BANKING | Q3FY20 Preview | 09 January 2020

Recoveries to aid earnings

Q3FY20 is likely to be a soft quarter in terms of business momentum as systemic loan growth has remained lackluster. However, we could see market share gains by banks with strong capital position and solid franchise. Credit costs could decline given recoveries from large corporate NPA resolutions may more than offset provision towards a few known stressed accounts. We expect ICICIBC to be a clear beneficiary of these recoveries as SBIN faces the risk of flagging DHFL as NPA. Margins are expected to remain broadly stable.

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NCLT recoveries to aid asset quality: Headline Gross and Net NPAs are likely to improve for select corporate banks given recoveries from a few large corporate NPA resolutions (Essar Steel, Ruchi Soya, JP Power and RattanIndia Power) under NCLT. AXSB sold its Essar Steel exposure to ARCs hence recoveries will be via security receipts. Few NBFCs, including DHFL will be classified as NPA but banks have been providing for couple these accounts and hence unlikely to offset recoveries.

Loan growth slips: Overall systemic loan growth has moderated to ~7% YoY in Q3FY20 vs. ~9% in the previous quarter. Slower corporate loan growth has led to subdued credit growth given that retail continues to be an outlier with ~16% YoY growth. Private banks will continue with their market share gains as public banks are likely to be impacted the most with slower credit growth. Loan growth for HDFCB and IIB is expected to remain strong ~20% but banks may lower their credit growth guidance.

NIMs to remain largely stable: Most banks have cut their MCLR by up to 75bps over the last nine months even as growth in unsecured retail loans has moderated, which is likely to put pressure on yields. However, this may be offset by a reduction in term deposit rates over the last few months, lower interest reversals and one-off interest recognition on NPA recoveries.

Earnings growth strong: We believe, banks will witness an improved performance as recovery in a few large corporate stressed cases during the quarter should lower provisions and drive strong earnings growth. We expect ~18% YoY growth in operating profit for the banks under our coverage driven by strong NII growth. More so, corporate private banks should benefit from lower tax rate post the DTA markdown.

KEY RECOMMENDATIONS

Ticker	Rating
AXSB IN	BUY
HDFCB IN	BUY
ICICIBC IN	BUY
IIB IN	BUY
KMB IN	BUY
SBIN IN	BUY
YES IN	SELL

FIG 1 – Q3FY20 RESULT EXPECTATIONS FOR BANKS UNDER COVERAGE

Particulars (Rs mn)	Q3FY19	Q2FY20	Q3FY20E	YoY (%)	QoQ (%)	Comments
Axis Bank						
Net interest income	56,037	61,018	62,706	11.9	2.8	Overall loan growth is likely to be 13-14% YoY with sustained retail credit momentum. NIM will remain stable given the benefit of recent capital raise. Movement of BB & below book will be keenly watched.
Pre-provisioning profit	55,247	59,516	56,827	2.9	(4.5)	
Profit after tax	16,809	(1,121)	26,901	60.0	NM	
HDFC Bank						
Net interest income	125,768	135,150	141,912	12.8	5.0	Loan growth will remain strong at ~20%. Commentary on health of unsecured retail portfolio will keenly watched. Slippages from the agri portfolio could be higher. During the quarter, change in senior management would be a key area of discussion.
Pre-provisioning profit	107,784	116,981	121,547	12.8	3.9	
Profit after tax	55,859	63,450	68,870	23.3	8.5	
ICICI Bank						
Net interest income	68,753	80,574	90,693	31.9	12.6	We expect credit costs to decline sharply given recoveries from resolutions of a few stressed accounts. GNPAs could decline given write-offs while slippages are likely to stay manageable.
Pre-provisioning profit	61,464	68,741	78,230	27.3	13.8	
Profit after tax	16,049	6,550	50,047	211.8	664.1	
IndusInd Bank						
Net interest income	22,881	29,094	30,079	31.5	3.4	During the quarter, asset quality coupled with change in senior management would be the key areas of discussion. Loan growth is likely to remain strong. Lower cost of funds will offset pressure on yields, keeping margins steady.
Pre-provisioning profit	21,170	26,234	25,128	18.7	(4.2)	
Profit after tax	9,850	14,010	13,178	33.8	(5.9)	
Kotak Bank						
Net interest income	29,391	33,496	35,516	20.8	6.0	Expect a steady Q3FY20 with stable asset quality and provisions. Loan growth will remain ahead of industry while margins are expected to remain strong.
Pre-provisioning profit	19,384	25,086	26,605	37.3	6.1	
Profit after tax	12,909	17,245	16,954	31.3	(1.7)	
State Bank of India						
Net interest income	226,910	246,003	270,858	19.4	10.1	Provisions on divergence and slippage of DHFL into NPA is likely to cap the benefit of recovery from Essar Steel. Commentary on asset quality will be keenly watched. We have not assumed the impact of DTA as management is yet to take a call on the same.
Pre-provisioning profit	126,250	181,988	164,514	30.3	(9.6)	
Profit after tax	39,548	30,117	59,003	49.2	95.9	
Yes Bank						
Net interest income	26,664	21,859	22,689	(14.9)	3.8	Earnings is likely to take a hit as credit costs inch up further with deteriorating asset quality. Management commentary on capital raising and movement of below investment grade book will be keenly watched.
Pre-provisioning profit	19,904	14,584	13,295	(33.2)	(8.8)	
Profit after tax	10,019	(6,001)	(3,499)	(134.9)	(41.7)	

Source: Company, BOBCAPS Research

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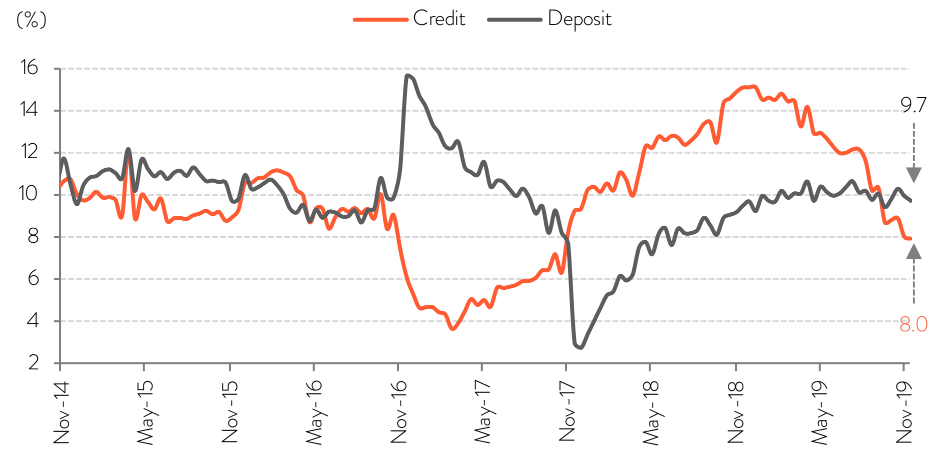
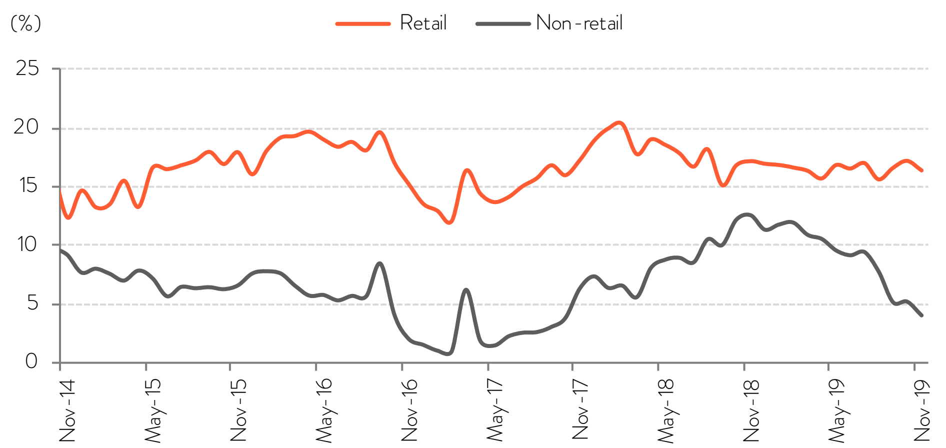
FIG 2 – CREDIT GROWTH IN THE SYSTEM IS LACKLUSTER



Source: RBI, BOBCAPS Research

FIG 3 – …BUT RETAIL MOMENTUM REMAINS STRONG



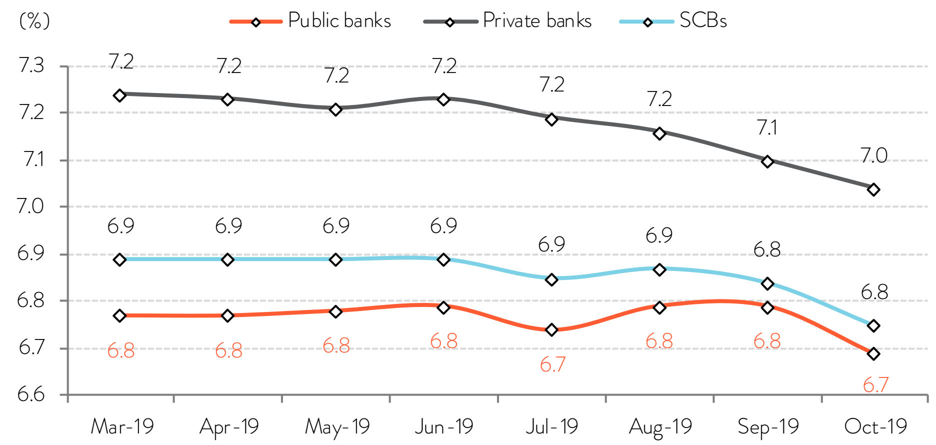
Source: RBI, BOBCAPS Research

FIG 4 – MOST BANKS HAVE REDUCED THEIR MCLR

Banks	1-year MCLR (%)				Change (bps)		
	Mar'19	Jun'19	Sep'19	Dec'19	3M	6M	9M
Axis Bank	8.90	8.70	8.45	8.15	(0.30)	(0.55)	(0.75)
HDFC Bank	8.75	8.70	8.45	8.15	(0.30)	(0.55)	(0.60)
ICICI Bank	8.80	8.75	8.55	8.35	(0.20)	(0.40)	(0.45)
IndusInd Bank	9.90	9.75	9.55	9.40	(0.15)	(0.35)	(0.50)
Kotak Bank	9.00	8.90	8.75	8.40	(0.35)	(0.50)	(0.60)
State Bank of India	8.55	8.45	8.15	7.90	(0.25)	(0.55)	(0.65)
Yes Bank	9.70	9.70	9.70	9.70	-	-	-

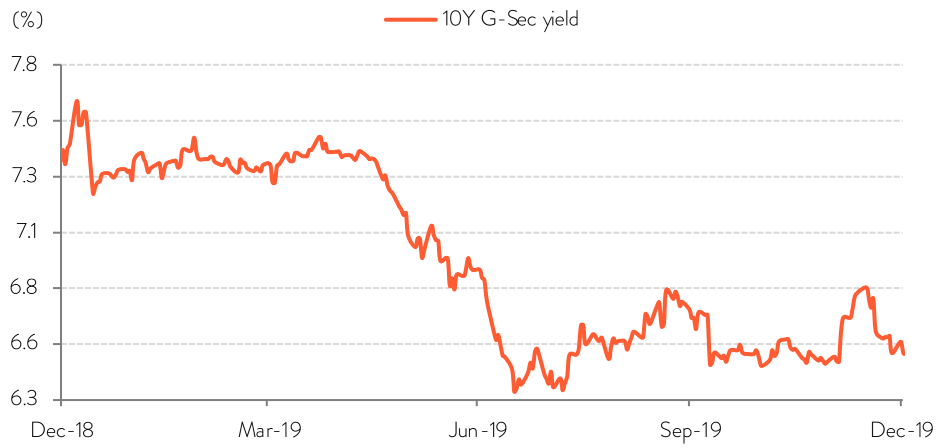
Source: RBI, BOBCAPS Research

FIG 5 – …BUT TD RATES HAVE DECLINED THUS EASING PRESSURE ON NIMS



Source: RBI, BOBCAPS Research

FIG 6 – G-SEC YIELDS BROADLY REMAINED STABLE DURING THE QUARTER



Source: RBI, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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