ICICI direct Research

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Faster revival to pre-Covid level surprises positively…

The Q2FY21 performance and management commentary calmed the nerves on the banking sector on the back of a steady performance. The collections trend saw a considerable improvement while initial commentary from management, industry data suggests the quantum of restructuring would be lower than anticipated earlier. Outstanding contingency buffer seems to be adequate to take care of incremental stress thereby safeguarding any adverse impact on earnings trajectory. Led by home, auto loans, ECLGS, disbursement are touching pre-Covid levels with further improvement expected ahead. This has been reflected on the Bank Nifty as well wherein after underperformance of ~19% in March-September 2020, the index have revived outperforming the Nifty by ~22% from September till date.

RBI's internal working group had made some recommendations pertaining to extent of ownership and corporate structure among others of which key recommendations included raising of cap on promoter stake from 15% to 26%, allowing large corporates as promoters of bank, large NBFCs with asset size of over ₹ 50000 crore to be considered for conversion into bank and conversion of payments bank into small finance bank post sufficient experience and track record. We opine that these steps were in the right direction for the sector, as a whole.

With a gradual revival in business and regulatory developments that have taken place, our outlook on the banking sector is;

- Recent management commentary suggests restructuring to be in lower single digits. Broad range for restructuring would be 2-5%, with incremental stress (restructuring, slippage of unviable or ineligible accounts) seen at 6-8% of advances. Credit cost may remain elevated but is likely to be lower than expected earlier

- Banks benefitted from standstill asset classification norms followed as per the Supreme Court (SC) order while moratorium is largely over in August 2020 itself. RBI had kept restructuring window open till December 31, 2020. However, bankers have requested an extension this March 2021. If this materialises, then we could see recognition of NPAs pushed further

- Unlocking of the economy and festive season are expected to lead to pick-up in credit offtake, especially retail pie. Low interest rates, cautious approach by lenders is seen keeping corporate credit on a slower trajectory. Extension of ECLGS scheme would help push credit growth in the MSME sector

- Amid excess liquidity, pick-up in credit growth is seen being margin accretive. This will act as a cushion on any pressure arising from incremental slippages

Given optimism creeping in over a faster-than-expected revival, mixed with caution over the actual outcome in the coming quarter for restructuring, we expect the stock price of lenders (banks, NBFCs) to remain slightly volatile in the near term. However, we continue to expect the positive impact of structural changes undertaken in the long run. Improving repayment rates, collection efficiencies and credit offtake seem promising. Restructuring is seen at 2-5% of advances with private banks relatively better. We prefer large private banks given adequate capital and liquidity which makes them well paced to garner incremental market share. Contingency buffer enables safeguarding against hiccups in asset quality. However, recent sharp run up in stocks could keep near term movement in a range until further clarity emerges. Therefore, we recommend **Axis Bank** and **IDFC First Bank** among banks and **SBI Life** among non-lenders. Large NBFCs could remain beneficiaries of recent working paper pertaining to new banking license.

Sector View

Banks & NBFCs – Overweight

Insurance – Overweight

AMC – Neutral

Exchanges- Neutral

Sector Update

Research Analyst

Kajal Gandhi
kajal.gandhi@icicisecurities.com

Vishal Narnolia
vishal.narnoliai@icicisecurities.com

Sameer Sawant
sameer.sawant@icicisecurities.com

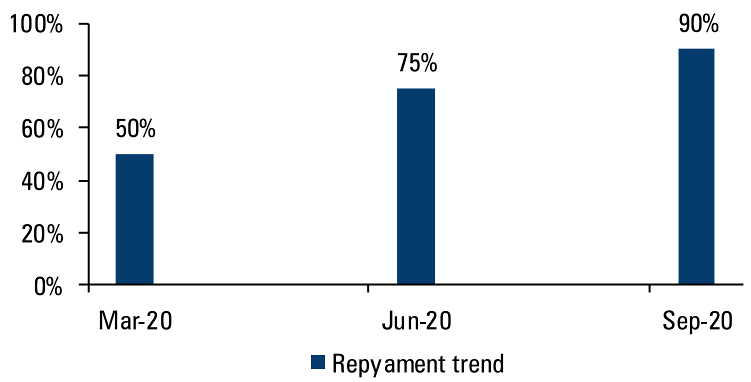
ICICI Securities – Retail Equity Research

Collections on the rise but still have cautious stance…

RBI permitted all banks/NBFCs to allow a moratorium up to August 2020 for payments of all term loan instalments outstanding on March 1, 2020. Further, the Supreme Court's order of not classifying those accounts affected by pandemic as NPA led to lower recognition of stress. During the quarter, banks have witnessed lower NPA levels as a result of standstill asset classification norms. However, they have been prudently making provisions based on internal assessment on proforma basis.

Slippages remained to be seen post deadline for restructuring i.e. December 31, 2020 and removal of standstill asset classification by court. On collection efficiency, most lenders have witnessed an improvement as months have progressed. Collections in the non-morat book have been nearing pre-Covid levels. **Repayments have taken a sharp jump from ~50% in March 2020 to ~90% in September 2020.** As per management commentary, collections have improved further in October 2020. **Key lenders have reported collections of over 95% and should reach pre-Covid levels by the next few quarters.** In its recent monetary policy, RBI has also indicated that the next two quarters should see positive GDP growth from de-growth estimated earlier. This indicates at a revival in the economy. In turn, this should also improve collections and reduce stress. Further, the central government taking the burden of providing interest on interest during the moratorium period thereby safeguarding lenders as well as providing respite to borrowers in the current difficult times.

Exhibit 1: Improving repayment trend



Source: Company, ICICI Direct Research

Exhibit 2: Collections data

Lender	Collection (% of advances)	Anticipated restructuring (%)
State Bank of India	97.00	0.9-1
HDFC Bank	97.00	1-2
Axis Bank	97.00	1.6
DCB	87.00	3.5
Federal Bank	95.00	2.5
CUB	90.00	4-5

Source: Company, ICICI Direct Research

Q2FY21 numbers were characterised by lower slippages on the back of standstill asset classification norms. In terms of recovery, suspension of the IBC stalled the recovery pace. In addition, extension of the IBC suspension till December 24, 2020 would keep recovery pace benign, thus delaying the required breather to major banks. Lower slippages due to less recognition led GNPA to decline 9% QoQ to ₹ 762308 crore. Subsequently, GNPA ratio fell ~70 bps QoQ to 7.2%. With provision continuing to remain elevated, PCR has improved in Q2FY21, which provides comfort in case of unexpected hiccups ahead.

Exhibit 3: Asset quality of Indian banking system as of September 2020

	FY17	FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
GNPA	776835	60484	59403	63006	69173	798675	818535	806145	771762	806145	818535	798675
NNPA	430173	40158	42507	49612	43432	214195	252154	260747	284932	260747	252154	214195
GNPA ratio	9.6	11.6	0.7	0.7	0.7	8.0	8.3	8.3	7.4	7.5	7.7	7.5
NNPA ratio	5.3	0.5	0.5	0.5	0.5	2.1	2.6	2.7	2.7	2.4	2.4	2.0
GNPA of PSU banks	684733	24604	25162	532056	502542	440624	466548	503394	474609	503394	466548	440624
GNPA of Private banks							92102	25660	25617	119501	119366	109619

Source: Company, Capitaline, ICICI Direct Research

Restructuring seen in single digit; Contingent buffer adequate

As per recent management commentary, the **quantum of restructuring that could come across could be in the range of 2 to 5% of total loans**, and some lenders have been making provisions for the same. However, a recent study done by Crisil on ~3500 companies suggests that only 1% of them would opt for restructuring, indicating lower quantum in general. **Banking companies have also approached RBI and appealed to extend the restructuring window from December 2020 to March 2021.** If permitted, this could extend the recognition of stress and assessment of the same would take more time.

Incremental stress amid Covid and ageing NPA are seen keeping credit cost elevated in the near term. Credit cost is expected to be at ₹ 4-4.5 lakh crore in the next two years i.e. ~200-225 bps in FY21-22E. Hence, the earnings trajectory is expected to remain moderate ahead. Consequently, we prefer large banks with low moratorium and limited exposure to troubled sectors, efficient business model, adequate provision buffer and capital for bolstering future balance sheet growth. Also, we expect restructuring demand from large corporates to remain benign.

Exhibit 4: Large private banks better placed in terms of contingency buffer

Lender	GNPA (%)	NNPA (%)	Expected Restructuring (%)	Gross stressed asset (%)	Net stressed asset (%)
HDFC Bank	1.4	0.4	1.1	2.5	0.4
Axis Bank	4.3	1.0	2.0	6.3	1.0
IndusInd Bank	2.3	0.6	2.0	4.3	0.6
Kotak Bank	2.7	0.7	1.5	4.2	0.7
Bandhan Bank	1.5	0.7	3.5	5.0	0.7
DCB	2.4	0.9	3.5	5.9	0.9
Federal Bank	3.0	0.4	2.5	5.5	0.4
IDFC First Bank	1.9	0.6	1.5	5.9	0.6
CUB	3.4	1.8	2.0	5.4	1.8
				0.6	
SBI	5.9	2.1	0.9	6.8	2.1
BoB	9.3	2.7	3.5	12.8	2.7
Canara Bank	8.2	3.4	4.0	12.2	3.4
Bajaj Finance	1.3	0.6	5.0	6.3	
HDFC Ltd	1.8	0.0	2.0	3.8	0.0

Source: Company, Media Articles, ICICI Direct Research

Credit offtake yet to witness pick-up in momentum

With a gradual unlocking of the economy, the credit offtake has shown some improvement in certain pockets on an MoM basis. However, on a yearly basis the growth has still remained subdued.

The **industry sector** growth remained flat YoY and saw some decline sequentially, mainly on account of lenders like Kotak, Axis, IndusInd, etc being cautious in their approach towards corporate book expansion and low interest rates. Large and micro segments showed slight de-growth while loans towards medium enterprise saw jump of 16.7% YoY. Metals de-grew 3.8% YoY to ~₹ 3.3 lakh crore while textile segment credit declined marginally by 1% to ₹ 1.8 lakh crore and credit to infrastructure segment de-grew just 2% YoY to ~₹ 9.9 lakh crore. Within the infrastructure segment, roads grew ~6.4% to ₹ 1.97 lakh crore.

The **services segment** loan traction was ~400 bps higher than of overall industry at 9.5% YoY, led by growth in tourism, hotels & restaurants at 12% and trade segment at 14%. Growth in the NBFC segment was at 9.2%.

Retail loan segment growth has fallen below double digits after a very long time at 9.3% YoY reflecting the impact of lockdown on this segment. Growth in consumer durable segment has been impacted the most while housing loan also saw a moderating trajectory. In absolute terms, housing loans were at ~₹ 13.7 lakh crore, while credit card outstanding was at ~₹ 1.1 lakh crore.

Going ahead, we believe that loan book traction in the industry will pick up gradually led by an increase in demand as we move ahead with unlocking of the economy, rise in business activities and waning effects of lockdown. The corporate segment may still need some time to witness healthy credit-offtake with many banks being cautious in their approach and focusing only on highly rated corporates. The government is pushing for loans in the MSME segment under ECLGS and currently have widened the scope for it. Of ₹ 3 lakh crore limit, lenders have sanctioned ₹ 2.05 lakh crore and disbursed ₹ 1.5 lakh crore. Retail segment loan growth that was impacted, especially the consumer durable and housing loans, are expected to show improvement with the festive season. Overall, things should start getting back on track at least to pre-Covid levels in terms of loan growth by the last quarter or the first quarter of the next fiscal.

Exhibit 5: Muted credit growth trend

₹ crores	FY19	FY20	Jul-20	Aug-20	Sep-20	Oct-20
Non-Food Credit	86,33,418	92,11,544	90,69,051	90,46,327	91,17,321	91,46,631
Agriculture & Allied Activities	11,11,300	11,57,796	11,69,273	11,68,075	11,94,488	12,18,717
Industry	28,85,778	29,05,151	28,21,316	27,78,672	27,74,867	27,39,841
Large	24,03,878	24,17,728	23,64,594	23,16,740	22,93,824	22,55,128
Services	24,15,608	25,94,945	25,47,228	25,51,467	25,76,254	25,76,581
NBFCs	6,41,208	8,07,383	7,93,451	7,96,763	8,02,552	7,78,739
Personal Loans	22,20,732	25,53,652	25,31,234	25,48,113	25,71,712	26,11,492
Housing (Including Priority Sector H	11,60,111	13,38,964	13,47,565	13,49,501	13,59,824	13,73,277
Credit Card Outstanding	88,262	1,08,094	1,01,391	1,04,833	1,05,640	1,10,207
Vehicle Loans	2,02,154	2,20,609	2,17,697	2,19,769	2,21,388	2,24,022
YOY growth (%)						
Non-Food Credit	12.3%	6.7%	6.7%	6.0%	5.8%	5.6%
Agriculture & Allied Activities	7.9%	4.2%	5.4%	4.9%	5.9%	7.4%
Industry	6.9%	0.7%	0.8%	0.5%	0.0%	-1.7%
Large	8.2%	0.6%	1.4%	0.6%	-0.6%	-2.9%
Services	17.8%	7.4%	10.1%	8.6%	9.1%	9.5%
NBFCs	29.2%	25.9%	24.6%	17.1%	12.5%	9.2%
Personal Loans	16.4%	15.0%	11.2%	10.6%	9.2%	9.3%
Housing (Including Priority Sector H	19.0%	15.4%	12.3%	11.1%	8.5%	8.2%
Credit Card Outstanding	28.6%	22.5%	7.9%	7.4%	6.3%	4.9%
Vehicle Loans	6.5%	9.1%	8.1%	8.4%	8.8%	8.4%
Proportion (%)						
Agriculture & Allied Activities	12.9%	13.4%	13.5%	13.5%	13.8%	14.1%
Industry	33.4%	33.5%	32.6%	32.1%	32.0%	31.6%
Large	27.8%	26.2%	26.1%	25.6%	25.2%	24.7%
Services	28.0%	30.0%	29.4%	29.5%	29.7%	29.7%
NBFCs	7.4%	8.8%	8.7%	8.8%	8.8%	8.5%
Personal Loans	25.7%	29.5%	29.2%	29.4%	29.7%	30.1%
Housing (Including Priority Sector H	13.4%	14.5%	14.9%	14.9%	14.9%	15.0%
Credit Card Outstanding	1.0%	1.2%	1.1%	1.2%	1.2%	1.2%
Vehicle Loans	2.3%	2.4%	2.4%	2.4%	2.4%	2.4%

Source: RBI, ICICI Direct Research

Exhibit 6: Industry wise credit deployment data

₹ crores	FY19	FY20	Jul-20	Aug-20	Sep-20	Oct-20
Food Processing	1,57,058	1,54,146	1,59,112	1,55,228	1,48,446	1,44,158
Textiles	2,03,549	1,92,424	1,88,874	1,88,159	1,88,917	1,85,856
Chemicals & Chemical Products	1,91,484	2,02,949	1,75,432	1,73,975	1,75,174	1,71,479
Basic Metal & Metal Product	3,71,564	3,50,325	3,38,908	3,44,005	3,43,016	3,37,746
All Engineering	1,68,621	1,57,259	1,41,558	1,39,390	1,40,249	1,37,361
Infrastructure	10,55,921	10,53,913	10,54,581	10,23,148	10,15,238	9,99,104
Power	5,68,966	5,59,774	5,66,977	5,49,080	5,51,886	5,52,553
Telecommunications	1,15,585	1,43,760	1,32,283	1,25,386	1,14,825	1,00,969
Roads	1,86,852	1,90,676	1,96,306	1,96,875	1,98,304	1,97,379
Industry	28,85,778	29,05,151	28,21,316	27,78,672	27,74,867	27,39,841
Non-Food Credit	86,33,418	92,11,544	90,69,051	90,46,327	91,17,321	91,46,631

YoY growth (%)	FY19	FY20	Jul-20	Aug-20	Sep-20	Oct-20
Food Processing	1.1%	-1.9%	13.9%	13.4%	2.0%	-4.1%
Textiles	-3.0%	-5.5%	0.6%	1.0%	-0.1%	-2.2%
Chemicals & Chemical Products	17.5%	6.0%	-0.4%	0.4%	-1.3%	-6.3%
Basic Metal & Metal Product	-10.7%	-5.7%	-3.5%	-1.1%	1.6%	0.8%
All Engineering	8.6%	-6.7%	-15.2%	-14.3%	-11.6%	-12.8%
Infrastructure	18.5%	-0.2%	3.4%	-0.2%	-1.4%	-3.6%
Power	9.5%	-1.6%	1.3%	-2.4%	-1.8%	-1.2%
Telecommunications	36.7%	24.4%	3.8%	-4.3%	-14.5%	-25.8%
Roads	12.2%	2.0%	5.9%	5.5%	6.1%	2.7%
Industry	6.9%	0.7%	1.2%	0.2%	-0.7%	-2.8%
Non-Food Credit	12.3%	6.7%	4.7%	4.3%	4.3%	2.8%

Proportion of non-food credit(%)						
Infrastructure	12.2%	11.4%	11.6%	11.3%	11.1%	10.9%
Power	6.6%	6.1%	6.3%	6.1%	6.1%	6.0%
Telecommunications	1.3%	1.6%	1.5%	1.4%	1.3%	1.1%
Roads	2.2%	2.1%	2.2%	2.2%	2.2%	2.2%
Industry	33.4%	31.5%	31.1%	30.7%	30.4%	30.0%
Non-Food Credit	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: RBI, ICICI Direct Research

Indian industry advances were at ₹ 106 lakh crore as of September 2020 with deposits at ₹ 146.7 lakh crore. Top five banks (Axis Bank, HDFC Bank, Kotak Mahindra Bank, SBI and a large private bank) contribute ~45% in advances and ~60% in systematic deposits. In Q2FY21, overall sequential growth has been muted mostly on account of lower demand, business and large banks like Kotak and SBI that have been cautiously growing their loan book, especially towards corporates. Going ahead, we believe as the economy unlocks more and more these large five banks on account of their adequate capital, customer base, extensive branch reach and customer confidence are well placed to garner majority of incremental business.

Exhibit 6: Top four banks contribute to majority of incremental business

Rs crore	Axis Bank		HDFC Bank		SBI		Kotak Bank	
	Q1FY21	Q2FY21	Q1FY21	Q2FY21	Q1FY21	Q2FY21	Q1FY21	Q2FY21
Advances	**5,61,341**	**5,76,372**	**10,03,299**	**10,38,335**	**23,85,000**	**23,83,624**	**2,03,998**	**2,04,845**
Corporate	2,05,557	2,10,114	5,28,294	5,53,332	8,09,000	7,87,559	76,359	74,237
SME	57,148	60,573			2,78,000	2,77,248		
Overseas					3,44,000	3,22,526		
Retail & Agri	2,98,636	3,05,685	4,75,005	4,85,003	9,54,000	9,96,290	1,27,639	1,30,608
Home Loans	1,07,509	1,10,047	62,652	62,847	4,55,000	4,68,382	47,168	47,732
Rural Lending	35,836	36,682	40,024	43,536	2,04,000	2,10,945	27,051	29,077
Auto loans	38,823	39,739	1,18,451	1,16,138	70,151	71,631	18,442	18,363
Personal Loan	38,823	39,739	1,11,567	1,12,446	2,24,849	2,45,332	31,479	32,117
LAP	26,877	27,512						
Credit Cards	14,932	15,284	54,698	58,142				
Business Banking	11,945	12,227	60,596	63,511				
Gold loan			5,571	6,039				
Others	23,891	24,455	21,446	22,344			3,499	3,319
Deposits	**6,28,150**	**6,35,454**	**11,89,387**	**12,29,310**	**34,19,000**	**34,70,462**	**2,61,524**	**2,61,564**
Saving deposit	1,76,318	1,80,689	3,27,358	3,48,432	12,90,000	13,14,950	1,09,754	1,08,990
Current deposit	80,439	1,00,099	1,50,077	1,63,019	2,04,000	2,12,057	38,594	40,454
Term deposit	3,71,393	3,54,666	7,11,952	7,17,859	18,12,000	18,37,128	1,13,176	1,12,120
Foreign deposit					1,13,000	1,06,327		

Source: RBI, ICICI Direct Research

RBI's internal working groups made key recommendations

The RBI had constituted an internal working group on June 12 to review extant ownership guidelines and corporate structure of Indian private sector banks. The internal working group has submitted its report. Key recommendation included:

- **The cap on promoters' stake in the long run (15 years) may be raised from the current level of 15% to 26% of paid-up voting equity share capital of the bank**
  View: If this gets implemented it would bring the criteria for other banks at par with Kotak Mahindra Bank that was given an exception. This would be positive for IndusInd Bank as the promoter was looking to increase stake (14.7% currently) but was unable to due to regulation while the bank was also in need of capital. Hence, this move addresses both concerns for IndusInd. It is neutral for Kotak Mahindra Bank.

- **Large corporate/industrial houses may be allowed as promoters of banks only after necessary amendments to the Banking Regulation Act, 1949, and strengthening of the supervisory mechanism**

  View: If this happens we could see stiff competition in the banking sector with large groups and deep pockets like Reliance, Tata, Birla entering the banking space. However, we believe this may not happen in the near term at least as changes in banking regulation act and other procedural issues may require time. Also, RBI has been very stringent on giving licence to large corporate houses due to their inter-linkages and diversified presence in various industries that may require higher supervision to avoid lending within the group.

- **Well run large non-banking finance companies (NBFCs), with an asset size of ₹ 50,000 crore and above, including those which are owned by a corporate house, may be considered for conversion into banks subject to completion of 10 years of operations and other criteria**

  View: This will allow large NBFCs who are willing to go for banking licence and have the desired criteria. We believe this would be a positive for companies like Bajaj Finance, M&M Finance, Shriram Transport and L&T Finance who can apply for a banking licence if the opportunity arises.

- **For payments banks intending to convert to a small finance bank, track record of three years of experience as payments bank may be considered as sufficient**

  View: This opens up a gateway for entities for their journey from payments bank to small finance bank to universal banks though it would be a long process. This could potentially increase competition, especially in the micro lending space.

- **Banks licensed before 2013 may move to an NOFHC structure at their discretion. Once the NOFHC structure attains a tax-neutral status, all banks licensed before 2013 shall move to the NOFHC structure within five years from announcement of tax-neutrality**

  View: This implementation may not be so straightforward and immediate as NOFHC structure to attain tax neutrality would require amendments in the Income Tax Act. However, if implemented, banks like SBI, Kotak Mahindra, etc, would have to move into this structure as they have other business like insurance, AMC, securities, etc. Hence, there could be a chance of holding company discount even for banking business. No immediate impact for SBI, Kotak Mahindra, Axis Bank.

- **Banks currently under NOFHC structure may be allowed to exit such a structure if they do not have other group entities in their fold**

  View: If implemented, this will be a positive for Equitas SFB, AU SFB, Ujjivan SFB and Bandhan Bank as they can roll the bank into a single entity and can get away from holding company discount. IDFC Ltd can also benefit if the AMC business is sold off.

- **The minimum initial capital requirement for licensing new banks should be enhanced from ₹ 500 crore to ₹ 1000 crore for universal banks and from ₹ 200 crore to ₹ 300 crore for small finance banks**

  View: If this guideline is implemented it will increase capital requirement and can act as a small entry barrier. It is neutral for the sector.

Bank of Baroda

- Strategy to focus on retail loans and only short term finance on corporate side is seen as a prudent strategy in current low interest environment thereby safeguarding margins ahead
- Adequate liquidity and capital makes the bank well placed to keep pace of credit growth along with revival in economy
- Though the management refrained from putting a number on restructuring, they indicated it would be in lower single digits. Improvement in collection at 91% bodes well, however, outstanding provision of ₹ 1748 crore i.e. ~26 bps of advances appears to be low
- We revise target price upwards to upgrade target price at ₹ 70, valuing the bank at 0.6x FY22E ABV. Maintain **HOLD** rating on the stock

Bank of Baroda

CMP (₹) – 65

Target (₹) – 70

Rating – HOLD

State Bank of India

- Substantial exposure to salaried class in retail segment, recognition of bulk of corporate stress in past three fiscals, ECLGC support to MSME provide comfort on asset quality trajectory
- Improving collections at ~97% and expected slippages of ₹ 20000 crore (~1% of book) bode well for future earnings trajectory. While resolution of stressed asset is expected to provide support and cushion earnings in case of delinquencies
- In a recent interview, the SBI management has indicated that very few retail loans have opted for restructuring till now, while a recent Crisil report also suggest only 1% of non-MSME customers could go for restructuring. These numbers are much better than estimated earlier
- In the wake of restrictions imposed on HDFC Bank in lieu of new digital launches and acquisition of new credit card customers, SBI remains vulnerable to scrutiny given recent outages in YONO apps
- We maintain **HOLD** rating on the stock with a revised target price of ₹ 290, valuing the bank at 0.8x FY22E ABV

SBI

CMP (₹) – 270

Target (₹) – 290

Rating – HOLD

Axis Bank

- Till now there has been not much demand for loan restructuring from customers. Along with that, increasing levels of demand resolution over past few months is encouraging. Delinquencies in retail segment are not ruled out, though contingency buffer should safeguard earnings
- Recent management commentary suggests a strong pick-up in consumption led business during festive season, demand for home loans have been increasing and secured business are back to pre-Covid levels
- IRDA is expected to approve stake hike to 19% in Max Life by March 2021 which will strengthen its relationship with the life insurer
- Thus, we maintain **BUY** rating on the stock with a revised target price of ₹ 710 valuing the bank at 2x FY22E ABV

Axis Bank

CMP (₹) – 617

Target (₹) – 710

Rating – BUY

DCB Bank

- A better-than-expected revival in the economy will propel credit growth across the board and especially in small business. Government initiative to support MSME segment by extending ECLGS scheme is helpful for players like DCB who have good exposure towards such segments
- Cautious outlook is expected to keep advances growth moderate in FY21E. Focus remains on granular secured loan segment including gold loans, LAP and tractor loans
- Unlocking of economy and resultant improving collection bodes well for the asset quality outlook. Incremental restructuring expectation remains low at 3-5% of advances. Cumulative contingency buffer at ~57 bps somewhat looks on the lower side, which is seen keeping credit cost on the higher side in the coming two quarters
- Adequate capital adequacy keeps away near term dilution risk. Inclination of promoters to increase stake (if current cap revised by RBI) provides comfort
- We upgrade the stock from Hold to **BUY** rating with a revised target price of ₹ 135, valuing the bank at 1.2x FY22E ABV

DCB Bank

CMP (₹) – 115

Target (₹) – 135

Rating – BUY

Federal Bank

- The bank had underperformed compared to other banks and is a healthy play amongst banks in the gold financing segment
- The bank is also a strong player in the MSME segment. Thus, it is likely to benefit from the government's ECLGS scheme
- There is not much restructuring demand while exposure to stressed segment including tourism, travel & entertainment sectors is negligible
- Thus we maintain **BUY** rating on the stock with a revised target price of ₹ 80 valuing the bank at 1.1x FY22E ABV

Federal Bank

CMP (₹) – 66

Target (₹) – 80

Rating – BUY

IndusInd Bank

- Restoration of depositor trust turning back outflow seen in previous quarters provides comfort on the liquidity front
- Recent capital raising demonstrates ability to strengthen the balance sheet. Recommendations by RBI working committee to increase cap on promoter stake from 15% to 26% and promoter inclination to increase stake provides comfort
- With balance sheet realignment over and deposit inflow being revived, the management is set to pedal asset growth with retail in focus. Micro finance, auto are expected to be the preferred segment entailing business growth along with prudent asset quality
- Though extent of slippages impacted by pandemic is to be seen, improving collection and low quantum of restructuring (low single digits) looks to keep asset quality pressure in manageable trajectory.
- We revised target price at ₹ 1050, valuing the bank at 2x FY22E ABV. Maintain **Hold** rating on the stock

IndusInd Bank

CMP (₹) – 925

Target (₹) – 1050

Rating – HOLD

Jammu and Kashmir Bank

- The bank posted a profit of ₹ 44 crore in Q2FY21 against a loss of ₹ 916 crore YoY. Asset quality saw some improvement as GNPA declined QoQ to 8.87% from 10.64% YoY
- Performance of the existing restructured asset pool is expected to deteriorate compared to earlier expectation. Further, exposure to small businesses in J&K state is seen keeping restructured asset elevated. Thus, uncertainty on asset quality is expected to keep earnings volatile ahead
- We maintain **HOLD** rating with a revised target of ₹ 25, valuing the bank at 0.3x FY22E ABV

Jammu & Kashmir Bank

CMP (₹) – 23

Target (₹) – 25

Rating – HOLD

Kotak Mahindra Bank

- RBI's working group recommendation on increasing promoter stake is seen as positive though Kotak had already been given special approval
- Adequate capital and focus on pedalling growth will enable the bank to gain market share in incremental growth
- Strong deposit franchise remains a core strength, which will enable the bank to maintain healthy margins ahead
- Prudent underwriting, adequate contingency buffer should safeguard earnings from any asset quality shocks this coupled with business growth is expected to lead to improvement in return ratios
- Given the recent rally in stock price, we downgrade the stock from Buy to **HOLD** rating with a revised SOTP based target price of ₹ 1950

Kotak Mahindra Bank

CMP (₹) – 1837

Target (₹) – 1950

Rating – HOLD

IDFC First Bank

- The robust trajectory of deposit growth is demonstrating earlier targeted focus on building retail franchise
- It is well on track to rebalance asset portfolio shifting towards retail segment with target of 70% of advances to be contributed by retail. The bank is undertaking continued pruning of corporate exposure
- Request for restructuring is in low single digits. Contingency buffer of ~2.2% of advances (including release of ₹ 800 crore pertaining to Vodafone) provides adequate cushion
- Focused trajectory on balance sheet realignment towards retail segment is expected to lead to gradual improvement in earnings as well as return ratios ahead
- We maintain **BUY** rating on the stock with a revised target price of ₹ 45 valuing the bank at 1.4x FY22E ABV

IDFC First Bank

CMP (₹) – 37

Target (₹) – 45

Rating – BUY

Bandhan Bank

- Faster than expected recovery in the economy, especially in rural sectors bodes well for Bandhan bank. The bank has been performing well in terms of growth and asset quality.
- MFI and MSME segment are witnessing improved levels of collections as economy unlocks and field staff is able to move swiftly.
- We maintain **BUY** rating on the stock with a revised target price of ₹ 460 valuing the bank at 3.5x FY22E ABV

Bandhan Bank

CMP (₹) – 400

Target (₹) – 460

Rating – BUY

Barring above mentioned stocks we also maintain HOLD rating on Indian Bank with revised PT of 88 valuing the bank at 0.3x FY22E ABV

Indian Bank

CMP (₹) – 90

Target (₹) – 88

Rating – Hold

Annexure

Exhibit 7: Asset quality trend

Asset quality trend	GNPA (₹ crore)					NNPA (₹ crore)				
	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
PSU coverage										
Bank of Baroda	69,969	73,140	69,381	69,132	65,698	24,894	26,504	21,577	19,450	16,795
SBI	1,61,636	1,59,660	1,49,092	1,29,661	1,25,863	59,939	58,248	51,871	42,704	36,451
Indian Bank	45,449	13,862	41,998	39,965	36,198	1,512	6,488	14,272	12,755	10,052
Private coverage										
Axis Bank	29,071	30,073	30,234	29,560	26,832	11,138	12,160	9,360	7,448	6,108
City Union Bank	1,135	1,185	1,413	1,346	1,221	624	649	7,785	716	631
Development Credit Bank	523	552	632	622	574	238	261	294	249	206
IndusInd Bank	4,370	4,578	5,147	5,099	4,532	2,203	2,173	1,887	1,703	1,056
HDFC Bank	12,508	13,427	12,650	13,773	11,305	3,791	4,468	3,542	3,280	1,756
Jammu & Kashmir Bank	7,473	7,712	7,672	7,607	6,317	2,942	2,810	2,244	1,986	2,023

Source: Company, ICICI Direct Research

Exhibit 8: Quarterly margin trend

NIM (%)	Q4FY19	Q1FY20	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
PSU coverage							
Bank of Baroda	2.9	2.6	2.8	2.8	2.7	2.6	2.9
Indian Bank	3.0	2.9	2.9	2.9	2.7	2.8	3.1
SBI	2.8	2.8	2.9	3.1	3.0	3.0	0.0
Private coverage							
Axis Bank	3.4	3.4	3.5	3.6	3.6	3.4	3.6
Bandhan Bank	10.7	10.5	8.2	7.9	8.1	8.2	8.0
City Union Bank	4.4	4.1	3.9	4.0	4.0	4.0	4.1
Development Credit Bank	3.8	3.7	3.7	3.7	3.7	3.4	3.7
HDFC Bank	4.4	4.3	4.2	4.2	4.3	4.3	4.1
IndusInd Bank	3.6	4.1	4.1	4.2	4.3	4.3	4.2
Jammu & Kashmir Bank	4.1	3.9	0.0	3.9	4.1	3.6	3.7
Kotak Mahindra Bank	4.5	4.5	4.6	4.7	4.7	4.4	4.5

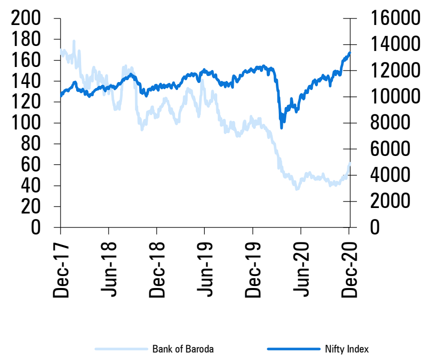
Source: Company, ICICI Direct Research

Exhibit 9: Key financials of industry as of Q2FY21

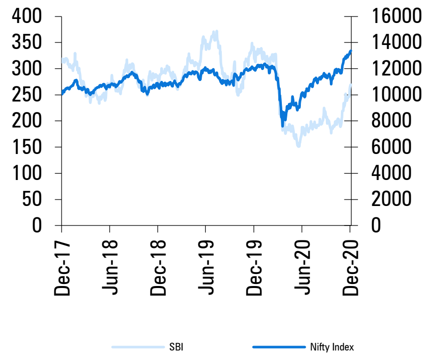
(₹ crore)	Q2FY21	Q1FY21	Q4FY20	Q3FY20	Q2FY20
NII	123044	124591	109705	103524	104062
Growth YoY	**18.2**	**28.1**	**19.0**	**15.9**	**26.0**
Other income	46865	45678	56653	46914	50054
Growth YoY	-6.4	13.0	28.3	24.9	49.1
Total operating exp.	79400	75768	82713	71753	72766
Staff cost	41633	43854	41278	34655	37913
Operating profit	90508	94501	83645	78685	81349
Growth YoY	11.3	34.6	20.9	24.9	36.9
Provision	53649	64138	89707	79395	60501
PBT	36859	30363	-8891	92	20775
PAT	26619	21140	-3958	-11230	6645
Growth YoY	**300.6**	**95.1**	**NM**	**NM**	**NM**
GNPA	798675	818535	806145	771762	921911
Growth YoY	**-13.4**	**-2.6**	**5.8**	**-3.2**	**11.2**
NNPA	214195	252154	260747	284932	341896
Growth YoY	**-37.4**	**-21.9**	**-10.6**	**-16.2**	**-9.9**

Source: Capital-line, Company, ICICI Direct Research

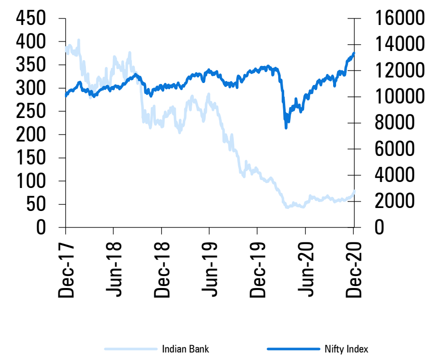
Bank of Baroda price chart



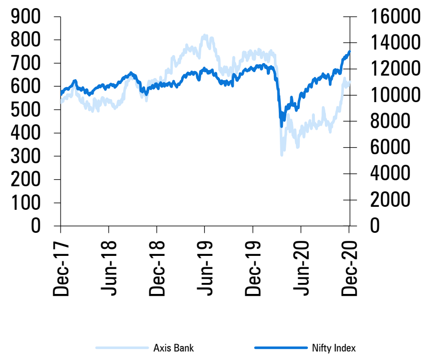
State Bank of India price chart



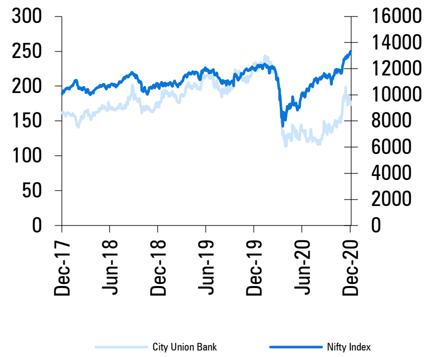
Indian Bank price chart



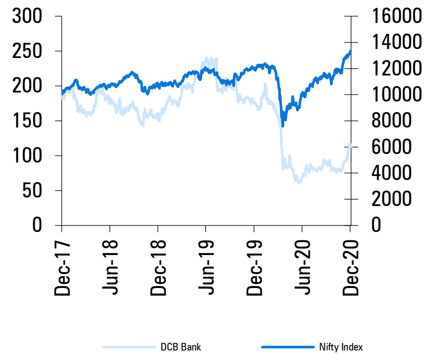
Axis Bank price chart



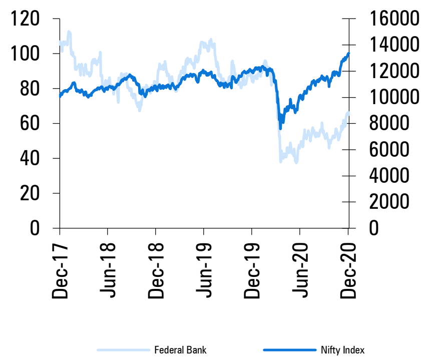
City Union price chart



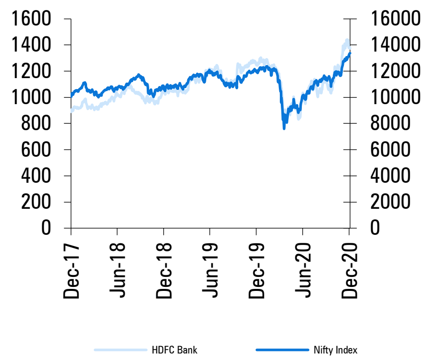
DCB Bank price chart



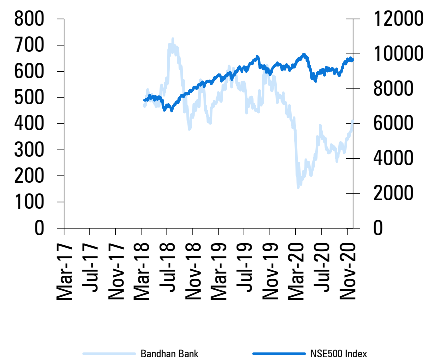
Federal Bank price chart



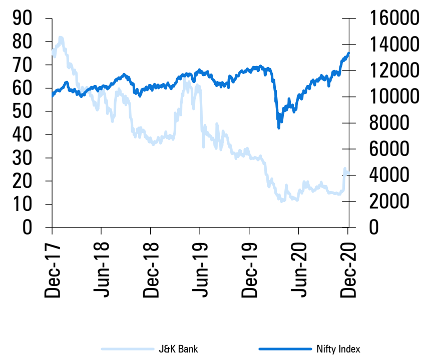
HDFC Bank price chart



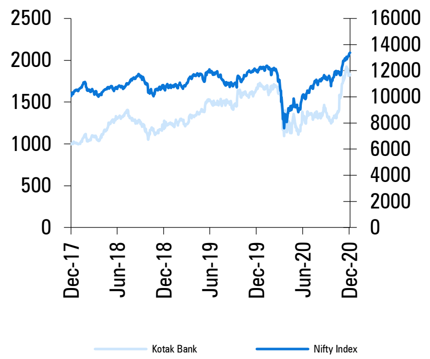
Bandhan Bank price chart



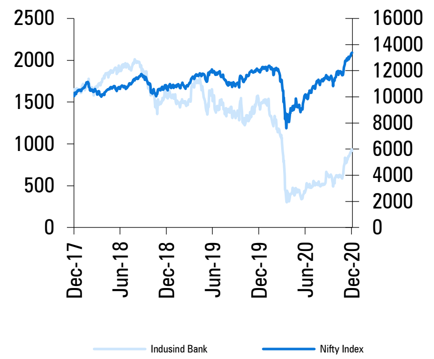
Jammu & Kashmir Bank price chart



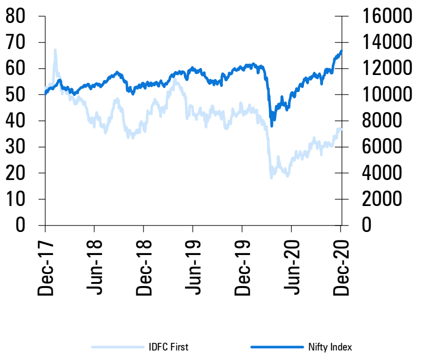
Kotak Mahindra Bank price chart



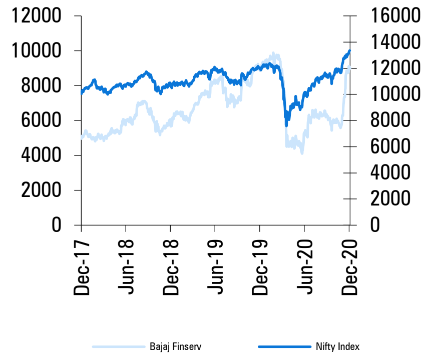
Indusind Bank price chart



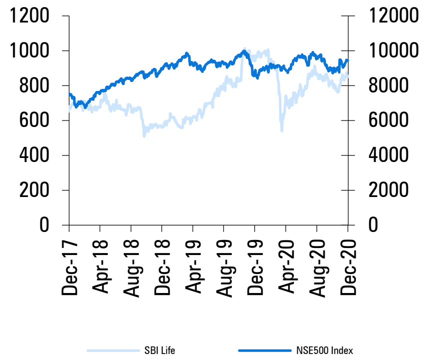
IDFC First price chart



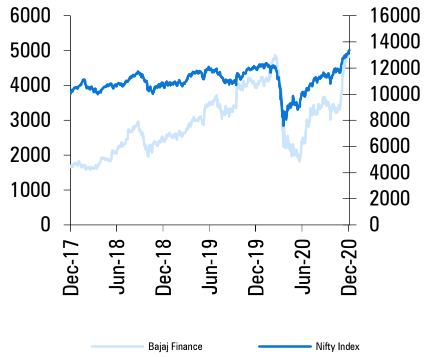
Bajaj Finserv price chart



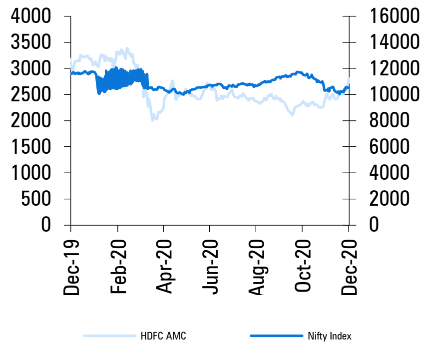
SBI Life price chart



Bajaj Finance price chart



HDFC AMC price chart



Nippon AMC price chart

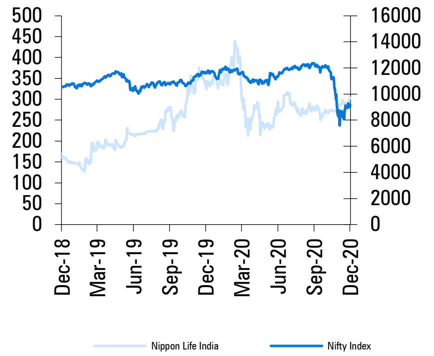


Exhibit 10: ICICI Direct coverage universe (BFSI)

Sector / Company	CMP			M Cap	EPS (₹)			P/E (x)			P/ABV (x)			RoA (%)			RoE (%)		
	(₹)	TP(₹)	Rating	(₹ Bn)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Axis Bank (AXIBAN)	617	710	Buy	1,887.8	5.8	10.6	25.6	106.9	58.1	24.1	2.3	2.3	2.2	0.2	0.3	0.7	2.1	3.5	8.0
Bandhan (BANBAN)	400	460	Buy	661.2	18.1	20.3	29.9	0.9	0.8	0.5	0.2	0.1	0.1	3.9	3.3	4.1	22.1	20.1	24.6
BoB (BANBAR)	65	70	Hold	273.8	1.2	4.3	7.1	55.0	15.1	9.1	0.6	0.5	0.5	0.1	0.2	0.3	0.9	2.7	4.4
City Union (CITUNI)	174	200	Buy	131.7	8.4	10.0	10.0	20.7	17.4	17.4	3.0	2.6	2.2	1.0	1.2	1.3	9.4	11.2	11.9
DCB Bank (DCB)	115	135	Buy	35.8	10.9	10.1	14.0	10.6	11.4	8.2	1.2	1.2	1.0	0.9	0.8	1.1	11.3	9.6	11.9
Federal Bank (FEDBAN)	67	80	Buy	133.3	7.7	6.8	9.5	8.6	9.8	7.1	1.0	1.0	0.9	0.9	0.7	0.9	11.1	9.1	11.6
HDFC Bank (HDFBAN)	1,392	1,450	Buy	7,523.4	47.9	52.3	63.3	29.1	26.6	22.0	4.6	4.1	3.7	1.9	1.8	1.9	16.4	15.7	17.0
IDFC First (IDFBAN)	37	45	Buy	210.4	-6.0	0.8	1.5	-6.2	47.3	24.5	1.2	1.2	1.2	-1.9	0.3	0.5	-18.7	2.7	4.7
Indian Bank (INDIBA)	90	88	Hold	83.2	22.6	33.7	33.2	4.0	2.7	2.7	0.4	0.3	0.3	0.4	0.5	0.4	5.5	7.8	7.3
IndusInd Bank (INDBA)	925	1,050	Hold	698.2	63.7	32.5	50.9	14.5	28.5	18.2	2.0	1.9	1.8	1.5	0.8	1.1	14.4	6.6	9.3
J&K (JAMKAS)	25	25	Hold	17.1	-16.0	7.5	10.4	-1.6	3.3	2.4	0.4	0.4	0.3	-1.1	0.5	0.6	-17.5	8.1	10.6
Kotak Bank (KOTMAH)	1,837	1,950	Hold	3,605.2	20.4	21.1	26.4	90.0	87.1	69.5	11.3	9.0	8.1	1.8	1.7	1.8	12.9	11.2	11.8
SBI (STABAN)	270	290	Hold	2,357.4	16.3	19.1	28.9	16.6	14.1	9.3	1.3	1.2	1.1	0.4	0.4	0.6	6.4	7.1	9.9

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;
Reduce: -15% to -5%;
Sell: <-15%

Pankaj Pandey Head – Research pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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