AU Small Finance Bank (formerly known as AU Financiers (India) Ltd)

March 30, 2020

Ratings

Facilities / Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities – Term Loans	309.46 (Rs. Three Hundred Nine Crore and Forty Six Lakh only) (Reduced from Rs.491.59 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

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings assigned to the debt instruments of AU Small Finance Bank Limited (AUSFB) continues to factor in continued growth momentum post conversion into Small Finance Bank (SFB) in April, 2017, demonstrated ability to mobilize considerable amount of deposits and healthy capital position of the bank with significant equity infusion during FY19 and 9MFY20 by Temasek Holdings Pvt. Ltd. (Temasek). The rating continues to factor in experienced management team, presence of strong institutional investor, comfortable capitalization levels, stable liquidity profile, robust resource profile, healthy profitability and stable asset quality parameters.

The ratings are constrained by lack of seasoning in AUSFB's new asset verticals (business banking, gold loan, consumer durable, 2 – wheelers). It also factors concentration in the liability profile of the bank in the form of Term Deposits (83% of the Total Deposits), out of which 63% is in the form of bulk Deposits (Bulk deposits form around 52% of overall deposit out of which 61% of which is non-callable as on December 31, 2019), and regional concentration of advances in the states of Rajasthan, Madhya Pradesh & Maharashtra.

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.*
- *Maintaining superior asset quality on a sustained basis.*
- *Scale up of operation in terms of CASA base becoming more comparable to 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%*
- *Moderation in profitability parameters with ROTA falling below 1% on a sustained basis*

Detailed description of the key rating drivers

Key Rating Strengths

Transition to small finance bank (SFB) and status of a scheduled commercial bank since November 2017

The company commenced operations as SFB from April 2017 and has completed more than two years of operation. During this period of operations, the company has been able to ramp up its operations to 496 branches (new and converted) as on December 31, 2019 (March 31, 2019 – 408 Branches). As on December 31, 2019, AUSFB had geographical distribution across 11 states with 496 branches (390 Bank Branches, 106 Business Correspondents Banking Outlets), 31 asset centers, 15,308 employees, 12 offices, and 310 ATMs

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

(including RISL/CMS ATMs at Atal Seva Kendras). It has also been able to mobilize deposits to the extent of Rs.23,865 (including Certificate of Deposits of Rs.1,813 crore) crore as on December 31, 2019. The Bank continued its growth momentum during the transition period with asset size increasing from Rs.32,623 crore as on March 31, 2019 to Rs.38,394 crore as on December 31, 2019 (growth – 18%).

Experienced management

AU SFB 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. M Venugopalan (Independent Non–Executive Chairman) who has over 48 years of experience in the banking industry and was associated with Bank of India as Chairman and Managing Director and was also CEO & MD of Federal Bank and has served as Executive Director of Union Bank of India. The operations of the bank are led by Mr. Sanjay Agarwal (Promoter, Managing Director & CEO), a Chartered Accountant by qualification with over 2 decades of experience in the fields of finance and credit. He is assisted by senior management team members who are experienced in their respective fields.

Presence of strong institutional investors

The company has presence of strong institutional investors like Redwood Investment (Warburg Pincus) holding (6.9%), Temasek Holdings (4.8%), Nomura (3.9%) 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, 2019. The promoters owned 30.99% equity stake in the bank. The proportion of Domestic: Foreign shareholding stood at 58:42 as on December 31, 2019.

During Q3FY20, the bank received Rs.525 crore from Camas Holdings (Temasek) for warrants conversion (Rs.175 crore during Q1FY19).

Comfortable capitalization with equity investment from Temasek Holdings during FY19 and 9MFY20.

AUSFB has been reporting comfortable capital adequacy ratio (CAR) over the last two years. During Q1FY19, Temasek Holdings Private Limited infused Rs.1,000 crore of capital. The details of capital infusion are as follows: Equity (30%) and Convertible Warrants (70%) at Issue price of Rs.692.77 per unit. Upfront investment: Rs.475 crore (47.5%) in the form of Equity capital of Rs.300 crore (30% of issue size) and convertible warrants application money of Rs.175 crore i.e. 25% of convertible warrants. Also during Q3FY20, the Bank received the balance Rs.525.00 Crore (the "Balance Consideration") w.r.t 75% balance consideration was received during Q3FY19. Additionally during Q3FY19, the bank also raised Tier II Capital by issuing 5000 fully paid up subordinated, rated, listed, redeemable, non-convertible bonds with face value of Rs.10,00,000 (Rupees Ten Lakh Each) aggregating to 500,00,00,000 (Rupees Five Hundred Crore only) being classified as subordinated debt and categorised as Tier-II capital Bonds under the Basel II framework. The said Bonds were allotted to leading financial institutions and Banks. As a result, AUSFB reported Capital Adequacy Ratio[2] (CAR) of 19.30% and Tier I CAR: 16.50% as on December 31, 2019 (March 31, 2019: CAR: 19.00% and Tier I CAR: 15.50%) against minimum regulatory requirement of 15% for CAR and 7.5% for Tier 1. ***Details of Capital infusion during FY19 and 9MFY20 are as mentioned in the table below:***

Period (Quarter and Year)	Amount	Route of Investment	Investor
Q1 FY19	300.00	Share Issued-Preferential Allotment	Temasek Holdings
Q1 FY19	175.00	Convertible share warrants	Temasek Holdings
Q2 FY19	5.21	ESOP	
Q3 FY19	500.00	Tier II Capital	
Q3 FY19	0.27	ESOP	
Q4 FY19	1.61	ESOP	
Q1 FY20	0.42	ESOP	
Q2 FY20	3.18	ESOP	
Q3 FY20	0.71	ESOP	
Q3 FY20	525.71	Conversion of balance Convertible share warrants	Temasek Holdings
Total	**1,512.11**		

[2] *CAR & Tier I CAR for interim period is excluding interim profit.*

Diversified resource profile with a strong deposit base:
The bank registered a 63% y-o-y growth in deposits. Total deposits of the bank grew from Rs.14,686 crore as on December 31, 2018 to Rs.23,865 crore as on December 31, 2019. Deposits were largely in the nature of Term Deposits ((83% of the Total Deposits, out of which Retail Deposits (37%) and Bulk Deposits (63%)). The bank is witnessing an increasing trend in Retail Term Deposits in the past one year. The bank got listed on July 10 2017, which considerably improved the financial flexibility of the company. Post conversion into SFB, AUSFB, has been able to raise more low cost deposits as compared to its earlier borrowings which reduced its cost of borrowing and further diversify its resource profile. As on December 31, 2019, The Borrowing profile was Deposits (73.4%), Refinance from FIs (18.7%), NCD (3.4%), CBLO/LC/Others (2.1%), and others (2.4%). Off-balance sheet portfolio was Rs.3,019 crore as on December 31, 2019 compared to Rs.1,618 crore as on December 31, 2018 (March 31, 2019: 1,297 crore).
**Retail Term Deposits refers to all Term Deposits of Individuals (including Salaried), HUF and TD of Corporates, Government & TASC having balance of less than INR 1 Crore till 31st December 2018 and less than Rs.2 Crore from 31st March 2019. ^Bulk Deposits refers to all Term Deposits of Banks and Term Deposits of Corporates, Government & TASC with balances of INR 1 Crore & above Crore till 31st Dec 18 and INR 2 Crore & above from 31st March 2019.*

Liquidity profile
The bank has a relatively low vintage and is in the process of building a depositor base. The ALM profile had cumulative negative mismatches up to one year time bucket on account of deposit maturity. However, the mismatches in all buckets were within regulatory and board-defined limits and the bank is raising additional long term deposits, as well roll over of deposits based on contractual maturity. As on December 31, 2019, the bank has SLR investment of Rs.5,586 crore as against regulatory requirement of Rs.4,764 crore and High quality liquid Non SLR investment of more than Rs.4,000 crore The liquidity coverage ratio was 95% as on December 31, 2019 as against regulatory requirement of 80% for SFBs (LCR for SFBs increased to 90% w.e.f. January 1, 2020). The bank's Certificate of Deposits has an outstanding of Rs.1,813 crore which stood at ~5% of external liabilities as on December 31, 2019 (down from 8% in Mar'19). Further, the bank's status as a scheduled bank, has enhanced 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.

Financial performance
PAT has shown an increasing trend in the last 2 years with improvement in Net interest income and lower credit cost. Post conversion to SFB and access to deposits, the cost of funds has declined over the last two years for AUSFB. However, with diversification in lending book, yields had seen marginal compression in FY19. For FY19, the Net Interest Income increased by 43% from Rs.940 crore in FY18 to Rs. 1,342 crore in FY19. It increased by 42% during 9MFY20 over 9MFY19 from Rs.956 crore to Rs.1,354 crore. Cost/Income ratio remained elevated at 60.0% in FY2019 (PY: 56.7%) reflecting the expenses towards establishing newer branches, however it reduced to 53.0% as on December 31, 2019 (December 31, 2018: 61%). The Profit after tax (PAT) during FY19 increased by 31% during FY19 to Rs.382 crore from Rs.292 crore during FY18 driven by increase in AUM by 50%. During 9MFY20 PAT stood at Rs.482 crore (excluding sale profit on sale of investment in Aavas Limited; In Q1FY20, the Bank divested 0.8% equity stake out of 7.2% equity in subsidiary-Aavas Financiers Limited resulting in pre-tax other income of Rs.77 Crores). The ROTA for FY19 stood at 1.48% as compared to 2.04% (excluding exceptional items) for FY18 and 1.80% for 9MFY20 (excluding sale of stake in Aavas Financers Limited.

Modest asset quality
As on December 31, 2019, GNPA and NNPA ratios were 1.9% [2% as on March 31, 2019] and 1% [1.3% as on March 31, 2019] respectively. NPAs are mainly due SBL-HVT (Secured Business Loan-High Value Ticket) segment not performing well, which has now merged with Agri-SME (3.76% of the AUM as on December, 2019). Also the bank witnessed high NPAs in the LAP segment, under REG (Real Estate Group, which forms 2.74% of the AUM), as a result of which the bank plans to discontinue further lending under this segment. NNPA/TNW ratio stood at 6.4% as on December 31, 2019 (March 31, 2019: 9.7%) as compared to 8.6% as on December 31, 2018. As the non–vehicle portfolio (including business banking, gold loan, consumer durable, 2 – wheelers) is relatively

unseasoned, and with the Company expanding its scale of operations by introducing new products the asset quality is yet to be seen.

Key Rating Weakness

Regional concentration

As on December 31, 2019, AUSFB's distribution network is spread around 11 states having 496 branches of which 16% are in metros, 25% in urban areas, 28% in semi-urban and remaining 31% in rural areas. Of the 496 branches, 249 branches (50%) are present in Rajasthan followed by Madhya Pradesh having 68 branches (14%) and Gujarat having 54 branches (11%). These top 3 states account for 75% of the total branch distribution. In terms of AUM as well, top three states of Rajasthan, Madhya Pradesh and Maharashtra collectively constituted 66% of AUM. The state of Rajasthan alone comprised 41% of AUM whereas Maharashtra constituted 15% and Madhya Pradesh constituted 11%.

AUSFB received RBI's approval for new Banking Outlets and has also identified key locations in Mumbai, Delhi and Pune and large cities across India like Chennai, Bengaluru, Hyderabad, Kolkata, Guwahati, Lucknow etc. for its first phase of opening Banking Outlets. AUSFB has added 16 new branches in Q3FY20. 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.

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, 2019, total wheels segment comprised 41.6% of AUM, MSME was 35% and other products (which are relatively new) comprised the remaining 23.5% 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 45.1% y/y to Rs.960 crores as on Q3FY20), Agri SME (up 31.1% y/y to Rs.1,125 crore), Gold Loan + Consumer Durable + Personal Loan (up 274% y/y to Rs.189 crore at Q3FY20). 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.

Analytical approach: Standalone

Liquidity Profile: Strong

As on December 31, 2019, the bank has SLR investment of Rs.5,586 crore as against regulatory requirement of Rs.4,764 crore and Non SLR investment of more than Rs.4,000 crore. The liquidity coverage ratio was 95% as against regulatory requirement of 80% for SFBs (LCR for SFBs increased to 90% w.e.f. January 1, 2020). The bank's Certificate of Deposits has an outstanding of Rs.1,813 crore which forms ~5% of external liabilities as on December 31, 2019. 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 to Credit Ratings
CARE's policy on default recognition
Financial Ratios-Financial Sector
CARE's Criteria for NBFC
CARE's Rating Methodology for Banks

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. As on December 31, 2019, the bank had 6.4% stake in Aavas Financiers Limited. Post becoming SFB it has expanded its portfolio to Gold loans, Agriculture Loans and Consumer Durables.

As on December 31, 2019, AUSFB had a Tangible Net-worth of Rs.4,237 crore with Gross Assets Under Management (AUM) of Rs.29,867 crore. Retail Portfolio (this includes Vehicles, Secured Business Loan (SBL)-MSME, SBL-SME and Home Loans, Gold Loans, Personal Loans, OD against FD facility etc. which together accounted for 81% of AUM and Small & Mid Corporates (this includes Real Estate Group, Business Banking, Agriculture SME and loans to NBFC) for 17% while Money Market Lending accounted for just 2% of Total Gross AUM. In the Retail portfolio, Vehicles portfolio contributed for 51%, MSME –43%, Housing loan-2% and others-4% of the total Retail Portfolio. As on December 31, 2019, AUSFB has geographical distribution across 11 states with 496 branches (390 Bank Branches, 106 Business Correspondents Banking Outlets), 31 asset centers, 15,308 employees, 12 offices, and 310 ATMs (including RISL/CMS ATMs at Atal Seva Kendras). As on December 31, 2019, the top three states of Rajasthan (41%), Madhya Pradesh (14%) and Maharashtra (11%) collectively constituted 66% of Gross AUM.

Brief Financials

(Rs. crore)

	FY18 (A)	FY19 (A)
Total Income	2,155	3.411*
PAT	292	292^
Total Assets^	18,822	32,623
Gross NPA (%)	2.01	2.04
ROTA (%)	2.04	1.48

*A: Audited; *: Including profit on sale of investment in subsidiaries/ associates; ^excluding profit on sale of investment*
^: Net of intangibles and deferred tax assets (DTA)

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	-	NA	-	-	309.46	CARE AA-; Stable
Certificate Of Deposit	-	NA	-	-	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017

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	309.46	CARE AA-; Stable	1)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+ (04-Apr-19)	1)CARE A1+ (09-Nov-18)	-	-

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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