

Enviable combination of superior growth and profitability

Transition to universal bank to further strengthen brand and unfold growth opportunities

We met Mr. Sanjay Agarwal, MD & CEO of AU Small Finance Bank, to discuss the bank's business outlook and growth strategy over the coming years, particularly as the bank takes the big leap and transitions into a universal bank after the final approval from the RBI. Following are the key takeaways from the discussion:

Industry-leading loan growth at ~22-23% CAGR over FY25-27E

AUBANK appears well poised to begin FY27 with a structurally stronger growth platform, underpinned by a diversified asset engine and sharper execution after integration. The bank's consistent track record of delivering ~25% loan CAGR over the last three years reflects its ability to scale up across cycles. AUBANK reported 22% YoY growth in 2QFY26 (despite the decline in MFI+Cards portfolio), underscoring the bank's ability to maneuver growth at the portfolio level even in a challenging industry backdrop. The merged franchise now offers a wider pan-India reach, deeper penetration in underbanked regions and product adjacencies, which will enable the bank to maintain robust growth in the coming years. We estimate AUBANK to deliver 24% loan CAGR over FY26-28E, aided by a recovery in the unsecured segments, while growth in secured business segments remains healthy.

Multiple growth engines to enable diversified loan book build-up

AUBANK's medium-term growth trajectory is anchored to the scale-up of its core secured businesses while maintaining healthy portfolio spreads.

Wheels/VF franchise remains the flagship growth engine, with management aspiring to build a significantly larger book, which should be supported by expanded distribution and deeper presence across new geographies. Mortgages and MBL are expected to accelerate toward ~20% growth as pan-India expansion and improved collection infrastructure support increased business volumes. Gold lending has got a fresh impetus after the merger with Fincare SFB and will likely witness exponential growth (on a small base) as the segment offers attractive loan yields. Commercial banking with a focus on MSME, NBFC and real estate lending remains another growth driver. As unsecured stress normalizes, calibrated re-acceleration in MFI, credit cards, PL/BL and LAS will further broaden the opportunity in the medium term.

Cost of funds to ease further; margin outlook positive

AUBANK expects funding cost to ease further over the coming quarters, led by deposit re-pricing. The transition to a universal bank will further help reduce the deposit premium and keep margins steady in the medium term. Deposit mobilization remains healthy, aided by a sharper go-to-market strategy, while the improved branding and market positioning after the transition to a universal bank will further support long-term funding efficiencies. Yield expansion remains limited due to a higher secured mix, but a recovery in MFI business and a sharp rise in gold lending, alongside steady growth in VF, will enable healthy portfolio yields. We thus estimate margins to recover steadily over the coming quarters, enabling a 25% CAGR in NII over FY26-28E.

AU Small Finance Bank



Mr. Sanjay Agarwal, MD & CEO

Mr. Agarwal has led AU's evolution

from a small NBFC into a high-performing, pan-India bank known for strong governance, disciplined execution and industry-leading asset quality. Under his leadership, AU has diversified across retail, MSME and commercial banking and recently received the RBI's in-principle universal bank approval, marking a major milestone in its long-term growth trajectory. He is a commerce graduate from Government College, Ajmer, and an all-India rank holder in CA.

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Cost-income ratio to remain in control; fee intensity to improve in medium term

AUBANK's C/I ratio stood at ~56.5% in FY25 (57.7% in 2QFY26) as the bank continues to invest in business and has significantly ramped up its fleet on street (added 6.9k employees over 1HFY26). However, management remains focused on driving operating efficiencies. With the merger integration largely completed across branches, operating leverage should begin to flow through in FY26-27. The bank is targeting a near-term C/I ratio of ~55% with a longer-term aspiration to move below 50% as scale benefits, better distribution income, and cross-selling momentum strengthen. Fee intensity is also expected to improve as AU scales up third-party distribution (insurance, wealth), accelerates SA acquisition through asset customers, and benefits from a stabilizing credit card franchise. Additionally, the AD-1 build-out is set to further boost non-interest income via FX, remittances, and trade flows, supporting a gradual uplift in fee income and driving the bank closer to its sustainable 1.8% RoA target.

Asset quality on right path after temporary dislocation

Asset quality indicators are showing early signs of stabilization, with easing forward flows in credit cards and tighter guardrails improving underwriting discipline in MFI. In FY25 and early FY26, asset quality trends were weak mainly due to MFI and elevated card stress, thereby driving GNPA to 2.47% in 1QFY26 with some improvements visible in 2QFY26. Slippages have started to ease, while credit cost moderated to ~30bp in 2QFY26 (34bp in 1QFY26), with management remaining confident of reducing it further in 2HFY26. MFI performance has strengthened, with CE rising to ~99% in Oct, while the portfolio decline has also been arrested as per the ongoing disbursement and collection run rate. Credit card flows have also eased for the first time in 12 months due to calibrated sourcing. With continued recoveries and unsecured books normalizing, AUBANK expects FY26 credit cost to remain within the 1% guidance (implying 36bp credit cost in 2H vs. 64bp incurred in 1H). We estimate credit cost to further ease to 1% (as a % of avg. advances) in FY27-28E vs. 1.4% in FY26E, enabling 34% earnings CAGR over FY26-28E.

Other highlights

- Treasury income may remain volatile and dependent on the movement in bond yields and OMOs. The focus thus remains on core revenue growth and fees.
- The bank is in discussions with the RBI for its universal bank transition and has requested for tax-free NOFHC conversion. AUBANK expects clarity on this matter in the near future and remains hopeful of completing the transition in FY27.

Valuation and view: Maintain BUY with a TP of INR1,100

- AUBANK remains well-positioned to deliver best-in-class business growth and earnings CAGR, supported by steady improvement in operating metrics and strong execution across its diversified secured businesses.
- Secured businesses across VF, mortgages and commercial banking continue to perform well and offer a strong growth outlook in the coming years.
- Asset quality cycle is showing signs of bottoming out, with slippages and credit costs moderating in 2Q and CE in MFI business showing further improvement. This provides confidence that credit costs will remain within the 1% as per FY26 guidance and trend toward the long-term 75-85bp range thereafter.
- The RBI's in-principle nod for the universal bank license is a remarkable milestone and will meaningfully enhance brand trust, unlock broader deposit pools, improve CoF, and accelerate cross-selling across wealth, insurance, FX and payments. With the cost of funds already declining and NIMs expected to expand over the coming quarters, the margin trajectory appears constructive.
- We model ~23-24% loan CAGR over FY26-28, supported by strong secured growth engines (VF, mortgages, gold, commercial banking) and normalization in MFI and cards. This, coupled with improving cost efficiency and rising fee income, should drive 34% earnings CAGR over FY26-28E. Notwithstanding the strong rally in the stock price, we remain excited about AUBANK's growth and earnings prospects and reiterate it as our preferred BUY in the mid-size banking space. **We revise our TP to INR1,100 (premised on 3.3x Sep'27E BV).**

STORY IN CHARTS

Exhibit 1: Estimate loan book to nearly double over FY25-28

We estimate loan/deposit portfolio to register a healthy 23-24% CAGR over FY26-28E

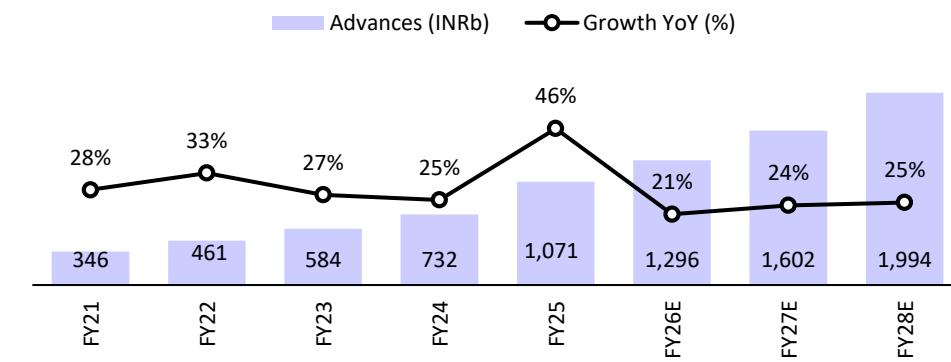


Exhibit 2: Estimate deposits to reach ~INR1.84t by FY27E

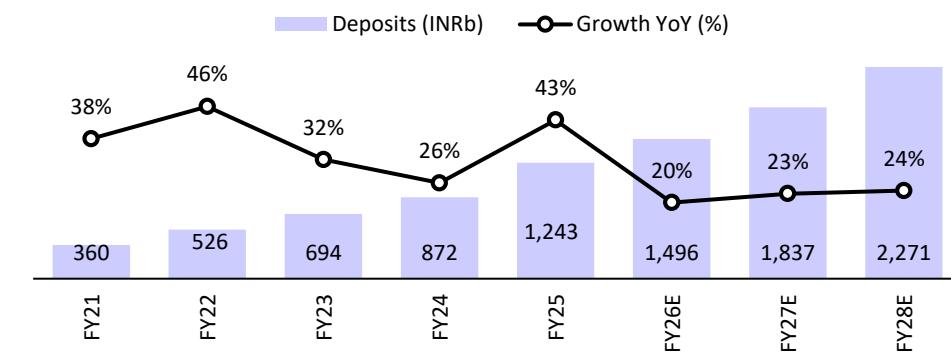


Exhibit 3: Estimate AUBANK's NIM to sustain at 5.8% in FY27-28E

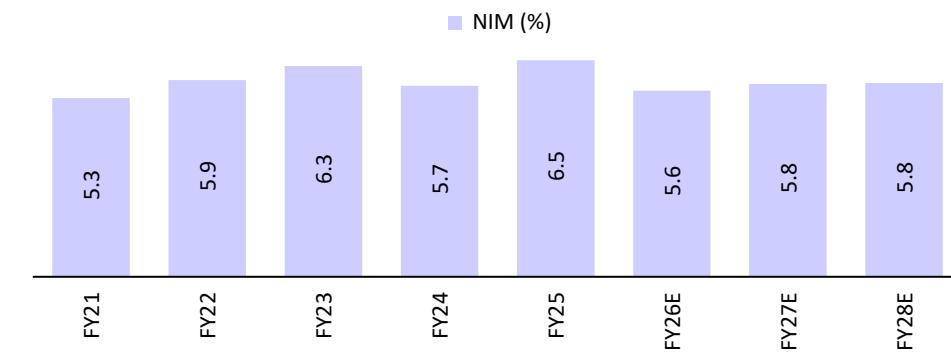
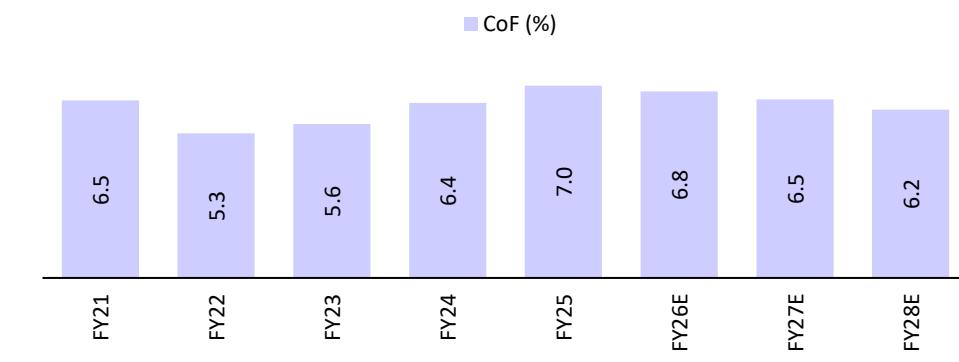


Exhibit 4: Cost of fund expected to decline to 6.5% in FY27E



Source: Company, MOFSL

Exhibit 5: Estimate C/I ratio to improve to 56.2% by FY28E

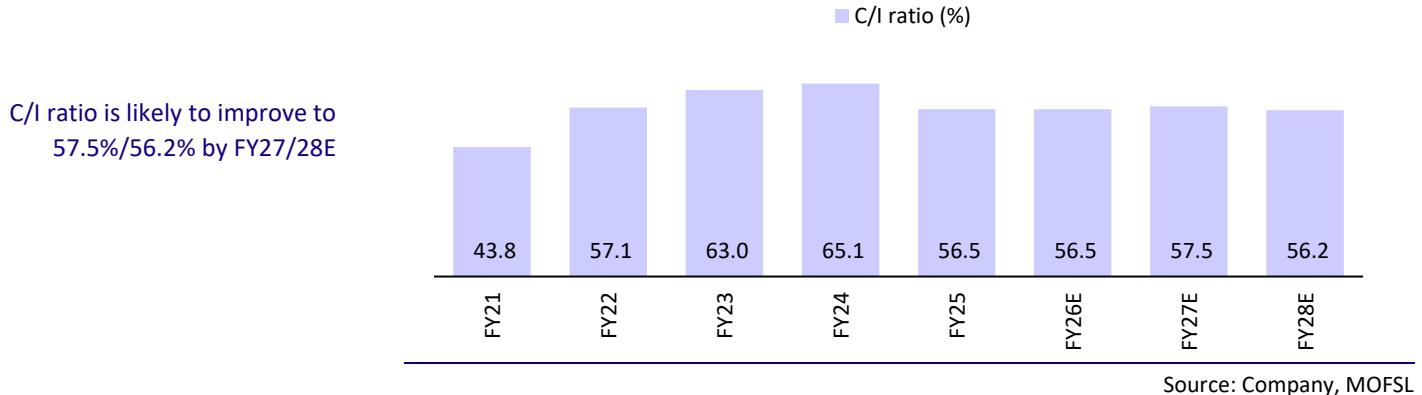


Exhibit 6: Estimate AUBANK's GNPA/NNPA ratios to decline to 2.1%/0.6% in FY27E

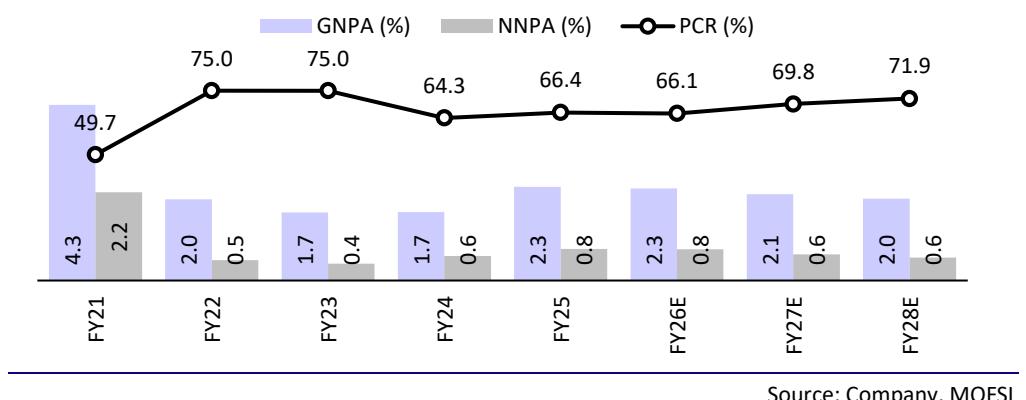
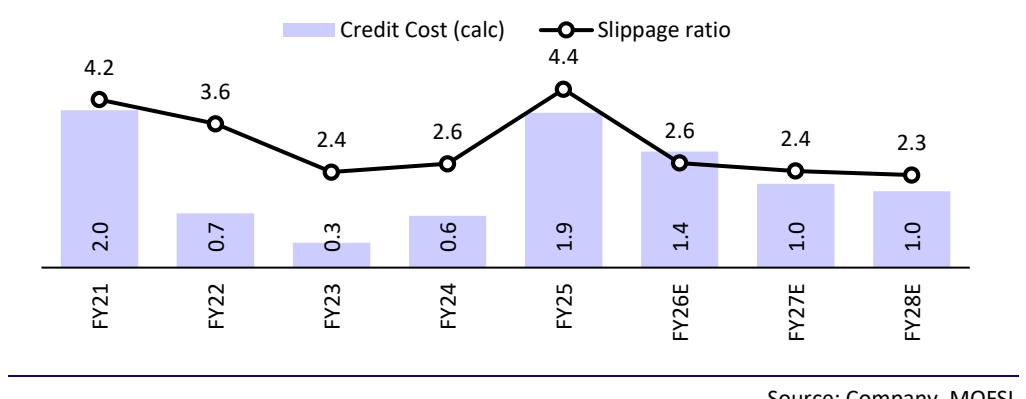
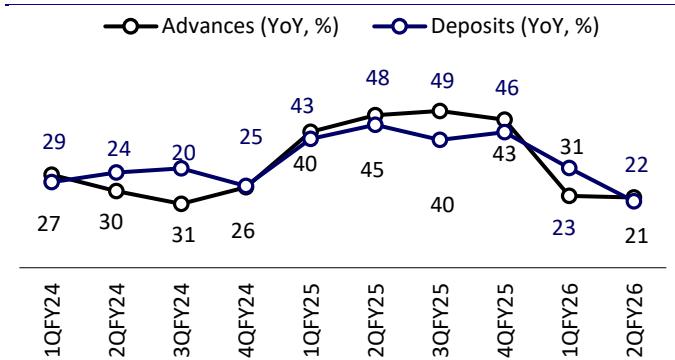


Exhibit 7: Estimate credit cost to sustain at avg. 1.0% over FY27-28E



Story in charts

Exhibit 8: Advances/deposits grew 22%/21% YoY



1Q-4QFY25 has a merger impact; Source: Company, MOFSL

Exhibit 10: Margins expanded 5bp QoQ to 5.5% in 2QFY26

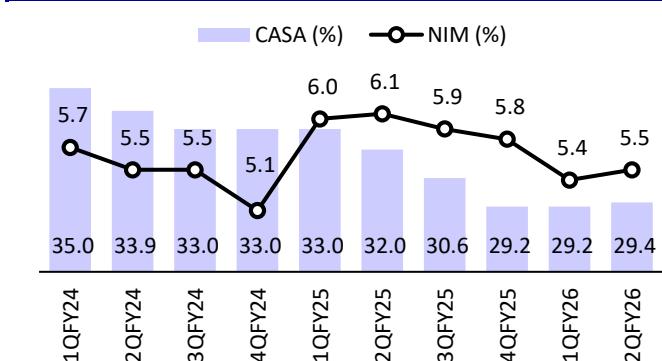


Exhibit 12: C/I ratio increased to 57.7% in 2QFY26

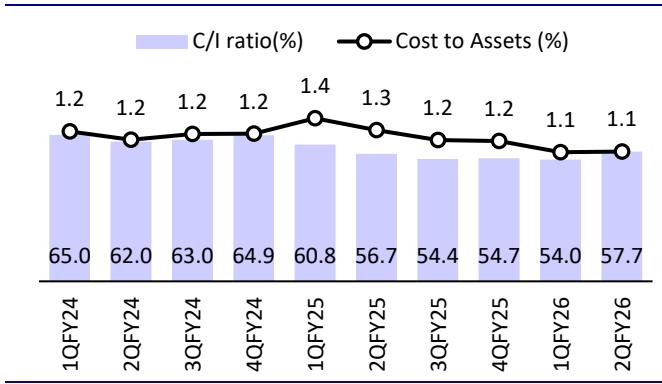
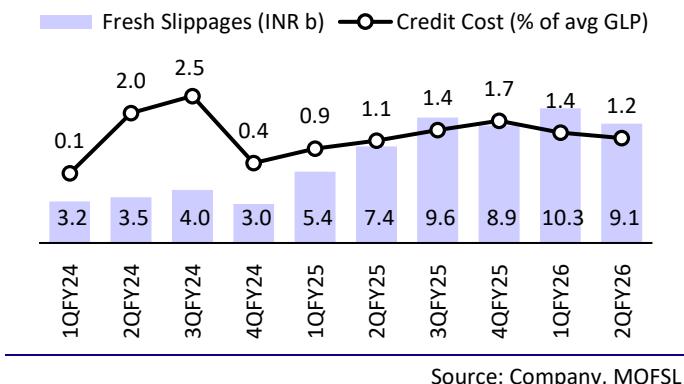
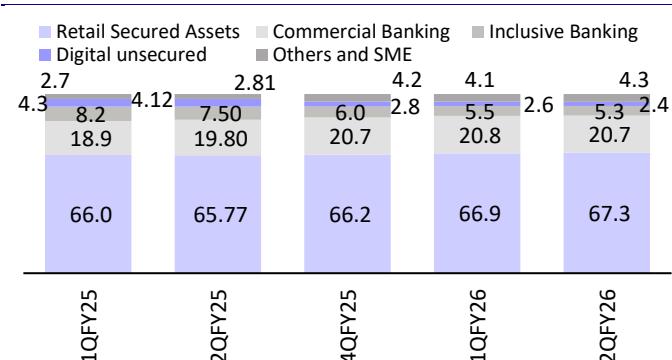


Exhibit 14: Credit costs declined to 1.2% annualized, and slippages declined 12% QoQ



Source: Company, MOFSL

Exhibit 9: Trend in the mix of total advances (%)



1QFY25 Numbers post-merger, Source: Company, MOFSL

Exhibit 11: Yield on gross advances declined to 13.9%

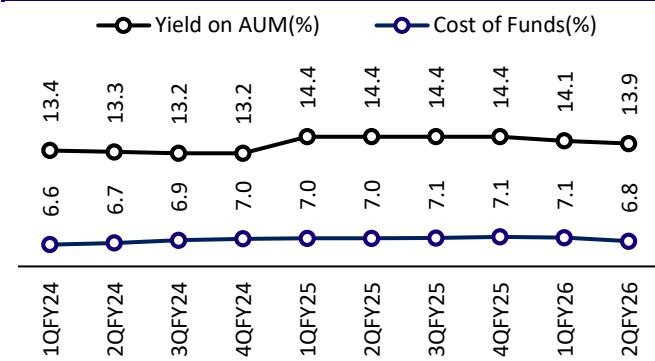


Exhibit 13: CD ratio increased to 87%; LCR at 119%

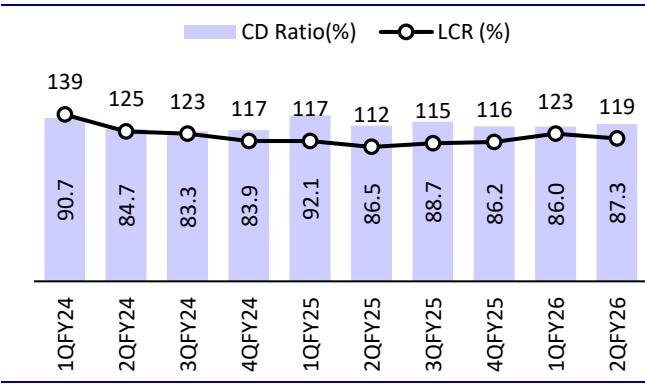
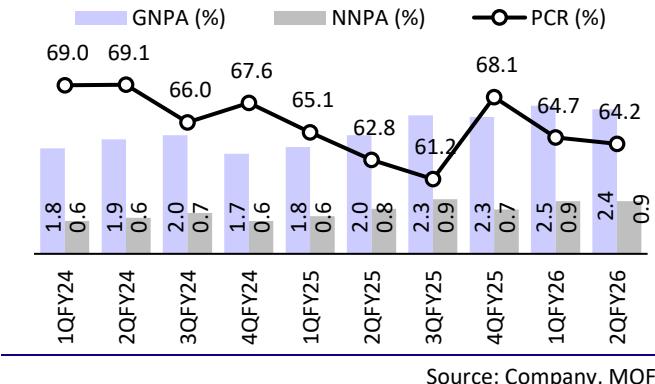


Exhibit 15: Asset quality ratios improved; PCR declined to 64.2%



Source: Company, MOFSL

Exhibit 16: DuPont analysis

Y/E March	FY22	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income	9.81	10.30	10.57	12.02	11.05	11.05	10.81
Interest Expense	4.45	4.75	5.41	6.03	5.89	5.67	5.37
Net Interest Income	5.36	5.56	5.17	6.00	5.15	5.38	5.44
Core Fee and Secu. Inc	1.41	1.35	1.65	1.71	1.57	1.48	1.47
Trading and others	0.24	-0.06	0.05	0.18	0.22	0.22	0.22
Non-Interest income	1.65	1.30	1.70	1.89	1.79	1.70	1.69
Total Income	7.01	6.85	6.87	7.89	6.95	7.08	7.14
Operating Expenses	4.00	4.32	4.47	4.46	3.92	4.08	4.01
- Employee cost	2.29	2.25	2.11	2.36	2.09	2.19	2.18
- Others	1.71	2.07	2.37	2.10	1.84	1.89	1.83
Operating Profits	3.01	2.54	2.39	3.43	3.02	3.01	3.13
Core operating Profits	2.77	2.59	2.34	3.25	2.80	2.79	2.90
Provisions	0.60	0.19	0.44	1.34	1.02	0.76	0.71
PBT	2.41	2.34	1.95	2.09	2.00	2.25	2.42
Tax	0.54	0.55	0.47	0.51	0.49	0.56	0.60
RoA	1.87	1.79	1.49	1.58	1.51	1.69	1.82
Leverage (x)	8.8	8.7	8.5	9.0	9.5	9.8	10.2
RoE	16.6	15.5	12.7	14.3	14.3	16.7	18.5

Exhibit 17: One-year forward P/E ratio

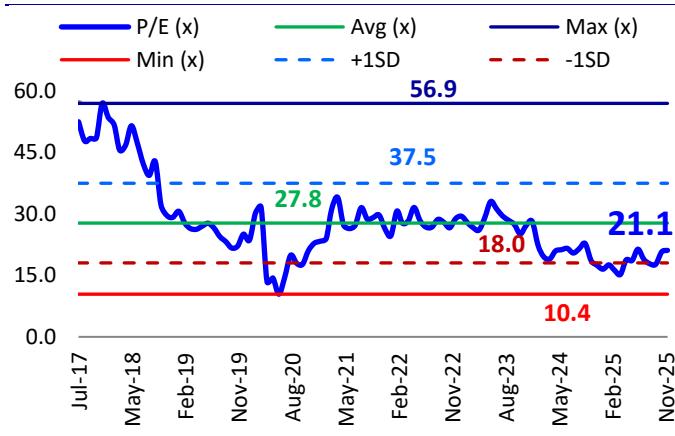
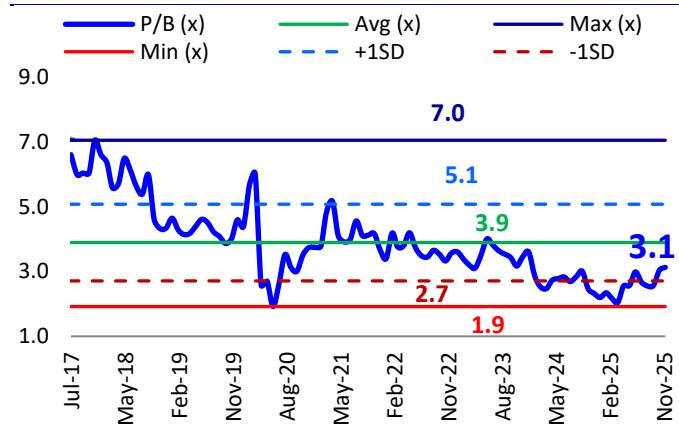


Exhibit 18: One-year forward P/B ratio



Financials and valuations

Income Statement						(INRb)
Y/E MARCH	FY23	FY24	FY25	FY26E	FY27E	FY28E
Interest Income	82.1	105.5	160.6	191.6	231.9	278.4
Interest Expense	37.8	54.0	80.5	102.2	118.9	138.2
Net Interest income	44.3	51.6	80.1	89.4	113.0	140.2
- growth (%)	36.8	16.5	55.4	11.6	26.4	24.1
Other Income	10.3	17.0	25.3	31.1	35.7	43.6
Total Income	54.6	68.5	105.4	120.5	148.7	183.8
- growth (%)	29.1	25.5	53.7	14.3	23.5	23.6
Operating Expenses	34.4	44.6	59.6	68.0	85.6	103.2
- growth (%)	42.6	29.8	33.4	14.2	25.8	20.6
Operating Profits	20.2	23.9	45.8	52.4	63.2	80.6
- growth (%)	11.3	18.3	91.7	14.5	20.5	27.6
Core Operating Profits	20.6	23.4	43.5	48.6	58.5	74.8
- growth (%)	23.4	13.3	85.9	11.8	20.3	27.9
Total Provisions	1.5	4.4	17.9	17.7	16.0	18.3
% to operating income	7.7	18.4	39.1	33.8	25.3	22.7
PBT	18.6	19.5	27.9	34.7	47.2	62.3
Tax	4.4	4.6	6.8	8.5	11.7	15.4
<i>Tax Rate (%)</i>	23.4	23.8	24.5	24.5	24.7	24.7
PAT	14.3	14.9	21.1	26.2	35.5	46.9
- growth (%)	26.4	4.1	41.7	24.4	35.5	32.1
Balance Sheet						
Y/E MARCH	FY23	FY24	FY25	FY26E	FY27E	FY28E
Equity Share Capital	6.7	6.7	7.4	7.5	7.5	7.5
Reserves & Surplus	102.7	118.3	163.0	188.4	223.1	269.2
Equity Networth	109.3	125.0	170.4	195.8	230.5	276.7
Deposits	693.6	871.8	1,242.7	1,496.2	1,837.3	2,270.9
- growth (%)	31.9	25.7	42.5	20.4	22.8	23.6
of which CASA Dep	266.6	291.3	362.5	441.4	569.6	717.6
- growth (%)	36.0	9.3	24.5	21.7	29.0	26.0
Borrowings	63.0	54.8	116.6	138.8	167.9	206.5
Other liabilities	35.8	42.0	47.5	58.4	71.3	87.0
- growth (%)	19.6	17.6	13.0	23.0	22.0	22.0
Total Liabilities	902.2	1,094.3	1,578.5	1,890.5	2,308.3	2,842.3
Current Assets	94.3	63.8	94.7	102.6	113.0	124.6
Investments	200.7	271.3	378.5	454.2	551.4	676.5
- growth (%)	31.1	35.2	39.5	20.0	21.4	22.7
Loans	584.2	731.6	1,070.9	1,295.8	1,601.6	1,994.0
- growth (%)	26.7	25.2	46.4	21.0	23.6	24.5
Net Fixed Assets	7.4	8.5	9.1	10.0	11.0	11.9
Other assets	15.6	19.0	25.3	27.8	31.2	35.3
Total Assets	902.2	1,094.3	1,578.5	1,890.5	2,308.3	2,842.3
Asset Quality						
GNPA (INR b)	9.8	12.4	24.8	29.5	34.2	40.3
NNPA (INR b)	2.9	4.4	8.3	10.0	10.3	11.3
Slippages (INR b)	12.4	17.0	40.0	30.8	34.8	41.4
GNPA Ratio (%)	1.7	1.7	2.3	2.28	2.13	2.02
NNPA Ratio (%)	0.5	0.6	0.8	0.77	0.65	0.57
Slippage Ratio (%)	2.4	2.6	4.4	2.6	2.4	2.3
Credit Cost (%)	0.3	0.6	1.9	1.4	1.0	1.0
PCR (Excl Tech. write off)	70.8	64.3	66.4	66.1	69.8	71.9

E: MOSL Estimates

Financials and valuations

Ratios

Y/E MARCH	FY23	FY24	FY25	FY26E	FY27E	FY28E
Yield and Cost Ratios (%)						
Avg. Yield - on IEA	11.7	11.7	13.0	11.9	11.8	11.5
Avg. Yield on loans	12.8	11.9	13.4	12.4	12.3	12.4
Avg. Cost of funds	5.6	6.4	7.0	6.8	6.5	6.2
Spreads	7.2	5.5	6.4	5.5	5.8	6.2
NIM (On total assets)	5.6	5.2	6.0	5.2	5.4	5.4
NIM (On IEA)	6.3	5.7	6.5	5.6	5.8	5.8

Capitalization Ratios (%)

CAR	23.6	20.1	20.1	18.9	17.9	17.3
<i>Tier I</i>	21.8	18.8	18.1	17.5	16.8	16.5
<i>CET 1</i>	21.8	18.8	18.1	17.5	16.8	16.5
<i>Tier II</i>	1.8	1.3	1.9	1.4	1.1	0.8

Business Ratios (%)

Loan/Deposit Ratio	84.2	83.9	86.2	86.6	87.2	87.8
CASA Ratio	38.4	33.4	29.2	29.5	31.0	31.6
Cost/Assets	4.3	4.5	4.5	3.9	4.1	4.0
Cost/Total Income	63.0	65.1	56.5	56.5	57.5	56.2
Cost/Core Income	62.5	65.6	57.8	58.3	59.4	58.0
Int. Expense/Int. Income	46.1	51.1	50.1	53.3	51.3	49.6
Fee Income/Total Income	19.8	24.0	21.4	22.6	20.9	20.6
Other Inc./Total Income	18.9	24.8	24.0	25.8	24.0	23.7

Efficiency Ratios (%)

Employee per branch (in nos)	51.5	47.3	65.9	51.9	47.0	42.5
Staff cost per employee (INR m)	0.6	0.7	0.6	0.7	0.9	1.0
CASA per branch (INR m)	485	463	469	439	502	559
Deposits per branch (INR m)	1,261	1,386	1,608	1,489	1,618	1,770
Bus. Per Employee (INR m)	45	54	45	54	64	78
Profit per Employee (INR m)	0.5	0.5	0.4	0.5	0.7	0.9

Profitability and Valuations

	FY23	FY24	FY25	FY26E	FY27E	FY28E
RoE	15.5	12.7	14.3	14.3	16.7	18.5
RoA (On bal Sheet)	1.8	1.5	1.6	1.5	1.7	1.8
RoRWA	2.9	2.3	2.3	2.4	2.7	2.9
Book Value (INR)	164.0	186.8	228.9	262.3	308.0	368.6
- growth (%)	38.2	13.9	22.6	14.6	17.4	19.7
Price-BV (x)	5.6	4.9	4.0	3.5	3.0	2.5
Adjusted BV (INR)	161.6	183.1	222.7	254.6	300.0	359.7
- growth (%)	38.5	13.3	21.7	14.3	17.8	19.9
Price-ABV (x)	5.7	5.0	4.1	3.6	3.1	2.6
EPS (INR)	22.0	22.2	29.8	35.2	47.5	62.6
- growth (%)	22.3	1.0	33.9	18.0	35.2	31.8
Price-Earnings (x)	41.9	41.5	31.0	26.3	19.4	14.7

E: MOSL Estimates

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Investment Rating	Expected return (over 12-month)
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

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