



**DALAL & BROACHA**  
STOCK BROKING PVT. LTD.

## Management Meet Update@ Dalal & Broacha

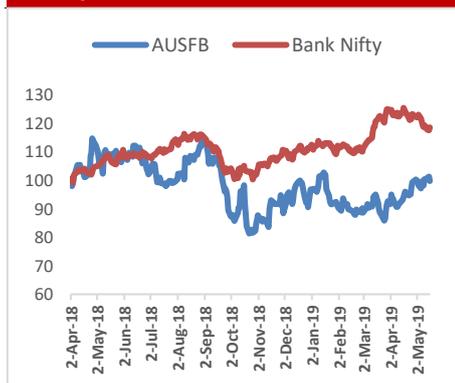
### HOLD

Current Price (Rs)	665
52 Week Range	745/502
Target Price (Rs)	711
Upside (%)	7%

### Key Share Data

Market Cap (Rs.bn)	195
Market Cap (US\$ mn)	2771
No of o/s shares (mn)	292
Face Value	10
Monthly Avg. vol (BSE+NSE) Nos'000	287
BSE Code	540611
NSE Code	AUBANK
Bloomberg	AUBANK:IN

### Price performance



% Shareholding	Mar-19	Dec-18
Promoter	32.2	32.2
DIs	14.4	15.9
FIS	23.8	22.4
Others	29.6	29.5
Total	100	100

We met the management of AU Small Finance Bank (AUSFB) to get an insight into its business and future plans. Being one of the few NBFCs to get a license from the RBI, AUSFB has shown robust performance in the last two years. Bank's loan AUM grew at 50% CAGR, while total assets grew at 83% CAGR during FY17-19. Starting with vehicle finance, they later entered into MSME financing; the entire business model evolution maps out as an expansion into related customer segments. Going forward, the bank is focusing on growing both sides of the balance sheet to improve its return ratios, targeting ROA of 1.7-1.8% and ROE of 17-18% by FY22.

- Bank has a well-diversified vehicle finance book (42% of AUM), out of which, around 70% is new vehicles and 30% is used vehicles. With slowdown in auto industry, bank is focusing more on used vehicles. The share of used vehicles will increase from 30% to around 40% in the next two to three years. The interest rate of a used vehicles loan is higher than that of a new vehicles loan by approximately 2% to 4%.
- MSME loans are secured by immovable property (Around 70-75% of customers provide self-occupied residential property as collateral, around 20-24% customers provide self-occupied commercial property as collateral, & around 1-2% customers provide rental commercial property or FD as collateral).
- 12-13% of bank's NBFC portfolio is BBB & below rated (other than normal evaluation, Bank also do channel check and assess promoter quality). Bank's exposure to Reliance ADAG group is Rs 13 Cr (in Reliance Home Finance/ come down from Rs 22 Cr as on March 31, 2019), while no exposure to DHFL.
- As old branches starts to break-even (around 300 Branches), bank's operating efficiency will improve, targeting cost to income ratio of 55% by FY22. Generally, new branches break even in three or three & half years.
- Bank will expand its branch network using a dual strategy- a hub and spoke model (One large branch monitoring few small branches) in locations where the bank is already present (cities like Mumbai, Delhi, Pune), while where bank doesn't have branches, it will open one large branch followed by few small branches.
- Bank's asset quality remained stagnant, with GNPA stood at around 2% for the last few quarters. While its PCR is lower than many of its large peers (stood at 37.4% in Q4FY19), it is still higher than regulatory requirement.

### Valuation and outlook

With sufficient capital, lower competition from smaller NBFCs and improving operating efficiency; we believe AU Small Finance Bank will continue its growth momentum for the next two to three years. We also believe that the premium valuations are justified, given (i) demonstrated track record of serving underbanked and unbanked customers, (ii) expectation of gradual ROA expansion, and (iii) large addressable opportunity. Thus, we have maintained a 'Hold' rating on AU Small Finance Bank with a price target of Rs 711, valuing the stock at 4.1x FY22E standalone P/ABV.

### Key Financials (Rs in Mn)

Year	NII	Growth (%)	PPOP	Growth (%)	PAT	Growth (%)	BVPS	P/B (X)
FY19	13425	43	7219	25	3818	31	108	6.1
FY20E	18031	34	10025	39	5164	35	137	4.9
FY21E	24542	36	14234	42	7416	44	159	4.2
FY22E	33045	35	19975	40	10463	41	189	3.5



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### On liability side,

The bank is looking to mobilize longer-term retail TDs, not just to match the asset growth but also to replace high-cost borrowings with low-cost deposits. Bank's cost of funds declined from 8.4% in FY18 to 7.9% in FY19 due to an increase in the proportion of deposits to 69% (v/s 51% in Q4FY18) in the overall funding mix.

- In order to increase deposit base, Bank is looking to open branches in large cities such as Mumbai, Pune, Delhi, Bangalore, Bhubaneswar, etc. Bank plans to open 100-120 branches in the next two to three years. Out of which, 27 branches will be open in H1FY20 and 20-22 branches will open in H2FY20.
- Bank will expand its branch network using a dual strategy- a hub and spoke model (One large branch monitoring few small branches) in locations where the bank is already present (cities like Mumbai, Delhi, Pune), while where bank doesn't have branches, it will open one large branch followed by few small branches.
- As old branches starts to break-even (around 300 Branches), bank's operating efficiency will improve, targeting cost to income ratio of 55% by FY22. Generally, new branches break even in three or three & half years.
- In order to attract customers, AU Bank is offering higher rates (interest rate upto 6.4% on SA/ upto 8.6% on Fixed Deposit) than most of its established peers like Kotak Mahindra Bank, Yes Bank & IndusInd Bank. Going forward, bank will continue with this strategy & will not enter into rate wars with other SFBs.
- Bank is showing good growth in savings accounts, with a lot of account openings on its tablet system at the customer's doorstep. 50,000 new accounts are being opened on a monthly basis mostly savings accounts, with an average ticket size of Rs 29 thousand in savings accounts.
- Bank is well capitalized and would not need capital infusion for the next 12-18 months.

### On the asset side,

AU Bank has three 'core asset business' lines namely, vehicle finance (the original business line), Micro, Small and Medium Enterprises (MSME) financing and Small & Medium Enterprises (SME) financing. Bank's core customer segment consists of low & middle-income individuals or self-employed individuals who are often underbanked or unbanked and mostly have no credit track record.

#### Vehicle finance (ATS Rs 3.5-4.0 Lakh/ Loan Tenure upto 5 years/LTV around 80-85%)

- Bank has a well-diversified vehicle finance book (42% of AUM), including two-wheeler vehicle loans to trucks and other heavy commercial vehicles, out of which, around 70% is new vehicles and 30% is used vehicles.
- With slowdown in auto industry, bank is focusing more on used vehicles. The share of used vehicles will increase from 30% to around 40% in the next two to three years. The interest rate of a used vehicles loan is higher than that of a new vehicles loan by approximately 2% to 4%, which will depend on the risk profile of the customer & the residual value of the vehicle being bought.
- With the higher yield on used vehicles, we expect that this transition will improve the bank's overall yields. During Q4FY19, vehicles loan disbursement IRR improves to 15.8% from 14.6% in Q3FY19 led by more focus on used vehicles.
- Bank's sales executive does the primary job of evaluating the customer, which involves appraising the vehicle type, the customer's experience in the transportation industry, age & usage of the vehicle. It is followed by a credit investigation officer verification who then confirms the accuracy of the information on a loan application and evaluate the creditworthiness of applicant.
- Main Competitors are IndusInd Bank, Mahindra & Mahindra Financial Services and Cholamandalam Investment & Finance
- Bank's loss given default (LGD) for this portfolio is broadly 30% (may vary from case to case).
- Bank's vehicle finance book grew by 43% YoY/ 9% QoQ to Rs 10,224 Cr in Q4FY19. Going forward, bank is targeting loan growth of 28-30% for the next two to three years.



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### MSME financing (ATS Rs 10-12 Lakh/ Loan Tenure upto 12 years/LTV around 40-50%)

- Bank provides loans to MSMEs (usually customer with annual turnover ranging between Rs 10 lakh & Rs 10 Cr), primarily for business expansion, working capital and purchase of equipment.
- Bank's approach to such customers is to first understand its business loan requirement, estimate business cash-flows and thereupon determine their loan eligibility.
- MSME loans are secured by immoveable property (Around 70-75% of customers provide self-occupied residential property as collateral, around 20-24% customers provide self-occupied commercial property as collateral, & around 1-2% customers provide rental commercial property or FD as collateral).
- Bank's loss given default (LGD) for this portfolio is broadly 0%.
- Customers are sourced through the sales team, customer referrals, cross sell to vehicle finance customers & employee referrals.
- Bank use a risk-based pricing matrix to determine the interest rate to be charged.

### SME financing (Loan Tenure upto 15 years)

- SME financing business categorizes into three segments SME business loans, construction finance loans and loans to NBFCs/HFCs
- Bank's approach to these customers is to first assess credit needs, collateral offered and repayment capabilities (cash flow assessment is generally supported by adequate business and financial income documentation).
- Bank's total exposure to top five borrowers is around Rs 250 Cr
- In NBFCs/HFCs,
  - Average Yields on this portfolio is around 12-13%, Loan Tenure upto 4 years.
  - Bank's NPA of NBFC - NIL; In fact the entire portfolio has been Current (Nil 0+ DPD) since started the product segment in FY 11-12.
  - 12-13% of bank's NBFC portfolio is BBB & below rated (other than normal evaluation, Bank also do channel check and assess promoter quality). Eg. Swagat Housing Finance Company
  - Bank's exposure to Reliance ADAG group is Rs 13 Cr (in Reliance Home Finance/ come down from Rs 22 Cr as on March 31, 2019), while no exposure to DHFL.
- Real Estate finance
  - Average Yields on this portfolio is around 15-16% and Loan Tenure upto 7 years.
  - It constituted 3% of total Gross AUM as on 31st March 2019.
  - Bank has been cautious on disbursements in this segment. This portfolio is largely construction linked loans; about 60-70% of which is small builders (mainly from Rajasthan), who typically construct G+2/G+3 structures (ATS around Rs 1-2 Cr). Remaining 30-40% builders from big cities like Mumbai & Delhi, with ATS is around Rs 5-10 Cr.
- Bank has started offering Gold Loans, Agri SME Loans, Two-Wheeler Loans and Consumer Durable Loans on a pilot basis. Depending upon performance, Bank will develop its strategy for this portfolio.



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<i>P&amp;L (Rs mn)</i>	FY19	FY20E	FY21E	FY22E
Interest Earned	29488	42095	57328	76613
Interest Expended	16064	23971	32877	43568
<b>NII</b>	<b>13425</b>	<b>18124</b>	<b>24451</b>	<b>33045</b>
Other Income	4620	5846	7307	9027
<b>Net Income</b>	<b>18045</b>	<b>23969</b>	<b>31757</b>	<b>42073</b>
Opex	10826	13851	17615	22098
<b>PPOP</b>	<b>7219</b>	<b>10118</b>	<b>14142</b>	<b>19975</b>
Provisions	1418	2179	2965	4077
<b>PBT</b>	<b>5801</b>	<b>7939</b>	<b>11177</b>	<b>15898</b>
Tax	1983	2714	3821	5435
<b>PAT</b>	<b>3818</b>	<b>5225</b>	<b>7356</b>	<b>10463</b>

<i>BS (Rs mn)</i>	FY19	FY20E	FY21E	FY22E
Capital	2924	3025	3025	3025
Reserves	28705	38398	44925	54132
Deposits	194224	278542	388614	525732
Borrowings	86134	97809	105687	114010
Other Liabilities	14241	16420	19386	23462
<b>Total</b>	<b>326228</b>	<b>434194</b>	<b>561636</b>	<b>720361</b>
Cash & Bank	17402	32717	36826	38695
Investments	71617	86500	112910	147512
Advances	228187	302235	396246	514745
Fixed Assets	4470	5170	5970	6820
Other Assets	4552	7572	9683	12588
<b>Total</b>	<b>326228</b>	<b>434194</b>	<b>561636</b>	<b>720361</b>

<i>Ratios (%)</i>	FY19	FY20E	FY21E	FY22E
<b>Growth</b>				
<b>NII</b>	43	34	36	35
<b>Operating profit</b>	25	39	42	40
<b>Net profit</b>	31	35	44	41
<b>Advances</b>	71	32	31	30
<b>Deposits</b>	145	43	40	35
<b>Returns</b>				
<b>ROA</b>	1.5	1.4	1.5	1.6
<b>ROE</b>	14	14	17	20

<i>Ratios (%)</i>	FY19	FY20E	FY21E	FY22E
<b>Asset quality</b>				
GNPA	2.0	2.1	1.9	1.7
NNPA	1.3	1.2	1.1	0.9
PCR	37	42	44	46
<b>Per share (Rs)</b>				
EPS	13	17	25	35
ABVPS	98	125	145	173
P/E	51	39	27	19
P/ABVPS	6.8	5.3	4.6	3.8



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