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### 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

<b>ESG RISK RATING</b>	<b>23.87</b>			
Updated Jan 08, 2022				
<b>Medium Risk</b>				
NEGL	LOW	<b>MED</b>	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

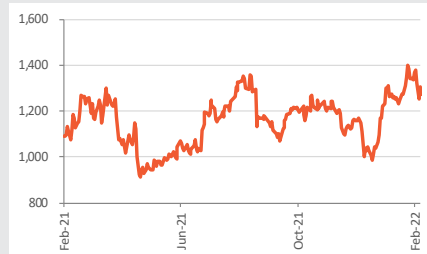
### Company details

Market cap:	Rs. 40,093 cr
52-week high/low:	Rs. 1,421 / 910
NSE volume: (No of shares)	7.8 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	22.5 cr

### Shareholding (%)

Promoters	28.3
FII	33.2
DII	20.0
Others	18.5

### Price chart



### Price performance

(%)	1m	3m	6m	12m
Absolute	0.2	5.4	-4.1	16.9
Relative to Sensex	5.6	8.8	-8.5	5.7

Sharekhan Research, Bloomberg

# AU Small Finance Bank

## Strong quarter, outlook positive

<b>Banks &amp; Finance</b>	<b>Sharekhan code: AUBANK</b>		
<b>Reco/View: Buy</b>	↔	<b>CMP: Rs. 1,276</b>	<b>Price Target: Rs. 1,425</b> ↑
↑ Upgrade	↔ Maintain	↓ Downgrade	

### Summary

- Q3 performance was strong across business metrics. NII grew by 30% y-o-y and 9% q-o-q with NIMs expanding by 40 bps y-o-y and 30 bps q-o-q to 6.3%.
- Asset quality improved with GNPA and NNPA ratios declining by 56 bps q-o-q and 36 bps q-o-q to 2.6% and 1.3%, respectively, driven by better collection efficiency of 106% in Q3FY22. PCR stood at 51% versus 49% in Q2FY22.
- The bank formalised 10 strategic business units with independent leadership and which will operate as a separate profit centres with an objective to drive growth.
- At the CMP, it is available at 4.7x/3.9x its FY2023E/FY2024E BVPS. We maintain a Buy on the stock with a revised PT of Rs. 1,425.

**AU Small Finance Bank (AUSFB) reported strong all-round performance in Q3FY22. PAT was at Rs. 302 crore, up by ~8% q-o-q. In Q3FY21, the bank recorded a gain of Rs. 480 crore from the stake sale in Aavas Financiers, which resulted in a higher base. NII grew by 30% y-o-y and 9% q-o-q with NIMs expanding by 40 bps y-o-y and 30 bps q-o-q to 6.3%. The management expects NIMs to be at 5.8-6% in the long run. However, Opex continued to be elevated and was up by ~51% y-o-y and 15% q-o-q, on account of spends in technology, brand-building, employee additions and branch expansion. The bank reported strong disbursements of Rs. 8,152 crore, up by 33% y-o-y and 59% q-o-q driven by growth across segments. Disbursements in Wheels, Secured Business Loans (SBL), MSME and home loans, which constituted 37%, 20% and 6% to the mix grew by 60% q-o-q, 67% q-o-q and 26% q-o-q, respectively. Its AUM rose by 27% y-o-y and 11% q-o-q. Asset quality improved with GNPA and NNPA ratios declining by 56 bps q-o-q and 36 bps q-o-q to 2.6% and 1.3%, respectively, driven by better collection efficiency of 106% in Q3FY22. Its PCR stood at 51% versus 49% in Q2FY22. Deposits were up by 49% y-o-y and 13% q-o-q. The share of retail deposits increased to 70% versus 64% in Q2FY22 versus 54% in Q3FY21. During the quarter, the bank formalised 10 SBUs with independent leadership in order to drive growth. These SBUs are Branch Banking, Wheels, SBL, housing loans, commercial banking, digital banking, credit card, merchant solution group, treasury, DCM & wholesale deposit and financial and digital inclusion. AUM of the Wheels segment stood at Rs. 15,525 crore in Q3FY22, with mix of 60% of financing for new vehicles, 25% is used vehicles, 13% is cash on wheels and 2% is two wheelers. Limited supply of semi-conductors continued to constrain the growth for new passenger vehicles, however, underlying demand remains robust and used vehicle segment continue to be direct beneficiary of supply shortage in new vehicles. For the SBL business, demand is yet to reach pre-COVID levels with AUM at Rs. 15,283 crore (up by 19% y-o-y and 6% q-o-q). In the home loan business, the disbursement was at Rs. 473 crore in Q3FY22, up by 55% y-o-y and 26% q-o-q. Disbursement for commercial banking witnessed strong growth (up by 139%) led by business banking and agri-banking.**

### Key positives

- NII grew robust at 30% y-o-y and 9% q-o-q with NIMs expanding by 40 bps y-o-y and 30 bps q-o-q to 6.3% in Q3FY22.
- Asset quality improved with GNPA and NNPA declining by 56 bps q-o-q and 36 bps q-o-q to 2.6% and 1.3% respectively driven by better collection efficiency of 106% in Q3FY22.
- The bank intends to de-centralize decision-making by forming 10 SBUs to drive growth.

### Key negatives

- Opex stayed high, rising ~51% y-o-y and 15% q-o-q, on account of spends in technology, brands building, employee addition and branch expansion.

### Management Commentary

- The management maintained its guidance of c/i ratio at 50 to 55% excluding technology and brand-building expenses.
- It seemed confident of improvement in GNPA's aided by better collection efficiency and strong underwriting practices.
- NIM which is currently on higher side, is likely to be at 5.8-6% in the long run.

### Our Call

**Valuation** – At CMP, AUSFB is available at 4.7x/3.9x its FY2023E/FY2024E BVPS. Factors such as AUSFB's long history and seasoned book are likely to support its asset quality and its superior return ratios and a long runway for growth are positives. With a strong provision coverage, helped by its strong underwriting track record, provides cushion on profitability. Further, the formation of SBUs and the appointment of Mr H.R. Khan, ex-RBI Deputy Governor on the board, is likely to be positive and is expected to drive growth going ahead. With augmented capital, the bank can move ahead to become a full-scale universal retail-focused bank adding to its products and features. We maintain Buy on the stock with a revised PT of Rs. 1,425.

### Key Risks

Deterioration in asset quality owing to a higher share in the risky segments and rising competition may adversely impact yields.

Valuation	Rs cr			
Particulars	FY21	FY22E	FY23E	FY24E
Net Interest Income (NII)	2,365	3,193	3,863	4,713
Net profit	1,170	1,094	1,302	1,588
EPS (Rs)	37.5	35.0	41.7	50.9
P/E (x)	34.0	36.4	30.6	25.1
BVPS (Rs)	197.7	233.3	277.6	338.7
P/BV (x)	6.5	5.5	4.6	3.8
RoE (%)	22.3	16.3	16.3	16.5
RoA (%)	2.5	1.9	1.9	1.8

Source: Company; Sharekhan estimates

Results						Rs cr
Particulars	Q3FY22	Q3FY21	Q2FY22	y-o-y (%) / bps	q-o-q (%) / bps	
Interest Income	1,496	1,261	1,405	18.7		6.5
Interest Expenses	676	628	652	7.6		3.7
<b>Net Interest Income</b>	<b>820</b>	<b>633</b>	<b>753</b>	<b>29.6</b>		<b>8.9</b>
NIM (%)	6.30	5.90	6.00	40.0		30.0
Other Income - Total	276	686	192	-59.8		43.6
<b>Net Operating Revenue</b>	<b>1,096</b>	<b>1,319</b>	<b>945</b>	<b>-16.9</b>		<b>16.0</b>
Employee Expenses	356	240	327	48.4		8.9
Other Opex	282	184	226	53.2		24.8
<b>Total Opex</b>	<b>638</b>	<b>424</b>	<b>553</b>	<b>50.5</b>		<b>15.4</b>
<b>Cost to Income Ratio (%)</b>	<b>58.2</b>	<b>51.9</b>	<b>58.5</b>			<b>-30.0</b>
Pre Provision Profits	458	895	392	-48.8		16.8
Provisions & Contingencies - Total	56	306	5	-81.7		
<b>Profit Before Tax</b>	<b>402</b>	<b>589</b>	<b>388</b>	<b>-31.7</b>		<b>3.8</b>
Tax	100	110	109	-8.9		-8.2
Effective Tax Rate (%)	25.0	18.7	28.2			
<b>Reported Profits</b>	<b>302</b>	<b>479</b>	<b>279</b>	<b>-36.9</b>		<b>8.4</b>
Basic EPS	9.6	15.6	8.9			
RoA (%)	2.2	4.2	2.1			
Gross NPA	1,058	303	1,151	249.3		-8.2
Gross NPA Ratio (%)	2.6	1.0	3.2	161.0		-56.0
PCR - (%)	51.0	49.0	49.0	200.0		200.0
Net NPA	520	73	591	615.6		-12.1
Net NPAs Ratio (%)	1.3	0.2	1.7	105.0		-36.0

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 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 are long-term positives

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 predominantly present in states such as Rajasthan and Madhya Pradesh (~41% and 17% 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 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 are strong and believe disbursements normalising and CASA improving are long-term positives. Despite near-term challenges, we expect AUSFB to tide over them, backed by its strong balance sheet and business model strength.

### ■ Valuation – Maintain Buy with a revised PT of Rs. 1,425

At CMP, AUSFB is available at 4.7x/3.9x its FY2023E/FY2024E BVPS. Factors such as AUSFB's long history and seasoned book are likely to support its asset quality and its superior return ratios and a long runway for growth are positives. With a strong provision coverage, helped by its strong underwriting track record, provides cushion on profitability. Further, the formation of SBUs and the appointment of Mr H.R. Khan, ex-RBI Deputy Governor on the board, is likely to be positive and is expected to drive growth going ahead. With augmented capital, the bank can move ahead to become a full-scale universal retail-focused bank adding to its products and features. We maintain Buy on the stock with a revised PT of Rs. 1,425.

#### Peer valuation

Particulars	CMP (Rs / Share)	MCAP (Rs Cr)	P/E (x)		P/B (x)		RoE (%)		RoA (%)	
			FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
AU Small Finance Bank	1,276	40,093	36.4	30.6	5.5	4.6	16.3	16.3	1.9	1.9
City Union Bank	131	9,737	13.1	9.7	1.5	1.3	9.5	13.0	0.8	1.1

Source: Company, Sharekhan estimates

## 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 25 years legacy of being a retail-focused and customer-centric institution, AUSFB started its banking operations in April 2017; and as on December 31, 2021, the bank has established operations across 880 banking touchpoints while serving 23.7 lakh customers in 15 states and two union territories with a talent base of 25,502 employees. 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 deposits presently forming ~70% of the total borrowings. Of the same, deposits are dominated by retail deposits, forming ~70% of the mix and low-cost CASA deposits form 23% of the deposit base.

## Key Risks

Any deterioration in the asset quality owing to higher share in the risky segments and rising competition may adversely impact the yields.

## 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	Capital Group Cos Inc/The	6.0
2	Kotak Mahindra Asset Management	4.7
3	CAMAS INVESTMENTS	4.6
4	Smallcap World Fund	3.8
5	WESTBRIDGE AIF I	3.7
6	Nomura India Invst Fund	2.7
7	Nippon Life India Asset Management	2.2
8	HDFC Life Insurance Co Ltd	2.2
9	MYS HOLDINGS PVT LTD	2.1
10	New World Fund Inc	2.0

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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