

Mar 21, 2024

**COMPANY UPDATE** | Sector: Financials

# Equitas Small Finance Bank

## Range-bound RoA delivery to continue

### Ongoing earnings/RoE downgrade cycle could end soon

We see conclusion nearing for the ongoing earnings/RoE downgrade cycle of Equitas SFB which was caused by 1) extended funding/deposit cost upcycle, 2) sharp decline in CASA share, 3) lagged improvement in portfolio yield, 4) calibration of growth in the light of rate environment and LDR moderation and 5) sustained franchise building investments. While we cut FY25/26 earnings by 5-7% in this update, it would likely mark the end of a significant downgrade cycle wherein earnings/RoE would have witnessed a cut of 10-15%/1-2 ppt since start of the year.

**Factors that would preclude incremental earnings reduction would be** 1) reducing pace of incremental CoF increase and likely peaking in next 2-3 quarters (if rate/liquidity scenario doesn't aggravate), 2) reasonable headroom for portfolio yield to catch-up with disbursement yield (portfolio yield movement has matched CoF increase in recent quarters), 3) impact of loan growth and LDR moderation already captured in current estimates, 4) better planning/roll-out of franchise investments (managed with steady RoA delivery) and 5) credit cycle/collections remaining healthy across products. Bank is confident of managing a gradual PCR increase through efficiencies and income levers.

Stock has witnessed a material correction which has been in excess of earnings cut, making valuation reasonable at 8.7x PE and 1.4x P/ABV on FY26 basis. **Valuation now looks fairly attractive in context of** 1) expected 23-25% loan/earnings CAGR over FY24-26, 2) likely range-bound RoA delivery at 1.8-2% and RoE improvement to 17%, 3) bank being a significant beneficiary in a rate cut cycle and 4) diversified asset portfolio and better-among-SFBs deposit franchise.

### Loan growth to stabilize at healthy level aided by sturdy deposits accretion

Guided by LDR achievement of 90% by March'24 and 85% by March'25, Equitas SFB's loan growth is expected to moderate and sustain around 25%. **Growth has been diversified in terms of products and markets; and is being now pivoted on better risk-adjusted yielding products like small-ticket SBL, used Car loans, used SCV/pick-ups financing, affordable housing, and microfinance (with relatively lower tickets).** Disbursement yield has increased by 120 bps over past 12m to 18.8%. Collections across products and markets (except Punjab & HR) remain firm. Implementation of new LOS in VF, SBL and Affordable Housing is expected to improve productivity of branches/teams over time.

**Deposits mobilization has been strong and driven by retail TD products of 444 days and 888 days where the bank is offering attractive rates to depositors.** SA balance in absolute terms has been maintained through FY24 without raising its average cost. Besides the pricing differential, relationship building with customers, introduction of new products like Cards, PL, etc. and investment in digital platforms would keep driving the deposits momentum in longer run.

### NIM could bottom-out, credit cost normalization on expected lines

While in near term NIM would decline further due to persistent increase in deposits cost and lowering of LDR, it should stabilize after a couple of quarters with peaking of TD cost and protracted re-pricing of the loan book. Cost of the TD stock stands at 8.2% as of Dec'23 and incremental mobilization is largely happening between 8-9%. The bank is hopeful about limiting the incremental decline in CASA share. **Portfolio Yield is nearly 120 bps below the disbursement yield and its improvement has matched the CoF increase in recent quarters.** Impact of further LDR moderation in FY25 can get mitigated by the extended Portfolio Yield improvement. **With 85% loan book at fixed rate, sizeable share of Bulk TDs and increasing share of 444 days Retail TDs, the bank's NIM should recover quickly when rates/liquidity softens.** Asset quality is trending within the credit cost guidance of 1.25% with collection efficiency in SBL and Affordable Housing remaining firm and peripheral challenges seen in MFI (3-4% book in Punjab & HR) and used CV portfolio.

Reco	:	BUY
CMP	:	Rs 94
Target Price	:	Rs 118
Potential Return	:	+25.5%

### Stock data (as on Mar 21, 2024)

Nifty	22,012
52 Week h/l (Rs)	117 / 62
Market cap (Rs/USD mn)	103899 / 1250
Outstanding Shares (mn)	1,134.9
6m Avg t/o (Rs mn):	502
Div. yield (%):	1.0
Bloomberg code:	EQUITASB IN
NSE code:	EQUITASBNK

### Stock performance



### Shareholding pattern

Promoter	0.0%
FII+DII	65.3%
Others	34.8%

### △ in stance

(1-Yr)	New	Old
Rating	BUY	BUY
Target Price	118	125

### △ in earnings estimates

	FY24e	FY25e	FY26e
EPS (New)	7.1	8.3	10.7
EPS (Old)	7.2	9.0	11.3
% Change	-1.0%	-7.5%	-5.1%

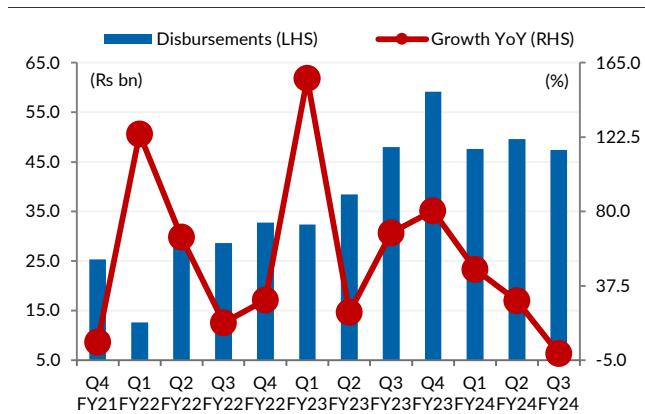
### Financial Summary

(Rs mn)	FY24E	FY25E	FY26E
Op. income	38,804	47,046	58,650
PPOP	13,733	17,051	21,911
Net profit	7,915	9,236	11,910
Growth (%)	38.0	16.7	28.9
EPS (Rs)	7.1	8.3	10.7
ABVPS (Rs)	49.1	55.1	67.7
P/E (x)	13.2	11.3	8.8
P/ABV (x)	1.9	1.7	1.4
ROE (%)	14.5	15.0	17.0
ROA (%)	2.0	1.8	1.9
Tier-1 (%)	20.0	18.1	16.7

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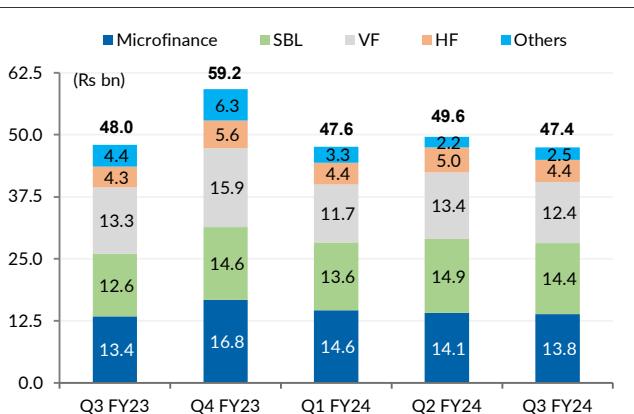
## STORY IN CHARTS

Exhibit 1: Disb. growth has come-off sharply



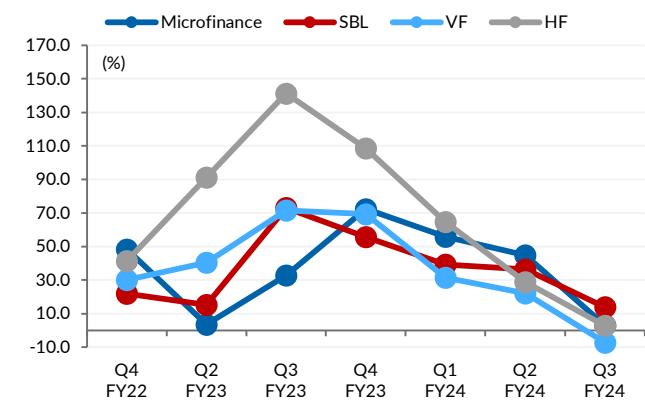
Source: Company, YES Sec

Exhibit 2: Disb. shift towards better-yielding products



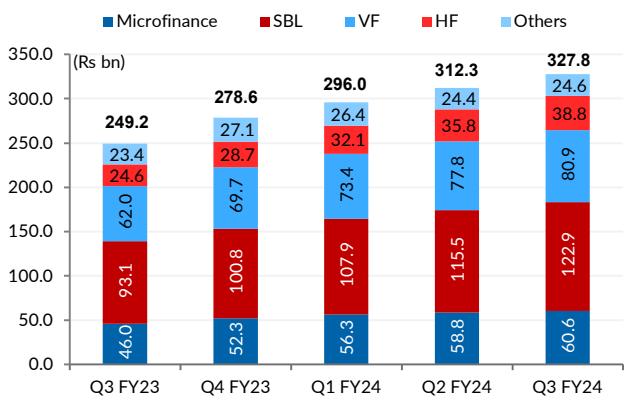
Source: Company, YES Sec

Exhibit 3: Disb. growth decelerated across loan segments



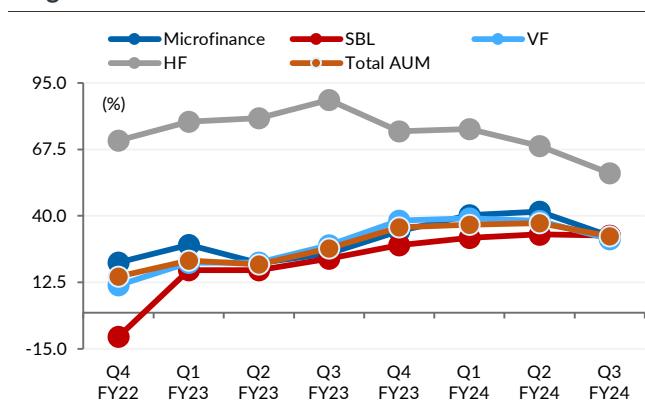
Source: Company, YES Sec

Exhibit 4: AUM growing in core loan segments



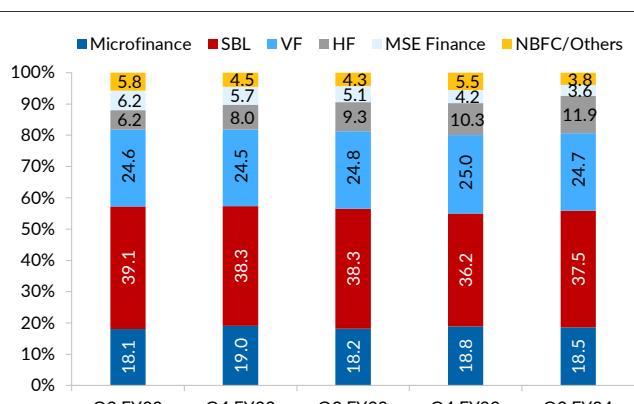
Source: Company, YES Sec

Exhibit 5: Except for AHL, AUM growth similar across segments



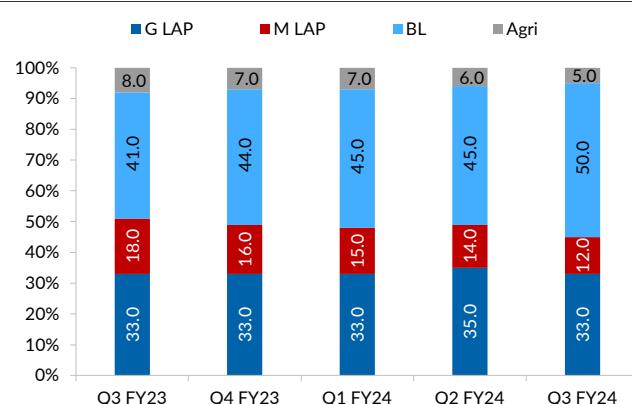
Source: Company, YES Sec

Exhibit 6: AUM shift towards core loan segments



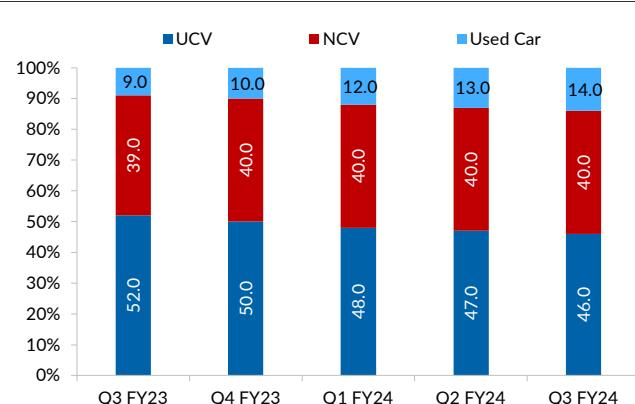
Source: Company, YES Sec

**Exhibit 7: Shift towards higher-ticket BL within SBL**



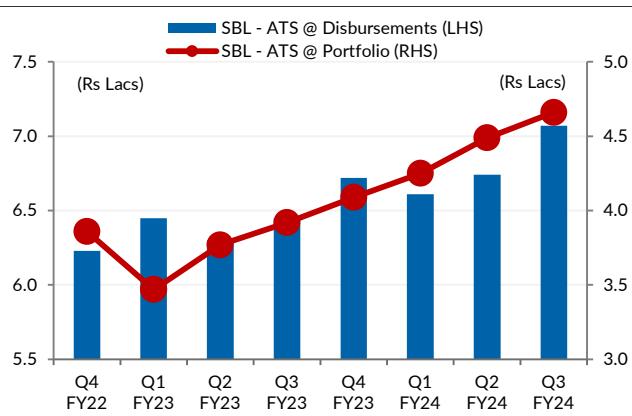
Source: Company, YES Sec

**Exhibit 8: Shift towards used-Car within VF**



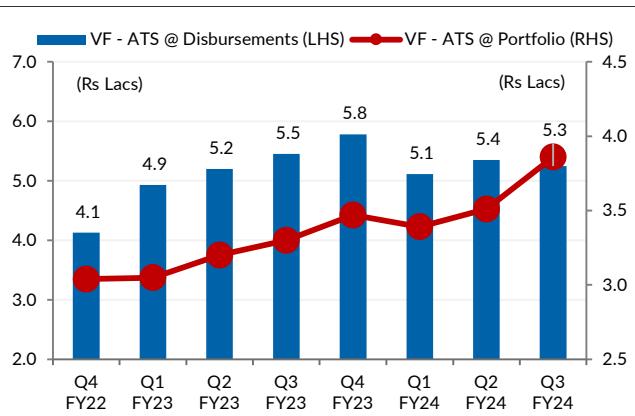
Source: Company, YES Sec

**Exhibit 9: Disb. & Portfolio ATS has increased in SBL**



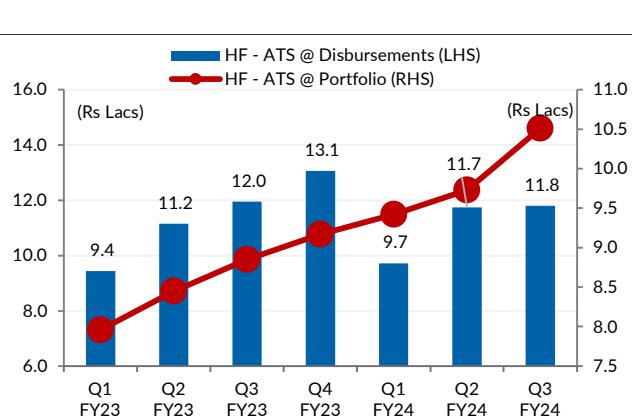
Source: Company, YES Sec

**Exhibit 10: Disb. ATS stable in VF**



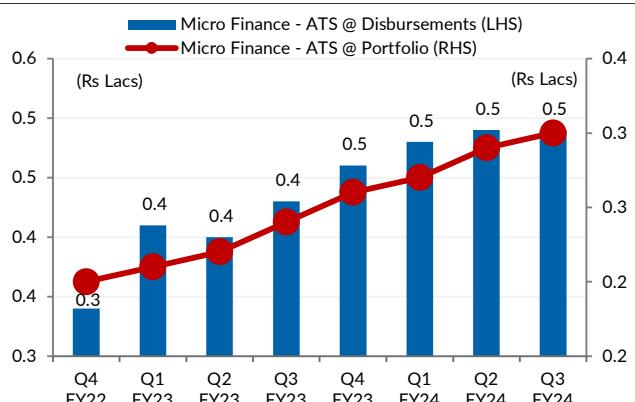
Source: Company, YES Sec

**Exhibit 11: Disb. ATS range bound in AHL**



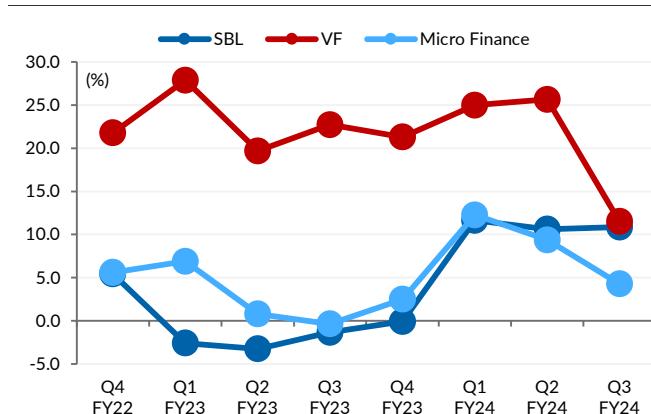
Source: Company, YES Sec

**Exhibit 12: No alarming increase in MFI Disb. and Portfolio ATS**



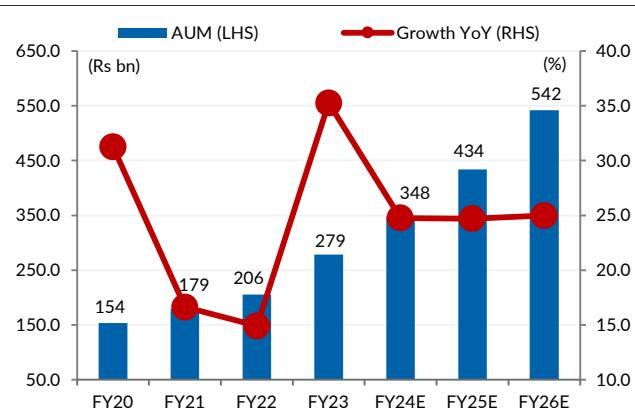
Source: Company, YES Sec

**Exhibit 13: Healthy trends in growth of live accounts**



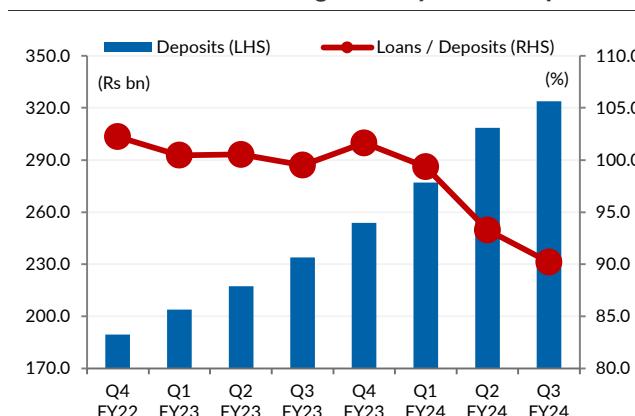
Source: Company, YES Sec

**Exhibit 14: AUM growth to stabilize around 25%**



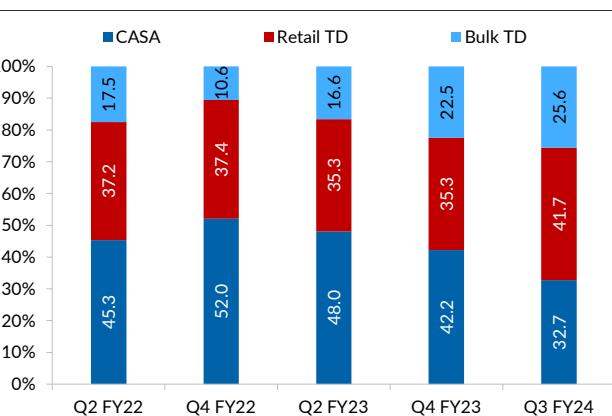
Source: Company, YES Sec

**Exhibit 15: LDR declined significantly in recent quarters**



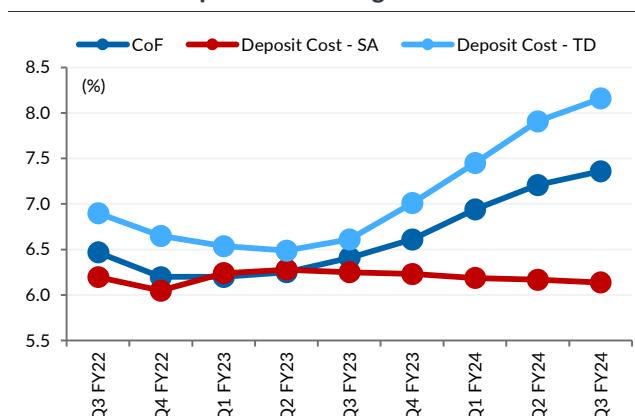
Source: Company, YES Sec

**Exhibit 16: Share of CASA has come down**



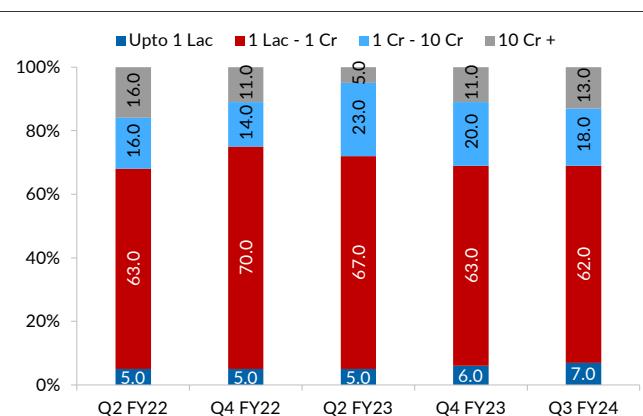
Source: Company, YES Sec

**Exhibit 17: Sharp increase in avg. cost of TDs**



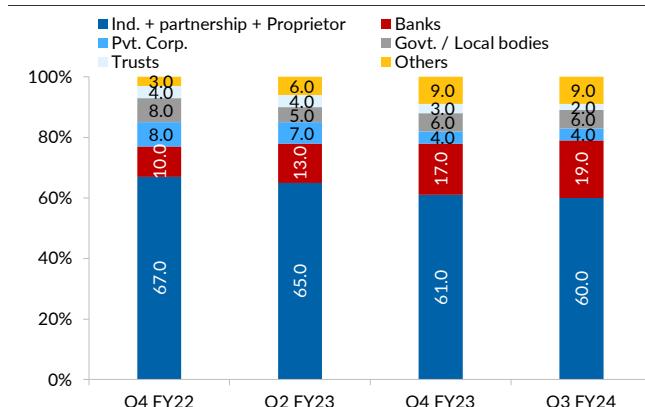
Source: Company, YES Sec

**Exhibit 18: Granularization of SA franchise**



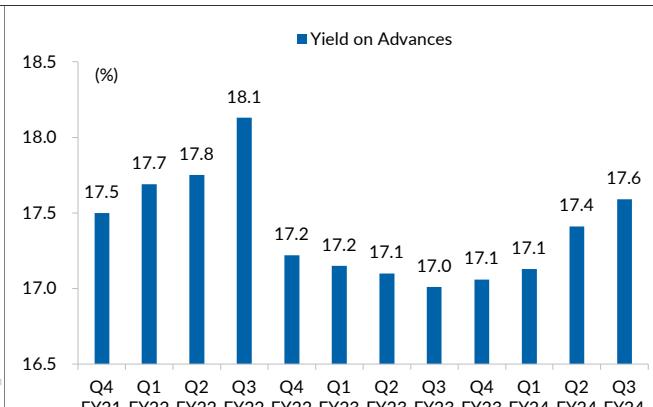
Source: Company, YES Sec

## Exhibit 19: Share of Ind. + Small Biz in Deposits has come-off



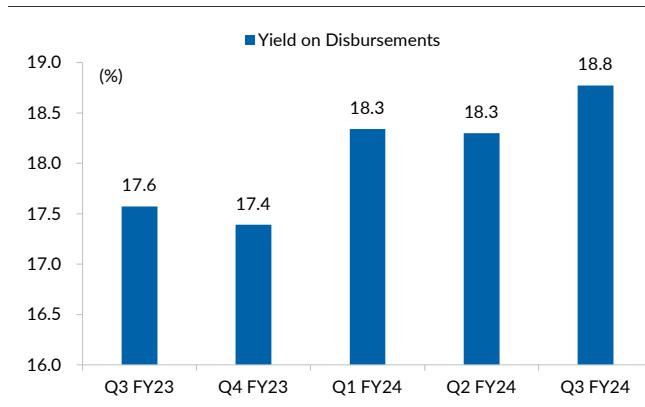
Source: Company, YES Sec

## Exhibit 20: Portfolio Yield has started to move up



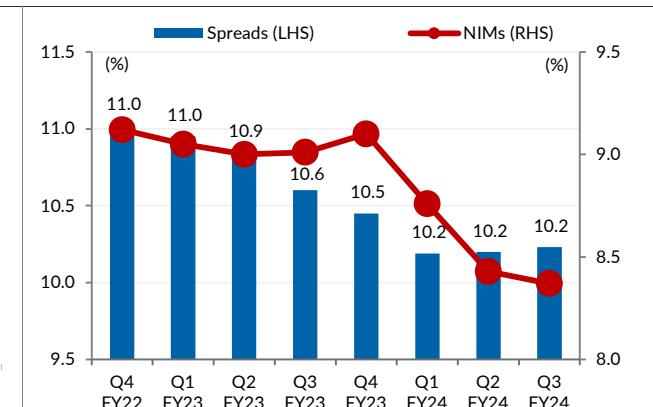
Source: Company, YES Sec

## Exhibit 21: Disbursement Yield has climbed much higher



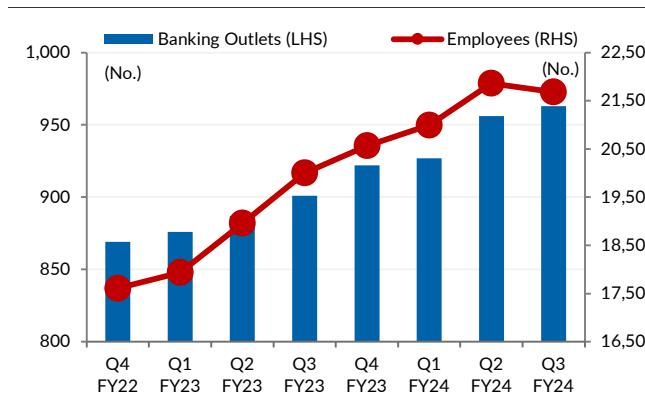
Source: Company, YES Sec

## Exhibit 22: Spread has stabilized but NIM is falling



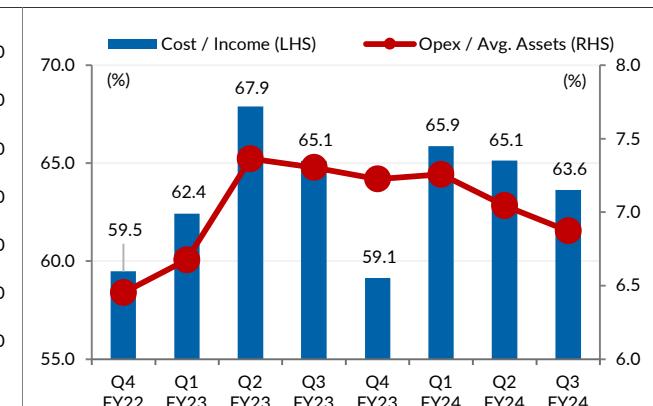
Source: Company, YES Sec

## Exhibit 23: Consistent investment in critical resources



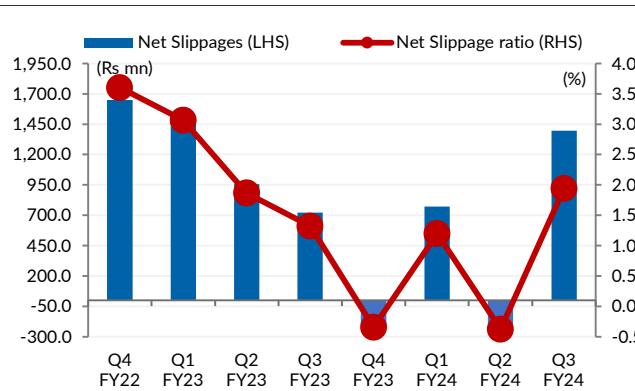
Source: Company, YES Sec

## Exhibit 24: Cost/Income gains have been elusive



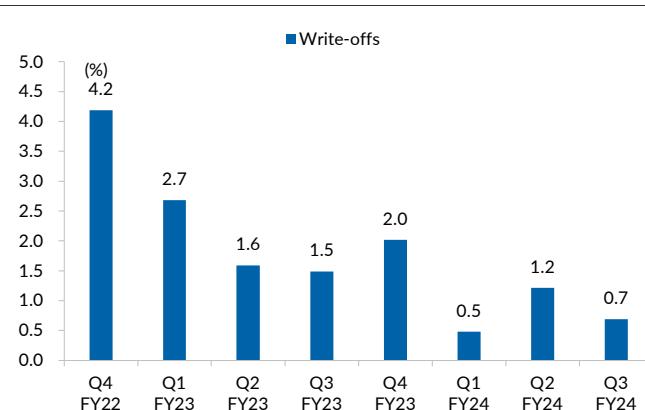
Source: Company, YES Sec

**Exhibit 25: Net Slippages are normalizing**



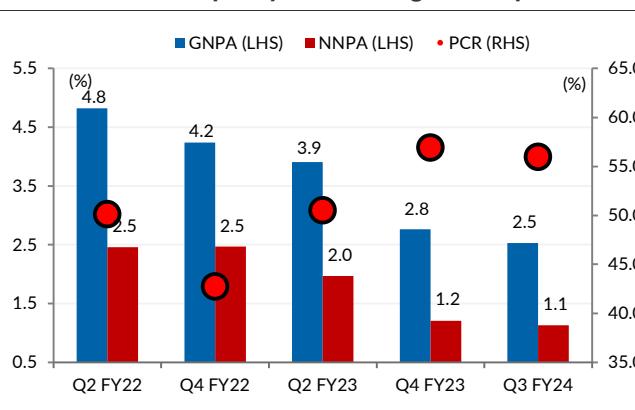
Source: Company, YES Sec

**Exhibit 26: Write-offs have fully normalized**



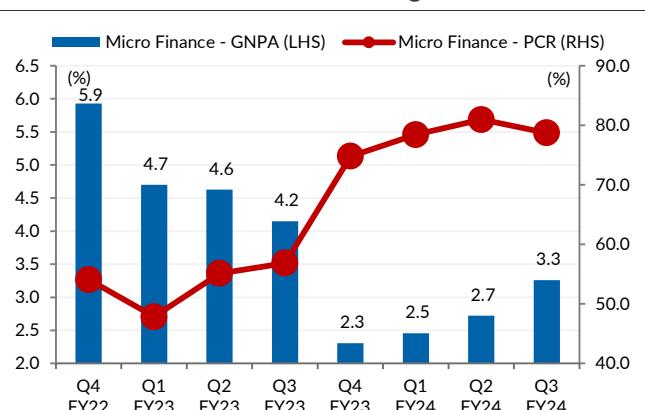
Source: Company, YES Sec

**Exhibit 27: Asset quality and coverage has improved**



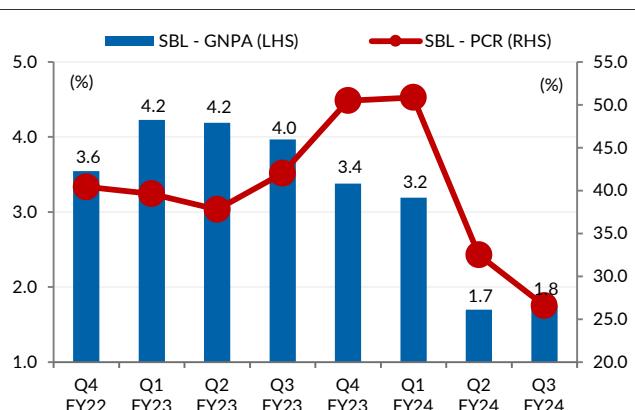
Source: Company, YES Sec

**Exhibit 28: MFIs NPLs are increasing**



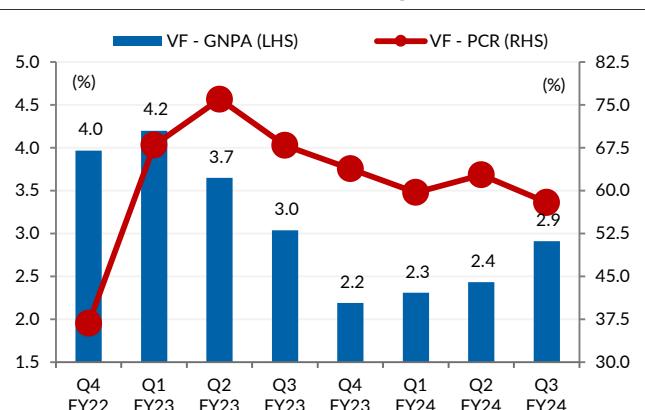
Source: Company, YES Sec

**Exhibit 29: SBL NPLs remain low**



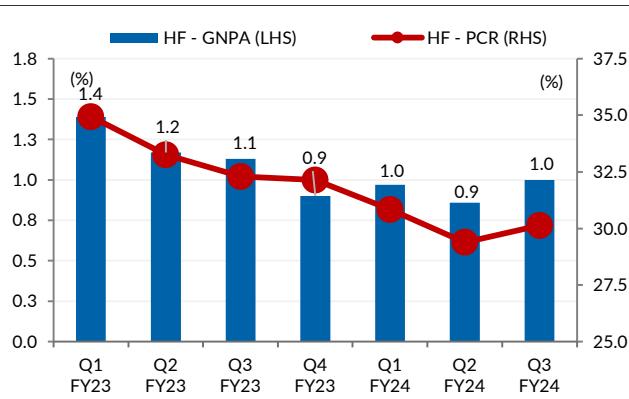
Source: Company, YES Sec

**Exhibit 30: VF NPLs have inched-up**



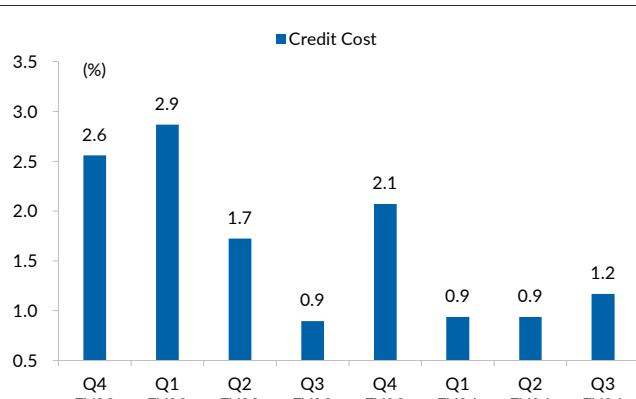
Source: Company, YES Sec

**Exhibit 31: AHL NPLs are stable**



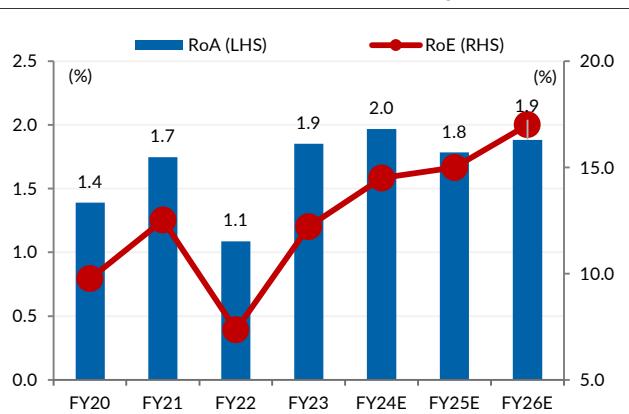
Source: Company, YES Sec

**Exhibit 32: Credit Cost in usual range**



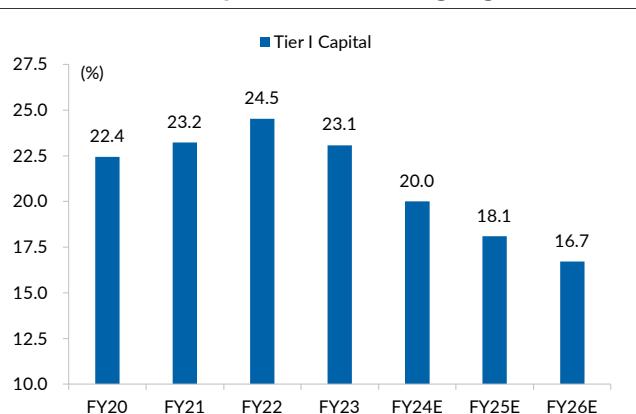
Source: Company, YES Sec

**Exhibit 33: See stable RoA/RoE delivery**



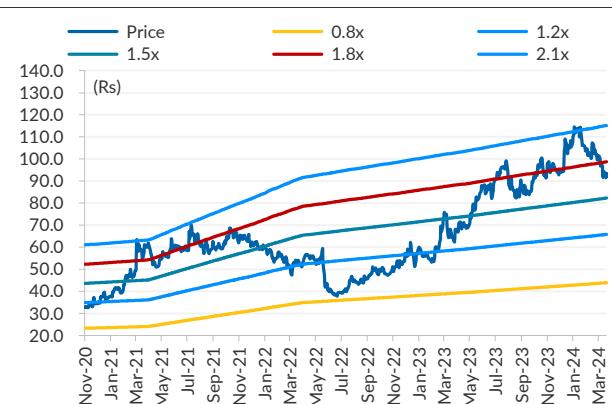
Source: Company, YES Sec

**Exhibit 34: Well-capitalized for envisaged growth**



Source: Company, YES Sec

**Exhibit 35: 1-yr rolling P/ABV band**



Source: Company, YES Sec

**Exhibit 36: 1-year rolling P/ABV vis-a-vis the mean**



Source: Company, YES Sec

## FINANCIALS

### Exhibit 37: Balance Sheet

Y/e 31 Mar (Rs m)	FY22	FY23	FY24E	FY25E	FY26E
Total cash & equivalents	21,325	12,443	29,603	36,572	40,334
Investments	44,498	66,646	86,639	1,07,433	1,33,217
Advances	1,93,742	2,57,986	3,21,865	4,01,452	5,01,748
Total interest-earning assets	2,59,566	3,37,074	4,38,108	5,45,457	6,75,298
Fixed assets	2,004	3,791	3,791	3,791	3,791
Other assets	7,949	8,716	9,588	10,547	11,601
<b>Total assets</b>	<b>2,69,519</b>	<b>3,49,581</b>	<b>4,51,487</b>	<b>5,59,795</b>	<b>6,90,691</b>
Net worth	42,462	51,579	57,945	65,245	75,218
Deposits	1,89,508	2,53,806	3,55,334	4,72,594	5,93,106
Borrowings	26,164	29,738	22,303	4,461	3,122
Total interest-bearing liabilities	2,15,672	2,83,543	3,77,637	4,77,055	5,96,228
Non-interest-bearing liabilities	11,385	14,459	15,905	17,495	19,244
<b>Total liabilities</b>	<b>2,27,057</b>	<b>2,98,002</b>	<b>3,93,542</b>	<b>4,94,550</b>	<b>6,15,473</b>
<b>Equity &amp; Total liabilities</b>	<b>2,69,519</b>	<b>3,49,581</b>	<b>4,51,487</b>	<b>5,59,795</b>	<b>6,90,691</b>

Source: Company, YES Sec

### Exhibit 38: Income statement

Y/e 31 Mar (Rs m)	FY22	FY23	FY24E	FY25E	FY26E
Interest Income	34,597	41,619	55,564	71,364	88,408
Interest expense	(14,211)	(16,172)	(24,394)	(32,943)	(39,893)
<b>Net interest income</b>	<b>20,385</b>	<b>25,447</b>	<b>31,171</b>	<b>38,421</b>	<b>48,515</b>
Non-interest income	5,376	6,696	7,633	8,626	10,135
Total op income	25,761	32,143	38,804	47,046	58,650
Total op expenses	(17,041)	(20,383)	(25,071)	(29,996)	(36,740)
<b>PPoP</b>	<b>8,719</b>	<b>11,760</b>	<b>13,733</b>	<b>17,051</b>	<b>21,911</b>
Provisions	(4,938)	(4,072)	(3,073)	(4,611)	(5,871)
Profit before tax	3,781	7,688	10,660	12,440	16,040
Taxes	(974)	(1,952)	(2,745)	(3,203)	(4,130)
<b>Net profit</b>	<b>2,807</b>	<b>5,736</b>	<b>7,915</b>	<b>9,236</b>	<b>11,910</b>

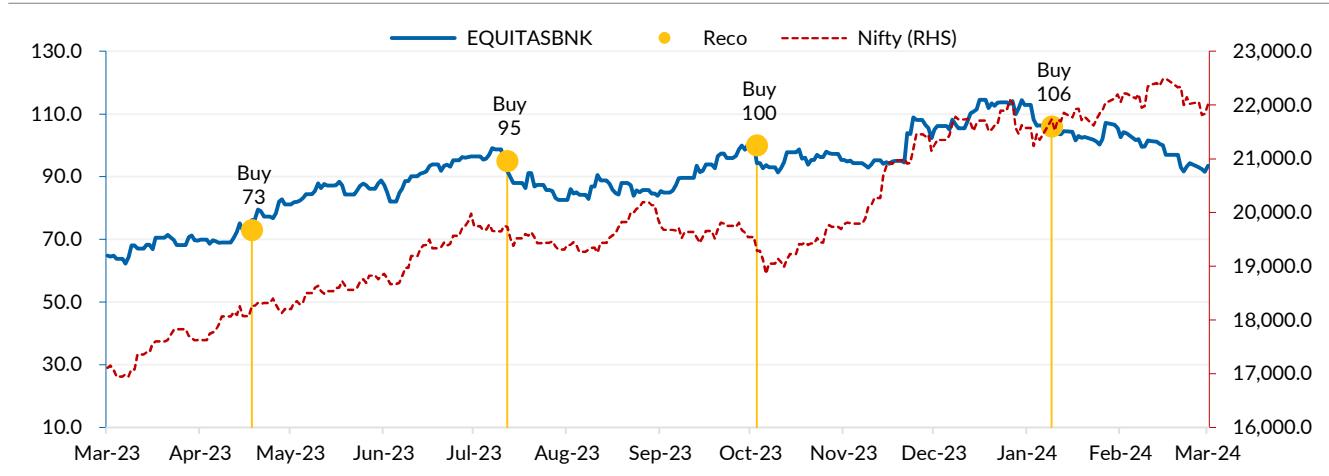
Source: Company, YES Sec

## Exhibit 39: Growth and Ratio matrix

Y/e 31 Mar	FY22	FY23	FY24E	FY25E	FY26E
<b>Growth matrix (%)</b>					
Net interest income	13.4	24.8	22.5	23.3	26.3
Total op income	16.2	24.8	20.7	21.2	24.7
Op profit (pre-provision)	(1.7)	34.9	16.8	24.2	28.5
Net profit	(26.9)	104.3	38.0	16.7	28.9
Advances	15.0	33.2	24.8	24.7	25.0
Deposits	15.6	33.9	40.0	33.0	25.5
Total assets	9.0	29.7	29.2	24.0	23.4
<b>Profitability Ratios (%)</b>					
NIM	9.2	9.0	8.5	8.4	8.5
Non-interest income /Total income	20.9	20.8	19.7	18.3	17.3
Return on Equity	7.3	12.2	14.5	15.0	17.0
Return on Assets	1.1	1.9	2.0	1.8	1.9
<b>Per share ratios (Rs)</b>					
EPS	2.2	5.2	7.1	8.3	10.7
Adj. BVPS	30.1	43.6	49.1	55.1	67.7
<b>Other key ratios (%)</b>					
Cost/Income	66.2	63.4	64.6	63.8	62.6
Tier-I capital	24.5	23.1	20.0	18.1	16.7
Gross NPLs/Loans	4.2	2.8	2.5	2.5	2.5
Net NPLs/Net loans	2.5	1.2	1.1	1.0	1.0
Tax rate	25.8	25.4	25.8	25.8	25.8

Source: Company, YES Sec

## Recommendation Tracker



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