Ref. No.: AUSFB/SEC/2023-24/111
Date: July 20, 2023

To,

National Stock Exchange of India Ltd.	BSE Limited
Exchange Plaza, C-1, Block G, Bandra Kurla Complex, Bandra (East), Mumbai 400051, Maharashtra. **NSE Symbol: AUBANK**	Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai 400001, Maharashtra. **Scrip Code: 540611, 958400, 974093, 974094 & 974095**

Dear Sir/Madam,

Sub: Reaffirmation of Credit Rating by India Ratings & Research

Ref: Disclosure under 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 (Ind-Ra) has reaffirmed rating of **IND AA/Stable (Double A; Outlook: Stable)** for the Long-Term Debt Instruments (Tier-II Bonds) of the Bank**.**

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

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

The details required pursuant to Regulation 55 of the Listing Regulations read with SEBI Circular No. SEBI/HO/DDHS/PoD1/P/CIR/2023/108 dated July 29, 2022 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	IND AA	Stable	Reaffirm	-	20-07-2023	Verified	20-07-2023

This for your information and records.

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

Manmohan Parnami
Digitally signed by Manmohan Parnami
Date: 2023.07.20 23:13:59 +05'30'

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

Encl.: As above

IndiaRatings & Research
A Fitch Group Company

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India Ratings Affirms AU Small Finance Bank's Debt Facilities at 'IND AA'/Stable

Jul 20, 2023 | Private Sector Bank

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

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Tier II bonds*	-	-	-	INR5.0	IND AA/Stable	Affirmed
Certificate of deposits (CDs)	-	-	7-365 days	INR6.0	IND A1+	Affirmed
CDs	-	-	7-365 days	INR9.0	IND A1+	Withdrawn (the company did not proceed with the instrument as envisaged)

* Details in annexure

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 assets contributing 88% and secured loans 92% to the FY23 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 35.0% in FY23 (FY18: 51.9%). 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 1,027 banking touchpoints (including 711 unique locations) across 21 states and three union territories at FY23.

Secured Products to Continue to Drive Growth: At FYE23, the bank's gross advances stood at INR591.6 billion, with a highly secured portfolio across products such as wheels (32%), secured business loans (31%), business banking (8%), home finance (7%) and others (22%). AU SFB has been operating in these segments even before turning into a bank. Its gross advances grew at a CAGR of 35% during FY20-FY23 as against 11.4% for the industry. 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 66% of gross advances at fY23. 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.

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, which was evident during the COVID-19 pandemic. The bank however has navigated the asset quality pressures by increasing its focus on collections and monitoring, thereby driving an overall recovery in gross non-performing assets to 1.7% in FY23 (FY22: 2.0%; FY21: 4.3%). In FY23, the bank's provision coverage ratio stood at 75% on gross non-performing assets (NPAs; FY21: 50%). The restructured loans to total advances stood at 1.2% in FY23 (FY22: 2.5%; FY21: 1.8%). NPAs from the COVID-19 restructuring book remained below 12% as of FY23, and the bank carried provision coverage of 17% on restructured loans.

Moreover, the bank carried covid contingency provisions of INR0.9 billion (0.14% of the gross advances) in FY23. Notably, AU SFB has also created a floating provision of INR 410 million from FY23 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. The loan book created since the start of the pandemic is 84% of advances and this pool has been exhibiting better than historical trends in asset quality so far with GNPA at 0.7% and 92% of the book being current.

Improved Equity Buffers and Adequate Profitability: During FY23, the bank raised INR20 billion of equity capital raised through the qualified institutional placement route. This coupled with a net profit of INR14.3 billion led to its net worth improving to INR109.8 billion at end-FY23 (FY22: INR75.1 billion). The tier-I capital stood at 21.8% in FY23 (FY22: 19.7%; FY21: 21.5%). AU SFB had a high pre-provision operating profit buffer (PPOP; PPOP/credit cost) of 13.0x in FY23 (FY22: 5.0x; FY21: 3.2x; FY20:4.2x). Its return on asset of 1.8% in FY23 (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.

On the back of the increase in deposit rates across competition, the bank's average cost of deposits increased 40bp yoy to reach 5.5% at end-FY23. 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 asset side compared to liability remaining floating in nature can impact AU SFB's net interest margins in the near term with expectation of interest rates remaining at current levels in FY24.

Liquidity Indicator – Adequate: AU SFB operated with a moderate gap of 10% in asset-liability tenors in the less-than-one-year bucket as of March 2023. The bank largely covers the gap with refinancing lines. It maintains funding lines of INR45 billion-50 billion from refinancing institutions at any given point in time. During 4QFY23, the bank had a quarterly average liquidity coverage ratio of 128%, which is above the regulatory requirement (100% for small finance banks, SFBs).

CASA Ratio Likely to Witness Consolidation: AU SFB's liability profile substantially improved in FY23, with the share of deposits in the external liabilities rising to 92% (FY18: 52%). Moreover, its current and savings account (CASA) ratio improved to 38.4% in FY23 (FY22: 37.3%; FY21:23%; FY20:14.5%). Consequently, the CASA ratio as a percentage of the total external liabilities increased to 35.2% in FY23 (FY22: 33%; FY21: 19%; FY20: 10%). Moreover, 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: 32%; FY20: 30%). The bank also continued to have a high proportion of deposits (FY23: 52.3%; FY22: 53.2%; FY21: 54.7%) with ticket size above INR20 million. That being said, the share of the top 20 term depositors in the total customer deposits declined to 9.4% in FY23 (FY22:11.9%; FY21: 15.5%; FY20: 18.3%).

During FY23, there was a system-wide increase in deposit rates, with significant competition for deposits. AU SFB focused on preserving its CASA deposits admit 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 CA customers and 57% of the SA 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. That being said, the bank's larger presence in the unorganised granular retail segment gives it the ability to pass on the increase in the cost of funds to its customers.

Rating Sensitivities

Positive: Strong growth in the franchise in line with higher rated peers, along with 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: Absence of a sustained improvement in the liability profile or a material decline in CASA deposits proportion or retail deposits would be negative for the ratings. Also, a significant drop in the capital buffers or gross NPAs as a percentage of the gross advances exceeding 5% on 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.

Company Profile

AU SFB is a scheduled commercial bank that commenced its operations as an SFB on 19 April 2017. As on 31 March 2023, the bank was the largest SFB in terms of AUM. The bank has established operations across 1,027 banking touchpoints (mainly in rural and semi-urban markets) and has a customer base of 3.86 million in 21 states and three union territories with an employee base of 28,320. The bank has a net worth of INR109.8 billion, deposit base of INR693.6 billion and net advances of INR584.2 billion. AU SFB is listed on the National Stock Exchange and BSE Ltd. The Reserve Bank of India vide its letter dated 19 April 2023 has also granted a licence to AU SFB to act as authorised dealer category-I under section 10 of FEMA, 1999 to deal in foreign exchange.

FINANCIAL SUMMARY

Particulars	FY23	FY22
Total assets (INR million)	9,02,161	6,90,778
Total equity (INR million)	1,09,773	75,140
Net profit (INR million)	14,279	11,298
Return on average assets (%)	1.8	1.9
Equity/assets (%)	12.2	10.9
Tier 1 capital (%)	21.8	19.7
Source: AU SFB, Ind-Ra		

Non-Cooperation with previous rating agency

Not applicable

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.

Ratings are not a recommendation or suggestion, directly or indirectly, to you or any other person, to buy, sell, make or hold any investment, loan or security or to undertake any investment strategy with respect to any investment, loan or security or any issuer.

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook			
	Rating Type	Rated Limits (billion)	Rating	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
CDs	Short-term	INR6.0	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+

Annexure

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Tier II Bonds	INE949L08418	30 November 2018	10.90	30 May 2025	INR5.0	IND AA/Stable
Total					**INR5.0**	

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Tier II Bonds	Low
CDs	Low

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

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APPLICABLE CRITERIA

Rating Bank Subordinated and Hybrid Securities

Financial Institutions Rating Criteria

Evaluating Corporate Governance

The Rating Process

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