AXIS DIRECT

EQUITAS HOLDINGS

BANKS & FINANCIAL SERVICES

12 MAY 2017 Quarterly Update

BUY

Target Price: Rs 190

Q4 hurt by MFI business

Q4FY17 was subdued due to moderation in AUM growth, significant decline in margin and further deterioration in headline asset quality. Additionally, higher operating expenses (due to opening of liability branches) & accelerated provisions (for impaired MFI portfolio) led to much lower-than-expected PAT of Rs 69 mn (down 85% YoY).

The weak performance was largely due to stress in MFI business (46% of total AUM) whereas performance in other business segments remained healthy. Initial years of transition from regional MFI to pan-India SFB and hiccups in MFI business may keep return ratios suppressed in the near term. However, we maintain our constructive stance on the financial inclusion theme and any sharp reaction could provide entry opportunity into the small finance bank story.

CMP	: Rs 161
Potential Upside	: 18%

MARKET DATA

No. of Shares	: 338 mn
Free Float	: 100%
Market Cap	: Rs 54 bn
52-week High / Low	: Rs 206 / Rs 138
Avg. Daily vol. (6mth)	: 1.5 mn shares
Bloomberg Code	: EQUITAS IB Equity
Promoters Holding	: 0%
FII / DII	: 12% / 30%

Q4FY17 key highlights

Cautious on MFI business; guides for 15-18% YoY growth in advances

- AUM growth moderated sharply (17% YoY vs. 30% YoY in Q3 and 53% YoY in Q4FY16) to Rs 71.8 bn largely due to 32% YoY decline in disbursements. Among business segments, MFI business was the prime reason for such subdued performance in disbursements and AUM growth largely due to unfavorable market conditions.

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Maintain BUY with revised TP of Rs 190: We do not foresee any significant change in Equitas transition plans due to the MFI turmoil. Disbursements may moderate in MFI business, but will be well compensated by newer product lines. We prefer Equitas given its better risk management practices, diversified portfolioand superior management bandwidth. We cut earnings for FY18E and FY19E by 9%/3% to factor in potential write-offs and cautious growth and, value Equitas at 2.5x FY19E P/ABV to arrive at a TP of Rs 190 (18% upside from CMP).At CMP, Equitas trades at 2.3x/2.1x FY18/19E P/ABV of Rs 69/Rs 76 respectively.

Financial summary (Standalone)

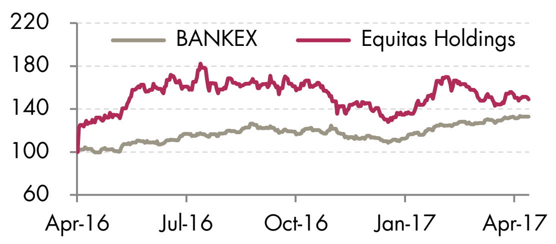
Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs mn)	1,671	1,594	2,103	2,860
EPS (Rs)	6	5	6	8
EPS chg (%)	56.3	(23.8)	32.0	36.0
Book value (Rs)	50	66	71	79
Adj. BV (Rs)	48	64	69	76
PE (x)	26.0	34.1	25.9	19.0
P/ABV (x)	3.3	2.5	2.3	2.1
RoE (%)	13.3	8.9	9.0	11.3
RoA (%)	3.0	2.0	2.1	2.4
Net NPA (%)	0.9	1.8	2.3	1.8

Source: Company, Axis Capital

Key drivers

(%)	Q2FY17	Q3FY17	Q4FY17
AUM growth	45	30	17
GNPA	2.5	2.5	3.5
NIM	10.0	10.5	9.8

Price performance



AXIS SECURITIES

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- MFI business witnessed a run-off of 7% QoQ (flat on YoY basis), while the key focus segments for growth– UCV and MSE – grew strong 28% YoY (3% QoQ) and 55% YoY (12% QoQ) respectively
- Consequently, the share of MFI business came down from 49% in Q3FY17 to 46% in Q4FY17; the management intends to bring it further down to less than 30% by FY18
- During Q4, Equitas launched 3 new asset products (business loans, agri loans and gold loans) and within a quarter all three products combined crossed Rs 1 bn of the book
- Management guided for a loan growth of 15-18% in FY18 with focus on UCV and MSE business segments

MFI business impacted asset quality; targets credit cost of 200 bps in FY18

- Overall headline asset quality deteriorated, with GNPL up by 42% QoQ to Rs 2.1 bn and ratio up by 107 bps QoQ to 3.5%
- Significant portion of deterioration again came from MFI segment, where GNPA in MFI business increased to 2.5% (up 223 bps QoQ) vs. 0.27% in Q3FY17
- Though not an NPA as per RBI norms, the management has identified stressed MFI portfolio of Rs 582 mn and made an accelerated provision of Rs 208 mn during the quarter (Rs 150 mn in Q3FY17)
- UCV and housing finance's asset quality also deteriorated but it was relatively much lower. GNPL in UCV increased 33 bps QoQ to 6.4%, while in housing finance it deteriorated 39 bps QoQ to 5.6%
- Management guided for a credit cost of ~200 bps in FY18 vs. 213 bps in FY17

Margin shrinks 70 bps QoQ; huge re-pricing of liabilities to prop FY18 margin

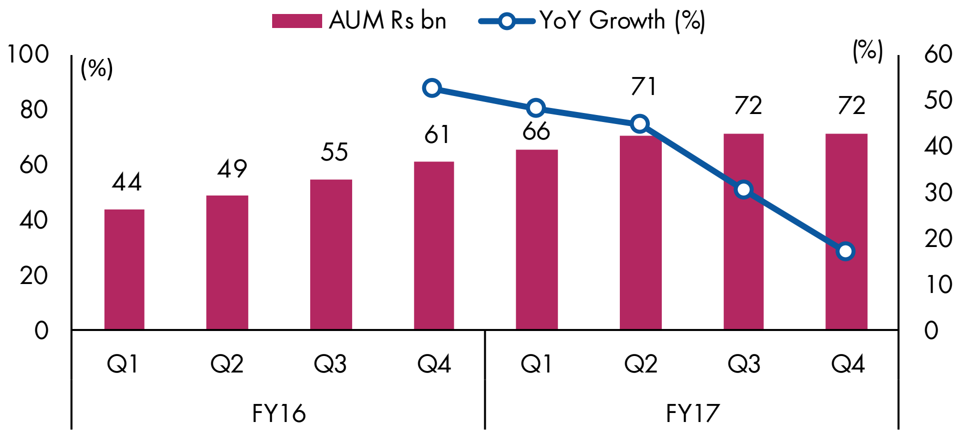
- In Q4, margin declined 70 bps QoQ to 9.8% primarily due to sharp decline in yields (90 bps QoQ to 20.2%) vs. cost of funds (40 bps QoQ to 9.7%)
- We believe the decline in yields was largely due to incremental growth in relatively low yielding segment and run-off in high yielding MFI business
- Given incremental disbursement in FY18 in relatively low yielding advances, we expect pressure on lending rates to continue
- However, a lot of high cost borrowings (50% of NCD, entire CPs etc.) are set to re-price in FY18 at a lower rate coupled with traction in low cost deposits; hence, the management expects margin to remain stable with some negative bias

Update on MFI portfolio

- Amongst the 20 most delinquent districts, Equitas MF lending is restricted to 7 districts namely Bangalore, Nagpur, Yavatmal, Amravati, Wardha, Akola and Sagar. For Equitas, Portfolio At Risk (PAR) for 0-90 days as % of portfolio is 3.2% vs. 12.9% for the industry (as per Equifax), while PAR for >90 days is at 2.7% vs. 8% for the industry

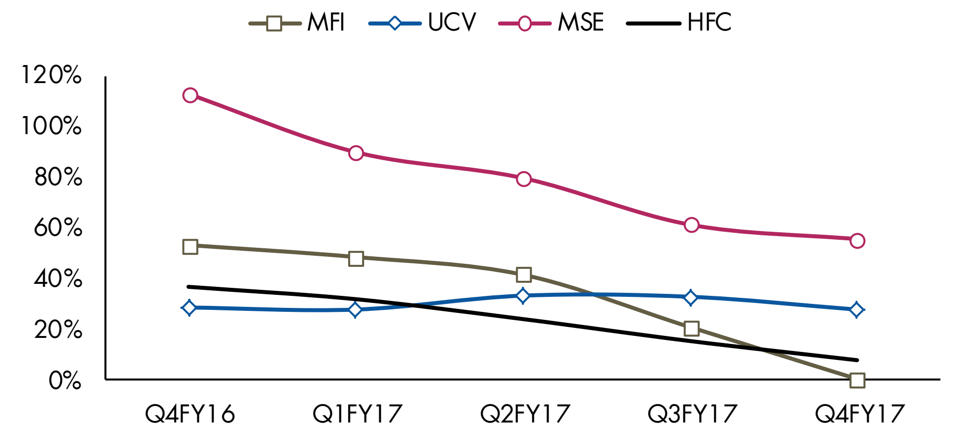
- Collections and billing efficiency trend: Despite strong macro headwinds, collections in Tamil Nadu remain resilient, with billing efficiency above 99%. Collections in affected region/geography remain subdued. Overall collection for any month has not improved to pre-demonetization level and remains at 95.4% in Q4FY17 vs. 98.4% in Q3FY17. Maharashtra is the most impacted region with lowest collection efficiency of 77.1%
- Out of the total count of recent defaulters (0.19 mn) in MFI segment, 24% of defaulters are 1 EMI due, while 22% of defaulters are 4+ EMI due

Exhibit 1: AUM growth slowed down primarily due to 7% QoQ run-off in MFI book



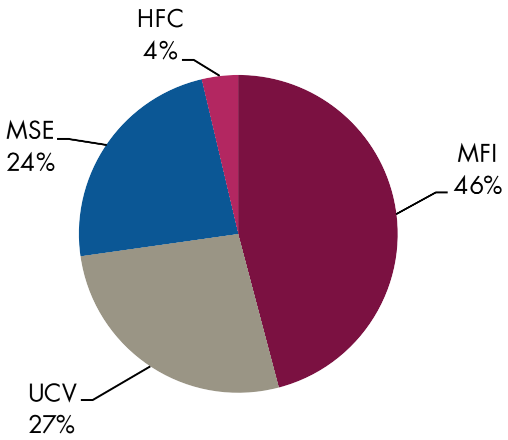
Source: Company, Axis Capital

Exhibit 2: YoY growth continued to fall across segments



Source: Company, Axis Capital

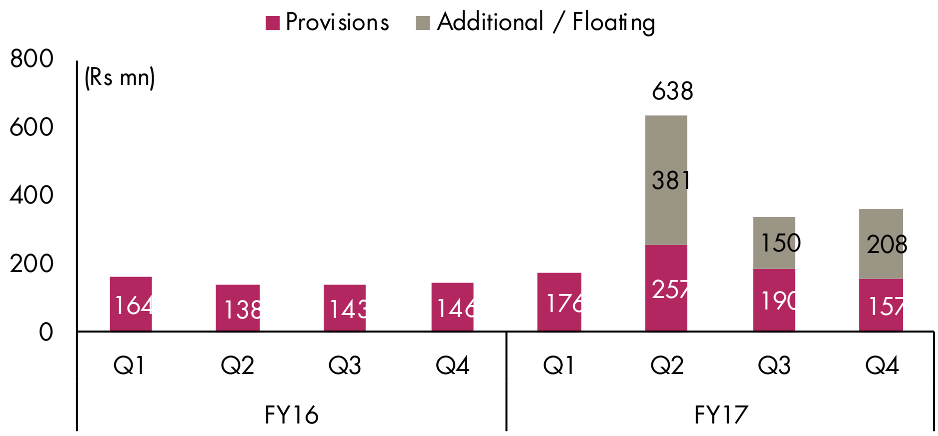
Exhibit 3: Loan book break-up: Share of MFI declined to 46% from 49% in Q3FY17



Source: Company, Axis Capital

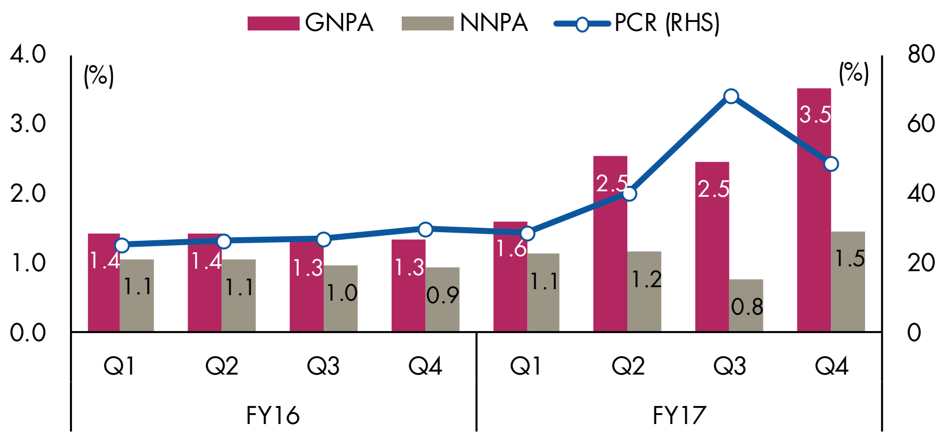
Management maintained its cautious approach on MFI segment and guided to bring share of MFI book down to less than 30% of total loan (46% in FY17) by FY18

Exhibit 4: Provisions moved up due to additional/floating provisions created



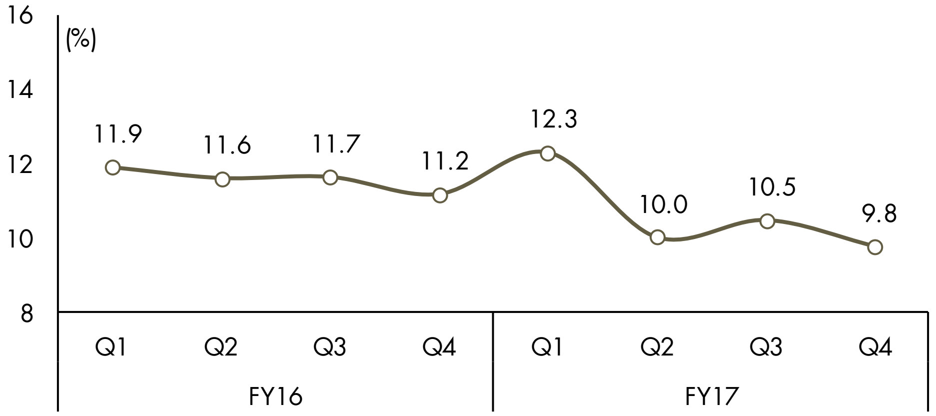
Source: Company, Axis Capital

Exhibit 5: Headline asset quality deteriorated QoQ



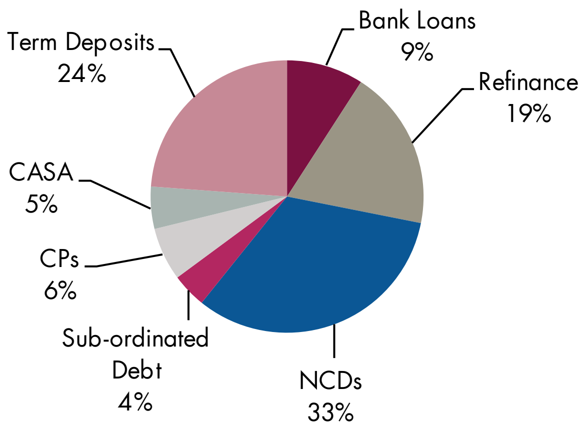
Source: Company, Axis Capital

Exhibit 6: NIM declined 70 bps QoQ due to pressure on yields



Source: Company, Axis Capital

Exhibit 7: Share of CASA and TD is now 28.8% of total borrowings



Source: Company, Axis Capital

Exhibit 8: Results update

	Quarter ended					12 months ended		
(Rs. mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg	Mar-18E	Mar-17	% Chg
Interest income	3,954	3,121	27	4,226	(6)	14,770	12,881	15
Interest expended	1,568	1,277	23	1,531	2	6,009	5,760	4
Net interest income	**2,385**	**1,844**	**29**	**2,694**	**(11)**	**8,761**	**7,121**	**23**
Non-interest income	34	81	(58)	15	133	3,391	2,684	26
Net income	**2,419**	**1,925**	**26**	**2,709**	**(11)**	**12,152**	**9,805**	**24**
Operating expenses	1,945	1,050	85	1,663	17	7,744	6,261	24
Operating profit	**475**	**875**	**(46)**	**1,045**	**(55)**	**4,408**	**3,545**	**24**
Provision & Contingencies	365	146	150	340	8	1,173	1,029	14
PBT	**110**	**729**	**(85)**	**706**	**(84)**	**3,235**	**2,516**	**29**
Tax	40	261	(85)	256	(84)	1,132	922	23
Net Profit	**69**	**468**	(85)	**449**	(85)	**2,103**	**1,594**	32
Exceptional Item	0	0	-	0	-	0	0	-
Reported Profit	**69**	**468**	**(85)**	**449**	**(85)**	**2,103**	**1,594**	**32**
Yields & Margins (%)								
Net interest margin	9.8	11.2	(140)bps	10.5	(70)bps	9.6	9.6	(5)bps
Cost to income	80.4	54.5	2,585 bps	61.4	1,898 bps	63.7	63.8	(13)bps
Asset quality								
Gross NPAs (Rs mn)	2,060	681	202	1,450	42	2,693	2,060	31
Gross NPAs (%)	3.5	1.3	219 bps	2.5	107 bps	3.9	3.5	37 bps
Net NPAs (Rs mn)	1,050	478	120	455	131	1,562	1,050	49
Net NPAs (%)	1.5	0.9	53 bps	0.8	70 bps	2.3	1.5	76 bps
Provisioning coverage (%)	49.0	29.9	1,918 bps	68.6	(1,959)bps	42.0	49.0	(703)bps
Balance sheet (Rs bn)								
AUM	71.8	61.3	17	71.8	(0.1)	84.3	71.8	17
Disbursements	10.4	15.2	(32)	11.7	(11.1)	66.9	51.4	30

Source: Company, Axis Capital Note: Ratios are on calculated basis, hence may differ from actuals

FY17 numbers are provisional as we await the annual report for granular details

Financial summary (Standalone)

Profit & loss (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	10,137	12,881	14,770	17,161
Interest expended	(4,360)	(5,760)	(6,009)	(6,741)
Net interest income	**5,777**	**7,121**	**8,761**	**10,420**
Non interest income	1,012	2,684	3,391	3,629
Net income	**6,789**	**9,805**	**12,152**	**14,049**
Operating expenses	**(3,597)**	**(6,261)**	**(7,744)**	**(7,875)**
Staff expenses	(2,338)	(3,961)	(5,117)	(5,345)
Other operating expenses	(1,259)	(2,300)	(2,627)	(2,531)
Operating profit	**3,192**	**3,545**	**4,408**	**6,174**
Provisions & contingencies	(591)	(1,029)	(1,173)	(1,775)
Pre-tax profit	**2,601**	**2,516**	**3,235**	**4,400**
Tax expense	(930)	(922)	(1,132)	(1,540)
Profit after tax	**1,671**	**1,594**	**2,103**	**2,860**
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	**1,671**	**1,594**	**2,103**	**2,860**

Balance sheet (Rs mn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	**65,065**	**94,435**	**106,946**	**134,764**
Cash & Balances with RBI	9,470	10,642	6,044	6,990
Investments	121	18,959	20,282	24,656
Advances	50,702	58,289	69,003	90,398
Fixed assets	589	3,247	3,702	4,033
Other assets	3,775	2,824	7,328	8,012
Total liabilities	**65,065**	**94,435**	**106,946**	**134,764**
Equity capital	2,699	3,378	3,378	3,378
Reserves & surplus	10,714	18,931	20,811	23,266
Networth	13,414	22,309	24,189	26,644
Borrowings	46,833	46,585	26,805	20,883
Deposits	-	18,844	48,746	78,974
Other liabilities & prov.	4,819	6,698	7,207	8,263

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	6	5	6	8
BV (Rs.)	50	66	71	79
Adj. BV (Rs.)	48	64	69	76
DPS (Rs.)	-	-	1	1
Dividend payout (%)	-	-	10	14
Yields & Margins (%)				
Yield on advances	21.8	22.2	20.8	19.4
Cost of deposit	-	-	7.1	6.9
Net interest margin	11.3	9.6	9.6	9.6
Asset quality (%)				
Gross NPAs	1.3	3.5	3.9	3.3
Net NPAs	0.9	1.8	2.3	1.8
Credit cost	0.3	1.0	1.2	1.4
Provisioning coverage	29.9	49.0	42.0	46.0
Efficiency (%)				
ROA	3.0	2.0	2.1	2.4
ROE	13.3	8.9	9.0	11.3
Cost to income	53	64	64	56
CASA	-	17	20	21
Effective tax rate	36	37	35	35
Growth (%)				
Net interest income	47	23	23	19
Fee income	44	52	30	20
Operating expenses	45	74	24	2
Profit after tax	57	(5)	32	36
Advances	46	15	18	31
Deposits	-	-	159	62
Total assets	46	45	13	26

Source: Company, Axis Capital

Note: Ratios are on calculated basis, hence may differ from actuals

FY17 numbers are provisional as we await the annual report for granular details

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