Sundaram Finance Ltd

Buy

BP WEALTH

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Company Overview

Sundaram Finance is part of Chennai based TVS group with business interest primarily in Auto finance business. The company lends mainly to CVs(53%), Cars(30%), Tractors(4%) and construction equipment(6.9%), in total SUF has today 20,735cr asset under management. Sundaram Finance continues to have major assets from South India due to long presences with region contribution 65% of to total business followed by North at 18% and West at 13%. Sundaram finance also own 50% stake in Sundaram BNP paribas home finance, 74% stake in Sundaram General insurance, 100% in Sundaram asset management company and 24% in recently demerged Sundaram Non-financial holdings.

Investment Rationale

Core lending business to drive major growth in AUM

The core lending business which includes Auto finance business is expected to continue to drive growth driven by sharp recovery in sales of CVs and construction equipments. Sundaram has been one of pioneers in CV lending space due to strong understanding of industry and decades long relationships with fleet operators. The company has good double digit market share in this segment and is expected to be prime beneficiary of CV up cycle and revival in capex spending is south India which accounts almost 65% of total assets under management. The market share gains by south based CV companies have also been working in favor of company which has been able to grow its book faster than the industry average. We CV growth to surprise driven by better volume growth prospects in CVs and higher price realizations due to 8% net increase CV prices. We expect the growth in CV portfolio at 7%, 8% and 7% for FY18, Fy19 and FY20 respectively. Sundaram's car finance business has 30% contribution has been under pressure on profitability front on account of increase in competitive intensity from banks the company has reduced to overall contribution from 37% in FY15 to 30% in FY17, company has single digit market share in this segment we expect the car portfolio to grow 7%, 7% and 8% in FY18, FY19 and FY20 respectively. According to us the spreads earned by the company is this segment (1.2% spread in cars) has comparatively lower than CV business (4.7%). With the improvement in economy especially road construction and agriculture is expected to drive sales of construction equipments and tractors going forward which constitute 7% and 4% of book. Further these two segments have higher spreads and competition in construction equipment segment is still lower than other segments. We expect Sundaram to have AUM of 25,952cr by FY 20 with portfolio mix remaining largely stable as company has the track record of preferring asset quality over growth.

Healthy liability mix to reduce cost of funds

Sundaram finance has one of the best liability book with debentures, commercial paper and deposit contributing 34%, 18% and 12%. The debenture and deposits which are presently priced at high interest rate(since these funds were fixed cost funds) are expected to mature in coming 2 years, post repricing of the liabilities the cost of funds for Sundaram finance are expected to fall further driving saving in cost of funds further driving spreads. The company has strong goodwill with 90% of its depositors been repeat deposits. Falling rates in money market are further expected to drive fall of cost of funds, these factors are evident from fact that there has been shift in liability from debenture and deposits contribution falling and CPs increasing from 8 to 18%. We expect cost of funds to fall from current 7.8% average to 7.5% by FY19.

Subsidiaries continue to be drag overall performance

The housing finance subsidiary has been facing growth issues with near 1% CAGR in AUM since 2014 on account of conservative nature of management and asset quality concerns in LAP book. Sundaram HFC has 7663cr AUM at end of FY17 and has been making 154cr profit with zero growth since last 4 years which is massive underperformance as all HFCs having growing excess 15%. We believe that company will return to average growth only when competitive intensity lowers and hence we assign lower valuation but the 25% CAR and lower debt to equity ratio add to additional comfort. The general insurance business has been facing market share losses on account of competitive intensity and lack of ability to expand from southern markets. Insurance business has broken even in Q1FY18 and we expect steady growth in profitability going forward but the valuation multiples for this business continue to be lower than industry average. Sundaram AMC continues to be better performing company with 34000cr AUM and 46% in equity which is one of best in sector for mid-sized funds. This business continues to remain profitable and we expect non-linear growth in profitability over next 2-3 years as the AUM increases.

Stock Rating

BUY	HOLD	SELL
> 15%	-5% to 15%	< -5%

Sector Outlook — **Positive**

Stock

CMP (Rs)	1674
Target Price (Rs)	2106
BSE code	590071
NSE Symbol	SUNDARMFIN
Bloomberg	SUF IN
Reuters	SNFN.BO

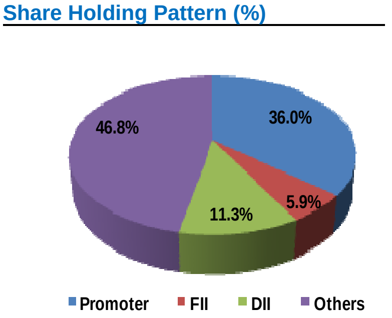
Key Data

Nifty	10323
52WeekH/L(Rs)	1800/1089
O/s Shares (mn)	111
Market Cap (Rs Bn)	187
Face Value (Rs)	10

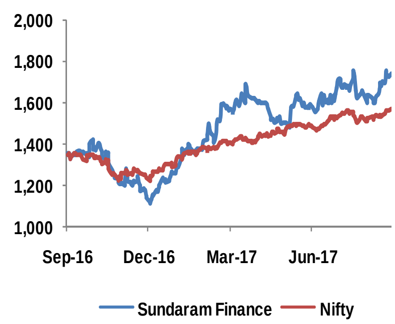
Average volume

3 months	41,430
6 months	40,750
1 year	43,280

Share Holding Pattern (%)



Relative Price Chart



Research Team

022-61596407

Fundamental Pick

Valuation and Outlook

The positive recovery in auto volumes has created an optimistic environment for auto financers who have been suffering from surging competitive intensity from banks. Sundaram finance is expected to be prime beneficiary of this factor as it has been major player in CV and PV lending business both are expected to grow in high single digits. Along with this fall in cost of funds and maturity of liabilities over next two three years is expected to protect the margins even in hyper competitive environment. The core lending business is expected to clock profits of 7648mn by Fy20 vs 4953mn at end of FY17 which translates in 18% CAGR for next three years. We value this business based on 3.6 times FY20 estimated book value as we believe that SUF is high quality lending franchise (evident from low NPAs, sticky customer base, huge trust among depositors) with credible track record, the company has not diluted since last 40 years. The HFC business has been valued at 2 times book as its struggling to grow and has stagnated profitability due to asset detoration and weaker presence in non-south states. The valuation of insurance and asset management business are expected re-rate on account new companies getting listed in respective space. We have valued on base of SoTP valuation and have assigned target price of 2106

SoTP Valuation	Stake	Valuation	Remark
Sundaram Finance(Std)	100%	18,925	We value at 3.6 times FY20E BV as company
Sundaram HFC	50%	822	We value at 2 times book value and 20% Holdco discount
Sundaram AMC	100%	1,306	We value at 6% of equity AUM and 2% of Debt AUM
Sundaram General Insurance	74%	1,957	Valued at 1.5 times GWP and 20% Holdco discount
Non-finance Holdings	26%	390	Internally valued to based on profitability of companies and given 40% Holdco discount
Total		23,400	
No.of shares		11.11	
Target Price		2,106.2	

Source: Company, BP Equities Research

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Disclaimer Appendix

Analyst (s) holding in the Stock : Nil

Analyst (s) Certification:

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