Au Small Finance Bank Ltd

Issue Snapshot:

Issue Open: June 28 – June 30 2017

Price Band: Rs. 355 – 358

Issue Size: 53,422,169 Equity Shares (entirely offer for sale – employees reservation 1,000,000 eq shares)

*Offer Size: Rs.1912.5 crs

QIB	upto	50% eq sh
Retail	atleast	35% eq sh
Non Institutional	atleast	15% eq sh

Face Value: Rs 10

Book value: Rs 70.34 (Mar 31, 2017)

Bid size: - 41 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity: Rs. 284.25 cr
Post issue Equity: Rs.284.25 cr

Listing: BSE & NSE

Book Running Lead Manager: ICICI Securities, HDFC Bank, Motilal Oswal Investment Advisors & Citigroup Global Markets

Registrar to issue: Link Intime India Pvt Ltd

Shareholding Pattern

Shareholding Pattern	Pre issue %	Post issue %
Promoters & Promoter Group	36.03	32.87
Public (incl institutions & employees)	63.97	67.13
Total	**100.0**	**100.0**

*= assuming pricing at the higher end of price band

Background & Operations:

AU Small Finance Bank (AUSFB) has recently transitioned from a prominent, retail focused non-banking finance company (NBFC), which primarily served low and middle-income individuals and businesses that have limited or no access to formal banking and finance channels. It received a license from the Reserve Bank of India to set up an SFB on December 20, 2016 and was the only NBFC categorized as an asset finance company to obtain such license. It commenced SFB operations with effect from April 19, 2017. Prior to such date, it was categorized as a "Systemically Important, Non-Deposit Accepting Asset Finance Company" (NBFCND-AFC) by the RBI.

AUSFB had commenced operations in 1996 in Jaipur, Rajasthan and was registered as an NBFC with the RBI in 2000. In 2005, it became a commercial associate of HDFC Bank for originating and servicing vehicle loans which assisted the company in the implementation of various processes and systems. It expanded its product portfolio to include MSME loans in 2007, housing finance in 2011 (sold in 2016) and SME loans in 2012, to cater to the evolving needs of customers. As an NBFC, AUSFB operated in three business lines: vehicle finance; micro, small and medium enterprises (MSME) loans; and small and medium enterprises (SME) loans.

As it commenced its SFB operations, it has expanded and strengthened its business model to offer working capital facilities, gold loans, agriculture related term loans, Kisan credit cards for farmers and loans against securities. The liability product offerings include current accounts, savings accounts, term deposits, recurring deposits and collections and payments solutions for MSME and SME customers. It is leveraging on its asset-based lending strengths, NBFC customer base and cost efficient, technology driven hub and spoke branch operating model to successfully operate as a SFB.

The vehicle finance business extends loans for the purchase of new and pre-owned vehicles and for refinancing of vehicles, which are primarily used for revenue generating activities with a tenure of upto five years. MSME business extends loans to MSMEs primarily for business expansion, working capital and the purchase of equipment while SME loans business extends loans to several types of small and medium sized businesses. The average ticket size for the three business segments in 2017 were Rs 3.4 lakhs, Rs 10.8 lakhs and Rs 2.2 cr respectively with 98.99% of the receivables secured. AUSFB has adopted a strategy of contiguous expansion across regions and as of May 31, 2017, its operation were conducted through 269 branches, 121 asset centers, one central processing center and 10 offices. In addition, it plans to set up an additional 162 branches and seven central processing centers during the financial year 2018.

Objects of Issue:

The objects of the offer are to achieve the benefits of listing the equity shares on the Stock Exchanges and for the Offer for Sale of 53,422,169 equity shares. AUSFB expects that listing of the equity shares will enhance its visibility and brand and provide liquidity to its existing shareholders. Listing will also provide a public market for the equity shares in India. The offer entirely comprises of an Offer for Sale and AUSFB will not receive any proceeds from the Offer for Sale. All proceeds from the Offer will go to each of the Selling Shareholders, in proportion to its portion of the Offered Shares.

Competitive Strengths:

Diversified product portfolio and revenue streams: AUSFB is a retail focused, technology driven SFB with a diversified portfolio of financial products. Its asset products primarily include vehicle finance loans, MSME loans and SME loans.

Vehicle Finance loans: Under vehicle finance it extends loans for new and pre-owned vehicles and for refinancing of vehicles across several categories including: (i) multi-utility vehicles (MUVs); (ii) cars; (iii) small commercial vehicles; (iv) light commercial vehicles; (v) medium and heavy commercial vehicles; (vi) tractors; (vii) three-wheelers; (viii) two-wheelers; and (ix) construction equipment. It had started operations with this segment in 1996 and accounted for 50.3% of its AUM at the end of FY17.

MSME loans: It introduced MSME loans business in 2007 to cater to the emerging needs of underserved customers. It extends loans to MSMEs primarily for business expansion, working capital and purchase of equipment. At the end of FY17, MSME loans constituted 30% of the gross AUMs. All the MSME loans are secured by immovable property.

SME loans: SME loans business was started in 2012 and extends loans to several types of small and medium sized business. It accounted for 19.8% of Gross AUMs at the end of FY17 and are secured by immovable property. Loans below Rs 50 lakhs are considered as MSME loans while those above are categorized as SME loans.

As on FY17	AUM (Rs Cr)	AUM share (%)	Avg. ticket size (Rs lakh)	Loan tenure (yrs)	5-yr CAGR (%)
Vehicle Finance	5396	50.3	3.4	upto 5 yrs	21.2
MSME loans	3216	30.0	10.8	upto 12 yrs	64.8
SME loans	2122	19.8	219.2	upto 15 yrs	56.1

Post the transition from NBFC to SFB it has added products like working capital facilities, gold loans, agriculture related term loans and Kisan credit cards for farmers and loans against securities. It intends to commence offering unsecured business loans and housing finance loans during the financial year 2018. On the liability side it is offering current accounts, savings accounts, term and recurring deposits and collections and payments solutions for MSME and SME customers. In FY18 it intends to commence offering payment wallets and customized prepaid instruments.

Subject to regulatory approvals it also plans to engage in the sale of third party investment products such as mutual funds, insurance and risk management products, as well as offer financial advisory and education programs for individual and new entrepreneurs.

Customer centric organizational commitment: AUSFB has built itself as a customer centric organization and serviced 280,349 active loan accounts as of FY17. Utilizing its knowledge of local markets AUSFB has developed strong relationships with customers by addressing their financial needs through in-person contact and widespread network of branches. Interactions with customers are primarily undertaken by our own employees. As part of our customer-centric approach, we have undertaken the several steps like (i) hiring local personnel to ensure better understanding of customers in that region and their requirements, (ii) establishing relationships with vehicle manufacturers and dealers with whom it enters into preferred financing arrangements from time to time, (iii) setting up call centres to primarily generate new business, while also focusing on customer service and collections and (iv) conducting referral and other programmes offering incentives to employees who refer their family and friends and sales team to cross sell products to the same customer.

Significant presence in rural and semi-urban markets with focus on low and middle income customers: AUSFB has over 20 years of operating experience in rural and semi-urban markets of India with ~50% of its erstwhile 301 NBFC branches located in such markets. AUSFB has successfully adopted a strategy of contiguous expansion across regions, which has enabled it to increase its customer base in the 10 states and one union territory in which it operates. A large segment of India's rural and semi-urban population is currently unserved and underserved by formal financial institutions. According to the Global Findex Database 2014, India is home to 21% of the world's unbanked adults and approximately two-thirds of South Asia's. Over the years, AUSFB has focused on customers in such markets, particularly those without a credit history, that provide significant growth opportunities. The widespread reach through its branches and understanding of the local characteristics has enabled the company to penetrate deeper into such markets.

The NBFC branch network was structured along a two-tiered hub-and-spoke model with 55 of our branches classified as hubs and 246 as spokes which AUSFB has leveraged to set up 269 branches, 121 asset centers, one central processing center and 10 offices for its SFB operations. Through its decentralized model, it has been able to optimize turn around times for customers while managing our credit requirements and associated risks.

Robust and comprehensive credit assessment and risk management framework: Credit management is crucial to the business since a significant number of customers are from the unserved or underserved financial segment and primarily first-time purchasers of financial products. AUSFB has a robust and comprehensive credit assessment and risk management framework to identify, monitor and manage risks inherent in its operations. It has set up separate credit teams for key business lines of vehicle finance, MSME loans and SME loans which conduct an independent verification of customers and evaluate their business and financing needs, and analyze their ability to repay loans. In vehicle finance and MSME business loans are primarily disbursed towards revenue generating assets, which results in lower risk.

The effective credit risk management is reflected in our portfolio quality indicators such as high repayment rates, and low rates of GNPAs and NNPAs across business and economic cycles. At the end of FY17 GNPA stood at 1.61% while NNPA were 1.05% of advances. As an SFB, it has enhanced our risk management framework by setting up a Risk Management Committee of the Board and an IT & Operational Risk Management Committee as well as introduced new internal audits to ensure rigorous monitoring and compliance.

Access to diversified sources of funding: AUSFB has set up a Treasury department that is responsible for fund raising and asset liability management, minimizing the cost of our borrowings, liquidity management and control, diversify fund raising sources, managing interest rate risk and investing funds in accordance with the criteria set forth in investment policy. Prior to the commencement of our SFB operations, our sources of liquidity included term loans and working capital facilities; proceeds from loans assigned and securitized; proceeds from the issuance of non-convertible debentures (“NCDs”) and commercial paper; and subordinated debt borrowings from banks, mutual funds, insurance companies and other domestic and foreign financial institutions. As an SFB, it will be able to access funds such as savings accounts, current accounts, term and recurring deposits and other market sources available to small finance banks. However, it will be unable to raise secured borrowings from banks and financial institutions or raise funds from the issuance of secured NCDs as a result of transitioning to an SFB.

As of FY17, its total borrowings stood at Rs 7071 cr comprising of 50% of NCDs, 32.9% of term loans, 6.8% of commercial paper, 4.7% of sub-ordinated debt and 5.6% of working capital facilities. Over the four year period from FY13-17 its average cost of borrowing has improved by 248 bps from 12.6% in FY13 to 10.1% in FY17 and long term credit rating has improved from ‘ICRA A (Stable)’ to ‘ICRA A+ (Stable)’.

Experienced management team and qualified operational personnel: AUSFB has an experienced management team having diverse experience in a range of financial products and functions related to our business and operations. The managers have an in-depth understanding of the geographic regions, loan products and types of collateral and businesses of borrowers. Key Management Personnel have been with the company for an average of over 15 years. In connection with the transition to an SFB, it has undertaken an extensive recruitment drive focusing on growing the team at all levels of management and employees.

Business Strategy:

Leverage existing capabilities and customer base: The company intends to leverage existing capabilities as a former asset finance NBFC including branch network, customer base, technology driven, low cost hub-and-spoke model and local know-how in the geographical areas for SFB operations. It was the only NBFC categorized as an asset finance company to obtain such license from RBI in Dec-2016. As an SFB it is looking to strategically expand operations by offering a diverse suite of banking products and services at its branches. It has developed and set up additional branch architecture, improved technology backbone for SFB operations in a phased manner and established consumer branch footprint in the geographical regions in which it conducted its NBFC operations. The focus will continue on go-to-market approach to increase customer base, implement customer reach programs and encourage all NBFC customers to open bank accounts.

Grow SFB branch network in existing markets: As of May-2017, AUSFB conducted its operations through 269 branches, 121 asset centers, one central processing center and 10 offices in 10 states and one union territory in India. While historically most of the operations were focused in Rajasthan, Gujarat and Maharashtra, it has grown its operations in relatively newer contiguous markets such as Madhya Pradesh, Punjab, Haryana, the National Capital Region and Himachal Pradesh. It intends to continue expanding branch network to drive greater and deeper penetration in the western and northern states of India, focusing on low and middle income individuals and businesses that have limited or no access to formal banking and finance channels, spread across rural, semi-urban and urban markets. It has converted 121 of its NBFC branches into asset centers where it offers vehicle finance, MSME and SME loans and plans to gradually open 162 additional branches in FY18 to reach 431 branches and 121 asset centers at the end of FY18.

Provide a comprehensive suite of banking services: As part of the SFB business AUSFB has commenced offering a broad range of banking and financing products and services beyond the previous business lines. It offers additional asset products such as working capital facilities, gold loans, agriculture related term loans, Kisan credit cards for farmers and loans against securities and plans to provide unsecured business loans and housing finance loans during the financial year 2018. The liability product offerings include current accounts, savings accounts, term deposits and recurring deposits, payment wallets and customized prepaid instruments and collections and payments solutions for MSME and SME customers. Subject to regulatory approvals it also intends to sell mutual funds, insurance and risk management products and provide financial advisory services.

Leverage technology to grow business: AUSFB has upgraded, and intends to continue to upgrade technology systems with automated, digitized and other technology-enabled platforms and tools, to strengthen banking and financing initiatives and derive greater operational, cost and management efficiencies. It has entered into agreements with several IT companies to assist in setting up IT infrastructure for SFB operations. Going forward, it intends to explore delivering services through alternate digital channels such as secure online banking, mobile banking, digital wallets and online loan processing and credit approvals. Greater adoption of our digital service delivery mechanisms will enable AUSFB to be more efficient, customer friendly and over time perform more reliable data analytics, resulting in target customer profiling, customized and tailor-made products to suit the diverse requirements of customers and improved customer satisfaction.

Enhance brand presence: AUSFB seeks to leverage and enhance its brand to build our presence in the banking sector and develop new customer and industry relationships beyond the existing business lines. It may explore opportunities to enter into strategic as well as service-level collaborations for customer aggregation and servicing, to take SFB to the customer and thereby build and expand network of branches and increase penetration of the non-institutional depositor and customer base. Further it is looking to continuously engage with existing and potential customers through customer literacy programs, sponsor popular events in the operational regions and place advertisements in newspapers, on the radio and in other advertising media.

Industry:

Vehicle Finance Industry

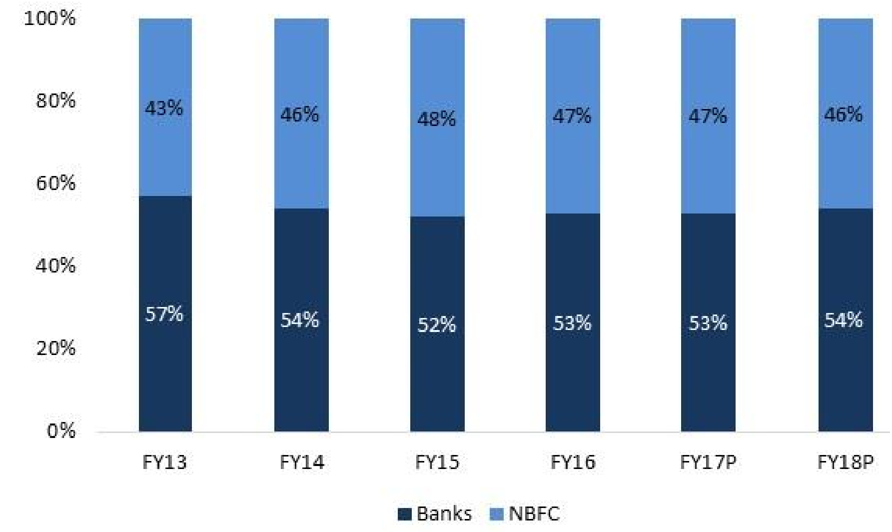
As a result of low fuel prices, interest rates cuts and an increase in demand from the mining and construction sectors, automobile sales grew by 8% during the financial year 2016. The vehicle finance industry grew by 13% during the same period, reaching a value of Rs 4,738 billion due to an increase in new commercial vehicle disbursements, a recovery in new private vehicle disbursements and muted growth in used vehicle loans. The growth outlook for vehicle finance remains positive due to a continued fall in fuel prices and inflation, as well as improving income growth.

Growth rates for sales of vehicles

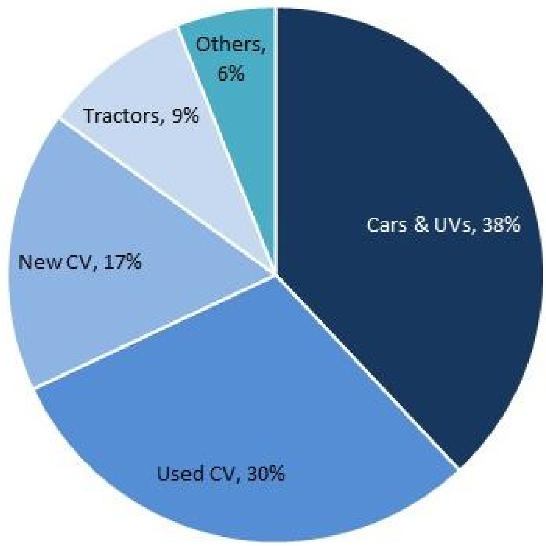
Category of Vehicle	FY13	FY14	FY15	FY16	FY17P	FY18P
Medium and Heavy Commercial Vehicles	-23%	-27%	21%	32%	1%	2%
Light Commercial Vehicles	14%	-18%	-13%	-1%	7%	6%
Cars	-8%	-5%	5%	7%	6%	7%
Utility Vehicles	32%	-9%	1%	9%	20%	8%
Two-Wheelers	3%	7%	8%	4%	11%	9%
Tractors	-2%	20%	-13%	-10%	17%	10%

NBFCs have increased their market share in the vehicle finance industry from an estimated 40% for the financial year 2012 to 47% for the financial year 2016. This growth is partially due to NBFCs developing stronger risk management capabilities and a better understanding of their customers, and consequently being able to serve customers that banks do not have the risk appetite to cater to. These customers, many of whom may have weaker credit profiles, include small fleet operators, first time buyers, first time users and used vehicle buyers.

NBFCs' share in vehicle finance



Portfolio break-up of auto finance NBFCs



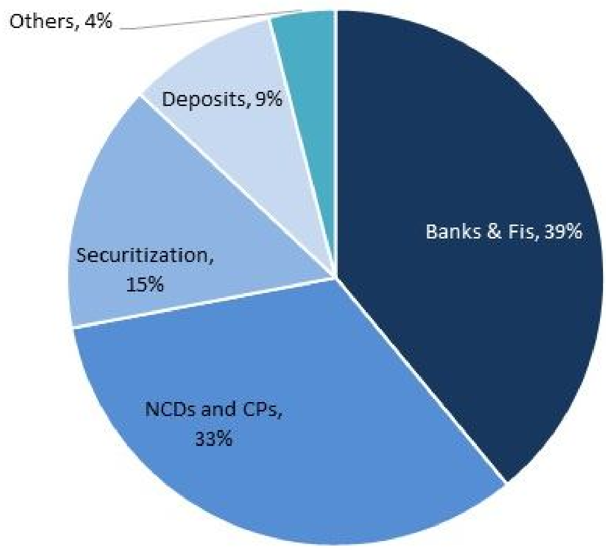
Comparison of key operating metrics across different segments in vehicle finance

Category of Vehicle	Indicative yields	Gross NPA	Comments
Used cars and UV	15% - 18%	2 – 2.5%	Attractive for financiers due to higher margins; Disbursement growth to moderate going forward; GNPAs higher in new cars and utility vehicles due to relatively weaker borrower profile.
New cars and UV	11% - 13%	0.5% - 1.5%	Profitability of car and used vehicle financiers to remain stable in the short term; Loan disbursement growth to be higher on account of higher LTV and sales growth; Despite early recognition of NPA norms, NBFCs are expected to limit their credit costs with better monitoring and recovery mechanisms.
Used CV	17 – 20%	3.5% - 4.5%	Used commercial vehicle sales to grow by 6%;
New CV	13% - 15%	3.5% - 4.0%	New commercial vehicle disbursements expected to increase at a much faster rate in the Financial Year 2017 due to higher competition, growth in MHCV sales and higher vehicle prices.
Tractors	18% - 20%	5.5% - 6.0%	Inherent risk in tractor financing keeps delinquencies high; Tractor financing to grow at a 14% CAGR over the next two years.

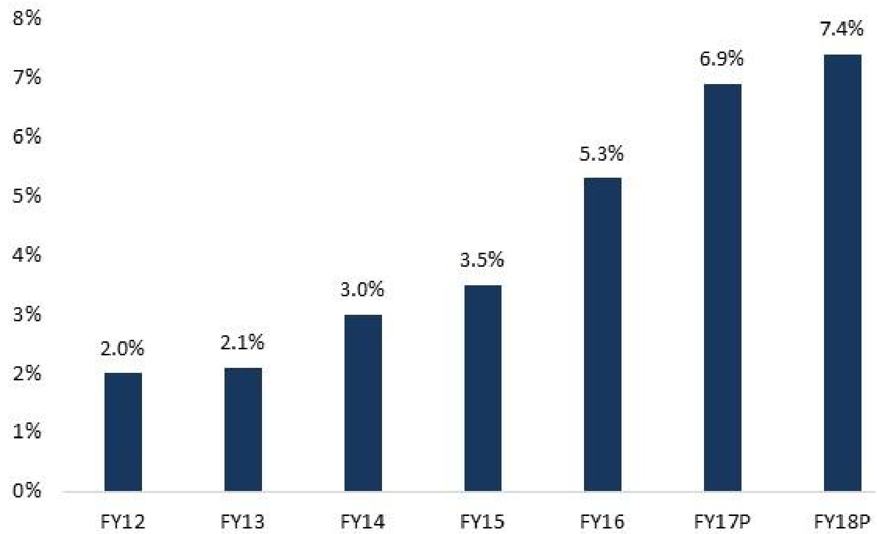
Vehicle finance NBFCs largely depend on wholesale borrowings from banks and financial institutions, which constituted 39% of their total borrowings for the financial year 2016. All major NBFCs have good credit ratings, so their debt instruments are well accepted across various investor classes such as banks, insurance companies and mutual funds. On account of strong credit ratings, their spreads over government securities are lower, keeping their cost of borrowings low. Vehicle finance NBFCs have also lowered their cost of borrowings by increasing their share of market borrowings through commercial papers and non-convertible debentures. It is expected that NBFCs will expand their operations steadily, claiming more market share from unorganized financiers and money-lenders.

However, RoA for vehicle finance NBFCs is expected to fall during the FY17 on account of higher credit cost and to remain at low levels till the FY18. Asset quality is also expected to deteriorate during FY17 as collection efficiency will be severely impacted in the short term post demonetization since over 40% of the industry's collections are in cash. Further, the Gross NPA levels will remain elevated till FY18 despite a growth in economic activity, as the industry moves to a 90 days past due policy by the FY18.

Funding sources for vehicle finance NBFCs



GNPAs for vehicle finance NBFCs



Some of the key risks for vehicle finance NBFCs include the changing regulatory framework and higher provisioning requirements that will impact profitability and increase competition, particularly from banks. New vehicle financing is expected to be the key growth driver for vehicle finance NBFCs in the short term. As private spending is expected to increase, sales growth of new light commercial vehicles is expected to turn positive. Tractor sales are expected to grow in double digits, and cars and utility vehicle sales are expected to grow at a CAGR of 7% and 14%, respectively, between the financial years 2016 and 2018.

MSME Finance Industry

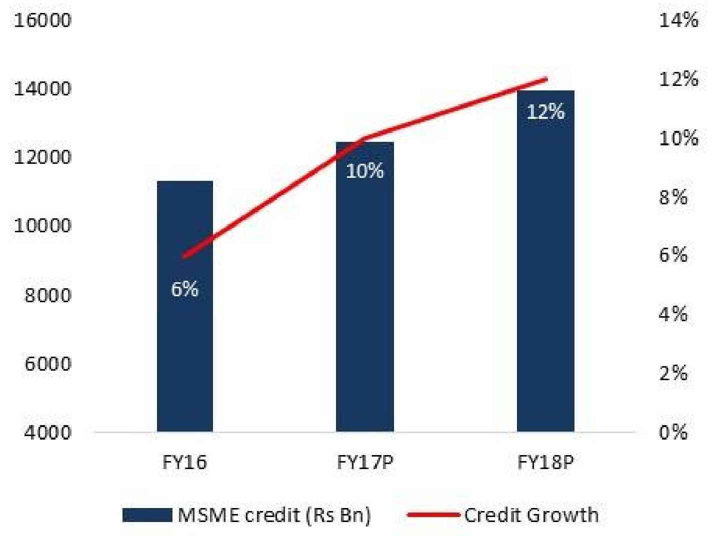
Micro, small and medium enterprises (MSMEs) are key parts of the Indian economy, accounting for an estimated 45% of India's manufacturing output and 40% of total exports for the financial year 2016. The RBI defines MSMEs in line with the Micro, Small and Medium Enterprises Development Act, 2006. The following table sets forth the RBI classification of MSMEs:

Investment in plant and machinery		
	Manufacturing	**Services**
Micro	Below Rs 25 lakhs	Below Rs 10 lakhs
Small	Rs 25 lakhs – Rs 5 crore	Rs 10 lakhs – Rs 20 lakhs
Medium	Rs 5 crore – Rs 10 crore	Rs 20 lakhs – Rs 50 lakhs

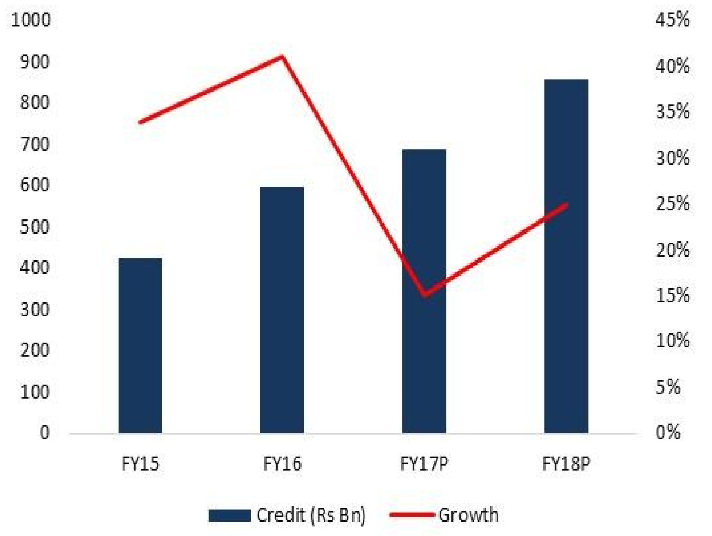
The number of MSMEs has been growing between 4% and 5% over the past five to six years. MSME credit rose at a CAGR of 11% between the financial years 2012 and 2016, as organized financiers increased their focus on MSME finance. MSME credit is further expected to grow 10 to 12% annually over the next two years (this does not include the impact of demonetization). This growth is partly fueled by a recovery in the economy that has resulted in significant unmet demand for credit in the MSME sector. MSME lending in banks' loan portfolios has increased steadily since the financial year 2013, with the segment comprising approximately 25% of the total credit disbursed to corporates in the financial year 2016. Traditionally, public sector banks held the dominant share of the MSME lending space. However, their share has contracted over the past four to five years as private banks and NBFCs have increased their presence in Tier-II and lower centers.

With increasing penetration, NBFCs have grown their share in overall MSME credit over the past 4 to 5 years. Presence in untapped territories has helped NBFCs reach out to unorganized sectors. System and process innovation, superior product delivery and a focus on relationship building have resulted in improved operating efficiency of NBFCs. NBFCs have strengthened their presence in non-metros, Tier-II and Tier-III cities. NBFCs are expanding their MSME loan book and targeting new customers. Growth will also be supported by better customer reach, faster documentation and NBFCs having a higher risk appetite. In addition, NBFCs loan books are growing as they replace credit typically extended by the unorganized sector. NBFCs are also attracting bank customers by offering higher loan amounts, a shorter turnaround time, greater market penetration and better operating efficiency.

MSME Credit



NBFC MSME loan book growth



Due to higher yields and strong appraisal and collection systems, NBFCs have a net profitability of 4%. Operating expenditure is high for financiers given the relatively low ticket size, making it imperative for them to have a workforce that is capable of soliciting new business as well as appraising and collecting payments. Increasing GNPAs and competition may result in a medium-term reduction in profitability.

Government initiatives in MSME lending

Initiative	Objective	Progress
Pradhan Mantri MUDRA Yojana	Provide collateral free credit up to Rs 1 million to proprietorships and partnership firms engaged in small businesses	Loans of approximately Rs 1.37 trillion disbursed in financial year 2016. Target for financial year 2017 is Rs 1.8 trillion, of which Rs 0.25 trillion has been disbursed.
Small finance banks	To improve credit availability for the unserved and underserved sections. Regulation stipulates 75% priority sector lending and 50% of loans being less than Rs 2.5 million	RBI has given in-principle approval to 10 applicants to set up small finance banks, 8 of which are microfinance institutions already serving weaker sections and small, unorganized entrepreneurs.
Trade receivables discounting system (TReDS)	Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporate and other buyers through multiple financiers	RBI has given in-principle approval in November 2015 to three applicants to set up and operate TReDS
Udyog Aadhaar	Notified in September 2015 to improve ease of doing business and encourage	Approximately 1.09 million Udyog Aadhars issued.

	registration of MSMEs One-page registration form through which an MSME self-certifies incorporation, and provides bank account, business activity, employment and ownership, and other basic information	Approximately 5 million MSMEs registered.
Launch of two MSME specific funds under Small Industries Development Bank of India (SIDBI) in August 2015 with total allocation of Rs 120 billion	India Aspiration Fund: Fund that will invest in various venture capital funds and help meet the equity requirement of MSME start-ups. SIDBI's "Make in India" loan for small enterprises: loans to help MSME	NA
Online employment exchange	Online employment exchange (www.eex.dcsme.gov.in) launched in June 2015 for enterprises in manufacturing segment and job-seekers Aimed at improving access to skilled labor for MSMEs	NA

Small Finance Banks

In 2014, the RBI released a set of draft guidelines for the licensing of small banks in the private sector, issuing requirements relating to size, area of operations, exposure norms and regulatory prescriptions. These small finance banks (SFBs) were intended to be set up to encourage financial inclusion in unbanked and under-banked regions. (Source: Guidelines for Licensing of Small Finance Banks in the Private Sector, available at https://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2901). The RBI issued in-principle approval for the set-up of 11 payments banks and ten SFBs in 2015.

SFBs are intended to primarily cater to provision of savings vehicles for the unserved and underserved sections of the population. They also help supply credit to small business units and micro and small industries through high technology and low cost operations. SFBs can also under take other simple financial services activities, such as the distribution of mutual fund units, insurance products and pension products. The minimum paid-up equity capital for SFBs is Rs 100 crore.

The entities eligible to set up an SFB include resident individuals or professionals with ten years of experience in banking and finance, companies and societies, existing NBFCs, microfinance institutions and local area banks. SFBs are subject to all prudential norms and RBI regulations applicable to existing commercial banks, including the requirement to maintain cash reserve ratio and statutory liquidity ratio. They are also required to have 25% of all branches in unbanked rural centers within one year from the data of commencement of operations. The priority sector lending requirement for SFBs is 75% of adjusted net bank credit, which is considerably higher than the 40% requirement for small commercial banks. At least 50% of an SFB's loan portfolio should constitute loans and advances of a size up to Rs 25 lakhs. (Source: Operating Guidelines for Small Finance Banks available at https://rbi.org.in/Scripts/NotificationUser.aspx?ID=10636).

Key differences between universal banks and SFBs

Parameters	Universal Banks	Small Finance Banks
Minimum Networth	Rs 500 crore	Rs 100 crore
Promoters Shareholding	Non-operative Financial Holding Company ("**NOFHC**") shall hold a minimum of 40% of the paid-up voting capital of the bank, which shall be locked in for a period of 5 years	Minimum promoter shareholding of 40%, which will be locked in for a period of five years. If the existing NBFCs, MFIs or LABs have diluted the promoter shareholding, it should be at least above 26%.
Timeframe for Dilution of Promoters'	Shareholding of NOFHC to be brought down to 20% of the paid-up voting equity capital	If the initial shareholding by promoter in the bank is above 40%, it should be brought

Equity	within a period of 10 years and to 15% within 12 years	down to 40% within a period of 5 years, 30% within a period of 10 years, and to 26% within 12 years
Maximum Foreign Shareholding	Cannot exceed 49% of the paid-up voting equity capital for the first 5 years from the date of licensing of the bank. After 5 years, it will be as per FDI policy for private sector banks	Aggregate foreign investment in an SFB will be allowed up to a maximum of 74% (automatic up to 49% and approval route beyond 49 % to 74%)
Maximum Shareholding of Entities Other than Promoter or NOFHC	No single entity or group of related entities, shall have directly or indirectly in excess of 10% of the voting equity capital of the bank	No single entity or group of related entities shall have shareholding in excess of 10% of the paid-up equity capital of the bank. In case of existing NBFCs, MFIs or LABs converting into an SFB, where there is shareholding in excess of 10% of the paid-up equity capital by entities other than the promoters, RBI may consider providing up to 3 years for the shareholding to be brought down to 10%
Listing Requirement	Within 3 years of commencement of business by the bank.	After the SFB reaches the net worth of ` 5 billion, listing will be mandatory within three years
Capital Adequacy Norm	13% for first three years of commencement of operations	15% (under Basel II standardized approach for credit risk)
Tier 1 Capital	7%	7.5%
Exposure Norms	Single borrower: 15% (additional 5% for infrastructure) Borrower group: 40%/50% (additional 10% for infrastructure) Additional 5% exposure allowed post board approval For Oil Marketing Companies: 25% of capital funds	Single borrower: 10% of capital funds Group Borrower: 15% of capital funds Further, at least 50% of the loan portfolio should constitute loans and advances of up to ` 2.5 million
Priority Sector Lending	40% of the adjusted net bank credit must be extended to sectors eligible for classification as PSL.	75% of the adjusted net bank credit must be extended to sectors eligible for classification as PSL
CRR/SLR Requirements	CRR: 4.0% of NDTL; SLR: 21.5% of NDTL	CRR: 4.0% of NDTL; SLR: 21.5% of NDTL

Key Challenges and Progress

Transitioning into an SFB presents several challenges, including meeting equity requirements for growth and regulatory norms. As of October 2016, eight SFB licensees have raised an aggregate amount of Rs 2500 crore of equity year to year to date Financial Year 2017. With entities raising fresh equity to meet foreign shareholding norms, a significant part of the equity required for growth and complying with regulatory norms has already been met.

Maximum foreign shareholding and promoter shareholding regulations also present SFBs with challenges. In order to address these challenges, SFB in-principle licensees raise domestic equity to bring foreign shareholding down to below 50%, and plan to follow holding company structures. Over the past twelve months, licensees have been in the process of implementing IT systems, setting up branches and new personnel. Most licensees are in the process of obtaining funds from non-bank sources such as non-convertible debentures and re-financing from SIDBI and NABARD.

Of the ten entities awarded in-principle SFB licenses, two entities have already commenced operations as SFBs, while various entities have applied to the RBI for their final license, suggesting that some of the regulatory challenges of the transition have been addressed.

Key Concerns:

Inability to successfully transition from an NBFC to an SFB: AUSFB received a license to set up an SFB on December 20, 2016 from the RBI and commenced SFB operations with effect from April 19, 2017. However, it has no operating history or experience as an SFB and as such are exposed to several risks and uncertainties, including an inability to: introduce and manage new product and service offerings; maintain asset quality; create value propositions to attract and retain customers and cross-sell SFB products to them; attract deposits from retail and corporate customers; set-up and update our information technology systems for our SFB operations; etc. The transition period could have an adverse effect on business, results of operations, financial condition and cash flows.

Unable to access some of the sources of funds that were available as an NBFC: The business and results of operations depend on our ability to raise funds from various external sources on suitable terms and in a timely manner. However, as an SFB, we will be unable to raise secured borrowings from banks and financial institutions or raise funds from the issuance of secured NCDs. Further, as an SFB, it would require to extend 75% of adjusted net bank credit ("ANBC") to the sectors eligible for classification as PSL and therefore may need to limit securitizations and assignments to comply with such requirement. In addition, money market and interbank borrowings will only be available once it becomes a scheduled commercial bank, which will require additional time after the commencement of SFB operations. It will be able to access funds such as savings and current account deposits and term and recurring deposits, but will have to compete with existing banks by offering attractive interest rates, and may be unable to raise sufficient funds. Inability to raise sufficient funds in a timely manner, or at all, may have an adverse effect.

Inability to comply with laws and regulations applicable to an SFB: AUSFB would be subject to laws and regulations that are more stringent than those, which were applicable to it as an NBFC. It would have to follow SFB Operating Guidelines and have to comply with circulars and directives issued by the RBI from time to time under the Banking Regulation Act. Further, the Banking Regulation Act limits the flexibility of shareholders and management in an SFB in many ways, including by way of specifying certain matters for which a banking company would require RBI approval. In the event we fail to meet prescribed prudential norms, the RBI may charge penal interest, restrict SFB activities, enforce increased scrutiny, impose additional conditions or may even terminate SFB license.

Customers default in their repayment obligations: AUSFB is primarily focused on serving low and middle-income individuals and businesses that have limited or no access to formal banking and finance channels. A significant number of customers are first time buyers of financial products and often do not have credit histories supported by tax returns and other documents that would enable to accurately assess their creditworthiness. Customers may default in their repayment obligations due to various reasons including insolvency, lack of liquidity, increase in operating costs and failure of their business operations. This could cause losses and may adversely affect the business.

Operations are concentrated in western India: As of May 31, 2017, AUSFB conducted its operations through 269 branches and 121 asset centers in India, of which 189 branches and 89 asset centers were located in western India in the states of Rajasthan, Gujarat and Maharashtra. As of March 31, 2017, 79.29% of its Gross AUM was located in such states, with Rajasthan accounting for 53.78%. Any significant social, political or economic disruption, or natural calamities or civil disruptions in this region, or changes in the policies of the state or local governments of this region or the Government of India, could disrupt business operations and require AUSFB to incur significant expenditure and change its business strategies.

Downgrade in credit ratings could increase finance costs: The cost and availability of capital depends in part on short-term and long-term credit ratings. Credit ratings reflect the opinions of rating agencies on AUSFB's financial strength, operating performance, strategic position and ability to meet obligations. Any downgrade in credit ratings could cause lenders to impose additional terms and conditions to any financing or refinancing arrangements that we enter into in the future. AUSFB has received a long-term credit rating of CRISIL A+ / Stable from CRISIL Ratings. Any downgrade in credit ratings could increase borrowing costs and adversely affect our business

Inability to manage interest rate risk: The results of operations depend substantially on the level of our net interest income, which is the difference between interest income and other charges, and interest expense and other borrowing costs. Any change in interest rates or their volatility would affect interest expense on floating interest-bearing liabilities as well as our net interest income and net interest margins. Any increase in cost of funds may lead to a reduction in net interest margin, or require AUSFB us to increase interest rates on loans disbursed to customers in the future to maintain our net interest margin. Interest rates are highly sensitive to many factors beyond control, including the monetary policies of the RBI, deregulation of the financial sector in India, domestic and international economic and political conditions and other factors, which have historically generated a relatively high degree of volatility in interest rates in India. Inability to effectively manage interest rate risk may cause net interest income and net interest margin to decline.

Asset-liability mismatches: Assets and liability mismatch (ALM), which represents a situation when the financial terms of an institution's assets and liabilities do not match, is a key financial parameter. AUSFB may rely on funding options with a short term maturity period for extending long term loans, which may lead to negative ALM. Further, mismatches between assets and liabilities are compounded in case of pre-payments of the financing facilities granted to customers. Any mismatch in ALM, may lead to a liquidity risk and have an adverse effect on operations and profitability.

New products may not be profitable: In addition to our previous NBFC offerings, AUSFB has introduced several new products and services. It will incur substantial costs to expand the range of products and services which may not be successful due to factors within or outside of its control, such as general economic conditions, a failure to understand customer demand and market requirements or management focus on these new products. Further, it will require approval from regulatory authorities before offering certain products and services. If it fails to obtain such approvals, or to develop and launch such products and services successfully, it may lose a part or all of the costs incurred in the development and promotion of such offerings, or discontinue these offerings, which could in turn adversely affect business and results of operations.

Significant dependence on vehicle finance business: Although AUSFB has recently introduced several new product offerings it has historically operated in three business lines of vehicle finance, MSME loans and SME loans. For FY17, the Gross AUM of its vehicle finance business accounted for 50.27% of total. Consequently, the financial performance significantly depends on vehicle finance business, which in turn depends on various factors that affect the demand for vehicles, including the demand for transportation services in India, changes in Indian regulations and policies affecting such vehicles, natural disasters, calamities, fuel prices and other macroeconomic conditions in India and globally. Any decline in sales of, or in demand for financing of such vehicles could adversely affect its business.

Inability to leverage existing customer base, expand branch network and attract new customers: The company intends to leverage its existing customer base for SFB operations by encouraging them to open savings and current accounts and cross-selling other products to them. It also intends to grow branch network in existing markets and new markets in India and attract new customers. Factors such as competition and customer requirements, in these new markets may differ from those in our existing markets. As it expands geographic footprint in India, the business may be exposed to additional challenges. It may have to make significant investments which may not yield desired results.

Non-compliance with the RBI's observations made during its periodic inspections: As an NBFC, we were subject to periodic inspection by the RBI under section 45N of the Reserve Bank of India Act, 1934. As an SFB, we will continue to be subject to RBI inspections, in the course of which, RBI may report on divergence from extant regulatory requirements as applicable to scheduled commercial banks. RBI had identified deficiencies in the past which were addressed by AUSFB. There may be future instances of deficiencies found by RBI and if it is unable to resolve such deficiencies then it could be subject to penalties and restrictions imposed by the RBI.

Unsecured trade advances to several vehicle dealers to promote business: AUSFB provides unsecured trade advances in the normal course of business to several vehicle dealers with whom it has business relationships and intends to continue to provide such trade advances in the future. These trade advances are not secured and consequently any failure to recover such advances or set these off, will have an adverse effect on our results of operations.

Highly competitive industry: The banking and financing sector in India is highly competitive and AUSFB faces competition from several Indian and foreign commercial banks in the private sector, as well as public sector. It will also face competition from

NBFCs, cooperative banks which have significant presence in rural areas, other financial services companies, regional rural banks, other small finance banks and payment banks in India. Due to intense competition in the banking sector in India, it may also face challenges in hiring and retaining adequate numbers of sufficiently qualified and experienced personnel. The inability to compete effectively may adversely affect business.

Exposed to operational and credit risks which may result in NPAs: AUSFB has a diversified customer base comprising self employed and salaried customers and businessmen who do not have access to formal banking and finance channels. Its ability to manage the credit quality of loans is a key driver of its results of operations. It tries to ensure strict adherence to its internally developed credit policy framework. Customers may, at times, not be able to provide requisite or complete information required which may affect customer on-boarding procedures. Further, customers may face cash flow constraints due to losses incurred by them in their businesses or in the economic activities pursued by them, which could lead to a diversion of the loan proceeds for purposes other than those for which the loan was sanctioned which may affect the ability of customers to repay their loans, and in turn, AUSFB's ability to recover the loans. As of FY17 its GNPA and NNPA stood at 1.61% and 1.05% respectively.

Profit &Loss:

Rs in Cr

Particulars	FY17	FY16	FY15	FY14	FY13
Revenue from Operations	1417.0	1046.9	687.0	565.5	410.7
Other Income	13.5	5.0	2.4	5.8	2.4
Total Income	**1430.5**	**1052.0**	**689.4**	**571.3**	**413.1**
Expenses					
Employee benefits expense	192.8	157.7	94.5	69.7	52.7
Finance Cost	500.3	395.3	282.0	287.6	197.2
Depreciation & Amortization expenses	5.8	8.5	6.5	3.3	2.9
Other expenses	150.4	87.5	50.4	40.4	40.9
Total Expenses	**849.3**	**649.0**	**433.4**	**401.0**	**293.6**
Pre Provisioning Profit	**581.3**	**402.9**	**256.0**	**170.4**	**119.4**
Provisions and write offs	76.7	25.7	48.7	60.7	16.8
Profit before exceptional item	504.6	377.2	207.3	109.7	102.7
Exceptional Item	670.3	0.0	0.0	0.0	0.0
PBT	**1174.9**	**377.2**	**207.3**	**109.7**	**102.7**
Total Tax	332.2	130.1	67.9	37.1	33.3
Reported Profit After Tax	**842.7**	**247.2**	**139.5**	**72.5**	**69.4**
Basic EPS	30.9	9.3	5.3	3.0	3.4
Diluted EPS	30.4	9.3	5.3	3.0	2.9

Balance Sheet:

Rs in Cr

Particulars	FY17	FY16	FY15	FY14	FY13
Equity & Liabilities					
Shareholders Funds	**1999.6**	**1000.7**	**766.5**	**597.8**	**441.9**
Share Capital	284.3	44.1	44.1	43.0	40.5
Reserves and surplus	1715.3	956.6	722.4	554.8	401.4
Non-Current Liabilities	**5058.7**	**2899.8**	**1649.0**	**1310.9**	**1486.3**
Long-term borrowings	4936.7	2810.9	1579.6	1273.5	1462.5
Other long-term liabilities	59.1	56.7	43.1	15.0	12.2
Long-term provisions	62.9	32.2	26.4	22.5	11.6
Current Liabilities	**2759.4**	**2372.5**	**1564.4**	**1049.9**	**1184.6**
Short-term borrowings	994.0	1006.6	972.6	468.5	677.8
Other current liabilities	1758.0	1344.5	574.7	573.8	502.7
Short term provisions	7.3	21.5	17.1	7.7	4.2
Total Equity & Liabilities	**9817.6**	**6273.0**	**3979.9**	**2958.6**	**3112.8**
Assets					
Non-Current Assets	**5450.4**	**3900.8**	**2433.4**	**1647.0**	**1338.2**
Fixed Assets	275.8	24.6	19.0	16.9	16.8

Non-current investments	615.2	59.3	112.7	87.4	56.7
Deferred tax assets (net)	3.8	21.1	36.4	30.6	15.7
Receivable under financing activity	4517.8	3780.5	2248.2	1491.4	1193.0
Long-term loans and advances	36.8	8.9	11.8	16.2	13.0
Other non-current assets	1.0	6.4	5.4	4.5	43.1
Current Assets	**4367.2**	**2372.2**	**1546.5**	**1311.6**	**1774.6**
Current Investments	1535.1	172.2	27.2	26.2	682.0
Cash and bank balances	624.5	123.4	202.9	203.4	376.0
Receivable under financing activity	2090.2	2008.9	1275.0	1025.3	661.7
Short-term loans and advances	53.6	21.0	13.9	33.1	32.6
Other current assets	63.9	46.6	27.6	23.6	22.3
Total Assets	**9817.6**	**6273.0**	**3979.9**	**2958.6**	**3112.8**

Financial Ratios:

Particulars	FY17	FY16	FY15	FY14	FY13
Gross AUM (Rs Cr)	10734	8221	5568	4449	3704
Disbursements (Rs Cr)	6730	5619	3378	2685	2438
Average Yield on Gross AUM	16.51%	17.09%	17.48%	17.68%	17.93%
Average Cost of Borrowing	10.13%	10.48%	11.42%	11.98%	12.61%
Net Interest Margin	9.67%	9.45%	8.09%	6.82%	6.82%
Gross NPA	1.61%	0.64%	0.92%	1.23%	0.53%
Net NPA	1.05%	0.38%	0.44%	0.62%	0.27%
Operating Exps / Avg Gross AUM	3.66%	3.67%	2.98%	2.73%	3.04%
No. of Branches	301	291	231	220	177
No. of Employees	8,515	5,072	3,553	2,716	2,266
Active loan accounts	280349	225713	189175	175531	146277

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