India Financials

Sector outlook

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India

Financial services

Relevant index performance

CAGR Return (%)	1Y	3Y	5Y
NIFTY 50	25.1	14.0	14.6
BANK NIFTY	13.5	12.6	10.3
NIFTY PSU Bank	84.7	44.3	19.2
NIFTY Private Bank	9.8	10.3	7.8

Our other recent reports

Still Going Strong

Unfortunate Confluence

Forgotten heroes

Stronger balance sheets, record profits, inexpensive valuations

We believe Indian banks are well placed after a rollercoaster decade. Balance sheets are the strongest they have been in over a decade and profits have rebounded sharply (quadrupling in 10 years). Sector ROE is at its highest since FY11. Loan growth has picked up from an average of 10% over FY12-22 to 15% over the past two years and deposit growth should follow. Against this backdrop, PSU Banks outperformed private sector banks by c.80ppt/100ppt in the past 1-year/5-year from a low base. Private sector banks, which have been stock market laggards, should now give better returns given a good business outlook and inexpensive valuations (10-15x PE versus the NIFTY50 at 18x). The key short-term risk is a sharp repo rate cut that would reverse the NIM improvement banks have delivered. We like large banks in our coverage, with a preference for ICICIB & IIB.

Strong balance sheet; resurgence in profits and profitability

The net NPL/net worth ratio of the banking sector has declined to decadal lows, driven by better asset quality, stronger provision buffers and an improved capital position. PAT for the sector has rebounded sharply and has quadrupled over the past decade. Banking sector ROE of 15% is the highest since FY11. In this context, PSU Banks have re-rated sharply from a low base, while private sector banks have been laggards. We expect the underperformance of the latter to reverse.

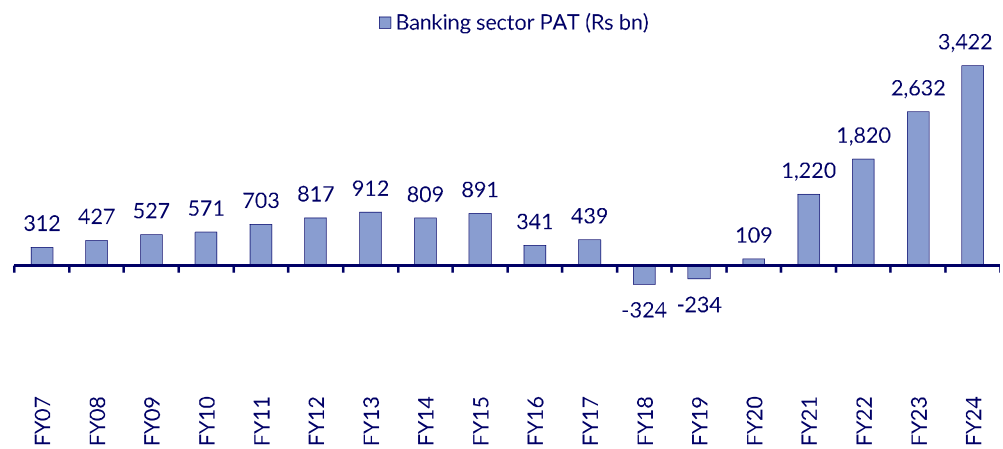
Loan growth has picked up sustainably; expect low-to-mid teens sector growth

The banking sector loan growth has picked up from a decadal average of 10% to 15% over the past two years driven by all sub-segments and possibly some shift from corporate bond substitution. While we expect a degree of normalisation in unsecured loan growth from 20%+ to mid-to-high teens, we estimate overall loan growth at 14-15% over the next two years. We expect private sector banks to continue gaining market share. However, FY25 loan growth across our coverage banks is likely to be divergent due to idiosyncratic issues.

Deposit growth to pick up; high CA ratio makes private banks competitive

Over long time-periods, loan growth and deposit growth have been in sync. In the past two years, lower deposit growth could be attributed to lower reserve money growth, which CLSA's India economist expects will pick up. One notable trend over the past decade is that private sector banks have outpaced PSU Banks in current account (CA) deposits by a margin and have also pared down non-deposit borrowings. This gives them a funding cost similar/marginally better than that of PSU Banks, making them competitive on the loan side.

Indian banking sector profits have quadrupled over the past decade



Source: RBI, CLSA, FY24 is our estimate basis PAT reported by all listed banks; Numbers are standalone

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Great

Solid

Meh

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Great
Solid
Meh

Cleaner, stronger balance sheets; record profits

Banks have a much stronger balance sheet today as compared to five or ten years ago. Not only are they well capitalised, they also have the lowest net Non-performing loan (NPL)/net worth in more than a decade. The quality of corporate credit, too, has improved over the past 5-7 years. The banking sector has seen a rebound in profits as well as profitability, with ROE in FY24 being the highest since FY11.

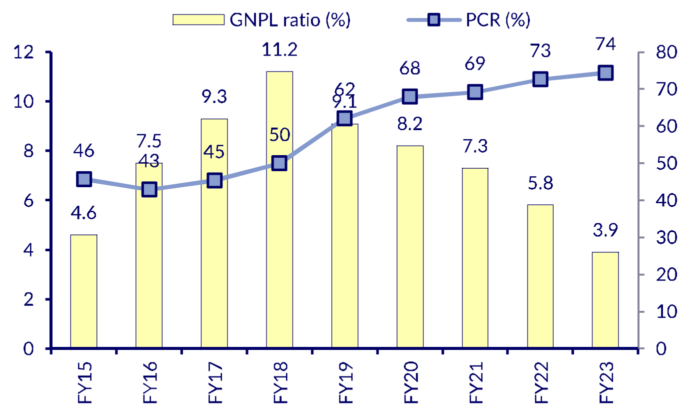
Provision coverage on GNPLs up from 45-50% earlier to c.75% now

Lower GNPLs coupled with higher provision buffers on the balance sheet

The asset quality cycle has seen a sharp recovery from the worst in FY18, driven by resolution of bad corporate assets. While there was some impact of Covid, it was manageable, thanks to dispensations by RBI. Coming out of Covid, banks enjoyed lower slippages and pent-up corporate resolutions. Retail net slippages have now largely normalised to pre-Covid levels, while corporate slippages are still benign. The gross non-performing loan (GNPL) ratio of 3.9% for the sector is at multi-year lows. This improvement is not driven only by write-offs - even new NPL formation has reduced and was at FY08 lows in FY23. Banks used this opportunity to improve provision buffers - PCR is from 50% to 74% over FY18-23.

Figure 1

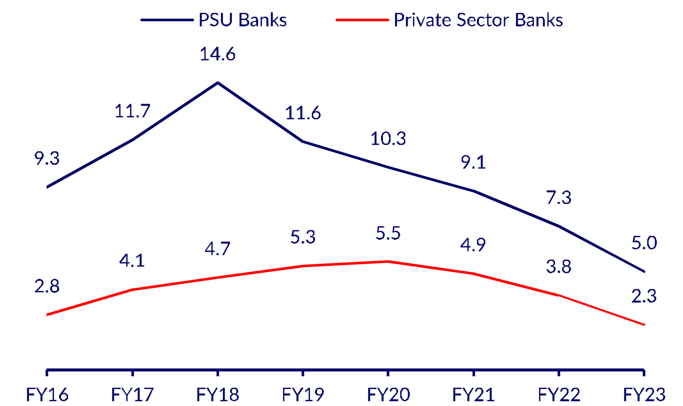
Improvement in GNPL ratio. . .



Source: RBI, CLSA

Figure 2

. . .for both PSU Banks and Private sector banks (%)

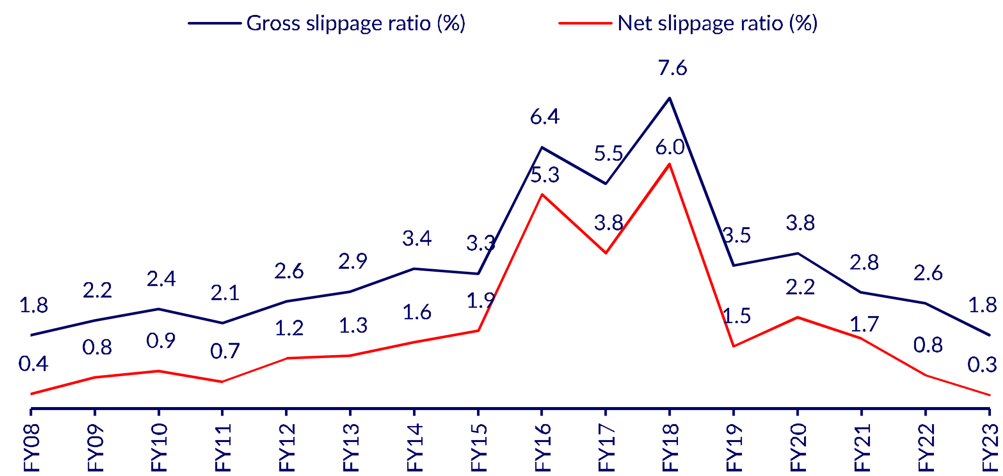


Source: RBI, CLSA

Improvement in the gross and net slippage ratio

Figure 3

New NPL formation also at multi-year lows



Source: RBI, CLSA

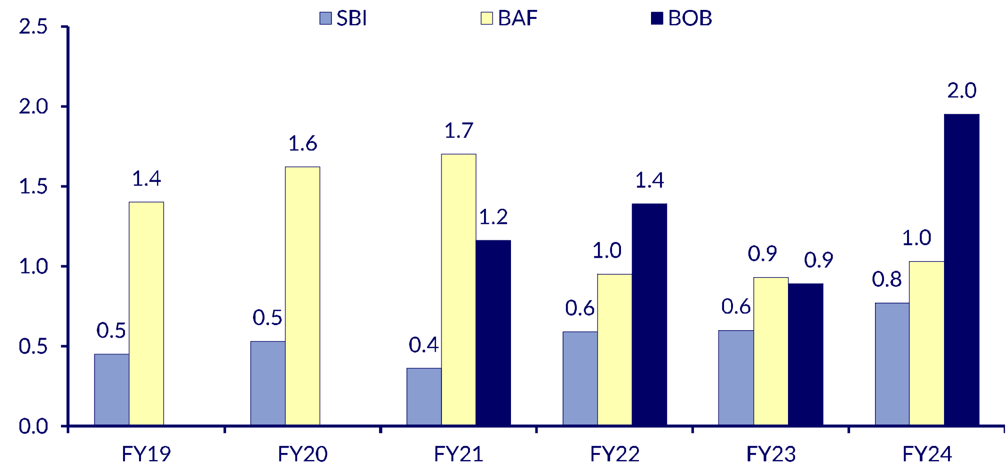
Sharp increase in the unsecured personal loan GNPL ratio for BOB; for SBI and BAF, it was only 10-20bps

Slight increase in unsecured loan GNPLs but nothing worrying

Investors have indicated a lot of concern about asset quality in unsecured loans. Most banks do not report this separately, and most report asset quality metrics for the overall retail book but not for each product. Among the major lenders, State Bank of India (SBI), Bank of Baroda (BOB) and Bajaj Finance (BAF) report a product-wise GNPL ratio. We note that for SBI and BAF, the GNPL ratio in unsecured loans is up only 10-20bps YoY; for BOB, it is up 100bp YoY off a low base.

Figure 4

Unsecured personal loans GNPL ratio trend (%)



Source: Companies, CLSA; 'Urban B2C' segment taken for Bajaj Finance

The share of corporate credit to corporates rated A and above has increased meaningfully in the past 5-7 years

Improvement in the quality of corporate credit

In the past 5-7 years, not only have corporate banks reduced the share of corporate lending, they have also increased the share of better rated corporates in the mix. For example, Axis Bank's (AXSB) share of corporates rated A and above improved from 62% in FY16 to 89% now. Likewise, for IndusInd Bank (IIB), this share has improved from 63% to 78% over the past five years.

Figure 5

Most large banks now have 85-90% of their corporate book rated A and above

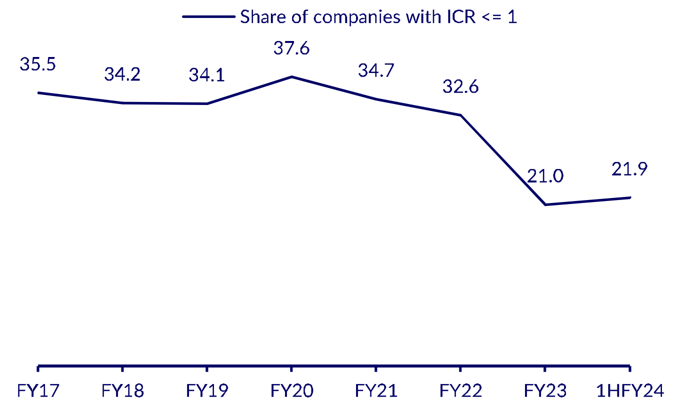
% of corporate loan book	HDFCB	ICICIB	AXSB	IIB	SBI	BOB
A- and above	88	86	89	78	86	90
BBB and below	12	14	11	22	14	10

Source: Banks, CLSA; ICICI numbers are our estimates

Data of c.3,000 companies analysed by the Reserve Bank of India (RBI) implies that the share of corporates with an interest coverage ratio (ICR) of less than 1x has declined meaningfully over the past three years. An ICR of less than 1x implies difficulty in servicing debt. These companies form only 6% of the total corporate revenue pool versus 11% two years ago.

Figure 6

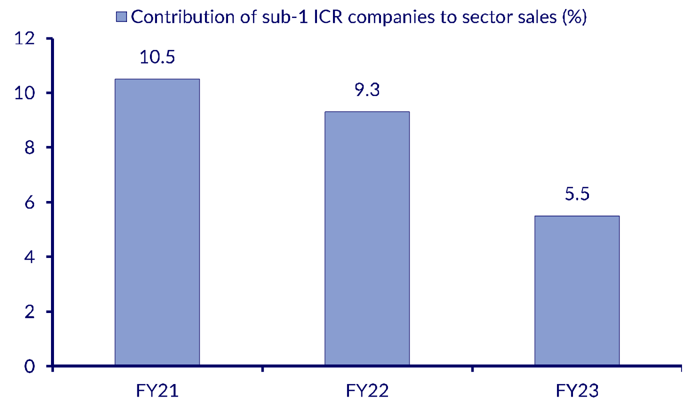
Reducing share of companies with <1 ICR (%)



Source: RBI, CLSA

Figure 7

The revenue contribution of such companies, also, is declining



Source: RBI, CLSA

Net slippages to normalise because of lower upgrades/recoveries and not because of higher gross slippages

We forecast normalisation of net slippage ratio

Barring a couple of small pockets where there has been some stress (for example, microfinance in Punjab), we have not seen any meaningful asset quality issue. This should keep gross slippages low. However, the benefit of pent-up corporate upgrades/recoveries is likely to be smaller in future, given that a lot has already been recovered. Hence, we forecast a normalisation of the net slippage ratio in FY25/26.

Figure 8

We build in normalisation in the net slippage ratio over the next two years

Net slippage ratio (%)	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL
HDFCB	1.59	1.62	1.34	1.59	1.57	0.81	0.45	0.60
ICICIB	0.78	1.04	1.48	0.35	0.20	0.72	1.09	0.97
AXSB	1.09	2.15	1.57	0.94	0.52	0.64	0.88	0.89
KMB	0.43	0.69	1.35	0.06	(0.01)	0.55	0.65	0.70
IIB	2.87	2.01	2.27	1.93	1.70	1.22	1.30	1.36
SBI	0.43	1.31	0.50	0.22	0.11	0.35	0.56	0.68

Source: Banks, CLSA; Note: HDFCB's net slippage ratio for FY24 optically higher due to the merger.

Stronger capital position across both PSU and private sector banks

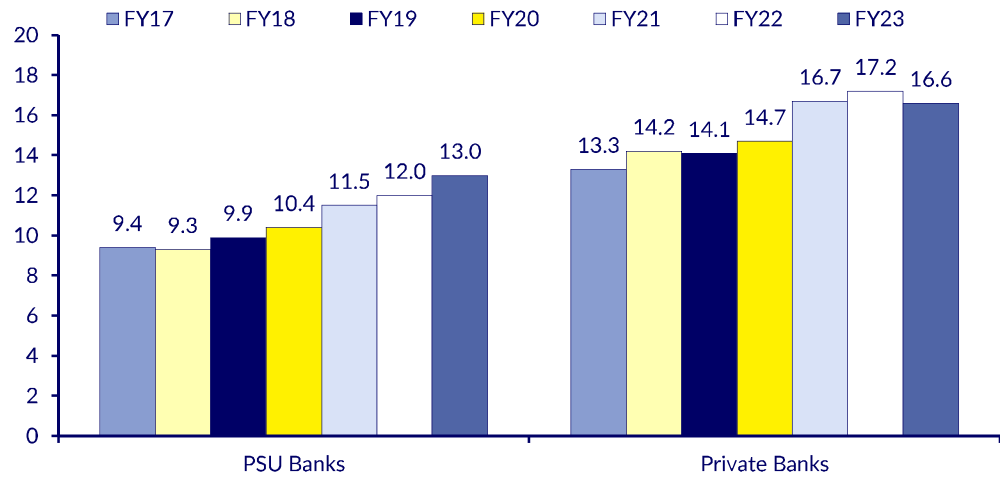
Over the past few years, banks have not only reported strong profits but also raised capital (only post-Covid). Consequently, the Tier-1 ratio of PSU Banks improved from c.10% levels pre-Covid to 13% in FY23, while that of private sector banks improved from 15% to 17% over the same time period.

While Tier-1 ratios declined in FY24 due to the increased risk-weights on unsecured personal loans and loans to NBFCs, the decline was modest (20-30bps). Moreover, with the new investment classification guidelines effective 1 Apr 2024, most banks expect some accretion to Tier-1 capital.

Tier-1 ratio has increased 2-3ppts over the past few years

Figure 9

Capital buffers have been strengthened across banks (Tier-1 ratio, %)



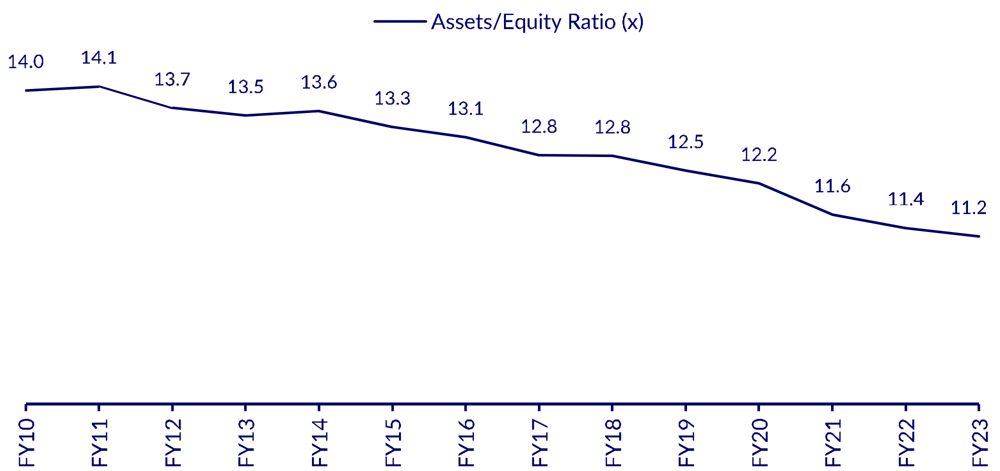
Source: RBI, CLSA

Another way of depicting this trend is using the leverage ratio (assets/equity). The banking sector's leverage has reduced from 14x to 11x over the past decade. This makes the balance sheet more resilient to external shocks.

Average assets/equity stands at 11x

Figure 10

Leverage for the sector has declined over the years, making the balance sheet stronger



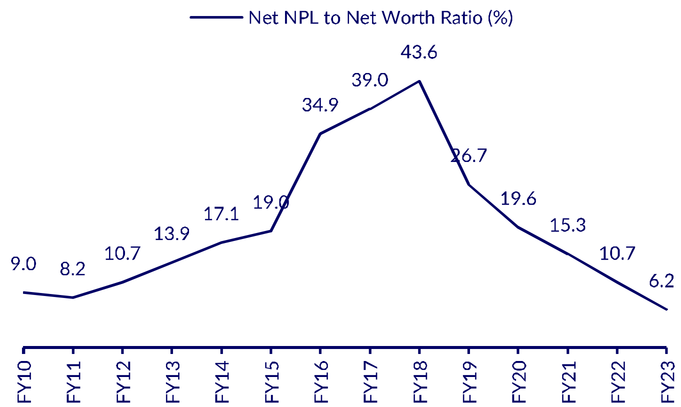
Source: RBI, CLSA

Negligible "residual" risk on the balance sheet

One measure of "residual" risk on the balance sheet is the net NPL/net worth ratio. This ratio depicts the erosion to net worth in a situation of a complete write-off of the NPL. From a peak of 44% in FY18, the net NPL/net worth ratio declined to only 6% in FY23 (even lower in FY24, in our view) driven by a lower GNPL ratio, higher provision buffers and higher capital adequacy. We believe this improvement in the balance sheet of Indian banks is often overlooked by consensus.

Figure 11

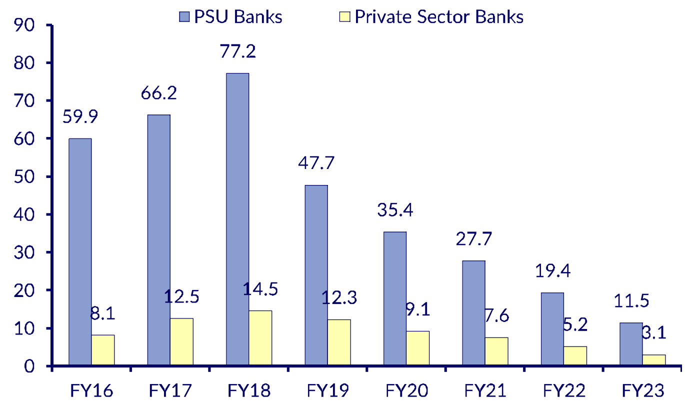
Net NPL/Net worth ratio is at decadal lows. . .



Source: RBI, CLSA

Figure 12

. . .driven by improvement for PSU and private sector banks (%)



Source: RBI, CLSA

Healthy liquidity on the balance sheet

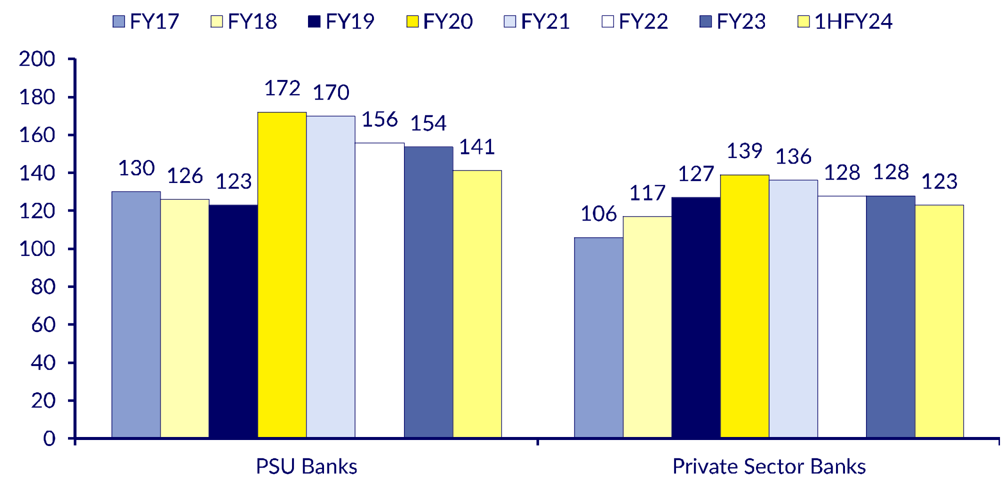
There are two ways of ascertaining "excess" liquidity on the balance sheet. One way is by calculating the ratio of investments/net demand and time liabilities (NDTL). However, this metric disregards the type of deposits raised - as per liquidity coverage ratio (LCR) norms, some deposits require higher liquidity on the balance sheet than other deposits. Hence, looking at the LCR gives a sense of excess liquidity on the balance sheet.

Banks are required to maintain a min LCR of 100%. Yet, banks typically maintain 115-120% LCR at all times. A number above this would imply excess liquidity. We note that PSU Banks, on average, currently have 140% LCR versus 120-130% pre-Covid. Private sector banks have an LCR of 120-125%, similar to pre-Covid levels.

LCR of 120%+ for private sector banks and 140%+ for PSU Banks

Figure 13

Adequate liquidity on the balance sheet (%)



Source: RBI, CLSA

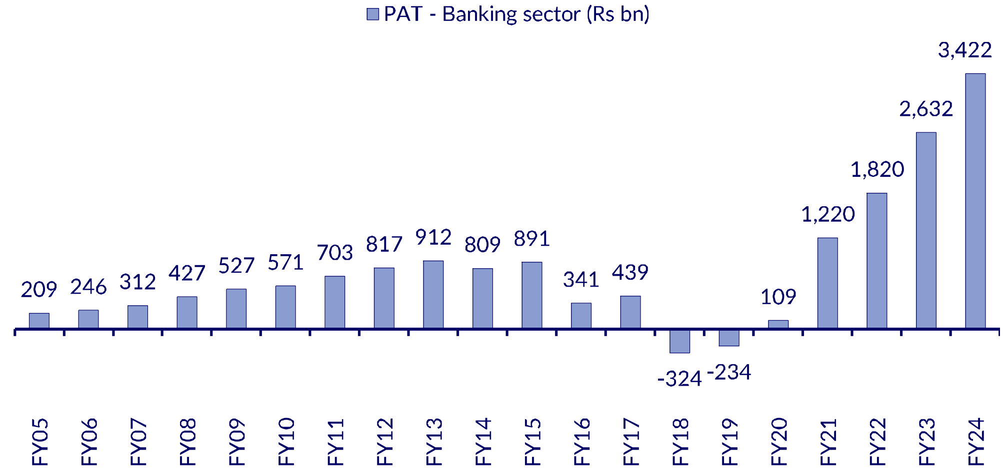
Sharp rebound: profits up by 4x in ten years

The Indian banking sector saw asset quality turmoil in the latter half of the past decade, but it has witnessed a sharp turnaround. Standalone profits have more than quadrupled from c.800bn to Rs3.4tn in the past ten years, implying a 16% Cagr. We accept that FY24 PAT was aided by corporate recoveries and low credit costs, but we believe the sector will deliver low double-digit PAT Cagr over the medium term.

Sharp rebound in Indian banking sector profits

Figure 14

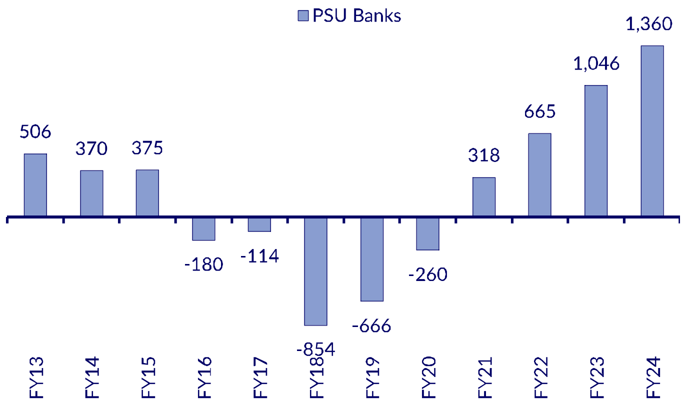
Indian banking sector PAT has quadrupled in 10 years



Source: RBI, CLSA; FY24 is our estimate basis PAT reported by all listed banks; Numbers are standalone

Figure 15

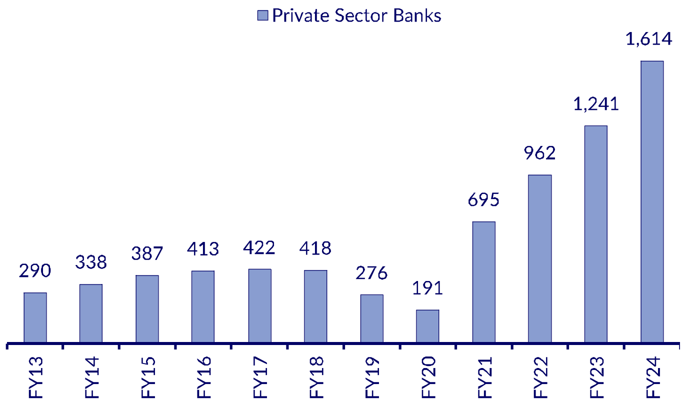
Sharp rebound in PSU Banks' profits (Rsbn)



Source: RBI, CLSA; FY24 PAT is our estimate

Figure 16

Healthy growth in private sector banks' profit pool (Rsbn)



Source: RBI, CLSA; FY24 PAT is our estimate

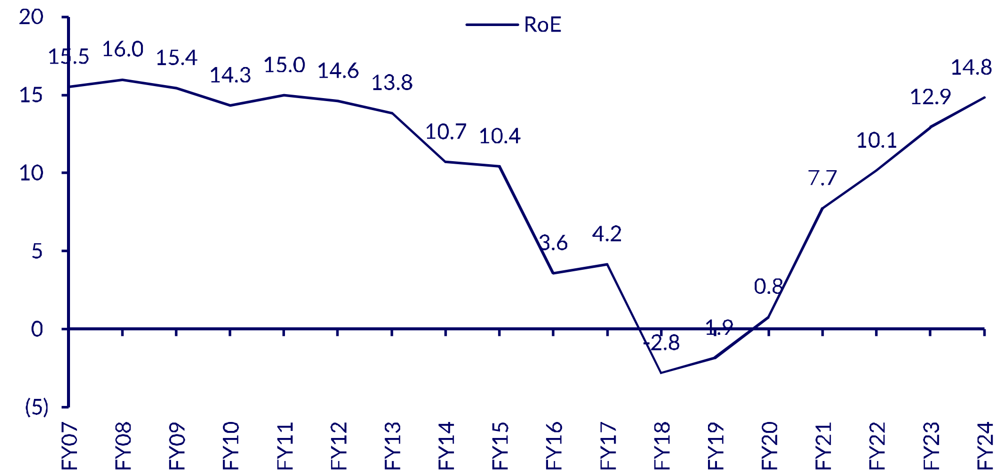
In FY24, the ROE of the Indian banking sector was 15%

Highest ROE since FY11

The banking sector delivered decadal high ROA of 1.3% and ROE of 15% in FY14. FY24's RoE is the highest since FY11.

Figure 17

Significant improvement in profitability of the banking sector (%)



Source: RBI, CLSA; FY24 is our estimate

Improving liability franchise

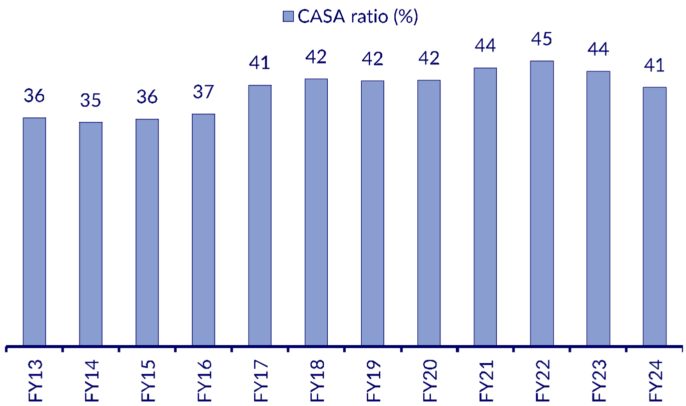
Over the past decade, the CASA franchise of the banking sector has improved. Private sector banks have become leaders in zero-cost current account deposits - this helps them enjoy a cost of deposits similar to that of PSU Banks, despite offering higher rates on term deposits. Banks have also trimmed dependence on non-deposit borrowings, thus making the liability side more granular.

CASA ratio has improved

While total banking sector deposits grew 10-11% over the past decade, CASA deposits grew at a faster clip. The CASA ratio improved 6ppts to 41% over the past decade driven by savings account (SA) deposits. One of the biggest reasons for this was the SA rate deregulation in FY12, resulting in some private sector banks offering a higher interest rate on SA deposits to lure customers. Other factors include demonetisation in 2016, increased use of digital payments instead of cash (leading people to leave money in their savings accounts), among others. Over the last year, the decline in CASA has been due to shift of money from SA deposits to term deposits due to the high interest rate differential between them. As interest rates come down, we expect the CASA ratio to pick up again.

Figure 18

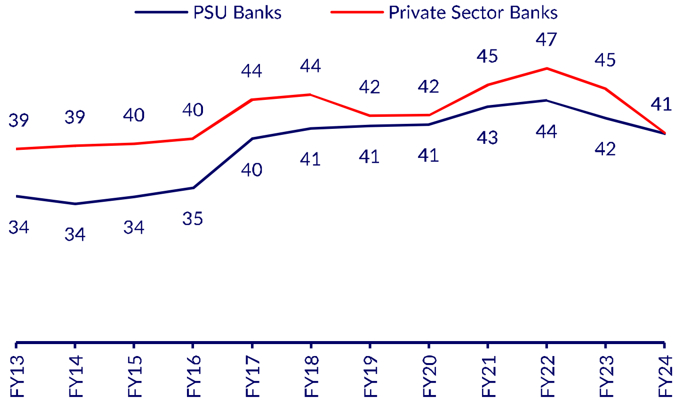
Steady improvement in the CASA ratio over a decade. . .



Source: RBI, CLSA

Figure 19

. . .driven by both PSU and private sector banks

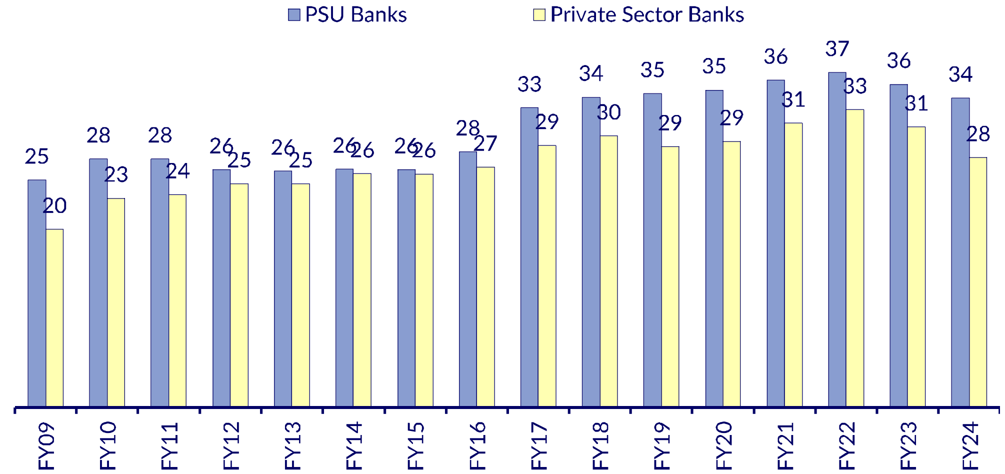


Source: RBI, CLSA

There has been a 8-9ppt increase in the SA deposit ratio over the past 15 years

Figure 20

Structural improvement in the SA deposit ratio (%)



Source: RBI, CLSA

Borrowings account for only 7%/11% of NDTL for PSU/private sector banks

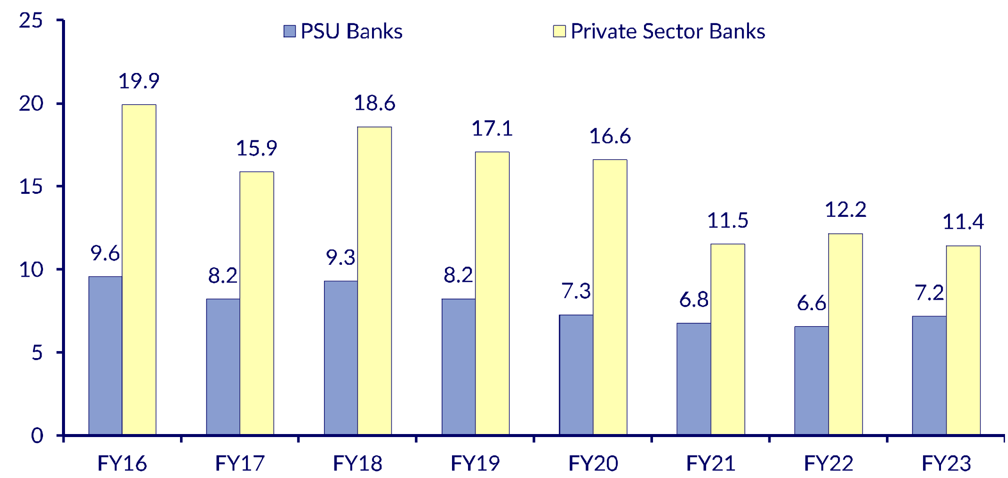
Kotak has the lowest calculated cost of funds among large banks due to its highest CASA ratio

Reducing dependence on non-deposit liabilities

Private sector banks have significantly reduced dependence on non-deposit borrowings - from 20% in FY16 to 11% in FY23. Note that such borrowings are usually more expensive than term deposits (there are some exceptions like infra bonds, though). Part of this reduction has been driven by lower international corporate lending business by ICICI Bank (ICICIB) and AXSB, for which they used to raise offshore bonds.

Figure 21

Private sector banks have trimmed non-deposit liabilities meaningfully in the past five years (%)

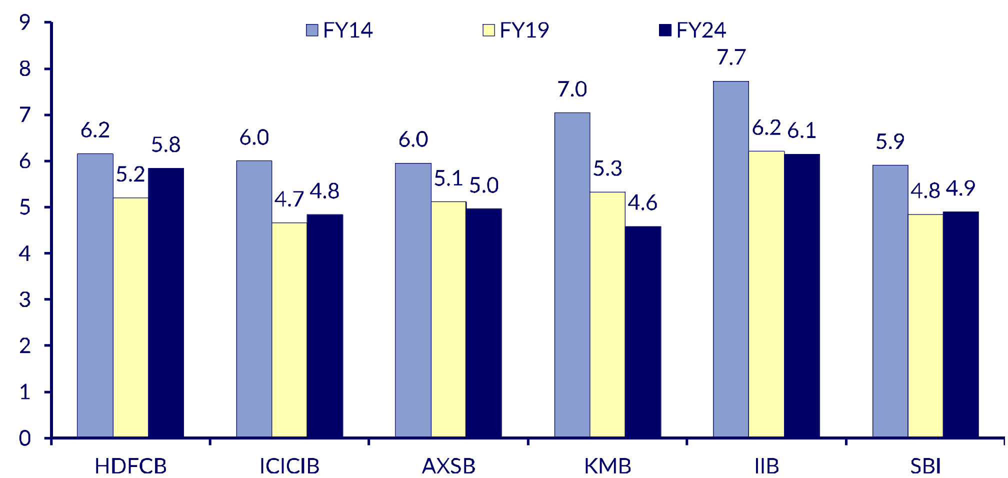


Source: RBI, CLSA; Ratio of borrowings to NDTL

Given the improvement in CASA ratio, the reduction in borrowings and an overall reduction in interest rates in the economy (compared to a decade back), the cost of funds for all banks has declined meaningfully over the past decade.

Figure 22

Cost of funds trended down over the past decade – maximum improvement for Kotak (%)



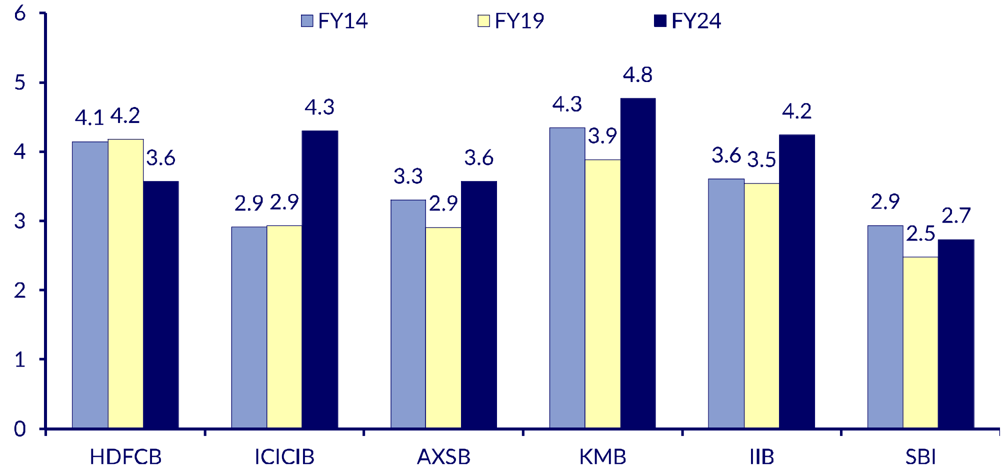
Source: Banks, CLSA; Note: Calculated ratios

Improvement in net interest margins

Most private sector banks have delivered an improvement in net interest margin (NIM) over the past 5-10 years (HDFC Bank's [HDFCB] NIM is lower due to the merger). Some of the NIM improvement is cyclical while most of it is due to structural factors, such as changing loan mix towards higher-margin retail loans, lower interest reversals and a higher CASA ratio (compared to 10 years ago). In the case of IIB, it is also due to the acquisition of Bharat Financial (a high-margin microfinance player).

Figure 23

NIM has improved for most players over the past 5-10 years (%)



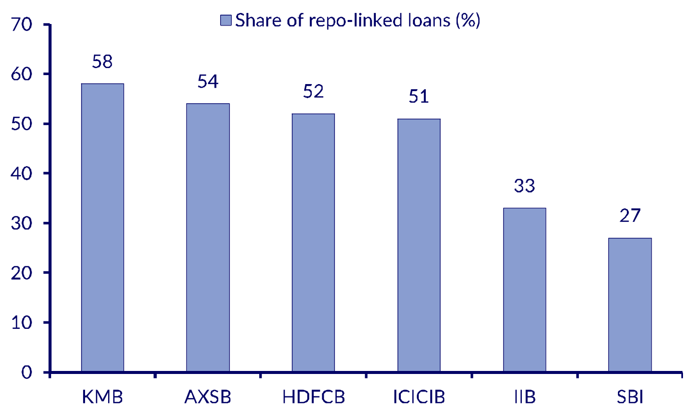
Source: Banks, CLSA; Calculated NIM on average assets

Sharp repo rate cut a key risk to NIM; IIB better placed in such an environment

In our view, the key risk to NIM in the near term is a sharp repo-rate cut as c.50% of loans for most banks are linked to the repo rate. These loans will reprice downwards immediately, while deposits will reprice only gradually. Hence, in the interim, there would be NIM compression for banks. IIB is better placed in such an environment as it has a lower share of repo-linked loans and higher share of bulk deposits (which would reprice downwards faster than retail deposits).

Figure 24

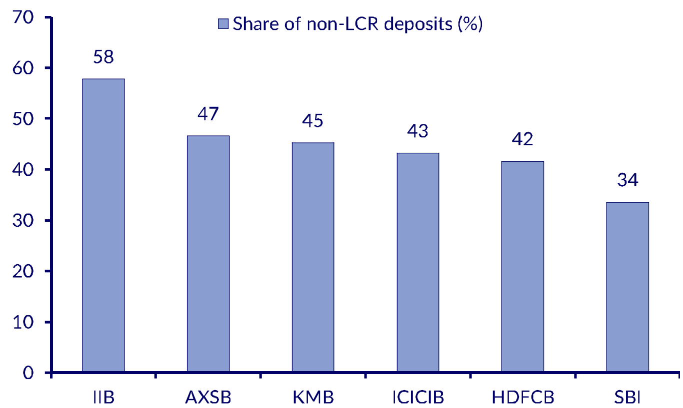
IIB has a lower share of repo-linked loans. . .



Source: Banks, CLSA

Figure 25

. . .and a higher share of non-retail deposits



Source: Banks, CLSA

Total credit growth is 200bps lower than bank credit growth in the past two years

Loan growth to remain healthy

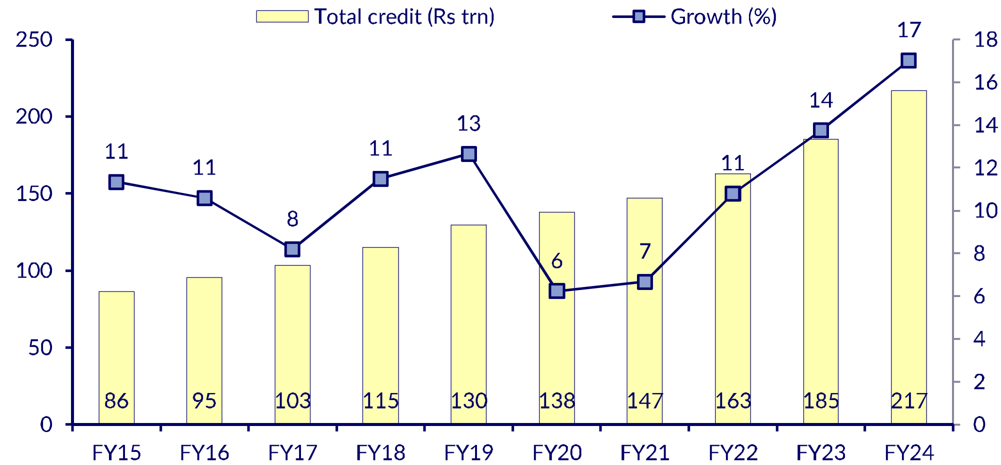
Overall loan growth is at decadal highs driven by a pick-up in all sub-segments. Banks are likely to have also benefitted from corporate bond substitution in the past two years. While we expect some moderation in loan growth driven by certain products, it should still be healthy. However, we think FY25 loan growth is likely to be divergent across large banks due to idiosyncratic issues.

Bond substitution may have helped bank credit growth

One of the key highlights of the strong performance of the banking sector is the sustained pick-up in loan growth over the past two years, after nearly a decade of sluggish growth. While demand has certainly been stronger than in the past, we highlight that substitution from corporate bonds to bank credit could be one reason for strong bank loan growth. This substitution is driven by an uptick in interest rates over the past two years. Simply put, demand for credit has grown at c.200bps lower than demand for bank credit in the past two years. However, we note that this is not a perfect calculation as there may be some "double-counting" when adding bank loans and corporate bonds.

Figure 26

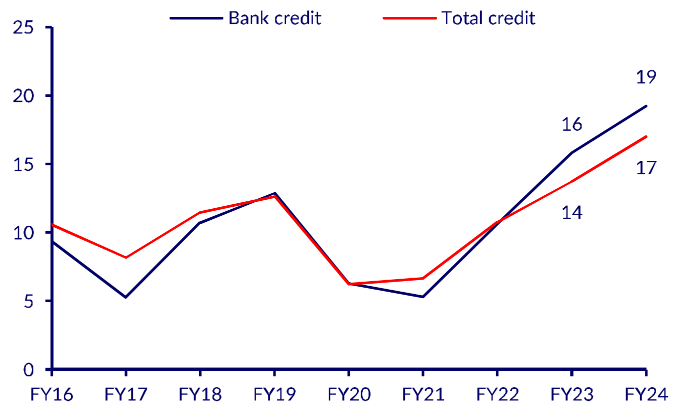
Total credit growth in India (banking sector plus corporate bonds)



Source: RBI, SEBI, CLSA; Note: FY24 growth is not adjusted for HDFCB merger

Figure 27

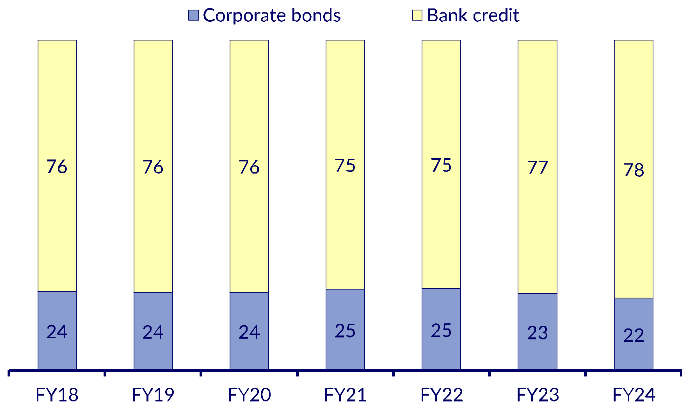
Bank credit grew 200bps faster than total credit in FY23/FY24 (%)



Source: RBI, SEBI, CLSA; 19% bank credit includes HDFCB merger impact; "Total credit" calculated as bank credit + corporate bonds

Figure 28

Share of corporate bonds in total credit declined over FY22-24 (%)



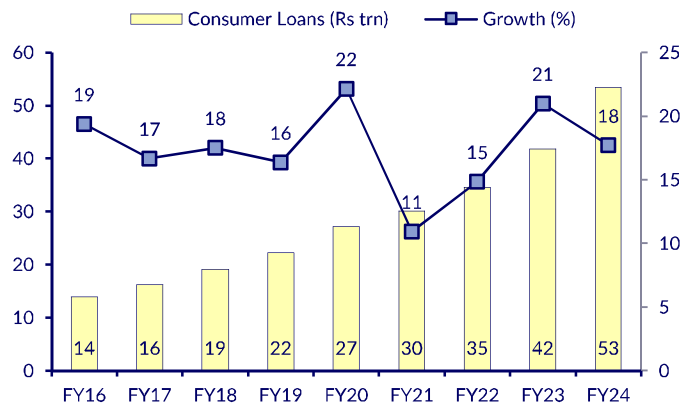
Source: RBI, SEBI, CLSA

Expect mid-to-high teens retail lending growth

Over the past 7-8 years, retail lending has picked up meaningfully driven by a multitude of factors – easier customer acquisition (digital), richer credit bureau data and a deliberate push by banks given weak corporate credit growth. As per our industry interactions, there are over 200m live retail borrowers. Consumer lending is now the largest segment of the Indian banking balance sheet, comprising 34% of total loans.

Figure 29

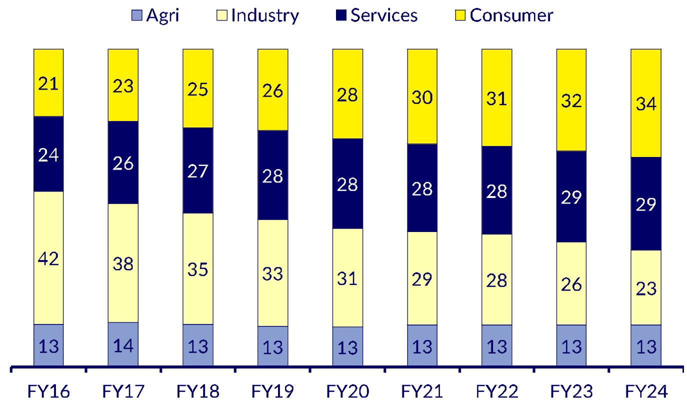
17% Cagr over the past five years



Source: RBI, CLSA; Note: FY24 growth is adjusted for the HDFCB merger

Figure 30

Share of consumer loans up from 26% to 34% over FY19-24

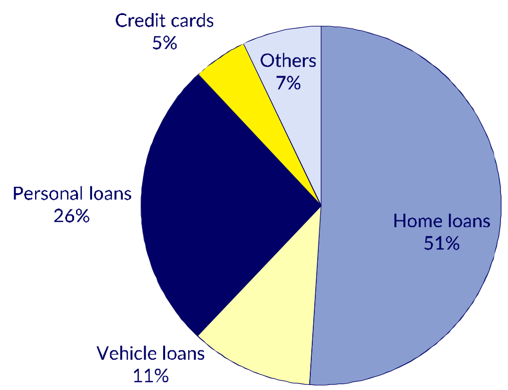


Source: RBI, CLSA

Mortgages comprise half of the consumer lending book for banks. While this segment witnessed strong growth in FY21/22 in the immediate aftermath of Covid, it has now normalised. We expect mortgages to grow at 15% Cagr over the medium term. Note that mortgage penetration in India (11% of GDP) is far below its global peers.

Figure 31

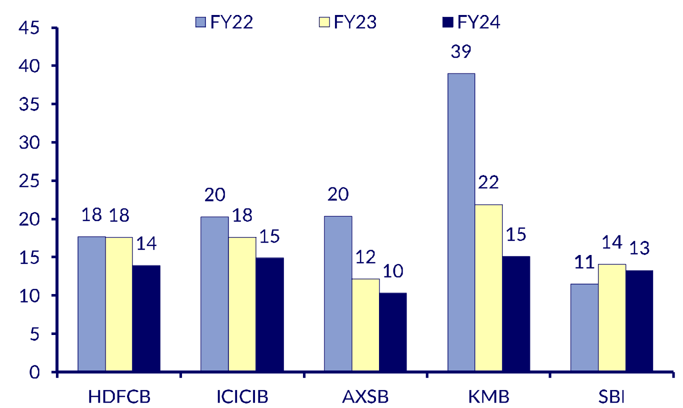
Mortgages comprise half of the total consumer loans



Source: RBI, CLSA; Note: Vehicle loans include personal vehicles only

Figure 32

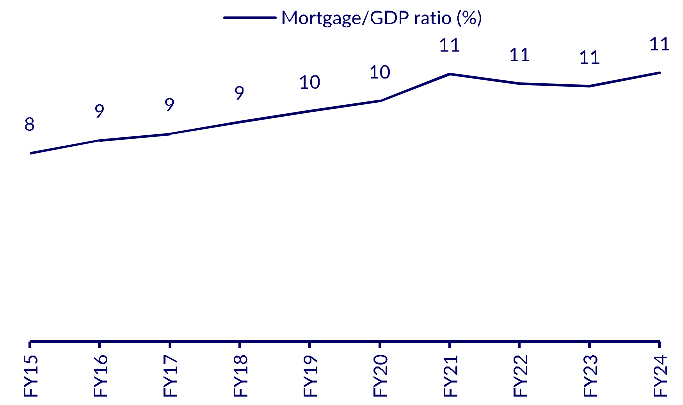
Mortgage growth has normalised from the highs of FY22



Source: Banks, CLSA

Figure 33

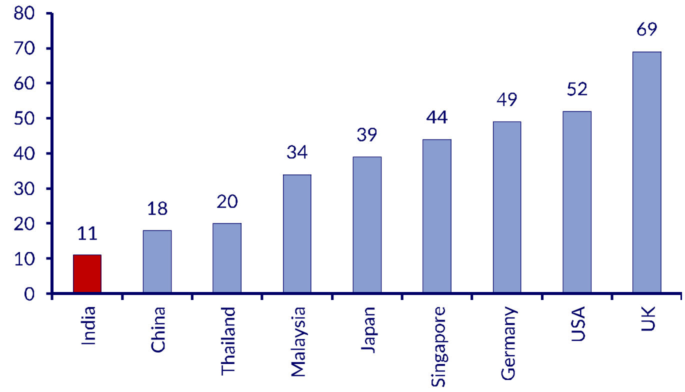
Mortgage penetration in India is still low. . .



Source: CLSA

Figure 34

. . .especially when compared to global peers (%)



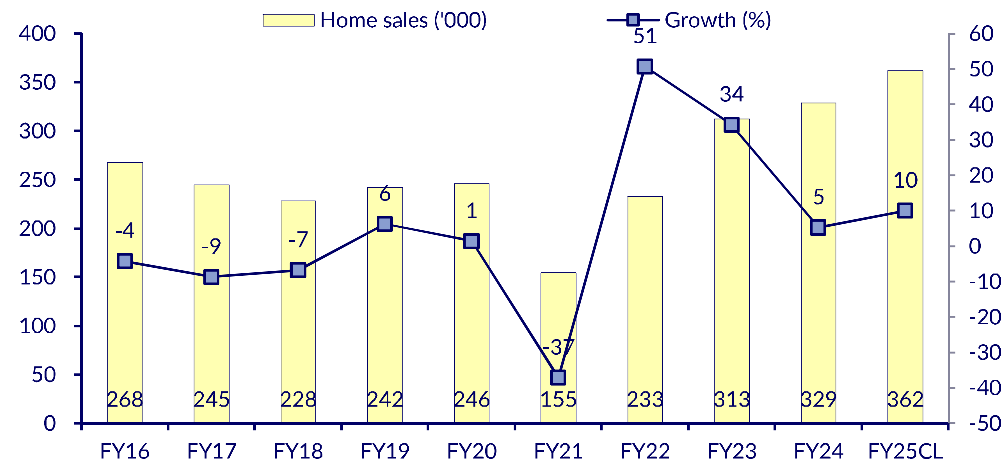
Source: HDFC, CLSA

We expect 10% housing sales volume growth in the top eight cities in FY25

Our real estate analyst expects 10% volume growth (and 5-6% pricing growth) over the next two years.

Figure 35

Trend in home sales in the top eight cities



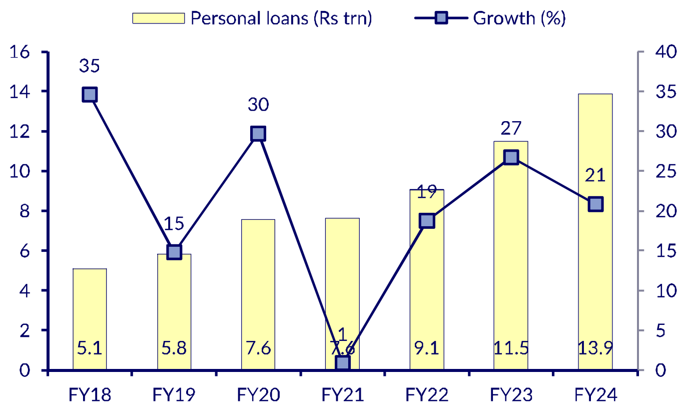
Source: Knight Frank, CLSA; Note: CY rounded-off to FY

Some slowdown in unsecured loans in 4QFY22; We expect this to continue in FY25

Unsecured personal loans has been the fastest-growing retail lending segment in the past 5-7 years. In Nov 2023, the RBI increased risk-weights on these loans, in a prompt to banks to go slow in this segment. Consequently, growth started tapering off in 4QFY24 and we expect it to moderate further (to mid-to-high teens) in FY25.

Figure 36

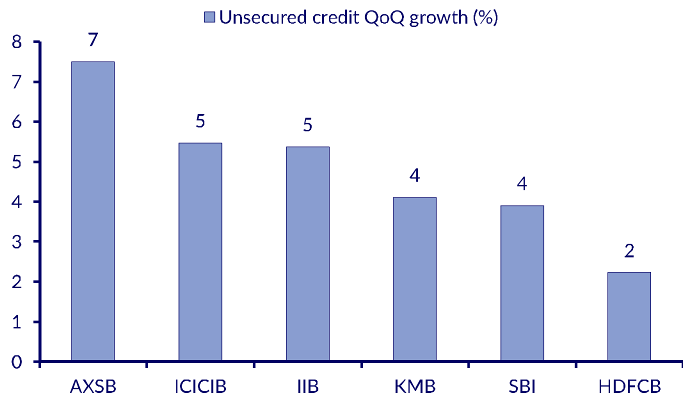
Unsecured PL has been a big growth driver for consumer loans. . .



Source: RBI, CLSA; Note: Approx. Rs2tn is in microfinance

Figure 37

. . .but is seeing some moderation post RBI's risk-weight guidelines



Source: Banks, CLSA

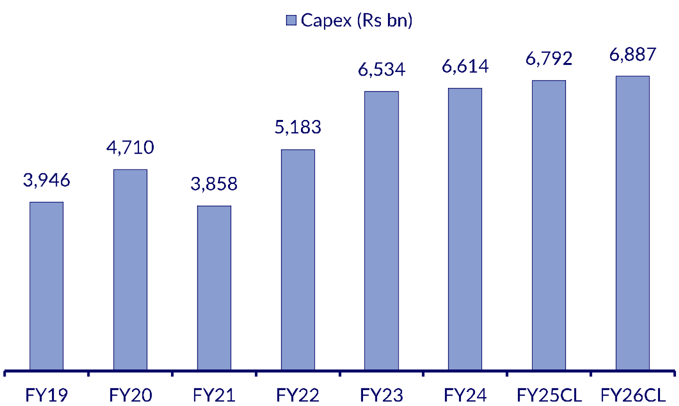
CLSA India analysts expect 6-7% growth in gross debt within their coverage universe (ex-financials)

CLSA universe points to stable capex and modest increase in gross debt

We analysed nearly 150 companies under CLSA's India coverage universe. While the gross capital expenditure (capex) of this universe grew at 12% Cagr over FY20-23, it remained stable in FY24. Our analysts expect a broadly stable capex for FY25 and FY26 too. Also, the gross debt of this universe, which grew at a 15% Cagr over the past two years, is estimated to grow at only 6-7% over the next two years.

Figure 38

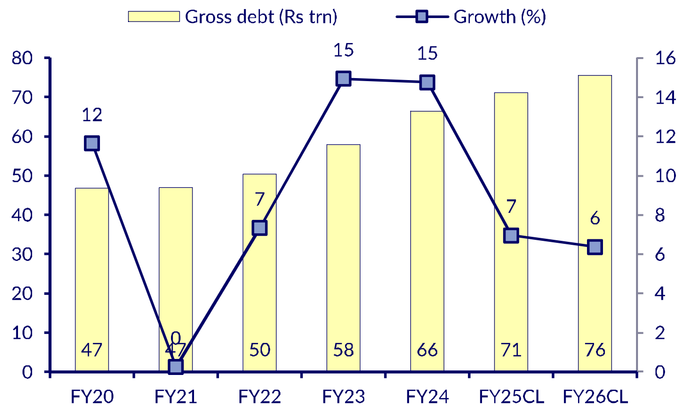
Capex trend of CLSA's India coverage universe



Source: CLSA

Figure 39

Modest growth in gross debt of CLSA's India coverage universe



Source: CLSA

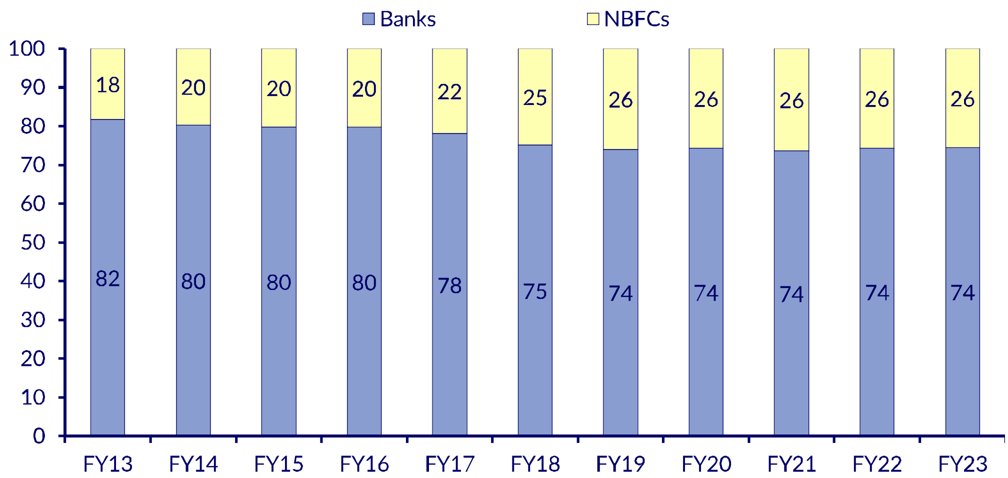
Banks maintaining a stable market share versus NBFCs

The past ten years have been an interesting journey for banks and NBFCs. The latter continually gained market share driven by geographic expansion, product segment (retail loans) and the slow growth of PSU banks. However, post the infrastructure leasing & financial services (IL&FS) crisis in FY19, banks have managed to maintain their market share in the overall system. More importantly, since PSU banks are growing slower than private sector banks, the latter are gaining market share from non-bank financial companies (NBFCs).

Banks have halted the market share loss to NBFCs in the past few years

Figure 40

Loan market share of banks versus NBFCs (%)



Source: RBI, CLSA

Private sector banks' loan market share doubled in the past decade

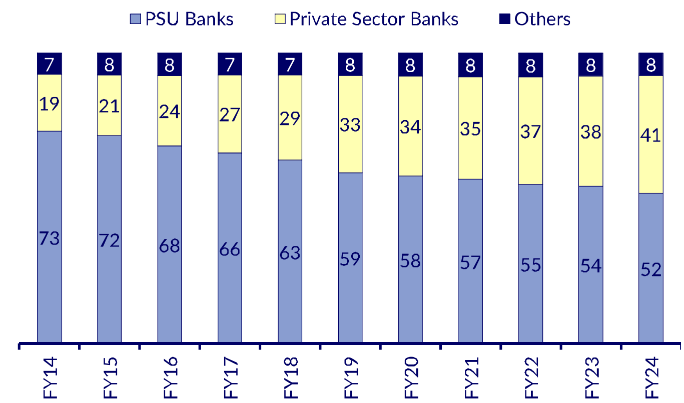
Private sector banks leading on growth, albeit by a lower margin

PSU Banks continue to lose market share on loans, albeit at a slower pace. One of the key reasons, in our view, is that most of them are still heavily into corporate loans and are only slowly making inroads into retail loans, which is the faster growing segment. For example, mortgages and unsecured personal loans typically comprise 30-40% of a private sector bank's loan book but only 10-15% of a PSU bank's loan book (SBI being an exception).

The difference of only 1ppt in FY24 loan growth between private sector and PSU banks is temporary, in our view, as the largest private sector bank, HDFCB (40%+ of private sector bank loan market share), chose to grow more slowly given its deposit situation. While this will continue in FY25 too, we expect the gap to start widening again over the medium term.

Figure 41

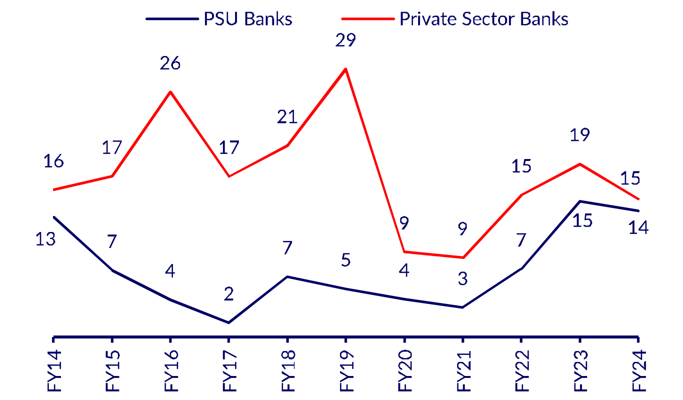
Private sector banks gaining loan market share (%). . .



Source: RBI, CLSA; FY24 numbers include HDFCB merger impact

Figure 42

. . .driven by faster loan growth than PSU Banks

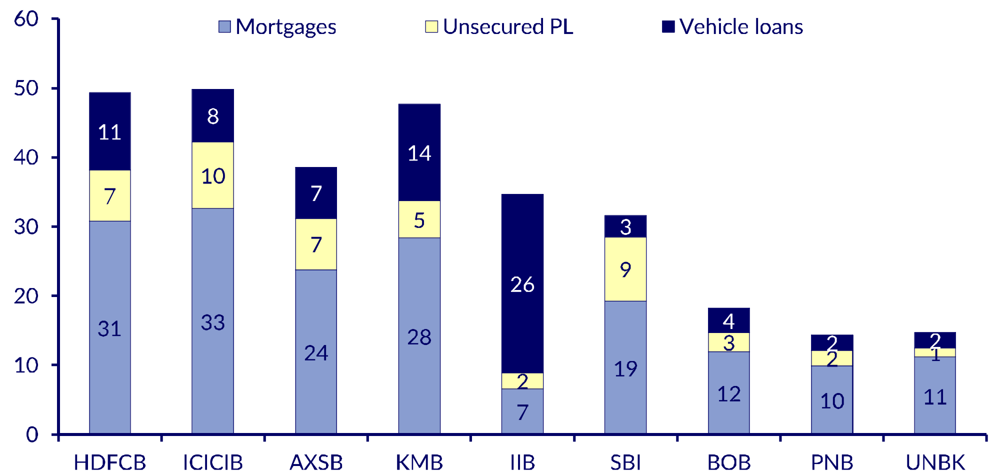


Source: RBI, CLSA; FY24 growth for private sector banks adjusted for HDFCB merger

PSU Banks (ex-SBI) have only 15-20% of the book in retail loans

Figure 43

PSU Banks typically have a lower share of retail loans (the faster growing segment) (%)



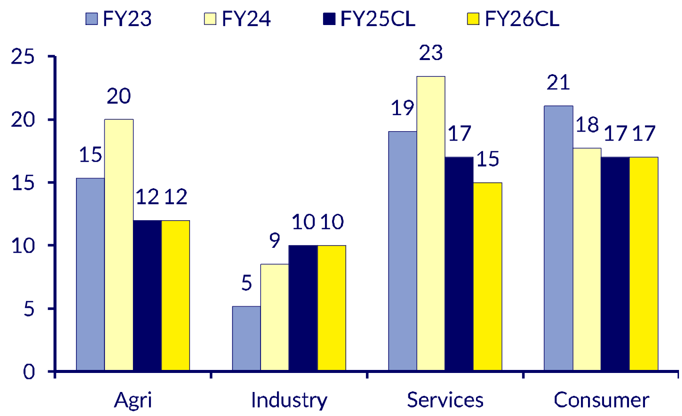
Source: Banks, CLSA

We expect 14-15% industry loan growth over the next two years

We model banking sector loan growth from the bottom up. While the agri segment has grown at 17-18% Cagr over the past two years, we expect a normalisation closer to its long-term average of 11-12% over the next two years. Industry loan growth is modelled at 10%, given the modest gross debt outlook from CLSA's coverage universe. The services and consumer segments, which have grown c.20% in the past two years, are likely to slow down to 15-17% over the next two years, in our view.

Figure 44

Segment-wise loan growth estimates (%)



Source: RBI, CLSA; Note: Adjusted for HDFCB merger

Figure 45

We expect 14-15% banking sector loan growth over FY24-26

Source: RBI, CLSA; Note: Adjusted for HDFCB merger

Idiosyncratic issues, rather than sectoral trends, driving loan growth divergence across banks

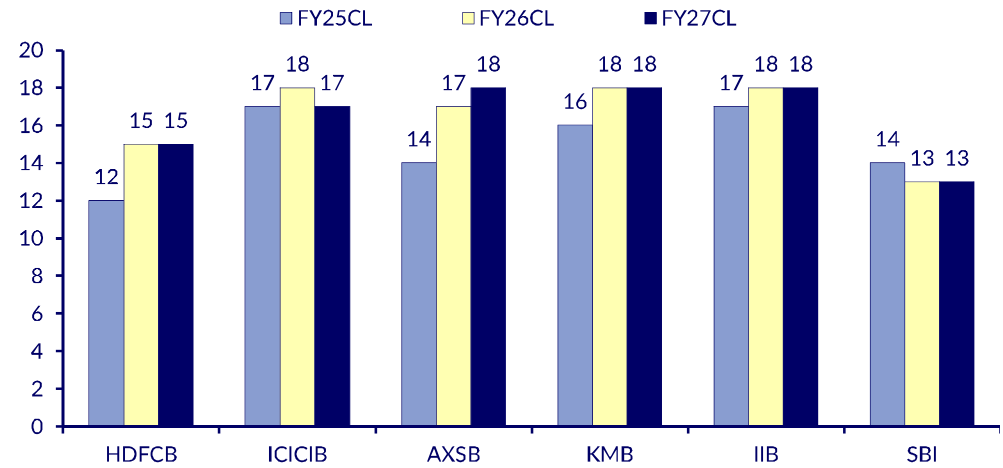
Loan growth to be divergent across banks

While overall credit growth should be decent, in our view, we expect slower-than-usual growth from a couple of private sector banks - HDFCB and AXSB. For HDFCB, we believe this will be driven by management's prioritisation of repaying erstwhile HDFC's liabilities rather than growing the loan book. For AXSB, loan growth is likely to be a function of lowering loan-to-deposit ratio (LDR) and weaker deposit growth. We expect other private sector banks to deliver 16-17% loan growth and SBI to deliver 14% loan growth (in line with the industry).

Expect 16-17% loan growth for ICICIB, KMB and IIB inFY25

Figure 46

Our estimate of loan growth for banks over FY25-27 (%)



Source: CLSA

Deposits: analysing the competitive landscape

In our report, *Unfortunate Confluence*, we analysed geography-wise and district-wise deposit trends in the banking system. In this section, we analyse the competitive landscape between private sector and PSU banks. We note that private sector banks are now leaders in zero-cost current account deposits as well as on overall corporate deposits. However, PSU banks still hold the fort when it comes to household deposits.

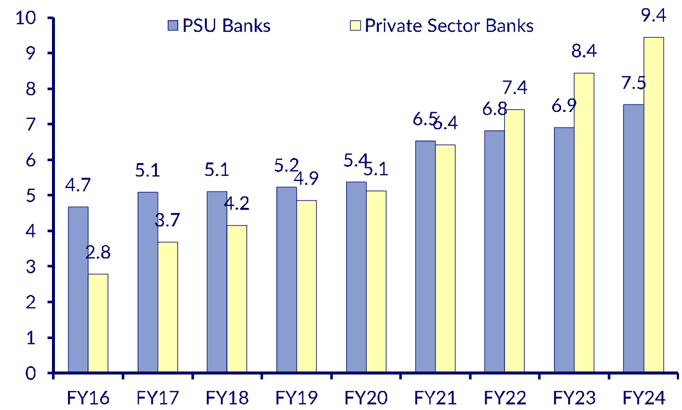
Private sector banks gaining an edge in current account (CA) deposits. . .

Private sector banks have a much higher CA ratio than PSU banks (13% vs 6%)

One interesting trend that has emerged over the past decade is the strength of private sector banks in current accounts. Private sector banks have outgrown PSU Banks in CA deposits, not just in percentage terms, but also in absolute terms. This is driven by factors like better transaction banking services, loans to MSMEs, etc. Kotak Mahindra Bank (KMB) leads in the CA deposit ratio among large banks, primarily because of its strengths in the custody business and its legacy in SME lending.

Figure 47

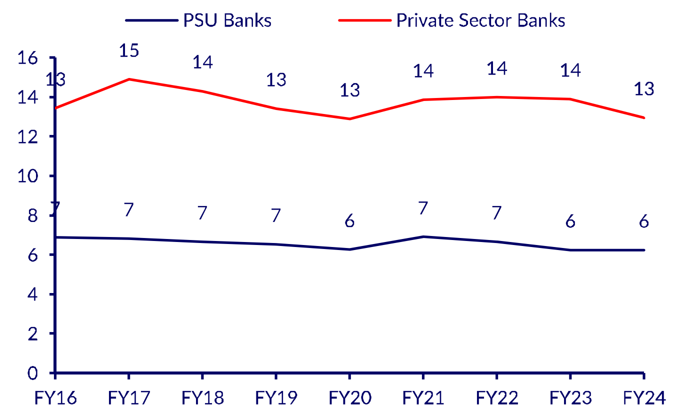
Private sector banks have overtaken PSUs in CA deposits (Rstn)



Source: RBI, CLSA

Figure 48

CA ratio is c.13% for private sector banks and c.6% for PSU banks

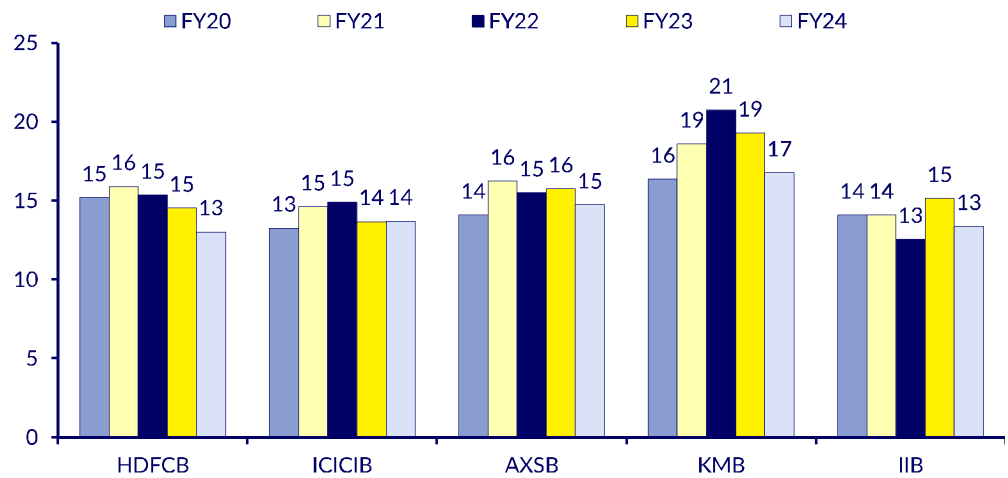


Source: RBI, CLSA

Kotak's CA ratio of 17% is higher than that of other private sector banks at 13-15%

Figure 49

Kotak is the leader in CA deposit ratio among private sector banks (%)



Source: Banks, CLSA

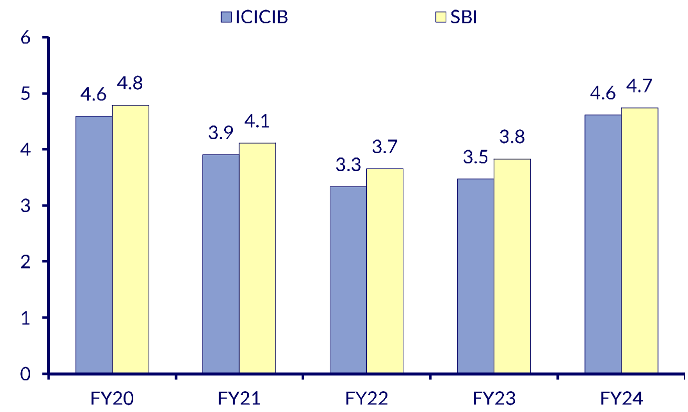
ICICIB and SBI have a similar cost of deposits, thanks to ICICIB's higher CA ratio

. . .leading to a competitive cost of deposits

While one would intuitively expect PSU Banks to have a lower cost of deposits, this is not true. The 7-8ppt difference in the CA deposit ratio would lead to c.30bp savings in the cost of deposits for private sector banks. Hence, while private sector banks offer a higher interest rate on term deposits and have a higher share of wholesale deposits, the overall cost of deposits is competitive vis-à-vis PSU Banks. For example, below is a chart showing ICICIB's versus SBI's cost of deposits.

Figure 50

ICICIB and SBI have a similar cost of deposits (%). . .



Source: ICICIB, SBI, CLSA; Note: Calculated cost of deposits

Figure 51

. . .despite ICICIB offering higher rates on most term deposits (%)

Tenure	ICICIB	SBI
< 1M	3.00	3.50
1-6M	4.75	5.50
6-12M	6.00	6.25
12-24M	7.20	6.80
24-36M	7.00	7.00
36M+	7.00	6.75

Source: ICICIB, SBI; Note: rate on retail term deposits (<Rs20m)

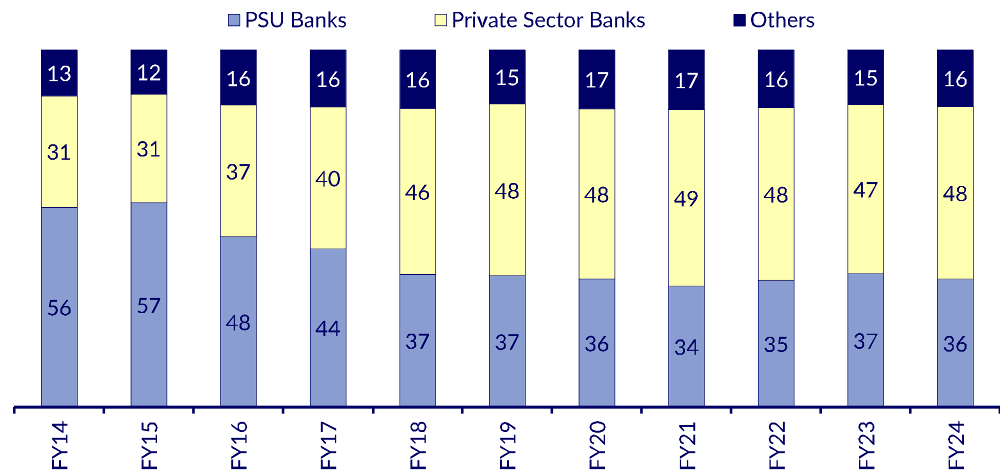
Private sector banks command nearly half of the corporate and NRI deposits in India. . .

Private sector banks leading in corporate and NRI deposits. . .

Another area where private sector banks have done well is corporate and non-resident Indian (NRI) deposits. Part of the success in corporate deposits is reflected in higher current account deposits.

Figure 52

Private sector banks have a higher market share than PSU Banks in corporate and NRI deposits. . .



Source: RBI, CLSA

. . .but only 30% of household and government deposits

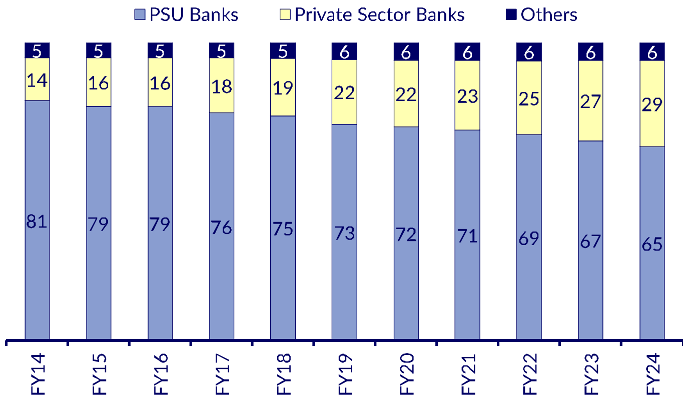
. . .but lag in household and government deposits

While the gap is narrowing, private sector banks are far behind PSU banks in market share in household and government deposits. PSU banks have 65% share in these deposits versus 29% share for private sector banks. This is attributed to a smaller and lower-vintage branch networks for the latter (41k branches vs 84k branches).

While the branch market share of private sector banks has increased over the years, it stands at only 27%.

Figure 53

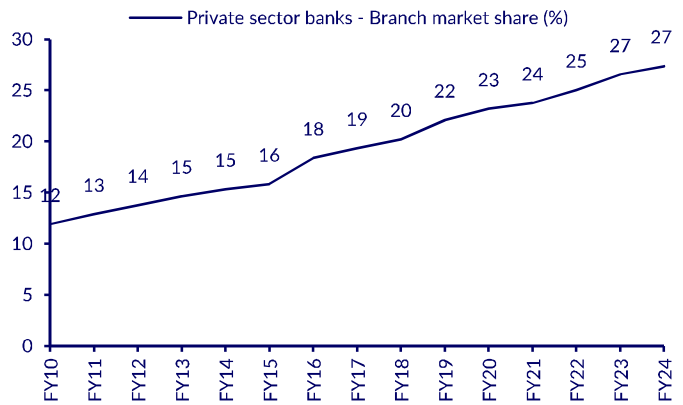
. . .but significantly lag in household and government deposits. . .



Source: RBI, CLSA

Figure 54

. . .due to a modest branch market share (%)



Source: RBI, CLSA

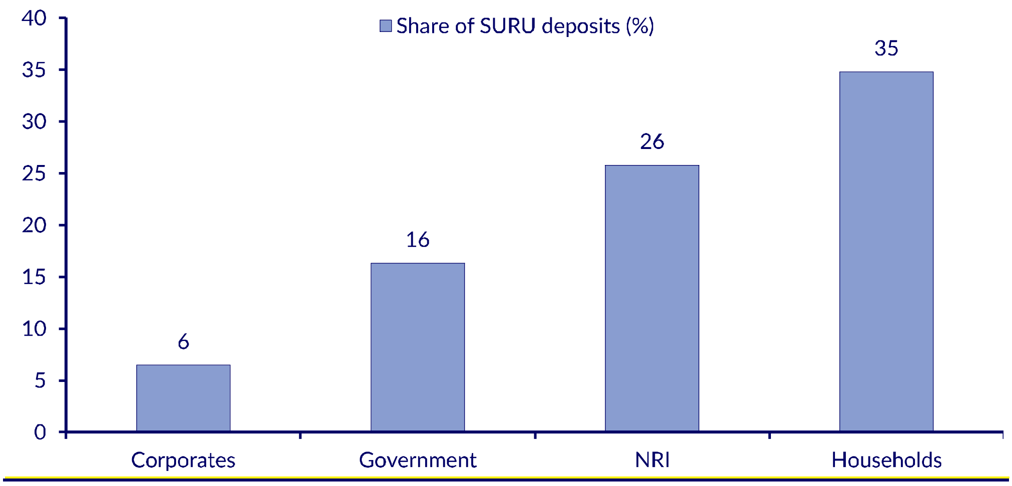
35% of household deposits lie in semi-urban and rural locations

Long road ahead in SURU deposits for private sector banks

Compared to corporates or non-resident deposits, household deposits have a higher contribution from semi-urban and rural (SURU) areas, which account for 35% of total household deposits. The deposit market share of private sector banks in SURU is significantly lower than their corresponding market share in urban and metropolitan regions.

Figure 55

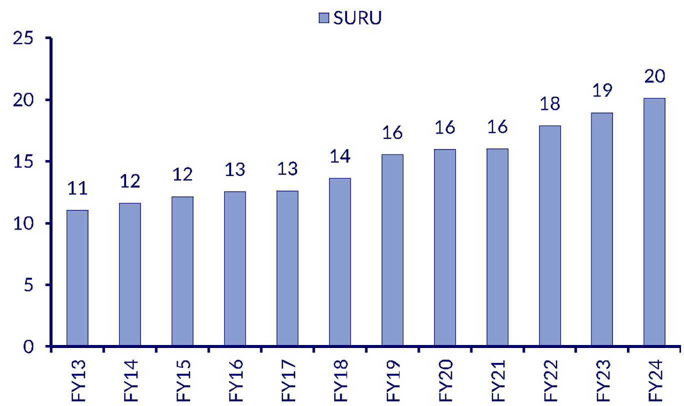
SURU is much more relevant for households than for corporates/government deposits



Source: RBI, CLSA

Figure 56

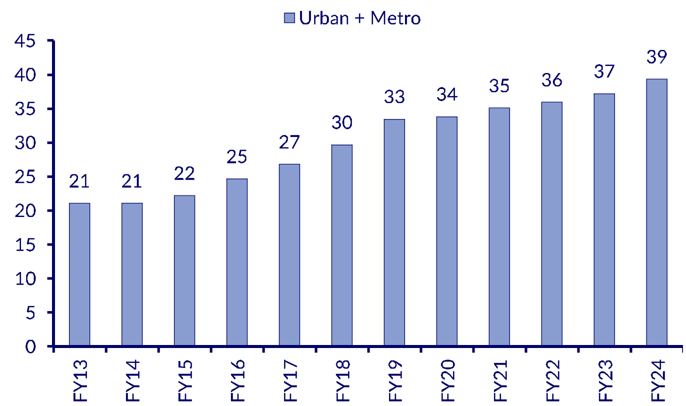
Deposit share of private sector banks is much lower in SURU (%). . .



Source: RBI, CLSA

Figure 57

. . .than in urban and metro areas (%)



Source: RBI, CLSA

Decoding 'lagging' deposit growth

Investors have been concerned that deposit growth is lagging loan growth, and hence banks will not be able to maintain strong loan growth. The reasons for slow deposit growth are attributed to factors such as household investments in equities, mutual funds, etc. This is incorrect, in our view. In this chapter, we attempt to address such concerns.

Deposit growth has moved in tandem with loan growth historically

What history tells us: deposit growth matches loan growth in the long term

Loan growth and deposit growth may differ over short time periods (like 1-2 years), but they match over longer time periods. As shown in the table below, deposit and loan Cagr over the past 5/10/20 years is largely similar. The marginal difference in growth over the past 20 years is due to reduction in regulatory SLR (statutory liquidity ratio) limits, due to which banks redeployed excess government securities (GSec) into loans.

Figure 58

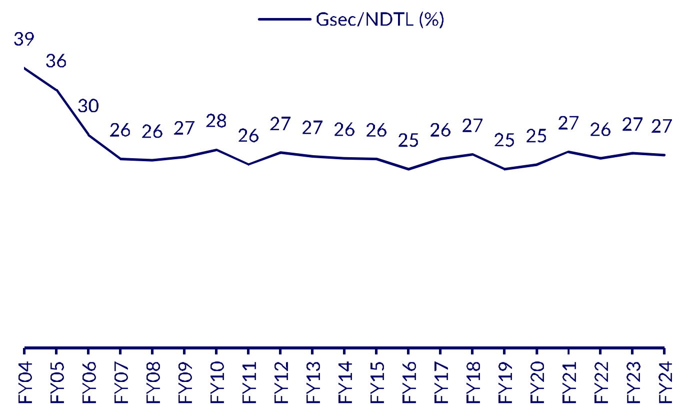
Loan and deposit growth are in sync over long periods

Cagr (%)	5Y	10Y	20Y
Deposits	11.0	10.3	14.1
Loans	11.3	10.4	15.9

Source: RBI, CLSA, Note: Includes HDFCB merger impact

Figure 59

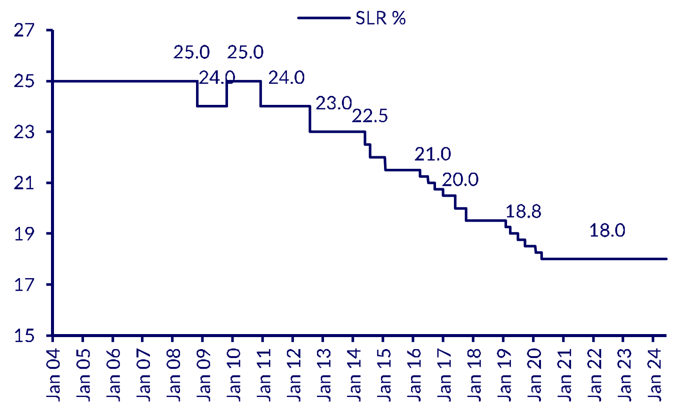
GSec as % of NDTL reduced over the past two decades. . .



Source: RBI, CLSA

Figure 60

. . .due to reduction in minimum SLR requirement by RBI



Source: RBI, CLSA

How did banks manage 16% loan growth with 11% deposit growth in FY23?

To answer this question, we analyse the consolidated balance sheet on the Indian banking sector. We note that loans grew 16-17% (Rs21tn), while deposits grew 11% (19tn). The gap was funded by the excess liquidity banks were sitting on. Banks drew down their cash balances by over Rs3tn and redeployed them into loans. After this redeployment, banks had 9% of NDTL as cash on the balance sheet - this is in line with pre-Covid levels.

Loan growth outpaced deposit growth in FY23 as banks reduced excess cash on the balance sheet

Figure 61

Banking system consolidated balance sheet

Rsbn	FY22	FY23	Increase (Rstn)
Net worth	19.0	21.7	2.6
Deposits	171.8	190.7	18.9
Other liabilities	25.9	30.8	4.9
Total Liabilities	**216.7**	**243.2**	**26.4**
Cash & equivalents	22.9	19.6	(3.3)
Loans	122.0	143.2	21.2
Investments	57.8	64.4	6.6
Other assets	14.1	16.1	1.9
Total Assets	**216.7**	**243.2**	**26.4**

Source: RBI, CLSA

Are deposits going into mutual funds/equities?

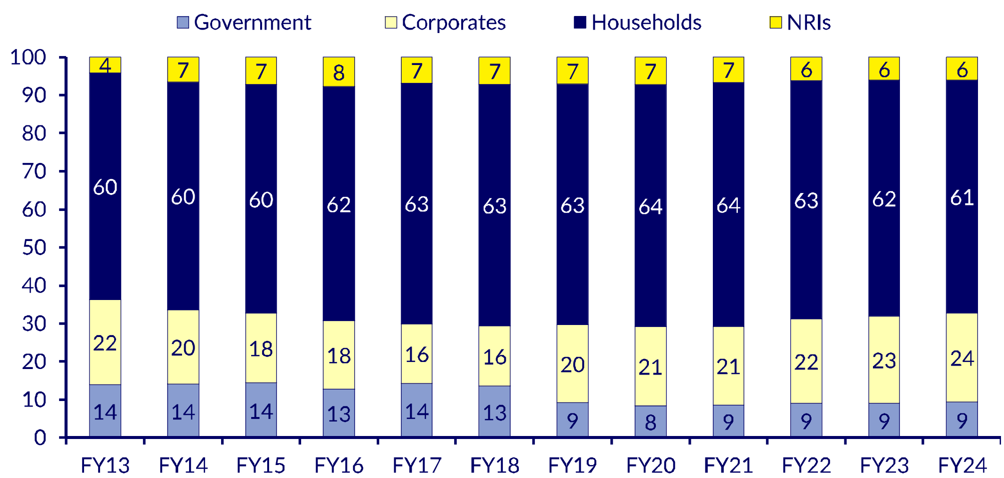
One argument we have heard many times is that bank deposit growth is weak due to retail investors moving money from bank deposits to other investment instruments such as stocks, mutual funds, real estate, etc. We refute this argument because we believe the money remains within the banking system (unless it is withdrawn in cash or leaves the country). For example, if someone buys a stock, the money moves from his/her deposit account to the seller's deposit account, and, hence, total banking sector deposits remain unchanged. The money may move from a household to a corporate (for example, PE fund, mutual fund, etc) but it remains as a deposit.

This is evidenced by the chart below. The share of banking sector deposits held by households has been range bound at 60-65% over the past decade.

Household ownership of deposits has remained constant at 60-65% over the past decade

Figure 62

Mix of ownership of deposits (%)



Source: RBI, CLSA

Reserve money creation has been weaker in the past two years

Reserve money growth was 7-8% in the past two years versus an average of 11-12% over the past decade

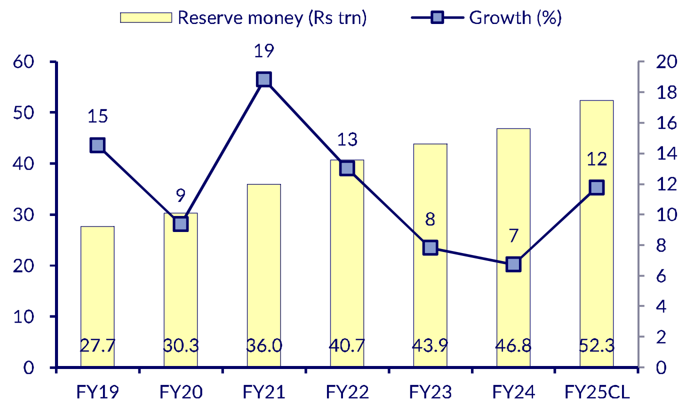
RBI's reserve money growth has been lower than historical levels in the past two years. Compared to an average growth of 12% over FY12-22, it has grown only 7-8% in FY23 and FY24. One of the reasons for weaker reserve money growth in FY24 was the demonetisation of Rs2000 currency notes (amounting to Rs3.5tn). We, however, do not know how much of that demonetised currency was once again withdrawn as cash.

In addition, the money multiplier has been marginally lower at 5.2-5.3x, vs the average of 5.6x over the past decade. These two reasons probably explain the reason for slightly lower deposit growth.

Our economist expects reserve money growth to normalise to 12% in FY25 and also expects an inch-up in the money multiplier to 5.7x.

Figure 63

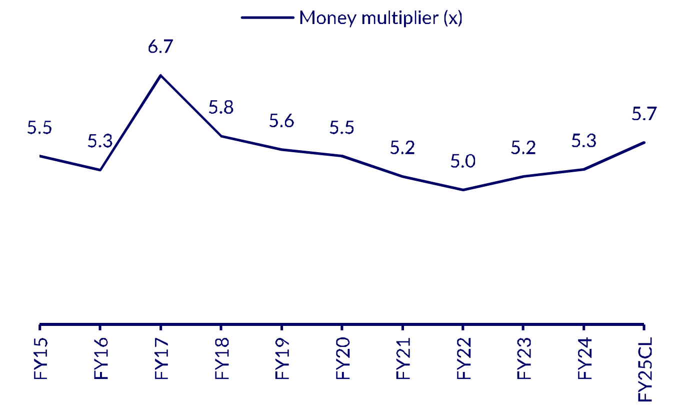
Reserve money growth has been modest in the past two years



Source: RBI, CLSA

Figure 64

Money multiplier has been slightly lower in the past two years

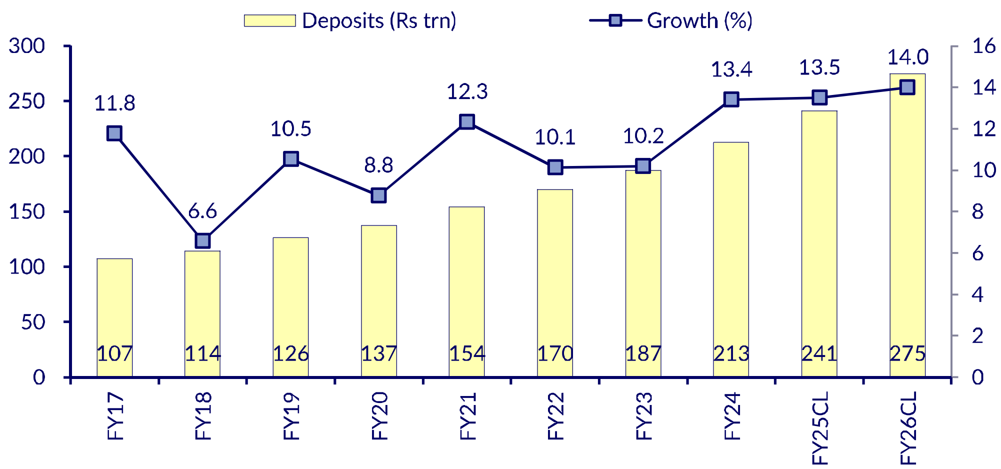


Source: RBI, CLSA

Going by the above assumptions on reserve money growth and money multiplier, money created in FY25 should be c.Rs31-32tn. Assuming Rs3tn is in currency, the remaining Rs28tn would be bank deposit creation. We forecast 13-14% deposit growth for the banking sector over the next two years.

Figure 65

We expect c.14% deposit growth in the medium term



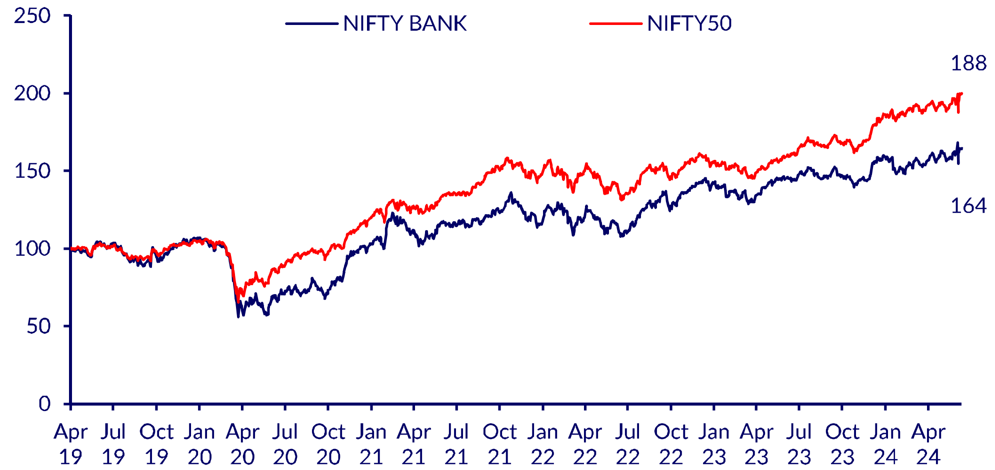
Source: RBI, CLSA

Big underperformance; valuations now compelling

Banks have underperformed the broader index by a wide margin in the past five years. Specifically, this is driven by private sector banks that have underperformed PSU Banks by c.80ppts in the past year alone.

Figure 66

Cumulative underperformance by banks versus the broader index over the past five years is 30ppts+

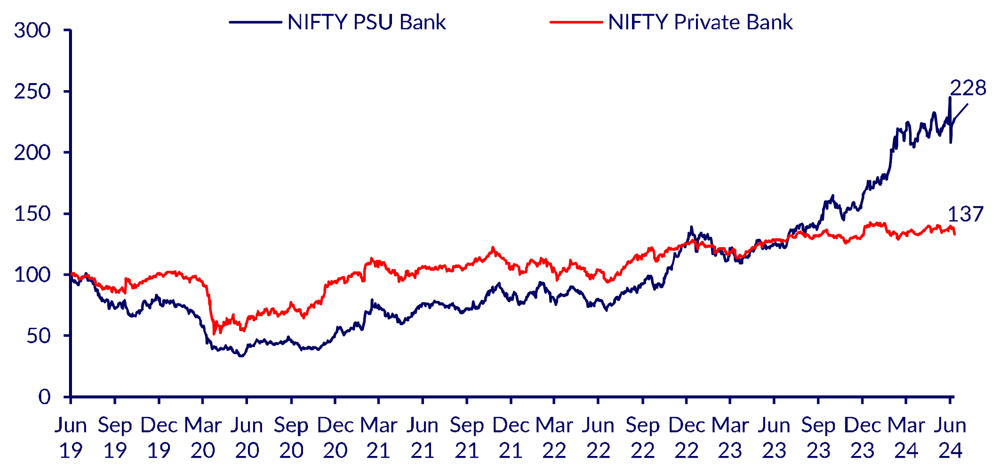


Source: CLSA

While the Nifty PSU Bank index has more than doubled, the Nifty Private Bank index has returned only 37% over the past five years

Figure 67

Significant underperformance of private sector banks vs PSU banks



Source: NSE, CLSA; Indices indexed to 100

Among the large banks under our coverage, we expect ICICIB to deliver the highest ROE (16-17%). While Kotak has a high ROA, its low leverage results in a low ROE. HDFCB's lower ROE is due to the NIM impact from the merger.

Figure 68

DuPont Comparison (%)

	ICICIB		HDFCB		AXSB		KMB		IIB		SBI	
	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL
Interest income	8.2	8.2	8.1	8.1	8.0	7.9	8.4	8.4	9.7	9.8	7.3	7.4
Interest expense	4.3	4.2	4.7	4.6	4.5	4.5	3.9	4.0	5.5	5.5	4.6	4.7
Net interest income	**4.0**	**4.0**	**3.4**	**3.5**	**3.4**	**3.4**	**4.4**	**4.4**	**4.2**	**4.2**	**2.7**	**2.7**
Other income	1.3	1.3	1.2	1.2	1.4	1.5	1.5	1.6	1.8	1.8	0.5	0.5
Total income	**5.3**	**5.2**	**4.6**	**4.7**	**4.9**	**4.9**	**6.0**	**5.9**	**6.0**	**6.0**	**3.2**	**3.2**
Operating expenses	2.2	2.2	1.9	1.9	2.5	2.4	3.1	3.0	3.0	2.9	1.8	1.8
PPOP	**3.1**	**3.1**	**2.7**	**2.8**	**2.5**	**2.6**	**3.2**	**3.2**	**3.2**	**3.2**	**1.6**	**1.6**
Provisions	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.8	0.8	0.3	0.3
PBT	**2.7**	**2.7**	**2.4**	**2.4**	**2.1**	**2.2**	**2.9**	**2.8**	**2.4**	**2.4**	**1.3**	**1.3**
Tax	0.7	0.7	0.6	0.6	0.5	0.5	0.7	0.7	0.6	0.6	0.3	0.3
ROA	**2.0**	**2.1**	**1.8**	**1.8**	**1.6**	**1.6**	**2.1**	**2.1**	**1.8**	**1.8**	**1.0**	**0.9**
Leverage (x)	8.1	8.3	8.2	8.2	9.8	9.8	6.5	6.6	8.3	8.6	16.3	16.0
ROE	**16.5**	**17.0**	**14.7**	**15.0**	**15.4**	**15.7**	**13.9**	**14.1**	**15.0**	**15.5**	**15.7**	**15.0**

Source: Banks, CLSA

Figure 69

HDFCB DuPont (%)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	9.0	8.6	8.3	8.6	8.3	7.4	6.7	7.1	8.5	8.1	8.1	8.2
Interest expense	4.9	4.5	4.2	4.4	4.2	3.4	2.9	3.3	4.9	4.7	4.6	4.6
NII	**4.1**	**4.1**	**4.2**	**4.2**	**4.0**	**4.0**	**3.8**	**3.8**	**3.6**	**3.4**	**3.5**	**3.6**
Other income	1.6	1.5	1.6	1.5	1.7	1.5	1.5	1.4	1.6	1.2	1.2	1.2
Total income	**5.8**	**5.7**	**5.7**	**5.7**	**5.7**	**5.5**	**5.3**	**5.2**	**5.2**	**4.6**	**4.7**	**4.8**
Operating cost	2.6	2.5	2.4	2.3	2.2	2.0	2.0	2.1	2.1	1.9	1.9	1.9
PPOP	**3.2**	**3.2**	**3.4**	**3.4**	**3.5**	**3.5**	**3.4**	**3.1**	**3.1**	**2.7**	**2.8**	**2.9**
Provisions	0.4	0.4	0.6	0.7	0.9	1.0	0.8	0.5	0.8	0.3	0.4	0.4
PBT	**2.8**	**2.8**	**2.8**	**2.8**	**2.6**	**2.5**	**2.6**	**2.6**	**2.3**	**2.4**	**2.4**	**2.5**
Tax	1.0	0.9	1.0	1.0	0.7	0.6	0.6	0.6	0.3	0.6	0.6	0.6
ROA	**1.8**	**1.8**	**1.8**	**1.8**	**1.9**	**1.9**	**1.9**	**1.9**	**2.0**	**1.8**	**1.8**	**1.9**
Leverage	9.9	10.1	10.0	9.0	8.7	8.7	8.6	8.7	8.4	8.2	8.2	8.3
ROE	**18.3**	**18.3**	**18.2**	**16.5**	**16.4**	**16.6**	**16.7**	**17.0**	**16.9**	**14.7**	**15.0**	**15.5**

Source: Bank, CLSA

Figure 70

ICICIB DuPont (%)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	7.7	7.3	6.7	6.9	7.3	6.8	6.5	7.3	8.3	8.2	8.2	8.1
Interest expense	4.6	4.3	3.9	3.9	4.0	3.4	2.9	3.1	4.0	4.3	4.2	4.2
NII	**3.1**	**2.9**	**2.8**	**2.9**	**3.2**	**3.3**	**3.6**	**4.1**	**4.3**	**4.0**	**4.0**	**3.9**
Other income	1.3	1.3	1.3	1.3	1.3	1.1	1.2	1.2	1.2	1.1	1.1	1.1
Total income	**4.4**	**4.2**	**4.0**	**4.2**	**4.6**	**4.4**	**4.8**	**5.3**	**5.5**	**5.1**	**5.1**	**5.1**
Operating cost	1.9	2.0	1.9	2.0	2.1	1.9	2.0	2.2	2.3	2.2	2.2	2.1
PPOP	**3.5**	**3.5**	**3.0**	**2.5**	**2.7**	**3.1**	**3.0**	**3.3**	**3.4**	**3.1**	**3.1**	**3.1**
Provisions	1.7	2.0	2.1	2.1	1.4	1.4	0.7	0.4	0.2	0.4	0.4	0.4
PBT	**1.8**	**1.5**	**0.9**	**0.4**	**1.4**	**1.7**	**2.3**	**2.8**	**3.2**	**2.7**	**2.7**	**2.7**
Tax	0.4	0.2	0.1	0.0	0.6	0.3	0.6	0.7	0.8	0.7	0.7	0.7
ROA	**1.4**	**1.3**	**0.8**	**0.4**	**0.8**	**1.4**	**1.8**	**2.1**	**2.4**	**2.0**	**2.1**	**2.0**
Leverage	8.4	8.3	8.4	9.0	9.6	9.1	8.5	8.2	8.0	8.1	8.3	8.4
ROE	**11.9**	**10.9**	**6.9**	**3.3**	**7.4**	**12.7**	**15.1**	**17.6**	**19.0**	**16.5**	**17.0**	**17.1**

Source: Bank, CLSA

Figure 71

AXSB DuPont (%)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	8.2	7.8	7.1	7.4	7.3	6.7	6.2	6.8	7.8	7.98	7.88	7.87
Interest expense	4.82	4.63	4.20	4.46	4.36	3.59	3.17	3.39	4.26	4.54	4.46	4.47
NII	**3.4**	**3.2**	**2.9**	**2.9**	**2.9**	**3.1**	**3.1**	**3.4**	**3.6**	**3.4**	**3.4**	**3.4**
Other income	1.9	2.0	1.7	1.8	1.8	1.3	1.4	1.3	1.6	1.6	1.6	1.5
Total income	**5.2**	**5.2**	**4.6**	**4.7**	**4.7**	**4.4**	**4.5**	**4.7**	**5.2**	**5.0**	**5.0**	**4.9**
Operating cost	2.0	2.1	2.2	2.1	2.0	1.9	2.2	3.2	2.5	2.5	2.4	2.3
PPOP	**3.2**	**3.1**	**2.4**	**2.5**	**2.7**	**2.4**	**2.3**	**1.6**	**2.7**	**2.5**	**2.6**	**2.6**
Provisions	0.7	2.1	2.4	1.6	2.2	1.5	0.7	0.2	0.3	0.4	0.4	0.5
PBT	**2.5**	**1.0**	**0.0**	**0.9**	**0.6**	**0.9**	**1.6**	**1.3**	**2.4**	**2.1**	**2.2**	**2.2**
Tax	0.8	0.3	0.0	0.3	0.4	0.2	0.4	0.6	0.6	0.5	0.5	0.5
ROA	**1.6**	**0.6**	**0.0**	**0.6**	**0.2**	**0.7**	**1.2**	**0.7**	**1.8**	**1.6**	**1.6**	**1.6**
Leverage	10.4	10.8	11.0	11.5	11.3	10.2	10.0	10.4	10.2	9.8	9.8	9.8
ROE	**17.1**	**6.9**	**0.5**	**7.2**	**2.1**	**7.1**	**12.0**	**7.7**	**18.1**	**15.4**	**15.7**	**15.8**

Source: Bank, CLSA

Figure 72

KMB DuPont (%)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	11.0	8.7	8.2	8.3	8.0	7.2	6.7	7.5	8.4	8.4	8.4	8.4
Interest expense	6.4	4.7	4.3	4.4	4.0	3.1	2.5	2.8	3.6	3.9	4.0	4.0
NII	**4.6**	**4.0**	**4.0**	**3.9**	**4.0**	**4.1**	**4.1**	**4.7**	**4.8**	**4.4**	**4.4**	**4.4**
Other income	1.8	1.7	1.7	1.6	1.6	1.3	1.5	1.5	1.9	1.9	1.9	1.9
Total income	**6.4**	**5.7**	**5.7**	**5.5**	**5.6**	**5.5**	**5.6**	**6.2**	**6.7**	**6.3**	**6.3**	**6.2**
Operating cost	3.7	2.8	2.7	2.6	2.6	2.3	2.6	3.0	3.1	3.1	3.0	3.0
PPOP	**2.7**	**2.9**	**3.0**	**2.9**	**3.0**	**3.2**	**3.0**	**3.2**	**3.6**	**3.2**	**3.2**	**3.3**
Provisions	0.6	0.4	0.4	0.3	0.7	0.7	0.2	0.1	0.3	0.4	0.4	0.5
PBT	**2.1**	**2.5**	**2.6**	**2.6**	**2.3**	**2.5**	**2.8**	**3.1**	**3.3**	**2.9**	**2.8**	**2.8**
Tax	0.7	0.9	0.9	0.9	0.6	0.6	0.7	0.8	0.8	0.7	0.7	0.7
ROA	**1.4**	**1.7**	**1.7**	**1.7**	**1.8**	**1.9**	**2.1**	**2.4**	**2.5**	**2.1**	**2.1**	**2.0**
Leverage	8.2	8.2	7.8	7.7	7.8	7.0	6.3	6.2	6.3	6.5	6.6	6.8
ROE	**11.4**	**13.7**	**13.2**	**13.0**	**13.9**	**13.1**	**13.2**	**14.7**	**15.9**	**13.9**	**14.1**	**13.9**

Source: Bank, CLSA

Figure 73

IIB DuPont (%)

	FY16	FY17	FY18	FY19*	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	9.3	9.0	8.6	8.9	9.8	8.7	8.1	8.5	9.4	9.7	9.8	9.7
Interest expense	5.8	5.2	4.9	5.4	5.7	4.6	4.1	4.4	5.2	5.5	5.5	5.5
NII	**3.5**	**3.8**	**3.7**	**3.5**	**4.1**	**4.0**	**3.9**	**4.1**	**4.2**	**4.2**	**4.2**	**4.2**
Other income	2.2	2.2	2.1	2.0	2.0	1.4	1.5	1.8	1.8	1.8	1.8	1.8
Total income	**5.8**	**5.9**	**5.8**	**5.6**	**6.1**	**5.4**	**5.5**	**5.9**	**6.0**	**6.0**	**6.0**	**6.0**
Operating cost	2.9	3.0	2.8	2.6	2.8	2.5	2.5	2.7	2.9	3.0	2.9	2.9
PPOP	**2.9**	**3.0**	**3.0**	**3.0**	**3.3**	**2.9**	**3.0**	**3.2**	**3.1**	**3.0**	**3.1**	**3.1**
Provisions	0.5	0.7	0.6	1.2	1.6	2.4	1.7	1.0	0.8	0.8	0.8	0.9
PBT	**2.7**	**2.7**	**2.7**	**2.0**	**2.1**	**1.1**	**1.6**	**2.3**	**2.5**	**2.4**	**2.4**	**2.4**
Tax	0.9	0.9	0.9	0.7	0.6	0.3	0.4	0.6	0.6	0.6	0.6	0.6
ROA	**1.80**	**1.78**	**1.80**	**1.3**	**1.5**	**0.8**	**1.2**	**1.7**	**1.8**	**1.8**	**1.8**	**1.8**
Leverage	9.2	8.7	9.2	10.0	9.6	8.7	8.5	8.5	8.3	8.3	8.6	8.8
ROE	**16.6**	**15.4**	**16.6**	**13.2**	**14.5**	**7.3**	**10.2**	**14.5**	**15.3**	**15.0**	**15.5**	**15.9**

Source: Bank, CLSA

Figure 74

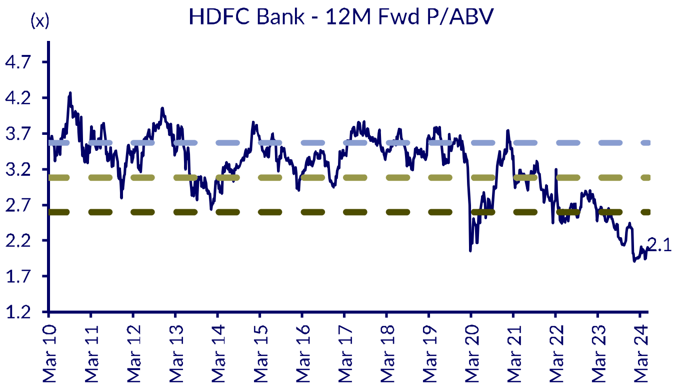
SBI DuPont (%)

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25CL	FY26CL	FY27CL
Interest income	7.4	6.9	7.2	6.8	6.7	6.2	5.8	6.3	7.1	7.3	7.4	7.4
Interest expense	4.8	4.5	4.7	4.3	4.2	3.6	3.3	3.6	4.4	4.6	4.7	4.7
NII	**2.6**	**2.4**	**2.4**	**2.5**	**2.6**	**2.6**	**2.5**	**2.8**	**2.7**	**2.7**	**2.7**	**2.7**
Other income	1.3	1.4	1.4	1.0	1.2	1.0	0.9	0.7	0.9	0.7	0.7	0.7
Total income	**3.9**	**3.8**	**3.9**	**3.5**	**3.8**	**3.6**	**3.4**	**3.5**	**3.6**	**3.4**	**3.4**	**3.4**
Operating cost	1.9	1.8	1.9	2.0	2.0	1.9	2.0	1.9	2.0	1.8	1.8	1.8
PPOP	**2.0**	**2.0**	**1.9**	**1.6**	**1.8**	**1.7**	**1.4**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**
Provisions	1.3	1.4	2.4	1.5	1.1	1.0	0.5	0.3	0.1	0.3	0.3	0.3
PBT	**0.6**	**0.6**	**(0.5)**	**0.0**	**0.7**	**0.6**	**0.9**	**1.3**	**1.5**	**1.3**	**1.3**	**1.3**
Tax	0.2	0.2	(0.3)	0.0	0.3	0.2	0.2	0.3	0.4	0.3	0.3	0.3
ROA	**0.5**	**0.4**	**(0.2)**	**0.0**	**0.4**	**0.5**	**0.7**	**1.0**	**1.2**	**1.0**	**0.9**	**1.0**
Leverage	16.2	15.2	15.1	16.2	16.9	17.5	17.8	17.3	16.6	16.3	16.0	15.8
ROE	**7.3**	**6.3**	**(3.2)**	**0.4**	**6.4**	**8.4**	**11.9**	**16.5**	**19.3**	**15.7**	**15.0**	**15.3**

Source: Bank, CLSA

Figure 75

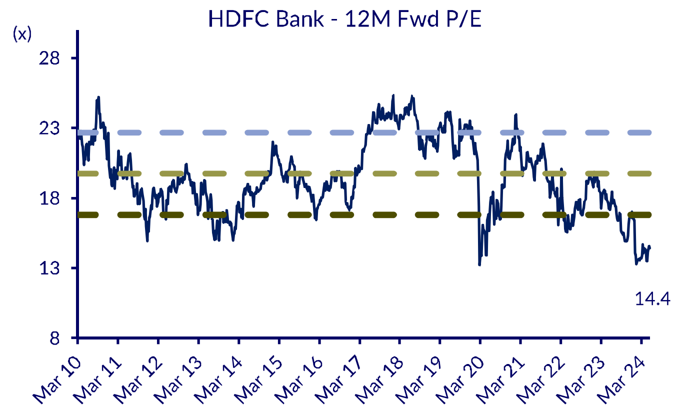
HDFCB PB trend



Source: BBG, Bank, CLSA

Figure 76

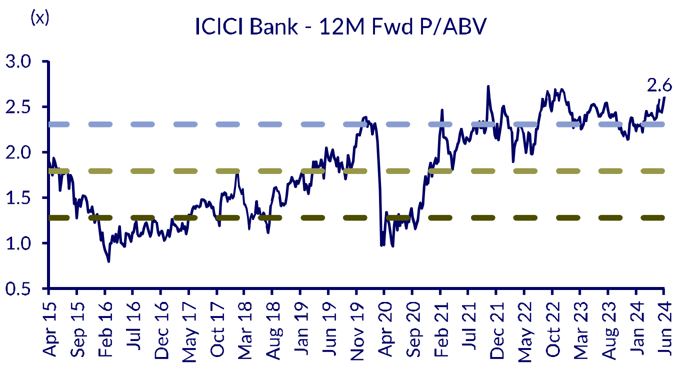
HDFCB PE trend



Source: BBG, Bank, CLSA

Figure 77

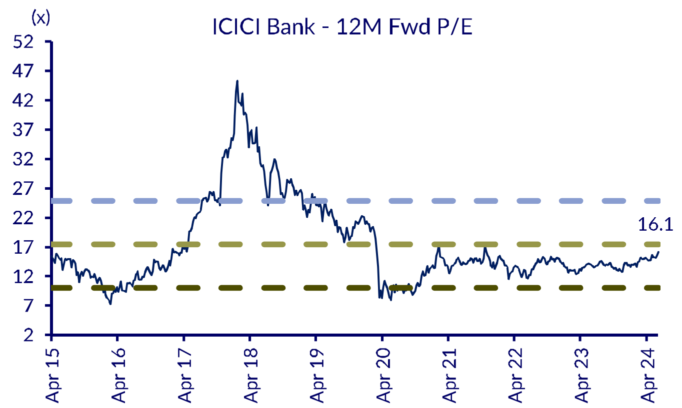
ICICIB PB trend



Source: BBG, Bank, CLSA

Figure 78

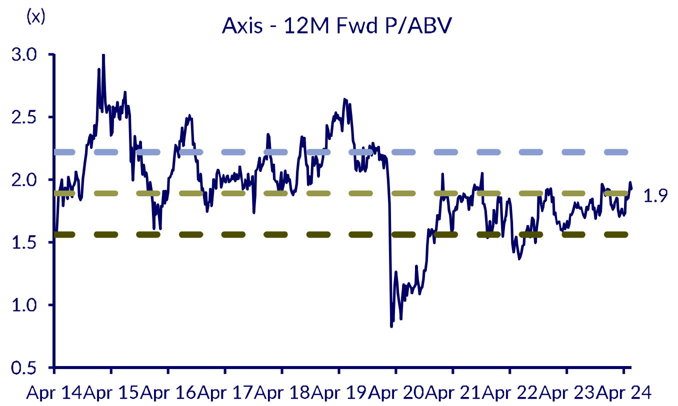
ICICIB PE trend



Source: BBG, Bank, CLSA

Figure 79

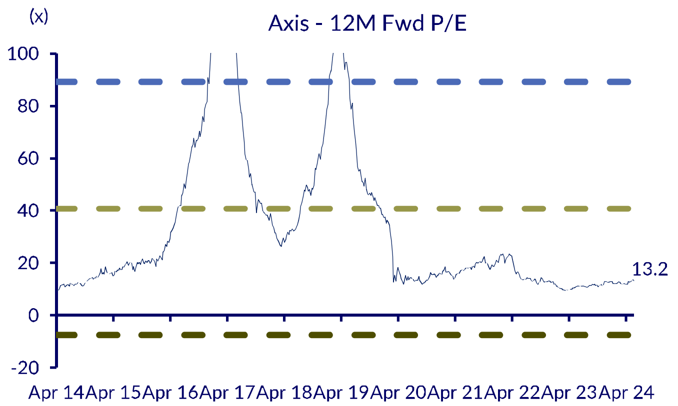
AXSB PB trend



Source: BBG, Bank, CLSA

Figure 80

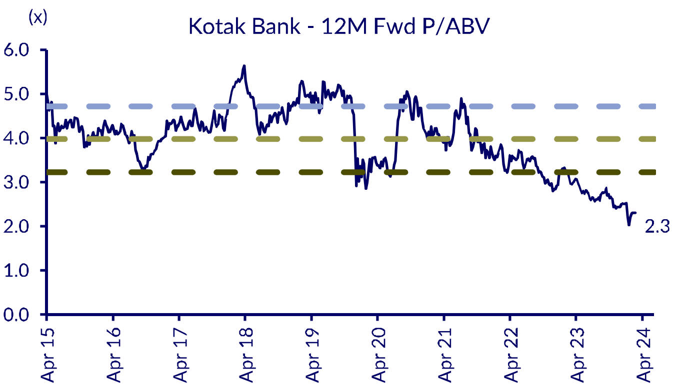
AXSB PE trend



Source: BBG, Bank, CLSA

Figure 81

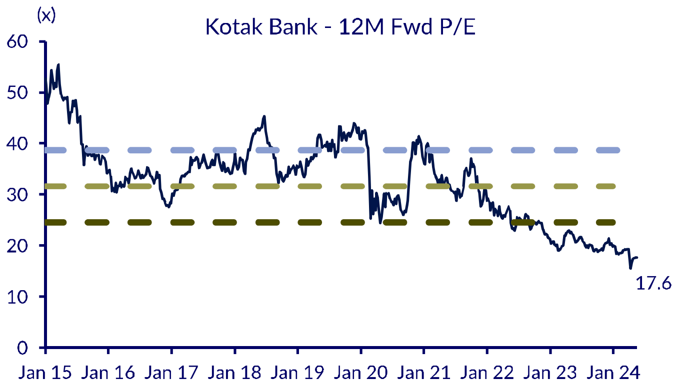
KMB PB trend



Source: BBG, Bank, CLSA

Figure 82

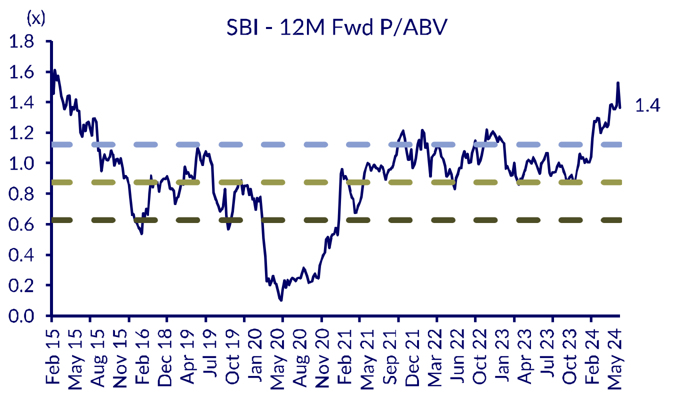
KMB PE trend



Source: BBG, Bank, CLSA

Figure 83

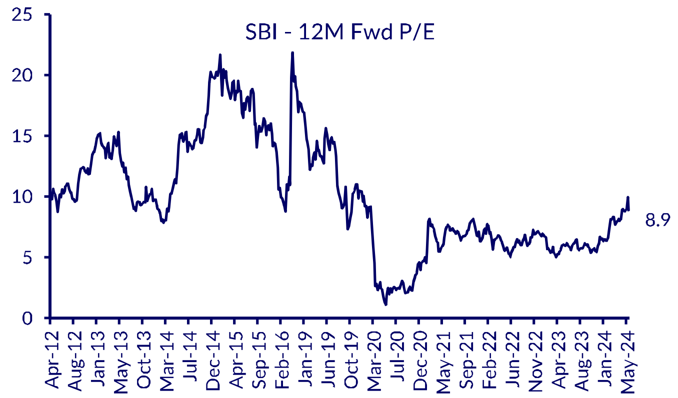
SBI PB trend



Source: BBG, Bank, CLSA

Figure 84

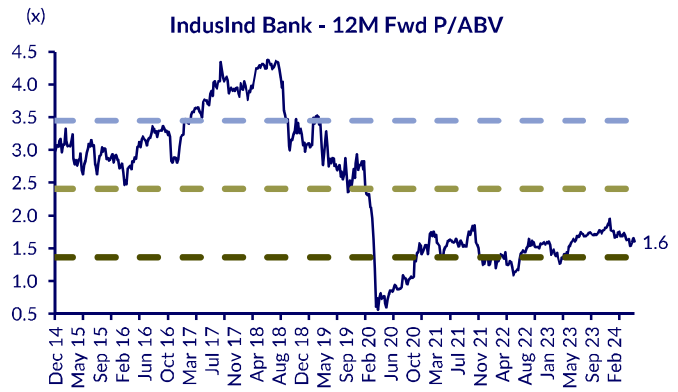
SBI PE trend



Source: BBG, Bank, CLSA

Figure 85

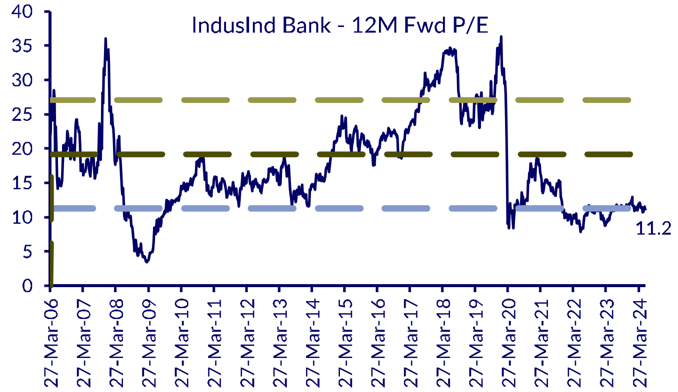
IIB PB trend



Source: BBG, Bank, CLSA

Figure 86

IIB PE trend



Source: BBG, Bank, CLSA

Figure 87

AXSB's RI model table

Rsbn	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	Term.
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Cost of Equity	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%
Net worth	1,747	2,039	2,322	2,650	3,023	3,450	3,934	4,485	5,111	5,821	6,628	7,542	8,580	9,755	11,087	12,594	14,408
ROEs	15.4%	15.8%	16.3%	16.6%	16.6%	16.6%	16.5%	16.5%	16.4%	16.4%	16.3%	16.2%	16.2%	16.1%	16.1%	16.0%	16.0%

Source: CLSA

Figure 88

AXSB's RI model summary

Rsbn	Value	Contribution of value	Avg. ROE assumption	Avg. COE assumption
Mar 24 net worth	1,502	40.3%		
PV of RI over FY25-30CL	393	10.6%	16.2%	12.78%
PV of RI over FY31-40CL	738	19.8%	16.3%	12.78%
Terminal value	1,092	29.3%	16.0%	12.78%
Total value of the firm	3,726	100.0%		
Total number of shares	3087			
Value per share	1,207			

Source: CLSA

Figure 89

AXSB and its subsidiaries' SOTP valuation

Business	Value (Rs bn)	Value/Share	Basis (FY26
Parent	3,726	1,207	RI model
Axis AMC	97	31	20x PE
Axis Securities	59	19	15x PE
Axis Capital	29	10	15x PE
Axis Finance	123	40	15x PE
Max Financial	87	28	Based on our TP for Max Financial
Total Subsidiary valuation		128	
Holdco discount (20%)		26	
Subsidiary valuation (post holdco discount)		102	
Total Company Valuation		**1,310**	

Source: Axis Bank, CLSA

Figure 90

HDFCB's RI model table

Rsbn	FY25CL	FY26CL	FY27CL	FY28CL	FY29CL	FY30CL	FY31CL	FY32CL	FY33CL	FY34CL	FY35CL	FY36CL	FY37CL	FY38CL	FY39CL	FY40CL
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Required Cost of Equity	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%
Networth	4,953	5,587	6,328	7,178	8,157	9,283	10,577	12,064	13,776	15,749	18,024	20,644	23,664	27,144	31,160	35,770
ROEs	14.7%	15.0%	15.5%	15.8%	16.0%	16.2%	16.4%	16.5%	16.7%	16.8%	17.0%	17.1%	17.2%	17.3%	17.4%	17.4%
PAT	688	793	926	1,067	1,230	1,417	1,628	1,873	2,157	2,487	2,870	3,307	3,812	4,396	5,074	5,825
growth		15%	17%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Required return	633	673	761	863	979	1,114	1,269	1,446	1,651	1,886	2,157	2,470	2,830	3,245	3,724	4,275
Residual income	55	120	165	204	251	303	360	427	507	601	713	837	982	1,151	1,350	1,550
Discounted Residual income	55	106	130	142	155	166	175	184	194	204	214	223	232	241	251	255

Source: CLSA

Figure 91

HDFCB's SOTP valuation

Subsidiary	Shareholding (%)	PAT (Rsbn)	Multiple (x)	Target Valuation (Rsbn)	HDFCB value per share
HDB Financial	95	36	22	782	97
HDFC Sec	95	14	20	285	36
HDFC Life Insurance	50				100
HDFC AMC	53				51
HDFC Ergo General Ins.	50	10	25	250	17
Total				**1,317**	**300**
Holdco discount				20%	20%
Subsidiary value				**1,053**	**240**

Source: CLSA

Figure 92

HDFCB's RI model summary

Rsbn	Value	Contribution of value	Avg. ROE assumption	Avg. COE assumption
FY25 net worth	4,953	43.9%		
PV of RI over FY26-30CL	699	6.2%	15.6%	12.8%
PV of RI over FY31-40CL	2,172	19.3%	17.0%	12.8%
Terminal value	3,448	30.6%	17.4%	12.8%
Total value of the firm	11,272	100.0%		
Total number of shares (m)	7,597			
Value per share	**1,484**			
Subsidiary value	240			
Target price	1,724			
TP (rounded-off)	**1,725**			

Source: CLSA

Figure 93

ICICIB's RI model table

Rsbn	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	Terml
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10
Required Cost of Equity	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%	12.8%
Net worth	2,384	2,715	3,104	3,553	4,079	4,689	5,399	6,225	7,189	8,301	9,593	11,085	12,810	14,803	17,106	19,767	22,843	26,606
ROEs	19.0%	16.5%	17.0%	17.1%	17.4%	17.6%	17.8%	18.0%	18.2%	18.2%	18.2&	18.3%	18.3%	18.3%	18.3%	18.3%	18.3%	18.3%
PAT	409	413	486	562	664	772	898	1,046	1,221	1,410	1,638	1,892	2,187	2,527	2,920	3,375	3,900	4,526
Growth	28%	1%	18%	16%	18%	16%	16%	17%	17%	15%	16%	16%	16%	16%	16%	16%	16%	
Required return	280	326	372	425	488	560	644	743	857	989	1,143	1,321	1,526	1,764	2,038	2,355	2,722	3,159
Residual income	128	87	115	137	177	212	254	304	364	420	495	572	661	763	882	1,019	1,178	1,367
Discounted Residual income		87	102	108	123	131	139	148	157	161	168	172	176	180	185	189	194	3,041

Source: CLSA; Note: the year mentioned refers to the fiscal year, not the calendar year

Figure 94

ICICIB's RI model summary

Rs bn	Value	Contribution of value	Avg. ROE assumption	Avg. COE assumption
Mar 24 Networth	2,384	30.4%		
PV of RI over FY25-30CL	690	8.8%	17.2%	12.8%
PV of RI over FY31-40CL	1,730	22.0%	18.3%	12.8%
Terminal value	3,041	38.8%	18.3%	12.8%
Total value of the firm	7,845	100.0%		
Total number of shares	7023			
Value per share	**1,117**			

Source: CLSA

Figure 95

ICICB's SOTP valuation

	Stake (%)	Value (Rsbn)	Value/Share (Rs)	Rationale
Parent		7,845	1,117	Based on RI model
ICICI Pru Life Insurance	51	479	68	Based on our TP
ICICI Home Finance	100	166	24	20x FY26 PE
ICICI Pru AMC	51	801	114	25x FY26 PE
ICICI Securities	75	176	25	Based on CMP
ICICI Lombard Gen. Ins	48	415	59	Based on our TP
Total Value of Subsidiaries		2,038	290	
Less: 20% holding Discount		408	58	
Value of Key Ventures		1,630	232	
Target Price			1,349	
Target Price (rounded-off)			**1,350**	

*as the stock is expected to be delisted soon. Source: CLSA

Figure 96

IIB's RI model table

Rsbn	2024	2025	2026	2027	2028	2029	2030	2037	2038	2039	2040	Terminal
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Required Cost of Equity	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%	13.3%
Net worth	628	713	811	919	1,042	1,184	1,347	3,442	3,939	4,508	5,160	5,949
ROEs	15.2%	14.9%	15.4%	15.6%	15.8%	16.0%	16.2%	17.0%	17.0%	17.0%	17.0%	17.0%
PAT	89	100	117	135	155	178	205	548	627	718	822	944
Growth	21%	12%	18%	15%	15%	15%	15%	14%	14%	14%	14%	
Required return	78	89	101	115	130	148	168	429	491	562	643	739
Residual income	11	11	16	20	25	30	37	119	136	156	179	205
Discounted Residual income		11	16	18	19	21	22	30	31	31	31	452

Source: IndusInd Bank, CLSA

Figure 97

IIB's RI model summary

Rsbn	Value	Contribution of value	Avg. ROE assumption	Avg. COE assumption
Mar 24 Net worth	628	42.5%		
PV of RI over FY25-30CL	106	7.2%	15.6%	13.30%
PV of RI over FY31-40CL	291	19.7%	16.9%	13.30%
Terminal value	452	30.6%	17.0%	13.30%
Total value of the firm	1,477	100.0%		
Total number of shares	778			
Value per share	1,898			
Target price (rounded off)	**1,900**			

Source: IndusInd Bank, CLSA

Figure 98

KMB's RI model table

Rsbn	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2039	2040	Term.
Risk free rate	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
Beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Required Cost of Equity	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%
Net worth	1,257	1,410	1,585	1,785	2,015	2,277	2,579	2,927	3,328	3,790	4,325	6,495	7,462	8,637
ROEs	14.1%	14.3%	14.6%	14.8%	15.1%	15.3%	15.6%	15.8%	16.1%	16.3%	16.6%	17.3%	17.5%	17.5%
PAT	162	191	219	250	287	329	379	436	503	582	673	1,052	1,221	1,409

Source: Kotak, CLSA

Figure 99

KMB's RI model summary

Rsbn	Value	Contribution of value	Avg. ROE assumption	Avg. COE assumption
FY25 Net worth	1,101	38.9%		
PV of RI over FY25-30CL	135	4.8%	14.5%	12.25%
PV of RI over FY31-40CL	542	19.1%	16.5%	12.25%
Terminal value	1,052	37.2%	17.5%	12.25%
Total value of the firm	2,831	100.0%		
Total number of shares	1,988			
Value per share	1,424			

Source: CLSA

Figure 100

KMB's SOTP valuation

Business	Value (Rs bn)	Value/Share	Basis (FY26)
Parent	2,831	1,424	RI model
Life Insurance	403	203	2x EV
Asset Management	197	99	25x PE
Kotak Prime	230	116	18x PE
Kotak Securities	233	117	15x PE
Kotak Investments	93	47	15x PE
International	37	19	15x PE
KMCC	43	21	15x PE
Total Subsidiary Valuation (post 20% holdco discount)	989	498	
Total Company Valuation	**3,820**	**1,922**	
TP (rounded-off)		**1,920**	

Source: Kotak, CLSA

Figure 101

SBI's RI model table

Rsbn	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY38	FY39	FY40	Terminal
Risk free rate	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%	7%
Risk premium	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.25%	5.25%	5.25%	5.25%
Beta	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15
Required Cost of Equity	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
Networth	3,575	4,082	4,628	5,225	5,908	6,690	7,587	8,618	9,803	11,151	21,236	24,156	27,478	31,479
ROEs	17.3%	15.7%	15.0%	15.2%	15.4%	15.6%	15.8%	16.0%	16.2%	16.2%	16.2%	16.2%	16.2%	16.2%
PAT	682	634	682	748	856	981	1,126	1,295	1,490	1,695	3,228	3,672	4,177	4,769
growth	36%	(7%)	8%	10%	14%	15%	15%	15%	15%	14%	14%	14%	14%	
Required return	434	499	568	642	726	821	931	1,056	1,201	1,366	2,601	2,959	3,366	
Residual income	248	135	114	105	130	160	196	238	289	329	626	713	811	
Discounted Residual income	248	127	95	78	85	92	100	107	115	116	120	121	121	1,509

Source: CLSA

Figure 102

SBI's RI model summary

Rsbn	Value	Contribution of Value	Avg. ROE assumption	Avg. COE assumption
Sep 24 Net worth	3,829	54%		
PV of RI over FY25-30CL	576	8%	15%	13%
PV of RI over FY31-40CL	1,172	17%	16%	13%
Terminal value	1,509	21%	16%	13%
Total value of the firm	7,086	100%		
Total number of shares	8,925			
Value per share	794			
Terminal growth assumption	5%			
Assumptions				
Risk free rate	7.0%			
Risk premium	5.3%			
Beta	1.2			
Required cost of equity	13.0%			
Terminal growth assumption	5%			

Source: SBI, CLSA

Figure 103

SBI's SOTP valuation

FY26 basis	Stake (%)	Entity Value (INR b)	Value for SBIN (INR b)	Value Per Share (INR)	Rationale
SBI (Parent Bank)		7,086		794	RI model
Subsidiaries					
SBI Life	55		988	111	Our TP
SBI Cards	69		516	58	Our TP
SBI MF	63	682	427	48	25x PE
SBI Caps	100	324	324	36	15x PE
SBI General	69	48	33	4	15x PE
Value of subsidiaries				256	
Value post 20% discount				205	
SOTP				999	
TP (rounded-off)				**1,000**	

Source: SBI, CLSA

Figure 104

Valuation Matrix

	CMP	PB (x)		PE (x)		ROA (%)		ROE (%)		BVPS		EPS		PPOP CAGR
	(Rs)	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY25CL	FY26CL	FY24-26CL
ICICI Bank	1,107	2.4	2.0	15.5	12.5	2.0%	2.1%	16.5%	17.0%	386	442	59	69	11.9%
HDFC Bank	1,581	2.2	1.9	15.1	12.8	1.8%	1.8%	14.7%	15.0%	631	714	91	104	20.0%
Axis Bank	1,174	2.0	1.7	13.7	11.3	1.6%	1.6%	15.4%	15.8%	557	652	81	97	58.1%
Kotak Bank	1,726	2.4	2.0	18.3	15.0	2.1%	2.1%	13.9%	14.1%	538	616	70	81	9.5%
IndusInd Bank	1,507	1.6	1.4	11.6	9.8	1.8%	1.8%	15.0%	15.5%	912	1,039	128	151	15.3%
Bandhan Bank	194	1.3	1.1	8.7	7.5	1.9%	1.9%	15.6%	15.9%	154	178	23	26	18.0%
SBI	844	1.5	1.3	9.2	8.3	1.0%	0.9%	15.7%	15.0%	439	495	71	76	14.8%

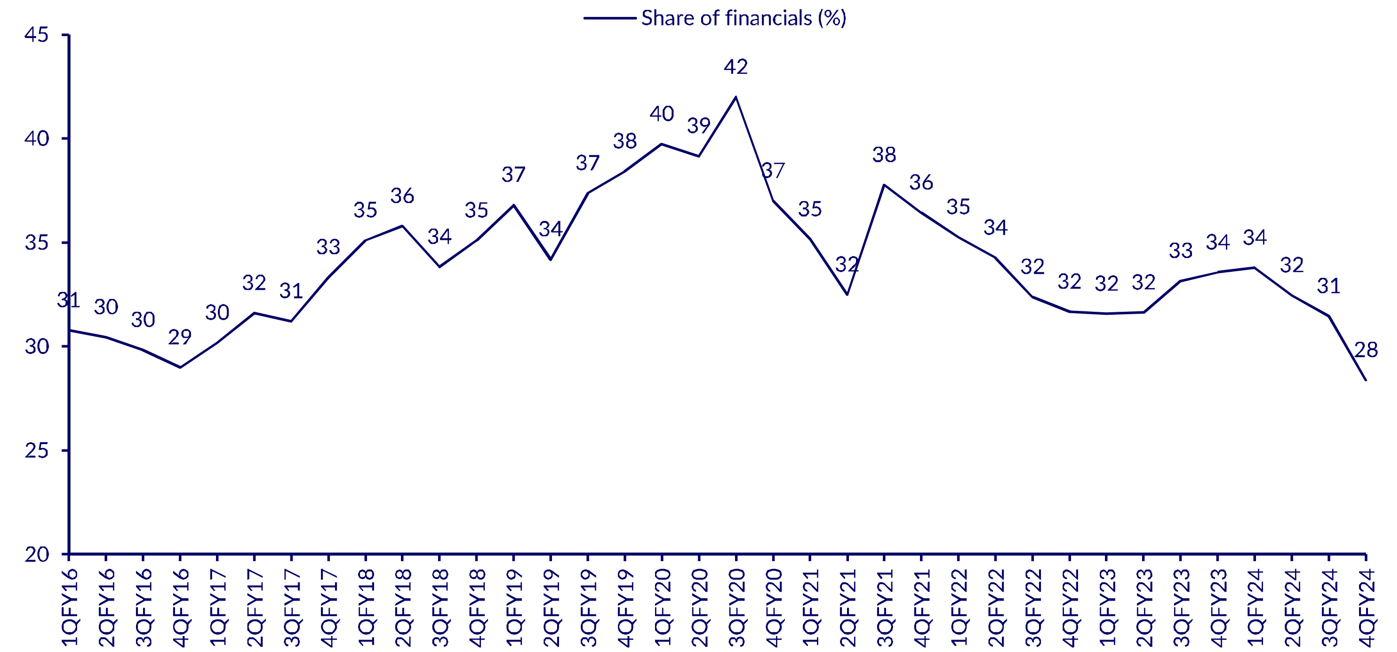
Source: BBG, CLSA

Annexure

Significant reduction in ownership of financial stocks by foreign investors
Since Covid, the share of financials in the portfolios of foreign institutional investors (FIIs) has declined from c.40% to 28%.

Figure 105

Allocation to financials in FII portfolios is at a multi-year low



Source: SEBI, CLSA

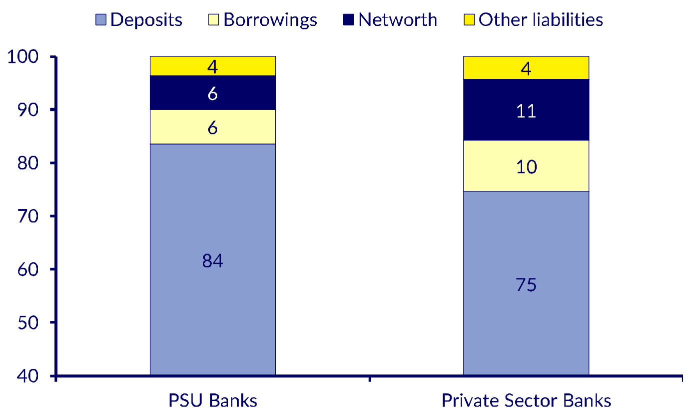
Why a mere LDR comparison between banks is not helpful
As of FY23, PSU banks had an LDR of 71% while private sector banks had an LDR of 85% - a 14ppt difference. Does this mean that PSU banks have a lot of excess liquidity that can be redeployed into loans, even if the deposit accretion is weak? Not necessarily, in our view.

Below is a common size liability profile of the actual balance sheet of the PSU bank sector and the private bank sector as of FY23. As can be seen, for every Rs100 of liabilities, PSU Banks have only Rs6 of net worth and Rs6 of borrowings, leaving Rs84 for deposits. On the other hand, private sector banks are better capitalised: they have Rs11 of net worth and Rs14 of borrowings, leaving only Rs75 for deposits. So out of the 14ppt difference in LDR, 9ppt is explained by the liability side itself. It has nothing to do with whether those banks are giving out more loans or less.

On the asset side, PSU Banks have Rs59 in loans, while Private Sector Banks have Rs64 in loans for every Rs100 in assets. Hence, only 5ppt of the LDR difference is explained by loans.

Figure 106

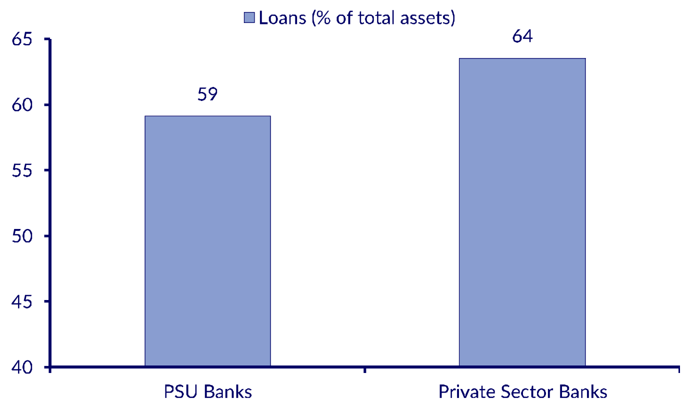
PSU and private sector banks have a very different liability structure (% of total liabilities). . .



Source: RBI, CLSA

Figure 107

. . .but not a very different asset structure



Source: RBI, CLSA

Indian banks typically have a higher LDR than global peers

We compare leading Indian private sector banks with global counterparts on LDR. We note that the American banks typically have the lowest LDR, followed by Chinese banks and then Indian banks.

Figure 108

LDR comparison across large global banks

JPM	56
BofA	55
Wells Fargo	69
ICBC	77
Agricultural Bank of China	74
Bank of China	87
China Construction Bank	82
HDFCB	104
ICICIB	84
AXSB	90

Source: Bloomberg, HDFCB, ICICIB, AXSB, CLSA

Largest states for banking sector deposits

The top five states account for 53% of India's total deposits and the top 10 account for 75%. Among the large states, Haryana and Karnataka have grown the fastest while Delhi and West Bengal, the slowest. The CASA ratio varies meaningfully among the large states - the more "commercial" states like Maharashtra and Delhi have 33% CASA ratio while Utter Pradesh (UP) has 53% CASA ratio.

Figure 109

Top 10 states for deposits; Karnataka the fastest growing while UP has the highest CASA ratio

	Total Deposits (Rs trn)	Share of India's deposits (%)	5Y Cagr (%)	CASA ratio (%)
Maharashtra	46.7	22.0	12.3	32.8
Delhi	18.6	8.7	8.9	32.7
Uttar Pradesh	17.5	8.2	10.9	52.9
Karnataka	16.8	7.9	12.5	39.8
Tamil Nadu	13.4	6.3	11.0	41.4
West Bengal	11.4	5.4	8.0	41.0
Gujarat	12.0	5.6	12.1	41.7
Kerala	8.0	3.8	10.1	34.0
Haryana	7.9	3.7	14.0	40.8
Telangana	7.9	3.7	11.4	42.5

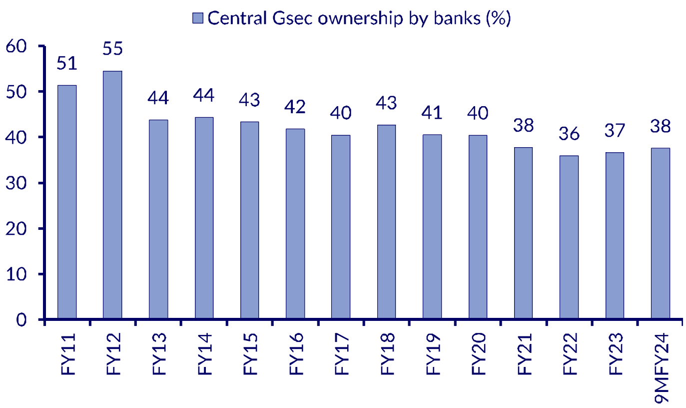
Source: RBI, CLSA

GSec ownership

Around 38% of Central GSecs are owned by banks. This ratio has declined over the past decade due to reduced SLR requirements. Note that while central government bonds are subscribed by all categories of banks, state government bonds are subscribed to primarily by PSU Banks.

Figure 110

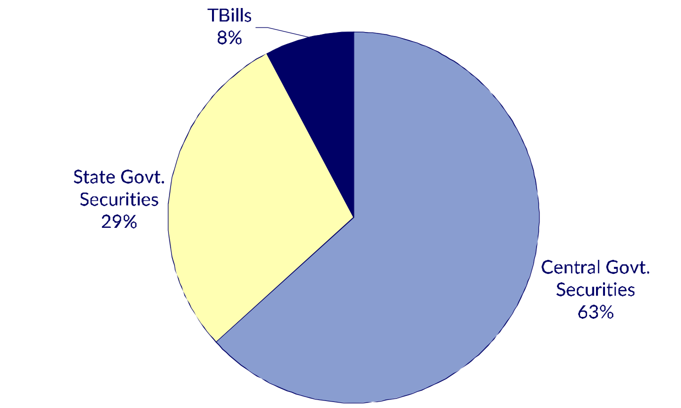
Banks now have a lower share of GSecs outstanding



Source: RBI, CLSA

Figure 111

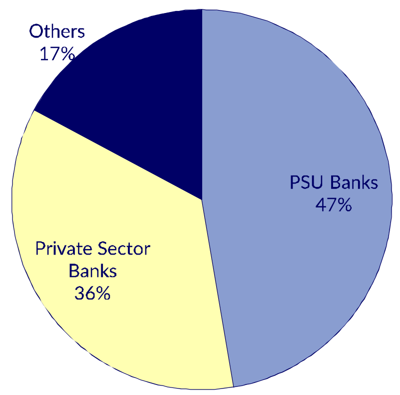
Two-thirds of Bank GSec ownership is central government bonds



Source: RBI, CLSA

Figure 112

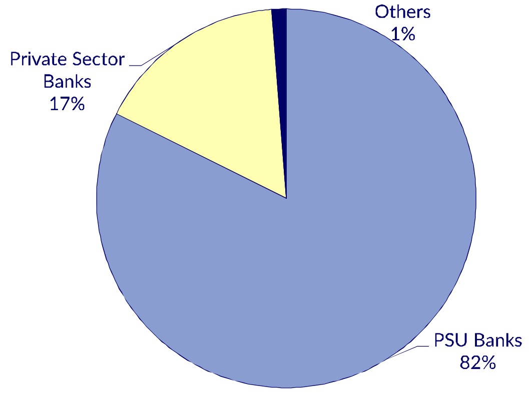
While the Central government has a diversified investor base. . .



Source: RBI, CLSA

Figure 113

. . .state governments rely heavily on PSU Banks for their bonds



Source: RBI, CLSA

Investment thesis - Axis Bank Ltd AXSB IB

Over the past five years, Axis has migrated its loan mix from corporate to retail, which has helped improve asset quality. At the same time, its focus on increasing the granularity of deposits is bearing fruit. Axis' NIM has improved 60-70bp in the past five years.

Catalysts - Axis Bank Ltd AXSB IB

Traction in loan growth and sustenance of NIM are key medium-term catalysts for the stock. ROE of 16% should help in PB multiple re-rating for the name.

Valuation details - Axis Bank Ltd AXSB IB

Our target price of Rs1,310 is based on an SOTP of the parent (bank) and its subsidiaries. We use a long-term residual income model to value the standalone business of the parent company. The subsidiaries are valued using appropriate valuation multiples and a holding company discount is applied to reach the final consolidated value of the business.

Investment risks - Axis Bank Ltd AXSB IB

The key risk is sluggish deposit growth, leading to even slower loan growth due to LDR reduction. Additionally, sharper-than-expected NIM compression is a risk to earnings and multiples of the stock.

Investment thesis - HDFC Bank Ltd HDFCB IB

HDFC Bank is the best run bank with a track record of strong growth and profitability for over two decades. However, return ratios and loan growth have moderated due to the merger and would take a few years to normalize. Valuations have come off significantly, in the past five years thus making risk-reward healthy, despite the lower profitability.

Catalysts - HDFC Bank Ltd HDFCB IB

Improvement in deposit accretion, especially CASA deposits, and increase in NIMs would be key catalysts for the stock.

Valuation details - HDFC Bank Ltd HDFCB IB

We value the lending business using a long-term residual income model till FY40. We use a cost of equity of 12.8% and an average RoE over FY25-40 of 16%. In addition to the lending business, we value the subsidiaries based on our target prices (for the listed subsidiaries).

Investment risks - HDFC Bank Ltd HDFCB IB

Inability to garner adequate deposits at competitive rates is the key risk to the stock. Slower CASA accretion could lead to higher cost of funds, and consequently, lower NIM.

Investment thesis - ICICI Bank Limited ICICIBC IB

ICICI Bank is the second largest private sector bank in India and has undergone a transformation under its new CEO. It is gradually moving from high-risk corporate loans to high-profitability retail loans and has been consistently gaining market share in the latter. Its asset quality has improved meaningfully in the past three years and credit costs are low. It has the highest estimated ROE among all large banks under our coverage.

Catalysts - ICICI Bank Limited ICICIBC IB

High-teens loan growth, aided by retail lending, and sustaining NIM above 4% are key catalysts for the stock.

Valuation details - ICICI Bank Limited ICICIBC IB

Our SOTP-based methodology values each of ICICI Bank's businesses (banking, insurance, asset management and international subsidiaries) based on growth and profitability. To value the banking business, we use a long-term residual income model. Our target price for the consolidated business of ICICI Bank is Rs1,350.

Investment risks - ICICI Bank Limited ICICIBC IB

The key risk is a slower-than-expected loan growth. Another is NIM compression from repo rate cuts. The bank also has sizeable exposure to unsecured retail assets, but the asset quality is unlikely to deviate materially from peers.

Investment thesis - IndusInd Bank Ltd IIB IS

IndusInd is a good cyclical play on the ongoing upcycle in auto loans and microfinance in India. In addition, with a higher share of fixed rate loans, it is better placed than peers in a rate cut cycle. Given its smaller size, it should grow faster than private sector peers.

Catalysts - IndusInd Bank Ltd IIB IS

Strong growth in vehicle loans and a possible rate cut in the next 12 months are key stock catalysts.

Valuation details - IndusInd Bank Ltd IIB IS

We use a residual income model with a risk-free rate of 7%, risk premium of 5.25% and beta of 1.2 to arrive at our target price. Our terminal growth rate assumption is 5%. We choose a residual income model as it values the company's return on capital over and above the cost of capital.

Investment risks - IndusInd Bank Ltd IIB IS
Downturn in the commercial vehicle segment and higher slippage in retail and corporate loans are key risks.

Investment thesis - Kotak Mahindra Bank Ltd KMB IB
Kotak is a "classic" compounder, with drivers being a favourable environment for private sector banks coupled with top-quality management and corporate governance. The company is looking to expand in high-margin businesses like unsecured personal loans and credit cards. With multiple de-rating over the past three years, we think it makes a strong entry point for this quality franchise.

Catalysts - Kotak Mahindra Bank Ltd KMB IB
Improvement in share of unsecured loans to 15% and sustenance of NIM above 4.5% are key catalysts for Kotak. Lifting of the RBI ban will also be a positive sentimental catalyst for the stock.

Valuation details - Kotak Mahindra Bank Ltd KMB IB
Our SOTP-based methodology is derived from the bank, nonbanking financial company, life insurance and asset management segments and other units based on growth and profitability. To value the banking business, we use a long-term residual income model. We believe high earnings growth, strong asset quality and ROE expansion will support premium valuations, although we see limited potential for a rerating. Our target price for Kotak Bank is Rs1,920.

Investment risks - Kotak Mahindra Bank Ltd KMB IB
The key risk is a longer-than-expected RBI ban on the credit card business and digital sourcing. A sharp repo rate cut will result in some NIM compression.

Investment thesis - State Bank of India SBIN IB
SBI is the largest lender in the country and continues to enjoy a healthy growth rate. Its liability profile is strong (41% CASA deposits) and is focusing on lending to high profitability retail and SME segments while maintaining good asset quality.

Catalysts - State Bank of India SBIN IB
Continued growth of retail and SME segments is key to overall performance. ROA of 1% and its future sustenance needs to be monitored.

Valuation details - State Bank of India SBIN IB
Our SOTP-based methodology values each of the businesses (banking, insurance, cards, asset management and others) separately, based on their growth and profitability. To value the bank, we use a long-term Residual Income model with a risk-free rate of 7%, risk premium of 5.25% and beta of 1.15x (in line with its historical beta). Our terminal growth rate assumption is 5%, in line with the rest of our financials coverage.

Investment risks - State Bank of India SBIN IB
A rise in credit costs and slowdown in loan growth are key risks.

Companies mentioned

ABC - A (601288 CH - RMB4.16 - O-PF)
Axis AMC (N-R)
Axis Bank (AXSB IB - RS1,187.5 - BUY)
Axis Capital (N-R)
Axis Finance (N-R)
Axis Securities (N-R)
Bajaj Finance (BAF IN - RS7,217.8 - BUY)
Bandhan Bank (BANDHAN IN - RS196.5 - O-PF)
Bank of America (N-R)
Bank of Baroda (BOB IB - RS283.4 - BUY)
Bank of China - A (601988 CH - RMB4.41 - O-PF)
Bharat Fin Inclusion (N-R)
CCB - A (601939 CH - RMB7.14 - O-PF)
HDB Financial (N-R)
HDFC AMC (HDFCAMC IN - RS3,996.2 - U-PF)
HDFC Bank (HDFCB IB - RS1,573.8 - O-PF)
HDFC Ergo General Insurance (N-R)
HDFC Financial (N-R)
HDFC Life Insurance (HDFCLIFE IN - RS593.5 - O-PF)
ICBC - A (601398 CH - RMB5.40 - O-PF)
ICICI Bank (ICICIBC IB - RS1,119.7 - BUY)
ICICI Home Finance (N-R)
ICICI Lombard (ICICIGI IN - RS1,666.0 - U-PF)
ICICI Pru AMC (N-R)
ICICI Prudential Life (IPRU IN - RS596.1 - U-PF)
ICICI Securities (ISEC IN - RS717.8 - O-PF)
IndusInd Bank (IIB IS - RS1,484.2 - BUY)
JPMorgan Chase (JPM US - US$194.36 - N-R)
KMCC (N-R)
Kotak Bank (KMB IB - RS1,715.5 - BUY)
Kotak Investments (N-R)
Kotak Prime (N-R)
Kotak Securities (N-R)
Max Financial (MAXF IB - RS988.0 - BUY)
PNB (PNB IB - RS127.5 - O-PF)
SBI Capital Markets (N-R)
SBI Cards (SBICARD IN - RS727.0 - U-PF)
SBI General Insurance Company Limited (N-R)
SBI Life (SBILIFE IN - RS1,449.9 - BUY)
SBI Mutual Fund (N-R)
State Bank of India (SBIN IB - RS839.1 - BUY)
Union Bank (N-R)
Wells Fargo (N-R)

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