Select banks, SFBs better placed to play the MFI recovery story

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BFSI- Banks ▸ Sector Report ▸ **July 07, 2025**

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Over the past one year, the Microfinance sector has undergone a much needed reset with the imposition of MFIN guardrails which in turn led to higher NPAs, exposing sector vulnerability and pushing a few players almost toward existential crisis and others into losses. We believe that this reset is likely to push hard for geographic/product diversification, re-calibrate lending/collection strategies, and hopefully contingency buffers. We hereby highlight in detail the outlook on the MFI sector, based on discussions with experts and our perspective on what lies ahead.

MFI stress moderation to begin from H2FY26E

After Andhra crisis, demonetization, and Covid, the imposition of MFIN guardrails (a cap of three lenders per borrower and Rs0.2mn loan exposure limit) and the resultant rise in stress have exposed sector vulnerability once again, even pushing a few players toward existential crisis. This was further accentuated by the ordinances in Karnataka and then TN, hurting collection efficiencies and leading to GLP de-growth for the first time in a decade in FY25. At the peak, the industry's PAR book in 0-180 DPD shot up to 8.2% in Dec-24. Our channel checks suggest that stress flow in Q1FY26 could likely remain elevated (also reflected in recent business updates) due to seasonal weakness and owing to Karnataka/TN ordinances. We believe unwinding of the residual 3+ lender portfolio at 12% in Mar-25 (down from 19% in Mar-24) will keep near-term stress flow elevated, but it will ease from H2FY26E, leading to steady improvement in asset quality/LLP. We believe banks (eg: Ujjivan, Bandhan) with a relatively lower share of 3+ lenders will be early to benefit from the recovery cycle.

Frequent disruptions, recent regulatory easing to accelerate portfolio diversification away from MFI

Frequent growth and asset quality disruptions in the MFI sector slowly pushed lenders toward alternate growth levers (Gold, Mortgage, AFH, MSE, VF, etc.). The recent reduction in qualifying asset classification threshold for NBFC-MFIs and SFBs to 60%, from 75%, should further accelerate portfolio diversification. However, we believe that the pivot to a diversified portfolio, from a pure-play NBFC-MFI, will require specialized underwriting skills, robust risk management models, product domain expertise and may even necessitate the need for a refreshed management team which is challenging. Geographic and portfolio diversifications attempted by banks like Bandhan and Ujjivan too had their share of pain, but are likely to accelerate the pace of diversification.

Rising share of individual loans should be monitored and regulated

Our channel checks suggest an increasing trend among MFI lenders, including SFBs, to extend individual loans to JLG borrowers, as a strategy to retain customers. In some cases, though, this could be a tactical manner of bypassing regulatory guardrails and suppressing stress. Also, many lenders are chasing these customers and could lead to overleveraging similar to JLG borrowers. Thus, we believe that MFIN should issue some regulatory guidelines for individual loans as well. Additionally, we believe that NBFC-MFIs need to build strong internal collection teams, hire senior chief credit and risk officers, and even build contingent provision buffers (like large banks as they increase their share of unsecured loans) to limit the impact on Profit and Loss account.

Prefer banks to play the MFI recovery story

While stress flows may remain elevated in H1FY26, we expect a meaningful decline in NPA formation and LLP from H2FY26, barring any unforeseen political or climatic disruptions. We prefer banks like Ujjivan (BUY) and Bandhan (ADD) to play the MFI recovery and asset diversification theme. Ujjivan SFB, a potential candidate for the Universal Bank license (similar to AU SFB), is well-positioned to deliver >2% RoA and stronger growth, but still trades at a steep discount (1.2x FY27E ABV) to AU SFB (2.8x), warranting a re-rating. We retain BUY on Ujjivan with revised TP of Rs60 (up 20%), valuing at 1.4x Jun-27E ABV. RBL, with exposure to MFI (6%) and Cards (18%), is a play on strong asset quality recovery; we raise our TP by 20% to Rs300 (1x Jun-27E ABV). We also retain ADD on Credag with revised TP of Rs1,350 (up 10%), valuing at 2.1x Jun-27E ABV, given its credible track record to ride the MFI recovery story and deliver strong RoA (3-5% over FY26-28E).

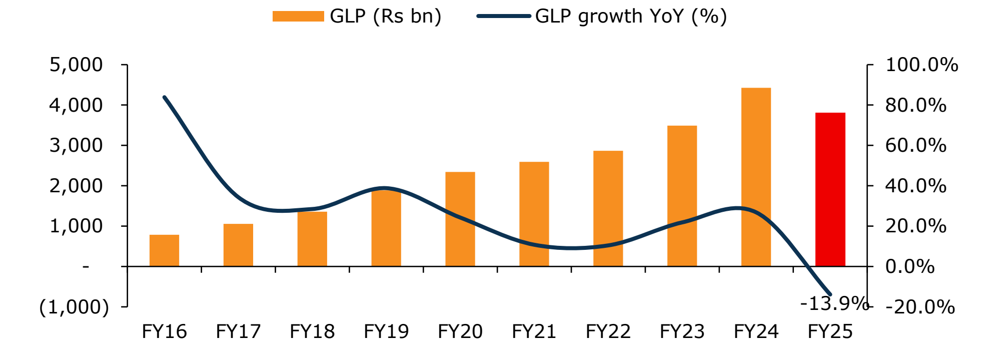
Anand Dama
anand.dama@emkayglobal.com
+91-22-66242480

Nikhil Vaishnav
nikhil.vaishnav@emkayglobal.com
+91-22-66242485

Kunaal N
kunaal.n@emkayglobal.com
+91-22-66121275

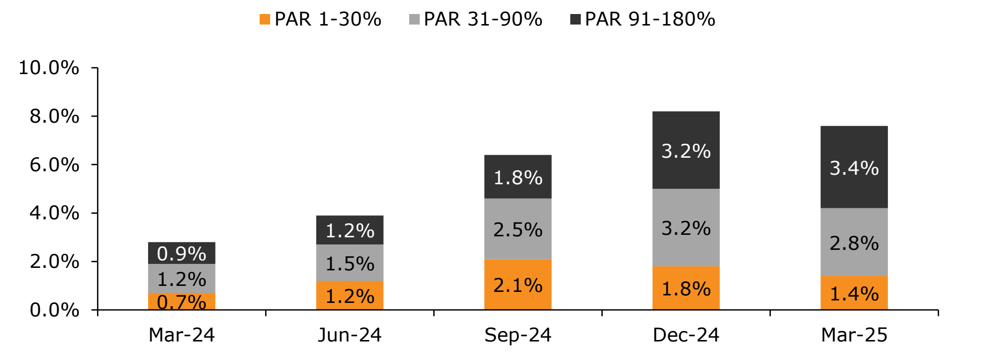
Story in charts

Exhibit 1: GLP growth never slipped into the negative zone in the past (even during DeMo, Covid), barring the recent disruption due to imposition of MFIN guardrails



Source: CRIF Highmark, Emkay Research

Exhibit 2: After peaking out in Q3FY25, incremental stress flow started to ease



Source: CRIF Highmark, Emkay Research

Exhibit 3: Valuation summary for banks under our coverage

Bank/ NBFC-MFI	Reco	TP (Rs)	Market Cap		RoA (%)				RoE (%)				P/ABV (x)				ABV (Rs)			
			(Rs bn)	(USD bn)	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E
RBL	Buy	300	155	2	0.5	0.8	1.0	1.2	4.6	7.5	10.7	12.7	1.0	0.9	0.9	0.8	254	269	295	329
AU SFB	Reduce	600	606	7	1.6	1.5	1.6	1.6	14.2	14.6	16.2	17.3	3.7	3.2	2.8	1.7	223	253	295	346
Bandhan	Add	180	286	3	1.5	1.5	1.7	1.8	11.9	11.9	13.7	15.1	1.2	1.1	1.0	0.9	145	160	181	207
Equitas	Reduce	60	72	1	0.3	0.8	1.2	1.5	2.4	7.6	11.6	15.7	1.2	1.2	1.0	0.9	51	55	61	70
Ujjivan	Buy	60	91	1	1.6	1.7	2.0	2.3	12.4	13.6	16.6	19.0	1.5	1.3	1.2	1.2	31	35	41	49
CREDAG	Add	1,350	205	2	1.9	3.1	4.3	4.7	7.9	12.1	16.8	18.0	3.1	2.6	2.1	1.8	410	490	601	738
Fusion	Reduce	170	27	0.3	(12.2)	0.9	1.7	1.7	(54.5)	3.5	6.1	6.1	1.2	1.2	1.2	1.1	159	152	161	161

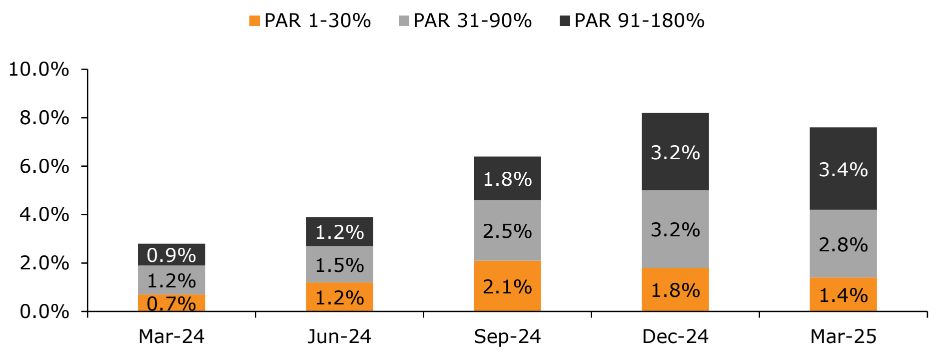
Source: Emkay Research

MFI stress normalization to begin from H2FY26E

After the imposition of MFIN guardrails, overall stress flow for the industry largely peaked in Q3FY25 and improved a bit in Q4FY25 despite the early impact of an unfavorable ordinance in Karnataka. However, the PAR>0 book inched up a bit in Q1FY26E due to seasonal weakness and owing to the impact of Karnataka/TN ordinances. X-bucket collection efficiency in Karnataka, TN, UP, and Bihar is improving, but in select pockets. Similarly, X-bucket collection efficiency in WB has been improving. However, Gujarat remains a pain point mainly due to continued higher employee attrition.

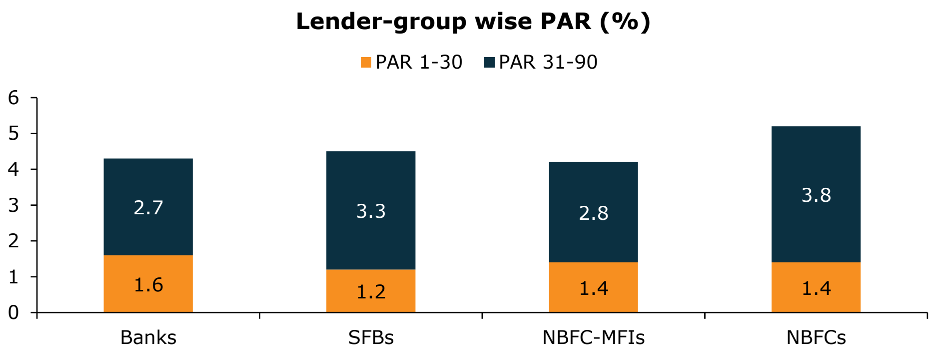
At the industry level, the 3+ lender portfolio has reduced to 12%, from 19% in FY24, which we believe shall unwind over H1FY26 and could keep stress flow elevated in the near term. However, we expect steady improvement in the pace of stress formation from H2FY26E and also asset quality/LLP. We believe Ujjivan and Bandhan, with a relatively lower share of 3+ lenders, will be early to benefit from the recovery cycle unless there is further deterioration in the states of Karnataka, TN, UP, and Bihar. Similarly, MFI-heavy RBL (6% of portfolio) too should benefit from the MFI recovery story.

Exhibit 4: After peaking out in Q3FY25, incremental stress flow started to ease



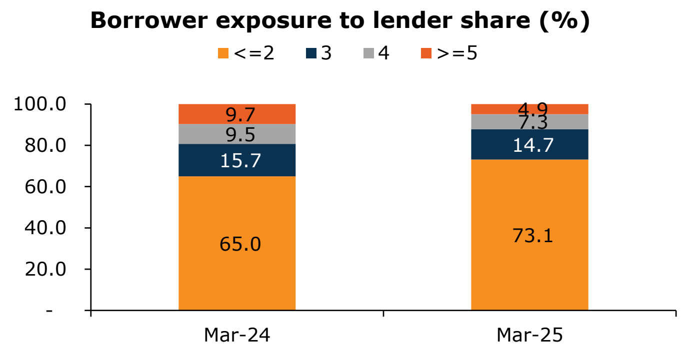
Source: CRIF Highmark, Emkay Research

Exhibit 5: NBFCs remain highly stressed



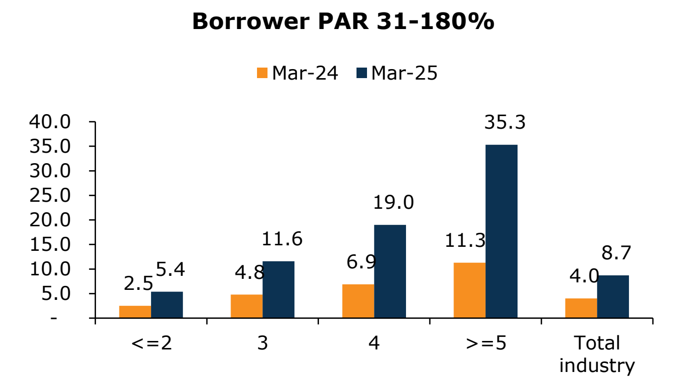
Source: CRIF Highmark, Emkay Research

Exhibit 6: Share of lender+3 borrowers have declined by ~700bps YoY to ~12%...



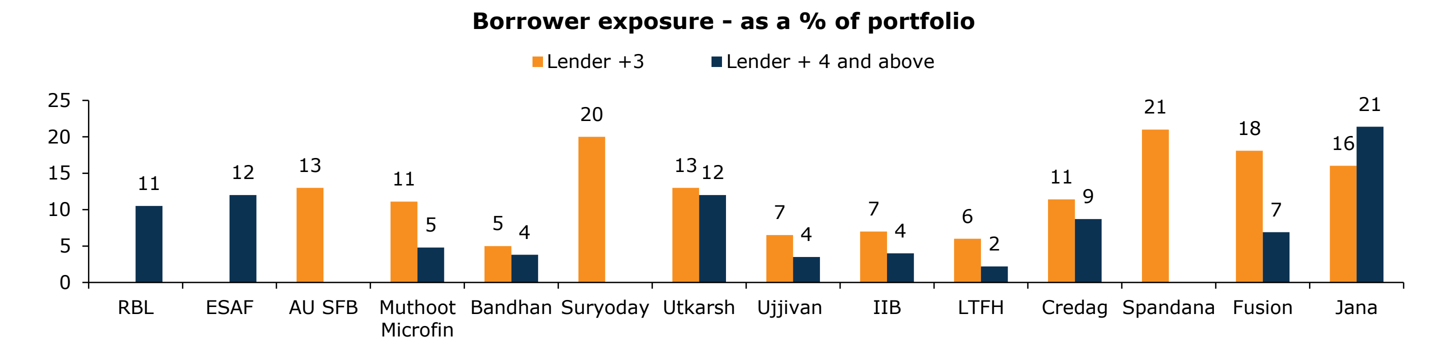
Source: CRIF Highmark, Emkay Research

Exhibit 7: ...while the PAR book still remains elevated



Source: CRIF Highmark, Emkay Research

Exhibit 8: Bandhan and Ujjivan have relatively lower lender+3 borrower share, and thus shall be early to benefit from the recovery cycle



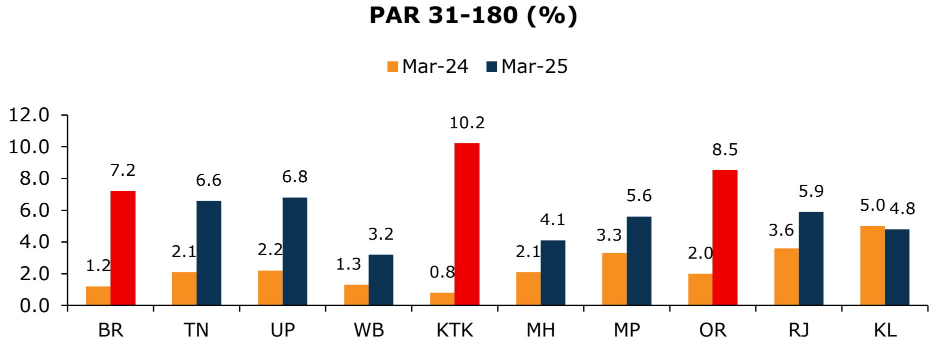
Source: Company, Emkay Research; Note: For Spandana and Fusion, lender +3 data denote ≥3 lenders. For Jana, lender+3 data represents borrowers with up to 3 lenders; for RBL and Suryoday, the data is as of Q3FY25

Exhibit 9: State-wise lender category-wise borrower exposure

States / Borrowers (mn)	<=2 lenders			3 lenders			4 lenders			>=5 lenders		
	Jun-24	Mar-25	Growth (%)	Jun-24	Mar-25	Growth (%)	Jun-24	Mar-25	Growth (%)	Jun-24	Mar-25	Growth (%)
BR	9.2	9.6	3.6	1.1	1.1	(5.4)	0.6	0.5	(21.1)	0.4	0.2	(47.5)
TN	7.1	7.0	(1.3)	1.0	0.9	(15.8)	0.6	0.4	(26.8)	0.6	0.3	(45.6)
UP	8.1	8.2	1.0	0.7	0.7	(4.2)	0.4	0.3	(20.0)	0.3	0.2	(44.4)
KA	5.5	5.3	(3.6)	0.6	0.5	(8.8)	0.3	0.2	(17.9)	0.3	0.2	(32.0)
WB	7.1	7.1	(0.3)	0.4	0.4	(7.1)	0.2	0.1	(13.3)	0.1	0.1	(44.4)
MH	5.8	5.7	(2.4)	0.5	0.4	(12.8)	0.2	0.1	(26.3)	0.1	0.1	(45.5)
OR	3.8	3.8	-	0.4	0.4	(13.6)	0.2	0.2	(21.7)	0.2	0.1	(45.5)
MP	4.8	4.6	(2.5)	0.4	0.3	(19.5)	0.2	0.1	(29.4)	0.1	0.1	(50.0)
RJ	3.3	3.2	(1.8)	0.3	0.3	(16.7)	0.1	0.1	(35.7)	0.1	0.0	(55.6)
KL	1.8	1.9	6.0	0.2	0.2	(19.0)	0.1	0.1	(30.0)	0.1	0.0	(50.0)
Industry	**74.3**	**73.1**	**(1.7)**	**6.7**	**5.9**	**(11.1)**	**3.2**	**2.4**	**(22.9)**	**2.5**	**1.3**	**(45.3)**

Source: CRIF Highmark, Emkay Research

Exhibit 10: States of Bihar, Karnataka, and Orissa reported a sharp surge in NPAs; the recent ordinance could possibly prolong recovery in TN and thus hurt Equitas



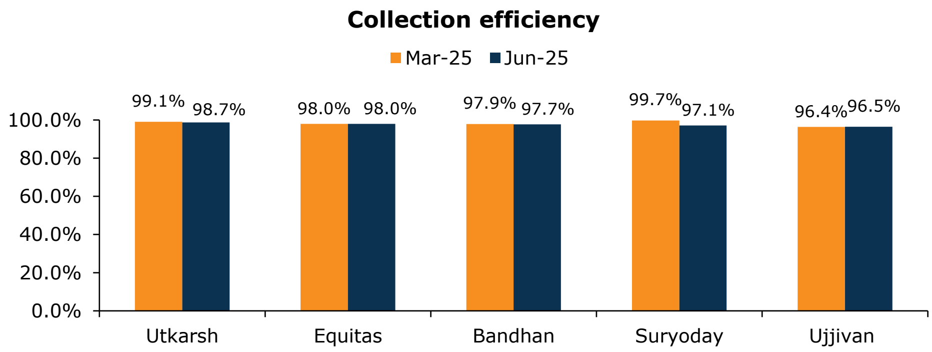
Source: CRIF Highmark, Emkay Research

Exhibit 11: State-wise exposure of lenders

	BR	TN	UP	KA	WB	MH	MP	OR	RJ
Credag	4.8%	19.0%	NA	31.1%	NA	21.5%	8.0%	NA	NA
Fusion	19.2%	7.2%	19.2%	NA	1.5%	NA	NA	11.4%	6.7%
Spandana	12.0%	1.0%	5.0%	10.0%	6.0%	8.0%	13.0%	13.0%	3.0%
Ujjivan SFB	6.1%	14.2%	6.8%	12.8%	11.7%	9.9%	1.6%	1.8%	4.5%
AU SFB	NA	2.0%	3.0%	2.0%	NA	16.0%	14.0%	NA	26.0%
Equitas SFB	NA	46.0%	1.0%	13.0%	NA	15.0%	3.0%	NA	4.0%
Jana	NA	11.2%	NA	6.3%	NA	NA	NA	NA	NA
Suryoday	NA	20.0%	NA	12.0%	NA	22.0%	8.0%	14.0%	NA
Bandhan Bank	10-12%	<1%	10.0%	1.1%	36.0%	<10%	NA	NA	2-3%
RBL	20.0%	NA	15.0%	<10%	NA	NA	NA	NA	NA
Utkarsh	44.0%	NA	27.0%	NA	NA	4.0%	3.0%	8.0%	NA
IIFL Samasta	23.0%	12.0%	9.0%	14.0%	8.0%	3.0%	4.0%	5.0%	7.0%
Muthoot Microfin	10.6%	25.8%	9.0%	14.9%	NA	NA	NA	NA	NA
Satin	14.0%	2.6%	25.6%	0.8%	9.1%	1.3%	NA	4.2%	3.5%

Source: Company, Emkay Research; Note: For Fusion, data is as of Q1FY23 (RHP); For Utkarsh, data denotes JLG state exposure

Exhibit 12: Though X bucket collection efficiency has improved, overall collection efficiency slipped a bit in Q1



Source: Company, Emkay Research; Note: For Utkarsh – CE denotes X Bucket CE (excluding pre-payments) for Micro Banking loan. For Bandhan- CE denotes pan-Bank CE (excluding NPA). For Equitas and Suryoday- CE denotes overall CE

Exhibit 13: While incremental stress flow is easing among all players, the existing stress pool is still under pain

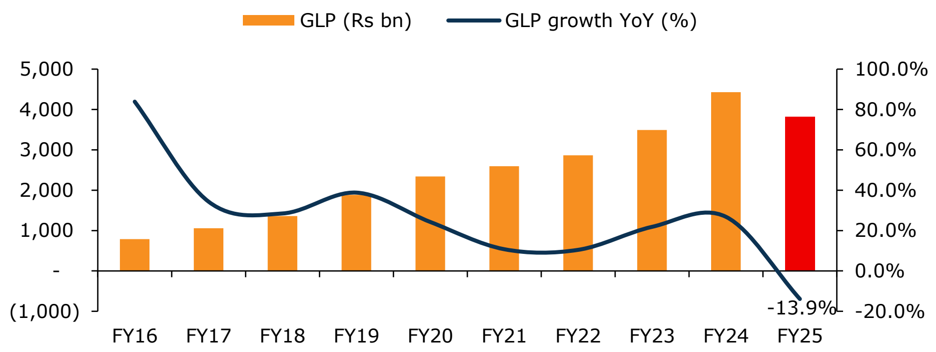
Bank/NBFC (Rs mn) - FY25	MFI loans	Overall loans	MFI as % of overall loans	MFI GNPA	0-30DPD	30-90DPD	90DPD+
Credag	232,370	259,480	90%	4.8%	1.4%	2.2%	3.3%
Fusion	83,070	89,800	93%	7.9%	na	na	na
Spandana	68,190	68,190	100%	5.6%	2.6%	9.2%	5.6%
LTFH	262,300	977,620	27%	2.9%	1.1%	1.4%	2.6%
Ujjivan SFB	130,900	321,220	41%	2.6%	0.7%	1.7-2.1%	4.1-5.7%
AU SFB	66,700	1,157,040	6%	4.4%	na	na	na
Equitas SFB	45,270	379,860	12%	3.0%	1.9%	5.9%	3.0%
Jana SFB	89,120	295,450	30%	4.0%	na	na	na
Utkarsh SFB	96,790	196,660	49%	16.7%	1.1%	3.8%	9.4%
Suryoday	50,890	102,510	50%	17.4%	na	na	na
Bandhan	565,400	1,369,900	41%	8.4%	1.5%	1.8%	8.4%
RBL	57,520	926,183	6%	21.2%	1.5%	3.9%	2.6%
IIB	309,090	3,450,186	9%	13.2%	na	na	na
IDFCB	95,710	2,419,260	4%	7.7%	1.6%	5.1%	7.7%
Muthoot Microfin	123,567	123,567	100%	4.8%	1.3%	3.8%	4.8%
Satin	111,350	127,840	87%	3.7%	0.3%	0.9%	3.7%

Source: Company, Emkay Research

Asset quality, regulatory disruption to accelerate portfolio diversification

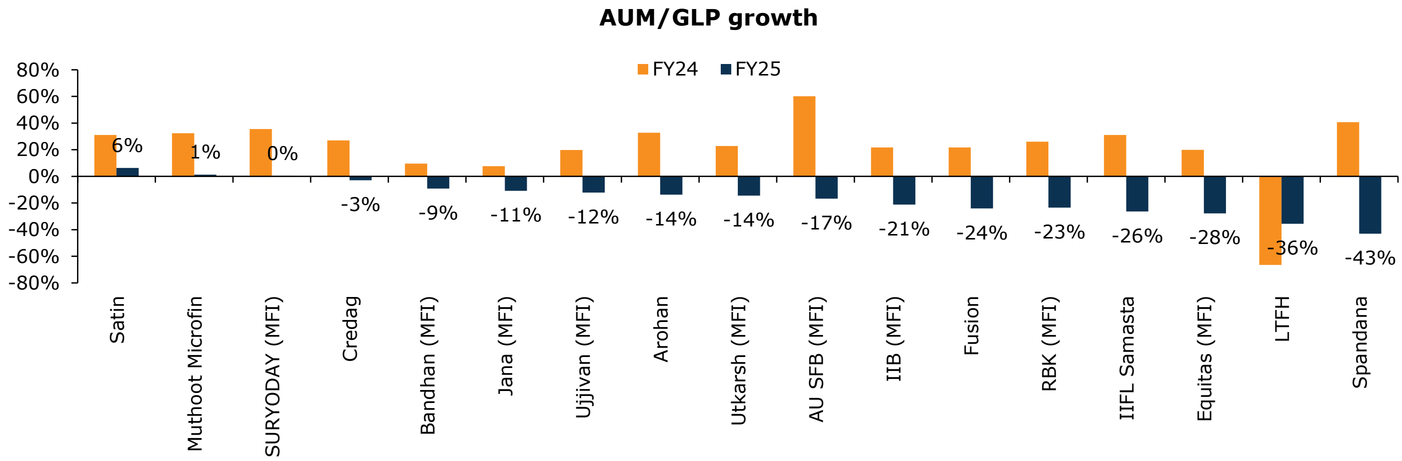
After Andhra crisis, the imposition of MFIN guardrails led to a decline in MFI GLP in FY25 (likely to remain muted in FY26 as well). Given frequent asset quality disruptions and the recent reduction in qualifying asset classification threshold to 60%, from 75%, for NBFC-MFIs and SFBs, we believe lenders would further accelerate portfolio diversification (Gold, MSE, Mortgage, VF) away from MFI, and in the process hurt overall systemic growth. However, we believe that the pivot to a diversified portfolio, from a pure-play MFI for NBFC-MFI, will call for specialized underwriting skills, robust risk management models, product domain expertise and may even necessitate the need for a refreshed management team (which is easier said than done). Geographic and portfolio diversification attempted by Equitas, Bandhan in the past had their share of pain; these banks are still struggling to find a balance. Factoring in the same, we believe portfolio diversification will be equally or more challenging for NBFC-MFIs and could moderate their RoAs in the process.

Exhibit 14: GLP growth never slipped into negative zone in the past (even during DeMo, Covid), barring the recent disruption due to imposition of MFIN guardrails



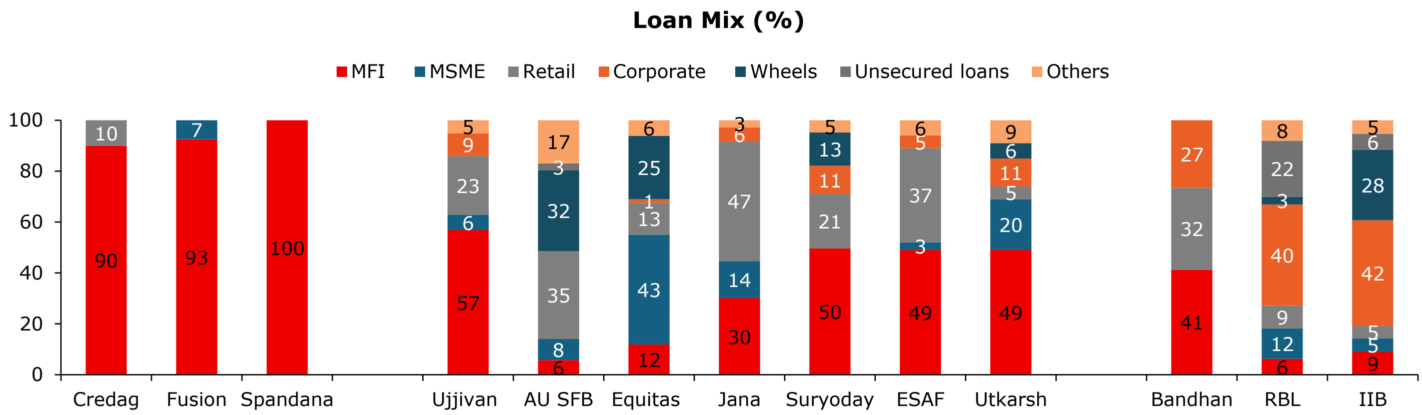
Source: CRIF Highmark, Emkay Research

Exhibit 15: Satin bucks the trend with ~6% MFI AUM growth; Credag and Suryoday see minimal declines



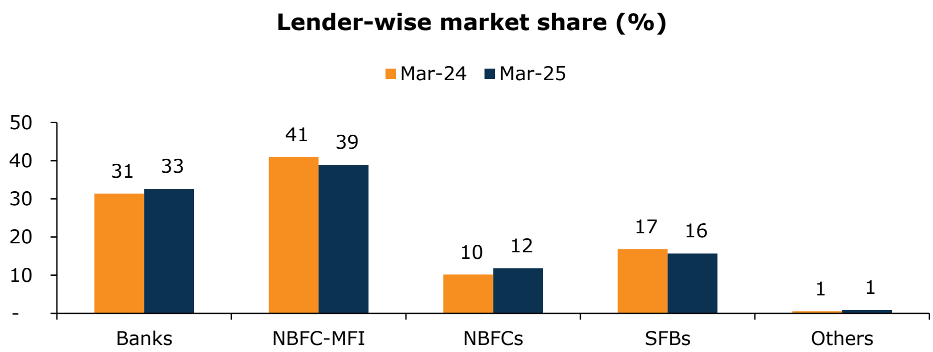
Source: Company, Emkay Research

Exhibit 16: While most players are already focusing on portfolio diversification, the RBI's move of reducing PSL requirement for SFBs and NBFC-MFI to 60% is a blessing in disguise



Source: Company, Emkay Research

Exhibit 17: NBFC-MFIs and SFBs lost market share post the imposition of MFIN guardrails

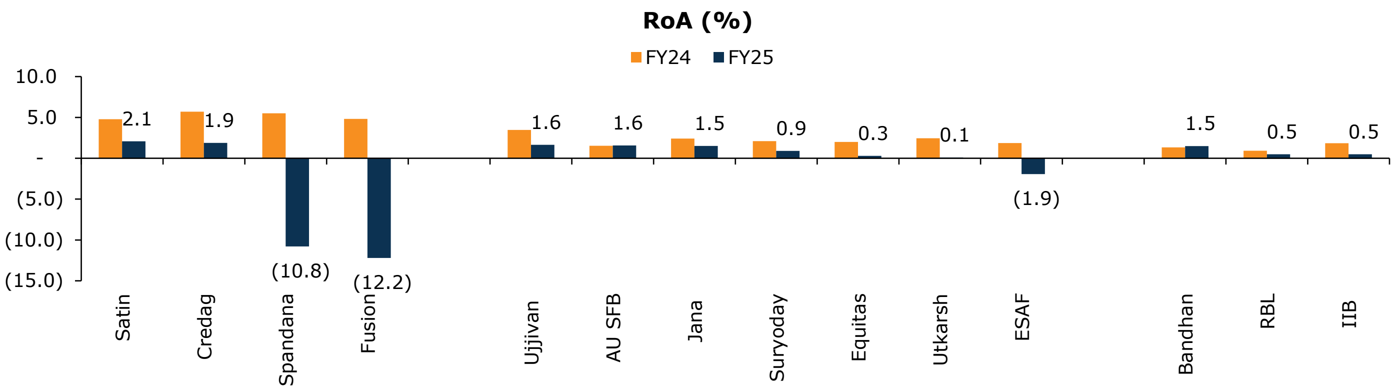


Source: CRIF Highmark, Emkay Research

Prefer select banks to play the MFI recovery story

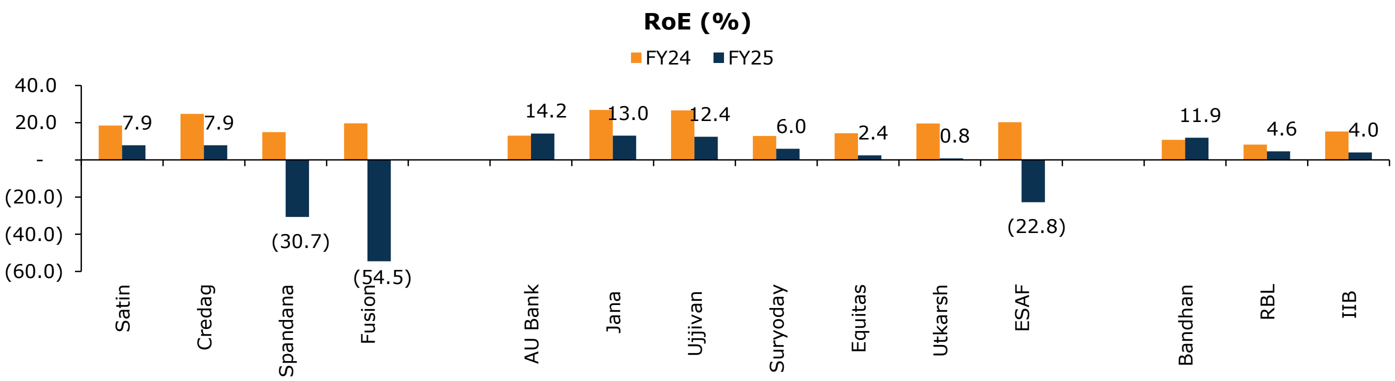
Though H1FY26E stress flow is likely to remain elevated, we believe a meaningful reduction in NPA formation/LLP should be seen from H2FY26E unless disrupted by any new political/climatic development. Our long-term preferred picks to play the MFI recovery plus asset diversification story are banks like Ujjivan (BUY) and Bandhan (ADD). Ujjivan SFB runs a good chance to secure the Universal Banking license similar to AU SFB, while it is well positioned to deliver higher growth and RoAs >2%; however, it trades at a huge discount (1.2x FY27E ABV) to AU SFB (2.8x), thereby calling for a re-rating. We retain BUY on Ujjivan with a revised TP (up 20%) of Rs60 (from Rs50), valuing it now at 1.4x June-27E ABV. RBL too being hit by MFI (6% of portfolio) and Card (18%) offers a strong play on the asset quality recovery story, leading to lower LLP. This, coupled with steady improvement in the growth trajectory, margin resiliency, and reduction in cost ratios should lead to better RoA at 0.8-1.2% over FY26-28E. Thus, we upgrade our TP by 20% to Rs300, valuing it at 1x June-27E ABV. We also retain ADD on Credag with a revised TP of Rs1,350 (up 10%), valuing at 2.1x Jun-27E ABV, given its credible track record to ride the MFI recovery story and deliver strong RoA (3-5% over FY26-28E).

Exhibit 18: Spandana, Fusion, and ESAF SFB slipped into losses. Despite higher NPAs/LLP, Ujjivan and Credag managed healthy RoAs vs peers



Source: Company, Emkay Research

Exhibit 19: Fusion, Spandana and ESAF SFB reported huge losses in FY25



Source: Company, Emkay Research

Exhibit 20: Ujjivan followed by Credag are trading below their mean valuations; this, along with their relatively better asset quality makes risk-reward favorable

Companies	P/ABV (x)						
	Trailing	Mean	+1SD	-1SD	FY26E	FY27E	FY28E
New Age PVBs/SFBs							
AU SFB	3.1	4.0	5.2	2.8	3.2	2.8	1.7
BANDHAN	1.1	2.8	4.5	1.2	1.1	1.0	0.9
EQUITAS	1.2	1.5	2.3	1.4	1.2	1.1	0.9
UJJIVAN	1.3	1.6	2.2	0.9	1.3	1.2	1.2
NBFC-MFI							
CREDAG	2.4	2.7	3.1	2.1	2.6	2.1	1.8
FUSION	1.2	2.2	3.1	1.4	1.2	1.2	1.1

Source: Emkay Research

Exhibit 21: Valuation summary for banks under our coverage

Bank/ NBFC-MFI	Reco	TP (Rs)	Market Cap		RoA (%)				RoE (%)				P/ABV (x)				ABV (Rs)			
			(Rs bn)	(USD bn)	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E	FY25	FY26E	FY27E	FY28E
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Bandhan	Add	180	286	3	1.5	1.5	1.7	1.8	11.9	11.9	13.7	15.1	1.2	1.1	1.0	0.9	145	160	181	207
Equitas	Reduce	60	72	1	0.3	0.8	1.2	1.5	2.4	7.6	11.6	15.7	1.2	1.2	1.0	0.9	51	55	61	70
Ujjivan	Buy	60	91	1	1.6	1.7	2.0	2.3	12.4	13.6	16.6	19.0	1.5	1.3	1.2	1.2	31	35	41	49
CREDAG	Add	1,350	205	2	1.9	3.1	4.3	4.7	7.9	12.1	16.8	18.0	3.1	2.6	2.1	1.8	410	490	601	738
Fusion	Reduce	170	27	0.3	(12.2)	0.9	1.7	1.7	(54.5)	3.5	6.1	6.1	1.2	1.2	1.2	1.1	159	152	161	161

Source: Emkay Research

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Ratings	Expected Return within the next 12-18 months.
BUY	>15% upside
ADD	5-15% upside
REDUCE	5% upside to 15% downside
SELL	>15% downside

Emkay Global Financial Services Ltd.
CIN - L67120MH1995PLC084899
7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India
Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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