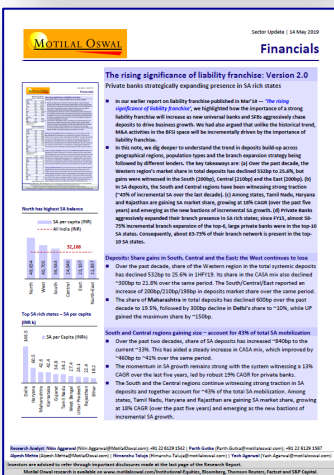
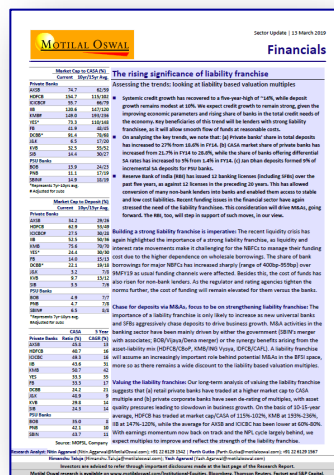




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Please refer our earlier reports on Liability franchise



Liability franchise – Version 3.0

Branch expansion back in focus; identifying states with strong growth potential

- In our earlier twin reports on liability franchise — *'The rising significance of liability franchise'* (Version 1.0, Version 2.0), we had highlighted that the importance of a strong liability franchise will increase as new universal banks and SFBs aggressively chase deposits to drive business growth. We also evaluated trends in deposits build-up across geographies, emphasizing strategy of private banks to expand their presence in top SA-rich states.
- In this note, we have assessed productivity gains that different banks displayed as they built strong liability franchise. Here, KMB, HDFCB and ICICIB are the clear outperformers. KMB has reflected highest improvement in SA per branch (INR531m in FY19 v/s INR110m in FY15), followed by HDFCB and ICICIB.
- With several private banks guiding for aggressive branch expansion over FY19-22, we analyzed region-wise SA build-up composition of branches for major banks. We note that private banks have lower branch presence in Bihar/UP/West Bengal (~5%/12%/6% SA market share), despite the three ranking among the top 10 SA states. We believe that the under-penetrated banking regions of West Bengal and Bihar have the potential to emerge as the new bastions for branch expansion.

Physical expansion v/s Digital initiatives — branch expansion back in focus

Over FY09-16, branch expansion across private banks/PSBs was healthy at ~16%/~7% CAGR; but, the last three years saw it moderate to a tepid overall CAGR of ~2%. While credit growth is in throes of revival currently, deposit growth has consistently lagged loan growth by an average ~460bp since Mar'18. In this scenario, private banks have highlighted the need to refocus on branch expansion strategy — in order to continue mobilizing retail deposits aggressively. Among private banks, AXSB plans to increase its branch count to 5,000, HDFCB is set to open another 700 branches, while IIB is aiming to bolster its branch strength to 2,000.

Varied productivity gains across private banks; KMB & HDFCB clear outperformers

Over the last few years, private banks have been focusing on improving branch productivity (SA per branch) and leveraging technology. Among private banks, KMB, HDFCB and ICICIB are the clear outperformers. KMB has reflected highest improvement in SA per branch (improved to INR531m in FY19 v/s INR110m in FY15), followed by HDFCB and ICICIB. AXSB showed lowest improvement due to continued focus on branch expansion.

Assessing potential regions for branch expansion

Based on our region-wise branch analysis, we note that private banks have lower branch presence in Bihar/UP/West Bengal (with ~5%/12%/6% SA market share), despite the three being among the top 10 SA states. Branch presence of private banks is highest in Maharashtra. We continue to believe that the under-penetrated banking regions of West Bengal and Bihar can emerge as the new bastions for branch expansion.

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Research analyst: Parth Gutka | Alpesh Mehta | Himanshu Taluja | Yash Agarwal

Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Branch expansion back in focus

- **Expansion phase:** Over FY09-16, private banks witnessed healthy branch expansion at ~16% CAGR compared to PSBs that grew branches at just ~7% CAGR. Further, overall deposits growth for private banks under our coverage has been strong at ~18% CAGR, while it grew at a modest pace of ~13.6% CAGR for PSBs. Among private banks, AXSB, HDFCB, ICICIBC and IIB witnessed rapid branch expansion (ranging between ~18-28%). Deposit growth remained strong for all private banks, with the exception of ICICIBC.
- **Consolidation phase:** Over the last three years, branch expansion was moderate across most banks with a tepid ~2% CAGR (AXSB and IIB continued with their branch expansion strategy). However, deposit growth for private banks under our coverage remained strong at ~19% CAGR, led by (a) improvement in branch productivity (deposit per branch), (b) increased focus on digital channels, and (c) cost control initiatives.
- **Branch expansion back in focus:** Currently, credit growth is in throes of a revival, but deposit growth has been consistently lagging loan growth by an average ~460bp since Mar'18. Thus, banks have increased focus on mobilizing retail deposits through branch expansion, offering higher interest rates and improving productivity of existing branches. AXSB has guided its total branch size to increase to ~5,000 v/s 4,050 branches currently, while HDFCB is also planning to open 600-800 branches annually over the next 3-4 years (after muted expansion in the last three years). IIB is continuing with its branch expansion strategy, aiming for a branch count of ~2,000 by FY20 (planning cycle 4). IDFCFB is aggressively devising branch expansion plans to support its guidance of adding 600-700 branches over the next 5-6 years v/s 242 branches currently.

Exhibit 1: Branch expansion pace moderates over the last few years

Branches YoY gr. (%)	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	CAGR (FY09-16)	CAGR (FY16-19)
AXSB	24.4	17.7	41.4	16.7	20.0	23.4	7.8	12.2	13.8	12.1	9.4	19.5	11.7
HDFCB	85.5	22.2	15.1	28.1	20.4	11.1	18.0	12.6	4.3	1.5	6.6	18.1	4.1
ICICIBC	8.5	20.3	48.2	8.8	12.6	21.1	7.9	9.9	9.0	0.4	0.1	17.7	3.1
IIB	-	16.7	42.9	33.3	25.0	20.4	33.1	24.8	20.0	16.7	18.9	27.8	18.5
KMB	13.8	4.8	13.6	6.0	10.8	18.0	8.5	4.8	2.7	1.4	8.1	9.4	4.0
SBIN	12.4	9.2	8.4	4.1	5.1	7.1	2.9	2.8	2.3	30.5*	(1.8)	5.6	9.5*
BOB	2.6	5.9	8.6	15.8	8.0	15.4	5.2	2.7	1.7	0.8	1.6	8.7	1.4
PNB	1.7	7.2	3.8	9.3	3.6	5.5	5.8	3.0	2.6	0.6	0.1	5.4	1.1
PSBs	5.0	6.8	6.2	7.9	7.3	10.7	7.0	3.8	2.2	(0.7)	0.1	7.1	0.5
Private Banks	11.1	13.5	15.3	16.0	15.3	15.8	10.7	24.2	9.2	6.0	2.5	15.8	5.9
Pan India	5.2	6.7	6.7	8.5	8.1	10.7	7.4	7.0	3.7	1.5	1.9	7.9	2.4

Source: MOFSL, Company; Note: *effect of merger

Exhibit 2: Branch expansion plans of private banks...

Branches	FY19	Branch Guidance	Comments
AXSB	4,050	5,000	Guided to increase branch count to 5,000 over next 3-4 years
HDFCB	5,103	8,000	Guided to add 600-800 branches annually over next 3-4 years
IIB	1,665	2,000	Increase branch count to 2,000 by FY20 (Planning cycle 4)
IDFCB	242	842-942	Plans to set up 600-700 more bank branches in next 5-6 years

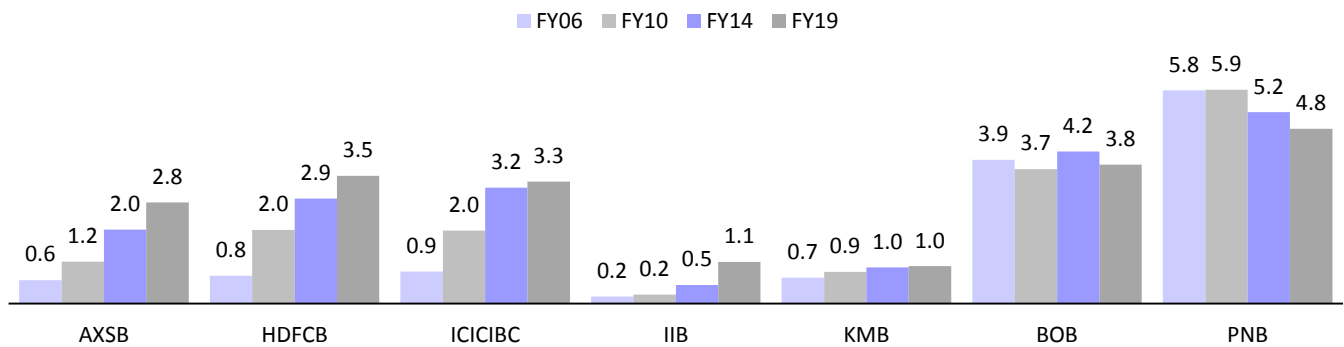
Source: MOFSL, Company

Exhibit 3: Private banks' deposits growth CAGR over the last decade

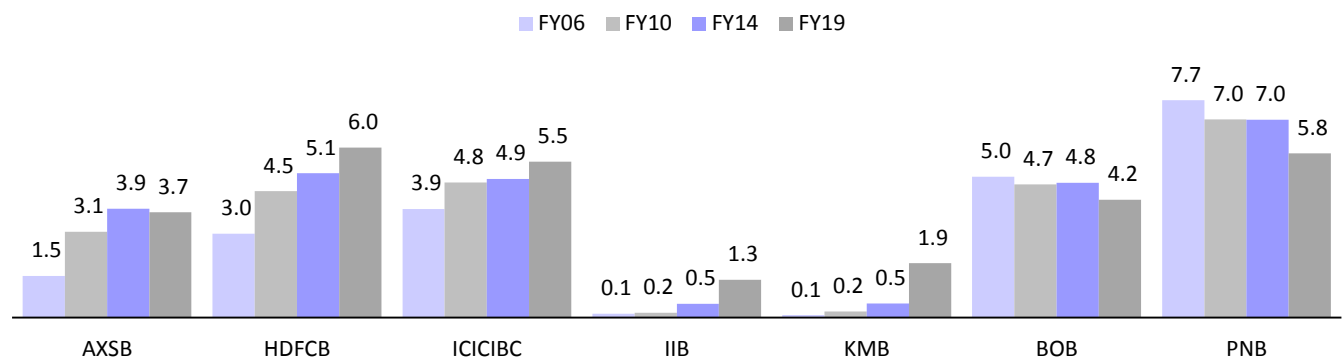
Deposits (INR m)	CAGR (FY09-16, %)	CAGR (FY16-19, %)
Private Banks	17.7	18.6
AXSB	17.3	15.3
HDFCB	21.1	19.1
ICICI	9.8	15.7
IIB	22.8	28.0
KMB	36.6	17.7
YES	31.8	26.8
RBL	51.9	33.9
FEDERAL	13.7	19.5
DCB	18.1	24.0
PSBs	13.6	7.1
BOB	16.9	3.6
BOI	15.3	0.5
CBK	14.4	7.7
INBK	13.7	10.7
PNB	14.9	6.9
SBIN	12.1	9.1
UNBK	13.8	6.7

Source: MOFSL, Company

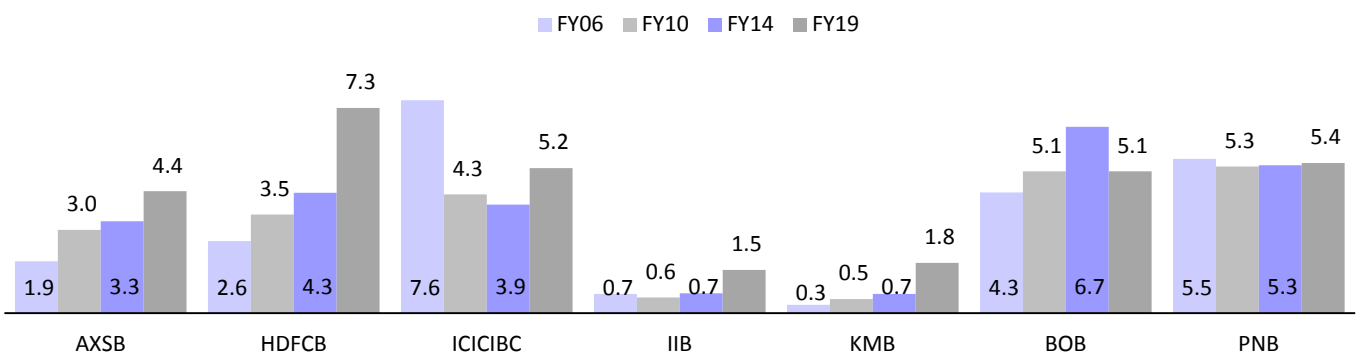
- Over the last five years, in terms of branch market share, AXSB was the highest gainer at 2.8% (an increase of ~0.8%) due to continued branch expansion strategy; HDFCB has maintained its position (highest branch market share holder). Among PSBs, BOB and PNB have continued losing branch market share.
- Despite gaining maximum branch market share in the last five years, AXSB lost SA market share during the same period. KMB's performance in building liability franchise was phenomenal and was led by productivity gains; thus, it gained maximum SA market share over the last couple of years. However, HDFCB sustained its strong deposit growth momentum due to improvement in branch productivity. This helped the bank to maintain its position as the highest deposit market share holder among private banks.

Exhibit 4: AXSB gained highest branch market share — by ~80bp over the last five years

Source: MOFSL, Company

Exhibit 5: KMB was the highest SA market share gainer over the last five years, while AXSB lost market share in SA deposits

Source: MOFSL, Company

Exhibit 6: HDFCB maintained its position of the highest deposits market share holder, followed by ICICIBC over the last 5 years

Source: MOFSL, Company

Potential branch expansion regions for private banks

Based on our region-wise analysis, we note that private banks have the lowest branch presence in Bihar (~5% SA market share) and West Bengal (~6% SA market share), despite both states ranking among the top 10 SA states. Highest branch presence was seen in Maharashtra. We believe that the under-penetrated banking regions of West Bengal and Bihar could be potential regions for branch expansion in the future.

Exhibit 7: Potential regions for branch expansion by banks; private banks have lowest branch presence in Bihar (5% SA market share)

AXSB	HDFCB	ICICIBC	IIB	KMB
Uttar Pradesh	West Bengal	Uttar Pradesh	Karnataka	Uttar Pradesh
Bihar	Bihar	Delhi	West Bengal	West Bengal
Delhi		Bihar	Delhi	Bihar
			Bihar	Kerala

Source: MOFSL, RBI

Exhibit 8: AXSB: Potential regions for branch expansion

Potential Regions	SA Market Share	Bank branch Share
Uttar Pradesh	12%	7%
Bihar	5%	3%
Delhi	6%	4%

Source: MOFSL, RBI

Exhibit 9: HDFCB: Potential regions for branch expansion

Potential Regions	SA Market Share	Bank branch share
West Bengal	6%	4%
Bihar	5%	2%

Source: MOFSL, RBI

Exhibit 10: ICICIBC: Potential regions for branch expansion

Potential Regions	SA Market Share	Bank branch share
Uttar Pradesh	12%	5%
Delhi	6%	4%
Bihar	5%	2%

Source: MOFSL, RBI

Exhibit 11: IIB: Potential regions for branch expansion

Potential Regions	SA market Share	Bank branch share
Karnataka	7%	3%
West Bengal	6%	4%
Delhi	6%	3%
Bihar	5%	2%

Source: MOFSL, RBI

Exhibit 12: KM: Potential regions for branch expansion

Potential Regions	SA Market Share	Bank branch share
Uttar Pradesh	12%	5%
West Bengal	6%	3%
Bihar	5%	1%
Kerala	4%	2%

Source: MOFSL, RBI

Exhibit 13: Branch expansion strategy by regions (%)

Banks Branch Share State-wise (%)	SA Market Share	Branch Market Share	AXSB	HDFCB	ICICIBC	IIB	KMB
Uttar Pradesh	12	12	7	10	5	8	5
Maharashtra	12	9	12	11	15	12	21
Karnataka	7	7	6	6	6	3	11
West Bengal	6	6	7	4	5	4	3
Tamil Nadu	6	8	8	5	10	6	5
Delhi	6	2	4	5	4	3	7
Gujarat	5	6	8	8	7	8	9
Bihar	5	5	3	2	2	2	1
Rajasthan	4	5	4	4	9	7	4
Haryana	4	3	6	7	4	7	4
Kerala	4	4	3	4	4	3	2
Telangana	4	4	3	4	4	4	6
MP	4	5	4	3	5	6	3
Punjab	4	4	8	10	5	8	5
Andhra Pradesh	3	5	4	3	3	3	8

Source: MOFSL, RBI

Private Banks reflecting strong productivity gains

Over the last few years, private banks have been focusing on improving branch productivity and leveraging technology. Thus, branch productivity (SA per branch) of most private banks saw high double-digit growth. Among private banks, KMB, HDFCB and ICICIBC are the clear outperformers, with KMB reflecting the highest improvement in SA per branch (INR110m in FY15 to INR531m in FY19), followed by HDFCB and ICICIBC. However, lowest improvement was seen in AXSB due to its continued branch expansion strategy. Among PSBs, SBIN has the highest SA per branch at INR493m.

Over FY15-19, KMB grew SA deposits at 54% CAGR and total deposits at ~32% CAGR, but branch expansion grew only ~4%, reflecting superior branch productivity. Thus, SA deposits increased 5.7x and total deposits grew 3.0x. Also, HDFCB/ICICIBC displayed healthy deposit growth momentum at ~20%/16% CAGR with single-digit branch growth of 6.2%/4.7% CAGR.

With the branch expansion strategy back in focus, banks are concentrating on branch productivity through digital channels. In its recent analyst meet, HDFCB highlighted branch productivity in terms of 'new customer accounts opened per branch per day', which has improved to 1.8accounts per branch per day (from 1.2accounts). The bank has guided for further improvement of 3accounts per branch per day over the next 18 months. Over the base of FY19, we estimate branch productivity of large private banks to improve between 1.4-2.0x by FY25. Hence, the deposits base of large private banks is expected to increase in the range of 2.1-2.8x by FY25, with FY19 as base. Hence, we expect AXSB/ICICIBC/ HDFCB/KMB to reach total deposits base of 12.7t/21.4t/15.3t/6.2t. This implies deposit CAGR of large private banks in the range of 13-18%.

Exhibit 14: Productivity to improve in the range of 1.4-2.0x by FY25 (v/s FY19)

Deposits Per branch improvement (INR m)	FY07-FY13	FY13-FY19	FY19-FY25
AXSB	1.2	1.0	1.6
HDFCB	1.0	1.9	1.9
ICICIBC	0.3	1.4	1.9
IIB	1.0	1.1	1.4
KMB	2.5	2.9	2.0

Source: MOFSL, Company

Exhibit 15: Expect deposits base to increase in the range of 2.1-2.8x by FY25 (v/s FY19)

Deposits (INR t)	FY15	FY19	FY25E
AXSB	3.2	5.5	11.6
HDFCB	4.5	9.2	20.1
ICICIBC	3.6	6.5	13.6
IIB	0.7	1.9	4.2
KMB	0.7	2.3	6.2

Source: MOFSL, Company

Exhibit 16: During FY09-15, deposits growth of HDFCB, ICICIBC, AXSB was led by branch expansion; while for KMB and SBIN, it was led by branch productivity

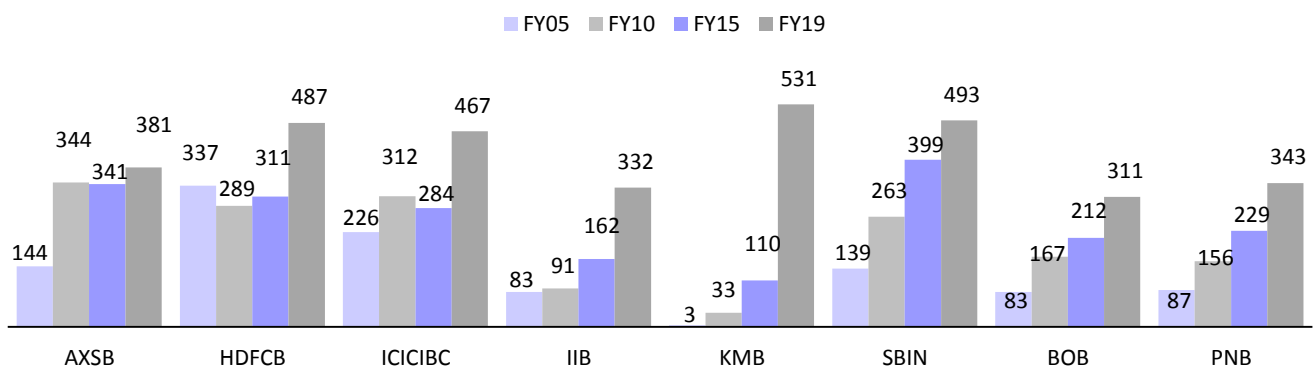
FY09-FY15	Branch increase	SA increase	Deposits increase	SA per branch improvement	Avg. C/I ratio
Branch Expansion					
AXSB	3.1x	3.4x	2.7x	1.1x	42%
HDFCB	2.8x	3.6x	3.2x	1.3x	47%
ICICIBC	2.9x	2.8x	1.7x	1.0x	39%
IIB	4.5x	10.0x	3.4x	2.2x	48%
Branch Productivity					
KMB	1.8x	8.3x	4.8x	4.6x	52%
SBIN	1.4x	2.5x	2.0x	1.8x	49%
BOB	1.7x	2.6x	3.2x	1.5x	42%
PNB	1.4x	2.4x	2.4x	1.7x	42%

Source: MOFSL, Company;

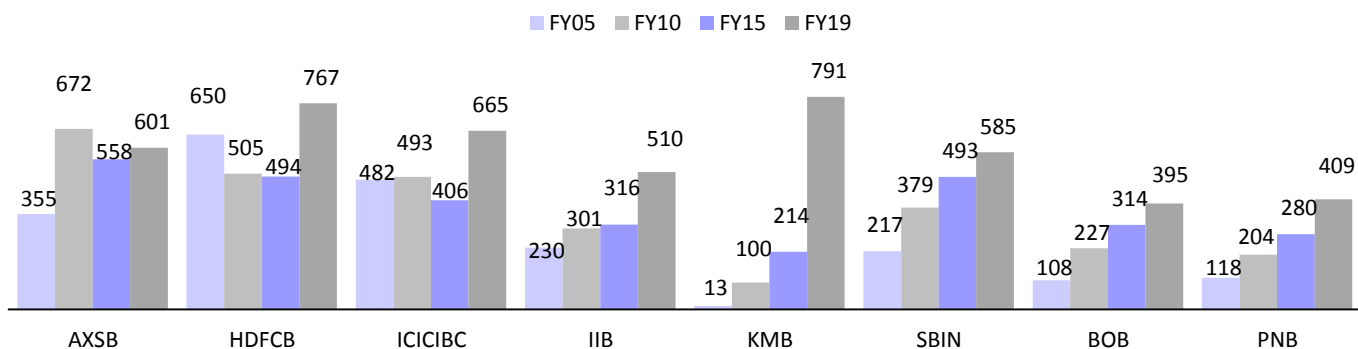
Exhibit 17: During FY15-19, deposits growth in KMB, HDFCB, ICICIBC was led by branch productivity; while for IIB and AXSB, it was led by branch expansion

FY15-FY19	Branch increase	SA increase	Deposits increase	SA per branch improvement	Avg. C/I ratio
Branch Expansion					
IIB	2.1x	4.3x	2.6x	2.1x	45%
AXSB	1.6x	1.7x	1.7x	1.1x	43%
Branch Productivity					
KMB	1.2x	5.7x	3.0x	4.8x	49%
HDFCB	1.3x	2.0x	2.0x	1.6x	41%
ICICIBC	1.2x	2.0x	1.8x	1.6x	39%
SBIN*	1.3x	1.7x	1.4x	1.2x	51%
PNB	1.1x	1.6x	1.3x	1.5x	47%
BOB	1.1x	1.6x	1.0x	1.5x	46%

Source: MOFSL, Company; Note: * effect of merger

Exhibit 18: SA per branch — KMB has emerged as the clear outperformer

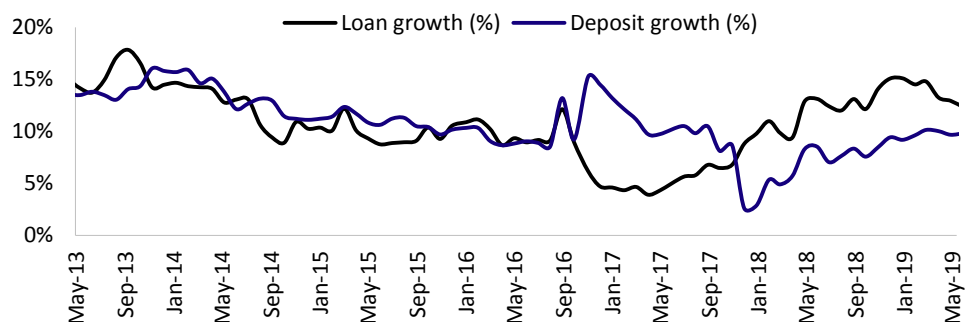
Source: MOFSL, Company

Exhibit 19: CASA per branch — KMB and HDFCB the clear outperformers

Source: MOFSL, Company

Moderation in bank deposits

Overall, deposit growth is lagging loan growth. We believe that the low deposit growth is largely due to constant moderation in GDP growth, changing household behavior from savings focused to consumption driven, rising Currency in Circulation (CIC) showing a tendency to hoard cash, and rising investments into other financial saving products.

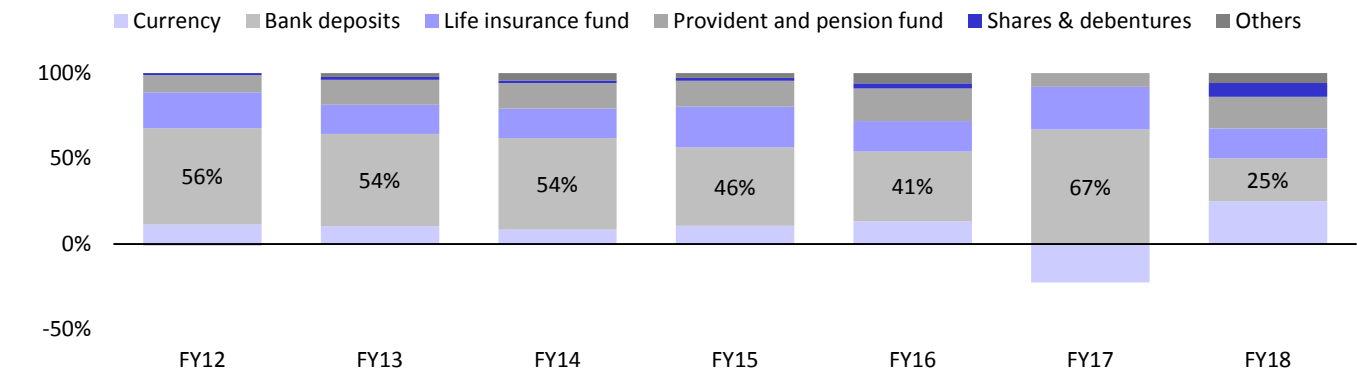
Exhibit 20: Deposit growth consistently lagging loan growth

Source: MOFSL, RBI

Exhibit 21: Rising proportion of Non-deposit financial saving products and CIC in total outstanding financial funds

INR b	Currency in Circulation (CIC)	%	Bank deposits	%	Insurance AUM	%	Mutual Funds AUM	%	Others	%	Outstanding Financial Funds
FY10	7,995	10	46,019	58	12,788	16%	6,140	8	6,137	8	79,079
FY11	9,497	10	54,265	59	15,126	17%	5,923	6	6,527	7	91,338
FY12	10,672	10	61,741	58	16,805	16%	5,872	5	12,192	11	107,282
FY13	11,910	10	70,513	58	18,679	15%	7,014	6	13,124	11	121,240
FY14	13,011	10	80,282	59	20,973	15%	8,252	6	14,404	11	136,922
FY15	14,483	9	88,910	58	24,082	16%	10,828	7	15,916	10	154,219
FY16	16,635	10	96,600	57	26,769	16%	12,328	7	18,255	11	170,587
FY17	13,353	7	107,514	57	30,601	16%	17,546	9	20,621	11	189,635
FY18	18,293	9	114,793	54	34,385	16%	21,360	10	22,622	11	211,453
FY19E	21,367	9	125,726	54	37,948	16%	23,796	10	24,939	11	233,776

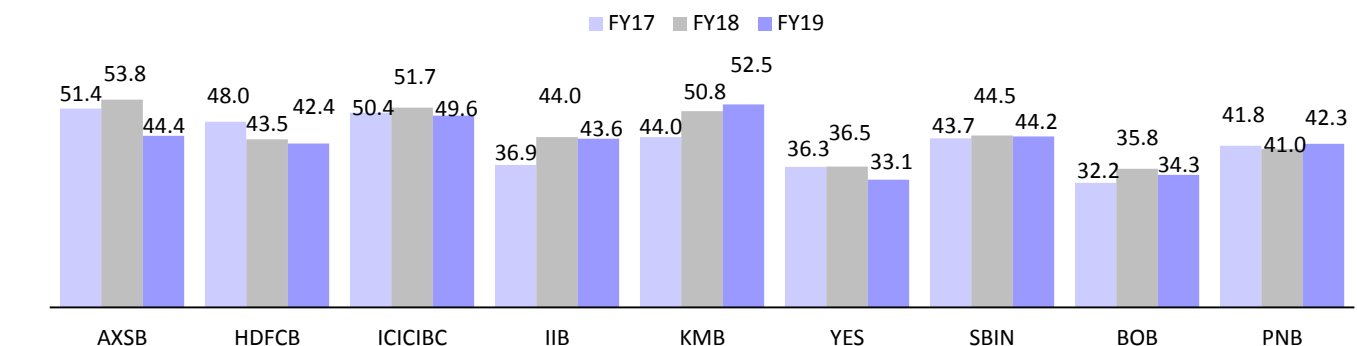
Source: RBI, National Housing Bank (NHB), Insurance Regulatory and development authority (IRDA), CEIC, Budget documents, MOFSL

Exhibit 22: Share of deposits in total Gross Financial Savings (GDS) is declining

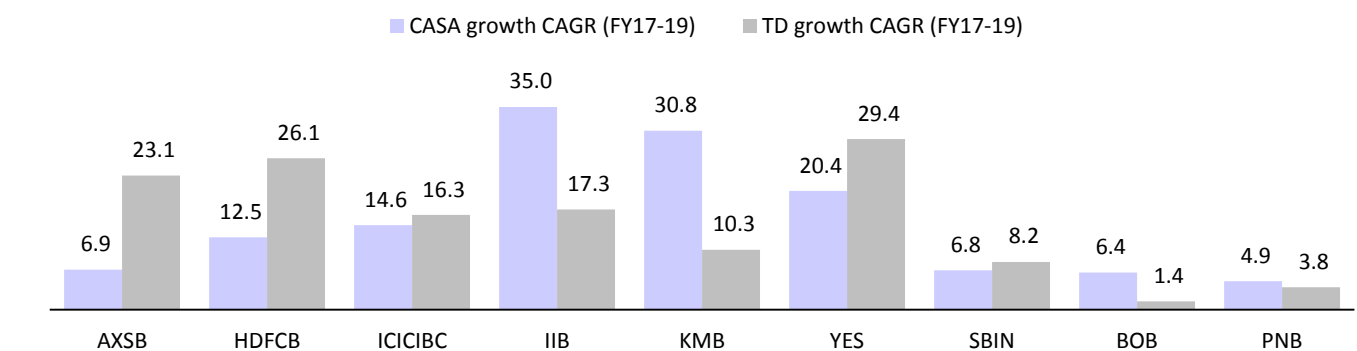
Source: RBI, MOFSL

Increased focus on retail deposits; retail term deposits leads deposit growth

The private banks under our coverage have reported deposit growth at an average of 18% YoY (range of 13-33%), led by healthy growth in term deposits at 24% YoY (v/s 18% in FY18), while CASA growth has moderated sharply from 19% average in FY18 to 12% currently, thus driving a moderation in CASA mix across banks (average 250bp YoY decline in CASA mix). Most banks like HDFCB, AXSB, KMB and ICICIBC have guided for faster growth in retail term deposits, which is likely to keep cost of deposits elevated in the near term.

Exhibit 23: CASA ratios has dipped over the years due to rise in term deposits growth

Source: MOFSL, Company

Exhibit 24: TD growth of private banks faster over CASA growth

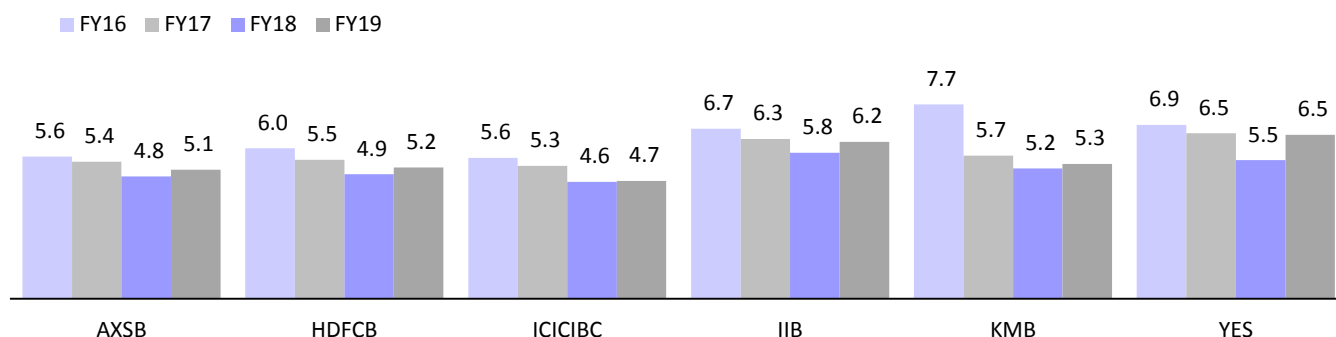
Source: MOFSL, Company

Cost of Funds rises on higher interest rates in SA and term deposits

While private banks are aggressively focusing on retail deposits to fund loan growth, PSBs were not competing for mobilizing deposits. This is reflected through their weighted average term deposits rates' (WATDR) differential being offered at an average of 35bp since Jan'18. Also, among large Private banks, like KMB, YES, and among mid-size banks like Bandhan, RBL offers higher interest rates on SA deposits, leading to strong transaction in their deposit balance.

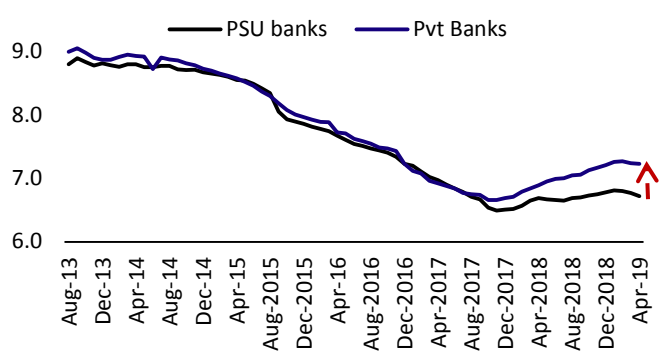
Private Banks have reported an increase in funding cost affected by moderating CASA mix and rising proportion of high-cost term deposits. Several managements have suggested limited downside for deposit rates in the near term. AXSB is guiding for flat margins in FY20 due to elevated cost of deposits.

Exhibit 25: Cost of funds affected by moderating CASA mix and rising proportion of high-cost term deposits



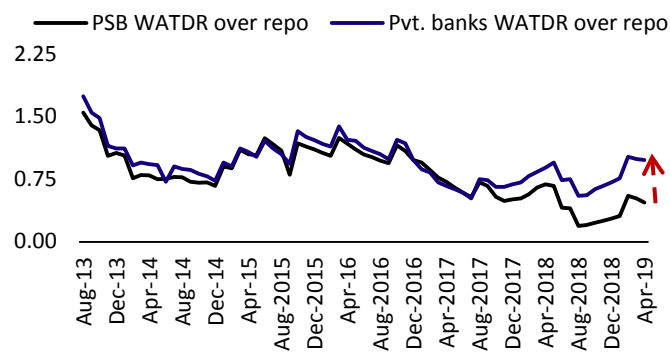
Source: MOFSL, Company

Exhibit 26: Weighted average term deposits rates (WATDR) increasing for private banks



Source: MOFSL, RBI

Exhibit 27: Pvt. Banks differential over repo rate consistently rising



Source: MOFSL, RBI

Exhibit 28: Private banks' offering higher term deposits rates over PSBs...

Banks	Interest Rates on Fixed Deposits				Interest Rates on Fixed Deposits-Senior Citizens			
	<1yr	1-2Yr	2-5yr	>5yr	<1yr	1-2Yr	2-5yr	>5yr
KMB	7.00	7.20	6.75	6.50	7.50	7.70	7.25	7.00
IIB	7.25	7.75	7.35	7.25	7.75	8.25	7.85	7.75
AXSB	7.10	7.30	7.25	7.00	7.35	7.95	7.75	7.50
HDFCB	7.10	7.30	7.25	6.50	7.60	7.80	7.75	7.00
ICICIBC	6.75	7.10	7.25	7.00	7.25	7.60	7.75	7.50
SBIN	6.40	7.00	6.70	6.60	6.90	7.50	7.20	7.10
BOB	6.50	6.80	6.70	6.70	7.00	7.30	7.20	7.20
PNB	6.35	6.85	6.25	6.25	6.85	7.35	6.75	6.75

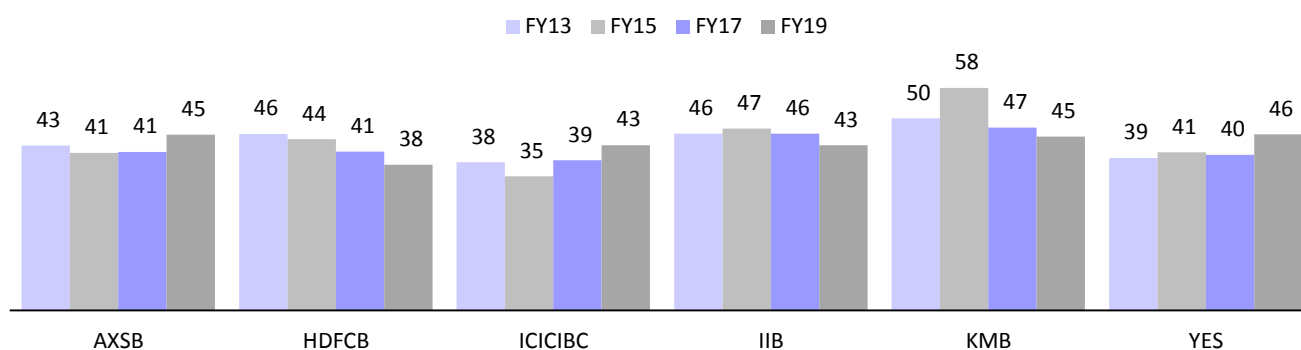
Source: MOFSL, Company

Opex ratios moderated led by productivity improvement

Cost ratios have moderated led by improvement in productivity levels, increasing digital focus and controlled network expansion. Amongst banks – HDFCB, KMB, IIB, PNB cost/assets ratio have moderated to 2.3%/2.6%/2.6%/1.5% (vs 2.6%/3.4%/2.9%/1.8% in FY15). However, AXSB reported stable cost/assets ratio due to continue with its branch expansion strategy, ICICIBC/SBIN reported stable cost/assets ratios.

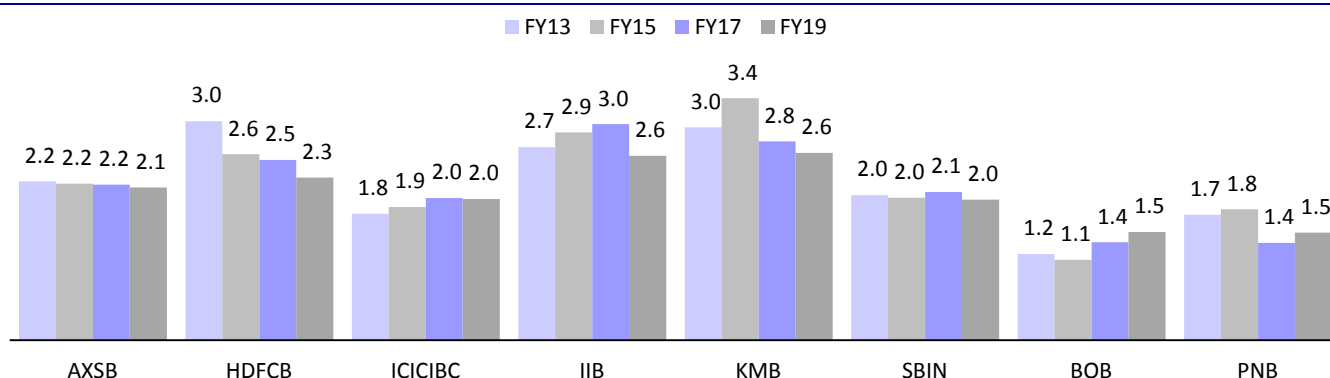
RBK has guided for cost-income ratio of 50-52% over the next few quarters (51.3% in FY19) as the bank plans to add ~80 branches in FY20. AXSB aims to bring down its cost-assets ratio to < 2% in next three years. DCB's cost-income ratio declined 292bp YoY in FY19, indicating further reduction as branch expansion moderates. Indusind also made significant improvement on the digital front and by collaborating with 13-14 Fintech companies. Thus, it expects reduction in C/I ratio by 150bp over FY20E.

Exhibit 29: C/I ratios — Trend of private banks over last few years



Source: MOFSL, Company

Exhibit 30: Cost/Assets ratios either remain stable/moderate for banks led by productivity improvement and controlled network expansion

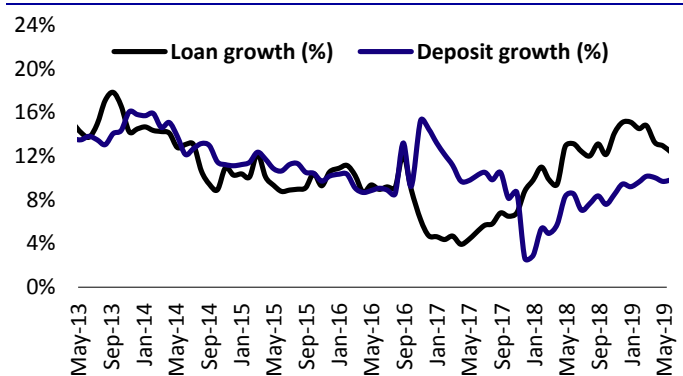


Source: MOFSL, Company

CD ratio at an all-time high...

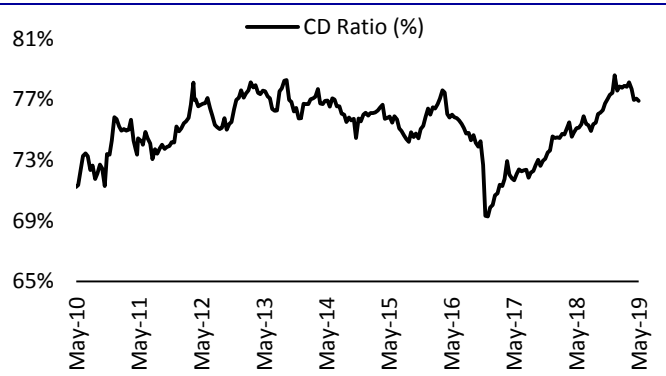
The trend in credit and deposit growth has propelled the overall system CD ratio to an all-time high of ~77%. The CD ratio of private banks is at 90-107% — a record high, while for PSBs, it is between 68-75%. Also, we note that incremental CD ratio (%) for banks under coverage is in the range of 58-141%. The deposit base mobilization is imperative for banks to sustain loan growth momentum. Thus, private banks are aggressively focusing on deposits by offering higher interest rates, refocus on branch expansion due to their stretched CD ratios.

Exhibit 31: Deposit growth lagging loan growth



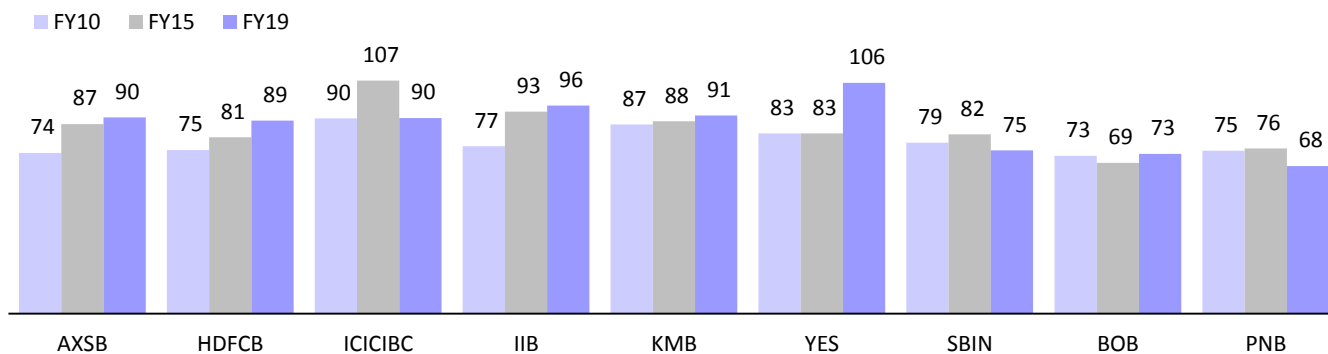
Source: MOFSL, RBI

Exhibit 32: While system CD ratio is expanding at an all-time high



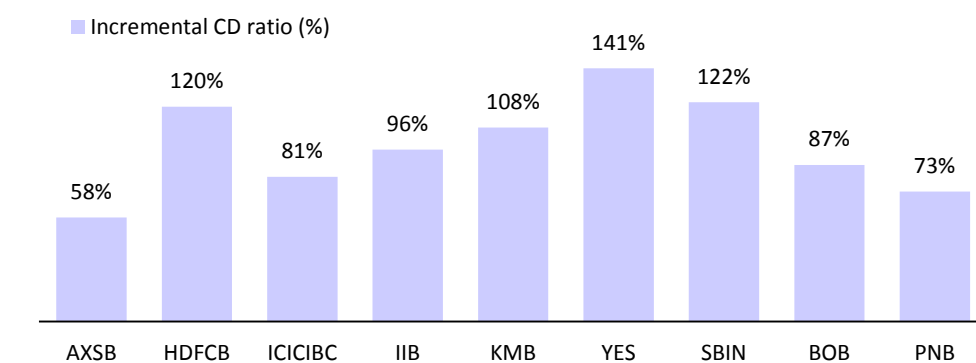
Source: MOFSL, RBI

Exhibit 33: CD ratio of private banks is at an all-time high...



Source: MOFSL, Company

Exhibit 34: Incremental CD ratio (%) of banks under coverage



Source: MOFSL, Company

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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