



3R MATRIX

	+	=	-
Right Sector (RS)	✓	✗	✗
Right Quality (RQ)	✓	✗	✗
Right Valuation (RV)	✓	✓	✗

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	✓	↔	✓
RQ	✓	↔	✓
RV	✗	↔	✗

Reco/View

Reco: Buy	↔
CMP: Rs. 1,255	
Price Target: Rs. 1,500	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

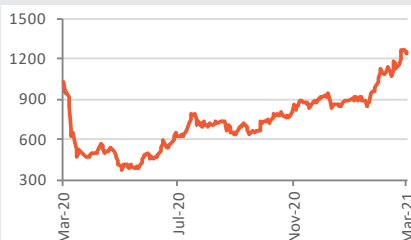
Company details

Market cap:	Rs. 38,544 cr
52-week high/low:	Rs. 1,316 / 366
NSE volume: (No of shares)	6.7 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	21.8 cr

Shareholding (%)

Promoters	29.0
FII	37.0
DII	15.1
Others	18.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-30.4	-20.7	-4.1	-15.2
Relative to Sensex	-20.7	-10.9	-4.8	-44.8

Sharekhan Research, Bloomberg

AU Small Finance Bank

Capital raising to help on the growth path

Banks & Finance

Sharekhan code: AUBANK

Company Update

Summary

- AU Small Finance (AUSFB) has announced its plans to raise equity funds via Qualified Institutional Placement (QIP), which will provide growth capital, help the bank on its way to become a Universal Bank.
- As per our calculations, Tier-1 ratio will likely increase by ~240 bps, equity dilution to be small (~1.6%), but the book value (Calculated) may increase by ~9.7%.
- AUSFB is available at 6.1x/4.9x its FY2022E/FY2023E ABPVS; expect bank to report healthy ROA/ROE to improve to 1.9%/18.1% in FY2023E from 1.8%/17.9% in FY2020.
- We maintain Buy on the stock with a revised price target (PT) of Rs. 1,500.

AU Small Finance (AUSFB) has announced its plans to raise equity funds via Qualified Institutional Placement (QIP). As per media reports, QIP is likely of size Rs. 600-700 crore (floor price of Rs. 1,181.06 per share; may offer a discount up to 5%). Management had earlier indicated in its Q3 concall that it may go for capital raising in Q4 to target growth prospects and strengthen the balance sheet. Hence, the present capital raising is likely part of the bank's plans to raise funds for meeting its growth requirements, which had earlier been delayed due to unfavourable market conditions due to the pandemic. AUSFB's Tier 1/CRAR ratio was at 16.3%/18.8% in Q3, while including profits stood at 20.3%/23.5% and is comfortable. Post the capital raising, as per our calculations, Tier-1 ratio will likely increase by ~240 bps (based on Q3FY2021 RWA), net worth will rise by ~11.8%. While equity dilution will be small (~1.6%), book value (Calculated) will likely increase by ~9.7%.

We expect capital raising will pave way for growth, increased products/services portfolio and help the bank on its way to become a Universal Bank, once it completes five years of operations as SFB. Since the bank has clear promoter led shareholding structure, the transition to a Universal Bank should be relatively smooth. The bank is well placed on the asset-quality part, with collections returning to normal levels; expects Q4FY2021 to positively surprise in terms of growth and collections. AUSFB is currently carrying Rs. 733 crore (72% coverage) on proforma GNPA and Rs. 48 crore on restructured assets (19% coverage). The bank had indicated that current provisioning levels were adequate and expects credit costs to normalise from Q4FY2021. Strong disbursements in Q3FY2021 were a reflection of improved confidence and management indicated disbursements growth was likely to sustain. We have accordingly revised our estimates and target multiples. We maintain Buy on the stock with a revised price target (PT) of Rs. 1,500.

Our Call

Valuation – At the CMP, AUSFB is available at 6.1x/4.9x its FY2022E/FY2023E ABPVS. We believe AUSFB is likely to sustain its premium valuations due to its strong asset-quality mix, superior return ratios, and a long runway for growth. We expect normalisation in asset quality along with improving collection efficiency from FY2022E to be further growth drivers. With capital augmentation, the bank moves ahead on its path to become a full-scale Universal retail focused bank. Given the secured nature of its lending book (98% of the loan book is secured), improving collection, conservative underwriting mechanism, efficient risk management capabilities, and long runway for growth, we find the business attractive. We expect the bank to report healthy ROA/ROE to improve to 1.9%/18.1% in FY2023E from 1.8%/17.9% in FY2020, which will support valuations. We have accordingly revised our estimates and target multiples. We maintain Buy on the stock with a revised PT of Rs. 1,500.

Key Risks

A prolonged delay in pick-up in economic activity will affect growth and profitability of the bank. Further, the bank has high exposure to the informal/SME segments, which may be vulnerable if economic recovery is delayed.

Valuation

	Rs cr				
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Interest Income	1,342.6	1,908.9	2,448.9	2,822.5	3,105.8
PPOP	721.9	1,197.2	1,683.2	2,146.3	2,580.1
PAT	381.8	674.8	915.0	1,244.9	1,552.2
EPS (Rs)	13.2	22.8	29.6	40.3	50.2
ABVPS (Rs)	92.6	126.2	168.0	207.4	255.4
P/E (x)	95.4	55.1	42.4	31.2	25.0
P/ABVPS (x)	13.6	9.9	7.5	6.1	4.9
ROE (%)	14.0	17.9	15.5	17.6	18.1
ROA (%)	1.5	1.8	1.7	1.9	1.9

Source: Company; Sharekhan estimates

Capital raising plan was delayed by the pandemic; to put the bank back on the growth track

Capital raising is part of the bank's plans to raise funds for meeting its growth requirements, which had earlier been delayed.

In May 2020, AUSFB's board had approved a plan to raise Rs. 2,500 crore, which it said would be mobilised through QIPs or other such instruments. However, due to the onset of the pandemic, the plans were delayed.

Some of past Capital Raise done by AU SFB

Date	Capital Raise	Amount (Rs Crore)	Price (Rs)
Mar-2017	Warrant Conversion	138.6	140
Jun-2018	Preferential basis	300	693
Dec-2019	Conversion of Warrants	700	693
Mar-2021	QIP (Proposed)	700 (Likely)	Floor Price Rs 1181

Source: Company, Media reports, Sharekhan Research

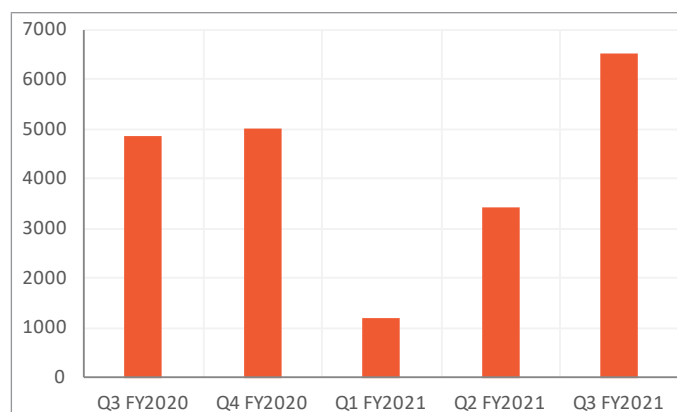
The small finance bank has marquee names such as Wasatch Global, Capital Group, Temasek, and Mauritius-based Westbridge Capital among its large public shareholders, which lend credibility to the stock.

Disbursement trends picking up, will be helped by higher capital raising

AUSFB's Tier 1/CRAR ratio was at 16.3%/18.8% in Q3, while including profits stood at 20.3%/23.5% and is comfortable.

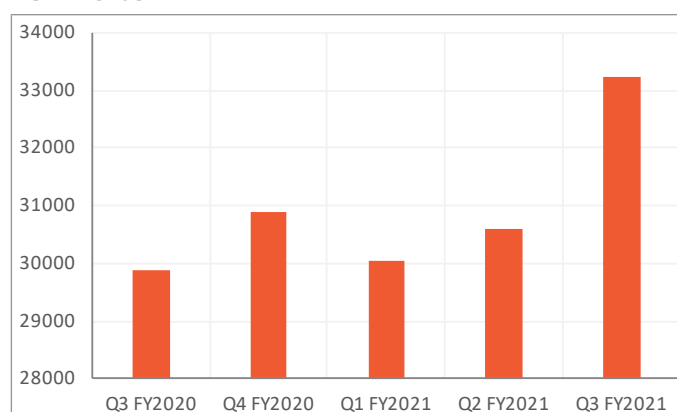
Post the capital raising, as per our calculations, Tier-1 ratio will likely increase by ~240 bps (based on Q3FY2021 RWA), net worth will rise by ~11.8%, which will provide growth capital.

Disbursements trends



Source: Company, Sharekhan Research

AUM Trends



Source: Company, Sharekhan Research

We expect capital raising will pave way for growth, increased products/services portfolio and help the bank on its way to become a Universal Bank, once it completes five years of operations as SFB. Since the bank has clear promoter-led shareholding structure, the transition to a Universal Bank should be relatively smooth.

Reasonably well placed on Asset Quality

Particulars	Amount (in Rs Cr)	Provisioning (Rs Cr)	Coverage (%)
Total Proforma GNPA (A)	1017	625	61%
Gross NPA	303	230	76%
Proforma Slippages	714	395	55%
Additional Contingency Provisions (B)		143	
Contingency Buffer		108	
Add'l for restructured assets (Excl. std prov)	251	35	
Standard Provisioning (C)		146	
On Standard Assets		133	
On Restructured assets		13	
Total Provisioning at Bank (A+B+C)		914	

Source: Company, Media reports, Sharekhan Research

The bank is well placed on the asset-quality part, with collections returning to normal levels; expects Q4FY2021 to positively surprise in terms of growth and collections. AUSFB is currently carrying Rs. 733 crore (72% coverage) on proforma GNPA and Rs. 48 crore on restructured assets (19% coverage). The Total provision is 3% of Gross Advances.

The bank had indicated that current provisioning levels were adequate and expects credit costs to normalise from Q4FY2021.

Outlook and Valuation

■ Sector view - Long-term positive outlook for SFBs

While financial inclusion (in terms of deposits, bank channels, and services accessibility) has reached a significant penetration level in India, we believe credit delivery and accessibility still lag for the non-salaried as well as non-urban centre clients. Therefore, there exists a large market that can be effectively catered to by special entities such as SFBs. We believe SFBs have a structural advantage of access to low-cost retail deposits (and opportunity for asset growth as well) compared to NBFCs, which will enable them to sustain margins and have sustainable growth. We believe the largely underpenetrated market segment is an attractive space with a large headroom for growth.

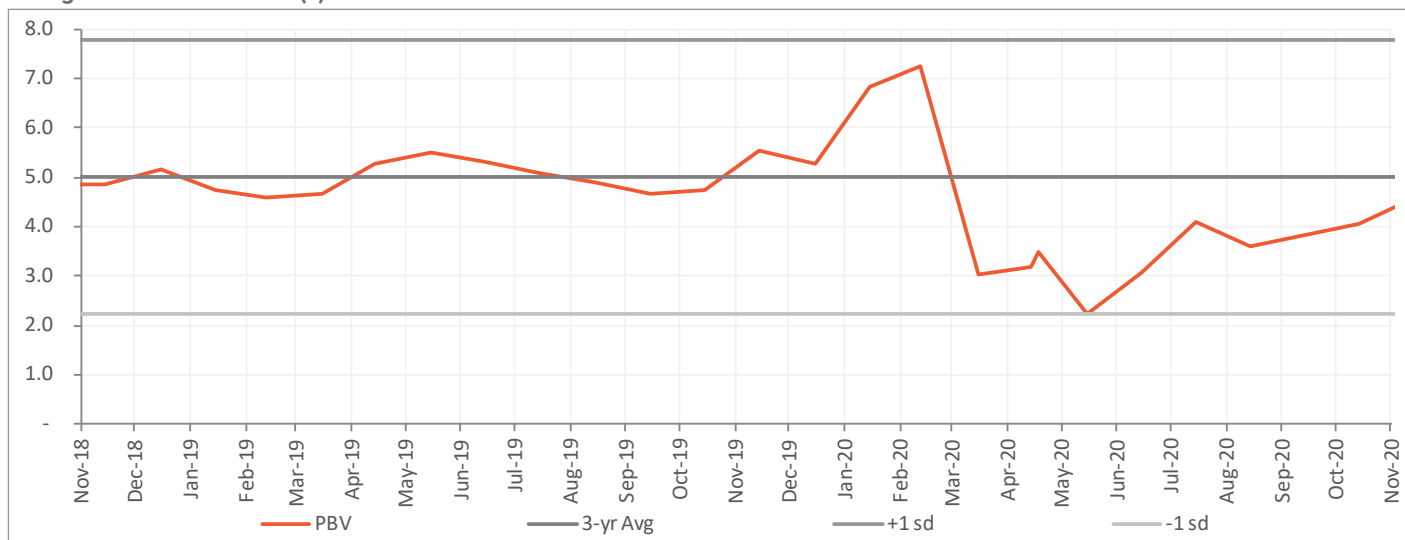
■ Company outlook - Strong fundamentals, improving outlook

AUSFB has had a long and successful history (since it was an NBFC and now as a bank) in credit underwriting quality, mainly in the under/unbanked self-employed customer segment that lacks formal income documentation. AUSFB is predominantly present in underpenetrated states such as Rajasthan and Madhya Pradesh (~42% and 16% of its AUM, respectively), which have significantly low credit and deposit penetration. We believe AUSFB's presence in these states provides the bank a competitive edge to pursue growth, along with its niche customer profile with low competition from peer banks and NBFCs. The drivers for loan growth are expected to remain for the core segments of AUSFB namely vehicles, small business loans etc. and the home loans is expected to pick up meaningfully as a strong growth driver. The bank has a strong skill-set and deep experience in its core segments. We believe business outlook is improving with disbursements normalising and CASA improving sharply to 22% of deposits. Improving collection efficiency trends are encouraging. We expect FY2022 to record normalised growth, helped by revival in credit offtake and lower credit cost burden.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,500

At the CMP, AUSFB is available at 6.1x/4.9x its FY2022E/FY2023E ABPVS. We believe AUSFB is likely to sustain its premium valuations due to its strong asset-quality mix, superior return ratios, and a long runway for growth. We expect normalisation in asset quality along with improving collection efficiency from FY2022E to be further growth drivers. With capital augmentation, the bank moves ahead on its path to become a full-scale Universal retail focused bank. Given the secured nature of its lending book (98% of the loan book is secured), improving collection, conservative underwriting mechanism, efficient risk management capabilities, and long runway for growth, we find the business attractive. We expect the bank to report healthy ROA/ROE to improve to 1.9%/18.1% in FY2023E from 1.8%/17.9% in FY2020, which will support valuations. We have accordingly revised our estimates and target multiples. We maintain Buy on the stock with a revised PT of Rs. 1,500.

One-year forward P/BVPS (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP Rs/Share	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
		FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
AU Small Finance Bank	1,255	6.1	4.9	31.2	25.0	1.9	1.9	17.6	18.1
HDFC bank	1556	3.9	3.4	21.9	19.6	2.0	1.9	18.2	17.8

Source: Bloomberg, Company, Sharekhan Research

About company

AUSFB is a small finance bank that transitioned from a prominent, retail-focused non-banking finance company (NBFC), which primarily served low and middle-income individuals and businesses that have limited or no access to formal banking and finance channels. AUSFB received a license from the Reserve Bank of India (RBI) to set up an SFB on December 20, 2016, and commenced its SFB operations from April 19, 2017. The bank's liability product offerings include current accounts, savings accounts, term deposits, recurring deposits, and collections and payments solutions for MSME and SME customers. The bank aims to be a retail-focused and preferred trusted SFB, offering integrated and tailored solutions to its customers. At the end of Q3FY2021, AUSFB had total AUM of Rs. 33,222 crore, spread across vehicle finance, SME, MSME, and other high-yielding products (including OD against FDs, gold loans, and personal loans etc.). At the end of Q3FY2021, the bank operates through 714 branches, with 63% of its branches in rural and semi-urban areas (Tier 2 to Tier 6). The distribution network is spread across 15 states and 2 Union territories; Rajasthan, Maharashtra, Madhya Pradesh, and Gujarat are the key geographies from where AUSFB sources 72% of its AUM and 68% of its total deposits.

Investment theme

AUSFB has expanded and strengthened its business model to offer a diverse suite of banking products and services by leveraging its asset-based lending strengths, NBFC customer base, and cost-efficient, technology driven hub-and-spoke branch operating model to successfully operate its SFB. In addition to its vehicle finance, MSME, and SME offerings, the bank's asset product offerings include working capital facilities, gold loans, agriculture-related term loans, Kisan credit cards for farmers, and loans against securities. The liability franchise has shaped up well with deposits presently forming ~70% of the total borrowings. Of the same, deposits are dominated by retail deposits, forming ~55% of the mix and low-cost CASA deposits form 22% of the deposit base.

Key Risks

A prolonged delay in pick-up in economic activity will affect growth and profitability of the bank. Further, the bank has high exposure to the informal/SME segments, which may be vulnerable if economic recovery is delayed.

Additional Data

Key management personnel

Mr. Sanjay Agarwal	Managing Director/CEO
Mr. Uttam Tibrewal	Whole Time Director
Mr. Vimal Jain	Chief Financial Officer
Mr. Deepak Jain	Chief Operating Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Agarwal Sanjay	18.5
2	CAMAS INVESTMENTS	4.7
3	Westbridge AIF I	3.9
4	Agarwal Shakuntala	3.9
5	AGARWAL JYOTI	3.9
6	Capital Group Cos Inc/The	3.8
7	Kotak Mahindra Asset Management Co	3.8
8	Nomura Holdings Inc	2.9
9	Motilal Oswal Asset Management Co	2.5
10	MYS HOLDINGS PVT LTD	2.2

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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