INSTITUTIONAL RESEARCH

Sundaram Finance

It's a marathon, not a sprint; downgrade to REDUCE

Sundaram Finance (SUF) earnings beat estimates benefitting from higher other income, partly offset by higher provisioning. AUM growth was strong (+27% YoY), driven by non-M&HCV segments, particularly retail CV (+55% YoY). SUF's product and geographic diversification approach to sustain its growth momentum and lift its margins has augured well in the past couple of years, driving superior operating performance. However, the softening CV and PV industry outlook, evident in the moderation of disbursements during H2FY24 (+17% YoY vs. 34% in H1FY24) is likely to moderate AUM growth, going ahead. While SUF remains a pristine franchise with steady growth and profitability metrics (core RoE of ~17-18%), the sharp run-up in the stock (43% during the past 6 months) robs us of material upside from current levels. We downgrade to REDUCE (from ADD) with a revised SoTP-based TP of INR4,050 (standalone entity at 3.8x Mar-26 ABVPS; 15% discount to CIFC).

- **Strong growth on the back of retail CV, commercial lending:** SUF continued to report strong AUM growth (+27% YoY), largely driven by retail CV (+55% YoY; 21.3% of AUM) and commercial lending (124% YoY; 7.2% of AUM). The core M&HCV segment continued to report modest growth (+6% YoY; 24.4% of AUM) due to a muted volume uptick during FY24. While SUF's product and geographic diversification strategy (non-South grew 35% YoY), a softer outlook on CV and PV segments is likely to moderate loan growth to ~17-18%.
- **Marginal NIM compression with rising funding costs:** NIMs (calculated) declined to 4.8% (-10bps QoQ), driven by rising cost of funds (7.1%). While SUF's cost of funds remains best-in-class (7% for FY24), the upward pressure on funding costs continued to weigh on margins. However, a shift in loan mix towards retail CVs and used vehicles is likely to alleviate NIM compression.
- **HFC subsidiary sustains growth momentum; AMC steady:** SHUF (SUF's HFC subsidiary) continued to sustain business momentum, with disbursals / AUM growth of 22%/24% YoY in Q4FY24, driven by stronger growth in the non-housing portfolio. Investments in branches (33 added since Sep-22) and headcount are likely to sustain the growth momentum, although weighing heavily on near-term opex. The AMC subsidiary delivered steady AUM growth (+29% YoY), while the GI business continues to grapple with a high COR (118%), as GWP growth remains subdued (+10% YoY).
- **Robust franchise; albeit valuations sprinting ahead of fundamentals:** SUF remains a robust franchise with strong profitability (core RoE of ~17-18%) and pristine asset quality (cross-cycle credit costs of ~50bps). The company's diversification strategy has further helped SUF solve for growth. However, most of these positives are factored into the current stock price, driving our downgrade to REDUCE.

Financial Summary

(INR bn)	Q4FY24	Q4FY23	YoY (%)	Q3FY24	QoQ (%)	FY24	FY25E	FY26E
NII	5.2	4.3	*20.0*	5.0	*3.2*	19.5	24.2	28.8
PPOP	6.0	4.2	*43.1*	4.1	*46.8*	19.7	23.0	27.4
PAT	5.1	3.2	*60.0*	3.0	*68.7*	13.2	15.7	18.7
EPS (INR)	45.6	28.5	*60.1*	27.0	*68.7*	118.8	140.9	167.9
ROAE (%)						15.3	15.5	16.3
ROAA (%)						2.9	2.8	2.8
ABVPS (INR)						637	739	864
P/ABV (x)						5.8	5.0	4.3
P/E (x)						31.0	26.1	21.9

Source: Company, HSIE Research

REDUCE

CMP *(as on 24 May 2024)*	INR4,430
Target Price	INR4,050
NIFTY	22,957

KEY CHANGES	OLD	NEW
Rating	ADD	REDUCE
Price Target	INR 3,610	INR 4,050
EPS %	FY25E	FY26E
	1.7%	2.2%

KEY STOCK DATA	
Bloomberg code	SUF IN
No. of Shares (mn)	111
MCap (INR bn) / ($ mn)	492/5,910
6m avg traded value (INR mn)	789
52 Week high / low	INR 4,998/2,211

STOCK PERFORMANCE (%)	3M	6M	12M
Absolute (%)	5.8	41.6	76.6
Relative (%)	2.7	27.2	54.5

SHAREHOLDING PATTERN (%)	Dec-23	Mar-24
Promoters	37.9	37.9
FIs & Local MFs	13.5	12.4
FPIs	13.0	16.9
Public & Others	35.6	32.8
Pledged Shares	0.0	

Source: BSE

Pledged shares as % of total shares

Deepak Shinde
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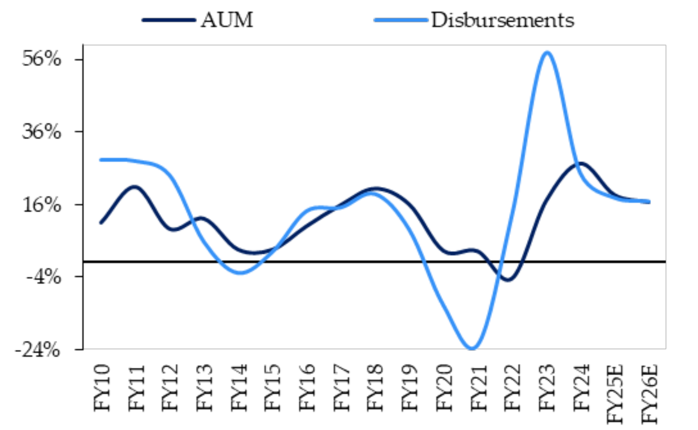
Strong loan growth; but moderation ahead

- **Strong loan growth on the back of retail CV, commercial lending:** SUF continued to report strong AUM growth of 27% YoY, largely driven by retail CV (55% YoY; 21.3% of AUM) and commercial lending (124% YoY; 7.2% of AUM). The core M&HCV segment continued to report tepid growth (6% YoY; 24.4% of AUM) due to a muted volume uptick in FY24, and elevated competitive intensity from banks.

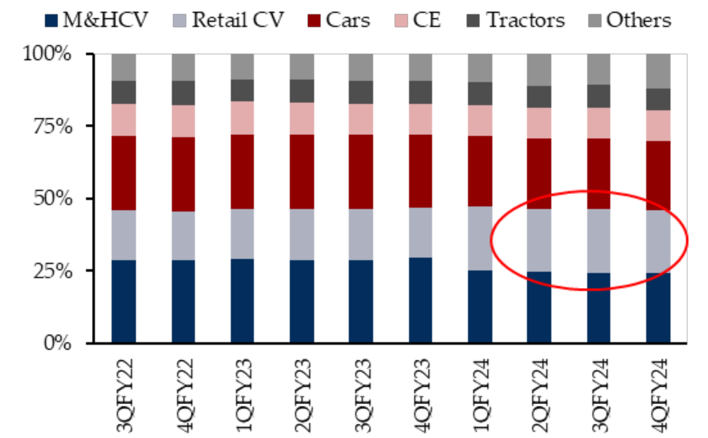
  In terms of geographic diversification, SUF is incrementally focused on non-South regions through higher branch additions, while also improving the productivity of these branches, which remains sub-par compared to branches in the South (non-South AUM grew 35% YoY).

Exhibit 1: AUM growth expected to moderate after strong growth during FY23 and FY24



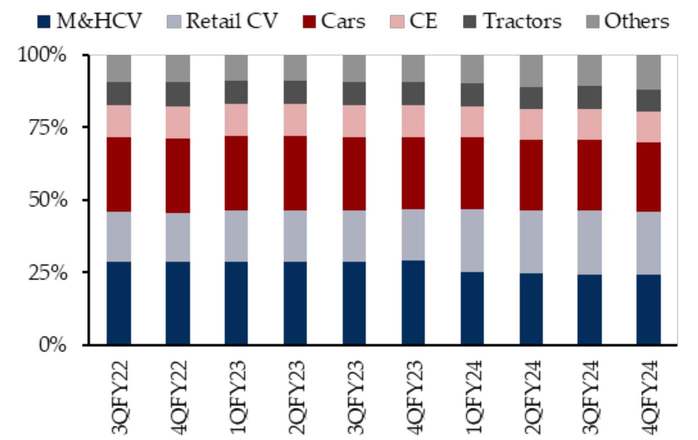
Source: Company, HSIE Research

Exhibit 2: Disbursement mix shifting towards non-M&HCV segments



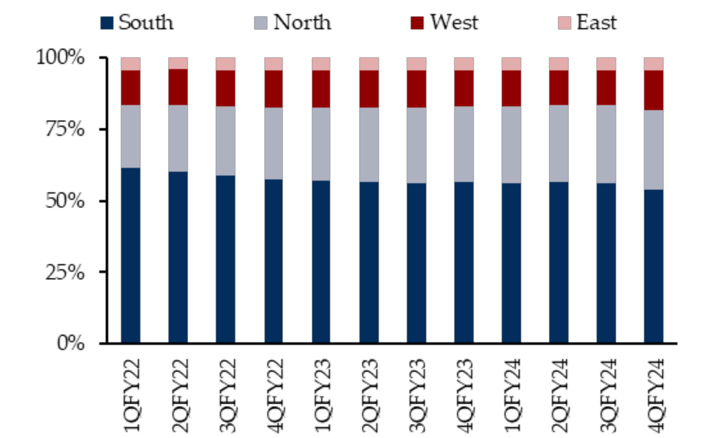
Source: Company, HSIE Research

Exhibit 3: AUM mix - increasing share of Retail CV, others segment



Source: Company, HSIE Research

Exhibit 4: AUM mix shifting towards non-south regions



Source: Company, HSIE Research

- **Expect growth moderation ahead:** SUF's strong AUM growth in the past couple of years has been driven by tailwinds from post-pandemic industry growth. Further, the product and geographic diversification strategy has offered further fillip to growth as the core M&HCV segment was muted during FY24. However, CV and PV volume growth moderated during H2FY24 and is likely to remain soft during H1FY25. Further, competitive intensity continues to remain elevated from banks and NBFCs across different segments. Consequently, we expect FY24-26E loan CAGR to moderate to 18% (last 2y CAGR: 22%) as disbursements begin to normalise from elevated levels (FY22-24 CAGR: 40%).

Exhibit 5: CV sales volumes for the industry, particularly LCV segment has been muted

% YoY	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24	2QFY24	3QFY24	4QFY24
CVs	**228%**	**89%**	**11%**	**21%**	**113%**	**23%**	**30%**	**14%**	**7%**	**12%**	**12%**	**6%**
-LCV	172%	56%	4%	22%	118%	16%	17%	4%	-1%	6%	7%	7%
-MCV	284%	196%	37%	19%	129%	30%	2%	6%	24%	30%	21%	20%
-HCV	493%	331%	71%	40%	122%	49%	41%	18%	15%	16%	14%	8%
-Others	133%	33%	-6%	-52%	14%	-18%	40%	34%	35%	39%	65%	74%

Source: FADA, HSIE Research

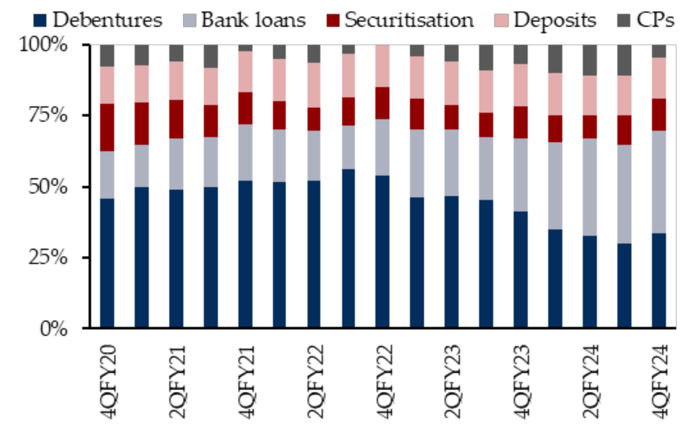
Exhibit 6: SUF's CV loan growth has been ahead of its peers

% YoY	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
SUF	**4%**	**22%**	**20%**	**23%**	**18%**	**4%**	**-4%**	**-7%**	**19%**	**25%**
IIB	6%	27%	14%	26%	26%	1%	1%	-3%	19%	17%
ICICIBC	-13%	18%	19%	15%	32%	8%	8%	-1%	5%	14%
CIFC	-14%	28%	8%	40%	35%	2%	9%	2%	24%	22%
SHFL	11%	18%	9%	24%	10%	7%	11%	12%	12%	15%
KMB	-4%	43%	45%	40%	30%	-2%	6%	10%	24%	33%

Source: Company, HSIE Research | Loan growth of CV+CE portfolio

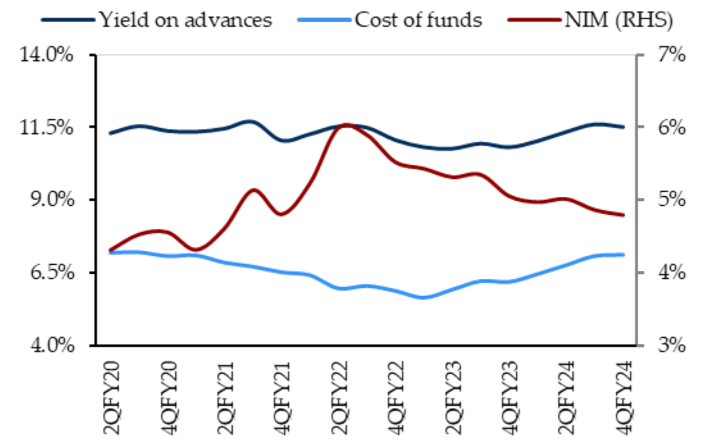
- **NIMs to remain steady, driven by product diversification**: SUF's spreads have declined from a peak of ~5.6% in Q2FY22 to 4.4% in Q4FY24, driven primarily by a rising cost of funds. However, the shift in loan mix towards retail CVs and used vehicles (higher-yielding segments) has driven yield reflation at the margin, which is expected to help stabilise NIMs, going ahead. Further, SUF's AAA rating and balance sheet optimisation are likely to contain any further rise in funding costs.

Exhibit 7: SUF's borrowings mix



Source: Company, HSIE Research

Exhibit 8: NIMs have moderated after peaking out in Q2FY22



Source: Company, HSIE Research

Exhibit 9: Peer comparison (FY24)

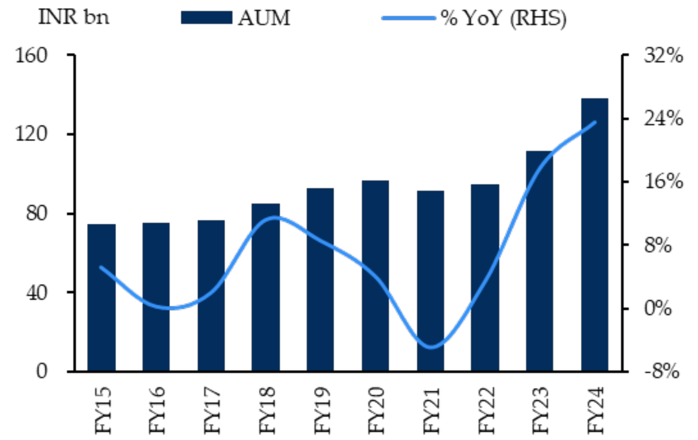
FY24		CIFC	SHTF	MMFS	SUF
AUM	INR bn	1,456	2,249	1,026	440
Disbursements	INR bn	887	1,422	562	262
Mar-26 P/ABV	x	3.8	1.6	1.5	4.3
Growth (% YoY)					
AUM	%	37%	21%	24%	27%
Disbursements	%	33%	28%	13%	25%
NII	%	32%	17%	9%	15%
PPOP	%	33%	15%	11%	27%
PAT	%	28%	20%	-14%	21%
Margins					
Yield on advances	%	13.5%	16.4%	13.3%	11.3%
Cost of funds	%	8.0%	8.6%	7.7%	7.0%
Δ Cost of funds	bps	106	-60	69	113
Spread	%	5.6%	7.8%	5.6%	4.3%
Δ Spread	bps	-41	-133	-83	-46
NIM (on AUM)	%	6.7%	9.2%	7.2%	5.0%
Δ NIM	bps	-26	-112	-106	-33
% Borrowings					
Banks	%	49%	22%	47%	47%
NCD + CPs	%	18%	24%	29%	38%
Off balance sheet (% of AUM)	%	1%	1%	0%	3%
Cost efficiency					
Cost-to-income ratio	%	41%	30%	41%	32%
Opex-to-AUM ratio	%	3.2%	2.9%	3.2%	2.4%
Opex/branch	INR mn	31.7	20.0	21.2	13.7
Portfolio mix (% of AUM)					
CV + CE	%	31%	55%	22%	56%
PV	%	13%	19%	40%	24%
Used vehicles	%	16%	NA	13%	18%
Non-vehicles	%	42%	14%	13%	12%
Productivity					
AUM/branch	INR mn	1,129	749	736	637
Disbursals/branch (/month)	INR mn	57.4	39.5	33.6	31.6
Disbursals/employee (/month)	INR mn	1.5	1.7	1.8	4.5
Employees/branch	x	39.0	24.2	19.0	7.1
Asset Quality					
GS III	%	2.5%	5.4%	3.4%	1.3%
NS III	%	1.3%	2.8%	1.3%	0.7%
PCR - Stage III	%	46.7%	52.0%	63.0%	49.9%
Credit costs	%	1.0%	2.2%	2.0%	0.7%
ROA profile (% of avg. assets)					
Interest earned	%	13.0%	15.2%	12.4%	9.8%
Interest expended	%	6.8%	6.7%	6.1%	5.6%
Net interest income	%	6.2%	8.5%	6.3%	4.2%
Non-interest income	%	1.2%	0.6%	0.4%	2.1%
Operating expenses	%	3.0%	2.7%	2.8%	2.1%
Pre-provisioning profit	%	4.4%	6.4%	4.0%	4.3%
Provisions	%	1.0%	2.0%	1.7%	0.6%
PBT	%	3.4%	4.4%	2.2%	3.7%
ROAA	%	**2.5%**	**3.3%**	**1.7%**	**2.9%**
Assets/Equity (x)	x	8.0	4.8	6.0	5.3
RoAE	%	**20.2%**	**15.6%**	**10.0%**	**15.3%**

Source: Company, HSIE Research | Earnings for SUF excludes exceptional items

- **HFC subsidiary sustains growth momentum, opex weighs on profitability:** Sundaram Home Finance (SHUF) reported strong growth in AUM/disbursements of 24%/29% YoY during FY24. The renewed focus on the business with investments in distribution (21 branches added during FY24 vs. 5 added during FY14-FY22), and product diversification (LAP etc.) is helping drive the loan growth and is likely to help sustain the growth momentum, going ahead.

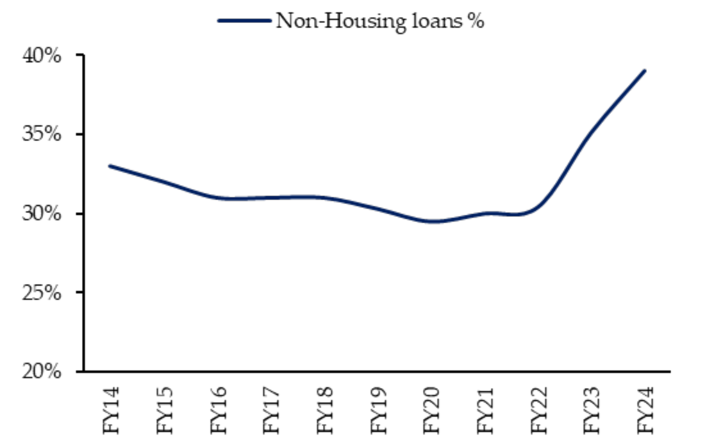
  SHUF's net interest income declined by 6% YoY during Q4FY24, largely due to the rising cost of funds, driving NIMs (3.5%) lower. Opex ratios (2.5% of AUM; C/I at 49%) are likely to remain elevated in the near-term due to sustained investments in the distribution network.

Exhibit 10: HFC – Growth has picked up significantly since FY23



Source: Company, HSIE Research

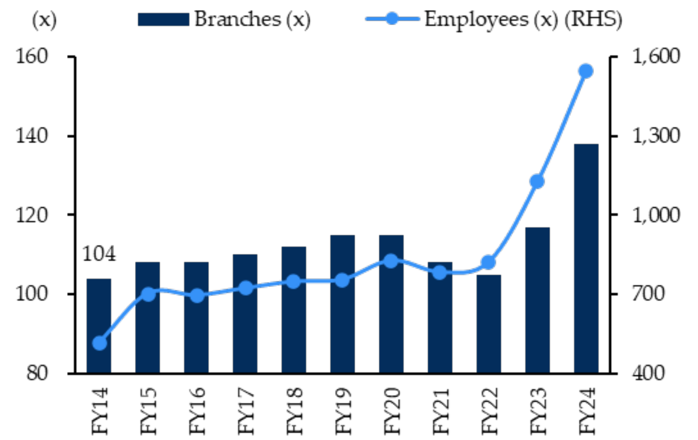
Exhibit 11: Rising share of non-housing loans



Source: Company, HSIE Research

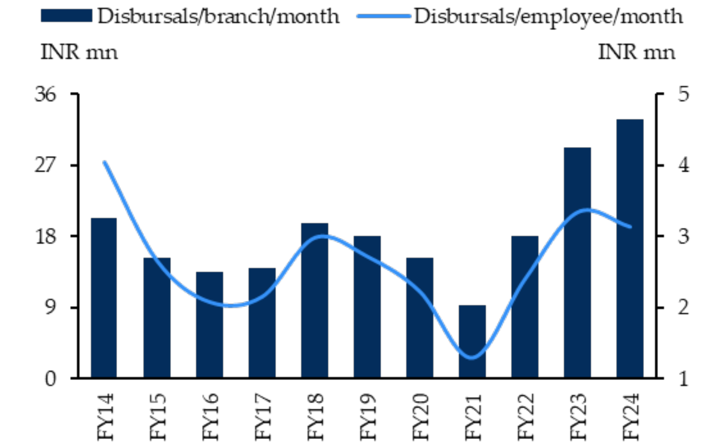
- **Incremental loan growth likely to be broad-based:** SHUF's focus on portfolio diversification has contributed to strong loan growth, partly cushioning margin compression. However, the RBI's floor cap on exposure towards housing finance of ~60% for HFCs is likely to cap the share of non-housing loans within the overall portfolio.

Exhibit 12: Branch additions during FY23 and FY24 after a long period



Source: Company, HSIE Research

Exhibit 13: Improving productivity metrics



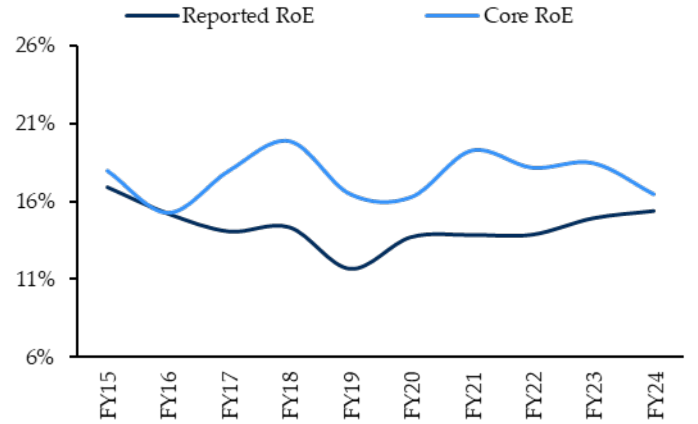
Source: Company, HSIE Research

Valuation outpacing fundamentals; downgrade to REDUCE

- **Robust franchise; diminished margin of safety:** SUF remains a robust franchise with strong profitability (core RoE of ~17-18%) and pristine asset quality (cross-cycle credit costs of ~50bps). The diversification strategy has been pivotal in enabling the franchise deliver higher loan growth.

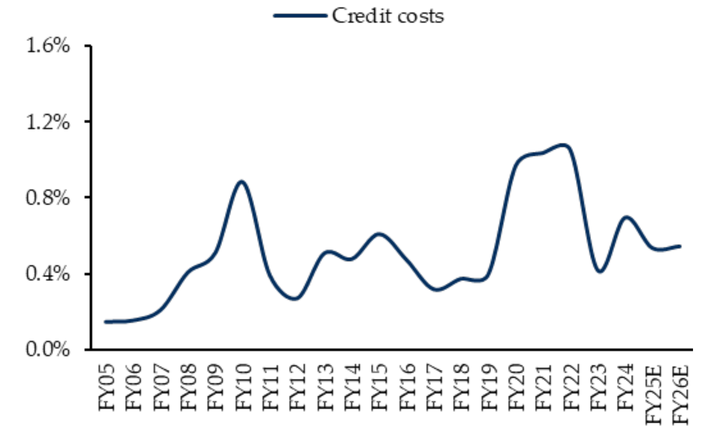
  However, a sharp run-up in stock price, coupled with likely growth moderation, leaves little margin of safety at current valuations (4.3x Mar-26 ABVPS). We raise our FY25/FY26E earnings estimates marginally due to higher loan growth, partly offset by higher opex intensity and downgrade SUF from ADD to REDUCE with revised RI-based TP of INR 4,050 (standalone entity at 3.8x Mar-26 ABVPS).

Exhibit 14: Healthy cross-cycle RoEs



Source: Company, HSIE Research | IND AS from FY18 onwards

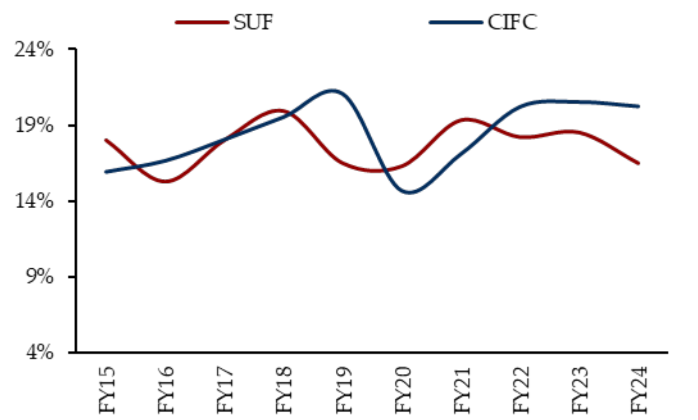
Exhibit 15: SUF's cross-cycle credit costs at ~50bps



Source: Company, HSIE Research | IND AS from FY!8 onwards

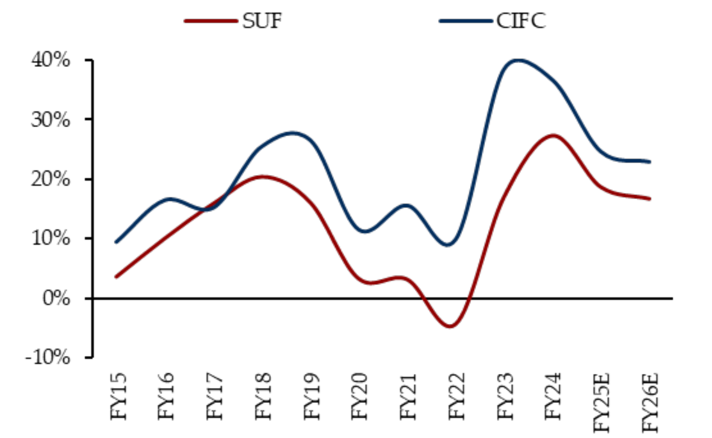
- **Implied valuation at ~15% discount to CIFC:** SUF and CIFC are robust franchises with strong profitability and loan growth. While SUF has demonstrated steady asset quality during down cycles, CIFC has delivered and is expected to deliver higher RoEs and loan growth. Further, CIFC's loan portfolio is increasingly getting relatively more diversified (non-vehicle book at 42% of AUM) and thus commands a valuation premium to SUF.

Exhibit 16: CIFC's RoE is expected to be higher comapred to SUF



Source: Company, HSIE Research | IND AS from FY18 onwards | Core RoE for SUF

Exhibit 17: CIFC scoring higher than SUF over AUM growth



Source: Company, HSIE Research

Exhibit 18: Change in estimates

(INR bn)	FY25E			FY26E		
	Old	New	Change	Old	New	Change
AUM	504	522	3.6%	588	609	3.6%
NIM (%)	4.3	4.4	1 bps	4.4	4.4	-2 bps
NII	23.7	24.2	2.0%	27.9	28.8	3.0%
PPOP	22.7	23.0	1.3%	26.9	27.4	1.7%
PAT	15.4	15.7	1.7%	18.2	18.7	2.2%
Adj. BVPS (INR)	672	739	9.9%	800	864	7.9%

Source: Company, HSIE Research

Exhibit 19: SoTP-based valuation of SUF

	Value (INR bn)	% Stake	Total (INR bn)	per share (INR)	% of TP	Valuation Methodology
SUF (standalone, Mar-26 ABV)	366	100%	366	3,291	81%	RI-based
Sundaram Home Finance	37	100%	37	331	8%	1.6x Mar-26 ABVPS
Sundaram AMC	22	100%	22	196	5%	13x FY26 EPS
Sundaram Finance Holdings	61	20.0%	12	110	3%	CMP
Royal Sundaram General Insurance	40	50%	20	180	4%	14x FY26 EPS
Total value of subsidiaries			**91**	**817**	**20%**	
Less: Holding company discount			6	58	1%	20% Hold co discount
Total SoTP valuation			**450**	**4,050**	100%	

Source: Company, HSIE Research

Financials

Income Statement

(INR mn)	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Interest earned	34,064	34,713	33,945	34,721	45,246	56,197	67,034
Interest expended	20,720	20,307	17,001	17,771	25,758	31,991	38,268
Net interest income	**13,344**	**14,406**	**16,944**	**16,950**	**19,488**	**24,205**	**28,766**
Other income	5,205	5,429	4,960	6,381	9,698	9,961	11,188
Total income	18,549	19,835	21,904	23,331	29,186	34,167	39,954
Operating expenditure	6,234	6,111	6,949	7,789	9,481	11,205	12,597
Pre-provisioning operating profit	**12,315**	**13,724**	**14,954**	**15,542**	**19,705**	**22,962**	**27,357**
Non-tax provisions	2,864	3,161	3,185	1,343	2,738	2,580	3,073
Profit before tax	9,451	10,563	11,769	14,200	16,967	20,382	24,284
Tax expenditure	2,212	2,473	2,735	3,317	3,765	4,729	5,634
Adjusted Profit after tax	7,239	8,090	9,034	10,883	13,202	15,654	18,650
Reported Profit after tax	**7,239**	**8,090**	**9,034**	**10,883**	**14,540**	**15,654**	**18,650**

Source: Company, HSIE Research

Balance Sheet

(INR mn)	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Share capital	1,111	1,111	1,111	1,111	1,111	1,111	1,111
Reserves and surplus	54,363	60,683	67,820	76,263	93,606	106,149	121,133
Net worth	55,498	61,795	68,931	77,374	94,717	107,260	122,244
Borrowings	273,367	282,134	278,353	327,549	408,769	500,607	586,141
Other liabilities and provisions	5,354	5,596	5,592	5,664	6,392	9,377	10,942
Total equity and liabilities	**334,195**	**349,525**	**352,875**	**410,587**	**509,878**	**617,244**	**719,327**
Cash and cash equivalents	6,298	6,932	6,171	10,703	14,184	14,520	27,029
Investments	39,377	40,524	53,187	50,628	63,829	67,004	67,517
Advances	280,447	294,039	284,002	337,552	420,768	520,941	607,892
Fixed assets	3,596	3,309	3,604	5,131	6,582	7,372	8,257
Other assets	4,477	4,721	5,911	6,573	4,515	7,407	8,632
Total assets	**334,195**	**349,525**	**352,875**	**410,587**	**509,878**	**617,244**	**719,327**

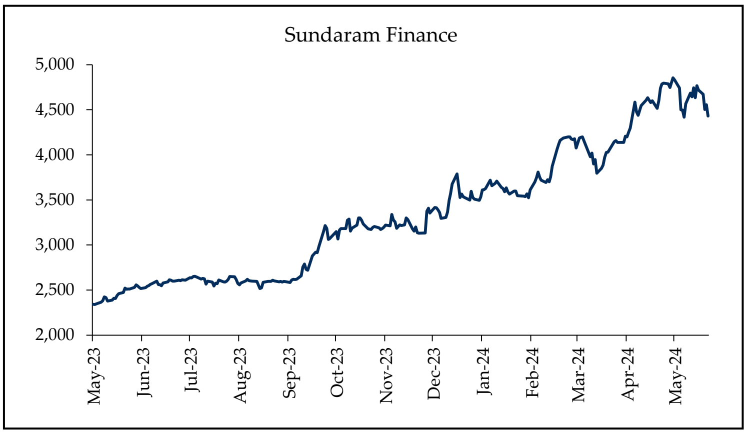
Source: Company, HSIE Research

Key Ratios

	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
VALUATION RATIOS							
EPS	65.2	72.8	81.3	98.0	118.8	140.9	167.9
Earnings Growth (%)	35.6%	11.8%	11.7%	20.5%	21.3%	18.6%	19.1%
BVPS (ex reval.)	499	556	620	696	853	965	1,100
Adj. BVPS (ex reval. & 100% cover)	458	351	402.4	479.3	637.1	738.6	863.7
ROAA (%)	2.3%	2.4%	2.6%	2.9%	2.9%	2.8%	2.8%
ROAE (%)	13.7%	13.8%	13.8%	14.9%	15.3%	15.5%	16.3%
P/E (x)	68.1	61.0	45.3	37.6	31.0	26.1	21.9
P/ABV (x)	9.7	12.6	9.1	7.7	5.8	5.0	4.3
P/PPOP (x)	40.1	35.9	33.0	31.7	25.0	21.5	18.0
Dividend yield (%)	0.3%	0.4%	0.5%	0.6%	0.7%	0.6%	0.7%
PROFITABILITY (%)							
Yield on Advances (%)	11.8%	11.6%	11.2%	10.6%	11.3%	11.4%	11.4%
Cost of Funds (%)	7.9%	7.3%	6.1%	5.9%	7.0%	7.0%	7.0%
Core Spread (%)	3.9%	4.3%	5.2%	4.8%	4.3%	4.3%	4.3%
NIM (% of AUM)	4.2%	4.3%	4.9%	4.5%	4.3%	4.4%	4.4%
OPERATING EFFICIENCY							
Cost to average AUM ratio (%)	2.1%	2.0%	2.3%	2.4%	2.4%	2.3%	2.2%
Cost-income ratio (%)	33.6%	30.8%	31.7%	33.4%	32.5%	32.8%	31.5%
BALANCE SHEET STRUCTURE RATIOS							
Loan growth (%)	2.8%	4.8%	-3.4%	18.9%	24.7%	23.8%	16.7%
AUM growth (%)	3.3%	3.2%	-4.4%	17.0%	27.3%	18.7%	16.7%
Borrowing growth (%)	9.3%	3.2%	-1.3%	17.7%	24.8%	22.5%	17.1%
Debt/Equity (x)	5.6	5.2	4.7	4.9	4.9	5.3	5.4
Equity/Assets (%)	16.6%	17.7%	19.5%	18.8%	18.6%	17.4%	17.0%
Equity/Loans (%)	19.8%	21.0%	24.3%	22.9%	22.5%	20.6%	20.1%
Total Capital Adequacy Ratio (CAR) (%)	18.4%	22.1%	24.4%	22.8%	20.5%	19.1%	18.9%
Tier I CAR (%)	13.2%	15.2%	17.5%	17.7%	16.8%	15.8%	16.1%
ASSET QUALITY							
Gross NPL (INR mn)	7,013	5,523	6,386	5,765	5,530	7,944	10,034
Net NPL (INR mn)	4,636	2,996	3,067	2,966	2,771	4,043	5,125
Gross NPL (%)	2.5%	1.8%	2.2%	1.7%	1.3%	1.5%	1.7%
Net NPL (%)	1.7%	1.0%	1.1%	0.9%	0.7%	0.8%	0.9%
Coverage Ratio (%)	33.9%	45.7%	52.0%	48.6%	49.9%	49.1%	48.9%
Provision/Avg. AUM (%)	1.0%	1.0%	1.1%	0.4%	0.7%	0.5%	0.5%
DUPONT ANALYSIS							
Interest earned	10.6%	10.2%	9.7%	9.1%	9.8%	10.0%	10.0%
Interest expended	6.5%	5.9%	4.8%	4.7%	5.6%	5.7%	5.7%
Net interest income	**4.2%**	**4.2%**	**4.8%**	**4.4%**	**4.2%**	**4.3%**	**4.3%**
Non-interest income	1.6%	1.6%	1.4%	1.7%	2.1%	1.8%	1.7%
Operating expenses	1.9%	1.8%	2.0%	2.0%	2.1%	2.0%	1.9%
Pre-provisioning profit	3.8%	4.0%	4.3%	4.1%	4.3%	4.1%	4.1%
Provisions	0.9%	0.9%	0.9%	0.4%	0.6%	0.5%	0.5%
Tax	0.7%	0.7%	0.8%	0.9%	0.8%	0.8%	0.8%
ROAA	**2.3%**	**2.4%**	**2.6%**	**2.9%**	**2.9%**	**2.8%**	**2.8%**
Average Assets/Equity (x)	6.0	5.8	5.4	5.2	5.3	5.6	5.8
ROAE	**13.7%**	**13.8%**	**13.8%**	**14.9%**	**15.3%**	**15.5%**	**16.3%**

Source: Company, HSIE Research

1 Yr. Price Movement



Rating Criteria

BUY: >+15% return potential

ADD: +5% to +15% return potential

REDUCE: -10% to +5% return potential

SELL: >10% Downside return potential

Disclosure:

We, **Deepak Shinde, PGDM, ASV Krishnan, PGDM & Akshay Badlani, CA** authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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