



# VANTAGEPOINT

Our Focus Makes All The Difference

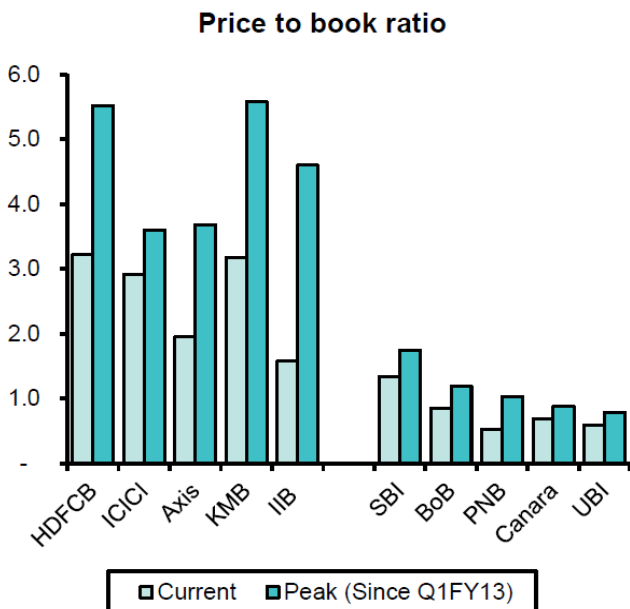
Dear Investor,

Hope you and your families are doing well!

The Q3 FY 23 earnings season turned out to be outstanding for **many banks** on account of growth in advances, increase in margins, maintaining comfortable asset quality and generating highest ever profits after tax. The concerns relating to the impact on asset quality due to the pandemic have abated and the slowdown concerns in the economy were neither reflected in the performance numbers nor in the management outlook. Banking was the leading sector of the market that saw earnings upgrades from the analysts.

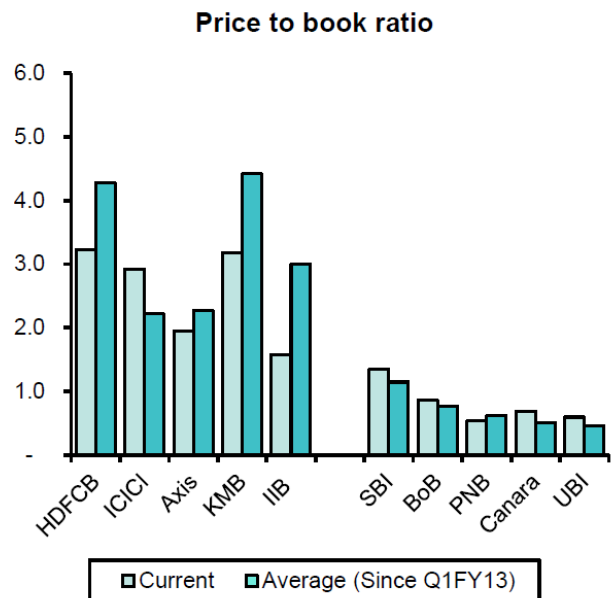
Despite the strong performance, the valuations of most of these banks are below their long-term averages. Exhibits 1 & 2 highlight the gap between the current valuations of leading banks with their highs and averages during the past ten years.

**Exhibit 1: The valuation multiples however remain much lower than the peak levels...**



Source: Bernstein, February 2023

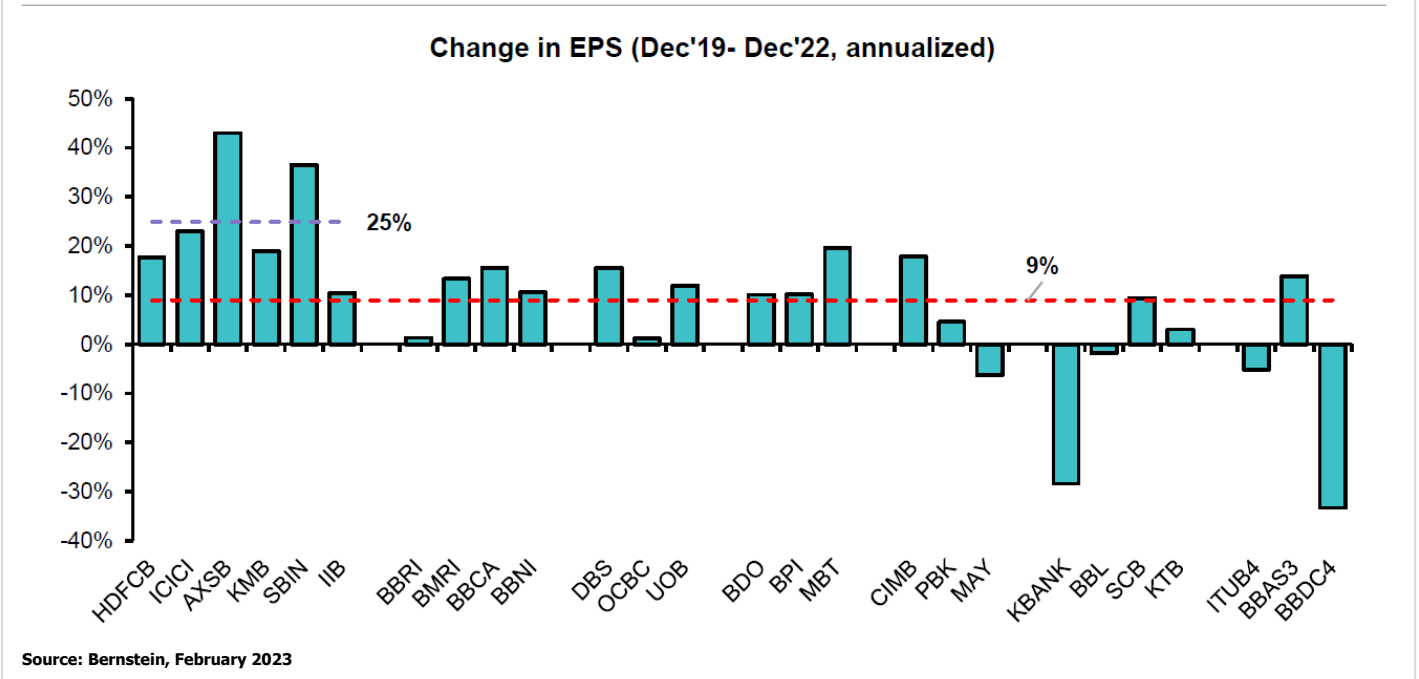
**Exhibit 2: ...and even lower than the average levels for the top PVBs (except ICICI)**



Source: Bernstein, February 2023

Exhibit 3 compares the performance of Indian banks with their Asian counterparts on an important metric of EPS CAGR over the past three years. The gaps are extremely glaring in favour of the Indian Banks which have shown a 25% CAGR since the pre-Covid level.

**Exhibit 3: The healthy metrics of Indian banks is even more apparent when compared with their regional peers – a 25% CAGR in earnings growth vs. pre-covid level**



**Some bank stocks have a significant room to appreciate as the market**

The recent underperformance of the bank stocks provoked us to look at the stock price movement over 5 years in the context of the growth in Net Interest Income (NII), Pre-Provision Operating Profit (PPOP) and Profit After Tax (PAT) since Q3 FY 18.

Most Banks in this analysis have made significant strides in growing these key metrics whereas the stock price moves in this period have not appropriately reflected this growth.

A few interesting observations:

1. Most Banks have grown their PPOPs in line with their NIIs indicating steady growth in their operating expenses.

AU Small Finance Bank has been an exception as they have made significant investments in upgrading their operating architecture so, in their case, while the NII is 4.6x, the PPOP is at a lower 3.6x.

**Exhibit 4: Net Interest Income (NII) Multiples vs. Stock Performance**



- The real highlight of these 5 years has been the conversion of PPOP to PAT as the provisions for NPAs started to taper off.

Though the pandemic generated a fresh set of provisions, the impact of those was luckily not very alarming.

In the years gone by therefore we have seen how the PAT multiple has outpaced the PPOP multiple in most cases with the exception of just a couple of banks.

This is best explained by the chart that shows the ratio of PAT multiple to PPOP multiple.

It is no surprise that the traditional “Corporate Lenders” such as BoB, SBI, Axis and ICICI have been the best performers.

In the case of a few banks, however, this ratio has been less than 1 indicating that their growth in PAT multiple is lower than the growth in PPOP multiple, or in other words, their provisions did not come down significantly enough in this period.

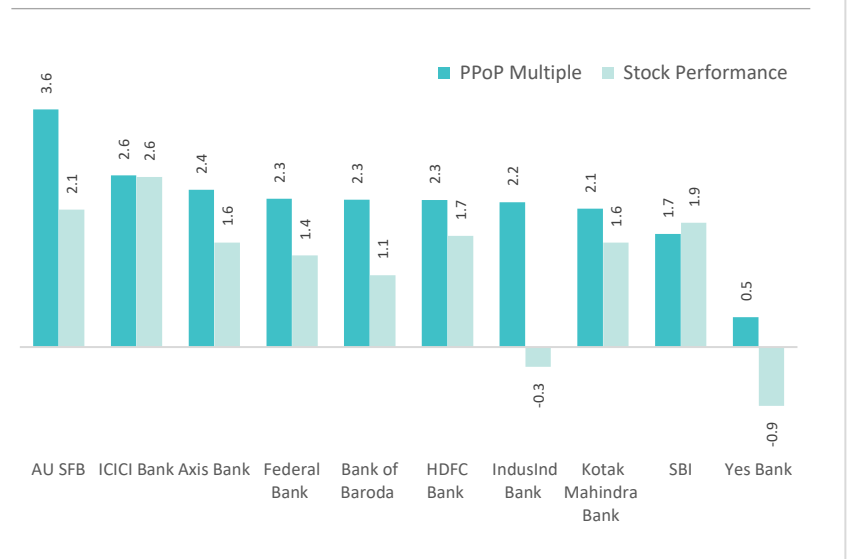
- Finally, we have tried to see if the stock price moves have been in line with any of these metrics.

The stock price multiple seems more directly connected with the growth in NII and PPOP and not much with the growth in PAT.

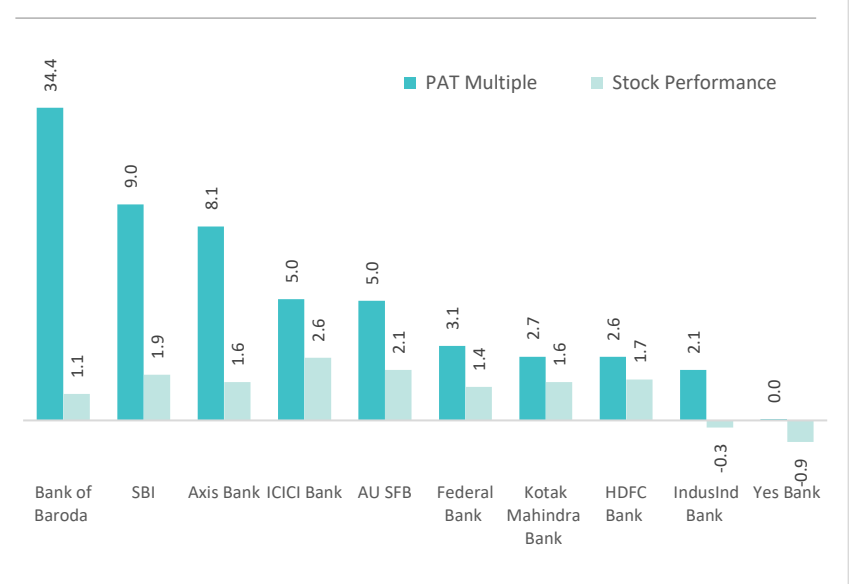
However, we observed that if the ratio of PAT multiple to PPOP multiple is less than 1, then the stock price multiple is negative.

**Basis our detailed evaluation, we believe that some bank stocks have a significant room to appreciate as the market seems to have disregarded some materially strong improvements in those banks’ fundamentals.**

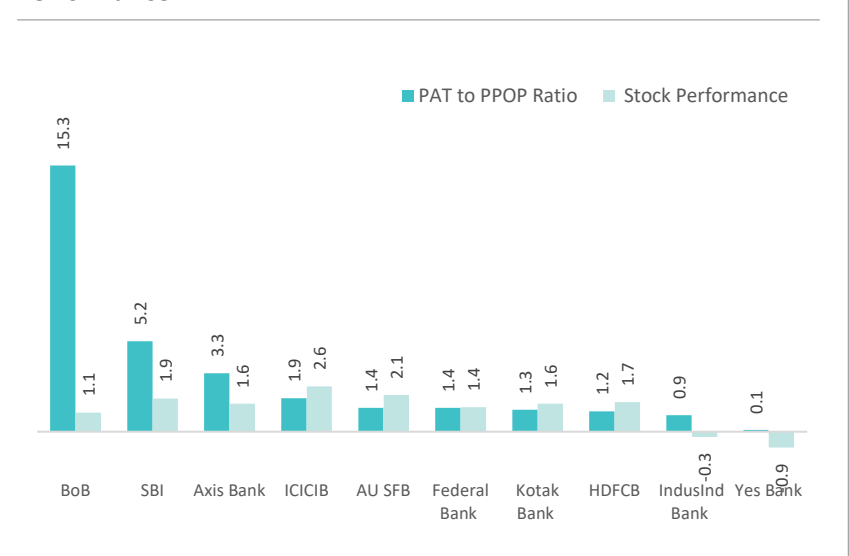
**Exhibit 5: Pre-Provision Operating Profits (PPOP) Multiples vs. Stock Performance**



**Exhibit 6: Profit After Tax (PAT) Multiples vs. Stock Performance**



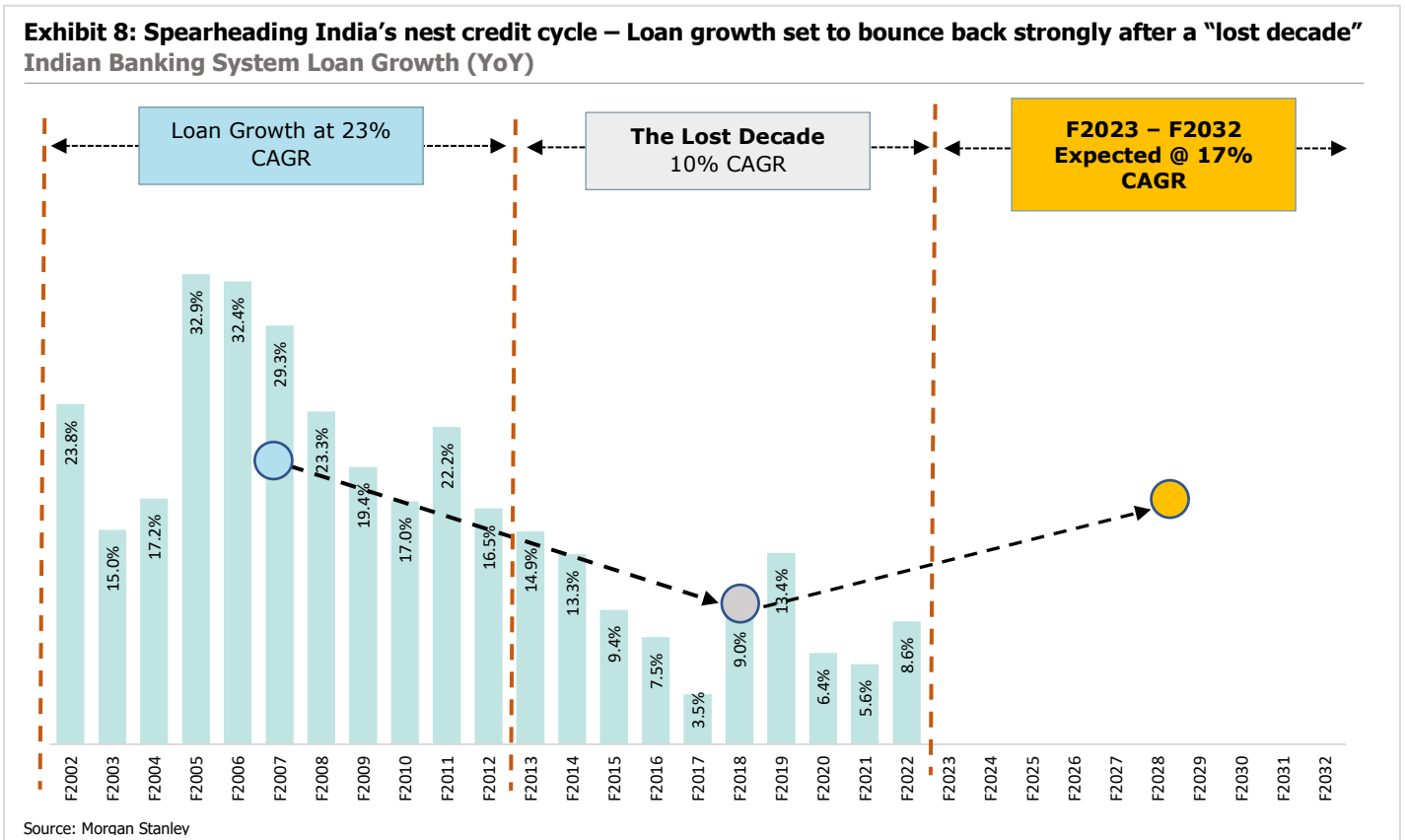
**Exhibit 7: Ratio of PAT multiple to PPOP multiple vs. Stock Performance**



For exhibits 4 to 8, multiples for NII, PPOP & PAT are calculated based on data for Q3FY18 & Q3FY23. For stock performance, data is from 22 Feb 2018 to 22 Feb 2023. For SBI, the multiples are for Q3FY23 vs Q2FY18, since Q3FY18 was a loss quarter. Source: Company presentations, Trivantage Capital Research.

**Portfolio & Market Outlook**

Due to several headwinds faced by the Indian financial sector in particular and the economy in general the past decade has been quite weak for the credit growth. Exhibit 8 forecasts the next decade to be quite robust with credit growth to be at an estimated 17% per annum.



We believe that the interest rates will go up by 50 to 100 bps further which will continue to benefit the Net Interest Margins for the banks.

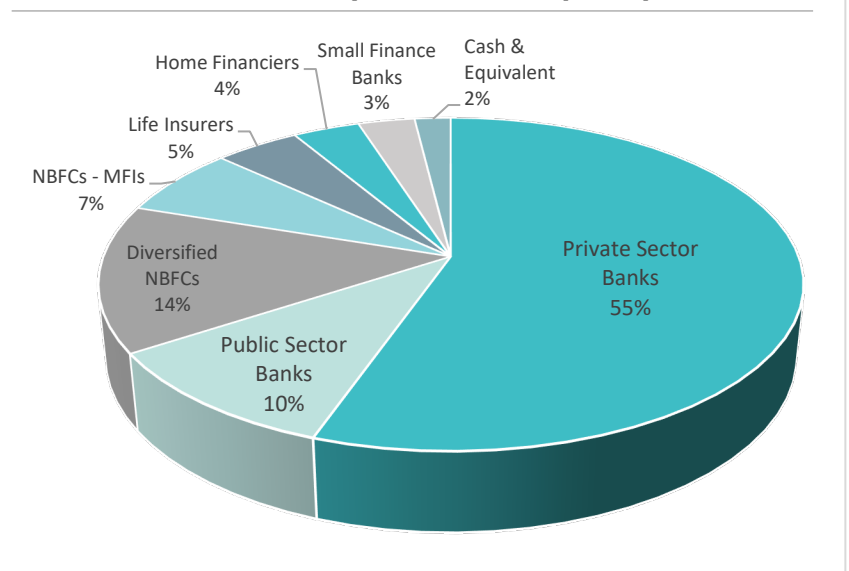
With a strong outlook of credit growth and margins our portfolio is well positioned with 65% in banks.

We continue to believe that the stock selection will remain the key to a strong portfolio performance as only a select few franchises are geared up to win market shares over the next credit cycle.

Yours Sincerely,

Nikhil Johri  
 Founder & Chief Investment Officer

**Exhibit 9: Trivantage Capital Resurgent Financials Equity Portfolio**  
**A Well-Diversified Portfolio (as on 28 February 2023)**



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