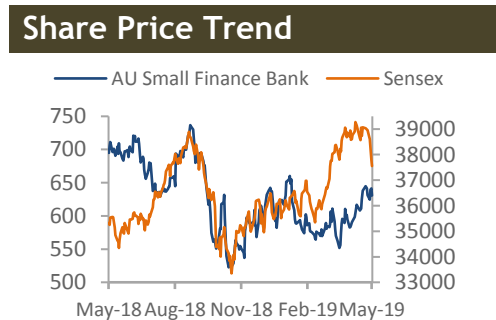


Sector	Banking
Recommendation	BUY
Upside	17%

Stock Data	
Sensex	37,559
52 Week h/l (₹)	745 / 502
Market cap (₹Cr)	18,471
BSE code	540611
NSE code	AUBANK
FV (₹)	10
Div yield (%)	0.08

Shareholding Pattern			
	Sept-18	Dec-18	Mar-19
Promoters	32.43	32.21	32.19
DII+FII	36.90	38.28	38.17
Individuals	30.68	29.51	29.63

Source: www.bseindia.com



Prices as on 09/05/2019

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May 10, 2019

AU Small Finance Bank (AU SFB) remains a play on industry leading loan growth, successful build up in liability franchise due to its banking license, lowering cost to income ratio and contained credit cost. Decline in funding costs as deposits build up, improving fee income due to cross-sell opportunities, operating leverage benefits and lower loan loss provisions will drive the bank's return ratios. We expect RoE to improve from 14.1% in FY19 to 17.1% in FY21E.

Strong loan growth of ~35% CAGR over FY19-21E

We forecast the bank's loan book to grow at ~35% CAGR over FY19-21E to ~Rs41,500cr. Its asset growth will be driven by both retail and wholesale loans. The key drivers of retail loans will continue to remain vehicle finance (42.1% of FY19 AUM) and MSME & SME (35.5% of FY19 AUM). These segments are well established in terms of scale, well laid sourcing, processing and collection infrastructure. Further, new products (1.7% of FY19 AUM) viz. gold loans, consumer durable loans, agriculture-SME and 2-wheeler loans will grow fast on a lower base. Within wholesale loans, NBFC funding and business banking will be high growth segments, as in real estate segment the bank is selective. The bank's higher capital adequacy ratio (19.3%) will also support loan growth.

Outlook & Valuations: We estimate AUM and PAT CAGR of ~35% and ~44% respectively over FY19-21E. This translates to FY21E RoA of 1.6% and RoE of ~17%. Though the stock is trading at ~3.8x FY21E P/BV, premium valuations are justified on the back of healthy ROE and better asset quality despite higher long growth. We value the stock at 4.5x FY21E P/BV and arrive at the target price of Rs741, implying an upside of 17% on CMP.

Financial summary

Consolidated (₹ cr)	FY18	FY19	FY20E	FY21E
NII	941	1,343	1,929	2,494
Total Income	1,329	1,805	2,543	3,305
PPOP	576	722	1,172	1,605
PAT	292	382	564	787
Growth (%) yoy	93.3	30.8	47.8	39.5
P/BV (x)	8.0	5.8	4.5	3.8
RoAE (%)	12.9	14.1	15.2	17.1
RoAA (%)	2.0	1.5	1.5	1.6

Source: Company, IIFL Research

Balance Sheet

Consolidated (₹ cr)	FY18	FY19	FY20E	FY21E
Shareholders' funds	2,264	3,163	4,246	4,981
Total Deposits	7,923	19,422	27,699	38,084
Total Borrowings	7,639	8,613	9,119	9,571
Other Liabilities, provisions	1,007	1,424	1,784	2,040
Total liabilities	18,833	32,623	42,848	54,676
Advances	13,312	22,819	31,337	41,497
Investments	3,051	7,162	8,142	9,576
Fixed assets	386	447	544	568
Other Assets	2,084	2,195	2,825	3,036
Total Assets	18,833	32,623	42,848	54,676

Source: Company, IIFL Research

Key Ratios

	FY18	FY19	FY20E	FY21E
Profitability Ratios (%)				
Net Interest Margin	5.9	5.3	5.3	5.3
ROAA	2.0	1.5	1.5	1.6
ROAE	12.9	14.1	15.2	17.1
P/E (x)	61.7	48.3	33.8	24.2
P/BV (x)	8.0	5.8	4.5	3.8
Efficiency Ratios (%)				
Cost to Income Ratio	56.7	60	54.6	53.5
Capital Adequacy Ratio (%)				
CAR	19.3	19.3	18.5	15.9
Assets Quality (%)				
Gross NPA	2.0	2.0	1.9	1.9
Credit Cost	1.0	0.7	1.1	1.0

Source: Company, IIFL Research

P&L

Consolidated (₹ cr)	FY18	FY19	FY20E	FY21E
Net interest income	941	1,343	1,929	2,494
Non-interest income	388	462	619	817
Total operating income	1,329	1,805	2,543	3,305
Total operating expenses	753	1,083	1,376	1,705
Pre provision operating profit	576	722	1,172	1,605
Provisions for loan losses	133	142	318	411
Profit before tax	443	580	859	1,199
Taxes	151	198	300	417
Net profit	292	382	564	787

Source: Company, IIFL Research

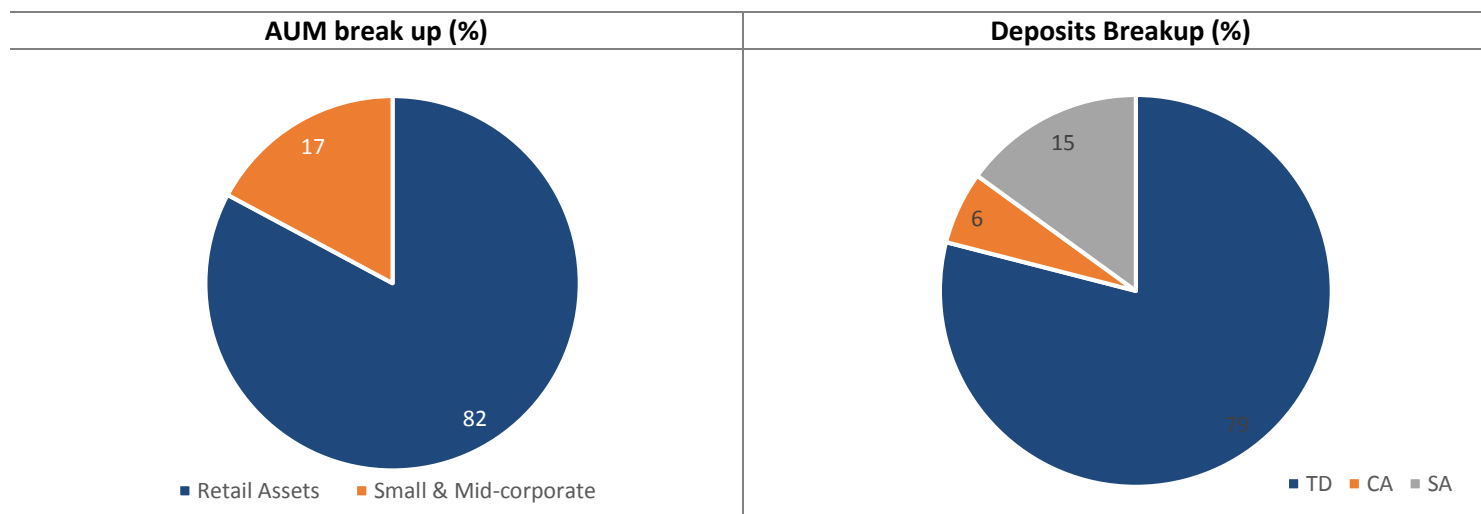
Dupont Analysis

	FY18	FY19	FY20E	FY21E
NII / Assets (%)	8.7	6.7	6.9	6.6
Other Income / Assets (%)	3.6	2.3	2.2	2.2
Total Income / Assets (%)	12.3	8.9	9.1	8.7
Cost / Assets (%)	6.9	5.4	4.9	4.5
PPOP / Assets (%)	5.3	3.6	4.2	4.2
Provisions / Assets (%)	1.2	0.7	1.1	1.1
PBT / Assets (%)	4.1	2.9	3.1	3.2
Tax rate (%)	34.1	34.2	34.5	34.5
ROA (%)	2.7	1.9	2.0	2.1
Leverage (%)	4.8	6.4	6.6	7.6
ROE (%)	12.9	12.1	13.3	15.8

Source: Company, IIFL Research

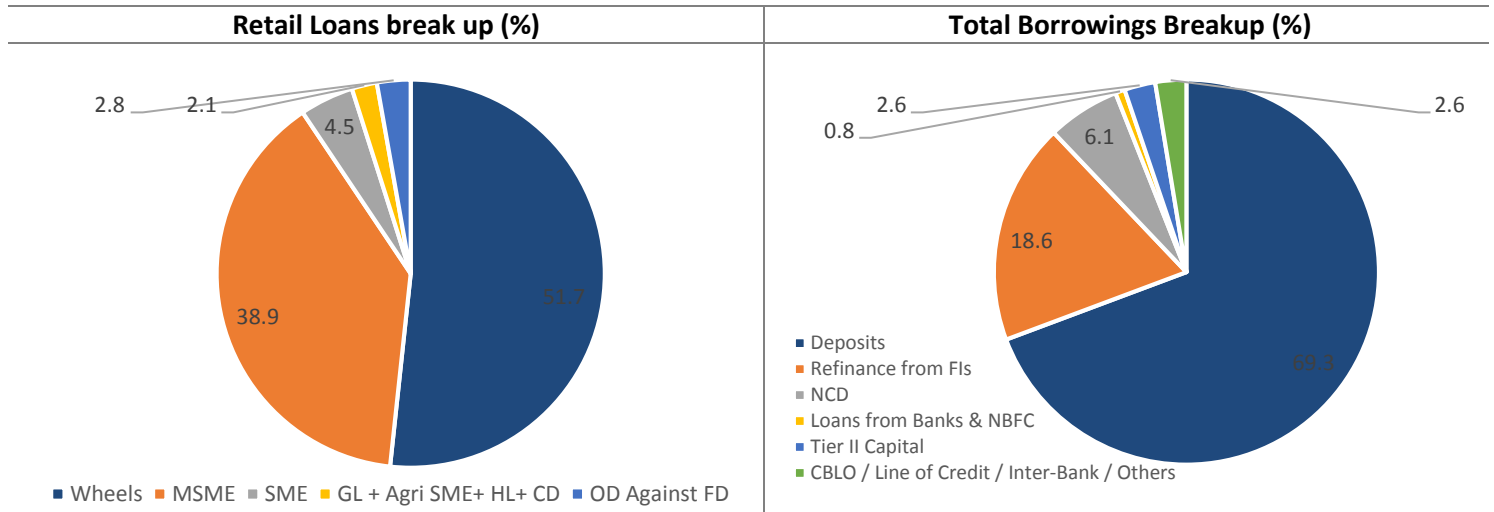
Company background

Incorporated in 1996, AU SFB is asset finance NBFC turned small finance bank. It offers retail loans (82% of FY19 AUM), which includes vehicle finance loan, secured business loans to MSMEs and SMEs, gold loans, agri-SME and consumer durable loans. It also offers wholesale loans (18% of FY19 AUM), which includes small and mid-corporate loans, including NBFC loans, real estate group loans and business banking loans. It commenced banking operations on April 19, 2017. As on FY19 end, AU SFB had 408 branches, 83 asset centers, 67 business correspondent agents across 11 states and one union territory (62% of its branches are in rural & semi urban Areas i.e. Tier 2 to Tier 6).



Source: Company, IIFL Research

As on FY19 end, AU SFB had gross AUM and total deposits totaling Rs24,246cr and Rs19,422cr respectively. Its GNPA and NNPA as of FY19 end stood at 2.0% and 1.3% respectively. The bank has an equity stake of about 7.2% in Aavas Financiers Limited (formerly AU Housing Finance Limited).



Source: Company, IIFL Research

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Focus on building deposit franchise to lower cost of funds

AU Banks's focus is on building granular retail deposit base, and as a result, on the liability front it has successfully scaled up its deposit base and is replacing the high cost of borrowings. Besides, it also helps it in getting sticky retail deposits, aiding the bank in its long term growth. The bank is already 69.3% funded by deposits as of FY19 end (50.9% in FY18 end), whereas the banks immediate aim is to replace most of the market borrowings with deposits. This would reduce the cost of funds and allow the bank to cross-sell assets and fee products to depositors. We estimate that AU SFB will become ~90% deposit-funded by FY21E.

Low cost distribution model and lower opex to check C/I ratio

AU SFB is witnessing improvement in operating efficiency from the last few quarters, its operating expenses as % of total assets has declined from 6.4% in Q4FY18 to 4% in Q4FY19. As a result, its cost to income ratio dropped from 62.7% in Q4FY18 to 58.3% in Q4FY19. We believe that its operating expenditure peaked in FY19 owing to an upfront opex. Further, operational synergies to keep costs under check through technological innovations (adopting a tech-heavy, customer-centric model against a branch expansion-led). After an aggressive expansion of bank branches, now management expects to slow down the pace of branch opening and hence cost to income ratio is likely to reduce going ahead with improvement in operational efficiency. While the bank will continue to open branches, it is now building a business correspondent (BC) model, which will allow it to reach deeper geographies at lower cost and be able to service customers.

Key Risks

- ✧ Slower than expected build-up of deposit franchise.
- ✧ Margin compression due to higher cost of funds.
- ✧ Rise in credit cost.

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%

Accumulate – Absolute return between 0% to +10%

Reduce – Absolute return between 0% to -10%

Sell – Absolute return below -10%

Please refer to <http://www.indiainfoline.com/research/disclaimer> for recommendation parameter, analyst disclaimer and other disclosures.

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