

India Banks

Loan Growth: Concern is just too generic...You deserve a number

■ Industry Overview

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- **The Concern** — The market is concerned about loan growth (FY14); bank mgmts are cautious, current 9% YTD growth is a 12-year low (16% yoy is not so), investment pipeline is thin, economy remains sluggish, and corporates continue to borrow off-shore. But all this is just too generic an apprehension; we piece together India's loan growth history, what lies below aggregates, and make a bottom up loan growth forecast for FY14...and what this could mean for bank stocks.
- **History** — Loan growth has averaged 21% over the last 15 years, its average Real GDP multiplier has been 3.0x (currently at average) and Nominal GDP multiplier at 1.6x (currently at 1.3x) – and loan growth lows have been 10/12% in FY02/10. India's loan growth currently (16% yoy) is well below averages and what the market has been used to; but is still well above its decadal lows.
- **Mix** — The market's caution is largely premised on a faltering project pipeline. This is important – infra is 15% of book, corporate a primary driver of growth (40% of FY12 grth) & they are visible/lumpy. But there is more to bank loans – Retail (19%, 17% yoy currently), Agri (12%, 21%) and other business loans (30%). These have their own dynamics, growth rates, and not as obvious to call; but will probably make the difference. We detail this: Shares, 10/5/1-Yr/YTD growth rates and our forecasts.
- **The Number** — **15%** — Our segmental analysis suggests loan growth in FY14 should average ~15% – with infra/corp./SME the laggards, and Agri/Retail the leaders. This will be ~5% below longer-term averages but largely consistent with expected GDP growth and current (~16%) growth levels. In our view, this is a little ahead of relatively generic market concerns/estimates (10-14%) on loan growth.
- **Bank Stocks** — Stocks/valuations have increasingly tracked loan growth over recent years (Fig 1); so it is critical. That said: a) Correlation is not strong enough for stock-specific calls; b) Recent val/growth dichotomy suggests some risk; c) Govt. banks more growth dependent than pvt; d) SBI/Axis/ICBK more exposed to wholesale/project growth risks; and e) Our view: 15% loan growth good enough for modest bank stock upsides but not enough to feed big bulls or bears. We maintain an Overweight on Banks in our Model portfolio, and ICBK/Axis are our top picks.

Figure 1. India Banks – Loan Growth (% YoY) and India Banks P/BV Multiple (1 Yr Fwd)



Source: Citi Research, RBI

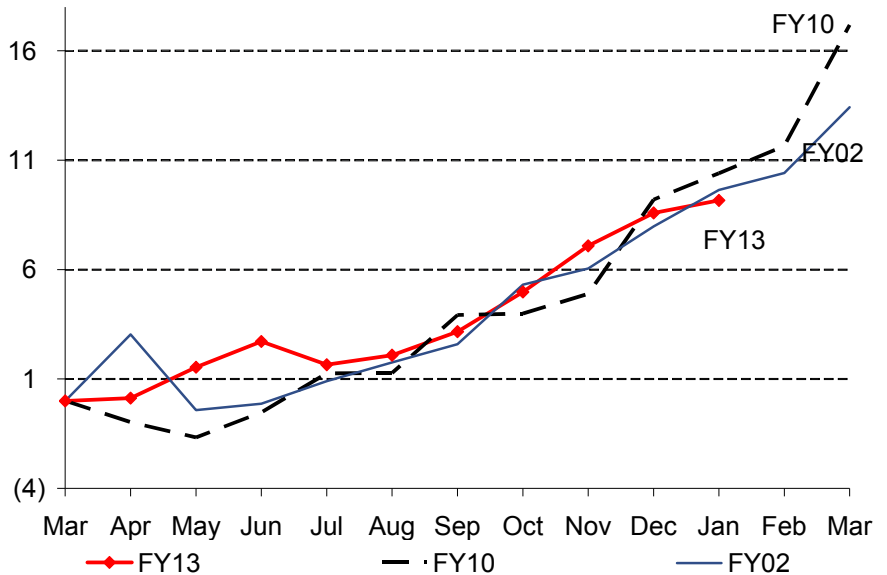
See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Loan Growth: The Concern

YTD loan growth at 9.5% is lower than in the two weakest years.....so it is a reason to worry (16% yoy growth is more respectable)

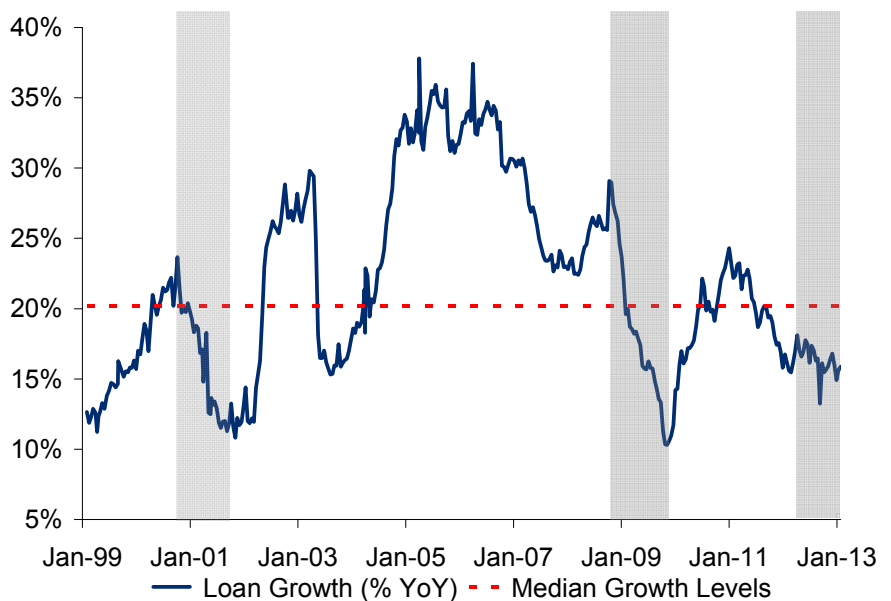
Figure 2. India Loan Growth (% YTD, FY02, FY10, FY13)



Source: Citi Research, RBI

But 16% yoy loan growth is more than 5% lower than its 15-year average of 21%....but well above its historical lows of ~10-12% in FY02 and FY10.

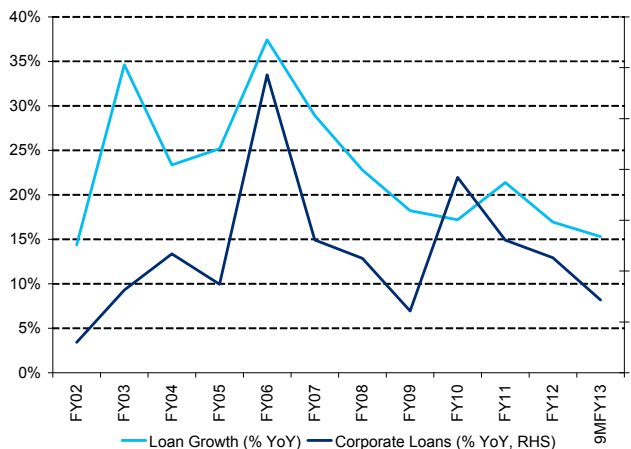
Figure 3. India Banks: Loan Growth (% YoY)



Source: Citi Research, RBI

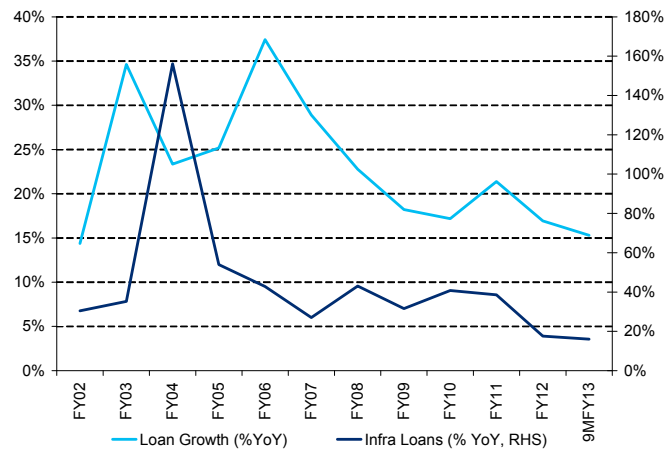
And this weakness, and bearishness...is largely on account of infra/corporate loans, which have been primary drivers of overall growth in recent years

Figure 4. There is a correlation between loan growth and corporate/infrastructure lending...



Source: Citi Research, RBI

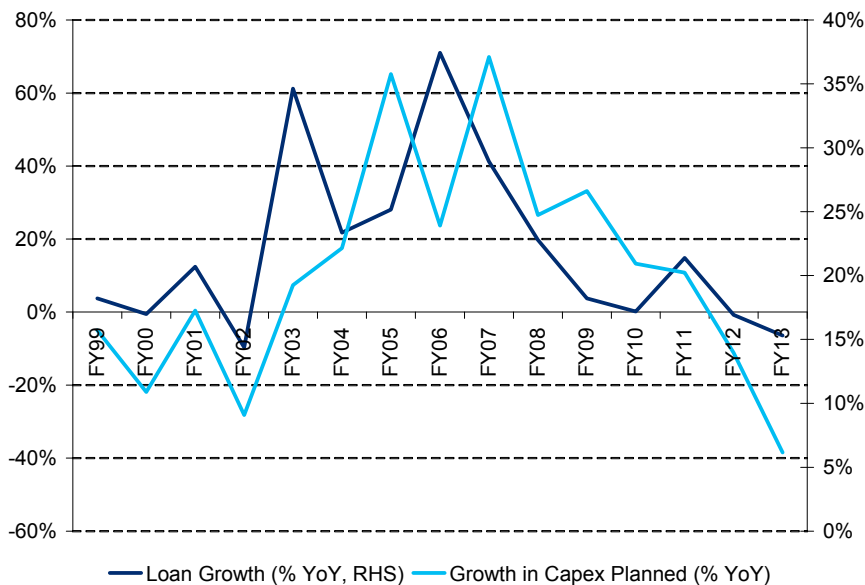
Figure 5. ...particularly in recent years – slowdown in infra has moderated overall loan growth



Source: Citi Research, RBI

The market's – and bankers' concerns are materially centered around new project/capex announcements...these are in negative territory, have thinned the lending pipeline of banks and because they are relatively easy to track.... are a key driver of weak loan growth expectations

Figure 6. Growth in Capital Expenditure Announced versus India Banks Loan Growth (% YoY)

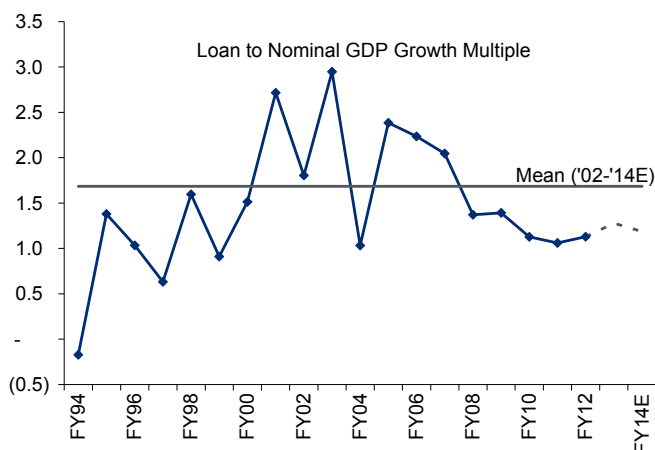


Source: Citi Research

The Top Down Picture...and some History

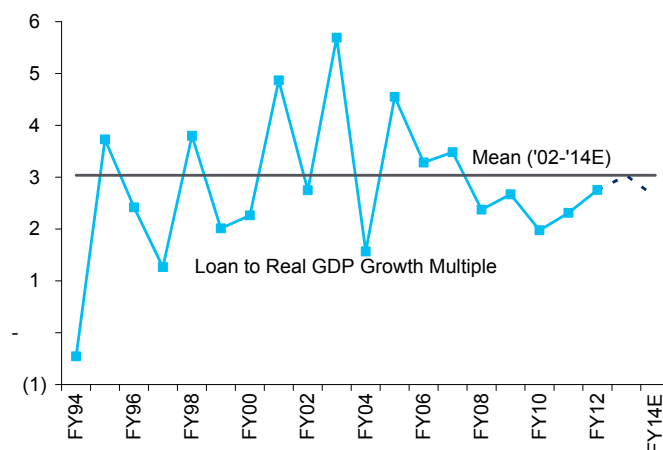
But, the bigger picture – Indian Bank loan growth has tended to operate off a mean loan growth-GDP multiplier, and this is hovering around its mean, even after accounting for Citi’s recently cut GDP forecasts (Citi at 5.7% for FY14).

Figure 7. Loan Growth versus Nominal GDP Multiplier



Source: Citi Research, RBI

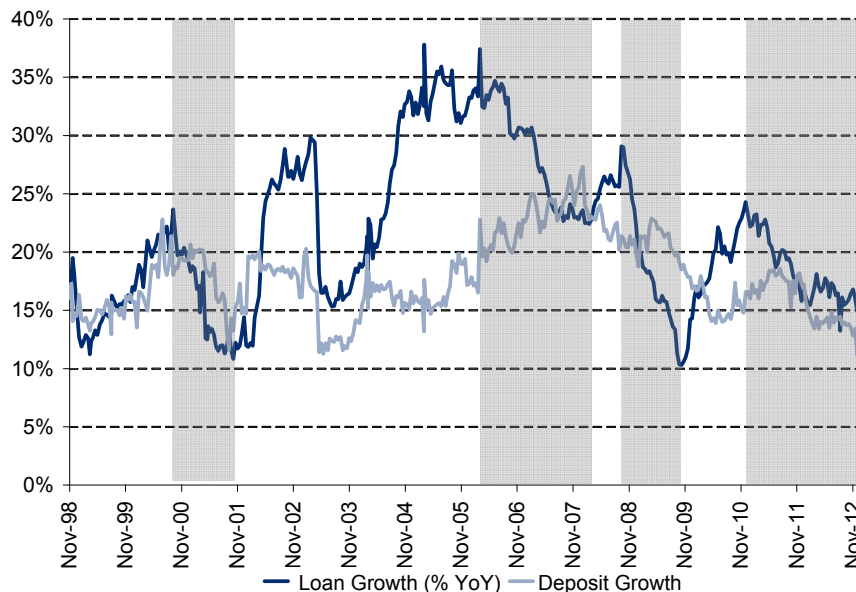
Figure 8. Loan Growth versus Real GDP Multiplier



Source: Citi Research, RBI

We are focusing on loan demand...but supply could be an issue too this time...deposit growth has fallen more rapidly than loan growth...and in previous demand slumps, this did not come into play.....we leave this angle for another analysis

Figure 9. India Banks: Loan and Deposit Growth (% YoY)



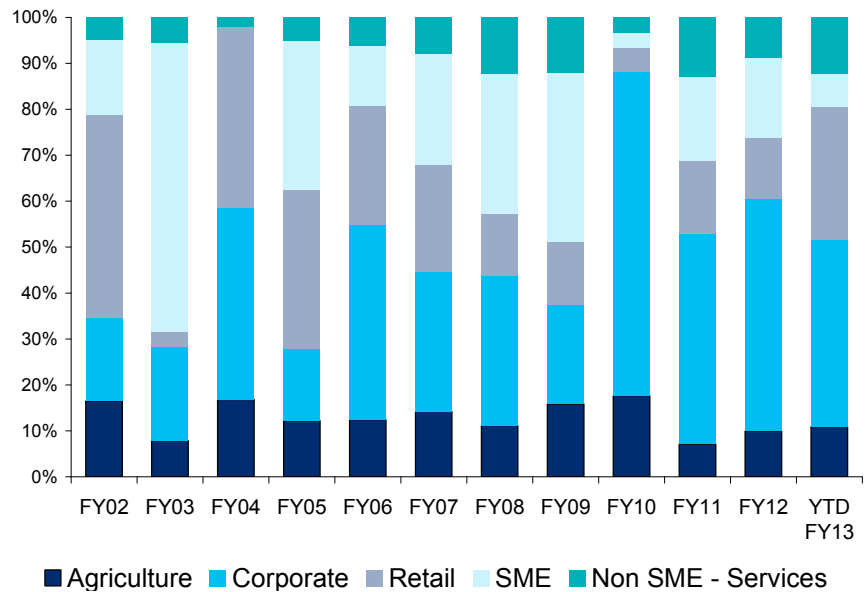
Source: Citi Research, RBI

The Mix

There is a lot below aggregate loan growth, which we believe needs a closer look.

Loan growth has become more broad-based recently – Agri and Retail are picking up some of the slack on account of already slowing corporate appetite

Figure 10. India Banks: Sectoral Mix of Incremental Loans (%)



Source: Citi Research, RBI

And this is what the Indian Banking system's loan book looks like

Figure 11. India Banks' Outstanding Loan Mix – Segmental Share of Overall Loans (% YoY)

Lending Segments	FY02	FY05	FY09	FY10	FY12	Dec'12
Agriculture	12.6%	12.4%	13.0%	13.7%	12.2%	12.1%
Corporate	35.7%	28.9%	30.6%	36.3%	39.8%	39.9%
- Infrastructure	3.1%	7.9%	10.4%	12.5%	14.4%	15.0%
- Other corporate	32.6%	21.0%	20.3%	23.8%	25.4%	24.9%
Retail	23.1%	25.5%	21.6%	19.3%	17.9%	18.7%
- Mortgages	4.6%	7.5%	10.6%	9.9%	9.0%	9.5%
- Other retail	18.5%	18.0%	11.0%	9.4%	8.9%	9.2%
SME	26.1%	29.6%	27.4%	23.9%	22.1%	21.1%
Non SME - Services	2.5%	3.6%	7.3%	6.8%	8.0%	8.3%
- NBFCs	2.0%	2.3%	3.8%	3.7%	5.2%	5.5%
- Commercial Real Estate	0.5%	1.3%	3.5%	3.0%	2.8%	2.8%
Total Bank Credit	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Citi Research, RBI

And this is how it's been growing...over the decade, the last 5 years, the last year, and YTD.

Figure 12. India Banks' Loan Growth – Segment-wise Loan Growth (% YoY)

Lending Segments	FY02	FY10	FY12	9MFY13 YTD	9MFY13 (YoY)	10 Yr CAGR	5 Yr CAGR
Agriculture	17.0%	22.7%	13.5%	7.0%	21.4%	24.0%	17.8%
Corporate	6.0%	38.4%	22.6%	7.9%	14.3%	25.8%	24.1%
- Infrastructure	30.5%	40.8%	17.6%	11.9%	16.0%	45.3%	34.0%
- Other corporate	4.2%	37.2%	25.7%	5.7%	13.3%	21.3%	20.0%
Retail	26.9%	4.1%	12.1%	12.5%	16.5%	21.3%	11.2%
- Mortgages	38.4%	8.7%	12.1%	13.6%	16.4%	33.0%	10.9%
- Other retail	24.3%	-0.3%	12.1%	11.4%	16.6%	15.6%	11.4%
SME	7.5%	1.9%	12.7%	2.6%	7.9%	22.4%	16.4%
Non SME - Services	27.7%	7.8%	19.1%	11.9%	16.6%	39.5%	29.8%
- NBFCs	23.6%	14.8%	26.3%	13.8%	19.9%	36.8%	35.3%
- Commercial Real Estate	45.6%	0.6%	7.8%	8.5%	10.8%	46.8%	22.3%
Total Bank Credit	12.5%	16.7%	17.0%	7.8%	14.3%	24.4%	19.0%

Source: Citi Research, RBI

The Forecast

And this is what we estimate FY14 will look like.....our base case is a 15% growth at the aggregate.

Figure 13. India Banks – Segment-wise Expectations Build-Up of Loan Growth (% YoY)

Lending Segments	Current (YoY)	10 Yr CAGR Growth	5 Yr CAGR Growth	Base Case - FY14 (%)	Bear Case - FY14 (%)	Bull Case - FY14 (%)
Agriculture	21.4%	24.0%	17.8%	20.0%	18.0%	22.0%
Corporate	14.3%	25.8%	24.1%	13.7%	8.1%	17.2%
- Infrastructure	16.0%	45.3%	34.0%	10.0%	0.0%	16.0%
- Other corporate	13.3%	21.3%	20.0%	16.0%	13.0%	18.0%
Retail	16.5%	21.3%	11.2%	17.0%	15.0%	20.0%
- Mortgages	16.4%	33.0%	10.9%	17.0%	15.0%	20.0%
- Other retail	16.6%	15.6%	11.4%	17.0%	15.0%	20.0%
SME	7.9%	22.4%	16.4%	12.0%	10.0%	15.0%
Non SME - Services	16.6%	39.5%	29.8%	17.3%	13.3%	19.3%
- NBFCs	19.9%	36.8%	35.3%	20.0%	16.0%	22.0%
- Commercial Real Estate	10.8%	46.8%	22.3%	12.0%	8.0%	14.0%
Total Bank Credit	14.3%	24.4%	19.0%	15.0%	11.4%	18.0%

Source: Citi Research, RBI

Bank positioning

The private banks are growing faster than the Government ones...and it should be the same in FY14, and beyond

Figure 14. India Banks – Loan Growth Trends and Outlook (%)

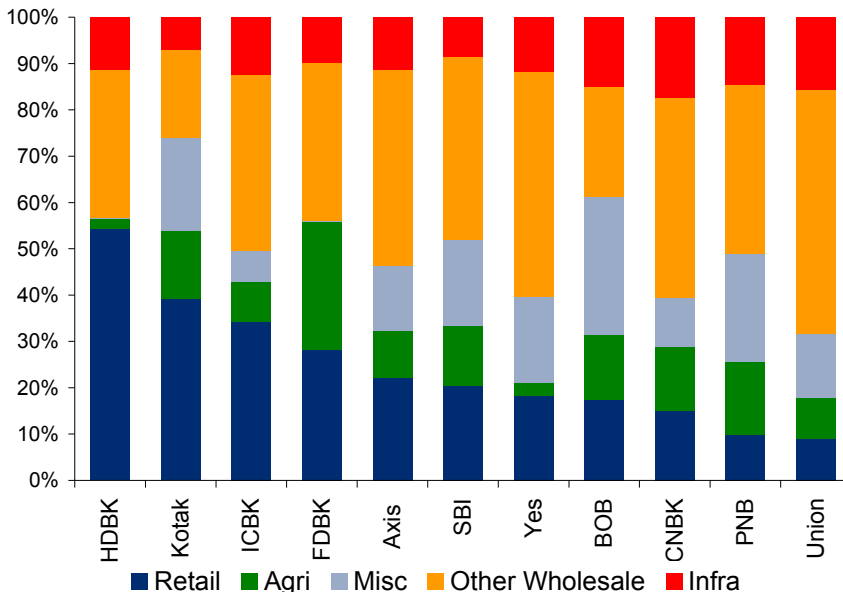
	Historical FY07-12 CAGR	Current Dec'12 (% YoY)	Forecast FY13-15E CAGR
Private Banks			
ICICI Bank	6.6%	16.5%	17.7%
HDFC Bank	29.3%	24.3%	23.0%
Axis	35.7%	20.7%	22.1%
Kotak	27.8%	26.8%	28.3%
Yes	43.3%	22.3%	26.3%
FDBK	20.4%	18.9%	20.0%
Government Banks			
SBI	20.8%	14.3%	16.2%
PNB	24.9%	13.2%	17.6%
BOB	28.0%	14.8%	17.6%
Canara	18.7%	-0.5%	15.1%
Union	23.3%	19.0%	17.7%

Source: Citi Research, RBI

How banks play this out depends on:

- a) Scale – a larger market share would mean more leverage to the macro – SBI/PNB/ICBK could see slower growth
- b) Balance Sheet mix – more wholesale lending implies a potential growth challenge – Axis, ICBK/ SBI are more industry/infra heavy
- c) Privates still better – Tend to be more strategically selective and re-align business growth – HDBK more rural, Axis/ICBK more retail
- d) Yes / Axis / ICICI Bank/SBI PNB are more exposed to infra/wholesale slowdown

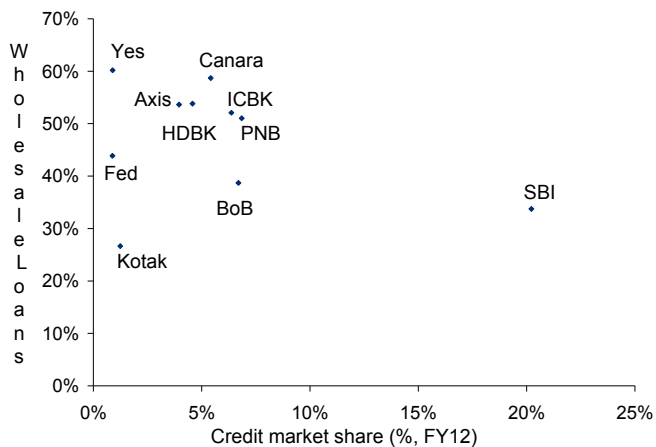
Figure 15. Select India Banks: Loan Mix (% , FY12)



Source: Citi Research, Company Data; Note: Some classification/ definitional overlaps possible from bank to bank

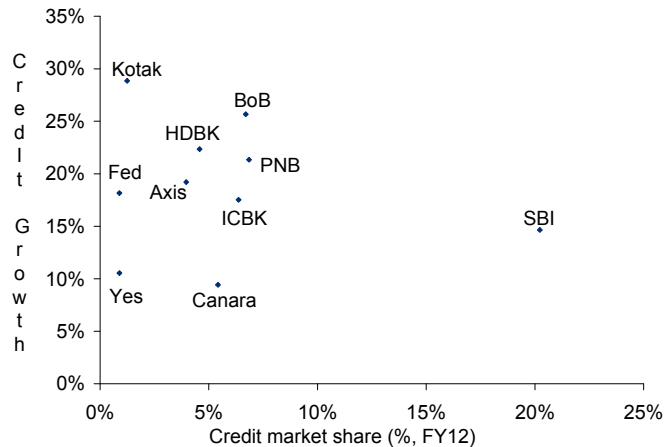
While the private banks are fundamentally faster growing and in cases more infra/wholesale biased – that they are coming off smaller bases, and have demonstrated greater asset selectivity – their growth risks are likely lower than the position map suggests.

Figure 16. Select India Banks: Market share and Wholesale loans (% , YoY, FY12)



Source: Citi Research, Company Data, RBI

Figure 17. Select India Banks: Market share and Loan Growth (% YoY, FY12)



Source: Citi Research, Company Data, RBI

And valuations do follow loan growth...

The banking sector has tracked loan growth...and a little more closely over recent years. That could suggest some risk given that most recently valuations have moved up...and loan growth has moved down...we think 15% loan growth in FY14 should be reasonably supportive of stocks.

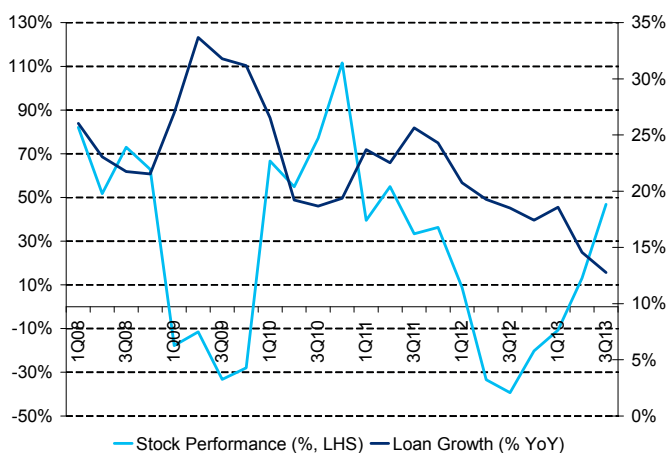
Figure 18. India Banks – Loan Growth (% YoY) and India Banks P/BV Multiple (1 Yr Fwd)



Source: Citi Research, RBI

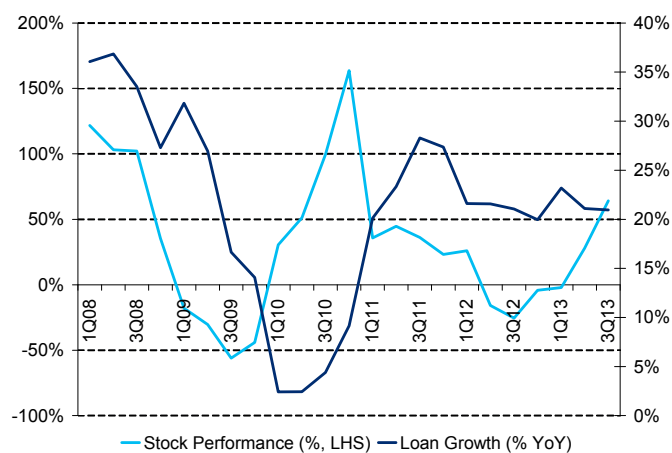
It is clearly not only about loan growth...but it is meaningful probably a little more for Government banks than private banks.

Figure 19. Govt. Banks: Loan Growth vs. Stock Performance (% YoY)



Source: Citi Research, RBI

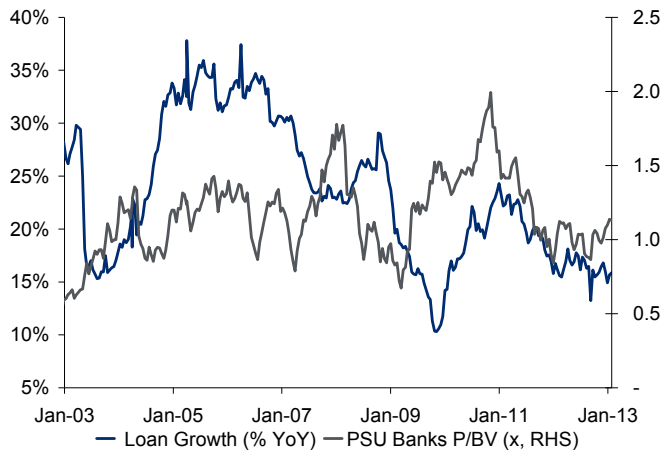
Figure 20. Private Banks: Loan Growth vs. Stock Performance (% YoY)



Source: Citi Research, RBI

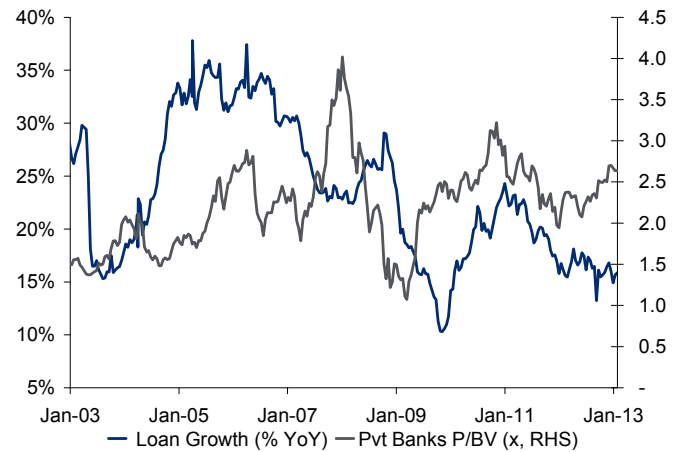
And it is probably even truer for valuations

Figure 21. Govt. Banks: Loan Growth vs. P/BV Multiple (% YoY)



Source: Citi Research, RBI

Figure 22. Private Banks: Loan Growth vs. P/BV Multiple (% YoY)



Source: Citi Research, RBI

Figure 23. India Banks – Valuation Summary

	RIC Code	Price (Rs) 13-Feb	TP (Rs)	Rating	P/E (x) FY13	P/E (x) FY14	P/B (x) FY13	P/B (x) FY14	ROE (%) FY13	ROE (%) FY14	ROA (%) FY13	ROA (%) FY14	Div. Yld FY13	M-Cap USD Mn
Private Sector Banks														
ICICI Bank	ICBK.BO	1,143	1425	1	15.9	13.0	2.0	1.8	13.1%	14.4%	1.6%	1.7%	1.5%	24,498
HDFC Bank	HDBK.BO	664	690	2	23.6	18.6	4.4	3.7	20.4%	21.7%	1.8%	1.9%	0.7%	29,279
AXIS Bank	AXBK.BO	1,477	1615	1	12.9	10.4	2.2	1.9	19.6%	20.0%	1.6%	1.6%	1.3%	12,822
Kotak Mahindra Bank	KTKM.BO	667	677	2	23.0	18.3	3.3	2.8	15.4%	16.6%	2.1%	2.1%	0.2%	9,241
Yes Bank	YESB.BO	513	550	2	14.1	10.7	3.2	2.5	24.8%	26.3%	1.5%	1.6%	1.2%	3,416
Federal Bank	FED.BO	508	550	1	9.7	8.4	1.4	1.2	14.8%	15.1%	1.4%	1.3%	1.9%	1,614
Govt. Banks														
State Bank of India	SBI.BO	2,255	2625	1	12.1	10.9	1.6	1.4	14.1%	14.0%	0.9%	0.9%	1.6%	28,130
SBI - Consolidated	SBI.BO	2,255	2625	1	8.9	7.8	1.5	1.3	16.7%	16.5%	0.9%	0.9%	1.6%	28,130
Punjab National Bank	PNBK.BO	850	1000	1	6.0	5.7	0.9	0.8	16.2%	16.9%	1.0%	1.0%	2.7%	5,361
Bank of Baroda	BOB.BO	761	900	1	6.6	5.9	1.0	0.9	16.2%	15.9%	1.0%	1.0%	2.4%	5,815
Canara Bank	CNBK.BO	440	485	2	5.2	4.4	0.8	0.7	15.3%	15.9%	0.9%	1.0%	2.6%	3,620
Union Bank Of India	UNBK.BO	233	210	2	7.3	5.7	1.1	0.9	13.7%	15.7%	0.7%	0.8%	3.7%	2,383
Diversified Financial Services														
HDFC Ltd.	HDFC.BO	815	860	1	26.0	22.1	5.0	4.4	22.1%	21.4%	2.7%	2.6%	1.5%	23,341
LIC Housing Finance	LICH.BO	268	290	1	12.0	9.6	1.9	1.6	17.5%	18.3%	1.6%	1.7%	1.5%	2,513
IDFC	IDFC.BO	158	196	1	12.9	10.8	1.7	1.5	14.2%	15.1%	2.7%	2.7%	1.6%	4,438
Multi Commodity Exchange Ltd.	MCEI.BO	1,200	1675	1	19.9	17.9	5.3	4.6	28.5%	27.5%	15.4%	15.1%	2.2%	1,137
Shriram Transport Finance	SRTR.BO	750	650	2	12.6	11.4	2.4	2.0	20.5%	19.1%	3.3%	3.0%	1.0%	3,161
Mahindra Finance	MMFS.BO	1,018	-	2	13.7	11.5	2.9	2.4	23.0%	22.9%	3.5%	3.3%	1.6%	2,153
Edelweiss Capital	EDEL.BO	33	-	2	15.1	12.6	0.9	0.9	6.1%	1.2%	1.1%	1.2%	1.8%	467

Source: Citi Research Estimates

Appendix A-1

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