Equitas Small Finance Bank Limited

January 17, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Certificate of deposit	250.00	CARE A1+	Reaffirmed
Issuer rating	0.00	CARE AA-; Stable	Assigned

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The issuer rating and certificate of deposit rating of Equitas Small Finance Bank Limited (Equitas or ESFB) factors in the long track record of operations with diversified asset classes, comfortable capitalisation levels, improving deposit franchise, and the adequate liquidity position. The ratings also takes note of the continuation of stable profitability metrics in H1FY24. The ratings strengths are, however, partially offset by the relatively high credit deposit ratio, which has improved in H1FY24, the regionally concentrated nature of business, and the moderate asset quality due to the marginal credit profiles of the borrowers.

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. The advances further witnessed a growth of 12% during H1FY24 to ₹31,229 crore as on September 30, 2023. The growth in advances is well supported by the mobilisation of deposits by the bank. The deposits witnessed a growth of 34% in FY23 and stood at ₹25,381 crore as on March 31, 2023, as against ₹18,951 crore as on March 31, 2022. The deposits further grew by 22% in H1FY24 and stood at ₹30,839 crore as on September 30, 2023. The credit deposit ratio (Net advances/deposits) of the bank improved over the years and stood at 102% as on March 31, 2023. The credit deposit ratio witnessed improvement to 93% as on September 30, 2023.

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, and witnessed further improvement with a GNPA of 2.12% as on September 30, 2023.

The ratings also factor in the improvement in the profitability indicators in FY23 and H1FY24. 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. The ROTA stood at 2.1% in H1FY24.

Rating sensitivities: Factors likely to lead to rating actions

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

- Sustained improvement in the scale of operations along with improvement in geographical diversification with sharp reduction in single state concentration while maintaining asset quality and profitability.

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

- Deterioration in the 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 18% on a sustained basis.
- Moderation in the profitability parameters, with the ROTA falling below 1% on a sustained basis.

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

Analytical approach: Standalone

Outlook: Stable

The stable outlook reflects the likely continuation of the steady growth in advances with comfortable capitalisation levels while maintaining stable profitability levels.

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 Limited in 2007 as a non-banking financial company (NBFC) engaged in microfinance activities. The group subsequently incorporated Equitas Finance Limited (vehicle financing arm) in 2011 and Equitas Housing Finance Private Limited (housing finance arm) in 2011, and Equitas was 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 or 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

The bank's capital adequacy has remained comfortable above 20% across the last five years, supported by internal accruals and timely capital infusion.

On account of the growth in advances 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%, respectively). During H1FY24, the advances witnessed a growth of 12% during H1FY24, thus the bank's CAR and Tier-I CAR witnessed moderation and stood at 21.33% and 20.65%, respectively, as on September 30, 2023. 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 its 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 comprising 73% of the total liabilities as on March 31, 2023, and 77% of the total liabilities as on September 30, 2023, followed by borrowings in the form of refinance from financial institutions (FIs) 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. During H1FY24, the deposits grew by 22% and stood at ₹30,839 crore as on September 30, 2023. 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 34% as on September 30, 2023, however, the same declined from 42% as on March 31, 2023 (PY: 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). However, the same has witnessed improvement to 93% as on September 30, 2023. CARE Ratings expects the bank to improve the CD ratio further during FY24, which also 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 enterprise (MSE) finance. SBL and VF continue 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 (37% and 25% as on September 30, 2023). 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, and remained stable at 19% as on September 30, 2023. The bank has seen an increase in HF, which comprises around 10% of the advances as on March 31, 2023 (PY: 8% as on March 31, 2022) and 11% as on September 30, 2023. Equitas also lends to the MSE and NBFC segments, which comprised around 4% and 4% of the advances, respectively, as on March 31, 2023 (4% and 6%, respectively, as on March 31, 2022). The MSE and NBFC segments stood at 3% each as on September 30, 2023. 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 12% in H1FY24 and stood at ₹31,229 crore as on September 30, 2023, as against ₹27,861 crore as on March 31, 2023. CARE Ratings expects the growth in advances to remain at higher levels, continued to be driven by the SBL and HF segments.

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 contributed to 76% and 85% of the gross advances as on March 31, 2023, as against 77% and 86%, respectively, as on March 31, 2022.

As on September 30, 2023, Tamil Nadu contributed 50% of the gross advances, followed by Maharashtra and Karnataka at 12% and 11%, respectively. 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. The top three states and top five states contributed to 74% and 85%, respectively, as on September 30, 2023. CARE Ratings expects the advances to remain concentrated in the medium term.

Asset quality witnessed improvement in FY23 and H1FY24, however the same continues to remain moderate due to marginal credit profile of the borrowers

The bank primarily lends to the self-employed segment of borrowers, who are vulnerable to income shocks and economic downturns. 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 GNPA and NNPA witnessed further improvement and stood at 2.12% and 0.91%, respectively as on September 30, 2023. 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%, respectively, as on March 31, 2022. SMA 1 and SMA 2 stood at 2.12% and 1.06% respectively as on September 30, 2023.

The bank has also sold its non-perming assets (NPA) book (including NPA and technical written-off book) to an asset reconstruction company (ARC; aggregating to ₹581 crore in FY23 and ₹162 crore in H1FY24). The net book value of the Security Receipts (SR) stood at ₹13 crore as on September 30, 2023. 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 gross stressed assets witnessed further improvement to 2.53% as on September 30, 2023. The net stressed assets/net worth stood at 7.33% as on March 31, 2023 (38.98% as on March 31, 2022). The net stressed assets as a percentage of the net worth improved to 5.78% as on September 30, 2023. CARE Ratings expects the bank's asset quality to remain stable over the medium term.

Moderate profitability with improvement seen in FY23 and H1FY24

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 and H1FY24. 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 by 20% and in the non-interest income by 25%, aided by a pickup in disbursements and income from the 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. Its 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.

During H1FY24, the NIM witnessed moderation to 8.06% on account of an increase in the cost of funds. The operating expenses (as a percentage of average total assets) remained at 6.51%. The bank reported a PPOP of ₹642 crore. With reduced credit cost of 0.66%, the bank reported a PAT of ₹389 crore and a ROTA of 2.08% during H1FY24. 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 as on September 30, 2023, the bank does not have negative cumulative mismatches up to the three months' time bucket. Equitas' liquidity coverage ratio (LCR) remained comfortable at 182% as on September 30, 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 ₹2,451 crore as on September 30, 2023 (8.1% of NDTL). Furthermore, the bank has access to systemic liquidity by way of the Reserve Bank of India's (RBI's) Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) schemes.

Environment, social, and governance (ESG) risks

Equitas Small Finance Bank have focused on serving the vast underbanked and unbanked population of the country.
The Bank deals with borrowers who are mostly from the economically weaker sections of the society with poor linkages to the mainstream financial markets. The Bank's policies and processes have been fine-tuned to ensure utmost clarity and fairness while dealing with such clients. Given the nature of the Bank's activities, bank does not have a significant carbon footprint. However, bank strives to reduce the environmental impact by reducing paper usage through digitalisation, tech-led innovations, recycling and reusing electronic equipment and using recycled paper, eco-friendly pads and pencils, among others.
The bank fosters a culture of continuous learning and improvement. Bank's people philosophy is based on Employee Care and Employee Connect, aims to attract, develop, and retain top talent and empower them with the requisite knowledge and skills to stay ahead of the curve.

Applicable criteria

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

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 was listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). Furthermore, the bank completed the amalgamation process of Equitas Holdings Limited with Equitas in February 2023.

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 September 30, 2023, the bank had a network of 956 banking outlets, with deposits of ₹30,839 crore and advances of ₹31,229 crore.

Brief Financials (₹ crore)	March 31, 2022 (A)	March 31, 2023(A)	September 30, 2023(UA)
Total operating income	3,997	4,831	2,966
PAT	281	574	389
Total assets	26,734	34,771	40,129
Net NPA (%)	2.4	1.1	0.9
ROTA (%)	1.1	1.8	2.1

A: Audited UA: Unaudited. Note: The above results are the latest financial results available.
As per CARE Ratings' calculations.

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

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+
Issuer Rating-Issuer Ratings	-	-	-	-	0.00	CARE AA-; Stable

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+	1)CARE A1+ (18-Jul-23)	-	-	-
3	Issuer Rating-Issuer Ratings	Issuer rating	0.00	CARE AA-; Stable				

*Long term/Short term.

Annexure-3: Detailed explanation of the covenants of the rated instruments/facilities

Not applicable

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

Sr. No.	Name of the Instrument	Complexity Level
1	Certificate of deposit	Simple
2	Issuer Rating-Issuer Ratings	-

Annexure-5: Lender details

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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