

Valuations expensive !!!

AU Small Finance results were mixed bag – PAT came in at INR 4.2 bn, up by 22.7% yoy and 8.1% qoq. Although NII was healthy (29.5% yoy), PPOp growth was relatively slow at 18.4% in Q4 due to higher opex. Margins were stable, assets growth is coming down and asset quality profile was stable. Going forward, profitability growth will be average given margin compression and elevated opex cost. Assign SELL rating with revised TP of 569, downside of 15% from current levels

Outlook

- As per management, advances are likely to grow by 30%+ in FY24
- Margins are anticipated to shrink by 30-40 bps in FY24 due to funding cost pressures
- Other income will get relatively boost in FY24 due to higher credit card fees, FX income, third party distribution of insurance products etc.
- Asset quality outlook going forward remains stable

Valuations – Valuations looks expensive at 3.4x/2.9x FY24e/FY25e ABV. Profitability outlook looks slightly bleak given margin contraction and higher opex cost that will be incurred. In our view, there are other large-cap banks like HDFC Bank, ICICI Bank are trading at cheaper valuations. We recommend switch from AU Small Finance Bank to HDFC Bank. We assign SELL rating to the stock with revised TP of 569, discounting its FY25e ABV by 2.7x FY25e ABV and downside of 15% from the current levels.

Financial Summary

Y/E Mar (Rs Bn)	FY21	FY22	FY23E	FY24E	FY25E
NII	23.7	32.3	44.3	53.6	66.7
PAT	11.7	11.3	14.3	15.9	18.5
Networth	62.8	75.1	109.8	124.9	142.4
Adj BVPS (Rs)	176.8	231.3	159.6	180.1	203.3
EPS (Rs)	37.5	35.9	21.4	23.8	27.7
P/E (x)	17.1	17.9	30.0	27.0	23.2
P/Adj BV (x)	3.6	2.8	4.0	3.6	3.2

Source: Company, Dalal & Broacha Research

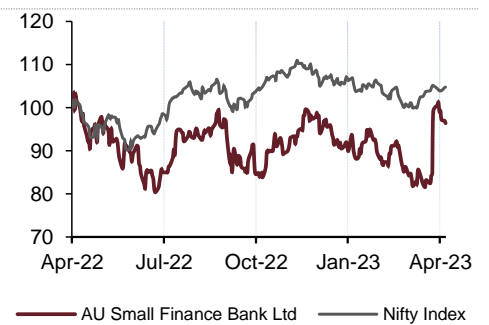
Rating	TP (Rs)	Up/Dn (%)
SELL	569	-14

Market data

Current price	Rs	660
Market Cap (Rs.Bn)	(Rs Bn)	440
Market Cap (US\$ Mn)	(US\$ Mn)	5,374
Face Value	Rs	10
52 Weeks High/Low	Rs	712 / 539
Average Daily Volume	('000)	2,902
BSE Code		540611
Bloomberg		AUBANK.IN

Source: Bloomberg

One Year Performance



Source: Bloomberg

% Shareholding	Mar-23	Dec-22
Promoters	25.54	25.55
Public	74.46	74.45
Total	100	100

Source: Bloomberg

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Key Financial & Concall Highlights

- **The bank is aiming for the ROA of 1.8-2% in FY24 vs. 1.8% reported in FY23**
- **Asset growth is relatively slowing down** – Gross advances reported growth of 26.7% yoy to INR 159.6 bn. In this, wheels related loans (32.3% share) showed growth of 15.7% yoy, MSME loans (31.3% share) 13.6% yoy. Segments that are witnessing very high growth are home loans (7.2% share) which grew by 61.3% yoy and commercial assets by 59.8% (21.6% share; which includes business banking, agri loans, NBFCs). Also, unsecured loans are witnessing very high growth rates viz. credit cards showed 2.6x growth in last one year, personal loans 94% growth. Total retail lending accounts for 88% of the advances. **Management highlighted in the concall that advances growth for FY24 could be to the tune of ~30%.**
- On liability side, deposits grew by 31.9% yoy and 13.5% qoq to INR 693.7 bn. In this, CASA deposits growth was healthy at 36% yoy and its share stood at 38.4% vs. 37.3% in FY22. **Share of retail TDs in total term deposits is 50% similar to last year levels** (while balance is bulk TDs at 50%) and while growth was at 33.7% yoy.
- **Spreads came off qoq due to increase in the funding cost** - Reported spreads came off by 30 bps to 7.1% in Q4FY23 vs. 7.4% in Q3FY23 led by increase in the cost of funds (30 bps rise qoq to 6.3%). While the yields on advances were stable at 13.4% on qoq basis. Going forward, management has indicated that margins are likely to shrink by 30-40 bps in FY24 which will largely due to higher funding cost pressures and limited increase in the incremental disbursement yields. Disbursement yields are not likely to increase materially as the bank has higher portion of the fixed rate book; ratio of fixed rate to floating rate loans is at 66%:34% in FY23 (vs. 74%: 26%). Also, low-yielding assets like home loans etc are rising at faster pace.
- **The bank is in continuous investment phase leading to higher opex cost** – Opex cost for the full year FY23 surged by 42.6% yoy, resultant rise in Cost/Income ratio to 63% levels vs. 57% in FY22; primarily due to variable expenses on higher business volumes and continued investment in the credit card businesses.

Bank continues to make investments (~INR 1.6 bn in Q4'FY23/ 5.1 bn in FY23 vs ~INR 1 bn in Q4'FY22/ ~2.6 bn in FY22) towards digital initiatives viz credit cards/QR/Video Banking (70%), distribution expansion (19%) and brand campaign (11%).

During the year, the bank added 69 liability branches and 108 new touchpoints. As the bank is still in the investing in the people, technology, branch expansion; cost ratios are likely to remain at higher levels in the near future.

- **Other income growth slow; but mgmt. guided for better visibility going forward** – Other income (excl. treasury gains) grew at slower pace of 27% yoy in FY23 and 16% in Q4FY23. However, going forward, the bank is expecting may levers for strong growth in fee income in FY24 viz. 1) credit card business is likely to break-even in FY25 2) it has recently received Authorized Dealership license for foreign exchange, fee income from this segment will also likely to get kick-started 3) higher income from the distribution of third-party insurance products. It collected gross premiums to the tune of ~INR 600 in FY23 which could be to the tune of ~INR 800 in FY24. 4) fee income from the wealth management business will also accelerate growth
- **Asset quality profile stable** – GNPA/NNPA came off to 1.66%/0.42% vs. 1.81%/0.5% in Q3FY23. Incremental gross slippages for the quarter was at INR 1.9 bn vs. INR 2.3 bn in Q3FY23 and INR 2 bn in Q4FY22. There was draw down on the contingent & covid restructuring provisions during the year resulting in provisions expenses coming down to INR 1.55 bn in FY23 vs. INR 3.6 bn in FY22 (in % terms, 0.19% vs. 0.6% in FY22).

The current focus of the CEO is to build brand, more focus on digitalisation and building technology, invest in strong HR practices and build retail deposits.

- The Board has recommended a dividend of ₹1 per equity share (10% of face value) for FY23
- Also, recently, MD & CEO, Mr. Sanjay Agarwal and ED, Mr. Uttam Tibrewal term got extended for the period of three years.

Quarterly Financials (Q4FY23)

(Rs Mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Interest earned	22,748	16,670	36.5	21,181	7.4	82,054	59,217	38.6
Interest expenses	10,616	7,305	45.3	9,653	10.0	37,801	26,876	40.7
Net Interest Income (NII)	12,132	9,366	29.5	11,527	5.2	44,253	32,341	36.8
Other Income	3,331	3,114	7.0	2,949	12.9	10,345	9,937	4.1
Total income	15,463	12,479	23.9	14,476	6.8	54,598	42,278	29.1
Operating expenses	9,753	7,656	27.4	8,919	9.4	34,403	24,128	42.6
-Employee cost	4,825	4,137	16.6	4,652	3.7	17,930	13,789	30.0
-Other operating expenses	4,928	3,519	40.0	4,267	15.5	16,472	10,339	59.3
Operating profit	5,709	4,823	18.4	5,557	2.7	20,195	18,150	11.3
Provision for contingencies	409	932	-56.2	326	25.2	1,548	3,610	-57.1
PBT	5,300	3,891	36.2	5,231	1.3	18,647	14,541	28.2
Provision for taxes	1,054	430	145.0	1,302	-19.1	4,367	3,242	34.7
Net profit	4,246	3,461	22.7	3,928	8.1	14,279	11,298	26.4
Equity	6,667	3,149	111.7	6,665	0.0	6,667	3,149	111.7
EPS	6.37	10.99	-42.0	5.89	8.1	21.42	35.88	-40.3
Ratios (%)								
Int. exp/Int earned (%)	46.7	43.8	-	45.6	-	46.1	45.4	-
Cost/Income ratio (%)	63.1	61.3	-	61.6	-	63.0	57.1	-
Gross NPAs (Rs)	9813.1	9243.8	6.2	10188.6	-3.7	9813.1	9243.8	6.2
Net NPAs (Rs)	2451.6	2308.5	6.2	2845.6	-13.8	2451.6	2308.5	6.2
Gross NPAs (%)	1.66	1.98	-	1.81	-	1.7	2.0	-
Net NPAs (%)	0.42	0.5	-	0.5	-	0.4	0.5	-
PCR (%)	75.0	75.0		72.1		75.0	75.0	
ROA (%)	0.5	0.5	-	0.5	-	1.5	1.5	-
CAR (%)	23.6	21.0	-	22.0	-	23.6	21.0	-
Balance Sheet (Rs.mn)								
Sources of Funds								
Capital	6,667	3,149	111.7	6,665	0.0	6,667	3,149	111.7
Reserves and Surplus	1,02,666	71,578	43.4	98,735	4.0	1,02,666	71,578	43.4
Deposits	6,93,650	5,25,846	31.9	6,11,010	13.5	6,93,650	5,25,846	31.9
-CASA Deposits	266600	196080	36.0	234710	13.6	266600	196080	36.0
Advances	5,84,215	4,60,953	26.7	5,56,010	5.1	5,84,215	4,60,953	26.7

Source: Dalal & Broacha Research, Company

Financials

P&L (Rs bn)	FY20	FY21	FY22	FY23E	FY24E	FY25E
Interest income	42.9	49.5	59.2	82.1	103.6	130.8
Interest expense	23.8	25.8	26.9	37.8	49.9	64.1
NII	19.1	23.7	32.3	44.3	53.6	66.7
Non-interest income	7.1	14.2	9.9	10.3	14.2	16.3
Net revenues	26.2	37.9	42.3	54.6	67.8	83.1
Operating expenses	14.2	16.6	24.1	34.4	44.7	55.5
PPOP	12.0	21.3	18.2	20.2	23.1	27.6
Provisions	2.8	6.7	3.6	1.5	2.4	3.5
PBT	9.1	14.6	14.5	18.6	20.7	24.1
Tax	2.4	2.9	3.2	4.4	4.9	5.6
PAT	6.7	11.7	11.3	14.3	15.9	18.5
Balance sheet						
	FY20	FY21	FY22	FY23E	FY24E	FY25E
Share capital	3	3	3	7	7	7
Reserves & surplus	41	60	72	103	118	136
Net worth	44	63	75	110	125	142
Deposits	262	360	526	694	911	1152
Borrowings	103	70	60	63	51	56
Other liability	13	23	30	36	44	52
Total liabilities	421	516	691	902	1131	1403
Fixed assets	h	5	6	7	8	9
Investments	107	108	153	201	246	300
Loans	270	346	461	584	759	949
Cash	34	48	59	94	104	132
Other assets	7	9	11	16	13	14
Total assets	417	516	691	902	1131	1403
Ratios						
	FY20	FY21	FY22	FY23E	FY24E	FY25E
Growth (%)						
NII	42	24	37	37	21	24
PPOP	66	78	-15	11	15	19
PAT	77	73	-3	26	11	16
Advances	18	28	33	27	30	25
Deposits	35	38	46	32	31	26
Spread (%)						
Yield on Funds	11.8	10.9	10.1	10.6	10.4	10.5
Cost of Funds	7.4	6.5	5.3	5.6	5.8	5.9
Spread	4.4	4.3	4.8	4.9	4.6	4.6
NIM	5.2	5.2	5.5	5.7	5.4	5.4
Asset quality (%)						
Gross NPAs	1.7	4.3	2.0	1.9	2.0	2.0
Net NPAs	0.8	2.2	0.5	0.6	0.6	0.7
Provisions	53	50	75	70	69	64
Return ratios (%)						
RoE	17.9	22.0	16.4	15.4	13.5	13.8
RoA	1.8	2.5	1.9	1.8	1.6	1.5
Per share (Rs)						
EPS	22	37	36	21	24	28
BV	144	201	239	165	187	214
ABV	137	177	231	160	180	203
Valuation (x)						
P/E	29.0	17.1	17.9	30.0	27.0	23.2
P/BV	4.5	3.2	2.7	3.9	3.4	3.0
P/ABV	4.7	3.6	2.8	4.0	3.6	3.2

Source: Dalal & Broacha Research, Company

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