

AU Small Finance Bank

BUY

On course

Our recent interaction with the top management of AUBANK, at their first analyst day, bolsters our constructive stance. Management's intent to eventually convert into a full-fledged bank, via granular growth, was visible (AUBANK has to remain an SFB for at least ten more quarters). A book accretive fund raise is likely (though not immediately).

Current asset quality trends are inspiring, amidst a bleak landscape. Increasing granularity will only help. Oplev (key to our anticipated RoAA expansion) has kicked in recently and is sustainable, in our view. Valuations are rich, but likely to persist so long as asset quality and growth hold up. Maintain BUY. Our SOTP-based TP is Rs 725 (4.75x Jun-21E ABV of Rs 148 + Rs 19/sh for AAVAS).

- **Growth is key:** AUBANK's scorching growth has been driven by its core segments (VF: 38% and MSME: 56% CAGR over FY17-19). We see several factors that point to sustainable industry beating growth e.g. diversification across segments and products (GL, HL, VF refinance), expansion into newer geographies (faster growth ex-Rajasthan) and fading competition from upcountry NBFCs. AUBANK's claimed focus on granular growth sans dilution of credit filters provides comfort. We model AUM CAGR of 34% over FY20-21E. Further deterioration of macros is a downside risk.
- **Deposit Traction:** Post conversion, AUBANK posted strong deposit traction despite slowing systemic deposit accretion (incremental deposits were 1.2x incremental AUMs post FY17, far ahead of other SFB converts). Strong retailisation was visible over FY19 (~39.6% of overall deposits vs. ~33% YoY), led by TDs

and SA. More retailisation is likely hereon. Fresh tech initiatives, geographical expansion and differential rate lure will help, we believe.

- **Stable Asset Quality:** Asset quality trends across core segments (VF and MSME) were stable, even on a lagged basis. Granular growth should increase predictability. Lending in the (relatively) higher ticket SME segment (higher GNPA's at 6.8%) was discontinued recently. We are cautious on asset quality in the wholesale book (esp. NBFCs and RE) despite low reported stress. We expect GNPA's to remain almost unchanged at 1.87% by FY21E. The wholesale segment poses a risk to our estimates.
- **Oplev To Drive RoAAs:** Tighter cost control is evident over the last three qtrs. Increased reliance on BCs and smaller low cost branches will further drive oplev. Growth will help cap C-I (est. ~54% over FY20-21E). AUBANK is set to reduce Cost/assets by ~44bps over FY19-21E.

FINANCIAL SUMMARY

YE Mar (Rs mn)	FY18	FY19E	FY20E	FY21E	FY22E
NII	9,405	13,425	19,703	25,846	33,218
PPOP	5,759	7,219	11,893	16,097	21,111
PAT	2,920	3,818	6,465	7,949	10,534
EPS (Rs)	10.2	13.1	19.2	26.3	34.8
ROAE (%)	13.8	14.1	15.7	17.2	19.2
ROAA (%)	2.0	1.5	1.5	1.6	1.7
Adj. BVPS (Rs)	73	101	118	141	171
P/ABV (x)	9.41	6.82	5.85	4.90	4.02
P/E (x)	67.5	52.8	35.9	26.3	19.8

Source : Company, HDFC sec Inst Research

INDUSTRY	BANKS
CMP (as on 9 Aug 2019)	Rs 690
Target Price	Rs 725
Nifty	11,110
Sensex	37,582

KEY STOCK DATA

Bloomberg/Reuters	AUBANK IN
No. of Shares (mn)	292
MCap (Rs bn) / (\$ mn)	202/2,852
6m avg traded value (Rs mn)	190

STOCK PERFORMANCE (%)

52 Week high / low	Rs 745/501		
	3M	6M	12M
Absolute (%)	9.4	17.7	7.1
Relative (%)	9.3	14.9	8.2

SHAREHOLDING PATTERN (%)

	Mar-19	Jun-19
Promoters	32.2	32.2
FIs & Local MFs	19.7	16.6
FPIs	38.3	39.3
Public & Others	9.7	12.0
Pledged Shares	-	-

Source : BSE

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MD's Session: Strategic Takes

- **Granularity Is Key:** Conscious focus on small ticket retail loans and risk based pricing. ~90% of existing loans are up to ~Rs 1mn with yields of ~15%. Focus on granular retail deposits (i.e. CASA + Retail TD) rather than CASA. Doubled network since FY17. While assets grew 3.3x, customer a/cs jumped ~5.4x (1.52mn).
- **Cost control** by way of reliance on smaller branches, more BCs (add 450 BCs over the next 2 years on a base of 56) and separate sales offices.
- **Strong traction in new products:** HL (O/S AUM of Rs 2bn & 2,100cases), CD (O/S AUM Rs 120mn & ~1100cases) and GL (O/s 510mn & 4300 cases).
- **Where Next?:** Target AUM CAGR of 30-35% to reach ~\$10bn without diluting credit filters. Prioritise asset quality over growth.
- Likely fund raise over the next 2-2.5 years. Will exit AAVAS financiers on an opportunistic basis.
- RoAA target of 1.9-2% over the next 10 qtrs.
- Plans in place to become a universal bank.
- Comfortable with CASA of ~20-22% over the next 2-2.5yrs
- Aim to fund ~80% of incremental AUMs by way of granular deposits.

Branch Banking

Deposits:

- Strong focus on granular deposits (below ~Rs 50mn) at the branch level, especially since Apr-19.
- Constituted a separate team to acquire bulk deposits, this was earlier done by branches. This should sustain the trend of increasing retailisation of deposits.
- Retail TDs are the top priority, given stickiness and relative ease of acquisition.
- Aim to mkt SA as a bundled 3 in 1 a/c along with TDs and cross-sell CA to existing SBL, BB, Agri and NBFC customers.

- Metro branches have CASA+RTD of ~Rs 1.9bn / branch i.e. 1.6x of the urban branches and 11.2x of the rural branches.

Low Cost Branch Expansion By Way Of:

- Addition of leaner branches
- Set up of branch agnostic sales team housed in separate offices, in turn reducing branch requirements and resulting in smaller branches.
- Continuance of the hub & spoke model by attaching spoke branches/ BCs/ asset centres to hub flagship branches.
- Set up of hybrid full service BCs that would save on costs while attempting to replicate the ambience of a branch.

Vehicle Finance

- The VF book has grown at ~47% CAGR over FY08-19 to ~Rs 102bn. This growth has not been linear, and the bank has cautiously and consciously slowed in uncondusive times (for eg. the book grew merely ~6% and ~1% in FY14 and FY15 resp.).
- Relatively stable asset quality across cycles in spite of scorching growth (peak GNPA's of 3.5% in FY14, currently at ~2.3%).
- Credited superior asset quality to 100% in-house sourcing and field investigation, strong referral flow, repeat customers and constant emphasis on absolute customer equity.
- Cover most customer categories (FTBs, FTUs, captive users etc) across segments (used / new and refinance) across OEMs.
- Diversification drives growth (likely to continue): Rajasthan forms 35% of VF assets vs. ~50% earlier.
- Conscious reduction in HCV exposure to ~5% from ~23% in FY12.
- Increasing focus on the used segment. It now forms 31% of the VF book vs. 25% in FY12.

- See increasing organisation in the used car market with business and financing moving from unorganised to organised players. AUBANK has opportunity to grow here.
- Commenced paperless 2wheeler loans.
- Segment stats:
 - Active loans : 0.42mn
 - ATS: Rs 0.35-0.4mn
 - Avg Tenure: 3.5 years
 - Avg LTV: 80%
 - Avg EMI: Rs 14,000
 - Avg LTV: Less than 50%
 - PSL Compliance: 85% of the book
- M-Share : 3.5% in new vehicles

MSME

- Scope includes financing businesses that supply basic human necessities (food, clothing, housing, education, healthcare and lifestyle) as their demand and cash flows tend to be more resilient. Focus is thus on B2C MSMEs.
- AUBANK does not prefer financing B2B MSMEs with more volatile and less predictable cash flows.
- AU plans to increase POS penetration in this segment.
- Segment stats:
 - Cumulative customers: 0.114mn
 - Avg EMI: Rs 19,500
 - Avg LTV: Less than 50%
 - New to credit customers: ~40% and 1st formal business loan for 80% of the customers
 - ATS: Rs 0.9mn
 - Segment reach: 11 states, 38 clusters and 321 branches
- This segment witnessed rapid growth between FY17-Jun19 (~55% CAGR) and delinquencies typically arise in 27 months. Internal models predict stability in 1 yr fwd asset quality.

- While NPAs in the segment are ~2.5%, historical LGDs are near NIL.
- Login/ disbursal rates are ~45% (stable for a while).
- Employee referral programmes a/c for 10% of the business in this segment.

Small & Mid Corporate Segment

NBFC Book Stats

- Granularity: 161 a/cs with 335 exposures, out of which ~81% are less than ~Rs 100mn and ~55% are less than ~Rs 50mn and an ATS of ~Rs 83mn.
- Diversification: Book spread across AFCs, HFCs, MFIs, Gold Financiers and Fintechs.
- Vintage book (seasoned for 6yrs) with Nil 0+ DPD.
- Lending to smaller NBFCs with high capital adequacy and limited reliance on capital mkt borrowings.
- 88% of the book is rated investment grade or above.
- Deposits from NBFC borrowers: ~Rs 16bn.

Real Estate Book Stats

- Customers engaged in building row houses and low/high rise projects.
- Granularity: ~93% of facilities are less than Rs 50mn and the ATS is ~Rs 24mn.
- Focus on near completion projects and the affordable housing segment.
- Financed 400+ projects till date.

Business Banking

- Focus is on the mfg, wholesale, trade and retail segments. Fund and non-fund based facilities offered.
- Agri lending is focussed on pre-production, distribution, storage processing and retail by way of WC/ Term Loans.
- 80% of this book is towards WC lending and ATS is ~Rs 5.5mn in business banking and ~Rs 3.4mn in the Agri SME segment.

The MSME segment grew at ~55% CAGR between FY17-19

Retail deposits (SA +TD) constitute ~39.6% of overall deposits (ex-CD)

Increasing retailisation of deposits evident with a conscious focus

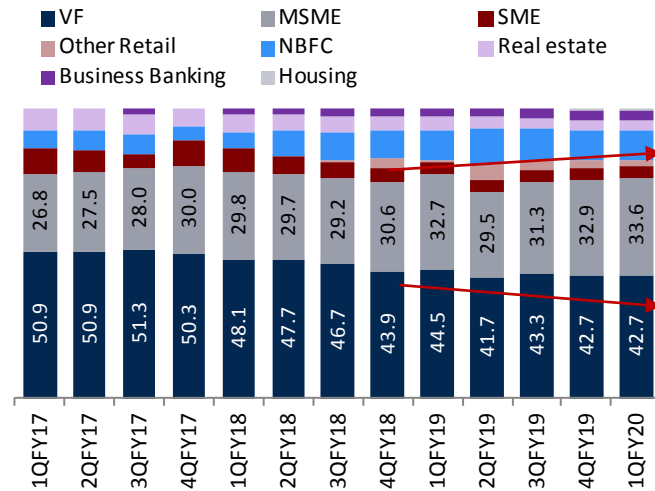
Retail SA (~82% of SA) grew ~53% YoY

Retail TD (~34% of TD) grew ~289%

Strong growth ex-Rajasthan evident

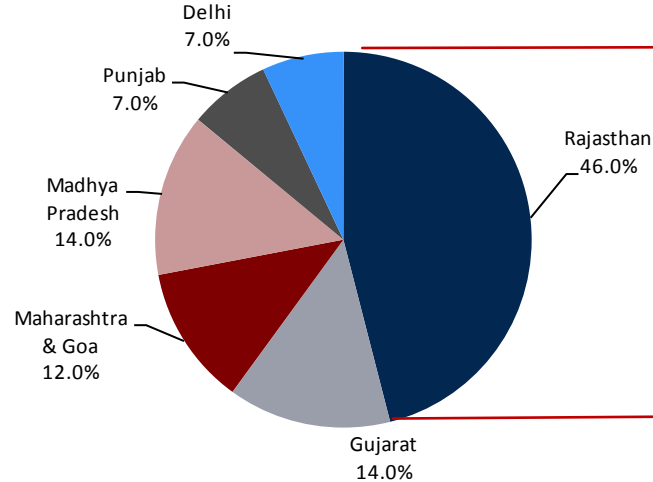
Maharashtra constitutes ~14% of AUBANK's advances and ~34% of deposits

Loan Book Mix: MSME Gaining Share



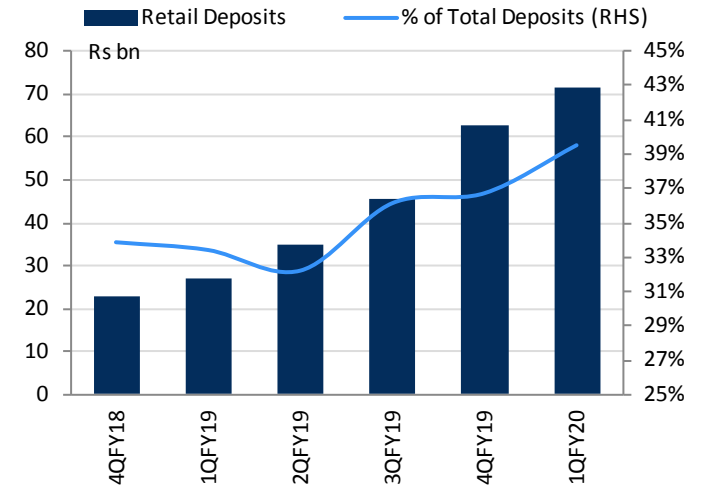
Source : Company, HDFC sec Inst Research

Geographical Book Mix: 1QFY19



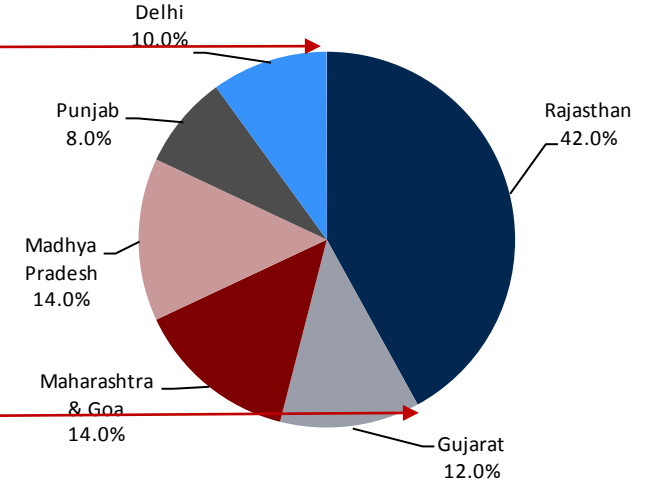
Source : Company, HDFC sec Inst Research

Retail Deposit Trends: Strong Traction



Source : Company, HDFC sec Inst Research

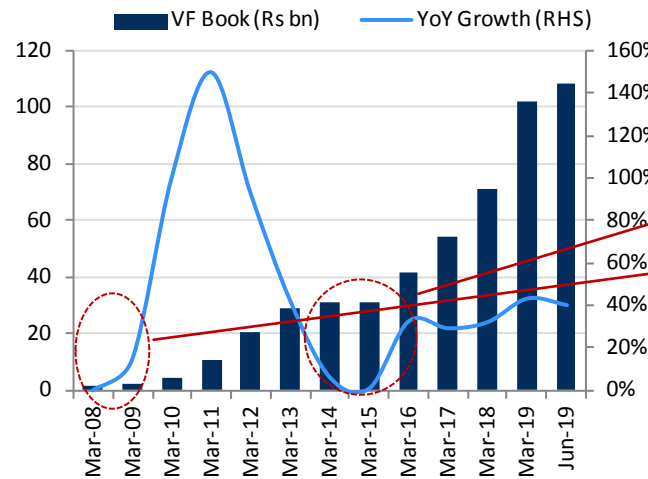
Geographical Book Mix: 1QFY20



Source : Company, HDFC sec Inst Research

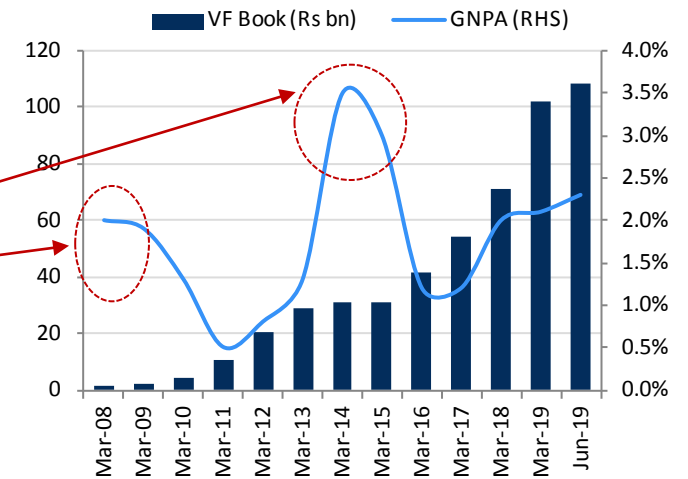
VF Growth and Asset Quality:
Sharp slowdown in growth a conscious strategy in times of asset quality stress

VF Segment: Book Size and Growth



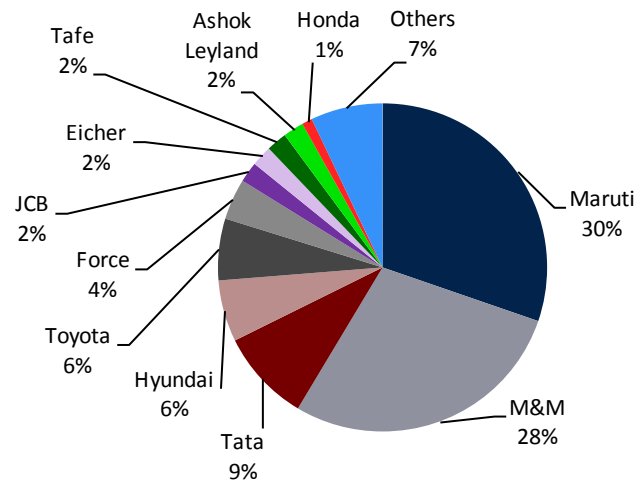
Source : Company, HDFC sec Inst Research

VF Segment: Book Size and Asset Quality



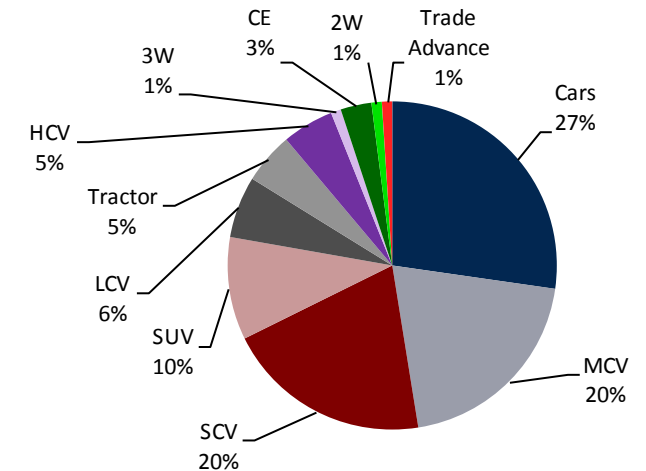
Source : Company, HDFC sec Inst Research

VF Book Split: Maruti and M&M Dominate



Source : Company, HDFC sec Inst Research

VF Book Split: Cars and MCVs Dominate



Source : Company, HDFC sec Inst Research

Strong geographical diversification visible in the core segment by way of ex-Rajasthan growth

Earlier, Rajasthan constituted ~50% of the VF book (vs. ~35% now)

QoQ opex growth and C-I trends suggest the sustenance of current oplev

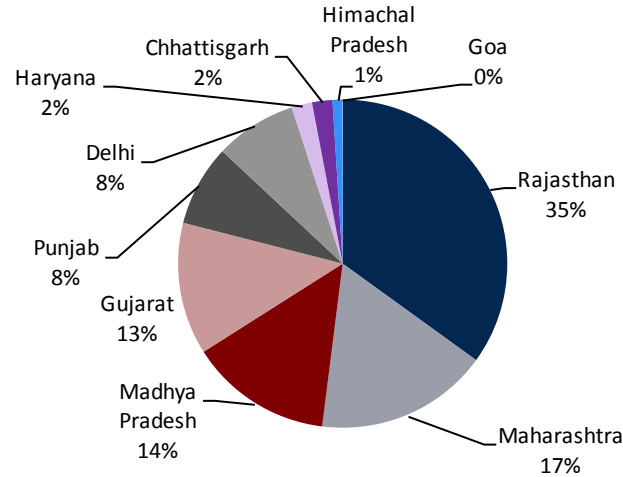
The C-I ratio for 1QFY20 was 59.6%

We model a C-I ratio of ~54% over FY20-21E with oplev driven by:
Addition of leaner branches
Greater reliance on BCs
Separation of sales functions from branches

Stable asset quality visible in core segments, even on a lagged basis

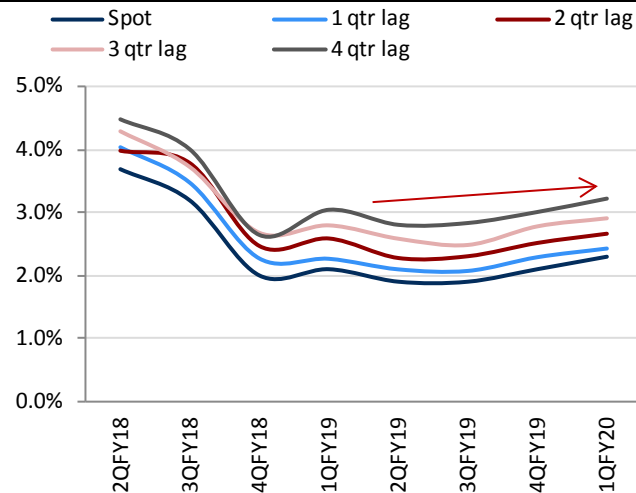
We evaluate asset quality on a lagged basis to offset the impact of a rapidly growing base

VF Book: Geographical Split



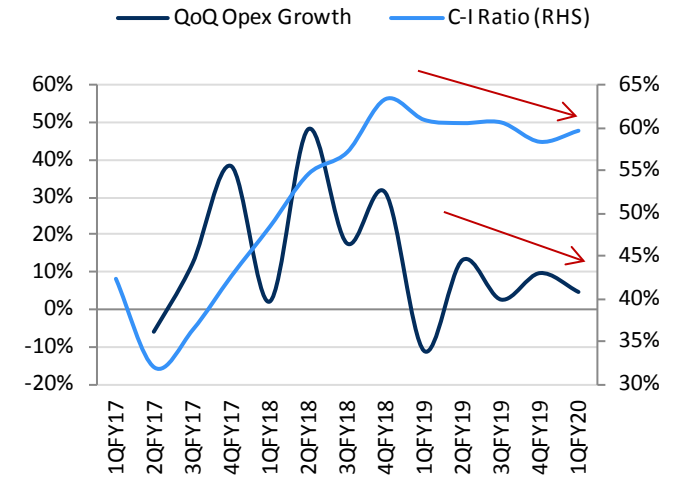
Source : Company, HDFC sec Inst Research

VF GNPA's: Stable Trends Visible



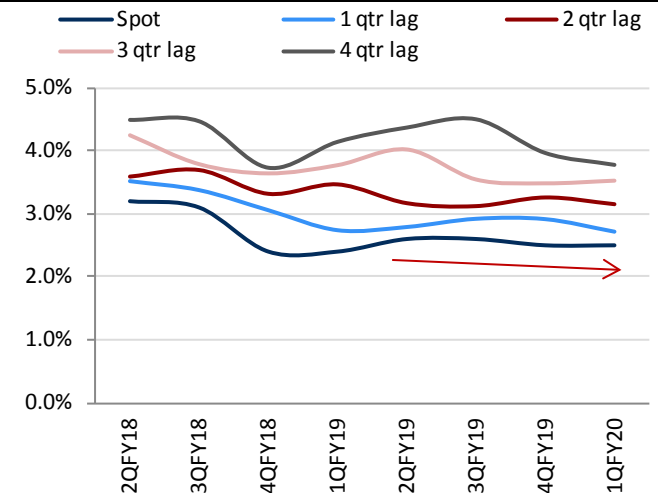
Source : Company, HDFC sec Inst Research

Trends Point Towards Improving Oplev



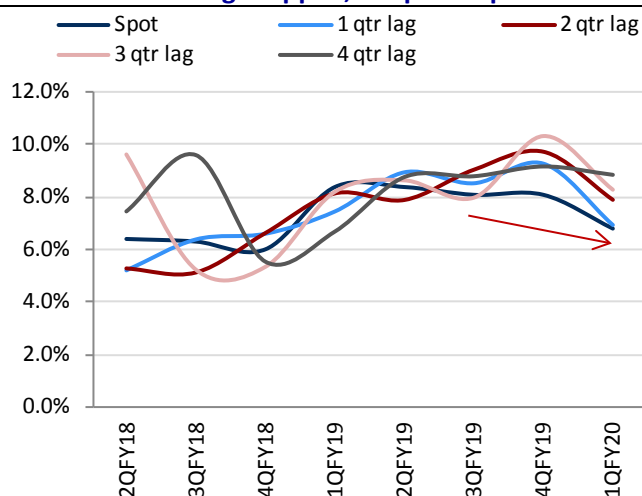
Source : Company, HDFC sec Inst Research

MSME GNPA's: Stable Trends Visible



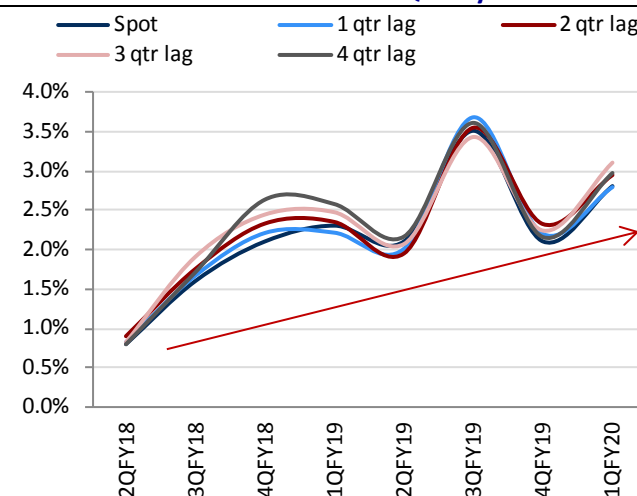
Source : Company, HDFC sec Inst Research

SME GNPA's: Lending Stopped, Despite Improvement



Source : Company, HDFC sec Inst Research

Deterioration in Real Estate Asset Quality



Source : Company, HDFC sec Inst Research

Peer Set Comparison

Banks	Mcap (Rs bn)	CMP (Rs)	Rating	TP (Rs)	ABV (Rs)			P/E (x)			P/ABV (x)			ROAE (%)			ROAA (%)		
					FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
KMB #	2,926	1,533	NEU	1,531	201	238	273	48.0	39.7	32.2	6.09	5.22	4.44	13.0	13.7	14.3	1.70	1.77	1.80
ICICIBC #	2,710	420	BUY	492	138	156	179	62.1	18.5	12.4	2.35	2.04	1.74	3.3	9.3	12.7	0.36	1.08	1.39
AXSB#	1,734	662	BUY	900	215	252	297	34.7	19.1	13.4	2.93	2.50	2.12	7.2	12.1	15.0	0.63	1.03	1.29
IIB	979	1,414	BUY	1,964	400	515	550	25.8	19.9	15.2	3.53	2.75	2.57	13.3	16.1	17.2	1.32	1.58	1.68
RBL	191	384	NEU	512	168	216	247	18.9	20.8	14.5	2.29	1.78	1.55	12.2	9.5	10.6	1.22	1.00	1.14
FB	174	88	BUY	117	59	64	75	14.0	10.9	8.3	1.50	1.37	1.17	9.8	11.5	13.7	0.84	0.93	1.06
CUB	145	197	BUY	246	58	68	79	21.2	18.3	15.8	3.41	2.90	2.50	15.2	15.1	15.1	1.60	1.62	1.60
DCBB	62	198	NEU	234	88	98	112	18.8	15.3	11.8	2.26	2.02	1.76	11.0	12.2	14.0	0.99	1.03	1.12
KVB	48	61	BUY	87	50	52	61	23.0	14.1	8.3	1.21	1.16	1.00	3.3	5.3	8.8	0.31	0.47	0.72
SBIN #	2,600	291	BUY	398	146	188	222	208.8	7.3	4.9	1.38	1.07	0.89	0.4	10.6	14.0	0.02	0.64	0.85
AUBANK	209	690	BUY	725	101	118	141	52.8	35.9	26.3	6.82	5.85	4.90	14.1	15.7	17.2	1.48	1.53	1.63

Source: Company, HDFC sec Inst Research; # Adjusted for Subsidiaries

Income Statement

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Interest Earned	17,672	29,488	44,379	57,384	73,642
Interest Expended	8,267	16,064	24,676	31,538	40,425
Net Interest Income	9,405	13,425	19,703	25,846	33,218
Other Income	3,881	4,620	6,693	8,667	10,804
Total Income	13,285	18,045	26,396	34,513	44,022
Total Operating Exp	7,526	10,826	14,503	18,416	22,911
PPOP	5,759	7,219	11,893	16,097	21,111
Provisions & Contingencies	1,326	1,418	3,155	4,189	5,329
PBT	4,434	5,801	8,737	11,908	15,782
Ex. Item	-	-	770	-	-
Provision for Tax	1,513	1,983	3,043	3,959	5,247
PAT	2,920	3,818	6,465	7,949	10,534
APAT	2,920	3,818	5,810	7,949	10,534

Source: Bank, HDFC sec Inst Research

Balance Sheet

(Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share capital	2,857	2,924	3,025	3,025	3,025
Reserves and surplus	19,995	28,705	39,541	47,013	56,915
Shareholders' funds	22,812	31,629	42,566	50,037	59,940
Total Deposits	79,233	194,224	285,042	371,689	497,388
CASA	21,335	35,901	47,557	62,958	80,602
Total Borrowings	76,389	86,134	90,440	99,484	109,433
Other Liabilities, provisions	9,894	14,241	17,089	19,653	22,601
Total	188,328	326,228	435,138	540,863	689,361
APPLICATION OF FUNDS					
Advances	133,121	228,187	312,617	414,217	548,838
Investments	30,506	71,617	82,606	94,235	121,364
Fixed assets	3,861	4,470	4,694	4,929	5,175
Other Assets	20,840	21,954	35,221	27,483	13,985
Total assets	188,328	326,228	435,138	540,863	689,361

Source: Bank, HDFC sec Inst Research

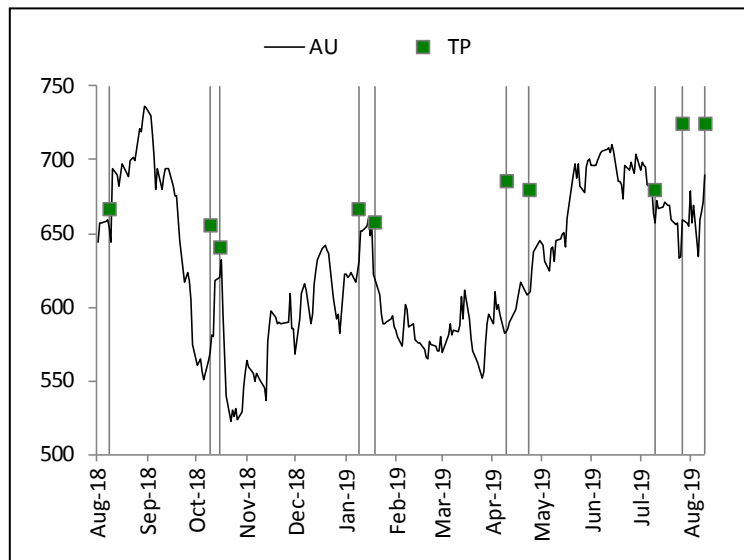
Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
VALUATION RATIOS					
EPS (Rs)	10.2	13.1	19.2	26.3	34.8
Earnings Growth (%)	(4.3)	30.7	52.2	36.8	32.5
BV (Rs)	79.2	108.2	127.1	151.8	184.6
Core ABV (Rs)	73.3	101.1	118.0	140.8	171.5
RoAA (%)	2.04	1.48	1.53	1.63	1.71
ROAE (%)	13.8	14.1	15.4	17.2	19.2
P/E (x)	67.5	52.8	35.9	26.3	19.8
P/ABV (x)	9.4	6.8	5.8	4.9	4.0
Dividend Yield (%)	0.1	0.1	0.1	0.2	0.3
PROFITABILITY					
Yield on Advances (%)	12.51	13.00	13.20	13.15	13.00
Cost of Funds (%)	7.29	7.37	7.53	7.45	7.50
Core Spread (%)	5.22	5.63	5.68	5.70	5.50
NIM (%)	5.88	5.30	5.36	5.42	5.42
OPERATING EFFICIENCY					
Cost-Income Ratio (%)	56.7	60.0	54.9	53.4	52.0
Cost/Avg. Asset Ratio (%)	5.3	4.2	3.8	3.8	3.7
BALANCE SHEET STRUCTURE RATIOS					
Loan Growth (%)	103.2	71.4	37.0	32.5	32.5
Deposits Growth (%)	-	145.1	46.8	30.4	33.8
Equity/Assets (%)	12.0	9.7	9.8	9.3	8.7
Equity/Loans (%)	17.0	13.9	13.6	12.1	10.9
CRAR (%)	19.3	19.3	20.4	19.3	18.0
Tier I (%)	18.4	16.0	17.3	16.3	15.3

	FY18	FY19	FY20E	FY21E	FY22E
ASSET QUALITY					
Gross NPLs (Rs m)	2,697	4,701	6,179	8,267	10,765
Net NPLs (Rs m)	1,693	2,945	3,924	4,755	5,655
Gross NPLs (%)	2.01	2.04	1.84	1.87	1.89
Net NPLs (%)	1.27	1.21	1.17	1.08	0.99
Coverage Ratio (%)	37.2	37.4	36.5	42.5	47.5
LLP (%)	0.99	0.70	1.09	1.08	1.05
Slippages (%)	1.5	2.2	2.0	2.0	2.0
ROAA TREE (%)					
Net Interest Income	6.57%	5.22%	5.18%	5.30%	5.40%
Non Interest Income	2.71%	1.80%	1.76%	1.78%	1.76%
Operating Cost	5.26%	4.21%	3.81%	3.77%	3.72%
Provisions	0.93%	0.55%	0.83%	0.86%	0.87%
Tax	1.06%	0.77%	0.80%	0.81%	0.85%
ROAA	2.04%	1.48%	1.50%	1.63%	1.71%
Leverage (x)	6.74	9.48	10.26	10.54	11.19
ROAE	13.76%	14.07%	15.35%	17.17%	19.16%

Source: Bank, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
9-Aug-18	652	NEU	667
9-Oct-18	565	NEU	656
15-Oct-18	620	NEU	641
8-Jan-19	616	NEU	667
19-Jan-19	622	NEU	658
9-Apr-19	583	BUY	683
23-Apr-19	610	BUY	680
9-Jul-19	680	BUY	680
29-Jul-19	660	BUY	725
10-Aug-19	690	BUY	725

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
Disclosure:

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Any holding in stock –No

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