

India's banking sector: ...through the lens of **NIFTY Bank Index**



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Executive Summary

In November 2017, domestic and foreign inflows in the Indian markets increased owing to previous month's news of government's plan to recapitalise public sector banks as well as positive developments in the economy in the current month.

Credit rating agency, Moody's Investors Service, upgraded India's sovereign bond rating from Baa3 to Baa2 with a stable outlook stating that government reforms has reduced the risk of a significant increase in debt.

India's September 2017 quarter GDP also saw an upward trend at 6.3% as compared to previous quarter's GDP of 5.7%. This rise indicated that the economy has shrugged off the effects of demonetisation and GST.

NIFTY Bank Index closed at 25,332 on 30th November 2017, 1.3% higher than the previous month.

The NIFTY Bank Index has returned a strong performance of 39.4% since the beginning of the year, as the largest constituents of the index, i.e., HDFC Bank, ICICI Bank and Kotak Mahindra Bank, delivered robust performance.

In November 2017, the volume of Future contracts traded for NIFTY Bank index decreased to 1.54 million from 1.60 million on a month-on-month basis, whereas volume of Option contracts traded during the same period increased by 17.2% to reach 86.6 million.

At the end of November 2017, there were 2.7 million open interest positions in Futures and 23.9 million open interest positions in Options.

Among key global indices tracking the banking sector, NIFTY Bank was one of the top performers on a month-on-month basis; whereas, it outperformed them on a year-to-date basis. Overall, Indian banks have so far produced the best total returns among key global banks this year.

1. Returns and Valuation Ratios

- NIFTY Bank Index closed at 25,332 on November 30, 2017, 1.3% higher than the previous month
- State Bank of India outperformed peers by a wide margin, rising 4.8% on a month-on-month basis
- Punjab National Bank performed weaker than all other constituents, delivering a negative return of 10.7%

Returns and Valuation

Index Returns

The NIFTY Bank Index has returned an attractive 39.4% since the beginning of the year, primarily driven by stronger performance of the three largest constituent banks, i.e., HDFC Bank, ICICI Bank and Kotak Mahindra Bank. HDFC Bank share price grew 53.7% YTD, ICICI grew by 32.5% and Kotak grew by 39%, similarly. This was weighed against weaker performance showed by IDFC Bank. However, November 2017 saw bank stocks deliver relatively muted performance of only 1.3% due to selling pressure and unfavourable global cues.

Index Returns and Constituent Level Performance (%)

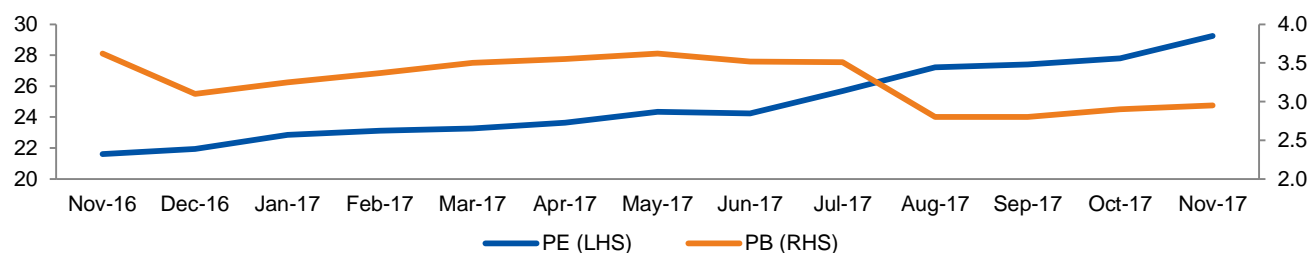
	1M	3M	6M	12M	YTD	2YR*	5YR*
NIFTY Bank	1.3	4.2	8.1	36.0	39.4	20.6	15.8
Axis Bank Ltd.	2.3	7.0	4.2	14.0	19.0	6.8	15.2
Bank of Baroda	-0.5	22.7	-5.0	3.0	10.2	-3.0	2.1
Canara Bank	-8.1	9.7	6.3	20.4	45.8	18.7	-3.8
Federal Bank Ltd.	-9.1	2.1	-0.7	56.3	65.5	37.3	18.1
HDFC Bank Ltd.	2.5	4.3	13.3	54.5	53.7	31.1	21.4
ICICI Bank Ltd.	2.5	3.2	3.6	27.4	32.5	11.0	9.0
IDFC Bank Ltd.	-3.1	0.1	-4.6	-19.8	-8.6	-3.6	NA
IndusInd Bank Ltd.	2.1	0.3	12.2	52.9	50.0	33.3	31.9
Kotak Mahindra Bank Ltd.	-2.4	2.5	3.5	32.4	39.0	20.2	24.4
Punjab National Bank	-10.7	22.5	17.0	27.5	52.5	10.3	2.3
State Bank of India	4.8	15.3	11.1	24.0	28.0	13.2	8.1
Yes Bank Ltd.	-2.3	-12.5	7.2	30.7	32.7	41.3	28.3

Source: Thomson Reuters; Note: * - Annualised percentage returns, YTD as of November-end 2017

Valuation

Price-to-Book (PB) valuation for NIFTY Bank Index reached 2.95 in November 2017. Kotak Mahindra Bank is trading as the most expensive among all, followed by HDFC Bank, which have PB ratios of 5.0 and 4.5 respectively. Canara Bank has the lowest PB valuation, owing to relatively poor asset quality.

Figure 1: Index Valuation (x)



Source: NSE

2. Earnings & Growth Estimates; Analysis of Ratios and other Key Parameters

- Earnings of NIFTY Bank Index constituent's increased by 3% in second quarter of FY2018
- Yes Bank was the most profitable, with ROE of 18.7%
- In the second quarter of FY2018, Bank of Baroda's profits plunged by 14% and State Bank of India's by 12%.

Financial Performance of NIFTY Bank Index

NIFTY Bank Index aggregate earnings in the second quarter of FY2018 recovered to USD 2.39 billion. Revenues during the period totalled to USD 12.32 billion. Reserve Bank of India's directive to conservatively account for banking non-performing assets (NPAs) resulted in higher write-offs by all banks, thus lowering net profits margins, which stood at 21.5%. The bottom-line is expected to bounce back in FY2018, at an estimated growth rate of 45%, compared to FY2017 levels.

Index constituent highlights

HDFC Bank and Yes Bank emerged at the top with 18.4% and 18.7% return on equity (ROE), respectively. Net profit margins for the two banks stood at 31.8% and 33.3%, respectively, well above the Index average of 21.5%. IndusInd Bank closely followed, with a 15% ROE. IDFC and Kotak Mahindra are well capitalised, with Tier 1 risk adjusted capital ratio at 18.5 and 16.5 respectively.

Revenue and Earnings Forecast (USD billion)

	Revenue Estimates				Earnings Estimates			
	FY2017	FY2018E	FY2019E	Past 5 year Revenue CAGR (%)	FY2017	FY2018E	FY2019E	Past 5 year PAT CAGR (%)
NIFTY Bank Index	65	51	58	13.2	8.6	9.8	14.1	23.4
<i>Bank Level Performance</i>								
Axis Bank	4.75	2.98	3.46	12.3	0.57	0.71	1.28	-6.6
Bank of Baroda	3.52	3.30	3.67	3.7	0.21	0.32	0.63	-25.8
Canara Bank	2.74	2.89	3.14	5.3	0.17	0.21	0.36	-22.3
Federal Bank	0.65	0.57	0.69	5.8	0.13	0.17	0.23	-2.2
HDFC Bank	7.42	8.59	10.18	14.6	2.25	2.71	3.32	17.6
ICICI Bank	12.11	3.62	4.11	8.2	1.53	1.37	1.83	4.4
IDFC Bank	0.48	0.50	0.62	NM	0.16	0.17	0.20	NM
IndusInd Bank	1.58	2.00	2.51	24.2	0.44	0.58	0.77	23.5
Kotak Mahindra Bank	3.47	1.99	2.35	16.0	0.77	0.89	1.10	17.4
Punjab National Bank	3.78	3.86	4.23	1.4	0.21	0.33	0.61	-25.6
State Bank of India	23.06	18.85	20.40	6.0	1.62	1.64	2.99	-5.5
Yes Bank	1.54	1.98	2.48	26.0	0.52	0.64	0.81	22.6

Source: Thomson Reuters, FY2018E and FY2019E forecasts are consensus from various brokers on Reuters. IISL and Aranca are not responsible for any deviations from the estimates, exchange rate as of November 30, 2017.

Figure 1: Profitability Ratios (%)

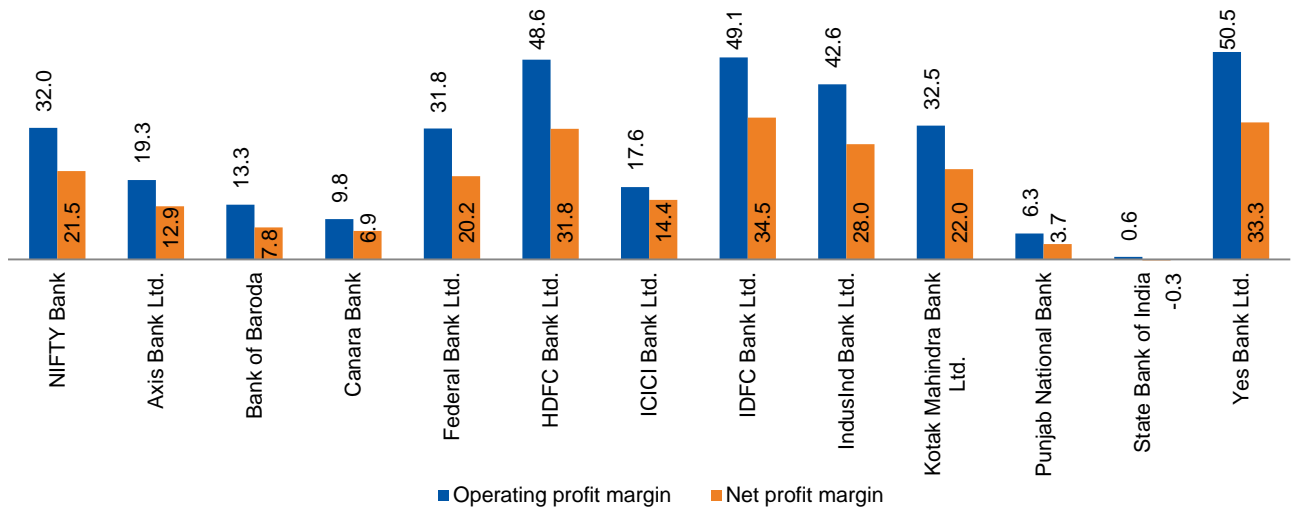


Figure 2: Returns Profile (%)

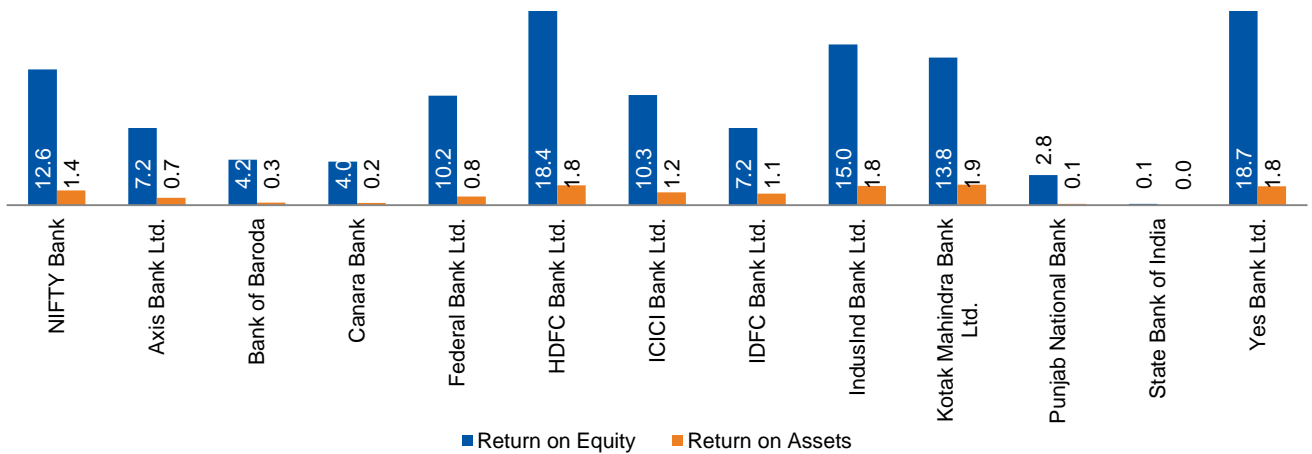


Figure 3: Leverage Ratios (x)

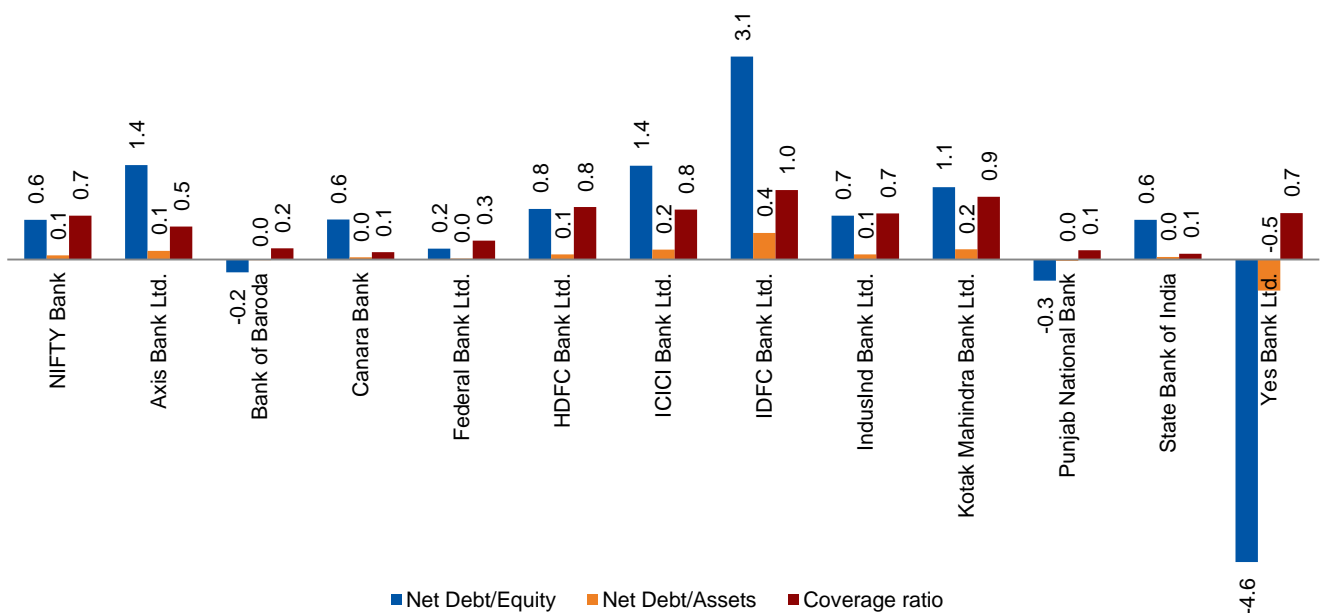


Figure 4: Turnover Ratios (x)

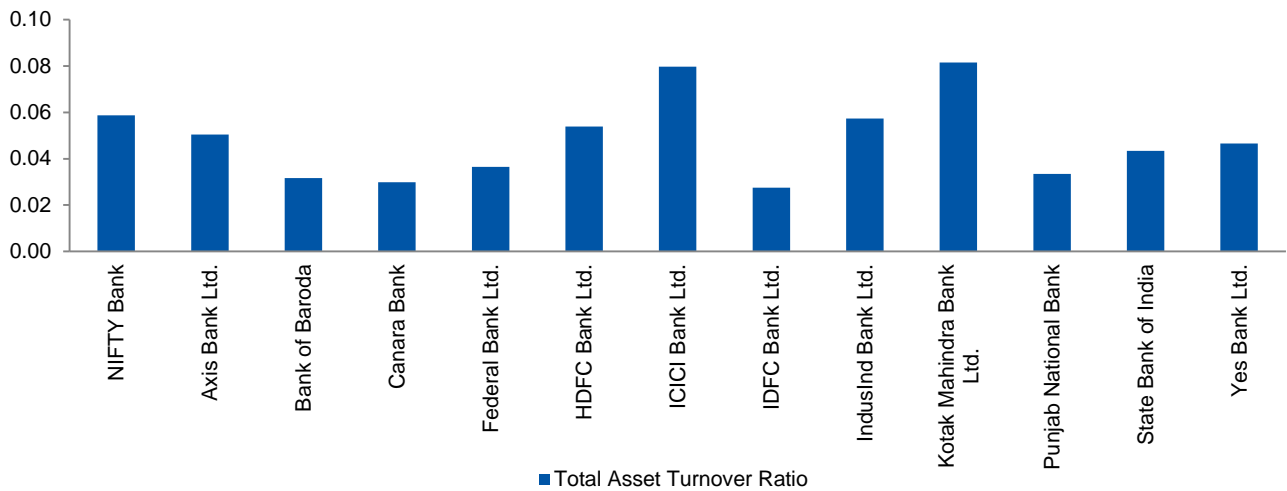


Figure 5: Cash Flow Ratio (x)

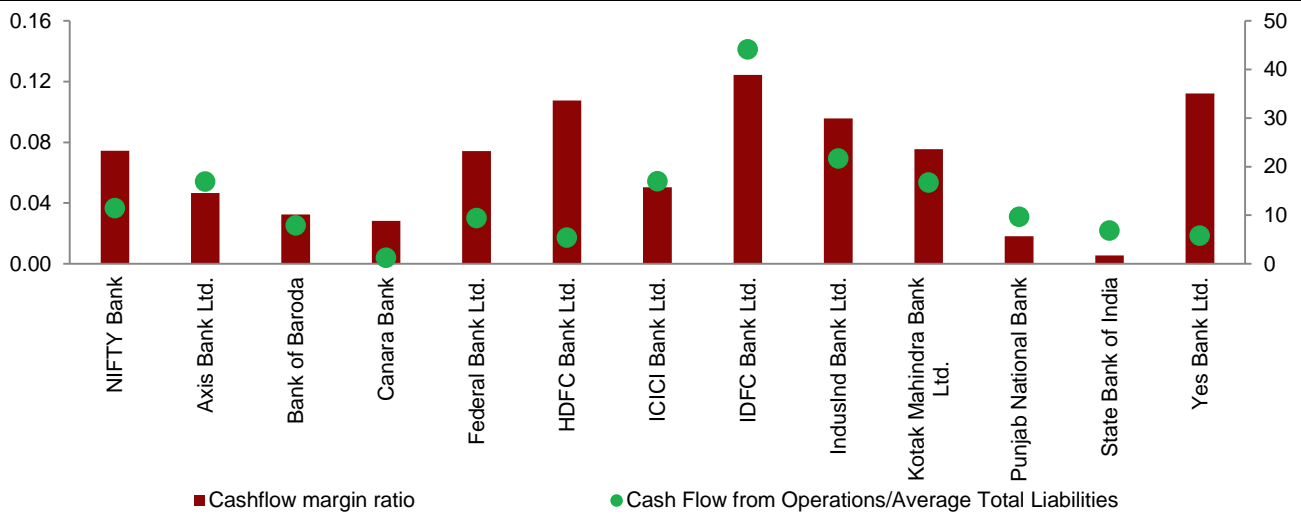
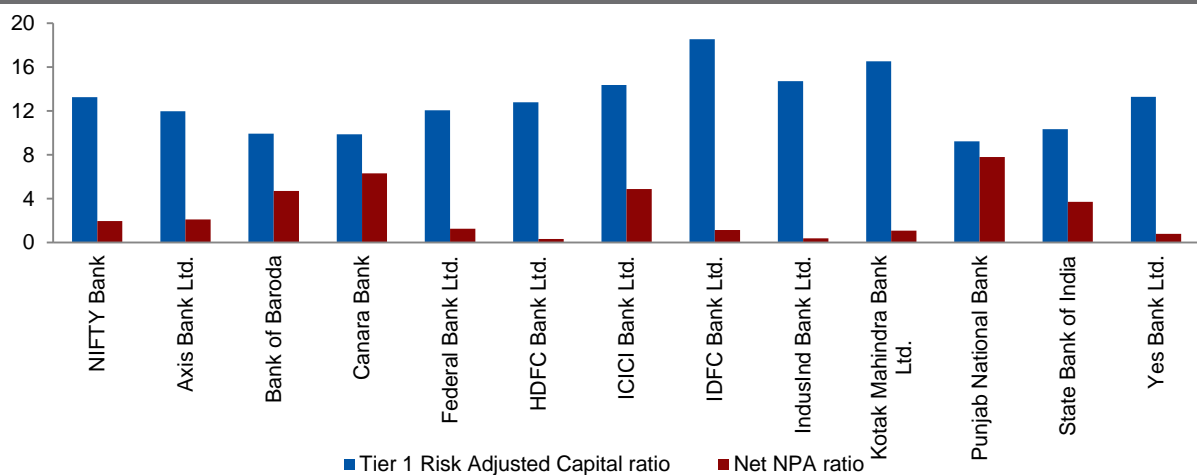


Figure 6: Capital ratio and NPA ratio



Source: Thomson Reuters

3. News Updates (Macro economy, Regulations, Key developments)

- Bank recap to drive GDP growth to 8% in next fiscal
- World Bank Group and HDFC create fund to finance affordable houses
- Paypal launches operations in India
- Largest Dubai lender Emirates NBD enters India
- India's fintech adoption rate exceeds global average

Top Financial Sector News – November 2017

Bank recap to drive GDP growth to 8% in next fiscal

According to a Goldman Sachs report, GDP growth in the economy is expected to reach 8% in the next fiscal on the government's bank recapitalisation plans. Last month, the government announced a recapitalisation plan worth USD 32 billion for public sector banks. The recapitalisation plan, as per the report, would help revitalise long-stalled credit demand and private investments, which would aid economic growth at a faster pace.

Source: Press Trust of India (Nov 27, 2017)

World Bank Group and HDFC create fund to finance affordable houses

HDFC Ltd. and The World Bank Group plan to create a fund worth USD 800 million to finance the construction of affordable houses. Builders of houses that qualify as affordable housing under the Pradhan Mantri Awas Yojana (PMAY) can access this fund. The HDFC-managed fund would be available for five years. Creditworthiness, track record and an ability to develop the project would be factors considered while deciding loan pricing and selecting developers. The World Bank's arm, the International Finance Corporation (IFC), would put in USD 200 million by subscribing to masala bonds (rupee-denominated instruments) issued by HDFC and to be listed on the London Stock Exchange (LSE), whereas HDFC would contribute USD 600 million from its own resources.

Source: Hindustan Times (Nov 16, 2017)

Paypal launches operations in India

Global payments aggregator Paypal Holdings started operations in India. The firm, which so far offered cross-border payment options to merchants in India, now offers payment options to both customers and merchants for domestic transactions. The launch date of Paypal's wallet in the country has not yet been decided, but the firm intends to offer other products such as working capital to micro, small and medium sized enterprises (MSMEs), consumer credit, peer-to-peer (P2P) transactions and remittances, etc.

Source: Live Mint (Nov 08, 2017)

Largest Dubai lender Emirates NBD enters India

Emirates NBD, Dubai's largest lender, set up its fifth international branch (its first in India) at Mumbai's Bandra Kurla Complex. The group would reportedly invest USD 100 million on its Indian operations and serve corporate, SME, institutional clients and NRIs. The branch would offer a range of services including trade

finance, treasury services, bilateral and syndicated loans and also support NRIs seeking cross-border wealth-management solutions.

Source: Press Trust of India (Nov 09, 2017)

India's fintech adoption rate exceeds global average

According to the EY FinTech Adoption Index, the level of financial technology (FinTech) usage among digitally active Indian consumers has increased over the past two years and overtaken the global average. India with a 52% fintech adoption rate among digitally active consumers is second only to China, which has a 69% adoption rate. Large cities have a significantly high adoption rate at 66%, whereas medium and small cities have a 51% adoption rate. Rural usage reportedly stands at 33%; this rate is expected to increase over the next few years due to various government initiatives. The change in India is being driven by money transfers and payments services that clocked an adoption rate of 72% in the current year.

Source: Press Trust of India (Nov 10, 2017)

4. Trading statistics

- Volumes for Call Options on the NIFTY Bank Index increased by 16.5% on a month-on-month basis during November 2017, but value traded decreased by 21.4%
- Volume for Put Options on the NIFTY Bank Index increased by 17.9% on a month-on-month basis during November 2017, but value traded decreased by 20.2%
- Open interest in NIFTY Bank Futures increased by 58.8% from 1.7 million contracts to 2.7 million contracts in November 2017

Trends in Trading Activity

During November 2017, trading activity for NIFTY Bank futures stood at 1.54 million contracts, compared to an average of 1.64 million contracts in the last twelve months. However, the turnover of the NIFTY Bank futures remained flat on a month on month basis at USD 24.2 billion. Turnover for call options decreased by 21.39% on a month-on-month basis, whereas turnover for put options decreased by 20.24% during the same period. Open Interest in put options on the NIFTY Bank stood at 8.9 million contracts (vs 9.5 million in October), whereas, the open interest for call options stood at 15 million contracts (vs 8.2 million in October).

Figure 1: Average Daily Turnover in NIFTY Bank Index Futures & Options Market (in USD billion)

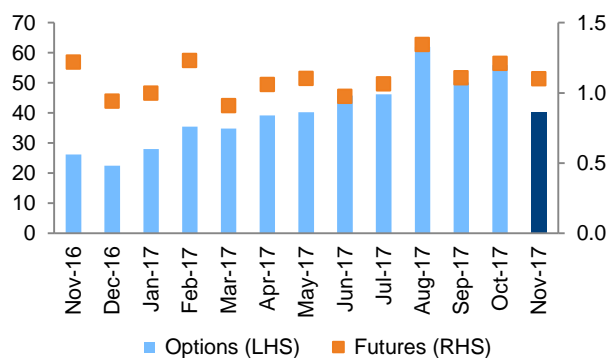


Figure 2: Open Interest in NIFTY Bank Index Futures & Options (in million)

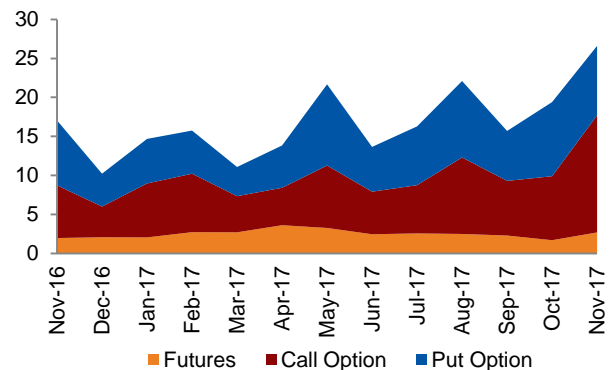


Figure 3: Value of transactions in NIFTY Bank Index Call and Put Options (in USD billion)

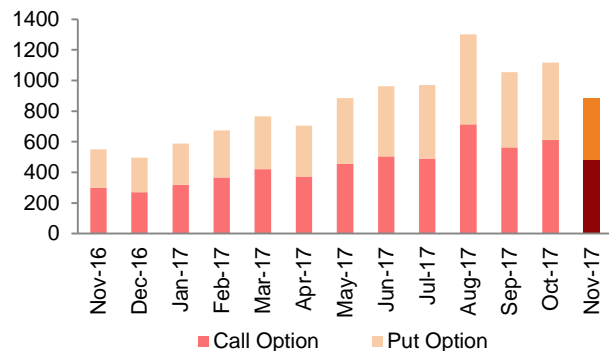
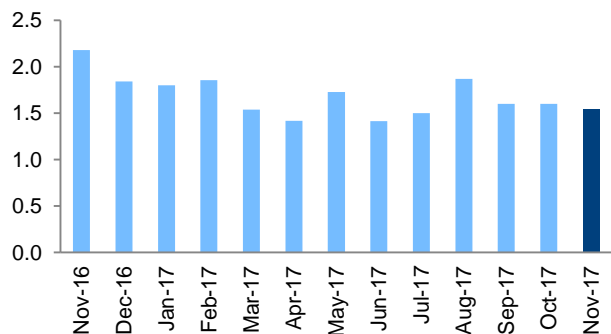


Figure 4: No. of NIFTY Bank Index Future contracts traded (in millions)



Source: NSE

5. Comparison with key Global Indices

- NIFTY Bank Index gained 1.3% during November 2017, on a month-on-month basis
- Nikkei Bank Index, STOXX Europe 600 Bank Index and FTSE Bank Index declined in November 2017
- DAX Bank Index was the top performer, followed by S&P 500 Banks Industry Group Index and NIFTY Bank Index

Movement in Key Global Bank Indices

NIFTY Bank Index gained 1.3% during the month of November 2017, which was relatively low as compared to other more established bank indices across the spectrum of developed markets. Still, it was better than its European and Japanese bank sector indices which delivered negative returns during the month.

NIFTY Bank Index outperformed all the major global bank indices on a YTD basis, gaining 39.4%. Nasdaq Hong Kong Bank Index also performed better than the other indices, registering 21.4% returns during the same period.

Index Returns (%)

	1M	3M	6M	12M	YTD	2YR*	5YR*
NIFTY Bank Index	1.3	4.2	8.1	36.0	39.4	20.6	15.8
S&P 500 Banks Industry Group Index	2.7	13.4	20.3	23.1	16.7	17.6	NA
STOXX Europe 600 Bank Index	-2.1	1.0	1.1	15.3	7.1	-2.8	2.7
FTSE Bank Index	-0.4	-0.5	2.4	11.6	7.0	7.9	0.5
DAX Bank Index	9.9	16.5	9.0	35.1	19.0	-6.5	-4.9
Nikkei Bank Index	-4.6	6.4	6.9	6.6	0.4	-6.2	9.2
Nasdaq Hong Kong Bank Index	0.2	0.5	8.9	20.9	21.4	12.6	NA

Source: Thomson Reuters, Bloomberg; Note: * - Annualised percentage returns, YTD as of November-end 2017

Correlation of Key Global Bank Indices

	NIFTY Bank	S&P500	STOXX	FTSE 350	DAX Bank	NIKKEI 500	Nasdaq HK
NIFTY Bank	1.0						
S&P 500 Banks	0.6	1.0					
STOXX Europe 600 Bank	0.7	0.4	1.0				
FTSE 350 Bank	0.6	0.6	0.6	1.0			
DAX Bank	0.5	0.5	0.6	0.5	1.0		
Nikkei 500 Bank	0.0	0.3	-0.1	0.4	0.1	1.0	
Nasdaq Hong Kong Bank	0.9	0.7	0.7	0.8	0.4	0.1	1.0

Source: Thomson Reuters, Bloomberg

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For more information, please visit: www.niftyindices.com

Key NSE Indices

Broad Based Indices	Sectoral Indices	Thematic Indices	Strategy Indices
NIFTY50*	NIFTY AUTO	NIFTY ADITYA BIRLA GROUP	NIFTY 100 EQUAL WEIGHT
NIFTY NEXT 50*	NIFTY BANK*	NIFTY COMMODITIES	NIFTY 100 LOW VOLATILITY 30*
NIFTY100*	NIFTY FINANCIAL SERVICES	NIFTY CPSE*	NIFTY50 ARBITRAGE
NIFTY200	NIFTY FMCG	NIFTY ENERGY	NIFTY50 FUTURES PR
NIFTY500	NIFTY IT	NIFTY INDIA CONSUMPTION*	NIFTY50 FUTURES TR
NIFTY MIDCAP 150	NIFTY MEDIA	NIFTY INFRASTRUCTURE*	NIFTY ALPHA 50
NIFTY MIDCAP 50	NIFTY METAL	NIFTY MAHINDRA GROUP	NIFTY ALPHA LOW VOLATILITY 30
NIFTY FULL MIDCAP 100	NIFTY PHARMA	NIFTY MIDCAP LIQUID 15	NIFTY ALPHA QUALITY LOW VOLATILITY 30
NIFTY FREE FLOAT MIDCAP 100*	NIFTY PRIVATE BANK	NIFTY MNC	NIFTY ALPHA QUALITY VALUE LOW VOLATILITY 30
NIFTY SMALL CAP 250	NIFTY PSU BANK*	NIFTY PSE	NIFTY DIVIDEND OPPORTUNITIES 50*
NIFTY SMALL CAP 50	NIFTY REALTY	NIFTY SERVICES SECTOR	NIFTY GROWTH SECTORS 15
NIFTY FULL SMALL CAP 100		NIFTY SHARIAH 25	NIFTY HIGH BETA 50
NIFTY FREE FLOAT SMALL CAP 100		NIFTY TATA GROUP	NIFTY LOW VOLATILITY 50
NIFTY MIDSMALLCAP 400		NIFTY TATA GROUP 25% CAP	NIFTY QUALITY 30*
NIFTY LARGEMIDCAP 250		NIFTY100 LIQUID 15	NIFTY QUALITY LOW VOLATILITY 30
		NIFTY50 SHARIAH*	NIFTY50 DIVIDEND POINTS
		NIFTY500 SHARIAH	NIFTY50 EQUAL WEIGHT
			NIFTY50 PR 1X INVERSE*
			NIFTY50 PR 2X LEVERAGE*
			NIFTY50 TR 1X INVERSE*
			NIFTY50 TR 2X LEVERAGE*
			NIFTY50 USD
			NIFTY50 VALUE 20*

*index used as a benchmark for ETFs

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