AU Small Finance Bank

Banking on small biz

Well-diversified loan book with focus on small- and mid-size businesses are key to growth

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A little over a year after converting itself into a small finance bank, the financials of AU Small Finance Bank appear on a sound footing. Strong traction in loans, quick ramp-up of deposit base, good asset quality, despite more stringent asset classification norms kicking in last fiscal, and healthy return ratios — notwithstanding the additional costs of transitioning into a small finance bank — have kept the bank's performance in good stead.

Since its listing last year, the stock has gained a whopping 77 per cent. Trading at about six times its one-year forward book value, the stock is not cheap. Nonetheless, given the strong uptick in loans and healthy financial metrics, the premium on valuation is likely to stay. Given the challenges within the banking sector, stocks such as AU Small Finance Bank that offer good earnings visibility, will continue to find favour among investors.

While a like-to-like comparison is difficult, AU Small Finance Bank appears a good bet compared to other high-valued banking stocks in the space; YES Bank and RBL Bank trade at three to four times their FY19 book. AU Small Finance's loan book has been growing by over 30 per cent annually, on a par with or even better than some mid-sized banks and highly priced NBFC players such as Bajaj Finance and Cholamandalam Investment and Finance Company.

Diversified portfolio

Unlike Ujjivan or Equitas, which depend heavily on their MFI business, AU Small Finance Bank already had a well- diversified loan book with retail focus — when it transitioned into a small finance bank. AU Small Finance Bank primarily focusses on low and middle-income individuals and businesses. The company operates in three business lines: vehicle finance, micro, small and medium enterprises (MSMEs) loans and small and medium enterprises (SMEs) loans.

Retail loans constituted 81 per cent of the company's assets under management as on March 2018 and share of vehicle loans is little more than half the retail portfolio. A chunk (about 71 per cent) of the vehicle finance portfolio pertains to new vehicles, which mitigates the risk. The company caters to various segments, of which cars, multi-utility vehicles, and small commercial vehicles contribute 22-28 per cent each of the vehicle loan portfolio. In FY18, while the company's retail loans (AUM) registered a 40.9 per cent y-o-y growth, its small and mid-corporate segment recorded a 102 per cent growth on a small base. Overall, the company's AUM grew by 49 per cent y-o-y.

Over the past five years, the company's AUM has grown by a healthy 34 per cent annually.

The banking platform provides opportunities for further diversification into other segments. Over the past year, the bank has expanded its retail offerings to include gold loan, two-wheeler loans, consumer durable loans and agri-SME loans.

Given its product portfolio and customer base, the company has always been well-placed to meet the regulatory norm of extending 75 per cent of loans to the priority sector and have at least 50 per cent of loans up to ₹25 lakh. As of March 2018, 58 per cent of the disbursements have ticket size of up to ₹25 lakh.

Garnering low-cost deposits

Complying with various regulatory requirements such as cash reserve (CRR) and statutory liquidity (SLR) was expected to impact returns in the near term. Also, the company was following a 120-day norm to classify bad loans, which was to move to a 90-day norm in FY18.

AU Small Finance Bank's return on asset (ROA) slipped from 2.7 per cent in FY17 to 1.7 per cent in FY18; cost-to-income ratio shot up from 38 per cent to 55.7 per cent during the same period.

But the dip in returns has been on expected lines. It is also on a par or better than most other mid-sized banks that sport ROA of 1-1.8 per cent.

Also, the company has weathered the migration to stringent asset classification norms well. From 1.9 per cent in FY17 based on 120-day norm, the bank's gross non-performing assets are still a comfortable 2 per cent in FY18 after implementing the 90-day norm.

Quickly ramping its low-cost deposit base has also helped the bank mitigate the pressure on profitability.

AU Small Finance Bank has raised about ₹6,742 crore of deposits (excluding certificate of deposits) as of March 2018, of which 32 per cent is low-cost current account savings account (CASA). The pace of deposit growth has been noteworthy. The company also has a significant presence in rural and semi-urban markets, with 50 per cent of branches in these areas.

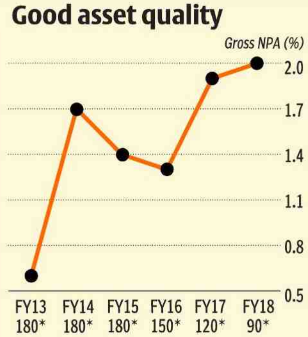
The company's operations are mostly concentrated in Rajasthan, Gujarat, Maharashtra, and Madhya Pradesh, though it has expanded its business into other geographies such as Punjab, Haryana, Delhi etc, over the years.

Rajasthan still constitutes 46 per cent of the retail portfolio. The concentration is expected to reduce gradually with diversification in other States.

Healthy growth

*Assets under management

Good asset quality



*DPD- Days Past Due

Why

- Strong traction in loans
- Healthy profitability
- Good asset quality

Did you know?

The bank had 377 branches and 5,31,062 deposit accounts as of March 31, 2018