July 06, 2021

# AU Small Finance Bank Limited: Rating reaffirmed and withdrawn

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Subordinated Debt Programme | 20.00 | - | [ICRA]AA-(Stable); reaffirmed and withdrawn# |
| Non-convertible Debentures | 56.70 | - | [ICRA]AA-(Stable); reaffirmed and withdrawn# |

**Instrument details are provided in Annexure-1; #withdrawn as instruments/ISINs stand fully redeemed basis publicly available information*

## Rationale

ICRA has reaffirmed and withdrawn the [ICRA]AA- (Stable) rating outstanding for subordinated debt programme and non-convertible debentures of AU Small Finance Bank Limited (AU) as the instruments/ISINs stand fully redeemed.

The rating reaffirmation factored in the continued ramp-up in AU Small Finance Bank Limited's (AU) liability franchise, its ability to report satisfactory profitability despite the challenging operating environment, and strong liquidity position. While the asset quality has come under pressure, due to the ongoing challenging environment, it is noted that AU's reported asset quality metrics have largely stayed under control and in line with ICRA's expectation. Also, comfort is drawn from AU's past track record of comfortable asset quality trajectory. Moreover, ICRA notes that AUs capitalisation level remains comfortable with Tier-I of 21.5% and total CRAR of 23.4% as of March 2021, though it is likely to moderate over the medium term, given the growth plans. ICRA notes that as the loan book grows at fast pace, the bank may require additional capital raisings as the internal accruals are likely to be lower (despite healthy profitability) than the growth capital requirements. Also, ICRA believes that as the bank expands it will be imperative to maintain asset quality and granularity in liabilities. The credit profile remains constrained by the relatively high geographical as well as product concentration given the focused approach adopted by the bank.

## Key rating drivers and their description

### Credit strengths

**Steady ramp-up in liability profile** – AU has demonstrated a steady and sustained ramp-up in its liability profile since its transition to an SFB four years ago. It has been able to build a deposit base of Rs. 35,979 crore (as on March 31, 2021) with a YoY increase of 38%. The deposits account for about 79% of the bank's external liabilities (including securitisation) as on March 31, 2021, followed by refinance from FIs. Further, with incremental funds being in the form of deposits and refinance from FIs, and decline in systemic rates, AU has witnessed a decline in the cost of funds over the last four years, with incremental cost of funds having been 5.9% in Q4 FY2021 compared to 7.2% in Q4 FY2020. In FY2021, the cost of funds for AU reduced by 86 bps to 6.83% compared to 7.7%, 7.9%, and 8.4% in FY2020, FY2019 and FY2018, respectively. Notwithstanding the healthy ramp-up in the deposit base, ICRA notes that AU will need to continuously strengthen its liability profile to improve the granularity of the deposit base by garnering a larger share of retail liabilities. Given the likely growth over the medium to long term and despite the expectations of continued growth in the share of retail liabilities (on the back of performance in FY2021), bulk deposits may continue to constitute a large share of the liability profile.

**Track record of comfortable asset quality, notwithstanding intermittent pressures amid challenging environment** - While the asset quality has come under pressure, especially for select segments, due to the ongoing challenging environment, it is noted that AU's reported asset quality metrics have largely stayed under control and in line with ICRA's expectation. It is noted that the loan book saw steady pullback in Q4FY2021, whereby 81% of loans were current as on March 31, 2021 (similar level as March 31, 2020). Also, while reported gross NPA % stood elevated at 4.3% as on March 31, 2021 (compared to eight quarter average of 2.0%) and 1.8% advances stood restructured, the 90+ dpd accounts reduced from 3.3% to 2.7% QoQ. Moreover, total provision cover against the loan book stood improved at 2.9% as on March 31, 2021 compared to 1.8% a year ago.

AU has more than two decades of experience in the vehicle finance/wheels segment (accounting for 37% of the total portfolio as on March 31, 2021) and about a decade of experience in MSME segment (accounting for 39% of the total portfolio as on March 31, 2021). Though, its track record in other segments remains relatively limited. Post conversion into an SFB, the bank has started new products like business banking, gold loans, unsecured personal/ consumer durable loans. Within the vehicle/wheels finance segment, the increased focus on used vehicles will remain a monitorable. Also, a large part of the bank's borrowers are new to credit. While AU has historically demonstrated good control over asset quality, these profiles could be more exposed to volatility in incomes during current challenging environment. The risk is, however, somewhat mitigated by the secured nature of lending, granular book, complete in-house business model, management's long-standing experience in its primary area of operations, and adequate lending spreads that provide a cushion to cover the credit costs.

**Satisfactory profitability trajectory** – While AU's net interest margins moderated on transitioning to a bank owing to the requirements to invest in lower-yielding government securities to comply with the statutory liquidity ratio (SLR) requirements, the yield pressure has been offset by the decline in the cost of funds. Hence, the pre-provision profitability remains healthy and continued to result in satisfactory RoA and RoE of 1.3% and 12% in FY2021 (excluding gains on divestment of stake in Aavas, and equity infusion in March 2021), despite the increased credit cost amid the challenging operating environment. Including the gains on divestment of stake in Aavas, AU reported RoA and RoE of 2.5% and 23.4% respectively in FY2021 compared to 1.8% and 17.9% respectively in FY2020. Going forward, the bank's ability to continue to raise low-cost retail deposits, increase the fee-based income with an increased distribution network, and cross-sell banking products to existing customers while keeping the operating and credit costs in control will remain key for further improving the profitability over the medium term. In the near term, given the likely slippages due to the pandemic, ICRA expects the credit costs to remain elevated in FY2022, thereby constraining the profitability of the bank.

## Credit challenges

**Relatively high geographical as well as product concentration with modest, albeit improving, scale of operations** – AU's loan book grew at a four-year CAGR of 37% during FY2017 to FY2021. However, despite the above-industry average growth, its scale of operations remains moderate in relation to universal banking sector peers. As on March 31, 2021, its AUM was Rs. 37,712 crore compared to Rs. 30,893 crore as on March 31, 2020 and Rs. 24,246 crore as on March 31, 2019. Further, while AU has over the years expanded its operations to 17 states & union territories, its portfolio remains geographically concentrated given the focused approach adopted by the bank. Rajasthan still accounts for about 40% of the portfolio as on March 31, 2021 followed by Madhya Pradesh (17%), Maharashtra (13%), and Gujarat (10%). These states also accounted for 82% of AU's branches and 63% of the deposits (excluding CDs) mobilised by the bank. Nevertheless, AU's strong track record in Rajasthan provides comfort. Also, AU has historically been present in the vehicle and MSME finance segment, thereby resulting in high concentration of the product portfolio towards these segments. As on March 31, 2021, the vehicle and MSME finance segments had shares of 37% and 39%, respectively, in AU's assets under management (AUM).

**Growth will require regular capital raising and monitoring of ability to maintain asset quality and granularity in liabilities** – As the loan book grows, the bank may require additional capital raisings as the internal accruals are likely to be lower (despite healthy profitability) than the growth capital requirements. Also, ICRA believes that as the bank expands it may face challenges such as maintaining asset quality and granularity in liabilities. Nevertheless, AUs capitalisation level remains comfortable with Tier-I of 21.5% and total CRAR of 23.4% as of March 2021, though it is likely to moderate over the medium term. Also, ICRA draws comfort from AU's demonstrated track record of capital raisings, the latest being in Q4 FY2021. Supported by regular capital infusion and healthy internal accruals, AU's net worth has doubled to Rs. 6,275 crore in March 2021 from Rs. 3,163 crore in March 2019. During this period, AU also benefited from stake sale in Aavas.

## Liquidity position: Strong

AU maintained a liquidity coverage ratio (LCR) of 116% as of March 31, 2021. To manage its liquidity risks, the bank has maintained excess government securities eligible for SLR. Hence, it can avail liquidity support from the RBI through reverse repo against excess SLR investments and the marginal standing facility scheme, in case of urgent liquidity needs. The bank also maintained a sizeable liquid non-SLR book. AU's access to the call money market/inter-bank money market window also provides comfort. Further, while AU's asset liability maturity profile is typically characterised by modest gaps in the near-term buckets, it can access unutilised refinance lines of over Rs. 2,000 crore from development finance institutions to plug these gaps. Moreover, given AU's focus on priority sector lending, it can securitise the loans at short notice to meet urgent liquidity needs.

## Rating sensitivities

**Positive factors** – Not Applicable

**Negative factors** – Not Applicable

### Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable Rating Methodologies** | ICRA's Credit Rating Methodology for Non-Banking Finance Companies<br>Rating Methodology for Banks<br>Policy on Withdrawal of Credit Ratings |
| **Parent/Group Support** | Not Applicable |
| **Consolidation/Standalone** | Standalone |

## About the company

AU is a scheduled commercial bank, which has transitioned from an asset financing NBFC to an SFB. While it was incorporated in 1996 as an NBFC, it commenced SFB operations on April 19, 2017. AU has an established market position in Rajasthan, and has expanded operations to Maharashtra, Gujarat, and other states over the years. As of March 31, 2021, it had 729 branches across 15 states and 2 union territories. Over 80% of its branches are in the four states of Rajasthan, Gujarat, Maharashtra and Madhya Pradesh.

AU operates in the retail asset financing segment, with the vehicle financing segment accounting for ~37% of its AUM as on March 31, 2021. Its product portfolio also includes MSME and SME financing, construction finance, loans to NBFCs, business banking, gold loans, home loans, agri-SME loans, unsecured personal loans (PL) and consumer durables (CD). AU's liability product offerings include current accounts, savings accounts, recurring & term deposits, transaction banking, as well as a bouquet of third-party mutual funds and insurance covers among others.

During its early years of operations, AU (formerly Au Financiers (India) Limited) was primarily engaged in vehicle financing through funds raised from high net worth individuals in Jaipur. Over the years, the company raised equity from private investors at regular intervals and expanded its product portfolio. In September 2015, the Reserve Bank of India (RBI) granted in-principle approval to AU for setting up an SFB. On December 20, 2016, AU got the final licence and it converted into an SFB on April 19, 2017. Further, the bank got listed on stock exchanges in July 2017 and was granted scheduled commercial bank status in November 2017.

AU reported a profit after tax (PAT) of Rs. 1,171 crore on a total asset base of Rs. 51,591 crore in FY2021 compared to PAT of Rs. 674 crore on a total asset base of Rs. 42,143 crore in FY2020. As of March 31, 2021, the net worth stood at Rs. 6,275 crore with a reported capital adequacy of 23.4%.

## Key financial indicators

| | FY2019 | FY2020 | FY2021 |
|---|---|---|---|
| PAT | 382 | 675 | 1,171 |
| Net worth | 3,163 | 4,377 | 6,275 |
| Assets under management | 24,246 | 30,893 | 37,712 |
| Total assets | 32,623 | 42,143 | 51,591 |
| Return on average assets (%) | 1.5% | 1.8% | 2.5% |
| Return on average net worth (%) | 14.0% | 17.9% | 23.4% |
| Gearing (times) | 8.9 | 8.3 | 6.9 |
| CRAR (%) | 19.3% | 22.0% | 23.4% |
| Gross NPAs (%) | 2.0% | 1.7% | 4.3% |
| Net NPAs (%) | 1.3% | 0.8% | 2.2% |
| Net NPA/Net worth (%) | 9.3% | 5.0% | 12.0% |

***Source:** AU, ICRA research*
*Amount in Rs. Crore*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

# Rating history for past three years

| | Instrument | Current Rating (FY2022) | | | | Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Jul 06, 2021 | FY2021 | FY2020 | FY2019 |
| | | | | | | Sep 30, 2020 | Aug 30, 2019 | Jun 29, 2018 |
| 1 | Sub-debt | LT | 20.00 | - | [ICRA]AA- (Stable) Withdrawn | [ICRA]AA- (Stable) | [ICRA]AA- (Stable) | [ICRA]AA- (Stable) |
| 2 | NCD | LT | 56.70 | - | [ICRA]AA- (Stable) Withdrawn | [ICRA]AA- (Stable) | [ICRA]AA- (Stable) | [ICRA]AA- (Stable) |

***Source:** ICRA research; MT: Medium Term*

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Sub-debt | Moderately Complex |
| NCD | Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

## Annexure-1: Instrument details

| ISIN | Instrument Name | Date of Issuance/ Sanction | Coupon Rate/ Yield | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| INE949L08160 | Subordinated Debt | Nov 19, 2015 | 11.07% | May 19, 2021 | 20.00# | [ICRA]AA-(Stable) Withdrawn# |
| INE949L07535 | Non-convertible Debenture | Mar 16, 2017 | 8.63% | Mar 16, 2021 | 56.70# | [ICRA]AA-(Stable) Withdrawn# |

***Source:*** *ICRA; #withdrawn as instruments/ISINs stand fully redeemed basis publicly available information*

## Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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## About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

## ICRA Limited

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