Banking

Large private banks offer safe havens

March 2020

Vikesh Mehta

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India's banking sector is battling lashing headwinds ranging from anaemic credit demand to elevated bad debt and Covid-19 fears. Against this backdrop, large private banks (ICICIBC, AXSB, HDFCB) offer a higher margin of safety backed by sturdy liability franchises, adequate growth capital and fortified balance sheets. Valuations also look attractive post the recent correction. Given growing Covid-19 tremors, we cut target multiples across banks but retain our preference for ICICIBC, AXSB & HDFCB. We initiate with BUY on FB; ADD on RBK, DCBB, IDFCFB.

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In the eye of the storm: The Indian banking sector is currently grappling with multiple headwinds. A slowdown in aggregate demand coupled with risk aversion has driven credit growth to a multi-year low. Lending yields are expected to soften as the system is flush with liquidity. Stress formation has moderated from its peak but remains elevated. Initial signs of stress are emerging from the retail segment while SME asset quality continues to worsen. Covid-19 is a new and emerging risk.

Select large banks offer safe ground: In our view, large private banks are best placed to weather the storm, anchored as they are by a lower cost of funds, strong liability franchise, adequate capital and structurally fortified balance sheets. ICICI Bank (ICICIBC), Axis Bank (AXSB) and HDFC Bank (HDFCB) are preferred picks from our banking coverage. At current respective valuations of 1.1x, 0.7x and 1.7x on core FY22E P/BV, these stocks offer robust risk-reward post the recent correction (down 40% on average in one month).

Small banks face risk aversion: We believe market share gains for large private banks will outpace those of small/mid-sized banks in light of the current risk aversion in the sector. On the other hand, public sector banks will continue to bleed market share given a lack of growth capital and mega-merger preoccupations. Initial signs of stress are emerging from the SME space which could further hurt smaller banks with material exposure to the sector.

Sector multiples pared; BUY ICICIBC, ASXB, HDFCB: A prolonged shutdown due to Covid-19 can exacerbate loan growth and credit cost pressures as loans sour and repayments slow, especially in unsecured retail and MSME. We model for lower credit growth (6-16%) and deterioration in asset quality for our existing coverage of large banks over FY20-FY22, leading to EPS cuts of 3-20% across banks. Our target prices for top picks ICICIBC (Rs 465), AXSB (Rs 520) and HDFCB (Rs 1,200) thus reduce 26%, 42% and 19% respectively.

RECOMMENDATION SNAPSHOT

Ticker	Price*	Target	Rating
ICICIBC IN	313	465	BUY
HDFCB IN	832	1,200	BUY
AXSB IN	368	520	BUY
SBIN IN	187	250	BUY
FB IN	41	50	BUY
RBK IN	150	170	ADD
DCBB IN	95	105	ADD
IDFCFB IN	21	23	ADD

Price & Target in Rupees | *As of 30 Mar 2020

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BANKING STOCKS HAVE CORRECTED SHARPLY…

Returns (%)	1W	1M	3M	6M	1Y
NSEBANK Index	(1.7)	(33.5)	(40.1)	(33.4)	(36.3)
AXSB IN Equity	(16.0)	(46.5)	(50.5)	(45.5)	(51.9)
ICICIBC IN Equity	(1.7)	(34.1)	(39.7)	(24.4)	(18.0)
HDFCB IN Equity	2.4	(27.1)	(33.1)	(30.1)	(25.4)
KMB IN Equity	10.8	(17.3)	(20.7)	(18.5)	0.5
FB IN Equity	(16.0)	(51.8)	(52.7)	(54.2)	(56.5)
IIB IN Equity	(6.6)	(63.0)	(73.3)	(70.4)	(76.9)
YES IN Equity	(42.5)	(27.6)	(47.1)	(39.5)	(90.8)
RBK IN Equity	(5.8)	(46.8)	(55.2)	(53.0)	(77.2)
IDFCFB IN Equity	8.7	(42.3)	(52.7)	(47.1)	(61.7)
DCBB IN Equity	(18.4)	(43.1)	(45.5)	(52.9)	(54.9)
SBIN IN Equity	(6.6)	(36.5)	(42.4)	(28.9)	(40.0)

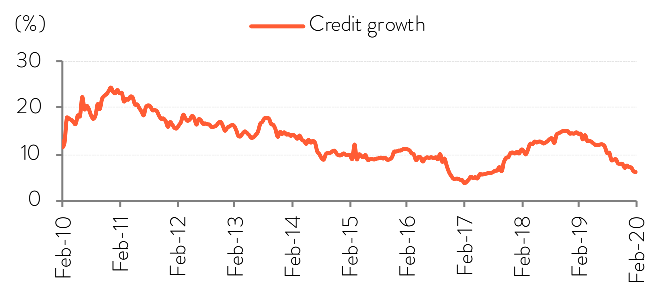
Source: Bloomberg, BOBCAPS Research

…MAKING PRIVATE BANK VALUATIONS ATTRACTIVE

Bank	Current core P/BV (x)		
	FY20E	FY21E	FY22E
AXSB	1.2	1.1	0.9
ICICIBC	1.5	1.3	1.1
HDFCB	2.6	2.3	2.0

Source: Bloomberg, BOBCAPS Research

SYSTEM CREDIT GROWTH WEAK AT 6.1%



Source: RBI, BOBCAPS Research

SEVERAL PSBS ARE EITHER UNDER PCA…

Banks	Exit date	Loans under PCA (Rs bn)	
		Dec-18	Sep-19
Exited PCA framework			
Bank of India	Jan-19	3,728	–
Allahabad Bank	Feb-19	1,585	–
Oriental Bank	Jan-19	1,539	–
Corporation Bank	Feb-19	1,179	–
Bank of Maharashtra	Jan-19	896	–
Dena Bank	Exited post-merger	657	–
Dhanlaxmi Bank	Feb-19	63	–
Lakshmi Vilas Bank	Brought under PCA framework in Sep-19	0	175
Under PCA framework			
IDBI Bank		1,525	1,297
Central Bank		1,513	1,664
Indian Overseas Bank (received Rs 44bn capital infusion in Dec-19)		1,506	1,386
UCO Bank (expect capital infusion worth Rs 21bn)		1,136	978
United Bank (to be merged with PNB)		693	685
Total loans under PCA		**16,020**	**6,186**
As a share of system credit (%)		**17.2**	**6.2**

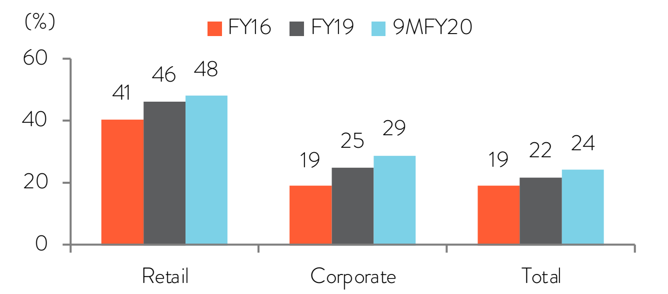
Source: RBI, Company, BOBCAPS Research

…OR PREOCCUPIED WITH THE MEGA MERGER…

Anchor bank	Amalgamating banks	Combined loan book (Rs bn)
Punjab National Bank	Oriental Bank of Commerce United Bank of India	7,165
Canara Bank	Syndicate Bank	6,618
Union Bank of India	Andhra Bank Corporation Bank	6,475
Indian Bank	Allahabad Bank	3,625
Total loan book of merged entities		**21,913**
As a share of system credit (%)		**22.4**

Source: Government of India presentation, BOBCAPS Research

…LEAVING ROOM FOR LARGE PRIVATE BANKS TO GAIN MARKET SHARE



Source: RBI, Company, BOBCAPS Research | includes HDFCB, ICICIBC and AXSB

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Valuation snapshot

BOBCAPS BANKING UNIVERSE: VALUATION SUMMARY

Bank	Rating	Target price (Rs)	BVPS (Rs)			P/BV (x)			EPS (Rs)			P/E (x)		
			FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AXSB	BUY	520	306	341	389	1.2	1.1	0.9	20	43	58	18.2	8.6	6.4
ICICIBC	BUY	465	177	198	223	1.8	1.6	1.4	18	27	33	17.6	11.5	9.6
HDFCB	BUY	1,200	312	354	402	2.7	2.4	2.1	49	55	63	16.9	15.2	13.2
FB	BUY	50	73	80	89	0.6	0.5	0.5	8	9	12	5.0	4.5	3.5
RBK	ADD	170	210	229	256	0.7	0.7	0.6	12	22	33	13.0	6.8	4.6
IDFCFB	ADD	23	32	32	38	0.7	0.7	0.5	(6)	(0)	1	(3.6)	(119.2)	15.0
DCBB	ADD	105	103	113	125	0.9	0.8	0.8	12	11	14	8.1	8.7	7.1
SBIN	BUY	250	286	311	341	0.7	0.6	0.5	28	33	39	6.8	5.7	4.8

Source: Bloomberg, Company, BOBCAPS Research

REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
ICICI Bank									
Net interest income (Rs bn)	318	361	413	326	379	450	(2.4)	(4.9)	(8.1)
Pre-provisioning profit (Rs bn)	273	316	373	278	330	405	(1.8)	(4.3)	(7.9)
Net profit (Rs bn)	115	176	211	119	205	256	(3.4)	(14.1)	(17.5)
EPS (Rs)	17.9	27.3	32.7	18.5	31.8	39.7	(3.4)	(14.1)	(17.5)
BVPS (Rs)	177.0	197.9	223.0	177.5	201.9	232.3	(0.3)	(1.9)	(4.0)
GNPA ratio (%)	6.0	5.1	4.3	5.9	4.6	3.6	8bps	58bps	68bps
HDFC Bank									
Net interest income (Rs bn)	579	666	774	593	725	883	(2.3)	(8.1)	(12.3)
Pre-provisioning profit (Rs bn)	478	568	654	483	591	712	(1.0)	(3.8)	(8.1)
Net profit (Rs bn)	268	298	343	276	358	435	(3.0)	(16.7)	(21.1)
EPS (Rs)	49.2	54.7	63.1	50.7	65.7	79.9	(3.0)	(16.7)	(21.1)
BVPS (Rs)	311.6	353.5	401.8	312.8	363.1	424.4	(0.4)	(2.6)	(5.3)
GNPA ratio (%)	1.5	1.8	1.9	1.4	1.5	1.4	9bps	36bps	50bps
Axis Bank									
Net interest income (Rs bn)	241	279	332	245	304	379	(1.8)	(8.3)	(12.3)
Pre-provisioning profit (Rs bn)	221	259	314	225	276	340	(1.6)	(6.1)	(7.7)
Net profit (Rs bn)	55	121	162	56	149	186	(2.9)	(19.0)	(12.7)
EPS (Rs)	20.3	42.9	57.7	20.9	52.9	66.1	(2.9)	(19.0)	(12.7)
BVPS (Rs)	306.2	341.4	388.7	306.7	350.1	404.3	(0.2)	(2.5)	(3.9)
GNPA ratio (%)	5.1	4.7	3.6	4.9	4.0	3.1	15bps	62bps	56bps
State Bank of India									
Net interest income (Rs bn)	995	1,071	1,208	1,004	1,177	1,401	(0.9)	(8.9)	(13.8)
Pre-provisioning profit (Rs bn)	727	719	821	805	774	898	(9.7)	(7.1)	(8.6)
Net profit (Rs bn)	247	291	349	304	360	425	(18.8)	(19.0)	(17.8)
EPS (Rs)	27.6	32.6	39.1	34.0	40.3	47.6	(18.8)	(19.0)	(17.8)
BVPS (Rs)	286.2	311.2	341.2	291.2	322.1	358.6	(1.7)	(3.4)	(4.9)
GNPA ratio (%)	6.5	5.7	5.2	6.4	5.1	3.9	6bps	60bps	123bps

Source: BOBCAPS Research

Limping credit growth

- Credit growth in Feb'20 at ~60-year low of 6.1% YoY; H1FY20 saw 60% drop in incremental flow of financial resources to commercial sector
- Loan growth in wholesale segment dominated by very large (>Rs 50bn) accounts, primarily of financials firms (+48% YoY in FY19) and PSU entities
- Offtake from large accounts (Rs 1bn-50bn) flat in last two years
- Abundant systemic liquidity but few takers leading banks to park surplus funds in G-secs

Credit growth at six-decade low

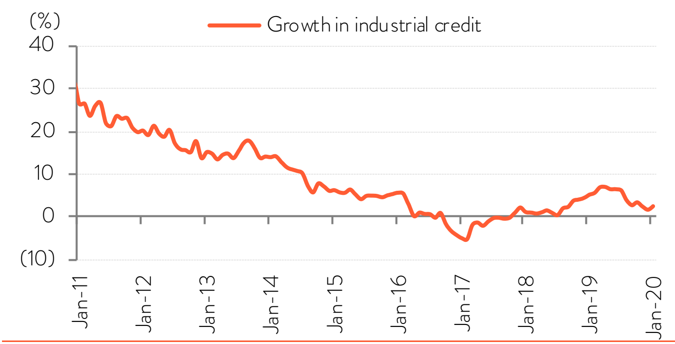
Credit growth has slowed due to weak corporate growth

At 6.1%, credit growth in the system is at a multi-decade low (excluding the impact of demonetisation). The cyclical downturn in India's economy triggered by disruptions due to policy reforms has delayed revival in the capex cycle, in turn crimping corporate loan growth which forms a chunk of non-food credit.

FIG 1 – AT 6.1% SYSTEM CREDIT GROWTH HAS SLOWED CONSIDERABLY…

Source: RBI, BOBCAPS Research

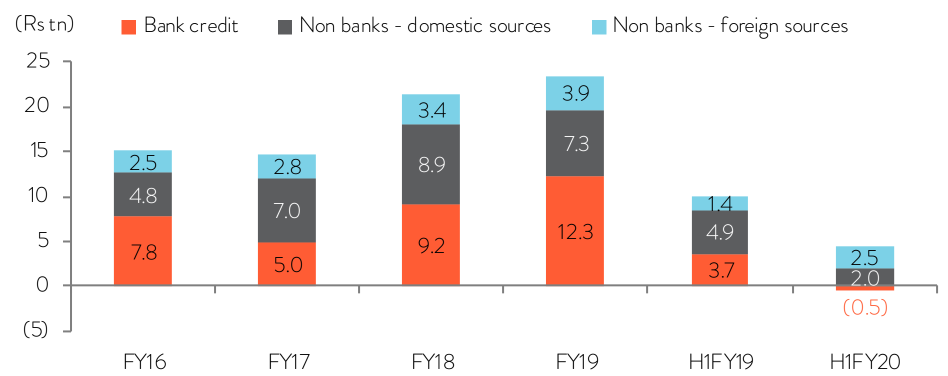
FIG 2 – …PRIMARILY DUE TO WEAKNESS IN INDUSTRIAL CREDIT



Source: RBI, BOBCAPS Research

A closer look at data released by the RBI reveals that the incremental flow of financial resources to the commercial sector nosedived ~60% YoY in H1FY20 to ~Rs 4tn, largely due to banks.

FIG 3 – SHARE OF BANKS IN FLOW OF RESOURCES TO THE COMMERCIAL SECTOR HAS DECLINED



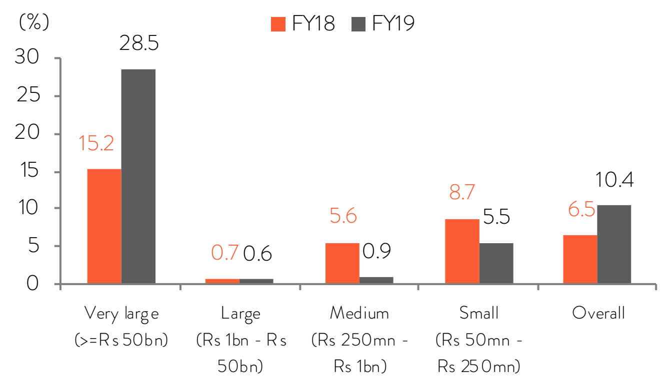
Source: RBI, BOBCAPS Research

Very large firms fuelling bulk of commercial lending

Wholesale loans for 'very large' accounts grew 28.5% YoY in FY19

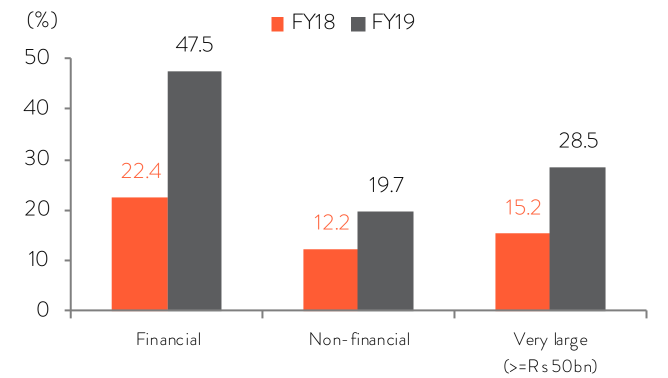
Over the past two years, credit growth in the wholesale segment has been dominated by 'very large' accounts, viz. firms that have exposure above Rs 50bn to the banking system. Wholesale loans to these 'very large' accounts grew 28.5% YoY in FY19 – within this segment, financial companies comprised a bulk of the borrowers, accounting for 48% YoY growth in credit.

FIG 4 – FIRMS WITH VERY LARGE LOAN EXPOSURE DRIVING GROWTH IN WHOLESALE ACCOUNTS…



Source: RBI, BOBCAPS Research

FIG 5 – …AND FINANCIAL ENTITIES FUELLING CREDIT GROWTH WITHIN VERY LARGE ACCOUNTS

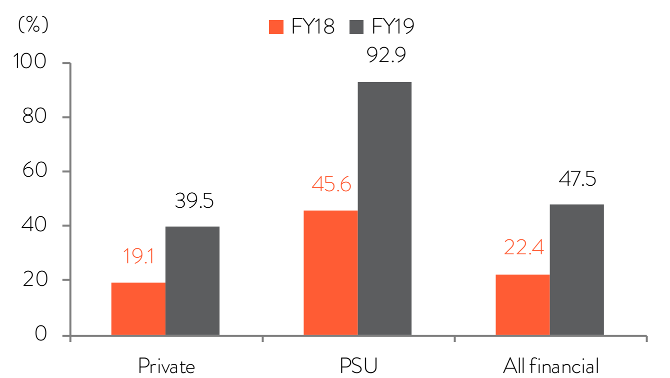


Source: RBI, BOBCAPS Research

PSU borrowers to the fore amid lack of private capex

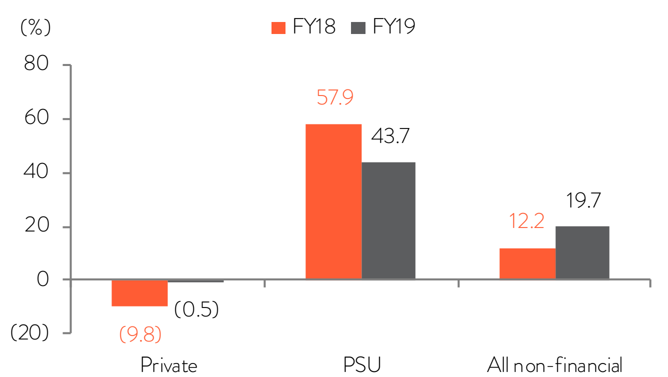
Given the slump in private sector capex, public sector units (PSU) are fuelling credit growth across 'very large' financial as well as non-financial loan accounts. This is also because lending to these entities is a relatively safer choice for banks, in our view. As per RBI, credit to financial PSU firms grew by over 90% while that to non-financial PSU entities grew by 44% in FY19.

FIG 6 – PSU ENTITIES LEAD CREDIT GROWTH IN VERY LARGE FINANCIAL ACCOUNTS…



Source: RBI, BOBCAPS Research

FIG 7 – ….AS WELL AS VERY LARGE NON-FINANCIAL ACCOUNTS



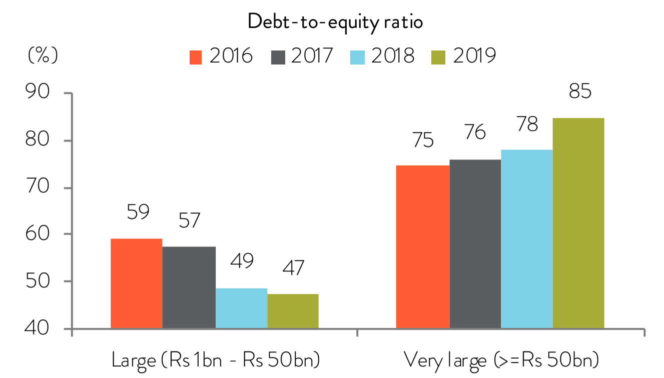
Source: RBI, BOBCAPS Research

Weak demand – not supply – dulling credit growth

Credit growth to 'large' accounts flat in last two years

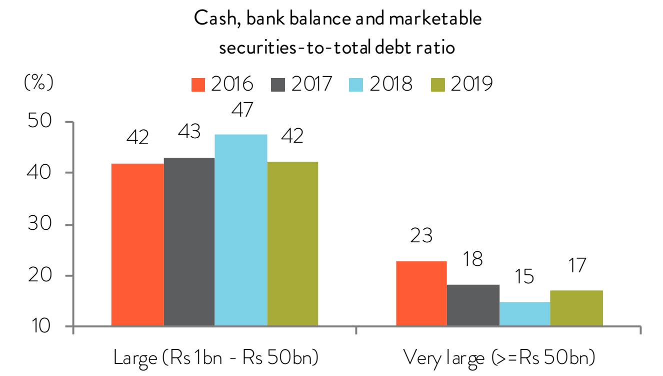
Firms with 'large' loan accounts (Rs 1bn-50bn exposure to the banking system) constitute a significant share of wholesale credit. Whereas credit demand from 'very large' accounts has increased, wholesale lending to the 'large' segment has flatlined over the last two years as steady deleveraging of balance sheets and comfortable liquidity have curbed the credit requirements of these borrowers.

FIG 8 – LARGE NON-FINANCIAL BORROWERS HAVE DELEVERAGED THEIR BALANCE SHEETS…



Source: RBI, BOBCAPS Research | Debt-to-equity ratio

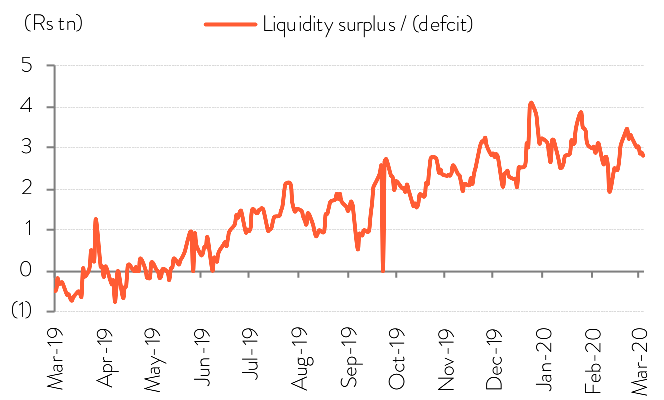
FIG 9 – …AND ARE ALSO FLUSH WITH LIQUIDITY



Source: RBI, BOBCAPS Research | Cash, bank balance and marketable securities-to-total debt ratio

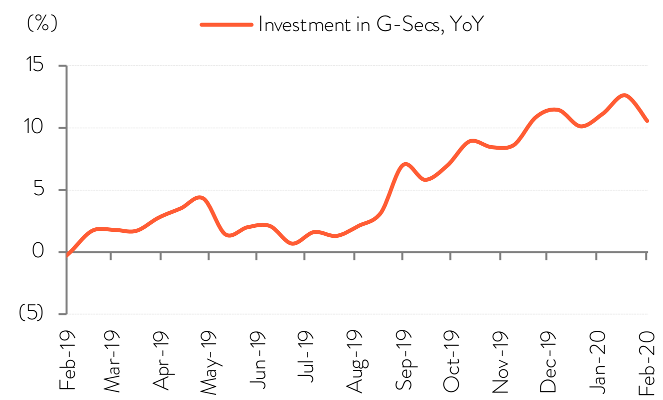
The RBI, via various instruments at its disposal such as liquidity adjustment facility (LAF), outright open market operations (OMO) and foreign exchange swaps, has ensured that the banking system has abundant liquidity. Banks, however, are increasingly parking their surplus funds in government securities (Fig 11), implying that the pressure on systemic credit growth stems from a lack of demand rather than supply.

FIG 10 – BANKING SYSTEM FLUSH WITH LIQUIDITY



Source: RBI, BOBCAPS Research

FIG 11 – LACK OF CREDIT GROWTH COMPELLING BANKS TO PARK SURPLUS FUNDS IN G-SECS



Source: RBI, BOBCAPS Research

Market share gains by large private banks to accelerate

- Public bank lending constrained by scarce growth capital, poor risk systems and merger travails – PSBs undergoing PCA or merger form 30% of system credit
- Top-3 private banks – HDFCB, ICICIBC, AXSB – have stepped in to corner market share, at 48%/29% in retail/corporate credit for 9MFY20 vs. 41%/19% in FY16
- Credit cycle to remain tepid over next two years but large private banks set for further market share gains as revival in PSB lending looks increasingly unlikely

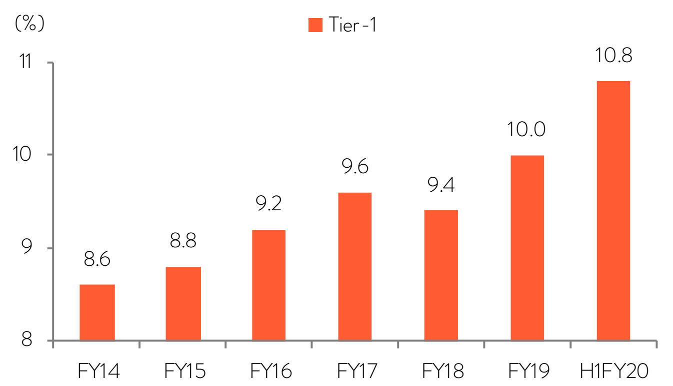
PSBs – Lack of growth capital, mega merger preoccupation

11 PSBs (17% of system credit) under PCA as of Dec'18

Since FY16, public sector banks (PSB) have seen weaker credit growth and deepening market share losses. Deteriorating asset quality and stringent RBI measures to clean up the banking system also led to erosion in tier-1 capital – this compelled the central bank to place several PSBs under the prompt corrective action (PCA) framework, further exacerbating their credit growth woes. As of Dec'18, 11 PSBs (and 1 private bank) were brought under the PCA framework, together contributing ~17% of system credit.

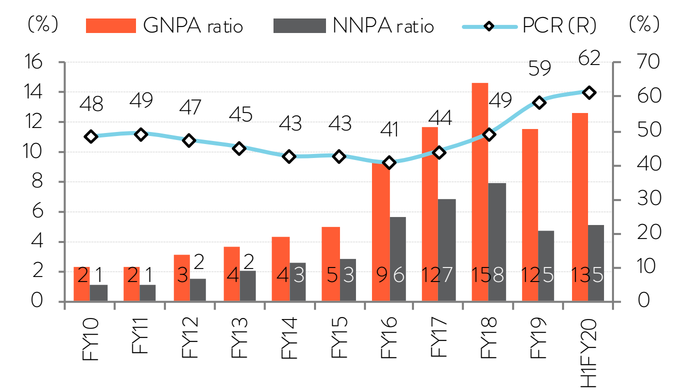
Consistent capital infusion by the central government has ensured that tier-1 capital levels improve, enabling seven PSBs to exit the PCA framework after meeting certain parameters, especially on the asset quality front. Consequently, the share of loans under PCA has dropped to ~7% currently.

FIG 12 – CONSISTENT CAPITAL INFUSION HAS IMPROVED TIER-1 RATIO OF PSBs...



Source: RBI, BOBCAPS Research

FIG 13 – ...ENABLING THEM TO IMPROVE PCR AND REDUCE NNPA RATIO



Source: RBI, BOBCAPS Research

FIG 14 – SHARE OF LOANS UNDER PCA HAS DECLINED TO ~6%

Banks	Exit date	Loans under PCA framework (Rs bn) Dec-18	Sep-19
Exited PCA framework			
Bank of India	Jan-19	3,728	–
Allahabad Bank	Feb-19	1,585	–
Oriental Bank	Jan-19	1,539	–
Corporation Bank	Feb-19	1,179	–
Bank of Maharashtra	Jan-19	896	–
Dena Bank	Exited post-merger	657	–
Dhanlaxmi Bank	Feb-19	63	–
Lakshmi Vilas Bank	Brought under PCA framework in Sep-19	0	175
Under PCA framework			
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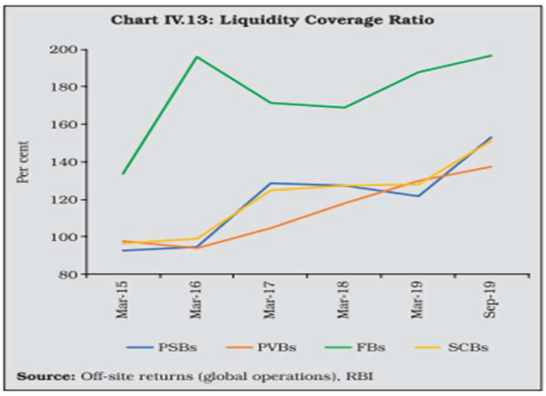
UCO Bank (expect capital infusion worth Rs 21bn)		1,136	978
United Bank (to be merged with PNB)		693	685
Total loans under PCA		**16,020**	**6,186**
As a share of system credit (%)		**17.2**	**6.2**

Source: RBI, Company, BOBCAPS Research

PSBs that control ~22% of system credit under merger integration

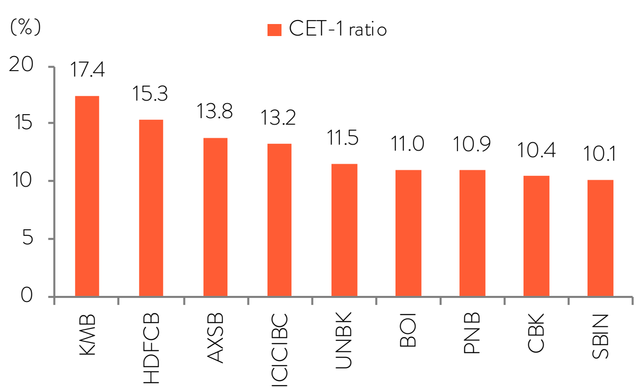
PSBs have a low credit-deposit ratio and excess liquidity as compared to private banks, suggesting enough headroom to grow. But a lack of growth capital and challenges around risk management are key constraints. Moreover, top management bandwidth is now occupied with the proposed amalgamation of 10 PSBs (which contribute >22% of system credit) to form 4 merged entities. We believe credit growth for PSBs is unlikely to revive in the medium term as banks that control ~30% of system credit are either under PCA or undergoing merger integration.

FIG 15 – PSBs HAVE EXCESS LIQUIDITY…



Source: RBI, Company, BOBCAPS Research

FIG 16 – …BUT NOT ENOUGH GROWTH CAPITAL



Source: RBI, Company, BOBCAPS Research

VALUATIONS OF PSBS REFLECT THESE CONCERNS

PBV (x)	FY21E	FY22E
Punjab National Bank	0.36	0.33
Canara Bank	0.22	0.21
Union Bank of India	0.25	0.25
Indian Bank	0.14	0.12
Indian Overseas Bank	0.65	0.60
Bank of India	0.23	0.22

Source: Bloomberg, BOBCAPS Research

FIG 17 – PSBs UNDERGOING MERGER HAVE >22% SHARE IN CREDIT

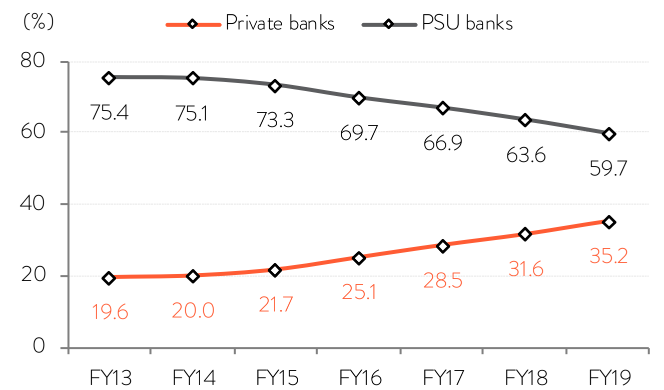
Anchor bank	Amalgamating banks	Combined loan book (Rs bn)
Punjab National Bank	Oriental Bank of Commerce United Bank of India	7,165
Canara Bank	Syndicate Bank	6,618
Union Bank of India	Andhra Bank Corporation Bank	6,475
Indian Bank	Allahabad Bank	3,625
Total loan book of merged entities		**21,913**
As a share of system credit (%)		**22.4**

Source: Government of India presentation, BOBCAPS Research

Private banks stepping into the breach

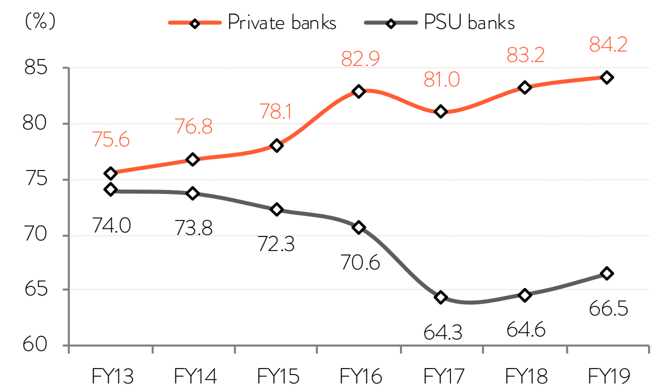
Over FY16-FY19, the domestic loan book of private banks has clocked a ~22% CAGR while their market share has increased from 25% to 35%. This has resulted in a rise in credit-deposit ratios at most private banks over the past three years, implying a significant increase in capacity utilisation.

FIG 18 – DOMESTIC CREDIT MARKET SHARE GAINS BY PRIVATE BANKS HAVE ACCELERATED



Source: RBI, BOBCAPS Research

FIG 19 – SHARP DIVERGENCE IN DOMESTIC CREDIT-DEPOSIT RATIOS OF PRIVATE BANKS VS. PSBs

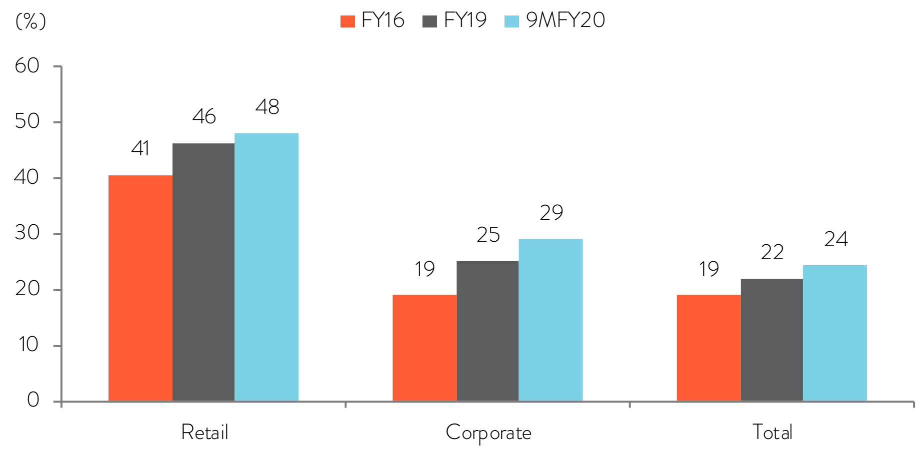


Source: RBI, BOBCAPS Research

Top-3 large private banks now have 48% market share in retail credit vs. 41% in FY16

Amongst private banks, it is the top-3 – HDFCB, ICICIBC and AXSB – that have managed to grab substantial market share since the lull in the credit cycle began. These banks have not only ramped up their retail portfolios significantly but also posted above-industry growth in domestic corporate loans.

FIG 20 – MARKET SHARE OF TOP-3 PRIVATE BANKS HAS INCREASED

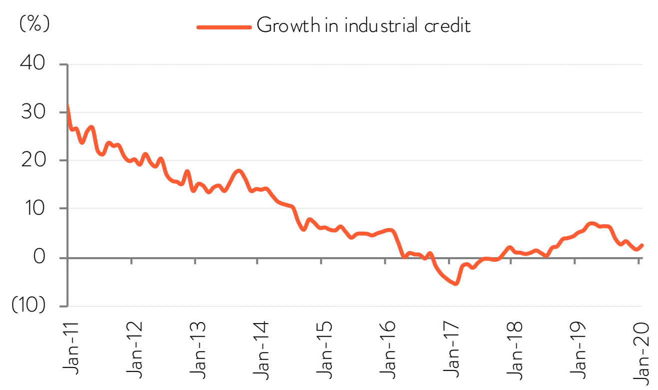


Source: RBI, Company, BOBCAPS Research | includes HDFCB, ICICIBC and AXSB

Domestic corporate loan growth for ICICIBC and AXSB well ahead of industry

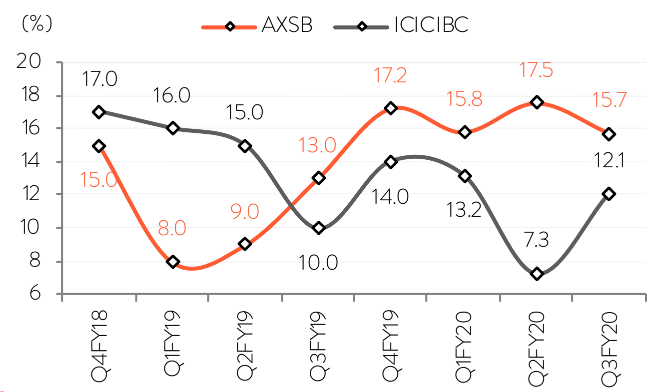
HDFCB has gained the most market share and achieved a dominant position in the retail as well as corporate segments. For ICICIBC and AXSB, corporate loan growth looks optically lower as these banks have been pruning exposure in the overseas book and moving toward underwriting new loans to higher rated corporates. In fact, domestic corporate loan growth for both banks has been well ahead of the industry and their corporate portfolios are now tilted towards securities rated 'A' and above. ICICIBC and AXSB have started to gain market share in select unsecured retail products as well.

FIG 21 – SYSTEMIC INDUSTRIAL CREDIT GROWTH HAS PLUMMETED DRAMATICALLY…



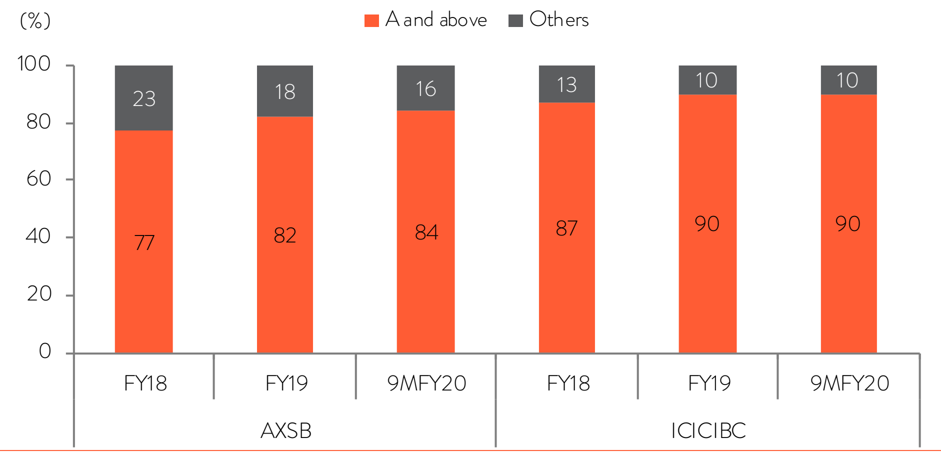
Source: Bloomberg, Company, BOBCAPS Research

FIG 22 – …BUT DOMESTIC CORPORATE GROWTH FOR AXSB AND ICICIBC SHOWS RESILIENCE



Source: Bloomberg, Company, BOBCAPS Research

FIG 23 – RATING PROFILE OF DOMESTIC CORPORATE BOOK HAS MOVED TOWARDS 'A' AND ABOVE



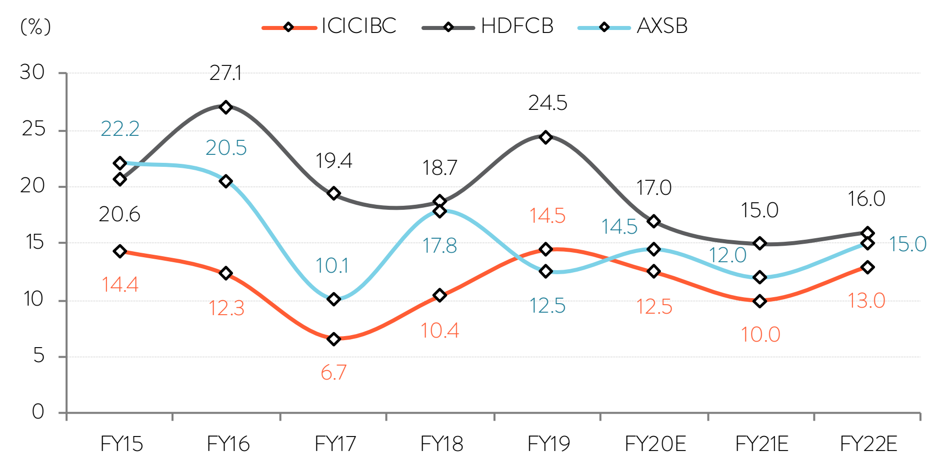
Source: Company, BOBCAPS Research

Large private banks will continue to drive credit growth

Expect continued market share gains for large private banks

We believe it is premature to foresee an uptick in credit growth, at least over the next 1-1.5 years, due to the weak corporate capex cycle. That said, we do believe large private sector banks are currently better equipped than PSBs to lend more and hence to experience accelerated market share gains. Though Yes Bank's (YES) collapse will make banks even more risk-averse and selective on credit disbursement, large players may manage to cherry pick loans from YES's Rs 1.9tn portfolio (as on Q3FY20) and gain further market share.

FIG 24 – EXPECT LOAN GROWTH FOR LARGE PRIVATE BANKS TO REMAIN STRONG



Source: Company, BOBCAPS Research

Healthy NIM outlook for corporate banks

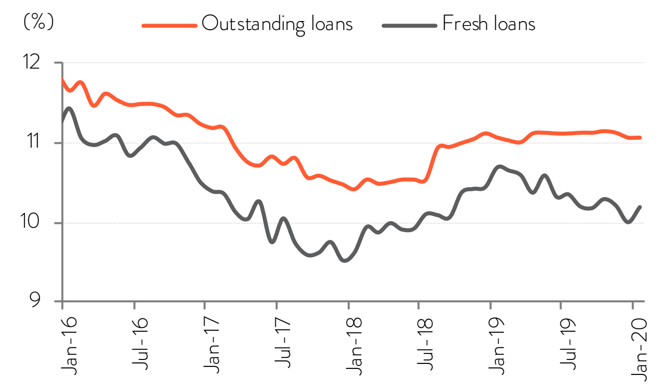
- Current lending spread for private banks at six-year high of 4.3% but likely to come off peaks given surplus liquidity and tepid credit growth
- Nonetheless, corporate banks such as ICICIBC and AXSB could see NIM expansion from lower interest reversals, better loan growth and reduced NPAs
- Strong liability franchise to also help insulate players like HDFCB, ICICIBC and AXSB from margin pressures

Yields expected to moderate

We note a clear dichotomy between the lending rates of PSBs and private banks owing to the transmission of rate cuts by the former and the lack thereof by private players. Between Aug'18 and Jan'20, the weighted average lending rate (WALR) on outstanding loans of PSBs declined by 47bps while the same on fresh loans dropped 43bps.

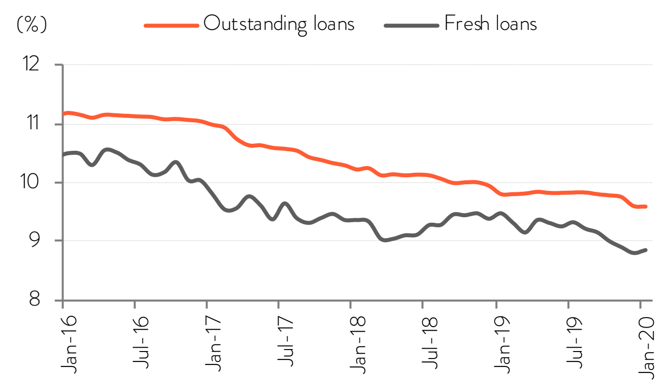
On the other hand, private banks have managed to increase their WALR by 13bps/10bps on outstanding/fresh loans over the same period. We believe this indicates that even large corporates are willing to pay extra yields to ensure they bank with reputed lenders who have stable balance sheets.

FIG 25 – WALR ON LOANS FOR PRIVATE BANKS HAS INCREASED SINCE AUG'19...



Source: RBI, BOBCAPS Research

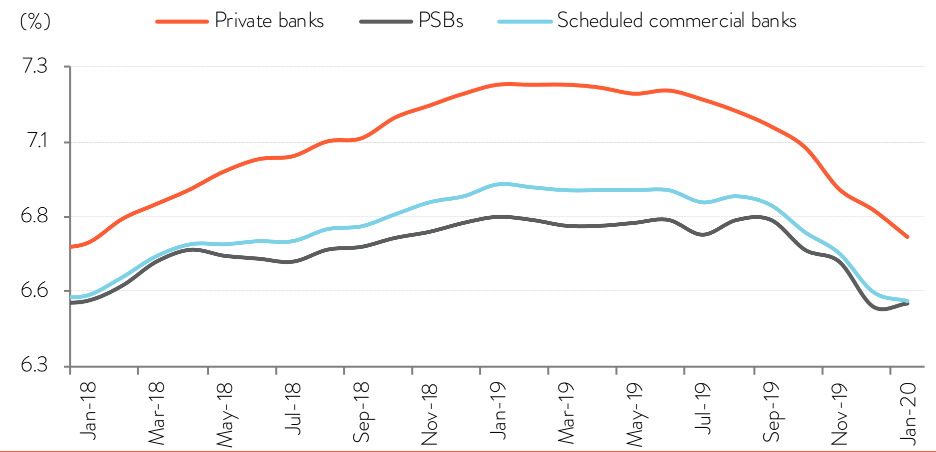
FIG 26 – ...WHILE DECLINING FOR PSBs OVER THE SAME PERIOD



Source: RBI, BOBCAPS Research

Term deposit rates had hardened by ~40bps to 6.9% from Dec'17 to Feb'19 and thereafter remained flat for a few months. Despite surfeit liquidity, banks only began to reduce deposit rates in the past 3-4 months (down ~40bps since Jun'19).

FIG 27 – TERM DEPOSIT RATES HAVE BEGUN TO COME OFF ONLY NOW

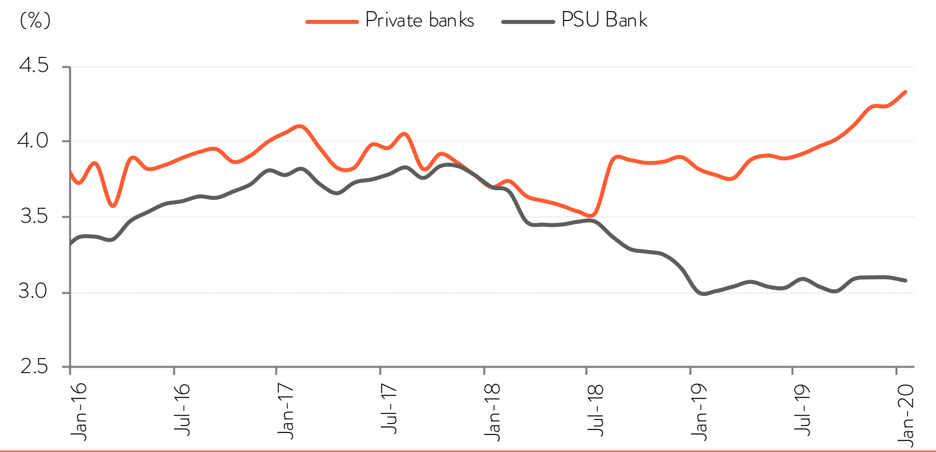


Source: RBI, BOBCAPS Research

Lending spread at highs of 4.3% for private players vs. 3.1% for PSBs

High lending rates and negligible reduction in term deposit rates have raised the lending spread (outstanding loan yields less outstanding term deposit costs) for private banks to the highest levels in over 6-7 years. As of Jan'20, the lending spread stood at 4.3% for private players vs. 3.1% for PSBs.

FIG 28 – LENDING SPREADS FOR PRIVATE BANKS AT SIX-YEAR HIGH

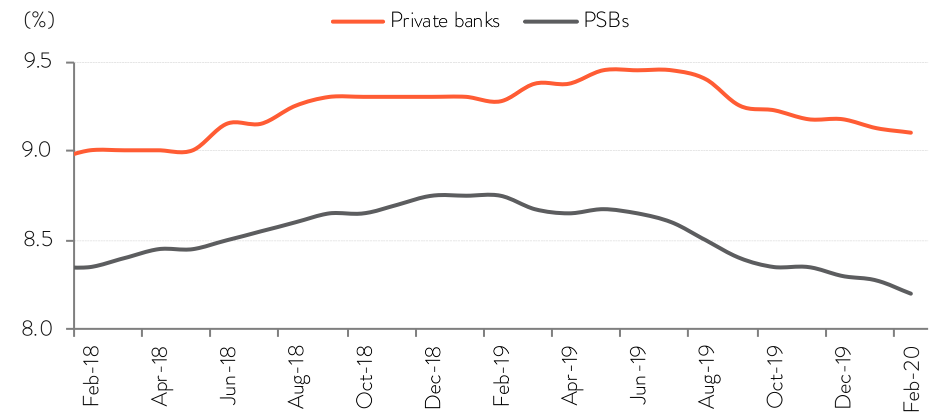


Source: RBI, BOBCAPS Research

Currently, a bulk of the banking sector's loan portfolio is linked to MCLR where both private and public sector banks have cut rates by 35-45bps in the last six months. We believe it won't be long before excess liquidity and weak credit growth start translating policy rate cuts into lower lending yields for banks. This apart, banks would also start to register the impact of repo-linked loans in a few quarters.

High liquidity and soft credit growth to dampen lending yields

FIG 29 – MEDIAN MCLR FOR BANKS



Source: RBI, BOBCAPS Research

FIG 30 – BANKS HAVE REDUCED MCLR BY 35-45BPS IN THE LAST SIX MONTHS

Banks (%)	1-year MCLR (%)				Change (bps)		
	Feb-20	Nov-19	Aug-19	May-19	3M	6M	9M
Axis Bank	8.15	8.25	8.55	8.80	(0.10)	(0.40)	(0.65)
HDFC Bank	8.15	8.30	8.60	8.70	(0.15)	(0.45)	(0.55)
ICICI Bank	8.20	8.35	8.65	8.75	(0.15)	(0.45)	(0.55)
IndusInd Bank	9.30	9.45	9.65	9.85	(0.15)	(0.35)	(0.55)
Kotak Bank	8.35	8.50	8.75	8.90	(0.15)	(0.40)	(0.55)
State Bank of India	7.85	8.00	8.25	8.45	(0.15)	(0.40)	(0.60)

Source: Company, BOBCAPS Research

NIM trajectory for corporate banks to remain resilient

Structurally, NIMs for select private banks appear to have peaked and would moderate from hereon, in our view. Moreover, with further repo rate cuts unlikely in the near term, banks may not fully reprice deposit rates downward – this gives us reason to believe that tapering lending yields will put pressure on margins.

Recovery in corporate cycle to bolster margins for AXSB, ICICIBC and SBIN

At the same time, corporate banks such as AXSB, ICICIBC and SBIN could see margins expand as we believe the corporate credit cycle is heading for recovery. NIM expansion will be supported by (a) reduction in interest reversals as slippages decline, (b) revival in loan growth along with lower NPAs that will bring in more interest-generating loans on the balance sheet, and (c) one-off recognition of interest income post resolution of stressed accounts via various schemes.

FIG 31 – NIMs OF CORPORATE BANKS SHOULD CONTINUE TO IMPROVE

Bank (%)	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Change in Q3FY20 (bps)	
						YoY	QoQ
AXSB	3.5	3.4	3.4	3.5	3.6	10	6
ICICIBC	3.4	3.7	3.6	3.6	3.8	37	13
SBIN	2.8	2.8	2.8	2.9	3.1	29	15

Source: Company, BOBCAPS Research

FIG 32 – NIM ESTIMATES FOR LARGE BANKS UNDER OUR COVERAGE

Bank (%)	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
ICICIBC	3.5	3.5	3.3	3.2	3.4	3.7	3.7	3.7
HDFCB	4.4	4.3	4.3	4.3	4.3	4.3	4.3	4.3
AXSB	3.9	3.9	3.7	3.4	3.4	3.4	3.6	3.7
SBIN	3.2	3.0	2.8	2.5	2.8	3.0	3.1	3.1

Source: Company, BOBCAPS Research

Strong liability franchise to cushion margins

The banking sector's reliance on term deposits is expected to increase as the pace of growth in deposits accelerates from current levels. This would drive a moderate increase in banks' cost of funds. Players such as HDFCB, ICICIBC and AXSB with a strong liability franchise (>80% share of retail deposits) would face lower NIM pressures considering that CASA deposits don't reprice and retail term deposits are cheaper than wholesale funds.

Banks with higher CASA and retail term deposits to face lower NIM pressure

FIG 33 – CASA RATIO OF LARGE BANKS EXPECTED TO REMAIN STRONG

Bank (%)	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
ICICIBC	45.5	45.8	50.4	51.7	49.6	48.7	47.9	46.8
HDFCB	44.0	43.2	48.0	43.5	42.4	40.2	40.9	41.4
AXSB	44.8	47.3	51.4	53.8	44.4	42.0	39.5	39.6

Source: Company, BOBCAPS Research

Asset quality headwinds to linger

- Widespread rating downgrades on corporate debt to exacerbate asset stress
- Initial signs of stress buildup – retail segment seeing higher 90+DPD levels across auto, credit card and LAP segments; PSBs facing MSME delinquency
- ICICIBC, AXSB and SBIN better placed vs. smaller players as bulk of their NPA recognition in place and rating profile of corporate book has improved
- Credit cost expected to be lower at 70bps for ICICIBC by FY22, but higher at 100bps for AXSB as it strives to strengthen the coverage ratio

Spate of rating downgrades to keep asset stress elevated

Credit ratings on >2,350 corporates worth ~Rs 18tn cut or suspended in FY20

FY20 has seen multiple rating downgrades or suspensions by rating agencies on corporate debt securities, as economic growth slowed and pro-activeness by these rating agencies. Consequently, both the credit ratio (number of upgrades to downgrades) as well as debt-weighted credit ratio (value of debt upgraded to downgraded) have dropped to their lowest levels in about a decade, indicating increased credit quality pressures, especially for highly leveraged companies. We believe this stress is yet to completely reflect in the books of banks.

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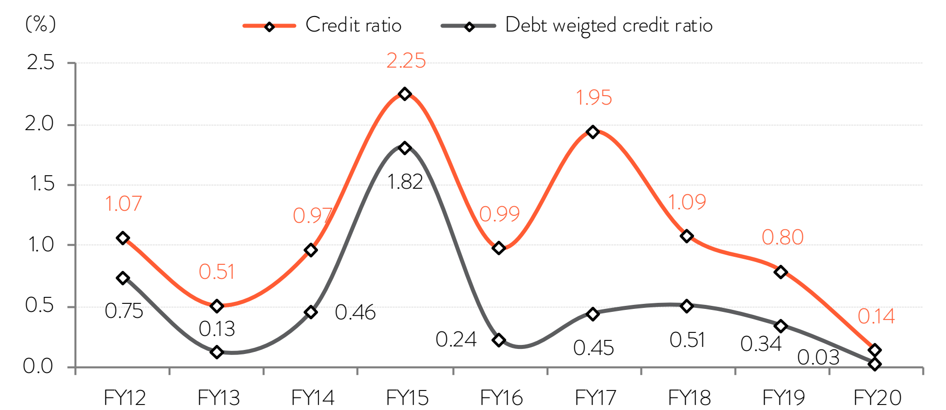
FIG 34 – RATINGS DOWNGRADES FOR CORPORATE DEBT SECURITIES (MATURITY ≥ 1 YEAR) IN FY20

Particulars	Upgraded		Downgraded		Reaffirmed		Rating Watch		Withdrawn/ Suspended		Total	
Period	Number (#)	Amount (Rs bn)	Number (#)	Amount (Rs bn)	Number (#)	Amount (Rs bn)	Number (#)	Amount (Rs bn)	Number (#)	Amount (Rs bn)	Number (#)	Amount (Rs bn)
FY11	743	1,574	310	282	3,605	41,997	100	387	518	873	5,276	45,113
FY12	696	1,015	650	1,355	3,935	37,366	45	328	717	819	6,043	40,884
FY13	463	286	904	2,193	3,827	39,168	57	229	637	1,072	5,888	42,948
FY14	225	466	231	1,024	1,788	50,150	21	121	358	616	2,623	52,377
FY15	464	1,874	206	1,032	1,930	59,471	50	607	451	658	3,101	63,644
FY16	347	973	352	4,120	1,747	66,344	54	534	450	1,184	2,950	73,154
FY17	368	793	189	1,776	2,647	90,575	59	504	600	2,613	3,863	96,262
FY18	360	1,549	331	3,035	3,591	107,725	134	2,025	894	2,500	5,310	116,833
FY19	711	3,142	892	9,136	5,489	122,520	494	11,244	1,101	4,758	8,687	150,790
FY20	209	476	1,443	14,812	3,586	64,915	687	6,961	946	3,483	6,875	90,653
-Apr-19	4	212	148	1,868	62	716	136	2,263	29	25	379	5,084
-May-19	16	18	221	3,011	227	5,695	48	647	117	318	629	9,689
-Jun-19	29	3	204	2,591	561	7,770	57	495	116	246	967	11,105
-Jul-19	7	6	139	896	380	3,472	70	220	94	349	693	4,948
-Aug-19	38	45	169	1,642	433	5,679	51	476	135	661	826	8,504
-Sep-19	11	35	178	2,160	597	16,387	109	956	115	213	1,010	19,751
-Oct-19	6	12	159	1,073	144	4,283	69	719	80	616	458	6,703
-Nov-19	25	9	71	527	350	12,787	31	286	91	439	568	14,048
-Dec-19	19	33	119	875	530	5,907	109	783	77	275	854	7,872
-Jan-20	54	102	35	171	302	2,220	7	116	92	339	491	2,948

Source: SEBI, BOBCAPS Research

FIG 35 – DEBT-WEIGHTED CREDIT RATIO HAS WORSENED SIGNIFICANTLY

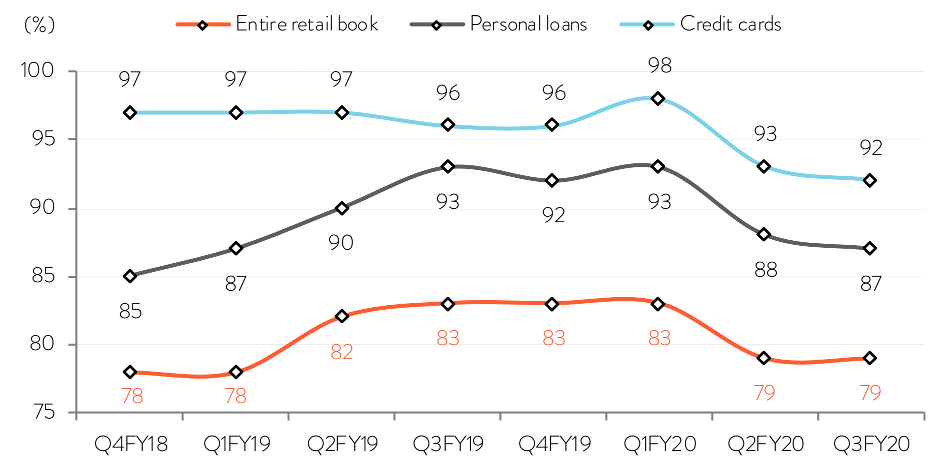


Source: SEBI, BOBCAPS Research

Early signs of stress in retail segment

Most banks have posted robust growth in retail loans, especially in the unsecured segment, over the past few years. For large banks, the unsecured retail asset growth strategy has largely revolved around internal customers. For instance, ICICIBC originates 65-70% of credit card and personal loans from existing liability customers, whereas AXSB originates 92% and 87% of the same from internal customers respectively.

FIG 36 – AXSB'S SHARE OF SOURCING FROM INTERNAL CUSTOMERS

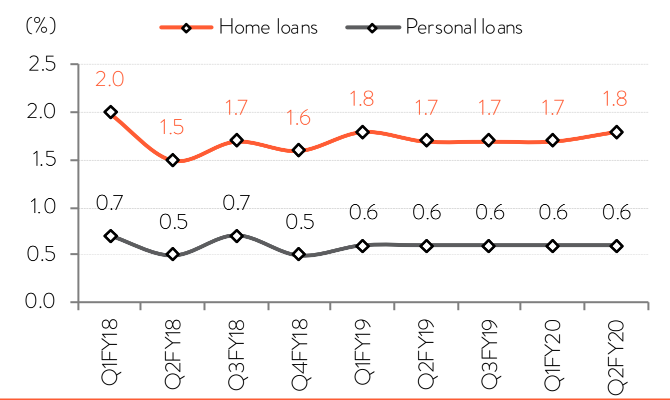


Source: Company, BOBCAPS Research

90+DPD levels inched up to 2-4% in auto, credit card and LAP segments in Q2FY20

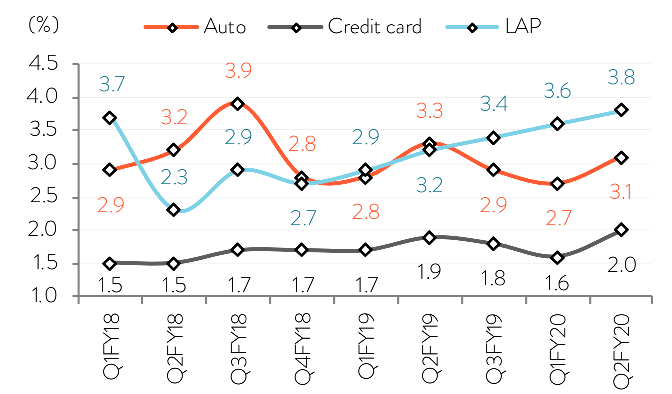
While it is difficult to predict the timing of the asset quality cycle, initial signs of stress buildup in retail loans are beginning to surface. Delinquencies across product levels in the retail segment have risen modestly in Q2FY20 and growth has decelerated amid a tough macro climate. CIBIL data indicates that barring home and personal loans, 90+DPD levels have increased across auto, credit card and LAP segments, albeit these are still manageable (Fig 38).

FIG 37 – DELINQUENCIES STABLE FOR HOME & PERSONAL LOANS…



Source: TransUnion CIBIL, BOBCAPS Research

FIG 38 – …BUT RISING FOR OTHER RETAIL PRODUCTS



Source: TransUnion CIBIL, BOBCAPS Research

Personal loan and credit card asset health stable as per management

Banks have reported higher retail slippages/GNPAs in Q3FY20 on the back of higher NPA additions in the agriculture and CV portfolios. In the personal loan and credit card segments, management commentary suggests that delinquency parameters across vintages remain stable and well within internally defined thresholds.

FIG 39 – MANAGEMENT COMMENTARY ON RETAIL ASSET QUALITY

Bank	Commentary excerpts from Q3FY20 earnings conference calls
Axis Bank	Retail asset quality remains under control. Risk metrics are steady and close to long-term lows in home loans, LAP, personal loans and credit cards.
ICICI Bank	Credit trends in the overall retail portfolio continue to be stable. Delinquency parameters across vintages in the personal loan and credit card portfolios have been stable and well within the internally defined thresholds.
Kotak Bank	We are not panicking in terms of retail asset quality, but are certainly more alert than before. Given the rise in GNPAs, provisions in our unsecured credit card, personal and business loan book have increased.
HDFC Bank	Most retail products such as auto, credit cards and personal loans have shown a slightly beneficial trend over recent times. The only growing concern would be in terms of commercial vehicles and, to some extent, commercial equipment. So, it is the commercial products that are continuing to hold some level of concern.

Source: Company, BOBCAPS Research

The moratorium on YES could result in a marginal increase in retail loan delinquencies, specifically because of customers who have linked repayments to their deposit accounts in the troubled bank.

Asset quality continues to worsen for MSME loans

As per data released by SIDBI, the MSME segment accounts for ~28% of overall commercial lending in India with outstanding on-balance sheet loans at ~Rs 18.3tn as of Q2FY20. At the same time, growth in MSME credit has decelerated sharply over the past few quarters to ~5% YoY in Q2FY20 from ~20% a year ago.

MSME NPAs up 40bps QoQ to 12.2% in Q2FY20

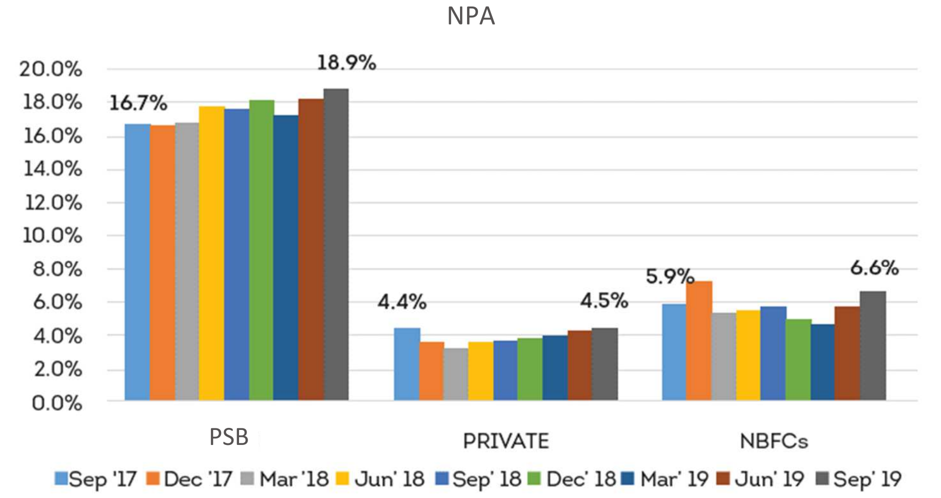
NPAs too have increased by ~40bps QoQ to 12.2% in Q2FY20. Banks, especially PSBs, have witnessed elevated stress in this segment. Further, the rise in NPAs for Mudra loans – i.e. loans up to Rs 1mn to non-agri, non-corporate micro and small enterprises – remains a concern. 'PSB loans in 59 minutes' launched by the government in Nov'18 to provide finance of up to Rs 10mn to MSMEs are yet to exhibit higher delinquency levels.

FIG 40 – GROWTH ACROSS MSME SEGMENTS HAS DECELERATED SHARPLY

Segments (%)	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Very small (Rs <1mn)	15.1	18.7	10.8	6.0	6.0
Micro 1 (Rs 1mn- Rs 5mn)	17.1	18.9	14.7	11.0	8.8
Micro 2 (Rs 5mn-Rs 10mn)	21.6	19.0	14.8	10.9	7.8
Small (Rs 10mn -Rs 150mn)	22.7	16.2	10.8	7.7	4.6
Medium (Rs 150mn -Rs 500mn)	14.0	10.9	8.6	5.2	1.9
Total MSME	**19.1**	**15.4**	**11.0**	**7.6**	**4.7**

Source: SIDBI, BOBCAPS Research

FIG 41 – MSME ASSET QUALITY FOR PSBs UNDER PRESSURE



Source: SIDBI, BOBCAPS Research

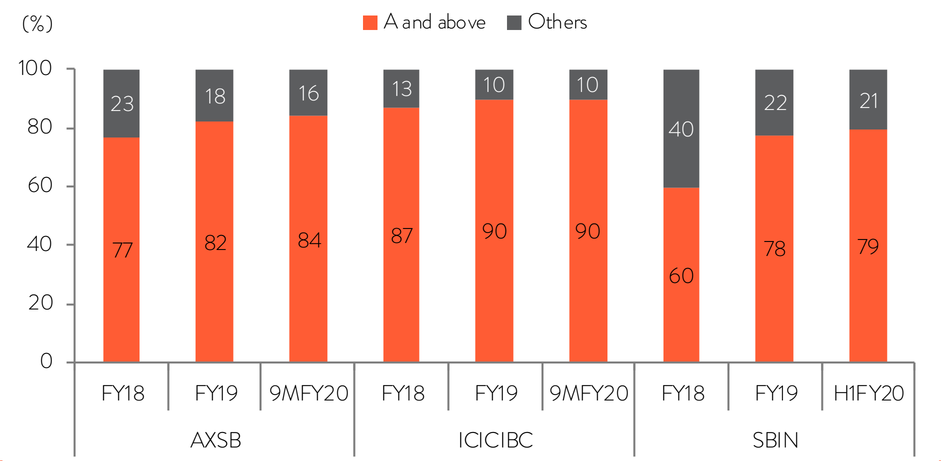
Large private banks better placed

ICICIB and AXSB likely to exit stressed corporate cycle early

We believe large banks, namely ICICIBC and AXSB, are in a better position to exit the stressed corporate cycle early as compared to small and mid-sized players. A substantial chunk of the troubled corporate accounts have already been classified as impaired by these large banks, either by recognising the exposure as NPA or downgrading it to 'BB & below'.

Further, continued risk aversion by ICICIBC and AXSB over the last few years has improved the rating profile of their corporate portfolios. This is likely to keep formation of new bad loans in check. GNPAs should also continue to decline as recovery of bad loans improves meaningfully.

FIG 42 – RATING PROFILE OF CORPORATE PORTFOLIO INCREASINGLY SHIFTING TOWARDS 'A' AND ABOVE



Source: Company, BOBCAPS Research

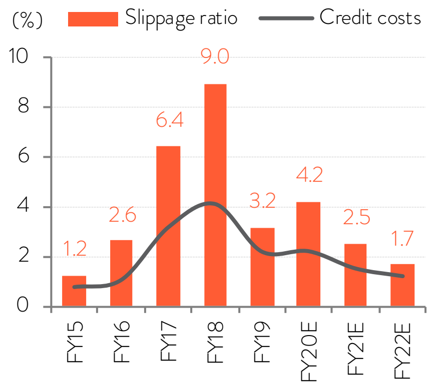
Credit cost to normalise for large banks

High GNPA coverage implies lower write-offs from FY21E

The improvement in asset quality that we expect for large banks is likely to bring about a reduction in their credit costs. These banks have meaningfully ramped up GNPA coverage by adequately providing for stressed assets under the Insolvency and Bankruptcy Code (IBC). We expect credit costs for ICICIBC to normalise to 70bps by FY22, with a higher 100bps for AXSB as it is aiming to strengthen its coverage ratio.

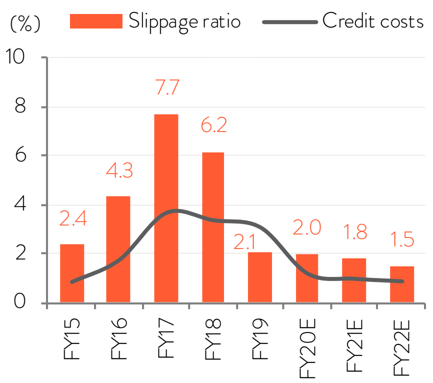
In the case of small-sized banks, credit costs would stay elevated for players with a lower coverage ratio (<55% – DCB Bank and RBL Bank) and for those that aim to maximise provisions on their stressed watchlist (AXSB and IDFC First Bank).

FIG 43 – AXSB: CREDIT COST & SLIPPAGES TO STAY ELEVATED IN FY20E



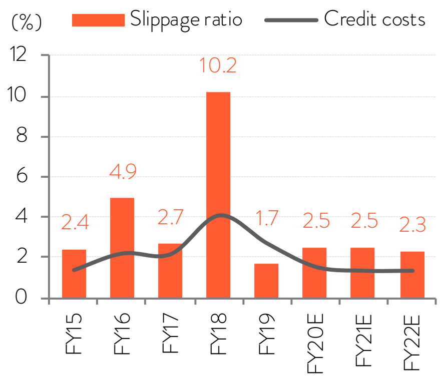
Source: Company, BOBCAPS Research

FIG 44 – ICICIBC: CREDIT COST TO REVERT TO NORMAL POST FY21E



Source: Company, BOBCAPS Research

FIG 45 – SBIN: CREDIT COST TO EASE SIGNIFICANTLY FROM FY21E



Source: Company, BOBCAPS Research

ICICIBC's high share of D2 and below loans implies lower credit costs

Incremental provisions for large private banks would likely be ageing-related, which should also come off as the share of substandard loans gradually declines. The table below classifies NPAs under different buckets. Notably, ICICIBC has the highest proportion of loans in the 'Doubtful 2' and below categories – indicating lower credit cost requirement for ageing-related provisions than other banks.

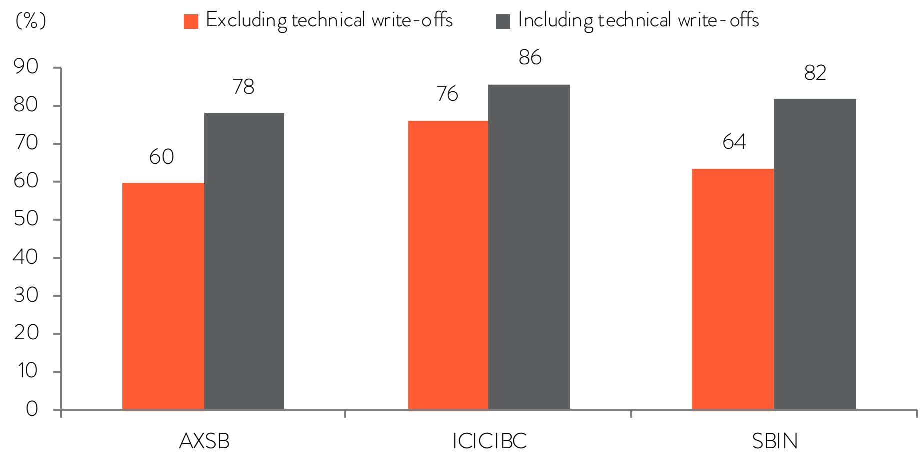
FIG 46 – NPA CLASSIFICATION ACROSS CORPORATE LENDERS

(as a % of GNPA)	AXSB		ICICIBC		SBIN	
	FY17	9MFY20	FY17	9MFY20	FY17	9MFY20
Sub Standard	27	27	34	14	25	24
Doubtful	48	55	61	78	73	61
-Doubtful 1	26	20	32	15	25	14
-Doubtful 2	20	35	27	42	40	25
-Doubtful 3	2	1	3	20	8	22
Loss	25	18	5	9	2	15
GNPA (Rs bn)	213	303	455	454	1,792	1,608

Source: Company, BOBCAPS Research

In a bid to clean up their balance sheets, corporate banks have written off a huge amount of loans in the past few years. Though this has come at a heavy financial price and necessitated massive capital infusion, the outstanding prudential (or technical) write-off pool across most corporate banks is now at an all-time high. Thus, banks could see lower write-offs from FY20 onwards. Also, higher recoveries from these accounts should aid stronger NIM or non-interest income depending on the accounting treatment.

FIG 47 – PCR: OUTSTANDING PRUDENTIAL TECHNICAL WRITE-OFF POOL AT MOST CORPORATE BANKS AT ALL-TIME HIGH



Source: Company, BOBCAPS Research

Correction offers entry point into large private banks

- Valuations look attractive post >30% correction in NSE Bank Index over the past month and 40% drop among our top picks
- Amid growing Covid-19 shocks, we cut earnings estimates and target multiples across banks but retain our preference for ICICIBC, AXSB and HDFCB
- Initiate coverage with BUY on FB; ADD on RBK, DCBB and IDFCFB

Valuations undemanding

The NSE Bank Index has corrected >30% in the last one month due to the Covid-19 outbreak, sector headwinds and global factors (Fig 48), with banking stocks down as much as 60%. Small/mid-sized banks have witnessed even sharper erosion in market cap following the YES bailout episode, as investors fear a flight of deposits to larger banks that are perceived as being more stable. With this correction, large private banks are now trading at undemanding valuations (Fig 50) and offer an attractive investment entry point.

FIG 48 – PRICE PERFORMANCE OF BANKING STOCKS UNDER COVERAGE

Returns (%)	1-week	1-month	3-months	6-months	1-year
NSEBANK Index	(1.7)	(33.5)	(40.1)	(33.4)	(36.3)
AXSB IN Equity	(16.0)	(46.5)	(50.5)	(45.5)	(51.9)
ICICIBC IN Equity	(1.7)	(34.1)	(39.7)	(24.4)	(18.0)
HDFCB IN Equity	2.4	(27.1)	(33.1)	(30.1)	(25.4)
KMB IN Equity	10.8	(17.3)	(20.7)	(18.5)	0.5
FB IN Equity	(16.0)	(51.8)	(52.7)	(54.2)	(56.5)
IIB IN Equity	(6.6)	(63.0)	(73.3)	(70.4)	(76.9)
YES IN Equity	(42.5)	(27.6)	(47.1)	(39.5)	(90.8)
RBK IN Equity	(5.8)	(46.8)	(55.2)	(53.0)	(77.2)
IDFCFB IN Equity	8.7	(42.3)	(52.7)	(47.1)	(61.7)
DCBB IN Equity	(18.4)	(43.1)	(45.5)	(52.9)	(54.9)
SBIN IN Equity	(6.6)	(36.5)	(42.4)	(28.9)	(40.0)

Source: Bloomberg, BOBCAPS Research

Covid-19 a key risk – RBI measures offer temporary relief

We note that a prolonged economic shutdown due to Covid-19 can exacerbate credit growth pressures and keep credit costs elevated as loans sour and repayments slow, particularly in the vulnerable MSME and unsecured retail segments. Corporate NPA recovery may be delayed owing to a higher downtime for court proceedings, which could prevent credit costs from normalising. The RBI in its recent Monetary Policy announced a series of measures (outlined below) to address the tight financial conditions and emerging downside risks to growth. In our view, these will provide only temporary relief to banks.

Since Feb'20, RBI has infused liquidity equivalent to 3.2% of GDP

- **Repo rate reduced to 4.4%:** In the highest single-day move post the Global Financial Crisis policy response, RBI cut the repo rate by 75bps with immediate effect from 5.15% earlier. The central bank also decided to continue with its accommodative stance as long as is necessary to revive growth and mitigate the impact of Covid-19 on the economy.
- **Targeted term repo operations:** The RBI will conduct Rs 1tn targeted term repo operations (TLTRO) with a three-year maturity at a floating rate linked to the repo rate. Liquidity availed by banks under this scheme will have to be deployed in investment-grade corporate bonds, CPs and NCDs in the primary and secondary market in equal proportion. In our view, this will help compress elevated credit spreads.
- **CRR reduced by 100bps:** The CRR has been slashed by 100bps to 3% of banks' NDTL effective till 26 Mar 2021. This would release primary liquidity worth ~Rs 1.4tn into the banking system.
- **Higher dispensation of borrowing under the MSF window:** Effective until Jun'20, banks will be allowed a higher dispensation of 3% borrowing under the marginal standing facility (MSF) window vs. 2% earlier. This enables banks to avail an additional ~Rs 1.4tn of liquidity under the liquidity adjustment facility (LAF) window in times of stress.

- **Moratorium on term loans:** The central bank has allowed a three-month moratorium on payment of installments in respect of all term loans (including agricultural, retail and crop loans). The repayment schedule for such loans as also the residual tenor stands shifted by three months after the moratorium period. Interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.
- **Deferment of interest on working capital facilities:** Lending institutions are allowed to defer the recovery of interest for three months on working capital facilities sanctioned in the form of cash credit or overdraft. The accumulated accrued interest shall be recovered immediately after completion of this period. The moratorium on term loans and deferment of interest provides regulatory forbearance and does not lead to downgrade in asset classification.

Targets revised down – prefer ICICBC, AXSB, HDFCB

FY20-FY22 EPS estimates cut 6-16% across banks given current visibility on Covid-19

Despite the respite offered by RBI measures, we expect banks to see slower growth momentum and higher asset quality risk in the unsecured retail and MSME sectors. Both duration and depth of the Covid-19 related downturn remain unknowns. Assuming the domestic economic shutdown continues for more than a quarter, we model for lower loan growth (6-16%) and a slight deterioration in asset quality for our coverage universe of large banks over FY20-FY22, leading to a 3-20% reduction in EPS across banks. We also pare target P/BV multiples across our coverage.

Our target prices for top picks ICICIBC (Rs 465), AXSB (Rs 520) and HDFCB (Rs 1,200) thus reduce by 26%, 42% and 19% respectively. In our view, this trio of large private banks is best placed to weather the storm, anchored by a lower cost of funds, strong liability franchise, adequate capital and structurally fortified balance sheets. At current valuations of 1.1x, 0.9x and 2x on core FY22E P/BV respectively, these stocks offer robust risk-reward post the recent correction (down 40% on average in one month).

FIG 49 – REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
ICICI Bank									
Net interest income (Rs bn)	318	361	413	326	379	450	(2.4)	(4.9)	(8.1)
Pre-provisioning profit (Rs bn)	273	316	373	278	330	405	(1.8)	(4.3)	(7.9)
Net profit (Rs bn)	115	176	211	119	205	256	(3.4)	(14.1)	(17.5)
EPS (Rs)	17.9	27.3	32.7	18.5	31.8	39.7	(3.4)	(14.1)	(17.5)
BVPS (Rs)	177.0	197.9	223.0	177.5	201.9	232.3	(0.3)	(1.9)	(4.0)
GNPA ratio (%)	6.0	5.1	4.3	5.9	4.6	3.6	8bps	58bps	68bps
HDFC Bank									
Net interest income (Rs bn)	579	666	774	593	725	883	(2.3)	(8.1)	(12.3)
Pre-provisioning profit (Rs bn)	478	568	654	483	591	712	(1.0)	(3.8)	(8.1)
Net profit (Rs bn)	268	298	343	276	358	435	(3.0)	(16.7)	(21.1)
EPS (Rs)	49.2	54.7	63.1	50.7	65.7	79.9	(3.0)	(16.7)	(21.1)
BVPS (Rs)	311.6	353.5	401.8	312.8	363.1	424.4	(0.4)	(2.6)	(5.3)
GNPA ratio (%)	1.5	1.8	1.9	1.4	1.5	1.4	9bps	36bps	50bps
Axis Bank									
Net interest income (Rs bn)	241	279	332	245	304	379	(1.8)	(8.3)	(12.3)
Pre-provisioning profit (Rs bn)	221	259	314	225	276	340	(1.6)	(6.1)	(7.7)
Net profit (Rs bn)	55	121	162	56	149	186	(2.9)	(19.0)	(12.7)
EPS (Rs)	20.3	42.9	57.7	20.9	52.9	66.1	(2.9)	(19.0)	(12.7)
BVPS (Rs)	306.2	341.4	388.7	306.7	350.1	404.3	(0.2)	(2.5)	(3.9)
GNPA ratio (%)	5.1	4.7	3.6	4.9	4.0	3.1	15bps	62bps	56bps
State Bank of India									
Net interest income (Rs bn)	995	1,071	1,208	1,004	1,177	1,401	(0.9)	(8.9)	(13.8)
Pre-provisioning profit (Rs bn)	727	719	821	805	774	898	(9.7)	(7.1)	(8.6)
Net profit (Rs bn)	247	291	349	304	360	425	(18.8)	(19.0)	(17.8)
EPS (Rs)	27.6	32.6	39.1	34.0	40.3	47.6	(18.8)	(19.0)	(17.8)
BVPS (Rs)	286.2	311.2	341.2	291.2	322.1	358.6	(1.7)	(3.4)	(4.9)
GNPA ratio (%)	6.5	5.7	5.2	6.4	5.1	3.9	6bps	60bps	123bps

Source: BOBCAPS Research

FIG 50 – REVISION IN TARGET PRICE

Bank	Current core P/BV multiple (x)			FY22E target P/BV multiple (x)		Target price (Rs)	
	FY20E	FY21E	FY22E	Old	New	Old	New
AXSB	1.2	1.1	0.9	2.1	1.2	900	520
ICICIBC	1.5	1.3	1.1	2.3	1.8	625	465
HDFCB	2.6	2.3	2.0	3.4	2.8	1,480	1,200
SBIN	0.3	0.3	0.2	1.0	0.5	400	250

Source: Bloomberg, BOBCAPS Research

Initiate coverage on FB with BUY

We initiate coverage on a select set of smaller banks, with a BUY on Federal Bank (FB: TP Rs 50) as we are positive on its improving profitability, and ADD ratings on DCB Bank (DCBB: TP Rs 105), RBL Bank (RBK: TP Rs 170) and IDFC First Bank (IDFCFB: TP Rs 23) given their undemanding valuations.

FIG 51 – BOBCAPS BANKING UNIVERSE: VALUATION SUMMARY

Bank	Rating	Target price (Rs)	BVPS (Rs)			P/BV (x)			EPS (Rs)			P/E (x)		
			FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AXSB	BUY	520	306	341	389	1.2	1.1	0.9	20	43	58	18.2	8.6	6.4
ICICIBC	BUY	465	177	198	223	1.8	1.6	1.4	18	27	33	17.6	11.5	9.6
HDFCB	BUY	1,200	312	354	402	2.7	2.4	2.1	49	55	63	16.9	15.2	13.2
FB	BUY	50	73	80	89	0.6	0.5	0.5	8	9	12	5.0	4.5	3.5
RBK	ADD	170	210	229	256	0.7	0.7	0.6	12	22	33	13.0	6.8	4.6
IDFCFB	ADD	23	32	32	38	0.7	0.7	0.5	(6)	(0)	1	(3.6)	(119.2)	15.0
DCBB	ADD	105	103	113	125	0.9	0.8	0.8	12	11	14	8.1	8.7	7.1
SBIN	BUY	250	286	311	341	0.7	0.6	0.5	28	33	39	6.8	5.7	4.8

Source: Bloomberg, Company, BOBCAPS Research

Companies

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 465 | 48%

ICICI BANK | Banking | 31 March 2020

Top pick among banks

We believe ICICI Bank (ICICIBC) offers the best risk-reward among our bank coverage given a healthy, sustainable earnings outlook. Asset quality is likely to strengthen following large NPA recognition in the past and limited exposure to recent stressed loan cases. We expect a lower cost of funds and loan book recalibration to curb credit costs and fortify margins, aiding ROE expansion to ~15% by FY22. We cut FY20-FY22 EPS by 3-18% and reiterate BUY with a revised Mar'21 TP of Rs 465 (vs. Rs 625) set at 1.8x FY22E P/BV (vs. 2.3x).

Vikesh Mehta
research@bobcaps.in

Limited incremental stress despite macro concerns: ICICIBC's pool of stressed loans (non-NPA) has come off sharply to 2.8% vs. ~14% in FY16. Barring one-offs in Q3FY20, corporate slippages have been declining while exposure to recent troubled accounts appears limited. Also, retail trends are broadly in line with best-in-class players, reflecting cyclical rather than underwriting issues in FY20. The bank has hiked NPA coverage to ~76% in Q3 and hence ageing-related provisions are likely to reduce. This should aid a sharp drop in credit cost to 80bps/70bps in FY21/FY22 and hence a surge in earnings.

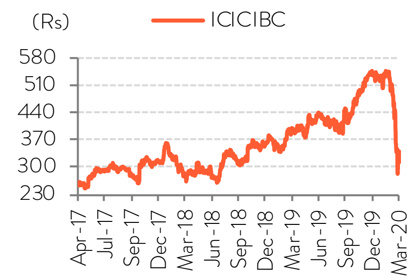
Margins to remain strong: ICICIBC has a robust funding franchise and its cost of funds at ~5% is amongst the lowest in its peer set, implying low risk of adverse portfolio selection. The bank's unsecured portfolio at Rs 583bn (9% of loans) is about a third that of HDFC Bank (18% of loans). Scale-up of this portfolio and a higher share of domestic loans should support strong NIM (3.7% in FY22E).

Our top pick: ICICIBC remains our top pick in the sector as we expect steady earnings improvement (35% CAGR: FY20-FY22) with revival in asset quality and normalising credit costs. The stock has corrected >30% in the past month and looks attractive at 1.1x FY22E core P/BV. We lower estimates and value the core book at 1.8x P/BV vs. 2.3x earlier to bake in sector-wide Covid-19 concerns.

Ticker/Price	ICICIBC IN/Rs 313
Market cap	US$ 26.8bn
Shares o/s	6,453mn
3M ADV	US$ 151.4mn
52wk high/low	Rs 552/Rs 268
Promoter/FPI/DII	0%/45%/55%

Source: NSE

STOCK PERFORMANCE



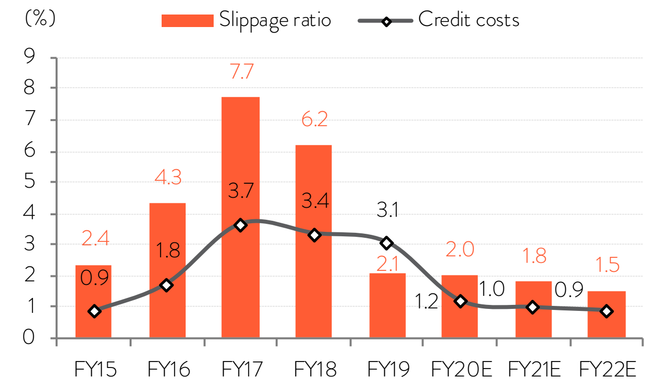
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	230,258	270,148	318,039	360,585	413,183
NII growth (%)	5.9	17.3	17.7	13.4	14.6
Adj. net profit (Rs mn)	67,774	33,633	115,110	175,941	211,035
EPS (Rs)	11.1	5.2	17.9	27.3	32.7
P/E (x)	28.3	60.0	17.6	11.5	9.6
P/BV (x)	1.9	1.9	1.8	1.6	1.4
ROA (%)	0.8	0.4	1.1	1.6	1.7
ROE (%)	6.6	3.2	10.3	14.6	15.6

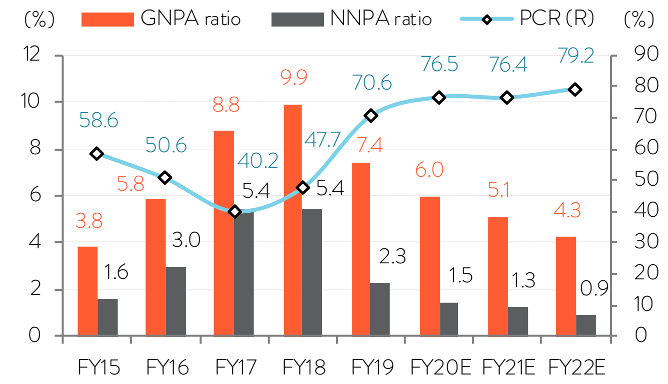
Source: Company, BOBCAPS Research

FIG 1 – EXPECT SHARP DIP IN CREDIT COST AND SLIPPAGES



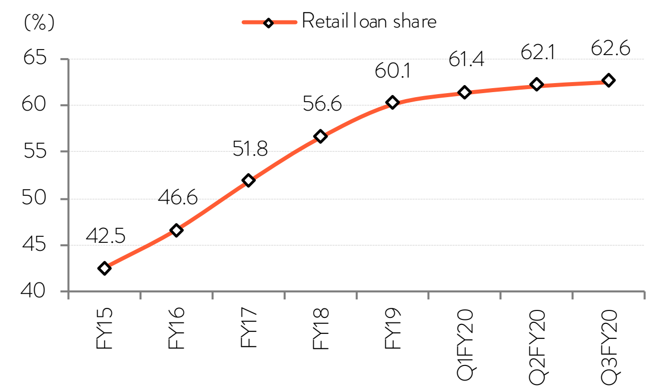
Source: Company, BOBCAPS Research

FIG 2 – ASSET QUALITY SHOULD CONTINUE TO STRENGTHEN



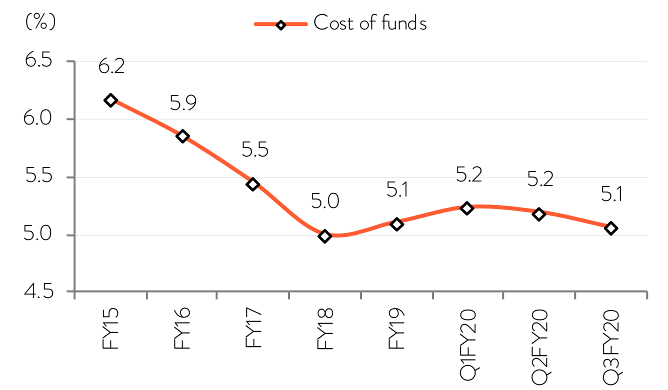
Source: Company, BOBCAPS Research

FIG 3 – ICICIBC HAS RECALIBRATED ITS ASSET PORTFOLIO IN FAVOUR OF RETAIL LOANS…



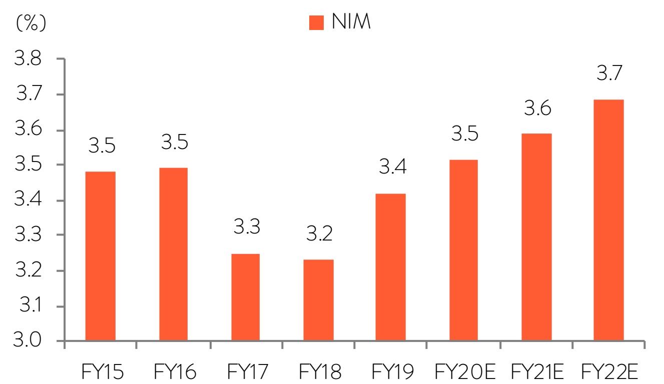
Source: Company, BOBCAPS Research

FIG 4 – …WHILE ITS COST OF FUNDS IS THE LOWEST AMONGST PRIVATE PEERS



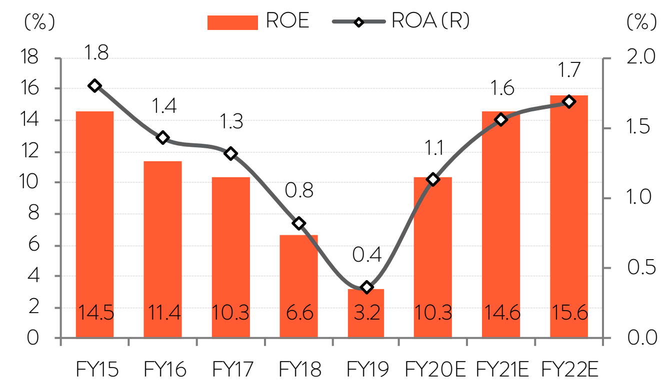
Source: Company, BOBCAPS Research

FIG 5 – MARGINS TO REMAIN STRONG…



Source: Company, BOBCAPS Research

FIG 6 – …AIDING STRONGER PROFITABILITY



Source: Company, BOBCAPS Research

Valuation methodology

ICICIBC remains our top pick in the banking sector as we expect steady earnings improvement (35% CAGR for FY20-FY22) backed by revival in asset quality and normalising credit costs. The stock is trading at attractive valuations of 1.1x FY22E core P/BV. Mindful of potential Covid-19 headwinds across the sector, we cut our FY20-FY22 EPS by 3-18%, reduce our core P/BV multiple from 2.3x to 1.8x, and reset our Mar'21 target price to Rs 465 (vs. Rs 625), based on the Gordon Growth Model. Maintain BUY.

FIG 7 – REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net interest income (Rs bn)	318	361	413	326	379	450	(2.4)	(4.9)	(8.1)
Pre-provisioning profit (Rs bn)	273	316	373	278	330	405	(1.8)	(4.3)	(7.9)
Net profit (Rs bn)	115	176	211	119	205	256	(3.4)	(14.1)	(17.5)
EPS (Rs)	17.9	27.3	32.7	18.5	31.8	39.7	(3.4)	(14.1)	(17.5)

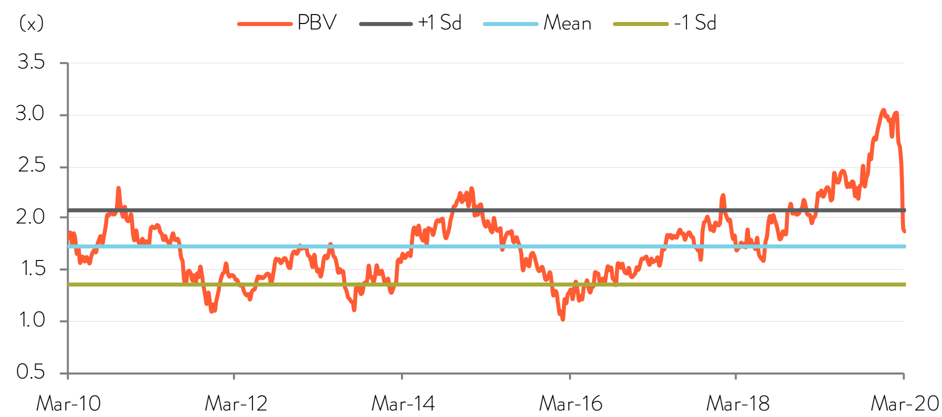
Source: BOBCAPS Research

FIG 8 – SOTP VALUATION

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for ICICIBC (Rs bn)	Per Share (Rs)	Contribution to TP (%)	Comments
Core Business	2,372	100	2,372	368	79	Valued at 1.8x Mar'22 P/BV on residual income model
ICICI Prudential Life	459	53	194	30	6	Valued at CMP; adjusted for 20% holdco discount
ICICI Lombard General	486	56	217	34	7	Valued at CMP; adjusted for 20% holdco discount
ICICI Securities	87	79	55	9	2	Valued at CMP; adjusted for 20% holdco discount
ICICI Prudential AMC	217	51	111	17	4	6% of Q3FY20 AAUM
ICICI Home Finance	19	100	19	3	1	Valued at 1x Mar'22 P/BV
ICICI Bank UK & Canada	26	100	26	4	1	Valued at 0.5x Mar'22 P/BV
Sum of Parts			**2,995**	**465**		

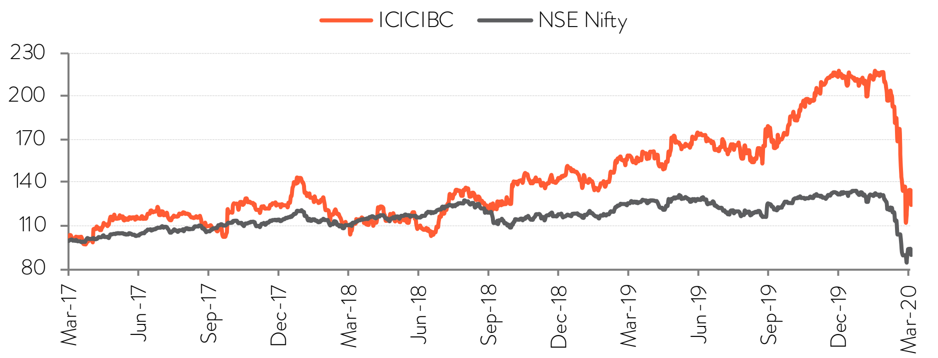
Source: BOBCAPS Research

FIG 9 – ONE-YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Significant deterioration in retail asset quality could derail the expected improvement in profitability.
- Delay in resolution of stressed assets can impact our credit cost assumptions.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**230,258**	**270,148**	**318,039**	**360,585**	**413,183**
NII growth (%)	5.9	17.3	17.7	13.4	14.6
Non-interest income	174,196	145,122	163,854	178,981	202,892
Total income	404,455	415,270	481,893	539,566	616,075
Operating expenses	(157,039)	(180,891)	(208,547)	(223,438)	(243,153)
Operating profit	247,415	234,379	273,346	316,128	372,921
Operating profit growth (%)	(6.6)	(5.3)	16.6	15.7	18.0
Provisions	(173,070)	(196,611)	(78,382)	(79,647)	(89,272)
PBT	74,346	37,768	194,963	236,480	283,650
Tax	(6,571)	(4,135)	(79,854)	(60,539)	(72,614)
Reported net profit	**67,774**	**33,633**	**115,110**	**175,941**	**211,035**
Adjustments	0	0	0	0	0
Adjusted net profit	**67,774**	**33,633**	**115,110**	**175,941**	**211,035**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	12,858	12,895	12,895	12,895	12,895
Reserves & surplus	1,038,731	1,070,786	1,128,468	1,263,239	1,424,892
Net worth	1,051,589	1,083,680	1,141,363	1,276,134	1,437,787
Deposits	5,609,752	6,529,197	7,526,285	8,292,383	9,385,855
Borrowings	1,828,586	1,653,200	1,764,831	1,874,516	2,034,838
Other liabilities & provisions	301,964	378,515	393,702	410,524	428,482
Total liabilities and equities	**8,791,892**	**9,644,591**	**10,826,180**	**11,853,557**	**13,286,963**
Cash & bank balance	841,694	802,963	787,540	890,618	1,012,380
Investments	2,029,942	2,077,327	2,334,994	2,569,698	2,901,995
Advances	5,123,953	5,866,466	6,599,774	7,259,751	8,203,519
Fixed & Other assets	796,303	897,836	1,103,872	1,133,490	1,169,068
Total assets	**8,791,892**	**9,644,591**	**10,826,180**	**11,853,557**	**13,286,963**
Deposit growth (%)	14.5	16.4	15.3	10.2	13.2
Advances growth (%)	10.4	14.5	12.5	10.0	13.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	11.1	5.2	17.9	27.3	32.7
Dividend per share	2.3	1.5	3.6	5.5	6.5
Book value per share	163.6	168.1	177.0	197.9	223.0

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	28.3	60.0	17.6	11.5	9.6
P/BV	1.9	1.9	1.8	1.6	1.4
Dividend yield (%)	0.7	0.5	1.1	1.7	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	2.8	2.9	3.1	3.2	3.3
Non-interest income	2.1	1.6	1.6	1.6	1.6
Operating expenses	1.9	2.0	2.0	2.0	1.9
Pre-provisioning profit	3.0	2.5	2.7	2.8	3.0
Provisions	2.1	2.1	0.8	0.7	0.7
PBT	0.9	0.4	1.9	2.1	2.3
Tax	0.1	0.0	0.8	0.5	0.6
ROA	0.8	0.4	1.1	1.6	1.7
Leverage (x)	8.0	8.6	9.2	9.4	9.3
ROE	6.6	3.2	10.3	14.6	15.6

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	5.9	17.3	17.7	13.4	14.6
Pre-provisioning profit	(6.6)	(5.3)	16.6	15.7	18.0
EPS	(34.3)	(52.8)	241.8	52.8	19.9
Profitability & Return ratios (%)					
Net interest margin	3.1	3.2	3.4	3.5	3.6
Fees / Avg. assets	1.1	1.1	1.1	1.1	1.2
Cost-Income	38.8	43.6	43.3	41.4	39.5
ROE	6.6	3.2	10.3	14.6	15.6
ROA	0.8	0.4	1.1	1.6	1.7
Asset quality (%)					
GNPA	9.9	7.4	6.0	5.1	4.3
NNPA	5.4	2.3	1.5	1.3	0.9
Provision coverage	47.7	70.6	76.5	76.4	79.2
Ratios (%)					
Credit-Deposit	91.3	89.8	87.7	87.5	87.4
Investment-Deposit	36.2	31.8	31.0	31.0	30.9
CAR	18.4	16.9	16.6	16.8	16.6
Tier-1	15.9	15.1	14.9	15.0	14.8

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 1,200 | ⮝ 44%

HDFC BANK | Banking | 31 March 2020

Market share gains to continue

HDFC Bank (HDFCB) is a solid play in the current macro climate by dint of its good funding profile, strong capital adequacy and ability to gain market share. Asset quality looks manageable with risk in the unsecured and corporate books reined in. We expect credit cost to hold in the range of 100-150bps through to FY22. Management transition, though, is a key monitorable. Amid sector-wide Covid-19 uncertainty, we cut FY20-FY22 EPS by 3-20% and reset our core target FY22E P/BV from 3.4x to 2.8x – this yields a new Mar'21 TP of Rs 1,200 (vs. Rs 1,480).

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Loan growth to remain strong: In our view, HDFCB's product suite, robust technology and rural reach would aid sustained loan growth. Moreover, the competitive environment remains weak which should enable the bank to make continued market share inroads. Despite industry-level loan growth of ~6%, HDFCB continues to grow at 18-20% by shifting focus to corporate/business banking and unsecured loans to offset the slowdown in select retail products.

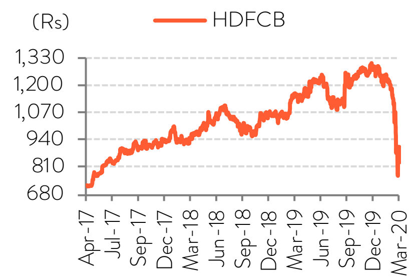
Asset quality manageable: We expect HDFCB's asset quality in the unsecured segment and corporate portfolio to be manageable, with overall GNPA ratio at 1.5-1.9% and credit costs in the region of 100-150bps for FY20-FY22.

Management transition remains an overhang: The bank has set up a **search committee** to identify a successor to MD Aditya Puri who is due to retire in Oct'20 after three decades at the helm. In the Q3FY20 conference call, management indicated that a list of candidates will be submitted to RBI by Jul-Aug'20. In our view, investors are skeptical of an external candidate who could create flux in the organisation and would prefer an internal appointee to ensure continuity and stability across the bank.

Ticker/Price	HDFCB IN/Rs 832
Market cap	US$ 30.1bn
Shares o/s	2,733mn
3M ADV	US$ 159.2mn
52wk high/low	Rs 1,306/Rs 739
Promoter/FPI/DII	27%/39%/34%

Source: NSE

STOCK PERFORMANCE



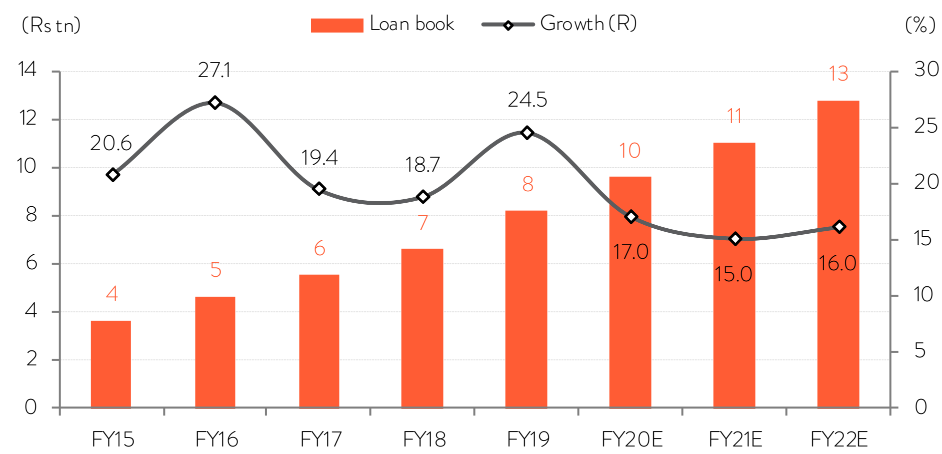
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	400,949	482,432	579,152	665,882	773,757
NII growth (%)	21.0	20.3	20.0	15.0	16.2
Adj. net profit (Rs mn)	174,867	210,782	267,821	298,165	343,439
EPS (Rs)	33.9	39.6	49.2	54.7	63.1
P/E (x)	24.5	21.0	16.9	15.2	13.2
P/BV (x)	4.1	3.0	2.7	2.4	2.1
ROA (%)	1.8	1.8	2.0	1.9	1.9
ROE (%)	17.9	16.5	16.8	16.5	16.7

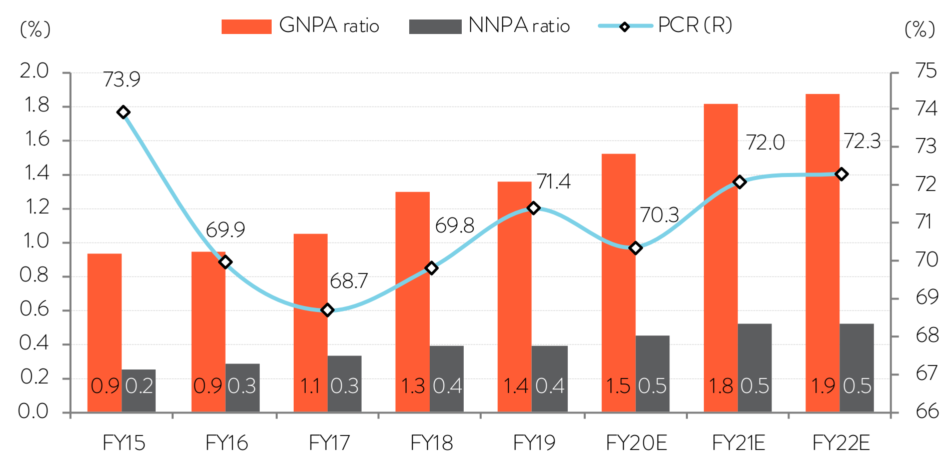
Source: Company, BOBCAPS Research

FIG 1 – LOAN GROWTH TO STAY WELL AHEAD OF INDUSTRY



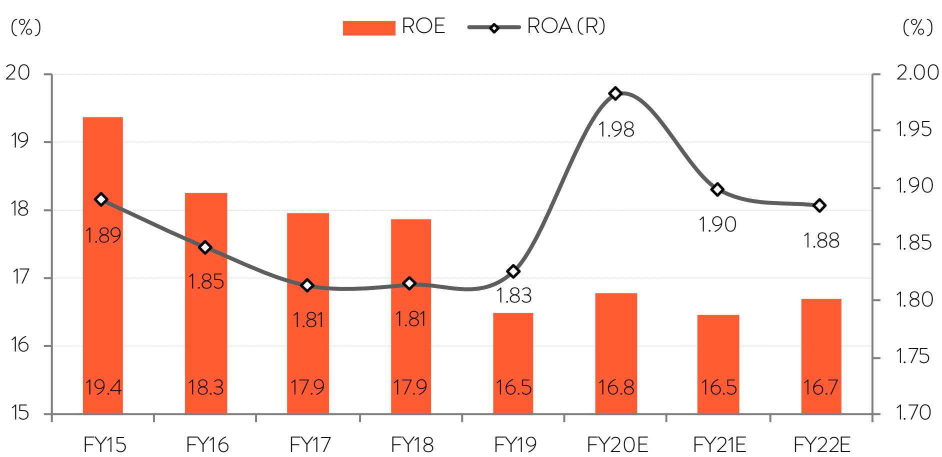
Source: Company, BOBCAPS Research

FIG 2 – ASSET QUALITY MANAGEABLE



Source: Company, BOBCAPS Research

FIG 3 – PROFITABILITY EXPECTED TO REMAIN HEALTHY



Source: Company, BOBCAPS Research

Valuation methodology

We like HDFCB for its strong processes, risk management practices and stable asset quality. But sector-wide uncertainty amidst the Covid-19 outbreak leads us to reduce our FY20-FY22 EPS estimates by 3-20% and FY22E core book target multiple to 2.8x (3.4x earlier) – this translates to a revised Mar'21 target price of Rs 1,200 (Rs 1,480 earlier). Maintain BUY.

Our target price is derived using the SOTP method where the core book has been adjusted for investment in subsidiaries – this is based on a two-stage Gordon Growth Model given that we expect the business to continue growing much faster than the industry for the next few years. Our SOTP model also includes the value of the bank's NBFC and broking businesses.

FIG 4 – REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net interest income (Rs mn)	579,152	665,882	773,757	592,722	724,667	882,660	(2.3)	(8.1)	(12.3)
Pre-provisioning profit (Rs mn)	477,664	568,349	654,218	482,653	591,092	712,204	(1.0)	(3.8)	(8.1)
Net Profit (Rs mn)	267,821	298,165	343,439	276,225	358,062	435,247	(3.0)	(16.7)	(21.1)
EPS (Rs)	49	55	63	51	66	80	(3.0)	(16.7)	(21.1)

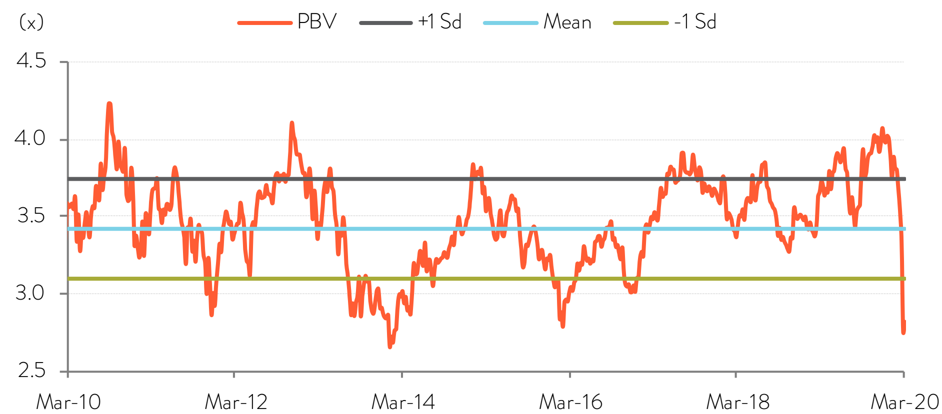
Source: BOBCAPS Research

FIG 5 – SOTP VALUATION

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for HDFCB (Rs bn)	Per Share (Rs)	Contribution to TP (%)	Comments
Core Business	6,104	100	6,104	1,121	93	Valued at 2.8x Mar'22 P/BV on Gordon Growth Model
HDB Financial	317	96	350	64	5	Valued at 3x FY22E P/BV
HDFC Securities	65	98	80	15	1	Valued at 12x FY22E P/E
Sum of Parts			**6,533**	**1,200**	**100**	

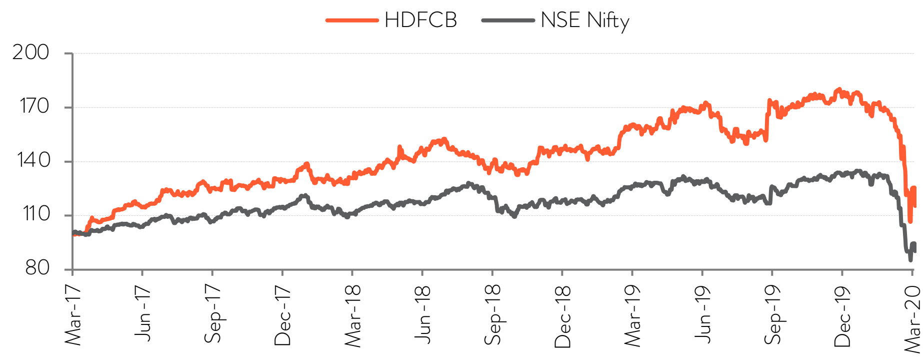
Source: Company, BOBCAPS Research

FIG 6 – ONE-YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Economic slowdown:** In our view, HDFCB's loan portfolio broadly imitates India's GDP mix by catering to the consumption theme. A slower-than-expected pickup in India's economic growth or a slowdown in job creation coupled with a sharp rise in interest rates could affect demand for retail loans and margins.
- **Leadership risk:** The bank will witness a change at the helm after three decades, with MD & CEO Aditya Puri retiring in Oct'20. While we continue to believe that HDFCB's process-driven business will hold it in good stead, the stock could be negatively affected should there be a slew of senior management exits during the transition phase.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**400,949**	**482,432**	**579,152**	**665,882**	**773,757**
NII growth (%)	21.0	20.3	20.0	15.0	16.2
Non-interest income	152,203	176,259	210,702	239,571	280,412
Total income	553,152	658,691	789,855	905,453	1,054,169
Operating expenses	(226,904)	(261,194)	(312,191)	(337,103)	(399,951)
Operating profit	326,248	397,497	477,664	568,349	654,218
Operating profit growth (%)	26.8	21.8	20.2	19.0	15.1
Provisions	(59,275)	(75,501)	(100,905)	(167,590)	(192,606)
PBT	266,973	321,997	376,759	400,759	461,612
Tax	(92,106)	(111,215)	(108,937)	(102,594)	(118,173)
Reported net profit	**174,867**	**210,782**	**267,821**	**298,165**	**343,439**
Adjustments	0	0	0	0	0
Adjusted net profit	**174,867**	**210,782**	**267,821**	**298,165**	**343,439**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	5,190	5,447	5,447	5,447	5,447
Reserves & surplus	1,057,760	1,486,617	1,691,768	1,920,162	2,183,237
Net worth	1,062,950	1,492,064	1,697,215	1,925,609	2,188,684
Deposits	7,887,706	9,231,409	10,863,973	12,565,636	14,711,919
Borrowings	1,260,946	1,207,248	1,450,751	1,654,564	1,911,551
Other liabilities & provisions	427,741	514,686	576,449	687,796	823,541
Total liabilities and equities	**10,639,343**	**12,445,407**	**14,588,387**	**16,833,606**	**19,635,695**
Cash & bank balance	1,229,151	813,476	842,359	873,156	906,013
Investments	2,422,002	2,905,879	3,418,517	3,857,008	4,420,198
Advances	6,583,331	8,194,012	9,586,994	11,025,043	12,789,050
Fixed & Other assets	404,859	532,040	740,517	1,078,398	1,520,434
Total assets	**10,639,343**	**12,445,407**	**14,588,387**	**16,833,606**	**19,635,695**
Deposit growth (%)	22.5	17.0	17.7	15.7	17.1
Advances growth (%)	18.7	24.5	17.0	15.0	16.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	33.9	39.6	49.2	54.7	63.1
Dividend per share	0.0	7.4	9.8	10.9	12.6
Book value per share	204.8	273.9	311.6	353.5	401.8

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	24.5	21.0	16.9	15.2	13.2
P/BV	4.1	3.0	2.7	2.4	2.1
Dividend yield (%)	0.0	0.9	1.2	1.3	1.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	4.2	4.2	4.3	4.2	4.2
Non-interest income	1.6	1.5	1.6	1.5	1.5
Operating expenses	2.4	2.3	2.3	2.1	2.2
Pre-provisioning profit	3.4	3.4	3.5	3.6	3.6
Provisions	0.6	0.7	0.7	1.1	1.1
PBT	2.8	2.8	2.8	2.6	2.5
Tax	1.0	1.0	0.8	0.7	0.6
ROA	1.8	1.8	2.0	1.9	1.9
Leverage (x)	9.8	9.0	8.5	8.7	8.9
ROE	17.9	16.5	16.8	16.5	16.7

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	21.0	20.3	20.0	15.0	16.2
Pre-provisioning profit	26.8	21.8	20.2	19.0	15.1
EPS	18.6	16.9	24.1	11.3	15.2
Profitability & Return ratios (%)					
Net interest margin	4.4	4.4	4.5	4.5	4.6
Fees / Avg. assets	1.2	1.2	1.2	1.2	1.2
Cost-Income	41.0	39.7	39.5	37.2	37.9
ROE	17.9	16.5	16.8	16.5	16.7
ROA	1.8	1.8	2.0	1.9	1.9
Asset quality (%)					
GNPA	1.3	1.4	1.5	1.8	1.9
NNPA	0.4	0.4	0.5	0.5	0.5
Provision coverage	69.8	71.4	70.3	72.0	72.3
Ratios (%)					
Credit-Deposit	83.5	88.8	88.2	87.7	86.9
Investment-Deposit	30.7	31.5	31.5	30.7	30.0
CAR	14.8	17.1	19.0	18.9	18.7
Tier-1	13.2	15.8	17.7	17.7	17.5

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 520 | ⮝ 41%

AXIS BANK | Banking | 31 March 2020

Recovery delayed but not out of sight

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Axis Bank (AXSB) is at the tail end of the corporate credit cycle. Its non-NPA pool of stressed loans has eased to 2.6% and SMA-2 loans at 35bps are on par with top-notch peers. Though slippages from unrecognised stressed assets have kept credit cost high, we believe the worst is behind us and expect costs at 1.2% in FY22. NIM is forecast to stay strong at 3.6% on a higher share of unsecured loans and stable funding. As with other large peers, we reduce FY20-FY22 EPS 3-19%, lower our target P/BV from 2.1x to 1.2x, and move to a new Mar'21 TP of Rs 520 (vs. Rs 900).

Stress recognition nearing an end: AXSB has recognised a bulk of its stressed loans as NPAs, but slippages remain elevated owing to steady additions to the pool of non-NPA stressed assets. In our view, the bank has weathered the worst of the asset quality headwinds and with the stressed pool/SMA-2 loans down to 2.6%/35bps, slippages are likely to start subsiding going forward.

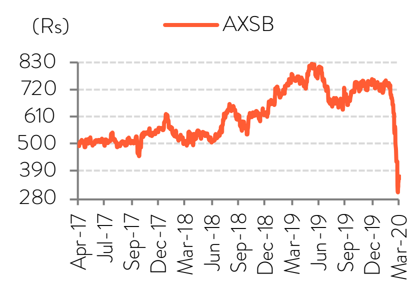
Credit cost normalisation to boost earnings: The bank's current provision coverage ratio (PCR) including technical write-offs is strong at ~78% and a ~Rs 26bn cushion of additional provisions for various contingencies is reassuring. Management plans to raise provisions in some pockets which may keep credit costs elevated in FY20. But as slippages begin to abate and recoveries start flowing in, we expect credit costs to normalise to ~1% for FY21/FY22, aiding earnings growth.

Business franchise fortified: AXSB has engineered a structural shift in underwriting norms for new loans, which has resulted in a better rating profile for its corporate portfolio (84% high-rated loans currently vs. 77% in FY18) and a granular retail portfolio (share of home loans down to 36% vs. 40% in FY18). Also, the high share of CASA and retail term deposits at >80% implies that funding costs will remain stable, thereby aiding NIMs.

Ticker/Price	AXSB IN/Rs 368
Market cap	US$ 12.8bn
Shares o/s	2,620mn
3M ADV	US$ 110.8mn
52wk high/low	Rs 828/Rs 286
Promoter/FPI/DII	26%/50%/24%

Source: NSE

STOCK PERFORMANCE



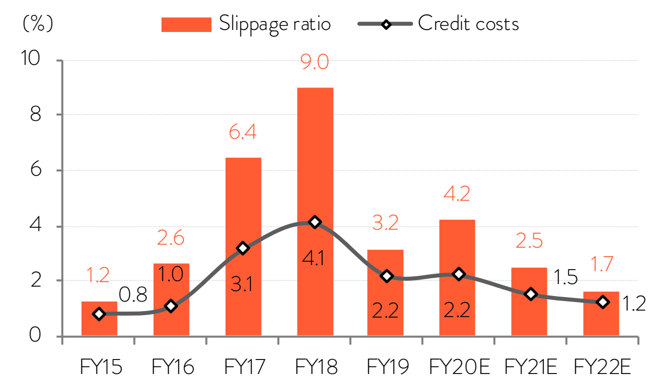
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	186,177	217,082	241,096	278,908	332,095
NII growth (%)	2.9	16.6	11.1	15.7	19.1
Adj. net profit (Rs mn)	2,757	46,766	54,608	120,746	162,409
EPS (Rs)	1.1	18.2	20.3	42.9	57.7
P/E (x)	331.3	20.2	18.2	8.6	6.4
P/BV (x)	1.5	1.4	1.2	1.1	0.9
ROA (%)	0.0	0.6	0.6	1.2	1.4
ROE (%)	0.5	7.2	7.1	13.2	15.8

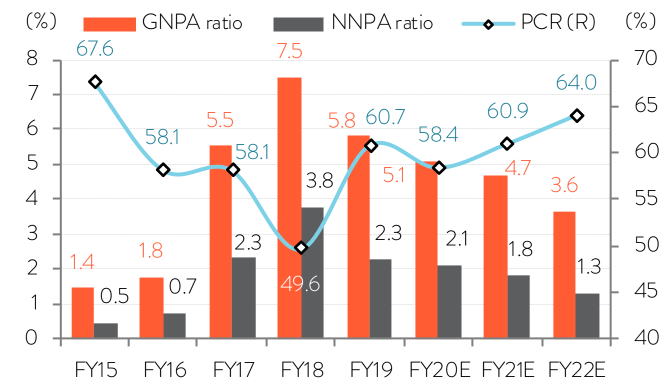
Source: Company, BOBCAPS Research

FIG 1 – SLIPPAGES AND CREDIT COSTS EXPECTED TO NORMALISE IN FY21E...



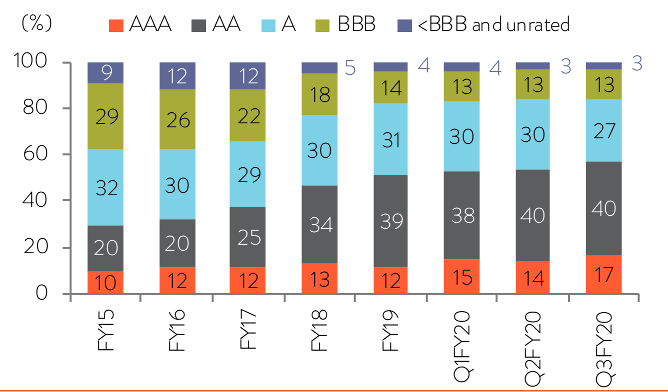
Source: Company, BOBCAPS Research

FIG 2 – ...WHICH ALONG WITH HIGHER RECOVERIES SHOULD DRIVE IMPROVEMENT IN ASSET QUALITY



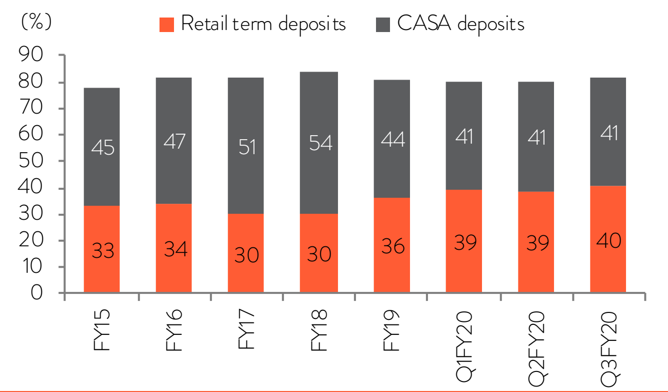
Source: Company, BOBCAPS Research

FIG 3 – RATING PROFILE OF CORPORATE PORTFOLIO HAS IMPROVED



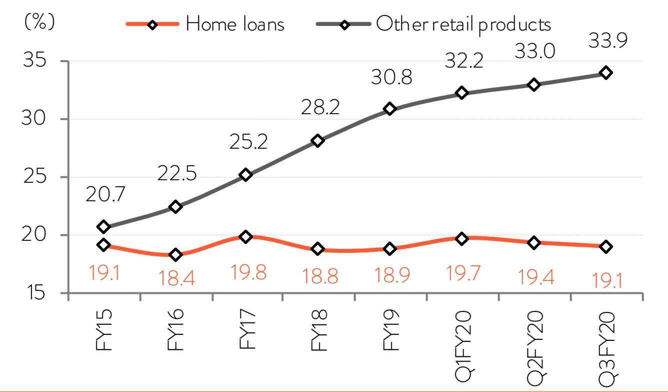
Source: Company, BOBCAPS Research

FIG 4 – FUNDING FRANCHISE IS STRONG WITH RETAIL DEPOSIT SHARE AT 80%



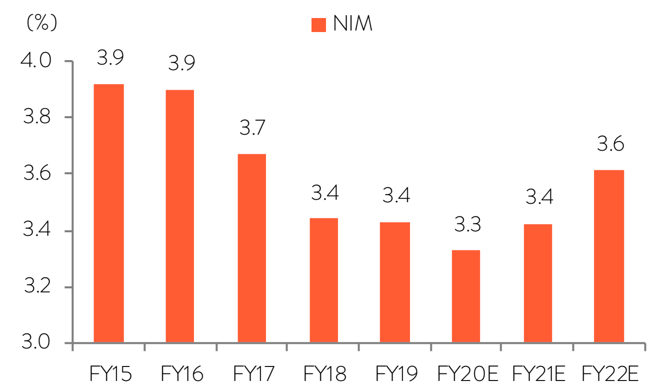
Source: Company, BOBCAPS Research

FIG 5 – RETAIL PORTFOLIO HAS TURNED GRANULAR



Source: Company, BOBCAPS Research

FIG 6 – MARGINS ARE EXPECTED TO IMPROVE



Source: Company, BOBCAPS Research

Valuation methodology

AXSB is currently trading at 0.9x on FY22E core P/BV and a rerating hinges on management's ability to rein in slippages. We scale back our FY20-FY22 EPS estimates by 3-19% and reduce our target multiple from 2.1x to 1.2x FY22E P/BV to bake in the growing earnings uncertainty arising from Covid-19. Maintain BUY with a revised Mar'21 SOTP-based target price of Rs 520 (vs. Rs 900 earlier).

For our SOTP valuation: (a) the core book has been adjusted for investment in subsidiaries and valued at Rs 476/sh based on a two-stage Gordon Growth Model (given that we expect the business to continue growing much faster than the industry for the next few years), and (b) subsidiaries are valued at Rs 44/sh.

FIG 7 – REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Net interest income (Rs mn)	241,096	278,908	332,095	245,413	304,064	378,806	(1.8)	(8.3)	(12.3)
Pre-provisioning profit (Rs mn)	221,194	259,466	313,997	224,865	276,377	340,055	(1.6)	(6.1)	(7.7)
Profit after tax (Rs mn)	54,608	120,746	162,409	56,263	149,051	186,092	(2.9)	(19.0)	(12.7)
EPS (Rs)	20	43	58	21	53	66	(2.9)	(19.0)	(12.7)

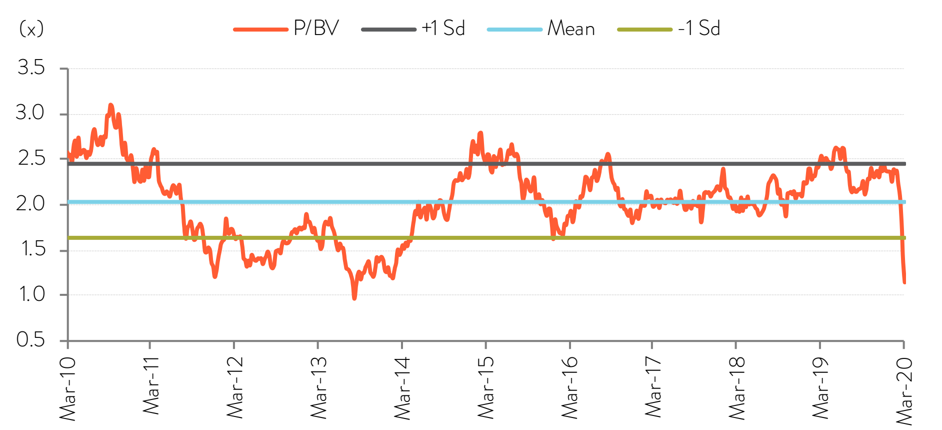
Source: BOBCAPS Research

FIG 8 – SOTP VALUATION

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for AXSB (Rs bn)	Per Share (Rs)	Contribution to TP (%)	Comments
Core Business	1,340	100	1,340	476	91	Valued at 1.2x FY22E P/BV on Gordon Growth Model
Axis AMC	74	75	55	20	4	6% of Q3FY20 AAUM
Axis Finance	43	100	43	15	3	2x FY22E P/BV
Axis Capital	13	100	13	5	1	12x FY22E P/E
Axis Securities	13	100	13	5	1	12x FY22E P/E
Sum of Parts			**1,465**	**520**		

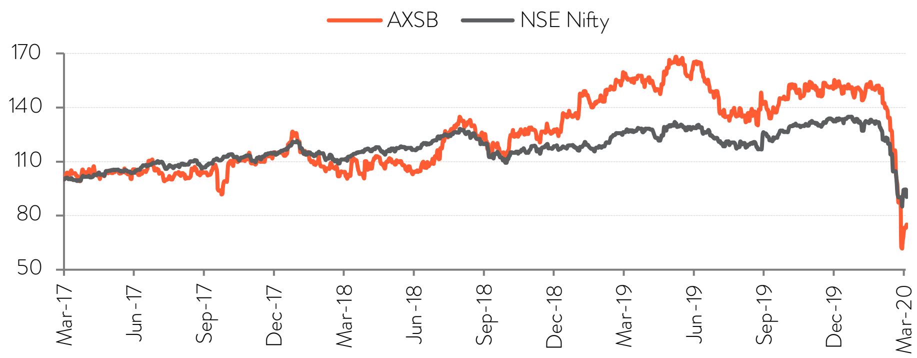
Source: BOBCAPS Research

FIG 9 – ONE-YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A worsening economic environment can impact our loan growth and credit cost assumptions and lead to deterioration in AXSB's asset quality.
- Slower capital markets activity can mute the performance of subsidiaries.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**186,177**	**217,082**	**241,096**	**278,908**	**332,095**
NII growth (%)	2.9	16.6	11.1	15.7	19.1
Non-interest income	109,671	131,303	154,481	173,175	200,817
Total income	295,848	348,385	395,577	452,083	532,912
Operating expenses	(139,903)	(158,334)	(174,383)	(192,617)	(218,915)
Operating profit	155,945	190,051	221,194	259,466	313,997
Operating profit growth (%)	(11.3)	21.9	16.4	17.3	21.0
Provisions	(154,729)	(120,310)	(120,915)	(97,173)	(95,705)
PBT	1,216	69,741	100,279	162,293	218,292
Tax	1,541	(22,975)	(45,672)	(41,547)	(55,883)
Reported net profit	**2,757**	**46,766**	**54,608**	**120,746**	**162,409**
Adjustments	0	0	0	0	0
Adjusted net profit	**2,757**	**46,766**	**54,608**	**120,746**	**162,409**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	5,133	5,143	5,631	5,631	5,631
Reserves & surplus	629,320	661,620	856,537	955,548	1,088,724
Net worth	634,453	666,763	862,168	961,180	1,094,355
Deposits	4,536,227	5,484,713	6,351,235	7,098,296	8,070,335
Borrowings	1,410,661	1,458,258	1,626,196	1,839,437	2,109,181
Other liabilities & provisions	331,955	400,231	520,301	676,391	879,308
Total liabilities and equities	**6,913,296**	**8,009,965**	**9,359,899**	**10,575,304**	**12,153,180**
Cash & bank balance	434,549	672,046	724,905	782,570	845,499
Investments	1,538,761	1,749,693	1,977,100	2,189,994	2,498,932
Advances	4,396,503	4,947,980	5,665,437	6,345,289	7,297,083
Fixed & Other assets	543,483	640,246	992,458	1,257,452	1,511,667
Total assets	**6,913,296**	**8,009,965**	**9,359,899**	**10,575,304**	**12,153,180**
Deposit growth (%)	9.5	20.9	15.8	11.8	13.7
Advances growth (%)	17.8	12.5	14.5	12.0	15.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	1.1	18.2	20.3	42.9	57.7
Dividend per share	5.5	0.0	3.5	7.7	10.4
Book value per share	247.2	259.3	306.2	341.4	388.7

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	331.3	20.2	18.2	8.6	6.4
P/BV	1.5	1.4	1.2	1.1	0.9
Dividend yield (%)	1.5	0.0	0.9	2.1	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	2.9	2.9	2.8	2.8	2.9
Non-interest income	1.7	1.8	1.8	1.7	1.8
Operating expenses	2.2	2.1	2.0	1.9	1.9
Pre-provisioning profit	2.4	2.5	2.5	2.6	2.8
Provisions	2.4	1.6	1.4	1.0	0.8
PBT	0.0	0.9	1.2	1.6	1.9
Tax	0.0	0.3	0.5	0.4	0.5
ROA	0.0	0.6	0.6	1.2	1.4
Leverage (x)	10.8	11.5	11.4	10.9	11.1
ROE	0.5	7.2	7.1	13.2	15.8

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	2.9	16.6	11.1	15.7	19.1
Pre-provisioning profit	(11.3)	21.9	16.4	17.3	21.0
EPS	(92.8)	1538.1	11.4	111.5	34.5
Profitability & Return ratios (%)					
Net interest margin	3.1	3.2	3.1	3.2	3.3
Fees / Avg. assets	1.2	1.2	1.2	1.2	1.2
Cost-Income	47.3	45.4	44.1	42.6	41.1
ROE	0.5	7.2	7.1	13.2	15.8
ROA	0.0	0.6	0.6	1.2	1.4
Asset quality (%)					
GNPA	7.5	5.8	5.1	4.7	3.6
NNPA	3.8	2.3	2.1	1.8	1.3
Provision coverage	51.6	62.1	59.7	62.1	64.8
Ratios (%)					
Credit-Deposit	96.9	90.2	89.2	89.4	90.4
Investment-Deposit	33.9	31.9	31.1	30.9	31.0
CAR	16.6	15.8	18.4	17.3	16.6
Tier-1	13.0	12.5	15.3	14.5	14.0

Source: Company, BOBCAPS Research

BUY
TP: Rs 250 | ⮝ 34%

STATE BANK OF INDIA | Banking | 31 March 2020

Only pick among PSBs

State Bank of India (SBIN) has seen linear progress in asset quality marked by receding headline NPAs, rising coverage and a manageable SMA book. Near-term headwinds from telecom sector exposure may remain an overhang but subsidiary monetisation can shore up earnings. We believe SBIN shares prospects akin to other corporate lenders and expect its earnings to rebound as the credit cycle turns. Stake purchase in Yes Bank is the better route than merger. We lower FY20-FY22 EPS 18-20% and cut our Mar'21 TP to Rs 250 (vs. Rs 400), set at 0.5x P/BV (vs. 1x).

Vikesh Mehta
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Consistent improvement in asset quality: SBIN's GNPA/NNPA ratios have reduced steadily from 10.9%5.7% in FY18 to 6.9%/2.7% currently. Its SMA-1/2 book is down to 0.4% of loans, and we believe the bank can comfortably tide over increased stress levels in the telecom sector. Further, its healthy coverage ratio of ~64% implies credit costs can decline sharply if recoveries progress well. Unlike other PSBs, SBIN's large balance sheet and recovery prospects are comparable to those of large private peers ICICIBC and AXSB.

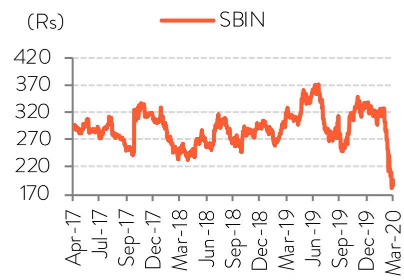
Liability franchise strong in the face of competition: Despite competition from peers, SBIN's CASA franchise is at 45% of deposits, better than that of AXSB and HDFCB. Domestic NIMs have improved by ~30bps YoY in Q3FY20 given lower cost of funds, lower GNPAs and higher recoveries. At ~3.3%, NIMs seem to have peaked as we see no large recoveries on the horizon and interest rates on deposits have bottomed. Nonetheless, a better portfolio mix and increase in loans accruing interest could drive structural improvement.

Maintain BUY: In our view, SBIN will receive a strong impetus to earnings from FY21 onwards as the corporate loan cycle revives, but performance of the MSME portfolio remains a risk. Given the Covid-19 overhang, we reduce FY20-FY22 EPS estimates by 18-20% and revise our Mar'21 TP to Rs 250.

Ticker/Price	SBIN IN/Rs 187
Market cap	US$ 22.1bn
Shares o/s	8,925mn
3M ADV	US$ 199.2mn
52wk high/low	Rs 374/Rs 174
Promoter/FPI/DII	59%/9%/32%

Source: NSE

STOCK PERFORMANCE



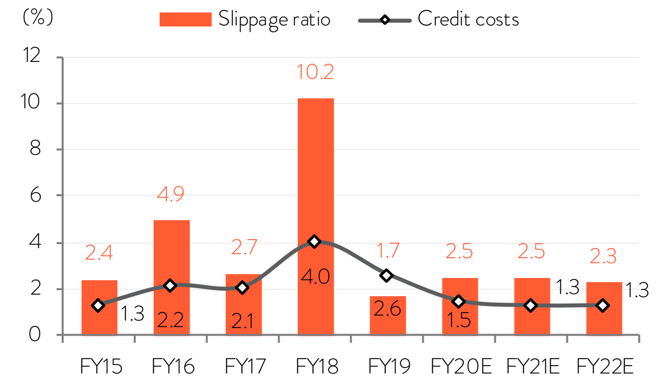
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	748,537	883,489	995,401	1,071,324	1,208,473
NII growth (%)	21.0	18.0	12.7	7.6	12.8
Adj. net profit (Rs mn)	(65,474)	8,622	246,713	291,069	349,389
EPS (Rs)	(7.7)	1.0	27.6	32.6	39.1
P/E (x)	(24.1)	193.5	6.8	5.7	4.8
P/BV (x)	0.8	0.8	0.7	0.6	0.5
ROA (%)	(0.2)	0.0	0.6	0.7	0.8
ROE (%)	(3.2)	0.4	10.4	10.9	12.0

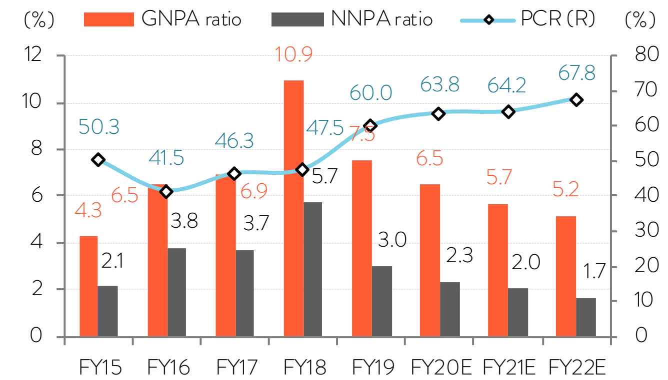
Source: Company, BOBCAPS Research

FIG 1 – EXPECT NORMALISATION OF CREDIT COSTS IN FY21/FY22



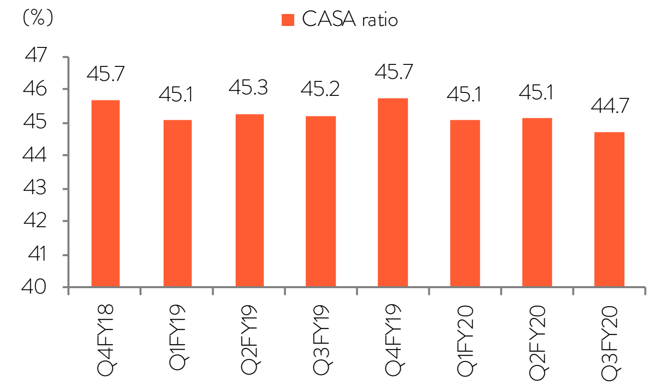
Source: Company, BOBCAPS Research

FIG 2 – REDUCTION IN GNPA/NNPA LEVELS SHOULD CONTINUE THROUGH FY22



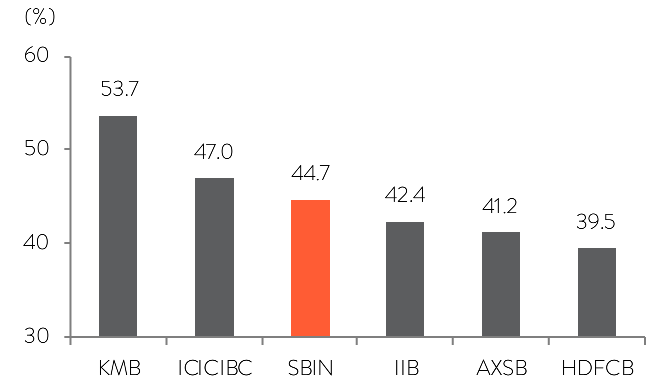
Source: Company, BOBCAPS Research

FIG 3 – SBIN HAS MAINTAINED CASA RATIO AT 45% OVER THE PAST FEW QUARTERS…



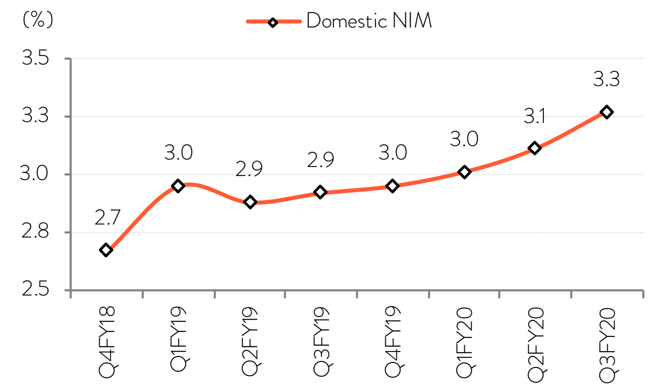
Source: Company, BOBCAPS Research

FIG 4 – …WHICH IS BETTER THAN SOME PRIVATE PEERS



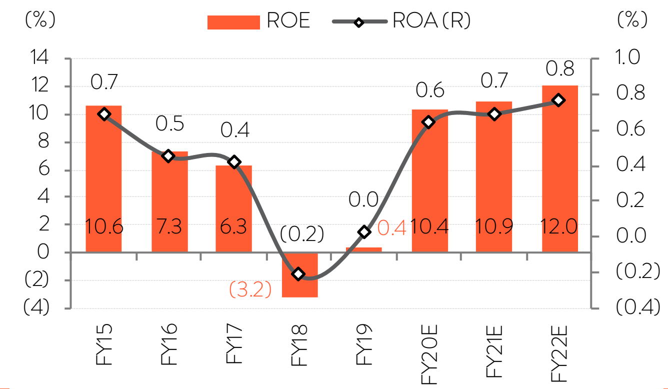
Source: Company, BOBCAPS Research

FIG 5 – DOMESTIC NIM HAS WITNESSED MATERIAL IMPROVEMENT



Source: Company, BOBCAPS Research

FIG 6 – EXPECT EARNINGS REBOUND WITH 1%/16% ROA/ROE BY FY22E



Source: Company, BOBCAPS Research

Valuation methodology

Our broad thesis around SBIN is that earnings are likely to rebound as credit costs reduce sharply in tandem with the uptick in corporate recovery cycle. The bank is our only pick among PSBs given its strong liability franchise and healthy capital adequacy. We value SBIN using the SOTP methodology and have a revised Mar'21 target price of Rs 250 (vs. Rs 400 earlier), as we reset our target FY22E P/BV multiple for the core business to 0.5x (1x earlier) and cut FY20-FY22 EPS estimates by 18-20% to adjust for Covid-19 uncertainty. Reiterate BUY.

FIG 7 – REVISED ESTIMATES

Particulars	New			Old			Change (%)		
	FY20	FY21	FY22	FY20	FY21	FY22	FY20	FY21	FY22
Net interest income (Rs mn)	995,401	1,071,324	1,208,473	1,004,362	1,176,621	1,401,398	(0.9)	(8.9)	(13.8)
Pre-provisioning profit (Rs mn)	726,777	719,375	820,671	804,991	774,213	898,155	(9.7)	(7.1)	(8.6)
Profit after tax (Rs mn)	246,713	291,069	349,389	303,684	359,511	424,900	(18.8)	(19.0)	(17.8)
EPS (Rs)	27.6	32.6	39.1	34.0	40.3	47.6	(18.8)	(19.0)	(17.8)

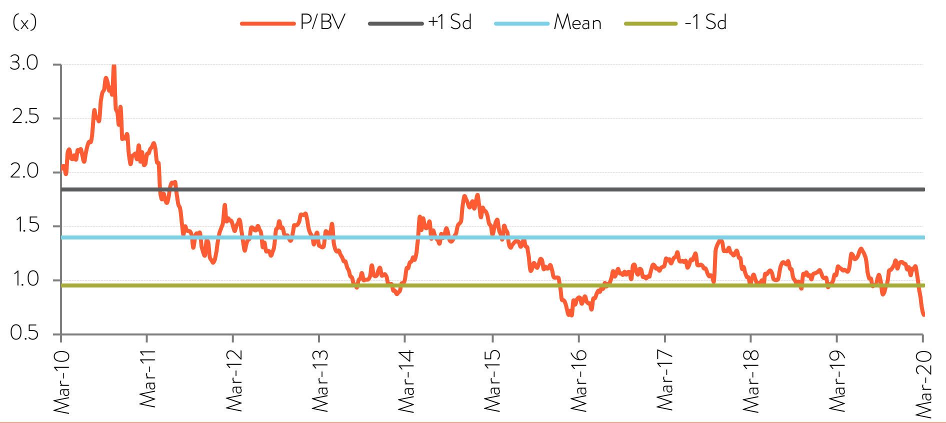
Source: BOBCAPS Research

FIG 8 – SOTP VALUATION

Sum of Parts	Company Value (Rs bn)	Stake in Company (%)	Value for SBIN (Rs bn)	Per Share (Rs)	Contribution to TP (%)	Comments
Core Business	1,369	100	1,369	153	61	Valued at 0.5x Mar'22 P/BV on Gordon Growth Model
SBI Life	620	58	286	32	13	Valued at CMP; adjusted for 20% holdco discount
SBI AMC	212	63	133	15	6	6% of Q3FY20 AAUM
SBI General	110	70	77	9	3	Valued at 15x Mar'22 P/E
SBI Card	594	70	333	37	15	Valued at CMP; adjusted for 20% holdco discount
SBI Capital	31	100	31	4	1	Valued at 10x Mar'22 P/E
Sum of Parts			**2,229**	**250**		

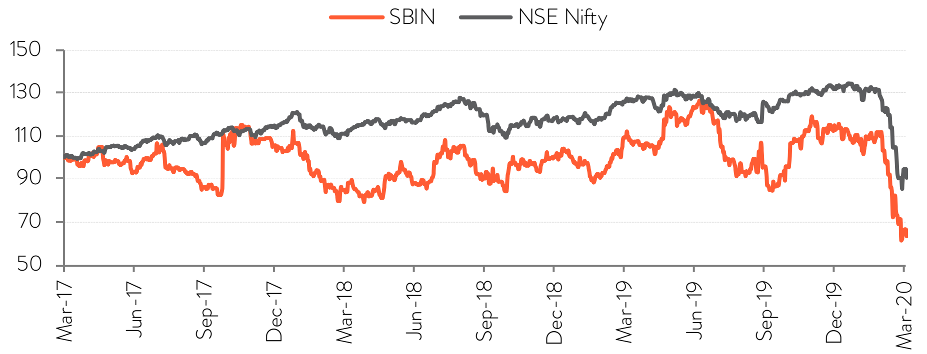
Source: BOBCAPS Research

FIG 9 – ONE-YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 10 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- We are building lower provisions into our estimates, assuming resolution of stressed assets. Any delays in this process or a worsening of economic conditions could lead to an elongated provisioning cycle.
- The risk of moral hazard arising from farm loan waivers could lead to higher slippages in the agriculture sector.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**748,537**	**883,489**	**995,401**	**1,071,324**	**1,208,473**
NII growth (%)	21.0	18.0	12.7	7.6	12.8
Non-interest income	446,007	367,749	459,847	414,229	451,669
Total income	1,194,544	1,251,238	1,455,248	1,485,553	1,660,142
Operating expenses	(599,434)	(696,877)	(728,470)	(766,178)	(839,470)
Operating profit	595,110	554,360	726,777	719,375	820,671
Operating profit growth (%)	17.0	(6.8)	31.1	(1.0)	14.1
Provisions	(750,392)	(538,286)	(354,982)	(328,153)	(351,063)
PBT	(155,282)	16,075	371,796	391,222	469,609
Tax	89,808	(7,453)	(125,083)	(100,153)	(120,220)
Reported net profit	**(65,474)**	**8,622**	**246,713**	**291,069**	**349,389**
Adjustments	0	0	0	0	0
Adjusted net profit	**(65,474)**	**8,622**	**246,713**	**291,069**	**349,389**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	8,925	8,925	8,925	8,925	8,925
Reserves & surplus	2,182,360	2,200,214	2,545,677	2,768,255	3,036,032
Net worth	2,191,285	2,209,138	2,554,601	2,777,180	3,044,956
Deposits	27,063,433	29,113,860	32,025,246	34,455,665	38,194,253
Borrowings	4,084,732	4,525,008	4,990,704	5,346,333	5,865,373
Other liabilities & provisions	1,208,070	961,136	1,029,723	1,104,517	1,186,122
Total liabilities and equities	**34,547,519**	**36,809,142**	**40,600,275**	**43,683,695**	**48,290,704**
Cash & bank balance	1,918,986	2,224,901	2,321,697	2,423,282	2,529,903
Investments	10,609,867	9,670,219	10,786,921	11,469,103	12,545,899
Advances	19,348,802	21,858,769	23,388,883	24,675,272	26,896,046
Fixed & Other assets	2,669,865	3,055,253	4,102,774	5,116,038	6,318,856
Total assets	**34,547,520**	**36,809,142**	**40,600,275**	**43,683,695**	**48,290,704**
Deposit growth (%)	32.4	7.6	10.0	7.6	10.9
Advances growth (%)	23.2	13.0	7.0	5.5	9.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	(7.7)	1.0	27.6	32.6	39.1
Dividend per share	0.0	0.0	5.5	6.5	7.8
Book value per share	245.5	247.5	286.2	311.2	341.2

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	(24.1)	193.5	6.8	5.7	4.8
P/BV	0.8	0.8	0.7	0.6	0.5
Dividend yield (%)	0.0	0.0	3.0	3.5	4.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	2.4	2.5	2.6	2.5	2.6
Non-interest income	1.4	1.0	1.2	1.0	1.0
Operating expenses	1.9	2.0	1.9	1.8	1.8
Pre-provisioning profit	1.9	1.6	1.9	1.7	1.8
Provisions	2.4	1.5	0.9	0.8	0.8
PBT	(0.5)	0.0	1.0	0.9	1.0
Tax	(0.3)	0.0	0.3	0.2	0.3
ROA	(0.2)	0.0	0.6	0.7	0.8
Leverage (x)	15.1	16.2	16.2	15.8	15.8
ROE	(3.2)	0.4	10.4	10.9	12.0

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	21.0	18.0	12.7	7.6	12.8
Pre-provisioning profit	17.0	(6.8)	31.1	(1.0)	14.1
EPS	(158.2)	(112.5)	2761.3	18.0	20.0
Profitability & Return ratios (%)					
Net interest margin	2.6	2.7	2.8	2.9	3.0
Fees / Avg. assets	0.7	0.7	0.6	0.6	0.6
Cost-Income	50.2	55.7	50.1	51.6	50.6
ROE	(3.2)	0.4	10.4	10.9	12.0
ROA	(0.2)	0.0	0.6	0.7	0.8
Asset quality (%)					
GNPA	10.9	7.5	6.5	5.7	5.2
NNPA	5.7	3.0	2.3	2.0	1.7
Provision coverage	50.4	61.9	65.3	65.5	68.9
Ratios (%)					
Credit-Deposit	71.5	75.1	73.0	71.6	70.4
Investment-Deposit	39.2	33.2	33.7	33.3	32.8
CAR	12.6	12.7	12.0	12.5	12.8
Tier-1	10.4	10.7	10.0	10.3	10.4

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 50 | ⮝ 23%

FEDERAL BANK | Banking | 31 March 2020

Preferred pick in mid-tier pack – initiate with BUY

Federal Bank (FB) is the only regional bank that has made strides in closing the gap with frontline banks. Asset quality has held up well with steady GNPA at ~3%, and we believe credit cost would remain manageable at 75bps through to FY22. FB also has the liability franchise to strengthen its retail business. Led by a mix of NIM improvement, efficient non-staff cost structure and lower credit cost, ROA is forecast to rise to 1.1% by FY22. FB is our top pick among midsized banks. We initiate coverage with BUY and a Mar'21 TP of Rs 50 (0.6x P/BV).

Vikesh Mehta
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Stressed assets at multi-year low: FB has consistently maintained GNPA at <3% over the past 7-8 years by avoiding the corporate accounts that have plagued some of the new mid-tier banks in recent years. Slippages in the retail, agriculture and SME segments have been within comfort levels over the past few quarters, while the pool of stressed loans is now down to an all-time low of 1.6%. Though SMA currently forms 2.2-2.5% of loans, FB is comfortable with its large corporate (>Rs 1bn) book and sees no residual stress in these accounts.

Focus on high-yield loans: FB has a 51:49 wholesale/retail asset mix. Leveraging the strengths of its liability franchise, data analytics and digital capabilities, it aims to foray into higher-yielding assets such as credit cards, MFI, CV/CE loans and business banking, besides raising retail loan share to 55% over the mid/long term.

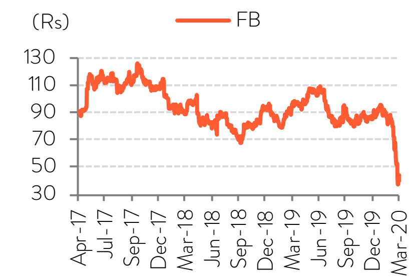
Multiple levers for ROA gains: We believe moderating slippages and loan mix skew in favour of high-yielding retail assets would drive 10-15bps improvement in margins to 3.1% over FY19-FY22. This apart, we estimate that lower credit costs and a better cost/income ratio can take ROA to 1.1% by FY22.

Initiate with BUY: At 0.5x FY22E P/BV, FB offers ample scope for rerating. Our Mar'21 target price of Rs 50 is based on 0.6x FY22E P/BV.

Ticker/Price	FB IN/Rs 41
Market cap	US$ 1.1bn
Shares o/s	1,992mn
3M ADV	US$ 13.2mn
52wk high/low	Rs 110/Rs 36
Promoter/FPI/DII	0%/32%/68%

Source: NSE

STOCK PERFORMANCE



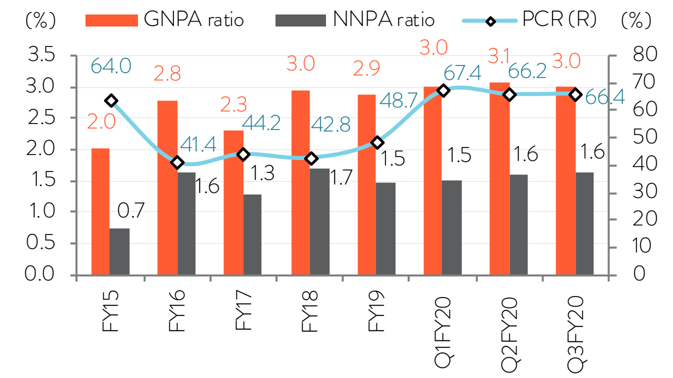
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	35,828	41,763	46,003	52,834	63,384
NII growth (%)	17.4	16.6	10.2	14.8	20.0
Adj. net profit (Rs mn)	8,788	12,439	16,166	17,882	23,222
EPS (Rs)	4.8	6.3	8.1	9.0	11.7
P/E (x)	8.6	6.5	5.0	4.5	3.5
P/BV (x)	0.7	0.6	0.6	0.5	0.5
ROA (%)	0.7	0.8	1.0	1.0	1.1
ROE (%)	8.3	9.8	11.6	11.8	13.8

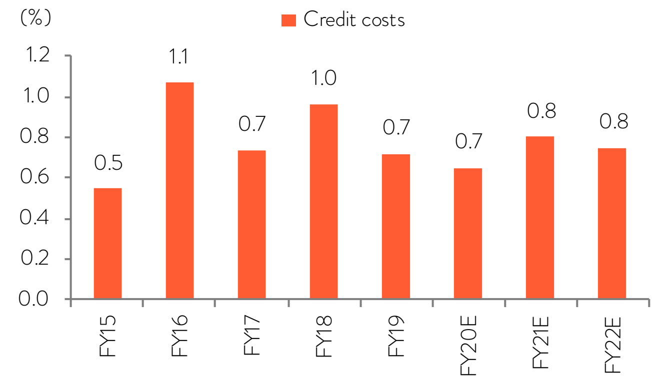
Source: Company, BOBCAPS Research

FIG 1 – GNPA RATIO HAS REMAINED STEADY AT <3% DESPITE CHALLENGING ENVIRONMENT



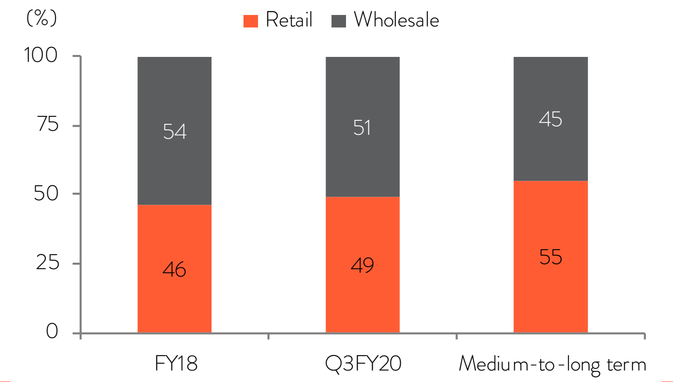
Source: Company, BOBCAPS Research

FIG 2 – LOW STRESS IN CORPORATE ACCOUNTS WORTH >RS 1BN CAN IMPROVE CREDIT COSTS



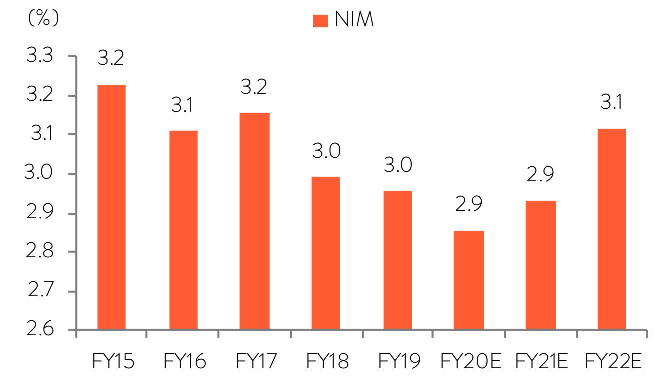
Source: Company, BOBCAPS Research

FIG 3 – LOAN MIX TO GRADUALLY REALIGN IN FAVOUR OF RETAIL ASSETS…



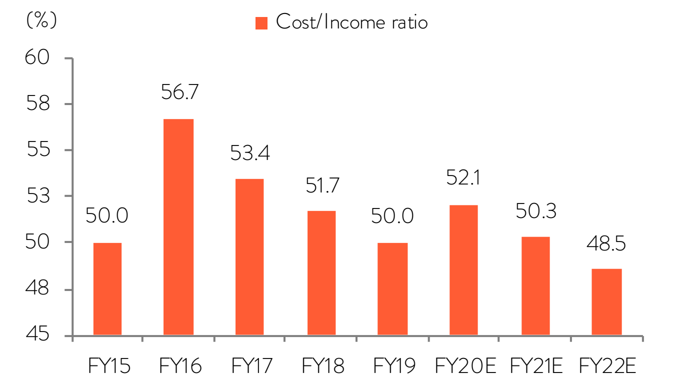
Source: Company, BOBCAPS Research

FIG 4 – …WHICH CAN AID 10-15BPS MARGIN EXPANSION



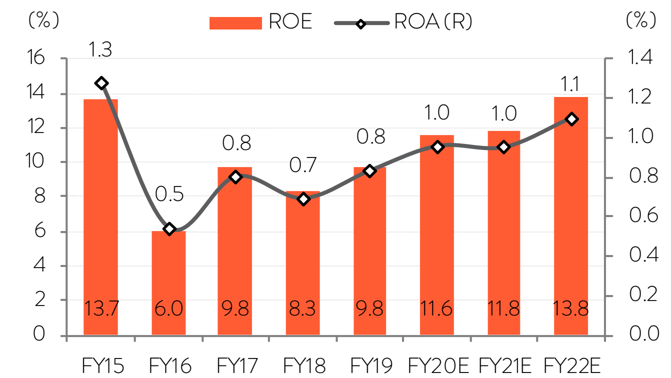
Source: Company, BOBCAPS Research

FIG 5 – CALIBRATED BRANCH ADDITION AND LEVERAGING OF TECHNOLOGY CAN AID C/I RATIO



Source: Company, BOBCAPS Research

FIG 6 – EXPECT 10BPS IMPROVEMENT IN ROA OVER FY20-FY22E



Source: Company, BOBCAPS Research

Valuation methodology

We expect FB to continue growing much higher than the industry for the next few years and hence use the two-stage Gordon Growth Model to set our target price as it captures valuations in a high-growth stage.

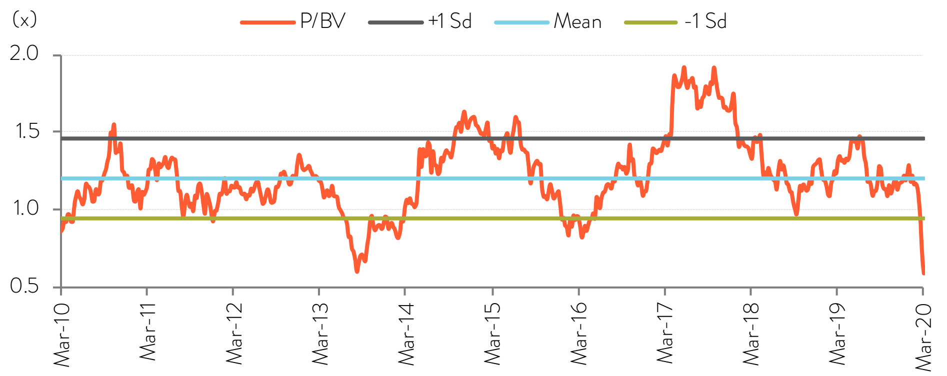
At 0.5x FY22E P/BV, FB is trading at inexpensive valuations and has ample scope for rerating given that the expected expansion in NIM, improvement in cost ratios and reduction in credit cost can propel ROA to an estimated 1.1% by FY22. We value the stock at 0.6x on FY22E P/BV for a Mar'21 target price of Rs 50. Initiate with BUY.

FIG 7 – VALUATION SNAPSHOT

Components of Gordon Growth Model	Assumptions (%)
Growth (Long-term)	2.5
Risk free rate	7.0
Market risk premium	5.0
Current beta for stock	1.2
Cost of equity	13.0
Blended ROE estimate	10.0
Discounted P/BV (x)	0.6
Book value taken for TP (Rs)	80
Fair value per share (Rs)	**50**

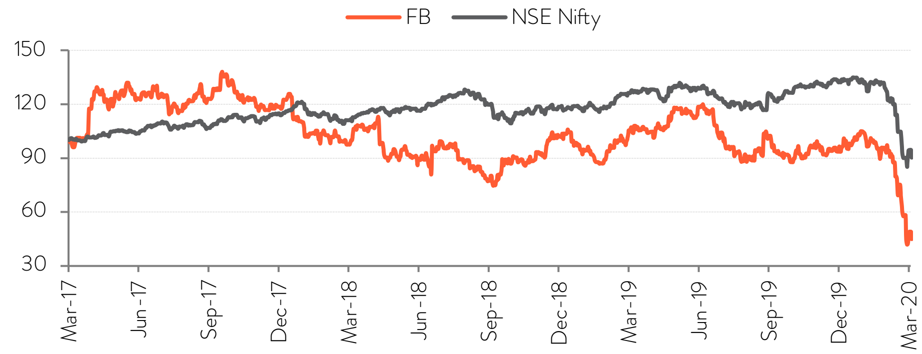
Source: Bloomberg, BOBCAPS Research

FIG 8 – ONE-YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- If FB fails to execute on its strategy to improve retail loan share, it can impact our ROA estimates.
- The bank has elevated exposure to the SME and LAP segments; its SMA book is also on the higher side. Above-expected delinquencies can affect our slippage and credit cost estimates.
- FB has high business concentration in Kerala – any natural disaster or economic shock afflicting the state can materially impact the bank's performance.

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FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**35,828**	**41,763**	**46,003**	**52,834**	**63,384**
NII growth (%)	17.4	16.6	10.2	14.8	20.0
Non-interest income	11,591	13,510	15,125	16,750	19,103
Total income	47,419	55,274	61,128	69,584	82,488
Operating expenses	24,509	27,643	31,850	34,997	40,045
Operating profit	22,910	27,631	29,278	34,587	42,443
Operating profit growth (%)	19.0	20.6	6.0	18.1	22.7
Provisions	9,472	8,559	7,666	10,681	11,397
PBT	13,439	19,073	21,612	23,906	31,046
Tax	4,650	6,634	5,446	6,024	7,824
Reported net profit	**8,788**	**12,439**	**16,166**	**17,882**	**23,222**
Adjustments	0	0	0	0	0
Adjusted net profit	**8,788**	**12,439**	**16,166**	**17,882**	**23,222**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	3,944	3,970	3,970	3,970	3,970
Reserves & surplus	118,158	128,760	141,208	154,977	172,858
Net worth	122,102	132,730	145,178	158,947	176,828
Deposits	1,119,925	1,349,543	1,511,489	1,685,310	1,921,253
Borrowings	115,335	77,813	81,704	84,972	90,920
Other liabilities & provisions	25,777	33,313	37,310	42,161	48,063
Total liabilities and equities	**1,383,140**	**1,593,400**	**1,775,681**	**1,971,390**	**2,237,065**
Cash & bank balance	92,034	100,668	118,788	140,170	165,401
Investments	307,811	318,245	340,522	354,143	389,557
Advances	919,575	1,102,230	1,256,542	1,413,609	1,625,651
Fixed & Other assets	63,720	72,258	59,829	63,468	56,456
Total assets	**1,383,140**	**1,593,400**	**1,775,681**	**1,971,390**	**2,237,065**
Deposit growth (%)	14.7	20.5	12.0	11.5	14.0
Advances growth (%)	25.4	19.9	14.0	12.5	15.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	4.8	6.3	8.1	9.0	11.7
Dividend per share	0.9	1.0	1.6	1.8	2.3
Book value per share	61.9	66.8	73.1	80.0	89.1

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	8.6	6.5	5.0	4.5	3.5
P/BV	0.7	0.6	0.6	0.5	0.5
Dividend yield (%)	2.2	2.5	4.0	4.4	5.7

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	2.8	2.8	2.7	2.8	3.0
Non-interest income	0.9	0.9	0.9	0.9	0.9
Operating expenses	1.9	1.9	1.9	1.9	1.9
Pre-provisioning profit	1.8	1.9	1.7	1.8	2.0
Provisions	0.7	0.6	0.5	0.6	0.5
PBT	1.1	1.3	1.3	1.3	1.5
Tax	0.4	0.4	0.3	0.3	0.4
ROA	0.7	0.8	1.0	1.0	1.1
Leverage (x)	12.0	11.7	12.1	12.3	12.5
ROE	8.3	9.8	11.6	11.8	13.8

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	17.4	16.6	10.2	14.8	20.0
Pre-provisioning profit	19.0	20.6	6.0	18.1	22.7
EPS	(1.5)	32.2	29.5	10.6	29.9
Profitability & Return ratios (%)					
Net interest margin	3.0	3.0	2.9	2.9	3.1
Fees / Avg. assets	0.5	0.5	0.5	0.5	0.6
Cost-Income	51.7	50.0	52.1	50.3	48.5
ROE	8.3	9.8	11.6	11.8	13.8
ROA	0.7	0.8	1.0	1.0	1.1
Asset quality (%)					
GNPA	3.0	2.9	2.9	3.1	2.9
NNPA	1.7	1.5	1.7	1.7	1.6
Provision coverage	42.8	48.7	42.5	43.8	46.9
Ratios (%)					
Credit-Deposit	82.1	81.7	83.1	83.9	84.6
Investment-Deposit	27.5	23.6	22.5	21.0	20.3
CAR	14.7	14.1	13.9	13.5	13.1
Tier-1	14.2	13.4	12.9	12.6	12.3

Source: Company, BOBCAPS Research

ADD
TP: Rs 170 | ⮝ 13%

RBL BANK | Banking | 31 March 2020

Downsides capped – initiate with ADD

In our view, near-term asset quality pressure is inevitable for RBL Bank (RBK). Rising systemic stress will likely keep slippages elevated even as the growth needed to assuage concerns on asset quality will be slow to materialise. That said, we initiate coverage with ADD as we believe (a) the bank's healthy CET-1 at 15% will act as an adequate buffer to help mitigate stress, and (b) downsides look capped at current beaten-down valuations of 0.6x FY22E P/BV – ~80% discount to the 3Y mean. Our Mar'21 TP of Rs 170 values RBK at 0.7x FY22E.

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Concerns over asset quality could persist: RBK's GNPA ratio has risen to 3.3% currently (1.4% in Q1FY20) as it has recognised ~85% of its Rs 18bn stressed loan pool as NPA. Despite steep slippages, its BB-&-below book remains at 6% of loans given fresh downgrades, which raises concerns over whether the stress is being adequately captured by the bank. We also perceive RBK's non-wholesale book to be relatively risky as it has a higher share of credit card (~16% of loans), LAP (~13%) and MFI (~9%) business. We factor higher NPAs into our estimates as slippages are unlikely to normalise quickly. Also, lower provision coverage is expected to keep credit cost elevated at 2.2%/1.8% in FY21/FY22.

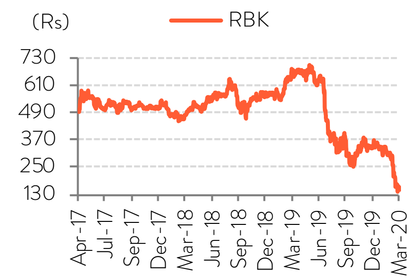
Wholesale growth on a backburner; retail to trend higher: We model for a loan CAGR of 22% over FY19-FY22 vs. 30-35% growth over the last few years as the bank recalibrates its corporate loan underwriting. RBK's focus will be on reorienting the portfolio toward the retail, development banking and financial inclusion (DB&FI) businesses and on managing asset quality instead of growth.

Initiate with ADD: We believe pressure on RBK's asset quality is likely to persist but derive comfort from its CET-1 ratio of 15% which is close to the levels of best-in-class players. We initiate coverage on the bank with ADD and a Mar'21 TP of Rs 170, valuing the stock at 0.7x FY22E P/BV.

Ticker/Price	RBK IN/Rs 150
Market cap	US$ 1.0bn
Shares o/s	508mn
3M ADV	US$ 43.6mn
52wk high/low	Rs 716/Rs 129
Promoter/FPI/DII	0%/24%/76%

Source: NSE

STOCK PERFORMANCE



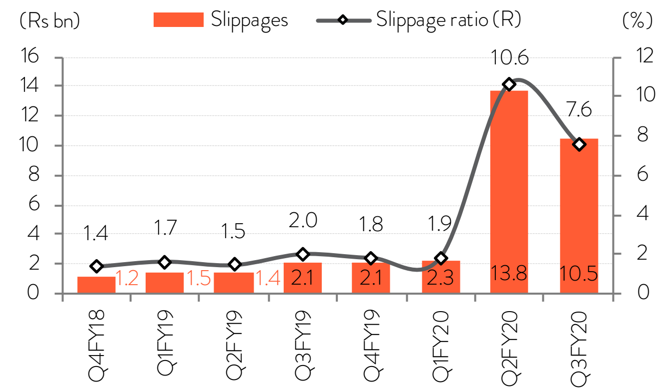
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	17,663	25,395	35,825	40,709	52,061
NII growth (%)	44.6	43.8	41.1	13.6	27.9
Adj. net profit (Rs mn)	6,350	8,670	5,388	11,271	16,643
EPS (Rs)	16.0	20.5	11.5	22.2	32.7
P/E (x)	9.4	7.3	13.0	6.8	4.6
P/BV (x)	0.9	0.8	0.7	0.7	0.6
ROA (%)	1.1	1.2	0.6	1.1	1.3
ROE (%)	11.5	12.2	5.9	10.1	13.5

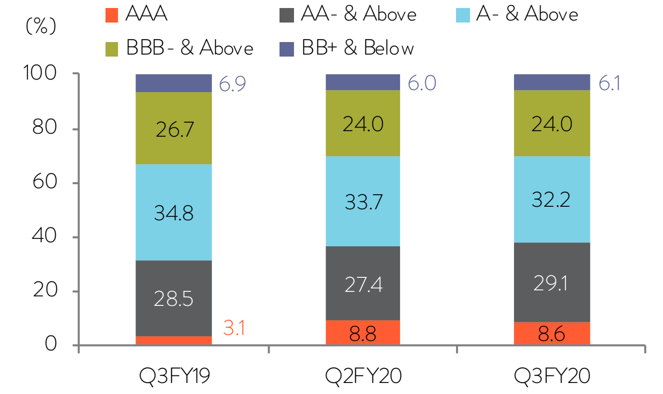
Source: Company, BOBCAPS Research

FIG 1 – STRESS RECOGNITION HAS LED TO A SHARP RISE IN SLIPPAGES



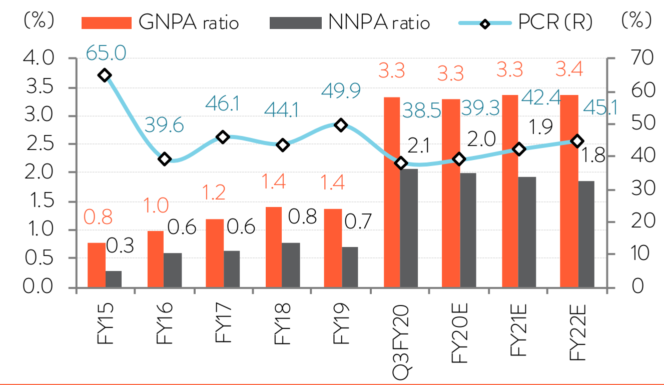
Source: Company, BOBCAPS Research

FIG 2 – SHARE OF BB-&-BELOW BOOK UNCHANGED QOQ AT ~6% GIVEN FRESH DOWNGRADES



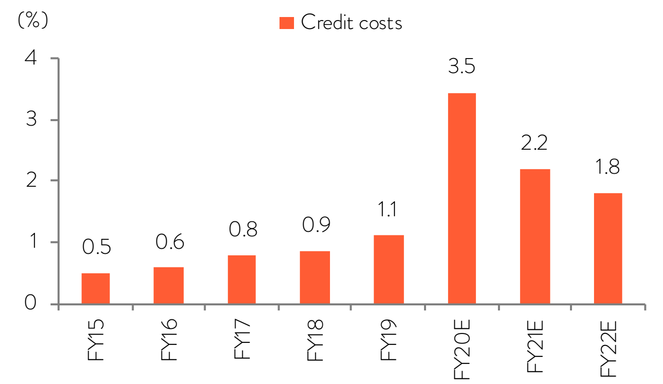
Source: Company, BOBCAPS Research

FIG 3 – GNPA RATIO EXPECTED TO REMAIN ELEVATED GIVEN RISING SYSTEMIC STRESS



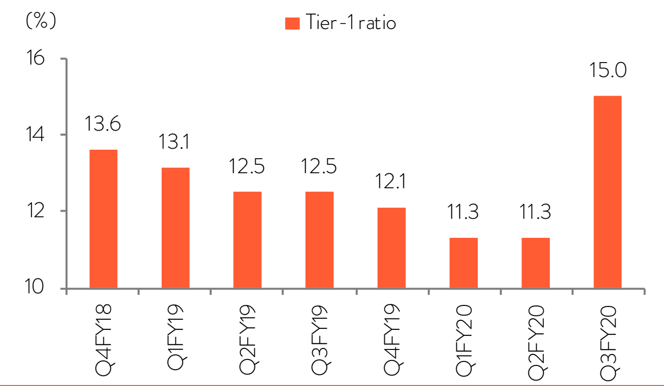
Source: Company, BOBCAPS Research

FIG 4 – CREDIT COST TO REMAIN HIGH AS RBK IMPROVES ITS PROVISION COVERAGE ON LOANS



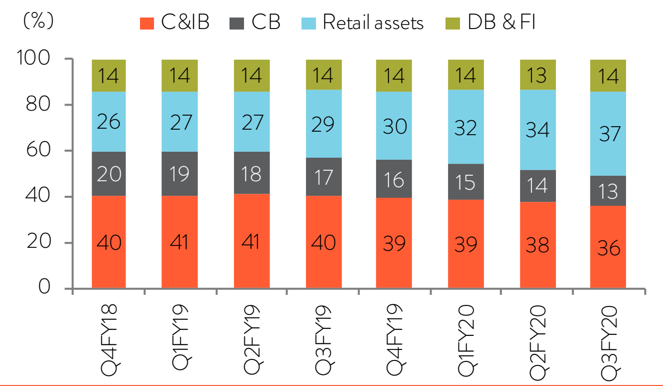
Source: Company, BOBCAPS Research

FIG 5 – HEALTHY TIER-1 RATIO GIVES RBK ADEQUATE BUFFER TO ABSORB STRESS



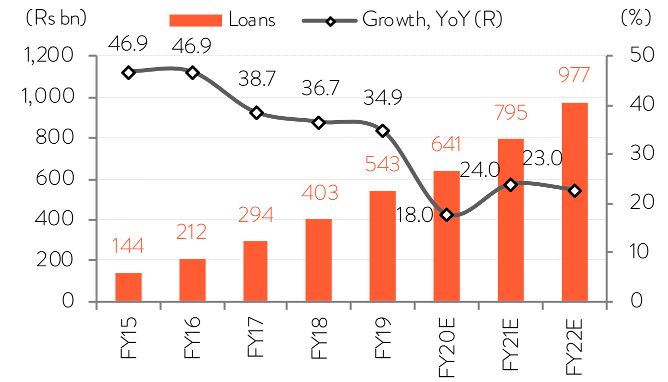
Source: Company, BOBCAPS Research

FIG 6 – SHARE OF WHOLESALE LOANS CONTINUES TO DECLINE



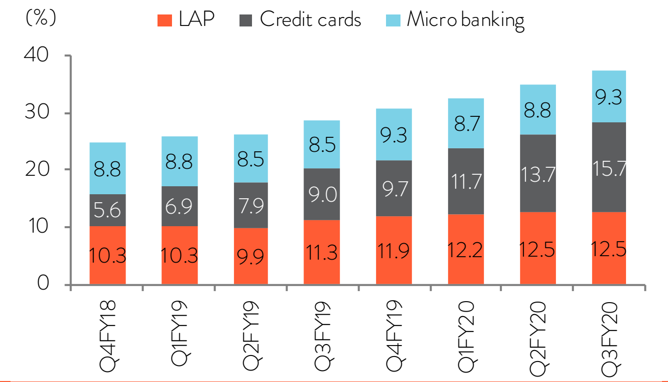
Source: Company, BOBCAPS Research

FIG 7 – LOAN GROWTH EXPECTED TO PICK UP POST FY21 DRIVEN BY NON-WHOLESALE LOANS



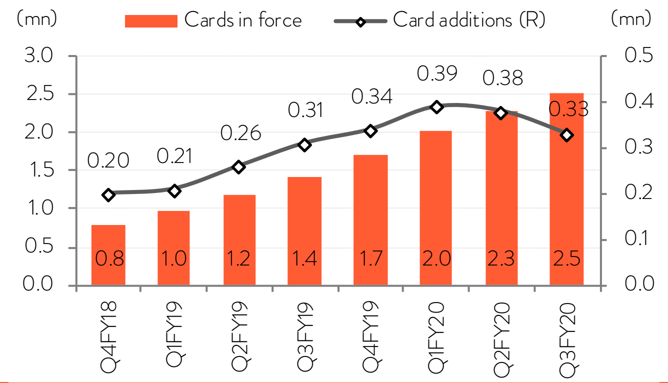
Source: Company, BOBCAPS Research

FIG 8 – SHARE OF LAP, CREDIT CARDS AND MICRO BANKING HAS INCREASED TO ~38% OF LOANS



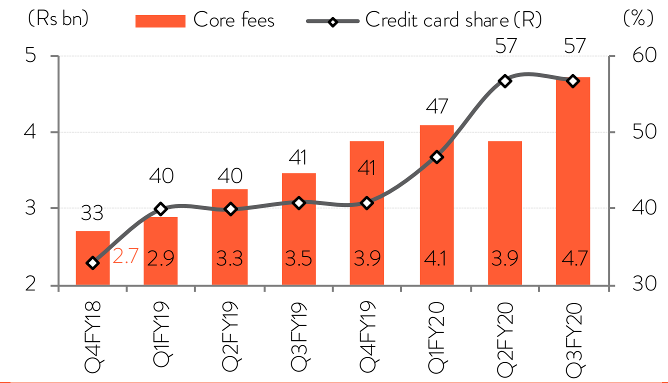
Source: Company, BOBCAPS Research

FIG 9 – RBK NOW HAS A BASE OF 2.5MN CREDIT CARDS



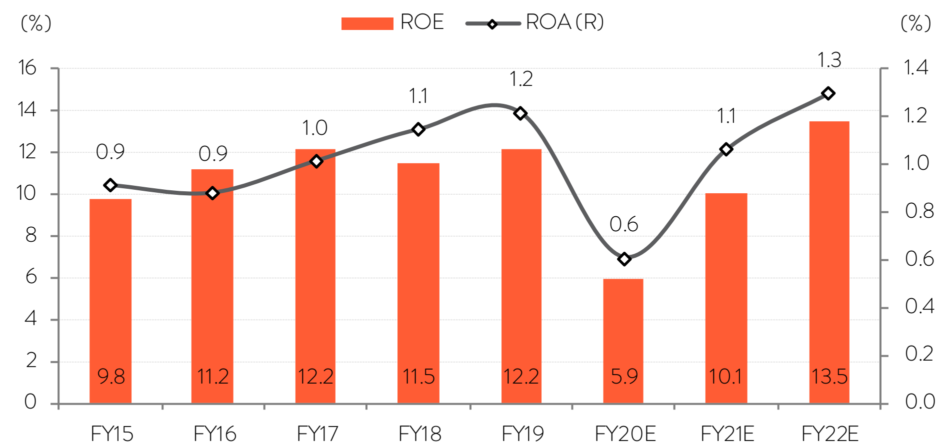
Source: Company, BOBCAPS Research

FIG 10 – CREDIT CARDS CONSTITUTE 57% OF CORE FEES



Source: Company, BOBCAPS Research

FIG 11 – PROFITABILITY TO IMPROVE FROM HEREON



Source: Company, BOBCAPS Research

Valuation methodology

We expect RBK to continue growing much higher than the industry for the next few years and hence use the two-stage Gordon Growth Model to set our target price as it captures valuations in a high-growth stage. Initiate with ADD and a Mar'21 target price of Rs 170, valuing the stock at 0.7x FY22E P/BV.

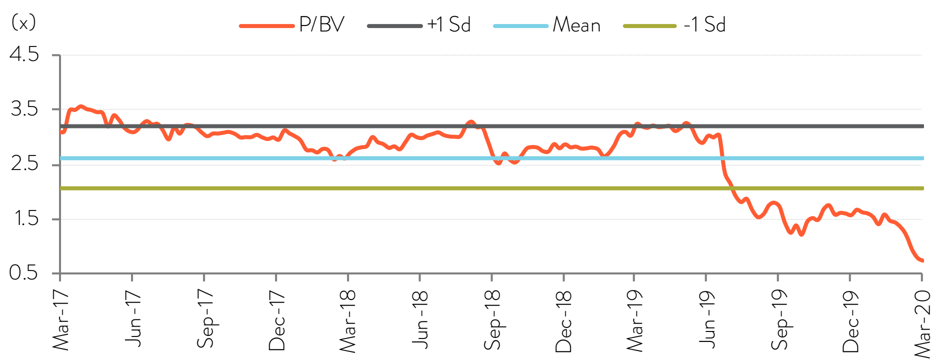
Despite the likelihood of continued asset quality pain in the near term, we derive comfort from the bank's high CET-1 ratio. Also, at current valuations of 0.6x FY22E P/BV, RBK is trading at a sharp ~80% discount to its three-year mean multiple – we see limited downside from current levels.

FIG 12 – VALUATION SNAPSHOT

Components of Gordon Growth Model	Assumptions (%)
Growth (Long-term)	3.1
Risk free rate	7.0
Market risk premium	5.0
Current beta for stock	1.7
Cost of equity	15.6
Blended ROE estimate	12.5
Discounted P/BV (x)	0.7
Book value taken for TP (Rs)	256
Fair value per share (Rs)	**170**

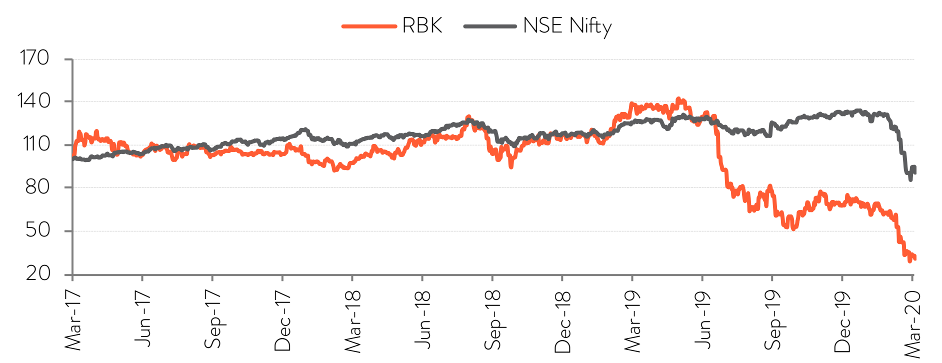
Source: Bloomberg, BOBCAPS Research

FIG 13 – ONE YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 14 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- RBK has high dependence on the unsecured loan book, viz. the credit card and MFI business. Also, exposure to the LAP segment is high. Further deterioration in the macro environment can adversely affect our slippage and credit cost estimates.
- A tough macro climate can drive slower-than-expected loan growth.
- Delayed scale-up in liability franchise can impact our margin assumptions.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**17,663**	**25,395**	**35,825**	**40,709**	**52,061**
NII growth (%)	44.6	43.8	41.1	13.6	27.9
Non-interest income	10,682	14,424	19,015	23,012	26,502
Total income	28,345	39,818	54,839	63,721	78,563
Operating expenses	15,035	20,420	27,064	32,662	40,115
Operating profit	13,310	19,398	27,776	31,059	38,448
Operating profit growth (%)	44.6	45.7	43.2	11.8	23.8
Provisions	3,645	6,407	20,573	15,990	16,198
PBT	9,665	12,992	7,203	15,068	22,250
Tax	3,315	4,322	1,815	3,797	5,607
Reported net profit	**6,350**	**8,670**	**5,388**	**11,271**	**16,643**
Adjustments	0	0	0	0	0
Adjusted net profit	**6,350**	**8,670**	**5,388**	**11,271**	**16,643**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	4,197	4,267	5,087	5,087	5,087
Reserves & surplus	62,643	71,206	101,944	111,400	125,172
Net worth	66,840	75,473	107,031	116,488	130,260
Deposits	439,023	583,944	683,215	840,354	1,025,232
Borrowings	92,614	118,321	139,618	167,542	204,401
Other liabilities & provisions	20,031	25,850	29,728	34,484	40,346
Total liabilities and equities	**685,347**	**879,061**	**1,066,623**	**1,275,356**	**1,530,499**
Cash & bank balance	42,844	66,021	77,905	91,928	108,475
Investments	154,473	168,404	210,505	252,605	298,074
Advances	402,678	543,082	640,837	794,638	977,405
Fixed & Other assets	18,512	26,081	30,345	19,697	16,285
Total assets	**618,508**	**803,588**	**959,592**	**1,158,868**	**1,400,240**
Deposit growth (%)	26.9	33.0	17.0	23.0	22.0
Advances growth (%)	36.7	34.9	18.0	24.0	23.0

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	16.0	20.5	11.5	22.2	32.7
Dividend per share	2.1	2.5	1.4	3.1	4.9
Book value per share	159.3	176.9	210.4	229.0	256.0

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	9.4	7.3	13.0	6.8	4.6
P/BV	0.9	0.8	0.7	0.7	0.6
Dividend yield (%)	1.4	1.7	0.9	2.1	3.3

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	3.2	3.6	4.1	3.8	4.1
Non-interest income	1.9	2.0	2.2	2.2	2.1
Operating expenses	2.7	2.9	3.1	3.1	3.1
Pre-provisioning profit	2.4	2.7	3.2	2.9	3.0
Provisions	0.7	0.9	2.3	1.5	1.3
PBT	1.7	1.8	0.8	1.4	1.7
Tax	0.6	0.6	0.2	0.4	0.4
ROA	1.1	1.2	0.6	1.1	1.3
Leverage (x)	10.0	10.0	9.7	9.5	10.4
ROE	11.5	12.2	5.9	10.1	13.5

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	44.6	43.8	41.1	13.6	27.9
Pre-provisioning profit	44.6	45.7	43.2	11.8	23.8
EPS	25.4	28.2	(43.8)	92.3	47.7
Profitability & Return ratios (%)					
Net interest margin	3.3	3.7	4.2	3.9	4.1
Fees / Avg. assets	1.3	1.6	1.7	1.7	1.7
Cost-Income	53.0	51.3	49.4	51.3	51.1
ROE	11.5	12.2	5.9	10.1	13.5
ROA	1.1	1.2	0.6	1.1	1.3
Asset quality (%)					
GNPA	1.4	1.4	3.3	3.3	3.4
NNPA	0.8	0.7	2.0	1.9	1.8
Provision coverage	44.1	49.9	39.3	42.4	45.1
Ratios (%)					
Credit-Deposit	91.7	93.0	93.8	94.6	95.3
Investment-Deposit	35.2	28.8	30.8	30.1	29.1
CAR	15.3	13.5	16.1	14.9	14.0
Tier-1	13.6	12.1	14.9	13.8	13.0

Source: Company, BOBCAPS Research

ADD

TP: Rs 105 | ▲ 10%

DCB BANK | Banking | 31 March 2020

Valuations undemanding – initiate with ADD

DCB Bank (DCBB) is a mid-market bank that focuses on the SME and self-employed retail categories. It is currently undergoing a bleak phase of low growth and high slippages – we expect the asset quality overhang to continue owing to high CV and SME exposure. Moreover, concentration in the high-risk LAP segment (40% of loans) magnifies the asset risk. We initiate coverage with ADD given undemanding valuations at 0.8x FY22E P/BV. Our Mar'21 TP of Rs 105 values DCBB at 0.8x FY22E P/BV.

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Asset quality overhang: DCBB continues to witness steady deterioration in asset quality which has pushed up the GNPA ratio to 2.2%. Slippages in FY20 have risen to 2.8% of loans due to deterioration in the CV, SME and corporate segments. Regardless of some corrective steps, CV exposure remains high. Further, despite SME/MSME exposure being well collateralised, immediate recoveries are ruled out.

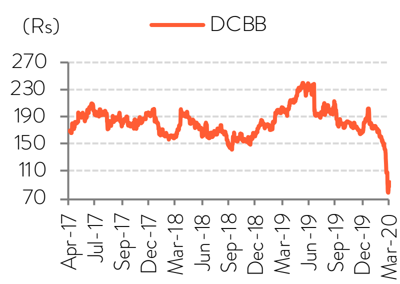
High loan book concentration: DCBB's loan growth has moderated to ~11% YoY in Q3FY20 due to a marked slowdown across key segments, viz. mortgage and SME, that form ~50% of its portfolio. Its corporate book has been declining while stress in the CV segment has compelled a rundown of CV exposure. The lack of a presence in credit cards and personal, auto and two-wheeler loans compels the bank to depend on the mortgage/ high-risk LAP book for growth, much to our discomfort. We believe DCBB needs to diversify away from LAP and SME lending considering the inherent risks in these segments.

Initiate with ADD: We believe current valuations of 0.8x FY22E P/BV look undemanding and price in concerns surrounding the bank. We value the stock at 0.8x FY22E P/BV for a Mar'21 TP of Rs 105 and initiate coverage with an ADD rating.

Ticker/Price	DCBB IN/Rs 95
Market cap	US$ 392.0mn
Shares o/s	310mn
3M ADV	US$ 1.7mn
52wk high/low	Rs 245/Rs 74
Promoter/FPI/DII	15%/25%/61%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	9,954	11,493	12,886	14,131	16,137
NII growth (%)	24.9	15.5	12.1	9.7	14.2
Adj. net profit (Rs mn)	2,453	3,254	3,655	3,405	4,203
EPS (Rs)	8.2	10.5	11.8	10.9	13.5
P/E (x)	11.6	9.1	8.1	8.7	7.1
P/BV (x)	1.2	1.0	0.9	0.8	0.8
ROA (%)	0.9	1.0	1.0	0.8	0.9
ROE (%)	9.8	11.0	11.1	9.5	10.7

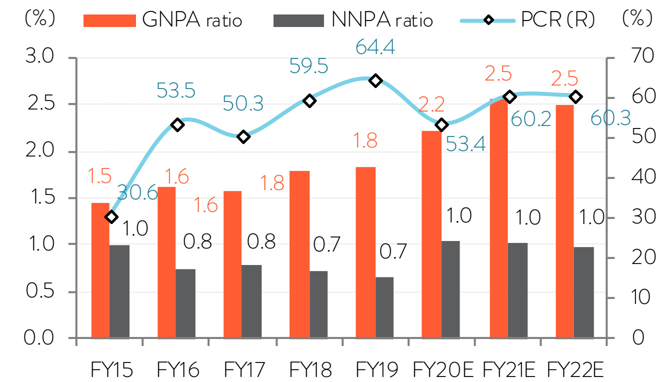
Source: Company, BOBCAPS Research

FIG 1 – SHARP DETERIORATION IN DCBB'S ASSET QUALITY ACROSS SEGMENTS

Segments (GNPA %)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Commercial vehicle	2.5	2.5	1.9	2.4	2.9	3.8	4.4	5.6
SME / MSME	1.3	1.3	1.4	1.5	1.5	1.7	2.5	2.4
AIB	1.7	1.9	1.8	2.3	2.1	2.6	2.1	2.1
Mortgages	1.7	1.7	1.7	1.8	1.7	1.8	2.0	1.7
Corporate banking	2.4	2.5	2.8	2.3	2.0	0.6	0.6	1.6
GNPA ratio	1.8	1.9	1.8	1.9	1.8	2.0	2.1	2.2

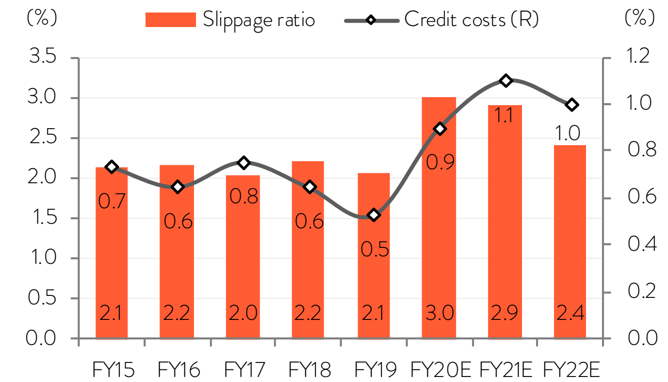
Source: Company, BOBCAPS Research

FIG 2 – OVERHANG ON DCBB'S ASSET QUALITY LIKELY TO PERSIST



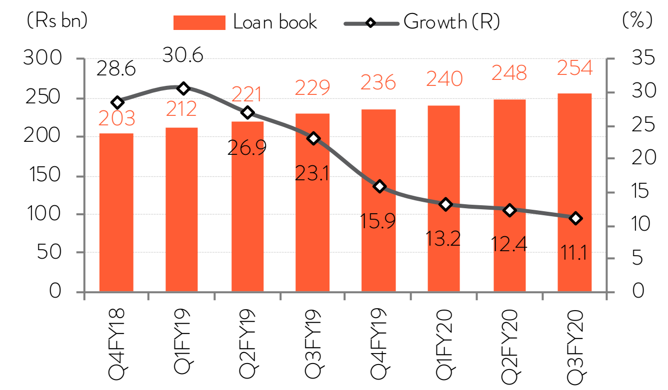
Source: Company, BOBCAPS Research

FIG 3 – EXPECT NORMALISED SLIPPAGES OF ~2% BY FY22E WHILE CREDIT COST REMAINS HIGH



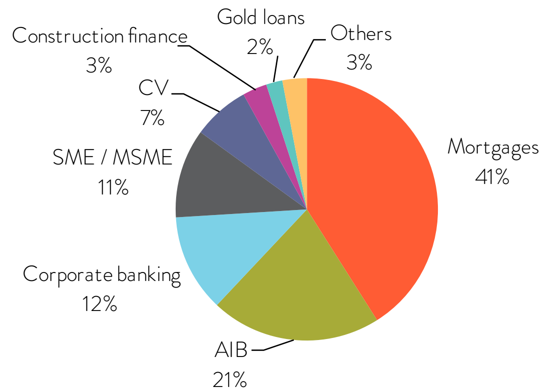
Source: Company, BOBCAPS Research

FIG 4 – DCBB'S LOAN GROWTH HAS MODERATED SHARPLY



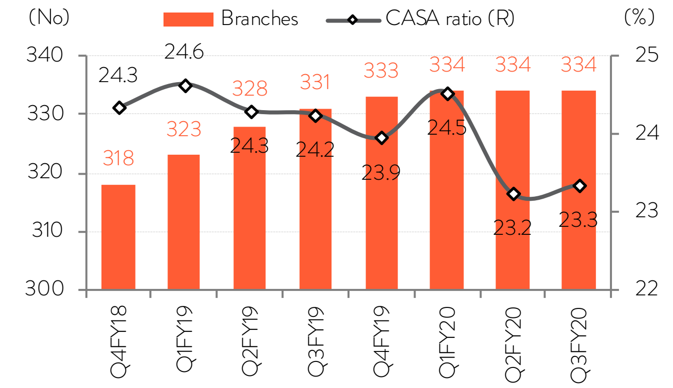
Source: Company, BOBCAPS Research

FIG 5 – MORTGAGES/LAP DOMINATE THE BANK'S PORTFOLIO AT ~40%



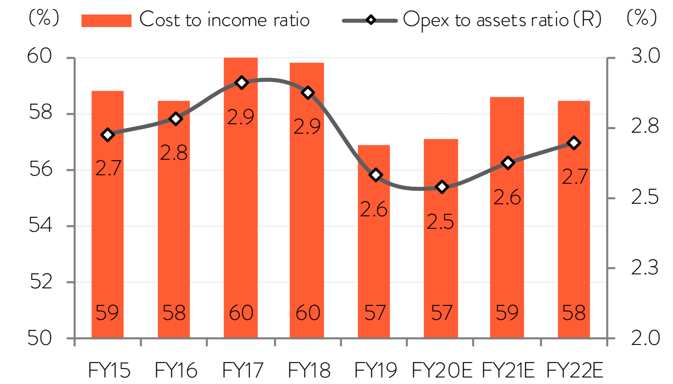
Source: Company, BOBCAPS Research

FIG 6 – DCBB MAY NOT BE INVESTING ENOUGH TO EXPAND ITS LIABILITY FRANCHISE



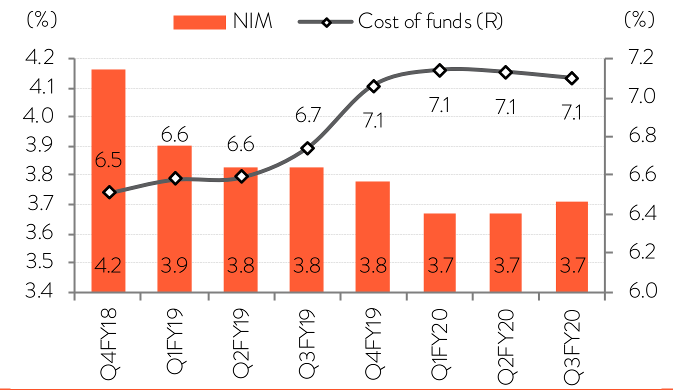
Source: Company, BOBCAPS Research

FIG 7 – EXPECT OPERATING LEVERAGE TO PLAY OUT GRADUALLY



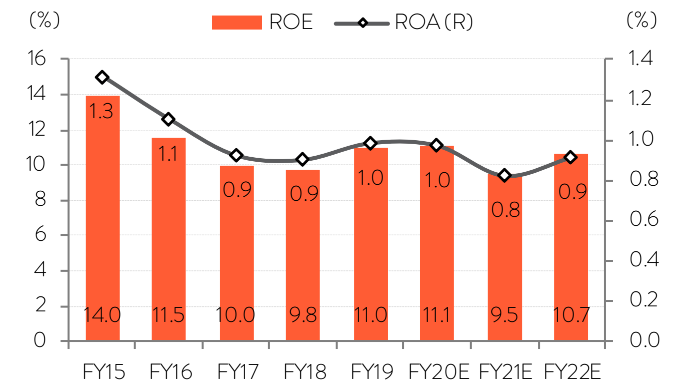
Source: Company, BOBCAPS Research

FIG 8 – HIGH COST OF FUNDS AND ELEVATED SLIPPAGES TO KEEP NIM UNDER PRESSURE



Source: Company, BOBCAPS Research

FIG 9 – PROFITABILITY LIKELY TO REMAIN SUBDUED



Source: Company, BOBCAPS Research

Valuation methodology

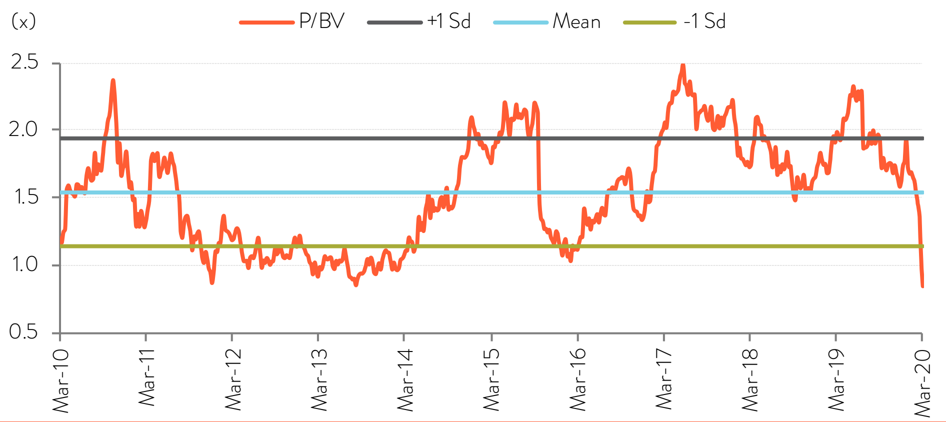
We expect DCBB to continue growing much higher than the industry for the next few years and hence use the two-stage Gordon Growth Model to set our target price as it captures valuations in a high-growth stage. DCBB currently trades at 0.8x FY22E P/BV, which prices in the concerns surrounding the bank. We initiate coverage with ADD and a Mar'21 target price of Rs 105 that values DCBB at 0.8x FY22E P/BV.

FIG 10 – VALUATION SUMMARY

Components of Gordon growth model	**Assumptions (%)**
Growth (Long Term)	3.0
Risk free rate	7.0
Market risk premium	5.0
Current beta for stock	1.3
Cost of equity	13.3
Blended RoE estimate	11.9
Discounted P/BV (x)	0.8
Book value taken for TP (Rs)	125
Fair value per share (Rs)	**105**

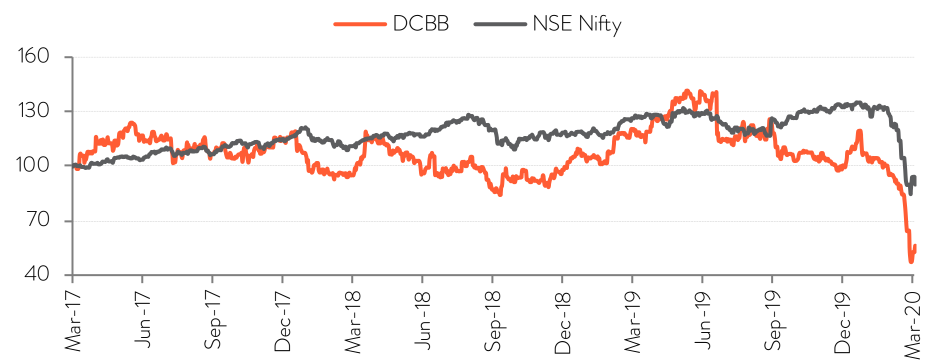
Source: Bloomberg, BOBCAPS Research

FIG 11 – ONE YEAR FORWARD P/BV



Source: Bloomberg, Company, BOBCAPS Research

FIG 12 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A pick-up in economic growth may ease asset stress and lead to lower SME slippages than estimated.
- If branch addition picks up pace, we could see improvement in the bank's liability franchise.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**9,954**	**11,493**	**12,886**	**14,131**	**16,137**
NII growth (%)	24.9	15.5	12.1	9.7	14.2
Non-interest income	3,103	3,502	3,842	4,359	5,062
Total income	13,057	14,995	16,728	18,490	21,199
Operating expenses	7,807	8,529	9,547	10,830	12,387
Operating profit	5,250	6,466	7,181	7,660	8,812
Operating profit growth (%)	25.5	23.2	11.1	6.7	15.0
Provisions	1,219	1,401	2,268	3,083	3,162
PBT	4,030	5,065	4,913	4,576	5,650
Tax	1,577	1,812	1,258	1,172	1,446
Reported net profit	**2,453**	**3,254**	**3,655**	**3,405**	**4,203**
Adjustments	0	0	0	0	0
Adjusted net profit	**2,453**	**3,254**	**3,655**	**3,405**	**4,203**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	3,081	3,095	3,095	3,095	3,095
Reserves & surplus	24,997	28,061	31,362	34,430	38,213
Net worth	28,078	31,156	34,457	37,525	41,308
Deposits	240,069	284,351	309,943	334,738	376,580
Borrowings	19,267	27,232	32,134	37,918	44,743
Other liabilities & provisions	14,807	15,179	17,456	20,598	24,718
Total liabilities and equities	**302,221**	**357,918**	**393,990**	**430,780**	**487,349**
Cash & bank balance	23,720	27,934	31,254	34,980	39,163
Investments	62,190	78,441	86,285	91,462	100,608
Advances	203,367	235,680	263,962	292,997	335,482
Fixed & Other assets	12,945	15,864	12,489	11,340	12,096
Total assets	**302,221**	**357,918**	**393,990**	**430,780**	**487,349**
Deposit growth (%)	24.5	18.4	9.0	8.0	12.5
Advances growth (%)	28.6	15.9	12.0	11.0	14.5

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	8.2	10.5	11.8	10.9	13.5
Dividend per share	0.6	0.9	1.0	0.9	1.2
Book value per share	82.6	92.4	102.9	112.7	124.9

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	11.6	9.1	8.1	8.7	7.1
P/BV	1.2	1.0	0.9	0.8	0.8
Dividend yield (%)	0.6	0.9	1.0	1.0	1.2

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	3.7	3.5	3.4	3.4	3.5
Non-interest income	1.1	1.1	1.0	1.1	1.1
Operating expenses	2.9	2.6	2.5	2.6	2.7
Pre-provisioning profit	1.9	2.0	1.9	1.9	1.9
Provisions	0.4	0.4	0.6	0.7	0.7
PBT	1.5	1.5	1.3	1.1	1.2
Tax	0.6	0.5	0.3	0.3	0.3
ROA	0.9	1.0	1.0	0.8	0.9
Leverage (x)	10.8	11.1	11.5	11.5	11.7
ROE	9.8	11.0	11.1	9.5	10.7

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	24.9	15.5	12.1	9.7	14.2
Pre-provisioning profit	25.5	23.2	11.1	6.7	15.0
EPS	18.0	27.5	12.1	(6.9)	23.4
Profitability & Return ratios (%)					
Net interest margin	3.9	3.7	3.6	3.6	3.6
Fees / Avg. assets	0.8	0.7	0.7	0.7	0.8
Cost-Income	59.8	56.9	57.1	58.6	58.4
ROE	9.8	11.0	11.1	9.5	10.7
ROA	0.9	1.0	1.0	0.8	0.9
Asset quality (%)					
GNPA	1.8	1.8	2.2	2.5	2.5
NNPA	0.7	0.7	1.0	1.0	1.0
Provision coverage	59.5	64.4	53.4	60.2	60.3
Ratios (%)					
Credit-Deposit	84.7	82.9	85.2	87.5	89.1
Investment-Deposit	25.9	27.6	27.8	27.3	26.7
CAR	16.5	16.8	15.2	13.8	12.4
Tier-1	12.7	13.1	12.0	10.9	9.9

Source: Company, BOBCAPS Research

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ADD
TP: Rs 23 | ⮝ 10%

IDFC FIRST BANK | Banking | 31 March 2020

Long road to profitability – initiate with ADD

We believe the overhang on IDFC First Bank's (IDFCFB) asset quality will continue due to stress from legacy accounts (despite 50% PCR) and high exposure to a troubled telecom account and also to infrastructure. The retail book runs the risk of rising credit costs from rampant growth and limited seasoning. A weak liability franchise could keep cost of funds high at 7.4% through to FY22E. We believe some similar-sized peers carry better fundamentals and risk-reward, with lower execution risk. Initiate with ADD on low valuations; Mar'21 TP Rs 23.

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Asset quality challenges: IDFCFB has a Rs 74bn stressed loan book (~7% of loans) with ~62% coverage. Additionally, it has exposure totalling ~Rs 59bn to telecom, including ~Rs 33bn to a stressed telecom company. Its infrastructure book remains elevated at Rs 150bn where slippages cannot be ruled out in the current weak economy. IDFCFB's retail GNPA ratio currently remains manageable at 2.3%. We model for credit costs of 2.4-4.2% in FY20-FY22, but see upside risk to our forecast considering the bank's growing proportion of high-risk, high-yield retail loans (~50% share).

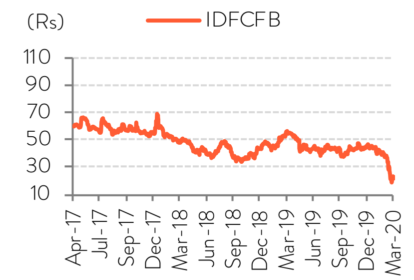
Low share of retail assets and liabilities: The funded book is stable at Rs 1.1tn but retail loan share has risen to 49% in Q3FY20 vs. 35% a year ago, aided in part by a rundown of the wholesale and infrastructure books. This implies that the retail portfolio has limited seasoning. IDFCFB also has a weak liability franchise with retail deposit share at ~22% vs. >80% for larger banks. Paying more on savings account and retail term deposits will help but this will keep cost of funds higher than large banks with stronger liability franchises.

Initiate with SELL: IDFCFB is trading at 0.5x FY22E P/BV. We initiate coverage with ADD as improvement in profitability appears a long way off but valuations seem to price that in. Our Mar'21 TP of Rs 23 is set at 0.6x FY22E.

Ticker/Price	IDFCFB IN/Rs 21
Market cap	US$ 1.3bn
Shares o/s	4,789mn
3M ADV	US$ 13.8mn
52wk high/low	Rs 39/Rs 18
Promoter/FPI/DII	40%/15%/45%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	17,981	31,991	48,526	66,570	80,475
NII growth (%)	NA	77.9	51.7	37.2	20.9
Adj. net profit (Rs mn)	8,593	(19,442)	(27,943)	(842)	6,955
EPS (Rs)	5.0	(4.8)	(5.8)	(0.2)	1.4
P/E (x)	4.2	(4.4)	(3.6)	(119.2)	15.0
P/BV (x)	0.5	0.6	0.7	0.7	0.5
ROA (%)	1.4	(1.3)	(1.7)	(0.1)	0.4
ROE (%)	11.3	(11.6)	(16.8)	(0.6)	4.0

Source: Company, BOBCAPS Research

FIG 1 – IDFCFB HAS A STRESSED LOAN RATIO OF >8%

Asset quality (Rs bn)	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
NPL	18	18	9	17	21	24	23	25
Legacy loans under watchlist	9	9	9	8	21	18	22	35
Bonds	-	-	-	-	-	15	13	-
Stressed equity	12	11	11	11	11	11	11	11
Stressed SRs (NPI)	-	-	2	2	2	2	2	2
Total stressed assets	**39**	**38**	**31**	**38**	**56**	**71**	**72**	**74**
NPL	9	9	6	9	10	12	13	14
Legacy loans under watchlist	8	8	6	5	7	7	7	18
Bonds	-	-	-	-	-	11	10	-
Stressed equity	10	10	11	11	11	11	11	11
Stressed SRs (NPI)	-	-	2	2	2	2	2	2
Provisions (for stressed assets)	27	27	25	28	31	44	43	46
PCR (for overall stressed assets) (%)	70.0	71.1	81.5	72.8	55.9	62.4	60.6	62.2
Security Receipts (SRs)	20	20	17	17	17	16	15	14
Provision on SRs	3	3	2	2	2	2	2	2
GNPA ratio (%)	3.3	3.2	1.6	2.0	2.4	2.7	2.6	2.8
PCR (on GNPAs) (%)	49.9	50.3	64.1	52.3	48.2	49.7	56.1	57.3
Total stressed assets ratio (including SRs) (%)	**12.8**	**12.4**	**8.8**	**6.5**	**8.2**	**9.5**	**9.9**	**8.4**
Total coverage on stressed assets (including SRs) (%)	58.9	59.7	48.0	54.3	45.9	53.1	52.2	54.4

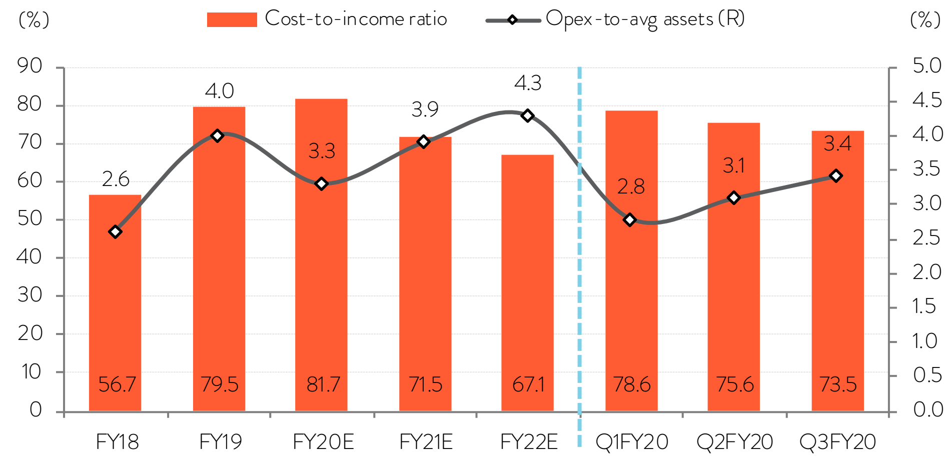
Source: Company, BOBCAPS Research

FIG 2 – PROVISION COVER OF ~51% ON LEGACY LOANS UNDER WATCHLIST

Legacy loans under watchlist	Exposure (Rs bn)	Provisions (Rs bn)	PCR (%)	Management comments
Financial services accounts (One HFC and one financial company)	12.3	9.3	75.0	Both companies have been under financial stress and the HFC case was moved to NCLT in Q2FY20
One South India-based logistics company	1.0	0.5	53.0	The company has been under financial stress at the group level since Jul'19
One tolling concession infrastructure account	9.6	1.5	16.0	This account is a performing tolling concession road with strong cash flows but repaying behind schedule and is in the SMA 2 category
Other infrastructure loans	8.5	6.0	70.9	Other infrastructure loan assets including wind energy projects, thermal energy projects and toll roads have been kept under watch due to the nature of the assets and respective market situations
Restructured but performing infrastructure accounts	3.4	0.4	11.2	A few toll projects and one coal power project have broadly been repaying on schedule, but delays are expected in future
Total legacy loans under watchlist	**34.9**	**17.7**	**50.9**	

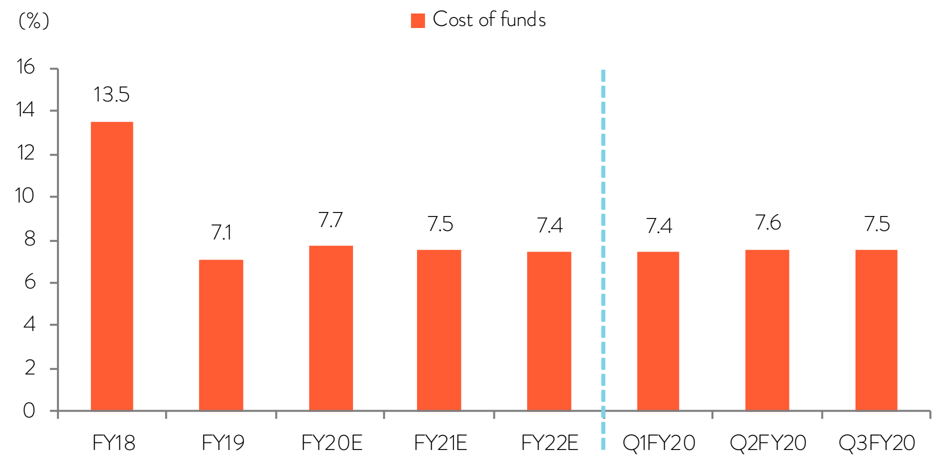
Source: Company, BOBCAPS Research

FIG 3 – MATERIAL IMPROVEMENT IN OPERATING COST RATIOS LOOKS DIFFICULT



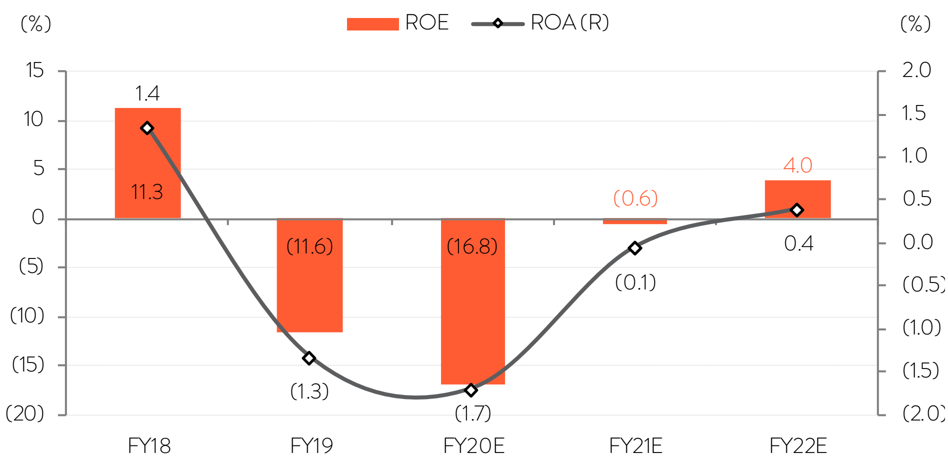
Source: Company, BOBCAPS Research

FIG 4 – COST OF FUNDS TO REMAIN ELEVATED AS THE BANK PAYS MORE FOR SAVINGS AND RETAIL TERM DEPOSITS



Source: Company, BOBCAPS Research

FIG 5 – IMPROVEMENT IN PROFITABILITY RATIOS STILL A LONG WAY OFF



Source: Company, BOBCAPS Research

Valuation methodology

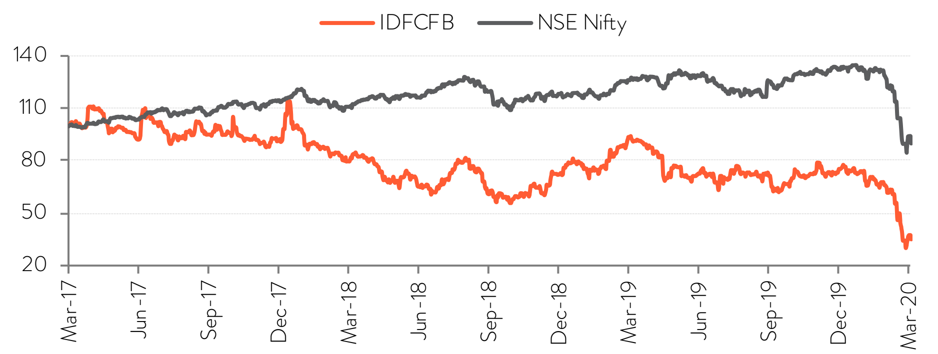
Using the two-stage Gordon Growth Model, we value IDFCFB at 0.6x FY22E P/BV for a Mar'21 target price of Rs 23. The bank is currently trading at 0.5x FY22E P/BV. We initiate coverage with ADD as current valuations appear to reflect concerns over the protracted improvement in profitability. However, we prefer similar-sized peers such as Federal Bank which offer better fundamentals at comparable valuations and far better risk-reward at lower execution risk.

FIG 6 – VALUATION SUMMARY

Particulars	Assumptions
ROE (%)	10.0
Initial growth (G) (%)	9.0
CoE (r) (%)	13.6
gn (perpetual growth rate) (%)	3.0
n (initial growth period, yrs)	5.0
Payout initial period (%)	10.0
Payout in high growth phase (%)	70.0
P/BV (x)	0.6
FY22E Book Value	38
Intrinsic value on 2- stage GGM	23

Source: BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Upside risks to our estimates include:

- much stronger-than-expected improvement in the retail liability franchise coupled with a sharp fall in system interest rates,
- below-expected risk emanating from retail NPAs plus sharp improvement in corporate asset quality, and
- weak earnings performance by peers which can make IDFCFB's valuations seem attractive.

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FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	**17,981**	**31,991**	**48,526**	**66,570**	**80,475**
NII growth (%)	NA	77.9	51.7	37.2	20.9
Non-interest income	11,179	9,386	17,938	23,555	31,027
Total income	29,160	41,377	66,464	90,125	111,502
Operating expenses	16,526	58,867	54,272	64,483	74,767
Operating profit	12,634	(17,491)	12,192	25,642	36,735
Operating profit growth (%)	NA	(238.4)	(169.7)	110.3	43.3
Provisions	2,361	15,461	40,135	26,769	27,437
PBT	10,273	(32,952)	(27,943)	(1,126)	9,299
Tax	1,680	(13,510)	0	(284)	2,343
Reported net profit	**8,593**	**(19,442)**	**(27,943)**	**(842)**	**6,955**
Adjustments	0	0	0	0	0
Adjusted net profit	**8,593**	**(19,442)**	**(27,943)**	**(842)**	**6,955**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Equity capital	34,041	47,817	47,817	47,817	51,354
Reserves & surplus	118,525	133,776	103,633	102,959	144,986
Net worth	152,565	181,593	151,450	150,776	196,340
Deposits	481,982	704,790	683,646	820,376	984,451
Borrowings	572,871	699,834	699,834	629,851	535,373
Other liabilities & provisions	57,784	85,632	85,632	85,632	85,632
Total liabilities and equities	**1,265,202**	**1,671,849**	**1,620,562**	**1,686,634**	**1,801,796**
Cash & bank balance	48,918	95,668	19,134	19,675	20,244
Investments	612,015	584,754	526,278	552,592	552,592
Advances	521,649	863,023	1,010,064	1,087,605	1,193,343
Fixed & Other assets	82,620	128,404	65,087	26,761	35,616
Total assets	**1,265,202**	**1,671,849**	**1,620,562**	**1,686,634**	**1,801,796**
Deposit growth (%)	NA	46.2	(3.0)	20.0	20.0
Advances growth (%)	NA	65.4	17.0	7.7	9.7

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
EPS	5.0	(4.8)	(5.8)	(0.2)	1.4
Dividend per share	0.7	0.5	0.5	0.0	0.3
Book value per share	44.8	38.0	31.7	31.5	38.2

Source: Company, BOBCAPS Research

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
P/E	4.2	(4.4)	(3.6)	(119.2)	15.0
P/BV	0.5	0.6	0.7	0.7	0.5
Dividend yield (%)	3.4	2.5	2.2	(0.2)	1.3

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	2.8	2.2	2.9	4.0	4.6
Non-interest income	1.8	0.6	1.1	1.4	1.8
Operating expenses	2.6	4.0	3.3	3.9	4.3
Pre-provisioning profit	2.0	(1.2)	0.7	1.6	2.1
Provisions	0.4	1.1	2.4	1.6	1.6
PBT	1.6	(2.2)	(1.7)	(0.1)	0.5
Tax	0.3	(0.9)	0.0	0.0	0.1
ROA	1.4	(1.3)	(1.7)	(0.1)	0.4
Leverage (x)	8.3	8.8	9.9	10.9	10.0
ROE	11.3	(11.6)	(16.8)	(0.6)	4.0

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Net interest income	0.0	77.9	51.7	37.2	20.9
Pre-provisioning profit	0.0	(238.4)	(169.7)	110.3	43.3
EPS	0.0	(194.1)	23.0	(97.0)	(896.3)
Profitability & Return ratios (%)					
Net interest margin	1.5	2.4	3.1	4.1	4.7
Fees / Avg. assets	0.7	0.5	0.7	1.0	1.3
Cost-Income	56.7	142.3	81.7	71.5	67.1
ROE	11.3	(11.6)	(16.8)	(0.6)	4.0
ROA	1.4	(1.3)	(1.7)	(0.1)	0.4
Asset quality (%)					
GNPA	3.3	2.4	2.9	2.7	2.7
NNPA	1.7	1.3	1.2	0.7	0.8
Provision coverage	48.2	46.9	58.2	74.1	68.7
Ratios (%)					
Credit-Deposit	108.2	122.5	147.7	132.6	121.2
Investment-Deposit	127.0	83.0	77.0	67.4	56.1
CAR	18.0	15.5	12.6	11.7	13.8
Tier-1	17.7	15.3	12.4	11.5	13.5

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

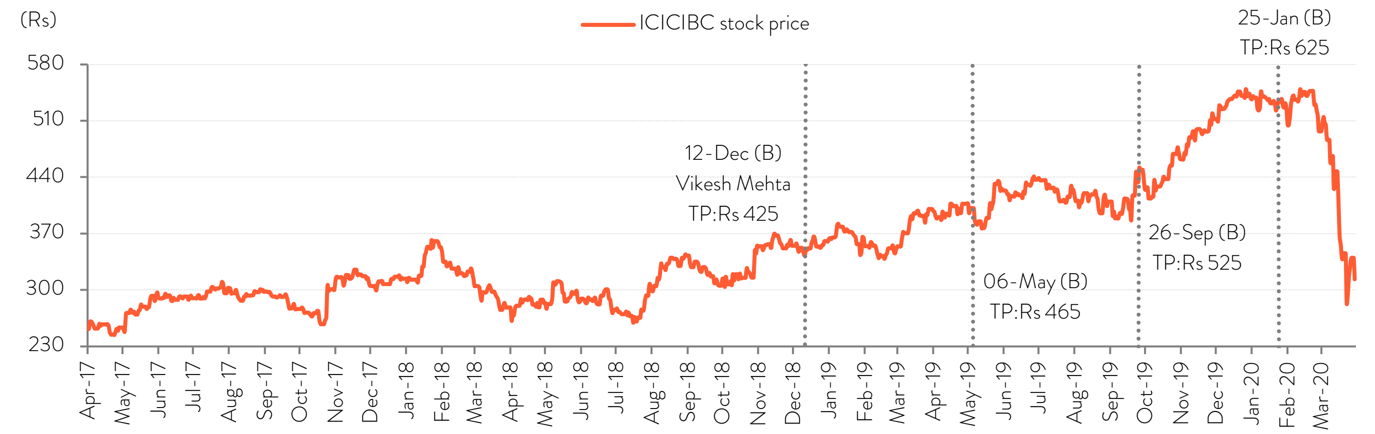
ADD – Expected return from >+5% to +15%

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

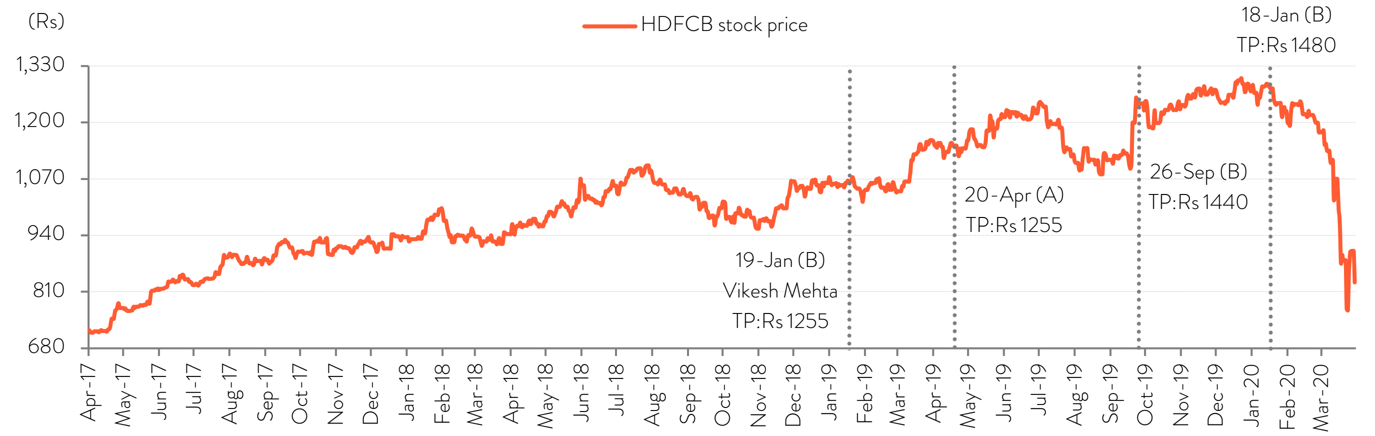
SELL – Expected return <-5%

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

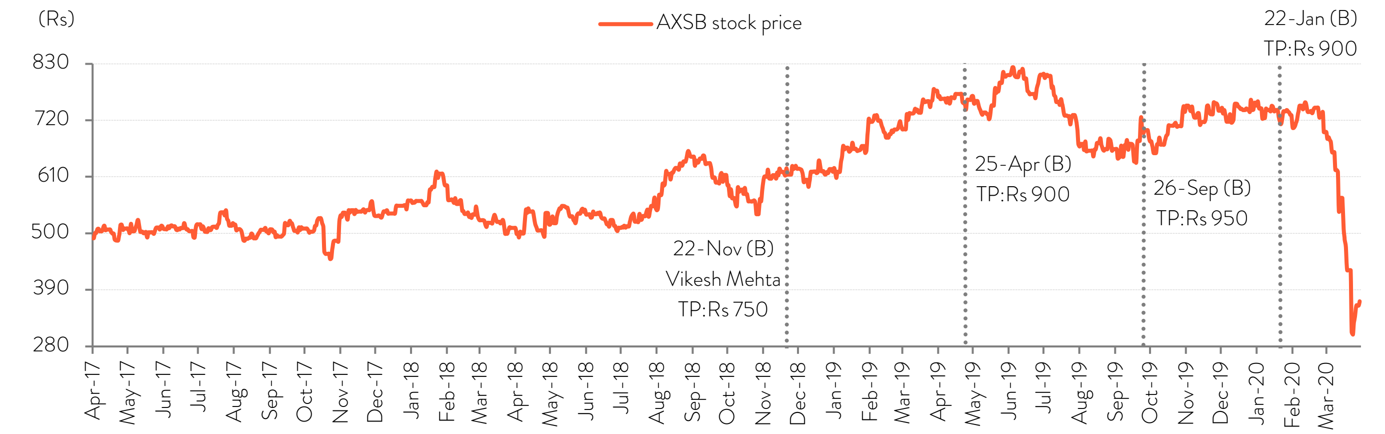
HISTORICAL RATINGS AND TARGET PRICE: ICICI BANK (ICICIBC IN)



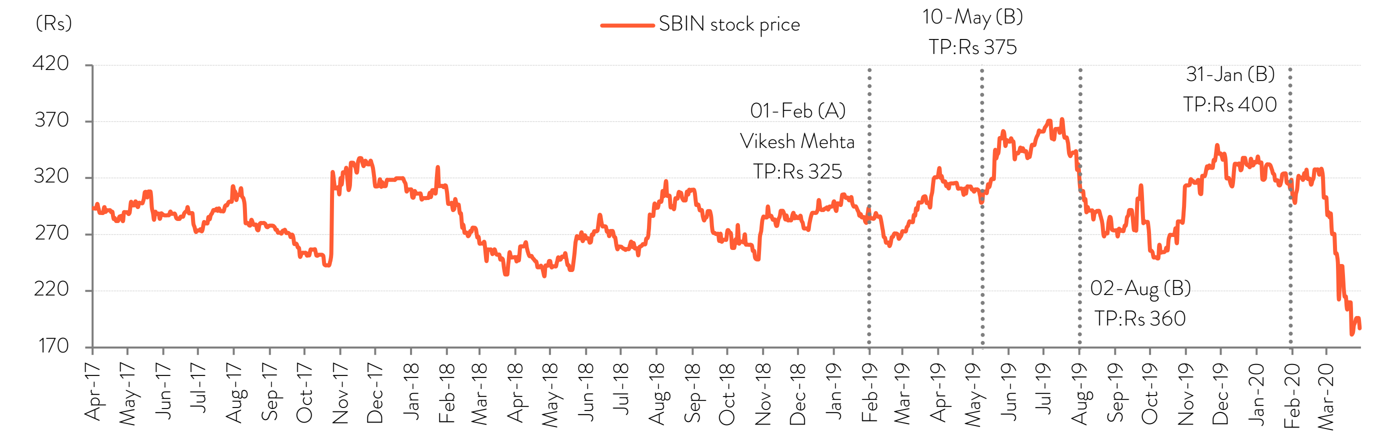
HISTORICAL RATINGS AND TARGET PRICE: HDFC BANK (HDFCB IN)



HISTORICAL RATINGS AND TARGET PRICE: AXIS BANK (AXSB IN)

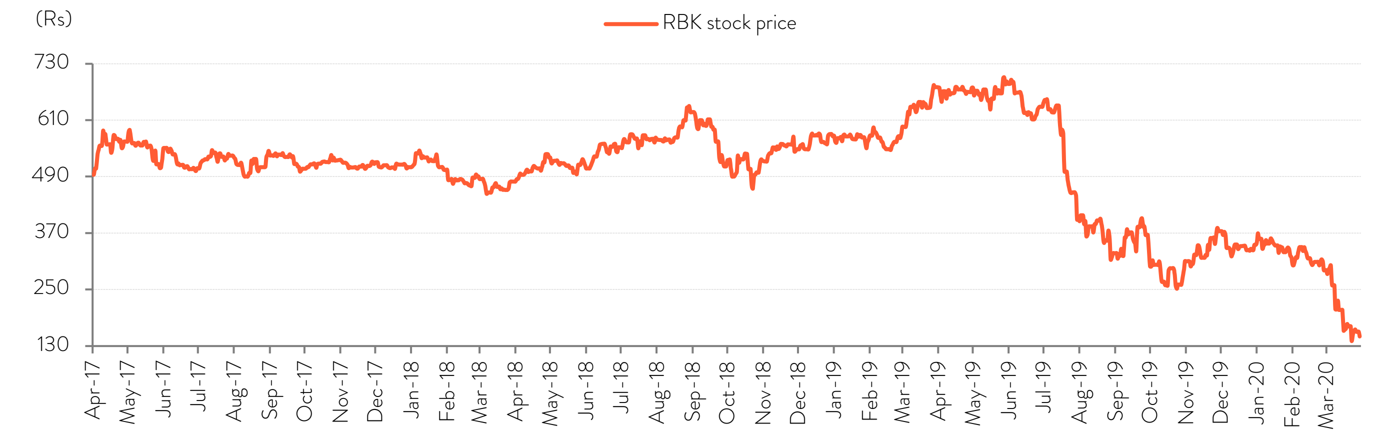


HISTORICAL RATINGS AND TARGET PRICE: STATE BANK OF INDIA (SBIN IN)

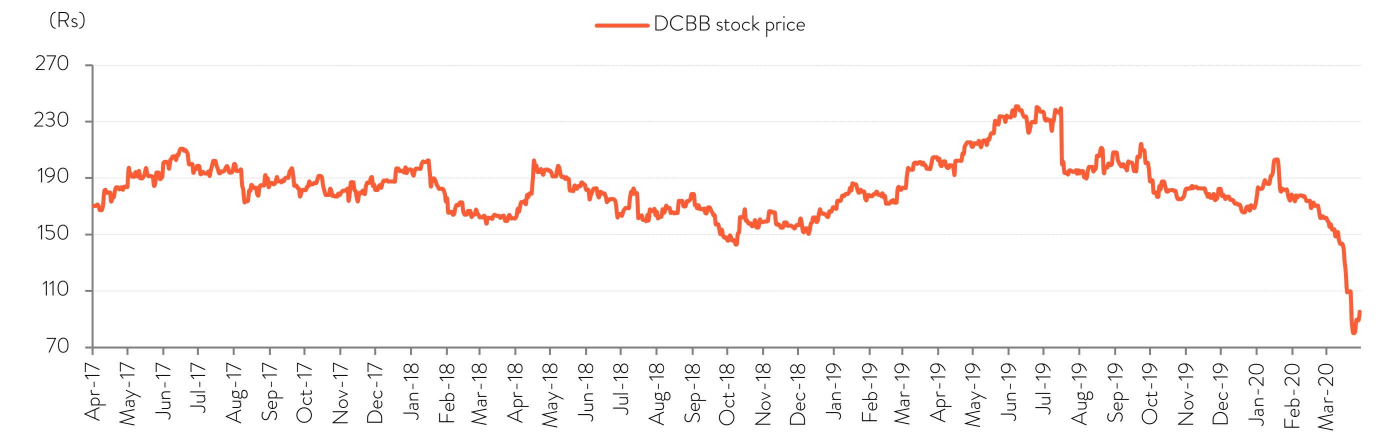


HISTORICAL RATINGS AND TARGET PRICE: FEDERAL BANK (FB IN)

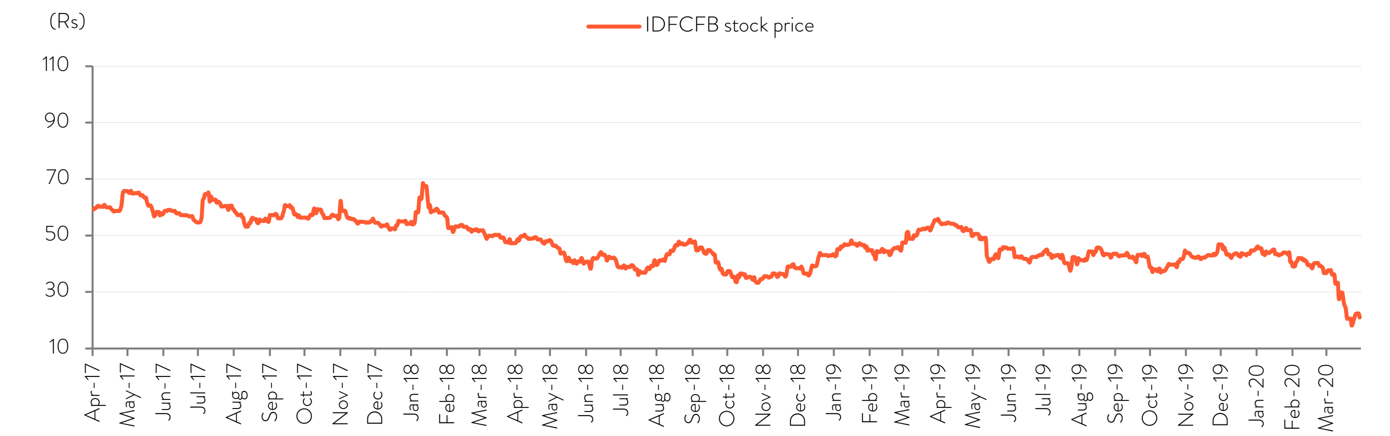
HISTORICAL RATINGS AND TARGET PRICE: RBL BANK (RBK IN)



HISTORICAL RATINGS AND TARGET PRICE: DCB BANK (DCBB IN)



HISTORICAL RATINGS AND TARGET PRICE: IDFC FIRST BANK (IDFCFB IN)



B – Buy, A – Add, R – Reduce, S – Sell

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