Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

AU Small Finance Bank Ltd

All round beat

Banks	Sharekhan code: AUBANK
Reco/View: Buy ↔	CMP: Rs. 626
	Price Target: Rs. 800 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- AU Small Finance Bank (AUSFB) reported strong all-round performance in Q2FY2023 with PAT at Rs. 343 crore (up 23% y-oy/28% q-o-q), which was above consensus expectations and our estimates (+11%) aided by strong NII growth, higher core fee income, and lower credit cost.
- NII grew by 44% y-o-y/11% q-o-q, led by strong advances growth of 44.4% y-o-y/6.3% q-o-q and margin improvement. NIM improved by 30 bps q-o-q to 6.2%. Core fee Income grew robustly by 32% y-o-y/14% q-o-q, driven by healthy growth in disbursements and increasing share of transactional customers on the liability side.
- Despite higher opex growth (up 51% y-o-y/12% q-o-q), PPOP grew at a healthy pace up 27% y-o-y/27% q-o-q, driven by strong NI growth and higher core fee income (2.0% of average advances vs. 1.8% in Q1FY2023).
- Asset quality remained stable. The stock is currently trading at 4.8x and 4.1x its FY2023E and FY2024E ABV, respectively. We maintain our Buy rating on the stock with a revised PT of Rs. 800. We believe strong earnings growth would support the rich valuations.

AU Small Finance Bank (AUSFB) reported overall strong performance in Q2FY2023. Net interest income (NII) grew by 44% y-o-y and 11% q-o-q to Rs. 1,083 crore, aided by strong advances growth of 44% y-o-y/6% q-o-q and margin expansion. Net interest margin (NIM) improved by 30 bps q-o-q to 6.2%. Yield on average advances (Cal.) increased by 50bps q-o-q, while the increase in average cost of funds was 10 bps q-o-q. Core fee income remained strong and grew by 32% y-o-y/ 14% q-o-q. The bank reported treasury profit of Rs. 2 crore vs. treasury loss of Rs. 55 crore in the last quarter. Opex continued to be elevated and was up ~51% y-o-y/12% q-o-q on account of investment towards building digital capabilities in the credit cards business/QR/Video Banking and distribution expansion. PPoP grew robustly by 27% y-o-y and 27% q-o-q. Total credit cost reported was 34 bps (as % of average advances) vs. 32 bps in the last quarter. Credit cost continued to remain benign. PBT grew by 18% y-o-y/28% q-o-q. On the business front, advances rose by 44% y-o-y/6% q-o-q, led by healthy disbursements across product segments. Deposits were up 49% y-o-y and 7% q-o-q. CASA balances recorded strong growth of 109% y-o-y and 16% q-o-q. CASA ratio now stands at 42.3% vs. 30.3% in Q2FY22. The share of CASA + retail TD as a percentage of total deposits stands at 73% vs. 70% in Q1FY2023. Asset-quality trends remained stable with GNPA and NNPA ratios reported at 1.90% and 0.56%, respectively. PCR stood at ~71%. Restructured book is now at 1.7% of advances vs. 2.1% of advances last quarter. Annualised slippage ratio stood at 2.0% vs. 2.1% q-o-q. The bank continued to hold contingent and floating provisions of Rs. 170 crore (0.3% of loans).

Key positives

- Strong loan growth along with healthy mobilisation of low-cost granular deposits.
- NIM improved by 30bps q-o-q.
- Strong PPoP growth along with stable asset-quality matrix.

Key negatives

- Opex stayed high, rising ~51% y-o-y/ 12% q-o-q on account of investment towards building digital capabilities in the credit cards business/QR/video banking and distribution expansion.

Management Commentary

- Demand environment continues to remain strong but the bank is being cognizant of the tough global macro environment. It expects to grow its asset book conservatively in the next two quarters, in a manner that would provide a sustainable growth path and remain watchful.
- The bank is focusing on prioritising and optimising its cost of funds, consolidating its deposits franchise, sustaining risk-adjusted yields, and growing at a pace that commensurates with its business strategy. Digital initiatives are also improving customer engagement.

Our Call

Valuation – The stock is currently trading at 4.8x and 4.1x 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 a cushion for any future risk. The bank is on track to become a full-scale universal retail-focused bank by adding to its products and features. The objective is to maintain strong credit filter, granular asset and liability, and cross-sell strategy, all of which should bode well for future earnings growth. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 800.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost especially from small business loans portfolio and wheels could affect earnings.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	3,234	3,823	4,551	5,617
Net profit	1,130	1,352	1,627	2,116
EPS (Rs)	17.9	20.3	24.4	31.8
P/E (x)	34.9	30.8	25.6	19.7
P/BV (x)	5.4	4.8	4.1	3.4
RoA	1.9	1.7	1.7	1.7
RoE	16.4	16.5	16.8	18.3

Source: Company; Sharekhan estimates

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 Aug 08, 2022

Medium Risk

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

Source: Morningstar

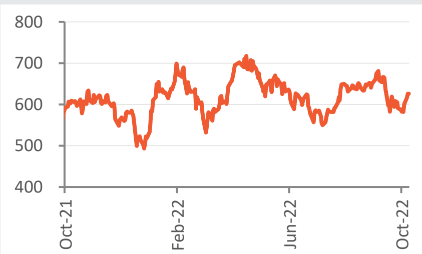
Company details

Market cap:	Rs. 41,701 cr
52-week high/low:	Rs. 733 / 468
NSE volume: (No of shares)	20.1 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	46.6 cr

Shareholding (%)

Promoters	26.8
FII	35.9
DII	19.8
Others	17.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.1	10.6	-11.8	5.9
Relative to Sensex	-4.1	2.7	-16.5	10.1

Sharekhan Research, Bloomberg

Key result highlights

- **Strong NII growth led by healthy advances growth and margin expansion:** NII grew by 44% y-o-y and 11% q-o-q to Rs. 1,083 crore, aided by strong advances growth of 44% y-o-y/6% q-o-q and margin expansion. NIM improved by 30 bps q-o-q to 6.2%. Incremental COF increased by 70 bps during H1FY2023 and the bank focused on margins by raising its disbursement yield by 100 bps in Q2FY2023 over Q4FY2022. 25% of its total loan book consists of floating rate loans (mainly commercial banking and housing loans), while 75% of its total book is fixed. However, fixed-rate loan tenure is lower and interest charged is higher. Moreover, its end-customer is not rate sensitive.
- **Opex likely to n ormalise over the medium term:** Total operating expenses grew by 51% y-o-y/12% q-o-q. Continued investments towards building digital capabilities in the credit cards business/QR /Video Banking, distribution expansion and brand campaign are likely to keep C/I ratio at ~60% for FY2023E. The bank has guided that opex is going to normalise over the medium term. Moreover, inflationary pressures and high interest rate remain key risk for opex in the current environment.
- **Remain watchful on growth, given the tough macro environment ahead:** Advances rose by 44% y-o-y/ 6% q-o-q, driven by healthy disbursements across product segments. Demand environment continues to remain strong, but the bank is being cognizant of the tough global macro environment. It expects to grow its asset book conservatively in the next two quarters and in a manner that would provide a sustainable growth path and remain watchful. The bank is focusing on prioritizing and optimizing its cost of funds, consolidating its deposits franchise, sustaining its risk adjusted yields, and growing at a pace that commensurate with its business strategy. Constant digital innovation is helping to scale the business and improve brand identity. Recently launched digital products and channels have given the pace of new customer acquisitions a significant uplift. The focus is on increasing cross sales among business units. The bank is maintaining sufficient liquidity with LCR at ~129%.
- **Building strong and sustainable retail liability franchise:** Deposits grew by 49% y-o-y/7% q-o-q. CASA mix stood at 42% during the quarter versus 30% in Q2FY2022. CASA balances recorded strong growth of 109% y-o-y and 16% q-o-q. The share of retail deposits stands at 73%. The granularity of deposits continued to improve.
- **Asset-quality trends stable:** Asset quality remained stable during the quarter with both GNPA and NNPA ratios reported at 1.90% and 0.56%, respectively. PCR stood at 71%. Restructured book is now at 1.7% of advances vs. 2.1% of advances last quarter. Annualized slippage ratio stood at 2.0% vs. 2.1% q-o-q. The bank continued to hold contingent provisions of Rs. 170 crore (0.3% of loans). Core asset underwriting principles followed by the bank include small ticket size and secured, risk-based pricing, mainly for income-generation purpose. Collection efficiency also remained strong during the quarter at ~108%.
- **Others:** The bank onboarded 3.4 lakh new customers during the quarter; 42% of customer acquisitions were via digital products. 77% of advances have been disbursed after the start of the pandemic and this pool has been exhibiting better than historical trends in asset quality so far, with GNPA at 0.55% and 92% book being current. During the quarter, the bank added 27 new touchpoints, of which 15 are liability branches with 13 of them in urban areas with a focus on southern cities such as Bengaluru, Chennai, and Hyderabad. The bank has added ICICI Lombard as its bancassurance partner with a view to expand the bank’s third-party product offerings to its customers.

Results (Standalone) **Rs cr**

Particulars	2QFY23	2QFY22	1QFY23	Y-o-Y %	Q-o-Q %
Interest Inc.	1,992	1,405	1,820	42%	9%
Interest Expenses	909	652	844	39%	8%
Net Interest Income	**1,083**	**753**	**976**	**44%**	**11%**
NIM (%)	6.2	6.0	5.9	3%	5%
Core Fee Income	245	186	214	32%	14%
Other Income	2	6	-55	-61%	-104%
Net Income	**1,331**	**945**	**1,135**	**41%**	**17%**
Employee Expenses	451	327	394	38%	15%
Other Opex	381	226	347	69%	10%
Total Opex	**832**	**553**	**741**	**51%**	**12%**
Cost to Income Ratio	62.5%	58.5%	65.3%		
Pre Provision Profits	**499**	**392**	**394**	**27%**	**27%**
Provisions & Contingencies - Total	43	5	38	828%	12%
Profit Before Tax	**456**	**388**	**356**	**18%**	**28%**
Tax	113	109	88	4%	29%
Effective Tax Rate	25%	28%	25%		
Reported Profits	**343**	**279**	**268**	**23%**	**28%**
Basic EPS (Rs)	5.3	4.5	4.3	18%	24%
Diluted EPS (Rs)	5.2	4.4	4.2	19%	24%
RoA (%)					
Advances	51,743	35,845	48,654	44%	6%
Deposits	58,335	39,034	54,631	49%	7%
Gross NPA	**997**	**1,151**	**970**	**-13%**	**3%**
Gross NPA Ratio (%)	1.90	3.16	1.96		
Net NPA	**288**	**591**	**275**	**-51%**	**5%**
Net NPAs Ratio (%)	0.56	1.65	0.56		
PCR - Calculated	71.1%	48.6%	71.7%		

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 with 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, which are expected to pick up meaningfully as strong growth drivers. The bank has a strong skill set and deep experience in its core segments. We find business metrics to be healthy with a robust balance sheet and business model strength.

■ **Valuation –** The stock is currently trading at 4.8x and 4.1x 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 a cushion for any future risk. The bank is on track to become a full-scale universal retail-focused bank by adding to its products and features. The objective is to maintain strong credit filter, granular asset and liability, and cross-sell strategy, all of which should bode well for future earnings growth. We maintain our Buy rating on the stock with a revised PT of Rs. 800.

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	626	41,701	30.8	25.6	4.8	4.1	16.5	16.8	1.7	1.7
City Union Bank	193	14,293	15.8	11.6	2.1	1.8	12.8	15.1	1.4	1.8

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, which 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 home loans, gold loans, agriculture loans, and commercial banking working capital loans. 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 small business loans portfolio and wheels 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	AGARWAL SANJAY	17.06
2	CAPITAL GROUP COS INC	7.58
3	WASATCH ADVISORS INC	6.36
4	KOTAK MAHINDRA ASSET MANAGEMENT CO LTD	4.39
5	CAMAS INVESTMENTS	4.05
6	SMALL CAP WORLD FUND INC	3.89
7	AGARWAL SHAKUNTALA	3.55
8	AGARWAL JYOTI	3.55
9	NEW WORLD FUND INC	3.28
10	WESTBRIDGE AIF I	3.14

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Ms. Binkle Oza; Tel: 022–61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

---

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai–400028, Maharashtra, INDIA, Tel: 022–67502000 / Fax: 022–24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.