AU Small Finance Bank Limited

October 03, 2023

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Tier-II Bonds	200.00	CARE AA; Stable	Reaffirmed
Tier-II Bonds	300.00	CARE AA; Stable	Reaffirmed
Tier-II Bonds	150.00	CARE AA; Stable	Reaffirmed
Certificate of deposit	300.00 (Reduced from 500.00)	CARE A1+	Reaffirmed

Details of instruments in Annexure-1.

Rationale and key rating drivers

The reaffirmation of the ratings assigned to the debt instruments of AU Small Finance Bank Limited (AUSFB) factors in the continued momentum of growth in business and asset size over the last six years post-conversion into a small finance bank (SFB) in April 2017 making it the largest SFB in India. The ratings factor in establishment of a growing deposit franchise, and a moderately-diversified advances portfolio with a largely secured lending portfolio. The ratings also factor-in the experience of the management team, comfortable capitalisation levels supported with periodic equity capital raise, stable asset quality parameters post COVID-19-related stress albeit slight increase in Q1FY24, and healthy profitability.

The ratings are, however, constrained by moderate seasoning in AUSFB's new product segments, including business banking loans, home loans, and two-wheeler financing. The ratings are also constrained by the regional concentration of advances and deposits, comparatively lower current account saving account (CASA) proportion as well as the relatively moderate size as compared to mid-sized private sector banks.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors: Factors that could lead to positive rating action/upgrade

- Sustained improvement in the scale of operations along with improvement in product and geographical diversification.
- Scale-up of deposits with increase in CASA and retail deposits base becoming more comparable to mid-sized private sector banking peers.

Negative factors: Factors that could lead to negative rating action/downgrade

- Deterioration in asset quality, with gross non-performing asset (GNPA) increasing to more than 4% on a sustained basis.
- Deterioration in capital adequacy parameters with capital adequacy ratio (CAR) falling below 17% on a sustained basis.
- Moderation in profitability parameters with return on total assets (ROTA) falling below 1% on a sustained basis.

Analytical approach: Standalone

Outlook: Stable

CARE Ratings Limited (CARE Ratings) believes that AUSFB shall continue to maintain its steady growth in advances, deposits and healthy profitability profile over the medium term while maintaining stable asset quality and comfortable capitalisation levels.

Detailed description of the key rating drivers:

Key strengths

Continued growth momentum in business

The company commenced operations as an SFB from April 2017 and got the status of a scheduled commercial bank (SCB) in November 2017. In over six years of operations as an SFB, the bank has been able to ramp-up its operations from 474 touchpoints as on March 31, 2018, to 1,038 touchpoints (new and converted) across 21 states and 3 Union Territories, with 28,400+ employees on roll, as on June 30, 2023. AUSFB, the largest SFB in India, in terms of asset size, has seen steady growth in the total assets increasing from ₹18,819 crore as on March 31, 2018 to ₹90,123 crore as on March 31, 2023 (June 30, 2023: ₹91,489 crore) at a compounded annual growth rate (CAGR) of 37%.

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

Comfortable capitalisation
Despite undertaking significant growth in the loan book, AUSFB continues to be sufficiently capitalised, helped by regular capital infusions by way of Qualified Institutional Placement (QIP), the latest being ₹2,000 crore in August 2022 and steady healthy internal accruals. The bank also raised Tier-II capital of ₹500 crore during FY23. The bank reported a CAR of 21.46% (March 31, 2023: 23.59%, March 31, 2022: 20.99%) and Tier-I CAR of 19.95% (March 31, 2023: 21.78% and March 31, 2022: 19.69%) as on June 30, 2023, which were well above the minimum regulatory requirement of 15% and 7.5%, respectively. As AUSFB continues to grow its book at a fast pace along, it would require regular capital infusions in addition to internal accruals, which alone may not be sufficient to support growth over the medium term. Going ahead, CARE Ratings expects AUSFB to maintain sufficient cushion over the minimum regulatory requirements.

Diversified resource profile with a strong growth in deposit base
AUSFB has transformed its liabilities profile by developing its deposit base since becoming a bank in FY18. The deposit franchise has consistently increased with deposits increasing from ₹7,923 crore as on March 31, 2018, to ₹69,315 crore as on June 30, 2023. Initially, CASA deposits growth was slow as compared with total deposit growth, which resulted in the CASA ratio falling from 26.9% as on March 31, 2018, to 14.5% as on March 31, 2020. With a focus on increasing CASA deposits, AUSFB continues to offer higher interest rates on saving accounts as compared to mainstream banks and undertaking extensive marketing exercises. The bank has a strategy of generating deposits from urban markets and lending in the rural markets. The bank is increasing its touchpoints in urban areas to garner more retail deposits.
The bank's CASA stood at 35.04% June 30, 2023 (March 31, 2023: 38.43%). The bank continues to granularise its deposit book with a focus on increasing retail deposits. The share of retail term deposits to total term deposits (excluding CD) has gone up from 30% as on March 31, 2019, to 51% as on June 30, 2023, which increases stability in the liability profile. Bulk deposits (over ₹2 crore) constituted around 49% of the term deposits, as on June 30, 2023. CARE Ratings observes, while the bank has been increasing its depositor base and the proportion of CASA in the past five years of operating as a SFB, it is relatively lower compared to few mid-sized private sector banks, and the scaling-up of the CASA over the next few years would be a key rating sensitivity for the bank.

Consistent track record of healthy earnings performance
Post conversion to an SFB and access to deposits, the cost of funds has declined over the period FY20-FY22 as it has increased the proportion of CASA and retail term deposits, further helped by lowering of the systemic interest rates. However, the cost of funds stayed constant during FY23 vis-à-vis FY22 even when there was increase in systemic interest rates due to rate hikes by Reserve bank of India (RBI). Also, as majority of advances comprise of small business customers from Tier II and Tier III cities which have lower banking penetration, AUSFB is able to enjoy relatively higher yield and therefore the net interest margin (NIM) is higher than the universal banks, ranging between 5% and 5.5%.
The net interest income (NII) is growing consistently, in trend with the growth in advances and deposits. For the year ended March 31, 2023, AUSFB continued to see growth in NII with interest income growing at 37% year-on-year following advances growth of 27% year-on-year. However, the non-interest income was impacted by mark-to-market loss on the investments due an increasing interest rate scenario while the fee-based income continued to increase resulting in non-interest income to marginally grow by 4% year-on-year for FY23. The bank's operating cost grew by 43% as the bank is actively spending on business expansion, capacity building and investments in digital initiatives, which resulted in PPOP showing moderate growth of 11% for FY23 as compared with FY22. The credit costs were lower by 57% year-on-year for FY23 supported by notable improvement in asset quality, which helped the bank report profit after tax (PAT) growth of 26% for FY23. AUSFB reported a ROTA of 1.80% for FY23 (FY22: 1.88%).
AUSFB reported a net profit of ₹387 crore for Q1FY24 on a total income of ₹2,773 crore as against a net profit of ₹268 crore on a total income of ₹1,979 crore for the corresponding quarter the previous year. AUSFB reported a ROTA of 1.70% (annualised) for Q1FY24 vs. 1.53% for Q1FY23. CARE Ratings expects AUSFB to continue to maintain healthy profitability over the near term.

Improving asset quality after COVID-19-induced stress
AUSFB has historically been able to manage its asset quality to comfortable levels, despite having significant exposure to segments that are more vulnerable to an economic downturn. About 89% of loans are retail which provides granularity and 91% of the advances of AUSFB are secured as on June 30, 2023, which provides comfort, in terms on eventual loss on the portfolio. The GNPA levels of AUSFB hovered around 1.7%-2.1% between FY18 and FY20, rising to peak levels of 4.3% as on March 31, 2021, and June 30, 2021, due to the impact of COVID-19 on its borrowers. Wheels and Secured Business Loans – the two biggest segments for AUSFB – saw higher slippages during COVID-19 period of FY21 and FY22. The asset quality has since been improving quarter-on-quarter from the peak of June 2021, with the GNPA ratio reducing to 1.66% as on March 31, 2023 (June 30, 2023: 1.76% seasonal increase) due to post COVID-19 improving environment increasingly supporting borrowers' cashflows and repayment behaviour which aided recoveries/ resolutions of stressed cases significantly resulting in improved collection efficiency

over 107% during FY23. The net stressed assets (Net Stressed Assets = Net NPA +Std. Restructured + Security Receipts outstanding) to net worth ratio improved from 23% as on March 31, 2021 to 8% as on June 30, 2023. As on June 30, 2023, the COVID-19 restructured constituted 1% of gross advances, respectively, and the provision cover stood at 1.74% of the gross advances, providing cushion against asset quality shocks.

Key weaknesses

Limited product diversification and lower seasoning of non-vehicle/non-SBL portfolio

AUSFB has witnessed significant portfolio growth in the MSME segments in the past few years. Post conversion to an SFB, it started new products like business banking, gold loan, agri loan, home loan, etc. As on June 30, 2023, the total wheels segment comprised 33% of the gross advances, secured business loans (SBL) was 30%, and other products which includes home loan, business banking, Agri, SME, NBFC, and builder loans comprised the remaining 37% of the AUM, reflecting concentration in wheels and the MSME segment. However, the bank has scaled up its efforts to diversify into other products such as business banking, agri MSME, personal loan, home loan, etc. Furthermore, the seasoning of the portfolio built up in these products as well as new geographies is still low, and their performance over cycles is yet to be seen.

Regional concentration and relatively moderate size

As on June 30, 2023, AUSFB's distribution network is spread around 21 states having 1,038 touchpoints out of which 401 touchpoints (39%) are located in Rajasthan, followed by Gujarat having 149 touchpoints (14%), and Madhya Pradesh having 137 touchpoints (13%) accounting for 66% of the total branch distribution. The top three states constituted 64% of the advances and 60% of the deposits as on June 30, 2023. The company intends to leverage its branch network to drive greater and deeper penetration in the western and northern states of India in which it operates, focusing on low and middle-income individuals and businesses that have limited or no access to formal banking and finance channels, spanning rural, semi-urban and urban markets. Although AUSFB has seen strong growth in the last few years, its asset size continues to be relatively smaller as compared to private sector universal banks in India.

Liquidity: Adequate

The asset liabilities maturity (ALM) profile of AUSFB as on March 31, 2023, had no negative cumulative mismatches as per the Structural Liquidity Statement in time buckets up to six months. In order to manage the gaps in an optimum manner, AUSFB has been focusing on increasing granular deposit, wherein, retail term deposits and CASA contributed 68% of the total deposits. AUSFB's liquidity coverage ratio (LCR) stood at 128% for the quarter-ended March 31, 2023 (June 30, 2023: 139%), as against the regulatory requirement of 100%. AUSFB has maintained sufficient excess statutory liquidity ratio (SLR) and high-quality non-SLR instruments, which can be readily used for repo or liquidated in the secondary market. Furthermore, it can also resort to rupee borrowing in the form of CDs, term money, securitisation of portfolio, and re-finance from various domestic financial institutions (NABARD, SIDBI, MUDRA, NHB, and others) in case of liquidity need. Furthermore, the bank has access to facilities like LAF, MSF and call money market to meet any liquidity requirement.

Environment, social, and governance (ESG) risks

- AUSFB is taking steps like strengthening ESG disclosures, developing dedicated training module for employees, ESG data infrastructure strengthening, carbon disclosure programme, framing of sustainability policy and green financing.

Applicable criteria

Policy on default recognition
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Short Term Instruments
Rating Basel III - Hybrid Capital Instruments issued by Banks
Bank

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Banks	Private Sector Bank

AU Small Finance Bank Limited (erstwhile AU Financiers (India) Limited) was incorporated in 1996 as a non-banking finance company (NBFC) and started the CV lending business in 2003 as a franchisee originator for HDFC Bank under 'Channel Business' and later moved to lend on its own books since 2007. Over the years, the company forayed into the MSME/SME, housing loans and structured financing and other types of vehicle financing as well.
The company received the license of an SFB from the RBI in December 2016, and commenced banking operations from April 2017 and received the status of a SCB in November 2017. Post becoming an SFB, it has expanded its product portfolio and geographical footprint. As on June 30, 2023, it has established operations across 1,038 banking touchpoints serving around 41.3 lakh customers across 21 States and 3 Union Territories with an employee base of around 28,400.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023 (A)	Q1FY24 (UA)
Total income	6,915	9,240	2,773
PAT	1,130	1,428	387
Total assets#	68,936	90,123	91,489
Net NPA (%)	0.50	0.42	0.55
ROTA (%)	1.88	1.80	1.70

A: Audited UA: Unaudited; Note: 'the above results are latest financial results available'
Note: All Analytical ratios are as per CARE Ratings' calculations.
Total Assets and Networth adjusted by DTA, revaluation reserve and intangible assets

Status of non-cooperation with previous CRA: Not applicable.

Any other information: Not applicable.

Rating history for the last three years: Please refer Annexure-2

Covenants of the rated instruments/facilities: Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of the various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Bonds- Tier-II Bonds	INE949L08442	03-08-2022	9.30%	03-08-2032	350.00	CARE AA; Stable
Bonds- Tier-II Bonds	INE949L08434	03-08-2022	9.30%	13-08-2032	100.00	CARE AA; Stable
Bonds- Tier-II Bonds	INE949L08426	03-08-2022	9.30%	23-08-2032	50.00	CARE AA; Stable
Bonds- Tier-II Bonds	Proposed	-	-	-	150.00	CARE AA; Stable
Certificate of deposit	Proposed	7-365 days	-	-	300.00	CARE A1+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021
1	Fund-based - LT-Term loan	LT	-	-	-	-	1)Withdrawn (23-Mar-22)	1)CARE AA-; Stable (30-Mar-21)
2	Certificate of deposit	ST	300.00	CARE A1+	1)CARE A1+ (04-Apr-23)	1)CARE A1+ (27-Jul-22)	1)CARE A1+ (23-Mar-22)	1)CARE A1+ (30-Mar-21)
3	Bonds-Tier-II Bonds	LT	200.00	CARE AA; Stable	1)CARE AA; Stable (04-Apr-23)	1)CARE AA; Stable (27-Jul-22)	1)CARE AA; Stable (23-Mar-22)	-
4	Bonds-Tier-II Bonds	LT	300.00	CARE AA; Stable	1)CARE AA; Stable (04-Apr-23)	1)CARE AA; Stable (27-Jul-22)	-	-
5	Bonds-Tier-II Bonds	LT	150.00	CARE AA; Stable	1)CARE AA; Stable (04-Apr-23)	1)CARE AA; Stable (27-Jul-22)	-	-

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities: Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Bonds- Tier-II Bonds	Complex
2	Certificate of deposit	Simple

Annexure-5: Lender details: Not Applicable

Note on the complexity levels of the rated instruments: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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