30 October 2023

2QFY24 Results Update | Sector: Financials

AU Small Finance Bank

Estimate change	↓
TP change	↓
Rating change	↔

Bloomberg	AUBANK IN
Equity Shares (m)	667
M.Cap.(INRb)/(USDb)	445 / 5.3
52-Week Range (INR)	795 / 548
1, 6, 12 Rel. Per (%)	-4/-6/8
12M Avg Val (INR M)	1200

Financials & Valuations (INR b)

Y/E March	FY23	FY24E	FY25E
NII	44.3	52.3	67.5
PPoP	20.2	25.8	34.3
PAT	14.3	17.0	22.6
NIM (%)	5.6	5.2	5.5
EPS (INR)	22.0	25.5	33.9
EPS Gr. (%)	22.3	15.7	33.1
BV/Sh. (INR)	159	184	218
ABV/Sh. (INR)	157	181	215
Ratios			
RoE (%)	15.8	14.8	16.8
RoA (%)	1.8	1.7	1.8
Valuations			
P/E(X)	30.1	26.1	19.6
P/BV (X)	4.2	3.6	3.0
P/ABV (X)	4.2	3.7	3.1

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	25.5	25.5	25.6
DII	19.6	19.3	21.3
FII	41.7	41.6	38.5
Others	13.3	13.6	14.6

FII Includes depository receipts

CMP: INR666 TP: INR780 (+17%) Buy

Earnings in line, aided by other income; NIMs compress QoQ

Announces merger with Fincare SFB – Merger to be EPS/BV accretive

- AUBANK reported 17% YoY growth in net earnings (in line), aided by higher other income (up 72% YoY). PPoP thus grew 30% YoY (up 19% QoQ, 9% beat). Margins declined 22bp QoQ to 5.5%. Provisions came in higher at INR1.1b.
- Advances grew 24%YoY (2% QoQ), while deposits grew strongly at 30% YoY (9.3% QoQ). CASA deposits grew 4% YoY, while CASA mix stood at 33.9%.
- Absolute GNPAs/NNPAs increased 11%/10.8% QoQ. Thus, the headline GNPA/ NNPA ratios deteriorated 15bp/5bp QoQ to 1.91%/0.6%.
- In the first round of consolidation amongst SFBs, AUBANK announced a merger with Fincare SFB. The merger is EPS, BV, and RoA accretive and will enable AUBANK to diversify the loan book and gain access to rural-dominated MFI portfolio as the segment will form ~7.5% of loans. The bank will also benefit from improved geographical presence with strong foothold in Southern India, while the ongoing pressure on margins and compliance with sub-segmental PSL targets will also see some relief from the merger.
- We slightly lower our FY24E/25E estimates by 2.8%/2.0% as higher other income and controlled opex compensate for higher provisions and weak margins. We reiterate our **Buy rating on the stock with a TP of INR780 (3.6x FY25E ABV).**

Deposit growth steady; provisioning expenses increase sharply

- AUBANK reported 17% YoY growth in net earnings (up 4% QoQ, in line), aided by robust other income (up 72% YoY, 28% beat). However, provisions came in higher at INR1.1b vs. INR0.3b in 1QFY24.
- PPoP thus grew 30% YoY (up 19% QoQ, 9% beat). Margins contracted 22bp QoQ to 5.5% in 2QFY24 and the management expects margins to be at 5.5%-5.7% going forward. Core Other Income grew 69% YoY in 2QFY24, driven by healthy growth in disbursements, and increasing contribution of credit card & bancassurance income.
- Opex grew 23% YoY as the bank continues to invest in building the franchise. However, total income grew 25.8% YoY (7.2% QoQ), enabling 370bp QoQ moderation in C/I ratio to 61.3% in 2QFY24.
- Advances grew 24% YoY to INR642b (up 2% QoQ), led by a healthy 10% QoQ growth in the wholesale book. The yield on advances thus moderated to 13.3%, owing to changing business mix; however, the incremental disbursement yield improved 27bp QoQ (41bp during 1HFY24).
- Deposits grew 30% YoY/9% QoQ, led by CASA growth of 6% on a QoQ basis, while TDs grew 11% QoQ. CASA ratio thus moderated 110bp QoQ to 33.9%. Cost of funds rose 12bp QoQ to 6.70%.

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- Absolute GNPAs/NNPAs increased 11%/10.8% QoQ and fresh slippages increased to INR3.5b (2.7% of loans). Thus, the headline GNPA/ NNPA ratios deteriorated 15bp/5bp QoQ to 1.91%/0.6%, partly affected by loan securitization of INR29.2b in 2QFY24. PCR ratio stood stable at ~69.1%.
- O/s restructured loans declined to INR5.1b (0.8% of loans vs. 1.0% in 1QFY24). The bank is carrying provisions of INR0.88b on its restructured book.

Highlights from the management commentary

- The bank has come a long way, evolving from an NBFC to becoming the largest SFB in the country. Fincare has experienced remarkable growth, positively impacting the life of millions of people at the bottom of pyramid. Both entities share core values, a common goal, and a shared vision.
- Fincare will help improve the Pan-India network; 49% of Fincare branches are located in the South where AUBANK has limited presence. Fincare has healthy presence in the states of UP and Bihar.
- The C/I ratio stood at 61%, indicating the bank's continued focus on efficiency. The bank is expected to maintain the same C/I ratio as in FY23.
- The credit cost, which previously ranged from 80bp-1%, is anticipated to decrease further, stabilizing within the range of 50-60bp in the long run.

Valuation and view

AUBANK reported a mixed quarter, aided by healthy deposits growth and higher other income. Asset quality deteriorated during the quarter, while margins continued to compress and now stands at the lower end of the guided range. On the business front, disbursement growth was healthy; however, higher securitization has affected the growth rate of on-balance sheet advances. Provisioning coverage remains stable, while the bank carries tiny contingent reserves of ~INR70m. We cut our earnings estimates in FY24E/FY25E by 2.8%/2.0% as higher other income and controlled opex compensate for higher provisions and weak margins. We estimate RoA/RoE to reach 1.8%/16.8% by FY25E. We reiterate our **Buy rating on the stock with a TP of INR780 (3.6x FY25E ABV).**

Quarterly performance table (INR m)

	FY23				FY24E				FY23	FY24E	FY24E	v/s Est
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	
Net Interest Income	**9,760**	**10,833**	**11,527**	**12,132**	**12,462**	**12,490**	**13,337**	**14,014**	**44,253**	**52,304**	**13,028**	**-4.1**
% Change (Y-o-Y)	34.8	43.8	40.5	29.5	27.7	15.3	15.7	15.5	36.8	18.2	20.3	
Other Income	1,592	2,474	2,949	3,331	3,151	4,255	4,052	4,370	10,345	15,827	3,324	28.0
Total Income	**11,352**	**13,307**	**14,476**	**15,463**	**15,613**	**16,744**	**17,389**	**18,384**	**54,597**	**68,131**	**16,352**	**2.4**
Operating Expenses	7,411	8,319	8,919	9,753	10,153	10,267	10,717	11,223	34,403	42,360	10,435	-1.6
Operating Profit	**3,941**	**4,988**	**5,557**	**5,709**	**5,461**	**6,477**	**6,672**	**7,161**	**20,195**	**25,771**	**5,917**	**9.5**
% Change (Y-o-Y)	-18.2	27.1	21.2	18.4	38.6	29.9	20.1	25.4	11.3	27.6	18.6	
Provisions	384	430	326	409	330	1,143	935	1,120	1,548	3,528	516	121.7
Profit before Tax	**3,557**	**4,558**	**5,231**	**5,300**	**5,131**	**5,334**	**5,737**	**6,041**	**18,646**	**22,243**	**5,401**	**-1.2**
Tax	878	1,132	1,302	1,054	1,262	1,315	1,452	1,221	4,367	5,249	1,361	-3.4
Net Profit	**2,679**	**3,426**	**3,928**	**4,246**	**3,869**	**4,018**	**4,286**	**4,820**	**14,279**	**16,994**	**4,040**	**-0.5**
% Change (Y-o-Y)	31.8	23.0	30.1	22.7	44.4	17.3	9.1	13.5	26.4	19.0	17.9	
Operating Parameters												
Deposit (INR b)	546.3	583.4	611.0	693.6	693.2	757.4	803.6	855.3	693.6	855.3	757.4	
Loan (INR b)	486.5	517.4	556.0	584.2	628.6	641.7	682.7	729.1	584.2	729.1	642.4	
Deposit Growth (%)	47.6	49.4	38.0	31.9	26.9	29.8	31.5	23.3	31.9	23.3	29.8	
Loan Growth (%)	43.3	44.4	38.4	26.7	29.2	24.0	22.8	24.8	26.7	24.8	24.1	
Asset Quality												
GNPA (%)	2.0	1.9	1.8	1.7	1.8	1.9	1.9	1.9	1.7	1.9	1.7	
NNPA (%)	0.6	0.6	0.5	0.4	0.6	0.6	0.6	0.5	0.5	0.5	0.5	
PCR (%)	71.7	71.1	72.1	75.0	69.0	69.1	70.6	71.8	70.8	71.8	68.6	

E: MOFSL Estimates

Quarterly snapshot (INR m)

	FY22				FY23				FY24		Change (%)	
Profit and Loss (INR m)	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**YoY**	**QoQ**
Net Interest Income	**7,240**	**7,531**	**8,204**	**9,366**	**9,760**	**10,833**	**11,527**	**12,132**	**12,462**	**12,490**	**15**	**0**
Other Income	**2,148**	**1,919**	**2,756**	**3,114**	**1,592**	**2,474**	**2,949**	**3,331**	**3,151**	**4,255**	**72**	**35**
Total Income	**9,388**	**9,451**	**10,961**	**12,479**	**11,352**	**13,307**	**14,476**	**15,463**	**15,613**	**16,744**	**26**	**7**
Operating Expenses	**4,570**	**5,526**	**6,376**	**7,656**	**7,411**	**8,319**	**8,919**	**9,753**	**10,153**	**10,267**	**23**	**1**
Employee	2,826	3,268	3,559	4,137	3,940	4,513	4,652	4,825	5,070	5,120	13	1
Others	1,743	2,258	2,818	3,519	3,471	3,806	4,267	4,928	5,082	5,147	35	1
Operating Profits	**4,818**	**3,925**	**4,584**	**4,823**	**3,941**	**4,988**	**5,557**	**5,709**	**5,461**	**6,477**	**30**	**19**
Provisions	2,072	46	560	932	384	430	326	409	330	1,143	166	247
PBT	**2,747**	**3,878**	**4,025**	**3,891**	**3,557**	**4,558**	**5,231**	**5,300**	**5,131**	**5,334**	**17**	**4**
Taxes	715	1,093	1,004	430	878	1,132	1,302	1,054	1,262	1,315	16	4
Adj. PAT	**2,032**	**2,785**	**3,020**	**3,461**	**2,679**	**3,426**	**3,928**	**4,246**	**3,869**	**4,018**	**17**	**4**
PAT	**2,032**	**2,785**	**3,020**	**3,461**	**2,679**	**3,426**	**3,928**	**4,246**	**3,869**	**4,018**	**17**	**4**
Balance Sheet (INRb)												
Loans	**340**	**358**	**402**	**461**	**487**	**517**	**556**	**584**	**629**	**642**	**24**	**2**
Deposits	**370**	**390**	**443**	**526**	**546**	**583**	**611**	**694**	**693**	**757**	**30**	**9**
Total Assets	**514**	**532**	**586**	**691**	**710**	**779**	**807**	**902**	**916**	**960**	**23**	**5**
Asset Quality												
GNPA	**14,959**	**11,514**	**10,576**	**9,244**	**9,696**	**9,967**	**10,189**	**9,813**	**11,212**	**12,448**	**25**	**11**
NNPA	**7,660**	**5,915**	**5,202**	**2,308**	**2,748**	**2,882**	**2,846**	**2,452**	**3,471**	**3,847**	**33**	**11**
AUM Mix (%)											**Change (bp)**	
Retail	**85.2**	**89.3**	**86.6**	**84.4**	**82.6**	**80.9**	**79.7**	**78.4**	**78.9**	**77.2**	**-367**	**-161**
Wheels	35.9	39.2	38.1	37.0	36.4	36.2	34.6	32.2	33.1	31.9	-434	-119
Secured MSME	39.4	39.5	37.5	35.3	33.9	33.0	32.1	31.3	29.9	28.6	-443	-129
Wholesale	**14.8**	**15.1**	**16.6**	**17.8**	**17.4**	**19.1**	**20.3**	**21.6**	**21.1**	**22.8**	**367**	**161**
NBFC	3.5	3.2	4.0	4.3	3.6	3.6	4.1	4.3	3.7	3.9	33	21
RE Group	1.6	1.7	1.7	1.7	1.7	1.8	1.9	2.1	2.0	2.1	28	13
Business Banking	5.0	5.2	5.6	6.2	6.6	7.4	7.8	8.4	8.7	9.4	208	77
Ratios (%)	**FY22**				**FY23**				**FY24**		**Change (bp)**	
Asset Quality Ratios (%)	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**YoY**	**QoQ**
GNPA (%)	4.3	3.2	2.6	2.0	2.0	1.9	1.8	1.7	1.8	1.9	1	15
NNPA (%)	2.3	1.7	1.3	0.5	0.6	0.6	0.5	0.4	0.6	0.6	4	5
PCR (Reported, %)	49	49	51	75	72	71	72	75	69	69	-210	0
Business Ratios (%)												
Non Int. to Total Income	22.9	20.3	25.1	25.0	14.0	18.6	20.4	21.5	20.2	25.4	682	523
Cost to Income	48.7	58.5	58.2	61.3	65.3	62.5	61.6	63.1	65.0	61.3	-120	-371
CASA (Reported)	26.0	30.3	39.0	37.0	39.0	42.0	38.0	38.4	35.0	33.9	-810	-110
CASA (incl CD's)	25.6	30.3	39.2	37.3	38.8	42.3	38.4	38.4	35.0	33.9	-841	-115
Loan/Deposit	91.7	91.8	90.7	87.7	89.1	88.7	91.0	84.2	90.7	84.7	-398	-597
Profitability Ratios												
Margins	6.0	6.1	6.3	6.3	5.9	6.2	6.2	6.1	5.7	5.5	-70	-22
Yield on AUM	14.0	13.9	13.7	13.4	13.3	13.3	13.4	13.4	13.4	13.3	0	-10
Cost of funds	6.3	6.1	5.9	5.7	5.7	5.8	6.0	6.3	6.6	6.7	90	12
RoA	1.6	2.1	2.2	2.2	1.5	1.8	2.0	2.0	1.7	1.7	-10	0
RoE	12.7	16.8	17.4	18.9	14.0	15.3	15.2	15.8	13.8	13.9	-140	10

CONFERENCE CALL

Highlights from the management commentary

Balance sheet and P&L related

- Festive demand continues to thrive, and consumer spending remains strong. On the liability side, the bank competitive.
- On boarded 3.6lac new customers and the total base now stands at 44.3 lac.
- The bank has experienced a CASA growth of 6% QoQ; however, there has been pressure in CASA mobilization, leading to a 4% decline in CASA ratio since Mar-23.
- The bank has recently established a new banking unit and launched “Swadesh”, a dedicated initiative aimed at focusing on the rural sector.

- Deposits rates increased 25bp in Q2. CoF increased 12bp QoQ; avg H1 rate is at 6.64%. Yields have remained flat, putting pressure on margins. This flattening of yields appears to be structural in nature. NIM stood at 5.5%. The bank is moving toward lower yield products, resulting in lower margins. However, this move is enhancing asset quality and maintaining a healthy RoA. NIMs are being managed within the guided range.
- Advances grew 2% QoQ; the gross securitization book grew 5% QoQ, with 63% of the book as fixed and the rest being floating rates. The bank has observed a continuous increase in disbursement yields, experiencing a 27bp uptick in 2Q.
- The C/I ratio stood at 61%, indicating the bank's continued focus on efficiency. The bank is expected to maintain the same C/I ratio as in FY23.
- The bank has a CAR of 22.4% in 2Q.
- Core PPOP grew 28% YoY, supported by 'other income' and third party distribution income.
- Divided the bank into five business group – 1st is urban market, 2nd is Swadesh, with focus on the rural sector, 3rd is retail asset group (wheels, micro business loans), 4th is Commercial banking (Agri, Real estate and NBFC, trade), and the 5th is digital transaction banking group.
- Announced partnership with Max Life and Bajaj finserv for the banca channel.
- Has increased disbursement yields, leading to a shift in the business structure. Lower yield products how constitute 31% of the portfolio, primarily driven by HL and SBL. Lower yields in this segment do not translate to lower RoA due to significantly reduced credit costs and lower opex.
- The credit cost, which previously ranged from 80bp-1%, is anticipated to decrease further, stabilizing within the range of 50-60bp in the long run.
- During the Covid pandemic, the bank ventured into the Wheels and Small Business Loans (SBL) segments resulting into lower yields. The portfolio is expected to gradually decrease, potentially leading to an uptick in yields in the future.
- The fee income line remains sustainable, with a continued focus on the insurance business and credit cards. Additionally, upon acquiring the AD1 license, the bank anticipates a healthy income stream from this source and sustaining the same. Although the bank did not sell any PSL in the second quarter, but post-merger, there will be a significant boost in PSL income.
- Securitization serves multiple purposes, relieving the team from the pressure of seeking funds from the liability side while also freeing up capital. The bank's guidance indicates a growth of 25-26% in advances, with the liability side driving asset expansion.
- Strategy of the bank is to be and remain PSL compliant.
- The strategic vision is to create a bank with comprehensive capabilities. By April 2024, the bank aims to offer over 30 products, providing a diverse range of financial services. Upon the integration of microfinance, additional product lines will be introduced, further enhancing the depth of the bank's franchise.
- The bank is not holding back its expansion efforts due to competition, as there is ample headroom for growth. However, the pace of expansion is contingent upon prevailing interest rates in the market.
- The bank anticipates increased competition in the deposits sector over the next few quarters.

- In the last quarter, the bank had excess liquidity, and the strategy was to utilize it effectively. In the current quarter, the LCR stands at 125%. This quarter's ratio reflects a balance between deposits and liquidity.

Asset quality

- Out of 15bp QoQ increase in GNPA, 8bp were attributable to the securitization effect. The bank has not identified any specific pockets of stress in any segment sector. The increase in GNPA is due to seasonality factors.
- The current quarter's slippage of 2% is consistent with the figures from the past few quarters. The bank's credit cost have started to normalize and a portion of these costs can be attributed to write-offs in credit card accounts.
- The bank has INR0.96b of provision against contingency and standard restructured asset.
- The credit card book saw INR0.24b of write-offs in 2Q. The bank is quite comfortable in this book and follows the w-off policy of 180 days policy. The bank expects the book to be seasoned in the next six months.
- The run rate of write-offs will be in the range of INR0.3b.

Merger related

- The bank has come a long way, evolving from an NBFC to becoming the largest SFB in the country. Fincare has experienced remarkable growth, positively impacting the life of millions of people at the bottom of pyramid. Both entities share core values, a common goal, and a shared vision.
- The merger deal is an all-stock merger and shares will be issued to all Fincare SFB in the disclosed share swap ratio.
- Fincare SFB has a strong and experienced management team. It has a deep understanding of the MFI segment.
- Fincare will help improve the Pan-India network; 49% of Fincare branches are located in the South; Fincare has healthy presence in the states of UP and Bihar.
- Will convert the touch points of Fincare SFB into the AU SFB touchpoints and branch.
- MFI as a segment has seen a strong CAGR of 35% over the past decade. With improved regulations in place, the bank has made the decision to explore opportunities in this segment.
- The merged bank intends to keep 10% of the book as MFI; currently, it stands at 8% of the book as MFI in merged entity. Further, it expects 2.5-3% of the credit cost in the MFI business.
- Gold loan book for the Fincare SFB stands at INR110b.
- Rajeev Yadav will be deputy CEO of the AU SFB post-merger.
- AU SFB has a stable and strong franchise; overall asset deposit or asset franchise is in shape. AU SFB were missing in the MFI segment. The bank needed to evolve with the market, as the MFI business registered a healthy CAGR of 35%.
- Fincare's established presence in the South will not only expand the company's product range but also enhance its geographical reach. The bank believes that it has the ability to effectively manage this type of transaction.
- The competition in the deposits sector is fierce, compelling the bank to offer attractive rates for deposits. While the management expects a few challenging quarters due to the merger, it believes that it will be beneficial in the long run.

- Through Fincare amalgation, the employee addition will be 15,000, of which 2/3rd of the base is working in the MFI segment. The bank has created five business units, which will be seamlessly integrated into the merger process. The bank believes that this integration will not impede its growth trajectory. Fincare bank will operate as a dedicated unit within this framework, maintaining its focus on business expansion.
- The merger will not result in any additional cost, except for the transition cost and some minor cost relating to employee wages. The management expects some merger synergies to play out in the 2-3 year time frame.
- AU has pursuing a strategy of geographic expansion, and this approach will persist in the future. The merged bank plans to capitalize on the existing 1300 touchpoints. Although challenges related to bandwidth and costs may arise, the bank is confident in its ability to effectively manage these issues during the merger process.
- The bank has had a long standing position of refraining from entering the MFI segment, conducting thorough evaluations of this strategy over time. With MFI business now more regulated, and significant growth within the MFI business, the bank recognizes the need to reevaluate this stance and consider entering the MFI segment.
- The merger will give an opportunity to understand the market of the south. Fincare is well governed and the size of the bank is also neither too big nor too small.
- Slippages on the MFI have been cyclical, as the MFI business goes through the cycle. Even though, the business cycle is volatile, it believes that it can generate the better RoA going ahead.
- FAU believes that the merger will take some more time.
- Fincare has strategically planned a capital infusion of INR7b to meet its increased capital requirements. The capital infusion of Fincare is not intended to clean-up the book, given that the GNPA is already at 1.6%. The bank has also conducted write offs and even engaged in ARCs transactions to sell off w-off books. Fincare follows a write-off policy of 180 days.
- The bank is not expecting a higher integration cost. There will be a minimal cost of integration and it is already baked into the merged bank’s RoA.
- The bank will need approach the regulator for executing the merger; it believes that the regulator will support this merger. The bank will put its best foot forward to merge this.
- For the holdco structure, the holdco shareholders will probably get the shares of the AU SFB, but is too early to judge.
- There are PEs at the holdco level. The bank will be issuing the shares to the holdco. The holdco will have to go through a liquidation process, and as a result the NCLT process will take a longer time. Share swap will include all the shareholders, including the ESOPs.
- Over the years, the AU bank has cultivated a strong lending culture. Fincare shares a similar mindset, aligning with the ethos of AU Small Finance Bank. Expanding into the MFI segment is imperative for the AU SFB. The bank firmly believes that the merged entity will sustain its asset quality resilience.
- The bank will be getting INR24b of net worth and will allow to leverage on the money. The bank will maintain its CAR above the 18% mark.

- There is no tenor lock-in for the Fincare management team; it has already appointed AON as a consultant for the better integration.
- The INR7bn of the capital infusion by Fincare SFB will be at the same valuations as the merger deal.
- Fincare had the higher write-off in FY23; the performance of 1H is more on a sustainable basis. Fincare is recovering INR0.1b monthly from the write-off pool.

Merger to aid business mix, geographical diversification; return ratios to improve

- AUBANK has stronger presence in Northern and Western regions with combined branch presence of 80% across these regions. Fincare SFB, on the other hand, has 49% of the branches present in the southern region. The merger thus enables AUBANK to have a more diversified branch presence across the country with West region at 40%, South region at 28%, North at 12%, Central at 11%, and East at 9%.
- Gross advances of AUBANK currently stands at INR650b, while Fincare has an advances portfolio of INR105b. The merged entity will see gross advances of INR756b (up 16% vs. standalone bank). With Fincare SFB focused on rural and semi urban areas, and AU's expertise in Urban and Semi-urban areas, the merger offers a good balance for the combined entity. Deposits of the merged bank too will see a ~12.5% increase vs. standalone AUBANK bank, while the mix of retail deposits will also increase.
- Historically, AUBANK has maintained a largely secured loan book with 31.9% mix of Vehicles, SBL at 28.6%, Commercial at 22.8%, and HL at 7.8%, while Fincare has 53.9% of the book in Microfinance, SBL at 18.9%, HL at 14.2%. The total merged bank will thus be having a diversified loan book with a mix of CV at 27.4%, SBL at 27.2%, while HL increased to 8.7% and Microfinance at 7.5%.
- Fincare earns a net interest margin at 10.9%, enabled by healthy yields in the MFI segment at 23.7%. We believe the increase in the mix of MFI portfolio would enable the bank to maintain healthy margins, which has come under pressure over the recent quarters. Moreover, Fincare SFB has 85% share of PSL advances, while 44% of its advances is toward Agri and Allied activities, which will help AUBANK meet the sub-segmental target on Small and Marginal Farmers.
- The merger is EPS and BVPS accretive and will improve AUBANK's 1HFY24 RoA by 18bp on a proforma basis. In 1HFY24, the standalone EPS of AUBANK stands at INR11.8, while the merged EPS on a proforma basis will improve to INR13.6 (15% accretive). Likewise, the BVPS of standalone bank stands at INR176, while for the merged entity, BVPS will increase to INR189 (7% accretive). Networth of AUBANK stands at INR118b, with Fincare at INR15b. The combined networth of the merged entity stands at INR133b (INR140b, including INR7b of capital infusion by AU SFB).

Exhibit 1: Pro-forma merged financials for AU SFB and Fincare SFB; RoA to increase to 1.9% for AU SFB

1HFY24 (INR m)	AUBANK	Fincare SFB	Proforma Merged	% change for AUBANK
Profit & Loss				
Interest income from Loans	49,894	12,122	62,016	24%
Interest Expense	24,942	4,614	29,556	
Net Interest Income	**24,952**	**7,508**	**32,460**	**30%**
Non-Interest Income	7,406	1,483	8,888	
Total Income	**32,358**	**8,991**	**41,348**	
Operating Expenses	20,420	5,468	25,888	
Pre Provision Profits	**11,937**	**3,523**	**15,460**	**30%**
Provisions	1,473	640	2,113	
PBT	**10,465**	**2,883**	**13,347**	**28%**
Tax	2,577	694	3,271	
PAT	**7,887**	**2,189**	**10,076**	**28%**
Balance Sheet				
Balances with Banks & money at Call & Short Notice	62,573	8,240	70,813	
Loans	6,41,685	1,04,695	7,46,380	16%
Investments	2,32,199	29,364	2,61,563	
Interest Earnings Assets	**9,36,457**	**1,42,299**	**10,78,756**	
Networth	1,17,627	15,390	1,33,017	13%
Deposits	7,57,429	94,532	8,51,961	12%
Borrowings	53,441	33,355	86,797	
Interest Bearing Liabilities	**9,28,497**	**1,43,277**	**10,71,774**	
CASA Dep	2,56,660	18,906	2,75,566	
Total Assets	9,59,774	1,47,776	11,07,550	15%
Asset Quality				
GNPA	12,448	1,675	14,123	
NNPA	3,847	804	4,651	
GNPA ratio	1.9	1.6	1.9	
NNPA ratio	0.6	0.8	0.6	
PCR	69.1%	52.0%	67.1%	
Key Ratios				
NIM	5.6%	10.9%		
CoF	6.6%	7.4%		
CASA ratio	33.9%	20.0%	32.3%	
Cost-income ratio	63.1%	60.8%	62.6%	
BVPS*	176.0	69.7	188.8	7%
CAR*	22.4%	22.3%	23.5%	
EPS*	11.8	9.9	13.6	15%
RoA*	1.7	3.2	1.9	11%
Others				
Touchpoints	1,042.0	1,292	2,334	
Employees	28,500	14,867	43,367	

* Proforma number includes primary capital Infusion of INR7b

Source: MOFSL, Company

Exhibit 2: AU SFB P/B for 1HFY24 to be ~2.9 after amalgamation with Fincare SFB

	Total
AUBANK O/s shares, mn	**668.2**
Fincare O/s shares, mn	**220.8**
Swap ratio	579:2000
New shares of AUBANK to be issued, mn	63.9
Revised shares of AUBANK post deal completion, mn	732.1
Dilution in current equity base	9.6%
AUBANK CMP, INR	697
Value of new shares, INRm	44,547.3
1HFY24 PAT for Fincare, INRm	2,190
PE based on 1HFY24 annualized	10.2
Fincare - 1HFY24 networth	15,390
P/B - 1HFY24 trailing	**2.89**

Source: MOFSL, Company

Exhibit 3: AUBANK loan mix after merger with Fincare SFB-in absolute terms

	AUBANK	Fincare SFB	Proforma merged
Loan mix, INRm			
Wheels	2,07,443	-	2,07,443
SBL	1,85,983	19,922	2,05,905
Commercial assets	1,48,266	-	1,48,266
Home loan	50,723	14,968	65,691
Microfinance	-	56,816	56,816
Gold loans	-	10,963	10,963
Others	57,876	2,741	60,616
Gross advances	**6,50,290**	**1,05,410**	**7,55,700**

Source: MOFSL, Company

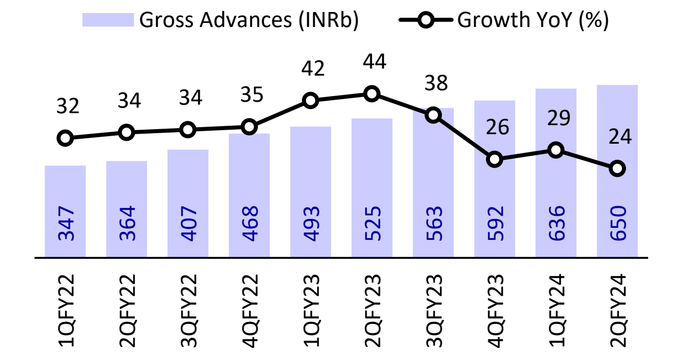
Exhibit 4: AUBANK loan mix after merger with Fincare SFB-in percentage terms

	AUBANK	Fincare SFB	Proforma merged
Loan mix			
Wheels	31.9%	0.0%	27.5%
SBL	28.6%	18.9%	27.2%
Commercial assets	22.8%	0.0%	19.6%
Home loan	7.8%	14.2%	8.7%
Microfinance	0.0%	53.9%	7.5%
Gold loans	0.0%	10.4%	1.5%
Others	8.9%	2.6%	8.0%
Gross advances	**100%**	**100%**	**100%**

Source: MOFSL, Company

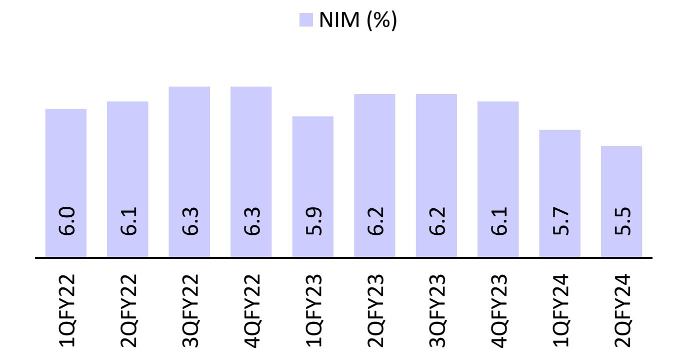
Story in charts

Exhibit 5: Gross advances grew 24% YoY to INR650b



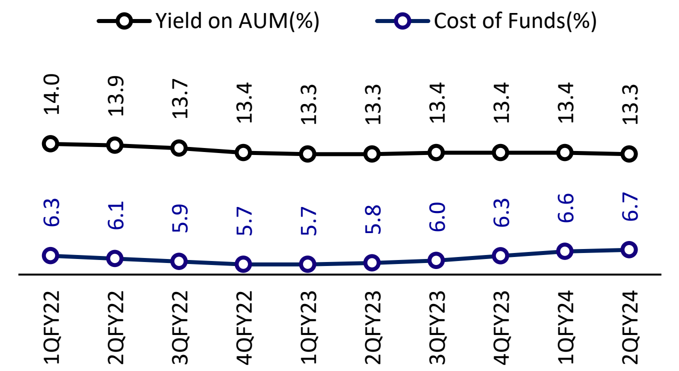
Source: Company, MOFSL

Exhibit 6: Margins moderated 22bp QoQ to 5.5%



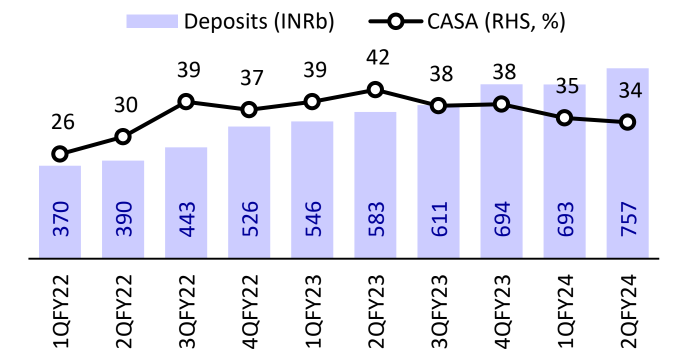
Source: Company, MOFSL

Exhibit 7: Yields on gross advances moderated 10bp QoQ, while cost of funds increased 10bp QoQ



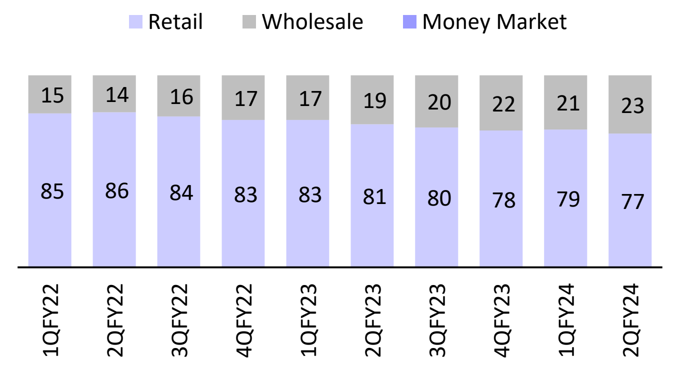
Source: Company, MOFSL

Exhibit 8: Healthy traction in deposit mobilization (~30% YoY); CASA ratio moderates to 33.9%



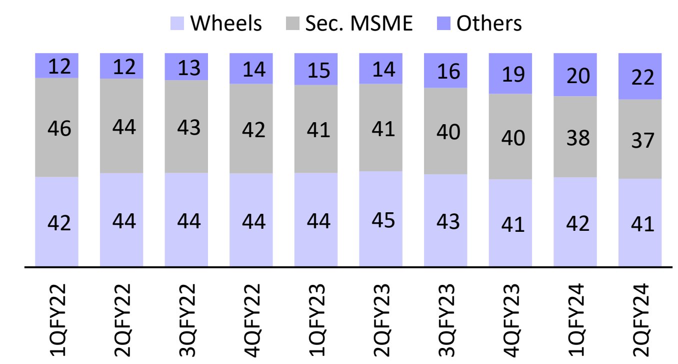
Source: Company, MOFSL

Exhibit 9: Retail mix share moderated to ~77%



Source: Company, MOFSL

Exhibit 10: Vehicles and MSME form ~78% of retail loans



Source: Company, MOFSL

Exhibit 11: DuPont Analysis | Expect return ratios to remain healthy

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	11.46	10.56	9.81	10.30	10.82	11.35	11.51
Interest Expense	6.36	5.51	4.45	4.75	5.60	5.84	5.68
Net Interest Income	**5.11**	**5.05**	**5.36**	**5.56**	**5.23**	**5.51**	**5.83**
Core Fee and Secu. Inc	1.43	1.21	1.41	1.35	1.37	1.40	1.42
Non-Interest income	**1.89**	**3.03**	**1.65**	**1.30**	**1.58**	**1.61**	**1.64**
Total Income	**7.00**	**8.08**	**7.01**	**6.85**	**6.81**	**7.12**	**7.48**
Operating Expenses	**3.79**	**3.54**	**4.00**	**4.32**	**4.23**	**4.32**	**4.41**
Employee cost	2.03	2.09	2.29	2.25	2.10	2.07	2.06
Others	1.76	1.45	1.71	2.07	2.14	2.25	2.36
Operating Profits	**3.20**	**4.54**	**3.01**	**2.54**	**2.58**	**2.79**	**3.06**
Core operating Profits	**2.74**	**2.72**	**2.77**	**2.59**	**2.36**	**2.58**	**2.84**
Provisions	**0.76**	**1.43**	**0.60**	**0.19**	**0.35**	**0.37**	**0.38**
NPA	0.17	1.36	0.19	0.31	0.30	0.34	0.34
Others	0.58	0.07	0.40	-0.12	0.05	0.03	0.03
PBT	**2.44**	**3.11**	**2.41**	**2.34**	**2.22**	**2.43**	**2.69**
Tax	0.64	0.61	0.54	0.55	0.52	0.58	0.66
RoA	**1.81**	**2.50**	**1.87**	**1.79**	**1.70**	**1.84**	**2.03**
Leverage (x)	10.0	8.9	8.8	8.8	8.7	9.1	9.4
RoE	**18.0**	**22.3**	**16.6**	**15.8**	**14.8**	**16.8**	**19.0**

Source: MOFSL, Company

Financials and valuations

Income Statement							(INRm)
Y/E MARCH	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Interest Income	42,859	49,501	59,217	82,054	1,08,291	1,39,086	1,73,367
Interest Expense	23,769	25,846	26,876	37,801	55,987	71,597	85,483
Net Interest income	**19,089**	**23,654**	**32,341**	**44,253**	**52,304**	**67,489**	**87,884**
Growth (%)	42.2	23.9	36.7	36.8	18.2	29.0	30.2
Other Income	7,061	14,209	9,937	10,345	15,827	19,784	24,730
Total Income	**26,150**	**37,864**	**42,278**	**54,597**	**68,131**	**87,273**	**1,12,614**
Growth (%)	44.9	44.8	11.7	29.1	24.8	28.1	29.0
Operating Expenses	**14,179**	**16,584**	**24,128**	**34,403**	**42,360**	**53,008**	**66,470**
Growth (%)	31.0	17.0	45.5	42.6	23.1	25.1	25.4
Operating Profits	**11,972**	**21,279**	**18,150**	**20,195**	**25,771**	**34,265**	**46,144**
Growth (%)	65.8	77.7	-14.7	11.3	27.6	33.0	34.7
Core Operating Profits	**10,246**	**12,737**	**16,721**	**20,638**	**23,624**	**31,590**	**42,814**
Growth (%)	46.4	24.3	31.3	23.4	14.5	33.7	35.5
Total Provisions	2,832	6,694	3,610	1,548	3,528	4,514	5,653
% to operating income	23.7	31.5	19.9	7.7	13.7	13.2	12.3
PBT	**9,140**	**14,585**	**14,541**	**18,646**	**22,243**	**29,750**	**40,491**
Tax	2,392	2,878	3,242	4,367	5,249	7,140	9,920
Tax Rate (%)	26.2	19.7	22.3	23.4	23.6	24.0	24.5
PAT	**6,748**	**11,707**	**11,298**	**14,279**	**16,994**	**22,610**	**30,571**
Growth (%)	76.8	73.5	-3.5	26.4	19.0	33.1	35.2
Adj. PAT	**5,962**	**6,002**	**11,298**	**14,279**	**16,994**	**22,610**	**30,571**
Growth (%)	56.2	0.7	88.2	26.4	19.0	33.1	35.2

Balance Sheet							
Y/E MARCH	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Equity Share Capital	6,082	6,244	6,298	6,667	6,667	6,667	6,667
Reserves & Surplus	37,164	55,477	68,429	99,332	1,16,326	1,38,936	1,69,507
Equity Networth	**43,247**	**61,721**	**74,727**	**1,05,999**	**1,22,993**	**1,45,603**	**1,76,174**
Deposits	**2,61,639**	**3,59,793**	**5,25,846**	**6,93,650**	**8,55,270**	**10,60,535**	**13,04,458**
Growth (%)	35%	38%	46%	32%	23.3%	24.0%	23.0%
Borrowings	1,03,353	70,297	59,908	62,987	76,844	93,749	1,14,374
Other liabilities	12,670	23,071	29,884	35,751	43,259	52,776	63,859
Total Liabilities	**4,21,431**	**5,15,913**	**6,90,778**	**8,98,827**	**10,98,806**	**13,53,104**	**16,59,306**
Current Assets	33,697	47,813	59,285	94,252	97,920	1,00,832	1,03,543
Investments	**1,06,682**	**1,08,154**	**1,53,065**	**2,00,720**	**2,44,879**	**2,98,752**	**3,66,568**
Growth (%)	49.0	1.4	41.5	31.1	22.0	22.0	22.7
Loans	**2,69,924**	**3,46,089**	**4,60,953**	**5,84,215**	**7,29,096**	**9,22,175**	**11,53,786**
Growth (%)	18.3	28.2	33.2	26.7	24.8	26.5	25.1
Net Fixed Assets	4,480	4,824	6,226	7,401	8,142	8,956	9,851
Other assets	6,648	9,033	11,250	15,573	18,770	22,390	25,556
Total Assets	**4,21,431**	**5,15,913**	**6,90,778**	**9,02,161**	**10,98,806**	**13,53,104**	**16,59,306**
Total Assets (incl. off BS)	**4,60,437**	**5,46,944**	**7,08,135**	**9,09,526**	**11,37,180**	**14,11,966**	**17,46,150**

Asset Quality	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
GNPA (INR m)	4,578	15,028	9,244	9,813	13,790	15,823	19,963
NNPA (INR m)	2,173	7,555	2,308	2,862	3,887	4,268	4,952
GNPA Ratio	1.7	4.3	2.0	1.7	1.9	1.7	1.7
NNPA Ratio	0.8	2.2	0.5	0.5	0.5	0.5	0.4
Slippage Ratio	2.5	4.2	3.6	2.4	2.1	2.0	2.0
Credit Cost	1.0	2.0	0.7	0.3	0.5	0.5	0.5
PCR (Excl Tech. write off)	52.5	49.7	75.0	70.8	71.8	73.0	75.2

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E MARCH	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Yield and Cost Ratios (%)							
Avg. Yield - on IEA	**12.1**	**11.2**	**10.7**	**11.7**	12.2	12.6	12.6
Avg. Yield on loans	12.4	11.5	11.4	12.8	13.4	13.5	13.3
Avg. Cost of funds	7.4	6.5	5.3	5.6	6.6	6.9	6.6
Spreads	**5.0**	**5.0**	**6.1**	**7.2**	6.8	6.6	6.7
NIM (On total assets)	**5.1**	**5.0**	**5.4**	**5.6**	5.2	5.5	5.8
NIM (On IEA)	**5.4**	**5.3**	**5.9**	**6.3**	**5.9**	**6.1**	**6.4**
Capitalization Ratios (%)							
CAR	22.0	23.4	21.0	23.6	21.6	20.1	19.3
Tier I	18.4	21.5	19.7	21.8	20.3	19.2	18.6
Tier II	3.6	1.8	1.3	1.8	1.3	0.9	0.7
Business and Efficiency Ratios (%)							
Loan/Deposit Ratio	103.2	96.2	87.7	84.2	85.2	87.0	88.4
CASA Ratio	14.5	23.0	37.3	38.4	36.7	36.2	36.7
Cost/Assets	3.8	3.5	4.0	4.3	4.2	4.3	4.4
Cost/Total Income	54.2	43.8	57.1	63.0	62.2	60.7	59.0
Cost/Core Income	58.1	56.6	59.1	62.5	64.2	62.7	60.8
Int. Expense/Int. Income	55.5	52.2	45.4	46.1	51.7	51.5	49.3
Fee Income/Total Income	20.4	15.0	20.1	19.8	20.1	19.6	19.0
Non Int. Income/Total Income	27.0	37.5	23.5	18.9	23.2	22.7	22.0
Investment/Deposit Ratio	40.8	30.1	29.1	28.9	28.6	28.2	28.1
Empl. Cost/Total Expense	53.6	59.1	57.2	52.1	49.5	47.9	46.6

Profitability and Valuations	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
RoE	18.0	22.3	16.6	15.8	14.8	16.8	19.0
RoA (On bal Sheet)	1.8	2.5	1.9	1.8	1.7	1.8	2.0
RoRWA	3.0	4.2	3.1	2.9	2.8	3.0	3.2
Book Value (INR)	71.1	98.8	118.7	159.0	184.5	218.4	264.2
Growth (%)	31.4	39.0	20.0	34.0	16.0	18.4	21.0
Price-BV (x)	**9.3**	**6.7**	**5.6**	**4.2**	**3.6**	**3.0**	**2.5**
Adjusted BV (INR)	69.5	92.0	116.7	156.6	181.0	214.6	259.7
Growth (%)	35.4	32.5	26.9	34.2	15.6	18.5	21.0
Price-ABV (x)	**9.6**	**7.2**	**5.7**	**4.2**	**3.7**	**3.1**	**2.6**
EPS (INR)	11.3	19.0	18.0	22.0	25.5	33.9	45.9
Adjusted EPS (INR)	11.3	19.0	18.0	22.0	25.5	33.9	45.9
Growth (%)	71.3	67.9	-5.1	22.3	15.7	33.1	35.2
Price-Earnings (x)	**58.7**	**35.0**	**36.9**	**30.1**	**26.1**	**19.6**	**14.5**

E: MOFSL Estimates

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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