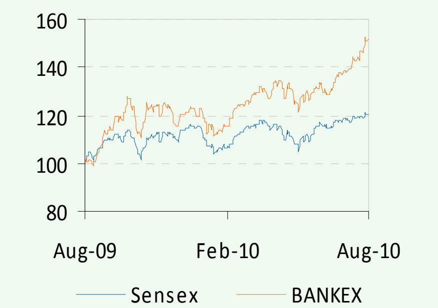
ENAM Securities
India Research

Sector avg. upside: -5% to 5%
(mkt cap wtd)

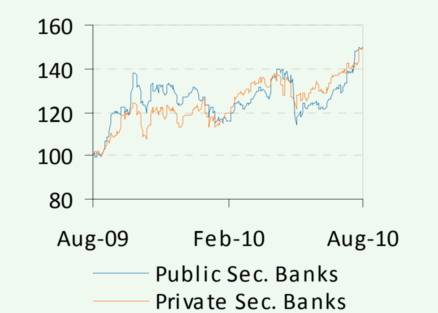
Banking Sector

Relative Performance



Source: ENAM Research, Bloomberg

Relative Performance



Source: ENAM Research, Bloomberg

C₹editable Performance
G₹owth Beckons!

Our preferred picks:

	Mkt. Cap (USD mn)	CMP (Rs)	EPS (Rs)		Adj BV (Rs)		ROE (%)		P/E (x)		P/Adj.BV (x)		Target (Rs)	Upside (%)
			FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E		
SBI	38,409	2,823	176	224	1,077	1,289	16	18	11.8	9.3	2.1	1.8	3,000	6
Canara	4,652	529	88	106	349	436	26	25	6.0	5.0	1.5	1.2	610	15
Axis	12,086	1,382	77	93	450	525	18	19	18.0	14.8	3.1	2.6	1,520	10
YES	2,440	333	20	25	109	131	20	21	16.4	13.2	3.1	2.5	380	14
PFC	8,387	341	25	29	139	164	19	19	13.7	11.7	2.5	2.1	360	6
IDFC	5,890	188	10	11	73	86	16	14	15.7	13.8	2.8	2.3	215	14

Source: Company, ENAM Estimates, Note: P/BV & P/E of SBI are calculated after deducting the value of investments from price & the cost of investments from BV

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August 23, 2010

Executive summary…

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The Banking sector delivered a noteworthy performance in the first quarter of the current fiscal with a steady pick up in credit growth and evading concerns of deterioration in asset quality

- **Overall demand for credit is expected to be buoyant** for the remaining of FY11 in light of the approaching festival season coupled with capacity utilization of over 90%. We expect ~21% credit growth and deposit growth of ~18% in the current fiscal, with an upward bias
- **Margins are likely to stabilize** at current levels with marginal negative bias on account of rising interest rates and competition for accumulation of funds
- **Proper implementation of base rate will facilitate in absorbing any interest rate hike and mitigate asset quality risks.** Moreover, **provisioning expenditure is likely to decline on the back of receding fears of incremental delinquencies** from the restructured books and majority of the banks meeting the Sept 2010 deadline for 70% NPA coverage ratio. These norms could provide immunity to the Indian banks against any external shocks
- **Policy rates: We do not anticipate the RBI to raise policy rates by more than 50 bps in the remaining fiscal** since inflation and IIP growth have begun to moderate as expected due to the lagged effects of interest rate hikes and softness in global commodity prices
- **The unofficial target of a minimum 8% Tier I ratio will force many banks to go for dilution** over the next 4-8 quarters. Dilution is likely to be book accretive for majority of the banks and will increase their leveraging ability

…Executive summary

- The government plans to infuse ~ Rs 165 bn in PSU Banks with the Union Bank, Bank of Maharashtra, IDBI Bank, UCO Bank and Central Bank of India already receiving approvals for fresh capital infusion
- The **key risks** to our assumptions are high interest rates and low liquidity. Any aggressive rate hikes or absorption of liquidity can negatively impact this sector
- **Overall, we maintain our positive stance on the sector**. In the current scenario of rising systemic interest rates, **we prefer banks with strong deposit franchise and high CASA ratio which would cushion the net interest margins**

  Our preferred picks are: **SBI, Canara Bank, Axis Bank, Yes Bank, PFC and IDFC**

Our preferred picks:

	Mkt. Cap (USD mn)	CMP (Rs)	EPS (Rs)			Adj BV (Rs)			ROE (%)			P/E (x)			P/Adj.BV (x)			Target (Rs)	Upside (%)
			FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E		
Public																			
SBI	38,409	2,823	144	176	224	929	1,077	1,289	15	16	18	14.4	11.8	9.3	2.2	1.9	1.6	3,000	6
Canara	4,652	529	74	88	106	276	349	436	27	26	25	7.2	6.0	5.0	1.9	1.5	1.2	610	15
Private																			
Axis	12,086	1,382	62	77	93	389	450	525	19	18	19	22.3	18.0	14.8	3.6	3.1	2.6	1,520	10
YES	2,440	333	14	20	25	91	109	131	20	20	21	23.6	16.4	13.2	3.7	3.1	2.5	380	14
NBFC																			
PFC	8,387	341	21	25	29	117	139	164	19	19	19	16.6	13.7	11.7	2.9	2.5	2.1	360	6
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Source: Company, ENAM Estimates, Note: P/BV & P/E of SBI are calculated after deducting the value of investments from price & the cost of investments from BV

Grand opportunities in the long term

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- **Strong GDP growth projected – GDP is estimated to grow by 5x in the next 20 years and $ 1.2 trillion capital investment is necessary to meet the projected demand in Indian cities during this period**
- **Favorable demographics, rising urbanization and higher income levels are likely to boost India's savings pool to $ 1.4 trn by 2020 of which financial savings corpus is likely to be ~$ 580 bn**
  - This would form the bulwark of discretionary consumption and also fund infra creation
- **India is likely to put up an Infra backbone to support the high growth rates with an overall investment of > $ 50 bn per annum over the next five years**
  - Power, roads, ports, airports, etc. will be the key segments to witness explosive growth
- **Under-penetrated markets –** With low credit to GDP ratio of ~53%, demand for organized credit is likely to remain strong
- **With fiscal deficit expected to reduce, the pressure on banks to fund the same will come down, thereby allowing them to redeploy resources in higher yielding assets**
- **The road ahead**
  - Competition and pricing efficiency is expected with Govt. contemplating entry of new private players in the banking space
  - Core loan growth to drive profitability as banks shift to the base rate regime and price risk adequately
  - With clean up of asset quality, incremental provisioning is likely to reduce
  - Focus on infra lending to drive volumes

Credit growth picking up, deposits to follow

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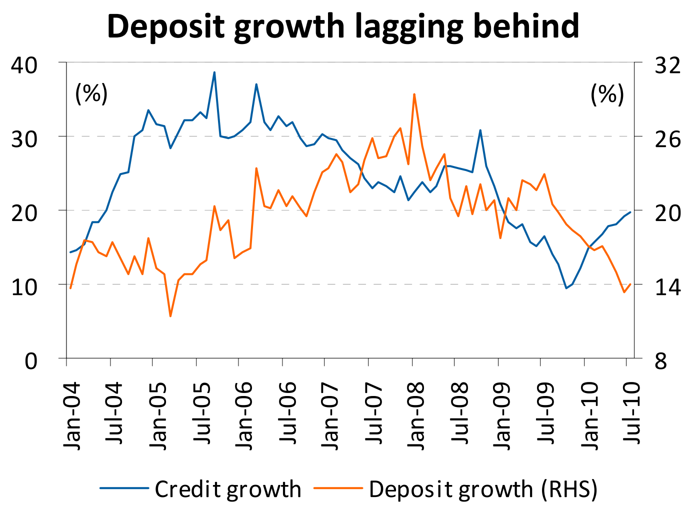
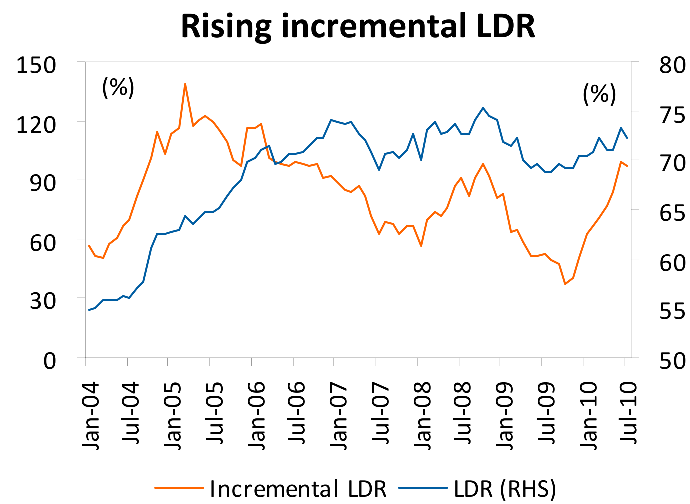
Pick up in credit growth, but deposits lag behind

- System-wide credit growth has picked up impressively to 22% YoY in Jun-10, from a low of 12.2% in Dec-10 led by increased momentum in infrastructure lending
- Disbursements towards 3G Telecom & BWA auctions also provided a fillip to the credit growth in June 10; however, these loans are short term in nature and may be repaid within a year
- Deposit growth, on the other hand, has lagged behind and declined to ~14% (almost at the levels last seen in 2004-05), but is expected to pick up as the systemic rates move up





Source: RBI, ENAM Research

Infrastructure sector gaining momentum

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- We expect most banks to achieve the RBI targeted non-food credit growth of 20% in FY11 led by pick up in infrastructure loans
- Amongst our coverage, we expect PNB, Canara Bank, Axis and Yes Bank to grow at the higher-than-industry average

	O/s loans FY10 (Rs bn)	YoY chg (%)
Non-Food Gross Bank Credit (1 to 4)	**30,215**	**18.1**
1. Agriculture and Allied Activities	**3,995**	**21.0**
2. Industry	**13,087**	**25.8**
3. Personal Loans	**5,890**	**6.5**
Housing	3,053	9.6
Advances against Fixed Deposits	470	2.4
Credit Card Outstanding	196	(27.4)
Education	370	28.8
Consumer Durables	81	1.8
4. Services	**7,243**	**14.1**
Transport Operators	522	18.7
Professional Services	495	19.5
Trade	1,610	13.1
Real Estate Loans	957	1.2
Non-Banking Financial Companies	1,110	17.5

	O/s loans (Rs bn)	YoY chg (%)
Industry	**13,087**	**25.8**
Food Processing	679	27.2
Textiles	1,206	18.6
Paper and Paper Products	195	23.9
Petroleum, Coal Products and Nuclear Fuels	631	24.1
Chemicals and Chemical Products	799	13.0
Rubber, Plastic and their Products	166	23.7
Iron and Steel	1,292	26.2
Other Metal and Metal Products	355	16.2
Engineering	738	13.1
Vehicles, Vehicle Parts and Transport Equipments	375	13.9
Gems and Jewellery	317	13.7
Construction	439	16.2
Infrastructure	3,965	44.3

Source: RBI

Fundamentals in place

- **Indian Banks are set to leverage on strong operational performance**
  - High margins and rising focus on sustainable fee income to help in maintaining profitability
  - Asset quality has stabilized while new technologies are being implemented to increase efficiency in terms of monitoring exposures/ risk profiling of borrowers
  - Clean balance sheet with 70% NPA provisioning coverage ratio (September 2010)

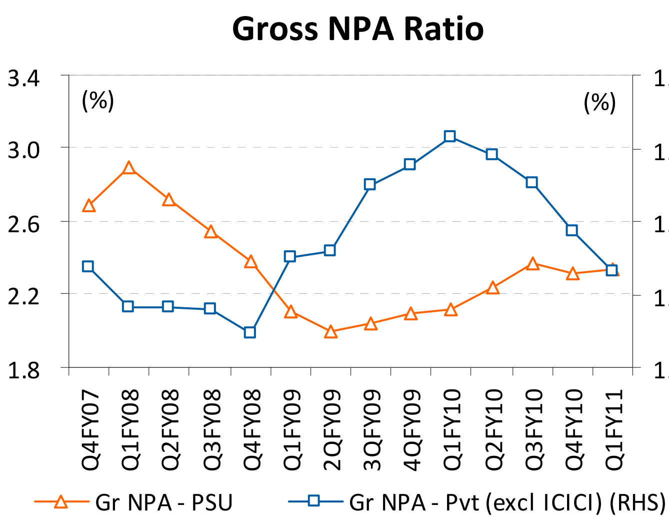
- **Unlocking value from subsidiary investments**
  - With HDFC Standard life becoming eligible for its IPO in Oct 2010 (followed by ICICI Pru and SBI life in subsequent months) IRDA is expected to come out with IPO guidelines before October 2010
  - The listing of private insurers will enable price discovery for the insurance sector and pave way for their parents to unlock value

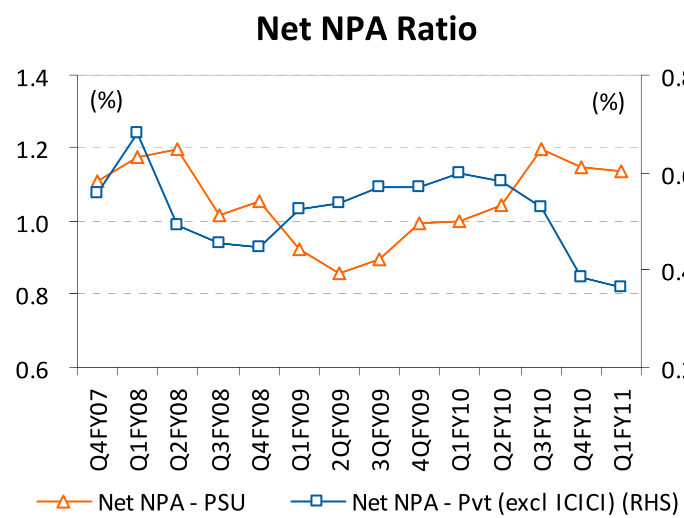
- **Not immune but relatively less impacted by global developments:** A healthy capital base, strong management quality, stringent regulatory requirement, lack of complex/ innovative products and risk taking capability along with low international presence has aided in protecting Indian banks from global pressures

- **Stringent guidelines making banks more accountable & strong**
  - Compliance with KYC and anti-money laundering norms, higher NPA provisioning, high Tier I ratio, restrictions on shareholding and voting rights provide additional safety
  - Credit Information Bureau, implementation of SARFAESI Act and corporate governance norms, higher disclosure requirements on derivatives exposures have strengthened the balance sheet of Indian banks

Stabilizing asset quality

- **Fresh slippages have moderated for most of the banks and focus has intensified on recoveries**
  - NPA ratios, for both public and private sector banks, have been declining over the last few quarters . The improvement has been more for private banks as compared to the PSU peers
- **NPA recognition norms based on CBS could prove to be a nasty surprise in a few cases**
  - Spurt in NPAs could be seen in the retail sector as well as priority sector loans as some of these may be in non-CBS branches
  - Some banks, such as SBI and Indian Bank, have disclosed that the current calculated NPAs are as per the CBS platform. Most other PSU banks are in the final stages of migrating to CBS and are currently determining NPAs under the manual system





Source: Company Reports

Capital requirement for PSU banks

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- **The unofficial target of min 8% Tier I ratio, will force many banks to go for dilution over the next 4-8 quarters**
  - Large private banks are well capitalized with Tier I ratio above 10%, whereas PSU peers are knocking Govt's door for funds
  - Dilution is likely to be book accretive for majority banks and will increase their leveraging ability. The government has plans to infuse ~ Rs 165 bn in PSU Banks
- **Government will maintain its minimum 51% holding and is willing to infuse capital wherever required**
  - Central Bank has got government permission for rights issue → Punjab and Sind Bank is coming out with an initial offering
  - SBI bill to reduce minimum government holding to 51% from currently restricted 55%, is under final stages of approval

Government's current holding

	Government shareholding (%)	Market cap (Rs bn)
Central Bank	80.2	75
Indian Bank	80.0	109
Bank of Maharashtra	76.8	31
Canara Bank	73.2	216
Syndicate Bank	66.5	62
UCO	63.6	63
IOB	61.2	74
SBI	59.4	1767
PNB	57.8	376
Corp Bank	57.2	90
Union Bank	55.4	183
Allahabad Bank	55.2	94
Vijaya Bank	53.9	37
BOB	53.8	303
IDBI Bank	52.7	96
Andhra Bank	51.6	78
Dena Bank	51.2	32
OBC	51.1	111

PSBs Tier 1 % (Mar-10)

	FY10 Tier-1 ratio (%)
Bank of Maharashtra	5.68
Central Bank	6.03
UCO	6.06
IDBI Bank	6.24
Syndicate Bank	7.26
Vijaya Bank	7.28
Andhra Bank	7.81
Union Bank	7.91
OBC	8.02
Allahabad Bank	8.12
Dena Bank	8.16
BOB	8.22
IOB	8.36
PNB	8.38
SBI	8.46
Canara Bank	8.54
Corp Bank	9.03
Indian Bank	10.65

Equity infusion by Govt during Apr – June 2010

Bank	Amount (Rs bn)
Vijaya Bank	7.0
UCO	3.0
Central Bank of India	2.5
United Bank	2.5

Further equity infusion announced by Govt

Bank	Amount (Rs bn)
IDBI Bank	31.2
Central Bank of India	20.2
Bank of Maharashtra	5.9
UCO	3.8
Union Bank	1.1

Source: RBI, CMIE, Bloomberg and news reports

Key challenges for banks

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- **Credit off-take is not broad based**
  - Though credit grew 22% YoY by June 30, 2010, it was not broad based but rather concentrated towards a few sectors and some short-term lending towards 3G/BWA. Growth in high-yielding retail products was missing.
  - Many sectoral exposure limits (esp. power) are being reached in the infrastructure space which will curtail the lending capacity of banks in these segments.
- **Resources/ liquidity/ Rising interest rates**
  - Capital constraints for PSU banks may hinder growth unless the Government replenishes them with more capital
  - Though rising interest rate scenario is generally positive for NIMs; however, this would depend upon the ability of banks to pass on higher rates to borrowers
  - Treasury losses/ AFS markdowns pose another challenge in a rising interest rate scenario
- **Changes in top management**
  - Most PSU banks' chiefs have either retired or due to retire during this fiscal. Therefore, there remains an element of surprise in terms of the new policies adopted by the fresh incumbents
- **Increase in bad assets/ forced write-offs**
  - Off-balance sheet exposures/ derivative exposures/ derivative related losses have always remained vulnerable to external shocks
  - Inclusion of technical write-offs while determining provision coverage ratio may pose a risk if the asset is unrecoverable

Regulatory environment in the banking space is also likely to undergo a sea change. The regulators are working on various guidelines like new banking licenses, holding company structure, IPO for insurance companies etc. *(Refer Appendix for details)*

Upcoming changes in the PSU management

- **Most PSU banks' chiefs have either retired or due to retire during the next few quarters**
- **Many public sector banks are currently operating without a chief, as the government is yet to issue appointment letters even though the selection process is completed for these posts**
- **Changes in the management for Private sector banks have usually been responded positively by the markets. Whereas, management changes in public sector banks have been watched**

Planned management changes

	Current role/ Retired as	Proposed/ Appointed
Mr S Raman	ED of Union Bank	CMD of Canara Bank
Mr N Pydah	ED of PNB	CMD of OBC
Mr R N Pradeep	ED of Central Bank	CMD of Corporation Bank
Mr Arun Kaul	ED of Central Bank	CMD of UCO Bank
Mr J M Garg	CMD of Corporation Bank	Chairman of SUUTI
Mr R Ramachandran	ED of Indian Bank	CMD of Andhra Bank
Mr A S Bhattacharya	ED of Indian Bank	CMD of Bank of Maharashtra
Mr M Narendra	ED of Bank of India	CMD of Indian Overseas Bank

Source: News reports
CMD = Chairman and Managing Director
ED = Executive Director

Smaller PSU banks have outperformed

- Recent out-performance of smaller banks has been supported by the low valuations, capital infusion, an up-tick in fundamentals along with rumors of inorganic expansion
- Most of these players have strong regional concentration/ base and are well geared to plan the "India Financial Inclusion" story

Smaller Public banks

Public sector	Total assets March 2010	Mkt Cap	CMP	Price performance (%)					P/E (x)		P/BV (x)		ROE (%)		ROA (%)	
Name	(Rs bn)	(Rs bn)	(Rs)	1d	5d	1m	3m	12m	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Indian Bank	1,014	109	253	(1)	4	1	21	95	7	5	1.4	1.1	20.5	21.3	1.4	1.5
Allahabad Bank	1,217	97	217	3	(1)	17	39	141	7	5	1.4	1.1	19.9	20.9	1.1	1.1
Andhra Bank	904	78	160	(1)	2	10	27	80	7	6	1.4	1.2	21.8	23.2	1.1	1.1
Indian Overseas Bank	1,311	73	134	(1)	4	16	45	67	9	6	1.1	0.9	12.1	15.5	0.6	0.7
UCO Bank	1,378	62	113	(1)	5	24	59	168	5	4	1.5	1.1	22.5	23.0	0.9	0.9
Syndicate Bank	1,391	62	119	1	7	13	36	55	6	5	1.2	1.0	17.2	18.0	0.7	0.7
Vijaya Bank	702	36	84	(1)	7	20	51	95	6	6	1.2	1.0	18.6	16.9	-	-
Dena Bank	576	31	109	(1)	5	8	24	118	5	5	1.2	1.0	21.2	20.3	0.9	0.9
Bank Of Maharashtra	711	31	72	(1)	6	11	33	77	7	7	1.5	1.2	21.5	18.9	0.7	0.6

Source: Bloomberg estimates, Capitaline

Smaller Private banks have risen as well

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- Inorganic growth, along with the appointment of new and dynamic management, has played a key role in the success of smaller banks. IndusInd Bank is the best example followed by other small private banks such as ING Vysya Bank, Federal Bank, Dhanlakshmi Bank, Development Credit Bank and Lakshmi Vilas Bank
- The recent Bank of Rajasthan deal (in which BoR was acquired by ICICI Bank) concluded at a rich multiple of 4.8 times its Dec-10 BV, which was much higher than the trading valuation multiples of its peers. This shows the potential of these banks to command rich valuations while being consolidated with larger ones

Smaller Private banks

Private sector	Total assets March 2010	Mkt Cap	CMP	Price performance (%)					P/E (x)		P/BV (x)		ROE (%)		ROA (%)	
Name	(Rs bn)	(Rs bn)	(Rs)	1d	5d	1m	3m	12m	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
IndusInd Bank Ltd	354	94	228	2	3	7	23	139	19	15	3.2	2.7	19.2	19.8	1.3	1.4
Federal Bank Ltd	390	61	355	0	5	(0)	13	63	10	8	1.2	1.1	12.3	13.8	1.3	1.4
Jammu & Kashmir Bank Ltd	425	43	882	(0)	1	11	18	58	7	6	1.3	1.1	17.6	18.2	1.3	1.3
Karur Vysya Bank Ltd	220	37	686	0	7	14	41	128	10	8	1.9	-	21.9	23.1	1.6	1.6
Karnataka Bank Ltd	271	23	172	(3)	(2)	(2)	10	39	11	8	1.2	1.1	11.1	13.7	0.7	0.8
South Indian Bank Ltd	255	23	205	(2)	(0)	9	32	79	9	7	1.4	1.2	17.1	18.7	1.0	1.0
City Union Bank Ltd	116	19	47	0	5	22	43	145	11	8	2.1	1.7	20.1	21.2	1.5	1.5
Dhanlaxmi Bank Ltd	81	17	184	(0)	0	4	23	59	26	12	1.9	1.7	9.5	14.6	0.5	0.8

Source: Bloomberg estimates, Capitaline

NBFCs in spotlight

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- **Several factors supported NBFCs in the recent past – Specialization, favorable demographics, improved affordability, greater reach, wider accessibility, distribution capability, benign interest rate scenario and adequate capitalization**
  - Specialized NBFCs such as power finance, mortgage finance and auto finance cos. have already gained a lot of prominence
  - Going forward, other segments such as Infrastructure finance, Micro finance and Gold finance is likely to lead the way

- **Possible upside for NBFCs which bag new Banking License from RBI**
  - RBI, in its recent discussion paper, has spelt out a number of options relating to eligibility norms such as minimum capital requirements, promoters' contribution, caps on promoter's shareholding & other shareholders and foreign shareholding
  - No definite conclusion can be drawn (as to the winners of the license) at the moment as the paper is very open ended and talks about all the possibilities
  - Potential NBFCs who are looking for licenses are L&T Finance, Shriram Transport Finance, IFCI, LIC Housing Finance, Mahindra & Mahindra Financial Services, Reliance Capital, Aditya Birla Nuvo, Bajaj Finserv, SREI Infrastructure Finance and Religare Enterprises

Specialization gaining prominence

Segment	Key players
Housing/mortgage finance	HDFC Ltd, LIC HF
Auto finance	Shriram Transport, Magma
Infrastructure/power finance	IDFC, IFCI, PFC, REC
Gold loan	Manappuram
Microfinance	SKS

Source: ENAM Research

Life insurance – Multiple headwinds

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Multiple regulatory headwinds

- IRDA introduced sweeping changes in the pricing norms for the unit-linked products (ULIP) which dominate the market with over 80% share in incremental business
- Regulatory caps have been introduced on almost all the charges that could be embedded in the ULIP products namely
  - A) Cap on surrender charges
  - B) Longer minimum tenure and higher minimum sum assured
  - C) Even distribution of charges during the lock-in period (no front loading)
  - D) Minimum mortality/ health cover for all ULIPs
  - E) Minimum guaranteed return of 4.5% pa on pension products

New business margins to take a significant hit

- Unless companies significantly alter the cost structure of the products along with the product mix itself, the new business margins could fall to lower double digits to even single digits Cēterīs paribus

Business volumes to get affected significantly in the medium term

- Current high growth in the business volumes is driven primarily by push from distributors/companies to sell under the old pricing frame work (new guidelines becomes applicable only starting 1st September 2010)
  - As a result, 2HFY11 to witness lower business growth (2H generally contributes ~70% of full year volumes) → FY12E may witness even a de-growth in the new business as both intermediaries & consumers come to terms with the new product suites/framework

Negative impact in the near to medium term, but positive over a longer term

- Lower profitability, delayed break and higher capital infusion to be the key negatives for most of the private players
- Players with strong distribution (e.g., bank-backed & bancassurance tie-ups) to be relatively better placed

Private sector reeling under pressure

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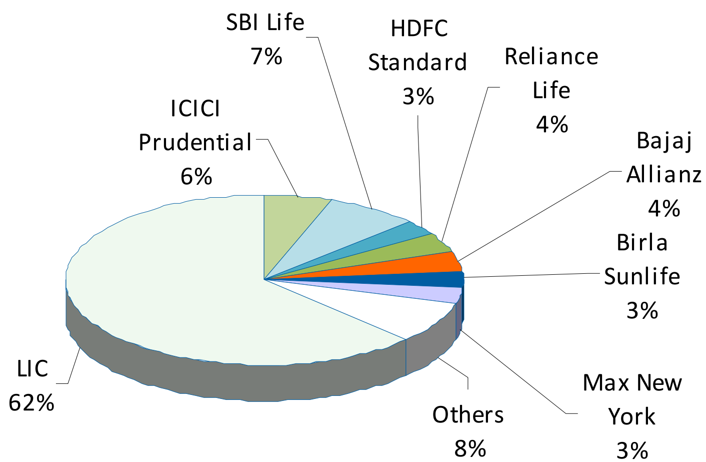
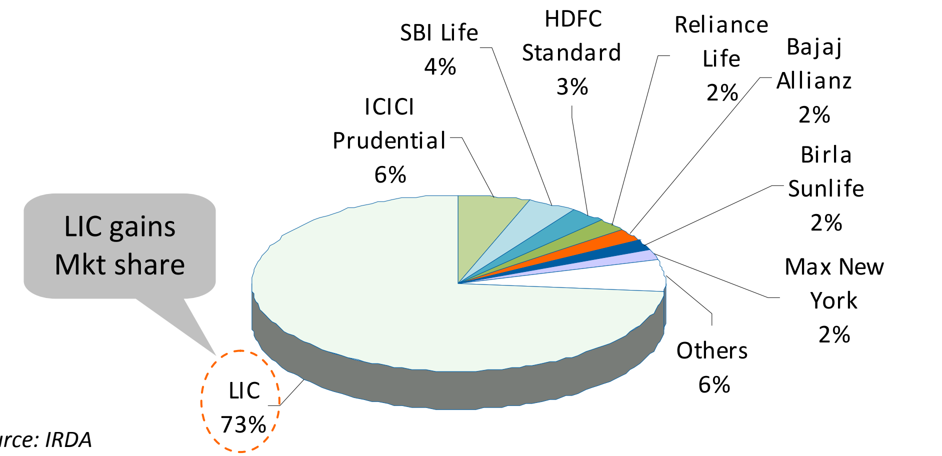
- Almost all of the larger private sector players have lost market share to the state run LIC, which has relatively higher share of traditional products
- LIC new business premium has grown at a whopping 108% YoY as compared to a 25% YoY growth registered by private sector players
- Amongst the larger private sector players, ICICI Pru Life and HDFC standard Life have managed to register a strong growth

New business premiums (Rs bn)	Q1FY11	Q1FY10	YoY (%)
ICICI Prudential	14.1	8.1	74
SBI Life	9.8	10.7	(9)
HDFC Standard	7.2	4.1	74
Reliance Life	6.1	5.1	20
Bajaj Allianz	6	5.8	4
Birla Sunlife	4.7	4.4	8
Max New York	4.6	4.3	6
Private Total	67.8	54.3	25
LIC	187.4	90.3	108
Grand Total	**255**	**145**	**77**

New business premiums Market Share (Q1FY10)



New business premiums Market Share (Q1FY11)



Source: IRDA

Comparative valuations

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Comparative Valuations & Ratings (Average sector upside -5% to 5%)

	Mkt. Cap (USD mn)	CMP (Rs)	EPS (Rs)			Adj BV (Rs)			ROE (%)			P/E (x)			P/Adj.BV (x)			Target (Rs)	Upside (%)	Relative to sector
			FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E			
Public																				
SBI	38,409	2,823	144	176	224	929	1,077	1,289	15	16	18	14.4	11.8	9.3	2.5	2.1	1.8	3,000	6	Outperformer
PNB	8,100	1,199	124	150	184	495	616	767	27	26	26	9.7	8.0	6.5	2.4	1.9	1.6	1,230	3	Neutral
BOI	5,212	463	33	48	57	215	255	302	14	18	19	14.0	9.7	8.2	2.2	1.8	1.5	455	(2)	Neutral
BOB	6,494	832	84	99	120	366	444	542	24	24	24	9.9	8.4	6.9	2.3	1.9	1.5	870	5	Neutral
Canara	4,652	529	74	88	106	276	349	436	27	26	25	7.2	6.0	5.0	1.9	1.5	1.2	610	15	Outperformer
Union	3,843	355	41	51	60	162	206	257	26	26	25	8.6	6.9	5.9	2.2	1.7	1.4	385	8	Outperformer
OBC	2,357	439	45	58	72	273	322	380	16	18	20	9.7	7.6	6.1	1.6	1.4	1.2	460	5	Neutral
Corp Bk	1,923	626	82	95	113	393	467	556	22	22	22	7.7	6.6	5.5	1.6	1.3	1.1	670	7	Outperformer
Private																				
ICICI BK	24,157	1,010	36	40	48	441	472	505	8	9	9	19.1	17.0	14.4	2.1	1.9	1.8	1,080	7	Outperformer
HDFC Bk	21,687	2,196	64	82	99	465	529	608	16	16	17	34.1	26.8	22.1	4.7	4.2	3.6	2,130	(3)	Neutral
Axis	12,086	1,382	62	77	93	389	450	525	19	18	19	22.3	18.0	14.8	3.6	3.1	2.6	1,520	10	Outperformer
YES	2,440	333	14	20	25	91	109	131	20	20	21	23.6	16.4	13.2	3.7	3.1	2.5	380	14	Outperformer
ING Vysya	926	359	20	26	34	173	197	225	13	13	15	17.8	13.9	10.7	2.1	1.8	1.6	380	6	Outperformer
NBFC																				
HDFC	19,631	629	20	23	26	105	137	154	20	19	18	19.0	16.3	14.3	7.3	4.5	3.9	645	3	Neutral
PFC	8,387	341	21	25	29	117	139	164	19	19	19	16.6	13.7	11.7	2.9	2.5	2.1	360	6	Outperformer
IDFC	5,890	188	8	10	11	53	73	86	16	16	14	20.0	15.7	13.8	4.2	2.8	2.3	215	14	Outperformer
REC	7,174	339	20	26	32	108	127	151	24	22	23	16.7	12.9	10.6	3.1	2.7	2.2	335	(1)	Neutral
Shriram. T.F	3,705	767	39	57	71	165	209	263	28	29	29	19.8	13.5	10.7	4.7	3.7	2.9	760	(1)	Neutral
LIC HF	2,568	1,262	70	100	110	353	435	523	24	22	23	17.8	12.4	11.3	3.5	2.9	2.4	1,260	(0)	Neutral
Manappurar	874	120	4	7	12	17	25	36	31	33	38	34.0	16.6	10.2	6.8	4.8	3.3	115	(4)	Neutral

Source: Company, ENAM estimates

Note: P/BV & P/E of ICICI Bank, SBI, HDFC, IDFC and LICHF are calculated after deducting the value of investments from price & the cost of investments from reported BV .

Assessment of Q1FY11 performance

Banking: Q1FY11 Earnings Review

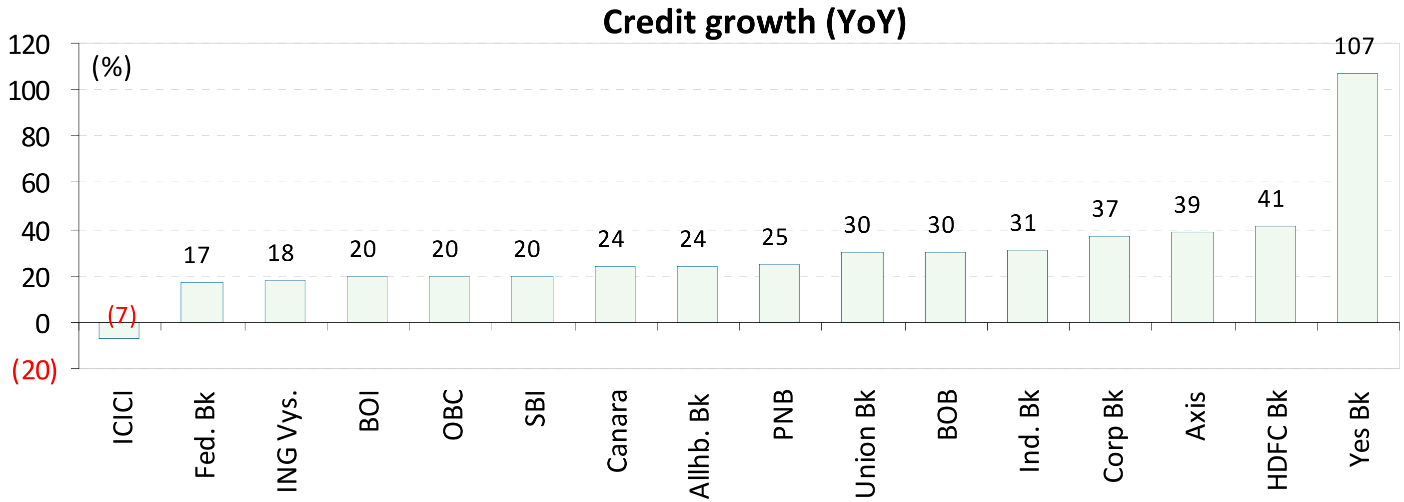
- **Net Profit for our coverage universe was up 31% YoY, with PSU banks outperforming the private players**
  - Higher PAT was driven primarily by higher core income, while negatively impacted by lower non-interest income
  - Lower provisioning helped ICICI Bank post a 17% PAT growth despite flat NII and 20% decline in non-interest income
- **Core income for our coverage banks reported 41% YoY growth led by 22% credit growth and improved margins**
  - PSBs outperformed private banks in NII growth at 48% YoY (vs. 23% for private banks)
  - Union, OBC and Yes bank reported NII growth in excess of 60%. ICICI bank reported flat NII led by de-growth in its loan book.

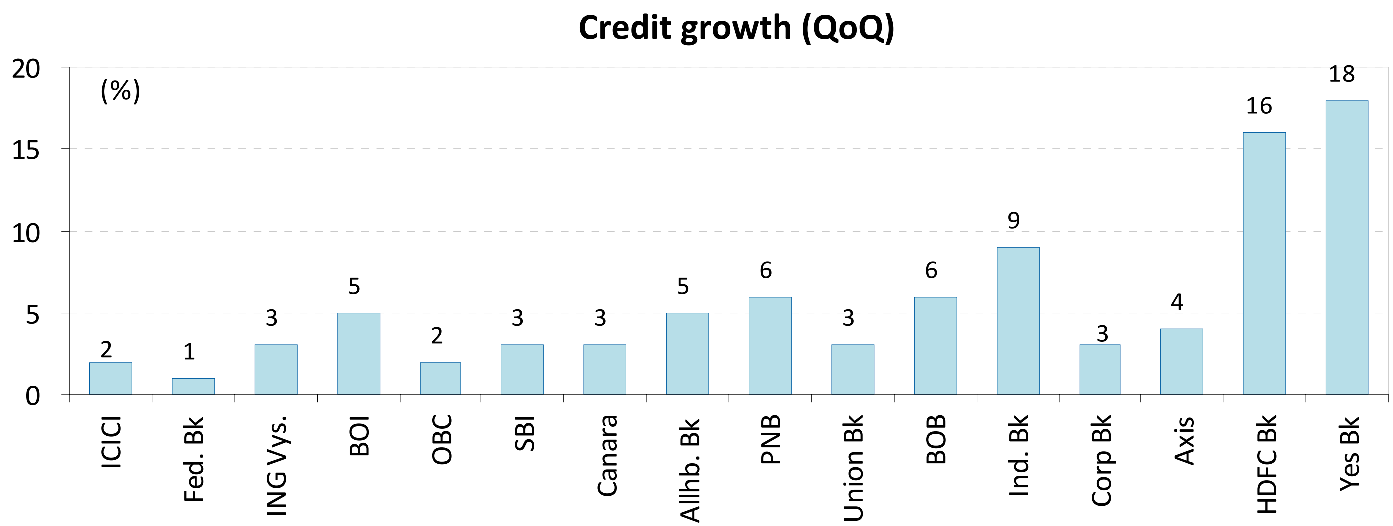
	Net Income (Rs mn)					NII (Rs mn)					Adjusted PAT (Rs mn)				
Company name	Q1FY11	Q1FY10	YoY (%)	Q4FY10	QoQ (%)	Q1FY11	Q1FY10	YoY (%)	Q4FY10	QoQ (%)	Q1FY11	Q1FY10	YoY (%)	Q4FY10	QoQ (%)
Banks	**360,614**	**296,972**	**21**	**361,863**	**(0)**	**247,575**	**176,066**	**41**	**234,766**	**5**	**106,831**	**81,550**	**31**	**87,953**	**21**
- PSBs	257,659	200,781	28	258,127	(0)	183,515	123,914	48	171,389	7	78,781	59,483	32	59,803	32
- Pvt. Bks	102,955	96,191	7	103,736	(1)	64,061	52,152	23	63,377	1	28,050	22,067	27	28,150	(0)
- Pvt. Bks (excl. ICICI)	66,240	55,440	19	64,479	3	44,150	32,299	37	43,028	3	17,790	13,285	34	18,095	(2)

Source: Company, ENAM Research.

- **Industry-wide, credit growth picked up by 22% YoY by June 2010**
  - Credit book for our coverage banks grew 22% YoY with PSBs (up 23% YoY) outpacing their private sector peers (up 19% YoY) However, private banks' credit book was up 42% excluding ICICI Bank
  - Credit growth for many banks (such as Axis, HDFC bank, Yes, etc.) was led by 3G/BWA auction funding
- **Almost all reported improved margins led by sharper decline in cost of funds than decrease in yield on assets**
  - Cost of deposits declined as a result of re-pricing/ repayment of high cost bulk deposits, which drove the NIMs upwards
  - CASA ratio improved for almost all banks, with ICICI and SBI leading the pack (up 11.7 and 9 percentage pts respectively)
  - However, NIMs declined sequentially for many banks due to lower CASA growth

Credit growth remained strong…



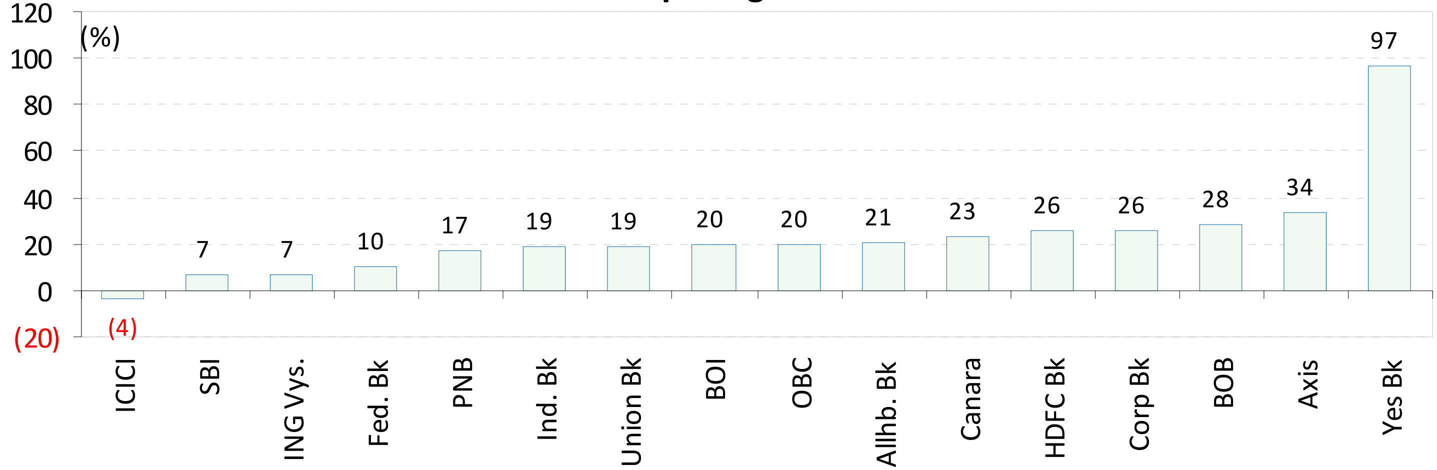


- Yes Bank continued to stand out in terms of loan growth
- Credit growth for Axis, HDFC bk and Yes bk was also supported by disbursements towards 3G/BWA leading to above-average growth
- Adjusting for one-off 3G loans, HDFC bank's loan growth was at 31%
- Lending for Canara, Union, OBC, BOB was aided by growth in SME loans
- ICICI bank's loan book continued to shrink led by its conscious strategy to go slow on retail loans

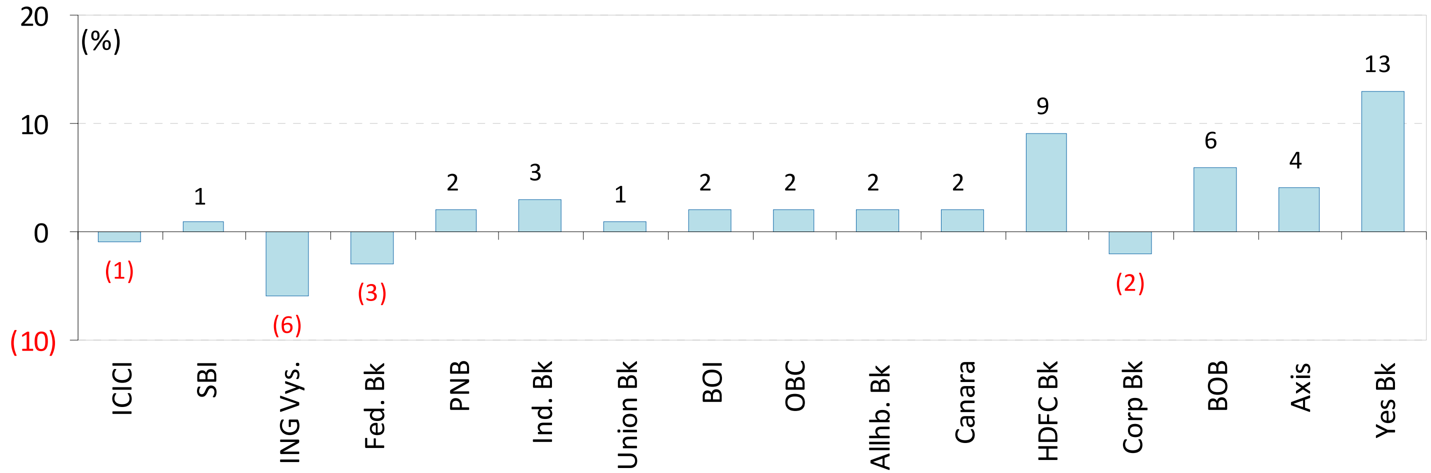
Source: Company, ENAM Research.

…while deposits lagged

Deposit growth YoY



Deposit growth QoQ

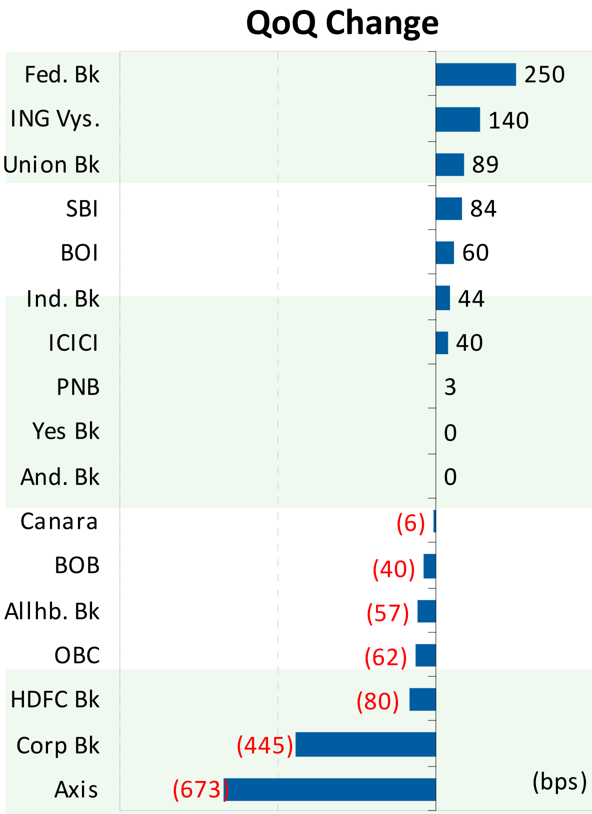


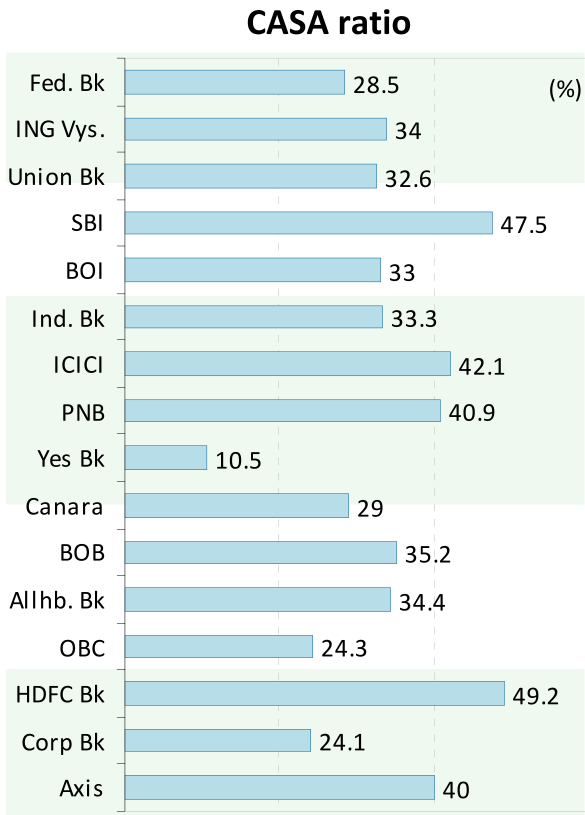
Source: Company, ENAM Research.

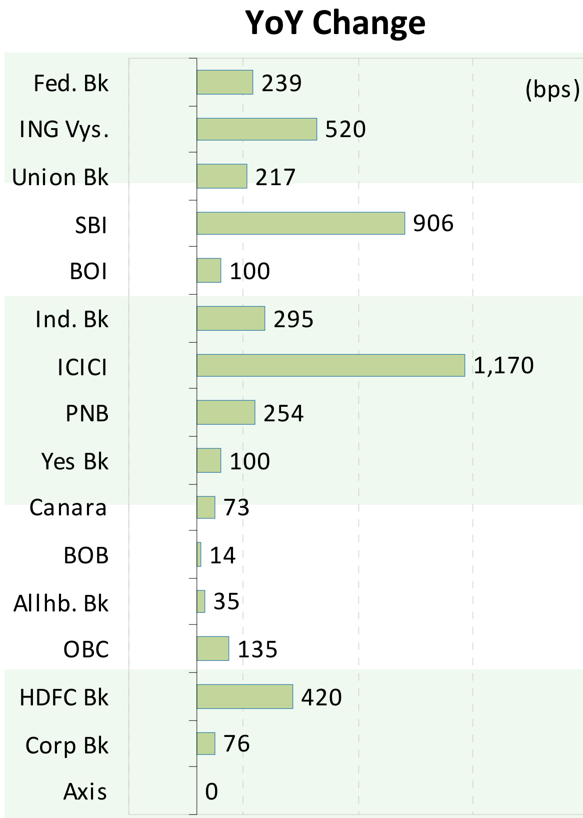
- Sector-wide deposit growth remained slow (slowed marginally from 17% in March '10 to 16.3% in June '10)
- Low deposit rates coupled with repayments of high cost deposits resulted in lower growth in term deposits
- Banks have started deposit mobilization with increase in term deposit rates
- Slower deposit growth than credit led to higher incremental LDRs

Improvement in CASA ratio…

- **CASA ratio of our coverage banks increased ~430 bps YoY led by 30% increase in CASA deposits**
  - HDFC Bank reported highest CASA at 49.2% (although declined sequentially by 80 bps)
  - SBI witnessed improvement in CASA ratio to 47.5%



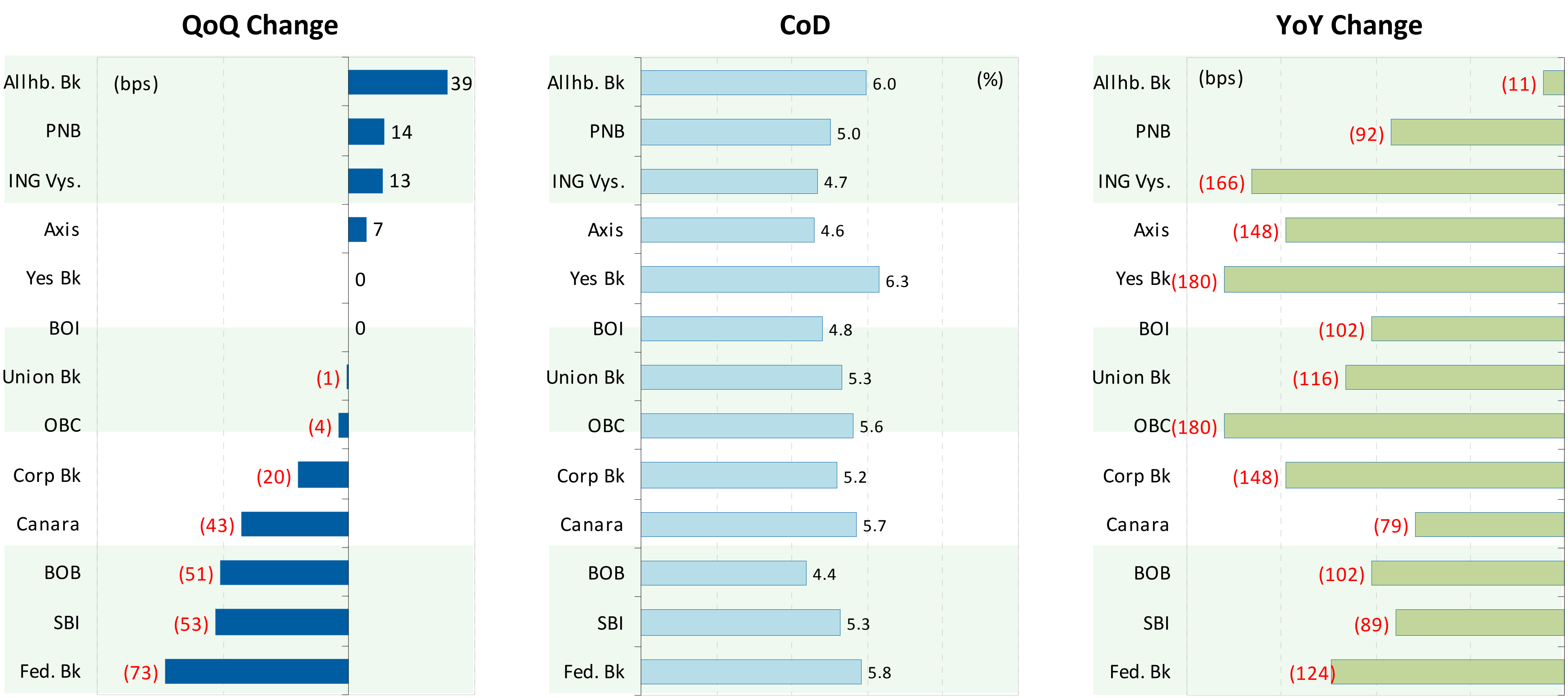




Source: Company, ENAM Research.

...and decline in cost of deposits...

- **Cost of Deposits which is at a 3-year low for most banks, fell due to high cost bulk deposit repricing/repayment**
- **With most of the repricing benefit behind us, we believe the cost of deposits are expected to rise going forward**

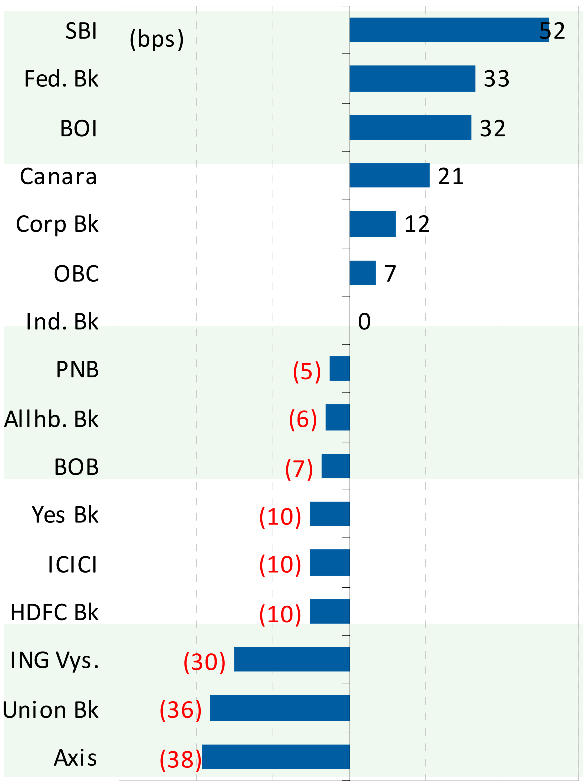


Source: Company, ENAM Research.

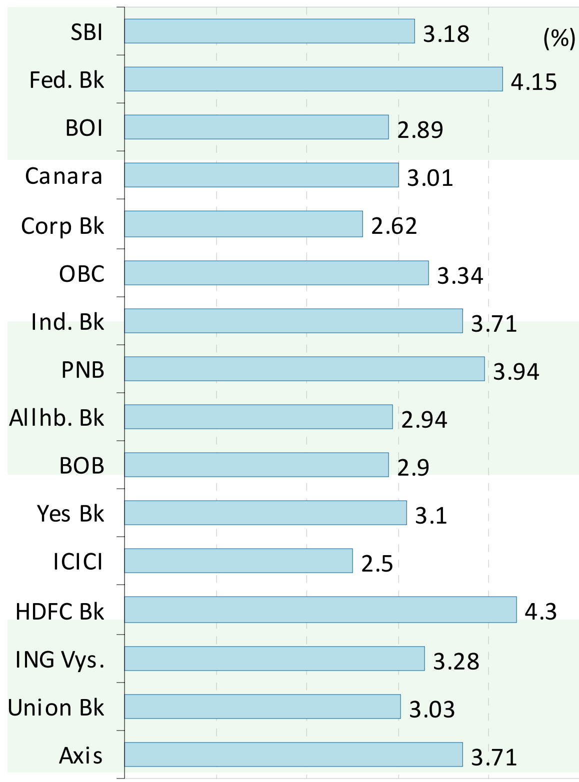
led to improvement in margins…

- **NIM improved for most banks despite higher interest on savings deposits and a sequential decline in CASA**
  - OBC's margins saw highest YoY increase of 151 bps (to 3.34%), while the co. has guided for margins of ~3 % for the full year

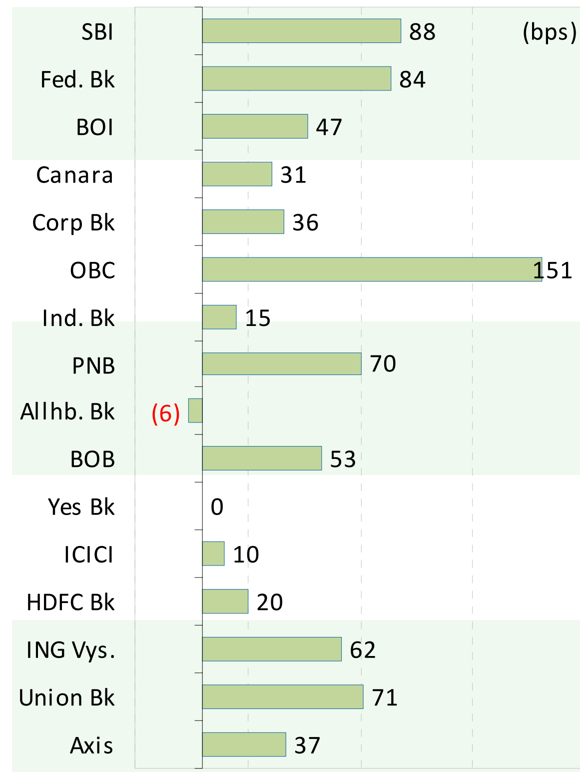
QoQ Change



NIM



YoY Change

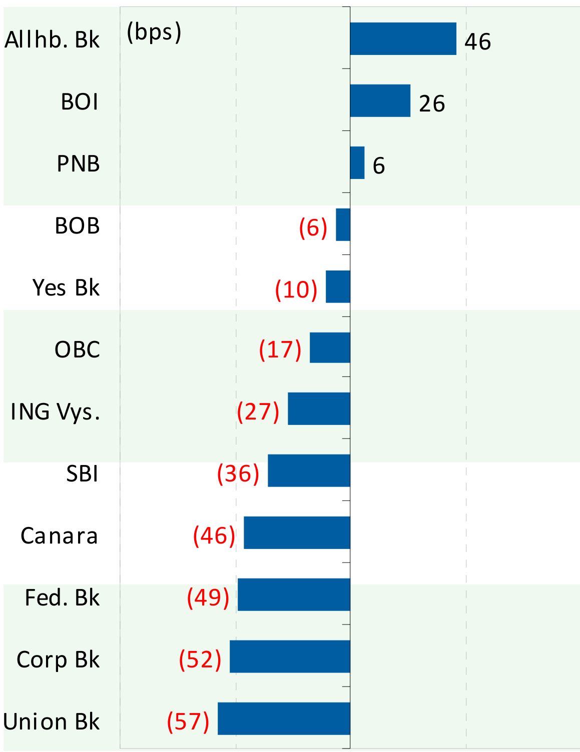


Source: Company, ENAM Research.

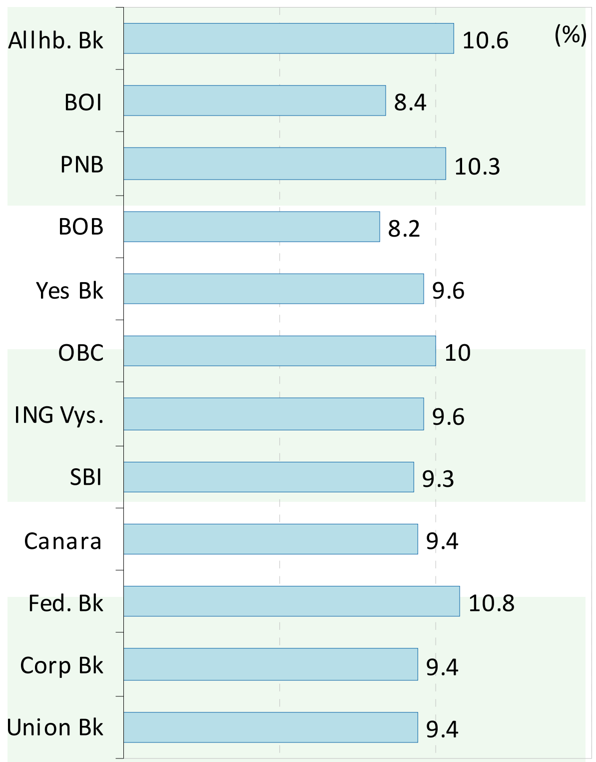
…despite fall in yields on advances

- **Yields on advances have declined for almost all banks; however, this was more than offset by a higher decline in cost of deposits leading to improvement in net interest margins which came as a positive surprise**

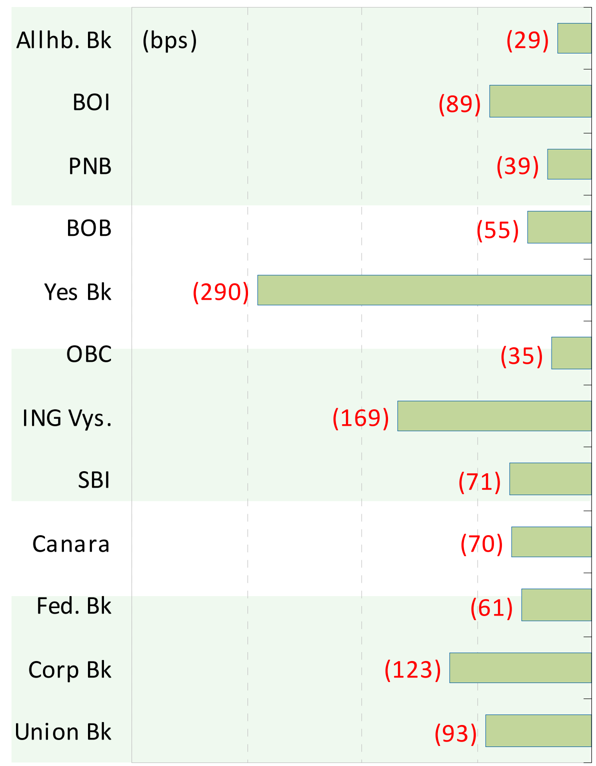
QoQ Change



YoA



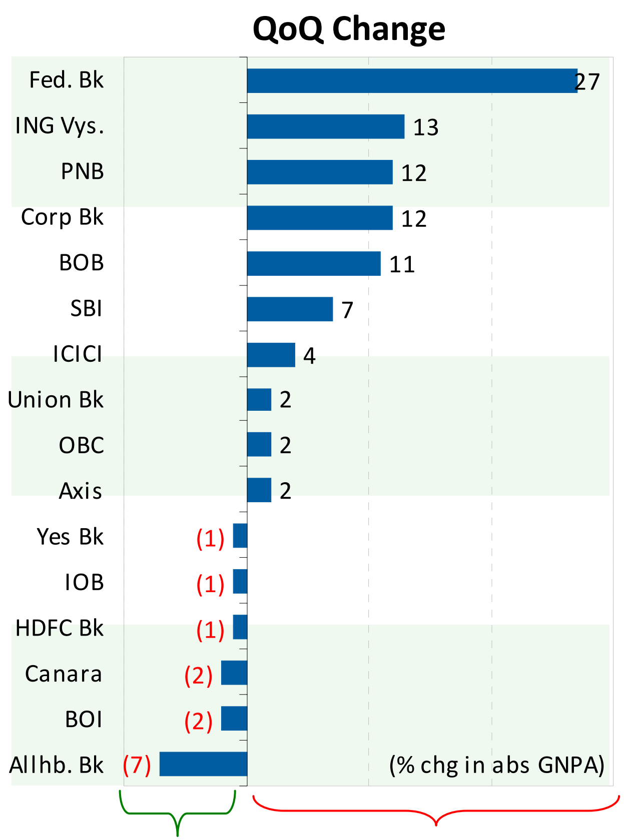
YoY Change

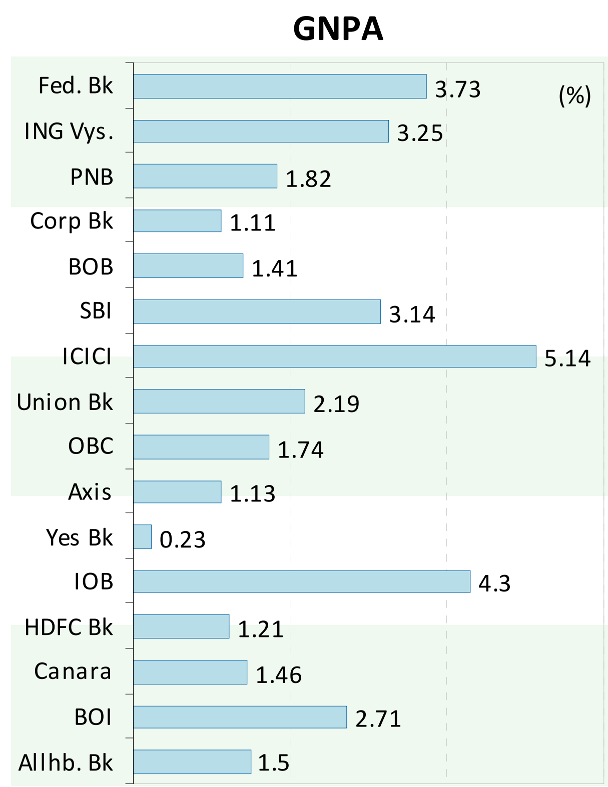


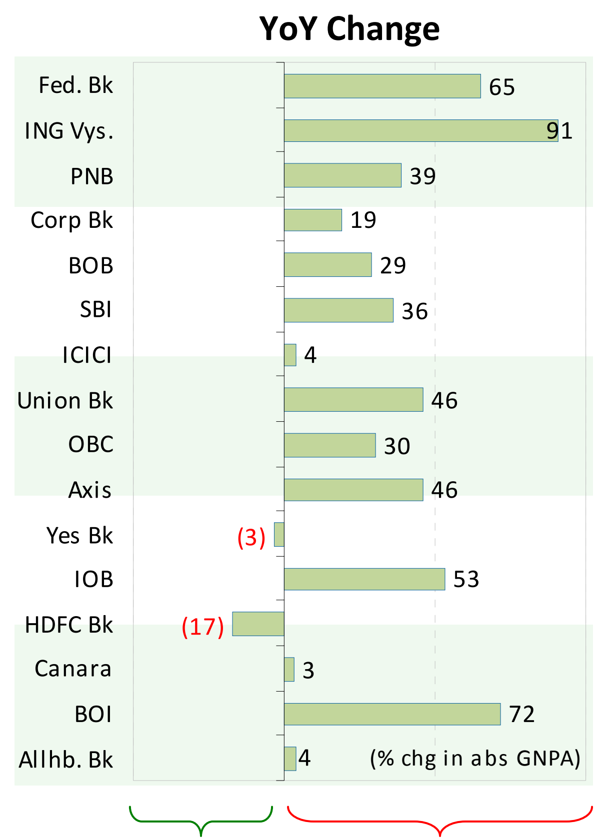
Source: Company, ENAM Research.

Gross NPAs - Stabilising asset quality

- **Moderation for most banks with improvement in asset quality led by lower slippages and higher recoveries**
  - PNB witnessed asset quality pressure as 8% of its restructured advances slipped into NPAs.
  - Union Bank expects NPAs to peak in 2QFY10, due to expected slippages in Agri-debt as well as in the restructured book







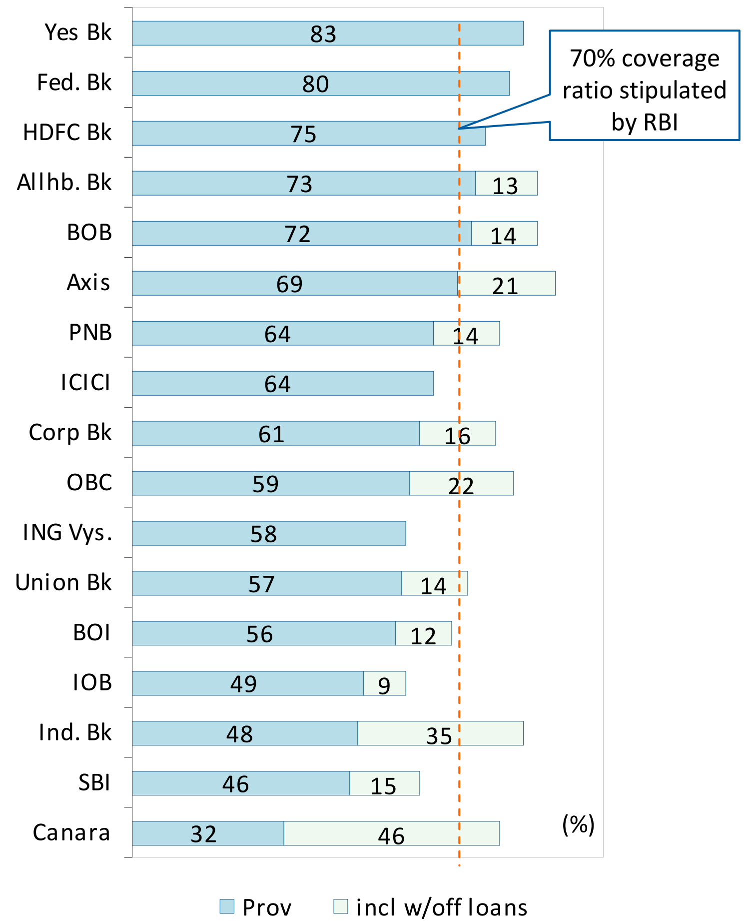
Red denotes deterioration
Green denotes improvement

Source: Company, ENAM Research.

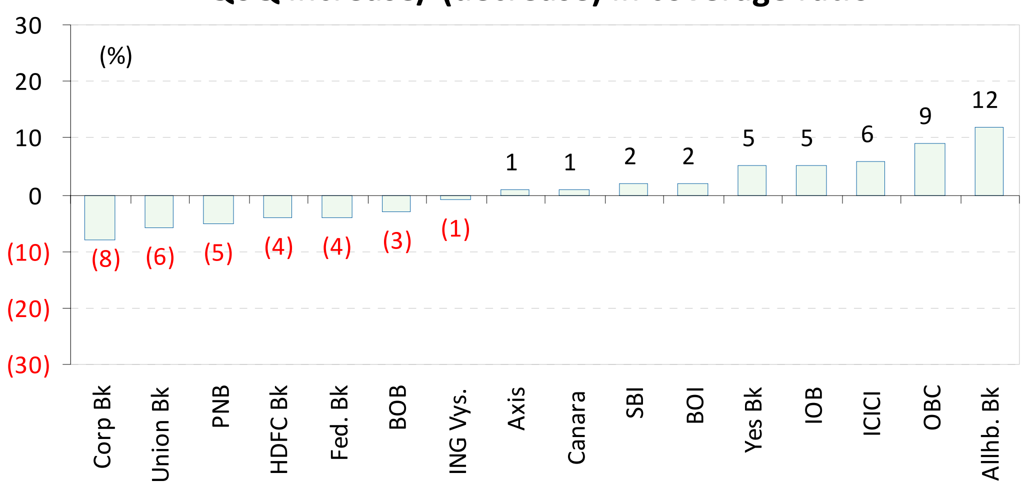
Provisioning coverage – not a major worry

- **ICICI coverage improved led by lower slippages (58% in Mar-10)**
  - It has RBI approval to meet 70% coverage up to Mar-11
- **SBI too expects to comfortably reach 70% coverage by its extended deadline of Sep-11**
- **ING Vysya is also seeking an extension of deadline from RBI for improving the coverage ratio**

Provision coverage



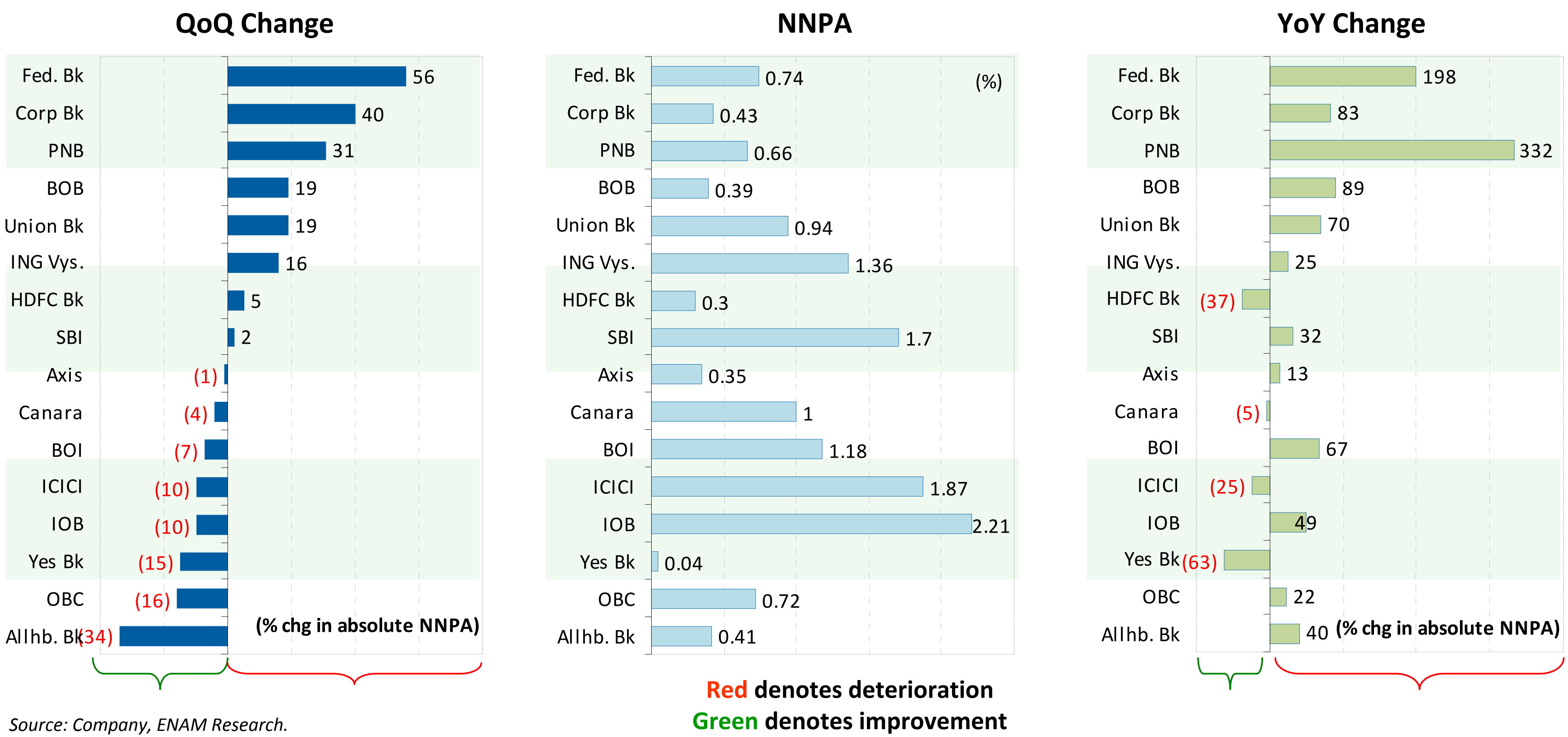
QoQ increase/ (decrease) in coverage ratio



Source: Company, ENAM Research.

Net NPAs - A mixed bag

- **Net NPAs fell for most banks sequentially despite an increase in gross NPAs (mainly OBC and ICICI)**
  - ICICI bank's net NPA ratio has fallen below 2% levels.

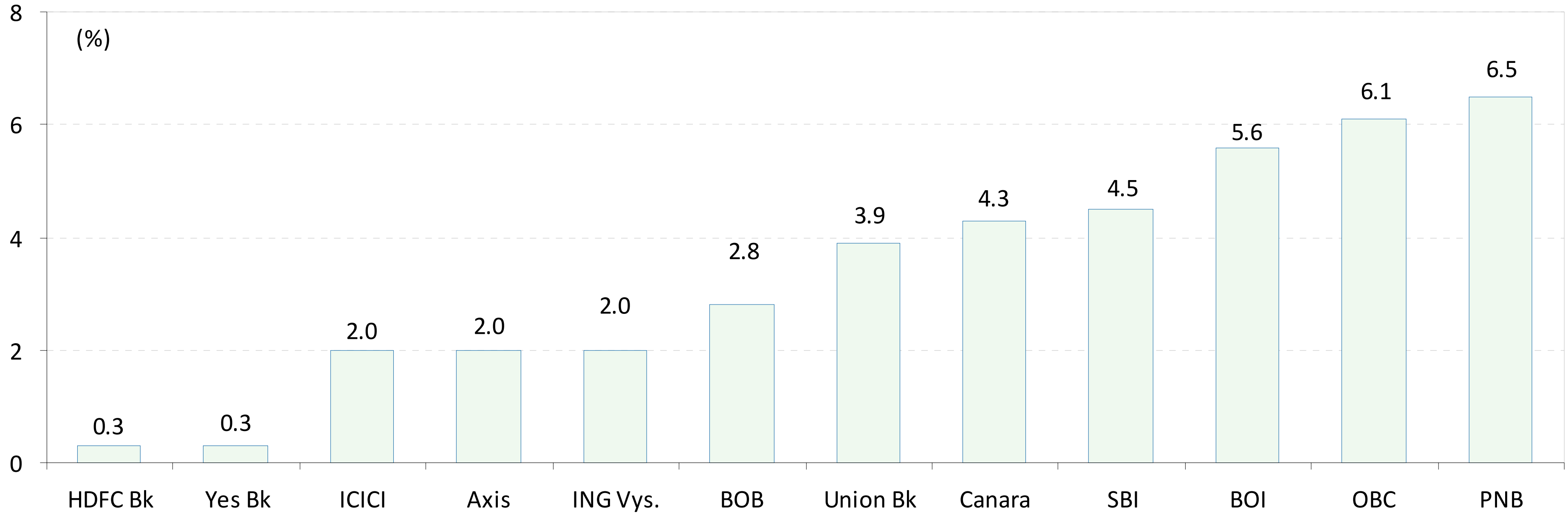


Source: Company, ENAM Research.

Restructured assets – Improvement in sight

- **Stress on assets improved for many banks as they witnessed a sequential decline in restructured advances**
  - ICICI Bank's restructured book declining ~30% (due to upgradations)
- **In addition, slippages from restructured loans into NPAs slowed down during the quarter**
  - For PNB, 8% of restructured book slipped into NPAs

Restructured loans as % of total loan book



Source: Company, ENAM Research.

Most banks are adequately capitalised

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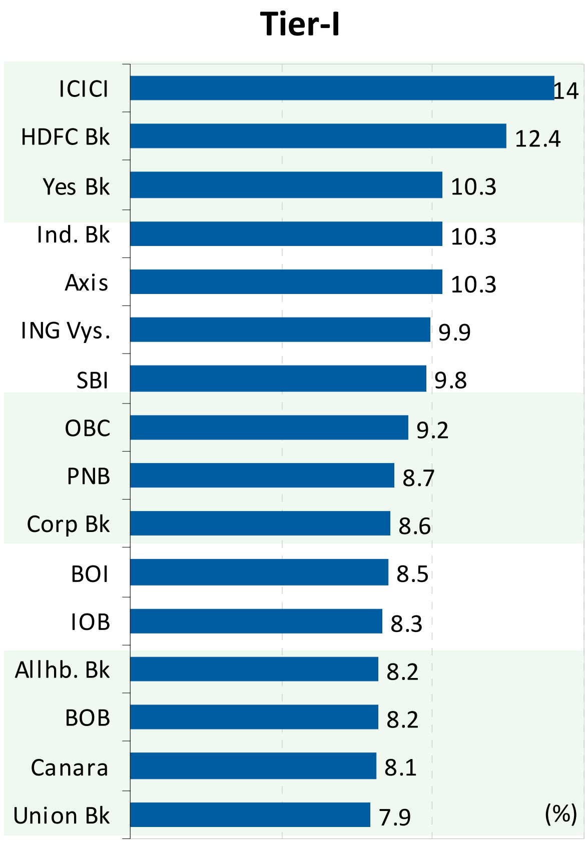
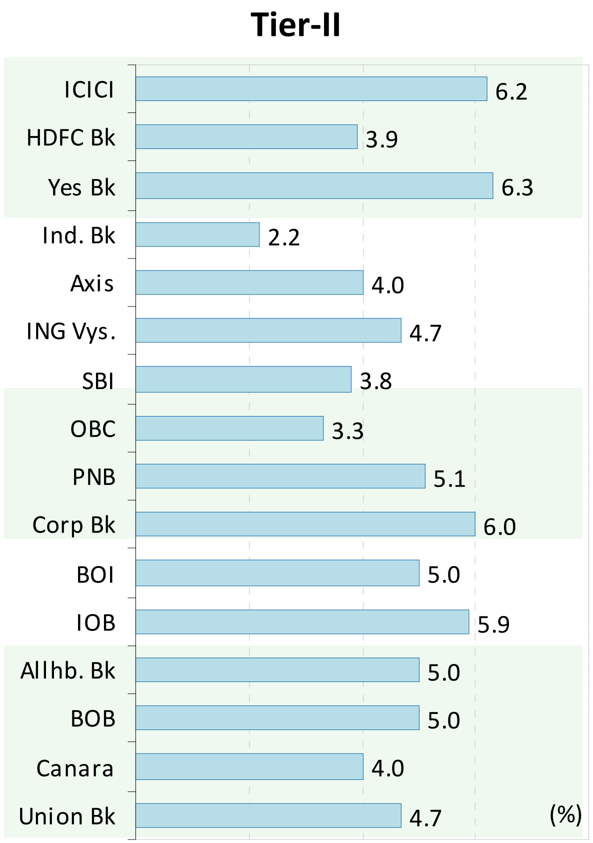
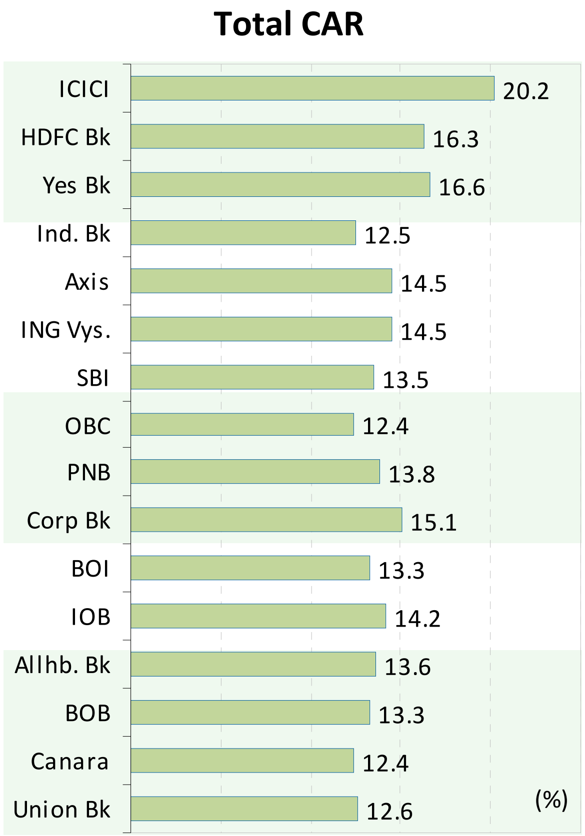
- **Larger private sector banks remain adequately capitalized → Axis and Yes bank might tap markets for capital in medium term**
  - Optically Tier I looks lower as according to new RBI guidelines, quarterly profits can not be included in Tier I calculation







Source: Company, ENAM Research.

Non-interest income remains subdued

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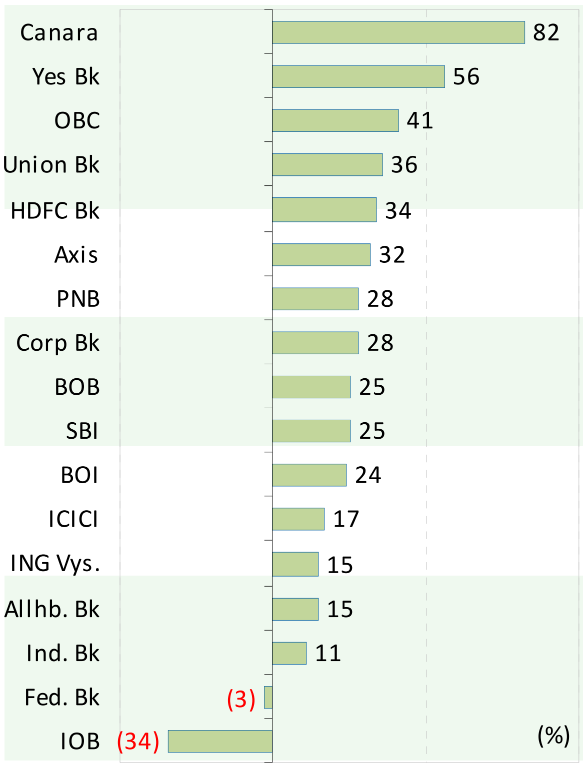
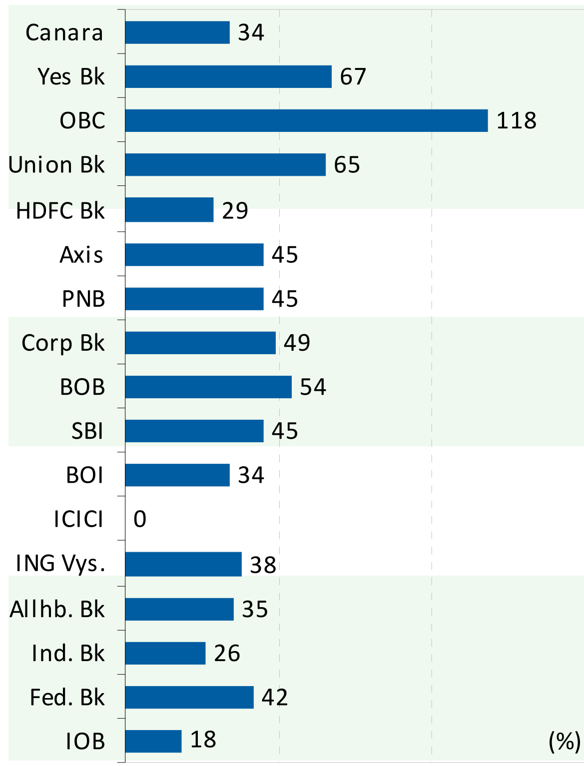
- **Robust growth in core income was offset by a lower non-interest income leading to a lower net profit growth**
  - All banks (except Canara) saw a de-growth in non-interest income (due to lower growth in treasury income)
  - For ICICI bank, despite a flat NII, PAT grew as a result of lower provisioning
  - OBC, Yes and Union Bank reported highest growth rates in NII on YoY basis

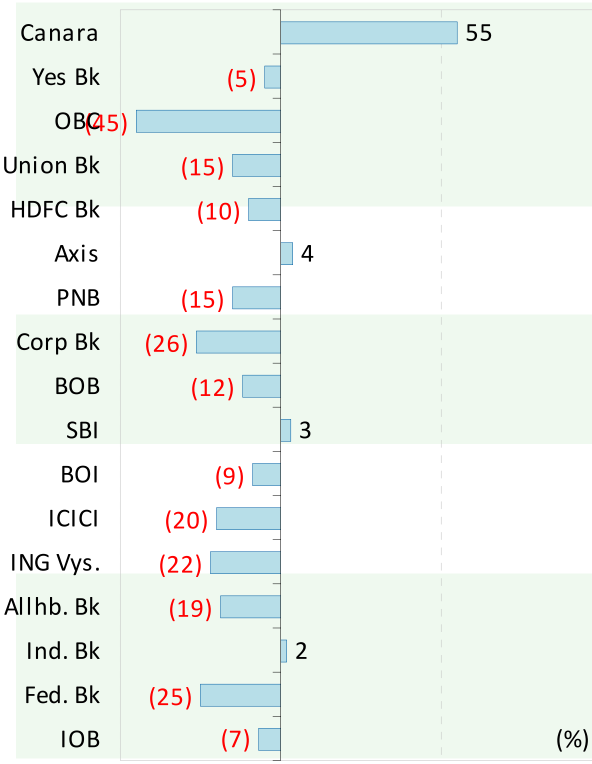
PAT growth (YoY)



NII growth (YoY)



Non-Interest Income growth (YoY)



Source: Company, ENAM Research.

Treasury gains were lower barring a few

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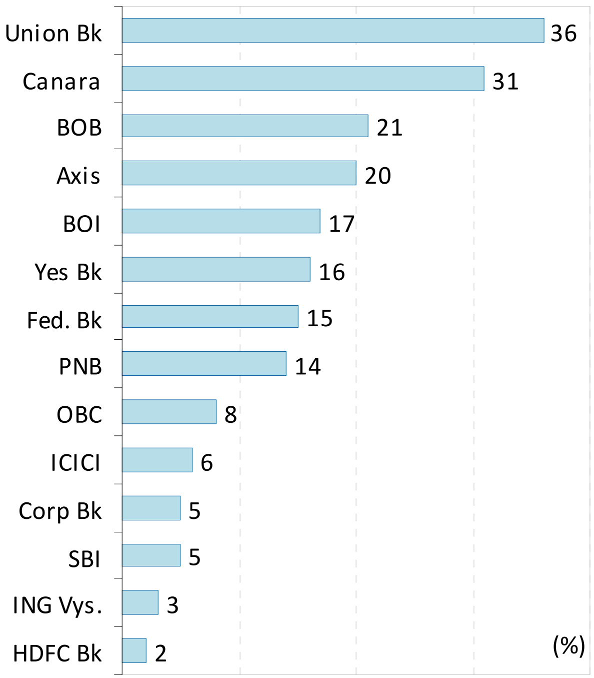
Treasury/Non Interest Income



Treasury Income contribution

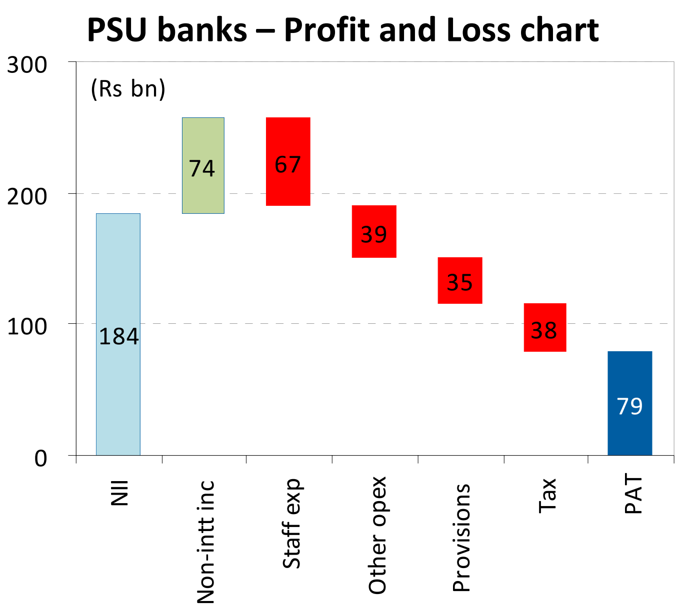
Banks	Treasury Inc (Rs mn)			Treasury / PBT (%)		
	Q1FY10	Q4FY10	Q1FY11	Q1FY10	Q4FY10	Q1FY11
HDFC Bk	2,560	(473)	215	30	(4)	2
Corp Bk	1,854	119	135	45	3	3
OBC	360	275	170	10	8	3
SBI	7088	4256	1734	20	15	4
ING Vys.	410		40	44		4
ICICI	7140	1960	1040	59	14	7
PNB	3585	565	1210	28	3	8
Fed. Bk	579	42	166	26	2	8
Yes Bk	919	474	226	60	22	10
BOI	2,400	1,365	1,000	28	29	10
BOB	2,566	1,254	1,279	24	11	10
Axis	3,261	1,027	1,957	38	9	18
Canara	282	1,140	2,240	4	16	18
Union Bk	2,510	1,720	1,550	42	21	18

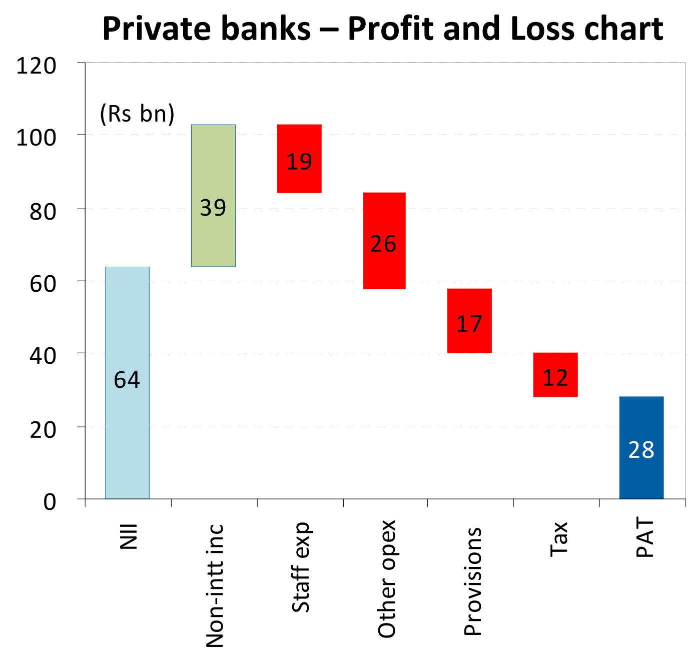
Source: Company, ENAM Research

- Treasury profits declined 63% for our coverage banks led by private sector banks (down 76%), on account of rising bond yields (average 10-yr bond yield for 1QFY11 was 7.8% vs. 6.5% for 1QFY10)

Pension/Gratuity expenses higher for PSBs

- **Public sector banks' staff expenses proportion was higher than private sector due to provisions towards employee benefits such as gratuity/pension**
  - Staff cost for Union bk increased 45% YoY due to pension provision (overall liability of Rs 12 bn to be spread over next 5 yrs)
  - BOI charged 313 mn during the quarter on account of a transitional liability towards employee benefits
  - OBC provided Rs 500 mn gratuity liability
- **PSU banks' non-staff operating expenses proportion was lower than private peers**
  - Cost-to-income ratio (after excluding staff exp from total expenses) of PSU Banks at 15% was lower than private banks at 26%



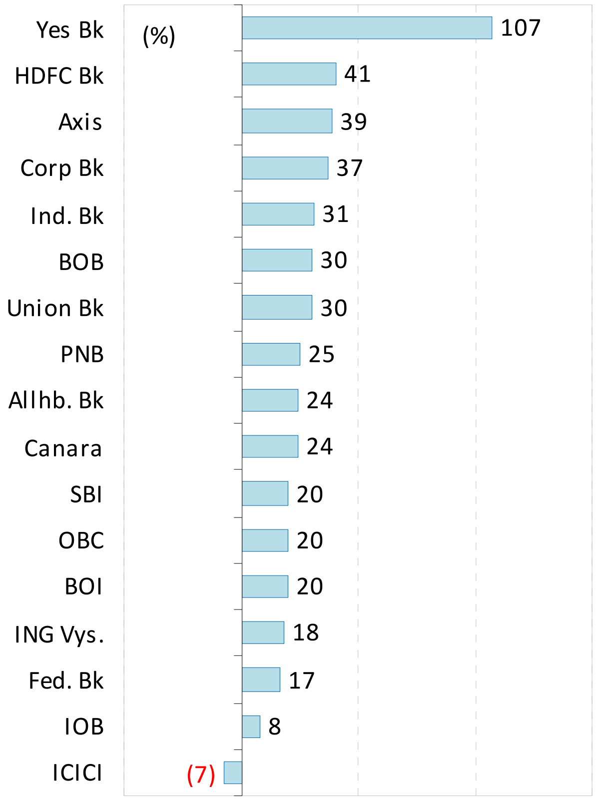


Source: ENAM Research

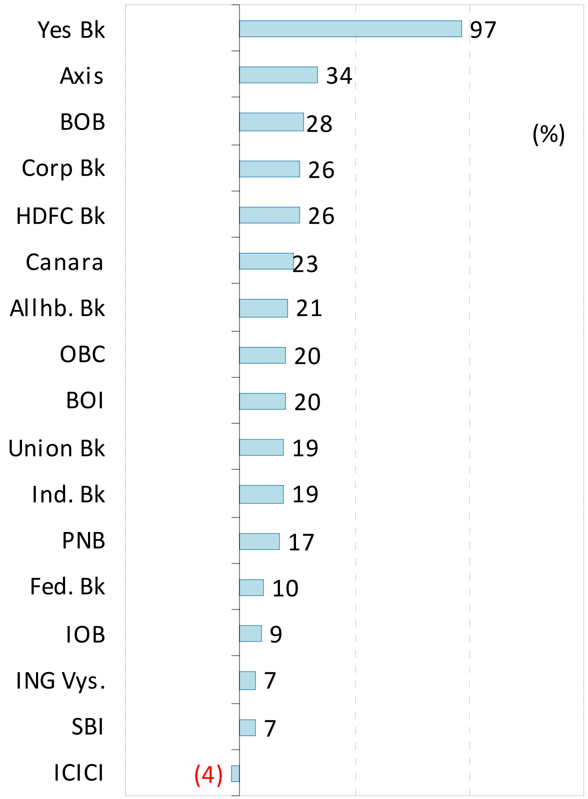
Appendix

Benchmarking at a glance

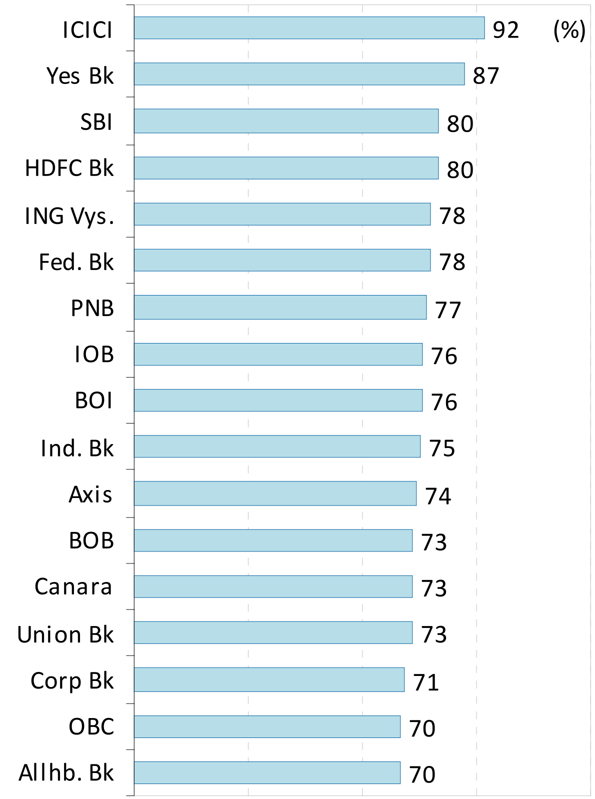
Credit Growth (YoY)



Deposit growth (YoY)



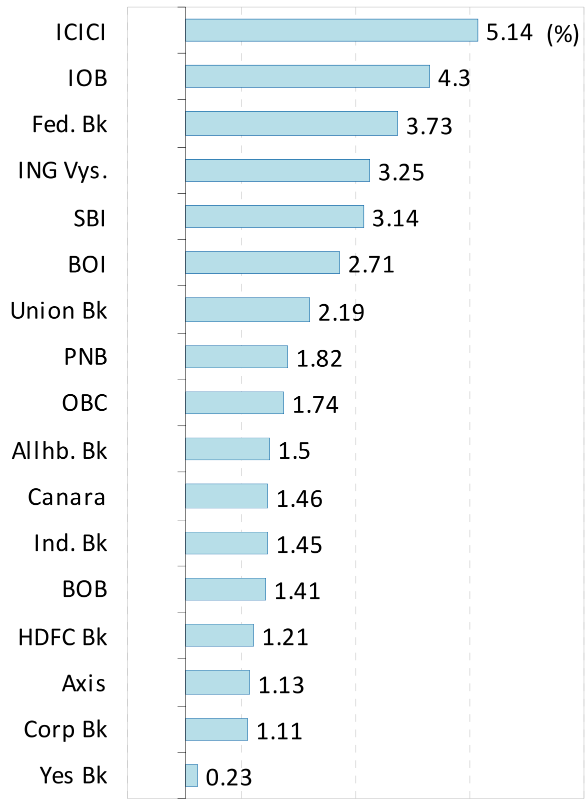
LDR



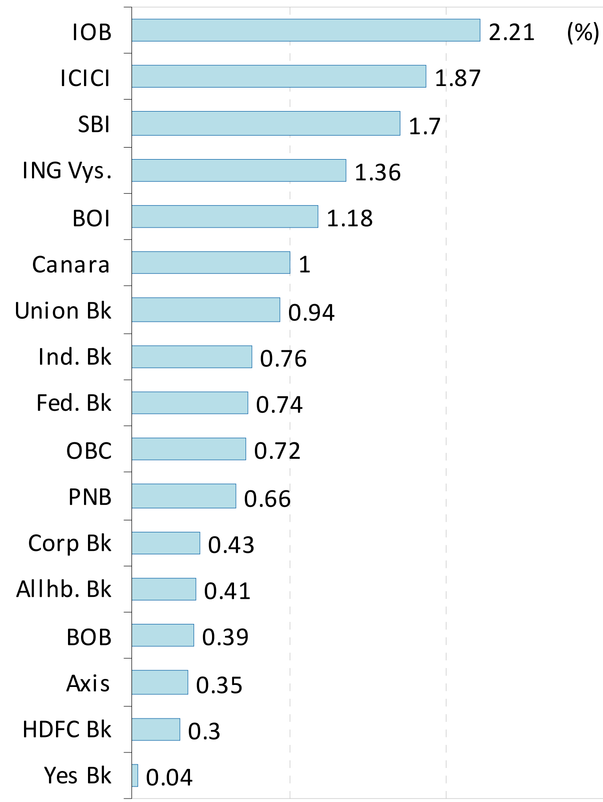
Source: Company, ENAM Research.

Benchmarking at a glance

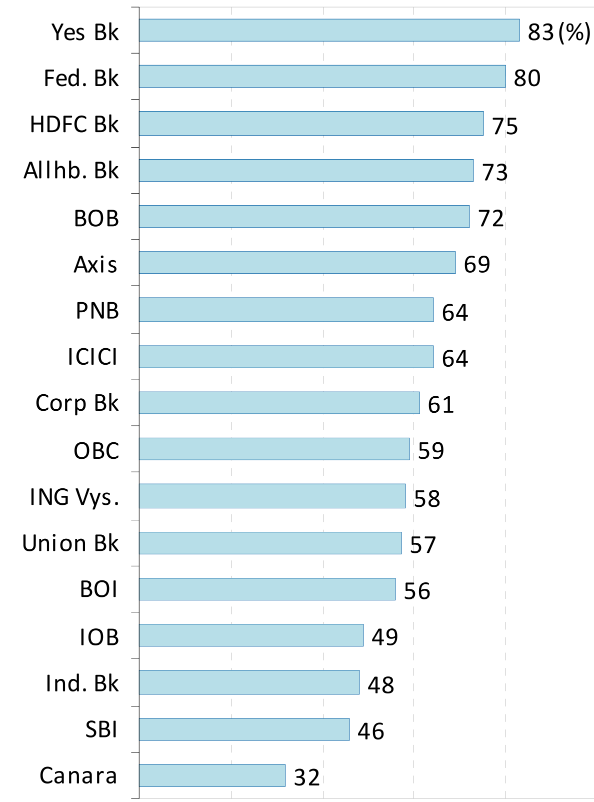
GNPA



NNPA



Provision coverage



Source: Company, ENAM Research.

Benchmarking at a glance

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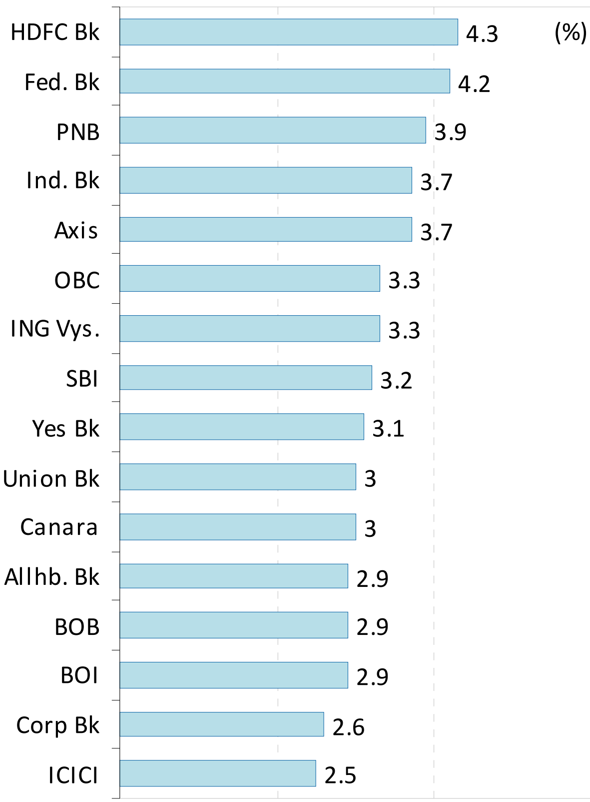
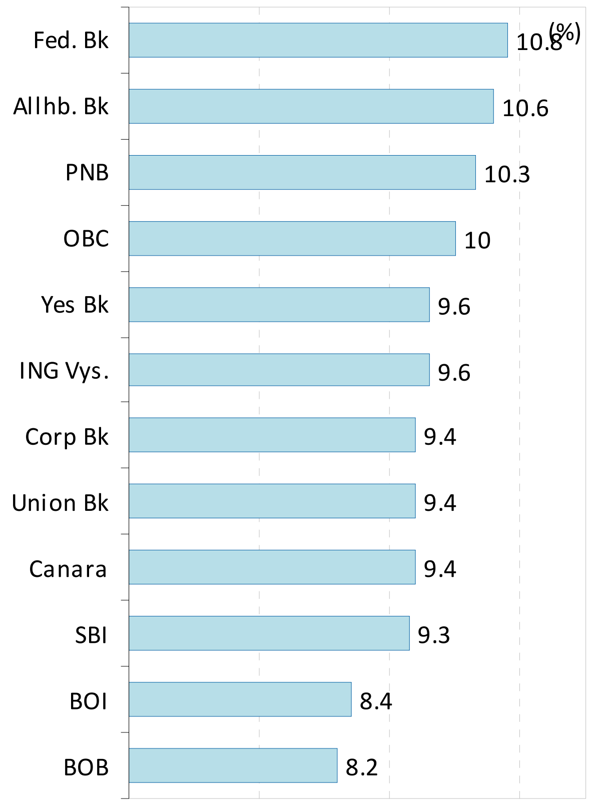
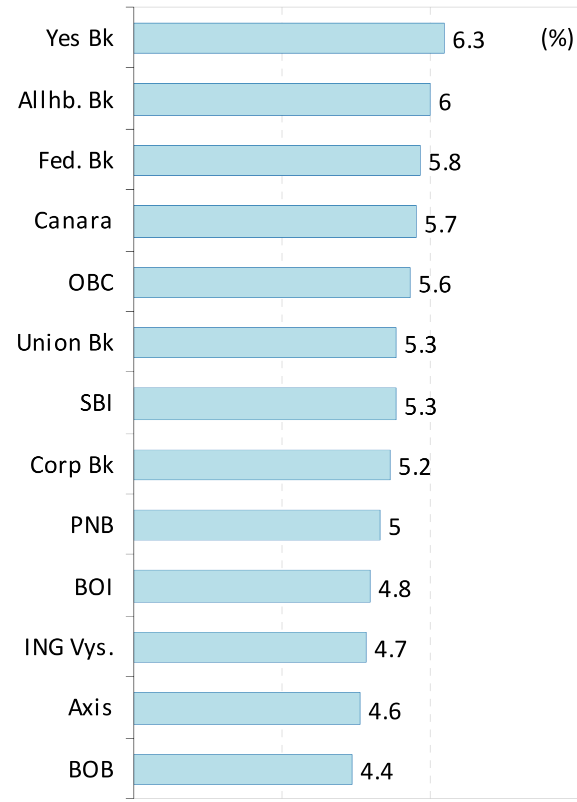
NIM



YoA



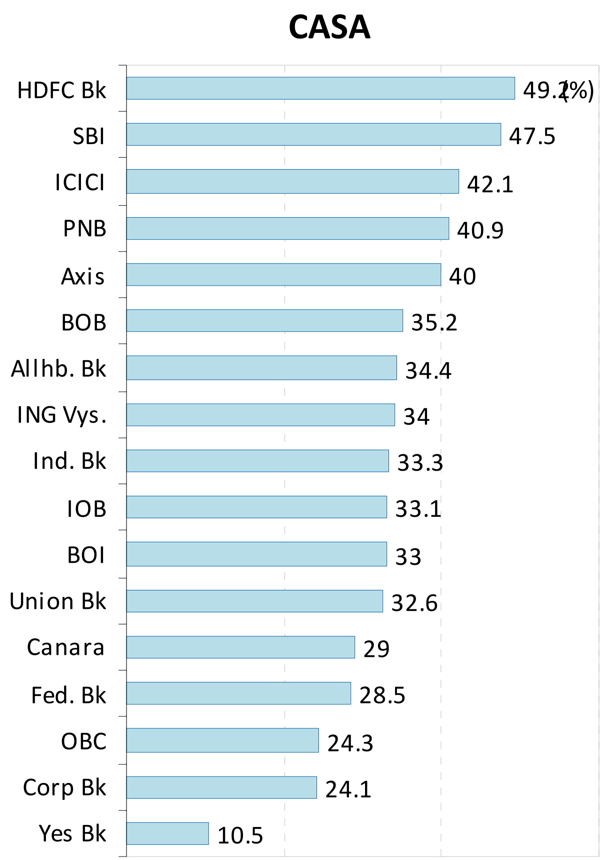
CoD

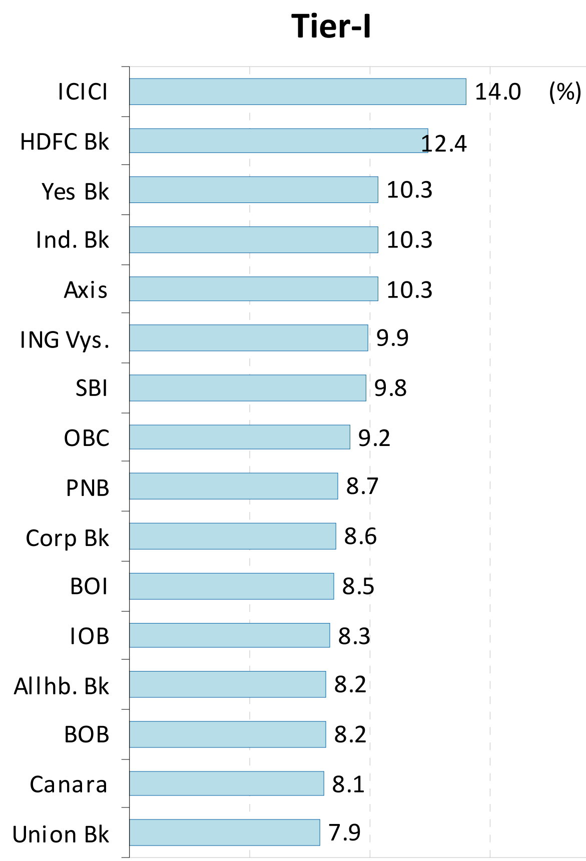


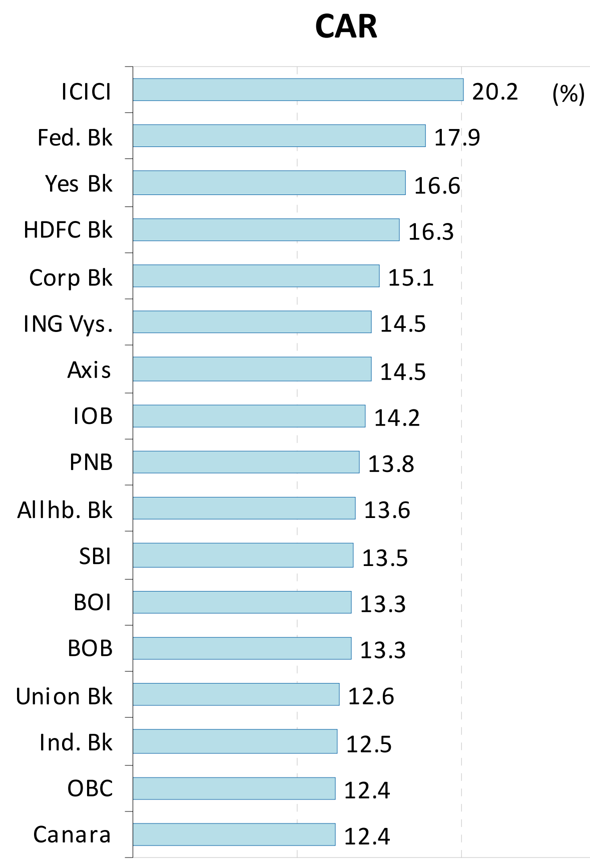
Source: Company, ENAM Research.

Benchmarking at a glance

ENAM
It's possible!

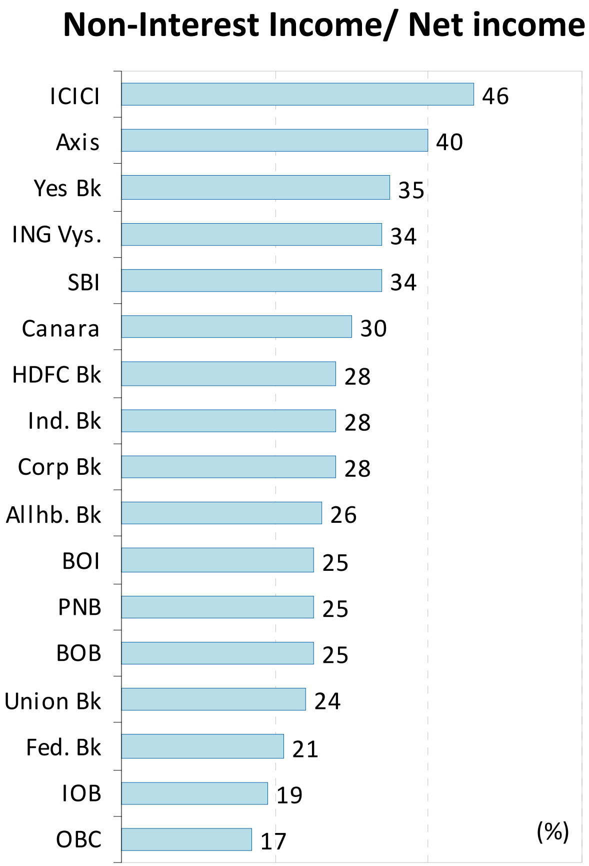


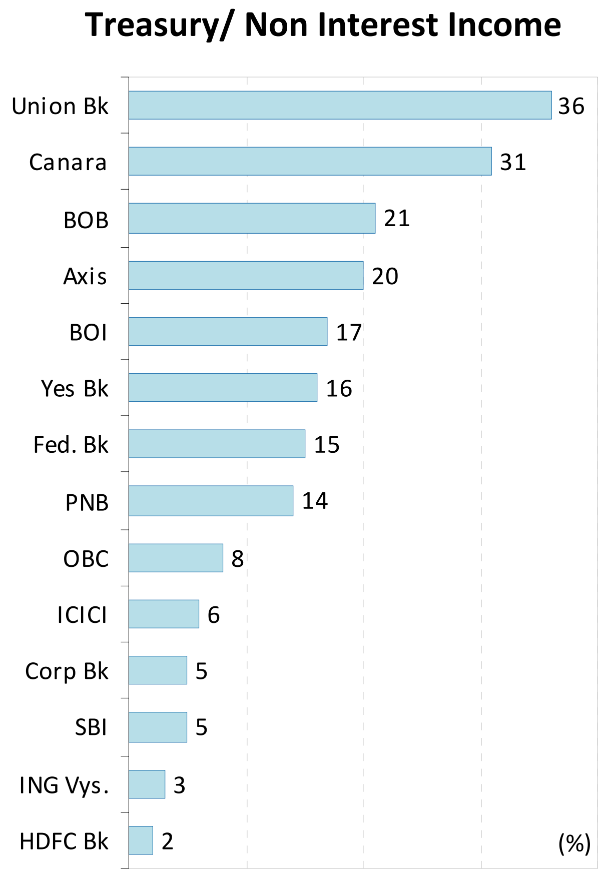


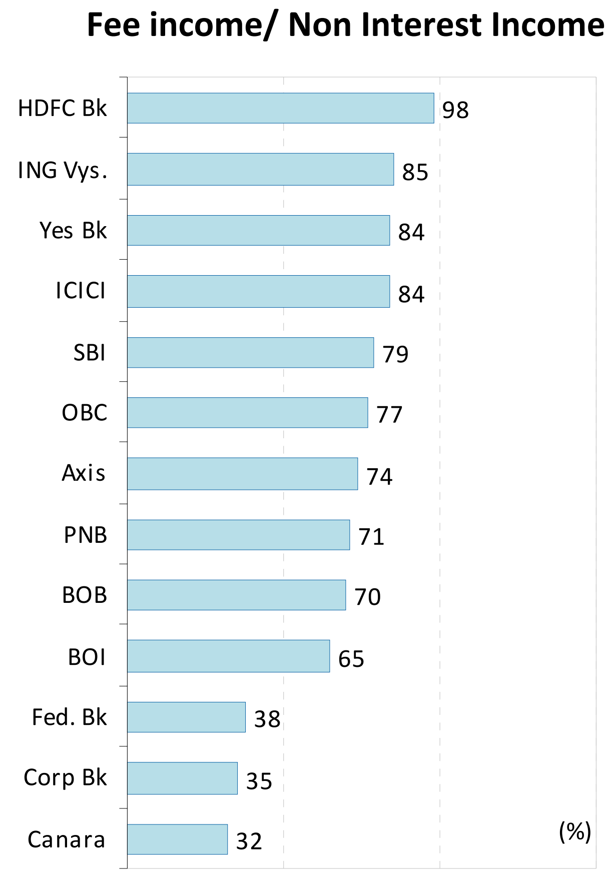


Source: Company, ENAM Research.

Benchmarking at a glance







Source: Company, ENAM Research.

Regulatory environment

- Government is more inclined toward financial inclusion & rural penetration; hence, some policies will be framed around these focus areas
  - Freeing up branch / ATM licensing
  - Appointment of business correspondents
  - New banking licenses
- FDI regulations to be relaxed in the insurance sector & IPO guidelines to follow
- Discussion on new banking licenses – to increase competition
- Introduction of "Base Rate" will aid in adequate risk pricing and transparency
- Introduction of "Infrastructure NBFC Status" to help in funding requirement for infra projects
- Introduction of plain vanilla OTC single-name CDS for corporate bonds
- Strict guidelines on sale of Investments held under "Held to Maturity" category
- Higher provisioning norms on NPAs to clean up the balance sheet
- Guidelines on securitization / ECBs / CAR for NBFCs – reducing the leveraging capability
- Change in methodology to calculate interest on savings balance
- UCBs have been advised to be the member of at least one Credit Information Company

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CONFLICT OF INTEREST DISCLOSURE

We, at ENAM, are committed to providing the most honest and transparent advice to our clients. However, given the nature of the capital markets, from time to time we are faced with situations that could give rise to potential conflict of interest. In order to provide complete transparency to our clients, before we make any recommendations, we are committed to making a disclosure of our interest and any potential conflict IN ADVANCE so that the interests of our clients are safe- guarded at all times. In light of this policy, we have instituted what we believe to be the most comprehensive disclosure policy among leading investment banks/brokerages in the world so that our clients may make an informed judgment about our recommendations. The following disclosures are intended to keep you informed before you make any decision- in addition, we will be happy to provide information in response to specific queries that our clients may seek from us.

Disclosure of interest statement (As of Aug 23, 2010)	**Axis**	**BOB**	**BOI**	**Canara**	**Corp. Bank**	**HDFC**	**HDFC Bank**	**ICICI**	**IDFC**	**MGFL**
1. Analyst/Associate ownership of the stock	No	No	No	No	No	No	No	No	No	No
2. Firm ownership of the stock	No	No	No	No	No	No	No	No	No	No
3. Directors ownership of the stock	No	No	No	No	No	No	No	Yes	Yes	No
4. Investment Banking mandate	No	No	No	No	No	No	No	No	No	No
5. Broking relationship	Yes	Yes	No	No	Yes	Yes	Yes	Yes	Yes	No

Disclosure of interest statement (As of Aug 23, 2010)	**ING Vysys**	**OBC**	**PNB**	**PFC**	**REC**	**SBI**	**UNBK**	**Yes Bank**	**LIC Hsg**	**SHFT**
1. Analyst/Associate ownership of the stock	No	No	No	No	No	No	No	No	No	No
2. Firm ownership of the stock	No	No	No	No	No	No	No	No	No	No
3. Directors ownership of the stock	Yes	No	No	Yes	Yes	Yes	No	Yes	No	No
4. Investment Banking mandate	Yes	No	No	No	No	No	No	No	Yes	No
5. Broking relationship	No	No	Yes	No	No	Yes	Yes	No	No	No

We are committed to providing completely independent and transparent recommendations to help our clients reach a better decision.
