DEVEN CHOKSEY RESEARCH

Q3 FY25 Banking Sector Review

Result Review

19th February 2025

Banking

Modest earnings growth on the back of higher provisions; slippages remain high

COVERAGE STOCKS

Coverage	Rating	CMP	Target (INR)	Upside
Axis Bank Ltd	BUY	994	1,283	29.1%
Bandhan Bank Ltd	ACCUMULATE	130	164	26.2%
HDFC Bank Ltd	BUY	1,723	1,934	12.2%
ICICI Bank Ltd	BUY	1,243	1,500	20.7%
IndusInd Bank Ltd	HOLD	1,024	1,031	0.7%
Kotak Mahindra Bank Ltd	ACCUMULATE	1,963	2,164	10.2%
State Bank of India Ltd	BUY	726	915	26.0%

Source: Deven Choksey Research, Closing as of 18th February 2025.

MARKET DATA

	Close	1M (%)	YTD (%)
Nifty	22,925	(1.1)	(3.0)
Sensex	75,967	(0.9)	(2.8)
Nifty Bank	49,068	1.1	(3.5)
USD / INR	86.931	0.4	1.6

SECTOR OVERVIEW – Banking

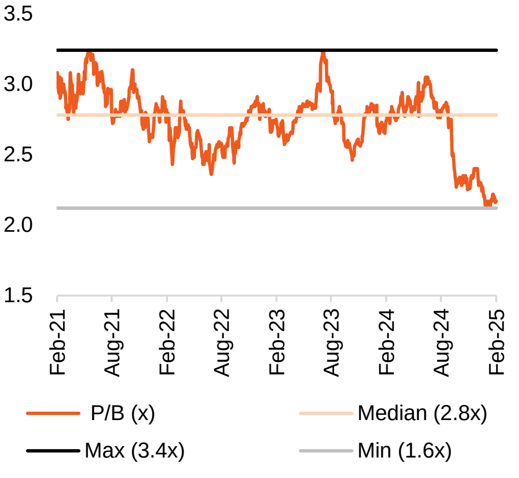
View and Valuation:

- The banking sector reported a mixed quarter, with moderation in margins, elevated credit costs, and soft business momentum.
- Net Interest Margins (NIMs) continued to decline, impacted by the rising cost of deposits and increased competition for funds, as seen across private and public sector banks.
- Credit growth moderated across segments, with corporate lending witnessing a sluggish recovery due to a subdued capex cycle and pricing pressures in large-ticket loans.
- For FY26E, we expect sector-wide credit growth of approximately 12.0%, supported by a pickup in corporate lending, sustained SME expansion, and a gradual revival in unsecured credit demand.
- Asset quality risks remain a key concern, particularly in unsecured lending, where slippages in personal loans and microfinance portfolios remain elevated. We remain cautious about asset quality in the unsecured segment, as slippages in personal loans and microfinance remain elevated.
- Despite near-term pressures, the sector remains resilient, backed by strong capital buffers and a strategic pivot toward secured lending, which should help mitigate risks and support long-term stability.
- Banks are currently trading at 1.7x P/BV for FY27E, significantly below their five-year average industry P/B multiple of 2.8x. This valuation discount reflects concerns around margin compression, elevated credit costs, and moderation in credit growth.
- **We remain positive on ICICIBC and SBIN, given their strong ability to navigate macroeconomic challenges. Both banks exhibit healthy business momentum, stable asset quality, and superior return ratios, positioning them well to outperform in a challenging environment.**

Continued sluggishness in the business momentum:

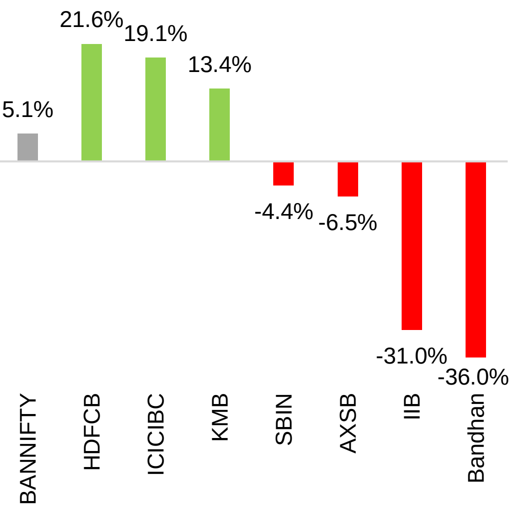
- As of December 31, 2024, systemic credit offtake stood at INR 175.9 Tn, reflecting an 11.3% YoY growth, which is slower than the 12.6% a year ago (excluding merger impact). Overall credit growth within our coverage remained moderate at ~10.3% YoY.
- Retail credit continued to expand but at a slower pace, with secured lending (home loans, auto loans, and SME loans) driving growth. Unsecured lending (personal loans, credit cards, and microfinance) saw a slowdown due to regulatory tightening, higher risk perception, and rising delinquencies.
- BANDHAN bank led the growth with 15.6% YoY/ 1.1% QoQ, while HDFCB continued to report a modest increase of 3.0% YoY/ 0.9% QoQ.

Nifty Bank and average 5 years Price to book value (x)



Source: NSE/ Bloomberg

Coverage stock returns 1 Yr (%)



Source: NSE/ Bloomberg

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Banking

- We expect FY25E to end with a credit growth in the range of 12.0-14.0% YoY for our coverage. In FY26E, policy support for MSMEs and rural credit will drive incremental lending, while large corporates will continue to rely on banks for working capital needs.
- As of December 31, 2024, industry deposit growth stood at 11.5% YoY, broadly in line with credit growth trends. The Credit-to-Deposit (CD) ratio has remained around 80% since September 2023, reflecting sustained reliance on deposits to fund credit expansion. In Q3FY25, the CD ratio saw a marginal decline of 16 bps QoQ, settling at 79.7%, indicating a slight improvement in liquidity conditions. However, deposit mobilization remains critical for supporting future credit growth, especially amid competitive pressures in the banking sector.
- Within our coverage, the deposit growth outpaced credit growth, rising by an average of 12.0% YoY, as banks focused on mobilizing stable funding. CASA deposits (Current Account and Savings Account) declined across the industry as customers shifted funds to higher-yielding term deposits due to elevated interest rates.
- Deposit mobilization was a key strategic priority, with banks increasing branch expansion and digital banking initiatives. Digital banking and branch expansion strategies will help banks acquire granular retail deposits, improving funding stability.
- Liquidity remained comfortable, but banks increased their reliance on wholesale funding to manage mismatches in credit-deposit growth.

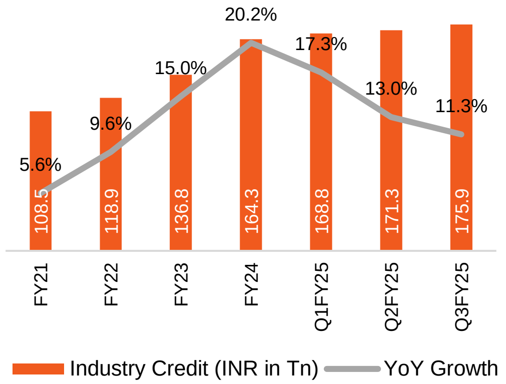
NIMs have bottomed out and expected to stabilize from here:

- NII growth for the banking sector remained moderate at an average of 6.5% YoY, reflecting a mix of stable loan growth and rising funding costs. NIMs saw mild compression, declining by ~10-20 bps YoY across the sector due to rising deposit costs. The industry-wide NIM remained in the 3.5-4.0% range, with retail-heavy banks maintaining relatively stronger margins.
- NIMs are expected to remain under pressure in the near term, with a possible stabilization in Q4FY25E as: a) deposit repricing is completed, and banks adjust their lending rates, b) shift toward retail and SME lending supports higher yields, mitigating cost pressures, and c) regulatory clarity on unsecured lending risks helps banks optimize portfolio mix.
- In Q3FY25, the cost-to-income ratios increased slightly YoY, reflecting rising employee costs and technology investments. The industry-wide cost-to-income ratio ranged between 45-50%, with some banks exceeding this due to expansion plans.
- Net profit growth varied across banks, with an aggregate decline of 1.1% YoY (excluding SBIN with 84.3% YoY growth). Cost escalations and higher credit costs were key drag factors, particularly in microfinance and unsecured retail credit. Banks with diversified loan books, especially ICICIBC and SBIN, managed provisions better, while those heavily reliant on microfinance and unsecured credit saw elevated credit costs.

MFI and unsecured loans segments reported higher slippages:

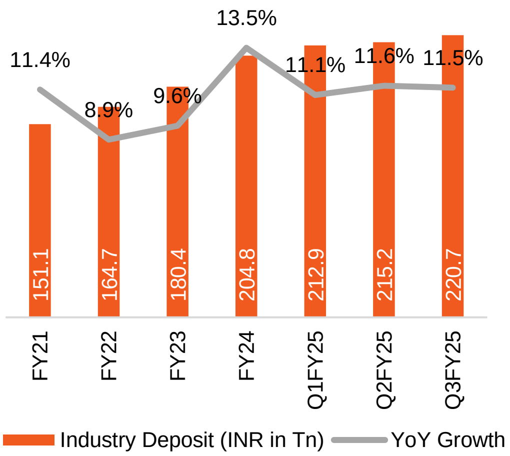
- Slippages increased in personal loans, credit cards, and microfinance loans, leading to higher provisions. Microfinance NPAs remained elevated, with some banks reporting 4.0-5.0% GNPA in this segment, indicating ongoing stress. Gross NPA ratios remained stable across the sector, averaging ~1.5-2.5%, with most banks reporting marginal YoY improvement. Net NPA ratios ranged between 0.4-0.8%, reflecting adequate provisioning buffers.

Credit offtake slowed down further on the back of stricter regulatory norms



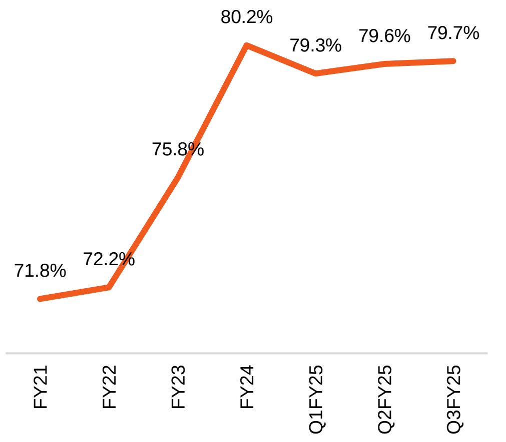
Source: RBI fortnight data

Deposit growth remained range bound



Source: RBI fortnight data

Credit-to-deposit Ratio continued to be higher



Source: Company filings

Banking

Axis Bank | Target: 1,283 | Rating: BUY | Upside: 29.1%

- AXSB expects NIMs to remain stable or show slight moderation in the near term due to a) a focus on improving the quality of deposits and balancing the loan mix, b) continued efforts to manage the cost of funds efficiently, and c) the impact of reduction of CASA % in deposit / liabilities mix will continue to be offset by rate benefit on liabilities.

- Axis Bank is cautiously optimistic about unsecured loan segments, such as personal loans and credit cards, due to rising delinquencies industry-wide.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	136,059	0.9%	8.6%	-0.8%
PPOP	105,339	-1.7%	15.2%	-0.7%
PAT	63,038	-8.9%	3.8%	-5.8%
Advances in Bn	10,146	1.5%	8.8%	-2.5%
Deposits in Bn	10,959	0.8%	9.1%	-3.4%

Bandhan Bank | Target: 164 | Rating: ACCUMULATE | Upside: 26.2%

- BANDHAN has announced plans to open approximately 200 new branches, with a strategic focus on South India, to reduce geographical concentration risk and drive pan-India growth.

- The credit costs for the quarter increased due to higher provisioning requirements, primarily related to the microfinance portfolio and write-offs. While the bank is experiencing short-term stress in asset quality, management remains optimistic about gradual improvement over the next few quarters.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	28,303	-4.0%	12.1%	-6.1%
PPOP	20,214	9.0%	22.1%	2.4%
PAT	4,265	-54.5%	-41.8%	-39.5%
Advances in Bn	1,274	1.1%	15.6%	-1.5%
Deposits in Bn	1,410	-1.1%	20.1%	0.0%

HDFC Bank | Target: 1,934 | Rating: BUY | Upside: 12.2%

- The bank expects loan growth to remain below the system's average as the bank focuses on rebalancing in FY25E. For FY26E, loan growth will match the system, while for FY27E, growth is expected to exceed the system.

- HDFCB aims to grow deposits in line with or above the system average over the next few years. The bank's branch expansion and digital initiatives are expected to drive deposit growth in rural and semi-urban markets.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	306,533	1.8%	7.7%	-0.1%
PPOP	250,004	1.2%	5.7%	0.6%
PAT	167,355	-0.5%	2.2%	0.3%
Advances in Bn	25,182	0.9%	3.0%	-0.1%
Deposits in Bn	25,638	2.5%	15.8%	0.0%

ICICI Bank | Target: 1,500 | Rating: BUY | Upside: 20.7%

- Vehicle loan growth has moderated following a strong phase but is expected to show cyclical recovery as demand picks up.

- Management expects credit costs to remain around 50 bps, supported by stable asset quality across segments. The bank remains watchful of macroeconomic factors, including interest rate movements, inflation, and liquidity conditions, which could influence credit demand and asset quality.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	203,706	1.6%	9.1%	-2.3%
PPOP	168,866	1.0%	14.7%	1.0%
PAT	117,924	0.4%	14.8%	4.9%
Advances in Bn	13,144	2.9%	13.9%	-1.3%
Deposits in Bn	15,203	1.5%	14.1%	-1.5%

Note:
QoQ – Quarter on Quarter Growth | YoY – Year over Year Growth | Surprise – deviation from estimates

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Banking

IndusInd Bank| Target: 1,031 | Rating: HOLD | Upside: 0.7%

- The MFI loan book continued to decline by 8.9% YoY/ 0.5% QoQ. However, while incremental stress formation is showing early signs of stability, IIB continues to be cautious in the microfinance segment.

- For the MFI segment, IIB continues to believe in its approach of focusing on 1) funding requirements of vintage customers and centers, 2) being conservative on overall customer industry indebtedness, 3) investing in collection infrastructure, and 4) continued diversification of the loan book.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	52,281	-2.2%	-1.3%	-3.6%
PPOP	36,007	0.0%	-10.9%	-2.6%
PAT	14,024	5.3%	-39.1%	24.7%
Advances in Bn	3,669	2.7%	12.2%	-0.1%
Deposits in Bn	4,094	-0.7%	11.0%	0.0%

Kotak Mahindra Bank | Target: 2,164 | Rating: ACCUMULATE | Upside: 10.2%

- As of December 31, 2024, the advances do not reflect the Standard Chartered portfolio discussed in Q2FY25. The bank has obtained all necessary approvals and is currently in the process of migrating this portfolio, which is expected to be completed within this quarter.

- KMB will maintain its focus on key segments by driving savings growth and strategically balancing savings, ActivMoney, and term deposits in a granular and targeted approach to achieve its growth objectives.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	71,963	2.5%	9.8%	1.0%
PPOP	51,810	1.6%	13.5%	-1.0%
Adj. PAT	33,048	-1.2%	10.0%	-1.8%
Advances in Bn	4,138	3.6%	15.1%	0.5%
Deposits in Bn	4,735	2.6%	15.9%	-1.0%

State Bank of India | Target: 915 | Rating: BUY | Upside: 26.0%

- The bank expects budget announcements to boost SME lending further, with the CGTMSE guarantee increased from INR 50 Mn to INR 10 Mn. SBIN expects continued high double-digit growth in SME lending.

- SBIN maintained its credit growth guidance of 14.0%-16.0% for FY25E, with above 14.0% YoY growth in domestic loans. The Foreign credit growth is expected to double-digit (~10.0-12.0% YoY) with trade finance adjustments. SBIN is monitoring trade policy shifts, particularly in the U.S. & China, to adjust strategy.

INR Mn	Q3FY25 A	QoQ	YoY	Surprise
NII	414,455	-0.4%	4.1%	-1.8%
PPOP	235,508	-19.6%	15.8%	-12.6%
PAT	168,914	-7.9%	84.3%	3.5%
Advances in Bn	40,046	3.8%	13.8%	-0.6%
Deposits in Bn	52,294	2.2%	9.8%	-1.5%

Note:
QoQ – Quarter on Quarter Growth | YoY – Year over Year Growth | Surprise – deviation from estimates

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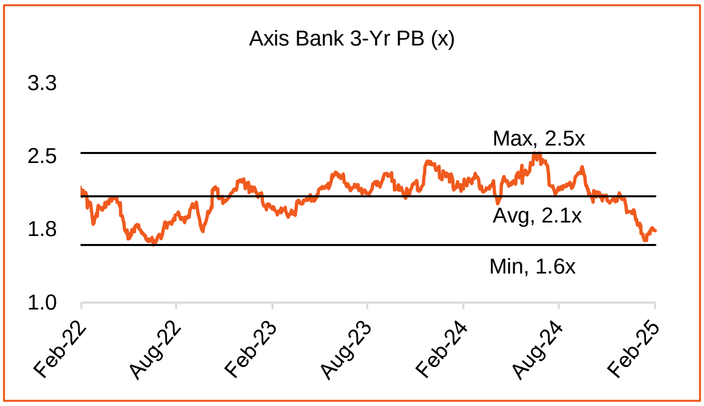
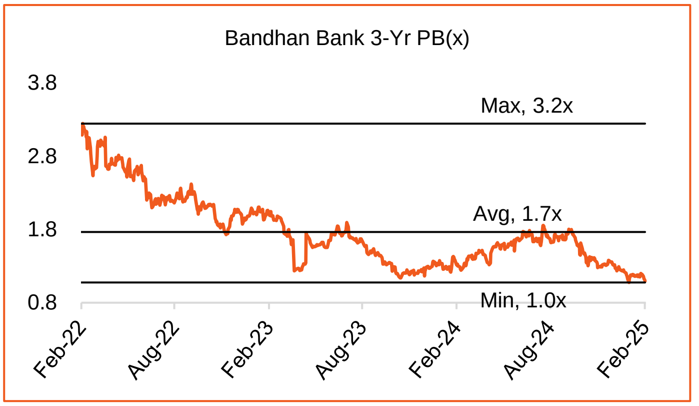
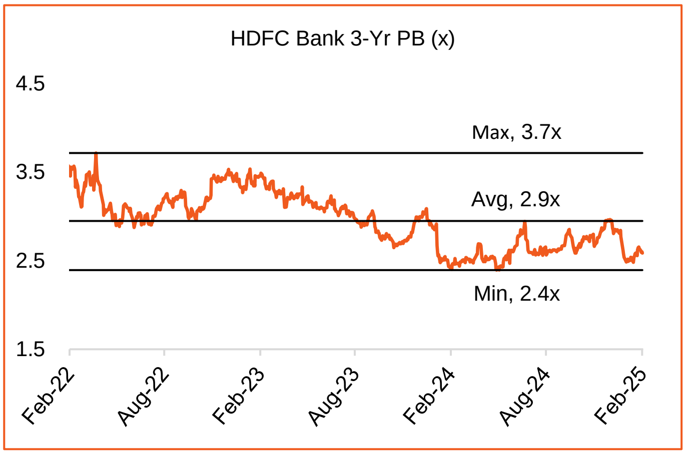
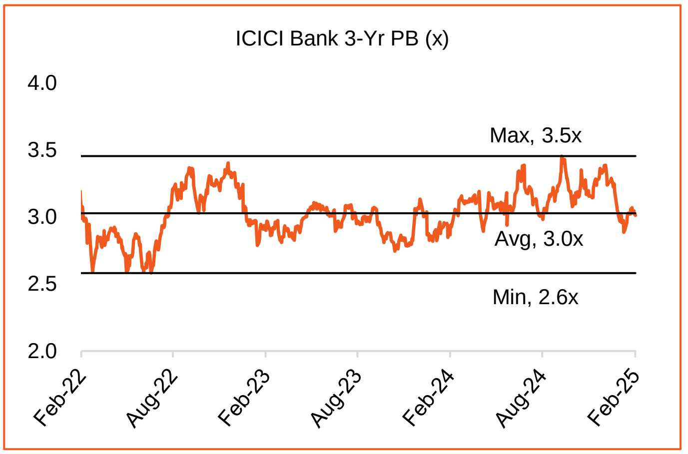
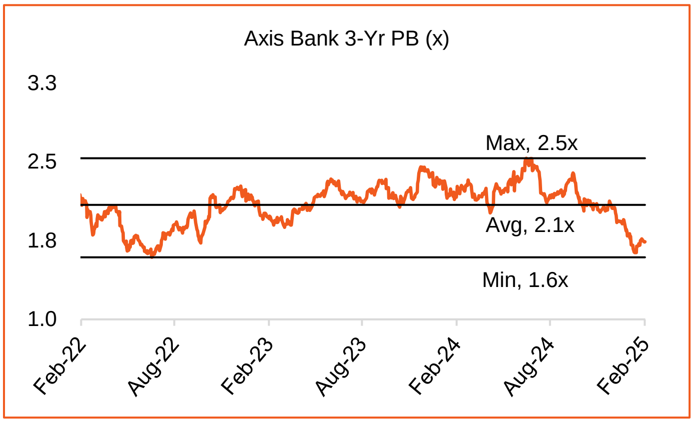
Banking

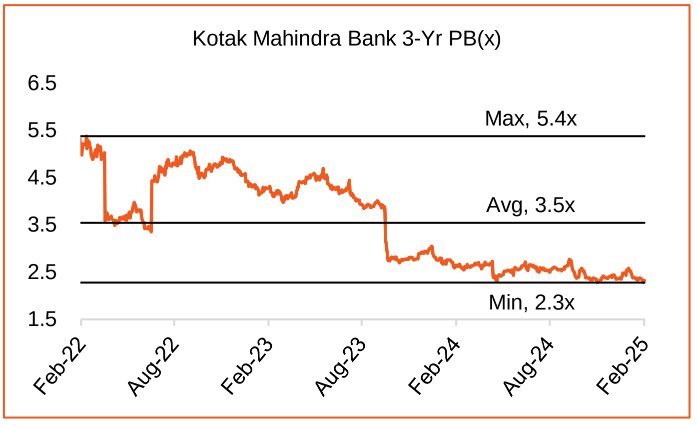


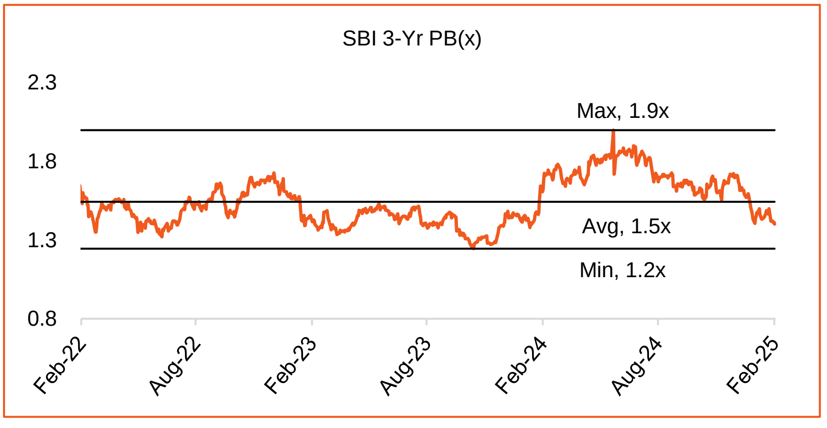












Source: NSE

Banking

Rating Legend (Expected over a 12-month period)	
Our Rating	**Upside**
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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