Narnolia®

25 Oct 2019

Indian Banking

Have we reached the structural peak in the Credit Cycle ?

Banking Sector credit growth has slowed down over the last few years. In recent past it has further slowed down along with the broader downturn in the economic growth. We believe this slowdown in credit is purely cyclical and not structural. A structural peak implies that in foreseeable future credit growth will be lower than or at best in line with the nominal GDP growth rate.

BANK	CMP	RECO.
AXSB	708	BUY
CUBK	210	NEUTRAL
DCBB	175	BUY
FB	80	BUY
HDFCB	1229	BUY
ICICIBC	469	BUY
IIB	1272	BUY
KVB	55	HOLD
KMB	1588	BUY
RBK	260	NEUTRAL
SIB	10	NEUTRAL
YES	52	UNDER REVIEW
BOB	91	BUY
BOI	66	BUY
CBK	193	BUY
SBIN	281	BUY
UNBK	53	HOLD

Example of Structural Peak in Credit Growth.

Japan, United Kingdom, Germany and European Union are some of the developed economies to have reached their structural peak in credit cycle couple of years back. **Credit penetration in these countries are at 108%, 136%, 77% and 93% of their GDP respectively.** But the structural slow down happened only after it first reached 100% of their nominal GDP.

Lower Domestic Credit Penetration of 50% to Private Sector in India.

Total domestic credit to private sector as a percentage of GDP for India is 50% only and that leaves good amount of headroom for the credit in India to grow higher than the nominal GDP growth. It is worth noting that credit penetration in **China, US and world average is 186%, 161% and 129% respectively.** Compared to other economies, India offers huge opportunity given their low credit penetration.

Underpenetrated Banking Credit assures the current downtrend in India is surely a cyclical

Indian bond market is at nascent stage and hence, banking system (SCB+NBFC) is the main source of raising long term funds in India. **The total banking (SCB+NBFC) credit of India to the private and public sector is of 62% in comparison to other banks globally (US 121%, China 147%, Singapore 316%).** The low bank loan penetration in India presents large opportunity and as far as credit is concerned the current downtrend in India is surely a cyclical.

Huge Opportunity for Retail Focused Bank in India

Under-penetrated **retail credit India at 17% (US at 73%, China at 34%, Singapore at 85%)** provides huge opportunity for retail focused banks in India.

Credit Growth has improved well since the low of FY17

Gross Credit **growth of SCBs touched low of 4% in FY17** and has been improving since then. However recent slowdown in the Indian economy as well as global economy may slowdown the pace in near term. As per recent RBI data, non-food credit growth to the major sector has slowed down to 9.8% in Aug 2019.

Recent slowdown impacted by Concerns in Industrial and NBFC loan

As per recent report by RBI, **fund flow to the commercial sector from banks have been negative from April to mid of September 2019.** However, this can be mainly attributed to the conservative approach of banks towards industrial and NBFC sector owing to slowdown.

Research Analyst

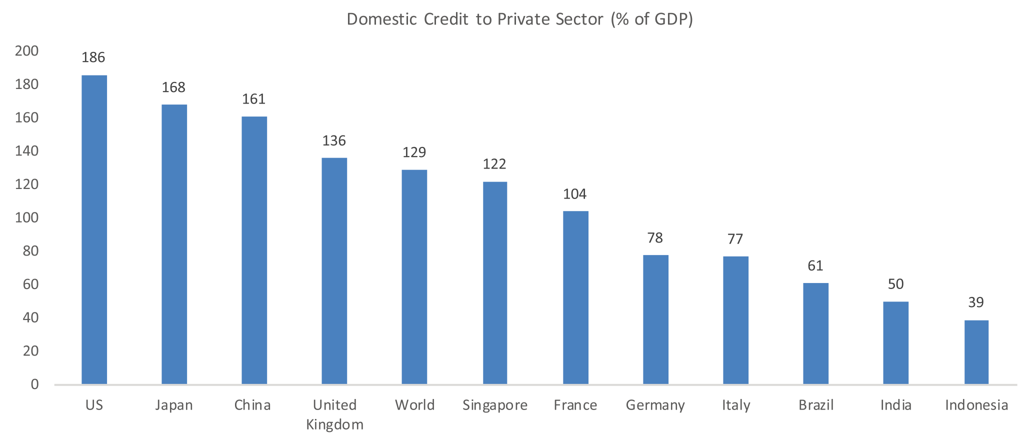
Deepak Kumar
deepak.kumar@narnolia.com

As far as credit is concerned the current downtrend in India is surely cyclical-

The under-penetrated credit in financial sector provides huge opportunity for banks in India.

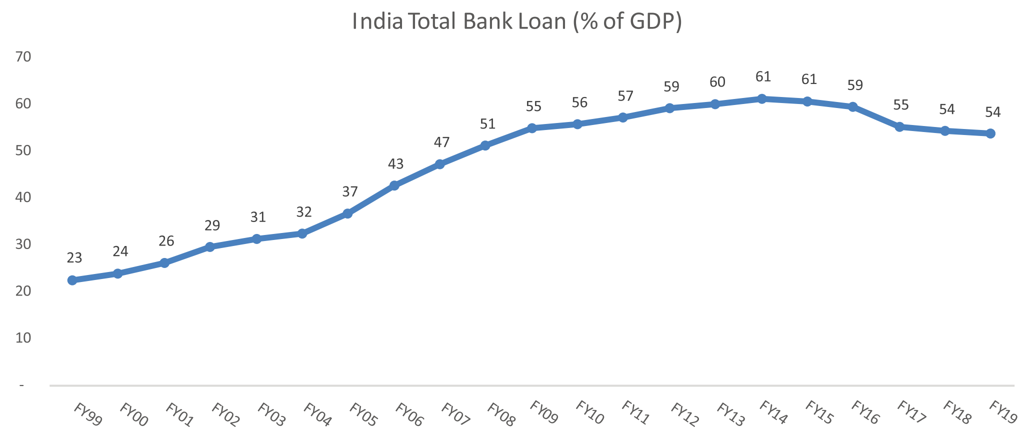
Total domestic credit to private sector as a percentage of GDP for India is 50% in comparison to United States, Japan, China and world average at 186%, 168%, 161% and 129% respectively. Compared to other economies, India offer huge opportunity given their low credit penetration.

Exhibit 1- Domestic Credit to private sector as a percentage of respective country GDP in 2018



Source: The world Bank

Exhibit 2- Under-Penetrated Banking Credit Penetration Provides Huge Opportunity



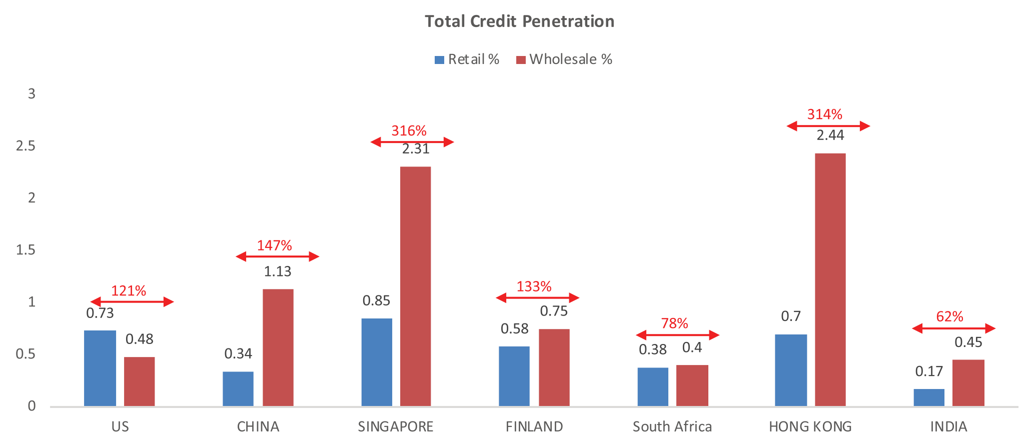
Source: The world Bank

Under Penetrated retail credit in India- Humongous Opportunity for retail lenders

Indian bond market is at nascent stage and hence, banking system (SCB+NBFC) is the large source of raising long term fund in India. The total banking (SCB+NBFC) credit of India to the private and public sector presents interesting opportunity with low loan penetration of 62% in comparison to other banks globally (US 121%, China 147%, Singapore 316%).

India's total credit exposure is around Rs 117 Trillion and out of this Schedule Commercial Banks' gross credit is around Rs 102 Trillion as on FY19. Loans penetration can be further broken up into retail loans and wholesale loans. The total credit penetration of India (SCB+NBFC), is low at 62% in comparison to other banks globally.

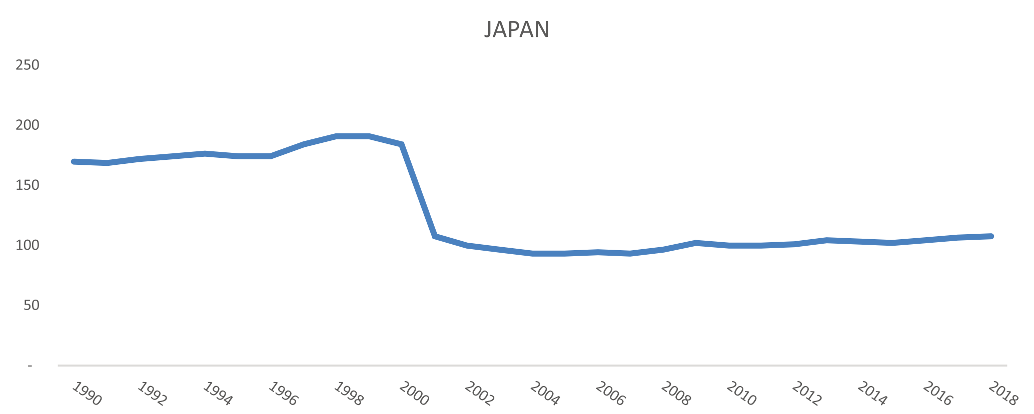
Exhibit 3- Under-penetrated retail credit (India 17%, US 73%, China 4%, Singapore 85%) provides huge opportunity for retail focus banks in India.



Source: Company, Article from McKinsey & Company

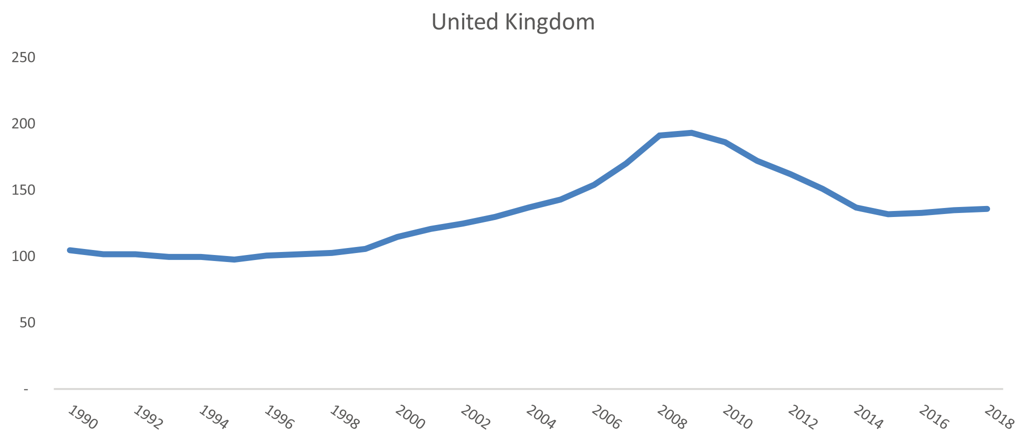
Developed Economy where the credit growth seems to have Peaked Structurally- Trend in credit suggest that fall happens only after credit penetration reaches 100% of the GDP.

Exhibit 4- JAPAN Domestic Credit to Private Sector by Banks (% of GDP)



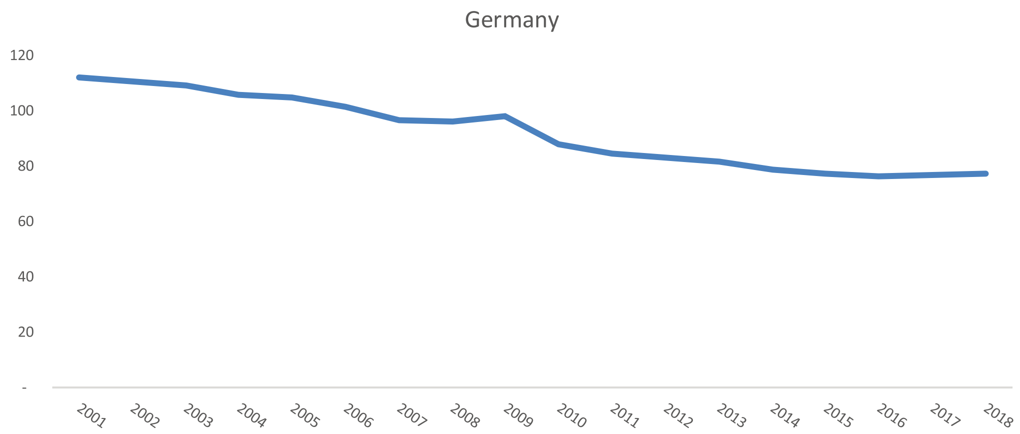
Source: The World Bank

Exhibit 5- UK Domestic Credit to Private Sector by Banks (% of GDP)



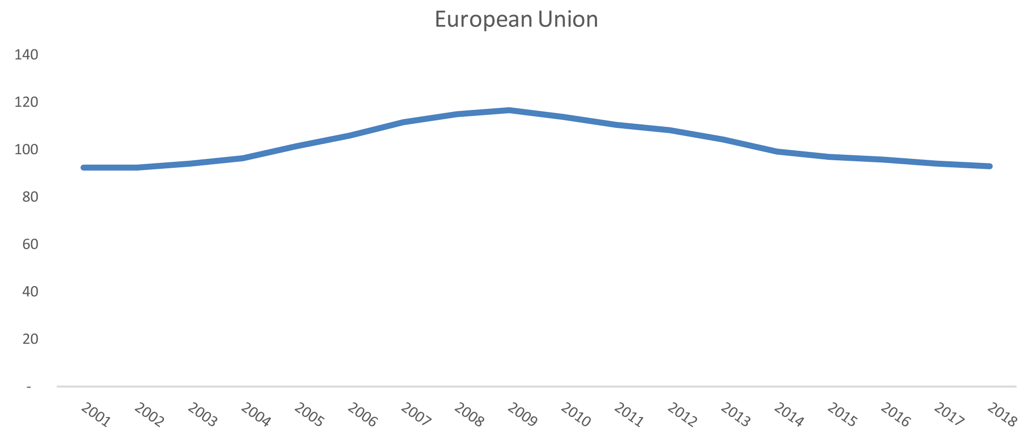
Source: The world Bank

Exhibit 6- Germany Domestic Credit to Private Sector by Banks (% of GDP)



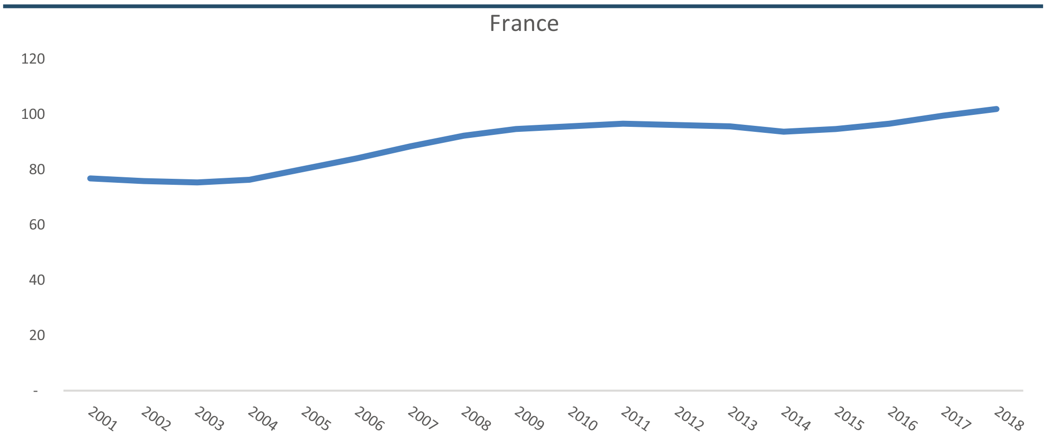
Source: The world Bank

Exhibit 7- EU Domestic Credit to Private Sector by Banks (% of GDP)



Source: The world Bank

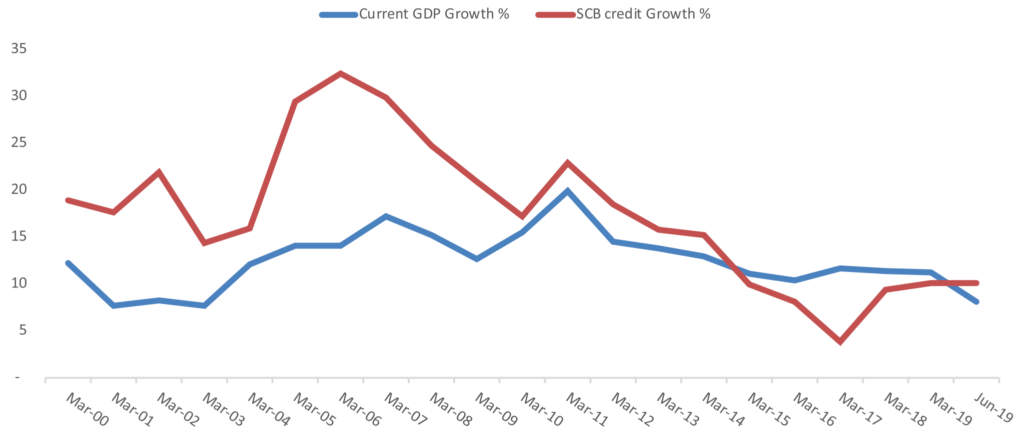
Exhibit 8- France Domestic Credit to Private Sector by Banks (% of GDP)



Source: The world Bank

Exhibit 9- India Bank Credit Growth surpassed the Nominal GDP growth after 5 years of underperformance

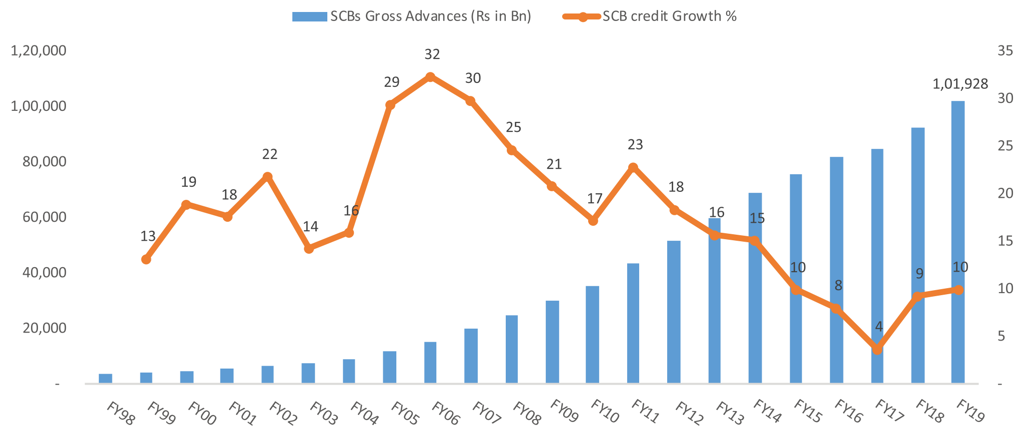
SCB gross credit growth was lower than the nominal GDP growth since FY15 to FY19 and has shown positive sign of revival in the 1Q FY20.



Source: Company, RBI

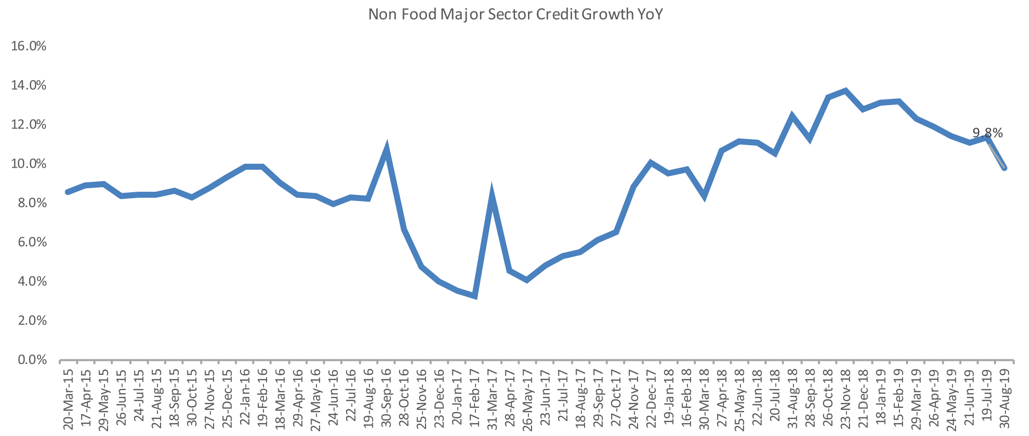
Exhibit 10- India Credit Growth has picked up well since low of FY17

Gross Credit growth of SCBs touched low of 4% in FY17 and has been improving. However recent slowdown in the Indian economy as well as global economy may slowdown the pace in near term.



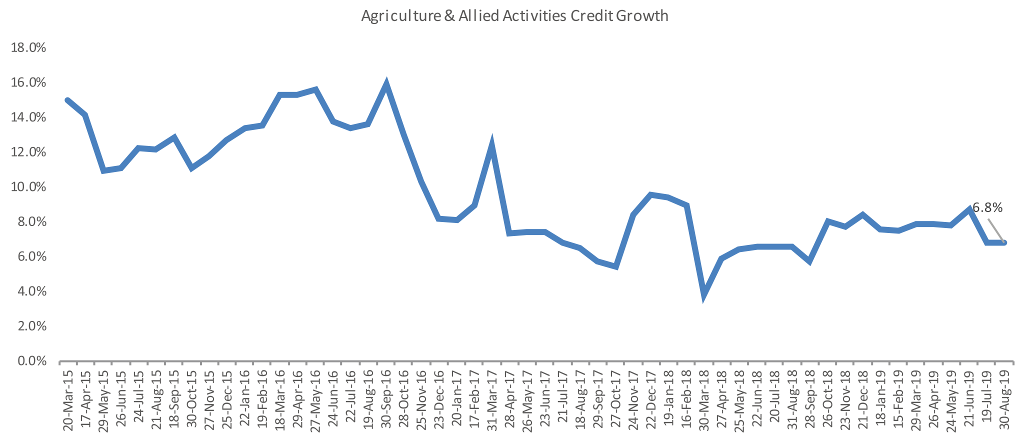
Source: Company, RBI

Exhibit 11- As per recent RBI data, non-food credit growth to the major sector has slowed down to 9.8% in Aug 2019.



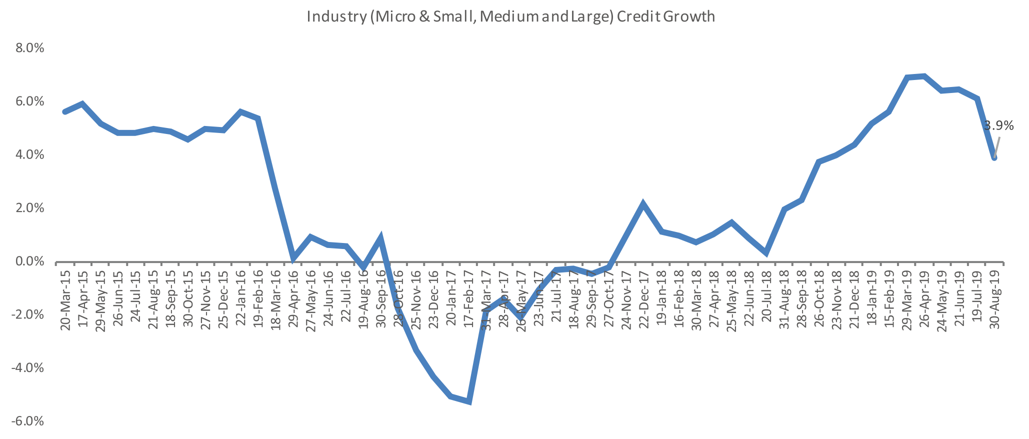
Source: RBI

Exhibit 12- Agriculture growth remained range bound



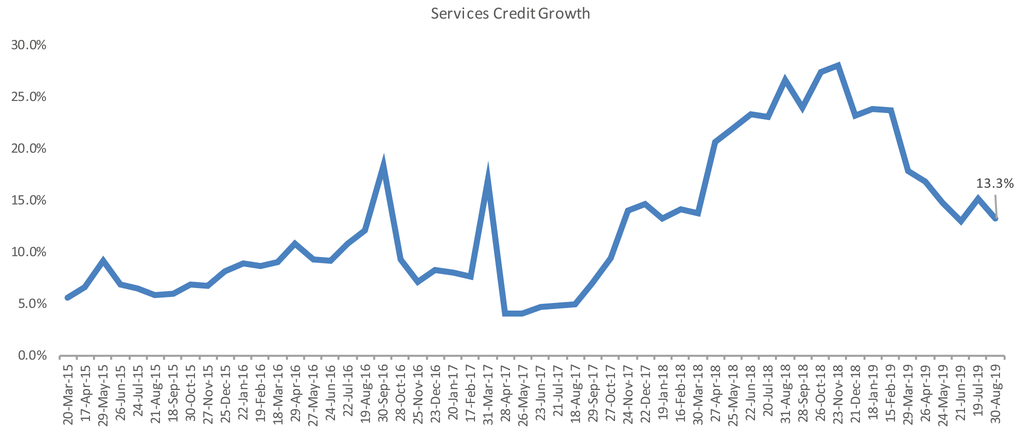
Source: RBI

Exhibit 13- Loan growth to industry dipped after pickup since the low in FY17.



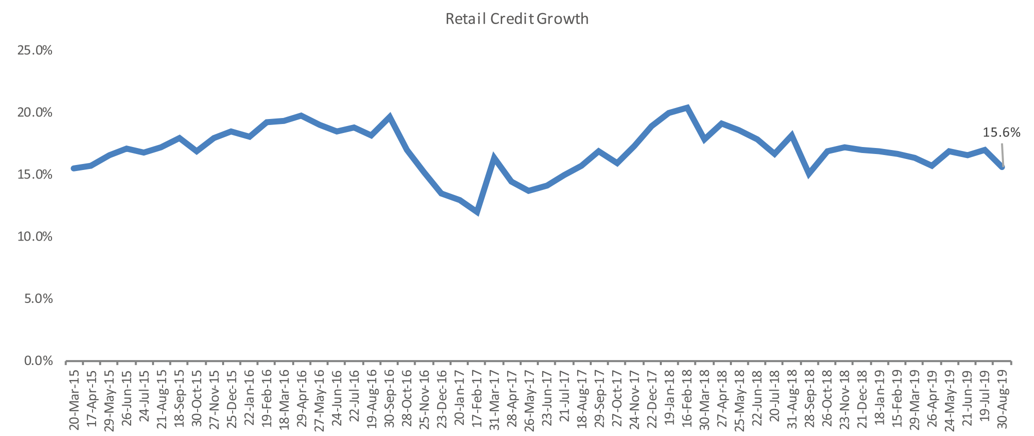
Source: RBI

Exhibit 14- Services sector growth moderated led by trade and NBFC loan



Source: RBI

Exhibit 15- Retail growth remained at range bound



Source: RBI

Recent Slowdown- Negative Bank fund Flow to the commercial Sector
After the shock of recent prolonged NPA cycle, most of the private banks in India has turned its focus towards retail loan category and has been more conservative towards the corporate lending. PSU banks severely impacted by higher NPAs are low on the regulatory capital constraint. While the banks have been trying to get over from the shock of higher NPAs the recent negative flow of news towards the NBFC sector has dampened the sentiment.

Recent data by RBI states that although banks funding to the commercial sector has been negative but there has been positive flow of funds from non-bank source.

Flow of Funds to the Commercial Sector

(Amount in ₹ crore)

Item	April to mid-Sep			
	2018-19		2019-20	
	Amount	Per cent to Total	Amount	Per cent to Total
A. Flow from banks, i.e., Adjusted non-food credit (A1+A2)	**1,85,083**	**25.1**	**-1,28,760**	**-141.5**
A1. Non-food credit	1,65,187	22.4	-93,688	-103.0
A2. Non-SLR investment by scheduled commercial banks	19,896	2.7	-35,072	-38.5
B. Flow from non-banks (B1+B2)	**5,51,004**	**74.9**	**2,19,755**	**241.5**
B1. Domestic sources	4,44,696	60.4	13,562	14.9
1. Public issues by non-financial entities *	6,253	0.8	58,326	64.1
2. Gross private placement by non-financial entities *	47,379	6.4	62,495	68.7
3. Net issuance of CPs subscribed by non-banks	2,53,669	34.5	19,118	21.0
4. Net credit by housing finance companies $	52,181	7.1	-6,003	-6.6
5. Total accommodation by 4 RBI regulated AIFIs *	40,032	5.4	-4,774	-5.2
6. NBFCs-ND-SI and deposit taking NBFCs (net of bank credit) $	41,200	5.6	-1,25,600	-138.0
7. LIC's net investment in corporate debt, infrastructure and social sector^	3,982	0.5	10,000	11.0
B2. Foreign sources	1,06,308	14.4	2,06,193	226.6
1. External commercial borrowings / FCCB *	-653	-0.1	54,073	59.4
2. Foreign direct investment to India ^	1,06,961	14.5	1,52,119	167.2
C. Total flow from banks and non-banks (A+B)	**7,36,087**	**100.0**	**90,995**	**100.0**

$: Up to Jun ^: Up to Jul *: Up to Aug.
Sources: RBI; SEBI; BSE; NSE; NHB; LIC and merchant

NPA Cycle- Is worst still not over?

2nd half of FY19 had suggested that the worst in NPA cycle is over as GNPA declined to 9.4% in 4Q FY19 from the high of 11.5% in 4Q FY18. But series of news flow and elevated slippage in Q1FY20 had put this thesis in risk. But factoring majority of large stressed assets into the slippages and delinquencies suggests that NPA will not cross the peak made in FY18.

BANK	CMP	RECO.
AXSB	708	BUY
CUBK	210	NEUTRAL
DCBB	175	BUY
FB	80	BUY
HDFCB	1229	BUY
ICICIBC	469	BUY
IIB	1272	BUY
KVB	55	HOLD
KMB	1588	BUY
RBK	260	NEUTRAL
SIB	10	NEUTRAL
YES	52	UNDER REVIEW
BOB	91	BUY
BOI	66	BUY
CBK	193	BUY
SBIN	281	BUY
UNBK	53	HOLD

FY18 saw highest level of delinquencies with slippages ratio of 8.1%
Slippage ratio as a percentage of TTM on standard advances touched high of 8.1% in FY18. In absolute term slippages were at Rs 5959 Bn for the combines PSU/Private banks in India. Slippages in FY18 saw an increase of 46% from the previous year whereas it declined by same 46% in FY19.

Deterioration in asset quality peaked in FY18 with GNPA of 11.5%
During the Asset Quality Review initiated by RBI, GNPA% and NNPA% of Indian Banking system peaked in FY18 at 11.5% and 6.2% respectively. GNPA in absolute terms touched to Rs 10215 Bn in FY18 with the growth of 32% over previous year for PSU/Pvt banks whereas NNPA was at Rs 5187 Bn in the same period. GNPA declined to four consecutive quarter of FY19 (2ND half fall 75%) before marginal rise in 1Q FY20.

Provisions were 127% of the PPP in FY18
NPL Provisions touched an all-time high of Rs 3378 Bn in FY18 which was 127% of the Pre-Provisioning profit of the banks. It remained elevated in FY19 at 116% of PPP before declining to 73% in 1Q FY20. Specific PCR touched high 62% in 1Q FY20.

Current level of Stress indicates NPA ratio to remain below the FY18 level
Factoring the major fresh stressed assets pool of Rs 3500 Bn over and above normal slippages run rate over the next two year, the total slippages for individual years doesn't surpass the slippages of FY18 level and GNPA/NNPA in FY20 comes at 10.7%/4.6% vs 11.5%/6.2% in FY18.

Gross slippages were more than net loan addition in FY17 whereas 50% of the loan added during FY13-FY18 turned NPA
PSU/Pvt banks added around Rs 39434 Bn of advances during the FY13 to FY18 while gross slippages addition were Rs 19609 Bn during the same period which was 50% of the loan addition. Addition to the slippages in FY17 was more than the addition of net loan.

Recoveries Improved led by NCLT, huge write-offs also led NPA to decline
Big ticket NPA resolution under NCLT cases has improved the recovery rate. Bank has seen huge write-offs in last 5 years and write-offs as a percentage of 12 months trailing GNPA has been hovering around 20%-23% range. Huge write-offs have also helped the banks to check the GNPA ratio.

Better in terms of Provision Coverage
Specific Provision Coverage improved by 20% to 62% in FY20 from the low of 42% in FY16. Banks are well placed in terms of provision cover, signaling lower requirement of credit cost on legacy NPA book going ahead.

Legacy Stress Over and Fresh stock of Stressed assets led by NBFCs
Legacy stress has been mostly recognised but new concerns emerged from NBFC and real estate exposure. The banking exposure towards stressed or rating downgraded NBFC companies are around Rs 2500 Bn (DHFL, IBULHSGFIN, RCAP, RELIGARE, EDELWEISS, JM FINANCIAL, L&TFH, PNB Housing, Piramal Capital).

Banks will turn profitable at PBT level in the current Financial Year
Provisions requirement on the stressed assets as well as on the legacy book can be around 2.5% of the advances in FY20 whereas banks are well placed to make PPP of 2.8% in FY20. The Whole banking system can turn to profitability in FY20 after two consecutive year of huge losses.

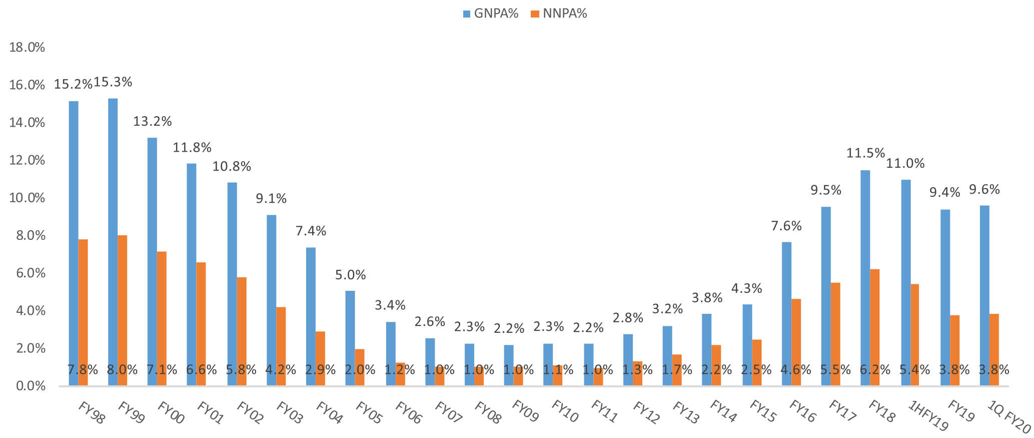
Research Analyst

Deepak Kumar
deepak.kumar@narnolia.com

Deterioration in Assets Quality Peaked in FY18

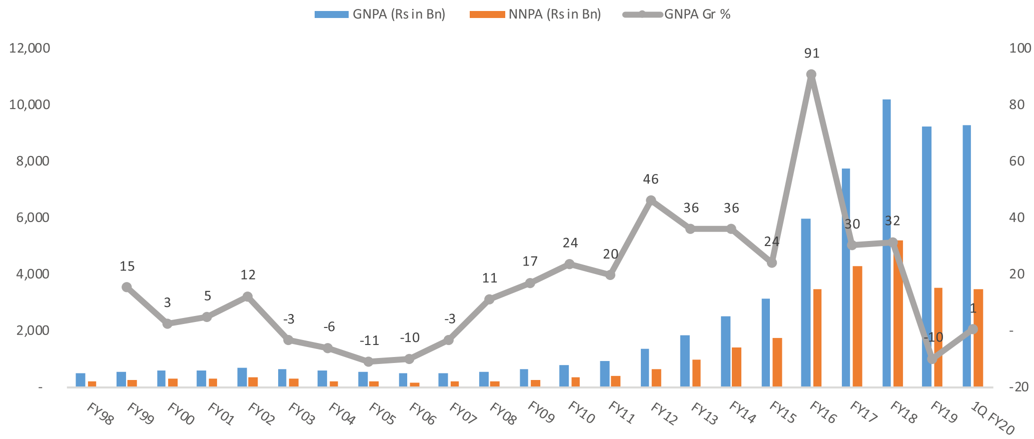
GNPA as a percentage of gross advances peaked in FY18 at 11.5% amounting to Rs 10250 Bn. It declined to four consecutive quarter of FY19 (2ND half fall 75%) before marginal rise in 1Q FY20. NNPA as a percentage of net advances peaked in FY18 at 6.2%.

Exhibit 1- Assets Quality of Banks



Source: RBI, Company

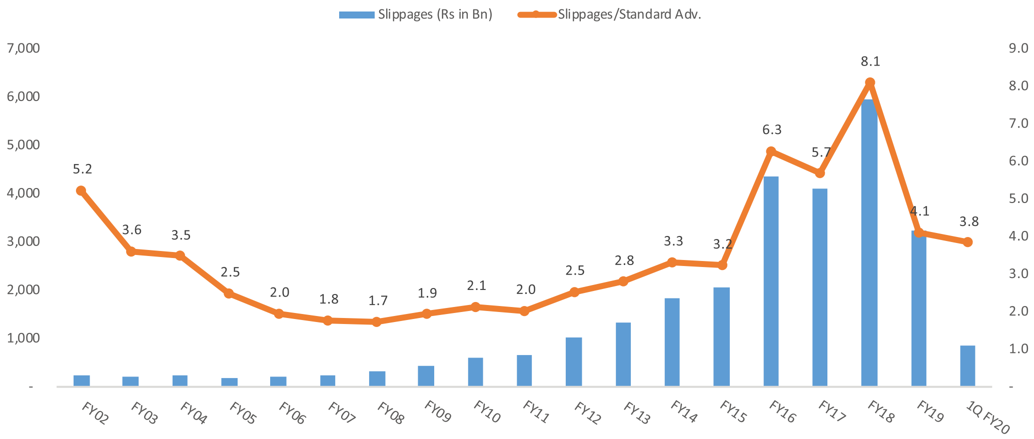
Exhibit 2- GNPA Growth was most in FY16



Source: RBI, Company

Slippages additions were the most in FY18

Exhibit 3- Slippages addition peaked in FY18 with around Rs 6000 Bn of gross slippages.



Source: RBI, Company

Current level of Stress assets indicates the NPA ratio to remain below the FY18 level

The fresh stressed pool (includes recent rating downgrades) is estimated around Rs 3500 Bn of which Rs 2500 Bn is towards NBFC/HFC sector. CRE exposure of the banks are also expected to come under pressure.

The SME sector is also facing some stress due to slowdown in the economy. Over and above fresh slippages pool of around Rs 3500 Bn there could be higher than of normal run rate of slippages. The average slippages ratio of Indian Banks from FY05 to FY12 was around 2.1%. This was the period when credit growth was also booming. Is normal run rate of slippages taken higher at 3%, then the total slippages pool over the next two year would be in range of:

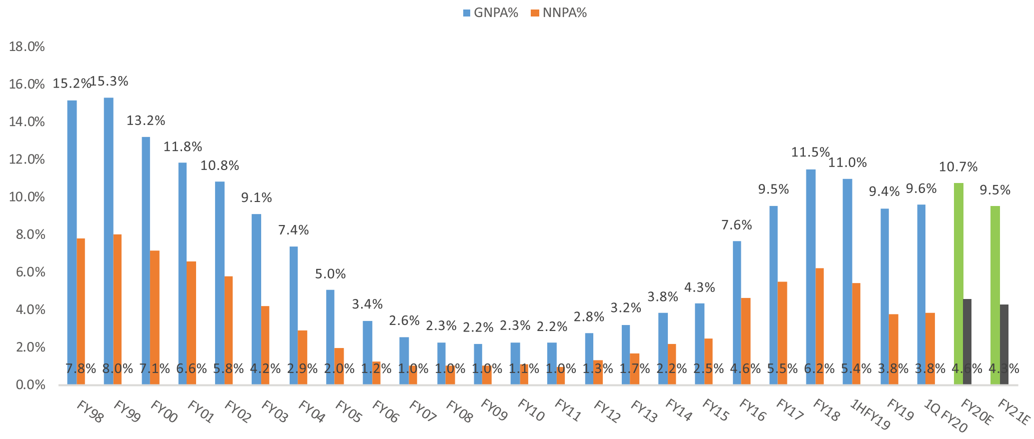
Exhibit 4- The total slippages for next two years are estimated at:

Slippages Analysis (Rs in Bn)	FY20e	FY21e
Normal run rate of slippages	3.0%	2.5%
Gross Slippages	2,657	2,357
Potential Fresh Stress	2,000	1,500
Total Slippages Potential	**4,657**	**3,857**

Source:Company estimate

Despite slippages taken at aggressive level, the total slippages for individual years doesn't surpass the slippages of FY18 level and GNPA/NNPA in FY20 comes at 10.7%/4.6% vs 11.5%/6.2% in FY18.

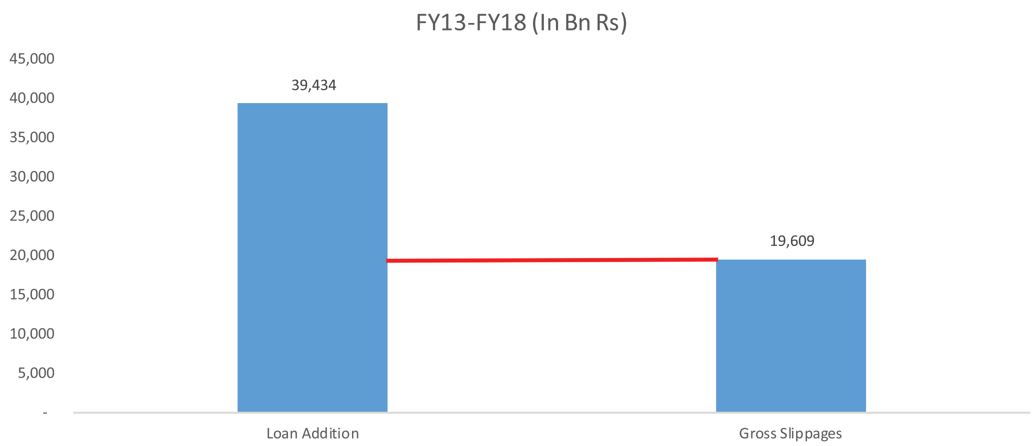
Exhibit 5- GNPA will remain below FY18 below



Source: Company

Exhibit 6- 50% of the loan additions resulted in NPA during FY13 to FY18.

PSU/Pvt banks added around Rs 39434 Bn of advances during the FY13 to FY18 while gross slippages addition were Rs 19609 Bn during the same period which was 50% of the loan addition.

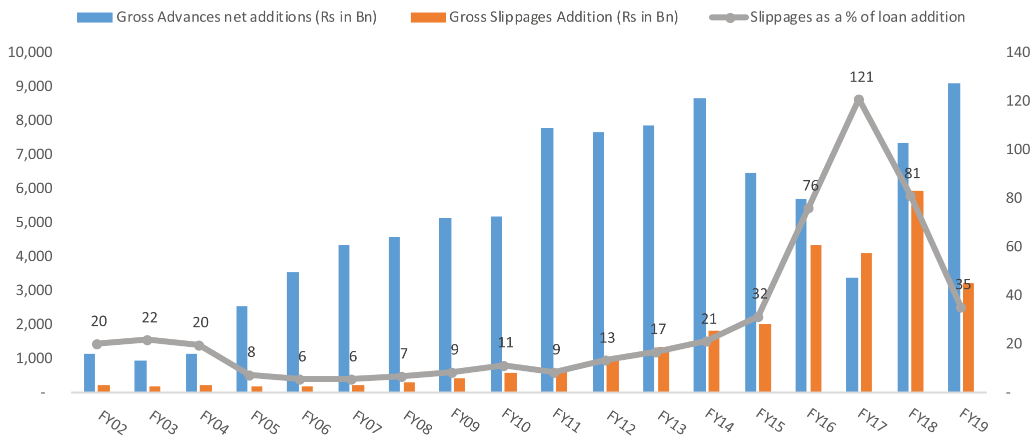


Source: Company

Addition to the slippages in FY17 was more than the addition of net loan

While FY18 saw the peak of NPA cycle but slippages addition as a percentage of gross advances additions was the highest in FY17 where advances increased by Rs 3385 Bn and gross slippages for the year was Rs 4089 Bn. However, the situation was far better in FY19.

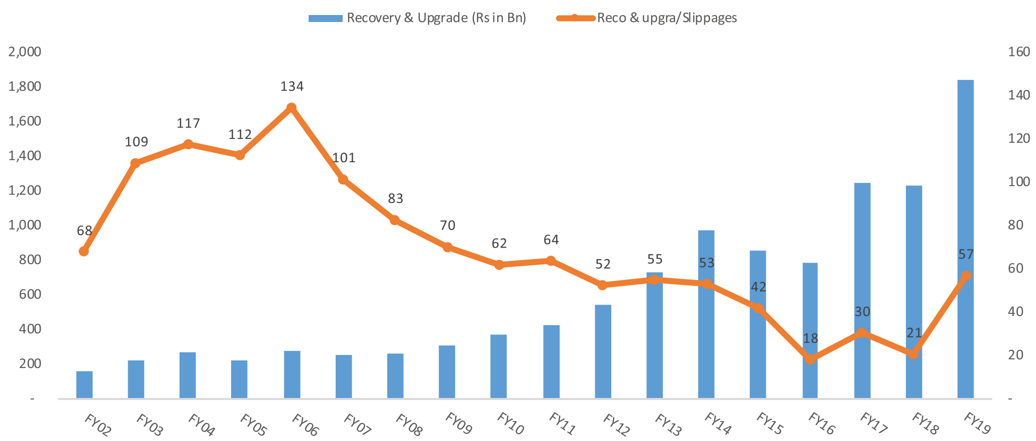
Exhibit 7- Slippages as a percentage of net loan addition



Source: Company

Exhibit 8- Recovery & upgrade was better in FY19

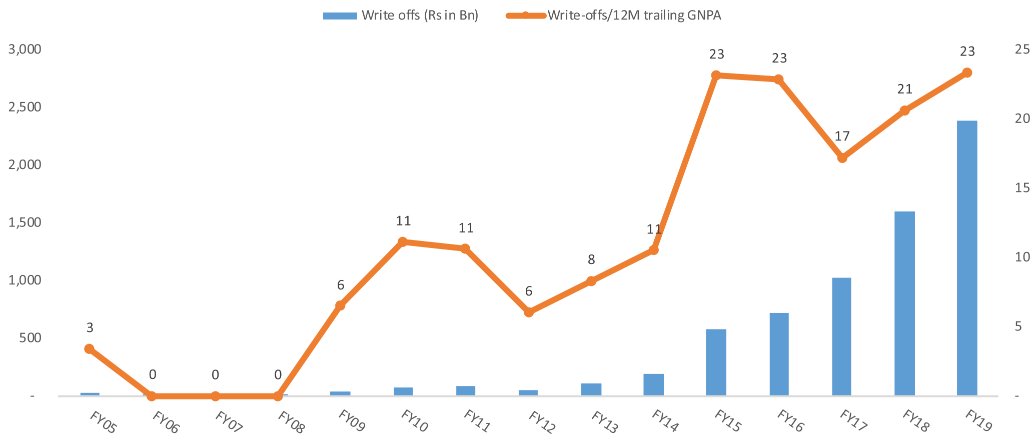
Led by big ticket NPA resolution under NCLT cases has improved the recovery rate



Source: Company

Exhibit 9- Write-offs on all time high

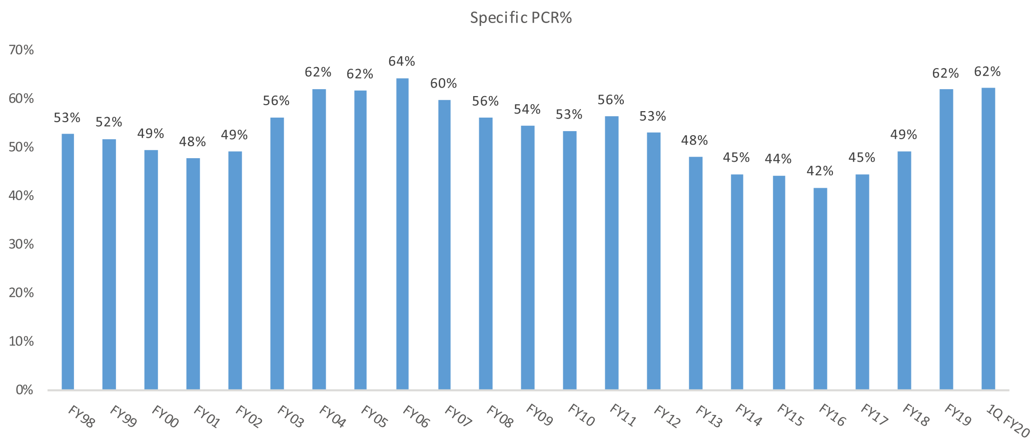
Bank has seen huge write-offs in last 5 years and write-offs as a percentage of 12 months trailing GNPA has been hovering around 20%-23% range. Huge write-offs have also helped the banks to curtail the GNPA ratio.



Source: RBI, Company

Exhibit 10- Specific PCR touched high of 62% in FY19 increased by 20% in last 3 years.

Banks are well placed in terms of provision cover signaling lower requirement of credit cost on legacy NPA book.



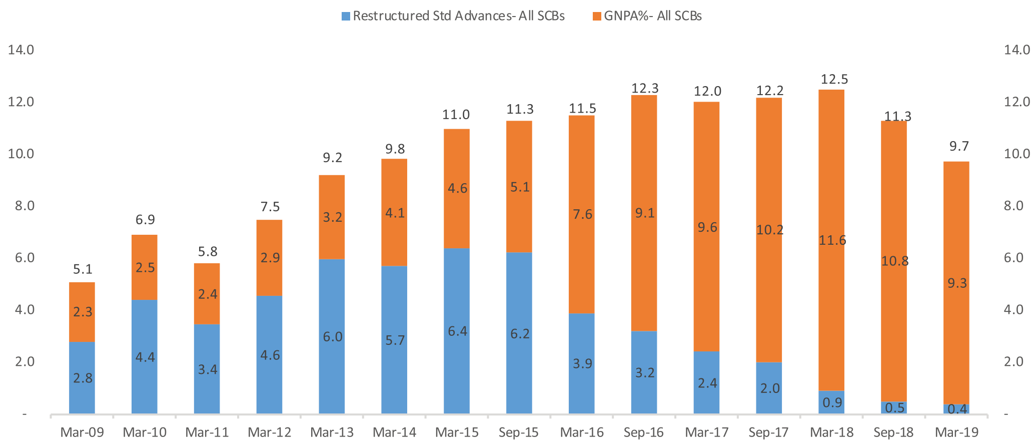
Source: RBI, Company

Specific Provision Coverage improved by 20% to 62% in FY20 from the low of 42% in FY16. Banks are well placed in terms of provision cover, signaling lower requirement of credit cost on legacy NPA book going ahead.

Legacy Standard Stress assets has been recognized.

GNPA started to increase in the system significantly from FY15 mainly due to mounted restructured assets in the system which was high at 6.4% in FY15. RBI forced the banks for cleanup of the balance sheet under AQR exercise which led to increase in GNPA. Since FY15 banks has almost recognized the stressed assets in the system which has reduced to just 40 bps in FY19.

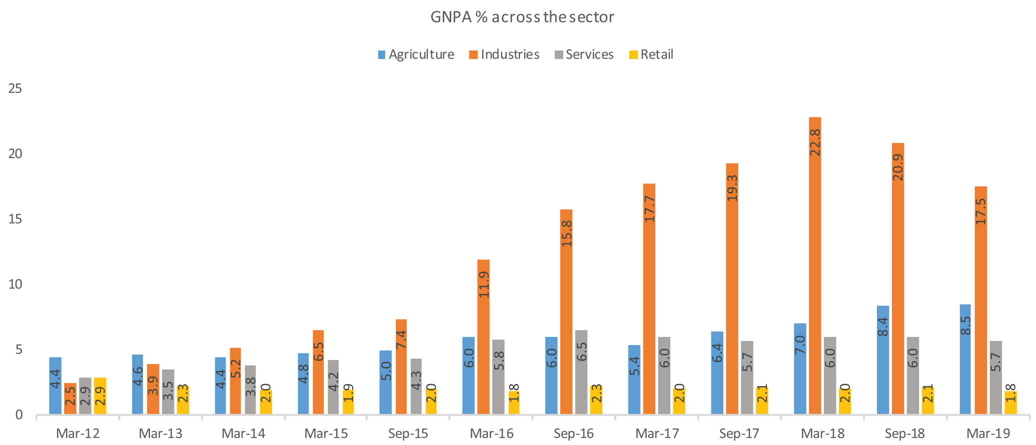
Exhibit 11- Stressed Assets of SCBs has declined significantly



Source: RBI

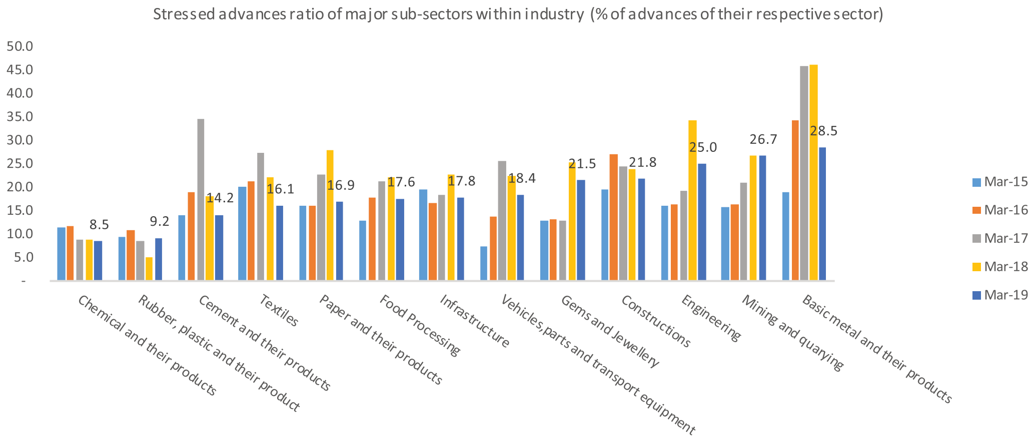
Exhibit 12- Stress was majorly in loans given to the Industry Sector

Stressed assets in the services and industry sector has been mostly recognized. Recent slowdown in the economy and pressure in NBFC/HFC/real estate sector has resulted increased downgrade of ratings in the sector.



Source: RBI

Exhibit 13- Breakup of stress in the Industry sector



Source: RBI

Exhibit 14- Legacy Over but new concerns emerged

While the legacy NPA has been mostly recognised, development of fresh stress pool has raised the concern of new peak of NPA cycle in the street. But the stress pool and balance sheet of banks are currently much better than it was in FY12-FY16.

Major Stress Companies	Total Borrowings	Bank exposure
DHFL	980	450
Reliance Commercial	191	180
Reliance Home Finance	133	120
Reliance Capital	201	190
LODHA	180	144
Suzlon	120	100
Sintax	71	66
Religare Finvest	70	60
Radius Developers	55	55
Altico Capital	53	44
Cox & King	32	18
Total Major Stress exposure (Rs in Bn)	**2,087**	**1,426**

Source: Media, Rating Agency, company, BSE

Recently the crisis of IL&FS and DHFL has created pressure of liquidity among the NBFC sector. There has been pressure on real estate developer segment too as most of the funding to their projects were done by the NBFC only.

Banks has turned very selective to the funding towards NBFC especially towards HFCs. As per the RBI data, total banking exposure towards NBFC and CRE are around Rs 6500 Bn and Rs 2055 Bn respectively. We analyzed the major NBFC (including HFCs) with significant exposures towards real estate developer segment. Among all we selected the companies which has been recently downgraded by rating agencies, under stress or whose market capitalization has eroded more than 50% from their recent high. The banking exposure towards these companies are around Rs 2500 Bn (DHFL, IBULHSGFIN, RCAP, RELIGARE, EDELWEISS, JM FINANCIAL, L&TFH, PNB Housing, Piramal Capital).

NBFC and Banks combined exposure towards real estate developer segment is pegged at Rs 6000 Bn out of which banks' exposure is around Rs 2055 Bn. NBFC/HFC is the largest fund provider to the developer segment and the liquidity pressure has squeezed the funding towards real estate segment. Thus, the exposure of banks towards CRE segment is also expected to come under pressure.

Provisions requirement in FY20 is around 2.5% of the advances whereas banks can make PPP of 2.8% in FY20.

The specific PCR of banks are at 62% as on FY19. According to the management of few banks, the LGD of 50% reflects fair haircut on the corporate loans. As per the bigger ticket resolutions under NCLT few accounts have shown more than 50% recovery rate. Provisions on most of the large NCLT cases referred by RBI is in the range of 80%-100% which also give huge write back in some good cases if resolution happens soon. But due to uncertainty over the timing of recovery we will not indulge into it for our calculation purpose.

The 7th June Circular of RBI has changed the game rule for provisioning. As per the rule if the Resolution Plan is not implemented within 1 year of default of the entity, then it will require 35% additional provisions over the ageing norm, hence the total provision require would be 50% within one year if RP not implemented.

In the worst case we assume that the RP is not implemented and banks have to take aggressive provisioning on the stressed exposure. We have assumed 50% haircut on the large exposure of fresh stressed assets pool and 35% provisions on the normal run rate of fresh slippages. Then the provisions requirement for next two years would be:

Exhibit 15- Provisions Requirement

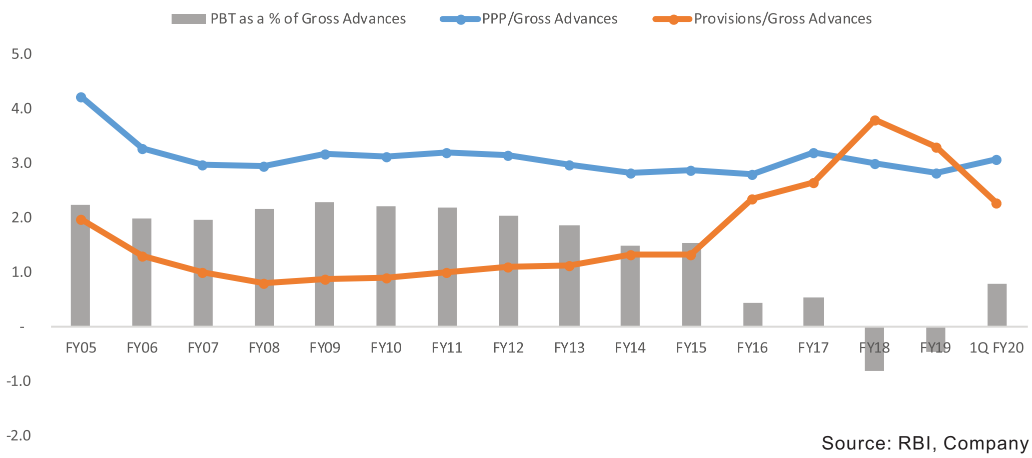
Provision Analysis (Rs in Bn)	FY20e	FY21e
Provisions for Potential Fresh Stress @ 50%	1,000	750
Provisions for Normal run rate of slippages @ 35%	930	825
Ageing related NPA @ 30%	573	185
Total Provisions Required	**2,503**	**1,760**

Source: Company estimate

Banks have enough operating profitability to absorb the next leg of huge provisions

Banking industry has reported huge loss in last two years on account of higher provisions. Owing to huge provisioning specific PCR ratio has jumped from 42% of the low in FY16 to 62% in FY19. And moreover, Banks have shown positive PBT in the 1st quarter of FY20.

Exhibit 16- PBT turns positive in 1Q FY20



Source: RBI, Company

Provisions requirement in FY20 is around 2.5% of the advances whereas banks can make PPP of 2.8% in FY20. Further our analysis shows that in the worst case also banks overall profitability at PBT level will remain positive in FY20 with massive recovery of income in FY21.

Analysis shows that the banks can absorb the provisioning requirement in FY20 from the operating profit without consuming the capital and the earnings at PBT level can still remain positive.

Exhibit 17- Financial Snapshot

Only PSU/Private Banks (Rs in Bn)	FY16	FY17	FY18	FY19	FY20E	FY21E
Gross Advances	77,946	81,331	88,676	97,781	1,05,603	1,16,163
>> Gr%	*7.9*	*4.3*	*9.0*	*10.3*	8.0	10.0
PPP	2,190	2,608	2,669	2,778	2,957	3,253
PPP/Gross Advances	2.81	3.21	3.01	2.84	2.80	2.80
Slippages	4,342	4,089	5,959	3,227	4,657	3,857
Slippages/Standard Adv.	*6.28*	*5.68*	*8.10*	*4.11*	*5.26*	*4.09*
Recovery & Upgrade	785	1,244	1,231	1,837	1,151	1,885
Reco & upgra/Stand Adv	*1.14*	*1.73*	*1.67*	*2.34*	1.30	2.00
Write offs	714	1,027	1,603	2,385	1,383	2,268
Write-offs/Lag GNPA	*22.86*	*17.23*	*20.63*	*23.35*	15.00	20.00
GNPA	5,958	7,766	10,215	9,219	11,342	11,045
NNPA	3,471	4,309	5,187	3,516	4,519	4,730
Total PL provisions	1,843	2,165	3,378	3,225	2,653	1,910
>> NPA PL provisions	1,719	2,016	3,171	3,061	2,503	1,760
Provisions/Gross Advances	2.36	2.66	3.81	3.30	2.51	1.64
BS NPA Provisions (Specific)	2,488	3,458	5,028	5,703	6,823	6,315
Specific PCR%	42%	45%	49%	62%	60%	57%
GNPA%	7.6%	9.5%	11.5%	9.4%	10.7%	9.5%
NNPA%	4.6%	5.5%	6.2%	3.8%	4.6%	4.3%
Net Advances	75,329	77,768	83,601	92,326	98,780	1,09,849
>> Gr%	*6.7*	*3.2*	*7.5*	*10.4*	7.0	11.2
PBT	348	443	-709	-447	304	1,343
PBT as a % of Gross Advances	*0.4*	*0.5*	*-0.8*	*-0.5*	*0.3*	*1.2*

Source: Company Estimate

Bet on PSU is a bet on Corporate Capex Revival

Most of the PSU banks are out of PCA. Government has done aggressive re-capitalization. But valuation multiple instead of re-rating is witnessing fresh de-rating. Question is –when PSU banks will again become part of institutional investment basket?

BANK	CMP	RECO.
AXSB	708	BUY
CUBK	210	NEUTRAL
DCBB	175	BUY
FB	80	BUY
HDFCB	1229	BUY
ICICIBC	469	BUY
IIB	1272	BUY
KVB	55	HOLD
KMB	1588	BUY
RBK	260	NEUTRAL
SIB	10	NEUTRAL
YES	52	UNDER REVIEW
BOB	91	BUY
BOI	66	BUY
CBK	193	BUY
SBIN	281	BUY
UNBK	53	HOLD

Revival in Capex Cycle will lead to gain in market share for PSU Banks.

Private Banks has been consistently gaining the credit market share from PSU Banks. **PSU bank lost 17% market share in last 20 years.** But a closer look of this falling market trend suggests that briefly 2008-2011 PSU Bank had gained market share and the reason being was the **industrial loan growth was much higher than the overall loan growth** in the system. That suggest the PSU bank stock will start re-rating with the capex revival implying the industrial loan growth pick-up.

Consequently, the Bank Nifty is at all time high whereas PSU Bank Nifty is trading at decadal low.

Focus of Indian Banking shifted towards retail financing and hence share of Loans given to Industry has been declining. **The retail share has increased by 800 bps whereas industrial loan share lost 11% since March 2011.** Consequently, the Bank Nifty is close to all time high whereas most of the PSU banks are trading at decadal low.

Government Recapitalization of Rs 70000 Cr will improve the capitalization ratio.

Most of the banks are out of PCA and as of FY19 CET 1 ratio of 4 PSU banks were below 8% range. Government decided to infuse Rs 70000 Cr in the PSU banks which provides much need boost to grow the advances. Moreover, tax rate cut will further boost the capital ratio.

PCR reached at comfortable level of 62%.

Specific PCR of PSU banks has reached to 62% and require less provisioning on legacy cases going ahead. Further banks can make enough operating profit to absorb the required provisioning on fresh stressed loan pool. PSU banks turned profitable in 1Q FY20 after making loss for last 4 consecutive year. **PSU banks are now in a better position than it was 5 years ago and with the pickup in the economy, credit growth can revive for PSU banks.**

Despite Near Term Slowdown, Growth vectors for Industrial Loan pickup are favourable.

- As per OBICUS report by RBI, Capacity Utilization of Indian Manufacturing unit has been improving which augurs well for the next capex cycle. The Capacity Utilization made low in FY17 and has improved but there might be near term disruption due to concern of slowdown in the economy.
- IIP growth improved from low of FY13 level but showed some weakness recently due to slowdown in economy.
- Gross Fixed Capital Formation as a percentage of GDP inched up in FY19 after the consecutive decline since FY13.
- Policy Rate are at 9 years of low favouring the economy for loan growth pickup.
- Liquidity has improved since July, 2019 and will favour the credit offtake.

PSU Credit Growth has improved since the low of FY17.

Gross Credit Growth for the Indian banking touched low of 4% in FY17 whereas the PSU banks registered only 1% growth. Since then the credit growth has improved well and reached 7% in FY19. As per RBI the non-food credit to major sector grew by 9.8% in August 2019.

Debt to Equity of corporates in a better position since FY15.

Barring Abruption in FY19, D/E ratio showed improvement since high in FY15. Corporate tax cut can boost the earnings for the corporate sector.

Research Analyst

Deepak Kumar
deepak.kumar@narnolia.com

Less Banks Are Under PCA Now

The Reserve Bank of India (RBI) had placed as much as 11 out of 21 public sector banks into the prompt corrective action (PCA) framework following the escalating non-performing assets and ballooning losses. Currently only 5 banks are under PCA list. United Bank of India will merger with PNB so effectively only 4 PSU banks are under PCA framework now.

Exhibit 1- Banks Under PCA

Earlier list of PSU Banks under PCA
BANK OF INDIA
IDBI BANK
CENTRAL BANK
INDIAN OVERSEAS BANK
ORIENTAL BANK OF COMMERCE
CORPORATION BANK
ALLAHABAD BANK
UCO BANK
BANK OF MAHARASTRA
UNITED BANK
Dena Bank

Current List of PSU Banks under PCA
IDBI BANK
CENTRAL BANK
INDIAN OVERSEAS BANK
UCO BANK
UNITED BANK

Mega Merger Plan

In a big reform under PSU banks, Government recently announced merger of 10 banks into form 4 large banks. With this merger, the number of PSU banks has reduced from 21 in 2018 to 12 (excluding IDBI being privatized).

Exhibit 2- Status of Banks after Merger

Consolidated PSBs for strong national presence & global reach

82% of PSB business

56% of commercial bank business

Anchor bank	Amalgamating bank(s)	Business size*	PSB rank by size
Punjab National Bank	Oriental Bank of Commerce United Bank of India	₹ 17.94 lakh cr.	2nd largest
Canara Bank	Syndicate Bank	₹ 15.20 lakh cr.	4th largest
Union Bank of India	Andhra Bank Corporation Bank	₹ 14.59 lakh cr.	5th largest
Indian Bank	Allahabad Bank	₹ 8.08 lakh cr.	7th largest
SBI	Amalgamated earlier	₹ 52.05 lakh cr.	
Bank of Baroda	Amalgamated earlier	₹ 16.13 lakh cr.	

To strengthen national presence

Bank	Business size*
Bank of India	₹ 9.03 lakh cr.
Central Bank of India	₹ 4.68 lakh cr.

To strengthen regional focus

Bank	Business size*
Indian Overseas Bank	₹ 3.75 lakh cr.
UCO Bank	₹ 3.17 lakh cr.
Bank of Maharashtra	₹ 2.34 lakh cr.
Punjab and Sind Bank	₹ 1.71 lakh cr.

Source: Finance Ministry

Further Recapitalization

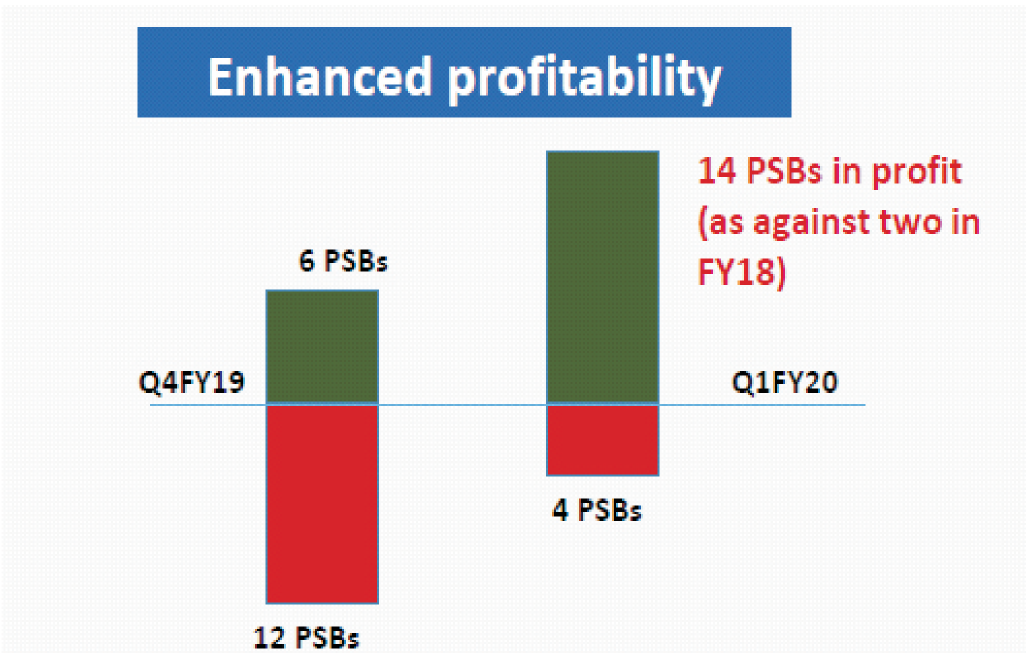
In 2018-19, the government had infused Rs 1.6 lakh crore in PSU banks to bear the burden of higher provisions. Recently Finance Minister announced Rs 70000 Cr of recapitalization to further strengthen their capital ratio. Out of this Rs 55250 Cr has been announced to the following banks-.

Exhibit 3- Capital Infusion

Banks	Amount (In Cr Rs)
Punjab National Bank	16000
Union Bank of India	11700
Bank of Baroda	7000
Canara Bank	6500
Indian Bank	2500
Indian Overseas Bank	3800
Central Bank of India	3300
UCO Bank	2100
United Bank of India	1600
Punjab & Sind Bank	750

Source: Company

Exhibit 4- Most of the banks turned to profitability in 1Q FY20

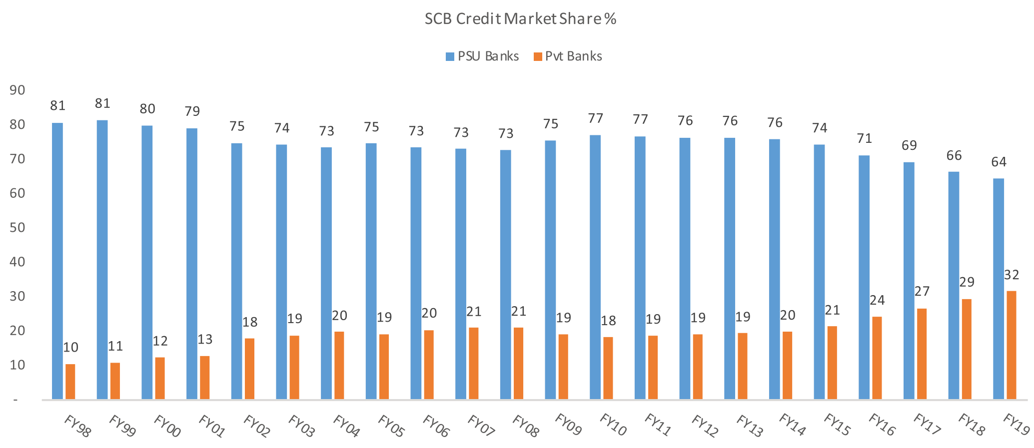


Source: Company

PSU Banks has lost Significant Market Share

Private Banks has been consistently gaining the credit market share from PSU Banks. PSU bank lost 17% market share in last 20 years. Out of this 76% share loss was made in last 6 years mainly on account of subdued growth in industrial loan and lower availability of capital. But PSU banks has briefly had gained market share between 2008-11 due to rising corporate loan.

Exhibit 5- SCB Credit Market Share %

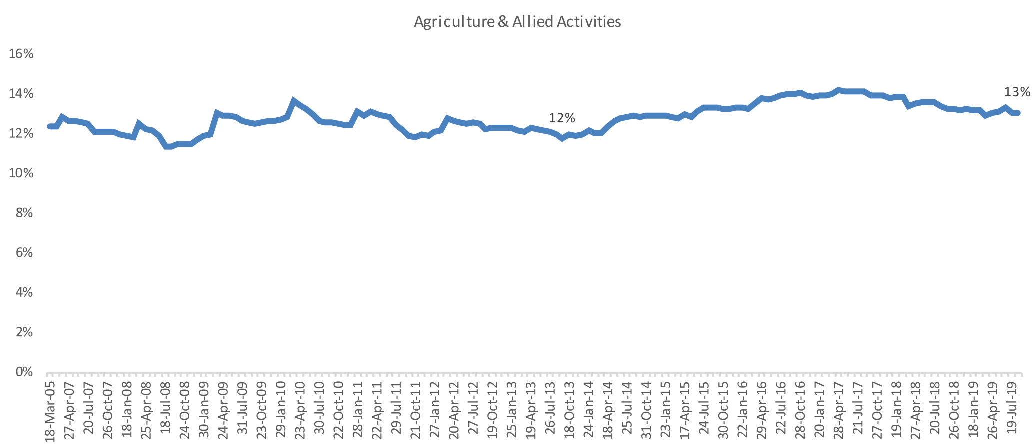


Source- Company, RBI

Bank sectoral breakup-

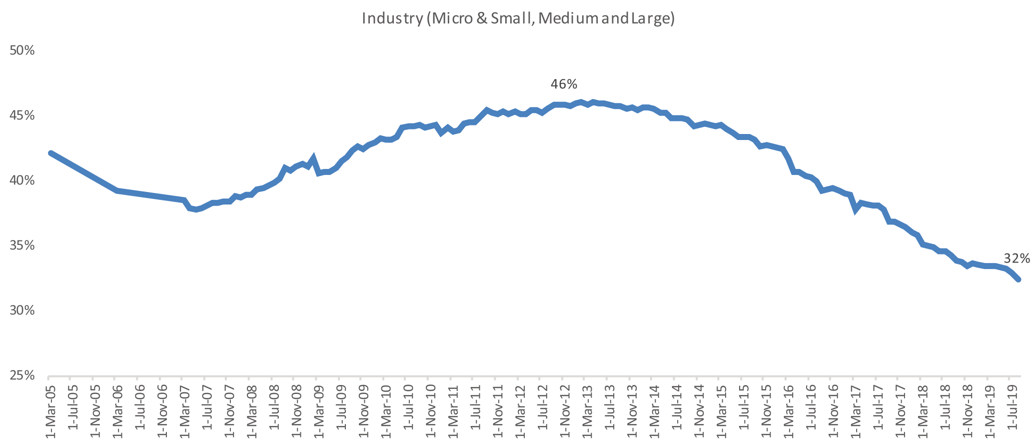
Focus shifted towards retail financing, Share of Loans Given to Industry has been declining. This is why Bank Nifty is close to all time high whereas most of the PSU banks are trading at decadal low.

Exhibit 6- Bank Credit Sectoral Breakup- Agriculture share remained stable over the period



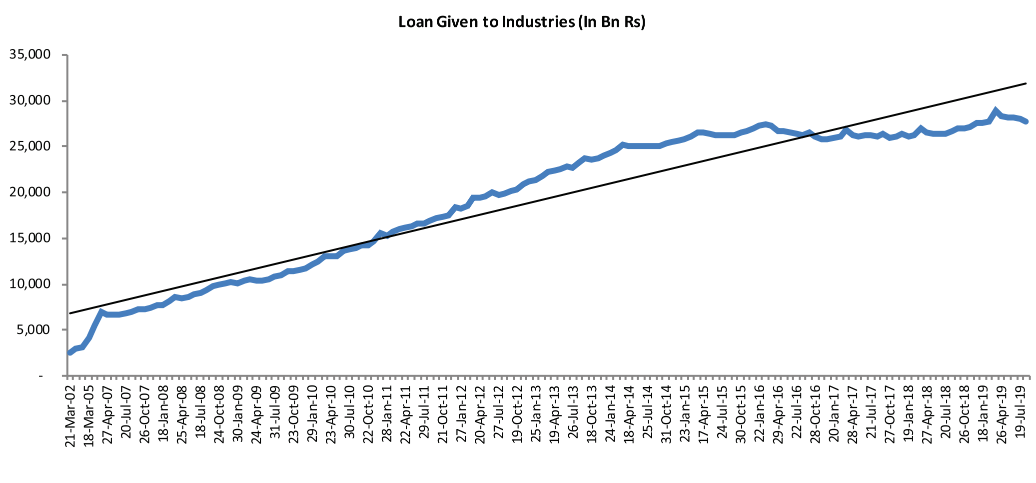
Source-RBI

Exhibit 7- Bank Credit Sectoral Breakup- Share of Loans Given to Industry has been declining



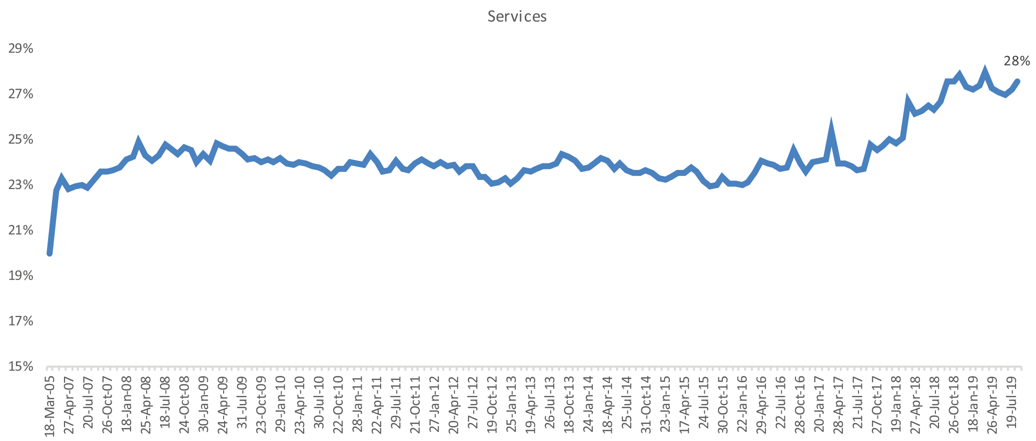
Source-RBI

Exhibit 8- But in absolute terms it has shown some sign of improvement



Source-RBI

Exhibit 9- Bank Credit Sectoral Breakup- Services sector spiked recently



Source: RBI

Exhibit 10- Bank Credit Sectoral Breakup- Focus shifted towards retail financing

Source: RBI

Exhibit 11- Bank Nifty at All time High

Source-Company

Exhibit 12- But PSU Bank Nifty at Decadal Low

Source-Company

What Future Holds-

Boost for the Capital

Most of the banks are out of PCA and as of FY19 CET 1 ratio of 4 PSU banks were below 8% range. Government decided to infuse Rs 7000 Cr in the PSU banks which provides much need boost to grow the advances. Moreover, tax rate cut will further boost the capital ratio.

Specific PCR of PSU banks has reached to 62% and require less provisioning on legacy cases going ahead. Further banks can make enough operating profit to absorb the required provisioning on fresh stressed loan pool. PSU banks turned profitable in 1Q FY20 after making loss for last 4 consecutive year. PSU banks are now in a better position than it was 5 years ago and with the pickup in the economy credit growth can revive for PSU banks.

The CET 1 capital of PSU banks as on FY19 was 9.08% and with the infusion of Rs 7000 Bn capital by Government, it is in quite comfortable position to grow in the range of 8-10%.

Exhibit 13- Core Capital Ratio of PSU Banks

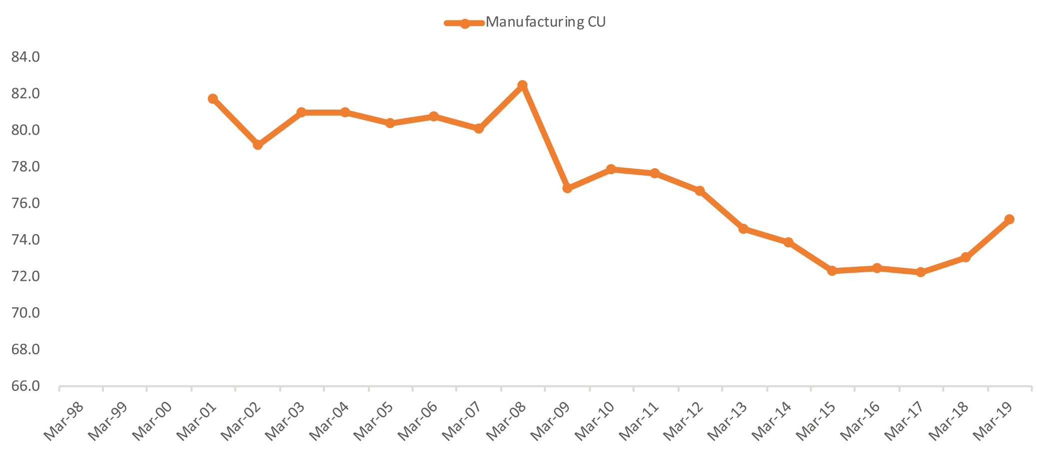
Capital Ratio (In Bn Rs)	FY19	FY20E	FY21E
CET 1%	9.08	9.38	8.79
CET 1	5,004	5,704	6,004
RWA	55,110	60,815	68,335
Net Advances	60,549	65,393	71,932
RWA/Total Advances	91	93	95

Source-Company

Despite near term slowdown growth vectors are favourable

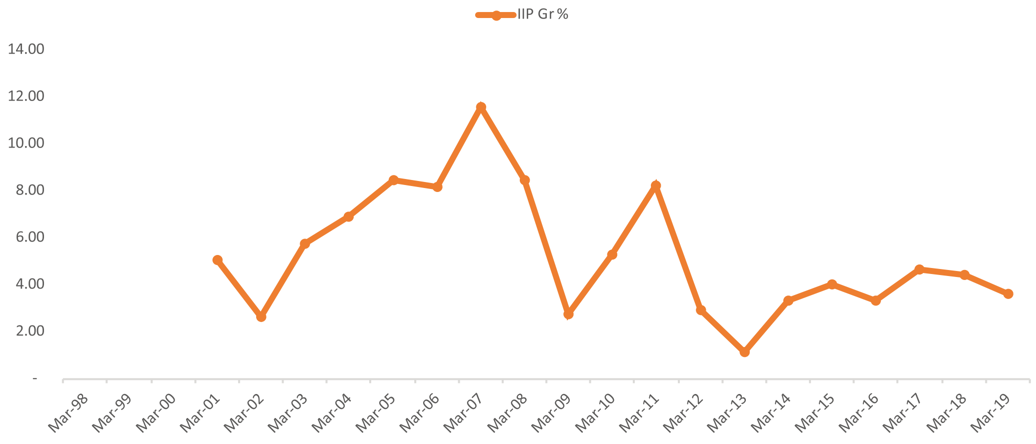
As per OBICUS report by RBI, Capacity Utilization of Indian Manufacturing unit has been improving which augurs well for the next capex cycle.

Exhibit 14- Improving Capacity Utilization rate of Manufacturing Unit



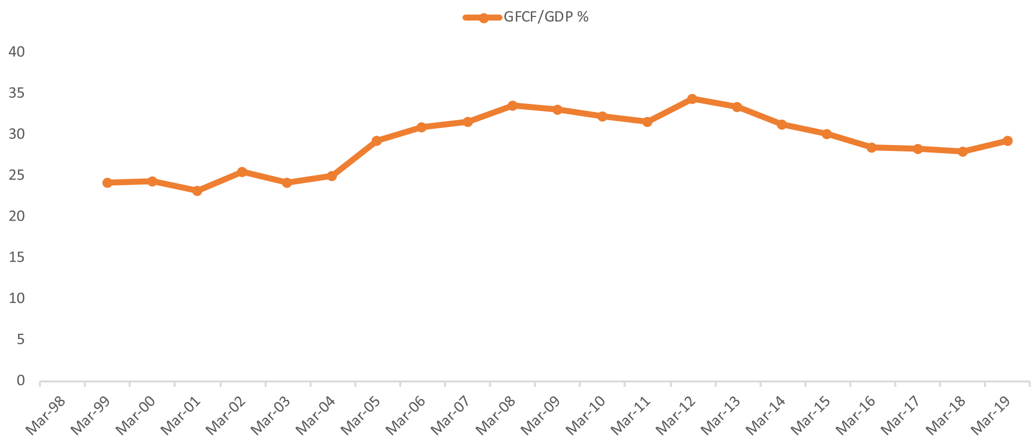
Source: RBI

Exhibit 15- IIP growth has improved from low of FY13 level but showed some weakness due to slowdown in economy



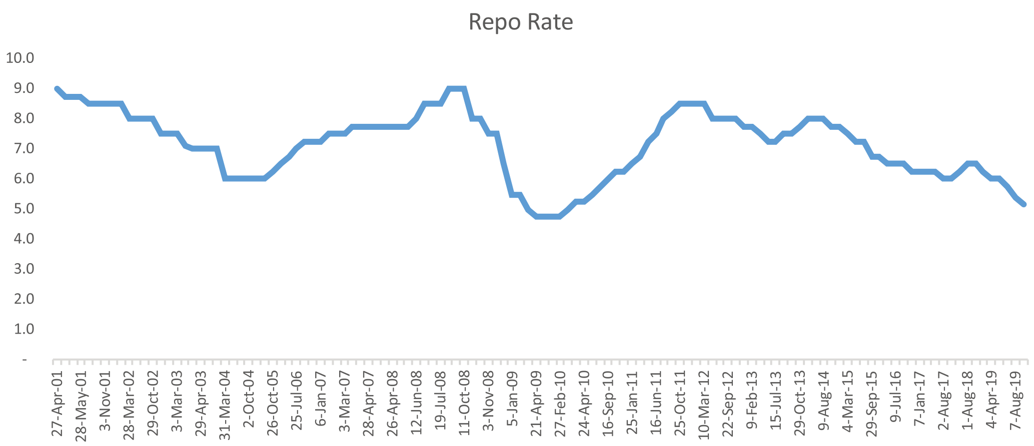
Source: RBI

Exhibit 16- Gross Fixed Capital Formation as a percentage of GDP has slightly improved in FY19



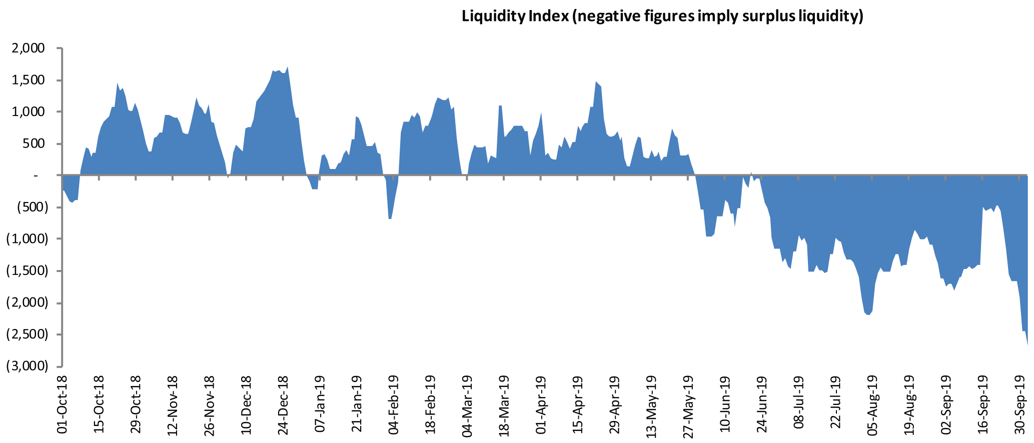
Source: RBI

Exhibit 17- Policy Rate are at 9 years of low favoring the economy for loan growth pickup



Source: RBI

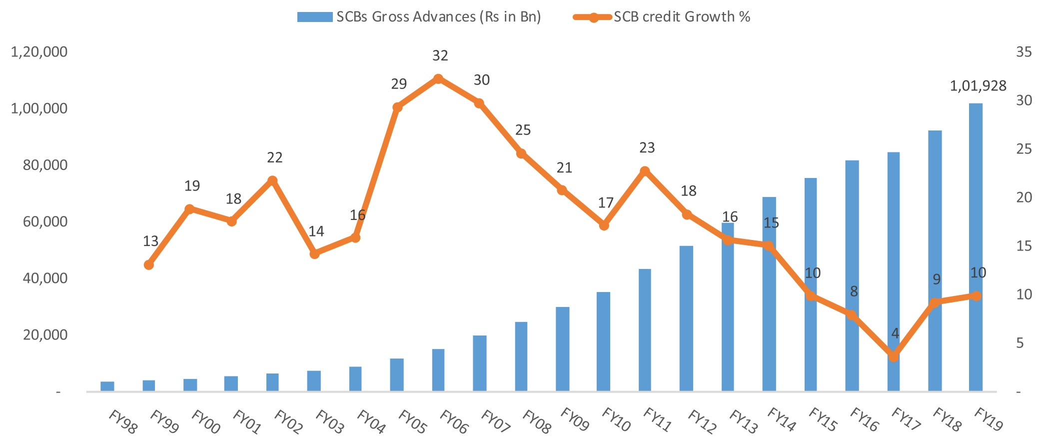
Exhibit 18- Favorable Liquidity Index



Source-Bloomberg

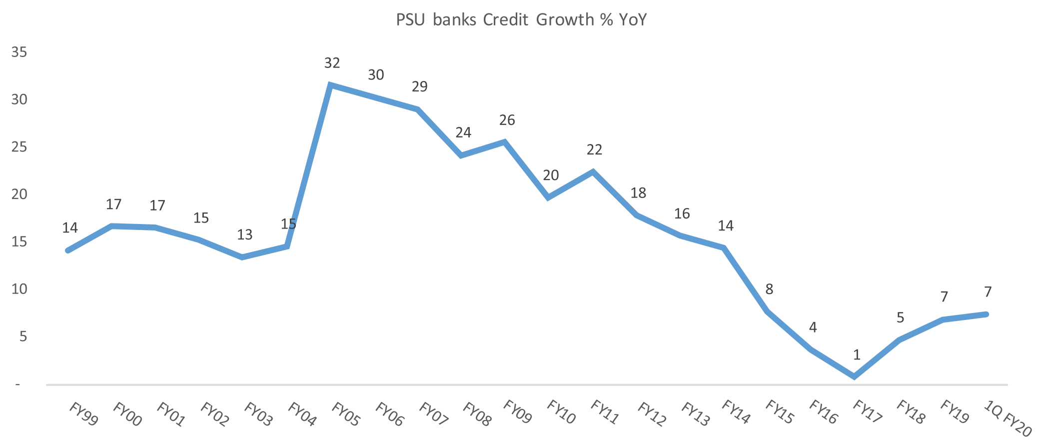
Exhibit 19- Credit Growth has picked up well since low of FY17

Gross Credit growth of SCBs touched low of 4% in FY17 and has been improving. However recent slowdown in the Indian economy as well as global economy may slowdown the pace in near term.



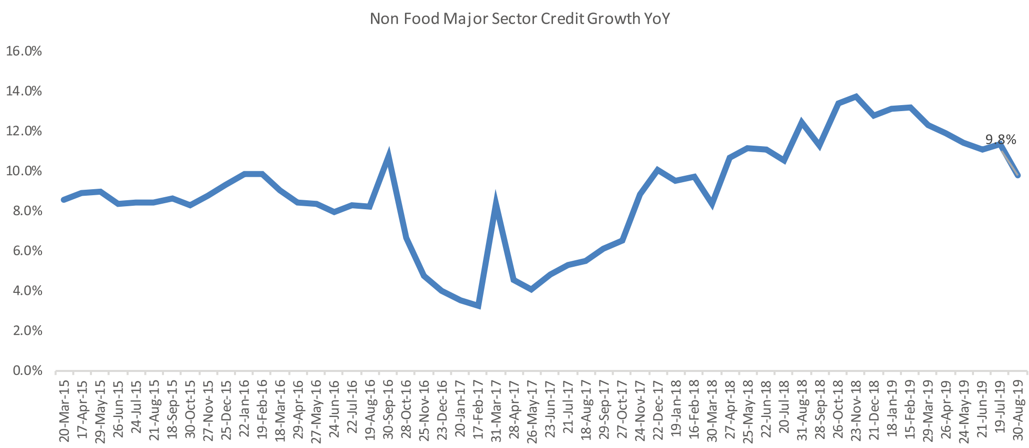
Source-RBI, Company

Exhibit 20- Credit Growth has been gradually improving for PSU banks



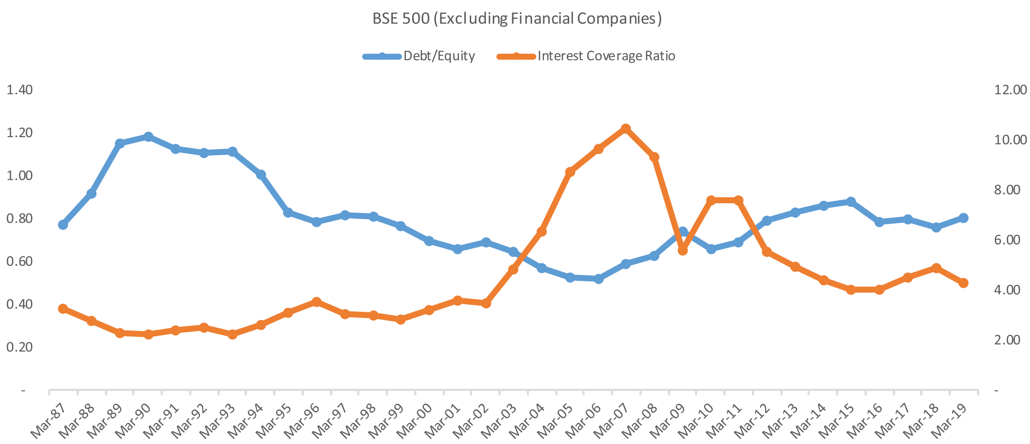
Source-RBI, Company

Exhibit 21- Recent Data by RBI- Deployment of Bank Credit by Major Sectors



Source: RBI

Exhibit 22- Barring Abruption in Fy19, D/E ratio showed improvement since high in FY15



Source-Company

IBC- A long pause or a lost opportunity

Total loan added from FY13-FY18 was Rs 39434, whereas gross slippages happened during the same period was Rs 19609 Bn representing 50% of the loan addition (net of repayment & write-offs). The sheer spike in NPA required intervention by all the stakeholder. RBI on its part kept on pushing banks to recognize the stress cases with various mechanism. Before FY17 series of act and agencies were formed to tackle the NPA mess but FY17 concluded the real reform with the Insolvency and Bankruptcy Code. IBC saw success also with the realization of 43% in NPA cases in two years against 23% average realization with earlier regime from 2008-18. But IBC still not upheld to the grand hopeful of stakeholders as the large 6 unresolved cases (Rs 1545 Bn) from dirty dozen has crossed 800 days against the promised deadline of 270 days. We kept on getting news on ESSAR steel and Bhushan Power that gives doubt on whether IBC framework has failed to deliver?

BANK	CMP	RECO.
AXSB	708	BUY
CUBK	210	NEUTRAL
DCBB	175	BUY
FB	80	BUY
HDFCB	1229	BUY
ICICIBC	469	BUY
IIB	1272	BUY
KVB	55	HOLD
KMB	1588	BUY
RBK	260	NEUTRAL
SIB	10	NEUTRAL
YES	52	UNDER REVIEW
BOB	91	BUY
BOI	66	BUY
CBK	193	BUY
SBIN	281	BUY
UNBK	53	HOLD

Only 120 Cases get resolved out of 2162 cases admitted

As per the IBBI report, 34% of the ongoing cases (CIRP) under IBC have crossed the deadline of earlier 270 days stipulated for resolution till June, 2019. Only 120 cases have been successfully resolved till June 2019, out of 2162 cases admitted for Corporate Insolvency Resolution Process (CIRPs). The success ratio is just below 6%. 475 companies (22% went for liquidation).

Average realization of large 6 cases from dirty dozen is 49%

Dirty Dozen- Out of 12 large cases shortlisted by RBI for resolution under IBC, only 6 cases have been resolved till date with average realisation of 49%. (Including ESSAR Steel India facing litigation in the court for realization appropriation between financial creditor and operation creditor).

Unresolved 6 cases from dirty dozen crossed 800 days against 270 days promised

Out of above the resolved 6 cases took average 458 days against stipulated maximum of 270 days under the NCLT. Whereas unresolved cases have crossed more than 800 days compelling banks to provide for ageing related provisions.

IBC recovery rate is 43% against 23% of earlier regime

The average recovery under IBC is around 43% where as it has been only 23% for various regimes earlier used by the banks. While the recovery realisation under IBC is much higher than the previous regime, however not adherence to the timeline prescribed for resolution has been losing its sheen as the delay in the resolution process deteriorate assets value as well as increasing the provisions requirement for the banks. The resolved 120 cases has seen average recovery of 43% on the claims admitted whereas it is 188% of the liquidation value.

50% of the cases was admitted by Operation creditors

Out of the 2162 corporate debtor admitted into the CIRP, 50% was initiated by Operation creditors while financial creditors initiated 40% of the CIRPs till June 2019.

Latest amendment provides 330 days to resolve the cases

The Amendment provides that the CIRP must mandatorily be completed within an overall timeline of 330 days from the insolvency commencement date (including all or any extensions granted as well as any litigations and related legal proceedings). Additionally, for an ongoing CIRP, in case the 330-day overall timeline has already been breached at the time the Amendment comes into force, the Amendment provides for an additional relaxation of 90 days as a transitionary measure.

Curious Case of ESSAR Steel

Essar Steel is a perfect case of various litigation paralysing the IBC process. Refer to the end.

Research Analyst

Deepak Kumar
deepak.kumar@narnolia.com

34% of the current outstanding cases has crossed the deadline

Exhibit 1- Status of Corporate Insolvency Resolution Process (CIRPs) as on 30th June 2019.

Status of CIRPs	No. of CIRPs
Admitted	2162
Closed on Appeal / Review/ Settled	174
Closed by Withdrawal under section 12A	101
Closed by Resolution	120
Closed by Liquidation	475
Ongoing CIRP	1292
> 270 days	445
> 180 days ≤ 270 days	221
> 90 days ≤ 180 days	349
≤ 90 days	277

Source: IBBI

Current Status of RBI's 1st List referred to NCLT

RBI shortlisted 12 large accounts aggregating about Rs 3.2 Lakh Crore to send to NCLT under IBC for quicker resolution. These accounts formed around 25% of the GNPA at the time of initiation. Later, during 2017, another list of 28 larger accounts with a total outstanding loan amount of Rs 2.3 lakh crore was shortlisted by the RBI to send to NCLT by the banks.

Exhibit 2- Dirty Dozen Status.

	Company	Claims Admitted (Rs in Cr	Date of CIRP initiated	Time Taken	Amount Realised (Rs in Cr)	Realization as a % of Claims	Remark
Resolved Cases	Electorsteel Steels Ltd	13,302	7/21/2017	270	5,320	40%	Average 458 days taken to resolve
	Bhushan Steel Ltd.	55,989	7/26/2017	293	35,571	64%	
	Monnet Ispat & Energy Ltd	10,412	7/18/2017	371	2,892	28%	
	Essar Steel India Ltd *	50,778	8/2/2017	583	30,030	59%	FC realised 49% of their claims
	Alok Industries Ltd.	29,912	7/18/2017	598	5,052	17%	
	Jyoti Structures Limited	8,078	7/4/2017	631	3,691	46%	
Unresolved	Amtek Auto Limited**	12,586	7/24/2017	Ongoing	-	-	Crossed more than 800 days till date
	Bhushan Power and Steel Ltd.	48,524	7/26/2017	Ongoing	-	-	
	ABG Shipyard***	18,539	8/1/2017	Ongoing	-	-	
	Jaypee Infratech Ltd	13,322	8/8/2017	Ongoing	-	-	
	Lanco Infra	51,505	8/7/2017	Ongoing	-	-	
	Era Infra Engineering Ltd	10,065	8/21/2017	Ongoing	-	-	

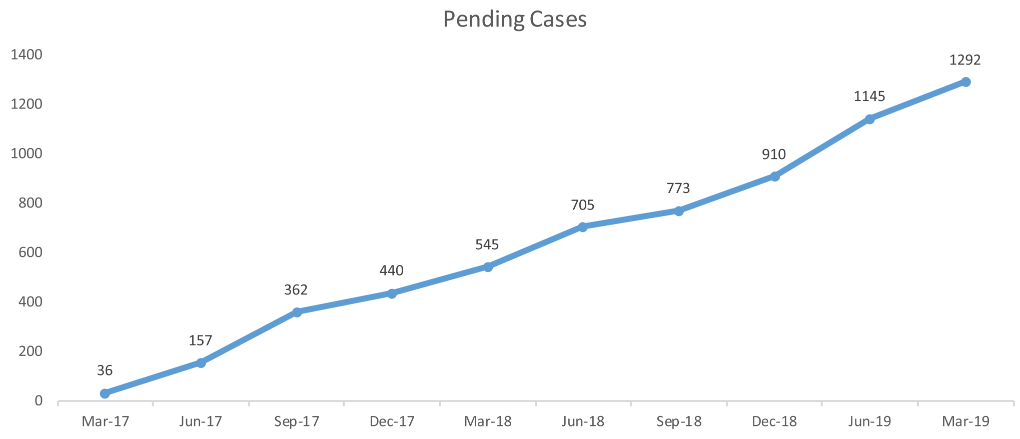
*Case is pending in SC for apportionment of reliasable value between FC and OC

**Again Initiated

***Ordered for Liquidation

Source: IBBI, media

Exhibit 3- Stacking Pending Cases.



Source: IBBI

Only 5.6% of the cases has been successfully resolved out of total cases admitted for CIRPs

Exhibit 4- Corporate Insolvency Resolution Process:

Quarter	CIRPs at the beginning of the Quarter	Admitted	Closure by				CIRPs at the end of the Quarter
			Appeal/ Review/ Settled	Withdrawal under Section 12A	Approval of Resolution Plan*	Commencement of Liquidation	
Jan - Mar, 2017	0	37	1	0	0	0	36
Apr - Jun, 2017	36	129	8	0	0	0	157
July - Sept, 2017	157	233	18	0	2	8	362
Oct - Dec, 2017	362	147	38	0	7	24	440
Jan - Mar, 2018	440	195	20	0	11	59	545
Apr - Jun, 2018	545	246	20	1	14	52	705
Jul - Sept, 2018	705	241	29	27	31	86	773
Oct - Dec, 2018	773	275	8	36	16	78	910
Jan - Mar, 2019	910	373	20	19	17	81	1145
Apr - Jun, 2019	1145	286	12	18	22	87	1292
Total	**NA**	**2162**	**174**	**101**	**120**	**475**	**1292**

Source: IBBI

Exhibit 5- Sectoral Distribution of CIRPs.

Manufacturing Sector lead the CIRP table with the share of 42% cases admitted followed by real estate at 19%. Real estate cases admitted has increased by 100% in last one year.

Sector	No. of CIRPs		
	Closed	Ongoing	Total
Manufacturing	382	517	899
Food, Beverages & Tobacco Products	37	68	105
Chemicals & Chemical Products	38	46	84
Electrical Machinery & Apparatus	32	46	78
Fabricated Metal Products	27	31	58
Machinery & Equipment	43	57	100
Textiles, Leather & Apparel Products	64	87	151
Wood, Rubber, Plastic & Paper Products	39	57	96
Basic Metals	76	86	162
Others	26	39	65
Real Estate, Renting & Business Activities	164	257	421
Construction	74	153	227
Wholesale & Retail Trade	97	117	214
Hotels & Restaurants	23	37	60
Electricity & Others	19	36	55
Transport, Storage & Communications	25	35	60
Others	86	140	226
Total	**870**	**1292**	**2162**

Source: IBBI

Resolved 120 Cases yielded 43% of the claimed amount

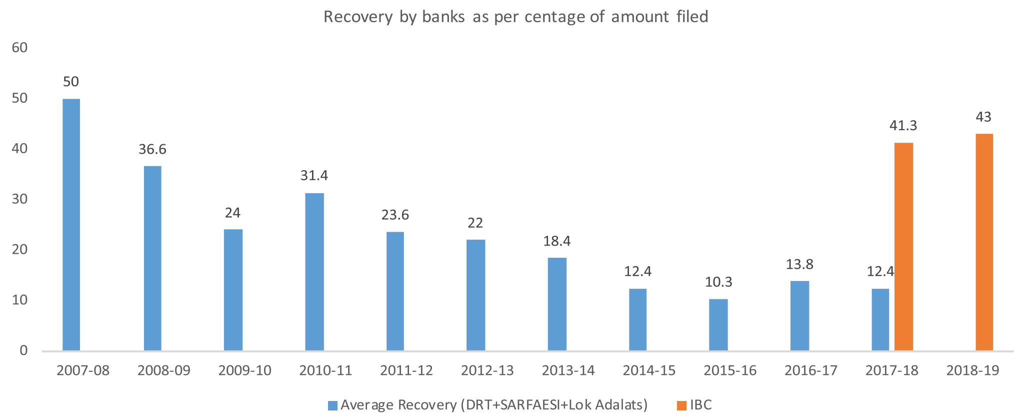
Exhibit 6- Realised Value till June 2019.

CIRPs yielding Result	Rs in Cr
Claims Admitted	2,52,577
Liquidation Value	57,547
Realised Value	1,08,070
Realised value % of Claim	43%
Realised Value % of Liquidation	188%

Source: IBBI

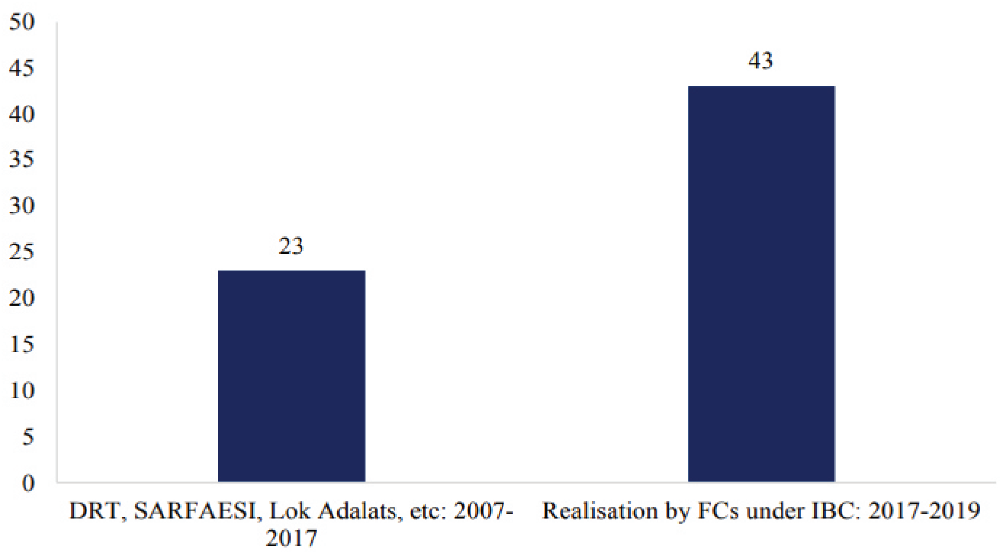
Recovery Under the IBC has been far better than earlier various regimes

Exhibit 7- Average recovery under various recovery regimes (in per cent).



Source: IBBI, RBI

Exhibit 8- Recovery under IBC is higher than previous regime.



Source: IBBI, RBI

Exhibit 9- Initiation of Corporate Insolvency Resolution Process.

Quarter	No. of CIRPs Initiated by			
	Operational Creditor	Financial Creditor	Corporate Debtor	Total
Jan - Mar, 2017	7	8	22	37
Apr - Jun, 2017	58	37	34	129
Jul - Sept, 2017	101	93	39	233
Oct - Dec, 2017	69	64	14	147
Jan - Mar, 2018	89	84	22	195
Apr - Jun, 2018	129	99	18	246
Jul - Sept, 2018	141	84	16	241
Oct - Dec, 2018	161	98	16	275
Jan - Mar, 2019	174	178	21	373
Apr - Jun, 2019	151	123	12	286
Total	**1080**	**868**	**214**	**2162**

Source: IBBI

Exhibit 10- Curious case of Essar Steel

Date	Status	Remark
Jun-17	Referre to NCLT	RBI referred banks dirty dozen cases to send to NCLT.
Aug-17	CIRP admitted	Essar Steel was admitted for Corporate Insolvency Resolution Process under Ahmedabad NCLT bench appointing Satish Kumar Gupta from Alvarez & Marsal India as IRP.
	Bids Offered	Numetal Ltd and Arcelor Mittal India Ltd submitted their bids in the first round.
	Eligibility Questioned	But their bids had been held ineligible. NCLAT had ruled that ArcelorMittal would be eligible to bid if it repaid the dues of debt defaulters KSS Petron and Uttam Galva as IBC doesn't allow participation of bidders connected to the companies that have defaulted. Numetal had been deemed in breach of this rule because it was established and partly owned, through intermediate entities, by a member of the Ruia family.
Sep-18	Bids Revised	Numetal and ArcelorMittal filed revised bids. ArcelorMittal offered Rs 42,000 crore to acquire Essar Steel Ltd, upstaging a Rs 37,000 crore bid by Russia's VTB Group-backed Numetal.
Oct-18	Eligibility Offered	Eligibility query of Numetal and ArcelorMittal ultimately reached the Supreme Court and the Court held that both parties may submit new bids for the company, but must first clear outstanding debts of related defaulters within two weeks.
Oct-18	CoC approved the Bid of Arcelor Mittal	CoC approved the Arcelor-Mittal plan that envisaged paying Rs 42,000 crore to the lenders.
	Offer from Promoter	Meanwhile Promoter of ESSAR Steel provided a settlement proposal to repay the complete debt of Rs 54,389 crore.
	Litigation by Operational Creditor	Around the same time, some operational creditors, Essar Steel shareholders and Standard Chartered separately challenged the resolution plan and the bid put in by ArcelorMittal.
Jan-19	Rejection of Promoter Offer	NCLT rejected Essar Steel's promotor offer to repay the debt.
Mar-19	NCLT approved Arcelor Mittal Bid	The Ahmedabad-bench of NCLT had okayed the bid submitted by ArcelorMittal, led by steel tycoon Lakshmi Mittal, for the takeover of Essar Steel.
Jul-19	NCLAT judgemenet on apportionment	In its judgment in July this year, the NCLAT positioned financial creditor (secured and unsecured) and operational collectors on the identical footing.
Jul-19	CoC filed petition against NCLAT judgement	The Financial Creditors challenged the NCLAT order within the Supreme Court, objecting to the equal therapy of varied courses of collectors. Additionally, they challenged the NCLAT's opinion on the ensures and indemnities given by Essar Metal promoter Prashant Ruia.
Oct-19	Still on	Case still going on.............

Source: Media, Company, IBBI

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Correspondence Office Address: Arch Waterfront, 5th Floor, Block GP, Saltlake, Sector 5, Kolkata 700 091; Tel No.: 033-40541700; www.narnolia.com.

Registered Office Address: Marble Arch, Office 201, 2nd Floor, 236B, AJC Bose Road, Kolkata 700 020; Tel No.: 033-4050 1500; www.narnolia.com

Compliance Officer: Manish Kr Agarwal, Email Id: mkagarwal@narnolia.com, Contact No.:033-40541700.

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