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20
YEARS

Initiating Coverage Sundaram Finance Ltd.

30-March-2021



Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.2487	Buy on dips to Rs.2131 and add further at Rs.1880	Rs.2387	Rs.2639	2 quarters

HDFC Scrip Code	SUNFINEQNR
BSE Code	590071
NSE Code	SUNDARMFN
Bloomberg	SUFIN
CMP Mar 26, 2021	2487
Equity Capital (RsCr)	111
Face Value (Rs)	10
Equity Share O/S (Cr)	11.1
Market Cap (Rs Cr)	27,632
Book Value (Rs)	548
Avg. 52 Wk Volumes	82507
52 Week High	2,883.95
52 Week Low	1,073.00

Share holding Pattern % (Dec, 2020)	
Promoters	35.93
Institutions	22.29
Non Institutions	40.96
Total	100.0

Fundamental Research Analyst

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Our Take:

Sundaram Finance Limited (SFL) is a six decade old established player in the vehicle finance business. Consistently high RoAAs and best in class asset quality represents vast experience and deep understanding of the market which the management possesses. Over the years, the company has established strong relationships with its customers- around 60% of the CV borrowers are repeat customers. This also helps company in managing risk profile. The company is an integrated financial services conglomerate with a diversified business model, which helps them hedging against downturns in specific segments and access multiple growth avenues. All three subsidiaries of the companies are performing well. The liquidity position of the company is also sound to tackle current down trend. Despite distressed economic environment the company has posted a decent set of H1FY21 numbers. With monsoon progressing well, the rural economy outlook seems promising. Management has also indicated that the demand is beginning to look up. Consistent dividend payment and no equity dilution demands premium valuation.

Valuations & Recommendation:

We have envisaged growth of 16% CAGR in NII, 13% CAGR in Pre-Provisioning Operating Profit and 7% in Net Profit over FY20-23E for standalone business. Advance growth is estimated at ~8.4% CAGR over the same period. Asset Quality might deteriorate in FY21E but we feel that the situation will start normalizing from FY22E. The core business of the company is currently trading at 4.5x and 4.0x for FY22E and FY23E P/ABV respectively.

We like SFL for its sustainable performance. We have valued SFL on SoTP basis to arrive base case fair value of Rs. 2387 (4.08x FY23E Net worth Adjusted for NPA and subsidiaries cost of investment of FY23E + Rs.549 subsidiaries value after giving 20% holding company discount). Our bull case fair value stands at Rs.2639 (4.64x FY23E Net worth Adjusted for NPA and subsidiaries cost of investment of FY23E + Rs.549 subsidiaries value after giving 20% holding company discount). Investors can buy on dips Buy on dips to Rs.2131 and add further at Rs.1880. The targets are for next six months.

Financial Summary (Standalone Financials)

Particulars (RsCr)	Q3FY21	Q3FY20	YoY-%	Q2FY21	QoQ-%	FY19	FY20	FY21E	FY22E	FY23E
NII	398.1	344.3	15.6	347.0	14.7	1171	1334	1534	1784	2096
PPOP	408	312	30.9	351	16.1	1003	1232	1399	1571	1846
PAT	242.1	166.5	45.4	191.9	26.1	1126	724	710	826	1002
EPS (Rs)						101.4	65.2	63.9	74.3	90.2
ABV (Rs)						433.4	456.8	496.9	555.2	627.5
P/E (x)						24.5	38.1	38.9	33.4	27.5
P/ABV (x)						5.7	5.4	5.0	4.5	4.0
RoAA (%)						4.0	2.3	2.1	2.3	2.6

(Source: Company, HDFC sec)

Q3FY21 highlights:

The company registered a net profit of Rs. 242 Cr for the quarter ended Dec,2020 as compared to Rs.166.5 Cr last year same quarter. Margins have improved on higher yields on better portfolio mix and reduced cost of funds. Net Interest Income (NII) reported growth of 15.6%/14.7% YoY/QoQ. Assets Under Management (AUM) stood at Rs. 31226Cr compared to Rs. 30,572 Cr same quarter last year. Disbursements stood at Rs 4334Cr, up 8% YoY, though still down 31% YoY on YTD basis at Rs 8437cr. The segments that showed disbursement growth in Q3FY21 were passenger cars(11% YoY), tractor(8% YoY) and Construction equipment (8% YoY) though CV segment remained subdued with decline of 25% YoY. CV disbursements has gradually gone up from 25.1% in Q1FY21 to 29.6% in 9MFY21, though still lower than 52% in 9MFY20. Car disbursements share have also picked up from 25.1% in Q1FY21 to 27.9% in Q3FY21. The Management suggested that overall business could revive to 100% of pre-COVID levels by Q4FY21E. NIM continues to outperform and the company expects this trend to continue. The company's deposits have seen strong growth in 9MFY21. Deposit stood at Rs.4112 Cr as on Dec,2020, registering a net accretion of Rs.390 Cr. The overall collection efficiency has reached pre-COVID levels. GNPA and NNPA improved from 2.14% and 1.17% in Q2FY21 to 1.59% and 0.83% in Q2FY21. During the quarter, the company has restructured 2.47% of loans outstanding, which were impacted severely by Covid -19. If we don't take the Supreme Court order in our calculation the GNPA and NNPA would have been at 2.47% and 1.51% respectively in Q3FY21.

Recent Developments

Change in Leadership

Mr. Rajiv C Lochan has recently been appointed as MD of Sundaram Finance. He would be taking over from Mr. T.T. Srinivasaraghavan who is retiring from service after 38 years with the company, of which the last 18 years as managing director. Under his leadership, the company had grown its balance sheet from under Rs. 800 crore to over Rs. 30,000

Mr. Lochan brings over 25 years of experience in financial services and was an independent director of Sundaram Finance since 2016 and in June 2020 he was designated as Director-Strategy His past experiences are Partner in Mckinsey & Co., Director in American Express and MD of Kasturi & Sons.

Sundaram AMC acquires Principal AMC

Sundaram through its wholly owned subsidiary Sundaram AMC is a significant player in the fund management space with a 25-year track record. It has over Rs 40,000cr in AUM, the majority of which is in equity-oriented schemes. Recently the company had announced the purchase of the asset management businesses of Principal Asset Management for a consideration of Rs. 338Cr. As per the agreement, Sundaram will acquire the schemes managed by Principal and acquires 100% share capital of Principal Asset, Principal Trustee Company and Principal Retirement Advisors. Principal Asset Management has assets under management of Rs 7,447Cr as on December 31, 2020, with about 90% of this in equity-oriented schemes.

Improving Vehicle Sales

With good monsoon, the rural economy outlook seems promising. According to the management, the passenger car sales are beginning to look up, tractors sales are robust and the Government's investment in infrastructure sector could provide boost to the construction equipment segment. Rising e-commerce deliveries are also leading to some volumes in the Commercial Vehicle (CV) segment, especially Light Commercial Vehicles (LCVs). The demand for personal vehicles has risen sharply especially because of COVID-19 led social distancing need.

The lockdown had immediately impacted these road transport operators choking their cash flows, thereby creating asset quality challenges for the lenders. But after gradual re-opening of the economy post the lock down, the transportation of goods has started to recover fast. We expect this will revive the demand for commercial vehicles. It has been observed that post transitions to BS-6, CV prices have increased ~10-15%; which will help company in getting higher demand for its products.

Long term Triggers

Established Player

With over Six decades of presence, SFL has emerged as an established player in the vehicle finance business. Across the credit cycles the company has able to maintain the business growth without any significant deterioration in asset quality. This represents the vast experience and deep understanding of the market the management possesses. Over the years, the company has established strong relationships with its customers- around 60% of the CV borrowers are repeat customers. This also helps company in managing risk profile.

Diversified Business

The company is an integrated financial services conglomerate with a diversified business model, which helps them hedging against downturns in specific segments and access multiple growth avenues. SFL on consolidated level provides a range of financial services like vehicle finance, housing finance, asset management and insurance. While on the standalone basis, 50.8% of AUM comes from commercial vehicles, 24% from cars, 11.2% from construction equipment, 7.1% from tractors and other contributes 6.9%. Even for the standalone business the management has been constantly trying to diversify away from CV segment. In H1FY20 the CV segment contributed 55.6% of total disbursement which now as of H1FY21 has been brought down to 28.7%.

Comfortable liquidity

The company has been maintaining comfortable liquidity in the form of liquid investments and undrawn bank limits, to meet its maturing liabilities and has not opted for moratorium in respect of its debt obligations to its lenders. One thing which is exceptional about the company is that it has not raised equity capital in the past 2-2.5 decades and continuously paying dividend since more than past decade. So there has been no dilution of equity for the stock holders since then.

Other ventures performing well

Other ventures of the company are performing well. We are very bullish on asset management industry as a whole. It has a multiyear growth story lying ahead of them on the back of several structural benefits. Currently Indian MF Industry is highly under penetrated compared to Global average. Since past few years Indian household saving are rapidly moving from physical and traditional investments to Mutual fund. More and more retail participation has been coming into mutual fund AUM via SIPs. Sundaram Mutual Fund being an established player has a lot to benefit. Its total AUM as on 9MFY21 stood at Rs. 35,512Cr of which Equity AUM stood at 72% while Debt comprised of remaining 28%.

The company's focus on prudent underwriting and effective risk management has helped in growing the general insurance business profitably. Royal Sundaram reported a decline of 26% in GWP for 9MFY21 v/s previous year corresponding period, however PAT for the same period stood at 289Cr v/s a loss of 12Cr in 9MFY21.

The headwinds in the real estate sector make us cautious about the growth perspective of the Housing finance business of the company. In the last five years the AUM growth in this segment has been at mere 6% CAGR and the asset quality pressure is also quite sizeable.

Risk Management Policy

The Company has a comprehensive Risk Management Policy in place and has laid down a well-defined risk management framework to identify, assess and monitor risks and strengthen controls to mitigate risks. Established procedures are periodically place before the Risk Management Committee. It is based on a meticulous assessment of risks through proper analysis and understanding of the underlying risks before undertaking any transactions and changing or implementing processes and systems. We believe that the company's long track record in the vehicle financing business, understanding of the target customer segment and robust underwriting practices should help company in this troubled time of asset quality deterioration.

What could go wrong?

- The company has high regional concentration. Almost 63% of the business comes from the southern states. Any adverse developments in these states could have an adverse effect business conditions.
- The competition from banks and other NBFCs are already high while growing competition from digital disruptors poses pricing risk especially form general insurance business.
- The switch over to BS 6 norms, effective April 1 2020 could not have come at a worse time for the Indian automotive industry. Commercial vehicle sales were already projected to be muted in light of the economic slowdown and the capacity overhang in the haulage segment. With the COVID-19 imposed lockdown coming into play, this situation has been greatly exacerbated. The revival of the sustained demand will be a key thing to watch out.
- The prospects of Commercial Vehicle industry are largely linked to economic activity, so any prolonged slowdown in the economy will impact the sale of Commercial Vehicles and ultimately to the vehicle financing companies both in terms of loan growth and asset quality.

- Prolonged COVID-19 lead slow down might impact negatively to the company on multiple fronts i.e. liquidity, asset quality, loan growth etc.
- SFL through its wholly owned subsidiary Sundaram AMC and its JV Company Royal Sundaram General Insurance has been Insurance and the AMC business which is highly competitive business and mainly dominated by top Banks. Inability of the company to scale-up and have a profitable growth can impact earnings.
- In the Home Finance business in the prevailing lower interest rate scenario, there can be higher competition from PSU and private sector banks from short to medium term point of view until and unless the corporate capex cycle picks up. This can be detrimental to the interest of HFC's like Sundaram Housing Finance.

Peer Comparison:

	Mcap (Rs bn)	CMP	P/E			P/BV			AUM(Rs. Bn)	FY20 NIM	FY20 NNPA	FY20 ROAA
			FY21	FY22	FY23	FY21	FY22	FY23				
CIFC	455	555	27.8	27.3	17.9	5.7	4.4	3.6	606	6.2	2.2	1.6
MMFS	255	207	25.9	15	12.9	2.5	1.9	1.6	772	7	6	1.3
SHTF	361	1428	14.7	11.1	9.4	2.4	1.9	1.5	1098	7.5	5.6	2.3
SFL *	276	2487	38.9	33.5	27.6	5	4.5	4	299	4.8	1.7	2.3

*standalone (Source: Company, HDFC sec Research)

Company Profile:

Sundaram Finance was established in 1954 by Sri T. S. Santhanam. It was started with the primary objective of financing the purchase of commercial vehicles. But today the company has grown into one of the most trusted financial services groups in India. It has a nation-wide presence of nearly 588 branches, over two lakh depositors and three lakh commercial vehicle and car finance customers.

Sundaram Finance Limited (SFL) has a diversified presence in Asset Management, Housing Finance, and General Insurance. Both Sundaram Asset Management Company Ltd and Sundaram Asset Management Company Ltd are wholly-owned subsidiaries of the company. Insurance business is carried through Royal Sundaram and recently Ageas International NV bought 40% stake in the Royal Sundaram General Insurance Company Ltd (RSGI), post which SFL holds 50% stake in the RSGI.

Subsidiaries

Sundaram Home Finance Limited
Sundaram Finance Holdings Limited
Sundaram Business Services Limited
Sundaram Asset Management Company Limited
Sundaram Asset Management Singapore Pte. Limited
Sundaram Trustee Company Limited
Sundaram Alternate Assets Limited
Sundaram Fund Services Limited
LGF Services Limited

Joint Venture

Royal Sundaram General Insurance Co. Limited

Associates of a subsidiary company

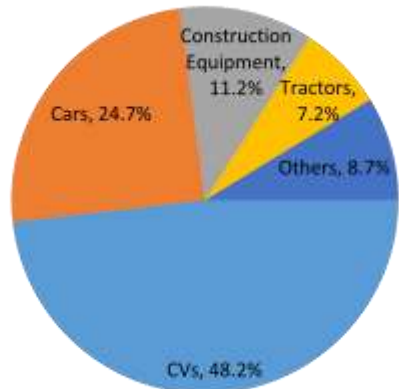
Axles India Limited
Wheels India Limited
Turbo Energy Private Limited
Transenergy Limited
Sundaram Dynacast Private Limited
Sundaram Hydraulics Limited
Flometallic India Private Limited
Dunes Oman LLC (FZC)

SOTP Valuation Table

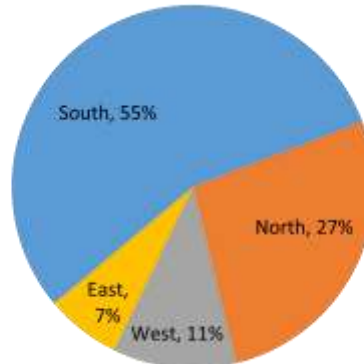
Business segments	% stake	Metric	Valuation (Rs/share)	
			Base Case	Bull Case
CV Finance	100	4.08x/4.64x Net worth Adjusted for NPA and subsidiaries cost of investment of FY23E	1837	2089
Home Finance	100	1.9x FY23E Net Worth	342	342
Sundaram AMC	100	5% of AUM of FY23	171	171
Royal Sundaram General Insurance	50	25x FY23E Net Profit	174	174
Total Value of Subsidiaries			687	687
Less: Holding Co Discount			137	137
Target Price			2387	2639

Sundaram Finance Ltd.

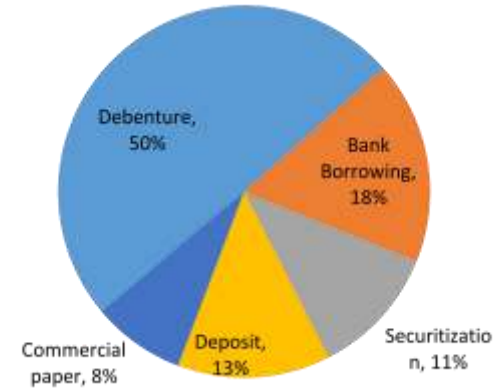
AUM Mix (%)



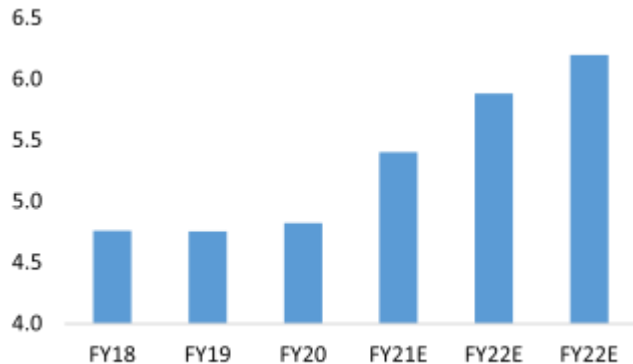
Branch Network



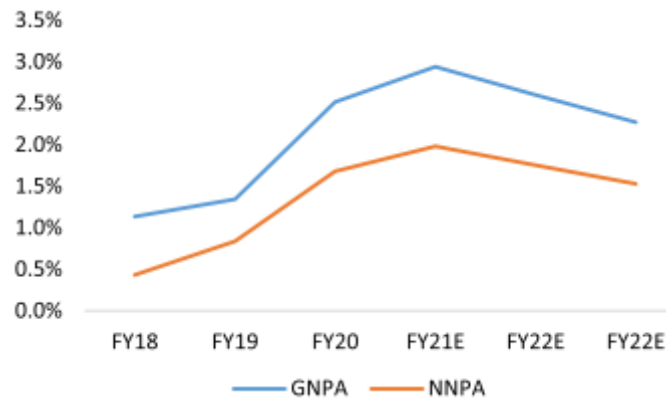
Funding Mix



NIM Trend



NPA Trend



RoAA Trend



(Source: Company, HDFC sec)

Financials

Income Statement (Standalone Financials)

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Interest Income	2937.9	3406.4	3407.4	3790.9	4261.6
Interest Expenses	1766.5	2072.0	1873.1	2006.9	2165.6
Net Interest Income	1171.4	1334.4	1534.4	1783.9	2096.0
Non interest income	404.2	520.5	533.8	576.2	608.8
Operating Income	1575.6	1854.9	2068.2	2360.2	2704.8
Operating Expenses	573.0	623.4	669.4	789.2	858.7
PPP	1002.6	1231.5	1398.8	1570.9	1846.2
Prov & Cont	107.3	286.4	425.9	439.7	473.5
Profit Before Tax	895.3	945.1	972.9	1131.2	1372.7
Tax	361.4	221.2	262.7	305.4	370.6
PAT	533.9	723.9	710.2	825.8	1002.0

Balance Sheet

(Rs Cr)	FY19	FY20	FY21E	FY22E	FY23E
Share Capital	111.1	111.1	111.1	111.1	111.1
Reserves & Surplus	4932.7	5436.3	5979.8	6616.7	7407.6
Shareholder funds	5043.8	5547.4	6090.9	6727.8	7518.7
Borrowings	25005.8	27336.7	28889.5	29101.3	32814.0
Other Liab & Prov.	599.6	535.5	690.8	759.9	835.9
SOURCES OF FUNDS	30649.2	33419.6	35671.2	36588.9	41168.6
Fixed Assets	293.2	350.5	400.0	475.0	475.0
intangible assets	11.9	9.1	10.0	10.0	10.0
Investment	1866.3	3937.7	5461.7	2871.7	3395.0
Cash & Bank Balance	838.6	629.8	622.5	845.7	1015.8
Advances	27271.5	28044.7	28745.8	31907.9	35736.8
Other Assets	367.7	447.7	431.2	478.6	536.1
TOTAL ASSETS	30649.2	33419.6	35671.2	36588.9	41168.6

(Source: Company, HDFC sec Research)

Sundaram Finance Ltd.

Key Ratios:

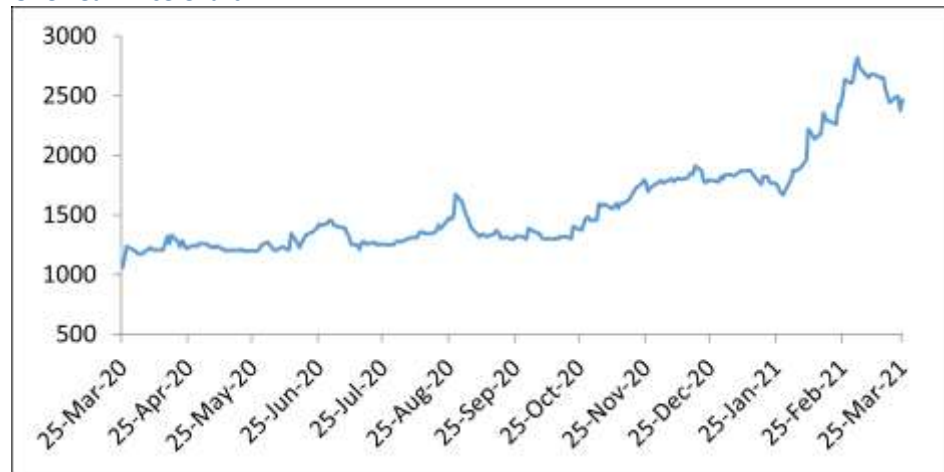
	FY19	FY20	FY21E	FY22E	FY23E
Return Ratios					
Calc. Yield on adv	11.9%	12.3%	12.0%	12.5%	12.6%
Calc. Cost of borr	7.1%	7.6%	6.5%	6.9%	6.6%
NIM	4.8%	4.8%	5.4%	5.9%	6.2%
RoAE	24.5%	13.7%	12.2%	12.9%	14.1%
RoAA	4.0%	2.3%	2.1%	2.3%	2.6%
Asset Quality Ratios					
GNPA	1.3%	2.5%	2.9%	2.6%	2.3%
NNPA	0.8%	1.7%	2.0%	1.8%	1.5%
PCR	38.0%	33.0%	33.0%	33.0%	33.0%
Growth Ratios					
Advances	23.9%	2.8%	2.5%	11.0%	12.0%
Borrowings	18.5%	9.3%	5.7%	0.7%	12.8%
NII	11.8%	13.9%	15.0%	16.3%	17.5%
PPP	7.2%	22.8%	13.6%	12.3%	17.5%
PAT	99.9%	-35.7%	-1.9%	16.3%	21.3%

(Source: Company, HDFC sec Research)

Key Ratios:

	FY19	FY20	FY21E	FY22E	FY23E
Valuation Ratios					
EPS	101.4	65.2	63.9	74.3	90.2
P/E	24.5	38.1	38.9	33.5	27.6
Adj. BVPS	433.4	456.8	496.9	555.2	627.5
P/ABV	5.7	5.4	5	4.5	4
Dividend per share	17.5	13	15	17	19
Dividend Yield (%)	1	0.7	0.8	1	1.1
Other Ratios					
Cost-Income	36.4	33.6	32.4	33.4	31.7
Leverage	5.4	5.1	4.7	4.7	4.8

One Year Price Chart



Disclosure:

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