AU Small Finance Bank

March 30, 2021

Ratings

Facilities / Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities – Term Loans	41.00 (Rs. Forty-One Crore Only) (Reduced from 309.46 crore)	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Reaffirmed
Certificate of Deposit (CD)	500.00 (Rs. Five Hundred Crore only)	CARE A1+ (A One Plus)	Reaffirmed

Details of instruments/facilities in Annexure-1 The reduction in rated amount of bank facilities is on account of redemption.

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities and debt instruments of AU Small Finance Bank Limited (AUSFB) continues to factor in continued growth momentum in business post conversion into a Small Finance Bank (SFB) in April 2017, experienced management team, comfortable capitalization supported by equity infusion from institutional investors as well as accretion to the net worth on profits earned. The bank has demonstrated ability to diversify the resource profile by mobilization of considerable amount of deposits with improvement in the Current Account Savings Account (CASA) deposits and has also diversified it's the loan portfolio. The rating continues to factor in stable liquidity profile, healthy profitability and moderate asset quality parameters of the bank.

The ratings are constrained by moderate seasoning in AUSFB's new asset verticals (business banking, gold loan, consumer durable loans and 2 – wheeler financing), concentration in the liability profile; although improving with increasing CASA deposit base, with reliance on bulk, regional concentration of advances as well as relatively moderate size as compared to mid-sized private sector banks.

Key Rating Sensitivities

Positive Sensitivities

- *Diversification in lending portfolio to reduce product concentration, along with geographical diversification at an overall level on a sustained basis*
- *Scale up of operations along with maintaining asset quality on a sustained basis*
- *Scale up of deposits with increase in CASA and retail deposits base becoming more comparable to mid-sized private sector banking peers*

Negative Sensitivities

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

COVID-19 Impact:

In line with the RBI's regulatory package, the bank had provided moratorium to its eligible borrowers on payments of installments / interest payment falling due between March 01, 2020 and May 31, 2020 and were classified as standard even if overdue on February 29, 2020. Further, in line with the RBI guidelines announced on May 23, 2020, the bank granted the second three-month moratorium on loan payments due between June 01, 2020 and August 31, 2020.

The aggregate provision against the likely impact of COVID-19, including RBI mandated provision, stood at Rs.283.88 crore as on September 30, 2020. During Q3FY21, the bank has further made additional provision of Rs.112.34 crore, and accordingly, the aggregate provision of Rs.394.96 crore against proforma slippages of Rs.714 crore. The bank has also made additional contingency provisions of Rs.142.78 crore for advances restructured under 'RBI Resolution Framework for COVID-19 related stress'. Hence, the aggregate provision against the likely impact of COVID-19, including RBI mandated provision, stood at Rs.537.74 crore as on December 31, 2020.

Out-off the total proforma slippages, 84% of the proforma slippages come from the two largest business segments i.e. wheels (vehicle finance) and secured business loans and are fully secured. Accordingly, the bank has reported a Proforma Gross NPA (i.e. without considering Supreme Court standstill order) of 3.3% and Proforma NNPA (i.e. without considering Supreme Court standstill order) of 1.31%. The bank has reported a PCR of 61.48% (incl. proforma GNPA) as on Dec 31, 2020. The bank expects the proforma Gross NPA to be below 3% as on March 31, 2021.

The bank's restructured loan portfolio stood at Rs.251 crore under the scheme allowed by RBI constituting 0.83% of net advances as on December 31, 2020 with more than 80% of the restructuring is done in wheels and secured business loans

[1] Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.

segment. The overall restructuring to stabilize at ~1.5% of gross advances including fresh restructuring that the bank may undertake in Q4FY21.

Detailed description of the key rating drivers
Key Rating Strengths

Continued growth momentum in business post conversion into a small finance bank (SFB) and status of a scheduled commercial bank (SCB)
The company commenced operations as SFB from April 2017 and got the status of SCB in November 2017. In almost three years of operations as a SFB, the bank has been able to ramp up its operations to 714 branches (new and converted) as on December 31, 2020 (March 31, 2020 – 528 Branches). As on December 31, 2020, AUSFB had geographical distribution across 15 states with 714 branches (550 Bank Branches and 164 Business Correspondents Banking Outlets), 18,992 employees and 341 ATMs (including RISL/CMS ATMs at Atal Seva Kendras).
It has also been able to mobilize deposits to the extent of Rs.29,708 crore (including Certificate of Deposits of Rs.1,505 crore) as on December 31, 2020. The Bank continued its growth momentum during 9MFY21 with asset size increasing from Rs.42,102 crore as on March 31, 2020 to Rs.46,499 crore as on December 31, 2020 (growth – 10%).

Experienced management
AUSFB is professionally managed under the overall guidance of the bank's Board of Directors (BoD) which includes individuals with wide experience in the financial services. The BoD of the bank is headed by Mr. Raj Vikash Verma (Independent Non–Executive Chairman) who has over 40 years of experience in fields of Finance, Economics, Banking, Regulatory Compliances, Housing & Mortgage Finance and the Real Estate Sector and has held many senior leadership positions including Chairman and Managing Director of National Housing Board (NHB).
The operations of the bank are led by Mr. Sanjay Agarwal (Promoter, Managing Director & CEO), a Chartered Accountant by qualification with over 25 years of experience in the fields of finance and credit. He is assisted by senior management team members who are experienced in their respective fields.

Comfortable capitalization with presence of strong institutional investors
The company has presence of strong institutional investors like Temasek Holdings (4.7%), Nomura (3.5%) and many other marquee investors comprising both domestic and international investors along with various mutual funds through their various mutual fund schemes as on December 31, 2020. The promoters owned 29% equity stake in the bank. The proportion of Domestic: Foreign shareholding stood at 65:35 as on December 31, 2020.
Capitalization is supported by equity infusion at regular intervals and steady internal accruals. During Q3FY20, the bank has received Rs.525 crore on conversion of share warrants held by Temasek. The capital base was further solidified by post-tax gains from stake sale in Aavas Financiers Ltd. done during FY20 and 9MFY21 for Rs.527 crore. Accordingly, the bank continues to be comfortable capitalized with total CAR at 22.9% and Tier-I CAR at 20.3% (incl. 9 months interim profits) well above the regulatory requirement of 15% and 7.5% respectively.
Further, the bank has raised additional equity capital of Rs.625 crore by way of Qualified Institutional Placement (QIP) during March 2021.

Diversified resource profile with a strong growth in deposit base
The bank's deposit base has grown to Rs.23,868 crore (excl. CD) as on March 31, 2020 recording a 40% y-o-y growth and further increased to Rs.28,203 crore as on December 31, 2020. The bank recorded a dip in its savings account during Q4FY20 due to crisis in a private bank but has the savings account deposits has almost doubled to Rs.5,191 crore as on December 31, 2020 eliminating all fears of decline in deposits attached to the bank. The bank continues to granulize its deposit book with focus on increasing Retail deposits. Bank has reported a CASA of 21.69% as on December 31, 2020 up from 14.48% as on March 31, 2020. Also, the share of retail term deposits to total term deposits (excl. CD) has gone up from 30% as on March 31, 2019 to 39% as on March 31, 2020 and further to 48% as on December 31, 2020. The bank has strong focus on deposit from individual which is evident from the fact that individual base has increased from 36% as on December 31, 2019 to 59% as on December 31, 2020 while share of corporates and banks has decreased from 49% to 28%. While the bank has been increasing its depositor base the proportion of CASA in the last three years of operating as a SFB, it is relatively lower compared to mid-sized private sector banks and scaling up of the next few years would be a key rating sensitivity for the bank.

Financial performance
Post conversion to SFB and access to deposits, the cost of funds has declined over the last two years for AUSFB. Also, with increased proportion of exposure to used vehicles segment, the yields have marginally improved. For FY20, the Net Interest Income increased by 42% from Rs.1,343 crore in FY19 to Rs. 1,909 crore in FY20 while the total income has increased by 46% to Rs.4,992 crore. The total income is supported by 34% y-o-y increase in non-interest income to Rs.620 crore (excl. one-time gain of Rs.86 crore from stake sale in Aavas Financiers Ltd.). Cost/Income ratio remained elevated at 54.22 in FY2020 (PY:

59.99%) reflecting the expenses towards establishing newer branches. The provisioning has doubled to Rs.283 crore as the bank made provisions of Rs.138 crore is the last quarter of FY20 due to COVID-19. The Profit after tax (PAT) during FY20 increased by 56% during FY20 to Rs.596 crore (excl. one-time net-gain of Rs.79 crore from stake sale in Aavas Financiers Ltd) from Rs.382 crore during FY19. Accordingly, the bank has reported an adjusted ROTA of 1.59% for FY20 as against 1.48% during FY19.

During 9MFY21 (UA), the bank reported a 15% increase in adjusted PAT to Rs.554 crore (excl. one-time net-gain of Rs.448 crore from stake sale in Aavas Financiers Ltd) but adjusted annualized ROTA for the period has declined to 1.66 as against 1.81% during 9MFY20 as the bank has significantly increased provisioning for the period.

Moderate asset quality

The bank has reported strong asset quality numbers over the years. Continuing the trend, the bank reported a decline in Gross NPAs to Rs.457 crore as on March 31, 2020 as against Rs.470 crore as on March 31, 2019 due to strong recoveries and upgradations of Rs.582 crore. Accordingly, the bank has reported a Gross NPA ratio of 1.68% and Net NPA ratio of 0.81% as on March 31, 2020 as against 2.04% and 1.29% respectively on March 31, 2019. The Net NPA to Net worth ratio stood at 5.01% as on March 31, 2020 (P.Y.: 9.34%). The bank's provisioning coverage ratio has improved from 37.36% as on March 31, 2019 to 52.53% as on March 31, 2020. Also, the bank has made COVID-19 provisioning of Rs.138 crore during Q4YF20 which is in excess of RBI required provisions.

There were no major slippages during 9MFY21 (refers to period from April 01 to December 31) due to moratorium while there were recoveries in non-performing accounts. As a result, the GNPA ratio has declined to 0.99% and Net NPA ratio has declined to 0.24% as on December 31, 2020. The bank reported proforma GNPA has increased to 3.33% and proforma Net NPA ratio has increased to 1.31% and a provisioning coverage (incl. proforma slippages) stood at 61.48%.

Key Rating Weakness

Limited product diversification and lower seasoning of non-vehicle portfolio

AUSFB has witnessed significant portfolio growth in the MSME/SME segments in the last few years. Post conversion of SFB, it has started new products like Business Banking, Gold Loan, Agri Loan and Consumer durables. As on December 31, 2020, total wheels segment comprised 41% of AUM, secured business loans was 39% and other products (which are relatively new) comprised the remaining 20% of AUM reflecting concentration in wheels and MSME segment.

However, the bank has scaled up its efforts to diversify into other products such as Business banking (up 45% y/y to Rs.1,393 crores), Agri SME (increased by 23% y-o-y to Rs.1,380 crore), Gold Loan + Consumer Durable + Personal Loan (increased by 27% y-o-y to Rs.239 crore). Further, seasoning of the portfolio built up in these products as well as new geographies is still low and performance is yet to be seen.

Regional concentration

As on December 31, 2020, AUSFB's distribution network is spread around 15 states having 714 branches of which 15% are in metros, 22% in urban areas, 31% in semi-urban and remaining 32% in rural areas. Of the 714 branches, 311 branches (44%) are present in Rajasthan followed by Madhya Pradesh having 104 branches (15%) and Gujarat having 102 branches (14%). These top 3 states account for 73% of the total branch distribution. In terms of AUM as well, top three states of Rajasthan, Madhya Pradesh and Maharashtra collectively constituted 72% of AUM. The state of Rajasthan alone comprised 45% of AUM whereas Maharashtra constituted 11% and Madhya Pradesh constituted 16%.

AUSFB has added 16 new branches in Q3FY21 in new locations including Bhubhaneshwar, Hyderabad, Kolkata and Lucknow. The company intends to leverage their branch network to drive greater and deeper penetration in the western and northern states of India in which they operate, 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.

Analytical approach: Standalone

Liquidity Profile: Strong

The bank's liquidity profile as on December 31, 2020 has positive cumulative mismatches of total cumulative outflows up to one month and negative cumulative mismatches of total cumulative outflows up to one year is mainly on account of repayment of deposits. The negative cumulative mismatch up to one year is within regulatory and board approved limits. The bank has a healthy rollover rate of retail term deposits at 66.6%. As on December 31, 2020, the bank has excess SLR investment as against regulatory requirement. Average liquidity coverage ratio was 122% for the quarter ended on December 31,2020 and LCR as on December 31, 2020 is at 111% as against regulatory requirement of 90% for SFBs. Further, the bank having status of a SCB, has increased its resource raising ability by providing access to facilities like LAF, MSF and CD to meet any liquidity requirement. Also, the bank has availability of excess PSL portfolio over and above regulatory requirement with optionality to capitalize on the same through right mix of Securitization and PSLC.

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE Policy on Default Recognition
Rating Methodology – Banks
Criteria for Rating Basel III - Hybrid Capital Instruments issued by Banks
Financial Ratios – Financial Sector
Criteria for Short Term Instruments

About AU Small Finance Bank
AU Small Finance Bank (erstwhile AU Financiers (India) Ltd) (AUSFB) was incorporated in 1996 as an NBFC by Mr. Sanjay Agarwal. The company started CV lending business in 2003 as a franchisee originator for HDFC Bank under 'Channel Business' and later moved to lending on its own books since 2007. Since 2008/09, the company forayed into MSME / SME & structured financing and other types of vehicle financing.
The company received license of Small Finance Bank (SFB) from Reserve Bank of India (RBI) on December 20, 2016 and commenced the banking operation from April 19, 2017. The company got its shares listed on BSE and NSE on July 10, 2017. The company also received Schedule Commercial bank status in November, 2017. Post becoming SFB it has expanded its portfolio to Gold loans, Agriculture Loans and Consumer Durables.

Brief Financials

(Rs. crore)

	FY19 (A)	FY20 (A)
Total Income	3,411	4,992
PAT	382	675
Adjusted PAT	382	596
Total Assets^	32,612	42,102
Gross NPA (%)	2.04	1.68
ROTA (%)	1.48	1.81
Adjusted ROTA (%)	1.48	1.59

A: Audited;
^: Net of intangibles and deferred tax assets (DTA)
Note: The calculations are as per CARE Rating's calculation.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	ISIN No.	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	21-Mar-17	NA	-	22-Feb-22	41.00	CARE AA-; Stable
Certificate of Deposits	-	-	-	-	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	-	-	-	-	-	1)Withdrawn (19-Mar-18) 2)CARE A+; Stable (03-Apr-17)
2.	Debt-Subordinate Debt	LT	-	-	-	-	-	1)Withdrawn (03-Apr-17)
3.	Fund-based - LT-Term Loan	LT	41.00	CARE AA-; Stable	-	1)CARE AA-; Stable (30-Mar-20) 2)CARE AA-; Stable (04-Apr-19)	-	1)CARE AA-; Stable (19-Mar-18) 2)CARE A+; Stable (03-Apr-17)
4.	Certificate Of Deposit	ST	500.00	CARE A1+	-	1)CARE A1+ (30-Mar-20) 2)CARE A1+ (04-Apr-19)	1)CARE A1+ (09-Nov-18)	-

Annexure-3: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Certificate Of Deposit	Simple
2.	Fund-based - LT-Term Loan	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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