

Banks

India

Sector View: **Attractive** NIFTY-50: **21,666**

January 03, 2024

Payouts are within the regulatory thresholds

The RBI has laid out an updated framework on dividend declaration for banks and the repatriation of profits for foreign banks. The framework ties the payout ratios to net NPL ratios as compared to the earlier grid-based framework that compared capital adequacy levels and net NPL ratios. Banks have generally been conservative on payout ratios even when we look back historically, and with net NPL ratios reaching closer to historical lows, the impact of the current guideline is negligible for the sector.

New guideline ties payout ratios to net NPL ratios

The RBI's new guideline for dividend payout ratios and profit repatriation for foreign banks is on the following lines: (1) the board should look at any divergence in asset classification, qualifications by auditors, current and projected capital adequacy ratios and long-term growth projections of the bank before dividend declaration; (2) eligibility criteria: comply with capital adequacy ratios for the preceding three financial years, including the financial year for which a dividend is declared and the net NPL ratio has to be <6%; and (3) the payout ratio would be tied to net NPL ratios, with a higher net NPL ratio leading to lower payout ratios and vice versa. These guidelines would be applicable for dividends declared from FY2024-25.

Adapting toward the current banking system

As highlighted by the notification, these guidelines have been revised in light of the implementation of Basel III standards, introduction of the prompt corrective action (PCA) framework, and the introduction of differentiated banks where the capital requirements are different. Note that the guidelines on payout ratios were previously updated in 2003-05 and there was a need to modify them to adapt to the current banking system.

Impact is closer to negligible based on the current policies adopted by banks

Exhibits 2 and 3 show the dividend payout ratios for banks. Exhibit 2 shows the historical payout ratios, while Exhibit 3 compares the latest net NPL ratio (2QFY24) with the payout ratio of FY2023 to provide a perspective on the potential impact of the current guideline. Historically, the payout ratios have usually been closer to 20%, which implies that the threshold net NPL ratio that is permissible is between 2 and 6%. We currently have very few banks that have net NPL ratios higher than 2% (2QFY24) and even these banks have been quite prudent in their dividend declaration. As such, we do not see any impact from the current guidelines for any of the banks. One of the reasons that the impact of the guideline is lower is because banks have been looking to grow their balance sheet ahead of their internal accruals. Hence, most banks are still in a capital consumption mode, which implies payout ratios are likely to be lower for nearly all banks. Overall, we do not see any reason for banks to change their dividend payout policies based on the current guideline.

Quick Numbers

Dividends to be declared only after banks comply with capital adequacy norms for the three preceding financial years and have a net NPL ratio <6%

Payout ratios are linked to net NPL ratios as compared to the grid-based framework adopted previously.

Negligible impact for banks under coverage. A few banks that still have net NPL ratios higher than 2%

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The current mechanism is linked to net NPL ratio of banks

Exhibit 1: RBI's framework for banks on dividend declaration

| Net NPL ratio bands | Payout ratio |
|---------------------|--------------|
| 0 | 50 |
| 0-1 | 40 |
| 1-2 | 35 |
| 2-4 | 25 |
| 4-6 | 15 |

Source: RBI, Kotak Institutional Equities

Dividend payout ratio has been closer to 20% post the resumption of dividends since Covid and closer to long-term averages

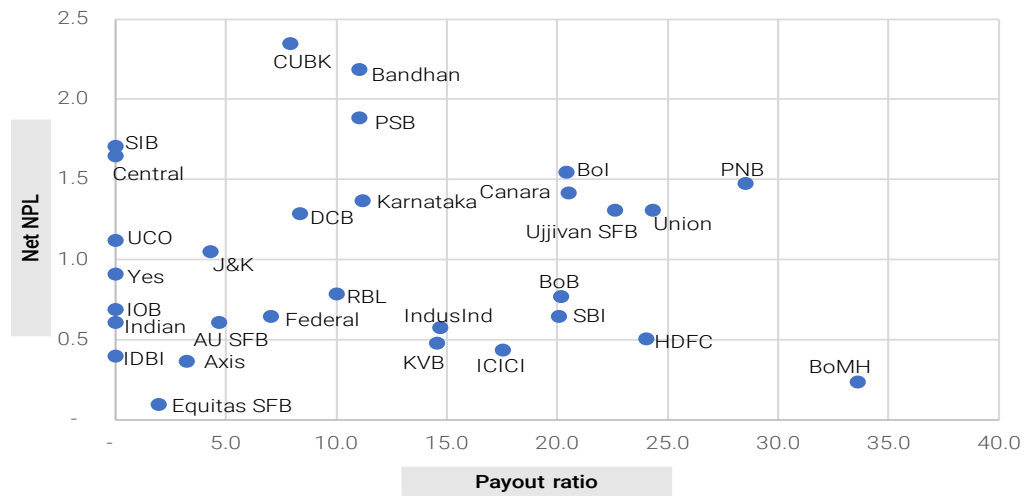
Exhibit 2: Dividend payout ratios across banks, March fiscal year-ends, 2009-23 (%)

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|----------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Public banks | | | | | | | | | | | | | | | |
| BoB | 15 | 18 | 15 | 14 | 20 | 20 | 21 | — | 20 | — | — | — | — | 20 | 20 |
| BoI | 14 | 21 | 15 | 15 | 22 | 12 | 19 | — | — | — | — | — | — | — | 20 |
| BoMH | 17 | 20 | 29 | 30 | 20 | 25 | 19 | — | — | — | — | — | — | 29 | 34 |
| Canara | 16 | 14 | 12 | 15 | 20 | 22 | 18 | — | 5 | — | — | — | — | 21 | 21 |
| Central | 14 | 8 | 11 | 28 | 26 | — | 14 | — | — | — | — | — | — | — | — |
| Indian | 18 | 19 | 19 | 19 | 18 | 18 | 20 | 10 | 21 | 23 | — | — | — | — | — |
| IoB | 18 | 27 | 29 | 34 | 33 | 10 | — | — | — | — | — | — | — | — | — |
| PNB | 20 | 18 | 16 | 15 | 20 | 54 | 20 | — | — | — | — | — | — | 20 | 29 |
| PSB | — | — | 8 | 10 | 20 | 20 | 20 | 20 | — | — | — | — | — | — | 11 |
| SBI | 20 | 21 | 23 | 20 | 20 | 21 | 20 | 20 | 20 | — | — | — | 17 | 20 | 20 |
| UCO | 11 | 13 | 32 | 31 | 47 | 17 | 19 | — | — | — | — | — | — | — | — |
| Union | 15 | 13 | 20 | 25 | 22 | 15 | 21 | 10 | — | — | — | — | — | 25 | 24 |
| New private banks | | | | | | | | | | | | | | | |
| Axis | 20 | 19 | 17 | 16 | 16 | 15 | 15 | 14 | 34 | — | 5 | — | — | 2 | 3 |
| Bandhan | | | | | | | | | — | — | — | — | 7 | — | 11 |
| DCB | — | — | — | — | — | — | — | — | 7 | 9 | 10 | — | — | 11 | 8 |
| HDFC | 19 | 19 | 20 | 20 | 20 | 19 | 20 | 20 | 19 | 19 | 19 | — | — | 23 | 24 |
| ICICI | 30 | 30 | 28 | 29 | 28 | 30 | 26 | 30 | 16 | 14 | 19 | — | 9 | 15 | 18 |
| IDBI | 21 | 21 | 21 | 19 | 24 | 14 | 14 | — | — | — | — | — | — | — | — |
| Indusind | 30 | 21 | 16 | 13 | 15 | 13 | 12 | 13 | 13 | 12 | 14 | — | — | 14 | 15 |
| RBL | 34 | 33 | 77 | 10 | 16 | 27 | 17 | 17 | 15 | 14 | 13 | 15 | — | 5 | 10 |
| Yes | | | 17 | 19 | 22 | 22 | 20 | 21 | 17 | 16 | 15 | — | — | — | — |
| Old private banks | | | | | | | | | | | | | | | |
| CUBK | 20 | 20 | 16 | 15 | 15 | 16 | 18 | 16 | 18 | 3 | 5 | — | 6 | 10 | 8 |
| FB | 17 | 18 | 25 | 20 | 18 | 41 | 19 | 25 | 19 | 22 | 22 | — | 9 | 20 | 7 |
| J&K | 20 | 21 | 20 | 20 | 23 | 20 | 20 | 21 | — | — | — | — | — | — | 4 |
| KVB | 27 | 19 | 31 | 30 | 27 | 33 | 35 | 39 | 26 | 13 | 23 | — | 11 | 19 | 15 |
| KBL | 27 | 32 | 28 | 27 | 22 | 24 | 21 | 23 | — | — | — | — | — | 11 | 11 |
| SIB | 17 | 19 | 19 | 17 | 19 | 21 | 26 | 20 | — | — | — | — | — | — | — |
| Small finance banks | | | | | | | | | | | | | | | |
| AU SFB | | | | | | | | | — | 10 | 11 | — | — | 3 | 5 |
| Ujjivan SFB | | | | | | | | | — | — | — | — | — | — | 23 |
| Equitas SFB | | | | | | | | | — | — | — | — | — | — | 2 |

Source: Company, Kotak Institutional Equities

We do not see the current guideline to have any impact on banks with the current payout structure

Exhibit 3: Net NPL (2QFY24) and payout ratios (FY2023) for banks, March fiscal year-ends (X)



Source: Company, Kotak Institutional Equities

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ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5+5% returns over the next 12 months.

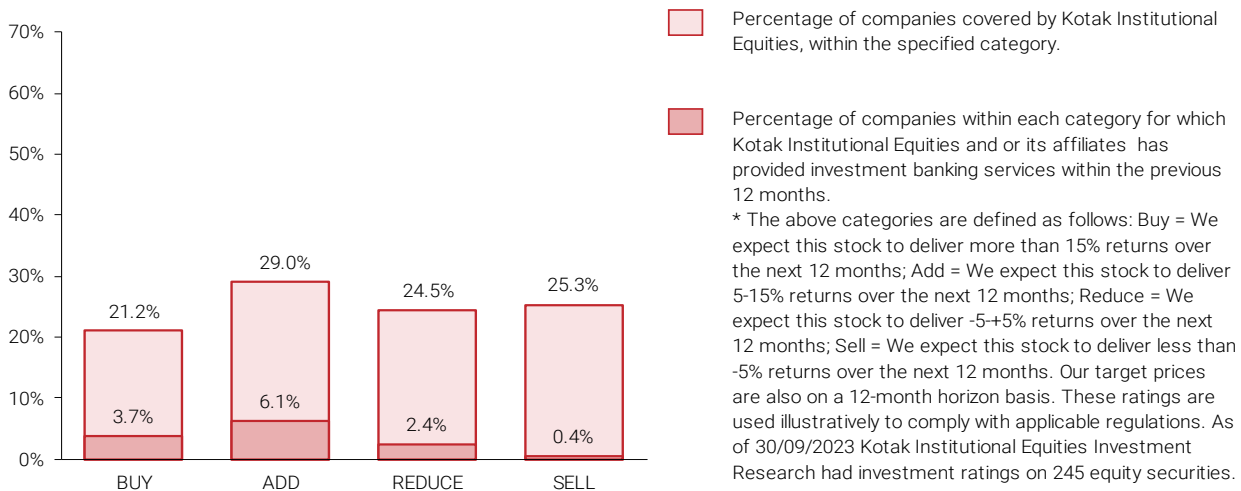
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As of September 30, 2023

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