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Company update and
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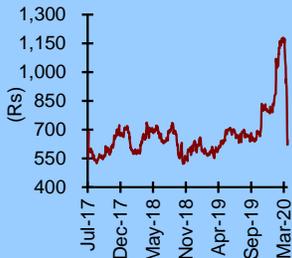
FINANCIALS

Target price: Rs1,330

Shareholding pattern

	Jun '19	Sep '19	Dec '19
Promoters	32.2	32.1	32.1
Institutional investors	38.4	41.8	42.3
MFs and UTI	11.8	12.6	11.76
FIs/Banks	0.0	0.1	0.0
Insurance co.	1.9	3.6	2.4
FIIIs	24.7	25.5	27.2
Others	29.4	26.1	26.7

Price chart



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INDIA

ICICI Securities

AU Small Finance Bank

BUY

Upgrade from Add

Rural/Semi-urban and local economy-based Business
model protecting asset quality

Rs648

AU Small Finance Bank (AU) hosted a business update call to share insights on: a) impact of COVID-19 on portfolio quality, and b) impact of recent developments on deposit accretion. Key takeaways: a) since COVID-19 impact is limited to metro and tier-1 cities as of now and given that AU's business model is largely focused on rural/semi-urban and local economics, the management expects asset portfolio quality to remain robust in Q4FY20E; b) AU's exposure to Rajasthan tourism is less than 15% of its total Rajasthan exposure and Q1 is normally a lean season; c) AU's exposure to M&HCV segment is only 1.5%; d) AU's exposure to wholesale deposits (>Rs500mn from HNIs, government, corporates, etc.) is less than 20% of total deposits, so it has witnessed minimal withdrawals in bulk deposits. Overall, the management highlighted that since COVID-19 impact on business aggravated only in the last 10-15 days, currently it is business as usual for them. However, the company will be closely watching the situation over next 15 days. Management is of the opinion that it is too early to comment on COVID-19 impact on FY21E outlook. Upgrade to BUY.

- **Rural/Semi-urban and local economy-based business model would help it to sustain asset quality.** Over the years, AU has built its franchise around rural/semi-urban markets and targeted customers whose cashflow is dependent on the local economy. Further, while expanding its balance sheet, the company always remained focused on building a granular secured portfolio. Vehicle (disbursed average ticket size: Rs0.3mn) and SME (Rs1mn) segments contributes ~76% of total AuM with average EMI around Rs15,000. In the current scenario, when COVID-19 impact is more aggravated in metro's and tier-1 cities, AU sounds confident of sustaining best-in-class asset quality in Q4FY20E. However, the management did highlight that customers whose cashflow is linked to tourism/taxi and who operate in metro's, might delay or default on one or two EMIs. But AU's experience suggests that once things normalise, customers clear all EMIs and real economic loss is minimal – even more so because the loans are highly collateralised. AU's exposure to taxi operators is ~20% of the vehicle finance book and spread across 11 states.
- **Exposure to bulk deposit is less than 20%; retail deposit traction unaffected thus far.** AU's exposure to wholesale deposits (deposits with >Rs500mn) is ~20% of its total deposit base. So far, it has witnessed minimal withdrawals in HNI and government categories and is closely tracking outflow on daily basis. Retail deposit mobilisation remains on track and ground feedback as of now is encouraging. In a worst case scenario, if deposit mobilisation gets impacted in coming days, AU's ability to source funds via refinancing/securitisation at competitive rates due to its retail focus, would ensure margin stability as well as growth momentum. However, in the current environment, preference would be towards quality than growth.

Market Cap	Rs197bn/US\$2.6bn
Reuters/Bloomberg	AUFI.BO/AUBANK IN
Shares Outstanding (mn)	304.1
52-week Range (Rs)	1180/552
Free Float (%)	67.9
FII (%)	27.2
Daily Volume (US\$/'000)	9,728
Absolute Return 3m (%)	(18.7)
Absolute Return 12m (%)	13.9
Sensex Return 3m (%)	(28.1)
Sensex Return 12m (%)	(21.2)

Year to March	2019	2020E	2021E	2022E
NII (Rs mn)	13,423	18,986	26,725	33,627
Net Profit (Rs mn)	3,818	7,588	9,823	12,629
EPS (Rs)	13.1	24.8	32.1	41.2
% Chg YoY	27.8	89.7	29.4	28.5
P/E (x)	49.6	26.1	20.2	15.7
P/BV (x)	6.3	4.5	3.7	3.2
Net NPA (%)	1.3	1.0	1.0	1.1
Dividend Yield (%)	0.1	0.5	0.3	0.6
RoA (%)	1.5	2.1	2.1	2.1
RoE (%)	14.0	20.1	20.3	21.8

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Other takeaways:

- Given current unease amongst HNIs and government in keeping deposits with private sector banks, bulk deposits might see some outflow during Q1FY21 but the management expects these deposits to flow back over time by Q2FY21 given that PSUs would find it challenging to match services offered by private sector banks.
- So far, the advances side is not showing sign of stress, but it is too early to comment on FY21E outlook.
- COVID-19 impact as of now is limited to metro cities; interior regions do not face any challenge from the pandemic and Yes Bank crisis.
- Action plan, if situation worsens from here: the management has initiated several measures under business continuity planning (BCP).
- Incremental flow from government and HNIs is likely to remain muted over the next one or two quarters.
- There is no change in branch expansion strategy.
- SBL book is completely normal; Q4FY20E would be better than Q3FY20.
- If the situation worsens from current level, high-ticket loans in SBL, CV and BB categories might get impacted.
- 98% of AU's advances is secured and ~99% of EMIs are in the form of ECS, PDC, etc.
- AU has created a niche in financing NBCs, especially in the self-employed segment. As per its historical trend, credit behaviour of these customers is better than the ones with 750+ score.
- AU's exposure to the tourism sector in Rajasthan is less than 15% of the state's outstanding book. Strategically, it does not fund the entire value chain. In addition, Q1 is normally a lean tourist season.

Financial summary

Table 1: Profit & loss statement

(Rs mn, year ending March 31)

	FY18	FY19	FY20E	FY21E	FY22E
Interest earned	17,672	29,488	42,812	56,421	72,583
Interest expended	8,267	16,066	23,825	29,696	38,957
Net interest income	9,405	13,423	18,986	26,725	33,627
			41%	41%	26%
Other income	3,881	4,620	6,842	7,200	9,400
Staff cost	4,249	6,011	7,497	8,977	11,116
Depreciation	533	639	767	920	1,104
Other operating expenses	2,745	4,174	5,481	7,986	10,673
Total operating cost	7,526	10,824	13,745	17,884	22,893
			27%	30%	28%
Pre-provisioning op profit	5,759	7,219	12,083	16,041	20,133
Provisions & contingencies	1,326	1,418	1,730	2,538	3,257
Profit before tax & exceptional items	4,433	5,801	10,353	13,502	16,877
Exceptional items	-	-	-	-	-
Profit before tax & exceptional items	4,433	5,801	10,353	13,502	16,877
Income taxes	1,513	1,983	2,765	3,680	4,248
PAT	2,920	3,818	7,588	9,823	12,629

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY18	FY19	FY20E	FY21E	FY22E
Capital	2,857	2,924	3,040	3,040	3,040
Reserves & surplus	19,955	28,705	40,846	49,939	59,650
Net worth	22,812	31,629	43,886	52,979	62,690
Total borrowings	1,55,622	2,80,358	3,37,428	4,47,413	6,00,266
Banks	43,107	54,173	57,896	81,200	1,01,238
NCDs/Bonds	33,147	24,391	16,671	10,150	12,655
Commercial papers/CDs	311	7,570	6,365	10,150	12,655
Term Deposits & CASA	79,055	1,94,224	2,56,495	3,45,914	4,73,718
Provisions	2,088	5,344	5,344	5,344	5,344
Other Liabilities	7,806	8,897	11,373	13,471	15,832
Total liabilities & stockholders' equity	1,88,328	3,26,228	3,98,031	5,19,208	6,84,132
Loans & advances	1,33,121	2,28,187	2,87,362	3,87,524	5,12,687
Investments	30,506	71,617	82,547	1,01,655	1,33,779
Cash and Balance	17,612	17,402	16,871	17,897	24,011
Fixed Assets	3,861	4,470	4,625	5,205	5,858
Current & other assets	3,227	4,552	6,626	6,927	7,796
Total Assets	1,88,328	3,26,228	3,98,031	5,19,208	6,84,132

Source: Company data, I-Sec research

Table 3: Key ratios

	FY18	FY19	FY20E	FY21E	FY22E
Growth (%):					
AUM	49.4	49.2	32.0	30.6	32.3
Disbursements	65.8	42.0	13.2	20.3	139.4
Loan book (on balance sheet)	97.6	72.2	25.2	34.9	32.3
Total Assets	91.9	73.2	22.0	30.4	31.8
Total Deposits	0.0	145.7	32.1	34.9	36.9
Total NDTL	120.1	80.2	20.4	32.6	34.2
Total Investments	41.9	134.8	15.3	23.1	31.6
Interest Income	28.6	66.9	45.2	31.8	28.6
Interest Expenses	65.2	94.3	48.3	24.6	31.2
Net Interest Income (NII)	7.7	42.7	41.5	40.8	25.8
Non-interest income	3567.9	19.1	48.1	5.2	30.6
Net Income	50.3	35.8	43.2	31.3	26.8
Total Non-Interest Expenses	82.6	52.1	31.3	45.7	33.6
Pre provisioning operating profits (PPoP)	7.6	25.3	67.4	32.8	25.5
PAT	-64.5	30.7	98.7	29.4	28.6
EPS	-66.0	30.7	98.7	29.4	28.6
CA		176.0	-6.0	57.5	47.9
SA		44.0	23.4	36.9	32.0
Time deposits		192.7	46.1	36.6	39.6
Yields, interest costs and spreads (%)					
NIM on AUM	7.0	6.7	6.8	7.3	7.0
Yield on loan assets	9.3	11.0	12.2	12.0	12.0
Average cost of funds	7.3	7.4	7.7	7.6	7.4
Interest Spread on loan assets	2.0	3.6	4.4	4.5	4.5
Operating efficiencies					
Non-interest income as % of net income	41.3	34.4	36.0	26.9	28.0
Cost to income ratio (%)	56.7	60.0	53.2	52.7	53.2
Op.costs/avg AUM (%)	5.6	5.4	5.0	4.9	4.8
No. of employees	11151	12623	15408	15808	15908
Average annual salary (Rs '000)	381.0	476.2	486.6	567.9	698.8
Salaries as % of non-int.costs (%)	56.5	55.5	54.5	50.2	48.6
AUM/employee(Rs mn)	14.4	19.0	20.5	26.1	34.3
Number of asset branches	97	83	36	56	61
AUM/asset branch(Rs mn)	1653.4	2882.0	8771.7	7361.8	8941.2
Balance Sheet Structure					
Loans/ deposits (%)	168.4	117.5	112.0	112.0	108.2
Loans/ Total assets	70.7	69.9	72.2	74.6	74.9
Loans/NDTL	85.5	81.4	85.2	86.6	85.4
CA% of NDTL	2.5	3.9	3.0	3.6	3.9
SA% of NDTL	11.2	8.9	9.2	9.5	9.3
CASA% of NDTL	13.7	12.8	12.2	13.1	13.3
Total deposits as % of NDTL	50.8	69.3	76.0	77.3	78.9
Capital Structure					
Leverage (x)	5.8	7.2	6.5	7.3	8.2
CAR (%)	19.3	19.3	20.8	18.7	17.1
Tier 1 CAR (%)	18.4	16.0	17.8	16.0	14.3
Tier 2 CAR (%)	0.9	3.3	3.0	2.8	2.8
Tier 1 Capital (Rs mn)	21,790	30,530	43,886	51,390	60,809
Tier 2 Capital (Rs mn)	1,050	6,410	7,403	8,852	11,664
RWA (Rs mn)	1,18,330	1,91,330	2,46,779	3,21,909	4,24,162
Asset quality and provisioning					
GNPA (%)	2.0	2.0	1.8	2.0	2.1
NNPA (%)	1.3	1.3	0.9	0.9	1.0
GNPA (Rs mn)	2697	4701	5029	7750	8705
NNPA (Rs mn)	1693	2945	2514	3643	4092
Coverage ratio (%)	37.2	37.4	50.0	53.0	53.0
Credit costs as % of average AUM	1.0	0.7	0.6	0.7	0.7
Return ratios					
RoAA (%)	2.0	1.5	2.1	2.1	2.1
RoAE (%)	13.7	14.0	20.1	20.3	21.8
Payout ratio (%)	4.9	0.0	0.0	0.0	0.0

	FY18	FY19	FY20E	FY21E	FY22E
Valuation Ratios					
EPS (Rs)	10.2	13.1	24.8	32.1	41.2
EPS fully diluted (Rs)	10.0	12.5	24.8	32.1	41.2
Price to Earnings	63.5	49.5	26.1	20.2	15.7
Price to Earnings (fully diluted)	64.8	51.8	26.1	20.2	15.7
Book Value (fully diluted)	78	103	143	173	205
Adjusted book value (fully diluted)	72	94	135	161	191
Price to Book	8.3	6.3	4.5	3.7	3.2
Price to Adjusted Book	9.0	6.9	4.8	4.0	3.4
DPS	0.5	0.8	3.0	2.0	4.0
Dividend yield (%)	0.1	0.1	0.5	0.3	0.6

Source: Company data, I-Sec research

Table 4: DuPont analysis (on average AUM)

	FY18	FY19	FY20E	FY21E	FY22E
Interest earned	12.3	11.5	11.8	12.3	12.1
Interest expended	5.8	6.2	6.6	6.5	6.5
Gross Interest Spread	6.6	5.2	5.2	5.8	5.6
Credit cost	0.9	0.6	0.5	0.6	0.5
Net Interest Spread	5.6	4.7	4.8	5.3	5.0
Operating cost	5.3	4.2	3.8	3.9	3.8
Lending spread	0.4	0.5	1.0	1.4	1.2
Non-interest income	2.7	1.8	1.9	1.6	1.6
Operating spread	3.1	2.3	2.9	2.9	2.8
Exceptional items	0.0	0.0	0.0	0.0	0.0
Final Spread	3.1	2.3	2.9	2.9	2.8
Tax rate (%)	1.1	0.8	0.8	0.8	0.7
ROAAUM	2.0	1.5	2.1	2.1	2.1
Effective leverage (AAUM/ AE)	6.7	9.5	9.6	9.5	10.4
RoAE	13.7	14.0	20.1	20.3	21.8

Source: Company data, I-Sec research

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