



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

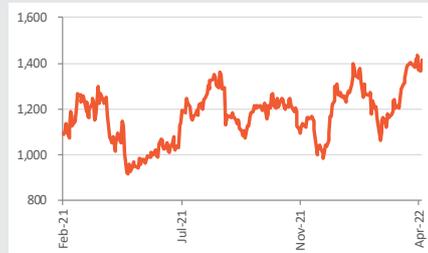
Company details

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

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	

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

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 inherent 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

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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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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