FIRST LIGHT

08 June 2020

RESEARCH

State Bank of India | Target: Rs 210 | +12% | ADD
Core operating profitability remains weak – cut to ADD

Divi's Labs | Target: Rs 2,350 | –4% | REDUCE
Q4 disappoints – downgrade to REDUCE

BOB Economics Research | May MPC Minutes
Room for another 25bps rate cut

Gujarat Gas | Target: Rs 335 | +17% | BUY
Robust margin outlook

Indian Oil Corp | Target: Rs 200 | +124% | BUY
Covid-19 update – operations fast returning to normal

Alkem Labs | Target: Rs 2,950 | +23% | BUY
Buoyant earnings outlook to fuel rerating

Banking
Apex court raises troubling spectre of interest waiver

SUMMARY

State Bank of India

SBIN's Q4 PAT at Rs 36bn disappointed on weak NII growth and high provisions. The bank reversed ~Rs 15bn of interest income on agri slippages worth ~Rs 50bn, which hit NII as well as NIM. Excluding gains worth Rs 27bn from the stake sale in SBI Cards, core operating profit remained weak. Apart from providing 15% (~Rs 9.4bn) on standstill accounts, SBIN did not build added buffers for Covid unlike other large peers. We slash FY21/FY22 EPS by 70% each on higher credit costs. Cut from BUY to ADD with a reduced Mar'21 TP of Rs 210 (vs. Rs 250).

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	690
Eicher Motors	Buy	18,100
GAIL	Buy	140
Petronet LNG	Buy	330

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Greenply Industries	Buy	145
Laurus Labs	Buy	630
Muthoot Finance	Buy	950
Transport Corp	Buy	240

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.82	8bps	19bps	(129bps)
India 10Y yield (%)	6.01	(2bps)	(7bps)	(92bps)
USD/INR	75.58	(0.1)	0.2	(9.1)
Brent Crude (US$/bbl)	39.99	0.5	47.0	(35.2)
Dow	26,282	0	10.7	2.2
Shanghai	2,919	(0.1)	1.7	3.2
Sensex	33,981	(0.4)	7.1	(14.0)
India FII (US$ mn)	**3 Jun**	**MTD**	**CYTD**	**FYTD**
FII-D	(128.1)	(90.5)	(14,145.8)	(4,386.3)
FII-E	287.0	2,249.4	(2,665.1)	3,937.8

Source: Bank of Baroda Economics Research

BOBCAPS Research
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BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda
Important disclosures, including any required research certifications, are provided at the end of this report.

Divi's Labs

Divi's Labs (DIVI) saw a steep 19% EBITDA miss as high gross margins (+200bps QoQ) were negated by staff/SGA cost, leading to subpar Q4 operating margins. PAT was boosted by tax reversals. Gross margin benefitted from better product mix within generic APIs; the CS sales mix was flat QoQ. DIVI expects healthy growth in FY21 but subdued EBITDA margins of 34-36% (38% guided earlier). We cut FY21/FY22 EPS 8-10% and revise our TP to Rs 2,350, based on 22x FY22 EV/EBITDA. Cut from ADD to REDUCE on rich valuations.

Click here for the full report.

India Economics: May MPC Minutes

MPC members reduced policy rate by 40bps as the impact of COVID-19 on the domestic economy is far more severe than initially anticipated. Inflation is likely to ebb and fall below RBI's target in H2 due to lower aggregate demand. Normal monsoon and easing of lockdown restrictions will help in reducing food inflation. While members see room for more rate cuts, space is limited if RBI would like to maintain positive real rates. We expect another 25bps reduction in repo rate in the next policy meet.

Click here for the full report.

Gujarat Gas

Gujarat Gas' (GUJGA) Q4FY20 earnings beat estimates, surging 115% YoY to Rs 2.5bn. Key highlights: (a) volumes came in well above expectations at 10.1mmscmd (+55% YoY), and (b) EBITDA margins outperformed at Rs 4.7/scm (+8.5% YoY). We raise FY21/FY22 earnings estimates by 5%/9% on a better operating margin outlook. Our Mar'21 TP rises to Rs 335 (from Rs 265) on higher earnings, an improved volume outlook and lower cost of equity assumptions. Sustained low LNG prices augur well for margins.

Click here for the full report.

Indian Oil Corp

IOCL announced that domestic petroleum product **demand improved in May** as staggered easing of the lockdown stemmed the decline in consumption to 30% YoY (from 46% YoY in April). Refinery utilisation has also ramped up from 39% levels in April to >80% currently. The company hinted at a massive inventory loss in Q4FY20 (results not yet out) but also expects a reversal of losses in Q1FY21 given the recent surge in oil price and INR appreciation. Overall, these developments support our view of a V-shaped recovery in Q2FY21.

Click here for the full report.

Alkem Labs

Alkem Labs reported in-line Q4 EBITDA; margins were a tad miss at 14.8% as the negative gross margin was offset by lower staff cost. India sales were weak, rising 3% YoY; US sales grew 3% QoQ to US$ 84mn. Q1 could be soft but Alkem is confident of expanding EBITDA margins in FY21. Management highlighted robust double-digit growth in the trade generics business and expects US operating leverage to support healthy FY21. We raise FY21/FY22 EPS 1-8%. Retain BUY with a revised TP of Rs 2,950 (vs. Rs 2,870).

Click here for the full report.

Banking

The SC in a recent hearing expressed concerns over banks charging interest on loans under moratorium but has sought the government's reply on the matter. While we expect more clarity in the next hearing on 12 June, our estimates suggest 4-11% erosion in net worth of private banks in the event of a waiver. Apart from the financial impact, the risk of moral hazard would also rise as borrowers opting for moratorium could surge. ICICIBC, HDFCB and KMB remain our top picks in the sector.

Click here for the full report.

ADD
TP: Rs 210 | ▲ 12%

STATE BANK OF INDIA | Banking | 05 June 2020

Core operating profitability remains weak – cut to ADD

SBIN's Q4 PAT at Rs 36bn disappointed on weak NII growth and high provisions. The bank reversed ~Rs 15bn of interest income on agri slippages worth ~Rs 50bn, which hit NII as well as NIM. Excluding gains worth Rs 27bn from the stake sale in SBI Cards, core operating profit remained weak. Apart from providing 15% (~Rs 9.4bn) on standstill accounts, SBIN did not build added buffers for Covid unlike other large peers. We slash FY21/FY22 EPS by 70% each on higher credit costs. Cut from BUY to ADD with a reduced Mar'21 TP of Rs 210 (vs. Rs 250).

Vikesh Mehta
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18% of loans under moratorium (ex-agri): Management highlighted that ~22% of customers by number availed of the moratorium. However, 82%/92% of borrowers have paid either two or more, or one or more of their monthly installments post opting for the scheme. In value terms, 18% of overall loans (ex-agriculture) and 35%/~8%/5% of SME/corporate/unsecured personal loans are under moratorium, as well as 16 entities totaling 2-3% of the bank's NBFC portfolio.

Asset quality improves on standstill benefit: SBIN's headline GNPA/NNPA ratios declined to 6.2%/2.2% as fresh slippages dropped to Rs 81bn (vs. Rs 165bn in Q3) on extension of the asset classification benefit to loans worth Rs 62.5bn for retail, agri and SME customers. Slippages were lower across segments barring agriculture (Rs 52bn in Q4 vs. Rs 30bn in Q3).

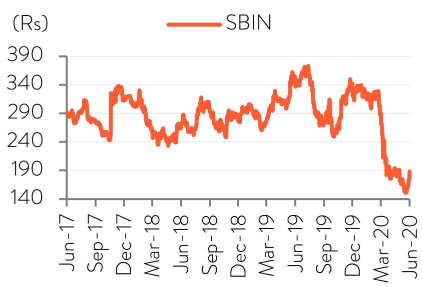
NIM appears to have peaked; no plans to raise capital: Domestic NIM declined by 8bps QoQ to ~3.2% as (1) Q3 had income booked on Essar Steel recovery, and (2) Q4 had interest reversals worth ~Rs 15bn owing to agri slippages. Management does not intend to raise capital.

Cut to ADD: We slash FY21/FY22 EPS by ~70% each on higher credit costs and sustained weak profitability. Downgrade to ADD; Mar'21 TP cut to Rs 210.

Ticker/Price	SBIN IN/Rs 188
Market cap	US$ 22.2bn
Shares o/s	8,925mn
3M ADV	US$ 189.2mn
52wk high/low	Rs 374/Rs 149
Promoter/FPI/DII	59%/9%/32%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Net interest income	748,537	883,489	980,848	978,634	1,054,954
NII growth (%)	21.0	18.0	11.0	(0.2)	7.8
Adj. net profit (Rs mn)	(65,474)	8,622	144,881	82,755	108,219
EPS (Rs)	(7.7)	1.0	16.2	9.3	12.1
P/E (x)	(24.2)	194.4	11.6	20.3	15.5
P/BV (x)	0.8	0.8	0.7	0.7	0.6
ROA (%)	(0.2)	0.0	0.4	0.2	0.2
ROE (%)	(3.2)	0.4	6.4	3.4	4.1

Source: Company, BOBCAPS Research

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REDUCE
TP: Rs 2,350 | ∀ 4%

DIVI'S LABS | Pharmaceuticals | 06 June 2020

Q4 disappoints – downgrade to REDUCE

Vivek Kumar
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Divi's Labs (DIVI) saw a steep 19% EBITDA miss as high gross margins (+200bps QoQ) were negated by staff/SGA cost, leading to subpar Q4 operating margins. PAT was boosted by tax reversals. Gross margin benefitted from better product mix within generic APIs; the CS sales mix was flat QoQ. DIVI expects healthy growth in FY21 but subdued EBITDA margins of 34-36% (38% guided earlier). We cut FY21/FY22 EPS 8-10% and revise our TP to Rs 2,350, based on 22x FY22 EV/EBITDA. Cut from ADD to REDUCE on rich valuations.

Q4 EBITDA miss, FY21 margin improvement to be subdued: EBITDA recovery QoQ was far weaker than expected due to lower revenues. Margins were soft at 32.6% (38% est.) despite strong gross margins of 63% (+200bps QoQ). Staff/SGA were up 11%/28% QoQ led by increased manpower for new units and higher compliance cost, repairs of old plants and CSR (Rs 200mn). CS business was up 10% YoY (revenue share flat QoQ at 41%) and generic APIs also increased 10% YoY. Management expect a softer Q1 due to logistical disruptions, but sees healthy revenue growth in FY21. EBITDA margins are guided to be subdued at 34-36% (vs. 38% guided earlier) given lower operating leverage on new capex and higher staff cost, driving our FY21/FY22 EPS cuts.

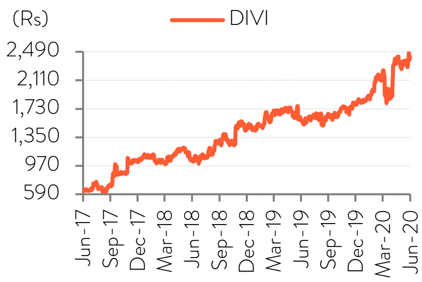
Earnings call highlights: (1) Q4 had a Rs 571mn forex gain. (2) Implementation of total capex of Rs 16.9bn is on track. (2) Q4/FY20 capitalisation stood at Rs 6.5bn/Rs 8.7bn (3) Naproxen market share is stable at 65% and continues to see further expansion in volumes. (4) Tax rate for FY21 pegged at ~25%.

Cut to REDUCE: While DIVI's execution track record is impressive, we believe the stock could underperform in the midterm in view of stretched valuations and delayed earnings benefit on new capex (we cut FY21/FY22 EPS 8-10%). The stock is trading at 34x FY22E EPS vs. the 3Y historical band of 20-35x.

Ticker/Price	DIVI IN/Rs 2,460
Market cap	US$ 8.6bn
Shares o/s	266mn
3M ADV	US$ 27.3mn
52wk high/low	Rs 2,538/Rs 1,466
Promoter/FPI/DII	52%/17%/17%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	38,906	49,462	54,088	61,595	72,773
EBITDA (Rs mn)	12,608	18,719	18,150	22,517	27,913
Adj. net profit (Rs mn)	8,482	13,219	12,903	15,409	19,418
Adj. EPS (Rs)	31.9	49.8	48.6	58.0	73.1
Adj. EPS growth (%)	(22.9)	55.8	(2.4)	19.4	26.0
Adj. ROAE (%)	15.0	20.6	18.2	19.7	21.5
Adj. P/E (x)	77.0	49.4	50.6	42.4	33.6
EV/EBITDA (x)	50.8	33.9	34.9	28.3	23.0

Source: Company, BOBCAPS Research

MAY MPC MINUTES

05 June 2020

Room for another 25bps rate cut

MPC members reduced policy rate by 40bps as the impact of COVID-19 on the domestic economy is far more severe than initially anticipated. Inflation is likely to ebb and fall below RBI's target in H2 due to lower aggregate demand. Normal monsoon and easing of lockdown restrictions will help in reducing food inflation. While members see room for more rate cuts, space is limited if RBI would like to maintain positive real rates. We expect another 25bps reduction in repo rate in the next policy meet.

Sameer Narang
Dipanwita Mazumdar | Aditi Gupta
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Growth to be sharply lower: MPC members agreed that impact of COVID-19 on the domestic economy is far more severe than initially estimated. While RBI has not projected GDP growth for FY21, members believe growth will be negative. Dr Dholakia said nominal GDP growth may also slip into negative zone. Dr Patra believes that India's potential output has been pushed down and it will take years to repair. Dr Janak Raj noted that investment spending will be impacted severely as 1) lower demand will create excess capacity, 2) lower profitability implies firms cant finance investments from own accruals and government spending will be on revenue rather than capital heads.

Inflation to soften in H2: Dr Dholakia believes headline inflation will ease to 3.1-3.2% range in Q4FY21. The decline in inflation will be led by both core and food inflation. While food inflation will ease as supply bottlenecks ease, core inflation will ebb due to lower demand. Dr Patra pointed out that sustained loss of momentum of seasonally adjusted GDP growth over eight consecutive quarters is depressing the underlying momentum of core inflation. This trend is likely to continue as aggregate demand will take time to recover to pre-COVID levels.

Room for more: RBI Governor, Shri Shaktikanta Das, pointed out that sharper loss of growth momentum in near-term has provided policy space to ease financial conditions and stimulate growth. Dr Patra and Dr Dholakia believe that some more policy space may open going forward. We believe inflation will average close to 3.6% in FY21 which gives MPC members room to reduce policy rate by another 25bps. Faster deceleration may open room for 50bps, but is unlikely in our opinion as of now.

KEY HIGHLIGHTS

- Inflation to fall below RBI's target in H2FY21.
- FY21 GDP growth expected to be in the negative territory.
- Space remains for further rate cuts.

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BUY
TP: Rs 335 | ⮝ 17%

GUJARAT GAS | Oil & Gas | 05 June 2020

Robust margin outlook

Gujarat Gas' (GUJGA) Q4FY20 earnings beat estimates, surging 115% YoY to Rs 2.5bn. Key highlights: (a) volumes came in well above expectations at 10.1mmscmd (+55% YoY), and (b) EBITDA margins outperformed at Rs 4.7/scm (+8.5% YoY). We raise FY21/FY22 earnings estimates by 5%/9% on a better operating margin outlook. Our Mar'21 TP rises to Rs 335 (from Rs 265) on higher earnings, an improved volume outlook and lower cost of equity assumptions. Sustained low LNG prices augur well for margins.

Rohit Ahuja | Harleen Manglani
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Improved long-term volume prospects: Ceramic units in Morbi (Gujarat) were absorbing >6mmscmd of GUJGA's volumes until Mar'20, resulting in a volume beat at 10mmscmd in Q4. Industrial volumes grew 3.5mmscmd YoY to 7.8mmscmd in Q4, with a bulk of the growth driven by Morbi. These are expected to average ~50% lower in Q1FY21 due to the economic lockdown, but may retrace to >7mmsmcd levels within a month of restrictions being lifted. CNG volumes (1.5mmscmd in Q4, +1% YoY) may take longer to recover from the >70% slump post-lockdown; domestic PNG could recover faster.

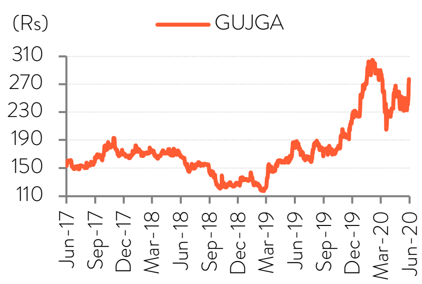
Volume potential from new areas to fructify from FY21: GUJGA's expansion plans are unlikely to be affected by the lockdown as a bulk of its capex usually occurs in H2 each year. The company plans to continue entering newer areas and has maintained capex guidance at Rs 6bn-7bn p.a. The initial strategy is to tap potential from existing networks (Rajasthan to rural Thane near Mumbai). It would simultaneously tap volumes from new areas such as Dahej, Punjab (licenced for six areas) and Rajasthan, that offer 4-5mmscmd potential.

Undemanding valuations: At 14.3x FY22E EPS, GUJGA's valuations remain attractive vs. CGD peers (17-20x for IGL/MAHGL). Expected volume and margin stability could narrow this gap.

Ticker/Price	GUJGA IN/Rs 286
Market cap	US$ 2.6bn
Shares o/s	688mn
3M ADV	US$ 3.1mn
52wk high/low	Rs 314/Rs 155
Promoter/FPI/DII	61%/10%/29%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	61,743	77,544	103,003	78,161	95,511
EBITDA (Rs mn)	8,951	9,836	16,344	17,201	21,232
Adj. net profit (Rs mn)	2,914	4,159	9,061	10,479	13,728
Adj. EPS (Rs)	4.2	6.0	13.2	15.2	19.9
Adj. EPS growth (%)	32.7	42.7	117.9	15.6	31.0
Adj. ROAE (%)	16.7	20.6	32.9	27.4	29.3
Adj. P/E (x)	67.5	47.3	21.7	18.8	14.3
EV/EBITDA (x)	24.1	22.2	13.2	12.3	9.7

Source: Company, BOBCAPS Research

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BUY
TP: Rs 200 | ⮝ 124%

INDIAN OIL CORP | Oil & Gas | 06 June 2020

Covid-19 update – operations fast returning to normal

Rohit Ahuja | Harleen Manglani
research@bobcaps.in

IOCL announced that domestic petroleum product demand improved in May as staggered easing of the lockdown stemmed the decline in consumption to 30% YoY (from 46% YoY in April). Refinery utilisation has also ramped up from 39% levels in April to >80% currently. The company hinted at a massive inventory loss in Q4FY20 (results not yet out) but also expects a reversal of losses in Q1FY21 given the recent surge in oil price and INR appreciation. Overall, these developments support our view of a V-shaped recovery in Q2FY21.

Sale volumes hit in Q1FY21: Demand for petroleum products declined 46% YoY in Apr'20. Specifically, sales of petrol/diesel/ATF saw the largest drops of 61%/57%/92%. Staggered easing of the nationwide lockdown in May has stemmed the decline in demand to 39% on average for these products. June could see further improvement in consumption.

Refinery utilisation also affected: IOCL had to curtail utilisation levels at its refineries to 39% on average in April. This has improved sharply to ~80% in May and the company expects further ramp-up in June as lockdown restrictions are eased across the country. Given IOCL's pan-India presence, its operations could recover much faster than OMC peers.

Inventory piles up, rise in working capital: The company indicated a spurt in working capital requirements due to lower sales volumes. However, the recent improvement in sales should lead to reversal of most of this debt burden. IOCL managed to defer or cancel some crude cargoes in Apr-May, while some were sold to the government for strategic petroleum reserves (SPR).

Capex guidance sustained: The company indicated that it is likely to maintain earlier approved capex levels of ~Rs 200bn for FY21 as work across most of its projects has resumed.

Remains our top pick: IOCL's pan-India presence across marketing, refining and pipeline assets gives it a significant advantage over peers in terms of faster normalisation of sales. Valuations at 3.7x FY22E EBITDA are at a significant discount to BPCL, offering a staggering >12% dividend yield potential. Like other PSUs, the stock has been under pressure owing to concerns over cash utilisation. We believe valuations price in most of these concerns. GRMs for IOCL could outperform peers, in our view.

Ticker/Price	IOCL IN/Rs 89
Market cap	US$ 11.5bn
Shares o/s	9,712mn
3M ADV	US$ 19.3mn
52wk high/low	Rs 169/Rs 71
Promoter/FPI/DII	52%/8%/41%

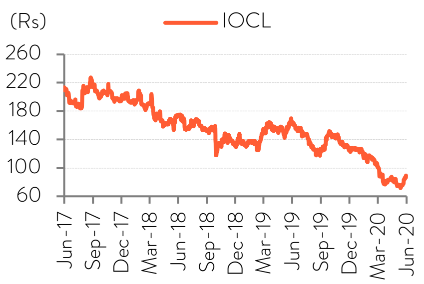
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	5,522,411	3,819,405	4,750,389
EBITDA (Rs mn)	293,308	425,094	440,281
Adj. net profit (Rs mn)	140,969	214,120	220,755
Adj. EPS (Rs)	15.4	23.3	24.0
Adj. EPS growth (%)	(18.9)	51.9	3.1
Adj. ROAE (%)	12.5	18.4	17.8
Adj. P/E (x)	5.8	3.8	3.7
EV/EBITDA (x)	5.6	4.1	3.8

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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BUY
TP: Rs 2,950 | ⮝ 23%

ALKEM LABS | Pharmaceuticals | 05 June 2020

Buoyant earnings outlook to fuel rerating

Alkem Labs reported in-line Q4 EBITDA; margins were a tad miss at 14.8% as the negative gross margin was offset by lower staff cost. India sales were weak, rising 3% YoY; US sales grew 3% QoQ to US$ 84mn. Q1 could be soft but Alkem is confident of expanding EBITDA margins in FY21. Management highlighted robust double-digit growth in the trade generics business and expects US operating leverage to support healthy FY21. We raise FY21/FY22 EPS 1-8%. Retain BUY with a revised TP of Rs 2,950 (vs. Rs 2,870).

Vivek Kumar
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Margin miss, India sales a tad lower while US stable: Q4 India sales growth of 3% YoY could be an aberration due to deferment of Rs 1.3bn in sales to Q1FY21. US growth was mainly led by the base portfolio and had limited stocking benefit. Gross margin contracted both YoY and QoQ to 56% (vs. 61% for 9M) due to an adverse business mix (higher trade generics + international sales) and competition for Mycophenolate. The EBITDA margin miss was contained by lower staff cost (–17% QoQ) due to rationalisation of incentives.

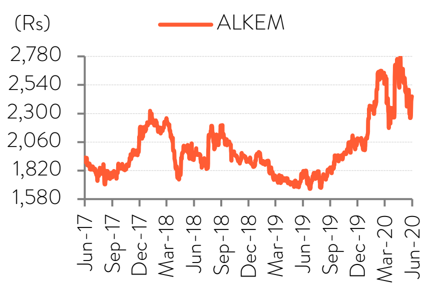
FY21 outlook cautiously optimistic: Alkem expects India growth to be <10% as slower Rx growth due to Covid-19 can be offset by the double-digit uptick in trade generics. Optimistic about a pick-up in parenteral antibiotics as surgeries are likely to surge from Jul'20. US commentary is stable with guidance for good growth over FY20 – we expect US$ 440mn in sales by FY22 (17% CAGR). Despite Covid, Alkem retains its 60% gross margin outlook and expects EBITDA margin expansion over FY20, led by cost control and US operating leverage.

Earnings call highlights: (1) Targeting 10 launches and 12-15 filings in the US in FY21. (2) Parenteral antibiotics contribute 40% of Alkem's anti-infective sales. (3) Q4 included a one-off accelerated depreciation charge of Rs 180mn. (4) FY21 capex to be Rs 3.5bn; tax rate 12-15%.

Ticker/Price	ALKEM IN/Rs 2,395
Market cap	US$ 3.8bn
Shares o/s	120mn
3M ADV	US$ 5.2mn
52wk high/low	Rs 2,879/Rs 1,660
Promoter/FPI/DII	66%/2%/5%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	64,218	73,558	82,983	94,912	105,981
EBITDA (Rs mn)	10,284	11,135	14,730	17,802	20,511
Adj. net profit (Rs mn)	6,309	7,298	11,270	13,458	15,520
Adj. EPS (Rs)	52.8	61.0	94.3	112.6	129.8
Adj. EPS growth (%)	(29.3)	15.7	54.4	19.4	15.3
Adj. ROAE (%)	15.8	16.3	22.7	23.5	22.7
Adj. P/E (x)	45.4	39.2	25.4	21.3	18.4
EV/EBITDA (x)	27.6	25.8	19.5	16.2	13.9

Source: Company, BOBCAPS Research

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BANKING

05 June 2020

Apex court raises troubling spectre of interest waiver

Vikesh Mehta
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The SC in a recent hearing expressed concerns over banks charging interest on loans under moratorium but has sought the government's reply on the matter. While we expect more clarity in the next hearing on 12 June, our estimates suggest 4-11% erosion in net worth of private banks in the event of a waiver. Apart from the financial impact, the risk of moral hazard would also rise as borrowers opting for moratorium could surge. ICICIBC, HDFCB and KMB remain our top picks in the sector.

SC against levying interest on loans under moratorium: As per **media reports**, the Supreme Court (SC) in its recent hearing on a petition seeking interest waiver during the moratorium period slammed RBI for permitting interest to be levied on such loans. The SC's view was that the economic aspect cannot be placed above peoples' health and that permitting a moratorium without interest relief would be more detrimental. It has sought the finance ministry's reply on the matter and deferred its next hearing to 12 June.

Loans availing moratorium could increase sharply: We agree with RBI's view that a waiver of interest would damage financial stability of the banking sector as a whole, given that banks would suffer a ~Rs 2tn (~1% of India's GDP) hit to interest income over the six-month moratorium period. We could further see a sharp rise in loans availing moratorium as borrowers currently honouring their dues may also queue up to seek relief. Such a move could also have a long-tail impact on asset quality and credit costs alongside the risk of moral hazard.

Net worth of banks could be eroded by 4-11%: Based on current data of loans availing moratorium, the net worth of private banks under our coverage could be depleted by 4-11%. We recommend sticking to banks with a robust liability franchise and strong capital position. ICICI Bank (ICICIBC), HDFC Bank (HDFCB) and Kotak Mahindra Bank (KMB) are our preferred picks in the sector.

Disclaimer

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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