

**Bullish**

**Bank Nifty: 11432**

## **PSU Banks struggle / UBI, OBC, Dena Bk bright spots / SBI disappoints Pvt. sector robust performance continues, ICICI Bank top pick**

The Q213 performance between PSBs and Pvt. Sector banks remains a story of contrasts. PSBs have severely under-performed both on the profitability and asset quality front. Despite the strains in macro economy and lull in demand, private sector banks have managed to report strong business growth while keeping asset quality under check. PSBs have barely managed to keep head above waters with low single digit NII growth (6%YoY) while PAT (7%YoY) has been distorted single-handedly by SBI's lower provisions. Excl. SBI, PSBs net profit declined 1%YoY.

PSB banks remain cautious on health of loan book. Bankers across the board are focused on Retail and SME segment to drive growth, hence competitive intensity is likely to increase going forward. Loan demand from large corporate remains sluggish as investment cycle yet to pick up. On the liability side, post the finance ministry directive, PSBs have begun to focus on lowering dependence on bulk deposits. Fee income growth remains lackluster and expected to remain weak going forward. Overall weak performance on asset quality is likely to continue ahead however NII & PAT is likely to rise on account of base effect.

Private sector banks have reported robust performance with NII growth of 25%YoY and PAT rising 26%YoY. Pvt. Banks have reiterated that investment cycle is yet to pick and environment remains challenging. Nevertheless, private banks remain confident of the quality of their loan book. Fee income growth remains strong thereby further driving pre-provisioning operating profits. Similarly, private banks are also focused on Retail, SME as large corporate demand remains weak while incremental spreads and higher granularity in loan book provides added comfort. On the liability side, banks have managed their CASA base, with smaller peers offering significantly higher interest rates on saving deposits. Overall private banks seem to be in a place of comfort and expected to move aggressively to garner business as PSB peers remain on mixed footing.

Q213 Performance Summary	NII	OI	Opex	C/I	PPOP	Provisions	PAT	GNPAs	NNPAs
<b>PSBs</b>	6%	4%	10%	45.4%	2%	-7%	7%	54%	64%
<b>Pvt. Banks</b>	25%	19%	20%	45.7%	26%	-81%	26%	23%	58%

YoY growth except C/I ratio

Source: Banks and Banhem Research

**PSBs – NII growth moderates to 6% YoY**

Public Sector Banks (PSBs) witnessed sharp moderation in net interest income (NII), growing 6% YoY as cost of funds continued to remain elevated while return on funds (advances + investments) deteriorated at much higher pace. Interest income grew 16% YoY while interest expended rose 20%YoY during the quarter. **Consequently spreads have narrowed 45bps to 2.97%, thereby lowering core profitability.** Banks have made healthy attempt to reduce their share of bulk deposits, which we believe would improve granularity on the liabilities sides, as well provide incremental support to margins going ahead.

**Other Income up 4%YoY**

PSU banks have found it difficult to ramp up other income, inching up merely 4%YoY. The weakness persists across the board with SBI only aggravating the pain in aggregate numbers. Ex-SBI, Other Income (OI) grew 6% driven by BoB(+13%), IDBI(+45%), Union Bank of India(+9%) while dragged by Canara Bk(-27%), PNB(+2%). SBI reported 1% drop in other income as core other income declined 2%YoY. Data available for 20 PSBs shows, aggregate other income (excl. treasury inc) in Q2FY13 has recorded a fall of 2% reflecting the thin cushion available with bankers to reduce the impact of elevated cost of funds on PPOP. Treasury income rose 7%YoY thereby aiding PSU banks to post marginal rise in overall other income.

**Cost to income deteriorates, PPOP up merely 2% YoY**

Operating expenses grew 13% which is largely in-line with trend. However the meek growth in NII and other income has resulted in 200 bps deterioration in Cost: income ratio. As a consequence, aggregate PPOP has managed to inch higher by mere 2%, reflecting the pressure on profitability. Aggregate PPOP (excl. SBI) grew 3%YoY.

**PAT up 7% at the expense of lower PCR**

PSBs despite a mediocre performance at the PPOP level has managed to post a PAT growth of 7% YoY, single-handedly on account of lower provisions for NPAs by SBI. PAT growth has come at the expense of provision coverage ratio (PCR). **SBI reduced Provisions for NPAs by 37%YoY despite gross NPAs surging 45%.** PCR for SBI has dropped to 62.78% from 68.10% and 63.5% seen in Q412 / Q212 respectively. Of the data available, other PSBs (16 bks, excl. SBI) provisions for NPAs grew 45% on account of sharp rise in slippages. Aggregate Net profit (excl. SBI) declined 1%YoY as overall provisions (prov. for NPA + other provisions) grew 8%. **Avg. PCR for PSBs (incl. SBI) has dropped to 61.1% in Q213 from 66.5% in Q212.**

**Asset quality remains pressure point**

PSBs performance has been significantly hampered on account of sharp rise in slippages in large accounts. The stressed sectors are said to be infrastructure, iron & steel, textiles, power amongst others. Aggregate fresh slippages in Q213 have grown 24%YoY however the excluding SBI, slippages have grown 42%. SBI has been aggressive in classifying weak accounts as NPAs over the last year. Hence we believe fresh slippages may trend lower in the quarters ahead. However the pain for other PSBs such as PNB, IOB, Canara Bk and CBI could continue in the quarters ahead. Gross NPAs for PSBs have grown 54% while Net NPAs have grown 64%YoY. Stressed assets (GNPA+RA) account for 11.0% of advances. We expect PSBs to remain under pressure as slippages are likely to continue, as economic environment remains subdued despite uptick in investor confidence. **However we highlight 3 factors 1) Pace of slippages may decelerate 2) incremental focus on recoveries is a positive 3) switch to system determined classification of NPAs aids in swift identification, besides has improved transparency on quality of loan book.**

**Advances grow 16.6%, Deposits 15.1%**

PSBs witnessed advances growth of 16.6% which is marginally ahead of RBI's guidance of 16%. Deposit grew 15.1% which is in-line with RBI's projection at 15% for the year. However costs of funds remains elevated for the sector as term deposits continue to grow at the expense of CASA deposits.

Term deposits for PSBs (excl. SBBJ, SBT, SBM) have grown 17%YoY while the low cost CASA deposits have grown merely 10.9%. CASA share of total deposits has declined to 29.89% in Q213 vs. 31.01% in Q212. Current account deposits grew 3.8% while savings deposits rose 12.9%.

**PSBs have lost market share in CASA deposits, declining 77bps YoY. PNB outperformed peers in the sector (PSB + Pvt.), adding 23bps to its market share to reach 7.44% while UCO bank was distant second in the PSB pack, adding 14bps to 2.0%. The sluggishness in PSBs CASA deposit accretion strategy is apparent, with 50% of PSBs witnessing decline in market share, with SBI leading the fall, shedding 58bps YoY to 24.72%.**

We believe the PSBs need to address the issue of deterioration in CASA market share with aggression in order to boost profitability.

**Advances have grown 16.6% which is marginally ahead of RBI's projected rate of 16% for the year. Credit deposit ratio has remained healthy, at 76.7%.** PSBs are aiming at retail, MSME sector to push credit growth on account of stable employment situation, incremental yields as well as availability of credit guarantee schemes for SMEs by the government adding to the comfort. However given that interest rates remain elevated and consumer and industry confidence remains conservative, bankers are struggling to boost asset growth. Besides weak demand from large corporate, bankers are also averse to sanctioning big-ticket loans and prefer WC loans in the corporate segment. BoI, CBI, Corporation Bank were the front-runners, recording healthy growth in MSME, retail loans as well as expanding their share of loan book.

**We expect competition to heat up in the retail and MSME segment. However given the challenges such as in-house financing for vehicle loans, aggressive intent of NBFCs, HFC and private sector banks, we believe PSBs have done well in terms of opening up specialized branches/cells and implementing faster application and processing mechanisms to deal with competition.**

## PSBs Key Highlights:

	NII y-o-y %	OI y-o-y %	PPOP y-o-y %	PAT y-o-y %	GNPA absolute y-o-y %	GNPA Ratio chg bps y-o-y	NNPA absolute y-o-y %	NNPA Ratio chg bps y-o-y	Remarks
<b>Allahabad Bk</b>	-11%	-2%	-15%	-52%	93%	2.95% 118bps	251%	2.1% 141bps	Sharp addition to NPA due to difference in opinion between mgmt & RBI NIMs decline 20bps to 2.8%
<b>Andhra Bk</b>	-6%	23%	-7%	3%	52%	3.48% 81bps	68%	2.16% 68bps	PAT in line with est; Pharma sector contributed half of 940cr slippages in Q213
<b>BoB</b>	12%	13%	11%	12%	73%	1.98% 57bps	113%	0.82% 35bps	PAT ahead of est., asset quality slips; Restructured Rs.973cr advances in Q2 vs.771cr in Q1FY13
<b>BoI</b>	15%	6%	19%	-39%	36%	3.42% 40bps	23%	2.04% 6bps	Sharp rise in provisions hit PAT growth
<b>BoM</b>	14%	23%	11%	65%	18%	2.00% (15)bps	97%	0.88% 31bps	
<b>Canara Bank</b>	0%	-27%	- 20%	-22%	48%	2.58% 85bps	47%	2.12% 69bps	Weak operating performance, Despite high slippages, lower provisions to curtail fall in PAT

	NII y-o-y %	OI y-o-y %	PPOP y-o-y %	PAT y-o-y %	GNPA absolute y-o-y %	GNPA Ratio chg y-o-y	NNPA absolute y-o-y %	NNPA Ratio chg bps y-o-y	Remarks
<b>CBI</b>	1%	9%	2%	35%	129%	5.54% 260bps	282%	3.80% 243bps	NPAs weigh on performance; further Rs.25-30bn of restructuring expected in H2FY13; Aim to improve NIMs to 2.75% vs. 2.68% in Q2.
<b>Corp Bank</b>	8%	-16%	-1%	1%	80%	1.97% 65bps	81%	1.38% 47bps	High focus on SMEs. Sharp 40% rise in provisions for NPAs hurt bottom-line. Aim to reduce bulk dep share from 25% to 15%- Mar end
<b>Dena Bank</b>	15%	18%	24%	24%	41%	1.97% 4bps	47%	1.38% 7bps	Strong NII and Other income drives PPOP and reduces impact of higher provisions on PAT growth
<b>IDBI Bank</b>	11%	45%	18%	-6%	50%	3.45% 98bps	39%	2.04% 47bps	Asset quality deteriorates sharply
<b>Indian Bank</b>	-1%	6%	-1%	6%	89%	2.06% 85bps	111%	1.33% 64bps	Weak operating performance, asset quality deteriorates; NIMs trim 18bps QoQ to 3.12%
<b>IOB</b>	-2%	-4%	-11%	-24%	52%	3.87% 80bps	124%	2.25% 104bps	Asset quality troubles persist, listless operating performance

	NII y-o-y %	OI y-o-y %	PPOP y-o-y %	PAT y-o-y %	GNPA absolute y-o-y %	GNPA Ratio chg y-o-y	NNPA absolute y-o-y %	NNPA Ratio chg bps y-o-y	Remarks
OBC	17%	47%	22%	80%	11%	2.92% (3)bps	21%	2.04% 14bps	Low base boosts PAT growth. Asset quality stable
PNB	6%	2%	0%	-12%	172%	4.66% 261bps	277%	2.69% 185bps	High NPA provisions drag PAT. NIMS at 3.5%, expected to remain steady
SBBJ	42%	-4%	48%	51%	2%	3.29% (41)bps	-12%	1.91% (57)bps	
SBM	19%	11%	24%	87%	33%	4.33% 61bps	20%	1.92% 10bps	
SBT	20%	-14%	1%	16%	27%	2.98% 14bps	19%	1.74% (3)bps	
Syndicate Bk	6%	11%	-5%	43%	17%	2.47% 9bps	11%	0.92% (1)bps	Tax refund of Rs.99.8cr powers PAT growth, Asset quality relatively stable, NIM erodes 11bps YoY to 3.33%
UCO Bank	0%	5%	0%	-55%	66%	4.88% 124bps	71%	2.94% 83bps	High fresh slippages and consequent provisions, flat operating performance shrinks PAT
UBI	11%	9%	6%	57%	26%	3.66% 17bps	20%	2.06% 2bps	Sharp decline in slippages, results in lower provisions, drives PAT

	NII y-o-y %	OI y-o-y %	PPOP y-o-y %	PAT y-o-y %	GNPA absolute y-o-y %	GNPA Ratio chg y-o-y	NNPA absolute y-o-y %	NNPA Ratio chg bps y-o-y	Remarks
United Bk of India	-3%	49%	6%	16%	27%	3.88% 40bps	-1%	1.95% (26)bps	Other income, flat provisions aid PAT growth
Vijaya Bank	-12%	-21%	-37%	-39%	37%	3.17% 63bps	47%	1.90% 48bps	Poor operating performance, Tax write-back limit decline in PAT
SBI	5%	-1%	-2%	30%	45%	5.15% 96bps	40%	2.44% 40bps	Weak operating performance, High slippages, PAT growth at expense of PCR

Fig. 1

## NII

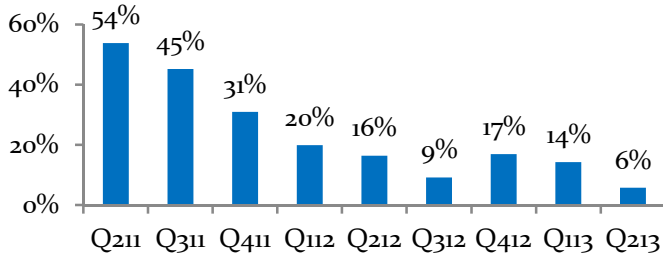


Fig. 5

## PPOP

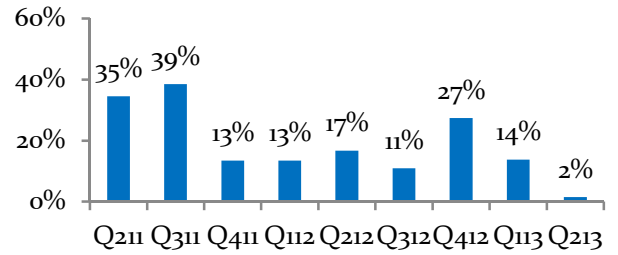


Fig. 2

## Other Income

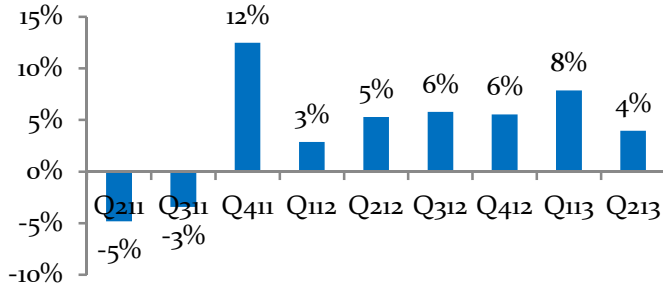


Fig. 6

## Provisions

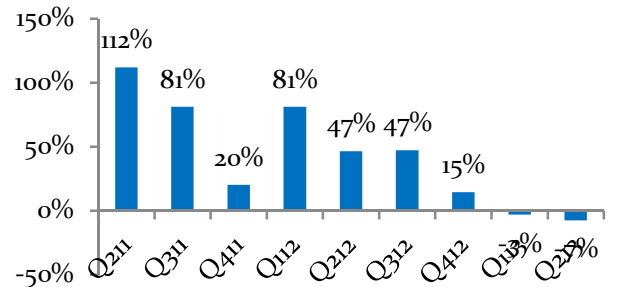


Fig. 3

## Opex

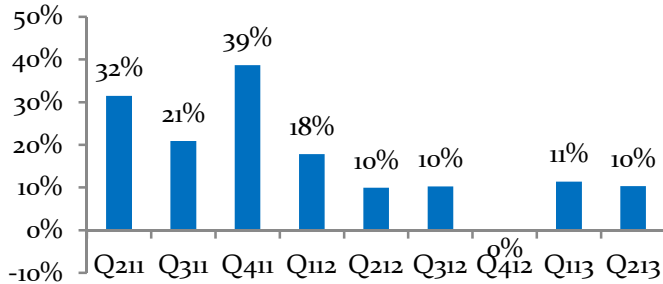


Fig. 7

## PAT

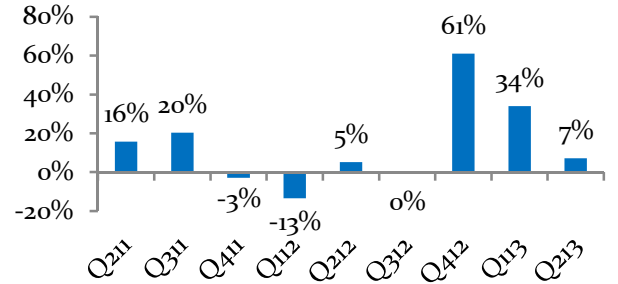


Fig. 4

## C/I

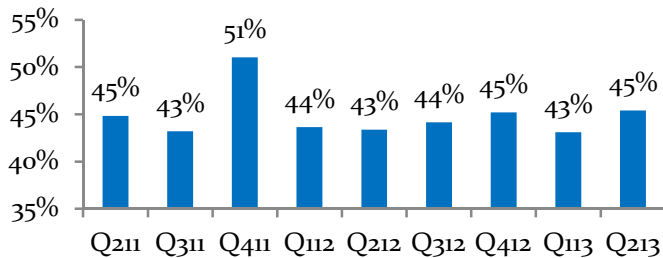
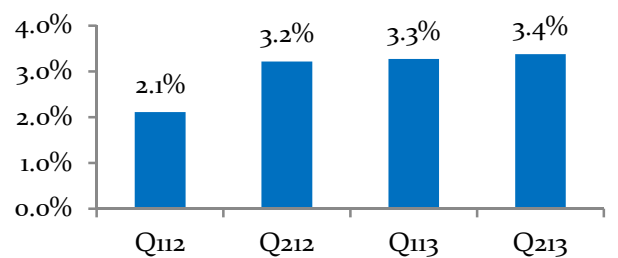
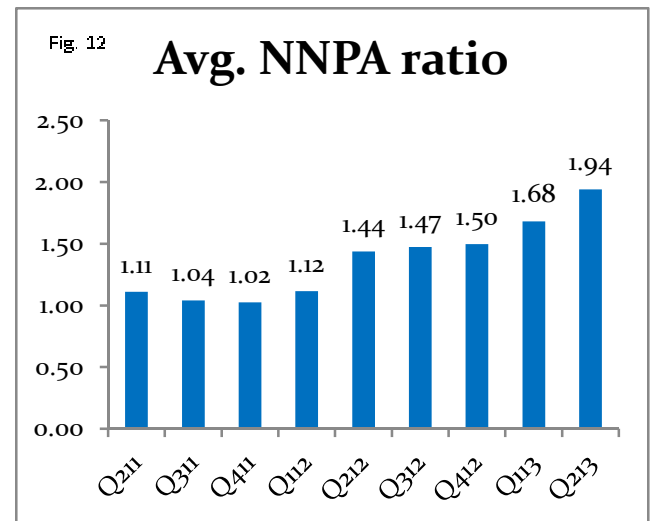
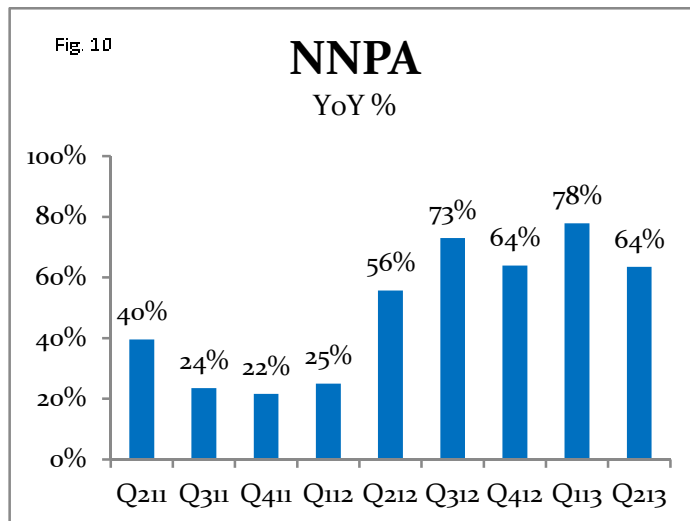
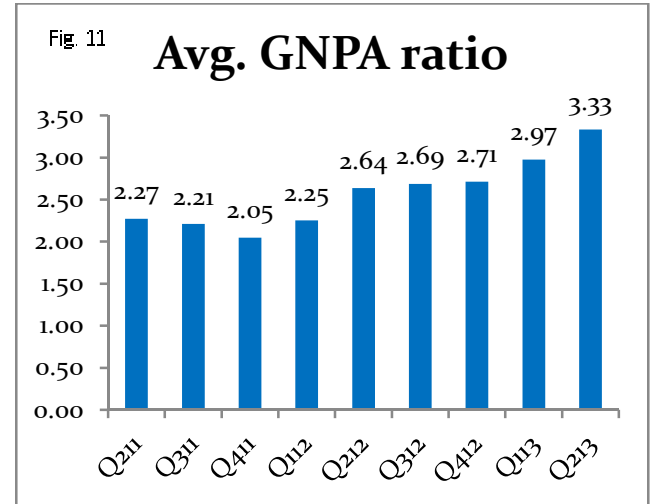
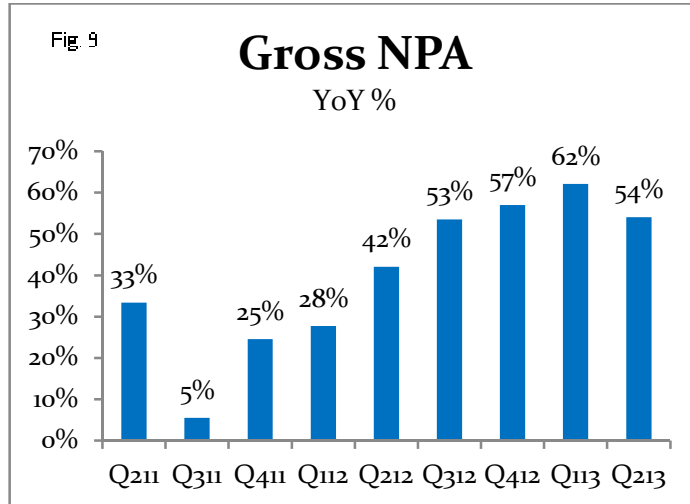


Fig. 8

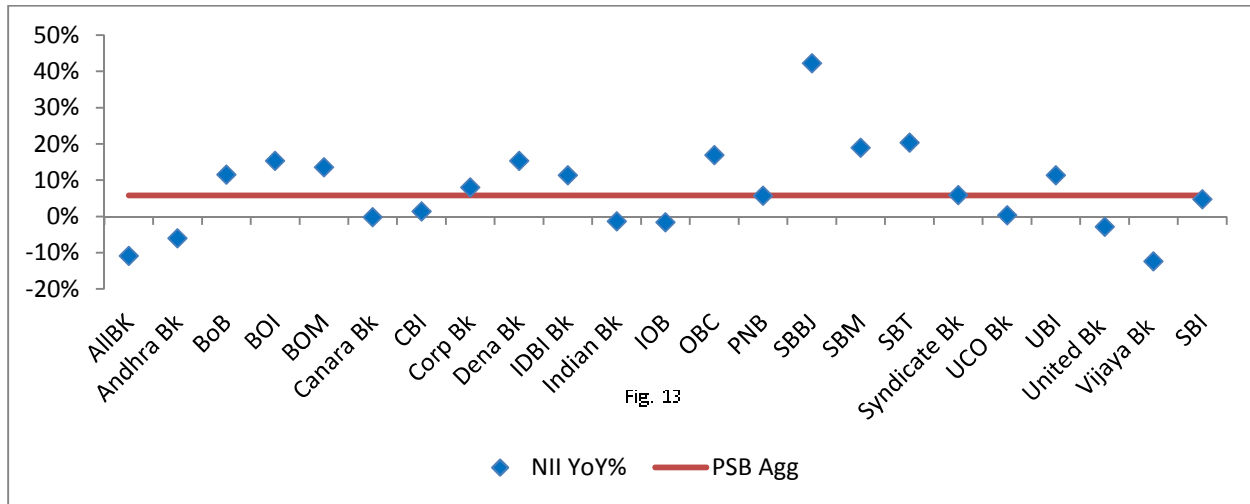
## Slippage Ratio



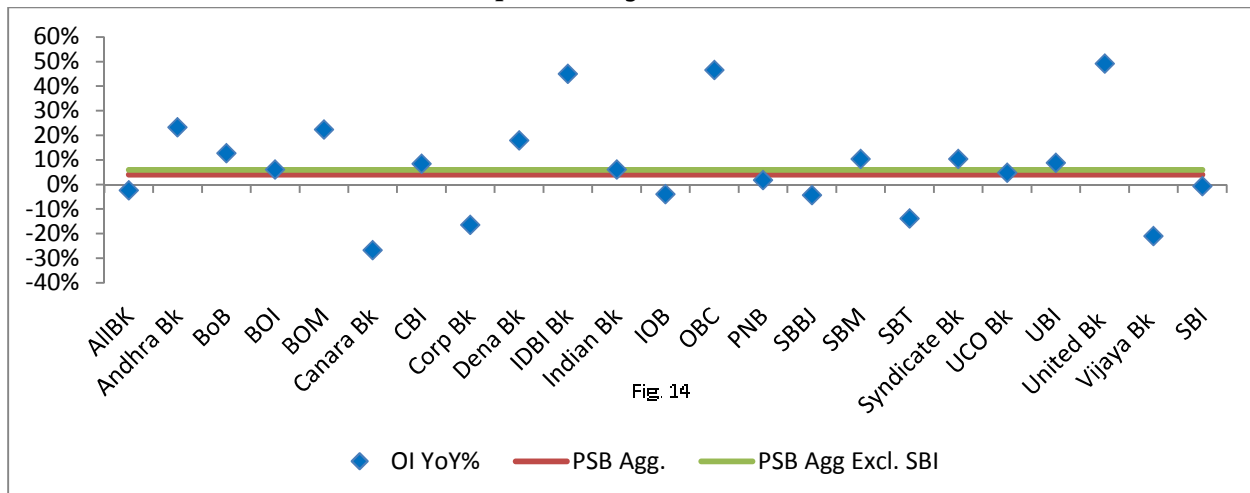




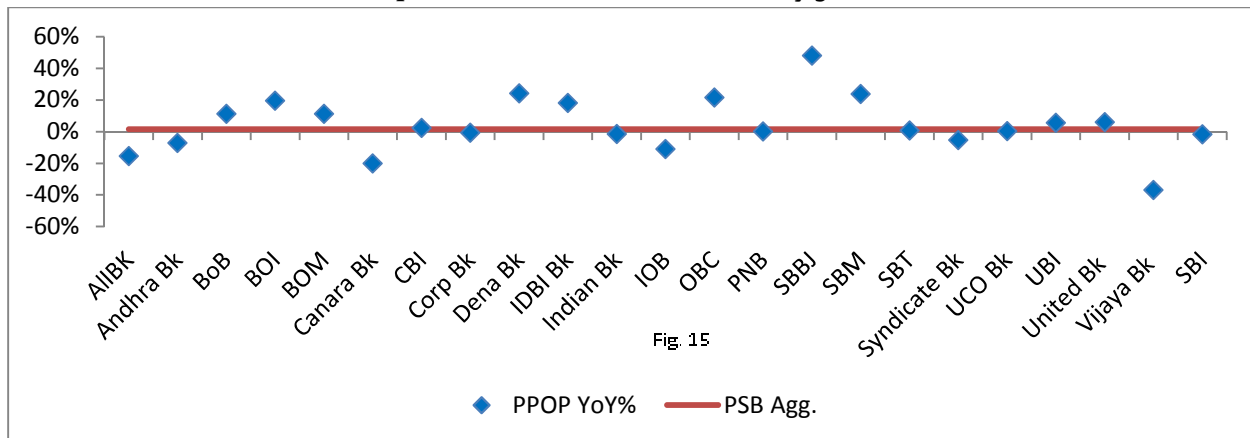
## Individual banks' vis-à-vis PSB Aggregate



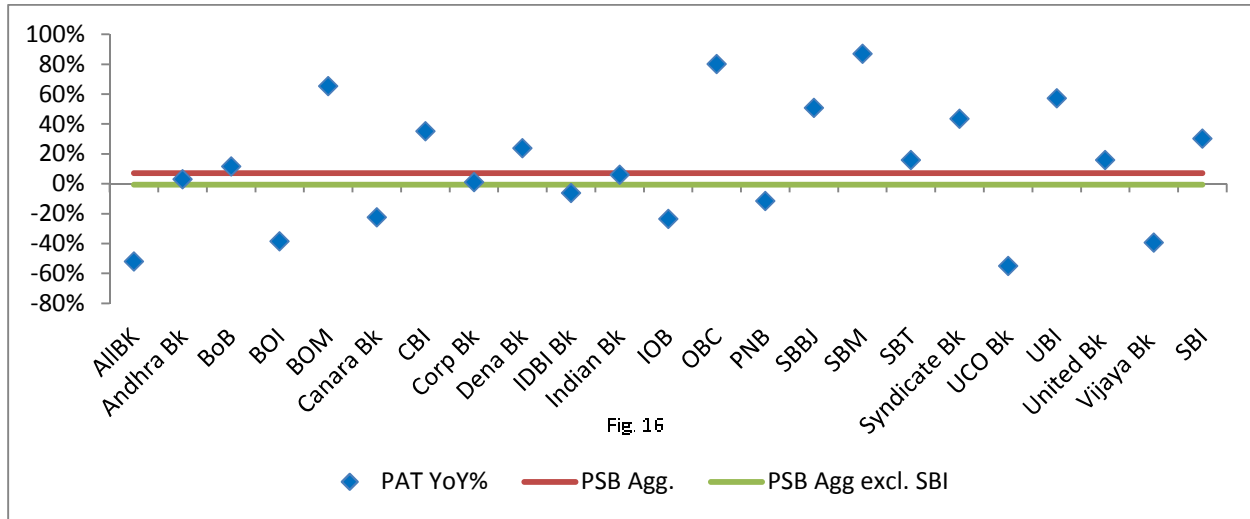
## Dena Bank, BoM, BOI, OBC observed superior NII growth



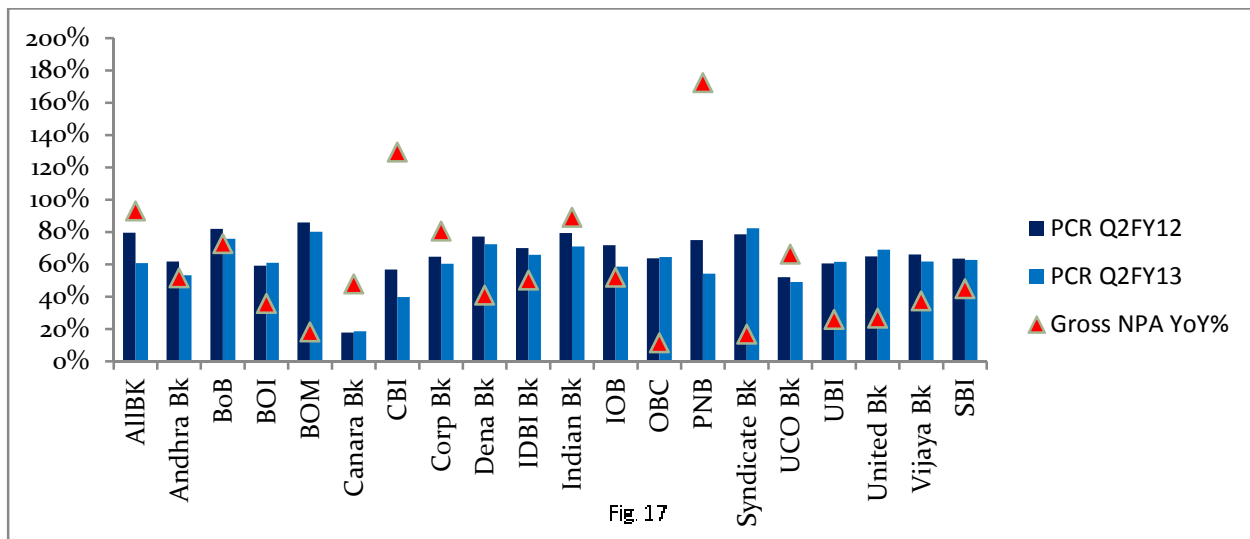
## Union Bank, OBC, IDBI and Corporation Bank witnessed healthy growth in core-other income



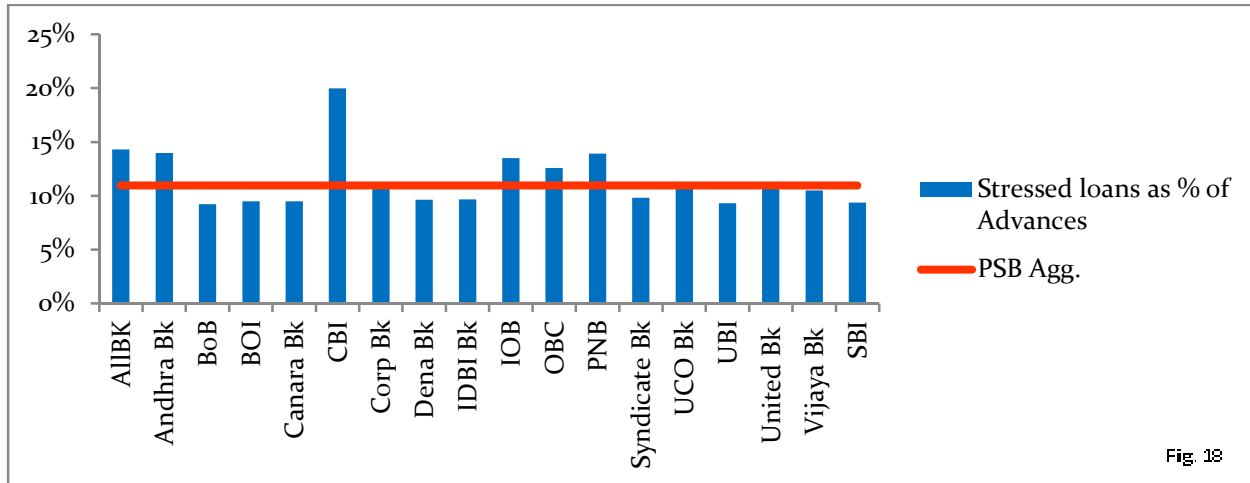
## BoI, OBC, Dena bank witnessed robust operating performance



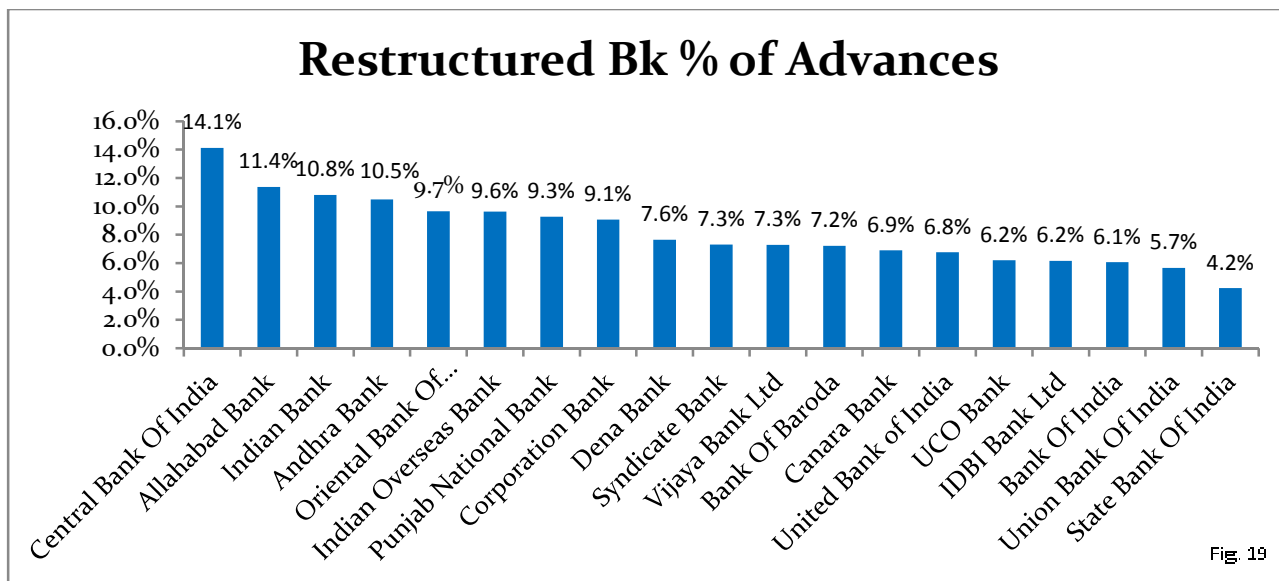
**Low base effect boosts OBC PAT growth**



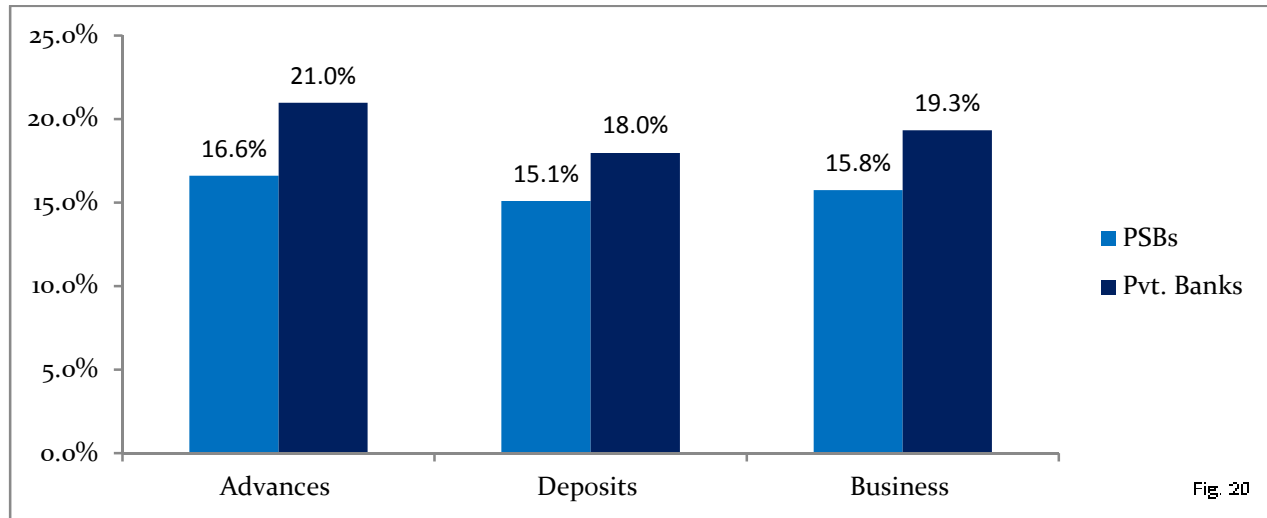
**70% of PSBs chose to limit fall in net profit at expense of PCR**



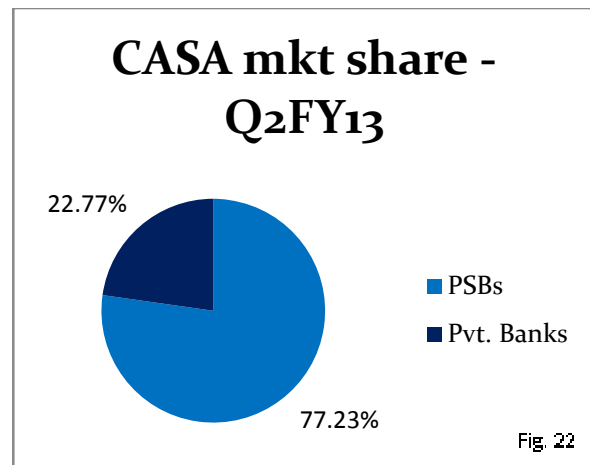
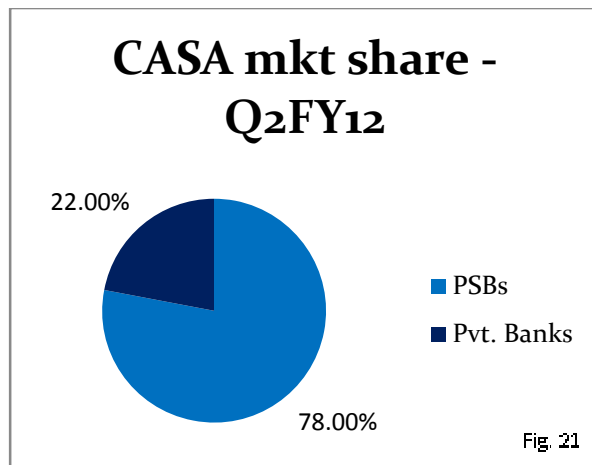
Central Bank of India (CBI) worst hit...



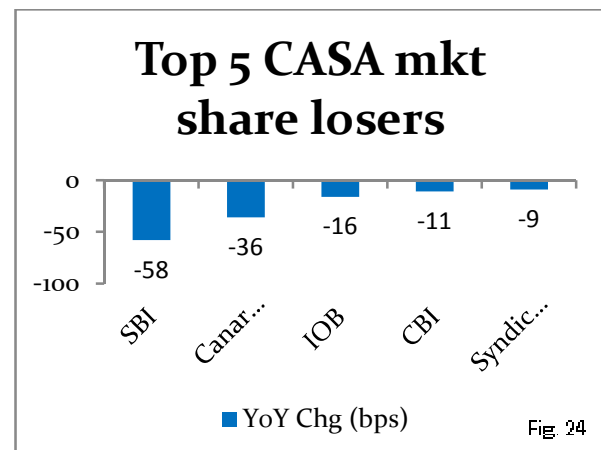
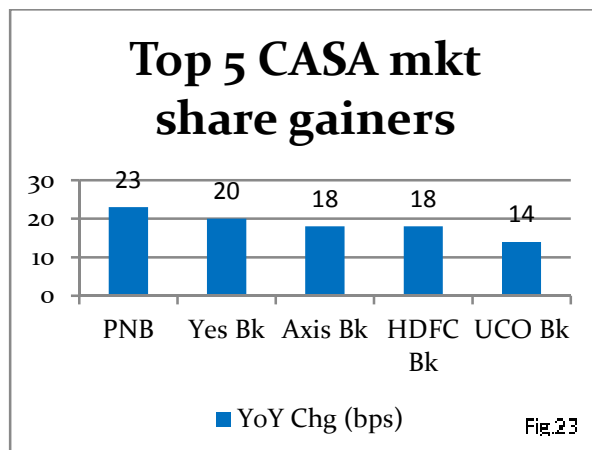
## Business Comparison – YoY%



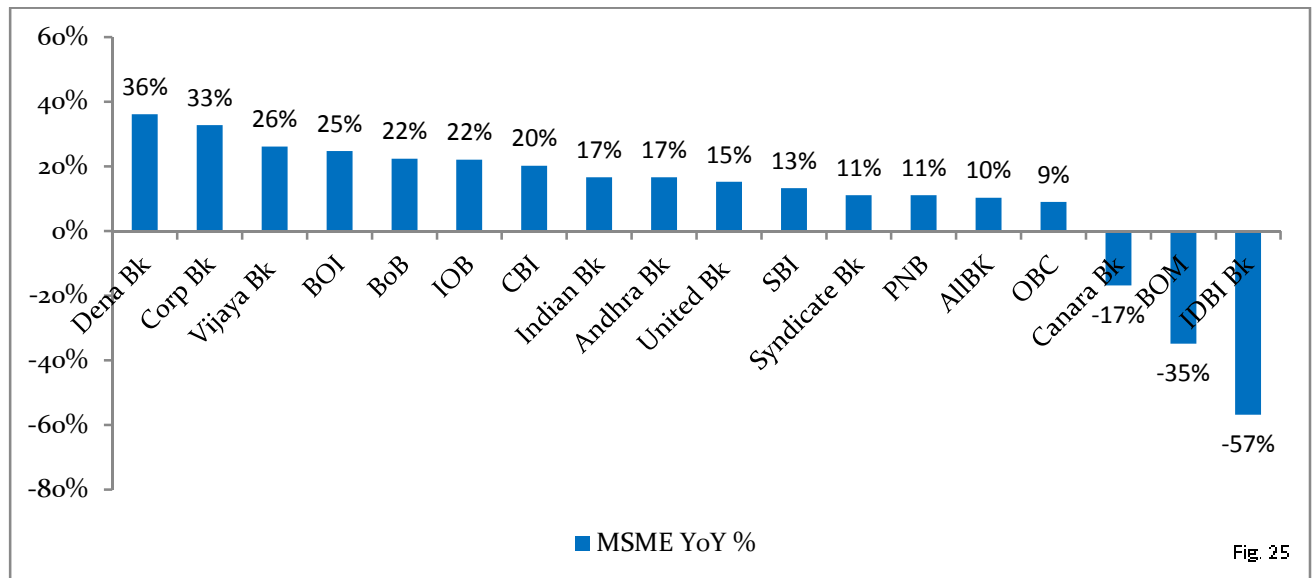
*PSBs tread with caution...*



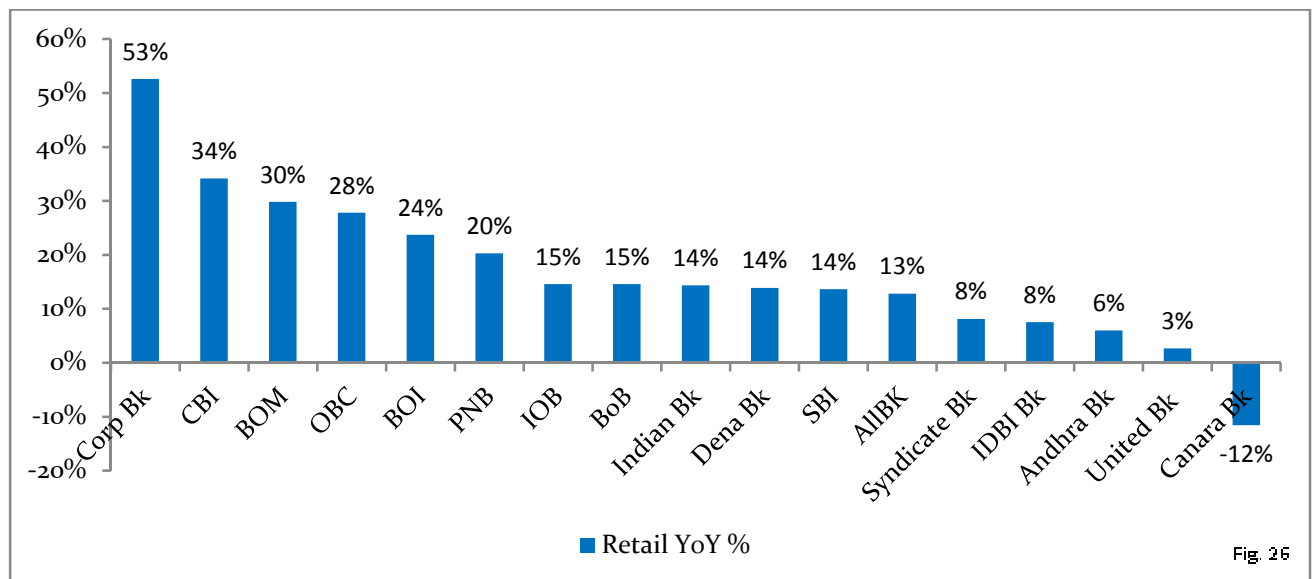
*PSB CASA market share shrinks...*



## PSBs focus on MSME loans



## And Retail loans...



## Private Sector Banks Key Highlights

	NII YoY%	OI YoY%	PPOP YoY%	PAT YoY%	GNPA absolute y-o-y %	Gross NPA Ratio chg bps y-o-y	NNPA absolute y-o-y	NNPA Ratio chg bps y-o-y	Remarks
Axis Bk	16%	29%	23%	22%	26%	1.10% 2 bps	19%	0.33% (1)bps	Healthy operating performance, Strain in asset quality
CUB	24%	31%	26%	4%	33%	1.24% 6bps	85%	0.60% 18 bps	Robust operating performance
DCB	13%	19%	27%	66%	-13%	3.85% (190) bps	-9%	0.68% (29) bps	Strong improvement in assets quality
Dhanlakshmi Bk	-15%	-50%	1765%	-528%	4799%	3.57% 302 bps	10885%	2.50% 233 bps	
Federal Bk	7%	19%	-3%	13%	15%	3.83% 22 bps	25%	0.68% 10 bps	CASA ratio has improved to 28.71% vs. 25.95%
HDFC Bk	27%	11%	21%	30%	13%	0.91% (9) bps	9%	0.20% 0 bps	Strong core performance; consistent PAT growth
ICICI Bk	35%	17%	36%	30%	0%	3.54% (60) bps	-2%	0.78% (15) bps	Strong performance across the board
Indusind Bk	22%	34%	26%	30%	23%	1.03% (6) bps	23%	0.29% (2) bps	Healthy NII growth, Core fee inc. drives OI, Asset quality stable
ING Vysya Bk	21%	4%	20%	30%	14%	1.90% (12) bps	-49%	0.13% (18) bps	NIMs up 10bps YoY at 3.45%, PCR at 93.1%
J&K Bk	27%	28%	35%	35%	2%	1.59% (30) bps	-12%	0.16% (6) bps	

	NII YoY%	OI YoY%	PPOP YoY%	PAT YoY%	GNPA absolute y-o-y %	Gross NPA Ratio chg bps y-o-y	NNPA absolute y-o-y	NNPA Ratio chg bps y-o-y	Remarks
Karnataka Bk	28%	8%	36%	185%	-6%	3.22% (79) bps	10%	2.08% (14) bps	Robust operating performance, lower provisions boosts PAT
Karur Vysya Bk	32%	14%	23%	17%	8%	1.26% (22) bps	38%	0.32% 3 bps	Strong core performance, Reversal of NPA provision & investment dep write-back; Tax expense higher due to investment gains/write-back
Kotak Mahindra Bk	25%	18%	27%	8%	21%	1.61% 0 bps	62%	0.75% 19 bps	High provisions for NPAs weigh on bottom-line
Lakshmi Vilas Bk	-6%	50%	-12%	-38%	149%	4.50% 226 bps	233%	2.95% 186 bps	Sharp deterioration in asset quality
SIB	15%	37%	20%	2%	115%	1.74% 75 bps	315%	0.86% 61 bps	CASA ratio dips 104bps, Asset quality worsens
Yes Bk	36%	29%	26%	30%	49%	0.24% 4 bps	48%	0.05% 1 bps	Healthy performance; Strong CASA accretion



**View:**

PSBs have witnessed significant headwind in terms of NII growth on account of elevated cost of funds. PSBs have found it extremely challenging to ramp-up fee income growth as loan growth remains subdued. Bankers despite losing market share of CASA deposits have done well to control operating costs through measured branch expansions, resulting in CASA per branch growing 4%YoY vs. 3%YoY for the private sector. **We believe bankers focus on boosting retail and MSME advances on the asset side and to reduce bulk deposits on the liability side are a structural positives**, as it improves granularity in the balance sheet, increases profitability through higher spreads while reduces risk of chunky slippages from few accounts. On asset quality side, we reiterate slippages are likely to continue as headwinds for industry borrowers remain, but the pace is likely to decelerate. **Low base of last year, further reduction in high cost deposits and incremental spreads on retail and SME loans, is likely to boost NII growth rate in the coming quarters.** Pre-provisioning operating profits are expected to improve however the pace is expected to be tempered as banks in contrast to trend, are expected to back-end operating expenses this year. Low base effect is expected to boost Net profit over second half of FY13. **We expect with the advent of rate cuts by the RBI, better balance sheet structure, and deceleration in fresh slippages, PSBs should receive a fillip.**

Private sector banks are expected to remain outperformers in terms of business growth, profitability and asset quality. The strong focus on improving CASA deposit base is expected to comfort NIMs despite aggressive moves to boost loan book. Fee income is expected to lag asset growth as project financing remains weak. Private sector is similarly focused on retail loans to boost credit off-take, as corporate loan book remains driven by past sanctions and working capital loans. Attempts to meet priority sector targets are expected to erode NIMs in H2FY13. Nevertheless, **private sector banks are well positioned in terms quality and structure of loan book, CASA base and capital adequacy to drive growth to deliver superior returns. Hence maintain bullish stance on the sector.**

**Analyst:**

Hedley Albuquerque

[fundamentals@banhem.in](mailto:fundamentals@banhem.in)

91 22 421 20 934

**RATINGS**

Buy	Accumulate	Neutral	Reduce	Sell
>15%	+5>15%	+5%/-5%	-5%<-15%	>-15%

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