

Multiple RoA Expansion Levers Identified, Eyeing RoA of 1.8% by FY27E!

We attended the Analyst Meet hosted by AU Small Finance Bank (AUSFB) to discuss the roadmap for the bank upto FY27E, post the merger and as it completes a decade as a bank. The management team also discussed the near-term challenges for the bank and the impact of the merger with Fincare SFB (Fincare).

AU @ 2027– Strong Growth; Eyeing RoA improvement

- **Strong balance sheet growth** – AUSFB will look to maintain its growth momentum in terms of deposits, growing the deposit franchise by 23-25% CAGR by FY27E, with a focus on individual and retail deposits. The bank will look to replicate this growth on the asset side, growing the book in line with deposits. Focus will remain on improving the share of higher RoA products – Wheels (25% CAGR), MBL (20-22% CAGR), and Fincare products (28-32% CAGR). AUSFB expects to gradually improve the share of high yield-high RoA businesses to 72-75% by FY27E vs. 70% as of Dec'23.
- **Risk-adjusted returns** – Post the merger with Fincare, AUSFB will look to cap the MFI book at ~10% of the overall portfolio. Similarly, the unsecured book will be capped at 15-20% at the portfolio level. AUSFB is committed to maintaining its asset quality and anticipates it to stay within the desired range. PCR is expected to remain range-bound between 65-70%. The MFI portfolio's credit costs are expected to be capped at 2.5-3% each year.
- **Improving Operational Profitability** – AUSFB will aim at calibrating investment based on learnings so far. The bank does not expect any significant fresh investments until FY27E. The platform build-out is largely completed and any expense hereon will be variable in nature to sweat the existing investments. The bank will look to moderate the card issuance growth to reduce the upfront customer acquisition cost. Furthermore, for both Credit Card and QR codes/merchants, the bank has aligned its strategy and increased its collaboration with branch banking. AUSFB will also strive to make the Video Banking business profitable by FY27E. Amongst the newer businesses, with Personal Loans and Business Loans having turned profitable, the bank will aim at developing a platform to acquire NTB customers and cross-sell its products to further enhance RoAs. Apart from these new businesses, the AD1 licence has some Capex scheduled in FY25.
- **Improving Branch Banking profitability** – With a focus on improving branch banking profitability, AUSFB will look at ~65% of the branches (which are live as of Dec'23) to be profitable by FY27E vs. ~25% currently. Key levers for this would be (a) **Growing CA deposits by 100-150bps by Mar'27**, which the bank plans to achieve by leveraging commercial banking and AD1 licence opportunities, deepening existing customers by attaching more products and offering segment-based CA propositions, (b) **Ensuring Cost Optimization**, as the bank does not have any aggressive branch addition plans in FY25 and plans to add ~80-100 branches over FY26-27E along with building-out of higher balances from existing branches and (c) **Cross-selling and deepening customer connect** by offering a complete set of products to liability customers, increasing penetration of wealth and insurance on CASA base and making branches the primary originator of commercial banking and credit cards.
- **Delivering RoA of 1.8% by FY27 aided by merger synergies** – Post the merger with Fincare, AUSFB will gain a presence in high-yielding, high-RoA segments, thereby supporting disbursement yields and aiding in the portfolio mix. Additionally, the incremental deposits of Fincare would be priced at AUSFB's incremental CoF. This is likely to be RoA and BVPS accretive. Thus, AUSFB has identified (a) **Improved NIMs**, (b) **Sustained fee income growth** and (c) **Opex savings via improved operational efficiency and investment calibration** as key levers for RoA improvement to 1.8%.

Outlook and Valuation: AUSFB has been facing headwinds on margins owing to the portfolio mix shifting towards lower-yielding/RoA products along with additional pressure from CoF headwinds. The management expects near-term pressure on margins to persist. With the focus now shifting towards enhancing the mix of high-yield/RoA products in the portfolio and with additional support from the merger with MFI/Gold loans forming part of the portfolio, along with expectations of a rate cut benefiting AUSFB's largely fixed book, margins are anticipated to receive support. AUSFB aspires to scale back RoA of 1.8%, driven by improving margins, gradually improving cost ratios, and strengthening the fee income profile. We believe the RoA improvement trajectory will be slower and expect AUSFB to deliver a RoA of 1.7% by FY26E. C-I Ratio reduction would be a key factor in this RoA improvement. The stock has corrected sharply post-Q3FY24 results, largely owing to margin headwinds and pressures on asset quality and credit costs in the credit card portfolio. **We believe the current risk-reward is favourable. We reiterate our BUY recommendation on the stock with a revised target price of Rs 680/share (2.7x FY26E ABV), implying an upside of 19% from the CMP.**

(CMP as of 18 March, 2024)

CMP (Rs)	570
Upside /Downside (%)	19%
High/Low (Rs)	813/548
Market cap (Cr)	38,161
Avg. daily vol. (6m) Shrs.	26,70,454
No. of shares (Cr)	66.9

Shareholding (%)

	Jun-23	Sep-23	Dec-23
Promoter	25.5	25.5	25.5
FIs	41.6	39.7	39.7
MFs / UTI	10.3	11.5	11.5
Others	22.6	23.3	23.3

Financial & Valuations

Y/E Mar (Rs Cr)	FY24E	FY25E	FY26E
NII	5,205	7,852	10,202
PPOP	2,523	3,795	5,175
Net Profit	1,573	2,135	2,937
EPS (Rs)	23.5	28.8	39.6
ABV (Rs)	182.1	217.0	252.6
P/ABV (x)	3.1	2.6	2.3
RoA (%)	1.6	1.6	1.7
NNPA (%)	0.4	0.5	0.5

Change in Estimates (%)

Y/E Mar	FY25E	FY26E
NII	Changes in estimates are not applicable as the revised numbers for FY25/26E include impact of merger with Fincare	
PPOP		
PAT		

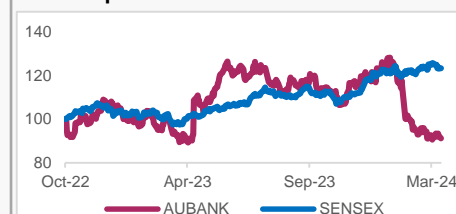
ESG disclosure Score**

Environmental Disclosure	22.7
Social Disclosure Score	28.8
Governance Disclosure Score	83.6
Total ESG Disclosure Score	45.1
Sector Average	39.1

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly and does not measure the company's performance on any data point. All scores are based on 2022 disclosures

Relative performance



Source: AceEquity, Axis Securities

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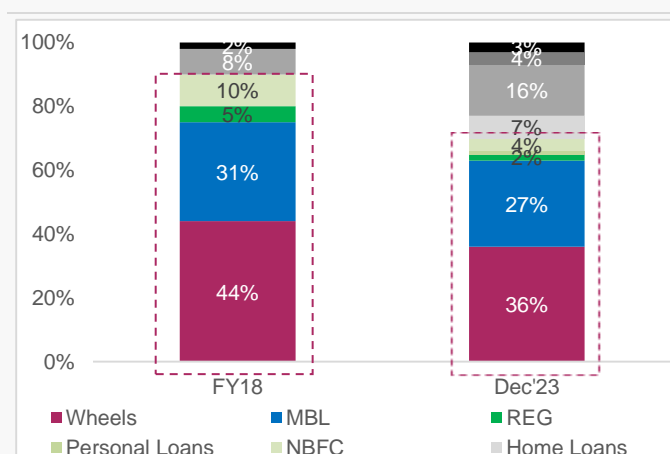
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Key Highlights

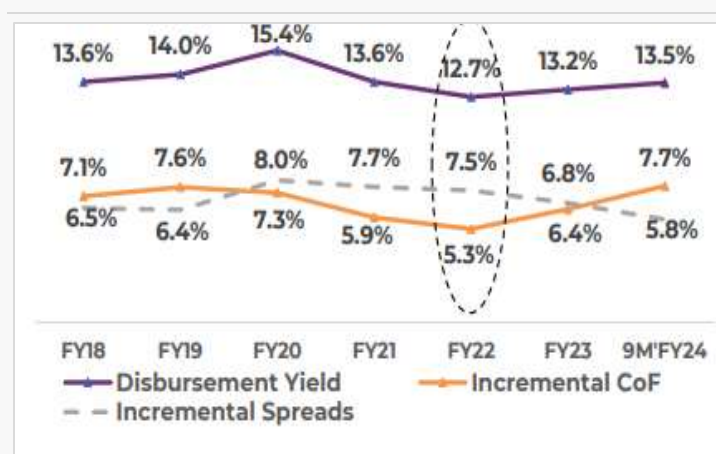
- Near-term headwinds are far from over** – Portfolio mix towards higher credit quality but lower yield products and ~75% of the loan book being fixed led to spread compression for AUSFB. Additionally, higher-than-expected liquidity tightening, interest rates staying higher for longer and intense competition collectively put further pressure on margins in 9MFY24. AUSFB's margins contracted by ~60bps over 9MFY24. The incremental CoF continues to remain elevated at ~7.7% and the bank expects marginal CoF to settle at 7.7-7.8% in FY25E, ~40-45bps higher vs. FY24E. In addition to margin headwinds, AUSFB continued to front-load investments to offer a complete product suite, thereby keeping Opex elevated. The C-I Ratio in the near term is likely to stay elevated at ~62-63% in FY24E. On the asset quality front, credit costs have started normalizing to pre-COVID levels across all 3 secured retail asset products. However, credit cost would depend mainly on the extant mix of various asset classes in the portfolio. With contingency buffers now exhausted, AUSFB expects FY25E credit costs to be benchmarked basis actual credit costs without contingency buffers. Thus, with multiple headwinds weighing on profitability, AUSFB's RoA is likely to remain constrained at ~1.6% over FY24-25E.

Exhibit 1: Portfolio Mix changed as lower yielding, lower RoA businesses scaled



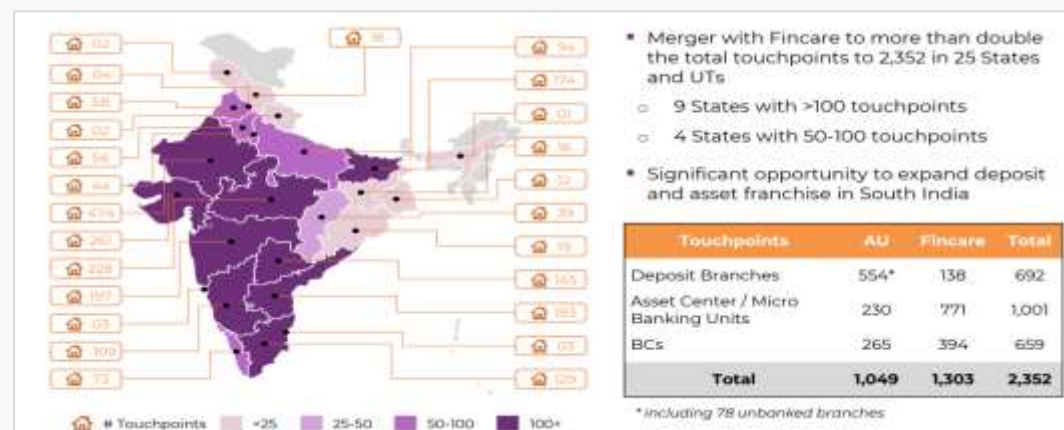
Source: Company, Axis Securities

Exhibit 2: CoF increased while Yields have declined; while incremental CoF have risen sharply



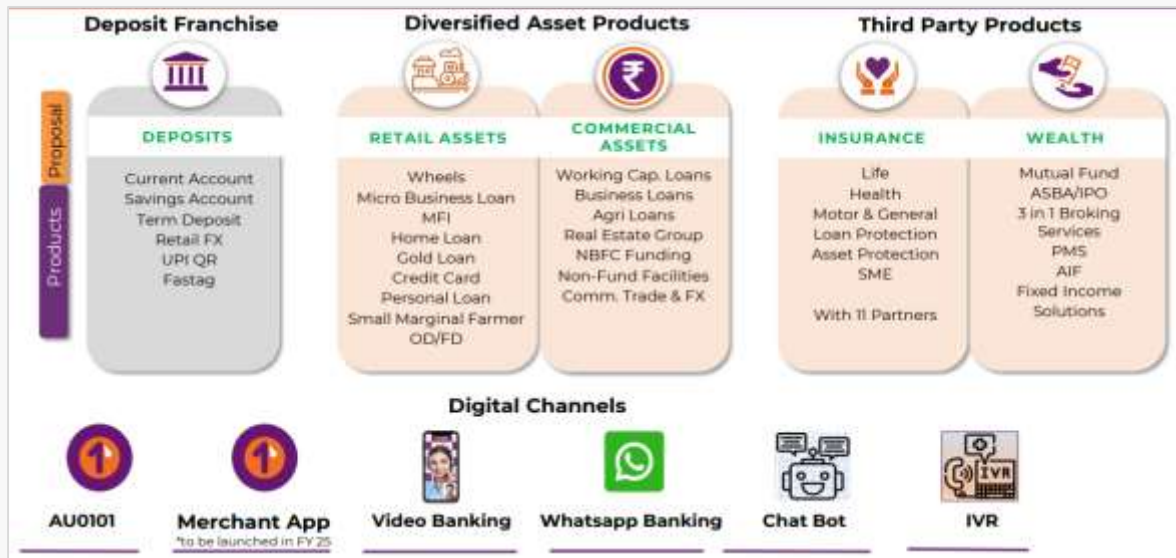
Post-Merger Synergies – With the completion of the merger with Fincare SFB, AUSFB will be in a position to offer all products across the customer spectrum – domestic, bottom-of-the-pyramid or UHNI. The merger will provide the bank with a larger distribution network, geographical expansion, and larger customer base and also help address the PSL sub-segment requirement by enabling larger lending to the Small and Marginal Farmers (SMF) segment. While AUSFB is yet to make in-roads in the southern region, this merger will enable AUSFB to significantly strengthen its geographical footprint, leveraging Fincare's strong presence in the southern region.

Exhibit 3: Reaching Pan India post-merger



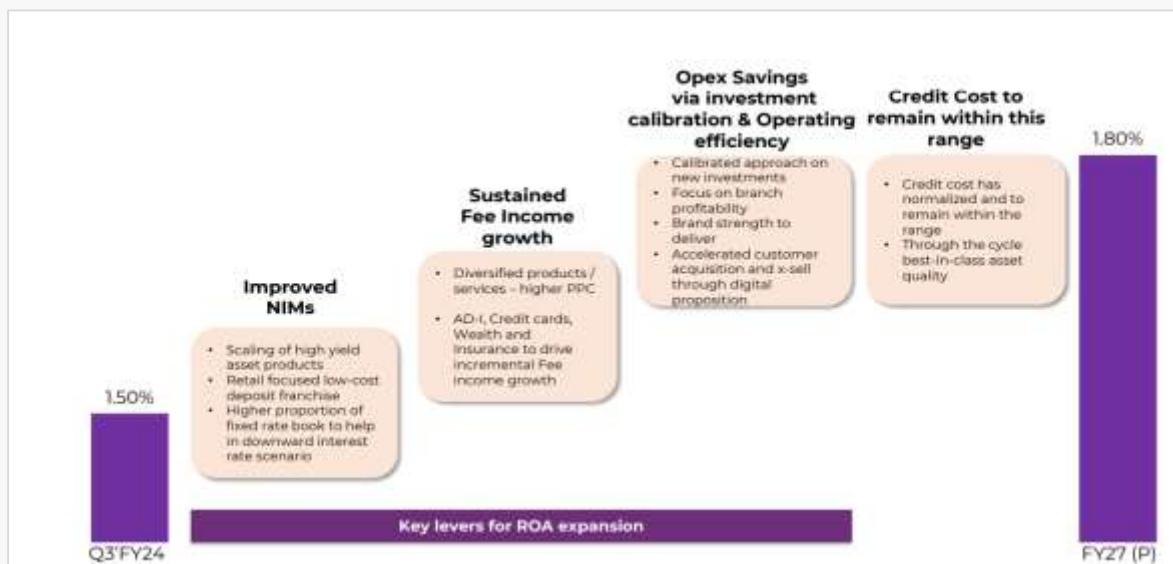
Source: Company, Axis Securities

Exhibit 4: Full-suite with digital capabilities



Source: Company, Axis Securities

Exhibit 5: Post-Merger RoA Profile, RoA improvement likely to 1.8%



Source: Company, Axis Securities

Financials (Standalone)

Profit & Loss

(Rs Cr)

Y/E March	FY23	FY24E	FY25E	FY26E
Net Interest Income	4,425	5,205	7,852	10,202
Other Income	1,034	1,608	2,431	3,230
Total Income	5,460	6,813	10,283	13,432
Total Operating Exp	3,440	4,290	6,488	8,257
PPOP	2,019	2,523	3,795	5,175
Provisions & Contingencies	155	434	941	1,249
PBT	1,865	2,089	2,854	3,926
Provision for Tax	437	516	719	989
PAT	1,428	1,573	2,135	2,937

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

Y/E March	FY23	FY24E	FY25E	FY26E
SOURCES OF FUNDS				
Share Capital	667	668	742	742
Reserves	10,311	11,825	15,849	18,659
Shareholder's Funds	10,977	12,493	16,591	19,401
Total Deposits	69,365	86,715	1,20,215	1,51,265
Borrowings	6,299	8,271	16,627	18,624
Other Liabilities & Provisions	3,575	4,102	5,856	7,224
Total Liabilities	90,216	1,11,580	1,59,288	1,96,513
APPLICATION OF FUNDS				
Cash & Bank Balance	9,425	5,452	8,400	9,814
Investments	20,072	30,035	40,917	49,973
Advances	58,422	73,251	1,05,914	1,31,722
Fixed Assets & Other Assets	2,297	2,841	4,056	5,004
Total Assets	90,216	1,11,580	1,59,288	1,96,513

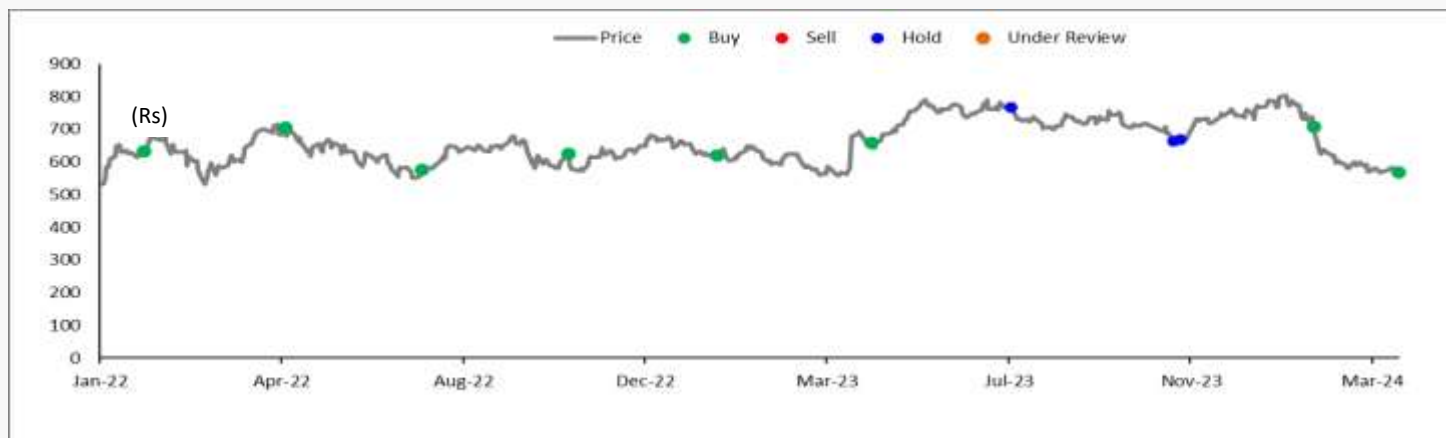
Source: Company, Axis Securities

Ratio Analysis
(%)

Y/E March	FY23	FY24E	FY25E	FY26E
VALUATION RATIOS				
EPS	21.4	23.5	28.8	39.6
Earnings Growth (%)	-40.3	9.9	22.3	37.5
BVPS	164.6	187.0	223.6	261.5
Adj. BVPS	161.0	182.1	217.0	252.6
ROAA (%)	1.8	1.6	1.6	1.7
ROAE (%)	15.4	13.4	14.7	16.3
P/E (x)	26.6	24.2	19.8	14.4
P/ABV (x)	3.5	3.1	2.6	2.3
PROFITABILITY				
NIM (%)	6.1	5.7	6.4	6.3
Cost-Income Ratio	63.0	63.0	63.1	61.5
BALANCE SHEET STRUCTURE RATIOS				
Loan Growth (%)	26.7	25.4	44.6	24.4
Deposit Growth (%)	31.9	25.0	38.6	25.8
C/D Ratio (%)	12.2	11.2	10.4	9.9
Equity to Assets (%)	18.8	17.1	15.7	14.7
Equity to Loans (%)	23.6	21.4	20.4	20.5
CAR	21.8	19.9	18.8	18.9
CAR Tier I	26.7	25.4	44.6	24.4
ASSET QUALITY				
Gross NPLs (%)	245	325	490	665
Net NPLs (%)	1.7	2.0	2.1	2.3
Coverage Ratio (%)	0.4	0.4	0.5	0.5
Credit Costs	0.6	0.7	1.0	1.0
ROAA TREE				
Net Interest Income	5.6	5.2	5.8	5.7
Non-Interest Income	1.3	1.6	1.8	1.8
Operating Cost	4.3	4.3	4.8	4.6
Provisions	0.2	0.4	0.7	0.7
Tax	0.5	0.5	0.5	0.6
ROAA	1.8	1.6	1.6	1.7
Leverage (x)	8.6	8.6	9.3	9.9
ROAE	15.4	13.4	14.8	16.3

Source: Company, Axis Securities

AU Small Finance Bank Price Chart and Recommendation History



Date	Reco	TP	Research
28-Jan-22	BUY	713	Result Update
26-Apr-22	BUY	780	Result Update
20-Jul-22	BUY	650	Result Update
20-Oct-22	BUY	750	Result Update
20-Jan-23	BUY	755	Result Update
26-Apr-23	BUY	765	Result Update
24-Jul-23	HOLD	700	Result Update
31-Oct-23	HOLD	685	Result Update
29-Jan-24	BUY	780	Result Update
19-Mar-24	BUY	680	Result Update

Source: Axis Securities

About the Analyst



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HOLD	Between 10% and -10%
SELL	Less than -10%
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