Asset stress eases in top banks

RESULTS SHOW REDUCTION IN NEW BAD LOANS IN SECOND QUARTER

RESOLUTION, RECOVERIES KEY FOR TREND TO SUSTAIN

HAMSINI KARTHIK
Mumbai, 28 October

The common thread to link the results of India's top banks, which have published their September quarter (second quarter, or Q2) results over the past week and which had seen bad loan issues in the past, is clearly that of an improvement in asset quality.

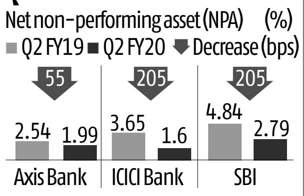
While Axis Bank's numbers gave some cue, State Bank of India (SBI) and ICICI Bank cemented the trend. ICICI Bank deserves mention, given its net non-performing assets (or bad loan ratio) at 1.6 per cent is inching lower towards pre-asset quality review days.

Slippages or formation of new bad loans also seemed to ease. SBI's 17-per cent reduction in slippages is the biggest takeaway from its Q2 results.

ICICI Bank also saw 10 per cent sequential reduction in slippages. Slippages remain a concern for Axis Bank, which saw 3-per cent sequential rise. This suggests that while a large part of asset quality run-down of the existing loan book is well behind for these top banks, not all may be satisfactory for the Indian banking system.

EASING ASSET QUALITY STRESS

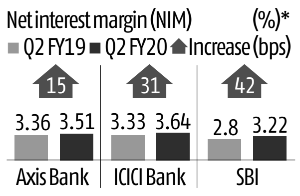
Net non-performing asset (NPA) (%)



SBI: State Bank of India
Bps: Basis points
Source: Banks

IMPROVING PROFITABILITY

Net interest margin (NIM) (%)*



* Domestic NIM
Bps: Basis points
Source: Banks

In the case of ICICI Bank, however, there was a slight increase in the pool of loan assets which don't enjoy 'BBB' or below-rated loans, the share of which rose from 30.7 per cent in the June 2019 quarter to 31.8 per cent in Q2.

While Axis Bank has reduced its watchlist (loans with potential to turn bad) to less than 2 per cent of the total loan book, analysts at JM Financial build incremental slippages of ₹20,400 crore over the next six quarters, forecasting a slippage ratio of 3.1 per cent in the second half of 2019-20 — this is higher than Axis Bank's guidance.

For SBI, the concerns are different. There's ₹16,000 crore to be recovered from three large accounts stuck in the resolution process and the bank has signed inter-creditor agreements to resolve loans worth ₹44,360 crore. While the fate of Essar Steel may be known in a few weeks, the resolution of loans under the June 7 circular of the Reserve Bank of India will hold the key if NPA numbers further decline for SBI. The management though is confident. But the December quarter results will reveal if banks can stitch together a resolution plan for these dicey cases. For now, analysts at Nomura peg SBI's asset quality risk at 2.2 per cent, which, according to them, is manageable. However, in the case of Axis Bank, the Street is a tad more apprehensive on asset quality outlook.

Asset quality aside, the other important point to note is the sharp growth in retail assets. For SBI and ICICI Bank, retail loans form over 60 per cent of the total loan book. Analysts say the rise in retail loans is partly by design and partly by default. In other words, little appetite from corporates has forced banks to reach out to retail customers for loan growth. In the past few quarters, personal loans have grown ahead of other retail loans. Yet their loan book remains largely granular and anchored by mortgages, which may, to some extent, insulate SBI, ICICI Bank, and Axis Bank from a potential retail loan bubble. Home loans account for 37 per cent of Axis Bank's retail loans, while for ICICI Bank and SBI, over half their retail loans are derived by home loans.

Thirdly, while private banks, including Axis and ICICI, are losing out on mobilising low-cost current account savings account deposits, their ability to raise retail term deposits at competitive rates has helped them trim the cost of funds. In turn, profitability or net interest margin has increased by 30–40 basis points (bps) for ICICI Bank and SBI, and by 15 bps year-on-year for Axis Bank.

Therefore, ticking the right boxes, analysts expect the stocks of Axis Bank, ICICI Bank, and SBI to be in the limelight on Tuesday's trade after a long weekend.

'Stock markets likely to remain range-bound'

Q&A

Market performance in Samvat 2075 wasn't satisfactory; the broader market participation was missing, says **MOTILAL OSWAL**, managing director and chief executive officer of Motilal Oswal Financial Services. In conversation with **Sundar Sethuraman**, Oswal says market gains will be capped until there is economic recovery. Edited excerpts:

'PRIORITISING GROWTH IS THE RIGHT POLICY STAND'

The market has gained 12 per cent in Samvat 2075. Are you satisfied with the performance?

The market continues to favour quality in times of tepid earnings growth. Samvat 2075 was marked by domestic and global economic slowdown, even though the markets touched new highs, with the Nifty breaching 12,000 after the Bharatiya Janata Party's win. The euphoria was short-lived; the focus shifted back to fundamentals. It recouped again after the corporate tax cut announcement. But the trend of wide divergence within the Nifty and between the Nifty and mid- and small-cap indices remains.

What are the key headwinds facing the market?

Since the Infrastructure Leasing & Financial Services crisis in September 2018, the financial sector has continued to see elevated stress across non-banking financial companies and housing finance companies. This has now spread to the banking sector as well. Gross domestic product growth estimates have been revised downwards, pointing towards a tough near-term macro environment.

How will the cut in corporate tax impact the companies and the overall economy?

The corporate tax rate cut, along with incentives for new manufacturing companies, is a positive catalyst for the economy. It will improve corporate profitability. It augurs well for private capital expenditure investment cycle over the next few years. While it may entail some risks for 2019-20 (FY20) fiscal deficit, prioritising growth is the right policy stand in the current environment.

What is your outlook for Samvat 2076? What will be the global and local factors which will influence market movement?

The markets are likely to remain range-bound in the near term till economic recovery is visible. The three key factors which would influence market movement would be the health of the financial sector, further stimulus announcements by the government, if any, and resolution of the US-China trade war.

How much time will it take for the economy to come out of the woods? What measures should be taken to revive the economy?

The Reserve Bank of India, since February 2019, has been accommodative and cut repo rates by 135 basis points (bps). With inflation under control and a stable currency, the interest rates appear to remain soft. This would give consumption a push in the festive season. The recovery in monsoon should also bolster rural consumption. These actions should lead to gradual recovery in macros over the next few quarters. The real estate sector needs more attention, although some measures have been announced.

When can one expect meaningful pick-up in earnings?

Earnings downgrade risks continue on account of tepid demand, uneven asset quality trends in financials, and the deflationary trends in commodity prices. Hence, the reduction in corporate tax rate is unlikely to drive big upgrades in FY20 and would largely limit the earnings downgrade. However, we expect it to be a big booster for 2020-21 (FY21) earnings as economic revival picks up. We are expecting 12 per cent earnings per share growth for Nifty in FY20 and a strong revival of 28 per cent growth in FY21.

Investors are fretting over the health of the financial sector. Are the fears warranted?

The rating downgrades for stressed companies have resulted in new names being added to the stressed asset pool. However, the incremental stress is much lower. Recoveries from large National Company Law Tribunal resolutions and the normalisation of credit cost should aid the financial sector's profitability. Further, the corporate tax cut should lead to higher corporate savings, which will improve their ability to pay debt obligations.

What is your advice to investors during these challenging times?

Investors with medium- to long-term perspective can look at large quality caps as well as select mid-caps and use the market volatility to build a solid long-term equity portfolio.

I-banking fee rises 6% to $783.5 million

ASHLEY COUTINHO
Mumbai, 28 October

The country's investment banking fee rose 5.8 per cent to $783.5 million in the first nine months of 2019, from the year-ago period, led by higher fees in the debt segment.

Debt capital market underwriting fees totalled $201.2 million, up 108.7 per cent from a year ago — the best-ever first three quarters since records began in 2000.

Equity capital market (ECM) underwriting fees stood at $134.2 million, a 4.7 per cent decrease from the same period last year.

Syndicated lending fees fell 5.2 per cent from the comparative period last year and generated $209.9 million. Merger and acquisition (M&A) advisory fees were down 15.6 per cent to $238.2 million, from the record high set a year ago.

Axis Bank took the top spot in India's investment banking fee league table, with 9.6 per cent market share and $75.5 million in related fees.

ICICI Bank was second, with an 8.4 per cent market share.

Bank of America Merrill Lynch leads the ranking for ECM underwriting, with $1.9 billion in fees and 11 per cent market share, followed by Morgan Stanley, with 10.5 per cent share.

The ECM segment has seen a mop-up of $17.4 billion this year, up 23.3 per cent from the comparable period in 2018. Initial public offerings totalled $2.2 billion, down 49.3 per cent from a robust period last year.

Rights offerings raised $7.4 billion to date and accounted for 42.4 per cent of India's ECM proceeds, after two of India's biggest rights offering on record priced this year — Vodafone Idea's $3.6-billion and Bharti Airtel's $3.5-billion issuances.

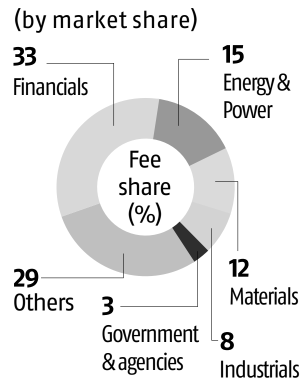
Primary bond offerings from India-domiciled issuers hit record high and totalled $66.7 billion during the first nine months of 2019, a 104.4 per cent increase in proceeds from a year ago.

India announced M&A activity is at $61.2 billion so far this year, a 46.1 per cent year-on-year decline after witnessing a record first nine months period last year. Target India M&A stood at $57 billion, down 42.7 per cent from the same period last year.

The largest India-targeted deal so far this year is Brookfield Asset Management's $3.7 billion (₹252.2 billion) acquisition of Reliance Industries' tower infrastructure trust.

TOP FEE-PAYING INDUSTRIES

(by market share)



Source: Refinitiv