

MFI stress nearing peak; estimate RoA to recover sharply over FY27-28

Pivoting towards a more secure business model

We interacted with the top management team of Equitas Small Finance Bank (Equitas SFB), represented by Mr. P.N. Vasudevan, to discuss the bank's business growth, profitability outlook, and other key focus areas. Following are the key takeaways from the discussion:

Pivoting towards secured growth, along with MFI stabilization

Equitas SFB has faced elevated stress in the MFI portfolio over the past few quarters but expects the CE trend to improve from 2H onwards, enabling improved asset quality performance. The bank's exposure to the MFI segment has moderated to ~10% of the loan book vs ~19% in FY22. Management has indicated plans for a further moderation in the MFI mix over the coming years. The bank has made a firm strategic shift toward secured lending, which forms ~90% of the portfolio. This shift is led by segments like SBL, VF, and Housing. SBL has become the most crucial lending segment, comprising ~45% of loans (vs 36% two years ago), while micro-LAP continues to gain traction despite challenges in certain regions. Used vehicle finance remains a strong contributor (up 32% YoY), with new disbursements in this segment forming 33% of total disbursements and 95% of VF disbursements. These businesses not only diversify the loan book but also provide attractive yields with contained risk. Management expects overall loan growth of ~14-15% in FY26, led by over 20% growth in secured products. For FY27, loan growth is expected to rebound to 18%.

Equitas Small Finance Bank



Mr. P.N. Vasudevan, MD & CEO

Mr. P.N. Vasudevan is the founder of Equitas SFB. He brings over three decades of experience in financial services, including over 18 years of leadership at the bank. He began his career with Cholamandalam Finance, where he spent two decades in senior roles, and later worked with DCB. He went on to lead Equitas Holdings before founding Equitas Finance, which he successfully transformed into a Small Finance Bank. A science graduate and a qualified Company Secretary, he has been instrumental in shaping the vision and growth of Equitas SFB.

Deposits likely to grow at a healthy pace; funding cost to ease

Deposits grew at a steady pace of ~19% YoY in FY25. However, elevated TD rates have resulted in a sharp decline in the bank's CASA mix over the years, which has declined to 29%. Management acknowledges that maintaining a high CASA ratio is a challenge, not only for the bank but for the industry as well. The bank is consciously reducing bulk deposits, while the retail deposit flow remains comfortable, supported by deeper cross-sell initiatives. On the cost side, the bank is steadily repricing liabilities. The SA cost has declined from ~6.1% to ~5.6%, and with another reduction scheduled in October, management expects to lower the overall CoF by ~20bp. The bank's retail TDs have a duration of ~1.2 years and will be repriced gradually. Meanwhile, its wholesale deposits, which make up ~20% of the book, are being repriced at lower rates.

NIMs to bottom out in 2Q, with 3Q and 4Q witnessing calibrated improvements

Management expects margins to see a further decline in 2Q, primarily driven by a lower MFI share and the residual repricing of the loan book. However, the cost of funds is trending lower due to a successive reduction in SA and bulk deposit rates, which should partially offset pressure on spreads. With a majority of the bank's loans on a fixed rate, the loan yield repricing will be gradual. This will enable recovery in margins over 3Q and 4Q, as funding costs ease further and the disbursement mix improves toward higher-yielding secured loans. This trajectory ensures that while near-term margins may face headwinds, the underlying earnings potential remains intact, which will reflect in improved profitability in FY27. C/I ratio, which spiked close to 70%, may remain elevated at ~72% in FY26, but is guided to drift lower towards ~65% over two years as growth revives and operating leverage in the business improves.

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Asset quality stress peaking; SBL and Vehicle portfolios witnessing steady trends

Asset quality stress appears to have peaked after a period of elevated stress, with GNPs at ~2.8% and NNPs just below 1%, while PCR remains at ~67%. The bank has tightened underwriting and prudently reduced riskier exposures, including new CVs and smaller LAP loans, while continuing to deepen focus on secured SME, Housing, and Used Vehicle financing. MFI stress is moderating, aided by calibrated disbursements, underwriting that follows new guardrails, and family-loan linkages that limit over-leveraging. Non-MFI slippages, which had spiked in regions such as Karnataka, are also showing early signs of recovery, with many accounts witnessing normalization. Collection efficiency has improved for July and August; this trend is likely to continue in Sep'25. Management expects 2Q to reflect lower credit costs, with further normalization in MFI by 3Q-4Q. On a full-year basis, we expect GNPA and NNPA to moderate further to ~2.7% and ~0.7% by FY26 and 1.9%/0.5% by FY27, signaling a cleaner balance sheet and enabling improved profitability in the medium term.

Provisioning reset – Positioning for sustainable profitability

Equitas SFB has consciously frontloaded provisions to strengthen the balance sheet amid ongoing MFI stress. The bank has created ~INR1.85b of standard provisions on logical guardrails, covering higher-risk borrowers, of which a part has already reversed as accounts normalized. Management expects credit cost to ease meaningfully in 2H, with MFI credit cost settling at ~4-5% by 4Q and the overall book normalizing closer to ~2%, of which only ~0.5% will stem from MFI. FY26 marks the transition from elevated provisioning to stability, with credit costs expected to ease in FY27, amid easing stress in MFI. While near-term profitability may remain suppressed, medium-term earnings are likely to remain healthy, supported by a sharper tilt towards secured products and healthier liability management. The bank targets an RoA recovery of ~1% for FY27E, which is expected to expand further to ~1.4% by FY28E.

Universal Banking License – A key opportunity ahead!

Equitas SFB plans to apply for a Universal Banking License by Mar'26. The bank has absorbed near-term pain by frontloading provisions, ensuring its asset quality meets the stringent requirements for eligibility. Removing the 'SFB' tag will enable the bank to narrow the 100-125bp cost-of-funds gap vs large private banks, enhance depositor trust, and elevate franchise credibility. The bank plans to apply for the Universal Banking License after FY26 and looks forward to the transition. (AU applied for Universal Banking License in Sep'24 and received approval in Aug'25, i.e. 11 months).

Other highlights

- Equitas SFB is focusing on scaling up its gold portfolio, which currently stands at ~INR3.5b. The bank aims to grow this portfolio exponentially over the next two years by making the product available across more branches. The yields on this product are healthy at ~16-17%.
- The bank has automated the ECL model and does not expect any significant difference in provisions between ECL and the current provisioning model.

Valuation and view: Reiterate BUY with a TP of INR70

- After a strong FY23 and a reported RoA of ~2% in FY24, Equitas SFB has faced significant challenges related to asset quality and earnings, leading to a notable dip in profitability in recent years.
- We believe that FY26 will be another reset year for Equitas SFB, driven by the frontloading of provisions, reduction in the MFI portfolio to decrease business cyclical, and benefits from liability repricing expected from 2H onwards.
- By diversifying into secured lending, investing in technology, and maintaining a controlled MFI mix, Equitas SFB is creating a stronger, more resilient bank. The Universal Banking License remains a significant opportunity, enabling the bank to reduce funding cost gaps, boost depositor trust, and help re-rate the franchise among investors.
- **With loan growth guided at 15-16%, credit costs normalizing at 1.25%, and cost of funds expected to drop 80-90bp, we estimate RoA to recover to 1%/1.4% over FY27-28, respectively. We reiterate our BUY rating with a TP of INR70 (premised on 1.3x FY27E BV).**

STORY IN CHARTS

Exhibit 1: Estimate healthy ~17% loan CAGR over FY25-28

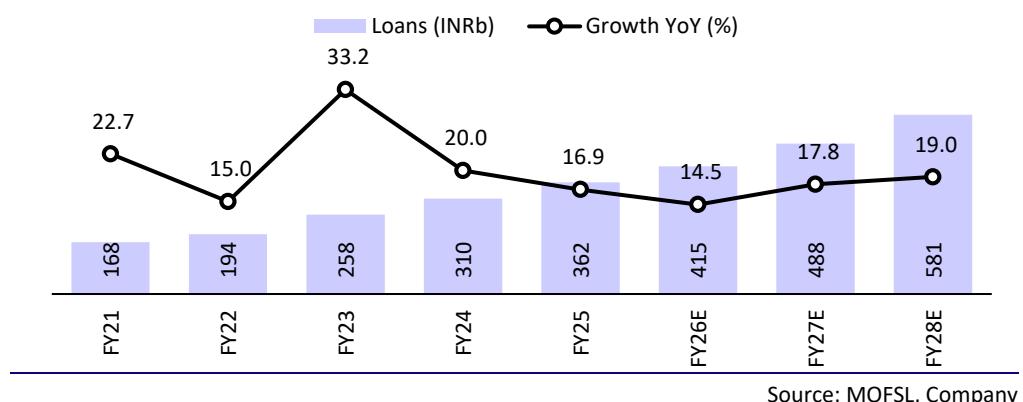


Exhibit 2: MFI loans growth has declined sharply

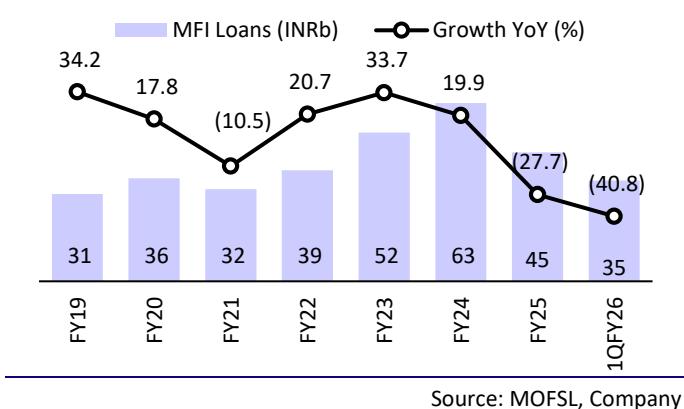


Exhibit 3: MFI mix has declined to 9% (19% in 2QFY24)

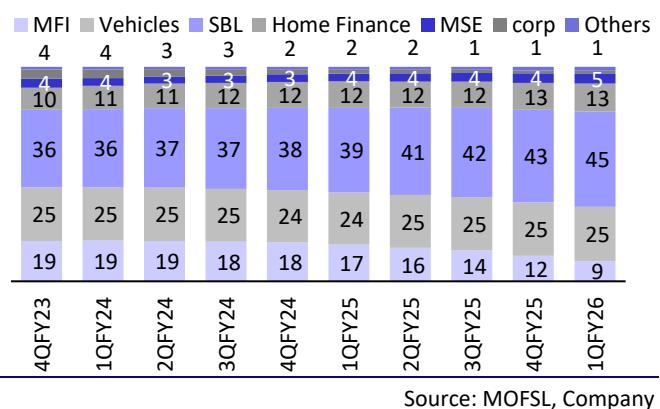


Exhibit 4: SBL continues to grow at healthy pace

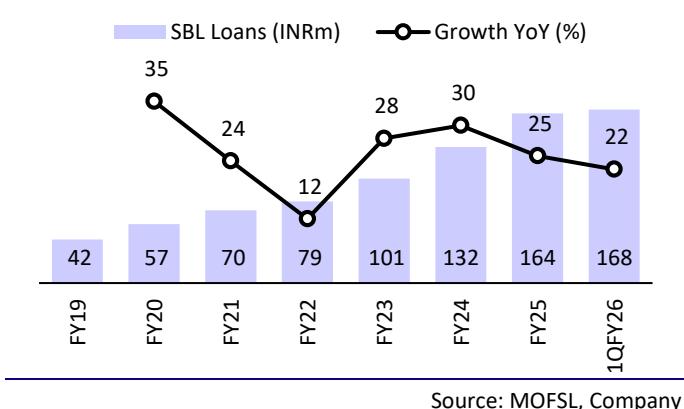


Exhibit 5: Vehicle loan book growth has moderated slightly

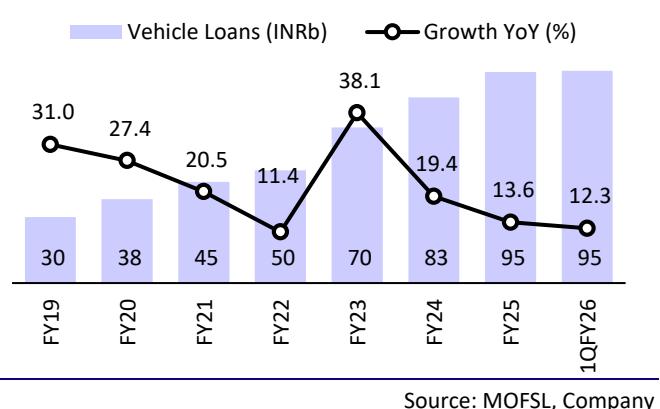
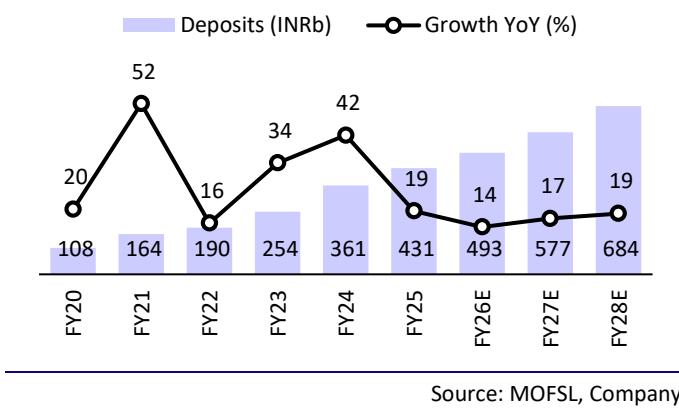
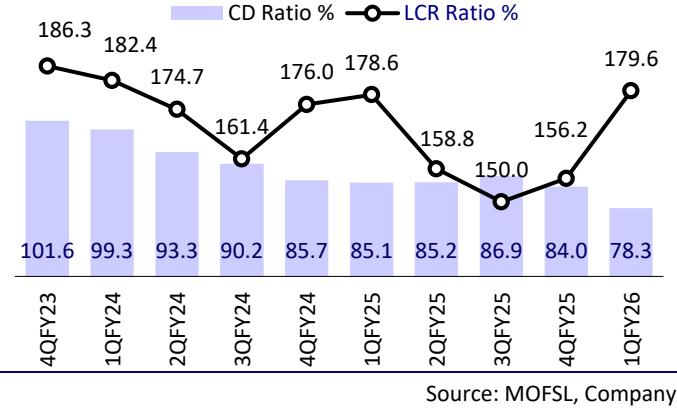


Exhibit 6: Deposits are expected to grow at ~17% CAGR



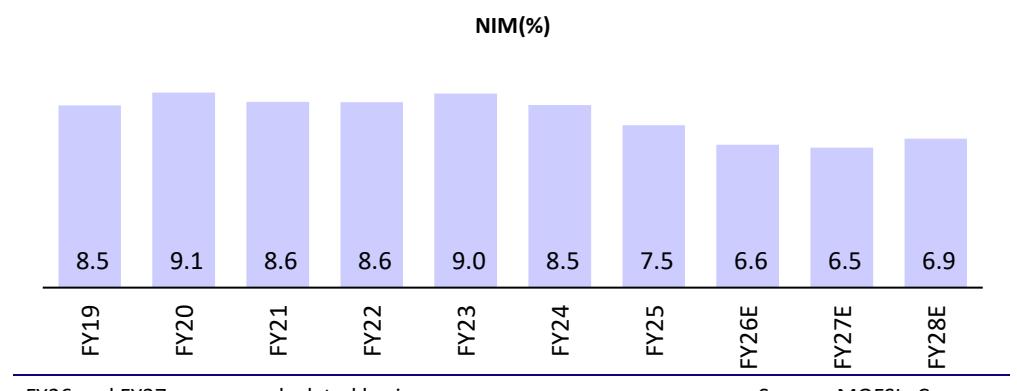
Source: MOFSL, Company

Exhibit 7: CD ratio has eased to 78% amid growth challenges



Source: MOFSL, Company

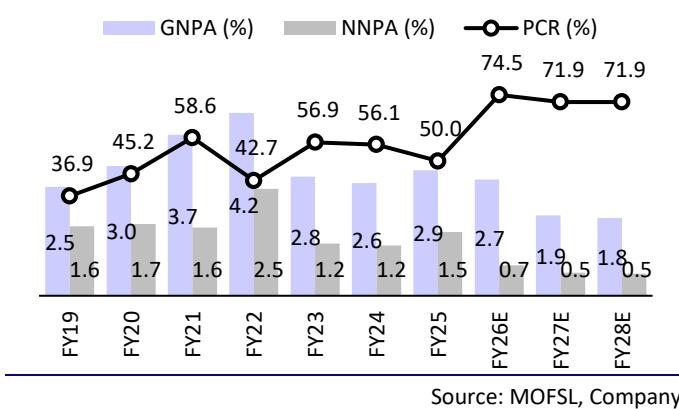
Exhibit 8: Estimate NIMs to contract over FY26 and FY27



FY26 and FY27 are on a calculated basis

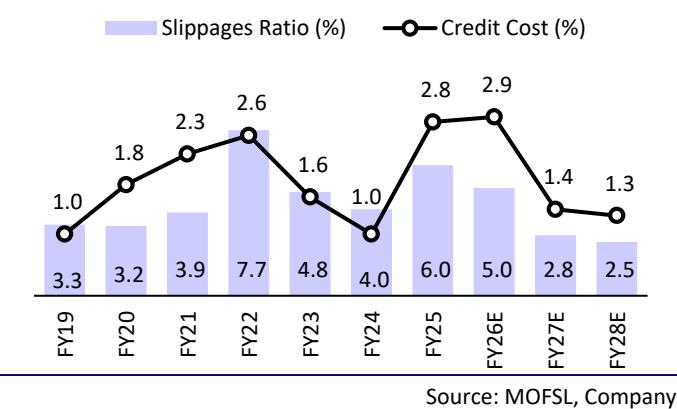
Source: MOFSL, Company

Exhibit 9: Estimate GNPA/NNPA ratios at 1.8%/0.5% by FY28



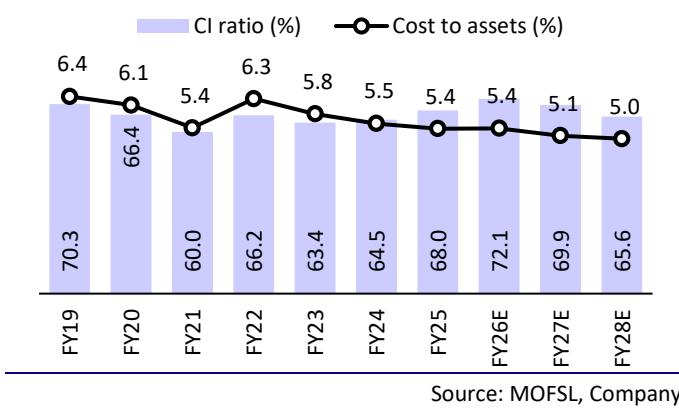
Source: MOFSL, Company

Exhibit 10: Est. credit costs to moderate sharply in FY27



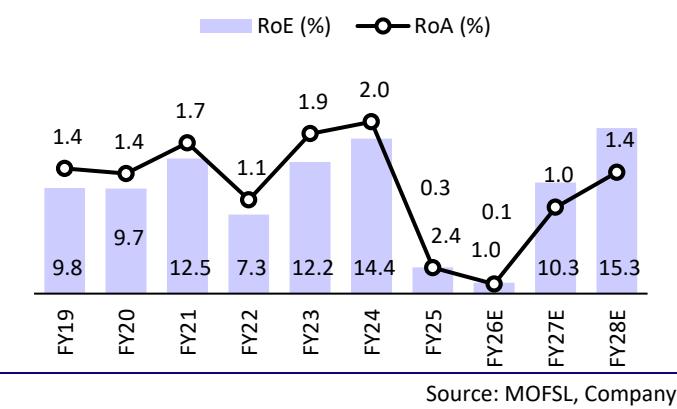
Source: MOFSL, Company

Exhibit 11: Estimate C/I ratio to moderate to ~64% by FY28



Source: MOFSL, Company

Exhibit 12: Estimate RoA to recover to 1.4% by FY28



Source: MOFSL, Company

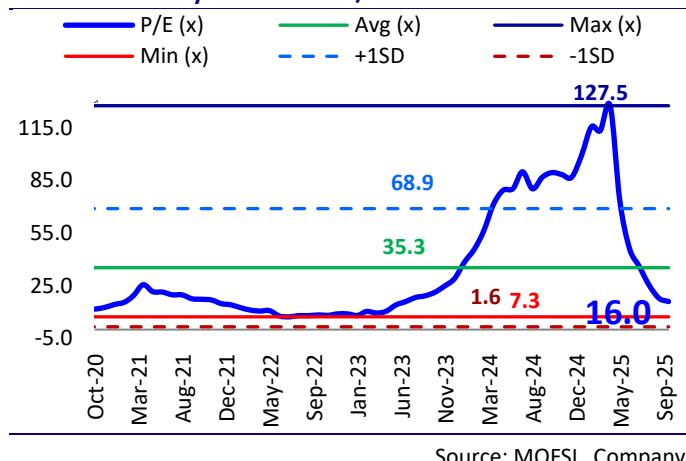
Exhibit 13: DuPont analysis

	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income	13.4	13.4	13.7	12.9	12.4	12.3	12.3
Interest Expense	5.5	5.2	6.0	6.2	6.5	6.4	6.0
Net Interest Income	7.89	8.22	7.67	6.63	5.90	5.91	6.34
Fee income	1.92	2.09	1.73	1.56	1.85	1.88	1.89
Trading and others	0.17	0.07	0.26	0.29	0.10	0.09	0.08
Other Income	2.08	2.16	1.99	1.86	1.95	1.97	1.96
Total Income	9.97	10.38	9.66	8.48	7.85	7.88	8.30
Operating Expenses	6.60	6.58	6.23	5.76	5.66	5.51	5.44
Employees	3.48	3.54	3.41	3.30	3.27	3.21	3.14
Others	3.12	3.04	2.82	2.46	2.39	2.30	2.30
Operating Profits	3.38	3.80	3.43	2.72	2.19	2.37	2.85
Core operating Profits	3.21	3.73	3.17	2.42	2.09	2.28	2.78
Provisions	1.91	1.32	0.75	2.23	2.05	1.03	0.98
PBT	1.46	2.48	2.68	0.49	0.14	1.33	1.88
Tax	0.38	0.63	0.69	0.19	0.03	0.34	0.47
RoA	1.09	1.85	1.99	0.30	0.11	1.00	1.41
Leverage (x)	6.8	6.6	7.2	8.2	9.3	10.3	10.9
RoE	7.3	12.2	14.4	2.4	1.0	10.3	15.3

Exhibit 14: One-year forward P/B ratio



Exhibit 15: One-year forward P/E ratio



Financials and valuations

Income Statement		(INRb)						
Y/E March		FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income		34.6	41.6	54.9	63.1	69.6	78.9	92.4
Interest Expense		14.2	16.2	24.1	30.6	36.5	41.0	44.8
Net Interest Income		20.4	25.4	30.8	32.5	33.0	37.8	47.5
-growth (%)		13.4	24.8	21.0	5.6	1.6	14.5	25.7
Non Interest Income		5.4	6.7	8.0	9.1	10.9	12.6	14.7
Total Income		25.8	32.1	38.8	41.6	44.0	50.4	62.3
-growth (%)		16.2	24.8	20.7	7.3	5.6	14.6	23.5
Operating Expenses		17.0	20.4	25.0	28.3	31.7	35.3	40.8
Pre Provision Profits		8.7	11.8	13.8	13.3	12.3	15.2	21.4
-growth (%)		-1.7	34.9	17.1	-3.1	-8.2	23.7	41.3
Core PPoP		8.3	11.5	12.7	11.9	11.7	14.6	20.8
-growth (%)		-1.5	39.2	10.3	-6.6	-1.8	24.8	42.9
Provisions		4.9	4.1	3.0	10.9	11.5	6.6	7.3
PBT		3.8	7.7	10.8	2.4	0.8	8.5	14.1
Tax		1.0	2.0	2.8	0.9	0.2	2.1	3.5
Tax Rate (%)		25.8	25.4	25.7	38.7	21.0	25.2	25.2
PAT		2.8	5.7	8.0	1.5	0.6	6.4	10.5
-growth (%)		-26.9	104.3	39.3	-81.6	-58.0	934.5	65.0

Balance Sheet								
Y/E March		FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Equity Share Capital		12.5	11.1	11.3	11.4	11.4	11.4	11.4
Reserves & Surplus		29.9	40.5	48.3	49.3	48.2	52.9	61.7
Net Worth		42.5	51.6	59.7	60.7	59.6	64.3	73.1
Deposits		189.5	253.8	361.3	431.1	493.1	577.0	683.7
-growth (%)		15.6	33.9	42.3	19.3	14.4	17.0	18.5
-CASA Dep		98.6	107.3	115.5	124.1	145.0	179.4	212.6
-growth (%)		75.6	8.9	7.6	7.4	16.8	23.8	18.5
Borrowings		26.2	29.7	17.9	21.4	22.4	27.6	33.9
Other Liabilities & Prov.		11.4	14.5	14.2	15.2	16.6	19.0	21.9
Total Liabilities		269.5	349.6	453.0	528.4	591.8	687.9	812.7
Current Assets		21.3	12.4	35.8	55.4	49.0	48.4	52.4
Investments		44.5	66.6	90.7	92.9	108.7	128.2	151.3
-growth (%)		20.1	49.8	36.0	2.5	17.0	18.0	18.0
Loans		193.7	258.0	309.6	362.1	414.6	488.4	581.2
-growth (%)		15.0	33.2	20.0	16.9	14.5	17.8	19.0
Fixed Assets		2.0	3.8	6.0	7.0	7.7	9.0	10.6
Other Assets		7.9	8.7	10.9	11.1	11.8	13.9	17.2
Total Assets		269.5	349.6	453.0	528.4	591.8	687.9	812.7
Total AUM		206.0	278.6	343.4	379.9	434.9	512.4	609.7
-growth (%)		14.9	35.3	23.2	10.6	14.5	17.8	19.0

Asset Quality		FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
GNPA (INR m)		8.4	7.2	8.2	10.7	11.4	9.2	10.6
NNPA (INR m)		4.8	3.1	3.6	5.3	2.9	2.6	3.0
Slippage (INR m)		13.9	10.9	11.4	20.3	19.4	12.6	13.4
GNPA Ratio		4.24	2.76	2.61	2.91	2.70	1.86	1.80
NNPA Ratio		2.47	1.21	1.17	1.48	0.70	0.53	0.51
Slippage Ratio		7.67	4.81	4.01	6.05	5.00	2.80	2.50
Credit Cost		2.19	1.43	0.90	2.82	2.90	1.40	1.30
PCR (Excl Tech. write off)		42.7	56.9	56.1	50.0	74.5	71.9	71.9

Financials and valuations

Ratios

Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Yield and Cost Ratio (%)							
Avg. Yield- on Earning Assets	14.6	14.8	15.1	14.6	14.0	13.6	13.4
Avg. Yield on loans	17.3	16.7	17.3	16.6	15.5	15.2	15.1
Avg. Yield on Investments	6.1	5.7	6.9	7.1	6.8	6.7	6.7
Avg. Cost of Int. Bear. Liab.	6.7	6.5	7.3	7.4	7.5	7.3	6.8
Avg. Cost of Deposits	6.4	6.1	7.0	7.3	7.4	7.2	6.6
Interest Spread	7.9	8.3	7.8	7.3	6.4	6.2	6.7
NIM (on IEA)	8.6	9.0	8.5	7.5	6.6	6.5	6.9
Capitalisation Ratios (%)							
CAR	25.2	23.8	21.7	20.6	19.4	18.1	17.6
<i>Tier I</i>	24.5	23.1	20.7	17.8	15.5	14.5	14.4
<i>CET 1</i>	24.5	23.1	20.7	17.8	16.0	15.6	15.6
<i>Tier II</i>	0.6	0.7	1.0	2.8	3.9	3.5	3.2
Business Ratios (%)							
Loans/Deposit Ratio	102.2	101.6	85.7	84.0	84.1	84.6	85.0
CASA Ratio	52.0	42.3	32.0	28.8	29.4	31.1	31.1
Cost/Assets	6.3	5.8	5.5	5.4	5.4	5.1	5.0
Cost/Total Income	66.2	63.4	64.5	68.0	72.1	69.9	65.6
Cost/Core income	-4.3	-11.2	-2.5	-2.0	-6.1	-6.8	-8.1
Int. Expense/Int.Income	41.1	38.9	43.9	48.5	52.5	52.0	48.5
Fee Income/Total Income	19.2	20.2	17.9	18.4	23.6	23.8	22.7
Other Inc./Total Income	20.9	20.8	20.6	21.9	24.9	24.9	23.6
Empl. Cost/Total Expense	52.7	53.8	54.7	57.3	57.7	58.2	57.8
Efficiency Ratios (INRm)							
Employee per branch (in nos)	20.4	22.3	23.7	25.6	27.5	29.6	31.9
Staff cost per employee	0.5	0.5	0.6	0.6	0.6	0.6	0.6
CASA per branch	114.5	116.4	119.8	124.9	138.9	163.7	184.8
Deposits per branch	220.1	275.3	374.8	433.7	472.5	526.5	594.2
Business per Employee (INR m)	21.8	24.9	29.4	31.2	31.6	32.8	34.5
Profit per Employee (INR m)	0.2	0.3	0.3	0.1	0.0	0.2	0.3

Profitability Ratios and Valuation

RoA	1.1	1.9	2.0	0.3	0.1	1.0	1.4
RoE	7.3	12.2	14.4	2.4	1.0	10.3	15.3
Book Value (INR)	34	46	53	53	52	56	64
-growth (%)	13.8	36.9	13.2	1.3	-1.8	7.8	13.7
Price-BV (x)	1.7	1.2	1.1	1.1	1.1	1.0	0.9
Adjusted BV (INR)	31	44	50	50	51	55	62
Price-ABV (x)	1.8	1.3	1.1	1.1	1.1	1.0	0.9
EPS (INR)	2.3	4.9	7.1	1.3	0.5	5.6	9.2
-growth (%)	-33.0	106.8	46.6	-81.8	-58.1	934.5	65.0
Price-Earnings (x)	24.3	11.7	8.0	44.1	105.2	10.2	6.2

E: MOFSL Estimates

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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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