AU Small Finance Bank Ltd

MARKET PERFORMER

Sector: Banks/Mid Cap | Earnings Update – 2QFY22

2 November 2021

Background: AU SFB, initially incorporated as a vehicle finance company in 1996, was transformed into a Small Finance Bank in April 2017. The bank has presence in 15 states and 2 union territories, with 794 branches, 470 ATMs, 31 asset centers and ~6,59,904 loan accounts. The bank offers a comprehensive and tailor made range of products (both asset and liability) and services to cater to the needs of various businessmen (SME and MSME) and other middle and low income customers. Loan book of the bank grew at a CAGR of 36% over FY12 to FY20 and stood at ₹380bn as of 2QFY22 with a deposit base of ₹390bn.

Sensex	60,138
Nifty	17,929
Price	₹ 1,236
Target Price (12 months)	₹ 1,289
Recommendation	MARKET PERFORMER

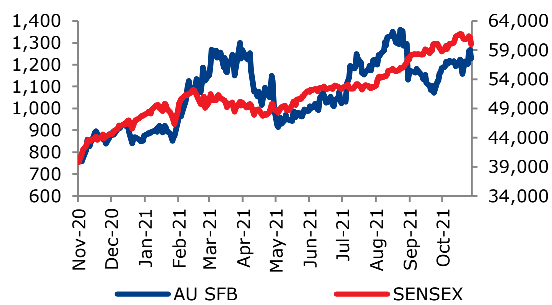
52 Week High/Low	₹1,389/723
Bloomberg / Reuters	AUBANK IN/ AUFI.NS
Equity (shares in mn)	313.1
Mkt. Cap in bn	₹ 408/ $ 5.4
Avg. Daily Vol. ('000)	1,736
Avg. Daily Vol. (mn)	₹ 2,263 /$ 30.2

Shareholding	Sep-20	Jun-21	Sep-21
Promoters (%)	29.0	28.4	28.4
FII (%)	30.6	31.9	32.5
DII (%)	15.6	21.4	20.9
Others (%)	24.9	18.3	18.3
Pledge (% of promoter holding)	0.0	0.0	0.0

Valuation Summary (₹ bn)

Y/E March	2021	2022E	2023E
Net Interest Inc	23.7	31.1	37.9
Other Inc	14.5	8.4	11.3
Pre Prov Profit	21.6	17.1	22.1
PAT	11.7	9.1	12.2
EPS (₹)	38.2	29.0	39.0
EPS growth (%)	72.1	-24.1	34.6
PE (X)	32.4	42.6	31.7
P /ABV (X)	7.0	5.8	4.8
Div Yield (%)	-	0.1	0.1
ROA (%)	1.3	1.5	1.8
ROE (%)	12.0	13.5	16.4
CAR (%)	22.7	21.5	21.5

Performance(%)	1M	3M	12M
AU SFB	5.0	1.9	56.9
SENSEX	-0.2	12.6	49.7



Stable quarter characterized by strong income growth and improved asset quality metrics; Robust CASA growth aids in keeping CoF low thereby enabling steady spreads; Management sees traction in wheels and home loans

- AU SFB's loan AUM increased by 24.3% YoY (3.8% QoQ) to ₹380bn in 2QFY22. The improvement in AUM was on account of strong quarterly disbursements of ₹51bn (171%/57% QoQ/YoY). The disbursement growth was led by robust performance in the 'Wheels' segment. The bank sees strong demand in Wheels and home loans segments.
- From a segment perspective, Wheels registered 86% YoY growth (₹19bn disbursement for 2QFY22) taking the segment AUM to ₹142bn. The used vehicle industry is in the phase of formalization and the bank is prepared to capitalize on this opportunity. The bank believes the industry mix between used and new cars is expected to reach 2:1 (vs 1.5:1 at present) in the next five years. However the bank's mix of used and new cars is only at 38% to 62% and expects this mix to improve to 50-50 in the near term. Wheels (37.5% of book) segment yields 14.4% (vs 13.8% for the total book) as on 2QFY22 making it an important driver of income for the bank.
- In 2QFY22 deposit registered a robust growth to ₹390bn compared to ₹372bn in 1QFY22 (up 54%/5% YoY/QoQ). The improvement in deposits was driven by conscious efforts to shed bulk deposits. The contribution of individual driven banking stood at 60% in 2QFY22 (vs 48% in 2QFY21). Meanwhile the continued strong CASA growth (122%/25% YoY/QoQ) was a clear positive led by savings deposits (138%/26% YoY/QoQ). The bank continues to focus on building granular deposits. This helped support CASA ratio further up to 30% in 2QFY22 (vs 20% in 2QFY21).
- NII improved by 4% to ₹7.5bn on a sequential basis, driven by improvement in yields. NIM held steady at 6% supported by low cost of funds (CoF). A strong growth in low-cost deposits aided improvement in CoF which stood at 6.2% (down 10 bps QoQ) in 2QFY22. The bank is confident of keeping the CoF low on account of improving CASA ratio and optimum prosing of the same. We believe this is likely to support margins going ahead.
- On asset quality, the GNPA improved to 3.2% in 2QFY22 (vs 4.3% in 1QFY22). This was on account of total slippages moderating towards pre-covid levels. Slippages for 2QFY22 was at ₹2.1bn (vs ₹2.5bn in 1QFY22) while strong recoveries of ₹5bn further supported asset quality improvement. The bank restructuring stood at ₹800mn (0.2% of book) during the quarter taking total restructured book to 3.6% of total book. The bank carries provisions of 3.3% of gross advances. However given the uncertainty in the restructured book and the bank's intent to strengthen balance sheet the credit costs are expected to be elevated in the coming quarters. On a positive side as most borrowers were self-employed with businesses opening the overall CE improved to pre-covid level and stood at 109% in 2QFY22. CE for July/Aug/Sept 2021 stood at 110%/107%/109%.
- The operating expense increased 45% YoY (21% QoQ) to ₹5.5bn in 2QFY22 on account of increase in hiring, branch expansion and investments in digital initiatives. This led to an increase in C/I ratio to 58% (~800bps QoQ) in 2QFY22. The bank intends to continue investing in technology. The C/I ratio is likely to stay elevated and range bound between 50-55% in the coming quarters.
- PAT at ₹2.8bn (down 13% YoY, +37% QoQ) improved sequentially as a result of lower credit costs. Given the experienced management, diversified loan mix/geographies and improved collection efficiency the bank remains well positioned to capitalize on the current macro environment.

Valuation: CASA growth coupled with improving disbursement yields should support NIMs in the short term. High provisions provide comfort for stress in the book. Improving fee income trend and recovery in AUM growth will support earnings for FY22E. With CE at robust pre-covid levels and management's focus to strengthen balance sheet, the bank is better positioned to continue its growth trajectory amidst the current crisis. However given the elevated C/I and uncertainty in the coming quarters on account of covid we believe the stock is fairly valued capturing the near term positives. The stock is currently trading at 4.8x P/ABV of FY23E. Assigning a P/ABV of 5x for FY23E, we arrive at a target of ₹1,289 thereby maintain our rating on the stock as MARKET PERFORMER.

Risks: Rising competition may put pressure on yields; asset quality deterioration owing to higher share of riskier segments; state specific issues may have greater impact owing to regional concentration.

Results Summary 2QFY22

Y/E March (₹ bn)	2QFY22	2QFY21	YoY Growth	1QFY22	QoQ Growth
Net Interest Income	7.5	5.6	34.3%	7.2	4.0%
Other Income	1.9	2.9	-33.2%	1.8	3.6%
Pre Provisioning Profit	3.9	4.7	-16.1%	4.5	-13.3%
PAT	2.8	3.2	-13.5%	2.0	37.1%
Cost / Income (%)	58.5	44.9		50.3	
Gross NPA (%)	3.2	1.5		4.3	
Net NPA (%)	1.7	0.5		2.3	
Prov Coverage Ratio (%)	49.0	71.1		49.0	
CAR (%)	22.0	21.5		23.1	

Arjun Prasad Pasumarthi **+91-44-40047363** **arjunpp@chola.murugappa.com**

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RESEARCH			
Kedar S Kadam	DGM & Head of Research	+91-44 - 4004 7361	kedarsk@chola.murugappa.com
Mugilan K	Technical Analyst	+91-44 - 4004 7353	mugilank@chola.murugappa.com
Arjun Prasad Pasumarthi	Fundamental Analyst	+91-44 - 4004 7363	arjunpp@chola.murugappa.com
Nilesh Patil	Fundamental Analyst	+91-44 - 4004 7366	nileshmp@chola.murugappa.com
Ammar Haider	Associate	+91-44 - 4004 7360	amarh@chola.murugappa.com
Balaji H	Compliance Officer	044-30007226	balajih@chola.murugappa.com
Gayathri Devi	Customer service	1800 425 4477	gayathrids@chola.murugappa.com