

AU SMALL FINANCE BANK LIMITED

Headwinds to persist in near term; promising outlook

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AU Small Finance Bank (AU SFB) delivered a healthy quarterly performance supported by sustained growth in secured business of its loan book. Amid ongoing stress in the unsecured sector, the bank gradually reduced its exposures. As a result, the bank reported a lower NIM on the back of higher funding costs. Furthermore, while the bank's asset quality deteriorated, it is expected to remain resilient in a challenging macro environment with prudent provisioning policies and tightening underwriting. Additionally, the bank's operating efficiency improved, partly aiding profitability. Despite the short-term challenges, we are optimistic about AU SFB's long-term prospects, given its broad distribution and the opportunity to obtain an universal banking license. Hence, we maintain our BUY rating on the stock, based on 2.3x FY27E BVPS with a revised target price of ₹701.

Profitability remains strong with improving operating leverage

In Q3FY25, AU SFB's net-interest income (NII) grew 5.2% QoQ to ₹41.14 bn (+50.4% YoY), driven by healthy growth in advances (+5.0% QoQ/+49.2% YoY). The bank's net interest margin (NIM) shrank 20bps QoQ to 5.90%, owing to higher proportion of investment book, adverse loan mix and higher cost of funds. Moreover, pre-provision operating profit increased 6.5% QoQ to ₹12.05 bn, due to reduced operating expenses (-3.0% QoQ) with cost-to-income (C/I) at 54.4% (down 230 bps QoQ) on merger synergies, lower acquisition in credit cards and moderation in overhead cost. Subsequently, PAT de-grew 7.5% QoQ to ₹5.28 bn (+40.8% YoY), on higher provisions (₹5.02 bn vs. ₹3.73 bn in Q3FY24).

Stress visible in the unsecured portfolio

During the quarter, growth in advances was primarily led by robust growth in wheels (+10.9% QoQ), MSME (+4.0% QoQ) and business banking (+8.0% QoQ). While on a sequential basis, the bank de-grew its credit card, personal loans and microfinance portfolio by 9.4%, 10.5% and 1.8%, respectively. The bank's deposits increased its (+2.3% QoQ/+40.1% YoY), of which current account deposits and saving account deposits de-grew 2.6% QoQ and 5.6% QoQ, respectively; term deposits continue to grow 5.0% QoQ, driven by a high interest rate scenario. As a result, the share of CASA deposits in total deposits stood at 30.6%. Moreover, asset quality deteriorated, with gross non-performing assets (NPAs) and net NPAs at 2.31% and 0.91%, respectively (vs. 1.98% and 0.0.75% in Q2FY25), led by increased slippages in the unsecured portfolio and some impact from wheels and agriculture business due to seasonality.

Key Financials (₹ mn)	FY23	FY24	FY25E	FY26E	FY27E
Loans & Advances	5,84,215	7,31,627	10,34,520	12,72,460	15,14,227
Net Interest Income	44,253	51,571	74,700	95,316	1,14,712
PPP ex Except. Items	20,195	24,382	41,967	56,506	71,291
Reported Profits	14,279	15,347	19,932	28,533	37,585
Earnings Per Share	21.4	22.9	26.8	38.4	50.5
P/E (x)	27.7	25.9	22.2	15.5	11.7
Adj. BV	162.1	183.8	218.6	257.0	307.6
P/ABV (x)	3.7	3.2	2.7	2.3	1.9
Gross NPAs Ratio (%)	1.7	1.7	2.1	2.0	1.9
Adj. RoA	1.8	1.4	1.5	1.7	1.8
Adj. RoE	15.5	11.8	13.8	16.0	17.7

BUY

Current Market Price (₹) : 594

12M Price Target (₹) : 701

Potential Return (%) : 18

Stock Data

Sector :	Banking
FV (₹)	10
Total Market Cap (₹ bn)	438
Free Float Market Cap (₹ bn)	329
52-Week High / Low (₹)	755 / 534
BSE Code / NSE Symbol	540611 / AUBANK
Bloomberg	AUBANK IN

Shareholding Pattern

(%)	Dec-24	Sep-24	Jun-24	Mar-24
Promoter	22.88	22.90	22.92	22.93
FPIs	39.35	40.72	39.58	35.47
MFs	17.11	15.54	12.45	13.09
Insurance	3.30	3.26	2.79	2.55
AIFs	1.36	1.33	3.20	5.48
Others	16.00	16.25	19.06	20.48

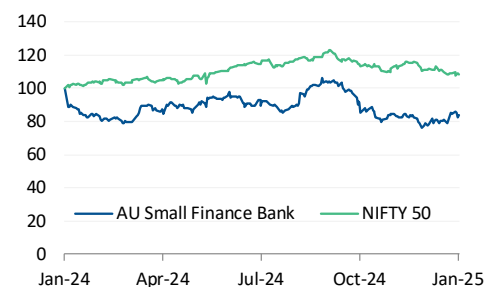
Source: BSE

Price Performance

(%)	1M	3M	6M	12M
AU SFB	6.9%	-7.9%	-9.8%	-16.0%
Nifty 50	-2.7%	-5.4%	-5.4%	8.1%

* To date / current date : January 24, 2025

AU Small Finance Bank vs Nifty 50



Key Concall Highlights

- Secured loans- (Wheels, MBL, HL, gold loan) expected to grow 23% - 25% for full year whereas unsecured businesses portfolio expected to de-grow ~10%; Total FY25 gross loan portfolio (GLP) growth expected to be ~ 20%. This growth is expected to be led by expanded distribution particularly in South India by leveraging erstwhile Fincare distribution.
- MFI Portfolio issues: The bank is facing challenges with customer indebtedness leading to higher slippages and credit costs. Thus, the bank is implementing stricter underwriting, enhancing collection efforts, and increasing CGFMU cover.
- Management expects full year cost of funds to remain around lower range of guidance of 7.10% - 7.15% (vs initial guidance of 7.20 – 7.25%). Credit costs for FY25 expected to be ~1.5% - 1.6% on GLP.
- Other income is growing sustainably driven by increasing penetration of insurance products in its customer base, investments in AD-1 business starting to yield and credit card fees.
- The bank plans to add 60-70 new liability branches in metro and urban cities in FY26. Also, converting 70-80 asset centers into deposit branches is under consideration.
- Universal bank license application is in progress, awaiting evaluation by the RBI's external advisory committee. The management has not provided any timeline on the same.

Outlook & Valuation

Stress in the unsecured portfolio, economic slowdown and tight liquidity is expected to persist, thereby keeping the slippages and credit cost of the bank at the elevated levels in the near term. Nevertheless, AU SFB is expected to maintain steady growth momentum driven by diversified asset portfolio, broadening distribution network and healthy asset quality. Additionally, the stock is currently trading at 1.9x FY27E BVPS, lower than its historical three-year average of 3.3x. Hence, we maintain our BUY rating on the stock, based on 2.3x FY27E BVPS with a revised target price of ₹701.

Exhibit 1: Change in Estimates

(₹ mn)	Previous			Revised			Change %		
	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Net interest income	76,107	1,01,902	1,27,997	74,700	95,316	1,14,712	-1.8	-6.5	-10.4
NIM (%)	6.0	6.1	6.1	5.9	5.8	5.8	-10bps	-26bps	-34bps
Pre Provision Profits	39,458	52,152	64,379	41,967	56,506	71,291	6.4	8.3	10.7
PAT	21,058	28,517	36,561	19,932	28,533	37,585	-5.3	0.1	2.8
Target Price (₹)			730			701			-4.0

Source: LKP Research

Exhibit 2 : Income Statement Analysis

(₹ mn)	Q3FY25	Q3FY24	% yoy / bps	Q2FY25	% qoq / bps	9MFY25	9MFY24	% yoy / bps
Interest Inc.	41,135	27,358	50.4	39,106	5.2	1,17,931	77,252	52.7
Interest Expenses	20,908	14,109	48.2	19,363	8.0	58,755	39,052	50.5
Net Interest Income	20,227	13,249	52.7	19,744	2.4	59,177	38,201	54.9
Other Income - Total	6,184	4,497	37.5	6,380	(3.1)	18,020	11,903	51.4
Net Operating Revenue	26,411	17,746	48.8	26,123	1.1	77,197	50,103	54.1
Employee Expenses	7,547	5,287	42.7	7,855	(3.9)	23,303	15,478	50.6
Other Opex	6,815	5,887	15.8	6,951	(1.9)	20,646	16,117	28.1
Total Opex	14,362	11,175	28.5	14,806	(3.0)	43,949	31,595	39.1
Pre Provision Profits	12,049	6,571	83.4	11,318	6.5	33,248	18,508	79.6
Exceptional Profit (Loss)	-	-	-	-	-	-	-	-
PPP ex Except. Items	12,049	6,571	83.4	11,318	6.5	33,248	18,508	79.6
Provisions & Contingencies - Total	5,017	1,589	215.6	3,730	34.5	11,939	3,062	289.9
Profit Before Tax	7,032	4,981	41.2	7,588	(7.3)	21,309	15,446	38.0
Tax	1,748	1,229.0	42.2	1,876	(6.8)	5,287	3,806	38.9
Reported Profits	5,284	3,752	40.8	5,712	(7.5)	16,022	11,640	37.7
Basic EPS	7.1	5.6	26.6	7.7	(7.6)	21.6	17.4	23.6

Source: Company, LKP Research

Exhibit 3 : Balance Sheet Analysis

(₹ mn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Net Worth	1,17,112	1,21,670	1,24,968	1,55,160	1,59,480	1,66,020	4.1	36.5
RoE (%)	13.7	12.3	11.9	13.0	14.3	12.7	(11)	3
Tier 1 %	21.0	19.6	18.8	18.9	17.4	16.9	(3)	(14)
Total CAR %	22.4	20.8	20.1	20.1	18.5	18.0	(3)	(13)
Advances - Total	6,41,685	6,67,400	7,31,627	8,96,520	9,48,382	9,95,590	5.0	49.2
Investments	2,32,199	2,67,140	2,71,334	2,73,150	3,18,608	3,36,130	5.5	25.8
Total Assets	9,59,774	10,11,750	10,94,257	12,59,420	13,88,292	14,30,440	3.0	41.4
RoA (%)	1.84	2.00	1.40	1.56	1.72	1.48	(14)	(26)
Deposits	7,57,429	8,01,200	8,71,821	9,72,900	10,96,931	11,22,600	2.3	40.1
CASA Deposits	2,56,660	2,64,460	2,91,260	3,20,350	3,55,210	3,44,020	(3.2)	30.1
CASA Ratio (%) reported	34.0	33.0	33.0	33.0	32.4	30.6	(6)	(7)
Term Deposits	5,00,769	5,36,740	5,80,561	6,52,550	7,41,721	7,78,580	5.0	45.1
Interest Bearing Liabilities - Total	8,10,870	8,55,340	9,26,615	10,62,210	11,84,703	12,22,480	3.2	42.9

Source: Company, LKP Research

Exhibit 4: Funding Profile Analysis

(₹ mn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Deposits	7,57,429	8,01,200	8,71,821	9,72,900	10,96,931	11,22,600	2.3	40.1
CASA Deposits	2,56,660	2,64,460	2,91,260	3,20,350	3,55,210	3,44,020	(3.2)	30.1
Saving Deposit	2,10,300	2,26,150	2,37,880	2,72,990	2,95,400	2,87,580	(2.6)	27.2
Current Deposit	46,360	38,310	53,380	47,360	59,810	56,440	(5.6)	47.3
Term Deposits	5,00,769	5,36,740	5,80,561	6,52,550	7,41,721	7,78,580	5.0	45.1
Borrowings	53,441	54,140	54,794	89,310	87,771	99,880	13.8	84.5
Interest Bearing Liabilities - Total	8,10,870	8,55,340	9,26,615	10,62,210	11,84,703	12,22,480	3.2	42.9

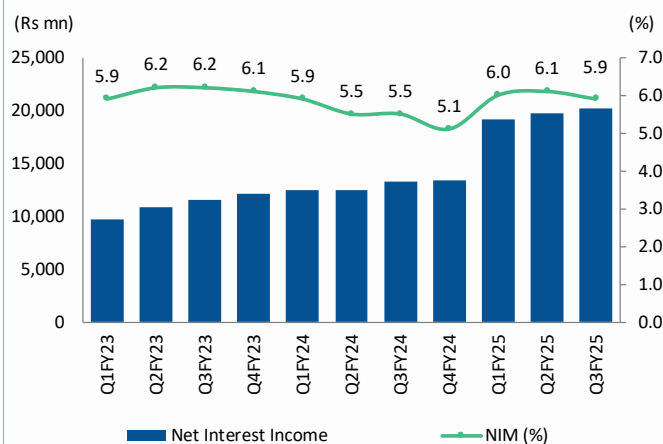
Source: Company, LKP Research

Exhibit 5: Assets Quality Analysis

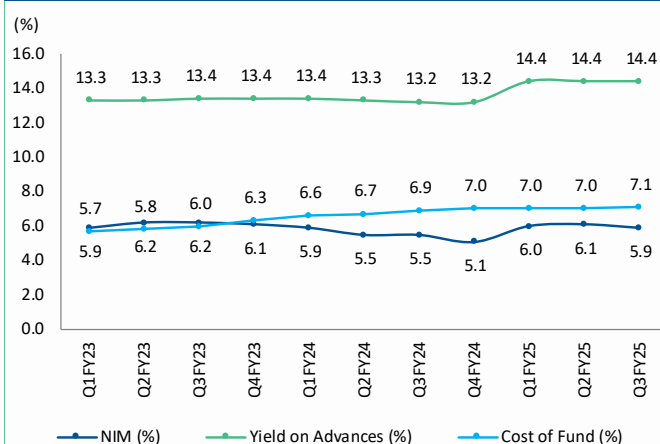
(₹ mn)	Q2FY24	Q3FY24	Q4FY24	Q1FY25	Q2FY25	Q3FY25	QoQ % / bps	YoY % / bps
Total Slippages	3,490	4,030	2,960	7,428	7,360	9,560	29.9	137.2
Slippages Ratio (%)	0.60	0.69	0.51	1.02	1.01	1.31	30	62
Gross NPA	12,448	13,397	12,374	16,132	19,017	23,355	22.8	74.3
Gross NPAs Ratio (%)	1.91	1.98	1.67	1.78	1.98	2.31	33	33
PCR - Adjusted (%)	69.1	66.0	67.6	65.1	62.8	61.2	(161)	(473)
PCR - Inc. Tech w/o (%)	73.0	72.0	76.0	84.0	82.0	80.0	(200)	800
Net NPA	3,847	4,562	4,010	5,626	7,067	9,056	28.1	98.5
Net NPAs Ratio (%)	0.60	0.68	0.55	0.63	0.75	0.91	16	23

Source: Company, LKP Research

Quarterly story in charts

Exhibit 6: NII Trend


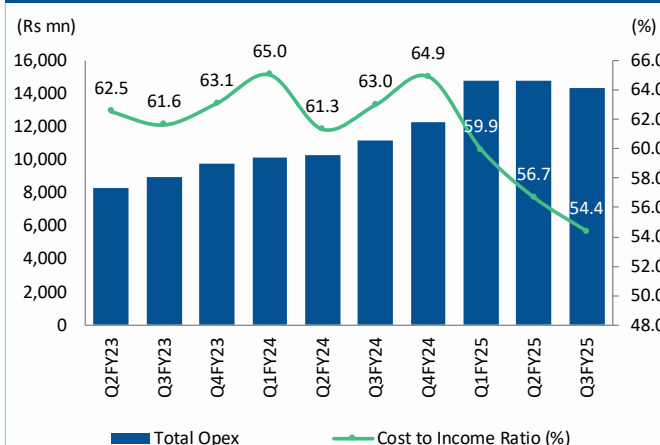
Source: Company, LKP Research

Exhibit 7: Yields and Margin Trend


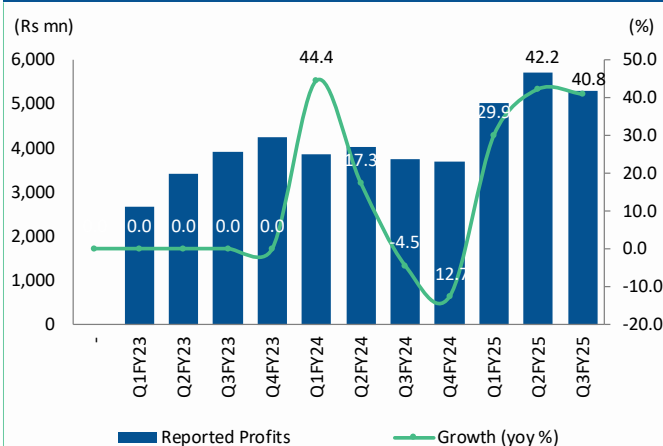
Source: Company, LKP Research

Exhibit 8: Other Income Trend

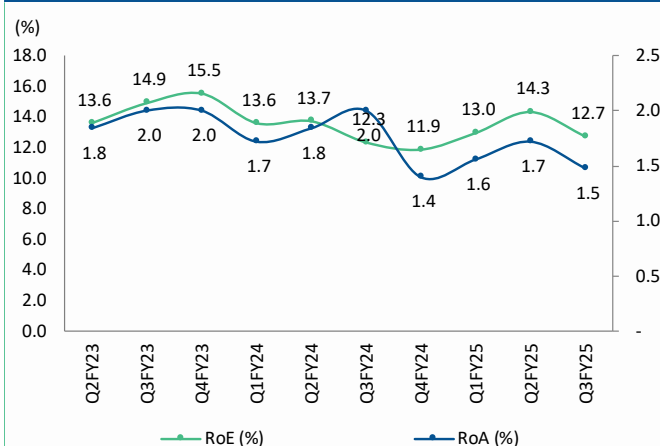

Source: Company, LKP Research

Exhibit 9: Total OPEX Trend


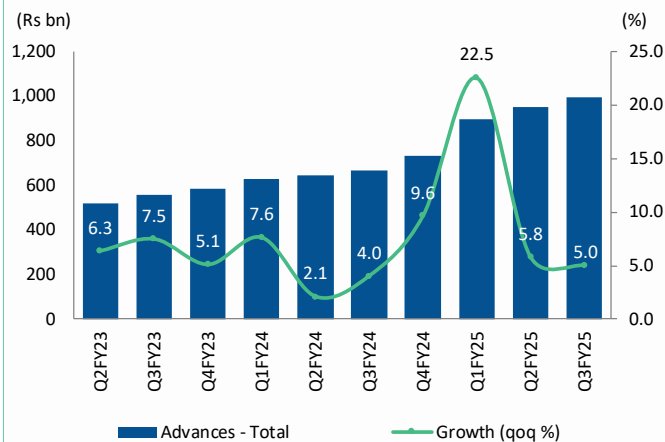
Source: Company, LKP Research

Exhibit 10: Reported Profit Trend


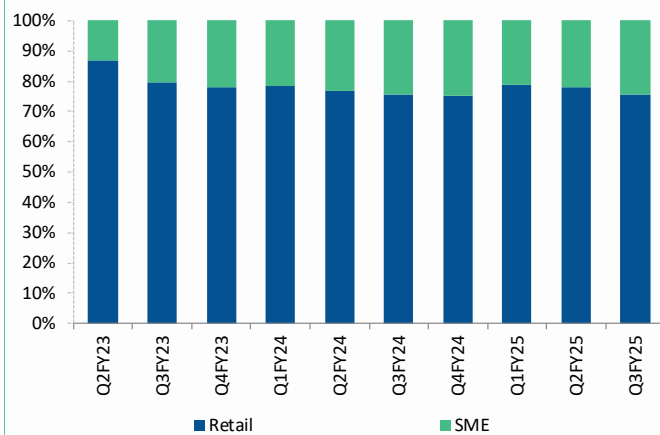
Source: Company, LKP Research

Exhibit 11: Return Ratio Trend


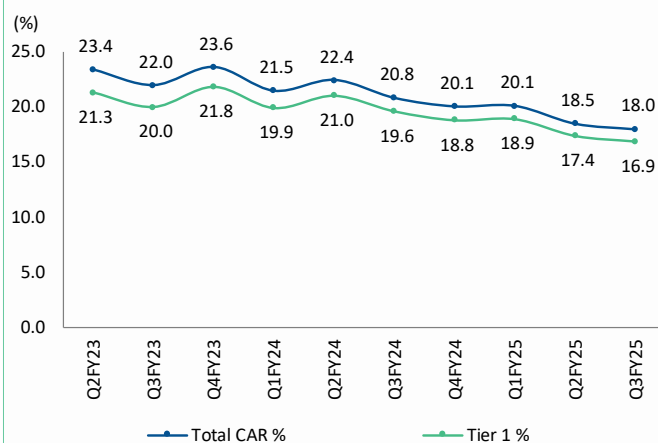
Source: Company, LKP Research

Exhibit 12: Loan Book Trend


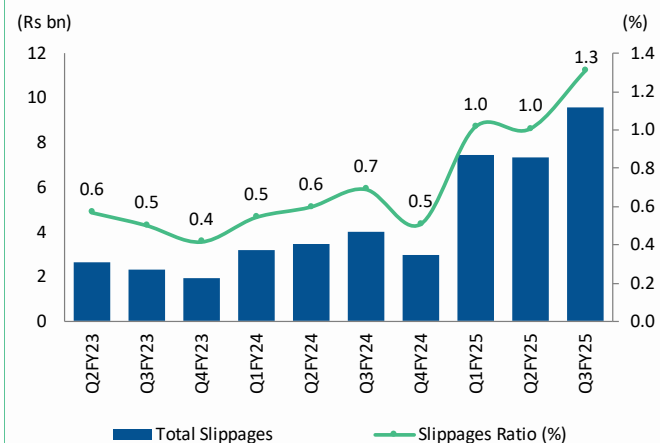
Source: Company, LKP Research

Exhibit 13: Loan Book Mix


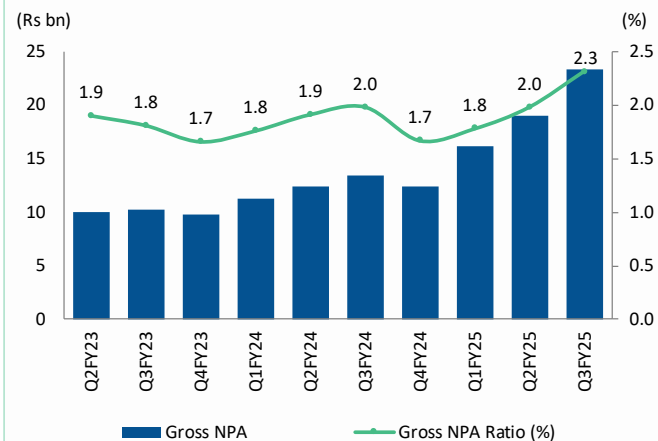
Source: Company, LKP Research

Exhibit 14: CAR & Tier 1 Ratio Trend


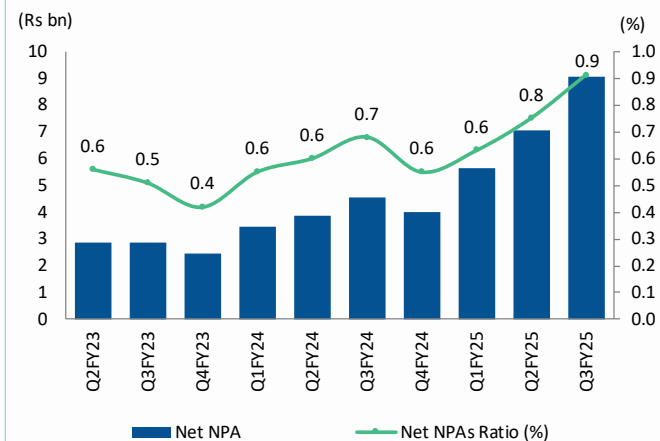
Source: Company, LKP Research

Exhibit 15: Slippages


Source: Company, LKP Research

Exhibit 16: Gross NPA Trend


Source: Company, LKP Research

Exhibit 17: Net NPA Trend


Source: Company, LKP Research

Annual Projections

Exhibit 18: Profit and Loss Statement

(₹ mn)	FY23	FY24	FY25E	FY26E	FY27E
Int. Income	82,054	1,05,547	1,54,557	1,97,612	2,37,096
Interest Expenses	37,801	53,976	79,856	1,02,296	1,22,384
Net Interest Income	44,253	51,571	74,700	95,316	1,14,712
<i>NIM (%)</i>	5.7	5.3	5.9	5.8	5.8
Other Income - Total	10,345	17,459	24,800	33,113	43,356
Net Operating Revenue	54,597	69,030	99,501	1,28,429	1,58,068
Employee Exp.	17,930	21,037	29,893	39,280	49,139
Other Opex	16,472	22,843	27,640	32,643	37,638
Total Opex	34,403	43,880	57,534	71,923	86,777
C/I Ratio	63.01	63.57	57.82	56.00	54.90
Pre Provision Profits	20,195	25,150	41,967	56,506	71,291
<i>PPP Growth (yoy %)</i>	11.3	24.5	66.9	34.6	26.2
Provisions & Contingencies - Total	1,548	4,387	15,682	18,878	21,726
Credit Cost (As % of Op. AUM)	0.28	0.62	1.50	1.35	1.30
Profit Before Tax	18,646	19,994	26,285	37,628	49,565
Tax	4,367	4,647	6,353	9,095	11,980
Effective Tax Rate	23.4	24.2	24.2	24.2	24.2
Reported Profits	14,279	15,347	19,932	28,533	37,585
<i>PAT Growth (yoy %)</i>	26.4	7.5	29.9	43.2	31.7

Source: Company, LKP Research

Exhibit 19: Balance Sheet

(₹ mn)	FY23	FY24	FY25E	FY26E	FY27E
Equity Share Capital	6,667	6,692	7,435	7,435	7,435
Reserves (ex Revel. Reserve)	1,02,666	1,18,276	1,57,130	1,85,663	2,23,248
Net Worth - Ex Revaluation	1,09,333	1,24,968	1,64,565	1,93,098	2,30,684
Equity Warrant & Other	440	627	932	932	932
Deposits	6,93,650	8,71,821	11,97,530	15,02,620	18,14,138
Borrowings	62,987	54,794	1,04,133	1,06,181	1,19,911
Interest Bearing Liabilities	7,56,636	9,26,615	13,01,663	16,08,801	19,34,049
Other Lia. & Prov.	35,751	42,046	48,353	54,204	58,649
Total Liabilities	9,02,161	10,94,257	15,15,514	18,57,036	22,24,313
Assets					
Cash & Cash Equivalent	94,252	63,763	93,217	1,07,859	1,34,165
Investments	2,00,720	2,71,334	3,47,981	4,25,656	5,10,728
Credit Equivalent	41,454	56,038	57,719	59,451	61,234
Loans & Advances	5,84,215	7,31,627	10,34,520	12,72,460	15,14,227
Fixed Assets	7,401	8,516	11,441	14,768	19,825
Other Assets	15,573	19,017	28,355	36,294	45,368
Total Assets	9,02,161	10,94,257	15,15,514	18,57,036	22,24,313

Source: Company, LKP Research

Exhibit 20: Detailed ROA Tree

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
<u>Yields / Margins</u>					
Yield on Advance	13.1	12.8	14.3	14.1	14.0
Yield on Funds	10.6	10.8	12.2	12.0	12.0
Cost of Funds (CoF)	5.6	6.4	7.2	7.0	6.9
Interest Spread	4.9	4.4	5.0	5.0	5.1
NIM's	5.7	5.3	5.9	5.8	5.8
Interest Income / Assets	10.3	10.6	11.8	11.7	11.6
Interest Exp. / Assets	4.7	5.4	6.1	6.1	6.0
NII / Assets	5.6	5.2	5.7	5.7	5.6
Fee Income / Assets	1.2	1.6	1.8	1.9	2.1
Other Non Core Income / Assets	(0.1)	0.1	0.0	0.0	0.0
Other Income / Assets	1.3	1.7	1.9	2.0	2.1
Net Operating Income / Assets	6.9	6.9	7.6	7.6	7.7
<u>Operating Ratios</u>					
NII to Net Operative Income	81.1	74.7	75.1	74.2	72.6
Other Income to Net Operative Income	18.9	25.3	24.9	25.8	27.4
Empl. Cost/Oper. Exps.	52.1	47.9	52.0	54.6	56.6
Other Op. Exps./Oper. Exps.	47.9	52.1	48.0	45.4	43.4
C/I Ratio	63.0	63.6	57.8	56.0	54.9
Provisions as % PPP	2.8	6.4	15.8	14.7	13.7
Credit Cost (As % of Op. AUM)	0.3	0.6	1.5	1.4	1.3
Effective Tax Rate	23.4	24.2	24.2	24.2	24.2
Employee Exp. / Assets	2.3	2.1	2.3	2.3	2.4
Other Opex/ Assets	2.1	2.3	2.1	1.9	1.8
Total Opex / Assets	4.3	4.4	4.4	4.3	4.3
Operating Profits / Assets	2.5	2.5	3.2	3.4	3.5
Exceptional Items / Assets	-	(0.1)	-	-	-
Op Profit ex Except Items / Assets	2.5	2.4	3.2	3.4	3.5
Provisions / Assets	0.2	0.4	1.2	1.1	1.1
Profit Before Tax / Assets	2.3	2.0	2.0	2.2	2.4
Tax Expenses / Assets	0.5	0.5	0.5	0.5	0.6
RoA	1.8	1.5	1.5	1.7	1.8
Leverage (x)	8.3	8.8	9.2	9.6	9.6
RoE	15.5	13.1	13.8	16.0	17.7
Adj. RoA	1.8	1.4	1.5	1.7	1.8
Adj. RoE	15.5	11.8	13.8	16.0	17.7

Source: Company, LKP Research

Exhibit 21: Per share data

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Face Value	10	10	10	10	10
Adjusted Share O/S - For Calculation	667	669	744	744	744
Earnings Per Share	21.4	22.9	26.8	38.4	50.5
EPS (% YoY)	(40.3)	7.1	16.9	43.2	31.7
P/E (x)	27.7	25.9	22.2	15.5	11.7
Adj. EPS	21.4	21.8	26.8	38.4	50.5
Adj. EPS (% YoY)	(40.3)	1.7	23.0	43.2	31.7
Adj. Price-Earnings (x)	27.7	27.3	22.2	15.5	11.7
Book Value	164.0	186.8	221.3	259.7	310.3
BVPS (% YoY)	(30.9)	13.9	18.5	17.3	19.5
P/BV (x)	3.6	3.2	2.7	2.3	1.9
Adj. BV	162.1	183.8	218.6	257.0	307.6
Adj. BV (% YoY)	(30.6)	13.3	19.0	17.6	19.7
P/ABV (x)	3.7	3.2	2.7	2.3	1.9

Source: Company, LKP Research

Exhibit 22: Credit Quality

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Slippage Ratio	2.0	2.3	2.6	2.0	1.4
Gross NPA (Cl Bal)	9,813	12,374	20,351	25,650	28,602
Gross NPAs Ratio (%)	1.7	1.7	2.1	2.0	1.9
PCR (%)	75.0	67.6	59.5	64.6	64.9
Net NPA (Cl. Bal.)	2,452	4,010	8,245	9,083	10,047
Net NPAs Ratio (%)	0.4	0.4	0.8	0.7	0.7
Total Impaired Loans	9,813	12,374	20,351	25,650	28,602
Impaired Loan as % of Loan / AUM	1.6	1.6	1.9	1.9	1.8
Total Risk Reserves	7,362	8,364	12,106	16,567	18,555
Total Risk As % of Loan Book	1.2	1.1	1.1	1.2	1.2

Source: Company, LKP Research

Exhibit 23: Capital and Asset-Liability Profile (%)

Y/E Mar	FY23	FY24	FY25E	FY26E	FY27E
Risk Weighted Assets	4,89,852	5,94,341	8,22,218	10,06,225	12,02,985
RWA as % of Total Assets	54.3	54.3	54.3	54.2	54.1
Total Shareholders' Equity to Assets	12.1	11.4	10.9	10.4	10.4
CET 1 Ratio	21.8	20.5	19.5	18.8	18.7
Tier 1 Ratio	21.8	20.5	19.5	18.8	18.7
Total CAR Ratio	21.8	20.5	19.5	18.8	18.7

Source: Company, LKP Research

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