Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

# AU Small Finance Bank

## Another stellar quarter, outlook positive

| Banks & Finance | Sharekhan code: AUBANK |
|---|---|
| Reco/View: Buy ↔ | CMP: Rs. 1,414 | Price Target: Rs. 1,621 ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

**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 | | ↔ | |

**ESG Disclosure Score** NEW

ESG RISK RATING 23.87

Updated Jan 08, 2022

Medium Risk

| NEGL | LOW | MED | HIGH | SEVERE |
|---|---|---|---|---|
| 0-10 | 10-20 | 20-30 | 30-40 | 40+ |

Source: Morningstar

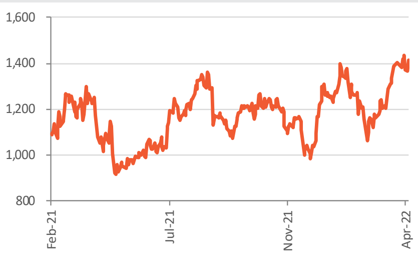
### Company details

| | |
|---|---|
| Market cap: | Rs. 44,535 cr |
| 52-week high/low: | Rs. 1,466 / 910 |
| NSE volume: (No of shares) | 12.5 lakh |
| BSE code: | 540611 |
| NSE code: | AUBANK |
| Free float: (No of shares) | 22.0 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 28.2 |
| FII | 34.3 |
| DII | 19.0 |
| Others | 18.5 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 17.2 | 13.5 | 17.6 | 34.5 |
| Relative to Sensex | 17.4 | 14.5 | 23.7 | 16.2 |

*Sharekhan Research, Bloomberg*


### Summary

- AU Bank reported Q4FY2022 PAT at Rs. 346 crore, which was ahead of street expectations (Rs.320 crore). PAT grew by 105% y-o-y/15% q-o-q due to strong growth in net interest income and lower tax rate (due to refund adjusted).
- NII grew by 43% y-o-y/14% q-o-q, aided by reduction in cost of funds and strong AUM growth of 27% y-o-y. Incremental cost of funds during the quarter was 5.3%. NIM remained stable at 6.3% q-o-q.
- Asset quality significantly improved during the quarter with both GNPA and NNPA ratios falling by 62 bps q-o-q and 79 bps q-o-q to 1.98% and 0.5%, respectively. PCR stood at 75% in Q4FY2022 versus 51% in Q3FY2022.
- The stock is currently trading at 5.2x/4.4x its FY2023E and FY2024E ABV. We maintain Buy with a revised PT of Rs. 1,621. We believe growth momentum would surprise on the upside and earnings are going to support rich valuations.


**AUSFB reported strong operating performance despite higher opex run rate in Q4FY2022. Net interest income (NII) grew by 43% y-o-y and 14% q-o-q at Rs. 937 crore. Despite reduction in cost of funds (20 bps q-o-q). Net interest margin (NIM) remained stable at 6.3% q-o-q. Core fee income grew by 11% y-o-y/18% q-o-q. Opex continued to be elevated and was up by ~37% y-o-y and 20% q-o-q on account of investment in tech, pick-up in business volume, and inflationary pressure. Operating profit grew by 29% y-o-y and 5% q-o-q. Provisions declined by 48% y-o-y but grew by 67% q-o-q. The bank has strengthened its provisioning policy with the aim to build higher buffers on the balance sheet, which are significantly higher than the Reserve Bank of India's (RBI) norms and conservative norms followed in the sector. The bank has utilised Rs. 143 crore of the contingent provisions to increase the NPA coverage to 75% from 51% as of Q4FY2022. Lower tax rate was reported for the quarter at 11% due to refund adjustment. PAT grew by 105% y-o-y/15% q-o-q because of strong growth in NII and lower tax rate (due to refund adjusted). The bank reported strong disbursements of Rs. 10,295 crore, up 44% y-o-y and 26% q-o-q, driven by growth across segments. Assets under management (AUM) rose by 27% y-o-y. Asset quality significantly improved during the quarter with both GNPA and NNPA ratios falling by 62 bps q-o-q and 79 bps q-o-q to 1.98% and 0.5%, respectively. PCR stood at 75% in Q4FY2022 versus 51% in Q3FY2022. Deeper on-ground engagement with customers and strong collection efficiencies aided in improved asset quality. Deposits were up 46% y-o-y and 19% q-o-q. The share of retail deposits stands at 66% as of Q4FY2022.**

### Key positives

- NII grew strongly at 43% y-o-y and 14% q-o-q with strong AUM growth of 27% y-o-y.
- Asset quality significantly improved during the quarter with both GNPA and NNPA ratios falling by 62 bps q-o-q and 79 bps q-o-q to 1.98% and 0.5%, respectively. PCR stood at 75% in Q4FY2022 versus 51% in Q3FY2022.
- The bank has strengthened its provisioning policy with the aim to build higher buffers on the balance sheet.

### Key negatives

- Opex stayed high, rising ~37% y-o-y and 20% q-o-q, on account of investment in tech, pick-up in business volume, and inflationary pressure.

### Management Commentary

- Constant digital innovation helping to scale the business and improve brand identity. Recently launched digital products and channels have given pace of new customer acquisitions a significant uplift.
- 25-30% asset growth is sustainable along with continued effort to build low-cost retail deposits franchise in a granular manner.

**Revision in estimates –** We have increased our FY2023E/FY2024E EPS estimates by 4%/2%, factoring in lower credit cost for FY2023E/FY2024E. We have introduced FY2025E numbers in this note.

### Our Call

**Valuation –** The stock is currently trading at 5.2x and 4.4x its FY2023E and FY2024E ABV, respectively. Factors such as AUSFB's long history, seasoned loan book, and superior underwriting practices are likely to support its asset quality and superior return ratios. There is a long runway for sustainable earnings compounding ahead. Higher provision coverage and contingent buffers provide cushion for any future risk. The bank is on track to become a full-scale universal retail-focused bank adding to its products and features. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,621. We believe growth momentum would surprise on the upside and earnings are going to support rich valuations.

### Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost especially from the unsecured retail book and SME portfolio could affect earnings.

**Valuation** Rs cr

| Particulars | FY22 | FY23E | FY24E | FY25E |
|---|---|---|---|---|
| Net Interest Income (NII) | 3,234 | 3,823 | 4,551 | 5,617 |
| Net profit | 1,130 | 1,352 | 1,627 | 2,116 |
| EPS (Rs) | 36.1 | 42.9 | 51.7 | 67.2 |
| BVPS (Rs) | 233.1 | 274.5 | 324.2 | 388.9 |
| P/E (x) | 39.2 | 32.9 | 27.4 | 21.0 |
| P/BV (x) | 6.1 | 5.2 | 4.4 | 3.6 |
| RoE (%) | 16 | 17 | 17 | 18 |
| RoA (%) | 1.9 | 1.7 | 1.7 | 1.7 |

*Source: Company; Sharekhan estimates*

## Key result highlights

- **Growth in advances and reduction in COF boost NII growth:** NII grew by 43% y-o-y/14% q-o-q to Rs. 937 crore because of strong AUM growth of 27% y-o-y and lower cost of funds (COF). NIM stood stable at 6.3% q-o-q. Core fee income grew by ~11% y-o-y. It has 25% of its total book on floating rate basis (mainly commercial banking and housing loans), while 75% of its total book is on fixed rate basis. However, fixed rate loan tenure is lower and interest charged is higher. Moreover, its end-customer is not rate sensitive. The bank is confident of passing on rates on incremental loans. Going forward, the bank would increase floating rate book.
- **Higher opex due to higher tech spends and inflationary pressure:** Total operating expenses grew by 37% y-o-y on account higher disbursement volumes, inflationary pressures, and an additional provision for annual variable pay for employees. The bank has guided that opex is going to normalise going forward.
- **Strengthening balance sheet:** Provisions declined by ~48% y-o-y but increased by ~67% q-o-q. The bank has strengthened its provisioning policy with the aim to build higher buffers on the balance sheet, which are significantly higher than RBI's norms and conservative norms followed in the sector. The bank has utilised Rs. 143 crore of its the contingent provisions to increase the NPA coverage to 75% from 51% as of Q4FY2022. Standard restructured accounts stood at 2.5% of gross advances (versus 3.1% in Q3FY2022). Total contingent and Floating provisions stood at Rs.198 crore as of March 2022.
- **Digital initiatives led accelerated growth in advances:** The bank reported strong disbursements of Rs. 10,295 crore, up 44% y-o-y and 26% q-o-q, driven by growth across segments. AUM rose by 27% y-o-y. Constant digital innovation is helping to scale the business and improving brand identity. Recently launched digital products and channels have given pace of new customer acquisitions a significant uplift.
- **Building strong and sustainable retail liability franchise:** Deposits grew by 46% y-o-y. CASA mix at 37% as of Q4FY2022 versus 23% in Q4FY2021. The share of retail deposits stands at 66% as of Q4FY2022.
- **Asset quality gets better:** Asset quality significantly improved during the quarter with both GNPA and NNPA ratios falling by 62 bps q-o-q and 79 bps q-o-q to 1.98% and 0.5%, respectively, due to reduction in GNPA on account of resolutions. PCR stood at 75% in Q4FY2022 versus 51% in Q3FY2022. Core asset underwriting principles followed by bank is small ticket size, secured, risk-based pricing, mainly for income generation purpose.
- **Bonus issue and dividend:** The board has recommended bonus issue in the ratio of 1:1. The board has also recommended a dividend of Rs. 1/- per share pre bonus.

Results Rs cr

| Particulars | Q4FY22 | Q4FY21 | Q3FY22 | Y-o-Y % | Q-o-Q % |
|---|---|---|---|---|---|
| Interest Income | 1,667 | 1,496 | 1,292 | 29% | 11% |
| Interest Expenses | 730 | 676 | 637 | 15% | 8% |
| **Net Interest Income** | **937** | **820** | **656** | **43%** | **14%** |
| NIM (%) | 6.30 | 6.30 | 5.70 | | |
| Other Income - Total | 311 | 276 | 277 | 13% | 13% |
| **Net Operating Revenue** | **1,248** | **1,096** | **932** | **34%** | **14%** |
| Employee Expenses | 414 | 356 | 337 | 23% | 16% |
| Other Opex | 352 | 282 | 222 | 59% | 25% |
| Total Opex | 766 | 638 | 559 | 37% | 20% |
| **Cost to Income Ratio (%)** | **61.3%** | **58.2%** | **59.9%** | | |
| Pre Provision Profits | 482 | 458 | 374 | 29% | 5% |
| Provisions & Contingencies - Total | 93 | 56 | 178 | -48% | 67% |
| **Profit Before Tax** | **389** | **402** | **196** | **99%** | **-3%** |
| Tax | 43 | 100 | 27 | 59% | -57% |
| Effective Tax Rate (%) | 11.1 | 25.0 | 13.8 | | |
| **Reported Profits** | **346** | **302** | **169** | **105%** | **15%** |
| Basic EPS | 11.0 | 9.6 | 5.5 | 101% | 14% |
| Diluted EPS | 10.9 | 9.5 | 5.5 | | |
| RoA (%) | 2.2 | 2.2 | 1.4 | | |
| Advances | 46,095 | 40,181 | 34,609 | 33% | 15% |
| Deposits | 52,585 | 44,278 | 35,979 | 46% | 19% |
| Gross NPA | 924 | 1,058 | 1,503 | -38% | -13% |
| Gross NPA Ratio (%) | 2.0 | 2.6 | 4.3 | | |
| PCR - (%) | 75.0 | 50.8 | 49.7 | | |
| Net NPA | 231 | 520 | 755 | -69% | -56% |
| Net NPAs Ratio (%) | 0.5 | 1.3 | 2.2 | | |

*Source: Company; Sharekhan Research*

## 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 gives them a competitive advantage to manage spreads and have healthy operating profit growth, with lower inherit credit risk relative to NBFCs, translating into sustainable earnings momentum. We believe the largely underpenetrated market segment is an attractive space with a large headroom for growth.

### ■ Company outlook – Attractive franchise over the long term

AUSFB has had a long and successful history (since its days as 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 gradually expanding into other geographies across India, which have significantly low credit and deposit penetration. We believe AUSFB's presence in under-penetrated areas provides the bank a competitive advantage to pursue growth, along with its niche customer profile with low competition from peer banks and NBFCs. Drivers for loan growth are expected to remain for the core segments of AUSFB, namely vehicles and small business loans and home loans are 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 find business metrics to be strong with a robust balance sheet and business model strength.

### ■ Valuation – Maintain Buy with a revised PT of Rs. 1,621

The stock is currently trading at 5.2x and 4.4x its FY2023E and FY2024E ABV, respectively. Factors such as AUSFB's long history, seasoned loan book, and superior underwriting practices are likely to support its asset quality and superior return ratios. There is a long runway for sustainable earnings compounding ahead. Higher provision coverage and contingent buffers provide cushion for any future risk. The bank is on track to become a full-scale universal retail-focused bank adding to its products and features. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,621. We believe growth momentum would surprise on the upside and earnings are going to support rich valuations.

**Peer Comparison**

| Particulars | CMP | MCAP | P/E (x) | | P/B (x) | | RoE (%) | | RoA (%) | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Rs/Share | (Rs Cr) | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E | FY23E | FY24E |
| AU Small Finance Bank | 1,414 | 44,535 | 32.9 | 27.4 | 5.2 | 4.4 | 16.5 | 16.8 | 1.7 | 1.7 |
| City Union Bank | 140 | 10,339 | 10.3 | 9.2 | 1.4 | 1.2 | 14.2 | 13.9 | 1.6 | 1.7 |

*Source: Company, Sharekhan research*

## About company

AUSFB is a scheduled commercial bank and a Fortune India 500 Company. Starting its journey from the hinterlands of Rajasthan, today AUSFB is the largest small finance bank with a deep understanding of the rural and semi-urban markets that have enabled it to build a robust business model facilitating inclusive growth. With a legacy of 25 years as a retail-focused and customer-centric institution, AUSFB started its banking operations in April 2017. The bank has consistently maintained a high external credit rating from all major rating agencies such as CRISIL, ICRA, CARE, and India Ratings.

## 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 shoring up of retail deposits.

## Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost especially from the unsecured retail book and SME portfolio could affect earnings.

## 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 | Wasatch Advisors Inc | 7.2 |
| 2 | Capital Group Cos Inc/The | 5.9 |
| 3 | Kotak Mahindra Asset Management | 4.7 |
| 4 | CAMAS INVESTMENTS | 4.6 |
| 5 | St. Jame`s Place PLC | 4.4 |
| 6 | Smallcap World Fund | 3.8 |
| 7 | WESTBRIDGE AIF I | 3.6 |
| 8 | Nomura India Invst Fund | 2.7 |
| 9 | Morgan Stanley | 2.6 |
| 10 | HDFC Life Insurance Co Ltd | 2.1 |

*Source: Bloomberg*

## 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 detoriating 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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