June 27, 2022

Improving traction in loans to aid valuations…

Amidst concerns pertaining to global inflation, broader markets have remained soft but banking indices have outperformed against the overall market (the Bank Nifty registered a fall of 3.5% whereas the Nifty fell 7.2% in the past six months). This was mainly on account of improving loan book trajectory, improved asset quality and better earning trajectory. We expect normalisation of business activities, as challenges due to pandemic have taken a backseat.

Credit offtake was led by the retail and MSME segments while corporate segment is showing green shoots of revival as working capital limits are getting utilised. Latest RBI data suggests rising capacity utilisation, which has crossed long term average of ~71% indicating that capex related loan requirements could follow soon. Bank credit growth is expected to pick up further as the impact of pandemic led disruptions recede, demand improves further, ECLGS scheme gets extended, etc.

Exits FY22 on high!

The banking sector exited FY22 with credit growth of 9.7% YoY. Latest data for June suggests growth has reached the ~12% mark indicating healthy demand for credit. During Q4FY22, our coverage universe NII was up at a healthy pace of 17% YoY but other income was down 19% YoY due to lower treasury income on the back of rising interest rates. Faster growth in topline compared to opex led to fall in C/I ratio sequentially. Credit cost declined YoY due to better asset quality performance. However, sequentially it was slightly up by ~8% as a few large banks took additional provisions. PAT, thus was up over 85% YoY. GNPA ratio was down 10-70 bps with the average drop being ~40 bps while R/S book also declined ~ 25 bps QoQ. Overall, Q4FY22 saw healthy business momentum as seen in the previous quarter along with better show on the asset quality front. HDFC Bank outperformed its comparable peers on the growth front.

Outlook

Interest rates are set to rise as RBI has hiked the repo rate by 90 bps cumulatively in its last two monetary policy meetings and also has withdrawn its accommodative stance. Banks in the near term may benefit on the margin front as most loans are on a floating rate basis while higher deposit cost may come with some lag. However, with CD ratio coming closer, this time deposit rates are also moving fast on the upside. Treasury income would be impacted (especially for PSU banks) but better margins, higher fee income due to increased business should largely make up for the same. With meaningful reduction in credit cost, bottomline is set to improve for most lenders. Hence, it would reflect positively on return ratios. This, in turn, should aid valuations. On a medium term basis, about two to three years, Bank Nifty has underperformed due to concerns over asset quality and credit growth. However, now with these concerns fading away, improvement in valuations can be seen going ahead. Further, recent market correction provides opportunity to enter quality stocks in the BFSI space.

We prefer lenders with healthy CASA base, higher floating rate asset, adequate PCR and capital. Thus, we pick Axis Bank and HDFC Bank from the private space from our coverage universe while from PSU segment we prefer State Bank of India as bottoming of NPA and business growth would aid earnings trajectory and, thus, return ratios ahead. Collaborative structure of neo banks could assist traditional banks to showcase and widen their offerings mostly towards untapped segment.

Sector View: Positive

Top Picks in BFSI space

Company	CMP (₹ /share)	Target Price	Upside (%)
Axis Bank	634	900	42%
State Bank of India	462	605	31%
HDFC Bank	1362	1650	21%

Key growth drivers

- NPAs have largely bottomed out for banks with a trend expected to continue going ahead
- Excess provision buffer, decline in stress to keep credit cost in check
- Revival in economy, rise in capex, retail credit push, etc. to drive overall bank credit growth

Key risks to our call

- Resurgence of pandemic may slow down growth
- Raising rate cycle may act as near term deterrent

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Top bets in BFSI Coverage Universe

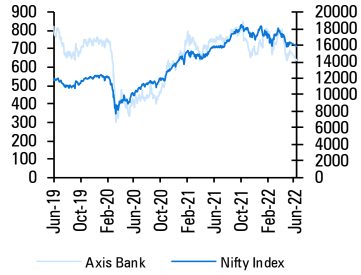
Axis Bank (AXIBAN)

Axis Bank is the third largest private sector bank in India with a balance sheet size of ₹ 11.7 lakh crore as on March 2022. The bank's key focus segments are wholesale (mid-corporate) and retail. Strong capitalisation (CRAR at 18.5%, Tier-1 at 16.3%) should support future growth.

- The shift from investments to advances is likely to improve margins, going ahead. Axis Bank has cumulative provisions of 132% of GNPA, which provides comfort on earnings trajectory. Also, Citi acquisition will give a competitive advantage by gaining market share and improve return profile of the bank.

Axis Bank's share price has corrected in the past one year (by ~15%). We believe its healthy capitalisation and provision buffer would aid smooth earnings traction. We have a **BUY** rating on the stock and value Axis Bank at ~2.1x FY24E ABV to arrive at a target price of ₹ 900.

Price Chart



Particulars

Particulars	Amount
Market Capitalisation	₹195492 crore
52 week H/L	866 /618
Net worth	₹ 115025 crore
Face value	₹ 2

Exhibit 1: Financial summary for Axis Bank

₹ crore	FY19	FY20	FY21	FY22	3 year CAGR	FY23E	FY24E	2 year CAGR
NII	21708	25206	29239	33132	15%	39323	47228	19%
PPP	19005	23438	25702	24742	9%	31570	38454	25%
PAT	4677	1627	6588	13025	41%	16152	19524	22%
ABV (₹)	215.4	267.9	308.8	350.0		396.8	416.7	
P/E	35.1	110.5	29.6	15.0		12.1	10.0	
P/ABV	3.0	2.4	2.1	1.8		1.6	1.5	
RoA	0.6	0.2	0.7	1.2		1.4	1.5	
RoE	7.2	2.1	7.1	12.0		13.3	14.8	

Source: Company, ICICI Direct Research

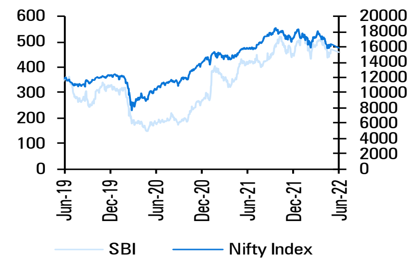
State Bank of India (STABAN)

SBI is the largest bank in India with a balance sheet size of over ~ ₹ 54 lakh crore (as of March 2022). It has a healthy retail portfolio and best operating metrics among PSU banks. Its strong subsidiaries add value to the bank.

- We believe overall strength in lending franchise and liability growth >9% guidance along with a well provisioned book remain positive. Prudent asset quality (GNPA at 3.97% and r/s at 1.1%) coupled with healthy provision coverage (~75%) provides comfort on earnings trajectory. Unlocking of subsidiaries holds upside potential.

SBI's share price has increased by ~8% in the past one year. Improving return ratios with RoE touching 12-13% and RoA reaching 0.7-0.8%, offer long term visibility for the stock. We maintain our **BUY** rating on the stock and value standalone bank at ~1.1x FY24E ABV and subsidiaries at ₹ 186 per share with a target price of ₹ 605.

Price Chart



Particulars

Particulars	Amount
Market Capitalisation	₹ 410844 Crore
52 week H/L	549/401
Networth	₹ 280088 Crore
Face value	₹ 1

Exhibit 2: Financial summary for SBI

₹ Bn	FY19	FY20	FY21	FY22	3 Year CAGR	FY23E	FY24E	2 Year CAGR
NII	883	981	1107	1207	11%	1429	1638	16%
PPP	539	681	716	679	8%	844	1003	22%
PAT	9	145	204	317	232%	358	421	15%
ABV (₹)	174.0	203.2	243.3	282.6		326.9	376.2	
P/E	489	28	20	13		11	10	
P/ABV	2.6	2.3	1.9	1.6		1.4	1.2	
RoA	0.0	0.4	0.5	0.7		0.7	0.7	
RoE	0.5	6.4	8.4	11.9		12.0	12.6	

Source: Company, ICICI Direct Research

Top bets in BFSI Coverage Universe

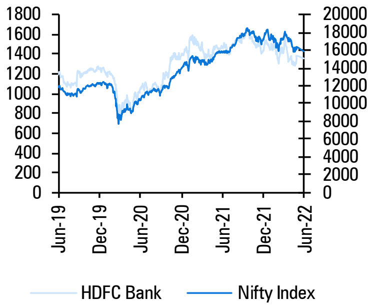
HDFC Bank (HDFBAN)

HDFC Bank is the largest private sector bank with loan book of ₹ 13.7 lakh crore as of March 2022. The bank has maintained superior return ratios compared to its peers resulting in premium valuations.

- The bank's focus is on improving mix towards MSME that should offset lending to better rated borrowers and rising corporate share keeping margin in a tight band. Building up of physical/digital infra to drive growth though merger related clarification to precede fundamentals in the near term. Moderation seen in retail growth momentum expected to revive with focus on tech and de-bottling of supply side issues.

HDFC Bank's share price has corrected in the past one year (by ~10%), which provides a good entry opportunity considering the kind of strong and consistent franchise HDFC Bank has been. We believe the merger could result in increased volatility. We maintain our **BUY** rating on the stock and value the bank at ~3x FY24E ABV and subsidiaries at ₹ 50 per share with a target price of ₹ 1650.

Price Chart



Particulars

Particulars	Amoun
Market Capitalisation	₹ 756409 cror
52 week H/L	1724/127
Networth	₹ 240093 cror
Face value	₹

Exhibit 3: Financial summary for HDFC Bank

₹ Crore	FY19	FY20	FY21	FY22	3 year CAGR (FY19-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
NII	48,243	56,186	64,880	72,010	14%	84,295	98,763	17%
PPP	39,750	48,750	57,362	64,077	17%	74,046	85,295	15%
PAT	21,078	26,257	31,117	36,961	21%	43,149	51,173	18%
ABV (₹)	268.0	305.4	361.3	425.2		478.7	526.5	
P/E	35.2	28.4	24.1	20.4		17.5	14.8	
P/ABV	5.1	4.5	3.8	3.2		2.8	2.6	
RoA	1.8	1.9	1.9	1.9		2.0	2.1	
RoE	16.5	16.4	16.6	16.7		16.8	17.8	

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%

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