

May 17, 2024

AU Small Finance Bank Limited: [ICRA]AA (Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Lower Tier II bonds ^	360.00	[ICRA]AA (Stable); assigned
Total	360.00	

*Instrument details are provided in Annexure I; ^Transferred from erstwhile Fincare Small Finance Bank on account of amalgamation

Rationale

The assigned rating factors in AU Small Finance Bank Limited's (AU) established retail asset franchise with a track record of comfortable asset quality and healthy capitalisation and adequate earnings. AU registered a compound annual growth rate of around 31% in its gross loan portfolio (GLP) during March 2018 to March 2024. Its GLP stood at Rs. 82,175 crore as on March 31, 2024 compared to Rs. 64,072 crore as on March 31, 2023, registering a growth of 28% in FY2024. ICRA notes that AU operates in the retail asset financing segment with the share of retail banking assets at 78% of the GLP as on March 31, 2024. It has more than two decades of experience in the vehicle finance segment and more than a decade of experience in the micro, small and medium enterprise (MSME) segment. AU's scale and diversification have improved further upon the merger with Fincare Small Finance Bank Limited (Fincare), w.e.f. April 1, 2024. The proforma merged GLP stood at Rs. 96,490 crore as on March 31, 2024.

As on March 31, 2024, AU's reported capital adequacy ratio (CAR) of 20.1% (Tier I: 18.8%) was well above the regulatory requirement of 15.0% (Tier I: 7.5%). In ICRA's opinion, the bank is fairly capitalised to support its envisaged growth in the near-to-medium term. Further, ICRA notes that AU's asset quality has remained comfortable and the gross non-performing assets (NPAs) were reported at 1.67% as on March 31, 2024 (net NPAs of 0.55%). The bank has been gradually expanding its product offerings over the years, adding new products like gold loans, home loans, agri-small and medium enterprise (SME) loans, personal loans, credit cards and business banking etc. AU's ability to maintain the asset quality as it grows in these segments and diversifies into other segments remains a key monitorable.

ICRA also takes comfort from AU's adequate earnings profile with the return on assets (RoA) at 1.5% in FY2024 (1.8% in FY2023). Margins were under pressure in FY2024 due to the increasing cost of funds, including deposits. While ICRA expects the cost of funds to increase further in FY2025, the bank should be able to maintain an adequate earnings profile. This will be supported by the addition of relatively higher-yielding loan assets, post the merger, the expectation of range-bound credit costs and the gradual improvement in the operating efficiency as AU continues to scale up its operations.

ICRA takes note of the healthy traction in deposit mobilisation by the bank over the years. Nevertheless, the share of current account savings account (CASA) remained relatively low at 33% as on March 31, 2024 (38% as on March 31, 2023). Also, the share of bulk deposits was quite high at 34% as on March 31, 2024.

The Stable outlook reflects ICRA's expectation that the bank would be able to maintain a steady credit profile while expanding its scale of operations and maintaining adequate profitability and comfortable capitalisation.

Key rating drivers and their description

Credit strengths

Established retail asset franchise with track record of comfortable asset quality – AU operates in the retail asset financing segment with the share of retail banking assets at 78% of the GLP as on March 31, 2024. Vehicle financing and micro business loans continue to dominate the retail asset portfolio, amounting to 35% and 27%, respectively, of the GLP as of March 2024. ICRA notes that AU has more than two decades of experience in the vehicle finance segment and more than a decade of

experience in the MSME segment. It has been expanding its product offerings gradually over the years and added new products like gold loans, home loans, agri-SME loans, personal loans, consumer durables, etc. The merger with Fincare has aided in the further improvement of AU's scale and diversification with microfinance becoming one of its major product segments (8% share of proforma merged GLP).

Further, ICRA notes that AU's asset quality has remained comfortable and the GNPA's were reported at 1.67% as on March 31, 2024 (net NPAs of 0.55%). However, the bank's ability to maintain the asset quality as it scales up the aforementioned relatively newer segments and diversifies into other segments remains monitorable.

Comfortable capitalisation profile – The bank's CAR of 20.1% (Tier I: 18.8%), as on March 31, 2024, was well above the regulatory requirement of 15.0% (Tier I: 7.5%). Also, ICRA draws comfort from AU's demonstrated track record of capital raising. The bank last raised ~Rs. 2,000 crore of equity capital in FY2023 through a qualified institutional placement, which helped it maintain a comfortable capitalisation profile while scaling up its portfolio. In ICRA's opinion, AU is fairly capitalised to support its envisaged growth in the near to medium term.

Adequate earnings profile – The bank has been able to maintain an adequate earnings profile, supported by healthy yields and contained credit costs. However, its net interest margin deteriorated in FY2024 following the increase in the cost of funds. The cost of funds¹ rose to 6.4% in FY2024 from 5.6% in FY2023 because of the hike in the deposit rates amid rising interest rates. The operating expenses also increased because of merger-related expenses and higher employee benefit expenses. Credit costs remained comfortable in FY2024 despite being higher than FY2023.

While the overall profitability deteriorated in FY2024 with the bank reporting a RoA of 1.5% and return on net worth (RoNW) of 13.0% (1.8% and 15.4%, respectively, in FY2023), it remains adequate. The earnings profile is expected to be positively impacted by the merger with the addition of Fincare's relatively higher-yielding microfinance portfolio (as on March 31, 2024, the proforma merged RoA and RoNW stood at 1.7% and 14.2%, respectively). ICRA expects the bank to maintain an adequate earnings profile, supported by range-bound credit costs and the gradually improving operating efficiency as it continues to scale up its operations.

Credit challenges

Relatively moderate CASA and retail deposits – AU has successfully built a large deposit base, constituting 94% of its external borrowings² as on March 31, 2024, up from 72% as on March 31, 2020. The overall deposit base increased to Rs. 87,182 crore as on March 31, 2024 from Rs. 69,365 crore as on March 31, 2023 (proforma merged deposits stood at Rs. 97,704 crore as on March 31, 2024). Also, AU's focus has been on building a stable retail deposit franchise. However, the share of CASA remained relatively low at 33% as on March 31, 2024 (38% as on March 31, 2023) and the share of bulk deposits was relatively high at 34%.

Environmental and social risks

Environmental considerations – Given AU's service-oriented business, its direct exposure to environmental risks as well as those stemming from regulations or policy changes is not material. While the bank is not materially exposed to physical climate risks, it indirectly encounters environmental risks through its portfolio of assets. Further, its lending typically involves short-to-medium-term durations, enabling it to adjust and incrementally invest in less environmentally vulnerable businesses.

Social considerations – Data security and customer privacy are among the key sources of vulnerability for AU, as any material lapse could be detrimental to its reputation and could invite regulatory censure. Customer preference is increasingly shifting towards digital banking, which provides an opportunity to reduce the operating costs. However, subpar execution of information technology strategies and the inability to meet the customers' requirements adequately may result in more costs

¹ ratio as per ICRA calculation

² Including deposits

than benefits. On the positive side, AU contributes to the enhancement of financial inclusion by providing several products and services that are specifically targeted towards the marginalised sections of society and attempts to address and cater to social concerns. Prudent lending to such under-served segments could create growth opportunities. However, these opportunities must be seen in conjunction with asset quality risks that could impact the bank's credit quality.

Liquidity position: Strong

The average liquidity coverage ratio was healthy at 117% for the quarter ended March 31, 2024 (123% for the quarter ended December 31, 2023). The net stable funding ratio (NSFR) stood at 117% as on March 31, 2024 remaining above the regulatory level of 100%. Its liquidity profile is supported by the strong borrowing ability on account of its 'scheduled' status and healthy deposit renewal rate. The liquidity profile is also supported by the availability of funding lines from financial institutions.

Rating sensitivities

Positive factors – A significant scale-up in the operations and improvement in deposit granularity, while maintaining healthy profitability and prudent capitalisation, could positively impact the rating.

Negative factors – Deterioration in the asset quality or profitability (RoA below 1.2%) on a sustained basis could negatively impact the rating. A decline in the capital cushions to less than 3% in relation to the Tier I regulatory levels on a sustained basis could also negatively impact the rating.

Analytical approach

Analytical approach	Comments
Applicable rating methodologies	ICRA Rating Methodology for Banks and Financial Institutions
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financial profile of the bank

About the company

AU Small Finance Bank (AU) is a scheduled commercial bank, which transitioned to a small finance bank (SFB) from an asset financing non-banking financial company (NBFC). While it was incorporated in 1996 as an NBFC, it commenced SFB operations on April 19, 2017 after receiving the final licence on December 20, 2016. The Reserve Bank of India (RBI) had granted in-principle approval in September 2015. AU got listed on the stock exchanges in July 2017 and was granted scheduled commercial bank status in November 2017.

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, it raised equity from private investors at regular intervals and expanded its product portfolio. AU has an established market position in Rajasthan and has expanded its operations to Maharashtra, Gujarat, and other states over the years. As of March 31, 2024, it had 1,074 touchpoints across 24 states and Union Territories.

AU operates in the retail asset financing segment, with the vehicle financing segment accounting for ~35% of its GLP as on March 31, 2024. Its product portfolio also includes micro business loans, home loans, loans to NBFCs, loans to real estate groups, business banking, agri-banking, credit cards, personal loans, etc. AU's liability product offerings include current accounts, savings accounts, recurring & term deposits, transaction banking, and insurance covers among others.

AU reported a profit after tax (PAT) of Rs. 1,535 crore on a total asset base of Rs. 1,09,426 crore in FY2024 compared to a PAT of Rs. 1,428 crore on a total asset base of Rs. 90,216 crore in FY2023. As of March 31, 2024, the net worth stood at Rs. 12,560 crore with a reported capital adequacy of 20.1%.

Key financial indicators (audited)

AU Small Finance Bank Limited	FY2022	FY2023	FY2024*
Accounting as per	IGAAP	IGAAP	IGAAP
Total income	6,915	9,240	12,301
Profit after tax	1,130	1,428	1,535
Total assets	69,078	90,216	1,09,426
CET I	19.7%	21.8%	18.8%
CRAR	21.0%	23.6%	20.1%
PAT/ATA (RoA)	1.9%	1.8%	1.5%
Gross NPAs	1.98%	1.66%	1.67%
Net NPAs	0.50%	0.42%	0.55%

Source: Bank, ICRA Research; All ratios as per ICRA's calculations; *Limited review; 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 (FY2025)				Rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as of Apr 30, 2024 (Rs. crore)*	Date & Rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				May 17, 2024			
1 Lower Tier II bonds	Long term	360.00	334.00	[ICRA]AA (Stable)	-	-	
2 Sub-debt	Long term	-	-		-	-	[ICRA]AA-(Stable); withdrawn
3 NCD	Long term	-	-		-	-	[ICRA]AA-(Stable); withdrawn

*Source: Bank

Complexity level of the rated instruments

Instrument	Complexity Indicator
Lower Tier II bonds	Highly complex

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 analysing 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 are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE519Q08152	Lower Tier II bonds	Sep 30, 2019	12.87%	Sep 30, 2025	100.00	[ICRA]AA (Stable)
INE519Q08160	Lower Tier II bonds	Jun 15, 2023	10.75%	Dec 15, 2028	49.00	[ICRA]AA (Stable)
INE519Q08178	Lower Tier II bonds	Jul 5, 2023	10.75%	Jan 5, 2029	75.00	[ICRA]AA (Stable)
INE519Q08186	Lower Tier II bonds	Aug 09, 2023	10.75%	Feb 9, 2029	50.00	[ICRA]AA (Stable)
INE519Q08194	Lower Tier II bonds	Aug 23, 2023	10.70%	Feb 23, 2029	60.00	[ICRA]AA (Stable)
To be issued	Lower Tier II bonds	NA	NA	NA	26.00	[ICRA]AA (Stable)

Annexure II: List of entities considered for consolidated analysis

Not applicable

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About ICRA Limited:

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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.

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