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India Financials

Q3 Preview: No respite from asset quality woes

We expect 10% YoY PAT growth for our banking coverage in Q3FY16, with private banks leading the pack. Loan growth is likely to be weak at 11-12% YoY though mid-size private banks are expected to grow by +20%. We expect NIMs to contract by ~5bps on average and credit costs to stay high due to asset stress. Loan growth and margins could expand for NBFCs due to lower bank borrowing cost, but chinks in asset quality remain.

- ➔ **Asset deterioration to continue:** We expect the stress on banks' asset quality to remain high, especially for corporate lenders and PSU banks. Slippages are likely to remain elevated due to a string of failed restructured loans. The RBI has been prodding banks to recognise troubled assets and clean up their balance sheets, creating uncertainty over the quantum of slippages that may emerge. Banks may accelerate provisions for their troubled assets which coupled with ageing NPAs would keep credit costs high. Management commentary regarding recognition of troubled assets will be a key element to watch.
- ➔ **Loan growth tepid:** With no visible signs of improvement in corporate demand and fresh investments, we expect overall credit growth of 11-12% in FY16. As per the latest available data, loan growth for the banking sector was weak at 11% YoY, only a tad better than the previous quarter. The corporate portfolio of lenders like ICICIB and AXSB should grow sub-10% with a strong performance expected from their retail books. Private banks would clearly outstrip public banks in credit growth, especially mid-tier names like IIB and YES, which we expect to grow even better than their private peers.
- ➔ **Margins under pressure:** We expect margins to come under pressure given the impact of a sharp 30-40bps cut in base rate that most banks took at the beginning of Q3. NIMs across the sector are likely to come off by ~5bps QoQ. Reductions in deposit rates are likely to make for a drop in lending yields, thereby limiting margin compression.
- ➔ **NBFCs should fare relatively better:** NBFCs under our coverage are expected to post 17% YoY PAT growth, since Q3 is a seasonally strong quarter for most of them. Margins could improve for CIFC, SHTF and MMFS, which have high bank borrowings as the impact of lower bank base rates begins to flow in. Management commentary on south-based NBFCs with regard to the Chennai flood impact will be a key parameter to monitor. Credit costs will continue to stay high for NBFCs that have migrated to 120-150dpd NPA recognition norms.


REPORT AUTHORS
Parag Jariwala, CFA

+91 22 6766 3442

parag.jariwala@religare.com

Vikesh Mehta

+91 22 6766 3474

vikesh.mehta@religare.com

RCML Universe: Recommendation summary

TICKER	CMP (Rs)	TP (Rs)	REC
Pvt. Banks			
AXSB	431	415	SELL
HDFCB	1,067	1,325	BUY
ICICIB	250	230	SELL
IIB	944	1,125	BUY
YES	704	870	BUY
KMB	704	900	BUY
PSU Banks			
BOB	149	145	SELL
BOI	114	100	SELL
CBK	228	220	SELL
PNB	110	110	SELL
SBIN	217	210	SELL
UNBK	144	130	SELL
NBFCs			
MMFS	237	270	HOLD
SHTF	873	1,250	BUY
SCUF	1,553	2,260	BUY
CIFC	648	850	BUY
POWF	201	265	HOLD
RECL	228	290	HOLD
SKSM	521	320	SELL

Source: Bloomberg, Company, RCML Research



Fig 1 - RCML financial universe: Q3FY16 preview

Particulars (Rs mn)	Net interest income			PPP			PAT		
	Q3FY16E	YoY (%)	QoQ (%)	Q3FY16E	YoY (%)	QoQ (%)	Q3FY16E	YoY (%)	QoQ (%)
PSU Banks									
State Bank of India	1,44,147	4.6	1.1	1,00,081	7.7	(2.5)	31,544	8.4	(18.7)
Bank of Baroda	33,739	2.7	4.0	24,544	4.9	5.0	3,951	18.3	217.4
Punjab National Bank	43,889	3.7	1.5	28,195	2.5	(4.1)	5,491	(29.1)	(11.6)
Bank of India	30,857	11.0	2.2	17,629	(5.5)	20.9	1,173	(32.4)	(110.4)
Canara Bank	26,529	11.4	0.2	20,350	13.2	4.7	4,312	(34.3)	(18.5)
Union Bank	21,484	1.3	2.2	15,321	4.6	2.8	6,077	101.0	(7.7)
Total PSU Banks	3,00,646	5.2	1.6	2,06,119	5.6	0.9	52,548	2.0	12.2
Private Banks									
Axis Bank	41,497	15.6	2.2	38,527	16.2	6.2	20,319	7.0	6.1
HDFC Bank	68,416	20.0	2.4	57,014	19.3	13.1	33,392	19.5	16.4
ICICI Bank	53,995	12.2	2.8	55,040	9.3	6.7	30,653	6.1	1.2
Kotak Mahindra Bank	22,261	41.0	(2.3)	15,640	39.6	0.4	9,207	28.5	(2.2)
Indusind Bank	11,121	29.1	1.6	10,158	31.3	0.9	5,582	24.8	(0.3)
Yes Bank	11,639	28.0	5.0	10,500	21.7	3.0	6,486	20.1	6.2
Total Private Banks	2,08,929	19.7	2.0	1,86,880	17.6	7.3	1,05,640	13.7	6.4
Total Banking	5,09,574	10.7	1.8	3,92,999	11.0	3.8	1,58,188	9.6	8.3
NBFCs									
Mahindra & Mahindra Fin Secs	9,045	9.7	4.0	5,755	10.4	5.6	1,732	10.5	10.3
Shriram Transport Finance	12,378	17.6	3.7	9,278	21.1	6.0	3,607	15.5	6.7
Shriram City Union Finance	6,274	10.6	4.4	3,677	9.0	5.1	1,626	13.8	6.8
Chola Finance	5,406	16.3	6.8	3,167	18.0	6.3	1,282	15.2	6.4
Power Finance Corp	29,600	16.3	0.6	27,612	19.6	(2.9)	18,152	17.7	7.1
Rural Electrification	23,693	9.7	(0.3)	23,251	8.2	0.0	16,061	16.4	(0.8)
SKS Microfinance	1,575	85.8	5.4	1,131	162.8	2.9	786	91.5	1.0
Total NBFCs	87,972	14.3	1.8	73,872	15.6	0.6	43,247	17.3	4.0

Source: Company, RCML Research



Fig 2 - Valuation snapshot

Particulars	P/E (x)			P/BV (x)			ROA (%)			ROE (%)		
	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
Private sector banks												
Axis Bank	13.8	12.3	10.4	2.3	2.0	1.7	1.7	1.6	1.6	17.8	17.2	17.7
HDFC Bank	25.6	21.3	17.8	4.3	3.7	3.2	1.9	1.9	1.9	19.4	18.7	19.3
ICICI Bank	13.0	11.9	10.2	1.8	1.6	1.4	1.8	1.8	1.8	14.5	14.2	14.8
IndusInd Bank	27.8	22.5	18.3	4.9	3.6	3.1	1.8	1.9	2.0	18.2	17.7	17.6
YES Bank	13.7	11.9	9.5	2.5	2.1	1.8	2.0	1.8	1.9	21.3	19.5	20.6
Kotak Bank	34.7	33.8	24.9	4.3	3.9	3.4	2.2	1.9	1.8	15.1	13.9	14.7
Public sector banks												
Bank of Baroda	9.6	10.0	7.3	0.9	0.8	0.7	0.5	0.4	0.6	9.0	8.0	10.3
Bank of India	4.4	-37.4	5.4	0.3	0.3	0.3	0.3	-0.0	0.2	5.6	-0.7	4.9
Canara Bank	3.9	5.1	4.1	0.4	0.4	0.4	0.5	0.4	0.4	8.8	6.7	8.2
PNB	6.6	6.3	5.1	0.5	0.5	0.5	0.5	0.5	0.6	8.2	8.1	9.5
SBI - Consolidated	9.2	8.4	7.1	1.0	0.9	0.8	0.7	0.7	0.7	11.3	11.3	12.1
Union Bank	5.1	4.8	4.4	0.5	0.5	0.5	0.5	0.5	0.5	9.3	9.6	10.4
NBFCs												
Mahindra & Mahindra Fin Secs	14.6	14.8	11.9	2.2	2.0	1.8	2.5	2.3	2.7	16.2	14.4	15.8
Shriram Transport Finance	15.5	14.4	11.3	2.1	1.9	1.7	2.4	2.2	2.5	14.6	14.0	15.8
Shriram City Union Finance	17.4	15.2	12.8	2.5	2.2	1.9	3.2	3.4	3.5	15.9	15.3	15.8
Chola Finance	21.4	18.9	14.7	3.5	2.8	2.4	1.9	2.1	2.5	17.5	16.9	17.5
Power Finance Corp	4.4	4.0	3.5	0.8	0.7	0.6	2.8	2.7	2.7	20.0	19.1	18.7
Rural Electrification	4.3	3.8	3.4	0.9	0.8	0.7	3.4	3.0	3.0	25.1	21.8	21.1
SKS Microfinance	35.0	27.6	22.0	6.3	5.1	4.2	5.2	4.5	4.2	24.9	20.4	20.9

Source: Bloomberg, Company, RCML Research

RESEARCH TEAM

ANALYST	SECTOR	EMAIL	TELEPHONE
Mihir Jhaveri	Auto, Auto Ancillaries, Cement, Logistics	mihir.jhaveri@religare.com	+91 22 6766 3459
Siddharth Vora	Auto, Auto Ancillaries, Cement, Logistics	siddharth.vora@religare.com	+91 22 6766 3435
Misal Singh	Capital Goods, Infrastructure, Utilities	misal.singh@religare.com	+91 22 6766 3466
Prashant Tiwari	Capital Goods, Infrastructure, Utilities	prashant.tiwari@religare.com	+91 22 6766 3485
Premal Kamdar	Consumer	premal.kamdar@religare.com	+91 22 6766 3469
Rohit Ahuja	Energy	ahuja.rohit@religare.com	+91 22 6766 3437
Parag Jariwala, CFA	Financials	parag.jariwala@religare.com	+91 22 6766 3442
Vikesh Mehta	Financials	vikesh.mehta@religare.com	+91 22 6766 3474
Rumit Dugar	IT, Telecom, Media	rumit.dugar@religare.com	+91 22 6766 3444
Saumya Shrivastava	IT, Telecom, Media	saumya.shrivastava@religare.com	+91 22 6766 3445
Pritesh Jani	Metals	pritesh.jani@religare.com	+91 22 6766 3467
Arun Baid	Mid-caps	arun.baid@religare.com	+91 22 6766 3446
Praful Bohra	Pharmaceuticals	praful.bohra@religare.com	+91 22 6766 3463
Aarti Rao	Pharmaceuticals	aarti.rao@religare.com	+91 22 6766 3436
Arun Aggarwal	Real Estate	arun.aggarwal@religare.com	+91 22 6766 3440
Jay Shankar	Economics & Strategy	shankar.jay@religare.com	+91 11 3912 5109
Rahul Agrawal	Economics & Strategy	ag.rahul@religare.com	+91 22 6766 3433

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