AU Small Finance Bank Limited

March 23, 2022

Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Tier-II Bonds	200.00	CARE AA; Stable (Double A; Outlook: Stable)	Assigned
Total Long-term Instruments	**200.00 (Rs. Two hundred crore only)**		
Certificate of Deposit (CD)	500.00	CARE A1+ (A One Plus)	Reaffirmed
Total Short-term Instruments	**500.00 (Rs. Five hundred crore only)**		
Long-term Bank Facilities – Term Loans	**-**	-	Withdrawn

Details of instruments in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the debt instruments of AU Small Finance Bank Limited (AUSFB) factor in the continued momentum of growth in business and size, post-conversion into a small finance bank (SFB) in April 2017, the establishment of deposit franchise along with a sizeable Current Account Savings Account (CASA) deposits, 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, improvement in asset quality parameters in the current year after being impacted due to COVID-19-related stress, and healthy profitability.

The ratings are, however, constrained by moderate seasoning in AUSFB's new asset verticals, including business banking, home loans, and two-wheeler financing, the regional concentration of advances and deposits as well as the relatively moderate size as compared to mid-sized private sector banks.

CARE Ratings has also withdrawn the ratings assigned to the bank facilities of AUSFB with immediate effect, as the company has repaid the aforementioned term loan in full and there is no amount outstanding under the loan, as on date.

Rating Sensitivities

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

- Significant scale-up of operations with broad basing the advances in terms of products and geographical spread along with maintaining asset quality and profitability on a sustained basis.

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

- Deterioration in asset quality, with gross NPA increasing to more than 4% on a sustained basis.
- Deterioration in capital adequacy parameters, with CRAR falling below 17% on a sustained basis.
- Moderation in profitability parameters, with ROTA falling below 1% on a sustained basis.

Detailed description of the key rating drivers

Key Rating Strengths

Continued growth momentum in business

The company commenced operations as a SFB from April 2017 and got the status of a Scheduled Commercial Bank (SCB) in November 2017. In four years and nine months of operations as a SFB, the bank has been able to ramp up its operations from 474 touchpoints as on March 31, 2018, to 880 touchpoints (new and converted) across 15 states and two Union Territories, with 25,502 employees on roll, as on December 31, 2021 (March 31, 2021: 744 touchpoints).

AUSFB, the largest SFB in India, in terms of asset size, has seen steady growth in total assets increasing from Rs.18,819 crore as on March 31, 2018 to Rs.58,645 crore as on December 31, 2021.

As per the Reserve Bank of India (RBI) guidelines, AUSFB will be eligible to apply to convert into a universal bank or after a review, RBI may increase its scope of activities after a satisfactory track record of five years of operating as a SFB. However, the conversion would be subject to RBI approval. While the bank would benefit from conversion into a universal bank with the minimum threshold of lending to priority sector reducing from 75% to 40%, the bank's asset strategy would largely continue in line with the current asset profile, and CARE Ratings does not expect the bank to have significant exposure to large-ticket corporate lending for the medium-term, even in case of conversion into a universal bank.

Comfortable capitalisation with proven capital raising ability

Despite undertaking significant growth in the loan book, AUSFB continues to be sufficiently capitalised as on December 31, 2021, helped by regular capital infusions by way of QIP, stake sale in Aavas Financiers, and steady internal accruals. The bank reported a capital adequacy ratio (CRAR) of 22.0% (including nine months interim profits) and Tier-I CRAR of 20.7%, as on December 31, 2021, 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, it would require regular capital infusions in addition to internal accruals, which alone

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

may not be sufficient to support growth over the medium-term. Going ahead, CARE Ratings expect AUSFB to maintain sufficient cushion over the minimum regulatory requirements.
AUSFB has demonstrated its ability to raise capital in the past, the latest being Rs.626 crore in the month of March 2021. Furthermore, the restriction of promoters to keep their shareholding of a minimum 26% will no longer be applicable from April 20, 2022 when the bank completes five years of its operations as a small finance bank.

Diversified resource profile with a strong growth in deposit base
AUSFB has transformed its liabilities profile by developing its deposit base since becoming a SFB in FY18. The deposit franchise has consistently increased from Rs.7,923 crore as on March 31, 2018, to Rs.35,979 crore as on March 31, 2021, and further to Rs.44,278 crore as on December 31, 2021.
Initially, CASA deposits growth was slow as compared to 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 retail deposits, AUSFB offered higher interest rates on saving accounts as compared to mainstream banks and undertook 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.
As a result, the bank was able to improve its CASA ratio to at 23% as on March 31, 2021, and to 39% as on December 31, 2022. The bank continues to granularize 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 44% as on March 31, 2021, and further to 51% as on December 31, 2021, which increases stability in the liability profile. Bulk deposits (over Rs.2 crore) constituted around 49% of the term deposits, as on December 31, 2021. A majority (70%) of the bulk deposits are non-callable, which prevents volatility due to premature withdrawals. While the bank has been increasing its depositor base and the proportion of CASA in the past four 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 a SFB and access to deposits, the cost of funds has declined over the past three years for AUSFB, as it has increased the proportion of CASA and retail term deposits, further helped by lowering of the systemic interest rates. Also, as a majority of advances (around 80%) of AUSFB are to the unorganised segment, which typically has a higher yield compared to the organised segment, the NIM for AUSFB is higher than all the universal banks, ranging between 5-5.5%.
The net interest income is growing consistently, in line with the growth in advances and deposits. The opex of AUSFB continues to be high and may not come down significantly in the medium-term as the bank is in the expansion phase and because of the digital push. Credit cost[2] rose significantly at 1.5% during FY21 (FY20: 0.8%) due to the impact of COVID requiring higher provisions and write-offs. AUSFB reported a ROTA of 1.3% for FY21, adjusted for gains from stake sale of Aavas Financiers Limited including which, the ROTA was 2.5%. For 9MFY22, AUSFB reported a NIM of 5.6% on account of lower cost of funds and ROTA of 1.9% due to lower credit cost.

Key rating weaknesses
Improving asset quality after stress during Q4FY21 and Q1FY22
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 98% of the advances of AUSFB are secured, which provides comfort, in terms on eventual loss on the portfolio.
The gross NPA 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 on its borrowers. Wheels and Secured Business Loans – the two biggest segments for AUSFB – saw higher slippages during COVID period of FY21 and 9MFY22.
The asset quality has since been improving q-o-q from the peak of June 2021, with the gross NPA reducing to 3.2% as on September 30, 2021, and to 2.6% as on December 31, 2021, due to improved collection efficiency of 109% and 106% during Q2FY22 and Q3FY22. As on December 31, 2021, the COVID restructured and Guaranteed Emergency Credit Line advances constituted 3.1% and 2.1% of gross advances, respectively, and the provision cover stood at 2.8% of the gross advances, providing cushion against asset quality shocks.

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 a SFB, it started new products like business banking, gold loan, agri loan, home loan, etc. As on December 31, 2021, the total wheels segment comprised 37% of the AUM, secured business loans (SBL) was 36%, and other products (which are relatively new) comprised the remaining 27% 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 is yet to be seen.

Regional concentration
As on December 31, 2021, AUSFB's distribution network is spread around 15 states having 880 touchpoints. Of the 880 touchpoints, 348 touchpoints (40%) are located in Rajasthan, followed by Gujarat having 131 touchpoints (15%), and Madhya

[2] Credit cost includes provisions on standard assets and provision for diminution in value of investments

Pradesh having 117 touchpoints (13%). These top three states account for 68% of the total branch distribution. In terms of AUM as well, the top three states of Rajasthan, Madhya Pradesh, and Maharashtra collectively constituted 71% of the AUM. The state of Rajasthan alone comprised 41% of the AUM, whereas Maharashtra constituted 13%, and Madhya Pradesh constituted 17%.
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.

Liquidity: Strong
While the ALM profile has certain negative mismatches within the one-year liquidity bucket, it is within the approved limits. In order to manage the gaps in an optimum manner, AUSFB has been focusing on increasing granular deposit, wherein, retail term deposits and savings deposits has grown significantly during 9MFY22. AUSFB's liquidity coverage ratio (LCR) stood at 131% for the quarter-ended December 31, 2021, as against the regulatory requirement of 100%. AUSFB has maintained sufficient excess 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's status as a SCB, has increased its resource raising ability by providing access to facilities like LAF, MSF and call money market to meet any liquidity requirement. Also, the bank has availability of excess PSL portfolio over and above regulatory requirement with optionality to capitalise on the same through the right mix of securitisation and PSLC.

Analytical approach: Standalone

Applicable Criteria
Rating Outlook and Credit Watch
Policy on default recognition
Financial Ratios – Financial Sector
Bank
Short Term Instruments
Policy on Withdrawal of Ratings

About the Company
AU Small Finance Bank Limited (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 the MSME/SME, housing loans and structured financing and other types of vehicle financing.
The company received the license of a SFB from the RBI in December 2016, and commenced banking operations from April 2017. The company received the status of a SCB in November 2017. Post becoming a SFB, it has expanded its product portfolio and geographical footprint. As on December 31, 2021, it has established operations across 880 banking touchpoints serving around 23.7 lakh customers across 15 States & 2 Union Territories with an employee base of 25,502 employees.

Brief Financials (Rs. crore)	31-03-2020 (A)	31-03-2021 (A)	9MFY22 (UA)
TOI	4,992	6,402	4,937
PAT	675	1,171	784
Adjusted PAT*	596	600	784
Total Assets#	42,102	51,491	58,645
Net NPA (%)	0.81	2.18	1.29
ROTA (%)	1.81	2.50	1.90
Adjusted ROTA (%)*	1.60	1.28	1.90

A: Audited; UA: Unaudited
Note: All Analytical ratios are as per CARE Ratings Limited's calculations.
**Adjusted for gain from sale of stake in Aavas Financiers Limited.*
#Total Assets are adjusted for Deferred Tax Assets

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

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

Complexity level of various instruments rated for this company: Annexure-4

Annexure-1: Details of Instruments

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	-	-	-	Withdrawn
Bonds-Tier II Bonds	-	Proposed	-	-	200.00	CARE AA; Stable
Certificate Of Deposit	-	7-365 days	-	-	500.00	CARE A1+

Annexure-2: Rating history of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1	Fund-based - LT-Term Loan	LT	-	-	-	1)CARE AA-; Stable (30-Mar-21)	1)CARE AA-; Stable (30-Mar-20) 2)CARE AA-; Stable (04-Apr-19)	-
2	Certificate Of Deposit	ST	500.00	CARE A1+	-	1)CARE A1+ (30-Mar-21)	1)CARE A1+ (30-Mar-20) 2)CARE A1+ (04-Apr-19)	1)CARE A1+ (09-Nov-18)
3	Bonds-Tier II Bonds	LT	200.00	CARE AA; Stable				

* Long-term/Short-term

Annexure-3: Detailed explanation of covenants of the rated instrument: Not Available

Annexure-4: Complexity level of various instruments rated for this company

Sr. No	Name of instrument	Complexity level
1	Certificate Of Deposit	Simple
2	Fund-based - LT-Term Loan	Simple
3	Bonds-Tier II Bonds	Complex

Annexure 5: Bank Lender Details for this Company

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

Note on complexity levels of the rated instrument: CARE Ratings Ltd. 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 CARE Ratings Limited:
Established in 1993, CARE Ratings Ltd. is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India (SEBI), it has also been acknowledged as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). With an equitable position in the Indian capital market, CARE Ratings Limited provides a wide array of credit rating services that help corporates to raise capital and enable investors to make informed decisions backed by knowledge and assessment provided by the company.
With an established track record of rating companies over almost three decades, we follow a robust and transparent rating process that leverages our domain and analytical expertise backed by the methodologies congruent with the international best practices. CARE Ratings Limited has had a pivotal role to play in developing bank debt and capital market instruments including CPs, corporate bonds and debentures, and structured credit.

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