

**BUY**

TP: Rs 1,300 | ▲ 29%

**AU SMALL FINANCE  
BANK**

| Banking

| 01 May 2021

**Miss on asset quality**

**AU Small Finance Bank (AUBANK) reported below-estimated Q4FY21 PAT of Rs 1.7bn due to slower NII growth and one-off employee cost. Asset quality was weak with a 60bps QoQ rise in GNPA ratio to 4.3%. Collection efficiency in Apr'21 was also 5% lower than normal. We turn cautious on growth amid the second Covid wave and pare our FY22/FY23 loan book estimates while raising credit cost assumptions, leading to a 16%/12% cut in earnings. We also lower our target FY23E P/BV from 5.3x to 4.8x, yielding a new Mar'22 TP of Rs 1,300 (vs. Rs 1,500).**

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**Sharp deterioration in asset quality:** AUBANK's GNPA ratio rose to 4.3%, which includes 1.5% from a pool of customers who were tagged as NPA after the Supreme Court vacated its stay on NPA classification. Management highlighted that this is a paying pool of customers and expects a large part of the bad debt to regularise as recovery initiatives kick in. Collection efficiency continues to show quarterly improvement but was 5% lower than the normal run-rate in Apr'21.

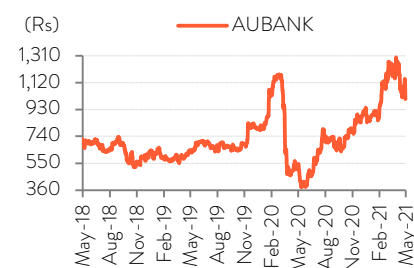
**Second pandemic wave may hurt growth:** AUM grew 22% YoY in Q4, the highest in four quarters as disbursements of vehicle, secured business and housing loans rebounded. But with severe stress emerging in Covid-hit segments such as taxis, school and private staff buses, loan growth could slow in Q1FY22.

**Continued traction in deposits:** Deposit growth momentum was strong at 38% YoY backed by a sharp increase in CASA deposits. NIM has been maintained around current levels of 5.3% over the last two years as the cost of funds has declined with an improving liability franchise.

**Maintain BUY:** We like AUBANK for its niche focus on small-ticket, secured retail loans to the self-employed and low-income segments. Maintain BUY with a revised Mar'22 TP of Rs 1,300 as long-term growth prospects remain promising.

Ticker/Price	AUBANK IN/Rs 1,004
Market cap	US\$ 4.2bn
Shares o/s	312mn
3M ADV	US\$ 22.1mn
52wk high/low	Rs 1,354/Rs 366
Promoter/FPI/DII	29%/33%/38%

Source: NSE

**STOCK PERFORMANCE**

Source: NSE

**KEY FINANCIALS**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Net interest income	13,425	19,089	23,654	28,324	36,230
NII growth (%)	42.7	42.2	23.9	19.7	27.9
Adj. net profit (Rs mn)	3,818	6,748	11,707	9,920	14,182
EPS (Rs)	13.2	22.6	38.0	31.8	45.4
P/E (x)	76.0	44.4	26.4	31.6	22.1
P/BV (x)	10.0	7.1	5.1	4.4	3.7
ROA (%)	1.5	1.8	2.5	1.7	2.0
ROE (%)	14.7	18.6	22.4	15.1	18.4

Source: Company, BOBCAPS Research | P – Provisional

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q4FY21	Q4FY20	Q3FY21	YoY (%)	QoQ (%)	FY21	FY20	YoY (%)
<b>Income Statement</b>								
Interest income	12,924	11,834	12,611	9.2	2.5	49,501	42,859	15.5
Interest expense	6,365	6,285	6,280	1.3	1.4	25,846	23,769	8.7
<b>Net interest income</b>	<b>6,558</b>	<b>5,549</b>	<b>6,331</b>	<b>18.2</b>	<b>3.6</b>	<b>23,654</b>	<b>19,089</b>	<b>23.9</b>
Non-interest income	2,766	1,831	6,634	51.1	(58.3)	14,515	7,061	105.6
<b>Net total income</b>	<b>9,325</b>	<b>7,381</b>	<b>12,965</b>	<b>26.3</b>	<b>(28.1)</b>	<b>38,170</b>	<b>26,150</b>	<b>46.0</b>
Staff expenses	3,368	2,045	2,398	64.7	40.5	9,802	7,596	29.0
Other operating expenses	2,218	2,178	1,839	1.8	20.6	6,783	6,582	3.0
Operating expenses	5,587	4,223	4,237	32.3	31.9	16,584	14,179	17.0
<b>Pre-provisioning profit</b>	<b>3,738</b>	<b>3,158</b>	<b>8,728</b>	<b>18.4</b>	<b>(57.2)</b>	<b>21,586</b>	<b>11,972</b>	<b>80.3</b>
Total provisions	1,778	1,506	2,836	18.1	(37.3)	7,001	2,832	147.2
Profit before tax	1,960	1,652	5,892	18.7	(66.7)	14,585	9,140	59.6
Tax	271	429	1,102	(36.9)	(75.5)	2,878	2,392	20.3
<b>Profit after tax</b>	<b>1,690</b>	<b>1,223</b>	<b>4,790</b>	<b>38.1</b>	<b>(64.7)</b>	<b>11,707</b>	<b>6,748</b>	<b>73.5</b>
<b>Balance Sheet</b>								
Advances	346,089	269,924	302,930	28.2	14.2	346,089	269,924	28.2
Deposits	359,793	261,639	297,080	37.5	21.1	359,793	261,639	37.5
CASA ratio (%)	23.0	14.5	21.7	853bps	130bps	23.0	14.5	853bps
<b>Yields and margins (%)</b>								
NIM (%) - AUM (calc)	5.3	5.7	5.7	(35bps)	(37bps)			
Yield on AUM (%) (calc)	11.3	13.0	12.2	(168bps)	(90bps)			
Cost of funds (%) (Calc)	6.4	7.8	7.0	(139bps)	(63bps)			
<b>Key ratios (%)</b>								
Cost/Income	59.9	57.2	32.7	270bps	2,723bps	43.4	54.2	(1,077bps)
Tax rate	13.8	26.0	18.7	(1,216bps)	(490bps)	19.7	26.2	(644bps)
Loan to Deposit ratio	96.2	103.2	102.0	(698bps)	(578bps)	96.2	103.2	(698bps)
<b>Capital adequacy ratios (%)</b>								
Tier 1	21.5	18.4	16.3	310bps	520bps	21.5	18.4	310bps
Total CAR	23.4	22.0	18.8	141bps	460bps	23.4	22.0	141bps
<b>Asset quality (Rs mn)</b>								
Gross NPAs	15,028	4,578	3,027	228.3	396.4	15,028	4,578	228.3
Net NPAs	7,555	2,173	727	247.7	939.2	7,555	2,173	247.7
Gross NPA ratio (%)*	4.3	1.7	1.0	257bps	326bps	4.3	1.7	257bps
Net NPA ratio (%)*	2.2	0.8	0.2	137bps	194bps	2.2	0.8	137bps
Credit costs (%)	2.1	2.0	3.7	12 bps	(157bps)	2.3	0.6	169bps
Coverage Ratio (%)	49.7	52.5	76.0	(280bps)	(2,626bps)	49.7	52.5	(280bps)

Source: Company, BOBCAPS Research | \*GNPA and NNPA ratio in Q3FY21 are on a proforma basis

## Valuation methodology

We like AUBANK for its niche focus on small-ticket, secured retail loans to the self-employed and low/mid-income segments. In our recent [initiation report](#), we were hopeful of recovery in the bank’s asset quality following its improved client activation and collection efficiency rates.

However, its asset quality has deteriorated sharply in Q4FY21 and AUBANK is the only one among banks and NBFCs to report a material spike in NPAs. Its asset quality may remain stressed in the near term in light of the recent resurgence of the pandemic. To factor in this impact, we pare our FY22-FY23 EPS estimates by 12-16% to bake in higher credit costs (140-100bps vs. 110-80bps earlier) and slower loan growth (21-25% vs. 23-27% earlier).

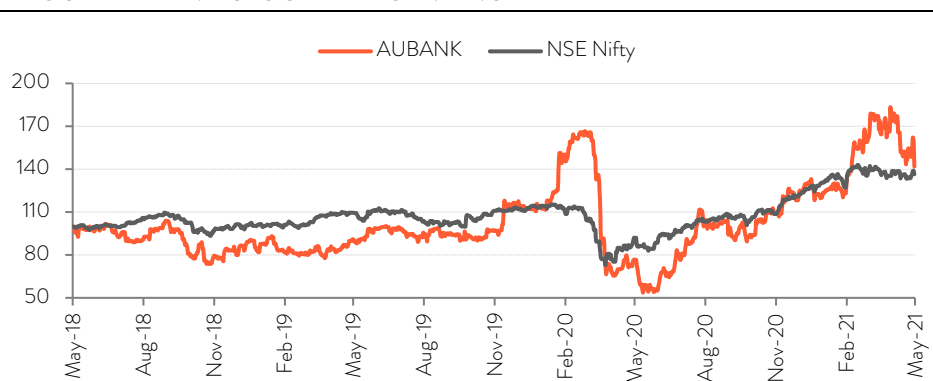
We also lower our target FY23E P/BV multiple from 5.3x to 4.8x to build in the potential impact of the Covid second wave. Retain BUY as the bank’s long-term growth prospects continue to look promising given its expertise in a large, under-served market comprising customers who are new to credit or have little access to formal loans. Regarding the recent resignation of its Chief Audit Officer (Internal Auditor), management has clarified that he is pursuing other growth opportunities.

**FIG 2 – REVISED ESTIMATES**

Particulars (Rs mn)	New		Old		Change (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Net interest income	28,324	36,230	29,425	37,221	(3.7)	(2.7)
Pre-provisioning profit	18,807	23,671	19,664	24,996	(4.4)	(5.3)
Net Profit	9,920	14,182	11,811	16,059	(16.0)	(11.7)
EPS (Rs)	32	45	38	51	(16.1)	(11.7)

Source: BOBCAPS Research

**FIG 3 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- Any delays in building a strong liability franchise, which is key to our growth and profitability assumptions, can adversely affect valuations.
- AUBANK's asset quality trajectory is dependent on broad-based economic recovery – any risks to this would affect our ROE outlook.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
<b>Net interest income</b>	<b>13,425</b>	<b>19,089</b>	<b>23,654</b>	<b>28,324</b>	<b>36,230</b>
NII growth (%)	42.7	42.2	23.9	19.7	27.9
Non-interest income	4,620	7,061	14,515	10,123	11,876
Total income	18,045	26,150	38,170	38,447	48,106
Operating expenses	10,826	14,179	16,584	19,640	24,435
Operating profit	7,219	11,972	21,586	18,807	23,671
Operating profit growth (%)	25.4	65.8	80.3	(12.9)	25.9
Provisions	1,418	2,832	7,001	5,545	4,711
PBT	5,801	9,140	14,585	13,261	18,960
Tax	1,983	2,392	2,878	3,342	4,778
<b>Reported net profit</b>	<b>3,818</b>	<b>6,748</b>	<b>11,707</b>	<b>9,920</b>	<b>14,182</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>3,818</b>	<b>6,748</b>	<b>11,707</b>	<b>9,920</b>	<b>14,182</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21P	FY22E	FY23E
Equity capital	2,924	3,041	3,122	3,122	3,122
Reserves & surplus	26,526	40,206	58,117	67,437	80,762
Net worth	29,449	43,247	61,240	70,560	83,884
Deposits	194,224	261,639	359,793	456,937	594,018
Borrowings	86,134	103,353	70,297	77,327	86,606
Other liabilities & provisions	14,241	12,670	23,071	24,686	27,154
<b>Total liabilities and equities</b>	<b>324,049</b>	<b>420,909</b>	<b>514,401</b>	<b>629,509</b>	<b>791,663</b>
Cash & bank balance	17,402	33,697	47,813	52,909	60,845
Investments	71,617	106,682	108,154	129,785	162,231
Advances	228,187	269,924	346,089	418,768	523,460
Fixed & Other assets	9,022	11,128	12,344	28,048	45,127
<b>Total assets</b>	<b>326,228</b>	<b>421,431</b>	<b>514,401</b>	<b>629,509</b>	<b>791,663</b>
Deposit growth (%)	145.1	34.7	37.5	27.0	30.0
Advances growth (%)	71.4	18.3	28.2	21.0	25.0

### Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21P	FY22E	FY23E
EPS	13.2	22.6	38.0	31.8	45.4
Dividend per share	0.5	0.9	0.0	1.6	2.3
Book value per share	100.7	142.2	196.1	226.0	268.7

Source: Company, BOBCAPS Research

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21P	FY22E	FY23E
P/E	76.0	44.4	26.4	31.6	22.1
P/BV	10.0	7.1	5.1	4.4	3.7
Dividend yield (%)	0.0	0.1	0.0	0.2	0.2

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21P	FY22E	FY23E
Net interest income	5.2	5.1	5.1	5.0	5.1
Non-interest income	1.8	1.9	3.1	1.8	1.7
Operating expenses	4.2	3.8	3.5	3.4	3.4
Pre-provisioning profit	2.8	3.2	4.6	3.3	3.3
Provisions	0.6	0.8	1.5	1.0	0.7
PBT	2.3	2.4	3.1	2.3	2.7
Tax	0.8	0.6	0.6	0.6	0.7
ROA	1.5	1.8	2.5	1.7	2.0
Leverage (x)	9.9	10.3	9.0	8.7	9.2
ROE	14.7	18.6	22.4	15.1	18.4

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
<b>YoY growth (%)</b>					
Net interest income	42.7	42.2	23.9	19.7	27.9
Pre-provisioning profit	25.4	65.8	80.3	(12.9)	25.9
EPS	28.9	71.3	67.9	(16.4)	43.0
<b>Profitability &amp; Return ratios (%)</b>					
Net interest margin	5.5	5.4	5.2	5.1	5.2
Fees / Avg. assets	1.2	1.1	1.1	1.2	1.3
Cost-Income	60.0	54.2	43.4	51.1	50.8
ROE	14.7	18.6	22.4	15.1	18.4
ROA	1.5	1.8	2.5	1.7	2.0
<b>Asset quality (%)</b>					
GNPA	2.0	1.7	2.8	2.7	2.2
NNPA	1.3	0.8	0.9	0.7	0.5
Credit cost	0.6	0.6	2.3	1.4	1.0
Provision coverage	37.4	52.5	69.4	75.0	79.3
<b>Ratios (%)</b>					
Credit-Deposit	117.5	103.2	96.2	91.6	88.1
Investment-Deposit	36.9	40.8	30.1	28.4	27.3
CAR	19.3	22.0	25.4	24.7	23.1
Tier-1	16.0	18.4	22.1	21.8	20.7

Source: Company, BOBCAPS Research

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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

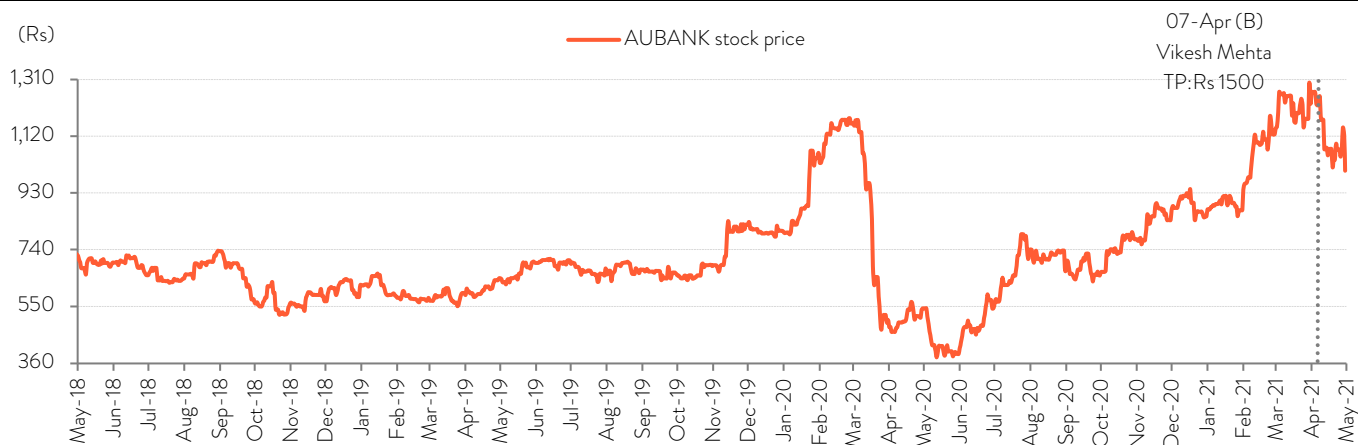
**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): AU SMALL FINANCE BANK (AUBANK IN)



B – Buy, A – Add, R – Reduce, S – Sell

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