Stock Update

Equitas Small Finance Bank Ltd.

May 12, 2023

Equitas Small Finance Bank Ltd

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Small Finance Bank	Rs.78.9	Buy between Rs.78-80 band & add more on dips of Rs.69-70.5 band	Rs.87	Rs.95.5	2-3 quarters

HDFC Scrip Code	EQUITASBNK
BSE Code	543243
NSE Code	EQUITASBNK
Bloomberg	EQUITASB:IN
CMP May 11 , 2023	78.9
Equity Capital (Rs Cr)	1111
Face Value (Rs)	10
Equity Share O/S (Cr)	111.1
Market Cap (Rs Cr)	8,775
ABook Value (Rs)	43.6
Avg. 52 Wk Volumes	3690662
52 Week High	80.90
52 Week Low	37.45

Share holding Pattern % (Mar, 2023)	
Promoters	0
Institutions	65.67
Non Institutions	34.33
Total	100.00

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Equitas SFB is one of the largest small finance banks in India and offers bouquet of products and services. The key business verticals include Micro Finance, Small Business Loans (SBL), Home Loans and Vehicle Finance. It started as an MFI and gradually forayed into other businesses like small business loans, home and vehicle loans. The Bank also has one of the best in class CASA ratio (at 42%), supported by its digital acquisition strategy and fintech tie-ups. This along with high growth in the other businesses has helped the bank maintain high margins, despite transforming itself from a micro finance institution to a diverse services provider.

COVID led weak economic scenario had impacted the Micro Finance Industry (MFI) and small business segment. Equitas SFB's performance had also deteriorated. There was a sharp spike in NPAs and due to higher provisions, the profitability of the bank was also impacted. However, we feel that going by the Q4FY23 results, the worst is over and situation has improved with the economy picking up again and the rural demand on the rise, the growth outlook looks positive for the short to medium term. RBI in March 2022 issued new directions for microfinance lending and has eased microfinance regulations. For the long term we feel that the opportunity is huge as penetration of MFI and SFB loans in Indian market is still low.

We had issued a report on Equitas Holding Ltd which was the erstwhile holding company of Equitas SFB (link). This company has now been merged with Equitas SFB. As the shareholders of Equitas holding Ltd have been allotted shares in Equitas SFB, we are now issuing this report on Equitas SFB incorporating the latest quarterly results of Q4FY23.

Valuation & Recommendation:

Numbers reported over the past 2-3 quarters show that there has been significant improvement in terms of business growth and the asset quality numbers also seem to be improving. The Bank has healthy capitalization level with CRAR standing at 23.8% (including Tier–1 of 23.08%.

The bank recently declared its results for Q4FY23, in which it reported total advances of Rs. 27,681 crores, up 35%/12% YoY/QoQ. The disbursements for the quarter stood at Rs. 5,917 crores up 80%/23% YoY/QoQ and were the highest quarterly disbursement in the bank's history. On the liability side, it reported a total deposit of Rs. 25,381 crores, growing by 34%/8% YoY/QoQ. Out of these deposits, CASA balance stood at Rs. 10,732 crores, which is up 9% on a yearly basis but flat at -1% on a sequential basis. The Term Deposits of the bank showed healthy growth of 61%/16% YoY/QoQ to Rs. 14,649 crores. In April 2023, the RBI granted the bank Authorized Dealer Category 1

(AD-1) License to the bank to deal in foreign exchange. This will enable the bank in providing foreign exchange facilities to its Non Resident customers who have contributed more than Rs. 1,300 crores of deposits to the bank.

We have envisaged 22% CAGR in NII and 31% in net profit over FY23-25E, while the loan book is estimated to grow at 26% CAGR over same time frame. As the collection efficiencies have improved and economic activities have picked momentum, the asset quality should improve further. ROAA is estimated to improve to 2% by FY25E. It could display steady improvement in return ratios driven by growing advances and contained slippages.

We feel that investors can buy Equitas SFB between Rs.78 & 80 (1.35x FY25E ABV) add more on dips to Rs.69-70.5 band (1.2x FY25E ABV). We expect the Base case fair value of Rs. 87 (1.5xFY25E ABV) and the Bull case fair value of Rs. 95.5 (1.65xFY25E ABV) over the next 2-3 quarters.

Equitas SFB Financial Summary

	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY21	FY22	FY23P	FY24E	FY25E
NII	707	552	28.0	648	9.2	1798	2039	2545	3156	3813
PPP	386	284	36.1	279	38.4	944	720	1176	1404	1696
PAT	190	120	59.0	170	11.7	384	281	574	781	981
EPS (Rs)						3.4	2.2	5.2	7.0	8.8
ABV						27.5	30.1	43.6	50.4	58.0
P/E (x)						23.4	35.2	15.3	11.2	8.9
P/ABV (x)						2.9	2.6	1.8	1.6	1.4
RoAA (%)						1.7	1.1	1.9	2.0	2.0
RoAE (%)						12.5	7.3	12.2	14.2	15.8

(Source: Company, HDFC sec)

Recent Developments

Q4FY23 result update

The bank recently came out with its Q4FY23 figures. It has continued to show healthy business momentum. It reported highest ever quarterly disbursement of Rs. 5,917 crores up 80%/23% YoY/QoQ. Gross advances stood at Rs. 27,681 crores, up 35%/12% YoY/QoQ. Deposits reached Rs. 25,381 crores, growing by 34%/8% YoY/QoQ. The CASA ratio declined to 42% compared to 46% in last quarter, while Cost of Funds stood at 6.61% which is up 23/20bps YoY/QoQ. As of March 2023, the bank has 20,563 employees, 922 branches and 349 ATMs across 18 states in the country.

Financial Performance

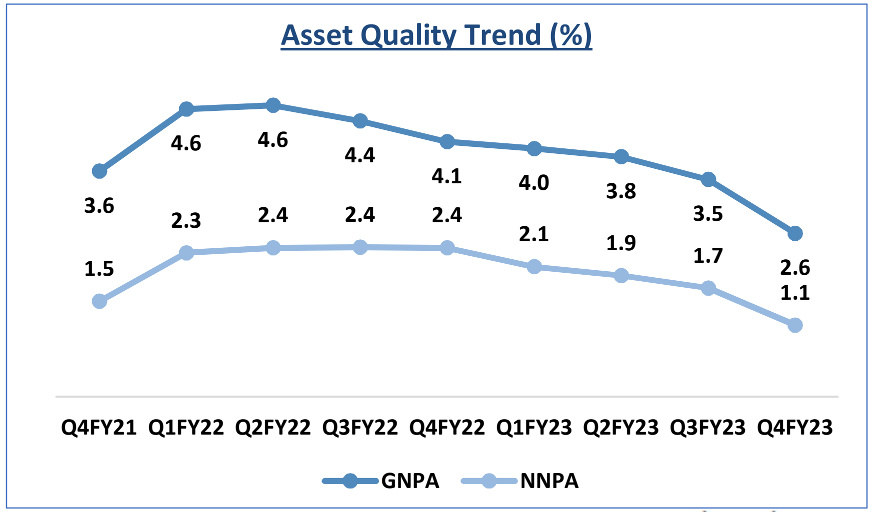
The Net Interest Income (NII) of the bank for Q4FY23 stood at Rs.707 crores up 28%/9% YoY/QoQ which was led by increase in the interest income of 29%/9% YoY/QoQ. The Net Interest Margin (NIM) stood at 9.1% which is -2/+9bps YoY/QoQ. The sequential growth was on account of increased lending rates and operational efficiencies. The bank reported other income of Rs.239 crores, up 61%/56% YoY/QoQ primarily driven by income from sale of NPAs to ARCs worth ~Rs.69 crores (loan amount sold- Rs. 580 crores). On the expenses side, the total opex of the bank stood at Rs.559 crores which was up 34%/7% YoY/QoQ on account of large recruitment drive and investment in digital initiatives by the bank. All this led to a strong 36%/38% YoY/QoQ rise in PPOP which stood at Rs.386 crores. Bank reported credit charge/provisions of ~ Rs. 126 crores which took the PAT to ~ Rs.190 crores, up 59%/12% YoY/QoQ. This is the highest ever quarterly PAT reported by the bank driven primarily by higher NII and Other Income. The quarterly RoA is healthy at 0.55% v/s 0.49% in Q3FY23 and 0.45% in Q4FY22. Further, the bank reported RoE of 15.52% v/s 14.95% in Q3FY23 and 12.21% in Q4FY22. Cost to Income ratio stood at 58.09% which has improved by 586 bps on a sequential basis. The management has guided for this ratio to stay within current range as it plans to enter new businesses such as personal loans, credit cards etc.

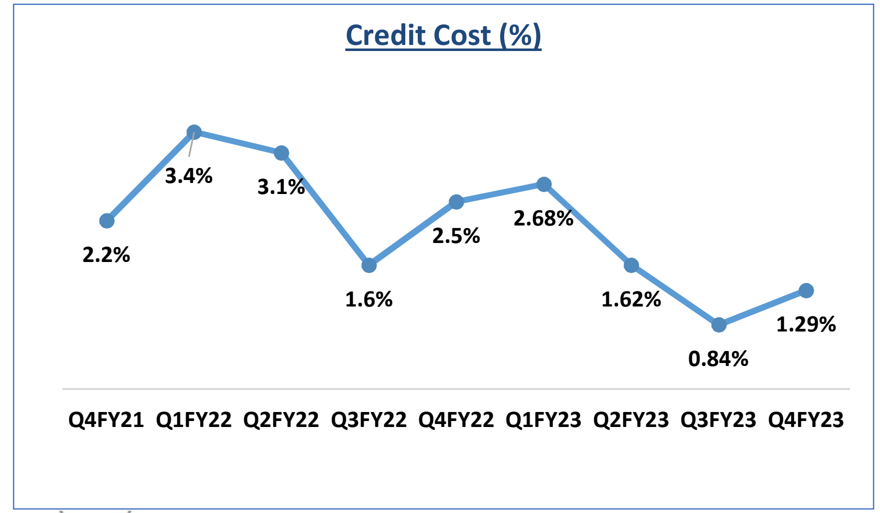
Asset Profile & Quality

As mentioned earlier, the Gross Advances of the bank stood at Rs. 27,681 crores, up 35%/12% YoY/QoQ and the disbursements for the quarter stood at Rs. 5,917 crores up 80%/23%% YoY/QoQ. This is the highest ever quarterly disbursement by the bank. NBFC segment displayed the highest sequential growth (63%) in terms of new disbursements during the quarter, followed by new commercial vehicles segment (56%). The management has guided for a loan growth of 25-30% for FY24.

In terms of asset quality, GNPA came at Rs. 724 crores which is 2.76% of advances compared to 3.63% in Q3FY23, while NNPA were Rs. 312 crores, being 1.21% of advances as compared to 1.82% in Q3FY23. The Provision Coverage Ratio improved to 56.9% from 50.8% in Q3FY23, on account of additional provisions created by the bank to the tune of Rs. 90 crores during Q4FY23. As of FY23, the bank has total provisions of Rs. 549 crores of which Rs.412 crores are related to NPAs. The annualized gross slippages stood at 3.1% v/s 5.0% in Q3FY23 and 8.3% in Q4FY22, on account of healthy recoveries, upgrades and write offs. The bank expects its slippages to reduce further in coming quarters.

During the quarter, the bank reversed provisions amounting to Rs. 11.24 crores being excess provisions on assets sold to Asset Reconstruction Companies. The credit cost stood at 1.29% for the quarter. The total restructured loan book of the bank stands at Rs. 235 crores (~1% of loans) v/s Rs. 730 crores as of Q3FY23 and Rs. 177 crores out of these are categorized as GNPAs, on which bank holds provisions of 88%. SMA1/SMA2 book stands at 2.08%/1.13% vs 3.64%/1.98% as of March, 2022 and the overall 1-90 dpd reduced to 3.21% v/s 3.88% in Q3FY23. All Security Receipts (SR) have been provided for and any receipts from these would be recorded as Other Income going forward.





GNPA Movement (Rs. Cr)	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Opening GNPA Balance	863.82	837.18	856.00	870.26	861.36
Add: Additions during the period	408.56	296.03	314.01	286.46	190.59
Less:					
i. Upgradations	109.88	51.75	136.67	144.81	125.71
ii. Recoveries (excluding recoveries made from upgraded accounts)	133.62	95.64	81.73	69.37	84.79
iii. Technical or Prudential write-offs	105.62	95.95	22.76	27.71	9.21
Write-offs other than those under (iii) above	86.08	33.87	58.58	53.47	108.28
Closing GNPA Balance	**837.18**	**856.00**	**870.26**	**861.36**	**723.96**

(Source: Company, HDFC Sec)

Liability Profile

The bank has reported Current Account deposits of Rs. 974 crores (up 26%/22% YoY/QoQ) and savings account deposits worth Rs. 9,758 crores (+7%/-3%YoY/QoQ), which takes the total CASA deposits of Rs. 10,732 crores (+9%/-1% YoY/QoQ) and a CASA ratio of 42% against 46% in Q3FY23. Further, the total Term Deposits stood at Rs. 14,649 crores which are up 16%/58% YoY/QoQ. This healthy increase in term deposits and a sequential fall in savings deposits due to high interest rate offered on term deposits has led to the 400bps sequential fall in the CASA ratio. Overall, the bank has reported deposits worth Rs. 25,381 crores which is up 34%/8% supported by strong growth in Term Deposits.

Going forward, the bank wishes to focus on mass affluent customers to garner deposits. Non-Resident deposits has crossed Rs. 1,300 crores for the first time. The bank has a liquidity coverage ratio of 181% as of March, 2023. Apart from CASA and Term Deposits, it has Refinance fundings and IBPC (interbank participation certificates) fundings worth Rs. 2,974 crores and Rs. 1,650 crores respectively. It has adequate eligible advances to raise funds via these means which act as a strong cushion to the ALM position of the bank. Further, its Certificate of Deposits have the highest ratings from of A1+ from CRISIL and Indian Ratings.

Particulars/As of	Q4FY22	Q3FY23	Q4FY23	YoY	QoQ	Contribution
Current Account (CA)	772	796	974	26%	22%	4%
Savings Accounts (SA)	9,083	10,021	9,758	7%	-3%	38%
CASA	**9,855**	**10,817**	**10,732**	**9%**	**-1%**	**42%**
Term Deposits	9,095	12,576	14,649	61%	16%	58%
Total Deposits	**18,950**	**23,393**	**25,381**	**34%**	**8%**	**100%**

Healthy capital positioning

The balance sheet remains well capitalized with Total CRAR at 23.80%, Tier I at 23.08% and Tier II at 0.72% as of March, 2023. Since transformation into a banking company, it has been maintaining capital adequacy ratio above 20% (compared to regulatory requirement of 15%). In FY22, the bank raised Rs.550 Cr through the QIP route (at a premium of Rs.43.59) to comply with SEBI's requirements on minimum public shareholding. We believe that the capitalization level remains healthy at the current level to fund the expected growth at least for the next few years. In February 2023, the erstwhile holding company of the bank- Equitas Holding Ltd has been reversed merged with Equitas SFB. On account of this reverse merger, the share capital of Equitas SFB has decreased from Rs. 125.2 crores to Rs.111 crores.

Reverse merger update

The RBI has clarified that promoter can exit or cease to be a promoter of a small finance bank after completing lock-in period of five years, subject to the RBI's regulatory and supervisory comfort and SEBI Regulations. Also in RBI's letter dated July 9, 2021 issued to the 'Association of Small Finance Banks of India' it has allowed reverse merger of holding company with the SFB subject to RBI approval. While keeping aforesaid rules in mind the parent company of the bank (Equitas Holding Ltd) had decided to reverse merge with Equitas SFB. The exchange ratio fixed for this reverse merger is- 231 shares of Equitas SFB of Rs. 10 each, fully paid up, for every 100 shares of EHL of Rs. 10 each, fully paid up. In February 2023, the shares of EHL have been delisted from the stock exchanges and shares of Equitas SFB have been allotted to the shareholders of EHL. As this is a reverse merger, the shares of Equitas SFB held by EHL shall be extinguished. The net impact of this has led to reduction in share capital which would stand at approximately Rs. 1111 crores post-merger.

Universal Banking License

Post this reverse merger, the MD & CEO of the bank has, in an interview, stated that the bank will reach out to the RBI to check if they're eligible for the universal banking license. If the bank is eligible and is granted this license, it can venture into various segments open to commercial banks such as personal loans, credit cards, asset management, underwriting, investment banking, etc. Further, the priority sector lending targets and capital adequacy requirements would also reduce once the bank gets this license. We will have to watch out for more developments in this matter in the coming period.

Key Triggers:

A well-diversified loan book

Despite headwinds in the micro finance as well as vehicle finance industry, Equitas SFB could report ~26% CAGR in the loan book during FY18-FY22. It is one of the largest small finance bank in the country. The key business verticals include Micro Finance, Small Business Loans (SBL), Home Loans and Vehicle Finance. It started as an MFI and gradually forayed into small business loans, home and vehicle loans. Other, relatively newer segments include corporate loans, medium sized enterprises and others. Micro Finance segment is primarily unsecured but high yielding in nature. The bank focused on de-risking its balance sheet and hence shifted its focus to secured loans but catered to customers from similar economic strata, in order to avoid large dips in its margins and at the same time contain the credit costs. Now the portfolio is largely secured in nature.

While the Bank's business model has transitioned over the years, but providing sustainable credit to the unserved and underserved segments continues to be its core focus. These underpenetrated segments, coupled with lower financial penetration in its main markets like Tamil Nadu, Maharashtra, and Karnataka etc., provide growth opportunities, along with attractive yields. Management has guided for ~25-30% growth in advances in the coming year supported by strong demand across key products. Following table shows the bifurcation of bank's loan book into different segments:

Loan Segments/As of (in crores)	Q4FY22	Q3FY23	Q4FY23	YoY	QoQ	Contribution	Avg Ticket Size (Rs.Lacs)	GNPA %	PCR %
Small Business Loans (SBL)	7,881	9,312	10,083	28%	8%	36%	4.09	3.4%	50.5%
Housing Finance	1641	2463	2873	75%	17%	10%	9.17	0.9%	32.1%
Micro Finance	3,907	4,600	5,225	34%	14%	19%	0.26	2.3%	74.8%
Vehicle Finance	5,047	6,203	6,971	38%	12%	25%	3.47	2.2%	63.8%
Used Commercial Vehicles	*2,861*	*3,226*	*3,463*	21%	7%	12%			
New Commercial Vehicles	*1,854*	*2,404*	*2,793*	51%	16%	10%			

Used Car	*332*	*573*	*715*	115%	25%	3%			
MSE Finance	1164	1172	1,175	1%	0%	4%	36.03	6.3%	47.6%
NBFC Financing	758	872	1184	56%	36%	4%	2,193	0.4%	100.0%
Others*	199	293	350	76%	19%	1%			
Total Gross Advances	**20,597**	**24,915**	**27,861**	**35%**	**12%**	**100%**			

* Others Include Gold Loans, Unsecured Business Loans, ODs against FD, and staff loans.

MFI: Under this segment, the Bank provides group loans with ticket sizes ranging between Rs. 5,000 and Rs. 60,000 to the customers. The interest rate offered under this segment is in the range of 18%-26%. Hence, this segment contributes heavily to the return ratios of the bank. As of Q4FY23, this segment contributed 19% of the advance mix and displayed a 34%/14% YoY/QoQ growth. In terms of disbursement, the segment contributed 28% of the total disbursements in Q4FY23, amounting to Rs. 1,676 crores up 72%/25% YoY/QoQ. The management have conveyed their guidance to reduce the contribution of this segment to the overall loan book from current levels to 4-5% in next five years. This is primarily due the nature of the risky unsecured loans advanced in this segment. The primary target customer are micro-entrepreneurial women with limited access to formal financing sources. These loans are provided essentially for use in their small businesses or other income generating activities. The group loan products are built on the peer-guarantee loan model.

Microfinance industry has seen several downtrends in the past due to demonetization, economic slowdown and now most recent pandemic. The COVID led pandemic hit this segment the hardest among all because of the lockdowns. Asset quality as well as loan growth deteriorated significantly across the industry. In last two quarters, across industry, the disbursements, collection efficiencies, and asset qualities displayed robust improvement. Further, the bank has sufficient provisioning of 74.8% for this segment which is up 1.7% QoQ. The GNPA contribution from this segment stands at 2.3% (which is lower than the overall GNPA of the bank of 2.6%) and has reduced by 184 bps sequentially. The company has attributed this to its conservative underwriting practices. With the economy picking up again and the rural demand on the rise, the growth outlook looks positive for the short to medium term.

Long term opportunity in the MFI segment is also huge as the market penetration in terms of borrowers is still low. The increase in eligible household income limit by new microfinance guidelines, from Rs. 1.25 lakh to Rs. 3 lakh for availing microfinance loans, will further increase the growth potential in the rural areas.

Small business loans: It is focused on self-employed individuals operating small enterprises, typically in urban and semi-urban locations. These small business loans are advanced to individuals belonging to low income groups engaged in business activities that do not maintain formal records for credit evaluation. Customers that typically comprise this product segment include mechanics with garages, push-cart owners, and individuals carrying out agriculture, dairy business, etc. It has a total of 2.7 lac customers in this segment and around 40% of its 1.9 million total customers own their own house which act as potential customers for small business loans. Hence, there is immense growth prospect in this segment for the bank. The ticket size ranges from Rs. 50,000 to Rs.0.2 Cr. This segment saw the fastest growth of 44% CAGR over FY15-23P. The bank has credited this achievement to its innovative cash flow-based credit assessment model, robust distribution network, and strong community presence.

As of Q4FY23, this segment contributed 36% of the total loan book showing a 28%/8% YoY/QoQ growth. During the quarter, the total disbursements amounted to Rs. 1,464 crores up 56%/16% YoY/QoQ and is this is the highest quarterly disbursement in this book for the bank. The disbursements account for 25% of the total disbursements for the quarter. The GNPA pertaining to this segment stands at 3.4% (above the bank's overall GNPA rate of 2.6%) and has reduced by 59 bps sequentially. The bank has a PCR of 50.5% for this segment which has increased by 840 bps sequentially. The bank is leveraging digital platforms to collect the overdue amounts. Around 40% of the overdue amounts in this segment are being collected digitally with a target of 70% for FY24. The Gross Advances stand at Rs. 10,083 crores which is above Rs. 10,000 crores for the first time. This book yielded ~ 17% and a collection efficiency of 99.6% in the quarter.

Housing Finance: The bank offers loans to self-employed individuals who have limited access to loans from banks and larger housing finance companies. Loans are provided for purchase of plots or house, construction of house, improvement/ restoration/ extension of home. Loans are issued up to Rs. 3 crores. The Bank also offers the benefits accruing under Pradhan Mantri Awas Yojana to deserving beneficiaries from economically weaker sections and low-income groups. This segment contributes 10% of the total loan book which amounts to Rs. 2,873 crores up 75%/17% YoY/QoQ. Further, it recorded disbursements worth Rs.557 crores up 109%/30% YoY/QoQ. It is looking to tap opportunities in this segment in the southern parts of the country. The bank has reported 0.9% GNPA under this segment which has reduced by 23 bps on a sequential basis. Further, the PCR for this segment stands at 32.1%, down 16 bps sequentially.

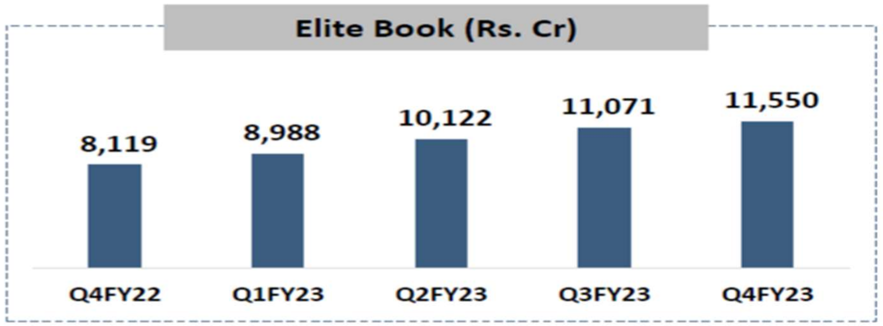
Vehicle finance: The vehicle finance customers are typically first-time formal financial channel borrowers purchasing used and new commercial vehicles, with significant experience in hyperlocal logistics. The loan provides experienced drivers an opportunity to own their vehicle and run their business. The vehicle finance customers also include small fleet operators. CV financing supports existing customers who had moved up from driver-cum-owner category to small fleet operators and wanted to replace their old vehicles with new ones. In FY20, the Bank had launched used passenger car loans. Vehicle Finance market saw robust demand revival in FY23. As of Q4FY23, the bank has issued loans worth Rs. 6,971 crores which is 25% of the loan book and has grown by 38%/12% YoY/QoQ. During the quarter, the bank disbursed an additional Rs. 1,591 crores under this segment which is higher by 69%/19% YoY/QoQ. The GNPA here is 2.2% and has reduced 85 bps sequentially. Product portfolio mix includes 50% Used Commercial Vehicles, 40% New Commercial Vehicle, and 10% used Passenger Cars. 71% of the bank's loans are to small and light CVs, 22% in MHCVs (Medium and Heavy Commercial Vehicles) with the maximum exposure of 50% to South Indian states. The PCR for this segment is 63.8%, down 410 bps sequentially. Collection efficiency for this book stood at 99%. The bank has recently entered new geographies for this segment being Kerala and Uttar Pradesh.

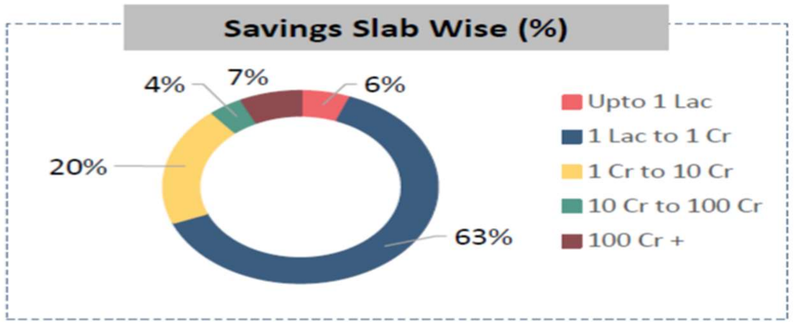
We believe that worst in terms of demand de-growth is over in auto financing sector and situation has started improving. Auto sales are picking up and chip shortage scenario has also been majorly resolved. Government's significant ramp-up in investments in road infrastructure, along with GST and e-way bill implementation, is aiding higher operating efficiencies for fleet operators (lower commute time, higher mileage, lower wear and tear, etc.), narrowing the gap further with rail freight rates. In addition to volumes, price inflation in autos should further aid growth in loan book. Further, normalization of credit costs (which jumped during COVID period) from this segment will allow it to contribute better to the overall return ratio of the bank.

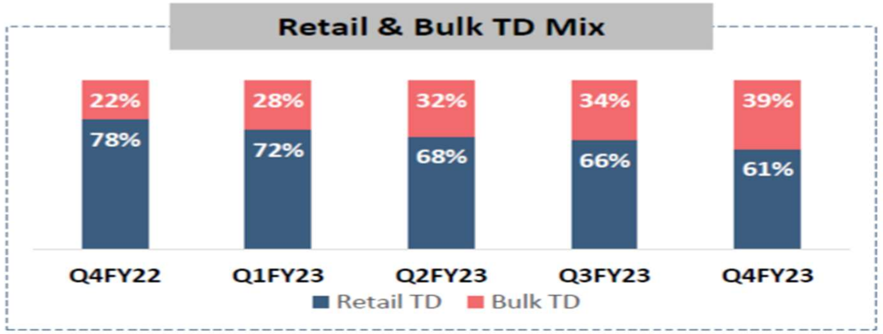
Disbursement Segments / As of (in crores)	Q4FY22	Q3FY23	Q4FY23	YoY	QoQ	Contribution	Avg Ticket Size (Rs.Lacs)
Small Business Loans (SBL)	940	1,260	1,464	56%	16%	25%	6.72
Housing Finance	267	427	557	109%	30%	9%	13.05
Micro Finance	972	1,340	1,676	72%	25%	28%	0.46
Vehicle Finance	939	1,334	1,591	69%	19%	27%	5.78
Used Commercial Vehicles	*514*	*699*	*635*	24%	-9%	11%	
New Commercial Vehicles	*323*	*477*	*743*	130%	56%	13%	
Used Car	*102*	158	*213*	109%	35%	4%	
MSE Finance	72	92	88	22%	-4%	1%	50.62
NBFC Financing	28	261	425	1418%	63%	7%	6,071
Others	60	83	116	93%	40%	2%	
Total Gross Advances	**3,278**	**4,797**	**5,917**	**81%**	**23%**	**100%**	

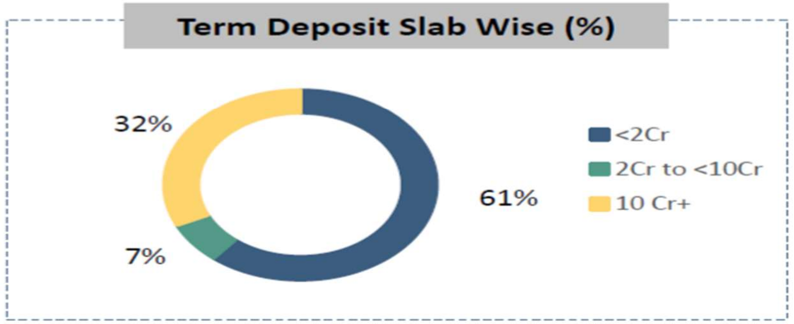
Ramp up in deposit franchise and granularity

As mentioned above, the bank has reported sequentially flat CASA deposits on account of flat savings account balances. However, its Current Account balances have grown 26%/22% YoY/QoQ. The management has attributed this growth to its customized digital solutions. To tap on CASA, the bank is implementing the family banking concept and to tap Term Deposits, it wishes to target senior citizens. Savings and Term Deposits from "Elite" the mass affluent customer segment has crossed Rs. 11,550 crores. Further, around 69% of the bank's savings balances are in the range of Rs. 1 lakh to Rs. 1 crore and around 61% of the Term Deposits are less than Rs. 2 crores; 61% of the Term Deposits are retail and rest are bulk in nature. Hence, the bank has healthy granularity in its deposit profile. Further, 94% of the Term Deposits of the banks are non-callable and therefore are LCR friendly. The blended cost of funds for the Q4FY23 was at 6.61% (up 20 bps sequentially).









(Source: Company, HDFC Sec)

Focus on Technology:

Historically, Equitas SFB has higher operating expenditures, compared to peer banks, mainly due to three reasons:

- Granular retail book.
- Presence in the informal income segment.
- Dual customer segmentation for asset and liability customers.

Hence, it is necessary for Equitas now to scale up its loan book, increase the ticket size of loans and embark on new technology trends to leverage the power of social, mobile, analytics and cloud in order to increase operational efficiency. Envisaging the above, the Technology team at Equitas has chosen a path towards architectural transformation for infrastructure, applications and information security using cutting-edge tools. Increased digital footprint has resulted in more and more online, non-physical interactions with customers, which emphasizes the need to provide a safe and secure platform to build customer confidence. The Bank has laid a strong foundation for ensuring information and cyber security, which it aspires to take to the next level. Some of the technological initiatives and digital milestones achieved by the bank include:

- As of Q4FY23, the Equitas Selfe Own Digital Platform/NiyoX/Freo have garnered a total of Rs. 601/416/5.7 crores of deposits.
- It issued 2.15 lacs prepaid cards in the quarter and processed more than 61 lac transactions valuing more than 618 crores on prepaid cards in Q4FY23. Further, it processed Rs. 10,767 crores worth of transactions in its Micro ATMs, Rs. 519 crores of transactions in its FASTags.
- During the quarter, the bank has completed its CBS version upgrade.
- The bank has invested in a hybrid cloud and an on-premises data warehouse that will lay the foundation for its analytical journey to enhance its proprietary credit assessment models and assist in cross selling products.
- It is expected to implement a state-of-the-art internet and mobile banking with new enhanced customer experience and a revamped CRM system by March 2024.
- The bank is in the process of launching a merchant app in order to garner current account deposits in FY24.

Management Guidance:

- The loan growth for FY24 is expected to be 25-30% (FY23 growth- 33%).
- As the bank plans to venture into personal loans, credit cards (subject to RBI approval) and foreign exchange, the cost to income ratio is expected to stay in the range of current levels, i.e. 59-62%, on account of digital developments that would be warranted by these businesses.
- NIMs are expected to hover around the current levels of ~9%, for the next 2-3 quarters after which it is expected to moderate over 3 years on account of change in loan mix and the new products mentioned above.
- Credit Cost is expected to be in the range of 1.2-1.25% in FY24 and the bank has set its PCR target at 70% in coming quarters (current level- 56.9%)
- RoA for FY24 is expected to be in the range of 2-2.25% (FY23-1.89%).
- Q4FY23 saw an increase in cost of funds of 20bps and this ratio is expected to rise by 4-5bps in next few months from current levels of 6.61%.
- Cost to Assets ratio for FY24 is expected to stay at the same level as that of FY23 (6.3%), however, it is expected to moderate over the next 3-4 years post FY24.
- The bank plans to add 15 liability branches and 30 asset branches in FY24.
- Target Loan Mix for FY24- Mortgage- 50%, Vehicle Finance- 20-25%, MFI- 15%.

Risks & Concerns

Concentration risk

The bank has presence across 18 states and UTs. However, top three states of Tamil Nadu, Maharashtra, and Karnataka contributed majority of the overall portfolio which brings geographic concentration risk. Any economic slowdown especially in the areas where the bank has strong presence could impact the business growth of the company.

Falling CASA Ratio

Since the start of FY23, the bank has seen declining CASA ratio from 52.01% as of March 2022, to 42% as of March, 2023. Though there is healthy traction in its Term Deposits, these are more expensive for the bank compared to CASA balances. Further, its credit to deposit ratio stands at 102% as of March 2023. Hence, in order to serve the rising demand of its loan products, it might have to resort to costly deposits and borrowings which may add downward pressure on its NIMs.

Risky nature of business

Micro finance and small business are inherently risky business because of cash dealing and collateral free nature. Clients have below-average credit risk profiles and lack the access to formal credit. The borrowers of individual microfinance loans and micro & small enterprise loans are typically vegetable vendors, small machine and lathe owners, tea shops, provision stores, small fabrication units, waste paper recycling units, tailors, and power looms. They are economically weaker class which faces income volatility. Further, the impact of El-Nino phenomenon can negatively affect rural earnings and hence the demand. The bank has already taken steps to move away from such unsecured loans to secured loans, however, this will add some downward pressure on its margins. We have modelled the NIMs in our model around 8.2-8.3% for next two years. Any further dip in NIMs can adversely impact our estimates.

Political risks due to nature of loans

Loan book of Equitas SFB is still dominated by microfinance loans and MSME loans. Political instigation in some of the states asking people not to pay back their dues, as witnessed in the past, could result in higher NPAs. Equitas SFB has huge dependence and concentration in south and west region for its business.

Deterioration of asset quality

A higher-than-expected deterioration in the asset quality could result in the erosion of the Tier I capital. Fresh formation of bad loans could keep provisioning high and return ratios compressed for a longer time. Further, any delay in the recovery, higher than expected haircuts or sharp rise in the slippage could impact the profitability and business growth prospects.

Rising interest rates

The rise in interest rates may impact the loan growth; the bank has high retail facing loan book and high interest rates negatively impacts the demand. Also the rise in G-sec yields could lead to MTM losses for the banking sector.

As the bank scales its secured portfolio, yields may decline marginally. This may result in compression of interest margins. Its ability to sustain the share of CASA and retail deposits at current levels while being able to reduce the cost of funds, remains to be seen. In order to serve the accelerated credit demand, it may have to rely on wholesale deposits in the coming periods as only retail deposits might not be adequate.

Exit at the top management

In May 2022, the founder and managing director & chief executive officer of Equitas SFB Mr. PN Vasudevan resigned from the post to pursue philanthropic activities. He is the founder and has been with the organization since 2007. Under his leadership the micro finance institution was converted into a small finance bank. The board had initially accepted his resignation and search committee was formed to find the new candidate. However, in December 2022, the bank said that Mr. PN Vasudevan had decided to withdraw his resignation and continue as bank's CEO and MD. As his current term expires in July 2023, the Board has approved to extend his term for a further period of 3 years. This is pending approval from the RBI. We will remain watchful in this front as RBI's approval shall be crucial in this matter.

Company Background:

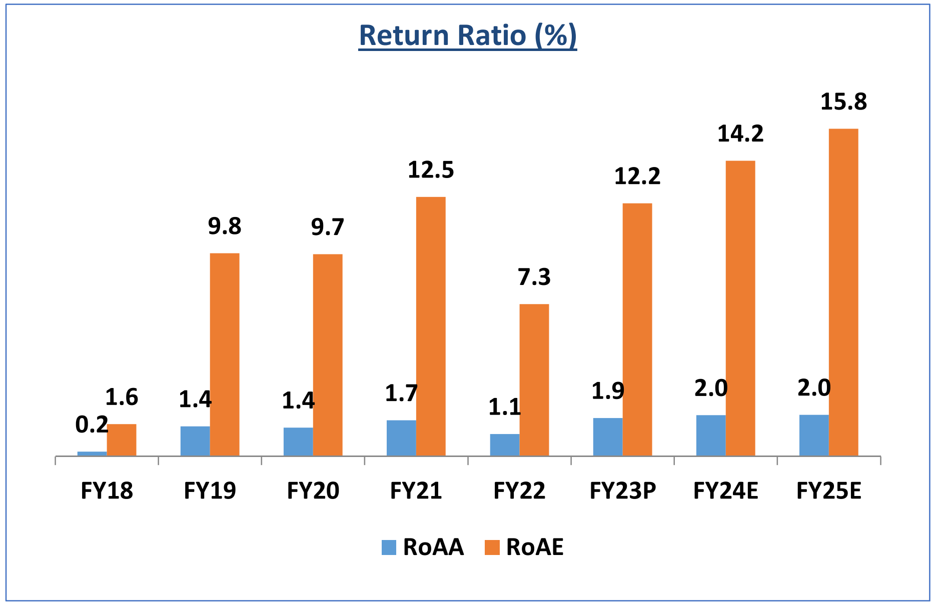
Equitas Small Finance Bank (SFB) is one of the largest small finance banks in India. As a new-age bank in one of the fastest growing economies, Equitas SFB offers a bouquet of products and services tailored to meet the needs of its customers – individuals with limited access to formal financing channels, as well as affluent and mass affluent, Micro, Small & Medium Enterprises (MSMEs) and corporates. The Bank's firmly entrenched strategy focuses on providing credit to the unbanked and underbanked micro and small entrepreneurs, developing products to address the growing aspirations at the 'bottom of the pyramid', fueled by granular deposits and 'value for money' banking relationships.

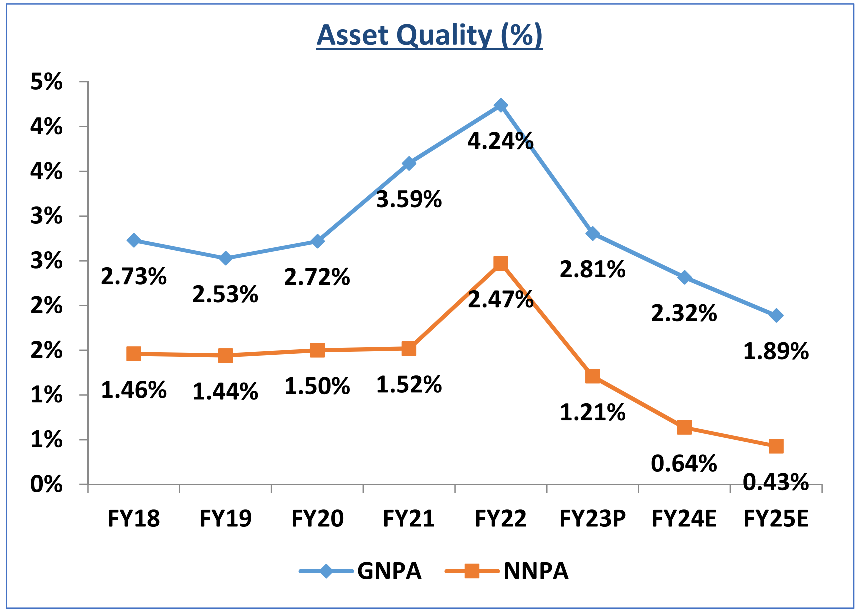
It provides small business loans comprising loan against property, housing loans, and agriculture loans to micro entrepreneurs, microfinance to joint liability groups predominantly comprising women, used and new commercial vehicle loans to drivers and micro entrepreneurs, MSE loans to proprietorships, and loans to non-banking financial companies (NBFCs).

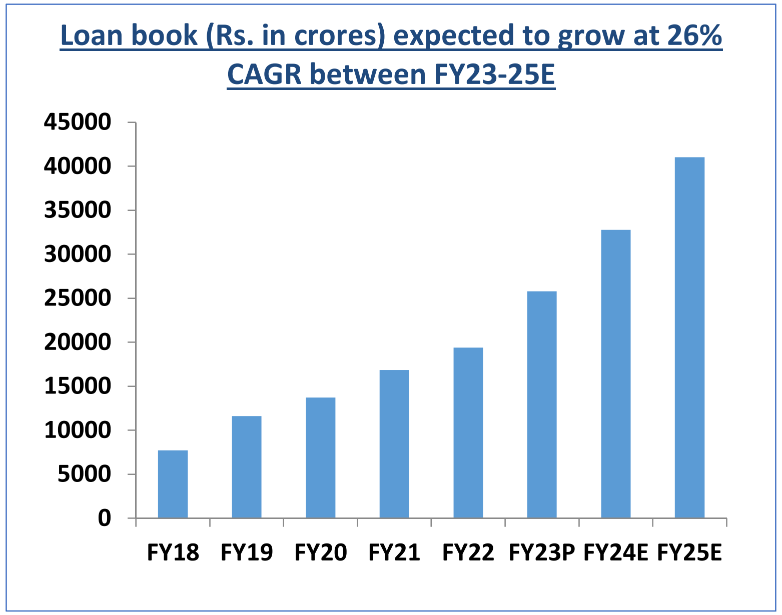
On the liability side, the Bank's target customers comprise mass and mass-affluent individuals to whom it offers current accounts, salary accounts, savings accounts, and a variety of deposit accounts. In addition, the Bank provides non-credit offerings comprising ATM-cum-debit cards, third party insurance, mutual fund products, and issuance of FASTag.

The bank has 922 branches, 349 ATMs and approximately 20,563 employees as of March, 2023.

Equitas Small Finance Bank Ltd







Income Statement

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Interest Income	3194	3460	4162	5291	6511
Interest Expenses	1396	1421	1617	2135	2698
Net Interest Income	**1798**	**2039**	**2545**	**3156**	**3813**
Non interest income	418	538	670	732	812
Total Income	**2216**	**2576**	**3214**	**3888**	**4625**
Operating Expenses	1272	1856	2038	2484	2929
PPP	944	720	1176	1404	1696
Prov & Cont	433	342	407	362	388
Profit Before Tax	511	378	769	1041	1308
Tax	127	97	195	260	327
PAT	**384**	**281**	**574**	**781**	**981**

Balance Sheet

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Share Capital	1139	1252	1111	1111	1111
Reserves & Surplus	2257	2994	4047	4695	5510
Shareholder funds	**3396**	**4246**	**5158**	**5806**	**6620**
Deposits	16392	18951	25381	31921	40394
Borrowings	4165	2616	2974	4259	5333
Other Liab & Prov.	759	1146	1445	1590	1876
SOURCES OF FUNDS	**24713**	**26959**	**34958**	**43576**	**54222**
Cash & Bank Balance	3379	2133	1244	1446	2036
Investment	3705	4450	6665	7998	9598
Advances	16848	19374	25799	32765	41021
Fixed Assets	185	200	379	417	459
Other Assets	596	802	871	950	1108
TOTAL ASSETS	**24713**	**26959**	**34958**	**43576**	**54222**

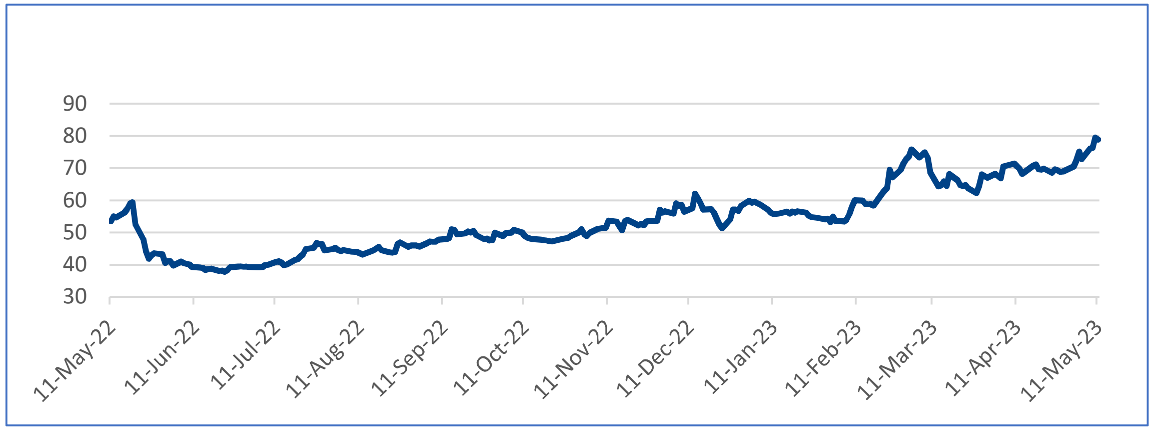
Key Ratio

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Return Ratios					
Calc. Yield on adv	17.4%	15.6%	14.8%	14.5%	14.3%
Calc. Cost of funds	6.8%	6.6%	5.7%	5.9%	5.9%
NIM	8.6%	8.6%	9.0%	8.6%	8.2%
RoAE	12.5%	7.3%	12.2%	14.2%	15.8%
RoAA	1.7%	1.1%	1.9%	2.0%	2.0%
Asset Quality Ratios					
GNPA	3.6%	4.2%	2.8%	2.3%	1.9%
NNPA	1.5%	2.5%	1.2%	0.6%	0.4%
PCR	56.6%	42.7%	56.9%	72.5%	77.4%
Growth Ratios					
Advances	22.7%	15.0%	33.2%	27.0%	25.2%
Deposits	51.9%	15.6%	33.9%	25.8%	26.5%
Borrowing	24.7%	13.5%	11.5%	13.0%	13.0%
NII	20.2%	13.4%	24.8%	24.0%	20.8%
PAT	57.7%	-26.9%	104.3%	36.1%	25.7%

Key Ratio

	FY21	FY22	FY23P	FY24E	FY25E
Valuation Ratios					
EPS	3.4	2.2	5.2	7.0	8.8
P/E	23.4	35.2	15.3	11.2	8.9
Adj. BVPS	27.5	30.1	43.6	50.4	58.0
P/ABV	2.9	2.6	1.8	1.6	1.4
Dividend per share	0.0	0.0	1.0	1.2	1.5
Other Ratios					
Cost-Income	57.4	72.1	63.4	63.9	63.3
CASA	34.2	52.0	96.2	40.3	38.7
CAR	24.2	25.2	23.8	23.6	23.8
Tier 1	23.2	24.5	23.1	22.9	23.3

One Year Price Chart



Varun Nitin Manek

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

I, **Varun Manek**, Research Analyst, **ACA**, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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