

Ref. No.: AUSFB/SEC/2023-24/379

Date: March 19, 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. Scrip Code: 540611, 958400
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Dear Sir/Madam,

Sub: Re-affirmation of Credit Rating by India Ratings & Research Limited

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 & Research Limited 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 assigned/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/PoD1/P/CIR/2023/108 dated June 30, 2023 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 & Research Limited	IND AA	Stable	Reaffirm	-	19-03-2024	Verified	19-03-2024

Rating Rationale of the India Ratings & Research Limited is enclosed herewith.

This for your information and records.

Thanking You,

Yours faithfully,

For AU SMALL FINANCE BANK LIMITED

Manmohan Parnami

Company Secretary and Compliance Officer

Membership No.: F9999

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Encl.: As above

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

Mar 19, 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	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating Assigned along with Outlook/ Watch	Rating Action
Certificate of deposits		-	-	7-365 days	INR3.0	IND A1+	Assigned
Tier II bonds*	INE949L08418	30 November 2018	10.90	30 May 2025	INR5.0	IND AA/Stable	Affirmed
Certificate of deposits		-	-	7-365 days	INR7.0	IND A1+	Affirmed

*Source: NSDL, AU SFB

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

Further, the ratings factor in the bank's strong franchise in granular retail assets, which bolsters its competitive position to generate higher yields than 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. Asset quality

performance of newer products with seasoning and the progress on merger integration of Fincare Small Finance Bank Limited ([Fincare SFB; 'IND A'/Rating Watch with Positive Implications](#)) remain key monitorables.

List of Key Rating Drivers

Strengths

Established retail secured asset franchise

Secured products to continue to drive growth

Improved equity buffers and adequate profitability

Stable asset quality

Weakness

CASA ratio consolidating

Detailed Description of Key Rating Drivers

Established Retail Secured Asset Franchise: The bank's continued focus on the unorganised customer segment 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. Moreover, it has a competitive advantage in its core geography, backed by its long operating experience. AU SFB has a well-established business model with a track record of over 28 years, with retail and secured loans contributing majority to the 9MFY24 loan book. Ind-Ra considers AU SFB's continued expansion within its home state and outside as well, with its share in its home state moderating to 33.0% in 9MFY24 (FY18: 53.8%). Furthermore, the bank has expanded its product lines while maintaining its growth trajectory in its core verticals of wheels and small business loans. The bank had 1,049 banking touchpoints (including 727 unique locations) across 21 states and three union territories at 9MFYE24. Moreover, post the bank's merger with Fincare Small Finance Bank, 1,292 touchpoints (deposit branches: 136; asset centres: 763; business correspondents: 393) will be added to the AUSFB's touchpoints.

Secured Products to Continue to Drive Growth: At 9MFYE24, the bank's gross advances increased 20% yoy to INR676.2 billion (FYE23: INR563.3 billion, FE22: INR467.9 billion) with a secured portfolio across products such as wheels (accounted for 30% of gross advances), micro business loans (28%), business banking (10%), home finance (8%) and others (24%). AU SFB has been operating in these segments even before turning into a bank. Ind-Ra expects the bank to continue to grow at above-industry growth rates due to its smaller scale and better position to grow than that for 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 63% of the gross advances at 9MFYE24 (FYE23: 65%, FYE22: 71%). While this creates geographical concentration risk, 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 and gaining sizeable scale in those segments compared to peers'.

Improved Equity Buffers and Adequate Profitability: During FY23, AU SFB raised INR20 billion of equity capital through the qualified institutional placement route. This, coupled with a net profit of INR14.3 billion, led to an improvement in its net worth to INR109.8 billion at FYE23 (FYE22: INR75.1 billion). The tier-I capital stood at 19.6% in 9MFY24 (FY23: 21.8%; FY22: 19.7%; FY21: 21.5%). AU SFB had a high pre-provision operating profit (PPOP) buffer (PPOP/provision cost) of 6.0x in 9MFY24 (FY23: 13.0x; FY22: 5.0x; FY21: 3.2x; FY20:4.2x). Its return on asset of 1.6% in 9MFY24 on an annualised basis (FY23: 1.8%; FY22: 1.9%; FY21:2.5%, FY20:1.8%) 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 YTD to 6.74% in 9MFY24 (4QFY23: 6.29%) 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, given the higher proportion of fixed-rate loans on the asset side compared to liability, with the remaining being floating in nature, can impact AU SFB's net interest margins in the near term with an expectation of interest rates remaining at current levels in FY24 and some part of FY25.

Asset Quality Stable: 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. While the reported gross non-performing asset (GNPA) ratio is almost stable (9MFY24: 2.0%; FY23: 1.7%; FY22: 2.0%; FY21: 4.3%), 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 monitorable. Moreover, with the merger of Fincare Small Finance Bank (predominantly microfinance institutions book, about 8% combined loan book post-merger), asset quality would be key monitorable. In 9MFY24, the bank's provision coverage ratio stood healthy at 72% on GNPA's (FY23: 78%; FY22: 77%; FY21: 50%). The restructured loans to total advances declined to 0.7% in 9MFY24 (FY23: 1.2%; FY22: 2.5%; FY21: 1.8%).

Moreover, the bank carried covid contingency and standard restructuring provisions of INR0.8 billion (0.12% of the gross advances) in 9MFY24. 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 Reserve Bank of India.

CASA Ratio Consolidating: AU SFB's current and savings account (CASA) ratio declined to 33% in 9MFY24 (FY23: 38.4%; FY22: 37.3%), driven by industry trend of CASA shift to term deposits due to attractiveness of high-term deposits offered. Retail term deposits grew at a 39% CAGR over FY20-FY23 (albeit on a small base), contributing 30% to the total deposits in FY23 (FY22: 30%; FY21: 33%; FY20: 30%). The bank also continued to have a high proportion of deposits (FY23: 52%; FY22: 53%; FY21: 55%) with ticket size above INR20 million. The share of the top 20 term depositors in the total customer deposits declined to 9.4% in FY23 (FY22:11.9%; FY21: 15.4%; FY20: 17.8%).

During FY23, there was a system-wide increase in deposit rates, with significant competition for deposits. AU SFB focused on preserving its CASA deposits amid the shift from savings to term deposits. The average cost of funds increased to 6.3% in 4QFY23 (4QFY22: 5.7%). The bank has undertaken a number of strategic initiatives during the past three years to improve its customer engagement. Consequently, about 71% of the current account customers and 57% of the savings account customers used two or more products of the bank at FYE23. Its product per customer ratio stood at 1.61 for savings account and 2.0 for current account customers in FY23. 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.

Ind-Ra expects the banks' cost of funds to increase in FY24, led by the system-wide rise in interest rates and its incremental funding. The bank's larger presence in the unorganised granular retail segment provides the ability to pass on the increase in the cost of funds to its customers.

Liquidity

Adequate: AU SFB operated with positive Gap upto Six Month Tenor and a moderate gap of 12% in asset-liability tenors in the less-than-one-year bucket as of December 2023. 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 3QFY24, the bank had a quarterly average liquidity coverage ratio of 123%, which is above the regulatory requirement (100% for small finance banks, SFBs).

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 GNPA's 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 31 December 2023, the bank was the largest SFB in terms of gross advances. The bank has established operations across 1,049 banking touchpoints (mainly in rural and semi-urban markets) and has a customer base of 4.68 million in 21 states and three union territories with an employee base of 28,904. The bank has a net worth of INR121.7 billion, deposit base of INR801.2 billion and net advances of INR667.4 billion. AU SFB is listed on the National Stock Exchange of India Limited and BSE Ltd. The Reserve Bank of India has also granted a licence to AU SFB to act as authorised dealer category-I under section 10 of the Foreign Exchange Management Act, 1999 to deal in foreign exchange.

FINANCIAL SUMMARY

Particulars	9MFY24	FY23	FY22
Total assets (INR million)	10,11,757	9,02,161	6,90,778
Total equity (INR million)	1,21,673	1,09,773	75,140
Net profit (INR million)	11,640	14,279	11,298
Return on average assets (%)	1.6^	1.8	1.9
Equity/assets (%)	12.0	12.2	10.9
Tier 1 capital (%)	19.6	21.8	19.7

Source: AU SFB, Ind-Ra, ^ Annualised

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	5 March 2024	20 July 2023	22 July 2022	19 August 2021	20 August 2020	6 April 2020
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	INR10.0	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+
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Complexity Level of the Instruments

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

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

APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Evaluating Corporate Governance

The Rating Process

Financial Institutions Rating Criteria

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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.

India Ratings is a 100% owned subsidiary of the Fitch Group.

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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