KRChoksey | Institutional

Q2 FY20 Banking & NBFCs Preview

9th October, 2019

Banking & Financial Services

Managing growth in a low rate cycle environment

MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty	11,126	(0.4%)	1.6%	2.4%
Sensex	37,532	(0.4%)	1.5%	4.1%
Bank Nifty	27,768	0.1%	1.9%	2.2%
USD / INR	71.0	(0.2%)	1.0%	(1.8%)

COVERAGE STOCKS

Company	Current Price (INR)	Target Price (INR)	Upside (%)	Market Cap. (INR mn)	Fwd P/ABV 2020E	Rating
HDFC Bank	1,187	1,342*	13.1%	6,493,293	3.92	BUY
ICICI Bank	416	500	20.2%	2,687,091	2.24	BUY
Axis Bank	673	770	14.3%	1,898,456	2.38	ACCUMULATE
IndusInd Bank	1,241	1,861	50.0%	748,506	2.42	BUY
SBI	249	335	34.5%	2,223,121	0.96	ACCUMULATE
Kotak Bank	1,556	1,620	4.1%	2,970,980	3.35	ACCUMULATE
Karur Vysya Bank	57	73	27.4%	45,792	0.66	ACCUMULATE

Note: Target price and Recommendation has been retained from previous update reports, unless explicitly mentioned; we will review it post detailed Q2 FY20 results analysis and conference call of the said companies ; Source: Bloomberg, Data as of October 8, 2019

** TP adjusted for stock split 1:2*

SECTOR OVERVIEW – Banking

- **Monetary policy support to revive credit growth, RBI slashes repo rates by 25 bps to 5.15%:** RBI took a fourth rate cut in FY20 in its bi-monthly Monetary Policy Committee (MPC) meeting, largely on market expected lines, following a global trend in central bank policies to bring in excess liquidity and revive higher lending activity. Key highlights of MPC meeting include: 1\ Repo rate cut by 25 basis points to 5.15% from 5.40%; 2\ Reverse repo rate adjusted to 4.90% ; 3\ Marginal standing facility and Bank rate to 5.40% ; 4\ Cash Reserve Ratio (CRR) was kept unchanged at 4% ; 5\ RBI also cut down the FY20 yoy real GDP forecast from 6.9% to 6.1%; 6\ Inflation (CPI) targeted to remain below 4% for the rest of FY20. Overall, we see the cost of funds (CoF) of banks to ease as a direct result of the repo rate cut. However, the interest margin on lending will come under stress as an adverse effect as banks are now mandatorily forced to link lending rates with MCLR /repo rates/benchmark interest rates, while the impact will be mostly felt in 3Q FY20 results onward.

- **Macro slowdown especially in the corporate lending segment to impact Q2 FY20 results:** Amid a weak GDP growth outlook in FY20, banks under our coverage are expected to report a consolidated lending growth of 3.4% qoq (+13.5% yoy) in Q2 FY20. The credit growth will be higher for the banks focused on retail loans (+20-25% yoy) and SME loans (13-20% yoy) while corporate loan growth remains modest (~10% yoy) on an average. Despite a weak macroeconomic backdrop, we continue to see banks with strong retail franchisee and digital presence to drive its loan book growth in double digits on a yoy basis. The month-on-month increase in the auto sales numbers for the month of Sep 2019 has helped improve sentiment in the auto industry. Auto players are offering heavy discounts, upgraded variants with BS VI norms preparing ahead of the upcoming festive season which should translate to vehicle financing growth. Deposit mobilization (+13% yoy) will remain at a steady pace but CASA share is expected to decline as banks are increasingly focusing on channelizing retail Term Deposits (meaning higher CoF). Overall, the L/D ratio is expected to be almost flat qoq at around 80% level (coverage banking stocks) in Q2 FY20 and stand at 89.5% level excluding SBI for banks under coverage in Q2 FY20.

- **Moderate NIM expansion expected; Asset quality risks could resurface:** Asset yields and cost of funds remain under check in the declining rate cycle environment. We expect, past RBI rate cuts to translate in lower asset yields/ CoF in Q2 FY20 which will impact margins as banks follow RBI suit of aligning lending rates with benchmark repo rates. The average NIM of banks under coverage are expected to improve by around 8bps q/q (20 bps yoy). Yields on interest earning assets is forecast to expand 14bps qoq (36 bps yoy). Overall, NII is forecast to improve 2.2% qoq (+15.8% yoy) with IndusInd and Kotak expected to outpace peers. On the asset quality front, distressed situation in MSME accounts and sectors such as Real Estate (HDIL), HFCs (IndiaBulls Housing Finance) and Travel companies – Cox & Kings / Thomas Cook; indicate a fresh round of slippages could emerge in Q2FY20 in select counters focused on corporate lending leading to elevated credit costs. On the C/I front, we expect bank's costs base to broadly remain steady with C/I forecast to range ~45% levels in Q2 FY20. Overall, PPOP is forecast to grow marginally by 1.8% qoq (20.1% yoy) , while PAT should see benefits of tax savings get offset by higher provisioning. Overall, PAT for banks under coverage is forecast to decline by 1.8% qoq (+40.5% yoy, low base effect).

- **Private sector banks continue to remain attractive on the valuation front:** Amid PSU bank consolidation (of 10 PSBs merging into 4 large PSB) and recapitalization efforts (INR 70,000 Cr recapitalization announced during the Union Budget), we continue to see private sector banks (in our coverage) to be the key beneficiaries of a systemic slowdown among the PSU banks (business integration risks, lending growth slowdown, elevated asset quality risks and recapitalization challenges) and the crisis hit NBFC sector (liquidity tightening and slowdown in lending). At an average 2020E P/B of 2.5x, the banking sector (under coverage) is trading at 5% premium to its past 5-year historical average of 2.2x. **In our view, stock specific valuation premium will continue for Kotak Bank (47% premium to sector), HDFC Bank (+72% over sector) while ICICI Bank has the potential for an update re-rating. On back of their industry leading ROEs, sound asset quality metrics and strong growth outlook, Kotak Bank, HDFC Bank and ICICI Bank are our top picks in the sector.**

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Exhibit 1: Quarterly result expectation for companies under coverage

Bank	Q2FY20E	Q1FY20	QoQ	Q2FY19	YoY	Remarks
HDFC Bank (in Cr)						
NII	13,398	13,294	0.8%	11,763	13.9%	HDFC Bank remains the top performer with a strong focus on retail portfolio of personal and credit card loans, expected to grow 25% yoy while the overall lending growth is expected to moderate to ~16% yoy (flat qoq) in Q2FY20. Lending growth along NIM expansion should will support PPOP growth of +18% YoY (stable sequentially). GNPA levels will remain below 1.4% and is expected to sustain at these levels in the near term.
PPOP	11,159	11,147	0.1%	9,480	17.7%	
PAT	5,466	5,568	-1.8%	5,006	9.2%	
Advances	870,228	829,730	4.9%	750,838	15.9%	
Deposits	999,069	954,554	4.7%	833,364	19.9%	
ICICI Bank (in Cr)						
NII	7,792	7,737	0.7%	6,418	21.4%	ICICI Bank's NII in Q2 FY20 is expected to be almost flat qoq (+21% yoy) impacted by a slowdown in lending (+13% yoy). Personal loans and credit card business segment will continue to remain the key growth drivers. NIM is expected to fall by 5-10 bps as banks calibrate their lending rates with benchmark. Increased cost of funds and contracting NIM is expected to put overall PPOP growth under stress (flat qoq) while PAT should see benefit of easing provisions and low base effect.
PPOP	6,287	6,288	0.0%	5,250	19.8%	
PAT	2,237	1,908	17.2%	909	146.1%	
Advances	616,131	592,415	4.0%	544,487	13.2%	
Deposits	688,509	660,732	4.2%	558,669	23.2%	
Axis Bank (in Cr)						
NII	6,207	5,844	6.2%	5,232	18.6%	Axis Bank's Q2 FY20 NII is expected to increase 6.2% qoq (+18.6% yoy) with better growth in the retail advances and credit cards through partnering with online retailers. Overall, we expect advances to increase 12.2% yoy/2.9% qoq. Higher focus on Retail term deposits should support deposit mobilisation while keeping CoF elevated. Robust fee income should support PPOP growth of 48% yoy/2.9% qoq. Asset quality is expected show improvement from FY19 levels with NPAs range of ~5% while the outlook on the stress pool will be a key factor to watch out for.
PPOP	6,061	5,893	2.9%	4,094	48.0%	
PAT	1,643	1,370	19.9%	790	108.0%	
Advances	511,566	497,276	2.9%	456,121	12.2%	
Deposits	556,175	540,678	2.9%	479,680	15.9%	
IndusInd Bank (in Cr)						
NII	3,161	2,844	11.1%	2,203	43.4%	IndusInd Bank will be reporting the consolidated revenue from the inclusion of Bharat Financial (Micro finance business) from this quarter. The renewed focus towards Micro lending and SME's, especially in the southern region of India will fuel the next stage of growth for the bank. NIM is forecast to improve to ~4.5% on back of lower wholesale deposit rates and high share of fixed rate loan book (~40% of loans) while C/I ratio should see benefits of the merger/synergies with Bharat Financial.
PPOP	2,888	2,591	11.5%	1,992	44.9%	
PAT	1,476	1,433	3.0%	920	60.4%	
Advances	204,622	193,520	5.7%	163,144	25.4%	
Deposits	212,517	200,586	5.9%	168,219	26.3%	
SBI (in Cr)						
NII	23,124	22,939	0.8%	20,906	10.6%	Macro economic slowdown is expected to overall hit SBI, especially its corporate lending side (loan book growth of ~11.7% yoy) while consumer lending growth is expected to stem from the tier 2 & 3 cities. NII is expected to be almost flat qoq/+10.6%yoy while deposit growth will remain muted. Housing loans will keep driving the business while we see a slow improvement in asset quality and big-ticket recoveries are yet to come.
PPOP	13,407	13,246	1.2%	12,344	8.6%	
PAT	1,338	2,312	-42.1%	945	41.7%	
Advances	2,186,251	2,134,774	2.4%	1,957,340	11.7%	
Deposits	3,009,693	2,948,821	2.1%	2,807,420	7.2%	
Kotak Bank (in Cr)						
NII	3,326	3,173	4.8%	2,689	23.7%	Kotak Mahindra Bank is expected to report NII growth of 4.8% qoq/24% yoy. Loan book is expected to improve 5% qoq/18% yoy and deposit mobilization will remain robust growing at 4% qoq/18% yoy. GNPA levels would remain at around slightly above 2% levels. The contribution from subsidiaries such as Life & General Insurance business should make a meaningful contribution to consolidated PAT numbers.
PPOP	2,488	2,399	3.7%	2,095	18.8%	
PAT	1,511	1,360	11.1%	1,142	32.3%	
Advances	218,633	208,030	5.1%	184,940	18.2%	
Deposits	241,803	232,931	3.8%	205,830	17.5%	
Karur Vysya Bank (in Cr)						
NII	625	584	7.1%	579	7.9%	Karur Vysya bank is expected to remain a laggard in terms of performance compared to other private sector banks. Loan book is expected to grow by 1.7% qoq/7.6% yoy in Q2 FY20 while deposit mobilization is expected to grow in single digits. CoF should continue to remain elevated at 5.7% while NIM is expected to remain broadly flat qoq. Asset quality concerns continue to resurface with GNPA expected to remain levels north of 9%.
PPOP	483	445	8.4%	361	33.6%	
PAT	93	73	27.0%	84	10.6%	
Advances	50,021	49,182	1.7%	46,480	7.6%	
Deposits	62,910	61,711	1.9%	58,262	8.0%	

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Shielded away from the NBFC issues

Company	Current Price (INR)	Target Price (INR)	Upside (%)	Market Cap. (INR mn)	Fwd P/ABV 2020E	Rating
Bajaj Finance Limited	3,901	3,808	-2.4%	22,62,132	9.45	BUY
Bajaj Finserv Limited	8,220	8,262	0.5%	13,07,802	2.90	BUY
Cholamandalam Investment & Finance Co. (CIFC)	291	308	6.0%	2,27,113	2.55	BUY
HDFC AMC	2,692	1,861	-30.9%	693	15.18	UR

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SECTOR OVERVIEW: Non- Banking companies

- **Measures to address NBFC crisis a long term positive:** The Finance Ministry announced of additional INR 20,000 Cr over the earlier allocated INR 10,000 Cr to be injected into the National Housing Bank (NHB) which will further extend additional INR 30,000 Cr of credit lines for the Housing Finance Companies (HFCs) along with the Partial Credit Guarantee Scheme for purchase of pooled assets of NBFCs up to INR 1 lakh Cr during Q2 FY20. Furthermore, in its recent MPC meet, RBI has also announced a higher limit for NBFC MFI (microfinance institutions) per customer from 1lakh to 1.25 lakh for rural areas and from 1.6 lakhs to 2 lakhs for urban and semi-urban areas. Overall, we see these measures as long term positive and help improve disbursements.
- **Premium valuation to continue for stocks under coverage:** While the NBFC sector is currently in a depressed valuation scenario, stocks under our coverage will see limited impact on their businesses. Consumer lending business of Bajaj Finance, Insurance operations under Finserve and Asset management operations of HDFC AMC are all relatively stable and well shielded from the ongoing liquidity issues and the HFC crisis. Both Bajaj Finance and Bajaj Finserv will continue to enjoy the rich valuations on their aggressive consumer lending business growth, whereas, Cholamandalam Investment & Finance is expected to benefit from growth in vehicle finance segment, with double digit growth in used-vehicle financing supported by an improving auto sales numbers (MoM) for the month of September. Among the non-banks, Bajaj Finserv and Bajaj Finance are expected to maintain healthy returns and remain our top picks.

Exhibit 2: Quarterly result expectation for companies under coverage

Non-Banking	Q2FY20E	Q1FY20	QoQ	Q2FY19	YoY	Remarks
Bajaj Finance (in Cr)						
NII	3,897	3,695	5.5%	2,729	42.8%	Bajaj Finance Limited will keep on performing at the tremendous growth it has shown over the last few years. The company's business which will see some fall in growth in the consumer finance business will be exploring new avenues of growth in the rural segment. We expect NII growth of 5.5% qoq/42.8% yoy.
PPOP	2,536	1,851	37.0%	1,749	45.0%	
PAT	1,640	1,195	37.20%	923	77.6%	
Bajaj Finserv (in Cr)						
Total Income	12,602	12,272	2.7%	9,698	29.9%	The business growth will come in Bajaj Finserv from its primary subsidiary Bajaj Finance, fuelled by robust performance in consumer lending business. The HoldCo's General insurance subsidiary is expected to make larger contribution in Q2FY20, on back of robust growth (GWP non-life: +21% yoy QTD till August) while Life business saw a muted performance in New Business activities (Life insurance: flat yoy QTD till August). Income growth is expected to be 2.7% QoQ/30% YoY hit marginally as lower rates which will put stress on the overall margin/investment income.
PBT	2,699	2,255	19.7%	1,810	49.1%	
PAT	1,817	1,454	25.0%	1,191	52.6%	
Cholamandalam Investment & Finance Company (in Cr)						
NII	812	824	-1.5%	730	11.2%	CIFC's business which is driven by vehicle financing business (three-fourth of revenue), is expected to see benefit from the monthly improvement in auto sales numbers for the month of Sept 2019 on a month-on-month basis. Significant rise in second sale/old vehicles should help overall growth in financing for CIFC (+25% yoy). Competition is expected to remain intense following the repo rate cut as the larger bank's decrease their lending rates in order to align with benchmark rates as per RBI norms. This will put stress on the bottom line of the company for the current quarter.
PPOP	569	593	-3.9%	521	9.3%	
PAT	304	314	-3.3%	305	-0.3%	
Advances	58,292	55,339	5.3%	46,752	24.7%	
Borrowings	56,599	55,122	2.7%	46,638	21.4%	
HDFC AMC (in Cr)						
Revenue	531	504	5.2%	480	10.4%	We expect revenue to grow by 10.4% yoy/5.2% qoq while EBITDA is forecast to increase by 51.4% yoy/1.6% qoq. YoY results will see the benefits of lower fees and commission being expensed (in adherence to SEBI guidelines w.e.f. October 2018) which should flow into net profit as well, expected to grow at 57.0% yoy/10.8% qoq. Key parameters for 2QFY20 include market share of AUM, AUM mix and share in SIP , impact of Corporate tax rate cut impact, and distribution channel mix.
EBITDA	402	396	1.6%	265	51.4%	
Net Profit	323	292	10.8%	206	57.0%	
NPM	60.9%	57.9%	309 bps	42.9%	1,808 bps	
AUM	3,67,401	3,56,700	3.0%	2,92,600	25.6%	

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Rating Legend (Expected over a 12-month period)	
Our Rating	**Upside**
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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