March 24, 2015

Sector View

Positive

Banking

Pain priced in; uncertain quarter to cap upside

In the past three months, gains in Bank Nifty have been muted at 3.5% vs. the Nifty rising by 6.3%. The laggards have been PSU banks. Large PSU banks, on an average, have clocked negative returns of 16.5% in the past three months while large private banks gave positive returns of ~11.6%. Weak Q3FY15 earnings, primarily, owing to higher-than-expected asset quality deterioration leading to higher credit cost & interest reversals led investors to stay away from PSU banks. In contrast, private banks were able to maintain a healthy earnings performance on the back of steady business growth, healthy margins and manageable asset quality.

We believe, in the near term i.e. next two quarters, PSU bank stocks would continue to stay under pressure mainly due to large restructuring assets (RA) pipeline in Q4FY15 due to end of regulatory forbearance (no restructuring would be allowed from April FY16). Further, any major improvement in advances traction (currently at a decade low of 10% YoY) is unlikely to happen. We suggest one should enter selective PSU banks with a horizon of a year or two considering their reasonable valuations. We believe post Q2FY16, a gradual structural improvement for PSU banks should begin in terms of increased traction in loan demand with improved capex cycle, enhanced government spending and decline in interest rates. Asset quality pain is expected to peak out by Q1FY16 enabling PSU banks to improve their return ratios and thereby multiple re-rating.

Exhibit 1: Banking Sector – Coverage Summary

	CMP			M Cap	EPS (₹)			P/E (x)			P/ABV (x)			RoA (%)			RoE (%)		
Sector / Company	(₹)	TP(₹)	Rating	(₹ Cr)	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
Bank of India (BANIND)	209	255	Hold	12,460	39	45	51	5.3	4.6	4.1	0.8	0.7	0.7	0.4	0.4	0.4	8	9	10
Bank of Baroda (BANBAR)	170	210	Buy	35,733	17	24	30	10.1	7.1	5.6	1.3	1.1	1.0	0.5	0.7	0.8	10	13	14
Dena Bank (DENBAN)	49	56	Hold	2,635	5	9	10	9.2	5.5	4.7	0.8	0.7	0.6	0.2	0.3	0.3	4	7	7
Punjab National Bank (PUNBAN)	163	215	Buy	29,527	20	23	29	8.1	7.0	5.7	1.3	1.1	0.9	0.6	0.7	0.7	10	10	12
Syndicate Bank (SYNBN)	105	124	Hold	6,317	23	28	32	4.7	3.8	3.3	1.0	0.9	0.9	0.5	0.6	0.6	12	13	14
Indian Bank (INDIBA)	170	221	Buy	7,304	23	27	36	7.5	6.3	4.7	0.8	0.8	0.7	0.6	0.6	0.7	8	8	10
Axis Bank (UTIBAN)	555	690	Buy	130,902	30	35	42	18.2	15.7	13.3	3.1	2.6	2.2	1.7	1.8	1.8	17	17	17
City Union Bank (CITUNI)	95	110	Buy	4,585	7	9	11	13.7	10.9	8.9	2.2	1.9	1.6	1.5	1.7	1.8	17	18	18
DCB Bank (DCB)	107	140	Buy	2,764	6	8	9	16.6	13.7	11.7	2.1	1.9	1.6	1.3	1.3	1.2	14	13	14
Federal Bank (FEDBAN)	136	164	Buy	11,590	12	14	17	11.4	9.5	7.8	1.6	1.4	1.3	1.3	1.3	1.4	14	15	16
HDFC Bank (HDFBAN)	1,048	1,160	Hold	261,938	41	50	60	25.3	20.8	17.4	4.3	3.7	3.2	1.9	2.0	2.1	20	19	19
IndusInd Bank (INDBA)	888	925	Buy	46,560	33	41	53	26.7	21.4	16.6	4.6	3.9	3.3	1.8	1.9	2.0	18	19	21
Jammu & Kashmir Bank(JAMKAS)	105	119	Hold	5,068	13	22	27	8.0	4.8	3.9	1.1	0.9	0.8	0.8	1.1	1.2	11	16	17
Kotak Mahindra Bank (KOTMAH)	1,336	1,505	Hold	102,426	23	27	32	58.5	49.5	41.2	7.6	6.7	5.8	1.8	1.8	1.8	13	14	15
South Indian Bank (SOUINO)	24	29	Hold	3,251	3	4	4	8.0	6.8	5.5	1.0	1.0	0.8	0.6	0.7	0.8	11	13	15
Yes Bank (YESBAN)	829	950	Buy	34,508	48	63	81	17.2	13.2	10.2	3.0	2.5	2.0	1.7	1.8	2.0	21	20	22

Source: Company, ICICIdirect.com Research

We prefer large PSU banks like PNB & BOB, while we recommend Indian Bank in the midcap space owing to its better standing among its peers, on various parameters.

Investor comfort would continue with private banks despite their trading at rich valuations. However, our per branch analysis (see exhibit 2) suggest that at CMP, upsides in IndusInd to be limited but can be considered on dips. We have raised our target price for Yes Bank to ₹ 950 with multiple rising to 2.3x FY17E ABV. Yes Bank would be a significant beneficiary of declining interest rates and increase in FII holding limits. Axis Bank remains our best pick in the private banking space. One can also look at HDFC Bank & DCB Bank post the recent correction. Pain seems largely priced in and risk reward is turning favourable, however uncertain quarter ahead to keep near term upside capped.

Research Analyst

Kajal Gandhi
kajal.gandhi@icicisecurities.com

Vasant Lohiya
vasant.lohiya@icicisecurities.com

Vishal Narnolia
vishal.narnolia@icicisecurities.com

Valuation – Sector analysis on M/Cap per branch

We have analysed the branch and employee matrix for the banking sector, which is indicating the valuation gap in store for future.

₹ crore	Market Cap per branch	Market Cap per employee	CASA per branch	Deposit per branch	Business per branch	Business per employee	Trailing P/E Ratio(NSE)	Trailing P/BV(NSE)	Dividend Yield - %(NSE)
Kotak Mah. Bank	175.6	4.0	31.1	97.6	185.3	4.2	60.9	8.7	0.1
IndusInd Bank	78.3	3.0	32.7	100.5	192.0	7.4	27.8	5.5	0.4
HDFC Bank	77.8	3.9	48.4	107.9	197.0	9.8	27.2	6.1	0.6
Yes Bank	61.4	3.9	29.2	132.5	231.8	14.8	18.2	3.4	0.8
Axis Bank	57.6	3.3	52.6	117.0	212.7	12.0	19.7	3.6	0.7
DCB Bank	32.4	1.4	27.5	109.8	196.4	8.3	18.2	2.3	0.0
ING Vysya Bank	33.5	1.9	24.7	74.0	138.3	7.7	28.7	2.7	0.6
City Union Bank	13.6	1.4	9.2	51.8	89.7	9.0	15.2	2.4	0.9
Karur Vysya Bank	11.9	1.0	14.8	72.2	128.3	10.6	16.2	1.8	1.9
Federal Bank	10.1	1.1	15.9	50.9	87.9	9.9	11.8	1.7	1.4
J & K Bank	6.7	1.5	34.9	89.2	148.9	33.9	7.9	0.9	4.7
Bank of Baroda	7.7	0.8	29.7	115.3	195.8	21.0	9.6	1.1	2.4
IDBI Bank	8.8	0.7	38.4	169.9	312.3	26.4	14.5	0.6	1.3
Punjab Natl.Bank	5.0	0.5	29.4	76.8	136.3	12.7	8.3	0.9	1.2
South Ind.Bank	4.4	0.5	12.4	59.8	105.4	11.8	9.1	1.1	3.1
Oriental Bank	3.3	0.4	22.1	91.0	156.4	17.0	6.3	0.6	3.3
Karnataka Bank	4.1	0.3	17.2	67.6	114.9	9.6	6.6	0.8	3.1
Canara Bank	4.0	0.4	21.7	88.5	151.8	14.8	7.0	0.8	2.7
Indian Bank	3.6	0.4	19.6	72.0	126.3	14.6	7.6	0.7	2.6
Bank of India	3.0	0.3	23.6	102.7	182.5	19.6	6.0	0.5	2.3
Union Bank (I)	2.8	0.3	22.7	76.9	136.1	15.6	5.6	0.6	2.3
St Bk of Bikaner	3.6	0.3	25.4	64.4	120.2	10.3	5.7	0.8	2.4
UCO Bank	2.4	0.3	20.4	68.9	120.6	14.2	5.7	0.7	3.6
St Bk of Mysore	2.6	0.2	21.8	65.2	117.6	10.2	6.5	0.6	0.6
Central Bank	3.4	0.4	17.5	52.5	91.3	10.3	26.2	1.2	0.0
Vijaya Bank	2.6	0.3	15.1	82.2	136.1	16.1	8.4	0.7	4.1
Dhanlaxmi Bank	2.2	0.2	10.0	45.6	75.4	8.3	0.0	0.6	0.0
Corporation Bank	2.5	0.3	19.5	95.7	163.5	18.1	8.6	0.5	2.3
Allahabad Bank	2.0	0.2	21.1	67.2	115.8	13.4	10.0	0.5	2.4
Andhra Bank	2.3	0.3	16.6	67.1	118.0	13.3	9.0	0.6	1.3
Syndicate Bank	2.2	0.3	17.2	65.3	118.8	14.2	4.6	0.6	4.9
Dena Bank	1.8	0.3	19.0	67.4	114.9	16.9	7.3	0.5	4.1
Pun. & Sind Bank	1.6	0.2	13.3	63.7	106.7	16.0	9.2	0.4	2.9
United Bank (I)	1.2	0.1	20.6	55.7	88.6	10.7	3.9	0.5	0.0

Source: Capitaline, ICICIdirect.com Research, Mcap used as on 20/03/2015

The Mcap/branch based valuation is ₹ 78 crore per branch at the highest level except Kotak Mahindra Bank (not comparable). The top two banks have a CASA of ₹ 33 crore/branch (IndusInd Bank), at ₹ 48 crore/branch (HDFC Bank), business per employee of ₹ 7.4 crore (IndusInd Bank) and at ₹ 9.8 crore (HDFC Bank). In contrast, in the same league of private banks, Axis Bank is available at ₹ 57.6 crore Mcap per branch with a better CASA per branch of ₹ 52.6 crore offering potential for appreciation.

Similarly, among large cap PSU banks, SBI trades at ₹ 13.3 crore market cap per branch while PNB is far distant at ₹ 5.0 per branch offering a significant gap bridging at least close to BoB trading at ₹ 7.7 crore/branch. Other large PSU banks trade at <₹ 5 crore and nowhere close due to higher stress levels and lower profits.

Investment book gains to continue ahead……

The benchmark 10 year G-Sec yield continues to be in a downward trajectory even in Q4FY15. The yield, at 7.86%, since the beginning of the quarter declined to 7.65% and is currently at 7.75% levels. In fact, since the start of Q3FY15, the decline has been around 80 bps. The reasons are a decline in inflation, government borrowings in line with market expectations and RBI cutting policy rates by 50 bps.

As we observed in Q3FY15, the decline in G-Sec yields benefited banks in the form of strong treasury gains and write-back of MTM provisions, especially in the case of PSU banks owing to their large AFS portfolio and higher duration. Such gains helped support PSU bank's earnings, which would otherwise have been severely impacted owing to higher provisions and interest reversals due to mounting asset quality pressure.

We believe with no respite expected from asset quality stress in Q4FY15, PSU banks will continue to resort to booking gains on their investment portfolio in order to cushion their earnings. However, the treasury gains expected during Q4FY15 may not be as high as in Q3FY15.

In our coverage universe, for a 40 bps yield movement, FY15E PAT of PSBs will be impacted positively by 5-13% with PNB & Syndicate Bank being major beneficiaries. In case of Dena Bank, the impact looks substantial owing to lower profits. Private banks will be impacted by 2-9% with Axis Bank and J&K Bank witnessing a higher impact.

Exhibit 2: Sharp decline in G-sec yields to help banks raise MTM and trading gains from AFS investments…

Q3FY15

Banks	Investment book (₹ crore)	AFS (₹ crore)	Modified duration (in years) AFS	Impact of yield movement of 40 bps (₹ crore)	Impact of yield movement of 30 bps (₹ crore)	PAT (₹ crore) FY15E	Impact on PAT of 40 bps yield movement (%)	Impact on PAT of 30 bps yield movement (%)
Public sector banks								
Bank of India	119,837	14,018	3.9	217.6	163.2	2,533	6.0	4.5
Bank of Baroda	132,224	22,184	3.1	272.4	204.3	3,729	5.1	3.8
Dena Bank**	36352	6820	4.6	125.5	94.1	299	29.4	22.0
PNB	139,943	39,037	3.8	596.5	447.4	3,730.3	11.2	8.4
Syndicate Bank	67,702	15,408	4.5	277.3	208.0	1,493	13.0	9.8
OBC*	68,851	18,945	4.7	356.2	267.1	1,013.0	24.6	18.5
Canara Bank*	153,426	46,398	4.4	811.0	608.3	2,865	19.8	14.9
Indian Bank	46,128	11,118	4.8	212.6	159.4	1,086.9	13.7	10.3
Private sector banks								
Axis Bank	122374	38621	3.3	516.0	387.0	7163	5.0	3.8
City Union Bank	6,747.3	1,276.5	2.2	11.4	8.5	7,162.7	0.1	0.1
DCB	4,034	955	1.2	4.6	3.4	406	0.8	0.6
J&K Bank	24,616.3	8,677.6	2.3	79.8	59.9	1,752.1	3.2	2.4

*Source: Company, ICICIdirect.com Research, * Not under coverage, AFS- Available for Sale, ** PAT impact higher for Dena Bank owing to lower profitability*

Budget proposals to help finance sector…..

The recent Union Budget of 2015-16 proposed to reduce the corporate tax rate from the current 30% to 25% in the next four years. However, the Finance Minister indicated that the reduction has to be accompanied by rationalisation and removal of various exemptions and incentives, which has led to a large number of tax disputes.

The banking sector would be a beneficiary of such a proposal. The average tax rate of the banking system (40 listed banks) in the last five years has been 28.6%. Private banks would benefit more as their tax rate is higher at 30.4% (five years average) while for PSU banks the tax rate is 27.22%.

For banks under coverage, we have assumed that the tax rate would remain the same in FY16 while in FY17 we have assumed a 2% reduction. This would impact PAT positively by ~3% during FY17E.

For the entire industry, our back of the envelope calculations indicate that during FY17E tax savings on account of a 2% reduction in tax rate are ~₹ 2600 crore with the bulk of the benefit accruing to private banks as their effective tax rate has been around 30% while PSU bank's effective tax rate is already close to ~25% as witnessed in the last few years.

Exhibit 3: Positive impact of ~3% on FY17E PAT for 2% reduction in tax rate

	PAT			Taxe rate			Tax savings for 2% reduction in tax rate (₹ crore)
PSU coverage	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY17E
Bank of India	2,533	2,911	3,250	23	30	30	93
Bank of Baroda	3,729	5,299	6,688	37	32	32	197
Dena Bank	299	501	587	23	31	31	17
Punjab National Bank	3,730	4,310	5,336	39	33	34	160
Syndicate Bank	1,493	1,830	2,117	27	24	24	-10
Indian Bank	1,087	1,290	1,729	32	34	33	52
Private coverage							
Axis Bank	7,163	8,283	9,800	32	32	34	295
City Union Bank	406	512	629	28	28	28	17
Development Credit Bank	181	218	256	17	26	26	2
Federal Bank	1,016	1,220	1,481	31	33	33	44
HDFC Bank	10,287	12,508	14,972	34	33	33	444
Indusind Bank	1,752	2,179	2,807	34	33	34	85
Jammu & Kashmir Bank	632	1,062	1,290	34	34	34	39
Kotak Mahindra Bank	1,759	2,077	2,495	31	31	31	72
South Indian Bank	411	480	590	25	29	31	17
Yes Bank	2,001	2,618	3,374	32	29	29	95

Source: Company, ICICIdirect.com Research

Enhancing of FII limit positive for private banks…..

The major positive that came out of the Budget for private banks is that the distinction between different types of foreign investments, especially between foreign portfolio investments (FPI) and foreign direct investments (FDI), will be done away with and be replaced with composite caps. Earlier, the maximum foreign investment in private banks was capped at 74% of which FII holding was capped at 49%. With the abolition of such sub-limits, FIIs will have larger headroom to increase their holding in private banks.

Major beneficiaries would be Axis Bank and Yes Bank as elaborated in the table below. Also, their weights in the MSCI index are expected to be enhanced by 4% and 1%, respectively.

Exhibit 4: Positive impact of ~3% on FY17E PAT for 2% reduction in tax rate

	Current Foreign holding*	Maximum Limit	Foreign limit approved by board	Head room available currently	Maximum availability in future
Axis Bank	53	74.0	62.0	9.0	21.0
Yes Bank	47	74.0	49.0	2.0	27.0
Kotak Mahindra Bank	43	74.0	49.0	6.0	31.0
Indusind Bank	72	74.0	72.0	-	2.0
HDFC bank	73	74.0	74.0	1.0	1.0

*Source: Company, ICICIdirect.com Research; * Foreign holding includes FII,GDR,ADR, NRI investments*

NBFC's loan recovery powers enhanced…

The Budget also announced that NBFCs registered with RBI and having asset size of ₹ 500 crore and above may be considered for notifications as 'financial institution' in terms of the SARFAESI Act, 2002. Such a move will bring parity in regulation of NBFCs with other financial institutions in matters relating to loan recovery. Earlier, NBFCs had to rely on civil court proceedings to recover their loans and take repossession of a property, which could take as long as 18-24 months.

Under The Securitisation and Reconstruction of Financial and Enforcement of Security Interest Act (SARFAESI) Act, NBFCs would be able to expedite repossession of the underlying property given as security for the loan to about six to eight months. NBFCs would be able to demand repayment of any defaulted loan within 60 days after it has classified the loans as NPA. Further, the act would also let NBFCs take over the management of a borrower's business if he does not discharge his liability fully.

The proposal is beneficial for the asset financing NBFCs and those involved in products such as loan against property (LAP). These include Reliance Capital, LIC Housing Finance, Magma Fincorp, Mahindra Finance, Shriram Transport Finance, etc.

Introduction of new bankruptcy code to help in early resolution

The Budget has also proposed to reform the bankruptcy law. A Comprehensive Bankruptcy Code of global standards would be brought in fiscal 2015-16, which would lead to ease of doing business. Such a code will further enhance the banking system's ability to deal with NPAs in an efficient manner and lead to early resolution. Acts like Sick Industrial Companies Act (SICA) and Bureau for Industrial and Financial Reconstruction (BIFR) have failed to speed up the process and provide necessary judicial capacity.

Insurance bill passed; value unlocking to enhance valuations

Finally, the Parliament has passed the Insurance Bill while a hike in FDI limit from 26% to 49% has become a reality. In the longer term, the approval has opened the window both for fresh foreign capital raising as well as value unlocking through a stake sale.

We believe direct listed beneficiaries are NBFCs like Reliance Capital, Max India and HDFC Ltd as the first two derive a significant portion of their SoTP valuations from insurance. Within the banking sector, large banks both private as well as PSU will unlock value in their insurance subsidiaries. Currently, life insurance forms only 3-4% of SoTP for banks due to the large equity base.

With FDI getting opened up, the valuation multiple for the sector can see upsides with banks and NBFCs clocking capital gains on sale. Value unlocking holds the key as larger players can come out with IPOs or enter private placements as happening already. First right in most companies will be with their foreign partners, in which case strong premium that could have arisen on account of new entrant's entry premium may not be seen.

Among our coverage NBFCs, Reliance Capital will fetch larger gains vs. HDFC as the former derives 35% of SOTP from life insurance valuation and 12% is general insurance valuation on an FY17E basis. Around ₹ 1716 crore of funds can be received if 23% life insurance stake is offered for sale and ₹ 985 crore if 49% general insurance stake is offloaded i.e. ₹ 2702 crore on a market capitalisation of ₹ 11600 crore currently.

For HDFC, life insurance and general insurance businesses contribute 5% and 1%, respectively, to its FY17E SoTP valuation. Together they can generate ₹ 3540 crore on a market cap of ₹ 209250 crore.

Exhibit 5: Insurance beneficiaries in coverage universe

	Total Market Vaue (₹ crore)	Stake(%)	stake Value (₹ crore)	Value per share (₹)	% of SoTP	Value of stake if only 51% maintained
HDFC LTD						
HDFC Std Life	15,410	71	11,003	71	5	3,144
HDFC ERGO	1,755	74	1,292	7	1	397
Reliance Capital						
Reliance Life	7,463	74	5,523	226	35	1,716
Reliance General Ins	2,011	100	2,011	82	12	985
Kotak Mahindra Bank						
Kotak Life	5,054	74	3,740	49	3	1,162

Source: Company, ICICIdirect.com Research, New Business Premium (NBP)

GNPA market share (₹ crore and %)

PSU coverage	Q3FY15	Market share	FY15E
Bank of India	16,694	5.6	16,530
Bank of Baroda	15,453	5.1	17,285
Dena Bank	4,230	1.4	4,421
Punjab National Bank	22,211	7.4	24,083
Syndicate Bank	6,724	2.2	7,719
Private coverage			
Axis Bank	3,902	1.3	4,242
City Union Bank	361	0.1	387
Development Credit Bank	179	0.1	202
Federal Bank	1,067	0.4	1,191
HDFC Bank	3,468	1.2	3,734
Indusind Bank	673	0.2	788
Jammu & Kashmir Bank	2,658	0.9	2,917
Kotak Mahindra Bank	1,220	0.4	1,188
South Indian Bank	661	0.2	711
Yes Bank	279	0.1	357

Source: Capitaline, Company, ICICIdirect.com Research

*Market share based on 40 banks

The market share in GNPA over the last three quarters has fallen for large PSU banks like SBI and PNB from 24.7% & 7.6% to 20.6% & 7.4, respectively. However, in case of BoB and especially in case of BoI, the market share has risen sharply since Q4FY14 from 4.8% & 4.7% to 5.1% and 5.6%, respectively

Private banks under our coverage have largely maintained their share except for J&K Bank whose share jumped to 0.9% from 0.3% in Q4FY15

Asset quality pressure stays; meaningful respite still 2-3 quarters away

Against the expectation of reducing pace of NPA in Q3FY15, the deterioration continued. The GNPA of the entire banking system rose 20% YoY (vs.17% YoY in Q2FY15) to ₹ 300452 crore forming 4.7% of credit (vs. 4.4% in Q2), thus reflecting that on the ground, the situation has not improved for Indian companies, especially in sectors like infra, metals, textiles, mining, power etc.

PSU banks remained the major contributor to systems asset quality woes. Their GNPA ex-SBI increased at a higher pace of 32% YoY to ₹ 207347 crore vs. 27% YoY rise seen in Q2FY15. During Q3FY15, even private banks saw a 26% YoY jump in GNPA to ₹ 31113 crore, which was higher than the 18% YoY increase witnessed in Q2FY15. Higher slippages from restructured assets were seen. The NNPA increased substantially by ₹ 17649 crore QoQ to ₹ 174644 crore in Q3 vs. ₹ 156996 crore in Q2.

In case of our coverage universe, fresh slippages for PSU banks were higher sequentially. Bank of Baroda surprised negatively with slippages of ₹ 3042 crore vs. the usual range of ₹ 1500 to ₹ 1700 crore. BoI and PNB also witnessed sequential hikes in slippages. Syndicate Bank and Axis Bank fared better than peers by clocking lower slippages QoQ. In terms of total stressed assets (GNPA + restructured assets) ratio Dena Bank, PNB and J&K Bank are at the highest levels as seen in the below table. For the industry, the stress asset ratio would be ~11% as on Q3FY15, with restructured assets forming ~6.3% of credit or ~₹ 400000 crore.

Our discussions with the managements reveal that though the sentiment has improved, an actual improvement on the ground has not taken place as yet. With various stalled projects getting clearances, an actual reflection in terms of improving recovery and decline in closing GNPA is expected to take place only after two or three quarters. As credit growth remains subdued, GNPA and NNPA ratio percentages appear elevated. Furthermore, with regulatory forbearance as regards restructured assets coming to an end post Q4FY15, we foresee a strong rise in restructured assets during Q4FY15 as was also indicated by various management.

Exhibit 6: No respite on stressed asset front, strong addition in Q4FY15 seems priced in for stocks

Q3FY15	Advances	Restructured assets (₹ crore)	RA to advances (%)	GNPA (₹ crore)	NNPA (₹ crore)	Total stressed (RA + GNPA)	Stressed (%)	GNPA (%)	NNPA (%)	Coverage ratio (%)	FY15E PAT (₹ cr)
PSU Banks											
Bank of India	410,410	21,836	5.3	16,694	10,061	38530	9.4	4.1	2.5	56.6	2,533
Bank of Baroda	393,631	23,099	5.9	15,453	8,291	38552	9.8	3.9	2.1	62.4	3,729
Dena Bank	75,356	8,589	11.4	4,230	2,929	12819	17.0	5.6	4.0	50.9	299
PNB	362,496	34,333	9.5	22,211	13,788	56544	15.6	6.0	3.8	57.3	3,730
Syndicate Bank	186,630	10,216	5.5	6,724	4,370	16940	9.1	3.6	2.4	63.0	1,493
Private banks											
Axis Bank	260,567	6,808	2.6	3,902	1,251	10710	4.1	0.4	0.4	78.0	7,163
City Union Bank	16,968	256.6	2	361	220	617	3.6	2.1	1.3	62.0	7,163
DCB	9,491	110	1.2	179	95	289	3.0	1.9	1.0	77.1	406
Federal Bank	48,726	2,427	5.0	1,067	333	3494	7.2	2.2	0.7	85.0	1,016
HDFC Bank	347,088	347	0.1	3,468	904	3815	1.1	1.0	0.3	0.0	1,016
IndusInd Bank	63,847	351	0.6	673	202	1024	1.6	1.1	0.3	70.0	10,287
J&K Bank	44,361	1,804	4.1	2,658	1,428	4462	10.1	5.8	3.2	51.0	1,752
Kotak Mahindra Bank	64,641	159	0.2	1,220	630	1379	2.1	1.9	1.0	56.8	632
South Indian Bank	36,394	59	0.2	661	661	720	2.0	0.0	1.8	60.4	1,759
Yes Bank	66,607	170	0.3	279	65	449	0.7	0.4	0.1	76.8	411

Source: Company, ICICIdirect.com Research

PSB efficiency to determine capital infusion .....

The Government of India (GoI) has adopted new criteria for capital infusion in PSBs, whereby efficiency of banks will determine eligibility for equity infusion in order to strengthen balance sheet. Two broad parameters have been taken into consideration for selection of banks for capital allocation - weighted average return on assets (RoA) of last three years and return on equity (RoE) for the last financial year.

Out of ₹ 11200 crore allocated in the interim Budget for capitalisation of PSBs in FY15, GoI has allocated ₹ 6990 crore to nine banks based on their performance on RoA and RoE metrics (refer exhibit below). Bank of Baroda and PNB have been allocated ₹ 1260 crore and ₹ 870 crore, respectively. Among mid and small PSBs, Allahabad Bank will get ₹ 320 crore while Indian Bank has been allocated ₹ 280 crore. Andhra and Dena Bank will get ₹ 120 crore and 140 crore, respectively.

Exhibit 7: Return ratios determine capital allocation in FY15

Banks	RoE (%)	RoA (%)	CaR (%)	Tier I (%)	GoI Infusion (₹ crore)
I O B	3.7	2.1	10.8	7.5	
Indian Bank	8.4	1.0	12.6	10.2	280
Bank of Baroda	12.6	1.0	12.3	9.3	1260
Punjab Natl.Bank	9.3	0.9	11.5	8.9	870
St Bk of Bikaner	13.7	0.9	9.8	6.5	
Syndicate Bank	14.4	0.9	11.4	8.7	460
SBI	9.2	0.8	12.4	9.7	2970
Andhra Bank	5.0	0.8	10.8	8.1	120
Dena Bank	7.7	0.8	11.1	7.4	140
Canara Bank	8.2	0.8	10.6	7.7	570
Allahabad Bank	9.9	0.7	10.0	7.5	320
Corporation Bank	5.6	0.7	11.6	8.1	
Union Bank of India	9.2	0.7	10.8	7.5	
IDBI Bank	4.7	0.7	11.7	7.8	
Oriental Bank	8.5	0.6	11.0	8.9	
Bank of India	9.1	0.6	10.0	7.2	
St Bk of Mysore	6.0	0.6	11.1	8.7	
UCO Bank	13.5	0.6	12.7	8.7	
Vijaya Bank	7.1	0.5	10.6	8.1	
S B T	6.1	0.5	10.8	8.5	
Bank of Maha	5.2	0.5	10.8	7.4	
Pun. & Sind Bank	6.0	0.5	11.0	7.6	
United Bank of India	-23.0	0.2	9.8	6.5	
Central Bank	-8.0	0.1	9.9	7.4	
Average	6.3	0.7			

*Source: Company, Capital Line, ICICIdirect.com Research; *RoE (%) pertains to FY14, RoA (%) is average of FY12-14*

With capitalisation expected to remain a key concern for PSBs coupled with fiscal consolidation being on the agenda of the government, the Finance Minister has proposed ₹ 7940 crore towards capital infusion of PSBs in FY16. Addressing further capital requirement of PSBs, GoI has allowed banks to raise additional resources by increasing public shareholding in a phased manner; preserving government holding at not less than 52%.

Keeping in mind the new criteria adopted by GoI for capital allocation in PSBs, we expect PNB and BoB to continue to be at the forefront on the list; followed by Union Bank of India and Canara Bank. Among the mid and small size pack; Indian Bank and Syndicate Bank are likely to be the beneficiary. IOB, United Bank and Central Bank may continue to be capital starved, especially from the government. Overall, we do not anticipate a substantial change in the composition of beneficiaries compared to the previous year.

Exhibit 8: Few banks to cross returns threshold

Banks	RoE	RoA	CaR	Tier I
I O B	-4.5	1.8	10.2	7.2
Syndicate Bank	13.5	0.9	10.5	7.6
SBI	9.8	0.8	12.0	10.0
Punjab Natl.Bank	10.7	0.8	11.5	8.5
Bank of Baroda	9.8	0.8	12.4	9.1
Indian Bank	9.2	0.8	13.1	10.6
Canara Bank	10.9	0.7	9.9	7.2
Union Bank of India	10.5	0.7	10.3	7.3
Oriental Bank	6.7	0.6	11.3	8.5
Andhra Bank	6.9	0.6	10.5	8.0
UCO Bank	11.6	0.6	12.1	8.5
St Bk of Mysore	9.1	0.6	11.7	
Dena Bank	2.7	0.6	10.8	7.1
Bank of India	8.9	0.6	10.7	7.8
Corporation Bank	7.1	0.5	11.3	7.9
Allahabad Bank	5.1	0.5	10.0	7.6
Bank of Maha	7.6	0.5	11.3	
Vijaya Bank	8.1	0.5	10.6	7.8
IDBI Bank	2.0	0.4	12.2	8.3
S B T	4.2	0.4	10.1	
Pun. & Sind Bank	5.9	0.4	11.6	
Central Bank	4.5	0.1	10.2	7.2
United Bank of India	5.0	0.1	10.4	7.2
Average	**7.2**	**0.6**		

*Source: Company, Capital Line, ICICIdirect.com Research; *RoE (%) pertains to 9MFY15, RoA (%) is average of FY13-14 and 9MFY15*

New PSL norms – Introduction of PSLC

The Internal Working Group (IWG), constituted by the RBI, has proposed revised guidelines for the priority sector lending (PSL) target, widening the overall scope of PSL lending to improve its effectiveness amid changes in the Indian economy. Among other recommendations, introduction of priority sector lending certificates (PSLC) would provide flexibility and a better framework to achieve their PSL targets.

Exhibit 9: Proposed PSL guidelines

Target/Sub-target	Existing	Proposed
Priority Sector	40%	40%
Agriculture	18%	18%
Marginal and small farmers		8%
Direct	13.5%	
Indirect	4.5%	
MSE		
Micro Enterprise	40% of MSE	7.5% of ANBC
Weaker Section	10%	10%

Source: Company, ICICIdirect.com Research

Key proposals made by IMG;

1. The overall PSL target of 40% has been retained for SCBs. Foreign banks will be brought on par with domestic banks with the same target applicable to them (currently – 32% of ANBC). However, foreign banks with more than 20 branches will be given time up to March 2018 while foreign banks with less than 20 branches need to comply with revised norms by March 2020
2. Introduction of PSLC will enable banks with surplus PSL to sell such certificates to another bank, deficient on PSL providing banks with a framework to specialise in certain segments of the priority sector and leverage their comparative advantage
3. The agriculture limit has been kept unchanged at 18% with a new sub-limit of 8% for small and marginal farmers, which is to be achieved over two years. Higher flexibility has been recommended for the remaining 10% including lending to other farmers and agriculture infrastructure and ancillary activities
4. Medium enterprises are to be included within the ambit of PSL with a credit limit of ₹ 10 crore. In order to avoid crowding for micro enterprise, a sub limit of 7.5% of ANBC has been recommended. This should be achieved in a phased manner over two years (7% by March 2016 and 7.5% by March 2017)
5. It has been recommended that the PSL limit for housing be increased to ₹ 28 lakh (currently at ₹ 25 lakh) for metros and ₹ 20 lakh for other centres (currently at ₹ 15 lakh). In addition, it has been suggested to either include housing loans up to prescribed limit under PSL or take the benefit from exception from ANBC
6. Social infrastructure such as schools, healthcare, drinking water and sanitation will be included under PSL. Bank loan up to ₹ 10 crore for renewable energy including solar based power generators, biomass based power generators, wind mills to be included under the ambit of priority lending. Export credit also to be considered under PSL pertaining to certain limit
7. Education loans (domestic and overseas loans) up to ₹ 10 lakh per borrower to be eligible for PSL
8. Recommended frequent monitoring of PSL compliance on a quarterly basis as compared to the current practise of annual compliance. In addition, agriculture PSL to be reset every three years

Annexure

Exhibit 10: Quarterly margin trend

NIM (%)	Q3FY13	Q4FY13	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15	Q2FY15	Q3FY15
PSU coverage									
Bank of India	2.4	2.5	2.5	2.3	2.4	2.3	2.2	2.3	2.2
Bank of Baroda	2.7	2.5	2.4	2.3	2.4	2.3	2.4	2.4	2.2
Dena Bank	2.9	2.5	2.6	2.6	2.7	2.3	2.2	2.3	2.2
Punjab National Bank	3.5	3.5	3.5	3.5	3.6	3.2	3.4	3.2	3.2
State Bank of India	3.4	3.3	3.2	3.2	3.2	3.2	3.1	3.1	3.1
Syndicate Bank	3.3	3.0	2.8	2.9	2.8	2.8	2.5	2.6	2.3
Private coverage									
Axis Bank	3.6	3.7	3.9	3.8	3.7	3.9	3.9	4.0	3.9
City Union Bank	3.5	3.4	3.6	3.5	3.6	3.3	3.3	3.5	3.5
Development Credit Bank	3.4	3.5	3.4	3.7	3.6	3.6	3.7	3.7	3.7
Indusind bank	3.5	3.7	3.7	3.7	3.7	3.8	3.7	3.6	3.7
Federal Bank	3.5	3.1	3.1	3.3	3.2	3.6	3.3	3.4	3.2
HDFC Bank	4.3	4.5	4.6	4.3	4.2	4.4	4.4	4.5	4.4
Jammu & Kashmir Bank	4.1	4.1	4.2	4.3	4.0	4.1	3.6	4.0	3.7
Kotak Mahindra Bank	4.6	4.6	4.8	4.9	4.9	4.9	5.0	5.0	4.7
South Indian Bank	3.2	3.2	2.9	3.1	3.0	3.0	2.7	2.8	2.7
Yes Bank	3.0	3.0	3.0	2.9	2.9	3.0	3.0	3.2	3.2

Source: Company, ICICIdirect.com Research

Exhibit 11: Financials of industry as on Q3FY15 (listed banks + SBI associates)

(₹ crore)	Q3FY15	Q2FY15	Q1FY15	Q4FY14	Q3FY14	Q2FY14	Q1FY14	YoY (%)	QoQ (%)
NII	68431	67664	65868	65203	63201	61352	59406	8.3	1.1
Growth YoY	**8.3**	**10.3**	**10.9**	**12.8**	**11.5**	**12.8**	**10.7**		
Other income	28394	25275	24101	29792	22375	20562	26808	26.9	12.3
Growth YoY	**26.9**	**22.9**	**-10.1**	**9.4**	**7.9**	**9.4**	**44.2**		
Total operating exp.	46464	45188	42072	42899	41376	40683	38724	12.3	2.8
Staff cost	25815	24700	24152	23178	23446	23043	22796	10.1	4.5
Operating profit	50361	47751	47898	52096	44200	41231	47490	13.9	5.5
Growth YoY	**13.9**	**15.8**	**0.9**	**15.6**	**3.0**	**3.8**	**17.3**		
Provision	23906	21407	16776	25670	21446	21580	18438	11.5	11.7
PBT	26436	26328	31108	26406	22736	19638	29042	16.3	0.4
PAT	17368	18207	20919	20007	15353	14145	20276	13.1	-4.6
Growth YoY	**13.1**	**28.7**	**3.2**	**-0.9**	**-21.1**	**-25.0**	**1.9**		
GNPA	300452	275550	258228	248210	249795	235273	213299	20.3	9.0
Growth YoY	**20.3**	**17.1**	**21.1**	**35.1**	**36.8**	**38.1**	**40.7**		
NNPA	174644	156996	144833	136859	142197	131695	117201	22.8	11.2
Growth YoY	**22.8**	**19.2**	**23.6**	**44.5**	**51.4**	**52.5**	**60.9**		

Source: Capitaline, Company, ICICIdirect.com Research

ICICIdirect.com coverage universe (BFSI)

Sector / Company	CMP (₹)	TP(₹)	Rating	M Cap (₹ Cr)	EPS (₹) FY15E	FY16E	FY17E	P/E (x) FY15E	FY16E	FY17E	P/ABV (x) FY15E	FY16E	FY17E	RoA (%) FY15E	FY16E	FY17E	RoE (%) FY15E	FY16E	FY17E
Bank of India (BANIND)	209	255	Hold	12,460	39	45	51	5.3	4.6	4.1	0.8	0.7	0.7	0.4	0.4	0.4	8	9	10
Bank of Baroda (BANBAR)	170	210	Buy	35,733	17	24	30	10.1	7.1	5.6	1.3	1.1	1.0	0.5	0.7	0.8	10	13	14
Dena Bank (DENBAN)	49	56	Hold	2,635	5	9	10	9.2	5.5	4.7	0.8	0.7	0.6	0.2	0.3	0.3	4	7	7
Punjab National Bank (PUNBAN)	163	215	Buy	29,527	20	23	29	8.1	7.0	5.7	1.3	1.1	0.9	0.6	0.7	0.7	10	10	12
Syndicate Bank (SYNBN)	105	124	Hold	6,317	23	28	32	4.7	3.8	3.3	1.0	0.9	0.9	0.5	0.6	0.6	12	13	14
Indian Bank (INDIBA)	170	221	Buy	7,304	23	27	36	7.5	6.3	4.7	0.8	0.8	0.7	0.6	0.6	0.7	8	8	10
Axis Bank (UTIBAN)	555	690	Buy	130,902	30	35	42	18.2	15.7	13.3	3.1	2.6	2.2	1.7	1.8	1.8	17	17	17
City Union Bank (CITUNI)	95	110	Buy	4,585	7	9	11	13.7	10.9	8.9	2.2	1.9	1.6	1.5	1.7	1.8	17	18	18
Development Credit Bank (DCB)	107	140	Buy	2,764	6	8	9	16.6	13.7	11.7	2.1	1.9	1.6	1.3	1.3	1.2	14	13	14
Federal Bank (FEDBAN)	136	164	Buy	11,590	12	14	17	11.4	9.5	7.8	1.6	1.4	1.3	1.3	1.3	1.4	14	15	16
HDFC Bank (HDFBAN)	1,048	1,160	Hold	261,938	41	50	60	25.3	20.8	17.4	4.3	3.7	3.2	1.9	2.0	2.1	20	19	19
Indusind Bank (INDBA)	888	925	Buy	46,560	33	41	53	26.7	21.4	16.6	4.6	3.9	3.3	1.8	1.9	2.0	18	19	21
Jammu & Kashmir Bank (JAMKAS)	105	119	Hold	5,068	13	22	27	8.0	4.8	3.9	1.1	0.9	0.8	0.8	1.1	1.2	11	16	17
Kotak Mahindra Bank (KOTMAH)	1,336	1,505	Hold	102,426	23	27	32	58.5	49.5	41.2	7.6	6.7	5.8	1.8	1.8	1.8	13	14	15
South Indian Bank (SOUINO)	24	29	Hold	3,251	3	4	4	8.0	6.8	5.5	1.0	1.0	0.8	0.6	0.7	0.8	11	13	15
Yes Bank (YESBAN)	829	950	Buy	34,508	48	63	81	17.2	13.2	10.2	3.0	2.5	2.0	1.7	1.8	2.0	21	20	22
NBFCs																			
IDFC (IDFC)	168	198	Buy	25,390	12	13	14	14.3	12.9	12.2	1.6	1.4	1.3	2.5	2.7	2.7	11	11	11
LIC Housing Finance (LICHF)	439	515	Buy	22,363	29	37	47	15.4	12.1	9.4	2.7	2.3	2.0	1.4	1.5	1.6	18	20	21
Reliance Capital (RELCAP)	441	562	Buy	10,834	49	40	44	9.1	11.0	10.1	1.0	0.9	0.8	2.5	1.8	1.6	9	7	7
HDFC (HDFC)	1,346	1,350	Hold	206,974	39	45	51	34.2	29.9	26.2	6.9	6.2	5.6	2.5	2.4	2.4	21	22	22
PTC India Financial Services	52	63	Hold	2,934	4	6	7	12.6	8.3	7.0	1.9	1.7	1.3	3.6	3.9	3.8	16	21	22
CARE (CARE)	1,512	2,175	Buy	4,385	50	60	68	30.0	25.0	22.2	12.1	11.1	10.6	40.0	43.8	47.1	40	44	48

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Hold and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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

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

ANALYST CERTIFICATION

We /I, Kajal Gandhi, CA, Vasant Lohiya, CA and Vishal Narnolia, MBA Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, *inter alia,* engaged in the business of stock brokering and distribution of financial products. ICICI Securities is a wholly-owned subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their relatives from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts have any material conflict of interest at the time of publication of this report.

It is confirmed that Kajal Gandhi, CA, Vasant Lohiya, CA and Vishal Narnolia, MBA, Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities are engaged in various financial service businesses, they might have financial interests or beneficial ownership in various companies including the subject company/companies mentioned in this report.

It is confirmed that Kajal Gandhi, CA, Vasant Lohiya, CA and Vishal Narnolia, MBA, Research Analysts do not serve as an officer, director or employee of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.