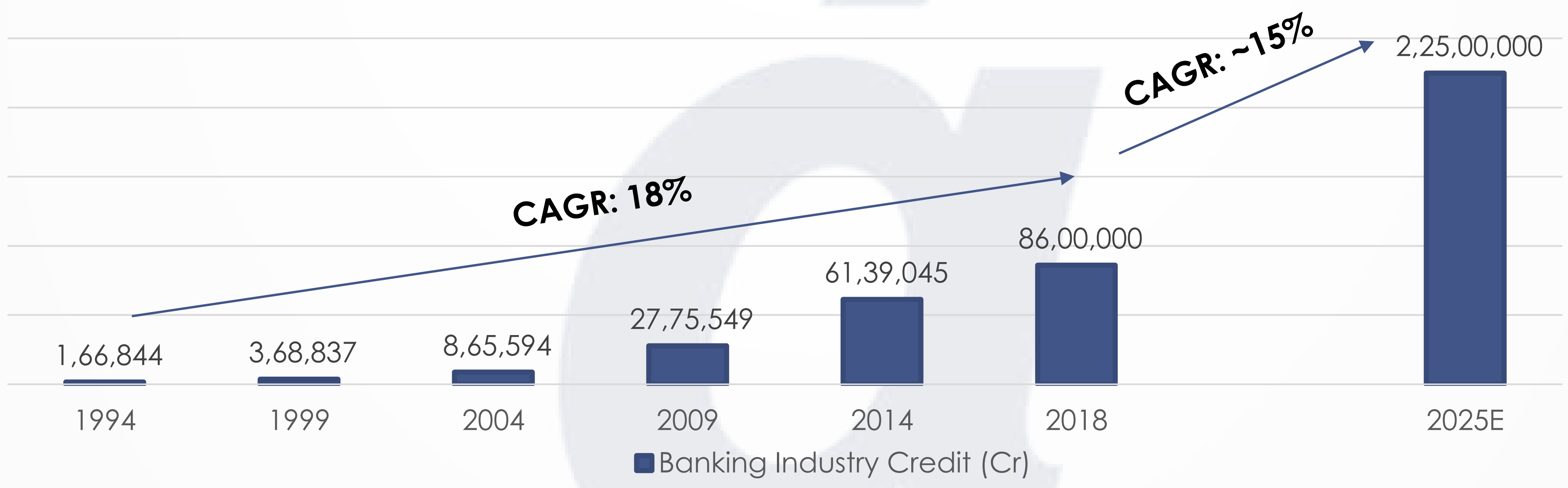
Alphá Invesco

Banking Sector & Capex Cycle

September 2018

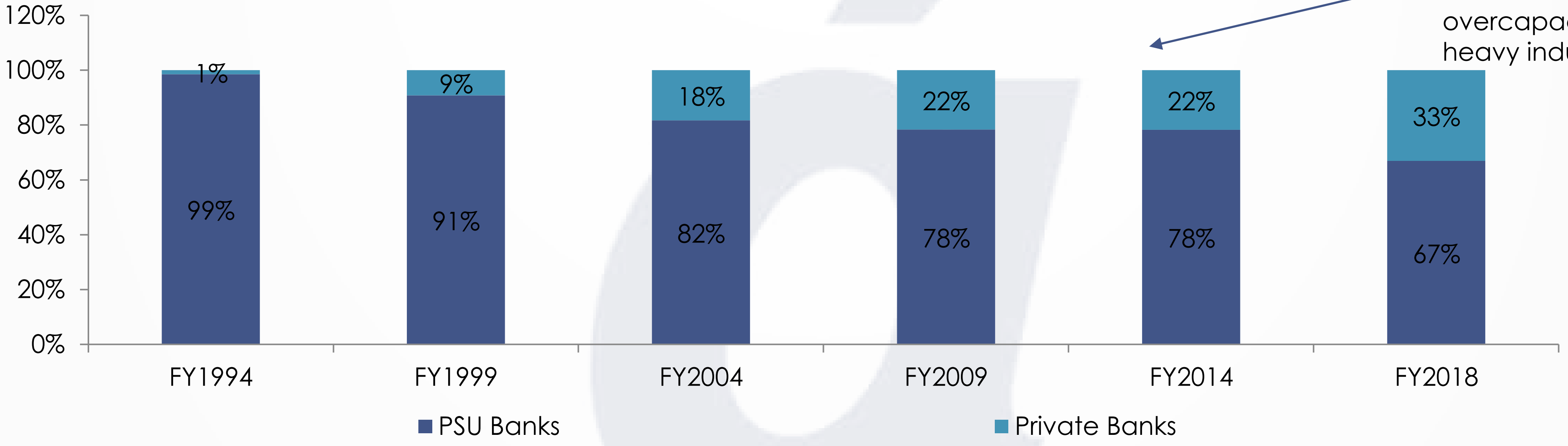
Private Banks – Gaining Market Share

Indian Banking Credit – Industry Size



- Incremental credit requirement of ~150 lac cr over next 7-8 years.
- Indian banks likely to lend in next 7-8 years almost twice of what they have lent in last 25 years combined!

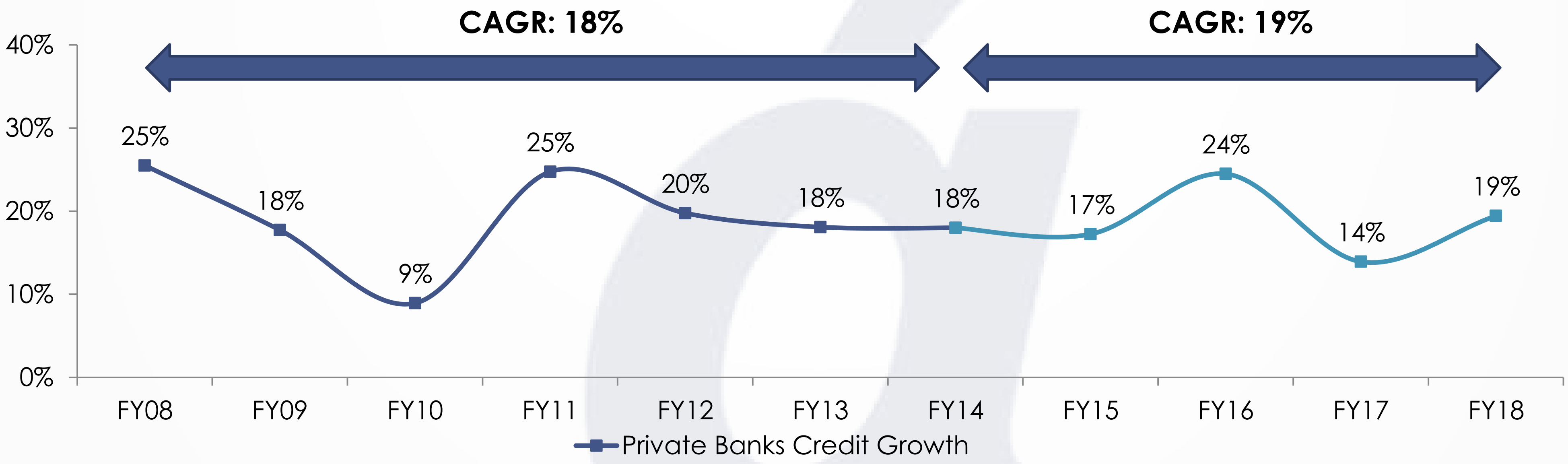
Credit Breakup – Market Share



2009 – 2014 was the only 5 year period when PSU banks didn't lose market share. On the back of above average lending. Which led to overcapacities across heavy industries.

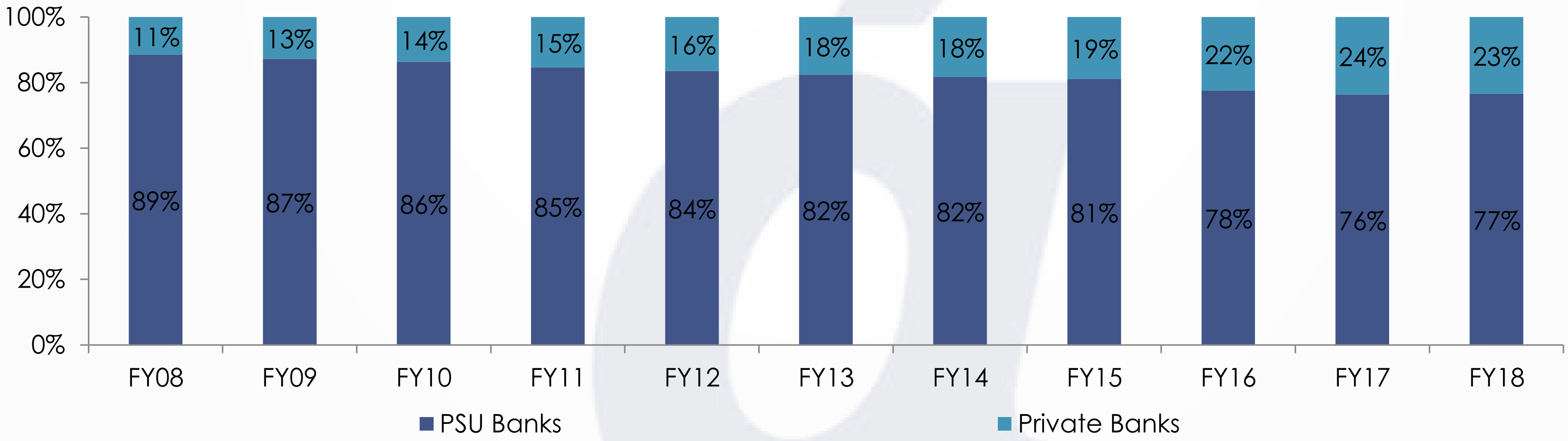
- Over last 25 years, private banks have increased their share from mere 1% to now being 1/3rd of total banking credit.

Credit Growth – Private Banks



- Private banks have maintained their credit growth evenly throughout the decade.
- Whereas PSU Banks witnessed credit stagnation post FY2014, which lead to Private banks' share increasing their market share from ~22% to ~33% in just 4 years!

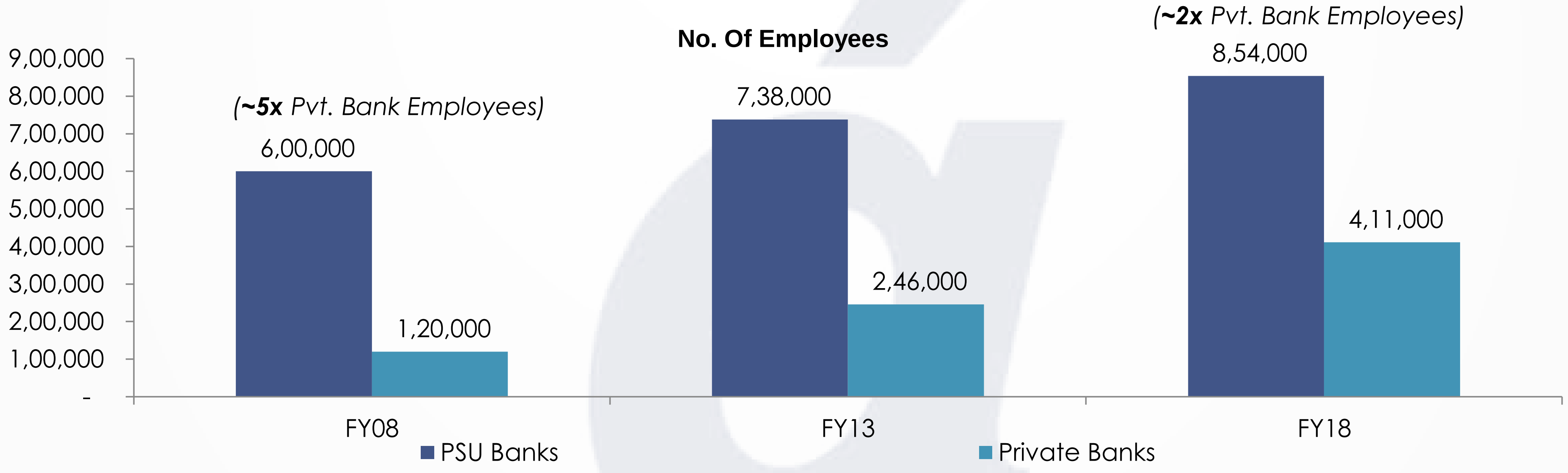
Branch Network



	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Bank Branches	54,168	58,329	63,004	68,754	75,105	81,604	91,147	98,143	106,457	110,595	118,572
PSU Bank Branches	47,959	50,896	54,400	58,191	62,750	67,257	74,448	79,612	82,580	84,473	90,827
Pvt. Bank Branches	6,209	7,433	8,604	10,563	12,355	14,347	16,699	18,531	23,877	26,122	27,745

- Over the past decade, private bank branches have increased their share from being 1 in every 10 bank branches to around 1 in every 4 bank branches.
- However, due to digitization, the rate of adding branches has decreased for the banking industry as a whole.

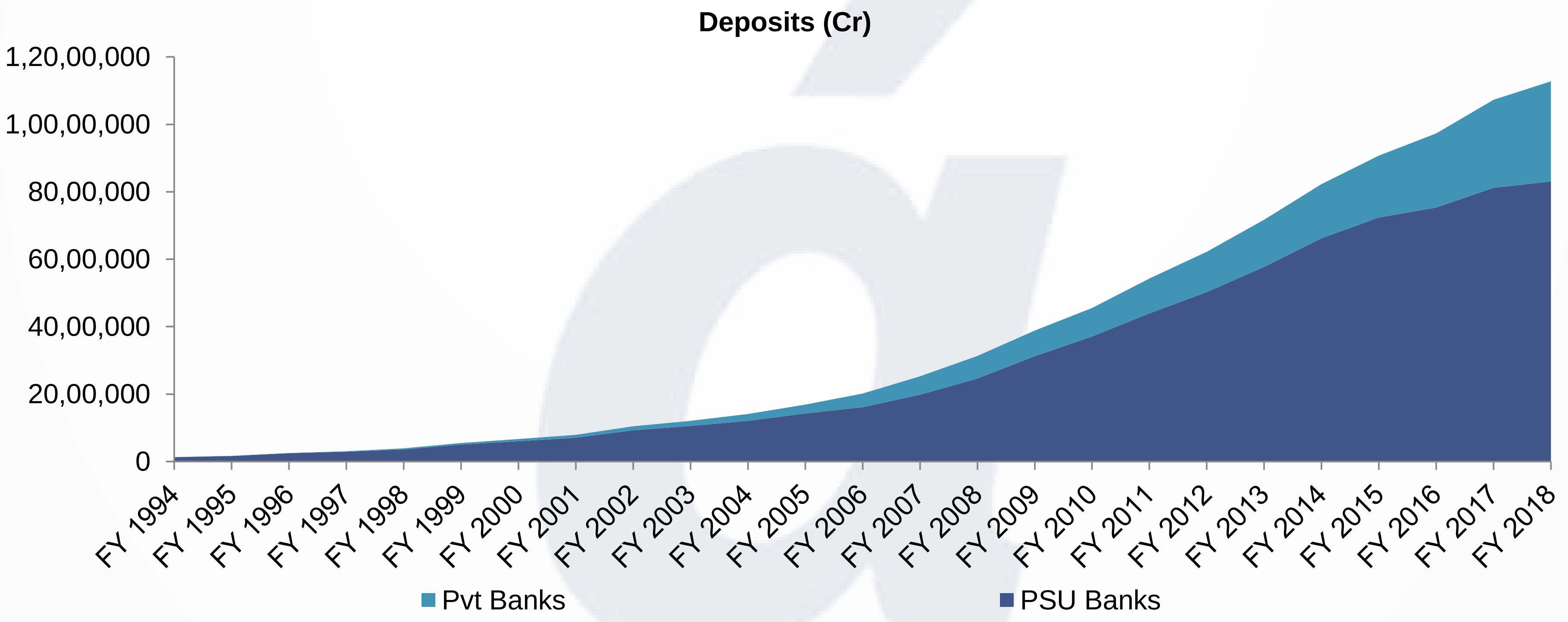
Employee Strength



Employees per Branch	**FY 2008**	**FY 2013**	**FY 2018**
PSU Banks	12.57	10.98	9.40
Private Banks	19.26	17.15	14.81

- Banking is one of the rare industry where private sector has higher per unit employees than PSU companies. Predominantly due to significant branch network in rural India where branches are small & need less employees. Also business per employee is higher for private banks. They are far more productive compared to PSU's.

Deposit Growth – Outcome Of Branches And Employee Growth



- Owing to aggressively increasing branch network and employee strength / sales force, private banks have improved their share in deposits in Indian banking sector.
- Better technology and convenience banking also plays a bigger role in attracting deposits.

CASA Trajectory

	FY 1998	FY 2008	FY 2018
SBI	43.5%	41.9%	44.5%
Bank of Baroda	32.0%	31.6%	35.6%
PNB	43.6%	42.9%	41.0%
Canara Bank	37.8%	31.6%	31.8%
HDFC Bank	38.8%	54.5%	43.5%
ICICI Bank	17.8%	28.4%	49.9%
Axis Bank	10.9%	45.7%	53.5%
IndusInd Bank	9.0%	15.7%	44.0%
Federal Bank	15.4%	25.1%	33.6%

- Improving deposits helps in improving CASA and hence lowering the Cost of Funds.
- Legacy PSU banks have their CASA in the same ranges over last 2 decades, whereas private banks have seen significant improvements.

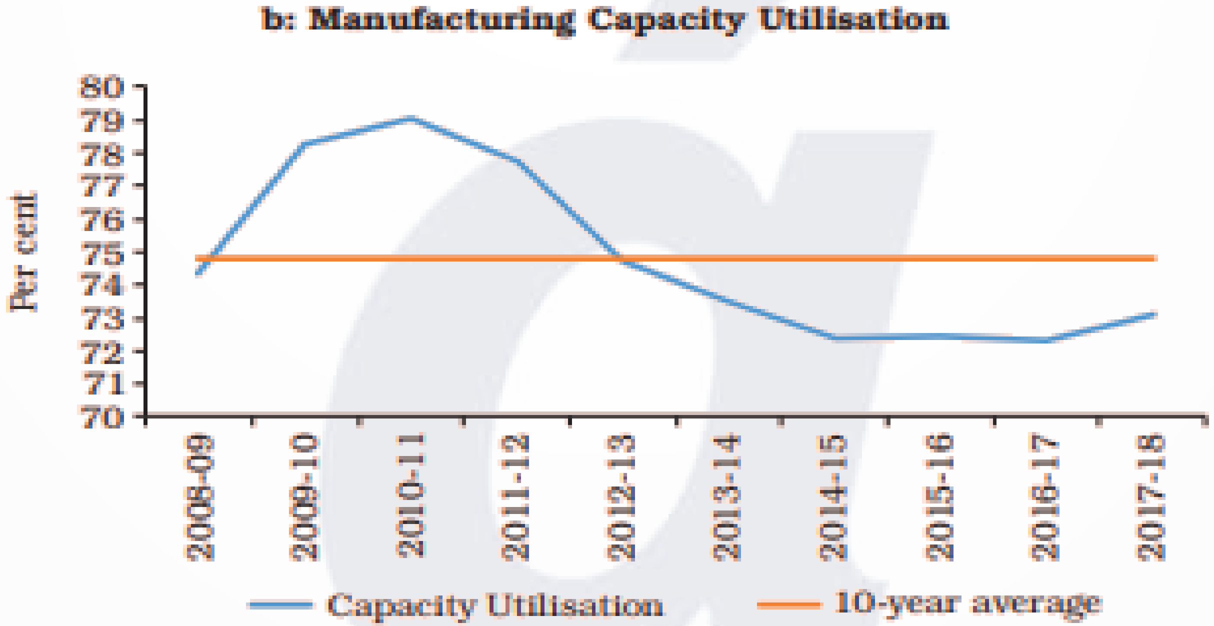
NIM Trajectory

	FY 2008	FY 2013	FY 2018
SBI	3.07%	3.34%	2.50%
Bank of Baroda	2.90%	2.66%	2.43%
PNB	3.58%	3.52%	2.16%
Canara Bank	2.42%	2.40%	2.42%
HDFC Bank	4.40%	4.50%	4.30%
ICICI Bank	2.22%	3.11%	3.23%
Axis Bank	3.47%	3.53%	3.44%
IndusInd Bank	1.53%	3.43%	3.99%
Federal Bank	3.49%	3.37%	3.21%

- Better Cost of Liabilities and improved Yield on Advances due to higher retail share of advances has helped private banks to improve their NIMs and maintain them.

- The NPA Problem Is Peaking Out
- Credit Growth Coming Back
- Fresh Capex Cycle On Cards

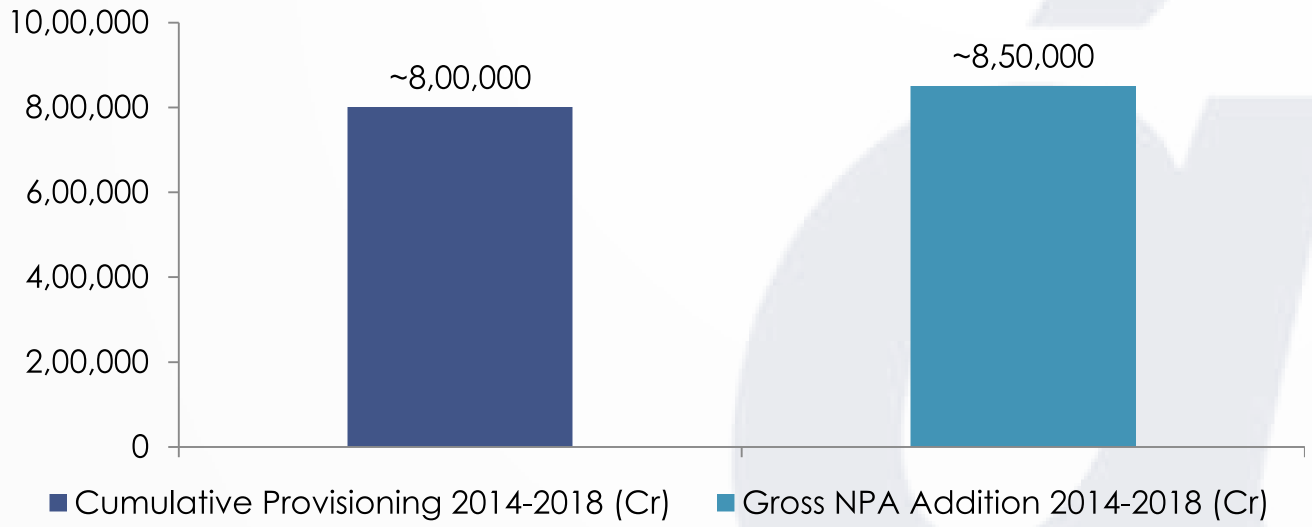
Manufacturing Sector – Low Capacity Utilisation



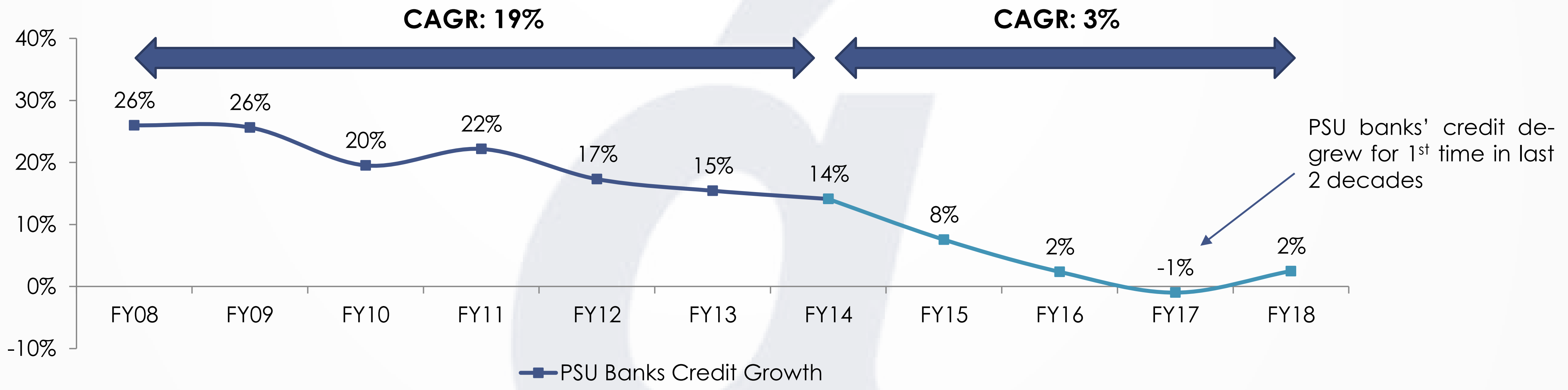
- FY 2008 – 2014 was the period when excessive capacities were built by companies, loans were easily available, crony capitalism / banker-politician-promoter nexus was thriving. Eventually we ended up in having very high capacities that were far ahead of the local demand. On top of it, global export markets slowed down in the after math of financial crisis.
- Post FY 2014, over capacities have lead to lower utilisation levels in the manufacturing sector. Most of this capex was across heavy industries like power-steel-infra was funded via debt, leading to massive losses & NPA's.

Provisioning Cycle Peaking Out

Cumilative provisioning of listed private + PSU banks

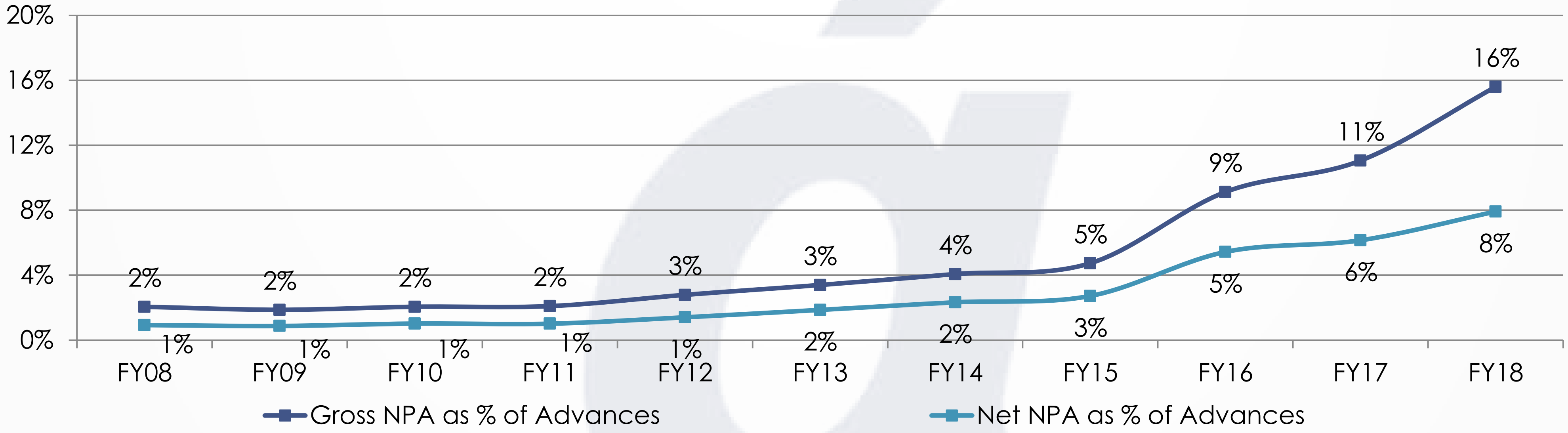


Credit Growth – PSU Banks



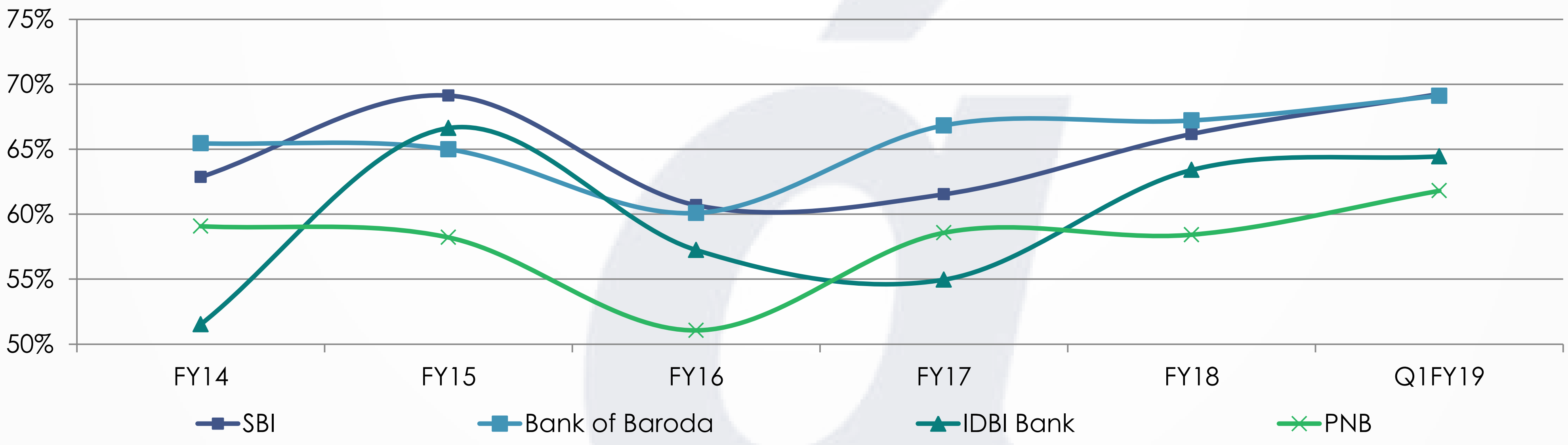
- Till date, PSU banks had their ~37% credit exposure towards corporate sector v/s. ~23% exposure towards retail, causing them to suffer during times of low manufacturing capex.
- Credit demand slowed down significantly as industry was already sitting on overcapacity. RBI's asset quality review in 2015 forced PSU banks to provide more. Their loan sanctions slowed down as a result.
- PSU Banks lending growth reduced drastically post 11 of 21 banks were added to PCA list (Prompt corrective action). Another 6 banks are under watchlist which might be added to the PCA list.

NPA Trajectory – PSU Banks



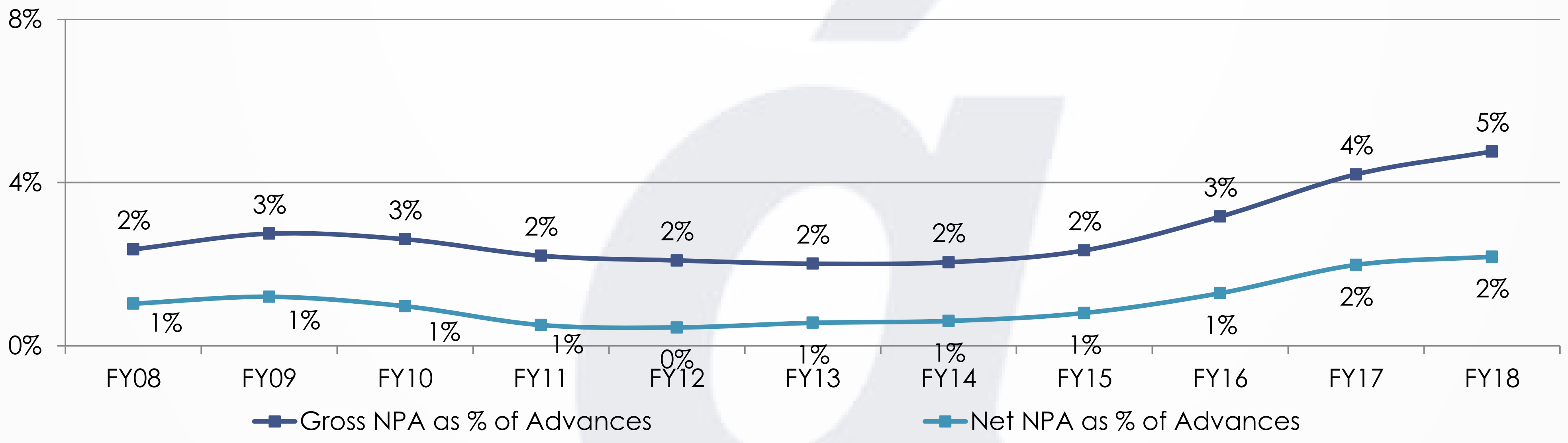
- Gross NPA in PSU Bank shoot up dramatically in last 3-4 years. This is the outcome of unchecked lending to weaker assets by PSU banks during 2008 - 2014 period.
- Over last 3 years, PSU banks have provisioned ~5.5 lac cr, which is 10% of their total advances!
- If we look at cumulative provisioning as a percentage of corporate book, one gets a sense that the NPA & provisioning cycle is peaking out. Major stress sectors like road & steel are back on track. Power is being fixed. Telecom & real estate especially developer loans could be next.

Provision Coverage Ratio – PSU Banks



- The strict regulations by RBI and government led to sudden jump in the Gross NPAs for the banks, leading to a dip in their PCR during FY 2016.
- However, over last 2 years, the provisions have increased proportionately and the banks have now provided for 65 – 70 % of their Gross NPAs, signaling toping out of aggressive provisions in few quarters.

NPA Trajectory – Private Banks



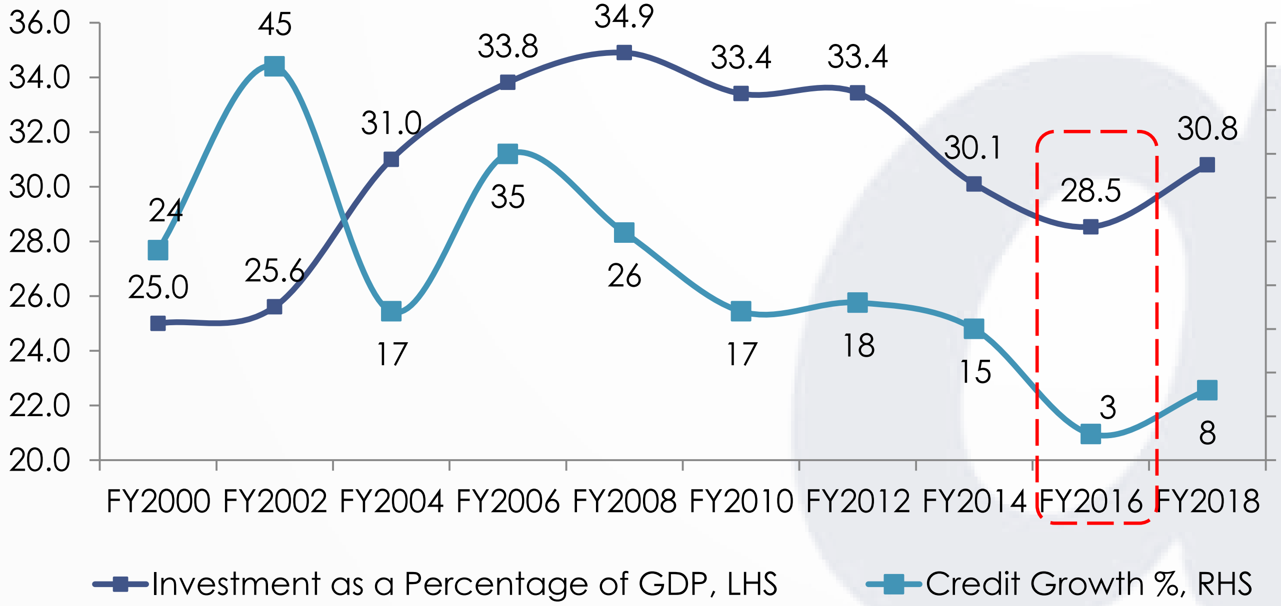
- Aggressive provisioning norms of RBI had very minor effect on the NPA structure of most of the private banks, apart from few banks. Barring ICICI & Axis bank, almost all large private banks have a book that is tilted towards retail assets. Not lending to corporates during 2008-2014 has helped private banks to be in relatively good shape.
- Currently, ICICI bank and Axis bank together account for ~65% of total gross NPA of the private banks. Out of the additional ~1 lac cr Gross NPA since 2014, ~75,000 cr have come from these 2 banks.

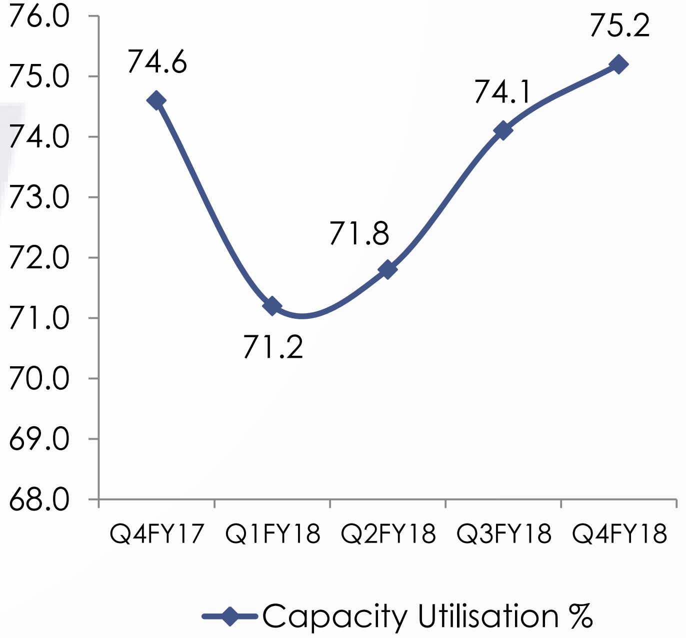
Industry Wise Credit Funded By Banks/FIs

Rs Cr	2017	Max	Max Capex Year
Infrastructure	1,13,200	2,01,500	2011
i) Power	82,400	1,73,300	2011
ii) Telecom	-	67,200	2010
iii) Ports & Airports	10,200	10,200	2017
iv) Storage & Water Management	6,600	6,600	2017
v) SEZ, Industrial, Biotech and IT Park	700	12,400	2008
vi) Roads & Bridges Construction	13,200	13,200	2017
Construction	21,600	47,100	2010
Metal & Metal Products	8,800	79,200	2011
Transport Equipment & Parts	7,900	9,300	2009
Textiles	7,300	13,400	2012
Cement	4,000	18,700	2009
Chemicals & Pesticides	3,800	6,700	2012
Hospitals & Health services	2,000	3,700	2010
Food Products	1,600	3,100	2009
Hotel & Restaurants	1,500	13,100	2011
Glass & Pottery	1,100	2,500	2012
Petroleum Products	900	17,200	2008
Transport Services	700	5,700	2010
Mining & Quarrying	700	10,200	2010
Sugar	200	3,700	2009
Electrical Equipment	400	7,500	2011
Others*	7,100	19,100	2008
Total Cost of Projects	**1,82,800**		

- We can see that the most of the industries saw maximum capex during the 2009 – 2014 phase.
- Also, 2017 capex by most of the industries was way smaller in magnitude compared to their historic high.
- Additionally, historic maximum capex was on a much smaller economy size of ~$1.2-1.5 trillion.

Investment – Driver Of Credit Growth

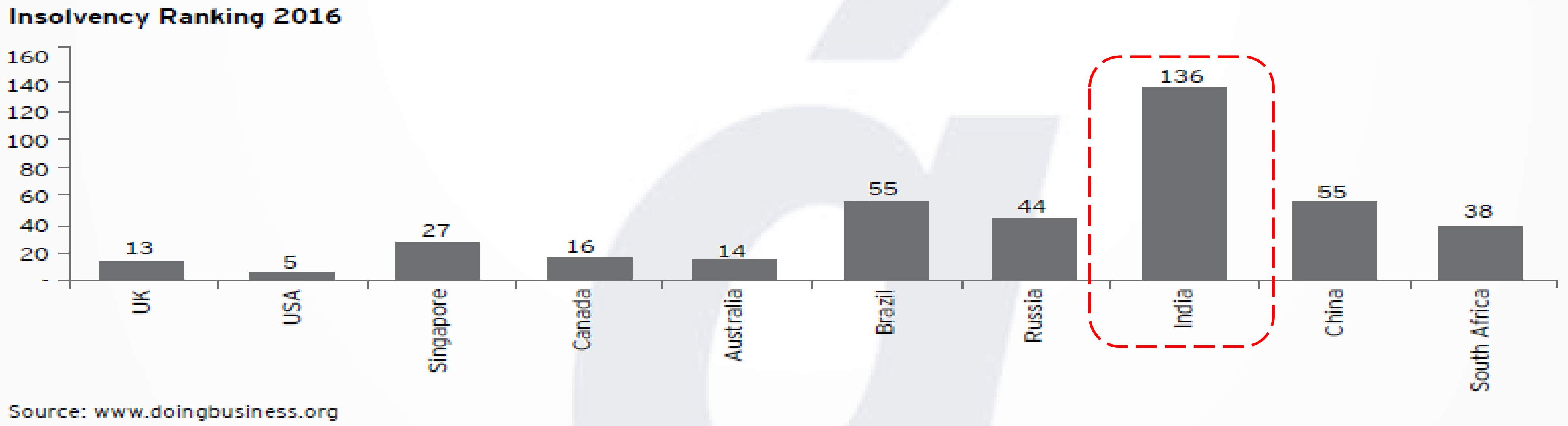




- For a growing economy like India, the investment as a % of GDP should be high. We saw investment drop to 28.5% in 2016 which mirrored with the lowest credit growth of 3%.
- Now green shoots are appearing in the economy as in FY2018, Investments have risen to 31% in FY18 and subsequently capacity utilization as a whole has bounced back to 75%. As utilizations move beyond 85-90%, a new capex cycle in industrials-heavy industries is expected to pick up.

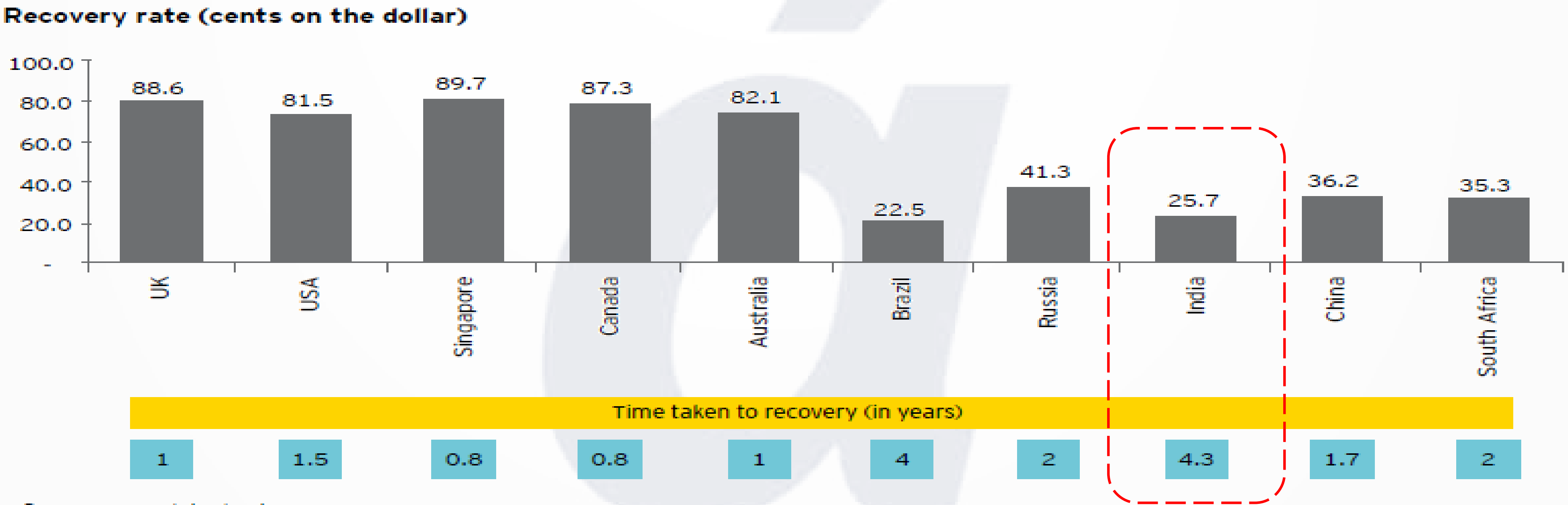
Insolvency & Bankruptcy Code Changes Everything For Bankers.
Promoters Can No More Behave In The Same Way.

Insolvency Ranking – Prior To The IBC



- As per the Doing Business index 2016 released by the World Bank, India fared the worst in insolvency ranking among the BRICS nation and with 136th rank, India was far behind the developed economies such as the UK, US, and others.

Recovery Rate & Time Taken For Recovery – Prior To IBC



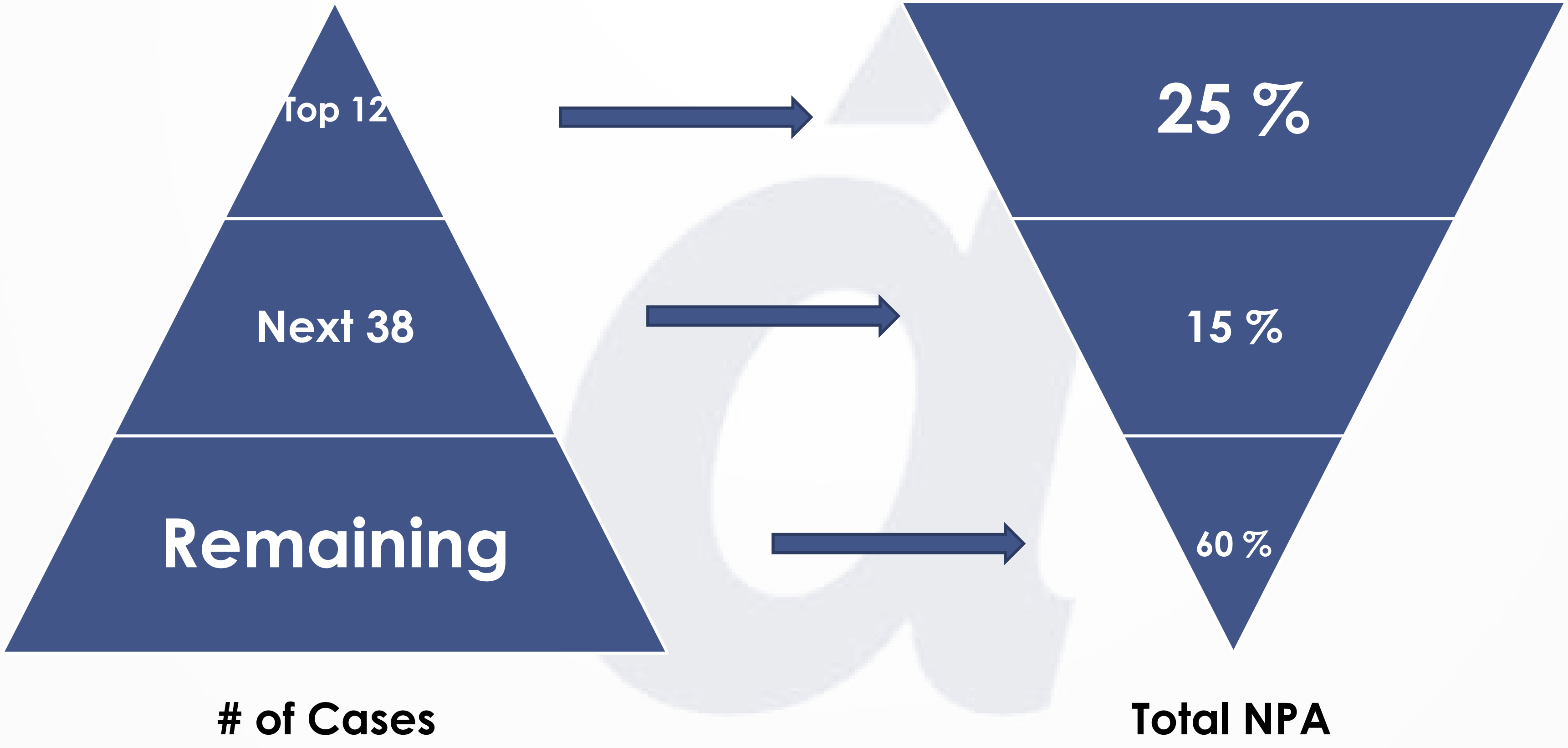
Source: www.doingbusiness.org

- Among several requisites of a effective insolvency regime, recovery & time taken to recovery is one of the most important parameters. At 25.7 cents per dollar and 4.3 years, India is ahead only of Brazil amongst BRICS.

Insolvency Resolution Gaining Momentum

- At the end of March 2018, 525 corporates were undergoing insolvency resolution pro

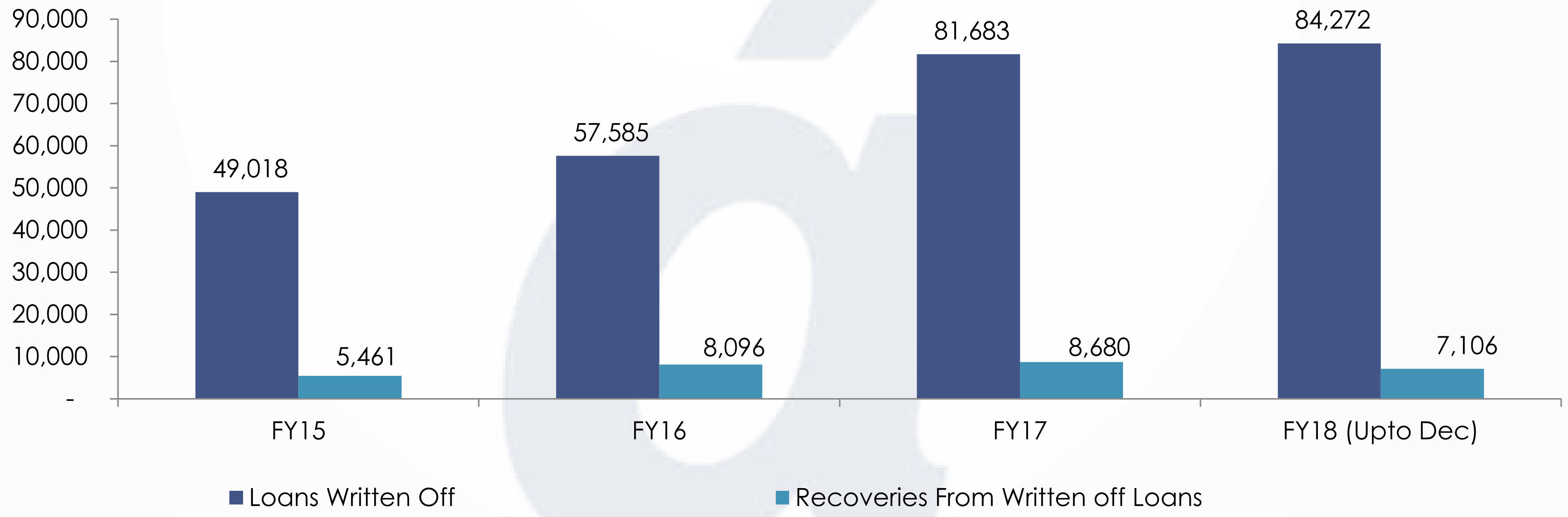
Resolving Top 50 Cases Solves 40% of NPA Mess



- A huge part of the total 10 lac cr NPAs is concentrated amongst top 50 cases. Resolving these 50 cases would solve ~40 % of the problem. Most of the NPA's have been provisioned for. And there could be potential writebacks in to the banking system once NCLT resolutions accelerate.

IBC Wave – Recoveries Touch 11%

\# FY18 recovery numbers do not include Bhushan steel (35000 cr) recovery since financial closure happened in FY19. The recovery numbers will jump substantially from FY19 onwards.



Cumulative Loans Written Off, cr	Cumulative Recoveries, cr
2,72,558	**29,343**

- Banks have been able to recover merely 11% of the bad loans they had to write off their balance sheets over the last 4 years. As the IBC/NCLT process matures, we can expect more recoveries & perhaps writebacks on bank balance sheets.

Insolvency & Bankruptcy Code – The Most Impactful Reform

- A certain path was taken - Original idea was to create a bad bank, where all bad loans will be transferred. However PSU banks would not have learnt any lesson & they would have continued with old practices. IBC was important to force a cultural change in how PSU banks operate.
- Under IBC regime banks will be forced to write the assets down, industry wont get capital as PSU banks are under pressure. Banks are quickly referring cases to NCLT & trying to recover the money.
- IBC enforces the principle of creative destruction. If companies fail, there will be no more ever greening of loans. Companies will be auctioned / sold off & old entrepreneurs will lose control.
- This creates a rule based economy & which is a sign of a living and thriving business culture. The old context of "nothing will happen even if we default" needed to be changed. And that's what IBC has achieved.
- Promoters will now have the fear of losing their company if they do anything wrong or cheat banks.
- Banks are in a much better position to recover their money in case of default.

Thank You.

Disclaimers :

The information herein is used as per the available sources of bseindia.com, company's annual reports & other public database sources. Alpha Invesco is not responsible for any discrepancy in the above mentioned data. Investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents

Future estimates mentioned herein are personal opinions & views of the author. For queries / grievances–

support@alphainvesco.com or call our support desk at 020-65108952.
SEBI registration No : INA000003106

Readers are responsible for all outcomes arising of buying / selling of particular scrip / scrips mentioned here in. This report indicates opinion of the author & is not a recommendation to buy or sell securities. Alpha Invesco & its representatives have vested interest in above mentioned securities at the time of this publication, and its directors / company have positions / financial interest in the securities mentioned above.

Alpha Invesco, or it's associates are not paid or compensated at any point of time, or in last 12 months by any way from the companies mentioned in the report.

Alpha Invesco & it's representatives do not have more than 1% of the company's total shareholding. Company ownership of the stock : YES, Served as a director / employee of the mentioned companies in the report : No. Any material conflict of interest at the time of publishing the report : No.

The views expressed in this post accurately reflect the authors personal views about any and all of the subject securities or issuers; and no part of the compensations, if any was, is or will be, directly or indirectly, related to the specific recommendation or views expressed in the report.