India Research

Banking Review : Q2FY09

High credit growth and margin uptick lead to a buoyant NII

NPA's continue to rise, faster for Private Banks

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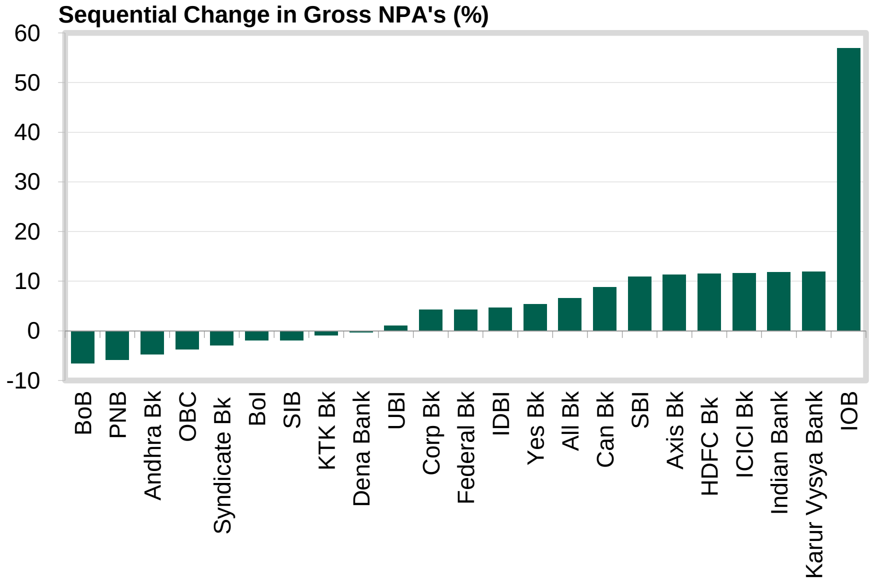
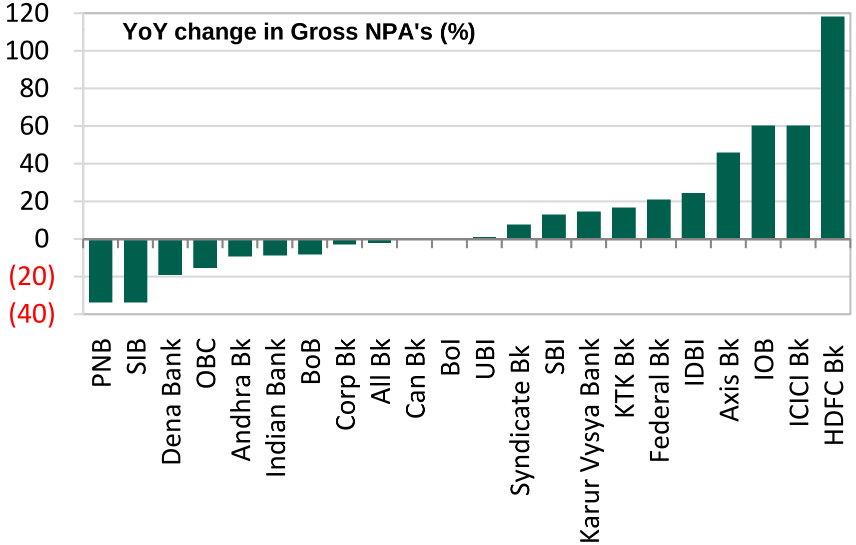
Banking Review : Q2FY09

- **Gross NPA's continue to rise; faster for Private Banks**
  - Gross NPA's of most of the banks have seen a sequential rise
  - However asset quality remained comfortable due to prudent higher provisioning
- **Credit book saw robust growth lead to a high C/D ratio**
  - Amongst the Private Banks, except for ICICI Bank (which saw a sequential contraction in its Credit book) most showed a +25% growth. Banks like HDFC, Axis and Yes recorded 50%+ YoY jump in their credit book
  - PSB's like Indian Bank, IDBI, SBI, IOB, BOI, Corp Bank and BOB reported +30% YoY growth
  - We expect the systemic credit growth to marginally moderate during H2FY09
- **Pricing power returns ; most banks witness margin improvement**
  - Improvement was largely due to PLR hike during 1HFY09
  - We expect NIM's to be sustained at these levels due to monetary easing (despite expected reduction in lending rates)
- **CASA proportion witnessed a mixed trend across the sector**
  - Among PSB's like SBI, BOI, BOB and Union, CASA saw a decent improvement
  - Private Banks like Yes Bank, Axis & Federal saw strong CASA growth
  - ICICI Bank, Federal Bank, SIB, Andhra Bank and YES Bank witnessed improvement in the CASA proportion with ICICI Bank and Federal Bank reducing its bulk deposits
- **Mixed trend seen in Non interest Income; Fee income showed better growth and Treasury profits declined**
  - Despite lower treasury gains, Non interest income was well supported by high fee based income
  - Excluding the treasury gains, the aggregate Non Interest Income has grown by ~ 30% driven by 32% growth in PSB and 27% growth in Private Banks.
- **Credit costs increased; offsetting high operating profit growth**
  - Total provisions were in the range of 50-90% of the operating profits for banks like Allahabad Bank, Federal Bank, ICICI Bank, Axis Bank, BoB, and HDFC Bank

Slippages continued to rise

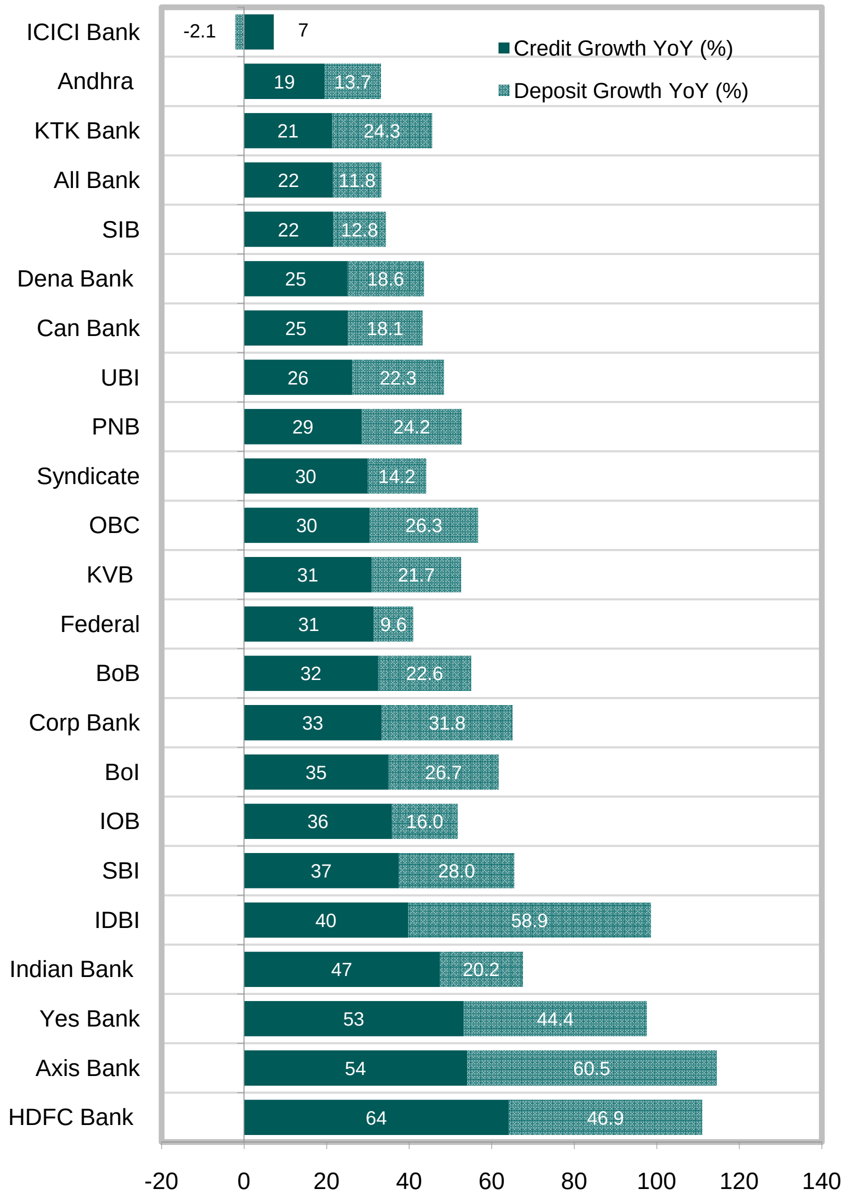




Asset Quality continued to deteriorate (though still at a comfortable levels) despite higher provisions

- Gross NPA's increased by 16.5% and 13% on QoQ and YoY basis respectively for Private Banks
- Net NPA's increased by 47% on YoY basis, it decreased by 7% on QoQ basis
- Private Banks like Federal Bank, HDFC Bank (Consolidated), AXIS Bank reported higher Gross NPA (YoY), SIB improved its Asset Quality during the same period
- ICICI Bank continued to witness high slippages
- IOB witnessed significant stress in its asset quality

Credit growth robust



Credit growth strong for yet another quarter

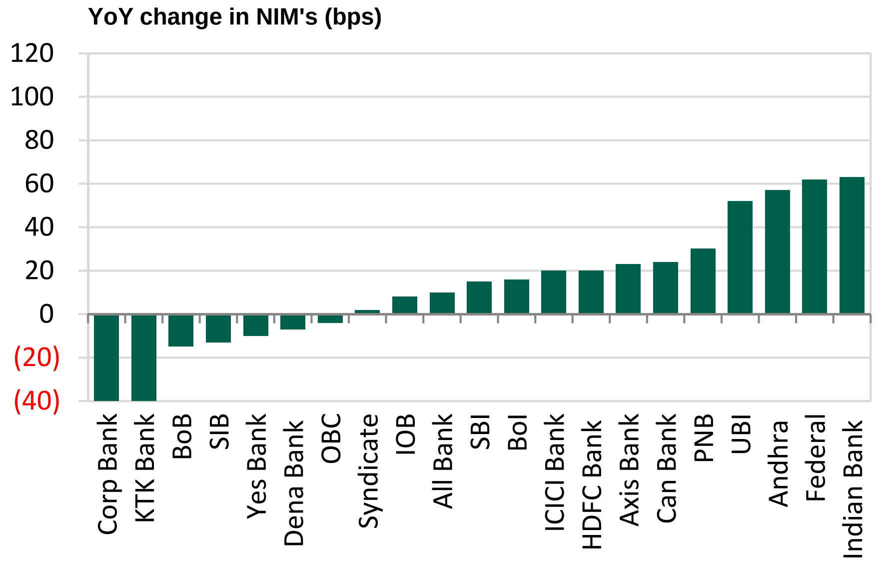
- Amongst the private banks, HDFC Bank, Yes Bank and Axis saw growth in its credit book at above 50% levels
- ICICI Bank pruned its advances portfolio over the quarter in a bid to restructure its asset book
- PSB's like Indian Bank, IDBI, SBI, IOB, BoI Corp Bank and BoB saw ~ 30% growth

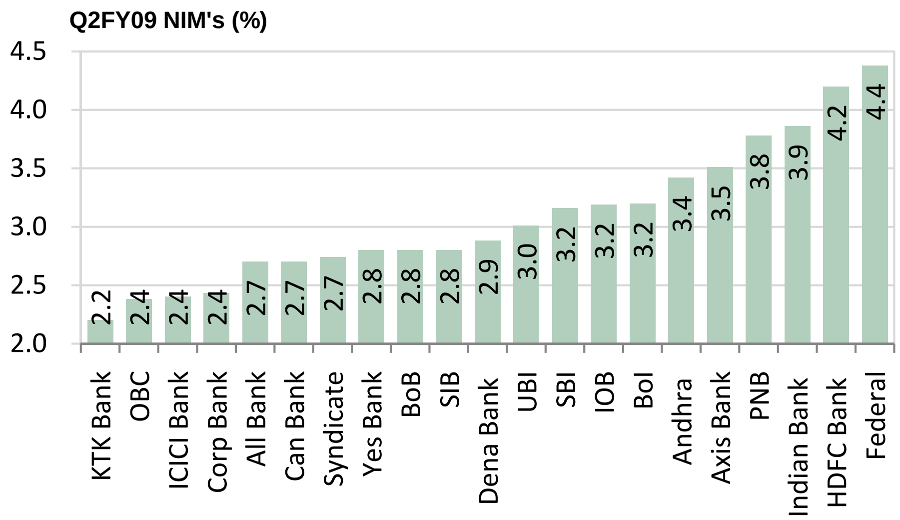
Deposit growth maintained

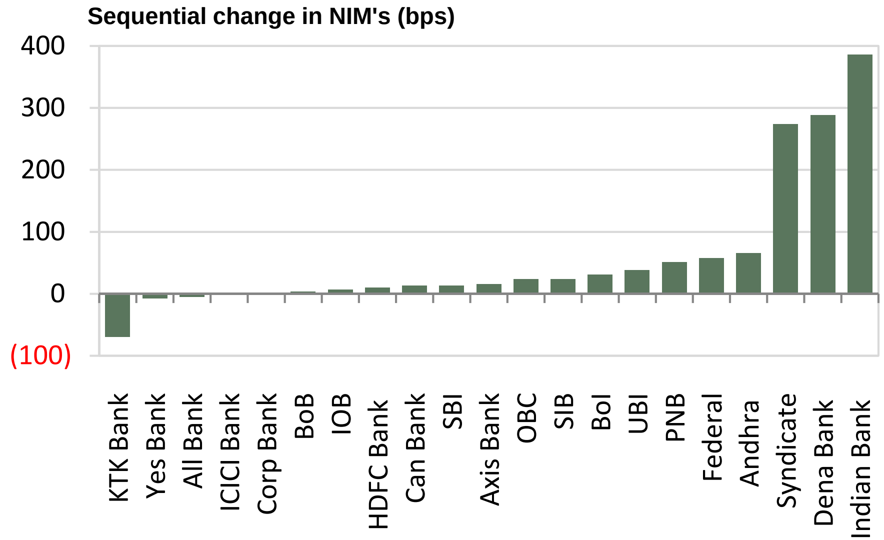
- Federal Bank, All Bank and SIB reported lower ~ 10% - 13% growth
- Federal Bank funded its credit growth by trimming its investment book (15% QoQ decline) and utilizing the capital raised from the rights issue
- ICICI Banks deposits de-grew by 2% as the bank shed its high cost bulk deposits

NIM's : Substantial improvement for few Banks

NIM's expand largely because of PLR hike during 1HFY09







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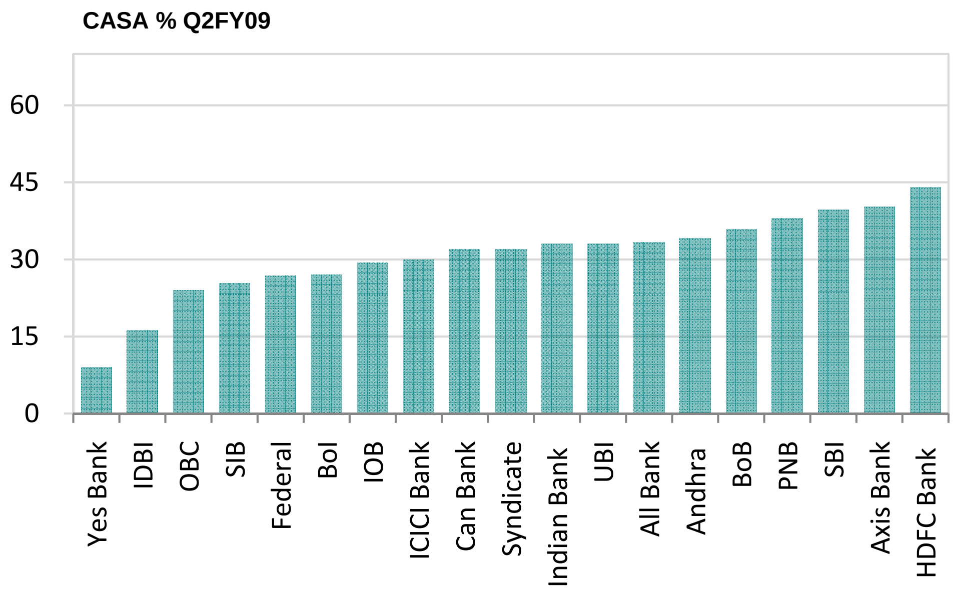
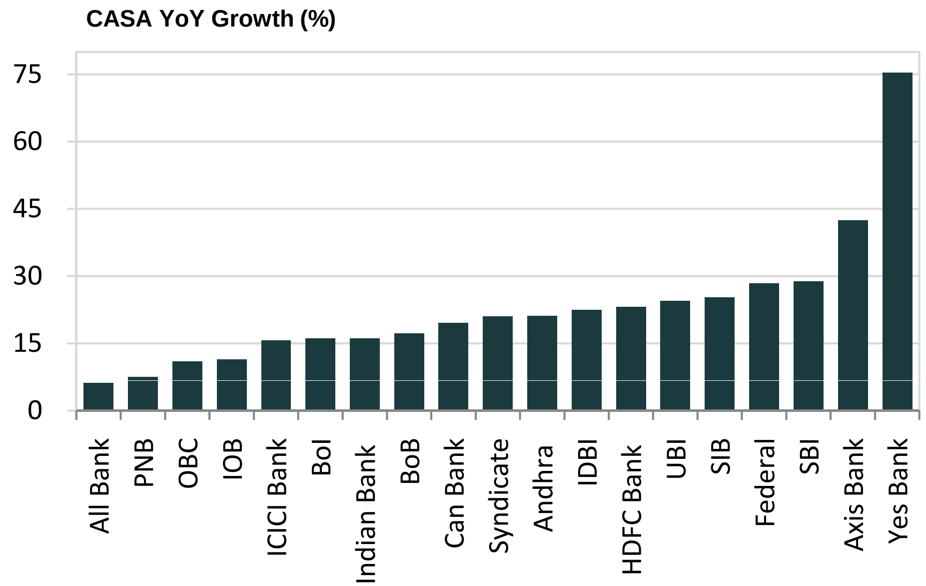
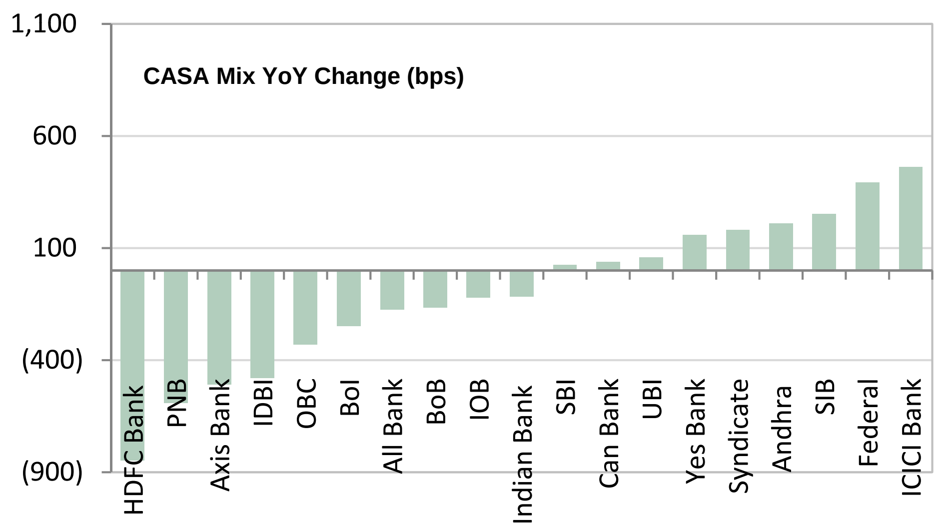
CASA proportion declined for most banks

- Current account balances witnessed decline (QoQ) as liquidity dried up
- Shift from savings account to term deposits (retail deposits) largely due to high interest rates offered by most banks
- ICICI saw a huge jump in its CASA proportion as the bank continued to shed bulk deposits







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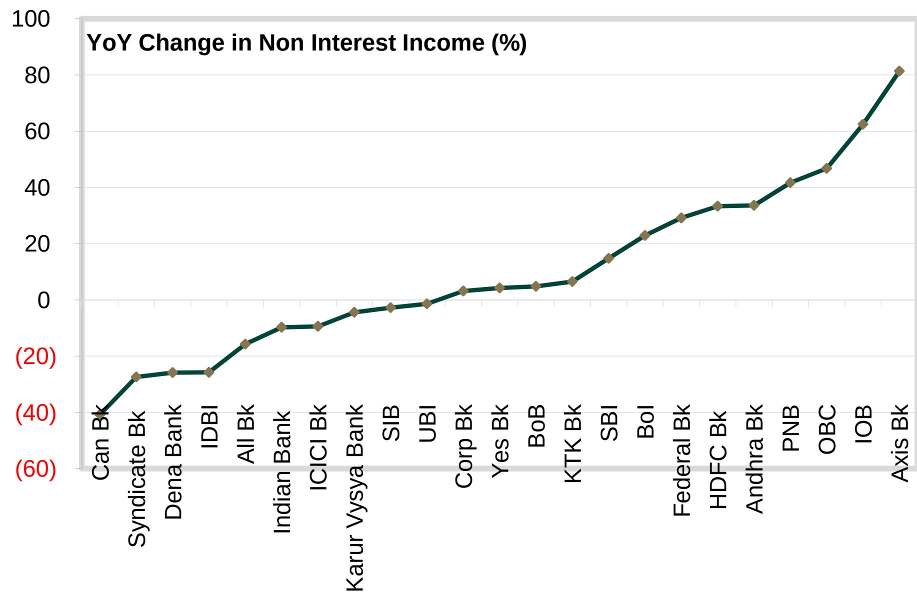
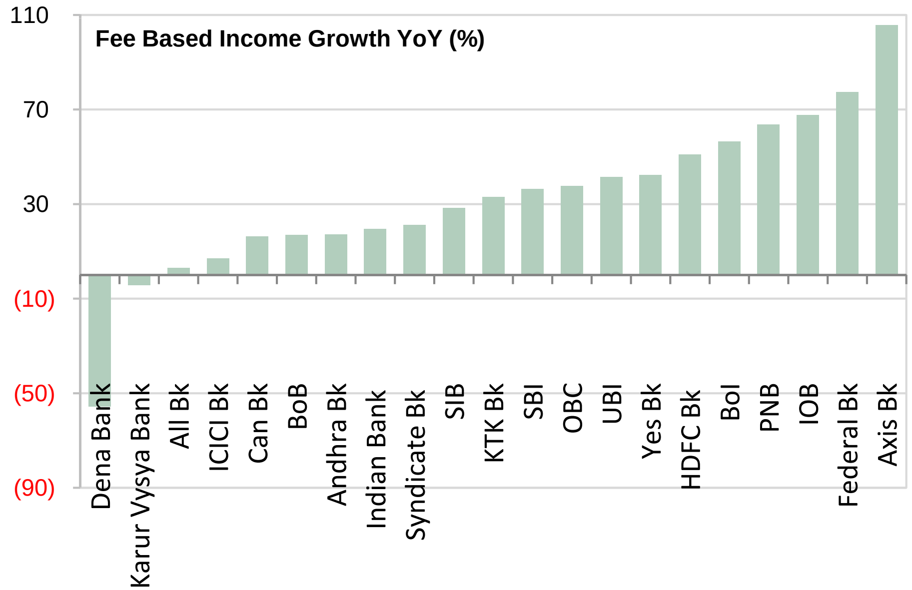
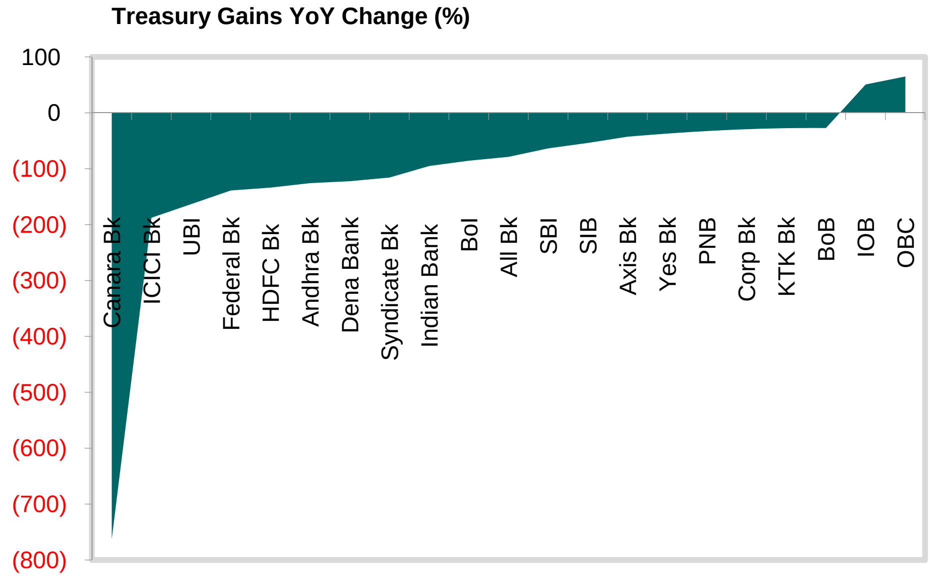
Fee Income surged; treasury profits declined

- Non Interest Income witnessed a mixed trend with strong fee income growth.
- Excluding Treasury Gains, the aggregate Non Interest Income has grown by ~ 30% driven by 27% growth in Private Banks and 32% in PSB's

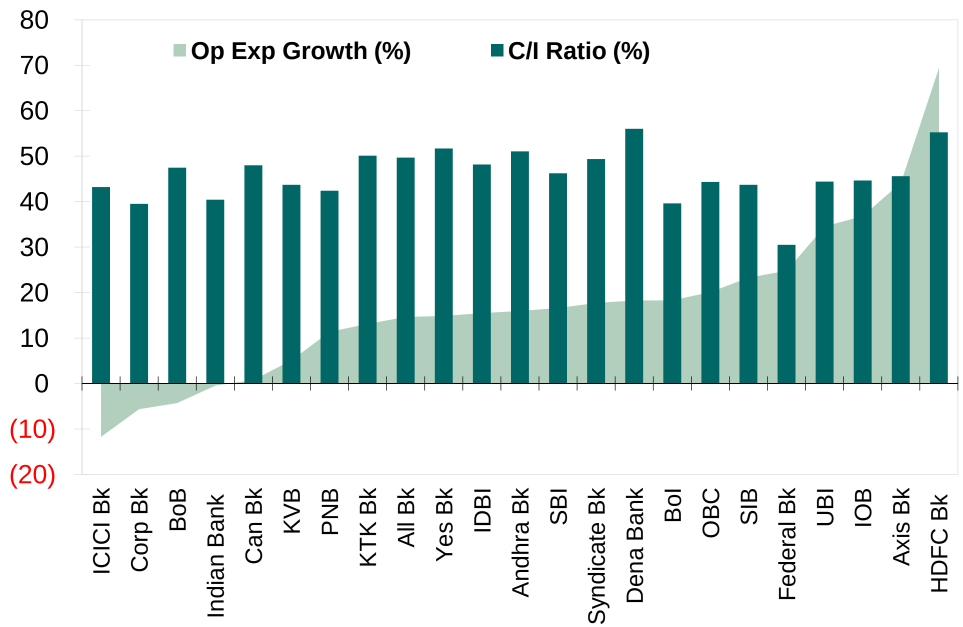






Opex : High for Private Banks; well managed for PSB's

- Staff costs for Private Banks continued to register a rapid growth of 30%; while it grew by mere 9% for PSB.
- Other Operating cost grew by ~21% for PSB and 11% for Private Banks
- PSB's continued to improve the operating efficiency with C/I Ratio at 45.4% ~ 500bps YoY improvement.
- The C/I Ratio for private banks stood at 46.6%, a ~ 370bps YoY improvement.



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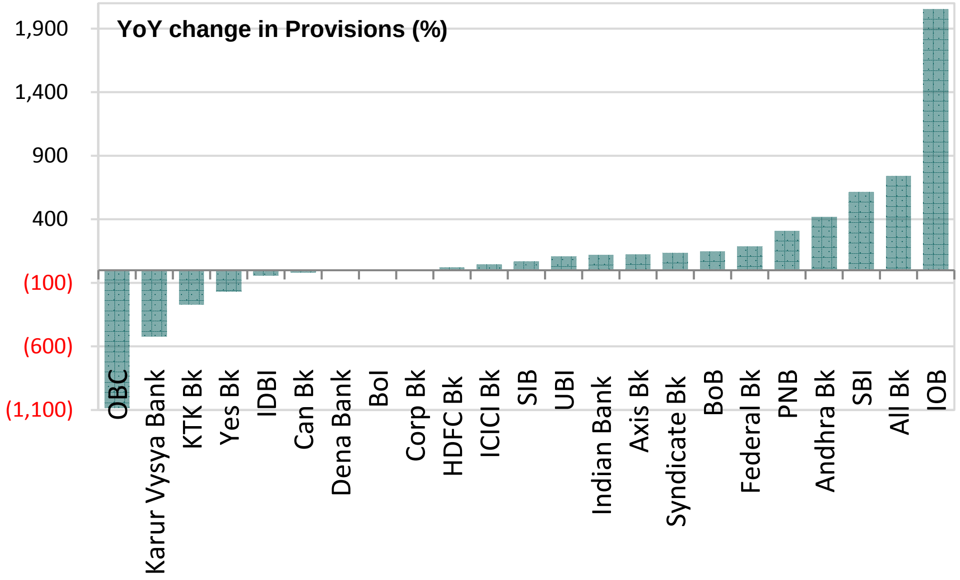
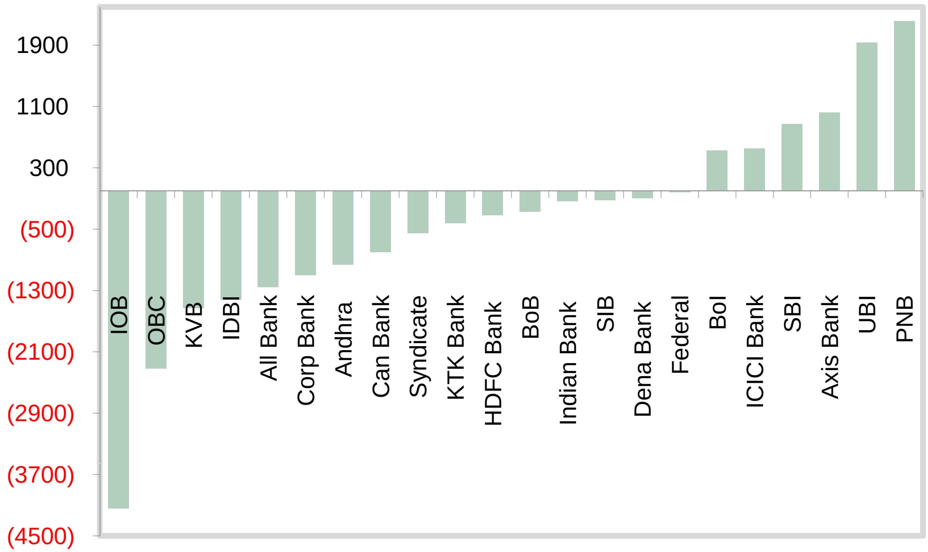
Provisioning saw a huge jump…

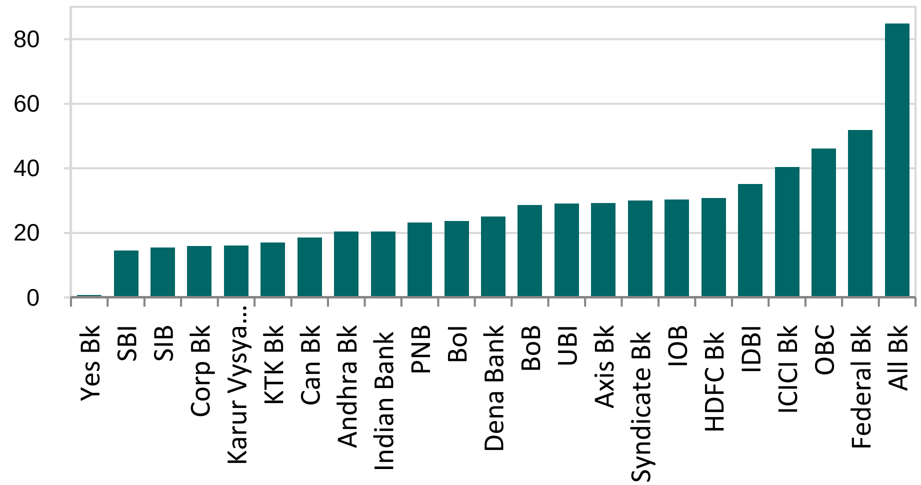
- Aggregate provisions continued to rise, offsetting the strong growth in Operating Profits
- Coverage Ratio decreased for most of the banks despite higher NPA provisions.



Coverage Ratio YoY change (bps)



Provision & contingencies as % of Op Profit



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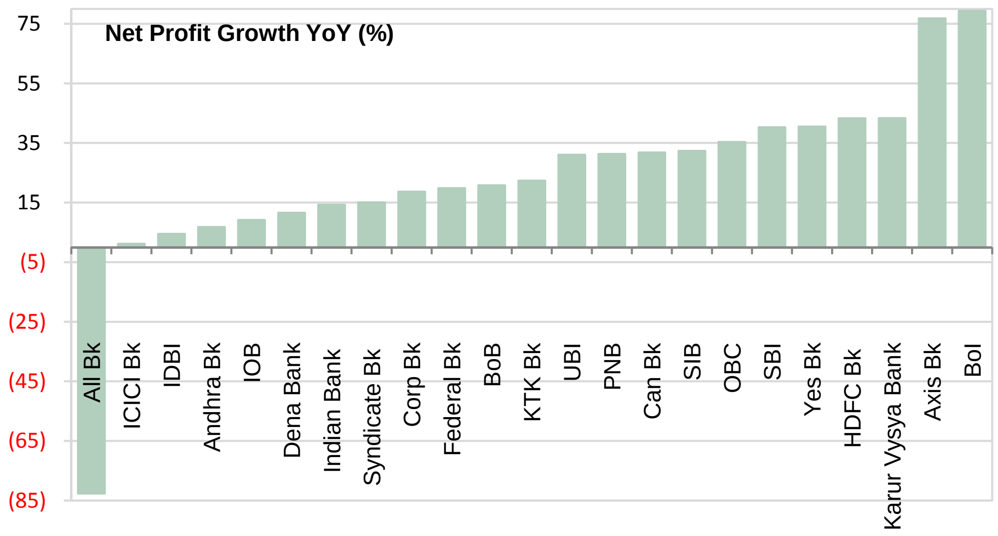
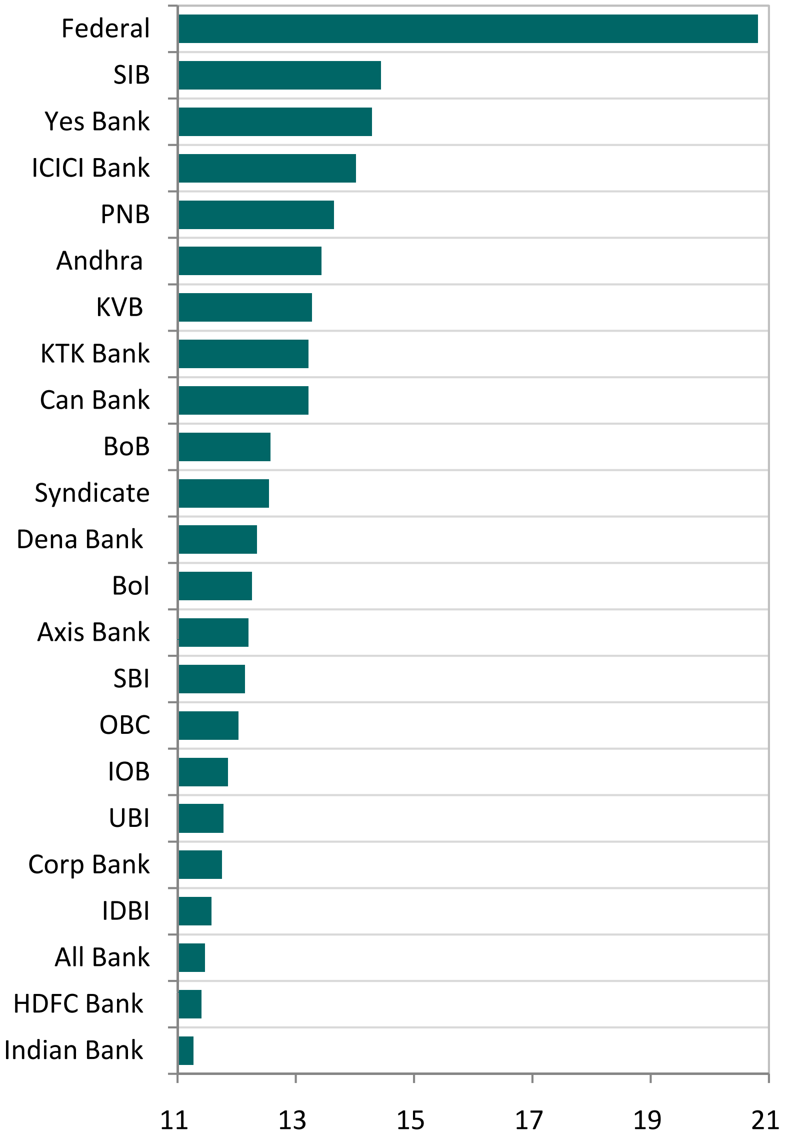
...leading to modest Net Profit growth

- BoI, AXIS Bank, Karur Vysya, HDFC Bank (Consolidated), YES Bank and SBI saw a strong Net Profit growth of +40%.
- Banks like ICICI, IDBI, Andhra Bank and IOB reported a single digit profit growth largely due to the rising credit costs; while decline in Non Interest Income moderated the profit of IDBI.
- Allahabad Bank reported de-growth of 83% YoY and 55% QoQ due to higher provisions on investment book.



Capital Adequacy



- Most Private Banks & PSB's are comfortably placed with regards to their capital adequacy
- Government's decision to keep PSU's well capitalized (+11%) is expected to benefit banks like Central Bank of India, UCO Bank & Vijaya Bank.

Sector outlook

- We expect Credit growth to marginally moderate during 2HFY09 due to the liquidity crunch.

- Margins are expected to be flat QoQ/ marginally higher due to the monetary measures (350bps cut in CRR, 150bps cut in Repo rate and 100bps cut in SLR) taken by RBI. However, most banks are expected to reduce their lending and deposits rates in the range of 25-75bps.

- The continued increase in delinquencies and deterioration of Asset quality (although still at contented levels) remains the key component to be monitored for the banking industry.

We remain Positive on Banking sector with preferred bets being AXIS Bank, HDFC Bank and Federal Bank amongst the Private Banks and SBI, BoI, PNB and UBI in the Public sector banks

Valuations

Banks	CMP	M Cap	NII			NIM (%)			Net Profit			EPS (Rs)			P/E (x)			P/BV (x)			P/ABV (x)			RoANW (%)		
Rs bn	(Rs)	Rs bn	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Private																										
ICICI Bank	449	500	73.0	93.0	111.4	2.1	2.3	2.3	41.6	46.9	55.7	37.4	42.1	50.1	12.0	10.7	9.0	1.1	1.0	0.9	1.2	1.1	1.0	11.7	9.7	10.8
HDFC Bank	1,075	450	52.3	70.3	95.4	4.9	4.3	4.1	15.9	20.8	27.1	44.9	49.6	64.6	24.0	21.7	16.6	3.3	3.1	2.7	3.4	3.2	2.8	17.7	16.0	17.2
Axis Bank	595	213	25.9	34.9	46.0	3.2	3.1	3.2	10.7	14.1	18.6	29.9	39.3	51.9	19.9	15.1	11.5	2.4	2.2	1.9	2.5	2.3	2.0	17.6	15.2	17.9
Federal Bank	148	25	8.7	10.9	13.1	3.1	3.1	3.1	3.7	4.3	5.1	21.5	24.9	30.1	6.9	6.0	4.9	0.6	0.6	0.5	0.7	0.6	0.5	13.6	10.4	11.5
Karnataka Bank	90	13	4.7	5.2	6.0	2.7	2.5	2.4	2.4	2.4	2.8	19.9	16.3	19.1	4.5	5.5	4.7	0.8	0.7	0.7	0.9	0.8	0.7	18.5	14.9	14.7
Karur Vysya Bank#	231	12	3.7	4.6	5.6	3.0	2.9	2.9	2.1	2.4	3.0	38.6	43.7	54.9	6.0	5.3	4.2	1.0	0.9	0.8	1.1	0.9	0.8	18.5	18.6	20.5
South Indian Bank	73.0	8	3.9	4.6	5.2	2.6	2.5	2.3	1.5	1.8	2.1	16.8	15.7	18.2	4.3	4.6	4.0	0.6	0.6	0.6	0.6	0.7	0.6	16.1	14.3	14.7
Public																										
SBI*	1,271	803	170.2	208.0	247.2	2.9	2.9	2.9	67.3	77.7	91.4	106.6	123.1	144.8	11.9	10.3	8.8	1.6	1.6	1.4	1.9	1.9	1.6	16.8	15.5	16.7
PNB	488	154	55.3	64.5	75.5	3.2	3.1	3.1	20.5	24.4	29.0	65.0	77.3	92.0	7.5	6.3	5.3	1.2	1.1	0.9	1.3	1.2	1.0	18.0	18.4	18.9
Canara Bank	178	73	35.4	41.0	49.4	2.1	2.2	2.2	15.7	15.2	18.4	38.2	37.1	44.9	4.7	4.8	4.0	0.7	0.6	0.6	0.8	0.7	0.6	15.0	13.8	15.0
IDB	83	45	26.8	29.8	34.2	3.0	2.7	2.7	12.0	12.7	13.7	22.1	23.3	25.2	3.8	3.6	3.3	0.9	0.7	0.6	1.0	0.9	0.7	27.2	23.1	20.1
IDBI	65	47	6.6	8.2	10.7	0.6	0.7	0.7	7.3	8.1	10.4	10.1	11.2	14.3	6.5	5.8	4.6	0.5	0.5	0.5	0.6	0.6	0.5	8.5	8.9	10.6
Bank of Baroda	279	102	39.1	45.1	53.3	2.5	2.4	2.4	14.4	16.7	19.3	39.3	45.7	52.7	7.1	6.1	5.3	0.9	0.8	0.7	1.0	0.9	0.8	14.6	14.2	14.6
Bank of India	271	143	42.3	50.3	59.7	2.7	2.6	2.6	20.1	23.9	28.0	38.2	45.4	53.3	7.1	6.0	5.1	1.3	1.1	0.9	1.4	1.2	1.0	24.4	20.5	20.1
Allahabad Bank	54	24	17.8	20.1	22.9	2.5	2.3	2.3	9.7	6.4	8.3	21.8	14.4	18.7	2.5	3.7	2.9	0.5	0.4	0.4	0.5	0.5	0.4	20.0	11.7	13.8
Andhra Bank	50	24	17.0	17.4	19.8	3.3	2.9	2.9	6.3	5.6	7.0	12.9	11.6	14.4	3.9	4.3	3.5	0.7	0.6	0.6	0.7	0.6	0.6	18.3	14.9	16.7
Syndicate Bank	54	28	20.7	22.9	25.8	2.2	2.0	2.0	8.5	7.0	7.7	16.2	13.5	14.8	3.3	4.0	3.7	0.7	0.6	0.5	0.8	0.7	0.6	21.4	15.5	15.2
Union Bank	146	74	30.9	33.3	37.5	2.9	2.6	2.4	13.9	14.3	16.4	27.5	28.3	32.4	5.3	5.2	4.5	1.0	0.9	0.8	1.1	0.9	0.8	22.1	18.0	17.8
Corporation Bank	221	32	15.0	16.9	18.8	2.8	2.7	2.6	6.1	6.9	7.8	42.5	48.3	54.1	5.2	4.6	4.1	0.7	0.7	0.6	0.8	0.7	0.6	15.2	15.3	15.1

CMP as on 5/11/2008

* Standalone

Quick Estimates

Thank You