Banking Sector

Institutional Equity Research

Results Preview | July 09, 2019

Stable Operating Performance; Large Corporate Banks to See Sharp Earnings Recovery

We expect the banks under our coverage universe should continue to deliver a stable operating performance in 1QFY20 with NII and PPoP growth of 15% and 28%, respectively. Though moderation in credit growth will impact revenues, higher treasury income should partially compensate for the same. Asset quality will continue to improve driven by moderation in slippages and higher write-offs. Large private corporate banks with adequate provisioning and less concerns over incremental slippages from select leveraged accounts could see sharp improvement in RoAs (ICICI Bank, Axis Bank).

Credit Growth Likely to Moderate

Domestic credit growth is expected to moderate to ~12% YoY in Q1FY20. Whilst diversion of credit from the NBFCs and PSBs coming out of PCA expected to have aided growth, higher YoY base (increased lending to NBFCs/HFCs during 1HFY19) and weak private capex are the key reasons for moderation in growth, in our view. Overall, we expect the private banks to witness credit growth to the tune of 17-18% YoY, while PSBs are likely to grow at 7-8% YoY. As per latest RBI bulletin, corporate credit growth continues to be driven by the infra sector (18% YoY growth as of May-19), led by telecom and roads. Even though retail growth has moderated from its peak, growth in housing portfolio remains resilient (~19% YoY).

Asset Quality Improvement to Continue

In the absence of large corporate recoveries, we expect improvement in asset quality to be primarily driven by moderation in slippages and higher write-offs. Also, positive impact of resolutions outside the NCLT and change in credit culture should continue to aid asset quality. While there are concerns over select large leveraged accounts, which could result in higher slippages for the banking system, we don't expect any of them to play out in1QFY20. However, residual standard exposure to Jet Airways is expected to be recognised as sub-standard. Moreover, slippages from the agri portfolio are also likely to be seasonally higher.

Margins to Remain Stable; Treasury Gains to Aid Revenue Growth

While lower interest reversals (moderation in slippages) will support expansion in margins, declining share of high-yielding unsecured loans, lower MCLR rates (most banks reduced MCLR rates over the last 2 months) and moderation in loan growth are likely to cap NIM expansion. Nonetheless, we expect NIM expansion to continue for select corporate banks (ICICI Bank and SBI). With ~45bps decline in benchmark 10-year bond yields during Q1FY20, PSBs could witness a big delta in treasury earnings. Within our banking sector coverage universe, we expect SBI and Canara Bank to benefit the most on the back of higher share of AFS book and elevated portfolio duration.

Sectoral Outlook

Despite a stable operating performance in 1QFY20, we see the near-term headwinds for the sector in the form of sluggish private capex cycle, softness in consumption cycle, delay in large corporate recoveries and challenges in deposit growth. We therefore prefer the corporate banks (ICICI Bank & SBI) with a strong liability franchise, fewer concerns over incremental slippages from select corporate accounts, adequate provisioning, and inexpensive valuations. Given a not-so-benign operating environment, we believe conservative plays like HDFC Bank and Kotak Bank should continue to do well, despite trading at expensive valuation multiples.

Our top sectoral picks: ICICI Bank, HDFC Bank and SBI

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Revision in Target Price & Ratings

Given the structural pressure in retail term deposits, we believe large banks with a strong liability franchise and higher provision coverage are well-placed vis-à-vis others, and therefore should attract premium valuations. Though ICICI Bank and SBI have outperformed their peers over the last few months, we have raised their target multiples given inexpensive valuations and expectations of strong turnaround in FY20E.

Yes Bank's delay in capital raising, concerns over its corporate portfolio and impact of revised growth strategy result in limited earnings visibility in the near to medium term. We therefore place our rating on Yes Bank "UNDER REVIEW", as we analyse its ability to manage capital-raising and asset quality issues. We will also watch out for developments in the bank's liability franchise, including cost of funds and CASA.

Exhibit 1: Revision in Target Price & Ratings

Company	Old Rating	Revised Rating	Old TP	Revised TP	Reason
ICICI Bank	BUY	BUY	460	500	Standalone target multiple revised to 2.1x FY21E from 1.9x earlier
SBI	BUY	BUY	390	420	Standalone target multiple revised to 1.4x FY21E from 1.3x earlier
Yes Bank	HOLD	Under Review	220	-	Limited earnings visibility due to delay in capital raise and concerns over corporate book

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Exhibit 2: Banking - 1QFY20 Results Preview

Company (Rs mn)	Jun-19E	Jun-18	YoY (%)	Mar-19	QoQ (%)	Comments
Axis Bank						
NII	60,413	51,668	16.9	57,056	5.9	▶ Fee income to gain traction, margins to remain stable ▶ Increased focus on retail term depsoits to limit NIM expansion in the interim ▶ Credit costs to moderate sequentially
Pre-provision profit	54,004	43,720	23.5	50,144	7.7	
Net Interest Margin (%)	89.4	84.6	477	87.9	150	
PAT	17,168	7,011	144.9	15,051.0	14.1	
Bank of Baroda						
NII	60,679	43,811	38.5	50,670	19.8	▶ Incorporated merged financials for Dena and Vijaya in Q1FY20 , YoY/QoQ numbers not comparable ▶ Advances growth for the domestic book to moderate on account of integration challenges ▶ Intergration related issues (IT, HR) to be a monitorable ▶ Credit costs to moderate sequentially as PCR remains high
Pre-provision profit	42,091	30,056	40.0	38,608	9.0	
Net Interest Margin (%)	69.4	68.6	76	76.2	(683)	
PAT	10,119	5,283	91.5	(9,914)	(202.1)	
Canara Bank						
NII	37,245	38,829	(4.1)	35,002	6.4	▶ Higher treasury gains to aid PPoP ▶ Jet exposure (Rs6bn) to be recognized as NPA, decline in slippages and high write-offs to continue to aid overall GNPAs ▶ We expect ageing related provisions to continue in H1FY20, with rise in PCR
Pre-provision profit	27,923	29,328	(4.8)	29,735	(6.1)	
Net Interest Margin (%)	75.0	75.5	(56)	85.0	(998)	
PAT	3,315	2,815	17.8	(5,515.3)	(160.1)	
DCB Bank						
NII	3,193	2,730	17.0	3,009	6.1	▶ Expect a stable set of numbers with healthy loan growth with gain in market share from NBFCs ▶ Cost/Income ratio to moderate further ▶ RoA to inch up marginally
Pre-provision profit	2,001	1,414	41.5	1,853	8.0	
Net Interest Margin (%)	62.7	51.8	1,086	61.6	108	
PAT	1,042	695	50.0	963.2	8.2	

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Banking - 1QFY20 Results Preview

Company (Rs mn)	Jun-19E	Jun-18	YoY (%)	Mar-19	QoQ (%)	Comments
Federal Bank						
NII	11,576	9,801	18.1	10,965	5.6	▶ Margins to get a boost of increased retail orientation (higher share of PL/CV loans)
Pre-provision profit	7,462	6,029	23.8	7,548	(1.1)	▶ Corporate slippages to remain contained, Stability in non-corporate slippages will be an area of watch
Net Interest Margin (%)	64.5	61.5	295	68.8	(436)	
PAT	3,572	2,627	36.0	3,815.1	(6.4)	▶ Benefits on cost efficiencies and improving fee lines to aid RoA
HDFC Bank						
NII	128,773	108,136	19.1	130,895	(1.6)	▶ Loanbook growth expected to remain healthy even as some moderation in auto portfolio is expected
Pre-provision profit	112,119	86,478	29.7	108,436	3.4	
Net Interest Margin (%)	87.1	80.0	710	82.8	423	▶ Expect elevated slippages in the argi portfolio
PAT	58,764	46,014	27.7	58,850.8	(0.1)	▶ Margins expected to remain stable sequentially
ICICI Bank						
NII	71,256	61,019	16.8	76,201	(6.5)	▶ Market share gains to continue to aid growth in the corporate portfolio
Pre-provision profit	62,647	46,984	33.3	62,334	0.5	▶ Led by increasing share of retail, margins are expected to increase
Net Interest Margin (%)	87.9	77.0	1,092	81.8	612	▶ Sharp decline in credit costs to support higher RoAs
PAT	16,496	(1,196)	(1,479.9)	9,690.6	70.2	
Indian Bank						
NII	19,271	18,070	6.6	17,635	9.3	▶ Loan book growth expected to be above industry average
Pre-provision profit	13,807	12,976	6.4	12,454	10.9	▶ Credit costs to remain elevated
Net Interest Margin (%)	71.6	71.8	(16)	70.6	102	▶ Recoveries from educational loan portfolio will be monitorable
PAT	2,133	2,093	1.9	(1,897.7)	(212.4)	

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Banking - 1QFY20 Results Preview

Company (Rs mn)	Jun-19E	Jun-18	YoY (%)	Mar-19	QoQ (%)	Comments
IndusInd Bank						
NII	28,520	21,224	34.4	22,324	27.8	▶ Incorporated merged financials for BHAFIN in Q1FY20 , YoY/QoQ numbers not comparable
Pre-provision profit	25,300	19,111	32.4	20,677	22.4	▶ Credit costs likely to remain elevated, guidance on the same remains critical
Net Interest Margin (%)	88.7	90.0	(133)	92.6	(391)	
PAT	9,720	10,356	(6.1)	3,601.0	169.9	
Kotak Mahindra Bank						
NII	31,336	25,829	21.3	30,479	2.8	▶ Uptick in business banking portfolio expected
Pre-provision profit	23,241	20,325	14.3	22,823	1.8	▶ Loan growth to remain strong led by market share gain from NBFCs
Net Interest Margin (%)	74.2	78.7	(452)	74.9	(71)	▶ NIMs to remain stable sequentially
PAT	12,879	10,249	25.7	14,078.0	(8.5)	
State Bank of India						
NII	245,369	217,984	12.6	229,538	6.9	▶ High share of AFS book and high duration of AFS to support treasury gains
Pre-provision profit	167,328	119,731	39.8	169,331	(1.2)	▶ Operating effciencicy to aid profits
Net Interest Margin (%)	68.2	54.9	1,327	73.8	(558)	▶ Credit costs to decline sharply, aiding profitability
PAT	29,561	(48,759)	(160.6)	8,384.0	252.6	

Source: Company, RSec Research

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Exhibit 3: Valuation Table

Company	CMP*	Recos	Target Price	Mkt. Cap	RoE (%)			RoA (x)			P/ABV (x)			P/E (x)		
Company	(Rs)		(Rs)	(Rs bn)	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Axis Bank	783	HOLD	800	2,051	7.2	13.1	16.4	0.6	1.1	1.4	3.6	3.0	2.5	43.1	21.4	14.6
Bank of Baroda	125	BUY	150	479	0.9	11.5	12.9	0.1	0.7	0.8	1.3	1.2	0.9	88.6	6.9	5.1
Canara Bank	270	HOLD	265	203	1.0	9.0	13.0	0.1	0.5	0.7	3.4	1.1	0.7	58.6	6.0	3.7
DCB Bank	224	BUY	250	69	11.0	13.4	15.8	1.0	1.1	1.3	2.6	2.2	1.9	21.3	15.6	11.6
Federal Bank	105	BUY	115	209	9.8	12.7	14.7	0.8	1.0	1.1	1.8	1.6	1.4	16.8	11.7	8.9
HDFC Bank	2,410	BUY	2,650	6,575	16.5	16.1	16.6	1.8	1.9	1.9	4.5	4.0	3.5	31.1	25.6	21.8
ICICI Bank	426	BUY	500	2,747	4.0	12.5	14.8	0.5	1.4	1.7	3.1	2.7	2.3	81.6	19.2	14.4
Indian Bank	241	HOLD	250	119	1.7	5.4	11.0	0.1	0.4	0.7	1.2	1.0	0.8	36.0	10.8	5.0
Indusind Bank	1,477	HOLD	1,650	891	13.1	17.1	19.0	1.3	1.7	1.9	3.8	3.1	2.6	27.0	19.2	13.8
Kotak Mahindra Bank	1,475	BUY	1,550	2,816	12.1	13.0	13.9	1.7	1.8	1.8	6.9	6.0	5.3	57.9	47.0	38.6
State Bank of India	355	BUY	420	3,171	1.8	12.7	13.6	0.1	0.8	0.9	2.5	1.8	1.4	367.7	10.6	8.8

Source: Company, RSec Research; CMP as on July 08, 2019

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Exhibit 4: Key Financials

Company	Gross NPAs Ratio (%)			Net NPAs Ratio (%)			Slippage Ratio (%)		
Company	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Axis Bank	5.3	4.6	3.8	2.1	1.7	1.2	3.2	2.5	1.6
Bank of Baroda	9.6	8.0	6.4	3.3	2.9	2.5	3.2	3.3	2.1
Canara Bank	8.8	5.3	3.8	5.4	3.0	1.9	4.1	2.9	2.0
DCB Bank	1.8	1.8	1.8	0.7	0.6	0.6	2.1	1.9	1.9
Federal Bank	2.9	2.7	2.5	1.5	1.2	1.0	1.8	1.4	1.3
HDFC Bank	1.4	1.4	1.4	0.4	0.4	0.4	2.2	1.9	1.8
ICICI Bank	6.7	5.6	4.2	2.1	2.0	1.5	2.5	2.2	1.6
Indian Bank	7.1	5.9	4.9	3.8	2.7	1.8	4.1	2.7	1.9
Indusind Bank	2.1	2.1	2.0	1.2	0.8	0.7	3.7	2.1	1.8
Kotak Mahindra Bank	2.2	2.2	2.2	0.8	0.7	0.7	1.2	1.3	1.2
State Bank of India	7.3	4.9	3.9	3.0	1.8	1.3	2.1	1.7	1.5

Source: Company, RSec Research

Continued...

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Exhibit 5: Key Financials

Company	PPoP growth (%)			Credit costs			NIM (%)		
Company	**FY19**	**FY20E**	**FY21E**	**FY19**	**FY20E**	**FY21E**	**FY19**	**FY20E**	**FY21E**
Axis Bank	21.9	17.3	21.4	2.3	1.1	0.8	3.2	3.2	3.3
Bank of Baroda	12.3	34.6	11.5	1.9	1.0	0.6	2.6	2.9	2.5
Canara Bank	10.9	14.2	10.6	3.1	1.6	1.0	2.4	2.4	2.5
DCB Bank	23.2	32.6	31.9	0.6	0.5	0.5	3.6	3.7	3.9
Federal Bank	20.6	27.3	28.1	0.7	0.6	0.6	2.9	3.0	3.1
HDFC Bank	21.8	19.4	18.4	0.9	0.8	0.7	4.4	4.4	4.4
ICICI Bank	15.0	20.5	18.7	3.7	1.1	0.7	3.2	3.3	3.4
Indian Bank	-2.4	17.0	17.0	2.3	2.2	1.6	2.8	2.8	2.8
Indusind Bank	21.5	32.5	27.1	1.5	1.2	0.8	3.8	4.2	4.3
Kotak Mahindra Bank	16.6	25.7	21.9	0.6	0.6	0.6	4.2	4.2	4.3
State Bank of India	-0.4	28.4	11.6	2.8	1.1	0.9	2.7	2.9	2.9

Source: Company, RSec Research

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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