AU SMALL FINANCE BANK
A SCHEDULED COMMERCIAL BANK

Ref. No.: AUSFB/SEC/2024-25/241
Date: September 09, 2024

To,

National Stock Exchange of India Ltd. Exchange Plaza, C-1, Block G, Bandra Kurla Complex, Bandra (East), Mumbai 400051, Maharashtra. **NSE Symbol**: AUBANK	**BSE Limited** Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai 400001, Maharashtra. **BSE Scrip Code**: 540611 and 958400

Dear Sir/Madam,

Sub: Re-Affirmation of Credit Rating

Ref: Regulation 30, 51 and 55 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations')

We wish to inform that India Ratings and Research Private Ltd. has reaffirmed rating of IND AA/Stable (Double A; Outlook: Stable) to the Long-Term Debt Instruments (Tier-II Bonds) of the Bank.

The rating on Short-term Instruments (Certificate of Deposits) of the Bank has been reaffirmed at IND A1+(A One Plus)

The details required pursuant to Regulation 55 of the Listing Regulations read with SEBI Master Circular no. SEBI/HO/DDHS/DDHS-PoD-1/P/CIR/2024/48 dated May 21, 2024, as amended from time to time are as follows:

Sr. No.	ISIN	Name of the Credit Rating Agency	Credit Rating Assigned	Outlook	Rating Action	Specify other rating action	Date of Credit rating	Verification status of Credit Rating Agencies	Date of verification
1	INE949L08418	India Ratings and Research Private Ltd.	IND AA	Stable	Reaffirm	-	09-09-2024	Verified	09-09-2024

Rating Rationale of the India Ratings and Research Private Ltd. is enclosed herewith.

This for your information and records.

Thanking You,
Yours faithfully,
For AU SMALL FINANCE BANK LIMITED

Manmohan Parnami
Digitally signed by Manmohan Parnami
Date: 2024.09.09 18:04:17 +05'30'

Manmohan Parnami
Company Secretary and Compliance Officer
Membership No.: F9999
investorrelations@aubank.in
Encl.: As above

India Ratings Assigns AU Small Finance Bank's Additional Certificate of Deposits 'IND A1+'; Affirms Existing Ratings

Sep 09, 2024 | Private Sector Bank

India Ratings and Research (Ind-Ra) has taken the following rating actions on AU Small Finance Bank Limited's (AU SFB) debt instruments:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating Assigned along with Outlook/ Watch	Rating Action
Tier II bonds*	-	-	-	INR5.0 (reduced from INR5.75)	IND AA/Stable	Affirmed
Certificate of deposits	-	-	7-365 days	INR10.0	IND A1+	Affirmed
Certificate of deposits	-	-	7-365 days	INR10.0	IND A1+	Assigned

*Details in Annexure

Analytical Approach

Ind-Ra continues to take a standalone view of AU SFB to arrive at the ratings.

Detailed Rationale of the Rating Action

The ratings reflect the bank's moderate liability franchise with progressing granularity, increasing diversification in assets and liabilities from its home state (Rajasthan), and adequately managed asset quality. The ratings also factor in the bank's small but fast-growing franchise, with above-average operating metrics and high capital buffers, which are likely to be maintained.

Furthermore, the ratings factor in the bank's strong franchise in granular retail assets, which has been generating higher yields compared to its peers, offsetting the higher cost of funds. AU SFB has a long track record and strong experience in its core segment of commercial retail assets as it expands its base in newer products. The asset quality performance of newer products with seasoning, the bank's ability to control the operating costs, and the smooth integration of Fincare Small Finance Bank Limited (Fincare) remain key monitorables.

AU SFB has applied to the Reserve Bank of India (RBI) for voluntary transition from a small finance bank (SFB) to a universal bank. Ind-Ra will monitor future developments on the same.

List of Key Rating Drivers

Strengths

- Established retail asset franchise
- Secured Products to continue to scale up
- Adequate capital and profitability buffers
- Stable asset quality

Weaknesses

Higher operating cost structure

Moderate current and savings account (CASA) ratio

Detailed Description of Key Rating Drivers

Established Retail Asset Franchise: AU SFB is the largest SFB in India in terms of total assets, with total asset base of INR1,259.4 billion at end-1QFY25. The bank has a demonstrated track record of 29 years of catering to the unorganised customer segment, which has enabled it to maintain a balance between profitability and asset quality across economic cycles. The bank has a well-defined strategic business unit structure, enabling a clear focus on product segments, along with teams that possess local knowledge across operating geographies.

In addition to expanding its presence within its home state, AU SFB has been increasing its operations in other states as well, with it's the share of its home state moderating to 27% in 1QFY25 (FY18: 54%). Furthermore, the bank has expanded its product lines while maintaining its growth trajectory in its core verticals of wheels and small business loans.

AU SFB has a competitive advantage in its core geography, backed by its long operating experience. With the addition of approximately 1,300 touchpoints of Fincare SFB, AUSFB has improved its geographic diversification, with access to newer geographies in the southern states of India. Post the completion of the merger of Fincare SFB with AU SFB, effective from 1 April 2024, the bank's presence increased to 2,414 touchpoints across 21 states and four union territories at end-1QFY25. The additional branch network of Fincare provides ready infrastructure to further expand existing products such as home loans, gold loans, and small business loans and it also offers an opportunity to diversify into microfinance as an asset class. The bank plans to cap the exposure to microfinance loans at 10% of the total loans by FY27.

Secured Products to Continue to Scale up: At end-1QFY25, the bank's gross loan portfolio stood at INR997.9 billion (FY24: INR964.9 billion (merged), FY23: INR640.7 billion (pre-merger)) with a secured portfolio across products such as wheels (accounted for 30% of gross loan portfolio), mortgage-backed business loans (25%), commercial banking (19%), microfinance (8%), home loan (9%) and others (9%). AU SFB has been operating in these segments even before turning into a bank. Ind-Ra expects the bank to continue to grow its loan book at above-industry rates due to its smaller scale, and also, it is in better position to grow compared to non-banking financial companies due to the cost of fund advantage.

The bank also has a competitive advantage in terms of reach and local knowledge in Rajasthan. In addition, it has a reasonable presence in Madhya Pradesh and Maharashtra, which, along with Rajasthan, accounted for 55% of the gross advances in 1QFY25 (FY24: 55%; FY23: 66%). While this creates geographical concentration risk, the contribution of the south region to total improved to 11% at end-1QFY25 post the merger; moreover, the bank has been focusing on expanding its franchise in newer geographies such as Uttar Pradesh, East India and southern markets, as well as broadening of product offerings.

Adequate Capital and Profitability Buffers: AU SFB has a demonstrated track record of equity capital raising in past. During FY23, AU SFB raised INR20 billion of equity capital through the qualified institutional placement route. At end-1QFY25, with a net worth of INR155.2 billion, the bank's capital buffers remained adequate, with capital adequacy ratio of 20.1% (Tier-I: 18.9%) (FY24: 20.1%; FY23: 23.6%).

AU SFB had a high pre-provision operating profit (PPOP) buffer (PPOP/provision cost) of 3.1x in 1QFY25 (FY24: 5.7x; FY23: 13.0x). Its return on asset (on a merged basis) of 1.6% in 1QFY25 (annualised) (FY24: 1.5%; FY23: 1.8%) is reasonably healthy. AU SFB has adequate PPOP and capital adequacy buffers to absorb incremental asset quality pressures in a stress case scenario.

The bank's average cost of funds increased 45bp yoy to 7.03% in 1QFY25 (1QFY24: 6.58%) on the back of the increase in deposit rates across competition. AUSFB largely operates in the secured retail space and competes mostly with non-banking financial companies, offering adequate pricing power. However, the higher proportion of fixed-rate loans on the asset side compared to liability, with the remaining being floating in nature, could impact AU SFB's net interest margins in the near term, with an expectation of interest rates remaining at elevated levels in FY25.

Stable Asset Quality: AU SFB lends to self-employed individuals who run small businesses, which are largely earn-and-pay in nature. Hence, the cash flows of such borrowers remain vulnerable to external economic shocks. That being said, at end-June 2024, 85% of the assets are secured in nature. While the reported gross non-performing asset (GNPA) ratio is almost stable (1QFY25: 1.8%; FY24: 1.7%; FY23: 1.7%), the bank has faced asset quality pressure in credit cards as the book witnessed seasoning. The medium-term trend in credit card asset quality would remain a monitorable. Moreover, with the merger of Fincare (predominantly microfinance institutions book, about 8% combined loan book post-merger), the asset quality would be a key monitorable. The bank's provision coverage ratio stood at a healthy 84% in 1QFY25 (FY24: 76% FY23: 78%). The standard restructured loans to total advances declined to 0.4% in 1QFY25 (FY24: 0.6%; FY23: 1.2%).

Moreover, the bank has created a contingency buffer of INR170 million during 1QFY25 towards microfinance loans. Notably, AU SFB has also created a floating provision of INR410 million from FY22 to further strengthen the balance sheet, acting as a counter cyclical buffer, to be utilised with the prior approval of the RBI.

High Operating Cost Structure: AU SFB focuses on granular retail asset loans, which require high on-field effort and high costs of customer acquisition. On the liability side, to build and sustain the liability franchise, the bank needs to spend upfront on operating investments through new initiatives including credit cards, QR code, video banking and other digital initiatives to continue to create brand awareness. Consequently, the cost to income ratio of the bank was on an increasing trend during FY21-FY24 (FY24: 64%; FY23: 63%; FY22: 57%; FY21: 52%). With incremental integration-related costs of Fincare, which is likely to take six-to-nine months, Ind-Ra expects the cost-to-income ratio to remain elevated in the near-to-medium term. That being said, FY25 onwards, the bank would be able to reap benefits of the additional presence of Fincare by leveraging the same to gain market share in profitable assets and build on the liability franchise.

Moderate CASA Ratio: AU SFB's CASA ratio declined to 32.9% in 1QFY25 (FY24: 33.4%; FY23: 38.4%), driven by the overall industry trend of a shift in CASA towards term deposits due to the attractiveness of high term deposit rates offered to the depositors. Retail term deposits expanded at 31% CAGR over FY21-FY24 (albeit on a small base), contributing 30% to the total deposits in FY24 (FY23: 30%; FY22: 30%). The bank also witnessed an increase in contribution of bulk deposits to 33.5% in FY24 from 30.3% in FY23. However, the share of the 20 largest depositors to the total deposits of the bank declined to 10.8% in FY24 (FY23: 14.5%).

Since FY23, there has been a system-wide increase in deposit rates, with significant competition for deposits. AU SFB has been focusing on preserving its CASA deposits amid the shift from savings to term deposits. The bank has undertaken a number of strategic initiatives during the past three years to improve its customer engagement. Consequently, about 74% (FY23: 71%) of the current account customers and 61% (FY23: 57%) of the savings account customers used two or more products of the bank at end-FY24. Its product per customer ratio stood at 1.85 (FY23: 1.61) for savings account and 2.0 (FY23: 2.0) for current account customers in FY24. As AU SFB becomes larger and expands its balance sheet, its ability to competitively build stickiness in the granular deposit profile will continue to be a key monitorable.

Liquidity

Adequate: AU SFB operated with gap of 15% in asset-liability tenors in the up to one-year bucket as of June 2024. The bank largely covers the gap with rollover of deposits and refinancing lines. It maintains adequate refinance funding lines from refinancing institutions at any given point in time. During 1QFY25, the bank had a quarterly average liquidity coverage ratio of 117%, which is above the regulatory requirement (100% for small finance banks).

Rating Sensitivities

Positive: A strong growth in the franchise in line with higher rated peers, along with a sustained market share gains in both asset and liabilities, product leadership coupled with diversification and ramping-up of the granular retail liabilities above 75% of the total external liabilities could be positive for the ratings.

Negative: An absence of a sustained improvement in the liability profile or a material decline in the CASA deposits proportion or retail deposits would be negative for the ratings. Also, a significant drop in the capital buffers or GNPAs as a percentage of the gross advances exceeding 5% on a sustained basis, thereby impacting the profitability and capital buffers, could be negative for the ratings.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on AU SFB, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

AU SFB is a scheduled commercial bank that commenced its operations as an SFB on 19 April 2017. As on 30 June 2024, the bank was the largest SFB in terms of gross advances and deposits. The bank has established operations across 2,414 banking touchpoints (mainly in rural and semi-urban markets) and has a customer base of 10.9 million in 21 states and four union territories with an employee base of 46,500+. The bank has a net worth of INR155.2 billion, deposit base of INR972.9 billion and gross advances of INR907 billion. AU SFB is listed on the National Stock Exchange of India Limited and BSE Ltd.

Key Financial Indicators

Particulars	1QFY25	FY24	FY23
Total assets (INR million)	1,259,425	1,094,257	902,161
Total equity (INR million)	155,160	125,595	109,773
Net profit (INR million)	5,026	15,347	14,279
Return on average assets (%)	1.6*	1.5	1.8
Equity/assets (%)	12.3	11.5	12.2
Tier 1 capital (%)	18.9	18.8	21.8
Source: AU SFB, Ind-Ra; * Return on average assets calculated on a merged basis			

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook				Historical Rating/Outlook				
	Rating Type	Rated Limits (billion)	Rating	10 April 2024	19 March 2024	5 March 2024	20 July 2023	22 July 2022	19 August 2021
Tier II bonds	Long-term	INR5.0	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA/Stable	IND AA-/Stable
Certificate of deposits	Short-term	INR20.0	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+

Complexity Level of the Instruments

Instrument Type	Complexity Indicator
Tier II bonds	Moderate*
Certificate of deposits	Low

*Lower ranked instrument with partial built in loss absorbing features

For details on the complexity level of the instruments, please visit www.indiaratings.co.in/complexity-indicators

Annexure

Tier 2 Bonds

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Rated Amount (billion)	Rating/Rating Watch
Tier II bonds	INE949L08418	30 November 2018	10.90	30 May 2025	INR5.0	IND AA/Stable
Tier II bonds^	INE519Q08145	20 March 2018	11.30	20 June 2024	INR0.37	WD (Paid in full)
Tier II bonds^	INE519Q08137	22 March 2018	11.30	21 June 2024	INR0.38	WD (Paid in full)
				Total	**INR5.0**	

Source: AU SFB

^ Post-merger, all debt instruments of Fincare SFB were migrated to AU SFB

Contact

Primary Analyst
Amit Rane
Senior Analyst
India Ratings and Research Pvt Ltd
Wockhardt Towers, 4th Floor, West Wing, Bandra Kurla Complex, Bandra East,Mumbai - 400051
+91 22 40001700
For queries, please contact: infogrp@indiaratings.co.in

Secondary Analyst
Jinay Gala
Director

Media Relation
Ameya Bodkhe
Marketing Manager
+91 22 40356121

About India Ratings and Research: India Ratings and Research (Ind-Ra) is committed to providing India's credit markets accurate, timely and prospective credit opinions. Built on a foundation of independent thinking, rigorous analytics, and an open and balanced approach towards credit research, Ind-Ra has grown rapidly during the past decade, gaining significant market presence in India's fixed income market.

Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

Headquartered in Mumbai, Ind-Ra has seven branch offices located in Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Pune. Ind-Ra is recognised by the Securities and Exchange Board of India, the Reserve Bank of India and National Housing Bank.

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For more information, visit www.indiaratings.co.in.

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Evaluating Corporate Governance

Financial Institutions Rating Criteria

The Rating Process