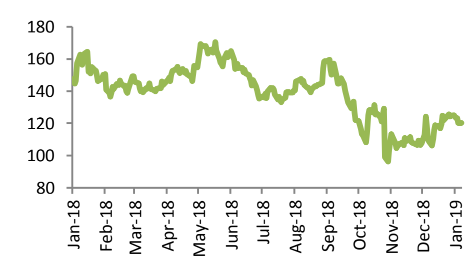
# Equitas Holdings Ltd.



| Recommendation | BUY |
|---|---|
| CMP | Rs. 123 |
| Target Price | Rs. 181 |
| Sector | Banks – SFB |

| Stock Details | |
|---|---|
| BSE Code | 539844 |
| NSE Code | EQUITAS |
| Bloomberg Code | EQUITAS IN |
| Market Cap (Rs Cr) | Rs. 4,136 Cr |
| Free Float (%) | 100% |
| 52- wk HI/Lo (Rs) | 174/78 |
| Avg. volume NSE (Monthly) | 31,43,652 |
| Face Value (Rs) | 10 |
| Div. Per Share (FY 18) | N.A |
| Shares o/s (Cr) | 34.0 |

| Relative Performance | 1Mth | 3Mth | 1Yr |
|---|---|---|---|
| Equitas | 12% | 8% | -14% |
| Sensex | 8% | 2% | -19% |




| Shareholding Pattern | Sept'18 |
|---|---|
| Promoters Holding | 0.0% |
| Institutional (Incl. FII) | 62.1% |
| Corporate Bodies | 6.8% |
| Public & others | 31.1% |

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## Best of both worlds: yield of NBFCs, cost of banks

*Equitas offers a unique opportunity to participate in a business model that offers nimbleness and pricing power of an NBFC on one hand and the deposit generating ability of a bank on the other. Equitas has successfully diversified across 9 products with its core focus on self-employed individuals and micro and small enterprises (MSEs) that are underserved by formal financing channels.*

**Fast paced transition towards high yield secured lending**: Diversifying its product portfolio over the years has been the key factor in Equitas' strong evolution and robust growth. Non-Microfinance mix in AUM has increased from 46% in FY16 to 72% in FY18. We expect the company to maintain its growth momentum and grow its AUM at 37% CAGR over FY18-21E.

**Multiple levers to maintain NIMs**: We expect Equitas to sustain NIMs in the ~7.0-7.5% range in the medium term. We believe a significant portion of the long term strategy to scale down MF portfolio has been already executed with the share of MF now at 27%. Equitas is on track to substantially reduce the excessive investments it held historically which should aid in expansion of NIMs. Cost of funds is expected to be under control on the back of increase in deposits from 52% of total borrowings today to 68% by FY21E.

**Scope for improvement in cost efficiency:** Post FY16, Equitas' conversion into a SFB resulted in quantum jump in opex. Equitas converted 375 of its 500 branches into bank branches and also added ~3500 branch banking employees. We believe the operating costs have peaked out and the benefit of operating leverage shall kick-in with acceleration in loan/NII growth. We forecast Equitas' opex to grow at 12% CAGR over FY18-21E as against NII growth of 26% CAGR and thus deliver cost/income ratio of 54.8% in FY21E v/s 80.0% in FY18.

**High capital adequacy to support high growth without dilution:** With current Tier 1 ratio of 22.3% and scope for raising Tier 2 capital (currently 1.6%), we do not foresee Equitas raising Tier 1 capital over the next four years. We believe Equitas can grow its AUM at 33%+ CAGR and reach top quartile profitability levels (ROE of 17-18%) over the same period.

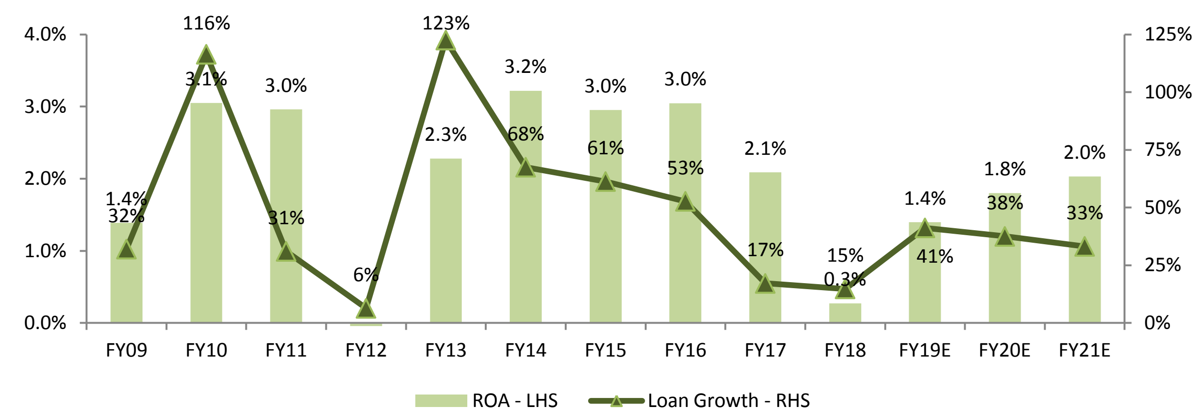
**ROE to expand 760 bps over FY19-21E to 16.3% driven by operating leverage:** We expect a strong revival in loan growth on one hand and modest increase in opex on the other; leading to robust operating leverage. Further, with an improvement in capital gearing, we foresee ROE expanding to 16.3% by FY21E from 8.7% in FY19E.

**Valuation and Recommendation:** With visible ROE expansion to ~17-18% levels in the long term (by FY22E) on the back of strong AUM growth, lower opex and lower credit costs, **we believe Equitas' valuations will gravitate towards that of SFBs, banks and NBFCs demonstrating similar growth and profitability. We value (Equitas SFB at 3.0x FY20E Adj. BV) Equitas Holdings at a 20% discount to SFB, at 2.4x FY20E Adj. BV at Rs. 181, post factoring the holdco discount. We initiate coverage with 'BUY' rating with a target price of Rs. 181.**

| Year | NII (Rs cr) | PBP (Rs. Cr) | PAT (Rs. Cr) | Growth (%) | EPS (Rs.) | PE (x) | Adj. BV (Rs.) | P/ABV (x) | RoE (%) |
|---|---|---|---|---|---|---|---|---|---|
| FY18 | 924 | 223 | 31 | -80% | 0.9 | 133.1 | 63.6 | 1.9 | 1.4% |
| FY19E | 1,148 | 445 | 207 | 559% | 6.1 | 20.2 | 66.9 | 1.8 | 8.7% |
| FY20E | 1,484 | 710 | 338 | 64% | 9.9 | 12.3 | 75.3 | 1.6 | 12.7% |
| FY21E | 1,858 | 1,032 | 502 | 48% | 14.7 | 8.3 | 88.1 | 1.4 | 16.3% |

## Evolution of Equitas over the years

**Exhibit 1: Evolution of Equitas**




*Source: Company, NBRR*

**Stage I: FY09-11 – Starting off on the right foot**

Equitas was setup in Dec 2007, by Mr. P N Vasudevan with the sole aim of providing MF (micro-finance) to households that did not have access to formal sources of funding especially in the unserved areas.

**Stage II: FY11-FY16 – Transition into a diversified, secured lender**

In 2011, the Andhra Pradesh state government ordinance regarding MFIs adversely impacted the business models of all MFIs. This ordinance led to a decline of 14% YoY in the industry portfolio in FY12. Equitas' MF portfolio de-grew marginally in FY12, given the crisis-like situation. However, the management took a conscious decision to prune the MFI book in order to de-risk it, by giving shorter-term (~1 Yr) loans of lower ticket size. The company diversified its portfolio into secured lending for housing finance and used commercial vehicle finance. This diversification helped the company grow its AUM at 52% CAGR over FY12-16.

**Stage III: FY16-FY18 – Run down of MF book contracted NIMs; Conversion into SFB inflated opex; thus pulling down profitability**

Equitas' strategy to reduce MF book gained momentum post demonetization whereby the bank reduced its MF portfolio by 31% over FY16-FY18 while the non-MF book increased by 109%. Lower yields in the non-MF book (~17%) vs the MF book (~20%) led to a steep decline in NIMs. The MF book mix declined from 54% in FY16 to 28% in FY18. Equitas was one of the 10 applicants to be granted approval to convert into a Small Finance Bank (SFB). This offered the company opportunities for growth with easy access to low-cost CASA and retail deposits, along with a basket of diversified products. In Sept'16, Equitas commenced banking operations. Over FY16-18, Equitas converted 375 of its NBFC/MFI branches into bank branches which involved a substantial increase in opex costs. This resulted in substantially higher cost/income ratio of 80% in FY18 (vs 53% in FY16). Equitas' ROE declined from 13.3% in FY16 to 1.4% in FY18.

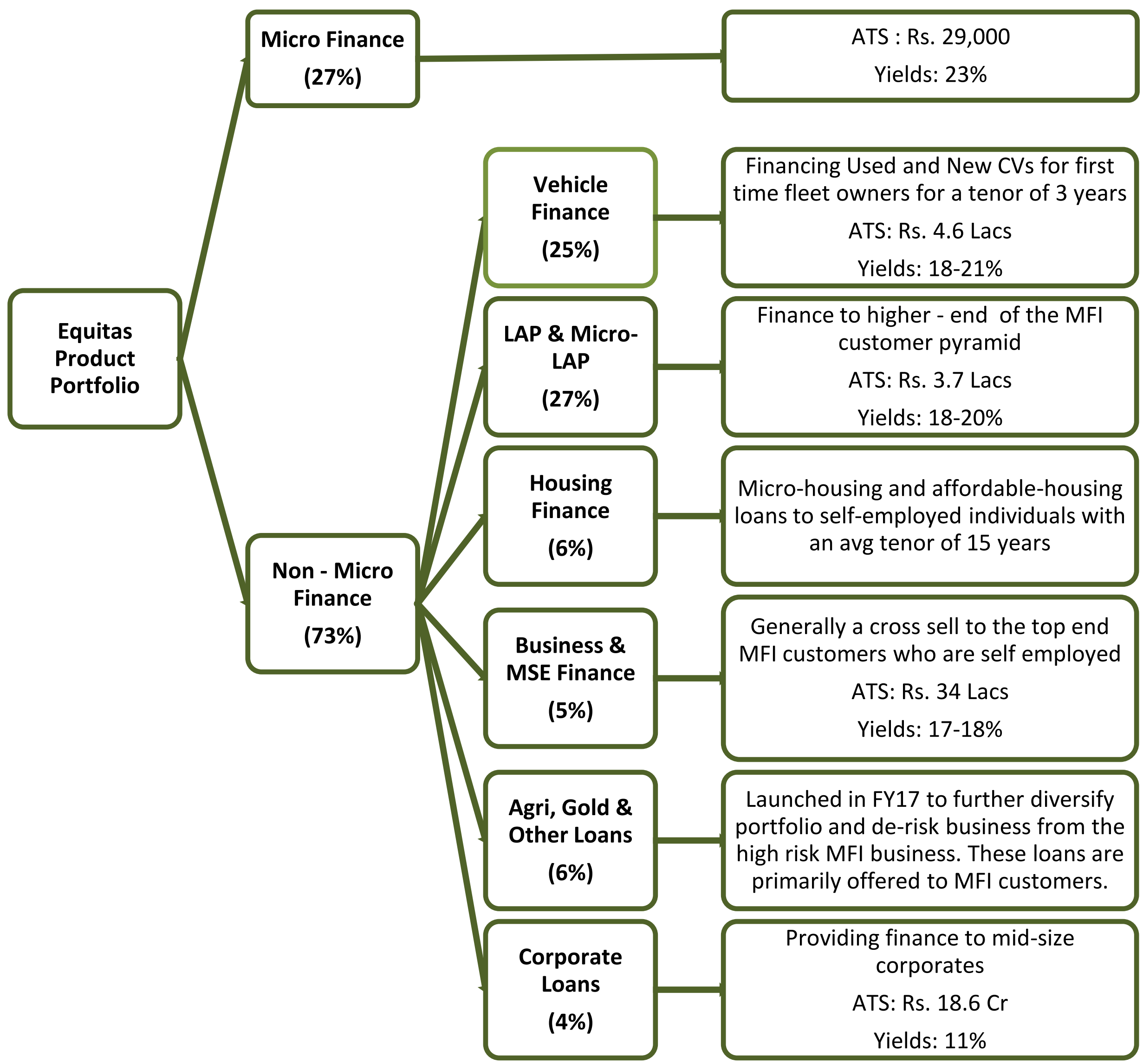
**Stage IV: FY18-FY21E – Commencement of growth phase**

We believe Equitas has the potential to repeat its impeccable past performance with a balanced mix of secured high yielding products, lower cost of liability deposits and grow its loan book at 37% CAGR during FY18-21E. We believe that a pro-active, highly skilled management team, prudent approach, right strategy will help Equitas outperform the banking and NBFC industry in coming years.

## Company Background

Equitas Holdings Ltd. is a diversified financial services provider focused on low income groups and economically weaker individuals operating small businesses, as well as MSEs with limited access to formal financing channels on account of their informal, variable and cash-based income profile.

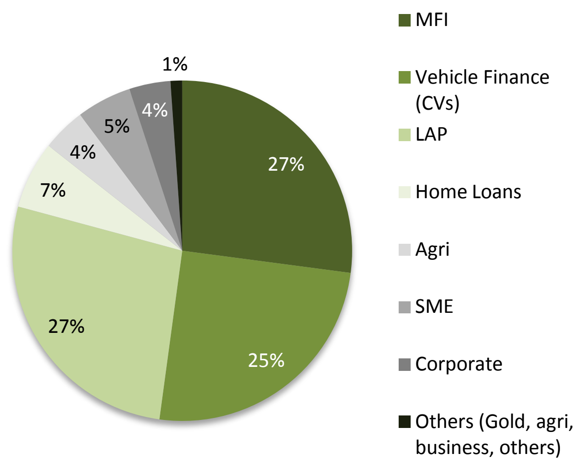
**Exhibit 2: Well diversified product portfolio with low ticket size and high yields**




*Source: Company, NBRR*

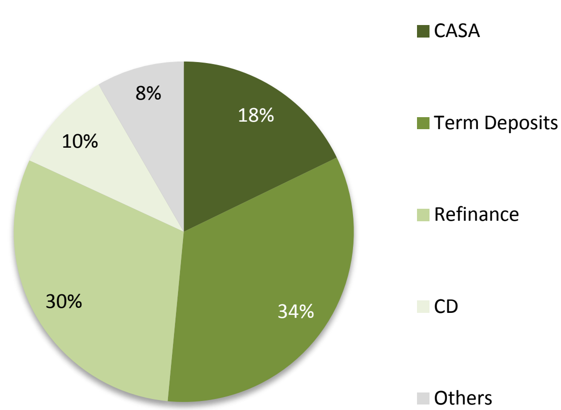
As on Q2FY19, Equitas has a total AUM of Rs. 9,981 Cr, spread across categories such as Micro-Finance, Vehicles, Micro LAP/Small business, Housing, Agri, Gold, MSE and corporate. The retail liability front is shaping up well, with deposits forming 52% of total borrowings and CASA forming 35% of the deposit base. Equitas as on Q2FY19 has an asset network of 500 branches and a liabilities network of 375 branches.

**Exhibit 3: Loan Book Mix**



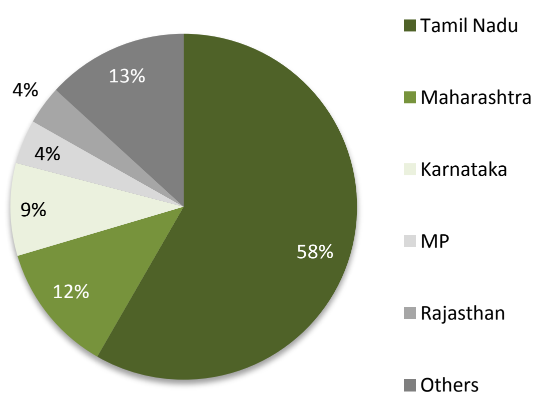

*Source: Company, NBRR*

**Exhibit 4: Borrowing Mix**



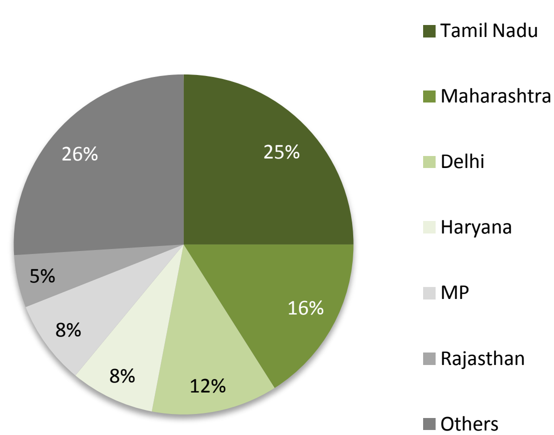

*Source: Company, NBRR*

**Exhibit 5: Advances Mix (Geography-wise)**




*Source: Company, NBRR*

**Exhibit 6: Deposits Mix (Geography-wise)**

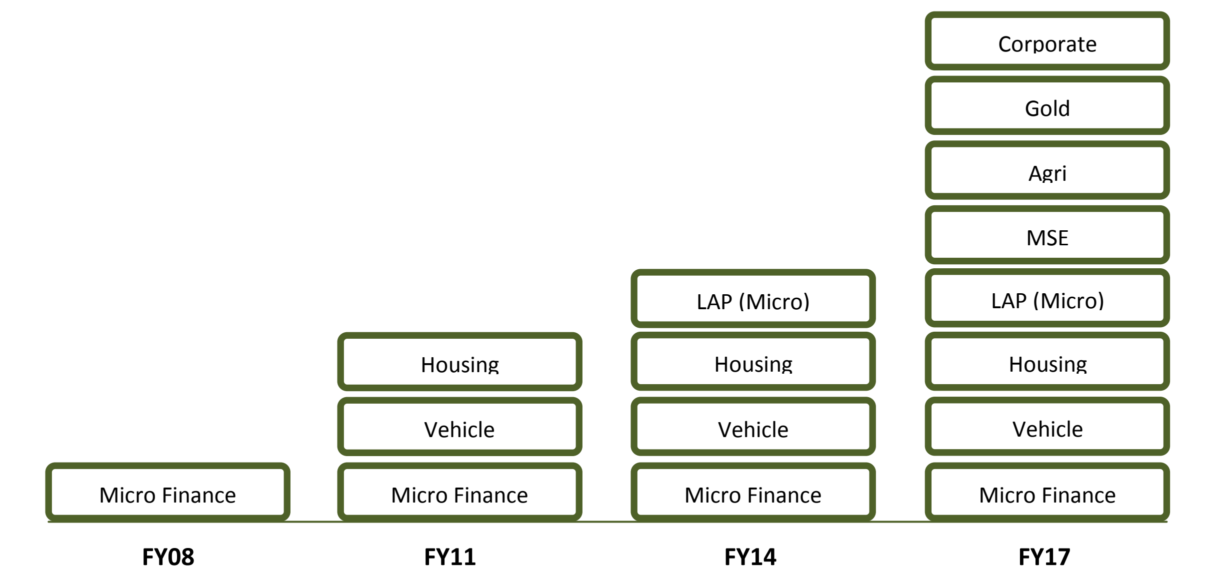



*Source: Company, NBRR*

## Fast paced diversification towards high-yield secured products

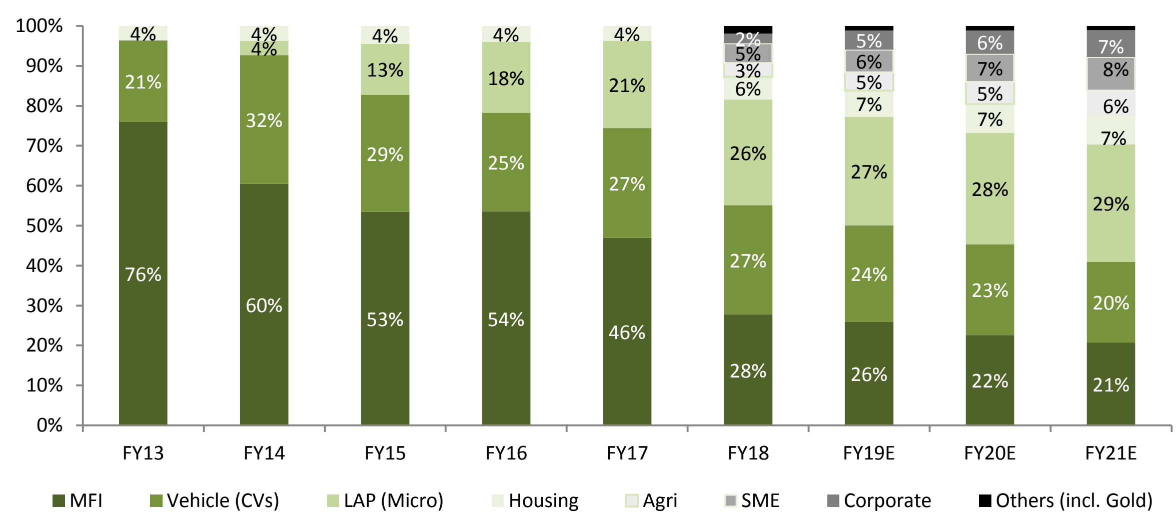
Diversifying its product portfolio over the years has been the key factor in Equitas' strong evolution and robust growth. Equitas' asset mix consists of high yielding portfolios across Micro Finance, Commercial Vehicles, Small business/Micro LAP, MSE, Housing, Agri, Gold and Corporate.

**Exhibit 7: Product evolution of Equitas**




*Source: Company, NBRR*

**Exhibit 8: Loan Book Mix – Transition towards secured lending**




*Source: Company, NBRR*

- **Microfinance (MF): 27% Mix | FY18-21E loan CAGR: 24% | Focus on cross-selling**

  - Although Equitas commenced operations as a 100% MFI, it consciously decided to de-risk the portfolio from FY11 onwards and brought down the share of MF to 27% by Q2FY19, given its unsecured nature.
  - Equitas has been extremely conservative in its lending to this high yielding, high risk portfolio, which is clearly reflected in the low ticket size (~Rs. 29,000 in Q2FY19) of lending and lower repeat lending. This conservative style of Equitas has resulted in consistently lower GNPAs (0.9% in Q2FY19).
  - The pace of decline of MF mix in total portfolio accelerated over FY17-18 on the back of demonetization.

**Exhibit 9: Declining share of MF in portfolio**

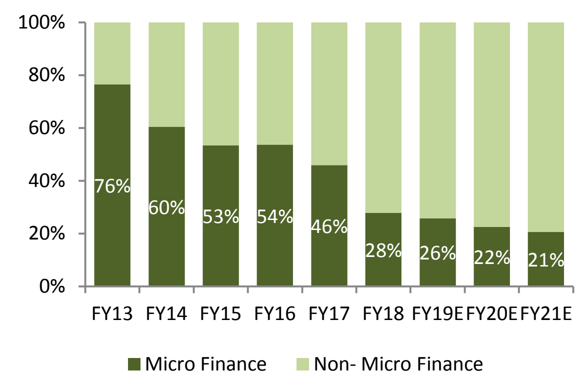
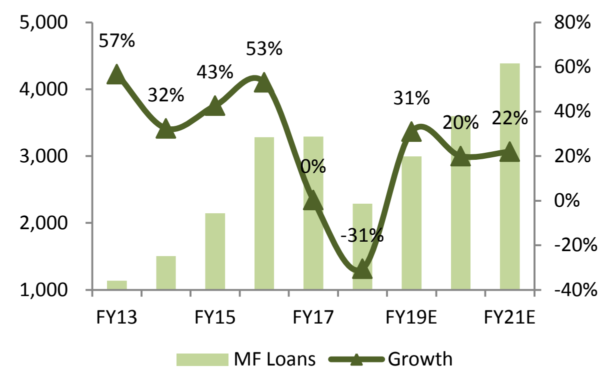



**Exhibit 10: Demonetization led decline over FY17-18**




*Source: Company, NBRR*

- **Vehicle Finance (VF): 25% Mix | FY18-21E loan CAGR: 25% | Focus on first time CV buyers**

  - The company provides finance to customers for the purchase of used commercial vehicles (82% of vehicle finance), who are small transport operators and are first time borrowers via a formal financial channel.
  - Equitas primarily being present in used CVs experiences higher rundown. The pre-closure is higher on used-vehicles as the customers want to sell away the old vehicle within a couple of years of taking finance and upgrade to the subsequent model. The company is also getting into new CVs (18% of vehicle finance) where the rundown is relatively lower.
  - Currently, the average ticket size in Q2FY19 is Rs. 4.6 Lacs with an average tenor of 2-4 years, and the portfolio yields ranging between 18-21%.

**Exhibit 11: Share of Vehicle Finance in portfolio**

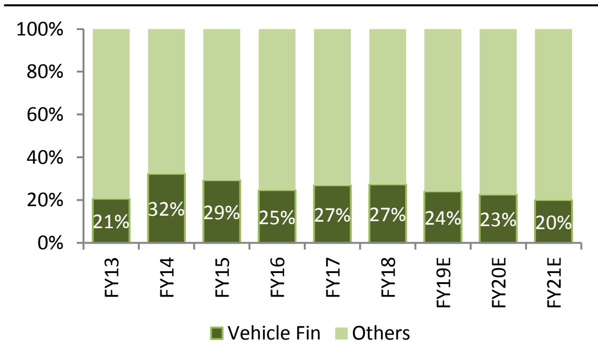
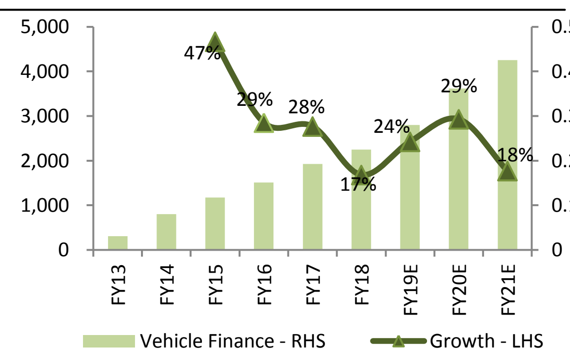



**Exhibit 12: Vehicle - AUM and Growth**




*Source: Company, SIAM, NBRR*

- **Small Business Loans (Micro-LAP): 27% Mix | FY18-21E CAGR: 42% | Lack of formal competition provides strong pricing power**

  - The focus within this segment is typically on top end Micro Finance customers who have had a strong credit history. This segment involves providing Small Business Loans (Micro LAP with ticket size of ~< Rs. 5 Lacs) to self-employed businessmen to augment their working capital requirements against the security of residential or commercial property.
  - While financing has been made available to the bottom of the pyramid via multiple MFIs across the country, there is a dearth of finance availability in the lower ticket sizes of between Rs. 1 – 10 Lacs. Equitas is thus in a sweet spot with its experience in dealing with and appraising credit profiles of its MF clients on one hand and lack of competition on the other, thus providing superior pricing power. (Yields of 18-20%).

**Exhibit 13: Share of Small Business Loans (M-LAP)**

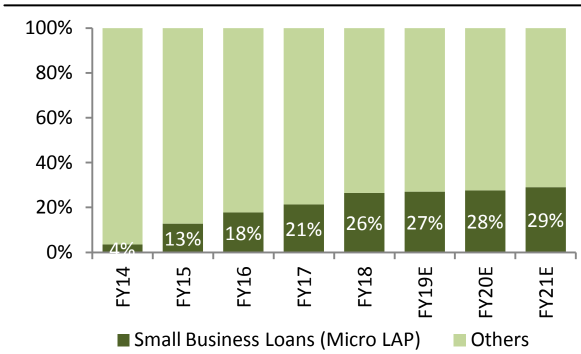
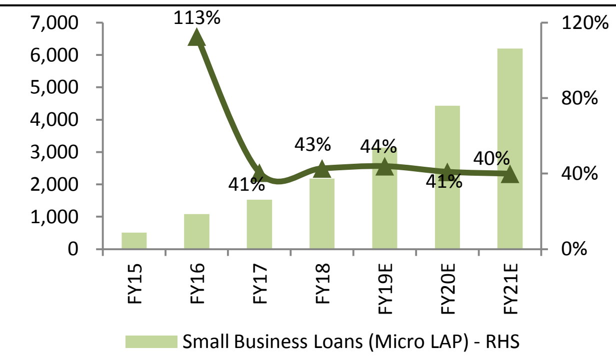



**Exhibit 14: Small Business - AUM and Growth**




*Source: Company, NBRR*

- **Micro and Small Enterprise loans (MSE): 5% Mix | FY18-21E CAGR: 63% | Huge addressable market & small base provides a long runway for growth**
  - Equitas undertakes asset backed financing primarily focused on self-employed individuals operating MSEs (micro and small enterprises) with ticket size of Rs. 30-40 Lacs.
  - In India, MSMEs face serious challenges in raising finance from banks and financial institutions. As per industry estimates, there is a total MSME debt demand of over Rs. 32 Lac Crs. and borrowing process is largely paper-driven. The lending of banks to MSME sector has remained lukewarm due to lack of sufficient information to assess creditworthiness of the borrower. This has led MSMEs to move towards informal sources of finance with high borrowing costs. Equitas is converting this challenge into an opportunity.

**Exhibit 15: Share of MSE Loans**

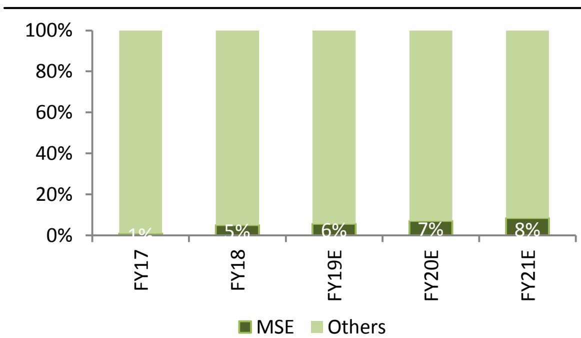
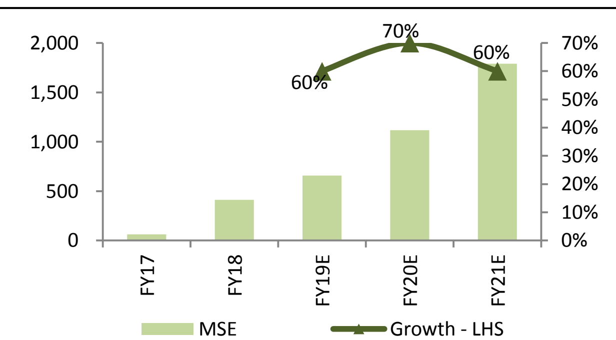



**Exhibit 16: MSE - AUM and Growth**




*Source: Company, NBRR*

We believe, Equitas will grow its advances at 37% CAGR over FY18-21E, led by higher growth in Small Business loans (Micro LAP) / MSE / Housing / Agri / Corporate growing at 42% / 63% / 56% / 64% / 94% respectively.

**Exhibit 13: Overall Loan Book Break-up (Segmental)**

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|---|---|---|---|
| Microfinance | 1,135 | 1,503 | 2,144 | 3,283 | 3,293 | 2,288 | 2,997 | 3,597 | 4,388 |
| *Growth* | | *32%* | *43%* | *53%* | *0%* | *-31%* | *31%* | *20%* | *22%* |
| Mix | 76% | 60% | 53% | 54% | 46% | 28% | 26% | 22% | 21% |
| Vehicle Finance | 305 | 801 | 1,175 | 1,510 | 1,928 | 2,252 | 2,798 | 3,618 | 4,258 |
| *Growth* | | *163%* | *47%* | *29%* | *28%* | *17%* | *24%* | *29%* | *18%* |
| Mix | 21% | 32% | 29% | 25% | 27% | 27% | 24% | 23% | 20% |
| Small Business (M-LAP) | | 88 | 511 | 1,087 | 1,528 | 2,182 | 3,142 | 4,430 | 6,202 |
| *Growth* | | | *481%* | *113%* | *41%* | *43%* | *44%* | *41%* | *40%* |
| Mix | | 4% | 13% | 18% | 21% | 26% | 27% | 28% | 29% |
| MSE | | | | | 63 | 411 | 658 | 1,118 | 1,789 |
| *Growth* | | | | | | *552%* | *60%* | *70%* | *60%* |
| Mix | | | | | 1% | 5% | 6% | 7% | 8% |
| Housing | 44 | 94 | 180 | 245 | 265 | 464 | 821 | 1,248 | 1,773 |
| *Growth* | | *114%* | *91%* | *36%* | *8%* | *75%* | 77% | 52% | 42% |
| Mix | 3% | 4% | 4% | 4% | 4% | 6% | 7% | 8% | 8% |
| Agri | | | | | 31 | 287 | 531 | 876 | 1,270 |
| *Growth* | | | | | | *826%* | *85%* | *65%* | *45%* |
| Mix | | | | | 0% | 3% | 5% | 5% | 6% |
| Corporate | | | | | | 194 | 553 | 940 | 1,410 |
| *Growth* | | | | | | | 185% | 70% | 50% |
| Mix | | | | | 0% | 2% | 5% | 6% | 7% |
| Others | | | | | 68 | 160 | 134 | 175 | 227 |
| *Growth* | | | | | | *135%* | *-16%* | *30%* | *30%* |
| Mix | | | | | 1% | 2% | 1% | 1% | 1% |
| **Gross AUM** | **1,484** | **2,486** | **4,010** | **6,125** | **7,176** | **8,238** | 11,635 | 16,002 | 21,317 |
| ***Growth*** | | ***68%*** | ***61%*** | ***53%*** | ***17%*** | ***15%*** | ***41%*** | ***38%*** | ***33%*** |
| Non - Micro Finance | 349 | 983 | 1,866 | 2,842 | 3,883 | 5,950 | 8,637 | 12,405 | 16,929 |
| *Growth* | | *182%* | *90%* | *52%* | *37%* | *53%* | *45%* | *44%* | *36%* |
| Mix | 24% | 40% | 47% | 46% | 54% | 72% | 74% | 78% | 79% |

*Source: Company, NBRR*

## Multiple levers to stabilise NIMs

NIMs have been compressing over the years on the back of two key reasons – (i) Decline in MF mix from 60% in FY14 to 27% as on Q2FY19. (MF yields are higher by ~300 bps v/s Non-MF yields); and (ii) Excessive increase in investment book as a proportion to total deposits and total assets. (Investment yields are substantially lower at ~7% v/s advances yields of 19.5%).

**Exhibit 17: Decline in MF mix impacts NIMs**

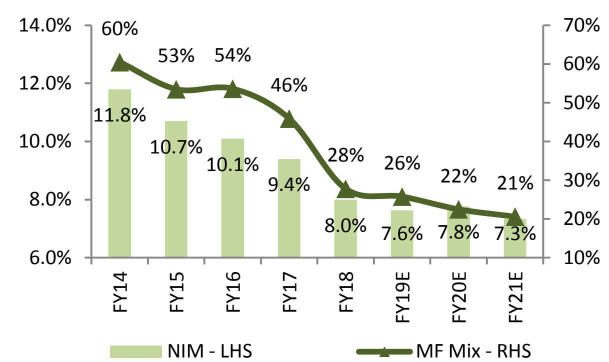
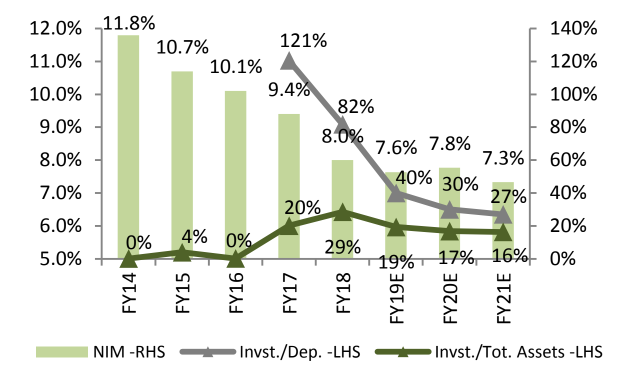



**Exhibit 18: Excess investments impact NIMs in FY17-18**




*Source: Company, NBRR*

We expect Equitas to sustain NIMs in the 7.0-7.5% range in the long run. We believe a significant portion of the long term strategy to scale down MF portfolio has been already executed with the share of MF now at 27%. From here on, we expect MF mix to decline marginally every year and reach 21% by FY21E.

Equitas has been maintaining excess investments in its books since FY17. Post the IPO in April 2016, Equitas had surplus liquidity which it parked in investments. However, owing to demonetization, Equitas had to restrict its lending. Even in FY18, investments continued to remain high as Equitas was preparing for the resumption of its loan growth post conversion into a SFB and hence further front loaded its borrowings. However the bank is now on track to reduce its investments which is evident in Q2FY19 and shall witness a substantial reduction in the investments/deposits ratio in coming years.

**Exhibit 19: MF loans – revival underway**

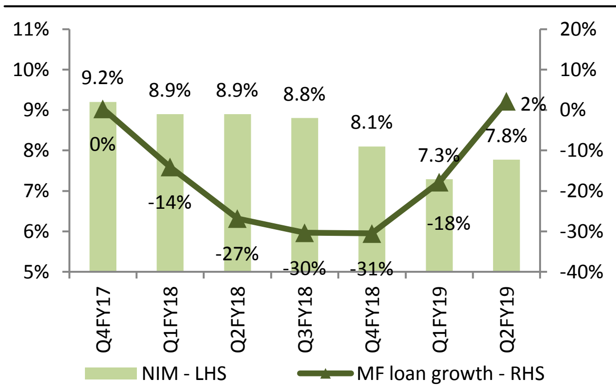
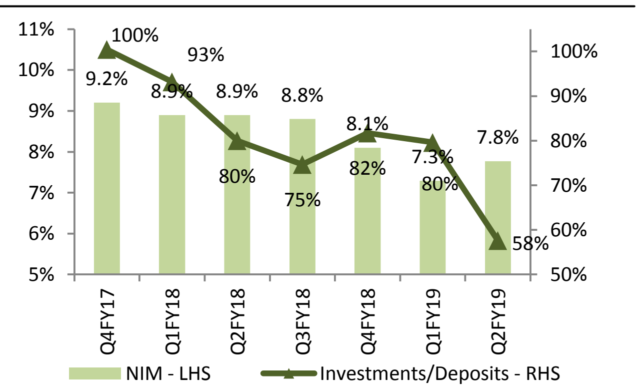



**Exhibit 20: Reduction in investments to continue**

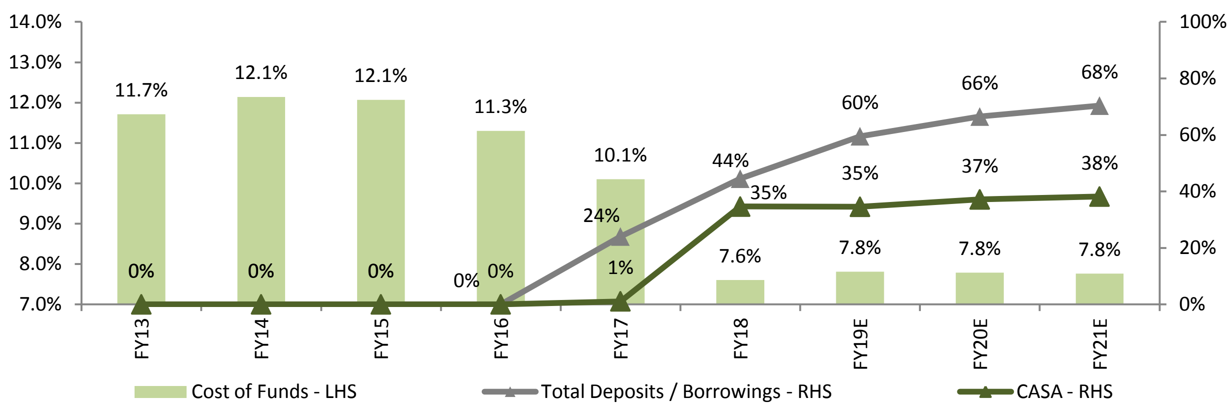



*Source: Company, NBRR*

**Robust liability traction shall ensure lower borrowing costs and support NIMs**

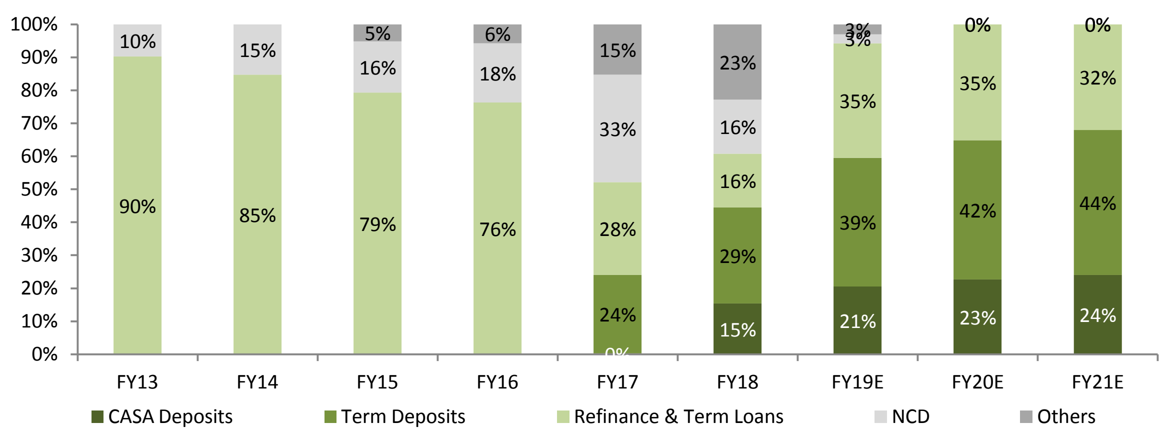
Cost of funds is expected to be under control on the back of a gradual and sustained increase in deposits and CASA; and lesser reliance on bank and money market borrowings. Since the transition of Equitas into a SFB, total deposits have witnessed strong traction which commenced their journey from Q2FY17 and have reached 52% of total borrowings. We expect it to reach 68% by FY21E. CASA ratio has also surged to 35% and is expected to consolidate at these levels.

**Exhibit 21: Strong liability traction to ensure lower cost of funds**




*Source: Company, NBRR*

**Exhibit 22: Borrowing mix to shift towards deposits**




*Source: Company, NBRR*

## Scope for improvement in cost efficiency

Until FY16, Equitas opex was under control and consistently in the 53-55% range. Post FY16, Equitas converted into a SFB considering the opportunity to build a diversified, stable and low-cost liability franchise. However, efforts to build the franchise resulted in a quantum jump in opex over FY17-19E. Equitas converted 375 of its 500 centres as branches for SFB and also added ~3500 branch banking employees. Each branch involved a set-up cost of Rs. 40 lacs and annual operational cost of Rs. 40 lacs.

We believe that the operating costs have peaked out as the bank does not intend to scale up/convert further branches and the benefit of operating leverage shall kick-in with an acceleration in loan/NII growth. We forecast Equitas' opex to grow at 12% CAGR over FY18-21E as against loan/NII growth of 26%/37% CAGR and thus deliver cost/income ratio of 60.9%/55.1% in FY20/21E.

**Exhibit 23: Cost to Income**

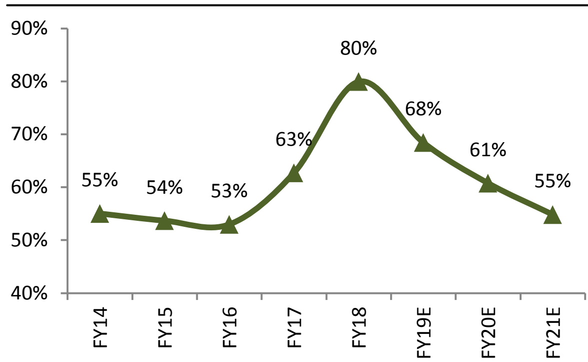
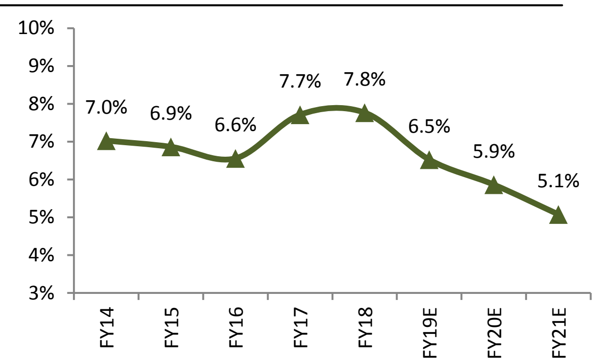



**Exhibit 24: Opex/Assets**




*Source: Company, NBRR (Q2FY19)*

**Exhibit 25: Cost to Income (Quarterly)**

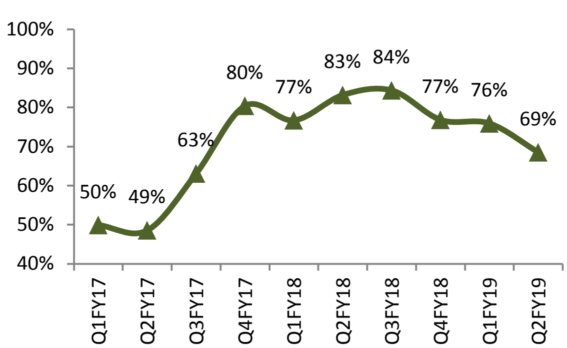
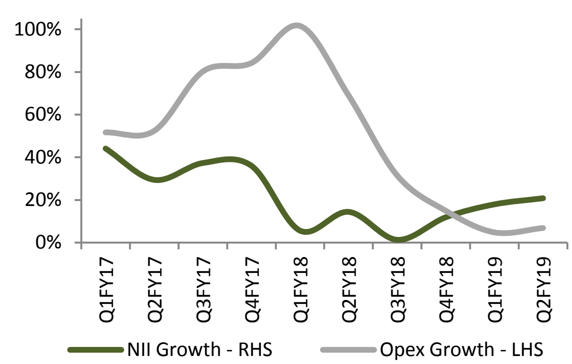



**Exhibit 26: NII growth vs. Opex growth**




*Source: Company, NBRR*

## Asset quality to stabilise; expect decline in credit costs

Equitas' asset quality has been largely stable despite presence in the lowest strata of borrowers. The company is extremely cautious with the MFI portfolio and tightly controls its ticket size to minimize risks. The asset quality of the vehicle finance portfolio seems weak primarily due to exposure to used CVs. In order to alleviate this stress, Equitas has ventured into new CV loans over the last one year. Inspite of the high GNPAs of 5.2% (on month end basis) in vehicle finance, we believe these are normal levels considering that the nature of the used CV financing industry which has even higher levels of GNPAs with the leader Shriram Transport Finance having GNPAs of 8.8% currently.

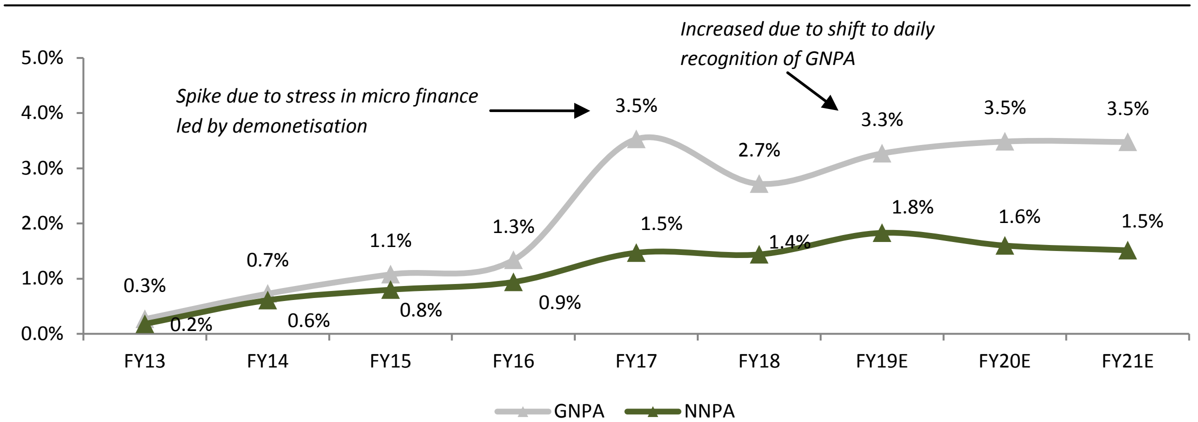
In Q2FY19, the company changed its NPA recognition norms from month end basis to daily basis, resulting in a spike in overall NPAs. Slippages during the quarter increased by Rs. 60 Cr due to change in recognition norms. Aggressive and prudent recognition of stress by Equitas has resulted in an increase in NPAs. We expect credit cost to normalize to ~1.3-1.4% levels as there are lower delinquencies in the MFI portfolio and the effect of demonetization has faded away.

**Exhibit 27: Impact of transition from Monthly to Daily recognition of NPAs (as on Q2FY19)**

| Key Portfolios | GNPA (Daily Recognition) (Rs. Cr) | GNPA % - Monthly Recognition | GNPA % - Daily Recognition | Impact |
|---|---|---|---|---|
| Micro Finance | 21 | 0.87% | 0.88% | 1 bps |
| Vehicle Finance | 171 | 5.24% | 6.83% | 160 bps |
| Small Business Loans | 110 | 2.54% | 3.08% | 56 bps |
| MSE Finance | 14 | 2.52% | 2.63% | 11 bps |
| Overall | 319 | 2.73% | 3.36% | 64 bps |

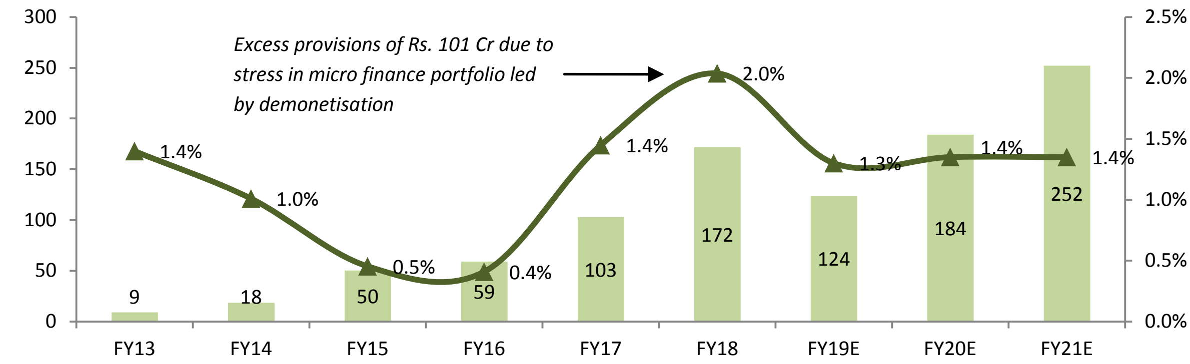
*Source: Company, NBRR*

**Exhibit 28: Asset Quality deterioration is mainly due to Vehicle Finance**




*Source: Company, NBRR*

**Exhibit 29: Credit Cost trend**

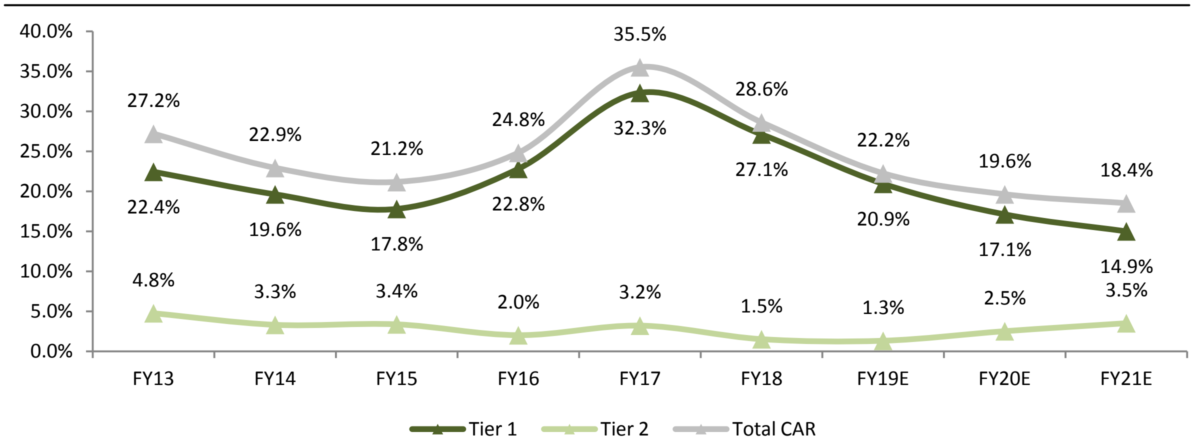



*Source: Company, NBRR*

## High capital adequacy to support high growth without dilution

According to RBI's regulations for SFBs, Equitas has to maintain a minimum capital adequacy ratio (CAR) of 15% of its risk weighted assets (RWA) comprising of a minimum of 7.5% as Tier 1 capital. With current Tier 1 ratio of 22.3% and scope for raising Tier 2 capital (currently 1.6%), we do not foresee Equitas raising Tier 1 capital over the next four years. Over next four years, we believe Equitas can grow its AUM at CAGR of 33%+ and reach top quartile profitability levels (ROE of 17-18%) supported by robust capitalization.

**Exhibit 30: Capital Adequacy Ratios**




*Source: Company, NBRR, Bloomberg*

## ROE to expand 760 bps over FY19-21E to 16.3% driven by operating leverage

We expect a strong revival in loan growth on one hand and a modest increase in opex on the other; leading to robust operating leverage. Thus, we foresee a sharp decline in opex/assets as the biggest lever contributing to increase in ROA over FY19-21E. With the microfinance-related losses already factored in FY18 and strong growth in assets, we expect credit costs/assets to normalize to 1.0% levels (credit costs/loans at ~1.35%). With an improvement in capital gearing, we foresee ROE expanding to ~16.3% by FY21E from 8.7% in FY19E.

**Exhibit 31: DuPont ROE**

| | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|---|---|---|---|
| NII | 14.3% | 10.8% | 10.9% | 10.5% | 10.9% | 8.1% | 7.8% | 7.9% | 7.5% |
| Other Income | 4.6% | 2.0% | 1.9% | 1.8% | 1.4% | 1.7% | 1.8% | 1.8% | 1.8% |
| Total Income | 19.0% | 12.8% | 12.8% | 12.4% | 12.3% | 9.7% | 9.5% | 9.6% | 9.3% |
| Opex | 13.6% | 7.0% | 6.9% | 6.6% | 7.7% | 7.8% | 6.5% | 5.9% | 5.1% |
| PPP | 5.3% | 5.7% | 5.9% | 5.8% | 4.6% | 1.9% | 3.0% | 3.8% | 4.2% |
| Provisions | 1.0% | 0.8% | 1.4% | 1.1% | 1.3% | 1.5% | 0.8% | 1.0% | 1.0% |
| PBT | 4.4% | 4.9% | 4.5% | 4.7% | 3.3% | 0.4% | 2.2% | 2.8% | 3.2% |
| Tax Rate | 20% | 35% | 35% | 36% | 37% | 39% | 36% | 36% | 36% |
| ROA | 3.5% | 3.2% | 3.0% | 3.0% | 2.1% | 0.3% | 1.4% | 1.8% | 2.0% |
| Leverage | 4.7 | 3.8 | 3.8 | 4.4 | 4.5 | 5.1 | 6.2 | 7.1 | 8.0 |
| ROE | 16.7% | 12.2% | 11.1% | 13.3% | 9.3% | 1.4% | 8.7% | 12.7% | 16.3% |

*Source: Company, NBRR*

**Exhibit 32: Opex/Assets**

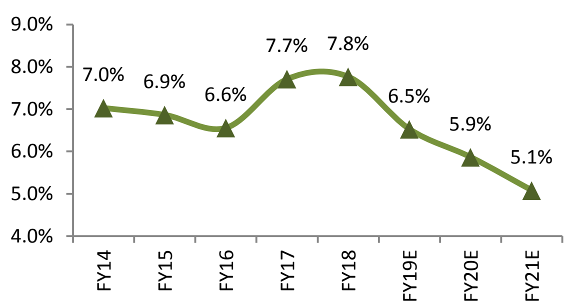
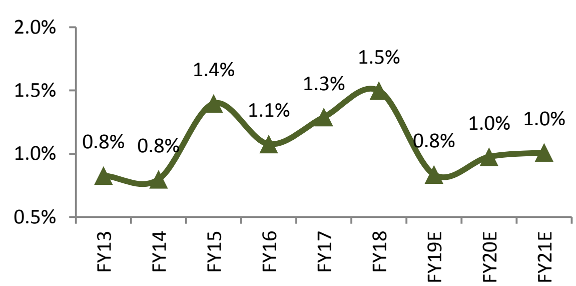



**Exhibit 33: Credit Cost/Assets**




*Source: Companies, NBRR, Bloomberg*

**Exhibit 34: ROA**

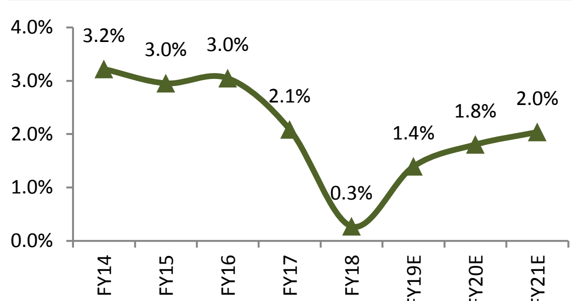
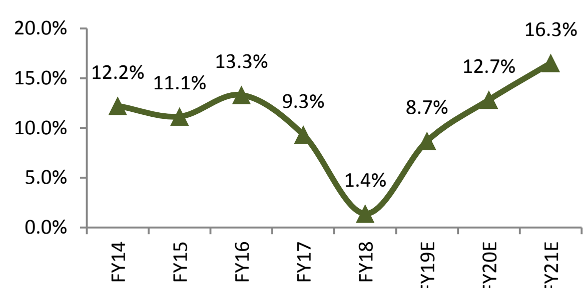



**Exhibit 35: ROE**




*Source: Companies, NBRR, Bloomberg*

## Competent and Experienced Management Team

**Exhibit 36: Key Management Personnel**

| Name | Designation | Joining Date | Role |
|---|---|---|---|
| P.N. Vasudevan | Managing Director | July 2007 | Mr. Vasudevan is the founder of the company. He has extensive experience in the financial services sector and had served as Head – Consumer Banking Group in Development Credit Bank Limited, for more than one and half years prior to starting Equitas. Before DCB Bank, he worked for 20 years at Cholamandalam Investment and Finance Co Limited, heading the vehicle finance business. |
| S. Bhaskar | Executive Director & CEO | Oct 2007 | Mr. Bhaskar S, joined Equitas in Oct, 2007 and served as the CFO prior to his appointment as the Executive Director & CEO in Oct, 2016. He is a Chartered Accountant. He started his career with Pricewaterhouse & Co., where he worked for one and a half years and later moved to Cholamandalam Investment and Finance Company Limited where he worked for two decades. Prior to joining Equitas Group, he was the Group Treasurer and Senior Vice President – Audit for the Murugappa Group, Chennai. |
| Sridharan N. | Chief Financial Officer - SFB | Aug 2010 | Prior to joining Equitas he was with SRA Systems Ltd as General Manager - Finance for nine years and prior to that, he was associated with Subhiksha Trading Services as Vice President – MIS and Commercial Control. |
| Srimathy Raghunathan | Chief Financial Officer | Oct 2013 | Prior to joining Equitas Group, she had 6 years professional experience working with Tata Capital Limited and Hinduja Leyland Finance Limited. |
| HKN Raghavan | President (Incl. Banking) | Dec 2008 | Vast experience of 25 years in Micro finance, lending and FMCG. He has worked with various FMCG majors like Hindustan Unilever Ltd, Dabur Ltd etc. |
| Bhadresh Phatak | President (SME Banking) | | 25 years' experience of in retail, SME financing. He has earlier worked with Axis Bank, IDBI Bank and Yes Bank. |
| Ajit Balakrishnan | Head – Emerging Enterprise Banking | | He has a vast experience in Vehicle financing from his previous association with Cholamandalam, GMAC and Apple Credit. |
| Dheeraj Mohan | Head – Strategy & IR | | He has 16 years of experience in capital markets, advisory and planning. He has earlier worked with Cholamandalam and Edelweiss. |

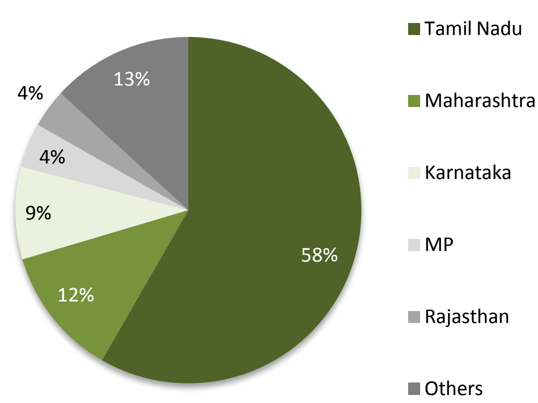
*Source: Company, NBRR*

## Key Risks & Concerns

**Regional Dependence on Tamil Nadu**

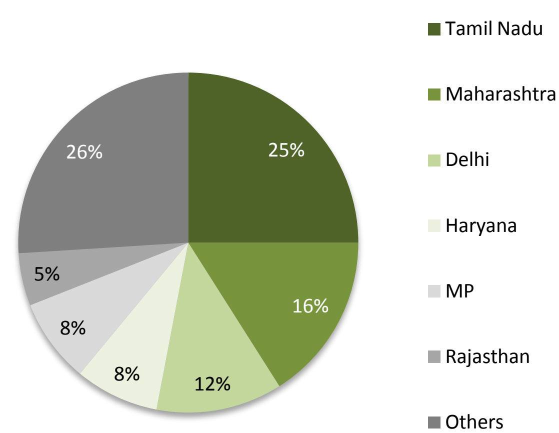
Equitas faces concentration risk with over ~58% of the advances sourced from Tamil Nadu. The southern region including Tamil Nadu comprises >~70% of the total loan book. Any major change in the state's policies or swing in regional environment can immediately affect our earnings estimates for the company.

**Exhibit 37: Advances Mix (Geography-wise)**




*Source: Company, NBRR*

**Exhibit 38: Deposits Mix (Geography-wise)**




*Source: Company, NBRR*

**Farm Loan Waivers could negatively impact MF book**

Although recent farm loan waivers in CY17 in the states of UP, Maharashtra, Punjab and Karnataka, had no impact on asset quality of MFIs, such waivers could lead to a more severe impact on MFIs in coming years. The newly elected governments in Madhya Pradesh and Chhattisgarh have announced a farm loan waiver. Madhya Pradesh comprises ~4.1% of the total loan book in Q2FY19 and loan waiver in this state could result in some stress on the MF book. As on date, MF GNPAs stand at 0.9%

**Macro headwind: Interest rates**

The rise in interest rates over CY18 has already had an adverse impact on the cost of borrowings and NIMs of all the banks. A continuous increase in interest rates would result in a compression in NIMs for Equitas.

## Valuation and Recommendation

Equitas primarily lends to the underserved areas with minimal or no access to formal sources of credit. Equitas has successfully reduced the microfinance mix in its loan book from 54% in FY16 to 27% today. Its diversified loan book, adequate capital, highly competent and experienced management and conservative approach to minimize risk, provides Equitas a long runway for profitable growth. Prior to turning into a bank, Equitas grew its AUM at 60% CAGR over FY13-16, way ahead of industry growth. We forecast Equitas' AUM to grow at 37% CAGR over FY18-21E.

Equitas' transition to a SFB resulted in lower AUM growth and higher opex growth during FY17-18, translating to lower return ratios. However, we expect opex to subside (already stabilisied since 5 quarters) and the company to improve its operating efficiency going ahead. We have factored in opex growth of 12% CAGR during FY18-21E which shall reduce the cost/income ratio from 80% in FY18 to 54.8% in FY21E.

With visible ROE expansion to 17-18% levels in the long term (by FY22E) on the back of strong AUM growth, lower opex and lower credit costs, **we believe Equitas' valuations will gravitate towards that of SFBs, banks and NBFCs demonstrating similar growth and profitability. We value (Equitas SFB at 3.0x FY20E Adj. BV and) Equitas Holdings at a 20% discount to SFB at 2.4x FY20E Adj. BV at Rs. 181, post factoring the holdco discount. We initiate coverage with a 'BUY' rating with a target price of Rs. 181.**

**Exhibit 39: Peer Group Comparison**

| | SFBs | | Banks | | | | NBFCs | |
|---|---|---|---|---|---|---|---|---|
| | Ujjivan | AU | Bandhan | CUB | Avg | Equitas | Chola | MMFS |
| As on Q2FY19 | | | | | | | | |
| Loan Book (Rs Cr) | 8,317 | 18,117 | 33,373 | 29,785 | **19,077** | 9,981 | 47,721 | 55,482 |
| CASA | 9% | 26% | 37% | 24% | **24%** | 35% | - | - |
| NIM | 11.7% | 6.0% | 10.3% | 4.3% | **9.0%** | 7.8% | 6.9% | 8.2% |
| Cost/Income | 74.9% | 60.5% | 33.2% | 42.7% | **49.4%** | 68.5% | 38.9% | 54.1% |
| GNPA | 1.9% | 2.0% | 1.3% | 2.9% | **1.8%** | 3.4% | 2.8% | 9.0% |
| NNPA | 0.3% | 1.3% | 0.7% | 1.7% | **0.8%** | 2.0% | 1.6% | 6.0% |
| Loan CAGR FY18-20E | 31% | 51% | 43% | 16% | **35%** | 39% | 21% | 23% |
| PAT CAGR FY18-20E | 523% | 44% | 40% | 17% | **156%** | 228% | 22% | 36% |
| ROA FY18 | 0.1% | 1.7% | 4.1% | 1.6% | **1.9%** | 0.3% | 2.6% | 1.9% |
| ROA FY19E | 1.6% | 1.7% | 5.7% | 1.6% | **2.7%** | 1.4% | 2.6% | 2.3% |
| ROA FY20E | 1.9% | 1.8% | 5.8% | 1.6% | **2.8%** | 1.8% | 2.6% | 2.3% |
| ROA FY21E | 2.0% | 1.9% | 3.6% | 1.7% | **2.3%** | 2.0% | 2.6% | 2.3% |
| ROE FY18 | 0.4% | 13.7% | 26.0% | 15.2% | **13.8%** | 1.4% | 20.8% | 13.3% |
| ROE FY19E | 10.0% | 15.0% | 19.2% | 15.3% | **14.9%** | 8.7% | 21.2% | 13.7% |
| ROE FY20E | 13.1% | 16.2% | 20.7% | 15.6% | **16.4%** | 12.7% | 21.1% | 15.0% |
| ROE FY21E | 16.4% | 17.9% | 21.1% | 16.2% | **17.9%** | 16.3% | 21.5% | 16.1% |
| P/ABV FY20E (x) | 1.6 | 5.0 | 4.1 | 2.7 | **3.3** | 1.6 | 2.8 | 3.5 |

*Source: Company, NBRR*

## Annexure

**Listing of Equitas SFB**

As per RBI guidelines, a small finance bank has to list within a period of three years from the commencement of operations and thus Equitas Holdings will have to list the small finance bank by September 4, 2019. Equitas Holdings plans to allot 50-55% of the SFB's shareholding to existing shareholders of Equitas Holdings.

The holding company was created to address a key requirement of the SFB guideline of having a promoter. The guidelines state that the promoter ownership has to be a minimum of 40% till five years of operations (Sep 2021). Eventually, the management plans to reverse merge the holdco into the SFB post the expiry of promoter lock-in of 5 years i.e. Sep 2021.

**Exhibit 40: Key RBI guidelines for SFBs**

| Parameter | Guidelines |
|---|---|
| Objectives | Furthering financial inclusion by -<br>• Providing savings vehicles primarily to unserved & underserved sections of the population<br>• Supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations |
| Eligible Promoters | • Resident individuals/professionals with 10 years of experience in banking and finance<br>• Companies and Societies owned and controlled by residents<br>• Existing NBFCs, MFIs, and Local Area Banks (LABs) |
| Capital Requirement | • The minimum paid-up equity capital for SFBs is Rs. 100 Cr<br>• Required to maintain a minimum capital adequacy ratio (CAR) of 15% of its risk weighted assets (RWA) on a continuous basis<br>• Tier I capital should be at least 7.5% of RWAs; Tier II capital should be limited to a maximum of 100% of total Tier I capital |
| Listing on stock exchanges | • After the SFB reaches a net worth of Rs. 500 Cr, listing is mandatory within three years of reaching that net worth<br>• SFBs having net worth of below Rs. 500 Cr can also get their shares listed voluntarily, subject to regulatory requirements |
| Prudential Norms | • To comply with CRR and SLR requirements in line with other banks, no forbearance would be provided<br>• To extend 75% of its Net Bank Credit (ANBC) towards priority sector lending (PSL)<br>• Maximum loan size and investment limit exposure to a single and group obligor restricted to 10% and 15% of its capital funds respectively<br>• At least 50% of its loan portfolio to constitute loans and advances of up to Rs. 25 Lacs |
| Additional Requirements | • On conversion into an SFB, the NBFC / MFI will cease to exist; all its business should fold into the bank and the activities which a bank cannot statutorily undertake be divested / disposed of<br>• Branches of NBFC/MFI should either be converted into bank branches or be merged/closed |

## Financials

| P&L (Rs. Crs) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| Interest earned | 1,443 | 1,598 | 2,103 | 2,740 | 3,563 |
| Interest expended | 576 | 674 | 955 | 1,255 | 1,705 |
| **NII** | **867** | **924** | **1,148** | **1,484** | **1,858** |
| Non interest income | 114 | 189 | 263 | 330 | 439 |
| **Total income** | **981** | **1,114** | **1,411** | **1,814** | **2,297** |
| *Growth* | *44%* | *14%* | *27%* | *29%* | *27%* |
| Operating expenses | 615 | 891 | 966 | 1,105 | 1,265 |
| *Growth* | *71%* | *45%* | *8%* | *14%* | *15%* |
| *Staff costs* | *396* | *520* | *551* | *634* | *729* |
| *Other Op Exp* | *219* | *371* | *415* | *471* | *536* |
| **Profit before prov** | **366** | **223** | **445** | **710** | **1,032** |
| *Growth* | *15%* | *-39%* | *100%* | *59%* | *45%* |
| Provisions | 103 | 172 | 124 | 184 | 252 |
| *Growth* | *74%* | *67%* | *-28%* | *49%* | *37%* |
| Exceptional items | -11 | 0 | 0 | 0 | 0 |
| Profit before tax | 252 | 51 | 321 | 526 | 780 |
| Taxes | 92 | 20 | 115 | 188 | 278 |
| **Net profit** | **159** | **31** | **207** | **338** | **502** |
| *Growth* | *-5%* | *-80%* | *559%* | *64%* | *48%* |

| Bal. Sheet (Rs. Crs) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| Equity capital | 338 | 340 | 340 | 340 | 340 |
| Reserves & surplus | 1,893 | 1,936 | 2,143 | 2,481 | 2,982 |
| Net worth | 2,231 | 2,276 | 2,483 | 2,821 | 3,323 |
| Deposits | 1,572 | 4,719 | 7,770 | 11,670 | 16,370 |
| *Growth* | - | *200%* | *65%* | *50%* | *40%* |
| Borrowings | 4,971 | 5,888 | 5,283 | 6,333 | 7,715 |
| Other liab and prov | 670 | 612 | 572 | 592 | 612 |
| Total liabilities | 7,213 | 11,219 | 13,625 | 18,595 | 24,697 |
| **Total liab and equity** | **9,443** | **13,495** | **16,108** | **21,416** | **28,019** |
| | | | | | |
| Cash and bank bal | 1,064 | 1,194 | 932 | 934 | 1,146 |
| Investments | 1,896 | 3,857 | 3,108 | 3,501 | 4,420 |
| Net Advances | 5,829 | 7,800 | 11,249 | 16,002 | 21,317 |
| *Growth* | *15%* | *34%* | *44%* | *42%* | *33%* |
| Other assets | 326 | 313 | 438 | 553 | 668 |
| Fixed Assets | 329 | 330 | 380 | 426 | 468 |
| **Total assets** | **9,443** | **13,495** | **16,108** | **21,416** | **28,019** |

| Key Ratios | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| Yield on Advances | 21.5% | 19.7% | 20.2% | 19.6% | 19.1% |
| Yield on Tot Assets | 18.5% | 14.3% | 14.6% | 14.9% | 14.7% |
| Cost of Borrowings | 10.1% | 7.6% | 7.8% | 7.8% | 7.8% |
| Spread | 11.4% | 12.1% | 12.4% | 11.8% | 11.2% |
| NIM | 9.4% | 8.0% | 7.6% | 7.8% | 7.4% |

| Asset Quality | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| GNPA | 206 | 213 | 369 | 559 | 743 |
| GNPA ratio | 3.5% | 2.7% | 3.3% | 3.5% | 3.5% |
| NNPA | 86 | 112 | 206 | 256 | 323 |
| NNPA ratio | 1.5% | 1.4% | 1.8% | 1.6% | 1.5% |
| PCR (Reported) | 47% | 44% | 54% | 56% | 57% |
| Credit Cost | 2.0% | 1.3% | 1.4% | 1.4% | 1.4% |

| Profitability Ratios | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| Cost / Income Ratio | 62.7% | 80.0% | 68.4% | 60.9% | 55.1% |
| ROA | 2.1% | 0.3% | 1.4% | 1.8% | 2.0% |
| ROE | 9.3% | 1.4% | 8.7% | 12.7% | 16.3% |

| Balance Sheet Ratios | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| CD Ratio | 370.8% | 81.7% | 40.0% | 30.0% | 27.0% |
| CASA | 1.1% | 34.6% | 34.6% | 35.0% | 35.3% |
| CAR | 35.5% | 28.6% | 22.2% | 19.6% | 18.4% |
| Tier - 1 | 32.3% | 27.1% | 20.9% | 17.1% | 14.9% |

| Per Share Data | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| EPS | 4.7 | 0.9 | 6.1 | 9.9 | 14.7 |
| BVPS | 66.0 | 66.9 | 72.9 | 82.9 | 97.6 |
| Adjusted BVPS | 63.5 | 63.6 | 66.9 | 75.3 | 88.1 |

| Valuation Ratios | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| P/E | 26.0 | 133.1 | 20.2 | 12.3 | 8.3 |
| P/BV | 1.9 | 1.8 | 1.7 | 1.5 | 1.3 |
| P/ABV | 1.9 | 1.9 | 1.8 | 1.6 | 1.4 |

*Source: Company data, NBRR*

| Disclosure: |
| --- |
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