

18 August 2021

## 1QFY22 REVIEW

Industry Banks

## Sector recommendations

	CMP (Rs)	TP (Rs)	Upside / Downside (%)	Reco.
SBI	420	513	22	HOLD
HDFC	1513	1421	-6	HOLD
ICICI	688	775	13	BUY
Axis	754	913	21	BUY
Kotak	1750	1625	-7	HOLD
Federal	83	109	31	BUY

Source: Systematix Institutional Research

## Episodic factors all-pervasive; business is in transition

The banking system's 1QFY22 performance was characterized by muted balance-sheet expansion (cyclical phenomenon), with an uptick in margins led by elevated one-off non-recurring non-interest income streams. The absence of wage revision related provisions led to lower establishment costs for state-owned banks (SBIN). Credit quality deteriorated further as mobility was restricted due to COVID-led sporadic lockdowns. Officials/agents could not visit field areas for collections which led to high NPLs in overdue accounts and also hindered NPL upgrades. We expect additional credit restructuring in the coming quarter, leading to a rise in NPL upgrades optically. This would minimize specific credit costs and lead to higher standard asset provisioning. Return ratios on visible earnings/net profitability adjusted for interest income reversals, one-off non-recurring gains (capital gains, a portion of forex gains, recoveries on written-off loans and sale of priority sector lending certificates-PSLC) and provision write-backs from contingent provision pool deteriorated during the quarter. The continued increase in credit risk due to external episodes would hurt banks' core operating margins (NIMs) and keep credit costs elevated, thereby impacting their bottom-lines. Leveraging non-recurring income streams would support earnings but for a limited time. Dipping into such reserves might not be the best option.

**Banks shift gears on credit choice; focus on secured retail & government guaranteed credit**

As a matter of prudence, banks are switching to safer credit segments (like housing loans) with a lower loss-given-default (LGD) even if it means compromising their profit margins to some extent. We believe this is a short-term strategy to resist the looming crisis.

## Differentiating elements to determine potential winners

Post this transitory phase, **1)** banks' positioning on incremental CA deposit market shares, **2)** the proportion of loans priced on external benchmark lending rates-EBLR **3)** eventual unutilized contingent provisions and **4)** market share gains in deposits & credit would be the differentiating fundamental elements. These elements would determine the trajectory of their margins and return ratios. Banks (HDFCB, ICICIBC & AXSB) that sacrificed credit yields to improve their CA deposit market share and credit quality would be winners. FB has been performing well on the profitability front but its cumulative provision on all stressed assets is relatively much lower at ~35%.

## Large private banks best-positioned; prefer ICICIBC, AXSB and HDFCB

Based on 1QFY22 financial performance, we prefer ICICIBC, AXSB and HDFCB. These banks have demonstrated incremental market share gains in CASA along with higher credit book growth. They also sacrificed their margins and return ratios to improve the CA composition, credit quality and build-up of unutilized provision buffers. As the COVID crisis subsides, we expect banks' asset composition to alter in favour of credit (instead of SLR and higher cash balances); they are also likely to start building in some credit risk in their credit books in a prudent & balanced manner to improve asset yields and margins. We firmly believe that change in the credit cycle (with likely moderation in net delinquencies) and interest rate cycle (tightening of policy repo rate) would aid the margins of private banks (PVBs) in FY23.

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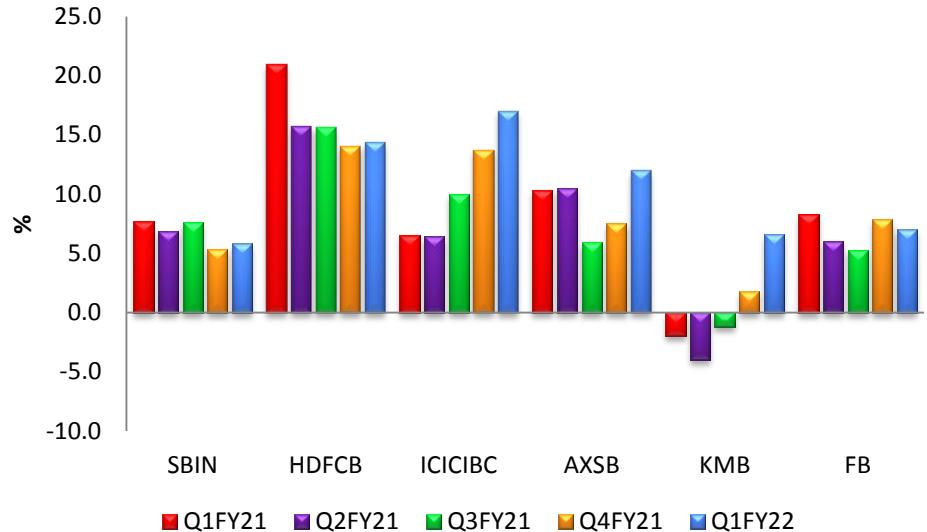
Investors are advised to refer disclosures made at the end of the research report.

## Banks - 1QFY22 results review

### Credit expansion pace remains muted in 1QFY22

The overall banking system's credit growth was flat on a sequential basis in 1QFY22 but increased ~6.2% YoY. Most private (PVBs) and public sector (PSBs) banks reported contraction in their credit books on a sequential basis but an improvement on a YoY basis. The credit books of HDFCB and ICICIBC increased by 1.3% and 0.7% sequentially, respectively, while AXSB's credit book was flat. SBI/KMB/FB reported a 0.7%/2.8%/1.6% QoQ decline in their credit books, respectively.

### Exhibit 1: Large PVBs reported healthy growth in advances



Source: Company, Systematix Institutional Research

Large PVBs gained market share while large PSBs lost market shares. Within our coverage universe, HDFCB/ICICIBC witnessed the maximum increase in domestic market share of 73bps/70bps, followed by AXSB at 32bps. The market shares of KMB/FB were flat while SBIN lost market share by ~11bps.

On an incremental basis, HDFCB gained the highest market share at ~75%, followed by AXSB/ICICIB at 28%/11%. HDFCB is consistently increasing its wholesale book while retail growth has been largely muted given the curbs imposed by the RBI on credit cards and digital on-boarding of customers; credit growth for most other banks was driven by retail loans.

Banks focused on increasing their retail loan books and within that, secured housing loans and gold loans. The traction in gold loans remains strong; some banks indicated that gold credit has gathered further momentum post the second wave.

Large banks with strong CASA deposits have been focusing on wholesale loans, largely to top-rated corporates and government entities, to garner higher CA deposits. Most banks point to green-shoots in capex demand in the metal, cement and infrastructure (road) verticals.

**Exhibit 2: HDFCB & ICICIBC consistently gaining domestic market shares**

Domestic market share (%)	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
SBIN	19.8	20.1	19.9	19.9	19.7
HDFCB	9.6	9.9	9.9	10.1	10.3
ICICIBC	5.7	5.9	6.1	6.4	6.4
AXSB	4.9	5.2	5.0	5.3	5.2
KMB	2.0	2.0	2.0	2.0	2.0
FB	1.2	1.2	1.2	1.2	1.2

Source: Company, Systematix Institutional Research

**Exhibit 3: On an incremental basis, top-3 PVBs gaining maximum domestic market share**

Incremental domestic market share (%)	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
SBIN	30.3	101.1	15.1	22.6	-128.2
HDFCB	13.3	167.4	9.5	20.9	75.3
ICICIBC	-7.6	127.0	10.6	16.3	11.5
AXSB	-27.2	128.2	1.4	16.8	27.9
KMB	-19.6	4.3	2.1	3.9	-30.4
FB	-1.2	8.2	0.6	2.6	-15.8

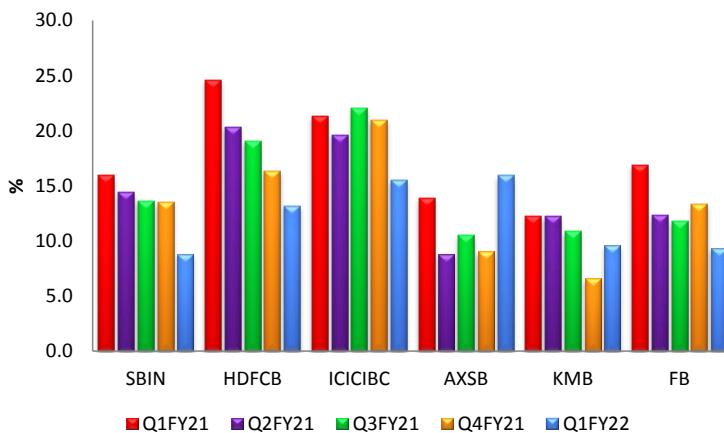
Source: Company, Systematix Institutional Research

**Deposits growth led by CASA deposits**

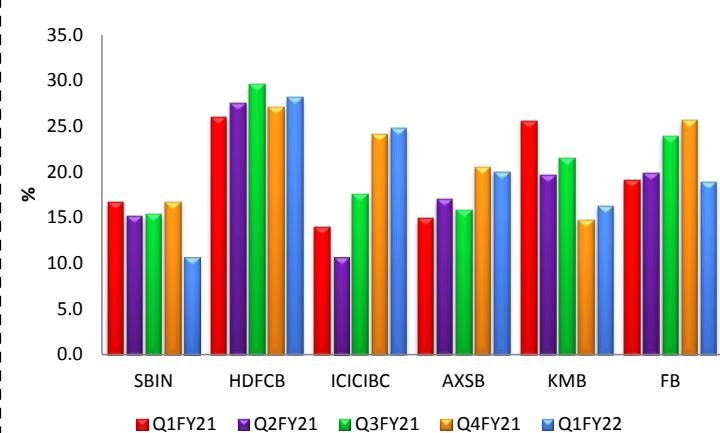
In 1QFY22, deposit growth was largely led by CASA deposits. Overall banking sector deposits grew by 9.8%, while deposits growth for our coverage universe of 6 banks, constituting ~46% of the overall banking deposits, witnessed 11.2% growth. CASA deposits mobilization for our coverage universe grew ~22.5% YoY. AXSB/ICICIBC/HDFCB reported 16%/15.5%/13.2% growth in overall deposits while growth for KMB/FB/SBIN was largely in-line with industry at 9.6%/9.3%/8.8%.

Large banks are largely focused on increasing CA deposits post promulgation of the RBI's guidelines on the opening of current accounts by banks. HDFCB is better positioned to gain incremental market share in CA deposits on the back of its strategy to increase wholesale credit since the last couple of years. ICICIBC indicated that CA deposits growth is likely to taper off in the next quarter on a sequential basis while KMB is not aggressively chasing wholesale credit and thus CA deposits. SBIN and FB witnessed pressure on CA deposits on a sequential basis due to RBI's circular; both banks are likely to see a moderation in CA deposits going forward.

Large banks with a focus on wholesale credit should further gain market shares in CA deposits given the last date for corporates to switch their bank account is 31<sup>st</sup> Oct'21 (further extended from the initial date of 30<sup>th</sup> July'21).

**Exhibit 4: Most large banks witness a deceleration in deposit growth**


Source: Company, Systematix Institutional Research

**Exhibit 5: But, CASA growth remains healthy**


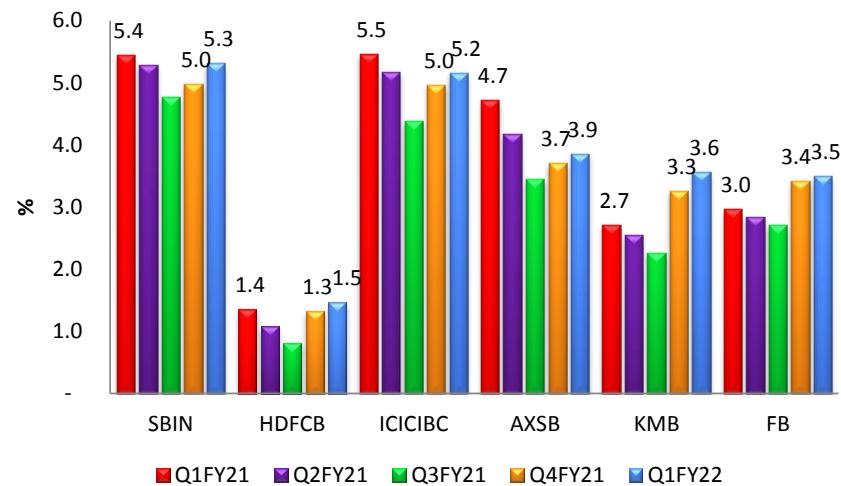
Source: Company, Systematix Institutional Research

### Asset quality impacted due to the second wave of COVID

Most banks saw a deterioration in their asset quality on a sequential basis as collections were impacted due to lockdown-led restricted movement. The absence of relief measures from RBI (moratorium or non-classification of NPA) resulted in higher delinquencies.

Delinquencies in the retail segment (mainly unsecured retail) increased as most retail borrowers saved cash for medical emergencies. Most banks witnessed credit quality stress in auto, MFI, MSME, housing, LAP and gold loans segments given the cash cycles of small businesses. Collection from individual borrowers was impacted due to restricted mobility. With the lifting of the lockdowns, most banks saw higher NPL recoveries in July and expect upgrades in 2QFY22.

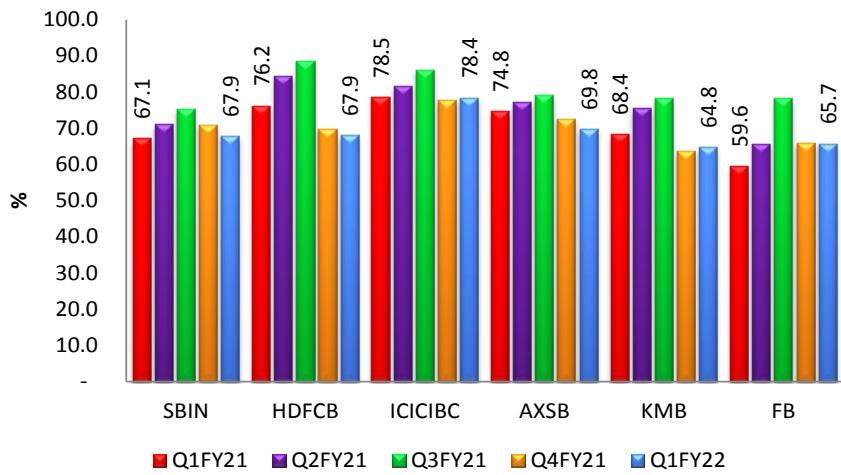
### Exhibit 6: Banks' GNPA rises further on a sequential basis



Source: Company, Systematix Institutional Research

In 4QFY21, most banks built large provision buffers to manage accumulated delinquencies and restructured credit, which was reflected in a higher provision coverage ratio. In 1QFY22, collections were impacted further due to the second wave, resulting in a rise in NPAs. A few banks (including ICICIBC) had embarked on COVID related contingent provisions, leading to lower credit costs and a higher bottomline. Most large PVBs carry high provision buffers that would likely cushion the credit costs in case of the third COVID wave.

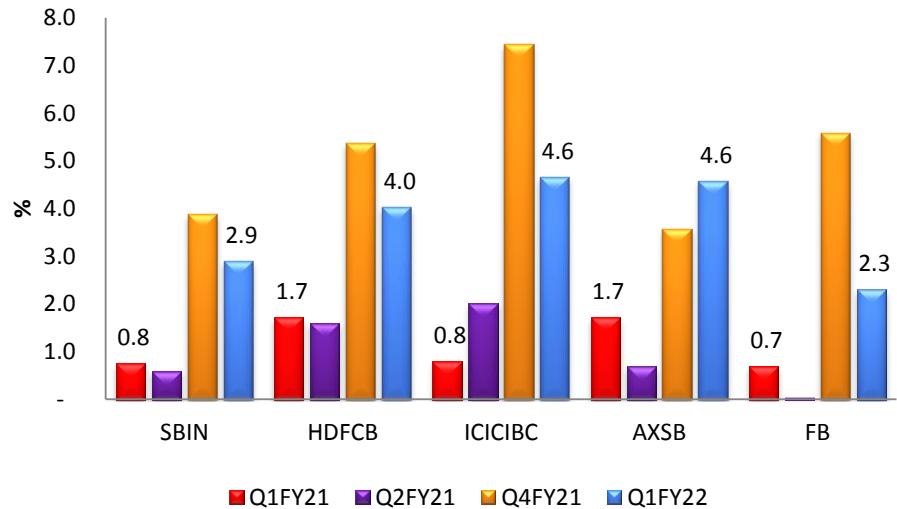
### Exhibit 7: Large banks' PCR remains comfortable



Source: Company, Systematix Institutional Research

Collections were impacted in 1QFY22 due to restricted mobility and cash flow disruptions for small businesses. Most banks reported higher slippages in the retail and MSME segments. NPL recoveries were also not feasible as the regulator does not permit legal action against borrowers during the COVID phase. Further, most banks did not auction gold loans and gave borrowers more time to repay interest & loans, leading to higher delinquencies in the segment. With the re-opening of the economy and easing of restrictions on mobility, the slippage ratio of banks should decline along with an improvement in NPL recoveries/upgrades.

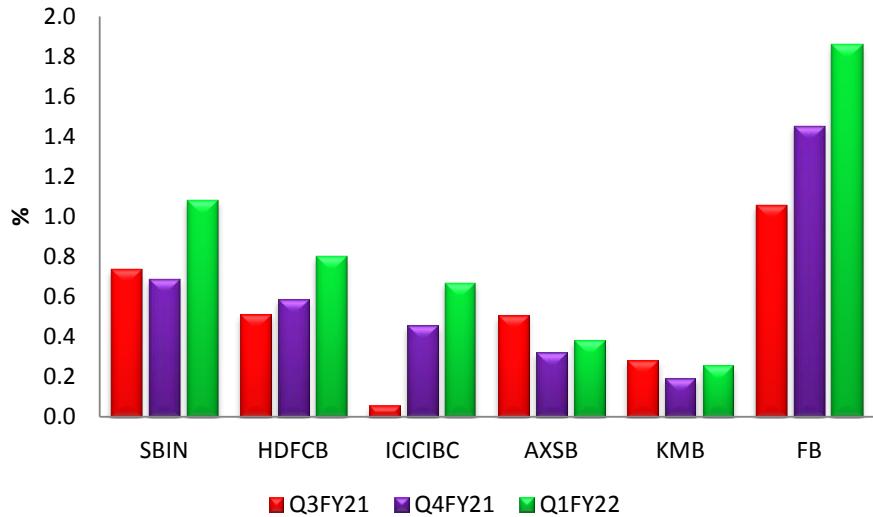
**Exhibit 8: Delinquencies remain elevated driven by unsecured retail and MSME credit**



Source: Company, Systematix Institutional Research

With the regulator extending one-time restructuring in the MSME and retail segments till the end of 2QFY22, most banks extended the restructuring to these segments, leading to higher restructuring as a percentage of advances. Banks have indicated that restructuring relief is being extended after stringent due diligence and is largely towards secured retail books wherein they do not see higher delinquencies going forward. Moreover, as the last date under scheme 2.0 is 30<sup>th</sup> Sep'21, most banks expect the restructuring to rise further in 2QFY22.

**Exhibit 9: Banks extended restructuring in RBI's scheme 2.0, leading to higher restructuring books (as % of total advances)**



Source: Company, Systematix Institutional Research

**RoA remains stable on the back of stable margins, high other income**

The net interest incomes (NII) of banks were impacted in 4QFY21 due to higher interest income reversals on account of the recognition of accumulated NPA as well as 'interest on interest' as per the SC Court final verdict. However, in 1QFY22, interest income reversals were lower, leading to healthier NII growth on a sequential basis. We expect NII growth to improve going forward as banks curtail net delinquencies and focus on credit growth.

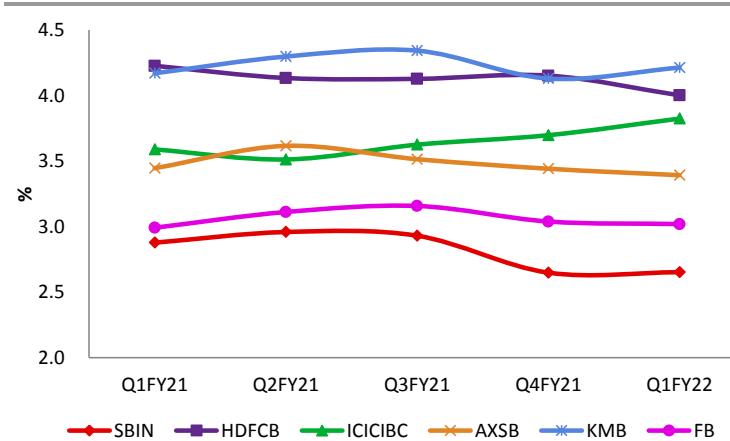
Banks' non-interest incomes were aided by higher treasury incomes and recoveries from written-off loans. Core fee income declined sequentially as business activities were muted due to lockdowns. Most PSBs expect healthy recoveries from NCLT (National Company Law Tribunal) accounts, while most other banks have indicated that recoveries would be higher as the economy re-opens and they receive court orders for the auctioning of properties.

Cost-income ratios moderated as sporadic lockdowns led to lower other overhead expenses, while healthy margins & non-interest incomes aided total net income. As a result of this, operating profits for most banks were healthy. However, credit costs were higher as compared to average historical run-rates as slippages remained elevated due to lower collections. Few banks used contingent COVID provision buffers during the quarter to restrict high credit costs. Currently, large banks have sufficient provision buffers to navigate any contingencies arising out of COVID without impacting their profitability significantly.

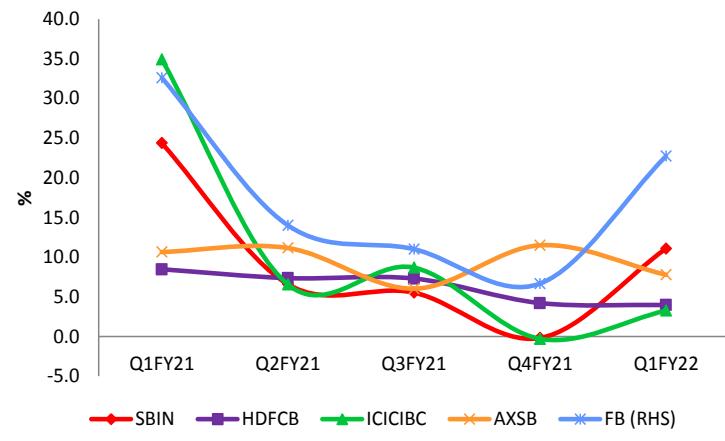
**Exhibit 10: Large PVBs' incremental CD ratios improve significantly**

Incremental CD ratio	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22
SBIN	23.9	30.4	34.8	26.6	38.2
HDFCB	72.6	66.4	64.5	72.7	90.2
ICICIBC	37.2	41.7	48.7	64.9	90.9
AXSB	57.7	89.9	42.7	87.7	68.1
KMB	-14.1	-29.7	-10.3	22.8	53.8
FB	41.4	40.8	36.8	47.2	58.6

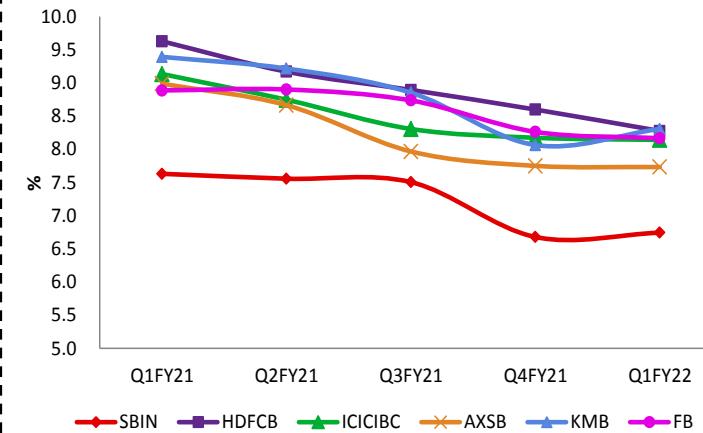
Source: Company, Systematix Institutional Research

**Exhibit 12: Mixed performance on margins**


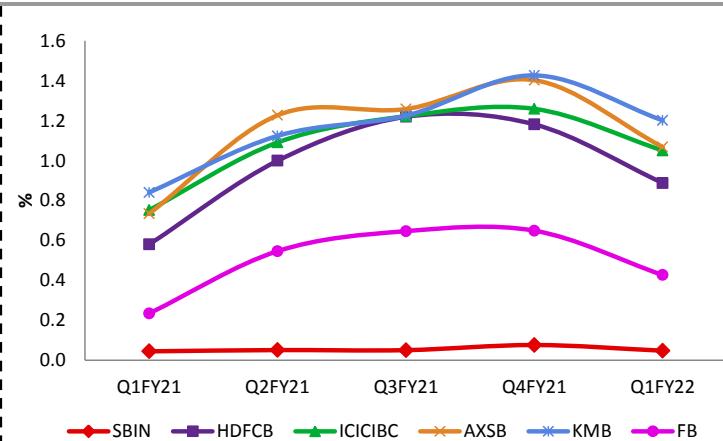
Source: Company, Systematix Institutional Research

**Exhibit 14: Higher treasury income (as % of PPOP) aided profitability**


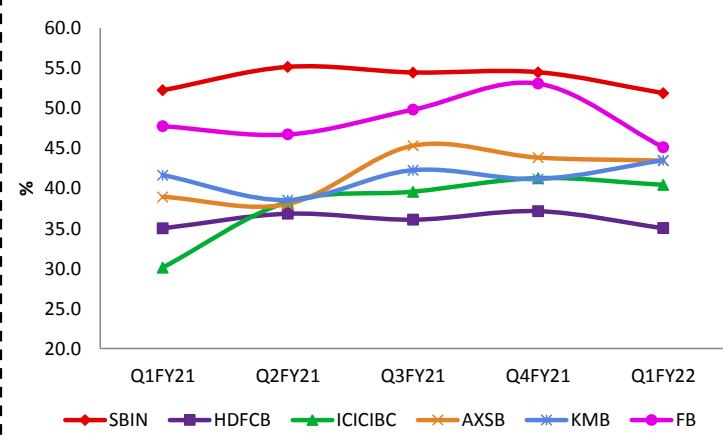
Source: Company, Systematix Institutional Research

**Exhibit 11: Credit yield stabilizes sequentially on the back of lower interest reversals**


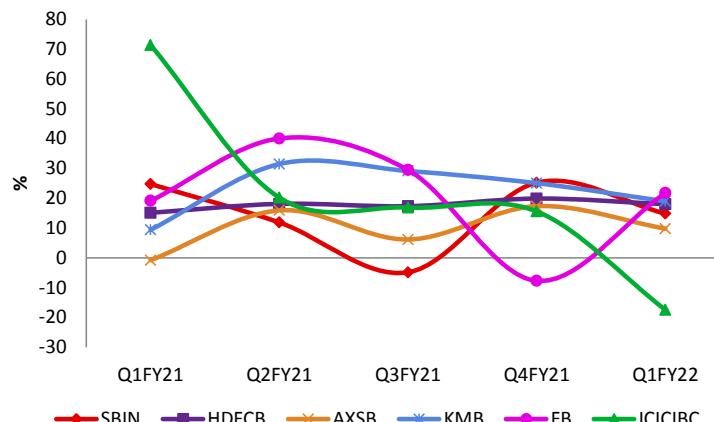
Source: Company, Systematix Institutional Research

**Exhibit 13: Fee income (as % of assets) impacted due to lower credit growth**


Source: Company, Systematix Institutional Research

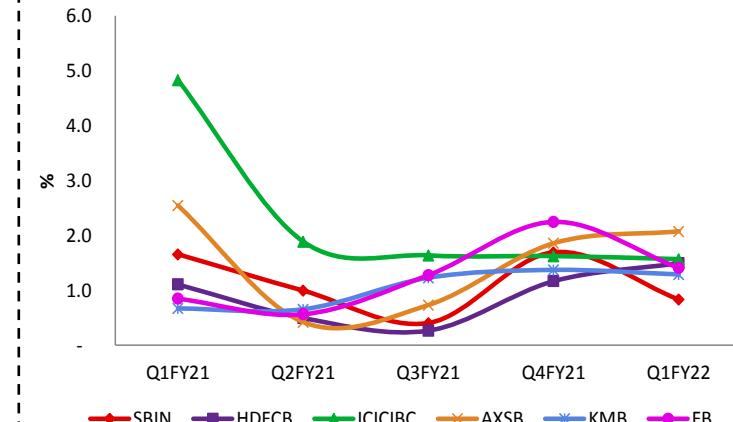
**Exhibit 15: Cost-income ratio declined sequentially as second wave impacted business activities**


Source: Company, Systematix Institutional Research

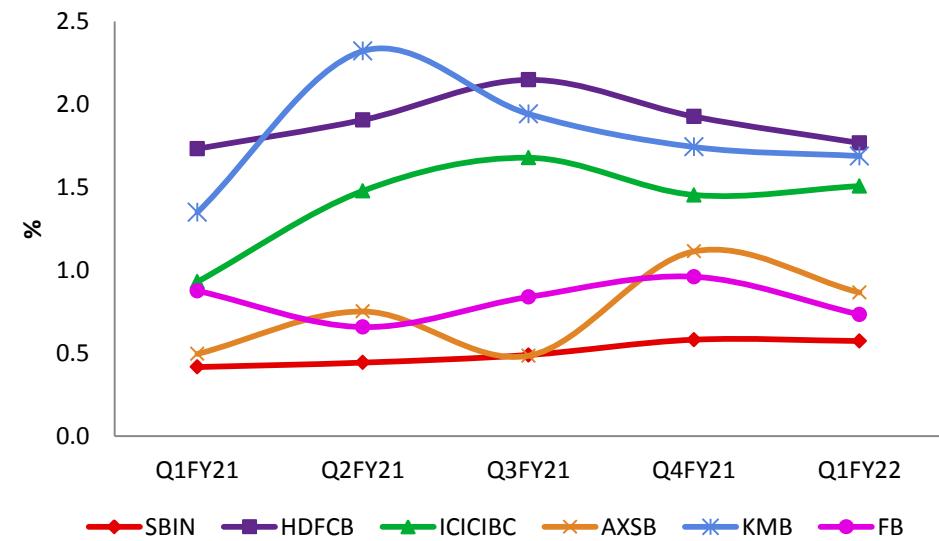
**Exhibit 16: Banks' PPoP growth deaccelerated**

Source: Company, Systematix Institutional Research;

(Note: For ICICIBC operating profit growth seems negative due to other income in Q1FY21 included one-time gain on stake sale in subsidiary)

**Exhibit 17: Credit cost remains elevated**

Source: Company, Systematix Institutional Research

**Exhibit 18: Coverage universe banks' RoA remained healthy**

Source: Company, Systematix Institutional Research;

## Exhibit 19: Asset quality review

Asset Quality (INR mn)	ICICI Bank				Axis Bank				HDFC Bank				Kotak Bank				Federal Bank				SBI			
	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY21	Q3FY21	Q4FY21	Q1FY22
GNPA (Reported)	5.17	4.38	4.96	5.15	4.18	3.44	3.70	3.85	1.08	0.81	1.32	1.47	2.55	2.26	3.25	3.56	2.84	2.71	3.41	3.50	5.28	4.77	4.98	5.32
NNPA (Reported)	1.00	0.63	1.14	1.16	0.98	0.74	1.05	1.20	0.17	0.09	0.40	0.48	0.64	0.50	1.21	1.28	0.99	0.60	1.19	1.23	1.69	1.23	1.50	1.77
PCR (%)	81.6	86.1	77.8	78.4	77.2	79.0	72.4	69.8	84.5	88.5	69.8	67.9	75.6	78.4	63.6	64.8	65.7	78.2	65.9	65.7	71.04	75.24	70.88	67.86
																					-	-	-	-
GNPA (Pro-forma)	5.36	5.42	-	-	4.28	4.55	-	-	1.37	1.38	-	-	2.7	3.3	-	-	2.84	3.38	-	-	5.88	5.44	-	-
NNPA (Pro-forma)	1.12	1.26	-	-	1.03	1.99	-	-	0.35	0.4	-	-	0.7	1.2	-	-	0.99	1.14	-	-	2.08	1.81	-	-
PCR (%)	79.90	77.60	-	-	77.00	75.00	-	-	74.69	88.98	-	-	73.1	62.8	-	-	64.65	66.12	-	-	65.96	67.99	-	-
BB & below (FB)	1.50	1.60	-	-	1.12	1.50	1.10	1.20	-	-	-	-	0.06	0.31	0.05	0.20	3.26	3.35	2.89	2.48	1.69	1.75	1.71	1.93
Net Standard restructured loans (%)	0.05	0.05	0.43	0.63	-	0.12	0.06	0.07	-	0.50	0.82	0.80	-	0.28	0.19	0.20	0.35	1.71	2.34	3.10	0.28	0.66	0.61	0.83
Net SRs (%)	0.29	0.26	0.24	0.23	-	-	-	-	0.04	0.04	0.12	0.12	0.40	0.38	0.36	0.37	0.24	0.18	0.12	0.38	0.31	0.30	0.17	0.17
<b>Total stress (%)</b>	<b>7.83</b>	<b>7.97</b>	<b>7.83</b>	<b>8.33</b>	<b>6.25</b>	<b>6.99</b>	<b>5.60</b>	<b>5.84</b>	<b>1.41</b>	<b>1.92</b>	<b>2.25</b>	<b>2.39</b>	<b>3.16</b>	<b>4.24</b>	<b>3.86</b>	<b>4.33</b>	<b>6.68</b>	<b>8.62</b>	<b>8.76</b>	<b>9.46</b>	<b>7.56</b>	<b>7.48</b>	<b>7.47</b>	<b>8.25</b>
<b>Provisions</b>																								
On reported GNPA	318,017	299,999	321,932	338,425	207,238	173,881	183,213	181,033	95,485	78,096	105,312	116,127	40,322	38,640	47,203	51,395	23,341	27,147	30,331	30,561	89,412.30	88,212.61	89,579.30	91,106.96
Fresh adhoc provisions post pandemic	87,723	99,845	74,750	64,250	108,390	118,560	50,120	50,120	23,000	42,928	58,612	66,000	12,790	12,790	12,790	12,790	5,879	5,367	-	-	7091	12976	11253	14100
Floating Provisions	-	-	-	-	33	33	33	33	14,513	14,513	14,513	14,513	14,513	-	-	-	819	819	819	819	-	-	-	-
General provisions	30,256	35,256	36,955	36,955	34,005	34,005	39,162	39,162	43,072	43,072	51,675	51,675	9,535	9,535	9,944	9,944	6,377	6,377	7,493	7,493	11,560	13,074	14,122	15,700
<b>Total provisions</b>	<b>435,996</b>	<b>435,099</b>	<b>433,637</b>	<b>439,630</b>	<b>349,665</b>	<b>326,478</b>	<b>272,528</b>	<b>270,348</b>	<b>176,070</b>	<b>178,609</b>	<b>230,112</b>	<b>248,315</b>	<b>62,647</b>	<b>60,965</b>	<b>69,938</b>	<b>74,129</b>	<b>36,416</b>	<b>39,710</b>	<b>38,643</b>	<b>38,873</b>	<b>108,063</b>	<b>114,263</b>	<b>114,954</b>	<b>120,907</b>
Total provision (%)	<b>6.37</b>	<b>5.97</b>	<b>5.67</b>	<b>5.74</b>	<b>6.07</b>	<b>5.60</b>	<b>4.68</b>	<b>4.64</b>	<b>1.70</b>	<b>1.65</b>	<b>2.03</b>	<b>2.16</b>	<b>3.06</b>	<b>2.85</b>	<b>3.13</b>	<b>3.31</b>	<b>2.90</b>	<b>3.16</b>	<b>3.08</b>	<b>3.10</b>	<b>4.71</b>	<b>4.82</b>	<b>4.69</b>	<b>4.97</b>
<b>Provision cover (%)</b>	<b>81.4%</b>	<b>74.9%</b>	<b>72.4%</b>	<b>69.0%</b>	<b>97.0%</b>	<b>80.1%</b>	<b>83.5%</b>	<b>79.4%</b>	<b>120.1%</b>	<b>85.9%</b>	<b>90.2%</b>	<b>90.7%</b>	<b>96.8%</b>	<b>67.2%</b>	<b>81.1%</b>	<b>76.5%</b>	<b>43.4%</b>	<b>36.7%</b>	<b>35.1%</b>	<b>32.8%</b>	<b>62.3%</b>	<b>64.5%</b>	<b>62.8%</b>	<b>60.2%</b>

Source: Company, Systematix Institutional Research

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