BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BANKING | Q2FY21 Preview | 12 October 2020

Seeking clarity on asset quality

Q2FY21 is yet another quarter where clarity on asset quality will be keenly awaited amid pandemic uncertainty. Fresh slippages are expected to be lower but credit costs will remain elevated as banks shore up provisions to strengthen their balance sheets. The focus will shift from moratorium to the expected quantum of restructuring. Loan growth is likely to remain subdued but NIMs should be largely stable. We expect operating profit to be impacted by muted fee income, lower treasury gains and a pick-up in opex.

Vikesh Mehta
research@bobcaps.in

Regulatory dispensations to mask true asset quality picture: In our view, fresh slippages are likely to be lower in Q2FY21 given the Supreme Court's stay on NPA recognition until its next hearing and the absence of lumpy corporate delinquencies. This is likely to result in lower headline NPAs even as banks continue to write off loans. We await clarity on key areas such as the expected quantum of restructuring, collection efficiency from the pool that was under moratorium and credit costs for FY21.

Loan growth to remain subdued: Based on recent RBI data, systemic credit growth has slowed down to ~5% YoY in Sep'20 driven by muted corporate growth and deceleration in the retail segment. Pre-result disclosures made by banks under our coverage suggest sluggish loan growth trends for IndusInd Bank (+2% YoY), Federal Bank (+6% YoY) and RBL Bank (–3% YoY). HDFC Bank remains an outlier and continues to grab market share with the disclosure of ~16% YoY growth. We believe credit growth is unlikely to revive quickly as banks retain their focus on protecting balance sheets and asset quality.

High provisions to keep earnings in check: Overall revenue growth is likely to remain weak considering steady deposit inflows and lack of credit deployment. We expect NIM to remain stable as the benefit of recent capital raising coupled with lower deposit costs will offset the impact of higher liquidity. However, muted fee income growth, lower treasury gains and some pick-up in opex could result in sequentially lower operating profit for banks under our coverage.

Despite lower NPA formation, banks are likely to strengthen their balance sheets by shoring up provisions, which will restrain earnings growth. Among our coverage, we expect ICICI Bank, Axis Bank and HDFC Bank to report better profitability.

RECOMMENDATION SNAPSHOT

Ticker	Rating
AXSB IN	BUY
CBK IN	ADD
DCBB IN	SELL
FB IN	ADD
HDFCB IN	BUY
ICICIBC IN	BUY
IDFCFB IN	SELL
IIB IN	BUY
KMB IN	BUY
RBK IN	SELL
SBIN IN	ADD

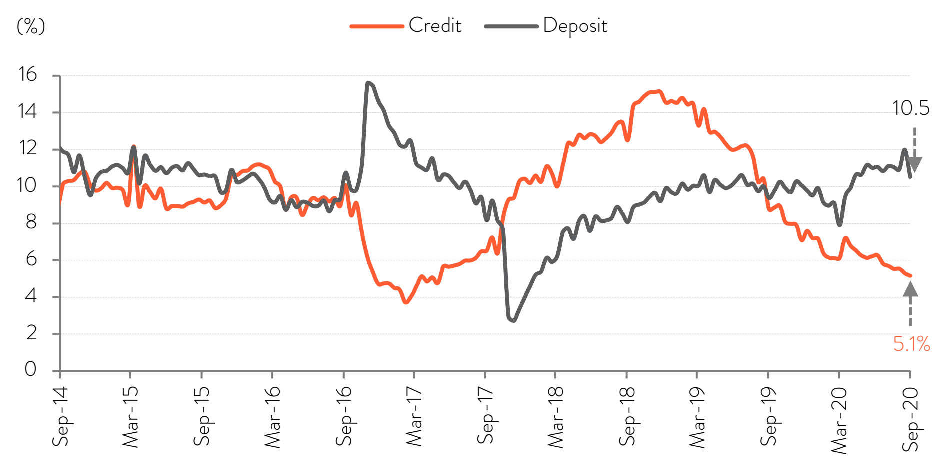
Source: BOBCAPS Research

FIG 1 – BOBCAPS BANKING UNIVERSE: Q2FY21 ESTIMATES

Particulars (Rs mn)	Q2FY21E	Q2FY20	Q1FY21	YoY (%)	QoQ (%)	Comments
Axis Bank						We expect NII to grow ~18% YoY driven by 10% loan growth and stable NIM. Management commentary around restructuring and collections from loans under moratorium is a key monitorable. The bank is likely to continue strengthening its balance sheet by building provisioning buffers.
Net interest income	71,970	61,018	69,853	17.9	3.0	
Pre-provisioning profit	61,140	59,516	58,444	2.7	4.6	
Profit after tax	16,254	(1,121)	11,122	(1,550.2)	46.1	
Canara Bank						Profitability would remain weak as provisions are expected to be elevated. We await management views on merger synergies and expected restructuring.
Net interest income	61,782	31,298	60,956	97.4	1.4	
Pre-provisioning profit	40,870	25,446	42,855	60.6	(4.6)	
Profit after tax	1,718	3,649	4,062	(52.9)	(57.7)	
DCB Bank						NII growth is forecast to be soft given muted loan growth, though NIM is likely to remain stable based on lower deposit costs. Management discussions around asset quality of the mortgage and CV portfolios will be keenly watched.
Net interest income	3,150	3,134	3,067	0.5	2.7	
Pre-provisioning profit	1,971	1,845	1,911	6.8	3.1	
Profit after tax	878	914	794	(4.0)	10.5	
Federal Bank						As per the bank's Q2FY21 business update, loan growth remained soft at 6% YoY while deposits grew 12% driven by 20% growth in CASA deposits. We expect NII growth of 12% YoY and stable NIM. Asset quality of the SME portfolio and restructuring would be key monitorables.
Net interest income	12,601	11,238	12,964	12.1	(2.8)	
Pre-provisioning profit	8,109	7,188	9,324	12.8	(13.0)	
Profit after tax	3,551	4,167	4,008	(14.8)	(11.4)	
HDFC Bank						The bank continues to gain market share with strong disclosed loan growth of ~16% YoY in Q2. Margins are likely to remain stable. Asset quality discussions should revolve around restructuring. Management may look to make prudent provisions in Q2.
Net interest income	158,926	135,150	156,654	17.6	1.5	
Pre-provisioning profit	131,381	116,981	128,293	12.3	2.4	
Profit after tax	74,821	63,450	66,586	17.9	12.4	
ICICI Bank						Expect loan growth to remain subdued at 6-7% YoY but steady NIM should drive ~15% growth in NII. We expect the bank to continue strengthening its balance sheet by making contingent provisions. Outlook on restructuring is keenly awaited.
Net interest income	92,893	80,574	92,798	15.3	0.1	
Pre-provisioning profit	78,397	68,741	107,765	14.0	(27.3)	
Profit after tax	36,214	6,550	25,992	452.9	39.3	
IDFC First Bank						Balance sheet restructuring is likely to continue with a focus on reducing the share of wholesale loans and increasing retail loan share. We remain watchful of the growth in retail deposits. Performance of the moratorium portfolio is crucial.
Net interest income	15,856	13,631	16,259	16.3	(2.5)	
Pre-provisioning profit	5,408	4,175	8,916	29.5	(39.3)	
Profit after tax	1,156	(6,795)	935	(117.0)	23.6	
IndusInd Bank						Loan growth at 2% YoY has come off sharply while deposits grew 10% in Q2FY21, per the bank's business update, showcasing that outflow has been capped while accretion has improved. NIM is expected to contract as deposit cost remains high.
Net interest income	31,293	29,094	33,092	7.6	(5.4)	
Pre-provisioning profit	27,634	26,234	29,277	5.3	(5.6)	
Profit after tax	4,350	14,010	5,103	(69.0)	(14.8)	
Kotak Bank						Expect loan growth to stay subdued but NIM to hold firm given lower cost of deposits. Asset quality should be benign but provisions could remain high as the bank builds buffers in light of the uncertainty.
Net interest income	38,360	33,496	37,239	14.5	3.0	
Pre-provisioning profit	24,975	25,086	26,237	(0.4)	(4.8)	
Profit after tax	12,890	17,245	12,445	(25.3)	3.6	
RBL Bank						Loan growth is expected to slow and deposit accretion to remain weak. We estimate high credit costs and await asset quality performance of the credit card portfolio.
Net interest income	10,364	8,687	10,413	19.3	(0.5)	
Pre-provisioning profit	6,607	6,358	6,897	3.9	(4.2)	
Profit after tax	1,227	543	1,412	125.9	(13.1)	
State Bank of India						Loan growth is forecast to remain weak at 6-7% YoY but we model for stable NIM given the cuts in lending as well as deposit rates, which should drive ~10% NII growth. Asset quality commentary should revolve around expected restructuring.
Net interest income	270,841	246,003	266,416	10.1	1.7	
Pre-provisioning profit	152,650	181,988	180,611	(16.1)	(15.5)	
Profit after tax	41,118	30,117	41,893	36.5	(1.9)	

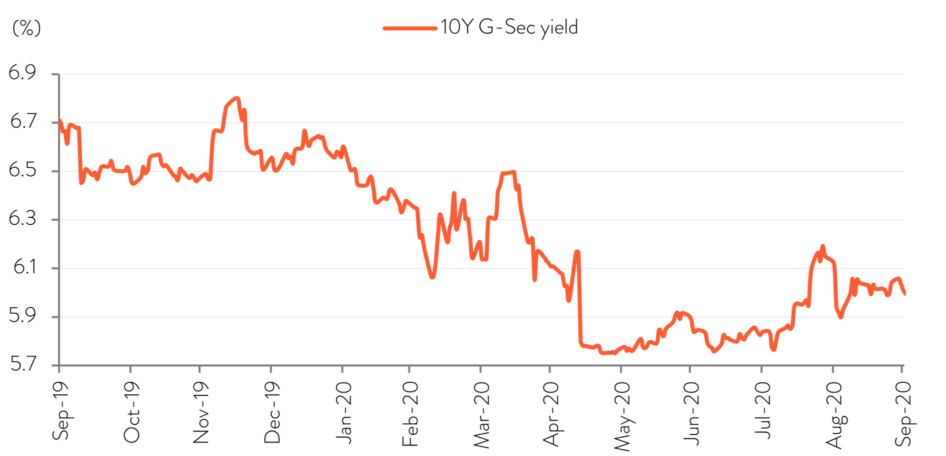
Source: Company, BOBCAPS Research

FIG 2 – SYSTEMIC CREDIT GROWTH REMAINS SUBDUED



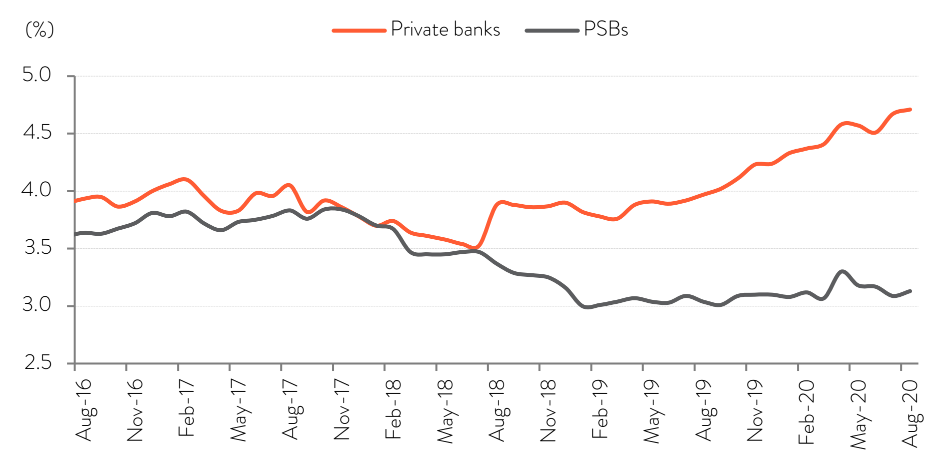
Source: RBI, BOBCAPS Research

FIG 3 – G-SEC YIELDS HAVE HARDENED POST Q1FY21 WHICH WOULD CURB TREASURY GAINS IN Q2FY21



Source: Bloomberg, BOBCAPS Research

FIG 4 – PRIVATE BANKS HAVE MANAGED TO IMPROVE THEIR SPREADS



Source: RBI, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

Rating distribution

As of 30 September 2020, out of 104 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 54 have BUY ratings, 18 have ADD ratings, 10 are rated REDUCE and 22 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2020. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.