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		↔	

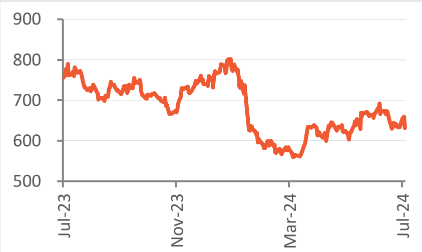
Company details

Market cap:	Rs. 46,916 cr
52-week high/low:	Rs. 813 / 554
NSE volume: (No of shares)	39.9 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	55.7 cr

Shareholding (%)

Promoters	22.9
FII	39.6
DII	18.4
Others	19.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.3	-10.9	-8.6	-2.0
Relative to Sensex	9.0	-19.1	-21.0	-22.4

Sharekhan Research, Bloomberg

AU Small Finance Bank Ltd

Downside risk keeps us on sidelines, maintain HOLD

Bank		Sharekhan code: AUBANK	
Reco/View: Hold	↔	CMP: **Rs. 631**	Price Target: **Rs. 700** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- The merged entity reported healthy operational performance (better than estimates), driven by higher-than-expected NIM expansion and lower opex growth. However, credit cost was higher than the guided range.
- Asset-quality trends saw normalisation q-o-q vs. the proforma basis. RoA for the merged entity came in at ~1.6%.
- We believe there could be downside risk in profitability or growth, given the outlook on margins and cost is negative in the near term and retail deposit mobilisation remains a tall task in the current challenging environment. Either growth would be lower or profitability will be challenged.
- Additionally, if stress build-up is higher than expected in the MFI/credit cards business going ahead, credit cost may also inch higher but the probability is low here. Thus, the uncertain outlook keeps us on the sidelines. We maintain our HOLD rating on AU SFB with an unchanged PT of Rs. 700. The stock trades at 2.5x/2.2x its FY2025E/FY2026E BV estimates.

Q1FY25 numbers for the merged entity were better than expectations, led by strong operational performance. Numbers on a y-o-y and q-o-q are not comparable as this is the first quarter for the merged entities. Net interest income (NII) at Rs. 1,921 crore was above estimates mainly led by higher-than-expected net interest margin (NIM) expansion. NII grew by 54% y-o-y/44% q-o-q. NIM improved by ~85 bps q-o-q to 6%, led by improvement in yields by ~120 bps due to the inclusion of MFI book and higher disbursement yields in the existing book of AU Bank vs. expectation of ~60 bps improvement along with marginal reduction in cost of funds due to efficient management. NIM outlook remains negative in the near term, led by elevated cost of funds. Core fee income grew by 77% y-o-y/down 4% q-o-q. The bank reported a treasury profit of Rs. 19 crore versus Rs. 8 crore in the last quarter and Rs. 17 crore in Q1FY2024. Opex (lower than estimates) grew by ~46% y-o-y/20% q-o-q. Pre-provisioning operating profit (PPoP) at Rs. 988 crore was above estimates mainly led by higher NII and lower opex, grew by 81% y-o-y/49% q-o-q. Net credit cost (higher than estimates) stood at 126 bps annualised (as a percentage of loans), higher than the guided range of 110-115 bps, led by additional contingent provisions created on the MFI book. PAT at Rs. 503 crore was above estimates, led by strong operational performance partially offset by higher credit cost. Net advances rose by 5% q-o-q on a proforma basis. Deposits were flat q-o-q on a proforma basis. Keeping deposit growth muted was a calibrated move to use excess liquidity and optimise the cost of funds simultaneously. Headline asset-quality ratios saw marginal deterioration on a proforma basis with GNPA/ NNPA ratio at 1.78%/0.63% vs. 1.66%/0.56% q-o-q. PCR is at 65% vs. 66% q-o-q. Restructured book stands at 0.4% of advances. Net slippages stand at Rs. 356 crore (~1.6% of loans, annualised).

Key positives

- NIMs was better than expected for the merged entity at ~6%.

Key negatives

- Write-offs were higher at Rs. 180 crore, predominately from MFI and credit card.
- Deposit growth was muted; however, it was a calibrated move to use excess liquidity and optimise the cost of funds simultaneously.

Management Commentary

- The bank reiterated its guidance to defend RoA at ~1.6% in FY2025 for the merged entity.
- Keeping deposit growth muted was a calibrated move to use excess liquidity and optimise the cost of funds simultaneously.
- Clear focus is on retail low-cost deposit mobilisation at an effective cost.
- The bank remained confident about the asset-quality outlook.
- The board has considered and approved making an application to the Reserve Bank of India (RBI) for transition to a Universal Bank under the RBI's guidelines. The bank is likely to file an application in August 2024 in this regard.

Our Call

Valuation – Maintain HOLD with an unchanged PT of Rs. 700: The stock trades at 2.5x/2.2x its FY2025E/FY2026E ABV estimates. The stock is expensive for less than ~2% RoA trajectory and RoE of less than 15%. We believe there could be a downside risk in profitability or growth, given the outlook on margins and cost is negative in the near term and retail deposit mobilisation remains a tall task in the current challenging environment. Either growth would be lower or profitability will be challenged.

Key Risks

Higher-than-expected growth in advances, lower margin compression than expected, execution risk in the merger.

Valuation Rs cr

Particulars	FY22	FY23	FY24	FY25E	FY26E
Net Interest Income	3,234	4,425	5,157	7,252	9,196
Net profit	1,130	1,428	1,535	1,985	2,681
EPS (Rs.)	17.9	21.9	23.0	26.6	36.0
P/E (x)	35.2	28.9	27.5	23.7	17.5
P/BV (x)	5.4	3.9	3.4	2.5	2.2
RoE (%)	16.4	15.4	13.0	12.3	12.8
RoA (%)	1.9	1.8	1.5	1.5	1.6

Source: Company; Sharekhan estimates

Key result highlights

- **NIM outlook negative:** NII at Rs. 1,921 crore was above estimates mainly led by higher-than-expected NIM expansion. NII grew by 54% y-o-y/44% q-o-q. NIM improved by ~85 bps q-o-q to 6%, led by 120 bps improvement in yields due to the inclusion of MFI book and higher disbursement yields in the existing book of AU Bank vs. expectation of ~60 bps improvement along with a marginal reduction in the cost of funds due to efficient management. NIM outlook remains negative in the near term, led by elevated cost of funds. Deposit growth remains challenging for the sector, thus the cost of deposits could further rise in the near term. CoF remains a key monitorable in the near term, as rate competition is intensifying in deposits.
- **Cost-to-income ratio outlook:** The bank reported a lower C/I ratio at 59.9% in Q1, led by seasonality in other operating expenses. The bank expects cost-to-income ratio for FY2025 to remain at similar levels as in FY2024 at 62-63%.
- **Loan growth would be calibrated with deposit growth:** Net advances rose by 5% q-o-q on a proforma basis. The bank guided that loan growth would be guided by deposit growth. Growing assets is not a challenge.
- **Deposit growth muted:** Deposits were flat q-o-q on a proforma basis. Keeping deposit growth muted was a calibrated move to use excess liquidity and optimise the cost of funds simultaneously. CASA deposits grew by 2% q-o-q with CASA ratio at 33%. CASA + Retail TD now stands at ~70%. The focus is to scale retail-granular, low-cost deposit franchise.
- **Asset-quality deteriorated:** Headline asset-quality ratios saw marginal deterioration due to seasonality on a proforma basis with GNPA/NNPA ratio at 1.78%/0.63% vs. 1.66%/0.56% q-o-q. PCR is at 65% vs. 66% q-o-q. Restructured book stands at 0.4% of advances. Net slippages stand at Rs. 356 crore (~1.6% of loans, annualised). Write-offs were higher at Rs. 180 crore predominately from MFI and credit card. The bank does not see any asset-quality challenge. Credit card portfolio trends are normalising. Collection efficiency in MFI is expected to improve going forward.

Results Rs cr

Particulars	1QFY25 (Merged entity)	1QFY24	4QFY24	Y-o-Y (%)	Q-o-Q (%)
Interest Income	3,769	2,458	2,829	53	33
Interest Expenses	1,848	1,212	1,492	52	24
Net Interest Income	**1,921**	**1,246**	**1,337**	**54**	**44**
NIM (%)	6.0	5.7	5.1	5	18
Core Fee Income	527	298	548	77	-4
Other Income	19	17	8	9	145
Net Income	**2,466**	**1,561**	**1,893**	**58**	**30**
Employee Expenses	790	507	556	56	42
Other Opex	688	508	673	35	2
Total Opex	**1,478**	**1,015**	**1,228**	**46**	**20**
Cost-to-Income Ratio	59.9%	65.0%	64.9%		
Pre-Provision Profits	**988**	**546**	**664**	**81**	**49**
Provisions & Contingencies – Total	319	33	133	868	141
Profit Before Tax	**669**	**513**	**532**	**30**	**26**
Exceptional Item	0	0	77		
Tax	166	126	84	32	98
Effective Tax Rate	25%	25%	16%		
Reported Profits	503	387	371	30	36
Basic EPS (Rs.)	6.8	5.8	5.5	17	22
Diluted EPS (Rs.)	6.7	5.8	5.5	17	22
RoA (%)	1.6	1.7	1.4		
Advances	89,652	62,861	73,163	43	23
Deposits	97,290	69,315	87,182	40	12
Gross NPA	**1,613**	**1,121**	**1,237**	**44**	**30**
Gross NPA Ratio (%)	1.78	1.76	1.67		
Net NPA	**563**	**347**	**401**	**62**	**40**
Net NPAs Ratio (%)	0.63	0.55	0.55		
PCR – Calculated	65.1%	69.0%	67.6%		

Source: Company; Sharekhan Research; Note: YoY & QoQ numbers are not comparable

Outlook and Valuation

■ Sector View – Deposit mobilisation to be in focus; banks with a superior liability franchise placed better

System-level credit offtake (ex-HDFC Ltd.) grew by ~16% y-o-y in the fortnight ending June 14, 2024, indicating loan growth has been healthy and sustaining, given distinct signs of improved macros, revival in private capex, and healthy demand. On the other hand, deposits rose by ~12%. The gap between advances and deposit growth has been reducing very gradually. We are seeing strong traction in loan growth but deposit growth remains a constraint. Margins are expected to stay stressed due to lower CASA, higher deposit rates, and an inability to pass on rates on the asset book. Overall, the asset-quality outlook is stable to positive for the sector. We believe banks with a robust capital base and strong retail deposit franchises are well-placed to capture growth opportunities.

■ Company Outlook – Valuation still expensive

AU SFB has had a long and successful history (since its days as an NBFC and now as a bank) in secured credit and its underwriting quality, mainly in the under/unbanked self-employed customer segment that lacks formal income documentation. The bank has a strong skill set and deep experience in its core secured segments. The merger with Fincare SFB further reduces the share of the core secured segment for the bank. We believe it will be a challenge for the franchise to sustain superior metrics across the economic cycle. Currently, the outlook remains uncertain on growth as well as profitability along with valuation remains expensive.

■ Valuation – Maintain HOLD with an unchanged PT of Rs. 700

The stock trades at 2.5x/2.2x its FY2025E/FY2026E ABV estimates. The stock is expensive for less than ~2% RoA trajectory and RoE of less than 15%. We believe there could be a downside risk in profitability or growth, given the outlook on margins and cost is negative in the near term and retail deposit mobilisation remains a tall task in the current challenging environment. Either growth would be lower or profitability will be challenged.

About company

AU SFB has navigated the first seven years of its banking operations relatively well despite macro headwinds such as demonetisation, GST implementation, NBFC crisis, and COVID-19 pandemic. During this period, the bank has delivered a consistent performance with deposits reporting a CAGR of 49%, advances registering a CAGR of 33%, and balance sheet posting a CAGR of 34% over FY2018-FY2024.

Investment theme

AU SFB has expanded and strengthened its business model to offer a diverse suite of banking products and services by leveraging its asset-based lending strengths. The liability franchise is also shaping up well with the shoring up of retail deposits. However, the merger with Fincare SFB would bring volatility in earnings during periods of economic downturn due to the inherent nature of the portfolio acquired; and currently,, the outlook remains uncertain on growth as well as profitability.

Key Risks

Higher-than-expected growth in advances, lower margin compression than expected, and execution risk in the merger.

Additional Data

Key management personnel

Sanjay Agarwal	Managing Director/CEO
Uttam Tibrewal	Deputy CEO and ED
Rajeev Yadav	Deputy CEO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Agarwal Sanjay	15.78
2	The Capital Group Cos Inc.	8.20
3	FINCARE BUSINESS SERVICES LTD.	8.05
4	Kotak Mahindra Asset Management Co.	4.02
5	Westbridge AIF	3.82
6	CAMAS INV PTE LTD	3.63
7	Agarwal Jyoti	3.18
8	Agarwal Shakuntala	2.51
9	HDFC Asset Management Co. Ltd.	2.13
10	Nomura India Investment Fund	1.97

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

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