Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

AU Small Finance Bank

All set on growth path

Banks & Finance	Sharekhan code: AUBANK	Company Update

Stock Update

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	Change
Reco: **Buy**	↔
CMP: **Rs. 1,091**	
Price Target: **Rs. 1,260**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 33460 cr
52-week high/low:	Rs. 1217/366
NSE volume: (No of shares)	3.9 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	18.7	22.0	69.9	-4.3
Relative to Sensex	12.3	3.4	26.9	-31.3

Sharekhan Research, Bloomberg

Summary

- AU Small Finance Bank (AUSFB) had front-loaded provisions (on a proforma basis); and going forward, we expect a strengthened balance sheet and healthier asset-quality book (compared to pre-COVID levels), which make it well placed for growth in FY2022E and FY2023E.
- The bank expects credit cost to normalise from Q4FY2021; collection efficiency has improved across most segments; restructuring book is expected to be at ~1.5% of total by Q4FY2021 and is manageable.
- As a large part of the loan book is secured (98%) and collections are improving, we find the stock attractive as it has a long growth runway.
- AUSFB trades at 5.7x/4.6x its FY2022E/FY2023E ABPVS; We maintain Buy with a revised PT of Rs. 1,260.

AU Small Finance Bank (AUSFB) had front-loaded provisions (on a proforma basis). Going forward, we expect a strengthened balance sheet and healthier asset-quality book (compared to pre-COVID levels), which make it well placed for growth in FY2022E and FY2023E. During the recent quarter, growth momentum and incremental spreads improved, which augur well. AUM at Rs. 33,222 crore grew by 11% y-o-y and ~9% q-o-q, with AUM spreads stable at 7.6% and incremental spreads improving to 8.1%. Demand normalised in most segments in Q3FY2021 and the bank expects Q4FY2021 to be better. Retail deposits (CASA + retail term deposits) are now at 55% of deposits versus 43% in Q3FY2020; CASA ratio is at 22% versus 16% in Q3FY2020. Reported GNPA/NNPA for Q3FY2021 improved to 0.99%/0.24% from 1.54%/0.45% in Q2FY2021. Collection efficiency has normalised across most segments. The bank has currently done restructuring of 0.8% of gross advances, overall to reach 1.5% by Q4FY2021. In Q3FY2021, the bank restructured Rs. 251 crore (0.8% of gross advances), mainly in the bus, taxi (within wheels), schools, and apparels (within SBL). The bank has indicated that total restructured advances should stabilise at ~1.5% of gross advances, including fresh restructuring that the bank may undertake in Q4FY2021. Proforma GNPA and NNPA was 3.3% and 1.3%, respectively. The bank has created additional provisions for these accounts. The bank is currently carrying Rs. 733 crore (72% coverage) on proforma GNPA and Rs. 48 crore on restructured assets (19% coverage). The bank indicated that current provisioning levels were adequate and expects credit costs to normalise from Q4FY2021. We have tweaked our target multiples to pre-COVID levels, in light of improved outlook. We maintain Buy on the stock with a revised price target (PT) of Rs. 1,260.

Our Call

Valuation – At the CMP, AUSFB is available at 5.7x/4.6x its FY2022E/FY2023E ABPVS. We believe AUSFB is likely to sustain its premium valuations due to its strong asset-quality mix, superior return ratios, a long runway for growth, along with high promoter ownership. As the bank moves ahead to become a full-scale retail focused bank, we expect ROA/ROE to improve to 2%/20% in FY2023E from 1.8%/17.9% in FY2020, which will support valuations. We expect normalisation in asset quality along with improving collection efficiency from FY2022E. 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 stock attractive. We have tweaked our target multiples to pre-COVID levels, in light of the improved outlook. We maintain Buy with a revised PT of Rs. 1,260.

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	30.1	40.9	51.0
ABVPS (Rs.)	92.6	126.2	150.0	190.0	238.8
P/E (x)	82.8	47.8	36.2	26.6	21.3
P/ABVPS (x)	11.8	8.6	7.3	5.7	4.6
ROE (%)	14.0	17.9	17.4	19.3	19.5
ROA (%)	1.5	1.8	1.7	1.9	1.9

Source: Company; Sharekhan estimates

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.

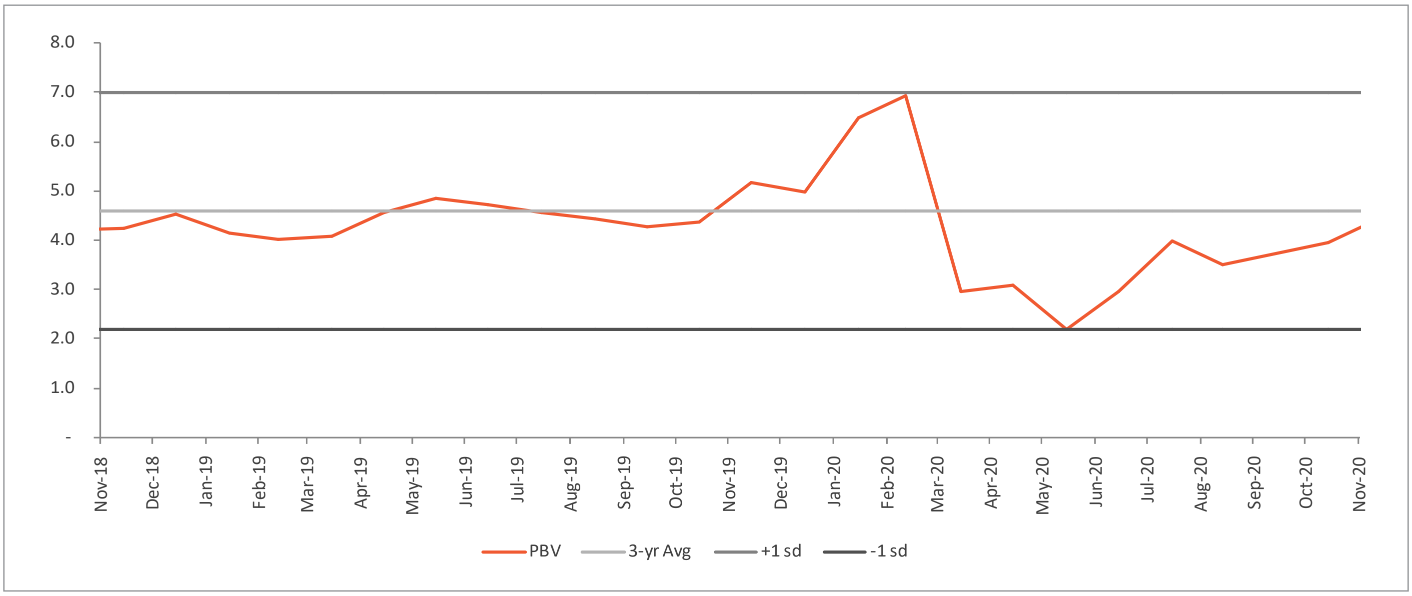
■ Company outlook - Strong fundamentals, improving outlook

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/un-banked 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. 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. 1,260

Valuation – At the CMP, AUSFB is available at 5.7x/4.6x its FY2022E/FY2023E ABPVS. We believe AUSFB is likely to sustain its premium valuations due to its strong asset-quality mix, superior return ratios, a long runway for growth, along with high promoter ownership. As the bank moves ahead to become a full-scale retail focused bank, we expect ROA/ROE to improve to 2%/20% in FY2023E from 1.8%/17.9% in FY2020, which will support valuations. We expect normalisation in asset quality along with improving collection efficiency from FY2022E. 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 stock attractive. We have tweaked our target multiples to pre-COVID levels, in light of the improved outlook. We maintain our Buy rating with a revised PT of Rs. 1,260.

One-year forward P/BVPS (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP	P/BV (x)		P/E (x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
AU Small Finance Bank	1,091	7.3	5.7	36.3	26.6	1.7	1.9	17.4	19.3
HDFC bank	1616	2.8	2.6	26.9	23.3	1.9	2.0	11.5	12.1

Source: Company, Bloomberg, 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 FY2020, AUSFB had total AUM of Rs. 30,893 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 Q2FY2021, the bank operates through 686 branches, with 63% of its branches in the rural and semi-urban areas. 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 small finance bank. 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 ~43% of the mix and low-cost CASA deposits form 14.5% 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: Bloomberg

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

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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