INDIA

8 June 2009

CENTRUM

Banking Sector

Passing on the Baton…

…Back to Basic Banking

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CENTRUM

Banking Sector

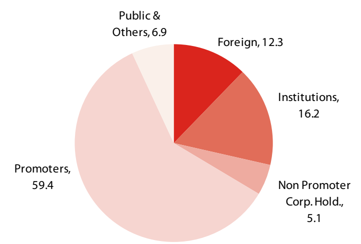
Initiation

Passing on the baton

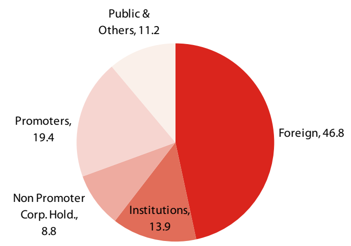
- **PSUs attractive vs private banks:** We reiterate our Equal weight stance on the sector *(Refer to our India strategy report, 'Premature extrapolation!,' 18 May 2009)* and initiate coverage on PNB with a Buy, SBI and Axis Bank with Acumulate, and HDFC Bank with Hold and ICICI Bank and KMB with Sell rating. We reiterate Buy on Union Bank, Hold on BoI and downgrade IOB to Hold.
- **Actionable ideas:** Idea 1: Switch to SBI from ICICI Bank; Idea 2: Switch to Axis Bank from HDFC Bank; Idea 3: Switch to PNB from BoI; Idea 4: Switch to UBI from IOB.
- **Sector seeing dynamic shift:** We expect banks to focus on basic banking as value triggers in non-banking subsidiaries appear sluggish. We attribute this to capital being a scarce commodity and regulatory overhang, notwithstanding the improving visibility.
- **Gap between PSU and private banks narrowing:** PSUs are playing catch up with their private peers, warranting a strong re-rating. Also, PSU banks have undergone significant positive structural changes leading to improvement on almost all financial and operational parameters, which underpins our view that the gap between PSU and private banks is narrowing
- **PSU banks score higher on CAMEL evaluation:** On CAMEL (a measure for banks' operational performance), PSU banks under our coverage score higher in liability franchise, focus on NII and RoE. Private sector banks, however, face near term headwinds. HDFC Bank and PNB score highest on CAMEL rating within the private and PSU banking space, respectively.
- **Earnings pressure, credit slowdown for banks until FY11E**: We expect earnings to remain sluggish with 5% FY10E PAT growth for banks under our coverage. Continuing margin pressure, downward pressure on fee income and higher NPA provision would hit earnings.
- **Near term value drivers in the non-banking business fading:** We believe that earnings and value momentum from non-banking businesses, viz, insurance, asset management and securities is unlikely to be robust in the near term, affecting overall earnings and valuations of these banks. Also, value unlocking in these subsidiaries appears hazy due to volatility in capital markets and regulatory overhang.

Shareholding Pattern

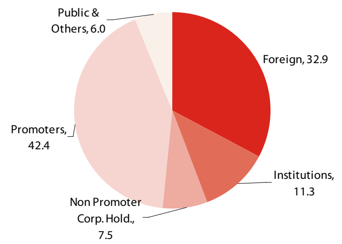
State Bank of India



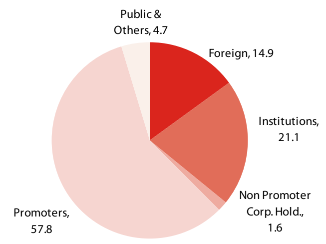
HDFC Bank



Axis Bank



Punjab National Bank



As on 31 March 2009
Source: NSE, Centrum Research

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Summary valuations

Company	Rating	M.Cap Rsbn	M.Cap US$bn	CMP (Rs)	Target Price	*Upside/ Downside (%)*	P/BV (x) FY09	P/BV (x) FY10E	P/BV (x) FY11E	P/E (x) FY09	P/E (x) FY10E	P/E (x) FY11E	*RoE (%) FY09*	*RoE (%) FY10E*	*RoE (%) FY11E*
SBI	Accumulate	1,191.5	25.4	1,877	1,958	*4.3*	2.5	2.3	2.2	9.1	12.5	11.3	*17.1*	*15.5*	*15.3*
ICICI Bank	Sell	804.2	17.1	723	589	*(18.5)*	1.8	1.7	1.5	16.3	19.7	17.0	*7.7*	*7.9*	*8.4*
HDFC Bank	Hold	610.0	13.0	1,434	1,376	*(4.0)*	4.4	3.7	3.2	20.7	22.4	17.7	*16.1*	*16.8*	*18.2*
Axis Bank	Accumulate	266.6	5.7	742	804	*9.2*	2.2	2.4	2.2	12.6	13.2	11.2	*19.8*	*18.4*	*18.8*
KMB	Sell	235.0	5.0	680	387	*(43.1)*	7.6	7.2	6.8	37.6	77.3	62.6	*7.5*	*7.7*	*8.8*
PNB	Buy	209.2	4.5	664	799	*20.4*	1.6	1.5	1.3	4.8	6.3	5.4	*22.7*	*20.9*	*20.6*
BOI	Hold	182.5	3.9	347	339	*(2.4)*	1.7	1.5	1.3	6.9	4.7	6.5	*30.1*	*22.7*	*20.8*
UBI	Buy	104.6	2.2	207	234	*13.2*	1.5	1.4	1.2	4.2	6.2	5.3	*27.1*	*21.6*	*21.1*
IOB	Hold	51.6	1.1	95	92	*(2.9)*	1.2	1.1	1.0	3.5	4.4	3.9	*24.1*	*19.2*	*18.8*

Source: Company, Centrum Research Estimates

Index

All prices used within the report are dated as at end of day 1 June 2009. The price variations between pricing date and date of publication are relatively insignificant for a change in rating.

Company Name	1-Jun-09	5-Jun-09	Difference (%)
SBI	1,877	1,818	(3.2)
ICICI Bank	723	755	4.4
HDFC Bank	1,434	1,419	(1.1)
Axis Bank	742	739	(0.5)
KMB	680	677	(0.4)
PNB	664	654	(1.5)
BOI	347	345	(0.7)
UBI	207	215	3.8
IOB	95	92	(3.3)

Source: Bloomberg, Centrum Research

Executive Summary

We reiterate our Equal weight on the sector (Refer to our India strategy report, *'Premature extrapolation!,'* dated 18 May 2009). We broadbase our coverage on the sector with initiations: PNB with a Buy, SBI and Axis Bank at Acumulate, HDFC Bank with a Hold and ICICI Bank and KMB at Sells, respectively. We also reiterate our bullish stance on Union Bank of India. We also downgrade BoI and IOB to Hold.

Actionable pair trade ideas:

Idea 1: Switch to SBI from ICICI Bank

Idea 2: Switch to Axis Bank from HDFC Bank

Idea 3: Switch to PNB from BoI

Idea 4: Switch to UBI from IOB

PSU banks attractive vs private banks

A rerating of PSU banks is imminent, in our view, with the valuation gap between PSU and private banks converging, as both banks score at par on CAMEL (parameters that measure operational peformance of banks). Despite higher RoE, PSUs trade at lower P/BV making a case of higher rating for PSU banks. Also, we expect the high premium on P/Adj BV of private banks to shrink, as private banks are unlikely to enjoy earlier growth rate of 40% in this cycle, given their large balance sheet sizes. The competitive advantage of private banks vs PSU banks is seen diminishing, and the latter is at par to seize the new growth opportunities.

Exhibit 1: Summary valuations

Company Name	Rating	M.Cap US$bn	CMP (Rs)	Target Price	Upside/ Downside (%)	P/BV (x) FY09	P/BV (x) FY10E	P/BV (x) FY11E	P/E (x) FY09	P/E (x) FY10E	P/E (x) FY11E	RoE (%) FY09	RoE (%) FY10E	RoE (%) FY11E
SBI	Accumulate	25.4	1,877	1,958	*4.3*	2.5	2.3	2.2	9.1	12.5	11.3	*17.1*	*15.5*	*15.3*
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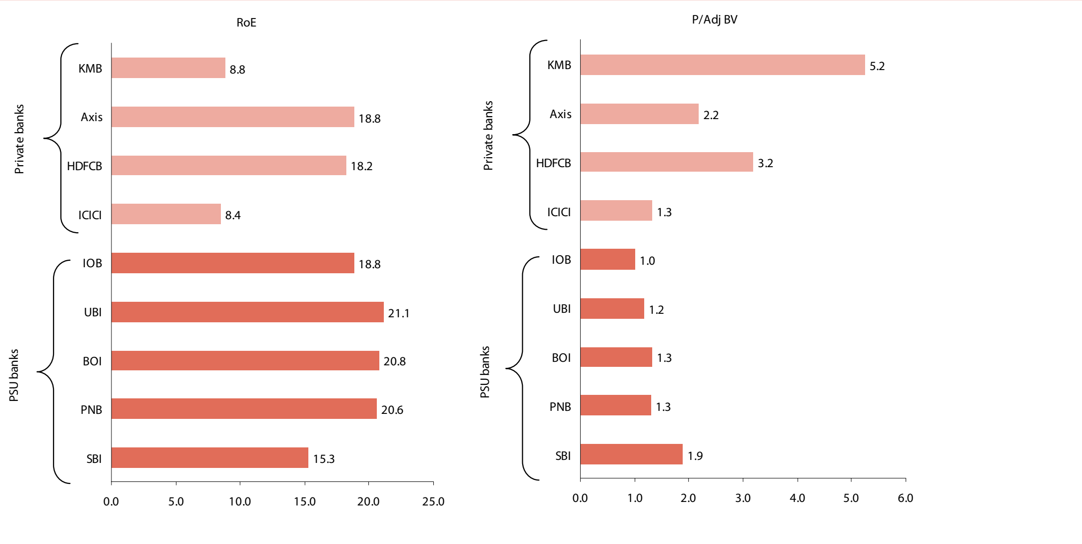
Source: Company, Centrum Research Estimates

Higher RoEs to eventually drive higher valuations

Despite higher RoEs, PSU banks have been trading at lower P/BV multiples. We believe this dichotomy will correct eventually as the differences in business and financial metrics are relatively insignificant.

Exhibit 2: FY11E RoE vs P/Adj BV



Source: Centrum Research Estimates

Gap between PSU and private banks narrowing

PSU banks are catching up with their private peers, warranting a strong re-rating even though historically they have been trading at lower multiples. Higher growth, improving productivity for branches, customer profiles, implementation of technology and improved products coupled with significant positive structural changes (led to the improvement of PSUs on almost all financial and operational parameters) makes us believe that the gap between PSU and private banks is narrowing. We believe PSU banks with strong franchisee network (opportunity to drive in higher CASA) will consolidate at a time when private banks are caught up with the adjustment phase (lower credit growth and house keeping). We believe asset quality concerns on both sides are similar, the difference being PSU banks are better placed this time to weather the NPA cycle. This is a result of prudent lending practices, better credit and risk recovery mechanisms and regulatory support. Further, the relatively higher corporate exposure (who have restructured problem loans) of PSU banks would suppress the reported NPAs in the short-term. However, our expectation of economic recovery in FY10 would offset the carrying risk of NPA deterioration in the long run.

Exhibit 3: Narrowing gap between PSU and private banks

Particulars	Private banks	PSU banks	Remarks
Balance sheet growth	29% CAGR over 2003-08	19% CAGR over 2003-08	Market share strategies to drive higher growth for PSU banks
Credit growth	34% CAGR over 2003-08	25% CAGR over 2003-08	
NIMs	Superior NIMs driven by high yielding advances and high CD ratios	Relatively lower NIMs	Gap to narrow, aided by lower cost of funding of PSUs
Fee income	Higher share of fee based products	Relatively lower share of Non-interest income	CBS implementation and distribution of personal investment products to augment fee income growth.
Employee and branch productivity	Profit per branch Rs25mn Profit per employee Rs0.76mn	Profit per branch - Rs5mn Profit per employee - Rs0.26mn	PSU banks have further scope for improvement
Asset quality	Historically, better asset quality but likely to deteriorate significantly	Witnessed significant improvement in asset quality	Expect PSU GNPA at 3.2% vs 4.6% for private banks in FY11E
Customer Profile	Share of younger customers over 60%	PSU banks have only 32% customers under the age of 40	PSU banks too have aligned their customer acquisition strategy in line with private banks, targeting youth
Innovation and new growth opportunities	Historically, proactive in identifying new growth opportunities. Insurance, asset management, international expansion	Select PSU banks have or are planning to venture into non-banking businesses	-
Technology	Superior technology	Has been a laggard in technology initiatives historically	PSU banks have begun to upgrade their technology
Return ratios	RoE at 14-15% over last 4 years RoA at 1.1-1.2% over last 4 years	RoE at 15-18% over last 4 years RoA at 0.9-1% over last 4 years	PSU will likely continue to witness relatively better RoE

Source: Centrum Research

Investment strategy - 'Back to Basic' banking

A dynamic shift is expected for banks, given the prevailing challenging macro environment and we now expect banks to increase focus on retail liabilities and expand branch network to gear for the next level of growth. The asset growth strategy that banks chased during FY04-08 came with a cost for a few banks, with interest rates turning unfavourable from FY09 onwards. We expect banks that score high on key banking operational parameters (CAMEL) to outperform. However, we do not see significant value from non-banking subsidiaries at least in the near term, given the subdued capital markets and regulatory overhang. We are positive on PSU banks based on our CAMEL approach - (capital, asset quality, management, earnings quality and liability franchise) - wherein these banks score higher vs private banks.

Exhibit 4: Core banking in focus

BASIC BANKING

CORE BANKING BACK IN FOCUS

Evaluating core- outperformance with CAMEL Model

Capital Strength
Asset Quality
Management
Earnings Quality
Liability Franchisee

Gap between PSU and Private narrowing down

Banking and Macro-Outlook

- Economic outlook
- Profitability and credit growth under pressure
- Resilient Indian banking system

NON - BANKING - FADING FOCUS

Near term drivers in non-banking business fading

Insurance - High gestation and long term growth story

Asset Management - Meager in value terms

Securities and Investment banking - Best behind us

Source: Centrum Research

Evaluating operating performance using CAMEL approach

We have tried to evaluate the performance of PSU and private banks (under coverage in this report) on CAMEL framework. Our CAMEL analysis suggests that PSU banks under our coverage score higher on liability franchise, focus on NII and RoE. Also, private sector banks, which face near term headwinds due to management reshuffle and reduced to access to capital on account of subdued capital markets, score similar to PSU banks. This makes us believe that the gap between PSU and private banks is narrowing with increased focus on ‘back to basic’ banking.

Under CAMEL, we have rated all banks with 5 being the best and 1 being the worst. We are sanguine on the operational performance of banks that have scored 3 or higher. Within our coverage, HDFC Bank has the highest score with PNB trailing in the second place. Out of the 5 PSU banks, all score higher than 3 except IOB.

Exhibit 5: Evaluating banks on CAMEL framework

Name of the bank	Capital	Asset quality	Management	Earnings	Liability franchise	Overall score
SBI	3	2	4	2	5	3.2
PNB	3	4	4	4	5	4.0
BOI	2	3	2	3	3	2.6
UBI	2	4	4	4	4	3.6
IOB	1	1	3	3	3	2.2
ICICI	5	1	2	2	2	2.4
HDFC	4	4	5	5	4	4.4
Axis	3	4	3	4	4	3.6
Kotak	5	1	4	1	1	2.4

Source: Centrum Research

Earnings pressure, credit slowdown for banks until FY11E

We expect the banks under our coverage to post sluggish 5% PAT growth in FY10E owing to continued margin pressure (due to lower loan growth and fall in CD ratios), downward pressure on fee income (capital market related fees, third party distribution and asset processing fees), increase in NPA provisions (systemic deterioration of asset quality) and rise in MTM provisions on investments (if bond yields harden). Also, PSU banks are expected to witness rise in employee costs with wage negotiations underway, and pension liability too knocking the door.

Exhibit 6: Banks' profitability under pressure

....NIM pressure to continue due to....

- Fall in yield on advances with softening interest rates and changing loan composition towards low-risk corporate loans
- Cost of funding will fall but with a lag, as deposits get re-priced - slower than loans
- Higher investment in government securities to yield relatively low return

Core other income to remain under pressure...Fee income to remain under pressure on account of:

- Decline in core banking products (LC,BG, etc) and asset processing fees with lower loan growth
- Lower recovery of NPA in a challenging macro environment
- Subdued income from personal investment product distribution (insurance, mutual fund)

Banks' profitability under pressure

Cost control would not yield more benefit to banks

- Benefit of stringent cost control measures would be offset by the branch expansion
- Also, we believe banks would not get be able to cut costs further as the rationalization has started in early FY09.

...High provision charges would be required

- Higher NPA provisions are required in a deteriorating asset quality scenario

Source: Centrum Research

Exhibit 7: 5% Earnings Growth in FY10E (Centrum Universe)

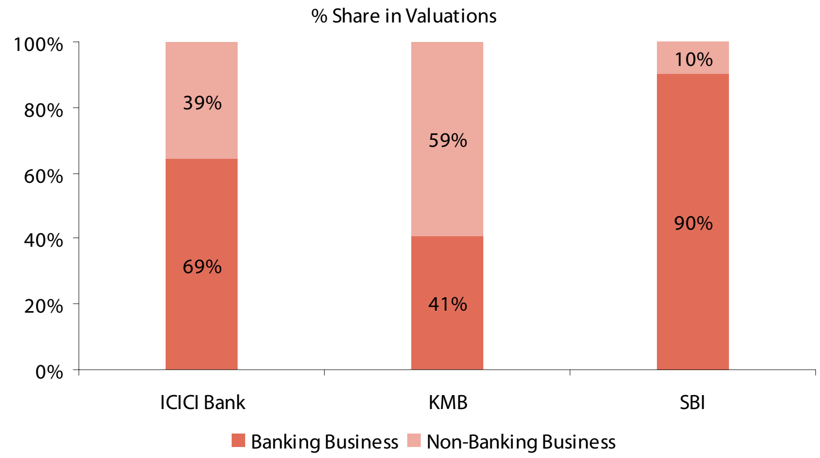
(%)	SBI	PNB	BOI	UBI	IOB	ICICI BK	HDFC BK	Axis BK	KMB
PAT Growth									
FY09	36	50	50	24	5	10	21	71	6
FY10E	5	8	(6)	(2)	(7)	9	21	11	10
FY11E	10	15	12	18	13	16	27	17	23
Loan growth									
FY09	30	29	26	30	25	(3)	56	37	7
FY10E	17	17	16	18	16	3	20	18	16
FY11E	19	19	19	19	18	16	24	20	17
NIM									
FY09	2.6	3.3	2.8	2.8	2.8	2.3	4.5	3.4	5.6
FY10E	2.5	3.2	2.7	2.7	2.6	2.3	4.6	3.2	5.7
FY11E	2.6	3.2	2.7	2.8	2.8	2.4	4.6	3.4	5.7
GNPA									
FY09	2.8	1.8	1.7	2.0	2.8	4.2	2.0	1.1	2.8
FY10E	3.6	3.5	2.9	2.9	4.3	4.9	2.7	2.0	3.3
FY11E	4.2	4.0	3.9	3.7	5.1	5.0	3.5	2.9	4.0
NNPA									
FY09	1.8	0.2	0.4	0.3	1.6	2.0	0.6	0.4	1.3
FY10E	2.1	1.1	1.0	0.8	2.2	2.4	0.7	0.7	1.4
FY11E	2.4	1.2	1.4	1.0	2.3	2.5	0.9	1.1	1.8
RoA									
FY09	1.1	1.4	1.5	1.2	1.1	1.0	1.3	1.4	1.0
FY10E	0.9	1.2	1.2	1.0	0.9	1.1	1.4	1.3	1.0
FY11E	0.9	1.2	1.1	1.0	0.9	1.1	1.4	1.2	1.0

Source: Company, Centrum Research Estimates

Near term drivers in non-banking businesses fading

Private banks have extensively diversified into non-banking areas such as insurance, asset management and securities businesses. PSU banks, which primarily concentrated on core banking too have had begun to venture in to non-core businesses of insurance and asset management. We expect the insurance business (highly capital-intensive with high gestation period) to remain a drag on banks' profitability. We also remain wary of the capital market business until significant and sustainable visibility arises. The asset management business, which has a high co-relation with capital markets too is likely to witness subdued growth. This makes us believe that earnings and value momentum from other businesses is unlikely to be robust in the near term, negatively impacting the overall earnings and valuation of banks in the near term.

Exhibit 8: Non banking subsidiaries - lower share in valuation



Source: Centrum Research Estimates

Valuation - PSU banks attractive vs private banks

Valuation

PSU banks attractive vs private banks

A re-rating of PSU banks is imminent, in our view, with the valuation gap between PSU and private banks converging, as both banks score at par on CAMEL (parameters that measure operational peformance of banks). Despite higher RoE, PSUs trade at lower P/BV making a case of higher rating for PSU banks. Also, we expect the high premium on P/Adj BV of private banks to shrink, as private banks are unlikely see earlier growth rate of 40% in this cycle, given their large balance sheet sizes. The competitive advantage of private banks vs PSU banks is seen diminishing, and the latter is at par to seize the new growth opportunities. We reiterate our Equal weight stance on the sector (Refer to our India strategy report, 'Premature extrapolation!,' 18 May 2009) and initiate coverage on PNB with a Buy, SBI and Axis Bank with Acumulate, and HDFC Bank with Hold and ICICI Bank and KMB with Sell rating. We reiterate Buy on Union Bank, Hold on BoI and downgrade IOB to Hold. We also recommend a switch to SBI from ICICI Bank.

Exhibit 9: Valuation summary

						P/BV (x)			P/E (x)			*RoE (%)*		
Company Name	**Rating**	**M.Cap (Rsbn)**	**CMP (Rs)**	**Target Price**	***Upside/ Downside (%)***	**FY09**	**FY10E**	**FY11E**	**FY09**	**FY10E**	**FY11E**	***FY09***	***FY10E***	***FY11E***
SBI	Accumulate	1,191.5	1,877	1,958	*4.3*	2.5	2.3	2.2	9.1	12.5	11.3	*17.1*	*15.5*	*15.3*
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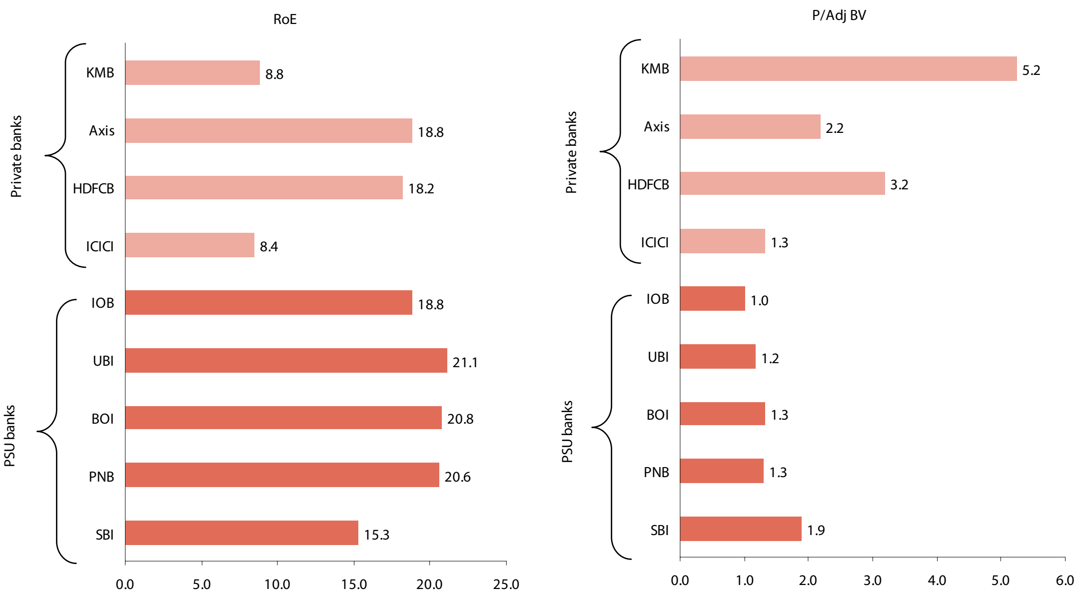
Source: Company, Centrum Research Estimates

High RoEs to translate into higher valuation

Despite higher RoE, PSUs trade at lower P/BV multiples making a case of higher rating for PSU banks.

Exhibit 10: FY11E RoE vs P/Adj BV



Source: Centrum Research Estimates

Valuation methodology

While PSU banks and ICICI Bank are valued on single stage Gordon Growth model, Axis and HDFC Bank are valued on two-stage Gordon Growth model with growth estimated at about 30% in the first stage, second stage growth is taken at 5%. We have provided a 15% premium to SBI for its market leadership on the single stage Gordon Growth, 10% discount to UBI and 20% discount to IOB due to lower capital adequacy and higher asset quality risks. We expect valuation premium to stay for a while but the gap to narrow, as private banks can no longer bank on technology as a competitive advantage and also due to lack of new growth drivers.

Exhibit 11: Banks valued on single and two-stage Gordon growth - growth premium to fade

	SBI	PNB	BOI	UBI	IOB	ICICI B	HDFC B	Axis	KMB
CoE (%)	12.3	12.0	12.8	11.8	12.5	13.0	11.5	12.8	13.0
Rf (%)	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
G - growth phase (%)	17.0	19.0	15.0	15.0	15.0	15.0	30.0	30.0	21.0
Beta	1.05	1.00	1.16	0.95	1.10	1.20	0.9	1.15	1.20
Market Return (%)	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0
Growth (Gn) (%)	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Normalised RoE (%)	15.0	16.0	15.0	15.0	14.0	12.0	17.0	18.0	13.0
Initial Payout ratio (P) (%)	12.0	12.0	12.0	12.0	12.0	20.0	16.0	20.0	12.0
Perpetual Payout ratio (Pn) (%)	14.0	16.0	16.0	16.0	17.0	25.0	25.0	25.0	25.0
Target P/Adj BV - Single Stage (x)	**1.4**	**1.6**	**1.3**	**1.5**	**1.2**	**0.9**	1.8	1.7	**1.0**
Target P/Adj BV - Two Stage (x)	0.4	0.7	0.4	0.5	0.4	0.5	**3.1**	**2.4**	0.8
Premium / Discount (%)	15.0	0.0	0.0	(10.0)	(20.0)	0.0	70.0	40.0	5.0
Target P/ Adj BV (x)	**1.6**	**1.6**	**1.3**	**1.3**	**1.0**	**0.9**	**3.1**	**2.4**	**1.1**

Source: Centrum Research Estimates

Initiating coverage

SBI - Return of the prodigal

SBI will continue to trade at a premium to the PSU banking sector mainly on account of market leadership. We recommend an Accumulate rating on the stock, valuing its banking business at 1.6x P/Adj BV on FY11E adj BV, insurance business at 15x FY11E NBAP at NBAP margin of 17% and other non-banking subsidiaries and strategic investments at Rs63 to arrive at a target price of Rs1,958. We believe SBI has favourable risk return, given its relatively stronger branch network, liability franchise, superior market share despite higher asset risks.

Exhibit 12: SBI Summary Financials

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	150,582	67,652	45,414	*3.1*	86	10.7	495	2.0	*15.4*	*0.9*
FY08	170,212	86,949	67,292	*48.2*	106	15.5	656	2.3	*16.8*	*1.0*
FY09	208,731	126,908	91,213	*35.5*	144	9.1	763	1.7	*17.1*	*1.1*
FY10E	246,077	116,455	95,455	*4.7*	150	11.3	817	2.1	*15.5*	*0.9*
FY11E	288,428	131,056	105,315	*10.3*	166	10.2	857	2.0	*15.3*	*0.9*

Source: Company, Centrum Research Estimates

Exhibit 13: SBI SOTP

Particulars	% Stake	Value In (Rsmn)	Value per share	Comments
SBI - Standalone	100%	870,296	1,372	1.6x FY11E Adj BV
Banking Subsidiaries	75-100%	228,865	361	1.6x FY11E Adj BV
SBI Life	74%		187	15x FY11E NBAP at NBAP Margin of 17%
Other Non Banking Subsidiaries & Non-strategic investments		40,052	63	
Holding Co discount			10%	
Non Bkg Subs Value after discount		242,025	225	
Value		1,112,321	1,958	
CMP			1,877	
Upside			*4.3%*	

Source: Company, Centrum Research Estimates

ICICI Bank - In adjustment mode

We value the standalone bank at 0.9x 2009 P/Adj BV using single stage Gordon Growth model. Given that the bank's cost of equity at 13% is higher than its RoE (where we do not see significant upside), we value the bank below book value. We have not valued the UK subsidiary, mainly on account of higher unrealised gains on investment book and risk of further asset write downs. Other subsidiaries are valued at Rs200 after providing for a 10% holding company discount has been provided to arrive at our target price of Rs589, a 18% downside from current levels. We initiate coverage on the stock with a Sell rating.

Exhibit 14: ICICI Bank Summary Financials

Y/E Mar (Rsmn)	NII	Non Int. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	56,371	69,279	31,102	*22.4*	35	19.3	248	2.7	*13.2*	*1.1*
FY08	73,041	88,108	41,577	*33.7*	38	25.1	386	2.5	*11.0*	*1.1*
FY09	83,667	76,042	37,588	*(9.6)*	34	16.3	404	1.4	*7.7*	*1.0*
FY10E	83,850	80,502	40,893	*8.8*	37	19.3	433	1.6	*7.9*	*1.1*
FY11E	94,561	88,352	47,300	*15.7*	42	16.7	468	1.5	*8.4*	*1.1*

Source: Company, Centrum Research Estimates

Exhibit 15: ICICI Bank sum-of-the-parts valuation

Particulars	Stake (%)	Value (Rsmn)	Rs/ share	Valuation Methodology
ICICI Bank		**433,617**	**390**	**0.9x Adj BV on single stage Gordon Growth model**
ICICI Securities Limited	100%	8,117	7	10x FY11 profit
ICICI Prudential Life Insurance Co.	74%	186,107	167	15x FY11 NBAP
ICICI Lombard General Insurance Co..	74%	6,433	6	
ICICI Prudential Asset Management Co. Ltd.	50%	11,749	11	4% of AUM
ICICI Bank UK PLC*	100%	0	0	Did not valued these business mainly on account of clarity on asset write-downs
ICICI Bank Canada	100%	23,426	21	Valued at 0.6x BV
Others (incl Home finance and Ventures, PD)		6,704	10	Ventures valued as 4% of AUM, PD and Home Finance at 10x FY10 PAT
Subsidiaries - Total		**242,536**	**222**	
Holding co discount (10%)		24,254	22	
Value of the Bank		651,899	589	

Source: Company, Centrum Research Estimates

HDFC Bank – Valuation premium justified

The bank will likely continue to trade at a premium to its peers due to its reasonably higher earnings visibility (CAGR above 24%) over FY09-11E, when earnings growth of most banks are likely to be stressed during this period. HDFC Bank has the ability to manage any significant deterioration in asset quality, given its higher provisioning. We recommend a Hold rating on the stock and assign a P/adj BV of 3.1x FY11E adj. BV of Rs450 to arrive at our target price of Rs1376 based on our 2-stage Gordon Growth model.

Exhibit 16: HDFC Bank - Summary financials

Y/E Mar (Rsmn)	NII	*YoY (%)*	Net Income	*YoY (%)*	Adj PAT	*YoY (%)*	EPS (Rs)	Adj BV (Rs)	*RoE (%)*	*RoA (%)*	P/E (x)	P/BV (x)
FY07	34,685	*36.2*	49,847	*35.8*	11,415	*31.1*	35.7	195	*19.5*	*1.4*	25.0	4.6
FY08	52,279	*50.7*	75,110	*50.7*	15,902	*39.3*	44.9	316	*17.7*	*1.4*	29.4	4.2
FY09	74,212	*42.0*	107,118	*42.6*	22,450	*41.2*	52.8	330	*16.1*	*1.3*	20.3	3.3
FY10E	88,173	*18.8*	124,540	*16.3*	27,212	*21.2*	64.0	388	*16.8*	*1.4*	22.4	3.7
FY11E	105,918	*20.1*	147,751	*18.6*	34,460	*26.6*	81.0	450	*18.2*	*1.4*	17.7	3.2

Source: Company, Centrum Research Estimates

Axis Bank - Quality growth to moderate

We recommend an Accumulate rating on Axis Bank with a target price of Rs804 an upside of 8%, valuing the bank at 2.4x FY11E P/Adj BV of Rs340.5 under the 2-stage Gordon Growth model. We are positive mainly on account of consistent quality growth over the last 5 years (Balance sheet CAGR of 44%, earnings CAGR of 47% during 2004-09), led by liability driven growth strategy, relatively better funding franchise (CASA second best in the private banking space next to HDFC Bank) and diverisified loan book.

Exhibit 17: Axis Bank Summary Financials

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	14,685	10,099	6,543	*34.9*	23	16	110.9	3.3	*20.9*	*1.05*
FY08	25,852	17,959	10,592	*61.9*	31	23	237.7	3.1	*16.3*	*1.16*
FY09E	36,860	28,948	18,133	*71.2*	50	13	275.4	2.3	*19.8*	*1.39*
FY10E	49,936	33,654	20,169	*11.2*	56	13	307.0	2.4	*18.4*	*1.25*
FY11E	63,391	37,566	23,682	*17.4*	66	11	340.5	2.2	*18.8*	*1.24*

Source: Company, Centrum Research Estimates

Kotak Mahindra Bank - Business model under stress

We value Kotak Mahindra Bank (KMB) on SOTP methodology giving us a target price of Rs387, providing a 43% downside from current levels. The stock has run up significantly in the recent past on expected improvement in capital markets, which we believe is too early to translate into profits. Moreover, given its declining market share in the securities business, we recommend avoiding KMB until reasonable and sustainable business visibility emerges. Stripping off other business values, the bank currently trades at 1.3x FY10E Adj BV on a standalone basis, which we believe is expensive, given its small size and the pressure it faces. Initiating coverage on the stock with a Sell rating.

Exhibit 18: Standalone KMB financials

Y/E Mar (Rsmn)	NII	*YoY (%)*	Net Income	*YoY (%)*	Adj PAT	*YoY (%)*	EPS (Rs)	Adj BV (Rs)	*RoE (%)*	*RoA (%)*	P/E (x)	P/BV (x)
FY07	6,199	*63.1*	9,385	*56.9*	1,414	*1,414*	4.3	36.3	*11.4*	*0.9*	77.1	9.2
FY08	12,258	*97.8*	16,892	*80.0*	2,940	*2,940*	8.5	85.7	*11.4*	*1.2*	87.7	8.7
FY09E	15,185	*23.9*	18,764	*11.1*	2,761	*2,761*	8.0	90.0	*7.5*	*1.0*	59.3	5.3
FY10E	16,538	*8.9*	20,332	*8.4*	3,040	*3,040*	8.8	93.8	*7.7*	*1.0*	77.3	7.2
FY11E	19,133	*15.7*	23,230	*14.3*	3,752	*3,752*	10.9	99.3	*8.8*	*1.0*	62.6	6.8

Source: Company, Centrum Research Estimates

Exhibit 19: KMB SOTP Valuation

Business Stream	Ownership Stake (%)	Value Per share (Rs)	% Share in valuations	Basis of valuation
Lending		**158**	**41%**	
Standalone bank	100	119		1.2x FY11E Adj BV
Kotak Prime (Car and other loans)	100	31		1.2x FY11E Adj BV
Kotak Investments (LAS)	100	7		1.2x FY11E Adj BV
Core capital market		**87**	**22%**	
Kotak Securities	100	66		12xFY11E PAT
Kotak Mahindra Capital	100	21		12xFY11E PAT
Asset Management		**70**	**18%**	
Kotak MF	100	29		4% of blended FY11E AUM
Private Equity and VC	100	24		10% of FY11E AUM
Offshore AMC	100	17		6% of FY11E AUM
Life Insurance	74	**73.2**	**19%**	15x NBAP FY10E
Total		**387**	**100%**	
CMP		**679**		
Downside		*-43%*		

Source: Company, Centrum Research Estimates

Punjab National Bank - Conservative banker

We recommend a Buy on PNB with a target price of Rs799 an upside of 20%, valuing the bank at 1.6x FY11E P/Adj BV using the single stage Gordon Growth model. We believe the bank is better positioned with 12% earnings CAGR over FY09-11E in the public sector banking space mainly due to better funding franchise, loan mix and better asset quality with higher provision coverage, which makes us positive on the bank.

Exhibit 20: PNB Summary Financials

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	52,132	17,304	17,236	*104.3*	37	12.8	299	1.5	*13.5*	*0.9*
FY08	55,342	19,976	20,643	*19.8*	49	10.8	318	1.4	*13.8*	*1.0*
FY09E	70,309	29,197	30,909	*49.7*	98	4.8	411	1.0	*22.7*	*1.4*
FY10E	84,011	27,567	33,329	*7.8*	106	6.4	436	1.4	*20.9*	*1.2*
FY11E	101,597	30,265	38,474	*15.4*	122	5.6	508	1.2	*20.6*	*1.2*

Source: Company, Centrum Research Estimates

Bank of India - Earnings momentum slowing

We recommend a Hold on Bank of India with a target price of Rs339, vauing the stock at 1.3x FY11E Adj BV of Rs264 on single stage Gordon Growth model. Our recommendation is primarily based on the bank's fading valuation premium, owing to slowing earnings momentum (after growing at an average pace of over 50% YoY over the last 10 quarters; PAT grew 7% YoY in Q4). We expect PAT to degrow at 6% for FY10E due to 30 bps higher credit costs, 10 bps NIM compression before it grows at 12% for FY11E.

Exhibit 21: Bank of India Summary Financials

Y/E March (Rsmn)	NII	Non Int Inc	Adj PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoE (%)*	*RoA (%)*
FY07	34,405	15,630	11,117	*60.1*	23.0	6.5	101	1.5	*21.2*	*0.9*
FY08	42,293	21,169	20,094	*78.9*	38.3	6.9	157	1.7	*27.6*	*1.3*
FY09E	54,989	30,519	30,074	*49.7*	57.3	4.7	200	1.3	*30.1*	*1.5*
FY10E	63,047	29,512	28,181	*(6.3)*	53.7	6.5	231	1.5	*22.7*	*1.2*
FY11E	73,118	33,314	31,537	*11.9*	60.1	5.8	264	1.3	*20.8*	*1.1*

Source: Company, Centrum Research Estimates

Union Bank of India - High profitability

We recommend a Buy on Union Bank of India with a target price of Rs239, vauing the bank at 1.3x FY11E Adj BV 179 on single stage Gordon Growth model and have provided a 10% discount for its smaller size. Our recommendation is primarily based on UBI's strong return ratios (over 20%), superior asset quality with high NPAprovision cover, diversified loan portfolio with a tilt towards relatively low risk corporate advances and better cost efficiency.

Exhibit 22: Union Bank of India Summary Financials

Y/E March (Rsbn)	NII	Non Int Inc	Adj PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoE (%)*	*RoA (%)*
FY07	26.4	8.4	8.5	*25.2*	16.7	7.0	81	1.4	*19.2*	*0.9*
FY08	28.5	13.2	13.9	*64.1*	27.5	5.5	108	1.4	*26.8*	*1.2*
FY09E	38.1	14.8	17.3	*24.5*	34.2	4.2	134	1.1	*27.1*	*1.2*
FY10E	44.9	15.1	16.9	*(1.9)*	33.5	6.2	153	1.4	*21.5*	*1.0*
FY11E	54.4	16.4	19.9	*17.5*	39.4	5.3	179	1.2	*20.9*	*1.0*

Source: Company, Centrum Research Estimates

Indian Overseas Bank - Fairly priced

We recommend a Hold on Indian Overseas Bank (IOB) with a target price of Rs92 valuing the bank at 1x FY11E Adj BV. We expect the bank to remain sluggish with higher asset quality risks (FY11E GNPAs at 5%) and relatively lower capital (FY11E 7.5%) among banks within our coverage. Above average return ratios (~19% RoE for FY10E) and high dividend yield of 5% is still a comforting factor.

Exhibit 23: IOB Summary Financials

Y/E Mar (Rsmn)	NII	Non Int. Inc.	Adj PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoE (%)*	*RoA (%)*
FY07	25,608	3,870	10,084	28.7	18.5	5.6	66.3	1.5	*29.1*	*1.4*
FY08	26,795	8,076	12,023	19.2	22.1	6.1	80.4	1.6	*27.9*	*1.3*
FY09	30,378	13,595	12,577	4.6	23.1	3.5	82.3	1.0	*24.1*	*1.1*
FY10E	34,168	10,532	11,741	(6.6)	21.6	4.0	84.4	1.0	*19.2*	*0.9*
FY11E	42,785	8,962	13,270	13.0	24.4	3.5	94.0	0.9	*18.8*	*0.9*

Source: Company, Centrum Research Estimates

Gap between PSU and private banks narrowing

PSU banks are catching up with their private peers, warranting a strong re-rating even though historically they have been trading at lower multiples. Higher growth, improving productivity for branches, customer profiles, implementation of technology and improved products coupled with significant positive structural changes (led to the improvement of PSUs on almost all financial and operational parameters) makes us believe that the gap between PSU and private banks is narrowing. We believe PSU banks with strong franchisee network (opportunity to drive in higher CASA) will consolidate and gain market share at a time when private banks are caught up with the adjustment phase (lower credit growth and house keeping). We believe asset quality concerns on both sides are similar, the difference being PSU banks are better placed this time to weather the NPA cycle. This is a result of prudent lending practices, better credit and risk recovery mechanisms and regulatory support. Further, as PSU banks have relatively higher corporate exposure, they are likely to witness asset quality deterioration with a lag.

Exhibit 24: GAP narrowing down between PSU and private banks

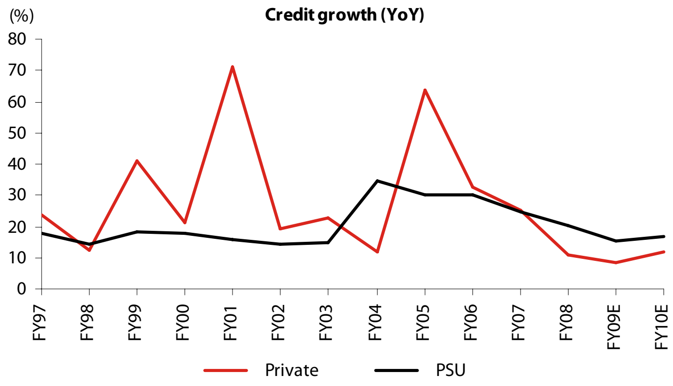
Particulars	Private Banks	PSU Banks	Remarks
Balance sheet Growth	29% CAGR over 2003-08	19% CAGR over 2003-08	Market share strategies to drive higher growth for PSU banks
Credit growth	34% CAGR over 2003-08	25% CAGR over 2003-08	
NIMs	Superior NIMs driven by High yielding advances and high CD Ratios	Relatively lower NIMs.	Gap to narrow, aided by lower cost of funding of PSUs
Fee Income	Higher share of fee based products	Relatively lower share of Non-interest income	PSU banks' product innovation, CBS implementation and their strategy to increase fee income growth
Employee and Branch Productivity	Profit per branch Rs25mn Profit per employee - Rs0.76mn	Profit per branch for - Rs 5 Mn Profit per employee - Rs 0.26 Mn	PSU banks still have further scope for improvement
Asset Quality	Historically, better asset quality but likely to deteriorate significantly	Witnessed significant improvement in asset quality	Going forward expect PSU GNPA to be relatively lower at 3.2% vs PVT GNPA at 4.6% in FY11E.
Customer Profile	Share of younger customers over 60%	PSU banks have only 32% customers under the age of 40	PSU banks too have aligned their customer acquisition strategy in line with private banks targeting youth
Innovation and tapping new growth opportunities	Historically, proactive in identifying the new growth opportunities. Insurance, Asset Mgmt, International expansion	Select PSU banks have or are planning to venture in to non-banking businesses	--
Technology	Superior technology	Historically been a laggard in technology initiatives	PSU banks have begun upgrading their technology
Return Ratios	RoE at 14-15% over last 4 years RoA at 1.1-1.2% over last 4 years	RoE at 15-18% RoA at 0.9-1% over last 4 years	PSU will likely continue to witness relatively better RoE

Source: Centrum Research

PSUs re-gaining market share

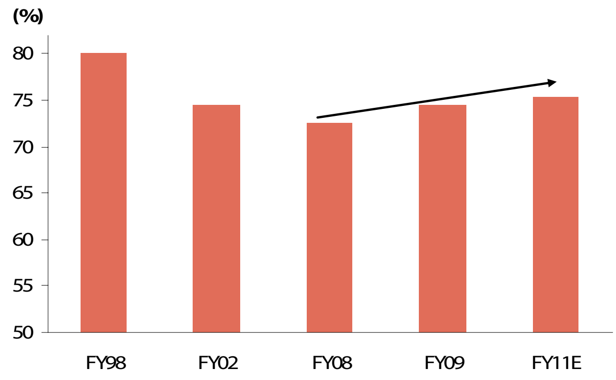
PSU banks are flush with liquidity and as a change in strategy have adopted aggressive growth posture, witnessing higher growth than private banks and re-gaining lost market share. We therefore perceive the loan book build–up during a downturn to be of relatively better quality and fetch superior returns, as and when interest rates rise. We expect this trend to continue in FY10 and FY11 and further narrow the growth premium gap between PSU and private banks.

Exhibit 25: PSU banks likely to outgrow private banks



Source: RBI, Centrum Research Estimates

Exhibit 26: Dominant PSU banks with increased market share in FY08 and FY09

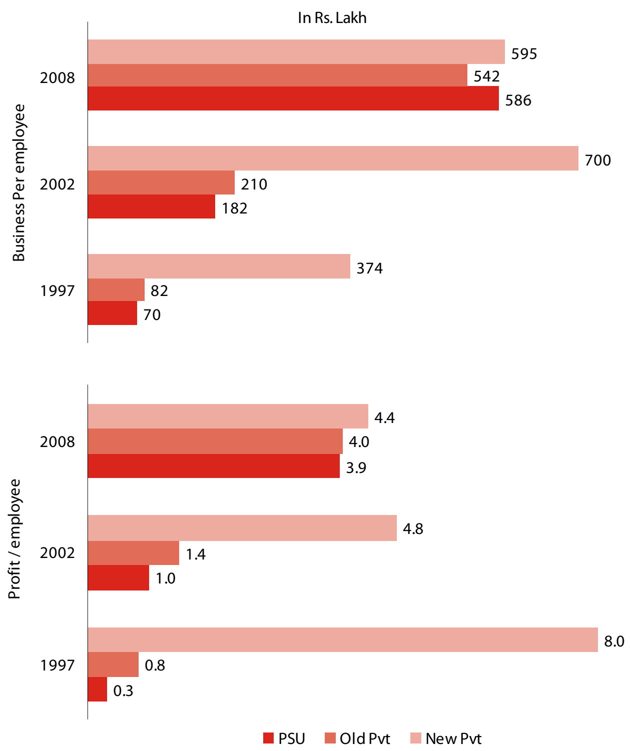


Source: RBI, Centrum Research Estimates

Improved productivity and better talent acquisition

PSU banks, which were traditionally plagued with lower employee productivity have improved significantly over the years through various employee rationalization programmes, training and new talent acquisition at a relatively lower cost. Average age of employees for most PSU banks, which was in the range of 50 years has significantly declined to sub 50 levels, leading to a superior mix of dynamism with experience. These measures have already percolated into the numbers with business per employee improving to Rs58.6mn in FY08 from Rs6.99mn in FY97 and profit per employee improving to Rs0.39mn in FY08 from Rs0.03mn in FY97. After a lull for many years, these banks have envisaged massive expansion plans to tap the next leg of growth and are on a hiring spree from premium institutes competing with their private peers.

Exhibit 27: Improving business and profit per employee for PSU banks



Source: RBI, Centrum Research

Capturing customer mind share

Over 60% of the customers in foreign and private banks are young, vs mere 32% in PSU banks (under the age of 40). However, sensing the trend and significant opportunity, PSU banks have re-positioned themselves adopting various strategies such as re-branding (thus more appealing), introducing new and dynamic products, and convenient technology with improved serviceability, leading to change in overall customer perception towards these banks. Further, with fading technological gap between PSU and private banks, 'Relationship and safer banking' would play a key role in garnering higher and sustainable customer mind share. PSU banks are relatively better placed on this front, leading to higher customer acquisition during downturn and hence we expect sustained growth momentum for PSU banks during an upturn.

Gaining share in fee based wholesale and retail banking products

Renewed focus on fee income with increased fee income share in ECM, M&A, institutional equity business, transaction banking and cross-sell products and insurance will likely result in higher growth in fee income for PSU banks. Private banks on the other hand are expected to witness pressure on fee income due to higher dependence on capital market-linked revenues.

Improving productivity of rural branches - a silver lining for PSUs

Rural economy, which was pre-dominantly dependent on agriculture, has undergone a sea change with significant government and private investments. Improving income levels and consumption patterns in these areas provide significant opportunity for financial intermediaries, primarily banks.

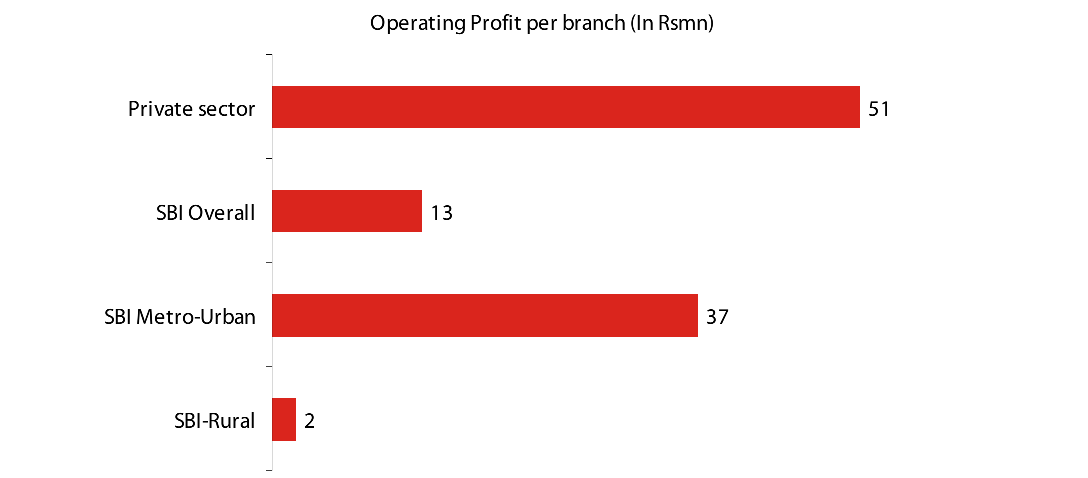
PSU banks have been front-runners in rural areas (though by compulsion than choice), given their strong franchisee network. These branches are a drag on the profitability of PSU banks. However, improving trends in loan disbursals in rural areas makes us positive on the profitability from this segment, going forward, driven by higher operating leverage. New private banks (ICICI, HDFC Bank, Kotak, Yes) are required to ensure that at least 25% of their total branches are in semi-urban and rural centres on an ongoing basis. Private banks are still learning nuances of rural banking with different business models. We beleive execution of rural strategy for private banks would be challenging while PSU banks with competitive advantage in these areas would be better placed.

Exhibit 28: Dominant presence of PSU banks in rural areas

	Rural	Semi-urban	Urban	Metro	Total
Nationalised Banks	13,198	8,140	8,440	7,997	**37,775**
State Bank group	5,328	4,545	2,820	2,421	**15,114**
Old Pvt sector Banks	808	1,498	1,270	874	**4,450**
New Pvt Sector Banks	223	870	1147	1285	**3,525**
Foreign Banks		2	48	224	**274**
SCBs	**19,557**	**15,055**	**13,725**	**12,801**	**61,138**

Source: RBI, Centrum Research

Exhibit 29: Profitability of rural branches - scope for improvement (eg, SBI - FY08)

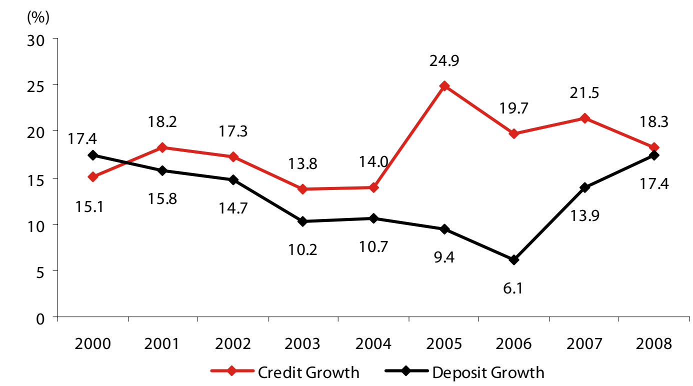


Source : Company, Centrum Research

Increased lending operations in rural areas

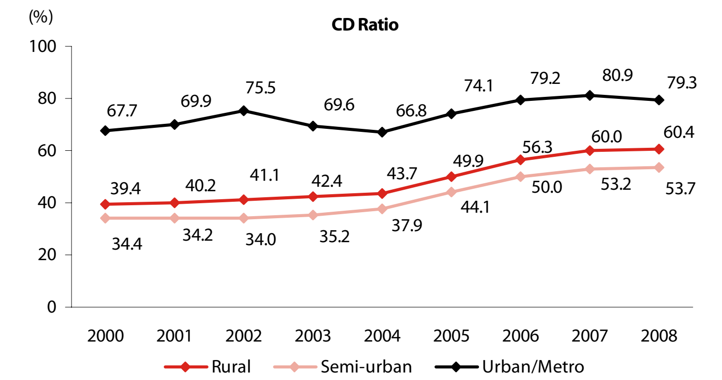
Credit-deposit ratio in rural and semi-urban branches has risen by about 20% over last five years vis-à-vis just 14% for urban branches, indicating better lending in these areas. While we believe opportunities always existed in these areas, prospects have improved in recent years. Thus we expect PSU banks that already have significant presence in these areas will be able to harness these opportunities which should result in increased productivity of rural branches.

Exhibit 30: Rural credit growth



Source : RBI, Centrum Research

Exhibit 31: Improving Rural CD ratio



Source : RBI, Centrum Research

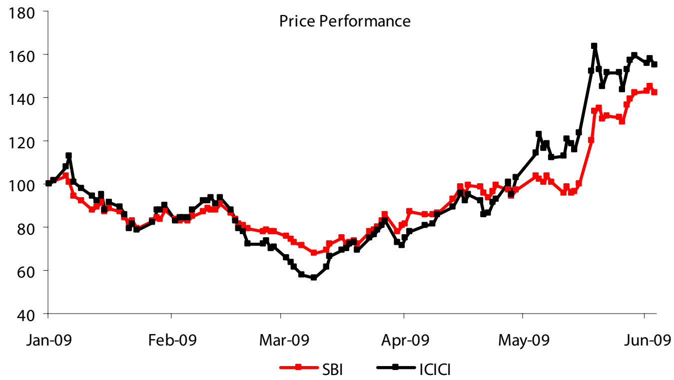
Actionable pair trade ideas

Actionable pair trade ideas

Pair Strategy: Switch to SBI from ICICI Bank

- **Market leadership:** SBI will continue to witness buoyant growth, riding the excess liquidity and lower cost of funds, further aided by larger distribution network and significant market share. However, we believe ICICI Bank would comparatively be sluggish in resolving its higher cost of funding and increasing its distribution network.
- **Higher profitability for SBI:** SBI's RoE at 15% is higher compared with 8% for ICICI Bank. We do not see significant RoE triggers in the near term for ICICI Bank with subdued balance sheet growth, flattish NIMs and fee income.
- **Key risks to our call:** ICICI is able to reduce its cost of funding earlier-than-expected on the back of improved retail deposit base and faster improvement in international credit markets.

Exhibit 32: Relative outperformance expected going forward



Source: Bloomberg, Centrum Researtch

Exhibit 33: SBI has relatively high RoE (%)

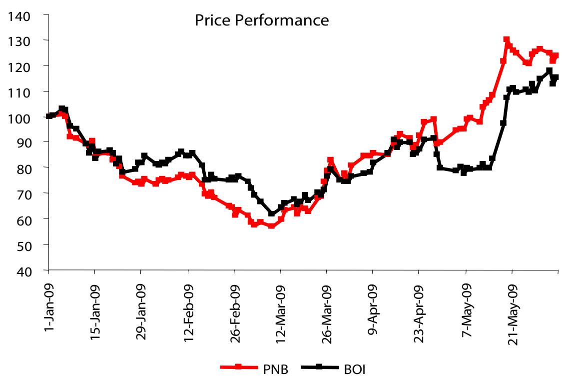
(%)	SBI	ICICI Bank
FY08	16.8	11.0
FY09	17.1	7.7
FY10E	15.5	7.9
FY11E	15.3	8.4

Source: Company, Centrum Researtch Estimates

Switch to PNB from BOI

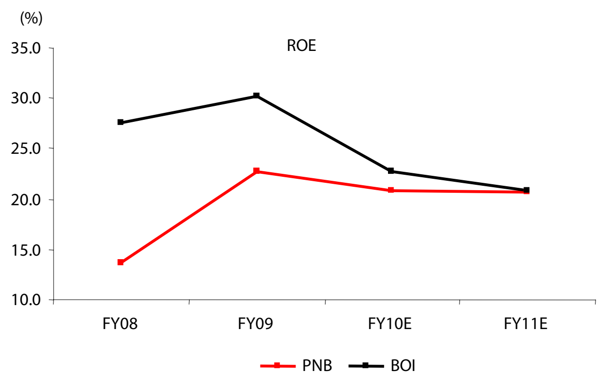
- **Earnings momentum:** Earnings momentum is slowing for BOI (PAT increased just 7% YoY in Q4FY09 after growing at an average +50% YoY in last 10 quarters). We expect BOI's FY10E PAT to contract 6% vs 8% growth for PNB.
- **Return ratios narrowing:** BOI's FY08-09 ROE at 27-30% was primarily driven by the cost-efficiencies (Cost Income ratio fell 1600 bp) and treasury income. However, going forward we expect the RoE gap between PNB and BoI to narrow to 21% levels.
- **Relatively low risky book:** PNB's loan book is relatively low risk and low yielding coupled with demonstrated cautious lending during FY09.
- **Valuation:** PNB currently trades at 1.2x FY11E P/Adj BV while BOI at 1.4x FY11E P/Adj BV. We expect PNB to outperform going forward and recommend a switch from BOI to PNB.

Exhibit 34: Relative outperformance expected going forward



Source: Bloomberg, Centrum Researtch

Exhibit 35: RoE gap narrowing

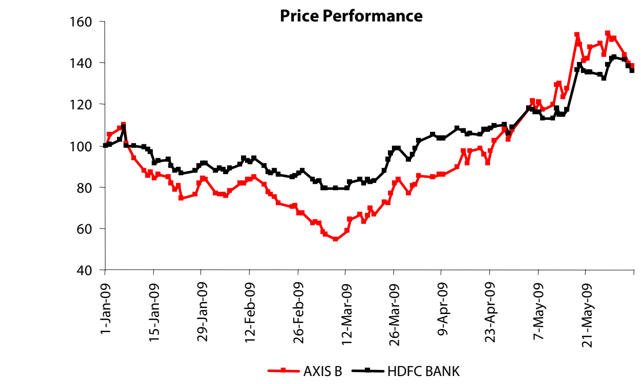


Source: Company, Centrum Researtch Estimates

Switch to Axis from HDFC Bank

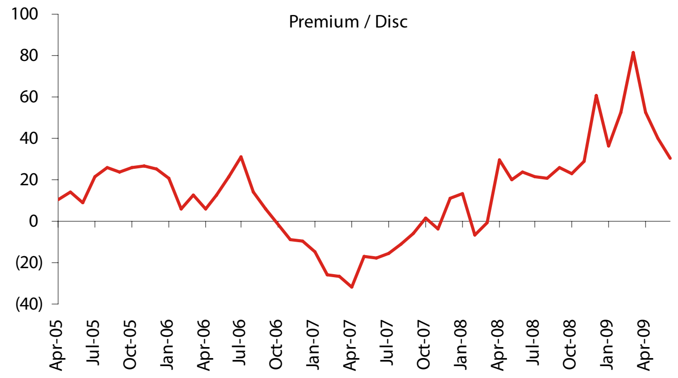
- **Valuation premium to fade off:** HDFC Bank currently trades at 30% premium to Axis Bank on P/Adj BV, which we believe should fade off mainly on account of similar return ratios and growth opportunities available for banks, going forward. We expect Axis to outperform HDFC Bank from these levels, going forward.
- **HDFC warrant non-conversion:** Warrant non-conversion could accentuate pressure on capitalization, necessitating dilution at lower prices.

Exhibit 36: Relative outperformance expected going forward



Source: Bloomberg, Centrum Researtch

Exhibit 37: Premium to fade off

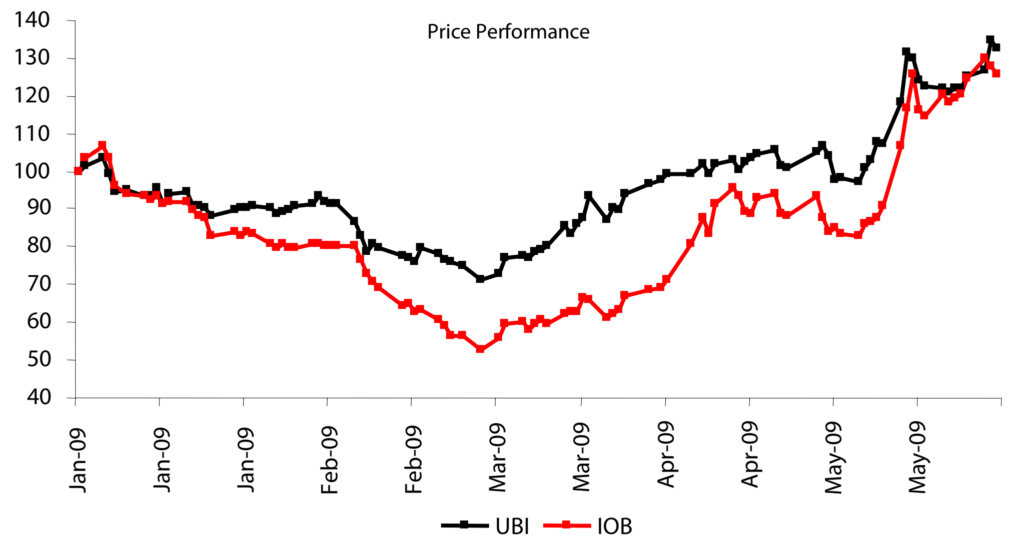


Source: Bloomberg, Centrum Research Estimates

Switch to UBI from IOB

- **Superior return ratios:** Compared to IOB, we believe UBI will continue to post superior return ratios (RoE) by FY11E. UBI's ability to sustain earnings is far superior to IOB with better NIMs and cost efficiency, in our view.
- **Better asset quality book:** UBI's asset book is less riskier than that of IOB with lower exposure to risky segments viz. capital markets and commercial real estate. Currently UBI's provision coverage is higher at 83% vs 44% for IOB.
- **Valuation:** IOB currently trades at 1.0x FY11E P/Adj BV vs 1.2x for UBI. We recommend a switch to UBI from IOB, mainly on account of superior return ratios, better asset quality and considering UBI's dynamism with business initiatives in the recent past.
- **Key risks to our call:** Worse-than-expected deterioration in asset quality.

Exhibit 38: Expected relative outperformance



Source : Bloomberg, Centrum Researtch

Back to basic banking

Back to basic banking

Changing landscape

Banks are expected to witness a dynamic shift on the back of prevailing challenging economic conditions. We expect banks to increase focus on retail liabilities and expand branch network to gear for the next level of growth. The asset growth strategy that banks chased during FY04-08 came with a cost for a few banks with interest rates turning unfavourable from FY09 onwards. Our analysis reveals that banks that score high on key banking operational parameters (CAMEL) would outperform. However, we do not see significant value from non-banking subsidiaries at least in the near term, given the subdued capital markets and regulatory overhang. We overweight PSU banks through our new approach - CAMEL (capital, asset quality, management, earnings quality and liability franchise), wherein these banks score higher vs private banks.

Exhibit 39: Core banking in focus

BASIC BANKING

CORE BANKING BACK IN FOCUS

Evaluating core- outperformance with CAMEL model

Capital Strength
Asset Quality
Management
Earnings Quality
Liability Franchisee

Gap between PSU and private banks narrowing

Banking and macro outlook

- Economic outlook
- Profitability and credit growth under pressure
- Resilient Indian banking system

NON - BANKING - FADING FOCUS

Near term drivers in non-banking business fading

Insurance - High gestation and long term growth story

Asset Management - Meager in value terms

Securities and Investment banking - Best behind us

Source: Centrum Research

Evaluating operating performance using CAMEL

We have attempted to evaluate the performance of PSU and private banks using the CAMEL (capital, asset quality, management, earnings quality and liability franchise) framework. Our analysis reveals that PSU banks under our coverage score higher in terms of liability franchise, focus on NII and RoE and are better placed than private banks in terms of asset quality. Also, private sector banks face near term headwinds due to management reshuffle and reduced access to capital on account of subdued capital markets score, similar to PSU banks. This strenghtens our view that the gap between PSU and private banks is narrowing with increased focus on 'back to basic banking'.

What is CAMEL?

CAMELS (**C**apital, **A**sset quality, **M**anagement, **E**arnings quality, **L**iquidity and **S**ensitivity to market risk) is a supervisory rating used in the US to measure a bank's overall performance. It is based on the banks' financial statements and on-site examination by regulators like the Fed and Federal Deposit Insurance Corporation (FDIC). It is also actively used by RBI for annual on-site inspection of banks. The same framework was also being used by the US government in response to the global financial crisis of 2008. The framework helped decide the special aid requirement for banks, as part of its capitalization program authorized by the Emergency Economic Stabilization Act of 2008.

While we have modified this framework to evaluate the operational performance of banks under our coverage, it caters more to the investor than the regulator. Within CAMEL (the L-part), we have considered liability franchise instead of liquidity mainly on account of lack of data on ALM in the public domain. Also, we believe evaluating the funding franchise is proxy to evaluating the liquidity position of the bank. We have ignored the sensitivity to market risk, the sixth parameter of CAMELS framework, mainly on account of lack of disclosure norms regarding market risk in

The gap between the PSU and private sector is narrowing in terms of growth and asset quality. PSU banks have been commanding higher RoE compared to private banks since 2002. We view the higher branch network of PSU banks as a competitive advantage, given that focus on CASA and spread is prevalent now.

India. We have scored the banks using CAMEL (i.e 5 pillars of a bank) on a scale of 1 to 5, with 1 being the best and 5 the worst. The scores are given based on our objective as well as subjective assessment and based on facts available or our expectations, going forward in the near term.

Exhibit 40: CAMEL score

Name of the bank	Capital	Asset quality	Management	Earnings	Liability franchise	Overall score
SBI	3	2	4	2	5	3.2
PNB	3	4	4	4	5	4.0
BOI	2	3	2	3	3	2.6
UBI	2	4	4	4	4	3.6
IOB	1	1	3	3	3	2.2
ICICI	5	1	2	2	2	2.4
HDFC Bank	4	4	5	5	4	4.4
Axis	3	4	3	4	4	3.6
Kotak	5	1	4	1	1	2.4

Source Centrum Research

Our CAMEL analysis suggests that …

- **HDFC Bank** scores the highest on all parameters inspite of some near term pressure due to Centurion Bank (CBOP) merger. Conservative management, liability-led growth strategy, consistent growth and high asset quality makes us positive on the bank.
- **Axis Bank** scored the second highest in the private banking space. Near term headwinds arise from asset quality due to loan mix and unseasoned loan book, and recent management reshuffle, whereby one can expect a strategy rejig in the bank.
- **PNB** scores the highest among PSU banks, mainly on account of strong liability franchise, demonstrated capabilities of margin protrection in turbulent times, which explains its superior earnings and manageable asset quality due to better risk underwriting standards and loan mix.
- **SBI** scores second highest in the PSU banking space, mainly on account of strong liability franchise, dynamic top management with demonstrated execution capabilities of increased market share and successful merger of SBS despite initial hiccups. But we expect headwinds from asset quality due to higher unseasoned loan book, portfolio mix and capital constraints.
- **ICICI Bank** socres low on CAMEL. This is mainly due to poor asset quality, weak liability franchise (bank is increasingly focusing on improving its funding mix but the same comes with execution risk) and management reshuffle, which would keep the bank in adjustment mode. However, higher capital comes as a comforting factor in a stressful environment, but again excessive capital remains a drag on RoE.
- **KMB** too scores lowest on CAMEL, mainly on account of low earnings quality due to high dependence on capital markets, expected higher asset quality deterioration due to higher dependence on retail loans and weak liability franchise. However, strong management and higher capital is a silver lining.
- **Bank of India and Union Bank** score similar on most of the parameters, given their better earnings quality and strong liability franchisee, except for asset quality and management (due to management change). Further, both banks have relatively lower Tier I capital, which may restrict their growth in the long run.
- **IOB** scores the lowest within our PSU coverage, owing to expected significant deterioration in asset quality and relatively lower scores on capital and management front.

The importance of the parameters are discussed in detail below. Our version of CAMEL varies slightly from the regulator's definition, wherein we have replaced the Liquidity (L in CAMEL) with Liability franchise.

Exhibit 41: CAMEL approach

Regulator Way	Centrum's way
C apital	**C** apital
A sset Quality	**A** sset Quality
M anagement	**M** anagement
E arnings	**E** arnings
L iquidity	**L** iability franchise
S ensitivity to market risk	

Source: Centrum Research

Capital adequacy

Capital availability is key for balance sheet growth and to absorb asset write downs (either loans or investments) across cycles. Hence, higher the capital, better for a bank. The regulator has prescribed minimum capital that a bank should maintain for stability (Tier 1, total capital ratio). But optimum capital is the one which has optimum leverage and props up the RoE of a bank.

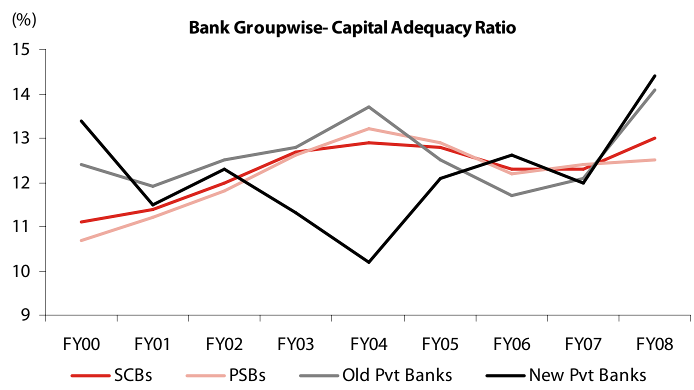
Exhibit 42: Score on Capital Adequacy

SBI	PNB	BoI	UBI	IOB	ICICI Bank	HDFC Bank	Axis	KMB
3	3	2	2	1	5	4	3	5

Source: Centrum Research

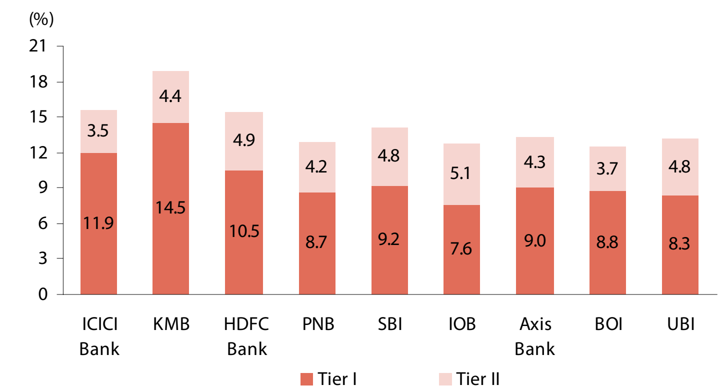
Private banks score high on capital adequacy with PSUs facing constraints due to government holding reaching the minimum level in several banks. Nonetheless, PSUs remain the most efficient users of capital. Moreover, with government being the promoter of PSU banks, it provides the necessary capital support, making them a safer bet in tough times. KMB, ICICI Bank, Axis, PNB, HDFC Bank and SBI have comfortable capital adequacy positions.

Exhibit 43: PSUs have lower but optimal CAR



Source: RBI, Centrum Research

Exhibit 44: ICICI Bank and KMB have among the highest Tier I (FY10E)



Source: Centrum Research Estimates

Stress testing Tier I on funding growth and NPA absorption

On our stress test, ICICI Bank, KMB and HDFC Bank score higher on funding growth and NPA absorption parameters, given their higher Tier I ratio. However, ICICI Bank and KMB despite having higher Tier I ratio are in adjustment mode and are conserving capital, which could be a drag on their profitability. Thus, we view excessive capital without appropriate deployment as a negative. PSU banks with ideal leverage to fund envisaged growth and generate decent earnings are the most efficient users of capital.

Exhibit 45: Stress testing Tier 1 for NPA absorption

Efficient users of capital

Bank	Tier 1 (%)	Excess Capital available (%)	Advances (Rsbn)	Additional Tier I capital cushion available to absorb potential additional NPA (%)
SBI	9.4	3.4	543	4.1
BOI	8.9	2.9	1,429	3.0
UBI	8.2	2.2	967	2.2
PNB	9.2	3.2	1,547	3.4
ICICI Bank	11.8	5.8	2,183	10.3
HDFC Bank	10.6	4.6	989	5.2
Axis	9.3	3.3	815	3.4
KMB	16.0	10.0	248	7.8

Note:RWA – Risk-weighted assets
Source: Company, Centrum Research

Asset quality

About 65-70% of Indian banks' balance sheet is loans to customers. Any deterioration in quality of loan book due to macro-economic conditions, poor underwriting, underpricing of risk or portfolio mix will impact earnings and hence capital position of the bank.

Exhibit 46: Scores on asset quality

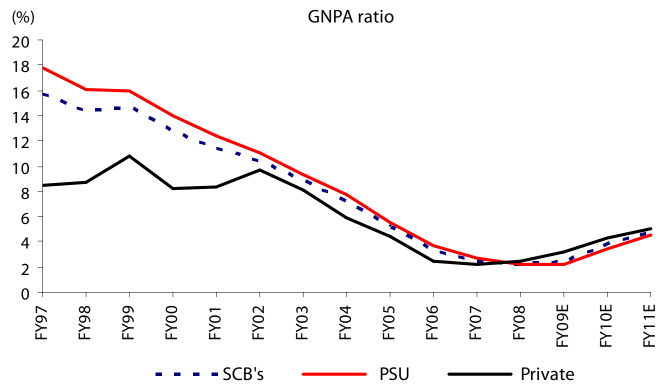
SBI	PNB	BoI	UBI	IOB	ICICI	HDFC Bank	Axis	Kotak
2	4	3	4	1	1	4	4	1

Source: Centrum Research

Score on asset quality

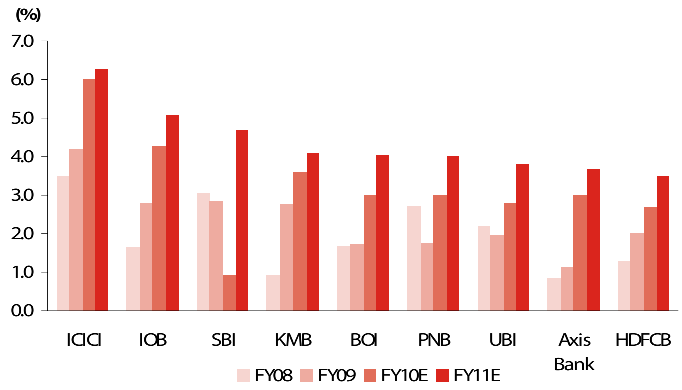
We expect PSU banks to be better placed this time around on asset quality front (PSU banks typically had poor asset quality) owing to relatively safer higher corporate exposure aided by better corporate balance sheets, restructuring, better risk & recovery mechanism and continued growth momentum of PSU banks, though at a moderate pace. We expect private banks particularly ICICI Bank, IOB and SBI to witness signficant deterioration in asset quality vis-à-vis peers in banking space and thus score lower on this parameter.

Exhibit 47: PSUs relatively better placed this time



Source: RBI, Centrum Research Estimates

Exhibit 48: GNPA



Source: Company, Centrum Research Estimates

Management depth and stability

HDFC Bank and KMB score high on management

Management's strategy, execution capabilities, independence and continuity are important for a bank's growth and has been a key consideration for the investors in valuing PSU banks valuation. On this parameter, private banks score better vis-à-vis PSUs, however, the gap has narrowed in recent past. Quantifying and rating the management is subjective in nature and we have evaluated this on four parameters, strategy, execution and continuity and assigned scores accordingly.

Exhibit 49: Scores on management

SBI	PNB	BoI	UBI	IOB	ICICI	HDFC Bank	Axis	Kotak
4	4	2	4	3	2	5	3	4

Source Centrum Research

We have capped management rating for PSU banks at 3 mainly on account of government intervention and control in the ownership of these banks. Our analysis suggests that HDFC bank scores highest on this parameter. While Axis and ICICI Bank are expected to have near term pressures mainly on account of impending management reshuffle at Axis and capital conservation strategy inspite of higher capital at disposal at ICICI Bank.

Exhibit 50: An evaluation of management continuity and strategy of the individual banks

Bank	Continuity of top management (CMD)	Strategy
SBI	31 Mar 2011	Strong management with clear focus on gaining market share. Bank has adopted liability driven growth strategy and is aggressively expanding branches. Successfully merged SBS in 2008 inspite of union's pressure. We expect banks dominance to continue with renewed aggression.
PNB	4 June 2012	Strategy rejig with financial inclusion taken the prime importance and renewed focus on Technology & franchisee Model driving the business growth. Leveraging the market leadership in under penetrated Indo-Gangetic plane
BOI	Current CMD - Mr.Narayanasami who was instrumental in banks turnaround is due for retirement on May 18, 2009 and hence top management change is impending	Aggressive business expansion strategy has paid off for the bank leading to a turnaround of the bank with improvement on all operating parameters.
UBI	1 April 2011	Under the leadership of Mr.Nair bank has undertaken various initiatives leading to significant improvement in all operating parameters and image. Bank's vision is to become one of the top 3 banks in India by 2012.
IOB	31 Oct 2010	
ICICI	Management Reshuffle is in process with appointment of Ms. Kochchar as MD & CEO, Mr. Kamath as Non-Executive Chairman, Mr. Vaidyanathan as MD & CEO ICICI Pru Life, Mr. Bhargavdas Gupta as MD & CEO ICICI Lombard	Adjustment mode with improving the loan mix, Improving the funding franchise with reduced dependence on wholesale funding and increasing the branch network is in progress
Axis Bank	Designated new MD & CEO which prompted the current CMD to resign.	Liability led growth strategy adopted by outgoing CMD in past few years had paid off and demonstrated execution capabilities of deploying huge amounts of capital raised
HDFC bank	Top management in place since incorporation of the bank. No signs of change at this point of time	Cautious growth strategy of the bank in up as well as down cycle has augured well. Acquisition of CBOP at a high price had dragged the operational performance in the near term. Leveraging the CBOP franchisee is under process.
Kotak Mahindra Bank	Top management in place since start of the bank. No signs of change at this point of time	Conserving capital and very cautious on growth inspite of sitting on huge capital we expect it to be a drag on ROE.

Source: Company, Centrum Research

Earnings quality

Within this parameter, we have looked at RoE to evaluate the quantum of earnings. As trading income, recovery of NPAs and cyclical capital market fees could impact the sustainability of RoE in the longer run, we have assigned scores on the basis of RoE and also considering each bank's earnings quality as well.

Exhibit 51: Scores on Earnings

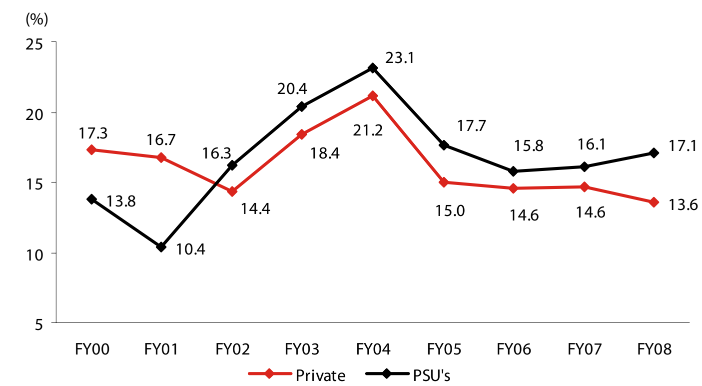
SBI	PNB	BoI	UBI	IOB	ICICI	HDFC Bank	Axis	Kotak
2	4	3	4	3	2	5	4	1

Source: Centrum Research

Return on Equity (RoE)

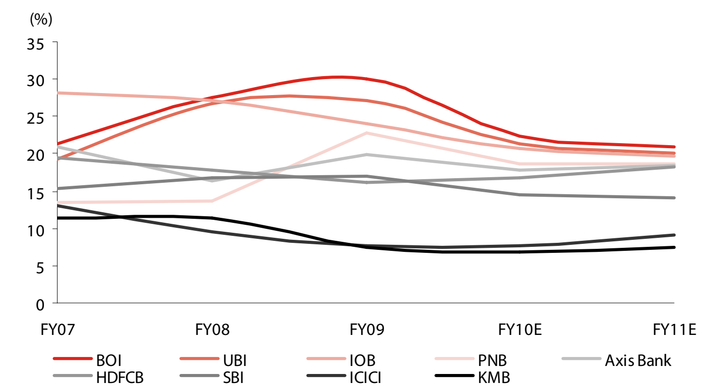
PSUs traditionally command higher RoE than private banks due to better profitability at lower capital. Given that earnings are under pressure for all banks, we expect private banks' RoE to deteriorate further and thus the gap between the RoE of PSU and private banks to widen.

Exhibit 52: RoE – PSUs v/s Private



Source:C-Line, Centrum Research

Exhibit 53: RoE

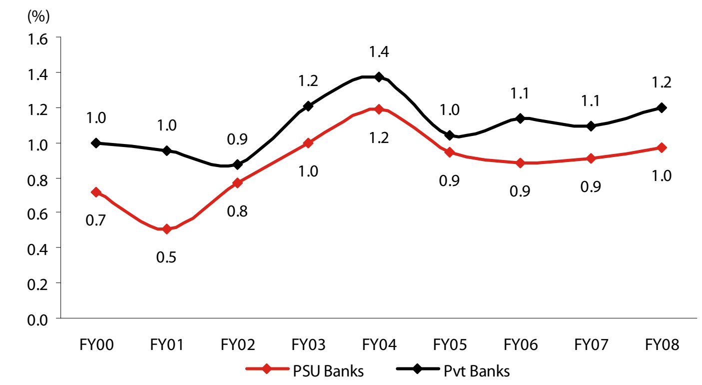


Source: Centrum Research Estimates

Return on Assets (RoA)

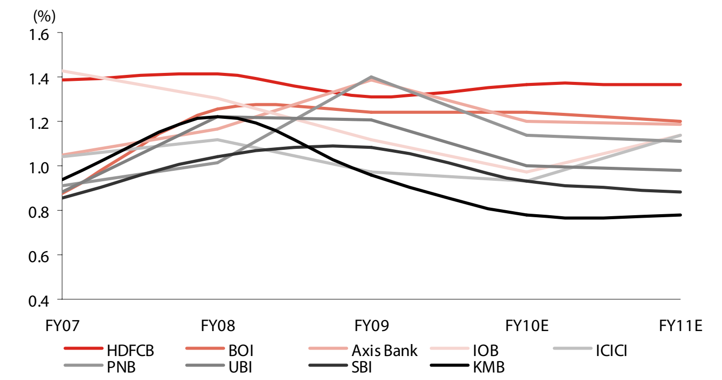
PSU's traditionally lagged private sector banks on RoA but with focus on fee-based income increasing, the former witnessed improvement from 2000 levels. HDFC Bank, Axis and PNB command relatively higher RoA's.

Exhibit 54: RoA's of private are higher than Public



Source:C-Line, Centrum Research

Exhibit 55: RoAs of banks under coverage

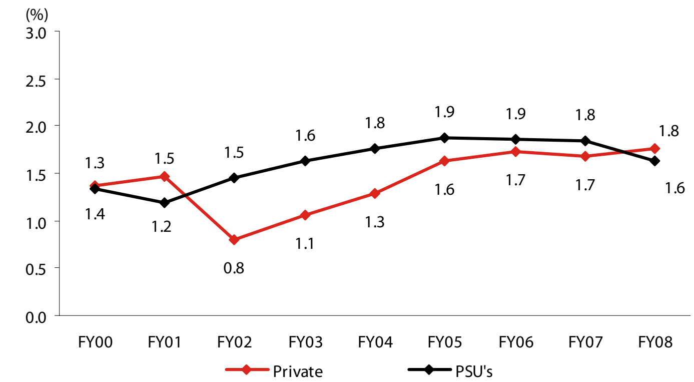


Source: Centrum Research Estimates

Core pre-provision profits

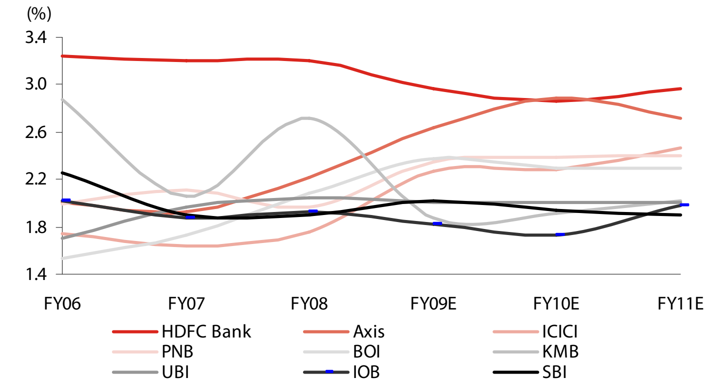
PSU's which traditionally commanded higher core pre-provision profits, witnessed a decline in FY08 due to marginal decline in NII. However, going forward we expect PSU banks to score better than private banks on this parameter, given their higher-than-industry credit growth and relatively lower pressure on fee income . Although HDFC and Axis Bank score high on core-pre provision profit on account of strong fee income base, the same is likely to come under pressure for Axis Bank due to lower loan growth and pressure on capital market related revenues.

Exhibit 56: Core pre-provision profits – PSUs v/s Pvt



Source: C-Line, Centrum Research

Exhibit 57: Core Pre-provision profits as percentage of Avg Assets



Source: Centrum Research Estimates

Liability franchise

Broad based funding including retail and wholesale sources augur well for a bank across cycles. Excessive dependence on concentrated wholesale sources could impact banks' operational performance in constrained credit markets (like that of 2008) which in turn would have a bearing on the liquidity and interest margins of a bank. We believe a strong liability franchise and inturn high proportion of retail deposits will be a key differentiator for operational performance to contain cost of funds.

Exhibit 58 : Scores on liability franchise

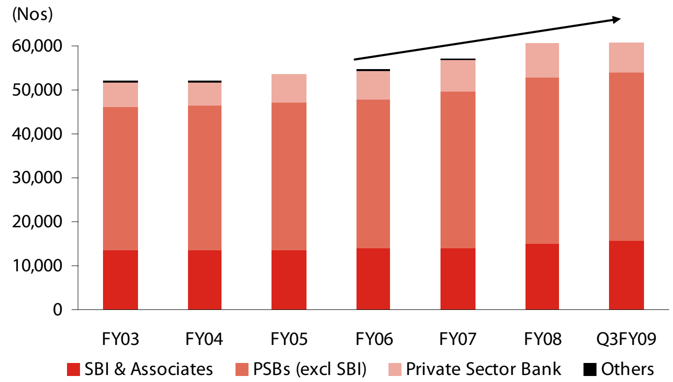
SBI	PNB	BoI	UBI	IOB	ICICI	HDFC Bank	Axis	Kotak
5	5	3	4	3	2	4	4	1

Source: Centrum Research

Branch network

PSUs constitute about 86% of total branches and have agressively expanded during last three years after a lull, pursuing basic banking strategy. This would be helpful in garnering higher share in low cost deposits aiding low cost of funds. Some private banks like Axis and HDFC Bank too have followed similar strategy and will be key beneficiary during a downturn.

Exhibit 59: PSUs have built strong branch network following liability-led growth strategy



Source: RBI, Centrum Research

Exhibit 60: PSUs have expanded agressively over last three years

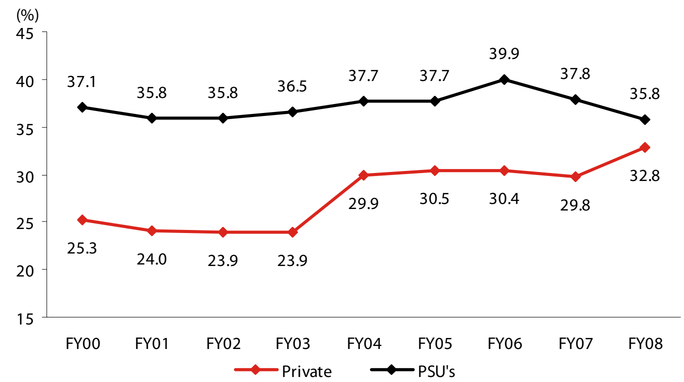
- SBI added ~ 1000 branches during past 9 months and is still pursuing aggressive branch expansion plans
- PNB, BOI and UBI too are pursuing significant branch expansions
- Private banks that have been laggards in branch network are pursuing organic as well as inorganic branch expansion strategies.

Source: Company, Centrum Research

CASA ratio

Traditionally PSUs enjoyed a higher share but now private banks have eaten into their share. However, with aggressive branch expansion plans and safety perception building around PSUs, we expect some relief for PSUs on this front in the near term. HDFC Bank and SBI are expected to command higher CASA ratio and we also like the liability-led growth strategies of PNB and Axis Bank.

Exhibit 61: PSU's v/s Pvt bank CASA ratio



Source: RBI, Centrum Research

Exhibit 62: CASA ratio

CASA (%)	FY06	FY07	FY08	FY09	FY10E	FY11E
PSU Banks						
SBI	47.6	48.5	47.0	38.3	40.0	43.0
PNB	49.0	46.2	43.0	38.0	38.0	38.0
BOI	35.0	32.2	30.6	25.6	29.0	31.0
UBI	32.4	34.5	34.9	30.1	34.0	36.0
IOB	39.9	34.9	33.5	30.3	30.1	29.9
PVT Banks						
ICICI	22.7	21.8	26.1	28.7	30	32
HDFC	55.4	57.7	54.5	44.4	45.0	46.0
Axis Bank	40.0	39.9	45.7	43.1	43.4	43.1
Kotak Mahindra Bank	19.0	27.2	28.4	32.0	29.5	30.0

Source: Centrum Research Estimates

Banking and the macro picture in India

The macro picture

Earnings pressure, credit slowdown for banks until FY11E

We expect banks' earnings to remain under pressure owing to continued margin pressure (due to lower loan growth and fall in CD ratios), downward pressure on fee income (capital market related fees, third party distribution and asset processing fees) and increase in NPA provisions (systemic deterioration of asset quality). FY09 PAT growth for PSU banks has been robust vs private banks, despite subdued sequential NII growth particularly in Q4FY09, well compensated by higher other income due to treasury gains and core fee income. Going forward, with receding pressure on yields and expected improvement in cost of funds, NII growth is likely to improve for PSU banks from Q4 levels. Further, with PSUs reporting stronger growth, we expect these banks to score high on RoE.

Exhibit 63: Banks' profitability under pressure in the near term

....NIM pressure to continue due to....

- Fall in yield on advances with softening interest rates and changing loan composition towards low-risk corporate loans
- Expected fall in cost of funding, but with a lag, as deposits get re-priced slower than loans
- Higher investment in government securities, yielding relatively low return

Core other income to remain under pressure...Fee income to remain under pressure on account of:

- Decline in core banking products (LC,BG etc) and asset processing fees with lower loan growth
- Lower recovery of NPA in a challenging macro environment
- Subdued income from personal investment product distribution (insurance, mutual fund..)

Banks' profitability under pressure

Cost control would not yield more benefit to banks

- Benefit of stringent cost control measures would be offset by branch expansion
- It is unlikely that banks would be able to further cut costs, owing to rationalization in early FY09

...High provision charges would be required

- Higher NPA provisions are required in a deteriorating asset quality scenario

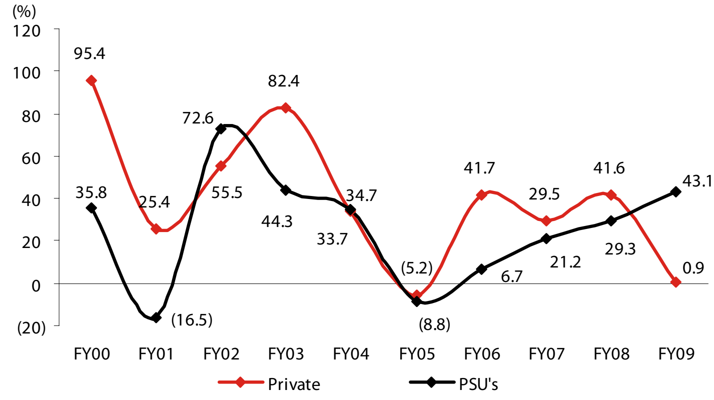
Source: Centrum Research

Exhibit 64: 5% Earnings Growth in FY10E (Centrum Universe)

(%)	SBI	PNB	BOI	UBI	IOB	ICICI BK	HDFC BK	Axis BK	KMB
PAT Growth									
FY09	36	50	50	24	5	10	21	71	6
FY10E	5	8	(6)	(2)	(7)	9	21	11	10
FY11E	10	15	12	18	13	16	27	17	23
Loan growth									
FY09	30	29	26	30	25	(3)	56	37	7
FY10E	17	17	16	18	16	3	20	18	16
FY11E	19	19	19	19	18	16	24	20	17
NIM									
FY09	2.6	3.3	2.8	2.8	2.8	2.3	4.5	3.4	5.6
FY10E	2.5	3.2	2.7	2.7	2.6	2.3	4.6	3.2	5.7
FY11E	2.6	3.2	2.7	2.8	2.8	2.4	4.6	3.4	5.7
GNPA									
FY09	2.8	1.8	1.7	2.0	2.8	4.2	2.0	1.1	2.8
FY10E	3.6	3.5	2.9	2.9	4.3	4.9	2.7	2.0	3.3
FY11E	4.2	4.0	3.9	3.7	5.1	5.0	3.5	2.9	4.0
NNPA									
FY09	1.8	0.2	0.4	0.3	1.6	2.0	0.6	0.4	1.3
FY10E	2.1	1.1	1.0	0.8	2.2	2.4	0.7	0.7	1.4
FY11E	2.4	1.2	1.4	1.0	2.3	2.5	0.9	1.1	1.8
RoA									
FY09	1.1	1.4	1.5	1.2	1.1	1.0	1.3	1.4	1.0
FY10E	0.9	1.2	1.2	1.0	0.9	1.1	1.4	1.3	1.0
FY11E	0.9	1.2	1.1	1.0	0.9	1.1	1.4	1.2	1.0

Source: Company, Centrum Research Estimates

Exhibit 65: PAT growth – PSU v/s private

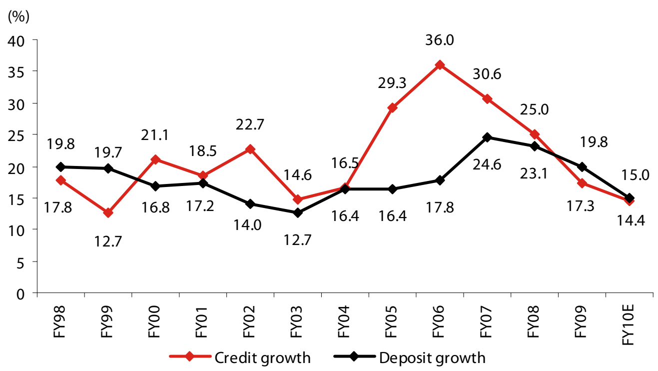


Source: C-Line, Centrum Research

Credit growth to moderate over FY10-11E

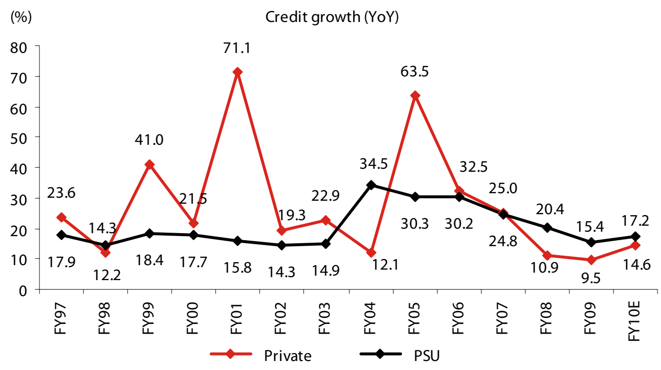
We expect credit growth in the sector to moderate (14.4% and 17.5% in FY10E and FY11E, respectively), led by slowing industry-wide demand and risk averseness amongst banks. Loan CAGR over FY05-09 stood at 27%, led by a buoyant economy and higher growth in retail loans (primarily private banks). Our expectation of improvement in credit growth in FY11E stems from our expectation of economic recovery by Q3FY10E. We expect PSU banks to continue to gain market share over the next two years, as private sector banks will be in the house keeping mode.

Exhibit 66: Credit and deposit growth



Source: C-Line, Centrum Research Estimates

Exhibit 67: PSUs to lead the pack

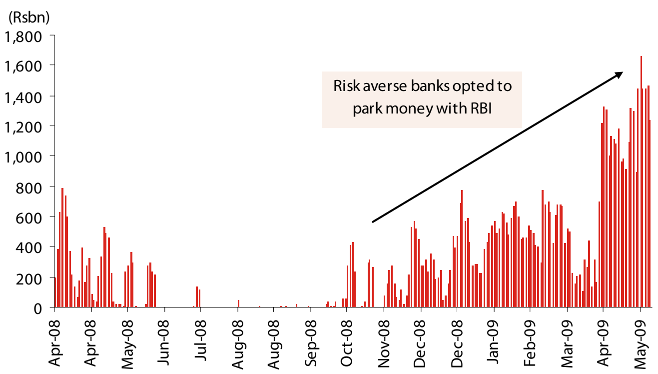


Source: C-Line, Centrum Research Estimates

Downward bias on G-Sec

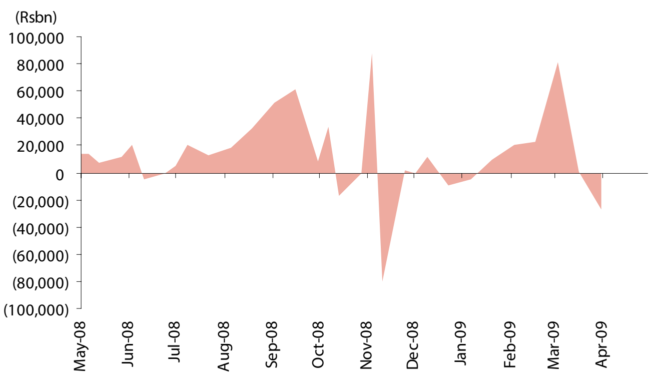
We have a downward bias on G-Sec, despite increased government borrowings. Our analysis suggests that fund availability with banks due to fall in C-D ratio would support the increased government borrowings. G-Sec yield has fallen by about 100bp since March end to 6.25% and we see it to remain range bound in 5-7% with more downward bias. The downward bias also makes us positive about the trading gains for PSU banks in FY10E which could offset the higher than expected asset quality risks.

Exhibit 68: Reverse Repo amount



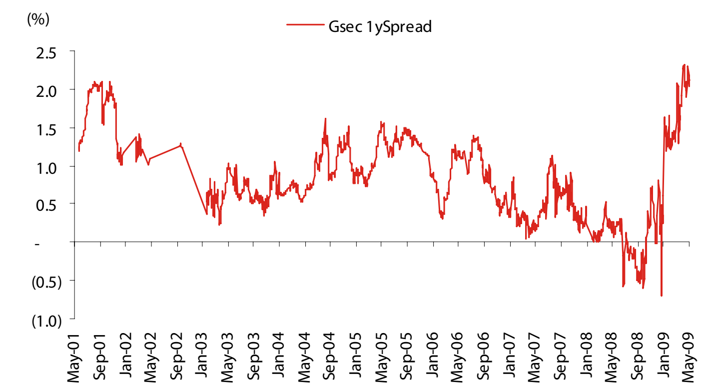
Source: Bloomberg, Centrum Research

Exhibit 69: Incremental lending Fortnightly basis



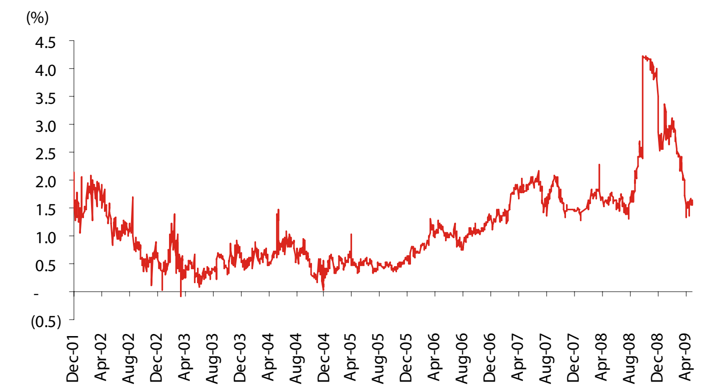
Source: Bloomberg, Centrum Research

Exhibit 70: Yield curve steepening



Source: Bloomberg, Centrum Research

Exhibit 71: Corporate-G-Sec spread declining



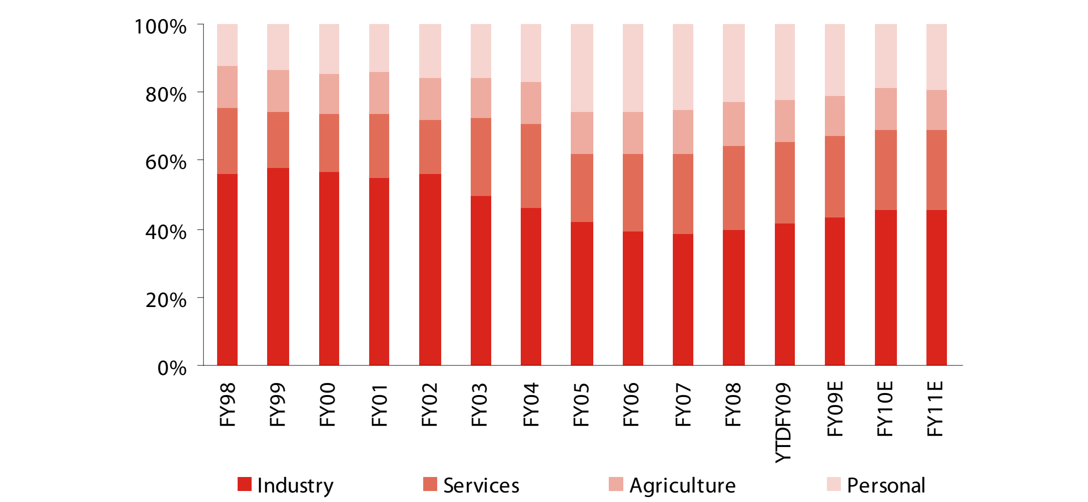
Source: Bloomberg, Centrum Research

Loan mix to further tilt towards corporates in the near term

Despite the slowdown in capex funding, industrial credit demand is likely to continue though at a moderate pace primarily driven by higher working capital credit requirements in the near term. However, we expect the capex cycle to pickup in FY11 as the economy shows signs of revival leading to renewed demand for long term loans and thus industrial credit demand.

Share of retail/personal loans in overall credit is expected to decline gradually in near term, driven by lower consumer spending and banks' (especially private banks) cautious strategy to slow down disbursements in this category due to risk-averseness. However, consumption demand is likely to pick up towards the end of FY10E, ultimately leading to improved demand for industrial credit. The share of services sector too is expected to remain muted in near term on account of lower credit demand and banks' reluctance to lend to high risk sectors such as real estate and NBFCs.

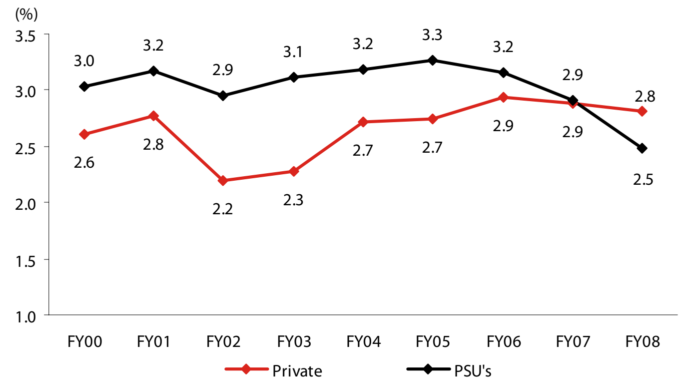
Exhibit 72: Share of retail and service sector loans to remain muted



Source: C-Line, Centrum Research Estimates

NIMs to be under pressure...

Exhibit 73: PSU v/s Pvt NIM comparison



Source:C-Line, Centrum Research

Exhibit 74: NIM

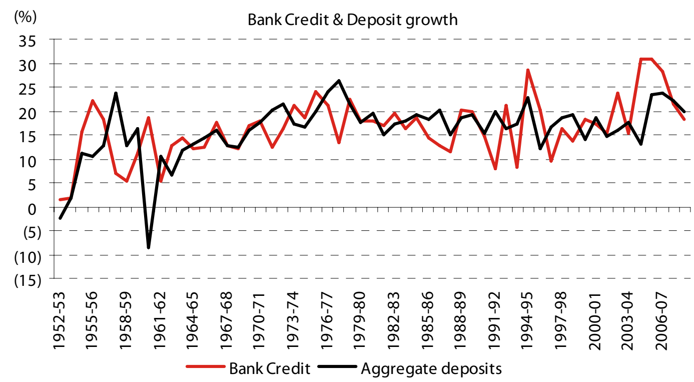
NIM (%)	FY06	FY07	FY08	FY09	FY10E	FY11E	NIM Contraction FY06-11E	NIM Contraction FY08-11E
PSU Banks								
SBI	3.4	3.0	2.8	2.6	2.5	2.6	(88)	(25)
PNB	3.6	3.5	3.2	3.6	3.4	3.4	(12)	27
BOI	2.6	2.8	2.7	2.8	2.7	2.7	5	(4)
UBI	2.9	2.9	2.7	2.8	2.7	2.8	(10)	9
IOB	3.9	3.7	3.0	2.8	2.6	2.8	(104)	(15)
PVT Banks								
ICICI	2.4	2.0	2.1	2.3	2.3	2.4	(3)	27
HDFC	4.3	4.4	4.9	4.5	4.6	4.6	33	(30)
Axis Bank	2.6	2.8	3.5	3.4	3.2	3.4	79	(5)
Kotak Mahindra Bank	4.7	4.3	5.3	5.6	5.7	5.7	100	39

Source: Centrum Research Estimates

With C-D ratio set to fall and fall in yield in advances

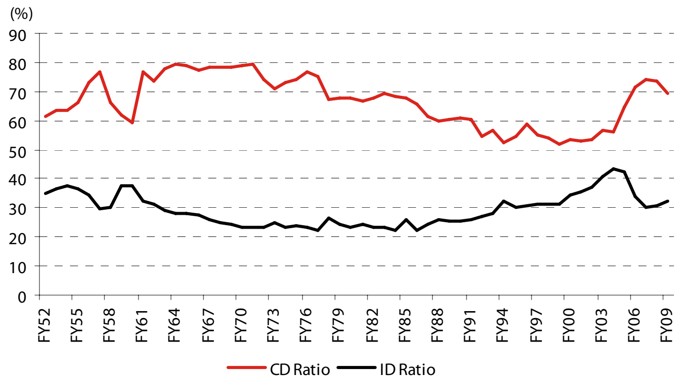
We expect CD ratio to fall from a high of 73-74% to sub 70% levels mainly on account of continued influx of higher deposit inflows into the banking system and lower credit growth. Also,with excess liquidity in the banking system, we have lower bias on yield on advances getting and benefit of deposits repricing will come with a lag.

Exhibit 75: Deposit growth trails credit growth



Source: RBI, Centrum Research

Exhibit 76: We expect CD ratio to fall after divergence in last three years



Source: RBI, Centrum Research

NPA concerns valid but overdone

Banks have been significantly de-rated due to rising concerns on asset quality emanating from higher unseasoned loan book and economic slowdown. We expect asset quality to peak out in peak out in FY11E with GNPA at 4.6% and NNPA at 2.3% from FY08 GNPA and NNPA levels of 2.3% and 1% respectively. However, we believe that asset quality deterioration during the current economic downturn will be well below the previous cycle on account of relatively better credit risk and recovery mechanism aided by regulatory changes, lower leverage of corporates, diversified loan book, pro-active restructuring of loans and improved technology to monitor NPAs.

Sensitivity analysis

We have assumed 48% CAGR in GNPA and 17% credit CAGR over FY09-11E, 3 times higher than considering that YoY growth in GNPA and NNPA has been never been higher than 16% and 23%, respectively, since 1994. Further, banks' 3 year CAGR in GNPA and NNPA has never exceeded 12.1% and 15.3% respectively. We had assumed a 3 times higher than the earlier cycle growth rates in our base case mainly on account of higher asset growth in the last four years and improving asset quality. Our sensitivity analysis suggests that in a base case scenario where GNPAs will grow at 48% CAGR during FY08-11E (our assumption) GNPA will be 4.6%.

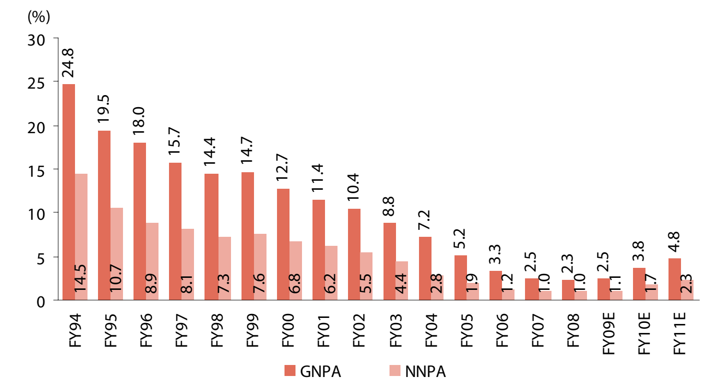
Exhibit 77: Sensitivity analysis to GNPA and NNPA

Credit CAGR Growth Rate	GNPA 3 year CAGR growth rate: 10%	25%	48%	100%	150%
5%	2.6%	3.8%	6.3%	15.6%	30.4%
10%	2.3%	3.3%	5.6%	13.5%	26.4%
15%	2.0%	2.9%	5.1%	11.8%	23.1%
17%	1.9%	2.8%	4.6%	11.3%	22.1%
20%	1.7%	2.5%	4.2%	10.4%	20.3%
25%	1.5%	2.3%	3.7%	9.2%	18.0%
30%	1.4%	2.0%	3.3%	8.2%	16.0%

Source: Centrum Research

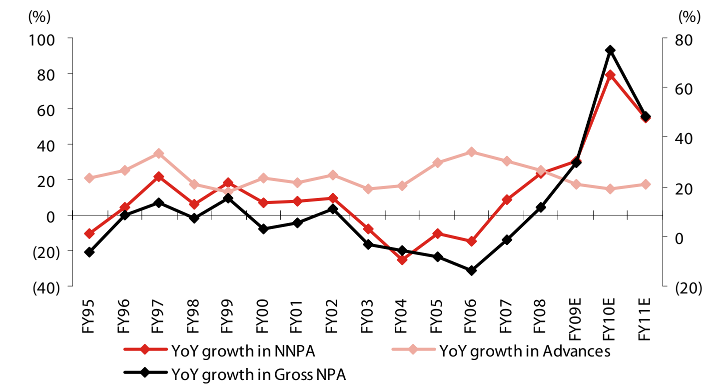
NPA unlikely to rise to levels seen in late 1990's…

Exhibit 78: Unlikely to reach 1997 NPA levels



Source : RBI, CentrumResearch Estimates

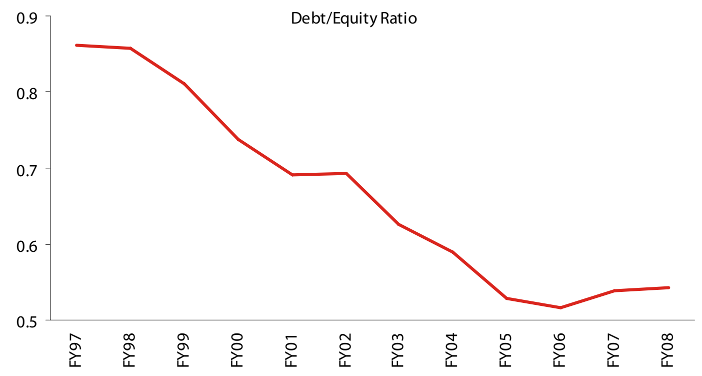
Exhibit 79: YoY growth in GNPA and NNPA has never been higher than 16% and 23%, respectively



Source: RBI, Centrum Research Estimates

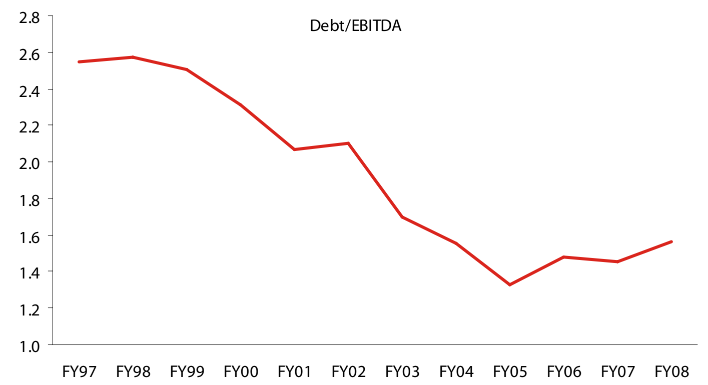
Stronger corporate balance sheets and improved cash flows than earlier cycle

Exhibit 80: Relatively strong corporate balance sheets



Source : CMIE, Centrum Research

Exhibit 81: Improved cash flows



Source : CMIE, Centrum Research

..Higher provisioning norms, stringent NPA recognition and regulatory framework than last NPA cycle

Exhibit 82: Stringent provisioning norms than earlier cycle

1997 NPA cycle - Provisioning requirements – less stringent	Current cycle - Provisioning requirements – cushion built
❍ NPL recognition: 180 days past due ❍ No standard asset and general provisioning mandated	❍ NPL recognition: 90 days past due ❍ General provisioning requirement: 1% ❍ Standard asset provisions - 0.4% of incremental credit, 2% of real estate sector, credit card receivables, capital market exposure, personal loans and 2% of non-deposit taking systemically important NBFCs (recently reduced to 0.4%) ❍ SARFAESI act to smoothen the recovery mechanism for corporate loans

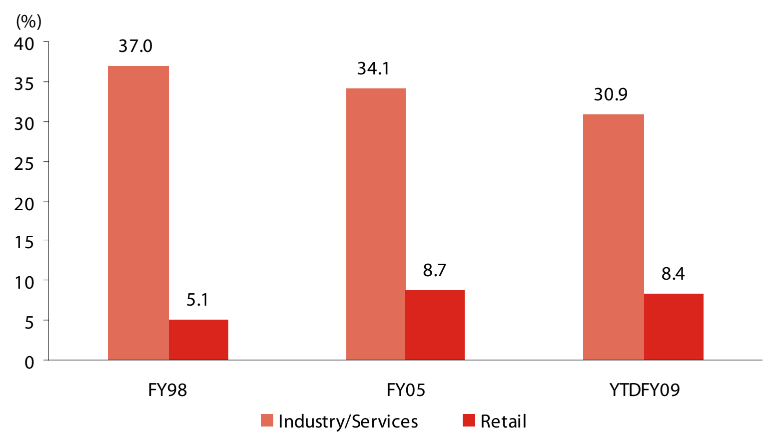
Source: Centrum Research

Source: Centrum Research

…Exposure to sensitive sectors relatively lower in this cycle

Within industrial/service segment, we believe textiles, Gems & jewelry, real estate, Construction/Infrastructure, Engineering/automobiles, Chemicals and metals are the key stress sectors. Infrastructure is the single largest constituent of banking credit contributing about 11.8%. The share of these stress sectors in February FY09 was lower by 6.1% at 30.9% v/s 37% in FY98. However, exposure to risky personal loans is higher by about 3.3% this time around.

Exhibit 83: % share of risky exposure in to Industry/Services and retail

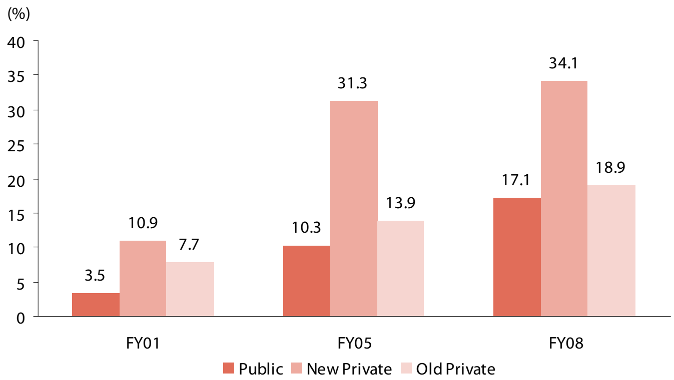


Source: RBI, Centrum Research

Exposure to sensitive sector lower for PSUs

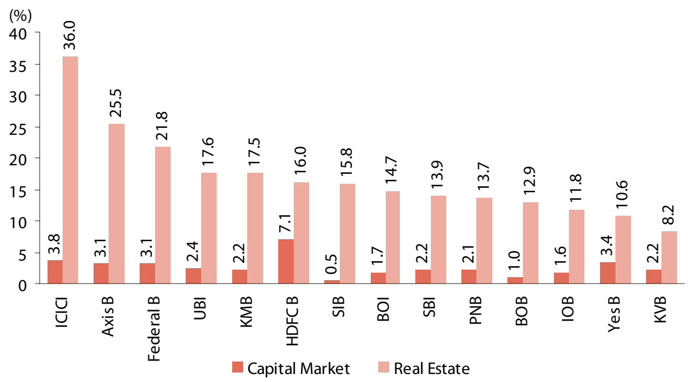
Banks' exposure to sensitive sectors including capital market and real estate has increased, within which new private banks have higher share making them more vulnerable to significant deterioration in asset quality.

Exhibit 84: Bank group-wise exposure to sensitive sector



Source : RBI, Centrum Research

Exhibit 85: Individual banks exposure to sensitive sector

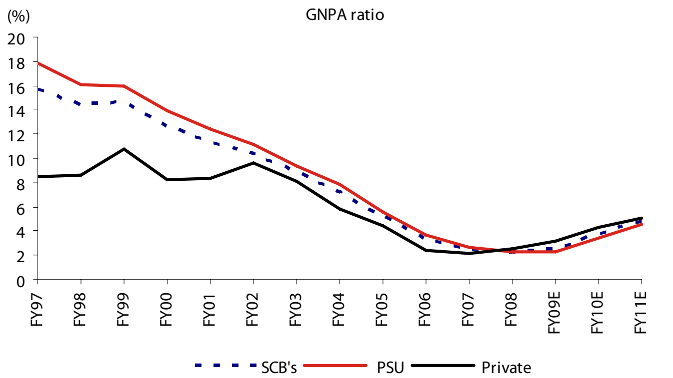


Source : Companies, Centrum Research

Share of PSU banks in gross NPA is likely to be lower

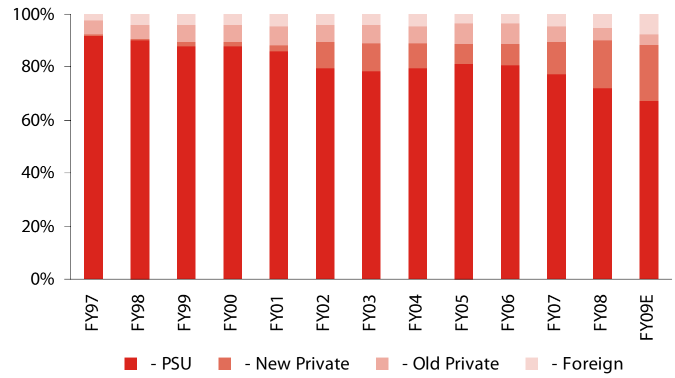
We expect private banks (particularly new private banks) to witness relatively higher NPA's vis-à-vis PSUs owing to relatively higher exposure to retail loans and declining credit growth. PSU's too face higher risk from chunky corporate loans, but we believe that restructuring, better credit risk management, strong corporate balance sheets and relatively higher credit growth should keep the share of NPAs for PSU banks at relatively lower levels.

Exhibit 86: Private banks NPA likely to be higher



Source: RBI, Centrum Research Estimates

Exhibit 87: Share of new private banks to increase gradually



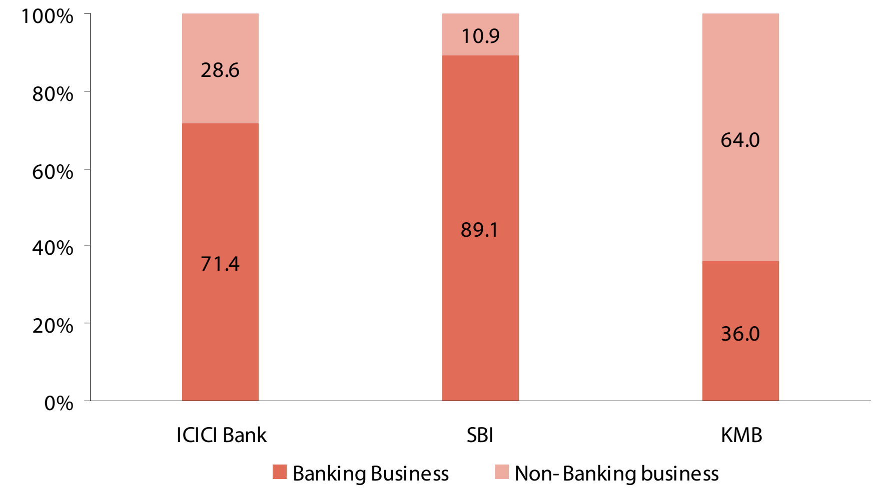
Source: RBI, Centrum Research Estimates

Near term drivers in non-banking business fading… focus more on core banking

Near term drivers in the non-banking businesses fading

Private banks have extensively diversified into non-banking areas such as insurance, asset management and securities businesses. PSU banks, which primarily concentrated on core banking too have had begun to venture in to non-core businesses of insurance and asset management. We expect the insurance business (highly capital intensive with high gestation period) to remain a drag on banks' profitability. We also remain wary of the capital market business until significant and sustainable visibility arises. This makes us believe that earnings and value momentum from other businesses is unlikely to be robust in the near term.

Exhibit 88: Non banking subsidiaries - lower share in valuation

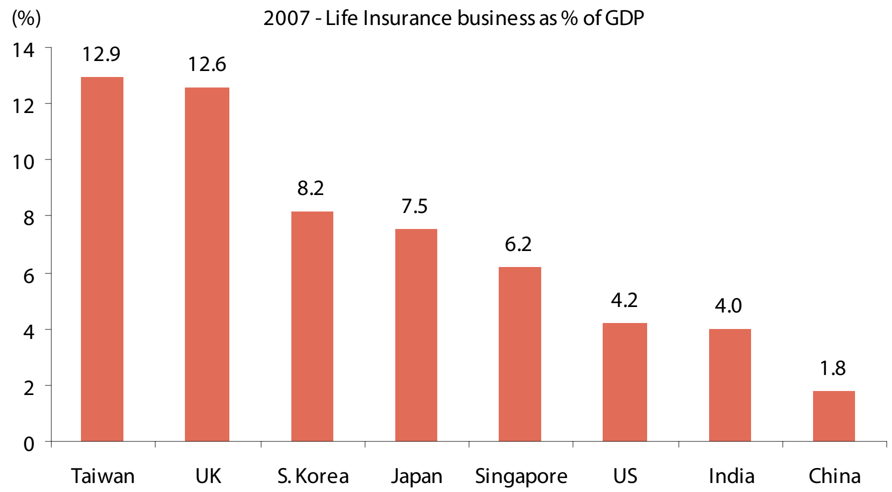


Source: Centrum Research Estimates

Life and general insurance - a long term growth story

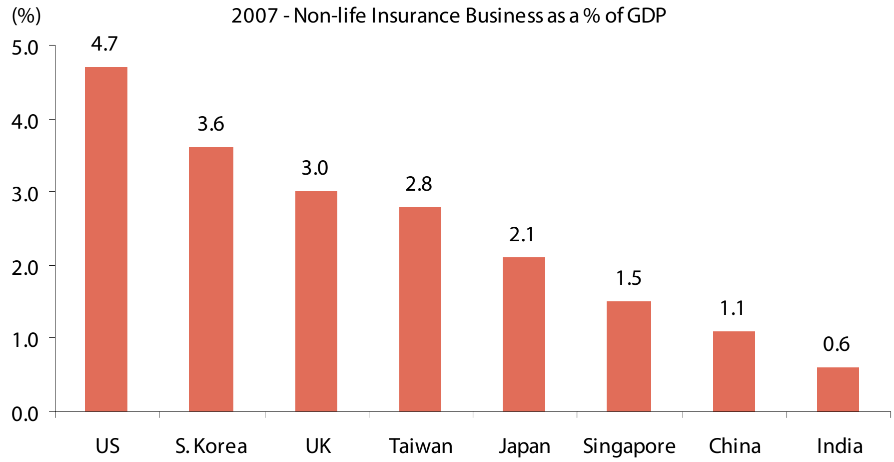
The foray of foreign players into the Indian market was a result of under-penetration in the industry. However, a slowdown in the global and domestic economy is likely to take away the shine from this industy with the life insurance premium CAGR tapering off to 15% over FY09-11E from 100% over FY05-09. Even though the recent easing of solvency margin requirements will reduce the capital commitment, majority of players are likely to break even only after 2011, considering the high gestation period involved in the life insurance business. Moreover, deregulation in non-life insurance premium is taking a toll on profitability of banks. We expect value unlocking of insurance subsidiaries to extend on account of the subdued capital markets, however with new government in place one can expect increase of FDI from 26% to 49% .

Exhibit 89: Life Insurance penetration is lower when compared with developed markets…



Source: Swiss Re, Centrum Research

Exhibit 90: Non-life insurance is relatively less underpenetrated compared to developed markets



Source: Swiss Re, Centrum Research

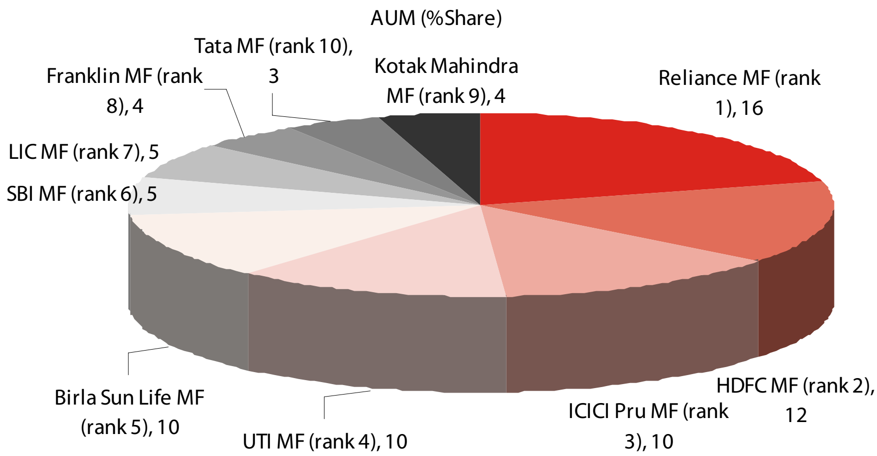
Asset Management – Meager in value terms

Asset management business - AUM growth under check

The asset management business has a high correlation with the capital market and we expect AUM to register 9% CAGR over FY08-11E vs 53% CAGR over FY05-08 (coincided with the bull phase), as sustainable recovery appears bleak in the current environment. This business has seen significant decline since Sep 2008 (had been growing every month since June 2003 until then) primarily due to net outflow of funds and partly due to the market meltdown. Regulatory requirements (compulsory PAN) and stiff competition from the insurance industry too has added to the industry's woes. Many banks have entered or are planning to enter the under-penetrated mutual fund business primarily due to following reasons:

- Ready distribution model and customer base
- Relatively lower investments and higher returns (RoE above 30%)
- Diversification of risk

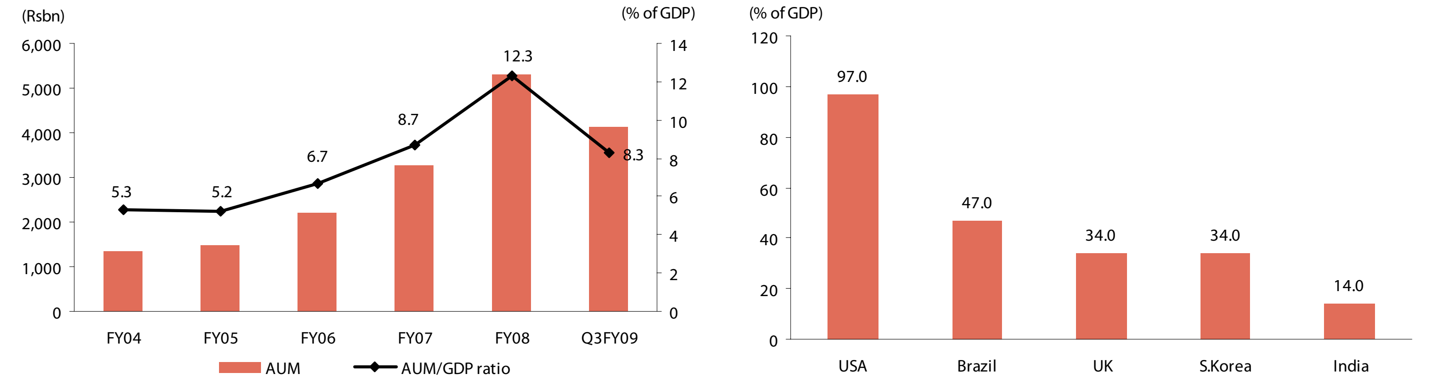
Exhibit 91: Reliance leads the pack



Source: AMFI, Centrum Research

Banks such as Axis, IDBI, BOI and UBI have already announced plans to venture into the AMC business, which will act as a value catalyst in the long run.

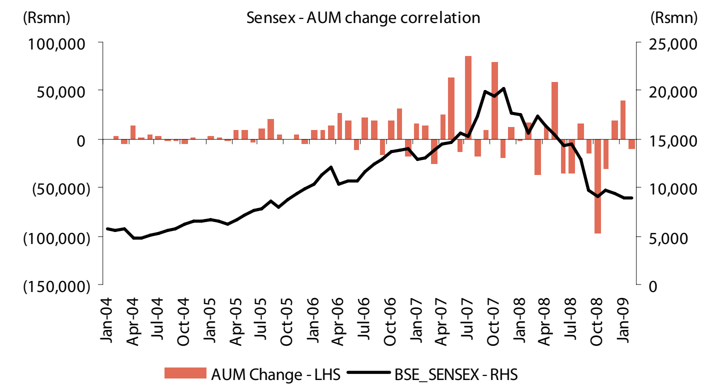
Exhibit 92: India still an under-penetrated market alluring new players



Source: AMFI, Bloomberg

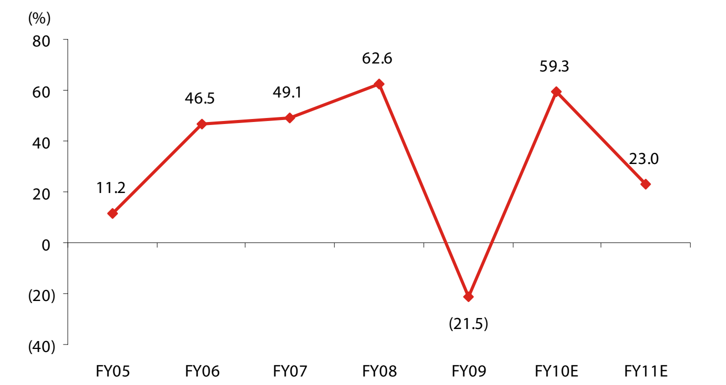
Source:Reliance Capital Investor Presentation
* as of Jan 09

Exhibit 93: Co-relation between Sensex and AUM



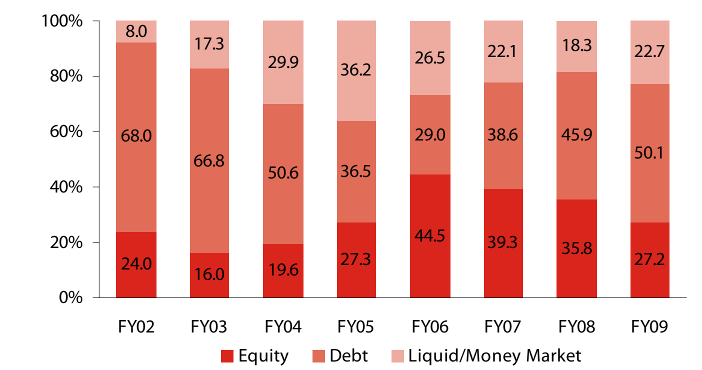
Source: BSE, AMFI, Centrum Research

Exhibit 94: AUM growth to taper in the near term



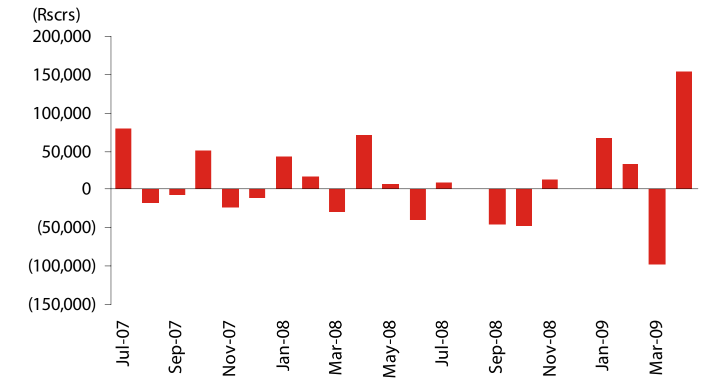
Source:AMFI, Centrum Research Estimates

Exhibit 95: Composition likely to tilt towards debt and balanced funds



Source: AMFI, Centrum Research

Exhibit 96: High redemption pressure

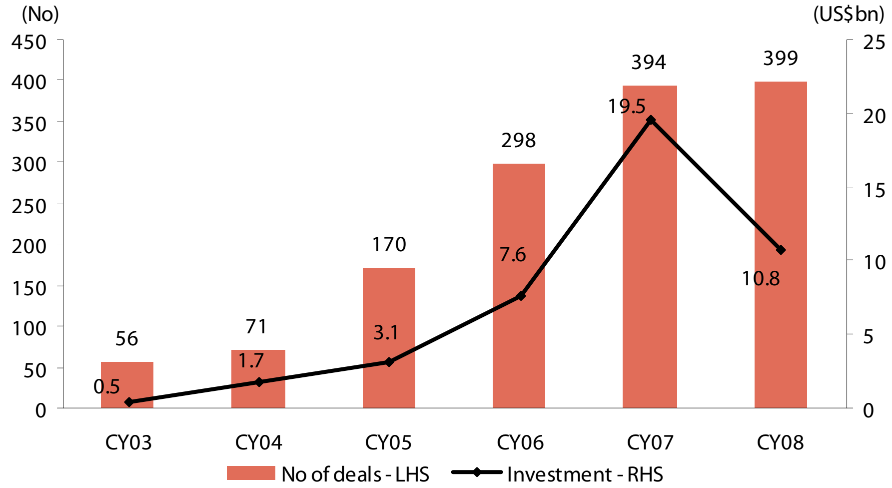


Source: AMFI, Centrum Research

Alternate asset management (PE/VC) in turbulent waters

The alternate asset management business has attracted several banks lured by high returns and low investment. However, the private equity business too has witnessed significant slump in deals and wealth erosion, impacted by lacklustre capital markets and global economic slowdown. Difficulty in new fund raising will impact the earnings and valuations of the business, thereby having a bearing on AUM growth.

Exhibit 97: Volumes and investment is falling

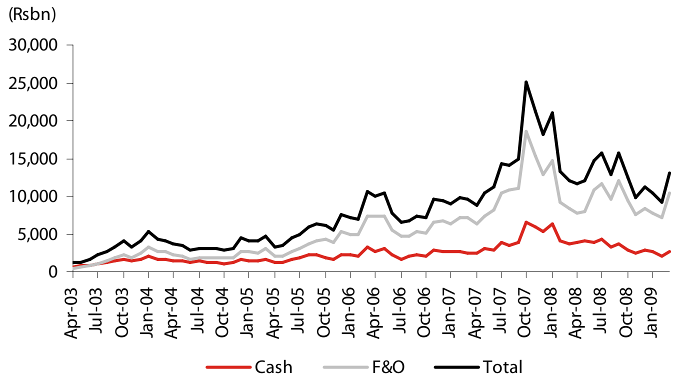


Source: Industry reports, Centrum Research

Securities and investment banking business

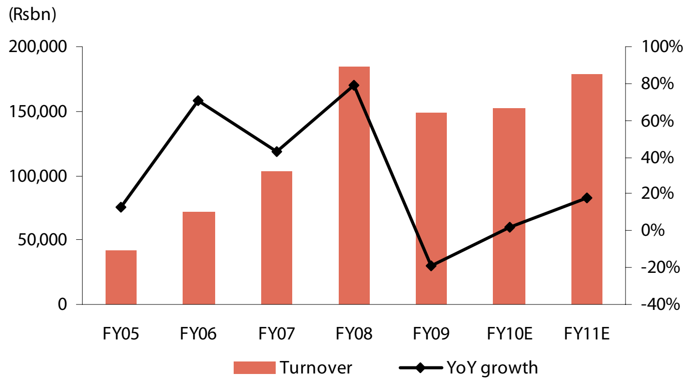
Subdued capital markets, 40% fall in index from peak resulted in fall in trading volumes and revenues impacting ICICI Bank and Kotak, which have higher dependence on the securities business. We expect volumes to remain range bound in FY10E and expect recovery only in FY11E. Further, capital market issuances and investment banking deals too have dried down and are expected to remain subdued in the near term, which would drag valuations.

Exhibit 98: Falling turnover (Cash & F&O)



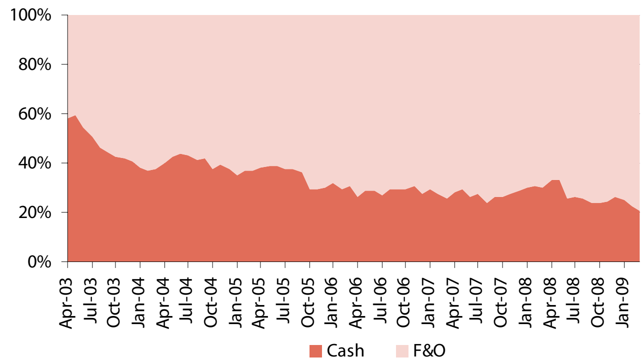
Source: BSE, NSE, Centrum Research

Exhibit 99: Volumes to improve only in FY11E



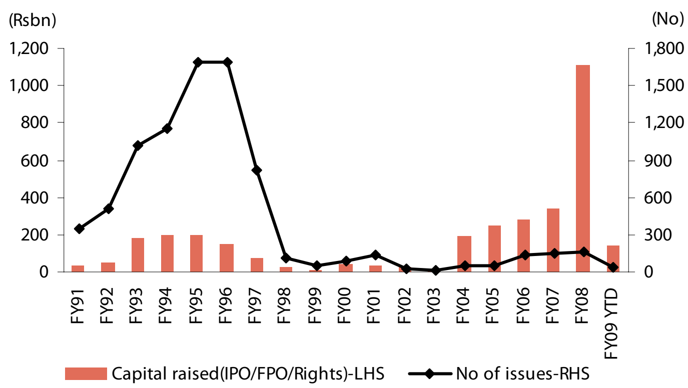
Source: BSE, NSE, Centrum Research Estimates

Exhibit 100: Increasing share of F&O means lower broking yield



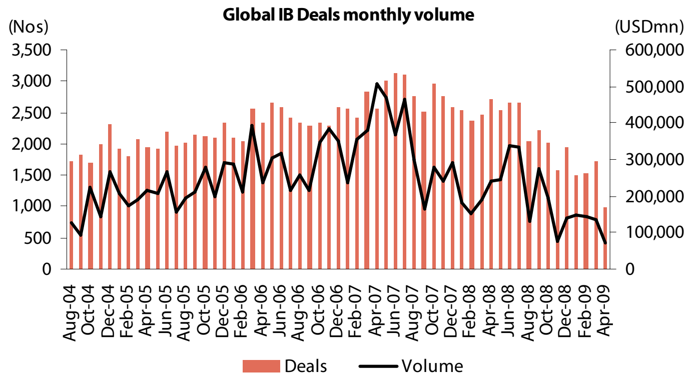
Source: BSE, NSE, Centrum Research

Exhibit 101: Drag on fee income as capital market issuances drying down



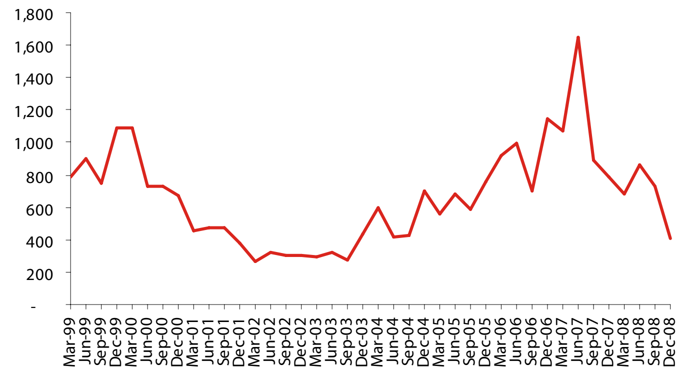
Source: Prime database, Centrum Research Estimates

Exhibit 102: Worldwide investment banking volumes drying down



Source: Bloomberg, Centrum Research

Exhibit 103: Global quarterly M&A index under pressure



Source: Bloomberg, Centrum Research

Resilient Indian banking system inherently strong

Exhibit 104: Indian banks - Proxy state owned banks

Country	Reserve / liquidity Req (%)
India	29.0%
China	15.5%
UK	NR
Canada	NR
Bahrain	7.0%
Singapore	NR
Sri Lanka	7.8%
Hong Kong	25.0%
USA	10.0%
Japan	0.1%
Australia	3.3%
Russia	0 .5%

NR: Not relevant

Source: Central banks, Centrum Research

High reserve ratios vs international peers – a blessing

Indian banks have to comply with high reserve requirements (30 %), which would make them proxy state owned banks with about 30% of their balance sheet guaranteed by the government. Also, the reserve requirements were gradually increased starting from CY07.The high reserve requirements acted as a blessing in disguise during the credit crisis and also acted as an inherited limitation on excess leveraging. This we believe should translate into the multiple expansions going forward vis-à-vis international counterparts.

Less leverage, less toxic assets and minimal international exposure

Indian banks have lower exposure to US subprime assets as their international exposure too is minimal (~10% of the balance sheet size).

Also, exposure to troubled financial institutions is also minimal. For example, Lehman's exposure is very minimal when compared to total % of FY09 profits.

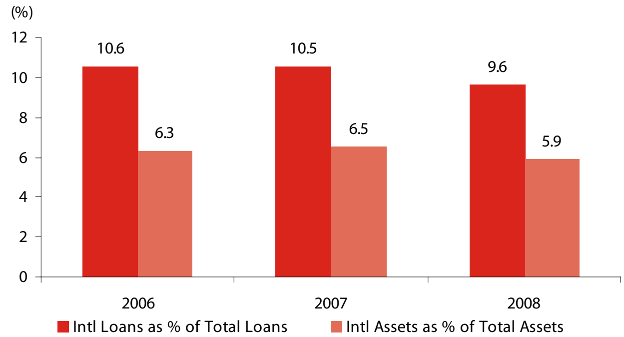
Unlike the European and US banks, Indian Banks are less leveraged and also relatively better capitalized. Also, the less exposure to the toxic and complex assets make the Indian banks financials more predictable and less surprises left. The off-balance sheet exposure is also highly concentrated towards forex swaps rather than the Mortgage backed securities.

Exhibit 105: Indian banks exposure to Lehman during FY09

	US$ mn
ICICI	80
SBI	5
BOB	10
BOI	11
PNB	5

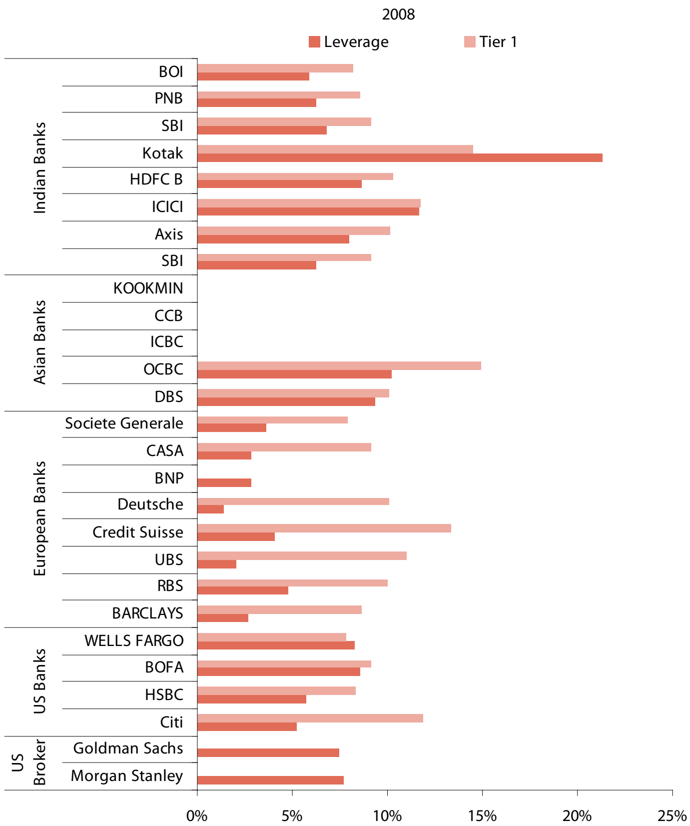
Source : Company, Centrum Research

Exhibit 106: Minimal International exposure



Source: RBI, Centrum Research

Exhibit 107: Lower leverage of the Indian banks comparative to global peers



Source: Bloomberg, Centrum Rsearch

Prudent regulator in challenging times

Central bank has increased risk weightages of exposures to overheated asset classes viz., capital market, venture capital and unsecured lending and also increased the provisioning requirements for these exposures. This helped banks to provide higher provisions and allocate higher capital for the risky asset classes which would act as cushion in deteriorating economic environment. Of late, RBI has eased these regulations to aid consumption and also protect these exposures. We believe this will augur well for the Indian banking system and also protect it from the asset bubble burst.

Exhibit 108: Prudent regulation

1-Jul-05	Capital market exposures risk weights Increased to 125% from 100%
May-06	Capital market exposures risk weights Increased to 150% from 100% Venture capital funds exposure will form a part of their capital market exposure and 150% risk weights are assigned
May-06	General provisioning on standard advances in specific sectors i.e. personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs20 lakh and commercial real estate loans increased to 1.0% from 0.40%.
Jun-06	**Utilisation of Floating provisions (Buffer for uncertain/challenging times):** The floating provisions could be used for contingencies under extra-ordinary circumstances for making specific provisions in impaired accounts after obtaining board's approval and with prior permission of the Reserve Bank.
Jul-06	**Standard provisions increased for risky assets: Personal loans loans and advances qualifying as capital market exposures residential** housing loans beyond Rs.20 lakh and commercial real estate loans. Additional provisioning requirement over the financial year 2006-07 would stand at: (a) 0.55 per cent for the quarter ended June 2006; (b) 0.70 per cent for the half-year ended September 2006; (c) 0.85 per cent for the quarter ended December 2006; and (d) 1 per cent for the year ended March 2007.
Mar-07	**Reduced dependence on wholesale borrowing and counterparty risk:** (a) Inter-bank Liabilities (IBL) of a bank should not exceed 200 per cent of its net worth as on 31st March of the previous year. (b) banks whose CRAR is at least 25 per cent more than the minimum CRAR (9 per cent) were allowed to have a higher limit of up to 300 per cent (c) the limit prescribed above would not include borrowings outside India (d) the above limits would not include collateralised borrowings under CBLO and refinance from NABARD SIDBI etc. (e) The existing limit on the call money borrowings prescribed by the Reserve Bank will operate as a sub-limit within the above limits; (f) banks having high concentration of wholesale deposits should be aware of potential risk associated with such deposits and may frame suitable policies to contain the liquidity risk arising out of excessive dependence on such deposits. *On 14 Sept 2007 Northern Rock sought and received a liquidity support facility from the Bank of England*
Apr-07	Banks advised to ensure that the date of completion of the infrastructure projects financed by them should be clearly spelt out at the time of financial closure of the project and to treat such accounts as sub-standard if the date of commencement of commercial production extended beyond a period of one year after the date of completion of the project as originally envisaged. The revised instructions came into force with effect from March 31 2007.
Jun-07	Banks advised to put in place appropriate stress test policies and relevant stress test framework for the various risk factors by September 30 2007.

Source: RBI, Centrum Research

INDIA

Banking

State Bank of India

Initiation **8 June 2009**

Accumulate

Target Price: Rs1,958

CMP: Rs1,877*

Upside: 4%

as on 1 June 2009

Return of the prodigal

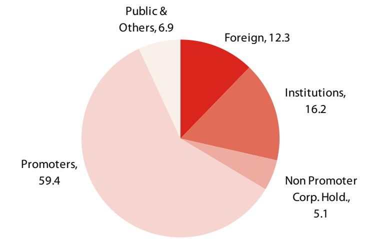
- **Regaining its lost lustre:** We like SBI's recent strategy of enhancing its market share through aggressive credit growth and branch expansion, partly due to excess balance sheet liquidity. Further, its aggressive branch expansion to mobilize low-cost funds should help it prepare for the next level of growth.
- **Asset quality risk persists, but lower vis-à-vis earlier cycle:** We expect GNPA and NNPA levels to remain under check and peak out at 4.2% and 2.4%, respectively, in FY11E. We do not see NPAs rising to historic highs primarily due to the diversified loan portfolio, better risk and recovery mechanism, restructuring of corporate loans and falling interest rates.
- **High Tier-I capital comforting:** SBI has one of the highest Tier-I capital (9.4%) amongst PSU banks. This, coupled with excess liquidity in its balance sheet, would provide enough leeway for growth and cushion against more-than-expected deterioration in asset quality.
- **Earnings growth set to moderate:** We estimate earnings growth to moderate (7% CAGR over FY09-11E) due to 10bp NIMs contraction, moderation in fee income and 30bp increase in credit costs.
- **Banking associates better managed banks:** SBI's subsidiaries collectively contribute about 29% to the banking business' profitability and 22 % to consolidated PAT. Asset quality of associate banks is better than the standalone with GNPA at 1.5% (vs. 3% standalone) and NNPA at 0.6% (vs. 1.8%).
- **Accumulate with price target of Rs1,958:** We recommend Accumulate with a target price of Rs1,958 valuing the banking business at 1.6x P/Adj BV on FY11E adj BV, insurance business at 15x FY11E NBAP. Despite the risk of higher assets, we believe SBI's risk-return is favourable due to its relatively strong branch network and rise in market share.
- **Key risks: Upside risk:** Lower-than-expected NPAs. **Downside risks:** Higher-than-expected deterioration on corporate asset quality, higher opex and frequent government intervention.

Key Data

Bloomberg Code	SBIN IN
Reuters Code	SBI.BO
Current Shares O/S (mn)	634.9
Diluted Shares O/S(mn)	634.9
Mkt Cap (Rsbn/USDbn)	1,191.5/25.4
52 Wk H / L (Rs)	2,040/892
Daily Vol. (3M NSE Avg.)	3,556,918
Face Value (Rs)	10
1 USD = Rs46.9	

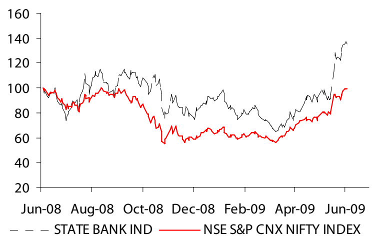
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
State Bank of India	46.8	71.1	35.2
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

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Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	150,582	67,652	45,414	*3.1*	86	10.7	495	2.0	*15.4*	*0.9*
FY08	170,212	86,949	67,292	*48.2*	106	15.5	656	2.3	*16.8*	*1.0*
FY09	208,731	126,908	91,213	*35.5*	144	9.1	763	1.7	*17.1*	*1.1*
FY10E	246,077	116,455	95,455	*4.7*	150	11.3	817	2.1	*15.5*	*0.9*
FY11E	288,428	131,056	105,315	*10.3*	166	10.2	857	2.0	*15.3*	*0.9*

Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

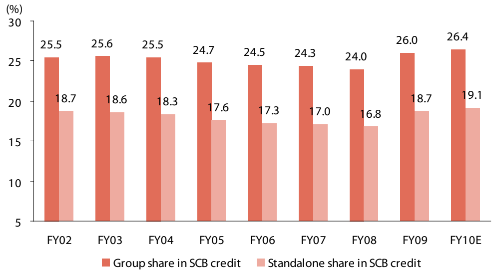
	Q408	Q109	Q209	Q309
Promoter	59.7	59.4	59.4	59.41
Foreign	12.8	12.7	12.1	10.4
Institutions	11.6	11.5	12.5	14.7
Public & Others	15.8	16.3	15.9	15.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: NSE

Company Background

State Bank of India (SBI) was constituted through an Act of Parliament on 8 May 1955 and is India's largest bank. It has nearly 11,100 branches on a standalone basis and more than 15,000 branches on consolidated basis. It is a proxy of Indian economy and commands a market share over 24% in advances and 23% in deposits along with its associates. Apart from 6 associate banking subsidiaries, it also has several diversified non-banking subsidiaries whose activities include insurance and asset management. SBI has entered into an agreement to venture into general insurance business with Insurance Australia Group (IAG) in 2008.

Dominant Bank in terms of Market share



Source: Company, Centrum Research Estimates

Associates and subsidiaries

Associate banks

State Bank of Bikaner & Jaipur
State Bank of Hyderabad
State Bank of Indore
State Bank of Mysore
State Bank of Patiala
State Bank of Travancore

Subsidiaries/ joint ventures

SBI Commercial & International Bank (SBICI)
SBI Capital Markets (SBICAP)
SBICAP Securities (SSL)
SBICAPS Ventures (SVL)
SBICAP (UK)
SBI DFHI
SBI Cards & Payments Services Pvt. Ltd.(SBICSPL)
SBI Life Insurance Company (SBILIFE)
SBI Funds Management (SBIFMPL)
SBI Factors & Commercial Services (SBIFACTORS)
Global Trade Finance
Insurance Australia Group (IAG) - General insurance JV

Source: Company

Key management personnel

Name	Position	Profile
Mr O P Bhatt	Chairman	Mr Bhatt started his career with SBI in 1972 and held several important assignments in India and abroad. Besides being the Head of the Group, Mr. Bhatt is also the Chairman of the Banking & Financial Institutions Committee of FICCI, director on the board of several other companies and a board member of ICRIER, XLRI, IBPS, IDRBT, KVIC and National Co-operative Development Corporation.
Mr SK Bhattacharyya	Managing Director	Appointed on 8 Oct 2007 as managing director & chief credit risk officer. Prior to that, he has served as MD of State Bank of Bikaner & Jaipur and SBI International (Mauritius)
Dr Ashok Jhunjhunwala	Director	He was appointed as director on 15 Sept 2005. He is a professor at IIT, Chennai, working closely with the telecom and computer network systems industry.

Source: Company

Investment Rationale

- SBI's strategy to re-gain its market-share would be beneficial in the long-term perspective
- Despite aggressive push on advances, NPAs unlikely to touch historical highs
- Its banking and non-banking subsidiaries are significant value drivers

Dupont Analysis

% of Average assets	FY09	FY10E	FY11E
Net-Interest Income	2.5	2.4	2.4
Non-Interest Income	1.5	1.1	1.1
Net Income	4.0	3.5	3.6
Operating Expenses	1.9	1.5	1.5
Operating Profit	2.1	2.0	2.1
Provisions & Contingencies	0.4	0.6	0.7
Taxes	35.7	35.0	35.0
RoAA (%)	1.1	0.9	0.9
Avg.assets/avg equity (x)	15.8	16.8	17.1
RoAE (%)	17.1	15.5	15.3

Source: Company, Centrum Research Estimates

Summary Financials

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Net Interest Income	**150,582**	**170,212**	**208,731**	**246,077**	**288,428**
Growth (%)	(3.7)	13.0	22.6	17.9	17.2
NIM (%)	3.0	2.8	2.6	2.5	2.6
Non Interest Income	**67,652**	**86,949**	**126,908**	**116,455**	**131,056**
Growth (%)	*(8.4)*	*28.5*	*46.0*	*(8.2)*	*12.5*
Pre-Prov Profits	**100,000**	**131,076**	**179,152**	**209,405**	**243,301**
Provisions & Contingencies	23,749	26,687	37,346	62,551	81,277
Provision for taxes	30,838	37,098	50,594	51,399	56,708
Adj PAT	**45,414**	**67,292**	**91,213**	**95,455**	**105,315**
Growth (%)	3.1	48.2	35.5	4.7	10.3
Key Balance Sheet Data					
Networth	276,440	312,985	490,326	579,480	651,183
Deposits	3,800,460	4,355,211	5,374,039	7,420,730	8,519,846
Others	8,617,940	9,974,557	13,508,969	16,441,200	18,204,723
Total Liabilities & Equity	**4,938,695**	**5,665,652**	**7,215,262**	**9,644,330**	**10,991,501**
Loans	2,616,415	3,373,365	4,167,682	5,425,030	6,347,285
Investments	1,625,342	1,491,488	1,895,012	2,759,540	3,168,267
Fixed & Other assets	6,969,374	8,007,983	11,525,680	14,597,500	14,759,491
Total Assets	**4,938,695**	**5,665,652**	**7,215,262**	**9,644,320**	**10,991,501**
Key Ratios					
Capital Adequacy & Credit Quality Ratios (%)					
Gross NPA	2.8	3.0	2.8	3.6	4.2
Net NPA	1.4	1.8	1.8	2.1	2.4
Total CAR	12.3	12.5	14.3	14.0	14.4
Tier 1 CAR	8.0	8.5	9.4	9.2	9.0
Per share data					
Fully diluted EPS	86.3	106.1	143.8	150.5	166.0
Book Value per share	595	773	913	1,026	1,150
Adj Book value per share	495	656	763	817	857
Valuations Ratios					
Price/BV (x)	1.6	2.0	1.4	1.7	1.5
Price/Adj. BV (x)	2.0	2.3	1.7	2.1	2.0
P/E (x)	10.7	15.5	9.1	11.3	10.2
Dividend Yield	1.5	1.3	2.2	1.9	2.1
Return Ratios (%)					
RoE	15.4	16.8	17.1	15.5	15.3
RoA	0.9	1.0	1.1	0.9	0.9
Dupont Analysis					
% of Average assets					
Net-Interest Income	2.8	2.6	2.5	2.4	2.4
Non-Interest Income	1.3	1.4	1.5	1.1	1.1
Net Income	4.1	4.0	4.0	3.5	3.6
Operating Expenses	2.2	2.0	1.9	1.5	1.5
Operating Profit	1.9	2.0	2.1	2.0	2.1
Provisions & Contingencies	0.4	0.4	0.4	0.6	0.7
Taxes	40.4	35.5	35.7	35.0	35.0
RoAA (%)	0.9	1.0	1.1	0.9	0.9
Avg.assets/avg equity (x)	18.0	16.0	15.8	16.8	17.1
RoAE (%)	15.4	16.8	17.1	15.5	15.3

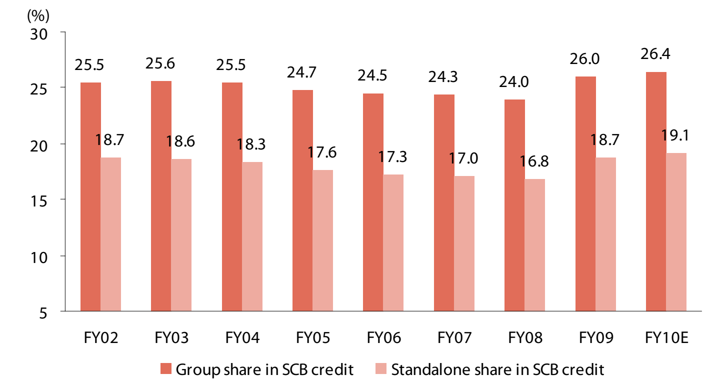
Source: Company, Centum Research Estimates

Investment Argument

Regaining lost lustre

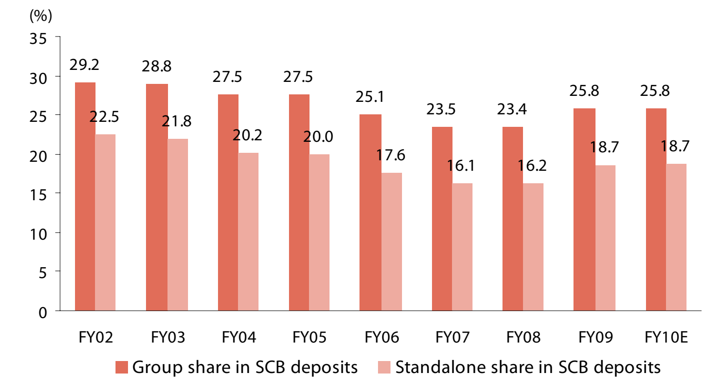
The SBI group (SBI and 6 banking associate banks) accounts for nearly 24% of India's banking assets and 23% of deposits, which makes it virtually a proxy of the economy. During the past few years, the bank witnessed a significant decline in its market-share with private sector banks pursuing aggressive growth strategies. We believe SBI's recent branch expansion and aggressive lending strategy, when private players are busy in house keeping, bodes well for the bank as it would help it regain lost market share. We believe the asset build-up during the downturn will be of relatively better quality and lead to long-term relationships which can be explored during downturn. Further, its aggressive branch expansion to mobilize low-cost funds should help it prepare for the next level of growth when the economy rebounds.

Exhibit 1: SBI Group's share in industry credit (SCB)



Source: Company, Centrum Research Estimates

Exhibit 2: SBI Group's share in deposits (SCB)

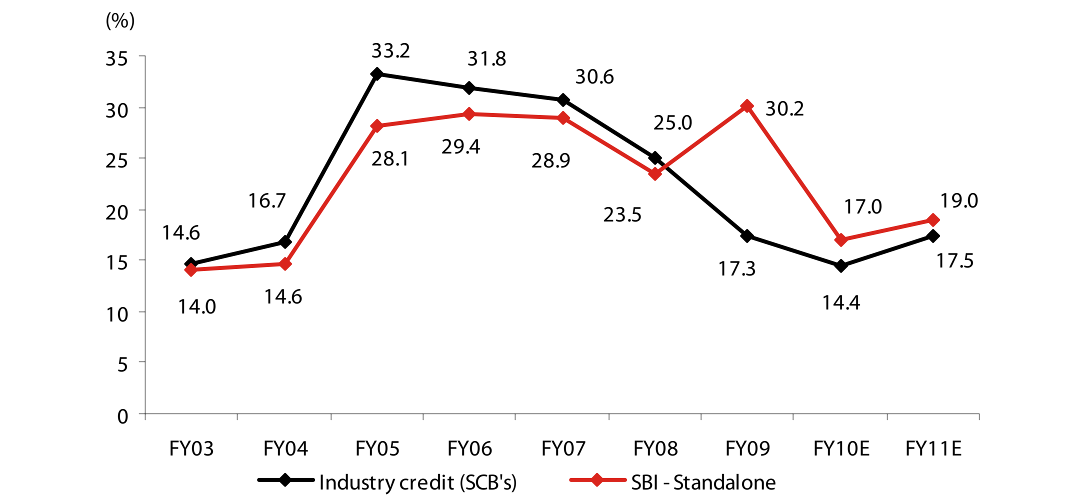


Source: Company, Centrum Research Estimates

SBI to outperform sector growth

Driven by higher liquidity in its balance sheet, we expect SBI to register 18% credit CAGR over FY09-11E, outperforming the industry. During FY03-08, SBI has underperformed the overall banking sector's credit growth as it consistently lost market-share, especially in retail loans, to the more nimble private sector banks. However, now the private sector banks are in adjustment mode to resolve their funding and loan mix and are expected to register moderate growth in business. We believe SBI's balance sheet size, access to low-cost funds, long-term relationship with corporate clients, extensive product range and improving customer service levels and would enable it garner a higher share of corporate credit.

Exhibit 3: SBI to outperform industry credit growth



Source: RBI, Company, Centrum Research Estimates

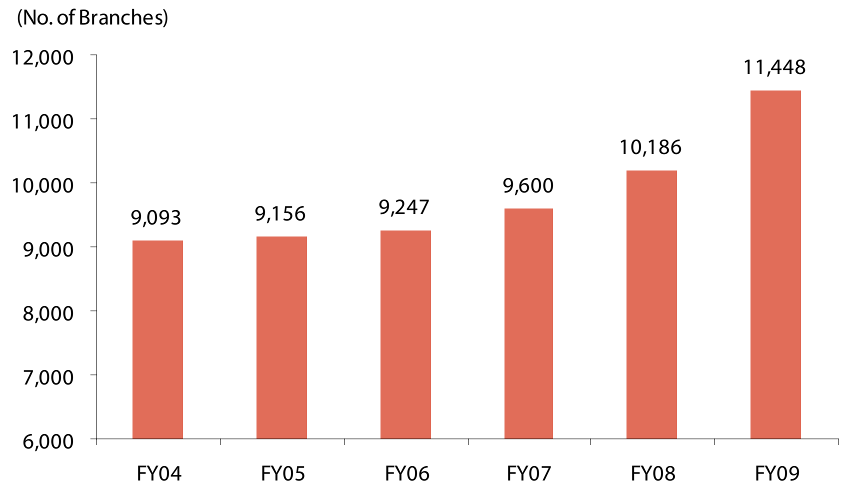
Strong technology-driven liability franchisee key enabler

The SBI Group already account for about one-fifth of India's branch network. This mammoth branch network (most of it already under CBS) gives SBI unmatched reach in mobilising low-cost deposits and aid asset and fee income growth. SBI is aggressively expanding its branch network to increase its low-cost deposit market share and prepare for the next level of growth when the economy rebounds.

Network expansion

SBI opened about 1,000 branches over the last four years (FY04-08). In FY09 alone, it opened almost 900 branches taking the total to over 11,111. It still has licences for another 1,500 branches. About 60% of the new branches are likely to come up in semi-urban and rural areas. This rapid expansion seems to be driven by its strategy to increase market share of deposits and garner more low-cost funds.

Exhibit 4: Aggressive branch expansion during past 2 years

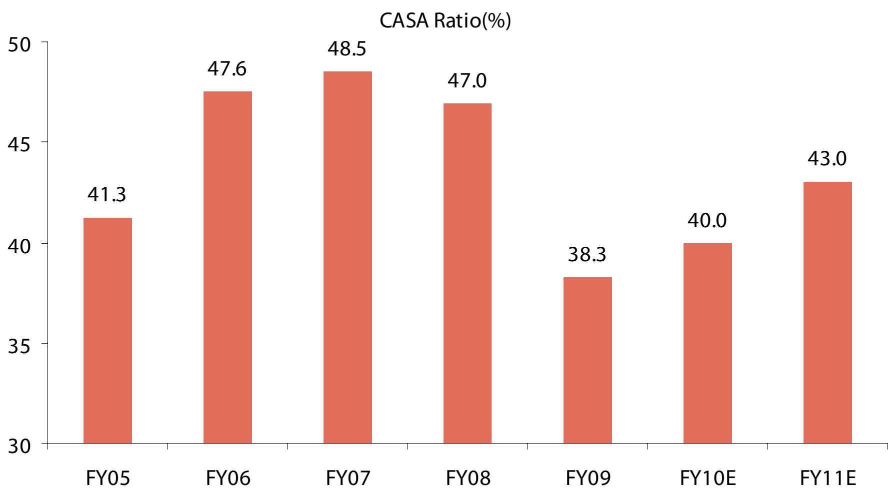


Source: Company, Centrum Research

Branch expansion to aid CASA deposit mobilisation

We expect the aggressive branch expansion and falling interest rates on long-term deposits would help SBI improve CASA ratio to about 42% by FY11E. In FY09 the bank had third highest CASA ratio in the industry, which resulted in relatively lower cost of funds and helped sustain margins. The steep fall in CASA ratio to 38% in FY09 had more to do with industry-wide cannibalization effect with more funds shifted towards term deposits carrying higher rates. However, with the spread between savings and term deposits declining once again, the tide towards long-term deposits is expected to slow down and thus lead to higher CASA ratio.

Exhibit 5: CASA ratio to improve

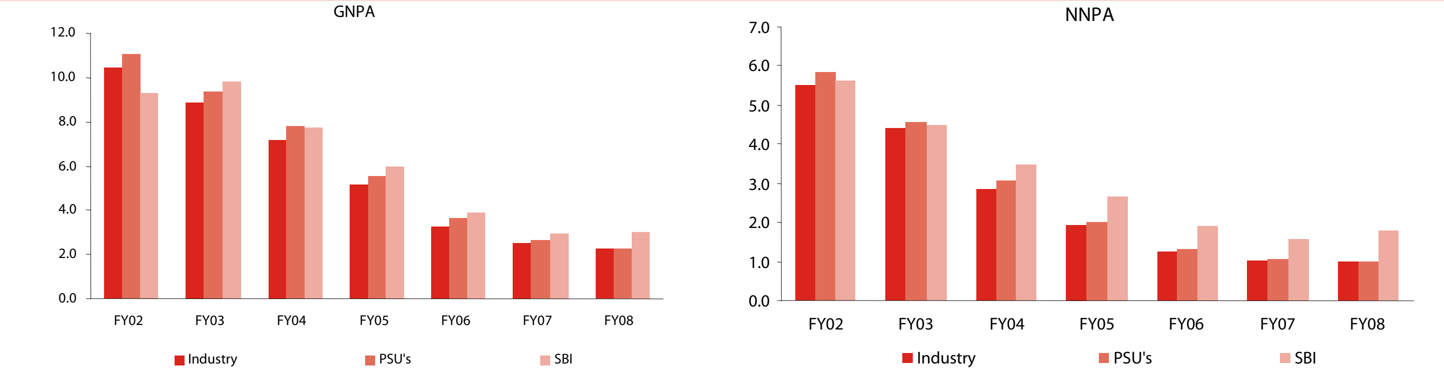


Source: Company, Centrum Research Estimates

Asset quality risk persists, but not as bad as earlier cycle

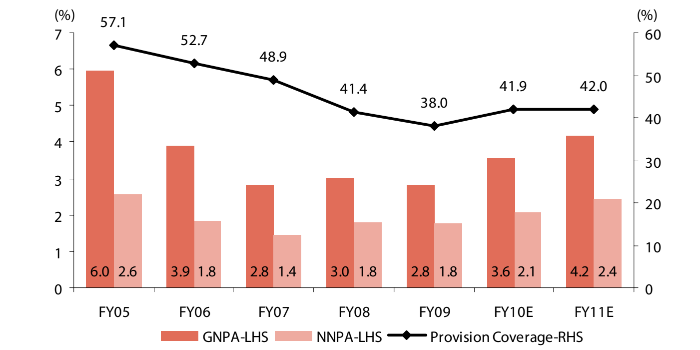
Historically, SBI's NPAs have been higher than the industry's. However, we do not see NPAs increasing to their 1997 historic highs of 16%, when the bank's loan portfolio, prudential/recovery norms and industry dynamics were on relatively weak wicket. This time we believe the bank's relatively diversified loan portfolio and improved risk and recovery mechanism would keep NPA levels under check. The RBI's move to reduce interest rates and more liberal corporate restructuring norms would also aid the bank. We expect GNPA (standalone) bank to peak out at 4.2% and NNPA at 2.4% in FY11E.

Exhibit 6: SBI's asset quality has been weaker than industry



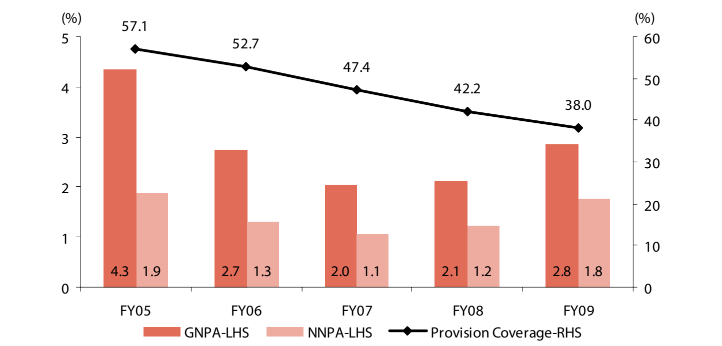
Source: RBI, Company, Centrum Research

Exhibit 7: SBI (standalone) asset quality to deteriorate further



Source: Company, Centrum Research Estimates

Exhibit 8: SBI group asset quality expected to deteriorate at lower pace

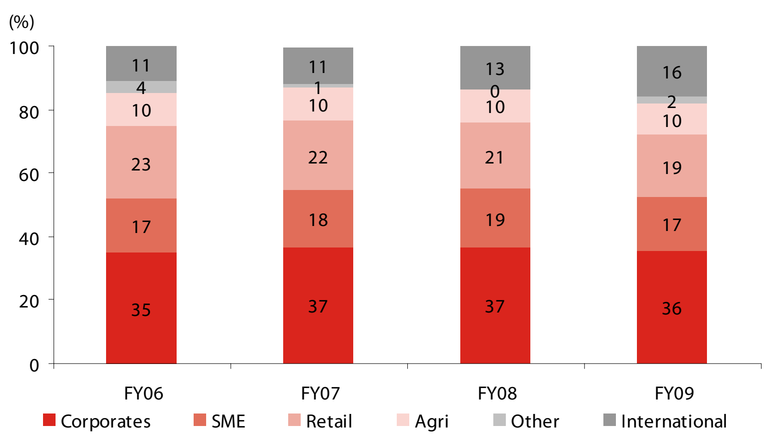


Source: Company, Centrum Research

Diversified loan portfolio should help keep NPAs under check

SBI has one of the most diversified loan-book with large corporates contributing about 36%, SMEs 17% and retail loans accounting for 19% of overall advances. We expect SME loans to witness higher deterioration going forward. However, NPAs arising from corporate loans would under control, with companies having relatively stronger corporate balance sheets this time around compared to the last down-cycle. The bank's pro-active restructuring of corporate and SME loans would also help contain NPAs.

Exhibit 9: SBI's loan composition

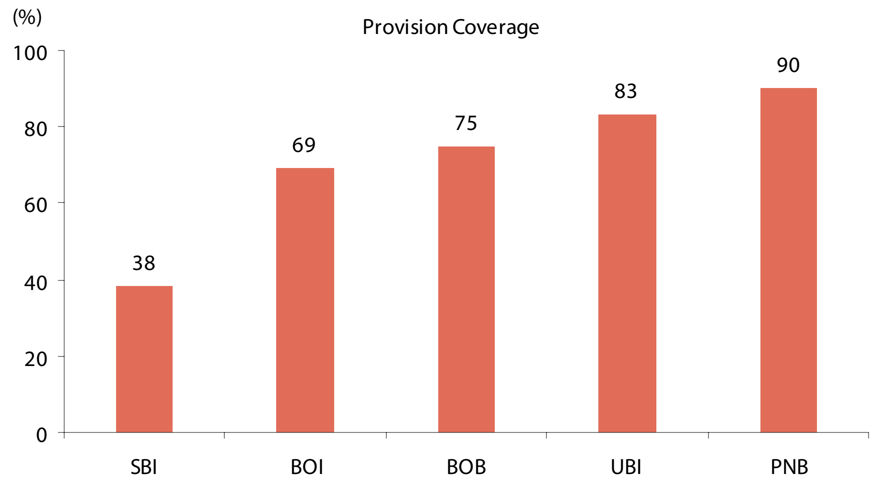


Source: Company, Centrum Research

Low provisioning remains a cause for concern

SBI's NPA coverage ratio at 38% in FY09 is relatively low compared to other PSU banks (except Canara Bank). However, including standard assets provision, the coverage ratio is about 60%. We are concerned that this lower provision would limit the shield against future slippages and result in higher provisioning going forward. We believe the bank would generate sufficient pre-provision profits to boost provisioning if required.

Exhibit 10: SBI's provision coverage is low



Source: RBI, Centrum Research

High Tier I capital comforting in stressed environment

SBI has one of the highest Tier 1 capital ratios amongst PSU banks (except PNB), providing enough leeway for growth and capacity to absorb credit shock if any. We believe that having higher Tier I capital in an environment when funds are scarce is an added advantage. According to our assumptions, for SBI's Tier I capital to fall to the minimum regulatory level of 6%, GNPA need to go up to 11.8% and provision coverage ratio increase to 48%.

Earnings growth, return ratios set to moderate

We estimate moderate 7% earnings CAGR over FY09-11E due to 10bp NIM, moderation in fee income and 30bp increase in credit costs. We also expect return ratios to moderate with RoE at about 15% and RoA at about 0.9% in FY11E.

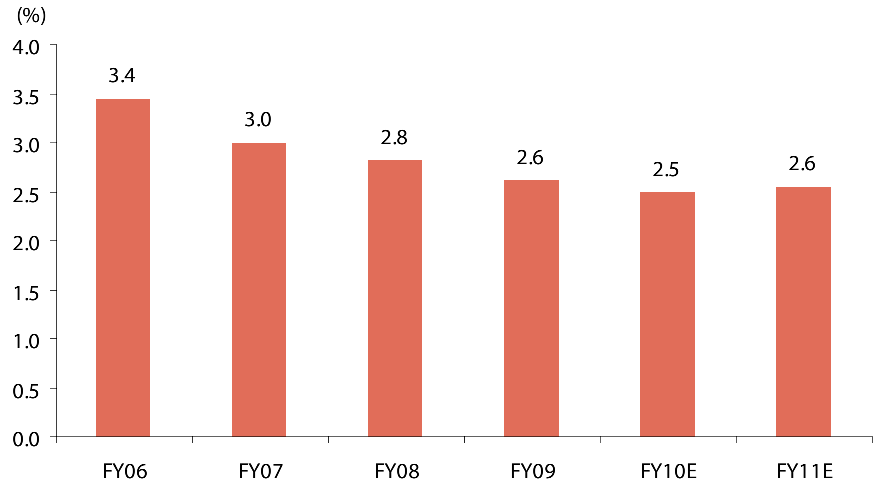
Exhibit 11: Return ratios to decline owing to pressure on earnings

Source: Company, Centrum Research Estimates

Margins likely to be under pressure

We expect NIMs to be under pressure as the bank deploys excess liquidity lying on the balance sheet into loans. We expect 10bp decline in NIMs in FY10 due to frequent the reduction in PLR without commensurate reduction in deposit rates, aggressive pricing strategy and changing portfolio mix towards low-yield earning assets. The improvement in CASA ratio would partly offset these pressures.

Exhibit 12: Margins to remain under pressure



Source: Centrum Research Estimates

Strong and relatively less volatile fee income, but growth to moderate

SBI has a relatively strong share of fee income flowing from conventional fee-based activities owing to its vast branch network, strong corporate and government business relationship. The bank's core fee income (commissions, exchange and brokerage registered 25% CAGR over FY06-09) contributing about 67% of non-interest income, which is one of the highest amongst PSU banks. The bank is expanding its product suite, which we believe would support its fee income. However, with subdued core banking business activity and third party distribution business, we expect moderate2% CAGR in core fee income.

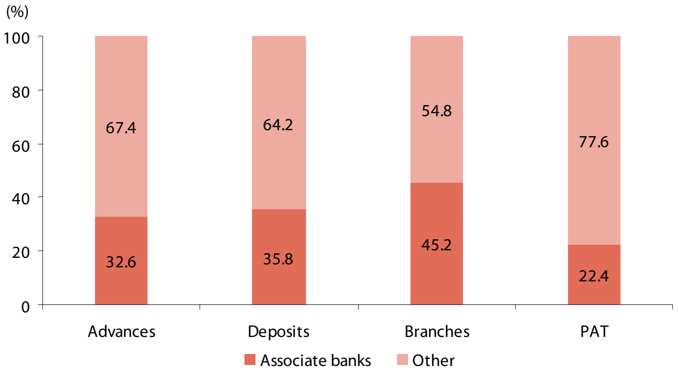
Banking and non-banking subsidiaries form significant portion of SOTP

Apart from its standalone banking business, we believe SBI's banking and non-banking subsidiaries provide immense value in terms of profitability and brand image. These subsidiaries collectively contributed about 29% to the group's PAT in FY09. Associate banks generate higher RoEs (in the range of 16-21%) than the standalone entity. SBI is a diversified conglomerate with interests in life insurance, asset management, factoring and insurance. We value SBI's banking and non-banking subsidiaries at Rs585 per share contributing 29% of overall valuations.

Associate banks have better operating metrics

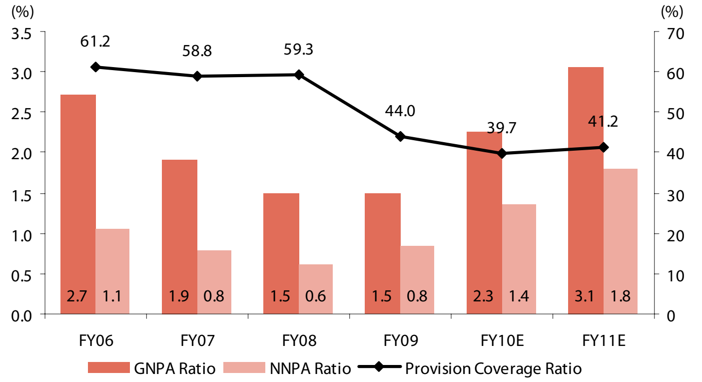
- Associate banks contribute about 29% of the group's banking business profitability and 22% to consolidated PAT
- Associate banks registered higher 30% credit CAGR FY04-08 vs. 27% for standalone bank
- Asset quality of associate banks is better with GNPA at 1.5% (vs. 3% standalone) and NNPA at 0.6% (vs. 1.8%)
- Except for State Bank of Hyderabad, State Bank of Indore and State Bank Patiala, other associate banks had CAR above 12% as of FY08
- Associate banks have a relatively higher RoE, except for State Bank of Saurashtra (already merged with SBI) and State Bank of Patiala

Exhibit 13: Share of associate banks (FY09)



Source: Company, Centrum Research

Exhibit 14: Asset quality of associate banks



Source: Company, Centrum Research Estimates

Valuation of associate banks

We value SBI's stake in associate banks at Rs361 per share, valuing at 1.6x P/Adj BV same as that of Standalone entity mainly on account of higher RoEs and profitability.

Exhibit 15: Associate banks – valuation

Associate Banks	EPS FY11E (Rs)	RoE (FY11E) (%)	Adj BV FY11E (Rsbn)	P/Adj BV multiple	Value (Rsbn)	SBI's stake (%)	Holding company/ Per share
State Bank of Hyderabad	463	18.6	4,182	1.6	6,691	100	105
State Bank of Patiala	23	15.6	3,515	1.6	5,624	100	89
State Bank of Travancore	133	21.2	2,265	1.6	3,624	75	43
State Bank of Bikaner	93	18.4	1,329	1.6	2,127	75	25
State Bank of Mysore	126	15.8	2,492	1.6	3,988	92	58
State Bank of Indore	189	16.6	1,733	1.6	2,772	98	43
Total value per share							**361**

Source: Centrum Research Estimates

SBI Life Insurance – a significant value contributor

SBI Life Insurance is the only private insurance company in India that has over 3-year record of profitability. The company's profitability is mainly attributed to its low expense ratio (15%) as it is able to leverage SBI's for distribution of its products. SBI Life clocked new premium YTD growth of 39% (ranked No. 5 among insurance players) due to the high growth in group insurance. We assign a 15x NBAP multiple mainly on account of lower operating expense ratios, premium growth inline with the industry and value it at Rs187 per share.

Exhibit 16: Valuation of SBI Life Insurance

Particular	FY11E
APE (Rsmn)	71,335
NBAP Margin (%)	15
NBAP (Rsmn)	10,700
NBAP Multiple (x)	15
SBI Life value (Rsmn)	160,504
SBI's stake (%)	74
Value of SBI's 74% stake	118,773
Number of shares (mn)	635
Value per share (Rs)	**187**

Source: Centrum Research Estimates

Valuation Analysis

Accumulate with price target of Rs1,958

SBI will continue to trade at a premium to the PSU banking sector mainly on account of market leadership. We recommend accumulate rating on the stock valuing the banking business at 1.6x P/Adj BV on FY11E adj BV, insurance business at 15x FY11E NBAP at NBAP margin of 17% and other non-banking subsidiaries and strategic investments at Rs. 63 to arrive at a target price of Rs1,958. We still believe Risk return is favourable with SBI due to its relatively stronger branch network, liability franchise, gaining market share inspite of higher asset risks.

Banking and non-banking subsidiaries

All its six banking subsidiaries are profitable with RoEs in the range of 16-21% and robust asset quality with net NPAs of about 1%. We value these banking subsidiaries at Rs361 per share based on 1.6x FY11E P/BV, contributing 18% of overall valuations. Among non-banking subsidiaries, SBI Life Insurance is the key value driver with Rs187 per share. We value other non-banking subsidiaries at Rs63 per share of SBI, contributing about 3% of overall valuations.

Exhibit 17: SOTP valuation

Particulars	% Stake	Value In (Rsmn)	Value per share	Comments
SBI - Standalone	100	870,296	1,372	1.6x FY11E Adj BV
Banking Subsidiaries	75-100	228,865	361	1.6x FY11E Adj BV
SBI Life	74		187	15x FY11E NBAP at NBAP Margin of 17%
Other Non Banking Subsidiaries & Non-strategic investments		40,052	63	
Holding Co discount			10%	
Non Bkg Subs Value after discount		242,025	225	
Value		1,112,321	1,958	
CMP			1,877	
Upside			4.3%	

Source: Company, Centrum Research Estimates

Risks

Upside risks

- A restructuring of loans, softening interest rate scenario and better-than- expected macro-economic environment could result in lower-than-expected NPAs. This could go a long way in allaying concerns over the bank's asset quality and result in a re-rating of the stock
- We believe that SBI will be a value bond play in the softening yield scenario given its higher share of SLR securities in AFS with relatively higher duration

Downside risks

- Government intervention has increased considerably during recent past (farm loan waiver and stimulus) which could impact the bank's earnings and outlook in the long-run
- Higher-than-expected deterioration in corporate asset quality
- Higher-than-expected wage increase and pension liability provision

Financials

Exhibit 18: Income Statement

Y/E Mar (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Interest Income	372,423	489,503	647,384	773,474	896,652
Interest Expense	221,841	319,291	438,653	527,398	608,224
Net Interest Income	**150,582**	**170,212**	**208,731**	**246,077**	**288,428**
YoY Growth (%)	*863.1*	*13.0*	*22.6*	*17.9*	*17.2*
Non Interest Income	**67,652**	**86,949**	**126,908**	**116,455**	**131,056**
YoY Growth (%)	*(8.4)*	*28.5*	*46.0*	*(8.2)*	*12.5*
Fee & OtLer Income	68,307	77,375	108,857	103,455	118,056
Gains / (Losses) on Securities	(655)	9,574	18,050	13,000	13,000
Total Net Income	**218,234**	**257,161**	**335,639**	**362,531**	**419,484**
Total Operating Expenses	**118,234**	**126,085**	**156,487**	**153,126**	**176,183**
YoY Growth (%)	*0.8*	*6.6*	*24.1*	*(2.1)*	*15.1*
Employee Expenses	79,326	77,859	97,473	88,211	101,531
Other Operating Expenses	38,909	48,227	59,014	64,915	74,653
Pre-provision Profit (Pre-excep)	**100,000**	**131,076**	**179,152**	**209,405**	**243,301**
Exceptionals					
Pre-provision Profit	**100,000**	**131,076**	**179,152**	**209,405**	**243,301**
Provisions	23,749	26,687	37,346	62,551	81,277
Profit Before Tax	**76,251**	**104,389**	**141,807**	**146,855**	**162,024**
Taxes	30,838	37,098	50,594	51,399	56,708
Net Profit	**45,414**	**67,292**	**91,213**	**95,455**	**105,315**
Exceptionals (Post Tax)	0	0	0	0	0
Adj Net Profit	**45,414**	**67,292**	**91,213**	**95,455**	**105,315**

Source: Company, Centrum Research Estimates

Exhibit 19: Balance Sheet

Y/E Mar (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Cash and balance with RBI	290,764	515,346	555,460	592,676	628,236
Inter-bank borrowings	228,923	159,317	488,580	425,992	392,378
Loans & Advances	3,373,365	4,167,682	5,425,030	6,347,285	7,553,269
Investments	1,491,488	1,895,012	2,759,540	3,168,267	3,482,351
Interest Earning Assets	**5,384,540**	**6,737,357**	**9,228,610**	**10,534,220**	**12,056,235**
Fixed Assets	28,189	33,735	38,380	42,218	46,440
Other Assets	252,923	444,170	377,330	415,063	456,569
Total Assets	**5,665,652**	**7,215,262**	**9,644,320**	**10,991,501**	**12,559,244**
Customer Deposits	4,355,211	5,374,039	7,420,730	8,519,846	9,809,441
o/w CASA	*2,111,345*	*2,523,628*	*2,838,434*	*3,407,938*	*4,218,059*
Borrowings	397,033	517,274	537,140	613,492	713,046
Interest Bearing Liabil.	**4,752,244**	**5,891,313**	**7,957,870**	**9,133,338**	**10,522,486**
Other Liab / Pref Capital	600,423	833,623	1,106,980	1,206,980	1,306,980
Equity Capital	5,263	6,315	6,350	6,350	6,350
Reserves	307,722	484,012	573,130	644,833	723,427
Total Liabilities	**5,665,652**	**7,215,262**	**9,644,330**	**10,991,501**	**12,559,244**

Source: Company, Centrum Research Estimates

Exhibit 20: Key Ratios

Y/E Mar	FY07	FY08	FY09	FY10E	FY11E
Balance SLeet Structure Ratios (%)					
Loans/Deposits	77.5	77.6	73.1	74.5	77.0
Investments / Deposits	34.2	35.3	37.2	37.2	35.5
CASA Ratio	48.5	47.0	38.3	40.0	43.0
Loan Growth	28.9	23.5	30.2	17.0	19.0
Deposit Growth	14.6	23.4	38.1	14.8	15.1
Operating Ratios (%)					
NIM	3.0	2.8	2.6	2.5	2.6
Non-interest income/Net income	31.0	33.8	37.8	32.1	31.2
Employee Costs as % of Total Op Costs	67.1	61.8	62.3	57.6	57.6
Cost/Income	54.2	49.0	46.6	42.2	42.0
Operating cost growtL	0.8	6.6	24.1	2.1	15.1
Total prov as % of avg. loans	0.8	0.7	0.8	1.1	1.1
Tax Rate (%)	40.4	35.5	35.7	35.0	35.0
Credit Quality Ratios (%)					
Gross NPA	2.8	3.0	2.8	3.6	4.2
Net NPA	1.4	1.8	1.8	2.1	2.4
Slippage	1.7	2.1	2.2	3.2	3.8
NPA Provisions / Avg loans	0.8	0.7	0.8	1.1	1.1
NPA coverage ratio	48.9	41.4	38.0	41.9	42.0
Capital Adequacy Ratios (%)					
Total CAR	12.3	12.5	14.3	14.0	14.4
Tier 1 CAR	8.0	8.5	9.4	9.2	9.0
Profitability Ratios (%)					
RoAE	15.4	16.8	17.1	15.5	15.3
RoAA	0.9	1.0	1.1	0.9	0.9
Valuations Ratios					
BVPS (Rs)	595	773	913	1,026	1,150
Price/BV (x)	1.6	2.0	1.4	1.7	1.5
Adjusted BVPS (Rs)	495	656	763	817	857
Price/Adj. BV (x)	2.0	2.3	1.7	2.1	2.0
EPS (Rs)	86	106	144	150	166
P/E (x)	10.7	15.5	9.1	11.3	10.2
Dividend Yield	1.5	1.3	2.2	1.9	2.1

Source: Company, Centrum Research Estimates

INDIA

Banking

ICICI Bank

Initiation **8 June 2009**

Sell

Target Price: Rs590

CMP: Rs723*

Downside: 18%

**as on 1 June 2009*

In adjustment mode…once again

- **Domestic business in adjustment mode:** We expect sluggish growth in ICICI Bank's business over FY10-11E as the bank tries to reduce its cost of funds replacing high-cost deposits. An improvement in loan growth would take at least 4 quarters, and that too would be contingent with the execution risk of expanding its retail liability franchise.

- **Retail liability expansion – a key execution risk:** We believe the bank would take quite sometime before it regains customer confidence, which would slowdown CASA growth. NIMs would be under pressure in H1FY10 until high-cost deposits raised during H2FY09 get re-priced in Q3FY10.

- **International operations to remain sluggish:** Loan growth in international book is expected to remain sluggish due to lack of demand by Indian corporates for international loans. The bank has scaled down its overseas operations as fund-raising and M&A activities have shrunk.

- **Triggers for RoE expansion missing:** ROE contracted 590bp to 7.7% over FY06-09 and is expected to remain flat at 7.9% during FY10E, before witnessing a marginal up-tick in FY11E to 8.4%. With incremental equity infusion into subsidiaries (international operations and insurance venture) not expected to generate higher returns, we do not see any near-term RoE expansion triggers.

- **No medium-term positive triggers; Sell:** We do not see any positive triggers for profitability in the near to medium-term. We believe the recent up-tick in performance and possible value unlocking of life insurance subsidiary has already been priced in. We initiate Sell with a target price of Rs589, valuing the bank at 0.9xFY11E Adj BV and life insurance business at 15x FY11E NBAP.

- **Key risks: Upside** - Risk perception fading off earlier-than-anticipated and the bank is able to mobilise retail deposits. **Downside** - A more-than-expected deterioration on asset quality.

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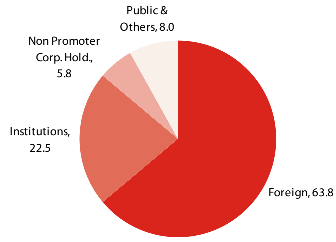
Key Data

Bloomberg Code	ICICIBC IN
Reuters Code	ICBK.BO
Current Shares O/S (mn)	1,113.0
Diluted Shares O/S(mn)	1,113.0
Mkt Cap (Rsbn/USDbn)	804.2/17.1
52 Wk H / L (Rs)	835/252
Daily Vol. (3M NSE Avg.)	18,877,370
Face Value (Rs)	10
1 USD = Rs46.9	

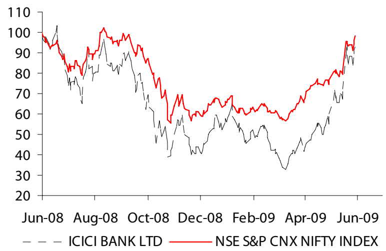
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
ICICI Bank	50.8	115.8	(5.0)
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	56,371	69,279	31,102	*22.4*	35	19.3	248	2.7	*13.2*	*1.1*
FY08	73,041	88,108	41,577	*33.7*	38	25.1	386	2.5	*11.0*	*1.1*
FY09	83,667	76,042	37,588	*(9.6)*	34	16.3	404	1.4	*7.7*	*1.0*
FY10E	83,850	80,502	40,893	*8.8*	37	19.3	433	1.6	*7.9*	*1.1*
FY11E	94,561	88,352	47,300	*15.7*	42	16.7	468	1.5	*8.4*	*1.1*

Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

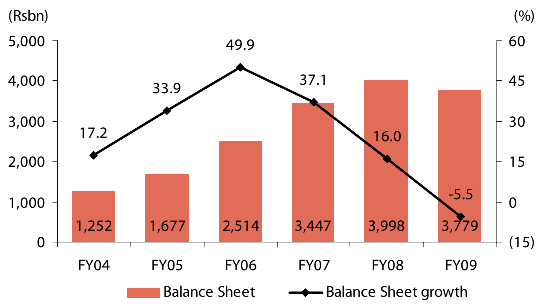
	Q408	Q109	Q209	Q309
Promoter	-	-	-	-
Foreign	40.7	39.4	37.1	38.2
Institutions	17.12	17.5	19.5	22.1
Public & Others	42.1	43	43.3	39.5
Total	**100**	**100**	**100**	**100**

Source: NSE

Company Background

ICICI Bank is India's largest private sector bank and was promoted by the erstwhile Industrial Credit Investment Corporation of India (ICICI) and the erstwhile Shipping Credit and Investment Corporation of India (SCICI). On 3 May 2002, ICICI merged with ICICI Bank. Till now, the bank has acquired Sangli Bank and Bank of Madura (unlisted private banks). It has a network of 1,416 branches and received approval from the RBI to set up another 580 branches. It has a wide international presence with branches in the UK, Russia and Canada, Singapore, Hong Kong, Sri Lanka, Belgium and the Middle East. ICICI Bank has diversified business interests including insurance, asset management, securities and debt market.

Balance sheet degrowth



Source: Company, Centrum Research

Key Events/ Timeline

1955	ICICI formed as a development financial institution (DFI) backed by the World Bank, Government of India and Indian industry representatives
June-88	ICICI Venture Funds Management was formed as a 100% Subsidiary of ICICI
June-93	ICICI Asset Management came into being with 50.9% ownership interest of ICICI
1994	ICICI Bank was incorporated as part of the ICICI group with initial equity capital of 75% contributed by ICICI and 25% by SCICI
1996	K V Kamath joined the ICICI Group
May-99	ICICI Home Finance formed as 100% subsidiary of ICICI Bank
Dec-00	ICICI Prudential Life Insurance started its operations after receiving approval from IRDA
Oct-01	Reverse Merger of ICICI with ICICI Bank with listing in India & on New York Stock Exchange
May-02	K V Kamath appointed as MD & CEO of the bank
Jan-04	ICICI Bank's subsidiaries in the UK and Canada commenced operations
Dec-05	Capital raised by the bank through public issue of size Rs50bn
Apr-06	Ms Kalpana Morparia elevated to Joint MD, Ms Chanda Kochhar and Dr Nachiket Mor to Deputy Managing Directors
Apr-07	Amalgamation of The Sangli Bank with the ICICI Bank
Jun-07	The bank announced the public issue of equity shares of Rs87.5bn and was priced at Rs940
May-09	Board appoints K. V. Kamath as Non-Executive Chairman & Chanda Kochhar as MD & CEO

Source: Company

Key management personnel

Name	Position	Profile
KV Kamath	Chairman	He started his career in 1971 at ICICI. 1988, he moved to the Asian Development Bank (ADB) before returning to ICICI as its CEO in 1996. He stepped down as MD and CEO and took over as non-executive chairman on 1 May 2009. Mr Kamath is the President of the CII and a member of the boards of the IIM, Ahmedabad, and the Manipal University. He was conferred with the *Padma Bhushan*, one of India's highest civilian honours, in 2008.
Ms. Chanda Kochhar	Managing Director & CEO	She is associated with the Bank since 1984 & the next CEO designate on 1 May 2009. Ms Kochhar was instrumental in setting up and scaling up the Retail business for ICICI Bank. In addition to finance, planning and communications; her responsibilities include the global treasury, principal investments & trading, risk management, legal functions, as also compliance and internal audit functions.
Mr. Sonjoy Chatterjee	Executive Director	Mr Chatterjee is a member of the EU Advisory Group of the City of London. He is responsible for Corporate & Investment Banking, Government Banking and International Banking business of the Bank. He has been the Managing Director & CEO of ICICI Bank UK Plc. He was also the Head of Strategic Support in the erstwhile ICICI.
V.Vaidyanathan	MD & CEO, ICICI Prudential Life Insurance	Mr Vaidyanathan has joined the ICICI Group in 2000 with 10 years of banking experience. He headed the Small and Medium enterprises (SME) banking and Rural Banking Business of ICICI Bank. He was also on the board of ICICI Lombard General Insurance, and was the chairman of ICICI Home Finance Co limited. He was earlier on the board of CIBIL, India's first credit bureau.

Source: Company

Investment Rationale

- ICICI Bank is expected to witness sluggish growth in business over FY10-11E as it tries to reduce its cost of funds by focusing more on low-cost domestic deposits and pares down retail loan book
- Scores low on liability franchise, asset quality, earnings quality and management reshuffle on CAMEL model
- Absence of near-term positive triggers for profitability a cause of concern

DuPont Analysis

	FY09	FY10E	FY11E
% of Average assets			
Net-Interest Income	2.2	2.2	2.2
Non-Interest Income	2.0	2.1	2.1
Net Income	**4.1**	**4.2**	**4.3**
Operating Expenses	(1.8)	(1.9)	(1.9)
Operating Profit	**2.3**	**2.4**	**2.4**
Provisions & Contingencies	(1.0)	(0.9)	(0.9)
Taxes	26.6	27.0	27.0
RoAA (%)	**1.0**	**1.1**	**1.1**
Avg.assets/avg equity (x)	7.9	7.5	7.6
RoAE (%)	**7.7**	**7.9**	**8.4**

Source: Centrum Research Estimates

Summary Financials (Standalone)

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Net Interest Income	**56,371**	**73,041**	**83,667**	**83,850**	**94,561**
Growth (%)	34.6	29.6	14.5	0.2	12.8
NIM (%)	2.2	2.2	2.3	2.3	2.4
Non Interest Income	**69,279**	**88,108**	**76,042**	**80,502**	**88,352**
Growth (%)	39.0	27.2	(13.7)	5.9	9.8
Pre-Prov Profits	**58,744**	**79,606**	**89,258**	**92,007**	**103,862**
Provisions & Contingencies	22,264	29,046	38,083	35,990	39,067
Provision for taxes	5,378	8,984	13,588	15,125	17,495
Adj PAT	**31,102**	**41,577**	**37,588**	**40,893**	**47,300**
Growth (%)	22.4	33.7	-9.6	8.8	15.7
Key Balance Sheet Data					
Networth	243,130	464,700	495,330	536,223	583,523
Deposits	2,305,100	2,444,310	2,183,480	2,292,654	2,567,772
Others	898,350	1,088,940	1,114,200	1,163,116	1,383,779
Total Liabilities & Equity	**3,446,580**	**3,997,950**	**3,793,010**	**3,991,993**	**4,535,074**
Loans	1,958,660	2,256,160	2,183,110	2,315,581	2,567,772
Investments	912,580	1,114,540	1,030,580	1,082,109	1,335,242
Fixed & Other assets	204,130	246,840	279,660	279,660	279,660
Total Assets	**3,446,580**	**3,997,950**	**3,793,010**	**3,991,993**	**4,535,074**
Key Ratios					
Capital Adequacy & Credit Quality Ratios (%)					
Gross NPA	2.4	3.5	4.2	4.9	5.0
Net NPA	1.0	1.5	2.0	2.4	2.5
Total CAR	11.7	14.9	15.5	15.5	14.4
Tier 1 CAR	7.4	11.3	11.8	11.9	11.3
Per share data					
Fully diluted EPS	35	38	34	37	42
Book Value per share	270	418	445	482	524
Adj Book value per share	248	386	404	433	468
Valuations Ratios					
Price/BV (x)	2.5	2.3	1.2	1.5	1.4
Price/Adj. BV (x)	2.7	2.5	1.4	1.6	1.5
P/E (x)	19.3	25.1	16.3	19.3	16.7
Dividend Yield	1.5	1.1	2.0	1.7	2.0
Return Ratios					
RoE	13.2	11.0	7.7	7.9	8.4
RoA	1.1	1.1	1.0	1.1	1.1

Source: Company, Centrum Research Estimates

Investment Argument

Domestic business in adjustment mode

We expect ICICI Bank's business to register sluggish growth over FY10-11E as the bank focuses more on reducing its cost of funds and pare down its retail loan-book. We believe any increase in loan growth would take on at least 4 quarters and that too would be contingent on the bank improving its retail liability franchise. However, this carries a great deal of execution risk. We expect pressure on NIMs would continue for the next couple of quarters with funding costs improving only post Oct 2009. This would be offset by the low yield on advances and change in loan mix.

Exhibit 1: ICICI Bank's 4C strategy - a critical evaluation

Strategy	Comments
Capital conservation	No triggers for RoE, makes us believe bank is still under adjustment mode
CASA improvement	Comes with an execution risk. Risk perception of the bank among customers would take at least one year to fade off. CASA ratio improved 260bp while absolute growth in CASA decreased 2% in FY09.
Cost control measures	Total operating expenses reduced 14% FY09. We expect expenses would marginally increase 3% in FY10E mainly on account of branch expansion
Credit monitoring	Loan book might have seasoned but still no escape from the macro economic deterioration

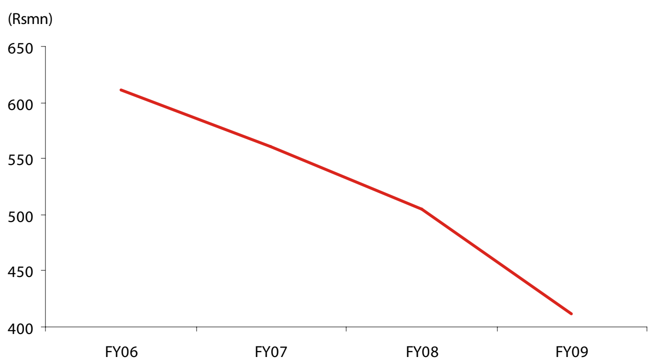
Source: Company, Centrum Research

Focus on liability franchise carries execution risk

The bank's current focus is to increase CASA levels and reduce its dependence on wholesale borrowings. The bank's aggressive branch expansion would reflect in improvement in CASA levels. However, this comes with execution risk. The bank faced a run on deposits in Oct 2008 over concerns that it was overexposed and we believe it would be quite sometime before the bank regains customers' confidence. This would make it tough for the bank to boost CASA levels by ramping up retail deposit base.

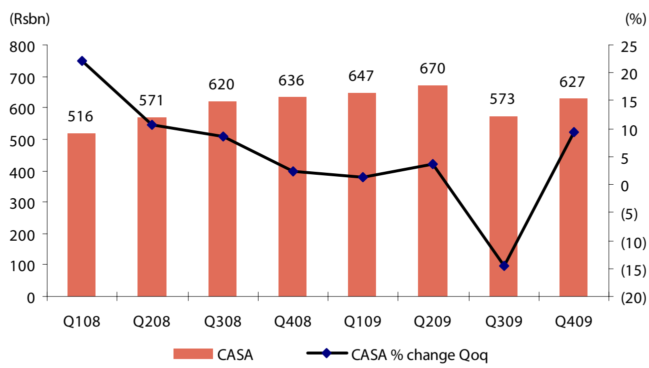
The bank plans to adding 500 new bank branches in FY10 and we expect CASA ratio to improve to 32% levels by FY11E from the current levels of 28.7%. Also, salaried employees account for a significant part of CASA deposits where growth is expected to remain sluggish.

Exhibit 2: CASA per branch has been falling



Source: Centrum Research

Exhibit 3: CASA growth always been sluggish



Source: Centrum Research

Loan growth to be sluggish

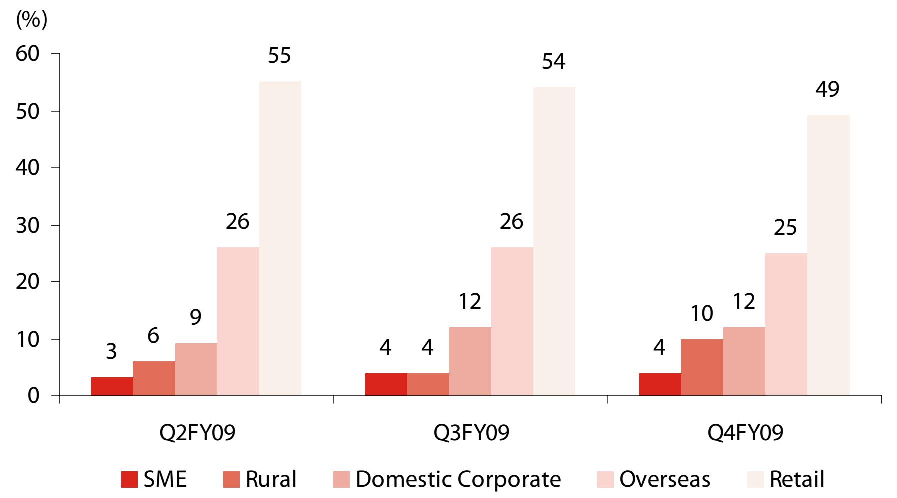
We expect only 8.4% CAGR in ICICI Bank's advances during FY10-11E. That is underpinned by our forecast of sluggish growth in international loan book (due to lower demand by Indian corporates for international loans). We also expect a slowdown in project financing as the bank would find it difficult to gain market share due to its higher cost of funding.

It is paring down its retail exposure as it intends to change loan mix towards corporates and SMEs. The bank is also expected to maintain its tight credit underwriting in this environment which will impede a significant acceleration in loan growth. We also expect the loan growth to be sluggish as the part of international book is on run off mode and management suggests balance sheet growth strategy to come in priority only when CASA reaches 33%.

Loan mix shifting towards domestic corporates, rural sector and SMEs

ICICI Bank's loan mix is expected to change with increased focus on domestic companies, SME and SMEs. The bank is scaling down its international operations in its subsidiary ICICI Eurasia and Sri Lanka and paring down its retail loan book, especially unsecured loans, with a shift to direct sourcing from third party sourcing model

Exhibit 4: Loan mix is changing

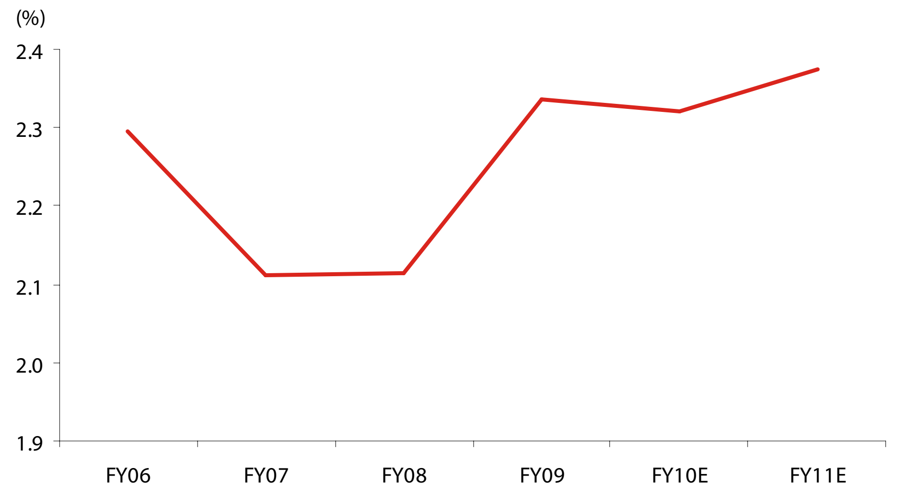


Source: Company, Centrum Research

Pressure on NIMs to continue

We expect NIMs to remain flat in FY10 due to high-cost deposits raised during Q2-Q3FY09 (which would be retired only during H1FY10 and falling yields on advances on account of changing loan mix. Also, cost of funds reduced by 50 bps during FY09 primarily due to decrease in cost of foreign currency borrowings as the benchmark rate (LIBOR) reduced and also on account of impact of rupee depreciation which we believe will not be available going forward.

Exhibit 5: NIMs to improve only after FY11E



Source: Company, Centrum Research Estimates

Fee-based income expected to be a drag

The slowdown in capital market-related revenues, including distribution of personal financial products, combined with sluggish balance sheet growth implies a decline in asset processing fees. We expect 5% growth in fee-based income in FY10E and a marginal up-tick in FY11E at 10%.

No significant room for cost rationalization

The bank's total operating costs have reduced 14% in FY09 mainly on account of significant reduction of the number of direct sales agents (DSAs) and shifting marketing of most products to the branches including a part of the SME business. The benefit of this reduction in DMA expenses would not be available in FY10. Further savings on account of cost rationalization would be offset by opening of 500 more branches.

10bp fall in provision charges

We expect a 10bp fall in credit costs in FY10 despite the rundown of unsecured personal loans due to an anticipated increase in losses from the other segments like domestic corporate as a result of the challenging macro environment.

International operations too remain sluggish

The growth in ICICI Bank's international book is also expected to remain sluggish due to lack of demand by Indian corporates for international loans. The bank is in fact scaling down its international Operations. Though the loan quality was stable in Q4FY09, the international investment book carries risks of further write-downs contingent on the CDS spread movements in the international markets.

The bank's UK subsidiary has reclassified certain investments from the 'held for trading' (HFT) category to the 'available for sale' (AFS) category and from AFS category to 'loans and receivables' category. If these reclassifications had not been made, pre-tax profit would have been lower by US$58.5mn and unrealised losses, as deducted from reserves (pre-tax), on AFS securities would have increased by US$10.5mn, which is 13% of the net-worth of UK subsidiary. Due to lack of clarity on the international investment book, we have not valued these investments.

Triggers for RoE expansion missing

ICICI Bank's net profit registered 17% CAGR over FY06-09, while RoE (standalone of core banking business) shrunk over 1,200bps to 7.6% during this period. Standalone RoE is expected to remain flat at 7.9% in FY10E. Taking into account the combined losses of the non-banking subsidiaries, especially insurance ventures which are expected to break-even only by FY13E, consolidated RoE is expected to hover around 8% for FY10E.

Also, the bank's incremental capital infusion into its UK and Canada subsidiaries, and insurance ventures (both life and non-life) have not resulted in higher RoEs. For instance, RoE of the Canadian subsidiary, adjusted for write-offs in Q4FY09, was ~5% in FY09. The bank is not growing its loan book in its ICICI Eurasia subsidiary mode and the UK subsidiary is focusing on reducing its wholesale deposits. Hence, we do not expect any significant RoE triggers.

Exhibit 6: Incremental capital spending (Rsmn)

Subsidiary	FY08	FY09	Incremental capex
UK	18,550	23,250	4,700
Canada	13,530	33,500	19,970
Eurasia	3,000	3,000	0
Life Business	27,820	35,900	8,080
Non-Life Business	7,170	10,960	3,790
AMC	610	610	0
Securities	870	870	0
Venture	50	50	0
Home	7,970	11,120	3,150
Primary Dealership	1,640	1,580	(60)
Total	**81,210**	**120,840**	**39,630**

Source: Company

Valuation Analysis

Recent improvement in performance already priced in

We value the standalone bank at 0.9x 2009 P/Adj BV using single stage Gordon growth model. As the banks cost of equity at 15% is higher than its RoE (where we do not see significant upside) hence we have value bank below book value. We have not valued UK subsidiary mainly on account of higher unrealised gains on investment book and risk of further asset write downs. Other subsidiaries are valued at Rs. 200 which and provided 10% holding company discount and arrive at a target price of Rs589 provides a downside of 19% and initiate with a Sell rating.

Exhibit 7: ICICI Bank – SOTP valuation

Particulars	Stake (%)	Value (Rsmn)	Rs. Per share	Valuation Methodology
ICICI bank		**433,617**	**390**	**0.9x Adj BV on single stage Gordon growth model**
ICICI Securities Limited	100%	8,117	7	10x FY11 Profits
ICICI Prudential Life Insurance Co. Ltd.	74%	186,107	167	15x FY11 NBAP
ICICI Lombard General Insurance Co. Ltd.	74%	6,433	6	
ICICI Prudential Asset Management Co. Ltd.	50%	11,749	11	4% of AUM
ICICI Bank UK PLC*	100%	0	0	Did not valued these business mainly on account of clarity on asset write-downs
ICICI Bank Canada	100%	23,426	21	Valued at 0.6x BV
Others (incl Home finance and Ventures, PD)		6,704	10	Ventures valued as 4% of AUM, PD and Home Finance at 10x FY10 PAT
Subsidiaries - Total		**242,536**	**222**	
Holding co discount (10%)		24,254	22	
Value of the BANK		651,899	590	

Source: Company, Centrum Research Estimates

Risks

Upside risks

- Risk perception fading off earlier-than-anticipated
- Improvement in global credit markets which would improve profitability of international subsidiaries
- Value unlocking of non-banking subsidiaries earlier than anticipated
- Sustained low G-Sec yields would be a positive surprise on the bond gains.

Downside risks

- Worse-than-expected impairments in asset quality
- Funding pressures to persist in domestic (with lower than anticipated CASA) and international markets (with wholesale funding markets to remain subdued)

Financials

Exhibit 8: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09A	FY10E	FY11E
Interest Income	219,956	307,883	310,926	305,419	335,152
Interest Expense	163,585	234,842	227,259	221,569	240,591
Net Interest Income	**56,371**	**73,041**	**83,667**	**83,850**	**94,561**
YoY Growth (%)	*35*	*30*	*15*	*0*	*13*
Non Interest Income	**66,630**	**88,108**	**76,042**	**80,502**	**88,352**
YoY Growth (%)					
Fee & Other Income	57,980	75,210	71,610	73,502	80,352
Gains / (Losses) on Securities	8,650	12,898	4,432	7,000	8,000
Total Net Income	**123,001**	**161,148**	**159,709**	**164,352**	**182,913**
Total Operating Expenses	**66,906**	**81,542**	**70,451**	**72,345**	**79,051**
YoY Growth (%)	*49*	*22*	*(14)*	*3*	*9*
Employee Expenses	16,168	20,789	19,717	20,703	22,773
Other Operating Expenses	50,738	60,753	50,734	51,643	56,278
PPP (Pre-excep)	**58,744**	**79,606**	**89,258**	**92,007**	**103,862**
Exceptionals					
Pre-provision Profit	**58,744**	**79,606**	**89,258**	**92,007**	**103,862**
Provisions	**22,264**	**29,046**	**38,083**	**35,990**	**39,067**
Profit Before Tax	**36,480**	**50,561**	**51,175**	**56,017**	**64,795**
Taxes	5,378	8,984	13,588	15,125	17,495
Net Profit	**31,102**	**41,577**	**37,588**	**40,893**	**47,300**
Exceptionals (Post Tax)	0	0	0	0	0
Adj Net Profit	**31,102**	**41,577**	**37,588**	**40,893**	**47,300**

Source: Company, Centrum Research Estimates

Exhibit 9: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09A	FY10E	FY11E
Cash & balance with RBI	371,210	380,410	299,660	314,643	352,400
Loans & Advances	1,958,660	2,256,160	2,183,110	2,315,581	2,567,772
Investments	912,580	1,114,540	1,030,580	1,082,109	1,335,242
Int Earning Assets	**3,242,450**	**3,751,110**	**3,513,350**	**3,712,333**	**4,255,414**
Fixed and other Assets	204,130	246,840	279,660	279,660	279,660
Total Assets	**3,446,580**	**3,997,950**	**3,793,010**	**3,991,993**	**4,535,074**
Customer Deposits	2,305,100	2,444,310	2,183,480	2,292,654	2,567,772
o/w CASA	*422,864*	*637,806*	*626,659*	*687,796*	*821,687*
Borrowings	512,560	656,489	720,549	769,465	990,128
o/w Subordinated debt	108,370	-	-	-	-
Int Bearing Liab	**2,817,660**	**3,100,799**	**2,904,029**	**3,062,119**	**3,557,900**
Other Liab / Pref Cap	385,790	432,451	393,651	393,651	393,651
Equity Capital	8,990	11,130	11,130	11,130	11,130
Reserves	234,140	453,570	484,200	525,093	572,393
Total Liabilities	**3,446,580**	**3,997,950**	**3,793,010**	**3,991,993**	**4,535,074**

Source: Company, Centrum Research Estimates

Exhibit 10: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Balance Sheet Structure Ratios (%)					
Loans/Deposits	85.0	92.3	100.0	101.0	100.0
Investments / Deposits	39.6	45.6	47.2	47.2	52.0
CASA Ratio	18.3	26.1	27.0	27.0	27.0
Loan Growth	34.0	15.2	(3.2)	3.3	15.7
Deposit Growth	39.6	6.0	(10.7)	5.0	12.0
Operating Ratios (%)					
NIM	2.1	2.1	2.3	2.3	2.4
Non-interest income/Net income	54.2	54.7	47.6	49.0	48.3
Employee Costs as % of Total Op Costs	24.2	25.5	28.0	28.6	28.8
Cost/Income	53.2	50.6	44.1	44.0	43.2
Operating cost growth	49.4	21.9	-13.6	2.7	9.3
Total prov as % of avg. loans	1.38	1.40	1.7	1.6	1.6
Tax Rate (%)	14.7	17.8	26.6	27.0	27.0
Credit Quality Ratios (%)					
Gross NPA	2.4	3.5	4.2	4.9	5.0
Net NPA	1.0	1.5	2.0	2.4	2.5
NPA Provisions / Avg loans	1.4	1.4	1.7	1.6	1.6
NPA coverage ratio	58.4	57.3	53.5	51.9	51.3
Capital Adequacy Ratios (%)					
Total CAR	11.7	14.9	15.5	15.5	14.4
Tier 1 CAR	7.4	11.3	11.8	11.9	11.3
Profitability Ratios (%)					
RoAE	13.2	11.0	7.7	7.9	8.4
RoAA	1.1	1.1	1.0	1.1	1.1
Valuations Ratios					
BVPS (Rs)	269.8	417.5	445.2	481.9	524.4
Price/BV (x)	2.5	2.3	1.2	1.5	1.4
Adjusted BVPS (Rs)	247.9	385.6	404.2	433.0	467.7
Price/Adj. BV (x)	2.7	2.5	1.4	1.6	1.5
EPS (Rs)	34.8	38.7	33.7	36.8	42.5
P/E (x)	19.3	25.1	16.3	19.3	16.7
Dividend Yield	1.5	1.1	2.0	1.7	2.0

Source: Company, Centrum Research Estimates

INDIA

Banking

CENTRUM

HDFC Bank

Initiation **8 June 2009**

Hold

Target Price: Rs1,374

CMP: Rs1,434*

Downside: 4%

as on 1 June 2009

Valuation premium justified

- **Strong liability franchise - the best among banks**: HDFC Bank's strong liability franchise will likely help arrest the significant slide in its sector-leading NIMs, especially at a time when the sector is faced with pressure owing to slower loan growth, falling interest rates and falling share of high yield assets.

- **CBoP merger expensive but a strategic fit:** HDFC Bank's merger with Centurion Bank of Punjab (CBoP) is a strategic fit. The latter's underutilized branches provide the former opportunity to improve CASA, drive business with ready access to huge customer base and provide additional impetus to fee income.

- **Asset quality to deteriorate but manageable:** We expect the bank's asset quality to deteriorate owing to higher exposure to retail loans and SME. However, we the bank should be able to effectively manage its FY11E GNPA and NNPA at 3.5% and 0.9%, respectively, aided by higher provisioning, lower exposure to high-risk assets.

- **Earnings growth and return ratios to remain below historical averages**: We expect RoE to remain at about 16-18% over FY09-11E, below historical average of 19% due to significant equity dilution (about 27.1%) post merger and moderation in earnings growth (24% CAGR v/s historical average of 30%). We also expect RoA to slip marginally to about 1.3% in FY09E, before improving to about 1.4% in FY11E.

- **Fairly priced; hold:** We expect HDFC Bank's valuation premium to the sector to continue, primarily due to its reasonably higher earnings visibility and better asset quality. We value HDFC Bank at P/adj BV of 3.1x on FY11E Adj. BV of Rs449 to arrive at our target price of Rs1,433.

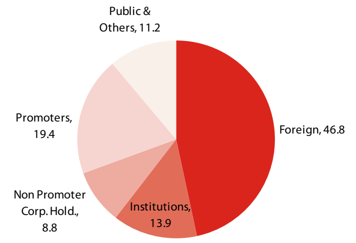
- **Key risks**: **Upside** – Higher-than-expected loan growth and CASA ratio. **Downside** – Higher-than-expected delinquencies.

Key Data

Bloomberg Code	HDFCB IN
Reuters Code	HDBK.BO
Current Shares O/S (mn)	425.5
Diluted Shares O/S(mn)	425.5
Mkt Cap (Rs bn/USD bn)	610/13
52 Wk H / L (Rs)	1,540/774
Daily Vol. (3M NSE Avg.)	16,46,998
Face Value (Rs)	10
1 USD = Rs46.9	

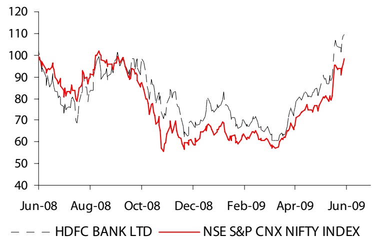
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
HDFC Bank	30.3	62.8	13.2
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
**as on 1 June 2009*

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Y/E Mar (Rsmn)	NII	YoY (%)	Net Income	YoY (%)	Adj PAT	YoY (%)	EPS (Rs)	Adj BV (Rs)	RoE (%)	RoA (%)	P/E (x)	P/BV (x)
FY07	34,685	36.2	49,847	35.8	11,415	31.1	35.7	195	19.5	1.4	25.0	4.6
FY08	52,279	50.7	75,110	50.7	15,902	39.3	44.9	316	17.7	1.4	29.4	4.2
FY09	74,212	42.0	107,118	42.6	22,450	41.2	52.8	330	16.1	1.3	20.3	3.3
FY10E	88,173	18.8	124,540	16.3	27,212	21.2	64.0	388	16.8	1.4	22.4	3.7
FY11E	105,918	20.1	147,751	18.6	34,460	26.6	81.0	450	18.2	1.4	17.7	3.2

Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

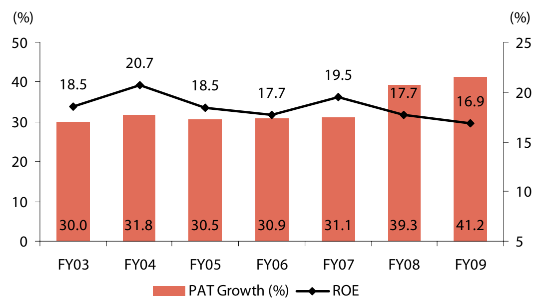
	Q408	Q109	Q209	Q309
Promoter	23.26	19.4	19.4	19.3
Foreign	1.7	3.9	3.1	2.3
Institutions	33.3	35.8	36.5	38.0
Public & Others	41.5	40.8	40.8	40.2
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: NSE

Company Background

HDFC Bank was incorporated in 1994 by the Housing Development Finance Corporation (HDFC) and is amongst the leading private sector banks in the country today. The bank has pursued both organic and inorganic growth strategies. It acquired Times Bank in Feb 2000 and Centurion Bank of Punjab (CBoP) in May 2008. As of 31 Dec 2008, the bank's balance sheet size was Rs1,832bn with the CASA mix for the merged entity at around 40% of total deposits. HDFC Bank's distribution network has got a boost with merger with CBoP with 1,412 branches and 3,177 ATMs in 527 cities. The bank's strengths include its brand equity, professional management, strong earnings growth, high CASA ratio and relatively better asset quality.

Consistent Profitability



Source: Centrum Research

Key events/timeline

1994	Incorporated by HDFC
1995	Public issue
2000	Acquisition of Times bank in a share swap deal
2008	Acquisition of Centurion Bank of Punjab in a share swap deal

Source: Company

Key management personnel

Name	Position	Profile
Mr. Jagdish Capoor	Chairman	He holds a Masters Degree in Commerce and is a Fellow of Indian Institute of Banking & Finance. Prior to joining HDFC Bank, he was Deputy Governor of Reserve Bank of India (RBI). While in the RBI, he was also the Chairman of Deposit Insurance & Credit Guarantee Corporation of India and Bharatiya Reserve Bank Note Mudran. He also served on the boards of EXIM Bank, NHB , NABARD and SBI.
Mr. Aditya Puri	Managing Director	He has been the managing director since Sept 1994. He has 35 years of banking experience in India and abroad. He holds a Bachelors Degree in Commerce from Punjab University and is an associate member of the ICAI.
Mr. Paresh Sukthankar	Executive Director	He was appointed on 12 Oct 2007 for a three-year term. He has been associated with the bank from 1994 in various senior capacities and has over 22 years of experience in finance and banking. Prior to joining the bank, he worked with Citibank for 9 years.
Mr. Harish Engineer	Executive Director, Wholesale Banking	He has been associated with the bank since 1994 in various capacities and is currently responsible for wholesale banking. Mr Engineer has over 38 years of experience in finance and banking and has prior experience working with Bank of America for 26 years in various areas, including operations and corporate credit management.

Source: Company

Investment Rationale

- HDFC Bank's liability-driven growth strategy has resulted in high CASA ratio, lower cost of funds and NIMs
- The HDFC Bank-CBoP merger is a strategic fit considering the latter's underutilized branches and ready access to huge customer base
- Earnings growth and return ratios to decline below historical averages in near-term
- HDFC Bank's valuation premium to the sector to narrow

Dupont analysis

Y/E March	FY09E	FY10E	FY11E
% of Average assets			
Net-Interest Income	4.3	4.4	4.4
Non-Interest Income	1.9	1.8	1.7
Net Income	6.3	6.2	6.2
Operating Expenses	(3.2)	(3.1)	(2.9)
Operating Profit	**3.0**	**3.1**	**3.2**
Provisions	(1.1)	(1.1)	(1.1)
Taxes	(0.6)	(0.6)	(0.6)
RoA (%)	**1.3**	**1.4**	**1.4**
Avg.assets/average equity (x)	12.3	12.3	12.7
RoE (%)	**16.1**	**16.8**	**18.2**

Source: Centrum Research Estimates

Summary Financials

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Net Interest Income	**34,685**	**52,279**	**74,212**	**88,173**	**105,918**
Growth (%)	*36.2*	*50.7*	*42.0*	*18.8*	*20.1*
NIM (%)	*4.4*	*4.9*	*4.5*	*4.6*	*4.6*
Non Interest Income	**15,162**	**22,832**	**32,906**	**36,367**	**41,833**
Growth (%)	*34.9*	*50.6*	*44.1*	*10.5*	*15.0*
Net Income	**49,847**	**75,110**	**107,118**	**124,540**	**147,751**
Growth (%)	*35.8*	*50.7*	*42.6*	*16.3*	*18.6*
Pre-Prov Profits	**25,639**	**37,654**	**51,790**	**62,286**	**77,168**
Provisions & Contingencies	9,248	14,843	18,797	22,848	27,227
Provision for taxes	4,977	6,909	10,543	12,226	15,482
Adj. PAT	**11,415**	**15,902**	**22,450**	**27,212**	**34,460**
Growth (%)	*31.1*	*39.3*	*41.2*	*21.2*	*26.6*
Key Balance Sheet Data					
Networth	64,332	114,972	150,527	173,911	205,181
Interest bearing liab	743,959	1,084,966	1,519,752	1,804,317	2,207,404
Other non-interest bearing liab	104,902	132,572	162,428	181,965	222,746
Total Liabilities & Equity	**913,193**	**1,332,510**	**1,832,708**	**2,160,193**	**2,635,331**
Cash and inter-bank balance	90,467	147,783	175,066	144,558	166,775
Loans	469,448	634,269	988,831	1,186,597	1,471,380
Investments	305,648	493,935	588,175	747,761	909,295
Fixed & Other assets	47,631	56,522	80,638	81,278	87,881
Total Assets	**913,193**	**1,332,510**	**1,832,710**	**2,160,193**	**2,635,331**
Key Ratios					
Capital Adequacy & Credit Quality Ratios (%)					
Gross NPA	1.4	1.3	2.0	2.7	3.4
Net NPA	0.4	0.5	0.6	0.7	0.9
Total CAR	13.1	13.6	15.7	15.4	14.9
Tier 1 CAR	8.6	10.3	10.6	10.5	10.4
Per share data					
EPS	35.7	44.9	52.8	64.0	81.0
BVPS	201.4	324.4	344.3	408.7	482.2
Adj BVPS	195.1	316.0	329.6	388.2	449.5
Valuations Ratios					
Price/BV (x)	4.4	4.1	3.1	3.5	3.0
Price/Adj. BV (x)	4.6	4.2	3.3	3.7	3.2
P/E (x)	25.0	29.4	20.3	22.4	17.7
Dividend Yield	0.8	0.6	0.8	0.4	0.5

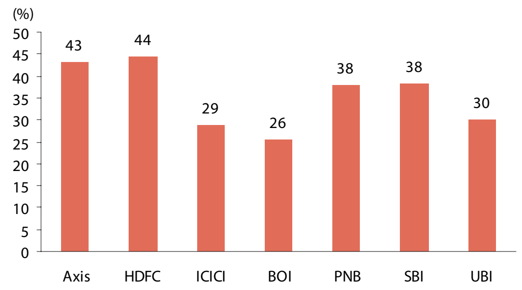
Source: Company, Centrum Research Estimates

Investment Argument

Strong and one of the best liability franchise - a key strength

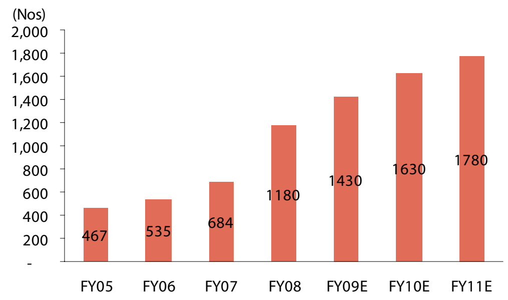
We believe that in current economic downturn coupled with falling interest rates and reducing share of high yield assets, banks such as HDFC Bank with a strong liability franchise and one of the highest CASA ratios would be able to arrest significant fall in NIMs and generate strong core income (19% CAGR NII growth over FY09-11E). HDFC Bank has traditionally pursued a liability-driven growth strategy resulting in a higher CASA ratio (over 50%), lower cost of funds and thus higher sustainable margins. However, with acquisition of CBOP CASA ratio has fallen to 45% levels, however the strategic motive behind acquiring CBoP was acquire its potential but underutilized CASA branch network and further strengthen its source of low cost funds apart from generating higher business.

Exhibit 1: One of the highest CASA ratio (FY09)



Source: Company, Centrum Research

Exhibit 2: Expanding branch network

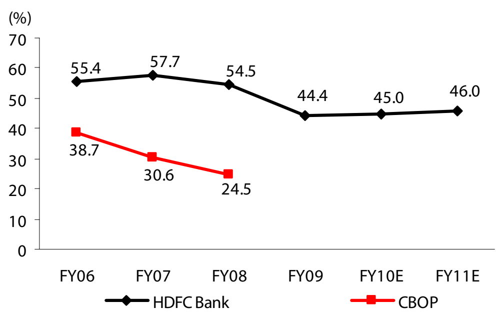


Source: Company, Centrum Research Estimates

CASA ratio to improve after initial hiccups …

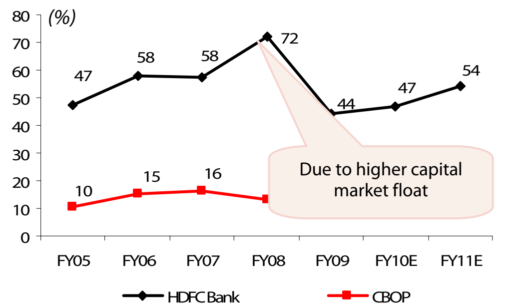
HDFC Bank traditionally had higher CASA ratio in excess of over 50% owing to its strong franchisee network and higher float generated from corporate, transactional banking (CMS/cash settlement) and capital market operations. However, off-late HDFC Bank has witnessed significant decline in its CASA ratio to 44% in FY09 due to industry-wide cannibilisation of savings (due to interest rate differential between savings and term deposits) and merger of under-utilised CBOP branches. However, with term deposit rates easing, integration of CBoP's branches and continued branch expansion, we expect CASA ratio to improve to 46% by FY11E.

Exhibit 3 CASA ratio to recover after FY09E



Source: Company, Centrum Research Estimates

Exhibit 4: CASA ratio per branch also set to improve

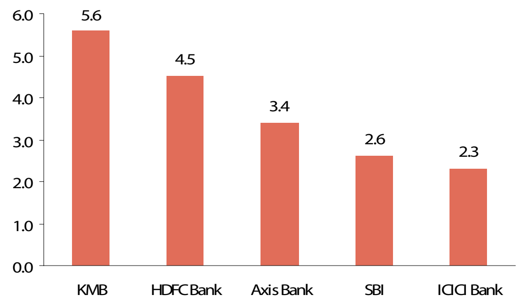


Source: Company, Centrum Research Estimates

…best in class NIMs to sustain during FY10-11E

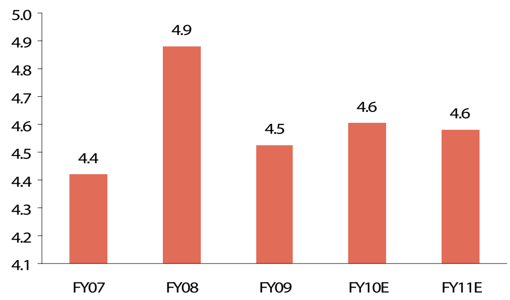
HDFC Bank commands one of the best NIMs in the banking industry (next only to Kotak Mahindra Bank), primarily on account of lower cost of funds (due to high CASA level) and better yields (higher retail exposure). However, with industry-wide NIMs under pressure due to slower loan growth, falling interest rates and reducing share of high yield assets, we believe HDFC bank will be able to sustain NIMs at about 4.5%-4.6% over FY09-11E.

Exhibit 5: HDFC Bank has one of the highest NIMs



Source: Company, Centrum Research

Exhibit 6: NIMs to improve after declining in FY09



Source: Company, Centrum Research Estimates

CBoP merger expensive, but value-accretive in long run

HDFC Bank acquired retail-focused CBoP at a relatively higher P/BV multiple of 4.1x (FY08) despite the latter's relatively weak fundamentals. The per branch acquisition worked to Rs177mn v/s cost per new branch of about Rs30-Rs100mn. Considering merger related adjustments of Rs7bn to net-worth for varying provisions and depreciation standards of the banks, the acquisition appears to be even more expensive.

However, we believe that merger made strategic sense, with both banks having adopted inorganic route to grow with well complementary retail asset book and one stroke addition of more than 400 branches (increasing its branch network by about 50%). Further, we believe HDFC Bank gained by acquiring fully operational branches (a new branch takes in an average 12-18 months to break even) apart from getting access to strong customer base of nearly 2.5mn customers. We expect the full benefits of the merger to reflect within next 12-24 months, leading to improved earnings and strong balance sheet.

Exhibit 7: Comparative merger matrix

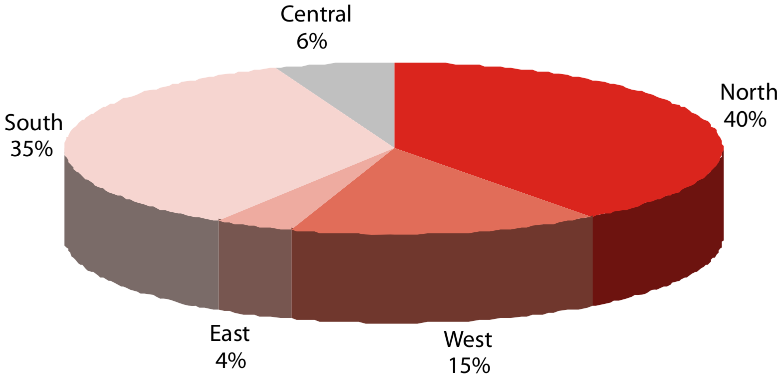
Parameters	FY08		Remarks
	HDFC Bank	CBOP	
Network			- Addition of about 55% to HDFC Banks branch network - Higher regional penetration in North (Punjab and NCR) and South(Kerala) - Higher penetration in metro and Tier I/II cities - CBOP had higher DSA network, which is essential for small ticket loans (especially TW) but is also costlier - Enhanced customer base to provide enormous cross selling opportunity
Branch	761	419	
ATM's	1977	452	
Cities	327	180	
Customers (mn)	10	2.5	
Debit Cards	5	1.1	
Credit Cards	3.5	0.2	
CASA			- HDFC Bank had better CASA profile with higher share of current deposits as compared to CBOP, which carry no interest - CASA per branch for CBOP (Rs134mn) was lower than HDFC Bank (Rs722mn). However, CBOP already has presence in CASA rich states especially Punjab and Kerala (NRI), which will provide opportunity to charge CASA deposits and thus improvement in NIM's
CASA ratio	54%	25%	
CASA per branch (Dec 07)	67	13	
Income and profitability			- CBOP had lower margins than HDFC Bank due to higher cost of funds, however, still better as compared to industry.CBOP's had higher cost-income ratio vis-à-vis HDFC Bank, which will increase over cost-income ratio of the merged bank and thus pressure on profitability. The acquisition led to about 19.7% equity dilution and thus relatively lower RoE.
NIM	4.9%	3.3%	
Cost of deposits	5.2%	7.9%	
Cost-income ratio	49.9%	73.5%	
RoE	17.7%	6.9%	
RoA	1.4%	0.5%	
Asset quality			- CBOP had poor asset quality and lower provision coverage - CBOP had higher exposure to TW, CV and SME loans, which are more susceptible to delinquency.
Gross NPA	1.3%	3.7%	
Net NPA	0.5%	1.6%	
Provision Coverage	67.1%	56.8%	
Balance Sheet			- Merger made stragic sense for both the banks due to well complimentary higher share of retail book and supplement HDFC' banks asset base by 21% and loan book by 26%
Assets (Rsbn)	1333	269	
Loans (Rsbn)	634	162	
- Retail	62%	60%	

Source: Company, Centrum Research

CBoP's underutilized branches opportunity to/will boost CASA in long run

CBoP had regional-focus branch profile, mainly in northern and southern India, with higher concentration of its branches in the CASA and NRI-rich states of Kerala and Punjab. Despite, its better branch profile, CBoP's branches remain under-utilised with CASA per branch at Rs129mn against Rs722mn for HDFC Bank. We believe HDFC Bank with its strong brand image, liability-focused strategy and a wider product offering is well placed to tap this opportunity and improve overall CBoP's CASA level.

Exhibit 8: Erstwhile CBoP's presence in CASA-rich states



Source: Company, Centrum Research

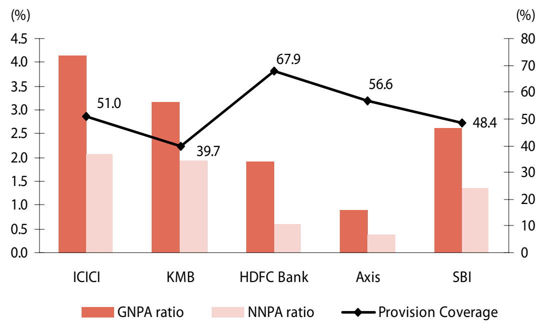
Merger to provide impetus to fee income in long run

HDFC Bank has strong and relatively less volatile non-interest income with non-trading income contributing about 80% of other income. The bank has a strong fee-based product portfolio for both retail and corporate clients, which has been further enriched due to acquisition of CBoP (the latter had a strong presence in fee-based third party product distribution business, remittances, forex and derivative business and strong customer base). Hence, apart from strengthening its fee-based portfolio and cross-selling, HDFC Bank will be able to further charge-up its network dependent fee- based CMS and other services, generating higher fee income in long run. We expect bank's non-interest income to register 13% CAGR over FY09-11E to Rs42bn.

Asset quality likely to deteriorate, but still manageable

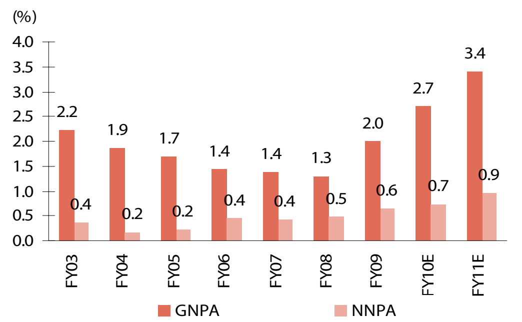
Historically, HDFC Bank has maintained robust asset quality despite high retail exposure primarily due to prudent lending practices and conservative provisioning policies. However, considering stressful economic environment, high share of retail book (about 20% are unsecured loans), concerns over CBoP's asset quality (two-wheelers and personal loans), and substantial capital market exposure, we believe asset quality is likely to deteriorate. However, taking comfort from banks proven track record to manage its asset quality aided by higher provisioning, reducing exposure to high risk assets and falling interest rates, we expect bank to effectively manage its GNPA's and NNPA's at about 3% and 0.9% through FY11E.

Exhibit 9: Better asset quality and provision coverage (Q4FY09)



Source: Company, Centrum Research

Exhibit 10: Asset quality to deteriorate but still manageable



Source: Company, Centrum Research Estimates

Moderate loan growth, reduction in CBoP's high-risk loan book should help…

CBoP's retail book composition is more risky than HDFC Bank's considering the higher exposure it has to two-wheeler and personal loans. Since the acquisition, the macro-economic scenario has undergone a significant change with slowdown leading to increased delinquencies. In a move to check delinquencies, HDFC Bank has consciously moderated loan growth and is also allowing CBoP's high-risk loan book to run off (particularly 2 wheelers, personal loans, CV loans and loans against shares). We expect overall loan growth to moderate to about 21% CAGR over FY09-11E from a high of +30% levels in earlier years.

Exhibit 11: Composition of loan book

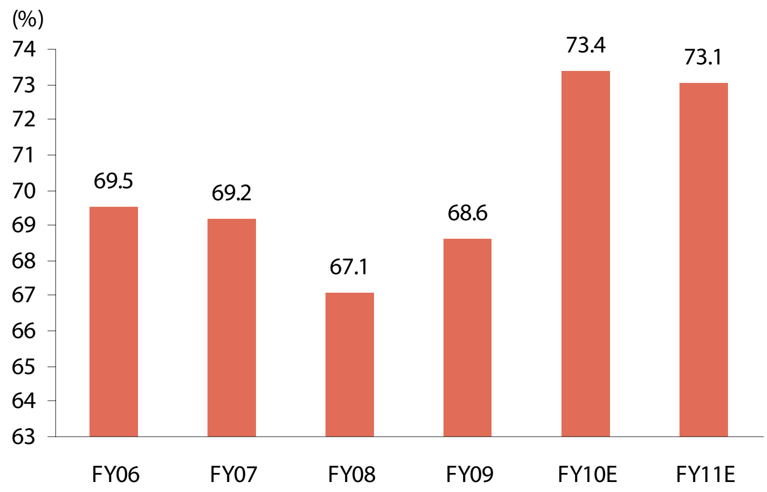
Loan Composition (% Share)	HDFC Bank			CBOP	HDFC Bank + CBOP	
HDFC Bank	**FY06**	**FY07**	**FY08**	**Q3FY08**	**Q1FY09**	**Q3FY09**
Wholesale	**39.0**	**39.0**	**38.0**	**40.2**	**43.0**	**40.0**
Retail + BB	**61.0**	**61.0**	**62.0**	**59.8**	**57.0**	**60.0**
% of retail loans						
Vehicle Loans	54.5	48.8	43.0	32.0	39.6	42.8
Personal Loans	15.5	15.8	17.0	21.0	15.3	14.9
Credit Cards	6.1	7.0	8.1	0.0	6.4	6.9
LAS	8.5	4.6	3.5	6.0	2.0	1.2
Mortgages	0.0	0.0	0.0	32.0	NA	NA
Agriculture	0.0	0.0	0.0	7.0	NA	NA
Business banking	11.3	18.2	21.8	0.0	24.9	22.7
Other	4.2	5.6	6.6	2.0	11.8	11.6

Source: Company, Centrum Research

… while higher provisioning should keep net NPAs under check

HDFC Bank has traditionally maintained a NPA coverage ratio ~68% driven by consistently higher operating profitability (higher operating income/average assets at about 3%). Despite the expected moderation in business, we estimate it would register 24% CAGR in operating profit over FY09-11E, providing it enough leeway to gear up NPA provisioning and thus higher specific NPA coverage in the range of about 65-75% keeping its net NPA below 1% over FY09-11E.

Exhibit 12: Higher provisioning cushion against higher NPAs

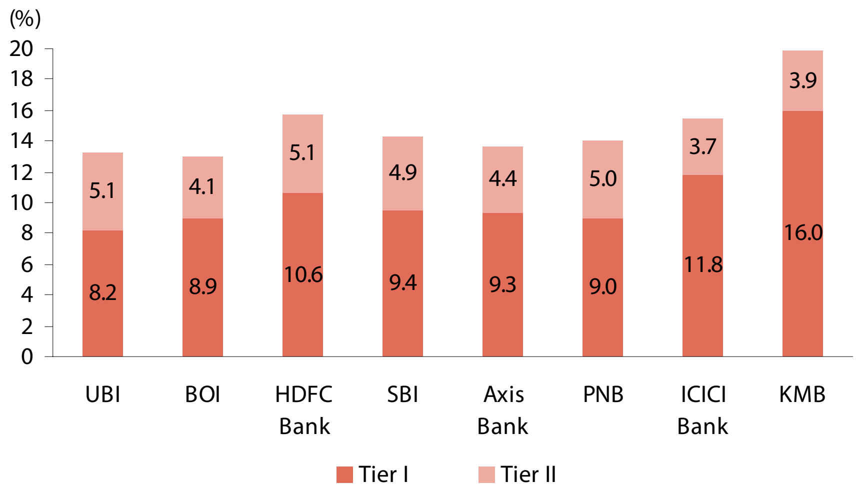


Source: Company, Centrum Research Estimates

High tier 1 ratio comforting

The bank has relatively high tier 1 capital adequacy ratio, which we believe is comforting in current stressed environment. HDFC Bank can absorb GNPAs up to 10% with provision coverage ratio of 68% keeping its tier-I ratio at minimum regulatory requirement of 6%.

Exhibit 13: Comfortable Tier 1 ratio (FY09)



Source: Company, Centrum Research

HDFC warrant conversion could be a positive surprise

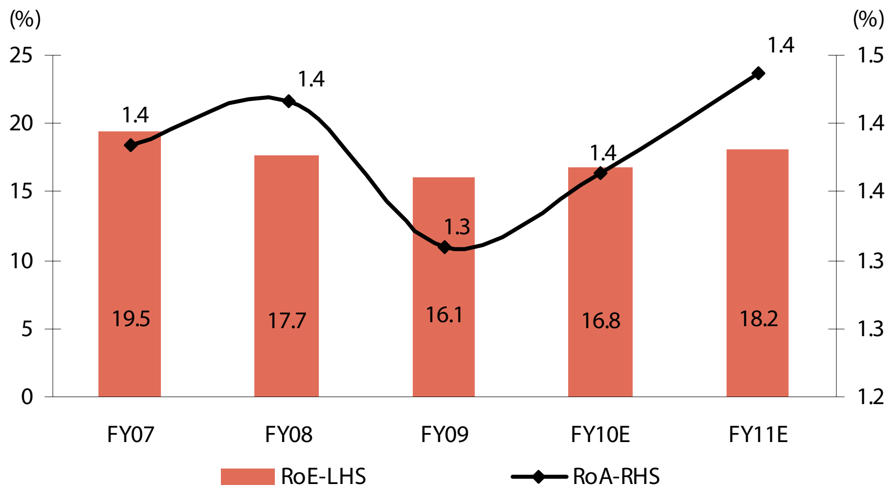
HDFC holds 26.2mn warrants with an exercise price of Rs1,530 valid until 31 Dec 2009. The conversion, we believe, would be contingent on capital market conditions. In case of non-conversion, HDFC would continue to hold a low 9% stake 's stake in the bank and HDFC Bank will forfeit 10% deposit amounting to Rs4bn. Another option is to issue fresh warrants (however there is a proposal to increase upfront deposit to 25% from 10%, making warrants less attractive) at a relatively lower price, which will save significantly for HDFC and also increase its share in the bank. However, in our projections, we have assumed that HDFC will allow the warrants to expire and HDFC Bank would forfeit the initial deposit amount. In case of conversion, HDFC Bank would witness a 230 bps hike in Tier 1.

Earnings growth and return ratios to remain below historic averages

We expect bank to register 24% PAT CAGR over FY09-11E (vs. the historical average of over 30%) which we believe indicate a reasonably earnings growth at a time when most banks are likely to witness significant stress. We expect a moderation in earnings primarily due to the bank's conscious decision to slow down the pace of loan growth resulting in relatively moderate core earnings, fee income and higher provisioning. We expect earnings growth to moderate from 41% YoY in FY09 (31% YoY on merged basis) to 24% YoY in FY10E, before picking up in FY11E to 35% as the merger synergies start playing its full effect.

We expect RoE at about 16-18% over FY0-11E, below the historical average of about 19%, primarily impacted due to significant equity dilution (about 20%) post merger and moderation in earnings growth. We expect RoA to slip marginally to about 1.3% in FY09E. It would however improve to about 1.4% in FY11E, as the fee income growth picks up leading to better RoA.

Exhibit 14: Return ratios unlikely to below historical averages



Source: Company, Centrum Research Estimates

Resilient investment book

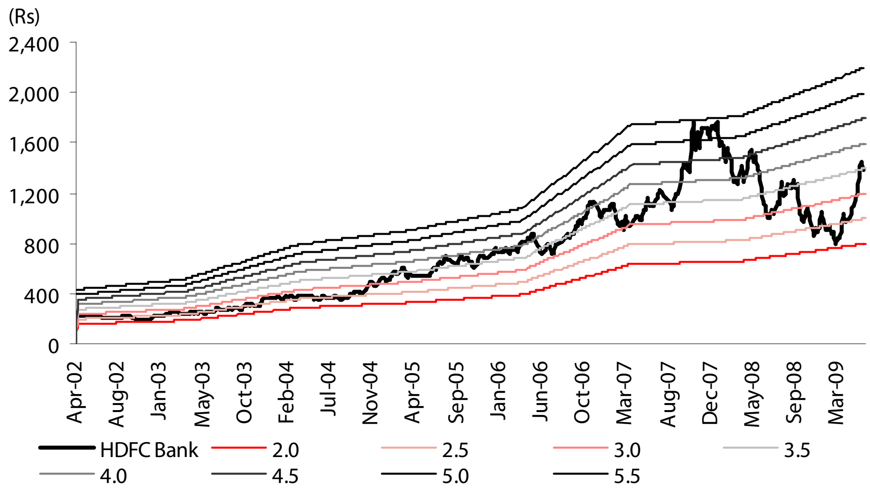
HDFC Bank does not have any international investment book of note and hence remains relatively better insulated to global turbulence compared to peers. Further, it has lower proportion of book in to AFS category (about 19%), which in a way insulates bank from any significant adverse moment in G-Sec yields. But this also restricts to some extent significant trading gains in case of declining yields scenario.

Valuation Analysis

Not cheap, but valuation premium justified, Hold with price target of Rs1,433

The bank will likely continue to trade at a premium to the sector due to its reasonably higher earnings visibility (CAGR above 24%) over FY09-11E, when earnings growth of most banks are likely to be stressed during this period. HDFC Bank has the ability to manage any significant deterioration in asset quality, given its higher provisioning. We recommend hold rating on the stock and assign a P/adj BV of 3.1x on FY11E adj. BV of Rs449 to arrive at our target price of Rs1,433 based on our 2-stage Gordon growth model.

Exhibit 15: One-year forward P/Adj BV



Source: Company, Centrum Research

Risks

Key upside risks

- Higher-than-expected loan growth and higher CASA ratio

Key downside risks

- Higher unsecured loan book resulting in higher delinquencies

Financials

Exhibit 16: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Earned	66,479	101,150	163,323	188,275	219,842
Interest Expended	31,795	48,871	89,111	100,102	113,924
Net Interest Income	**34,685**	**52,279**	**74,212**	**88,173**	**105,918**
Growth (%)	*36.2*	*50.7*	*42.0*	*18.8*	*20.1*
Non Interest Income	**15,162**	**22,832**	**32,906**	**36,367**	**41,833**
Growth (%)	*34.9*	*50.6*	*44.1*	*10.5*	*15.0*
Fee, forex and other income	15,906	21,191	29,081	33,117	38,083
Profit on sale of investments	(744)	1,640	3,825	3,250	3,750
Net Income	**49,847**	**75,110**	**107,118**	**124,540**	**147,751**
Growth (%)	*35.8*	*50.7*	*42.6*	*16.3*	*18.6*
Operating Expenses	**24,208**	**37,456**	**55,328**	**62,254**	**70,582**
Growth (%)	*43.1*	*54.7*	*47.7*	*12.5*	*13.4*
Employee expenses	7,769	13,014	22,382	25,794	29,459
Other expenses	16,439	24,443	32,946	36,460	41,123
Pre-Prov Profits	**25,639**	**37,654**	**51,790**	**62,286**	**77,168**
Provisions & Contingencies	**9,248**	**14,843**	**18,797**	**22,848**	**27,227**
Loan loss provisions	6,912	10,264	16,063	19,539	25,630
Other provisions	2,336	4,580	2,734	3,309	1,596
PBT	**16,392**	**22,811**	**32,993**	**39,438**	**49,942**
Provision for taxes	4,977	6,909	10,543	12,226	15,482
Effective tax rate (%)	*30.4*	*30.3*	*32.0*	*31.0*	*31.0*
PAT	**11,415**	**15,902**	**22,450**	**27,212**	**34,460**
Growth (%)	*31.1*	*39.3*	*41.2*	*21.2*	*26.6*

Source: Company, Centrum Research Estimates

Exhibit 17: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Cash & balance with RBI	50,753	125,532	135,272	113,967	124,968
Bal with banks & money at call	39,714	22,252	39,794	30,590	41,807
Loans	469,448	634,269	988,831	1,186,597	1,471,380
Investments	305,648	493,935	588,175	747,761	909,295
Total int. earning assets	**865,562**	**1,275,988**	**1,752,072**	**2,078,916**	**2,547,450**
Fixed Assets	9,667	11,751	17,070	18,181	18,771
Other Assets	37,964	44,771	63,568	63,097	69,110
Total Assets	**913,193**	**1,332,510**	**1,832,710**	**2,160,193**	**2,635,331**
Deposits	682,979	1,007,686	1,428,116	1,699,458	2,090,333
Other Int. bearing liabil.	60,980	77,280	91,636	104,859	117,071
Total int. bearing liab	**743,959**	**1,084,966**	**1,519,752**	**1,804,317**	**2,207,404**
Other non-int. bearing liab	104,902	132,572	162,428	181,965	222,746
Total Liabilities	**848,861**	**1,217,538**	**1,682,180**	**1,986,282**	**2,430,150**
Equity	64,332	114,972	150,527	173,911	205,181
Total Liabil. & Equity	**913,193**	**1,332,510**	**1,832,708**	**2,160,193**	**2,635,331**

Source: Company, Centrum Research Estimates

Exhibit 18: Key Ratios

	Standalone		Merged		
Y/E March	**FY07**	**FY08**	**FY09**	**FY10E**	**FY11E**
Balance Sheet Structure Ratios (%)					
Loans/Deposits	68.7	62.9	69.2	69.8	70.4
CASA Ratio	57.7	54.5	44.4	45.0	46.0
Loan Growth	33.9	35.1	24.2	20.0	24.0
Deposit Growth	22.4	47.5	16.5	19.0	23.0
Operating Ratios (%)					
NIM	4.4	4.9	4.5	4.6	4.6
Non-int inc/Net income	30.4	30.4	30.7	29.2	28.3
Employee Costs as % of Total Op Costs	32.1	34.7	40.5	41.4	41.7
Cost/Income	48.6	49.9	51.7	50.0	47.8
Operating cost growth	43.1	54.7	47.7	12.5	13.4
Total provi as % of avg. loans	1.7	1.9	1.8	1.8	1.9
Credit Quality Ratios (%)					
Gross NPA	1.4	1.3	2.0	2.7	3.4
Net NPA	0.4	0.5	0.6	0.7	0.9
Slippage	1.7	1.9	1.8	2.2	2.3
NPL coverage ratio	69.2	67.1	68.1	73.4	73.1
Capital Adequacy Ratios (%)					
Total CAR	13.1	13.6	15.7	15.4	14.9
Tier 1 CAR	8.6	10.3	10.6	10.5	10.4
Profitability Ratios (%)					
RoAE	19.5	17.7	16.1	16.8	18.2
RoAA	1.4	1.4	1.3	1.4	1.4
Valuations Ratios					
BVPS (Rs)	201.4	324.4	344.3	408.7	482.2
Price/BV (x)	4.4	4.1	3.1	3.5	3.0
Adjusted BVPS (Rs)	195.1	316.0	329.6	388.2	449.5
Price/Adj. BV (x)	4.6	4.2	3.3	3.7	3.2
EPS (Rs)	35.7	44.9	52.8	64.0	81.0
P/E (x)	25.0	29.4	20.3	22.4	17.7
Dividend Yield	0.8	0.6	0.8	0.4	0.5

Source: Company, Centrum Research Estimates

INDIA

Banking

Axis Bank

Initiation **8 June 2009**

Accumulate

Target Price: Rs804

CMP: Rs742*

Upside: 8%

**as on 1 June 2009*

Quality growth to moderate

- **High quality growth to slow down:** We expect Axis Bank's liability-driven high quality growth to moderate and translate in 17% PAT CAGR over FY09-11E. The bank reported 40% earnings CAGR during FY04-08 led by 58% loan CAGR and ~ 50% CASA levels over the same period.

- **Robust and diversified fee-based income streams:** We expect growth in fee income to slowdown to 25% and 20% during FY10 and FY11E, respectively, after the robust 64% CAGR during FY04-08. About 74% of fee income is non-capital market-related, which strengthens confidence about growth, going forward.

- **Asset quality to deteriorate further:** We expect GNPAs to spike 3.4x due to bank's unseasoned loan book. GNPA likely to head up to 2.9% in FY11E.

- **Scores moderately on CAMEL rating:** The bank scored 3.6 on our CAMEL model, the second highest among private banks. The moderate score is due to near-term headwinds in terms of asset quality due to loan mix and unseasoned loan book.

- **Fairly valued, Accumulate:** We recommend an Accumulate with a target price of Rs804 an upside of 8% valuing the bank at 2.4x FY11E P/Adj BV of Rs. 340 under two stage Gordon Growth model. We are positive mainly on account of consistent quality growth in the last 5 years (Balance sheet CAGR of 45%, earnings CAGR of 51% during 2004-09), led by liability driven growth strategy and relatively better funding franchise (CASA second best in private banking space next to HDFC Bank) and diversified loan book.

- **Key risks: Upside:** Faster-than-expected loan growth, lower NPAs and sharp decline in bond yields. **Downside:** Uncertainty on change in management and its consequent impact on strategy plus the lack of clarity on the SUUTI stake sale.

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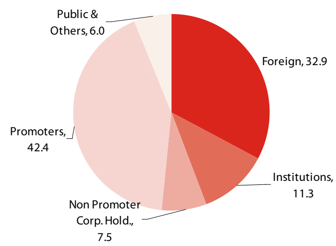
Key Data

Bloomberg Code	AXSB IN
Reuters Code	AXBK.BO
Current Shares O/S (mn)	359.4
Diluted Shares O/S(mn)	359.4
Mkt Cap (Rsbn/USDbn)	266.6/5.7
52 Wk H / L (Rs)	849/278
Daily Vol. (3M NSE Avg.)	5,287,090
Face Value (Rs)	10
1 USD = Rs46.9	

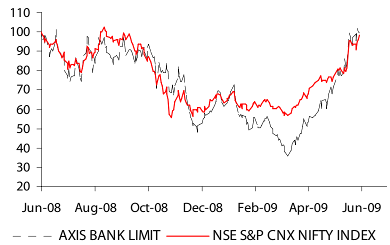
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Axis Bank	33.1	71.0	(2.1)
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	14,685	10,099	6,543	*34.9*	23	16	110.9	3.3	*20.9*	*1.05*
FY08	25,852	17,959	10,592	*61.9*	31	23	237.7	3.1	*16.3*	*1.16*
FY09E	36,860	28,948	18,133	*71.2*	50	13	275.4	2.3	*19.8*	*1.39*
FY10E	49,936	33,654	20,169	*11.2*	56	13	307.0	2.4	*18.4*	*1.25*
FY11E	63,391	37,566	23,682	*17.4*	66	11	340.5	2.2	*18.8*	*1.24*

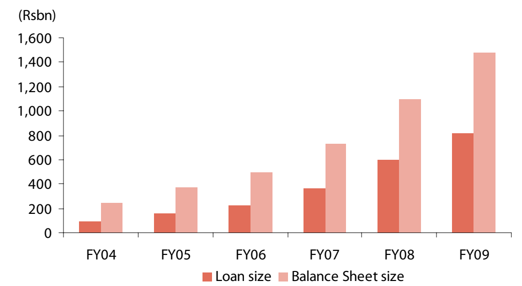
Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

	Q408	Q109	Q209	Q309
Promoter	42.5	42.4	42.4	42.4
Foreign	1.5	1.5	1.4	1.6
Institutions	42.2	40.4	38.3	35.9
Public & Others	13.6	15.9	17.7	19.9
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: NSE

Demonstrated growth – FY04-09



Source: Centrum Research

Company Background

Axis Bank, promoted in 1993 has a network of 729 branch offices, 20 extension counters and 3,171 ATMs (the third largest) as on 31 Dec 2008. The bank's net worth stood at Rs95.8 bn and an asset base at Rs1,374 bn. The bank has employee strength of 14,739 with a business per employee of Rs112mn. The bank has been proactive in business segments like cash management services (CMS), corporate banking, debt syndication, liability business and card business. The bank also has branches in Singapore, Hong Kong and Dubai, with representative offices at Shanghai and Dubai.

Key events/timeline

Dec-93	Incorporated as UTI Bank with its registered office in Ahmedabad, head office in Mumbai
Sep-99	Cash management services (CMS) launched, co-branded credit card launched
Jan-00	Dr PJ Nayak takes over as Chairman and Managing Director from Supriya Gupta
Feb-00	Adopts Finacle software from Infosys Technologies for core banking
Apr-00	Launches its Internet banking module, iConnect retail loans introduced for first time
Apr-00	UTI Bank calls off its proposed merger with Global Trust Bank
Oct-00	UTI Bank becomes fully networked
Sep-01	Private placement of 26% stake in the Bank to CDC Capital Partners. UTI holding reduces to 44.88%
Oct-02	Launches corporate iConnect - the Internet banking facility for corporates
Mar-03	UTI Bank signs agreement with Employees Provident Fund Organization (EPFO) for disbursement of pension
May-05	UTI Bank and Bajaj Allianz join hands to distribute general insurance products
Apr-06	UTI Bank opens its first international branch in Singapore
May-06	UTI Bank ties up with Geojit Financial Services to offer Online Trading service
July-06	UTI Bank opens representative Office in Shanghai
Aug-06	UTI Bank announces the launch of its Credit Card Business
Mar-07	UTI Bank ties up with IIFCL to provide finance for infrastructural projects in the country
Mar-07	UTI Bank ties up with Hyundai Motor India Ltd. for Car Loans
July-07	UTI Bank re-brands itself as Axis Bank

Source: Company

Key management personnel

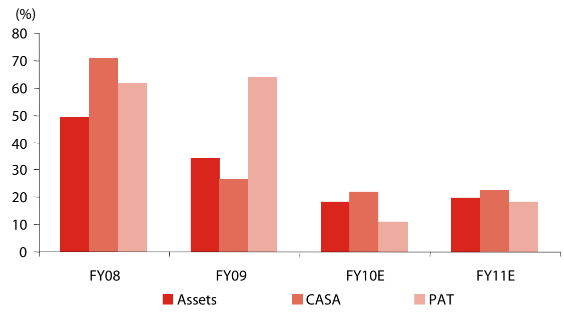
Name	Position	Profile
Ms. Shikha Sharma	Managing director	She had joined the Axis bank in June 2009. While she began her career with ICICI in 1980, where she has been instrumental in setting up various ICICI group businesses for the company, primarily ICICI Prudential Life insurance business and investment banking and retail finance.
Mr Hemant Kaul	Executive Director (Retail Banking)	He joined the bank in 1994 and heads the bank's retail initiatives. He has 29 years of banking experience including 17 years with the SBI Group. He has extensive experience in operations, branch management and foreign exchange.
Mr MM Agrawal	Executive Director (Corporate Banking)	He has been associated with the bank since 1994. He has been in the banking industry for 34 years, including 22 years with the SBI Group. His specialist areas are merchant banking, equity markets and credit supervision.
Mr VK Ramani	Executive Director (Technology/Business Processes)	He joined the bank in 1995. He has vast experience in banking operations and technology. He has spearheaded the transition of the bank's core IT platform from ISBS to Finacle.
Mr SK Chakrabarti	Executive Director (Mid-corporate banking)	He joined the bank in 1994. He has over 32 years of experience in banking and has also served as a faculty member with the State Bank Staff College in Hyderabad in the areas of international banking and human resources management.

Source: Company

Investment Rationale

- Axis Bank's liability-driven high quality growth is expected to moderate over FY09-11E
- We expect GNPAs to spike 3.4x due to bank's unseasoned loan book. Further, the high credit growth during the past three years and low base would result in NPAs also spiking
- We believe the stock is fairly valued after the 30% appreciation in the last one month

Growth moderates



Source: Company, Centrum Research

Summary Financials

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Net Interest Income	**14,685**	**25,852**	**36,859.9**	**49,935.7**	**63,391.3**
Growth (%)	*36.2*	*76.0*	*42.6*	*35.5*	*26.9*
NIM (%)	*2.8*	*3.5*	*3.4*	*3.2*	*3.4*
Non Interest Income	**10,099**	**17,959**	**28,948.1**	**33,654.1**	**37,566.0**
Growth (%)	38.41	77.83	61.19	16.26	11.62
Pre-Prov Profits	**12,591**	**22,145**	**37,228.1**	**47,548.1**	**58,293.7**
Provisions & Contingencies	2,676	5,796	9,396.8	16,591.5	21,944.9
Provision for taxes	3,372	5,757	9,698.4	10,787.5	12,666.5
Adj PAT	**6,543**	**10,592**	**18,132.9**	**20,169.1**	**23,682.3**
Growth (%)	*34.9*	*61.9*	*71.2*	*11.2*	*17.4*
Key Balance Sheet Data					
Networth	33,884	87,518.0	102,135.5	117,120.9	134,923.0
Deposits	587,850	876,193.2	1,173,740.7	1,425,589.8	1,759,143.8
Others	110,735	131,929.8	201,331.1	203,735.2	192,422.7
Total Liabilities & Equity	**732,559**	**1,095,662.8**	**1,477,219.4**	**1,746,445.9**	**2,086,489.6**
Loans	368,765	596,610.6	815,567.5	962,372.6	1,154,847.1
Investments	268,871	337,050.9	463,303.4	562,714.2	694,376.0
Fixed & Other assets	25,740	37,072.5	0.0	51,620.7	51,620.7
Total Assets	**732,559**	**1,095,775.9**	**1,477,219.7**	**1,746,445.9**	**2,086,489.6**
Key Ratios					
Cap. Adequacy & Credit Quality Ratios (%)					
Gross NPA	1.1	0.8	1.1	2.0	2.9
Net NPA	0.7	0.4	0.4	0.7	1.1
Total CAR	11.6	13.7	13.9	13.3	12.7
Tier 1 CAR	6.4	10.2	9.4	9.0	8.7
Per share data					
Fully diluted EPS	22.6	31.0	50.3	56.2	66.0
Book Value per share	120.3	244.7	284.5	326.2	375.8
Adj Book value per share	110.9	238	275.4	307.0	340.5
Valuations Ratios					
Price/BV (x)	3.1	3.0	2.2	2.3	2.0
Price/Adj. BV (x)	3.3	3.1	2.3	2.4	2.2
P/E (x)	16.0	23.2	12.6	13.2	11.2
Dividend Yield	1.20	0.81	1.57	1.62	1.89
Dupont Analysis (*% of Average assets*)					
Net-Interest Income	2.36	2.84	2.82	3.10	3.31
Non-Interest Income	1.62	1.97	2.22	2.09	1.96
Net Income	**3.98**	**4.82**	**5.04**	**5.19**	**5.27**
Operating Expenses	1.96	2.38	2.19	2.24	2.23
Operating Profit	**2.02**	**2.44**	**2.85**	**2.95**	**3.04**
Provisions & Contingencies	0.43	0.64	0.72	1.03	1.15
Taxes	34.01	35.21	34.85	34.85	34.85
RoAA (%)	**1.05**	**1.16**	**1.39**	**1.25**	**1.24**
Avg.assets/avg equity (x)	19.9	14.0	14.3	14.7	15.2
RoAE (%)	**20.90**	**16.32**	**19.78**	**18.40**	**18.79**

Source: Company, Centrum Research Estimates

Investment Argument

High quality, liability-driven growth to moderate

Axis Bank reported 40% earnings CAGR during FY04-08 led by 58% loan CAGR and propped by 50% growth in CASA. We expect this fast-paced, high quality, liability-led growth to moderate to 17% earnings CAGR in FY09-11E.

Strong operational performance to moderate

The bank has been the fastest-growing bank with 55% balance sheet growth in Q3FY09. It reported 45% CAGR in balance sheet size during FY04-08. During the same time, it grew its CASA by 50% CAGR driven by expansion in branches and ATMs. It also has been able to maintain its asset quality mainly on account of better risk management systems. We believe this high quality growth would moderate with balance sheet growing at a slower 23% in FY10E and 20% in FY11E and asset quality deteriorating with GNPA rising to 2.3% from 1% as on Q3FY09E, mainly on account of economic conditions and capital constraints.

Exhibit 1: Industry high growth with strong operational performance to moderate

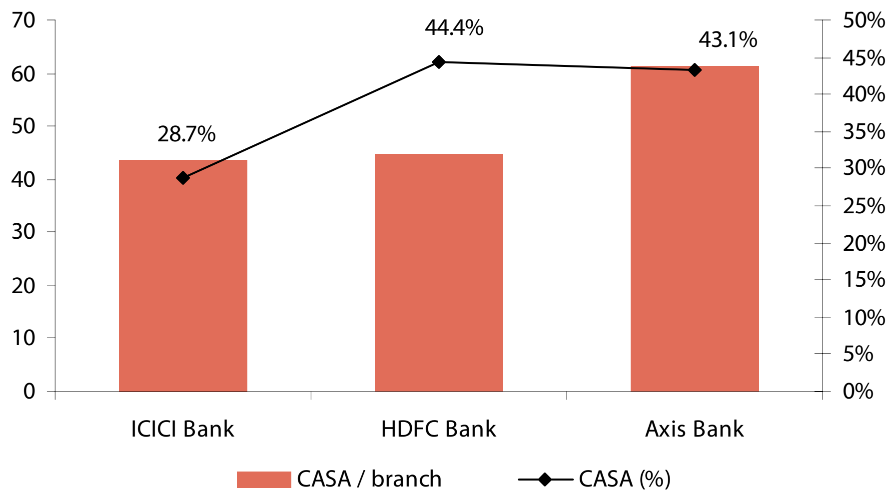
Year	Assets	%YoY	Loans	%YoY	CASA	%YoY	PAT	%YoY	GNPA(%)	NNPA(%)
FY05	241501.2	0	93,629	*0*	79,782		2,676		*2.9*	*1.2*
FY06	377436.1	56	156,029	*67*	120,457	*51*	3,346	25	*2.0*	*1.4*
FY07	497,310	32	223,142	*43*	160,355	*33*	4,851	45	*1.7*	*1.0*
FY08	732,559	47	368,765	*65*	234,300	*46*	6,543	35	*1.1*	*0.7*
FY09	1,095,776	50	596,611	*62*	400,253	*71*	10,592	62	*0.8*	*0.4*
FY10E	1,477,220	35	815,568	*37*	506,440	*27*	18,133	71	*1.1*	*0.4*
FY11E	1,746,446	18	962,373	*18*	618,157	*22*	20,169	11	*2.0*	*0.7*

Source: Company, Centrum Research Estimates

Liability-led growth strategy paying off

Axis Bank has one of the highest CASA levels (next to HDFC Bank) among private sector banks, mainly led by leadership in CMS and cautious liability-led growth strategy. It has been able to support this high balance sheet growth with consistent CASA growth which we believe to sustain going forward.

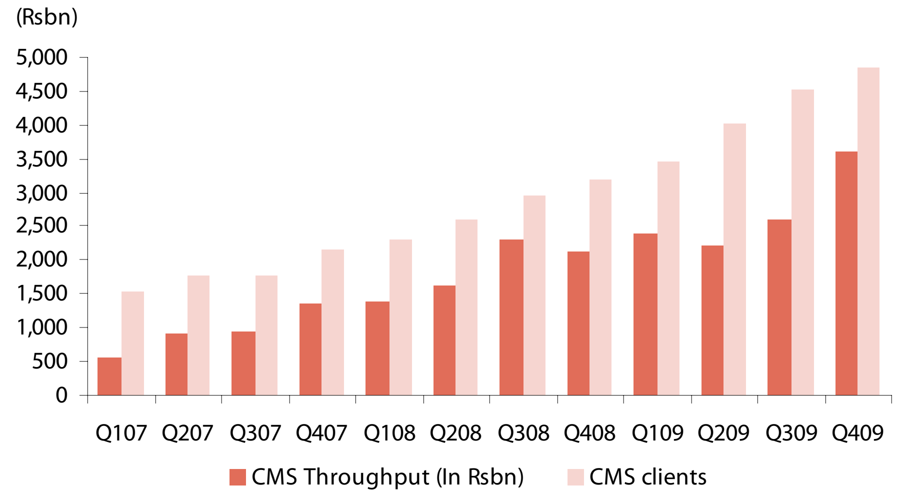
Exhibit 2: Axis Bank's has high productive franchise among private banks



Source: Company, Centrum Research

The bank's consistent focus on CMS aided-customer acquisition has given it a competitive advantage in terms of scaling up deposit franchise, which we believe would help it going forward in maintaining NIMs.

Exhibit 3: Increased focus on CMS-aided customer acquisition



Source: Company, Centrum Research

Exhibit 4: Consistent improvement in deposit franchise

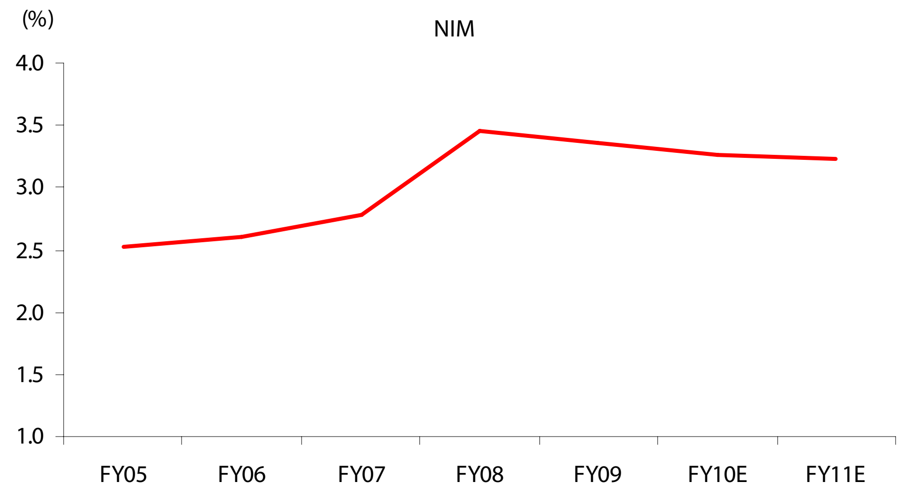
	FY04	FY05	FY06	FY07	FY08	FY09
CASA (Rsmn)	79,782	120,457	160,355	234,300	400,269	506,440
CASA (%)	38	38	40	40	46	43
No.of branches	252	339	450	561	671	827
CASA / branch (Rsmn)	316.6	355.3	356.3	417.6	596.5	612.4

Source: Company

NIM deterioration minimal

Axis Bank's NIM for FY09 at 3.4% is expected to deteriorate by 10bp in FY10 and FY11 respectively mainly on account of reduced yield on advances on corporate loans (constitute 50% of total loan book) but partially benefited by the reduced cost of deposits on account of strong liability franchise. Any significant change in the loan mix going forward would be a positive surprise for the NIM.

Exhibit 5: NIM dip insignificant



Source: Company, Centrum Research Estimates

Robust and diversified fee-based income streams

We expect fee income growth to slowdown to 20% during FY09-11E, after the 64% CAGR during FY04-08 due to de-growth in capital market related fees, lower distribution of personal investment products and reduced asset processing fees on account of slow loan growth. However, 80% of fee income is non-capital market related which gives the confidence about the growth going forward.

Exhibit 6: Break-up of fee income

Fee income (Rsmn)	Q108	Q208	Q308	Q408	FY08	Q109	Q209	Q309	Q409	FY09	Composition (%) FY08	Composition (%) FY09
Corporate Banking	520	570	660	760	2,510	1,150	1,070	1,140	1,120	4,480	12.3	16.4
Agri & SME Banking	250	310	300	430	1,290	370	480	530	730	2,110	6.3	5.3
Business Banking	450	490	550	610	2,100	680	720	790	850	3,040	10.3	9.7
Capital Markets	370	220	410	410	1,410	920	1,110	1,010	630	3,670	6.9	13.1
Retail Banking	1,010	1,210	1,470	1,830	5,520	1,620	2,000	1,780	2,300	7,700	27.0	23.1
o/w Cards Fees	240	320	390	450	1,400	380	460	440	500	1,780	*6.8*	*5.4*
o/w Personal Invst product fees	220	300	500	820	1,840	450	660	530	870	2,510	*9.0*	*6.4*
o//w Other Retail fees	550	590	580	560	2,280	790	880	810	930	3,410	*11.1*	*11.3*
Treasury	440	480	550	640	2,110	650	880	940	1,000	3,470	10.3	9.3
Total fees	**4,050**	**4,490**	**5,410**	**6,510**	**20,460**	**7,010**	**8,260**	**7,970**	**8,930**	**32,170**	**100.0**	**100.0**

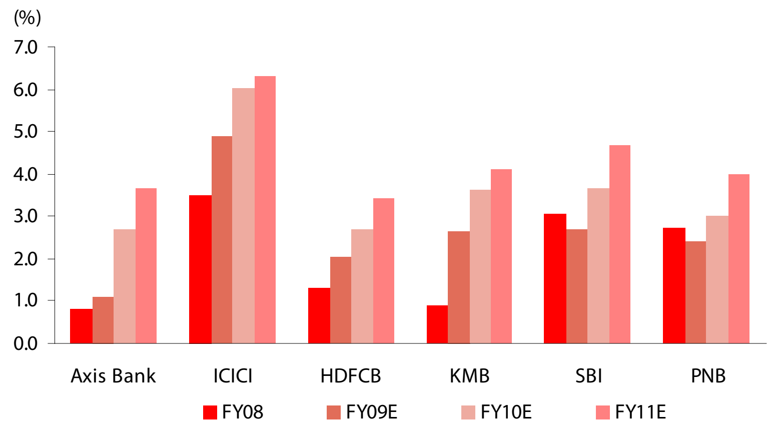
Source: Company, Centrum Research

Asset quality to deteriorate further

NPAs expected to spike, but still under control

We expect GNPAs to increase 3.4x and NNPAs 4.7x in FY10 from FY09 levels mainly on account of the bank's high exposure to sectors that are perceived to be risky – metals & metal products, gems & jewellery, shipping and logistics coupled with 55% unseasoned loan book due to high credit growth in the past three years. However, stringent risk management systems and diversified loan book provides us comfort in terms of asset quality.

Exhibit 7: One of the lowest GNPAs, but expected to deteriorate



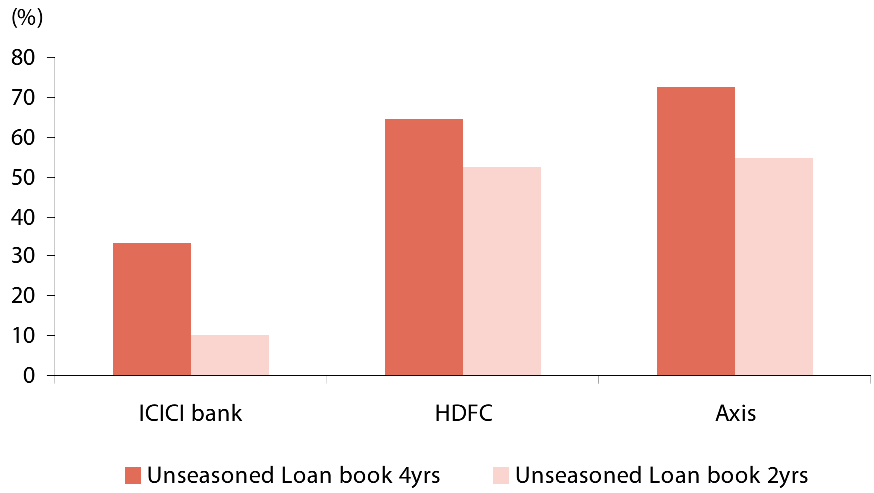
Source: Company, Centrum Research Estimates

Exhibit 8: High exposure to perceived risky sectors

Sector	% as end FY09
Infrastructure	12.43
Financial companies	8.57
Metals & Metal products	8.28
Gems and Jewellery	3.93
Shipping & Logistics	6.12
Real estate	5.54
Trade	5.01
Textiles	4.45
Chemicals	4.51
Telecommunications	4.52

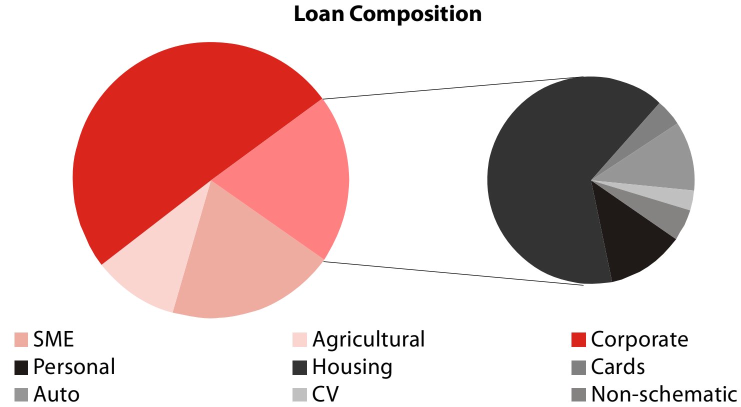
Source: Company

Exhibit 9: Unseasoned loan book



Source: Company, Centrum Research

Exhibit 10: Diversified loan book



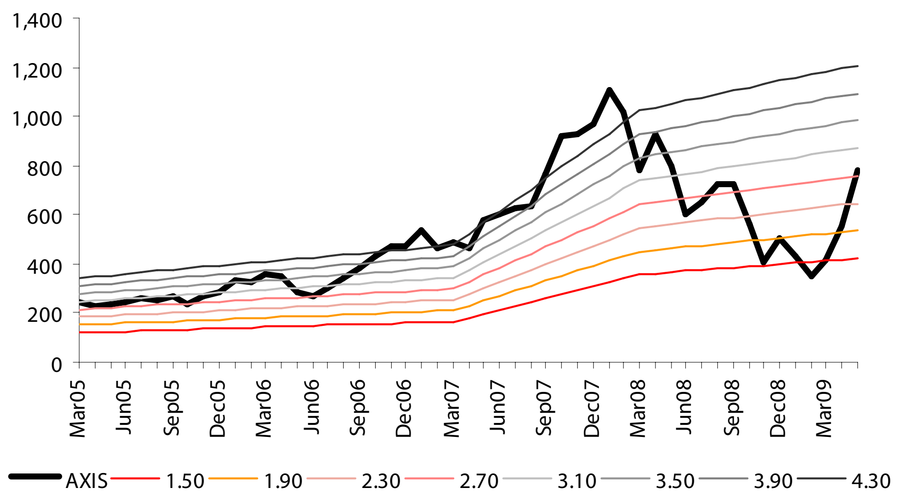
Source: Company, Centrum Research

Valuation Analysis

Stock fairly valued after recent run up in price

We recommend an Accumulate with a target price of Rs804 an upside of 8% valuing the bank at 2.4x FY11E P/Adj BV of Rs. 340 under two stage gordon growth model. We are positive mainly on account of consistent quality growth in the last 5 years (Balance sheet CAGR of 45%, earnings CAGR of 51% during 2004-09), led by liability driven growth strategy and relatively better funding franchise (CASA second best in private banking space next to HDFC Bank) and diverisified loan book.

Exhibit 11: Price/adj BV chart



Source: Bloomberg, Centrum Research

Risks

Key upside risks

- Faster-than-expected loan growth, lower NPAs and sharp decline in bond yields provide upside.
- Improvement in capital markets would surprise us positively on fee income front.

Key downside risks

- Management overhang with a strategy restructuring and uncertainty about SUUTI stake sale provides investment risks .

Financials

Exhibit 12: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	44,616	70,051	108,353	135,375	161,906
Interest Expense	29,932	44,198	71,493	85,439	98,515
Net Interest Income	**14,685**	**25,852**	**36,860**	**49,936**	**63,391**
YoY Growth (%)	*36.2*	*76.0*	*42.6*	*35.5*	*26.9*
Non Interest Income	**10,099**	**17,959**	**28,948**	**33,654**	**37,566**
YoY Growth (%)	*38.4*	*77.8*	*61.2*	*16.3*	*11.6*
Fee & Other Income	9,519	15,908	29,480	30,852	34,764
Gains / (Losses) on Securities	580	2051	2802	2802	2802
Total Net Income	**24,784**	**43,811**	**65,808**	**83,590**	**100,957**
Total Operating Expenses	**12,193**	**21,666**	**28,580**	**36,042**	**42,664**
YoY Growth (%)	*49.8*	*77.7*	*31.9*	*26.1*	*18.4*
Employee Expenses	3,912	7,521	9,976	13,717	18,106
Other Operating Expenses	8,281	14,146	18,604	22,325	24,557
Pre-provision Profit (Pre-excep)	**1,259**	**2,215**	**3,723**	**4,755**	**5,829**
Exceptionals	**0**	**0**	0	**0**	**0**
Pre-provision Profit	**1,259**	**2,215**	**3,723**	**4,755**	**5,829**
NPA Provision	737	3,440	7,322	16,001	21,172
Provisions for Depn on Invest	670	65	1,078	0	0
Other Provisions	1,269	2,291	0	590	773
Provisions	**2,676**	**5,796**	**9,397**	**16,592**	**21,945**
Profit Before Tax	**9,914**	**16,349**	**27,831**	**30,957**	**36,349**
Taxes	3,372	5,757	9,698	10,787	12,667
Net Profit	**654**	**1,059**	**1,813**	**2,017**	**2,368**
Exceptionals (Post Tax)	0	0	0	0	0
Adj Net Profit	**654**	**1,059**	**1,813**	**2,017**	**2,368**

Source: Company, Centrum Research Estimates

Exhibit 13: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Cash and balance with RBI	4,661	7,306	9,419	10,175	10,175
Inter-bank borrowings	2,257	5,199	5,598	6,799	8,389
Loans & Advances	36,876	59,661	81,557	96,237	115,485
Investments	26,887	33,705	46,330	56,271	69,438
Interest Earning Assets	**70,682**	**105,870**	**142,904**	**169,483**	**203,487**
Fixed Assets	678	923	1,073	855	855
Other Assets	1,896	2,785	3,745	4,307	4,307
Total Assets	**73,256**	**109,578**	**147,722**	**174,645**	**208,649**
Customer Deposits	58,785	87,619	117,374	142,559	175,914
Borrowings	5,196	5,624	10,185	10,026	8,895
Int-bearing liabilities	**63,981**	**93,243**	**127,560**	**152,585**	**184,809**
Other Liab /Pref capital	69,859	100,812	137,507	162,933	195,157
Equity Capital	282	358	359	359	359
Reserves	3,107	8,394	9,855	11,353	13,133
Total Liabilities	**73,256**	**109,566**	**147,722**	**174,645**	**208,649**

Source: Company, Centrum Research Estimates

Exhibit 14: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Balance Sheet Structure Ratios (%)					
Loans/Deposits	62.7	68.1	69.5	67.5	65.6
Investments / Deposits	45.7	38.5	39.5	39.5	39.5
CASA Ratio	39.9	45.7	43.1	43.4	43.1
Loan Growth	65.3	61.8	36.7	18	20
Deposit Growth	46.5	49.1	34.0	21.5	23.4
Operating Ratios (%)					
NIM	2.8	3.5	3.4	3.2	3.4
Interest Spread	36.2	76.0	42.6	35.5	26.9
Non-interest income/Net income	40.7	41.0	44.0	40.3	37.2
Employee Costs as % of Total Op Costs	32.1	34.7	34.9	38.1	42.4
Cost/Income	49.2	49.5	43.4	43.1	42.3
Operating cost growth	49.8	77.7	31.9	26.1	18.4
Total prov as % of avg. loans	0.9	1.3	1.4	1.9	2.1
Tax Rate (%)	34.0	35.2	34.8	34.8	34.8
Credit Quality Ratios (%)					
Gross NPA	1.1	0.8	1.1	2.0	2.9
Net NPA	0.7	0.4	0.4	0.7	1.1
Slippage	0.6	0.8	1.3	2.5	3.0
NPA Provisions / Avg loans	0.3	0.5	1.0	1.8	2.0
NPA coverage ratio	36.4	49.8	63.6	64.1	61.7
Capital Adequacy Ratios (%)					
Total CAR	11.6	13.7	13.9	13.3	12.7
Tier 1 CAR	6.4	10.2	9.4	9.0	8.7
Profitability Ratios (%)					
RoAE	20.9	16.3	19.8	18.4	18.8
RoAA	1.0	1.2	1.4	1.3	1.2
Valuations Ratios					
BVPS (Rs)	120.3	244.7	284.5	326.2	375.8
Price/BV (x)	3.1	3.0	2.2	2.3	2.0
Adjusted BVPS (Rs)	110.9	237.7	275.4	307.0	340.5
Price/Adj. BV (x)	3.3	3.1	2.3	2.4	2.2
EPS (Rs)	23.3	31.8	50.6	56.2	66.0
P/E (x)	16.0	23.2	12.6	13.2	11.2
Dividend Yield	1.2	0.8	1.6	1.6	1.9

Source: Company, Centrum Research Estimates

INDIA

Banking

Kotak Mahindra Bank

Initiation **8 June 2009**

CENTRUM

Sell

Target Price: Rs387

CMP: Rs680*

Downside: 43%

as on 1 June 2009

Concentration risk

- **Highly capital market leveraged business model:** Nearly one-fifth of Kotak Mahindra Bank's (KMB) revenues and almost half of profits are derived from capital market-linked business. Earnings outlook remain hazy due to the volatility in equity markets.

- **Declining market share in stock broking a cause of concern:** Kotak Securities (K-Sec) witnessed a sharp decline in average daily volumes to about Rs35bn (FY09) and market-share has declined to 5.5% from a high of 9%.

- **Banking and other lending business too under stress:** KMB is still a small player in the banking space (about 0.7% share in advances and 0.4% in deposits), making it susceptible to strong headwinds/credit shocks. With growth taking a backseat and earnings under stress, we see little support from this business to sustaining profitability.

- **AMC growth capped; insurance ensuring some comfort:** We believe growth in the AMC and insurance businesses too would be capped considering their close linkages to capital markets and the economic slowdown. We value the AMC and insurance business at Rs143 per share and emerging as major contributor (37%) to overall valuations.

- **Valuations expensive; Sell:** Hitherto, the market assigned very high multiples to KMB's capital market-linked businesses. But the business model would be vulnerable till visibility emerges. Initiate coverage with a Sell and target price of Rs387, providing a downside of 43%.

- **Key risks: Upside risk** – Significant sustainable recovery in the equity markets with improvement in broking and deal volumes. **Downside risk –** Continued downturn in capital markets and higher delinquencies in its lending business.

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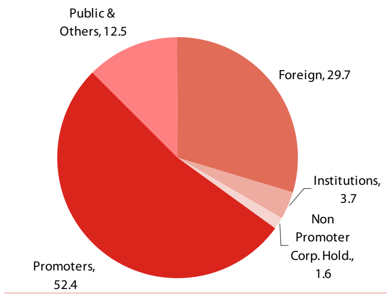
Key Data

Bloomberg Code	KMB IN
Reuters Code	KTKM.BO
Current Shares O/S (mn)	345.8
Diluted Shares O/S(mn)	345.8
Mkt Cap (Rs bn/USD bn)	235/5.0
52 Wk H / L (Rs)	728/208
Daily Vol. (3M NSE Avg.)	2,506,720
Face Value (Rs)	10
1 USD = Rs46.9	

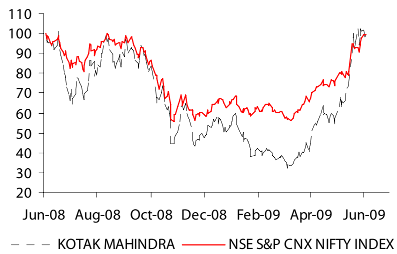
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Kotak	76.4	106.5	1.6
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

Y/E Mar (Rsmn)	NII	*YoY (%)*	Net Income	*YoY (%)*	Adj PAT	YoY (%)	EPS (Rs)	Adj BV (Rs)	RoE (%)	*RoA (%)*	P/E (x)	P/BV (x)
FY07	6,199	*63.1*	9,385	*56.9*	1,414	*1,414*	4.3	36.3	*11.4*	*0.9*	77.1	9.2
FY08	12,258	*97.8*	16,892	*80.0*	2,940	*2,940*	8.5	85.7	*11.4*	*1.2*	87.7	8.7
FY09E	15,185	*23.9*	18,764	*11.1*	2,761	*2,761*	8.0	90.0	*7.5*	*1.0*	59.3	5.3
FY10E	16,538	*8.9*	20,332	*8.4*	3,040	*3,040*	8.8	93.8	*7.7*	*1.0*	77.3	7.2
FY11E	19,133	*15.7*	23,230	*14.3*	3,752	*3,752*	10.9	99.3	*8.8*	*1.0*	62.6	6.8

Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

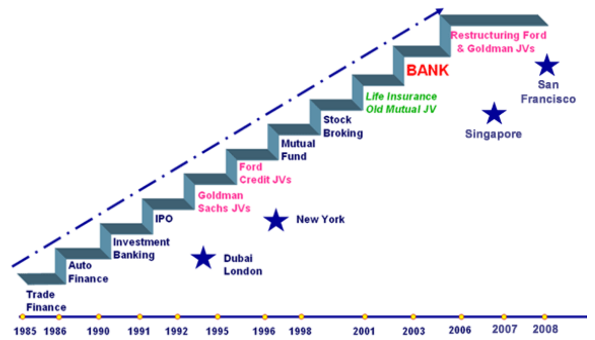
	Q408	Q109	Q209	Q309
Promoter	52.5	52.5	52.4	52.4
Foreign	26.8	26.3	27.4	29.4
Institutions	4.8	4.6	5.8	4.1
Public & Others	15.9	16.5	14.2	14.0
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: NSE

Company Background

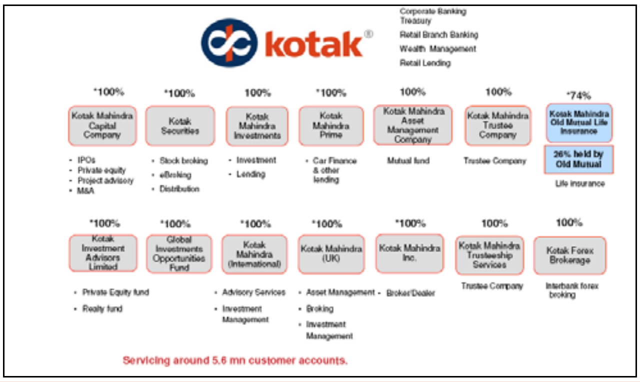
Kotak Mahindra Bank, which was formed in 2003, is a full service financial conglomerate offering a wide range of services – commercial banking, stock broking, mutual funds, life insurance and investment banking. As of 31 Dec 2008, the bank's total asset base was Rs320bn and consolidated net-worth was Rs632.66bn. The bank is adequately capitalized at 19.9% with a Tier I ratio 16% as on 31 March 2009. The bank offers services in retail and corporate banking, trade finance products and NRI services. The registered office of the bank is in Mumbai and the bank operates with 217 branches and 387 ATMs across 123 locations.

Timeline of KMB growth



Source: Company

Evolution of KMB



Source: Company

Key management personnel

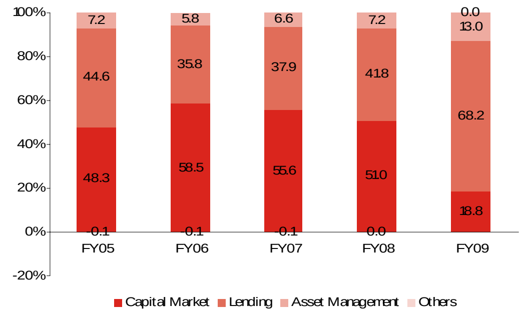
Name	Position	Profile
Mr Uday Kotak	Executive Vice-Chairman and Managing Director	Responsible for starting the business as a start-up venture with limited range of activities and then building it up into a full financial services group. He is also on the Board of the Indian Council for Research on International Economic Relations (ICRIER), Indian School of Business and Indian Institute of Banking and Finance.
Mr C Jayaram	Executive Director, Wealth Management	Has varied experience of over 29 years in finance and business and was the CEO of Kotak Securities. He has been with the Kotak Group for 17 years and has been instrumental in building some of the new businesses of the Kotak Group.
Mr Dipak Gupta	Executive Director	Has over 19 years of experience in the financial services industry, out of which 15 years have been with the Kotak Group. He was responsible for leading the Kotak Group's initiatives into the banking arena and is in charge of the retail banking business and operations. He was also the CEO of Kotak Prime.

Source: Company

Investment Rationale

- The downturn in the capital markets has exposed the vulnerability of KMB's equity-linked business model
- Growth prospects in AMC and insurance businesses capped
- KMB still a small player in the banking space, making it more susceptible to strong headwinds/credit shocks

Capital market dependent business model



Source: Company, Centrum Research

Summary Financials

Y/E March (Rsmn)	FY07	FY08	FY09	FY10E	FY11E
Net Interest Income	**6,199**	**12,258**	**15,185**	**16,538**	**19,133**
Growth (%)	*63.1*	*97.8*	*23.9*	*8.9*	*15.7*
NIM (%)	*4.3*	*5.3*	*5.6*	*5.7*	*5.7*
Non Interest Income	**3,187**	**4,634**	**3,579**	**3,793**	**4,097**
Growth (%)	*46.1*	*45.4*	*-22.8*	*6.0*	*8.0*
Net Income	**9,385**	**16,892**	**18,764**	**20,332**	**23,230**
Growth (%)	*56.9*	*80.0*	*11.1*	*8.4*	*14.3*
Pre-Prov Profits	**3,258**	**6,699**	**6,800**	**7,446**	**8,956**
Provisions & Contingencies	1,226	2,721	2,539	2,861	3,297
Provision for taxes	619	1,038	1,500	1,545	1,907
Adj. PAT	**1,414**	**2,940**	**2,761**	**3,040**	**3,752**
Growth (%)	*19.6*	*107.9*	*(6.1)*	*10.1*	*23.4*
Key Balance Sheet Data					
Networth	16,335	35,355	38,136	40,917	44,409
Interest bearing liab	167,254	223,251	223,313	255,866	296,572
Other non-int. bearing liab	15,577	24,547	32,639	37,922	45,471
Total Liabilities & Equity	**199,166**	**283,153**	**294,089**	**334,705**	**386,452**
Cash and inter-bank balance	12,960	21,495	13,450	15,837	18,140
Loans	109,241	155,522	166,253	192,853	225,639
Investments	68,620	91,420	91,102	100,754	114,787
Fixed & Other assets	8,346	14,716	23,284	25,261	27,886
Total Assets	**199,166**	**283,153**	**294,089**	**334,705**	**386,452**
Key Ratios					
Capital Adequacy & Credit Quality Ratios (%)					
Gross NPA	0.5	0.9	2.8	3.3	4.0
Net NPA	0.2	0.4	1.3	1.4	1.8
Total CAR	11.6	18.6	19.9	18.8	18.3
Tier 1 CAR	6.5	14.5	16.0	14.5	13.8
Per share data					
EPS	4.3	8.5	8.0	8.8	10.9
BVPS	42.9	93.7	101.4	109.5	119.6
Adj BVPS	36.3	85.7	90.0	93.8	99.3
Valuations Ratios					
Price/BV (x)	7.0	3.2	3.0	2.7	2.5
Price/Adj. BV (x)	8.3	3.5	3.3	3.2	3.0
P/E (x)	69.2	35.2	37.6	34.1	27.6
Dividend Yield	0.2	0.3	0.3	0.3	0.3
Dupont Analysis					
% of Average assets					
Net-Interest Income	4.1	5.1	5.3	5.3	5.3
Non-Interest Income	2.1	1.9	1.2	1.2	1.1
Net Income	**6.2**	**7.0**	**6.5**	**6.5**	**6.4**
Operating Expenses	(4.1)	(4.2)	(4.1)	(4.1)	(4.0)
Operating Profit	**2.2**	**2.8**	**2.4**	**2.4**	**2.5**
Provisions & Contingencies	0.8	1.1	0.9	0.9	0.9
Taxes	0.4	0.4	0.5	0.5	0.5
RoAA (%)	**0.9**	**1.2**	**1.0**	**1.0**	**1.0**
Avg.assets/avg equity (x)	12.1	9.3	7.9	8.0	8.5
RoAE (%)	**11.4**	**11.4**	**7.5**	**7.7**	**8.8**

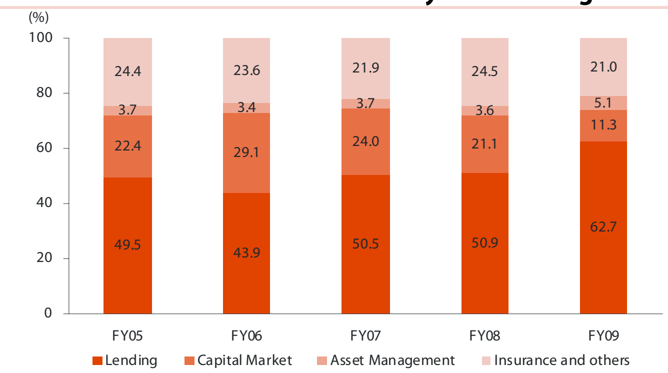
Source: Company, Centrum Research Estimates

Investment Argument

Highly capital market leveraged business model under stress

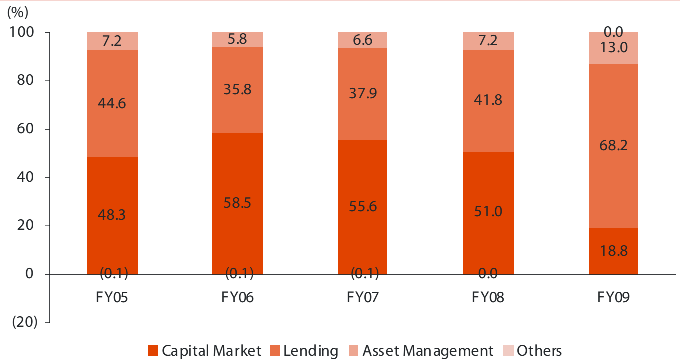
KMB derived more than 20% of revenues and 50% of profits during past three years from capital market-related business – stock broking and investment banking – making it vulnerable to cyclicality associated with capital markets. It also derives a significant portion of revenues from asset management and insurance business, both closely linked to capital market activity. With the capital markets in doldrums, KMB has been impacted by the downturn with the share of profits from capital market business falling to about 36% during FY09. We expect the capital markets to remain range-bound in the near-term impacting KMB's business and overall profitability.

Exhibit 1: Consolidated revenues by business segment



Source: Company, Centrum Research

Exhibit 2: Profit break-up by business segment

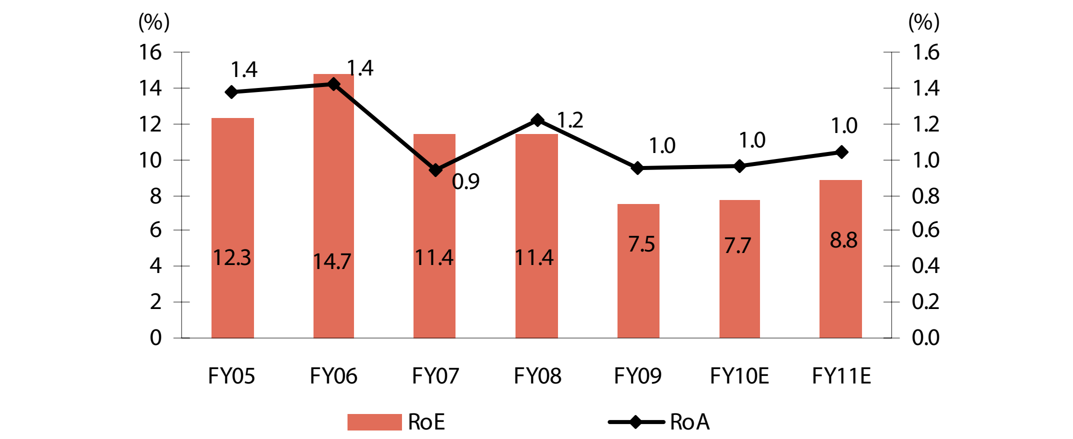


Source: Company, Centrum Research

Bleak earnings visibility

We expect KMB's consolidated revenues (excluding the insurance business) to register a moderate 9% CAGR over FY09-11E. This is a huge fall from the 47% growth registered in FY08. Further, the banking business, which was considered to be relatively stable, is also facing stress. We expect earnings from the banking business to remain relatively subdued registering 11% CAGR over FY09-11E due to slower credit growth that would impact margins and core earnings, moderating fee income and higher provisioning due to deteriorating asset quality. With earnings moderating and higher CAR, we expect KMB's ROEs (standalone for banking) to remain at sub-10% levels over FY09-11E.

Exhibit 3: RoEs (standalone for banking) to fall below 10%

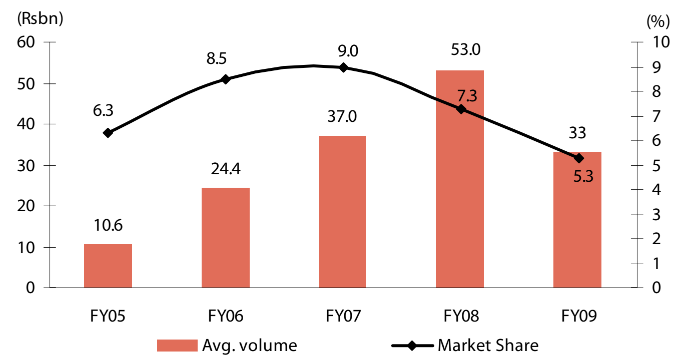


Source: Company, Centrum Research Estimates

Decline in market share in broking a cause of concern

With the slump in the equity markets, K-Sec, a major player among Indian brokerages, has witnessed its average daily volumes declining to about Rs33bn (Q4FY09). Further, its market share also declined to 5.3% (Q4FY09) from 7.3% in Q4FY08 on account of industry-wide slowdown and increasing competition. The company derives significant portion of revenues from retail broking and was continuously ramping up its retail broking business (online as well as off-line). With retail volumes drying up, it has consciously rationalise its operations. Its PMS business too has witnessed significant fall with AUM falling to Rs23bn from a high of Rs34bn in FY08, putting further pressure on fee income. We estimate K-Sec's market-share would be range-bound at about 5.2-5.5% and PMS AUM at about Rs24bn over FY09-11E. We expect earnings to dip in FY09 and recover gradually over FY10-11E.

Exhibit 4: K-Sec's average volumes, market share dropping



Source: Company, Centrum Research

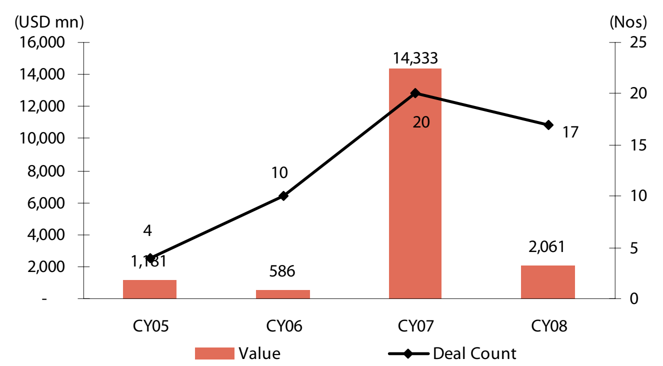
Exhibit 5: K-Sec's revenue and profitability under stress

Source: Company, Centrum Research Estimates

No significant activity in M&A space

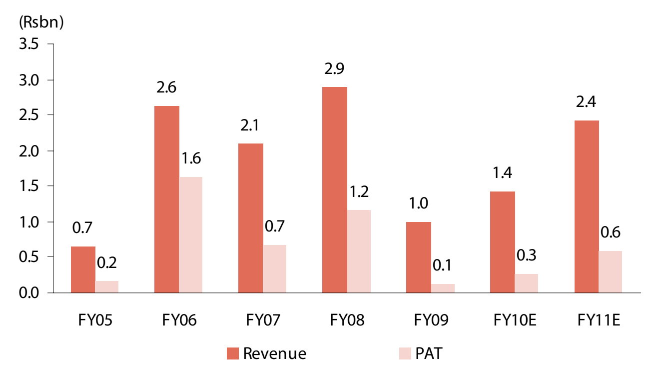
KMCC has a strong presence in managing large equity issues and M&A (it featured in top slot for IPOs with 79% market share and No. 1 in QIPs with 58% market share in FY08). Last year (FY08) was one of the best years for the investment banking industry and also for KMCC. Despite the revival in the capital markets, we would wait for the significant sustainable recovery in the equity markets with improvement in broking and deal volumes.

Exhibit 6: M&A volumes are down



Source: Bloomberg, Centrum Research

Exhibit 7: Profitability too under stress



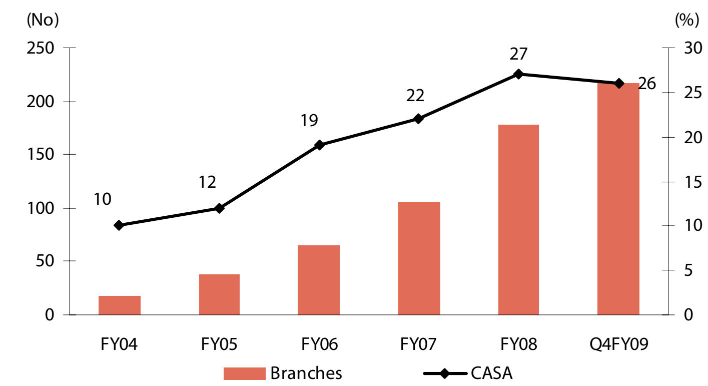
Source: Company, Centrum Research Estimates

Asset management business growth to remain muted

The asset management business too is closely linked to the state of the equity market and with the down-turn, AUMs of mutual funds have been hit. We expect the overall mutual funds sector to register a muted 14% CAGR over FY09-11E. Kotak's MF AUM declined to about Rs151bn in Oct 2008 before recovering to Rs174bn in Feb 2009, due to heavy redemption pressure and fall in the value of equity portfolio.

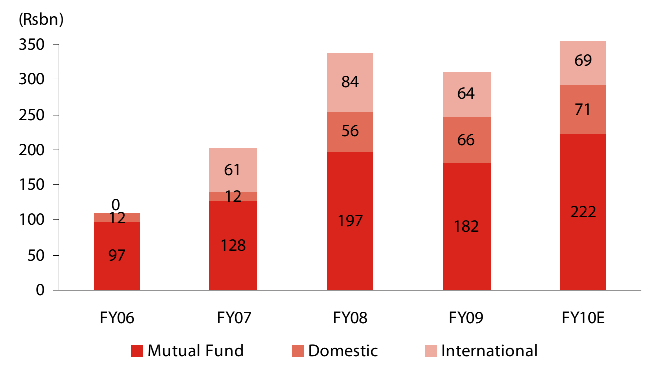
KMB also runs one of the largest alternate asset management businesses, comprising both domestic and international funds, and has been able to mobilize sizeable funds till during the year. On the domestic front, Kotak Investment Advisors (KIAL) managed to complete its first closure of realty fund with a commitment of about Rs13.4bn (US$281mn) and an offshore PE fund with an initial commitment of Rs3.75bn. However, international asset book remained nearly flat at about US$1.3bn. We believe that with equity markets subdued the world over, declining savings and general risk aversion towards all asset classes, growth in AUMs and revenue-generating capacity from these businesses is likely to remain muted in the near-mid term. We value the asset management business collectively at about Rs70, contributing about 18% of overall valuations.

Exhibit 8: Growth in AUM to remain subdued



Source: Company, Centrum Research

Exhibit 9: Kotak's AUM* growth to remain muted



**Note: MF and alternate AMC AUM only*

Source: Company, Centrum Research Estimates

Insurance business provides some comfort

Kotak Mahindra Old Mutual Life Insurance is a 74:26 JV between KMB and Old Mutual plc. The company has followed value creation strategy targeting mass affluent segment rather than mass retail, leading to relatively slower growth as compared to other private players. It is the only private insurance company after SBI to report profits (though during past 2 quarters only).We assign this business a relatively lower multiple than SBI, mainly on account of its lower profitability and assign a higher growth due to the lower concentration of single premiums and higher persistency and value the business at Rs73per share.

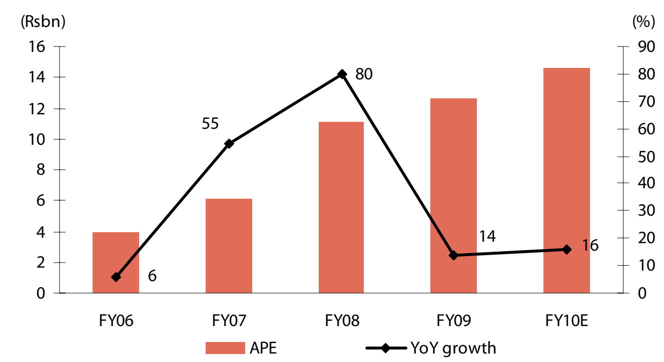
Exhibit 10: Valuation of life insurance JV stake

(Rs.crs.)

OM Kotak Life Insurance	FY10E	FY11E
APE	1059	1270
NBAP Margin (%)	16	16
NBAP (Rs. Mn)	169.4	203.3
Valuation NBAP multiple	12.0	12.0
Value of Life Insurance business at FY10 NBAP	2033	2439
Stake In Life insurance Co. (%)	74	74
Value of Life Insu. business assigned to Holding Co	1504	1805
Total No of Holding Co Shares (FY09)	34.6	34.6
Value Per Share of Holding Co.	43.5	52.2

Source: Company, Centrum Research Estimates

Exhibit 11: Insurance (APE)



Source: Company, Centrum Research Estimates

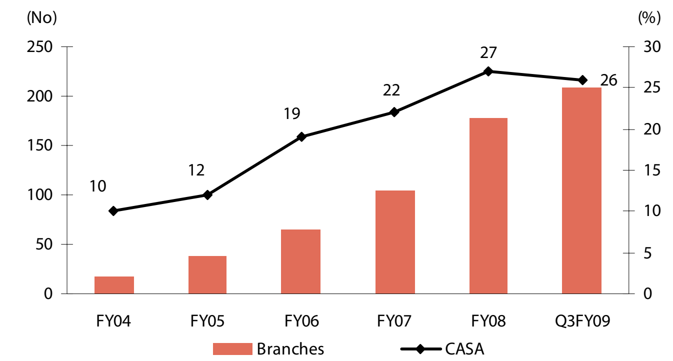
Banking and other lending businesses too under stress

KMB is a small player in the banking sector with just about 0.7% share in advances and ~0.4 % share in deposits. We expect it to register relatively slower 17.5% CAGR standalone credit growth over FY09-11E (57% over FY06-08), thus affecting its core revenues and dragging standalone RoEs to below 10%.

The bank had contemplated robust branch expansion targeting about 278 branches by FY09, which has been significantly cut back to about 225 leading to lower CASA mobilization, thus impacting margins. It has also decided to focus on the relatively less risky, low-yield corporate loans. Recognizing its vulnerability to broad market risks due to its small size and exposure to high-risk retail assets, KMB has adopted a conservative approach of slowing down its pace of growth and focusing more on asset quality and margins.

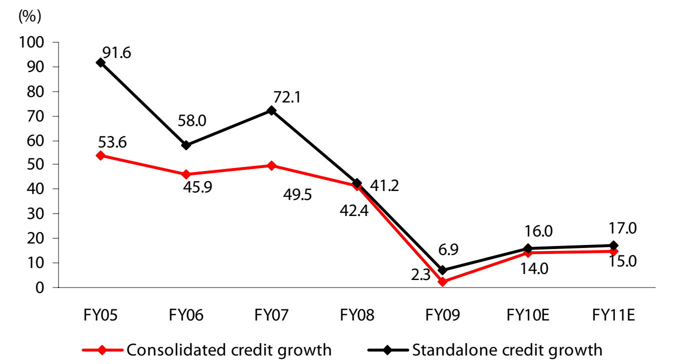
Kotak Mahindra Investments which is primarily into loans against shares (LAS) too is unlikely to see any growth considering its linkage to high-risk and cyclical capital markets. However, we believe that downturn will be conducive for the bank to grow its stress asset portfolio book at higher discount and reap decent profits. We expect consolidated KMB's loan book to register 14% CAGR over FY09-11E.

Exhibit 12: Slowing pace of branch expansion



Source: Company, Centrum Research

Exhibit 13: Loan growth takes back seat

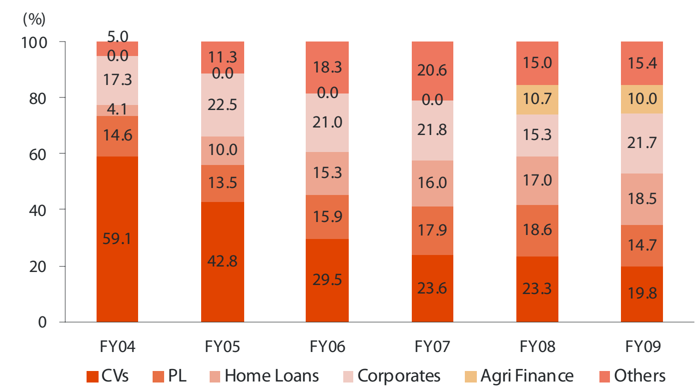


Source: Company, Centrum Research Estimates

Expect significant asset quality deterioration

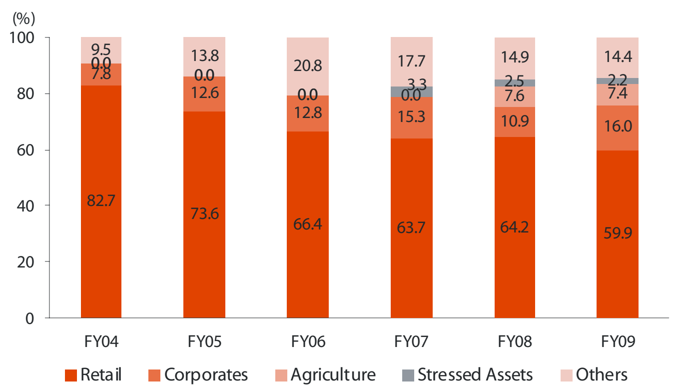
KMB's loan portfolio is highly concentrated towards retail loans contributing about 75% (including other loans) of total loans. Further, within the retail portfolio, it has higher concentration towards high-risk commercial vehicle and personal loan segment (more than 25%), which is the highest amongst all private banks.

Exhibit 14: Standalone loan book



Source: Company, Centrum Research

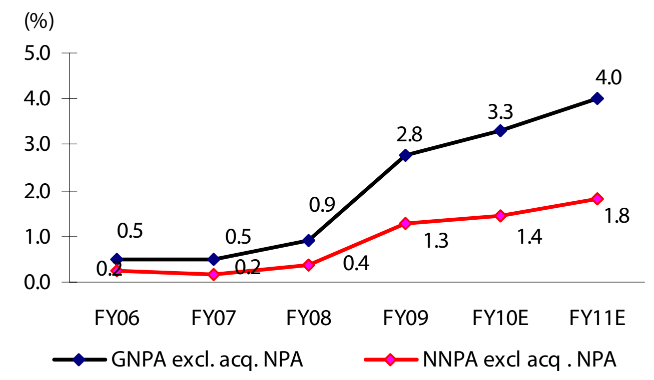
Exhibit 15: Consolidated loan book



Source: Company, Centrum Research

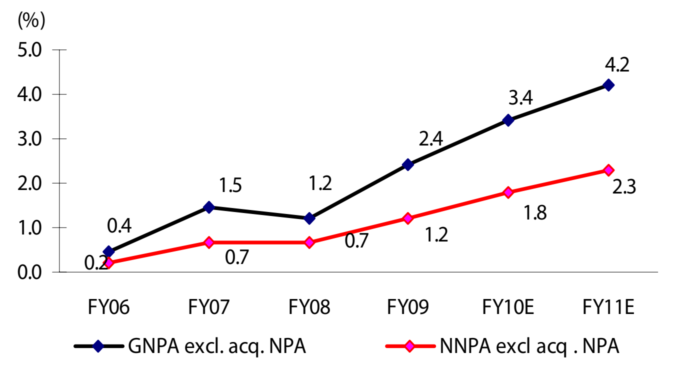
We believe its exposure to these high-risk loans makes it vulnerable to significant asset quality deterioration, which has already started playing out with banks NNPA (excluding stressed assets) jumping to 1.2% in Q4FY09 from 0.4% at the beginning of the year. We estimate GNPA and NNPA (standalone), excluding stress assets, to rise to 4.3% and 2.1% and overall group's GNPA and NNPA at about 4.5% and 2.6%, respectively, in FY11E.

Exhibit 16: GNPA, NNPA levels to rise (standalone) ...



Source: Company, Centrum Research Estimates

Exhibit 17: So also that of the group



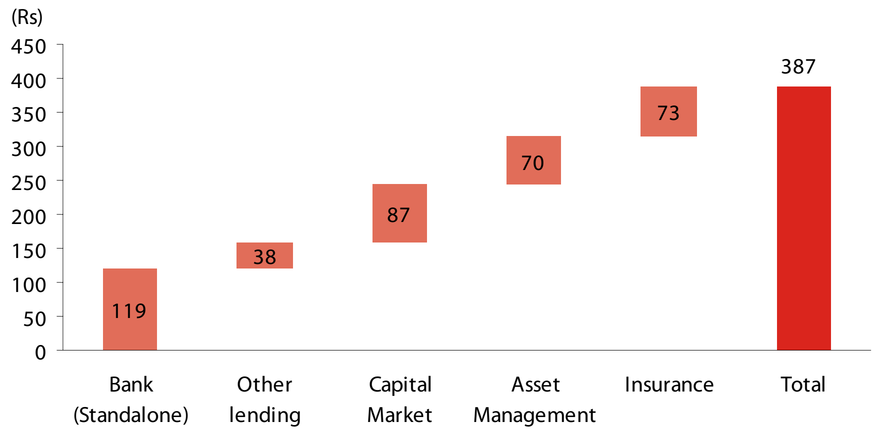
Source: Company, Centrum Research Estimates

Valuation Analysis

Multiple stresses, expensive valuations

We value KMB on SOTP methodology giving us a target price of Rs387, providing a downside of 43% from current levels. Stock has run up significantly in the recent past with a hope building on the improvement in capital markets which we believe is too early to translate into the profitability. Also, with loosing market share in the securities business, we recommend avoiding Kotak Mahindra bank until the reasonable and sustainable business visibility emerges. Stripping off other business values, standalone bank currently trades at 1.3x FY10E Adj BV, which we believe is still expensive, given its small size and the pressure the bank currently faces. Initiate coverage on the stock with a Sell rating.

Exhibit 18: KMB's SOTP valuation



Source: Company, Centrum Research Estimates

Exhibit 19: SOTP valuation methodology

Business Stream	Ownership Stake (%)	Value Per share (Rs)	% Share in valuations	Basis of valuation
Lending		**158**	**41**	
Standalone bank	100	119		1.2x FY11E Adj BV
Kotak Prime (Car and other loans)	100	31		1.2x FY11E Adj BV
Kotak Investments (LAS)	100	7		1.2x FY11E Adj BV
Core capital market		**87**	**22**	
Kotak Securities	100	66		12xFY11E PAT
Kotak Mahindra Capital	100	21		12xFY11E PAT
Asset Management		**70**	**18**	
Kotak MF	100	29		4% of blended FY11E AUM
Private Equity and VC	100	24		10% of FY11E AUM
Offshore AMC	100	17		6% of FY11E AUM
Life Insurance	74	**73.2**	**19**	15x NBAP FY10E
Total		**387**	**100**	
CMP		**679**		
Downside (%)		**(43)**		

Source: Company, Centrum Research Estimates

Risks

Key upside risks

- A significant recovery in the equity market could see volumes increase leading to higher revenues and profitability

Key downside risks

- More-than-expected deterioration in capital markets

- Higher delinquencies in its lending business.

Financials

Exhibit 20: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Earned	13,191	25,354	30,651	32,821	37,166
Interest Expended	6,992	13,096	15,466	16,283	18,033
Net Interest Income	**6,199**	**12,258**	**15,185**	**16,538**	**19,133**
Growth (%)	*63.1*	*97.8*	*23.9*	*8.9*	*15.7*
Non Interest Income	**3,187**	**4,634**	**3,579**	**3,793**	**4,097**
Growth (%)	*46.1*	*45.4*	*(22.8)*	*6.0*	*8.0*
Fee, forex and other income	3,029	4,487	2,879	3,293	3,597
Profit on sale of investments	158	147	700	500	500
Net Income	**9,385**	**16,892**	**18,764**	**20,332**	**23,230**
Growth (%)	*56.9*	*80.0*	*11.1*	*8.4*	*14.3*
Operating Expenses	**6,127**	**10,194**	**11,964**	**12,885**	**14,274**
Growth (%)	*58.1*	*66.4*	*17.4*	*7.7*	*10.8*
Employee expenses	2,930	5,192	5,568	6,269	6,913
Other expenses	3,197	5,001	6,396	6,617	7,361
Pre-Prov Profits	**3,258**	**6,699**	**6,800**	**7,446**	**8,956**
Provisions & Contingencies	**1,226**	**2,721**	**2,539**	**2,861**	**3,297**
Loan loss provisions	602	1,437	1,200	2,160	2,254
Other provisions	624	1,284	1,339	701	1,043
PBT	**2,033**	**3,978**	**4,261**	**4,585**	**5,659**
Provision for taxes	619	1,038	1,500	1,545	1,907
Effective tax rate (%)	*30.4*	*26.1*	*35.2*	*33.7*	*33.7*
PAT	**1,414**	**2,940**	**2,761**	**3,040**	**3,752**
Growth (%)	*19.6*	*107.9*	*(6.1)*	*10.1*	*23.4*

Source: Company, Centrum Research Estimates

Exhibit 21: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Cash and balance with RBI	7,512	17,103	9,266	10,439	11,879
Bal with banks & money at call	5,448	4,392	4,184	5,398	6,261
Loans	109,241	155,522	166,253	192,853	225,639
Investments	68,620	91,420	91,102	100,754	114,787
Total int. bearing assets	**190,820**	**268,437**	**270,805**	**309,444**	**358,566**
Fixed Assets	1,411	2,103	2,485	2,727	2,829
Other Assets	6,935	12,614	20,799	22,534	25,057
Total Assets	**199,166**	**283,153**	**294,089**	**334,705**	**386,452**
Deposits	110,001	164,237	156,450	179,918	208,704
Other Int. bearing liab.	57,253	59,015	66,863	75,948	87,867
Total int. bearing liab	**167,254**	**223,251**	**223,313**	**255,866**	**296,572**
Other non-int. bearing liab	15,577	24,547	32,639	37,922	45,471
Total Liabilities	**182,831**	**247,798**	**255,953**	**293,788**	**342,043**
Networth	16,335	35,355	38,136	40,917	44,409
Total Liabilities & Equity	**199,166**	**283,153**	**294,089**	**334,705**	**386,452**

Source: Company, Centrum Research Estimates

Exhibit 22: Key Ratios

Y/E March	FY07	FY08	FY09	FY10E	FY11E
Balance Sheet Structure Ratios (%)					
Loans/Deposits	99.3	94.7	106.3	107.2	108.1
CASA Ratio	27.2	28.4	32.0	29.5	30.0
Loan Growth	72.1	42.4	6.9	16.0	17.0
Deposit Growth	67.5	49.3	-5.0	15.0	16.0
Operating Ratios (%)					
NIM	4.3	5.3	5.6	5.7	5.7
Non-interest income/Net income	34.0	27.4	19.1	18.7	17.6
Employee Costs as % of Total Op Costs	47.8	50.9	46.5	48.7	48.4
Cost/Income	65.3	60.3	63.8	63.4	61.4
Operating cost growth	58.1	66.4	17.4	7.7	10.8
Total provi as % of avg. loans	1.4	2.1	1.6	1.6	1.6
Credit Quality Ratios (%)					
Gross NPA	0.5	0.9	2.8	3.3	4.0
Net NPA	0.2	0.4	1.3	1.4	1.8
Slippage	2.6	1.6	1.1	2.0	1.8
NPL coverage ratio	21.9	37.1	45.7	46.7	47.1
Capital Adequacy Ratios (%)					
Total CAR	11.6	18.6	19.9	18.8	18.3
Tier 1 CAR	6.5	14.5	16.0	14.5	13.8
Profitability Ratios (%)					
RoAE	11.4	11.4	7.5	7.7	8.8
RoAA	0.9	1.2	1.0	1.0	1.0
Valuations Ratios					
BVPS (Rs)	42.9	93.7	101.4	109.5	119.6
Price/BV (x)	7.8	8.0	4.7	6.2	5.7
Adjusted BVPS (Rs)	36.3	85.7	90.0	93.8	99.3
Price/Adj. BV (x)	9.2	8.7	5.3	7.2	6.8
EPS (Rs)	4.3	8.5	8.0	8.8	10.9
P/E (x)	77.1	87.7	59.3	77.3	62.6
Dividend Yield	0.2	0.1	0.2	0.1	0.1

Source: Company, Centrum Research Estimates

CENTRUM

Punjab National Bank

Initiation **8 June 2009**

Buy

Target Price: Rs810

CMP: Rs664*

Upside: 22%

**as on 1 June 2009*

Conservative banker

- **Expected to deliver consistent performance:** We expect PNB to deliver 11% net profit CAGR over FY09-11E driven by 18% loan CAGR, 3.2% NIMs (one of the highest in PSU banking space), RoEs of ~21 for FY10E and FY11E, respectively.

- **Strategic advantage, growth levers already in place:** PNB has 17% market-share in the under-penetrated Indo-Gangetic region of northern India. Also, Indo-gangetic region is a primary source of CASA (45% of overall India's CASA) which provides access to the low cost of funds.

- **Scores high on CAMEL parameters:** PNB scores well on CAMEL rating due to its high Tier1 capital (9% in FY09), quality assets (GNPA at 1.8% and NNPA 0.2% as of FY09), and low-cost funding franchise (CASA levels of 38% in FY09).

- **Conservative banker :** PNB has been prudent in their lending in the challenging economic environment with paring down its exposures stress sectors (textiles, gems and jewellry, leather products) by 10% while increasing its exposure to relatively safer sectors viz., infrastructure, agriculture and allied industries.

- **Valuation premium among PSU banks justified, initiate with a Buy:** PNB's operational parameters and performance is expected to remain superior in PSU banking space and hence we believe the stock would command a premium. We initiate coverage with a Buy rating and target price of Rs810 an upside of 22%.

- **Key Risks: Upside:** Faster-than-expected loan growth, lower NPAs and sharp decline in bond yields. **Downside:** Higher-than-expected deterioration in asset quality and rise in bond yields

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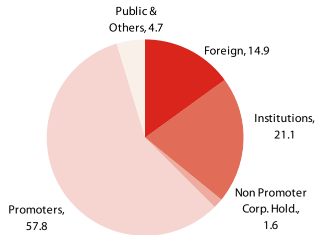
Key Data

Bloomberg Code	PNB IN
Reuters Code	PNBK.BO
Current Shares O/S (mn)	315.3
Diluted Shares O/S(mn)	315.3
Mkt Cap (Rsbn/USDbn)	209.2/4.4
52 Wk H / L (Rs)	725/286
Daily Vol. (3M NSE Avg.)	2,110,394
Face Value (Rs)	10
1 USD = Rs47.0	

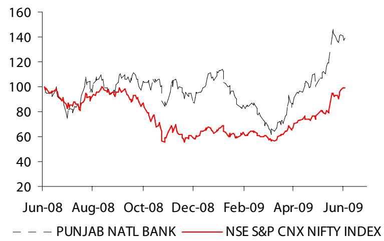
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Punjab National Bank	38.8	54.2	40.6
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

Y/E Mar (Rsmn)	NII	NonInt. Inc.	Adj PAT	*YoY %*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*ROE (%)*	*ROA (%)*
FY07	52,132	17,304	17,236	*104.3*	37	12.8	299	1.5	*13.5*	*0.9*
FY08	55,342	19,976	20,643	*19.8*	49	10.8	318	1.4	*13.8*	*1.0*
FY09E	70,309	29,197	30,909	*49.7*	98	4.8	411	1.0	*22.7*	*1.4*
FY10E	84,011	27,567	33,329	*7.8*	106	6.4	436	1.4	*20.9*	*1.2*
FY11E	101,597	30,265	38,474	*15.4*	122	5.6	508	1.2	*20.6*	*1.2*

Source: Company, Centrum Research Estimates

Shareholding Pattern (%)

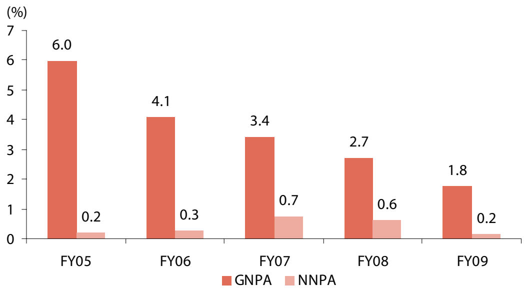
	Q408	Q109	Q209	Q309
Promoter	57.8	57.8	57.8	57.8
Foreign	20.0	19.8	18.5	18.3
Institutions	16.6	16.7	17.8	18.3
Public & Others	5.4	5.6	5.8	5.5
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: NSE

Company Background

Punjab National Bank (PNB) is India's second largest PSU bank, with an asset base of Rs2,208bn, 4,586 branches and 322 extension counters as on 30 Sept 2008. It has a pan-India presence, primarily in the fertile Indo-Gangetic belt of northern India, which has enabled it to capture17-18% of business in the region. The bank's global presence comprises of branches in Hong Kong, UK, Shanghai, Dubai, an off-shore unit in Singapore, subsidiary in Canada and representative office in Norway. PNB has implemented 100% CBS at its branches as also RTGS, NEFT and online share trading services. As a part of financial inclusion measures, PNB has actively undertaken various projects both at the geographical and functional levels. The bank has undertaken organizational restructuring process called *PNB Parivartan* in consultation with Boston Consulting Group (BCG) to initiate steps based on Basel II framework and operational risk management.

Best asset quality



Source: Company, Centrum Research

Key management personnel

Name	Position	Profile
Dr K C Chakrabarty	Chairman	A banking veteran, he was appointed chairman in June 2007 for a 5-year term. Prior to that, he was with Bank of Baroda for 26 years in different capacities at different levels in various facets of banking operations and administration. He was Executive Director of PNB for 9 months and was chairman and managing director of Indian Bank for 2 years.
Mr JM Garg	Executive Director	He was appointed as ED in June 2007. He has 34 years of banking experience with expertise in credit, corporate finance, foreign exchange, marketing and other portfolios in Indian Bank.
Mr Mushtaq A Antulay	Director	He was appointed as director in Feb 2008 for a three-year period. He has been member of Maharashtra Legislative Council and also served as chairman of the Maharashtra Pollution Control Board. He has also been a member of various committees set up by Central Government such as Regional Advisory Committee of Indian Airlines, Central Board of Film Censor & Certification, Telephone Advisory Committee of MTNL.
Mr Gautam P Khandelwal	Director	He was appointed as director in Feb 2008. He has over two-decade experience in industry and business.

Source: Company

Investment Rationale

- Moderate loan growth and high-quality deposit franchise due to extensive rural network help in checking cost of funds and maintain margins at comparatively higher levels
- Successfully gaining market share in loans and deposits without impacting margins
- Improvement in asset quality, strong growth in non-interest income and management continuity till Jun 2012

Dupont Analysis

	FY09E	FY10E	FY11E
% of Average assets			
Net-Interest Income	3.2	3.1	3.1
Non-Interest Income	1.3	1.0	0.9
Net Income	**4.5**	**4.1**	**4.0**
Operating Expenses	1.9	1.7	1.5
Operating Profit	**2.6**	**2.4**	**2.5**
Provisions & Contingencies	0.4	0.6	0.7
Taxes	35.2	35.2	35.2
RoAA (%)	**1.4**	**1.2**	**1.2**
Avg.assets/avg equity (x)	16.2	17.1	17.4
RoAE (%)	**22.7**	**20.9**	**20.6**

Source: Company, Centrum Research Estimates

Summary Financials

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Net Interest Income	46,668	52,132	55,342	70,309	84,011
Growth (%)	16.47	11.7	6.2	27.0	19.5
NIM (%)	*3.6*	*3.5*	*3.3*	*3.3*	*3.2*
Non Interest Income	**12,735**	**17,304**	**19,976**	**29,197**	**27,567**
Growth (%)	*(23.0)*	*35.9*	*15.4*	*46.2*	*(5.6)*
Pre-Prov Profits	**29,171**	**36,174**	**40,063**	**57,444**	**66,480**
Provisions & Contingencies	14,778	14,483	7,103	9,774	15,078
Provision for taxes	5,955	6,291	12,472	16,760	18,073
Adj PAT	**8,438**	**17,236**	**20,643**	**30,909**	**33,329**
Growth (%)	*46.8*	*104.3*	*19.8*	*49.7*	*7.8*
Key Balance Sheet Data					
Networth	93,763	104,354	123,183	147,640	171,931
Deposits	1,196,849	1,398,596	1,664,572	2,097,600	2,549,331
Others	162,061	121,273	202,448	223,950	264,685
Total Liabilities & Equity	**1,452,673**	**1,624,224**	**1,990,203**	**2,469,190**	**2,985,948**
Loans	746,274	965,965	1,195,016	1,547,030	1,810,025
Investments	410,553	451,898	539,917	634,940	846,378
Fixed & Other assets	47,930	49,906	66,964	66,964	66,964
Total Assets	**1,452,673**	**1,624,224**	**1,990,203**	**2,469,190**	**2,985,948**
Key Ratios					
Capital Adequacy & Credit Quality Ratios (%)					
Gross NPA	3,391	3,319	2,767	6,335	8,616
Net NPA	726	754	264	1,901	2,585
Total CAR	12.3	13.5	14.0	12.9	12.2
Tier 1 CAR	8.9	9.0	9.0	8.7	8.6
Per share data					
Fully diluted EPS	36.6	49.2	98.0	105.7	122.1
Book Value per share	321.7	342.0	419.5	496.6	590.3
Adj Book value per share	298.6	318.1	411.2	436.3	508.3
Valuations Ratios					
Price/BV (x)	1.4	1.4	1.0	1.2	1.1
Price/Adj. BV (x)	1.5	1.4	1.0	1.4	1.2
P/E (x)	12.8	10.8	4.8	6.4	5.6
Dividend Yield (%)	2.1	2.5	4.3	3.2	3.6
Dupont Analysis					
% of Average assets					
Net-Interest Income	3.4	3.1	3.2	3.1	3.1
Non-Interest Income	1.1	1.1	1.3	1.0	0.9
Net Income	**4.5**	**4.2**	**4.5**	**4.1**	**4.0**
Operating Expenses	2.2	2.0	1.9	1.7	1.5
Operating Profit	**2.4**	**2.2**	**2.6**	**2.4**	**2.5**
Provisions & Contingencies	0.9	0.4	0.4	0.6	0.7
Taxes	35.3	44.6	35.2	35.2	35.2
RoAA (%)	**0.9**	**1.0**	**1.4**	**1.2**	**1.2**
Avg.assets/avg equity (x)	15.5	15.9	16.2	17.1	17.4
RoAE (%)	**13.5**	**13.8**	**22.7**	**20.9**	**20.6**

Source: Company, Centrum Research Estimates

Investment Argument

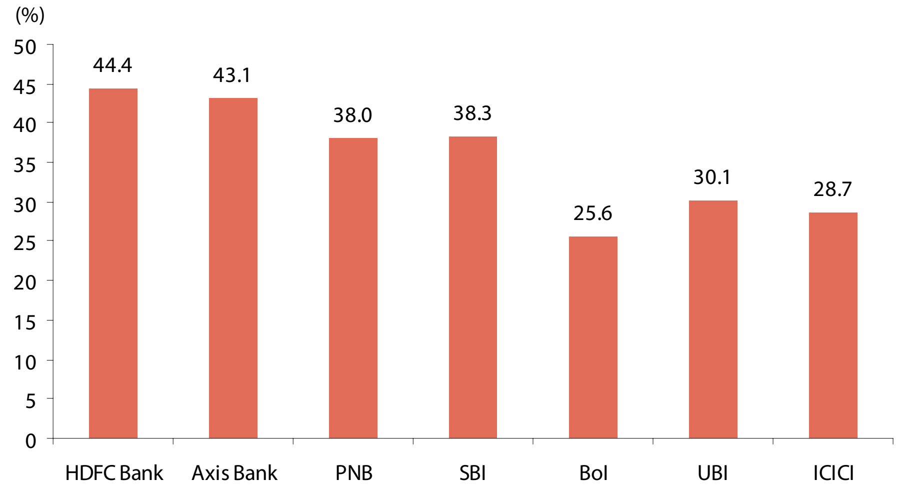
Expected to deliver consistent performance

We expect PNB to deliver 16% net profit CAGR over FY09-11E driven by 18% loan CAGR and 3.2% NIMs with RoEs of ~21% for FY10-11E.

Strong liability franchise to curtail NIM contraction

PNB has the highest CASA ratio in the PSU banking space and the third highest in the overall banking space, next only to Axis Bank and HDFC Bank. This high CASA level provides us the confidence that the bank would be able to contain the dip in NIMs relatively better than its peers. We expect 10bp contraction in NIMs in FY10E to 3.2% from 3.3% for FY09. Also, the bank demonstrated better margin management in FY09 inspite of being the first bank to cut lending and deposit rates, which enhances our confidence in the stock, as it would be able to manage its margin better than peers.

Exhibit 1: PNB CASA - highest among the PSU banks

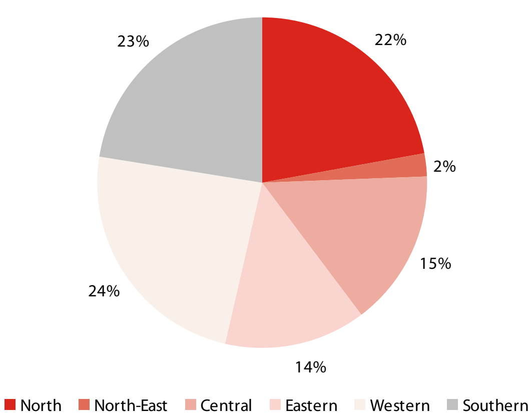


Source: Company

Also, Indo-gangetic region is a primary source of CASA (45% of overall India's CASA) which provides access to the low cost of funds.

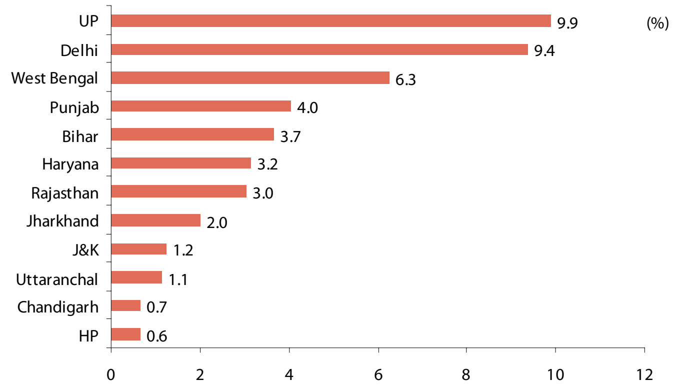
Exhibit 2: Strategic advantage in access to CASA

All India CASA market share



Source: RBI, Centrum Research

Strong presence in CASA rich states – All India CASA Market share of individual states



Source : RBI, Centrum Research

PNB has been proactive in reducing lending and deposit rates during H2FY09 provide us comfort in terms of sustainability of the margins going forward.

Exhibit 3: First to cut lending rates during H2FY09

	Announcement date	Effective date	Reduction	Effective rate (%)
PNB	31-Oct-08	1-Nov-08	50 bps	13.5
	26-Nov-08	1-Dec-08	100 bps	12.5
	29-Dec-08	1-Jan-09	50 bps	12.0
SBI	6-Nov-08	10-Nov-08	75 bps	13.0
	22-Dec-08	1-Jan-09	75 bps	12.0

Source: Company, Centrum Research

Strategic advantage, growth levers already in place

PNB has a 17% market-share in the under-penetrated Indo-Gangetic belt of northern India and 5% of India's total banking assets. We believe this depth and reach would provide the bank the necessary advantage to enhance its loan and deposit market-share through financial inclusion initiatives. Also, Indo-gangetic region is a primary source of CASA (45% of overall India's CASA) which provides access to the low cost of funds.

PNB's has the second-largest branch network in the country (4,600 branches) with 85% of these branches are located in northern and central India, 10% are in the south and 5% in the west. The bank's strong presence in Indo-Gangetic belt (which consists of Punjab, Haryana, Rajasthan, Delhi, Uttar Pradesh, Bihar, Chattisgarh) would provide it a strategic advantage as financial penetration is lower in these regions as compared to the rest of the country. Further, PNB's financial inclusion initiatives are expected to provide it long-term strategic advantage over its peers.

Scores high on CAMEL parameters as of FY09

PNB scores well on CAMEL rating due to its high Tier 1 capital (9% in FY09), quality asset book (GNPA at 1.8% and NNPA at 0.2% as of FY09) and low-cost funding franchise (CASA levels of 38% in FY09) which could fund 20% loan growth over the next three years with no equity dilution. Further, the bank's low dependence on treasury income (7% next to SBI) and also management continuity for the next three years makes us positive on the next two years operational performance.

Exhibit 4: PNB scores on Tier 1 capital, asset quality and CASA level

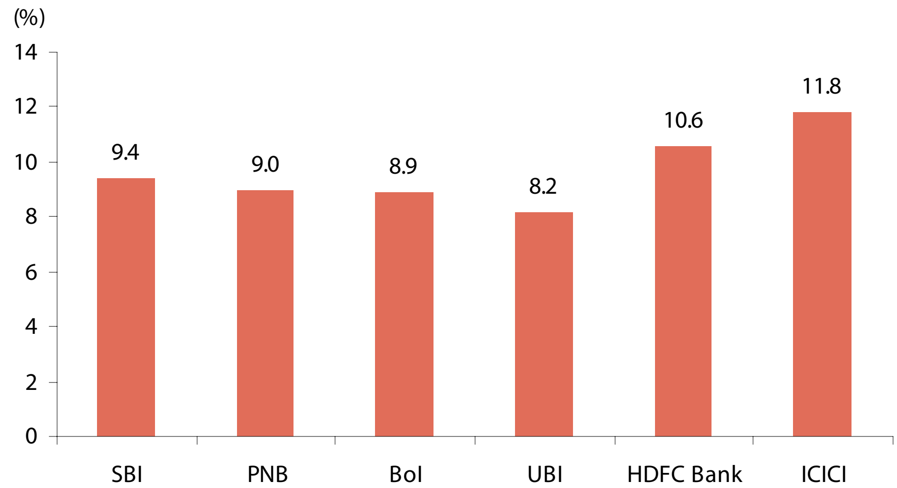
	Tier 1	CASA	GNPA	NNPA	Coverage	Management Continuity
SBI	9.4	38.3	2.8	1.8	38.0	31-Mar-11
PNB	**9.0**	**38.0**	**1.8**	**0.2**	**90.4**	**4 June 2012**
BoI	8.9	25.6	1.7	0.4	74.6	18-May-09
UBI	8.2	30.1	2.0	0.3	83.0	1-Apr-11
HDFC Bank	10.6	44.4	2.0	0.6	68.4	No change
ICICI	11.8	28.7	4.2	2.0	53.5	1-May-09
Axis Bank	9.3	43.2	1.1	0.4	63.6	1 Aug, 2009

Source: Respective banks, Centrum Research

Comfortable Tier 1 capital

Standalone PNB's Tier 1 capital of 9% in FY09 is the next to only SBI in our PSU banking space which should provide as a cushion for further deterioration in asset quality and to fund the growth going forward. Also bank is considering the merger of PNB gilts with the PNB which could potentially provide a 60 bps spike in the Tier 1 capital going forward. Currently we have not factored this into our estimates.

Exhibit 5: Optimally capitalised with PNB Tier 1 capital at 9%



Source: Company, Centrum Research

Conservative banker

Prudent lending practices

PNB has been prudent in their lending in the challenging economic environment with cautious lending to the stress sectors viz., Textiles, Gems and Jewellry, Leather products while increasing its exposure to relatively safer sectors viz., Infrastructure, Agriculture and allied industries.

Exhibit 6: Cautious lending practices

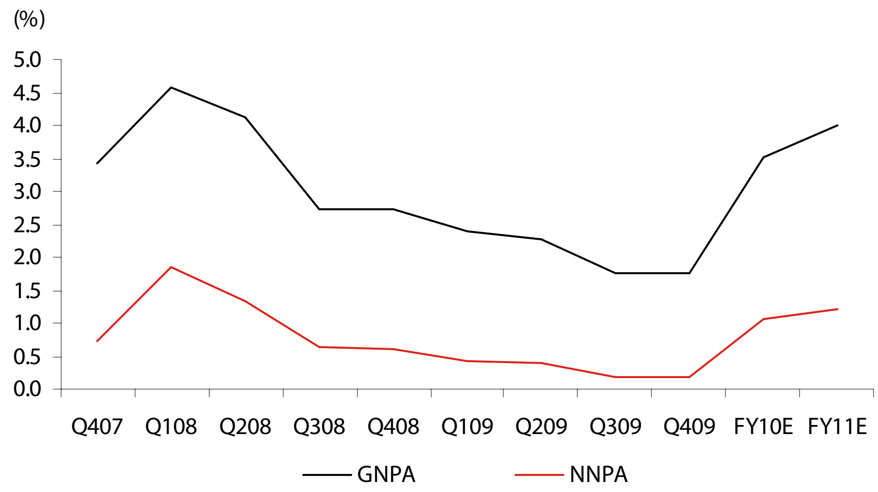
	Loan Book (Rsbn)		Loan composition (%)		Comments
Fund based exposure	**FY08**	**FY09**	**FY08**	**FY09**	
Metals & Mining	88	87	7.3	5.6	
Textiles	56	42	4.6	2.7	**Cautious lending in stress sectors**
Gems And Jewellery	6	6	0.5	0.4	
Leather & Leather Products	5	3	0.4	0.2	
Infrastructure	67	221	5.5	14.1	**Participating in India growth story**
Cement & Construction	38	47	3.1	3.0	
Sugar	24	23	2.0	1.5	
Vegetable Oils And Vanaspati	7	5	0.6	0.3	**Supporting Agriculture & allied industries**
Food Processing	16	28	1.3	1.8	
Electricity	48	50	4.0	3.2	
All Engineering	34	33	2.8	2.1	
Chemicals, Dyes, Paints, Etc.	28	23	2.3	1.5	
Paper & Paper Products	11	10	0.9	0.6	
Petroleum	21	6	1.7	0.4	
Automobiles Including Trucks	4	4	0.3	0.3	
NBFCs	59	62	4.9	3.9	
Trading	13	18	1.0	1.1	
Other	78	99	6.5	6.3	
Total	**608**	**767**	**50.3**	**49.1**	
Residuary Other Advances	601	794	49.7	50.9	
Grand Total	1,209	1,561	100.0	100.0	

Source: Company, Centrum Research

.. to aid asset quality be better than industry

We expect 100bps deterioration in PNB's NNPA for FY11E at 1.2% from 0.2% in FY09, one of the lowest in the PSU banking space. We expect PNB to be better placed than the industry with GNPAs at 4% for FY11E vs. our industry NPAs at 4.6% in terms of asset quality aided by the prudent lending practices.

Exhibit 7: Asset quality has improved over the last 8 quarters



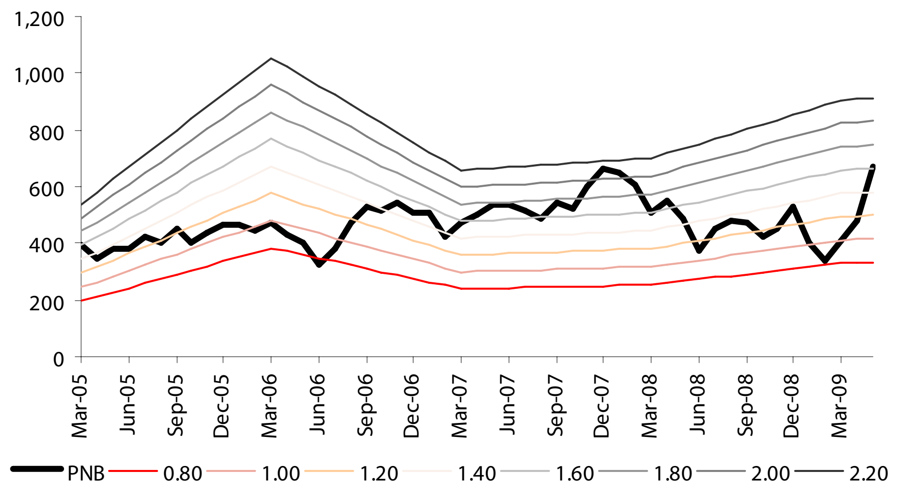
Source: Company, Centrum Research Estimates

Valuation Analysis

Premium in the PSU banking space to stay, initiate with buy

We recommend a Buy on PNB with a target price of Rs810 an upside of 22%, valuing the bank at 1.6x P/Adj BV using single stage Gordon growth model. We believe the bank is better positioned with earnings CAGR of 15% over FY09-11E in the Public Sector banking space mainly on account of better funding franchise in the public sector banking space, loan mix and better asset quality with higher provision coverage which makes us positive on the bank.

Exhibit 8: Trading near historical low P/Adj BV but of late it has corrected.



Source: Company, Centrum Research

Key risks

Key upside risks

- Faster-than-expected loan growth, lower NPAs and sharp decline in bond yields.

Key downside risks

- Higher-than-expected deterioration in asset quality
- Margin compression

Financials

Exhibit 9: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	112,361	142,650	193,262	232,357	278,494
Interest Expense	60,229	87,308	122,953	148,346	176,897
Net Interest Income	**52,132**	**55,342**	**70,309**	**84,011**	**101,597**
YoY Growth (%)	*11.7*	*6.2*	*27.0*	*19.5*	*20.9*
Non Interest Income	173,037	199,755	288,847	277,669	303,152
YoY Growth (%)	*35.9*	*15.4*	*46.2*	*(5.6)*	*9.8*
Fee & Other Income	13,568	15,545	22,238	23,267	25,815
Gains / (Losses) on Securities	3,736	4,431	6,647	4,500	4,500
Total Net Income	**225,169**	**255,097**	**359,156**	**361,680**	**404,749**
Total Operating Expenses	**33,262**	**35,254**	**42,062**	**45,098**	**49,073**
YoY Growth (%)	*10.0*	*6.0*	*19.3*	*7.2*	*8.8*
Employee Expenses	23,524	24,615	29,244	30,998	32,858
Other Operating Expenses	9,737	10,639	12,818	14,100	16,215
Pre-provision Profit (Pre-excep)	36,174	40,063	57,444	66,480	82,789
Exceptionals	3,868	(4,978)	-	-	-
Pre-provision Profit	**40,042**	**35,085**	**57,444**	**66,480**	**82,789**
NPAProvisions	5,998	2,771	8,206	13,428	21,802
Provisions for Depn on Invest	6,749	1,042	2,160	-	-
Other Provisions	1,736	3,291	(1,420)		
Provisions	14,483	7,103	9,774	15,078	23,452
Profit Before Tax	17,824	27,982	47,669	51,401	59,337
Taxes	6,291	12,472	16,760	18,073	20,863
Net Profit	13,368	15,665	30,909	33,329	38,474
Exceptionals (Post Tax)	3,868	4,978	-	-	-
Adj Net Profit	17,236	20,643	30,909	33,329	38,474

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Cash and balance with RBI	123,720	152,581	176,198	209,045	221,460
Inter-bank borrowings	32,735	35,725	44,050	53,536	54,607
Loans & Advances	965,965	1,195,016	1,547,030	1,810,025	2,153,930
Investments	451,898	539,917	634,940	846,378	1,031,459
Interest Earning Assets	**1,574,318**	**1,923,239**	**2,402,218**	**2,918,984**	**3,461,456**
Fixed Assets	10,098	23,155	23,155	23,155	23,155
Other Assets	39,808	43,808	43,808	43,808	43,808
Total Assets	**1,624,224**	**1,990,203**	**2,469,190**	**2,985,948**	**3,528,420**
Customer Deposits	1,398,596	1,664,572	2,097,600	2,549,331	3,033,704
o/w CASA	645,543	715,609	814,600	1,019,732	1,274,156
Borrowings	19,488	54,465	75,968	116,703	145,253
o/w Subordinated debt	36,948	61,648	-	-	-
Interest Bearing Liabil.	**1,418,085**	**1,719,038**	**2,173,568**	**2,666,034**	**3,178,957**
Other Liab / Pref Capital	1,519,870	1,867,020	2,321,550	2,814,016	3,326,939
Equity Capital	3,153	3,153	3,153	3,153	3,153
Reserves	101,201	120,030	144,487	168,778	198,328
Total Liabilities	**1,624,224**	**1,990,203**	**2,469,190**	**2,985,948**	**3,528,420**

Source: Company, Centrum Research Estimates

Exhibit 11: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Balance Sheet Structure Ratios (%)					
Loans/Deposits	69.1	71.8	73.8	71.0	71.0
Investments / Deposits	32.3	32.4	32.1	33.2	34.0
CASA Ratio	46.2	43.0	39.0	40.0	42.0
Loan Growth	29.4	23.7	29.5	17.0	19.0
Deposit Growth	16.9	19.0	26.0	21.5	19.0
Operating Ratios (%)					
NIM	3.5	3.3	3.3	3.2	3.2
Non-interest income/Net income	76.8	78.3	80.4	76.8	74.9
Employee Costs as % of Total Op Costs	70.7	69.8	69.5	68.7	67.0
Cost/Income	47.9	46.8	42.3	40.4	37.2
Operating cost growth	10.0	6.0	19.3	(7.2)	8.8
Total prov as % of avg. loans	1.7	0.7	0.7	0.9	1.1
Tax Rate (%)	35.3	44.6	35.2	35.2	35.2
Credit Quality Ratios (%)					
Gross NPA	3.4	2.7	1.8	3.5	4.0
Net NPA	0.7	0.6	0.2	1.1	1.2
Slippage	2.4	1.8	1.3	4.0	5.0
NPA Provisions / Avg loans	1.7	0.7	0.7	0.9	1.1
NPA coverage ratio	78.6	77.3	90.4	70.0	70.0
Capital Adequacy Ratios (%)					
Total CAR	12.3	13.5	14.0	13.0	12.5
Tier 1 CAR	8.9	9.0	9.0	8.8	8.9
Profitability Ratios (%)					
RoAE	13.5	13.8	22.7	20.9	20.6
RoAA	0.9	1.0	1.4	1.2	1.2
Valuations Ratios					
BVPS (Rs)	321.7	342.0	419.5	496.6	590.3
Price/BV (x)	1.4	1.4	1.0	1.2	1.1
Adjusted BVPS (Rs)	298.6	318.1	411.2	436.3	508.3
Price/Adj. BV (x)	1.5	1.4	1.0	1.4	1.2
EPS (Rs)	36.6	49.2	98.0	105.7	122.1
P/E (x)	12.8	10.8	4.8	6.4	5.6
Dividend Yield	2.1	2.5	4.3	3.2	3.6

Source: Company, Centrum Research Estimates

INDIA

Banking

Bank of India

Update/Rating change **8 June 2009**

Hold

Target Price: Rs339

CMP: Rs347*

Downside: 2%

**as on 1 June 2009*

Running out of steam

- **Downgraded to Hold with a price target of Rs339:** We value the bank at 1.3x FY11E Adj BV as we believe the valuation premium would fade off due to slowing earnings momentum, higher asset quality risks and expected reorientation of strategy by the incoming CMD.

- **Earnings momentum slowing:** PAT increased just 7% YoY in Q4FY09 after growing at an average pace of over 50% YoY in the previous 10 quarters. We expect bank to report a 6% FY10E PAT de-growth.

- **But RoEs expected above 20%:** BOI is expected to report RoEs of over 20% during FY09-11E after factoring in 10bp margin contraction, 30bp spike in credit costs and moderation in treasury income. Above average RoEs would be a key positive for the bank.

- **Asset quality risk still lingers:** Though the bank reported marginal sequential decline in NPAs during Q4FY09, considering the overall stressed environment, higher unseasoned loan book and higher restructured assets of Rs50bn, we believe that significant asset quality risk still persists. We expect GNPA and NNPA levels to rise to 4% and 1.4% by FY11E from 1.7% and 0.4%, respectively, in FY09.

- **New CMD due for appointment:** We seek strategic clarity from the new CMD who is yet to be appointed. Mr Narayanasami retired in May 2009.

- **Key risks: Upside** - Higher treasury gains in a softening yield scenario. **Downside** – Higher-than-expected deterioration in asset quality.

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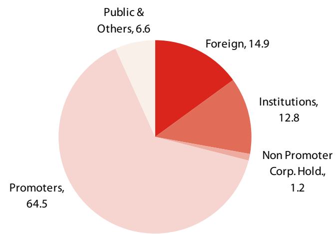
Key Data

Bloomberg Code	BOI IN
Reuters Code	BOI.BO
Current Shares O/S (mn)	525.2
Diluted Shares O/S(mn)	525.2
Mkt Cap (Rsbn/USDbn)	182.5/3.9
52 Wk H / L (Rs)	369/179
Daily Vol. (3M NSE Avg.)	2,582,568
Face Value (Rs)	10
1 USD = Rs46.9	

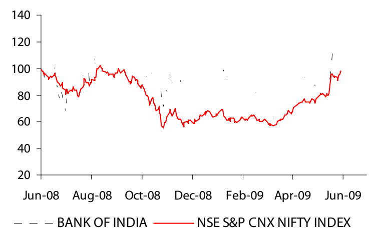
*Source: Bloomberg; ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Bank of India	47.8	42.3	18.3
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

Y/E March (Rsmn)	NII	Non Int Inc	Adj PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoE (%)*	*RoA (%)*
FY07	34,405	15,630	11,117	*60.1*	23.0	6.5	101	1.5	*21.2*	*0.9*
FY08	42,293	21,169	20,094	*78.9*	38.3	6.9	157	1.7	*27.6*	*1.3*
FY09E	54,989	30,519	30,074	*49.7*	57.3	4.7	200	1.3	*30.1*	*1.5*
FY10E	63,047	29,512	28,181	*(6.3)*	53.7	6.5	231	1.5	*22.7*	*1.2*
FY11E	73,118	33,314	31,537	*11.9*	60.1	5.8	264	1.3	*20.8*	*1.1*

Source: Company, Centrum Research Estimates

Financials

Exhibit 1: Income Statement

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Earned	89,363	123,552	163,474	187,925	217,062
Interest Expended	54,958	81,260	108,485	124,878	143,944
Net Interest Income	**34,405**	**42,293**	**54,989**	**63,047**	**73,118**
Growth(%)	*30.7*	*22.9*	*30.0*	*14.7*	*16.0*
Non Interest Income	**15,630**	**21,169**	**30,519**	**29,512**	**33,314**
Growth(%)	*32.0*	*35.4*	*44.2*	*-3.3*	*12.9*
- Fee & other income	13,580	17,507	23,059	23,512	26,314
- Profit/loss on sale of investments	2,049	3,662	7,460	6,000	7,000
Net income	**50,034**	**63,462**	**85,508**	**92,559**	**106,432**
Growth(%)	*31.1*	*26.8*	*34.7*	*8.2*	*15.0*
Operating Expenses	**26,084**	**26,450**	**30,940**	**34,894**	**39,662**
Growth(%)	*23.3*	*1.4*	*17.0*	*12.8*	*13.7*
- Employee expenses	16,140	16,570	19,374	22,175	24,745
- Other operating exp.	9,944	9,880	11,566	12,719	14,917
Pre-Prov Profits	**23,950**	**37,012**	**54,568**	**57,665**	**66,770**
Provisions & Contingencies	8,621	10,165	12,924	19,323	23,862
Loan loss provisions	5,269	6,973	6,230	17,835	22,867
Other provisions	3,353	3,192	6,694	1,488	996
Profit Before Tax	**15,329**	**26,847**	**41,644**	**38,342**	**42,907**
Taxes	4,097	6,753	11,571	10,161	11,370
PAT before extra-ordinary items	**11,232**	**20,094**	**30,074**	**28,181**	**31,537**
Growth(%)	*60.1*	*78.9*	*49.7*	*-6.3*	*11.9*
Extra-ordinary items	(115)	(0)	-	-	-
PAT after extra-ordinary items	**11,117**	**20,094**	**30,074**	**28,181**	**31,537**

Source: Company, Centrum Research Estimates

Exhibit 2: Balance Sheet

Y/E March (Rsmn)	FY07	FY08	FY09E	FY10E	FY11E
Cash and balance with RBI	71,969	117,419	116,325	113,953	134,572
Inter bank borrowings	102,087	59,755	62,604	57,956	68,678
Loans	851,159	1,134,763	1,429,090	1,657,744	1,972,716
Investments	354,928	418,029	533,169	679,866	779,227
Total interest earning assets	**1,380,142**	**1,729,966**	**2,141,188**	**2,509,520**	**2,955,193**
Fixed Assets	7,893	24,261	27,302	29,422	31,476
Other Assets	30,435	34,380	66,079	82,033	102,013
Total Assets	**1,418,470**	**1,788,606**	**2,234,568**	**2,620,975**	**3,088,682**
Deposits	1,198,817	1,500,120	1,897,080	2,229,069	2,641,447
Other Int. bearing liabil.	113,798	121,184	156,860	176,460	192,616
Total interest bearing liab	**1,312,615**	**1,621,304**	**2,053,940**	**2,405,529**	**2,834,063**
Other non-int. bearing liab	46,901	61,408	51,561	61,561	72,561
Total Liabilities	**1,359,516**	**1,682,712**	**2,105,501**	**2,467,090**	**2,906,624**
Equity	58,954	105,894	129,067	153,884	182,058
Total Liabilities & equity	**1,418,470**	**1,788,606**	**2,234,568**	**2,620,975**	**3,088,682**

Source: Company, Centrum Research Estimates

Exhibit 3: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Balance Sheet Structure Ratios (%)					
Loans/Deposits	71.0	75.6	75.3	74.4	74.7
CASA Ratio	32.2	30.6	25.6	29.0	31.0
Loan Growth	30.6	33.3	25.9	16.0	19.0
Deposit Growth	27.6	25.1	26.5	17.5	18.5
Operating Ratios (%)					
NIM	2.8	2.7	2.8	2.7	2.7
Non-interest income/Net income	31.2	33.4	35.7	31.9	31.3
Employee Costs as % of Total Op Costs	61.9	62.6	62.6	63.5	62.4
Cost/Income	52.1	41.7	36.2	37.7	37.3
Operating cost growth	23.3	1.4	17.0	12.8	13.7
Total provi as % of avg. loans	1.1	1.0	1.0	1.3	1.3
Credit Quality Ratios (%)					
Gross NPA	2.5	1.7	1.7	2.9	3.9
Net NPA	1.0	0.5	0.4	1.0	1.4
Slippage	1.1	1.2	1.2	2.0	2.1
NPL coverage ratio	64.5	75.6	74.6	65.0	63.8
Capital Adequacy Ratios (%)					
Total CAR	11.6	12.0	13.0	12.5	12.5
Tier 1 CAR	6.5	7.7	8.9	8.8	8.9
Profitability Ratios (%)					
RoAE	21.2	27.6	30.1	22.7	20.8
RoAA	0.9	1.3	1.5	1.2	1.1
Valuations Ratios					
BVPS (Rs)	117.7	168.1	212.2	261.3	316.9
Price/BV (x)	1.3	1.6	1.3	1.3	1.1
Adjusted BVPS (Rs)	101.1	156.8	200.2	231.2	264.5
Price/Adj. BV (x)	1.5	1.7	1.3	1.5	1.3
EPS (Rs)	23.0	38.3	57.3	53.7	60.1
P/E (x)	6.5	6.9	4.7	6.5	5.8
Dividend Yield	2.3	1.5	3.0	1.3	1.3

Source: Company, Centrum Research Estimates

INDIA

Banking

CENTRUM

Union Bank of India

Update **8 June 2009**

Buy

Target Price: Rs239

CMP: Rs207*

Upside: 15%

**as on 1 June 2009*

High profitability

- **Liability franchisee expansion good from long-term perspective:** UBI is pursuing an aggressive branch expansion strategy which will boost CASA in the long-term supporting margins. However, the bank is expected to witness 10bp NIM contraction in FY10E, mainly on account of assets getting re-priced at lower levels and the re-pricing of liabilities will with a lag.

- **Asset quality expected to be best among PSU banks:** FY11E NNPAs at 1.1% is expected to be among the best in the PSU banking space. The high provision coverage at 83% for FY09E also provides comfort in case of higher-than-expected deterioration in asset quality.

- **Earnings growth set to moderate; RoEs still to remain above 20%:** We expect RoEs to be above 20% despite moderation in earnings growth (8% CAGR over FY09-11E) factoring in lower loan growth, 10bp NIM contraction in FY1OE and 30bp increase in credit costs.

- **Buy with target price of Rs239:** We recommend a Buy with a target of Rs239 valuing the bank at 1.3x FY11E Adj BV using single stage Gordon growth model and providing a 10% discount for its smaller size. Our recommendation is premised on UBI's strong return ratios (over 20%), superior asset quality with high NPA provision cover, a diversified loan portfolio with a relatively lower exposure to the SME and retail segments, and better cost efficiency.

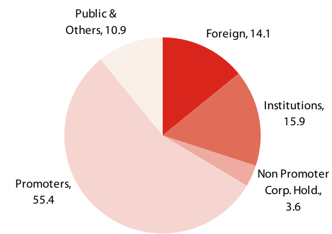
- **Key risks: Upside** - Higher treasury gains in a softening yield scenario. **Downside** - Lower Tier-I capital and thus SBI style equity dilution a medium term possibility.

Key Data

Bloomberg Code	UNBK IN
Reuters Code	UNBK.BO
Current Shares O/S (mn)	505.1
Diluted Shares O/S(mn)	505.1
Mkt Cap (Rsbn/USDbn)	104.6/2.2
52 Wk H / L (Rs)	225/96
Daily Vol. (3M NSE Avg.)	1,484,715
Face Value (Rs)	10
1 USD = Rs46.9	

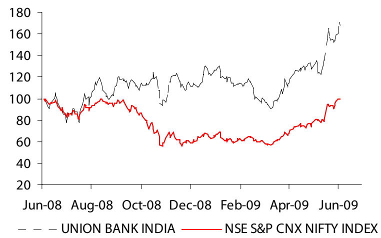
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
UBI	26.4	43.8	60.3
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

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Y/E March (Rsbn)	NII	Non Int Inc	Adj PAT	*YoY gr (%)*	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	*RoE (%)*	*RoA (%)*
FY07	26.4	8.4	8.5	*25.2*	16.7	7.0	81	1.4	*19.2*	*0.9*
FY08	28.5	13.2	13.9	*64.1*	27.5	5.5	108	1.4	*26.8*	*1.2*
FY09E	38.1	14.8	17.3	*24.5*	34.2	4.2	134	1.1	*27.1*	*1.2*
FY10E	44.9	15.1	16.9	*(1.9)*	33.5	6.2	153	1.4	*21.5*	*1.0*
FY11E	54.4	16.4	19.9	*17.5*	39.4	5.3	179	1.2	*20.9*	*1.0*

Source: Company, Centrum Research Estimates

Financials

Exhibit 1: Income Statement

Y/E March (Rsbn)	FY07	FY08	FY09E	FY10E	FY11E
Interest Earned	72.3	92.1	118.9	137.8	157.9
Interest Expended	45.9	63.6	80.8	92.9	103.5
Net Interest Income	**26.4**	**28.5**	**38.1**	**44.9**	**54.4**
Growth (%)	*17.4*	*8.3*	*33.6*	*17.8*	*21.2*
Non Interest Income	**8.4**	**13.2**	**14.8**	**15.1**	**16.4**
Growth (%)	*34.8*	*56.8*	*12.3*	*1.6*	*8.8*
- Fee and other income	7.3	10.3	9.7	11.3	13.4
- P/L on sale of invest	1.1	2.9	5.2	3.8	3.0
Net income	**34.8**	**41.7**	**53.0**	**60.0**	**70.8**
Growth (%)	*21.2*	*20.0*	*26.9*	*13.3*	*18.1*
Operating Expenses	**14.8**	**15.9**	**22.1**	**24.4**	**28.1**
Growth (%)	*5.2*	*7.9*	*39.0*	*10.1*	*15.4*
- Employee expenses	8.7	8.5	11.5	13.0	15.0
- Other operating exp.	6.0	7.5	10.6	11.4	13.1
Pre-Prov Profits	**20.0**	**25.8**	**30.8**	**35.6**	**42.7**
Prov & Cont	**6.2**	**7.3**	**7.4**	**12.4**	**15.4**
Provisions for NPA	3.3	5.9	5.5	10.8	14.6
Other provisions	2.9	1.4	1.9	1.6	0.8
Profit Before Tax	**13.8**	**18.5**	**23.4**	**23.2**	**27.3**
Taxes	5.4	4.6	6.2	6.3	7.4
Profit after Tax	**8.5**	**13.9**	**17.3**	**16.9**	**19.9**
Growth (%)	*25.2*	*64.1*	*24.5*	*(1.9)*	*17.5*

Source: Company, Centrum Research Estimates

Exhibit 2: Balance Sheet

Y/E March (Rsbn)	FY07	FY08	FY09E	FY10E	FY11E
Cash and bal with RBI	59	95	87	84	99
Inter bank borr	25	6	42	45	48
Loans	624	743	967	1,141	1,355
Investments	280	338	432	517	606
Total int assets	**988**	**1,183**	**1,527**	**1,787**	**2,108**
Fixed Assets	8	22	27	27	27
Other Assets	32	39	57	50	52
Total Assets	**1,028**	**1,244**	**1,610**	**1,864**	**2,187**
Deposits	852	1,039	1,387	1,616	1,907
Other Int bearing liab.	66	85	97	110	125
Total int bearing liab.	**918**	**1,124**	**1,484**	**1,726**	**2,031**
Other non-int bearing liab.	58	47	38	35	36
Total Liabilities	**976**	**1,170**	**1,522**	**1,761**	**2,068**
Equity	52	73	88	103	120
Total Liab & equity	**1,028**	**1,244**	**1,610**	**1,864**	**2,187**

Source: Company, Centrum Research Estimates

Exhibit 3: Key Ratios

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Bal Sheet Ratios (%)					
Loans/Deposits	73.2	71.6	69.7	70.6	71.1
CASA Ratio	34.5	34.9	30.1	34.0	36.0
Loan Growth	16.9	19.2	30.0	18.0	18.8
Deposit Growth	15.0	21.9	33.5	16.5	18.0
Operating Ratios (%)					
NIM	2.9	2.6	2.8	2.7	2.8
Non-int inc/Net income	24.2	31.6	28.0	25.1	23.1
Emp. costs/ Total Op Costs	59.2	53.1	52.0	53.1	53.4
Cost/Income	42.5	38.2	41.8	40.6	39.7
Operating cost growth	5.2	7.9	39.0	10.1	15.4
Total prov/avg. loans	1.1	1.1	0.9	1.2	1.2
Credit Quality Ratios (%)					
Gross NPA	2.9	2.2	2.0	2.9	3.7
Net NPA	1.0	0.2	0.3	0.8	1.0
NPL coverage ratio	67.4	91.2	83.0	73.0	72.7
Capital Adeq Ratios (%)					
Total CAR	12.8	11.7	13.3	13.3	13.2
Tier 1 CAR	7.8	7.0	8.2	8.3	8.5
Profitability Ratios (%)					
RoAE	19.2	26.8	27.1	21.6	21.1
RoAA	0.9	1.2	1.2	1.0	1.0
Valuations Ratios					
BVPS (Rs)	93.3	110.9	140.4	169.0	203.0
Price/BV (x)	1.2	1.4	1.0	1.2	1.0
Adjusted BVPS (Rs)	81.4	108.4	134.4	151.3	175.7
Price/Adj. BV (x)	1.4	1.4	1.1	1.4	1.2
EPS (Rs)	16.7	27.5	34.2	33.5	39.4
P/E (x)	7.0	5.5	4.2	6.2	5.3

Source: Company, Centrum Research Estimates

INDIA

Banking

Indian Overseas Bank

Update/Rating change **8 June 2009**

Hold

Target Price: Rs92

CMP: Rs95*

Upside: 15%

**as on 1 June 2009*

Fairly priced

- **Downgraded to Hold with price target of Rs92:** After the recent run-up in the stock price (45% in one month), we believe IOB is fairly valued. We have downgraded our rating to Hold from Buy with a target of Rs92 valuing the bank at 1x FY11E Adj BV. High dividend yield of 5% is still comforting factor.

- **Earnings pressure in FY10E, improvement in FY11E:** We expect IOB to report 7% de-growth in FY10E PAT mainly on account of the 14bp margin contraction and 15bps increase in credit costs. We expect 24% growth in FY11E PAT factoring in 30bp YoY margin improvement, though offset by the 30bp increase in credit costs.

- **Margins to stabilize in FY11E:** IOB to witness 15bp margin contraction due to mobilization of high-cost deposits during H2FY09 and downward bias on yields on advances. Its CASA mobilization has not been healthy.

- **Asset quality vulnerability increases:** Bank has restructured relatively higher proportion of loans in the PSU banking space (Rs50bn or 6.6% of loan book) which makes us believe the bank is more vulnerable to deterioration in asset quality. We had factored in 15bp and 30bp increase in credit costs for FY10E and FY11E, respectively.

- **Key risks: Upside** - Higher treasury gains in a softening yield scenario. **Downside** – Higher-than-expected deterioration in asset quality.

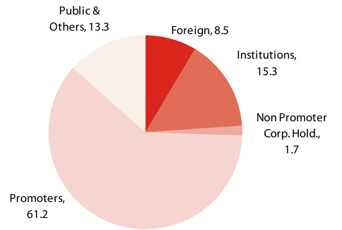
Key Data

Bloomberg Code	IOB IN
Reuters Code	IOBK.BO
Current Shares O/S (mn)	544.8
Diluted Shares O/S(mn)	544.8
Mkt Cap (Rsbn/USDbn)	51.6/1.1
52 Wk H / L (Rs)	121/38
Daily Vol. (3M NSE Avg.)	2,390,938
Face Value (Rs)	10

1 USD = Rs46.9

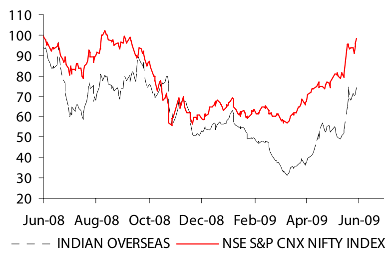
*Source: Bloomberg ; * As on 1 June 2009*

Shareholding Pattern



As on 31 March 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Indian Overseas	47.2	43.7	(17.9)
NIFTY	30.3	70.3	(4.0)

Source: Bloomberg, Centrum Research
** as on 1 June 2009*

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Y/E Mar (Rsmn)	NII	Non Int. Inc.	Adj PAT	YoY gr (%)	EPS (Rs)	P/E (x)	Adj BV (Rs)	P/Adj BV (x)	RoE (%)	RoA (%)
FY07	25,608	3,870	10,084	28.7	18.5	5.6	66.3	1.5	29.1	1.4
FY08	26,795	8,076	12,023	19.2	22.1	6.1	80.4	1.6	27.9	1.3
FY09	30,378	13,595	12,577	4.6	23.1	3.5	82.3	1.0	24.1	1.1
FY10E	34,168	10,532	11,741	(6.6)	21.6	4.0	84.4	1.0	19.2	0.9
FY11E	42,785	8,962	13,270	13.0	24.4	3.5	94.0	0.9	18.8	0.9

Source: Company, Centrum Research Estimates

Financials

Exhibit 1: Income Statement

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E
Interest Income	79,682	98,097	113,316	131,250
Interest Expense	52,888	67,718	79,148	88,465
Net Interest Income	**26,795**	**30,378**	**34,168**	**42,785**
YoY Growth (%)				
Non Interest Income	**8,076**	**13,595**	**10,532**	**8,962**
YoY Growth (%)				
Fee Income	4,687	5,390	6,199	7,129
Gains / (Losses) on Securities	(367)	5812	2500	2000
Others	3,756	2,392	1,833	1,833
Total Net Income	**34,871**	**43,973**	**44,700**	**51,747**
Total Operating Expenses	**14,853**	**19,417**	**20,180**	**21,663**
YoY Growth (%)				
Employee Costs	9,497	12,718	13,195	14,119
Other Operating Expenses	5,356	6,698	6,985	7,544
Pre-provision Profit (Pre-excep)	**20,018**	**24,556**	**24,520**	**30,084**
Exceptionals		0		
Pre-provision Profit	**20,018**	**24,556**	**24,520**	**30,084**
NPL Provisions	1,254	3,746	5,731	9,585
Provisions for Depn on Invest	1,502	0	720	0
Other Provisions	715	1,948	545	693
Provisions	**3,471**	**5,694**	**6,996**	**10,279**
Profit Before Tax	**16,547**	**18,862**	**17,524**	**19,806**
Taxes	4,524	6,285	5,783	6,536
Net Profit	**12,023**	**12,577**	**11,741**	**13,270**
Exceptionals (Post Tax)		0		
Adj Net Profit	**12,023**	**12,577**	**11,741**	**13,270**

Source: Company, Centrum Research Estimates

Exhibit 2: Balance Sheet

Y/E March (Rsmn)	FY08	FY09	FY10E	FY10E
Cash and balance with RBI	91,242	97,629	104,463	104,463
Inter-bank borrowings	12,171	15,017	17,825	17,825
Loans & Advances	604,228	758,095	879,391	1,037,681
Investments	284,747	333,154	389,790	462,678
Total Interest Earning Assets	**992,389**	**1,203,896**	**1,391,470**	**1,622,648**
Fixed Assets	5,586	6,102	6,681	6,681
Other Assets	20,613	23,293	26,321	29,742
Total Assets	**1,018,587**	**1,233,291**	**1,424,471**	**1,659,071**
Customer Deposits	843,256	1,001,159	1,188,351	1,410,564
Other Interest Bearing Liab	63,536	95,188	87,558	90,112
Total Int Bearing Liab	**906,792**	**1,096,347**	**1,275,909**	**1,500,676**
Other Non-Int Bearing Liab	63,238	67,238	71,238	71,238
Total Liabilities	**970,031**	**1,163,585**	**1,347,147**	**1,571,914**
Equity	48,567	69,706	77,324	87,156
Total Liab & Equity	**1,018,597**	**1,233,291**	**1,424,471**	**1,659,071**

Source: Company, Centrum Research Estimates

Exhibit 3: Key Ratios

Y/E March	FY08	FY09	FY10E	FY10E
Balance Sheet Structure Ratios (%)				
Loans / Deposits	71.7	75.7	74.0	73.6
CASA Ratio	33.5	30.3	30.1	29.9
Loan Growth	28.4	21.0	16.0	18.0
Deposit Growth	22.7	18.7	18.7	18.7
Operational Ratios (%)				
Net Interest Margin	3.0	2.8	2.6	2.8
Non-Int Inc as % of Total Inc	23.2	30.9	23.6	17.3
Core fee income Growth	20.7	15.0	15.0	15.0
Emp Costs as % of Total Op Costs	63.9	65.5	65.4	65.2
Cost to Income Ratio	42.6	44.2	45.1	41.9
Operating costs growth	7.0	30.7	3.9	7.3
Total prov as % avg loans	0.2	0.6	0.7	1.0
Tax Rate (%)	27.3	33.3	33.0	33.0
Credit Quality Ratios (%)				
Gross NPLs as % of loans	1.6	2.8	4.3	5.1
NPL Coverage Ratio	63.6	43.5	48.4	54.7
Net NPLs as % of net loans	0.6	1.6	2.2	2.3
Capital Adequacy Ratios (%)				
Total CAR (%)	11.3	13.2	12.7	12.1
Tier 1 Capital ratio (%)	7.3	7.6	-	-
Profitability Ratios (%)				
Adj RoE	27.9	24.1	19.2	18.8
RoA	1.3	1.1	0.9	0.9
Valuation Ratios				
EPS (Rs)	22.1	23.1	21.6	24.4
P/E (x)	6.1	3.5	4.0	3.5
Adj BV per share (Rs)	80.4	82.3	84.4	94.0
P/ Adj BV (x)	1.6	1.0	1.0	0.9
Dividend Yield (%)	2.6	5.3	5.3	5.8

Source: Company, Centrum Research Estimates

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Buy: Expected outperform Nifty by>15%, **Accumulate:** Expected to outperform Nifty by +5 to 15%, **Hold:** Expected to outperform Nifty by -5% to +5%, **Reduce:** Expected to underperform Nifty by 5 to 15%, **Sell:** Expected to underperform Nifty by>15%

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