Sector Update

Scenario appears to have improved

Banking and NBFC

Q3FY2019 results preview

Eventful quarter, much has changed: The Q3 FY19 was an eventful quarter for the banking sector with some key developments/ trend reversals taking place which have had a significant impact on the financial services sector. Developments like 1) a steep ~65BPS intra quarter decline in bond yields, 2) NPA recoveries and resolutions continued (albeit at a lukewarm pace), 3) RBI's stance on interest rates (courtesy the lower inflation numbers) having softened to dovish and 4) peaking of corporate credit cycle with initial signs of credit demand pickup have all had a significant bearing on the BFSI sector and the players.

Private Banks – Positives better aligned in their favor: We believe that Private Banks (PB), especially large corporate lenders like ICICI Bank and Axis Bank should see improved scenario, where on one hand they themselves would see lesser NPA stress recognition (and thus lower provisions), they also will benefit from an improved credit outlook. The liquidity challenges, and the resultant pressures on most NBFCs will result in shift in pricing power back in favor of banks, and PBs stand to gain. Consequently, we expect their loan growth to improve sequentially (also as the busy season begins). The faster growing retail banks should continue to outperform the industry in terms of growth and maintain their profitability trend. Some banks which have had exposure to a beleaguered Infrastructure Finance conglomerate will likely see an overhang of account slippages, which may impact near term profitability. However, positive cues like a shift in borrowings profile (helped by the rate cycle, market volatility) and portfolio buy-outs from NBFCs are further cues that appear to favor Banks, especially private banks. The bond yields fall, will also result in MTM reversals/lower provisions which will help profitability.

PSU Banks – bond yields fall positive, asset stress still to be over: For the PSU Banks (PSB) the key positive development is the fall in bond yields. PSBs are well placed to gain from healthy treasury profits in Q3 FY19 as the yields on G-Secs have corrected by ~65 bps intra quarter, after peaking out in Sept 2018. Not only will this help banks in getting write-backs, mainly for the PSBs this is a relief as they were impacted by high NPA provisions as well as MTM provisions. A significant chunk of the MTM provision (if taken upfront and not availed of the RBI's dispensation) is expected to be reversed, aiding profitability. However, high NPA provisions are likely to continue to suppress the earnings for the PSBs and hence we believe that investor caution is warranted for most of the PSU Banks.

NBFCs – Structural challenges emerge: We believe that several structural changes and concerns have emerged for NBFCs. Though at the fag end of the quarter, liquidity and availability of funds scenario had improved, the sector had been under significant pressure at the beginning of the quarter. This is likely to take a toll on NBFCs' growth rates and profitability going forward. As per the developments, several NBFCs may need to tweak their borrowing profile in the near term, to be better aligned with respect to their asset profile which may impact their near to medium term growth outlook. NBFCs dealing with consumer durable loans, microfinance, CVs, etc are looking well-placed to maintain margins as they have a strong own balance sheet (or their parent firm has), which will help them access market funding more easily.

Outlook: While the "competitive populism" (and its offshoots of loan waivers etc) are near term risks, we believe that the long term secular reform driven trends are well in play. Improved formalization of the economy, encouraging penetration to the SME segment and revival in credit demand are some of the positive factors that are going to be long term growth drivers for the Banks and NBFCs. We believe that the corporate banks are likely to begin to show improvement in earnings and profitability, aided by lower provisions pressures / recoveries. Capital infusion and possible PCA framework exits are triggers for PSU Bank stocks, but we believe that a business case at present exists only with SBI and BOB (amongst PSU Banks). For NBFCs we believe that the quarter may result in slower growth, though some of the stronger NBFCs (with either balance sheet strength or strong parent) should be able to continue to maintain trend growth.

Valuations: The recent correction in the financial space provides opportunities but one needs to be selective and cautious. Though valuations of a few banks may appear cheap, one must also consider their growth outlook. We find retail focused and large corporate private banks attractive at present times.

Earnings Outperformers: HDFC Bank, ICICI Bank, Axis Bank, RBL Bank

Earnings Underperformers: PNB, Bank of India

Preferred picks: HDFC Bank, Axis Bank, ICICI Bank, RBL Bank

Q3FY2019 results estimates Rs cr

Particulars	Net interest income				Pre-provisioning profit				Profit after tax			
	Q3 FY19	Q3 FY18	YoY %	QoQ %	Q3 FY19	Q3 FY18	YoY %	QoQ %	Q3 FY19	Q3 FY18	YoY %	QoQ %
Public												
State Bank of India	22,774.2	18,688	21.9	8.9	14,801.3	11,755	25.9	6.4	1,727.2	-2,416	NA	82.8
Punjab National Bank	3,805.6	3,989	-4.6	-4.2	2,542.2	4,245	-40.1	-10.5	-509.7	230	NA	-88.8
Bank of Baroda	4,627.2	4,394	5.3	3.0	3,751.2	3,650	2.8	21.7	967.7	112	765.7	127.5
Bank of India	3,112.7	2,501	24.4	6.4	1,553.3	1,354	14.7	-5.7	-438.3	-2,341	NA	-62.1
Union Bank	2,747.4	2,548	7.8	10.2	1,768.9	1,655	6.9	-0.2	199.1	-1,250	NA	43.2
PSBs total	**37,067.1**	**32,120.2**	**15.4**	**6.5**	**24,416.9**	**22,659.2**	**7.8**	**5.0**	**1,946.1**	**-5,665.2**	**NA**	**NA**
Private												
ICICI Bank	6,761.2	5,705	18.5	5.4	5,699.9	5,058	12.7	8.6	1,950.1	1,650	18.2	114.6
HDFC Bank	12,421.4	10,314	20.4	5.6	10,116.9	8,451	19.7	6.7	5,439.9	4,642	17.2	8.7
Axis Bank	5,664.0	4,732	19.7	8.3	4,623.7	3,854	20.0	12.9	1,326.0	726	82.5	67.9
Federal Bank	1,053.5	950	10.9	3.0	689.7	561	22.8	-1.1	296.6	260	14.1	11.5
Yes Bank	2,676.7	1,889	41.7	10.7	2,660.1	2,002	32.9	12.4	1,228.1	1,077	14.0	27.3
Private banks total	**28,576.7**	**23,590**	**21.1**	**6.4**	**23,790.3**	**19,926**	**19.4**	**8.7**	**10,240.7**	**8,356**	**22.6**	**29.1**
Grand total	**65,643.8**	**55,710**	**17.8**	**6.5**	**48,207.3**	**42,585**	**13.2**	**6.8**	**12,186.9**	**2,691**	**352.9**	**224.5**
Soft Coverage												
IndusInd Bank	2,420.1	1,894.8	27.7	9.8	2,120.2	1,665	27.4	6.4	1,028.5	936	9.9	11.8
RBL Bank	626.4	467	34.1	5.6	500.1	333	50.0	11.4	234.8	165	42.0	14.8
L&T Finance Holding	1,625.5	1,270.6	27.9	1.8	1,210.0	941	28.6	11.0	581	384	51.3	3.9
Kotak Mahindra Bank	2,820.2	2,394	17.8	4.9	2,228.8	1,820	22.5	6.4	1,252.9	1,053	19.0	9.7
Can Fin Homes	164.7	142.6	15.5	21.5	142.3	122.3	16.4	21.3	87.5	75.1	16.5	13.1
PNB Housing Finance	463.3	369.1	25.5	0.1	440.3	351.6	25.2	0.7	253.5	190.1	33.4	0.2
NBFCs												
HDFC	2,736.8	2,919	-6.3	4.1	3,008.3	8,230	-63.4	-22.7	2,113.0	5,740	-63.2	-14.4
LIC Housing Finance	1,037.4	963	7.7	2.0	982.5	865	13.6	2.0	591	514	15.0	3.1
Capital First	0.0	0	-	-	0.0	0	-	-	0	0	-	-
Bajaj Finance	2,691.2	2,370	13.6	2.8	1,833.7	1,422	29.0	3.6	957	766	24.9	3.9
PTC India Fin. Ser.	116.4	114	2.0	4.9	106.4	123	-13.2	6.0	53.7	34	56.8	8.1
NBFCs Total	**6,465.3**	**6,252.5**	**3.4**	**3.2**	**5,824.5**	**10,517.0**	**-44.6**	**-12.1**	**3,660.7**	**7,020.3**	**-47.9**	**-7.6**

Valuation

Banks	Reco.	Price target (Rs)	RoA (%)			RoE (%)			P/BV(x)		
			FY18	FY19	FY20	FY18	FY19	FY20	FY18	FY19	FY20
Public											
State Bank of India	Buy	365	0.9	0.8	0.7	12.9	12.4	10.5	1.4	1.3	1.2
Punjab National Bank	Hold	UR	-1.8	0.2	0.3	-32.1	3.9	9.4	0.6	0.6	0.6
Bank of Baroda	Buy	140	-0.3	0.5	0.6	-5.8	8.1	9.9	0.8	0.8	0.7
Bank of India	Reduce	UR	-0.4	0.0	0.2	-8.5	0.7	5.0	0.5	0.4	0.4
Union Bank	Reduce	UR	-1.1	0.1	0.1	-21.4	2.2	2.5	0.5	0.3	0.3
PSBs total / avg.			**-0.6**	**0.3**	**0.4**	**-11.0**	**5.5**	**7.5**	**0.76**	**0.69**	**0.64**
Soft Coverage											
IndusInd Bank	Positive		1.6	1.7	1.8	16.2	17.3	18.9	4.0	3.4	3.4
RBL Bank	Positive		1.3	1.1	1.0	13.4	12.1	13.3	3.5	3.2	3.2
L&T Finance Holding	Neutral		1.6	2.0	2.2	13.3	17.6	19.6	2.6	2.3	2.3
Kotak Mahindra Bank	Positive		1.7	1.7	1.7	12.5	12.2	12.8	6.2	5.5	4.9
PNB Housing Finance	Neutral		1.4	1.4	1.3	13.4	15.7	18.2	2.4	2.1	1.8
Private											
ICICI Bank	Buy	410	0.8	0.7	0.9	6.7	6.9	9.3	2.5	2.2	2.1
HDFC Bank	Buy	2,470	1.8	1.8	1.9	17.9	18.7	19.9	5.1	4.6	4.0
Axis Bank	Buy	720	0.0	0.4	0.5	0.5	4.7	5.4	2.6	2.5	2.4
Federal Bank	Buy	UR	0.7	0.8	0.9	8.2	10.1	12.3	1.5	1.4	1.3
Yes Bank	Hold	225	1.7	1.6	1.6	17.7	19.0	21.1	1.7	1.5	1.3
Private banks total / avg.			**1.0**	**1.1**	**1.2**	**10.2**	**11.9**	**13.6**	**2.7**	**2.5**	**2.2**
Grand total / avg.			**0.2**	**0.7**	**0.8**	**-0.4**	**8.7**	**10.5**	**1.7**	**1.6**	**1.4**
NBFCs											
HDFC Ltd	Buy	2,200	3.0	2.4	2.4	23.9	16.3	16.9	5.2	4.7	4.2
LIC Housing Finance	Hold	440	1.6	1.5	1.4	16.7	16.2	16.5	1.6	1.4	1.4
Bajaj Finance	Buy	2,450	3.3	3.5	3.6	19.7	19.9	22.7	8.4	7.0	5.8
PTC India Fin. Ser.	Hold	20	1.6	1.2	1.1	7.8	7.1	7.6	0.4	0.4	0.4
NBFC's Total/Avg			**2.2**	**2.0**	**2.1**	**16.3**	**14.8**	**16.2**	**3.5**	**3.0**	**2.6**

Key expectations in Q3FY2019 results

Axis Bank: Fresh slippage rate to come down, most of the addition largely from stressed segment. Elevated Credit cost but to moderate sequentially, Loan growth will be better than industry average

Bajaj Finance: We expect a strong performance from Bajaj Finance to continue, Healthy growth in loan book and higher growth in earnings look highly likely

Bank of India: Sluggish business growth to remain as the bank is under PCA, not much improvement in asset quality expected

Bank of Baroda: Domestic loan growth to be above industry average, margins are expected to improve as NPA additions are expected to decline

Federal Bank: Kerala floods are expected to impact negatively, retail and SME asset quality to be key monitorable

HDFC Bank: Steady performance as usual expected on overall basis

HDFC Ltd: Amongst the better placed NBFCs to wither margin and competitive pressures, highly rated company hence impact of rising borrowing costs would be lesser.

ICICI Bank: Incremental slippage to be lower, drilldown list is expected to form most of the NPA additions. NIMs sequentially could improve as lower base, retail loan growth to help

IndusInd Bank: While loan growth momentum to sustain, while high yielding consumer finance and CV segment is expected to drive growth. Overhang on margins due to exposure to a large infrastructure conglomerate which may slip during the quarter

Kotak Mahindra Bank: margins and asset quality is expected to be stable, loan growth likely to show higher momentum. Subsidiaries performance would contribute meaningfully

L&T Finance Holdings: We expect business momentum to continue to be strong across rural and housing. Return ratios are expected to remain is guided range

LIC Housing Finance: Loan growth momentum would be reasonable with steady levels of asset quality.

Punjab National Bank: This quarter is also expected to be marred by high credit cost but treasury profits should help. Loan growth should remain below industry average. Recoveries during the quarter would be key to watch

PNB Housing Finance: Housing Finance companies including PNB Housing is expected to witness margin pressure on account of higher borrowing costs and competitive environment however in non-salaried segment some cost pressures can be negated by higher yields

RBL Bank: Expect robust loan growth momentum with steady asset quality performance.

State Bank of India: We expect domestic loan growth to improve driven by retail loans and some corporate lending. International book expected to decline. Incremental stress is likely to be contained & slippages anticipated to be lower sequentially

Union Bank of India: Weak loan growth (below industry) due to capital constrains. Slippages from corporate segment to watch for. Treasury profits can help PAT

Yes Bank: Loan growth to remain healthy with largely stable asset quality. Outlook on succession plan and capital raising plans would be key to watch

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