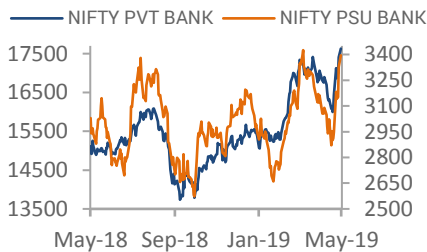




Index (% returns)	3 M	6 M	1 Y
Nifty50	6.0	(1.0)	11.0
Nifty Bank	7.0	4.0	15.0
Nifty Midcap 50	6.0	(3.0)	(1.0)
S&P BSE Sensex	5.0	(1.0)	11.0
PSU Bank	13.6	8.1	12.1
Private Bank	11.1	15.7	15.7

Source: IIFL Research

Index Price Trend



Prices as on 30/05/2019

Analyst:

Saurabh Rathi
and
Hadrien Mendonca
research@iifl.com

May 31, 2019

PSU Banks are likely to see turnaround in profitability given that most of the pain has been recognized and NPA & credit costs are peaking out, which will lead to an improvement in return ratios. With an anticipated improvement in the capex cycle over the coming years, PSU Banks are likely to benefit the most since they hold the majority market share in the lending book (68% as of Q4FY19). PSU Banks have also strengthened their balance sheet by improving their provision coverage ratio, reduction in stressed assets and capitalization from government. We believe PSU Banks are likely to report better earnings going ahead driven by moderation in slippages leading to lower credit costs, improving margins through better income recognition and improving loan growth. **We believe SBI, Bank of Baroda and Canara Bank will lead the rally in PSU Banks.**

SBI: SBI has multiple levers to improve its RoA viz. improving domestic loan book growth, lowering stress asset formation, decline in slippages & credit cost and improvement in return ratios. Further, low cost deposit profile and better income recognition will drive NIM. The stock is trading attractively at 1.1x FY21E P/BV.

Bank of Baroda (BoB): BoB to benefit from merger synergies, lowering stress asset formation, decline in slippages & credit cost and improvement in return ratios. The stock is trading attractively at 0.60x FY21E P/BV.

Canara Bank: The bank's improving asset quality, better NIM prospects and rising non-interest income bodes well for its profitability over FY19-21E. The stock is trading attractively at 0.59x FY21E P/BV.

From the technical perspective, SBI has confirmed a multi-year consolidation breakout, indicating meaningful upside in the medium term. Bank of Baroda has exploded out from the long drawn Symmetrical Triangle pattern, which signifies that an upmove is likely. Canara Bank has witnessed a Golden Crossover, which indicates that the trend has reversed and is all set to move higher.

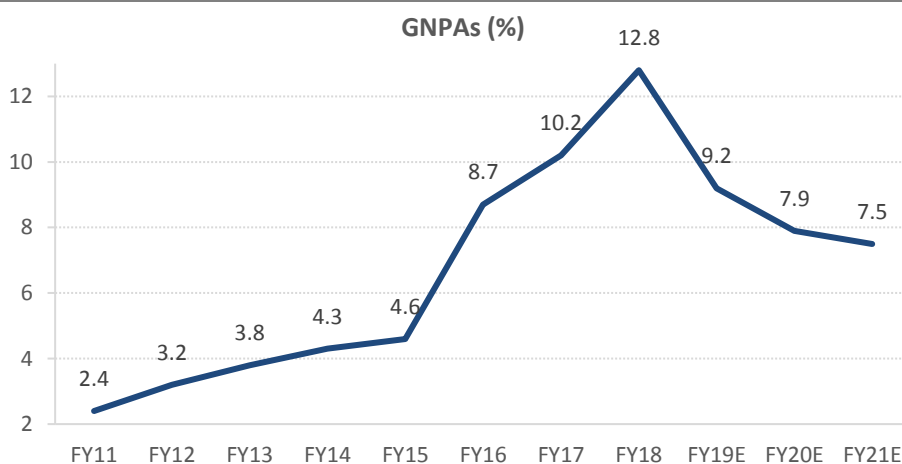


Improving asset quality of PSU Banks to aid faster RoA expansion

PSU Banks, which have been suffering from rising bad loans, are witnessing moderation in their GNPA & NNPA ratios as well as slippages and credit costs since the last few quarters. Their stressed asset formation has also considerably reduced.

We estimate that the GNPA ratio of PSU Banks are likely to decline from 9.2% (expected) in FY19 to 7.5% in FY21E. We expect credit costs for PSU Banks to continue normalization over FY19-21E leading to faster RoA/RoE expansion. Further, strong balance sheet will support their profitability over FY19-21E. Considering these favorable factors, PSU Banks are poised to perform better in terms of profitability and return ratios.

Asset quality of PSU Banks to improve



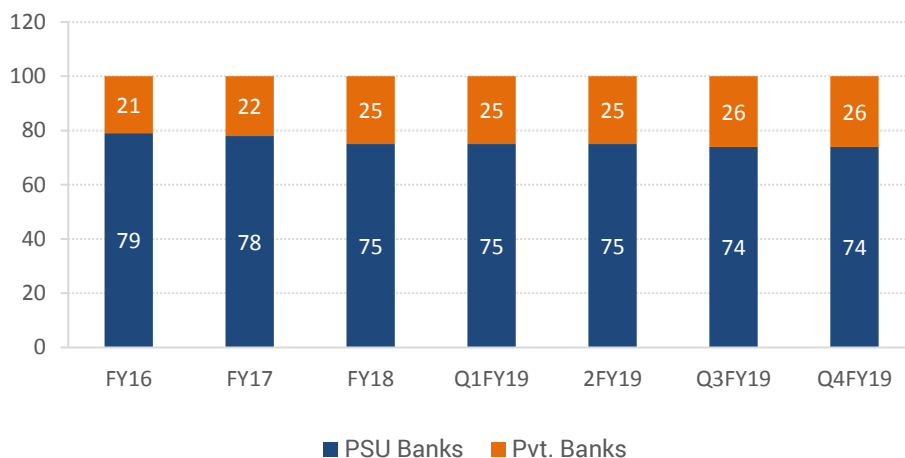
Source: IIFL Research

PSU Banks have higher deposit market share vs. Private Banks

PSU Banks have ~74% share in the total deposit base as against ~26% for private sector banks for Q4FY19. Notably, deposit growth of Private Banks has picked up, but lag on the loan growth front continues as they have higher loan/deposit ratio as compared to PSU Banks. As a result, frontline Private Banks are either increasing Term Deposit (TD) rates to accelerate deposit accretion or are utilizing market borrowings to fund credit growth. Contrary to this PSU Banks' credit growth is mostly funded by deposits. Better deposit franchise for PSU Banks vis-à-vis Private Banks will provide them competitive advantage over private peers in terms of falling cost of funds and margin improvement. Moreover, it will also aid consistency in liability profile for business growth.

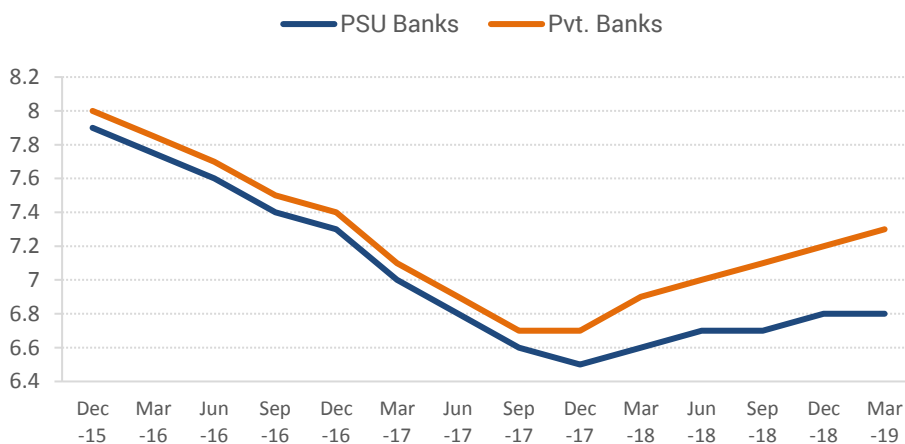


Deposits market share PSU Banks vs. Private Banks (%)



Source: IIFL Research

Weighted average term deposit (TD) rates (%)



Source: IIFL Research

Attractive valuations make select PSU Banks compelling Buy

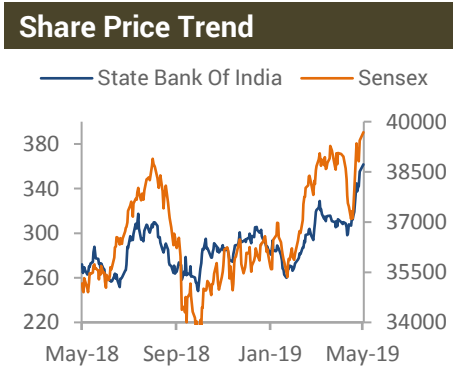
The earnings trajectory of PSU Banks is likely to trend up over the next few years. Lower incremental stressed asset formation, higher resolution of stressed assets, improved growth appetite and enhanced revenue recognition will drive the profitability of these banks. Since PSU Banks are trading at attractive valuations of >1x FY21E P/BV (barring SBI), we believe there is a strong case for re-rating going forward given improving earnings growth prospects.

Sector	Bank
Recommendation	BUY
Upside	18%

Stock Data	
Sensex	39,650
52 Week h/l (₹)	364 / 247
Market cap (₹ Cr)	3,21,999
BSE code	500112
NSE code	SBIN
FV (₹)	1.0
Div yield (%)	0.0

Shareholding Pattern			
	Sep-18	Dec-18	Mar-19
Promoters	58.5	58.5	57.9
DII+FII	34.0	33.9	34.4
Individuals	7.5	7.5	7.7

Source: www.bseindia.com



Prices as on 30/05/2019

Multi-year consolidation breakout

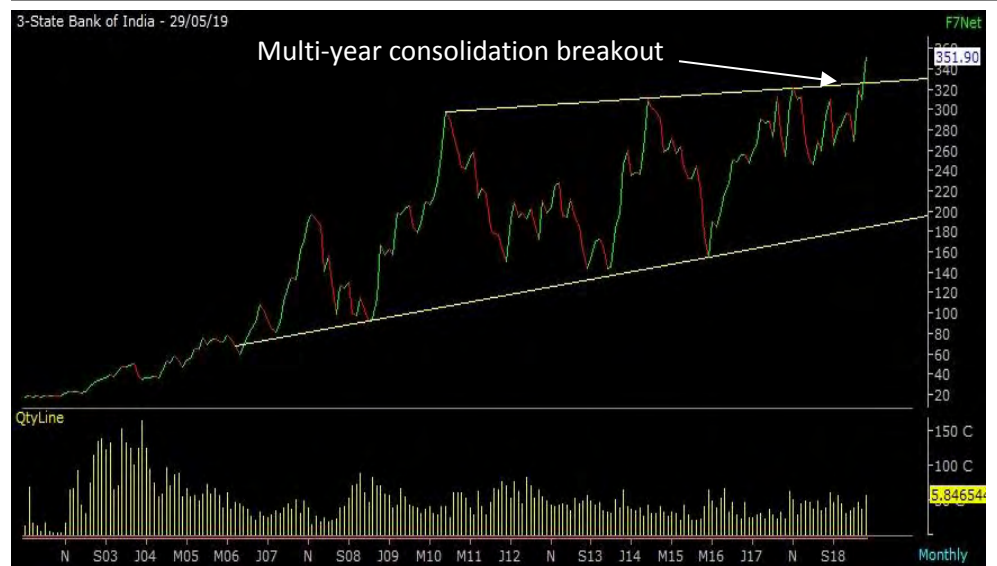
The stock has been oscillating in a controlled range of ₹150-330 for the past nine years. Since October 2017, SBI made multiple attempts to breakout above the trading range but failed to do so. However, for the first time the stock has successfully managed to surpass the rising trend line resistance which was placed at ₹325. This breach has confirmed the multi-year consolidation breakout indicating meaningful upside in the medium term.

Higher top higher bottom structure

Our larger time frame analysis suggests that since hitting the June 2006 lows of ₹56, SBI has persistently recorded higher tops and higher lows on the charts. Stock has also held convincingly above its long term 200-DMA and is also riding the Golden Crossover wave at the current juncture.

Based on the above evidence, the projection of the consolidation structure indicates a potential target of ₹417, translating into ~18% upside. The breakout would stand void if SBI cracks below the support of ₹310 on weekly closing basis.

Monthly Chart



Source: IIFL Research

SBI's return ratios for FY20/21E should improve on better traction in core fee income and drop in credit costs. Further, better loan growth, lower cost-to-income ratio and margin expansion will drive its RoA, which is expected to improve from 0.1% in FY19 to 0.9% in FY21E.

Improved outlook for FY20-21E

Resolutions in NCLT accounts, lower residual stressed assets and enhanced income recognition and provision write-backs will likely drive SBI's revenues and profits. We forecast the bank to report earnings CAGR of 59% over FY19-21E. SBI is also engaged in several efficiency enhancing initiatives which should drive lower cost ratios in the medium term.

Visibility on NPA resolution

SBI's asset quality is expected to improve with lower stress asset formation over FY20-21E. Its proportion of performing loans will likely reduce interest reversals going ahead. We expect recoveries from big accounts like Essar Steel, Bhushan Steel and Alok Industries totaling to ₹16,000cr along with recoveries of around ₹17,000cr from other NPA accounts to aid improvement in asset quality. We estimate SBI's gross NPA to decline from 7.4% in FY19 to 4.4% in FY21E.

Change in business mix and better asset quality to drive NIMs

SBI's focus towards increasing retail loans, stable CASA ratio, redeployment of balance sheet liquidity into loans and improving asset quality will help drive its NIMs. It has largest cheap deposit base compared to peers, which should boost NIMs. Further, increase in loan/deposit ratio as loan demand revives will aid margins. We estimate ~40bps NIM expansion to 3.3% over FY19-21E.

Valuations attractive

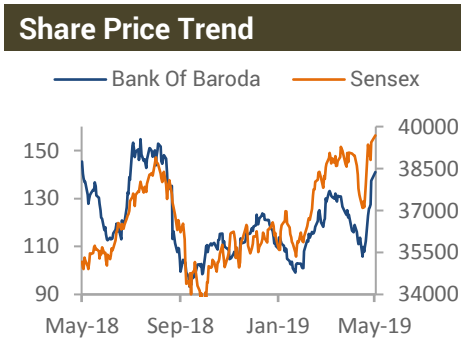
SBI's RoA will improve owing to domestic loan book growth, lowering stress asset formation, decline in slippages & credit cost and improvement in return ratios. Further, low cost deposit profile and better income recognition will drive NIM. The stock is trading attractively at 1.1x FY21E P/BV. The bank's core operating performance is expected to improve over FY20-21E and recovery in IBC cases will drive RoA. We expect core RoA of 0.9% and RoE in the range of 13-14% by FY21E.

Sector	Bank
Recommendation	BUY
Upside	21%

Stock Data	
Sensex	39,657
52 Week h/l (₹)	157.5 / 91
Market cap (₹ Cr)	48,367
BSE code	532134
NSE code	BANKBARODA
FV (₹)	2.0
Div yield (%)	0.0%

Shareholding Pattern			
	Dec-18	Mar-19	Apr-19
Promoters	63.7	63.3	65.4
DII+FII	27.5	28.0	25.6
Individuals	8.8	8.8	9.1

Source: www.bseindia.com



Prices as on 30/05/2019

Symmetrical Triangle Pattern breakout

Bank of Baroda (BoB) has been consolidating in a structured manner for the past 8-months. The stock has been coiling like a spring as the trading range has got narrower over the past 3-months. BoB made an attempt to break out of the consolidation zone in April 2019 but failed to surpass the declining resistance trend line. However, after going through another month of oscillation, the stock has finally exploded out from the long drawn Symmetrical Triangle pattern.

Re-conquering of 200DMA leads to Golden Crossover

Bank of Baroda, in the recent past, has managed to close convincingly above its short and medium term moving averages of 50-DMA and 100-DMA respectively. The Symmetrical Triangle breakout has further led the stock price to surpass its long term 200-DMA. Additionally, the 50-DMA has surpassed the 200-DMA from below, producing a Golden Crossover, which indicates that the trend has reversed and is all set to move higher.

Based on the above evidence, the projection of the consolidation structure indicates a potential target of ₹170, translating into ~21% upside. The breakout would stand void if BoB cracks below the support of ₹115 on closing basis.

Weekly Chart



Source: IIFL Research

The merger of Dena Bank and Vijaya Bank with Bank of Baroda (BoB) is effective from April 01, 2019. The consolidated entity stands to benefit from merger synergies, lowering stress asset formation, improvement in margins, cross-selling opportunities, decline in slippages & credit cost and improvement in return ratios.

Asset quality set to improve

The bank's asset quality is set to improve over FY20-21E led by resolution of stress assets, stable residual stress, moderation in slippages and focus on recovery. With improving PCR and incremental slippages trending lower, we believe that the bank is in the last leg of the asset quality cycle, with credit costs normalising over the next 1-2 years. We expect the banks credit cost to decline from 2.7% in FY19 to 1% in FY21E. Further, on a consolidated basis provisions are likely to remain lower. Its net NPA for the consolidated entity is expected to decline to 2% by FY21E vs. 3.3% in FY19.

Focus on high yielding mix and better asset quality to drive NIMs

Rationalisation in the overseas book to lead to better domestic loan book mix which in turn will have positive impact on NIMs. In addition, lower interest reversal, focus on retail loans and higher credit/deposit ratio augur well for NIMs. Strong liability franchise and increasing contribution towards high yielding domestic loans to keep margins higher over the next couple of years. We expect the banks NIMs to improve by 30bps to 2.9% over FY19-21E.

Valuations attractive

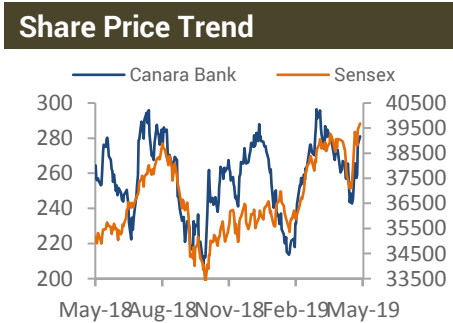
The NPA cycle for the bank has started reversing and would reduce the provisioning substantially in the coming years. Moreover, recognition of majority of stressed assets and focus on recovery to check credit cost. The bank's healthy operational performance led by business growth and cross-selling opportunities in addition to merger synergies to aid earnings for FY20E/21E. The stock is trading attractively at 0.60x FY21E P/BV.

Sector	Bank
Recommendation	BUY
Upside	20%

Stock Data	
Sensex	39,659
52 Week h/l (₹)	302 / 204.75
Market cap (₹ Cr)	20,812
BSE code	532483
NSE code	CANBK
FV (₹)	10
Div yield (%)	0.0%

Shareholding Pattern			
	Dec-18	Feb-19	Mar-19
Promoters	72.6	70.6	70.6
DII+FII	22.2	21.7	21.9
Individuals	5.2	7.7	7.5

Source: www.bseindia.com



Prices as on 30/05/2019

Resumption of higher top higher bottom

Canara Bank has been in a declining mode since October 2017. However, post hitting its 52-week lows of ₹204.75 in October 2018, the stock began to form higher lows. Our daily chart analysis indicates that the stock has also broken out from falling channel pattern accompanied with smart uptick in traded volumes. Notably, the ADX line is also hovering above the 30 mark which indicates that the stock is trending higher. Additionally, positive crossover on the DI+ and DI- lines further accentuate our bullish stance on the stock.

Golden Crossover

Our larger time frame analysis indicates that Canara Bank has also been forming a fresh base for the past 12-months. During this phase, the 50-DMA has surpassed the 200-DMA from below, producing a Golden Crossover, which indicates that the trend has reversed and is all set to move higher.

Based on the above evidence, the stock has the potential to reach ₹318 over the next 9-12 months, translating into 20% upside. The breakout will stand void if Canara Bank cracks below the support of ₹230 on weekly closing basis.

Monthly Chart



Source: IIFL Research

Canara Bank's lower incremental stressed asset formation, higher resolution of stressed assets, lower provisioning, improving growth appetite and enhanced revenue recognition will drive further profitability of the bank. Moreover, margin improvement and better non-interest income growth to support earnings. We expect RoA of the bank to improve from 0.1% in FY19 to 0.5% in FY21E.

Improved prospects for asset quality improvement

Bank's prospects for recovery have improved given that a fairly large portion of corporate NPLs are now undergoing resolution in the NCLT. The bank's focus on retail loans will also help in asset quality improvement; GNPA ratio has declined from 11.84% in FY18 to 8.83% in FY19. The bank is focusing on recoveries, through Insolvency and Bankruptcy Code route and its focus on increasing lending to better rated corporates will aid asset quality improvement over the medium term. We expect gross slippages to be contained to ₹8,000cr in FY20E (Rs15,400cr in FY19). Further, the management has guided that stressed loans addition to remain lower over next couple of years.

Focus towards retail loans and NIMs improvement to drive NII

Management continues its focus upon MSME, retail (higher margin retail loans) and agriculture. The retail asset to total assets ratio has improved from 55.4% in FY18 to 56.3% in FY19 and we expect it to improve to ~60% in FY21E. We project the bank's loan book to grow at ~14% CAGR over FY19-21E. The bank's focus towards retail assets, improving CASA & CD ratio and reduction in slippages to drive NIMs. We expect its overall NIMs to improve by ~30bps over FY19-21E to ~2.7%. We forecast its NII to register ~15% CAGR over FY19-21E.

Attractive Valuation

Canara Bank's improving asset quality, better NIM prospects and rising non-interest income bodes well for its profitability over FY19-21E. The earnings trajectory of Canara Bank is likely to trend higher over the next few years. The bank has recognised major part of its stressed assets as NPA, we expect normalcy in earnings. It holds 30% stake in Canfin Homes where the improving loan book and return ratios raises the prospects for further growth. The stock is trading attractively at 0.59x FY21E P/BV.

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%

Accumulate – Absolute return between 0% to +10%

Reduce – Absolute return between 0% to -10%

Sell – Absolute return below -10%

Please refer to <http://www.indiainfoline.com/research/disclaimer> for recommendation parameter, analyst disclaimer and other disclosures.

IIFL Securities Limited (Formerly 'India Infoline Limited'), CIN No.: **U99999MH1996PLC132983**, Corporate Office – IIFL Centre, Kamala City, Senapati Bapat Marg, Lower Parel, Mumbai – 400013 Tel: (91-22) 4249 9000. Fax: (91-22) 40609049, Regd. Office – IIFL House, Sun Infotech Park, Road No. 16V, Plot No. B-23, MIDC, Thane Industrial Area, Wagle Estate, Thane – 400604 Tel: (91-22) 25806650. Fax: (91-22) 25806654 E-mail: mail@indiainfoline.com Website: www.indiainfoline.com, Refer www.indiainfoline.com for detail of Associates.

Stock Broker SEBI Regn.: INZ000164132, PMS SEBI Regn. No. INP000002213, IA SEBI Regn. No. INA000000623, SEBI RA Regn.: INH000000248

For Research related queries, write at research@iifl.com

For Sales and Account related information, write to customer care: cs@iifl.com or call on 91-22 4007 1000