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AU Small Finance Bank Ltd

MARKET PERFORMER

Sector: Banks/Mid Cap | Earnings Update – 1QFY22

10 August 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 742 branches, 440 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 ₹366bn as of 1QFY22 with a deposit base of ₹359bn.

Sensex	54,554
Nifty	16,280
Price	₹ 1,304
Target Price (12 months)	₹ 1,289
Recommendation	MARKET PERFORMER

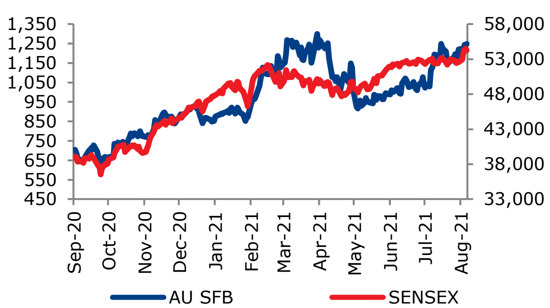
52 Week High/Low	₹1,356.3/616.3
Bloomberg / Reuters	AUBANK IN/ AUFI.NS
Equity (shares in mn)	312.9
Mkt. Cap in bn	₹ 395.5/ $ 5.3
Avg. Daily Vol. ('000)	1,650.4
Avg. Daily Vol. (mn)	₹ 2,086.1 /$ 28.1

Shareholding	Jun-20	Mar-21	Jun-21
Promoters (%)	29.0	28.5	28.4
FII (%)	30.0	32.1	31.9
DII (%)	13.5	20.5	21.4
Others (%)	27.5	18.9	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	31.2	38.4
Other Inc	14.5	8.6	11.4
Pre Prov Profit	21.6	18.3	22.4
PAT	11.7	9.3	12.4
EPS (₹)	38.2	29.8	39.7
EPS growth (%)	72.1	-22.1	33.3
PE (X)	34.1	43.8	32.9
P /ABV (X)	7.4	6.1	5.1
Div Yield (%)	-	0.1	0.1
ROA (%)	1.3	1.6	1.8
ROE (%)	12.0	13.8	16.6
CAR (%)	22.7	21.5	21.5

Performance(%)	1M	3M	12M
AU SFB	9.4	30.5	76.0
SENSEX	3.3	10.9	42.7



Healthy quarter characterized by strong income growth and improved C/I metrics; Robust CASA growth drives CoF down enabling steady spreads; Management expects C/I ratio to be range bound between 50-55%

- The bank's loan AUM increased by 22% YoY (down 3% QoQ) to ₹366bn in 1QFY22, the sequential decline was on account of lower disbursements (down 76% QoQ) due to covid restrictions. However disbursement picked up in July reaching ₹13bn led by 'Wheels'. The bank has forayed into new businesses such as credit cards and personal loans. During the quarter the bank issued 25,000+ cards. Management aims to focus more on small ticket loans and secured loan book. In the light of covid-19 there is rising preference for personal mobility and the bank expects Wheels segment to drive growth robustly. In addition the Home Finance, Agri and Business banking verticals are expected to drive growth in FY22.
- In 1QFY22 deposit registered a robust growth to ₹372bn compared to ₹359bn in 4QFY21 (up 40%/4% YoY/QoQ). The improvement in deposits was driven by conscious efforts to shed bulk deposits. The contribution of individual driven banking stood at 57% in 1QFY22 (vs 41% in 1QFY21). Meanwhile the continued strong CASA growth (145% YoY/ 15% QoQ) was a clear positive led by savings deposits (166% YoY/ 22% QoQ). The bank continues to focus on building granular deposits. This helped support CASA ratio further up to 26% in 1QFY22 (vs 16% in 1QFY21).
- On a sequential basis, NII improved by 10.4% QoQ to ₹7.2bn, driven by steady spreads. NIM registered a robust performance with an increase of 100bps YoY and stood at 6% in 1QFY22, primarily supported by low cost of funds (CoF). A strong growth in low-cost deposits aided improvement in CoF which stood at 6.3% (down 88 bps YoY) in 1QFY22. The bank has revised interest rates in SA (savings deposits) which is expected to further aid in reducing CoF. This is likely to support margins going ahead.
- On asset quality, the GNPA remained stable at 4.3% in 4QFY21 (vs 4.25% in 4QFY21) as total slippages moderated to ₹2.5bn (vs ₹12.4bn in 4QFY21). The bank carries provisions of 3.6% 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 101% in 1QFY22. CE for April/May/June/July 2021 stood at 95%/94%/114%/100%.
- The operating expense increased 54% YoY (down 72% QoQ) to ₹4.5bn in 1QFY22 on account of increase in hiring and investments in digital initiatives. However the robust increase in NII and sequential decline in opex led to an improvement in C/I ratio to 50.3% (down 960bps QoQ) in 1QFY22. 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.
- The total restructuring book during the quarter stood at ₹6.5bn (3.6% of loan book in 1QFY22 vs 1.8% in 4QFY21). The management observes that the restructuring requests have come down and are expected to further decline as Macro environment improves. PAT at ₹2bn (up 1.2% YoY, 20.3% QoQ) was a result of better operating performance and stable 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 expected rise in C/I and challenges facing disbursements 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 5.1x P/ABV of FY23E. Assigning a P/ABV of 5x for FY23E, we arrive at a target of ₹1,289 therby downgrade our rating on the stock to MARKET PERFORMER (Earlier: BUY).

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 1QFY22

Y/E March (₹ bn)	1QFY22	1QFY21	YoY Growth	4QFY21	QoQ Growth
Net Interest Income	7.2	5.2	40.4%	6.6	10.4%
Other Income	1.8	2.3	-18.4%	2.8	-33.4%
Pre Provisioning Profit	4.5	4.5	1.3%	3.7	20.7%
PAT	2.0	2.0	1.2%	1.7	20.3%
Cost / Income (%)	50.3	41.4		59.9	
Gross NPA (%)	4.3	1.7		4.3	
Net NPA (%)	2.3	0.6		2.2	
Prov Coverage Ratio (%)	49.0	63.7		50.0	
CAR (%)	23.1	21.7		23.4	

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