Management Discussion and Analysis

MACROECONOMIC OVERVIEW

For most part of the FY 2019-20, global growth was impacted by a wide set of issues including weaker trade and investment activity, elevated trade tensions, geopolitical uncertainties, and volatile crude prices. Though there was a minor pick-up in the third quarter, the overall world economic performance mostly remained subdued as the Global GDP grew ~2.9% in calendar year 2019 (source: IMF), its weakest since 2009 post the global financial crisis. The outbreak of the novel coronavirus in the fourth quarter led to the onset of a bear market with a global sell-off in equities and a sharp movement in yields. COVID-19 is expected to have major economic and socio-economic implications in the medium-term including dislocations in global production, supply chains and trade, and extreme volatility across global commodity prices.

Inflation, for most part of the year, remained benign in most advanced and emerging market economies. Given this backdrop, most central banks maintained an accommodative policy stance and undertook several policy and quantitative easing initiatives in line with the macro.

As we progress to FY 2020-21, albeit on a sombre note and under the shadow of COVID-19, governments across the world are taking numerous measures for balancing the safety and continuity lives with means of livelihood, and containment of the spread of COVID-19. The pace of recovery would be slow and gradual.

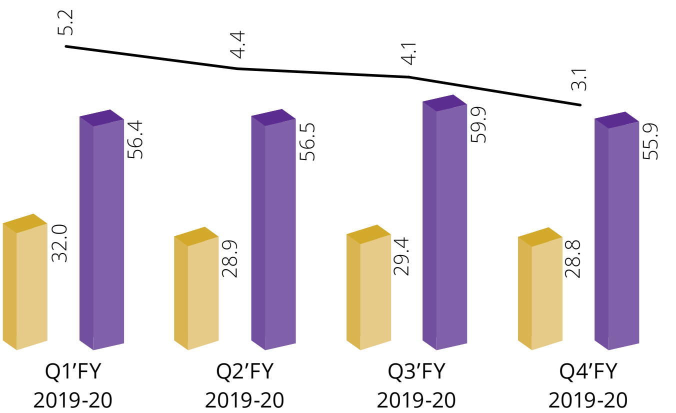
The Indian economy underwent a cyclical downturn in the last financial year with growth further slowing down in the second half. Multiple events weighed on growth in the previous fiscal including contraction in private consumption, drag in gross fixed investments, decline in manufacturing capacity utilisations, and stress in the banking and NBFC sector. However, this was partially offset by higher revenue spending by the government, reduction in current account deficit, a major cut in corporate tax rate, initiatives for easing funding, and liquidity issues in general.

The Indian government was quick to respond with its war-scale containment, relief and sustenance measures, including the imposition of a 21-day complete lockdown from 25th March 2020 and extending it with some partial relaxations.

Following the lockdown announcement, the RBI came up with its monetary policy announcement on 27th March 2020 (brought forward from early April) and announced a slew of measures aimed at improving liquidity (by announcing long-term repo operations, reducing Cash Reserve Ratio (CRR) requirements), and providing interim relief to borrowers by announcing moratorium on EMI payments for term loans and lowering policy rates. This was followed by another announcement on 17th April 2020 which gave further relief to borrowers in terms of NPL classification forbearance, taking measures to ease liquidity for the banking system, and particularly for the Non-Banking Financial Company/Microfinance Institutions (NBFCs/NBFC-MFIs).

GDP growth trends

(%)



- Gross Fixed Capital Formation as % of GDP
- Private final consumption expenditure as % of GDP
- India GDP Growth Y-o-Y

Source: PIB

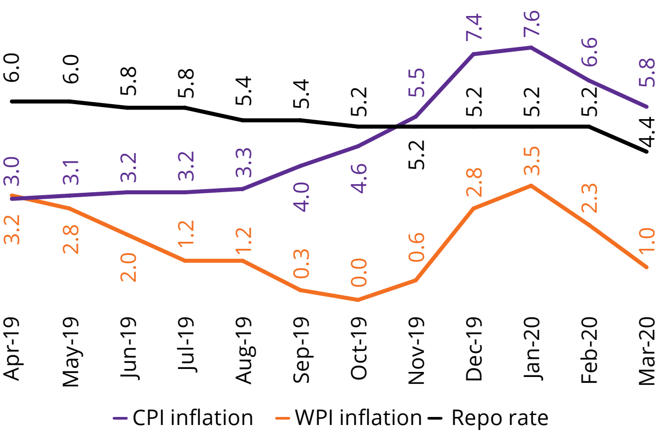
During the FY 2019-20, the Index of Industrial Production (IIP) contracted by 0.7%, compared with 3.8% growth in the previous financial year. A sharp decline was seen in the capital goods (-13.7%), consumer durables (-8.4%), and construction and infrastructure (-4.0%) sectors, while primary and intermediate goods grew by 0.8% and 8.8% respectively.

Inflation, as measured by the Consumer Price Index (CPI), remained well under the RBI's medium-term target of 4.0% until September 2019. However, post September 2019, it overshot for the next five months straight to hit a six-year high of 7.6% in January 2020, before cooling off to 5.8% in March 2020. Overall, for most part of the previous year, CPI inflation was primarily driven by elevated prices of food and vegetables. Wholesale Price Index (WPI) inflation too remained in low single digits in FY 2019-20.

The RBI made four consecutive cuts in its policy rates before holding the rates in October 2019, following the CPI inflation spike. RBI went back to its accommodative stance in February 2020 as a measure to support economic growth and maintained the stance in March 2020, post the COVID-19 outbreak.

Policy actions and inflation trends

(%)



Source: RBI

The Indian rupee (₹) remained weak for most part of the year and hit an all-time low against the US dollar (USD) owing to improving US yields, weak domestic fundamentals and outflows from domestic markets.

Despite the weak near-term outlook, the outbreak of COVID-19 presents an opportunity for India to emerge as a credible manufacturing alternative. India's long-term economic fundamentals remain intact with favourable demographics, continuing policy reforms, significantly better Current Account Deficit (position 0.2% of GDP for Q3 FY2019-20), and improved banking and corporate balance sheet positions. Moreover, a prolonged fall in crude prices could further boost India's current account balance.

INDIAN BANKING INDUSTRY

For the near-term including FY 2020-21, recovery is expected to be gradual and is likely to be significantly influenced by the trajectory of COVID-19, and the growth outlook for the Indian Economy which is bleak for FY2021.

The Indian banking industry faced multiple challenges through the year – a slowing macro, adverse events related to specific financial institutions, which threatened the overall stability of the financial system, fresh sources of corporate stress, and the more recent jolt from the COVID-19 pandemic.

Policy responses to the challenges mentioned above led to key measures in banking regulations to boost growth, better financial system stability, and improve monetary policy transmission. Some notable measures with a more durable impact, in our view, include 1) reducing risk weights for retail loans (excluding credit card loans) from 125% to 100%, 2) making it mandatory for banks to link all new floating rate personal or retail loans, and floating rate loans to Micro, Small and Medium Enterprises (MSMEs) to an external benchmark, 3) introducing Liquidity Coverage Ratio (LCR) requirements for NBFCs, 4) increasing the deposit insurance amount from ₹ 1 lakh to ₹ 5 lakh. To tackle more near-term challenges, several measures such as temporary and partial exemption of CRR requirements, relaxation of Non-Performing Loans (NPL) recognition in MSME and real estate sectors, and Long-Term Repo Operation (LTROs) were implemented. Moreover, restructuring of a private bank and the Reserve Bank of India's (RBI's) regular reiteration on safety of deposits with private sector banks, were other notable initiatives.

These measures notwithstanding, the credit growth of scheduled commercial banks declined to 6.4% in March 2020 as against 13.1% in March 2019 as non retail growth remained lacklustre and retail lending remained the key driver.

Credit and deposit trends

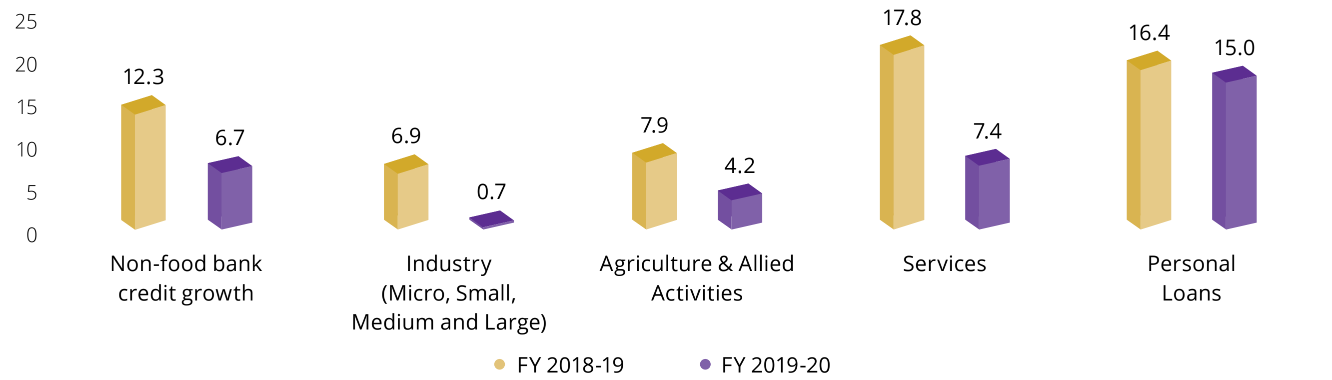
Y-o-Y growth (%)

	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Aggregate deposits	**10.1**	**10.1**	**10.0**	**9.5**
Bank credit	**11.7**	**8.9**	**7.4**	**6.4**
Credit-deposit ratio	**76.7**	**75.6**	**75.7**	**76.0**
Small Finance Banks				
Aggregate deposits	104.3	131.9	96.3	66.7
Bank credit	81.8	104.0	72.5	57.6
Private Sector banks				
Aggregate deposits	16.3	16.9	14.0	10.4
Bank credit	17.5	14.4	13.1	9.3
Public Sector Banks				
Aggregate deposits	6.7	6.6	7.8	8.2
Bank credit	8.7	5.2	3.7	4.2

Source: RBI

Sector-wise credit Y-o-Y growth

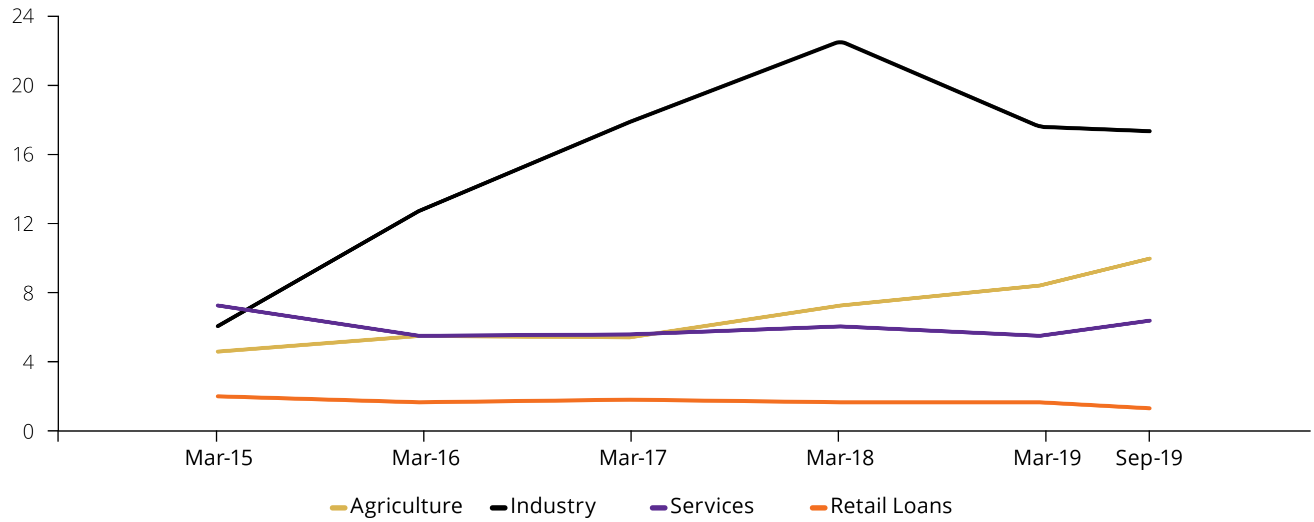
(%)



Source: RBI

GNPA Ratio of major sectors

(%)



Source: RBI

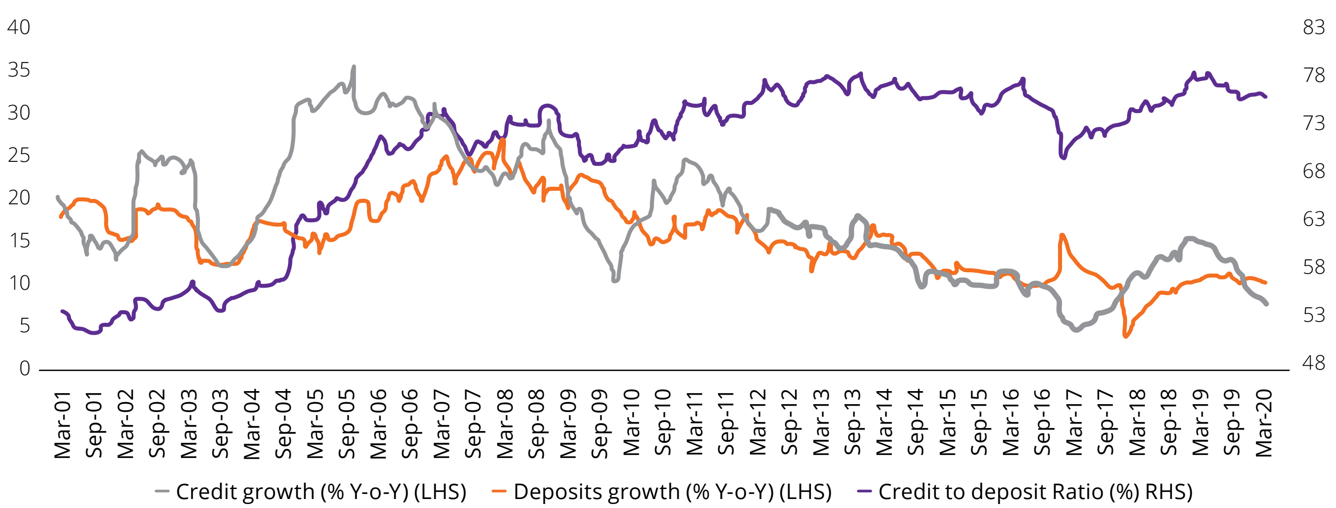
However, if we look closer into banking system credit growth trends, we observe that credit growth was significantly muted in metros and urban (partly due to deceleration in corporate credit), while semi-urban and rural grew at a faster clip. Similarly, even though the progress of the banking system has been anaemic, private banks (including SFBs), continued to gain market share and grow in double digits. Further, the upcoming PSU banks consolidation could create more opportunities for market share gains by private banks.

Demography-wise credit and deposit trends for the banking system

	June 2019	September 2019	December 2019	March 2020
Annual Growth Rates (%)				
Aggregate Deposits	10.1	10.1	10.0	9.5
Bank Credit	11.7	8.9	7.4	6.4
Population Group Annual Growth Rates (%)				
Rural				
Aggregate Deposits	11.5	12.1	12.8	15.5
Bank Credit	13.8	14.8	13.0	11.5
Semi-urban				
Aggregate Deposits	10.2	11.2	11.4	12.3
Bank Credit	12.3	12.3	11.1	8.4
Urban				
Aggregate Deposits	9.6	10.7	11.2	10.5
Bank Credit	10.9	9.9	9.9	8.8
Metropolitan				
Aggregate Deposits	10.0	9.0	8.5	6.9
Bank Credit	11.5	7.2	5.3	4.8

Source: RBI

Credit and Deposit trends for the banking system



Source: RBI

Key measures for the financial sector in the Indian Budget

Proposals	Impact on sectors
Increased deposit insurance coverage from the current ₹ 1 lakh to ₹ 5 lakh per depositor	Positive for overall stability of banking system and positve for SFBs at the margin
Extended tax holiday by one year to 31st March 2021 for affordable housing projects. Tax holiday is provided on the profits earned by developers of affordable housing projects	Beneficial for affordable housing finance segment
Extended MSME restructuring scheme. The extant scheme for restructuring of MSME loans was up to 31st March 2020, which would get extended to 31st March 2021	Provides interim relief to struggling MSMEs, which have been impacted by the slowdown in economic activity and ongoing reforms

Proposals	Impact on sectors
Lowered personal income tax rates for income up to ₹ 15 lakh, but individuals opting for this regime will need to forego most of the exemptions available to them. Exemption for Housing Rent Allowance (HRA), interest on housing loans has also been removed	May have adverse impact on housing sales, which in turn could impact demand for housing loans. Further, cross-sell fee on sale of insurance could come under pressure due to potentially lower demand for these products for the purpose of savings
Undertook measures to improve regulatory framework for NBFCs, which included widening scope for debt recovery for NBFCs, as well as partial credit guarantee scheme for the NBFCs	Beneficial for NBFCs struggling to obtain liquidity, as well for their collection mechanism

Following the outbreak of COVID-19 and the ensuing lockdown, the Reserve Bank of India (RBI) came with several measures including – repo rate cut by 75bps, widening of the policy rate corridor, liquidity infusion, and providing regulatory forbearance. Further, it announced a three-month repayment moratorium for all outstanding term loans, as on 29th February 2020. A deferment of interest to be paid on outstanding working capital loans (cash-credit/overdraft) as on 29th February 2020 for three months, was also announced. Further, for moratorium granted for overdue term loans and working capital, facilities which were overdue but standard as on 29th February, the moratorium period shall be excluded by lending institutions from the number of days for the purpose of asset classification under the Income Recognition and Asset Classification Norms (IRAC norms). These should significantly alleviate pressures of borrowers, whose repayment ability could be impaired by the lockdown. Overall, RBI's measures including those relating to Targeted Long Term Repo Operations (TLTROs), CRR and Marginal Standing Facility (MSF) will inject total liquidity of over ₹ 3.5 trillion into the system. The CRR cut will also marginally help bank profitability.

On the fiscal side, the Indian government announced several welfare measures including cash transfers, measures on food security, free cooking gas to the poor, and insurance cover of ₹ 50 lakh to healthcare workers. Going forward, more fiscal measures are likely to be announced depending on how the situation evolves.

Outlook

Given the macro uncertainties, RBI abstained from providing any GDP growth estimates for FY 20-21 in its March 2020 monetary policy announcement. Overall, the outlook for FY 2020-21 remains uncertain as the full extent of the COVID-19 impact is yet to be ascertained.

We believe the government's 21-day country-wide lockdown imposition was an assessed step. Further, in our view, the responsibility of fighting the pandemic and mitigating its fallout should be collectively shared by everyone, including corporates, banks, Financial Institutions (FIs) under the guidance of the RBI and the Government of India, to avoid any long-term negative impact on the Indian economy.

SMALL FINANCE BANKS

Small Finance Banks (SFBs) had been introduced by the RBI with the intent of driving financial inclusion for the unbanked and under-banked sections of the economy. In their three years of existence, SFBs have made their presence felt, growing their market share in both loans and deposits.

SFBs: Growing prominence

(Share as % of total)

Particulars	March 2019	March 2020
Deposit	0.3	0.5
Credit	0.6	0.9
Reporting offices	1.5	2.8

Source: RBI

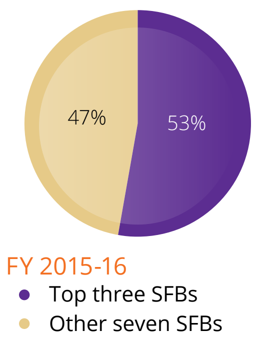
We believe these early trends are encouraging and further testimony to the significant untapped opportunities in the informal/semi-formal sectors, and efficacy of this delivery model for financial services for the underserved segments. This is further vindicated by the fact that RBI introduced on-tap licensing guidelines for SFBs during FY 2019-20.

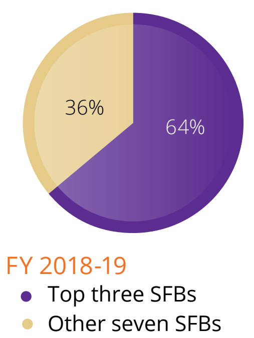
In terms of outlook, we believe there remains significant scope for growth in several underserved segments. Further, as branches mature and visibility for the SFBs improves, benefits from improving operating leverage will improve core profitability, going ahead.

Growth trajectory for SFBs

SFBs have been gaining market share in loans and grew at a CAGR of 26% from FY 2015-16 to FY 2018-19, and should continue to gain the market share in the medium term. Notably, share of top three SFBs (AU Bank being one of them) increased between FY 2015-16 to FY 2018-19 within total SFB AUM as they recorded a CAGR of 34% for the period.

SFBs - Market share split evolution





Performance of key sectors

Wheels loans

India is one of the largest automobile markets in the world. The sector contributes about 7.5% of India's GDP and employs, directly and indirectly, ~3.7 crore people, while continuing to present a significant opportunity for financiers.

The vehicle loans market stood at ₹ 4.4 trillion, growing at 10.3% Y-o-Y as on 30th September 2019, though origination volumes and balances declined on the back of tepid demand. Despite the ongoing slowdown in vehicle sales, the structural growth outlook remains intact as vehicle sales are likely to benefit from relatively low car penetration, emerging demographic dividend, increasing urbanisation and nuclearisation, rising incomes levels, and consumption.

Furthermore, opportunities are opening up as the industry evolves. In recent years, the vehicle financing business has expanded beyond the traditional core segment of new vehicles to the used vehicles and refinance as well. This has been driven by increasing formalisation in the used car space and deeper and wider proliferation of credit bureau scores. In the past few years, we have witnessed a significant roll out of new 'used vehicle' dealerships by Original Equipment Manufacturers (OEMs), emergence of well-funded online used car dealers offering certification, and ease of registration transfer and financing.

The key trends in both new and used vehicle segments are briefly discussed here under:

New vehicles

(in Units)

Particulars	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	5-year CAGR
All vehicles including two-wheelers	19,724,371	20,468,971	21,863,281	24,981,312	26,266,179	21,547,552	2%
Y-o-Y growth		4%	7%	14%	5%	-18%	

(in Units)

Particulars	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	5-year CAGR
All vehicles excluding two-wheelers	3,748,810	4,013,120	4,273,543	4,781,195	5,086,332	4,129,936	2%
Y-o-Y growth		7%	6%	12%	6%	-19%	
Passenger Vehicle (PVs)	2,601,236	2,789,208	3,047,582	3,288,581	3,377,389	2,775,679	1%
Y-o-Y growth		7%	9%	8%	3%	-18%	
Commercial Vehicle (CVs)	614,948	685,704	714,082	856,916	1,007,311	717,688	3%
Y-o-Y growth		12%	4%	20%	18%	-29%	
Three-wheelers	532,626	538,208	511,879	635,698	701,632	636,569	4%
Y-o-Y growth		1%	-5%	24%	10%	-9%	

Source: SIAM

The sharp decline partly reflects the impact of demand moderation (exacerbated by the outbreak of COVID in March 2020), liquidity crunch for some lenders, and inventory de-stocking by dealers on the back of transition to BS-VI.

It is expected that post COVID-19 lockdown there could be an increase in demand for vehicles arising from preference for personal mobility versus public transport. Besides this, factors like favourable demographics with a growing middle class and young population, improved road infrastructure, Goods and Services Tax (GST) implementation paving the way for bigger warehouses, increased e-tailing, last-mile delivery opportunities and pent-up demand following migration to newer emission standards, will continue to drive growth for this segment.

Projected growth in disbursements*

(in ₹ billion)

Category	FY 2018-19	FY 2023-24	CAGR FY 2019-24
Passenger vehicles	1,012	1,486	7-9%
Commercial vehicles	820	1,133	6-8%
Three wheelers	302	496	10-12%
Two wheelers	104	142	5-7%

Source: Crisil Research, Retail Finance – Auto November 2019 | *The growth projections were forecasted prior to COVID -19

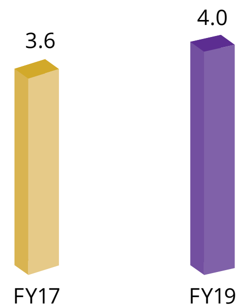
With reference to the medium-term estimates mentioned above, it is important to note that they may be revised downward as they were forecasted prior to the COVID-19 outbreak. However, structural growth drivers (which include relatively low penetration of vehicle ownership, favourable demographics, and increasing disposable income) remain intact and should play out in the medium to long term.

Used Vehicles – Cars

The Indian used car market was valued at USD 24.2 billion in 2019, with the pre-owned car market rapidly evolving in recent years. As per the Indian Blue book, it crossed the 4-million-unit mark and stood at 1.2x the size of new car market. The industry has been seeing increased investments across the value chain, from procurement to retail. This has resulted in a shift in market composition where the organised channel of the pre-owned car market almost doubled its share from 10% to 18%, between FY 2010-11 and FY 2018-19.

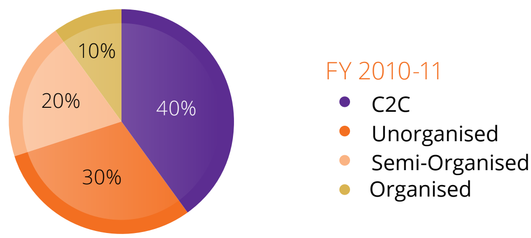
Pre-owned car market

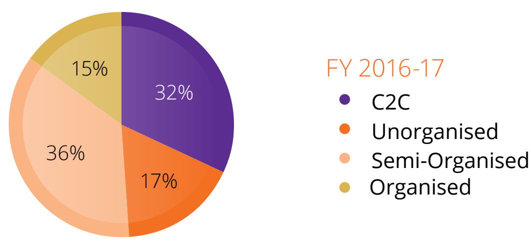
(in million units)

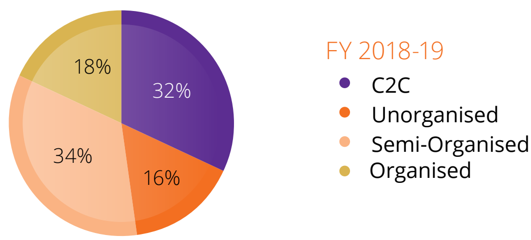


Source: Indian bluebook

Evolution of pre-owned car market in India

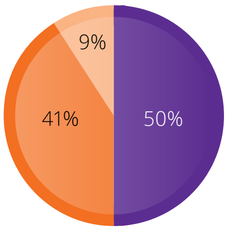




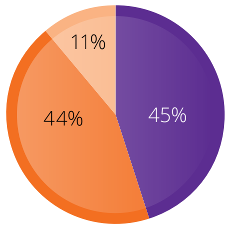


Source: Indian bluebook

Types of dealers across India – organised dealers' presence in the mix has been increasing



FY 2015-16
- Unorganised dealers
- Semi-organised dealers
- Organised dealers



FY 2018-19
- Unorganised dealers
- Semi-organised dealers
- Organised dealers

Source: Indian bluebook

Some key growth drivers that would drive used vehicles industry growth include:

- Migration of two-wheeler owners to pre-owned car owners and increased share of value seekers
- Trickle down impact of massive investment of ₹ 5,000 crore in new-age digital companies in the previous four years
- Leasing and corporate fleet buyers are expected to grow significantly in the next couple of years. Owing to their focus on car quality, it is likely to shorten the replacement cycle for their fleets and increase supply in the used car market as well
- Emergence of online marketplaces has significantly increased options for online buyers
- Increase in total cost of ownership of new cars on account of changes in insurance cost, taxes and other such factors has increased the relative appeal for used vehicles
- Some key changes in the auto industry are creating favourable tailwinds for used cars. These include 1) transition to BS-VI from April 2020, where price differential between new and used cars is likely to grow further 2) gradual focus on reducing the production of diesel cars would also increase the demand for compact diesel cars in the used car market

Banks have significant room to grow in pre-owned cars segment, which is still at 17% (compared to 75% for new cars). The development of the organised channel for buying used vehicles also bodes well for the banks as buyers who use the organised channel can be offered pre-approved loans since majority of the transactions are below ₹ 3 lakh and the ease of finance will encourage buyers to avail loans.

MSME lending

Globally, MSMEs are regarded as the engine of equitable economic development, providing large employment opportunities in less developed regions. In India too, MSMEs have been the backbone of the Indian economy. According to the Annual Report of the Ministry of MSME of FY 2018-19, India is home to ~6.34 crore MSMEs (51% are in rural areas and more than 99% of them are categorised as micro), which cumulatively accounted for 30% of nominal GDP. These MSMEs together employ ~11.1 crore people with micro enterprises accounting for 97% of the total employment in the MSME sector.

MSME classification (as of 31st March 2020*)

Nature of activity	Micro enterprises	Small enterprises	Medium enterprises
Manufacturing – investment in plant and machinery	<= ₹ 25 lakh	> ₹ 25 lakh but <= ₹ 5 crore	> ₹ 5 crore but <= ₹ 10 crore
Services – investment in equipment	<= ₹ 10 lakh	> ₹ 10 lakh but <= ₹ 2 crore	> ₹ 2 crore but <= ₹ 5 crore

*New definition of MSME was announced in May 2020

Overview of MSMEs in India and AU Bank's focus segments

Most of the MSMEs in India are informal in nature, which makes accessing finance a challenge for them partly due to their lack of comprehensive documentation for income proof and collaterals, perceived higher risk of the segment and higher cost of delivering services from the perspective of mainstream banks. Besides, the MSMEs' informal set up also does not make it easy for them to avail government schemes, which are based on digital infrastructure and require beneficiaries to have some form of digital presence.

Credit opportunities for lenders in India's MSME space

Banks/Development Institutions

More than ₹ **25 Lakh**
- Organised sectors
- Corporate entity
- Organised financials
- Cash flow analysis
- Projects specific loans

Banks/SFBs/NBFCs/ Co-op Banks

₹ **2 Lakh - ₹ 25 Lakh**
- Unorganised sectors
- Cash basis accounting
- Composite loan requirements

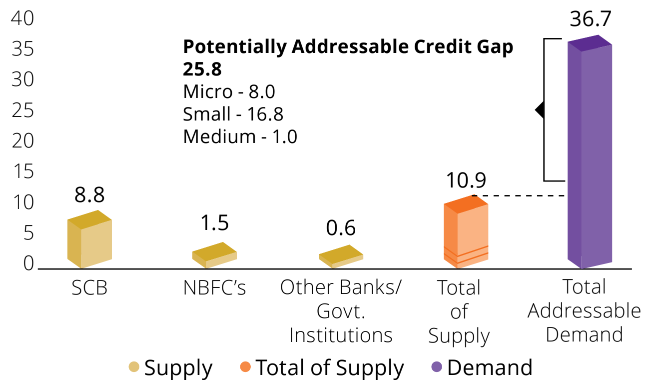
Micro Finance Institutions

Upto ₹ **2 Lakh**
- No financials
- General need of funds

Access to credit and opportunities for AU Bank

The growth outlook for this segment is quite encouraging due to the size of the opportunity and several reforms such as implementation of GST, extension of the credit guarantee fund scheme to NBFCs and lower tax rates, which will incentivise lenders and improve transparency. These and several other focused initiatives aim to increase the sector's contribution to GDP to over 50% as the nation aspires to be a ₹ 5 trillion economy. The opportunity size for financiers is significant – an IFC study (November 2018) pegs the addressable credit gap at ₹ 25.8 lakh crore, which is more than 2.5x the current size of formal credit to this sector, with the bulk of it in the micro and small segments.

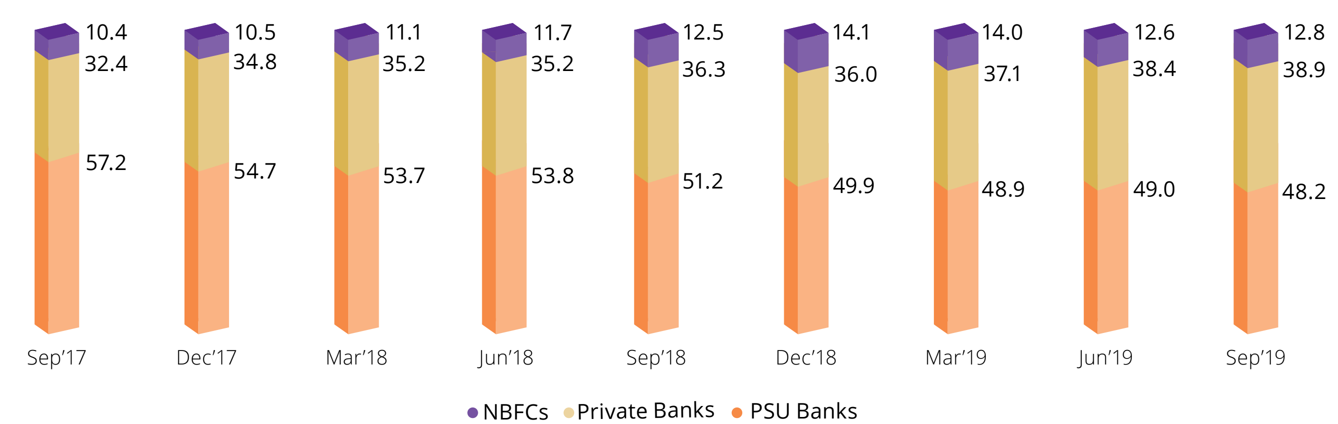
Demand supply gap (in ₹ lakh-crore)



*Source IFC Report - Nov 2018

Private banks have been growing the fastest in this segment in recent years, and of late have been gaining market share from PSU banks and NBFCs alike. AU Bank has emerged as one of the leading lenders to MSMEs since 2009 and is perceived as a trusted solution provider to the sector with strong track record in maintaining asset quality while scaling up. With average ticket size around ₹ 10-12 lakh, AU Bank has catered to only 0.11 million units as on date and has a long runway for growth in this segment.

Market share shifting from public sector banks to private banks and NBFCs (%)



Source: TransUnion CIBIL

Housing loans

Of India's 130 crore+ population, rural population constitutes over 60%, where there is a massive shortage of housingand further, rapid urbanisation is also increasing the demand for housing in urban areas.

The housing mortgage market, particularly the affordable housing segment, has received significant regulatory support, in terms of lower risk weights, tax exemptions, interest subventions, and incentives for developers. The Government of India has taken several measures to address this gap. Under the 'Housing for All' scheme, 60 million houses are to be built—40 million in rural areas and 20 million in urban areas by 2022—which will provide significant demand growth for the housing finance industry.

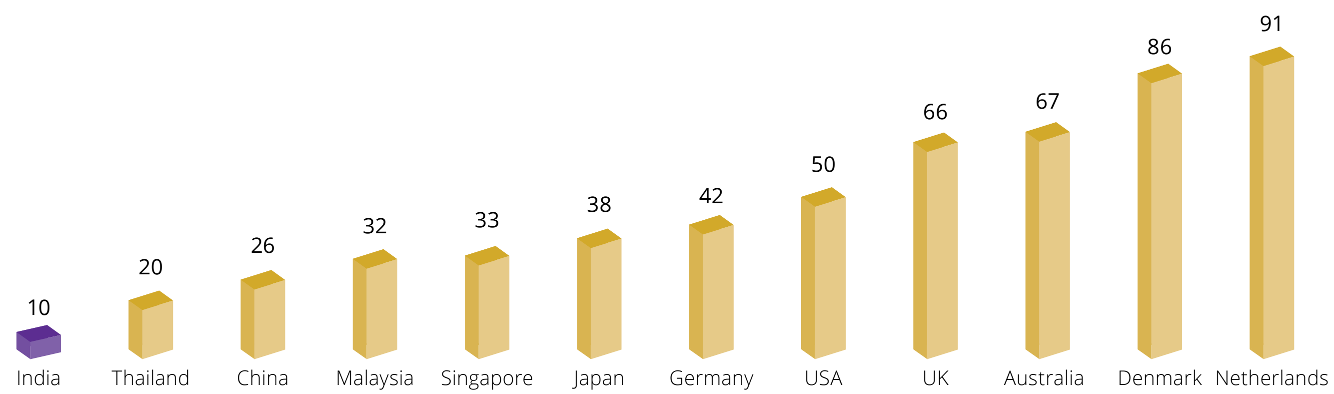
Requirement/shortage of housing units (units in lakh)

Category	Analysts estimate	Government estimate
Economically Weaker Section (EWS)	336	450
Lower Income Group (LIG)	440	500
Middle Income Group (MIG) and above	64	50
Total	**840**	**1,000**

Source: GoI, Analyst Estimates

Overall, the mortgage market in India is relatively under-penetrated compared to peers (see figure below). According to industry estimates, India's mortgage penetration stood at ~10% and is expected to reach to 14% by FY 2021-22.

Low mortgage penetration offering huge headroom for growth (mortgage as a % of nominal GDP)



Source: European Mortgage Federation, Hofinet and HDFC estimates for India

Despite the strong impetus by policymakers and the significant size of the opportunity, credit growth in home loan (including affordable housing) continued to decelerate as aspiring buyers deferred their purchase decisions given the slowing macro, and broadly stagnant housing prices. As a result, origination volumes and balances continued to decline, while delinquencies recorded a slight increase. As of Q2 FY20, housing loans stood at ₹ 19.1 trillion (~50% of consumer credit), with growth decelerating to 10% Y-o-Y from 20% in Q2 FY19. Notably, private banks have increased their market share in recent quarters and have increased focus on affordable housing. Balances originated by private banks from the affordable segment increased 14% Y-o-Y in Q2 FY20. Also, of the total volumes originated by private banks in Q2 FY20, 63.5% were from the affordable housing segment, up from 59.3% in Q2 FY19.

At AU Bank, the housing loans segment has been one of our focus areas and was re-launched in Q4 of 2018. Through our housing loan offering, we aim to help our customers in building/buying probably the most valuable and cherished asset in their lifespan, and onboard their entire family with us.

Gold loans

Gold loans are typically small ticket, short tenor loans, which offer the convenience of quick disbursals during times of emergency or meeting short-term cash flow mismatches. As of March 2019, the gold finance industry AUM recorded a growth of ~13% Y-o-Y and stood at ₹ 2.8 trillion. As per industry reports, the gold loan market is further expected to grow at a CAGR of ~10% to ₹ 3.8 trillion by FY 2021-22. India is the world's largest consumer of gold jewellery and holds a stock over 20,000 tonnes of gold valued at over USD 800 billion with rural India holding ~65% of it. Although gold has been one of the oldest forms of collaterals for loans, the organised gold loan segment still has low penetration. Informal and unregulated players, including local money lenders, control ~ 60% of all gold loan transactions and typically charge usurious interest rates due to the lack of formal financing channels.

However, technological advancements are giving new-age banks such as us, the ability to improve accessibility and offer tailored schemes with flexible tenors. Our gold loan product was rolled out ~ 2.5 years back and has been performing well. Our experience so far has given us more confidence in our ability to scale up in this segment and we will be investing in it further and making it a significant revenue stream in the next three to five years.

Consumer durable loans

Growing awareness, easier access, and changing lifestyles and mindset (perception of some consumer durables as a need rather than a luxury, for instance) are likely to be the key growth drivers for the consumer durables market. In rural/semi-urban areas, there is significant scope for growth of consumer durables with consumption expected to grow in these areas as penetration of brands increases. Also, demand for durables like refrigerators as well as consumer electronic goods are likely to witness growing demand in the coming years in the rural markets as the government plans to invest significantly in rural housing and electrification.

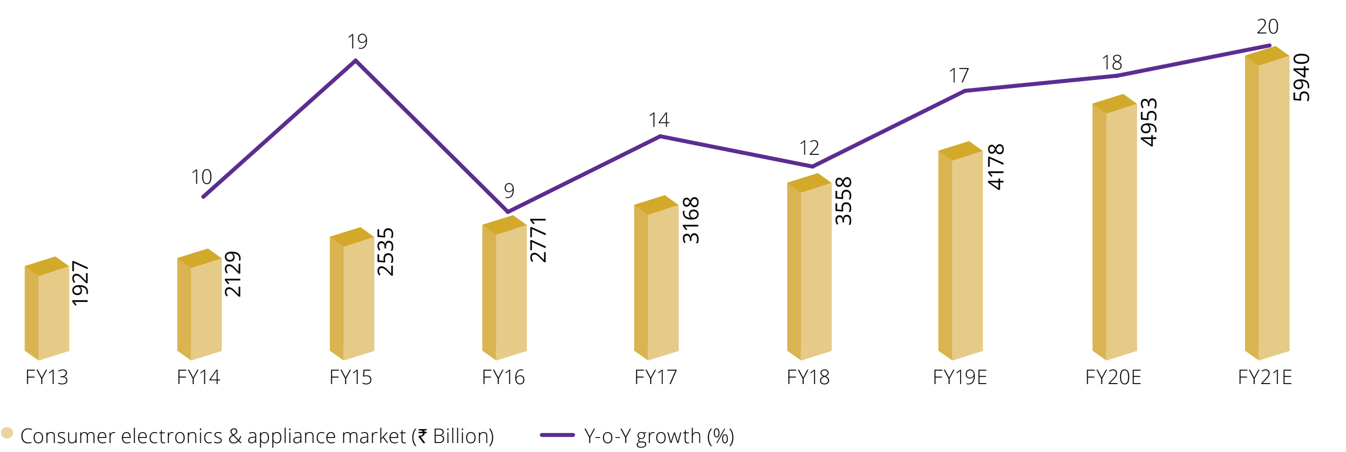
A consumer durable loan gives an opportunity to the customers to buy consumer durables and electronics like refrigerators, washing machines, TVs, smart phones and others at an affordable instalment plan. The consumer durable loan segment has been seeing increasing interest by mainstream banks. The government and the banking industry's continued push for digitisation, as well as a higher financial inclusion, augur well for consumer durable loan growth in the near to medium term. This product offering helps us leverage our reach and relationships to capitalise on this trend. Further, it helps our offering to be more comprehensive and meet our customer's evolving needs.

- Consumer durable loans is estimated to have grown by 27-29% in FY 2019-20 (Source: Crisil)
- Consumer durable loans remained one of the fastest growing sector within the banking industry
- More players (banks as well as NBFCs) entered this segment during the year
- Asset quality remained strong in this segment

Key growth enablers

- Increasing disposable incomes
- Easy credit availability
- Rising aspirations of consumers

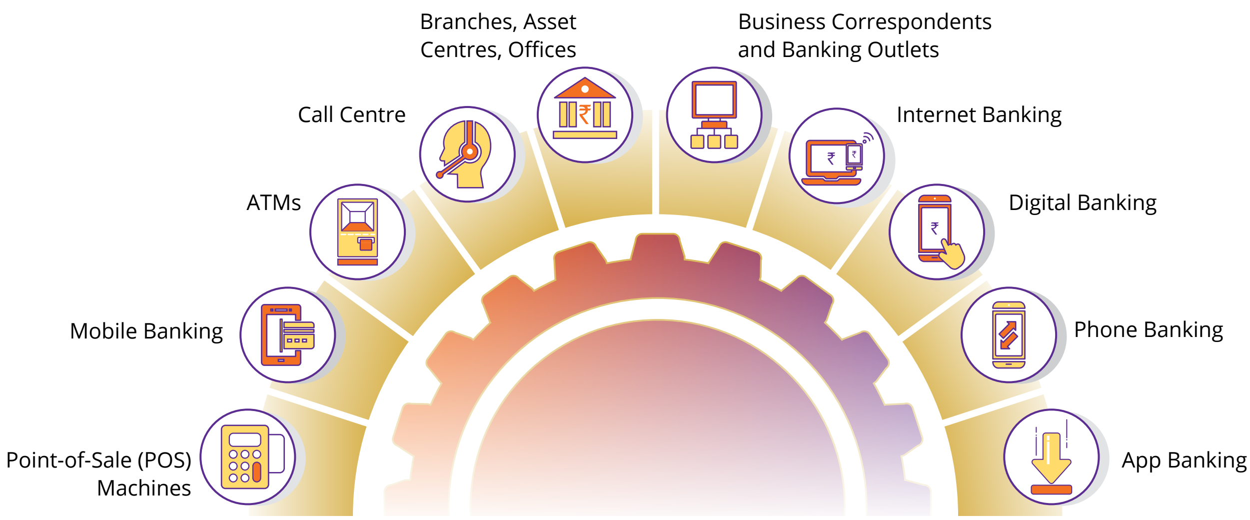
Strong prospects of the consumer electronics and appliances market in India



Source: MOSL, Company, Frost & Sullivan analysis, CEAMA, Dixon Technologies RHP

AU SMALL FINANCE BANK AT A GLANCE

AU Small Finance Bank Limited (AU Bank) is a Fortune India 500 Company. We are the only scheduled commercial Bank headquartered in Rajasthan. As on 31st March 2020, we had ~647 touchpoints operational across 11 states and 1 Union Territory of North, West and Central India with a team of 17,112 people.



Synopsis of our financial performance

Profit and Loss Summary

(In ₹ crore)

	FY 2019-20	FY 2018-19	Y-o-Y
Income			
Interest Earned	4,286	2,949	45%
Interest Expended	2,377	1,607	48%
Net Interest Income	1,909	1,343	42%
Other Income	620	462	34%
Income from sale of equity shares of Aavas Financiers Ltd.	86	-	-
Total Net Income	2,615	1,805	45%
Expenses			
Operating Expenses			
Employee Cost	760	601	26%
Other Operating Expenses	658	481	37%
Operating Profit before Provisions and Contingencies	**1,197**	**722**	66%
Provisions (other than tax) and Contingencies	283	142	100%
Exceptional Items			
Profit Before Tax	914	580	58%
Tax Expenses	239	198	21%
Profit After Tax	**675**	**382**	77%
Profit After Tax (excluding profit from partial divestment in Aavas)	596	382	56%

Asset and liability composition

(In ₹ crore)

	31st March 2020	31st March 2019	Y-o-Y
Liabilities			
Capital	304	292	4%
Money Received against Share Warrants	-	175	-
Employees Stock Options Outstanding	52	43	21%
Reserves and Surplus	4,021	2653	52%
Deposits	26,164	19,422	35%
Borrowings	10,335	8,613	20%
Other Liabilities and Provisions	1,267	1,424	-11%
Total liabilities	**42,143**	**32,623**	**29%**
Assets			
Cash and Balances with RBI	1,050	811	29%
Balances with banks and money at call and short notice	2,320	929	150%
Investments	10,668	7,162	49%
Advances	26,992	22,819	18%
Fixed Assets	448	447	-
Other Assets	665	455	46%
Total Assets	**42,143**	**32,623**	**29%**

Key Ratios

(%)

	FY 2019-20	FY 2018-19
Net Interest Margin (NIM)	5.4	5.5
Net Interest Income (Excluding Income from Securitisation and Assignment) as a % of Average Total Assets	4.6	4.6
Total Cost to Average Assets	3.8	4.2
Return on Average Total Assets (ROA)	1.8	1.5
Return on Average Total Equity (ROE)	17.9	14.0
Gross Non-Performing Advances (GNPA)	1.68	2.04
Net Non-Performing Advances (NNPA)	0.81	1.29

Key highlights of FY 2019-20

1. Acquired ~0.5 million new customers and expanded AU Bank customer universe to ~1.7 million+ satisfied customers

2. Our Assets Under Management (AUM) increased by 27% Y-o-Y from ₹ 24,246 crore to ₹ 30,893 crore primarily driven by growth in the retail asset under management, which expanded ~38% over the same period. Share of Retail AUM in Total AUM increased from 78% as on 31st March 2019 to 84% on 31st March 2020

3. Nearly 79% of loans are small ticket secured loans primarily for income generation/productive purposes; ~98% portfolio is secured by collaterals, which is predominantly a key/sole income generating asset for the customers

4. Despite a challenging environment and change in Non-Performing Assets (NPA) reporting to daily basis, our Gross NPA/ Net NPA (GNPA/NNPA) ratio improved to record 1.68% and 0.81%, respectively as on 31st March 2020 vis-à-vis 2.04% and 1.29% as on 31st March 2019, partly due to improved collections

5. Clocked 10% and 35% sequential and annual growth in its aggregate deposits, which stood at the ₹ 26,164 crore mark on 31st March 2020

6. Strong compliance with regulatory requirements with Capital Adequacy Ratio of 22.0% and Tier-I ratio of 18.4% well above minimum requirements of 15% and 7.5%, respectively

7. As on 31st March 2020, we maintained a Liquidity Coverage Ratio of ~133% against the regulatory requirement of 90%, which also speaks of our strong liquidity position.

8. Enhanced governance by increasing our Board strength to 9 members (six Independent Directors) from seven members at the end of FY 2018-19

9. For FY 2019-20, the aggregate Priority Sector Lending (PSL) Certificate sold amount to ~₹ 15,505 crore

10. Average PSL achievement of ~85% for FY 2019-20 against regulatory requirement of 75%

11. For FY 2019-20, expanded distribution and opened 33 new bank branches and 36 banking outlets – on track to widening geographic footprint in newer metros

12. Launch of our best-in-class offering 'AU Royale' – premier Contactless Debit Card targeting the upper middle-income segment

13. First bank to offer Saving Accounts on WhatsApp; launched fully automatic, paperless two-wheeler loans and consumer durable loans

14. Enhanced our customer engagement; launched our first-ever digital brand campaign #BharosaApnoJaisa on Hotstar, which generated over 120 million impressions

15. Profit After Tax (PAT) grew by 77% from ₹ 382 crore to ₹ 675 crore (includes ₹ 79 crore of profit from Aavas sale), driven by robust growth, improving cost efficiencies and stable asset quality

16. Our net interest income increased by 42% from ₹ 1,343 crore in FY 2018-19 to ₹ 1,909 crore in FY 2019-20 driven by healthy AUM growth of 27%. Other income (excluding gains on sale of partial divestment of shares of Aavas Financiers Ltd.) grew broadly in line with balance sheet (34% Y-o-Y) from ₹ 462 crore to ₹ 620 crore

17. Despite COVID-19 impacting operations in the last two weeks of March 2020, disbursements for the full year FY 2019-20 rose 16% over FY 2018-19 led by 27% growth in retail disbursements

18. In FY 2019-20, blended disbursement yield for our new loans increased by 123 bps to 15.36%. As on 31st March 2020, our full-year yield on our Assets Under Management was at 14.71%

19. Our average cost of funds improved by ~18 basis points to 7.69% for FY 2019-20, causing an improvement in 60 bps in our spreads Y-o-Y.

20. We continued to derive benefits of improving operating leverage, which resulted in the cost-to-income ratio declining from 60% in FY 2018-19 to 54.2% (56.1% excluding impact of partial divestment in Aavas) in FY 2019-20. We expect to see further cost efficiencies improving in the near to medium term as branch productivity improves

21. There has been a significant improvement in our Return on Equity (ROE), mainly on account of improving leverage and other income from partial divestment of Aavas stake from 14.0% at the end of FY 2018-19 to 17.9% (15.8% excluding impact of partial divestment in Aavas) at the end of FY 2019-20. We delivered a ROA of 1.8% (1.6% excluding impact of partial divestment in Aavas), which is a significant improvement from 1.5% in FY 2018-19. While these are comparable to the best-in-class private banks, we expect further improvement from improving productivity in branch banking, which is still in its build-out phase and continues to be a drag on overall ROA, as on 31st March 2020

22. Our other asset products (business banking, gold loan, home loan, Agri-SME, consumer durables and two-wheelers) were introduced in the last few years, and were in the build-out mode throughout FY 2019-20. As these products gain more market traction and scale, they would start contributing to our profitability

Business segment review

AU Bank is emerging as a trusted banking partner for customers and various stakeholders with our longstanding presence and stable growth trajectory. As a bank, our endeavour is to carve a strong and lasting identity for ourselves in the banking space, which stands for trust and customer centricity. We aspire to leverage our proven systems and skills in the small ticket secured retail lending segment, with the underserved segment as our focus. Through this, we will empower people at the bottom of the pyramid in some of the remotest parts of the country.

We entered India's dynamic banking landscape in 2017, after two decades of expertise in lending to the underserved. With over 61% of our branches in rural and semi-urban areas, we have enhanced our focus on the unbanked and underbanked customers at the bottom of the pyramid to drive financial inclusion. Retail loan assets are our mainstay comprising over 80% of our loan AUM. Besides retail, we also offer small and mid-corporate loan asset products.

Lending Segments

Retail assets

We have a fairly long, and stable track record in lending small ticket, secured, retail loans primarily to unbanked and underbanked self-employed individuals for purchasing assets that will generate income. Our retail asset segment includes our three key focus products – Vehicle Loans, Small Secured Business Loans to MSMEs and Housing Loans. It also includes Gold Loans, Consumer Durable Loans and Personal Loans, along with overdraft (OD) on fixed deposits (FD).

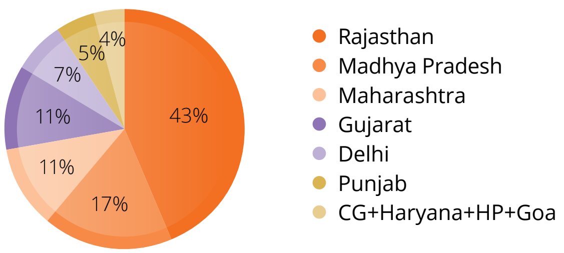
Breakup of retail assets

Type of retail asset	Disbursement in FY 2018-19 (₹ in crore)	Disbursement in FY 2019-20 (₹ in crore)	Y-o-Y growth (%)	Share in total AUM (%)
Vehicle Loans	6,725	7,799	16%	42%
SBL – MSME	3,698	4,865	32%	37%
Housing Loan	115	490	326%	2%
Gold Loan, Consumer Durable Loan and Personal Loan	83	331	299%	1%
OD Against FD	1,178	1,555	32%	3%
Total	**11,800**	**15,040**	**27%**	**84%**

As on 31st March 2020, 61% of our loan portfolio was upto ₹ 25 lakh.

Geographically well diversified

Retail AUM – geography-wise



Growth trajectory outside of Rajasthan

(₹ in crore)

Details	FY 2019-20	FY 2018-19
Total Retail Assets Disbursements	15,040	11,800
Rajasthan Disbursements	40%	40%
Outside Rajasthan Disbursements	60%	60%

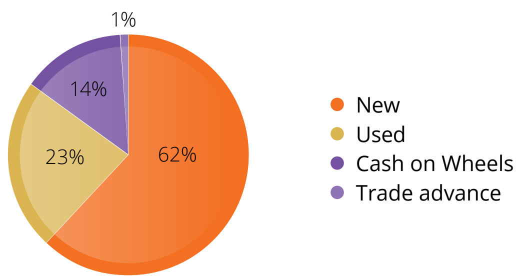
Vehicle loan

Vehicle loan has been a key product since our inception and is the most seasoned book in our portfolio. Despite sluggish growth in the overall automobile sector, our vehicle loan AUM recorded a growth of 27% and stood at ₹ 12,985 crore comprising 42.0% of our total AUM during FY 2019-20. Wheels disbursements grew 16% Y-o-Y to ₹ 7,799 crore during the reporting year. Average Ticket Size (ATS) for this product was ₹ 2.4 lakh for FY 2019-20.

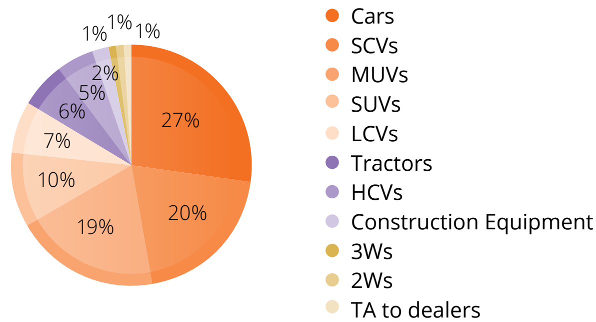
We offer one of the widest product ranges in the industry and extend credit for 2 to 22 wheeler vehicles for personal and commercial use. We offer loans for new and pre-owned vehicles and for refinancing of vehicles across several categories including cars, Multi-Utility Vehicle (MUV), Sports Utility Vehicle (SUVs), Light Commercial Vehicle (LCV), Medium and Heavy Commercial Vehicle (MHCVs), Construction Equipment (CE), tractors, two and three-wheelers. We finance vehicles for personal as well as commercial use. In the commercial space, we serve First-Time Buyers (FTBs), First-Time Users (FTUs), Small Road Transport Operators (SRTOs) and captive users. We secure our wheels loans with the vehicles we finance.

Vehicle loan – AUM split

Segment-wise



Vehicle type-wise split



During FY 2019-20, we took several initiatives that helped us stay ahead of the curve:

- Continued focus on used refinance vertical
- Reduced Heavy Commercial Vehicle (HCV) exposure judiciously and focused more on Small Commercial Vehicle (SCV)
- Introduced a complete digital journey for two-wheelers enabling higher customer convenience and lower cost of acquisition for the Bank
- Created separate team for the tractors business for better focus and execution

Secured Business Loans (SBL)

Secured business loans MSME (SBL-MSME) is a key product within the retail assets segment and comprised 36.5% of our total AUM as on 31st March 2020.

Our loans primarily serve MSMEs with annual turnover between ₹ 40 lakh and ₹ 10 crore, having at least a few years of track record in such businesses, generating cashflows at high frequency and having limited or no formal documented income proofs (for example grocery/kirana stores, dairy/cattle rearing and hotel/restaurants). Such loans are then secured by immoveable property, and the uses include working capital needs, expansion, purchase of machines/equipment and infrastructure requirements. We understand our customers' business and their future requirements to arrive at the loan amount that can be offered to them.

We also cater to larger businesses in terms of turnover, which have more formal and documented income proofs. Our target Small and Medium-sized Enterprises (SMEs) include traders, wholesalers, distributors, retailers, manufacturers and self-employed professionals, and these loans are meant to meet their needs for expansion, working capital and purchase of equipment.

Gross AUMs for our SBL business increased by 44% Y-o-Y to ₹ 11,287 crore as on 31st March 2020. SBL disbursements grew 32% Y-o-Y to ₹ 4,865 crore in FY 2019-20. Average ticket size for this product was ₹ 9.4 lakh for FY 2019-20.

Home loans

We provide a comprehensive range of home loan products to cater to every home buyer's loan needs (self-construction, purchase of flat/house, extension/renovation and takeover/top-up), with a focus on the affordable housing segment. We offer loans from ₹ 2 lakh to above ₹ 50 lakh for a maximum 30-year tenure for salaried customers; and 20 years for self-employed non-income proof/self-employed income-proof profile customers. Our customers can apply for loans at any of our branches. We have well-trained relationship officers, who help customers select the right loan mix, calculate a suitable loan EMI and choose tenure.

Gross AUMs for our home loans business increased by 388% to ₹ 567 crore as on 31st March 2020 from just ₹ 116 crore a year earlier. Home loan disbursement increased by 326% to ₹ 490 crore from ₹ 115 crore in FY 2018-19.

Gold Loan

Gross AUMs for our gold loans business increased by 11% to ₹ 55 crore as on 31st March 2020 from ₹ 49 crore a year earlier; gold loan disbursements grew 27% Y-o-Y to ₹ 85 crore during the year.

Personal loans

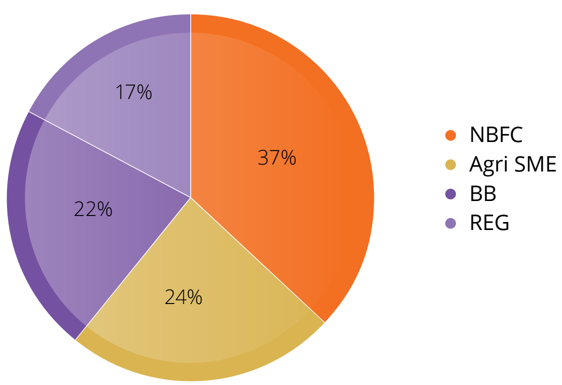
We offer easy and convenient personal loans that enable our customers to meet emergency needs/spends, as well as take care of all their necessities. We have a seamless, flexible and transparent paperless loan process along with quick approvals. Existing AU Bank customers can get a pre-approved personal loan instantly with no additional documents.

Gross AUMs for our personal loans business increased to ₹ 181 crore as on 31st March 2020 from nil, a year earlier.

Small and mid-corporate (SMC) assets

We cater to SMEs for their business banking, working capital and trade finance needs in this segment. We understand the bespoke requirements of businesses, therefore have created comprehensive offerings with simplified documentation and efficient turnaround time. We also lend to Non-Banking Financial Companies (NBFCs), Housing Finance Companies (HFCs), Micro Finance Institutions (MFIs) and Real Estate Developer construction finance. As on 31st March 2020, small and mid-corporate assets declined by 3% Y-o-Y and comprised 16% of gross AUM as we become more cautious and slowed down disbursements in Real Estate and NBFCs in the past 18 months.

SMC Mix



Business banking

Business banking provides fund-based credit facilities such as overdraft and cash credit and non-fund-based facilities such as letters of credit and bank guarantees to SME customers. We cater to wholesalers, retailers, traders, manufacturers, service providers, contractors, stockist, distributors, educational institutes and healthcare enterprises in this segment.

Gross AUMs for our business banking increased 33% Y-o-Y to ₹ 1,081 crore as on 31st March 2020; business banking disbursements grew 77% Y-o-Y to ₹ 1,641 crore.

Lending to NBFCs, HFCs and MFIs

After two decades of functioning as a NBFC, we understand the need for constant stream of funds for NBFCs, which include Asset Finance Companies (AFCs), Housing Financial Companies (HFCs) and Micro Finance Institutions (MFIs). Our ears to the ground approach and presence in areas where these NBFCs are active, improves our knowledge and understanding of their business and prospects. With our customer-centric approach, we are well prepared to serve these financial institutions at various stages in their business cycles.

We cater to diverse asset categories with a substantial proportion to asset finance companies (~58%) in this segment. Our book has a granular spread across 150+ customers. Over 92% of our lending is Term Loans (mostly for two years and above). With a stringent verification process, we verify quality of underwriting, assets, governance practices, capital, balance sheet strength and promoter involvement before disbursing the loans. We start with small ticket size loans and gradually build upon it, after examining the business across various parameters. In recent years, we have implemented stricter standards in asset provisioning at 1% against a requirement of 0.4%. Our exposure remains largely to small and mid-size customers with higher capital adequacy and with limited dependence on capital market borrowings.

With a cautious approach on NBFC sector, gross AUMs for this business decreased by 26% from ₹ 2,511 crore on 31st March 2019 to ₹ 1,856 crore as on 31st March 2020. Lending disbursements declined by 61% Y-o-Y to ₹ 940 crore in FY 2019-20.

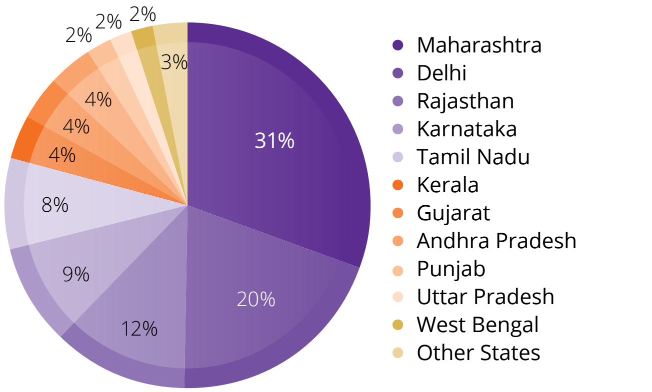
NBFC leading spread across varied asset categories – substantially in asset finance companies

NBFC Type	No. of Clients	POS (₹ crore)	% Mix	Deposits (₹ crore)
Asset Lending	91	1,070	57.7%	902
- MSME	*48*	*655*	*35.3%*	
- Vehicle	*21*	*155*	*8.3%*	
- Two-Wheeler	*17*	*145*	*7.8%*	
- NBFC having RE book	*2*	*64*	*3.5%*	
- NBFC having some RE exposure	*3*	*52*	*2.8%*	
MFI	24	225	12.1%	418
HFC	21	362	19.5%	323
Fintech	14	144	7.8%	134
Gold	4	55	3.0%	10
Total	**154**	**1,856**	**100.0%**	**1,787**

Over 88% of the NBFC exposure is in investment grade category

Credit Rating	POS (₹ crore)	Exposure (%)
Investment Grade	1,638	88.3%
- AA	*35*	*1.9%*
- A	*738*	*39.8%*
- BBB	*865*	*46.6%*
Non-Investment Grade	71	3.8%
Unrated	147	7.9%
Total	**1,856**	**100%**

NBFC Book geographic distribution



Agri - SME loans

Agri banking aims to meet the comprehensive requirement of all the stakeholders engaged in the agri value chain. Product Offerings are similar to SBL-SME loans wherein we have a dedicated team to serve the term loan, and working capital requirements of the entities involved in agriculture and allied value chain like food and agri processing units, warehouses/cold storages, fertilisers/seeds/pesticides wholesalers and retailers. Loans are also provided for construction, acquisition, renovation and carrying out machinery or equipment upgradation. We have a greater focus on customer segments in non-urban areas, where we can leverage our distribution network.

Gross AUMs for our agri business loans increased by 23% Y-o-Y from ₹ 984 crore on 31st March 2019 to ₹ 1,213 crore as on 31st March 2020, while disbursements grew 19% to ₹ 608 crore during the year.

Real estate group (REG)

We cater to the credit needs of small builders, who operate in the affordable housing segment or who develop small projects (majorly one or two tower projects) having completion period of 24 months to 36 months. In this vertical, we primarily cater to projects with last-mile funding towards project completion or payment of statutory approval cost.

We follow a strict and very selective sourcing model largely focused on near completion projects with fast-moving small units. We have internally developed an online tool for project monitoring, including No Objection Certificate (NOC) issuance and escrow management, and closely supervise timely action for key monitorables like cost overrun, time overrun and slow-moving inventory.

Gross AUMs for this segment's lending business increased marginally by 3% from ₹ 801 crore as on 31st March 2019 to ₹ 826 crore as on 31st March 2020; disbursements in FY 2019-20 declined by 8% at ₹ 406 crore versus ₹ 440 crore in FY 2018-19.

Liabilities and branch banking

As on 31st March 2020, we had 647 touchpoints, which comprised 406 bank branches, 122 banking outlets, 88 business correspondents, 31 asset centers, 13 offices and 356 ATMs (including TATA Indicash ATMs) across 11 states and one Union Territory.

We aim to address all the banking requirements of our customers as individuals as well as business owners. Through branch banking, we provide savings, investments, insurance, payment solutions, and loan products such as auto loans, home loans, personal loans, OD against FD, CD loans and gold loans to individuals.

For transactions and investments, we offer Current Account, Savings Account (SA), Term Deposits and Recurring Deposits. We are focused on building a granular retail deposit base. We are quite competitive in terms of pricing and product features, as well as service intensity vis-à-vis private sector banks. The share of CASA + Retail term deposits has been steadily increasing and stood at 43% in end-FY 2019-20 as against 39% in end-FY 2018-19. We constantly improvise based on our learnings and customers' needs. In December 2019, we launched AU Royale, a premium savings account targeting high-value customers with best-in-class features. The product has seen significant traction in the three months since its launch in December 2019, and we have acquired 4,701 New-to-Bank customers, and a total of 11,120 customers including upgrades of Existing-to-Bank account holders with an overall ATS of ₹ 10.5 lakh.

We use digital technology extensively to enhance customer experience wherever possible. For instance, new customers can open Savings Account (SA) using tablets that offer Aadhar validation through biometric identification. It enables us to open accounts without any forms, documents or photographs. In FY 2019-20, ~93% of our SA accounts were opened through TABs. We also rolled out digital Current Account (CA) opening on tablets and increased thrust on this segment with a dedicated Current Account acquisition team. Additionally, we have developed a dedicated team for government business across locations.

We sourced 572 crore of asset products through our liabilities team during FY 2019-20, and contribution of cross-sell will only grow in the future. At present, we are committed to developing new avenues for growth.

We provide a mix of investment and insurance products to our customers. During FY 2019-20, we sourced 82,508 life insurance policies, 3,74,332 general insurance policies and 48,325 health insurance policies. We have 5575 active SIPs, and we also opened 5,777 3-in-1 accounts in a tie up with Motilal Oswal Financial Services. During FY 2019-20, we earned ₹ 41 crore of cross-sell fee vis-à-vis ₹ 35 crore in FY 2018-19.

Deposit mix – by amount

(₹ in crore)

Financial year	Current Account	Savings Account	Term Deposits	Total deposits
FY 2019-20	1,114	2,673	22,377	26,164
FY 2018-19	1,082	2,508	15,832	19,422

Deposit mix – by number of accounts

(No.)

Financial year	Current Account	Savings Account	Term Deposits	Total deposits
FY 2019-20	78,907	12,33,929	2,08,776	15,21,612
FY 2018-19	47,783	8,73,031	107,912	10,28,726

Share of retail in term deposit (Excluding CD)

Financial year	Retail TD	Bulk TD
FY 2019-20	39%	61%
FY 2018-19	30%	70%

Digital banking

Digital banking services are an essential part of our strategy to enhance customer satisfaction, and as a young, agile bank we continuously invest in our digital banking franchise. Our key digital offerings include an instant Savings Account, two-wheeler and consumer finance loan.

Instant Savings Account

Our new-age instant Savings Account, AU ABHI, can be opened by just downloading the AU ABHI App and registering with the Aadhaar number, PAN and other minimal details.

WE ALSO STARTED AN INDUSTRY-FIRST INITIATIVE OF SAVINGS BANK ACCOUNT OPENING THROUGH WHATSAPP

Consumer finance loans

Our paperless digital consumer finance loans are processed digitally either by sales personnel at the point of sale or by customers themselves, thereby reducing operational processes and costs.

We offer consumer durable loans in partnership with a leading digital platform, which offers cashless Equal Monthly Instalment (EMI) options to customers purchasing consumer durables from various online retailers. Consumer finance loan disbursements through our digital platform grew from ₹ 6 crore to ₹ 43 crore in FY 2019-20.

Financial inclusion

At AU Bank, we are building a bank for 'Bharat' and are working ceaselessly to reach the remotest corners of the country. The RBI's small finance banking licensing guidelines require us to have:

- 75% of our loan portfolio under Priority Sector Lending
- 50% of loan portfolio should be upto ₹ 25 lakh of ticket size
- 25% branches in unbanked rural areas

With financial inclusion at the core of AU Bank's business philosophy, leveraging our deep market penetration and market insights, we have developed a unique business model and have been working relentlessly for 25 years to ensure easy access to credit in the unserved and under served markets. We are also driving various financial inclusion initiatives including the Pradhan Mantri Jan Dhan Yojana (PMJDY), Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY) Atal Pension Yojana (APY).

Over the years, our financial inclusion initiatives have encouraged over a million plus underbanked and unserved people to join the formal banking sector. At present, ~61% of our branches are in rural and semi-urban and unbanked areas of the country. We have increased our reach to the unserved section of society by opening our branches in unbanked rural areas and our reach stands at 164 (31% of total) from 116 as at end of FY 2018-19. During the year, we have opened 46,973 BSBD accounts, and 80,303 cumulatively as on 31st March 2020. The Bank has disbursed, ₹ 2,857.4 crore under MUDRA scheme in FY 2019-20 and have issued 3,85,653 Rupay card as on 31st March 2020.

Total 1,767 financial literacy and education camps were organised in FY 2019-20, covering nearly 3 lakh people.

Treasury management

The treasury function at the bank is primarily responsible for our Asset Liability Management (ALM); effective fund planning and positioning; day-to-day liquidity and fund management; managing statutory reserves in adherence to the statutory guidelines and judiciously managing investments and trading portfolio according to regulatory and internal policy frameworks. In addition, risk management is a key focus for us whereby market risk, ALM risk, interest rate risk and liquidity related risks are effectively monitored and managed. The treasury, along with Financial Institutions Group (FIG) maintains a close interface with financial markets and participants for augmentation of counter-party lines for our balance sheet management.

The treasury on a day-to-day basis focuses on fund management, compliance with regulatory requirements of Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR) and Liquidity Coverage Ratio (LCR) and managing liquidity and interest rate risks, along with effective assets and liability management. The treasury maintains a portfolio of government securities, in line with the regulatory norms governing the SLR. SLR securities are primarily retained as Held to Maturity (HTM), and remainder portions are held as Available for Sale (AFS). It concentrates on optimising yield on the overall portfolio, while maintaining an appropriate portfolio duration within the overall risk framework and under the oversight of regulatory framework and internal policy parameters.

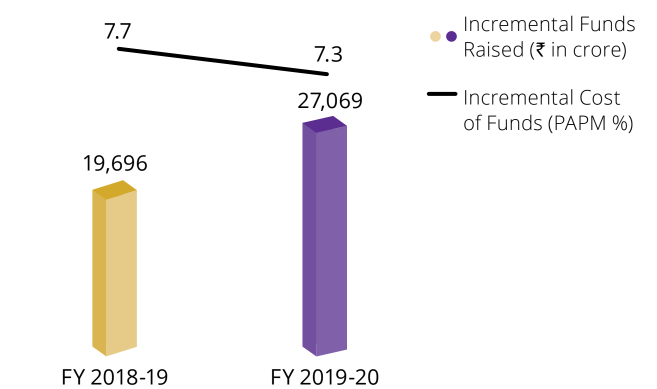
Funding profile

(₹ in crore)

Funding sources	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20
Deposits + Borrowings	28,856	30,732	32,534	36,499
Deposits	68.8%	72.1%	73.4%	71.7%
Refinance from FIs	20.0%	19.7%	18.7%	18.4%
NCDs	5.0%	3.7%	3.4%	2.7%
Loans from Banks and NBFCs	0.7%	0.5%	0.4%	0.7%
Tier II Capital	2.5%	2.3%	2.1%	1.9%
CBLO*/line of credit /inter-bank/others	3.0%	1.8%	2.1%	4.7%
Total	**100%**	**100%**	**100%**	**100%**
Off-book Source of Funds				
Securitisation and Assign O/s AUM	2,266	2,795	3,019	3,582

*Collateralised Borrowing and Lending Obligation

Incremental Funds Raised* and Cost of Raising



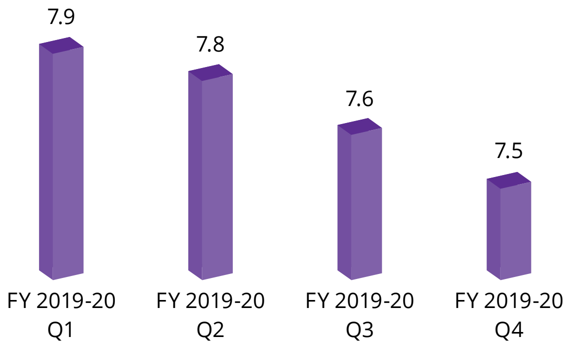
*Including Securitisations Assignments

Credit Ratings

Rating Agency	Term	Current Credit Ratings
CRISIL Ratings	Long term	AA-/Stable
	Short term	A1+
ICRA	Long term	AA-/Stable
	Short term	Not Rated
India Ratings	Long term	AA-/Stable
	Short term	A1+
CARE Ratings	Long term	AA-/Stable
	Short term	A1+

Cost of Funds Trend

(%)



Our incremental cost of funds declined by 32 bps to 7.33% in FY 2019-20 helped by a more granular liability base. Our cost of deposits (excluding certificates of deposit) stood at 7.44%. As on 31st March 2020, we maintained Statutory Liquidity Ratio (SLR) investments of ₹ 7,313 crore (versus requirement of ₹ 5,303 crore) in the form of government securities/SDLs (held to maturity) and government securities/T-Bills (available for sale). There was no mark-to-market (MTM) provision/loss during FY 2019-20 for both SLR and non-SLR portfolio. During FY 2019-20, we maintained a healthy LCR of 97%, well above the minimum requirement of 90% for SFBs. We have built a profitable and high-quality non-SLR investment book of ~₹ 1,896 crore to offset negative carry on account of incremental cost of funds to maintain SLR and LCR. Our treasury reported a profit of ₹ 54 crore in FY 2019-20.

Liquidity, interest rate and ALM management

We are maintaining sufficient liquidity and contingency buffer in the wake of volatile markets, which are invested in High Quality Liquid Assets in the form of excess SLR and high-quality Debt Capital Market instruments (G-Sec/T-Bills and AAA/AA+ Non SLR instruments) and can be readily used for repo or liquidated in secondary market. We have strengthened and diversified our liquidity profile in view of additional regulatory requirements through a judicious mix of deposit mobilisation (CASA, Retail Deposit and Bulk Deposit) and rupee borrowing in the form of CDs, Term Money, securitisation of portfolio, and re-finance from various domestic financial institutions (NABARD, SIDBI, MUDRA and others) to optimise cost and manage the ALM profile. During the year, high-cost grandfather borrowing in the form of Term Loans and NCDs were substituted with low-cost deposits and market borrowings.

The treasury closely works with the internal teams and monitors deposit mobilisation besides regularly undertaking analysis of competitive landscape of interest rates to benchmark our deposit rates. The treasury regularly monitors the portfolio and incremental cost of funds and takes suitable measures to optimise cost of funds by allowing branches to mobilise deposits by offering competitive rates of interest, keeping in view the prevailing interest rate scenario, along with ALM position and optimum liquidity management.

We have also established a trading desk for government bonds and highly rated money market instruments. We endeavour to generate trading surplus by prudently taking advantage of interest rate movements through proprietary positions at appropriate levels with approved policy and risk framework with the guidance of Investment Committee and the Board. During the year, we also participated in the RBI's Open Market Operations (OMO) bond buying programme, and generated capital gains from the SLR portfolio. We also participated in Long-Term Repurchase Operations (LTRO) to raise long-term funds at repo rate to provide credit to productive sectors.

All ALM parameters like Structural Liquidity Statement (SLS) and Interest Rate Sensitivities (IRS) positions are efficiently managed within regulatory and the Board approved limits under the supervision and guidance of the Asset and Liability Management Committee (ALCO) through investments and borrowings in appropriate buckets. We also have well-defined Contingency Fund Planning parameters to monitor liquidity under stress scenarios. In line with RBI guidelines, we have moved to External Benchmarked Rate (EBR) based pricing of floating rate loans for better transmission of rates to our customers.

Debt Capital Market (DCM) Desk

The DCM desk was started in FY 2018-19, for investments in short-term and medium-term bonds, debentures and commercial papers. Its objective is to enhance return on funds and create high-quality liquid assets to aid in regulatory LCR as well as effective liquidity management within regulatory and investment policy risk parameters. DCM undertakes investments, origination, holding and trading of bonds, and works closely with leading corporates, asset managers, insurance companies, other banks and market participants with understanding of day-to-day market positioning and changing dynamics. During FY 2019-20, we generated income from our high-quality liquid investments in addition to the fundamental of adequate liquidity cushioning at all times with prudent risk framework.

Financial Institutions Group (FIG)

Financial Institutions Group (FIG) is responsible for managing overall relationships with various financial market participants such as banks, mutual funds, cooperative banks, insurance companies, Development Finance Institutions (DFI) and multilaterals, as well as associates and intermediaries such as credit rating agencies, legal firms and stock exchanges. The group helps in setting up fund-based and non-fund-based limits with various counter parties and market participants and vice versa. This group is also responsible for raising Tier-II capital for us according to capital adequacy requirement to maintain healthy capital position.

FIG also facilitates the raising of medium to long-term liability, depending on our funding and ALM position through various borrowing instruments like bonds, securitisation and managing deposit relationship with other FIs.

During the year under review, we continued to grow our relationships with banks and financial institutions in both private and public sectors through mutual counter-party limit set up, including committed lines of credit for ensuring various inter-bank transactions and liquidity management.

We tied-up with various banks to ensure availability of trade and remittances products for our clients. We successfully facilitated inward and outward foreign currency transactions, including issuances of trade instruments (letters of credit and bank guarantees) and processing of trade payments within the capacity of an AD-II category bank.

As part of liquidity management measures, we continued to enhance our relationship with domestic Development Financial Institutions (DFI) and availed long-term, low-cost refinance facilities under various schemes. Money raised under various refinance schemes helps to lower our cost of funds and improve the ALM profile, concurrently allowing us to continue providing long-term financing assistance to various underbanked and underserved customers in rural and semi-urban locations.

In the current financial year, we also used securitisation route for raising long-term, low-cost liability by assigning part of our retail-loan portfolio to various investors. During the year under review, we securitised a total portfolio of ₹ 4,042 crore, with ₹ 1,013 crore worth of portfolio being securitised in March 2020 itself helping the Bank enhance its liquidity position.

Credit management

Credit underwriting is an integral part of our frontline functions at AU Bank. It plays an active role in portfolio building within the accepted risk appetite of AU Bank. We use in-house field investigation techniques to evaluate and analyse customers' income and repayment ability. With a robust and comprehensive credit assessment architecture we cater to a large segment of underserved customers, who are primarily first-time users of financial products.

A separate credit team for each business vertical evaluates prospective customers' business needs, identifies expansion plans and analyses their ability to repay.

Our credit assessment framework follows a three-layered system of assessment, which includes visits by credit officers, relationship officers and business officers to inspect the business and collateral quality.

Legal assessment: We have a central legal team that facilitates both external and internal legal investigations. A two-level inspection of title papers and legal documents help, us manage the risks. We have added people across all states and branches with legal experience and domain knowledge in our legal teams.

Technical setup: We have a centralised technical team with experienced coordinators for both external and internal technical checks. We also have appointed valuers across all states and branches.

Risk Containment Unit (RCU): Our regional RCU teams conduct detailed document verification and thorough checks on several parameters before disbursing loans.

Post-disbursal monitoring: We also have a post-disbursal monitoring process, which allows us to maintain portfolio quality. This mechanism also helps us adhere to policy and improve the documentation process. The monitoring of working capital limits is also under this process. It is conducted regularly for all working capital products across AU Bank.

Collection management

Our asset quality is a result of our robust collections management system. Our collections management function is based on geography, delinquency, products and customer repayment history, among others.

Our regular customer engagement and Business-to-Employee (B2E) communication enable us to strengthen the collection management function of AU Bank. We capture profile data of customers to develop a strong customer database, which our MIS and reporting departments use for regular updates to the management.

Over 85% of the collection is in-house, which enables us to maintain superior asset quality. We have specialised partners in select metro and micro markets for bucket 1 and bucket 2 cases, which provide cost efficiency in collection management operations. At AU Bank, we are inculcating proactive collections that help us better bond with our customers.

Collection facilitators

Newgen

100% customer engagement on New-Gen application

Insurance claim recovery

Dedicated team ensuring claim recovery

Mature Case Collection Team (MCCT)

A 12-member tele-calling team for managing run off portfolio (matured pool)

Repo-sale and ARD

A centralised Repo Sale Unit and dedicated Loss on Sale recovery team

Call centre

In-house tele-calling set-up done primarily by women driving vernacular calling

Field collection

Strong in-house field collection team and agency set up in all urban locations

Legal

Centralised legal driving SARFAESI, Sec-9, Lok Adalat, Arbitration

Bond team

Driven by the philosophy 'think the unthinkable, achieve the unbelievable' in managing chronic pool

Information technology

We use the latest technology across all functions in AU Bank, enhancing convenience for our customers, streamlining operations and reducing costs. With our transition into an SFB, we also underwent major technology upgradation, by incorporating modern hardware, software, risk management products and solutions. We are confident that this infrastructure investment will serve us well, going forward.

We procured our Core Technology Stack (CBS) from Oracle Corporation. Our other key systems include customer relationship management application, treasury application, expense management system, compliance and others encounter regular upgrades and integration. With our flexible yet robust technology architecture, we nurture partnerships with digital applications of other technology and IT partners.

We have strategically aligned our skilled workforce into three focussed IT sub-verticals:

- Build the Bank
- Run the Bank
- Govern the Bank

This ensures hassle-free banking for our customers and the continued growth of our organisation.

We will continue to upgrade our systems with automated, digitised and other technology-enabled platforms and tools, which will help us in delivering banking services to a broad spectrum of customers. A greater adoption of our digital service delivery mechanism and innovative applications will enable us to be more efficient and customer friendly. Today, our branches are equipped with paperless and faster customer onboarding processes across products and our customers have various digital payment options via Net banking and UPI (Paytm and PhonePe).

For our corporate customers, we have the ‘Corporate Internet Banking’ platform. For further empowering our customers, we have integrated our systems with two of the largest payment gateway aggregators, CCAvenue and Bill Desk, among others. This will help our customers to make payments to various merchants directly from their bank accounts. We also implemented Rupee Power, a paperless two-wheeler loan origination system, which enabled us to process two-wheeler loans faster during the last financial year.

At AU Bank, we are focusing on implementing cutting-edge banking solutions to enhance our systems' stability and sustainability. Our disaster readiness has been tested in a range of scenarios to ensure there is no business disruption beyond the stipulated threshold.

We have dual network connectivity at most of our branches to maximise business uptime. Error free and rule-based automated computation of various banking charges are also live to enhance staff productivity.

Serving India's vision of financial inclusion Aadhar Enabled Payment System (AEPS) on Micro ATMs and OFF US Card transactions have also been implemented to serve the respective sectors.

Human resource

We have been unlocking the power of our people through a culture based on inclusivity, which enables them to grow as goodwill ambassadors of AU Bank. Our organisational culture serves as the key enabler for the progress of our people and enriches their experience of working with us.

We are evolving to meet the demands of the workforce and grow as a preferred employer with contemporary management practices and a well-defined HR structure. Our processes are designed for taking a strategic approach towards talent acquisition, performance mapping, and rewards and recognitions.

Our people receive several opportunities to grow, while we consistently engage with them. During the year, we introduced the following training programmes:

- Pratyarambh training programmes
- Connect-Customer Delight
- Buniyaad – Back to Basics – The AU Way
- E-learning
- Management Development Programme
- AU Talk Show: Leadership Connect
- Virtual Training Sessions
- Executive coaching

As part of rewards and recognitions programme, we have several awards based on business performance and the AU value that acknowledges people based on their accomplishments and ability to embrace the AU Dharma. We also have different programmes for employee engagement, including townhalls, workshops, Connect (for recruits), HR Sampark and Retention Day, among others.

At AU Bank, we are embracing data-based decision-making and automation to enhance services and reduce risks. In the coming years, we will focus on retaining our best performers, concurrently building our pipeline for leadership roles and promote the use of technology among our people.

Compliance

At AU Bank, compliance starts at the top and is a shared responsibility of the entire team. Our Board of Directors and Audit Committee are responsible for overseeing the management of compliance risk and implementation of the compliance risk management framework across the organisation.

We promote awareness of compliance obligations and ethical values across the organisation to build a culture focused on compliance. The key elements for building and maintaining a strong compliance culture at AU Bank are:

Engaging the leaders: Our Board and senior management actively participate, provide direction and vision within the defined compliance and risk management framework. With a well-defined risk management infrastructure, we involve the senior management in monitoring operations of the organisation continuously. We have various Board-level and Board-delegated committees, where the Board members and the senior management are apprised of the current affairs of AU Bank.

Stringent policies and procedures: We have a set of well-documented policies and procedures in place and operate within the framework defined by the regulator and the policies approved by the Board.

Monitoring our functions: Audit, risk and compliance departments conduct regular reviews to ensure that our operations are within the defined framework, which helps us monitor these functions. We operate according to the laid down/defined principles, guidelines and policies, thereby reducing risk and uncertainty through the establishment of sound governance mechanism and strong compliance culture. These three functions roll up to the Audit Committee and Board through managerial hierarchy.

Training our teams: We educate our people on internal policies and external regulations in a regular and influential way. With a dedicated training department in place, we ensure to circulate relevant information among our people. Our communication channels are open to all our employees, who can approach various departments and senior management officials for guidance and resolution of their queries.

Technological support: We adhere to all transaction-based requirements/limits by using technology. Our systems and applications are used for monitoring transactions as well as for ensuring that post facto controls are in place.

Incident reporting and case management: Incident reporting and case management is an important aspect of our compliance programme. They help us track and address any misconduct. Being aware of non-compliance is half the battle won, when it comes to mitigating risks. We identify misconduct/noncompliance/violation through regular monitoring programme and system controls and undertake appropriate actions thereafter.

We believe integrity, ethics and compliance are important. We reiterate this idea to our people through policies and trainings. Ensuring that we have our finger on the pulse of the evolving laws and regulations helps us proactively steer the organisation in accordance with the requirements.

Internal control systems

At AU Bank, our management is the first line of defence and is primarily responsible for ensuring adequate and effective internal control systems.

Risk, compliance and internal audit together form the second line of defence and perform the governance function. Internal audit is the third line of defence operating independently with functional reporting to the Audit Committee of the Board. It works in close conjunction with Risk and Compliance functions (second line of defence) to ensure a strong overall governance mechanism within the Bank.

To bring in more efficiencies and to eliminate duplication, the Internal Audit, Risk and Compliance functions leverage each other's work without compromising on their independence. This in turn, results in better coordination and total assurance on all the important areas/processes/functions of our Bank.

- Our Internal Audit department evaluates business and controls risks of all business processes and branches to create a risk-based internal audit plan, aligned to the regulators' expectations. This risk-based Internal Audit plan is approved by the Audit Committee.
- Our Internal Audit function performs independent and objective assessments. It monitors adequacy, effectiveness and adherence to internal controls, processes and procedures instituted by the management and extant regulations.
- Following RBI's guidelines, we have adopted a robust Internal Audit policy, which drives the conduct of Risk-Based Internal Audit (RBIA) across all auditable entities.
- The audit frequency of auditable units is aligned with the risk profile of each auditable unit.
- As part of audits, internal audit also provides process improvement recommendations to the management and the same is tracked/followed up for implementation.
- As part of meeting management expectations, in addition to the approved internal audit plan, internal audit also carries out certain management-advised audits based on specific areas/triggers identified and communicated by the management/senior leadership to internal audit.
- Moreover, the internal audit function conducts self-assessment of our internal financial controls, adequacy and operating effectiveness of such controls in terms of the Companies Act, 2013.
- Our Audit Committee is appointed by the Board of Directors and it assists the Board in reviewing auditing and accounting matters as well as risks related therewith. It assesses the robustness, adequacy and reliability of our internal control systems and provides assurance to stakeholders accordingly.
- Our internal audit function is using the renowned Pentana Audit System (audit documentation tool) for end-to-end management of audits carried out during the year. For any audit, the above system captures the entire audit lifecycle – audit preparation, planning, providing assurance (design & operating effectiveness evaluation, validation & reporting) and action against the findings.
- Internal Audit has also started evaluating few data analysis tools and the goal is to move from excel based data analysis to CAAT tools for data analysis due to the ever increasing volume and complexity of data.

SWOT ANALYSIS

STRENGTHS

Our capabilities and resources that enable us to grow and sustain in the competitive banking landscape:

- Well positioned to derive benefits of both the 'Pull' factor of being a bank, and 'Push' factor of its NBFC roots
- Secured retail loans focussed scheduled commercial bank with strong track record of underwriting loans to under-banked population
- Comprehensive suite of products and services – a significant cross-sell lever; longstanding presence in relatively untapped markets
- Extensive phygital distribution network enabling efficient delivery of products and services to customers across urban, semi-urban and rural (Tier I to VI) centres
- Healthy capital adequacy levels and options to augment capital to absorb negative surprises
- Execution focused leadership team, and stable and seasoned second line

WEAKNESSES

Aspects of the business that can be improved to minimise risks in our business:

- Geographical Concentration: Four states (Rajasthan, Madhya Pradesh, Maharashtra and Gujarat) together account for ~80% of our loan book
- Product Concentration: Significant concentration of wheels (~42%) in total loan assets

OPPORTUNITIES

We are consistently identifying potential areas where we can grow and enhance market and brand prominence:

- Leveraging technology, along with door step servicing would enable us to rapidly gain market share. Profileration of data, digital usage and smartphones is opening new opportunities
- Longstanding presence in underpenetrated regions offers strong growth potential
- New retail products—gold loan, home loan, two wheeler loan, agri-SME loan and consumer durable loan—hold significant growth potential
- Scaling up of third-party products (mutual funds, general insurance, health insurance and life insurance) could boost other income

THREATS

We are identifying potential threats to our business, owing to evolving macroeconomic factors and consumer perceptions:

- Growing competition from other banks and financial institutions
- COVID-19 situation and related lockdown is an unprecedented situation and poses a threat to asset quality and growth if situation becomes worse than expected
- Dent in depositors' confidence in private banks following several events including moratorium being placed on deposits withdrawals for two private banks in FY 2019-20 could slow our growth in granular deposits
- Volatility in global or domestic economy and political uncertainty might hamper growth