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Fundamental Financial Analysis as a Cornerstone of Investment: Lessons from Public and Private Banking

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ABSTRACT

The Indian banking sector has experienced substantial growth, driven by digital advancements and the increased demand for financial services following the pandemic. With a strong emphasis on financial inclusion and the transition toward a cashless economy, the sector has expanded significantly, creating lucrative opportunities for investors seeking to grow and reinvest their funds. Supported by India's solid macroeconomic fundamentals, this growth positions the banking sector as an attractive avenue for investment. This study explores The banking industry's performance over a period of five financial years, concluding in March 2024. It provides critical insights aimed at helping investors make informed decisions by analyzing key financial metrics and trends. The study evaluates the performance of a few public and private sector banks and identifies areas for expansion by providing a thorough basic analysis.. By examining the evolving dynamics of the sector, the study highlights its potential and the challenges influencing its trajectory. The results are a useful tool for investors hoping to profit from the Indian banking sector's bright future..

Keywords: Indian banking sector, digitalization, financial inclusion, cashless economy, public sector banks, private sector banks, fundamental analysis.

INTRODUCTION

In the heartbeat of any thriving economy lies the Banking Sector, often hailed as its "Backbone." The engine keeps the wheels of commerce turning as banks dutifully accept deposits from those with surplus cash and extend loans to those in need. This essential process, known as monetary intermediation, ensures that funds flow seamlessly from savers to borrowers, fueling economic growth and development. But for investors navigating the choppy waters of finance, finding the right investment avenue can feel like searching for a needle in a haystack. Enter fundamental analysis, a tried-and-tested method that peels back the layers of financial data to reveal the actual value of securities. Fundamental analysis empowers investors to decide where to allocate their hard-earned capital by scrutinizing economic trends, industry dynamics, and company performance.

REVIEW OF LITERATURE

The recent study sought to marry fundamental analysis with banking performance, offering investors a roadmap to navigate the complex world of banking stocks. Through meticulous ratio analysis, Parveen & Sameera (2016) uncovered the financial health of public sector giants like Punjab National Bank, State Bank of India, and Bank of Baroda, affirming their stability and reasonable performance. In the meanwhile, Sodhi & Waraich (2016) examined a variety of public and private sector banks for their study, emphasizing the crucial role that fundamental analysis plays in evaluating the risk-return profile of assets.

Undavia (2016) shed light on the unique evolution of the Indian banking system, highlighting its vast growth potential alongside challenges such as heightened competition and nonperforming assets. These insights underscored the importance of a nuanced understanding of the banking landscape for investors seeking to navigate its twists and turns. Reflecting on the origins of stock valuation research, Bauman (1996) traced its roots to seminal works by pioneers like Lev and Ohlson (1982), Lev (1989), and Bernard (1994). These groundbreaking studies challenged conventional wisdom, urging researchers to delve deeper into accounting data and industry-specific analysis to unlock the actual value of stocks.

In essence, the fusion of fundamental analysis with banking performance evaluation offers investors a powerful tool to decipher the complexities of banking stocks. With insights from this study, investors can chart a course toward financial success confidently and clearly, navigating the turbulent market waters with poise and purpose.

DATA ANALYSIS

This study's main goal is to evaluate the financial standing of a few public and private sector banks in terms of solvency, liquidity, and profitability. Four banks from each sector were selected based on decreasing market capitalization over five consecutive financial years ending in March 2024. The study relies on secondary data, with data collection methods ensuring reliability. The study aims to provide comprehensive insights for sound decision-making by analyzing numerous tables and figures depicting changes in company positions. The findings derived from the summarized data form the basis for the study's conclusion.

Table.1 Top 4 Public and Private Sector Banks based on Market Capitalization

Public Sector Bank	Market Capitalization (In Rs. Crores)
State Bank of India	4,620,271
Bank of Baroda	634,009
Canara Bank	417,250
Punjab National Bank	367,217
Private Sector Bank	**Market Capitalization (In Rs. Crores)**
HDFC Banks	8,179,567
ICICI Bank	6,052,510
Kotak Mahindra Bank	3,687,633
AXIS Bank	2,293,479

Source: Authors compilation from market data; moneycontrol.com

Table.2 Financial Indicators Used for Analysis

Financial Indicator	Indicates
Net Profit Margin	Profitability Position
Earnings Per Share (EPS)	
Return on Equity	
Liquidity coverage ratio (LCR)	Liquidity Position
Capital Adequacy ratio	Solvency Position
Gross NPA’s and Net NPA’s	Asset Quality & Bank’s Financial Health
Price to Earning (P/E) Ratio	Stock Valuation
Price to Book Value (P/B Ratio	

Source: Authors own contribution

The study calculates all the indicators serially as per Table 2 in the methodology section, and the interpretation is done accordingly.

FINDINGS AND DISCUSSION

1. Profitability Position: The **Net Profit Margin** indicates the company's earnings after deducting expenses from operating income. In the provided table, public sector banks exhibit a rising trend in profit margins, with almost all showing positive margins, a significant turnaround from previous negative margins. This could be attributed to increased banking services and activities, fostering greater customer trust. However, compared to private banks, public sector banks still lag significantly behind, with private banks boasting nearly double the profit margins. Notably, Kotak Mahindra Bank leads the pack with the highest and increasing profit margin among all banks.

Table.3 Net Profit Margin Percentage

Indian Public Sector Banks	Net Profit Margin (%)				
	March 2020	**March 2021**	**March 2022**	**March 2023**	**March 2024**
State Bank of India	-2.0	0.9	7.3	8.1	12.2
Bank of Baroda	-4.1	2.1	1.2	2.1	10.7
Canara Bank	-9.6	1.3	-4.0	4.1	8.7
Punjab National Bank	-24.9	-18.4	0.8	3.1	5.1
Indian Private Sector Banks	Net Profit Margin (%)				
	March 2020	**March 2021**	**March 2022**	**March 2023**	**March 2024**
HDFC Banks	21.7	21.2	22.3	24.8	28.0
ICICI Bank	12.4	5.9	11.3	20.6	26.3
Kotak Mahindra Bank	24.7	24.1	25.7	30.4	35.8
AXIS Bank	1.0	9.0	2.9	11.2	20.5

Source: Authors compilation from market data; Equity master factsheet

The percentage of the company's distributable profit allocated to each existing equity share is referred to as **Earnings per share, or EPS**, and it is an excellent method to determine how profitable a business is. It is among the most used measures to evaluate profitability. It gives a view of the comparative earning power of the companies. We can see a mixed result in terms of EPS for both public and private sector banks. The public sector bank has shown rapid change and growth after the outbreak of the COVID-19 pandemic and is now competing with private sector banks, whereas the private is now on prolonged decreasing trends in terms of EPS. ICICI banks have the best distributing profits trends with a maximum in the year ending 2022, and Canara Bank is competing with SBI to outgrow distribution.

Table 4 Earning Per Share

Indian Public Sector Banks	Earnings per share (EPS) in Rs				
	March 2020	**March 2021**	**March 2022**	**March 2023**	**March 2024**
State Bank of India	-5.1	2.6	22.1	25.1	39.6
Bank of Baroda	-7.1	4.2	2.0	3.0	15.2
Canara Bank	-53.9	8.0	-19.3	17.6	33.8
Punjab National Bank	-43.9	-20.8	0.7	2.4	3.5
Indian Private Sector Banks	Earnings per share (EPS) in Rs				
	March 2020	**March 2021**	**March 2022**	**March 2023**	**March 2024**
HDFC Banks	71.3	82.0	49.7	57.7	68.6
ICICI Bank	12.0	6.6	14.8	26.6	36.1
Kotak Mahindra Bank	32.5	37.7	44.9	50.4	60.9
AXIS Bank	1.8	19.6	6.6	23.5	46.0

Source: Authors compilation from market data; Equity master factsheet

2. Return on Equity reveals how much profit a company earns compared to the total shareholder equity on the balance sheet. Return on Equity is essential for a company because it compares it against its competitive firms. Return on equity measures profitability and performance; the higher the ROE, the better the investment company. The majority of public sector banks have had poor returns on equity over the past five years, as the accompanied by the Table. In contrast, private sector banks, HDFC Bank, ICICI Bank, and Kotak Mahindra Bank have handsome and lucrative Returns on equity. This indicates that all the private banks have generated maximum profit compared to the shareholder's equity.

Table 5 Return on Equity (ROE % for 5 Years)

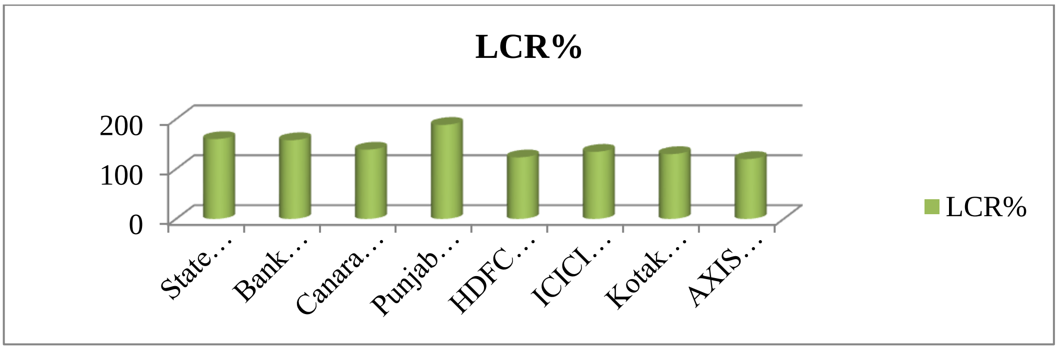
Public Sector Bank	ROE (%)
State Bank of India	11.6
Bank of Baroda	8.5
Canara Bank	8.8
Punjab National Bank	4.0
Private Sector Bank	**ROE (%)**
HDFC Banks	15.4
ICICI Bank	13.8
Kotak Mahindra Bank	12.4
AXIS Bank	12.0

Source: Authors compilation from market data; Screener. in

3. Liquidity Position

The liquidity coverage ratio, or LCR, quantifies the proportion of highly liquid assets held by financial institutions to meet short-term obligations. A minimum requirement of 100% as of 2018-19 is a crucial indicator of a bank's short-term liquidity position. The State Bank of India and Punjab National Bank boast the highest LCR among the selected banks, signaling their robust liquidity positions. Conversely, AXIS Bank trails with the lowest LCR, highlighting potential liquidity challenges.

Figure 1 Liquidity Coverage Ratio as of 30.06.2023



Source: Authors compilation from market data; Banks' websites

4. Solvency Position

The capital adequacy ratio (CAR) measures the amount of capital a bank retains compared to its risk. Capital adequacy ratio is used for identifying the solvency position of the banks just like a solvency ratio is used for any company. The Above table shows that Kotak Mahindra Bank and HDFC Bank have the highest capital adequacy ratio, indicating a strong solvency position. In contrast, Punjab National Bank has the lowest capital adequacy ratio.

Table.6 Capital Adequacy Ratio (As of March 2024)

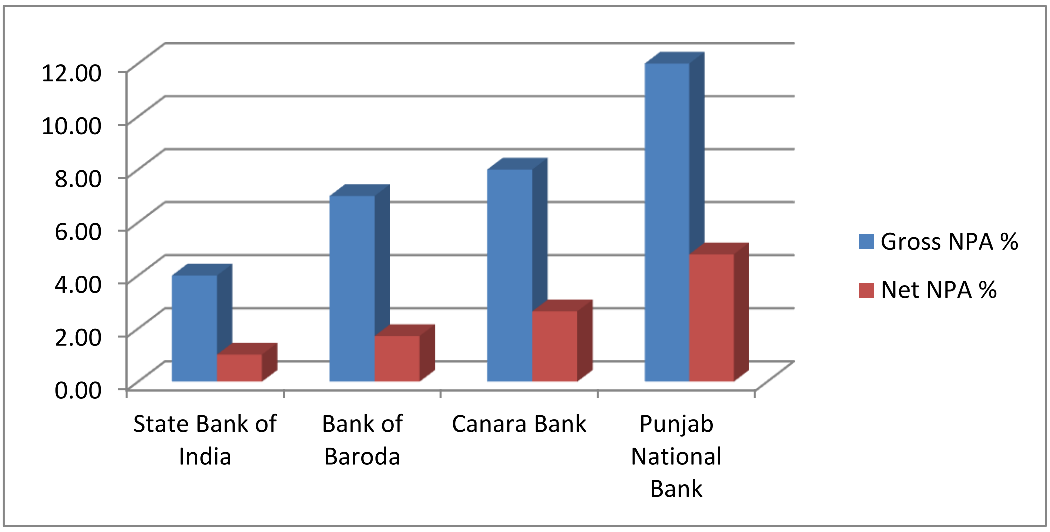
Public Sector Bank	CAR (%)
State Bank of India	13.9
Bank of Baroda	15.8
Canara Bank	14.9
Punjab National Bank	14.5
Private Sector Bank	**CAR (%)**
HDFC Banks	18.9
ICICI Bank	19.2
Kotak Mahindra Bank	22.7
AXIS Bank	18.5

Source: Authors compilation from market data; Equity master factsheet

5. Bank's Financial Well-Being and Asset Quality

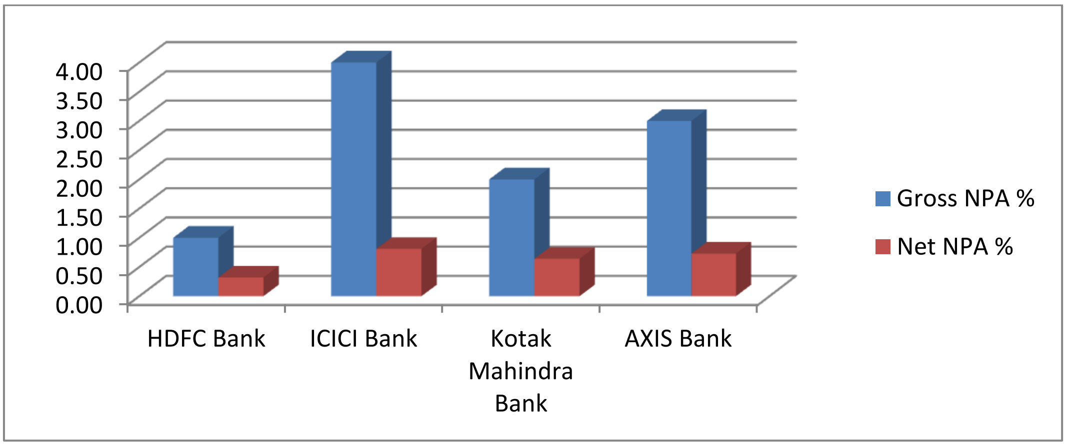
Loans or advances that are past due by 90 days or more are known as non-performing assets (NPAs), which indicate that banks have not received their money back. Higher NPAs indicate poorer asset quality, potentially leading to bankruptcy if not managed. Public sector banks typically exhibit higher NPAs than private counterparts, with PNB leading among public banks and ICICI Bank among private banks. This raises investor concerns, urging caution. Conversely, private banks present lower NPA levels, making them safer investment options.

Figure 2 NPA Position of Public Sector Bank



Source: Authors compilation from market data; moneycontrol.com

Figure 3 NPA Position of Private Sector Bank



Source: Authors compilation from market data; moneycontrol.com

6. Stock Valuation

For stock valuation, the price-to-book (P/B) and price-to-earnings (P/E) ratios are essential. Indicating declining asset quality, public sector banks exhibit undervaluation based on P/E but undervaluation based on P/B. Conversely, private sector banks like HDFC, Kotak Mahindra Bank, and ICICI Bank appear overvalued based on P/B, but their market prices are justified by superior asset quality and financial performance. Kotak Mahindra Bank is an attractive option based on both valuation ratios. Investors should scrutinize underlying asset quality and performance before making investment decisions.

Table 7 Valuation Ratio, Price to Earnings Ratio, and Price to Book Value Ratio

Public Sector Bank	P/E Ratio (%)	P/B Ratio (%)
State Bank of India	12.7	1.5
Bank of Baroda	7.3	0.68
Canara Bank	6.2	0.59
Punjab National Bank	12.7	0.37
Private Sector Bank	**P/E Ratio (%)**	**P/B Ratio (%)**
HDFC Banks	20.5	3.29
ICICI Bank	21.3	3.31
Kotak Mahindra Bank	28.7	3.82
AXIS Bank	14.2	1.94

Source: Authors compilation from market data; screener.in

CONCLUSION

In our latest analysis, we've examined the financial performance of Public and Private sector banks, uncovering a clear trend: Private banks outshine their public counterparts in profitability, liquidity, and solvency. This underscores their agility and resilience in today's competitive banking landscape. Of particular note is the superior asset quality of private banks, reflected in valuation ratios and Non-Performing Asset (NPA) levels. This positions them as prime targets for investors seeking maximum returns. Among private players, HDFC and Kotak Mahindra Bank stand out, offering stability and potential for substantial gains. As we conclude, there's ample opportunity for future research to explore the nuances of Economic, Industry, and Company Analysis, guiding investors toward success in the banking sector.

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