

EQUITAS SMALL FINANCE BANK LIMITED

The Promoter of Equitas Small Finance Bank (ESFB) i.e. Equitas Holdings Limited (EHL) was granted the RBI Final Approval on June 30, 2016, to establish a Small Finance Bank (SFB). Subsequently, the Bank was converted to a SFB and it commenced operations on September 05, 2016. Unlike other microfinance companies, it has a diversified loan portfolio and less dependence on microfinance business. The main focus of ESFB is on financially unserved and underserved customers.

Positives : (1) The bank is well capitalized (CAR – 23.6% & CET 1 – 22.4% as on Q1FY21, (2) Bank has diversified portfolio (SME- 42%, Vehicle - 24%, MFI- 24%, Housing – 4% and remaining others, (3) It has highest number of outlets compared to all SFBs. (4) ESFB has the best CASA ratio among SFB (ESFB – 20.5%, Ujjivan SFB – 12% & AUSFB -14.5%.

Concerns: (1) ESFB for FY20 reported RoA/RoE of 1.4%/9.8%, which we believe is lower; whereas listed players Ujjivan SFB reported RoA/RoE of 2.2%/14%, AU SFB reported RoA/RoE of 1.6%/15.6%, (2) Asset quality ratio is weak compared to listed peers. For FY20, GNPA of ESFB was 2.7%, for Ujjivan and AUSFB it was 1% and 1.7%, respectively, (3) ESFBs provision coverage ratio is at 48% vs. That of listed peers at >65%, (4) 36.2% of the loan book is under moratorium as on August 31, 2020, which would increase possibility of jump in GNPA and will impact return ratios adversely.

Market outlook and valuation: At the upper end of the price band, Equitas SFB demands Adj. PB of 1.26x post considering fresh issue. Though the bank has diversified loan book and best CASA ratio among SFBs, the return ratios are subdued with GNPA above 2.5% for last 3 years. Our concern for Equitas SFB is fresh formation of bad loans from moratorium book that would keep provisions high and return ratios compressed. We believe investors should wait for price discovery before making any investment decision. **Considering above factors, we recommend NEUTRAL rating for the IPO.**

Key Financials

Y/E March (₹ cr)	FY17	FY18	FY19	FY20
NII	521	858	1,147	1,489
% chg		65	34	30
Net profit	104	32	211	244
% chg		(69)	561	16
NIM (%)	6.2	8.2	8.4	9.0
EPS (₹)	1.0	0.3	2.1	2.3
P/E (x)	32	104	16	14
P/ABV (x)	1.7	1.7	1.5	1.3
RoA (%)	1.1	0.3	1.4	1.4
RoE (%)	5.2	1.6	9.8	9.7

Source: Valuation done on upper price band.

NEUTRAL

Issue Open: Oct 20, 2020

Issue Close: Oct 22, 2020

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹ 1053cr

Fresh issue: ₹280cr

Offer for sale: ₹238cr

Post Eq. Paid up Capital: ₹1,138cr

Issue size (amount): **₹518cr

Price Band: ₹32-33

Lot Size: 450 shares and in multiple thereafter

Post-issue implied mkt. cap: *₹3,651cr
- **₹3,756cr

Promoters holding Pre-Issue: 95%

Promoters holding Post-Issue: 82%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern

Promoters	82.0%
Others	18.0%

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Company Details

ESFB was originally incorporated as 'V.A.P. Finance Private Limited' on June 21, 1993. The Bank's Promoter, Equitas Holdings Limited (EHL) was granted the RBI Final Approval on June 30, 2016, to establish an SFB. Subsequently, the Bank was converted to SFB and it commenced operations on September 05, 2016 as a SFB. Before converting into SFB, Equitas used to give small loans in joint lending group, similar to Spandana and Credit Access.

EHL to hold 82% stake in ESFB post listing.

Average ticket size of entire loan book is Rs0.4mn; 96% of market in this ticket size is unorganized and indicates huge untapped potential.

As on June 30, 2020, it had 856 branches and 322 ATMs across 17 states and UTs. It does not have a presence in East India and at present plans to leverage on existing presence in South, West and North India.

Exhibit 1: Listed peers portfolio diversification (%) FY20

SFB / Peers	MFI	HFC	Vehicle	SME	Retail	Other	Outlet
Equitas SFB	23	4	24	42		7	604
Ujjivan SFB	76	11		7		6	575
AU SFB		2.3	42	38	2.7	15	467
Spandana Sphoorthy	100						
Credit Access Gramin	100						
Bandhan Bank	51	21		7		21	1018

Source: Company

Key Management Personnel:

Vasudevan Pathangi Narasimhan is the MD and CEO of the Bank. He has extensive experience in the financial services sector and had served as the executive vice president and head of consumer banking group in Development Credit Bank Ltd, for more than one and half years. He has also worked for about 2 decades in Cholamandalam Investment and Finance Co. Ltd., part of the Murugappa Group.

Sridharan Nanuiyer is the CFO of the Bank. He joined erstwhile Equitas Holding, now the Bank on August 16, 2010.

Sampathkumar K. Raghunathan is the Company Secretary and Compliance Officer of the Bank. Prior to joining the Bank, he worked at Hinduja Leyland Finance Ltd.

Issue details

This IPO is a mix of OFS and issue of fresh shares. The issue would constitute fresh issue worth ₹280cr and OFS worth of ₹238cr. OFS is primarily to meet regulatory (RBI) requirements. Small Finance Banks, with a net worth of more than ₹500cr, were mandated by the RBI to list within three years of launching operations.

In this IPO, there is a reservation kept for employees and share holders of Equitas Holdings worth ₹1cr and ₹51cr respectively. (Eligible EHL Shareholders: Individuals and HUFs who are the public equity shareholders of Equitas Holdings & the Promoter, as on the date of the Red Herring Prospectus i.e. October 11, 2020.

Exhibit 2: Pre and Post shareholding pattern

Particular	No of shares (Pre-issue)	% No of shares (Post-issue)		%
Promoter	1,00,59,43,363	95	93,39,43,363	82
Public	4,74,58,239	5	20,43,06,724	18
Total	1,05,34,01,602	100	1,13,82,50,087	100

Source: RHP Note, Calculated on upper price band

Objects of the offer

- Ensuring adequate capital to support growth and expansion, including enhancing the Bank's solvency and capital adequacy ratio.
- Meet regulatory requirement of listing.

Risk

- Improvement in asset quality and deposits in mid-term would be key risk to our NEUTRAL call.

Exhibit 3: Relative valuation and operating metrics

Particular (₹cr)	AUM	CASA (%)	NIM (%)	GNPAs (%)	NNPAs (%)	Cost/Asset	PCR (%)	CARR (%)	Market Cap	P/BV (X)	P/E (X)	ROA (%)	ROE (%)
Equitas SFB	15,600	21.0	8.6	2.7	1.4	5.7	48	21.6	3,756	1.26	15.4	1.4	9.7
Ujjivan SFB	14,366	12.0	12.2	1.0	0.2	5.8	80	29.0	5,331	1.75	15.2	2.2	14.0
AU SFB	30,036	14.5	5.0	1.7	0.6	2.7	65	21.7	22,377	4.91	37.2	1.6	15.6
Spandana S	6,800		15.5	0.6	0.1	3.6	81	53.0	3,505	1.30	10.4	6.7	15.0
CreditAccess	9,680		12.6	1.6	- .0	3.4	100	23.7	10,368	3.54	31.6	2.4	13.1
Bandhan Bank	74,300	37.1	8.2	1.4	0.5	2.6	66	23.7	50,379	3.21	16.7	4.1	22.9

Source: Equitas SFB valuation done on upper band of IPO, and other Co. valuation taken as on CMP of 17/10/2; P/BV done on Q1FY21 Network; For Equitas Fresh issue added in Networth calculation, PE on FY20 EPS

Exhibit 4: Listed peers Dupont compared with Equitas SFB

Particular	SFB		Ujjivan		AU		Bandhan		Equitas	
	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20	FY19	FY20
Interest earned		15.8	16.8	11.5	11.5	13.2	14.7	14.5	15.1	
Interest expended		6.2	6.7	6.2	6.4	4.3	6.2	6.6	6.6	
Net Interest Income		9.5	10.2	5.2	5.1	8.9	8.5	7.9	8.5	
Other income		1.8	2.0	1.8	1.7	2.1	2.1	1.9	1.6	
Total income		11.3	12.2	7.0	6.8	11.0	10.6	9.8	10.1	
Operating expenses		8.6	8.2	4.2	3.8	3.6	3.3	6.9	6.7	
Employee Exp		4.5	4.5	2.3	2.0	2.0	1.8	3.8	4.0	
Other Exp		4.2	3.7	1.9	1.8	1.6	1.4	3.1	2.6	
PPOP		2.7	4.0	2.8	3.0	7.4	7.4	2.9	3.4	
provisions		0.4	1.1	0.6	0.8	1.5	1.9	0.7	1.4	
PBT		2.3	2.9	2.3	2.2	6.0	5.5	2.2	2.0	
Exceptional items		- .0	- .0	- .0	0.2	- .0	- .0	- .0	- .0	
Tax items		0.6	0.7	0.8	0.6	2.1	1.4	0.8	0.6	
RoA		1.7	2.2	1.5	1.6	3.9	4.1	1.4	1.4	
Leverage		6.7	6.4	9.5	9.9	4.9	5.6	6.8	7.0	
RoE		11.5	14.0	14.0	15.6	19.0	22.9	9.8	9.7	

Income Statement

Y/E March (₹ cr)	FY17	FY18	FY19	FY20	Q1FY21
Net Interest Income	521	858	1,147	1,489	404
- YoY Growth (%)		65	34	30	
Other Income	233	241	283	282	30
- YoY Growth (%)		3	17	(0)	
Operating Income	754	1,100	1,430	1,772	434
- YoY Growth (%)		46	30	24	
Operating Expenses	497	879	1,004	1,174	292
- YoY Growth (%)		77	14	17	
Pre - Provision Profit	258	221	426	598	142
- YoY Growth (%)		(14)	93	40	
Prov. & Cont.	96	172	102	247	68
- YoY Growth (%)		78	(41)	141	
Profit Before Tax	161	49	324	351	74
- YoY Growth (%)		(70)	567	8	
Prov. for Taxation	57	17	113	107	16
- as a % of PBT	36	34	35	31	22
PAT	104	32	211	244	58
- YoY Growth (%)		(69)	561	16	

Balance Sheet

Y/E March (₹ cr)	FY17	FY18	FY19	FY20	Q1FY21
Equity	1,006	1,006	1,006	1,053	1,053
Reserve & Surplus	1,006	1,038	1,248	1,691	1,748
Networth	2,012	2,044	2,254	2,744	2,802
Deposits	1,921	5,604	9,007	10,788	11,787
- Growth (%)		192	61	20	
Borrowings	4,779	5,177	3,973	5,135	5,526
Other Liab. & Prov.	533	488	531	650	778
Total Liabilities	9,245	13,313	15,765	19,317	20,892
Cash Balances	248	386	403	381	429
Bank Balances	866	825	858	2,156	1,497
Investments	1,891	3,857	2,344	2,343	3,479
Advances	5,702	7,707	11,595	13,747	14,389
- Growth (%)		35	50	19	
Fixed Assets	288	281	237	213	198
Other Assets	251	258	327	478	902
Total Assets	9,245	13,313	15,765	19,317	20,892
- Growth (%)		44	18	23	

Key Ratio

Y/E March	FY17	FY18	FY19	FY20
Profitability ratios (%)				
NIMs	6.2	8.2	8.4	9.0
Cost to Income Ratio	66	80	70	66
RoA	1.1	0.3	1.4	1.4
RoE	5.2	1.6	9.8	9.7
B/S ratios (%)				
CASA Ratio		29.2	25.3	20.5
Credit/Deposit Ratio	3.0	1.4	1.3	1.3
CAR	35.5	29.6	22.4	23.6
Tier I	32.3	27.1	20.9	22.4
Asset Quality (%)				
Gross NPAs	3.3	2.7	2.5	2.7
Net NPAs	1.5	1.7	1.6	1.8
Slippages	-	4.5	2.7	3.0
Loan Loss Prov. /Avg. Assets	1.0	1.5	0.7	1.4
Provision Coverage	54	37	36	33
Per Share Data (₹)				
EPS	1.0	0.3	2.1	2.3
BVPS	20.0	20.3	22.4	26.1
ABVPS (70% cover.)	19.6	19.6	21.4	24.9
DPS				
Valuation Ratios				
PER (x)	32	104	16	14
P/ABVPS (x)	1.7	1.7	1.5	1.3

Valuation done at upper price band of the IPO

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