

# Equitas Small Finance Bank

25 March, 2022

Reuters: HDFC.BO; Bloomberg: HDFC IN

## Near term pain priced in; AUM growth should trigger re-rating

Equitas Small Finance Bank (EquitasB) recently raised Rs5.5bn through QIP to meet Minimum Public Shareholding requirement, resulting in 9% equity dilution. Post QIP, the promoter shareholding (Equitas Holdings - EHL) has dropped to 74.7% and the Board has approved the Scheme of Amalgamation between EHL and EquitasB (Swap Ratio of 2.31 shares of EquitaB for 1 share in EHL). The reverse merger is likely to be completed between Dec'22 and Mar'23. We recently hosted EquitasB for a client interaction and the key takeaways from our call are: (1) Credit demand is picking up across products and the management remains upbeat about achieving 25-30% AUM growth in FY23E (2) Collections remain strong and incremental flow into delinquencies from the standard book has normalized (3) Some pain is visible in the restructured book in Micro Finance (MF) and Used CV (UCV) portfolios. However, EquitasB expects normalized credit costs from 2QFY23E; (4) Despite increase in deposit rates, the bank may see further reduction of 25bps in CoF (5) Expects competition to emerge from NBFCs in Small Business Loans (SBL) (6) Expects cost to income ratio of 60% by FY23-end and 55% by FY24-end (7) Equitas model can deliver RoAs of 2-2.5% and RoEs of 15-18% with normalization of credit costs and improvement in other income. We have incorporated the recent capital raise in our model, thereby leading to increase in ABVPS. We continue to value EquitasB at 2x FY24E ABV to arrive at our Target Price (TP) of Rs81. EquitasB is trading attractively at 1.3x FY24E P/ABV, pricing in the increase in credit costs for the next two quarters and geographical concentration. However, the stock, in our view remains under-valued despite its long runway for growth, improving liability franchise and improved returns profile.

**Credit demand strong; expects 25-30% AUM growth in FY23E:** Disbursements have been strong in Feb'22 and March'22 across segments, underlining management's confidence of 25-30% AUM growth in FY23E. Around 80% of staff is redeployed in sales and expects all field staff to move back to sales post March'22.

**Collection efficiency improving; expects normalization in credit costs from 2QFY23E:** Collection efficiency has remained strong and flow of delinquencies from the standard book has normalized. Concerns about the restructured book remains in MF (income displacement) and VF (slow rebound in few pockets). The restructured book has now a history of 90 days of collections and the management does not expect bucket movements post March'22. This should result in normalization of credit costs from 2QFY23E. In our 3QFY22 result update, we had highlighted that the provisioning seems inadequate and we may expect some increase in 4QFY22 ([Link](#)).

**Improved liability franchise:** The share of CASA deposits stands at 50.8%. Recently, EquitasB hiked deposit rates by ~10-25bps across buckets. Despite this, the bank remains confident of 25-30bps reduction in CoF. The landed CoD (includes acquisition cost, which is set-off by fee income) is ~9% and the bank expects it to fall to ~8% with increase in branch network and improved technology. The bank has increased the rates of TD (earlier savings accounts garnered higher rates) in order to match increased asset tenure. Overall, the liability franchise is gaining strength.

## BUY

**Sector:** SFB

**CMP:** Rs53

**Target Price:** Rs81

**Upside:** 52%

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### Key Data

Current Shares O/S (mn)	1,251.0
Mkt Cap (Rsbn/US\$mn)	66.7/873
52 Wk H / L (Rs)	77/45
Daily Vol. (3M NSE Avg.)	827,448

### Price Performance (%)

	1 M	6 M	1 Yr
Equitas Small Fin.	2.0	(10.1)	(11.3)
Nifty Index	3.4	(3.5)	20.2

Source: Bloomberg

[Initiating Coverage](#)

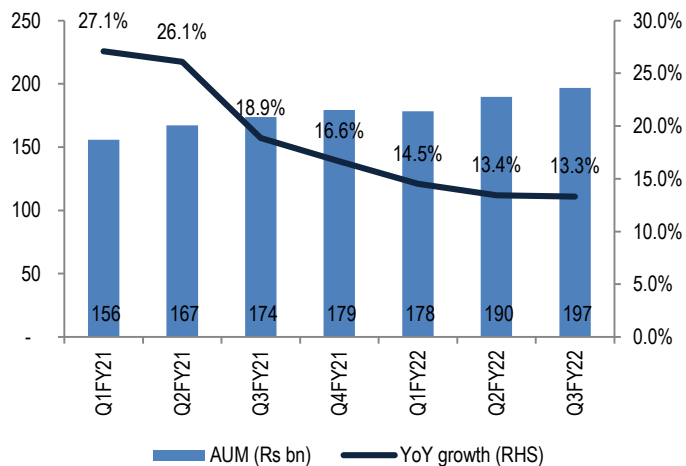
**Exhibit 1: Merger calculation – Loss of ownership of 3.3% for promoters; investing through Equitas Holding is at 21% discount**

Equitas SFB	Shares o/s	%	Market cap in Mn
Equitas Holdings Ltd	93,39,43,363	74.6%	49,732
Public	31,74,48,000	25.4%	16,904
<b>Total</b>	<b>1,25,13,91,363</b>	<b>100.0%</b>	<b>66,637</b>
<b>Shareholding pattern (Mar'21) - Equitas Holdings</b>			
Name	Shares o/s	%	
Promoter	-	0	
Public	34,17,90,115	100%	
<b>Total</b>	<b>34,17,90,115</b>	<b>100%</b>	
Share price (Rs)		110.4	
EHL Marketcap		37,717	
Value of stake in SFB		49,732	
<b>Scheme</b>			
Current bank market cap		66,637	
Post merger			
SWAP (1_2.31)	78,95,35,166	<<New shares issued	
<b>New share structure</b>			
EHL shareholding	78,95,35,166	71.3%	47,527
Bank public shareholding	31,74,48,000	28.7%	19,109
<b>Total</b>	<b>1,10,69,83,165.65</b>	<b>100.0%</b>	<b>66,637</b>
Loss of ownership due to amalgamation			3.3%
Investing through Equitas Holding - discount to current market cap			-20.6%

Source: Company, Nirmal Bang Institutional Equities Research

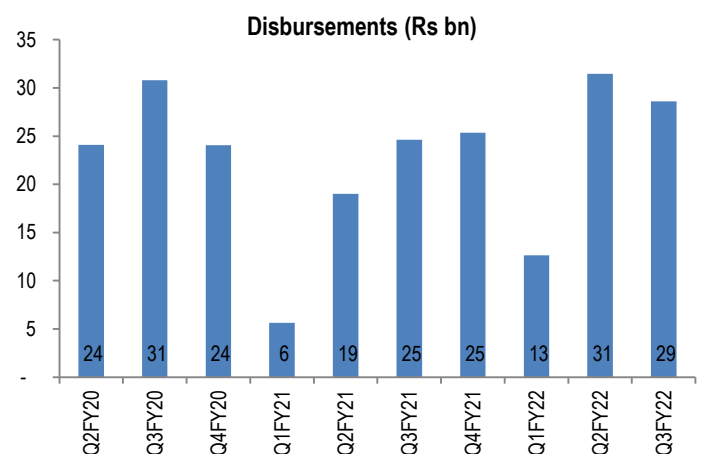
Swap ratio has been revised from 226 shares of EquitasB to 100 shares of EHL (226:100) to 231:100

**Exhibit 2: AUM (Rs bn), AUM growth**



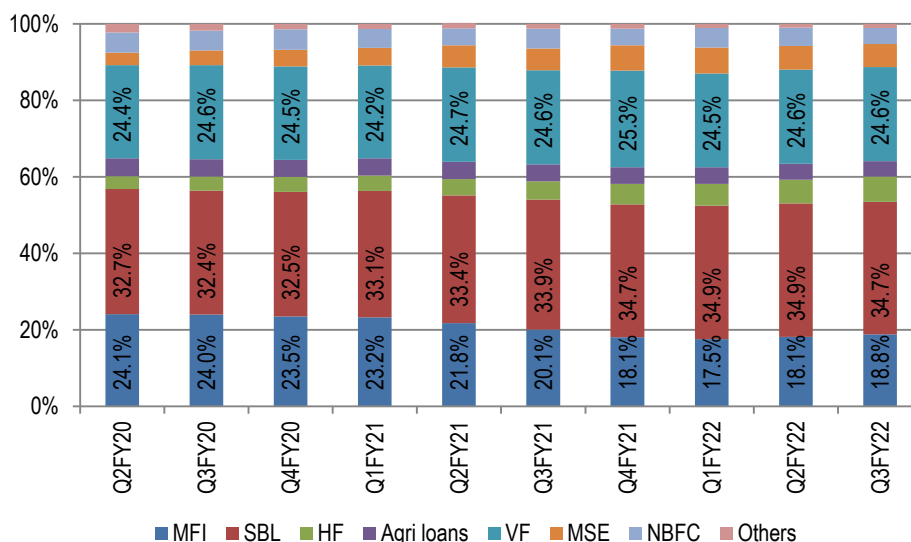
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 3: Disbursements**



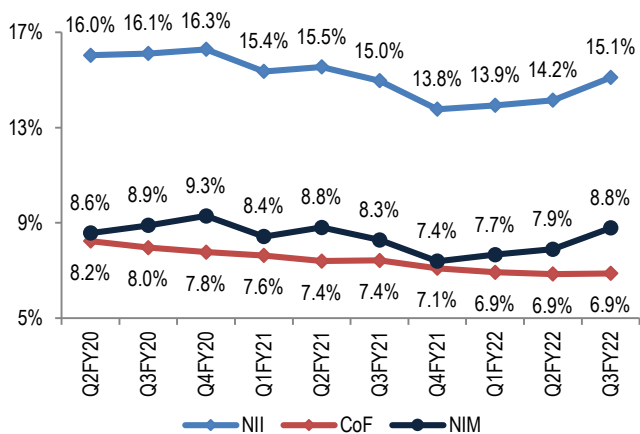
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 4: AUM mix**



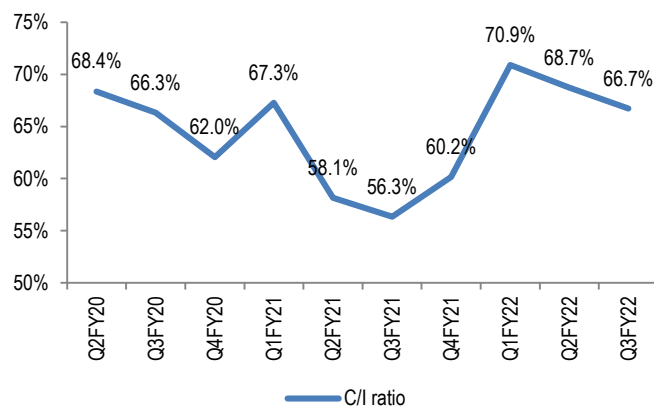
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 5: NII, CoF and NIMs**



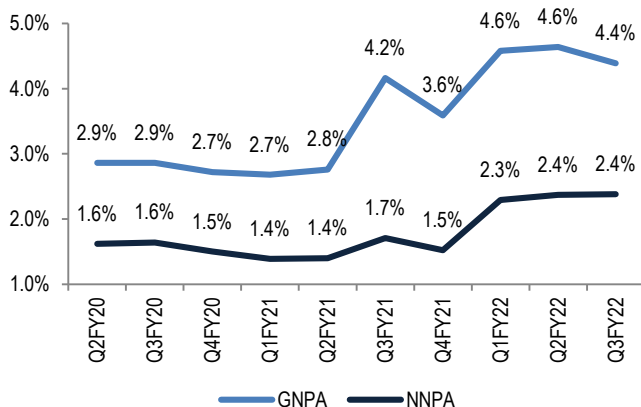
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 6: Cost to income ratio**



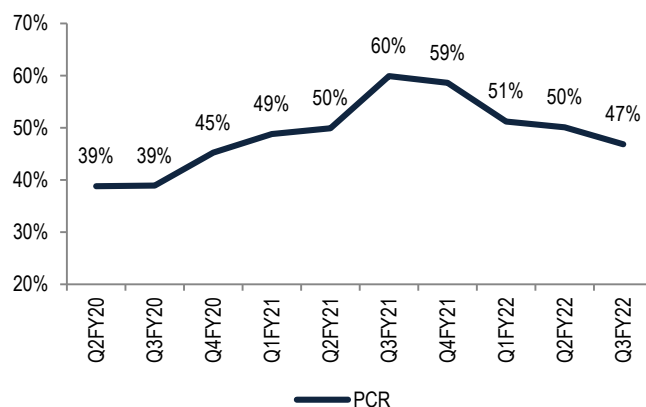
Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 7: GNPA & NNPA**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 8: PCR**



Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 9: GNPA & PCR segment wise**

Segment wise GNPA & PCR	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22
Micro Finance	1.2%	5.2%	3.4%	6.6%	6.8%	6.1%
PCR	70.6%	89.6%	84.6%	56.9%	52.7%	48.6%
SBL (incl HF)	2.5%	3.0%	3.3%	3.5%	3.7%	3.5%
PCR	38.6%	35.7%	36.7%	38.3%	39.8%	41.3%
Vehicle Finance	3.0%	5.5%	3.8%	4.3%	4.6%	4.3%
PCR	50.5%	47.4%	60.8%	54.5%	47.8%	37.0%
MSE Finance	0.9%	2.0%	2.8%	6.0%	4.8%	5.1%
PCR	27.8%	29.9%	24.2%	19.5%	24.8%	25.6%
NBFC	0.8%	0.7%	0.7%	0.6%	0.5%	0.6%
PCR	20.4%	20.4%	15.0%	25.0%	25.0%	25.0%

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 10: Financial Summary**

Y/E March (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Net Interest Income	14,953	17,980	20,363	24,099	29,520
Pre-provisioning operating profit	5,976	8,866	8,492	10,862	14,943
PAT	2,436	3,842	2,571	5,333	7,551
P/E (x)	23.0	15.8	25.9	12.5	8.8
P/BV (x)	2.0	1.8	1.6	1.4	1.2
P/ABV (x)	2.2	1.9	1.8	1.5	1.3
EPS (Rs)	2.3	3.4	2.1	4.3	6.0
BV (Rs)	26	30	34	38	44
ABV (Rs)	24	27	30	35	41
Gross NPAs (%)	3.0	3.7	4.1	4.0	3.9
Net NPAs (%)	1.6	1.5	2.1	1.6	1.4
RoA (%)	1.4	1.7	1.0	1.7	2.0
RoE (%)	9.7	12.5	6.8	11.9	14.7

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 11: Change in our estimates**

	Revised Estimates			Earlier Estimates			% Revision		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Net Interest income (Rs mn)	20,363	24,099	29,520	20,363	24,552	30,076	0.0	-1.8	-1.8
Operating Profit (Rs mn)	8,492	10,862	14,943	8,492	11,315	15,499	0.0	-4.0	-3.6
Profit after tax (Rs mn)	2,571	5,333	7,551	2,571	5,672	7,967	0.0	-6.0	-5.2
ABVPS	30	35	41	28	33	40	7.3	4.2	1.3

Source: Company, Nirmal Bang Institutional Equities Research

## Financials

**Exhibit 12: Income statement**

Y/E March (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Interest Income	26,454	31,944	35,171	42,083	51,504
Interest expenses	11,501	13,965	14,808	17,984	21,984
<b>Net interest income</b>	<b>14,953</b>	<b>17,980</b>	<b>20,363</b>	<b>24,099</b>	<b>29,520</b>
Growth (%)	29.8	20.2	13.3	18.3	22.5
Other Income	2,824	4,181	5,351	6,689	8,027
<b>Net Income</b>	<b>17,777</b>	<b>22,160</b>	<b>25,714</b>	<b>30,788</b>	<b>37,547</b>
Growth (%)	23.9	24.7	16.0	19.7	22.0
Employee Cost	7,098	7,914	9,260	10,371	11,616
Other Operating Exp.	4,703	5,380	7,962	9,555	10,988
<b>Operating Profit</b>	<b>5,976</b>	<b>8,866</b>	<b>8,492</b>	<b>10,862</b>	<b>14,943</b>
Growth (%)	40.2	48.4	-4.2	27.9	37.6
Provisions	2,466	3,753	5,054	3,732	4,849
PBT	3,509	5,113	3,437	7,130	10,095
Tax	1,073	1,270	866	1,797	2,544
Tax Rate (%)	30.6	24.8	25.2	25.2	25.2
<b>PAT</b>	<b>2,436</b>	<b>3,842</b>	<b>2,571</b>	<b>5,333</b>	<b>7,551</b>
Growth (%)	15.7	57.7	-33.1	107.4	41.6
Extraordinary items	0.0	0.0	0.0	0.0	0.0
<b>Net profit for the period</b>	<b>2,436</b>	<b>3,842</b>	<b>2,571</b>	<b>5,333</b>	<b>7,551</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 13: Balance sheet**

Y/E March (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E
Capital	10,534	11,393	12,508	12,508	12,508
Reserves & Surplus	16,907	22,571	29,616	34,949	42,500
<b>Net Worth</b>	<b>27,441</b>	<b>33,963</b>	<b>42,124</b>	<b>47,457</b>	<b>55,008</b>
<b>Deposits</b>	<b>1,07,884</b>	<b>1,63,920</b>	<b>1,99,188</b>	<b>2,53,731</b>	<b>3,16,723</b>
Change (%)	19.8	51.9	21.5	27.4	24.8
<b>Borrowings</b>	<b>51,349</b>	<b>41,653</b>	<b>31,240</b>	<b>31,240</b>	<b>31,240</b>
Change (%)	29.2	-18.9	-25.0	0.0	0.0
Other Liabilities	6,471	7,616	8,758	9,634	10,598
<b>Total Liabilities</b>	<b>1,93,145</b>	<b>2,47,152</b>	<b>2,81,310</b>	<b>3,42,062</b>	<b>4,13,569</b>
Cash/Equivalent	25,368	33,787	21,915	24,296	24,125
Investments	23,425	37,052	55,577	63,914	70,306
Change (%)	-0.1	58.2	50.0	15.0	10.0
<b>Advances</b>	<b>1,37,472</b>	<b>1,68,479</b>	<b>1,94,809</b>	<b>2,43,492</b>	<b>3,07,224</b>
Change (%)	18.6	22.6	15.6	25.0	26.2
Net Fixed Assets	2,128	1,851	2,128	2,447	2,814
Other Assets	4,752	5,983	6,881	7,913	9,100
<b>Total Assets</b>	<b>1,93,145</b>	<b>2,47,152</b>	<b>2,81,310</b>	<b>3,42,062</b>	<b>4,13,569</b>

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 14: Key ratios**

Y/E March	FY20	FY21	FY22E	FY23E	FY24E
<b>Spreads Analysis (%)</b>					
Interest yield on IEA	16.0	15.3	14.1	14.3	14.3
Cost of deposits	7.5	7.1	6.5	6.7	6.7
Cost of Funds	8.0	7.7	6.8	7.0	6.9
NIMs on IEA	9.1	8.6	8.2	8.2	8.2
<b>Efficiency Ratios (%)</b>					
Cost to income ratio	66.4	60.0	67.0	64.7	60.2
Empl. Cost/Op. Exps.	60.1	59.5	53.8	52.0	51.4
<b>Profitability Ratios (%)</b>					
RoE	9.7	12.5	6.8	11.9	14.7
RoA	1.4	1.7	1.0	1.7	2.0
Int. Expended/Int.Earned	43.5	43.7	42.1	42.7	42.7
Other Inc./Net Income	15.9	18.9	20.8	21.7	21.4
<b>Asset Quality (%)</b>					
Gross NPA (Rs mn)	4,173	6,428	8,246	10,061	12,425
Net NPA (Rs mn)	2,286	2,662	4,123	4,024	4,349
GNPA	3.0	3.7	4.1	4.0	3.9
NNPA	1.6	1.5	2.1	1.6	1.4
Provision coverage	40.7	55.6	50.0	60.0	65.0
Slippage ratio	3.5	4.2	7.0	5.0	5.0
Credit cost	1.9	2.5	2.8	1.7	1.8
<b>Asset-Liability Profile (%)</b>					
CD ratio	1.3	1.0	1.0	1.0	1.0
CASA ratio	20.5	34.2	51.2	52.1	52.1
Leverage (x)	7.0	7.3	6.7	7.2	7.5
Tier 1 Capital	22.4	23.2	24.2	22.4	21.5
Tier 2 Capital	1.2	1.0	0.8	0.7	0.6
Total CAR	23.6	24.2	25.0	23.1	22.1

Source: Company, Nirmal Bang Institutional Equities Research

**Exhibit 15: Valuations**

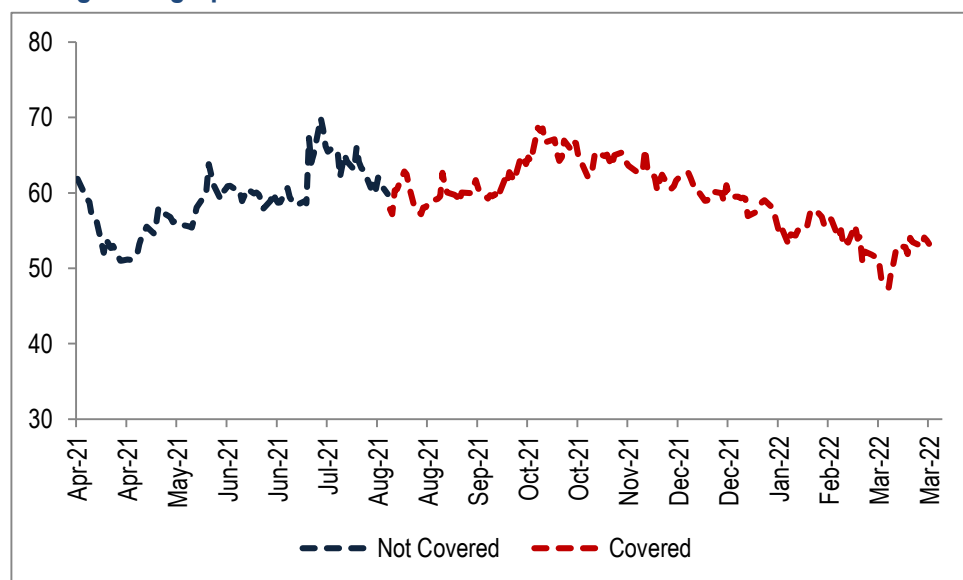
Valuations	FY20	FY21	FY22E	FY23E	FY24E
BVPS (INR)	26.1	29.8	33.7	37.9	44.0
BV Growth (%)	16.2	14.4	13.0	12.7	15.9
<b>Price-BV (x)</b>	<b>2.0</b>	<b>1.8</b>	<b>1.6</b>	<b>1.4</b>	<b>1.2</b>
<b>Adjusted BV per share</b>	<b>23.9</b>	<b>27.5</b>	<b>30.4</b>	<b>34.7</b>	<b>40.5</b>
<b>P/ABV</b>	<b>2.2</b>	<b>1.9</b>	<b>1.8</b>	<b>1.5</b>	<b>1.3</b>
EPS (INR)	2.3	3.4	2.1	4.3	6.0
Growth (%)	10.5	45.8	-39.0	107.4	41.6
<b>Price-Earnings (x)</b>	<b>23.0</b>	<b>15.8</b>	<b>25.9</b>	<b>12.5</b>	<b>8.8</b>
Dividend	0.0	0.0	0.0	0.0	0.0
<b>Dividend Yield (%)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Source: Company, Nirmal Bang Institutional Equities Research

## Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
10 October 2021	Buy	64	89
31 October 2021	Buy	65	84
1 Feb 2022	Buy	55	73
25 Mar 2022	Buy	53	81

## Rating track graph



## DISCLOSURES

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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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