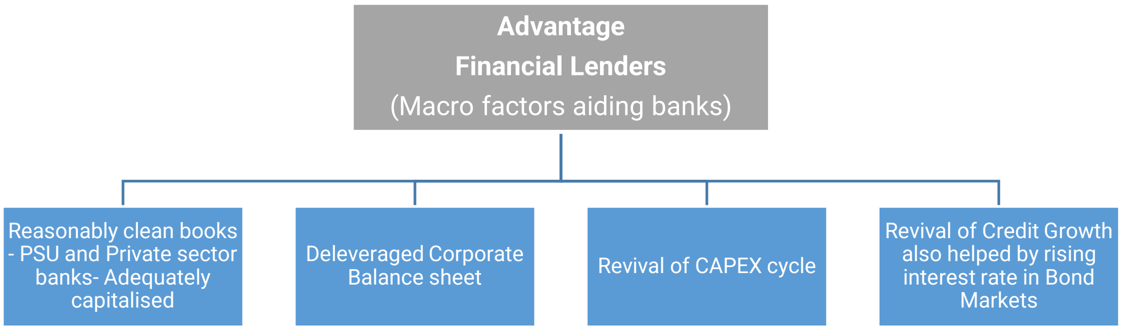
Why We Own What We Own- Financial Play

Jan 2023

Background

In the global economy, where financial conditions are tight and volatility in financial markets is on the rise, the Indian economy is confronting strong global headwinds. Sound macroeconomic fundamentals and healthy financial and non-financial sector balance sheets are providing strength and resilience and engendering financial system stability. Buoyant demand for bank credit and early signs of a revival in the investment cycle are benefiting from improved asset quality, return to profitability and strong capital and liquidity buffers of banks.



Lending Financials well placed in this cycle…

The RBI report released recently concluded that the banking sector has seen continuous improvement in most areas during the year i.e., improvement in credit and deposit growth, capital adequacy ratios are satisfactory, and non-performing assets (NPAs) have declined.

We believe that within financials, lenders are well placed in the current cycle for the following reasons:

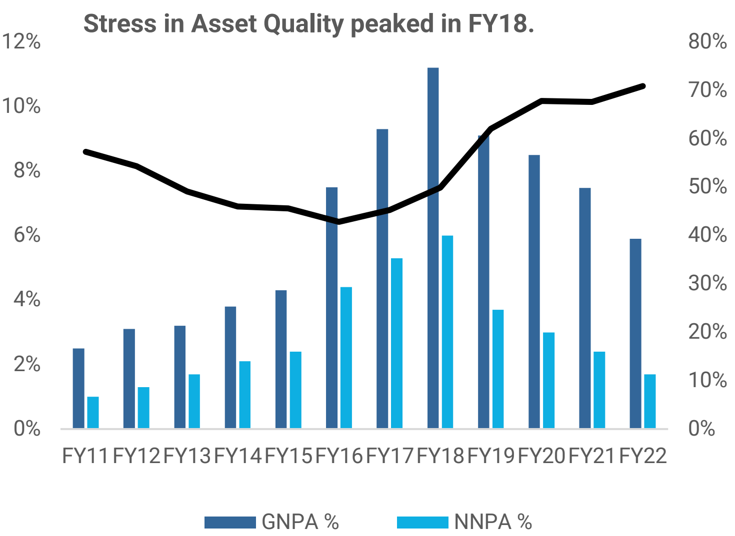
- **Revival of CAPEX cycle:** The current CAPEX by the central and states government is largely in the space of roads, railways and infra. However, the combined CAPEX announcements made by the private sector companies is 6-7 times more than the public sector. The capacity utilization has marched towards 75% levels and any further increase will augur well for private investment cycle. Revival in capex cycle shall aid industrial credit demand.

- **Deleveraged Corporate Balance sheet:** De-leveraging by the corporate sector has indicated the ability of the corporate sector to make fresh investments. This has given the much needed thrust to private sector capital investments, as companies, particularly in the capital-intensive sectors, have announced massive capacity expansion plans.

- **Revival of Credit growth:** Credit growth was at a 10-year high at the end of September 2022. All segments of loans, including working capital credit and term loans, have increased. Increase in yield in both, domestic and international bond markets have also led to increased credit growth in banking system.

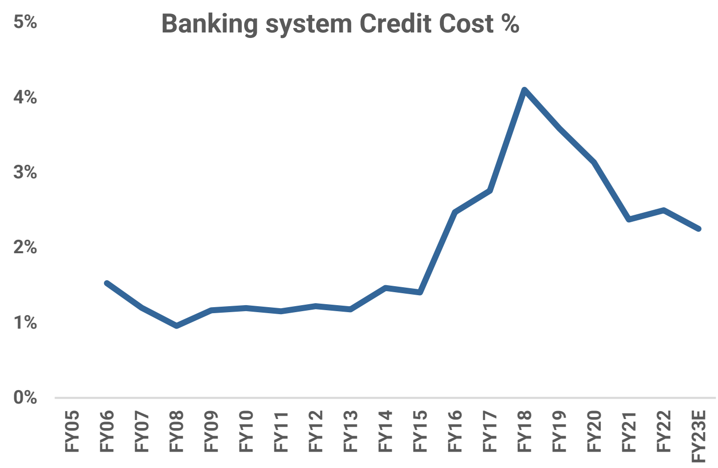
Reasonably clean books of PSBs and Private sector banks:

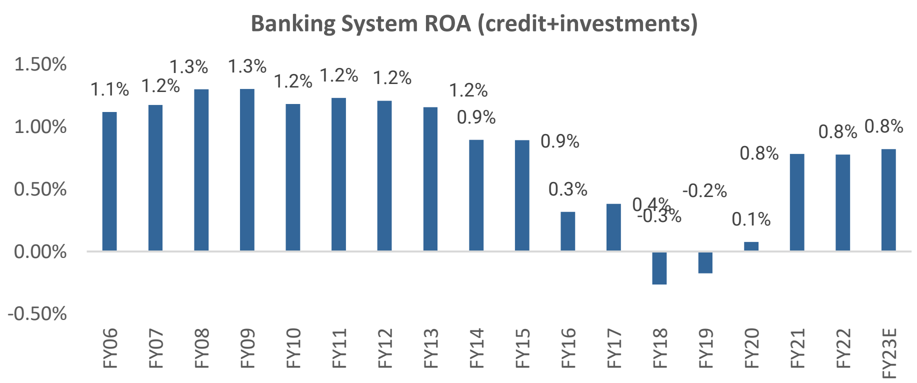
Both, PSBs and Private sector banks have seen significant improvement in their asset quality and capital position. Asset Quality stress peaked out in FY18 post the RBI AQR. PSU banks were the worst hit while Pvt corporate banks also took the hit. The Govt has made structural changes for longer management continuity in PSBs which is likely to improve their performance. Most banks have raised capital in the last 3 years, and they are now adequately capitalised to fund any increase in credit growth/CAPEX cycle.



Return ratios are improving:

Credit cost which used to be below 2%, increased to more than 4%. It has started to come down sharply but is yet to reach the earlier levels. It should reach the earlier levels in next few years which will lead to increase in profitability & return ratios for lenders. The ROA bottomed out in FY18 as most of the larger banks made losses due to high provision. Going forward, loan growth is expected to be strong, and provisions would be contained. Consequently, ROA is likely to inch up to earlier levels.





Source: RBI, Bloomberg, Internal Research.

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EDELWEISS MUTUAL FUND

We are overweight lending financials across our Equity Funds…

- We believe that Financial Lenders are better placed than the capital market, insurance, or other players as their earnings growth will be better and return ratios are set to improve.
- Banks will be better than NBFCs as we are in a rate tightening cycle, hence banks with higher retail deposits will benefit owing to lower cost of funding.
- Both Private and PSU banks may see earnings growth and improvement in return ratios.
- Large and mid-private sector banks provide visibility of stable & strong earnings as they have cleaned up the balance sheet and are adequately capitalised/have the ability to raise capital.

Lending Financials Play	Edelweiss Flexi Cap Fund	Edelweiss Large & Mid Cap Fund	Edelweiss Focused Equity Fund	Edelweiss Long Term Equity Fund	Edelweiss Mid Cap Fund	Edelweiss Small Cap Fund
% of NAV in Portfolio as of 31st Dec 2022						
Axis Bank Ltd.	5.0%	3.7%	5.6%	4.9%		
Federal Bank Ltd.	1.6%	1.7%	3.2%	0.5%	5.2%	2.2%
HDFC Bank Ltd.	6.2%	6.2%	6.6%	6.0%		
ICICI Bank Ltd.	9.1%	6.9%	8.5%	9.1%		
State Bank of India	5.6%	3.7%	5.2%	5.1%		
Canara Bank Ltd.					0.6%	
City Union Bank Ltd.					3.8%	2.2%
Indian Bank Ltd.					4.1%	1.7%
CSB Bank Ltd.						0.9%

Disclaimer

For fund risk-o-meter, please click here