HSBC Global Research

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Commercial Banks
Equity – India

India Financials

4Q12 Preview: What NOT to expect

- **We do not expect an acceleration in loan growth (17-19% y/y) or a margin pickup, particularly as rate rigidity sets in**
- **We do not expect an improvement in impaired loans or credit costs; However, slippage ratios may plateau and recovery ratios may start looking up; Overall, a single digit q/q growth in earnings appears unexciting this quarter**
- **HFCs likely to be in favour as rate cycle tops out, teaser rate loans reprice and new loan growth remains robust**

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Variance vs consensus Our 4Q12 net profit estimates are 10-15% below the street for PSU banks and broadly in line for private banks. We believe the key reason for the deviation for PSU banks is our expectations of sequentially weaker margins given the high cost of short-term borrowings in 4Q.

Growth trends are distorted for the PSU banks on a Y/Y basis given that last year 4Q saw i) chunky pension provisioning for PSUs and ii) several one-offs for SBI dragging down earnings growth 99%. On a quarterly basis, we expect PSU banks earnings growth to be in a range of -9% to +9% except for Union Bank which we see much higher sequential growth given the chunky, conservative provisioning hit it took last quarter on GTL. For private banks we expect 22% y/y growth in earnings but limited to 2% q/q mainly due to some margin pressures.

Rate rigidity likely to dominate worries as several banks have raised deposit rates given persistent liquidity tightness and increasing competition in household savings from i) physical assets, ii) tax-free investments and iii) higher savings account rates. It is hard to imagine how margins could expand in a soft credit cycle given these rigidities and the oncoming inflation from fuel, electricity and freight rates.

Restructured loans continue to act as the single biggest pressure point against an improving outlook on asset quality. With each week bringing new cases (chunky or otherwise) to the fore in terms of restructurings, credit costs are unlikely to see any major or sustained downtrend especially if dynamic provisioning norms are introduced this year by the RBI. However, we may see some improvement in both slippage and recovery ratios from this or the next quarter. Also, with the recent proposed tariff hikes announced by a couple of SEBs, there is some light at the end of the 'power-tunnel'.

Stock preferences remain centered around private names, especially HFCs which are likely to enjoy a more stable growth and asset quality outlook.

4Q Estimates Preview

Q4FY12 Earnings estimates (INR bn)

	Net interest income	Other income	Ops. income	Ops. expense	Ops. profit	Core Operating profit	Provisions	PBT	Tax	Net profit
BOB	28.00	9.07	37.07	12.47	24.60	23.53	8.50	16.10	4.35	11.75
BOI	22.00	9.00	31.00	12.50	18.50	17.50	8.60	9.90	3.07	6.83
Canara	19.73	8.70	28.43	11.93	16.51	14.81	5.90	10.61	2.46	8.15
PNB	36.93	10.21	47.14	18.91	28.22	27.22	10.00	18.22	6.01	12.21
SBI	124.52	41.07	165.58	71.95	93.63	92.57	43.00	50.63	15.18	35.45
Union Bank	19.47	6.69	26.16	11.65	14.52	13.52	7.50	7.02	2.01	5.01
PSU Banks	**250.65**	**84.74**	**335.39**	**139.41**	**195.98**	**189.14**	**83.50**	**112.48**	**33.08**	**79.40**
Axis Bank	22.00	16.30	38.30	16.20	22.10	20.90	4.70	17.40	5.69	11.71
HDFC bank	32.40	16.34	48.75	24.78	23.97	23.97	3.05	20.92	6.38	14.54
ICICI Bank	27.93	20.61	48.55	21.00	27.55	26.93	4.20	23.35	6.16	17.18
IIB	4.62	2.86	7.48	3.62	3.86	3.74	0.45	3.41	1.16	2.25
Yes Bank	4.48	2.30	6.78	2.58	4.20	3.90	0.40	3.80	1.26	2.55
Pvt banks ex NBFC	**91.44**	**58.42**	**149.86**	**68.18**	**81.68**	**79.45**	**12.80**	**68.88**	**20.65**	**48.23**
HDFC	17.67	0.86	18.53	1.18	17.34	17.34	- 0.03	17.37	4.86	12.51
LICHF	3.44	0.60	4.04	0.60	3.44	3.44	-	3.44	0.86	2.58
LTFH	3.40	0.12	3.52	1.22	2.30	2.30	0.62	1.68	0.56	1.13
NBFC	**24.50**	**1.58**	**26.09**	**3.01**	**23.08**	**23.08**	**0.59**	**22.50**	**6.28**	**16.22**

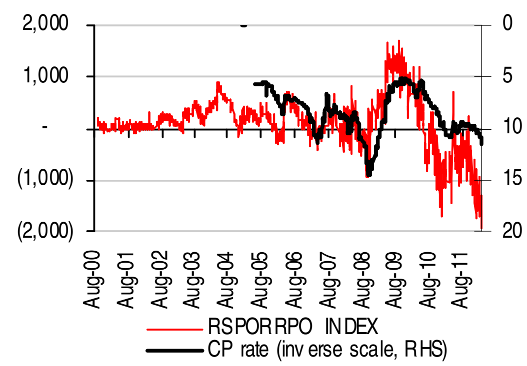
Source: Company data, HSBC

Q4FY12 Earnings estimates (y/y growth)

	Net interest income	Other income	Ops. income	Ops. expense	Ops. profit	Core Operating profit	Provisions	PBT	Tax	Net profit
BOB	7%	9%	8%	-17%	26%	29%	44%	19%	612%	-9%
BOI	-5%	9%	-1%	-35%	53%	62%	80%	36%	31%	38%
Canara	0%	-7%	-2%	-2%	-3%	-14%	8%	-8%	-2%	-9%
PNB	22%	-11%	13%	13%	13%	11%	37%	2%	4%	2%
SBI	55%	-15%	29%	6%	54%	61%	3%	163%	-20%	16880%
Union Bank	13%	11%	13%	-20%	67%	93%	389%	-2%	69%	-16%
PSU Banks	**27%**	**-7%**	**16%**	**-4%**	**37%**	**40%**	**26%**	**47%**	**5%**	**76%**
Axis Bank	29%	12%	22%	22%	21%	19%	85%	11%	4%	15%
HDFC bank	14%	30%	19%	24%	14%	15%	-29%	26%	16%	30%
ICICI Bank	11%	26%	17%	14%	20%	8%	9%	22%	31%	18%
IIB	19%	58%	31%	33%	29%	34%	12%	32%	35%	31%
Yes Bank	29%	23%	27%	38%	21%	20%	-8%	25%	23%	25%
Pvt banks ex- NBFC	**17%**	**24%**	**20%**	**21%**	**19%**	**14%**	**11%**	**20%**	**18%**	**22%**
HDFC	17%	-40%	12%	24%	11%			12%	18%	10%
LICHF	-18%	-39%	-22%	-15%	-23%			-20%	-25%	-18%
LTFH	18%	-13%	16%	19%	15%		54%	5%	-1%	8%
NBFC	**10%**	**-38%**	**5%**	**12%**	**5%**	**5%**	**-9%**	**5%**	**8%**	**4%**

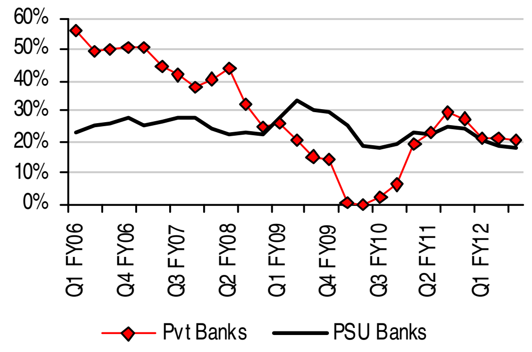
Source: Company data, HSBC

Tight liquidity, high rates is a function of savings leakage



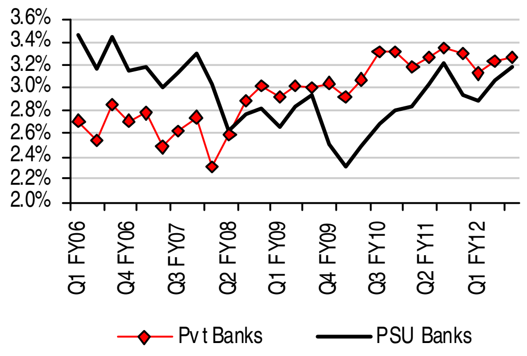
Source: Bloomberg, HSBC

Loan growth likely to slow further



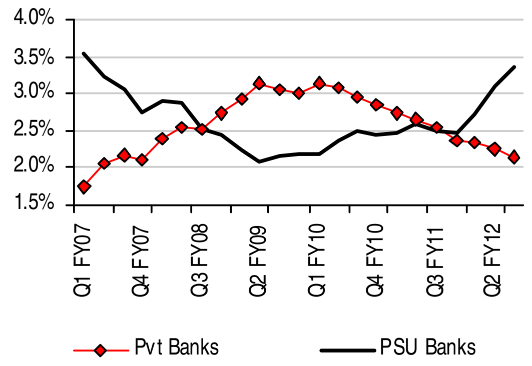
Source: Company data, HSBC

End of rising NIMs?



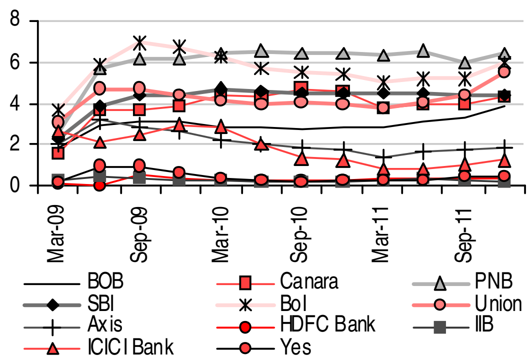
Source: Company data, HSBC

Rising NPLs at PSU banks



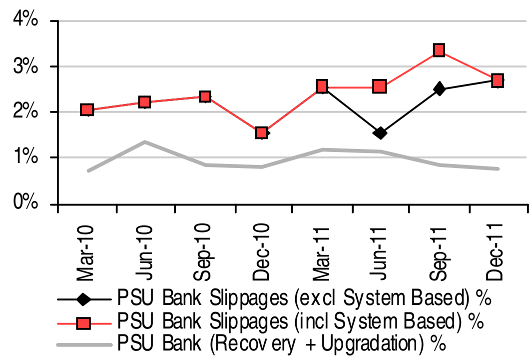
Source: Company data, HSBC

PSUs also have higher (and rising) restructured book



Source: Company data, HSBC

Likely improvement in PSUs slippage, recovery trends



Source: Company data, HSBC

Valuation Summary

India Banks Coverage Universe (closing price as on 02 April, 2012)

RIC Code	Stock	Market Price INR	Target Price INR	Rating	Market cap (USDm)	HSBC P/E Fy12e	HSBC P/E Fy13e	HSBC P/E Fy14e	HSBC P/B Fy12e	HSBC P/B Fy13e	HSBC P/B Fy14e	EPS CAGR Fy11-14e
Public Sector banks												
BOB.BO	Bank of Baroda	795	889	N	6,118	6.5	5.6	4.5	1.3	1.1	0.9	16.8%
BOI.BO	Bank of India	367	358	UW	3,942	8.7	7.3	5.7	1.1	1.0	0.9	11.3%
CNBK.BO	Canara Bank	470	544	OW	4,090	6.1	5.4	4.6	1.0	0.9	0.7	2.3%
PNBK.BO	Punjab National	929	1,039	N	5,785	6.4	5.5	4.7	1.2	1.0	0.9	11.9%
SBI.BO	SBI	2,130	2,000	UW	26,590	12.8	10.6	8.7	1.8	1.6	1.4	23.3%
UNBK.BO	Union Bank	235	236	OW	2,426	8.1	6.2	4.9	1.0	0.9	0.8	5.6%
PSU Universe					**48,951**	**9.0**	**7.5**	**6.2**	**1.4**	**1.2**	**1.0**	**15.3%**
Private Sector banks												
AXBK.BO	Axis Bank	1,155	1,477	OW	9,379	11.7	10.0	8.2	2.1	1.8	1.6	19.0%
HDBK.BO	HDFC Bank	528	569	OW	24,355	23.8	19.8	16.4	4.2	3.6	3.1	23.6%
ICBK.BO	ICICI Bank	890	1,234	OW	20,113	16.1	13.4	10.7	1.7	1.6	1.4	22.3%
INBK.BO	IndusInd Bank	326	326	OW	2,998	18.9	14.0	10.6	3.4	2.8	2.3	32.6%
YESB.BO	Yes Bank	373	372	OW	2,586	13.4	10.8	8.7	2.8	2.3	1.9	26.4%
Pvt Universe					**59,430**	**17.4**	**14.4**	**11.8**	**2.5**	**2.2**	**1.9**	**23.2%**
NBFC												
HDFC.BO	HDFC	683	808	OW	19,841	24.1	20.0	17.0	5.1	4.4	3.9	18.6%
LICHF.BO	LIC Housing Finance	266	299	OW (V)	2,482	13.9	9.8	7.7	2.6	2.1	1.8	18.7%
LTFH.BO	L&T Finance Holding	47	51	N (V)	1,598	19.0	12.9	9.5	1.7	1.5	1.3	21.6%
NBFC Universe					**23,920**	**22.1**	**17.6**	**14.5**	**4.1**	**3.6**	**3.1**	**19.5%**
Total Coverage Universe					**132,301**	**13.3**	**11.0**	**9.0**	**2.0**	**1.8**	**1.5**	**18.7%**

Note: Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Indian stocks of 11% and for stocks without a volatility indicator, the Neutral band is 5 percentage points above and below the hurdle rate for Indian stocks of 11%. Our target prices provided upside potential that was above, below, or within the Neutral band of our model at the time we set our target; therefore, we rate the stock OW(V), OW, UW(V), UW, N(V) or N, as indicated in the "Rating" column above.
Source: Company data, Bloomberg, HSBC estimates

Valuations and risks

We base our weights for PE, PB and EPM on macro factors influencing the sector. Historically, PE holds sway above PB in valuing banking stocks during a recovering credit cycle. As economic growth peaks, the focus is likely to shift from earnings growth potential towards asset quality and the risk to book. The three-stage EPM uses explicit forecasts until FY14e, followed by 10 years of semi-explicit forecasts. The final stage of 12 years (fade period) assumes convergence of ROE and COE. EPM is based on the assumptions in the following table:

EPM assumptions

	BOB	BoI	CNBK	PNBK	SBI	UNBK	AXSB	HDBK	ICBK	IIB	Yes	HDFC	LICHF	LTFH
Semi-explicit forecasts for 10 yrs														
Loan CAGR	8%	8%	8%	8%	8%	8%	13%	20%	14%	8%	13%	14%	10%	15%
Dividend payout	18%	18%	15%	18%	20%	10%	23%	25%	30%	20%	13%	45%	20%	15%
Fade period of 12 yrs														
Risk free rate	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%	8%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.7	1.0	1.0	1.0	1.0	1.0	1.0
Equity risk premium	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Cost of Equity	14%	14%	14%	14%	14%	14%	14%	12%	14%	14%	14%	14%	14%	14%
EPM value	965	449	534	1,086	1,786	274	1,037	443	704	186	335	663	255	48

Source: HSBC

Coverage Stocks: Valuation and risk factors

	PE multiple	PE-based value (INR)	PB multiple	PB-based value (INR)	DCF value(INR)	Weighted TP (INR)	Upside risks	Downside risks
Public sector banks								
Weights		**20%**		**50%**	**30%**			
BOB	5.5	929	1.0	827	965	889	Less than expected asset quality issues	Management change in Nov-12
BOI	5.0	303	0.8	326	449	358	Upside surprise in asset quality; Sustained operating profit growth	---
CNBK	5.0	483	1.0	575	534	544	---	Higher slippages; management change in 2HFY13.
PNBK	5.5	1,043	1.0	1,009	1,086	1,039	Turnaround in macro environment	Higher than expected asset quality stress; margin pressure
SBI	9.3	2,168	1.4	2,061	1,786	2,000	Upturn in the economic cycle and asset quality improves	--
UNBK	5.0	224	0.8	218	274	236	---	Weak asset quality trends, negative margins surprise, management change
Private sector banks								
Weights		**50%**		**20%**	**30%**			
AXSB	13.0	1,742	2.1	1,477	1,037	1,477	---	Margins surprising downwards again; asset quality risks
HDBK	21.0	647	3.4	564	443	569	---	Slower loan growth, worsening asset quality
ICBK	20.0	1,580	1.9	1,165	704	1,234	---	Slower than expected loan growth momentum, spike in NPLs and credit costs
IIB	15.0	433	2.0	267	186	326	---	Macro headwinds; Higher than expected loan slippages and credit costs
YES	10.0	407	1.8	342	335	372	---	Longer than expected build up of retail liabilities; Asset quality risks
NBFC								
Weights		**50%**		**20%**	**30%**			
HDFC	23.5	909	4.5	771	663	808	---	A sharp increase in competitive pressures could slow business growth or impact margins; Asset quality risks
LICHF	10.0	327	2.0	294	255	299	---	Further margin compression and higher provision
Weights		**20%**		**30%**	**50%**			
LTFH	11.0	55	1.5	53	48	51	Sharp decline in rates, potential banking licence and asset quality risks not materialising	Rates remaining high and asset quality risks increasing

Source: HSBC

Disclosure appendix

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BANK OF BARODA	BOB.NS	1,5,6,7,11
BANK OF INDIA	BOI.NS	1,5,6,7,11
CANARA BANK	CNBK.BO	1,4,5,6,7,11
HDFC	HDFC.NS	2,6,7
HDFC BANK	HDBK.BO	2,6,7
ICICI BANK	ICBK.NS	1,2,4,5,6,7,9,11
INDUSIND BANK	INBK.BO	4,7
L&T FINANCE HOLDING	LTFH.NS	1,2,5
LIC HOUSING FINANCE LTD	LICH.BO	4,7
PUNJAB NATIONAL BANK	PNBK.BO	6,7
STATE BANK OF INDIA	SBI.NS	1,2,4,5,6,7,11
UNION BANK OF INDIA	UNBK.BO	6,7,11
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Source: HSBC

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- Sachin Sheth has a long position in the shares of ICICI Bank.

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