income	2,709	3,039	3,441	3,479	3,153	3,849	3,799	3,632
Operating expenses	1,239	1,067	1,294	1,251	1,212	1,258	1,309	1,541
PPOP	1,470	1,972	2,147	2,228	1,941	2,590	2,489	2,092
Provisions	145	128	137	205	169	175	169	113
PBT	1,325	1,843	2,011	2,022	1,771	2,415	2,320	1,979
Tax	424	567	628	630	598	815	783	682
PAT	902	1,277	1,382	1,393	1,173	1,600	1,537	1,297
Balance Sheet								
Disbursements	32,170	31,770	32,840	34,650	34,200	37,970	48,750	35,400
AuM	1,86,030	1,93,480	2,00,110	2,07,350	2,13,200	2,24,690	2,43,380	2,47,340
Borrowings	1,74,910	1,79,670	1,83,250	1,93,730	1,99,760	2,14,130	2,27,620	2,35,650
Ratios								
Growth YoY (%)								
<i>NII</i>	0.2	(3.3)	16.4	12.4	13.6	22.2	11.7	8.0
<i>Opex</i>	3.3	(16.2)	4.4	2.8	(2.1)	17.9	1.2	23.1
<i>PPOP</i>	(9.4)	(17.7)	30.3	12.6	32.0	31.4	15.9	(6.1)
<i>PAT</i>	(8.9)	(17.1)	35.3	14.0	30.1	25.3	11.2	(6.9)
<i>AuM</i>	13.1	12.9	14.7	15.9	14.6	16.1	21.6	19.3
<i>Borrowing</i>	19.5	14.6	14.7	16.7	14.2	19.2	24.2	21.6
Asset quality								
<i>GNPA (%)</i>	2.2	2.2	2.2	1.5	2.0	2.0	1.7	1.3
<i>NNPA (%)</i>	1.0	1.0	1.0	0.6	0.9	1.0	0.8	0.5

Source: Company, Centrum Research

Financials – Sundaram Finance (Standalone)

Exhibit 12: Income Statement

Y/E March (Rsmn)	FY16	FY17	FY18P	FY19E	FY20E
Interest Income	22,338	23,248	26,183	30,850	36,605
Interest Expense	12,177	11,645	12,826	15,035	17,763
Net Interest Income	10,161	11,603	13,357	15,815	18,842
Non Interest Income	2,412	1,015	780	860	953
Total Net Income	12,573	12,617	14,138	16,675	19,795
Total Operating Expenses	4,930	4,801	5,443	6,246	7,062
Employee Expenses	4,088	3,980	4,807	5,576	6,355
Other Operating	842	820	636	670	706
Pre-provision Profit	7,643	7,817	8,694	10,429	12,733
Provisions & Contingencies	811	615	626	694	752
Profit Before Tax	6,832	7,202	8,068	9,734	11,982
Taxes	2,060	2,249	2,738	3,304	4,067
Profit after Tax	4,773	4,953	5,330	6,430	7,915

Source: Company, Centrum Research Estimates

Exhibit 13: Key Ratios

Y/E March	FY16	FY17	FY18P	FY19E	FY20E
Growth Ratios (%)					
Loans	3.4	10.8	23.6	17.3	17.6
AuM	10.0	15.9	19.3	18.7	18.3
Borrowings	(1.1)	11.9	28.8	16.6	16.3
NII	1.1	14.2	15.1	18.4	19.1
Opex	8.9	(2.6)	13.4	14.7	13.1
PPOP	2.2	2.3	11.2	20.0	22.1
Provisions	(16.2)	(24.1)	1.8	10.9	8.2
PAT	5.1	3.8	7.6	20.7	23.1
Operating ratios (%)					
Yield on advances	14.4	13.8	13.3	13.3	13.5
Cost of borrowings	8.9	8.0	7.5	7.3	7.4
NIM	6.4	6.8	6.7	6.7	6.8
Non-int inc / Total income	19.2	8.0	5.5	5.2	4.8
Opex/ Avg assets	2.9	2.6	2.6	2.5	2.4
Effective tax rate (%)	30.1	31.2	33.9	33.9	33.9
RoA	2.8	2.7	2.5	2.6	2.7
RoE	15.2	14.0	13.8	15.1	16.1
RoAuM	2.8	2.6	2.3	2.4	2.5
Credit Quality Ratios (%)					
Gross NPA	2.1	1.5	1.3	1.3	1.3
Net NPA	0.9	0.5	0.5	0.5	0.5
NPA coverage ratio	56.4	64.5	61.4	61.9	62.9
Per Share (Rs)					
BVPS	298.2	337.1	357.4	409.4	474.8
Adjusted BVPS	286.7	329.4	348.6	398.9	462.9
Core ABV	198.6	239.4	258.5	308.8	372.8
EPS - wt avg	43.0	44.6	48.0	57.9	71.2
Valuations Ratios					
Price/BV (x)	4.8	4.1	4.8	4.3	3.7
Price/Adj. BV (x)	5.0	4.2	4.9	4.4	3.7
P/E (x)	32.5	30.8	35.4	30.1	24.3

Source: Company, Centrum Research Estimates. FY16-19E YTD have been valued on average market cap basis.

Exhibit 14: Balance Sheet

Y/E March (Rs mn)	FY16	FY17	FY18P	FY19E	FY20E
Current assets	8,038	9,902	12,010	13,372	13,286
Loans & Advances	1,43,525	1,59,005	1,96,484	2,30,551	2,71,092
Investments	18,362	18,832	22,582	23,840	25,223
Total Int Earning Assets	1,69,926	1,87,739	2,31,076	2,67,764	3,09,601
Other assets	2,784	2,767	2,228	2,301	2,376
Total assets	1,72,710	1,90,505	2,33,305	2,70,065	3,11,977
Borrowings	1,23,918	1,38,702	1,78,602	2,08,336	2,42,382
Interest Bearing Liabilities	1,23,918	1,38,702	1,78,602	2,08,336	2,42,382
Other non int bearing Liab.	15,666	14,348	14,994	16,243	16,846
Total Liabilities	1,39,584	1,53,049	1,93,596	2,24,579	2,59,229
Equity	33,126	37,456	39,708	45,486	52,748
Total Liabilities	1,72,710	1,90,505	2,33,305	2,70,065	3,11,977

Source: Company, Centrum Research Estimates

Exhibit 15: DuPont analysis

% Average Assets	FY16	FY17	FY18P	FY19E	FY20E
Yield on assets	13.2	12.8	12.4	12.3	12.6
Cost of funds	7.2	6.4	6.1	6.0	6.1
Spreads	5.5	5.8	5.9	6.0	6.0
NIM	6.4	6.8	6.7	6.7	6.8
Other income	1.4	0.6	0.4	0.3	0.3
Total income	7.4	6.9	6.7	6.6	6.8
Operating expenses	2.9	2.6	2.6	2.5	2.4
Provisions	0.5	0.3	0.3	0.3	0.3
PBT	4.0	4.0	3.8	3.9	4.1
Tax	1.2	1.2	1.3	1.3	1.4
RoA	2.8	2.7	2.5	2.6	2.7
Leverage	5.4	5.1	5.5	5.9	5.9
RoE	15.2	14.0	13.8	15.1	16.1
Core RoE	15.8	16.7	16.0	17.3	18.1

Source: Company, Centrum Research Estimates.

Appendix A

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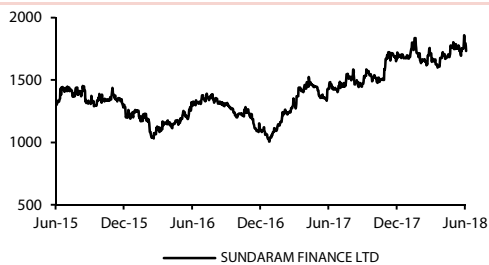
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Sundaram Finance price chart



Source: Bloomberg, Centrum Research

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Sell	Downside > 20%	Downside > 15%	Downside > 10%

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