ARIHANT capital markets ltd

SECTOR REPORT

Q3FY11 - Sustained Healthy Growth Despite Looming Concerns

17th Feb 2011

We have briefly analysed the Q3'11 results for an array of 27 major banks (including 12 private banks). These banks have been compared on select parameters, with data collected from the press releases, presentations available in public domain and interactions with the spokesperson of banks.

Observations

- **Overall Sector Did Not Disappoint**- Overall banks reported healthy profit growth despite the overhang of tight liquidity, tightening norms and low deposit growth. The quarter saw a series of rate hike by banks. Since this began only at the end of quarter and as deposit rate increase impact lags lending rate increase, there was no margin compression in the quarter though it is most likely to happen in next quarter. While credit growth picked up marginally deposit growth was lower with private banks reporting a sequential de-growth. Lower cost and provision hit made private banks winners at the bottom-line.
    - PSU banks 'Strong Core Weakened by Provision' – Pick up in deposit as well as advances growth, strong top-line growth, subdued bottom-line, NIM's improved, **high provision expense**, Slippage continued but controlled sequentially, core provision coverage improved, marginal CASA dip.
    - Private Banks 'Healthy Core and Healthy Bottom-line'– Deposit growth slowed down, advances growth picked up, average top line, Strong bottom line, YoY NIM improved but sequentially down controlled slippage, **controlled provision hit**, core provision coverage improved, sustained CASA.
- **Credit Growth Better Than Previous Two Quarters With Subdued Deposit Growth** –
  Credit growth of private banks continued to report better growth (28% YoY, 20% YTD) as against PSU banks (25% YoY, 15% YTD). Sequentially the deposit growth was slower for private banks (-1%; 23%YoY) while PSU banks it improved (4%; 19% YoY). The YTD CD ratio of PSU and private banks remained in the range of 115%-125%. Amongst private bank Yes bank and amongst PSU IOB has seen the highest credit growth on YTD basis.
  During the period of liquidity abundance and low demand the banks had resorted to mortgage loans and with tightened norms there the focus now has shifted to the SME sector, which can also be risky going forward. The corporate credit demand was more for working capital requirements and capex demand was missing. This also reduced the fee income.
- **Thus Improving Margins Despite Tight Liquidity** –
  YoY NIM expanded yet again in this quarter for almost all the banks with the average improving from 3.1% to 3.4%; however most top private banks reported marginal fall. The lag effect of increase in cost of deposits along with reasonable credit demand has been the key reasons for improvement. Maintaining NIM's and asset quality has been one of prime aims of banks and the same is likely to prevail ahead, even though the coming quarters will see come compression. The banks are getting more and more mindful of the margins and will be seen doing a balancing act with growth, margins and asset quality. The yield on investments increased for all banks though very few reported depreciation hit.
- **But PAT growth was Constrained**–
  NII growth was robust at 38% YoY but plunging other income, increased employee expenses and provisions hit, limited the bottom line growth to 24%. The NII growth was again better for PSU banks while private banks did better at bottom line. This was mainly on account of provision burden on PSU banks. In PSU banks net profit growth was best for IOB, Bank of India and IDBI while in Private it was IndusInd, Yes and Karur.
- **The CASA Ratio Slipped Slightly mainly Due to Lower CA** –
  Despite slower deposit expansion and increased rates on deposits**,** CASA ratio decreased marginally for most banks and the average fell from 31.3% in September quarter to 30.9%. The fall was across private and PSU banks. Tight liquidity and high rates resulted in fall in corporate surplus and hence fall in CA. With rise in rates the impact of negative return on deposits due to inflation will reduce and the deposit accretion from retail segment may see a pick-up.

- **Sequentially Asset Quality Slipped Further Even though Banks Sounded No Major Concerns** –
  Overall the gross NPA improved further from 2.32% in June quarter to 2.28% in September quarter to 2.23% in December quarter. However this improvement was lesser than expected by markets. While 78% of the banks have reported stable to better GNPA ratio sequentially, banks like IDBI, OBC, Corporation, Karnataka etc reported an increase. The overall restructured assets remained stable at ~ 4.2% of gross advances with banks reporting continued slippages from it. With RBI tightening norms the banks are improving their provision coverage and overall net NPA has reduced to 0.77%.
- **And Provision Coverage Continued to Increase -**
  While overall average 'core' provision coverage improved on a YoY basis as well as QoQ basis, 40% PSU banks reduced the core coverage cushion on a QoQ basis to protect bottom-line because as per RBI stipulated norms they were above 70% coverage. IDBI, BOI, Andhra and IOB improved core coverage while OBC, Corp and UBI decreased the coverage. J&K has surpassed all banks and reached a core coverage as high as 98%. IOB, SBI and Vijaya are still below 70% coverage as per RBI norm with time till FY11 to achieve the same.
- **Efficiency Improved** –
  All banks reported better efficiency on a YoY as well as QoQ basis. Apart from healthy growth of core income, lesser burden of increased wages and sufficient provision on employee pension in the first half also helped in improving the average cost to income from 45.3% to 43.3%. The improvement was substantial for banks like IOB, DCB and IDBI. However the new RBI notification requiring PSU banks to amortise the second option pension provision for present employees only, may see some pressure on PSU banks.

Conclusion

The one way up move in banking sector halted this quarter. It turned but has not reversed. Tight liquidity, base rate, inflation, inflation combating measures, housing loan scam, loans to microfinance institutions, lower deposit pick-up, rising deficit, lower Govt spending, rising CD ratios, teaser home loans, telecom loans, deregulation of savings rate, political mess, etc are some of the major things which haunted the sector and the banks covered in the report gave negative 20% return in last three months. While many of these concerns still continue and may keep the sector movement under check going forward, the overall potential growth prospects keep the interest in the sector alive and make the sector a value buy at present level and on any further dips. The average price to book multiple has come down by 20-22% for both PSU as well as private banks from November 2010.

Inflation – After increasing the target from 5.5% to 7%, the sentimental effect on achieving the same will be good, but the concern remains.
Liquidity – Will take time before the situation regularizes and deposit rate hike and Govt spending efforts yield results. Improvement in liquidity will be the key positive for the banks.

Interest Rates- Further hike is possible if the demand is good and inflation is high. But looking at current economic situation, there is very little capacity to absorb rates hikes of more than 100-150 bps from here onwards.

Credit – Will require some easing in domestic inflation and global commodity prices before it actually picks-up.
Margins – Will be under pressure till liquidity eases and demand picks up. The banks with healthy CASA, low cost of funds and ALM support will sail more smoothly in high interest rate scenario.
Asset quality – Concern remains. Need to be cautious of the SME sector which has found flavor with many banks as the potential credit expansion zone.
Regulations – RBI is getting stricter and will continue to take steps to make banks more cautious and well covered.

The gap between bigger private banks and PSU banks has again widened. Private Banks have demonstrated consistency and lesser regulatory pressures and therefore have gained more confidence from investors. PSU banks main pressure point was heavy provision hit. Of this employee cost pressure will remain though the same is deferred over five years. Provision coverage overhang is nearly done. Therefore they are expected to report better numbers going ahead. One of the major attractions for FII's in India is banking sector. The recent belief and observation of market participants that the focus is shifting back to developed markets may have a temporary impact on the sector though overall we feel that the sector will continue to attract investors.

Valuations bets – J&K, Syndicate, Karnataka, Federal, Allahabad, OBC, Andhra, Karur Vysya, Indian, PNB.
Fundamental bets –Bank of Baroda, HDFC Bank, ICICI, PNB, State Bank, Yes, South Indian.

		Top		Bottom	
		I	II	I	II
	Quarterly Results – Q3FY11				
1	NII Growth	IDBI	Syndicate	ICICI	Federal, Kotak
2	PBPT Growth	DCB	IOB	Kotak	ICICI
3	NP growth	IOB	IndusInd	DCB	Canara/Karnataka
4	YOY NIM growth	Karnataka	IDBI/ Syndicate	KMB	Yes
	Business				
5	Deposits growth	Yes	Axis	IDBI	Federal
6	Advances growth	Yes	Axis	Federal	Vijaya
7	CD Ratio	Kotak	ICICI	J&K	Karnataka
8	Incremental QoQ CD ratio	IDBI	ICICI	J&K	OBC
9	Incremental YoY CD ratio	Andhra	Kotak	DCB	J&K
10	CAR	ICICI	Kotak	Karnataka	Syndicate
11	CTI	IDBI	Corporation	DCB	Kotak
12	CASA	HDFC Bank	SBI	Yes	IDBI
13	CASA/branch	Axis	HDFC Bank	South India	Karnataka, Vijaya
14	YoY CASA Ratio growth	HDFC Bank	Vijaya	DCB	Axis
	Asset Quality				
15	Gross NPA%	Yes	Corporation	DCB	ICICI
16	Net NPA %	J&K	Yes	SBI	IOB
17	Core Provision Coverage	J&K	KVB	Canara*	Vijaya
18	YoY Change in GNPA%	DCB	Kotak	Federal	Union
19	YoY Change in NNPA%	DCB	ICICI	UBI	Indian
	Valuation				
20	ROA (9M Ann)	KVB	Kotak	DCB	Karnataka
21	P/BV	Karnataka	Syndicate	HDFC	IndusInd
22	P/ABV	Karnataka	Syndicate	HDFC	IndusInd
23	PE	IOB	IDBI	DCB**	ICICI

*Note that as per RBI Canara bank is sufficiently covered

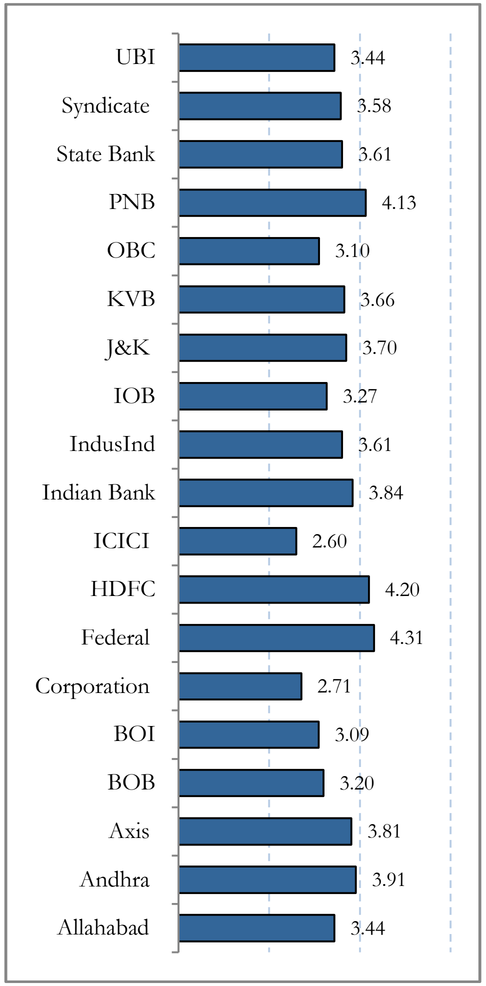
**Till last quarter the TTM EPS of DCB was Re 0.2 hence was ignored

Averages	NII Growth	GP Growth	NP growth	NIM growth%
Avg -All	37.6	30.9	24.2	11.6
Private	24.0	15.7	34.6	4.8
PSU	42.8	37.6	20.2	18.0

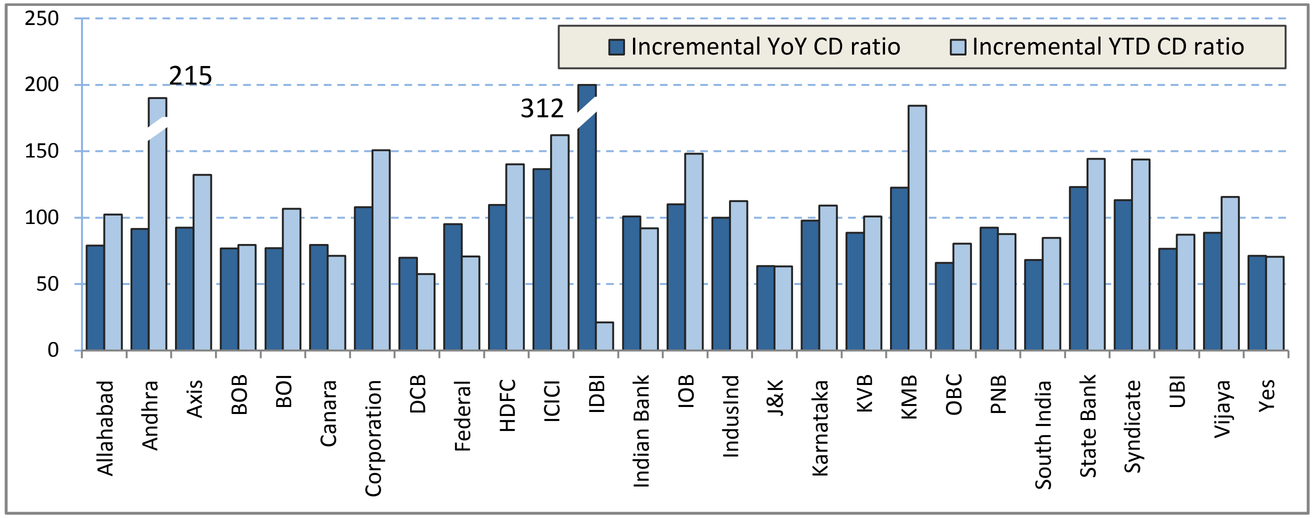
Profitability Indicator

Averages	Deposits growth	Advances growth	CD ratio	YTD Dep Growth	YTD Adv Growth
Avg - All	19.8	25.4	76.6	**10.2**	**15.9**
Private	22.9	28.1	78.3	12.3	19.7
PSU	19.0	24.7	76.1	9.6	14.8

NIM Q3FY11

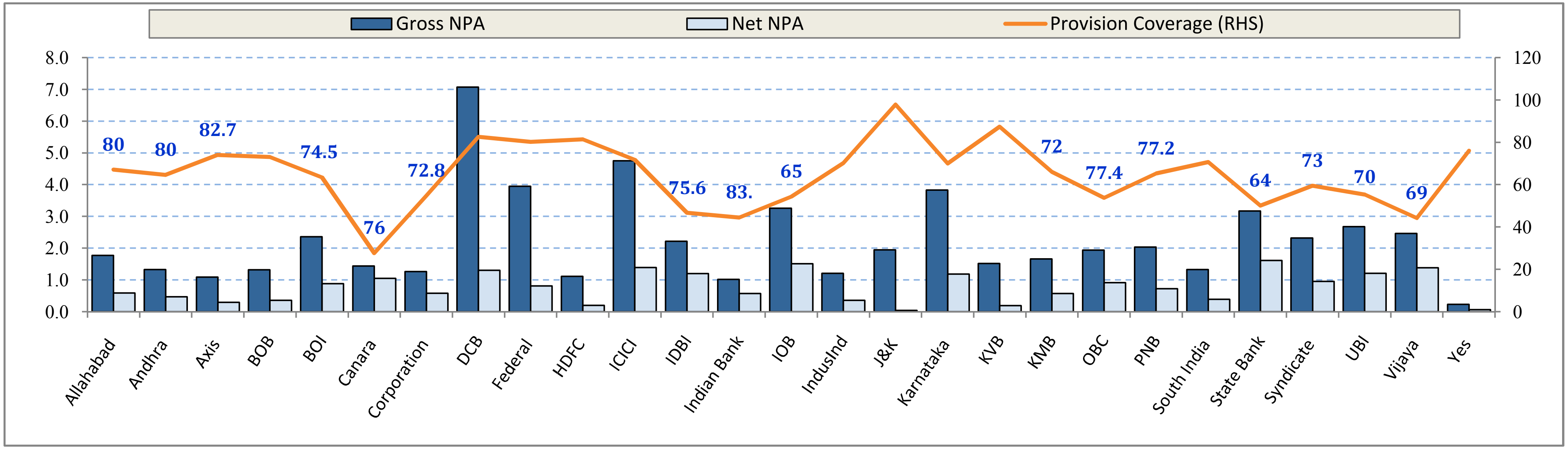


Business Indicator

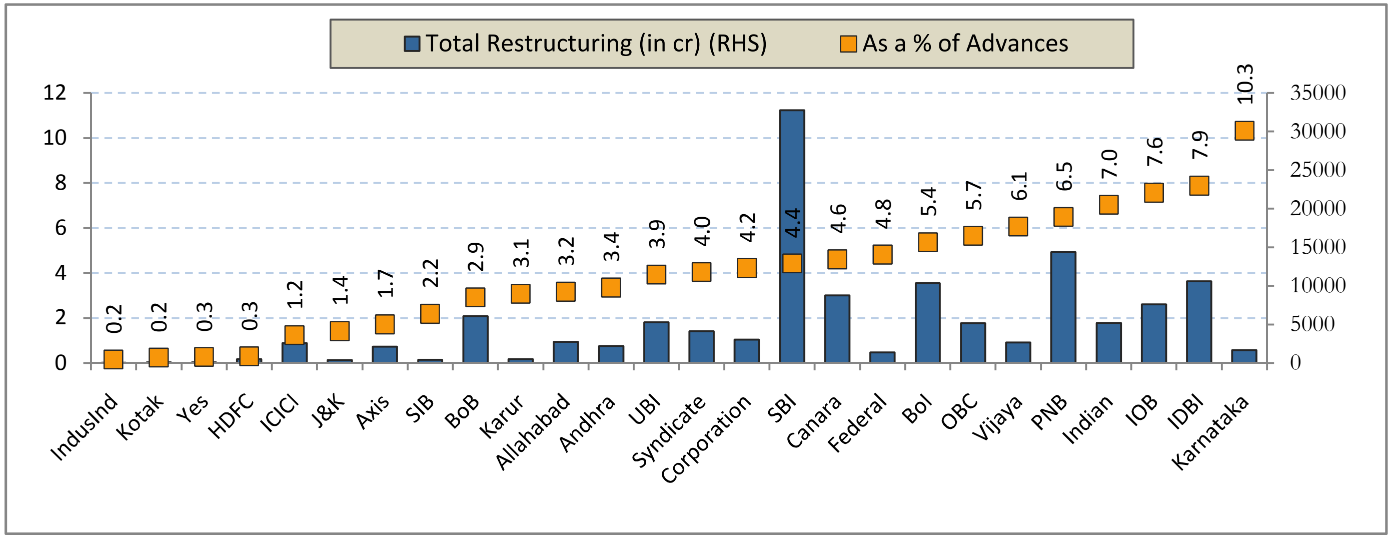


Efficiency Indicator

Averages	CTI	CASA	CASA/Branch (Rs in Crs)
Avg - All	43.3	30.9	24.2
Private	46.0	31.3	28.3
PSU	41.2	30.6	21.0



For core coverage less than 70%, RBI coverage indicated as Data Labels



Averages	Provision Coverage	Gross NPA	Net NPA	Provision Coverage LY
Avg - All	58.7	2.2	0.8	52.8
Private	74.5	2.5	0.6	58.8
PSU	53.9	2.0	0.9	50.8

Asset Health Indicator

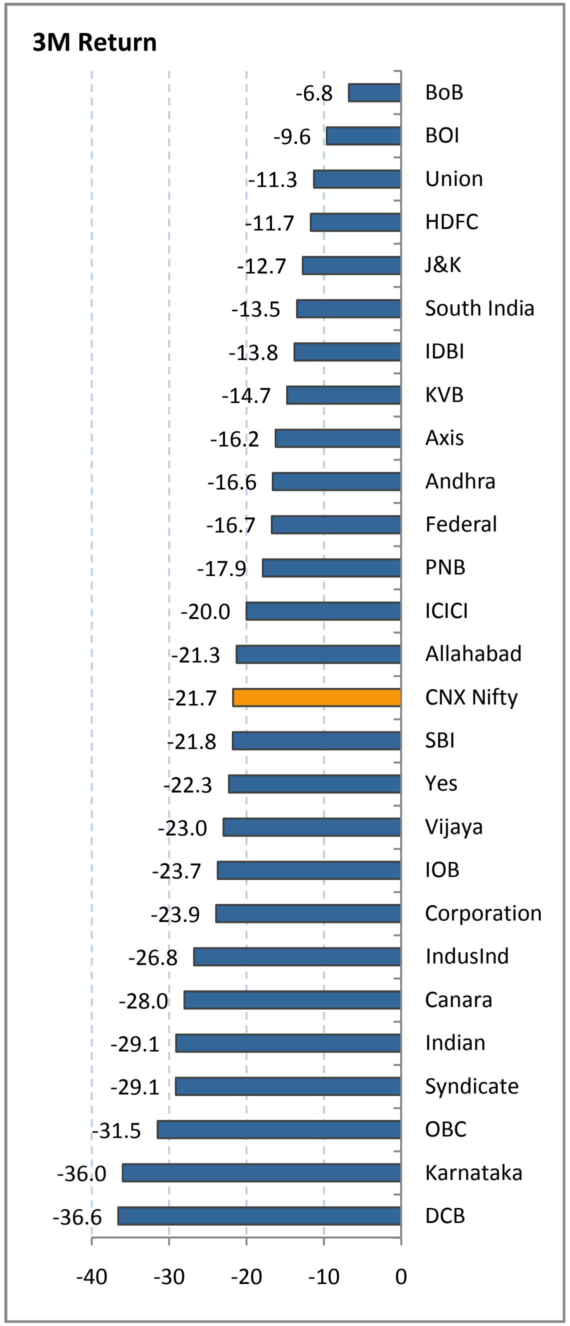
Averages	P/ABV	P/BV	PE	RoA (9M Ann)
Avg - All	1.7	1.7	13.6	1.2
Private	2.1	2.1	21.3	1.3
PSU	1.5	1.4	7.4	1.1

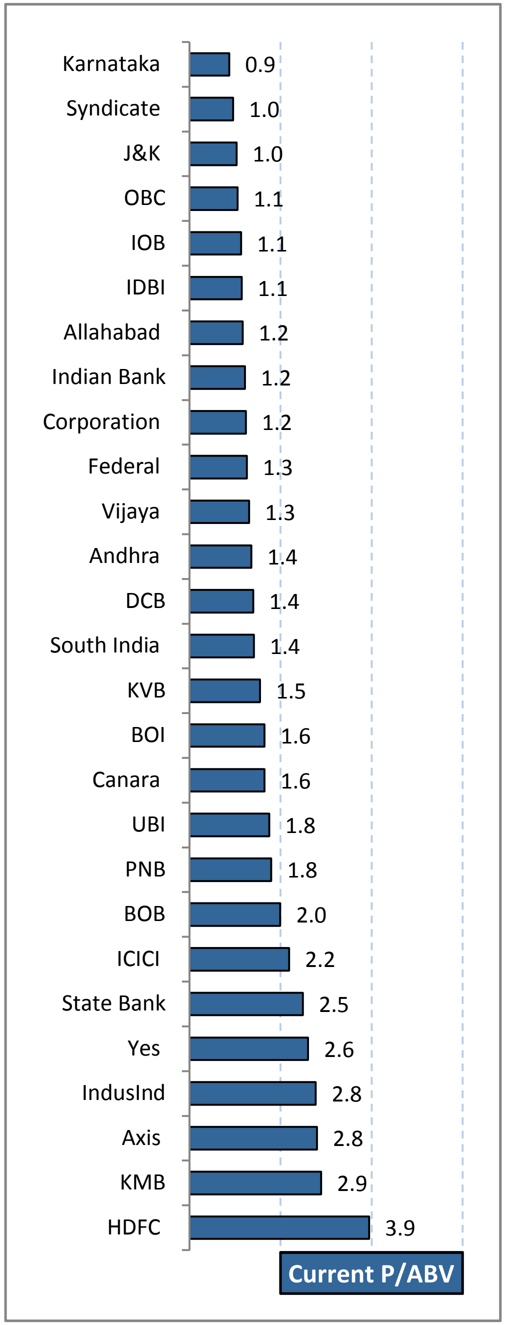
The gap between bigger private banks and PSU banks has again widened. Private Banks have demonstrated consistency and lesser regulatory pressures and therefore have gained more confidence from investors. PSU banks main pressure point was provision pressure which will be little relaxed going forward and therefore cannot be ignored.

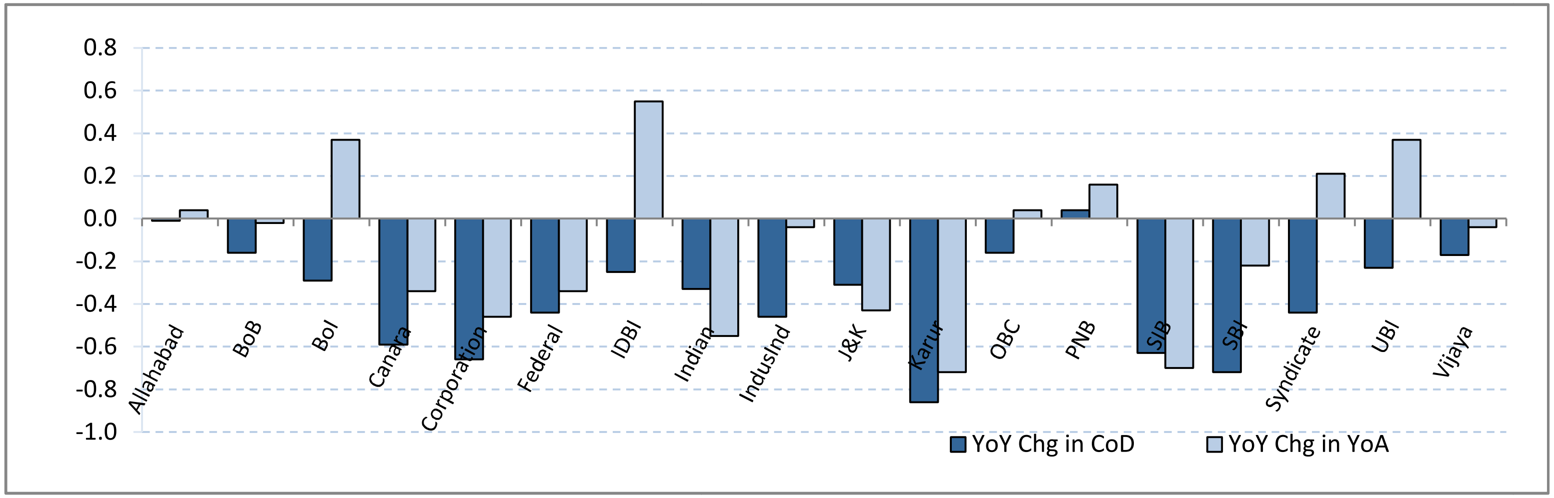
The concerns have been more or less priced in and the banks are available are reasonable discount. Time for Value Buying (Accumulate)!

Adjusted book value is at 70% coverage
Book value is as at end of Q3FY11
PE is based on TTM EPS
RoA is nine months annualized
CMP – 15th Feb 2011

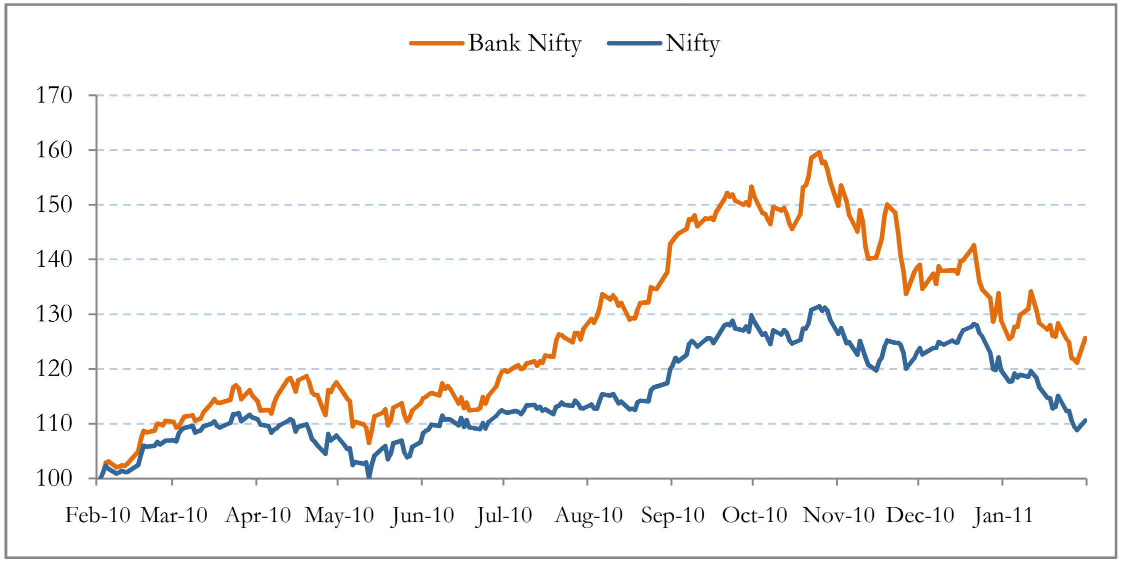
Valuation Indicator





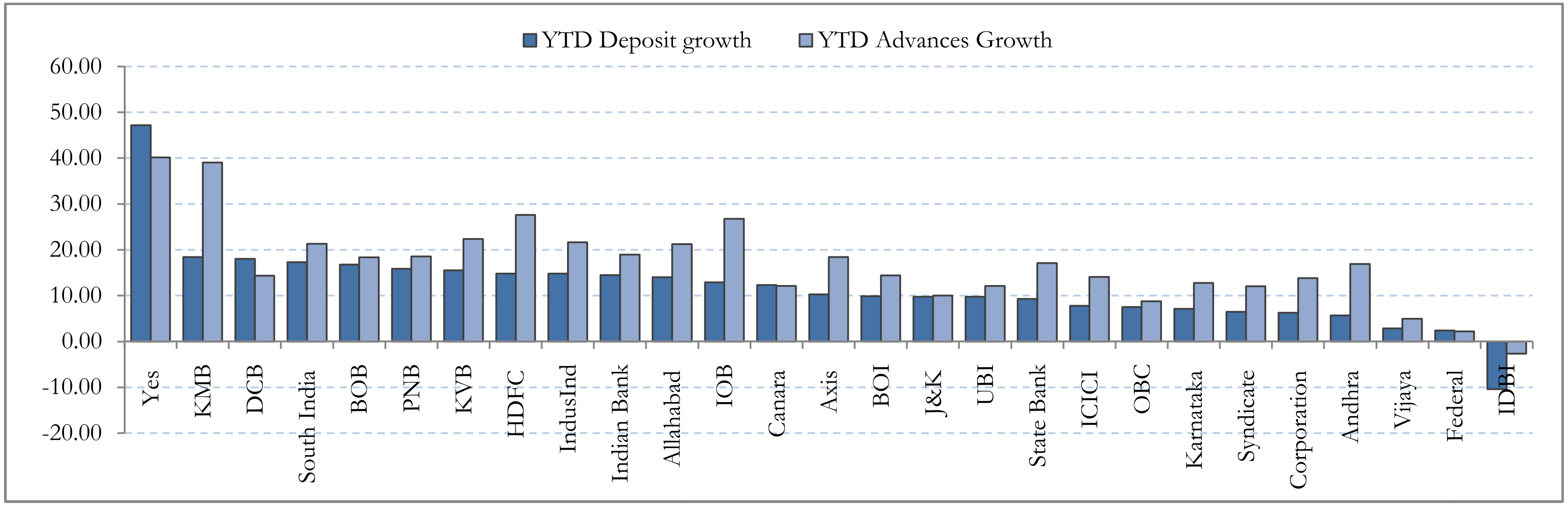


YoY Fall In Interest Rate Continued while QoQ they saw an increase in cost as well as Yields

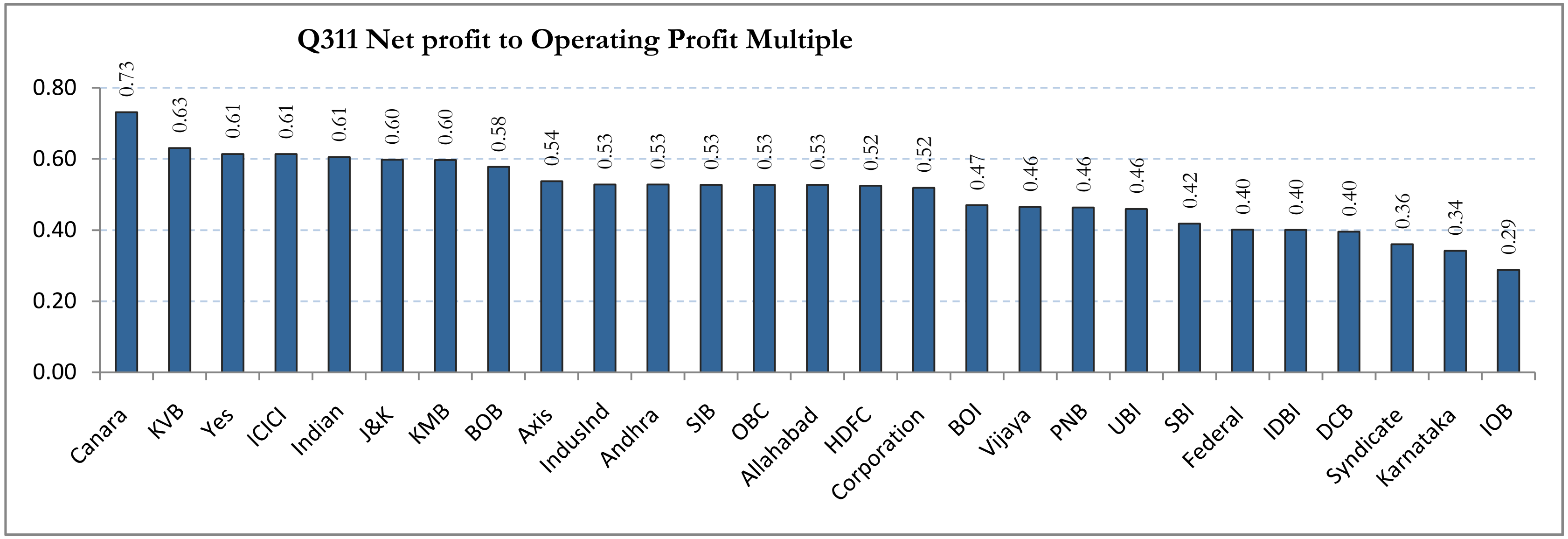


Banking – Still in Favour and Flavour

Return Over	1W	3M	6M	12M
Top Five	Kotak	Karur	Karur	Karur
	OBC		BoB	Vijaya
	Federal		Federal	BoB
	Yes		Canara	Allahabad
	BoB		IDBI	Federal
Bottom Five	DCB	DCB	Karnataka	Karnataka
	IndusInd	Karnataka	OBC	Kotak
	Vijaya	OBC	Yes	IDBI
	Karur	Syndicate	J & K	Yes
	SBI	IDBI	Indian	Axis
	Karnataka			



Deposit Growth remained Slow while Advances Growth picked up - Second half YTD credit growth for the sector was 5.5% while in 9M it improved to 16%



The operating profit came off by an average of 50 percent due to provisions and taxes

Aerial view of Q3'11 Performance **Amount in Cr**

	CMP	Net Interest Income			PBPT			Net Profit			Deposit			Advance		
	15.02.11	Q3 '11	Q3 '10	% chg	Q3 '11	Q3 '10	% chg	Q3 '11	Q3 '10	% chg	Q3 '11	Q3 '10	% chg	Q3 '11	Q3 '10	% chg
Allahabad bank	206	1052	676	*56*	788	650	*21*	416	345	*20*	120,948	94,164	*28*	86837	65680	*32*
Andhra Bank	149	840	583	*44*	627	482	*30*	331	275	*20*	82,095	66,547	*26*	65587	51352	*27*
Axis Bank	1275	1733	1349	*28*	1658	1375	*21*	891	656	*36*	155,811	113,854	*37*	123547	84770	*46*
Bank of Baroda	919	2292	1601	*43*	1851	1265	*46*	1,069	832	*28*	281,512	215,117	*31*	207209	156171	*33*
Bank of India	443	1987	1495	*33*	1389	1130	*23*	653	406	*61*	252526	206002	*23*	192754	156953	*23*
Canara Bank	581	2119	1478	*43*	1513	1380	*10*	1,106	1,053	*5*	263,497	210,093	*25*	189882	147411	*29*
Corporation Bank	577	842	599	*41*	737	538	*37*	382	305	*25*	98,526	84,411	*17*	71,934	56,710	*27*
DCB	45	49	32	*52*	21	8	*165*	8	-18	*-145*	5,651	4,482	*26*	3,956	3,139	*26*
Federal Bank	385	447	381	*17*	357	332	*8*	143	110	*30*	36,914	34,587	*7*	28,240	26,030	*8*
HDFC Bank	2107	2777	2224	*25*	2073	1624	*28*	1,088	819	*33*	192,202	154,789	*24*	160619	121051	*33*
ICICI Bank	1054	2312	2058	*12*	2343	2369	*-1*	1,437	1,101	*31*	217,747	197,653	*10*	206692	179269	*15*
IDBI	137	1204	717	*68*	1135	640	*77*	454	287	*58*	150,239	142,798	*5*	134491	111262	*21*
Indian Bank	218	1038	827	*25*	812	691	*18*	491	441	*11*	101,015	84,733	*19*	73919	57468	*29*
Indian Overseas Bank	131	1130	794	*42*	804	406	*98*	232	102	*128*	125,062	106,249	*18*	100129	79407	*26*
IndusInd Bank	224	363	238	*53*	291	174	*68*	154	88	*75*	30,663	24,755	*24*	25001	19090	*31*
J&K Bank	773	390	290	*34*	281	245	*15*	168	140	*20*	40,877	33,664	*21*	25363	20784	*22*
Karnataka Bank	124	161	103	*56*	113	70	*62*	39	37	*5*	25,424	22,307	*14*	16282	13233	*23*
Karur Vysya Bank	536	211	151	*39*	180	132	*37*	113	76	*49*	22,263	17,892	*24*	16514	12641	*31*
Kotak Mahindra Bank*	411	571	487	*17*	315	329	*-4*	188	142	*32*	28,288	22,186	*28*	28885	21406	*35*
Oriental Bank	345	1030	873	*18*	774	623	*24*	408	289	*41*	129,335	110,745	*17*	90801	78555	*16*
Punjab National Bank	1095	3203	2212	*45*	2350	1818	*29*	1,090	1,011	*8*	288,873	233,946	*23*	221252	170427	*30*
South India Bank	21	205	172	*19*	143	118	*21*	75	62	*21*	26,998	20,643	*31*	19,198	14,868	*29*
State Bank	2737	9050	6316	*43*	6764	4618	*46*	2,828	2,479	*14*	878,979	770,985	*14*	739,971	607,154	*22*
Syndicate Bank	112	1150	718	*60*	712	425	*68*	256	206	*25*	124,603	108,515	*15*	101,307	83,104	*22*
Union Bank	341	1616	1089	*48*	1261	914	*38*	580	534	*9*	186,655	151,085	*24*	133787	106534	*26*
Vijaya Bank	84	536	393	*36*	327	299	*9*	152	125	*22*	63,702	58,928	*8*	43,570	39,344	*11*
Yes Bank	277	323	211	*53*	311	216	*44*	191	126	*52*	39,453	22,039	*79*	31112	18710	*66*

* Book Value, PE is consolidated
Note – All are standalone results
Wherever applicable global deposit and advance numbers considered
Source-Banks, Arihant research

Banking Synonyms used –

- PBPT – Profit Before Provision and Tax
- CAR – Capital Adequacy Ratio
- CASA – Current Account Savings Account
- CD Ratio – Credit Deposit Ratio
- CTI – Cost to Income
- GNPA – Gross Non Performing Assets
- NNPA – Net Non Performing Assets
- NIM – Net Interest Margin
- NII – Net Interest Income
- PSU banks – Public Sector Banks
- SCB – Scheduled Commercial Banks
- TTM – Trailing Twelve Months

ARIHANT - Research Desk

For more information contact: research@arihantcapital.com

Tel: 022-42254834/32

Head Office

3rd Floor, Krishna Bhavan,
Opp. Green House Restaurant,
67,Nehru Road, Vile Parle (East),
Mumbai-400057.
Tel: (91-22) 42254800
Fax: (91-22) 42254880

Registered Office

Arihant House,
E-5, Ratlam Kothi,
Amit Apartment,
Indore- 452003, (M.P.)
Tel: (91-731) 2519610
Fax: (91-731) 2519817

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