AU Small Finance Bank Limited

August 14, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Lower Tier-II Bonds	75.00	CARE AA; Stable	Reaffirmed
Tier-II Bonds	250.00	CARE AA; Stable	Reaffirmed
Tier-II Bonds	650.00	CARE AA; Stable	Reaffirmed
Certificate of deposit	2,400.00 (Enhanced from 1,400.00)	CARE A1+	Reaffirmed

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

CARE Ratings Limited (CARE Ratings) has reaffirmed ratings to debt instruments of AU Small Finance Bank Limited (AUSFB), factoring in the continuous growth momentum in business and asset size over in the last seven years post-conversion into small finance bank (SFB) in April 2017, making it the largest SFB in India. Ratings consider a growing deposit franchise and a moderately diversified advances portfolio which largely consists of secured lending. Ratings also take into cognisance the management team's experience, comfortable capitalisation levels supported with periodic equity capital raise, stable asset quality parameters post COVID-19-related stress, and healthy profitability.

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

The merger of Fincare SFB with AUSFB became effective from April 1st, 2024, and this merger has helped the bank in increasing its geographical reach in south India. Addition of FSFB's customer base and product lines such as microfinance, including joint liability group (JLG) business, gold loans, micro business loans, and home loans has helped AUSFB in having more granular and diversified advances profile. Although the proportion of unsecured loans has increased mainly due to addition of microfinance loan book, overall proportion of unsecured loans to total advances remains low. AUSFB's combined branch strength stood at 2,414 as on June 30, 2024.

Further, CARE (CARE Ratings) has taken cognisance of the fact that AUSFB has received Board approval for applying to RBI for transition to a Universal Bank and for the same the AUSFB has constituted a Committee of Directors to vet the application for submission with RBI.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Sustainably improving scale of operations with improving product and geographical diversification.
- Scaling up deposits with increasing CASA and retail deposits base, becoming more comparable to mid-sized private sector banking peers.

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

Negative factors

- Deteriorating asset quality, with gross non-performing assets (GNPA) increasing to more than 4% on a sustained basis.
- Deteriorating capital adequacy parameters, with capital adequacy ratio (CAR) falling below 17% on a sustained basis.
- Moderating 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 will continue maintaining 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

Continuous 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. Merger of Fincare with AUSFB is completed and has become effective from April 1, 2024. In over seven years of operations as an SFB, the bank has been able to ramp up operations from 474 touchpoints as on March 31, 2018, to 2414 touchpoints (new and converted including branches of Fincare) across 21 states and four Union Territories, with more than 46,500 employees as on June 30, 2024. AUSFB, the largest SFB in India in terms of asset size, has seen steady growth in total assets increasing from ₹18,833 crore as on March 31, 2018, to ₹1,09,426 crore as on March 31, 2024. Post the merger, the bank's total asset base stood at ₹1,25,942 crores as on June 30, 2024. The bank expects its advances and deposits to grow at 23-25% CAGR by FY27.

Comfortable capitalisation

Despite significant growth in 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. It reported a capital adequacy ratio (CAR) of 20.06% (March 31, 2023: 23.59%, March 31, 2022: 20.99%) and Tier-I CAR of 18.80% (March 31, 2023: 21.78% and March 31, 2022: 19.69%) as on March 30, 2024, well above the minimum regulatory requirement of 15% and 7.5%, respectively. Post merger, AUSFB reported a capital adequacy ratio (CAR) and Tier-I of 20.11% and 18.88% as on June 30, 2024. Going forward, CARE Ratings expects AUSFB to maintain sufficient cushion over minimum regulatory requirements.

Diversified resource profile with 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 ₹87,812 crore as on March 31, 2024. Initially, CASA deposits growth was slow as compared to total deposit growth, resulting 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 rural markets. AUSFB is increasing its touchpoints in urban areas to garner more retail deposits.

The bank's CASA stood at 33.41% March 31, 2024 (March 31, 2023: 38.43%). It continues to granularize its deposit book with a focus on increasing retail deposits. AUSFB has resorted to securitisation on a strategic tool for diversifying its sources of funds and using capital efficiently. Post merger, AUSFB reported a total deposit of ₹97,290 crores as on June 30, 2024, of which CASA was at 32.93%.

CARE Ratings observes that while the bank has been increasing its depositor base and proportion of CASA in the recent years of operating as a SFB, it has shown a declining trend and is relatively lower compared to a few mid-sized private sector banks, thereby the scaling-up of CASA over next few years will be a key rating sensitivity.

Consistent track record of healthy earnings performance

Post-conversion to an SFB and access to deposits, cost of funds declined between FY20 and FY22, as it increased proportion of CASA and retail term deposits, further helped by lowering of systemic interest rates. However, cost of funds stayed constant in FY23 as against FY22, even when there was an increase in systemic interest rates due to rate hikes by the RBI. As majority advances comprise small business customers from Tier-II and Tier-III cities that have lower banking penetration, AUSFB is able to enjoy relatively higher yields. Hence, the net interest margin (NIM) is higher than universal banks, ranging between 5% and 6%.

The net interest income (NII) is growing consistently, in trend with growing advances and deposits. For the year-ended March 31, 2024, AUSFB continued to grow in NII, with interest income growing at 29% y-o-y, following gross advances growing at 25% y-o-y. Further, non-interest income also grew significantly by 69% y-o-y in FY24. The bank's operating cost grew by 30% as it is actively spending on business expansion, capacity building and investments in digital initiatives, which resulted in the pre-provision operating profit (PPOP) growing by 21% for FY24 as compared to FY23. However, credit costs grew significantly in FY24 due to increased slippages and additional provisions created by AUSFB. Further, PAT reported a marginal increase in the profit-after-tax (PAT) by 7% for FY24 post exceptional item. AUSFB reported ROTA of 1.54% for FY24 post exceptional item (FY23: 1.80%).

Post merger, AUSFB reported a net profit of ₹503 crores on a total income of ₹4,315 crores during Q1FY25. Further, it reported a ROTA of 1.71% (annualised) for Q1FY25. CARE Ratings expects NIMs to increase due to integration of high yielding microfinance business, however, it will also impact credit cost going forward. CARE Ratings expects AUSFB to continue maintaining healthy profitability over the medium term.

Stable asset quality post COVID-19-induced stress

Historically, AUSFB has been able to manage its asset quality at comfortable levels, despite having significant exposure to segments that are more vulnerable to economic downturns. About 89% of the advances of AUSFB are secured as on March 31, 2024, providing comfort in terms of eventual loss on the portfolio. The bank's GNPA levels hovered about 1.7-2.1% between FY18 and FY20, rising to peak levels of 4.3% as on March 31, 2021, due to COVID-19 impact on borrowers.

Wheels and micro business loans (MBL; earlier known as secured business loans) – two biggest segments for AUSFB – saw higher slippages in the COVID-19 period of FY21 and FY22. Asset quality has since been improving quarter-on-quarter, improved from the peak of June 2021, with the GNPA ratio at 1.67% as on March 31, 2024, considering improving environment post-COVID increasingly supporting borrowers' cashflows and repayment behaviour. This aided recoveries and resolutions of stressed cases significantly, resulting in improved collection efficiency in FY24. However, delinquencies increased in FY24, mainly due to credit card portfolio impacting credit cost. The credit card book stood at ₹3,058 crore, contributing about 4.1% of gross advances as on March 31, 2024. Further, the GNPA and NNPA as on June 30, 2024, stood at 1.78% and 0.63%, respectively.

CARE Ratings expects the merger to add to the relatively risker portfolio of microfinance, which may increase credit cost and asset quality going forward. However, the proportion of unsecured book will be limited to 15-20% with microfinance book capped at 10% of loan portfolio (including securitisation), limiting the impact on asset quality.

Key weaknesses

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

AUSFB's portfolio grew significantly in the micro, small, and medium enterprise (MSME) segments in the last few years. Post-conversion to an SFB, it started new products such as business banking, gold loan, agri loan, and home loan, among others. As on March 31, 2024, the wheels segment comprised 30% of gross advances, MBL was 28%, and other products including home loan, business banking, agri, small and medium enterprise (SME), non-banking financial company (NBFC), and builder loans comprised the balance 42% of the Gross Advances, reflecting concentration in wheels and MSME segments.

However, the bank has scaled up its efforts for diversifying into products such as business banking, agri, MSME, personal loan, home loan, and credit card, among others. The portfolio built-up seasoning in these products is still low, with their performance over cycles yet to be tested. CARE Ratings expects the merger with FSFB to boost existing products such as home loan, gold loan, and MBL, further diversifying with the addition of microfinance although this would be restricted to 10% of Loan portfolio up to FY27.

Regional concentration and relatively moderate size

As on March 31, 2024, AUSFB's distribution network is spread around 21 States and Four Union Territories having 2,383 touchpoints (merged figure), of which 475 touchpoints (20%) are in Rajasthan, followed by Gujarat having 265 touchpoints (11%), and Madhya Pradesh having 233 touchpoints (10%), accounting for 41% of the total branch distribution. Top three states, after considering Fincare merger, constituted 54% of advances and 55% of deposits as on March 31, 2024. 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. The merger has added approximately 1,300 touchpoints and help AUSFB diversify geographically with access to newer geographies in the southern states of India.

Although AUSFB has seen strong growth in past few years, its merged asset size continues to be relatively smaller as compared with private sector universal banks in India.

Liquidity: Adequate

AUSFB's asset liabilities maturity (ALM) profile as on June 30, 2024, had no negative cumulative mismatches per the Structural Liquidity Statement in time buckets up to 1 month. To manage gaps in an optimum manner, the bank has been focusing on increasing granular deposit, where retail term deposits and CASA contributed 70% of total deposits. Post merger, AUSFB's average liquidity coverage ratio (LCR) stood at 117% for the quarter-ended June 30, 2024, as against the regulatory requirement of 100%. The bank 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. It can also resort to Rupee borrowing as corporate deposits (CDs), term money, portfolio securitisation, and re-finance from domestic financial institutions such as NABARD, SIDBI, MUDRA, NHB, and others, in case of liquidity need. The bank has access to facilities such as liquidity adjustment facility (LAF), marginal standing facility (MSF), and call money market to meet liquidity requirements.

Environment, social, and governance (ESG) risks
Environmental

- Sourced 10291 fixed deposits amounting ₹703 crore raised.
- ~₹189 crore deployed in Green Assets Lending.
- Currently Lending in Solar and EV Infrastructure.
- AU's Tree Plantation drive conducted, and 550 saplings planted at 10 different locations.
- Sustainability Idea Contest conducted within AU and more that 1,000 responses received on ESG. Top 10 winners were awarded.

Social

- Skill development is the flagship project of the bank. Till Q1'FY25, 21,962 youth were trained, of which 78% were linked to employment across 16 centres of Rajasthan. Three trainees have also secured placement overseas.
- Rural Sports Initiative Project, aimed at holistic development of rural children, is live across 60 locations with more than 8,100 children in the age group of 8-16 years getting trained by certified coaches. Two athletes of this initiative clinched medals at the 19th National Youth Athletics Championship 2024.
- The bank supports women entrepreneurs for livelihood generation and capacity building by providing support and access. To date, more than 2,580 women are engaged and 872 are nurtured.

Governance

- The bank has 70% independent directors, 20% women directors.
- Board committee on sustainability driving the sustainability agenda.

Applicable criteria
Definition of Default
Rating Outlook and Rating Watch
Bank
Financial Ratios - Financial Sector
Rating Basel III - Hybrid Capital Instruments issued by Banks
Short Term Instruments

About the company and industry

Industry classification

Macro Economic Indicator	Sector	Industry	Basic Industry
Financial Services	Financial Services	Banks	Other Bank

AUSFB
AUSFB (erstwhile AU Financiers (India) Limited) was incorporated in 1996 as an 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 MSME and SME, housing loans, and structured financing and other types of vehicle financing.

The company received the license of an SFB from the RBI in December 2016 and commenced banking operations from April 2017; it received the status of an SCB in November 2017. Post becoming an SFB, it expanded its product portfolio and geographical footprint.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	June 30, 2024 (UA)
	12M	12M	3M
Total income	9,240	12,301	4,315
PAT	1,428	1,535	503
Total assets#	90,123	1,09,310	1,25,689
Net NPA (%)	0.42	0.55	0.63
ROTA (%)	1.80	1.54	1.71

A: Audited; UA: Unaudited. Note: These are latest available financial results.
Note: All analytical ratios are per CARE Ratings' calculations.
#Total assets and net worth 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 last three years: Annexure-2

Covenants of rated instruments/facilities: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

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
Lower Tier-II bonds	INE519Q08137*	22-Mar-18	11.30%	22-Jun-24	38	CARE AA; Stable
Lower Tier-II bonds	INE519Q08145*	20-Mar-18	11.30%	20-Jun-24	37	CARE AA; Stable
Bonds- Tier-II bonds	INE519Q08152	30-Sep-19	12.87%	30-Sep-25	100	CARE AA; Stable
Bonds- Tier-II bonds	INE519Q08178	05-Jul-23	10.75%	05-Jan-29	75	CARE AA; Stable
Bonds- Tier-II bonds	INE519Q08186	09-Aug-23	10.75%	09-Feb-29	50	CARE AA; Stable
Bonds- Tier-II bonds	INE949L08442	03-Aug-22	9.30%	03-Aug-32	350	CARE AA; Stable
Bonds- Tier-II bonds	INE949L08434	03-Aug-22	9.30%	13-Aug-32	100	CARE AA; Stable
Bonds- Tier-II bonds	INE949L08426	03-Aug-22	9.30%	23-Aug-32	50	CARE AA; Stable
Bonds- Tier-II bonds	Proposed	-	-	-	175	CARE AA; Stable
Certificate of deposit	INE949L16CN4	31-Jul-24	7.82%	03-Feb-25	25	CARE A1+
Certificate of deposit	INE949L16CN4	31-Jul-24	7.82%	03-Feb-25	50	CARE A1+
Certificate of deposit	INE949L16CN4	31-Jul-24	7.82%	03-Feb-25	75	CARE A1+
Certificate of deposit	INE949L16CN4	31-Jul-24	7.82%	03-Feb-25	50	CARE A1+
Certificate of deposit	INE949L16CF0	06-Mar-24	8.17%	05-Mar-25	100	CARE A1+
Certificate of deposit	INE949L16CG8	07-Mar-24	8.17%	06-Mar-25	100	CARE A1+
Certificate of deposit	INE949L16CH6	11-Mar-24	8.15%	10-Mar-25	50	CARE A1+
Certificate of deposit	INE949L16CH6	11-Mar-24	8.15%	10-Mar-25	200	CARE A1+
Certificate of deposit	INE949L16CI4	13-Mar-24	8.15%	20-Feb-25	200	CARE A1+
Certificate of deposit	INE949L16CI4	13-Mar-24	8.15%	20-Feb-25	50	CARE A1+
Certificate of deposit	INE949L16CP9	31-Jul-24	8%	28-Jan-25	100	CARE A1+
Certificate of deposit	INE949L16CP9	31-Jul-24	8%	28-Jan-25	100	CARE A1+

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
Certificate of deposit	INE949L16CM6	31-Jul-24	7.43%	28-Oct-24	100	CARE A1+
Certificate of deposit	INE949L16CM6	30-Jul-24	7.43%	28-Oct-24	200	CARE A1+
Certificate of deposit	Proposed	-	-	Upto 364 days	1,000	CARE A1+

*ISIN Matured.

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 2024-2025	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
1	Fund-based - LT-Term Loan	LT	-	-	-	-	-	1)Withdrawn (23-Mar-22)
2	Certificate Of Deposit	ST	2400.00	CARE A1+	1)CARE A1+ (10-Apr-24)	1)CARE A1+ (15-Mar-24) 2)CARE A1+ (11-Mar-24) 3)CARE A1+ (03-Oct-23) 4)CARE A1+ (04-Apr-23)	1)CARE A1+ (27-Jul-22)	1)CARE A1+ (23-Mar-22)
3	Bonds-Tier II Bonds	LT	200.00	CARE AA; Stable	1)CARE AA; Stable (10-Apr-24)	1)CARE AA; Stable (15-Mar-24) 2)CARE AA; Stable (11-Mar-24) 3)CARE AA; Stable (03-Oct-23)	1)CARE AA; Stable (27-Jul-22)	1)CARE AA; Stable (23-Mar-22)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	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
						4)CARE AA; Stable (04-Apr-23)		
4	Bonds-Tier II Bonds	LT	300.00	CARE AA; Stable	1)CARE AA; Stable (10-Apr-24)	1)CARE AA; Stable (15-Mar-24) 2)CARE AA; Stable (11-Mar-24) 3)CARE AA; Stable (03-Oct-23) 4)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 (10-Apr-24)	1)CARE AA; Stable (15-Mar-24) 2)CARE AA; Stable (11-Mar-24) 3)CARE AA; Stable (03-Oct-23) 4)CARE AA; Stable (04-Apr-23)	1)CARE AA; Stable (27-Jul-22)	-
6	Bonds-Lower Tier II	LT	75.00	CARE AA; Stable	1)CARE AA; Stable (10-Apr-24)	-	-	-

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	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
7	Bonds-Tier II Bonds	LT	150.00	CARE AA; Stable	1)CARE AA; Stable (10-Apr-24)	-	-	-
8	Bonds-Tier II Bonds	LT	100.00	CARE AA; Stable	1)CARE AA; Stable (10-Apr-24)	-	-	-

LT: Long term; ST: Short term; LT/ST: Long term/Short term

Annexure-3: Detailed explanation of 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-Lower Tier II	Complex
2	Bonds-Tier II Bonds	Complex
3	Certificate Of Deposit	Simple

Annexure-5: Lender details

To view the lender wise details of bank facilities please [click here]

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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