



AU Small Finance Bank Ltd . (AUSFB) : Robust business model; slightly expensive - "SUBSCRIBE" 28th June, 2017

AU SFB has recently transitioned from a prominent; retail focused non - banking finance company which primarily served low and middle income individuals and businesses that have limited or no access to formal banking and finance channels. The Company received a license from the Reserve Bank of India to set up an SFB on Dec. 20, 2016 and it is the only NBFC categorized as an asset finance company to obtain such license. The Company commenced SFB operations with effective from April 19, 2017. Prio to such date, the Company was categorized as a "Systemically Important, Non - Deposit Accepting Asset Finance Company (NBFC - ND- AFC) by the RBI.

The Company is focused on rural and semi urban markets particularly on customers without credit history that offers significant growth opportunities. Deep understanding of local characteristics has enabled the Company to understand unique needs of target customers and penetrate deeper.

The Company is present across 10 states (with presence in states of Rajasthan, Gujarat, Maharashtra and Madhya Pradesh), 1 union territory with 301 branches and 8,515 employees including contract personnel serving 280,349 active loan accounts. as at March 31, 2017. Gross NPA - 1.6%; Net worth ~ INR 2,000 cr; FY17 PAT ~326 crs and Long-term credit rating of CRISIL A+/Stable. The credit penetration of Gujarat, Madhya Pradesh and Rajasthan is below average, while the credit penetration of Maharashtra is above average (Source: CRISIL Inclusix Report, June 2015), thus offering AUSFB significant growth potential. AU SFB intends to gradually open 162 additional branches during the financial year 2018 to reach 431 branches and 121 asset centers at the end of the financial year 2018. This proposed branch expansion plan also includes opening 23 branches in Tier 1 centers beyond the 10 states and one union territory in which we are currently present, thereby expanding its geographic reach into new states and regions. The Company has been diversifying its funding mix. As of FY17, 50 percent of the borrowings was from NCDs (Non convertible debentures), 32.9 percent from term loans, 6.8 percent from Commercial Papers (CP), 4.7 percent from subordinated debt and 5.6 percent from working capital facilities. The Company has successfully brought down its cost of funding from 12.6 percent in FY13 to 10.13 percent in FY17, thanks to the improvement in credit rating to A+ (stable) from top four rating agencies.

Investment rationale and recommendation

At the upper end of the price band of Rs. 358, the IPO is valued at 5x at FY17 Book value of Rs.70 (including exceptional item - profit on sale of investment in two subsidiaries of Rs. 5168 mn net of tax). The IPO is valued at a premium due to its following strong credentials like: a) significant untapped potential in the industry , b) diversified retail portfolio serving low and middle income group borrowers, c) experienced and credible promoters, d) customer centric organisation, e) significant presence in rural and semi-urban markets, f) robust and comprehensive credit assessment and risk, g) well defined future expansion strategy, h) NPAS under control, i) robust NIMs, ROE and ROA. We believe, investors' appetite for this issue would be high considering recent run up in NBFCs space and considering the above factors, we recommend "SUBSCRIBE" to the issue for only listing gains.

Issue date	June 28 – June 30 , 2017		
Type of issue	Offer for sale: 53.42 mn equity shares		
Issue size	Rs. 19.1 bn		
Face Value	Rs. 10		
Price Band	Rs. 355 – Rs. 358 per share		
Lot size	41 equity Shares		
Equity shares pre/post issue	36 mn equity shares		
Issue structure	QIB: 50% Retail: 35% Non – Institutional: 15%		
Post issue market cap	Rs. 101.2 bn		
Book Running Lead Managers	ICICI Securities, HDFC Bank, Motilal Oswal, Citigroup		
Registrar to the issue	Link Intime		
Shareholding	Promoters - 33% (post issue) Public and others - 67 % (post issue)		
Y/e 31 Mar (Rs. mn)	FY17	FY16	FY15
Gross AUM	107339	82,213	55,677
Operating Income	14,827	14,067	9,069
NIM (%)	9.67	9.45	8.09
PAT	8,427	2,472	1,395
Gross NPA (%)	1.61	0.64	0.92
Net NPA (%)	1.05	0.38	0.44
Networth	19,996	10,007	7,665
No. of branches	301	291	231
No. of active loan accounts	280,349	225713	189175
Post issue EPS (Rs.)	11.74	9.28	5.31
Book Value (Rs.)	70	35	27
Networth	19,996	10,006	7,665
P/BV(x)	5.1	10.2	13.3
RoE (%)	21.7	28	20.4
RoA (%)	3.4	3.6	2.8

Source: RHP, Ajcon Research

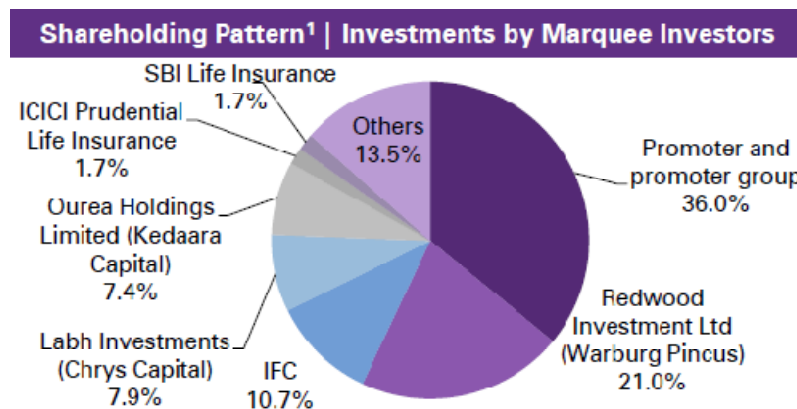


Objects of the issue

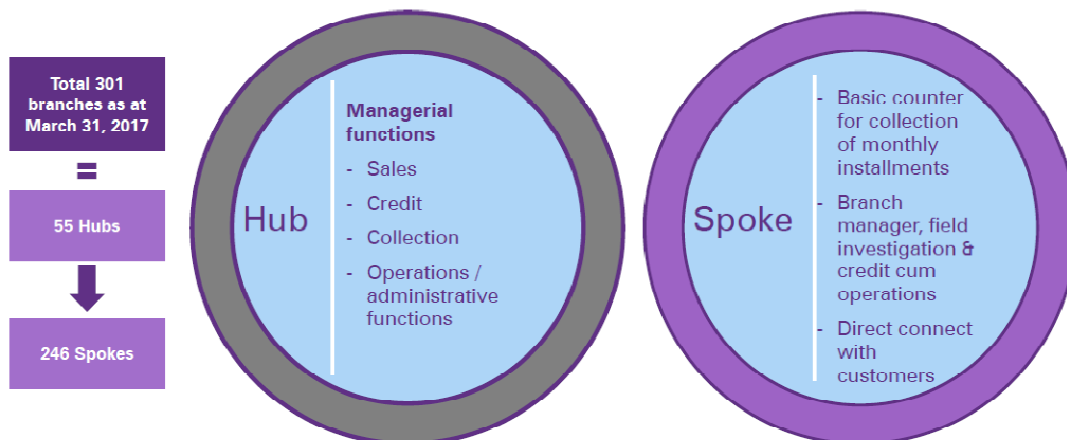
Offer for sale by promoter group and PE players like Redwood Investments, IFC, Labh, Ourea and Keddara – 53.42 mn equity shares (Rs. 1924 cr at upper end of price band.) Promoters and promoter group - Sanjay Agarwal, (to sell up to 24.94 lakh shares), Jyoti Agarwal (23.63 lakh shares), Shakuntala Agarwal (22.74 lakh shares), Chiranji Lal Agarwal (12.9 lakh shares) and MYS Holdings (5.76 lakh shares) will sell their stake through OFS. Other than promoters, Redwood Investment (up to 1.48 crore shares), International Finance Corporation (75.72 lakh shares), Labh Investments (1.12 crore shares), Ourea Holdings (1.03 crore shares) and Kedaara Capital Alternative Investment Fund (4.34 lakh shares) will also offload their shares in the offer.

Company and Promoters' background

The Company promoters include Mr. Sanjay Agarwal, MD & CEO, who is a first generation entrepreneur. The Company's shareholders include marquee investors such as the International Finance Corporation (part of the WORLD Bank group), Redwood Investment Ltd. (belonging to the Warburg Pincus group), Labh Investments Ltd. (a wholly owned subsidiary of ChrysCapital VI, LLC), Ourea Holdings Ltd. (a wholly owned subsidiary of Kedaara Capital I Ltd.) and Kedaara Capital Alternative Investment Fund – Kedaara Capital aif 1.



Hub & Spoke Model



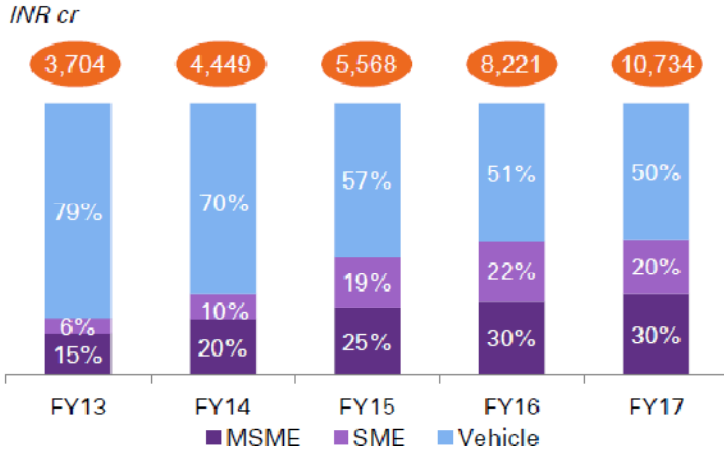
- Benefits of Hub and Spoke model**
- Enables low-cost penetration into underserved markets
 - Decentralized model optimizes turn around times
 - Benefit from economies of scale and uniformity in operations
 - Cost efficient, technology driven hub-and-spoke model allows to develop & commence SFB operations at existing locations



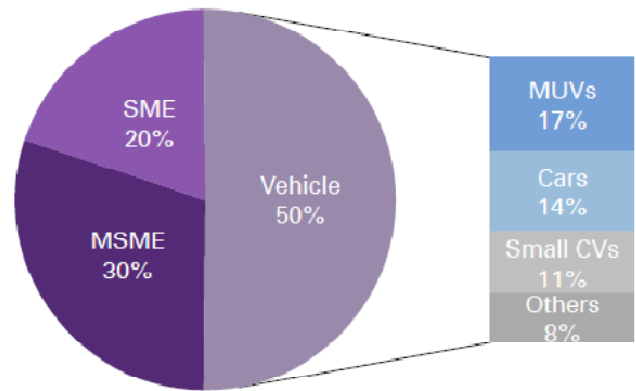
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Retail diversified product portfolio

Diversified Portfolio



Suite of products



% mix of Gross AUM as at March 31, 2017

Significant cross sell opportunities

- Offers diversified products including vehicle finance, MSME and SME which also provide significant cross selling opportunities to target customer segments
- Eg: MSME loan business was introduced to cater to the emerging needs of existing underserved customers

More than 90% Portfolio is Secured

- Serves low and middle income borrowers with limited or no access to formal banking
- As of March 31, 2017, 98.99% of our total receivables under financing activity were secured



Key Product segments

Key Product Segments			
Parameter	Vehicle Loans	MSME Loans	SME Loans
Commencement	• 1996	• 2007	• 2012
Clientele typically includes	• First time users/ buyers, Small Road Transport operators, Self Employed	• Provision stores, dairy businesses, hotels, restaurants	• Traders, wholesalers, distributors, retailers, NBFCs, self-employed professionals and small construction companies
Target Segment	• Low & middle income individuals and businesses in rural, semi-urban & urban markets who have limited or no access to formal banking and finance channels	• Turnover > INR 10 lacs < INR 1 cr	• Turnover > INR 1 cr
Average Loan Ticket size	• INR 3.4 lacs ¹	• INR 10.8 lacs ¹	• INR 2.2 cr ¹
Loan Tenure	• Up to 5 years	• Up to 12 years	• Up to 15 years
Security	• Vehicle	• Immoveable property	• Immoveable property / loan receivables
Purpose	• Income / Revenue Generation	• Business Expansion; Working capital requirement / Equipment purchase	• Business Expansion; Working capital requirement / Equipment purchase
Gross AUM	<p>INR cr</p> <p>2,931² → 5,396² CAGR: 16%</p>	<p>INR cr</p> <p>561 → 3,216 CAGR: 55%</p>	<p>INR cr</p> <p>212 → 2,122 CAGR: 78%</p>

Key Performance Metrics

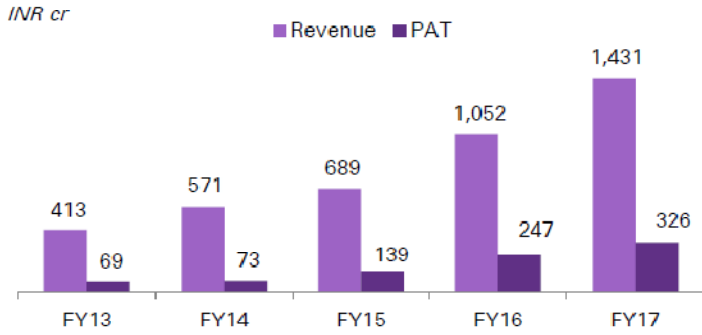
Key Performance Metrics			
	FY13	CAGR	FY17
Gross AUM (INR cr)	3,704	30%	10,734
Networth (INR cr)	442	46%	2,000
Active Loan Accounts	146,277	18%	280,349
Employees	2,266	39%	8,515
Branches	177	14%	301
PAT ¹ (INR cr)	69	47%	326
Return on average network ¹	16.8%		21.7%
RoA ¹	2.2%		3.4%
Gross NPA ² (% to Gross AUM)	0.5%		1.6%
CAR	18.3%		23.2%



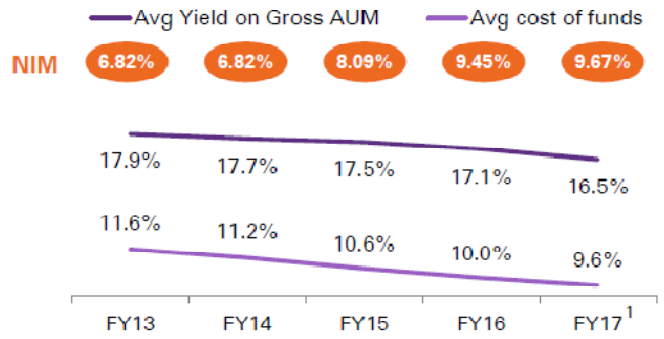
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Financial Performance

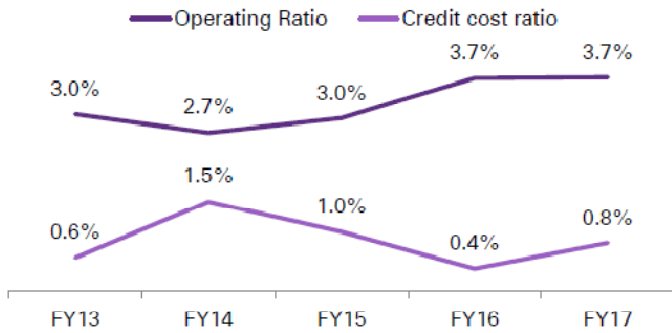
Total Revenue and PAT¹



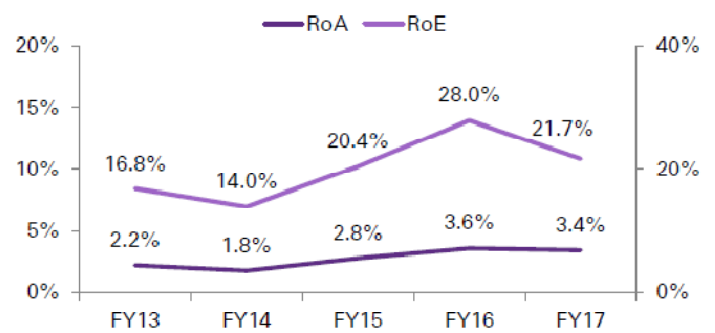
Yields and Cost of Funds²



Opex and Credit Cost Ratio (to average Gross AUM)



Consistent returns (RoA¹ & RoE¹)





Equity ♦ Currency ♦ D.P. ♦ Advisory Services ♦ Investment Banking ♦ Insurance

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