



Powered by the Sharekhan 3R Research Philosophy

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 Oct 08, 2022

Medium Risk

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

Source: Morningstar

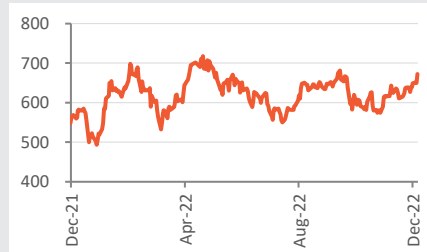
Company details

Market cap:	Rs. 44,781 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)	48.0 cr

Shareholding (%)

Promoters	26.8
FII	35.9
DII	19.8
Others	17.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.1	4.8	5.7	19.6
Relative to Sensex	6.7	-1.6	-7.3	11.1

Sharekhan Research, Bloomberg

AU Small Finance Bank

Building sustainable franchise with strong underwriting capabilities

Banks & Finance	Sharekhan code: AUBANK		
Reco/View: Buy	↔	CMP: Rs. 672	Price Target: Rs. 800
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- AUSFB outlined how the bank is attractively positioned to capture a large untapped MSME opportunity in the fastest growing Indian economy along with building strong competitive moats for sustained growth in a risk calibrated manner.
- The bank, in depth, discussed about its strategy build around the two business units on asset side – Secured Business Loans (SBL) and Commercial Banking. The bank's focus is on building a granular book using its time-tested prudent underwriting practices developed through deep understanding of customer profile and geography, by expanding into rural and semi-urban areas.
- The bank guided that SBL is the most profitable book for the bank and has created a niche for itself; average ticket size is less than Rs. 25 lakh for almost ~75% of the total business. Commercial banking also generates healthy ROA of ~2.5% for the bank along with maintaining pristine asset quality in both the business segments.
- We believe AUSFB has a clear road map for its sustainable profitable growth path with the right strategy in place on both asset as well as liability sides along with strong execution capabilities. Thus, we retain our Buy rating on the stock with an unchanged PT of Rs. 800. The stock is currently trading at 5.2x/4.4x/3.7x its FY2023E/FY2024E/FY2025E ABV. We believe strong earnings growth and longevity of the franchise would support the rich valuations.

We attended the fourth session of AUSFB's virtual insights day. The bank has guided on its strategy build around its two business units on asset side – Secured Business Loans (SBL) and Commercial Banking (CB). Management has been focusing on building a granular book in a risk-calibrated manner by expanding into rural and semi-urban areas. SBL is the most profitable book for the bank. The bank has created a niche for itself; 75% of business done has ATS less than Rs. 25 lakh to underserved micro enterprises. Here the competition is less and the bank enjoys competitive advantage through deep understanding of the local nuances; while in commercial banking, ~75% of the book is self-funded and generates 2.5% ROA delivering pristine asset quality. Majority of the book under CB consists of Business banking and Agri banking tested through a tough economic cycle in the past 2-3 years. The exposure is granular, generates fee income, qualifies for PSL, and the bank enjoys pricing power.

- Secured Business Loans:** Mr. Amar Bahl, Head of SBL, along with his team gave insights about how they have built the SBL segment along with strong execution to deliver superior and sustainable performance. The first principle of lending money is for income generation activity with strong cash flow visibility and not for consumption purpose. The second principle is mostly loans, which are given against the self-occupied property as collateral or where income generation is solely dependent on property given as collateral. The third principle is exposure, which is granular (average ticket size is less than Rs. 25 lakh for almost ~75% of total business done) with lower LTV of less than 50%.
- Commercial Banking:** Mr. Vivek Tripathi, Head of CB, along with his team gave insights about how they have built the book along with strong execution to deliver a superior and sustainable performance. The portfolio consists of business banking, agri banking, NBFC lending, and real estate lending. AUSFB's market share in this segment stands at 0.2%. Business and agri banking constitute 70% of the total business. ~75% of the book is self-funded and generates 2.5% ROA. This book has been tested through a tough economic cycle in the past 2-3 years, delivering pristine asset quality. The exposure is granular, generates fee income, qualifies for PSL, and the bank enjoys pricing power.

Our Call

Valuation – The stock is currently trading at 5.2x/4.4x/3.7x its FY2023E/FY2024E/FY2025E ABV. 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 an unchanged price target (PT) of Rs. 800.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost.

Valuation (Standalone)

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)	37.6	33.2	27.6	21.2
P/BV (x)	5.8	5.2	4.4	3.7
RoE (%)	16.4	16.5	16.8	18.3
RoA (%)	1.9	1.7	1.7	1.7

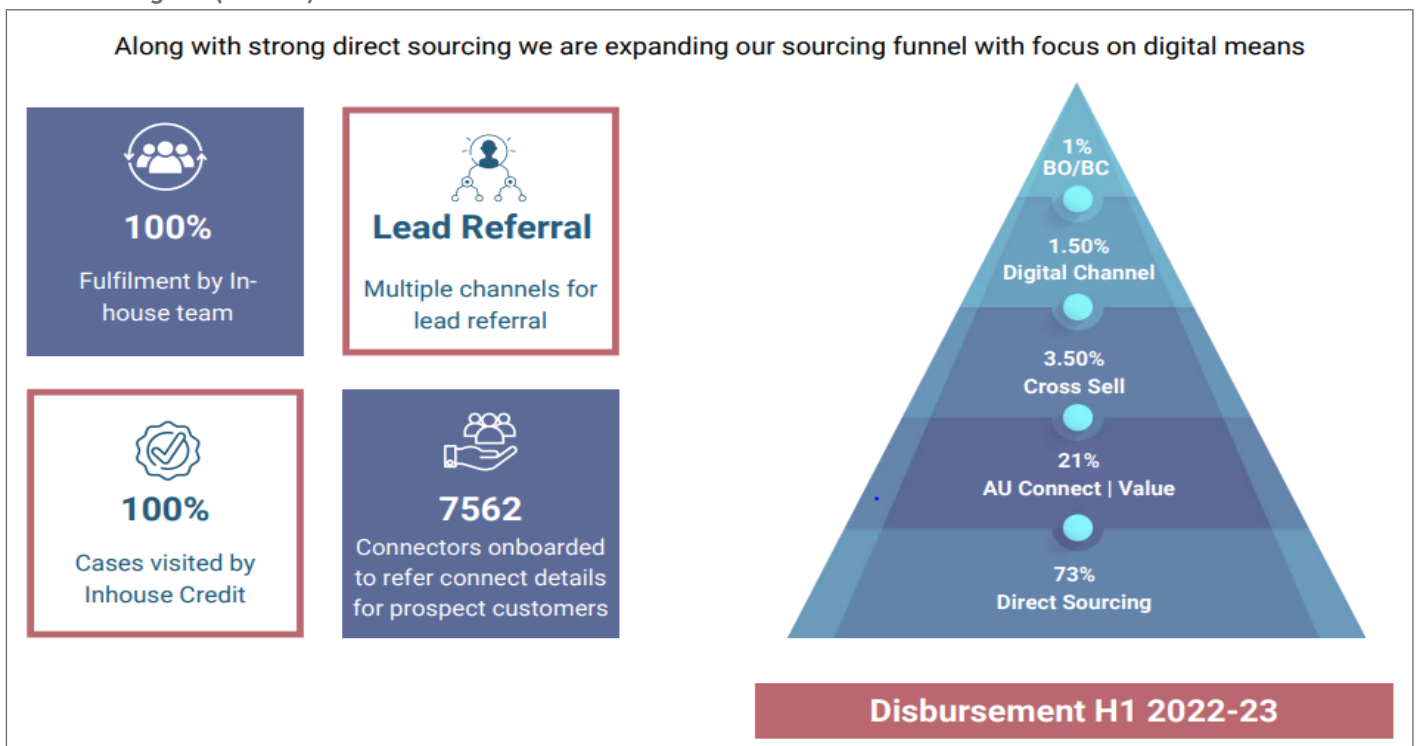
Source: Company; Sharekhan estimates

Key Highlights

Secured Business Loans

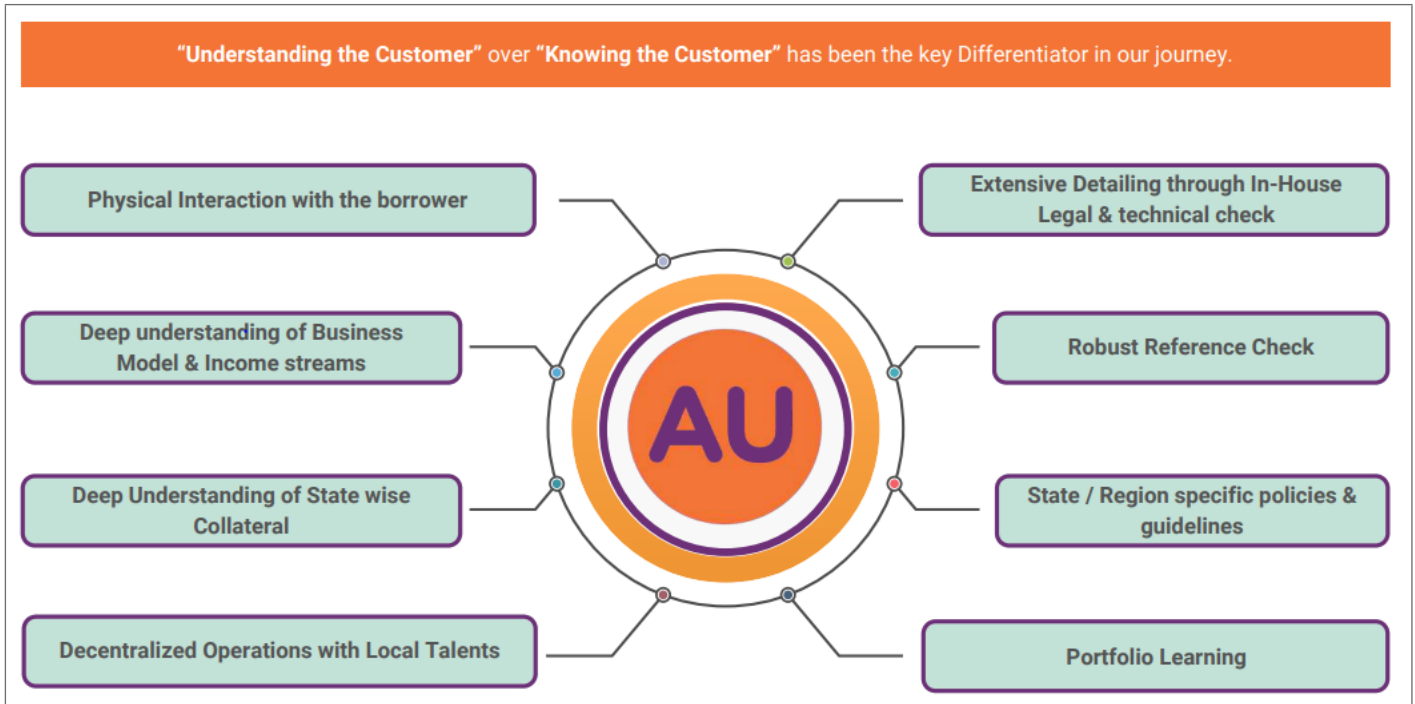
- ◆ First principle of lending money is for income generation activity with strong cash flow visibility and not for consumption purpose.
- ◆ Second principle is mostly loans are given against the self-occupied property as collateral or where income generation is solely dependent on property given as collateral.
- ◆ Third principle is exposure are granular (average ticket size is less than Rs. 25 lakh for almost ~75% of total business done) with lower LTV of less than 50% with tenure upto 15 years.
- ◆ Focus is on rural & semi urban underserved micro enterprises who lacks formal documentation but have capacity to pay.
- ◆ It has internally designed questionnaire as per the business segment and customer profile of the borrower to assess cash flow and the income profile of borrowers for the purpose of underwriting.
- ◆ These questionnaires are developed over the period based on deep understanding of geography, business and customer profile of the borrower. Here learnings can be replicated but model needs to be crafted state & area wise.
- ◆ It has also put in place a robust mechanism to assess the property and the collateral offered with the help of in-house technical team.
- ◆ MSMEs contributes 30% to India's GDP. In India, ~20% of the loans required by MSMEs are met by the formal sector, 40% by the informal sector and there is still a 40% credit gap to be met for the MSMEs – so big opportunity pie.
- ◆ Around 75% of its customers are New to Bank customer, with a GNPA of 2.69%.

SBL : Sourcing Mix (H1FY23)



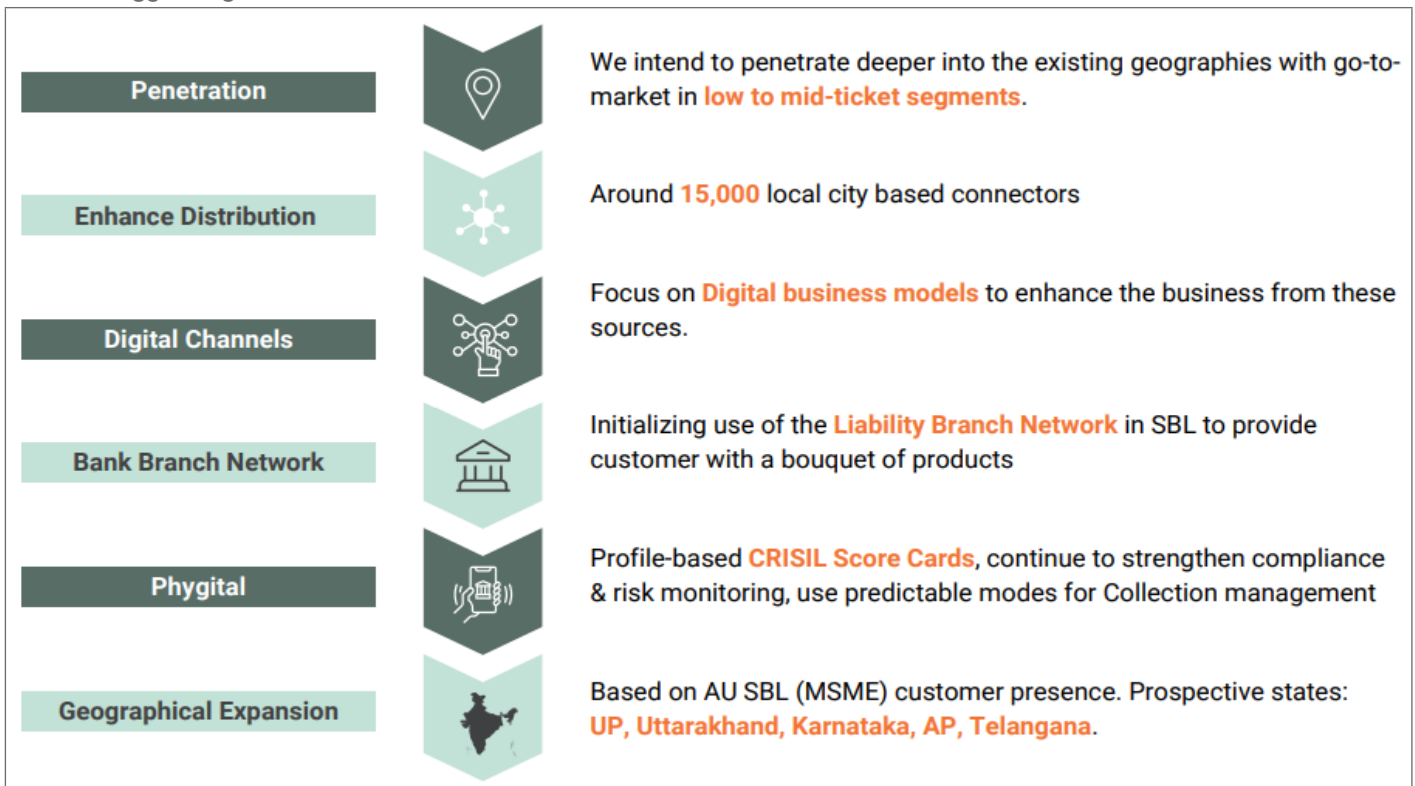
Source: Company, Sharekhan Research

Prudent Underwriting Practises



Source: Company, Sharekhan Research

SBL : Strategy – Way Forward







Source: Company, Sharekhan Research

Commercial Banking

- ◆ Portfolio consists of Business Banking, Agri Banking, NBFC lending, Real Estate lending mostly floating rate book.
- ◆ AUBANK's market share in this segment stands at 0.2%.
- ◆ Business and Agri Banking constitute 70% of total business.
- ◆ ~75% of the book is self-funded & generates 2.5% ROA.
- ◆ This book has been tested through tough economic cycle in past 2-3 years delivering pristine asset quality.
- ◆ The exposure is granular, generates fee income, qualifies for PSL and bank enjoys pricing power.
- ◆ In Business Banking, ATS stands at Rs. 85 lakh, with working capital constituting 70% of total loans. GNPA at 0.17%.
- ◆ In Agri Banking, ATS stands at Rs. 98 lakh, with working capital constituting 60% of total loans. GNPA at 0.74%.
- ◆ In NBFC lending: It has an exposure to 146 NBFCs, with 90% of the book in investment grade category. ATS stands at Rs.1.3 crore. GNPA at 0.01%.
- ◆ In Real estate, RERA projects constitute 92% of the portfolio, with an average loan cycle of 30 months. GNPA ratio stands at 1.85%.

Commercial Banking – Business Segment

Commercial Banking			
 <p>Business Banking</p>	 <p>Agri Banking</p>	 <p>NBFC Lending</p>	 <p>Real Estate Group</p>
<p>TG: MSMEs engaged in Manufacturing, Trading, EPC and Services</p> <p>Products: CC/OD, LC/BG for Working Capital & Term Loans for Capex</p>	<p>TG: MSMEs engaged in Agri Value Chain</p> <p>Products: CC/OD, LC/BG for Working Capital & Term Loans for Capex</p>	<p>TG: Small and Mid Size NBFCs and HFCs</p> <p>Products: Term Loan, Cash Credit / WCDL for Onward Lending Purpose</p>	<p>TG: Small and Mid Size Developers in select T1 Markets</p> <p>Products: Construction Linked Project Loan, RERA Collection & Escrow Accounts</p>
<p>Transaction Banking Providing CMS Solutions including Doorstep Banking, API Banking, UPI/QR, and Trade Solutions to Commercial Banking & Current Account Customers</p>			

Source: Company, Sharekhan Research

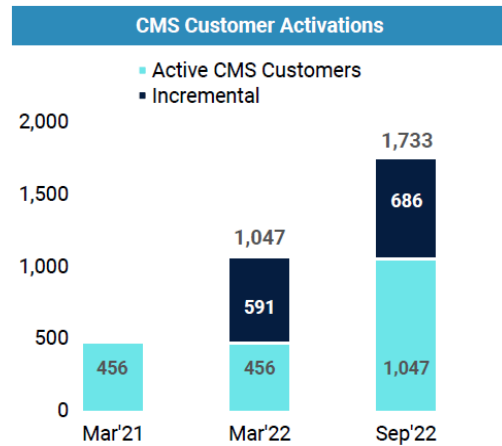
Self-funded Book – Scaling up the liability relationship

Deepening : Complete Banking and Investment Needs of Enterprise & Promoters

Balances Build up : Current Accounts Acquisition & CMS Solutioning

Salary Mandates 256	POS 470	QR 4144
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Rs. in Crs	
ACCOUNT	EOP
Current Accounts (CA)*	~700
Saving Accounts (SA)	~350
Term Deposits (TD)	~4,220
Total	~5,270



Source: Company, Sharekhan Research

Business Banking – Underwriting Practice

STRONG TEAM BUILDING

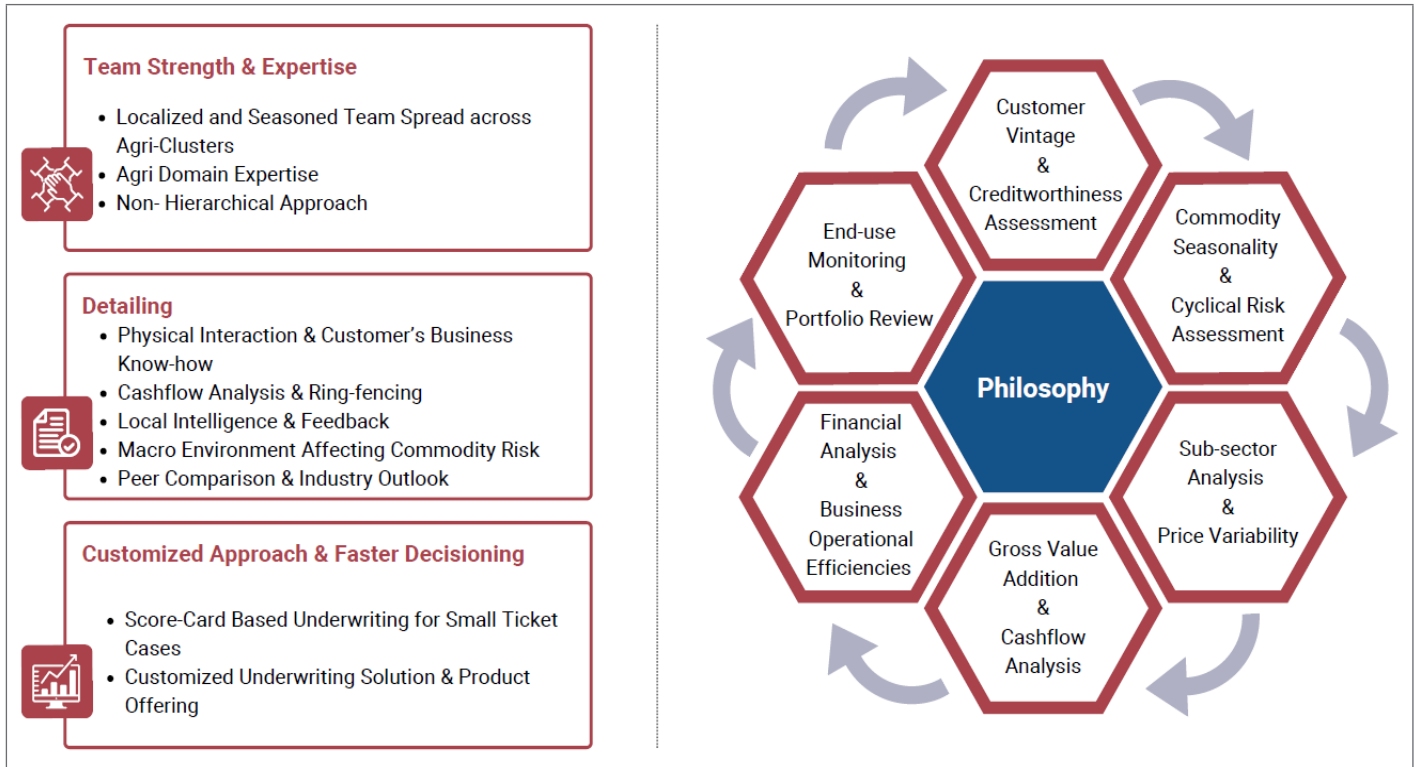
- Qualified Professionals
- Credit on Ground – Decentralised Approach
- Local Hiring – Avoiding Geographical & Communication Barriers
- Cross Functional Training & Knowledge Sharing

UNDERWRITING APPROACH

- Localised Decisioning – Faster Turnaround
- Comprehensive 360° Evaluation:
 - Cashflow & Sensitivity Analysis
 - Market Feedback
 - Actual End-use of Funds
 - The worthiness of the Customer
- Cashflow Entrapment
- Collateralized Lending Approach
- Bank Guarantees Assessment basis Beneficiary, Budgetary Allocation & Cashflow Control

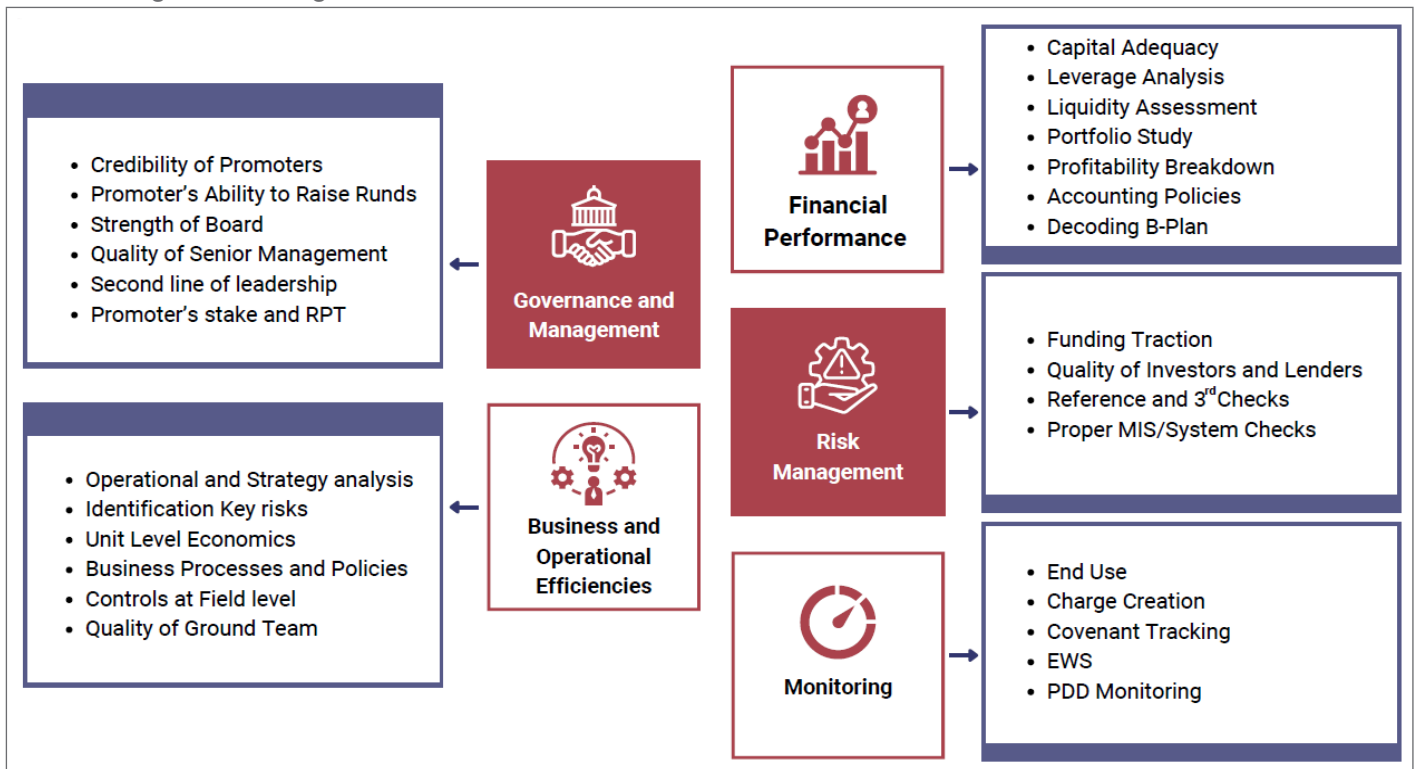
Source: Company, Sharekhan Research

Agri Banking : Underwriting Practises



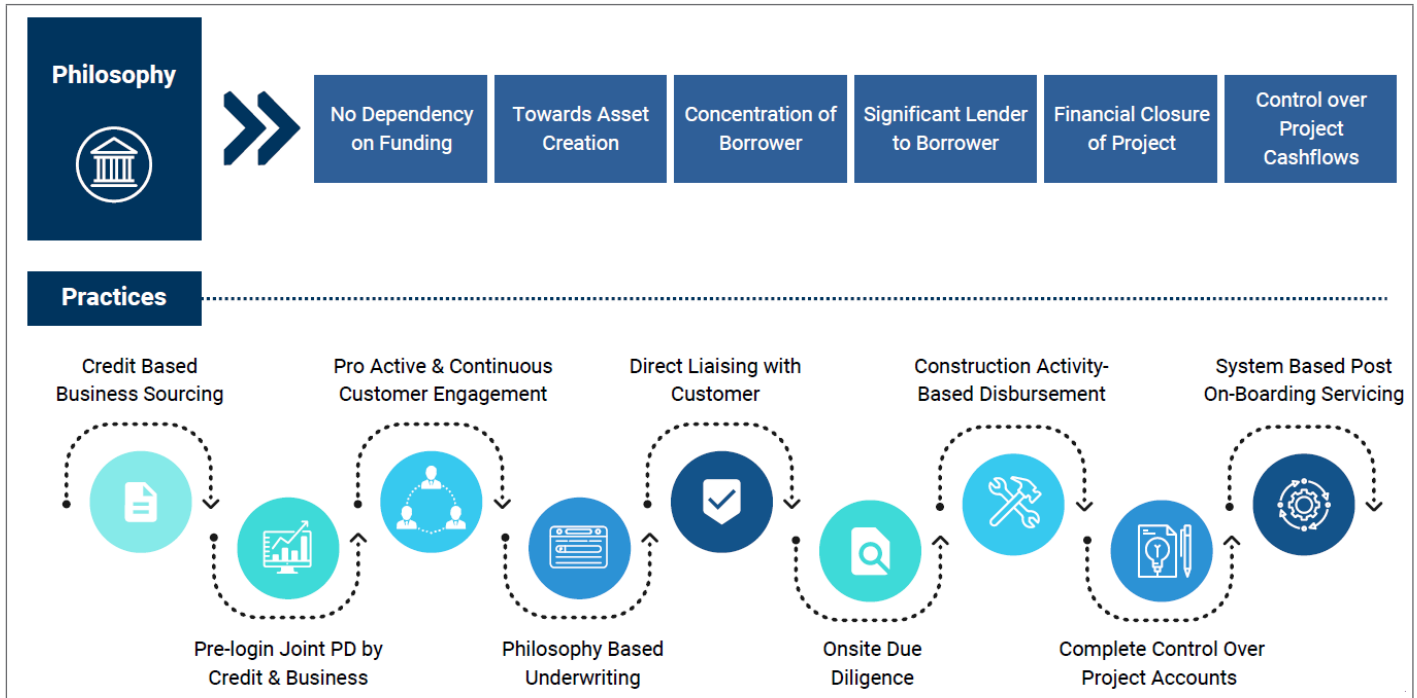
Source: Company, Sharekhan Research

NBFC Funding : Underwriting Practises



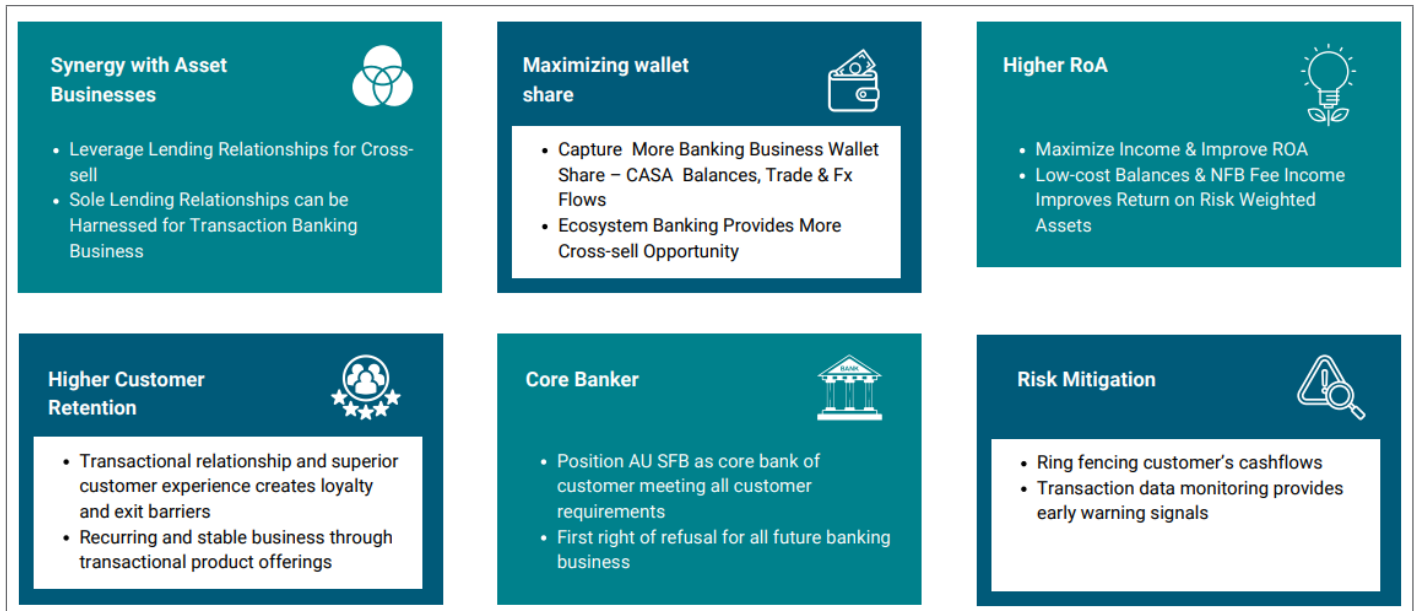
Source: Company, Sharekhan Research

Real Estate Funding – Underwriting Practises



Source: Company, Sharekhan Research

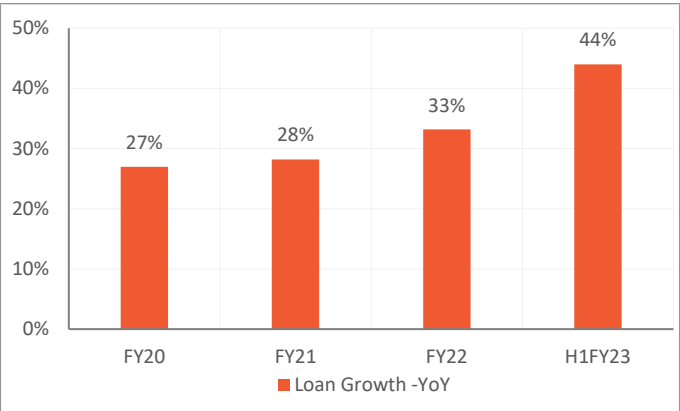
Transaction Banking – Enabling Holistic Banking



Source: Company, Sharekhan Research

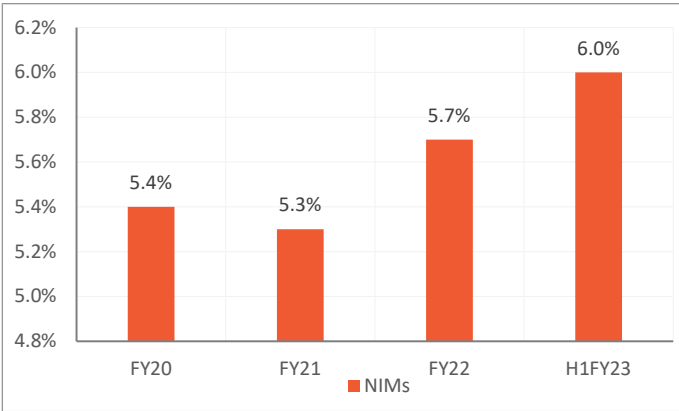
Financials in charts

Trend in Loan Growth



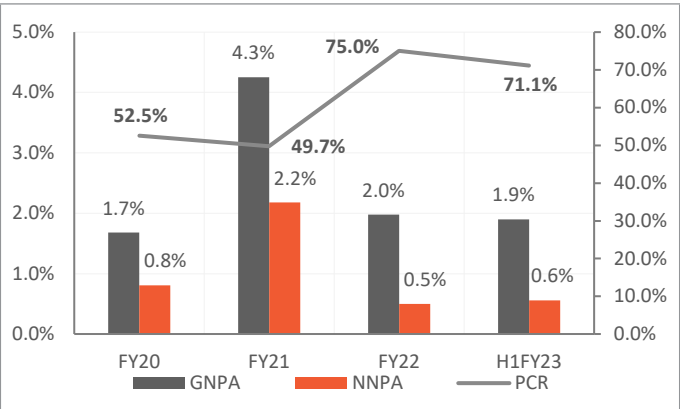
Source: Company, Sharekhan Research

Trend in NIMs



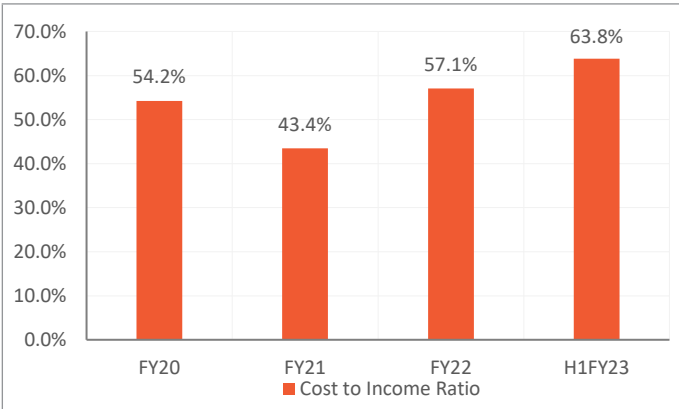
Source: Company, Sharekhan Research

Trend in Asset Quality



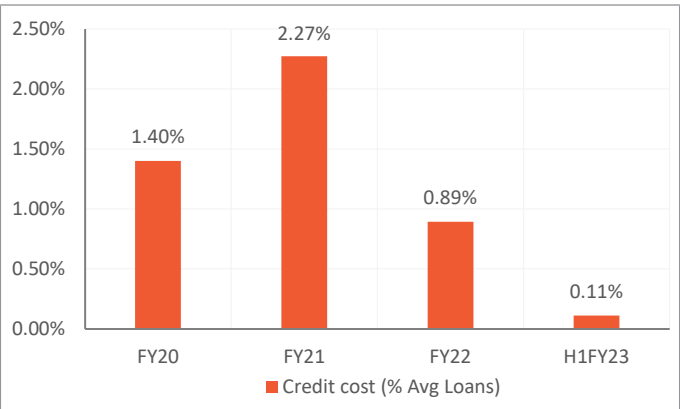
Source: Company, Sharekhan Research

Trend in Cost to Income Ratio



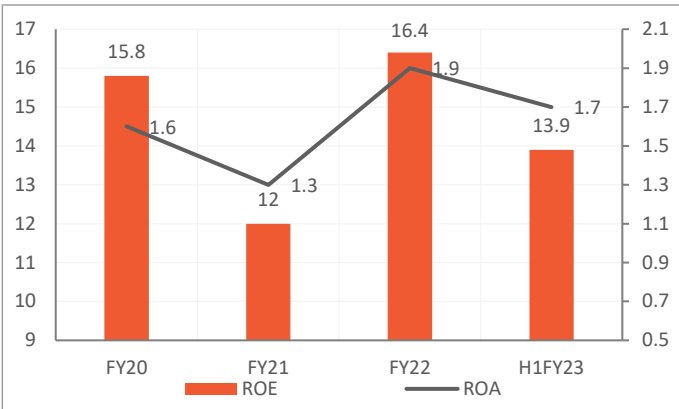
Source: Company, Sharekhan Research

Trend in Credit cost



Source: Company, Sharekhan Research

Trend in Return Ratio



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 5.2x/ 4.4x/ 3.7x its FY23E/24E/25E ABV. Factors such as AU bank'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 an unchanged price target (PT) of Rs. 800.

Peer Valuation

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	672	44,781	33.2	27.6	5.2	4.4	16.5	16.8	1.7	1.7
City Union Bank	196	14,536	13.6	9.8	2.1	1.8	15.0	17.7	1.7	2.1

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.

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	3.14

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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