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VALUATION AND RISKS

We value Union Bank of India using a two-stage Gordon growth model. Key assumptions are: cost of equity of 13.3%, normalized RoE of 10%, growth during stage one 10%, and steady state growth 4%. This gives us a target multiple of 0.8x, which we multiply by Sept '19E Adjusted BVPS (adjusted for Net NPLs) to get to our target price of Rs80.

Key upside risks that could cause Union Bank's shares to trade above our target price include: 1) sharp reduction in asset quality pressures, 2) easier interest rate environment leading to high treasury gains, 3) increase in loan growth, and 4) improvements in its deposit mix.

We value ICICI Bank using sum of parts methodology. The core banking business is valued using the two-stage Gordon Growth Model. Key assumptions are: cost of equity of 13.5%, normalized RoE of 14%, growth during stage one 15%, and steady state growth 4%. These give us a target multiple of 1.6x Sep '19E adjusted BVPS (adjusted for net NPA and investment in subsidiaries). Subsidiaries (post Holdco discount) contribute INR 140 to our TP, of which we value life insurance at our TP which is based on appraisal value, non-life insurance at its market price, and asset management as % of AuM. This gives us a Sep '19E SOTP target price of INR 390.

Downside risks that could impede the ICICI Bank shares from reaching our target price are: (1) higher-than-expected deterioration in asset quality; (2) reduction in net interest margins; (3) aggressive expansion in international operations where returns appear low and risk levels relatively high; and (4) inability to leverage capital, which keeps ROEs low.

Our target price of INR 2,270 for Indusind Bank shares is based on a two-stage Gordon Growth Model. Our key assumptions are: cost of equity of 12.2%, normalized RoE of 19%, growth during stage one 22%, and steady state growth 4%. This gives us Sep '19E P / Adj. BVPS (adjusted for net NPA) target multiple of 4.6x.

Key downside risks that could mean the IIB stock trades below our target price are: a) a continued slack in the overall credit cycle; b) a sharp squeeze in liquidity and/or interest rates; and c) pain in the CV cycle.

We value Yes Bank using two stage Gordon growth model. Key assumptions are: cost of equity of 14.0%, normalized RoE of 20%, growth during stage one 20%, and steady state growth 4%. This gives us target multiple of 2.9x, which we multiply by Sept '19E adjusted BVPS (adjusted for net NPA) to get to our target price of INR425.

Key downside risks that could prevent the stock from reaching our target price are: a) any further deterioration in the macroeconomic environment leading to lower growth; b) sharp deterioration in asset quality environment; c) weaker-than-expected capital markets given its relatively high proportion of fees from related activities; and d) further tightening of liquidity and interest rate environment.

We value SBI Life Insurance shares using an appraisal value methodology. Appraisal value is the sum of Embedded Value and Structural Value.

For EV calculations, we assume APE growth of 29.3% / 25.8% in FY19E / FY20E, and VNB margin of 17.0% / 17.5% in FY19E / FY20E.

To calculate Structural Value, we multiply one-year VNB by New Business (NB) multiple. We derive NB multiple of 34.0x using a modified two-stage Gordon growth model, the key assumptions being 20% growth during high-growth stage and 4% terminal growth.

This derives our target price of Rs910, which translates to Sep'19E P/EV of 3.5x.

While our quantitative risk-rating system suggests a High Risk rating for stocks with short trading histories, we believe a High Risk flag is not appropriate for SBI Life given multiple factors including its business model, solid track record, management, and industry dynamics.

Key downside risks which could prevent the shares from reaching our target price include: regulatory changes increasing compliance costs, competitive intensity leading to lower profitability, and volatile capital markets impacting investment returns.

We value MMFS using a sum-of-parts methodology. The core business is valued using the two-stage Gordon Growth Model. Key assumptions are: cost of equity of 13.3%, normalized RoE of 18.5%, growth during stage one 22%, and steady state growth 4%. This gives us a target multiple of 3.8x, which we multiply by Sep '19E Adjusted BVPS (adjusted for Net NPA and investment in subsidiaries). Subsidiaries contribute INR 50 to our TP, of which we value Rural Housing based on P/B and Insurance Broking based on P/E. This gives us Sep '19E SOTP based target price of INR 600.

Key downside risks that could cause MMFS shares to trade below our target price include: a) fall in market share and slower loan growth; b) deterioration in asset quality; c) tight liquidity and high interest environment; and d) regulatory changes.

Our target price of Rs225 for LTFH is based on a two-stage Gordon Growth Model. Key assumptions are: cost of equity of 13.5%, normalized RoE of 18%, growth during stage one 21%, and steady state growth 4%. These give us a target multiple of 3.0x Sept '19E Adjusted BVPS (adjusted for Net NPLs).

Key downside risks that could cause the stock to trade below our target price include: a) Deterioration in the growth outlook for the infrastructure segment; b) Worse than expected asset quality performance; and c) Change in interest rates/tighter liquidity.

We value EDEL on a 2-stage Gordon Growth valuation model. Key assumptions are: cost of equity of 13.5%, normalized RoE of 17%, growth during stage-one of 24%, and steady state growth of 4%. This gives us a target multiple of 3.9x PBV / 22x PE, which we multiply by Sep'19E adjusted BVPS (adjusted for net NPLs) / Sep-19 EPS to get to our target price of Rs350.

Given that ~35% of EDEL's PAT comes from capital light businesses, a pure PBV focus on valuation metrics may not be relevant - therefore PE ratio is also an important valuation benchmark.

Key downside risks that could cause EDEL shares to trade below our target price include: (1) asset quality pressures, (2) slower than expected credit growth, and (3) headwinds in the capital markets and asset management businesses.

We value Federal Bank using a two-stage Gordon growth model. Key assumptions are: cost of equity of 14.5%, normalized RoE of 13%, growth during stage one 18%, and steady state growth 4%. This gives us a target multiple of 1.5x, which we multiply by Sept '19E Adjusted BVPS (adjusted for Net NPLs) to get to our target price of INR 105.

Key upside risks that could mean the Federal Bank stock trades above our target price include: a) Improvement of the asset quality environment, especially large asset resolutions; and b) sustained loan growth and c) higher return on assets. The downside risks to Federal Bank shares achieving our target price include: a) small size and geographical concentration, which could lead to higher asset quality pressures in a slow growth environment; b) high dependence on the NRI segment, which is exposed to global, regulatory and competitive risks; c) aggressive acquisitions.

Our target price of Rs2,425 for HDFC Bank is based on a two-stage Gordon Growth Model. Key assumptions include: cost-of-equity of 12.0%, normalized RoE of 20.5%, growth during stage-one 21%, and steady-state growth 4%. These give us a target multiple of 4.8x Sept '19E adjusted BVPS (adjusted for net NPA).

The key downside risks to our target price for HDFC Bank include: 1) any negative news on asset quality; 2) potential management changes; 3) emergence of high quality and scale competitors; and 4) changing risk perceptions of private banks.

We value Kotak shares at Rs1,430 using sum of parts methodology. The banking business is valued using the two-stage Gordon Growth Model. Key assumptions are: cost of equity of 12.3%, normalized RoE of 17%, growth during stage one 25%, and steady state growth 4%. These give us a target multiple of 4.7x Sep '19E adjusted BVPS (adjusted for net NPA and investment in subsidiaries). We value life insurance using appraisal value, asset management and alternate assets as % of AuM, securities and capital markets on P/E, and other business like Kotak Prime, International subsidiaries and Kotak Investments on P/B.

We believe key downside risks to our target price and the business include: a) a sharp downturn in the capital markets; b) significant pressure on asset quality; c) and loan growth slowing down due to economic weakness, as Kotak tends to be more conservative than other banks.

We value ICICI Prudential Life Insurance shares using an appraisal value methodology. Appraisal value is the sum of Embedded Value and Structural Value. For EV calculations, we assume APE growth of 25.9% / 22.3% in FY19E / FY20E, and VNB margin of 17.5% / 18% in FY18E / FY19E.
To calculate Structural Value, we multiply one-year VNB by New Business (NB) multiple. We derive NB multiple of 38.6x using a modified two-stage Gordon growth model, the key assumptions being 17% growth during high-growth stage and 4% terminal growth. This derives our target price of INR 525, which translates to Sep '19E P/EV of 3.0x.

Key downside risks that could cause ICICI Prudential Life Insurance shares to trade below our target price include: (1) regulatory changes increasing compliance costs, (2) competitive intensity leading to lower profitability, and (3) forced open architecture for banks impacting distribution arrangement with ICICI Bank.

We value HDFC Life Insurance shares using an appraisal value methodology. Appraisal value is the sum of Embedded Value and Structural Value. For EV calculations, we assume APE growth of 29% / 28% in FY19E / FY20E, and VNB margin of 24.0% / 24.5% in FY19E / FY20E. To calculate Structural Value, we multiply one-year VNB by New Business (NB) multiple. We derive NB multiple of 35.2x using a modified two-stage Gordon growth model, the key assumptions being 20% growth during high-growth stage and 4% terminal growth. This derives our target price of Rs400, which translates to FY19E P/EV of 3.7x.

While our quantitative risk rating system suggests a High Risk rating for stocks with short trading histories, we believe a High Risk flag is not appropriate for HDFC Life given multiple factors including its business model, solid track record, management, and industry dynamics.

Key upside risks that could cause HDFC Life shares to trade above our target price include: i) Further improvement in margins which may warrant higher multiple; ii) Higher yield on investments; iii) Strong pick-up in volume growth; iv) Favorable regulatory directive; and v) Macro tailwinds - Increase in India's life insurance penetration and density, higher GDP, and rising financial awareness.

Our target price of Rs600 for LIC Housing Finance is based on a two-stage Gordon Growth model. Key assumptions are: cost of equity of 13.9%, normalized RoE of 18%, growth during stage one 16%, and steady state growth 4%. These give us a target multiple of 2.0x Sept '19E adjusted BVPS (adjusted for net NPA).

Key upside risks that could mean the LIC Housing Finance stock trades above our target price include: a) a strong pickup in retail mortgage growth either due to affordable housing or broader economic revival, and b) a sharp decline in funding costs leading to NIM expansion. Key downside risks that could impede the stocks from reaching our target price include: a) higher NPLs from its non-mortgage book, which has grown significantly in recent years, and b) competitive intensity leading to sharper lending rate cuts that impact NIM.

We value RBL Bank using a two-stage Gordon growth model. Key assumptions are: cost of equity of 13.5%, normalized RoE of 15%, growth during stage one 24%, and steady state growth 4%. This gives us a target multiple of 3.2x, which we multiply by Sep '19E Adjusted BVPS (adjusted for Net NPLs) to get to our target price of Rs590.

Key upside risks include: 1) Higher than expected growth rates and a faster shift in favour of non-wholesale loan; 2) CASA gains beyond the ~25% ratio that we estimate by FY19E. Key downside risks include: 1) Volatility in asset quality (particularly in Corporate banking or in DBFI, which has been facing challenges after demonetization); 2) Slower than expected growth rates, especially in non-wholesale segments.

We value Shriram Transport using a two-stage Gordon growth model. Key assumptions are: cost of equity of 14.5%, normalized RoE of 18%, growth during stage one 20%, and steady state growth 4%. This gives us a target multiple of 2.3x, which we multiply by Sept '19E Adjusted BVPS (adjusted for Net NPLs) to get to our target price of Rs1,580.

We believe the key downside risks that could impede Shriram Transport shares from reaching our target price include: a) Asset quality - slower economic activity and weak rural demand could keep credit costs high; b) Wholesale funding - can hurt in a tight-liquidity scenario; c) Regulatory changes in the NBFC and transportation sectors; d) Impact of GST – A rise in formalization post GST could see banks gaining some share from SHTF.

Our target price of INR155 for BoB is based on a two-stage Gordon Growth Model. Key assumptions are: cost of equity of 14.0%, normalized RoE of 13%, growth during stage one 12%, and steady state growth 4%. These give us a target multiple of 1.1x Sept '19E adjusted BVPS (adjusted for net NPA).

Key upside risks that could mean the BoB stock trades above our target price include: a) Improvement of the asset quality environment, especially large asset resolutions; and b) a sustained pickup in loan growth, in its focus segments of Retail and MSME. Key downside risks that could impede the stock from reaching our target price include: a) consolidation among government banks leading to BoB being asked to acquire one or more weaker banks and b) competitive intensity leading to NIM compression.

Our target price for AUBANK is Rs590. We value the AUBANK stock using a two-stage Gordon Growth Model, with our key assumptions being: cost of equity of 13.8%, normalized RoE of 20%, growth during stage one of 30%, and a steady state growth of 4%. This gives us a target multiple of 6.1x Sep' 19E adjusted BVPS (adjusted for net NPLs).

Key upside risks that could mean the AUBANK stock trades above our target price include: a) stronger than expected AUM growth; b) an accelerated build-up of the deposit franchise; and c) lower interest rates and funding costs.

We value BJFN using a two-stage Gordon growth model. Key assumptions are: cost of equity of 13.0%, normalized RoE of 20%, growth during stage-one of 22%, and steady-state growth of 4%. This gives us target multiple of 6.0x, which we multiply by Sep '19E adjusted BVPS (adjusted for net NPA) to get to our target price of Rs2,200

Key upside risks that could cause BJFN shares to trade above our target price include: a) stronger than expected AuM growth due to strong economy; and b) sharp decline in funding costs leading to NIM expansion. Key downside risks that could cause BJFN shares to trade below our target price include: a) decline in lending yields due to increasing competitive intensity in the segments in which BJFN lends; and b) higher than expected NPL, especially from unsecured loans.

Our target price for Axis for INR 560 is based on a two-stage Gordon Growth Model. Key assumptions are: cost of equity of 13.8%, normalized RoE of 17%, growth during stage-one 17%, and steady state growth 4%. These give us a target multiple of 2.1x Sept '19E adjusted BVPS (adjusted for net NPA).

Key downside risks for the Axis shares achieving our target price include: 1) Greater-than-expected asset quality pressures, as Axis has grown rapidly: while recovery expectations are rising; 2) Sharp slowdown in rapidly growing retail fee income.

Key upside risks: (1) Faster resolutions under IBC process leading to higher than expected NPA recoveries; (2) Improvement in economic activity leading to faster than expected corporate loan growth.

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