

## RETAIL EQUITY RESEARCH

# ESAF Small Finance Bank Ltd.

## Banking

SENSEX: 64,081

NIFTY: 19,133

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Price Range Rs.57 - Rs.60

## South-based Small Finance Bank....

ESAF Small Finance Bank Ltd. (ESFBL) established in 2016 is a south-centric small finance bank targeting unbanked and underbanked customers, primarily in rural and semi-urban areas. The bank offers micro loans, retail loans, MSME loans, loans to financial institutions, and agricultural loans. ESFBL serves 7.15 million customers through its 700 banking outlets out of which 502 banking outlets are in rural and semi-urban centres, across 21 states and two union territories, as of June 30, 2023.

- **Advances under management (AUM) for small finance banks industry saw a 29% CAGR from March 2018 to June 2023, and CRISIL MI&A projects a 22-24% CAGR increase in AUM between June 2023 and March 2025.**
- **ESFBL's AUM grew from ₹8,425.9cr to ₹16,331cr, with a 39% CAGR between FY21-23, the highest among peers according to CRISIL, while deposits rose from ₹8,999.4cr to ₹14,665.6cr during the same period, with a 27.7% CAGR. As of June 30, 2023, ESAF SFB ranked as the fifth largest SFB in India by AUM, holding a 9% market share.**
- **Net Interest Income (NII) grew to ₹1,529cr at a CAGR of 41% between FY21-23, while net interest margin (NIM) improved to 9.7% in FY23 from 8.5% in FY21.**
- **The RoA improved from 0.9% to 1.6% over FY21-23, while the RoE improved from 8.7% to 19.4% over the same period, which is impressive within the industry.**
- **ESFBL recorded a net profit of ₹130cr on a total income of ₹992cr in Q1FY24, with net interest income rising by 30% to ₹585cr. Moreover, the bank saw a significant improvement in asset quality, with gross NPAs decreasing to 1.7% from 6.2% and net NPAs declining to 0.81%.**
- **At the upper price band of ₹60, ESFBL is available at a P/BV of 1.8x (FY23), which appears reasonably priced compared to its peers. The huge market opportunity in the rural segment, increased focus on diversifying their portfolio and expanding their reach, access to low-cost funds, & huge cross-sell opportunities augur well for the small finance banking sector. With consistent growth in loan books and deposits, healthy return ratios, and an increasing pan-India presence, we assign a "Subscribe" rating on a medium- to long-term basis.**

### Purpose of IPO

The offer comprises fresh shares valued at ₹390.7cr and an offer-for-sale for ₹72.3cr by the existing shareholders. The proceeds will be utilized towards the augmentation of their Tier-1 capital base, increasing its onward lending business, and ensuring compliance with regulatory requirements on capital adequacy.

### Key Risks

- The bank's main operations are in Kerala and Tamil Nadu, accounting for 66% of total advances and 83% of deposits, which is expected to decrease in future.
- As an MFI turned SFB, 75% of their advances (net of provisions) are unsecured; product diversification is likely to reduce this percentage in future.

### Peer Valuation

Company	MCap(₹ cr)	NII(₹ cr)	NIM(%)	BV(₹)	EPS(₹)	RoE (%)	RoA (%)	P/BV	P/E(x)	CMP(₹)
ESAF Small Finance Bank	3,088	1,836	9.7	33	5.9	19.4	1.6	1.8	10.2	60
Creditaccess Gramin Bank	25,715	2,114	10.8	327	52	17.8	4.2	4.9	30.9	1,606
Ujjivan Small Finance Bank	10,346	2,698	9.5	21	5.9	31.8	3.9	2.4	8.7	51
Equitas Small Finance Bank	10,521	2,545	8.2	46	4.7	12.2	1.9	2.0	19.3	91
AU Small Finance Bnak	44,768	4,425	5.6	164	21.9	16	1.8	4.1	30.5	666

Source: Geojit Research, Bloomberg; Valuations of ESFBL are based on upper end of the price band (post issue), Financials as per FY23 consolidated.

### Issue Details

Date of opening	November 03, 2023
Date of closing	November 07, 2023
Total No. of shares offered (Cr.)	7.72
Post Issue No. of shares (Cr)	51.5
Price Band	₹ 57- ₹ 60
Face Value	₹10
Bid Lot	250 Shares
Minimum application for retail (upper price band for 1 lot)	₹ 15,000
Maximum application for retail (upper price band for 13 lot)	₹ 1,95,000
Listing	BSE,NSE
Lead Managers	ICICI Securities Ltd, DAM Capital, Nuvama Wealth Management .
Registrar	Link Intime India Pvt. Ltd.

Issue size (upper price)	Rs.cr
Fresh Issue	390.7
OFS	72.3
<b>Total Issue</b>	<b>463.0</b>

Shareholding (%)	Pre-Issue	Post Issue
Promoter & Promo. Group	74.4	62.6
Public & Others	25.6	37.4
<b>Total</b>	<b>100</b>	<b>100</b>

Issue structure	Allocation (%)	Size Rs.cr
Retail	35	157.67
Non-Institutional	15	67.57
QIB	50	225.25
Employee Reservation	-	12.50
<b>Total</b>	<b>100.0</b>	<b>463.0</b>

Y.E March (₹ cr) Consol.	FY22	FY23	Q1FY24
<b>Net Interest Income (NII)</b>	1,147	1,836	585
% Change	24	60	-
<b>Net Interest Margin (%)</b>	<b>7.6</b>	<b>9.7</b>	<b>2.9</b>
<b>PAT Adj.</b>	55	302	130
% Change	-48	452	-
<b>EPS</b>	1.1	5.9	2.5
P/E (x)	56	10	6*
P/BV (x)	2.2	1.8	1.4*
RoE (%)	4.0	19.4	7.3
RoA (%)	0.4	1.6	0.6

\*Annualised

## Business Operation & Product Offerings

ESAF SFB is promoted by ESAF Financial Holdings Pvt Ltd (EFHPL), ESAF Small Finance Bank (ESFBL) was incorporated on May 5, 2016. The Bank was granted the RBI's Final Approval to carry on business as an SFB, on November 18, 2016. The ESAF brand has been built over more than 27 years, beginning in 1995 when ESAF Foundation started its micro loan activities.

Their primary products are advances (asset products) and deposits (liability products). As at June 30, 2023, their Retail Deposits were ₹13,977.27 crore, which accounted for 89.28% of their total deposits.

### 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 ₹8,425.93cr to ₹16,331.27cr as at March 31, 2021 and 2023, respectively, registering a CAGR of 39.22%, and increased to ₹17,203.97cr as at June 30, 2023, an increase of 5.34%. Their deposits grew from ₹8,999.43cr to ₹14,665.63cr as at March 31, 2021 and 2023, respectively, registering a CAGR of 27.66%, and increased to ₹15,655.85cr 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).

## Strengths

### • Deep understanding of the microfinance segment

As at June 30, 2023, ESAF SFB's products and services were offered in 21 states and 2 union territories. Their gross Micro Loans to customers outside of Kerala were ₹4,330.52cr, 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 ₹5,043.73cr, 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 ₹9,095.18cr, representing 62.97% of the gross advances. As at June 30, 2023, 0.41cr 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 ₹8,999.43cr as at March 31 2021 to ₹14,665.63cr as at March 31, 2023, representing a CAGR of 27.66%, and further increased to ₹15,655.85cr 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 ₹8,796.38cr as at March 31, 2021 to ₹13,323cr as at March 31, 2023, representing a CAGR of 23.07%, and further increased to ₹13,977.27cr as at June 30, 2023, an increase of 4.91%. The CASA increased from ₹1,747.65cr as at March 31, 2021 to ₹3,137.45cr as at March 31, 2023, representing a CAGR of 33.99%, and decreased to ₹2,851.97cr 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.

### • Experienced Board and Key Management Personnel

ESAF SFB has an experienced Board comprising members with diverse business experience, many of whom have held senior positions in well-known financial services institutions. The members of the Senior Management Personnel have expertise in scaling up financial services organizations and collectively they have all the relevant experience in credit evaluation, risk management, treasury, and technology.



## Key Strategies

- Penetrate deeper into the existing geographies
- Increase the deposits and in particular the Retail Deposits
- 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
- Increase fee-based income by cross-selling, expanding third-party products and service offerings and expanding the feebased Offerings
- Continue to leverage technology and customer data analytics

## Industry Outlook

Small finance banks aim to service the underserved through savings instruments, and supplying credit to small business units, small and marginal farmers, micro and small industries, and other unorganized sector/lending through informal channels. The 12 small finance banks, including ESAF, cumulatively accounted for approximately 13% of the total AUM of the industry as of June 30, 2023. Small finance banks advances under management (AUM) clocked 29% CAGR from March 31, 2018 to June 30, 2023 and CRISIL MI&A expects this to increase by a CAGR of 22- 24% between June 30, 2023 and March 31, 2025. (Source: CRISIL MI&A Report).

## Promoter and promoter group

ESAF Financial Holdings Pvt Ltd and Kadambelil Paul Thomas are the Promoters of the Bank. Currently, promoters collectively hold 311,945,181 Equity Shares equivalent to 69.40% of the pre-Offer issued, subscribed and paid-up Equity Share capital of the Bank.

## Brief Biographies of directors

- **Ravimohan Periyakavil Ramakrishnan** is the Part-Time Chairman and Non-Executive Independent Director of the Bank. He was previously employed as a chief general manager in the department of banking supervision of the RBI. He was previously a resident advisor, financial sector supervision, International Monetary Fund, AFRITAC South, Mauritius.
- **Kadambelil Paul Thomas** is the Promoter, Managing Director and Chief Executive Officer of the Bank. He was previously the managing director of ESAF Financial Holdings Pvt. Ltd. He was also previously a director on the boards of Sanma Garments Pvt. Ltd., Rhema Dairy Products India Pvt. Ltd., Rhema Milk Producer Co. Ltd., Lahanti Homes and Infrastructure Pvt Ltd, ESAF Health Care Services Pvt Ltd, ESAF Swasraya Producers Co Ltd, CEDAR Retail Pvt Ltd, ESAF Enterprise Development Finance Ltd and CEDAR Livelihood Services Pvt Ltd (Formerly Cedar Agri Solutions Pvt Ltd).
- **Vinod Vijayalekshmi Vasudevan** is a Non-Executive Independent Director on the Board of the Bank. He is the group CEO of FLYTXT, Dubai and Amsterdam. He is currently on the board of directors of Flytxt Mobile Solutions International, Z3P Tech Fund and Z3P Global, Mauritius.
- **Ravi Venkatraman** is a Non-Executive Independent Director on the Board of the Bank. He was the former Executive Director and Chief Financial Officer of Mahindra and Mahindra Financial Services Ltd. He is currently on the board of directors of Bajaj Finserv Mutual Fund Trustee Ltd, Kotak Mahindra General Insurance Co Ltd, Avanse Financial Services Ltd, Kotak Mahindra Prime Ltd, Sarvagram Solutions Pvt Ltd, Aditya Birla AMC Ltd.
- **Kolasseril Chandramohan Ranjani** is a Non-Executive Independent Director on the Board of the Bank. She has held senior management positions with SIDBI, and has more than 21 years of experience in Micro, Small and Medium Enterprises in India.
- **Biju Varkkey** is an Additional Non-Executive Independent Director on the Board of the Bank. He was on the board of directors of Bank of Baroda.
- **John Samuel** is a Non-Executive Nominee Director on the Board of the Bank. He was previously a Member of the Postal Services Board and held the position of Chief Post Master General.
- **Ajayan Mangalath Gopalakrishnan Nair** is a Non-Executive Nominee Director on the Board of the Bank. He was previously employed as the Executive Vice President of the Bank. He is currently an additional director on the board of directors of EFHPL.
- **Gireesh C P** is the Chief Financial Officer of the Bank. He was previously the chief financial officer of South Indian Bank Ltd. He joined the Bank with effect from September 5, 2018.
- **Ranjith Raj P** is the Company Secretary and Compliance Officer of the Bank. He was previously employed as company secretary of EFHPL. He joined the Bank with effect from March 29, 2017.

## CONSOLIDATED FINANCIALS

### PROFIT & LOSS

Y.E March (Rs cr)	FY22	FY23	Q1FY24
Interest Income	1,940	2,854	899
Interest Expense	793	1017	313
<b>Net Interest Income</b>	<b>1,147</b>	<b>1,836</b>	<b>585</b>
% Change	24	60	-
Non-Interest Income	208	288	93
<b>Operating income</b>	<b>1,355</b>	<b>2,124</b>	<b>678</b>
Operating Expenses	863	1,231	378
Total Income	2,148	3,142	992
Total Expenditure	1,656	2,248	691
<b>Pre-Prov.Profit</b>	<b>492</b>	<b>894</b>	<b>301</b>
% Change	18	82	-
Provisions	418	541	127
<b>PBT</b>	<b>74</b>	<b>353</b>	<b>174</b>
Tax	19	51	44
Tax Rate %	26	14	25
<b>Reported PAT</b>	<b>55</b>	<b>302</b>	<b>130</b>
Adj.	-	-	-
<b>Adj. PAT</b>	<b>55</b>	<b>302</b>	<b>130</b>
% Change	-48	452	-
Post Issue No.of Shares (Cr.)	51.5	51.5	51.5
<b>Adj. EPS (Rs)</b>	<b>1.1</b>	<b>5.9</b>	<b>2.5</b>
% Change	-48	452	-

### BALANCE SHEET

Y.E March (Rs cr)	FY22	FY23	Q1FY24
<b>Liabilities</b>			
Capital	449.5	449.5	449.5
Reserve & Surplus	962.1	1,265.5	1,395.4
Deposit	1,2815	1,4666	1,5656
Borrowings	2,952.8	3,354.2	2,739.1
Provision & Other Liabilities	528.1	488.8	556.1
<b>Total Liabilities</b>	<b>17,708</b>	<b>20,224</b>	<b>20,796</b>
<b>Assets</b>			
Fixed Assets	159.5	187.9	187.3
Investments	4,070.3	4,888.5	4,882.1
Advances	11,637.0	13,924.3	14,321.6
Other Assets	328.9	4,55.8	518.2
Cash & Bank Balances	1,511.9	767	886.8
<b>Total Assets</b>	<b>17,708</b>	<b>20,224</b>	<b>20,796</b>

### RATIOS

Y.E March	FY22	FY23	Q1FY24
<b>AUM (Rs Cr.)</b>	12,341	16,331	17,204
Banking Outlets	575	700	700
<b>Per Share Data (Rs.)</b>			
EPS	1.1	5.9	2.5
BV	27.4	33.3	43.4*
<b>Spread %</b>			
NIM	7.6	9.7	2.9
Yield on Advances	17.4	19.8	5.81
Cost of Deposits	6.2	6.1	1.7
Cost of Funds	5.9	6.0	1.7
Cost to Income	63.7	57.9	56
<b>Capital %</b>			
CRAR %	18.6	19.8	20.6
Tier I	16.0	18.0	19.0
<b>Asset Quality %</b>			
GNPA	7.8	2.5	1.7
NNPA	3.9	1.1	0.8
PCR	59.4	56.7	74.0
<b>Return Ratios (%)</b>			
RoE	4.0	19.4	7.3
RoA	0.4	1.6	.6
<b>Valuations</b>			
P/E (x)	56	10	6*
P/BV (x)	2.2	1.8	1.4*

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