Stock Update

Result Update

AU Small Finance Bank Ltd

Upgrade to Buy on brighter outlook

Bank	Sharekhan code: AUBANK	
Reco/View: Buy ↑	CMP: Rs. 613	Price Target: Rs. 750 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↑	

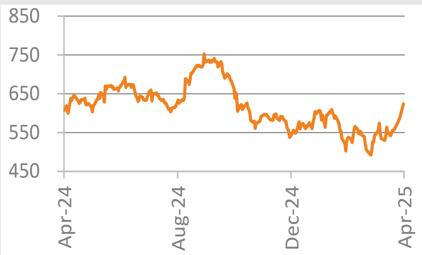
Company details

Market cap:	Rs. 45,629 cr
52-week high/low:	Rs. 755/ 479
NSE volume: (No of shares)	29.7 lakh
BSE code:	540611
NSE code:	AUBANK
Free float: (No of shares)	56.0 cr

Shareholding (%)

Promoters	22.9
FII	35.6
DII	27.2
Others	14.4

Price chart



Source: NSE India, Mirae Asset Sharekhan Research

Price performance

(%)	1m	3m	6m	12m
Absolute	12.9	1.5	-4.1	0.8
Relative to Sensex	9.5	-2.5	-3.1	-7.1

Source: Mirae Asset Sharekhan Research, Bloomberg

Summary

- Overall, FY25 has been tough for the bank on higher interest rates, tight liquidity, and high stress in unsecured loans, but we believe profitability/ return ratios have broadly bottomed out.
- Although Q4 earnings missed estimates on accelerated provisioning for unsecured loans, the PCR surged. Asset quality improved with slippages declining q-o-q however slippages still remained on the higher side.
- Policy tailwinds, better liquidity, likely peaking out of stress in H1FY26 would aid profitability in FY26E. The bank is reasonably confident that improvement will be largely seen in H2FY26 led by a lower repo rate and normalisation of credit cost. Guidance on growth remained intact at 20-25%.
- We upgrade our rating on the stock from Hold to Buy with a revised PT of Rs. 750 given steady growth outlook and improving profitability. RoA likely to expand by 20-30 bps over FY25-27E. The stock trades at 2.3x/2.0x its FY2026E/ FY2027E ABV estimates.

FY25 has been weak for the bank marked by elevated stress in unsecured retail loans resulting in a sharp increase in credit costs, higher interest rates and tight liquidity. Q4 earnings missed estimates led by accelerated provisioning on account of the stress in unsecured loans, yet PCR improved. Asset quality improved with slippages declining q-o-q however slippages still remained on the higher side. Numbers on a y-o-y are not comparable as this is the fourth quarter after merger. Net interest income (NII) at Rs. 2,094 crore (in line) grew 57% y-o-y/ 4% q-o-q. NIMs fell by ~6 bps q-o-q reported at 5.79%. Core fee income grew by 20% y-o-y/ 15% q-o-q aided by higher forex/ distribution/ processing fee income. The bank reported a treasury profit of Rs. 103 crore vs Rs. 46 crore in the last quarter and Rs. 8 crore in Q4FY2024. Opex growth was higher at ~27% y-o-y/ 9% q-o-q. PPoP at Rs. 1,292 crore (in-line), grew 95% y-o-y/ 7% q-o-q mainly led by higher other income offsetting higher opex. Core PPoP grew by 3% q-o-q. Provisions increased by 379% y-o-y/ 27% q-o-q. Credit cost stood at 1.7% annualised (as a percentage of avg. assets) vs 1.4% q-o-q. PAT at Rs. 504 crore (up 36% y-o-y/ down 5% q-o-q) was below estimates, led by higher credit cost. Net advances rose by 8% q-o-q. Deposits grew by 11% q-o-q. CASA grew by 5% q-o-q. Retail term deposits grew by 5% q-o-q while wholesale bulk deposits grew by 23% q-o-q. Share of total retail deposits fell to 62% vs 65% q-o-q. Headline asset quality ratios improved with GNPA/ NNPA ratio at 2.28%/ 0.74% vs 2.31%/ 0.91% q-o-q. PCR at 68% versus 61% q-o-q. Restructured book stood at 0.3% of gross advances stable q-o-q. Gross slippages were lower at 3.3% of net advances vs 3.8% q-o-q. Net slippages were also lower at Rs. 530 crore vs Rs. 687 crore q-o-q. SMA book for MFI segment at 3.7% vs 4.4% q-o-q. 16% of the MFI portfolio is affected by MFIN 2.0 guidelines (~13% loans has >3 lenders and remainder have total unsecured exposure > Rs.2 Lakh). Credit cost for credit card and MFI segment was at 11% & 7.75% in FY25. The bank made an accelerated provision of Rs 150 crore in Q4 (primarily in unsecured) to strengthen provision coverage. Slippages in unsecured loans have started to peak out with March month witnessing strong collection and resolution across buckets. The bank is reasonably confident that improvement will be largely seen in H2FY26 led by lower policy rate (supporting NIMs as 70% book is fixed rate in nature) along with normalisation of credit cost.

Key positives

- Higher core fee income and treasury gains aided operating profits.
- Policy tailwinds, better system liquidity, stress likely to peak out in H1FY26 are likely to aid profitability in FY26E. improvement will be largely seen in H2FY26 led by lower policy rate and normalization of credit cost. Guidance on growth remained intact at 20-25%.

Key negatives

- Elevated credit cost (as % of avg assets) at 1.7% vs 1.4% q-o-q.
- Cost to Avg assets ratio increased to 4.2% 4.1% q-o-q.
- Deposit growth was supported by bulk deposits.

Management Commentary

- The bank is confident of growing the loan book at 20-25% in FY26E. Deposit growth is expected to be in similar lines. The bank aims to maintain the cost to ~ 60%, while building out tech and distribution capabilities.
- Profitability outlook is expected to improve from H2FY26 onwards. Policy tailwind, improving system liquidity, stress likely to peak out by H1FY26 are likely to aid profitability in FY26E.
- Lower repo rate (supporting NIMs as 70% book is fixed in nature) and normalization of credit cost will support profitability in H2FY26. Currently, the bank has cut term deposit rates & savings deposit rate by 25 bps. NIM may remain under pressure in H1.
- Going forward, most MFI disbursements will be under CGFMU with target to have >75% book under coverage. Currently ~36% of total portfolio is covered under the CGFMU.
- Credit costs (based on average assets) is expected to decline from 1.3% in FY25 to 85 bps in FY26 and 75bp in FY27. Provisioning coverage on MFI portfolio is ~100%.
- Credit cost on secured assets (retail and commercial) is broadly in line with the long-term average. MFI business will take two more quarters in terms of credit cost normalcy. Credit costs on credit cards should be in the range of 6-7% by H2FY26.

Our Call

Valuation – Upgrade to buy with a revised PT of Rs. 750: Overall FY25 has been tough for the bank due to higher interest rates, tight liquidity, and elevated stress in unsecured segment but we believe profitability/ return ratios have broadly bottomed out. Policy tailwinds, improving system liquidity, stress in unsecured loans likely to peak out in H1FY26 are likely to aid profitability in FY26E. The bank is reasonably confident that improvement will be largely seen in H2FY26 led by lower policy rate and normalization of credit cost. Guidance on growth remained intact at 20-25%. We upgrade our rating on the stock from Hold to Buy with a revised PT of Rs. 750 given steady growth outlook and improving profitability. RoA likely to expand by 20-30 bps over FY25-27E, led by lower credit cost and marginally higher NIMs. The stock trades at 2.3x/2.0x its FY2026E/FY2027E ABV estimates. Risk-reward is favorable..

Key Risks

Lower than-expected growth in advances, lower margins and higher credit cost than expected.

Valuation (Standalone) Rs cr

Particulars	FY23	FY24	FY25	FY26E	FY27E
Net Interest Income	4,425	5,157	8,012	9,655	12,268
Net profit	1,428	1,535	2,106	2,934	3,929
EPS (Rs.)	21.9	23.0	28.3	39.1	52.4
P/E (x)	28.0	26.7	21.6	15.7	11.7
P/BV (x)	3.8	3.3	2.8	2.3	2.0
RoE	15.4	13.5	13.1	15.7	17.8
RoA	1.8	1.6	1.5	1.7	1.8

Source: Company; Mirae Asset Sharekhan estimates

Result Table Rs cr

Particulars	4QFY25	4QFY24	3QFY25	Y-o-Y	Q-o-Q
Interest Inc.	4,271	2,829	4,113	51%	4%
Interest Expenses	2,177	1,492	2,091	46%	4%
Net Interest Income	**2,094**	**1,337**	**2,023**	**57%**	**4%**
NIM (%)	5.8	5.1	5.9	14%	-2%
Core Fee Income	658	548	572	20%	15%
Other Income	103	8	46	1247%	121%
Net Income	**2,855**	**1,893**	**2,641**	**51%**	**8%**
Employee Expenses	817	556	755	47%	8%
Other Opex	745	673	682	11%	9%
Total Opex	**1,562**	**1,228**	**1,436**	**27%**	**9%**
Cost to Income Ratio	54.7%	64.9%	54.4%		
Pre Provision Profits	**1,292**	**664**	**1,205**	**95%**	**7%**
Provisions & Contingencies - Total	635	133	502	379%	27%
Profit Before Tax	**657**	**532**	**703**	**24%**	**-7%**
Extraordinary item		77			
Tax	153	84	175	82%	-12%
Effective Tax Rate	23%	16%	25%		
Reported Profits	**504**	**371**	**528**	**36%**	**-5%**
Basic EPS (Rs)	6.8	5.5	7.1	22%	-5%
Diluted EPS (Rs)	6.8	5.5	7.1	22%	-5%
RoA (%)	1.4	1.4	1.5		
Advances	1,07,092	73,163	99,559	46%	8%
Deposits	1,24,269	87,182	1,12,260	43%	11%
Gross NPA	**2,477**	**1,237**	**2,336**	**100%**	**6%**
Gross NPA Ratio (%)	2.28	1.67	2.31		
Net NPA	**791**	**401**	**906**	**97%**	**-13%**
Net NPAs Ratio (%)	0.74	0.55	0.91		
PCR - Calculated	68.1%	67.6%	61.2%		

Source: Company; Mirae Asset Sharekhan Research; Note: YoY numbers are not comparable

Outlook and Valuation

Sector Outlook – Deposit mobilisation, NIMs and asset quality to be in focus

Deposit mobilisation and asset quality to be in focus System credit growth is slowing and has declined to ~11.4% y-o-y from 16.4% in FY2024 as per the latest fortnight data, mainly driven by slower deposit growth, slowdown in unsecured retail segment and a high credit-deposit ratio. Deposit growth at 10.3% is lagging loan growth and stays rangebound at 10-12%. Moreover, deposit growth is mainly led by time deposits rather than CASA. Margins are expected to be under pressure due to the elevated cost of term deposits, while a lower interest rate cycle will lead to yield pressure. Overall, asset quality outlook is stable to positive for the sector, except for the unsecured retail loans and MFI segment. We believe banks with a robust capital base, strong asset quality, and healthy retail deposit franchises are well-placed to capture growth opportunities.

Company Outlook – Outlook improving

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-sets and a deep experience in its core secured segments. It entered the unsecured business to enhance its product offering/ geographic reach and use it as a key tool to accelerate and retain liability customer. However, its execution track record in scaling the unsecured portfolio has remained subpar so far, warranting a course correction. Management acknowledged the challenges and initiated corrective measures to improve performance. We believe profitability/ return ratios have broadly bottomed out. The bank is reasonably confident that improvement in profitability/ return ratio will be largely seen in H2FY26 led by lower policy rate and normalisation of credit cost. Growth outlook remains strong.

Valuation – Upgrade to buy with a revised PT of Rs. 750

Overall FY25 has been tough for the bank due to higher interest rates, tight liquidity, and elevated stress in unsecured segment but we believe profitability/ return ratios have broadly bottomed out. Policy tailwinds, improving system liquidity, stress in unsecured loans likely to peak out in H1FY26 are likely to aid profitability in FY26E. The bank is reasonably confident that improvement will be largely seen in H2FY26 led by lower policy rate and normalization of credit cost. Guidance on growth remained intact at 20-25%. We upgrade our rating on the stock from Hold to Buy with a revised PT of Rs. 750 given steady growth outlook and improving profitability. RoA likely to expand by 20-30 bps over FY25-27E, led by lower credit cost and marginally higher NIMs. The stock trades at 2.3x/2.0x its FY2026E/FY2027E ABV estimates. Risk-reward is favorable.

About company

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Investment theme

Its execution track record in scaling the unsecured portfolio has remained subpar so far warranting a course correction. Management acknowledged the challenges and initiated corrective measures to improve performance. We believe profitability/ return ratios have broadly bottomed out. The bank is reasonably confident that improvement in profitability/ return ratio will be largely seen in H2FY26 led by lower policy rate and normalization of credit cost. Growth outlook is strong.

Key Risks

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Additional Data

Key management personnel

Name	Designation
Sanjay Agarwal	Managing Director/CEO
Uttam Tibrewal	Deputy CEO and ED
Rajeev Yadav	Deputy CEO
Vimal Jain	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Agarwal Sanjay	15.74
2	HDFC Asset Management Co Ltd	5.65
3	Capital Group Cos Inc/The	5.54
4	CAMAS INV PTE LTD	3.62
5	Nippon Life India Asset Management	3.31
6	Agarwal Jyoti	3.17
7	DSP Investment Managers Pvt Ltd	2.59
8	Agarwal Shakuntala	2.50
9	Aditya Birla Sun Life Asset Manage	2.26
10	Blackrock Inc	2.18

Source: Bloomberg

Understanding the Mirae Asset 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: Mirae Asset Sharekhan Research

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