

## Equitas Small Finance Bank Limited

December 06, 2019

### Ratings

Facilities/Instruments	Amount (Rs. crore)	Rating <sup>1</sup>	Rating Action
Subordinate Debt (EMFL)	30.00 (Rupees Thirty crore only)	CARE A+; Stable (Single A plus; Outlook: Stable)	Reaffirmed
Long term Bank Facilities	00.00 (reduced from 19.72)	-	Withdrawn
Non-Convertible Debenture III (EFL)	0.00 (reduced from 50.00)	-	Withdrawn
Non-Convertible Debenture IV (EMFL)	0.00 (reduced from 100.00)	-	Withdrawn
Non-Convertible Debenture I (EMFL)	0.00 (reduced from 60.00)	-	Withdrawn

Details of instruments/facilities in Annexure-1

### Detailed Rationale & Key Rating Drivers

The rating assigned to the debt instrument of Equitas Small Finance Bank (ESFB) continues to factor in the experienced management team, fairly diversified product profile, comfortable capital adequacy levels and adequate liquidity profile. The ratings take note of the improvement witnessed in the overall business supported by increase in advances & deposits during FY19 (refers to the period April 01 to March 31) and H1FY20 (refers to the period April 01 to September 30) and improving profitability indicators supported by improving NIMs and reducing credit costs. The rating is however constrained by regionally concentrated nature of business in the southern states of India, although improving moderate asset quality levels and the inherent risks associated with the borrower segments.

### Rating Sensitivities

#### Positive Factors

- Further diversification of product offering along with geographical diversification on sustained basis
- Increase its retail deposit base
- Improve profitability indicators on a sustained basis

#### Negative Factors

- Weakening of asset quality
- Weakening of liquidity levels

### 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 11 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.

**Increasing scale of operations and fairly diversified product mix:** During FY19, the bank's total advances (including off-book) increased by 50% to Rs.11,835 crore as on March 31, 2019 (PY: 8,238 crore) and further by 13% during H1FY20 to Rs.13,269 crore as on September 30, 2019 supported by growth in new product segments. As on March 31, 2019, the AUM mix of vehicle finance, Small business loans (including LAP and HF), corporate loans stood at 25%, 31% and 3% respectively (PY:30%, 26% and 3% respectively). AUM mix of vehicle finance, business (including LAP) and corporate loans 24%, 41% and 5% respectively as on September 30, 2019. The share of Microfinance portfolio has reduced to 24% as on September 30, 2019 (27% and 26% as on March 31, 2018 and March 31, 2019) from 54% as on March 31, 2016. As on March 31, 2019, the total unsecured loan AUM stood at Rs. 3,417 crore (PY:2,699 crore) accounting for 29% of AUM (PY:33%) and as on September 30, 2019 it stood at 26% of AUM. The bank has introduced secured working capital loans –MSE finance and the share of these

<sup>1</sup>Complete definition of the ratings assigned are available at [www.careratings.com](http://www.careratings.com) and other CARE publications

secured loans stood 2% of overall portfolio mix as on March 31, 2019 (5% of the overall portfolio mix as on September 30, 2019). The bank has entered into New CV financing segment, which is lending to new SCVs and LCVs and it stood at 6% of the overall AUM mix as on March 31, 2019 (PY:3%) and at 7% as on September 30, 2019.

**Traction in deposits and scaling up of retail deposit base:** Deposits mobilized by the bank improved significantly from Rs. 4,719 crore as on March 31, 2018 to Rs.8,016 crore as on March 31, 2019 (Rs.9,640 crore as on September 30, 2019). Deposits which stood at 35% (as a % total borrowing mix) as on March 31, 2018 improved to 63% as on March 31, 2019 (67% as on September 30, 2019). Term Deposits stood at Rs. 6,732 crore, while retail Term Deposits stood at Rs. 2,408 crore which is 42% of Term Deposits balance as on March 31, 2019. As of March 31, 2019, CASA deposits stood at Rs. 2,274 crore comprising a Current Account balance of Rs. 482 crore and a Savings Account balance of Rs. 1,792 crore. Total CASA ratio stood at 25% of deposits as on March 31, 2019. Of this, share of retail CASA stood at 70%. During H1FY20, total deposits stood at Rs.9,640 crore with CASA and Term deposits at Rs.2,249 crore and Rs. 7,391 crore. CASA balance has marginally declined from Rs.2,274 crore as on March 31, 2019 to Rs. 2,249 crore as on September 30, 2019 and CASA% has also marginally declined from 25% of deposits as on March 31, 2019 to 23% as on September 30, 2019.

**Improving profitability indicators:** The bank's yield on advances improved to 15.68% in FY19 (15.08% in FY18) as the share of investments as a % of total assets has declined from 29% in March 31, 2018 to 15% in March 31, 2019 and the relatively higher yielding advances has increased from 58% in March 31, 2018 to 74% in March 31, 2019. The cost of borrowings of the bank stood at 8.16% in FY19 as against 7.80% in FY18 as the bank offered attractive interest rates to increase the deposit base. The bank's NIM stood at 7.96% for FY19 (PY: 7.67%) and 8.36% during H1FY20. The NIM may decline marginally going forward, as the share secured loan portfolio is increasing and as the bank has introduced new-vehicle loans and secured working capital loans which are relatively lower yielding loan products. The operating expenses (as a % average total assets) stood at 6.97% for FY19 (6.81% for H1FY20) as against 7.9% during FY18. The bank has improved its branch network from 990 to 1,068 from March 31, 2018 to March 31, 2019 hence going forward, the operating expenses is expected to decline by deriving scale benefits. Credit costs (as a % of average total assets) declined during FY19 and stood at 0.71% (0.89% in H1FY20) as against 1.53% in FY18. ROTA improved to 1.46% in FY19 (1.30% in H1FY20) as against 0.3% in FY18.

**Comfortable capitalisation profile:** Bank's CAR and Tier 1 CAR stood comfortable at 22.44% and 20.92% as on March 31, 2019 as against 29.63% and 27.09% as on March 31, 2018. The reduction in CAR level when compared to FY18 is due to increase in scale of operations, however it is well above the regulatory limit of 15% of CAR and 7.5% of Tier I CAR.

#### Key Rating Weaknesses

**Regionally concentrated with majority of the business in Southern states:** ESFB has presence across 13 states across 674 asset and 394 liability branches as on September 30, 2019. Tamil Nadu accounts for majority of the AUM at 63% as on March 31, 2019 (PY: 59%) and 56% as on September 30, 2019. The share of the top state- Tamil Nadu accounts for majority of the segments such as microfinance (69%), housing (58%), LAP (57%), business loans (48%). Following Tamil Nadu, the states of Maharashtra and Karnataka had relatively higher share of portfolio at 13% and 10% (13% and 10% as on September 30, 2019) respectively. However, in terms of branch presence (as a % total branch network) the TN, Maharashtra and Karnataka stood at 38%, 18% and 9% respectively as on March 31, 2019. The ability of the bank to maintain its asset quality levels while scaling up and expanding its operations is key monitorable.

**Moderate asset quality; risks on account of modest credit profile of borrowers:** Gross NPA and net NPA levels stood at 2.53% and 1.61% as on March 31, 2019 (PY: 2.73% and 1.71%). The bank's credit costs stood at 0.7% in FY19 and improved from 1.53% as the management improved its loan recoveries. The bad debts writing off accounts reduced during FY19. During FY18, the bank had written off Rs. 180 crore during FY18 mainly due to the impact demonetization in its the Microfinance portfolio, however in FY19, the bank reduced its written-off levels to Rs.61 crore on its overall advances. As on September 30, 2019, the gross NPA and net NPA levels stood at 2.88% and 1.63% (3.36% and 2.00% as on September 30, 2018).

The bank's product profile comprise 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 67% as on March 31, 2018 to 69% as on March 31, 2019 and further to 74% as on September 30, 2019. Also the bank has introduced new-CVs financing and secured business loans which are lent to relatively better borrower profiles.

### Liquidity: Adequate

As per the bank's structural liquidity statement (SLS) as on March 31, 2019, liquidity profile is comfortable with no cumulative negative mismatches in any of the time buckets. The liquidity coverage ratio of bank remained comfortable at 117.55% as on March 31, 2019 (103.54% as on Jun'19 and 116% as on September 30, 2019) as against the regulatory requirement of 80%. The Bank has excess SLR of Rs.1,336 crore at 13.03% of the net demand and time liabilities as on Mar'19 over the regulatory requirements. The average roll-over rate of fixed deposits is at 50% as on March 31, 2019.

**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](#)

[Bank - CARE's Rating Methodology For Banks](#)

[Policy on withdrawal of ratings](#)

### **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 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, 2019, the bank had a network of 394 liability branches and 674 asset branches, with deposits of Rs.9,640 crore and advances of Rs.13,269 crore.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	1,784	2,404
PAT	32	211
Interest coverage (times)	1.32	1.44
Total Assets	13,247	15,675
Net NPA (%)	1.71	1.61
ROTA (%)	0.28	1.46

A: Audited

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

**Any other information:** NA

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

### **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
Long term bank facilities	-	-	-	-	0.00	Withdrawn
Non-Convertible Debenture issue – I (EMFL)	INE186N07068	20-Aug-14	12.67%	28-May-19	0.00	Withdrawn
Subordinated Debt (EMFL)	INE186N08033	16-Sep-15	13.80%	16-Sep-22	30.00	CARE A+; Stable
Non-Convertible Debenture issue – III (EFL)	INE063P08047	24-Aug-16	10.15%	24-Sep-19	0.00	Withdrawn
Non-Convertible Debenture issue – IV (EFL)	INE063P08070	30-Aug-16	10.15%	30-Sep-19	0.00	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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
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)
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)
3.	Fund-based-Long Term	LT	-	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
4.	Fund-based-Long Term	LT	-	-	-	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
5.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
7.	Debt-Subordinate Debt	LT	30.00	CARE A+; Stable	-	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
8.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
9.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
10.	Debentures-Non Convertible Debentures	LT	-	-	-	1)Withdrawn (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable (14-Dec-16) 2)CARE A+ (21-Jul-16)
11.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A+; Stable (05-Oct-18)	1)CARE A+; Stable (07-Jul-17)	1)CARE A+; Stable

								(14-Dec-16) 2)CARE A+ (12-Aug-16)
12.	Debentures-Non Convertible Debentures	LT	-	-	-	1)CARE A+; Stable (05-Oct-18)	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)

**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](http://www.careratings.com). Investors/market intermediaries/regulators or others are welcome to write to [care@careratings.com](mailto:care@careratings.com) for any clarifications.

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