

BANKING

26 September 2019

Tax cut to bolster earnings

The corporate tax cut provides much needed cheer for banks under our coverage – we raise FY21-FY22 earnings by 2-14% and ROE estimates by 30-220bps, but believe the near-term impact is already in the price. Also, the sustainability of higher ROE is debatable as banks may concede some of the gains to spur loan growth. Corporate banks such as AXSB and ICICIBC could also witness a one-time hit on EPS upon DTA reversal. We retain ICICIBC as our top pick and upgrade HDFCB to BUY.

Vikesh Mehta

research@bobcaps.in

Near-term impact of tax cut priced in: The government has reduced the marginal/effective tax rate to 22%/25.6% vs. 30%/34.9% earlier. We see banks that operated near the marginal tax rate, especially retail players such as HDFC Bank (HDFCB) and IndusInd Bank (IIB), benefiting the most from this reduction. However, the rally in financial stocks after the tax announcement last week appears to have priced in most of the near-term benefits.

Premature to gauge sustainable ROE uplift: We do see a positive impact on financials of banks under our coverage as the tax cut drives a 2-14% increase in EPS and a 30-220bps spike in our ROE estimates for FY21-FY22. But the odds of long-term sustainable improvement in ROE are debatable. In our view, the tax cut may lead to pickup in economic activity, but this will only come with a lag given that most capex-heavy sectors are either facing financial stress or deficient demand. Further, banks may pass on some of the tax benefit to spur loan growth, which could claw back much of the ROE improvement over the long run.

DTA reversal to hurt FY20 earnings: Banks, especially corporate players such as Axis (AXSB) and ICICI Bank (ICICIBC), that faced NPA woes over the past few years have large outstanding deferred tax assets (DTA) on their balance sheets. DTA was created due to the write-off policy on bad loans, assuming a marginal tax rate of ~34%. Rebasing to the new level of ~26% may result in a one-time hit for banks as the markdown impact will pass through the P&L in FY20.

Upgrade HDFCB to BUY; retain ICICIBC as top pick: HDFCB, IIB and AXSB have the biggest ROE upsides of banks under our coverage. We roll our target prices over to Sep'20 and upgrade HDFCB from ADD to BUY. However, we retain ICICIBC as our top pick given receding asset quality pangs, normalising credit costs and reviving loan growth.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AXSB IN	700	950	BUY
HDFCB IN	1,246	1,440	BUY
ICICIBC IN	452	525	BUY
IIB IN	1,548	1,850	BUY
SBIN IN	282	360	BUY
YES IN	51	50	SELL

Price & Target in Rupees



FIG 1 – REVISED EARNINGS ESTIMATES

Bank	Old EPS (Rs bn)			New EPS (Rs bn)			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AXSB	98.1	138.8	187.1	87.0	151.8	196.8	(11.3)	9.3	5.2
HDFCB	258.2	318.8	383.0	276.2	358.1	435.2	7.0	12.3	13.7
ICICIBC	147.2	195.7	237.2	118.9	205.9	254.4	(19.3)	5.2	7.3
IIB	55.2	75.4	98.0	61.2	85.4	110.4	10.9	13.2	12.6
SBIN	327.0	340.8	409.9	317.6	348.8	419.8	(2.9)	2.4	2.4
YES	10.1	28.6	42.5	4.0	31.7	47.2	(60.8)	11.0	11.0

Source: Company, BOBCAPS Research

FIG 2 – REVISED ROE ESTIMATES

Bank	Old ROE (%)			New ROE (%)			Change (bps)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
AXSB	12.1	13.7	16.4	11.2	16.0	18.0	(93)	221	163
HDFCB	16.2	17.6	18.4	17.3	19.5	20.3	106	186	189
ICICIBC	13.1	15.8	16.9	10.7	16.8	18.2	(242)	106	132
IIB	17.5	18.6	20.0	19.3	20.6	21.7	173	194	165
SBIN	13.6	12.4	13.5	13.2	12.7	13.8	(37)	31	31
YES	3.4	8.4	11.4	1.3	9.4	12.7	(204)	105	130

Source: BOBCAPS Research

FIG 3 – IMPACT OF DTA REVERSAL ON NET WORTH

Bank (Rs bn)	O/s DTA	Revalued DTA	Net worth	Impact on net worth (%)
AXSB	76.4	54.5	666.8	3.3
HDFCB	43.5	31.0	1,492.1	0.8
ICICIBC	104.4	74.4	1,053.2	2.8
IIB	6.7	4.8	266.9	0.7
SBIN	104.2	74.3	2,209.1	1.4
YES	25.3	18.1	269.0	2.7

Source: BOBCAPS Research

FIG 4 – REVISED RATINGS AND TARGET PRICES

Bank	Rating		TP (Rs)		Comments
	Old	New	Old	New	
AXSB	BUY	BUY	900	950	<ul style="list-style-type: none"> TP rolled over to Sep'20, FY21-FY22 earnings raised 5-9% Core book multiple increased to 2.4x from 2.3x earlier in light of ROE expansion AXSB well placed to play the turning asset quality cycle
HDFCB	ADD	BUY	1,255	1,440	<ul style="list-style-type: none"> TP rolled over to Sep'20, FY21-FY22 earnings raised 12-14% Core book multiple raised to 3.5x from 3.4x earlier as HDFCB is one of the biggest beneficiaries of the reduced tax rate
ICICIBC	BUY	BUY	465	525	<ul style="list-style-type: none"> ICICIBC is our top pick in the sector TP rolled over to Sep'20, FY21-FY22 earnings raised 5-7% Core book multiple increased to 2x from 1.9x given ROE expansion
IIB	BUY	BUY	1,850	1,850	<ul style="list-style-type: none"> FY21-FY22 earnings raised ~13% TP remains at Rs 1,850 on rollover to Sep'20 to reflect concerns surrounding management transition and recent buildup of asset quality stress

Bank	Rating		TP (Rs)		Comments
	Old	New	Old	New	
SBIN	BUY	BUY	360	360	<ul style="list-style-type: none"> FY21-FY22 EPS estimates raised marginally TP remains unchanged on rollover to Sep'20, reflecting uncertainty around asset quality
YES	SELL	SELL	90	50	<ul style="list-style-type: none"> TP rolled over to Sep'20, FY21-FY22 earnings raised 11% Target P/B multiple cut to 0.7x from 1.2x earlier to bake in asset quality concerns surrounding the bank

Source: BOBCAPS Research

Stock performance

FIG 5 – AXIS BANK

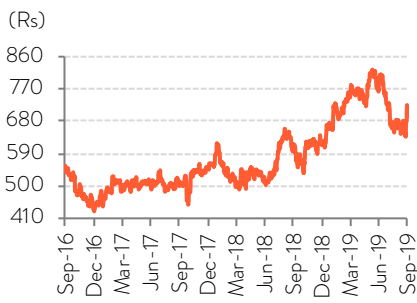


FIG 6 – HDFC BANK

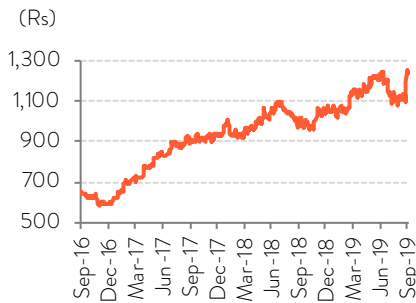


FIG 7 – ICICI BANK

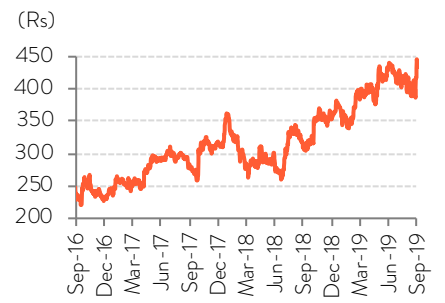


FIG 8 – INDUSIND BANK

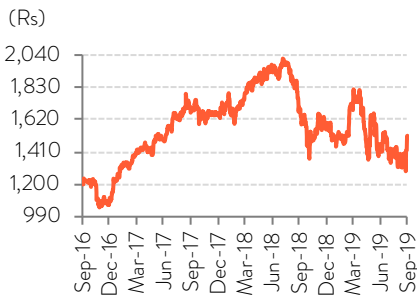


FIG 9 – STATE BANK OF INDIA

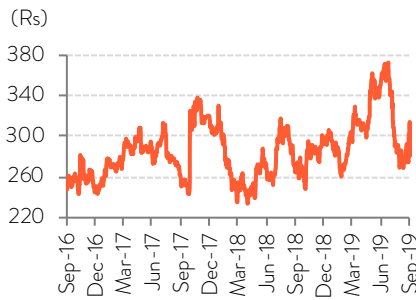
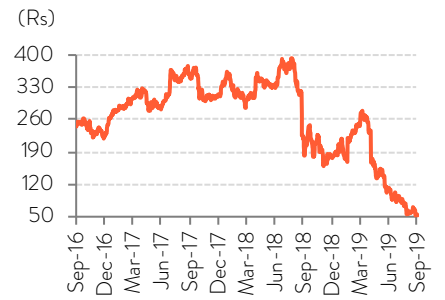


FIG 10 – YES BANK



Source: NSE

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

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

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

SELL – Expected return <-5%

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

Rating distribution

As of 31 August 2019, out of 77 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 47 have BUY ratings, 14 are rated ADD, 7 are rated REDUCE and 9 are rated SELL. None of these companies have been investment banking clients in the last 12 months.

Analyst certification

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

General disclaimers

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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