

Equitas Small Finance Bank Limited (Revised)

December 4, 2020
Rating

Facilities/Instruments	Amount (Rs. crore)	Rating ¹	Rating Action
Subordinate Debt (EMFL)	30 (Rs. Thirty crore only)	CARE A+; Stable (Single A Plus; Outlook: Stable)	Reaffirmed

Details of instruments/facilities in Annexure-1
Detailed Rationale & Key Rating Drivers

The rating assigned to the debt instrument of Equitas Small Finance Bank Limited (ESFB) continues to factor in the experienced management team, fairly diversified product profile, improvement in the overall business during FY20 (refers to the period April 01 to March 31) and H1FY21 (refers to the period April 01 to September 30), comfortable capital adequacy levels, relatively stable profitability and adequate liquidity profile. The rating is however constrained by regionally concentrated nature of business in the southern states of India, moderate asset quality levels and the inherent risks associated with the borrower segments.

Rating Sensitivities

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

- Improvement in business size along with improvement in geographical diversification
- Improve profitability indicators on a sustained basis along with improvement in asset quality

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

- Deterioration of asset quality levels
- Decline in capitalisation levels below 18%

Detailed description of the key rating drivers
Key Rating Strengths

Experienced senior management team and professional board promoters and Management team

Equitas group was founded by 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 a private bank. The entire senior management team is from NBFC/formal financial services sector with significant experience in the vehicle and retail financing business. 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.

¹Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications

Increasing scale of operations and fairly diversified product mix

During FY20, the bank's Asset under Management increased by 31% to Rs.15,367 crore as on March 31, 2020 from Rs.11,704 crore as on March 31, 2019 and further by 9% during H1FY21 to Rs.16,731 crore as on September 30, 2020. As on March 31, 2020, the AUM mix of vehicle finance, small business loans (including LAP and HF), corporate loans stood at 24%, 41%, 5% (PY: 25%, 39% and 4% respectively). AUM mix of vehicle finance, small business loans (including LAP) and corporate loans 25%, 42% and 5% respectively as on September 30, 2020. The share of microfinance portfolio has reduced from 26% as on March 31, 2019 to 24% as on March 31, 2020 and subsequently to 22% as on September 30, 2020. New CV financing segment, which is lending to new SCVs and LCVs stood at 7% of the overall AUM mix as on March 31, 2020 (PY:6%) and at 8% as on September 30, 2020.

Traction in deposits and scaling up of retail deposit base

Deposits (excluding CD) mobilized by the bank improved from Rs.8,195 crore as on March 31, 2019 to Rs. 10,300 crore as on March 31, 2020 and Rs.12,588 crore as on September 30, 2020. Deposits stood at 66% (as a percentage total borrowing mix) as on September 30, 2020. Term Deposits stood at Rs. 8,580 crore, while retail Term Deposits stood at Rs. 3,811 crore which is 45% of Term Deposits balance as on March 31, 2020. As of March 31, 2020, CASA deposits stood at Rs. 2,208 crore comprising a Current Account balance of Rs. 350 crore and a Savings Account balance of Rs. 1,859 crore. Total CASA ratio stood at 20.47% of deposits as on March 31, 2020. During H1FY21, total deposits stood at Rs.12,901 crore with CASA and Term deposits at Rs.3,246 crore and Rs.9,655 crore. CASA% improved from 20% of deposits as on March 31, 2020 to 25% as on September 30, 2020.

Relatively stable profitability indicators

The bank's profitability was lower during FY18 due to branch expansion phase. However, the profitability has started stabilising with improvement in scale of operations during FY19 and FY20. The bank's yield on advances improved to 19.10% in FY20 (18.99% in FY19). The cost of funds reduced to 7.96% in FY20 from 8.16% in FY19 mainly because of the reduction in bulk deposits and improvement in retail deposits. Bulk deposit has moderated 6% Y-o-Y from Rs.5,096 crore as on March 31, 2019 to Rs.4,769 crore as on March 31, 2020. Thus, NIM improved to 8.57 % in FY20 (7.97% for FY19) and 8.23% during H1FY21. The operating expenses (as a percentage of average total assets) stood at 6.77% for FY20 (6.97% for FY19) and 5.68% for H1FY21. Credit costs (as a percentage of average total assets) increased to 1.41% in FY20 from 0.71% in FY19 (1.45% in H1FY21) on account of increased provisions for COVID-19. Total provisioning stood at Rs. 247 crore in FY20 including Rs. 99.63 crore (till March 2020) provisioning for covid-19. Covid-19 provisioning increased to Rs. 171 crore by end of September 2020. ROTA decreased and stood at 1.40% in FY20 (PY: 1.46%) on account of increased credit costs. ROTA stood at 1.53% for H1FY21.

Comfortable capitalisation profile

Bank's CAR and Tier 1 CAR stood comfortable at 23.61% and 22.44% as on March 31, 2020 as against 22.44% and 20.92% as on March 31, 2019, (20.93% and 20.16% as on September 30, 2020). The bank's net worth stood at Rs. 2,631 crore and Rs.2,905 as on March 31, 2020 and September 30, 2020 respectively. Gearing ratio stood at 6.12x times as on March 31, 2020 and 6.57x times as on September 30, 2020 (6.09x times as on March 31, 2019)

In the month of October 2020, ESFB has come out with IPO to list the bank and raised sum of Rs.280 crore through primary issue of shares and Equitas Holdings Limited (EHL) has divested 7.2 crore shares during IPO.

Key Rating Weaknesses

Regionally concentrated with majority of the business in southern states

ESFB has presence across 16 states across 856 banking outlets as on September 30, 2020. However, the concentration of business remains in the state of Tamil Nadu which accounted for 54% of the overall AUM as on March 31, 2020 and 54% as on September 30, 2020. The share of the top state Tamil Nadu accounts for majority of the segments such as microfinance (67%), housing (47%), and vehicle finance (27%). Following Tamil Nadu, the states of Maharashtra and Karnataka had relatively higher share of portfolio at 13% and 10% as on March 31, 2020 (13% and 11% as on September 30, 2020) respectively. The ability of the management to scale up its operations across new geographies and maintain its asset quality is a key monitorable.

Moderate asset quality; risks on account of modest credit profile of borrowers

The overall gross NPA and net NPA levels stood at 2.72% and 1.66% as on March 31, 2020 (PY: 2.53% and 1.44%). Gross NPA increased to Rs. 417 crore as on March 31, 2020 from Rs. 296 crore as on March 31, 2019. The bank's credit costs stood at 1.41% as on March 31, 2020 (PY: 0.71%). As on September 30, 2020, the gross NPA and net NPA levels improved and stood at 2.39% and 1.00% as per Supreme Court order.

The bank's product profile comprises of microfinance loans, vehicles and SME loans whose borrower profiles are modest. The borrowers of vehicle finance loans- Used CV segment are drivers-turned-owners and small fleet operators. The bank lends housing, SME and LAP loans to primarily self-employed borrowers whose credit profiles are also vulnerable to economic cycles. It is critical for the bank to improve its overall risk profile and diversify its product profile from the asset quality perspective. However, the bank has taken initiatives to improve the proportion of secured loans from 71% as on March 31, 2019 and to 75% as on March 31, 2020. Also the bank has introduced new-CVs financing and secured business loans which are lent to relatively better borrower profiles.

Impact of Covid-19

On account of COVID-19 significant proportion of borrowers have availed moratorium. As on August 31, 2020 about 35% of the advances were under moratorium. The collection efficiency has witnessed gradual improvement and reached around 90% in the month of September, 2020 and 94.3% in the month of October 2020. The bank has already made provisions for Rs. 171 crore as on September 30, 2020, for the impact of Covid-19.

Liquidity position: Adequate

As per the bank's structural liquidity statement (SLS) as on September 30, 2020, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets up to six months. The liquidity coverage ratio of bank remained comfortable at 126% as on September 30, 2020 (128% as on March 31, 2020) as against the regulatory requirement of 80%. The bank has excess SLR of Rs. 2,942 crore as on September 30, 2020.

Analytical approach: Standalone

Applicable Criteria

[Criteria on assigning 'Outlook' and 'Credit Watch' to Credit Ratings](#)

[CARE's Policy on Default Recognition](#)

[Financial Ratios-Financial Sector](#)

[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 was a 100% owned subsidiary of Equitas Holdings Ltd (EHL, holding company of the group). Post IPO in October 2020, the bank is listed on BSE & NSE. As on October 28, 2020 EHL held 82.05% stake in the ESFB.

ESFB is currently focussed in retail banking business with focus on micro-finance, vehicle finance, housing finance, business loans, loan against property (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 September 30, 2020, the bank had a network of 856 banking outlets, with deposits of Rs. 12,901 crore and assets under management of Rs.16,731 crore.

Brief Financials (Rs. crore)	FY19 (A)	FY20(A)
Total operating income	2,394	2,928
PAT	211	244
Interest coverage (times)	1.44	1.52
Total Assets	15,675	19,201
Net NPA (%)	1.44	1.66
ROTA (%)	1.46	1.40

A: Audited

As per CARE's Calculation

Total assets and Net worth is excluding deferred tax

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

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

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

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Debt-Subordinate Debt	INE186N08025	March 30,2015	16%	April 30,2021	30.00	CARE A+; Stable

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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Debentures-Non	LT	-	-	-	-	1)Withdrawn	1)CARE A+;

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
	Convertible Debentures						(03-Apr-18)	Stable (07-Jul-17)
2.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (03-Apr-18)	1)CARE A+; Stable (07-Jul-17)
3.	Fund-based-Long Term	LT	-	-	-	-	-	1)Withdrawn (07-Jul-17)
4.	Fund-based-Long Term	LT	-	-	-	1)Withdrawn (06-Dec-19)	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)
5.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (06-Dec-19)	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (07-Jul-17)
7.	Debt-Subordinate Debt	LT	30.00	CARE A+; Stable	-	1)CARE A+; Stable (06-Dec-19)	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)
8.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (07-Jul-17)
9.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (07-Jul-17)
10.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)
11.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (06-Dec-19)	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)
12.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (06-Dec-19)	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)

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

Annexure 4: Complexity level of various instruments rated for this Company

Sr. No.	Name of the Instrument	Complexity Level
1.	Debt-Subordinate Debt	Simple

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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