Stock Update

Result Update

Sharekhan by BNP PARIBAS

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 Updated Oct 08, 2022	23.87

Medium Risk

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

Source: Morningstar

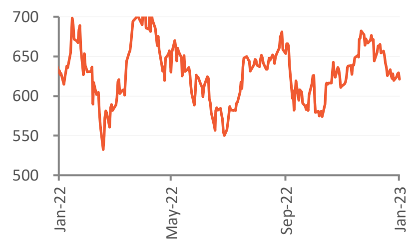
Company details

Market cap:	Rs. 41,420 cr
52-week high/low:	Rs. 733 / 525
NSE volume: (No of shares)	17.3 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	48.0 cr

Shareholding (%)

Promoters	25.6
FII	38.6
DII	21.3
Others	14.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.5	-0.8	9.7	-1.7
Relative to Sensex	-5.9	-4.0	-1.9	-1.9

Sharekhan Research, Bloomberg

AU Small Finance Bank Ltd

Steady performance

Banks	Sharekhan code: AUBANK
Reco/View: **Buy** ↔	CMP: **Rs. 621**
	Price Target: **Rs. 800** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- AU Small Finance Bank (AUSFB) reported steady performance in Q3FY2023, with PAT at Rs. 393 crore, aided by strong revenue growth, partly offset by higher costs and lower credit cost. However, the bank has utilised contingent buffers worth Rs. 31 crore during the quarter.
- NII growth was strong at 41% y-o-y/6% q-o-q, in line with advances growth. NIM was stable q-o-q at 6.2%. Core other income was up by 7% y-o-y/17% q-o-q, driven by healthy growth in disbursements, increasing contribution of bancassurance income, and rising share of transactional customers on the liability side.
- Operating profit grew by 21% y-o-y/11% q-o-q, led by strong revenue growth, but was offset by rising costs. Asset-quality performance remained strong with credit costs at just 0.24%, with lower slippages q-o-q (12%) and improvement in NPL ratios — GNPL at 1.81% and NNPL at 0.51%. The bank is comfortably placed with ~72% provision coverage on NPLs and excess loan provision of ~40 bps.
- The near to medium-term outlook looks stable to positive for the bank, except for cost of funds. The stock is currently trading at 3.8x/3.4x/2.9x its FY2023E/FY2024E/FY2025E ABV estimates, respectively. We maintain Buy with an unchanged PT of Rs. 800. We believe strong earnings growth would support the rich valuations.

AU Small Finance Bank (AUSFB) reported steady performance in Q3FY2023. Net interest income (NII) grew by 41% y-o-y and 6% q-o-q, in line with advances growth. Net interest margin (NIM) was stable q-o-q at 6.2%. Incremental cost of funds increased by 23 bps during the quarter, resulting in a decline in loan spreads; however, at the book level, spreads remained broadly stable, aided by uptick in yields on advances, especially in commercial banking, which is a floating rate book. Core other income grew strongly by 7% y-o-y/17% q-o-q. The bank reported treasury profit of Rs. 8 crore vs. Rs. 2 crore in the last quarter. Opex continued to be elevated and was up ~40% y-o-y/7% q-o-q on account of investment towards building digital capabilities in the credit cards business/QR/Video Banking, distribution expansion, and brand campaign. PPoP grew by 21% y-o-y and 11% q-o-q. Total credit cost reported was 24 bps (as % of average advances) vs. 34 bps in the last quarter. However, the bank utilised contingent buffers (24 bps of average advances) during the quarter. PBT grew by 30% y-o-y/15% q-o-q. Net advances rose by 38% y-o-y/8% q-o-q, led by strong disbursements in the commercial banking segment. Deposits were up 38% y-o-y and 5% q-o-q, driven by strong growth in term deposits. CASA balances grew by 35% y-o-y and declined by 5% q-o-q. CASA ratio now stands at 38.4% vs. 42.3% in the last quarter. Term deposits grew by 40% y-o-y and 12% q-o-q. The share of CASA + retail TD as % of total deposits stands at 70% vs. 73% in the last quarter. Asset-quality trends remained stable with GNPA and NNPA ratios reported at 1.81% and 0.51%, respectively. PCR stood at ~72%. Restructured book is now at 1.4% of advances vs. 1.7% of advances last quarter. Annualised slippage ratio (based on 12m trailing advances) stood at 2.3% vs. 2.9% q-o-q. The bank continued to hold excess loan provisions of 40 bps of net advances.

Key positives

- Healthy revenue growth in line with advances growth
- Strong retail term deposits growth at 40% y-o-y/10% q-o-q.
- Improving asset-quality matrix with lower slippages

Key negatives

- Opex stayed high, rising ~40% y-o-y/ 7% q-o-q as the franchise continues to invest in future growth.
- Bulk term deposits grew by 40% y-o-y/15% q-o-q.
- CASA declined q-o-q.

Management Commentary

- The bank is being cognizant of the tough global macro environment and is taking a more measured approach towards growth with a focus on sustainable profitability.
- Focus is on prioritising and optimising the cost of funds, while improving retail deposits franchise further, sustaining risk-adjusted yields, and growing at a pace that commensurates with its business strategy. Digital initiatives are also improving customer engagement and acquisition.

Our Call

Valuation – The stock is currently trading at 3.8x/3.4x/2.9x its FY2023E/FY2024E/FY2025E ABV estimates, respectively. The near to medium-term outlook looks stable to positive for the bank, except for cost of funds. The bank has demonstrated its ability to execute and deliver strong performance. Accelerated investments continues in uplifting the franchise in order to sustain growth and expand more steams of revenue and activities, with the eventual goal of becoming a universal bank. The objective is to maintain a strong credit filter, granular growth in asset and liability along with sustaining stable spreads, 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; slower growth in retail deposit franchise; and lower-than-expected margin.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Interest Income	3,234	4,470	6,341	8,462
Net profit	1,130	1,401	1,990	2,721
EPS (Rs.)	17.9	21.0	24.4	29.7
P/E (x)	34.6	29.5	25.5	20.9
P/BV (x)	5.3	3.8	3.4	2.9
RoE	16.4	15.1	15.2	15.5
RoA	1.9	1.7	1.8	1.9

Source: Company; Sharekhan estimates

Key result highlights

- **Healthy revenue growth in line with advances growth:** NII grew by 41% y-o-y and 6% q-o-q, aided by strong advances growth. NIM remained stable q-o-q at 6.2%. Incremental cost of funds increased by 23 bps during the quarter, resulting in a decline in loan spreads; however, at the book level, spreads remained broadly stable, aided by uptick in yields on advances, especially in commercial banking, which is a floating rate book. Cost of funds remains a key monitorable going forward for the bank, but we believe its end-customer, especially in the retail segment, is not rate sensitive, which should lend support in terms of higher incremental disbursement yield in the retail segment. Core other income grew strongly by 7% y-o-y/17% q-o-q.

- **Accelerated investments continued to strengthen the franchise:** Total operating expenses grew by 40% y-o-y/7% q-o-q. Continued accelerated 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 60-62% for FY2023E. Opex is expected to normalise over the medium term. The franchise continues to invest in future growth and expanding more revenue streams, which is a key positive, given the benign credit cycle.

- **Taking a more measured approach to growth with a focus on sustainable profitability:** Net advances rose by 38% y-o-y/7% q-o-q, driven by strong disbursements in commercial banking. Disbursements were healthy in the unsecured segment, wheels as well as in SBL segment. Wheels book grew by 35% y-o-y; SBL – 20% y-o-y; home loans – 76% y-o-y; commercial banking – 76% y-o-y; and unsecured segment – 52% y-o-y. Demand environment continues to remain strong, but the bank is being cognizant of the tough global macro environment. Digital capabilities are helping to scale the business and improve brand identity. Recently launched digital products and channels have given a significant uplift to the pace of new customer acquisitions. The focus is on increasing cross sales among business units. The bank is maintaining sufficient liquidity with LCR at ~123%.

- **Strong deposit growth:** Total deposit base grew by 38% y-o-y/5% q-o-q. CASA balances grew by 35% y-o-y and declined by 5% q-o-q. CA grew by 58% y-o-y/down 2% q-o-q. SA grew by 32% y-o-y/down 5% q-o-q. CASA ratio now stands at 38.4% vs. 42.3% in the last quarter. Term deposits grew by 40% y-o-y and 12% q-o-q. The share of CASA + retail TD as a percentage of total deposits stands at 70% vs. 73% in the last quarter. The bank reported strong growth in retail as well as bulk term deposits.

- **Better asset-quality trends:** Asset-quality trends remained stable with GNPA and NNPA ratios reported at 1.81% and 0.51%, respectively. PCR stood at ~72%. Restructured book is now at 1.4% of advances vs. 1.7% of advances last quarter. Annualised slippage ratio (based on 12m trailing advances) stood at 2.3% vs. 2.9% q-o-q. The bank continued to hold excess loan provisions of 40 bps of net advances. Restructured advances amounting to Rs. 38 crore were upgraded during the quarter. Underwriting principles followed by the bank include small ticket size; secured lending; risk-based pricing; and loans mainly for income-generation purpose. Collection efficiency also remained strong during the quarter at ~107%, led by recovery of arrears and some pre-payments.

- **Others:** The bank on-boarded 3.3 lakh new customers during the quarter; 36% of customer acquisitions were via digital products. 81% of the existing advances pool disbursed at the start of the pandemic has been exhibiting better than historical trends in asset quality so far, with GNPA at 0.6% and 92% book being current. The bank added 42 new touchpoints during the quarter. The bank is working on developing a well-diversified and granular set of fee income pools across 1) Branch Banking –Bancassurance, asset cross-sell, wealth etc., 2) Assets – processing fee, transaction banking, PSLC, treasury income etc., and 3) Payments – credit cards, UPI QR etc.

Result Table (Standalone) **Rs cr**

Particulars	3QFY23	3QFY22	2QFY23	Y-o-Y	Q-o-Q
Interest Inc.	2,118	1,496	1,992	42%	6%
Interest Expenses	965	676	909	43%	6%
Net Interest Income	**1,153**	**820**	**1,083**	**41%**	**6%**
NIM (%)	6.2	6.0	6.2	3%	0%
Core Fee Income	287	268	245	7%	17%
Other Income	8	8	2	-1%	235%
Net Income	**1,448**	**1,096**	**1,331**	**32%**	**9%**
Employee Expenses	465	356	451	31%	3%
Other Opex	427	282	381	51%	12%
Total Opex	**892**	**638**	**832**	**40%**	**7%**
Cost to Income Ratio	61.6%	58.2%	62.5%		
Pre Provision Profits	**556**	**458**	**499**	**21%**	**11%**
Provisions & Contingencies – Total	33	56	43	-42%	-24%
Profit Before Tax	**523**	**402**	**456**	**30%**	**15%**
Tax	130	100	113	30%	15%
Effective Tax Rate	25%	25%	25%		
Reported Profits	**393**	**302**	**343**	**30%**	**15%**
Basic EPS (Rs.)	5.9	4.8	5.3	23%	12%
Diluted EPS (Rs.)	5.9	4.8	5.2	23%	12%
RoA (%)	2.0	2.2	1.8		
Advances	55,601	40,181	51,743	38%	7%
Deposits	61,101	44,278	58,335	38%	5%
Gross NPA	**1,019**	**1,058**	**997**	**-4%**	**2%**
Gross NPA Ratio (%)	1.81	2.60	1.90		
Net NPA	**285**	**520**	**288**	**-45%**	**-1%**
Net NPAs Ratio (%)	0.51	1.29	0.56		
PCR – Calculated	72.1%	50.8%	71.1%		

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – table to 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 informal as well as in rural geography. 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 deposits compared to NBFCs, which gives them a competitive advantage to manage spreads and have healthy operating profit growth, with lower inherent liquidity and 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 that 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 – We maintain buy rating on the stock with an unchanged price target (PT) of Rs. 800

The stock is currently trading at 3.8x/3.4x/2.9x its FY2023E/FY2024E/FY2025E ABV estimates, respectively. The near to medium-term outlook looks stable to positive for the bank, except for cost of funds. The bank has demonstrated its ability to execute and deliver strong performance. Accelerated investments continues in uplifting the franchise in order to sustain growth and expand more steams of revenue and activities, with the eventual goal of becoming a universal bank. The objective is to maintain a strong credit filter, granular growth in asset and liability along with sustaining stable spreads, 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 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	621	41,420	29.5	25.5	3.8	3.4	15.1	15.2	1.7	1.8
City Union Bank	159	11,801	11.0	7.9	1.7	1.4	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.

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 as an SFB. In addition to its vehicle finance, MSME and SME offerings, the bank's asset product offerings include home loans, gold loans, agriculture loans, unsecured (PL/CC), 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; slower growth in retail deposit franchise; and lower-than-expected margin.

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	Sanjay Agarwal	17.58
2	Capital Group Cos Inc.	8.86
3	Wasatch Advisors Inc.	4.96
4	SMALL CAP WORLD FUND INC.	4.57
5	Kotak Mahindra Asset Management Co. Ltd.	4.42
6	CAMAS INV. PTE. LTD.	4.04
7	NEW WORLD FUND INC.	3.77
8	AGARWAL JYOTI	3.55
9	WESTBRIDGE AIF I	3.14
10	AGARWAL SHAKUNTALA	2.80

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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