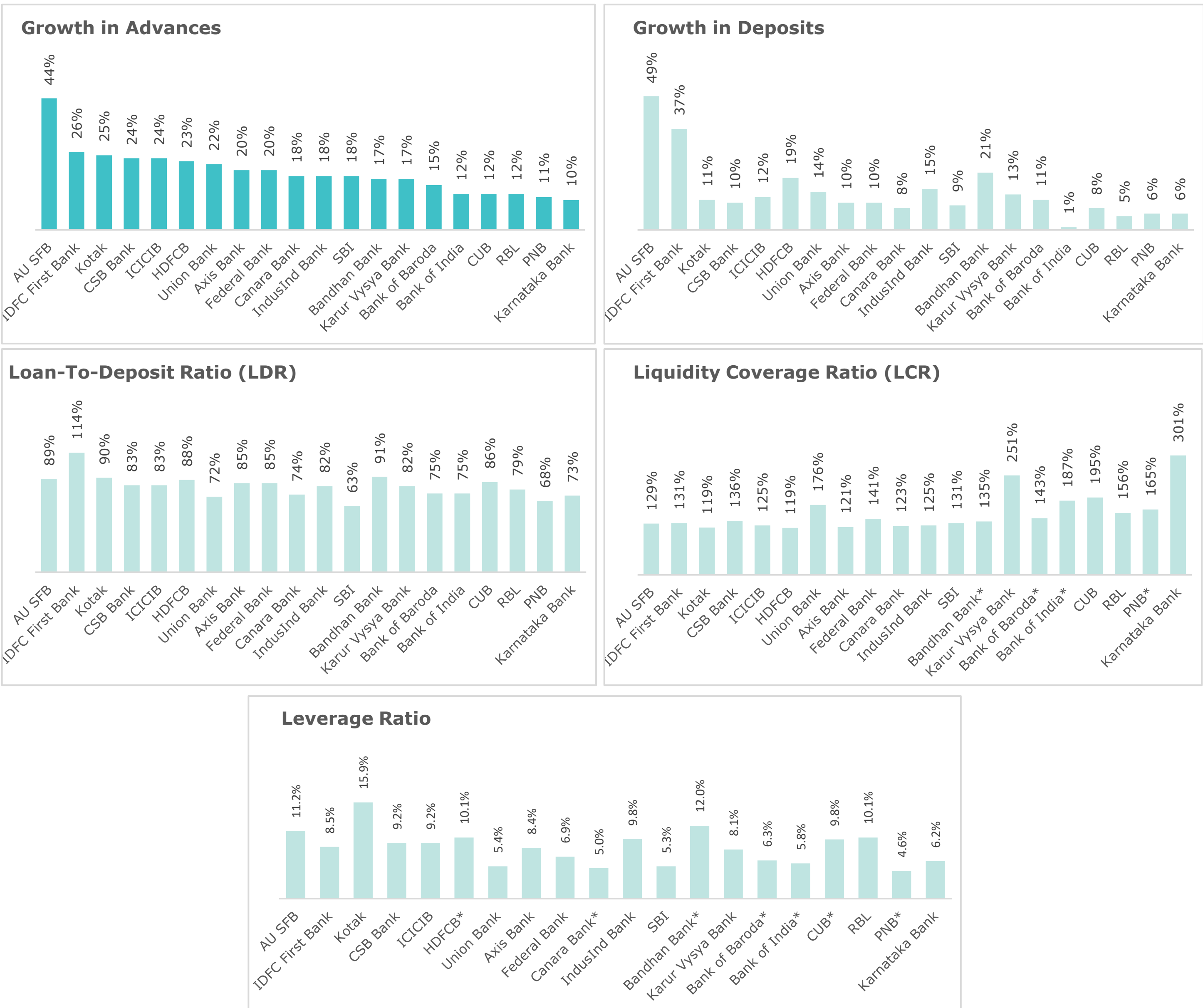
TRIVANTAGE CAPITAL

Dear Investor,

The recently concluded earnings season for our portfolio companies, particularly for the banks, was one of the best in many years. Banks across the private and public sectors have benefited from strong tailwinds and have thus shown impressive growth in loans and advances and in profitability metrics.

Rising policy repo and other benchmark interest rates have helped banks' Net Interest Margins (NIMs) as the deposits take longer to reprice. The only glaring gap in the performance has been a much slower growth in deposits that has led to an increase in loan-to-deposit ratios (LDRs).

Exhibit 1: A look at key metrics for leading private and public sector banks



All figures pertain to domestic Deposits & Advances. Data as of Q2FY23. Data for Banks marked with '*' are as of Q1FY23.
Source: Trivantage Capital, Investor presentations of the respective banks.

The LDR chart indicates these ratios to be exceeding 80% for many banks thereby indicating a need to raise deposits rather quickly.

The Liquidity Coverage Ratio (LCR) chart indicates that many banks have low liquidity buffers at around 120% beyond the regulatory minimum of 100%.

The Leverage Ratio (LR) chart indicates how most private sector banks are quite comfortably placed regarding their leverage levels with LRs at around 7 to 9 as disclosed in their Basle 3 reporting. A few public sector banks (PSBs) have high leverage due to their low Common Equity Tier 1 (CET1) positions and will need to raise equity to maintain strong growth in advances.

AU Small Finance Bank has been an outlier by reporting exceptionally strong growth, both in deposits and advances @ above 40%. Large private sector banks such as HDFC, ICICI and Axis have each reported a growth of over 20% in advances.

Large PSBs such as SBI, Canara and Union have also shown credit growth at around 20%. All these banks have thus gained market share with system credit growth for the year ended September 30, 2022, at 16.9%. A few large PSBs such as PNB and BoI have ceded market share in advances.

With system deposit growth at around 10%, some of the leading winners of market share are IDFC First and HDFC Bank whereas PNB and BoI have ceded market shares here too.

Going forward, the pressure on deposits & the current negative real interest rates for the savers will force the deposit rates upwards by between 100 to 150bps. In this environment, the strong liability franchises will ensure raising a better quality of deposits which will lower the pressure on their Net Interest Margins (NIMs) too.

For the past few years, the investor focus has been on asset quality and capital positions whilst evaluating bank stocks. After years of huge provisioning, the focus has now shifted to how banks grow advances in the new credit cycle & fund them with high quality stable & granular deposits.

The quality of underwriting will, of course, remain important for a lending institution but the impact of that will be visible after a few years.

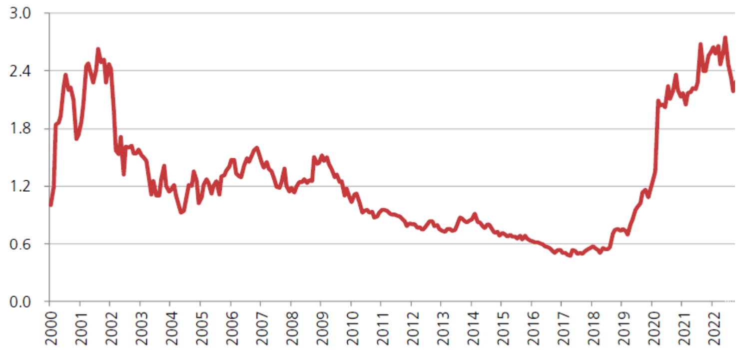
Exhibit 2 shows how an index comprising the three frontline private sector banks (HDFC, ICICI and Axis) have outperformed the index comprising a few other smaller private sector banks, both national and regional since 2018.

However, given that the credit costs of the previous credit cycle have already peaked, and the incremental loans are more granular in nature, the valuations of the beaten-down banks have shown a sharp bounce in recent months resulting in these banks outperforming the frontline banks.

Similar is the case with the stocks of public sector banks which have also bounced back sharply.

Exhibit 2: Frontline bank index has outperformed other banks between 2018-2021

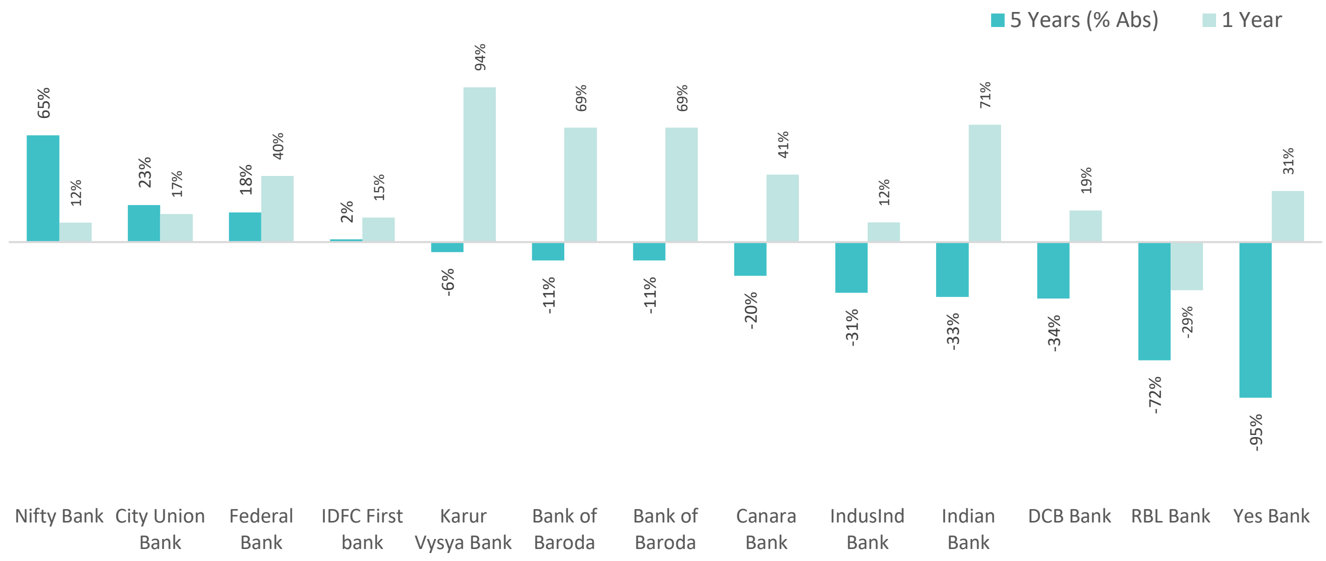
Ratio of frontline bank composite index to the other bank composite index



Notes: (a) Index ratio = Frontline bank index/ Other bank index. Both series indexed at 100 in January 2000.
(b) Frontline bank index includes HDFCB, ICICIBC, AXSB.
(c) Other bank index includes IIB, RBK, YES, FB, DCBB, KVB, CSBBANK, IDFCB, CUBK.
Source: Kotak Institutional Equities, November 2022

This, however, must be seen in the context of the continued underperformance over a 5-year period as shown in Exhibit 3.

Exhibit 3: 5-Year (absolute) & 1-Year Performance of Select Banks



Source: Trivantage Capital Research, NSE, 18 November 2022.

Market Outlook

Inflation in India seems to have peaked and is likely to decline in 2023. RBI will, however, continue to raise rates till the Monetary Policy Committee (MPC) is convinced that the inflation is no longer persistent and will settle in their target range. Like many other global central banks, RBI may also want to keep the real interest rates positive thereby implying that the policy repo rates will be higher than the CPI inflation print.

The economic growth in India in FY23 is likely to remain strong with the system credit growth expected around 15 percent. The loan growth will be well distributed across the Retail, SME and Corporate segments however will be led by Retail and in particular the housing segment which is witnessing buoyant demand. Since most of the loans are floating rate, the NIMs are likely to remain high and because of that the RoAs and RoEs for most banks will be amongst the best they have seen in many years.

We are encouraged by the recent quarter's performance metrics and have expanded the portfolio weightages in banks other than the frontline banks. Even though the frontline banks will continue to grow their deposits and advances higher than the market average and will therefore gain market shares, the stock prices of some other banks may rise faster on the back of depressed valuations. As always, we think that the **opportunities will remain quite selective and performance in the coming quarters will remain a key monitorable**.

We wish you the very best.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer