

**PSLCs bought by Banks**

(INRb)	FY21	FY22
HDFCB	843	1,006
ICICIBC	358	715
KMB	199	121
AXSB	597	536
IIB	168	12
BANDHAN	24	190
FB	120	162
RBK	54	65
DCBB	11	-
SBIN	1,258	1,380
BOB	40	35
PNB	100	60

PSLCs sold by Banks

(INRb)	FY21	FY22
HDFCB	20	-
ICICIBC	418	1,014
KMB	246	546
AXSB	500	544
IIB	174	114
BANDHAN	704	418
AUBANK	147	180
RBK	10	-
DCBB	80	56
SBIN	-	-
BOB	52	10
CBK	480	400
UNBK	185	89
INBK	NA	348.3

Credit growth witnessing sharp recovery – How PSL ready banks are?**PSLC purchase rises sharply during FY22; expect demand to surge further**

- Demand for PSL loans are set to rise mainly as the overall credit growth revives. We note that already during FY22 system trading volume of PSLCs rose 12.4% to INR6.6t as compared to a growth of 25.9% in FY21. Besides, the impending merger of HDFCB with HDFC may also drive elevated demand for PSL assets.
- Over the past few years, the top Private Banks have grown their Priority Sector Loan (PSL) book faster than aggregate loans. The PSL loans for the top four Banks (barring ICICIBC) have grown faster than overall loans (~3 to 16% range) due to slower growth in the Corporate segment. Public Banks too (barring PNB) witnessed a higher growth trend in PSL advances.
- Although most banks in our report do meet the broad PSL norms – lending 40% of their Adjusted Net Bank Credit (ANBC) to priority areas and the weaker sections of society, there are frequent slippages in meeting targets for individual sub-segments. This deficit is plugged by purchasing PSLCs for a fee or putting money in RIDF deposits.
- Private Banks are far more active in transacting (buying/selling) PSLCs to meet their PSL targets as compared to their Public counterparts.
- On asset quality – PSL portfolio of Private Banks is better placed v/s their Public counterparts owing to former's stronger underwriting skills. Headline GNPA for the priority sector loan book of large Private Banks is in the 1.9-2.7% range while for PSBs NPAs in PSL portfolio varies between 7.5%-19.9%.
- As credit growth continues to revive (MOFSL of avg. ~13% over FY23-24 vs 7% avg. over FY20-22) we believe that the focus on PSL compliant loans will increase significantly. We thus believe that banks with healthy PSL portfolios are well positioned to capitalize from the revival in credit growth.

PSL growth tracking higher than overall loan growth for Private Banks

Over the recent years Private Banks have grown their PSL book faster than aggregate loans due to muted trends in Corporate segment after the clean-up and ongoing deleveraging across most large corporates. Among Private Banks, the gap between growth in PSL loans and total advances is highest for AXSB (at +1,620bp), followed by KMB (at +1,020bp), and IIB (at +580bp). BANDHAN and DCBB reported a lower growth in their PSL portfolio v/s total advances with BANDHAN also buying heavy quantum of PSLCs during FY22 though DCB remains comfortably placed. Within PSBs, the gap is narrower, but the trend of higher growth in PSL loans in comparison to overall advances is intact, with PNB being the outlier.

Industry category leads growth in priority sector advances

Priority sector advances are bifurcated into four different categories: a) Agriculture and allied activities, b) Advances to industries under PSL ambit (MSMEs engaged in the production of a wide range of specified items), c) Services, and d) Personal loans. A close examination of banks under our coverage reveal that the combined PSL grew at 17% CAGR between FY19-22 and was led by Industry (22% CAGR over FY19-22), followed by Agriculture (20% CAGR), Services (15% CAGR), and Personal loans (13% CAGR). Most Private Banks reflect this trend, barring AUBANK, BANDHAN, and DCBB, which have aggressively grown their Personal loan book. For PSBs, the growth in priority sector loans is more broad-based.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilalosal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Cost of buying PSLCs

INRb	FY21	FY22
ICICIBC	13.2	13.2
AXSB	10.1	12.5
PNB	1.8	1.5

Income from sale of PSLCs

INRb	FY21	FY22
AXSB	2.2	3.5
BANDHAN	7.3	6.6
CBK	7.9	9.1
UNBK	0.2	1.4
INBK	4.1	5.7

Income from sale of PSLCs as a % of Other Income

%	FY21	FY22
AXSB	1.8%	2.3%
BANDHAN	36.2%	23.3%
CBK	5.3%	5.5%
UNBK	0.2%	1.1%
INBK	7.3%	8.3%

PSL Shortfall: Stable trend in deposits with National Development Banks

Priority sector loan compliance is evaluated on a quarterly average basis from FY17. The shortfall in the amount required to be lent to priority sectors and weaker sections can be deposited in the Rural Infrastructure Development Fund (RIDF) established with NABARD, and other funds with NABARD/NHB/SIDBI/MUDRA as decided by the RBI from time to time. These deposits have a maturity of up to seven years and carry an interest lower than market rates, depending on the shortfall. This is usually in the range of the Bank rate minus 2% to Bank rate minus 5%. Most Banks meet their priority sector loan regulations via the purchase of PSLCs. However, in case of a further deficit, they are required to place deposits with such institutions. Given limited disclosures by Banks, we note that KMB/ICICIBC/HDFC Bank are better placed with a lower share of RIDF deposits compared to AXISB and FB.

Buying PSLCs has been a key alternative to comply with PSL targets

Although most banks in our coverage broadly meet the overall priority sector lending norms – lending 40% of their ANBC to priority areas and weaker sections of society, there are frequent slippages in meeting targets for individual sub-segments. For instance, a minimum of 18% of ANBC should be lent to Agriculture and 7.5% to micro enterprises. To bridge this deficit, Banks frequently trade in PSLCs and there is no transfer of risks or loan assets in these transactions. The fee paid for the purchase of PSLC is treated as an 'expense', while fee received from the sale of a PSLC is treated as 'other income'. Usually, Private Banks are significantly more active in transacting in PSLCs. Within private, HDFCB was the biggest buyer (net) of PSLC in FY22 while other larger Banks were net sellers. Within PSU Banks, SBIN was the biggest buyer (net) of PSLC while CBK and INBK were prominent sellers.

PSL loans: AQ divergence high between Private Banks and PSBs

PSL portfolio of Private Banks is better placed vis-à-vis their Public counterparts, owing to their conservative underwriting and pressure to lend for social objectives for PSBs. As a result, GNPA ratio of PSL segment for coverage Private Banks (1.9-7.2% range) compares favorably to that of PSBs (7.5-19.9% range). Excluding personal loans, other segments suffer from a high GNPA ratio, with Agriculture being the highest.

PSLC demand to increase; healthy PSL enables bank to capitalize on growth

We note that the cost of buying a PSLC varies in the range of 0.6-2.5% of the value of the certificate. At times, prices can be affected due to one-off events. For instance, in a drought like situation, the demand for Agriculture certificates will rise as Banks turn cautious in lending to the sector. A lower fee is typically charged for general PSLCs, while a higher fee is charged for small and marginal farmer PSLC (requirement of 10% of ANBC). Private Banks typically buy more of Agriculture, Small and Marginal Farmer related certificates as compared to Public Banks, driven by their past asset quality experiences in lending to these segments. Demand for PSL loans is set to increase mainly as the overall credit growth revives. Moreover the impending merger of HDFCB with HDFC may also drive elevated demand for PSL assets thereby increasing the cost of PSLCs. We thus believe that banks with healthy PSL portfolios are well positioned to capitalize from revival in credit growth.

PSL portfolio growing faster than overall loans for most Banks

Fairly balanced product mix within PSL loans with slight tilt towards Agri segment

RBI's guidelines on priority sector lending require Banks to lend 40% of their ANBC to fund certain types of activities carried out by specified borrowers. These priority sectors include Agriculture; micro, small, and medium enterprises; Education; Housing, Social Infrastructure, Renewable Energy, and export credit.

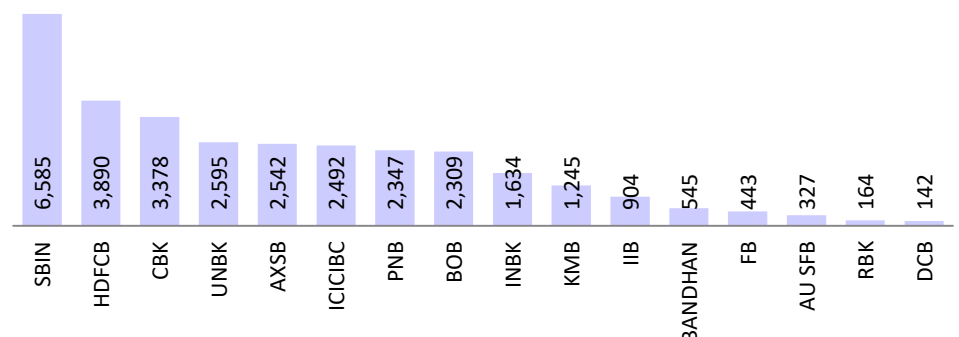
Priority sector loans are bifurcated into four different categories:

- **Agriculture and allied activities** include credit extended to farms, be it an individual, or a group or an association of farmers. It also includes loans disseminated for infrastructure and ancillary services related to Agriculture, such as procurement of produce, food processing, etc.
- **Advances to industries** eligible under priority sector loans include lending to MSMEs engaged in the production of a wide range of specified items under the first schedule to the Industries (Development and Regulation) Act, 1951.
- **Services:** This consists of loans given to small and micro enterprises and individuals in order to enable them to provide services and thus, conduct their business activities.
- **Personal loans:** This primarily comprises of loans to individuals for the purpose of education and housing. In addition, it also includes loans given for affordable housing projects and housing finance companies (HFCs) with some specific conditions.

Exhibit 1: Three PSU Banks feature among the top 5 Banks by size of PSL portfolio

■ Priority Sector Advances (Net), INRb

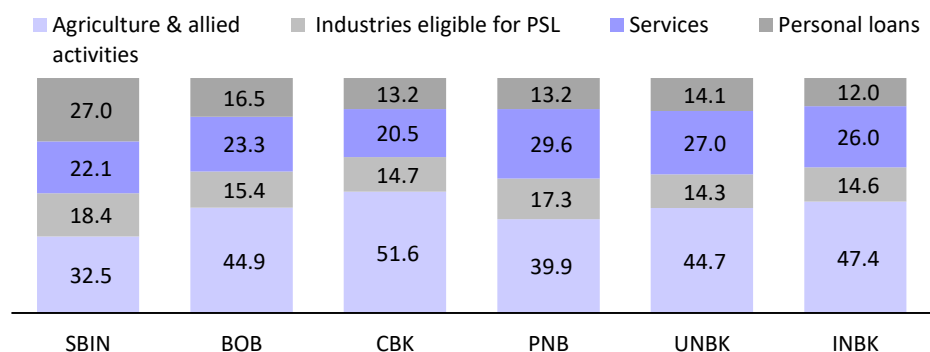
Despite highest PSL portfolio in coverage, SBIN and HDFCB were also the largest buyers of PSLCs across all categories



In the following exhibits, we have shown the segmental split of PSL portfolio across Banks.

Exhibit 2: Agriculture and allied activities is the largest segment for PSBs within the priority sector loan portfolio

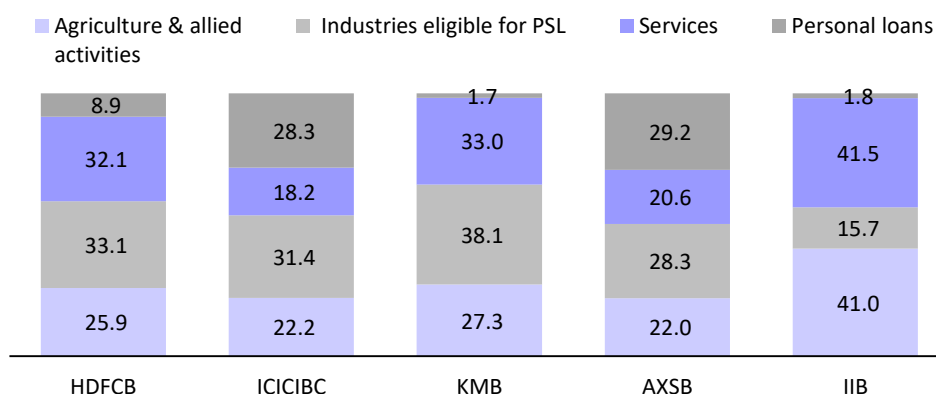
The mix of the Agriculture segment in priority sector loans is significantly higher for PSBs as compared to their Private peers



Source: MOFSL, Company

Exhibit 3: ICICIBC and AXSB have the most balanced PSL portfolio amongst large Private Banks

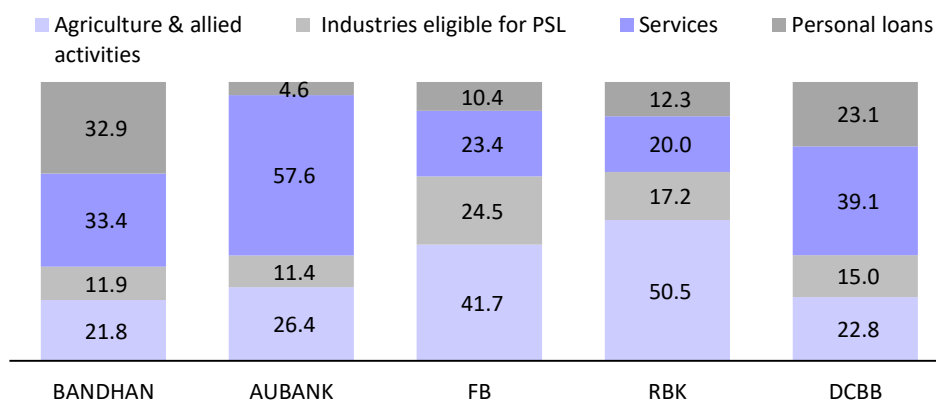
Within priority sector loans, KMB, IIB, and HDFCB have low exposure to personal loans due to lower market share in mortgages in comparison to ICICIBC and AXSB



Source: MOFSL, Company

Exhibit 4: Small and mid-sized Private Banks have a fairly balanced PSL mix

Small and mid-sized Private Banks have a higher share of Personal loans in the priority sector loan mix as compared to larger Private Banks



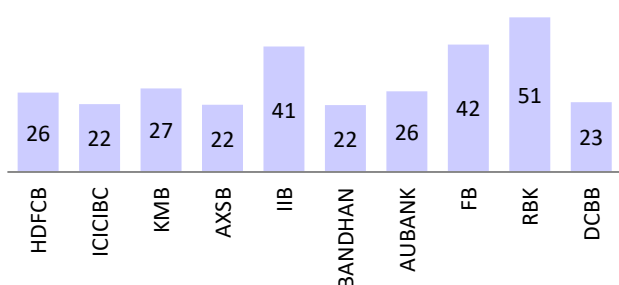
Source: MOFSL, Company

Comparison of different segments in PSL portfolio

Agriculture segment: Out of the overall target of 40%, Banks are required to lend a minimum 18% of their ANBC to the Agriculture sector. Most Banks have a relatively higher exposure of the Agriculture segment within priority sector loans, especially PSBs. **Within Agriculture, Banks need to comply with the sub-segmental target for lending to small and marginal farmers. The same stands at 9.5%/10% of ANBC for FY23/FY24.**

Exhibit 5: Exposure of small and mid-size Private Banks to Agriculture higher in the priority sector loan portfolio

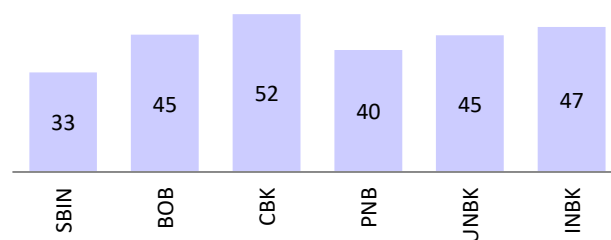
■ Mix of Agriculture segment in PSL portfolio (%)



Source: Company, MOFSL

Exhibit 6: Agriculture constitutes the largest segment within the priority sector loan portfolio for PSBs

■ Mix of Agriculture segment in PSL portfolio (%)

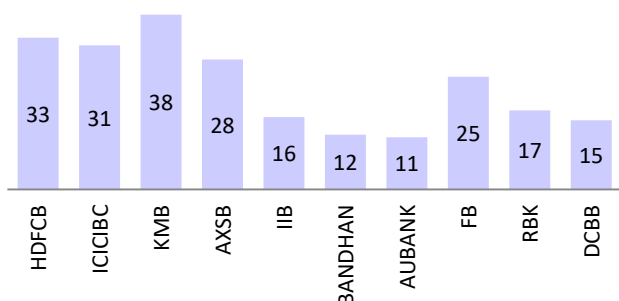


Source: Company, MOFSL

Industry segment: Top Private Banks are more comfortable in underwriting priority sector loans to the Industry segment as compared to their Public counterparts. The same is reflected in a higher mix of this segment in the top four Private Banks. The share of the Industry segment is in the 28-38% range of the priority sector loan portfolio. **Within the Industry segment, Banks also need to comply with the sub-segmental target for lending to micro enterprises. The target for the same stands at 7.5% of ANBC.**

Exhibit 7: Larger Private Banks have higher exposure to the Industry segment in the priority sector loan portfolio

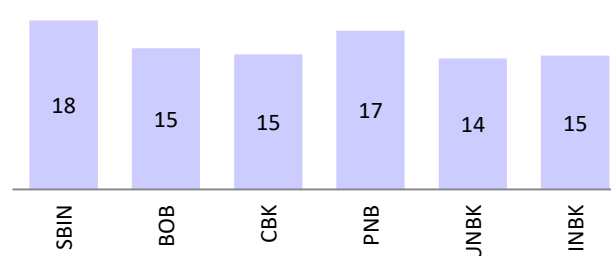
■ Mix of Industry segment in PSL portfolio (%)



Source: Company, MOFSL

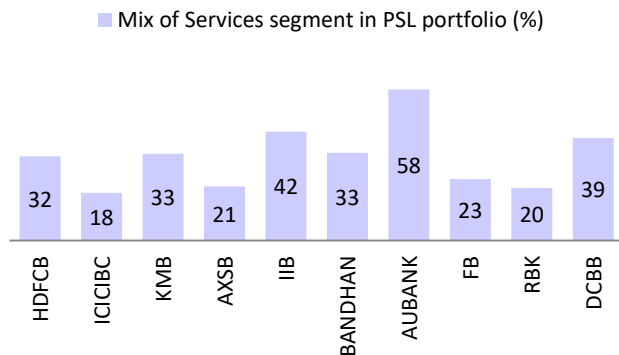
Exhibit 8: Most PSBs have a similar share in the Industry segment in the priority sector loan portfolio

■ Mix of Industry segment in PSL portfolio (%)

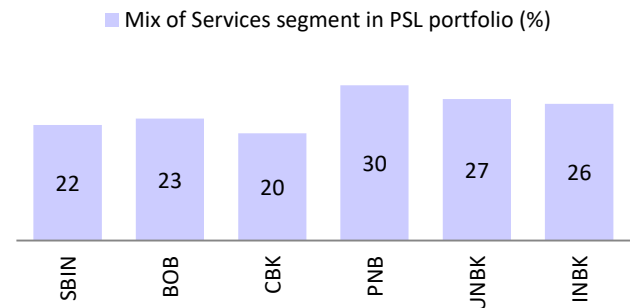


Source: Company, MOFSL

Services segment: This is another important focus area within the priority sector loan portfolio. Of the four different business segments, this forms the second highest for PSBs in general. AUBANK and IIB have a relatively higher exposure to this segment compared to larger Private Banks.

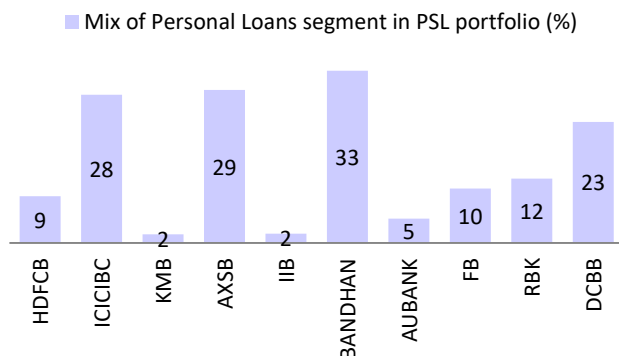
Exhibit 9: AUBANK/IIB's exposure to the Services segment is the highest at 58%/42% of their priority sector loan portfolio

Source: Company, MOFSL

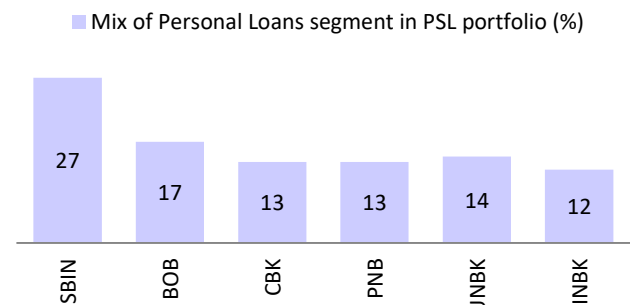
Exhibit 10: PNB/UNBK's exposure to the Services segment is the highest at 30%/27% of their priority sector loan portfolio

Source: Company, MOFSL

Personal loans: We see mixed trends with respect to the proportion of this segment within Banks. Most Banks have a relatively smaller share of Personal loans in their priority sector loan portfolio. For instance, HDFCB, KMB, IIB, and AUBANK have a single-digit exposure, while ICICIBC/AXSB has a relatively higher share at 28%/29% owing to higher mix of retail/mortgage loans.

Exhibit 11: Within the priority sector loan portfolio, Personal loans constitute the smallest mix for most Private Banks

Source: Company, MOFSL

Exhibit 12: SBIN's Personal loan exposure relatively higher at 27% of its priority sector loan portfolio v/s other PSBs

Source: Company, MOFSL

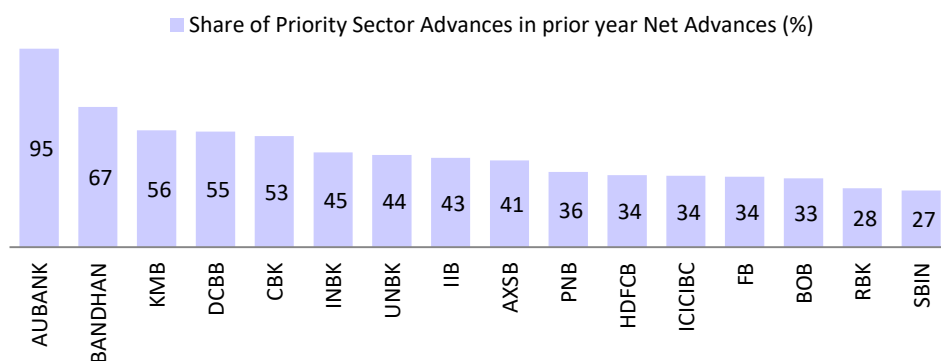
Priority sector loans, as a percentage of total advances, is highest for AUBANK, followed by BANDHAN

AUBANK and BANDHAN have the highest share of PSL advances owing to the borrower profile and geographic concentration in semi-urban and rural areas

In the following exhibit, we have analyzed the mix of priority sector loan portfolio as a percentage of the prior year's overall advances. This gives us an idea of the nature of the loan book that has been built. Amongst Private Banks, AUBANK has the highest mix followed by BANDHAN. This is driven by a higher concentration of loans to individuals and MSMEs for business in rural and semi-urban areas for the former while MFI segment is the primary driver for the latter.

Within PSU Banks, CBK is the leader followed by INBK. This is due to a stronger presence in lesser developed areas compared to other PSU Banks, where distribution is more evenly spread through the country. Such Banks have the advantage of selling PSLCs to the ones which are lagging behind the regulatory limits. We have covered PSLC transactions and income and expenses in greater detail, later in the report.

Exhibit 13: AUBANK has the highest mix of priority sector loans followed by BANDHAN

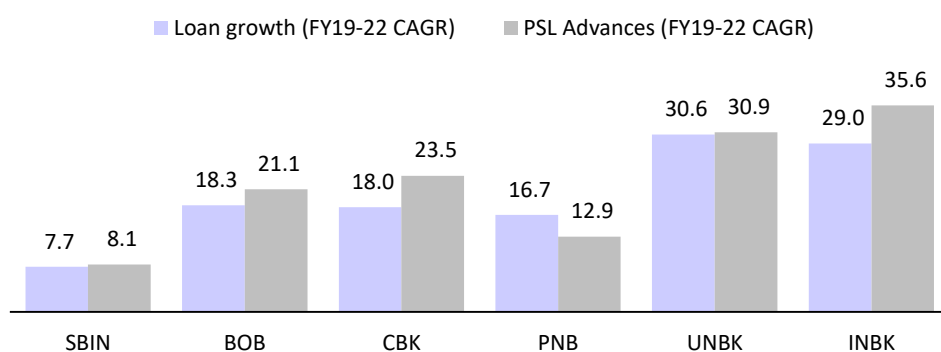


Source: RBI, MOFSL

Most Banks have grown their PSL portfolio faster than overall loans, aided by slower growth in large corporate loans and consistent efforts to improve compliance

In the following exhibits, we compare overall loan growth v/s growth in the PSL portfolio for all Banks under our coverage. We note that the pace of growth in the priority sector loan portfolio is higher than overall advances for most banks. This signals increasing compliance with respect to RBI's priority sector lending norms however has also been aided by slower growth in large corporate segment – a significant part of the overall Bank portfolio.

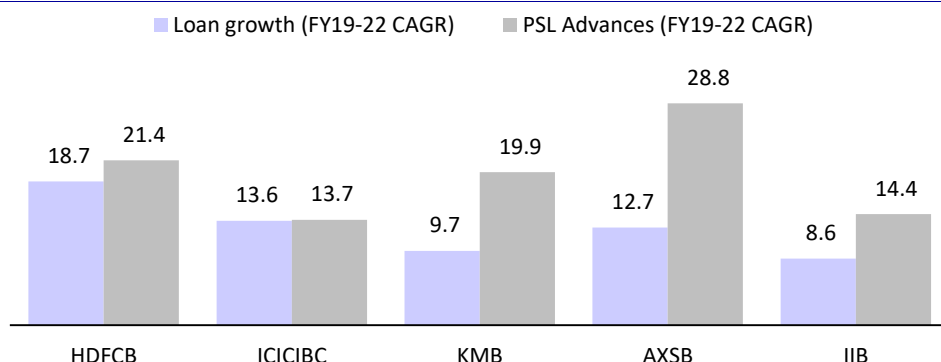
Exhibit 14: Growth in the PSL portfolio for PSBs is higher than overall loan growth



Source: MOFSL, Company

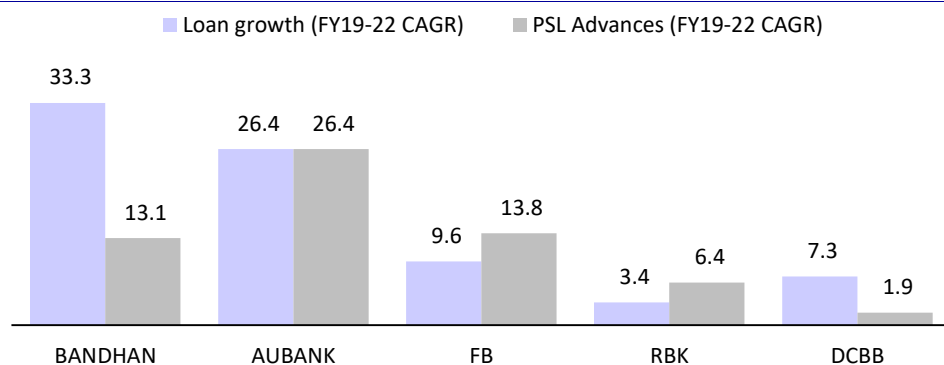
Large Private Banks have seen a stronger pick-up in priority sector loans as compared to overall advances

Exhibit 15: Similarly, PSL portfolio of large Private Banks have risen faster than overall loans



Source: MOFSL, Company

Exhibit 16: Mid-sized Banks: FB and RBK are few where growth in PSL loans is higher than overall advances



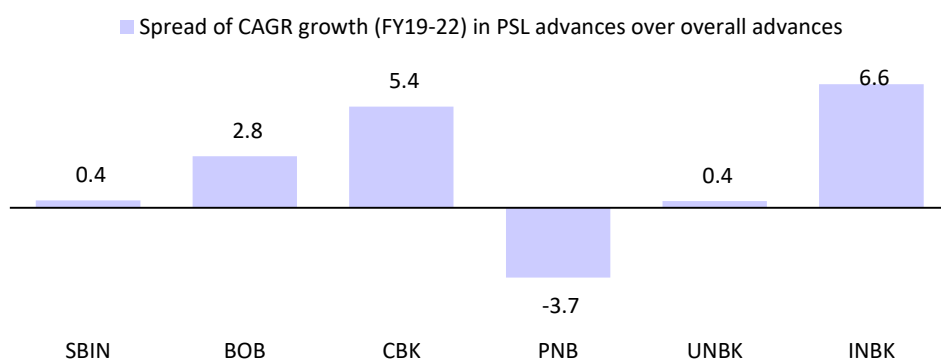
Source: MOFSL, Company

A negative spread exists in BANDHAN due to reclassification of PSL advances in FY22 owing to an observation by RBI as the Bank does not have land records for loans given in 'Agriculture' segment

We see a positive spread between growth in the priority sector loan portfolio and overall advances for most Banks. However, there is a significant deviation in the extent of spreads between Banks. Barring PNB, other PSBs under our coverage have reported a spread in 0.4-6.6% range with SBIN being at the lower end of the range.

A narrow spread exists in the growth of PSBs' PSL portfolio v/s overall advances

Exhibit 17: Narrow (0.4-6.6%) spread in growth of PSL portfolio vs overall advances for PSBs; PNB an outlier with a negative spread

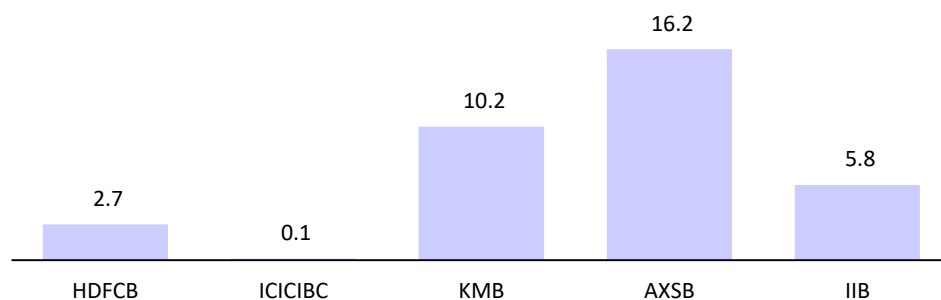


Source: MOFSL, Company

AXSB and KMB clock the highest growth in their PSL portfolio v/s overall advances

Exhibit 18: Spread of growth in PSL portfolio v/s overall advances is higher for Private Banks

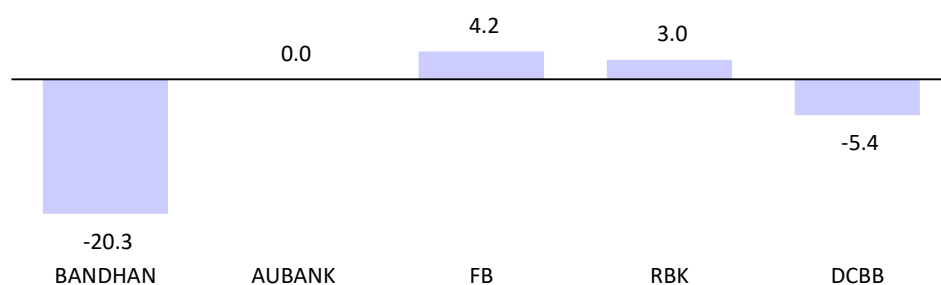
■ Spread of CAGR growth (FY19-22) in PSL advances over overall advances



Source: MOFSL, Company

Exhibit 19: Among small and mid-sized Banks, only FB and RBK display a positive spread in the growth of PSL portfolio v/s overall advances

■ Spread of CAGR growth (FY19-22) in PSL advances over overall advances



Source: Company, MOFSL

Mixed trends among small and mid-sized Banks in their PSL portfolio v/s overall advances growth.

FB and RBK clock higher growth, while BANDHAN and DCBB report a negative spread

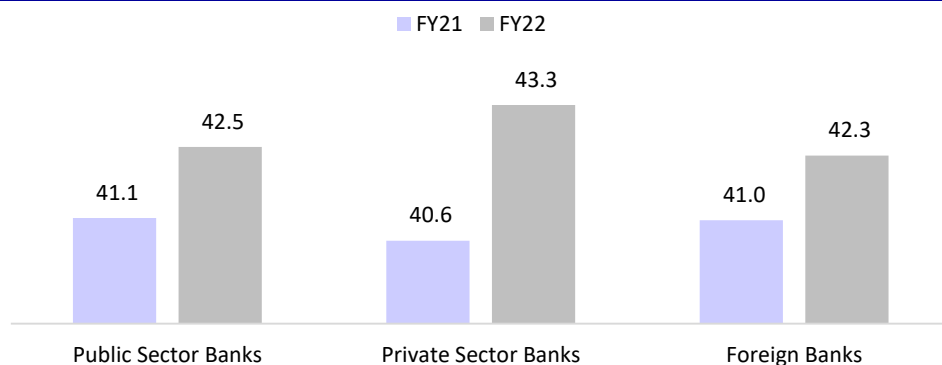
Where do Banks stand on their PSL compliance?

SBIN and HDFCB were largest buyers of PSLCs in FY22

RBI's guidelines on priority sector lending require Banks to lend 40% of their ANBC to fund certain types of activities carried out by specified borrowers. Priority sector lending for Scheduled Commercial Banks (SCBs) stood at 42.8% as of 31st Mar'22 with both Public and Private sector banks meeting the PSL target at the aggregate level. The compliance of Private Sector Banks was in fact marginally higher compared to public peers. Foreign banks also reported better compliance data in FY22.

Exhibit 20: Improved compliance of priority sector targets by all bank categories in FY22

Improved compliance with PSL norms by all categories of Banks in FY22 vs. FY21

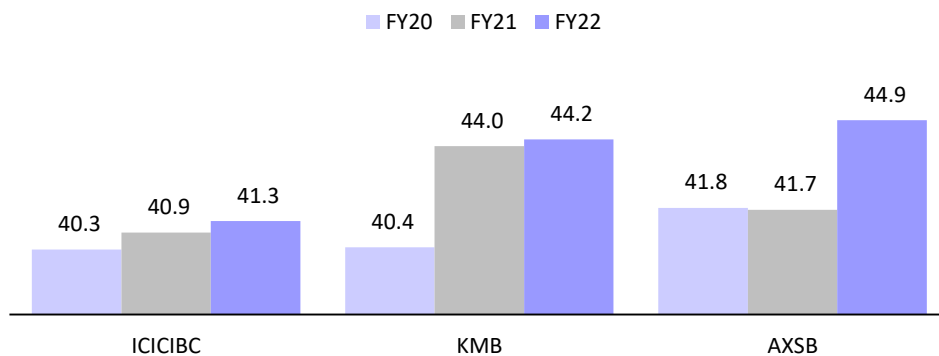


Source: MOFSL, Company

Select private Banks which disclose the PSL compliance ratio have witnessed an improvement in FY22 with AXSB posting the highest jump.

Exhibit 21: PSL as % of ANBC for select Private Sector Banks

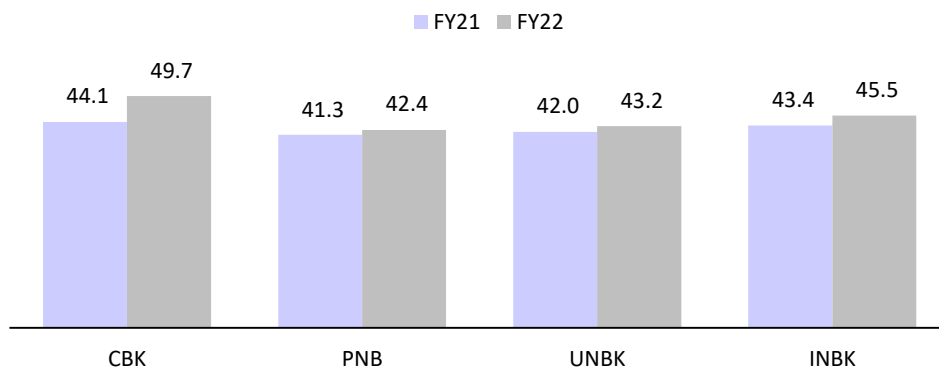
KMB and AXSB reported stronger headline PSL mix (% of ANBC) in FY22



Source: RBI, MOFSL

Exhibit 22: PSL portfolio for select Public Sector Banks as a percentage of ANBC

Usually, PSBs report a higher mix of priority sector loans as compared to private peers, given their rural presence and lending to fulfill social objectives



Source: MOFSL, Company

Priority Sector Loans: Overall targets met - segmental compliance remains tricky

Several segmental targets have been prescribed by RBI to ensure availability of credit where it is needed the most

In addition to the overall target of 40%, RBI has also prescribed segment-wise targets to ensure credit availability where it is needed the most. Out of the overall target, Banks are required to lend a minimum of 18% of their ANBC to the Agriculture sector. The sub-targets for lending to Small and Marginal Farmers (within Agriculture) and weaker sections will be increased in a phased manner till FY24.

Accordingly, the revised sub-targets for lending to small and marginal farmers (within Agriculture) stands at 9.5%/10% for FY23/FY24, while the same for weaker sections stands at 11.5%/12%. Banks are also required to lend 7.5% of ANBC to micro-enterprises.

PSLC is an important tool to meet priority sector lending norms. It also helps Banks, which have a higher mix of priority sector loans in their total portfolio to generate other income

To meet these segmental and overall limits, other than direct lending, Banks also rely on transacting in PSLCs. A shortfall can be met by purchasing PSLCs from another bank at a nominal cost. There is no transfer of risk or loan assets in these transactions. The fee paid for the purchase of the PSLC is treated as an 'expense', while the fee received from the sale of a PSLC is treated as 'other income'.

The total trading volume of PSLCs grew 12.4% YoY to INR6.6t in FY22 (v/s a 25.9% YoY growth in FY21). Among the four PSLC categories, the highest trading was observed in PSLC-general and PSLC-small and marginal farmers, with transaction volumes at INR2.7t and INR2.3t in FY22, respectively.

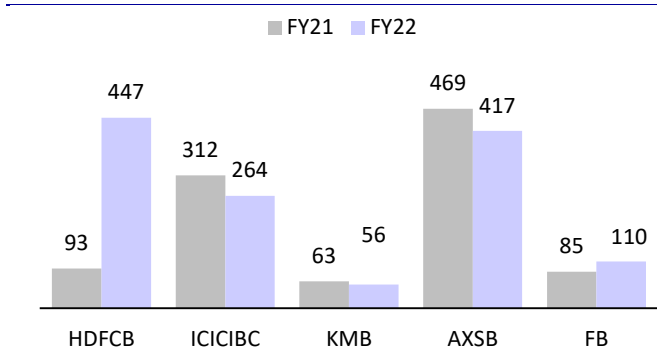
The shortfall in priority sector lending can be deposited in the RIDF with NABARD, or other specified funds.

While Banks are expected to comply with priority sector lending requirements prescribed by RBI, there is an additional option to deposit the shortfall in the RIDF established with NABARD and other funds with NABARD/NHB/SIDBI/MUDRA as decided by RBI from time to time.

Such deposits have tenure of up to seven years and attract a lower interest rate depending on the shortfall in PSL targets

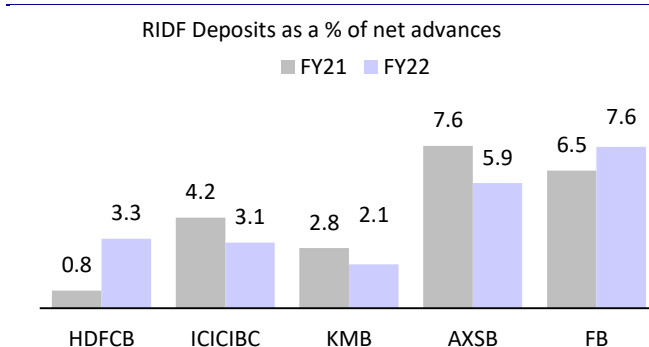
These deposits have a maturity of up to seven years and earn an interest lower than the market rate. The interest rates on the Banks' contribution to RIDF or any other funds, tenure of deposits, etc. will be fixed by the RBI from time to time. As per RBI guidelines on RIDF deposits, the interest paid on such deposits vary from the bank rate minus 2% to bank rate minus 5% depending upon the shortfall in priority sector lending.

Exhibit 23: Significant increase in RIDF deposits by HDFCB, (INRb)



Source: MOFSL, Company

Exhibit 24: Such deposits are in the 2-8% range of net advances



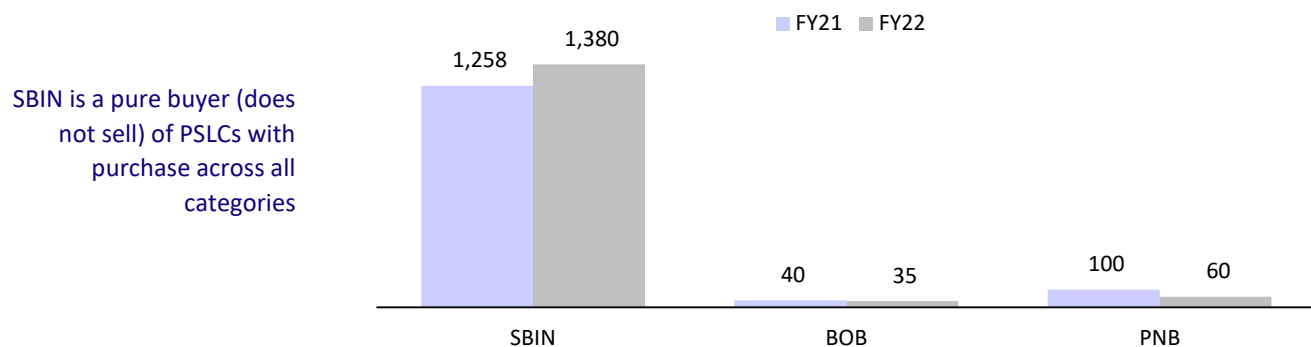
Source: MOFSL, Company

PSLC transactions: Private banks more active; HDFCB & SBIN biggest buyers

Private Banks transact more actively in PSLCs due to their cautious underwriting approach in segments like Agriculture, and Small and Marginal Farmers

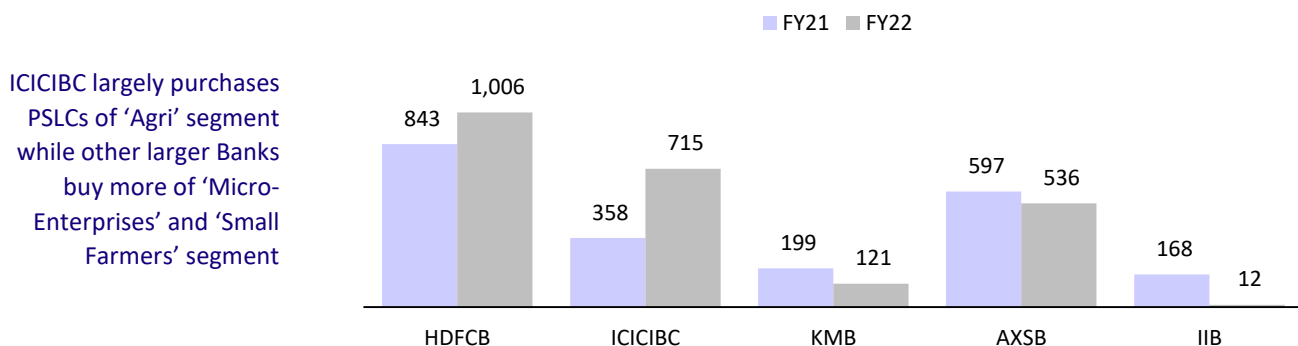
Private Banks are far more active in transacting (buying/selling) in PSLCs in order to meet PSL norms as compared to their Public counterparts. In FY22, HDFCB emerged as the largest buyer of PSLCs across all categories. Other large private Banks were net sellers. Among mid-size Banks under coverage, only FB and RBK were net buyers of PSLCs. Among PSBs, SBIN is the largest net buyer of PSLCs in a meaningful manner while CBK and INBK are net sellers of PSLCs in FY22.

Exhibit 25: Within PSU Banks, SBIN is the largest buyer of PSLCs (INRb)



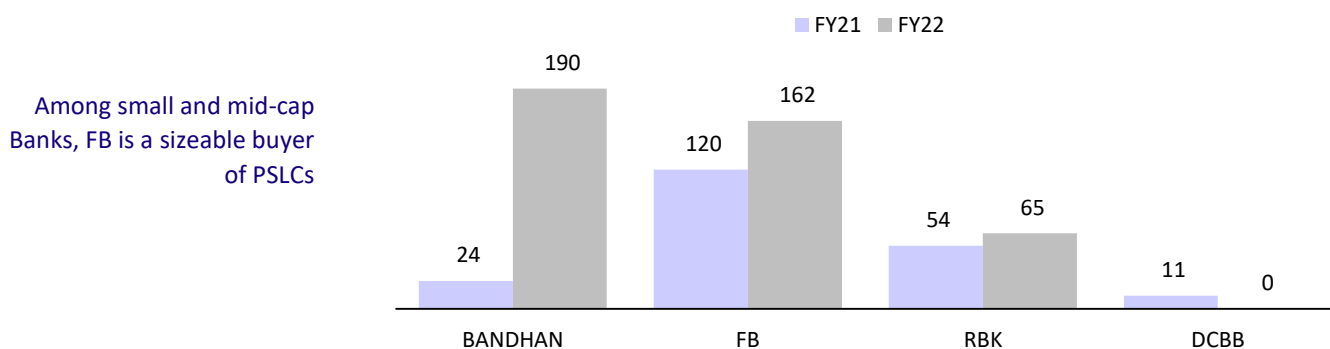
Source: MOFSL, Company

Exhibit 26: HDFCB and ICICIBC witnessed an increase in the amount of PSLCs bought in FY22



Source: MOFSL, Company

Exhibit 27: BANDHAN bought an unusually high amount of PSLCs in FY22 due to RBI observation on classification of Priority Sector Loans without adequate land records



Source: MOFSL, Company

Exhibit 28: SBIN is a pure buyer of PSLCs across all categories

INR m Sector	FY19		FY20		FY21		FY22	
	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold
Agriculture	12,230	-	-	-	1,48,835	-	1,01,920	-
Small and marginal farmers	5,530	-	93,520	-	6,34,425	-	6,36,543	-
Micro Enterprises	1,62,728	-	4,75,258	-	3,74,053	-	57,920	-
General	3,35,575	-	3,04,513	-	1,00,500	-	5,83,618	-
Total	5,16,063	-	8,73,290	-	12,57,813	-	13,80,000	-

Source: MOFSL, Company

Exhibit 29: HDFCB bought a significantly higher amount of PSLCs across all categories

INR m Sector	FY19		FY20		FY21		FY22	
	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold
Agriculture	55,720	5,000	1,03,415	-	30,300	-	7,260	-
Small and marginal farmers	3,12,940	100	4,20,773	-	6,250	-	8,873	-
Micro Enterprises	73,388	-	56,665	30,000	1,88,300	-	3,12,800	-
General	17,500	1,11,713	64,330	1,37,500	6,18,425	20,000	6,77,075	-
Total	4,59,548	1,16,813	6,45,183	1,67,500	8,43,275	20,000	10,06,008	-

Source: MOFSL, Company

Exhibit 30: While ICICIB bought a chunk of PSLCs in Agriculture segment, it remains a net seller of PSLCs in FY22

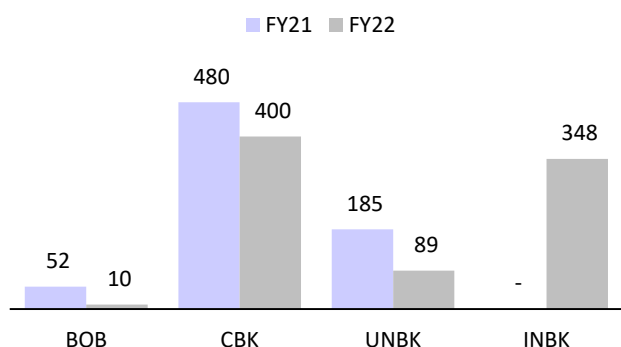
INR m Sector	FY19		FY20		FY21		FY22	
	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold	PSLC bought	PSLC sold
Agriculture	2,49,175	-	3,33,480	-	3,57,740	-	6,73,065	-
Small and marginal farmers	-	-	-	-	-	-	-	-
Micro Enterprises	-	47,253	-	2,23,463	-	1,06,840	42,060	3,59,100
General	-	1,97,500	48,500	1,67,980	-	3,11,055	-	6,55,300
Total	2,49,175	2,44,753	3,81,980	3,91,443	3,57,740	4,17,895	7,15,125	10,14,400

Source: MOFSL, Company

PSLC sale has aided other income growth for select banks

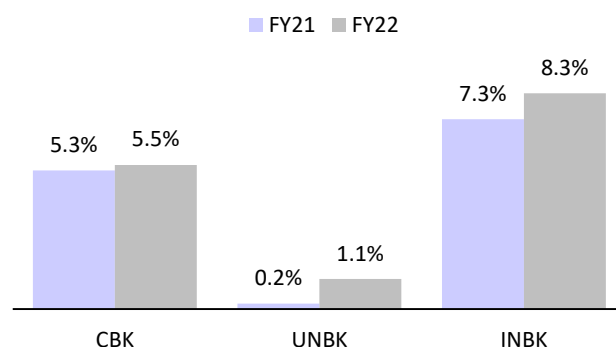
Private Banks are also very active in selling PSLCs to generate fee income. This is usually done when direct lending crosses the target prescribed by the RBI, and the bank monetizes the same by selling the right to their excess PSL portfolio to generate fee income. Smaller PSBs are also active in this space by selling their excess portfolio to other Banks. This aids in a healthy traction in fee income. INBK/CBK are the most active and sold PSLCs worth 21%/12% of their PSL portfolio.

Exhibit 31: CBK is clearly the leader in the sale of PSLCs among PSBs, followed by INBK (INR b)



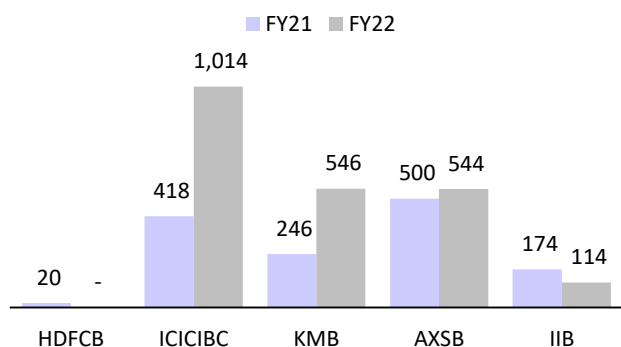
Source: MOFSL, Company

Exhibit 32: Income from sale of PSLCs contributes 8% and 5% of Other Income for INBK and CNBK, respectively



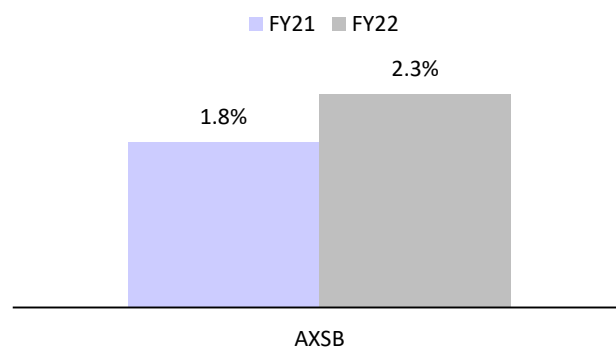
Source: MOFSL, Company

Exhibit 33: ICICIBC is the biggest seller in PSLCs amongst private banks (INR b)



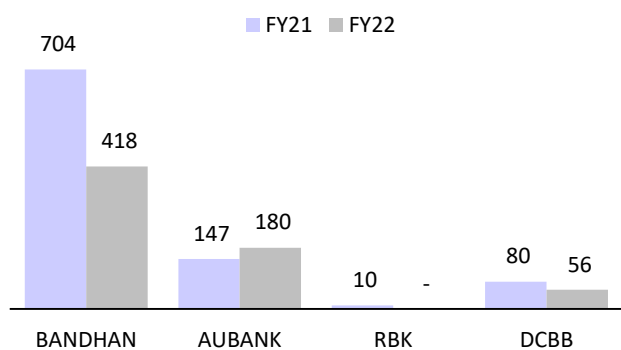
Source: MOFSL, Company

Exhibit 34: AXSB derived 2.3% of Other Income from sale of PSLCs in FY22



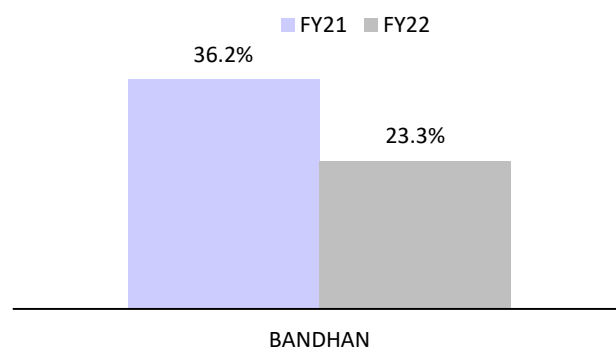
Source: MOFSL, Company

Exhibit 35: Small and mid-sized Banks are very active in selling PSLCs (INRb)



Source: MOFSL, Company

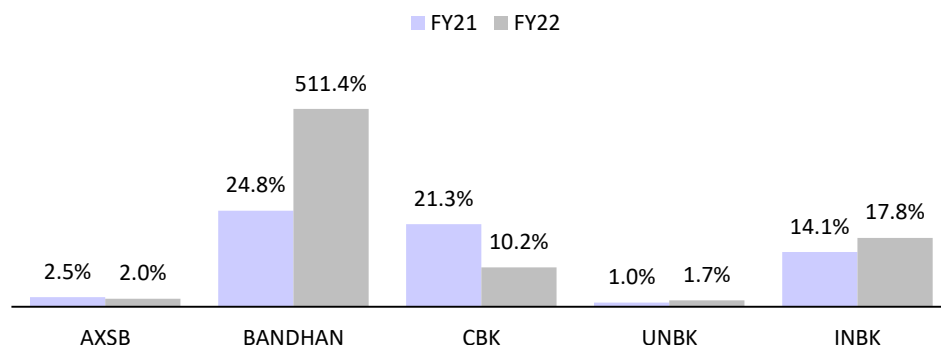
Exhibit 36: BANDHAN Bank derived a significantly higher share of Other Income from sale of PSLCs



Source: MOFSL, Company

Exhibit 37: Income from sale of PSLCs contributed an unusually high % of PBT for BANDHAN in FY22 due to elevated provisions

PSU Banks such as INBK and CBK also derived mid-teen % of PBT from sale of PSLCs

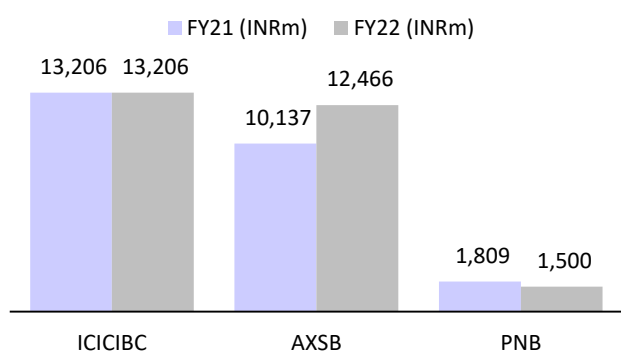


Source: MOFSL, Company

PSLC purchase: Cost varies significantly based on segment, duration and supply demand dynamics

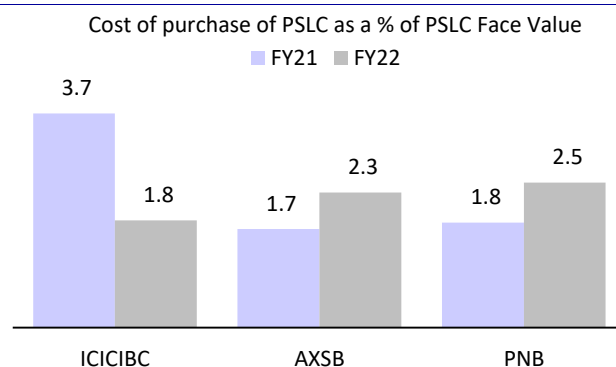
Fees paid/received for PSLCs are recorded as an expense in other expenses/income in other income. This is usually amortized on a straight-line basis over the period of the certificate. The cost of PSLCs depends on market demand-supply dynamics, underlying segment and residual tenure.

Exhibit 38: Only ICICIBC and AXSB report the cost of PSLC purchase amongst large Private banks



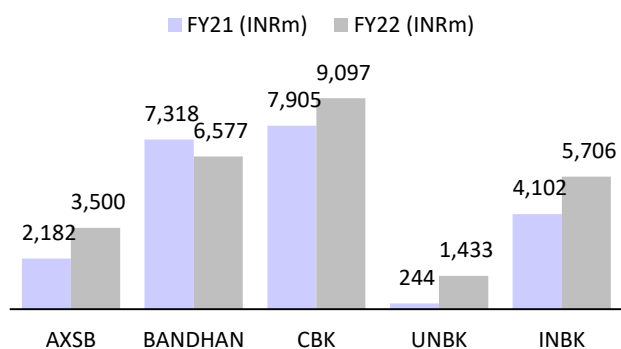
Source: MOFSL, Company

Exhibit 39: Cost of PSLC purchase is in 1.7-3.7% range during last two years



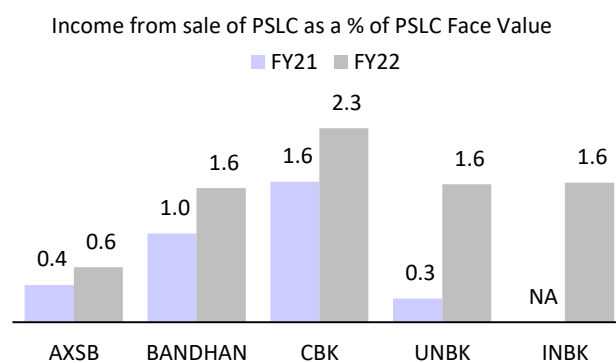
Source: MOFSL, Company

Exhibit 40: PSBs are more active in selling PSLCs, thus generating a strong fee income



Source: MOFSL, Company

Exhibit 41: CBK has the highest yield on sale of PSLCs while percentage of PSLCs sold is also the highest



Source: MOFSL, Company

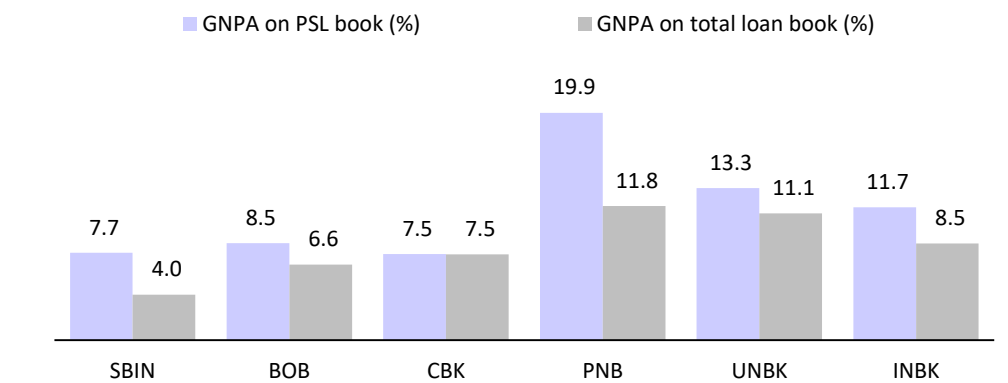
Asset quality performance in priority sector loans – Large Banks faring better

Agriculture NPA though remains elevated

Asset quality in the PSL portfolio is typically weaker than that of the rest of the portfolio, more so for PSBs. This is partly due to the moral hazard, pressure from the government to lend for social reasons, and the quest for achieving segmental priority sector loan targets. **The gap between the GNPA ratios of the priority sector loan book v/s overall loans is the highest for PNB, while CBK has the lowest gap. For other Banks, the spread between the two is in the 190-370bp range.**

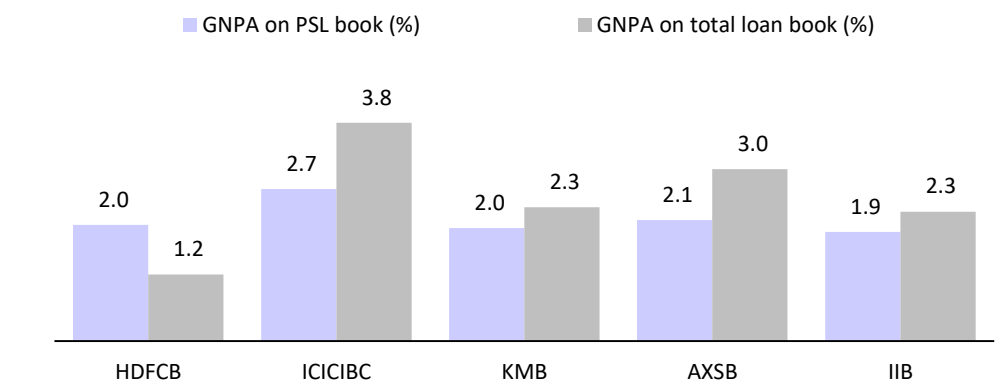
For Private Banks, the trend is mixed, with a higher GNPA ratio in the priority sector loan portfolio of HDFCB, AUBANK, and FB, while others reported a lower ratio.

Exhibit 42: Asset quality in PSL portfolio of PSBs is significantly worse v/s overall portfolio



Source: MOFSL, Company

Exhibit 43: Unlike PSBs, large Private Banks display better asset quality in PSL portfolio



Source: RBI, MOFSL

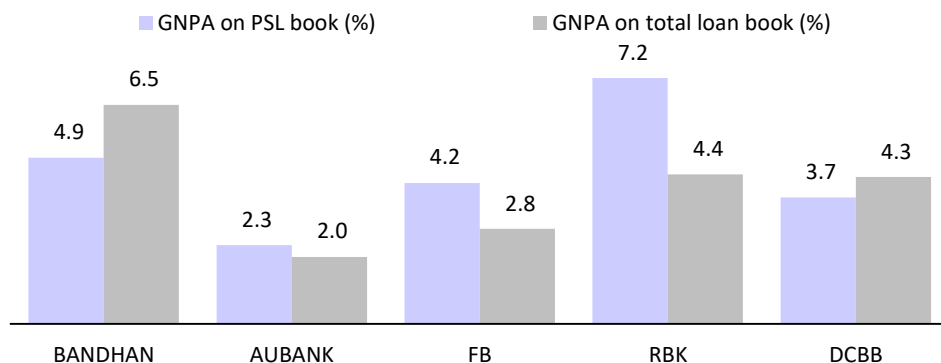
Private Banks fare much better than Public peers in terms of asset quality performance in priority sector loans

The adverse gap between the GNPA ratio of the priority sector loan book v/s overall loans is the highest for PNB, while CBK has the lowest gap

HDFCB is the only large bank where asset quality in the overall portfolio is better as compared to its priority sector loan portfolio

Exhibit 44: Small and mid-sized Banks: Mixed trends in asset quality of the overall loan book v/s the PSL portfolio

BANDHAN and DCBB report better asset quality in their priority sector loan portfolio v/s the overall loan book



Source: MOFSL, Company

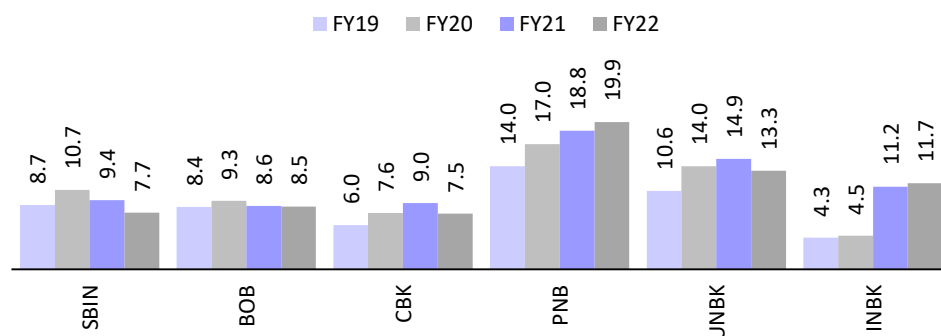
Asset quality for the Banking sector, in general, improved in FY22. The same is also reflected in the lower GNPA ratio in the priority sector loan portfolio of all Banks. This trend is likely to continue over the next few quarters, led by sustained economic recovery and normalization of the cash flow cycle for borrowers.

Asset quality for the priority sector loan portfolio has improved over past few years across most players

Top public sector Banks like SBIN and CBK reported an improvement in asset quality of their priority sector loan portfolio in FY22. PNB and INBK, however, reported an increase in GNPA in their priority sector loan portfolio in FY22. Barring RBK and FB (largely flat), all Private Banks clocked a lower GNPA ratio in their priority sector loan book.

Exhibit 45: SBI and BOB report a second consecutive year of improvement in asset quality in priority sector loans

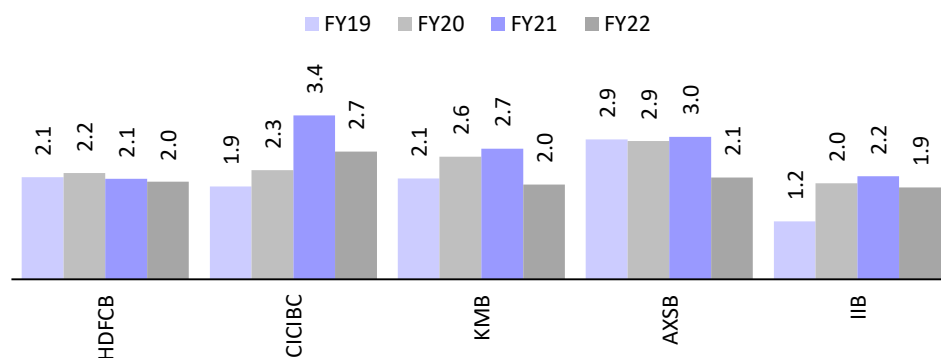
The GNPA ratio for SBIN's priority sector loan portfolio is the lowest in the last four years. CBK and UNBK also posted a marginal improvement in FY22



Source: MOFSL, Company

Exhibit 46: All large Private Banks report better asset quality in priority sector loans

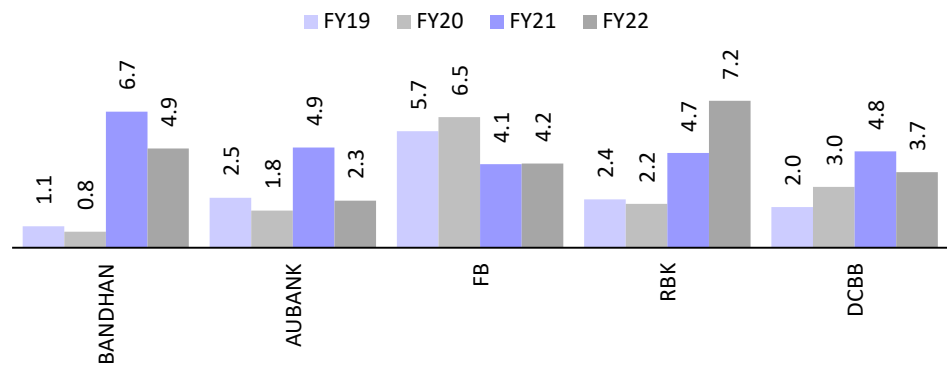
Sharpest improvement in asset quality in priority sector loans for AXSB, followed closely by ICICIB and KMB



Source: MOFSL, Company

Exhibit 47: Barring RBK and Federal Bank, other small and mid-sized Private Banks under our coverage reported a better asset quality in priority sector loans

We see scope for better performance by small and mid-size Private Banks as asset quality continues to improve with a normalized cash flow for borrowers



Source: MOFSL, Company

Segmental analysis of asset quality reveals highest stress in Agriculture segment

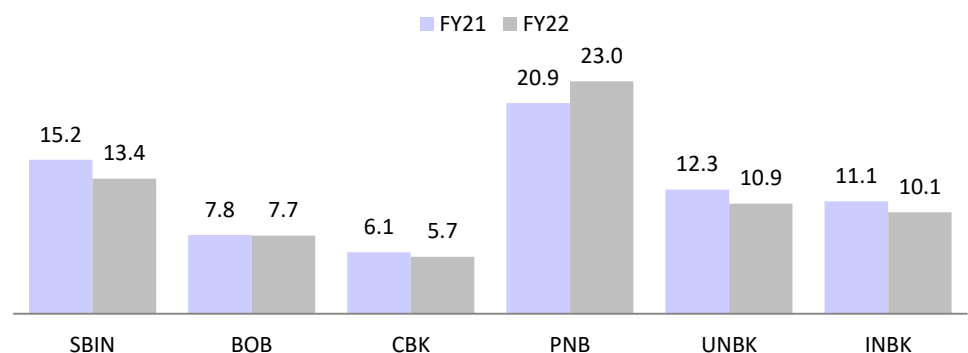
In the next series of exhibits, we drill down asset quality across individual loan segments, within the priority loan portfolio, to better understand the segmental differences.

Among all segments, agriculture is usually the biggest pain point for all Banks, whether private or public

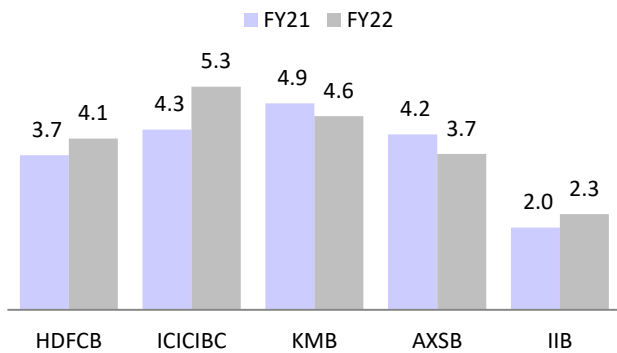
- Among all segments, Agriculture is usually the biggest pain point for all Banks, be it private or public. We do not foresee any challenges for large Private Banks in segments other than Agriculture.
- Another trend noticed is that small and mid-sized Banks display a lower resilience as compared to larger peers. We see scope for better performance by small and mid-size Private Banks as the asset quality cycle continues to improve, with normalized cash flow for borrowers.
- PSBs have significant room for improvement. As PSBs are also a medium to fulfill social objectives, we remain watchful of their performance. We do think that an improving asset quality cycle will have a positive impact here too.

Exhibit 48: PSBs report much worse metrics v/s Private Banks in the Agriculture segment

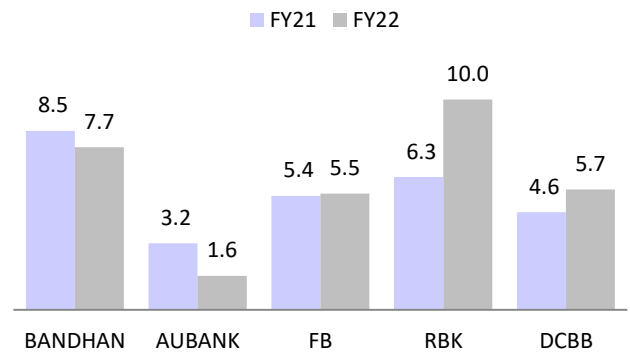
PSBs, other than PNB, see an improvement in asset quality of Agriculture segment in FY22



Source: MOFSL, Company

Exhibit 49: Mixed performance trends in Agriculture priority loans for large Private Banks

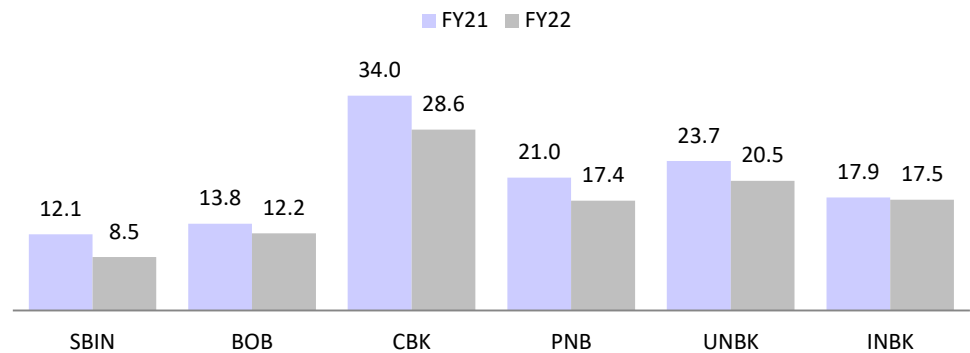
Source: MOFSL, Company

Exhibit 50: Much like larger Private Banks, trends are mixed in FY22 for small and mid-sized Banks in the AQ of Agri PSL

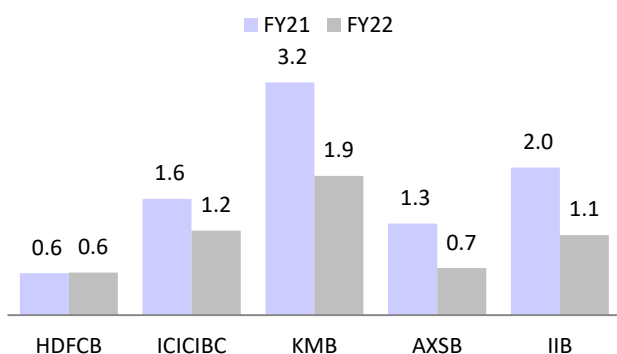
Source: MOFSL, Company

Exhibit 51: Much like Agriculture, PSUs too have visibly higher stress v/s Private Banks in PSL Industry segment

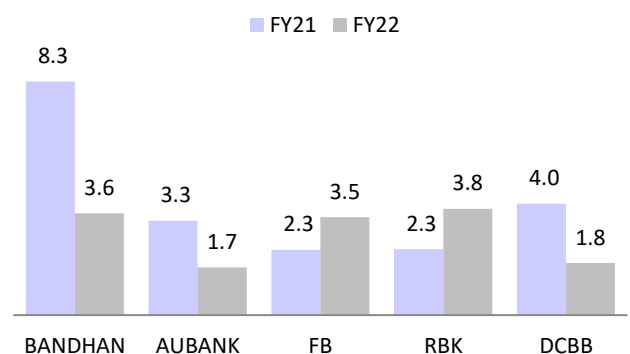
While asset quality pain is high in this segment for PSBs, all of them reported an improvement in FY22



Source: MOFSL, Company

Exhibit 52: HDFCB and AXSB report the strongest AQ in PSL Industry segment

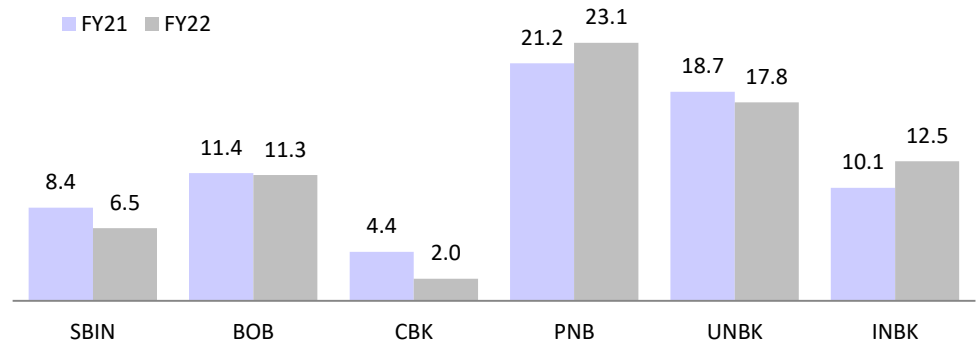
Source: MOFSL, Company

Exhibit 53: Mixed trends in AQ performance of small and mid-sized Banks in the PSL Industry segment

Source: MOFSL, Company

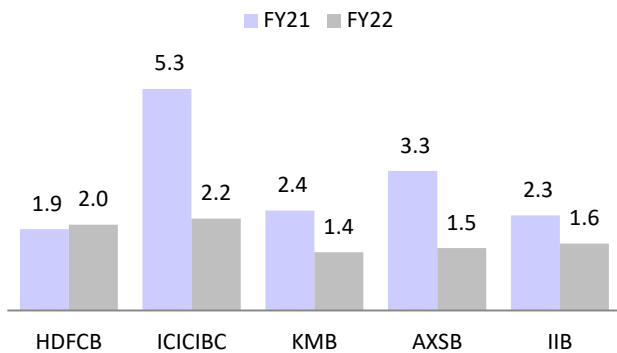
Exhibit 54: Small PSBs fare worse than their larger peers in terms of asset quality of priority sector loans in the Services segment

Despite a higher GNPA ratio, PNB and INBK report a further increase in pain in priority sector loans in the Services segment



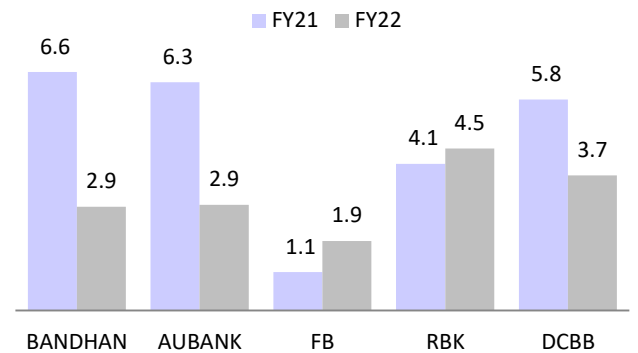
Source: MOFSL, Company

Exhibit 55: Large Private Banks, barring HDFCB, report a moderate improvement in AQ in PSL Services segment



Source: MOFSL, Company

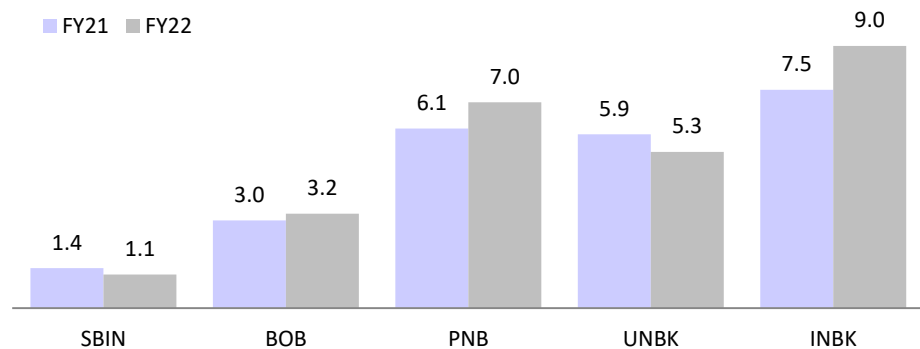
Exhibit 56: BANDHAN, AUBANK, and DCBB witnessed improvement in AQ in PSL Services segment



Source: MOFSL, Company

Exhibit 57: Larger PSU Banks fare much better compared to smaller peers in asset quality performance of PSL Personal Loans

SBIN has the lowest GNPA ratio in PSL Personal Loans segments, among PSU Banks by a wide margin



Source: MOFSL, Company

Exhibit 58: Large Banks, barring IIB, report their strongest performance in asset quality in PSL Personal Loans

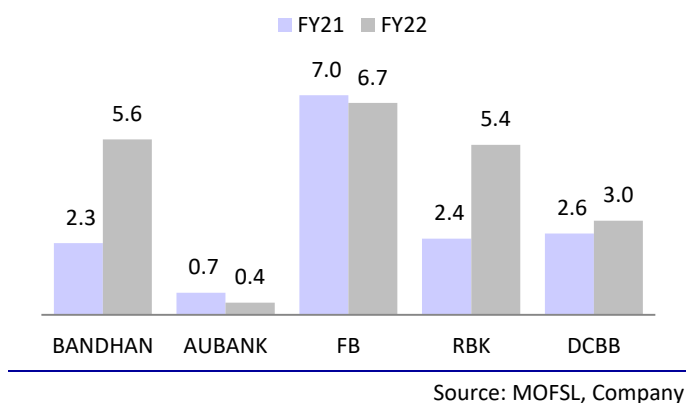
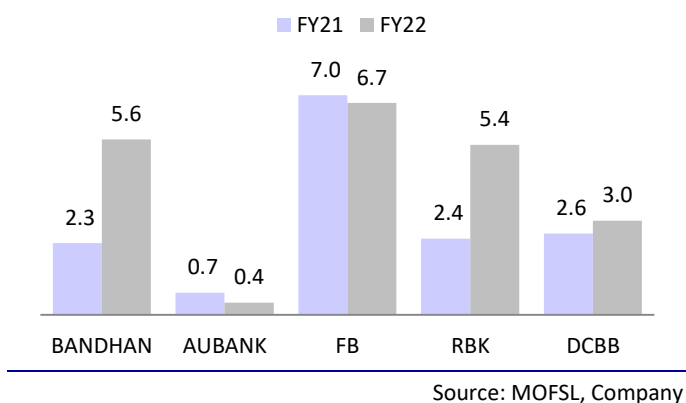


Exhibit 59: AUBANK has the lowest pain in PSL Personal Loans, reflecting strong underwriting strength

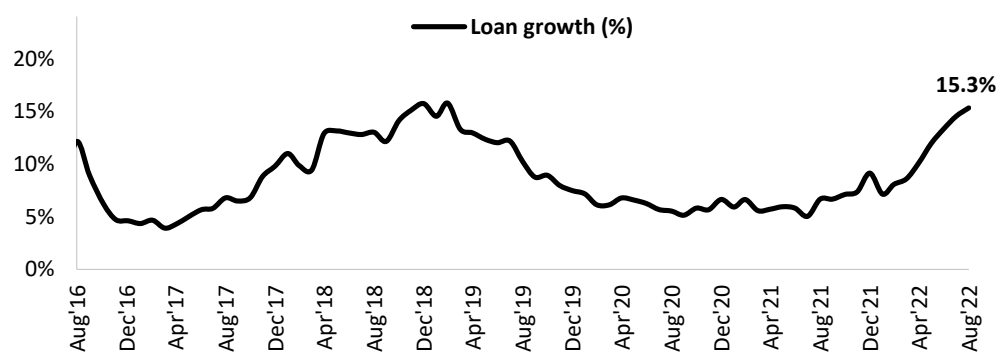


Focus on PSL to increase as growth gains further traction

Strong system credit growth and merger of HDFCB and HDFC to aid demand

- Credit growth in the system has been improving steadily (~15% currently v/s avg. of 7% over FY20-22) reflecting sustained momentum in Retail demand and pick-up in services & SME growth. A revival in demand from large corporates has the potential to further boost overall credit growth. Deleveraged corporate balance sheets and higher utilization levels will prompt capex and lead to a recovery in credit demand from corporates.

Exhibit 60: Strong pick up in credit growth in recent quarters, expect traction to sustain



Source: MOFSL, Company

- As per RBI norms, Banks need to lend 40% of ANBC to priority sectors. Within this, there are further sub-segmental targets (refer Annexure). As credit growth picks up, demand for PSL and PSLCs will pick-up further.
- The merger between HDFCB and HDFC will also boost demand for priority sector loans. As per the management of HDFCB, the merger will result in a demand of priority sector loans worth INR1.75t. This is ~6% of the combined PSL portfolio of the 16 Banks we have analyzed for this report.

Exhibit 61: Demand for priority sector loans to get a boost of INR1.75t after the merger of HDFCB and HDFC Limited

PSL requirements - Illustrative	INRb
Total loans	575
Less: Affordable housing assets backed by bonds	-75
ANBC Base for PSL requirement	500
PSL required to be maintained	~200
PSL available with HDFC Limited	~25
PSL to be generated	~175
50% of PSL through affordable housing/core PSL	~80-90
50% of PSL (agri - SMF/Micro etc)	~80-90

Source: MOFSL, Company

- Due to these reasons, Banks, with a strong mix of priority sector loans, will benefit from higher demand for such loans. These Banks will have the potential to generate a higher fee income by selling PSL certificates after meeting their own requirements. We thus believe that banks with healthy PSL portfolios are well positioned to capitalize from revival in credit growth.

Annexure: Priority Sector Lending regulations

- As prescribed by the RBI in its master direction on 'Priority sector lending – targets and classification,' dated 4th Sep'20, priority sectors include Agriculture; Micro, Small, and Medium Enterprises; Education; Housing; Social Infrastructure; Renewable Energy; and export credit.
- Of the overall target of 40%, Banks are required to lend a minimum of 18% of their ANBC to the Agricultural sector. The sub-targets for lending to small and marginal farmers and weaker sections (within Agriculture) will be increased in a phased manner till FY24.
- The target for lending to small and marginal farmers now stands at 9.5%/10% for FY23/FY24 (v/s 9% in FY22). The same for weaker sections of society now stands at 11.5%/12% in FY23/FY24 (v/s 11% in FY22).
- Banks are also required to lend 7.5% of ANBC to micro-enterprises.

Exhibit 62: Snapshot of target/sub-targets for the priority sector

Categories	Domestic Commercial Banks (excluding RRBs and SFBs) and foreign Banks with 20 branches and above	Foreign Banks with less than 20 branches	Regional Rural Banks	Small Finance Banks
Total priority sector	Around 40% of ANBC, or CEOBE, whichever is higher	Around 40% of ANBC, or CEOBE, whichever is higher, of which up to 32% can be in the form of lending to exports, and not less than 8% can be to any other priority sector	Around 75% of ANBC, or CEOBE, whichever is higher. A target of 15% of ANBC has been prescribed for lending to Medium Enterprises, Social Infrastructure, and Renewable Energy under the priority sector	Around 75% of ANBC, or CEOBE, whichever is higher
Agriculture	Around 18% of ANBC, or CEOBE, whichever is higher, out of which a target of 10% has been prescribed for small and marginal farmers	NA	Around 18% of ANBC, or CEOBE, whichever is higher, of which a target of 10% has been prescribed for small and marginal farmers	Around 18% of ANBC, or CEOBE, whichever is higher, out of which a target of 10% is prescribed for small and marginal farmers
Micro Enterprises	Around 7.5% of ANBC, or CEOBE, whichever is higher	NA	Around 7.5% of ANBC or CEOBE, whichever is higher	Around 7.5% of ANBC, or CEOBE, whichever is higher
Advances to weaker sections	Around 12% of ANBC or CEOBE, whichever is higher	NA	Around 15% of ANBC, or CEOBE, whichever is higher	Around 12% of ANBC, or CEOBE, whichever is higher

Source: MOFSL, Company

- RBI has directed Banks to maintain direct lending to non-corporate farmers at a last three-year average for the Banking system, failing which Banks will attract penalties for the shortfall. RBI will notify Banks of the Banking system's average at the beginning of each fiscal. It had notified a target level of 12.73% of ANBC for this purpose for FY22.
- Achievement of PSL is evaluated on a quarterly average basis from FY17. However, this will now be computed on the weightage assigned to the incremental priority sector in identified districts. This was done to address regional disparities in the flow of priority sector credit at the district level. The adjustment and calculation will be undertaken by the RBI on a quarterly basis, as per data submitted by Banks.

- **From FY22, a higher weightage (125%) has been assigned to incremental priority sector credit in the identified districts, where the credit flow is comparatively lower (per capita PSL less than INR6k), and a lower weightage (90%) will be assigned for incremental priority sector credit in the identified districts where the credit flow is comparatively higher (per capita PSL greater than INR25k). The list of such districts will be specified by RBI.**
- Banks have to comply with PSL norms prescribed by RBI from time to time, failing which it may attract penalties for non-compliance.
- The shortfall in the amount required to be lent to priority sectors and weaker sections will have to be deposited in the RIDF, established by NABARD, and other funds with NABARD/NHB/ SIDBI/MUDRA, as decided by the RBI from time to time.
- These deposits have a maturity of up to seven years and earn an interest lower than market rates. The interest rate on Banks' contribution to RIDF, or any other funds, tenure of deposits, etc. will be fixed by RBI from time to time. As per the central bank's guidelines on RIDF deposits, the interest paid on bank deposits vary from the bank rate minus 2% to the bank rate minus 5% depending upon the shortfall in PSL.

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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