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Excesses disappear, valuations touching base...

Covid-19 and the recent fiasco of a private sector bank has added to the woes of the financial sector with expectation of continued slower growth and rising retail delinquencies to dent earnings ahead. A sharp correction in the Bank Nifty that fell ~50% from the top has removed excesses in valuations of large banks as well as large NBFCs, though a bottom may or may not be formed yet. HDFC Bank (-35%), IndusInd Bank (-78%) are trading at 2.6x, 0.7x ABV from peak of 3.4x, 2.9x, respectively, while Bajaj Finance is now trading at 3.6x ABV. While it is not necessary that leaders of previous rally will remain so in a new rally, outperformers may change ahead.

Markets are moving towards non-lender based financial sector stocks- insurers and asset managers as they do not carry balance sheet risk and offer growth opportunities.

Therefore, our top picks are SBI Life, HDFC AMC, Axis Bank and Kotak Mahindra Bank in this market environment. Valuation decline has made HDFC Bank attractive for accumulation but leadership concerns are in sight.

We believe large private banks are better than NBFCs as balance sheet management and lower growth concerns stay. Secured loan based entities are more preferable than unsecured in the current environment. Small HFCs, as a segment, can be avoided as concerns on delinquencies both on retail and developer level would stay apart from growth concerns.

An economic slowdown is expected to lead credit growth to stay in single digits even in FY21. Fresh concerns on large exposures (e.g. Vodafone-Idea, Indiabulls, etc) and now MSME/ unsecured retail as a pie are seen adding to the overall stress. Exposure of PSU banks and regional private sector banks is high in SME, MSME segments. Therefore, these banks may take longer to recover from the current balance sheet blow.

Sector View

Banks & NBFCs –Neutral

Insurance – Overweight

AMC – Overweight

Recommend staying in large private sector banks. ***BUY*** *on HDFC Bank, Kotak Mahindra Bank and Axis Bank*

SBI Life Insurance – good investment opportunity in life insurance space

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Sector Update

Exhibit 1: ICICI Direct Research coverage universe (BFSI)

Sector / Company	CMP (₹)	TP(₹)	Rating	M Cap (₹Cr)	EPS (₹) FY19	FY20E	FY21E	P/E (x) FY19	FY20E	FY21E	P/ABV (x) FY19	FY20E	FY21E	RoA (%) FY19	FY20E	FY21E	RoE (%) FY19	FY20E	FY21E
Bank of Baroda (BANBAR)	58	65	Hold	30,033.7	1.8	2.1	9.3	32.4	27.8	6.2	0.7	0.6	0.6	0.1	0.1	0.4	0.9	1.5	5.9
State Bank of India (STABAN)	195	250	Buy	1,88,577	1.0	16.8	24.2	201.0	11.6	8.1	1.4	1.2	1.0	0.0	0.4	0.6	0.5	7.6	11.0
Indian Bank (INDIBA)	46	50	Hold	3,108	6.7	-27.2	8.5	6.9	NA	5.4	0.6	0.3	0.3	0.1	-0.8	0.2	1.7	-11.6	3.5
Axis Bank (UTIBAN)	360	500	Buy	1,22,998	18.2	19.0	42.6	19.8	18.9	8.5	1.7	1.3	1.2	0.6	0.6	1.2	0.6	6.8	12.7
City Union Bank (CITUNI)	140	171	Buy	11,281	9.3	8.7	10.1	15.0	16.1	13.9	2.5	2.2	1.9	1.6	1.4	1.4	15.3	12.6	13.0
Development Credit Bank (DCB)	82	92	Hold	3,407	10.5	12.0	14.0	7.8	6.8	5.9	0.9	0.9	0.8	1.0	1.0	1.0	12.2	12.3	12.7
Federal Bank (FEDBAN)	42	47	Hold	10,845	6.3	6.5	5.7	6.7	6.5	7.4	0.7	0.7	0.6	0.8	0.8	0.6	9.8	9.4	7.7
HDFC Bank (HDFBAN)	880	1,100	Buy	4,79,115	38.7	49.3	61.1	22.7	17.8	14.4	3.3	2.9	2.5	1.8	2.0	2.1	16.5	16.8	18.1
Indusind Bank (INDBA)	429	475	Hold	30,304	60.9	80.3	107.5	7.0	5.3	4.0	1.0	0.8	0.7	1.6	1.8	2.1	14.5	16.4	18.3
Jammu & Kashmir Bank (JAMKAS)	14	12	Sell	771	8.3	-13.0	0.0	1.6	NA	NA	0.2	0.2	0.2	0.5	-0.7	0.0	7.0	-10.1	-0.1
Kotak Mahindra Bank (KOTMAH)	1,300	1,700	Buy	2,36,237	25.5	32.4	32.7	51.0	40.1	39.8	6.0	5.4	4.8	1.7	1.8	1.6	12.1	13.5	12.0
Bandhan Bank (BANBAN)	200	260	Buy	36,085	16.4	18.6	23.3	12.2	10.8	8.6	2.2	2.4	1.9	3.9	4.1	3.7	19.0	23.5	23.3
HDFC (HDFC)	1,705	2,000	Buy	2,92,146	57.5	108.3	69.5	29.7	15.7	24.5	4.7	3.9	3.6	2.3	3.8	2.2	16.4	26.8	15.2
Mahindra & Mahindra Financial	170	190	Hold	12,741	25.3	20.6	25.9	6.7	8.3	6.6	1.4	1.5	1.4	2.6	1.7	1.9	15.2	11.0	12.3
Bajaj Finserv (BAFINS)	6,040	7,200	Buy	96,009	196.9	248.4	332.5	30.7	24.3	18.2	4.0	3.5	2.9	1.6	1.6	1.7	14.1	15.3	17.4
Bajaj Finance (BAJFI)	2,750	3,000	Hold	1,79,878	69.3	95.0	128.1	39.7	28.9	21.5	8.8	5.1	4.3	3.6	3.9	4.0	22.4	21.9	21.4
SBI Life Insurance (SBILIF)	642	800	Buy	64,491	13.4	13.1	16.1	47.9	49.0	39.9	2.9	2.4	2.1	0.9	0.8	0.8	19.2	16.5	17.7

Source: Bloomberg, ICICI Direct Research

Re-aligning with current market prices, reality ahead…

We have revised our earnings estimates for the BFSI sector factoring in:

- Lower credit growth led by near term shutdown and a gradual revival ahead
- Marginally higher slippages from sectors like telecom, MSME, unsecured retail, etc and, thereby rising credit costs
- Accordingly, we lower NII and PAT growth estimates
- Valuation multiples adjusted in light of current equity market risk premium

We have gone underweight on PSU stocks in the BFSI space except SBI (even though they may be beneficiaries of declining G sec yields) and retain **BUY** selectively on large private banks.

Exhibit 2: Coverage universe - Public sector bank

PSU Banks	CMP	ABV		Multiple		Target		Rating		Upside /Down side	Comments
		Old	New	Old	New	Old	New	Old	New		
SBI	195	218.9	214.5	1.2	1.2	325	250	Buy	Buy	28.2%	Bailout of Yes Bank impacted valuation multiple of the bank, we value at 0.8x ABV vs 1x earlier. Risk of future merger continues to loom. High exposure to telecom and MSME sector may result in elevated slippages. However, moderation in credit cost ahead is seen to support earnings growth.
Bank of Baroda	58	130.2	122.6	0.7	0.6	110	65	Buy	Hold	12.1%	Focus on building operational granularity, improving efficiency and disbursements based on risk & capital consumption bodes well. However, ongoing integration process is expected to keep balance sheet growth moderate. Extant of pressure on asset quality in near term remains uncertain. Hence, we downgrade the stock to Hold
Indian Bank	46	186.5	179.5	0.4	0.3	100	50	Buy	Hold	8.7%	Amid Covid-19 outbreak, increase in exposure towards MSME & retail could lead to higher slippages in near term. Integration with Allahabad bank to impact balance growth. Therefore, downgrade the stock to Hold

Source: Company, ICICI Direct Research

Exhibit 3: Coverage universe - Private sector banks

Private Banks	CMP	ABV		Multiple		Target		Rating		Upside /Down side	Comments
		Old	New	Old	New	Old	New	Old	New		
HDFC Bank	880	395.4	394.0	3.3	2.6	1,550	1,100	Buy	Buy	25.0%	HDFC Bank has reported consistent performance in terms of business growth and asset quality. Slowdown in business and change in leadership acts as near term deterrent, however, fundamental strength continue to persist. Relative premium in valuation to continue. Recent correction in stock price offers opportunity. Therefore, we continue with our Buy rating
Kotak Bank	1,300	322.0	307.0	5.1	5.1	1,700	1,700	Hold	Buy	30.8%	Exposure to auto and MSME sector is seen to impact growth in near term. Hiccups in asset quality are not ruled out. However, management prudence, consistent performance and strong subsidiaries induces confidence. Recent correction warrants upgradation of rating to Buy
Bandhan Bank	200	140.0	129.0	3.7	2.5	650	260	Buy	Buy	30.0%	Covid 19 hampering people movement is expected to impact collection efficiency for MFI, particularly large player like Bandhan (~60% of advances). Post Gruh acquisition, housing portfolio is also likely to witness slowdown. Accordingly, we lower our growth estimate and raise credit costs estimates.Considering RoA and RoE still sustaining at ~3% +and >18%, we believe risk reward turns favourable. Reduction in promoter stake & State/ MFI concentration remain concerns but valuations are attractive
DCB Bank	82	131.0	125.3	1.4	0.9	220	92	Buy	Hold	12.2%	Higher exposure to MSME& LAP remains a risk at current juncture, given the shutdown anticipated to hit the segment. Also growth has taken a setback, leading to ROA guidance of 1% taking longer than expected, we remain cautious in near term. Therefore, downgrade the stock to Hold
Federal Bank	42	71.0	79.8	1.3	0.6	125	47	Buy	Hold	11.9%	Federal Bank has one third exposure to MSME sector which is expected to be vulnerable in the current situation. Shutdowns are seen to impact growth as well as asset quality, thereby impacting revival in return ratios. Therefore, remain cautious on regional banks. Hence, downgrade to Hold
Axis Bank	360	369.4	356.0	1.9	1.3	865	500	Buy	Buy	38.9%	Axis Bank's exposure to telecom sector stands at ~₹16000 crore (3.2% of advances). Recent supreme court judgement could impact asset quality & take a toll on earnings. Wide presence, well distributed book is seen to lead to faster recovery of balance sheet growth. Prudent management and focus on risk adjusted lending is expected to deliver consistent returns. Therefore, Axis Bank remains an attractive Buy
Indusind Bank	429	712.0	670.6	1.7	0.7	1,700	475	Buy	Hold	10.7%	Lumpy exposure to telecom sector (₹8800 crore) and 10% MFI exposure would lead to surge in asset quality and expected to dent earnings. Substantial exposure to real estate and gems & jewellry sector induces discomfort. Though leadership change overhang is behind, overall growth and return ratios to be watched. Hence, downgrade our target price and rating to Hold
City Union Bank	140	90.5	82.9	2.1	2.1	255	171	Buy	Buy	22.1%	Substantial exposure to MSME (33% of advances) is expected to impact growth in near term. As the bank has low exposure towards large troubled names, lumpy slippages to remain under check but MSME slippages may be seen. We expect consistent prudence as depicted by management and strength in southern region to continue. Therefore, maintain Buy rating
IDFC First	21.8	32.9	32.1	1.2	0.8	54	29.0	Buy	Buy	33.0%	Exposure to lumpy corporate including telecomn sector and MSME/LAP segment warrants cautious outlook in near term. Prudent management and healthy pace of restructuring induces confidence ahead. Recent steep correction in stock price offers favourable risk reward. Hence, maintain our Buy rating
J&K Bank	14	70.6	50.1	0.6	0.2	20	12	Hold	Sell	-16.1%	J&K Bank had faced tough times due to recent unrest in the J&K state. Outbreak of Covid-19 is seen to further add to uncertainty in growth as well as asset quality which is high. Therefore, earnings to remain volatile with return ratios expected to remain subdued. Hence, we downgrade the stock to Sell.

Source: Company, ICICI Direct Research

Exhibit 4: Coverage universe - NBFC & Insurance

IBFC & insurer	CMP	ABV		Multiple		Target		Rating		Upside /Down side	Comments
		Old	New	Old	New	Old	New	Old	New		
Mahindra Finan	170	168.8	162.0	2.2	1.4	425	190	Buy	Hold	11.8%	Headwinds in auto sector is sen to get aggravated by short term shutdown, however, overall impact is expected to remain marginal on MMFS. Asset quality pain in home finance business to remain ahead. Therefore, we downgrade our rating to Hold
Bajaj Finance	2,750	772.0	824.0	5.7	4.7	4,800	3,000	Hold	Hold	9.1%	Led by shutdown, growth is seen to moderate from 35% to <30%. Margins seen to remain under pressure. Asset quality concerns on unsecured loan portfolio to surge with near term deliquincies. Valuations across financial services has taken a knock, expect high premium multiples to no longer remain, though stronger relative to peers. Estimated target value at 4.7x P/ABV (22x FY22 PAT) on FY22E
Bajaj Finserv	6,040	2,598	2,504	3.7	2.9	10,340	7,200	Hold	Buy	19.2%	Covid-19 outbreak is expected to impact business growth and claims in near term in life & general insurance business. For lending business, slower traction in advances and slippages in unsecured loan portfolio remains near term concern. However, prudent management and high share in niche business continue to keep fundamentals ahead of peers. With recent steep correction in stock price, we upgrade our rating
SBI Life	642	115.9	112.4	1.9	2.3	1,180	800	Buy	Buy	24.7%	Outbreak of covid-19 is seen to impact business as well as lead to higher claims in near term. Given improvement in protection business, consistency in persistency and strong distribution, structural fundamentals continue to remain intact. Therefore, we maintain our Buy rating
HDFC Ltd	1,705	504.3	495.8	4.4	3.7	2,650	2,000	Hold	Buy	17.3%	Housing as a segment is now in subdued growth zone and still a while away to see recovery. Slippages expected in some commercial (35% of portfolio) and LAP category. HDFC to remain beneficiary of reduced market players in HFC segment. Subsidiaries have seen valuation multiple correction and accordingly SoTP target reduced. Considering the secured nature of business and lower LGD at its size, upgrade to Buy.

Source: Company, ICICI Direct Research

Amid Covid-19, unsecured retail advances remains vulnerable

Post financial crises of 2008-09, Indian banks undertook accelerated loan disbursement to corporate sector, which later on led to heightened asset quality pressure. In the last couple of fiscals, the Indian banking sector has witnessed large corporate exposures getting into trouble starting with power sector and followed by metals, infra sector. In the foray, new entrants were large HFC and telecom sector. Such high slippages have kept credit cost elevated and accordingly impacted earnings of banks, especially PSU banks.

In the aftermath of pain and uncertainty in corporate loans, Indian lenders moved towards retail segment. Initially banks started with secured retail category - home and auto loans. With focus on balance sheet growth and higher yield, lenders moved towards unsecured category - credit cards, personal loans and micro finance loans. Till recently, this strategy moved well on path as anticipated, however, outbreak of Covid-19 and nationwide lockdown has raised uncertainty on retail exposure, especially unsecured loans. So far as secured loans are concerned, anticipated dispensation by RBI should do away the concern.

In the current scenario, MSME and unsecured retail loans including micro finance exposure remains the most vulnerable. Therefore, we have analysed exposure of coverage banks to MSME and unsecured retail advances and impact on earnings and net worth in the event of various level of delinquencies. Large private sector banks – HDFC Bank, Axis Bank and Kotak Bank has 18-27% of exposure to vulnerable segment (MSME, LAP and unsecured retail) which is lower compared to mid size regional players.

While higher delinquencies is seen to impact earnings for FY21E, however, impact on net worth for large private players remain relatively lower at 7-15%; the same being higher for mid size lenders. For SBI with ~21% of exposure to vulnerable segment, higher delinquency is seen to derail FY21E earnings, however, impact on net worth is seen in the range of ~4-20%. Therefore, we recommend large private sector banks – HDFC Bank, Axis Bank and Kotak Mahindra Bank as preferred picks. In insurance space, continued business opportunity makes us recommend SBI Life Insurance. Among NBFCs, we advise to stay invested in HDFC Ltd and Bajaj Finserv due to their strong business fundamentals and consistent performance.

Exhibit 5: Analysing impact of varying degree of delinquencies on earnings, net worth of FY21E

₹crore	Axis Bank	HDFC Bank	SBI	Kotak	Federal Bank	CUB	IDFC Bank	Bandhan
Total advances	550138	936030	2301669	216774	120861	33828	106140	65456
MSME	61741	0	278035	0	22529	12148	9498	2332
% of total advances	11%	0%	12%	0%	19%	36%	9%	4%
Retail (incl agri)	291554	480133	929763	133351	49020	11598	42008	59974
% of total advances	53%	51%	40%	62%	41%	34%	40%	92%
Unsecured retail	88924	197608	207927	38114	12025	4922	35926	40100
% of total advances	16%	21%	9%	18%	10%	15%	34%	61%
Vulnerable advances	150665	197608	485962	38114	34554	17070	45424	42432
% of total advances	27%	21%	21%	18%	29%	50%	43%	65%
Additional NPA in MSME & unsecured retail								
2%	3013	3952	9719	762	691	341	908	849
5%	7533	9880	24298	1906	1728	854	2271	2122
8%	12053	15809	38877	3049	2764	1366	3634	3395
10%	15066	19761	48596	3811	3455	1707	4542	4243
PAT (FY21E)								
Impact on PAT (FY21E)	11831	33284	24500	6239	1137	740	185	3753
2%	25%	12%	40%	12%	61%	46%	490%	23%
5%	64%	30%	99%	31%	152%	115%	1224%	57%
8%	102%	47%	159%	49%	243%	185%	1959%	90%
10%	127%	59%	198%	61%	304%	231%	2449%	113%
Networth (FY21E)	98498	197304	241400	55011	15197	6112	16254	17824
2%	3%	2%	4%	1%	5%	6%	6%	5%
5%	8%	5%	10%	3%	11%	14%	14%	12%
8%	12%	8%	16%	6%	18%	22%	22%	19%
10%	15%	10%	20%	7%	23%	28%	28%	24%

Source: Company, ICICI Direct Research

Impact of Covid-19 to remain under watch

In Q3FY20, recovery of a large account of Essar Steel was a positive, offsetting slippage of a large housing financier in the quarter. Therefore, asset quality broadly remained steady with absolute GNPA at ₹ 895706 crore. Going ahead, absence of resolution of any large account (Bhushan Power & Steel) is expected to remain a dragger, thus delaying the required breather to lenders. Shutdown and restriction undertaken amid outbreak of Covid-19 could impact credit offtake, with repayment in MSME and retail segment at risk. Consequently, banks with higher exposure to MSMSE segment remain more vulnerable. RBI is seeking to provide some respite to borrowers with relaxation anticipated in NPA classification norms, especially for businesses engaged in service oriented industry including hospitality, tourism and aviation.

Exhibit 6: Asset quality remains steady in Q3FY20

	FY17	FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
GNPA	7,76,835	10,21,959	9,99,858	9,93,381	9,55,970	9,12,417	9,12,179	9,04,777	8,95,706
NNPA	4,30,173	5,16,462	4,83,919	4,61,063	4,14,961	3,50,022	3,46,883	3,32,139	3,26,900
GNPA Ratio	9.6	11.6	11.2	10.7	10.2	9.1	9.3	9.3	8.6
NNPA Ratio	5.3	5.8	5.4	5.0	4.4	3.5	8.5	3.4	3.1
GNPA of PS	6,84,733	8,96,601	8,74,071	8,68,812	8,29,745	7,89,016	7,88,087	7,78,310	7,66,154
GNPA of Pvt	92,102	1,25,358	1,25,787	1,24,569	1,26,226	1,23,401	1,24,092	1,26,467	1,29,552
w/off	1,08,374	1,61,328				1,97,705			

Source: Company, ICICI Direct Research

Exhibit 7: Exposure to the telecom sector

	Amount (₹ crore)	% of loan book	% of networth
Axis Bank	16,600.0	3.2%	19.8%
HDFC Bank	24,500.0	2.7%	15.7%
Indusind Bank	8,800.0	4.5%	26.3%
Kotak Mahindra Bank	4,700.0	2.2%	10.2%
RBL Bank	500.0	0.8%	5.8%
Federal Bank	1,600.0	1.4%	11.6%
State Bank of India	42,400.0	2.0%	19.0%
Bank of Baroda	14,000.0	2.2%	22.1%
Canara Bank	6,100.0	1.4%	16.6%
PNB Bank	8,400.0	2.0%	18.3%
Union Bank	15,200.0	5.2%	57.1%

Source: Company, ICICI Direct Research

In the recent judgement, the Supreme Court has asked telecom operators to pay adjusted gross revenue (AGR) dues as per the previous order. Rejecting any self-assessment of dues by operators, the court has said that further delay will attract legal actions. Such judgement by the court raises question on the business viability of Vodafone and, thus leads, to increasing uncertainty for lenders with funded and non-funded exposure to the telecom provider. While majority of lenders will be impacted, Axis Bank and IndusInd Bank have higher exposure among private banks and SBI and Union Bank of India among PSU lenders may witness higher incremental stress accretion.

Exhibit 8: Bank wise industry exposure

	Infrastructure	Financial Institui	Chemicals	Gems & Jewellery	Metals	Textile	Telecom	Real Estate & Constr	Total
SBI	14.9%	13.6%	6.0%	0.5%	6.0%	1.7%	1.3%	1.4%	45.5%
BOB	8.6%		6.1%	0.9%	8.6%	3.4%	1.3%	3.4%	32.3%
Indian Bank	6.7%	15.4%	0.7%	0.1%	5.9%	3.9%	1.8%	4.0%	38.6%
Axis Bank	3.4%	10.3%	3.7%		3.8%	1.1%	1.9%	2.2%	26.4%
City Union Bank	1.1%		1.1%	0.3%	5.7%	10.3%		4.1%	22.6%
DCB Bank	2.7%	6.6%	1.1%	1.2%	1.8%	2.9%		7.7%	24.1%
HDFC Bank	8.2%	8.8%	0.8%	1.0%	3.1%	2.0%	2.7%	2.7%	29.4%
Indusind Bank	9.1%	3.5%	0.8%	2.2%	2.0%	0.7%	3.1%	4.9%	26.3%
Kotak Mahindra Bank	3.0%	12.5%	1.4%	1.4%	3.6%	2.0%	1.6%	5.1%	30.6%
IDFC First	12.7%	11.0%	1.7%		2.1%	0.3%	2.5%	5.2%	35.6%

Source: Company, ICICI Direct Research

Exhibit 9: Bank wise MSME exposure

	Loan Book	% MSME Exposure
Andhra Bank	1,78,690	18.40
Bank of India	3,28,137	16.64
Bank of Maharashtra	93,467	15.00
Corporation Bank	1,21,251	17.00
ICICI Bank	5,86,646	5.00
Karnataka Bank	54,828	19.00
Oriental Bank	1,71,549	18.00
RBL Bank	54,308	2.00
South Indian Bank	63,636	24.00
Syndicate Bank	1,74,822	15.00
Union Bank	3,25,392	15.00
Bank of Baroda	6,90,000	13.00
Axis Bank	4,94,798	13.00
Indusind Bank	1,86,394	
SBI	22,93,454	13.00
Kotak Mahindra Bank	2,05,695	
HDFC Bank	8,19,401	
Canara Bank	4,27,727	
PNB	4,90,975	17.00

Source: Company, ICICI Direct Research

Credit offtake remains benign; gradual recovery ahead

Slower economic growth has led to a continued deceleration in the pace of credit growth to 6.5% YoY as of February 28, 2020. Increased focus on retail lending and portfolio buyout from NBFCs continued to provide respite to overall growth while a slowdown persists in the industry segment, especially in mid and small industries. The shutdown undertaken amid outbreak of Covid-19 is seen impacting advances growth in the near term keeping credit offtake in single digits in FY20E. Recovery of credit offtake in H1FY21E remains uncertain with larger impact on MSME and granular retail loans.

The industry sector growth stayed in single digits to 2.5% in January 2020, mainly due to de-growth in metals and textile but growth in infrastructure segment has provided some respite. Metals and textiles de-grew 9.3% & 4.1% YoY to ~₹ 3.3 lakh crore and ~₹ 1.9 lakh crore, respectively, while credit to infrastructure segment grew 5.1% YoY to ~₹ 10.4 lakh crore. Within infrastructure segment, roads grew ~2.1% and telecom surged 46.7% YoY.

The services segment reflected growth in line with industry at 8.9% YoY, primarily led by traction in NBFCs segment at 32.2%, which was at ~ ₹ 7.4 lakh crore vs.₹ 5.57 lakh crore in January 2019. NBFC credit and portfolio buyout from NBFCs is expected to further drive growth ahead.

Retail loan segment continued with consistent growth at ~16.9% YoY in January 2020 with major traction towards housing loans and credit cards whereas consumer durables loan growth remained broadly flattish YoY. In terms of absolute number, housing loans were at ~₹ 13.2 lakh crore while credit card outstanding loans were at ~₹ 1.1 lakh crore.

In the near term, pace of advances is expected to remain benign, especially in the MSME and retail segment. However, as the situation normalises, the large industrial sector is poised to grow steadily compared to small & medium industry. The government's focus on MSME is expected to push up disbursements. Moderate economic growth and base effect is seen keeping overall credit growth in single digits in FY20E. Going ahead, we expect credit growth to improve from FY21E onwards led by a gradual improvement in credit scenario and shifting of credit demand from NBFCs to banks. Consolidation in PSU banks is seen acting as a deterrent for the balance sheet as large PSU banks will focus on integration. Therefore, private banks are expected to garner higher market share in incremental business, thereby increasing their proportion in overall advances.

Exhibit 10: Retail segment provides support to overall credit growth

₹ crores	FY17	FY18	FY19	Nov-19	Dec-19	Jan-20
Non-Food Credit	7,094,490	7,688,424	8,633,418	8,673,908	8,737,346	8,900,136
Agriculture & Allied Activities	992,386	1,030,215	1,111,300	1,134,004	1,139,092	1,153,386
Industry	2,679,831	2,699,268	2,885,778	2,772,248	2,794,372	2,817,525
Large	2,205,296	2,222,589	2,403,878	2,306,889	2,321,808	2,337,662
Services	1,802,237	2,050,472	2,415,609	2,362,956	2,370,600	2,431,975
NBFCs	391,032	496,393	641,208	730,907	728,561	737,198
Personal Loans	1,620,034	1,908,469	2,220,732	2,404,701	2,433,282	2,497,250
Housing (Including Priority Sector Housing)	860,086	974,565	1,160,111	1,274,747	1,289,637	1,316,481
Credit Card Outstanding	52,132	68,628	88,262	105,860	105,905	110,864
Vehicle Loans	170,525	189,786	202,154	207,996	213,601	220,240
YOY growth (%)						
Non-Food Credit	8.4%	8.4%	12.3%	7.2%	7.0%	8.5%
Agriculture & Allied Activities	12.4%	3.8%	7.9%	6.5%	5.3%	6.5%
Industry	-1.9%	0.7%	6.9%	2.4%	1.6%	2.5%
Large	-1.7%	0.8%	8.2%	3.0%	1.8%	2.8%
Services	16.9%	13.8%	17.8%	4.8%	6.2%	8.9%
NBFCs	10.9%	26.9%	29.2%	29.1%	27.6%	32.2%
Personal Loans	16.4%	17.8%	16.4%	16.4%	15.9%	16.9%
Housing (Including Priority Sector Housing)	15.2%	13.3%	19.0%	18.3%	17.6%	17.5%
Credit Card Outstanding	38.4%	31.6%	28.6%	24.1%	25.3%	31.6%
Vehicle Loans	11.5%	11.3%	6.5%	4.7%	7.2%	9.8%
Proportion (%)						
Agriculture & Allied Activities	14.0%	13.4%	12.9%	13.1%	13.1%	13.3%
Industry	37.8%	35.1%	33.4%	32.0%	32.3%	32.5%
Large	31.1%	28.9%	27.8%	26.6%	26.6%	26.3%
Services	25.4%	26.7%	28.0%	27.3%	27.4%	28.1%
NBFCs	5.5%	6.5%	7.4%	8.4%	8.3%	8.3%
Personal Loans	22.8%	24.8%	25.7%	27.8%	28.1%	28.8%
Housing (Including Priority Sector Housing)	12.1%	12.7%	13.4%	14.7%	14.8%	14.8%
Credit Card Outstanding	0.7%	0.9%	1.0%	1.2%	1.2%	1.2%
Vehicle Loans	2.4%	2.5%	2.3%	2.4%	2.4%	2.5%

Source: RBI, ICICI Direct Research

Exhibit 11: Industry wise credit deployment data

₹ crores	FY17	FY18	FY19	Dec-19	Jan-20
Food Processing	145,523	155,363	157,058	145,578	150,279
Textiles	196,295	209,903	203,549	189,152	190,108
Chemicals & Chemical Products	172,426	162,992	191,484	177,427	183,048
Basic Metal & Metal Product	420,958	416,018	371,564	337,587	335,104
All Engineering	149,620	155,320	168,621	158,648	157,586
Infrastructure	906,394	890,937	1,055,921	1,029,417	1,036,852
Power	525,393	519,619	568,966	562,025	559,305
Telecommunications	85,066	84,560	115,585	134,310	136,080
Roads	179,972	166,540	186,852	186,870	192,232
Industry	2,679,831	2,699,268	2,885,778	2,794,372	2,817,525
Non-Food Credit	7,094,490	7,688,424	8,633,418	8,737,346	8,900,136

YoY growth (%)	FY17	FY18	FY19	Dec-19	Jan-20
Food Processing	-3.0%	6.8%	1.1%	-1.5%	-0.2%
Textiles	-4.6%	6.9%	-3.0%	-5.4%	-4.1%
Chemicals & Chemical Products	4.8%	-5.5%	17.5%	0.0%	2.0%
Basic Metal & Metal Product	1.2%	-1.2%	-10.7%	-11.1%	-9.3%
All Engineering	-2.9%	3.8%	8.6%	-1.8%	-2.2%
Infrastructure	-6.1%	-1.7%	18.5%	5.9%	5.1%
Power	-9.4%	-1.1%	9.5%	2.6%	0.9%
Telecommunications	-6.8%	-0.6%	36.7%	48.2%	46.7%
Roads	1.4%	-7.5%	12.2%	-0.1%	2.1%
Industry	-1.9%	0.7%	6.9%	1.6%	2.5%
Non-Food Credit	8.4%	8.4%	12.3%	9.2%	8.5%

Proportion of non-food credit(%)	FY17	FY18	FY19	Dec-19	Jan-20
Infrastructure	12.8%	11.6%	12.2%	11.9%	12.0%
Power	7.4%	6.8%	6.6%	6.5%	6.5%
Telecommunications	1.2%	1.1%	1.3%	1.6%	1.6%
Roads	2.5%	2.2%	2.2%	2.2%	2.2%
Industry	37.8%	35.1%	33.4%	32.4%	32.6%
Non-Food Credit	100.0%	100.0%	100.0%	101.2%	103.1%

Source: RBI, ICICI Direct Research

RBI seen following global central banks in cutting rates

After a fall in yields in first half of the fiscal, G-sec yield witnessed a surge rising ~ 53 bps to 6.78% from lows of 6.25% in July 2019. Further, RBI has lowered repo rate by 25 bps in October 2019 and maintained status quo in February 2020. While RBI maintained status quo on benchmark rates, implementation of LTRO has led the yield curve to move southwards for up to three to five years duration. In order to mitigate impact of Covid-19 pandemic on the Indian economy and financial markets, RBI has announced sell/buy swap auction worth $2 billion to provide dollar liquidity. In addition, long-term repo operations (LTRO) is been announced to the tune of ₹ 1 lakh crore to infuse liquidity. However, transmission of decline in rates is to be seen amid anticipated deceleration in credit offtake in the near term.

Post January 2020, concerns related to spread of Coronavirus and its impact on economic activity has led global central banks to cut down their benchmark rates. Accordingly, G-sec yields have moved southwards to 6.15% led by anticipation of RBI following global central banks in cutting rates. In the event of G-sec yields moving southwards, PSU banks, being more sensitive to change in yield, will remain major beneficiaries with positive impact in the range of 12-26% while the benefit for private players will remain in lower single digits.

Exhibit 12: Treasury income to remain muted

Q3FY20 ₹ crore	Investment book	AFS	Duration (yrs)	Absolute Impact due to decline in Yield 30 bps	50 bps		Average asset	Impact on RoA due to decline in yield 30 bps	50 bps	Impact on PAT due to decline in yield 30 bps	50 bps	Networth	Impact on NW due to decline in yield 30 bps	50 bps
Public sector banks														
Bank of India*	157,277	47,425	3.1	438	730	2,431.0	894,378	4.9	5.7	12.6%	21.0%	47251	0.9%	1.5%
Bank of Baroda	256157	84198	1.3	318	530	6,465.0	852,017	3.7	4.4	3.4%	5.7%	75440	0.4%	0.7%
PNB*	234,144	73,304	3.6	781	1,301	3,062.0	1,116,352	7.0	8.2	17.8%	29.7%	63775	1.2%	2.0%
SBI	973,320	409,768	2.3	2,815	4,692	26,000.0	5,199,376	5.4	6.3	7.6%	12.6%	232520	1.2%	2.0%
Indian Bank	64,091	24,190	3.3	239	398	1,212.0	426,495	5.6	6.5	13.8%	23.0%	23224	1.0%	1.7%
Private sector banks														
Axis Bank	155,979	38,995	NA	NA	NA	9,816.0	570,907	NA	NA	NA	NA	86198	NA	NA
City Union Bank	9,098	1,775	1.2	6	11	758.0	698,903	0.1	0.1	0.6%	1.0%	5181	0.1%	0.2%
DCB	8,139	2,076	0.8	5	8	417.2	54,667	0.9	1.1	0.8%	1.4%	3352	0.2%	0.3%
J&K Bank**	21,612	4,402	0.9	11	19	820.0	154,448	0.7	0.9	1.0%	1.6%	5781	0.2%	0.3%

Source: Company, ICICI Direct Research

Top Picks

HDFC Bank (CMP – 910, target – 1100)

HDFC Bank has efficiently focused on retail business and has garnered strong liability franchise to yield superior profitability over the years. Seasoned portfolio and management experience led to higher than industry advances growth at ~24% CAGR in FY08-19. Advances were at ₹ 9.3 lakh crore as of December 2019, with major traction towards the retail book. Enriched customer experience, strong network of 5345 branches and focus on digitisation have enabled it to build a strong liability franchise with CASA comprising ~40% of deposits. Such high CASA limits cost of funds and thereby enable to report superior NIM above 4% consistently. Prudent asset quality has been core to the bank and the same has safeguarded the bank from NPA issues faced by the industry in recent fiscals. RoA at ~1.5% and RoE at 15-18% remain consistent for the bank with valuations expected to remain at premium. We recommend **BUY.**

Kotak Bank (CMP – ₹ 1340, target – ₹ 1700)

Kotak Mahindra Bank, promoted by Uday Kotak, reported loan book of ₹ 216774 crore as on December 2019. It has built a branch network of 1539 branches. Increased focus towards retailisation of loans has enabled KMB to earn the best NIM in industry at 4.7%. The savings rate was hiked by KMB to 6% in 2011, boosting savings deposits growth to ₹ 239354 crore by December 2019. CASA ratio improved from 50.7% in Dec 18 to 53.7% in Dec 19, which is the best in industry. Overall asset quality remained resilient with GNPA ratio at 2.46% and bank has no major exposure to IL&FS & other stressed asset. Going ahead, healthy business growth coupled with stable margins is expected to augur well for the bank. We recommend **BUY.**

SBI Life (CMP – ₹ 642, target – ₹ 800)

Continued focus on business growth and improvement in product mix has remained the core strength. In terms of business growth, SBI Life has reported highest NBP growth among top private insurers above 30% CAGR in the last four years, thereby increasing its market share to ~20%. Proportion of high margin protection business has been on the uptrend from 5% in FY18 to ~11% in Q3FY20, which remains accretive for VNB margins expected at ~18% ahead. Improving persistency and excellent operating efficiency remain strong levers for earnings. Strong distribution with ~24000 branches of SBI and more than 1 lakh agents, remain key catalyst. With annual gross premium of ₹ 40000 crore and AUM of ₹ 164000 crore in FY20, we expect operating RoEV to improve to ~18% in FY22E translating into EV growth at 15-16% CAGR in EV in FY20-22E to ~₹ 35000 crore. Therefore, we remain positive on SBI Life, being a play on growth led by distribution, brand reach and adequate product mix. We recommend **BUY**.

Annexure

Exhibit 13: Asset quality trend

Asset quality trend	GNPA (₹ crore)					NNPA (₹ crore)				
	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
PSU coverage										
Bank of Baroda	53,184	48,233	69,714	69,969	73,140	19,131	15,610	25,030	24,894	26,504
SBI	187,765	172,750	168,494	161,636	159,660	80,944	65,895	65,624	59,939	58,248
Indian Bank	13,198	13,353	13,541	13,981	13,862	7,571	6,793	6,824	6,613	6,488
Private coverage										
Axis Bank	30,855	29,789	29,405	29,071	30,073	12,233	11,276	11,037	11,138	12,160
City Union Bank	892	977	1,076	1,135	1,026	528	591	600	624	649
Development Credit Bank	445	439	476	523	552	163	154	196	238	261
IndusInd Bank	1,968	3,947	4,200	4,370	4,578	1,029	2,248	2,381	2,203	2,173
HDFC Bank	10,903	11,224	11,769	12,508	13,427	3,302	3,215	3,567	3,791	4,468
Jammu & Kashmir Bank	6,860	6,221	6,031	7,473	7,712	3,049	3,240	2,962	2,942	2,810

Source: Company, ICICI Direct Research

Exhibit 14: Quarterly margin trend

NIM (%)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
PSU coverage							
Bank of Baroda	2.7	2.6	2.7	2.9	2.6	2.8	2.8
Indian Bank	3.1	3.0	2.9	3.0	2.9	2.9	2.9
SBI	2.8	2.7	2.8	2.8	2.8	2.9	3.1
Private coverage							
Axis Bank	3.5	3.4	3.5	3.4	3.4	3.5	3.6
Bandhan Bank	10.3	10.3	10.5	10.7	10.5	8.2	7.9
City Union Bank	4.2	4.3	4.4	4.4	4.1	4.0	4.0
Development Credit Bank	3.9	3.8	3.8	3.8	3.7	3.7	3.7
HDFC Bank	4.2	4.3	4.3	4.4	4.3	4.2	4.2
IndusInd Bank	3.9	3.8	3.8	3.6	4.1	4.1	4.2
Jammu & Kashmir Bank	3.7	3.7	3.9	4.1	3.9	0.0	3.9
Kotak Mahindra Bank	4.3	4.2	4.3	4.5	4.5	4.6	4.7

Source: Company, ICICI Direct Research

Exhibit 15: Key financial of industry as of Q3FY20

(₹ crore)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
NII	91925	89715	96470	99779	100055	103916	110960
Growth YoY	**27.5**	**10.9**	**15.1**	**20.7**	**8.8**	**15.8**	**15.0**
Other income	35416	35546	40408	48118	41393	49408	51938
Growth YoY	-13.1	-30.2	9.8	4.7	16.9	39.0	28.5
Total operating exp.	63066	62543	69896	73797	69446	73395	75838
Staff cost	31462	32155	35369	35468	35539	37144	38041
Operating profit	64275	62717	66983	74100	72002	79929	87061
Growth YoY	7.1	-14.7	10.2	22.0	12.0	27.4	30.0
Provision	76611	69531	65287	103481	54326	59165	62698
PBT	-12381	-6863	1696	-29381	17598	20691	24136
PAT	-8390	-5368	-1199	-19961	11095	7245	6867
Growth YoY	**NM**	**NM**	**NM**	**NM**	**NM**	**NM**	**NM**
GNPA	999858	993381	955970	912417	912179	904777	895706
Growth YoY	**20.8**	**18.6**	**8.3**	**-10.7**	**-8.8**	**-8.9**	**-6.3**
NNPA	483919	461063	414961	350022	346883	332139	326900
Growth YoY		**2.2**	**-11.3**	**-32.2**	**-28.3**	**-28.0**	**-21.2**

Source: Capital-line, Company, ICICI Direct Research

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