ESAF Small Finance Bank Limited

02-November-23

Subscribe- Long term

Kuber Chauhan
kuberchauhan@rathi.com

Issue Details

Issue Details	
Issue Size (Value in ₹ million, Upper Band)	4,630
Fresh Issue (No. of Shares in Lakhs)	651
Offer for Sale (No. of Shares in Lakhs)	121
Bid/Issue opens on	03-Nov-23
Bid/Issue closes on	07-Nov-23
Face Value (₹)	Rs. 10
Price Band (₹)	57-60
Minimum Lot	250

Objects of the Issue

- **Fresh issue: ₹ 3,907 million**
- To utilize the Net Proceeds from the Fresh Issue towards fully augmenting its Tier - 1 capital base to meet the future capital requirements.
- General Corporate Purposes.
- **Offer for sale: ₹ 723 million**

Book Running Lead Managers
ICICI Securities Limited
DAM Capital
Nuvama Wealth Management
Registrar to the Offer
Link Intime India Pvt. Ltd

Capital Structure (₹ million)	Aggregate Value
Authorized share capital	6,000
Subscribed paid up capital (Pre-Offer)	4,495
Paid up capital (post-Offer)	5,146

Share Holding Pattern %	Pre-Issue	Post Issue
Promoters & Promoter group	74.43	63.41
Public – Selling shareholders	8.64	6.80
Public – Others	16.94	29.79
Total	100.0	100.0

Financials

Particulars (₹ In million)	FY23	FY22	FY21
Interest Earned (A)	28,536	19,399	16,411
Other Income (B)	2,879	2,075	1,272
Total (A+B) (i)	**31,415**	**21,475**	**17,684**
Interest Expended (C)	10,173	7,927	7,195
Operating Expenses (D)	12,305	8,628	6,318
Provisions and Contingencies (E)	5,913	4,371	3,115
Total (C+D+E) (ii)	**28,392**	**20,927**	**16,630**
PAT (i)-(ii)	**3,023**	**547**	**1,053**
EPS	6.73	1.22	2.46
Diluted EPS	6.71	1.22	2.46
Ratios	**FY23**	**FY22**	**FY21**
Interest Earned Growth (%)	47.1%	16.9%	NM
Net Interest Margin (%)	9.6%	7.6%	8.5%
PAT Growth (%)	453%	-48.1%	NM

Company Description

The “ESAF” brand has been built over more than 27 years, beginning in 1995 when ESAF Foundation started its micro loan activities. They have a license to use the “ESAF Brand” and related logos from ESAF Foundation. As an NBFC-MFI, EFHPL, their corporate promoter, was unable to accept deposits as per applicable laws in India. After acquiring the business of EFHPL, they have been able to leverage the strength of the “ESAF” brand to grow their deposits since they began their business as a small finance bank on March 10, 2017.

The bank has placed an emphasis on increasing the Retail Deposits. As on June 30, 2023, their Retail Deposits were ₹13,977 crore, which accounted for 89.28% of their total deposits. As on June 30, 2023, they had 0.67 crore deposit accounts.

ESAF SFB has focus on unbanked and under-banked customer segments, especially in rural and semi-urban centres. As at June 30, 2023, their gross advances to their customers in rural and semi-urban centres (combined) accounted for 62.97% of the gross advances and 71.71% of the banking outlets were located in rural and semi-urban centres (combined). Their primary products are advances (asset products) and deposits (liability products).

Their advances comprise:
- Micro Loans, which comprises Microfinance Loans and Other Micro Loans
- Retail Loans, which includes Gold Loans, Mortgages, Personal Loans, and Vehicle Loans
- MSME Loans
- Loans to Financial Institutions and
- Agricultural Loans.

ESAF SFB has a network of 700 banking outlets (including 59 business correspondent-operated banking outlets), 767 customer service centres (which are operated by their business correspondents), 22 business correspondents, 2,116 banking agents, 525 business facilitators and 559 ATMs spread across 21 states and 2 union territories, serving 0.72 crore customers as on June 30, 2023. While their operations are spread out across India, their business is concentrated in South India, particularly in the states of Kerala and Tamil Nadu.

The Bank is led by Mr. Kadambelil Paul Thomas, Managing Director and Chief Executive Officer, who has over 27 years of experience in the banking/microfinance industry in India.

The Board comprises individuals having diverse experience across industries and our Independent Directors provide strategic guidance to help improve and grow the operations. The senior management team has significant experience in the banking and financial services industry. The bank had 5,034 employees as at March 31’23

Valuation & Outlook

ESAF SFB provides micro, retail and corporate banking, para-banking activities like debit cards, and third-party financial distribution, in addition to Treasury and permitted foreign exchange business. The bank's assets under management have nearly doubled between March 2021 and 2023 and stand at Rs172,041 mn as of June’23. The have 700 banking outlets and 767 customer service centres across 21 states and 2 union territories, with 62% of their banking outlets being in southern India.

At the upper price band company is valuing at P/B of 1.8x with a market cap of ₹30,880 million post issue of equity shares and return on net worth of 17.69%.

We believe that company is fairly priced and recommend a “**Subscribe- Long term**” rating to the IPO.

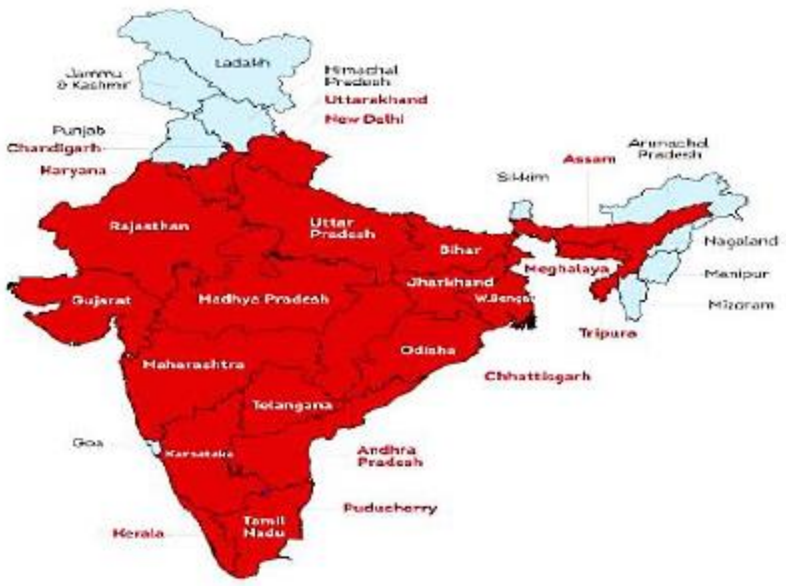
Company's Operations

ESAF Small Finance Bank ("ESAF SFB") is a small finance bank with a focus on unbanked and under-banked customer segments, especially in rural and semi-urban centres. As at June 30, 2023, their gross advances to their customers in rural and semi-urban centres (combined) accounted for 62.97% of the gross advances and 71.71% of the banking outlets were located in rural and semi-urban centres (combined). Their primary products are advances (asset products) and deposits (liability products).
Their advances comprise:
- Micro Loans, which comprises Microfinance Loans and Other Micro Loans;
- Retail Loans, which includes Gold Loans, Mortgages, Personal Loans, and Vehicle Loans;
- MSME Loans;
- Loans to Financial Institutions; and
- Agricultural Loans.

Company's liability products comprise current accounts, savings accounts, term deposits and recurring deposits. Their AUM grew from ₹8,425.93 crore to ₹16,331.27 crore as at March 31, 2021 and 2023, respectively, registering a CAGR of 39.22%, and increased to ₹17,203.97 crore as at June 30, 2023, an increase of 5.34%. Their deposits grew from ₹8,999.43 crore to ₹14,665.63 crore as at March 31, 2021 and 2023, respectively, registering a CAGR of 27.66%, and increased to ₹15,655.85 crore as at June 30. 2023, an increase of 6.75%. Their services includes safety deposit lockers, foreign currency exchange, giving their customers access to the Bharat Bill Payment System, money transfer services and Aadhaar Seva Kendra services. They also distribute third-party life and general insurance policies and Government pension products.

ESAF SFB has a network of 700 banking outlets (including 59 business correspondent-operated banking outlets), 767 customer service centres (which are operated by their business correspondents), 22 business correspondents, 2,116 banking agents, 525 business facilitators and 559 ATMs spread across 21 states and 2 union territories, serving 0.72 crore customers as at June 30, 2023. While their operations are spread out across India, their business is concentrated in South India, particularly in the states of Kerala and Tamil Nadu. As at June 30, 2023, 62.43% of their banking outlets are located in South India (including 43.43% in Kerala and 13.86% in Tamil Nadu), 73.09% of their gross advances are from customers in South India (including 43.45% from Kerala and 22.14% from Tamil Nadu) and 86.90% of their deposits are from banking outlets in South India (including 80.04% from Kerala and 3.36% from Tamil Nadu).
As a small finance bank, they are required to have at least 75% of their adjusted net bank credit to the priority sectors. Their business model focuses on the principles of responsible banking, providing customer-centric products and services through the innovative application of technology. They follow a social business strategy seeking a triple bottom line impact: people; planet; and prosperity.
The "ESAF" brand has been built over more than 27 years, beginning in 1995 when ESAF Foundation started its micro loan activities. They have a license to use the "ESAF Brand" and related logos from ESAF Foundation. As an NBFC-MFI, EFHPL, their corporate promoter, was unable to accept deposits as per applicable laws in India. After acquiring the business of EFHPL, they have been able to leverage the strength of the "ESAF" brand to grow their deposits since they began their business as a small finance bank on March 10, 2017. The bank has placed an emphasis on increasing the Retail Deposits. As at June 30, 2023, their Retail Deposits were ₹13,977.27 crore, which accounted for 89.28% of their total deposits. As at June 30, 2023, they had 0.67 crore deposit accounts.

Delivery Channel



ESAF SMALL FINANCE BANK

Name of the State/ Union Territory	Banking Outlets	ATMs	CSCs
Andhra Pradesh	3	3	1
Assam	3	2	10
Bihar	10	9	12
Chhattisgarh	35	26	31
Gujarat	5	5	49
Haryana	6	2	6
Jharkand	15	14	5
Karnataka	26	19	94
Kerala	304	275	25
Madhyapradesh	68	45	90
Maharashtra	71	49	117
Meghalaya	1	0	0
New Delhi	9	8	1
Odisha	10	5	52
Rajasthan	9	2	37
Tamil Nadu	97	77	118
Telangana	4	4	0
Tripura	3	0	6
Union Territory Of Chandigarh	1	1	0
Union Territory Of Puducherry	3	1	1
Uttar Pradesh	9	7	34
Uttarakhand	3	1	6
West Bengal	5	4	72
Grand Total	**700**	**559**	**767**

Note: CSC means customer service centre.

Region-wise Banking Outlets:

Banks's banking outlets comprise their Branches (all of which they operate) and their business correspondent-operated banking outlets (in which they have some employees assisting with the operations).

The number of Branches and the business correspondent-operated banking outlets:

Region	Jun'30' 23	March 31' 23	March 31' 22	March 31' 21
Number of Branches (all of which Bank operates)	641	641	573	550
Number of business correspondent operated	59	59	2	0

banking outlets (in which Bank has some employees assisting with the operations)				
Total	**700**	**700**	**575**	**550**

Strengths:

- **Deep understanding of the microfinance segment**

As at June 30, 2023, ESAF SFB had over 0.33 crore customers with Micro Loans, the majority of whom were women. As at June 30, 2023, their products and services were offered in 21 states and 2 union territories. Their gross Micro Loans to customers outside of Kerala were ₹4,330.52 crore, representing 42.30% of the total gross Micro Loans, as at June 30, 2023. As at June 30, 2023, their Top-5 states outside Kerala for gross Micro Loans were Tamil Nadu, Maharashtra, Madhya Pradesh, Karnataka and Chhattisgarh, with gross Micro Loans in those states (combined) being ₹5,043.73 crore, which represented 49.27% of the total gross Micro Loans.

- **Strong rural and semi-urban banking franchise**

Bank's customers in rural and semi-urban centres (combined) have increased from 0.30 crore as at March 31, 2021 to 0.41 crore as at June 30, 2023. As at June 30, 2023, their gross advances to customers in rural and semi-urban centres (combined) were ₹9,095.18 crore, representing 62.97% of the gross advances. As at June 30, 2023, 0.41 crore of their customers were in rural and semi-urban centres (combined), representing 56.92% of the total customers, and the number of banking outlets in rural and semi-urban centres (combined) was 502, representing 71.71% of the total banking outlets.

- **Growing retail deposit portfolio**

Bank's total deposits increased from ₹8,999.43 crore as at March 31 2021 to ₹14,665.63 crore as at March 31, 2023, representing a CAGR of 27.66%, and further increased to ₹15,655.85 crore as at June 30, 2023, an increase of 6.75%. They have placed an emphasis on increasing their Retail Deposits. The Retail Deposits increased from ₹8,796.38 crore as at March 31, 2021 to ₹13,323 crore as at March 31, 2023, representing a CAGR of 23.07%, and further increased to ₹13,977.27 crore as at June 30, 2023, an increase of 4.91%. The CASA increased from ₹1,747.65 crore as at March 31, 2021 to ₹3,137.45 crore as at March 31, 2023, representing a CAGR of 33.99%, and decreased to ₹2,851.97 crore as at June 30, 2023, a decrease of 9.10%.

- **Customer connections driven by customer-centric products and processes and other non-financial services for Micro Loan customers**

Bank's products and services are designed to meet the various lifecycle needs of their customers, such as home loans, clean energy product loans, loans for agricultural activities, loans against property, personal loans, education loans, gold loans and vehicle loans. In addition, they have various non-financial services, which include, among other things, conducting financial literacy programmes, livelihood programmes, entrepreneurship training programmes and community engagement programmes. The customer-centric products and processes have resulted in high customer retention rates.

- **Technology driven model with an advanced digital technology platform**

The Bank continuously works towards improving their customers' experience through the use of technology. They offer their customers various digital platforms, including an internet banking portal, a mobile banking platform, SMS alerts, bill payments and RuPay branded ATM cum debit cards. All banking and payment transactions, such as remittances and utility payments, can be completed through these platforms. Their customer on-boarding process has been predominantly digitalised for their micro loans. They leverage technology for underwriting and credit sanctioning for their loan products based on inputs from credit bureaus and/or their customer data analytics. They have implemented technology solutions that enable them to ensure cashless disbursement of loans and implemented electronic signing for micro loans, both of which have reduced paperwork.

Key Strategies

- **Increase the deposits and in particular the Retail Deposits**

The bank plans to continue to increase their deposits, in particular their Retail Deposits, in order to help grow their business and reduce their Cost of Funds. For this, they will continue to target new and existing customers to source deposits in the form of CASA, fixed deposits, and recurring deposits by focusing on customer service and offering competitive pricing. Furthermore, they intend to continue to target NRIs to scale up their deposit base and in particular their CASA base. They also intend to continue to target HNIs to scale up their deposit base and in particular the CASA base.

- **Penetrate deeper into the existing geographies**

In Fiscal 2021, they expanded their operations to Meghalaya, Uttar Pradesh, Haryana, Tripura and Chandigarh, by opening banking outlets and/or appointing business correspondents for this states/union territory. In Fiscal 2022, they expanded their operations to Uttarakhand by appointing a business correspondent for that state. In Fiscal 2023, they opened Branches in Tripura and Uttarakhand for the first time. They intend to deepen their distribution within the states and union territories they operate in by opening additional Branches, opening more customer service centres and business correspondent-operated banking outlets and encouraging them to enter into agreements with more banking agents, entering into relationships with new business correspondent entities and business facilitators and adding ATMs.

- **Continue diversifying the retail asset portfolio**

Bank's primary focus will be to continue to diversify their asset portfolio. They intend to leverage their wide base of existing customers in the unserved and underserved segments by developing a range of asset products based on their vintage and credit worthiness to create sustainable livelihood. Therefore, they intend to extend the offering from JLG loans to individual loans to micro enterprise loans, affordable housing loans and other new products. They will also seek to increase visibility and penetration of their other assets products to achieve a well-diversified lending book along with a continued focus on financial inclusion.

- **Continue to grow the Micro Loans while increasing the other categories of advances both in absolute terms and as a percentage of the total AUM**

• Expand the retail loan business: They plan to continue to increase their retail advances both in terms of amount and as a percentage of their AUM. They plan to continue to focus on their individual customers to continue to build their retail loan portfolio:
• Increase the MSME loans: They plan to increase their MSME loans both in terms of amount and as a percentage of their AUM. They will also help the existing Micro Loan customers to grow their businesses with additional funding.

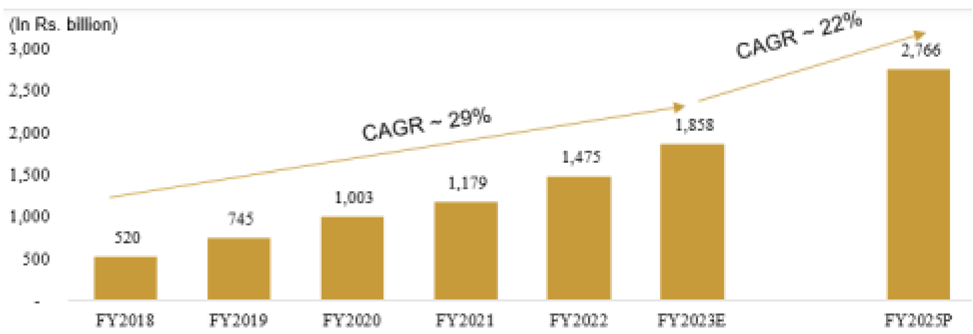
- **Continue to leverage technology and customer data analytics**

The Bank plans to further enhance their technology platforms, such as internet banking, mobile banking, ATMs, cash deposits machines, customer service applications and payment interfaces, which will increase the adoption of their service delivery mechanisms. This will also enable them to perform more reliable data analytics, resulting in more efficient risk management processes, targeted customer profiling and offer customised products to suit their customers' diverse requirements.

Industry Snapshot

Small Finance Bank Industry

SFBs' AUM is estimated to have clocked 29% CAGR from Fiscal 2018 to Fiscal 2023. CRISIL MI&A estimates that the top three SFBs accounted for approximately 62% of the aggregate AUM as of Fiscal 2023, compared to 55% as of Fiscal 2017, indicating the rising concentration and expansion of the top three players within the SFBs. CRISIL MI&A also estimates that the top six players accounted for approximately 89% of the market share as of Fiscal 2023. In Fiscal 2021 and Fiscal 2022, new loan origination remained low as SFBs turned cautious and selective in disbursals due to the pandemic.



However, as the economy revived and business operations normalised, SFBs' AUM witnessed strong growth following the pandemic. As of Fiscal 2023, SFBs' AUM is estimated to have crossed ₹ 1,800, billion growing at 26% - 27% year-on-year. CRISIL MI&A expects SFBs' loan portfolio to see a strong CAGR of approximately 22% between Fiscal 2023 and Fiscal 2025, as most SFBs have completed the transition phase and are likely to benefit from the operating leverage.

Drivers for growth in SFBs' AUM are as folllows :

- **Huge market opportunity in the rural segment –** Despite its larger contribution to GDP of 47%, the rural segment's share in credit remains fairly low at approximately 9-10% of the overall credit outstanding as of Fiscal 2022. This provides a huge market opportunity for SFBs and other players present in the segment.

- **Presence of informal credit channels –** In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population. SFBs have an opportunity to tap this market.

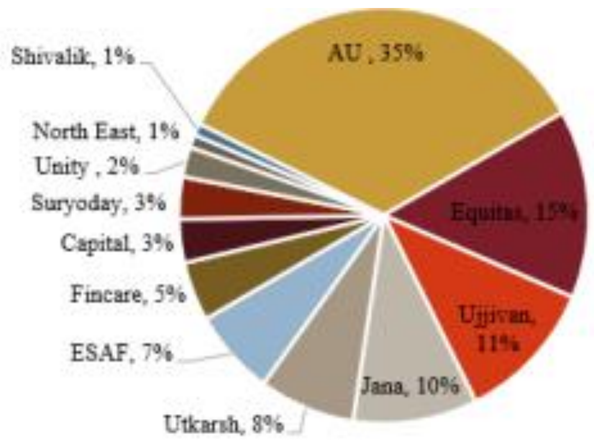
- **Geographic diversification –** With increased focus on diversifying their portfolio and expanding their reach, SFBs are expected to log higher growth as they tap newer geographies.

- **Loan recovery and control on aging NPAs –** SFBs are experienced in collection and monitoring of defaultrisk. This will help them keep asset quality under check.

- **Ability to manage local stakeholders –** With their microfinance experience, SFBs have the ability to manage local stakeholders and maintain operational efficiency.

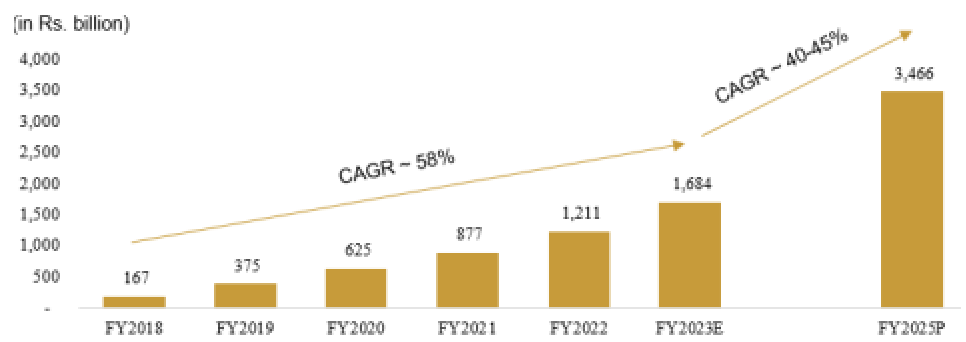
- **Access to low-cost funds & huge cross sell opportunity–** SFBs' cost of funds is low substantially as they are allowed to raise CASA deposits. This will also help them lend at more reasonable rates to its customers, hence enhancing their cross-sell opportunity in terms of asset products, insurance etc

Top six players estimated for 84% of industry advances as of December 31, 2022.



SFB deposits to grow faster than private and public-sector banks

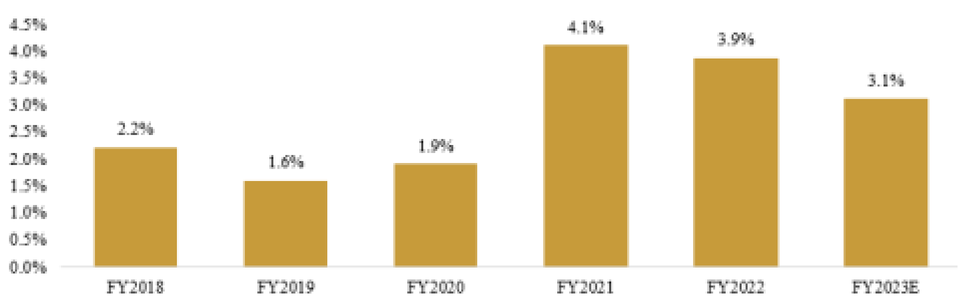
SFB deposits to grow robustly



SFBs have significant growth potential as most of them were functioning as NBFCs/MFIs previously. Immediately after commencement of their operation, all SFBs focused on increasing their deposit base. Their overall deposit base doubled to around ₹ 375 billion as of Fiscal 2019. Further, proportion of CASA deposits has short up from nearly around 20% as of Fiscal 2020 to approximately 39% as of December 31, 2022. The increase could be attributed to the higher interest rates they offer and increase in their branch network. Deposit growth for SFBs continued to grow at a strong pace of 36% in the nine months ended December 31, 2022 year-on-year and is estimated to have reached ₹ 1,684 billion at the end of Fiscal 2023. Going forward, CRISIL MI&A expects SFBs' deposit to grow at 40% - 45% CAGR over Fiscal 2023 – Fiscal 2025 as players focus on popularising convenient banking habits to cover the last mile and widen financial inclusion by deepening their penetration in untapped geographies.

Asset quality for SFBs to marginally improve after pandemic-related stress

GNPA trend of overall SFB Industry



GNPA of SFBs improved to 1.6% as of Fiscal 2019 from 2.2% as of Fiscal 2018, which was significant impacted by demonetization and residual asset quality issues. This could be attributed to diversification of product mix into relatively less risky assets, write-off of legacy loans and reduction in microfinance loans due to better collection mechanism and deep understanding of their local geographies and customers. In Fiscal 2021, SFBs faced severe asset quality issues, as near-term collections saw disruptions on account of COVID-19. However, RBI in March 2020 announced the moratorium on term loans/ working capital for instalments falling due between March 1, 2020 and May 31, 2020. This was subsequently extended in May 2020 by another three months to August 31, 2020. A stand-still in asset classification for accounts availing the moratorium was provided from March 1, 2020 to August 31, 2020. For all accounts classified as standard as on February 29, 2020, even if overdue, the moratorium period, wherever granted, was to be excluded by the lending institutions from the number of days past-due for the purpose of asset classification. Recently, Government of India and RBI has announced various measures to support the stability of the financial service sector. These measures are likely to contain the impact of COVID-19 and economic slowdown.

Despite government measures, the lockdown impacted the low- and middle-income segments the most. They also happened to be the target audience of SFBs. While banks offered moratorium period to borrowers, SFBs' asset quality deteriorated due to difficulties faced by their borrowers. In Fiscal 2022, GNPAs improved marginally to 3.9%. In Fiscal 2023, the asset quality of SFBs improved on account of lower slippages, write-offs and improved collection efficiencies. GNPA for SFBs is estimated at 3.1% at the end of Fiscal 2023. The asset quality of SFBs is expected to improve further. However, it will vary depending on efficiency in credit underwriting, monitoring and collection over the long term.

- **Accounting ratios**

Particulars	FY 2021	FY 2022	FY 2023
Advances (Rs mn)	81,676	116,370	139,243
Deposits (Rs mn)	89,994	128,151	146,656
CASA (%)	19	23	21
NIMs (%)	8.7	7.9	10
GNPA (%)	6.7	7.8	2.5
NNPA (%)	4.0	4.1	1.1
Provision Coverage Ratio (%)	40	48	54
ROAA (%)	1.0	0.4	1.6
ROAE (%)	8.7	4.0	19.4
CRAR (%)	24.2	18.6	19.8

Comparison with listed entity

Name of the company	Latest FY	Face value	P/B	EPS (Basic) (₹)	EPS (Diluted) (₹)	RONW (%)	NAV per equity share (₹)
ESAF Small Finance Bank Ltd	Consolidated	10	1.8*	6.73	6.71	20.22	38.03
Listed peers							
Equitas Small Finance Bank Ltd	Consolidated	10	2.53	4.71	4.67	11.12	46.44
Ujjivan Small Finance Bank Ltd	Consolidated	10	2.96	5.88	5.87	27.79	20.25
Credit Access Grameen Ltd	Consolidated	10	3.98	52.04	51.82	16.18	326.89
Spandana Sphoorty Financial Ltd	Consolidated	10	1.71	1.74	1.74	0.40	436.58
Bandhan Bank Ltd	Consolidated	10	2.07	13.62	13.62	11.21	121.58
AU Small Finance Bank Ltd	Consolidated	10	4.64	21.86	21.74	13.01	164.64
Suryoday Small Finance Bank	Consolidated	10	1.14	7.32	7.32	4.90	149.28
Fusion Micro Finance Ltd	Consolidated	10	2.62	43.29	43.13	16.67	230.74

Note: 1) P/B Ratio has been computed based on the closing market price of equity shares on NSE on November 02, 2023.
2) * P/B of company is calculated on BVPS of FY23 and post issue no. of equity shares issued.

Key Risks

- As its business is significantly dependent on micro-loans, any adversity in that sector has the potential to have a negative impact on the business and finances.
- A large portion of this bank's advances are unsecured. Hence, failing to recover them promptly can result in a negative impact on its financial condition and cash flow
- As the company's non-convertible debentures are listed on BSE, any failure in compliance with the rules and regulations regarding the same can result in penalties or similar actions.
- Lately, there have been continuous technological advancements in the financial sector. Failing to keep at par with these can result in poor performance of its products and services and lose the interest of its customer base. Bank is subject to stringent regulatory requirements and prudential norms of RBI and any inability to comply with such laws, regulations and norms may have an adverse effect on business, results of operations, financial condition and cash flows.

Valuation

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Ratings Methodology

- Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>₹300 Bn) and Mid/Small Caps (<₹300 Bn) or SEBI definition vide its circularSEBI/HO/IMD/DF3/CIR/P/2017/114 dated 6th October 2017, whichever is higher and as described in the Ratings Table below:

Ratings Guide (12 months)	Buy	Hold	Sell
Large Caps (>₹300Bn.)	15%	5%-10%	Below 5%
Mid/Small Caps (<₹300 Bn.)	20%	10%-15%	Below 10%

Research Disclaimer and Disclosure inter-alia as required under Securities and Exchange Board of India (Research Analysts) Regulations, 2014

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