## More legs in this cycle?

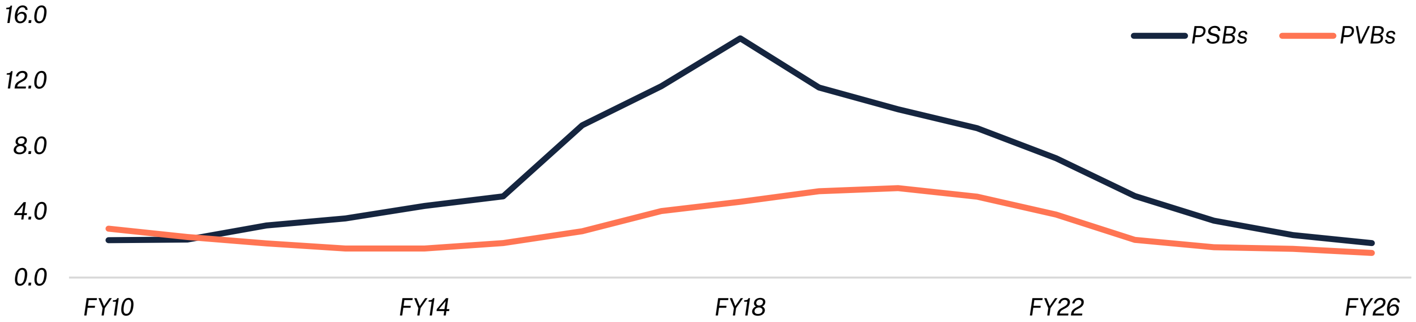
### Indian Financials Entered This Air Pocket Lean, Not Broken

**Last Decade's Banking Crisis – False Equivalence**

*The banking crisis of the previous decade is programmed into the muscle memory of investors when they deal with Indian bank stocks. The 2011–2018 banking crisis had a clear genesis: a post-GFC infrastructure and corporate lending binge, financed with short-tenor bank liabilities against long-gestation project assets, compounded by regulatory forbearance. There was rampant evergreening that followed after the solvency levels had gone well past the point of no return. The 2016 Insolvency and Bankruptcy Code provided the first credible resolution mechanism. Gross NPAs for PSU banks peaked near 14-15% around 2018.*

*The structural picture today differs on both sides of the transaction. On the borrower side, corporates have broadly deleveraged through the IBC-era pain. Corporate gearing sits at multi-year lows. On the lender side, underwriting discipline, large-exposure norms, and sectoral concentration limits are materially tighter than the pre-2015 regime. Credit growth today is more retail and working-capital-driven than large corporate project finance — a different, generally shorter-duration risk profile than the infrastructure lending that drove the last cycle.*

**Gross Non-Performing Asset of Indian Banks (%)**




*Note: PSB – Public Sector Banks, PVB – Private Sector Banks*
*Source: RBI, Spark Fund Research*

**RBI's Pre-Emptive Strike**

*A genuine break from the pre-2018 playbook is the RBI's willingness to act counter-cyclically ahead of visible stress, rather than waiting for NPA data to confirm it. The risk-weight increase on unsecured retail loans, credit cards, and bank lending to NBFCs — announced roughly two years before this note — is the clearest example: a pre-emptive tightening on a segment showing early acceleration, not a reaction to realised losses.*

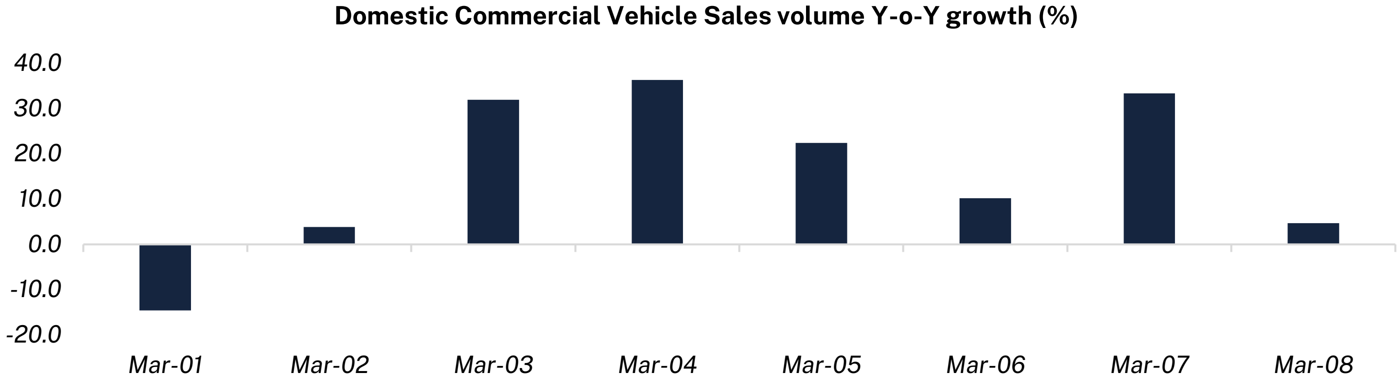
*This sits alongside a broader regulatory scaffold: the phased move towards expected-credit-loss provisioning, tighter co-lending norms between banks and NBFCs, stiffer project-finance provisioning requirements, and digital lending guidelines curbing the more predatory fintech-NBFC partnerships. None of this eliminates the credit cycle. What it does is to keep the cycle hydrated and extend its shelf life.*

**Technology as a Structural Efficiency Lever**

*India's digital public infrastructure — UPI transaction data, the Account Aggregator framework, e-KYC — gives Indian lenders a richer, more real-time alternative-data substrate for underwriting than most EM or even DM peers, who remain more reliant on legacy bureau data alone. Layered with agentic AI in collections, fraud detection, and underwriting, the plausible outcome is a structural, not merely cyclical, improvement in cost-to-income ratios for institutions that can operationalise this data.*

*This is not a uniform lift. Large private banks and the strongest PSU banks are well ahead on this curve; smaller PSU banks, cooperative banks, and undercapitalised NBFCs lag meaningfully. The efficiency dividend is likely to widen the dispersion between adopters and laggards within the sector, rather than lifting the sector uniformly — a bifurcation worth building into any relative-value framework.*

**The Case for Cycle Extension: A Golden Quadrilateral Parallel**




*Source: PL Institutional Equities, Spark Fund Research*

*The 2001–2008 Golden Quadrilateral highway programme is a useful analogue. It did not merely add capacity — it converted commercial vehicle demand from a cyclical, replacement-driven market into a structural multi-year supercycle, because logistics efficiency gains (hub-and-spoke networks, faster turnaround times) generated demand beyond what GDP growth alone implied.*

*The parallel for banking: proactive regulation combined with the UPI/Account Aggregator/digital-lending data infrastructure may function as the equivalent "highway" — infrastructure that extends and smooths the credit cycle rather than simply riding it. Better real-time underwriting data and earlier regulatory intervention can push out the peak of the cycle and reduce the amplitude of the downturn.*

*The necessary caveat: the CV super cycle still ended, in the 2008–09 GFC. The current developments change the contours of the credit cycle — its duration and its amplitude — it does not make the cycle immortal. A sufficiently large exogenous shock, whether household solvency stress or capital-market contagion, still ends this one. The argument here is for extension, not perpetuity.*

**Reading Balance Sheet Signals Before They Break**

*Leverage build-ups do not accumulate silently — they leave visible fingerprints before crystallising into stress: credit growth outpacing income growth, a rising share of unsecured and NBFC-sourced lending, compressed risk premia, and rising leverage-to-income ratios. The discipline is to read these signals in real time rather than retrospectively.*

- *Corporate gearing: at multi-year lows for large corporates — the deleveraging that followed IBC-era pain has largely persisted.*
- *Household leverage: the one area showing genuine build-up — household debt-to-GDP has been rising, with unsecured personal loan growth outpacing income growth in recent years, though the RBI's 2023 risk-weight action has begun cooling this segment specifically.*
- *Capital markets: rapid growth in retail F&O participation, rise in leverage through MTF, sticky SIP flows that continue regardless of valuation, and signs of valuation excess in IPOs/QIPs — this is where risk-taking currently sits, not on bank balance sheets. This is the underplayed stress building up on household balance sheets. The assumption that equity investments can never fail in the long run is inherently violative of the market-based price discovery mechanism which provides for market equilibrium through destruction. We need to worry about whether this will spill over to banks at least in terms of sentiment, disruptive impact to credit quality or even regulatory intervention from fear of a contagion. Having said that, this is not yet showing up on the radar as an imminent issue. The geography of risk today is different from 2011–18: it is concentrated in household unsecured credit and in capital-market risk-taking, not in corporate or bank balance sheets.*

*The other area of stress may transmit through India's external account vulnerability. While Indian banks are not directly exposed to this, there could be an impact on bank stocks through FPI selling – this has been playing out. In fact, bank stocks, particularly large private banks, are the most liquid part of the Indian market. They have historically been a play on India's growth story. FPIs have fed into this and benefited from the out-performance of Indian private banks. The script is now playing in reverse and is possibly overdone.*

**A Peep into the Global Landscape**

*Indian banks stack up rather well against global comparisons. US bank ROEs sit near 12%, European banks near 11.6%, against SBI's 17.3% and ICICI's 16.3%. This ought to be viewed as a growth premium rather than risk mispricing. PSU banks specifically remain inexpensive against both their own history and the ROE improvement delivered — the re-rating (NIFTY PSU Bank now above its median P/B) looks to us still underway rather than exhausted.*

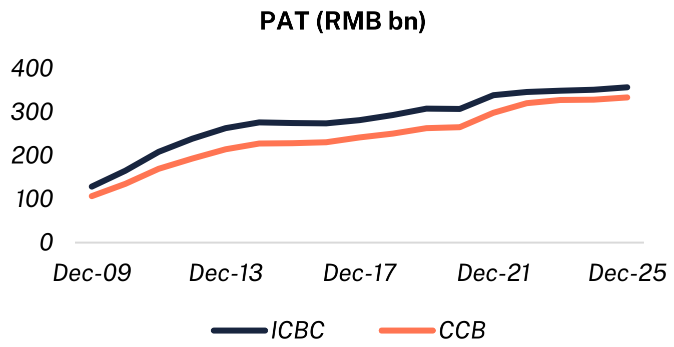
| Global Peers | P/B Ratio (x) | ROE |
|---|---|---|
| JPMorgan Chase | 2.6 | 18.4 |
| DBS Group Holdings | 3.0 | 15.9 |
| Commonwealth Bank of Australia | 3.8 | 13.6 |
| HSBC Holdings | 2.1 | 12.2 |
| Agricultural Bank of China | 0.9 | 10.8 |
| China Construction Bank | 0.5 | 9.9 |
| Westpac Banking | 1.8 | 9.8 |
| Industrial & Commercial Bank of China | 0.6 | 9.5 |
| Bank of China | 0.7 | 9.5 |
| Citigroup | 1.2 | 8.5 |
| ANZ Group Holdings | 1.6 | 8.3 |

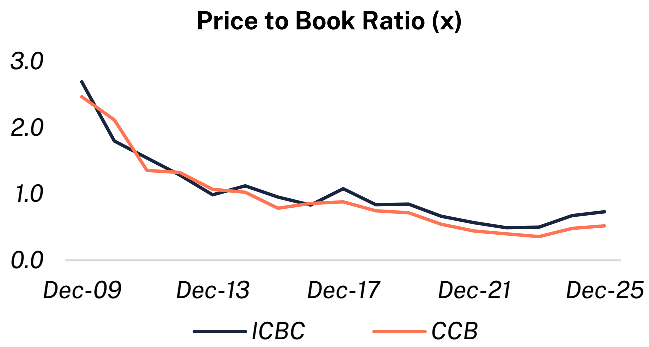
*Note: P/B ratio as on 31 July 2026, ROE calculated for trailing 12 months.*
*Source: Bloomberg, Spark Fund Research*

*Global neobanks post ROEs incumbents rarely match — Nubank near 30%, Revolut near 35% and Wise near 27% — a genuine breakout beyond the traditional growth-versus-returns frontier, not growth financed by margin sacrifice. Measured against this bar, India's best private bank ROEs (roughly 16–18%) look unremarkable rather than stretched. The point here is that the Indian banks are now comparable or lower in valuation when compared to global peers. This is now an anomaly.*

*A natural cross-check for the India financials thesis is a large, mature, state-anchored banking system that has already been through the valuation compression India's PSU banks are only now exiting. ICBC and CCB — the two largest of China's "Big Four" — offer a seventeen-year dataset (FY2009 to date) spanning a credit boom, a slowdown, and a severe multi-year de-rating.*

| Metric | ICBC | CCB |
|---|---|---|
| PAT (FY09, RMB bn) | 129 | 107 |
| PAT (FY25, RMB bn) | 357 | 333 |
| PAT CAGR (FY09 - FY25) | 6.6 | 7.4 |
| Book value CAGR (FY09 - FY25) | 11.2 | 11.5 |
| P/B (FY09) | 2.7x | 2.5x |
| P/B, as on 31-07-2026 | 0.6x | 0.5x |



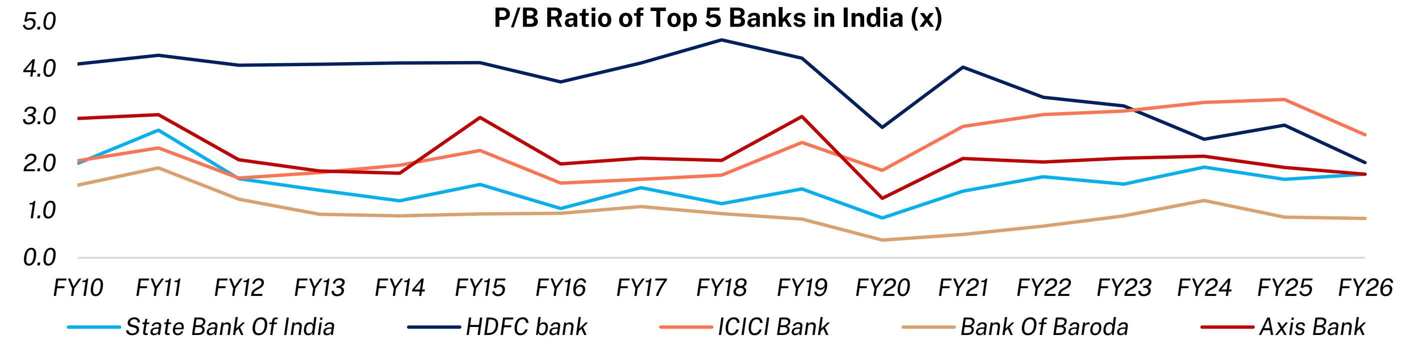

*Note: ICBC - Industrial & Commercial Bank of China; CCB - China Construction Bank*
*Source: Bloomberg, Spark Fund Research*

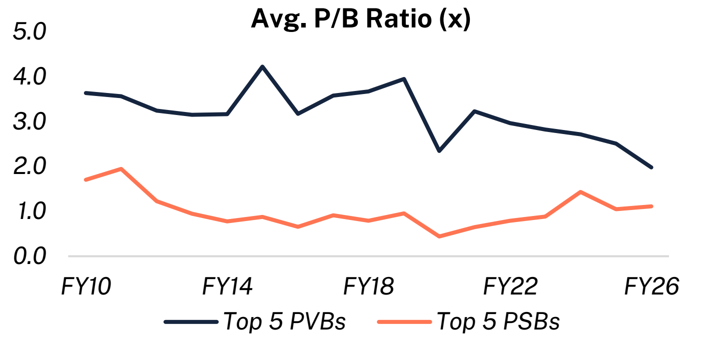
*PAT growth has been real, if unspectacular. Both banks roughly tripled net profit over sixteen years. This is consistent with a large, mature banking system growing broadly in line with nominal GDP. This is a useful reference point for how PAT CAGR* *moderates as a banking system matures and NIMs compress. The P/B collapse is the more striking data point. Both banks now trade at roughly 0.5x book, down from a starting point we estimate at roughly 2.0–2.5x book in 2009–2010.*

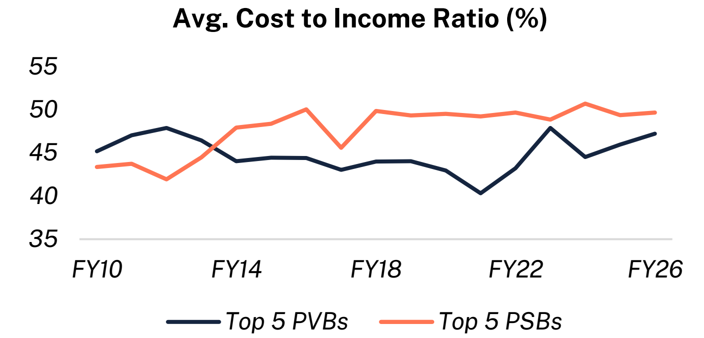
*The mechanism behind the de-rating is instructive for the India thesis, not because the drivers are identical, but because they show what a sustained multi-year compression in bank multiples actually looks like once it starts: structurally falling NIMs as China's rate cycle turned, state-directed lending eroding perceived capital-allocation discipline, a persistently low ROE ceiling (roughly 9-10% currently) against which any book-value growth commands a smaller multiple, and a market that came to price bank equity as a slow-growth utility rather than a credit-cycle beneficiary.*

*Read against the Indian thesis, the Chinese experience cuts both ways. On the positive side, the PSU banks re-rating off a depressed multiple is a real, multi-year phenomenon rather than a brief mean-reversion trade — Chinese banks have now traded sub-1x book for over a decade, so a re-rating is not mechanically inevitable just because a multiple looks cheap. The Chinese parallel also disciplines the bull case: China's de-rating shows what happens when ROE structurally declines even as PAT keeps growing — book value compounds, but the multiple paid for that book value keeps falling. The Indian argument in this note rests on ROE holding up (SBI 17.3%, ICICI 16.3%) rather than eroding the way China's did; that ROE durability, not the PAT growth rate in isolation, is the load-bearing assumption.*

**INDIAN BANK METRICS OVER 15 YEARS REVEAL A STEADY PICTURE**




*Note: Top 5 PVBs: HDFC, ICICI, Kotak Mahindra, Axis and IndusInd Bank; Top 5 PSBs: State Bank of India, Bank of Baroda, Punjab National Bank, Union Bank of India and Canara Bank. PSB – Public Sector Banks, PVB – Private Sector Banks*
*Source: Ace Equity, Spark Fund Research*

*There is one conundrum that needs to be answered:*

*In a market where even a newbie small cap commands valuations that rival Silicon Valley innovators, Indian banks are trading cheap – against their history, against the market, against their ROE and against global peers. They arguably have one of the world's best regulators of banking presiding over them. Indian bank managements are rated amongst the best. Indian banks have deployed technology that puts India on par with the best in the world – one of the few large sectors where we can make that claim. Why this disconnect?*

*Indian private banks have high free float and this is possibly the biggest culprit. FPIs own a lot of this and two-way liquidity is available here. In other words, this supports our argument that the over-valuation elsewhere in the Indian market is in good measure due to constrained liquidity which has been gamed by the relentless domestic flows which have tended to be indiscriminate. The problem is not with the bank valuations but at some other end. There is of course the fear that banks may* *morph into utilities with AI commoditising everything that banks are supposed to do. We believe the efficiency gains from tech adoption may play out first in India. This is not a sector like IT services where topline has been added by headcount. It will be a while before robots and BOTs take over a country like India. India's bank sector weightage is another issue. Again, it is partially driven by free float and hence the comparison with the high weightage of US banks in 2007 is inappropriate. It is also a reflection of physical India not keeping pace.*

*On balance, we conclude that the attractive valuations for Indian banks are just that – they are attractive. Until asset quality stress looms on the horizon, we may want to view this as mispricing at least to a great extent. We believe banks are probably best placed to pick up the pieces and prepare for another leg up from the mid-cycle shock that the Indian economy is currently negotiating.*

**The Next Crisis May Wear a Capital-Markets Coat**

*The previous decade's crisis had a recognisable pathology: infrastructure conglomerates raised debt against inflated cash-flow assumptions. Capital allocation decisions were compromised by proximity to the source of capital, and the market largely looked away. The echo of that collective denial is not in corporate leverage, but in the narrative around the durability of SIP flows and the depth of India's F&O market. The mechanisms built to deepen and stabilise capital markets — systematic retail flows, weekly options liquidity — carry their own iatrogenic risk: they can become a source of instability precisely because their stability is assumed rather than tested, in much the same way infrastructure lending was assumed to be self-financing until it wasn't.*

*Capital markets resemble the banks of the previous decade. Rampant over-valuation is endorsed on the assumption that if you wait long enough, all will end well. It was easy to see how a QIP of under Rs 1000 crores could not have supported a balance sheet of many tens of thousands in debt with operating cash flows at a fraction of debt – in the previous decade. There was an airline which never showed any viable path to settling its debt. There were asset owners with real liabilities wherein the legitimacy of assets was stuck in court rulings. Yet the banks and the markets were in denial back then. Right now, the capital markets are in a similar denial. The fact that the value of stocks cannot be backstopped by regulators is all but ignored. Indian banks in contrast are on a better wicket now – other than the fact that the owners of the free float view these as liquidity on tap whenever in need. The bank stocks seem to have priced in this and that offers some margin of safety now in a market where the term is an oxymoron.*

**Warm regards,**
**P Krishnan (CIO) and Team Spark Fund**

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