Higher Operating Profit, Lower Provision Aid SCBs Q2 Net Profit; Asset Quality Improves

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Synopsis

- Net Interest Margin (NIM) of Scheduled Commercial Banks (SCBs) improved by 22 basis points (bps) y-o-y to 3.11% in Q2FY23 due to higher yield on advances, lagged increase in deposit rates, and reduced credit costs. The banks have hiked lending rates in response to an increase in policy interest rates.
- Growth in the total income of 15.1% y-o-y for the quarter was supported by high Net Interest Income (NII). However, non-interest income marginally dropped by 1.1% due to a fall in mark-to-mark (MTM) profit driven by hardening bond yields. Meanwhile, it witnessed a healthy rise of 21.7% quarter-on-quarter (Q-o-Q). MTM profit and trading income of SCBs dropped by 75.9% y-o-y to Rs.2,058 crore in Q2FY23, a sequential improvement compared to the Rs.7,086 crore loss reported in Q1FY23.
- SCBs pre-provisioning operating profit (PPOP) rose by 17.8% y-o-y to Rs.1.1 lakh crore in Q2FY23 due to faster growth in net interest income (NII) and a lower rise in operating expenses. Credit cost for SCBs (annualised) declined to 0.7% in Q2FY23 from 0.9% in Q2FY22. It is expected to be lower in the coming quarters due to comparatively lower incremental slippages and stable recoveries.
- The Gross Non-Performing Asset (GNPA) ratio declined to 5.1% as of September 30, 2022, from 7.2% over a year ago due to a reduction in slippages, stable recoveries, and lower restructured books driven by pick up in business activities.
- Net profit of SCBs grew by 57.5% y-o-y to reach Rs.0.58 lakh crore in Q2FY23 mainly due to PPoP growth and controlled credit costs. Private sector banks (PVBs) reported a rise of 64.2% in their net profit to Rs.0.32 lakh crore, while PSBs witnessed a rise of 49.9% to Rs.0.26 Lakh crore. The Return on assets (RoA, annualised) of SCBs improved by 19 bps to 0.9%.

Credit Growth

Non-food credit grew by 16.9% y-o-y in September 2022 vs. 6.8% in the year-ago period. The growth expanded by 977 bps primarily due to a low base, retail credit, inflation-induced working capital requirements, improvement in capacity utilisation, lower funds raised from the capital market, higher borrowing costs in the overseas market, and credit demand for new capex. The credit o/s of the services segment rose at 20.0% y-o-y as compared to 1.2% over the year-ago period due to strong growth in NBFCs. Banking sector exposure to NBFCs reached Rs.11.7 lakh crore as of September 23, 2022, from Rs.9.0 lakh crore a year ago. Retail credit o/s rose by 19.6% due to festive demand and an uptick in business activities. Industry credit o/s too rose by 12.6% as compared to 1.7% in September 2021, mainly due to growth in borrowings by MSMEs

Figure 1: SCBs: Movement in Interest Rates (%) – Rising Interest Trend

Month	TDR<1 yr	WALR (O/S loan)
Mar-21	5.28	9.10
Jun-21	5.17	9.00
Sep-21	5.07	8.92
Dec-21	5.04	8.86
Mar-22	5.03	8.74
June-22	5.13	8.92
Sep-22	5.38	9.23

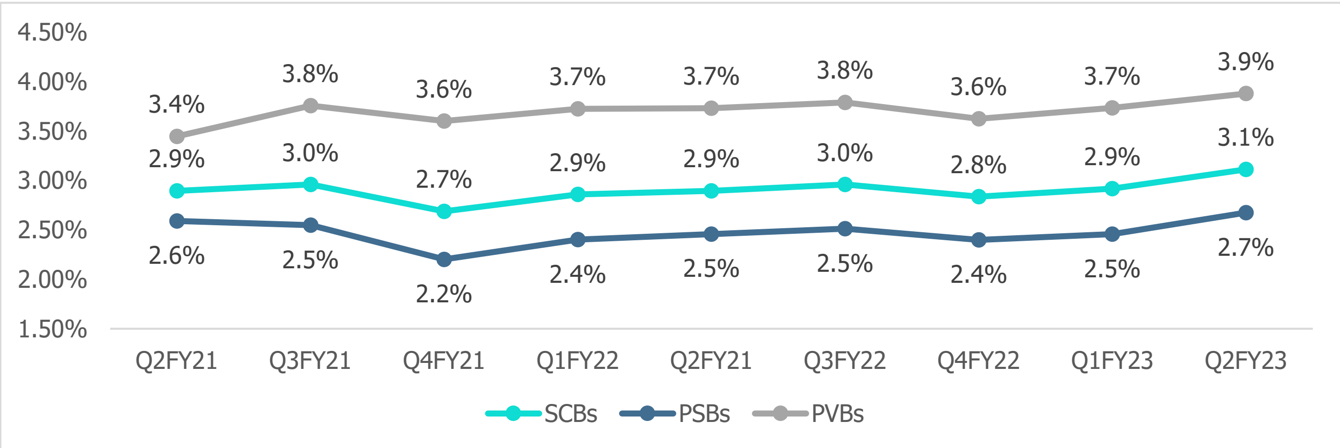
Source: RBI

The interest rate had been trending down since September 2019 due to accommodative monetary policy, however, the trend has reversed since April 2022 and is expected to continue due to an increase in policy rates driven by elevated inflation. RBI has already increased the repo rate by 190 bps to 5.9% (four hikes so far) in FY23 in trend with global central banks and more hikes are anticipated in the current fiscal due to elevated inflation. The last hike of 50 bps in the repo rate was on September 30, 2022, which has not been reflected in these numbers. The rates for near-term bulk deposits have, however, shot up. The Daily Weightage Average Call Money rate stood at 5.55% as on September 30, 2022, which reached higher than the pre-covid level of 4.9% (as on February 28, 2022). Moreover, the call rate increased by 70.8% y-o-y, and 69.7% since the beginning of FY23.

Net Interest Margins

- NII of SCBs grew by 21.9% y-o-y to Rs.1.61 lakh crore in Q2FY23. The growth was due to a healthy improvement in credit offtake, a higher yield on advances driven by the repricing of loans and a lagged increase in deposit rates. The gross advances of SCBs rose by 19.4% to Rs.129.7 lakh crore, while PVBs and PSBs reported an increase of 20.6% and 18.7%, respectively, during the period.
- Interest income of SCBs rose by 18.2% y-o-y in Q2FY23 wherein PVBs rose by 21.2%, while PSBs reported a rise of 16.2%. On the other hand, interest expenses of SCBs rose by 15.1% in Q2FY23, wherein PVBs rose by 17.8% while PSBs reported a lower rise at 13.6% in the same period.
  - Weighted Average Lending Rate (WALR) for outstanding loans and Weighted Average Domestic Term Deposit Rate (WADTDR) of SCBs has been falling since the beginning of FY20. However, lending and borrowing rates rose by 31 bps each y-o-y in September 2022, indicating a trend reversal.
  - On a q-o-q basis, WALR for outstanding loans of SCBs rose by 31 bps to 9.23% in September 2022 from June 2022, whereas WADTDR rose by 25 bps to 5.38% in the same period.

Figure 2: Movement in NIMs – PVBs Reported Highest Margin in the Last 23 Quarters

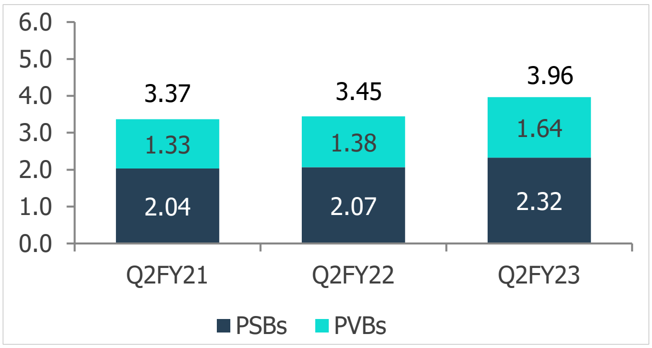


Source: Ace Equity and banks presentations

- NII of PSBs and PVBs grew by 19.8% and 24.5% y-o-y, respectively, in Q2FY23. PVBs reported a higher NII growth as compared to PSBs, indicating their strong franchise with both depositors and borrowers.
- NIM of SCBs improved by 22 bps y-o-y at 3.1% in Q2FY23, within this, PSBs improved 22 bps at 2.7%, whereas PVBs rose by 15 bps at 3.9%.

Total Income

Figure 3: Total Income of SCBs (Rs. Lakh – Crore)



Source: Ace Equity

Total income of SCBs rose by 15.1% y-o-y to Rs.3.96 lakh crore in Q2FY23. Interest income of SCBs grew by 18.2% in Q2FY23, whereas non-interest income dropped by 1.1% due to MTM losses primarily on the PSBs investment book driven by hardening bonds (G-Sec) yields. The hit was much lower on it as compared to Q1FY23 as yield on bonds stabilised in Q2FY23. Non-interest income of PVBs witnessed a rise of 7.9% whereas PSBs reported a drop of 8.2% in Q2FY23 on y-o-y basis.

Operating Expenses (Rs. Lakh – Crore)

Figure 4: Employee Costs

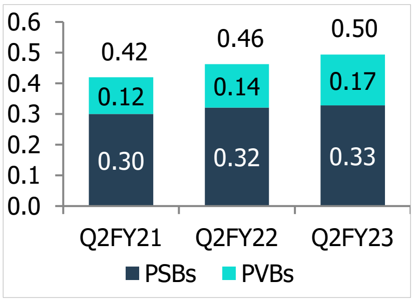


Figure 5: Other Op. Expenses

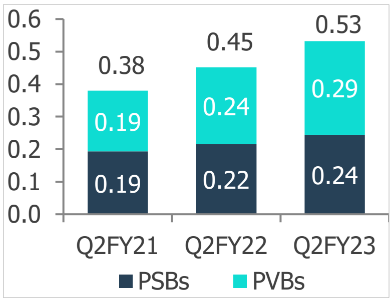
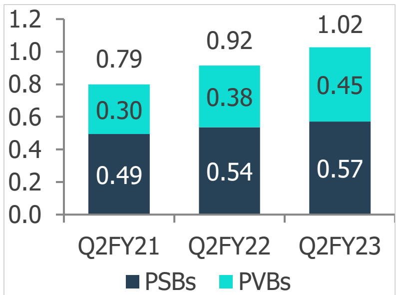


Figure 6: Total Op. Expenses



Source: Ace Equity

- The operating expenses of SCBs rose by 12.2% y-o-y to Rs.1.02 lakh crore in Q2FY23 due to an increase in other expenses attributed to higher retail credit growth, a rise in technological expenses, an increase in employee count for PVBs and higher other operating expenses.
- Other operating expenses-(rent, advertising, depreciation, amortization, printing, stationery and, etc.) accounted for 51.9% of total operating expenses in Q2FY23 vs 49.4% in Q2FY22.
- Employee expenses witnessed a marginal rise of 2.1% y-o-y in Q2FY23 whereas other operating expenses rose by 13.3%. The wage revision is expected to take place for the PSBs employees in the next couple of quarters. This will increase the operating costs, hence cost to income ratio is expected to go up.
- Operating expenses of PVBs saw a rise of 20.3% y-o-y in Q2FY23 as other operating expenses rose by 22.2%, while employee expenses increased by 17.1%.

Figure 7: Movement of Cost to Income Ratio and PPOP Margin (%)

	Q2FY21	Q2FY22	Q2FY23
Cost to Income Ratio (%)			
PSBs	52.1	51.3	49.1
PVBs	41.0	45.4	45.7
SCBs	47.2	48.7	47.5
PPOP Margin (%)			
PSBs	1.7	1.7	1.8
PVBs	2.9	2.9	2.9
SCBs	2.1	2.1	2.2

Source: Ace Equity, CareEdge Calculations

- Cost to income ratio of SCBs dropped by 122 bps y-o-y to 47.5% due to higher growth in NII than operating expenses. Contracting of PSBs cost to income ratio helped SCBs a reduction in the ratio, whereas for PVBs it marginally rose by 30 bps to 45.7% due to a higher run rate in operating expenses (20.2%).
- PPOP of SCBs rose by 17.8% y-o-y to Rs.1.13 lakh crore in Q2FY23 due to higher growth in NII and managed growth in operating expenses. Reflection of NII in the PPoP partially offset by a drop in the non-interest income. PPOP margin of SCBs rose by 8 bps y-o-y to 2.2% in Q2FY23 driven by PSBs.

Asset Quality

Figure 8: Gross and Net NPAs (Rs. Lakh – Crore)

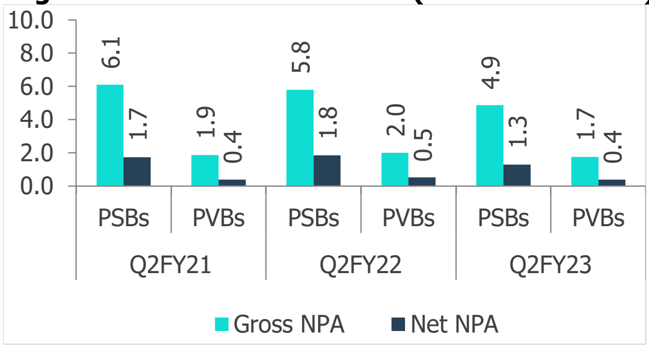
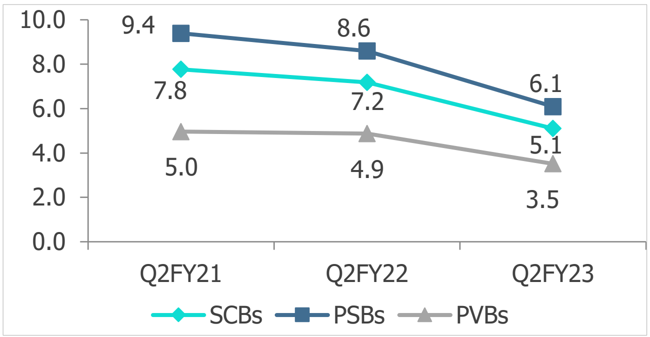


Figure 9: Gross NPA Ratio (%)



Source: Ace Equity, CareEdge Calculations

- Despite an increase in advances by 19.4% (y-o-y), the GNPAs of SCBs dropped by 15.1% to Rs.6.6 lakh crores as of September 30, 2022, vs Rs.7.8 Lakh crores as of September 30, 2021. GNPAs of PSBs reduced by 15.8% y-o-y to Rs.4.9 lakh crore in Q2FY22 due to lower slippages, a significant reduction in SMA account balances and stable recoveries driven by a pick-up in economic activities and scheduled write-offs.
- Generally, SCBs continued to witness a reduction in slippages. PSBs slippages dropped by 42.9% y-o-y in Q2FY23 to Rs.0.25 lakh crore from Rs.0.43 lakh crore in Q2FY22. Overall, their stress has reduced as also outstanding SMAs in the quarter.
- The GNPA ratio of SCBs reduced to 5.1% as of September 30, 2022, from 7.2% as of September 30, 2021, and 7.8% as of September 30, 2020, which was majorly driven by PSBs.
- Credit cost of the SCBs declined to 0.7% in Q2FY23 from 0.9% in Q2FY22. For PVBs, it declined to 0.6% in Q2FY23 from 1.2% in Q2FY22, whereas for PSB, it marginally rose by 6 bps to 0.7% in Q2FY23.
- Reflecting the improvement of GNPAs, the Net Non-Performing Assets (NNPAs) of SCBs too dropped by 25.4% y-o-y to Rs.1.7 lakh crore in Q2FY23. The NNPA ratio of SCBs too reduced to 1.3% from 2.3% in Q2FY22. NNPAs of PSBs dropped by 122 bps to 1.7% whereas PVBs reported a drop of 54 bps to 0.8% in Q2FY23.

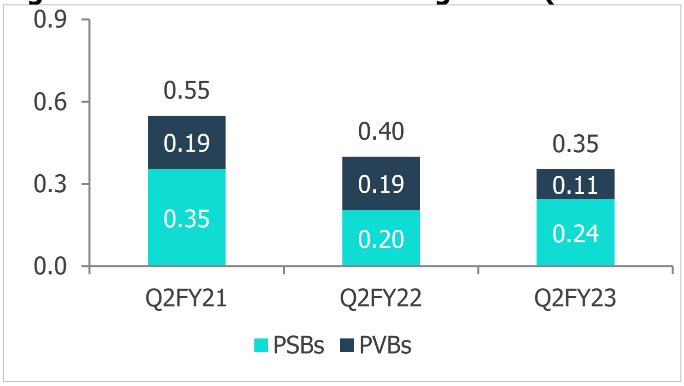
Figure 10: Fresh Slippages of Select Banks (Rs. Crore) – Sharp Declines in PSBs

PSBs	Q2FY22	Q1FY23	Q2FY23	PVBs	Q2FY22	Q1FY23	Q2FY23
SBI	4,176	9,740	2,399	HDFC**	5,300	7,200	5,700
BoB	5,223	3,266	3,479	ICICI*	5,578	5,825	4,366
PNB	7,620	5,890	5,301	Axis	5,464	3,684	3,383
UBI	6,141	3,714	2,702	IndusInd	2,658	2,250	1,572
Canara	6,525	3,606	3,523	Kotak	1,217	654	983
Total	**29,685**	**26,216**	**17, 404**	**Total**	**20,217**	**19,613**	**16,004**

Source: Banks Presentation, * Gross additions, ** Excluding one-off items and seasonal Agri

Provisions and Contingencies (Profit & Loss)

Figure 11: Provisions and contingencies (Rs. Lakh - Crore)



Source: Ace Equity, CareEdge Calculations

- SCBs provisions declined by 11.5% y-o-y to Rs.0.35 lakh crore in Q2FY23 due to improvement in asset quality and with banks already holding a substantial buffer for provisions.
- The SCBs already maintain a high level of provisioning to manage uncertainties caused by the pandemic, however, they have not fully utilized the same, which has led to lower incremental provisions.
- The Provision Coverage Ratio (PCR) has generally been on an uptrend since Q4FY21. The aggregate PCR has improved by 483 bps (y-o-y) to 74.7% in Q2FY23. Hence, SCBs are better placed compared to the previous quarter in the last year.

Capital Adequacy Ratio (CAR)

Figure 12: CAR Median (%)

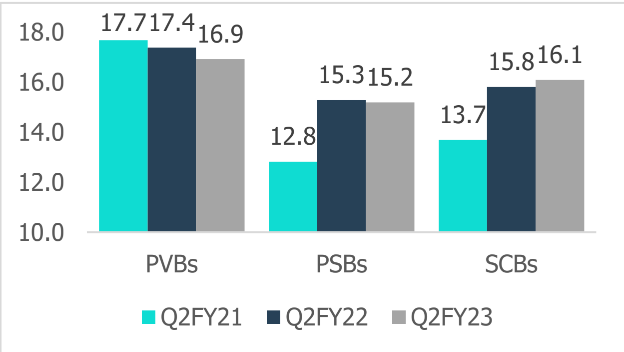
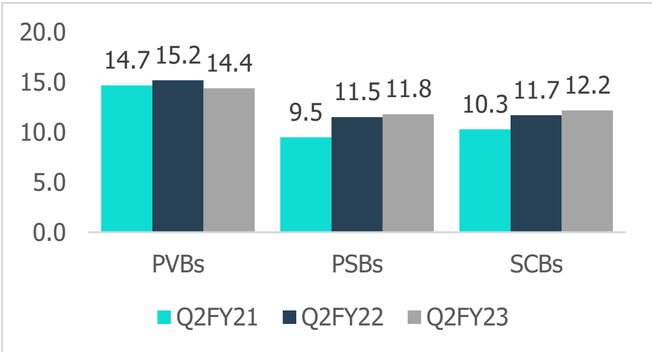


Figure 13: Common Equity Tier 1 Ratio Median (%)



Source: Banks Presentations and Ace Equity Calculations,
Note 1: 12 PSBs and 6 PVBs are taken for Median calculation, Note 2: 11 PSBs and 7 PVBs are taken for median calculation

- All SCBs have maintained CAR greater than the minimum required ratio for Q2FY23, indicating that they are well capitalized. The median CAR of SCBs witnessed a rise from Q2FY21 to Q2FY23 driven by PSBs, indicating a better and stable position. The Median Common Equity Tier 1 (CET-1) ratio of SCBs too witnessed a healthy rise in Q2FY23 from Q2FY21 and Q2FY22 driven by PSBs.
- To support the anticipated credit growth, banks are expected to shore up their liability franchise by raising capital and deposits in FY23. The market has been facing liquidity issues and elevated inflation, hence borrowing costs for the deposits and the cost of raising capital are expected to go up in the coming quarters.

Net Profit and Return on Assets

Figure 13: Trend in net profit (Rs. Lakh, Crore)

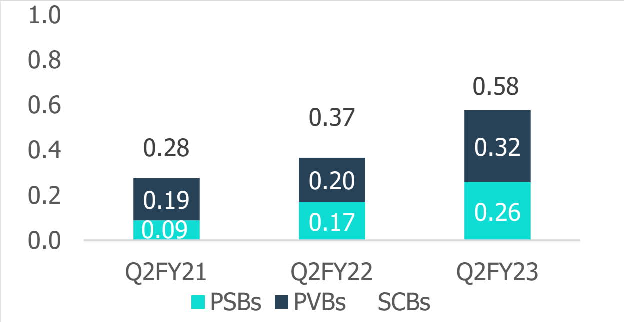
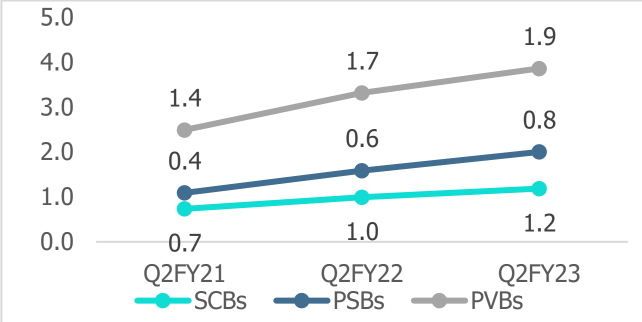


Figure 14: Movement of RoA (annualized, %)



Source: Banks' Presentations, Ace Equity

- The net profit of SCBs grew by 57.5% y-o-y to Rs.0.58 lakh crore in Q2FY23 due to the improvement in PPoP and decline in credit costs. In absolute terms, total PPoP of SCBs rose by Rs.0.17 lakh crore in Q2FY23 from Q2FY22 whereas net profit rose by Rs.0.21 lakh crore in the same period. The net profit of PVBs rose by 64.2% y-o-y to Rs.0.32 lakh crore in Q2FY23 whereas PSBs reported a rise of 49.9% to Rs.0.26 lakh crore.
- The RoA of SCBs improved by 19 bps y-o-y from 1.0% in Q2FY22 to 1.2% in Q2FY23 whereas PSBs improved by 22 bps to 0.8% in Q2FY23. Meanwhile, RoA of PVBs rose by 13 bps at 1.9% in Q2FY23 (y-o-y).

Outlook

- The banking sector's operational and credit growth performance is expected to continue for FY23. The credit growth is expected in double-digit for FY23, as previously estimated by CareEdge; however, multiple rate hikes may slow the credit growth.
- RBI has already increased the repo rate four times in FY23 (to date), and additional hikes are anticipated during the year. Deposit rates are also expected to rise as the competition for deposits would increase due to liquidity issues amidst strong underlying credit demand, coupled with a widening difference between credit and deposit growth rates. Term deposits are expected to rise faster than CASA over the next couple of quarters.
- Banks that have a higher CASA share and proportion of floating loans are expected to benefit and protect the NIM in the current rising interest scenario. NIMs are expected to increase in the short term and then stabilise with negative bias due to the repricing of liabilities.
- The banks have already witnessed significant treasury losses in Q1FY23, further, the yields on bond have stabilised in Q2FY23. As per the CareEdge Report titled " India: The Economic Pathway, October 2022", the yield on 10 years G-sec is expected to be around 7.5%-7.75%. Hence, incremental MTM losses are not likely to be as severe in the coming quarters. Nevertheless, treasury income is expected to be muted for FY23.
- The GNPA ratio of SCBs is expected to be around 5.0% in FY23 and reach pre-AQR levels of approximately 4.0% in FY24 due to lower incremental slippages, SMAs, and reduction in restructured books. Nevertheless, the performance of restructured accounts especially for the MSME segment continues to be a key monitorable. Sales of NPAs to, especially to newly set-up asset reconstruction companies (ARCs) are expected to further clean up the books and bring liquidity to the banks.
- Banks have raised substantial capital over the last few years and currently are well capitalised. Besides, they are expected to raise Tier 2 capital and deposits from the market to meet strong credit demand.

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