# Equitas Small Finance Bank Limited

July 18, 2023

| Facilities/Instruments | Amount (₹ crore) | Rating[1] | Rating Action |
|---|---|---|---|
| Certificate Of Deposit (Proposed) | 250.00 | CARE A1+ | Assigned |

Details of instruments/facilities in Annexure-1.

## Rationale and key rating drivers

The rating assigned to the Certificate of Deposit of Equitas Small Finance Bank Limited (Equitas) factors in the long track record of operations with diversified asset classes, comfortable capitalisation levels, improving deposit franchise, and the adequate liquidity position. The rating strengths are, however, partially offset by the relatively high credit deposit ratio notwithstanding the improvement seen over the years, the regionally concentrated nature of business, the moderate asset quality and moderate profitability parameters despite improvement seen in FY23 (refers to the period from April 01 to March 31).

The credit deposit ratio of the bank improved over the years from 138% as on March 31, 2018, to 102% as on March 31, 2023. The credit deposit ratio continues to be above 100% and is expected to improve during the current financial year. The bank's asset quality witnessed improvement in the last three years ending March 31, 2023, with reduced slippages and increase write-offs; the gross non-performing assets (GNPA) stood at 2.60% as on March 31, 2023. The ratings also factor in the improvement in profitability indicators in FY23.

The profitability was impacted during the COVID-19-induced pandemic, however, with improved asset quality and reduced credit cost, the bank reported a return on total assets (ROTA) of 1.8% in FY23 as against 1.1% in FY22.

## Rating sensitivities

**Positive factors – Factors that could individually or collectively, lead to positive rating action/upgrade:**

- Not applicable

**Negative factors – Factors that could individually or collectively, lead to negative rating action/downgrade:**

- Deterioration in asset quality, with the GNPA increasing to more than 4% on a sustained basis.
- Deterioration in the capital adequacy parameters with the capital adequacy ratio (CAR) falling below 17% on a sustained basis.
- Moderation in profitability parameters with the ROTA falling below 1% on a sustained basis.

## Analytical approach: Standalone

## Detailed description of the key rating drivers

**Key strengths**

**Long track record of operations in diversified asset classes**

Equitas is a Chennai-headquartered small finance bank (SFB), which commenced its banking operations on September 05, 2016. The group has been founded by PN Vasudevan by setting up Equitas Micro Finance India Private Ltd in 2007 as a non-banking financial company (NBFC) engaged in microfinance activities. The group subsequently incorporated Equitas Finance Ltd (vehicle financing arm) in 2011 and Equitas Housing Finance Private Limited (housing finance arm) in 2011 and Equitas was

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE Ratings Ltd.'s publications

formed through the amalgamation of these three entities. Equitas has a demonstrated track record in varied asset classes such as microfinance (MF), vehicle finance (VF), housing loans, and small business loans (SBL). PN Vasudevan, who is currently the Managing Director and CEO of Equitas, has an extensive experience in the financial services sector. He is supported by the entire senior management team, which is from the NBFC/formal financial services sector with significant experience in the retail financing business. The board of ESFB comprises 10 directors, of which nine are independent directors.

**Comfortable capitalisation levels**

On account of advances growth of 35% in FY23, the bank's CAR and Tier-1 CAR witnessed moderation to 23.80% and 23.08%, respectively, as on March 31, 2023, as against 25.16% and 24.53%, respectively, as on March 31, 2022, however, the same remains comfortably above the regulatory requirements (minimum regulatory requirement of 15% and 7.5%). The bank's tangible net worth (TNW) stood at ₹4,971 crore as on March 31, 2023, as against ₹4,033 crore as on March 31, 2022. CARE Ratings Limited (CARE Ratings) notes that the bank has completed the amalgamation process of Equitas Holdings Limited with Equitas, which has also aided in increasing the net worth. CARE Ratings expects the CAR levels to remain comfortable over the medium term.

**Improving deposit franchise; however, credit/deposit (CD) ratio remains relatively high**

The bank's resource profile mainly consists of deposits (73% of the total liabilities as on March 31, 2023), followed by borrowings in the form of refinance from financial institutions and inter-bank participation certification (IBPC). The total deposits grew by 34% during FY23 and stood at ₹25,381 crore as on March 31, 2023, as against ₹18,951 crore as on March 31, 2022. In terms of granularity of deposits, 68% of the total deposits stood below the ticket size of ₹2.0 crore as on March 31, 2023. The bank's deposit profile is characterised by the relatively higher current account savings account (CASA; as a percentage of the total deposits) in comparison to its peers at 42% as on March 31, 2023, however the same declined from 52% as on March 31, 2022. Despite the growth in deposits over the years, the bank's CD ratio remained high at 102% as on March 31, 2023 (102% as on March 31, 2022). CARE Ratings expects the bank to improve the CD ratio further during FY24 and it remains a key monitorable.

**Diversified product profile**

The bank's advances book is relatively diversified with its presence across MF, SBL, VF, housing finance (HF) and micro and small enterprises (MSEs) finance (MSE). SBL and VF continues to comprise the major proportion of around 36% and 25%, respectively, as on March 31, 2023, as against 38% and 25%, respectively, as on March 31, 2022. Over the last five years, the bank has been able to reduce the proportion of MF from 28% as on March 31, 2018, to 19% as on March 31, 2023. The bank has seen an increase in HF, which comprises around 10% of the advances (PY: 8% as on March 31, 2022) and Equitas also lends to the MSE and NBFC segments, which comprised around 4% and 4% of advances, respectively, as on March 31, 2023 (4% and 6%, respectively, as on March 31, 2022). The portfolio diversification has helped the bank in reducing the concentration risk pertaining to high exposure to a single product. The loan book of Equitas is also skewed towards secured lending, thus lowering the riskiness of the exposure.

The bank's advances witnessed a growth of 35% in FY23 and stood at ₹27,861 crore as on March 31, 2023, as against ₹20,597 crore as on March 31, 2022. CARE Ratings expects the growth in advances to remain at higher levels, continued to be driven by SBL and HF.

**Key weaknesses**

**Regional concentration of the loan portfolio**

Equitas' advances are geographically concentrated, with Tamil Nadu contributing to 52% of the gross advances as on March 31, 2023 (54% as on March 31, 2022), followed by Maharashtra and Karnataka at 14% and 10%, respectively, as on March 31, 2023 (PY: 13% and 10%, respectively). The top three states and top five states contribute to 76% and 85% of the gross advances as on March 31, 2023, as against 77.48% and 85.93%, respectively, as on March 31, 2022. The bank has its presence in 18 states across 922 banking outlets as on March 31, 2023. CARE Ratings expects the advances to remain concentrated in the medium term.

**Asset quality witnessed improvement in FY23, although the same continues to remain moderate**

The bank's asset quality was impacted by the COVID-19-induced pandemic, resulting in higher GNPA levels in FY21 and FY22, however, with reduced slippages and higher write-offs, the bank's GNPA and net non-performing assets (NNPA) improved during FY23. The GNPA and NNPA improved and stood at 2.60% and 1.14%, respectively, as on March 31, 2023, as against 4.06% and 2.37%, respectively, as on March 31, 2022. The bank has written off loans aggregating to ₹410 crore in FY23 and the slippage ratio has been reduced to 5.5% in FY23 (PY: 8.0%). The bank's SMA 1 and SMA 2 stood at 2.08% and 1.13% respectively as on March 31, 2023 as against 3.64% and 1.98% as on March 31, 2022.

The bank has also sold its non-perming assets (NPA) book (including NPA and technical written-off book) to ARC, aggregating to ₹581 crore. The bank has also provided against the full Security Receipts (SR) book of ₹40 crore. The gross stressed assets (GNPA + standard restructured advances + SR) reduced and stood at 2.95% as on March 31, 2023, as against 9.96% as on March 31, 2022. The net stressed assets/net worth stood at 7.33% as on March 31, 2023 (38.98% as on March 31, 2022).

CARE Ratings expects the bank's asset quality to remain stable over the medium term.

**Moderate profitability, albeit improvement in FY23**

In the last two years ending March 31, 2022, the bank's profitability was impacted due to the COVID-19-induced pandemic, with higher credit cost. With a recovery in the economy, the profitability witnessed an improvement in FY23. During FY23, the bank's total income witnessed a growth of 21% and stood at ₹4,831 crore (FY22: ₹3,997 crore), aided by a healthy increase in the interest income of 20% and in the non-interest income by 25%, aided by a pickup in disbursements and income from sale of technical write-off accounts to ARC.

The bank's net interest margin (NIM) witnessed improvement to 8.27% in FY23 from 7.95% in FY22. The bank's operational expenses/average total assets continue to remain high at 6.63% in FY23 as against 6.64% in FY22. The bank's pre-provisioning operating profit (PPOP) improved by 35% to ₹1,176 crore in FY23 from ₹872 crore in FY22. With a reduction in credit cost to 1.32% in FY23 from 1.93% in FY22, the bank reported an improvement in profitability with a profit-after-tax (PAT) of ₹574 crore in FY23 as against a PAT of ₹281 crore in FY22. Thus, the ROTA improved to 1.8% in FY23 as against 1.1% in FY22. The ability of the bank to control operating expenses remains critical. CARE Ratings expects the profitability to remain relatively stable. However, as the bank introduces new products, the profitability with respect to the same remains to be seen.

## **Liquidity:** Adequate

As per the structural liquidity statement of the bank as on March 31, 2023, the bank does not have negative cumulative mismatches up to the six months' time bucket. Equitas' liquidity coverage ratio remained comfortable at 186% as on March 31, 2023, against the minimum regulatory requirement of 100%. In addition, the bank consistently maintains excess statutory liquidity ratio (SLR) investments, which provide a cushion to the bank's liquidity profile. Equitas had excess SLR investments of

₹2,061 crore as on March 31, 2023 (8.1% of NDTL).

## Applicable criteria

Policy on default recognition
Financial Ratios - Financial Sector
Rating Outlook and Credit Watch
Short Term Instruments
Bank
Policy on Withdrawal of Ratings

## About the company and industry

**Industry classification**

| Macro Economic Indicator | Sector | Industry | Basic Industry |
|---|---|---|---|
| Financial Services | Financial Services | Banks | Other Bank |

Equitas is a Chennai-headquartered SFB, which commenced its banking operations on September 05, 2016. Post its initial public offering (IPO) in October 2020, the bank is listed on the Bombay Stock Exchange (BSE) and Nation Stock Exchange (NSE). Furthermore, the bank completed the amalgamation process in February 2023 of Equitas Holdings Limited with Equitas.

ESFB is currently focussed on the retail banking business with focus on MF, VF, HF, business loans, loan-against-property (LAP) and providing financing solutions for individuals and MSEs that are underserved by formal financing channels while providing a comprehensive banking and digital platform for all. As on March 31, 2023, the bank had a network of 922 banking outlets, with deposits of ₹25,381 crore and advances of ₹27,861 crore.

| Brief Financials (₹ crore) | March 31, 2022 (A) | March 31, 2023(A) |
|---|---|---|
| Total operating income | 3,997 | 4,831 |
| PAT | 281 | 574 |
| Total Assets | 26,734 | 34,771 |
| Net NPA (%) | 2.37 | 1.14 |
| ROTA (%) | 1.1 | 1.8 |

A: Audited UA: Unaudited. Note: The above results are latest financial results available
As per CARE's calculation

**Status of non-cooperation with previous CRA:** NA

**Any other information:** NA

**Rating history for the last three years:** Please refer Annexure-2

**Covenants of the rated instruments/facilities:** Detailed explanation of the covenants of the rated instruments/facilities is given in Annexure-3

**Complexity level of the various instruments rated**: Annexure-4

**Lender details**: Annexure-5

## Annexure-1: Details of instruments/facilities

| Name of the Instrument | ISIN | Date of Issuance | Coupon Rate (%) | Maturity Date | Size of the Issue (₹ crore) | Rating Assigned along with Rating Outlook |
|---|---|---|---|---|---|---|
| Certificate Of Deposit (Proposed) | - | - | - | - | 250.00 | CARE A1+ |

## Annexure-2: Rating history for the last three years

| Sr. No. | Name of the Instrument/Bank Facilities | Current Ratings | | | Rating History | | | |
|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Outstanding (₹ crore) | Rating | Date(s) and Rating(s) assigned in 2023-2024 | Date(s) and Rating(s) assigned in 2022-2023 | Date(s) and Rating(s) assigned in 2021-2022 | Date(s) and Rating(s) assigned in 2020-2021 |
| 1 | Debt-Subordinate Debt | LT | - | - | - | - | 1)Withdrawn (09-Aug-21) | 1)CARE A+; Stable (04-Dec-20) |
| 2 | Certificate Of Deposit | ST | 250.00 | CARE A1+ | | | | |

*Long term/Short term.

**Annexure-3: Detailed explanation of covenants of the rated instruments/facilities:** Not applicable

## Annexure-4: Complexity level of various instruments rated for this company

| Sr. No. | Name of the Instrument | Complexity Level |
|---|---|---|
| 1 | Certificate Of Deposit | Simple |

## Annexure-5: Lender details

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|---|
| To view the lender wise details of bank facilities please click here |

**Note on the complexity levels of the rated instruments:** CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

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**About us:**

Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.



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