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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
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Dear Sir/Madam,

Sub: Disclosure under Regulation 30 and 51 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015- Credit Rating

We wish to inform that India Ratings has upgraded rating of the Long-term debt Instruments (Tier II Bonds) of AU Small Finance Bank Limited to IND AA/Stable (**Double A; Outlook: Stable**) from the earlier rating AA-/Stable (**Double A Minus; Outlook: Stable**).

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

Rating Rationale of the India Ratings 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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Formerly known as Au Financiers (India) Limited



India Ratings Upgrades AU Small Finance Bank's Debt Facilities to 'IND AA'; Outlook Stable

Jul 22, 2022 | Banks

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
Bank facilities*	-	-	-	0.13	WD	Withdrawn (paid in full)
Non-convertible debentures (NCDs)*	-	-	-	3.35	WD	Withdrawn (paid in full)
Tier II bonds*	-	-	-	INR5.0	IND AA/Stable	Upgraded
Certificate of deposits (CDs)	-	-	7-365 days	INR15.00	IND A1+	Affirmed
CDs	-	-	7-365 days	INR5.1	IND A1+	Withdrawn (the company did not proceed with the instrument as envisaged)

* Details in annexure

The upgrade reflects the strengthening of the bank's liability franchise, with progressing granularity, increasing diversification from its home state (Rajasthan) in both asset and liabilities, adequately managed asset quality, and stable credit cost even after factoring in the impact of the pandemic. The upgrade also factors in the bank's small but fast-growing franchise, with above-average operating matrices and high capital buffers, which are likely to be maintained.

While the liability profile remains significantly wholesale, AU SFB has made considerable progress in strengthening the same, as evident from the improving trend in savings account deposits, supported by the above-average yields offered by the bank. In addition, the bank has a 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.

Key Rating Drivers

Strengthening of Liability Profile, with High Growth in Retail Deposits: AU SFB has seen a substantial improvement in its the liability profile, with the share of deposits in the external liabilities rising to 90% in FY22 from the levels of 51% in FY18. Moreover, the bank's current and savings account (CASA) ratio improved to 37% in FY22 (FY21:23%; FY20:14%). The CASA ratio as a percentage of the total external liabilities increased to 33% in FY22 (FY21: 19%; FY20: 10%). As per the provisional business update, the CASA ratio further improved to 39% at end-June 2022. Within term deposits, retail term deposits grew at 40% CAGR over FY20-FY22 (albeit on a small base), contributing 29% to the total deposits in FY22 (FY21: 32%; FY20: 30%). Simultaneously, the share of bulk deposits in the total deposits dropped to 31% in FY22 (FY21: 41%; FY20: 47%). The deposit concentration moderated in line with reduction in bulk deposits, with the share of the top 20 term depositors in the total customer deposits declining to 11.9% in FY22 (FY21: 15.5%; FY20: 18.3%).

The improvement in the liability profile is also reflected in the decline in the cost of funds to 5.9% in FY22 (FY21: 6.8%), with incremental cost of 5.3% in 4QFY22. The bank had undertaken a number of strategic initiatives during the last 15 months to improve the customer engagement. Consequently, about 62% of the current account customers and 47% of the savings account customers used two or more products of the bank at FYE22. As the bank becomes larger and expands its balance sheet, its ability to competitively build stickiness in the granular deposit profile will be a key monitorable.

Ind-Ra expects the banks' cost of funds to increase in FY23, led by the system-wide rise in interest rates and its incremental funding. That 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.

Strong Retail Asset Franchise, with Reducing Share in Home State: The rating reflects AU SFB's continued expansion within its home state and outside as well, with its share in its home state moderating to 40.8% in FY22 from 51.9% in FY18. Furthermore, the bank has expanded its product lines along with maintaining its growth trajectory in its core verticals of wheels and small business loans. AU SFB has a well-established track record of over 27 years in retail assets (accounted for 90% of the 1QFY23 loan book) and secured book (94%). 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. The bank has been expanding its presence, and had 919 banking touchpoints (including 703 unique locations) across 18 states and two union territories at FYE22.

Asset Quality Adequately Managed Despite Pandemic Impact: AU SFB lends to self-employed individuals who run small businesses, which are largely earn-and-pay in nature. Hence, the cash flows for such borrowers remain vulnerable to external economic shocks, which was evident during the first and second waves of COVID-19. The bank has navigated the asset quality with increased focus on collections and monitoring, thereby driving an overall recovery in gross non-performing assets to 2% in FY22 (FY21: 4.3%). The bank continues to have an average recovery rate of 30% of opening gross non-performing plus additions; this would remain a monitorable. The restructured loans to total advances stood at 2.5% in FY22 (FY21: 1.8%). In addition, the bank disbursed INR10.4 billion over FY21-22 under the emergency credit line guarantee scheme (ECLGS); incremental stress from the proportion of AUM supported by ECLGS remains a monitorable. Ind-Ra believes a reasonable portion of the loan book has benefitted through ECLGS and restructuring by the bank. With the inflationary pressure building up for small businesses, this portion could witness incremental slippages in the medium term once the moratorium on ECLGS is over.

In FY22, the bank increased its provision coverage ratio to 75% on gross non-performing assets (FY21: 50%) and carried 16% coverage on restructured assets. AU SFB has stated that its historical losses on repossession and settlement has been below 35% for wheels and below 20% for small business loans. Moreover, the bank carried covid contingency provisions of INR1.6 billion (0.3% of the AUM) in FY22. 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 collection efficiency (calculated as all money received during the month from borrowers (excluding foreclosure) as a percentage of current billing for the month) was healthy at 106% in June 2022 (May 2022: 105%; April 2022: 103%).

Adequate Profitability and Equity Buffers: The bank largely operates in the secured retail space and competes mostly with non-banking financial companies, offering adequate pricing power. Consequently, AU SFB had a high pre-provision operating profit buffer (PPOP; PPOP/credit cost) of 5.0x in FY22 (FY21: 3.2x; FY20:4.2x). The bank's return on asset 1.9% in FY22 (FY21:2.5%, FY20:1.8%) is fairly strong. As the bank expands into newer segments, wherein the competition from the banking segment is higher, the incremental yield is likely to come under pressure, though the impact should be cushioned through an improvement in the cost of funds as well as a fall in operating costs.

Moreover, post the equity raise of INR6.25 billion in FY21 and gains of INR6.5 billion from the sale of stake (pre-tax) in Aavas Financiers Limited during the same year, the bank's tier-I capital adequacy ratio remained healthy at 19.7% in FY22 (FY21: 21.5%; FY20: 18.4%). AU SFB has adequate PPOP and capital adequacy buffers to absorb incremental asset quality pressures in a stress case scenario.

Liquidity Indicator – Adequate: AU SFB operated with a moderate gap of 9% in asset-liability tenors in the less-than-one-year bucket as of March 2022. The bank largely covers the gap with refinancing lines. It maintains adequate liquidity buffers in the form of funding lines of INR40 billion-45 billion from refinancing institutions at any given point in time. During 1QFY23, the bank maintained adequate on-balance sheet liquidity, reflected by the quarterly average liquidity coverage ratio of 129%, which is above the regulatory requirement (100% for SFBs).

Secured Products to Continue to Drive Growth: At 4QFY22, the bank's AUM stood at INR478.3 billion, with a highly secured portfolio across products such as wheels (36%), secured business loans (35%), business banking (6%), home finance (6%) and others (17%). AU SFB has been operating in these segments even before turning into a bank. Its AUM grew at a CAGR of 25% during FY19-FY22, though it was flat during 1QFY22 as disbursements were impacted by the second wave of COVID-19. Moreover, the bank has restricted the growth of its wholesale book (which has a higher ticket than the overall book) by curtailing its incremental real estate exposure over the last five years. That said, Ind-Ra expects the bank to continue to grow at above-industry growth rates due to its small scale and lower competitive intensity from non-banking financial companies.

The bank 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 71% of the AUM at FYE22, indicating geographical concentration risk. Pre-COVID-19, the bank had been focused on expanding its franchise in newer geographies, incremental action in diversifying outside key geographies, and broadening of product offerings and gaining sizable scale in those segments vis-à-vis peers; these remain key monitorables.

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 granular liabilities above 75% of the total external liabilities could be positive for the rating.

Negative: Any significant weakening in the liability profile i.e. material decline in CASA deposits proportion or retail deposit would be negative for the ratings. Also, a significant drop in capital buffers or the gross non-performing assets as a percentage of the gross advances moving above 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 a small finance bank (SFB) on 19 April 2017. As on 31 March 2022, the bank was the largest SFB in terms of AUM. The bank has established operations across 919 banking touchpoints (mainly in rural and semi-urban markets) and a customer base of 2.75 million in 18 states and two union territories with an employee base of 27,817 employees. The bank has a net worth of INR75.1 billion, deposit base of INR525.85 billion and net advances of INR460.95 billion. AU SFB is listed on the National Stock Exchange and Bombay Stock Exchange.

FINANCIAL SUMMARY

Particulars	FY22	FY21
Total assets (INR million)	6,90,778	5,15,913
Total equity (INR million)	75,140	62,752
Net profit (INR million)	11,298	11,707
Return on average assets (%)	1.9	2.5
Equity/assets (%)	10.9	12.2
Tier 1 capital (%)	19.7	21.5
Source: AU SFB, Ind-Ra		

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	19 August 2021	20 August 2020	6 April 2020	8 April 2019
Tier II Bonds	Long-term	INR5.0	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
Bank facilities	Long-term	0.13	WD	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
NCDs	Long-term	3.35	WD	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable	IND AA-/Stable
CDs	Short-term	INR15	IND A1+	IND A1+	IND A1+	IND A1+	IND A1+

Annexure

Instrument	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Bank loan	-	-	-	INR0.13	WD (paid in full)
Total				INR0.13	

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
NCDs	INE949L07493	5 January 2017	8.653	20 December 2021	INR3.35	WD (paid in full)
Total					INR3.35	

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
Bank facilities	Low
NCDs	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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