Equitas Small Finance Bank Limited

October 05, 2018

Ratings

Facilities/Instruments	**Amount (Rs. crore)**	**Ratings[1]**	**Rating Action**
Long-term Bank Facilities	19.72 (reduced from 609.82)	CARE A+; Stable [Single A Plus; Outlook: Stable]	Reaffirmed
Sub-total	**19.72 (Rupees Nineteen crore and seventy two lakh only)**		
Non-Convertible Debentures Issue III (EFL)	50.00 (reduced from 500.00)	CARE A+; Stable [Single A Plus; Outlook: Stable]	Reaffirmed
Non-Convertible Debentures Issue IV (EFL)	100.00 (reduced from 750.00)	CARE A+; Stable [Single A Plus; Outlook: Stable]	Reaffirmed
Non-Convertible Debenture Issue I (EMFL)	60.00	CARE A+; Stable [Single A Plus; Outlook: Stable]	Reaffirmed
Sub total	**210.00 (Rupees two hundred and ten crore only)**		
Subordinate Debt (EMFL)	30.00	CARE A+; Stable [Single A Plus; Outlook: Stable]	Reaffirmed
Non-Convertible Debenture Issue V (EMFL)	-	-	Withdrawn

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the long term bank facilities and debt instruments of ESFB continue to factor in the experienced management team, fairly diversified product profile, comfortable capital adequacy levels and liquidity profile. The ratings take note of the improvement witnessed in the overall business supported by increase in advances & deposits during FY18 (refers to the period April 01 to March 31) and decline in NPA levels on account of bad loan write-offs. The ratings are however constrained by regionally concentrated nature of business, moderate asset quality in Vehicle Finance (VF) and Loan against Property (LAP) segment and decline in profitability on account of increased credit provision costs during FY18. Going forward, ability of the company to diversify its portfolio across geographies and products, improve asset quality and profitability in all segments will be key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced Management team

Mr. P N Vasudevan, who is currently the Managing Director and CEO of ESFB and has extensive experience in the financial services sector. He has around 20 years of experience in Cholamandalam Investment and Finance Company Ltd (CIFCL, rated CARE AA+; Stable/A1+) for more than two decades and served as business head- Vehicle Finance and had also served as the Head – Consumer Banking Group in Development Credit Bank Limited. The entire senior management team is from NBFC/banking sector with significant experience in their respective fields. The board of ESFB comprises 10 directors of which 8 are Independent directors. The chairman of EFSB board is Mr. Arun Ramanathan, a retired IAS officer and he has served as a secretary to the Government of India in various departments. The entire board has varied experience in microfinance, banking and NBFC sector.

Increase in overall advances during FY18 and Q1FY19 and fairly diversified product profile

During FY18, the bank's total advances (including off-book) grew from Rs. 7,110 crore as on March 31, 2017 to Rs. 7,788 crore as on March 31, 2018 registering growth rate of around 10%. The advances further grew to Rs. 8,539 crore as in June 30, 2018 supported by growth in new products. Post transition to SFB, EFSB has introduced new product segments like Business loans, corporate loans, gold loan etc. the Advances in new products grew from Rs.341 crore as on March 31,

[1]*Complete definition of the ratings assigned are available at www.careratings.com*

2017 to Rs. 1,046 crore as on March 31, 2018. The share of new products increased from 4.80% as on March 31, 2017 to 13.43% as on March 31, 2018 and further to 14.10% as on June 30, 2018. MFI loans witnessed moderation and MFI loan portfolio de-grew from Rs. 3,289 crore as on March 31, 2017 to Rs. 2,107 crore as on March 31, 2018, the share of MFI loans subsequently reduced from 46.25% as on March 31, 2017 to 27.06% as on March 31, 2018. However, Bank's other traditional products like Vehicle finance and MSE loans witnessed increase in share from 27.12% and 18.11% as on March 31, 2017 to 30.43% and 25.62% respectively as on March 31, 2018 while Housing Finance proportion remained at around 3.50% as in March 31, 2018. LAP, Business Loans and corporate loans accounted for 5.30%, 5.38% and 2.98% of the overall advances as on June 30, 2018. The other products like gold loan, 2-Wheeler loans, personal loans occupied around 0.5% of overall advances as on June 30, 2018.

Significant growth in deposits; high cost borrowings are replaced with relatively lower cost deposits
During FY18, the bank's deposit witnessed significant growth with total deposits grew from Rs.1,921 crore as on March 31, 2017 to Rs. 5,604 crore as on March 31, 2018 registering growth rate of 191.69%. As on June 30, 2018, the total deposits was Rs. 5,721 crore. The CASA base also increased from Rs.332 crore as on March 31, 2017 to Rs. 1,638 crore as on March 31, 2018 and CASA ratio increased from 17.26% to 29.23% during the aforementioned period. The company opened around 108 liabilities branches during FY18 which increased the total liabilities branches to 392 as on March 31, 2018. Deposits with ticket size more than one crore occupied around 83.17% of the total term deposits as on June 30, 3018.
Deposits as % of total borrowings increased from 28.8% as on March 31, 2017 to 44.88% as on March 31, 2018 and further to 49.17% as on June 30, 2018. With increase in share of Deposits, the Credit to Deposit (CD) ratio reduced from 296.77% as on March 31, 2017 to 137.52% as on March 31, 2018 and the high cost borrowings raised before banking operations are being replaced by deposits which reduced the cost of funds from 10.73% in FY17 to 7.80% in FY18.

Reduction in NPA levels on account of write-offs
The bank faced challenging environment post demonetization and GST implementation which impacted the overall asset quality profile in the recent past. The bank has written off Rs. 142 crore (2.00% of total advances as on March 31, 2017) during FY18 in the Microfinance portfolio due to which the overall gross NPA reduced to 2.73% (net NPA: 1.71%) as on March 31, 2018 from 3.56% (Net NPA: 1.84%) as on March 31, 2017 and Gross NPA in Microfinance Portfolio reduced to 0.73% as on March 31, 2018 from 2.71% as on March 31, 2017. However, in Non MFI book, the asset quality remained moderate with gross NPA was 3.54% (PY: 4.66%) as on March 31, 2018 and 3.55% as on June 30, 2018. The ability of the bank to improve asset quality indicators across the segments while increasing its scale of operations by expanding into new regions remains key rating sensitivity.

Comfortable capital adequacy profile and Liquidity profile
Bank's CAR and Tier 1 CAR stood comfortable at 29.63% and 27.09% as on March 31, 2018 as against 35.51% and 32.30% as on March 31, 2017. The reduction in CAR level when compared to FY17 is due to increase in risk weighted assets however it is well above the regulatory limit of 15% of CAR and 7.5% of Tier I CAR.
As per structural liquidity statement of the bank as on March 31, 2018, the bank has negative cumulative mismatches in less than 1 year bucket however remained within the regulatory limits. Also, the Liquidity Coverage Ratio (LCR) stood comfortable at 213.10% as March 31, 2018 (as compared to the minimum requirement of LCR is 70% for FY18 and would increase by 10% annually to 100% by 2021). In addition, the bank has maintained excess SLR investments which is more than the one year cumulative mismatch as on March 31, 2018 which remained favorable on the liquidity perspective.

Key rating weaknesses
Regionally concentrated with majority of the business in Southern states
Though, ESFB has presence in 13 states spread across 392 liability branches and 598 asset branches as on June 30, 2018, distribution of the advances is skewed towards Southern region which accounted for 70.57% of the overall loan portfolio as on June 30, 2018 (Mar'17:69.64%). Within South India, Tamil Nadu accounted for 59.41% (Mar'17: 60.18%), Karnataka accounted for 8.60% (6.98%), AP & Telengana accounted for 1.03% (2.39%) & 1.15% (0.01%) respectively as on June 30, 2018 of the overall advances. Even in terms of branch presence, the bank is predominately present in Southern region which accounted for 50.50% (Mar'17:51.64%) of total asset branches and 52.30% (57.75%) of the total liability branches as on June 30, 2018. The ability of the bank to diversify geographically and spread across each region while increasing its scale of operations remains critical for rating perspective.

Decline in profitability on account of increased credit provisioning costs
During FY18, The bank reported PAT of Rs. 32 crore on a total income of Rs.1,784 crore reduced from PAT of Rs. 104 crore on a total income of Rs. 1,214 crore during FY17 mainly on account of increase in loan loss provisioning costs due to increased NPA levels post demonetization. During FY18, the bank had written off Rs. 142 crore which increased credit provisioning costs to average total assets to 1.53% in FY18 from 1.08% in FY17. Also, the bank's NIM reduced to 7.67% in FY18 from 9.20% in FY17 despite reduction in cost of borrowings was mainly due to reduction in interest yield to 7.67% in

FY18 from 9.20% in FY17. The reduction in the interest yield is on account of increase in share of investments (to maintain SLR requirements) from 20% of the total assets as on March 31, 2017 to 29% as on March 31, 2018, decline in share of MFI loans (which are high yielding) from 46.25% of loans as on March 31, 2017 to 27.06% as on March 31, 2018 and income reversals on NPA accounts during FY18. The operating expenses as a % of average total assets reduced to 7.85% in FY18 from 9.36% due to rationalisation of branch expenses. With reduction in NIM level and increased credit provisioning costs, the bank reported ROTA of around 0.28% in FY18 as against 1.79% in FY17. During Q1FY19, the company reported PAT of Rs. 34 crore on a total income of Rs. 543 crore with annualized NIM of 6.99% and annualized ROTA of 0.99%.

Prospects

Transformation from NBFC to SFB offers various benefits including ability to offer wider range of products both on assets and liability side, reduce cost of funds, increased regulatory supervision and support. As compared to other SFB players, Equitas has experience in relatively diversified asset classes which is likely to help it to grow and manage its book in better. However, the ability of the SFB to improve asset quality and overall profitability while increasing their scale of operations remain critical for key rating perspective.

Analytical approach: Standalone

Applicable Criteria

Criteria on assigning Outlook to Credit Ratings

CARE's Policy on Default Recognition

Financial ratios – Financial sector

Bank - CARE's Rating Methodology For Banks

About the company

Equitas Small Finance Bank Limited (ESFB) is a Chennai based Small Finance Bank (SFB) which has commenced its banking operations on September 05, 2016. ESFB is 100% subsidiary of Equitas Holdings Ltd (EHL,holding company of the group).EHL has other two wholly owned subsidiaries namely, Equitas Micro Finance Limited [EMFL] and Equitas Housing Finance Limited [EHFL] and got merged with EFL to form SFB in order to comply with RBI's condition to operate as SFB. The name of EFL was changed to Equitas Small Finance Bank Limited vide a fresh Certificate of Incorporation dated September 2, 2016.

ESFB is currently focused mostly in retail banking business with focus on micro-finance, VF, housing finance, business loans, LAP and providing financing solutions for individuals and micro and small enterprises (MSEs) that are underserved by formal financing channels while providing a comprehensive banking and digital platform for all. As on June 30, 2018, the company had a network of 392 liability branches and 598 asset branches, with deposits of Rs.5,721 crore and advances of Rs.8,539 crore.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total income	1,214	1,784
PAT	104	32
Interest coverage (times)	1.50	1.32
Total Assets	9,202	13,247
Net NPA (%)	1.84	1.71
ROTA (%)	1.79	0.28

** The financials of ESFB for FY17 represents the NBFC operations of EFL from April 1, 2016 to September 1, 2016 and of the SFB operations from September 2, 2016 to March 31, 2017.*

***Note**: A – Audited;*

(a) ROTA Ratio has been computed based on average of annual opening and closing balances

Status of non-cooperation with previous CRA: NA

Any other information: NA

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based-Long Term	-	-	-	19.72	CARE A+; Stable
Debt-Subordinate Debt	September 16, 2015	13.80%	September 16, 2022	30.00	CARE A+; Stable
Debentures-Non Convertible Debentures	August 20, 2014	12.67%	May 28, 2019	60.00	CARE A+; Stable
Debentures-Non Convertible Debentures	August 30, 2016	10.15%	September 30, 2019	100.00	CARE A+; Stable
Debentures-Non Convertible Debentures	August 23, 2016	10.15%	September 24, 2019	50.00	CARE A+; Stable
Debentures-Non Convertible Debentures	-	-	-	-	Withdrawn

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Debentures-Non Convertible Debentures	LT	-	-	1)Withdrawn (03-Apr-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A- (11-Aug-15)
2.	Debentures-Non Convertible Debentures	LT	-	-	1)Withdrawn (03-Apr-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A- (11-Aug-15)
3.	Fund-based-Long Term	LT	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A- (11-Aug-15) 2)CARE A- (22-Apr-15)
4.	Fund-based-Long Term	LT	19.72	CARE A+; Stable	-	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (10-Mar-16) 2)CARE A (24-Jul-15)
5.	Debentures-Non Convertible Debentures	LT	60.00	CARE A+; Stable	-	1)CARE A+; Stable (07-Jul-17)	1)CARE A+ Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (24-Jul-15)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (24-Jul-15)
7.	Debt-Subordinate Debt	LT	30.00	CARE A+; Stable	-	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A- (24-Jul-15) 2)CARE A- (02-Apr-15)
8.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (24-Jul-15) 2)CARE A (28-May-15)
9.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (24-Jul-15) 2)CARE A (15-Jun-15)
10.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)	1)CARE A (01-Sep-15)
11.	Debentures-Non Convertible	LT	50.00	CARE A+;	-	1)CARE A+; Stable	1)CARE A+; Stable	-

	Debentures			Stable		(07-Jul-17)	(14-Dec-16) 2)CARE A+ (12-Aug-16)	
12.	Debentures-Non Convertible Debentures	LT	100.00	CARE A+; Stable	-	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (06-Sep-16) 3)CARE A+ (24-Aug-16)	-
13.	Fund-based - LT-Term Loan	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
14.	Debentures-Non Convertible Debentures	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
15.	Debentures-Non Convertible Debentures	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
16.	Debentures-Non Convertible Debentures	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
17.	Debentures-Non Convertible Debentures	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
18.	Debt-Subordinate Debt	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-
19.	Debentures-Non Convertible Debentures	-	-	-	-	-	1)CARE A+; Stable (14-Dec-16)	-

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