

Ref. No.: AUSFB/SEC/2017-18/521

Date: 23rd February 2018

To,
Listing Department
National Stock Exchange of India Limited,
Exchange Plaza, Bandra Kurla Complex,
Bandra (East), Mumbai 400051,
Maharashtra.

Department of Corporate Services,
The Bombay Stock Exchange Limited,
Phiroz Jeejeebhoy Towers,
Dalal Street, Mumbai 400001,
Maharashtra.

NSE Symbol: AUBANK

BSE SCRIPT CODE: 540611

Dear Sir(s),

Sub: Upgradation in ratings by India Ratings

Pursuant to the regulation 30 & 51 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 please be informed that, India Ratings has upgraded rating of **AU SMALL FINANCE BANK LIMITED** to AA-/Stable from A+/Positive earlier.

The rating upgrade announcement as issued by Rating Agency India Ratings is attached as annexure.

We request you to take the same on record.

This is for your information and appropriate dissemination.

Thanking You,

FOR AU SMALL FINANCE BANK LIMITED


Manmohan Parnami
Company Secretary & Compliance Officer

Registered Office

AU SMALL FINANCE BANK LIMITED

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CIN: L36911RJ1996PLC011381

Formerly known as **Au Financiers (India) Limited**

India Ratings Upgrades AU Small Finance Bank's NCDs to 'IND AA-/Stable'

23

FEB 2018

By **Harshal Patkar**

India Ratings and Research (Ind-Ra) has undertaken the following rating actions on AU Small Finance Bank Limited's (AU SFB) non-convertible debentures (NCDs) and bank facilities:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
NCDs*	-	-	-	INR27.65	IND AA-/Stable	Upgraded
Bank facilities	-	-	-	INR3.1 (reduced from INR3.3)	IND AA-/Stable	Upgraded
Subordinate debt*	-	-	-	INR1.5	IND AA-/Stable	Upgraded
Commercial paper	-	-	-	INR2.75	WD	Withdrawn (paid in full)
Certificates of deposit	-	-	-	INR10.0	IND A1+	Affirmed

* Details given in Annexure

The upgrade reflects AU SFB's reasonable transition to the small finance bank (SFB) platform, with reasonable traction on retail liability and simultaneous strengthening of product portfolios while containing delinquencies at a comfortable level. The ratings benefit from AU SFB's policy to maintain leverage at a moderate level (around 7.0x for the medium term) commensurate with its asset side risks, as well as from an improved access to equity-raising after the listing in July 2017. AU SFB intends to maintain healthy liquidity with matched asset and liability tenors. Ind-Ra derives comfort from AU SFB's execution capabilities that have been displayed from time to time (e.g. transition to the SFB platform, asset side transitioning and liability accretion), in addition to the quality of the management team.

The ratings, however, are constrained by AU SFB's regional concentration, unseasoned loan book (last 12 months disbursements/assets under management (AUM) of 66% as of December 2017) and insufficient track record in asset-liability management on the SFB platform.

KEY RATING DRIVERS

Strong Footing in Core Geography: AU SFB transitioned to the SFB platform with a fairly competitive positioning on the asset side. It has a competitive advantage of reach and local knowledge in Rajasthan. AU SFB has one of the largest banking footprints in Rajasthan and is expanding its footprint in 10 states. AU SFB's ability to increase wallet share in the core geography while cross-selling asset (working capital and personal loan products) and liability products will be a key monitorable.

Comfortable Liquidity Profile: The tenures of AU SFB's assets and liabilities are fairly matched, with no negative gaps in the up-to-one-year bucket as of December 2017. AU SFB plans to expand its asset tenure, keeping its liability tenure in consideration without running mismatches in the softer buckets. As of December 2017, AU SFB had a statutory liquidity ratio over and above required under the regulation (about 3.0% excess).

Additionally, AU SFB plans to maintain adequate liquidity buffers in the form of banking lines for overnight facilities, lines from developmental financial institutions and excess investments in government securities that can help tide over refinancing challenges in the event of a market disruption and a liquidity shock. It had an INR11.0 billion line from development finance institutions, apart from INR2.4 billion worth of committed bank lines of credit at 9MFY18. Furthermore, the inclusion of AU SFB in the Second Schedule to the Reserve Bank of India Act, 1934, provides it access to the repurchase agreement window for contingent liquidity requirement and widens the liability generation spectrum.

Funding Profile Gradually Evolving: AU SFB has achieved a reasonable traction in granular liabilities accretion, along with a low-cost current account and savings account ratio of 37% of deposits as of 3QFY18. Moreover, as a percentage of total borrowings (on book), deposits stood at 33.7% in 3QFY18 (2QFY18: 21.0%; 1QFY18: 9.9%). The ability to scale up its granular liability franchise as its non-banking financial company (NBFC) liabilities' grandfather and replace pre-conversion bank loans and NCDs as they mature with granular deposits without materially affecting its asset liability profile would be critical. This is especially important in light of limited access to bank funding post the transition to the SFB platform.

AU SFB's funding is fairly diversified, with NCDs, refinance from financial institutions and bank loans accounting for 26%, 18% and 4% of its borrowings (including deposits and off-balance sheet) in 9MFY18, respectively. The company has a sizeable dependence on off-balance sheet funding through bilateral

assignments and securitisation. The share of off-balance sheet funding in the overall funding reduced to 22.4% in 9MFY18 (FY17: 36.0%) from over 47.0% in FY14 and is likely to fall further in the medium term.

Comfortable Capitalisation: As an SFB, the company plans to maintain a moderate leverage of around 7.0x in the medium term in line with its asset-side risk profile. It had a tier 1 BASEL II ratio of 20.0% and an equity/AUM ratio of 16.4% in 9MFY18. AU SFB's equity/AUM ratio looks comfortable for medium-term growth aspirations.

Comfortable Asset Quality: AU SFB's wheels portfolio, the largest segment within retail assets (47.0% share: 9MFY18), exhibited better-than-industry median NPLs on a 90 days past due basis. Overall, the reported NPLs increased on the SFB platform (on-book GNPA: 3QFY18: 2.8%; 2QFY18: 3.1%; 1QFY18: 3.0%) on account of the transition from 120 days past due to 90 days past due.

The portfolio in the micro, small and medium enterprise (MSME) and small and medium enterprise (SME) segments, which represent 30% and 6% of the loan book, respectively, remains largely unseasoned (especially that in the SME segment). Asset quality for the SME segment has already witnessed pressure. Ind-Ra believes the portfolio behaviour under stress conditions for the SME and MSME segments is yet to be fully tested and would be a key monitorable.

The NPLs in the wholesale portfolio (18% of AUM) marginally increased to 0.5% in 3QFY18 (2QFY18: 0.3%), largely driven by the real estate group segment (5.5% of AUM) owing to the implementation of the goods and services tax and other macroeconomic factors. Portfolio performance in this largely regionally concentrated book (average ticket size INR38 million) would be a key monitorable.

Improvement in Operating Performance Likely from FY19: The transition to the SFB platform impacted AU SFB's profitability owing to a negative carry on cash reserve ratio, statutory liquidity ratio and operating expense, along with compliance cost. Moreover, return on average assets was 2.3% in 9MFY18. While cost/income ratio remains on the higher side (9MFY18: 53.6%), Ind-Ra expects operating expenditure to peak in FY18 owing to upfront opex and operational synergies (which are likely to kick in with a lag). AU SFB's ability to keep costs under check through technological innovations (adopting a tech-heavy, customer-centric model against a branch expansion-led model) while expanding its liability footprint will be a key monitorable.

AU SFB's profitability buffers have remained healthy over the years due to a high return on risk-adjusted returns from the SME, MSME and REG segments. Thus, pre-provision operating profit/credit costs remained steady at 4.3x in 9MFY18 (FY17: 8.1x) from 4.6x in FY15. However, through-the-cycle credit costs in the SME, MSME and REG segments are yet to be established. Hence, buffers could likely dip in the medium term.

RATING SENSITIVITIES

Outlook Revision to Positive: Creating a sizeable sticky granular deposit (especially low-cost retail deposits) base in line with those of established banks and creating a reasonable franchise in the banking space both in terms of assets and liabilities, while maintaining adequate short-term liquidity and robust capital buffers, which, in Ind-Ra's opinion, increases AU SFB's long-term tolerance to asset quality deterioration, could result in the Outlook revision to Positive.

Negative: A significant increase in leverage without a corresponding reduction in the asset-side risk or any significant deterioration in the asset quality and profitability buffers could be negative for the ratings. Large gaps in short-term buckets, and inability to keep the momentum in the liability franchise and generate reasonable risk adjusted returns could also be negative for the ratings.

COMPANY PROFILE

AU SFB is a Rajasthan-based systemically important asset finance NBFC turned SFB. It was incorporated in 1996 by Mr Sanjay Agarwal. AU SFB offers retail loans, including wheels loan, secured business loans to MSME and SME, gold loans, agri-SME and consumer durables loans while the wholesale platform offers NBFC loans, real estate group loans and business banking loans.

AU SFB commenced banking operations on 19 April 2017 and was listed on the Bombay Stock Exchange and the National Stock Exchange on 10 July 2017. As on 31 December 2017, AU SFB had 306 branches, 105 asset centres, 23 offices and 291 ATMs across 11 states and one union territory. Moreover, at 9MFYE18 AU SFB had gross AUM of INR134 billion, total deposits of INR37.2 billion and an employee base of 10,666.

FINANCIAL SUMMARY

Particulars	FY17	FY16
Total assets (INR million)	96,514	62,294
Total equity (INR million)	18,942	9,893
Net profit (INR million)	821.9	211.6
Return on average assets (%)	10.4*	4.14
Equity/assets (%)	19.6	15.9
Tier 1 capital (%)	21.5	13.7
Source: AU SFB, Ind-Ra's analysis		
* Includes an exceptional item of profit on sale of investment in subsidiary/associates		

RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (billion)	Rating	7 November 2017	2 March 2017	23 March 2016
Bank facilities	Long-term	INR3.1	IND AA-/Stable	IND A+/Positive	IND A+/Positive	IND A+/Stable
NCDs	Long-term	INR27.65	IND AA-/Stable	IND A+/Positive	IND A+/Positive	IND A+/Stable
Subordinate debt	Long-term	INR1.5	IND AA-/Stable	IND A+/Positive	IND A+/Positive	IND A+/Stable
Commercial paper	Short-term	INR2.75	WD	IND A1+	IND A1+	IND A1+
Certificates of deposit	Short-term	INR10.0	IND A1+	IND A1+	-	-

ANNEXURE

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
NCDs	INE949L07386	9 September 2015	10.50	19 April 2019	INR1.25	IND AA-/Stable
NCDs	INE949L07360	25 August 2015	10.50	16 July 2018	INR0.2	IND AA-/Stable
NCDs	INE949L07378	25 August 2015	10.50	24 August 2018	INR0.25	IND AA-/Stable
NCDs	INE949L08285	21 May 2015	8.95	21 May 2021	INR2	IND AA-/Stable
NCDs	INE949L08293	26 June 2015	8.95	26 June 2020	INR3	IND AA-/Stable
NCDs	INE949L08350	10 May 2016	10.05	29 March 2019	INR0.4	IND AA-/Stable
NCDs	INE949L08368	10 May 2016	10.05	30 September 2019	INR0.45	IND AA-/Stable
NCDs	INE949L08376	10 May 2016	10.05	10 November 2019	INR0.5	IND AA-/Stable
NCDs	INE949L08384	10 May 2016	10.05	30 March 2020	INR0.65	IND AA-/Stable
NCDs	INE949L08335	30 April 2015	10.50	8 March 2018	INR0.5	IND AA-/Stable
NCDs	INE949L08343	19 August 2015	10.50	25 June 2018	INR0.5	IND AA-/Stable
NCDs	INE949L07477	13 June 2016	10.05	13 June 2019	INR0.5	IND AA-/Stable
NCDs	INE949L07485	13 June 2016	10.05	12 June 2020	INR0.5	IND AA-/Stable
NCDs	INE949L07394	22 September 2015	10.25	21 September 2018	INR0.25	IND AA-/Stable
NCDs	INE949L07402	22 September 2015	10.25	20 September 2019	INR0.25	IND AA-/Stable
NCDs	INE949L08277	11 August 2015	10.50	10 August 2018	INR1	IND AA-/Stable
NCDs	INE949L08244	8 May 2015	10.50	26 April 2018	INR0.35	IND AA-/Stable
NCDs	INE949L08251	8 May 2015	10.50	13 June 2018	INR0.35	IND AA-/Stable
NCDs	INE949L08400	31 May 2016	10.05	29 May 2020	INR0.5	IND AA-/Stable
NCDs	INE949L08392	31 May 2016	10.00	31 May 2019	INR0.5	IND AA-/Stable
NCDs	INE949L07493	5 January 2017	8.84	20 December 2021	INR3.35	IND AA-/Stable
NCDs	INE949L08269	23 February 2017	8.75	23 October 2018	INR1.5	IND AA-/Stable
NCDs	INE949L08301	28 February 2017	8.90	30 April 2020	INR0.5	IND AA-/Stable

NCDs	INE949L08319	28 February 2017	8.75	28 January 2019	INR1.5	IND AA-/Stable
NCDs	INE949L08178	15 March 2017	8.84	14 September 2018	INR1	IND AA-/Stable
NCDs	INE949L08186	15 March 2017	8.89	15 February 2019	INR1	IND AA-/Stable
NCDs	INE949L08228	6 April 2017	9.51	6 April 2020	INR2.45	IND AA-/Stable
NCDs	INE949L08236	6 April 2017	9.51	6 April 2021	INR2.45	IND AA-/Stable
Total					INR27.65	

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
Subordinated debts	INE949L08152	4 November 2015	11.75	4 May 2021	INR0.8	IND AA-/Stable
Subordinated debts	INE949L08145	30 September 2015	12.25	2 April 2021	INR0.7	IND AA-/Stable
Total					INR1.5	

COMPLEXITY LEVEL OF INSTRUMENTS

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

SOLICITATION DISCLOSURES

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India Ratings and Research (Ind-Ra) is India's most respected credit rating agency 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, structured finance and project finance companies.

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Applicable Criteria

[Financial Institutions Rating Criteria](#)

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