Equitas Small Finance Bank Ltd. – Investment BUY Call

Dear Bajaj Capital Investors,

New Stock Recommendations for BUY on 16 July 2026

CMP -> 77
Buying Range -> 77 to 79
Upside Potential-> 12%
Investment Horizon -> 6 Months
Target price -> 86

1. Investment Summary & BUY Recommendation

We recommend a BUY on Equitas Small Finance Bank Ltd. for a medium-term investment horizon of 6 months, supported by improving earnings quality, strengthening asset quality, healthy balance sheet growth and multiple growth levers across its secured retail lending franchise. The bank has successfully navigated the microfinance stress cycle and is entering a new growth phase with improving profitability, expanding net interest margins (NIMs) and declining credit costs. Management has guided for 20–25% advances growth in FY27, after delivering nearly 19% YoY growth in FY26, while targeting an exit RoA of around 1.5%, compared with ~ 1.46% achieved in Q4FY26. The growth strategy is increasingly focused on secured lending businesses including Small Business Loans (SBL), Affordable Housing Finance, Vehicle Finance and Gold Loans, reducing dependence on the legacy Microfinance portfolio. Simultaneously, improving operating leverage, falling funding costs, higher cross-selling, branch expansion and digital initiatives are expected to support earnings growth over the next 2–4 quarters. Considering the improving business fundamentals, strong management execution and multiple sectoral tailwinds, we believe the bank is well positioned to deliver superior earnings growth and shareholder value over the medium term.

2. Business Overview, Business Segments & Business Transformation

Equitas Small Finance Bank is a diversified retail-focused lender catering primarily to India's underbanked population, including micro-entrepreneurs, self-employed individuals, first-time borrowers, transport operators and small businesses. The bank has transformed itself from a microfinance institution into a well-diversified retail bank with multiple secured lending businesses. Its largest business segment is Small Business Loans (around 40% of advances), where loans are secured against residential property and extended to micro and small entrepreneurs based on field-level cash flow assessment rather than conventional income documentation. The bank also operates across Vehicle Finance, Affordable Housing Finance, Microfinance, Gold Loans, Micro & Small Enterprise (MSE) Finance, NBFC Lending and a growing third-party distribution business comprising insurance, mutual funds and wealth products.

The business transformation over the last few years has focused on gradually reducing dependence on unsecured Microfinance while increasing the share of secured and higher-quality retail assets. Microfinance now serves primarily as a customer acquisition funnel, with successful borrowers graduating into secured lending products such as Small Business Loans and Housing Finance. The bank's diversified product portfolio enables deeper customer relationships, higher cross-selling opportunities and improved customer lifetime value, thereby strengthening franchise quality and improving long-term profitability.

3. Products, End-Use Industries & Growth Drivers Across Business Segments

Equitas operates across multiple lending businesses that cater to different sectors of the economy, creating a diversified and resilient earnings profile. Small Business Loans finance working capital and business expansion requirements of micro-enterprises, traders, retailers, manufacturers and service businesses. Affordable Housing Finance provides home construction, home purchase and LAP solutions to self-employed families across Tier-II to Tier-5 towns, benefiting from increasing housing demand and government housing initiatives. Vehicle Finance primarily focuses on financing used CV and used PV, supporting logistics, transportation, infrastructure, construction and rural mobility sectors.

Gold Loans have emerged as one of the fastest-growing business segments, offering a capital-efficient and high-yield lending opportunity through loans against household gold jewellery. Beyond lending, the bank continues to strengthen its liability franchise through retail deposits, NRI banking, wealth management, insurance distribution, mutual fund distribution and digital banking services. The overall business therefore benefits from structural growth across MSMEs, affordable housing, logistics, transportation, financial inclusion, rural consumption and formalisation of India's credit ecosystem. This diversified operating model reduces concentration risk while creating multiple independent earnings engines capable of supporting sustainable long-term growth.

4. Q4FY26 & FY26 Financial Performance, Balance Sheet & Funding Strength

Equitas delivered a significant improvement in operating performance during Q4FY26, reflecting the successful execution of its strategic priorities despite a challenging environment for the microfinance industry. Advances grew ~ 19% YoY during FY26, exceeding the management's earlier guidance of around 15%, while profitability recovered meaningfully due to lower credit costs, improving collection efficiencies and better portfolio mix. Management highlighted that the bank achieved an exit RoA of ~1.46% during Q4FY26, already surpassing its earlier 1% target and expects to improve further towards 1.5% by FY27 exit.

The balance sheet remains healthy, with advances increasing to INR 44,080 crore and total deposits rising to nearly INR 46,533 crore, supported by a granular retail liability franchise. Retail deposits continue to account for a majority of total deposits, providing stable funding for future loan growth. Management has also undertaken significant deposit repricing initiatives, resulting in the cost of funds declining from 7.54% in Q4FY25 to 6.94% in Q4FY26. Around 60% of the term deposit book has already been repriced, while another sizeable portion will be repriced over the coming quarters, creating a meaningful tailwind for NIM expansion. Combined with healthy capitalisation, improving funding profile and disciplined balance sheet management, the bank remains well positioned to support its guided 20–25% advances growth in FY27 while delivering stronger profitability.

5. Detailed Growth Catalysts & FY27 Management Guidance

The management has outlined a strong growth roadmap for FY27, supported by improving profitability, normalising asset quality and expansion across multiple secured lending businesses. After delivering nearly 19% YoY advances growth in FY26, significantly ahead of its earlier guidance of around 15%, the bank has guided for 20–25% advances growth in FY27, reflecting confidence in both demand and execution capabilities. Importantly, the bank has already achieved an exit RoA of ~ 1.46% in Q4FY26, exceeding its earlier target and now expects to improve this further to around 1.5% by FY27 exit, demonstrating that incremental growth is expected to be accompanied by higher profitability rather than coming at the expense of margins. Growth over the next 2–4 quarters is expected to be driven by Small Business Loans, Affordable Housing Finance, Gold Loans, Vehicle Finance and Microfinance normalisation, while the continued expansion of the retail deposit franchise will support sustainable balance sheet growth. Management also expects improving operating efficiency, lower funding costs and disciplined underwriting to further strengthen earnings quality over the medium term.

A key strategic milestone remains the proposed Universal Bank licence, with management indicating that the bank expects to satisfy the required RBI eligibility criteria. A successful transition to a Universal Bank structure would provide greater operational flexibility, remove regulatory constraints associated with the Small Finance Bank model and support sustainable advances growth of over 20% with a steady-state RoA of around 1.5%.

6. Operating Leverage, Margin Expansion & High-Margin Growth Opportunities

One of the strongest earnings catalysts over the coming quarters is the significant improvement in the bank's funding profile. The cost of funds declined sharply from 7.54% in Q4FY25 to 6.94% in Q4FY26, primarily due to deposit repricing, optimisation of the liability mix and lower savings deposit rates. Around 60% of the term-deposit portfolio has already been repriced, while another meaningful portion will be repriced over the next 2–3 quarters, providing a structural tailwind for further Net Interest Margin (NIM) expansion. Consequently, NIM improved to 7.29% in Q4FY26 from 6.72% in Q3FY26 and management expects further improvement as lower-cost liabilities gradually replace higher-cost deposits. Since a large portion of operating expenses has already been incurred through branch expansion, technology investments and employee additions over the past few years, incremental loan growth is expected to generate meaningful operating leverage, supporting stronger profitability and improved cost-to-income ratios.

High-margin businesses are expected to remain the primary earnings drivers. Gold Loans, yielding around 15%, continue to offer attractive risk-adjusted returns while requiring virtually no incremental regulatory capital. Monthly disbursements have stabilised at ~ INR 100–120 crore and the strategy is now shifting from branch-led cross-selling towards dedicated customer acquisition, significantly expanding the addressable market. Similarly, the Used Commercial Vehicle and Used Passenger Vehicle finance businesses continue to generate yields of around 17%, providing superior spreads compared with conventional vehicle financing. As these higher-yield businesses increase their contribution within the overall loan portfolio, they are expected to support both margin expansion and profitability over the medium term.

7. Business Transformation, Future Growth Engines & Sectoral Tailwinds

Equitas has undergone a significant business transformation over the last few years by gradually reducing its dependence on unsecured Microfinance and increasing the share of secured retail lending businesses. Small Business Loans (SBL) remain the bank's largest portfolio, accounting for nearly 40% of total advances and management expects this segment to grow by more than 20% in FY27. Credit quality has improved substantially, with net slippages declining to only 0.11% during Q4FY26, while the rapidly growing Micro Loan Against Property (Micro LAP) portfolio expanded nearly 50% YoY, providing additional opportunities for secured lending. As the largest earnings contributor, the normalisation of credit costs within this segment is expected to significantly improve overall profitability.

The Microfinance business has also witnessed a sharp recovery. Collection efficiency improved to 99.71%, fresh overdue formation reduced significantly and the 1 to 90-day delinquency ratio declined to around 1.34% from 7.82% a year earlier. With nearly 65% of the portfolio now originated under the revised underwriting framework and the overall Microfinance portfolio maintained at ~ 10% of total advances, management believes the legacy stress has largely subsided. Consequently, Microfinance is expected to gradually return as a profitable customer acquisition engine without materially increasing credit costs.

The Affordable Housing Finance business has turned profitable and continues to benefit from increasing demand for affordable housing across Tier-II and Tier-III cities. Management plans to add around 120 new branches during FY27, strengthening distribution and expanding geographic reach. Since housing loans generally attract lower regulatory risk weights and exhibit superior credit quality, this business is expected to enhance capital efficiency while generating sustainable long-term earnings growth. Meanwhile, the Vehicle Finance business continues to focus on used commercial vehicles and used passenger vehicles, where demand remains healthy due to logistics, transportation, infrastructure development and rural economic activity. Additionally, the bank has utilised the CGTMSE guarantee scheme for a significant portion of its vehicle finance portfolio, reducing capital consumption while maintaining healthy loan growth. Together with continued expansion in Gold Loans, secured MSME lending, digital customer acquisition, cross-selling of insurance and wealth products and ongoing branch expansion, these businesses provide multiple structural growth drivers capable of supporting sustained earnings growth over the next several quarters.

8. Asset Quality Improvement, GNPA & NNPA Trends, Credit Cost and Near-Term Risks

One of the strongest positives supporting Equitas Small Finance Bank's investment case is the sharp improvement in asset quality following the normalisation of the Microfinance portfolio and strengthening performance across secured lending businesses. Management highlighted that collection efficiency in the Microfinance portfolio improved to 99.71%, while fresh overdue formation reduced sharply from nearly INR 97 crore in April to around INR 24 crore by October, indicating that the stress cycle has largely subsided. The 1–90 Days Past Due (DPD) ratio improved significantly to 1.34% from 7.82% a year earlier, reflecting better borrower repayment behaviour and the effectiveness of revised underwriting standards. Similarly, the bank reported a substantial improvement in Small Business Loan asset quality, with net slippages declining to only 0.11% during Q4FY26, providing confidence that credit costs have largely normalised in its largest lending portfolio. Management expects GNPA and NNPA ratios to continue improving gradually, supported by better recoveries, disciplined underwriting, higher share of secured assets and lower incremental slippages. Consequently, credit costs are expected to moderate further over the next 2–4 quarters, which should directly support profitability, Return on Assets (RoA) and Return on Equity (RoE), while enabling stronger earnings compounding.

Short-Term Headwinds & Business Risks

Despite the improving outlook, certain near-term risks continue to warrant monitoring. The Microfinance portfolio, although substantially stabilised, remains vulnerable to localised disruptions arising from borrower overleveraging, political interventions, natural calamities or regulatory changes affecting the industry. Rising competitive intensity across Small Finance Banks, Private Banks and NBFCs may exert pressure on loan pricing and deposit mobilisation. Any unexpected increase in deposit rates or slower-than-anticipated liability growth could delay the expected improvement in funding costs and Net Interest Margins (NIMs). Furthermore, execution risks associated with aggressive branch expansion, Affordable Housing scaling and Gold Loan expansion could temporarily increase operating expenses before the full benefits of operating leverage materialise. Vehicle Finance demand also remains linked to economic activity, freight movement and commercial vehicle utilisation. While the proposed Universal Bank licence represents a meaningful long-term opportunity, regulatory approvals remain subject to RBI's assessment and timelines. Nevertheless, given the bank's strengthened balance sheet, improving asset quality and diversified secured lending mix, these risks appear manageable and do not materially alter the medium-term investment outlook.

9. Overall Investment Thesis & Conclusion

Company has successfully transitioned from navigating an industry-wide Microfinance stress cycle to entering a new phase of diversified, profitable and sustainable growth. The bank today is structurally stronger than it was a few years ago, with a significantly higher proportion of secured retail assets, improving liability franchise, better underwriting standards and multiple independent growth engines across Small Business Loans, Affordable Housing Finance, Gold Loans, Vehicle Finance and secured MSME lending. Management's confidence in delivering 20–25% advances growth during FY27, together with an exit RoA target of around 1.5%, reflects improving business visibility and disciplined execution. Simultaneously, declining funding costs, expanding NIMs, lower credit costs, stronger operating leverage, branch expansion, digital initiatives, cross-selling opportunities and higher contribution from capital-efficient, high-yield lending businesses are expected to drive healthy earnings growth over the next 2–4 quarters.

The bank also stands to benefit from favourable structural tailwinds including continued formalisation of the MSME sector, rising demand for affordable housing, increasing financial inclusion, expansion in logistics and transportation, growing gold loan demand, rural credit penetration and deeper adoption of digital banking services. These secular trends, combined with improving asset quality, moderation in slippages, gradual improvement in GNPA and NNPA, declining credit costs and a well-diversified retail lending franchise, position the bank favourably for sustained value creation. Furthermore, the potential transition to a Universal Bank over the medium term could unlock additional growth opportunities by expanding the bank's operating flexibility and addressable market. Considering the improving earnings trajectory, strong management execution, healthy balance sheet, robust operating leverage and attractive long-term growth opportunities, we maintain our BUY recommendation on Equitas Small Finance Bank Ltd. for a medium-term investment horizon of six months.

Recommendation Timeline & Performance Summary: -

1. 7 November 2025 – Initial Recommendation: BUY call initiated at a price of 60.6 with a target price of 77, implying ~27% upside over a 12 to 15-month investment horizon.

2. **6 May 2026 – Target Price Upgrade:** Target price revised upward to 82.5, indicating ~12% additional upside from the then prevailing price of 73.5 over the next 6 months.

3. **10 July 2026 – Upgraded Target Price Achieved:** The stock achieved the revised upgraded target, delivered cumulative returns of ~38.5% (stock price touched to 84 on 15 July 2026) from the initial recommendation within ~8 months, significantly outperforming the original timeline.

4. **16 July 2026 – Re-Initiation of BUY Call:** We have re-initiate the BUY call at the CMP of 77 with a target price of 86, indicating an envisaged upside potential of 12% over the next 6 months.

Happy Investing!

Thank you and best regards,

On behalf of Bajaj Capital's Research Team