June 2023

TRIVANTAGE CAPITAL

Dear Investor,

The Q4FY23 earnings season turned out to be one of the strongest for lending businesses in many years. The demand for credit remained quite strong with most banks reporting QoQ growth between 2% to 6%. The Net Interest Margins for most banks jumped up to record levels, though they are likely to moderate over FY24. Asset quality, both in terms of incremental slippages and credit costs remained benign.

NBFCs also showed strong growth in AUM, disbursements, and profitability. Vehicle financiers such as Cholamandalam Investment & Finance recorded 38% growth in AUM dominating the NBFC category. Bajaj Finance also reported a strong 7% QoQ growth in AUM.

FY23 has been a 'turnaround year' for many smaller lending businesses. In the following charts, we have looked at the evolution of a few select small & mid-cap lenders over the past 5 financial years.

Exhibit 1: Key metrics for select lenders over a 5-year period

For Home First, the NIMs are for FY20 & FY23. Cost of Funds: Data for CSB not available since the bank does not disclose the same. Tier 1 Capital: For CreditAccess Grameen, it is CRAR.
Source: Company presentations, Trivantage Capital Research

Almost all of these have shown an improvement in key metrics such as Net Interest Margins, cost of funds, asset quality, cost-income efficiencies, capital positions and return ratios such as RoA & RoE. This has come on the back of robust growth in advances.

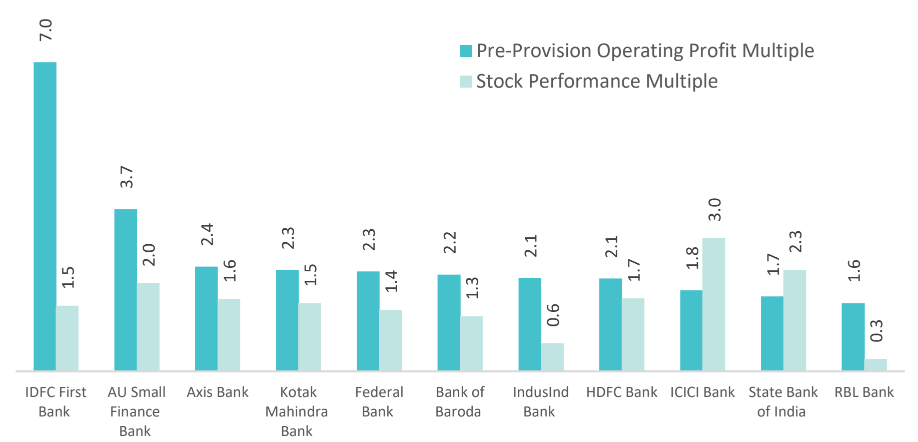
In another interesting analysis, we have compared the growth in the Pre-Provision Operating Profits (PPOP) of select banks and compared that with their stock performance.

Exhibit 2 shows some interesting difference between the way the market has responded to different banks.

For example, IDFC First Bank's PPOP has gone up 7x whereas the stock price is up only 1.5x.

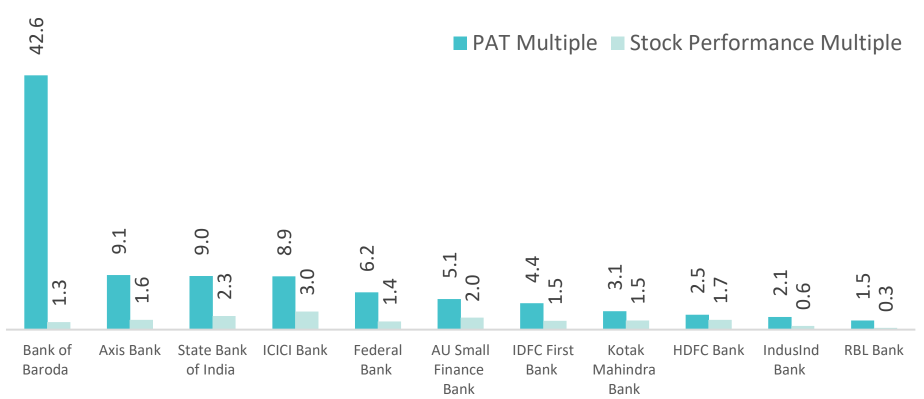
While ICICI Bank's PPOP is up 1.8x but the stock price is up 3x.

Exhibit 2: Pre-Provision Operating Profits (PPOP) Multiples vs. Stock Performance



Multiples for PPOP are calculated based on data for Q4FY18 & Q4FY23. For IDFC First, data is for Q4FY23 vs Q1FY19 due to lack of reported data. For SBI, the multiples are for Q3FY23 vs Q2FY18, since Q3FY18 was a loss quarter. For stock performance, data is from 12 May 2018 to 12 May 2023. Source: Company presentations, Trivantage Capital Research.

Exhibit 3: Profit After Tax (PAT) Multiples vs. Stock Performance



Multiples for PAT are calculated based on data for Q4FY18 & Q4FY23. For IDFC First, data is for Q4FY23 vs Q1FY19 due to lack of reported data. For Axis, Q4FY23 net profit excludes the Citi-related exceptional expenses. For SBI, the multiples are for Q3FY23 vs Q2FY18, since Q3FY18 was a loss quarter. Data is for Q4FY23 vs Q3FY18 since Q4FY18 was a loss quarter. For stock performance, data is from 12 May 2018 to 12 May 2023. Source: Company presentations, Trivantage Capital Research.

To understand this better, we have compared these banks' PAT with their stock performance.

So, in Exhibit 3, IDFC First's PAT has gone up 4.4x whereas ICICI Bank's PAT is up 8.9x.

This just goes to show that in the case of ICICI Bank, the credit costs have come down much more rapidly as compared to IDFC First and the investors have given much more weightage to that.

Market Outlook

India's macro environment outlook is turning favourable on the back of strong growth, stable currency, peaking inflation, stable policy interest rates, etc.

The Q4FY23 GDP data indicates a pickup in growth leading to upgrades of GDP forecasts. RBI's forecast is 6.5% for FY24. Indian banks have shown a system growth rate of 16% in FY23 indicating robust demand for credit, in particular from lower to middle-income households and businesses.

The current macro conditions are particularly conducive for lending financials. These conditions, combined with monetary easing later in FY24, can kick-start the private capex cycle.

In the recent months, we have increased the proportion of small and mid-cap lenders in the portfolios and have added the leading credit rating agency which we believe would benefit from the rising demand for debt issuances.

Overall, we remain quite confident of our portfolio choices and are upbeat on the market outlook.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer

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