NIRMAL BANG
a relationship beyond broking

Institutional Equities

Initiating Coverage

AU Small Finance Bank

17 March 2021

Reuters: AUFI.BO; Bloomberg: AUBANK IN

Rapid growth with strong asset profile

AU Small Finance Bank is best placed among its peers due to its NBFC DNA (ability to assess unbanked and under-banked customers) and its deposit franchise. It has strong credentials, a strong management team and a proven history of execution. It has built an asset portfolio of Rs331bn (AUM as on 3QFY21) and has grown this at a CAGR of 36% over the last 4 years. AU has built a strong deposit base (Rs303bn), which now constitutes 76% of liabilities. CASA (22%) and retail TD (35%) account for 57% of its total deposit base. The impact of moratorium is fully visible now with pro-forma GNPA at 3.3% and credit cost at 3.9% (annualized) in 3QFY21. We build in 32% earnings CAGR over FY20-23E with ROE and ROA of 16.1%/2% in FY22E and 17.2%/2% in FY23E. We initiate coverage on AU with a BUY rating and value it at 4.9x FY23 P/B to arrive at our PT of Rs1,360. AU is trading at 100% premium to sector average. However, the valuation needs to be seen in the context of super-normal AUM growth of ~26% expected over the next few years, strong asset quality and benefit of scaling up its deposit franchise. On the asset side, we can compare its franchise with Cholamandalam (Vehicles and MSME account for ~95 of its AUM), which is trading at 4x FY23 P/B. We value Chola at 3.25x FY23 P/B. We assign a 50% premium to AU for its strong deposit franchise and high growth to arrive at our target P/B multiple of 4.9x. Risks: (1) slower-than-expected build-up of deposit franchise (2) margin compression due to low yields or high cost of funds (3) rise in NPA or credit cost.

Strong asset franchise: AU focuses on secured, small-ticket commercial loans to under banked customers located in Tier II to Tier VI centers. A mix of high yields, lean operating model, strong record of credit processes and asset quality have helped it to generate high returns. AU has largely retained its asset strategy with Wheels (vehicle loans) and SBL (MSME & SME lending) still contributing 80% to AUM. Over the last 4 years, it has entered new segments of Home Loans, Gold Loans, Consumer Financing etc, which remain a small part of its overall business.

Focus on building a robust deposit franchise: AU has delivered differentiation in liability products through simplified processes, high interest rates, monthly interest payment, ease of account opening, etc. It is focused on building individual retail base in its deposit franchise. It has partnered with multiple players under API banking on leading online platforms, payments banks, brokerages, etc. It has registered 34000 merchants under UPI QR. This all has led to increase in the share of CASA deposits from 14% in FY20 to 22% in 3QFY21. High interest rates aided in increase in the share of TD from 30% in FY20 to 35% in 3QFY21. Retail business is stickier in nature and aids in keeping cost of funds low. The launch of credit card in FY22 will further aid in increasing the share of CASA deposits.

Covid-led asset quality stress largely behind: 25% of AU's loan book opted for moratorium in April'20, which fell to 5.5% by Aug'20 with only 3% of customers not servicing any installment by Oct'20. The collection efficiency improved from 54% in April'20 to 103% in Dec'20. Customer activation reached 84% (full EMI) in Dec'20 compared to ~80% pre-Covid level. The pro-forma GNPA at 3.3% (Rs10bn) in our view has already factored in the non-paying customers and the slippages might be near normal level from 4QFY21E. The bank is carrying adequate provisions of 76% of pro-forma GNPA and the increase in credit cost may be limited hereon. AU restructured loans worth Rs2.5bn (0.8% of loans) in 3QFY21 and expects overall restructuring to stabilize at 1.5%. We build in credit cost of 2.2%/1.2%/1.1% for FY21E/FY22E/FY23E. AU follows strong underwriting practices reflected in low NPA (below 2%) historically.

Y/E March (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
NII	18,045	25,293	31,285	39,416	49,405
PPOP	7,219	11,115	15,642	18,920	23,715
PAT	3,818	5,961	6,762	10,834	13,717
Deposits	194,224	261,639	327,049	425,164	552,713
Advances	228,187	269,924	319,128	408,346	523,901
RoA (%)	*1.5*	*1.6*	*1.5*	*2.0*	*2.0*
RoE (%)	*14.7*	*16.4*	*12.9*	*16.1*	*17.2*
CAR (%)	*19.3*	*22.0*	*24.2*	*23.4*	*22.6*
P/BV (x)	11.6	8.0	5.8	5.0	4.2
P/ABV (x)	12.9	8.5	6.1	5.2	4.4

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: BFSI

CMP: Rs1,175.6

Target Price: Rs1,360.0

Upside: 15.7%

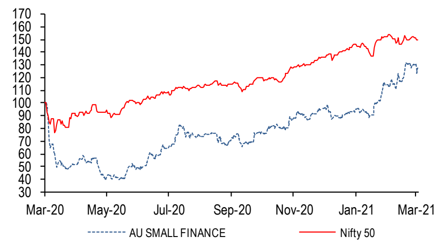
Sonal Gandhi
Research Analyst
sonal.gandhi@nirmalbang.com
+91 9552595929

Key Data

Current Shares O/S (mn)	307.1
Mkt Cap (Rsbn/US$bn)	377.7/5.2
52 Wk H / L (Rs)	1,317/366
Daily Vol. (3M NSE Avg.)	1,318,438

Share holding (%)	3QFY21	2QFY21	1QFY21
Promoter	29.0	29.0	29.0
Public	71.0	71.0	71.0
Others	-	-	-

One Year Indexed Stock Performance



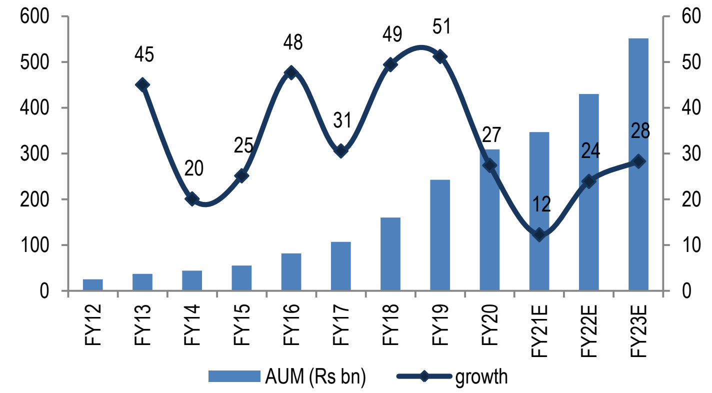
Price Performance (%)

	1 M	6 M	1 Yr
AU SFB	8.2	68.6	41.0
Nifty Index	(2.0)	29.5	66.3

Source: Bloomberg

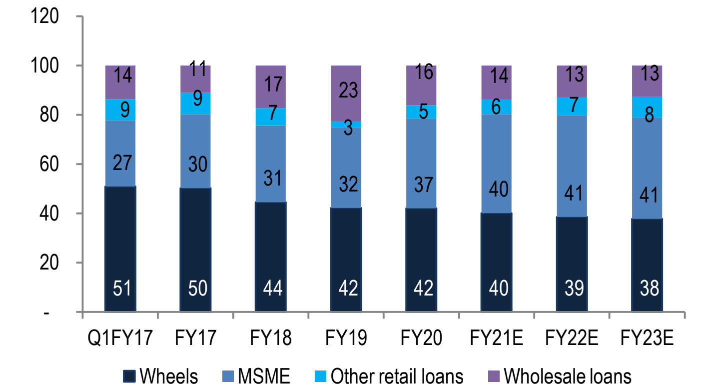
Key charts and tables

Exhibit 1: AUM CAGR of 37% over FY12-20; we expect 21% AUM CAGR over FY20-23E



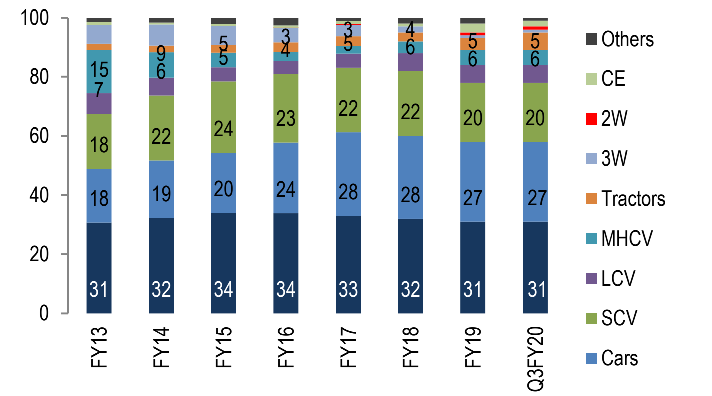
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 2: AUM mix over the years



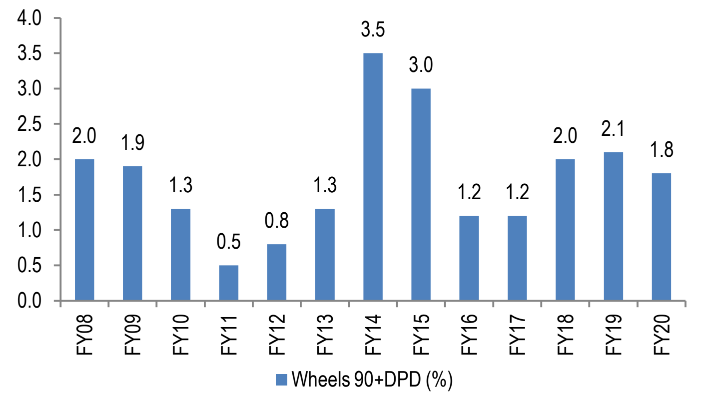
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 3: Wheels AUM mix shows de-emphasis on HCV



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 4: Wheels- superior asset quality across cycles



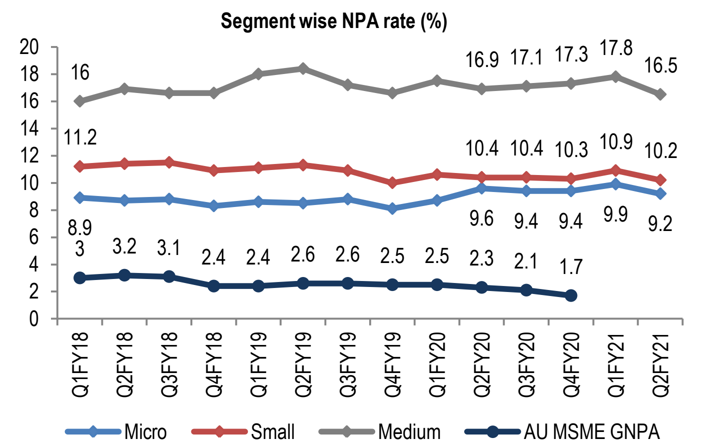
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 5: Huge MSME finance opportunity

Source	Proportion of finance
Finance from institutional sources	5.2%
Finance from non-institutional sources	2.0%
No access to credit or self-financing	92.8%

Source: Nirmal Bang Institutional Equities Research, Crisil

Exhibit 6: Strong underwriting practices have aided in keeping NPA below industry level



Source: Nirmal Bang Institutional Equities Research, Transunion CIBIL

Exhibit 7: Comparative analysis in affordable housing space

	Aavas Financiers	Aadhar Housing*	AU SFB
AUM as on 3QFY21 (Rs mn)	88,226	1,14,320	9,870
Yields	13.4%	13.1%	13.2%
CoF	7.7%	8.9%	7.4%
GS3	1.0%	1.3%	0.2%
ATS (Rs)	910000	840000	10,60,000
Salaried customers	60.7%	65.0%	66.0%
Branches	263	294	550

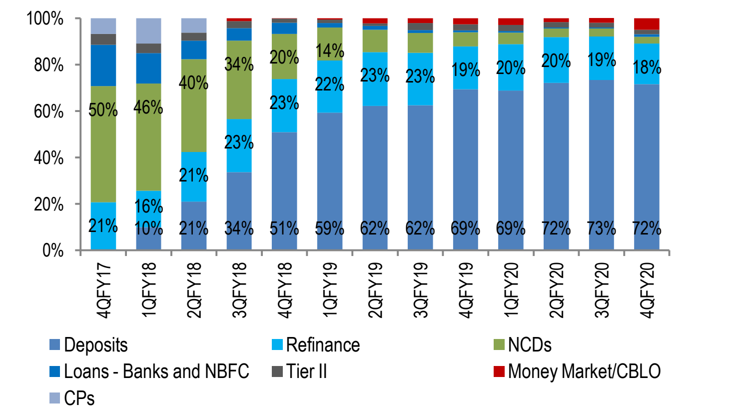
Source: Nirmal Bang Institutional Equities Research, Bank; Note: AUM for Aadhar housing is as on 31st March, 20

Exhibit 8: Summary – Asset wise segmental data

	Retail loans				Wholesale loans			
FY20	Wheels	MSME	Home loans	Others	REG	Business Banking	Agri-SME	NBFC
AUM Size (Rs bn)	130	113	6	11	8	11	12	19
% of AUM	42	37	2	3	3	4	4	6
GNPA (%)	1.8	1.7	0.2	0.6	2.5	ND	4.5	0.5
AUM IRR (%, Q3FY20)	15.0	15.3	12.9	ND	15.1	11.3	12.1	12.2
Average ticket size (Rs in mn)	0.36	1.05	1.06	ND	26.7	5.5	3.4	120
Tenor (years)	3 to 4 years	5 to 7years	6to 8 years	ND	ND	ND	ND	ND

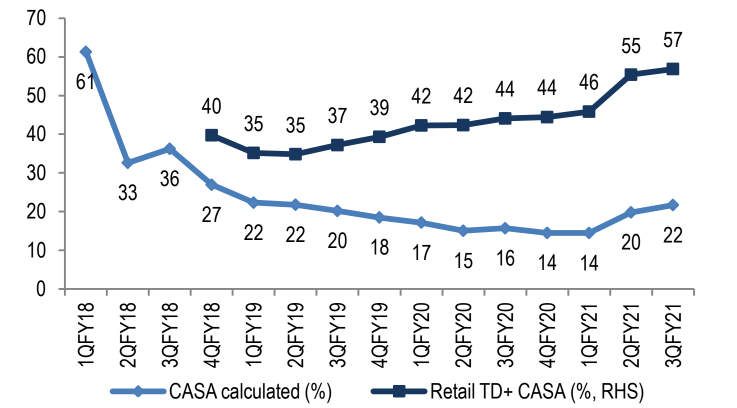
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 9: Increase in deposits as a % of on-book liabilities



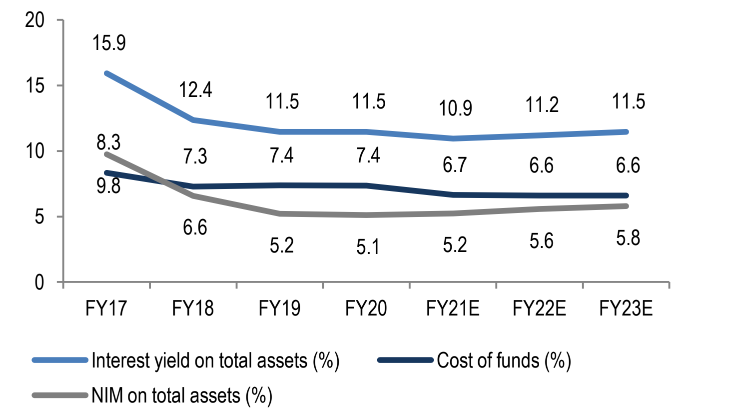
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 10: Retail share of deposits scaling up



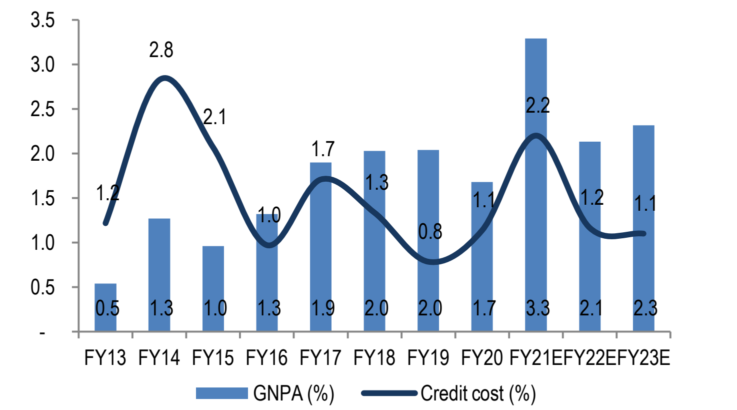
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 11: Low cost of funds to aid in NIMs improvement



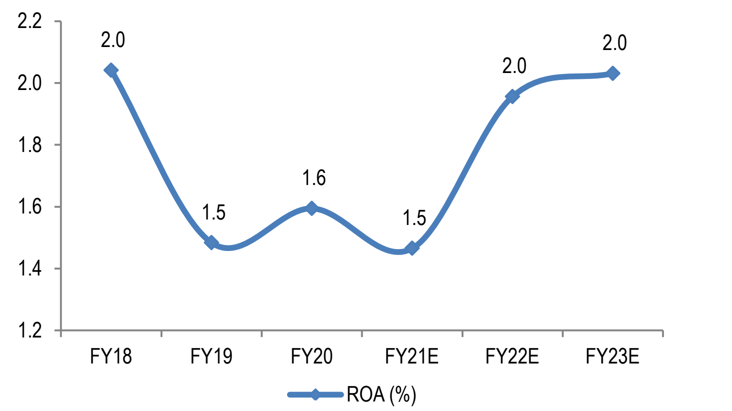
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 12: We expect credit cost to normalize in FY22E



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 13: ROA to improve to 2.0%

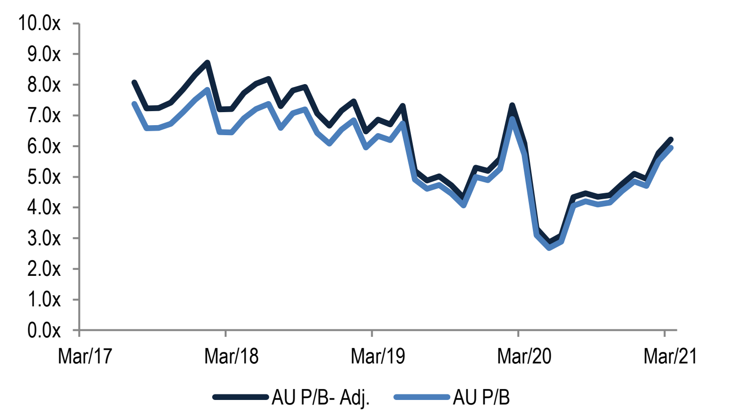


Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 14: ROE to improve to 17.2%

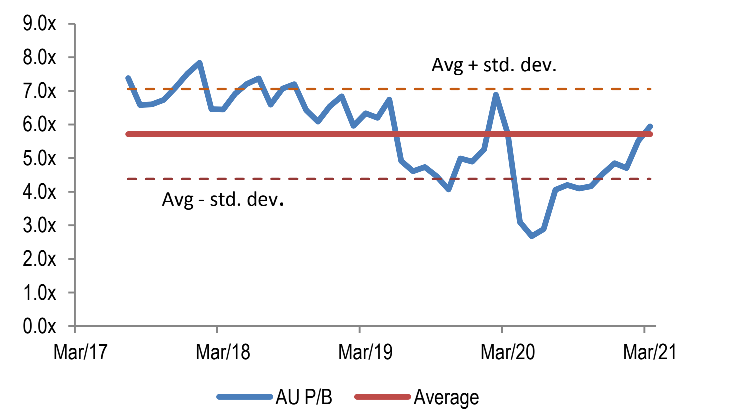
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 15: AU's 12-month fwd. P/B and P/B – Adj. nearing its highs



Source: Nirmal Bang Institutional Equities Research, Bloomberg

Exhibit 16: AU trading at a slight premium to 4-year avg 12-month fwd P/B



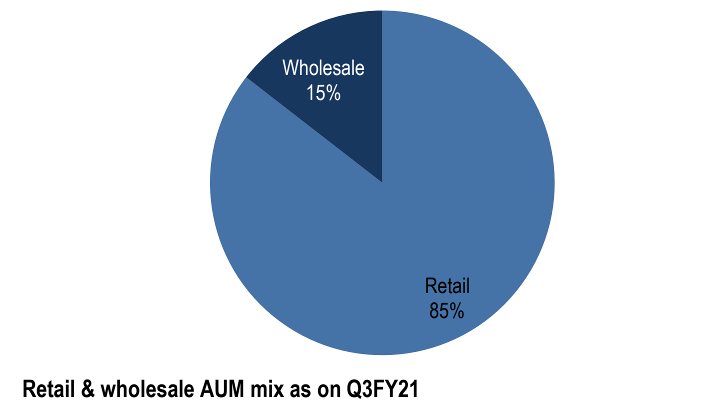
Source: Nirmal Bang Institutional Equities Research, Bloomberg

Investment Arguments

Multi product strategy to aid long-term AUM growth of ~25%

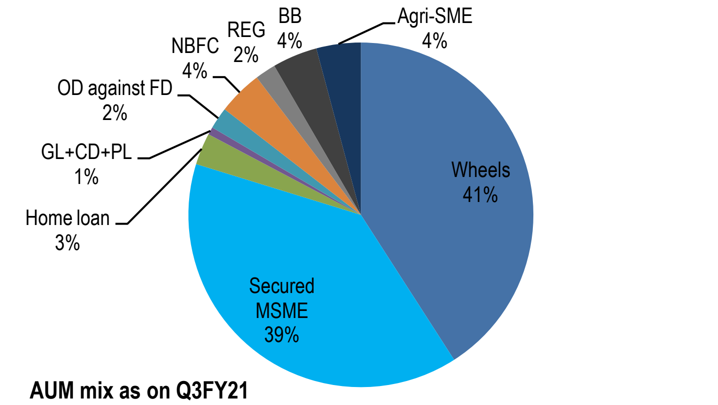
AU is a retail focused SFB. Retail assets contribute 86% to its AUM. Wheels and Secured MSME (LAP), vintage of 25/14 years, contribute 80% to its portfolio. In the last 3 years, the company has expanded its offerings by entering home loans, consumer finance, gold loans and personal loans on the retail side. The wholesale assets contribute 14% to its AUM. Business banking and Agri SME will be the key focus areas due to their stickiness on CASA. The management may opportunistically increase disbursements in NBFC & REG segments as and when the business activity improves. The primary focus area will be the granular secured retail loans to underserved customers.

Exhibit 17: Retail & wholesale AUM mix



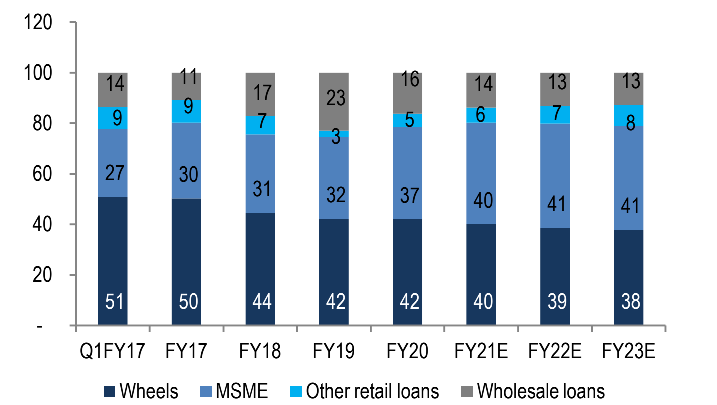
Source: Nirmal Bang Institutional Equities Research

Exhibit 18: Product wise AUM mix



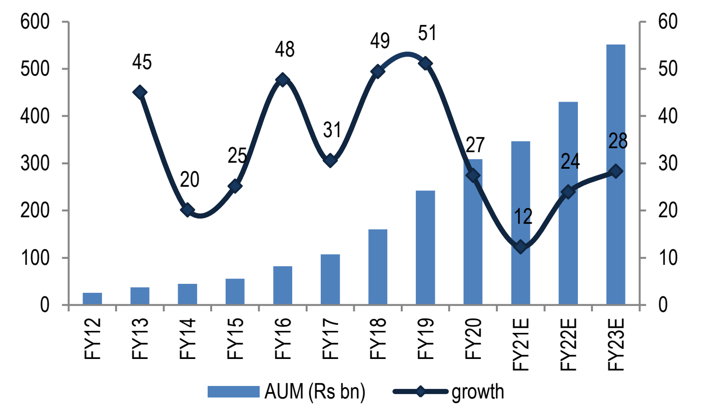
Source: Nirmal Bang Institutional Equities Research

Exhibit 19: AUM mix over the years



Source: Nirmal Bang Institutional Equities Research

Exhibit 20: AUM CAGR of 37% over FY12-20; we expect 21% AUM CAGR over FY20-23E



Source: Nirmal Bang Institutional Equities Research

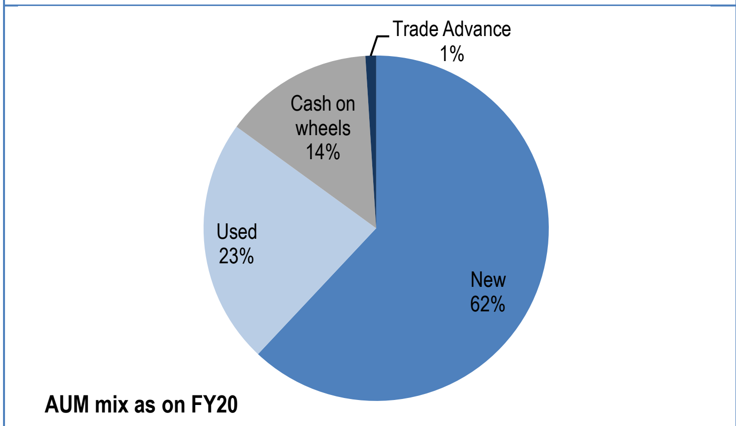
Focus on secured retail small loans to underserved segment

AU started Wheels (vehicle financing) business in 1996 and expanded its offerings to MSME funding in 2007. In Wheels and MSME loan business, AU provides loans primarily for revenue generating assets. It started financing home loans through its subsidiary 'Au Housing Finance" in 2011 and sold it to Kedara Capital in 2016. After conversion to SFB, it commenced the housing loan business from 2018. The retail loan book is more granular in size with an avg. ticket size of less than Rs1mn. 98% of assets are secured in nature.

(1) Wheels – Multi-product, multi-borrower portfolio

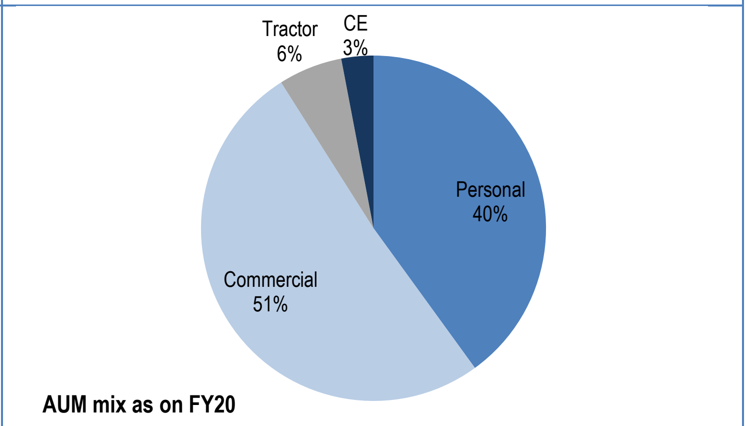
AU started its operations with vehicle finance loans in 1996 and has lending vintage of 25 years. Wheels segment contributes 41% to its overall AUM. AU extends loans for new and used vehicles and for refinancing of old vehicles. It is well-diversified across several categories, including: (i) multi-utility vehicles (MUVs) (ii) cars (iii) small commercial vehicle (SCV) (iv) light commercial vehicles (v) medium and heavy commercial vehicles (vi) tractors (vii) three-wheelers (viii) two-wheelers (ix) construction equipment and (x) sports utility vehicles.. Wheels book has an avg. ticket size of Rs0.36mn. Average EMI outflow for the customer is to the tune of Rs14,000 with an average loan tenor of 3-4 years. 85% of the loans are towards the PSL category. Majority of the portfolio (~90%) has CIBIL score above 650/NTC.

Exhibit 21: Wheels AUM break-up by segment



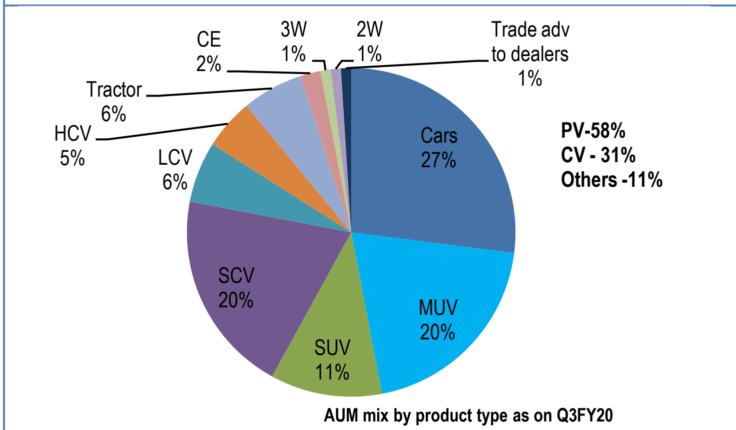
Source: Nirmal Bang Institutional Equities Research

Exhibit 22: Wheels AUM break-up by usage



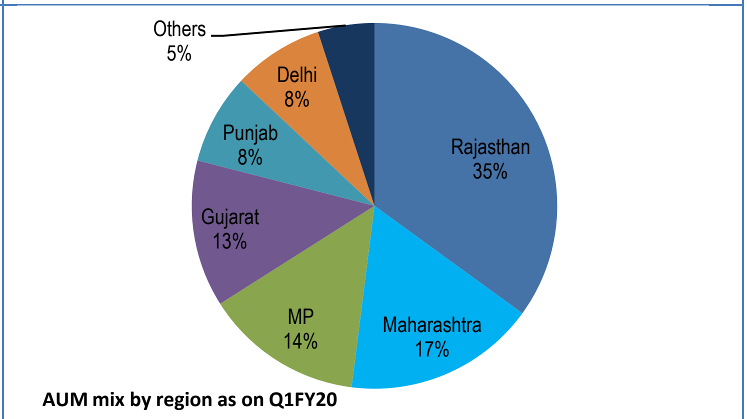
Source: Nirmal Bang Institutional Equities Research

Exhibit 23: Product-wise AUM – PV is more resilient across cycles



Source: Nirmal Bang Institutional Equities Research

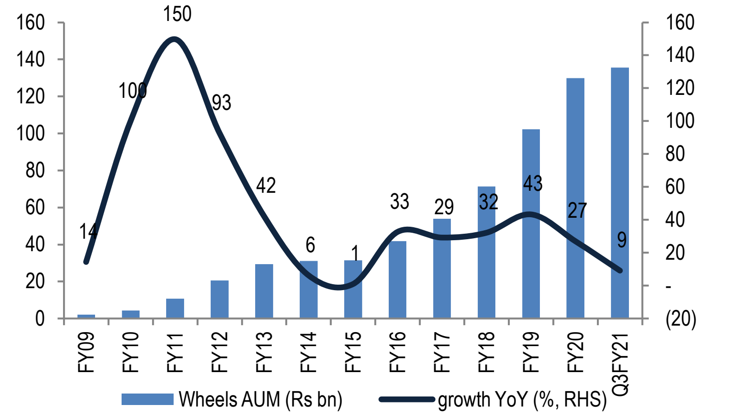
Exhibit 24: Wheels AUM by region – increasing penetration outside Rajasthan



Source: Nirmal Bang Institutional Equities Research

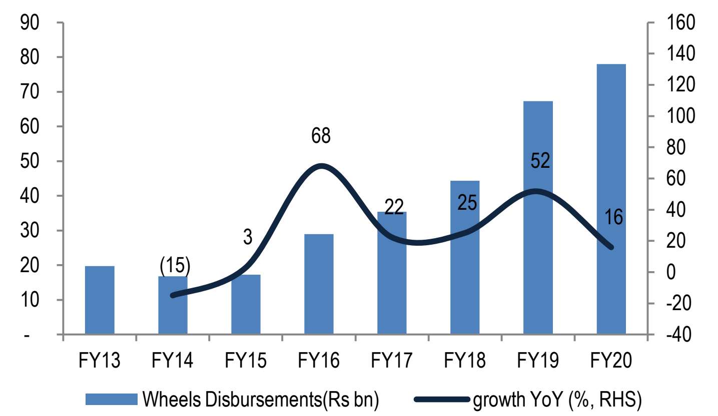
Passenger Vehicles (PV) contribute 58% to the portfolio and is more resilient across cycles as the end-use of majority of purchases is for the personal use of the borrower. SCV constitutes majority of CV lending, which is less affected by CV cycles as end use is towards last mile connectivity. In CV, the share of HCV has reduced from 23% in Mar'12 to 5% as on 3QFY20. A multi product strategy with low focus on financing of cyclical vehicles has aided AUM CAGR of 34% over FY08-9MFY21. AU is focused on increasing the share of used vehicles given the vast business opportunity and the formalization of end market in the last few years. Used vehicles contribute 23% to the Wheels AUM and cash on wheels (refinancing of old vehicles) constitutes 14%.

Exhibit 25: Wheels AUM growth has been steady over the last 6 years



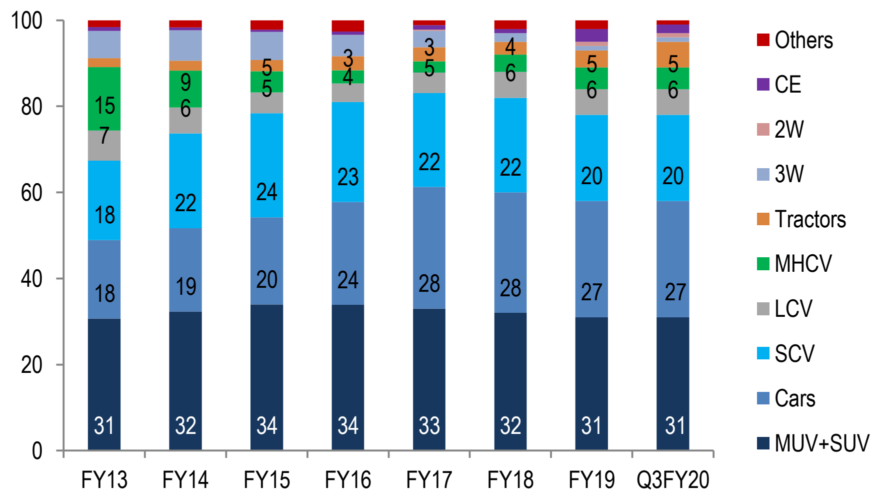
Source: Nirmal Bang Institutional Equities Research

Exhibit 26: Disbursements have grown at a CAGR of 35% over FY15-20



Source: Nirmal Bang Institutional Equities Research

Exhibit 27: AUM mix shows de-emphasis on MHCV and high focus on PV

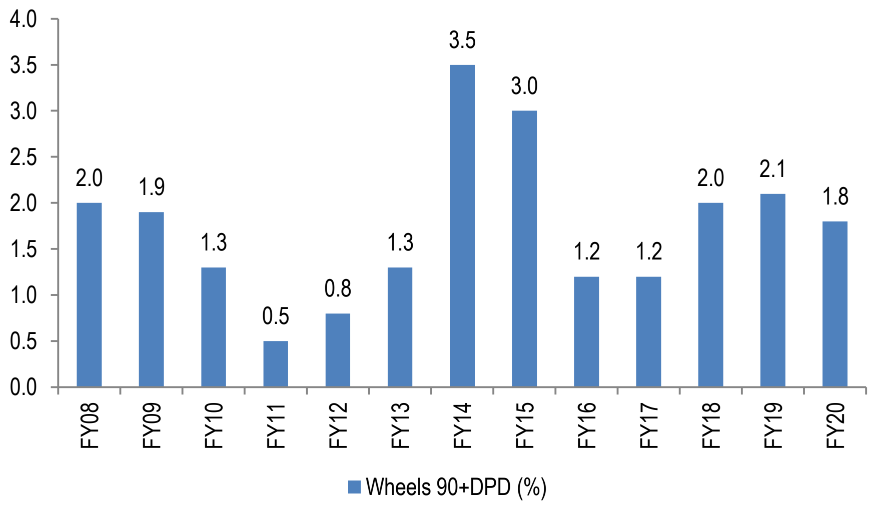


Source: Nirmal Bang Institutional Equities Research, Bank

Sourcing and credit assessment of Wheels segment

AU's target consumer segment comprises the unbanked/under-banked individuals who may not have necessary documents to source the loans or self-employed individuals with documentation, which may not be reflective of their real earnings. The borrower will be typically a first time buyer, tour or travel operator or a self-employed small transport operator. The Wheels borrowers are sourced directly by AU through presence at dealerships, direct walk-ins, referrals or through repeat borrowers. The credit appraisal is done through in-house field investigation where the field officer assesses customer's cash flows by visiting his residence or business premises. The approval process is centralized, which in our view is a necessary check for any loan sanction. Pricing is based on risk assessment of the borrower.

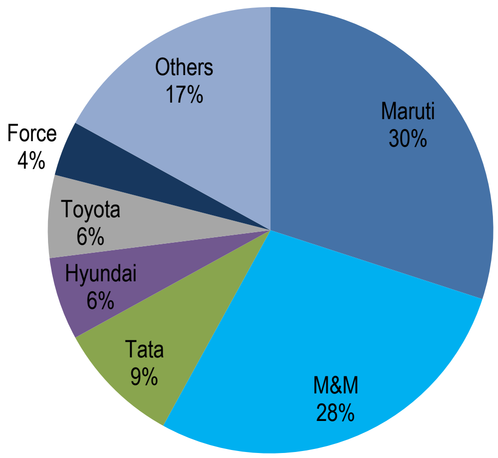
Exhibit 28: Wheels - superior asset quality across cycles



Source: Nirmal Bang Institutional Equities Research, Bank

AU is able to cater to a wide set of vehicles due to clear monitoring of the models, pricing, demand and resale value. It has established a strong relationship with leading auto OEMs and is clearly focused only on-lending to models that meet their loan requirement criteria of operating efficiency, low maintenance cost, ease of servicing & residual value.

Exhibit 29: Strong manufacturer and model selection

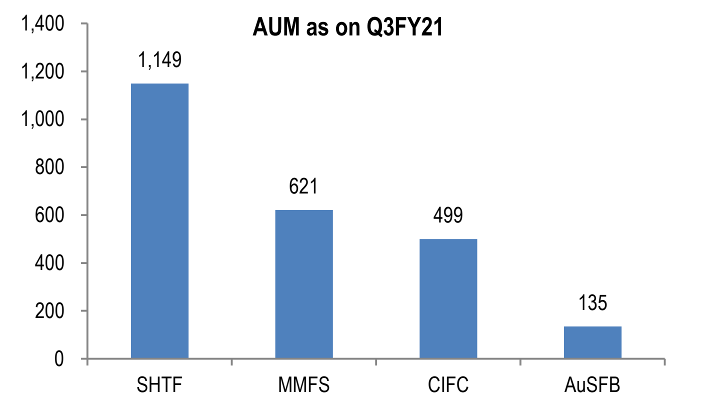


Data as on Q1FY20

Source: Nirmal Bang Institutional Equities Research, Bank

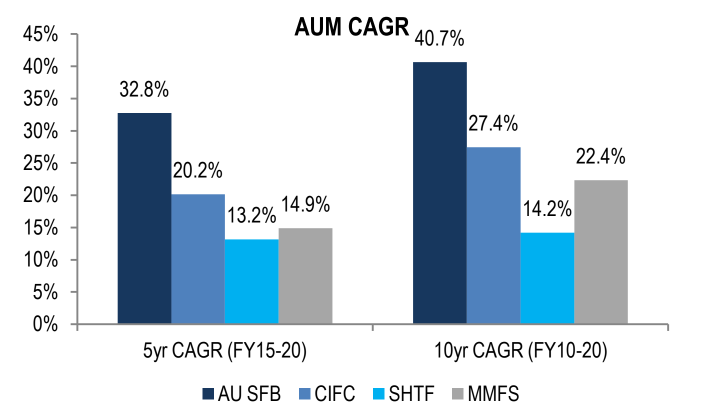
AU's Wheels portfolio has grown ahead of the auto NBFC peers, albeit on a low base despite being present only in Western India. Asset quality has been impressive despite catering to largely unbanked customers (more comparable with SHTF & MMFS). AU's interest yields have been strong.

Exhibit 30: AU's Wheels portfolio is small compared to auto NBFC peers…



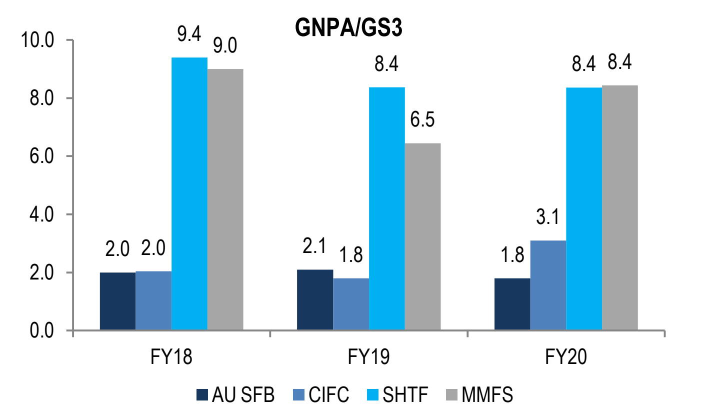
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 31:..leading to strong AUM CAGR



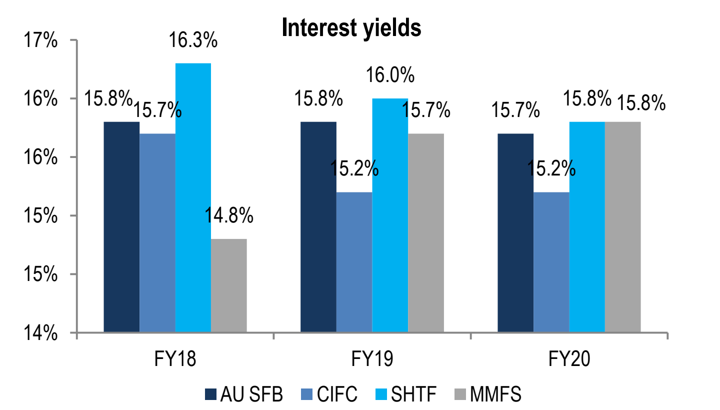
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 32: Asset quality impressive despite catering to LIG & MIG customers



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 33: Yields



Source: Nirmal Bang Institutional Equities Research, Bank

(2) **MSME segment – Granular book with strong growth prospects**

AU entered the MSME financing business in 2007 as a direct product extension of its ability to underwrite low and mid income groups without income documentation. It is fo**cused on financing of consumer driven businesses** and is 1st formal business loan provider for 80% of its customers. Its MSME loan customers are generally dairy businesses, provision stores, hotels and restaurants. These customers are acquired through sales team, referrals from existing customers or sales team, cross selling to the Wheels customers. The ATS of loan is Rs1.07mn with a monthly installment of ~Rs18,000. Around 93% of the MSME business is secured by SORP/SOCP or self occupied institutional and industrial properties with avg. LTV of 45%. The avg. loan tenor is 5 to 7years. Around 62% of loans are in rural and semi-urban areas.

Upon sourcing a customer, a relationship officer visits the customer's business premises to assess credit needs, collateral offered and repayment capabilities. A cash flow assessment is drawn on the basis of business and financial documents and other information received. An appraisal officer verifies documents such as bills of purchase and sale, stock registers, cash books, fuel & energy consumption bills to assess the turnover and margins of a customer's business and his repayment capability. AU also conducts credit bureau checks and assesses the value of the collateral through internal and external teams. A risk based pricing matrix is drawn to determine the interest rate to be charged for different loans.

AU merged the MSME business with a part of SME business; thereby it is difficult for us to give any growth rate conclusively. However, for simplicity, if we add segment AUM of SME & MSME in FY17 (Rs41bn), the bank has grown at a CAGR of 35% to arrive at MSME AUM of Rs128bn in 3QFY21.

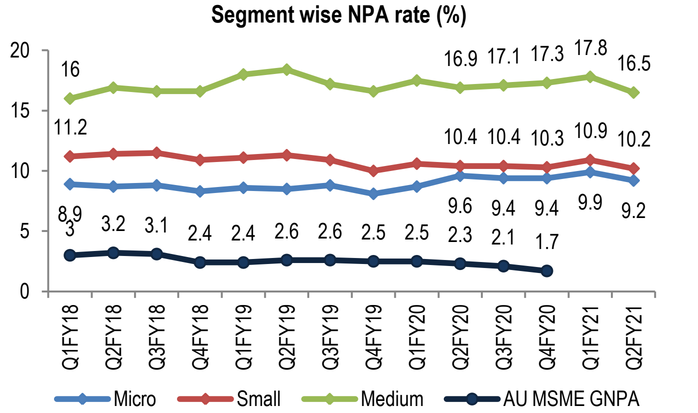
In our view, AU has strong potential to grow in the MSME business given the huge credit gap and reluctance of private banks to extend loans without proper documentation for low ATS. As per the Ministry of MSME, there are 63mn MSMEs in India with 99.5% being Micro MSMEs and ~0.5% being Small MSMEs. There is a reported credit gap of Rs26tn compared to AU's AUM book of Rs112.9bn. AU's credit quality is better than the industry due to better customer understanding and strong underwriting practices. Segment-wise asset quality is robust compared to industry.

Exhibit 34: Huge MSME finance opportunity

Source	Proportion of finance
Finance from institutional sources	5.2%
Finance from non-institutional sources	2.0%
No access to credit or self-financing	92.8%

Source: Nirmal Bang Institutional Equities Research, Crisil

Exhibit 35: Strong underwriting practices have aided in keeping NPA below industry level



Source: Nirmal Bang Institutional Equities Research, Transunion CIBIL

(3) Housing Loan – Small segment with huge potential

AU has 10 years' experience operating a housing finance business. It successfully launched and built a housing finance NBFC called 'AU Housing Finance Ltd' over FY11-16. It sold 90.1% stake in AU Housing Finance to Kedara Capital and Partners group at 4.75x P/B in 2016. Given the vast opportunity in the affordable housing space, AU re-entered this segment in FY18 and has AUM size of ~Rs10bn as on 3QFY21. It currently contributes 3% to AUM and we expect it to reach ~5% of AUM by FY23E. Management expects housing loans to contribute 10-15% to AUM over the next few years and will be the fastest growing segment within its portfolio. Given its prior experience in housing finance and its strong presence in tier 2 & tier 3 cities, we believe AU is well placed to rapidly scale up this business. The average ticket size is Rs1.06mn with LTV ratio of 53%. The avg EMI outflow for the customer is Rs12,000.

The Indian housing finance market is estimated at Rs21.2tn and has grown at a CAGR of 15% over FY15-20. While the overall housing market was up 11% in FY20, the affordable housing segment grew at a higher pace of 18%. The affordable housing segment (which AU serves) is likely to grow at a faster pace. The overall mortgage penetration is at 10.3%, suggesting that most of the fund requirement is met through internal accruals likely due to credit shortages.

Customer profile: Home Loan segment is a further extension of AU's ability of underwriting loans of low and mid-income groups. These are credit worthy customers who may or may not have much credit history or income proof documents and hence are excluded by other large Housing Finance Companies (HFC). Even within this category, 66% of AU's borrowers are salaried and another 33% are self-employed professionals. About 95% of the mortgaged properties are self-occupied by the borrowers. More than 80% of the funding is to 700+ or FTB CIBIL score customers who have demonstrated better repayment record in the past across various portfolios of AU.

AU's home loan business enjoys IRR of ~12.9% and its primary competitors in the affordable housing space are Aavas Financiers and Aadhar Housing.

Exhibit 36: Comparative analysis in the affordable housing space

	Aavas Financiers	Aadhar Housing*	AU SFB#
AUM as on 3QFY21 (Rs mn)	88,226	1,14,320	9,870
Yields	13.4%	13.1%	13.2%
CoF	7.7%	8.9%	7.4%
GS3	1.0%	1.3%	0.2%
ATS (Rs)	910000	840000	10,60,000
Salaried customers	60.7%	65.0%	66.0%
Branches	263	294	550

Source: Nirmal Bang Institutional Equities Research, Banks

Note: *data for Aadhar housing is as on FY20.

(4) Personal Loans, Consumer Finance & Gold Loans

These segments constitute a very small chunk of the overall portfolio, contributing about 1% to the AUM. Most of the loans in these segments are extended to ETB customers with a good repayment history.

Wholesale business – focus on BB & Agri SMEs

REG Book – The AUM share of REG book has declined from 7.2% in 1QFY17 to less than 2% in 3QFY21. The business is selectively sourced with focus on near completion projects. Larger focus is on the affordable housing segment, which can aid in the growth of home loan segment as well. The ATS is Rs26.7mn with GNPA of ~2.5% (FY20). The AUM has registered a decline of 2% over the last 4 years.

NBFC – Book is well diversified (more than 160 clients) across AFCs, HFCs, MFIs, Gold Loans and Fintech segments with an ATS of ~Rs120mn. In FY20, against the AUM size of Rs18.5bn, the bank had deposits worth Rs16bn from these NBFC segments, making them relatively less risky. In the NBFC lending history of 7 years, AU only had one case of slippage [Altico Capital, amount due of Rs620mn against which AU held FD of Rs500mn (link)]. 88% of the exposure is towards investment grade and above rated clients. NBFC AUM has registered a CAGR of 24% over the last 4 years.

Agri SMEs – Agri SME book is focused on funding across the agri value chain like pre-production, production distribution/storage, processing and retail in the form of working capital and term loans. Around 80% of the book is towards working capital loans with an ATS of Rs3.4mn. Larger focus is on non-metro and semi-urban areas to leverage on its distribution strength. Agri SMEs constitute 4% of total AUM.

Business banking – Business banking provides funding to manufacturers, wholesalers, traders, retailers, service providers in the form of overdraft, cash credit, term loans, letter of credit and bank guarantees. Around 80% of the book is in the nature of working capital loans with an ATS of Rs5.5mn. Business banking contributes ~4% of total AUM but the management expects this to increase going ahead.

Agri SME and Business banking are strategic products from the branch banking perspective as it brings in stickiness around CASA.

Exhibit 37: Summary – Asset wise segmental data

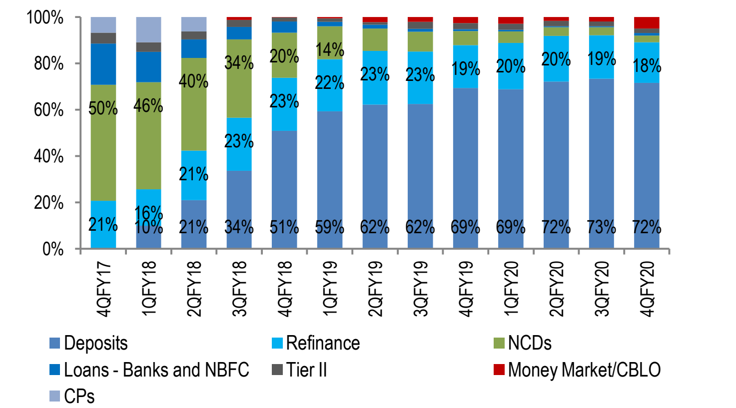
	Retail loans				Wholesale loans			
FY20	**Wheels**	**MSME**	**Home loans**	**Others**	**REG**	**Business Banking**	**Agri-SME**	**NBFC**
AUM Size (Rs bn)	130	113	6	11	8	11	12	19
% of AUM	42	37	2	3	3	4	4	6
GNPA (%)	1.8	1.7	0.2	0.6	2.5	ND	4.5	0.5
AUM IRR (%, Q3FY20)	15.0	15.3	12.9	ND	15.1	11.3	12.1	12.2
Average ticket size (Rs in mn)	0.36	1.05	1.06	ND	26.7	5.5	3.4	120
Tenor (years)	3 to 4 years	5 to 7years	6to 8 years	ND	ND	ND	ND	ND

Source: Nirmal Bang Institutional Equities Research, Bank

Focus on creating a strong deposit franchise

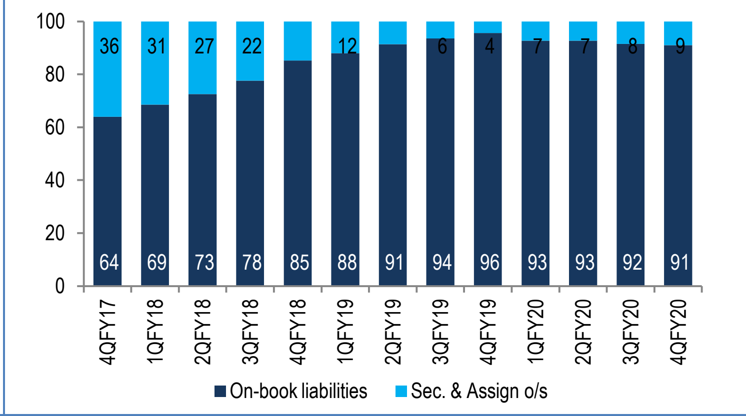
The key strategy to build upon the deposit franchise is (1) primary account transition through multiple products, channels, offers and campaigns (2) Core and urban market segmentation – focus on the urban markets to raise deposits (3) Digital first – simplified processes, payments, communication, etc in order to simplify processes for customers and increase productivity for employess (4) Effective sales and resource management – on-boarding, training, incentives, etc. aligned for the sales team (5) Communication through automated CCLMs, virtual RMs, newsletters, etc to increase customer engagement. AU has delivered differentiation in liability products through simplified processes, monthly interest payments, video KYC and account opening, Whatsapp account opening, etc. This has aided improvement in the share of retail deposits. The share of CASA has been volatile as a percentage of total deposits, but it has increased at 49% CAGR over the last 2.75 years. The share of retail (CASA+ Retail TD) in deposits has increased from 40% in 4QFY18 to 57% in 3QFY21, registering a CAGR of 84% over the last 2.75 years.

Exhibit 38: Increase in deposits as a % of on-book liabilities



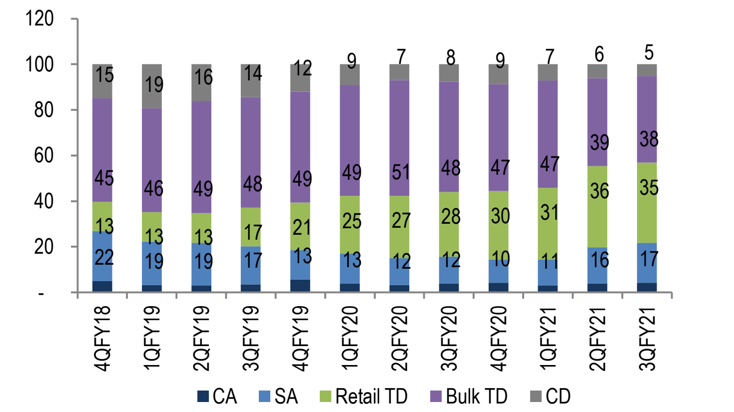
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 39: Share of securitization moderated over time



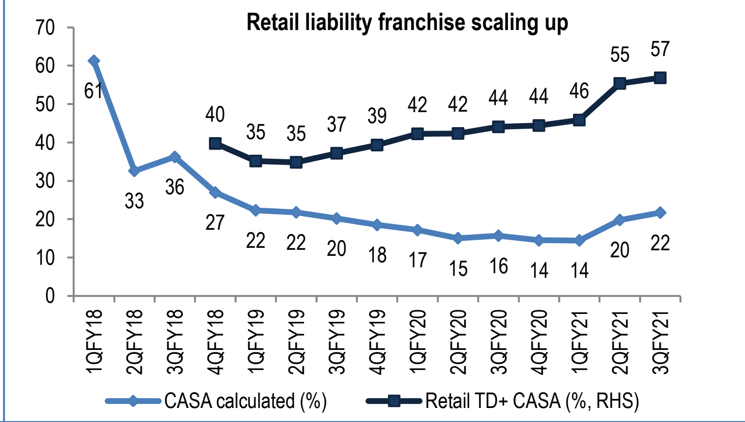
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 40: Deposits break - up



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 41: Retail share of deposits scaling up



Source: Nirmal Bang Institutional Equities Research, Bank

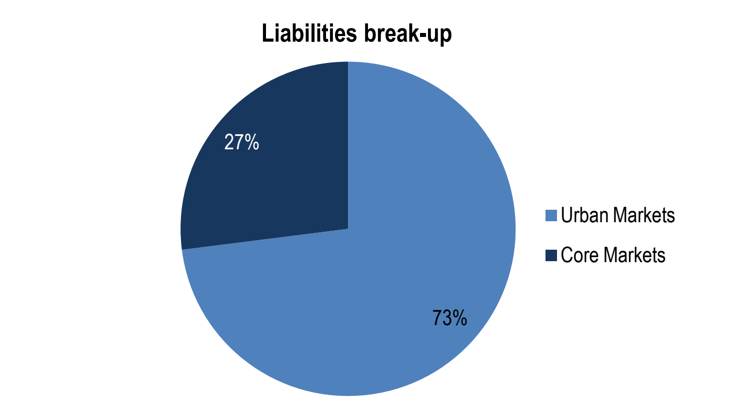
Note: Retail TD refers to all TD of Individuals (including salaried), HUF and TD of Corporates, Government & TASC having balance of less than Rs 20 mn, while Bulk TD refers to all TD of Banks and TD of Corporates, Government & TASC with balances of Rs 20 mn and above.

The share of CASA as % of total deposits has declined from 33% in 2QFY18 to 14% in 4QFY20 on increasing deposit base. However, with the bank's concerted efforts and improvement in the liquidity situation, the CASA has increased to 22% in 3QFY21. The bank has been more successful in scaling up retail TD. The overall share of retail deposits (CASA + retail TD) has increased steadily from 35% in 1QFY19 to 57% by 3QFY21.

AU has a genesis of non-deposit taking NBFC and has historically funded its expansion through NCDs from market, term finance and refinance from banks. The conversion of borrowers towards current and savings accounts was challenging as the borrowers already held a deposit account with PSBs. However, the focus on Business Banking and Agri SME asset segments should aid in current account expansion. On the savings side, the bank is targeting senior citizens and women with high rate of interest.

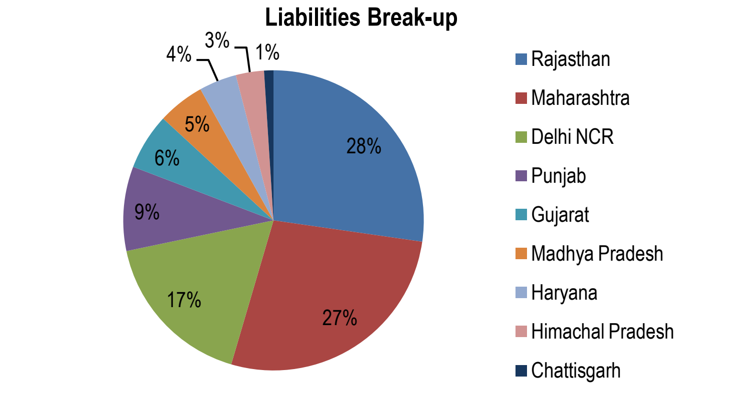
AU has carved out a strategy of raising deposits from urban markets and using the same to lend in its core markets. Core markets are smaller centers in rural/semi-urban areas, which typically have a local economy built around agriculture and small businesses, and where AU typically lends. Larger centers which have a more advanced infrastructure such as airports, malls, etc. are defined as urban markets.

Exhibit 42: Liabilities break-up



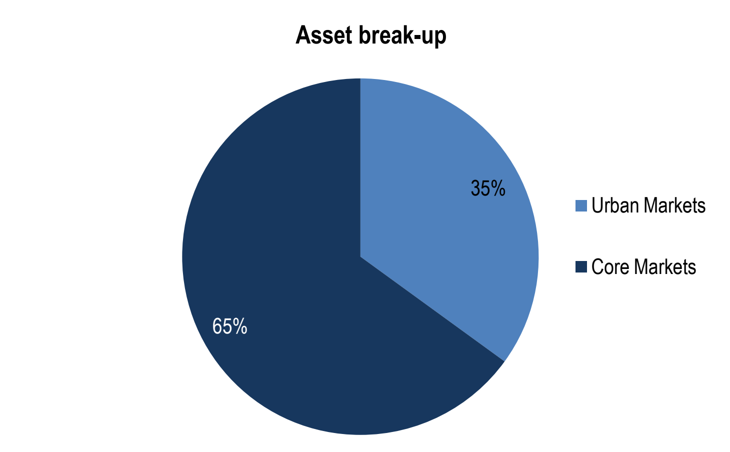
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 43: Liabilities break-up state wise



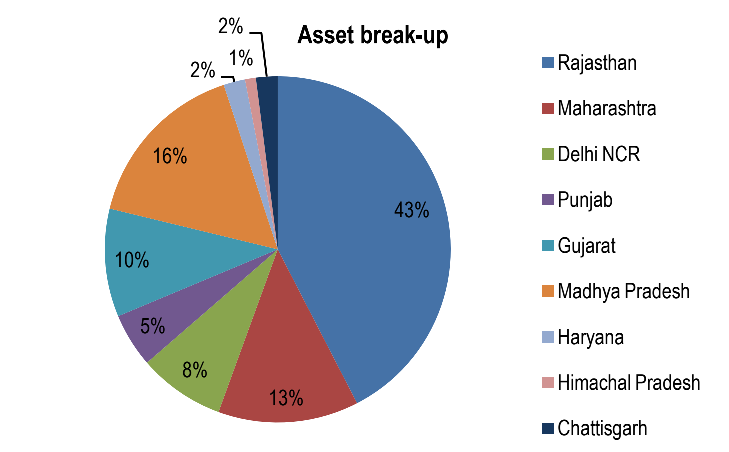
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 44: Assets break-up



Source: Nirmal Bang Institutional Equities Research, Bank

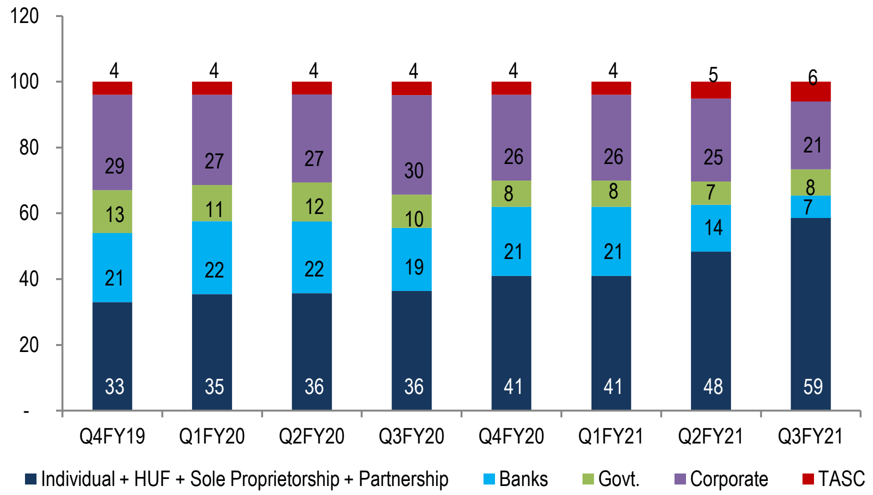
Exhibit 45: Assets break-up state wise



Source: Nirmal Bang Institutional Equities Research, Bank

AU is trying to build a higher proportion of "individual" retail base in its deposit franchise. The share of individual deposits (individual + HUF + sole proprietorship + partnership) has increased from 36% to 59% in the last one year. This is a sticky business and will aid in keeping the cost of funds low. The share of banks and corporate is down from 49% to 28% over the last one year.

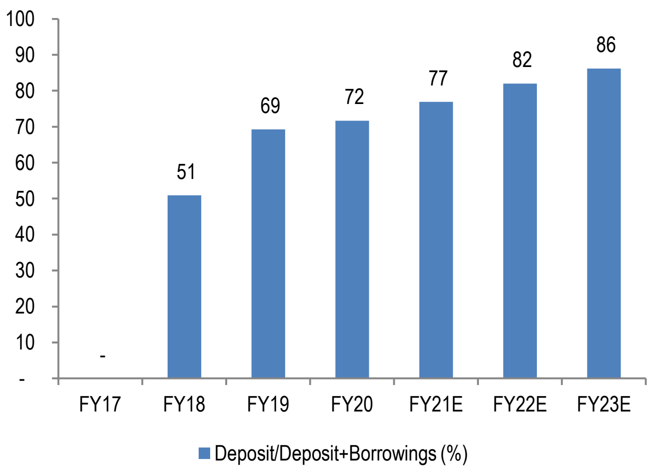
Exhibit 46: Profile of deposits spread across segments



Source: Nirmal Bang Institutional Equities Research, Bank
Note: Deposits excludes Certificate of deposits

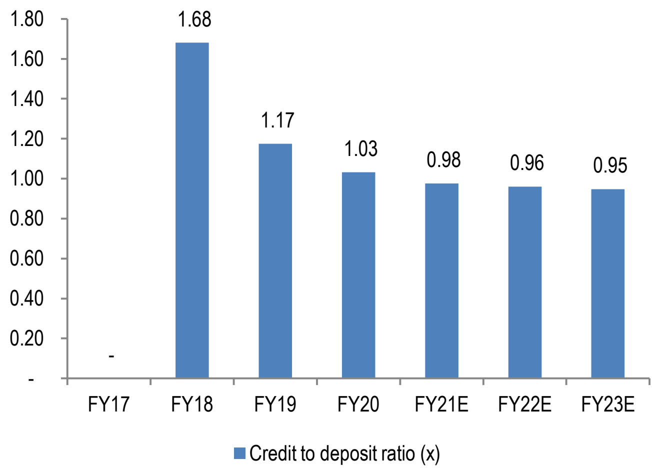
AU started accepting deposits from 1QFY18 and it currently contributes 76% to total deposits and borrowings. We expect it to go up to 86% by FY23E. Credit to deposits ratio stood at 1.02x in 3QFY21 and the bank expects it to fall to ~0.9x in the next two years. We are building in credit/deposit ratio of 0.95x by FY23E.

Exhibit 47: Share of deposits to increase



Source: Nirmal Bang Institutional Equities Research, Bank

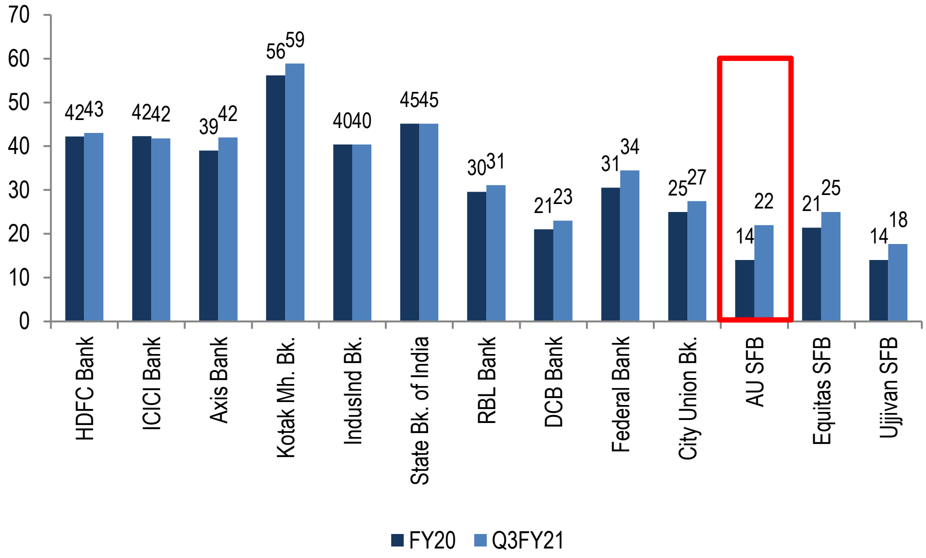
Exhibit 48: Credit to deposit ratio to reduce to 0.95x by FY23E



Source: Nirmal Bang Institutional Equities Research, Bank

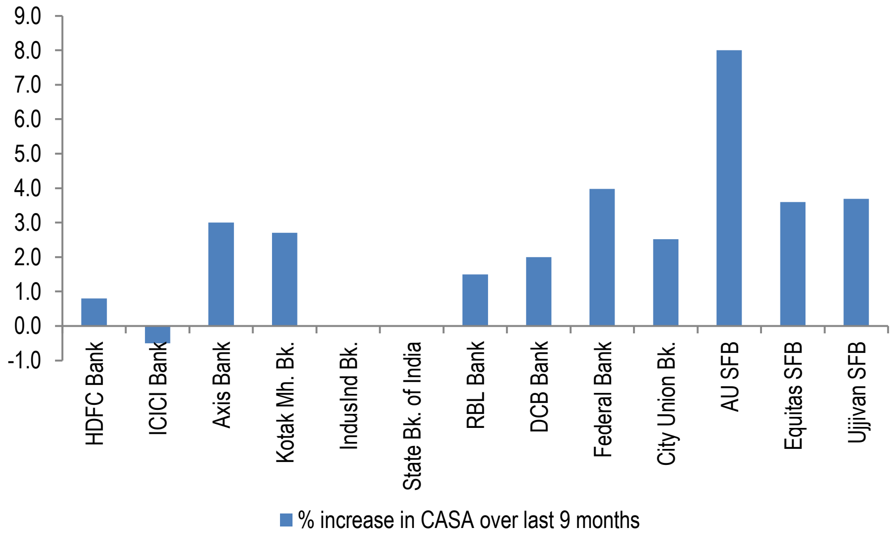
The large private sector banks have CASA as a % of deposits in the range of 40-60%. While AU still stands small in terms of the size of deposits and CASA ratio, it has been able to increase the share of CASA by 800bps over the last 3 quarters. In our view, CASA provides stability and profitability boost and any improvement in this should lead to better margins.

Exhibit 49: CASA as a % of deposits across banks



Source: Nirmal Bang Institutional Equities Research, Banks

Exhibit 50: AU SFB witnessed highest growth in CASA over last 9 months, albeit on a low base



Source: Nirmal Bang Institutional Equities Research, Banks

One of the key reasons for increase in CASA has been the traction in savings account due to high interest rates compared to its large private sector bank peers. The bank adopted a strategy of different interest rates across different slabs of deposits with high interest rates for higher slabs with high deposits.

Exhibit 51: Savings Rate Comparison: AUBANK vs. Peers

Savings rate comparison	AU SFB	Ujjivan SFB	Equitas SFB	RBL Bank	Yes Bank	HDFC Bank
Balances less than Rs 1 lakh	3.5%	4.0%	3.5%	4.8%	4.0%	3.0%
Balances more than Rs 1 lakh to less than Rs 5 lakhs	5.0%	7.0%	7.0%	6.0%	4.8%	3.0%
Balances from 5 lakh to less than Rs 10 lakh	6.0%	7.0%	7.0%	6.0%	4.8%	3.0%
Balances from Rs 10 lakhs to less than Rs 25 lakhs	7.0%	7.0%	7.0%	6.5%	5.5%	3.0%
Balances from Rs 25 lakhs to less than Rs 5 crores	7.0%	6.0%	7.0%	6.5%	5.5%	3%-3.5%
Balance from Rs 5 crores to less than Rs 10 crores	6.0%	6.0%	7.0%	-	5.5%	3.5%

Source: Nirmal Bang Institutional Equities Research, Banks

Exhibit 52: Fixed Rate Comparison: AUBANK vs. Peers

FD Rates	AU SFB	Ujjivan SFB	Equitas SFB	RBL Bank	Yes Bank	HDFC Bank
7 days to 1 month 15 days	3.50%	3.05%-4.05%	3.6%-3.65%	3.25%-4.0%	3.5%-4.0%	2.5%-3.0%
1 month 16 days to 3 months	4.00%	4.05%	4.15%	4.50%	4.50%	3.00%
3 months 1 day to 6 months	4.75%	4.80%	4.90%	5.25%	5.00%	3.50%
6 months 1 day to 12 months	5.25%	5.20%	4.90%	5.5%-5.75%	5.5%-5.75%	4.9%-5.4%
12 months 1 day to 15 months	6.35%	6.50%	6.50%	6.50%	6.25%	4.90%
15 months 1 day to 24 months	6.25%	6.50%	6.65% - 6.8%	6.50%	6.25%	4.90%
24 months 1 day to 36 months	6.50%	6.75%	6.8% - 6.65%	6.50%	6.50%	5.15%

Source: Nirmal Bang Institutional Equities Research, Banks

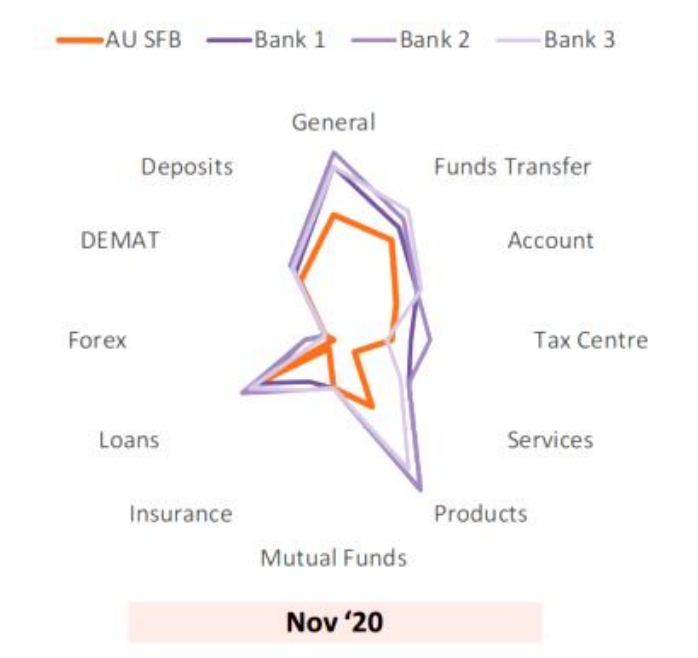
In addition to deposits, AU can borrow long-term money from various refinancing institutions like SIDBI, NABARD, etc at cheaper rates, which should help it to sustain loan growth.

Focus on customer experience and increasing digital product offering

On conversion to SFB, AU focused on early adoption of technology in order to gain business and to ensure smooth consumer experience. AU was one of the first few banks to start branch agnostic account opening process with minimum documentation. It was the first in the industry to open savings account on Whatsapp or by giving a missed call. AU is leveraging tab banking across products for customer on-boarding to enhance experience, reduce TAT and optimize workforce productivity. Around 90%+ deposit accounts are being opened via digital platforms. AU started tab based SBL lending and is in the process of launching the same for home loans and wheels in FY22. AU is leveraging data analytics to generate risk based score cards for credit underwriting to reduce TAT and quantify risk.

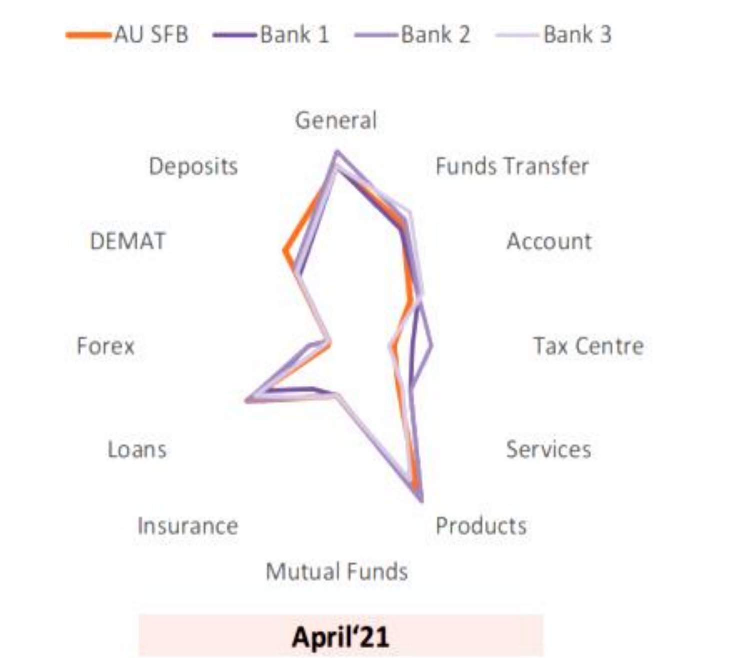
AU has 350 in-house employees for technology and products and plans to increase this strength to 500 by 1QFY22. The tech team is sourced from premium institutes and leading organizations. In 3QFY21, AU upgraded its mobile banking and internet banking platforms and launched 130+ new functionalities, including ASBA, UPI, investments, bill payments and various lifestyle related services like taxi booking, flights, hotels, etc. It plans to launch 10+ new end-to-end banking service and product journeys for both NTB and ETB customers in 1QFY22. The bank plans to upgrade 12 product functionalities in line with leading banks by April'21.

Exhibit 53: Increasing digital product offering – Nov 20



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 54: Increasing digital product offering – April 21



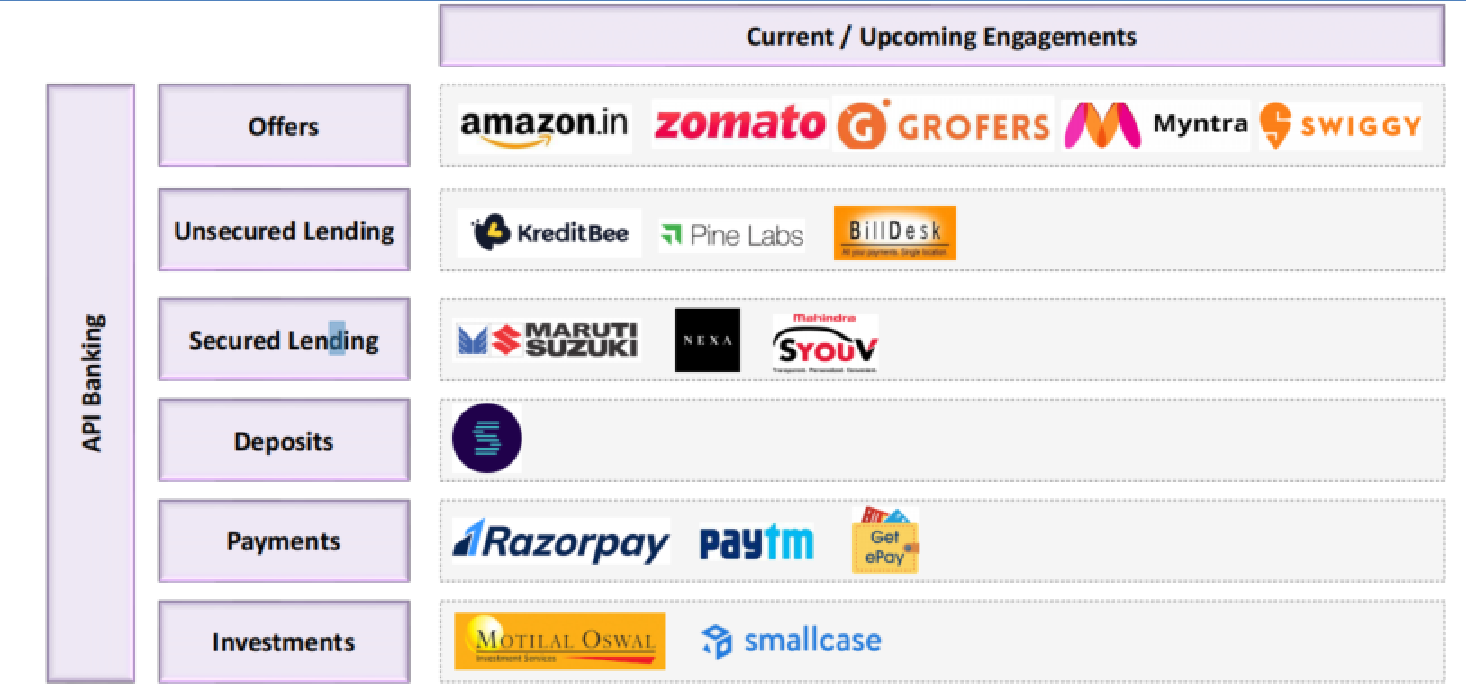
Source: Nirmal Bang Institutional Equities Research, Bank

Note: Functionality comparison based on Au's internal analysis. Bank 1 – large public sector in India, Bank 2 and Bank 3 – top 5 private sector banks in India.

AU has always been focused on leveraging technology to grow its business. The Covid-19 pandemic led to an early adoption of technology and the bank saw its transactions of active users double. While digitalization has been a theme across banks, AU does stand out in terms of its execution (reflected in increase in CASA and disbursements).

It has partnered with multiple players under API banking on leading online platforms, payment banks, brokerages and leading auto OEMs. Offers across various online platforms aided in new customer acquisition. According to AU's internal metrics, 78% of Amazon debit card users were new activations. The company is now focused on converting parking accounts (second/ third account) into customer's primary accounts, which will aid in healthy CASA.

Exhibit 55: Building API stack to partner with the ecosystem



Source: Nirmal Bang Institutional Equities Research, Banks

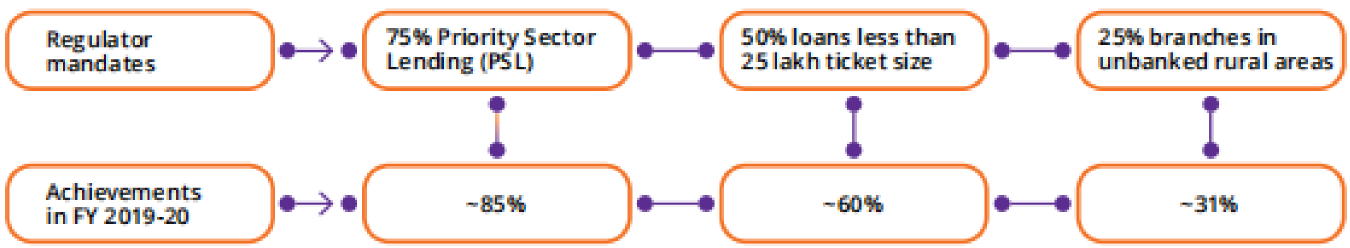
AU has 34000 merchants registered under UPI QR. It registered around 28,000 new merchant QR codes in 3QFY21 alone. The expansion in the network of merchants will aid in current account acquisition and analytics based lending. Under digital payment ecosystem, it is already live under all platforms like UPI, FASTag, BBPS, AePs, etc. AU is in the process of launching credit cards on its own platform with best–in-class partners. It is already live for employees and will be launched for customers in the next few months. In order to further augment its digital banking journey, AU participated in the equity raising process of NPCI to the maximum permissible limit.

ESG Framework

Environmental: Focus on digitization and tab banking has reduced paper requirement in branches. On the liability side, the bank has digitized account opening processes with 0.35mn accounts getting opened digitally in FY20. It has completely done away with the deposit slips. On the asset side, the company has fully digitized two wheeler and consumer durables loans by using Aadhar, e-Mandate and e-Sign. This is now being extended to personal loans, wheels and SBL. Customers are educated in order to use online banking in order to promote ease of banking, save consumption of fuel and reduce travel time. AU has taken a lot of initiatives like installation of BTU meters in the chilled water system, installation of energy star appliances, use of solar panels, etc to reduce energy consumption. In FY20, the bank saved ~5.9mn kWh electricity using 13,200 ACPI enabled devices. It virtualized its physical servers into software based machines, which can hold data equivalent to that held on many physical servers. This nearly led to savings of 82mn kWh of energy by virtualising 1094 servers. The company keeps engaging in different drives and campaigns like save the birds, no plastic campaigns, tree plantation, etc on a regular basis.

Social: As a SFB, AU needs to have 25% of its branches in unbanked/under-banked areas, with 75% of loans towards priority sector lending and 50% loans less than Rs2.5mn in ticket size. AU outpaced these mandates by wider margins. It established several programs for women entrepreneurship, skill development, sports, financial literacy and digital literacy.

Exhibit 56: AU bank financial inclusion objectives and achievements

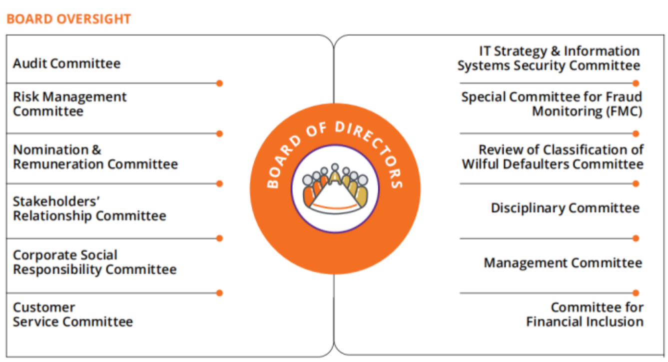


Source: Nirmal Bang Institutional Equities Research, Banks

AU is driving key government initiatives of financial inclusion under various schemes like Mudra Loans, BSBDA, Pradhan Mantri Jeevan Jyoti Bima Yojna, Atal Pension Yojna, etc. It conducted 854 physical literacy camps in 3QFY21 alone. The bank had CSR obligation to spend Rs164mn for FY20, of which Rs37mn remained unspent.

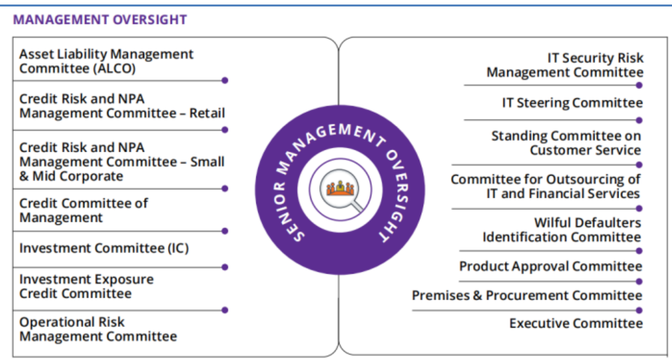
Governance: AU has eight board members, of which six are independent members with expertise in various fields. The committee members were present in all committee meetings throughout the year. The bank follows risk governance structure with three lines of defence – business & control groups, risk & compliance functions and internal audit.

Exhibit 57: Corporate governance structure



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 58: Corporate governance structure



Source: Nirmal Bang Institutional Equities Research, Bank

Financials set to improve

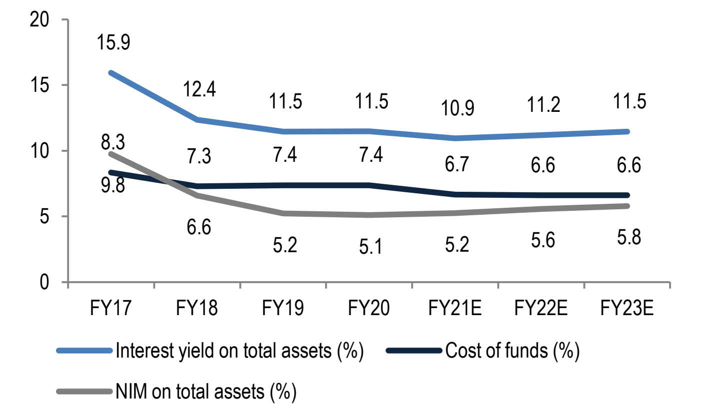
Low cost of funds will aid in NIM expansion

We expect cost of funds to improve as the proportion of deposits increase in overall funding. Also, the refinancing of old high cost borrowings will aid in reduction of cost of funds.

Interest on total assets declined from 15.9% in FY17 to 11.5% in FY20 due to decline in the share of off-book assets (securitization), change in asset mix and pass-through of the benefit of reduction in cost of funds. We expect interest yield to decline to 10.9% in FY21 due to negative carry of excess liquidity. However, we expect it to increase to 11.5% by FY23E as the excess liquidity normalizes.

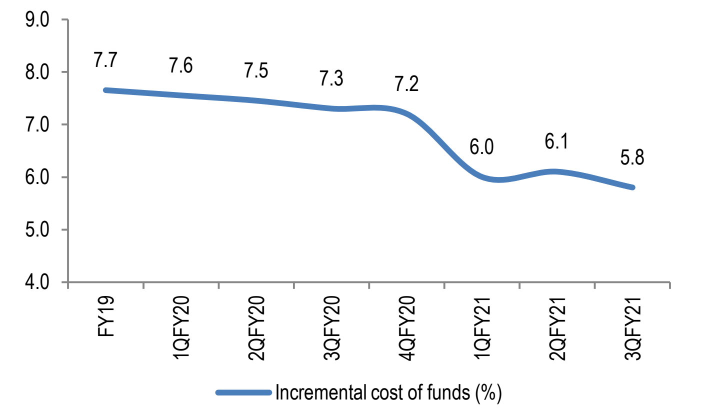
Robust interest yields coupled with low cost of funds should aid in NIM expansion.

Exhibit 59: Low cost of funds to aid in NIMs improvement



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 60: Incremental cost of funds on a declining trend



Source: Nirmal Bang Institutional Equities Research, Bank

Cross-selling opportunity and PSLC to add to other income

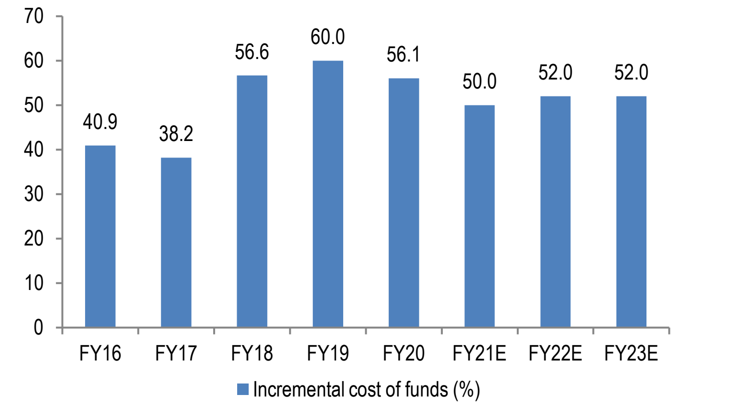
Around 85% of AU's lending is towards priority sector loans vs a regulatory requirement of 75%. On a conversion to a universal bank, regulatory requirement on priority sector loans will fall to 40%. However, AU has established its niche in lending to un-banked/under-banked customers and the business model in our view might not change that drastically. This should open up ~30-40% of the portfolio to be traded under the PSLC instruments, which can be a major source of other income.

Expansion in payment ecosystem, bancassurance partnerships and introduction of credit cards will provide other avenues to increase fee income.

Cost to income ratio to decline as technology adoption increases

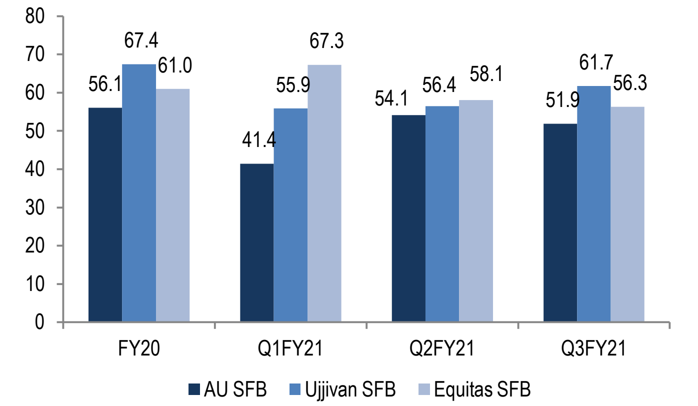
Cost-to-income ratio increased from 38% (NBFC) in FY16 to 56% in FY20 due to investment in branches, CRR/SLR drag and technology upgradation. Around 60% of its costs are fixed in nature while 40% are variable. The branch count increased from 284 branches in FY17 to 714 branches (550 branches and 164 business correspondents banking outlets) in 3QFY21. We expect AU to add another ~400 touchpoints by FY23E. We believe that AU's business was back to normal after registering a growth of 34% in disbursements in 3QFY21. It also carried out annual appraisals and invested heavily in technology. Despite this, the cost-to-income ratio fell to 52% in 3QFY21. We believe this number is sustainable because of (1) high denominator effect due to improvement in NIM and other income (2) cost rationalization and (3) increase in productivity due to technology adoption. Management has guided that the cost-to-income ratio is likely to remain in the range of 50-53%.

Exhibit 61: Cost to income ratio to stabilize at ~52%



Source: Nirmal Bang Institutional Equities Research, Banks

Exhibit 62: C/I ratio lower than other SFBs

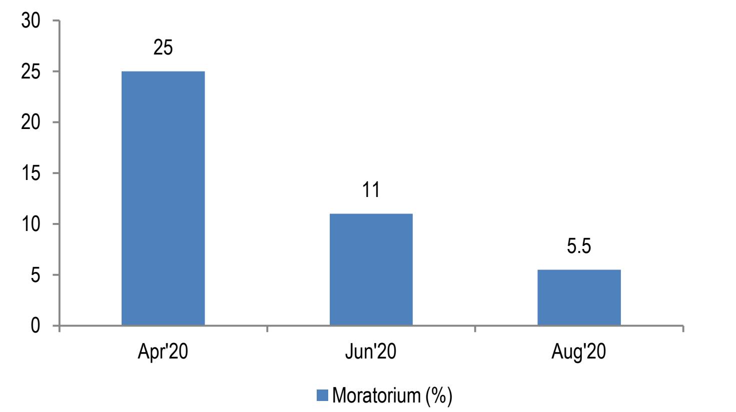


Source: Nirmal Bang Institutional Equities Research, Banks

Asset quality better than peers

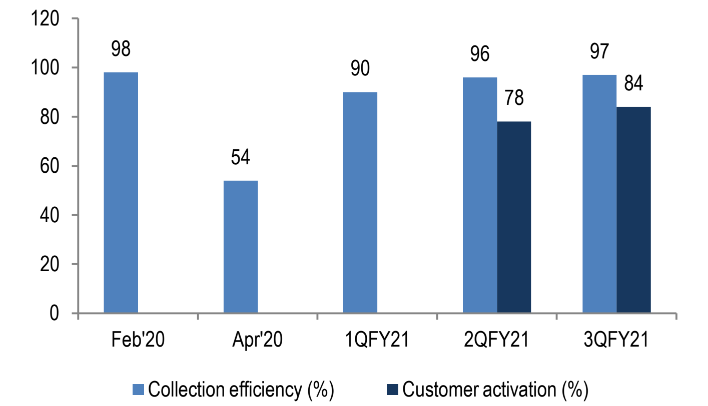
In accordance with the RBI guidelines related to COVID-19 regulatory package, 25% of AU's loan book (29% of customers) opted for moratorium in 4QFY20. This fell to 11% in June'20 and 5.5% in Aug'20. The moratorium book fell to 3% by Oct'20. The collection efficiency stood at 54% in April'20, which improved to 90% in June'20 and 96% in 2QFY21. Collection efficiency improved to 97%/103% in 3QFY21/Dec'20 vs pre-Covid level of 98%. Customer activation reached 84% (full EMI) in Dec'20 compared to ~78% in 2QFY21 and pre-Covid level of ~80%. Around 7% of customers paid part EMIs in Dec'20. Customer activation denotes % of customers paying in the same month as the month of billing.

Exhibit 63: Customers under moratorium declined steadily



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 64: … as reflected in collection efficiencies



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 65: Collection Efficiency – Normalcy achieved in almost all segments

Product	Dec-20	3QFY21	2QFY21	3QFY20
SBL	113%	108%	106%	99%
Wheels	98%	92%	89%	99%
NBFC	99%	99%	105%	100%
Business Banking	97%	100%	105%	96%
REG	105%	102%	110%	91%
Agri	146%	113%	119%	94%
Home Loan	124%	126%	112%	100%
SME	149%	126%	106%	88%
Personal Loans	99%	92%	88%	95%
Gold Loan	104%	162%	116%	100%
Consumer Durable	108%	97%	85%	97%
Others	200%	90%	100%	100%
Grand Total	**103%**	**97%**	**96%**	**98%**

Source: Nirmal Bang Institutional Equities Research, Bank

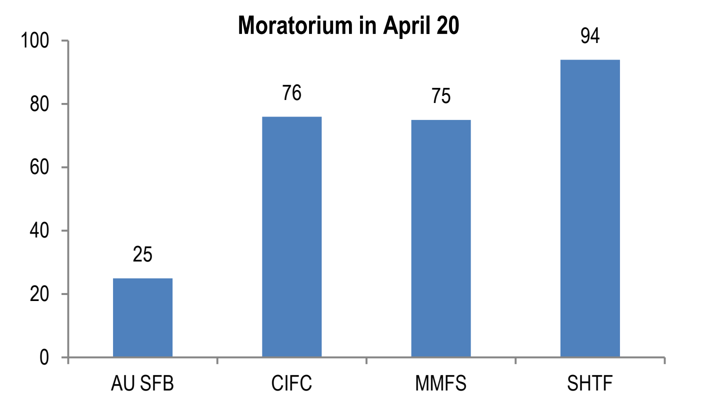
Exhibit 66: Customer activation – Normalcy achieved in almost all segments

Product	Total Gross advances in Rs bn	Dec-20 % of gross advances Full	Dec-20 % of gross advances Part
SBL	123	84%	8%
Wheels	113	81%	6%
NBFC	14	99%	0%
Business Banking	13	96%	2%
REG	6	86%	12%
Agri	9	93%	4%
Home Loan	10	93%	3%
SME	5	75%	14%
Personal Loans	1	82%	8%
Gold Loan	2	75%	6%
Others	8	100%	0%
Grand Total	**304**	**84%**	**7%**

Source: Nirmal Bang Institutional Equities Research, Bank

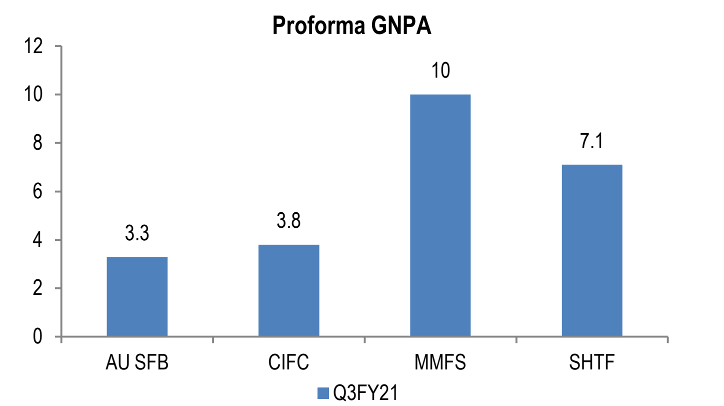
The asset side of AU is comparable with auto NBFCs like CIFC, SHTF and MMFS with all financing the need of under-banked customers with low documentation. Surprisingly, AU's moratorium was lower than the auto NBFC peers and the asset quality is reasonably better.

Exhibit 67: Less customers opted for moratorium



Source: Nirmal Bang Institutional Equities Research, Bank

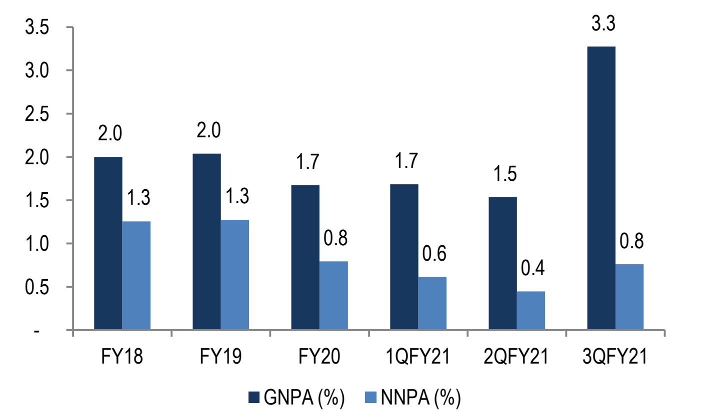
Exhibit 68: Asset quality better than peers



Source: Nirmal Bang Institutional Equities Research, Bank

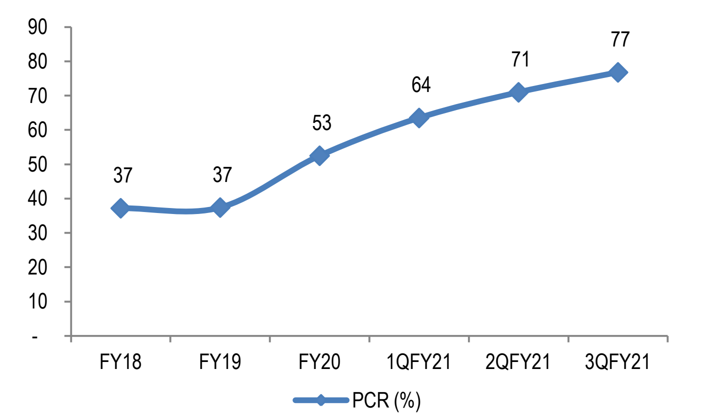
Restructured loans in 3QFY21 stood at Rs2.5bn (0.8% of loans). Most of the restructuring was from sectors like buses and taxi (wheels segment) and schools and apparels (MSME segment). AU expects overall restructuring to stabilize at 1.5% of loans. Pro-forma GNPA and NNPA ratio stood at 3.3% and 1.3%, respectively. AU is carrying 72% coverage on pro-forma GNPA and 19% on restructured loans. 84% of the pro-forma GNPA was contributed by Wheels (48%) and SBL business (36%), which are fully secured. Given the secured nature of loans, the actual write-offs will be low.

Exhibit 69: Asset quality stress fully visible in 3QFY21



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 70: Provision coverage ratio improved to ~72%

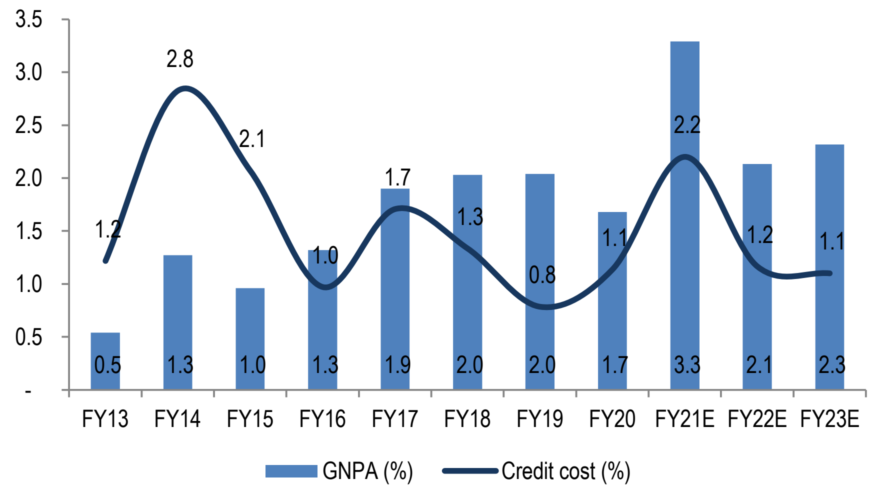


Source: Nirmal Bang Institutional Equities Research, Bank

Credit cost at all time high, likely to normalize from FY22

The bank increased provision on GNPA from 53% in FY20 to 77% in 3QFY21 (72% coverage on pro-forma GNPA and 19% coverage on restructured assets). This led to an increase in credit cost from 1.1% in FY20 to 3.9% in 3QFY21. The credit cost for 9MFY21 stands at 1.8% (not-annualised) and we expect it to increase to 2.2% in FY21. The stressed assets are small ticket, secured and are used for income generation. The resolutions are likely to pick up pace going ahead.

Exhibit 71: We expect credit cost to normalize FY22 onwards

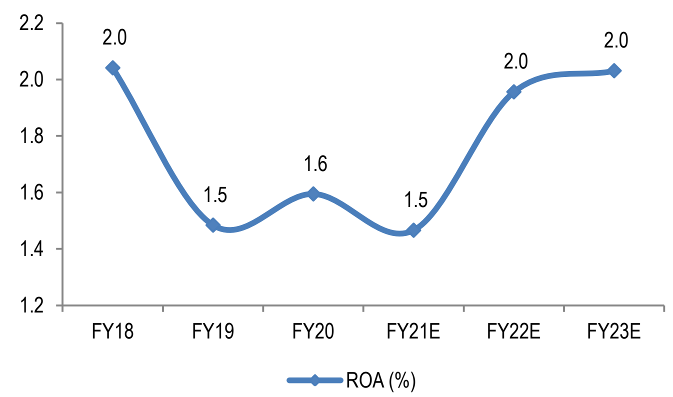


Source: Nirmal Bang Institutional Equities Research, Bank

ROE & ROA to improve to ~2.1% and 18.7% by FY23E

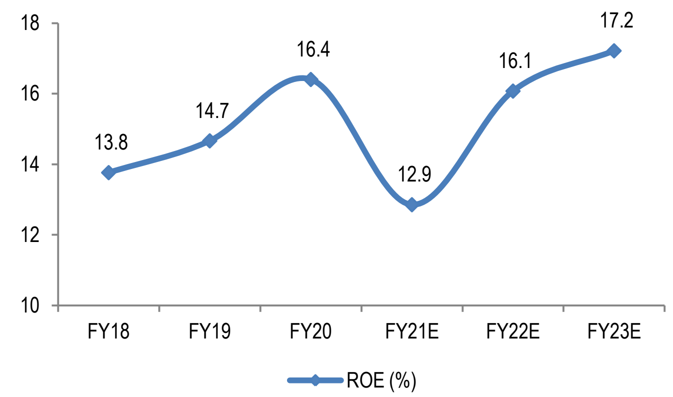
We expect earnings to increase at 32% CAGR over FY20-23E. This is largely driven by low cost of funds (17% CAGR vs 22% CAGR over FY20-23E in interest income) and operating leverage.

Exhibit 72: ROA to improve to 2.0%



Source: Nirmal Bang Institutional Equities Research, Bank

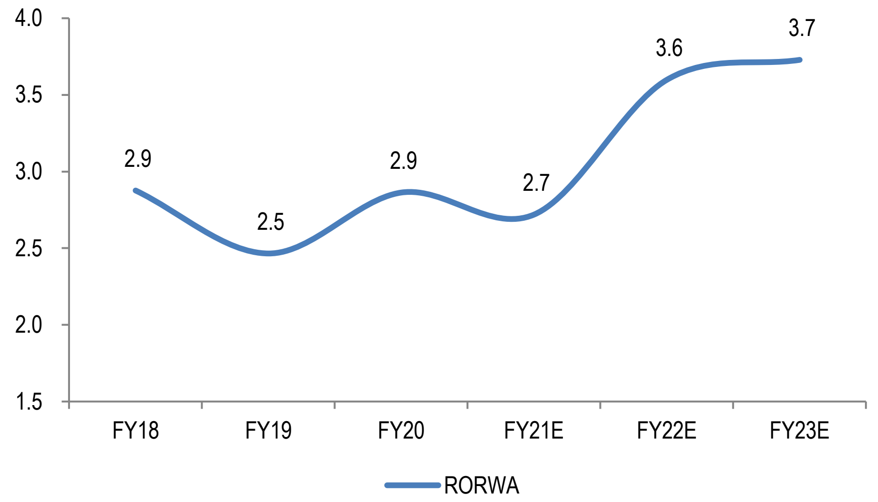
Exhibit 73: ROE to improve to 17.2%



Source: Nirmal Bang Institutional Equities Research, Bank

Note: PAT does not include profit from sale of Aavas Financiers in FY20 & FY21E

Exhibit 74: RoRWA set to reach 3.7% in FY23E



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 75: ROA Tree & Du-Pont Analysis (%)

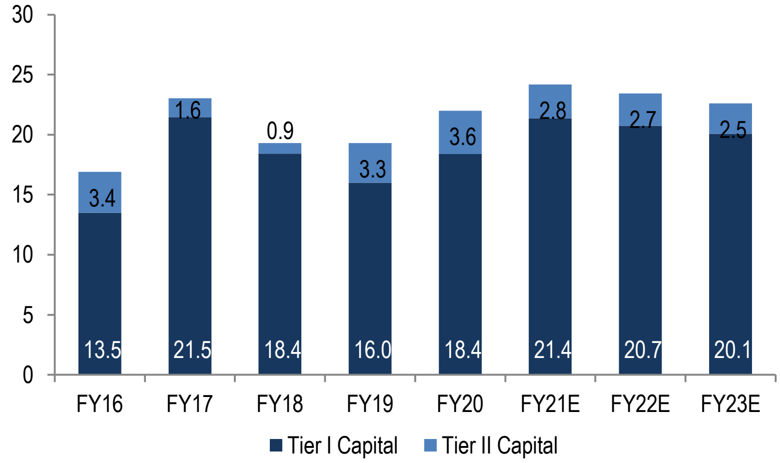
Particulars	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Interest Income	19.1	18.6	20.1	19.6	15.9	12.4	11.5	11.5	10.9	11.2	11.5
Interest Expenses	9.2	9.5	8.1	7.7	6.2	5.8	6.2	6.4	5.7	5.6	5.7
Net Interest Income	9.9	9.1	12.1	11.9	9.8	6.6	5.2	5.1	5.2	5.6	5.8
Non-Interest Income	0.1	0.2	0.1	0.1	1.7	2.7	1.8	1.7	1.5	1.5	1.5
Operating Income	10.0	9.3	12.1	12.0	11.5	9.3	7.0	6.8	6.8	7.1	7.3
Operating expenses	4.5	3.7	4.4	4.9	4.4	5.3	4.2	3.8	3.4	3.7	3.8
Pre-Provision operating profit	5.5	5.6	7.7	7.1	7.1	4.0	2.8	3.0	3.4	3.4	3.5
Provisions	0.8	2.0	1.7	0.8	1.3	0.9	0.6	0.8	1.4	0.8	0.8
Profit before tax	4.7	3.6	6.0	6.2	5.8	3.1	2.3	2.2	2.0	2.7	2.8
Tax	1.6	1.2	1.9	2.1	3.9	1.1	0.8	0.6	0.7	0.7	0.7
ROA	**3.1**	**2.3**	**4.0**	**4.1**	**4.2**	**2.0**	**1.5**	**1.6**	**1.5**	**2.0**	**2.0**
Leverage	5.7	5.8	5.0	5.7	5.4	6.7	9.9	10.3	8.8	8.2	8.5
ROE	**17.8**	**13.6**	**19.9**	**23.3**	**22.6**	**13.8**	**14.7**	**16.4**	**12.9**	**16.1**	**17.2**

Source: Nirmal Bang Institutional Equities Research, Bank

Adequately capitalised for growth

As per the regulatory requirement, AU is required to maintain capital adequacy ratio of 15% at all times. Minimum Tier I capital requirement of 7.5% and maximum Tier II capital requirement of 7.5%. AU has been adequately capitalized since its transition to bank. We expect capital adequacy ratio to improve further post the sale of stake in Aavas Financiers and equity dilution of 1.6% (raised Rs6.25bn through QIP) in March 2021. We build in disbursement growth of 32% and 31% for FY22E and FY23E and this should be easily met from internal accruals, in our view.

Exhibit 76: Capital adequacy to remain robust



Source: Nirmal Bang Institutional Equities Research, Bank

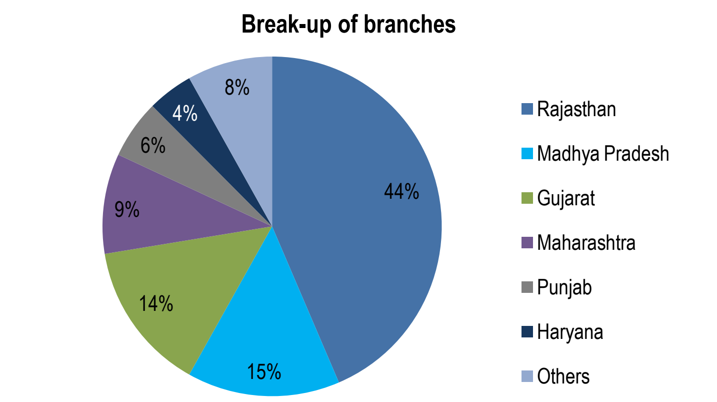
Expanding distribution and reach

AU launched its SFB operations in April 2017 through 284 branches in 11 states and one union territory. Apart from this, it had 119 asset centers, which were focused on loans only and primarily housed sales staff and team. It gradually expanded its branch count and converted some asset centers into full fledged branches. In 3QFY21, it operates with 550 branches and 164 business correspondents as part of branches apart from 14 BCs. The distribution network is spread across 15 states and 2 union territories. Over the last four years, the employee count has increased 2.2x to 18,992.

AU has strong presence in its home state of Rajasthan (311 branches), where it commenced operations and is headquartered. The company has adopted a strategy of expansion into neighboring geographies of Gujarat (102 branches), Maharashtra (68 branches) and Madhya Pradesh (104 branches).

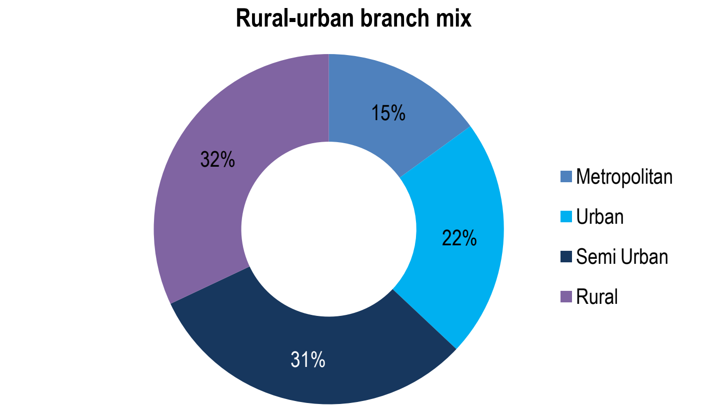
63% of its branches are in semi-urban and rural areas (Tier 2 to Tier 6).

Exhibit 77: Break up of branches



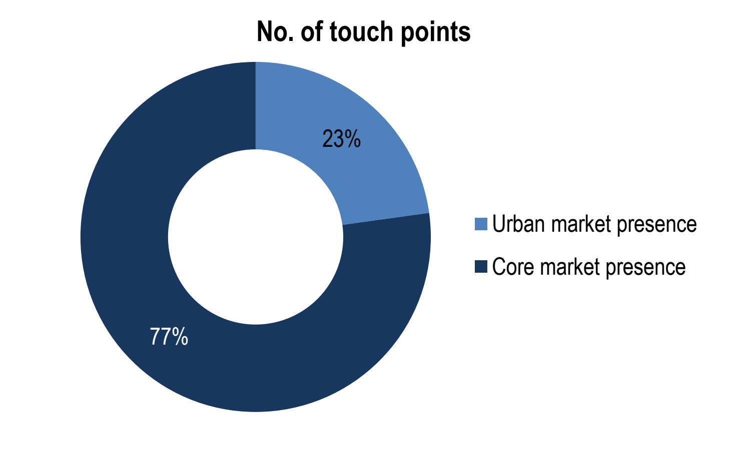
Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 78: Rural-Urban branch mix



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 79: Deeper penetration in core markets – where lending happens



Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 80: Presence in 15 states and 2 UT's

Source: Nirmal Bang Institutional Equities Research, Bank

Exhibit 81: Key modeling assumptions

Particulars	FY21E	FY22E	FY23E
Growth in Wheels AUM	7.1%	19.3%	25.5%
Growth in Secured MSME	23.4%	27.3%	28.2%
Growth in AUM	12.3%	23.9%	28.3%
Growth in disbursements	-2.0%	31.5%	31.4%
Growth in deposits	25.0%	30.0%	30.0%
Credit to deposit ratio	97.6%	96.0%	94.8%
Investment to deposit ratio	38.0%	33.0%	30.0%
Yield on total assets	10.9%	11.2%	11.5%
Cost of funds	6.7%	6.6%	6.6%
NIM on total assets	5.2%	5.6%	5.8%
Cost to income ratio	50.0%	52.0%	52.0%
Credit costs	2.2%	1.2%	1.1%
GNPA	3.3%	2.1%	2.3%
NNPA	1.0%	0.6%	0.7%
PCR	70.0%	70.0%	70.0%
Credit RWA density	55.0%	55.0%	55.0%

Source: Nirmal Bang Institutional Equities Research, Bank

Valuations - expensive but need to be seen in a context

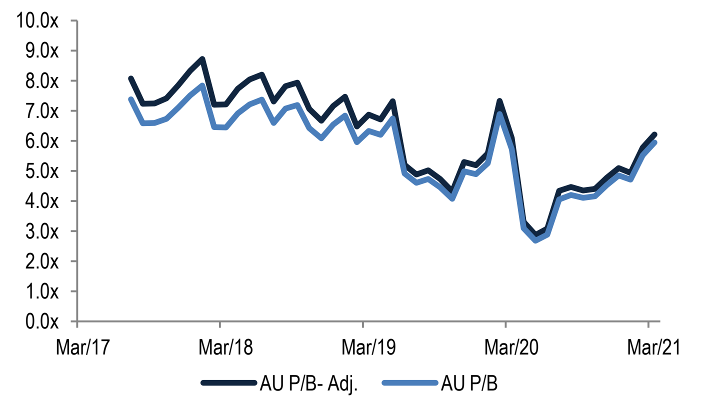
AU is best placed among its peers due to its NBFC DNA (ability to assess unbanked and under-banked customers) and its strong deposit franchise, which will ensure less volatility on the liability side coupled with low cost of funds. It has strong credentials, a strong management team (led by a hands-on CEO) and a proven history of execution. It is trading at 5.9x 12-month forward P/B value, a slight premium to its 4-year avg P/B value of 5.7x. It is at more than 100% premium to sector avg. P/B of 2.1x (FY23E). The valuation though expensive needs to be seen in a context. We understand that the valuation is likely to normalize to sector avg. once the super-normal growth phase is over. The fact that said asset growth is being delivered in under-penetrated customer segment and geographies ensure that the ~25% growth momentum can be sustained over the next 4-5 years. We value Cholamandalam (NBFC with similar kind of asset profile) at 3.25x 12-month fwd P/B. In our view, AU deserves at least a 50% premium due to its strong liability profile and high asset growth.

We value it at 4.9x FY23E P/B due to super normal growth and strong asset quality to arrive at our TP of Rs1,360. This leaves us with an upside of 16%. We build in 26% AUM CAGR over FY21-FY23E and ROE and ROA of 17.2% and 2% in FY23E, respectively.

AU's stock price has run up by 30% in the last two months as the business achieved normalcy. The current market price in our view fully reflects end of asset quality stress but does not fully factor in the AUM growth that the bank may achieve.

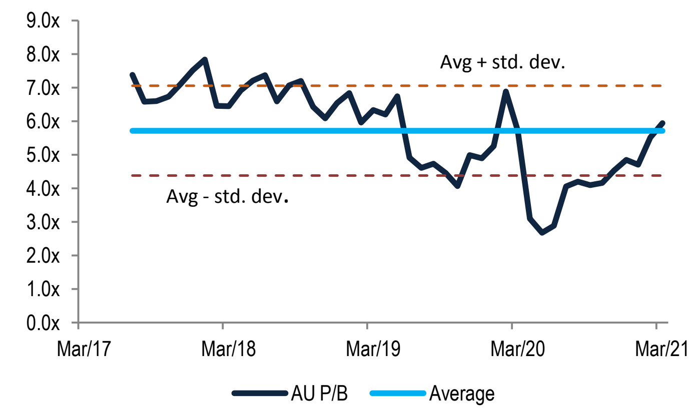
Risks: Key downside risks that could mean the AU stock trades below our target price include: (1) slower-than-expected build up of deposit franchise (2) margin compression due to low yields or high cost of funds and (3) rise in NPA or credit cost.

Exhibit 82: AU's 12-month fwd. P/B and P/B – Adj. nearing its highs



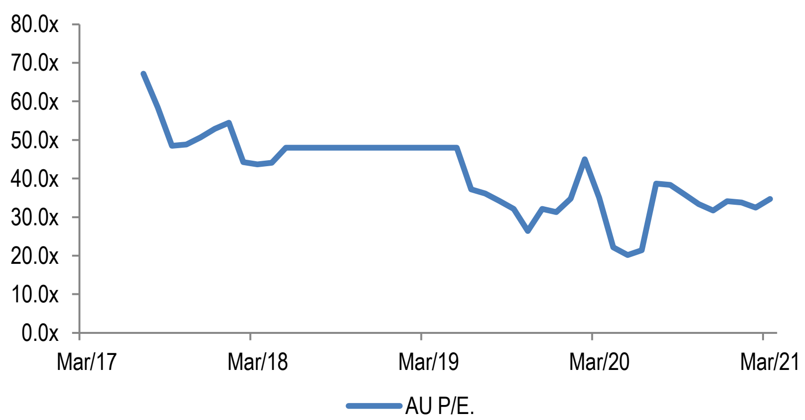
Source: Nirmal Bang Institutional Equities Research, Bloomberg

Exhibit 83: AU trading at a slight premium to 4-year avg 12-month fwd P/B



Source: Nirmal Bang Institutional Equities Research, Bloomberg

Exhibit 84: AU's 12-month fwd P/E



Source: Nirmal Bang Institutional Equities Research, Bloomberg

Exhibit 85: Peer Valuation

	CMP	M-cap	CAGR FY21E-23E				P/E(X)			P/BV (X)			RoE			RoA			Avg GNPA
Banks		**US$mn**	**AUM**	**NII**	**PPOP**	**PAT**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E**	**FY22E**	**FY23E**	**FY21E-23E**
AU SFB	**1230**	**5,210**	**26.1**	**27.3**	**23.1**	**42.4**	**53.8**	**34.2**	**27.0**	**5.9**	**5.1**	**4.3**	**12.9**	**16.1**	**17.2**	**1.5**	**2.0**	**2.0**	**2.6**
Axis Bank	738	31,168	14.0	14.3	16.3	64.8	37.4	17.9	13.8	2.3	2.0	1.8	6.5	12.0	14.0	0.6	1.2	1.4	4.7
Bandhan Bank	340	7,541	22.2	20.1	15.0	36.0	18.5	12.6	10.0	3.0	2.5	2.1	17.7	21.7	22.9	2.9	3.6	3.7	4.5
Bank of Baroda	79	5,624	8.0	7.2	11.0	107.4	18.7	6.3	4.4	0.8	0.5	0.4	2.7	7.6	10.0	0.2	0.5	0.6	9.3
HDFC Bank	1512	114,927	17.1	19.0	20.4	24.0	25.8	20.3	16.8	4.3	3.6	3.1	17.4	18.9	19.6	1.9	2.1	2.1	1.4
ICICI Bank	595	56,737	16.0	14.2	14.3	24.3	26.5	22.0	17.1	3.1	2.6	2.3	11.9	12.2	14.0	1.3	1.4	1.6	5.7
IndusInd Bank	1035	10,808	15.2	16.6	15.4	62.4	25.5	13.5	9.7	2.0	1.7	1.5	8.3	13.7	16.7	0.9	1.5	1.9	3.1
Kotak Mahindra Bank	1903	52,014	15.3	13.1	12.2	21.5	53.3	43.6	36.1	6.2	5.3	4.7	12.7	12.9	13.7	1.9	2.1	2.2	3.0
Punjab National Bank	40	5,751	6.0	5.8	5.1	78.1	19.6	9.5	6.2	0.7	0.4	0.4	2.8	4.7	6.8	0.2	0.3	0.5	14.4
State Bank of India	379	46,593	10.2	9.5	16.6	46.2	17.7	9.5	8.3	1.9	1.2	1.0	7.8	13.1	13.3	0.5	0.8	0.8	5.8
Yes Bank	15	5,339	15.0	10.7	7.5	0.0	-15.5	29.8	18.3	1.5	1.1	1.0	-8.9	3.7	5.8	-0.9	0.4	0.6	14.2
Banks Average			**15.0**	**14.3**	**14.3**	**46.1**	**25.6**	**19.9**	**15.2**	**2.9**	**2.4**	**2.1**	**8.3**	**12.4**	**14.0**	**1.0**	**1.4**	**1.6**	**6.2**
NBFC																			
Cholamandalam	541	6,116	14.8	13.6	11.2	20.7	25.5	20.3	17.5	4.6	3.8	3.2	19.5	20.5	20.0	2.6	2.9	2.9	4.1
Shriram Transport	1323	4,614	12.2	9.8	9.9	21.5	13.0	9.8	9.1	1.5	1.4	1.2	12.6	14.8	14.1	2.1	2.6	2.5	8.0
Mahindra Finance	211	3,596	15.0	11.9	9.9	75.5	35.0	15.0	11.3	1.7	1.6	1.5	5.6	11.0	13.4	1.0	2.2	2.6	7.5
NBFC Average			**14.0**	**11.8**	**10.3**	**39.2**	**24.5**	**15.0**	**12.6**	**2.6**	**2.3**	**2.0**	**12.6**	**15.4**	**15.8**	**1.9**	**2.6**	**2.7**	**6.5**

Source: Nirmal Bang Institutional Equities Research, Bloomberg, Closing price as on 16/03/21

Corporate History

Au Small Finance Bank, a western-India focused lender, has transitioned from a prominent NBFC, which primarily served low and middle-income individuals, and businesses that have limited or no access to formal banking and financing channels. AU received a license from the RBI to set up an SFB on Dec. 20, 2016. It was the only asset finance NBFC to obtain such a license from the RBI. It commenced SFB operations w.e.f. April 19, 2017. AU has strong presence in its home market of Rajasthan and has made inroads into adjacent states. The bank focuses on secured commercial loans in two major segments – Wheels (vehicle financing) and SBL (SME & MSME). It started the Housing Finance business in 2018 and is the fastest growing book in its portfolio.

Board of Directors

Board of Directors	Experience	Education
Mr. Raj Vikash Verma Chairman & Independent Director	Ex-Chairman at NHB Leadership position at IMGC, CERSAI, PFRDA, etc	Masters in Economics, MBA, CAIIB
Mr. V G Kannan Independent Director	Ex MD at SBI Ex Chief Executive - Indian Bank Association Member of Governing Council - IIBF	MBA
Mr. Krisan Kant Rathi Independent Director	Ex-CEO, Future Consumer Ltd Ex-CFO, Future Group	FCA, CS
Ms. Jyoti Narang Independent Director	Ex-COO, Taj Group of Hotels	MBA
Prof. M S Sriram Independent Director	Visiting faculty at IIM-B, Distinguished Fellow-IDRBT, Chairperson- Centre for public policy - IIMB	MBA, Fellow, IIMB
Mr. Pushpinder Singh Independent Director	Ex- CIO, Bank of India Ex Advisor, NPCI (FI & new business)	Bsc, CAIIB
Mr. Sanjay Agarwal MD & CEO	25+ years of experience in BFSI	FCA
Mr. Uttam Tibrewal Whole Time Director	23+ years of experience	B. Com

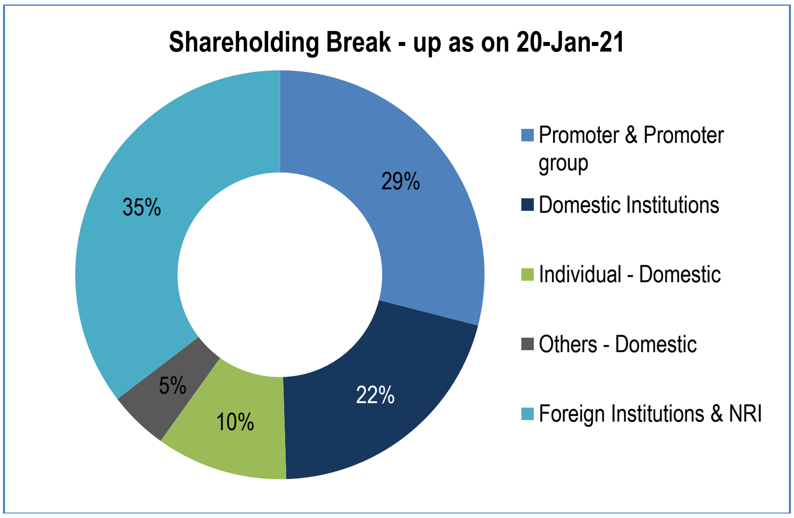
Source: Nirmal Bang Institutional Equities Research, Bank

Key Management Personnel

Key Management	Position
Mr. Sanjay Agarwal	MD & CEO
Mr. Uttam Tibrewal	Executive Director
Mr. Deepak Jain	COO
Mr. Yogesh Jain	Chief of Staff & Group Head of Strategy
Mr. Vimal Jain	CFO
Mr. Mayank Markandy	Chief Risk Officer
Mr. Vivek Tripathi	Chief of Credit & Strategy for commercial banking
Mr. Bhaskar Karkera	Chief of Wheels
Mr. Ankur Tripathi	Chief Information Officer
Mr. Shoorveer Singh Shekhawat	Chief of Products - Liabilities & Communication

Source: Nirmal Bang Institutional Equities Research, Bank

Shareholding



Source: Nirmal Bang Institutional Equities Research, Bank

Key Institutional shareholders	Holding on 20-Jan-21
Wasatch	4.9%
Temasek	4.7%
Capital Group	4.0%
WestBridge Capital	3.9%
Kotak Mahindra MF & AIF	3.8%
Nomura	3.5%
Motilal Oswal MF	2.7%
UTI MF	2.4%
JP Morgan Funds	2.1%
HDFC Life Insurance Co. Ltd	1.9%
VANGUARD	1.7%
Amansa Holdings	1.6%
SBI Life Insurance	1.2%
Nippon MF	1.2%
Kotak's Offshore Funds	1.1%
Motilal Oswal Financial Services Ltd	1.1%
William Blair	1.1%
Motilal Oswal Private Equity	1.0%

Source: Nirmal Bang Institutional Equities Research, Bank

The bank diluted 1.6% shares in March 2021 at an issue price of Rs1,251 (FV Rs10). Consequently, the promoters' stake fell to 28.5%. Below funds participated in the equity dilution.

Name of the allottee	% of total Equity shares offered in the issue
Govt. of Singapore	26.69
Monetary Authority of Singapore	5.91
HDFC Life Insurance Co. Ltd	23.6
Small Cap World Fund, INC	39.66

Source: Nirmal Bang Institutional Equities Research, Bank

Financials

Exhibit 86: Income statement

Y/E March (Rs in mn)	FY19	FY20	FY21E	FY22E	FY23E
Financing Income	29,491	42,859	50,431	62,004	77,398
Finanancing charges	16,065	23,769	26,281	31,149	38,266
Net Financing income	**13,426**	**19,089**	**24,150**	**30,854**	**39,132**
Change (%)	*42.8*	*42.2*	*26.5*	*27.8*	*26.8*
Other Income	4,619	6,204	7,135	8,561	10,274
Net Income	**18,045**	**25,293**	**31,285**	**39,416**	**49,405**
Change (%)	*35.8*	*40.2*	*23.7*	*26.0*	*25.3*
Employee cost	6,011	7,596	8,358	11,167	14,652
Other Operating Exp.	4,815	6,582	7,284	9,329	11,038
Operating Profit	**7,219**	**11,115**	**15,642**	**18,920**	**23,715**
Change (%)	*25.3*	*54.0*	*40.7*	*21.0*	*25.3*
Total Provisions	**1,418**	**2,832**	**6,480**	**4,239**	**5,128**
% to operating income	*19.6*	*25.5*	*41.4*	*22.4*	*21.6*
Excpetional items	0	857	6,514	0	0
PBT	**5,801**	**9,140**	**15,677**	**14,681**	**18,586**
Tax	1,983	2,392	3,211	3,846	4,870
Tax Rate (%)	*34.2*	*26.2*	*20.5*	*26.2*	*26.2*
PAT	3,818	6,748	12,466	10,834	13,717
Adjusted PAT	**3,818**	**5,961**	**6,762**	**10,834**	**13,717**
Change (%)	*30.7*	*56.1*	*13.4*	*60.2*	*26.6*
Dividend	0.0	0.0	0.0	0.0	0.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 87: Key ratios

Y/E March	FY19	FY20	FY21E	FY22E	FY23E
Spreads Analysis (%)					
Interest of total assets (%)	11.5	11.5	10.9	11.2	11.5
Avg Cost of funds	7.4	7.4	6.7	6.6	6.6
Int Spread	4.1	4.1	4.3	4.6	4.9
NIMs on total assets	5.2	5.1	5.2	5.6	5.8
Profitability Ratios					
RoE (%)	14.7	16.4	12.9	16.1	17.2
RoA (%)	1.5	1.6	1.5	2.0	2.0
Int. Expended/Int.Earned (X)	1.8	1.8	1.9	2.0	2.0
Other Inc./Net Income (%)	25.6	24.5	22.8	21.7	20.8
Efficiency Ratios (%)					
Op. Exps./Net Income	60.0	56.1	50.0	52.0	52.0
Empl. Cost/Op. Exps.	55.5	53.6	53.4	54.5	57.0
Asset-Liability Profile					
Credit/Deposit ratio (X)	1.2	1.0	1.0	1.0	0.9
GNPA (Rs mn)	4,701.4	4,577.8	10,807.7	8,883.4	12,402.4
NNPA (Rs mn)	2,945.0	2,173.0	3,242.3	2,665.0	3,720.7
GNPL ratio reported(%)	2.0	1.7	3.3	2.1	2.3
NNPL ratio (%)	1.3	0.8	1.0	0.6	0.7
Leverage (X)	11.1	9.7	8.1	8.3	8.6
Average leverage (X)	9.9	10.3	8.8	8.2	8.5
Tier I Capital (%)	16.0	18.4	21.4	20.7	20.1
Tier II Capital (%)	3.3	3.6	2.8	2.7	2.5
CAR (%)	19.3	22.0	24.2	23.4	22.6
Valuations					
BVPS (INR)	101.5	146.0	202.7	233.4	277.3
BV Growth (%)	27.7	43.9	38.8	15.2	18.8
Price-BV (x)	11.6	8.0	5.8	5.0	4.2
Adjusted book value (Rs)	91.3	138.7	192.1	224.8	265.4
Price-ABV(x)	**12.9**	**8.5**	**6.1**	**5.2**	**4.4**
EPS (INR)	13.2	20.1	22.1	34.7	44.0
Growth (%)	28.3	53.0	9.8	57.1	26.6
Price-Earnings (x)	89.3	58.4	53.2	33.8	26.7
Dividend	-	-	-	-	-
Dividend Yield (%)	-	-	-	-	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 88: Balance sheet

Y/E March (Rsmn)	FY19	FY20	FY21E	FY22E	FY23E
Capital	2,924	3,041	3,121	3,121	3,121
Reserves & Surplus	26,526	40,206	58,877	69,711	83,428
Net Worth	**29,449**	**43,247**	**61,998**	**72,832**	**86,549**
Deposits	**194,224**	**261,639**	**327,049**	**425,164**	**552,713**
Change (%)	145.1	34.7	25.0	30.0	30.0
Borrowings	**86,134**	**103,353**	**98,353**	**93,353**	**88,353**
Change (%)	12.8	20.0	(4.8)	(5.1)	(5.4)
Other Liabilities	16,421	13,191	13,794	15,124	16,587
Total Liabilities	**326,228**	**421,431**	**501,194**	**606,473**	**744,202**
Investments	71,617	106,682	124,279	140,304	165,814
Change (%)	134.8	49.0	16.5	12.9	18.2
Advances	**228,187**	**269,924**	**319,128**	**408,346**	**523,901**
Change (%)	71.4	18.3	18.2	28.0	28.3
Net Fixed Assets	4,470	4,480	4,928	5,421	5,963
Net Current Assets	21,954	40,344	52,859	52,402	48,525
Total Assets	**326,228**	**421,431**	**501,194**	**606,473**	**744,202**
Assumptions					
Deposits Growth	145.1	34.7	25.0	30.0	30.0
Advances Growth	71.4	18.3	18.2	28.0	28.3
AUM Growth	51.2	27.4	12.3	23.9	28.3
Dividend per share	-	-	-	-	-

Source: Company, Nirmal Bang Institutional Equities Research

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Team Details:			
Name		**Email Id**	**Direct Line**
Rahul Arora	CEO	rahul.arora@nirmalbang.com	-
Girish Pai	Head of Research	girish.pai@nirmalbang.com	+91 22 6273 8017 / 18
Dealing			
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 6273 8230, +91 22 6636 8833
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 6273 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address
B-2, 301/302, Marathon Innova,
Nr. Peninsula Corporate Park,
Lower Parel (W), Mumbai-400013.
Board No. : 91 22 6273 8000/1; Fax. : 022 6273 8010