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JM FINANCIAL

Banking Sector

Resilience in the midst of Turbulence

JM Financial Institutional Securities Private Limited

Contents

JM FINANCIAL

Country: India

Sector: Banking & Financial Services

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Bank		TP	Returns	FY10E	
		Rs	%	P/B	P/E
ICICI Bank	Buy	1,000	37%	1.53	14.0
HDFC Bank	Hold	1,300	2%	2.76	20.0
Axis Bank*	Buy	800	9%	2.34	14.3
Yes Bank	Buy	180	19%	2.01	12.6
KBL	Buy	190	25%	1.06	7.2
DCB	Sell	38	-32%	1.33	15.2

* Axis bank was intiated on 30 July 2008.

10 August 2008

Sector Report

India Financials

Resilience in the midst of Turbulence

Turbulent times… Unprecedented rise in crude prices, surge in inflation and continued strong growth is money supply has led to significant monetary tightening by RBI, leading to liquidity tightening, significant rise in interest rates and moderation in economic growth. Challenging macro environment is expected to a) result in slowdown in credit growth, b) impact margins and c) put pressure on asset quality. However, we do not overly harbour fears about the underlying strengths and resilience of the Indian Banking sector.

- **Slowdown in credit growth - we favour it:** While rise in interest rates should lead to a moderation in demand for credit, Indians banks too are exercising caution while lending. And we would favour banks exercising caution while lending even if it amounts to loosing on assets growth. In our opinion, lost assets growth can easily be recovered in subsequent years (when the environment improves); however the build-up of NPAs due to aggressive lending would lead to irrecoverable damages. We expect system credit growth of 18% yoy in FY09E and 17% yoy in FY10E vs. 22% yoy in FY08.
- **Impact on margins - Return of pricing power:** We also believe that the tight liquidity conditions and banks cautious approach has resulted in return of pricing power to the banks. This would not only help banks to adequately price in risks but also help protect their margins. Consequently, we expect margin pressure due to the recent CRR hikes and increase in funding costs to be neutralised by right pricing of loans and PLR hikes. Historical evidence suggests that NIM for the Indian banking system tend to be higher in such environment.
- **Pressure on credit quality - Concerns are over magnified**: While higher lending rates are expected to result in higher slippages, however the concerns in this regard are being over-magnified. Strong fundamentals of Indian corporates (lower leverage and strong profitability), considerably lower interest rate levels when compared to 1990s and superior risk management system of Indian Banks give us the confidence that credit quality would remain under control. While we have factored in higher loan loss provisions in our estimates, higher than expected delinquencies would be the key risk to our estimates.
- **Profitability to display stability:** Negative impact of pressure on credit quality to some extent would be neutralised by improvement in cost ratios on account of several cost containment measures being undertaken by banks. We expect return ratios (ROA and ROE) of the Indian banks to continue to display strength (ignoring one-off treasury losses).
- **Crude prices - Key Risk:** How global crude prices would behave probably has no easy answers; however we believe that the current uncertain macro-economic conditions do not lead Indian banks into a state of crisis. But continued rise in crude prices and its resultant impact on inflation, interest rates and government finances has the potential to do so. Hence, crude price remains the key risk to our positive stance on the Indian banking sector.
- **Top picks:** ICICI Bank is our Top pick with an upside of 37%. We believe that significant fundamental improvements in the parent Bank coupled with significant value creation in the international banking and non-banking subsidiaries should lead to significant upside for the stock. We are also positive on Axis Bank however for HDFC Bank we would wait for declines to enter the stock (as expensive eCBoP's acquisition and resultant dilution would hold HDFC Bank's ROE down to ~16% till FY11). Among the mid cap banks we are positive on Karnataka Bank and Yes Bank with an upside of 36% and 30% respectively. With a solid franchise Karnataka Bank is available at attractive valuations while for Yes Bank different levers at work will ensure superior return ratios. We recommended a Sell on DCB as we expect significant asset quality risk to resurface.

Challenging Macro-economic environment

Risks still at elevated levels

Macro-economic environment in India has taken a serious turn since the beginning of the year. Unprecedented rise in crude prices, surge in inflation and continued strong growth in money supply (M3) have forced the government and RBI to take strong fiscal and monetary measures leading to liquidity tightening, significant rise in interest rates and slowdown in economic growth.

The current macro-economic scenario in India is expected to: a) result in slowdown in credit growth, b) impact margins of the banks and c) put pressure on credit quality. However, we do not overly harbour fears about the underlying strengths and resilience of the Indian banking sector.

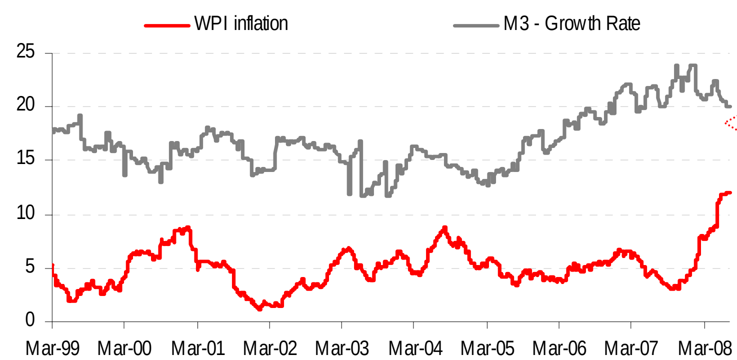
We would favour banks exercising caution while lending even if it amounts to loosing on assets growth. In our opinion, lost assets growth can easily be recovered in the subsequent years (when the environment improves); however the build-up of NPAs due to aggressive lending would lead to irrecoverable damages and systemic problems. We also believe that the tight liquidity conditions and banks cautious approach has resulted in return of pricing power to the banks. This would not only help banks to adequately price in risks but also help protect their margins.

We believe profitability (ROA) of most of the banks to display considerable strength going ahead. Though we expect some impact on ROA in FY09, there would be a recovery in FY10 and onwards. Expected increase in credit cost would more or less be compensated by cost containment measures being undertaken by the banks.

Inflation and M3 growth way above RBI's comfort zone

Inflation is posing a serious challenge to the economic growth of India. Since Jan'08 onwards, inflation in the country has surged by 8.2% to hit a 13-year high of ~12%. M3 growth in the economy too continued to remain strong at 20% (in July'08), well above the RBI's comfort level of 17%.

Exhibit 2: M3 growth (YoY) and Inflation (%)

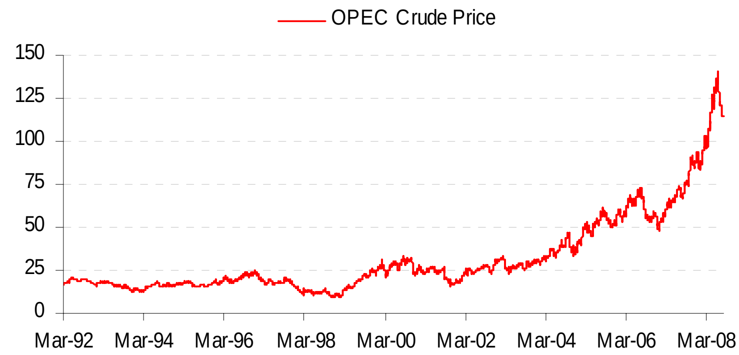


Further course of monetary measures is dependent on M3 growth and inflation, both running well ahead of the RBI's comfort zone.

Source: RBI, Bloomberg, JM Financial.

The WPI inflation rate flared up during the period driven by significant increase in the prices of commodities, primary articles and manufactured products, even though very small part of global crude price increase has been passed on to the Indian consumers. Crude prices globally are still up 15% since Jan'08 despite a recent correction of 22% from its peak of ~US$ 145.

Exhibit 3: Opec Crude Price (USD)



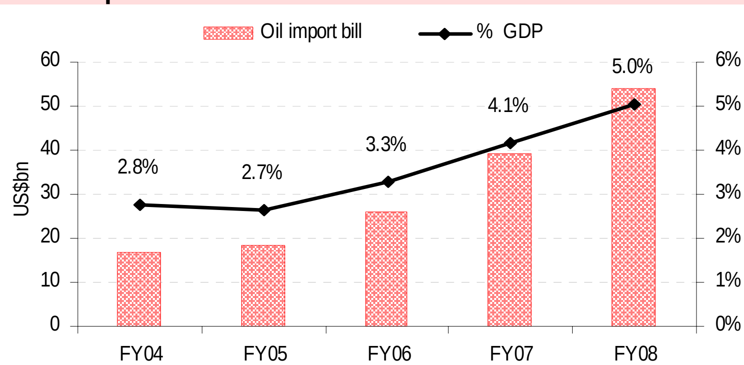
Source: Bloomberg, JM Financial.

Further rise in crude price - Remains the key risk

How global crude prices would behave probably has no easy answers; however we believe that the current challenging and uncertain macro-economic conditions does not lead Indian financials into a state of crisis. But continued rise in crude prices and its resultant impact on inflation, interest rates and government finances has the potential to do so. Hence, crude price remains the key risk to our positive stance on the Indian financials.

Significant Impact on government finances and economic health: In the last couple of months oil prices have surged by 45% from US$ 100 to US$ 145 (and now back to US$ 115). India currently imports 70% of its crude requirement, resulting in pressure on government coffers on back of rising crude prices. The import bill is expected to cross US$100 bn in FY09, which would be about 8% of India's FY09E GDP.

Exhibit 4: Oil Import Bill as % of GDP



Source: GOI data, JM Financial.

While crude price has risen quite significantly, domestic prices have been raised by only 5-10%. This is expected to lead to incremental under-recoveries of close to US$ 30 bn (3% of GDP), which has to be borne directly or indirectly by the economy. Additionally, incremental fertilizer subsidies are expected to be around

US$ 12 bn (1% of GDP). These under-recoveries and subsidies in tandem with expenditure of Sixth Pay Commission Revision and one-time farm loan waiver are putting pressure on government finances. This poses a potential risk of government curtailing its spending needed for the economic growth to sustain.

Exhibit 5: Government finances: Feeling the Pressure

	US$ bn
Incremental oil import bill	30
Farm loan waiver	14
Fertilizer subsidy	12
Sixth pay commission	5
Total	61

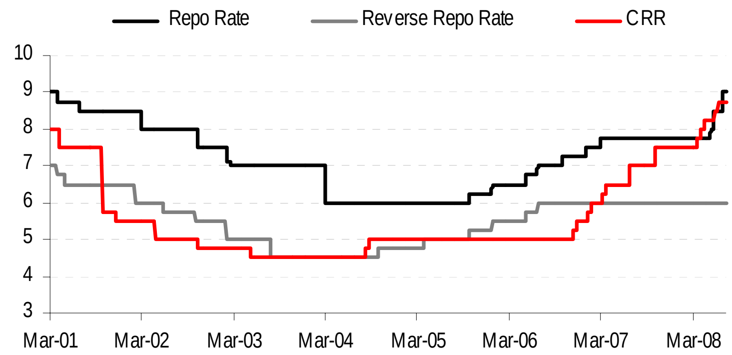
Source: Industry data, JM Financial

India's incremental oil and gas production - some saving grace: Incremental domestic gas production of 120 mmscmd in FY11E would be equivalent to US$28 bn import of equivalent crude at US$100/bbl. Assuming around 70-75% of this gas production would be utilised in applications that directly replace petroleum products, it can result in annual savings of US$20 bn on oil imports. These savings would be equivalent to about 25% of India's FY08 trade deficit. Additionally there would be oil production from Cairn India fields in Rajasthan that would be equivalent to 10% of India's domestic oil demand.

Monetary tightening: RBI getting aggressive

Recent aggressive tightening: Surge in inflation and continued strong growth in M3 in the system have forced the RBI to take aggressive monetary measures during the past couple of months. Since April'08, CRR has been raised by 150 bps and Repo rate 125 bps. Further course of monetary measures is dependent on M3 growth and Inflation, both running well ahead of the RBI's comfort zone.

Exhibit 6: CRR, Repo Rate & Reverse Repo Rate (%)



Source: RBI, Bloomberg, JM Financial.

Earlier measures: RBI has also taken several measures over the past two years to restrict banks exposure to segments considered to be relatively risky. RBI has increased risk-weights and provisioning requirements for exposures towards commercial real estate, capital market, personal loans and credit cards receivables. General provisioning requirements for the banks has also been increased from 25 bps to 40 bps.

Exhibit 7: RBI Monetary Measures

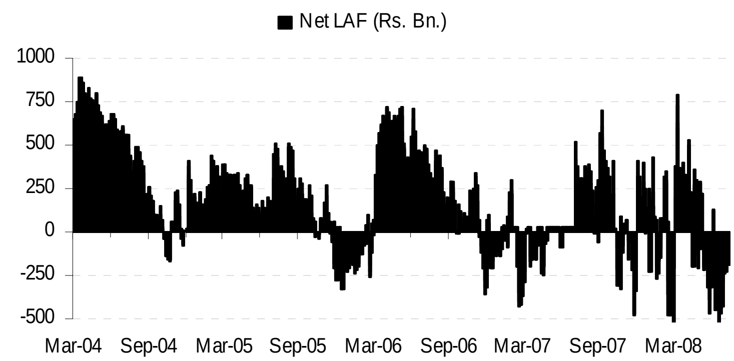
Date	Measures	Bank's Exposure	Change
23-Dec-04	Risk Weights	Consumer credit, including personal loans and credit cards receivables	100% to 125%
23-Dec-04	Risk Weights	Housing loans to individuals	50% to 75%
26-Jul-05	Risk Weights	Commercial real estate exposures, capital market exposures	100% to 125%
4-Nov-05	Gen. Prov.	General provisioning for 'standard advances'	25 bps to 40 bps
25-May-06	Risk Weights	Commercial real estate, Capital Markets (Venture capital funds included)	125% to 150%
29-May-06	Gen. Prov.	General provisioning requirement on standard advances in specific sectors, i.e., personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs 2 mn and commercial real estate loans.	40 bps to 100 bps
24-Jun-06	CRR	No interest on Statutory minimum CRR balances from 24th June'06 onwards	
31-Jan-07	Gen. Prov.	Increase in general provisioning requirement on standard advances in specific sectors: 1. Direct advances to agricultural and SME sectors - 0.25% 2. Residential housing loans beyond Rs. 2 mn - 1.0% 3. Personal loans (including credit card receivables), Loans and advances qualifying as capital market exposures, Commercial real estate loan and Non-Deposit Taking Systemically Important Non-Banking Finance Companies.	100 bps to 200 bps
31-Jan-07	Risk Weights	Systemically Important Non-Banking Finance Companies	100% to 125%
30-Apr-07	Risk Weights	Gold and Silver ornaments upto Rs. 0.1 mn	125% to 50%
3-May-07	Risk Weights	Housing loans to individuals upto Rs. 2 mn	75% to 50%

Source: RBI, JM Financial.

Tight liquidity conditions & Interest rates inching upwards

Significant CRR increases have absorbed substantial liquidity from the system. Banks have been net borrowers on an average of Rs. ~300 bn under LAF during the past several weeks.

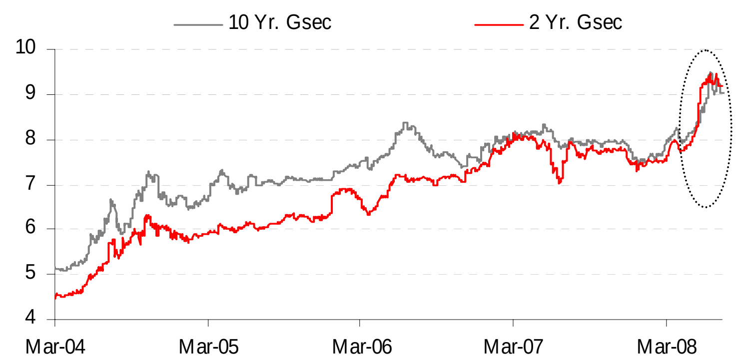
Exhibit 8: Net LAF (Rs. Bn.)



Source: RBI, Bloomberg, JM Financial.

Spike in Yields: Tight liquidity conditions and hike in repo rates has resulted in: a) shorter end yields to strengthen quite sharply (2yr G-sec yield is currently higher than 10yr G-sec yield) and b) increase in cost of borrowing for banks and pressure on their NIM, hence leading to PLR hikes.

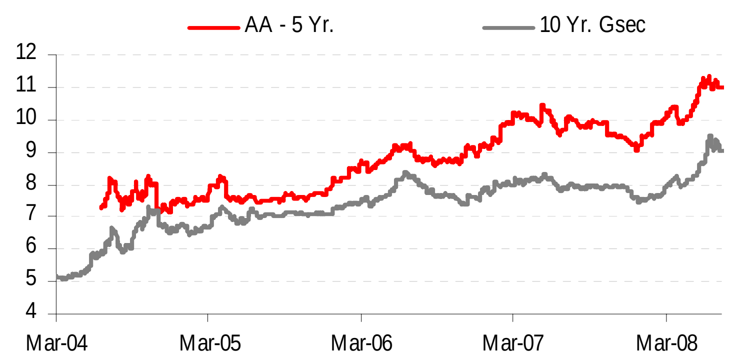
Exhibit 9: 10 Yr G-Sec Yield & AA 5-Yr. Yield (%)



Source: RBI, Bloomberg, JM Financial.

Cost of borrowing for Indian corporates has also moved up quite sharply.

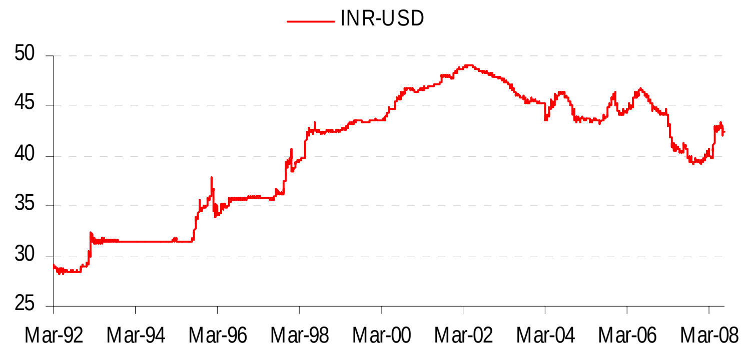
Exhibit 10: 10 Yr G-Sec Yield & AA 5-Yr. Yield (%)



Source: RBI, Bloomberg, JM Financial.

Depreciating INR: Surge in crude prices has severely impacted current account deficit of the country. This coupled with the outflow of FII investments has resulted in INR to depreciate sharply against dollar further fueling inflation.

Exhibit 11: INR-USD (Rs.)



Source: RBI, Bloomberg, JM Financial.

Impact on Indian financials

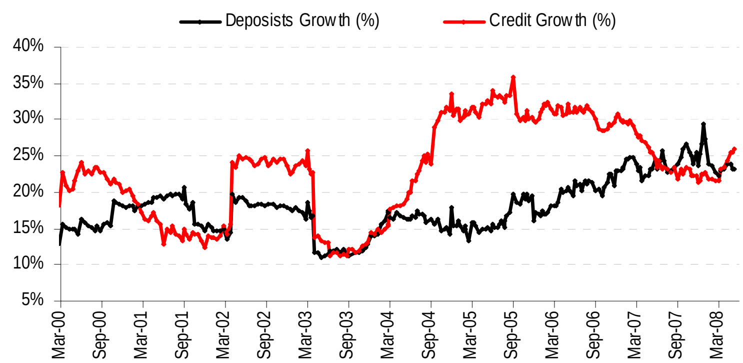
Indian Bank's fundamentals to display resilience in turbulence

The current macro-economic conditions are expected to: a) result in slowdown in credit growth b) impact margins of the banks and c) put pressure on credit quality. However, we do not overly harbour fears about the underlying strengths and resilience of the Indian banking sector. We believe profitability (ROA) of most of the banks to display considerable strength going ahead. Though we expect some impact on ROA in FY09, there would be a recovery in FY10 and onwards.

A) Slowdown in credit growth: Banks to exercise caution

While the rise in interest rates should lead to a moderation in demand for credit, Indians banks too are exercising caution while lending. We expect credit growth of 18% yoy in FY09E and 17% yoy in FY10E vs. 22% yoy in FY08. Currently credit growth for the system is running at ~25% yoy helped by: a) Lower base last year during this period (system credit growth was negative in 1Q'08) and b) demand from oil marketing companies for their increased working capital requirements.

Exhibit 12: Deposits & Credit growth (%)



Source: RBI, Bloomberg, JM Financial.

Demand for credit would get impacted: In our opinion, risks and uncertainties in the system have increased given the higher crude and commodity prices and its inflationary impact. This would curtail consumption, which would impact economic growth adversely. Further higher rates will not only impact the profitability of Indian corporates but also impact IRRs of various proposed capex projects. This coupled with elections next year could lead to some postponement of capex plans of corporates, leading to negative impact on demand for credit.

Higher rates have particularly impacted retail loan growth. As can be seen in the exhibit below, retail loan growth has slowed down significantly from 26.5% in FY07 to ~13% in FY08. On the other hand, corporate loan growth continues to remain strong for now, driven by their capex programme.

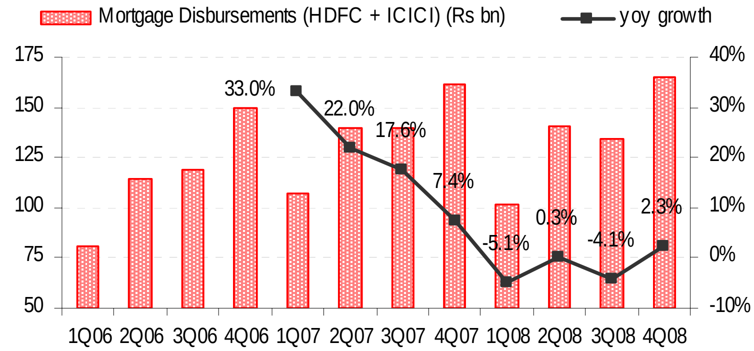
Exhibit 13: Retail Loans Mix & Growth

Retail Loans % of Non Food credit	As % of Non-food credit					Growth YoY (%)			
	Mar-05	Mar-06	Mar-07	Feb-08	May-08	Mar-06	Mar-07	Feb-08	May-08
Retail Loans	25.5%	25.7%	25.4%	24.5%	24.3%	40.5%	26.5%	13.2%	15.9%
Consumer Durables	0.9%	0.5%	0.5%	0.5%	0.4%	-20.9%	28.9%	6.0%	-6.0%
Housing	13.3%	13.2%	12.8%	12.2%	12.1%	38.3%	24.6%	12.0%	13.8%
Advances against Fixed Deposits	3.0%	2.4%	2.3%	2.1%	1.9%	15.1%	18.0%	16.1%	8.0%
Credit Card Outstanding	0.6%	0.6%	0.7%	0.9%	1.2%	41.3%	46.6%	50.6%	87.0%
Education	0.6%	0.7%	0.8%	1.0%	1.0%	75.4%	50.8%	40.9%	38.3%
Other Retail Loans	7.1%	8.2%	8.2%	7.8%	7.7%	59.9%	28.3%	8.8%	13.6%

Source: RBI, JM Financial. Note: The data for Mar'05 is not exactly comparable with the rest of the years.

Mortgage disbursements have also been impacted adversely due to higher rates as well as substantial increase in property prices. Disbursements for ICICI Bank and HDFC Ltd. have seen significant slowdown from 20% plus levels to low single digit yoy growth. In our opinion, mortgage disbursements growth will remain muted on account of monetary tightening as well as high property prices.

Exhibit 14: Mortgage Disbursements (HDFC & ICICI Bank combined) (%)



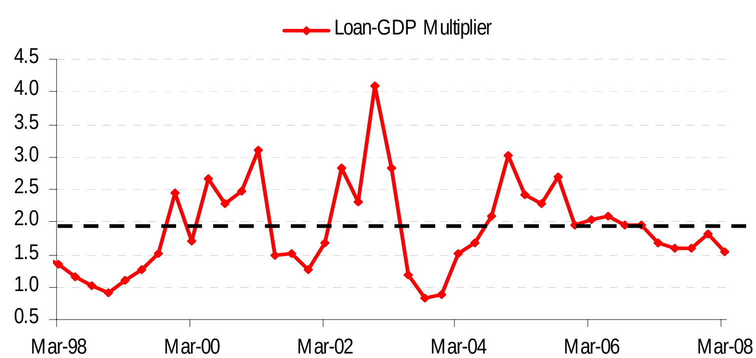
Source: Company, JM Financial.

Even banks would be cautious while lending: We believe that in this tighter monetary and uncertain macro environment, banks would exercise caution while lending and would focus on credit quality.

And we would be comfortable with lower but quality credit growth: We would be much more comfortable with slower assets growth in such an environment rather than the banking system witnessing significant slippages and deteriorating in asset quality. We would favour banks exercising caution while lending even if it amounts to loosing on assets growth. In our opinion, lost assets growth can easily be recovered in subsequent years (when environment improves); however build-up of NPAs due to aggressive lending would cause irrecoverable damage.

Credit growth expectations: Our credit growth expectations seem reasonable if we look at the loan to GDP multiplier over the past decade. Nominal GDP growth is expected to be at 14-15%. The loan-GDP multiplier had on an average been 1.87x with lowest and highest value being 0.83x and 4.09x respectively over the past decade. Our credit growth assumption of 18% in FY09 and 17% in FY10 implies loan-GDP multiplier of ~1.3x, which is reasonable in our opinion.

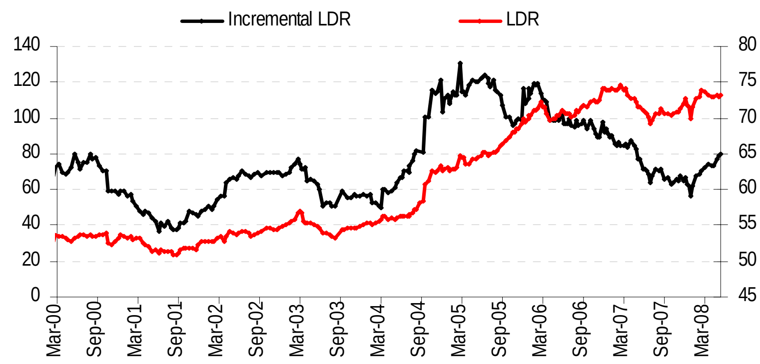
Exhibit 15: Loan-GDP multiplier



Source: RBI, Bloomberg, JM Financial.

Incremental LDR: At the beginning of credit boom of FY04-07, SLR in the system stood at above 45% (significantly higher than statutory requirement of 25%) thereby enabling the banks to operate at an incremental LDR of over 100%. SLR ratio of the system touched ~27% during FY08 and expectedly LDR ratio stabilised at over 70%.

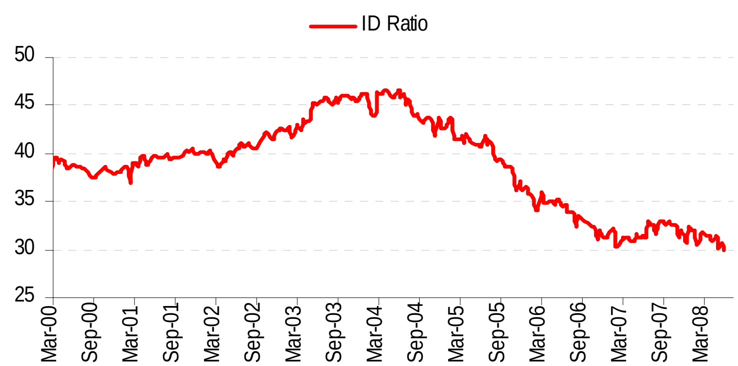
Exhibit 16: LDR (RHS) & Incremental LDR (LHS)



Source: RBI, Bloomberg, JM Financial.

SLR Ratio of the system has started rising since mid FY08 and currently stands at 28.7%. Given the expected negative impact on credit growth, increase in government borrowings and sharp increase in yields, we expect SLR ratio in the system to rise gradually.

Exhibit 17: I-D ratio



Source: RBI, JM Financial. Note: ID ratio is slightly higher than SLR but follows the similar trend

B) Impact on Margins: Return of Pricing Power

During the past 18 months, CRR has increased by 400 bps to 9.0% currently and RBI has also discontinued with interest payment on CRR balances. Every 50 bps hike in CRR generally negatively impacts margins by ~5 bps. Till June'08, most of the banks had restrained from hiking lending rates despite significant monetary tightening. However on account of recent measures by RBI, banks have resorted to hiking PLRs in July/August by 50-150 bps to preserve their margins. In our opinion, given the recent PLR hikes, pressure on margins would get neutralised to some extent.

Exhibit 18: Recent PLR hikes by the banks

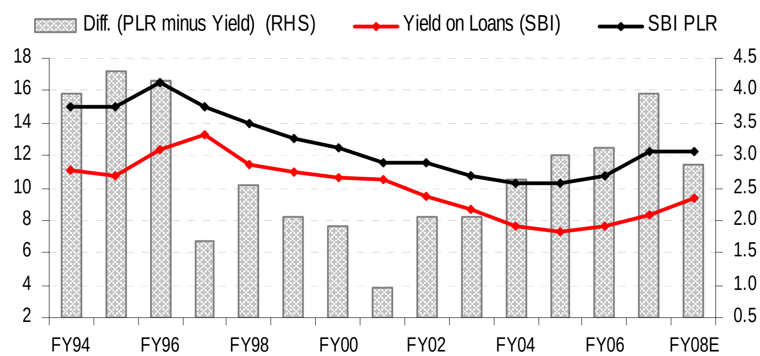
	PLR in Jan'08	PLR in Aug'08	Cumulative PLR hikes	effective since
ICICI Bank	15.75%	17.25%	150bps	July'08
HDFC Bank	15.00%	16.00%	100bps	June'08
Axis Bank	15.00%	15.75%	100bps	July'08
Yes Bank	15.50%	17.00%	150bps	June'08
SBI	12.75%	12.75%	Restored PLR by 50bps	July'08
PNB	13.00%	14.00%	150bps (incl. 50bps restoration of PLR)	July'08
BOB	13.25%	13.25%	Restored PLR by 50bps	July'08
BOI	13.25%	14.00%	125bps	July'08
Canara Bank	13.25%	14.00%	125bps	July'08
UBI	13.25%	14.00%	125bps	July'08
HDFC Ltd	14.00%	15.00%	125bps	July'08

Source: Company, JM Financial.

Note: Many of the banks had reduced their PLRs around Feb'08 and later on restored the same.

Right-pricing of Loans: Infact in an environment, where liquidity is tight, interest rates are at elevated levels and risk premiums have increased, the banks tend to regain the pricing power. This would not only help the banks to adequately price in risks but also help protect their margins. Apart from hiking PLRs, banks are also resorting to repricing (infact right-pricing) the loans that were sanctioned well below PLRs. Significant portion of fixed rate loans would also get re-priced over the period of 12-18 months. Hence, we believe that the yield on loans would continue to move upwards.

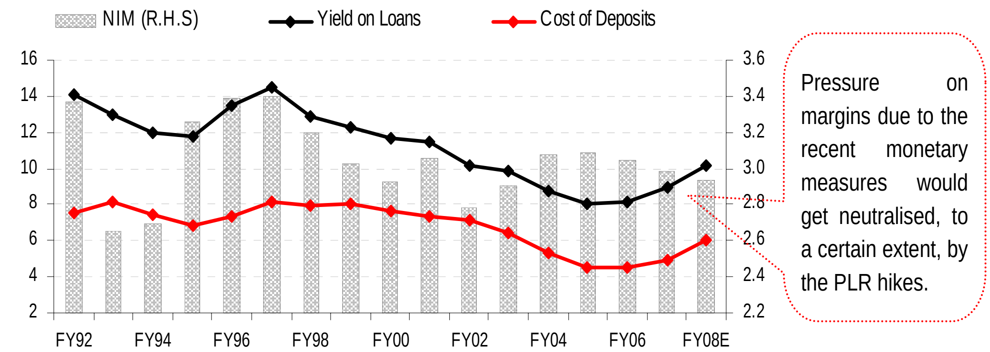
Exhibit 19: SBI PLR & SBI Yield on Loans (%)



Source: Company, JM Financial.

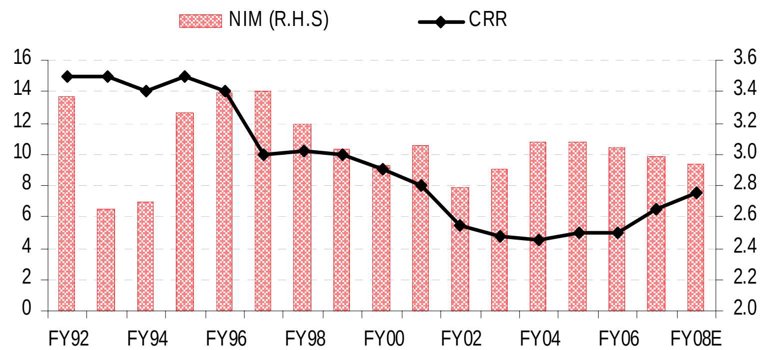
Better NIM in tight conditions: As can be seen in exhibits below, banking system enjoyed higher margins in an environment of higher interest rates and CRR requirements.

Exhibit 20: Banking System: NIM, Yield on Loans & Cost of Deposits (%)



Source: RBI, JM Financial.

Exhibit 21: Banking System: NIM & CRR (%)



Source: RBI, JM Financial.

Banks with stronger liability franchise are well-positioned in this environment as, a) it provides the flexibility to the bank to lend at competitive rates to customer segments with better credit risk profile and hence keep the credit cost low and b) it helps the banks to maintain its margins, in an environment where tightening monetary policy is putting considerable pressure on margins.

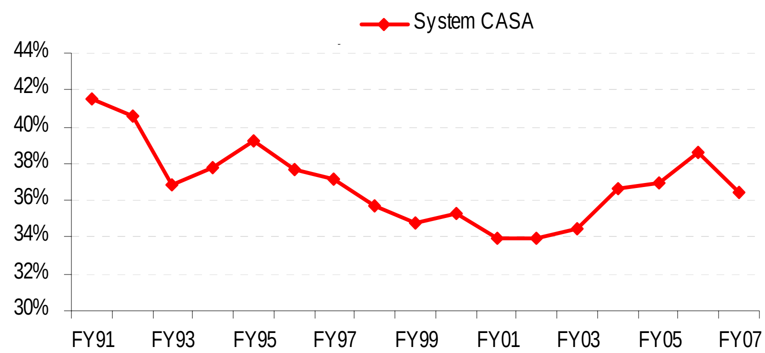
Exhibit 22: CASA Ratio (FY08)

Banks	CASA / Total Deposits	CASA / Domestic deposits
HDFC Bank	54.5%	-
Axis Bank	45.7%	46.3%
ICICI Bank	26.0%	27.0%
DCB	24.3%	-
Yes Bank	8.5%	-
SBI	47.0%	49.0%
Punjab National Bank	43.0%	-
Union Bank of India	34.9%	-
Canara Bank	31.5%	32.4%
Bank of Baroda	31.2%	38.8%
Bank of India	30.6%	36.6%

Source: Company, JM Financial.

System-wise CASA: Higher interest rates and weak performance of equity markets would lead to a decline in low-cost mix as individuals move their current and savings deposits into fixed deposits, which currently are offering rates of 9-10%. Infact system-wise CASA has declined in FY07 due to rising rates and we expect some further going forward.

Exhibit 23: Banking System: CASA Trends (%)



Source: RBI, JM Financial.

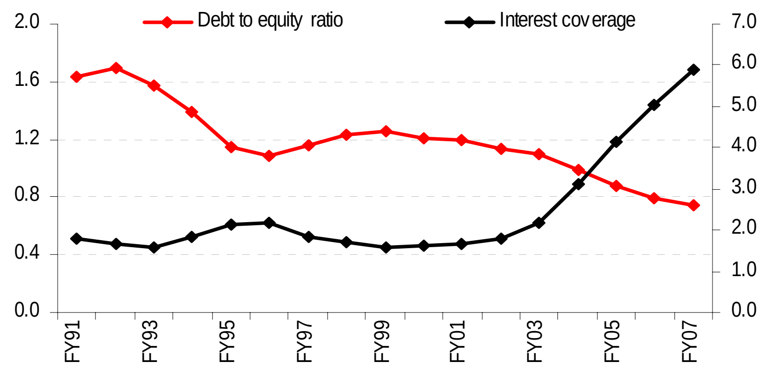
C) Pressure on Credit quality: Key Risk to our Positive Stance

Slippages to rise but remain under control: Higher lending rates are expected to impact credit quality for the banking system. The extent of the impact on credit quality would also be bank specific given the loan mix (retail vs. corporate), proportion of unsecured lending, credit profile of corporate loan book and industry-wise exposure. Except for a few banks, where we expect delinquencies to be significantly higher (like DCB), rise in credit cost for most of the banks would be under manageable levels.

Health of Indian banks and corporates is relatively strong when compared to the era of 1990s. We believe that the overall credit quality of Indian banks would not come under severe stress and we don't expect re-occurrence of the 1990s scenario due to: a) strength of Indian corporates – comparatively low leverage, higher profitability and more competitive, b) better risk management systems of Indian banks and c) we are still far away in terms of interest rate levels (when compared to 1990s). However, crude price is a big threat at this juncture.

a) **Corporate health is stronger,** looking at the improving financial health of the Indian corporates over the years. With lowest debt-equity mix and highest interest coverage ratios over the past 17 years, we are of the opinion that corporate India is in a relatively better position to service their debt, though some increase in delinquencies will happen (particularly in the SME and Mid-corporates segments).

Exhibit 24: Manufacturing Companies: D/E ratio & Interest Coverage (RHS)

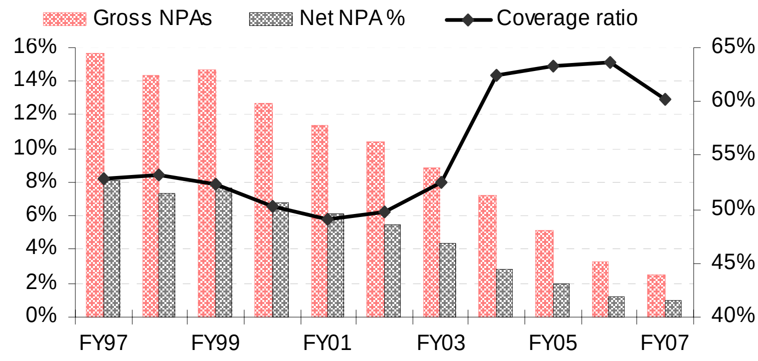


Source: CMIE, JM Financial.

b) **Indian banks' fundamentals are relatively resilient:** With better risk management systems, dramatically improved asset quality, stronger recovery mechanisms (legal provisions) and with adequate capitalization and provisioning, Indian banks are far stronger than they were in the 1990s. Further, RBI has taken several measures on the provisioning front over the past couple of years to ensure that the Indian banks are adequately provisioned.

Looking at the historical data over the past decade, Indian banks have dramatically improved their asset quality. Further, they would become cautious and slow down their credit growth to avoid taking excessive risks.

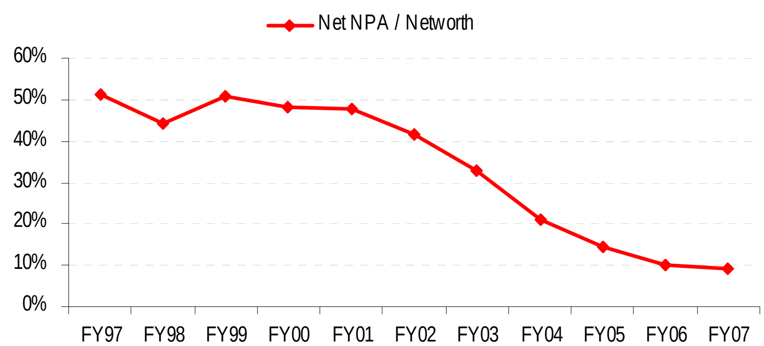
Exhibit 25: Banking System: Trends in Asset Quality (%)



Source: RBI, JM Financial.

Banks are also more than adequately capitalised to meet any credit related stress. Net NPA to networth ratio is at all time lows of ~10%.

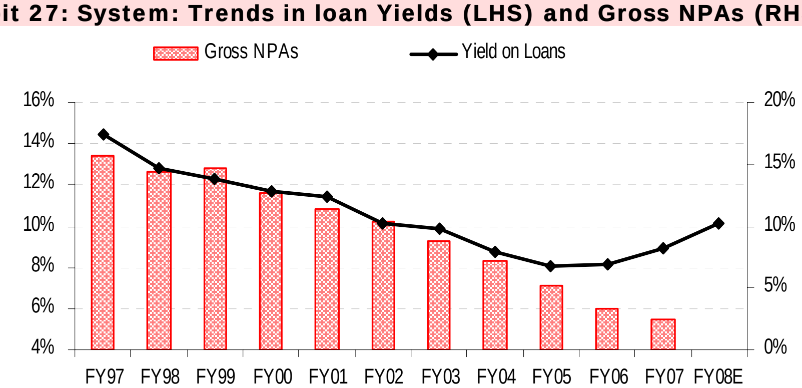
Exhibit 26: Banking System: Trends in system NPA and networth (%)



Source: Company, JM Financial.

c) **Interest rate levels:** Further, we would like to point out that yields on loans (which truly represent the interest rates prevailing for corporates in the economy) are still well below (about 350 bps) the levels seen in 1997. While monetary tightening might continue leading to further rise in interest rates, it would be premature at this stage to argue whether interest rates would reach to levels seen in mid 1990s. If that happens, impact on the Indian economy and health of corporates and banks would be severe.

Exhibit 27: System: Trends in loan Yields (LHS) and Gross NPAs (RHS) (%)



Source: RBI, JM Financial. Note: System FY08 GNPAs data is not available.

Certain sectors (like real estate, airlines industry) might feel the stress due to the changing macro environment and rise in interest rates. Many companies where crude forms a key raw material component are expected to get hit more severely. Similarly, sectors like real estate and SMEs, which are interest rate sensitive, would face higher delinquencies if interest rates strengthen further by 100-200 bps. However, the extent of the impact on credit quality would also be bank specific given the loan mix (retail vs. corporate), proportion of unsecured lending, credit profile of corporate loan book and industry-wise exposure.

Exhibit 14: Non Food Credit Mix and Segmental Growth

	As % of Non-food credit					Growth YoY (%)			
	Mar-05	Mar-06	Mar-07	Feb-08	May-08	Mar-06	Mar-07	Feb-08	May-08
1. Agriculture & Allied Activities	12.4%	12.4%	12.8%	11.7%	12.2%	39.9%	32.4%	16.4%	19.3%
2.Industry (Small, Medium & Large)	42.1%	39.2%	38.5%	39.6%	39.5%	30.0%	25.7%	25.9%	26.9%
Food Processing	2.4%	2.2%	2.2%	2.3%	2.3%	28.8%	27.9%	32.1%	35.1%
Textiles	4.4%	4.2%	4.4%	4.4%	4.3%	33.2%	34.2%	23.3%	20.9%
Petroleum and Coal Products	1.5%	1.8%	2.0%	1.9%	2.2%	64.8%	41.0%	23.3%	62.8%
Chemicals and Chemical Products	3.9%	3.5%	3.1%	3.0%	3.0%	24.5%	14.2%	14.0%	24.8%
Iron and Steel.	3.6%	3.6%	3.5%	3.5%	3.6%	42.6%	24.7%	19.3%	24.4%
All Engineering	2.9%	2.5%	2.4%	2.5%	2.4%	20.4%	24.5%	26.3%	23.4%
Gems and Jewellery	1.4%	1.5%	1.3%	1.2%	1.1%	45.2%	15.8%	9.3%	6.0%
Construction	0.8%	0.9%	1.1%	1.1%	1.2%	59.5%	46.7%	31.7%	29.6%
Infrastructure	7.9%	8.0%	8.0%	9.1%	9.3%	42.8%	26.8%	42.5%	41.7%
Others	13.4%	11.0%	10.5%	10.5%	9.9%	14.5%	22.6%	21.3%	15.4%
3. Services	20.0%	22.8%	23.3%	24.3%	24.1%	58.8%	31.0%	28.8%	31.3%
Transport Operators	0.8%	1.2%	1.5%	1.6%	1.6%	106.5%	52.3%	43.4%	39.2%
Professional & Other Services	1.0%	1.1%	1.3%	1.3%	1.5%	58.3%	55.6%	24.6%	28.6%
Trade	5.8%	5.9%	6.0%	5.8%	5.6%	43.4%	29.5%	18.3%	16.0%
Real Estate Loans	1.3%	1.9%	2.5%	2.6%	2.8%	97.1%	69.8%	26.7%	31.9%
NBFCs	2.3%	2.4%	2.7%	3.1%	3.3%	50.3%	41.5%	50.2%	62.0%
Others (residual figure)	8.8%	10.1%	9.3%	9.9%	9.2%	60.8%	16.7%	28.8%	32.0%
4. Retail Loans	25.5%	25.7%	25.4%	24.5%	24.3%	40.5%	26.5%	13.2%	15.9%
Total Non-Food Gross Bank Credit (1 to 4)	100.0%	100.0%	100.0%	100.0%	100.0%	39.6%	27.9%	22.1%	24.1%

Source: RBI, JM Financial.

Our view: While there has been a considerable increase in delinquencies as far as the uncollateralised retail segments are concerned due to the rise in interest rates in India over the past 12 months, we believe that despite the recent tightening, the overall credit quality of Indian banks would not come under severe stress. Given the strong growth expectations of the Indian economy, we believe profitability of Indian corporates would remain reasonably strong enough to service their debt obligations (unless the economic growth slows down to 3-5%, probability of which we feel is low at this stage).

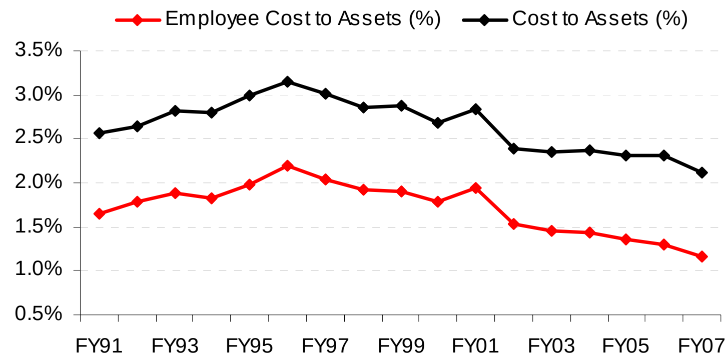
Higher than expected delinquencies would be a key risk to our estimates: We have built-in higher level of slippages in our projections for banks covered in this report to reflect increased risks. However, higher than expected delinquencies would be a key risk to our estimates.

Cost saving initiatives to protect profitability

Banks have significantly restructured their operations and become more efficient. Consequently, the cost ratios for the Indian banking system have declined over time. We expect this trend to continue given: a) continued improvement in productivity and b) With most of the banks under 100% CBS, technology related expenses would stabilise.

Cost containment - key focus area: The banks would be focusing on containing costs going forward and we believe easing of wage inflation and saving on account of branch rents (particularly for new branches) would help protect profitability of the Indian banks.

Exhibit 29: Banking System: Trends in cost ratios (%)

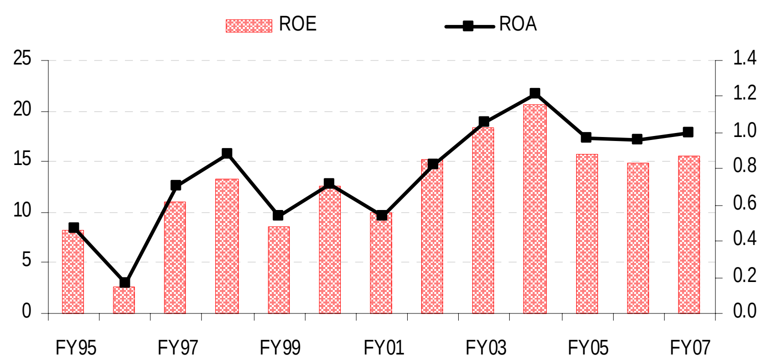


Source: RBI, JM Financial.

Profitability to display stability

Negative impact of pressure on margins and credit quality to some extent would be neutralised by improvement in cost ratios on account of several cost containment measures being undertaken by banks. We expect return ratios (ROA and ROE) of the Indian banks to continue to display strength (ignoring one-off treasury losses).

Exhibit 30: Banking System: Profitability trends: ROA (RHS) & ROE (%)



Source: Company, JM Financial.

Well capitalised

Many of the banks have raised capital over the past 12 months, in anticipation of higher requirement for BASEL II and to fund balance sheet growth. We do not expect capital to be a constraint (apart from few smaller banks).

Exhibit 31: Tier I ratio of various banks

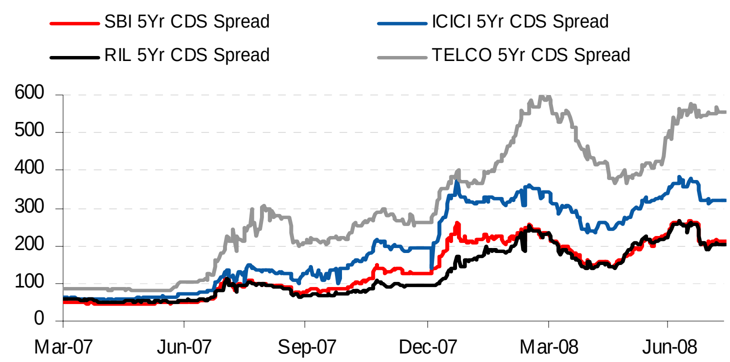
Banks	FY07	FY08	1Q FY09
ICICI Bank	7.4%	11.8%	11.3%
Axis Bank	6.4%	10.2%	9.9%
HDFC Bank	8.6%	10.3%	9.3%
Yes Bank	8.2%	8.5%	8.2%
SBI	8.0%	9.1%	9.3%
PNB	8.9%	8.5%	8.9%
BOB	8.7%	7.6%	7.9%
BOI	6.4%	7.7%	7.8%
UBI	7.8%	7.5%	7.5%
Canara bank	7.2%	7.0%	6.8%

Source: Company, JM Financial.

Recent issues

International credit markets have deteriorated significantly because of the sub-prime crisis affecting financials globally. CDS spreads for the Indian banks like ICICI, SBI and corporates like Reliance spiked significantly. Banks had to take MTM hits on the derivative exposure. However, in our opinion, the exposure of Indian banks is not significant and most of these losses are MTM losses and not realised loss. Further, significant proportion of underlying assets is towards Indian corporates, none of whom have defaulted till date. These investments are typically held to maturity and the bank has no intention of selling these investments at a loss. If the underlying corporate does not default, the bank would write back all these provisions at maturity.

Exhibit 32: Spreads on Indian corporate CDS (bps)



Source: Bloomberg, JM Financial.

Proposed Reforms: Possible near-term Triggers

A) Voting Rights: Proposed amendments to The Banking Regulation Act, 1949.

Proposal to remove 10% restriction on voting rights: The current provisions of The Banking Regulation Act provides that voting rights of shareholders holding more than 10% of a bank's equity be restricted to 10%. This provision is proposed to be removed. Hence, voting rights of investors holding more than 10% in a banking company would be made proportional to their shareholding.

Proposal to impose restriction on holding 5% or more stake in a banking company without prior approval of RBI: Even though under the 'Guidelines on Ownership and Governance in Private Sector Banks', RBI's permission is required at present for acquisition of 5% or more stake in a banking company, the proposed amendments to The Banking Regulation Act would formalise RBI's policy in this regard.

In our opinion, the new proposals open up the possibility of foreign players to acquire large shareholding as well as management control in Indian banks as their voting interest would be in proportion to their shareholding. Hence, the proposals, if passed, will remove the disincentive for foreign banks to acquire Indian banks. If RBI permits acquisition of significant stake, it will give additional boost to foreign interest. However, we believe RBI would be selective and allow acquisition of weak Indian banks only to begin with.

B) Proposed Insurance reforms: Government seeks to hike FDI from 26% to 49%.

The government is proposing to raise FDI in Insurance from 26% to 49%. If the reform goes through, it would be significantly positive for the Insurance sector.

Impact for the sector: The insurance sector requires substantial capital as: a) Break-even for new insurance company takes about 8-10 years, b) to meet solvency norms, c) to fund the growth and d) to expand the distribution network. This proposal will ensure capital for the private insurance players as well as unlock value for Indian partners. The foreign partners could hike their stake in the insurance JV to 49% from the current levels of 26% at substantially higher price (strategic premium) than the current implied price, which could help unlock value for the Indian partners.

For example, For ICICI Bank, it would provide an opportunity to unlock substantial value by selling its stake in ICICI Prudential Life Insurance to its insurance partner, Prudential Life. In our opinion, if the stake sale happens it would be at least at the valuation at which last capital infusion by the partners happened into the Insurance JV and can generate Rs. 129 bn (~USD bn) for ICICI Bank for 23% stake sale. The last capital infusion valued the company at Rs. 560 bn (USD ~13 bn) and implies per share value of Rs. 373 for ICICI Bank. However, we have valued ICICI Prudential Life at Rs. 230 per share for ICICI Bank.

Shareholding of Institutional Investors

Exhibit 34: Trend in Institutional Holdings in Indian Banks

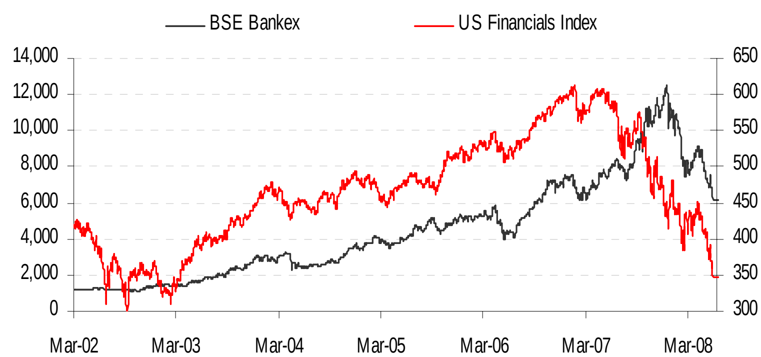
Banks	FII Holding (incl. Foreign Fin. Inst.& ADR/GDR)			Change over Dec'07 to Jun'08	DII Holding (other than Promoters)			Change over Dec'07 to Jun'08
	Dec-07	Mar-08	Jun-08		Dec-07	Mar-08	Jun-08	
HDFC Ltd	79.1%	77.7%	75.9%	-3.2%	7.9%	9.2%	10.7%	2.8%
ICICI Bank	70.3%	68.9%	67.9%	-2.4%	16.9%	17.1%	17.5%	0.6%
Yes Bank	51.1%	54.4%	51.8%	0.8%	4.1%	0.9%	1.9%	-2.2%
HDFC Bank	48.6%	47.5%	47.0%	-1.7%	7.3%	7.5%	7.8%	0.5%
Karnataka Bank	35.5%	39.8%	39.3%	3.9%	6.5%	6.0%	6.1%	-0.4%
Indusind Bank	29.6%	28.2%	35.8%	6.2%	2.2%	2.5%	2.1%	-0.1%
Axis Bank	37.3%	37.5%	35.0%	-2.3%	8.3%	8.3%	9.2%	0.9%
Kotak Bank	26.4%	26.2%	25.7%	-0.8%	5.0%	4.8%	4.7%	-0.4%
ING Vysya	22.8%	22.8%	22.7%	-0.1%	15.4%	15.7%	15.9%	0.5%
DCB	30.3%	30.0%	17.7%	-12.6%	2.3%	2.1%	4.1%	1.7%

Source: BSE, JM Financial.

Bankex Performance

BSE Bankex is down 35% YTD as compared to 21% decline in the Dow Jones US Financials Index.

Exhibit 33: BSE Bankex vs. US Financial Index



Source: Bloomberg, JM Financial.

JM FINANCIAL

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Key Data

Market cap (bn)	Rs811.1 / US$19.3
Shares in issue (mn)	1,113
Diluted share (mn)	1,113
3-mon avg daily val (mn)	Rs5,39.1 / US$128.2
52-week range	Rs1,465/515
BSE sensex (08/08/08)	15,168
Nifty (08/08/08)	4,530
Rs/US$	42.1

Shareholding Pattern (%)

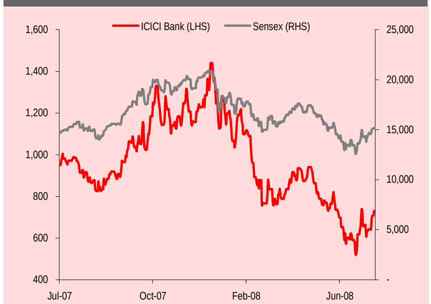
	1Q FY08	1Q FY09
Promoters	0.0	0.0
FIIs	45.8	39.0
MFs/FIs/Banks	16.6	17.5
Public	12.6	14.6
Others (incl. GDR/ADR)	24.9	28.9

Price Performance (%)

	1M	3M	12M
Absolute	18	(17)	(16)
Relative*	6	(7)	(18)

** To the BSE Sensex*

Daily Performance



(As of 8 August 2008)

10 August 2008

Initiating Coverage

ICICI Bank

Bloomberg: ICICIBC IB

Buy

Price: Rs. 729 | **Target Price (Aug 09): Rs. 1,000**

The Game Goes International

International banking assets constitutes 25% of consolidated banking assets of over US$ 100 bn and would be the growth driver for ICICI Bank. Leveraging on home country links and building global retail deposits franchise would create immense value. While other subsidiaries too would maintain robust growth trends, the parent bank would undergo significant fundamental improvements.

- **International business offers immense opportunities:** ICICI Bank along with its international banking subsidiaries has gained substantial scale outside India. The combined assets outside India (including subsidiaries) has expanded at 83% CAGR during FY05-08 to the size of Rs. 1,084 bn (US$ ~25bn) & now constitutes ~25% of the consolidated banking assets. Leveraging the home country links is driving strategy for international business and is expected to create substantial value for ICICI Bank.
- **'HiSAVE' - Building a strong global retail deposits franchisee:** ICICI Bank's 'HiSAVE' retail deposit products have been a huge success in UK & Canada and has attained critical mass that would support bank's strong asset origination capabilities and meet the demand for Indian corporate credit both in India and globally. ICICI Bank's subsidiaries enjoy total deposits of Rs. 366 bn, of which ~84% are retail.
- **NBFC model to drive mortgage growth:** Significant widening of regulatory arbitrage offers opportunity to ICICI Bank to house its non-priority sector mortgage business in ICICI Home Finance (IHFL). We expect IHFL to gain significant assets size of about ~Rs. 400 bn by FY11 and generate ROE of ~18%.
- **Parent bank to undergo significant fundamental improvements:** There is visible shift in the Bank's strategy from aggressively pursuing assets growth to increased emphasis on margins, pricing and credit quality. In our opinion, bank's efforts to a) strengthen liabilities franchisee, b) consolidate retail portfolio, c) improve credit quality & containing delinquencies and d) contain operating costs would lead to significant improvement in fundamentals going ahead.
- **Subsidiaries to continue to create significant value:** Apart from non-banking companies, banking subsidiaries too are expected to create significant value for ICICI Bank over the next 2-3 years. While the parent bank is expected to moderate growth, its subsidiaries would maintain robust growth trends.
- **Valuation:** Post the substantial dilution, ROE of the bank is expected to recover by 330 bps to 12.3% in FY11. Based on a normalised ROE of 15%, we value the stock at 1.25x book, implying standalone value of Rs. 550 per share. We value subsidiaries at Rs. 450 for ICICI Bank, contributing 45% to Aug'09 **TP of Rs. 1,000 (37% upside)**.

Exhibit 1: Financial Summary (Standalone) (Rs mn)

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	24,870	29,744	40,421	42,944	57,735	68,139
Net Profit (YoY) (%)	28.6%	22.4%	33.7%	3.3%	34.4%	18.0%
Assets (YoY) (%)	49.9%	37.1%	16.0%	10.7%	15.0%	15.2%
ROA (%)	1.21%	1.04%	1.12%	1.02%	1.21%	1.24%
ROE (%)	14.6%	13.4%	11.7%	9.0%	11.3%	12.3%
EPS (Rs.)	28.5	34.6	37.4	38.6	51.9	61.2
EPS (YoY) (%)	6.5%	21.2%	8.0%	3.3%	34.4%	18.0%
PE (x)	25.5	21.1	19.5	18.9	14.0	11.9
BV (Rs.)	249.6	270.3	417.6	443.3	477.9	518.5
P/BV (x)	2.92	2.70	1.75	1.64	1.53	1.41
P/BV (x) (ex subsidiaries)	1.12	1.03	0.67	0.63	0.58	0.54

Source: Company, JM Financial. Note: Valuations as of 08 August 2008

Exhibit 2: Key Financials (Standalone)

Key Parameters	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR (04-07)*	CAGR (03-08)*	CAGR (08-11)E*	Remarks
Balance sheet													
Deposits (Rs. bn)	482	681	998	1,651	2,305	2,444	2,689	3,119	3,618	50.1%	38.4%	14.0%	With slowdown in balance sheet growth, substantial branch additions in FY08 and increased focus on strengthening its liabilities franchisee, the bank is set to further improve its CASA mix to ~32% by FY11E (from ~26% in FY08).
CASA (Rs. bn)	75	156	242	375	502	638	794	967	1,158	47.6%	53.5%	22.0%	
CASA Mix (%)	15.5%	23.0%	24.3%	22.7%	21.8%	26.1%	29.5%	31.0%	32.0%	-1.2%	10.6%	5.9%	
Loans (Rs. bn)	533	626	914	1,462	1,959	2,256	2,527	2,930	3,415	46.2%	33.5%	14.8%	Parent's retail loan book is expected to show a contraction of ~3.5% in FY09. Loan growth of ~15% CAGR during FY08-11E would be driven by international and wholesale advances. Loan book mix would undergo a significant change, with retail loosing ~13% share from 60% in FY08 to ~47.5% in FY11.
Retail Loans (Rs. bn)	191	335	567	929	1,293	1,348	1,302	1,429	1,614	56.8%	47.8%	6.2%	
International Loans (Rs. bn)	1	11	62	125	244	477	619	733	854	184.2%	n.m.	21.4%	
Retail Loans Mix (%)	35.8%	53.5%	62.0%	63.6%	66.0%	59.7%	51.5%	48.8%	47.3%	12.5%	23.9%	-12.5%	
International Loans Mix (%)	0.1%	1.7%	6.8%	8.6%	12.5%	21.2%	24.5%	25.0%	25.0%	10.8%	21.1%	3.8%	
Total Assets (Rs. bn)	1,068	1,252	1,677	2,514	3,447	3,998	4,425	5,088	5,864	40.1%	30.2%	13.6%	While we expect parent's balance sheet to grow at 14% CAGR during FY08-11E, substantial growth would be visible in the assets size of 3 key subsidiaries (vis-à-vis ICICI Home Finance, ICICI UK and ICICI Canada).
Assets Growth (%)	1.8%	17.2%	33.9%	49.9%	37.1%	16.0%	10.7%	15.0%	15.2%				
Branches	450	469	562	614	755	1,262	1,425	1,550	1,650	17.2%	22.9%	9.3%	
Income statement													
NII (Rs. bn)	14.4	21.9	29.3	38.7	55.3	72.2	89.5	105.7	124.0	36.3%	37.9%	19.8%	Bank's efforts to strengthen liabilities franchise, consolidate retail portfolio, improve credit quality & contain operating costs would lead to significant fundamental improvements. Core operating profits to expand at ~32% CAGR.
Core operating profits (Rs. bn)	7.5	11.5	21.3	31.5	46.9	60.6	99.6	118.3	138.4	59.9%	51.8%	31.7%	
PAT (Rs. bn)	12.0	16.4	19.8	25.4	31.1	41.6	42.9	57.7	68.1	23.9%	28.3%	17.9%	
Profitability													
Interest Spread (%)	0.65%	1.76%	1.79%	1.51%	1.48%	1.35%	1.40%	1.57%	1.67%	-0.3%	0.70%	0.33%	Post the substantial dilution, ROE of the bank is expected to recover by 330 bps to 12.3% in FY11.
NIM (%)	1.51%	2.08%	2.18%	1.98%	1.98%	2.06%	2.26%	2.36%	2.40%	-0.1%	0.55%	0.34%	
ROA (%)	1.13%	1.41%	1.35%	1.21%	1.04%	1.12%	1.02%	1.21%	1.24%	-0.4%	-0.01%	0.13%	
ROE (%)	17.7%	21.9%	19.2%	14.6%	13.4%	11.7%	9.0%	11.3%	12.3%	-8.5%	-5.9%	0.5%	
Asset Quality													
Net NPAs (Rs. Bn)	27.7	13.7	15.1	10.5	19.9	34.9	40.3	41.0	45.5	13.2%	4.7%	9.2%	With rising interest rates and increase in delinquencies, ICICI bank slowed down its retail disbursements and exited from few of the riskier segments. The impact of these remedial measures and enhanced focus on credit quality would be visible from FY10 onwards leading to stabilising trend in delinquencies and LLP.
LLP (Rs. Bn)	14.7	4.6	-1.2	7.9	21.6	27.0	36.7	43.7	46.9	67.5%	12.9%	20.1%	
Slippages (%) ^	2.5%	2.9%	4.1%	1.3%	2.0%	2.0%	2.5%	2.4%	2.3%	-0.9%	-0.5%	0.3%	
LLP (%)	2.9%	0.8%	-0.2%	0.7%	1.3%	1.3%	1.5%	1.6%	1.5%	0.5%	-1.7%	0.2%	

Source: Company, JM Financial, Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

International Business: Next growth Driver

ICICI Bank has gained significant scale outside India

83% CAGR in International assets during FY05-FY08: ICICI Bank along with its international banking subsidiaries has gained substantial scale outside India during the last 2 years. The combined assets size outside India (including subsidiaries) has expanded at 83% CAGR during FY05-08 to the size of Rs. 1,084 bn (US$ ~25bn) and now constitutes close to 25% of the consolidated banking assets.

ICICI Bank has rapidly scaled up its operations and assets size in **UK and Canada** through its subsidiaries in these 2 countries. The combined assets size of ICICI UK and ICICI Canada is to the tune of Rs. 469 bn (US$ ~11 bn) contributing 10.5% to the consolidated banking assets.

Exhibit 3: International Banking Assets

International Assets (Rs. Bn.)	FY05	FY06	FY07	FY08	CAGR FY05-08
ICICI - UK	44	89	195	354	100%
ICICI - Canada	5	27	71	115	193%
ICICI - Parent 's International Assets (approx.)	127	276	408	615	69%
Total International Assets	176	391	674	1,084	83%
Total Banking Assets (Rs. Bn.)					
ICICI - UK + Canada	49	115	266	469	112%
ICICI - Parent	1,677	2,514	3,447	3,998	34%
Total Banking Assets	1,726	2,629	3,713	4,467	37%
International Assets - Share (%)					
ICICI - UK + Canada	2.8%	4.4%	7.2%	10.5%	
ICICI - Parent	7.4%	10.5%	11.0%	13.8%	
Total International Assets	10.2%	14.9%	18.1%	24.3%	

Source: Company, JM Financial. Note: ICICI Canada figures are December ending.

Substantial International Footprints

Since ICICI Bank identified international banking as a key opportunity, it has created significant international footprints. The bank set up its first overseas branch in Singapore in 2003. It currently has subsidiaries in the United Kingdom, Canada and Russia, and branches in Singapore, Bahrain, Hong Kong, Sri Lanka, Dubai International Finance Centre, Qatar Financial Centre and the United States and representative offices in the UAE, China, South Africa, Bangladesh, Thailand, Malaysia and Indonesia.

The Bank's subsidiary ICICI Bank UK has nine branches in the United Kingdom (five of them in areas of high NRI population) and a branch each in Belgium and Germany. ICICI Canada has eight branches including three in Toronto. ICICI Eurasia has six branches including three branches in Moscow and one in St. Petersburg.

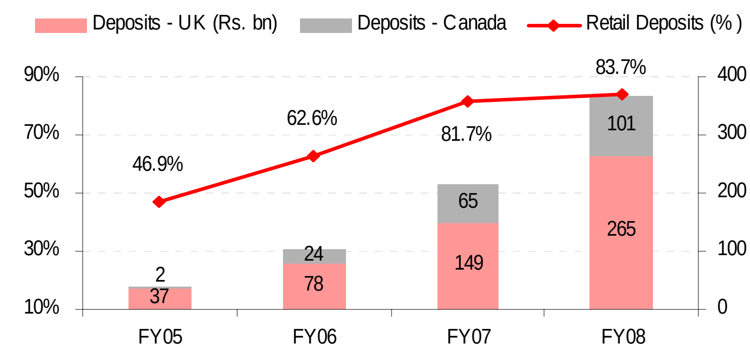
Focus on India-linked businesses: Increasing presence of Indian companies outside India along with large existence of NRIs offer immense opportunities for Indian banks. ICICI Bank intends to leverage on these home country links and has built a strong international foundation to capitalise on these long-term growth opportunities. The bank has launched various commercial and retail banking products to develop its international business franchise. During FY08 the bank was involved in 75% of outbound M&As deals from India and was ranked number one in offshore loan syndications of Indian corporates in CY07. The bank also enjoys a market share of 25% in inward remittances to India.

'HiSAVE' - Building a strong global deposits franchisee: Retail banking is one of the key element of the bank's international growth strategy. It is focusing on building a strong global retail deposits franchisee to support its strong asset origination capabilities and meet the demand for Indian corporate credit both in India and globally. ICICI Bank's subsidiaries enjoy total deposits of Rs. 366 bn, of which ~84% are retail in nature.

Online retail deposit: In international markets, the bank's primary emphasis is on direct banking through a low-cost operating platform, which allows it to offer competitive deposit products. ICICI Bank has launched online retail deposit products under the brand **'HiSAVE'**. The products are built on the concept of housing all operational and service processes on the main ICICI Bank internet platform in India. ICICI Bank outsources both low-end and high-end operations to India, thereby saving as much as 70% of operating costs, giving the bank cost advantage over foreign banks in their home turf. Savings on account of operating cost is passed on the depositors by offering higher deposit rates.

Huge success even with local customers: 'HiSAVE' products have been huge success in UK & Canada markets, and the bank has been able to build up attain critical mass of Rs. 366 bn in deposits in FY08. Significant proportion of the customer segment that comes into this product is the local residents (non-NRIs).

Exhibit 4: Retail deposits franchisee (UK+Canada)



Source: Company, JM Financial. Note: ICICI Canada figures are December ending.

HiSAVE Savings account: The HiSAVE Savings Account is an online account offered by bank's subsidiaries in various countries of presence. Unlike a standard savings account, HiSAVE does not provide the customer with a cheque book, debit card or branch access and all monetary inflow and outflow of funds happen online.

Savings account in UK is available only in British Pound. The bank currently offers a floating rate of interest on its HiSAVE savings. In UK, the rate is linked to Bank of England (BoE) Base Rate. Currently interest offering is at 6%, 75 bps higher than BoE base rate of 5.25%. The bank has guaranteed a minimum of 30 bps spread over BoE base rate till December 2011.

In Canada, the bank is currently offering 3.4% on C$ HiSAVE savings account and 2.50% on US$ HiSAVE savings account.

HiSAVE Term Deposit: ICICI bank's subsidiaries also offer term deposits products to its customers and are offered in GBP, USD and Euro for the tenure from 7 days to 5 years. Fixed deposits products are attractively priced – currently the bank is offering 7% for 1 year deposit and 6.7% for 6 month deposit in UK.

HomeVantage Current Account: In UK, the bank has launched its current account under the brand 'HomeVantage' with focus on NRI population. The bank offers a range of rewards & services, specially designed for NRIs like free debit card transactions in India, remittances through phone and email and other attractive features like no minimum balance, free cheque book, free debit card etc..

Sizeable presence outside offers immense opportunity

Increasing presence of Indian companies outside India along with large existence of NRIs offers immense opportunities for the Indian banks. ICICI Bank has launched several commercial and retail banking products to develop its international business franchise and to leverage on these home country links to generate significant fund and non-fund based income.

ICICI Bank's international strategy is focused on building a retail deposit franchise, diverse wholesale funding sources and strong syndication capabilities to support its corporate and investment banking business; achieving the status of a non-resident Indian (NRI) community bank in key markets; and expanding private banking operations for India-centric asset classes.

Substantial NRI customer base: The bank has established a strong franchise among NRIs by offering a comprehensive product suite, technology enabled access, a wide distribution network in India and alliances with local banks in various markets. Currently, it enjoys over 0.5 mn NRI customers base and has emerged as a well-recognised financial services brand for NRIs.

Commercial banking products / offerings

- **Global corporate and investment banking** activities focused on Indian companies covering advisory, origination, structuring, execution and syndication. ICICI Bank has created an integrated Global Investment Banking Group, which is responsible for working with the relationship team in India and its international subsidiaries and branches, for origination, structuring and execution of investment banking mandates on a global basis. During FY08, the bank was involved in 75% of outbound M&As deals from India.
- **Debt origination, financing and syndication** for Indian corporates raising debt in the offshore markets (through commercial loans, syndicated loans, bonds and floating rate notes etc.) under the ECBs guidelines or require cross-border acquisition financing. In addition to taking credit exposures (directly or through subsidiaries), ICICI Bank earns significant fee incomes from its arranging activities. It has been ranked number one in offshore loan syndications of Indian corporates in CY07.
- **Transaction banking -** The bank has also restructured its delivery team by creating dedicated sales teams for trade services and transaction banking products. It would help the bank to increase its market share from transaction banking products, which will translate into recurring fee income for the Bank.
- **International alliances to support domestic businesses** - The bank has correspondent banking relationship with over 950 foreign banks in various markets to offer variety of products to its Indian clients and further capture market share in trade finance.

Retail banking products / offerings

- **Remittances:** with the launch of its cost effective and instant money transfer products, ICICI Bank has now captured significant 25% market share in all inward remittances to India. The bank has also undertaken the development of low cost remittance products in non-India geographies with correspondent tie-ups for disbursements in over 100 such geographies.
- **Trade finance and personal financial** services for NRIs.

Private banking solutions:

- Through its international private banking services, ICICI Bank offers various products to mass affluent and high networth clients. The offerings range from simple deposits and loans to more sophisticated structured products, private equity and products giving exposure to the real estate sector in India.

ICICI Bank UK PLC - Key Financials

Exhibit 5: ICICI Bank UK – Key figures (Rs mn)

Balance Sheet - (Rs. mn)				
Y/E March	FY05	FY06	FY07	FY08
Equity Capital	4,362	5,868	5,420	17,857
Reserves and Surplus	1	453	1,503	2,879
Available for sale securities reserve	0	0	-15	-4,045
Share holders equity	4,363	6,322	6,908	16,691
Preference Capital	2,181	2,174	2,006	2,006
Debt securities in issue	0	0	29,878	53,811
Deposits by banks	20,476	32,490	36,635	56,696
Deposits by customers	16,884	45,801	112,816	207,835
Other Liab. & Provisions	534	1,858	7,067	17,183
Total Liabilities	44,438	88,645	195,311	354,221
Cash, Treasury & other eligible bills	4	8,143	15,681	126
Loans to banks	19,017	25,534	43,579	89,289
Loans to customers	17,446	31,563	31,560	78,764
Debt securities	7,345	22,339	100,046	175,126
Fixed & Other Assets	628	1,066	4,445	10,917
Total Assets	44,438	88,645	195,311	354,221
Growth YoY (%)		*99%*	*120%*	*81%*

Loss of Rs. 4.04 bn (5.73 bn gross of tax) on AFS portfolio due to widening on credit spreads has been directly reflected in networth.

Building global retail deposits franchisee. Of the total retail deposits, ~65% are savings / current deposits.

Retail deposits are parked in debt securities till the bank establishes behavioural pattern of these deposits which should happen over the next 12-18 months.

Income Statement - (Rs. mn)				
Y/E March	FY05	FY06	FY07	FY08
NII	220	671	1,239	2,000
Growth YoY (%)		*204%*	*85%*	*61%*
Fees and commissions	288	961	1,371	3,251
Dealing profits	16	108	631	-1,096
Other operating income	63	110	204	248
Total Non-Interest Income	367	1,179	2,206	2,403
Total Income	587	1,850	3,444	4,403
Operating & Admin expenses	416	732	1,004	1,886
Operating Profit	171	1,119	2,440	2,517
Total Provisions	47	193	195	241
PBT	124	926	2,246	2,276
Tax	25	294	659	735
Net Profit	99	631	1,586	1,541
Growth YoY (%)		*538%*	*151%*	*-3%*

International presence offers substantial opportunities to leverage home country links and generate significant fee based income.

Includes MTM loss of Rs. 2.36 bn on credit derivatives and debt securities held in trading portfolio accounted through P/L statement.
Similar MTM loss (Rs. 2.23 bn) is also incurred by ICICI Canada.

Du-pont Analysis (%)	FY06	FY07	FY08
NII / Assets (%)	1.01%	0.87%	0.73%
Fee / Assets (%)	1.44%	0.97%	1.18%
Total Non-Interest Inc. / Assets (%)	1.77%	1.55%	0.87%
Total Income / Assets (%)	2.78%	2.43%	1.60%
Cost to Assets (%)	1.10%	0.71%	0.69%
Provisions / Assets (%)	0.29%	0.14%	0.09%
PBT / Assets (%)	1.39%	1.58%	0.83%
ROA (%)	0.95%	1.12%	0.56%
ROE (%)	11.8%	24.0%	13.1%

Going forward we expect International banking subsidiaries to generate ROA of ~1.0%

Source: Company, JM Financial.

International Business: As profitable as domestic business

Spreads to improve after behavioural pattern of deposits is established

ICICI Bank through its UK and Canada subsidiaries has been able to build substantial deposit franchise. Retail deposits in the UK subsidiary alone amounts to ~ Rs 20 bn (US$ 5 bn). Average tenure of these deposits is couple of months as ~65% of retail deposits in UK are primarily savings deposits. Hence it becomes imperative for a bank to establish a behavioral pattern of these deposits before they can be used for lending purposes as it might create asset-liability mismatches. As a result, these deposits are being invested in short-term debt securities. Consequently, spreads generated by the bank on retail deposits is very marginal. As per the management, the bank would develop the behavioural pattern of retail deposits over the next 12-18 months. Once developed, retail deposits can be disbursed as loans, which could improve spreads and margins significantly.

ROA generated on international business similar to domestic ROA

Both domestic and international businesses are equally remunerative as measured on ROA. Lower margins in international business are compensated by higher fee income, lower operating costs and provisioning. Consequently, we expect UK and Canada subsidiaries of ICICI Bank to generate ROA of ~1% by FY11E and beyond. Our rough cut estimates, factoring in reasonable assets growth, shows that UK and Canada subsidiaries could potentially report PAT of Rs 7.3 bn and 2.3 bn respectively by FY11E, which would be ~14% of standalone ICICI Bank's FY11E PAT.

Exhibit 6: ICICI Bank UK and Canada – Key figures (Rs Bn)

ICICI UK (Rs. bn.)	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Total Assets	44	89	195	354	496	645	806
Growth YoY (%)		99%	120%	81%	40%	30%	25%
PAT	0.1	0.6	1.6	1.5	3.4	5.1	7.3
ROA (%)		0.95%	1.12%	0.56%	0.80%	0.90%	1.00%

ICICI Canada (Rs. bn.)	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Total Assets	5	27	71	115	167	226	282
Growth YoY (%)		483%	165%	62%	45%	35%	25%
PAT	-0.2	-0.3	0.0	0.1	0.6	1.4	2.3
ROA (%)		-2.1%	-0.03%	0.11%	0.40%	0.70%	0.90%

Source: Company, JM Financial.

Valuation for UK & Canada subsidiaries (Per share value: Rs. 100)

We value ICICI Bank's UK and Canada subsidiaries by assigning a PE multiple of 10x on FY11E PAT, valuing ICICI UK at Rs. 72.5 bn (i.e. 3.5x FY08 book) and ICICI Canada at Rs. 22.8 bn (i.e. 2.2x FY08 book). On 12 month forward basis, this implies combined per share value of **Rs. 100 for ICICI Bank.** We have used FY11E PAT because in our opinion, the international banking subsidiaries currently are not able to generate normalised/expected profitability as they are still in the process of establishing maturity pattern of retail deposits, thereby generating marginal spreads on these deposits. Once these retail deposits are deployed and disbursed as loans (along with continued strong expansion in assets size), profitability of these subsidiaries will increase substantially. At the ascribed valuation, ICICI UK and ICICI Canada have been valued at ~3.5x and 2.2x respectively of their FY08 book which in our opinion is reasonable given the substantial increase in asset size and net profits over FY08-11E.

Mortgages: NBFC model to drive growth

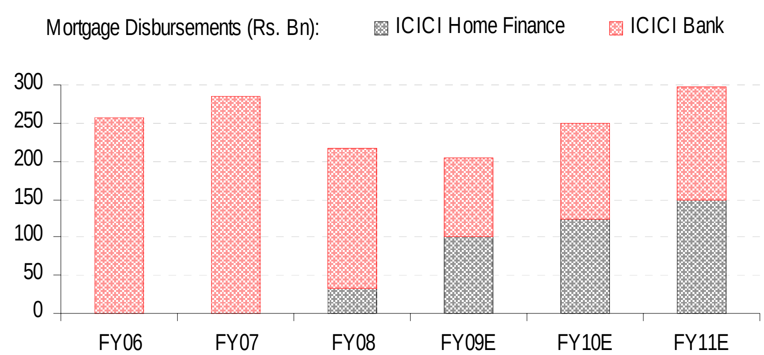
ICICI Home Finance: Vehicle for non-priority sector mortgages

Significant Regulatory arbitrage: While NBFCs have always enjoyed regulatory arbitrage over banks due to non requirement of maintaining CRR and SLR, however the arbitrage has widened considerably during the past 18 months. CRR has increased by 400 bps to 9.0% currently and RBI has discontinued with interest payment on CRR balances. NBFCs also enjoy substantially lower cost ratios as compared to banks. Hence, ICICI Home Finance (IHFL) would now be the primary vehicle for all non-priority sector mortgage disbursements going ahead.

ICICI Home Finance Company Ltd (IHFL) is a home finance company owned 100% by ICICI Bank. It was incorporated on May 28, 1999 for lending and providing various fee based services in the real estate sector.

IHFL to gain substantial scale over next 3 years: We expect IHFL to gain significant assets size of about ~**Rs. 400 bn** by FY11 from the current levels of Rs. 85 bn in FY08. The bank till 2Q'08 booked almost all the mortgage loans on its own book. In 3Q'08, the bank received RBI approval to infuse fresh equity capital into IHFL and infused funds of ~ Rs 5 bn in FY08. Going forward, we expect ~50% of the incremental mortgage disbursements to be booked in IHFL. The company would also be operating in LAP and construction funding.

Exhibit 7: Mortgage Disbursements (Rs Bn)



Source: Company, JM Financial.

ICICI Bank has concrete plans to make significant investments in IHFL and build-up the required infrastructure and expand distribution network. The bank has already moved its key employees to IHFL on deputation. It plans to further increase its offices from current levels of 150-160. Back-end operations would be separated from the bank. Resources would be raised in form of borrowings from capital market as well as retail deposits.

ICICI Home Finance to generate ~18% ROE: We expect IHFL to generate superior return ratios and we expect its ROA and ROE to stabilise at close to ~1.6% and ~18% respectively by FY10E.

Exhibit 8: ICICI Home Finance - Key Financials

Key Financials (Rs. Bn)	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Networth	2	4	4	9	16	25	35
Borrowings	36	41	41	72	159	246	337
Loans	38	43	43	67	149	238	328
Total Assets	31	41	45	85	180	282	394
Growth YoY (%)		*32%*	*11%*	*88%*	*111%*	*56%*	*39%*
Net Profits	0.10	0.12	0.47	0.70	1.66	3.57	5.33
Growth YoY (%)		*23%*	*282%*	*50%*	*135%*	*115%*	*49%*
ROA (%)	0.34%	0.34%	1.09%	1.08%	1.47%	1.54%	1.58%
Change YoY (%)		*0.00%*	*0.75%*	*-0.01%*	*0.39%*	*0.07%*	*0.03%*
ROE (%)	5.4%	4.5%	13.0%	11.2%	17.2%	17.8%	17.7%
Change YoY (%)		*-0.84%*	*8.51%*	*-1.85%*	*6.04%*	*0.54%*	*-0.02%*

Source: Company, JM Financial.

Valuation for IHFL (Per share value: Rs. 30)

Using Gordon growth model, we value IHFL at Rs. 32.3 bn, implying value of **Rs 30 per share for ICICI Bank** on 12 month forward basis, contributing 3% to our target price for ICICI Bank. **Possible listing of IHFL** is expected to unlock considerable value for the group and it would possibly enjoy better multiples vis-à-vis ICICI Bank, due to superior return ratios.

Parent's B/S to consolidate and to undergo significant improvement in fundamentals

Since 2002, ICICI Bank started scaling-up its retail business rapidly and within a span of few years achieved a leadership position in most of the retail segments. To gain market share, the bank not only aggressively competed on pricing but also had to invariably rely on wholesale deposits to fund the growth. And hence the bank enjoyed lower margins as compared to its peers.

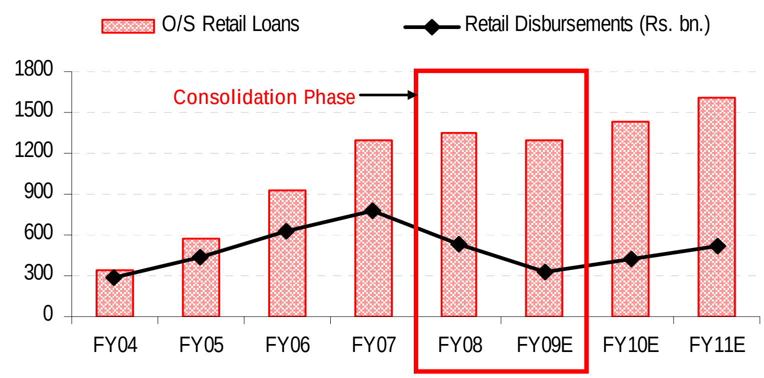
Till 4Q'07 the bank continued with robust retail disbursements. However, with the rise in interest rates and resultant pressure on credit quality, the bank started scaling down its retail disbursements from FY08 onwards. Clearly, during the past couple of quarters its focus has shifted from pursuing aggressive growth to: a) consolidating the retail portfolio, particularly non-collateralised portfolio, b) improving the credit quality and containing delinquencies, c) strengthening the liabilities franchisee (leading to margin expansion) and d) containing operating costs.

Asset growth shifts to IHFL and International banking subsidiaries

Significant slowdown in retail disbursements: ICICI Bank has significantly slowed down its retail disbursements during FY08, registering a degrowth of 31% yoy (decline of 27% yoy if disbursements in ICICI Home finance is included). Given the significant rise in interest rates and the credit quality pressures that ICICI Bank is facing on its retail book (particularly non-collateralised), we expect retail disbursements to decline further in FY09.

We expect the retail business to remain in consolidation phase in FY09 as interest rate environment is expected to remain at elevated levels. Our assumed growth in retail disbursements in FY10 is based on the assumption that inflation and interest rates would start easing out in FY10 and credit quality of ICICI Bank too would show stability on the back of corrective measures that has been taking since the last couple of quarters.

Exhibit 9: ICICI Parent's Bank: Retail disbursement trends (Rs bn)



Source: Company, JM Financial.

Parent's retail loan book to show contraction this year: Given the significant slowdown in retail disbursements, parent's retail loan book is expected to show a contraction of ~3.5% in FY09 (retail advances were up only 4% yoy in FY08). Parent's loan growth of 16% yoy in FY08 was primarily driven by 96% yoy growth in international advances and would continue to do so in FY09. Even the corporate loan book is expected to pick-up in FY09. Hence we expect loan book mix to undergo a significant change, with retail share declining by ~13% from 60% in FY08 to ~47.5% in FY11, while share of wholesale and international loans increasing.

Exhibit 10: Parent Bank: Gross Loan Book Break-up

Gross Loan (Rs. Bn.)	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	FY04-08	FY08-11
Retail - Mortgages	166	285	455	639	664	658	724	826		
Retail - Others	169	282	474	654	683	669	730	815		
Wholesale	298	298	419	443	472	630	794	976		
International Loans	11	62	125	244	477	619	733	854		
Total Gross Loans	643	927	1,473	1,980	2,297	2,576	2,980	3,470		
Growth (%)									CAGR	
Retail - Mortgages		71%	60%	40%	4%	-1%	10%	14%	41%	8%
Retail - Others		67%	68%	38%	4%	-2%	9%	12%	42%	6%
Wholesale		0%	41%	6%	7%	33%	26%	23%	12%	27%
International Loans		485%	101%	95%	96%	30%	18%	17%	159%	21%
Total Gross Loans		44%	59%	34%	16%	12%	16%	16%	37%	15%
Mix (%)									Mix Change (%)	
Retail - Mortgages	26%	31%	31%	32%	29%	26%	24%	24%	3%	-5%
Retail - Others	26%	30%	32%	33%	30%	26%	24%	23%	4%	-6%
Wholesale	46%	32%	28%	22%	21%	24%	27%	28%	-26%	8%
International Loans	2%	7%	9%	12%	21%	24%	25%	25%	19%	4%
Total Gross Loans	100%	100%	100%	100%	100%	100%	100%	100%		

Source: Company, JM Financial.

With rising interest rates, tightening monetary policy and increase in delinquencies, ICICI Bank started slowing down its retail disbursements (particularly non-collateralised segment) from 1Q'08 onwards and exited from few of the riskier segments like small ticket personal loans (exited in Nov'07).

Exhibit 11: Parent Bank: Retail Gross Loan Book Break-up

Retail Loan Break-up (Gross)	FY06		FY07		FY08		Growth	
	(Rs. bn.)	%	(Rs. bn.)	%	(Rs. bn.)	%	FY06-07	FY07-08
Home loans	455	49.0%	593	45.8%	637	47.2%	30.3%	7.4%
Developer Financing	n.a.	n.a.	46	3.6%	28	2.1%	n.a	-39.5%
Automobile loans	189	20.3%	192	14.8%	175	13.0%	1.6%	-8.9%
Commercial business	120	13.0%	202	15.6%	204	15.1%	67.8%	0.8%
Two-wheeler loans	21	2.3%	23	1.8%	30	2.2%	10.9%	28.1%
Personal loans	59	6.3%	125	9.6%	144	10.7%	111.3%	15.7%
Credit cards	35	3.8%	61	4.7%	96	7.2%	71.5%	58.7%
LAS & others	50	5.3%	52	4.0%	34	2.6%	4.1%	-33.4%
Gross Retail Loans	929	100%	1,293	100%	1,348	100%	39.1%	4.2%
Gross Retail Loans / Total Gross Loans			65.2%		58.6%			

Source: Company, JM Financial.

Consolidated banking assets at 17% CAGR during FY08-11E: While we expect parent's balance sheet to grow at 14% CAGR during FY08-11E, substantial growth would be visible in the assets size of 3 key subsidiaries (vis-à-vis ICICI Home Finance, ICICI UK and ICICI Canada). Incremental non-priority sector mortgage disbursements would be booked in IHFL and that would help the company to build an assets size of ~Rs. 400 bn by FY11 implying a CAGR of 66% during FY08-11E. International banking subsidiaries (UK + Canada) are expected to grow over at 32% CAGR during the same period and would enjoy assets size of Rs. 1,088 bn in FY11.

Parents share of consolidated banking assets to reduce to 80% in FY11E: We expect 20% of the consolidated banking assets to reside outside the balance sheet of ICICI bank (parent) in FY11E.

Exhibit 12: Consolidated Banking Assets

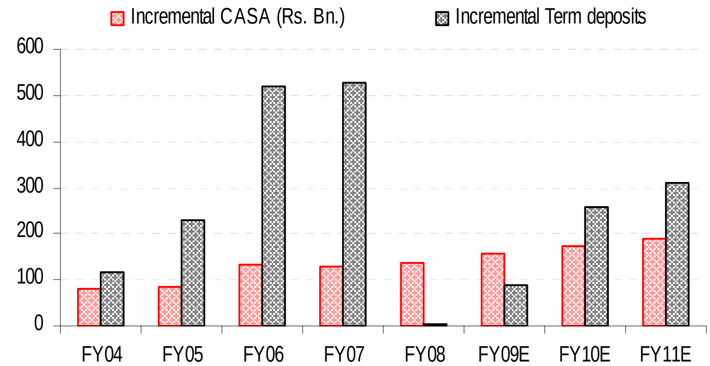
Total Banking Assets	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	FY05-08	FY08-11
ICICI Bank - Parent	1,677	2,514	3,447	3,998	4,425	5,088	5,864		
ICICI UK + Canada	49	115	266	469	663	870	1,088		
ICICI Home Finance	31	41	45	85	180	282	394		
Total Banking Assets	1,757	2,670	3,758	4,553	5,268	6,241	7,345		
Growth (%)	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR (%)	
ICICI Bank - Parent		50%	37%	16%	11%	15%	15%	34%	14%
ICICI UK + Canada		135%	131%	76%	41%	31%	25%	112%	32%
ICICI Home Finance		32%	11%	88%	111%	56%	39%	40%	66%
Total Banking Assets		52%	41%	21%	16%	18%	18%	38%	17%
Mix (%)	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	Mix Change (%)	
ICICI Bank - Parent	95%	94%	92%	88%	84%	82%	80%	-8%	-8%
ICICI UK + Canada	3%	4%	7%	10%	13%	14%	15%	8%	4%
ICICI Home Finance	2%	2%	1%	2%	3%	5%	5%	0%	3%
Total Banking Assets	100%	100%	100%	100%	100%	100%	100%		

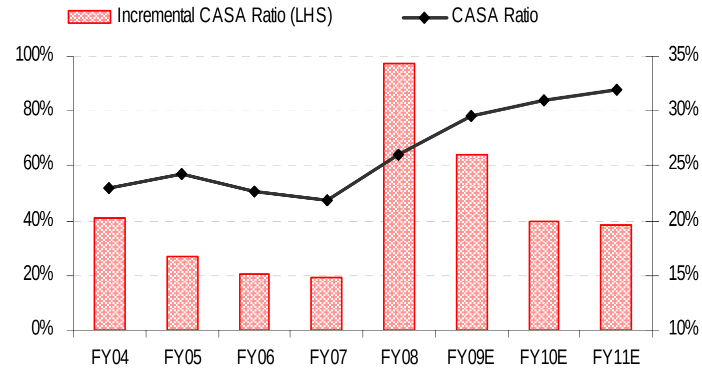
Source: Company, JM Financial. Note: ICICI Canada figures are December ending.

Improving liabilities franchisee: Key focus area

CASA mix to improve to 32% in FY11E: ICICI Bank had pursued growth quite aggressively during FY04-FY07 and had to invariably rely on wholesale term deposits. Hence, CASA ratio remained low during the period, despite low cost deposits showing a robust growth of 47% CAGR during FY04-07 (as term deposits too expanded at 51% CAGR during the same period). With slowdown in its balance sheet growth, substantial branch additions in FY08 and increased focus on strengthening its liabilities franchisee, the bank is set to witness a significant improvement in its low-cost deposits mix. In FY08, low-cost deposits mix improved by 4.3% to 26.1% and we expect it to further improve to ~32% by FY11.

Exhibit 13: CASA Trends

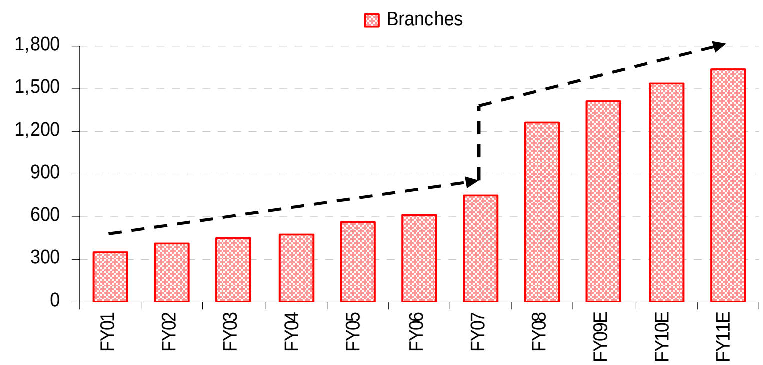




Source: JM Financial, Company.

Significant branch expansion to improve liability franchisee: The bank has added 126 branches in FY09 so far, over and above the 507 branches that it added during FY08 (including ~190 branches from Sangli Bank, of which about 100 are in rural and semi-urban areas). Of the total network, over 35% of the branches are in rural and semi-urban areas (as against RBI's stipulation of at least 25%). Significant branch additions would help ICICI Bank to reach a larger section of customers with an array of products and services and help the bank to expand its retail deposit franchisee. The bank is focused on improving the low-cost deposit mix with the intention to reach levels of ~33-35% over the next 2-3 years.

Exhibit 14: Branch Network

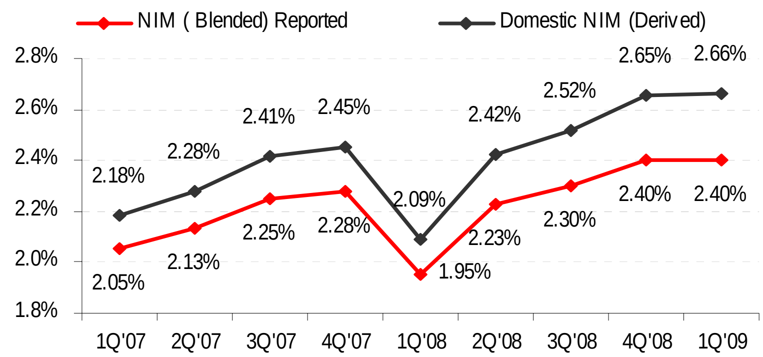


Source: Company, JM Financial.

Domestic margins showing strength

While the reported blended NIM of the bank is on an uptrend during the past couple of quarters, expansion in domestic NIM is even higher by 10 bps than that in blended NIM. Blended NIM is negatively impacted by lower NIM (around 1%) earned for assets of foreign branches, proportion of which has increased from 11.8% in FY07 to 15.4% in FY08.

Exhibit 15: Blended NIM (reported)* & Domestic NIM (derived) (%)



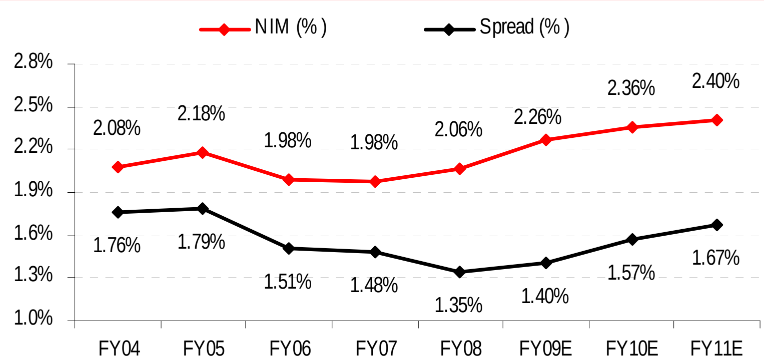
Source: Company, JM Financial. * Blended NIM as reported by ICICI Bank.

NIM to further improve: There has been significant improvement in margins during the recent quarters despite substantial CRR hikes and monetary tightening. Expansion in NIM has been supported by: a) improvement in liabilities franchisee (low-cost deposits mix improved by 4.3% to 26.1%), b) Increased focus on pricing as against aggressively growing the balance sheet and c) substantial capital infusion in July'08. We expect NIM to improve further to 2.4% in FY11 from 2.06% in FY08.

Interest spreads to start rising: Interest spread is a more appropriate reflection of margins as it excludes the impact of equity. The declining trend in interest spreads is expected to reverse from FY09 onwards and we expect around 30 bps expansion over the next 2-3 years.

NII to grow at ~20% CAGR during FY08-11E driven by improving margins, despite a slowdown in assets growth to ~13% CAGR during the same period.

Exhibit 16: NIM & Spreads (%)



Source: Company, JM Financial.

Cost containment to support profitability

Cost containment - key focus area: Cost ratios are expected to show considerable improvement in FY09 driven by significant decline in DMA (due to decline in disbursements) and other cost containment measures undertaken by the bank.

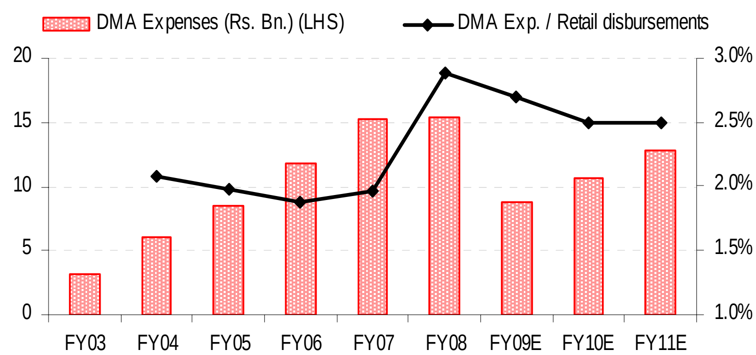
Exhibit 17: Operating Expenses Increase (%)

Increase YoY (%)	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Employee Cost	35%	35%	47%	49%	29%	17%	19%	15%
DMA Expenses	88%	42%	38%	29%	1%	-43%	23%	20%
Other Operating Expenses	20%	20%	32%	29%	28%	19%	20%	17%
Total Operating Expenses	33%	27%	36%	34%	22%	7%	20%	17%

Source: Company, JM Financial.

DMA expenses declined by ~40% yoy in 1Q'09 and we expect this trend to continue in FY09.

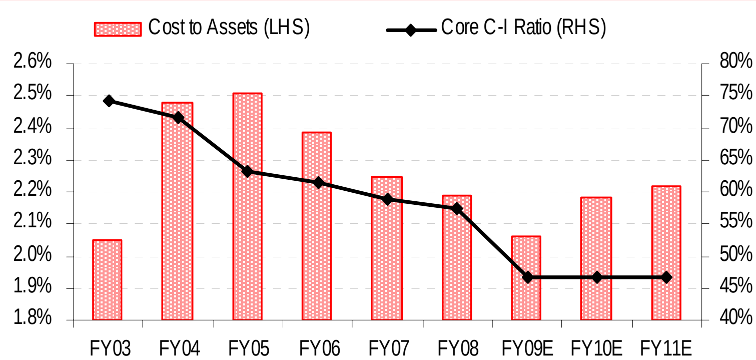
Exhibit 18: DMA Expenses



Source: Company, JM Financial.

Cost ratios to improve in FY09: Employee expenses growth is expected to moderate due to moderation in wage inflation, employee rationalisation and increased focus on productivity. Initiatives to contain other operating expenses (like on advertisement, etc.) and decline in DMA expenses will result in overall moderation in increase in expenses. We expect operation expenses to increase by ~7% in FY09 and cost to assets ratio to decline by 13 bps to 2.06% in FY09. Core cost to income is expected to show an improvement of 10.8% to ~47% in FY09.

Exhibit 19: Cost Ratios (%)



Source: Company, JM Financial.

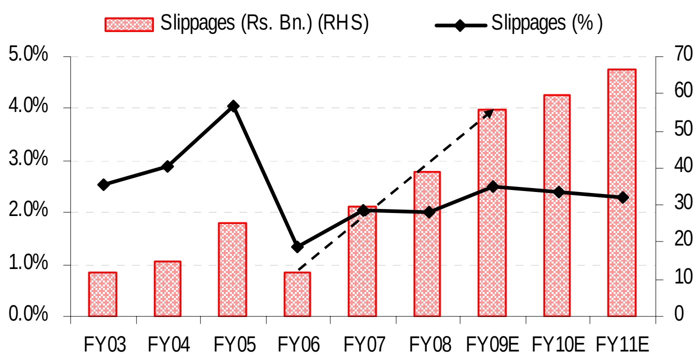
NPL trends to stabilise in FY10

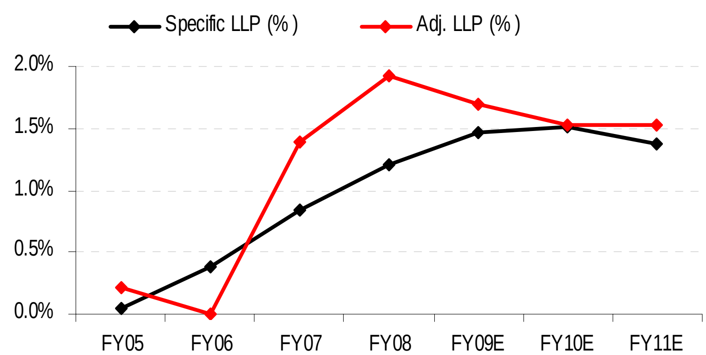
During the past few years, ICICI Bank aggressively pursued growth and scaled-up its retail business quite rapidly. Till 4Q'07 the bank continued with robust retail disbursements. However, with the rise in interest rates and resultant pressure on credit quality, the bank started scaling down its retail disbursements from FY08 onwards. And visibly during the past couple of quarters the focus of the bank has shifted from pursuing aggressive growth to consolidating the retail portfolio, improving the credit quality and containing delinquencies.

Delinquency levels for ICICI Bank (primarily emanating from the uncollateralised retail book) have increased quite significantly from FY07 onwards. And we expect the rising trend to continue even in FY09 and would start stabilising from FY10 onwards. Consequently, LLP charge too has risen quite sharply during the past 2 years.

We expect LLP (including provisions for standard advances) to increase from 1.28 bps in FY08 to 160 bps FY10 and then improve to 1.48 in FY11. Adjusted LLP also incorporates change in the levels of absolute Net NPLs, which is expected to show improvement in FY09.

Exhibit 20: Slippages (%) and Loan loss provisioning

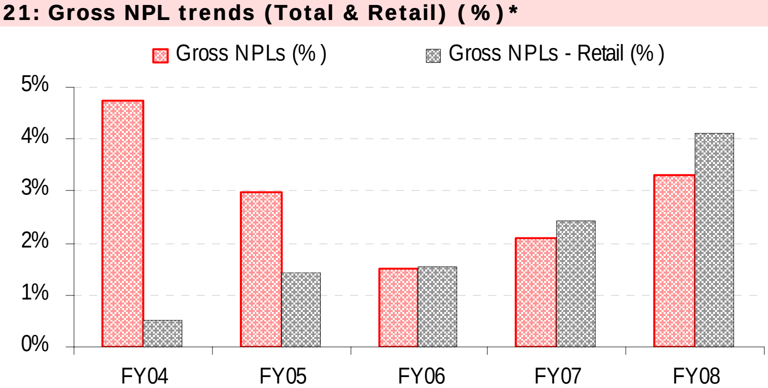




Source: JM Financial, Company. Note: Adj. LLP - Adjusted for change in absolute Net NPLs.

Uncollateralised retail loans a problem zone: The worsening asset quality at ICICI Bank has been primarily driven by significantly higher delinquencies in the uncollateralised retail book. Gross non-collateralised retail NPLs increased significantly from 8.9% in FY07 to ~13% in FY08 (and at the net levels from 3.9% in FY07 to 6.2% in FY08).

Exhibit 21: Gross NPL trends (Total & Retail) (%)*

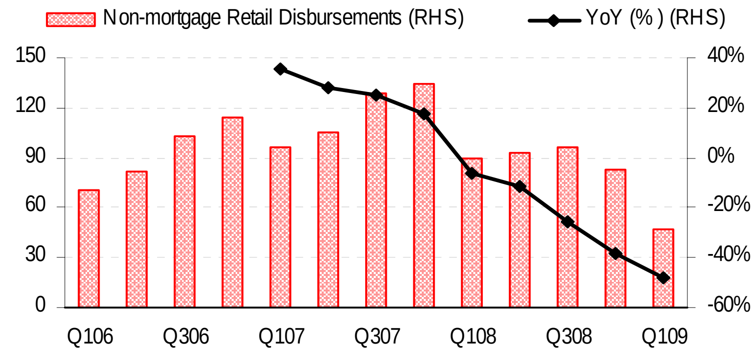


Source: Company, JM Financial. * Ratios of NPL are pertaining only to advances

Remedial measures - slowdown in retail disbursements and exit from riskier segments:

With rising interest rates, tightening monetary policy and increase in delinquencies, ICICI Bank started slowing down its retail disbursements (particularly the non-collateralised segment) from 1Q'08 onwards and exited from few of the riskier segments like small ticket personal loans (exited in Nov'07).

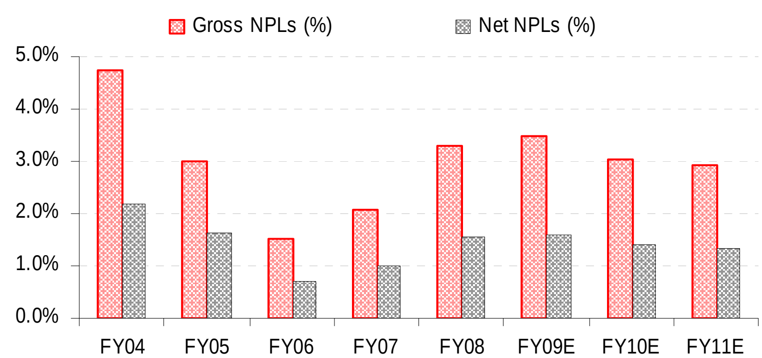
Exhibit 22: Non-mortgage retail disbursements



Source: Company, JM Financial.

NPL trends to stabilise FY10 onwards: We believe the impact of these remedial measures and enhanced focus on credit quality would be visible from FY10 onwards leading to stabilising trend in delinquencies and LLP.

Exhibit 23: Gross & Net NPL trends (%)*



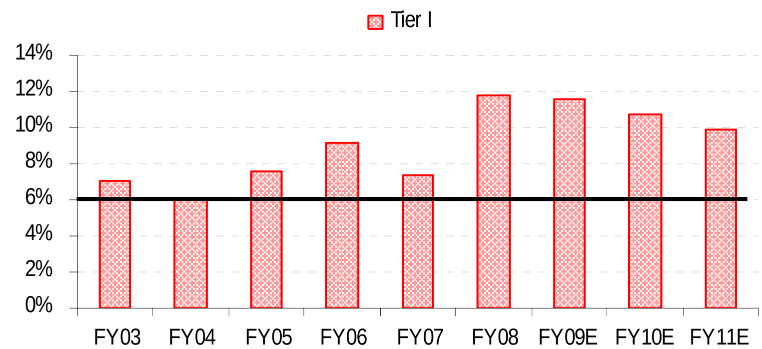
Source: Company, JM Financial. * Ratios of NPL are pertaining only to advances

Significant release of Tier 1 capital under Basel II

There has been significant release of Tier 1 capital for ICICI Bank under Basel II as under the new norms, 50% of investments in subsidiaries is deducted from Tier I (as against 100% in Basel I) and rest 50% from Tier II capital. Accordingly, as per Basel II, ICICI Bank had a Tier 1 ratio of 11.76% vs. 11.32% as per Basel I norms.

However, given the significant equity issuance in FY08, ICICI Bank would remain over-capitalised over the next couple of years (unless the assets growth is significantly higher than our expectations going ahead).

Exhibit 24: Tier I (%)



Source: Company, JM Financial.

Exhibit 25: Tier I (%)

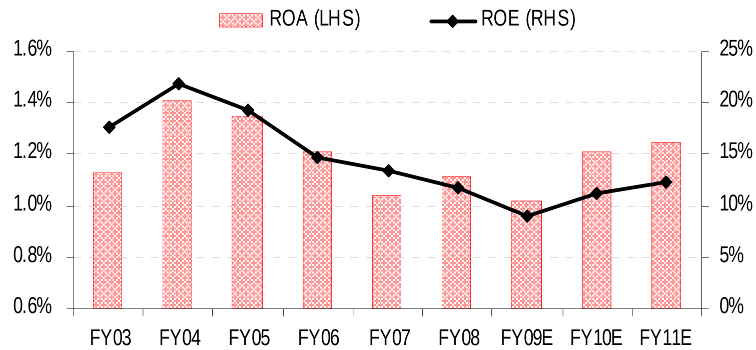
	Basel I	Basel II
RWAs (Rs. Bn)	3,368	3,585
Tier I	11.32%	11.76%
Tier II	3.60%	2.20%
CAR	14.92%	13.97%

Source: Company, JM Financial.

Standalone valuations

While we expect Parent's balance sheet growth to slowdown considerably to ~14% CAGR during FY08-11E, we expect the bank to undergo a significant fundamental improvement that would help ROA to improve to ~1.20% in FY10 post a 10 bps decline in FY09. However, given the significant dilution, we expect ROE of ICICI Bank to remain below historical averages over the next 3 years (12.3% in FY11E).

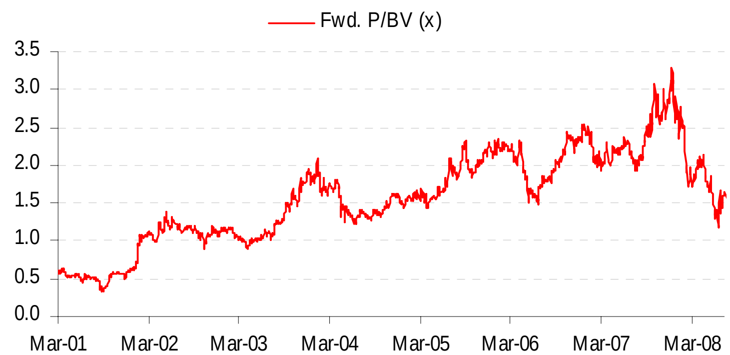
Exhibit 26: ROA and ROE Chart



Source: Company, JM Financial.

Based on a normalised ROE of 15%, we value the stock at 1.25x book (on 2-stage Gordon growth model), implying 12 month forward standalone value of Rs. 550 per share of ICICI bank, contribution of 55% to our target Price of Rs. 1,000.

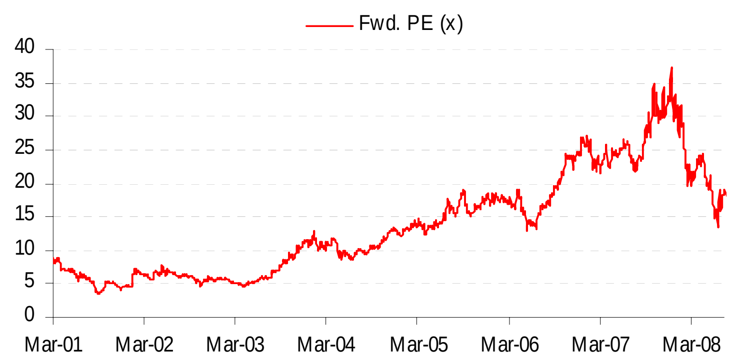
Exhibit 27: One-year Fwd P/BV (x)



Source: Company, JM Financial.

The standalone value of Rs. 550 per share would imply P/E of 10.6x FY10E EPS.

Exhibit 28: One-year Fwd PE (x)



Source: Company, JM Financial.

ICICI Bank: Normalised ROE

Based on a normalised ROE of 15%, we value the stock at 1.25x book (on 2-stage Gordon growth model), implying 12 months forward standalone value of **Rs. 550** per share of ICICI bank, contribution of 55% to our **target Price of Rs. 1,000**.

Exhibit 29: Normalised Earnings (%)

ICICI Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	2.40%	1.98%	1.98%	2.06%	2.26%	2.36%	2.40%
NIM (as % of avg. Assets)	2.26%	1.85%	1.86%	1.94%	2.13%	2.22%	2.27%
Core Non-IR/Asset	2.37%	2.05%	1.96%	1.88%	2.30%	2.45%	2.48%
Core Non-IR/Revenues	51.3%	52.6%	51.4%	49.2%	52.0%	52.4%	52.3%
Core Revenue / Assets	4.63%	3.89%	3.82%	3.82%	4.43%	4.67%	4.74%
Cost/ Core Income	47.5%	61.3%	58.8%	57.4%	46.6%	46.8%	46.7%
Cost/Assets	2.20%	2.39%	2.24%	2.19%	2.06%	2.19%	2.22%
Core operating Profits	2.43%	1.50%	1.57%	1.63%	2.37%	2.49%	2.53%
LLP/Loans	1.20%	0.67%	1.26%	1.28%	1.53%	1.60%	1.48%
Loans/Assets	58.0%	56.7%	57.4%	56.6%	56.8%	57.4%	57.9%
Profits/Provisions on Sect.	0.00%	-0.33%	-0.34%	-0.43%	0.19%	-0.05%	-0.05%
Pre-Tax	1.73%	1.46%	1.19%	1.33%	1.31%	1.62%	1.72%
Effective Tax Rate	27.0%	17.7%	14.1%	17.4%	22.0%	25.0%	27.5%
ROAA	1.26%	1.20%	1.02%	1.10%	1.02%	1.21%	1.24%
Equity / Assets	8.40%	8.29%	7.80%	9.51%	11.37%	10.78%	10.12%
RoE	15.0%	14.6%	13.4%	11.7%	9.0%	11.3%	12.3%
Adjusted BV	503						
PV of Adj BV	352						
g (high growth phase, FY11-16E)	17.5%						
g (perpetual)	5%						
COE	14.5%						
Current Price	729						
Fair P/BV	1.25x	(2 stage Gordon Growth Model)					
Current Fair Value	482	12 months standalone per share value (August 2009) = Rs. 550					

Source: Company, JM Financial.

Key Risks

Higher than expected delinquencies - Key Risk: Given the uncertain and difficult macro-economic environment and bank's significant uncollateralised book, we have built-in higher delinquencies for ICICI Bank in our projections. We expect LLP to increase from 1.28 bps in FY08 to 160 bps FY10 and then improve to 1.48 in FY11. Higher than expected slippages remains the key risk to our expectations.

Slowdown in life insurance premium growth: Lower than expected growth rates in new business life insurance premium will adversely impact the valuation of ICICI Prudential Life and consequently the parent's stock price.

Lower than expected assets growth and profitability in UK and Canada subsidiaries: Slower than expected assets growth in the UK and Canada subsidiaries will impact profits and valuations for the international subsidiaries. Also any significant widening of credit spreads will lead to MTM loss on its investment book and impact profits.

Upsides to our estimates

Possible upsides to our standalone estimates would be a) Possibility of write-back of MTM provisions on credit derivate exposures if the credit market improves, b) easing of inflation, interest rates and monetary policy leading to reversal of treasury losses on bond portfolio and improvement in NIM on account of CRR cuts, c) higher than expected balance sheet growth and d) lower than expected delinquencies and hence lower LLP charge.

Subsidiaries: Continue to create value

Apart from non-banking companies, banking subsidiaries too are expected to create significant value for ICICI Bank over the next 2-3 years. While parent bank is expected to moderate growth, its subsidiaries would maintain robust growth trends. Subsidiaries contribute Rs. 450 (45%) to our target price of Rs. 1,000 for ICICI Bank.

ICICI Prudential Life Insurance (Per share value: Rs. 230)

Private sector to continue to gain market share: We expect the Indian life insurance industry to grow at 20% CAGR (APE basis) for FY08-11E. In our opinion, market share gains for the private sector will continue and we expect the private players to occupy ~67% of the market by FY2011E vs. 52% in FY08 (APE basis) implying a CAGR of 31% for the private players and 7% for LIC. Rapid expansion of the distribution network, new product launches and aggressive marketing should ensure further market share gains for the private players.

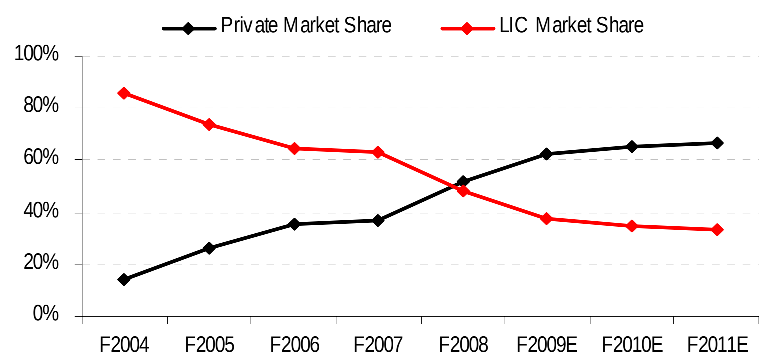
While in our opinion, the structural growth story for Indian life insurance sector is intact, the recent equity market turmoil would impact the near term growth rates. Consequently we expect the market to grow at 22% (APE basis) in FY09E as against 31% in FY08.

Exhibit 30: Indian Insurance industry trends

Rs bn	F2004	F2005	F2006	F2007	F2008	F2009E	F2010E	F2011E
Private Players								
Regular New Business Premium	20	42	75	155	288	427	531	644
Single New Business Premium	4	13	27	40	50	60	83	87
Total New Business Premium	24	56	103	196	338	488	614	731
Private sector APE	21	44	78	159	293	433	540	653
Growth YoY (%)		*109%*	*79%*	*104%*	*84%*	*48%*	*25%*	*21%*
LIC								
Regular New Business Premium	118	114	129	239	236	220	250	289
Single New Business Premium	52	86	127	320	356	371	376	394
Total New Business Premium	170	200	256	559	592	591	626	684
LIC APE	123	122	142	271	271	257	288	329
Growth YoY (%)		*0%*	*16%*	*91%*	*0%*	*-5%*	*12%*	*14%*
Total Market	144	166	220	430	564	690	827	981
Growth YoY (%)		*16%*	*33%*	*95%*	*31%*	*22%*	*20%*	*19%*

Source: IRDA, Company, JM Financial.

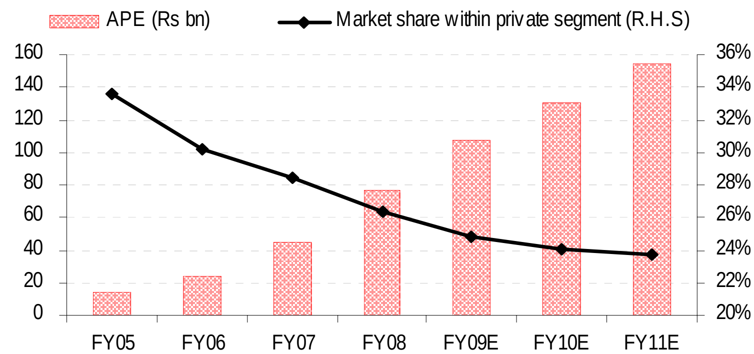
Exhibit 31: LIC vs. Private Players Market share trends



Source: IRDA, Company, JM Financial.

ICICI Prudential Life Insurance Company is a joint venture between ICICI Bank and Prudential Plc (UK) with ICICI Bank having 74% stake and the remaining 26% held by Prudential PLC. It is the second largest life insurance company in India by premium written after public sector insurer Life Insurance Corporation of India (LIC). ICICI Prudential Life Insurance is the market leader amongst private life insurance companies with a market share of ~ 26.3% on an APE basis in FY08. ICICI Prudential Life Insurance recorded a total new business premium of ~Rs. 83 bn during FY08 vs 52.5 bn in FY07. We expect 26% CAGR in new business premium (APE basis) over FY08-11E with market share at ~25% implying that ICICI Prudential Life will continue its leadership position within the private players.

Exhibit 32: ICICI Prudential: Trend in APE (Rs bn) and market share



Source: Company, JM Financial.

Distribution network: Since FY05, ICICI Prudential has rapidly expanded its distribution network with 5x expansion in agency force to ~0.3 mn and 20x expansion in branch network to 1,956 currently. Significant expansion in the distribution network coupled with improvement in productivity levels should ensure 26% CAGR in new business premium (APE basis) for ICICI Prudential Life.

Exhibit 33: ICICI Prudential Life distribution network

	March-05	March-06	March-07	March-08
Agents	57,000	72,000	234,000	291,000
Branches	107	177	583	1956

Source: Company, JM Financial.

Valuation: Using appraisal based valuation; we value ICICI Prudential Life at Rs 302 bn (on 11x NBAP) implying value of Rs 230 per share for ICICI Bank on 12 month forward basis, contributing 23% to our target price for ICICI Bank.

Exhibit 34: ICICI Prudential Life: Valuations

ICICI Prudential Life Insurance	Rs bn
FY09E APE for ICICI Prudential Life(Rs mn)	107.7
Private Players FY09E APE	433.2
ICICI Prudential Life Market Share within private players	~25%
NBAP Margin	19%
NBAP	20.0
Multiple	11.0
Structural Value	220.3
Embedded value	82.2
Appraisal Value	302.5
ICICI Bank Economic interest (%)	74%
Value for ICICI Bank	223.4
Per share value for ICICI Bank (12 months forward)	230

Source: Company, JM Financial

Exhibit 35: Sensitivity to NBAP multiple

Sensitivity	NBAP Multiple		
	11	13	15
Per share value for ICICI Bank (Rs) (12 month forward)	230	260	290

Source: Company, JM Financial.

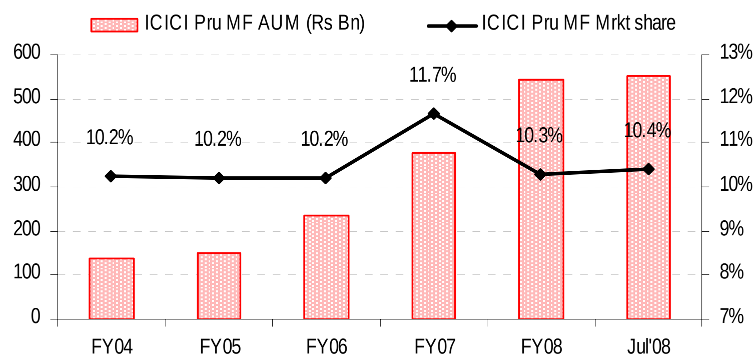
Proposed Insurance reforms would be a significant positive: The government is proposing to raise FDI insurance from 26% to 49%. If the reform goes through, it would be significantly positive for the Insurance sector. For ICICI Bank, it would provide an opportunity to unlock substantial value by selling its stake to its Insurance partner, Prudential Life. In our opinion, if the stake sale happens it would be at least at the valuation at which last capital infusion by the partners happened into the Insurance JV and can generate Rs. 129 bn for ICICI Bank for 23% stake sale. The last capital infusion valued the company at Rs. 560 bn (US$ ~13 bn) and implies value of Rs. 373 per share for ICICI Bank. However, we have valued ICICI Prudential life at Rs. 230 per share for ICICI Bank.

ICICI Prudential AMC (Per share value: Rs. 17)

ICICI Prudential AMC is the second largest mutual fund house in India with assets under management (AUM) of ~Rs.552 bn as on July'08 and market share of ~10%. AUM of the company has expanded at 41% CAGR durring FY04-08. ICICI Prudential AMC achieved a net profit of Rs 821 mn in FY08 vs. Rs 484 mn in FY07. It has a debt-equity mix of ~70:30 which we expect will remain stable going forward.

The Indian MF industry grew 75% yoy in FY08, helped by buoyant markets. While the near term growth is expected to remain muted on account of capital market weakness, we expect long term growth to remain strong for the industry. In our opinion strong growth for MF industry would be led by robust economic growth and increasing allocation of financial savings towards MF products (we expect MF penetration to improve significantly from the current levels of ~12%) supported by favorable demographic profile, increased penetration to non-metros, introduction of innovative products, and improved regulatory standards.

Exhibit 36: ICICI Prudential AMC: Trend in AUM (Rs bn) and market share (%)



Source: Company, JM Financial.

Valuation: We have valued ICICI Prudential AMC at Rs. 33 bn (6% of the AUM), implying value of Rs. 17 per share for ICICI Bank on 12 month forward basis, contributing 1.7% to our target price for ICICI Bank.

Exhibit 37: ICICI Prudential AMC: Valuations

ICICI Prudential AMC	
July'08 AUM for ICICI Prudential AMC (Rs bn)	552
Industry AUM FY09E (Rs bn)	5,296
ICICI Prudential Life Market Share	10.4%
Valued at % of AUM	6%
Value (Rs bn)	33
ICICI Bank holding (%)	51%
Per share value for ICICI Bank (12 months forward)	17

Source: Company, JM Financial.

Exhibit 38: Recent MF Industry Deals

Acquisition Date	Acquirer	Target	Stake (%)	AUM (Rs mn)	Valuation (% of AUM)
Mar-08	IDFC	Standard Chartered MF	100%	141,800	5.8%
Dec-07	Eton Park	Reliance Capital AMC	5.0%	770,000	13.0%
Mar-07	Robeco Group NV	Canara Bank MF	49.0%	22,000	10.7%
Oct-05	BNP Paribas	Sundaram MF	49.9%	27,790	7.2%
Sep-05	SBI, BOB, PNB, LIC	UTI MF	100%	249,690	5.0%

Source: Company, JM Financial.

ICICI Venture Funds Management (Per share value: Rs. 10)

ICICI Venture is one of the largest private equity firms in India with assets under management of ~US$ 2.6 bn. The AUM comprises of private equity assets and real estate funds. The company has aggressive target of AUMs close to US$ 10 bn by FY10 by raising PE fund, an infrastructure fund and a real estate fund. However, given the uncertain macro environment and weak markets, raising so much capital would be a challenging task. Hence, we are valuing ICICI Ventures on current AUM of ~US$ 2.6 bn by benchmarking it with other listed global peers.

Exhibit 39: ICICI Ventures: Valuations

ICICI Ventures	
Current AUM for ICICI Ventures (Rs bn)	95.5
Valued at % of AUM	10%
Value (Rs bn)	0.96
ICICI Bank holding	100%
Per share value for ICICI Bank (12 months forward)	10

Source: Company, JM Financial.

Exhibit 40: ICICI Ventures: Global Comparison

Global Comparisons (Rs. Bn)	MCap	AUM	Mcap / AUM (%)
Blackstone Group	20.1	119.4	16.8%
Fortress Investment Group	4.1	35.1	11.8%

Source: Company, JM Financial.

ICICI Securities (Per share value: Rs. 23)

ICICI Securities provides Investment banking & broking services to institutional and retail investor clients. During FY07, ICICI Web Trade Ltd has been merged with ICICI Securities. Consequently, ICICI Direct with customer base of ~ 1.5 mn is now a part of ICICI Securities. We have valued ICICI Securities at Rs. 22.5 bn at 15x FY08 PAT (implying 1.25x FY08 book) (by benchmarking it to other listed players). This implies value of Rs. 23 per share for ICICI Bank on 12 month forward basis, contributing 2.3% to our TP.

Exhibit 41: ICICI Securities: Valuations

ICICI Securities	
FY08 PAT of ICICI Securities (Rs. bn)	1.51
Valued at (x) multiple to FY08 PAT	15x
Value (Rs bn)	22.5
ICICI Bank holding	100%
Per share value for ICICI Bank (12 months forward)	23

Source: Company, JM Financial.

Exhibit 42: ICICI Securities: Peer Comparison

Peer Comparison (Rs. Bn.)	Current Mcap	PAT		PE	
		FY08	1Q'09	FY08	1Q'09*
Edelweiss Capital	46.1	2.7	0.6	16.9	18.1
India Infoline	43.2	1.6	0.5	27.0	21.8
Indiabulls Securities	19.7	2.5	0.4	7.8	13.2
Motilal Oswal	15.0	1.7	0.3	8.8	14.3
Geojit Financial	10.1	0.6	0.1	17.3	35.6
Average				15.5	20.6
* on annualised basis					

Source: Company, JM Financial.

ICICI Bank: SOTP valuations

Valuation: Post the substantial dilution, ROE of the bank is expected to recover by 330 bps to 12.3% in FY11. Based on a normalised ROE of 15%, we value the stock at 1.25x book, implying standalone per share value to Rs. 550. We value subsidiaries at Rs. 450 for ICICI Bank, contributing 45% to Aug'09 **TP of Rs. 1,000 (37% upside)**.

Exhibit 43: ICICI Bank: SOTP Valuations

ICICI Bank SOTP	Holding (%)	Valuation Methodology	FY08 PAT Rs. Bn	Value Per Share	Contribution to TP (%)
ICICI Bank - Parent	100%	1.25x book	41.58	550	55%
ICICI Prudential Life	74%	Appraisal value - 11x NBAP	-13.95	230	23%
ICICI Bank UK	100%	10x FY11E PAT	1.55	75	8%
ICICI Bank Canada (CY08)	100%	10x FY11E PAT	0.12	25	3%
ICICI Home Finance	100%	2.2x book	0.70	30	3%
ICICI Lombard	74%	2x book	1.03	30	3%
ICICI Securities	100%	15x FY08 PAT	1.51	23	2%
ICICI Prudential AMC	51%	6% of AUM	0.82	17	2%
ICICI Venture Funds	100%	10% of AUM	0.90	10	1%
ICICI Securities Primary Dealership's	100%	8x FY08 PAT	1.40	10	1%
Total			35.65	1,000	100%

Source: Company, JM Financial.

Financial Tables (Standalone)

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	218,933	307,012	347,063	388,971	444,796
Interest Expenses	163,585	234,842	257,539	283,263	320,757
Net Interest Income (NII)	55,348	72,170	89,525	105,709	124,039
Profit on Investments	10,802	18,121	-6,700	3,500	3,500
Exchange Income	6,440	1,102	8,263	9,502	10,928
Fee & Other Income	52,037	68,885	88,740	107,021	124,835
Non-Interest Income	69,279	88,108	90,303	120,023	139,263
Total Income	124,627	160,278	179,828	225,732	263,301
Operating Expenses	66,906	81,542	86,884	103,934	121,449
Pre-provisioning Profits	57,721	78,736	92,944	121,798	141,852
Loan Loss Provisions	21,593	27,010	36,688	43,717	46,868
Provisions on Investments	419	623	700	500	500
Other Provisions	281	1,443	500	600	500
Total Provisions	22,294	29,076	37,888	44,817	47,868
PBT	35,428	49,660	55,056	76,980	93,984
Tax	5,005	8,661	12,112	19,245	25,846
PAT (Pre-Extra ordinaries)	30,423	40,999	42,944	57,735	68,139
Extra ordinaries (Net of Tax)	679	578	0	0	0
Reported Profits	29,744	40,421	42,944	57,735	68,139
Dividend	10,543	13,774	14,395	19,194	23,032
Retained Profits	19,880	27,225	28,548	38,542	45,106

Source: Company, JM Financial.

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	8,993	11,127	11,127	11,127	11,127
Reserves & Surplus	234,139	453,575	482,124	520,665	565,771
Deposits	2,305,102	2,444,311	2,688,742	3,118,940	3,617,971
Borrowings (Incld Sub Debt)	706,611	863,986	995,283	1,152,839	1,341,907
Other Liabilities	191,735	224,952	247,447	284,564	327,249
Total Liabilities	3,446,581	3,997,951	4,424,722	5,088,136	5,864,024
Investments	912,578	1,114,543	1,227,815	1,390,544	1,569,159
Net Advances	1,958,656	2,256,161	2,527,132	2,930,315	3,414,729
Cash & Equivalents	371,213	380,411	409,232	470,601	541,876
Fixed Assets	39,234	41,089	45,944	50,289	55,025
Other Assets	164,899	205,746	214,599	246,387	283,235
Total Assets	3,446,581	3,997,951	4,424,722	5,088,136	5,864,024

Source: Company, JM Financial.

Key ratios (%) (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	39.6%	6.0%	10.0%	16.0%	16.0%
Advances	34.0%	15.2%	12.0%	16.0%	16.5%
Total Assets	37.1%	16.0%	10.7%	15.0%	15.2%
NII	43.1%	30.4%	24.0%	18.1%	17.3%
Non-Interest Income	39.0%	27.2%	2.5%	32.9%	16.0%
Operating Expenses	33.8%	21.9%	6.6%	19.6%	16.9%
Operating Profits	50.0%	36.4%	18.0%	31.0%	16.5%
Core Operating Profits	48.8%	29.2%	64.4%	18.7%	17.0%
Provisions	180.5%	30.4%	30.3%	18.3%	6.8%
PAT	22.4%	33.7%	3.3%	34.4%	18.0%
Yields / Margins (%)					
Interest Yield (%)	7.83%	8.78%	8.77%	8.69%	8.62%
Cost of Funds (%)	6.35%	7.43%	7.37%	7.12%	6.95%
Interest Spread (%)	1.48%	1.35%	1.40%	1.57%	1.67%
NIM (%)	1.98%	2.06%	2.26%	2.36%	2.40%
Profitability (%)					
ROA (%)	1.04%	1.12%	1.02%	1.21%	1.24%
ROE (%)	13.4%	11.7%	9.0%	11.3%	12.3%
Assets Quality (%)					
Gross NPAs (%)	2.08%	3.30%	3.48%	3.06%	2.91%
Net NPAs (%)	1.02%	1.55%	1.60%	1.40%	1.33%
Provision Coverage (%)	51.7%	53.9%	55.0%	55.0%	55.0%
Capital Adequacy (%)					
Tier I (%)	7.42%	11.76%	11.55%	10.70%	9.94%
CAR (%)	11.69%	13.96%	14.80%	13.48%	12.32%

Source: Company, JM Financial.

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	1.86%	1.94%	2.13%	2.22%	2.27%
Other income / Assets (%)	2.32%	2.37%	2.14%	2.52%	2.54%
Total Income / Assets (%)	4.18%	4.31%	4.27%	4.75%	4.81%
Cost to Assets (%)	2.24%	2.19%	2.06%	2.19%	2.22%
PPP / Assets (%)	1.94%	2.12%	2.21%	2.56%	2.59%
Provisions / Assets (%)	0.75%	0.78%	0.90%	0.94%	0.87%
ROA (%)	1.04%	1.12%	1.02%	1.21%	1.24%

Source: Company, JM Financial.

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	899.3	1,112.7	1,112.7	1,112.7	1,112.7
EPS (Rs.)	34.6	37.4	38.6	51.9	61.2
EPS (YoY) (%)	21.2%	8.0%	3.3%	34.4%	18.0%
PE (x)	21.1	19.5	18.9	14.0	11.9
BV (Rs.)	270.3	417.6	443.3	477.9	518.5
P/BV (x)	2.70	1.75	1.64	1.53	1.41
P/BV (x) (ex subsidiaries)	1.03	0.67	0.63	0.58	0.54
DPS (Rs.)	11.7	12.4	12.9	17.3	20.7
Div. yield (%)	1.6%	1.7%	1.8%	2.4%	2.8%

Source: Company, JM Financial.

JM FINANCIAL

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Key Data

Market cap (bn)	Rs543.2 / US$12.9
Shares in issue (mn)	424
Diluted share (mn)	451
3-mon avg daily val (mn)	Rs1,835.2 / US$43.6
52-week range	Rs1,825/ 890
BSE sensex (08/08/08)	15,168
Nifty (08/08/08)	4,530
Rs/US$	42.1

Shareholding Pattern (%)

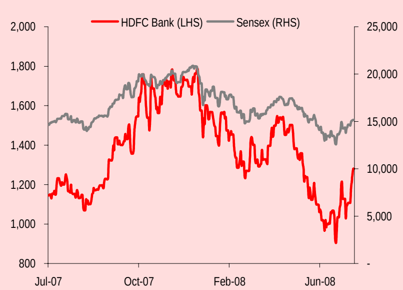
	1Q FY08	1Q FY09
Promoters	24.7	19.4
FIIs	26.5	28.0
MFs/FIs/Banks	8.6	7.8
Public	57.3	25.8
Others (incl. GDR/ADR)	18.0	19.0

Price Performance (%)

	1M	3M	12M
Absolute	21	(12)	13
Relative*	9	(2)	11

** To the BSE Sensex*

Daily Performance



(As of 8 August 2008)

10 August 2008

Initiating Coverage

HDFC Bank

Bloomberg: HDFCB IB

Hold

Price: Rs. 1,280 **Target Price (Aug 09): Rs. 1,300**

Safe Harbour

Substantial accretion to distribution network & customer base in CASA rich states due to eCBoP's merger offers significant opportunities to HDFC Bank. However, the expensive acquisition and resultant dilution would hold the Bank's ROE down to ~16% till FY11. In the times of turbulence, HDFC Bank's strong liabilities franchise is a safe habour, and any decline in stock should be looked as an opportunity.

- **eCBoP valued at ~23% premium to HDFC Bank:** Unarguably, HDFC Bank's fundamentals are far superior to erstwhile CBoP (eCBoP), however the deal valued eCBoP at 11% premium to HDFC Bank (and at 23% premium on adjusted networth basis). Since March 2004, eCBoP has traded at an average 23% discount to HDFC Bank on P/BV basis. We believe its purchase consideration exceeds expected benefits.
- **Excessive Dilution - ROE to remain depressed:** Cumulative dilutions for HDFC Bank since Mar'07 have been to the extent of 41%. Post CBoP's merger, the bank has allotted 26 mn warrants convertible at Rs. 1,530 to HDFC Ltd. to enable it to maintain its stake. Given the significant dilution, we expect ROE of HDFC Bank to remain below historical averages (of ~19%) over the next 3 years at ~16%.
- **Opportunity to leverage the CBoP's under-utilised branch network:** 404 branches of eCBoP is a significant addition of 53% to HDFC Bank's 761 branches. However, the eCBoP's CASA per branch is $1/5^{th}$ as compared to that of HDFC Bank (despite having considerable presence in CASA rich states) & adds 25% to customer base of HDFC Bank. This provides an opportunity to HDFC Bank to strengthen its liabilities franchisee and to reach larger section of customers.
- **However accelerated assets growth cannot be expected:** Though eCBoP is considerably under-leveraged on assets per branch basis; however we do not expect accelerated assets growth for the merged entity. HDFC Bank has expanded its assets at ~33% CAGR during the past four years and we expect slower assets growth of 26% CAGR during FY08-11E.
- **Liabilities franchisee - Key strength:** HDFC Bank's stellar performance in the past has been backed by its strong liabilities franchisee. Low cost and stable funding sources provide it the flexibility to lend at competitive rates and still maintain one of the best margins in the industry. Though we expect CASA ratio to decline to 48% in FY11, it would still be among the best in the industry.
- **Valuations:** Based on a normalised ROE of 19.6%, we value the stock at 2.95x book, implying Aug'09 **target price of Rs. 1,300** - upside of ~2% from the current levels.

Exhibit 1: Financial summary (Proforma Merged) (Rs mn)

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	9,237	12,629	17,358	22,040	28,989	37,114
Net Profit (YoY) (%)	33.7%	36.7%	37.5%	27.0%	31.5%	28.0%
Assets (YoY) (%)	51.4%	29.3%	46.0%	27.8%	26.7%	23.3%
ROA (%)	1.31%	1.30%	1.29%	1.21%	1.25%	1.28%
ROE (%)	16.3%	18.0%	16.8%	15.8%	16.2%	16.6%
EPS (Rs.)	24.1	32.4	40.9	51.9	64.3	82.4
EPS (YoY) (%)	32.6%	34.5%	26.1%	27.0%	23.9%	28.0%
PE (x)	53.1	39.5	31.3	24.6	19.9	15.5
BV (Rs.)	162.3	200.5	302.9	353.3	464.0	529.8
P/BV (x)	7.89	6.38	4.23	3.62	2.76	2.42

Source: Company, JM Financial. Note: Valuations as of 08 August 2008

Exhibit 2: Key Financials (Proforma Merged)

Key Parameters - Merged	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR (03-08)*	CAGR (08-11)E*	Remarks
Balance sheet												
Deposits (Rs. bn)	252	334	399	652	832	1,227	1,595	2,026	2,532	37.2%	27.3%	Strong liabilities franchisee is the key strength of HDFC Bank. Significant accretion in distribution network due to eCBoP merger would further strengthen it.
CASA (Rs. bn)	102	175	231	346	439	602	758	973	1,224	42.6%	26.7%	
CASA Mix (%)	40.5%	52.2%	57.9%	53.0%	52.8%	49.0%	47.5%	48.0%	48.3%	8.5%	0.8%	
Loans (Rs. bn)	131	193	278	416	582	792	1,023	1,305	1,624	43.4%	27.1%	Given the macro-economic environment, retail proportion is is expected to decline, but would still form ~50% of the loan book.
Retail Loans (Rs. bn)	42	84	127	247	352	453	552	678	820	60.8%	21.9%	
Retail Loans Mix (%)	32.2%	43.6%	45.8%	59.5%	60.5%	57.2%	54.0%	52.0%	50.5%	25.0%	-3.5%	
Total Assets (Rs. bn)	338	459	560	848	1,097	1,602	2,047	2,593	3,198	36.5%	25.9%	Expectation of accelerated assets growth would be high, despite assets per branch for eCBoP being significantly lower.
Branches	310	393	566	778	963	1,154	1,304	1,429	1,529	30.1%	9.8%	
Income statement												
NII (Rs. bn)	8.7	13.7	17.6	26.6	40.0	59.3	78.2	99.5	124.7	46.7%	28.1%	Earnings growth to remain strong at ~28% CAGR over FY08-11. Higher LLP to some extent would get neutralised by improvement in cost ratios.
Core operating profits (Rs. bn)	5.1	8.9	12.4	19.0	28.9	39.5	51.5	68.3	87.8	50.6%	30.5%	
PAT (Rs. bn)	3.6	4.0	6.9	9.2	12.6	17.4	22.0	29.0	37.1	36.8%	28.8%	
Profitability												
Interest Spread (%)	2.49%	3.04%	3.05%	3.39%	3.69%	3.85%	3.69%	3.71%	3.75%	1.36%	0.06%	Given the significant dilutions (41% since Mar'07), ROE of HDFC Bank would remain below historical averages over the next 3 years (at close to ~16%).
NIM (%)	3.07%	3.67%	3.62%	3.97%	4.33%	4.62%	4.48%	4.49%	4.50%	1.55%	0.02%	
ROA (%)	1.17%	1.02%	1.36%	1.31%	1.30%	1.29%	1.21%	1.25%	1.28%	0.11%	0.07%	
ROE (%)	16.0%	15.2%	17.3%	16.3%	18.0%	16.8%	15.8%	16.2%	16.6%	0.8%	0.7%	
Asset Quality												
Net NPAs (Rs. Bn)	1.5	1.0	1.2	2.3	3.4	5.5	5.4	6.9	8.2	30.2%	14.2%	Net NPL ratio of eCBoP at ~1.7% was higher than HDFC Bank's level of 0.45%. This would have required additional provisions of Rs. 180 mn (to maintain NNPL ratio at 0.45%), however higher than expected merger related adjustments indicate certain eCBOP's assets have been recognised as NPLs and adjusted.
LLP (Rs. Bn)	1.4	2.8	1.8	5.8	9.5	14.4	17.9	26.6	34.1	59.7%	33.5%	
Slippages (%) ^	2.28%	1.69%	1.52%	3.44%	2.28%	2.85%	2.90%	3.00%	3.00%	0.57%	0.10%	
LLP (%)	1.28%	1.70%	0.78%	1.66%	1.90%	2.09%	1.97%	2.28%	2.33%	0.81%	0.36%	
Key Ratios - HDFCB Standalone												
ROA (%)	1.43%	1.40%	1.42%	1.39%	1.39%	1.42%				-0.01%		
ROE (%)	18.5%	20.6%	18.5%	17.7%	19.5%	17.7%				-0.8%		
Slippages (%) ^	1.57%	1.19%	1.46%	2.23%	2.23%	2.57%				1.0%		
LLP (%)	0.95%	1.21%	0.81%	1.58%	2.10%	2.20%				1.3%		

Source: Company, JM Financial, Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

CBoP Merger: Expensive Acquisition

eCBoP valued at ~23% premium to HDFC Bank

Distribution franchise in the current regulatory framework certainly commands a premium; however, in our opinion the purchase consideration for CBoP's distribution network considerably exceeds the benefits likely to be derived from the expected synergies. Unarguably, HDFC Bank's fundamentals are far superior to eCBoP, however the deal valued eCBoP at 11% premium to HDFC Bank (and at 23% premium if compared on adjusted networth basis).

The deal would look even expensive if **higher than expected merger related adjustments of ~ Rs. 7 bn** are considered, that have been effected through amalgamation reserve account. As per the management, 70% of the adjustments have been on account of alignment of loan loss provisioning and depreciation policies of CBOP with HDFC bank and the balance 30% on account of other merger related expenses. In our opinion, these adjustments are significantly higher than our expectations. Net NPL ratio of eCBoP was at ~1.7%, (as against HDFC bank's level of 0.5%). This would have required HDFC bank to create additional provisions of approximately Rs. 1.8 bn (to maintain NNPL ratio of ~0.5%). Higher than expected adjustments indicate certain eCBOP's assets have been recognised as NPLs and adjusted against networth.

Marginally BV dilutive for HDFC Bank - The share-swap ratio for the merger was 1:29 (shareholders of eCBoP have been allotted 1 share of HDFC Bank for every 29 shares of eCBoP held by them). CBoP merger resulted in 19.7% dilution for HDFC Bank but added 17.8% to its networth and 16% on adjusted basis (and even lower if merger related expenses are considered).

Exhibit 3: Deal valued eCBoP at a Premium

	HDFCB	CBoP	Ratio	Premium
Dilution (share-swap 1:29) (mn)	354	70*	19.7%	
Networth#	115.0	20.4	17.8%	11.0%
Adjusted Networth^	112.0	17.9	16.0%	23.5%
Net NPAs / Networth (%)	3%	13%		

* Shares allotted to CBoP shareholders, # Mar'08, ^ Adjusted for Net NPAs

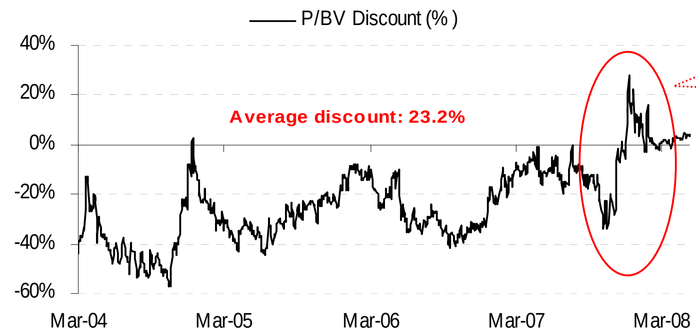
Source: Company, JM Financial.

CBoP merger resulted in 23.5% dilution for HDFC Bank but added 18% to its networth (and 16% on adjusted basis).

eCBoP historically traded at average 23% discount to HDFC Bank

Since March 2004, eCBoP has traded at an average 23% discount to HDFC Bank on P/BV basis. However, the deal valued the bank at ~23% premium to HDFC Bank.

Exhibit 4: eCBoP: Discount to HDFC Bank on P/BV



Run-up in eCBoP stock price on the back of merger rumours.

Source: Company , JM Financial.

Excessive Dilution: ROE to remain depressed

Cumulative dilutions for HDFC Bank since Mar'07 have been to the extent on 41%. Post CBoP's merger, HDFC bank has allotted 26 mn warrants convertible at Rs. 1,530 to HDFC Ltd. to enable it to maintain its stake in the bank. Warrants are convertible into equity shares at any time within a period of 18 months from the date of allotment i.e. by Nov'09. We have assumed the conversion in FY10.

Exhibit 5: Equity Dilution (%)

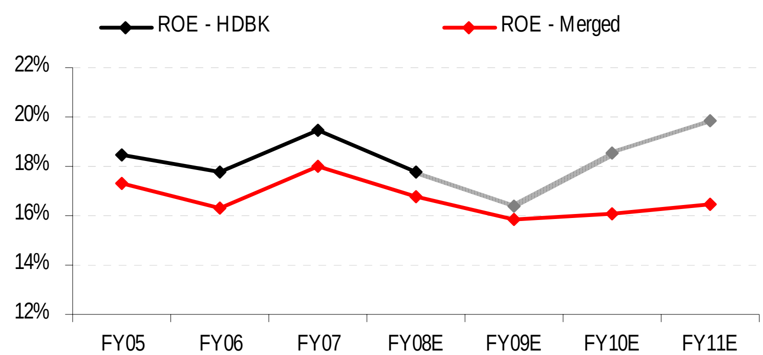
	No. of shares	Dilution
Shares O/S (Mar'07)	319	
Equity Issuance (June/July'07)	33	10.4%
Shares O/S (Mar'08)	354	
Shares allotted to CBoP's Shareholders (May'08)	70	19.7%
Warrants allotted to HDFC Ltd. (June'08)^	26	7.4%
Cumulative dilution since Mar'07 (shares)	129	40.5%

Source: Company, JM Financial. ^Assumed conversion in FY10.

Would take 3-4 years for ROE to reach to historical averages

Given the significant dilution, we expect ROE of HDFC Bank to remain below historical averages over the next 3 years (at close to ~16%).

Exhibit 6: ROE (%)

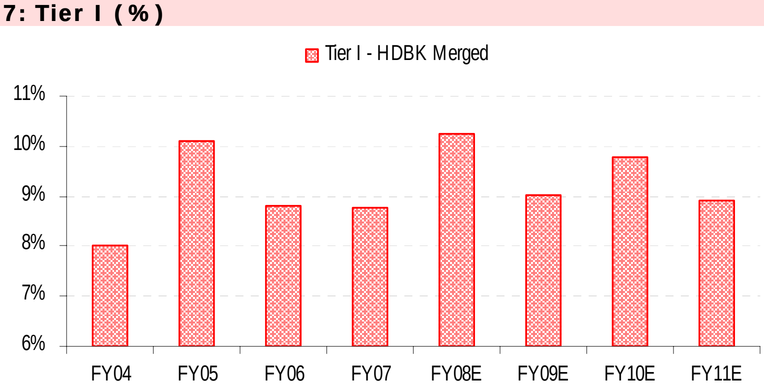


Source: Company, JM Financial.

Tier I: HDFC Bank to remain overcapitalised

Given the significant equity issuance (including warrants allotted to HDFC Ltd.), HDFC Bank would remain over-capitalised over the next couple of years (unless the assets growth is significantly higher than our expectations going ahead).

Exhibit 7: Tier I (%)



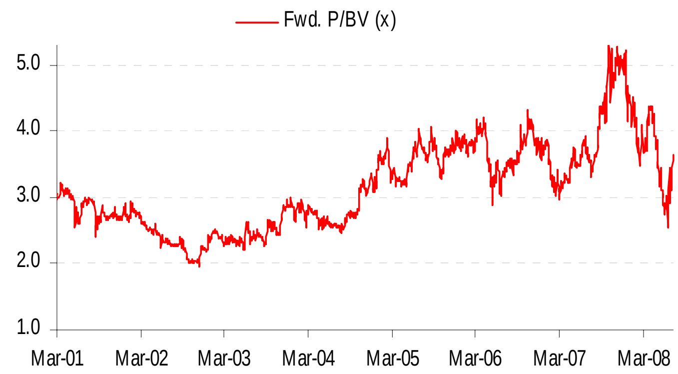
Source: Company, JM Financial.

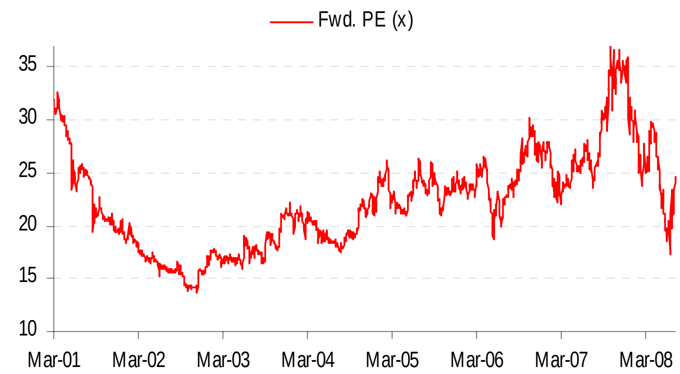
ROE to remain below historical averages

Trading at close to its 5 years averages on P/BV basis

Given the significant dilution, we expect ROE of HDFC Bank to remain below historical averages (of ~19%) over the next 3 years at ~16%. Despite the recent correction, the stock is trading at close to its 5 years averages on P/BV basis, pricing in the merger related opportunities. Hence, while we believe that HDFC Bank would continue to enjoy superior fundamentals and would deliver strong growth, we would wait for a correction to buy into the stock.

Exhibit 8: One-year Fwd P/BV (x) & One-year Fwd PE (x)





Source: JM Financial, Company.

Merger related opportunities priced-in

Substantial accretion to distribution network & customer base in CASA rich states due to eCBoP's merger offers significant opportunities to HDFC Bank. However, we believe these opportunities have been priced-in at CMP.

Under-utilised eCBoP's branches offer considerable opportunities

The branch network of 404 branches of eCBoP is a significant addition of 53% to HDFC Bank's 761 branches. However, the acquisition has added only 20% to the HDFC Bank's assets base and eCBoP's CASA per branch is 1/5th as compared to that of HDFC Bank (despite having considerable presence in CASA rich states). This, in our opinion provides an opportunity to HDFC Bank to leverage eCBoP's under-utilised branch network.

With significant expansion of branch and ATM network post the merger, strong technology infrastructure, superior range of products and high quality retail and wholesale banking services, HDFC Bank would be able to further strengthen its strong liability franchise and reach a larger section of customers. This would help the bank to reduce upward pressure on cost of funds, provide cross-selling opportunities and offer better transaction banking services to its clients. HDFC Bank would also get access to large NRI base from middle-east due to significant branch presence of eCBOP in Kerala.

We also believe there is a significant scope of improvement in cost ratios for the merged entity.

Branches: Significant addition in CASA rich states

The primary reason for a bank to go for inorganic growth in India is to acquire a branch network - which under the current regulatory framework takes time to build up. eCBoP's branch network (404 branches) would be significant 53% addition to HDFC Bank's network (761 branches).

a) **68% of eCBoP branches are concentrated in 5 states -** Though ecBoP branches have high concentration in 5 states, each of these sates offers significant opportunities. These 5 states account ~30% of total system's deposits and credit. Three states of Delhi, Punjab and Haryana (40% of total branches) are CASA rich states, while states of Kerala and Tamil Nadu (28% of branches) offer access to large NRI base from Middle-East (and hence sizeable opportunities in remittance business). These 5 states are also said to enjoy lower delinquencies ratios due to higher per-capita income (and hence opportunities in retail credit).

Exhibit 9: State-wise eCBoP's branches

States	Banking System (FY07)		CBoP Branches (FY08)		Opportunities
	Deposits	Credit	No.	%	
Delhi	12.9%	12.2%	55	13.6%	CASA rich states
Punjab	3.3%	2.7%	78	19.3%	
Haryana	2.3%	1.8%	26	6.4%	
Kerala	3.7%	3.1%	91	22.5%	Remittances business
Tamil Nadu	6.3%	9.4%	24	5.9%	
Others	71.5%	70.8%	130	32.2%	
Total	100.0%	100.0%	404	100%	

Source: Company, JM Financial.

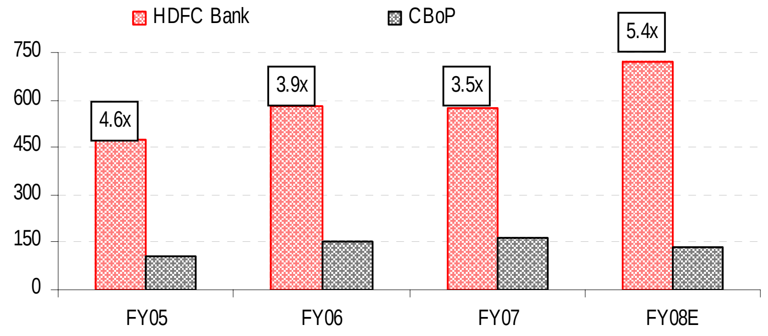
b) **Integration is progressing smoothly -** Given that the two banks enjoyed technological, cultural and compensation structure fit, the integration has been progressing quite smoothly. All systems (retail & corporate banking) would get integrated by the year end. However, HDFC Bank might be required to deal with integration issues with respect to the network of erstwhile Lord Krishna Bank (LKB). LKB was acquired by CBoP in August 2007 and faced significant protest from LKB's employees. Also, integrating 400+ branches and adding another 100+ new branches would be a challenging task for HDFC Bank.

c) **Overlapping branches would be relocated** within the city area to improve the presence. However, possibility of relocating a branch outside a city region is remote.

Liabilities franchisee: Levering up the CASA per branch - key opportunity

CBoP's deposits base, with low CASA mix and high dependence on wholesale bulk deposits has a significant scope of improvement. eCBoP's CASA per branch (and the CASA ratio) is substantially lower than the HDFC Bank's levels. We believe the focus area for HDFC bank would be to lever up the CASA per branch of eCBoP (given that it has high presence in CASA rich states) and further strengthen its liabilities franchisee of the merged entity.

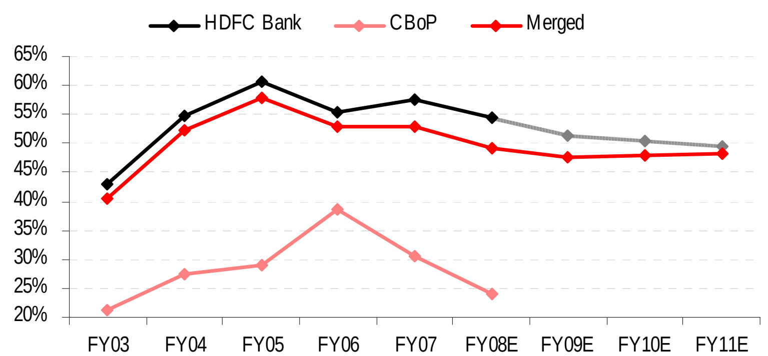
Exhibit 10: CASA per Branch (Rs. mn.)



Source: Company, JM Financial.

HDFC Bank had enjoyed CASA ratio of close to 55% over the past several years. However, with its the growing balance sheet size, increasing competition among the banks for low-cost deposits and changing macro-economic environment, it would have become increasingly difficult for HDFC Bank to sustain such higher levels of low-cost funds (although we believe it would still have been well above industry average). Hence, eCBoP significant branch addition is expected to have a stabilising effect on the CASA ratio of the merged entity. Integration of CBoP's substantial branch network coupled with HDFC Bank's strong technology infrastructure, superior range of products and high quality retail and wholesale banking services would help the merged entity to continue to expand its deposit franchisee.

Exhibit 11: CASA Mix (%)



Source: Company, JM Financial.

Low-cost deposit ratio at 49% (merged) as on Mar'08 is among the best in the industry and we expect the ratio to remain stable going ahead (~48% in FY11).

HDFC Bank's stellar performance in the past has been backed by its strong liabilities franchisee

Low cost and stable funding sources and large retail customer base has provided HDFC Bank the flexibility to lend at competitive rates to the customer segments with better credit risk profile and still maintain one of the best margins in the industry.

Retail deposits have been the key focus area for the bank as it provides low cost and relatively stable funding base. While 64.2% of its total deposits are retail deposits, 70% of its CASA deposits are retail in nature. Also corporate salary accounts constitute significant proportion of retail savings deposits by value. During FY08, average savings balance per account was close to Rs. 40,000. All these factors reflect high quality of funds of the bank.

Exhibit 12: Retail deposits base (%)

Retail Deposits	March, 2006			March, 2007		
	Rs. bn	%	% of Total*	Rs. bn	%	% of Total*
Savings	153.1	44.1%	94.6%	184.9	42.2%	94.4%
Current	70.8	20.4%	48.0%	91.2	20.8%	46.0%
Time	123.5	35.6%	49.7%	162.3	37.0%	56.1%
Total	347.3	100%	62.2%	438.4	100%	64.2%

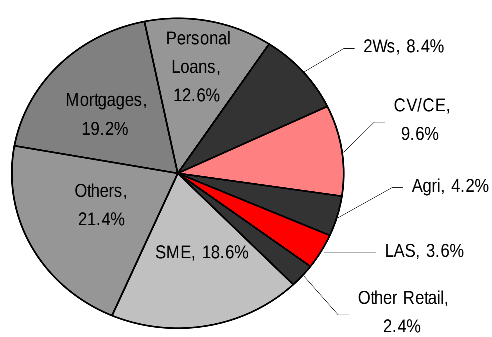
Source: Company, JM Financial. *Retail deposits in each category of deposits.

HDFC Bank also enjoys substantial free float generated by its transactional banking services like cash management, stock exchange clearing, banker to IPOs, correspondent banking services, and tax collection. All these services, apart from generating decent fee income also help to reduce the cost of funds.

Loans: eCBoP's retail concentration complements HDFC Bank's loan book

Retail portfolio constitutes 60% and 53% of the total loan book for eCBoP and HDFC Bank respectively. Except for mortgage portfolio on eCBoP's book (Rs. ~29 bn, and would probably be sold to HDFC Ltd), the loan book of both the banks complement each other and we do not see any integration issues.

Exhibit 13: eCBoP Loan Mix (%)



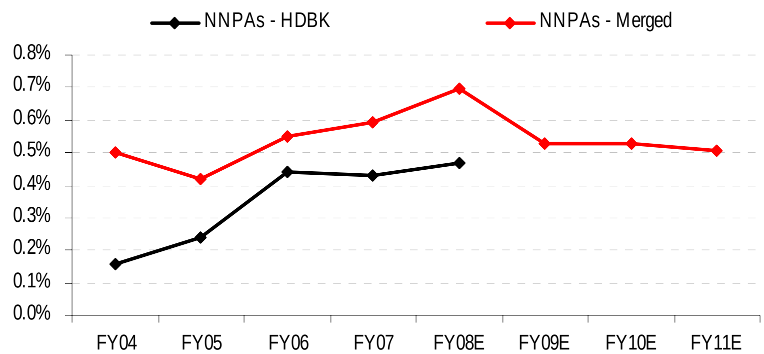
Source: Company, JM Financial.

Asset Quality: Higher than expected merger related expenses

Net NPL ratio of eCBoP at ~1.7% was higher than HDFC bank's level of 0.45%. While this would have required HDFC Bank to create additional provisions of Rs. 180 mn (to maintain NNPL ratio of 0.45%), however higher than expected merger related adjustments indicate certain eCBOP's assets have been recognised as NPLs and adjusted against networth. Merger related adjustments of ~Rs. 7 bn have been effected through amalgamation reserve account. As per the management, 70% of the adjustments have been on account of alignment of loan loss provisioning and depreciation policies of CBOP with HDFC bank and the balance 30% on account of merger related expenses.

Net NPL ratio of merged entity stands at 0.51% as on 1Q'09. Any further unexpected slippages from CBoP's books (particularly LKB's) would impact profitability.

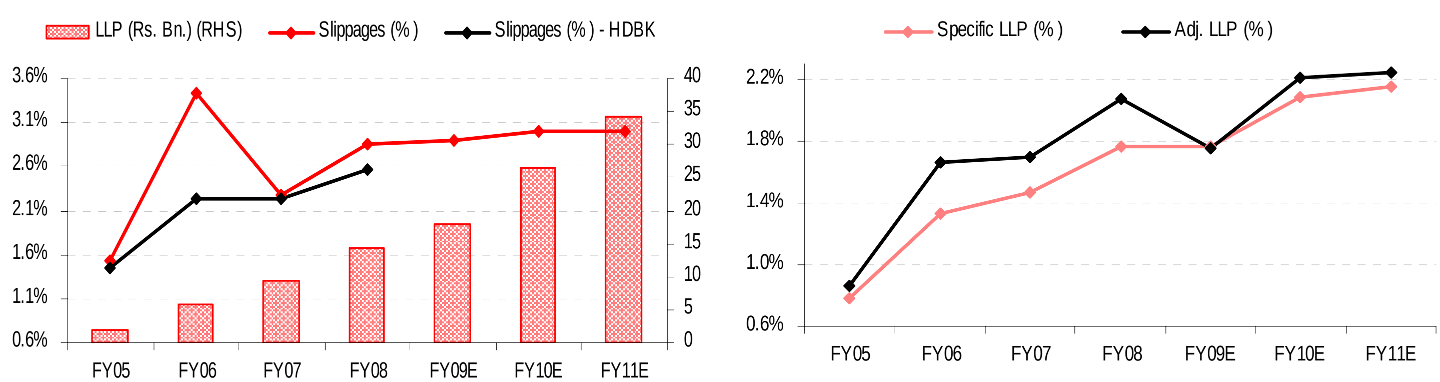
Exhibit 14: Net NPAs (%)



Source: Company, JM Financial.

Slippages for HDFC Bank, both in absolute terms and as a percentage of opening standard assets, has been on the rise since FY04, reflecting a changing balance of risk and returns due to a change in product mix. Going ahead, we expect the slippages to stabilise close to ~2.8-3.0% for the merged entity.

Exhibit 15: Slippages (%) and Loan loss provisioning (merged)

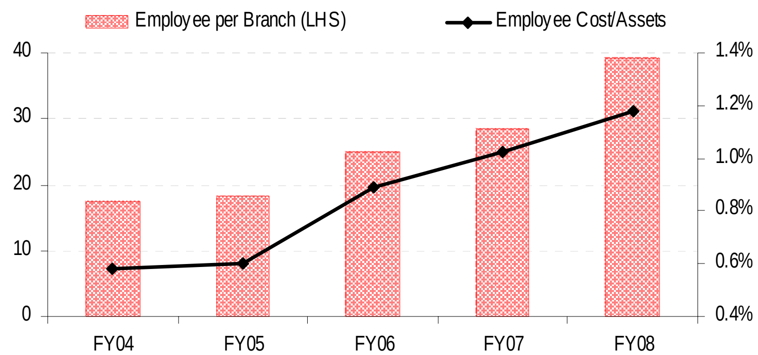


Source: Company, JM Financial. Note: Adj. LLP - Adjusted for change in absolute Net NPLs.

Cost ratios: Significant scope of improvement

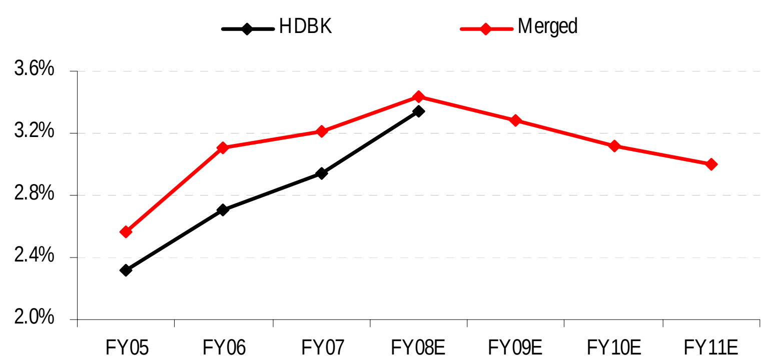
In our opinion, there would be considerable scope of cost rationalisation post the merger. Employee per branch for HDFC Bank (merged) has moved up from 17 in FY04 to 39 in FY08. This coupled with high wage inflation has led to significant increase in employee cost to assets ratio. Going ahead, we expect employee per branch to stabilise at current levels and wage inflation to moderate leading to improvement in cost ratios for HDFC Bank.

Exhibit 16: Employee Cost (%)



Source: Company, JM Financial.

Exhibit 17: Cost to Assets (%)

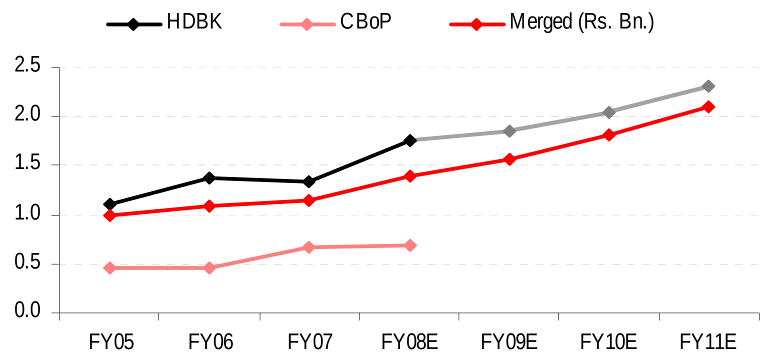


Source: Company, JM Financial.

However expectation of accelerated assets growth would be high

While it can be argued that assets per branch for eCBoP too is significantly lower than that of HDFC Bank's levels, and hence it can be levered-up, leading to accelerated assets growth for the merged entity. However we believe, expectations in this regard, if any, are high. We do not expect accelerated assets growth due to significant branch accretion on account of the merger. HDFC Bank has expanded its assets at ~33% CAGR during the past four years and we expect slower assets growth of 25% CAGR during FY08-11E.

Exhibit 18: Assets Per branch (Rs. bn.)



Source: Company, JM Financial.

HDFC Bank: Normalised ROE

Based on a normalised ROE of 19.6%, we value the stock at **2.95x book** (on 2-stage Gordon growth model), implying **August'09 target price of Rs. 1,300** - upside of 2% from the current levels.

Exhibit 19: Normalised Earnings (Proforma Merged) (%)

HDFC Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	4.50%	3.97%	4.33%	4.62%	4.48%	4.49%	4.50%
NIM (as % of avg. Assets)	4.32%	3.78%	4.11%	4.40%	4.28%	4.29%	4.31%
Core Non-IR/Asset	1.85%	2.02%	2.07%	1.96%	1.82%	1.78%	1.73%
Core Non-IR/Revenues	30.0%	34.8%	33.5%	30.9%	29.8%	29.3%	28.6%
Core Revenue / Assets	6.17%	5.80%	6.19%	6.36%	6.11%	6.07%	6.04%
Cost/ Core Income	48.6%	53.6%	51.9%	54.0%	53.7%	51.5%	49.8%
Cost/Assets	3.00%	3.11%	3.21%	3.44%	3.28%	3.12%	3.00%
Core operating Profits	3.17%	2.69%	2.98%	2.92%	2.82%	2.94%	3.03%
LLP/Loans	2.15%	1.66%	1.90%	2.09%	1.97%	2.28%	2.33%
Loans/Assets	50.0%	49.2%	51.3%	50.9%	49.7%	50.2%	50.6%
Profits/Provisions on Sect.	0.00%	0.02%	0.13%	0.02%	0.12%	0.01%	0.01%
Pre-Tax	2.10%	1.85%	1.87%	1.84%	1.73%	1.79%	1.84%
Effective Tax Rate	30.0%	29.3%	30.7%	30.3%	30.2%	30.2%	30.5%
ROAA	1.47%	1.31%	1.30%	1.29%	1.21%	1.25%	1.28%
Equity / Assets	7.48%	8.04%	7.21%	7.65%	7.63%	7.74%	7.73%
RoE	19.6%	16.3%	18.0%	16.8%	15.8%	16.2%	16.6%
Adjusted BV	530						
PV of Adj BV	375						
g (high growth phase, FY11-16E)	25%						
g (perpetual)	5%						
COE	14.0%						
Current Price	1,280						
Fair P/BV	2.95x	(2 stage Gordon Growth Model)					
Current Fair Value	1,130	12 months (July 2009) = Rs. 1,300					

Source: Company, JM Financial.

Key concerns

Higher than expected delinquencies - Key Risk: Slippages for HDFC Bank, both in absolute terms and as a percentage of opening standard assets, have been on rise since FY04, reflecting a changing balance of risk and returns due to a change in product mix. Going ahead, we expect the slippages to stabilise close to ~2.8-3.0% for the merged entity. Higher than expected slippages remains the key risk to our expectations.

Slower than expected assets growth: We have built-in slower assets growth at 26% CAGR (merged entity) during FY08-11E (as against 42% CAGR during FY05-08). Slower than expected assets growth is a risk to our projections.

Financial Tables (Proforma Merged)

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	78,812	122,786	168,896	215,585	269,026
Interest Expenses	38,784	63,447	90,742	116,083	144,334
Net Interest Income (NII)	40,028	59,339	78,153	99,502	124,691
Profit on Investments	-612	2,518	-1,000	500	600
Exchange Income	2,385	3,481	4,526	5,431	6,517
Fee & Other Income	17,796	23,026	28,706	35,794	43,546
Non-Interest Income	19,569	29,026	32,232	41,725	50,664
Total Income	59,597	88,365	110,385	141,227	175,355
Operating Expenses	31,266	46,389	59,858	72,445	86,996
Pre-provisioning Profits	28,331	41,975	50,527	68,782	88,359
Loan Loss Provisions	9,471	14,351	17,851	26,550	34,107
Provisions on Investments	8	50	500	100	100
Other Provisions	628	2,688	600	600	750
Total Provisions	10,108	17,089	18,951	27,250	34,957
PBT	18,224	24,887	31,576	41,532	53,401
Tax	5,595	7,529	9,536	12,543	16,287
PAT (Pre-Extra ordinaries)	12,629	17,358	22,040	28,989	37,114
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	12,629	17,358	22,040	28,989	37,114
Dividend	2,619	3,525	4,636	5,958	7,512
Retained Profits	10,009	13,833	17,404	23,031	29,602

Source: Company, JM Financial.

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	3,893	4,243	4,243	4,505	4,505
Reserves & Surplus	74,155	124,292	145,679	204,556	234,157
Deposits	831,617	1,226,926	1,595,004	2,025,655	2,532,068
Borrowings (Incld Sub Debt)	71,939	92,312	109,276	127,345	149,932
Other Liabilities	115,581	154,149	192,373	230,848	277,018
Total Liabilities	1,097,184	1,601,922	2,046,576	2,592,909	3,197,680
Investments	351,798	563,212	711,334	889,437	1,081,489
Net Advances	581,662	791,817	1,022,582	1,304,735	1,623,972
Cash & Equivalents	105,359	176,356	221,317	284,425	353,954
Fixed Assets	13,040	16,538	20,105	24,176	28,216
Other Assets	45,325	53,998	71,237	90,136	110,048
Total Assets	1,097,184	1,601,922	2,046,576	2,592,909	3,197,680

Source: Company, JM Financial.

Key ratios (%) (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	27.6%	47.5%	30.0%	27.0%	25.0%
Advances	39.8%	36.1%	29.1%	27.6%	24.5%
Total Assets	29.3%	46.0%	27.8%	26.7%	23.3%
NII	50.2%	48.2%	31.7%	27.3%	25.3%
Non-Interest Income	36.3%	48.3%	11.0%	29.5%	21.4%
Operating Expenses	42.7%	48.4%	29.0%	21.0%	20.1%
Operating Profits	48.4%	48.2%	20.4%	36.1%	28.5%
Core Operating Profits	52.7%	36.3%	30.6%	32.5%	28.5%
Provisions	67.5%	69.1%	10.9%	43.8%	28.3%
PAT	36.7%	37.5%	27.0%	31.5%	28.0%
Yields / Margins (%)					
Interest Yield (%)	8.53%	9.55%	9.69%	9.72%	9.72%
Cost of Funds (%)	4.84%	5.71%	6.00%	6.02%	5.97%
Interest Spread (%)	3.69%	3.85%	3.69%	3.71%	3.75%
NIM (%)	4.33%	4.62%	4.48%	4.49%	4.50%
Profitability (%)					
ROA (%)	1.30%	1.29%	1.21%	1.25%	1.28%
ROE (%)	18.0%	16.8%	15.8%	16.2%	16.6%
Assets Quality (%)					
Gross NPAs (%)	1.65%	1.88%	1.54%	1.53%	1.51%
Net NPAs (%)	0.59%	0.69%	0.53%	0.53%	0.50%
Provision Coverage (%)	64.5%	63.4%	66.0%	66.0%	67.0%
Capital Adequacy (%)					
Tier I (%)	8.77%	10.23%	9.01%	9.77%	8.93%
CAR (%)	12.78%	13.17%	11.38%	11.62%	10.41%

Source: Company, JM Financial.

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	4.11%	4.40%	4.28%	4.29%	4.31%
Other income / Assets (%)	2.01%	2.15%	1.77%	1.80%	1.75%
Total Income / Assets (%)	6.13%	6.55%	6.05%	6.09%	6.06%
Cost to Assets (%)	3.21%	3.44%	3.28%	3.12%	3.00%
PPP / Assets (%)	2.91%	3.11%	2.77%	2.97%	3.05%
Provisions / Assets (%)	1.04%	1.27%	1.04%	1.17%	1.21%
ROA (%)	1.30%	1.29%	1.21%	1.25%	1.28%

Source: Company, JM Financial.

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	389.3	424.3	424.3	450.5	450.5
EPS (Rs.)	32.4	40.9	51.9	64.3	82.4
EPS (YoY) (%)	34.5%	26.1%	27.0%	23.9%	28.0%
PE (x)	39.5	31.3	24.6	19.9	15.5
BV (Rs.)	200.5	302.9	353.3	464.0	529.8
P/BV (x)	6.38	4.23	3.62	2.76	2.42
DPS (Rs.)	6.7	8.3	10.9	13.2	16.7
Div. yield (%)	0.5%	0.6%	0.9%	1.0%	1.3%

Source: Company, JM Financial.

JM FINANCIAL

Country: India

Sector: Banking & Financial Services

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Key Data

Market cap	Rs243 bn/US$5.74 bn
Shares in issue (mn)	357.7
Diluted share (mn)	357.7
3-mon avg daily val (mn)	Rs1,821.8/US$43.0
52-week range	Rs1,291/534
BSE sensex (30/07/08)	14,287
Nifty (30/07/08)	4,314
Rs/US$	42.4

Shareholding Pattern (%)

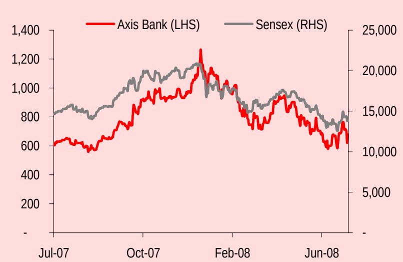
	1Q FY08	1Q FY09
Promoters	42.9	42.4
FIIs	36.2	31.2
MFs/FIs/Banks	8.6	9.2
Public	8.7	13.3
Others	3.6	3.8

Price Performance (%)

	1M	3M	12M
Absolute	12.6	(26.5)	6.4
Relative*	6.4	(9.1)	12.7

** To the BSE Sensex*

Daily Performance



(As of 30 July 2008)

30 July 2008

Initiating Coverage

Axis Bank

Bloomberg: AXSB IB

Buy

CMP: Rs 680 | **Target Price (Aug 09): Rs 800**

Align with the Right Axis

Axis Bank's corporate focused growth strategy and significantly improved distribution & liabilities franchisee would continue to help it gain further scale and still deliver superior return ratios. While current macro-economic environment would put pressure on margins & credit quality, we believe concerns are over-magnified and the bank would deliver profitable growth.

- **Corporate focused Private Bank:** In contrast to its peers, Axis bank has positioned its growth strategy on strong corporate investments happening in India and has demonstrated that it is equally remunerative (margins adjusted for operational & credit cost) being predominantly a corporate bank as against a retail focused bank.
- **Substantially improved liabilities franchisee:** Deposits profile of Axis Bank has undergone a significant improvement during the past 2-3 years. Its low cost deposit mix on daily average balance basis has improved significantly to 40.3% in FY08, up from 21.6% in FY04. Strong liability franchisee would help it to reduce the upward pressure on cost of funds and protect margins.
- **Assets growth to moderate to ~25% CAGR during FY08-11E:** Axis Bank, over the past couple of years, has been aggressively pursuing growth and is expected to continue to deliver strong assets growth of ~25% CAGR during FY08-11E (as against 41% CAGR during the past 5 years). We expect Axis Bank to achieve substantial assets base of over Rs. 2 trillion by FY11.
- **Credit quality concerns are over-magnified:** Uncertain macro-economic environment, tightening liquidity and rising interest rates are expected to put pressure on the credit quality of the banks. While we are expecting the specific LLP for Axis Bank to increase (from 71 bps in FY08 to 108 bps in FY11), the concerns in this regard are being over-magnified. Strong fundamentals of Indian corporates (lower leverage and strong profitability), considerably lower interest rate levels when compared to 1990's and superior risk management system of Axis Bank gives us the confidence that credit quality would remain under control.
- **Earnings CAGR at ~29% over FY08-11E, ROE to recover to ~19% in FY11 post the recent dilution:** Backed by strong earnings growth we expect ROE of the bank to expand to ~19% over the next 2-3 years. Based on a normalised ROE of 20.8%, we value the stock at 2.65x book, implying Aug'09 **target price of Rs. 800 - upside of ~18%** from the current levels.
- Higher than expected delinquencies is the **Key Risk** to our recommendation.

Exhibit 1: Financial summary **(Rs mn)**

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	4,851	6,590	10,710	13,830	18,356	22,926
Net Profit (YoY) (%)	45.0%	35.9%	62.5%	29.1%	32.7%	24.9%
Assets (YoY) (%)	31.8%	47.3%	49.6%	29.3%	25.0%	21.0%
ROA (%)	1.11%	1.07%	1.17%	1.10%	1.15%	1.17%
ROE (%)	18.4%	21.0%	17.6%	14.9%	17.4%	18.9%
EPS (Rs.)	17.4	23.4	29.9	38.7	51.3	64.1
EPS (YoY) (%)	42.4%	34.4%	28.0%	29.1%	32.7%	24.9%
PE (x)	39.1	29.1	22.7	17.6	13.3	10.6
BV (Rs.)	103.1	120.5	245.1	274.6	313.8	363.0
P/BV (x)	6.60	5.64	2.77	2.48	2.17	1.87

Source: Company, JM Financial. Note: Valuations as of 30 July 2008

Exhibit 2: Key Financials

Key Parameters	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR (03-08)*	CAGR (08-11)E*	Remarks
Balance sheet												
Deposits (Rs. bn)	170	210	317	401	588	876	1,161	1,475	1,799	38.9%	27.1%	Continuously improving liability franchisee would help the bank to reduce the upward pressure on cost of funds, lend to better rated assets at competitive rates and still protect margins.
CASA (Rs. bn)	39	80	120	160	234	400	509	640	775	59.2%	24.6%	
CASA Mix (%)	23.0%	38.1%	38.0%	40.0%	39.9%	45.7%	43.9%	43.4%	43.1%	22.6%	-0.8%	
Loans (Rs. bn)	72	94	156	223	369	597	774	966	1,183	52.7%	25.6%	Corporate focused growth strategy has helped the bank to gain significant scale in a short span. We expect loan growth to moderate (but still remain healthy at ~25% CAGR) and mix of better rated corporates and international advances to increase.
Retail Loans (Rs. bn)	11	21	42	65	89	136	176	217	263	65.3%	24.6%	
International Loans (Rs. bn)	0	0	0	0	26	54	85	116	154	-	42.0%	
Retail Loans Mix (%)	15.3%	21.9%	26.8%	29.1%	24.2%	22.8%	22.7%	22.5%	22.2%	7.5%	-0.5%	
International Loans Mix (%)	0.0%	0.0%	0.0%	0.0%	7.0%	9.0%	11.0%	12.0%	13.0%	9.0%	2.0%	
Total Assets (Rs. bn)	196	242	377	497	733	1,096	1,417	1,770	2,142	41.1%	25.0%	We expect Axis Bank to achieve substantial assets base of over Rs. 2 trillion by FY11, supported by rapidly expanding distribution network and increasing presence in international markets.
Assets Growth (%)	36.4%	23.1%	56.3%	31.8%	47.3%	49.6%	29.3%	25.0%	21.0%			
Branches	192	252	339	450	561	671	791	891	966	28.4%	12.9%	
Income statement												
NII (Rs. bn)	3.2	5.7	6.8	9.9	14.7	25.9	34.5	43.4	53.8	51.6%	27.6%	Earnings growth to remain strong at ~29% CAGR over FY08-11. Higher LLP to some extent would get neutralised by improvement in cost ratios.
Core operating profits (Rs. bn)	1.6	3.7	5.3	7.8	12.0	20.1	28.7	36.6	46.0	65.0%	31.9%	
PAT (Rs. bn)	1.9	2.8	3.3	4.9	6.6	10.7	13.8	18.4	22.9	41.0%	28.9%	
Profitability												
Interest Spread (%)	1.86%	2.59%	2.24%	2.19%	2.21%	2.55%	2.37%	2.41%	2.46%	0.69%	0.09%	Post the recent dilution, we expect ROE of Axis Bank to expand to ~19% over the next 2-3 years, backed by strong earnings growth. ROA too is expected to recover post 7 bps dip in FY09E.
NIM (%)	1.99%	2.73%	2.36%	2.40%	2.49%	2.93%	2.84%	2.82%	2.84%	0.93%	0.00%	
ROA (%)	1.13%	1.27%	1.08%	1.11%	1.07%	1.17%	1.10%	1.15%	1.17%	0.04%	0.07%	
ROE (%)	25.1%	27.1%	18.9%	18.4%	21.0%	17.6%	14.9%	17.4%	18.9%	-7.5%	4.1%	
Asset Quality												
Net NPAs (Rs. bn)	1.6	1.1	2.2	2.2	2.7	2.5	3.4	4.2	4.8	8.9%	24.6%	While we are expecting the specific LLP for Axis Bank to increase (from 71 bps in FY08 to 108 bps in FY11), the credit-quality concerns are over-magnified.
LLP (Rs. bn)	1.0	2.5	0.2	1.7	2.0	5.0	6.2	9.8	12.9	36.9%	37.2%	
Slippages (%) ^	1.66%	3.43%	1.40%	1.17%	0.77%	1.05%	1.25%	1.45%	1.50%	-0.6%	0.3%	
LLP (%)	1.7%	3.1%	0.1%	0.9%	0.7%	1.0%	0.9%	1.1%	1.2%	-0.6%	0.3%	

Source: Company, JM Financial, Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

Uniquely Positioned Private Bank

Axis Bank is unique in terms of business and growth strategy that it has been following over the years. The bank is more of a play on the strong corporate investments happening in India, rather on the booming retail finance (that has now been impacted by sharp rise in interest rates). And the bank has demonstrated that it is equally remunerative being predominantly a corporate bank as against a retail focused bank. Margins adjusted for operational and credit cost would largely be similar in both cases.

What highlights the contrast in the growth strategies being pursued by the 3 largest private sector banks in India - ICICI Bank, HDFC Bank and Axis Bank - is aggressive volume growth vis-à-vis superior margins. While ICICI Bank, till last year, has aggressively pursued assets growth and hence invariably has to rely on fixed / bulk deposits, HDFC Bank has a focus towards superior margins by maintaining higher CASA mix. Axis Bank is following a more balanced approach and has been able to improve its CASA mix despite strong assets growth.

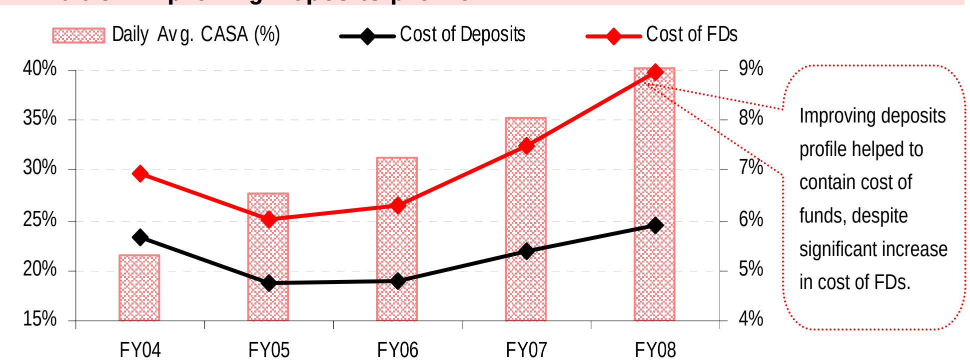
Substantially improved liabilities profile

Low cost of funds provide significant flexibility

Deposits profile of Axis Bank has undergone a significant improvement during the past 2-3 years. Its low cost deposit mix on daily average balance basis has improved significantly to 40.3% in FY08, almost up by 9% in 2 years (and up from 21.6% in FY04). With continued expansion of branch network and increased focus on retail deposits, we believe Axis Bank is well positioned to further strengthen its liabilities franchise and we expect it to maintain a stable low-cost deposits ratio (~43%) that would help it to reduce the upward pressure on cost of funds. Even within the term deposits, retail proportion has increased significantly from 20% in FY07 to 25% in FY08; and we expect it to show further improvement going ahead.

Significantly improved deposits franchisee would serve dual purposes for Axis Bank. a) It would provide flexibility to the bank to lend at competitive rates to customer segments with better credit risk profile & hence keep the credit cost low. b) help maintain its margins relatively stable, in an environment where tightening monetary policy is putting pressure on margins of the banking system.

Exhibit 3: Improving Deposits profile



Source: Company, JM Financial. Note: Figures as reported by Axis Bank.

Strong build-up in liabilities franchisee has been supported by a) rapid expansion of presence across the country (671 branches + 2764 ATMs). We expect Axis Bank to continue with its run rate of adding 100+ branches every year over the next few years. b) Launch of several superior and customer-centric range of liability products. For example, to increase its savings account base, Axis Bank offers differentiated products based on factors such as age group, gender, income and occupation. c) Superior wholesale and transactional banking services like cash management (CMS), correspondent banking services, tax collection, and merchant acquiring business have helped the bank to generate significant free cash floats.

Deposits: market share

The market share of Axis Bank in the system deposits has been on a rise since FY06 and now enjoys 2.75% share, which we expect to go upto 3.46% by FY11. The incremental market share for the bank is currently at 4.97%. We expect deposits for Axis Bank to grow at ~27% CAGR during FY08-11E.

Exhibit 4: Axis Bank's share in system deposits

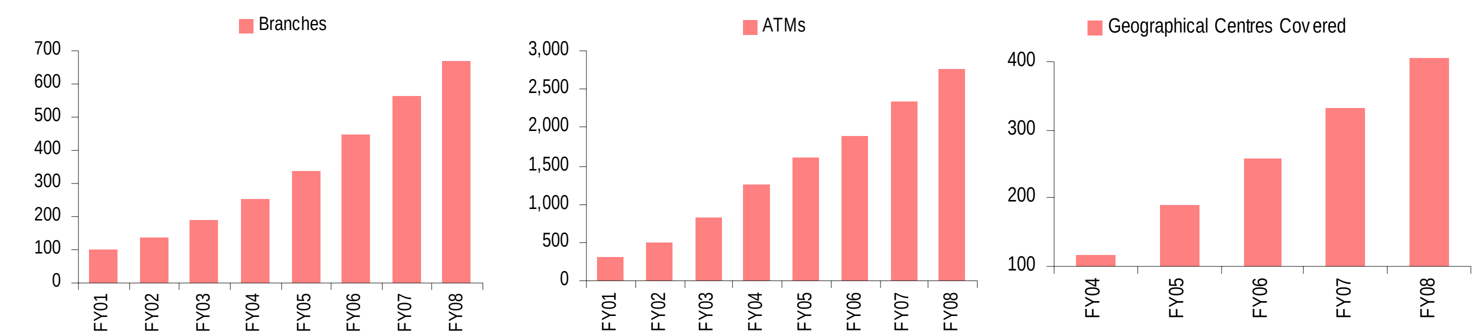
Share in system deposits	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
System total Deposits (Bn.)	11,234	13,043	15,428	17,851	21,090	26,119	31,921	37,827	44,447	52,002
Share (%)	1.09%	1.30%	1.36%	1.78%	1.90%	2.25%	2.75%	3.07%	3.32%	3.46%
Incremental share (%)	2.28%	2.59%	1.67%	4.44%	2.59%	3.71%	4.97%	4.82%	4.74%	4.29%

Source: Company, JM Financial, RBI.

Rapidly expanding distribution reach

Extended reach would also help the Bank to reach out to a large cross-section of customers with an array of products and services catering to both the retail and the corporate segment & hence generate significant amount of fee income as well as strengthen its liabilities profile.

Exhibit 5: Expanding Reach



Source: Company, JM Financial.

Fee Income momentum to remain strong

Fee income momentum for Axis Bank is expected to remain strong. Significant proportion (~90%) of fee income comes from regular banking activities. Capital markets related fee income constitutes only ~10% of fee income, which would probably see some slowdown (though growth in 1Q'09 was strong at 149% yoy).

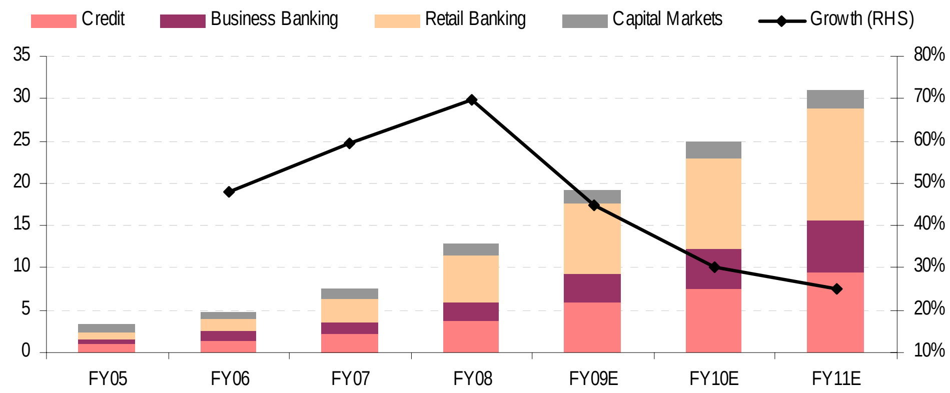
Exhibit 6: Fee Income Drivers

Segments	Drivers
Credit	Fund & Non-funds Services/Charges to corporates like processing charges, LCs, Guarantees
Business Banking	CMS, Collection of taxes, Remittances, Collections & Funds transfer.
Capital markets	Debt Syndication, Equities Issue Mgmt, Corporate & Financial Advisory, Trusteeship, Capital Market Services
Retail Banking	Fee from Retail banking - Processing charges, Cards biz, Third Party products, ATM sharing etc.

Source: Company, JM Financial.

We expect fee based income to expand to 30% CAGR during FY08-11E (59% CAGR during FY05-08).

Exhibit 7: Fee Income (Rs. Bn)



Source: Company, JM Financial.

Exhibit 8: Fee Income Ratios (%)

	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Core Non-Int. Inc / Total Core Inc.	38.5%	37.7%	39.3%	37.9%	39.6%	40.1%	40.2%
Core Non-Int. Inc /Assets	1.38%	1.37%	1.54%	1.72%	1.80%	1.83%	1.85%

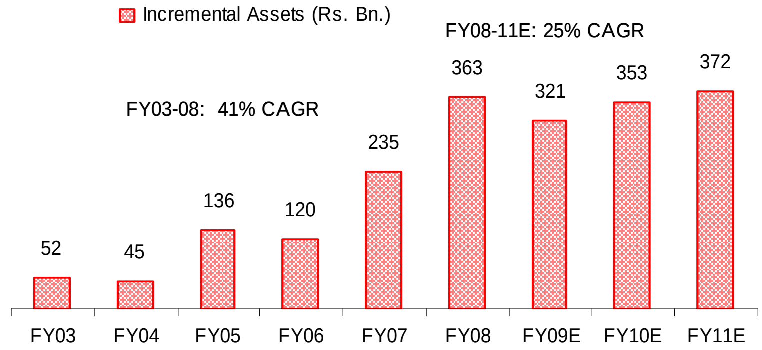
Source: Company, JM Financial.

Assets growth to remain strong

Assets size to expand at ~25% CAGR during FY08-11E

Axis Bank, over the past couple of years, has been aggressively pursuing growth and is expected to continue to deliver strong growth going ahead. The Assets size has expanded at a robust rate of 41% CAGR during the past 5 years. While we expect the assets size to expand at a lower rate of 25% CAGR during FY08-11E, we have assumed a similar increase in assets size during the next 3 years as has been witnessed in FY08. We expect Axis Bank to achieve substantial assets base of over Rs. 2 trillion by FY11.

Exhibit 9: Incremental Assets (Rs. Bn)



Source: Company, JM Financial.

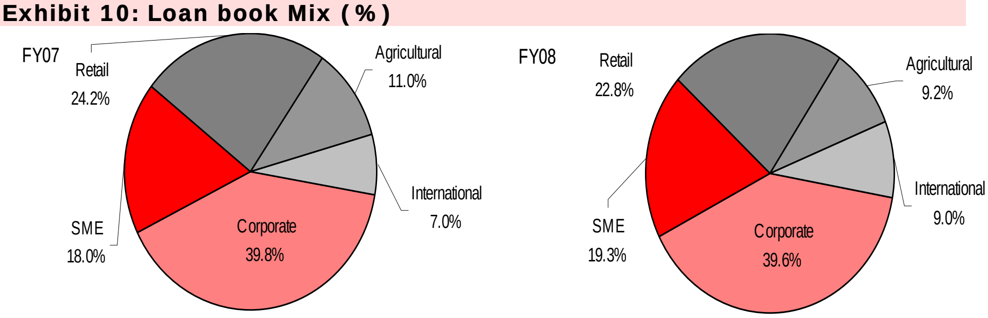
Loan Book to remain predominantly corporate

Axis Bank is primarily a corporate focused bank with corporate loans forming bulk of its loan book. Retail concentration is only ~25% as compared to its peers where retail book constitutes 60-65% of the total loans. Going forward too, corporate loans would continue to remain an important driver for loan book growth for Axis bank. We expect loan book to expand at a CAGR of 25.6% during FY08-11E (lower than deposits growth of 27% CAGR, due to the impact of increase in CRR).

Establishing international footprints: India's growing integration with the global economy and increasing presence of Indian companies abroad has given rise to significant opportunities. Hence, Axis Bank has also embarked on creating international footprints with pan-Asia presence to capitalise on offshore corporate and merchant banking business opportunities. The Bank has established its presence in Singapore, Hong Kong, Dubai and Shanghai, besides entering into strategic alliances with Banks and Exchange houses in the Gulf Co-operation Council region.

The business of the overseas branches has increased substantially and has achieved critical mass levels. During FY08, Total assets at overseas branches were USD 1.66 bn constituting 6.1% of the Bank's total assets. We expect proportion of International assets to continue to rise to 12-13% over the next couple of years.

Exhibit 10: Loan book Mix (%)



Source: JM Financial, Company.

Credit Quality concerns are over-magnified

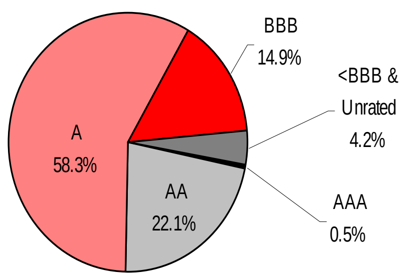
The change in the current macro-economic environment and tightening liquidity is expected to put pressure on fundamentals of certain sectors like real estate, and hence on the credit quality of the banks. While we are expecting the delinquency levels of the banks to increase, the concerns in this regard are being over-magnified. Although tightening liquidity conditions and rising interest rates is likely to increase slippages in certain sectors like non-collateralised retail, real estate etc. however, broadly Indian corporates are expected to show decent growth in profits and hence should be in a position to service their debt obligations.

Axis Bank follows rating tools, which are tailored to specific market segments such as large corporates, Mid corporates and SMEs to assess the credit quality and probability of default. The bank has also developed a monitoring tool to regularly supervise the credit quality of the borrower taking into consideration the actual behaviour at the post disbursement stage so that timely corrective actions can be taken whenever required. For retail exposures, credit quality is monitored at the portfolio level. Additionally, the bank follows a) Ratings linked exposure norms, a) Industry linked exposure norms, c) separate risk limits for exposure to sensitive sectors, d) additional monitoring and care for exposures with long gestations, long moratorium etc.

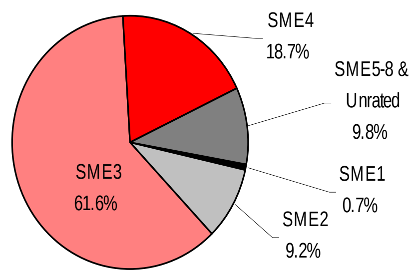
Distribution of credit risk assets by Asset quality:

Exhibit 11: Rating Linked Exposures (%)

Large & Mid Corporate Exposure Break-up



SME Exposure Break-up



Source: JM Financial, Company.

Exhibit 12: SME Ratings Definition – Credit rating Agencies

Ratings	Definitions
SME 1	Highest Credit Quality with negligible Credit risk.
SME 2	Highest Credit Quality with very low Credit risk.
SME 3	Above average Credit Quality with low Credit risk.
SME 4	Above average Credit Quality with average Credit risk.
SME 5	Below average Credit Quality with above average Credit risk.

Source: Company, JM Financial.

Distribution of credit risk assets by Industry sectors:

Concerns about high non-fund based exposures to Gems and Jewellery segment are over magnified as 76% of these exposures is backed by cash margins and are short term in nature to facilitate trade. Even high fund-based exposures to NBFCs is primarily because Axis Bank lends to Home finance companies (Like GIC home finance, LIC home finance) to fulfill its priority sector commitments. With expanding reach, Axis Bank's direct lending to priority sector bank has been increasing and hence high exposure to these NBFCs is expected to reduce.

Exhibit 13: Industry-wise exposure (Rs. Bn)

Industry (Rs. Bn.)	Fund Based		Non-Fund Based		Total	
NBFCs & Trading	126.2	13.6%	20.0	9.9%	146.2	12.9%
Gems and Jewellery	8.2	0.9%	79.9	39.5%	88.1	7.8%
Infrastructure	41.8	4.5%	26.4	13.0%	68.2	6.0%
Construction	34.9	3.8%	1.1	0.5%	36.0	3.2%
Cotton Textiles	21.2	2.3%	1.9	0.9%	23.1	2.0%
Iron and Steel	14.0	1.5%	7.0	3.5%	21.0	1.9%
Chemicals, Dyes, Paints etc.	13.4	1.4%	5.0	2.5%	18.4	1.6%
All Engineering	10.3	1.1%	5.7	2.8%	16.1	1.4%
Electricity	9.4	1.0%	5.6	2.8%	15.0	1.3%
Other Industries	209.8	22.6%	49.5	24.5%	259.2	22.9%
Residual exposures	440.1	47.4%	0.1	0.1%	440.2	38.9%
Total	929.2	100%	202.2	100%	1,131.4	100%

Source: Company, JM Financial.

Loan assets subjected to restructuring

There has been significant increase in loans subject to restructuring for Axis Bank. While restructuring does indicate that a loan account is facing certain credit quality issues and potentially might turn out to be an NPA, however following points too should be considered a) Restructuring is applicable to credit facilities to industrial units (and not to trading companies), provided they are fully covered by tangible securities. b) Banks are not expected to repeatedly restructure / reschedule the accounts. c) Banks can not reschedule / restructure borrowal accounts with retrospective effect.

Exhibit 14: Loan assets subjected to restructuring

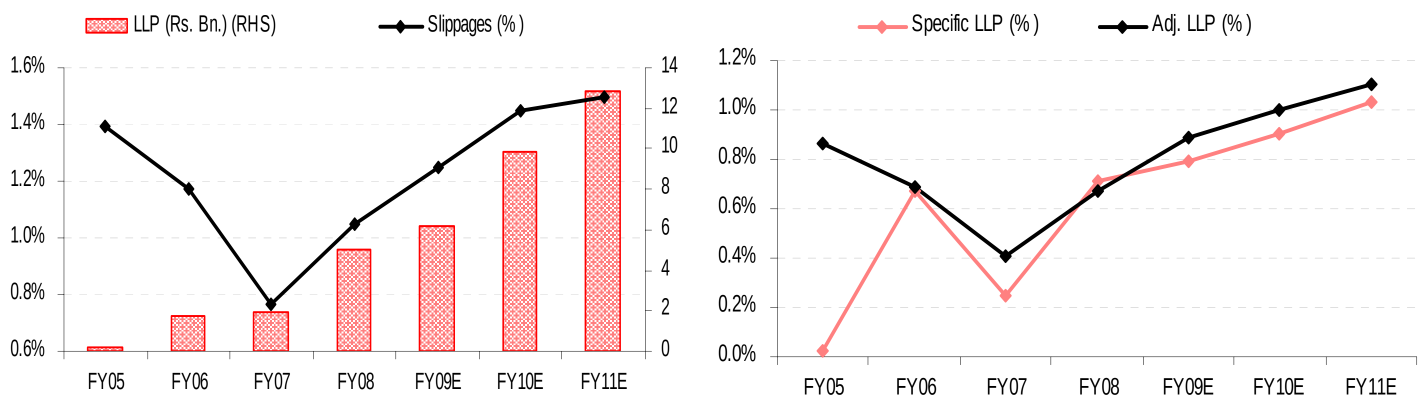
Loan assets subjected to restructuring, rescheduling, renegotiation (Rs. Bn.)	FY07	FY08	+/- (%)
Total amount of loan assets subjected to restructuring	2.17	6.30	190%
- of which under CDR	-	2.54	
Total amount of Standard assets subjected to restructuring	1.78	6.24	250%
- of which under CDR	-	2.54	

Source: Company, JM Financial.

Loan loss provisioning expected to rise but would remain under control

Given the uncertain and difficult macro-economic environment and bank's exposure towards mid-corporates and SMEs, we have built-in higher delinquencies for Axis bank in our projections. We expect specific LLP to increase from 71bps in FY08 to 108 bps FY11. Higher than expected slippages remains the key risk to our recommendation.

Exhibit 15: Slippages & LLP (%)

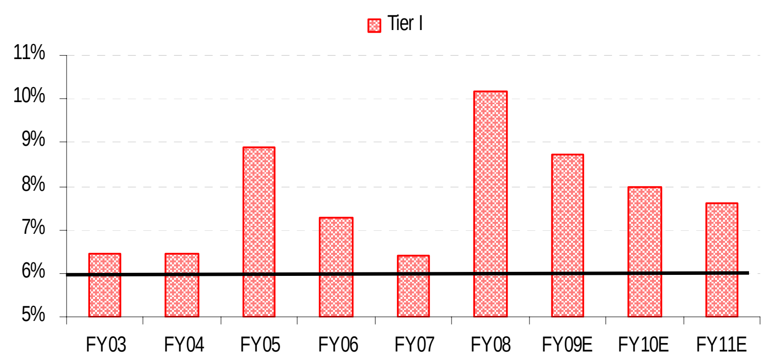


Source: Company, JM Financial.

No dilution required till FY11

Axis Bank would have sufficient Tier I capital till FY11 (along with sufficient headroom in the form of perpetual debt). Hence we don't expect any dilution over the next 3 years (unless the assets growth is significantly higher than our expectations going ahead).

Exhibit 16: Tier I (%)



Source: Company, JM Financial.

Release of capital in Basel II

There has also been release of capital for Axis Bank under Basel II norms.

Exhibit 17: Tier I (%)

	Basel I	Basel II
RWAs (Rs. Bn)	867.2	849.9
Tier I	10.2%	10.4%
Tier II	3.6%	3.6%
CAR	13.7%	14.0%

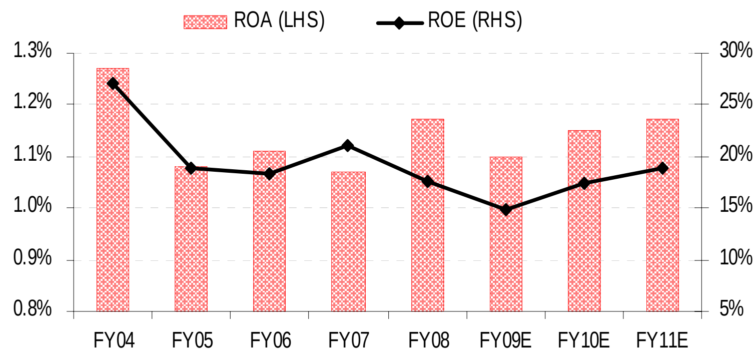
Source: Company, JM Financial.

Attractive valuations

We expect ~25% CAGR in balance sheet growth over FY08-11E with stable ROA of ~1.15% in FY11E which should lead to 29% CAGR in profits for Axis Bank. We expect ROE to improve to ~19% by FY11E.

Given the substantial expansion in ROE of the bank going ahead (post the recent dilution); we believe CMP presents an attractive entry point for long term investors.

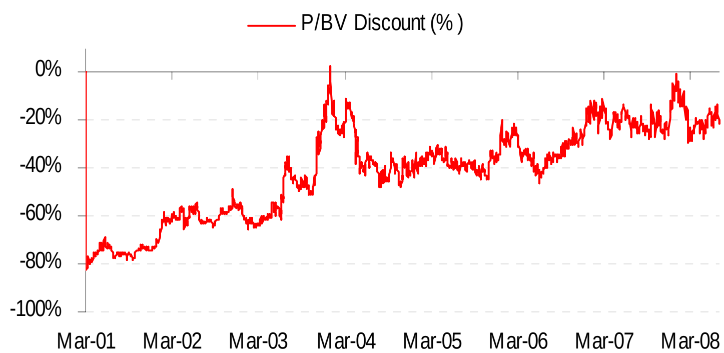
Exhibit 18: ROA and ROE Chart



Source: Company, JM Financial.

Historically, Axis Bank has traded at a discount to HDFC Bank because of superior liability and return profile of the latter. However, given the substantial improvement in liability franchise of Axis Bank and superior return ratios over FY08-11E (Axis Bank would generate higher ROEs as compared to HDFC Bank during FY08-11E), we believe that such a significant discount is unwarranted. Axis Bank is currently trading at ~20% discount to HDFC Bank on P/BV basis.

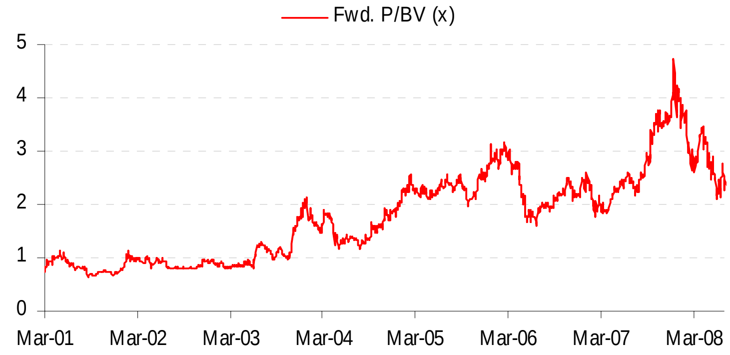
Exhibit 19: Axis Bank: Discount to HDFC Bank on P/BV



Source: Company, JM Financial.

Based on a normalised ROE of 20.8%, we value the stock at 2.65x book (on 2-stage Gordon growth model), implying August'09 target price of Rs. 800 - upside of ~18% from the current levels.

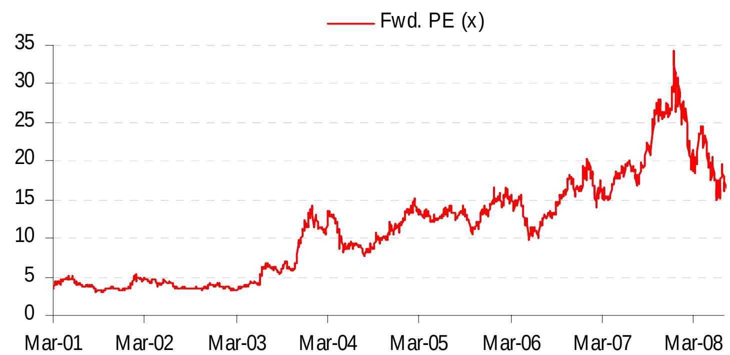
Exhibit 20: One-year Fwd P/BV (x)



Source: Company, JM Financial.

On PE basis, the target price of Rs. 800 would imply P/E of 15.6x FY10E EPS.

Exhibit 21: One-year Fwd PE (x)



Source: Company, JM Financial.

Axis Bank: Normalised ROE

Based on a normalised ROE of 20.8%, we value the stock at 2.65x book (on 2-stage Gordon growth model), implying August'09 target price of Rs. 800 - upside of ~18% from the current levels.

Exhibit 22: Normalised Earnings (%)

Axis Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	2.93%	2.40%	2.49%	2.93%	2.84%	2.82%	2.84%
NIM (as % of avg. Assets)	2.84%	2.27%	2.39%	2.83%	2.75%	2.73%	2.75%
Core Non-IR/Asset	1.74%	1.37%	1.54%	1.72%	1.80%	1.83%	1.85%
Core Non-IR/Revenues	38.0%	37.7%	39.3%	37.9%	39.6%	40.1%	40.2%
Core Revenue / Assets	4.58%	3.64%	3.93%	4.55%	4.54%	4.55%	4.60%
Cost/ Core Income	48.0%	51.2%	50.2%	51.8%	49.8%	49.5%	48.9%
Cost/Assets	2.20%	1.86%	1.98%	2.36%	2.26%	2.25%	2.25%
Core operating Profits	2.38%	1.78%	1.96%	2.19%	2.28%	2.30%	2.35%
LLP/Loans	1.15%	0.91%	0.66%	1.03%	0.91%	1.13%	1.20%
Loans/Assets	55.0%	43.3%	48.1%	52.8%	54.5%	54.6%	54.9%
Profits/Provisions on Sect.	0.00%	-0.29%	0.02%	-0.15%	0.14%	-0.04%	-0.06%
Pre-Tax	1.75%	1.67%	1.62%	1.80%	1.64%	1.72%	1.75%
Effective Tax Rate	33.0%	33.7%	33.8%	34.9%	33.0%	33.0%	33.0%
ROAA	1.17%	1.11%	1.07%	1.17%	1.10%	1.15%	1.17%
Equity / Assets	5.65%	6.04%	5.09%	6.65%	7.40%	6.60%	6.19%
RoE	20.8%	18.4%	21.0%	17.6%	14.9%	17.4%	18.9%
Adjusted BV	363.0						
PV of Adj BV	252.7						
g (high growth phase, FY11-16E)	25%						
g (perpetual)	5%						
COE	14.5%						
Current Price	680						
Fair P/BV	2.65x	(2 stage Gordon Growth Model)					
Current Fair Value	698	12 months Price Target (August 2009) = Rs. 800					

Source: Company, JM Financial.

Key Risks

Higher than expected delinquencies - Key Risk: Given the uncertain and difficult macro-economic environment and bank's exposure towards mid-corporates and SMEs, we have built-in higher delinquencies for Axis Bank in our projections. We expect specific LLP to increase from 71bps in FY08 to 108 bps FY11. Higher than expected slippages remains the key risk to our expectations.

Slower than expected assets growth: Axis Bank, over the past couple of years, has been aggressively pursuing growth. We have build-in slower assets growth going ahead at 29% in FY09 (vs. 50% in FY08). Slower than expected assets growth is a risk to our projections.

Succession plans: Dr Nayak would retire in Jul'09. While the bank has a strong second rung management team, uncertainty with regard to succession of Dr. Nayak may continue to linger at the top of investors' mind.

Financial Tables

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	44,617	70,053	99,208	125,562	153,894
Interest Expenses	29,933	44,200	64,722	82,134	100,120
Net Interest Income (NII)	14,683	25,854	34,485	43,428	53,774
Profit on Investments	609	2,203	750	750	1,200
Exchange Income	1,248	2,075	2,801	3,501	4,289
Fee & Other Income	8,244	13,678	19,779	25,589	31,909
Non-Interest Income	10,101	17,955	23,330	29,840	37,398
Total Income	24,784	43,808	57,815	73,268	91,173
Operating Expenses	12,146	21,549	28,399	35,907	43,994
Pre-provisioning Profits	12,639	22,259	29,417	37,361	47,179
Loan Loss Provisions	1,961	4,975	6,224	9,814	12,862
Provisions on Investments	670	65	2,500	100	50
Other Provisions	46	756	50	50	50
Total Provisions	2,676	5,796	8,774	9,964	12,962
PBT	9,962	16,463	20,642	27,397	34,218
Tax	3,372	5,753	6,812	9,041	11,292
PAT (Pre-Extra ordinaries)	6,590	10,710	13,830	18,356	22,926
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	6,590	10,710	13,830	18,356	22,926
Dividend	1,488	2,516	3,291	4,319	5,348
Retained Profits	5,102	8,194	10,539	14,036	17,578

Source: Company, JM Financial.

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	2,816	3,577	3,577	3,577	3,577
Reserves & Surplus	31,116	84,108	94,647	108,684	126,262
Deposits	587,856	876,262	1,161,047	1,474,530	1,798,927
Borrowings (Incld. Sub Debt)	86,970	90,534	104,594	118,654	135,526
Other Liabilities	23,814	41,298	52,833	64,720	77,664
Total Liabilities	732,572	1,095,778	1,416,699	1,770,165	2,141,956
Investments	268,972	337,051	422,204	531,811	631,659
Net Advances	368,765	596,611	773,940	965,629	1,182,531
Cash & Equivalents	69,183	125,042	172,922	213,447	255,696
Fixed Assets	6,732	9,229	11,223	13,138	14,826
Other Assets	18,921	27,845	36,410	46,140	57,244
Total Assets	732,572	1,095,778	1,416,699	1,770,165	2,141,956

Source: Company, JM Financial.

Key ratios (%) (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	46.5%	49.1%	32.5%	27.0%	22.0%
Advances	65.3%	61.8%	29.7%	24.8%	22.5%
Total Assets	47.3%	49.6%	29.3%	25.0%	21.0%
NII	48.2%	76.1%	33.4%	25.9%	23.8%
Non-Interest Income	38.4%	77.8%	29.9%	27.9%	25.3%
Operating Expenses	49.2%	77.4%	31.8%	26.4%	22.5%
Operating Profits	39.5%	76.1%	32.2%	27.0%	26.3%
Core Operating Profits	54.9%	66.7%	42.9%	27.7%	25.6%
Provisions	52.9%	116.6%	51.4%	13.6%	30.1%
PAT	35.9%	62.5%	29.1%	32.7%	24.9%
Yields / Margins (%)					
Interest Yield (%)	7.55%	7.94%	8.17%	8.15%	8.14%
Cost of Funds (%)	5.34%	5.38%	5.80%	5.75%	5.68%
Interest Spread (%)	2.21%	2.55%	2.37%	2.41%	2.46%
NIM (%)	2.49%	2.93%	2.84%	2.82%	2.84%
Profitability (%)					
ROA (%)	1.07%	1.17%	1.10%	1.15%	1.17%
ROE (%)	21.0%	17.6%	14.9%	17.4%	18.9%
Assets Quality (%)					
Gross NPAs (%)	1.13%	0.83%	0.88%	0.87%	0.81%
Net NPAs (%)	0.72%	0.42%	0.44%	0.44%	0.41%
Provision Coverage (%)	36.4%	49.8%	50.0%	50.0%	50.0%
Capital Adequacy (%)					
Tier I (%)	6.42%	10.17%	8.71%	7.96%	7.61%
CAR (%)	11.57%	13.73%	11.44%	10.14%	9.41%

Source: Company, JM Financial.

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	2.39%	2.83%	2.75%	2.73%	2.75%
Other income / Assets (%)	1.64%	1.96%	1.86%	1.87%	1.91%
Total Income / Assets (%)	4.03%	4.79%	4.60%	4.60%	4.66%
Cost to Assets (%)	1.98%	2.36%	2.26%	2.25%	2.25%
PPP / Assets (%)	2.06%	2.43%	2.34%	2.34%	2.41%
Provisions / Assets (%)	0.44%	0.63%	0.70%	0.63%	0.66%
ROA (%)	1.07%	1.17%	1.10%	1.15%	1.17%

Source: Company, JM Financial.

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	281.6	357.7	357.7	357.7	357.7
EPS (Rs.)	23.4	29.9	38.7	51.3	64.1
EPS (YoY) (%)	34.4%	28.0%	29.1%	32.7%	24.9%
PE (x)	29.1	22.7	17.6	13.3	10.6
BV (Rs.)	120.5	245.1	274.6	313.8	363.0
P/BV (x)	5.64	2.77	2.48	2.17	1.87
DPS (Rs.)	5.3	7.0	9.2	12.1	15.0
Div. yield (%)	0.8%	1.0%	1.4%	1.8%	2.2%

Source: Company, JM Financial.

JM FINANCIAL

Country: India

10 August 2008

Initiating Coverage

Yes Bank

Bloomberg: YES IB

Buy

Price: Rs 138 | **Target Price (Aug 09): Rs 180**

Sector: Banking & Financial Services

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Key Data

Market cap	Rs41.1 bn/US$976.0 mn
Shares in issue (mn)	297
Diluted share (mn)	297
3-mon avg daily val (mn)	Rs237.2/US$5.6
52-week range	Rs278/102
BSE sensex (08/08/08)	15,168
Nifty (08/08/08)	4,530
Rs/US$	42.1

Shareholding Pattern (%)

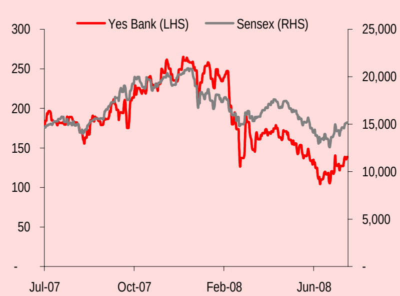
	1Q FY08	1Q FY09
Promoters	35.9	33.6
FIIs	52.5	51.8
MFs/FIs/Banks	1.1	1.9
Public	10.5	12.7
Others (incl. GDR/ADR)	0.0	0.0

Price Performance (%)

	1M	3M	12M
Absolute	16	(15)	(24)
Relative*	3	(6)	(26)

** To the BSE Sensex*

Daily Performance



(As of 8 August 2008)

Different Levers at Work

Expected pressure on knowledge banking and fee based revenues due to capital market weakness would be neutralised by improvement in other levers like margins and operating cost. Contrary to concerns, we expect Yes bank to continue to generate superior ROA of 1.3% driven by strong growth in core banking revenues.

- **Knowledge banking significant contributor to ROA:** The bank is focusing on key growth sectors like Food & Agribusiness, Life-sciences, etc. wherein it has developed significant domain expertise and this enables it to offer customised financial products to its clients. This approach also helps the bank to cross sell non-credit products and generate substantial fee based revenues leading to superior ROA.
- **Moderation in growth with focus on margins:** The bank has taken a conscious decision to moderate growth in the current uncertain economic environment to ensure quality growth with focus on margins and asset quality. We expect 31% CAGR in assets over FY08-11E with expansion in margins on account of improvement in low-cost mix to about 17% in FY11E.
- **Branch roll–out programme to gain momentum in FY09:** There was an execution delay with respect to branch expansion in FY08 (bank had 67 branches in FY08 vs. guidance of 100) on account of property related issues. Going ahead, the branch roll – out programme will gain momentum since the newer branches will primarily be smaller in size leading to a faster roll out. We expect 210 branches by FY11E, which should help improve the liability profile of the bank and lead to margin expansion.
- **Superior return ratios to continue:** Despite moderation in loan growth and slowdown in capital market related fee income, Yes Bank is on track to continue to maintain its superior return ratios led by improvement in core banking revenues and moderation in cost ratios. We expect ROA and ROE of ~ 1.3% and ~19% in FY11E, highest amongst its peer group.
- **Valuations:** Based on a normalised ROE of 18.6%, we value the stock at 2.3x book, implying August'09 **target price of Rs.180 - upside of 30%** from current levels. Any potential M&A activity would be an additional catalyst for the stock.
- **Risks to recommendation:** Management attrition, slower than expected fee based income, delay in branch expansion and higher than expected delinquencies are the risks to our recommendation.

Exhibit 1: Financial summary **(Rs mn)**

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	553	944	2,000	2,421	3,458	4,502
Net Profit (YoY) (%)	n.m	70.6%	112.0%	21.1%	42.8%	30.2%
Assets (YoY) (%)	225.7%	166.7%	52.9%	33.1%	32.1%	27.2%
ROA (%)	2.03%	1.24%	1.42%	1.22%	1.32%	1.33%
ROE (%)	14.0%	13.9%	19.0%	16.8%	18.5%	18.7%
EPS (Rs.)	2.0	3.4	6.8	8.2	10.9	14.3
EPS (YoY) (%)	n.m	64.5%	100.7%	21.1%	33.8%	30.2%
PE (x)	67.3	40.9	20.4	16.9	12.6	9.7
BV (Rs.)	21.2	28.1	44.6	52.8	68.9	83.2
P/BV (x)	6.51	4.91	3.09	2.61	2.00	1.66

Source: Company, JM Financial.: Valuations as of 8 August 2008.

Exhibit 2: Key Financials

Key Parameters	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR * (05-08)	CAGR * (08-11)E	Remarks
Balance sheet										
Deposits (Rs. bn)	6.6	29.1	82.2	132.7	179.2	240.1	312.1	171.5%	33.0%	Branch expansion should lead to improvement in liability profile and help reduce the upward pressure on cost of funds.
CASA (Rs. bn)	0.1	3.1	4.7	11.3	20.6	34.8	53.1	398.2%	67.5%	
CASA Mix (%)	1.4%	10.7%	5.8%	8.5%	11.5%	14.5%	17.0%	83.5%	8.5%	
Branches	2	8	40	67	120	165	210	222.4%	46.3%	
Total Assets (Rs. bn)	12.8	41.6	111.0	169.8	226.0	298.5	379.8	136.8%	30.8%	Despite slowdown, we expect asset growth of ~31% CAGR over FY08-11E supported by rapidly expanding distribution network and domain expertise due to its knowledge banking strategy
Asset growth	n.m	225.7%	166.7%	52.9%	33.1%	32.1%	27.2%			
Loans (Rs. bn)	7.6	24.1	62.9	94.3	126.1	166.9	215.0	131.4%	31.6%	
Income statement										
NII (Rs. bn)	0.2	0.9	1.7	3.3	4.7	6.5	8.8	163.2%	38.5%	Earnings growth to remain strong at ~31% CAGR over FY08-11E despite a slowdown in non-interest income and higher LLP.
Non-interest income	0.2	1.0	2.0	3.6	4.2	5.3	6.5	170.6%	22.0%	
Core operating profits (Rs. bn)	-0.1	1.0	1.6	2.9	4.3	5.8	7.7	n.m.	38.4%	
PAT (Rs. bn)	0.0	0.6	0.9	2.0	2.4	3.5	4.5	n.m.	31.1%	
Profitability										
Interest Spread (%)	2.66%	2.69%	1.57%	1.80%	1.89%	2.02%	2.19%	-0.87%	0.39%	Despite slowdown, we expect Yes Bank to report ROE of ~19% in FY11E. ROA too is expected to recover to ~1.3% after 20 bps dip in FY09E.
NIM (%)	3.00%	3.30%	2.26%	2.47%	2.47%	2.57%	2.69%	-0.53%	0.22%	
ROA (%)	-0.58%	2.03%	1.24%	1.42%	1.22%	1.32%	1.33%	2.00%	-0.10%	
ROE (%)	-3.4%	14.0%	13.9%	19.0%	16.8%	18.5%	18.7%	22.41%	-0.25%	
Asset Quality										
Net NPAs (Rs. Bn)	0.0	0.0	0.0	0.1	0.3	0.5	0.5	n.m.	76.3%	With the seasoning of the loan book, we expect increase in loan loss provisions by ~26bps.
LLP (Rs. Bn)	0.0	0.1	0.3	0.2	0.5	0.7	1.0	120.5%	70.0%	
Slippages (%) ^	0.0%	0.0%	0.0%	0.2%	0.7%	0.7%	0.7%	0.2%	0.48%	
LLP (%)	0.5%	0.5%	0.6%	0.3%	0.5%	0.5%	0.5%	-0.2%	0.26%	

Source: Company, JM Financial. Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

Different Levers at Work

Expected pressure on knowledge banking and fee based revenues due to capital market weakness would be neutralised by improvement in other levers like margins and operating cost. Knowledge banking strategy has enabled Yes Bank to develop significant domain expertise and generate substantial fee-based income which has supported the bank's profitability in the initial years of inception when contribution of core banking revenues to ROA is low and there are margin and cost pressures on account of low CASA ratio and network expansion. Consequently, Yes Bank reported superior ROA of 1.42% in FY08, which is the highest amongst its peer group.

Contrary to concerns, we expect Yes bank to continue to generate superior ROA of 1.3% despite 25bps decline in fee-based revenues which would get neutralised by margin expansion (helped by improvement in CASA mix) and improvement in cost ratios (led by focus on productivity). We expect 31% CAGR in profits over FY08-11E leading to superior ROA of ~1.3% and ROE of ~19% over FY08-11E (highest amongst its peer group).

Knowledge Banking: Enhancing Profitability

Focus on six sectors: Knowledge banking has been the key strength for Yes Bank since its inception. This knowledge based approach has enabled the bank to develop domain expertise which helps it to understand the growing needs of its clients and consequently introduce new and innovative products specially structured for them. The bank has identified key growth sectors like Food & Agribusiness, Life-sciences, Telecommunications, Auto, Media & Technology, Infrastructure and Textiles where it is leverages the experience and knowledge of its management team to offer customised financial products to its clients. This approach to banking helps Yes Bank to institutionalise strong customer relationships and also helps it to cross sell products more effectively thereby generating fee based revenues (with low capital requirements).

Exhibit 3: Knowledge banking: Focus sectors

Knowledge Sectors	Segment Focus
Food & Agri	Agro Chemicals
Life Sciences	Drugs
Engineering	Electric comp.
TMT	IT/Telecom
Infrastructure	Wind Energy

Source: Company, JM Financial

Supported profitability in initial years when contribution of core banking revenues to ROA was low

The bank has been able to generate significant fee based revenues through the knowledge banking approach in initial years of inception when margin and cost pressures on ROA are high due to low CASA ratio and significant expenses are incurred on network expansion. Knowledge banking also gains importance as capital requirements (for CAR purposes) are negligible as compared to other fee based sources like LCs, guarantees where capital has to be allocated.

Exhibit 4: Peer comparison of CASA, fee income, costs and ROA

	CASA mix		Core non-interest income /Assets		Cost/Assets		ROA	
	FY07	FY08	FY07	FY08	FY07	FY08	FY07	FY08
Yes Bank	5.8%	8.5%	2.49%	2.15%	2.54%	2.43%	1.24%	1.42%
Karnataka Bank	23.4%	22.1%	0.78%	0.90%	1.52%	1.72%	1.14%	1.36%
HDFC Bank (merged)	52.8%	49.0%	2.07%	1.96%	3.21%	3.44%	1.30%	1.28%
Axis Bank	40.0%	46.3%	1.54%	1.72%	1.98%	2.36%	1.07%	1.17%
ICICI Bank	22.6%	26.9%	1.96%	1.88%	2.24%	2.19%	1.04%	1.12%
ING Vysya Bank	28.9%	31.5%	1.45%	1.81%	2.80%	2.72%	0.49%	0.70%
Development Credit Bank	28.3%	24.3%	2.40%	2.51%	3.82%	3.73%	0.16%	0.60%
Indusind Bank	14.9%	15.7%	1.38%	1.19%	1.78%	1.82%	0.35%	0.34%

ROA in the initial years was supported by high core non-interest income to assets, despite low CASA and high operating costs.

Source: Company, JM Financial

Business model helps generate highest ROA within its peers

The business model of Yes Bank based on knowledge banking (leading to substantial non-interest income) helps it to generate superior ROA and ROE within its peers despite frequent capital infusion. Strong sources of non-fund based income like financial advisory, financial markets, transaction banking and third party distribution of products has resulted in fee based income's component as a proportion to total income at ~50%. This coupled with fund based income enables the bank to generate highest ROA within its peer group. ROA for FY08 was an impressive 1.42% vs. ~1% for its peer group, thereby highlighting the success of its business model and the bank's ability to generate superior return ratios.

Exhibit 5: Peer comparison of ROA

ROA	FY06	FY07	FY08
Yes Bank	2.03%	1.24%	1.42%
Karnataka Bank	1.28%	1.14%	1.36%
HDFC Bank (merged)	1.31%	1.30%	1.28%
Federal Bank	1.20%	1.28%	1.28%
Axis Bank	1.11%	1.07%	1.17%
ICICI Bank	1.21%	1.04%	1.12%
ING Vysya Bank	0.06%	0.49%	0.70%
Development Credit Bank	-2.03%	0.16%	0.60%
Indusind Bank	0.22%	0.35%	0.34%

Source: Company, Bloomberg, JM Financial

ROA expected to remain stable at ~1.3%

Increasing contribution of core banking revenues to ROA to neutralize decline in fee based revenues

We believe that profitability of Yes Bank (in terms of ROA) would remain stable at ~1.3% despite the **expected decline in contribution of fee based revenues** (decline of 25 bps as contribution to ROA) driven by:

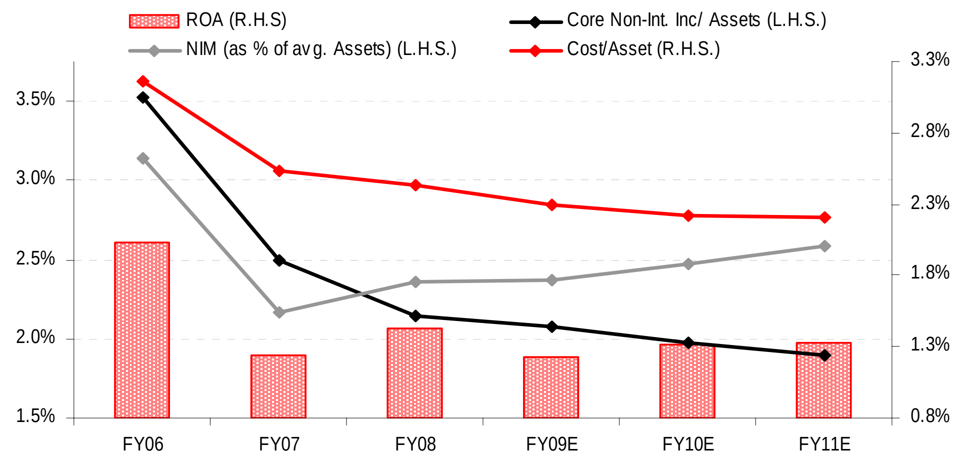
1) Improvement in liability profile to lead to better margins

Expansion of distribution network should lead to an improvement in liability profile. This coupled with repricing of loans at higher rates should lead to margin expansion of ~22 bps over FY08-11E.

2) Improving cost ratios

Focus on improvement in productivity levels coupled with benefits of economies of scale should result in improvement in cost ratios, with cost to assets ratio declining from 2.43% in FY08 to ~2.21% in FY11E (~22 bps decline).

Exhibit 6: Trend in margins, fees, costs and return ratios



Source: Company, JM Financial

We expect non-interest income as proportion of total income to decline going ahead.

Exhibit 7: Non-interest income as proportion of total income

	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Total income	363	1,852	3,659	6,912	8,891	11,767	15,325
Total non-interest income	182	998	2,007	3,607	4,199	5,269	6,547
yoy		*448%*	*101%*	*80%*	*16%*	*25%*	*24%*
Non-Int. Inc. / Total Inc. (%)	50.1%	53.9%	54.8%	52.2%	47.2%	44.8%	42.7%

Source: Company, JM Financial

Fee income: Different levers in different market conditions

Yes bank has developed strong sources of fee income, which include: a) Financial markets (risk management solutions), b) Financial advisory (investment banking and corporate advisory), c) transaction banking and d). third party distribution of insurance and mutual funds products.

Exhibit 8: Non-interest income mix

Non-interest income break mix	FY07	FY08	FY09E	FY10E	FY11E
Financial Markets	42%	41%	34%	34%	34%
Financial advisory	33%	27%	22%	22%	22%
Transaction Banking	11%	14%	25%	27%	28%
Third Party Distribution	10%	12%	11%	11%	11%
Others	4%	6%	8%	6%	5%
Total	100%	100%	100%	100%	100%

Source: Company, JM Financial

Financial Markets

Financial Markets contributed ~41% of total non-interest income in FY08. Financial market transactions typically include income from risk management solutions, currency swap sales, sales of derivative contracts, forex and treasury income. Within this, derivative contributes 25% of the financial market's income which implies about 11% of total income. In the current uncertain environment in the currency markets, we expect corporates to primarily use high volume, low commission traditional hedging instruments rather than low volume, high commission complex derivatives. Consequently, the loss of fee income from sale of complex derivative products will be neutralised by fees from normal hedging activity. However, we have assumed a **3% decline in financial markets fee income in FY09E** (on account of slowdown in sale of complex derivative products) and a moderate 15% CAGR over FY08-11E going forward.

Concern on forex derivatives overblown: Yes Bank has actively sold forex derivative contracts to hedge client's foreign currency exposure. However, in the current uncertain environment in the currency markets and heightened volatility, corporates have been facing mark to market losses (MTM). There have been concerns that the corporates will default on their MTM liabilities. However the management has clarified that it does not expect significant losses from these contracts since 70% of its exposure is towards large corporates (wherein the probability of default is very less). Thus, counterparty risk is minimal, as these large companies are unlikely to default. Further, none of the corporates have defaulted so far. The bank has no SME exposure to forex derivatives where counter party risk is substantially higher. The management has also clarified that based on their internal ratings, all the clients in the derivatives segment are either A rated or above. Also, with ~125 clients, concentration risk is also minimal. Hence, in our opinion, concerns related to forex derivatives are overblown.

Exhibit 9: Sources of Financial Markets revenue

Financial Markets	Impact of Capital market weakness	Comments
Forex Swaps and Derivatives	Neutral	Complex derivative products to witness slowdown due to MTM losses by corporates on these products.
Plain vanilla hedging products	Neutral	Corporates to use plain vanilla hedging instruments rather than complex derivatives
Fixed income products	Marginally positive	With volatile interest rate movement, activity in fixed income market is expected to increase.

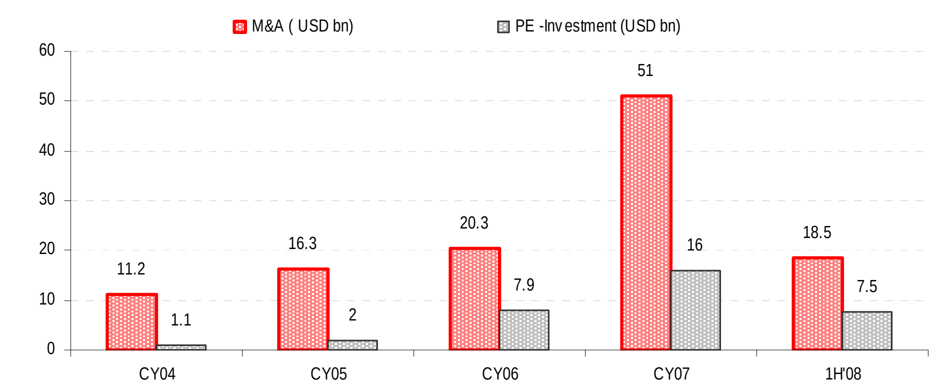
Source: Company, JM Financial

Financial Advisory

Financial Advisory revenues contributed ~27% of total non-interest income in FY08. These revenues primarily include fees from investment banking and corporate advisory. There have been concerns that investment banking fees are co-related to markets and hence will adversely impact Yes Bank. Primary source of investment banking fees are a) M&A deals, b) Pre-IPO placement and c) PE investment. In our opinion, M&A deals as well as capital raising plans from initial public offering are co-related to the equity markets and as such will be impacted. Nonetheless, we believe that private equity investment will show improvement in such adverse market conditions since private equity deals can be struck at far better value in adverse market conditions. Further, with capital raising plans delayed, companies will increasingly look at private equity investors for capital.

So far, till June 2008, M&A deals in India have slowed down significantly while private equity deals have remained relatively stable supporting our hypothesis.

Exhibit 10: Trend of deals in India



Source: Company, Grant Thornton, JM Financial

Further, with weak capital markets, corporate finance fees should improve as debt related deals will increase. The bank expects fees from corporate finance to increase significantly over the next two years. However, we have factored a **5% decline in financial advisory fee income in FY09E** and expect a moderate growth of 14% CAGR over FY08-11E in financial advisory fees.

Exhibit 11: Sources of Financial Advisory revenue

Financial Advisory	Impact of Capital market weakness	Comments
Investment banking		
Private Equity Venture Capital	Positive	Secondary market downturn leads to increased private equity deals as valuations become attractive.
Mergers & Acquisitions	Negative	M&A activity declines due to capital market weakness.
Merchant Banking	Negative	Adverse impact in market downturn.
Pre-IPO financing	Negative	Primary market weakness leads to decline in pre-IPO deals.
Distressed Assets	Positive	Equity market weakness usually leads to increase in distressed assets.
Corporate Finance		
Project Advisory	Neutral	
Project Syndication	Positive	Equity market downturn leads to increased debt related advisory and structured finance revenues.
Structured Finance	Positive	
Financial Restructurings	Positive	

Source: Company, JM Financial

Transaction Banking

Revenue from transaction banking includes fees from LCs, guarantees, acceptances and cash management. Yes Bank has the latest technology and with growth in balance sheet, the management is focused on increasing the share of transaction banking fees from ~14% of non-interest income to ~30% by FY11E. Volumes of LCs, guarantees and acceptances have increased significantly over FY06-08 generating significant fee income. We have assumed **54% CAGR in transaction banking fees** over FY08-11E.

Exhibit 12: Sources of Transaction banking revenues

Transaction Banking	Impact of Capital market weakness	Comments
Trade Finance	Neutral	
LC's	Neutral	Impacted more by the decline in global trade rather than the capital markets.
BG's	Neutral	
Trade Acceptances	Neutral	
Cash Management Services	Neutral	Dependent on technology, distribution network, balance sheet size and service levels rather than capital markets. With increasing distribution network and balance sheet size, we expect significant growth in CMS based fee income.

Source: Company, JM Financial

Third party distribution

Yes Bank has a tie up with Max New York Life and Bajaj Allianz to distribute their life and general insurance policies respectively. With the slowdown in the capital markets, we expect some slowdown in fees from this source. However, so far the life insurance industry has grown by 15% YTD with private players witnessing strong growth of 77% YTD, despite capital market weakness. We have assumed a moderate **7% increase in third party distribution fee in FY09E** and 19% CAGR in fee from this source over FY08-11E.

Exhibit 13: Sources of Third party distribution revenues

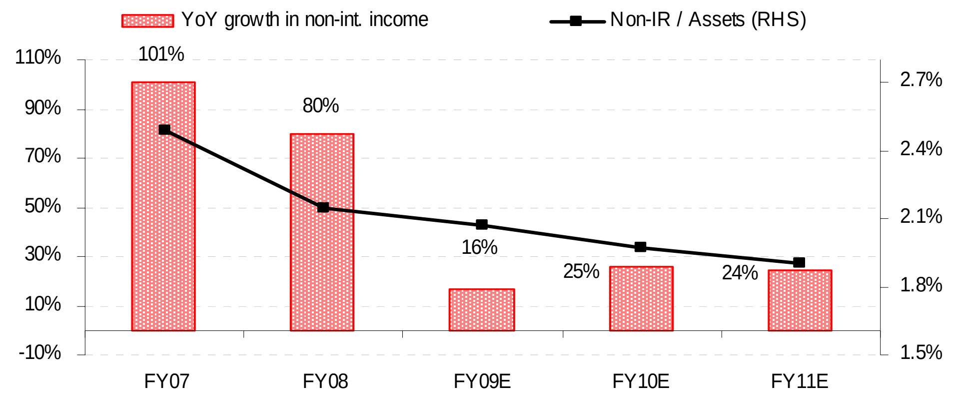
Third party distribution	Impact of Capital market weakness	Comments
Life insurance products	Negative	Unit linked products to witness slowdown on account of capital market weakness. However so far, private players have witnessed robust growth.
General insurance products	Neutral	Impacted by growth in the economy.
Mutual Funds	Negative	Co-related to equity markets, sale of MF could witness a slowdown.

Source: Company, JM Financial

Decline in non-interest income to asset

In our opinion, capital market weakness will lead to a decline in contribution of fee based revenues with non-interest income to assets expected to decline by 25 bps from 2.15% in FY08 to 1.9% in FY11E, implying a 22% CAGR over FY08-11E as against 90% over FY06-08.

Exhibit 14: Trend in non-interest income



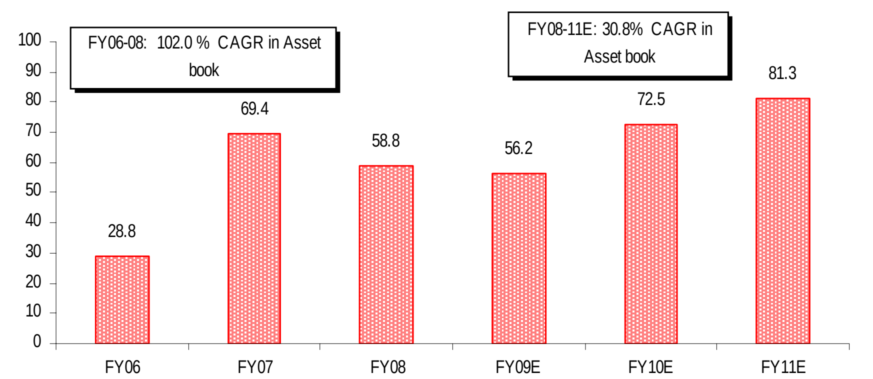
Source: Company, JM Financial

Asset growth: Management to exercise caution in uncertain environment

Assets size to expand at ~31% CAGR during FY08-11E

Asset growth in FY08 slowed to 53% vs. 167% in FY07. Absolute addition to assets on an incremental basis was lower in FY08 than FY07. In an uncertain macro environment, we believe that Yes Bank has become slightly cautious and is slowing down its balance sheet growth. We favour such a strategy of slower asset growth in the current scenario, as it would prevent significant deterioration in asset quality going forward. Consequently, we expect slower asset growth of 31% CAGR over FY08-11E as against 102% over FY06-08. In terms of incremental addition to the asset book, we have assumed a slower increase in assets size during FY09 and moderate increase thereafter, which we believe is reasonable for a rapidly expanding bank like Yes.

Exhibit 15: Incremental assets (Rs bn)



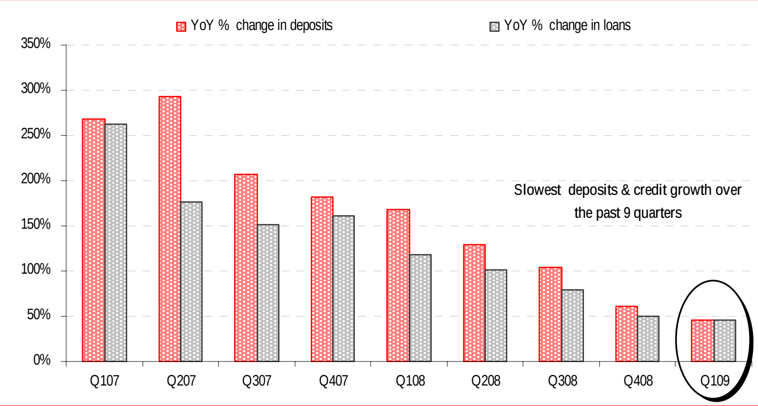
Source: Company, JM Financial

Moderation in Loan growth

There has been a moderation in loan growth at Yes Bank. For FY08, loan growth slowed to 50% as against 161% in FY07. Absolute addition to loan book on an incremental basis was lower in FY08 than FY07. Loan growth during 1QFY09 at 45% yoy was the slowest over the past nine quarters.

We expect further moderation in loan book which is expected to expected to expand at slower pace of 32% CAGR during FY08-11E vis-a-vis 98% CAGR over FY06-08.

Exhibit 16: Quarterly trends in loan and deposit growth



Source: Company, JM Financial

Loan mix

As of March 2008, Corporate & Institutional Banking (includes large corporates with turnover in excess of Rs. 7.5 bn) constitutes 54% of the advances and small/ emerging corporates (which include mid/small corporates with turnover less than Rs 7.5 bn) constitutes 44%. Currently, retail constitutes ~2% of the loan book.

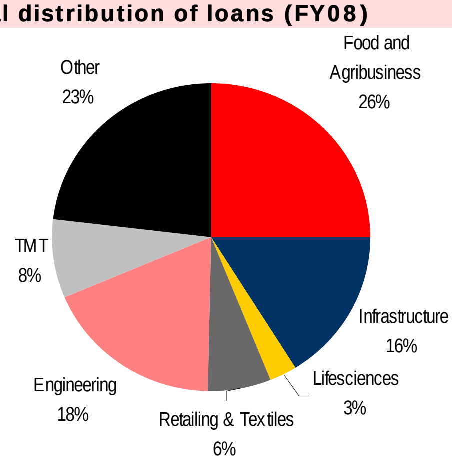
Exhibit 17: Loan mix (Rs mn)

	FY07	FY08	YoY Growth
Corporate and Institutional Advances	45,600	51,140	12%
Emerging Corporates and Business Banking	16,476	41,320	151%
Retail	821	1,843	124%
Total advances	62,897	94,303	50%

Source: Company, JM Financial

Key focus sectors at Yes Bank, which includes Food & Agribusiness, Life-sciences, Telecommunications, Auto, Media & Technology, Infrastructure and Textiles constitute ~77% of the loan book.

Exhibit 18: Sectoral distribution of loans (FY08)



Source: Company, JM Financial

Branch expansion gaining momentum

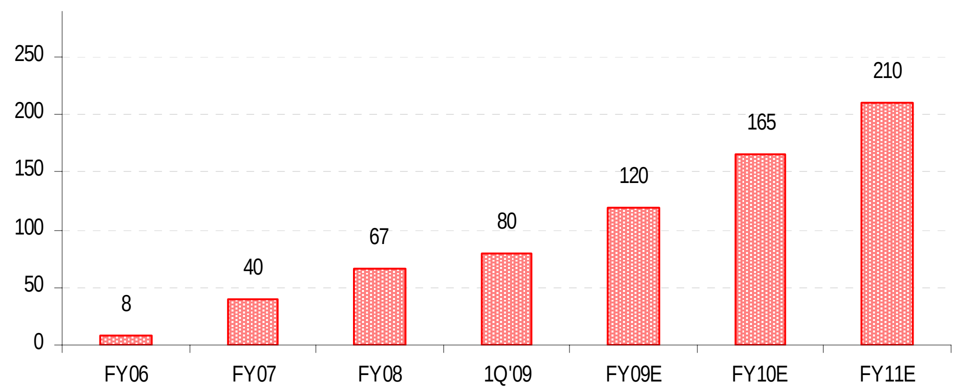
Execution delays in FY08…

The bank added 27 branches in FY08 to reach a total of 67 as against management guidance of 100. The branch roll out programme at Yes Bank has been delayed primarily due to property-related issues. Property rentals had increased significantly and hence closure of deals faced some delay.

….Branch expansion gaining momentum in FY09

Branch roll–out programme is expected to gain momentum in FY09 (there has been an addition of ~33 branches so far in FY09E). This is due to the fact that most of the hub branches have been rolled out and the newer branches will primarily be smaller branches which will roll out faster and require 15 employees on an average as against 40-45 employees for larger hub branches. We expect 210 branches by FY11E which should help improve the liability profile of the bank leading to an improvement in CASA mix.

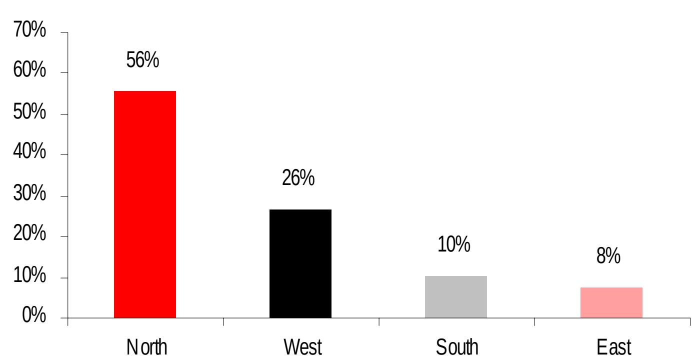
Exhibit 19: Branch progression

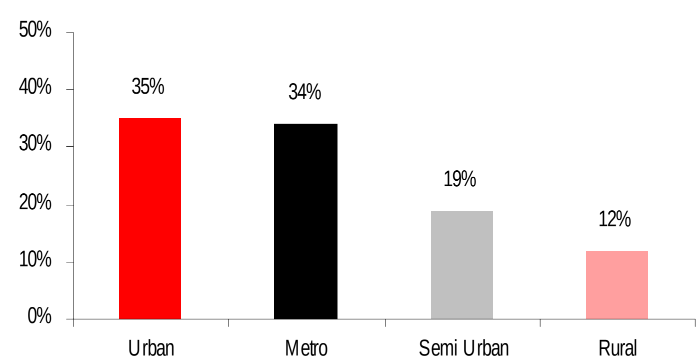


Source: Company, JM Financial

Yes Bank is focusing on the CASA rich Northern region for setting up branches. It has ~56% of the branches in this region and the management intends to add more branches in the North to improve its CASA mix.

Exhibit 20: Branch distribution as of 1QFY09





Source: Company, JM Financial

Branch additions to improve liability franchise

The liability franchise at Yes Bank is weak as compared to peers because of significantly less number of branches. With branch additions expected to gain momentum, we expect CASA mix to improve by 150-200 bps every year to 17% by FY11E vs. management guidance of 300-400 bps every year.

Focus on margin improvement

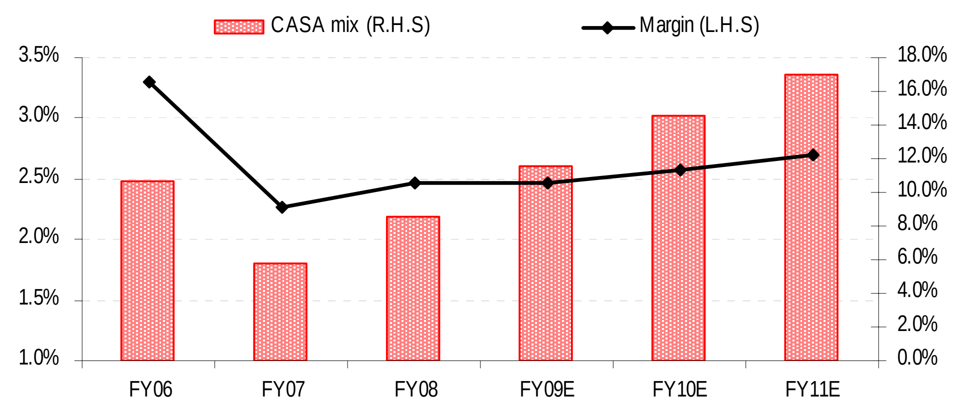
Margins improved in FY08 by 21 bps due to the improvement in low-cost mix by 270 bps to 8.5%. We expect 22 bps improvement in margins over FY08-11E led by:

a) Increase in low-cost deposit mobilisation as branch network expands to about 210 branches in FY11E. We expect low-cost deposit mix to reach levels of ~17% as against management guidance of 25%.

b) Moderation in loan growth to 32% CAGR over FY08-11E should help improve margins.

c) Repricing of loans at higher rates should also help enhance the margins. Yes Bank has been very proactive in raising its PLR with a view to improve its margins due to monetary tightening and corresponding hike in funding cost.

Exhibit 21: Trends in margins and CASA mix



Source: Company, JM Financial

Possibility of CASA to surprise on the upside

If we benchmark CASA per branch of Yes bank with other private sector banks, CASA per branch generated by Yes Bank is expected to be Rs253 mn in FY11E, which would still be substantially lower than other private banks implying that Yes Bank could surprise on the upside in terms of improvement in CASA mix.

Exhibit 22: Peer comparison of CASA per branch

CASA per branch (Rs mn)	FY07	FY08	FY09E	FY10E	FY11E
Yes Bank	118	168	172	211	253
HDFC Bank	456	521	582	681	801
ICICI Bank	665	505	557	624	702
Axis Bank	418	597	644	718	802

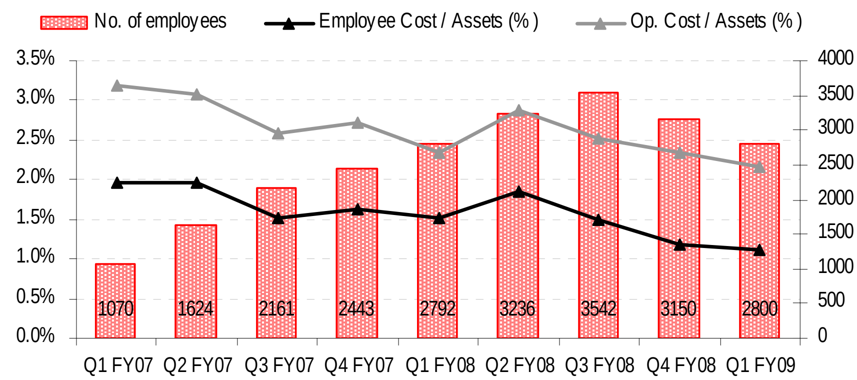
Source: Company, JM Financial

Cost containment to improve cost ratios

Employee rationalisation: increased focus on productivity

Yes Bank fares poorly when it comes to productivity levels. It generates one of the lowest assets per employee and the bank is currently focused on improving the productivity levels. Consequently, the bank has rationalised its workforce over the past two quarters and reported 11% sequential decrease in employee base during 1QFY09 after witnessing a similar trend in 4QFY08.

Exhibit 23: Quarterly trend in number of employees



Source: Company, JM Financial

Employee costs amongst the highest within peers

Compared to peers, employee costs are very high at Yes Bank with employee/cost at 1.44% in FY08 (though they have declined by 40 bps over FY06-08). We expect this ratio to decline further to 1.2% by FY11E as the bank focuses on improving the productivity levels. Further, the incremental branches would be smaller in size and require fewer employees.

Exhibit 24: Peer comparison – Employee Costs/ Assets

Employee Cost/ Assets	FY06	FY07	FY08
DCB	1.25%	1.54%	1.52%
Yes Bank	1.84%	1.54%	1.44%
ING Bank	1.46%	1.26%	1.35%
HDFC Bank (incl. CBOP)	0.89%	1.03%	1.18%
Karnataka Bank	0.85%	0.83%	1.02%
Federal Bank	1.22%	1.14%	0.95%
Axis Bank	0.55%	0.62%	0.73%
ICICI Bank	0.52%	0.54%	0.56%
Indusind Bank	0.51%	0.50%	0.55%
Average	1.01%	1.00%	1.03%

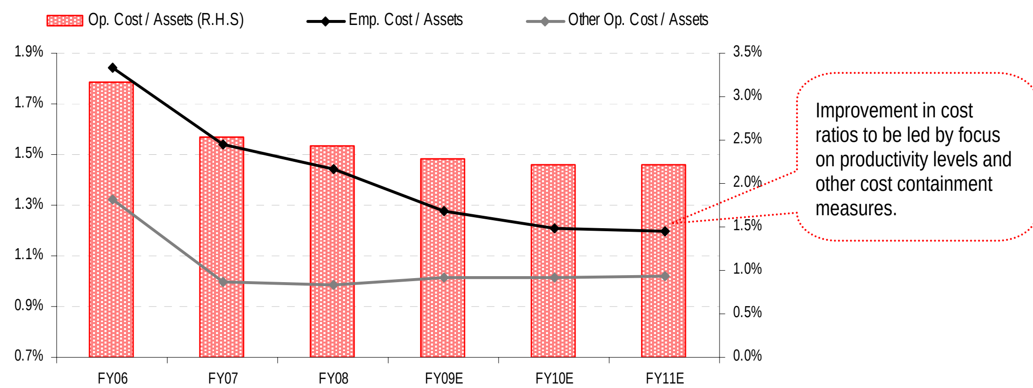
Source: Company, JM Financial

Other operating costs not expected to improve due to branch expansion

Other operating costs are not expected to improve as branch roll-out gains momentum at the bank. We expect other operating expense/asset to inch up to 1.02% in FY11E vis-à-vis 0.99% in FY08.

Improvement in cost ratios: We expect cost to assets ratio to decline from 2.43% in FY08 to ~2.21% in FY11E led by employee rationalisation efforts and focus on productivity levels. Post FY11E, we believe significant operating leverage could accrue once the bank has set up most of its branches and would enjoy benefits of economies of scale.

Exhibit 25: Trend in cost ratios

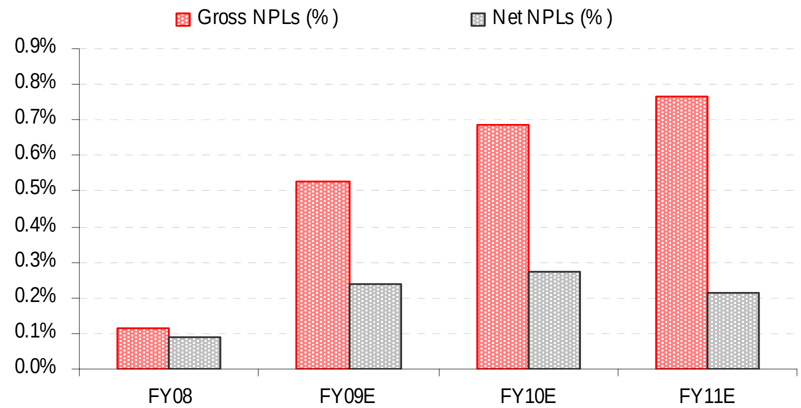


Source: Company, JM Financial

Reports NPLs after three years of operation

After more than three years of operations, the bank reported NPLs for the first time with gross and net NPLs at Rs.106 mn and Rs.85 mn, respectively in FY08. In our opinion, with the seasoning of the portfolio, we would expect NPLs to rise further. We forecast gross NPLs to rise from 0.11% in FY08 to 0.77% by FY11E and provisions to rise at 36% CAGR over FY08-11E. Loan loss charges are expected to go up from the current level of 26 bps in FY08 to ~52 bps by FY11E.

Exhibit 26: Trend in NPA ratios

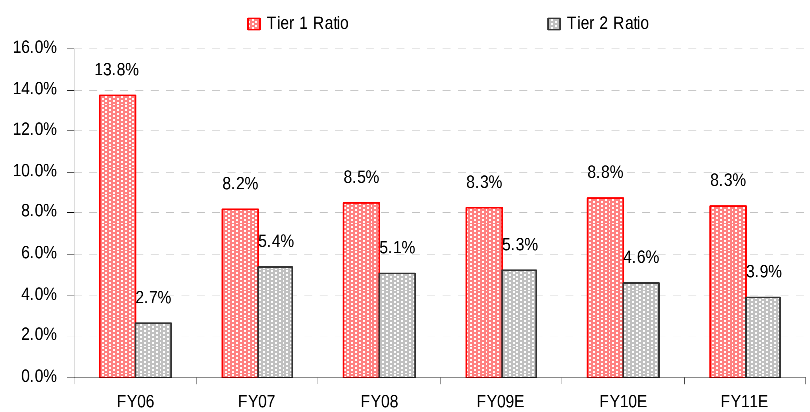


Source: Company, JM Financial

Dilution in FY10E

Being in its growth phase, Yes Bank will need access to equity capital. The bank recently raised Rs.3.3 bn of Tier I capital in 3Q FY08 through private placement to Orient Global at a price of Rs.225 per share leading to a dilution of 5.3%. The bank has a Tier I ratio of 8.23% as of 1QFY09 and we believe it will be able to maintain its growth rate for the next couple of quarters. In our opinion, the bank would need to raise capital in FY10E to support balance sheet growth. We have assumed dilution of 6.8% in FY10E at a base price of Rs. 135 per share.

Exhibit 27: Capital ratios



Source: Company, JM Financial

Top class management at the helm

The management led by Mr. Rana Kapoor is top class with proven track record in the financial sector. Yes bank also fosters a sense of ownership through stock options and performance stock options. It has a policy to maintain executive ownership at 5% at all times. Currently, the direct employee ownership is at 2% with fully diluted ownership at 7.3%.

Exhibit 28: Management team table

Name	Designation	Previous assignment
Rana Kapoor	Managing Director & CEO	Managing Partner / CEO & Managing Director - Rabo India
Rajat Monga	CFO and Group President – Financial Markets, Institutions and Investment Management	Head of Treasury - Rabo India
Sunil Gulati	Group President – Corporate & Institutional/ Emerging Corporates Banking & Corporate Development	Managing Director - GE Commercial Finance
Somak Ghosh	President–Corporate Finance and Development Banking	Director – Project Advisory & Infrastructure Mgmt - Rabo India
Suresh Sethi	President –Transaction Banking Group	Global Transaction Services Head - Caribbean, Central & Latin America, Citibank N.A.
Aditya Sanghi	Managing Director – Investment Banking	Executive Director, Head of Mergers & Acquisitions - Rabo India
Suhail Kazmi	President – Retail Banking & Wealth Management	Retail Head, West and South India - ABN Amro Bank
Varun Tuli	President – Business Banking	Executive Director and Country Head - Avigo Capital Partners
Sumit Gupta	Country Head – Emerging Corporates Banking	Associate Director & Head (North) - Rabo India
Subir Bisht	Chief Risk Officer	Head of Corporate Credit - ICICI Bank
Deodutta Kurane	President – Human Capital	Head of HR - Bajaj Allianz Life Insurance
Arun Agrawal	Group EVP & Global Head – International Banking	General Manager - ICRA
Alok Rastogi	President –Operations & Service Delivery & Financial Market Operations	Citibank N.A.
Umesh Jain	Chief Information Officer	Citigroup IT Operations & Solutions (CITOS)

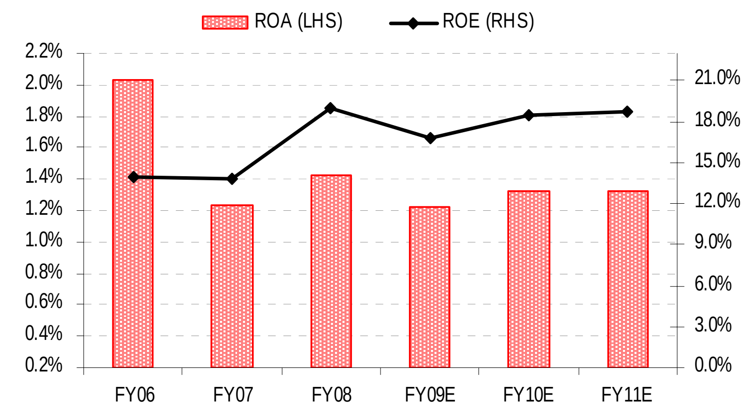
Source: Company, JM Financial

Attractive valuations

Superior return ratios, attractive valuations

While there have been concerns on issues such as slowdown in growth, execution delays and slowdown in non-interest income for Yes Bank, we believe that the bank is on track to report a 31% CAGR over FY08-11E in its assets book. Earnings are expected to grow at 31% CAGR over FY08-11E which would lead to superior ROA and ROE of ~1.3% and ~19% by FY11E.

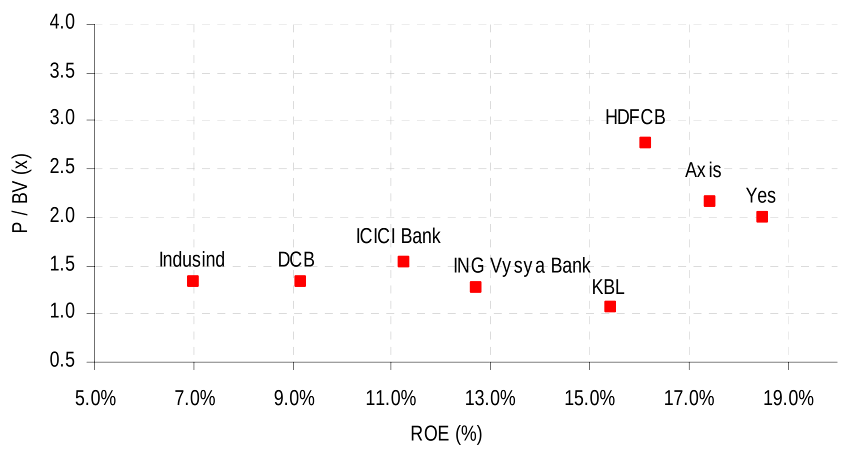
Exhibit 29: Trend in ROA and ROE



Source: Company, JM Financial

Yes Bank is one of the cheapest private sector banks in India when looked in the context of the superior return ratios it generates.

Exhibit 30: Peer comp. of ROE vis-a-vis P/BV (FY10E)



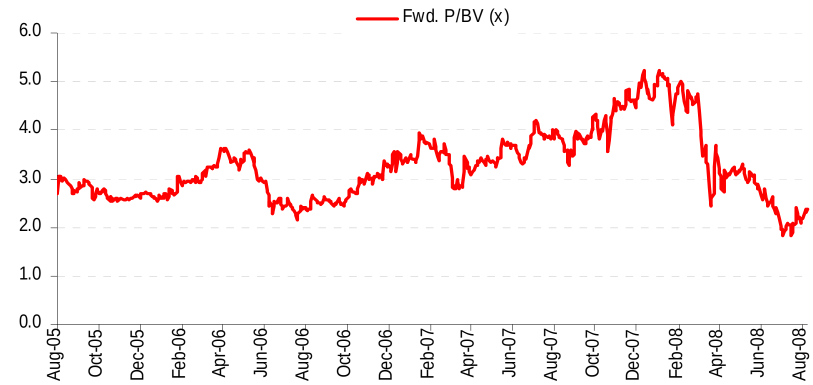
Source: Bloomberg, JM Financial

Based on a normalised ROE of 18.6%, we value the stock at 2.36x book (using two stage Gordon Growth model), implying **August 2009 target price of Rs.180**- upside of 30% from current levels.

Trading at life time low valuations

At the CMP of Rs.139, Yes Bank is trading at one year forward multiple of 2.3x, which is the lowest in its trading history as against three year average of 3.3x.

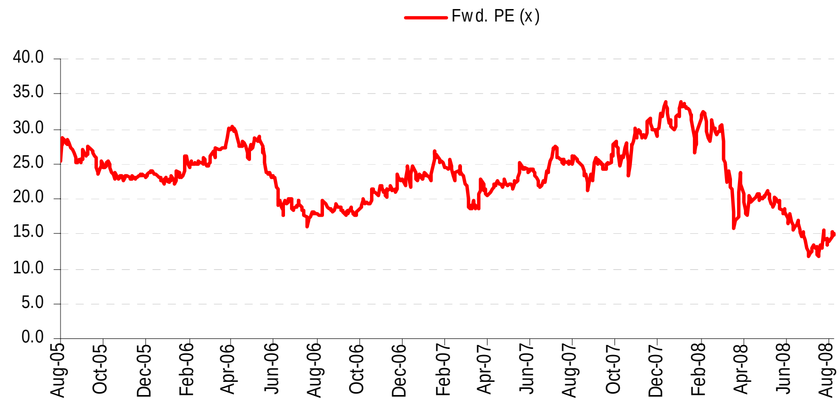
Exhibit 31: One-year forward P/BV (x)



Source: Bloomberg, JM Financial

On PE basis, the target price of Rs.180 would imply P/E of 16.4x FY10E EPS.

Exhibit 32: One-year forward PE (x)



Source: Bloomberg, JM Financial

Exhibit 33: One and three year forward P/BV and P/E trading range (x)

P/B forward			P/E forward		
Current	1 yr Average	3 yr Average	Current	1 yr Average	3 yr Average
2.3	3.7	3.3	14.8	23.9	23.4

Source: Company, JM Financial

Prime M&A candidate

With its superior technology, top class management team, strong corporate relationships and superior profitability, Yes Bank is likely to emerge as a strong M&A candidate post 2009. In our opinion, any potential M&A activity would be a significant catalyst for the stock.

Yes Bank: Normalised ROE

Based on a normalised ROE of 18.6%, we value the stock at 2.36x book (using two stage Gordon Growth model), implying **August 2009 target price of Rs.180**-upside of 30% from current levels.

Exhibit 34: Normalised earnings (%)

Yes Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	2.72%	3.30%	2.26%	2.47%	2.47%	2.57%	2.69%
NIM (as % of avg. Assets)	2.61%	3.14%	2.16%	2.35%	2.37%	2.48%	2.59%
Core Non-IR/Asset	1.90%	3.52%	2.49%	2.15%	2.07%	1.97%	1.90%
Core Non-IR/Revenues	42.1%	52.9%	53.5%	47.7%	46.6%	44.3%	42.3%
Core Revenue / Assets	4.51%	6.66%	4.65%	4.50%	4.44%	4.45%	4.49%
Cost/ Core Income	48.3%	47.5%	54.5%	54.0%	51.6%	49.9%	49.3%
Cost/Assets	2.18%	3.17%	2.54%	2.43%	2.29%	2.22%	2.21%
Core operating Profits	2.33%	3.49%	2.12%	2.07%	2.15%	2.23%	2.28%
LLP/Loans	0.55%	0.46%	0.58%	0.26%	0.49%	0.47%	0.52%
Loans/Assets	57.0%	58.2%	57.0%	56.0%	55.7%	55.9%	56.3%
Profits/Provisions on Sect.	0.00%	0.12%	-0.10%	-0.26%	0.05%	0.00%	0.00%
Pre-Tax	2.02%	3.10%	1.88%	2.18%	1.83%	1.97%	1.98%
Effective Tax Rate	33.0%	34.5%	34.3%	34.7%	33.0%	33.0%	33.0%
ROAA	1.35%	2.03%	1.24%	1.42%	1.22%	1.32%	1.33%
Equity / Assets	7.28%	14.51%	8.91%	7.50%	7.28%	7.13%	7.08%
RoE	18.6%	14.0%	13.9%	19.0%	16.8%	18.5%	18.7%
Adjusted BV	83.2						
PV of Adj BV	66.2						
g (high growth phase, FY11-16E)	25%						
g (perpetual)	5%						
COE	15.0%						
Current Price	138						
Fair P/BV	2.36x	(2 stage Gordon Growth Model)					
Current Fair Value	156	12 months Price Target (August 2009) = Rs.180					

Source: Company, JM Financial

Key Risks

Management attrition: Any significant attrition at the senior management level may increase the execution risk and hamper growth plans, which will adversely affect profitability.

Slower than expected branch openings: Any execution delay in terms of branch openings will impact the liability franchise and margins adversely.

Slower than expected growth in fee based income: Since Yes bank derives substantial portion of its income from capital market related fees, any prolonged capital market downturn will impact fee income negatively. While we have factored in 25 bps decline in the contribution of fee-based revenue to ROA, slower than expected growth will be downside risk to our estimates.

Higher than expected delinquencies: Economic downturn may result in deterioration in asset quality and could adversely affect the profitability of the bank. We have built-in higher delinquencies for Yes Bank in our projections. We expect specific LLP to increase from 26 bps in FY08 to 52 bps FY11. Higher than expected slippages remains risk to our estimates.

Company background

Yes Bank is the only Greenfield private sector bank to be set up in India since 1995. It was promoted by Mr Ashok Kapur and Mr Rana Kapoor, who has more than 30 years of experience in the financial services industry, with financial assistance from Rabobank of Netherlands. Promoters hold 33.6% stake while Rabobank has 18.2% stake in the bank. The bank currently has an asset base of US$4.2bn with a network of 80 branches spread across the country. The bank successfully completed its US$ 75mn IPO in July 2005 which was oversubscribed ~26 times. The bank recently completed preferential equity placement of 14.7 mn shares for US$ 84 mn to Orient Global Tamarind Fund in FY08 at a price of Rs 225 per share. Foreign shareholding currently stands at ~53% with top notch investors like Orient Global, Rabobank, AIF, Khazanah Nasional, Fidelity, HSBC, Swiss Re, amongst others.

Financial Tables

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	5,815	13,047	18,606	24,761	32,189
Interest Expenses	4,163	9,741	13,914	18,263	23,411
Net Interest Income (NII)	1,652	3,306	4,692	6,498	8,778
Profit on Investments	106	591	100	100	100
Exchange Income	330	220	246	283	326
Fee & Other Income	1,570	2,796	3,853	4,886	6,121
Non-Interest Income	2,007	3,607	4,199	5,269	6,547
Total Income	3,659	6,912	8,891	11,767	15,325
Operating Expenses	1,935	3,412	4,534	5,821	7,504
Pre-provisioning Profits	1,724	3,501	4,357	5,946	7,821
Loan Loss Provisions	254	204	543	685	1,001
Provisions on Investments	31	133	200	100	100
Other Provisions	2	99	0	0	0
Total Provisions	287	436	743	785	1,101
PBT	1,437	3,065	3,614	5,161	6,719
Tax	493	1,065	1,193	1,703	2,217
PAT (Pre-Extra ordinaries)	944	2,000	2,421	3,458	4,502
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	944	2,000	2,421	3,458	4,502
Dividend	0	0	0	0	0
Retained Profits	944	2,000	2,421	3,458	4,502

Source: Company, JM Financial

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	2,800	2,958	2,958	3,158	3,158
Reserves & Surplus	5,071	10,231	12,653	18,611	23,113
Deposits	82,204	132,732	179,188	240,112	312,146
Borrowings (Incld. Sub Debt)	13,459	17,137	23,089	27,252	30,648
Other Liabilities	7,501	6,766	8,119	9,337	10,738
Total Liabilities	111,035	169,824	226,007	298,469	379,802
Investments	30,731	50,937	68,465	90,982	116,340
Net Advances	62,897	94,303	126,066	166,898	215,013
Cash & Equivalents	12,928	16,276	24,001	29,131	34,052
Fixed Assets	710	1,012	1,219	1,460	1,668
Other Assets	3,769	7,297	6,256	9,998	12,730
Total Assets	111,035	169,824	226,007	298,469	379,802

Source: Company, JM Financial

Key ratios (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	182.5%	61.5%	35.0%	34.0%	30.0%
Advances	161.3%	49.9%	33.7%	32.4%	28.8%
Total Assets	166.7%	52.9%	33.1%	32.1%	27.2%
NII	93.4%	100.1%	41.9%	38.5%	35.1%
Non-Interest Income	101.2%	79.7%	16.4%	25.5%	24.3%
Operating Expenses	124.7%	76.3%	32.9%	28.4%	28.9%
Operating Profits	74.0%	103.0%	24.5%	36.5%	31.5%
Core Operating Profits	70.2%	79.9%	46.3%	37.3%	32.1%
Provisions	96.4%	51.6%	70.4%	5.6%	40.3%
PAT	70.6%	112.0%	21.1%	42.8%	30.2%
Yields / Margins (%)					
Interest Yield (%)	7.95%	9.73%	9.79%	9.80%	9.87%
Cost of Funds (%)	6.38%	7.93%	7.90%	7.78%	7.67%
Interest Spread (%)	1.57%	1.80%	1.89%	2.02%	2.19%
NIM (%)	2.26%	2.47%	2.47%	2.57%	2.69%
Profitability (%)					
ROA (%)	1.24%	1.42%	1.22%	1.32%	1.33%
ROE (%)	13.9%	19.0%	16.8%	18.5%	18.7%
Assets Quality (%)					
Gross NPAs (%)	0.00%	0.11%	0.53%	0.69%	0.77%
Net NPAs (%)	0.00%	0.09%	0.24%	0.28%	0.22%
Provision Coverage (%)	#DIV/0!	20.0%	55.0%	60.0%	72.0%
Capital Adequacy (%)					
Tier I (%)	8.20%	8.50%	8.29%	8.76%	8.31%
CAR (%)	13.56%	13.60%	13.55%	13.35%	12.24%

Source: Company, JM Financial

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	2.16%	2.35%	2.37%	2.48%	2.59%
Other income / Assets (%)	2.63%	2.57%	2.12%	2.01%	1.93%
Total Income / Assets (%)	4.79%	4.92%	4.49%	4.49%	4.52%
Cost to Assets (%)	2.54%	2.43%	2.29%	2.22%	2.21%
PPP / Assets (%)	2.26%	2.49%	2.20%	2.27%	2.31%
Provisions / Assets (%)	0.38%	0.31%	0.38%	0.30%	0.32%
ROA (%)	1.24%	1.42%	1.22%	1.32%	1.33%

Source: Company, JM Financial

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	280.0	295.8	295.8	315.8	315.8
EPS (Rs.)	3.4	6.8	8.2	10.9	14.3
EPS (YoY) (%)	64.5%	100.7%	21.1%	33.8%	30.2%
PE (x)	40.9	20.4	16.9	12.6	9.7
BV (Rs.)	28.1	44.6	52.8	68.9	83.2
P/BV (x)	4.91	3.09	2.61	2.00	1.66
DPS (Rs.)	0.0	0.0	0.0	0.0	0.0
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, JM Financial

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JM FINANCIAL

Country: India

10 August 2008

Initiating Coverage

Karnataka Bank

Bloomberg: KBL IB

Buy

CMP: Rs141 **Target Price (Aug 09): Rs 190**

Sector: Banking & Financial Services

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Key Data

Market cap	Rs17.0 bn/US$405 mn
Shares in issue (mn)	121
Diluted share (mn)	121
3-mon avg daily val (mn)	Rs26.7/US$ 0.6
52-week range	Rs286/117
BSE sensex (08/08/08)	15,168
Nifty (08/08/08)	4,530
Rs/US$	42.1

Shareholding Pattern (%)

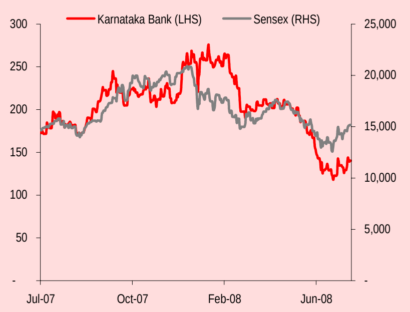
	1Q FY08	1Q FY09
Promoters	0.0	0.0
FIIs	33.3	39.3
MFs/FIs/Banks	4.7	6.1
Public	62.1	54.6
Others (incl. GDR/ADR)	0.0	0.0

Price Performance (%)

	1M	3M	12M
Absolute	5	(31)	(23)
Relative*	(7)	(22)	(25)

** To the BSE Sensex*

Daily Performance



(As of 8 August 2008)

Solid franchise at attractive valuation

Karnataka Bank's (KBL) balanced strategy of stable balance sheet growth with focus on margins, credit quality and cost efficiency would ensure that the bank continues to deliver profitable growth with decent return ratios. Solid franchise of 431 branches and ~3.5 mn customers makes KBL an ideal M&A play. With ROE of ~17%, KBL is currently trading at an attractive valuation of 0.9x FY11E book.

- **Consistent performer**: KBL has consistently delivered profitable growth with ROA and ROE averaging 1.3% and ~18% over FY03-08 respectively. We expect the bank to continue this trend and report ROA and ROE of ~1.2% and ~17% respectively by FY11E.
- **Balanced strategy with focus on margins**: KBL has delivered steady asset growth of 16% CAGR over FY03-08 without sacrificing on its margins (helped by excess SLR securities), which led to a stable 17% CAGR in profits during the same period. Going forward, we expect assets growth of 17% CAGR (FY08-11E) with stable margins leading to a steady 13 % CAGR in profits over FY08-11E (adversely impacted due to MTM provisions on AFS book).
- **Cost efficiency key strength**: KBL is one of the most efficient banks with cost to income ratio of ~40% and cost to assets ratio of ~1.7% vis-a-vis. 2.5-3% for its peer group helped by lean employee base and lower technology related expenses since 100% of its branches are under CBS.
- **Better capital management could lead to higher ROE:** KBL operates at significantly higher than required Tier I capital (~11% since FY02) and underutilises Tier II capital options. More efficient capital utilisation can lead to even higher ROE, which could re-rate the stock in our view.
- **Solid franchise makes it an ideal M&A candidate:** With a solid franchise of 431 branches and loyal customer base of 3.4 mn, KBL is an ideal takeover candidate. Any M&A activity should act as a significant catalyst for the stock.
- **Value pick**: KBL is one of the cheapest private sector banks in India, trading at P/BV of 0.9x FY11E. Given the expected return ratios and valuable franchise, we believe KBL is an attractive value pick. Based on a normalised ROE of 17%, we value the stock at 1.4x book, implying August 2009 **target price of Rs. 190 - upside of 36%** from current levels.
- **Risks to recommendation:** Higher than expected delinquencies, significant deterioration in cost ratios and high proportion of investments in AFS book (which leads to volatility in reported earnings) are the key risks for the stock.

Exhibit 1: Financial summary **(Rs mn)**

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	1,760	1,770	2,417	1,723	2,837	3,502
Net Profit (YoY) (%)	19.6%	0.6%	36.5%	-28.7%	64.7%	23.4%
Assets (YoY) (%)	19.4%	8.5%	19.2%	16.8%	17.4%	16.7%
ROA (%)	1.28%	1.14%	1.36%	0.82%	1.16%	1.22%
ROE (%)	16.9%	15.1%	18.5%	11.1%	15.4%	17.0%
EPS (Rs.)	14.5	14.6	19.9	11.8	19.5	24.0
EPS (YoY) (%)	19.6%	0.5%	36.5%	-40.6%	64.7%	23.4%
PE (x)	9.6	9.5	7.0	11.7	7.1	5.8
BV (Rs)	91.6	102.1	113.3	119.4	132.9	149.9
P/BV (x)	1.52	1.36	1.23	1.16	1.05	0.93

Source: Company, JM Financial.: Valuations as of 8 August 2008

Exhibit 2: Key Financials

Key Parameters	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR * (03-08)	CAGR * (08-11)E	Remarks
Balance sheet												
Deposits (Rs. bn)	82.9	94.1	108.4	132.4	140.4	170.2	197.4	232.9	272.5	15.5%	17.0%	Liability mix to remain fairly stable. Management is targeting CASA mix of 25% over the next two years.
CASA (Rs. bn)	15.4	19.1	23.4	27.6	32.8	37.7	45.0	55.0	65.4	19.7%	20.2%	
CASA Mix (%)	18.5%	20.3%	21.6%	20.9%	23.4%	22.1%	22.8%	23.6%	24.0%	3.6%	1.9%	
Loans (Rs. bn)	39.0	46.7	62.9	77.9	95.5	108.4	126.8	149.8	175.1	22.7%	17.3%	Loan growth of ~17% CAGR expected going forward. Branch addition of ~20 per year going forward
Total Assets (Rs. bn)	92.6	105.8	125.3	149.5	162.2	193.4	225.8	265.2	309.4	15.9%	17.0%	
Branches	363.0	370.0	381.0	395.0	410.0	431.0	451.0	471.0	491.0	3.5%	4.4%	
Income statement												
NII (Rs. bn)	1.5	2.1	3.1	3.6	4.1	4.6	5.3	6.2	7.2	24.3%	16.5%	Earnings growth of ~13% CAGR over FY08-11E. Earnings to be impacted by MTM provisions on the AFS book.
Core operating profits (Rs. bn)	0.8	1.3	2.0	2.4	2.9	3.1	4.0	4.9	6.0	31.4%	24.4%	
PAT (Rs. bn)	1.1	1.3	1.5	1.8	1.8	2.4	1.7	2.8	3.5	17.0%	13.2%	
Profitability												
Interest Spread (%)	1.40%	1.72%	2.34%	2.21%	2.22%	2.10%	2.04%	2.01%	2.00%	0.70%	-0.10%	Significant MTM provisions in FY09E on the AFS book to lead to a dip in ROA. Going ahead, we expect recovery in ROA helped by stable growth and steady cost ratios
NIM (%)	1.88%	2.17%	2.75%	2.66%	2.70%	2.66%	2.62%	2.61%	2.58%	0.78%	-0.07%	
ROA (%)	1.29%	1.34%	1.27%	1.28%	1.14%	1.36%	0.82%	1.16%	1.22%	0.07%	-0.14%	
ROE (%)	21.5%	20.8%	17.6%	16.9%	15.1%	18.5%	11.1%	15.4%	17.0%	-2.98%	-1.49%	
Asset Quality												
Net NPAs (Rs. Bn)	2.9	2.3	1.4	0.9	1.2	1.1	1.2	1.2	1.3	-17.9%	7.2%	We are expecting slippages to go up from ~1.5% in FY08 to ~1.7% in FY11E leading to an increase in LLP charges by ~16 bps.
LLP (Rs. Bn)	0.8	1.3	0.6	0.5	0.5	0.6	0.6	0.9	1.0	-7.4%	23.4%	
Slippages (%) ^	3.4%	3.7%	1.2%	0.9%	1.7%	1.5%	1.7%	1.7%	1.7%	-2.0%	0.2%	
LLP (%)	2.2%	3.0%	1.0%	0.7%	0.5%	0.5%	0.5%	0.7%	0.6%	-1.7%	0.1%	

Source: Company, JM Financial, Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

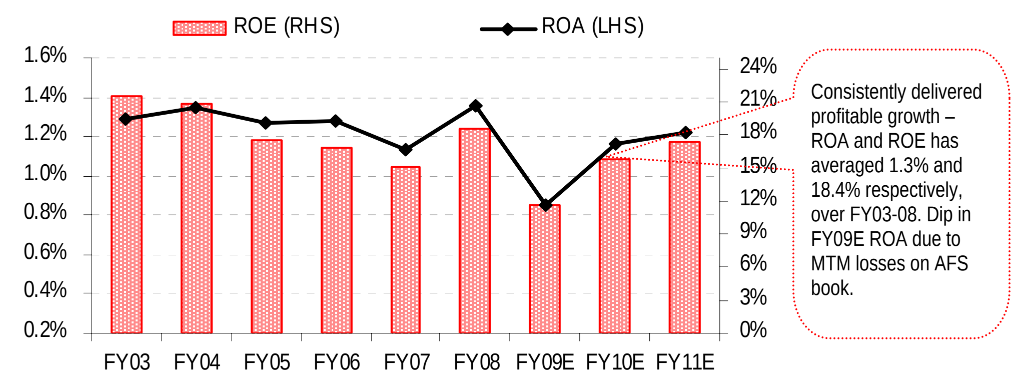
Solid franchise at attractive valuation

KBL has followed a balanced strategy of stable asset growth with focus on margins and asset quality which has resulted in consistent profitability and return ratios over FY03-08. We expect the bank to continue its consistent performance and report ROA and ROE of ~1.2% and 17% in FY11E. With 80% of its branches in the South, the management intends to expand outside the southern region by setting up more branches in the North and West going ahead. Solid franchise of 431 branches (100% of which are under CBS) and loyal customer base of ~3.4 mn makes KBL an ideal M&A candidate, which is available at attractive valuations.

Consistency in delivering profitable growth

KBL has been consistently delivering profitable growth and generating impressive return ratios. ROA and ROE generated by the bank has averaged 1.3% and 18.4% respectively over FY03-08. We expect the bank to continue this trend and report ROA and ROE of ~1.2% and ~17% by FY11E. Return ratios will primarily be impacted due to MTM losses on the AFS book (~50% of the investments is in AFS) and significantly lower treasury gains.

Exhibit 3: Consistent profitable growth



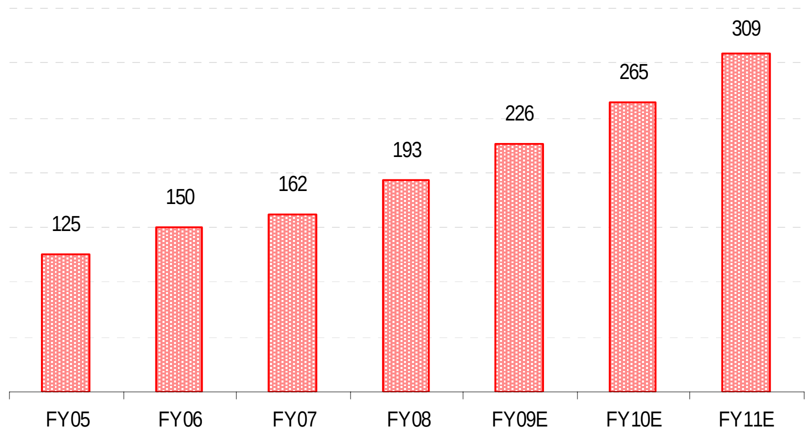
Source: Company, JM Financial

Stable Assets growth to continue

Assets size to expand at ~17% CAGR during FY08-11E

KBL has followed a balanced strategy of stable asset growth with focus on margins and asset quality in the past. It has witnessed an asset growth of 16% CAGR over FY03-08 and we expect similar growth rate of ~17% CAGR in asset book over FY08-11E with loan mix remaining relatively stable.

Exhibit 4: Asset book (Rs bn)



Source: Company, JM Financial

Deposits: Market share

Balanced growth at KBL is reflected in the fact that the bank is not a market share player. Its market share in the system deposits has infact declined from ~0.64% in FY03 to ~0.53% in FY08 and we expect it to stabilise at ~0.52% in FY11E. The incremental market share for the bank is currently at 0.5%. We expect deposits for KBL to grow at ~17% CAGR during FY08-11E.

Exhibit 5: Karnataka Bank's share in system deposits

Share in system deposits	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
System total Deposits (Rs Bn.)	11,234	13,043	15,428	17,851	21,090	26,119	31,921	37,827	44,447	52,002
KBL's Market share (%)	0.62%	0.64%	0.61%	0.61%	0.63%	0.54%	0.53%	0.52%	0.52%	0.52%
Incremental share (%)	0.69%	0.71%	0.49%	0.61%	0.75%	0.16%	0.50%	0.46%	0.54%	0.52%

Source: RBI, Company, JM Financial.

Diversified loan book

KBL has a well diversified loan book with exposure towards retail, mid-corporate and large corporates. Retail comprises ~31% of the loan book of which a significant proportion comprises mortgages. Going forward the bank expects SME to be the key driver of loan book growth. We expect loan book to expand at 17.3% CAGR during FY08-11E. The bank has a diversified industry–wise exposure as shown below.

Exhibit 6: Loan mix as on FY08

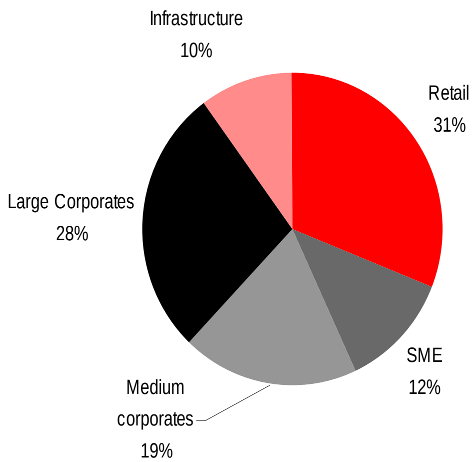
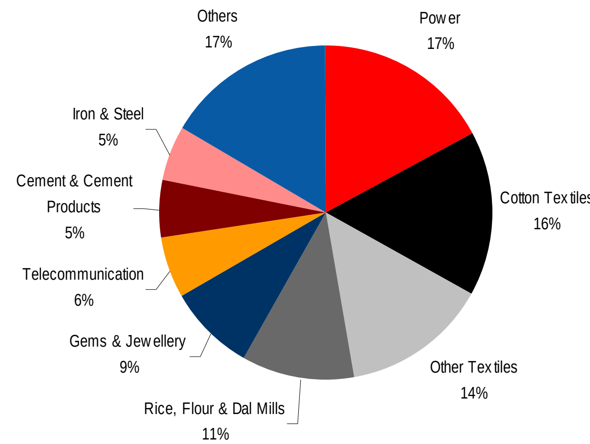


Exhibit 7: Industry wise exposure as on FY08



Source: Company, JM Financial.

To expand outside Karnataka

While currently ~80% of its branches are concentrated in South India (and 63% of the total is in Karnataka), substantial proportion of its incremental branches would be in the Northern and Western regions going ahead. KBL gets about 55% of deposits and 37% loans from its home state Karnataka, which it expects to reduce going forward on account of expanding distribution reach outside the Southern region.

Exhibit 8: Advances region wise break up (FY08)

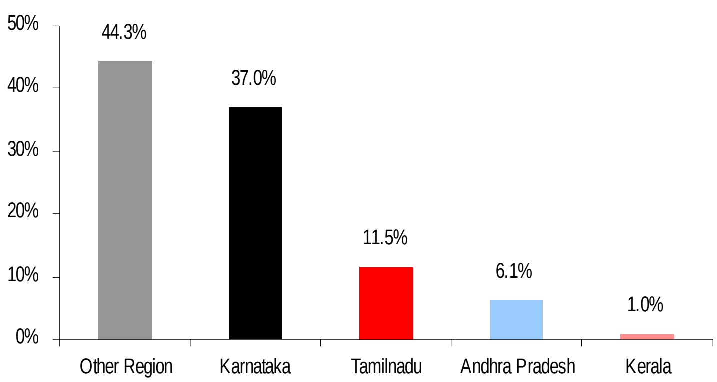
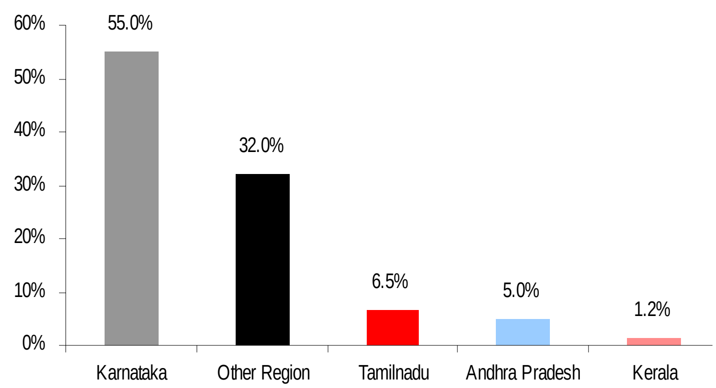


Exhibit 9: Deposits region wise break up (FY08)

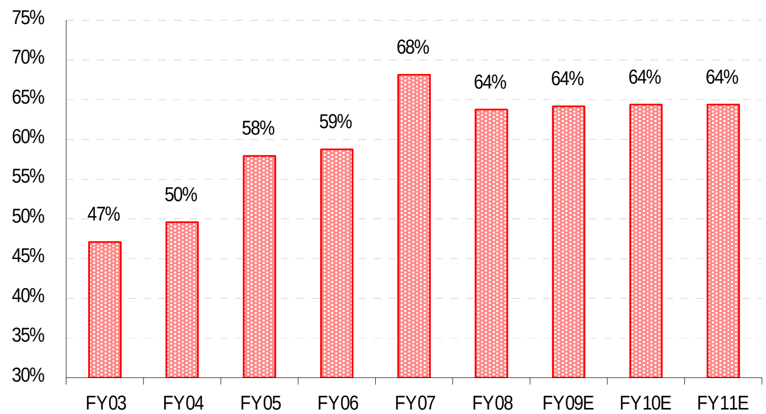


Source: Company, JM Financial

LDR to remain at current levels

Loan – Deposit ratio (LDR) at KBL has improved significantly from its historical levels of ~47% to 64% currently since it funded a portion its growth through unwinding excess SLR securities. We expect the LDR to remain stable at ~ 64% going forward.

Exhibit 10: Trend in LDR

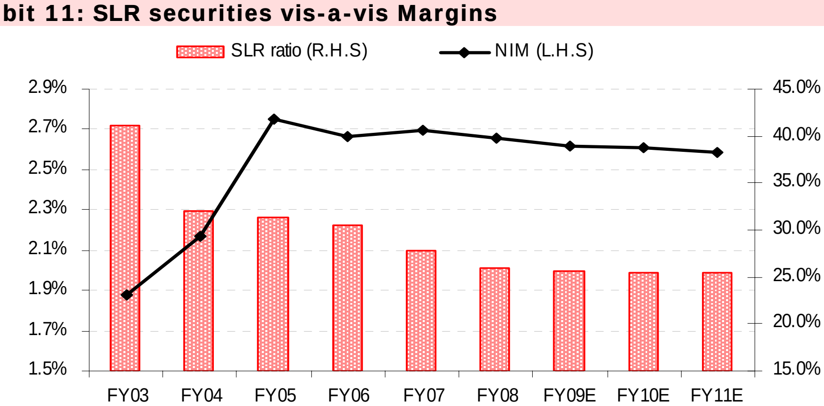


Source: Company, JM Financial

Margins to remain stable

KBL had excess SLR securities which were used effectively to fund the loan book from FY03-08. This coupled with improvement in LDR had led to ~80 bps improvement in margins during FY03-08. Currently, SLR ratio stands at 26% (regulatory minimum of 25%) as against ~50% in FY03. Going forward, we expect margins to remain stable led by improvement in CASA mix and repricing of loans at higher rates.

Exhibit 11: SLR securities vis-a-vis Margins

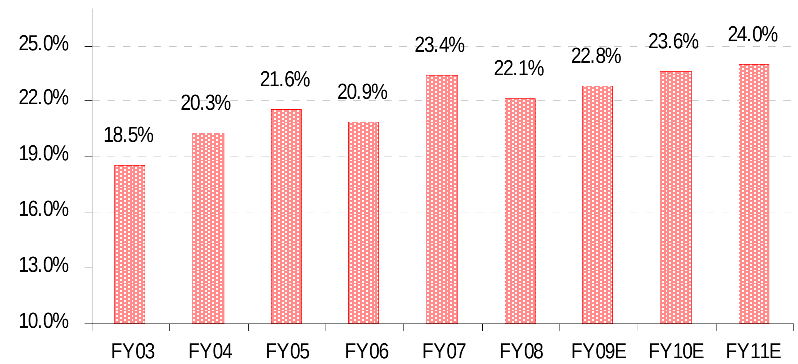


Source: Company, JM Financial

CASA mix to improve by 190 bps over FY08-11E

CASA mix at KBL has improved by ~400 bps over FY03-08 to 22.1%. Going forward, we expect the low-cost mix to improve by 190 bps through FY08-11E led by the fact that substantial portion of the incremental new branches will be set up in the CASA rich Northern region.

Exhibit 12: Trend in CASA mix

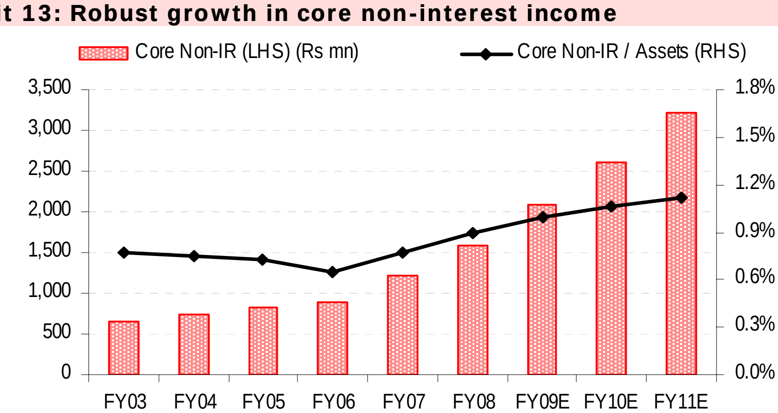


Source: Company, JM Financial

Improvement in core non-interest income

KBL has significantly increased its focus on fee based sources of revenues over the last couple of years. It has filled up the gaps in its product and services portfolio and has embarked upon achieving higher growth in income from various agency businesses like Life Insurance, General Insurance, Western Union Money Transfer and Mutual Fund Distribution. It has started distributing life and non-life insurance policies of Met Life and Bajaj Allianz respectively. It has also tied up with Franklin Templeton to sell their mutual funds. The bank also offers remittance services (tied up with Western Union) and demat services. This along with fee income generated from corporates through cash management services; transaction banking etc. should lead to a robust 26% CAGR in core non-interest income over FY08-FY11E. We expect significant decline in treasury income due to which the non-interest income is expected to grow at 13% CAGR over FY08-11E.

Exhibit 13: Robust growth in core non-interest income



Source: Company, JM Financial

Cost Efficiency - Key strength

KBL is one of the most efficient banks in India with cost to income ratio of ~40% and has one of the lowest costs to assets ratio of ~1.7% as against 2.5%-3% for its peers. This efficiency is driven by a) stable employee base and b) 100% of its branches are already under CBS due to which there are no significant technology related expenses. Consequently, the bank has the lowest other operating expenses to assets ratio within its peer group.

Exhibit 14: Peer comparison of cost to assets

Total costs/Assets	FY03	FY04	FY05	FY06	FY07	FY08
DCB	2.3%	2.7%	3.3%	3.6%	3.8%	3.7%
HDFC Bank (merged)	2.8%	2.6%	2.4%	3.1%	3.2%	3.4%
ING Vysya Bank	3.0%	2.8%	2.7%	3.2%	2.8%	2.7%
Yes Bank	0.0%	0.0%	6.2%	3.2%	2.5%	2.4%
Axis Bank	1.9%	1.9%	1.9%	1.9%	2.0%	2.4%
Indusind Bank	1.2%	1.7%	1.7%	1.9%	1.8%	1.7%
Karnataka Bank	1.7%	1.6%	1.7%	1.5%	1.5%	1.7%
Federal Bank	2.0%	2.1%	2.0%	1.9%	1.8%	1.6%
Average	1.9%	1.9%	2.7%	2.5%	2.4%	2.5%

Source: Company, JM Financial

KBL has the lowest costs to assets ratio of 1.7% vis-a-vis 2.5% for its peer group.

Exhibit 15: Peer comparison of operating expense to assets

Other operating cost/Assets	FY03	FY04	FY05	FY06	FY07	FY08
HDFC Bank (merged)	2.2%	2.0%	1.8%	2.2%	2.2%	2.3%
DCB	1.3%	1.5%	2.2%	2.3%	2.3%	2.2%
Axis Bank	1.4%	1.4%	1.3%	1.3%	1.4%	1.6%
ING Vysya Bank	1.4%	1.4%	1.4%	1.8%	1.5%	1.4%
Indusind Bank	0.9%	1.3%	1.3%	1.4%	1.3%	1.2%
Yes Bank	0.0%	0.0%	2.9%	1.3%	1.0%	1.0%
Federal Bank	0.0%	0.8%	0.8%	0.7%	0.6%	0.7%
Karnataka Bank	0.6%	0.6%	0.6%	0.6%	0.7%	0.7%
Average	1.0%	1.1%	1.6%	1.5%	1.4%	1.4%

Source: Company, JM Financial

KBL has the lowest other operating expenses to assets ratio within peers.

Exhibit 16: Peer comparison of employee cost to assets

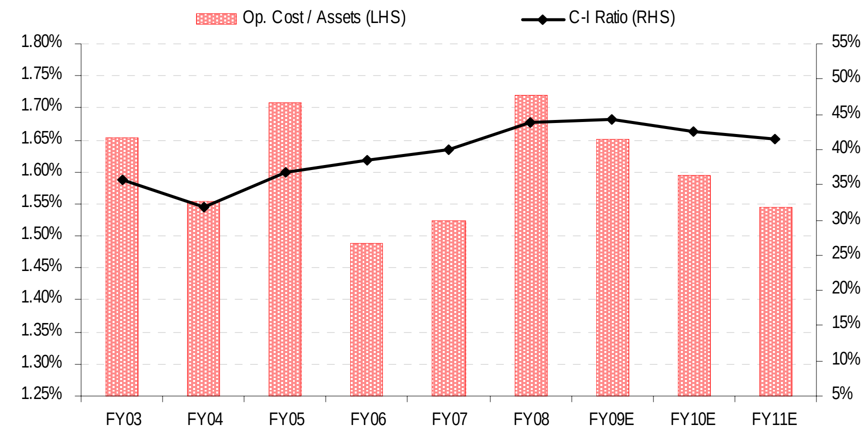
Employee Cost/Assets	FY03	FY04	FY05	FY06	FY07	FY08
DCB	0.99%	1.15%	1.09%	1.25%	1.54%	1.52%
Yes Bank	0.00%	0.00%	3.33%	1.84%	1.54%	1.44%
ING Vysya Bank	1.56%	1.36%	1.23%	1.46%	1.26%	1.35%
HDFC Bank (merged)	0.62%	0.58%	0.60%	0.89%	1.03%	1.18%
Karnataka Bank	1.05%	0.95%	1.08%	0.85%	0.83%	1.02%
Federal Bank	0.00%	1.31%	1.16%	1.22%	1.14%	0.95%
Axis Bank	0.50%	0.55%	0.57%	0.55%	0.62%	0.73%
Indusind Bank	0.28%	0.40%	0.39%	0.51%	0.50%	0.50%
Average	0.6%	0.8%	1.2%	1.1%	1.1%	1.1%

Source: Company, JM Financial

Employee expense to assets for KBL is in line with peer group average of ~1.1%.

Going forward, the bank is not planning any significant employee additions. Further with 100% of branches under CBS and no significant planned branch additions (20 branch additions every year), we expect cost ratios to remain steady going ahead with cost to income ratio of ~ 43% and cost to asset ratio of ~ 1.6%.

Exhibit 17: Trend in cost income and cost to assets ratio



Source: Company, JM Financial

Slippages to rise by 20 bps during FY08-11E

Asset quality at KBL has improved significantly over the years primarily helped by substantial improvement in risk management and credit monitoring systems. Gross and net NPLs have consistently improved to 3.41% and 0.98% respectively in FY08 from ~13% and ~7.5% in FY03. Coverage ratio has also improved during this period from ~47% in FY03 to 72% in FY08. Going ahead, we expect some pressure on asset quality, as a result the slippages are expected to rise by ~20 bps to 1.7% and correspondingly loan loss charges are expected to go up from ~0.5% to ~0.7% in FY11E. We expect the gross and net NPL ratio to stabilise at ~3% and ~0.8% respectively.

Exhibit 18: Trend in gross and net NPLs (%)

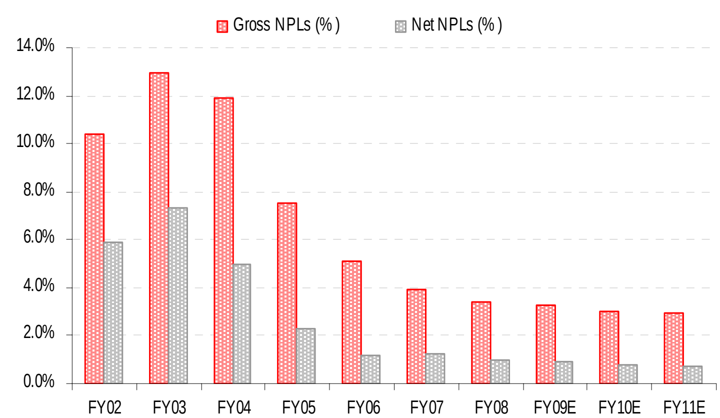
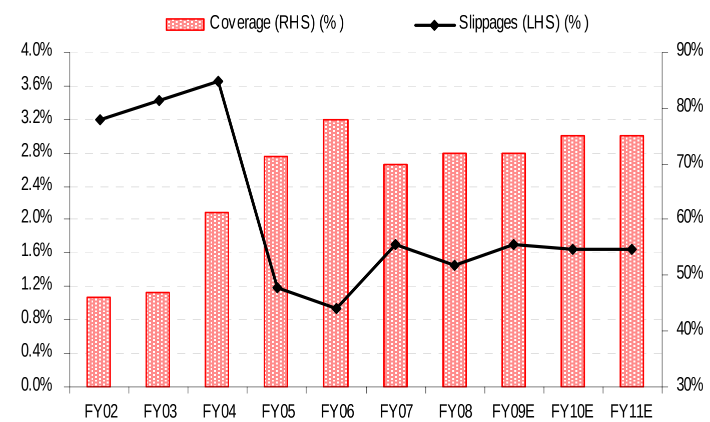


Exhibit 19: Slippages and coverage ratio (%)



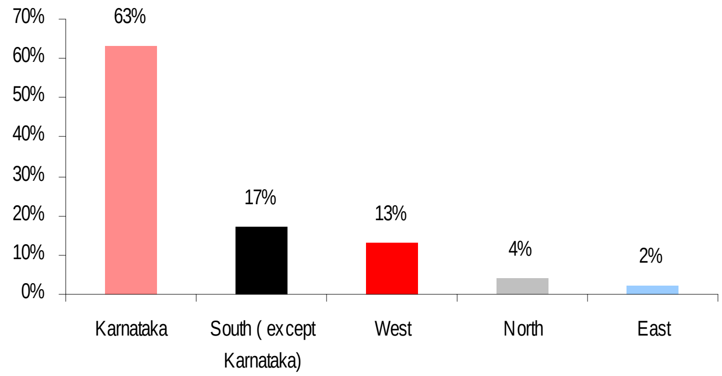
Source: Company, JM Financial

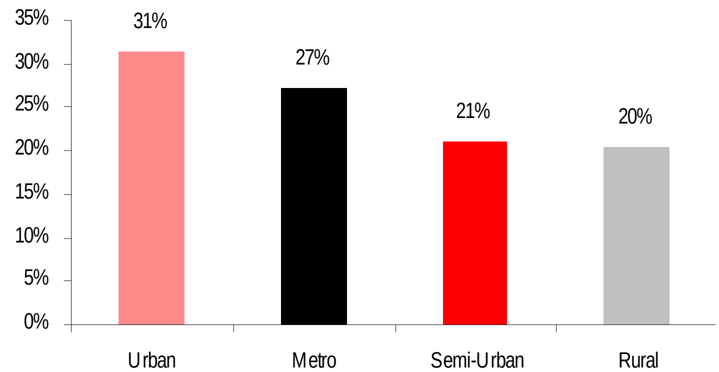
Valuable franchise

Strong branch network with large customer base

KBL currently has a network of 431 branches. While currently ~80% of its branches are concentrated in South India (and 63% of the total is in Karnataka), going ahead substantial proportion of its incremental branches would be set up in the Northern and Western regions. We expect the bank to open ~20 branches per year over the next couple of years.

Exhibit 20: Branch distribution (FY08)





Source: Company, JM Financial

100% of branches under CBS

KBL was one of the earliest banks to go in for core banking solution and currently all its branches have been brought under core banking solution (CBS) employing Finacle software provided by Infosys. It also provides all modern banking facilities like mobile and internet banking, online shopping, demat accounts, money transfer, etc. which is a testimony of the latest technology at KBL.

Strong Customer Base of ~ 3.4 mn

KBL has also developed a loyal customer base of ~3.4 mn over the past 8 decades. This coupled with a solid branch network ensures a valuable franchise at KBL.

Exhibit 21: Branch and Customer Base of South Based Banks as on FY08

Bank	Customer Base (mn)	Branches
Karnataka Bank	3.4	431
South Indian Bank	4	500
Federal Bank	4	603
Karur Vysya Bank	3	300
Indusind	1.9	180
ING Vysya Bank	1.4	446
City Union Bank	0.8	180

Source: Company, JM Financial

Ideal M&A candidate

In our opinion, the solid franchise of KBL coupled with the latest technology platform makes it an ideal takeover candidate. We believe any potential M&A activity would be a significant catalyst for the stock.

Better capital management could lead to higher ROE

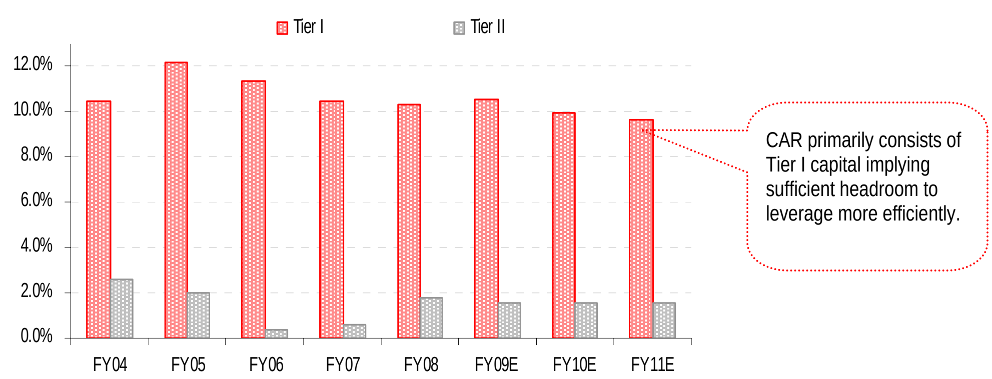
Rights issue

The bank has recently announced a rights offering in the ratio of 1:5 at a price of upto Rs 100 per share. Assuming the rights issue is priced at Rs 100, KBL will raise Rs 2.4 bn implying a dilution of 20%. This rights issue was announced after RBI did not give approval to the management's plans of preferential issue to International Finance Corporation. The bank also has a board approval to raise upto Rs 5 bn through the QIB route. We have not factored in any dilution from this, since; we believe that the bank has more than adequate capital to support its growth plans.

Inefficient capital management

This rights issue was not required in our opinion since the bank is more than adequately capitalised with current Tier I ratio at 10.4%. Capital adequacy ratio (CAR) at KBL primarily consists of Tier I capital implying sufficient headroom to leverage more efficiently (by using upper Tier I and Tier II capital) and report higher ROE, which could re-rate the stock in our view.

Exhibit 22: Tier I ratio and Tier II ratio

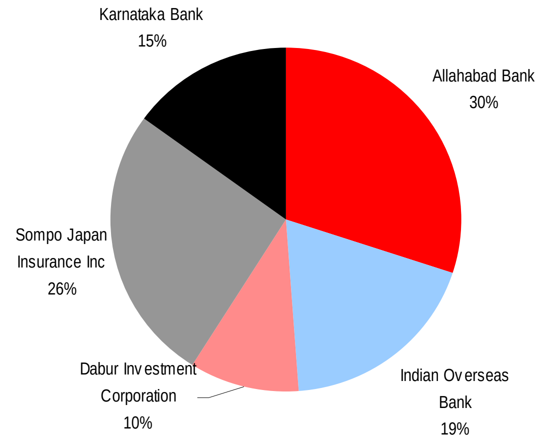


Source: Company, JM Financial

Non-life insurance venture to expand visibility of the bank

KBL has entered into a joint venture for carrying on general insurance business with Allahabad Bank, Universal Sompo of Japan, Indian Overseas Bank and Dabur Investment Corporation. KBL holds 15% stake in this venture.

Exhibit 23: Non-life insurance JV shareholding structure



Source: Company, JM Financial

The insurance JV is present across almost all product lines such as property, marine, motor, etc. The joint venture has been capitalised with shareholder fund of ~ Rs 2.35 bn. The company is targeting a premium income of around Rs 1.5 bn in FY09 which implies a market share of 2-3%. The insurance joint venture will help expand visibility for KBL at the national level, besides diversifying its business activity. At present KBL has no further plan of venturing into other related businesses.

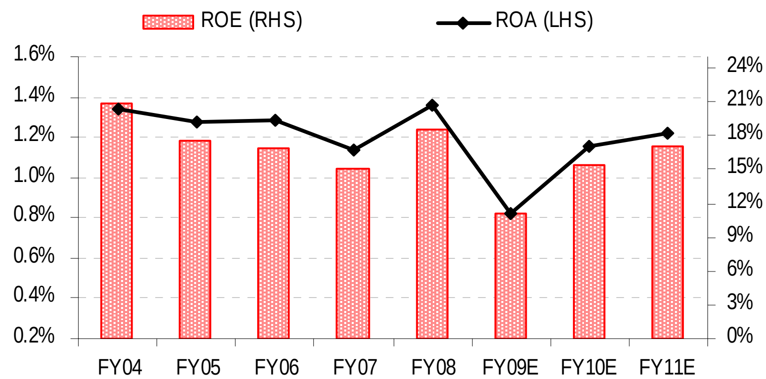
Dispersed shareholding

The shareholding at KBL is widely dispersed with no promoter group. Consequently, the bank has a free float of 100%. As of FY08, foreigners owned ~40% of the equity, and are permitted to own a maximum of 49%.

Valuations

We expect ~17% CAGR in balance sheet growth over FY08-11E with ROA of ~1.2% in FY11E, implying 13% CAGR in profits for KBL (despite significant MTM AFS provision in FY09E). We expect ROE of ~17% in FY11E.

Exhibit 24: Trend in ROA and ROE



Source: Company, JM Financial

KBL compares favourably with its peers in terms of market capitalization per customer and market capitalization per branch.

Exhibit 25: Peer comparison of market capitalisation per customer

Banks	Market Cap. (Rs bn)	Customers (mn) (FY08)	Market Cap/Customer (Rs)
South India Bank	10.8	4	2,700
Karnataka Bank	17.1	3.4	5,020
Karur Vysya Bank	18.2	3	6,081
Federal Bank	38.1	4	9,517
City Union Bank	9.1	0.8	11,340
Indusind Bank	23.2	1.9	12,011
Development Credit Bank	9.7	0.6	15,372
ING Vysya Bank	23.6	1.4	16,841

Source: Company, JM Financial

Exhibit 26: Peer comparison of market capitalisation per branch

Banks	Market Cap. (Rs bn)	Branches (FY08)	Market Cap/Branch (Rs mn)
South India Bank	10.8	500	22
Karnataka Bank	17.1	431	40
City Union Bank	9.1	180	50
ING Vysya Bank	23.6	446	53
Karur Vysya Bank	18.2	300	61
Federal Bank	38.1	603	63
Indusind Bank	23.2	210	110
Development Credit Bank	9.7	80	121
Axis Bank	263.7	671	393
HDFC Bank	545.1	1154	472
Yes Bank	41.1	67	613
ICICI Bank	801.5	1262	635

Source: Company, JM Financial

KBL is one of the cheapest private sector banks in India – trading at P/BV and P/E of 1.1x and 7x respectively for FY10E.

Exhibit 27: Peer comparison of P/B and P/E

	FY10E	FY10E
Banks	P/B	P/E
South India Bank	0.7	4.8
Federal Bank	0.8	6.6
Karnataka Bank	1.1	7.2
Karur Vysya Bank	1.1	6.1
ING Vysya Bank	1.2	10.9
City Union Bank	1.2	7.3
DCB	1.3	15.1
Indusind Bank	1.4	10.0
ICICI Bank	1.5	14.7
Yes Bank	2.0	12.3
Axis Bank	2.3	14.3
HDFC Bank	2.7	19.4

Source: Company, JM Financial

Based on a normalised ROE of 17%, we value the stock at 1.4x book (on two stage Gordon growth model), implying August 2009 **target price of Rs.190 - upside of ~36%** from the current levels.

On PE basis, the target price of Rs.190 would imply P/E of 9.8x FY10E EPS.

Exhibit 28: One-year forward P/BV (x)

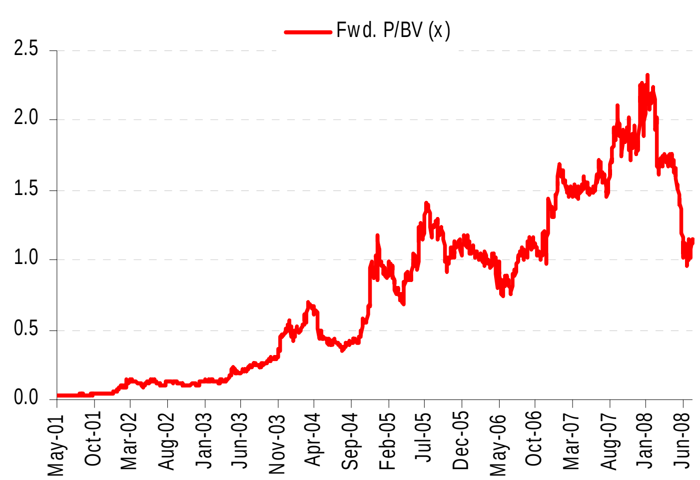
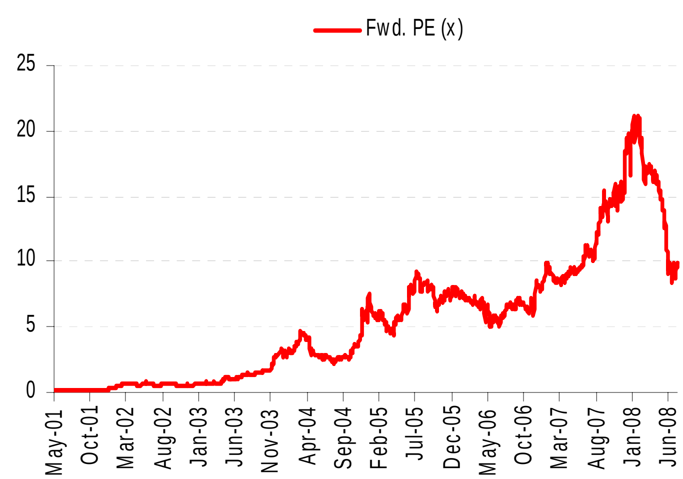


Exhibit 29: One-year forward PE (x)



Source: Bloomberg, JM Financial

Karnataka Bank: Normalised ROE

Based on a normalised ROE of 17%, we value the stock at 1.4x book (on two stage Gordon growth model), implying August 2009 target price of Rs.190 - upside of ~36% from the current levels.

Exhibit 30: Normalised earnings (%)

Karnataka Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	2.62%	2.66%	2.70%	2.66%	2.62%	2.61%	2.58%
NIM (as % of avg. Assets)	2.57%	2.59%	2.62%	2.58%	2.54%	2.54%	2.52%
Core Non-IR/Asset	1.14%	0.65%	0.78%	0.90%	0.99%	1.06%	1.12%
Core Non-IR/Revenues	30.7%	20.0%	22.8%	25.8%	28.1%	29.5%	30.7%
Core Revenue / Assets	3.71%	3.24%	3.40%	3.48%	3.54%	3.60%	3.64%
Cost/ Core Income	41.6%	45.9%	44.8%	49.4%	46.7%	44.3%	42.5%
Cost/Assets	1.54%	1.49%	1.52%	1.72%	1.65%	1.59%	1.55%
Core operating Profits	2.17%	1.75%	1.88%	1.76%	1.89%	2.01%	2.09%
LLP/Loans	0.67%	0.67%	0.52%	0.54%	0.55%	0.68%	0.64%
Loans/Assets	57.0%	51.2%	55.6%	57.3%	56.1%	56.3%	56.5%
Profits/Provisions on Sect.	-0.10%	-0.55%	-0.16%	-0.46%	0.41%	-0.10%	-0.09%
Pre-Tax	1.88%	1.96%	1.75%	1.91%	1.17%	1.72%	1.82%
Effective Tax Rate	33.0%	34.6%	35.1%	28.7%	30.0%	33.0%	33.0%
ROAA	1.26%	1.28%	1.14%	1.36%	0.82%	1.16%	1.22%
Equity / Assets	7.43%	7.60%	7.54%	7.35%	7.43%	7.48%	7.17%
RoE	17.0%	16.9%	15.1%	18.5%	11.1%	15.4%	17.0%
Adjusted BV	148.0						
PV of Adj BV	101.2						
g (high growth phase, FY11-16E)	17.5%						
g (perpetual)	5%						
COE	15%						
Current Price	141						
Fair P/BV	1.40x	(2 stage Gordon Growth Model)					
Current Fair Value	162	12 months Price Target (August 2009) = Rs.190					

Source: Company, JM Financial.

Key Risks

High proportion of AFS book leads to volatility in earnings: KBL has ~50% of its investment book in the available for sale (AFS) category, which leads to volatility in earnings depending on the movement of rates. The average duration of the AFS book is ~2.5 years. The bank provided Rs1.03 bn as MTM provision in its 1QFY09 results as yields headed northwards. In our opinion, with yields expected to harden, the bank would have to provide another Rs250mn in FY09E. However, the bank will have the ability to write-back such provisions with decline in interest rates which could boost profitability. We expect FY09E numbers to show a decline of 23% primarily on account of Rs1250 mn of MTM provision on the AFS book.

Exhibit 31: MTM provisions leads to earnings volatility

MTM table	FY05	FY06	FY07	FY08	FY09E
Reported PAT	1,472	1,760	1,770	2,417	1,723
yoy growth	*10%*	*20%*	*1%*	*37%*	*-29%*
AFS provisions	139	107	388	-59	1250
% of PAT	9%	6%	22%	-2%	73%

Source: Company, JM Financial

Negative surprise on costs: KBL is one of the most efficient banks with commendable cost income ratio of ~40%. However, any negative surprise on costs could be a downside risk for the stock.

Higher than expected delinquencies: Significant economic downturn may result in deterioration in asset quality and could adversely affect the profitability of the bank. While given the current macro uncertainty, we have built in increase in loan loss provisions by ~16 bps. Higher than expected slippages remains a risk to our estimates.

Company background

KBL is one of India's largest old generation private banks based out of Mangalore. The bank has a network of 431 branches across 19 states and 2 Union territories. The Bank was incorporated on February 18, 1924 to cater to the banking needs of the South Kanara Region. Over the years the bank grew with the merger of Sringeri Sharada Bank Ltd., Chitladurg Bank Ltd. and Bank of Karnataka. KBL came out with its initial public offering in October'95 at Rs 120 per share aggregating Rs 5.4bn. The bank with its valuable franchise of branches and ~3.4mn customer base is an ideal takeover candidate.

Exhibit 32: KBL: Key events

Year	Key Events
2000	Signed MoU with Infosys Technologies for implementation of FINACLE - Core Banking Solution
2002	Maiden Bonus Issue of shares in the ratio 1:1
2003	Rights Issue in the ratio of 1:2 aggregating Rs. 337.2 mn
2004	Completion of FINACLE at 200 branches
2006	Tie up with Franklin Templeton for distribution of their mutual funds.
2007	Bank signed MoU for setting up of non-life insurance joint venture with Allahabad Bank, Universal Sompo of Japan, Indian Overseas Bank and Dabur Investment Corporation. KBL holds 15% stake in this joint venture.
2008	100% net working of branches under core banking platform.

Source: Company, JM Financial

Management

The bank has no identifiable promoter and is managed by a professional team led by its chairman and CEO, Mr Ananthakrishna who has held this position since July 2000. He is a career banker with experience of more than 35 years. Mr Ananthakrishna, who has been with the bank for over three decades, is scheduled to be the CEO of the bank till July 2009. KBL's tier-II management comprises primarily of employees who have over three decades of experience at the bank.

Exhibit 33: KBL: Management Background

Name	Designation	Date of Appointment	Experience in the bank (years)
Mr. Ananthakrishna	Chairman & CEO	11.7.2000	35
Mr. Jayaram Bhat	Chief General Manager-P&D and HR & IR	17.1.1973	33
Mr. M. Gopalakrishna Bhat	General Manager- Inspection and Audit and Vigilance	11.4.1972	34
Mr. N.S. Chakkera	General Manager-Treasury & Accounts, Legal & Recovery	9.3.1971	35
Mr. Shivaswamy Aithal KH	General Manager- Credit	25.4.1972	34
Mr. Jayarama Hande P	General Manager Planning & Development, IT & MIS	22.11.1976	31

Source: Company, JM Financial

Financial Tables

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	12,455	15,605	18,626	21,864	25,604
Interest Expenses	8,364	11,017	13,293	15,635	18,358
Net Interest Income (NII)	4,091	4,587	5,333	6,229	7,246
Profit on Investments	639	782	400	350	250
Exchange Income	183	248	335	419	502
Fee & Other Income	1,028	1,344	1,748	2,192	2,705
Non-Interest Income	1,850	2,374	2,483	2,961	3,458
Total Income	5,941	6,962	7,815	9,190	10,704
Operating Expenses	2,375	3,056	3,461	3,914	4,439
Pre-provisioning Profits	3,566	3,906	4,354	5,276	6,265
Loan Loss Provisions	450	552	643	941	1,038
Provisions on Investments	388	-59	1,250	100	0
Other Provisions	0	25	0	0	0
Total Provisions	838	518	1,893	1,041	1,038
PBT	2,728	3,388	2,462	4,235	5,227
Tax	958	971	738	1,398	1,725
PAT (Pre-Extra ordinaries)	1,770	2,417	1,723	2,837	3,502
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	1,770	2,417	1,723	2,837	3,502
Dividend	497	710	510	874	1,019
Retained Profits	1,273	1,708	1,213	1,964	2,483

Source: Company, JM Financial

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	1,214	1,214	1,456	1,456	1,456
Reserves & Surplus	11,173	12,535	15,933	17,896	20,379
Deposits	140,374	170,162	197,388	232,918	272,514
Borrowings (Incld. Sub Debt)	4,207	2,922	3,506	4,262	5,057
Other Liabilities	5,257	6,566	7,544	8,668	9,961
Total Liabilities	162,225	193,398	225,827	265,201	309,367
Investments	50,482	59,637	68,328	80,414	93,818
Net Advances	95,527	108,420	126,845	149,755	175,147
Cash & Equivalents	11,615	19,842	24,185	28,548	33,128
Fixed Assets	1,068	1,198	1,286	1,377	1,452
Other Assets	3,533	4,301	5,183	5,106	5,821
Total Assets	162,225	193,398	225,827	265,201	309,367

Source: Company, JM Financial

Key ratios (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	6.0%	21.2%	16.0%	18.0%	17.0%
Advances	22.6%	13.5%	17.0%	18.1%	17.0%
Total Assets	8.5%	19.2%	16.8%	17.4%	16.7%
NII	14.8%	12.1%	16.2%	16.8%	16.3%
Non-Interest Income	4.9%	28.3%	4.6%	19.3%	16.8%
Operating Expenses	16.2%	28.6%	13.3%	13.1%	13.4%
Operating Profits	8.6%	9.5%	11.5%	21.2%	18.7%
Core Operating Profits	21.5%	6.8%	26.6%	24.6%	22.1%
Provisions	41.5%	-38.2%	265.4%	-45.0%	-0.3%
PAT	0.6%	36.5%	-28.7%	64.7%	23.4%
Yields / Margins (%)					
Interest Yield (%)	8.22%	9.03%	9.15%	9.15%	9.13%
Cost of Funds (%)	6.00%	6.94%	7.11%	7.14%	7.13%
Interest Spread (%)	2.22%	2.10%	2.04%	2.01%	2.00%
NIM (%)	2.70%	2.66%	2.62%	2.61%	2.58%
Profitability (%)					
ROA (%)	1.14%	1.36%	0.82%	1.16%	1.22%
ROE (%)	15.1%	18.5%	11.1%	15.4%	17.0%
Assets Quality (%)					
Gross NPAs (%)	3.94%	3.41%	3.30%	3.03%	2.93%
Net NPAs (%)	1.21%	0.98%	0.95%	0.78%	0.75%
Provision Coverage (%)	70.0%	71.9%	72.0%	75.0%	75.0%
Capital Adequacy (%)					
Tier I (%)	10.46%	10.36%	10.69%	10.13%	9.80%
CAR (%)	11.03%	12.17%	12.21%	11.69%	11.36%

Source: Company, JM Financial

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	2.62%	2.58%	2.54%	2.54%	2.52%
Other income / Assets (%)	1.19%	1.34%	1.18%	1.21%	1.20%
Total Income / Assets (%)	3.81%	3.92%	3.73%	3.74%	3.73%
Cost to Assets (%)	1.52%	1.72%	1.65%	1.59%	1.55%
PPP / Assets (%)	2.29%	2.20%	2.08%	2.15%	2.18%
Provisions / Assets (%)	0.54%	0.29%	0.90%	0.42%	0.36%
ROA (%)	1.14%	1.36%	0.82%	1.16%	1.22%

Source: Company, JM Financial

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	121.4	121.4	145.6	145.6	145.6
EPS (Rs.)	14.6	19.9	11.8	19.5	24.0
EPS (YoY) (%)	0.5%	36.5%	-40.6%	64.7%	23.4%
PE (x)	9.5	7.0	11.7	7.1	5.8
BV (Rs.)	102.1	113.3	119.4	132.9	149.9
P/BV (x)	1.36	1.23	1.16	1.05	0.93
DPS (Rs.)	4.1	5.8	3.5	6.0	7.0
Div. yield (%)	2.9%	4.2%	2.5%	4.3%	5.0%

Source: Company, JM Financial

JM FINANCIAL

Country: India

10 August 2008

Initiating Coverage

Development Credit Bank

Bloomberg: DEVB IB

Sell

Price:Rs 56 **Target Price (Aug 09): Rs 38**

Sector: Banking & Financial Services

Karan Uberoi
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Poonam Saney
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Credit Risk Resurfaces

DCB's riskier loan profile coupled with increasing stress levels on both, its retail and corporate book has resulted in resurfacing of credit risk after addressing legacy asset quality issues in FY07. Higher provisioning requirements and increase in effective tax rate would keep ROA and ROE depressed. Any potential M&A activity would be a positive catalyst for the stock and remains the key upside risk to our target price.

- **Riskier loan book profile:** Retail loans constitute ~45% of DCB's loan book, of which ~39% comprises riskier unsecured personal loans, which is facing significant stress levels on account of higher interest rates. Asset quality concerns would lead to moderation in balance sheet growth of 29 % CAGR (FY08-11E), as the management exercises caution in the current uncertain macro environment.
- **Higher delinquencies to adversely impact return ratios:** Portfolio delinquency at DCB jumped to ~4% in FY08 vs. ~2% in FY07. With a riskier asset book, we expect high levels of delinquency to continue going forward and adversely impact return ratios due to higher loan loss charges. Asset quality is expected to deteriorate with FY11E gross NPL at ~3.4% % vs. 1.5 % in FY08.
- **Risky strategy not resulting in high margins:** Despite riskier loan profile, margins generated at ~2.9% are lower than the system average of ~3% reflecting inadequate risk–return profile. This leads to unattractive return ratios for the bank.
- **Increase in effective tax rate to further depress ROA:** Due to accumulated losses, DCB is still a zero tax paying company. We expect DCB to pay tax from FY11 onwards, which will further impact return ratios. Helped by low base, we expect 31% CAGR in profits over FY08-11E. Despite that, the bank is expected to generate ROE of 11.1% in FY11E (one of the lowest amongst peer groups).
- **Resumption in branch expansion a positive:** DCB added eight branches in FY08 after adding just twelve branches over FY01-07 (on account of legacy problems). Going ahead we expect addition of ~20 branches per year which should lead to an improvement in low-cost mix to ~26% by FY11E and help mitigate funding cost pressure to an extent.
- **Valuations**: Based on a normalised ROE of 12.9%, we value the stock at 0.9X book, implying Aug'09 **target price of Rs 38** - downside of 32% from the current levels.
- **Risks to recommendation:** Any potential M&A activity would act as a positive catalyst for the stock and remains the key upside risk to our target price. Higher than expected delinquencies remains the key downside risk to our estimates.

Key Data

Market cap	Rs9.7 bn/US$230.8 mn
Shares in issue (mn)	174
Diluted share (mn)	174
3-mon avg daily val (mn)	Rs255.2/US$6.1
52-week range	Rs162/42
BSE sensex (08/08/08)	15,168
Nifty (08/08/08)	4,530
Rs/US$	42.1

Shareholding Pattern (%)

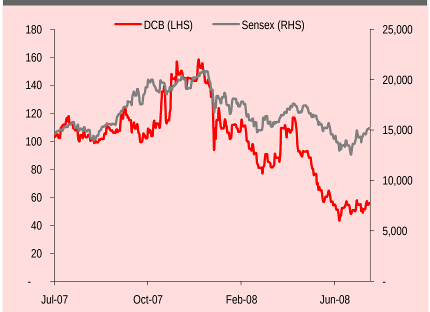
	1Q FY08	1Q FY09
Promoters	31.3	26.5
FIIs	30.8	17.7
MFs/FIs/Banks	2.1	4.1
Public	35.8	51.8
Others (incl. GDR/ADR)	0.0	0.0

Price Performance (%)

	1M	3M	12M
Absolute	(2)	(40)	(46)
Relative*	(15)	(31)	(48)

** To the BSE Sensex*

Daily Performance



(As of 8 August 2008)

Exhibit 1: Financial summary **(Rs mn)**

Y/E March	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Profit	-853	74	383	417	641	859
Net Porfit (YoY) (%)	n.m	n.m	419.5%	8.9%	53.5%	34.0%
Assets (YoY) (%)	-19.7%	40.3%	44.1%	28.9%	28.7%	28.7%
ROA (%)	-2.03%	0.16%	0.60%	0.48%	0.57%	0.60%
ROE (%)	-47.0%	3.1%	8.1%	6.5%	9.2%	11.1%
EPS (Rs.)	-11.2	0.5	2.2	2.4	3.7	4.9
EPS (YoY) (%)	n.m	n.m	340.0%	8.9%	53.5%	34.0%
PE (x)	n.m	111.2	25.3	23.2	15.1	11.3
BV (Rs.)	21.6	21.5	35.8	38.2	41.9	46.8
P/BV (x)	2.58	2.59	1.55	1.46	1.33	1.19

Source: Company, JM Financial.: Valuations as of 8 August 2008.

Exhibit 2: Key Financials

Key Parameters	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E	CAGR * (03-08)	CAGR * (08-11)E	Remarks
Balance sheet												
Deposits (Rs. bn)	36.6	44.7	38.9	31.2	44.2	60.8	79.0	102.7	133.5	10.7%	30.0%	Resumption of expansion in branch network should lead to improvement in CASA.
CASA (Rs. bn)	6.2	8.4	8.8	10.0	12.5	14.7	20.0	26.5	35.1	18.9%	33.5%	
CASA Mix (%)	17.0%	18.8%	22.7%	32.1%	28.3%	24.3%	25.3%	25.8%	26.3%	7.3%	2.0%	
Loans (Rs. bn)	24.7	25.1	21.6	18.7	26.6	40.7	53.3	69.8	91.0	10.5%	30.8%	Asset to grow at ~29% CAGR over FY08-11E with management intending to increase the share of secured retail loan mix going forward.
Total Assets (Rs. bn)	43.5	52.8	46.6	37.4	52.5	75.7	97.5	125.5	161.5	11.7%	28.7%	
Assets growth		21%	-12%	-20%	40%	44%	29%	29%	29%			
Branches	59.0	64.0	67.0	67.0	67.0	80.0	90.0	105.0	120.0	6.3%	14.5%	
Income statement												
NII (Rs. bn)	0.8	1.0	0.7	0.5	1.0	1.7	2.3	3.1	4.0	16.4%	33.1%	Helped by a low base, earnings growth is expected at ~31% CAGR over FY08-11E.
Core operating profits (Rs. bn)	0.3	0.3	-0.2	-0.3	0.3	0.9	1.3	1.8	2.6	25.6%	41.6%	
PAT (Rs. bn)	-0.1	-0.4	-0.7	-0.9	0.1	0.4	0.4	0.6	0.9	n.m.	30.8%	
Profitability												
Interest Spread (%)	1.70%	2.03%	1.38%	1.16%	2.13%	2.30%	2.29%	2.38%	2.47%	0.61%	0.17%	Return ratios to remain muted with ROE at ~11% by FY11E. Going forward, return ratios would remain under pressure due to higher loan loss charges and increasing tax rates.
NIM (%)	1.97%	2.13%	1.50%	1.28%	2.32%	2.77%	2.82%	2.85%	2.87%	0.79%	0.11%	
ROA (%)	-0.23%	-0.90%	-1.47%	-2.03%	0.16%	0.60%	0.48%	0.57%	0.60%	0.83%	0.00%	
ROE (%)	-3.9%	-24.8%	-40.5%	-47.0%	3.1%	8.1%	6.5%	9.2%	11.1%	12.1%	3.0%	
Asset Quality												
Gross NPAs (Rs. Bn)	3.2	3.5	3.1	3.1	1.5	0.6	1.8	2.4	3.1	-27.5%	70.0%	Significant increase in slippages of ~4% in FY08 raises asset quality concerns.
Net NPAs (Rs. Bn)	2.3	1.9	1.4	0.8	0.4	0.3	0.9	1.2	1.6	-34.9%	79.5%	
Gross NPAs ratio (%)	12.4%	13.0%	13.3%	15.0%	5.3%	1.5%	3.4%	3.4%	3.4%	-10.8%	1.8%	
Net NPAs ratio (%)	9.4%	7.5%	6.3%	4.5%	1.6%	0.7%	1.7%	1.7%	1.7%	-8.7%	1.1%	
Coverage ratio (%)	26.8%	45.2%	56.0%	73.3%	70.2%	57.5%	50.0%	50.0%	50.0%	30.7%	-7.5%	
LLP (Rs. Bn)	0.2	0.6	0.4	0.6	0.4	0.7	0.9	1.3	1.7	25.1%	34.5%	
Slippages (%) ^	n.a.	n.a.	3.5%	3.1%	2.0%	4.0%	4.0%	3.5%	3.5%	n.m.	-0.5%	
LLP (%)	1.0%	2.4%	1.8%	3.0%	1.6%	2.1%	2.0%	2.1%	2.1%	1.1%	0.0%	

Source: Company, JM Financial, Note: ^ Additions to NPAs (fresh delinquencies) as %age of opening standard advances, * Figures for ratios signify change over the specified period.

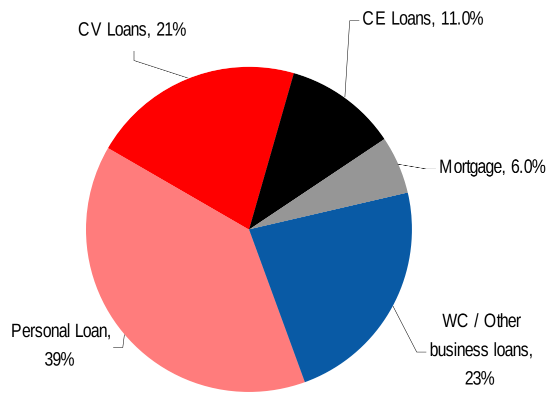
Credit Risk Resurfaces

DCB's riskier loan profile coupled with increasing stress levels on both, its retail and corporate book has resulted in resurfacing of credit risk after addressing legacy asset quality issues in FY07. DCB has witnessed significant deterioration in asset quality, which till FY08 was primarily in its unsecured retail book. However in 1QFY09, this has percolated to its corporate book raising significant asset quality concern. Helped by a low base, the bank will be able to report 31% CAGR in profits over FY08-11E. Despite that, the return ratios will continue to be amongst the lowest in its peer group with FY11E ROA and ROE at 0.6% and 11.1% respectively. Going forward, higher provisioning requirements and increase in effective tax rate would keep ROA and ROE depressed. Any potential M&A activity would be a positive catalyst for the stock and remains the key upside risk to our target price.

Riskier loan book profile

DCB has a riskier loan book profile with ~39% of retail assets (which is 45% of the book) as unsecured personal loans, which is facing high level of delinquencies on account of the increase in interest rates. The balance retail book comprises commercial vehicle loans (21% of retail book), construction equipment loans (21%) working capital or business loans (23%) and home equity loans (6% of the retail book) which have also been facing higher stress levels. Going forward the management expects to bring down the proportion of unsecured book on account of credit quality issues.

Exhibit 3: Retail loan book mix as on FY08 (%)



Source: Company, JM Financial.

Asset Quality Concern

Legacy asset quality problems addressed during FY06 and FY07

The new management team at DCB, which was inducted in FY06, had addressed the legacy NPA problem through capital raising, aggressive recognition and provisioning of bad loans and focusing on recoveries. Consequently, gross and net NPL ratio had improved from ~13% and ~7.6% in FY04 to ~1.5% and ~0.6% in FY08, respectively.

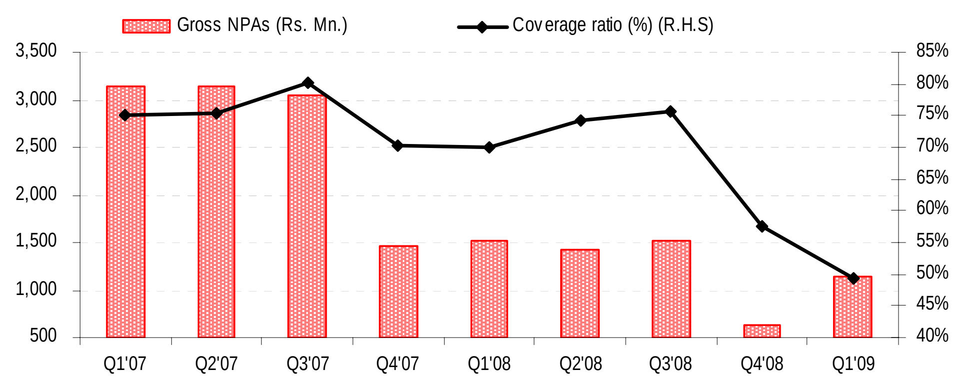
Credit quality concerns re-emerge in FY08

Significant increase in delinquency level during FY08: DCB witnessed a significant increase in the delinquency levels during FY08 primarily on account of higher levels of slippages in the unsecured personal loan segment. Portfolio delinquency for FY08 witnessed a substantial jump of 200 bps yoy to 3.96%.

Percolates to the corporate book in 1QFY09: DCB witnessed significant deterioration in asset quality in 1QFY09 with 81% and 115% qoq increase in gross and net NPLs, respectively. As a result during 1QFY09, gross and net NPLs rose by 142bps and 86bps qoq to 2.96% and 1.52% respectively. According to the management, ~63% of the incremental increase in gross NPL levels is related to corporate account which could be upgraded going forward. However, we believe that DCB will face significant asset quality issues, both on the retail and corporate book, as implied from FY08 delinquency levels of ~4% and significant deterioration in credit quality in 1QFY09.

Coverage ratio down to below 50% over the last two quarters: Over the last two quarters, profits were supported by a decline in coverage ratio from ~75% in 3QFY08 to below 50% in 1QFY09.

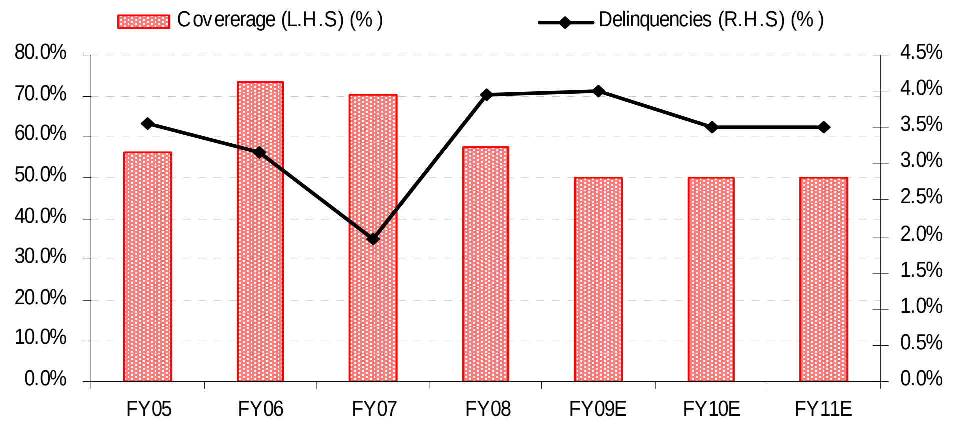
Exhibit 4: Quarterly trends in asset quality



Source: Company, JM Financial

High level of delinquency to continue going ahead: We believe that given the uncertain macro environment and elevated levels of interest rates, DCB's riskier loan book will continue to face high level of delinquencies going forward. We expect delinquencies to stabilise at ~3.5% by FY11E with coverage ratio expected to remain at ~50%.

Exhibit 5: Trends in delinquencies and coverage ratio



Source: Company, JM Financial

Increasing Loan loss charges to impact return ratios

We expect increasing delinquencies to result in higher loan loss charges going ahead. In our opinion, loan loss charges are expected to increase to ~2.12% going forward. Despite such an increase, coverage ratio is expected to be at 50% over FY08-11E.

Exhibit 6: Trend in delinquencies (%)

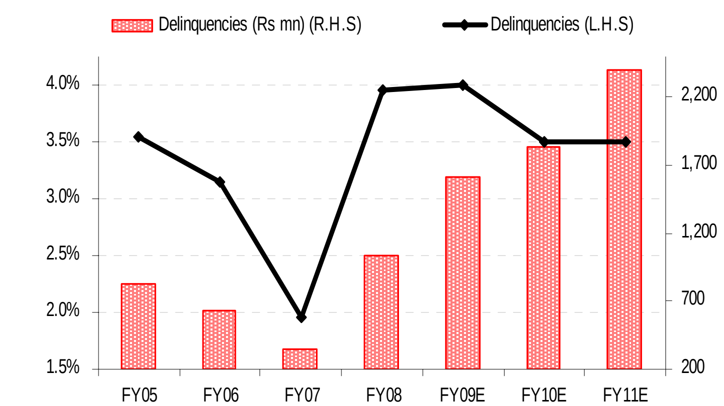
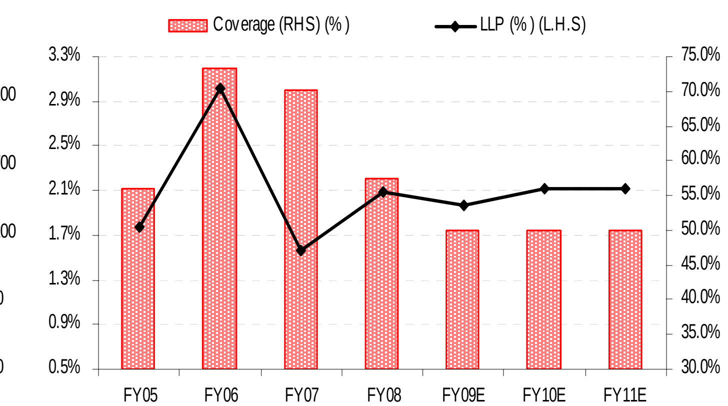


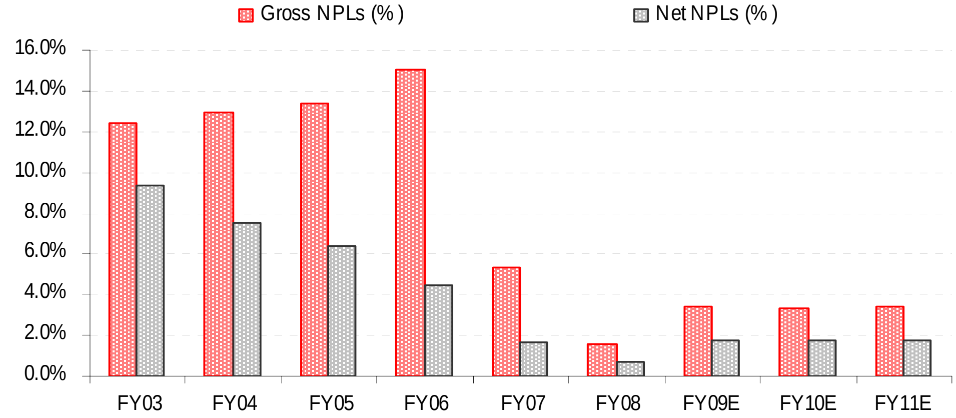
Exhibit 7: Trend in coverage ratio and LLP



Source: Company, JM Financial.

Increase in gross and net NPLs: We expect gross and net NPLs to rise to 3.37% and 1.71% respectively, by FY11E from 1.55% and 0.66% in FY08.

Exhibit 8: Trend in gross and net NPL ratios

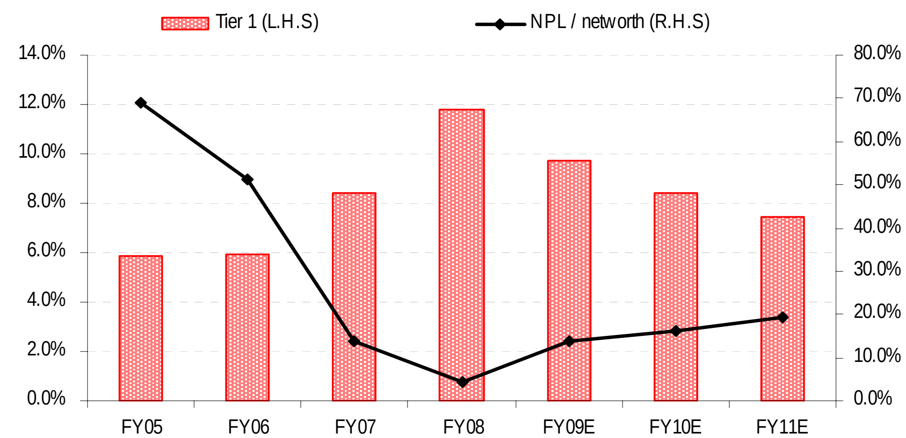


Source: Company, JM Financial

Higher than expected delinquencies could lead to capital raising

The bank raised Rs 2.8 bn of Tier I equity capital in 2QFY08 at a price of Rs 105 per share through preferential allotment leading to a dilution of 18.1%. While capital would be sufficient given the expected balance sheet growth (the bank has headroom to raise hybrid Tier I capital), higher than expected delinquencies could lead to raising of equity capital going forward. As per our estimates, net NPL to networth is expected to rise to 20% by FY11E. We however, do not expect any significant increase in delinquencies from FY08 levels of ~4% and hence have not assumed any capital raising in our estimates.

Exhibit 9: Trend in Tier I capital and NPL/networth ratio



Source: Company, JM Financial

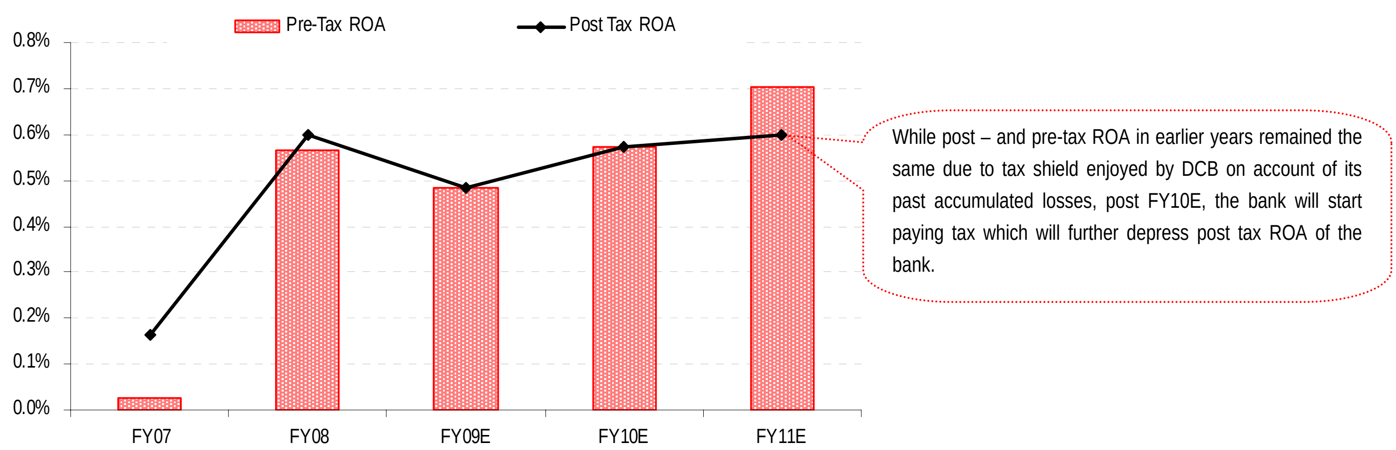
Inadequate Risk-Return Profile

DCB has a riskier loan profile with ~39% of the retail book comprising of unsecured personal loans. However riskier loan profile is not getting adequately rewarded as reflected in higher margins, which currently at ~2.8%, is lower than the Indian banking system average of ~3%. This implies that more risk on balance sheet is not getting translated into higher margins. It is this risky strategy coupled with below par returns that does not enthuse us in the current uncertain macro environment.

Increase in effective tax rate to further depress ROA

Currently, DCB is not paying any tax on account of accumulated losses to the tune of ~Rs 2 bn as of FY08. The bank is expected to start paying tax from FY11E however; the tax rate in FY11E is estimated to be at 15% due to some remaining accumulated losses. Post 2011E, the bank will pay tax at the marginal tax rate of 33% as the accumulated losses are expected to get wiped out, which will further depress ROA and ROE reported by DCB (apart from the increase in loan loss charges). Consequently, we expect DCB to post the lowest return ratios within its peer group.

Exhibit 10: DCB to start paying tax from FY11E



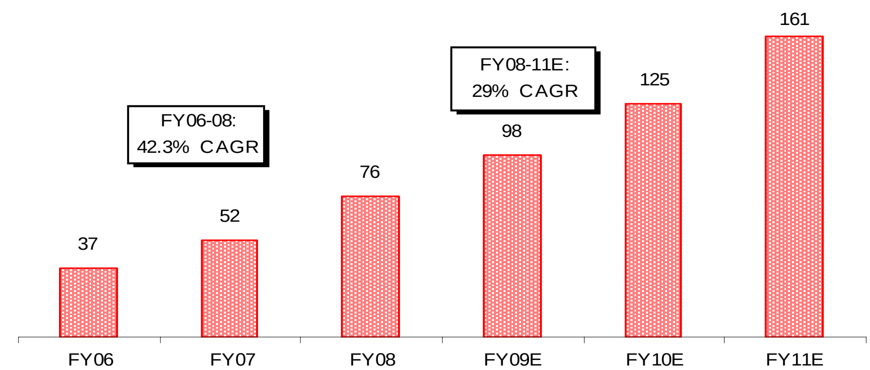
Source: Company, JM Financial

Asset growth to moderate

Assets size to expand at ~29% CAGR during FY08-11E

After addressing the legacy problems and raising capital via IPO in FY07, DCB began to scale up its operations which led to robust balance sheet growth of 42% CAGR over FY06-08. However, rise in delinquencies and credit quality issues will lead the management to exercise caution, in our opinion. We expect a slowdown in balance sheet growth to 29% CAGR over FY08 -11E.

Exhibit 11: Asset book (Rs bn)

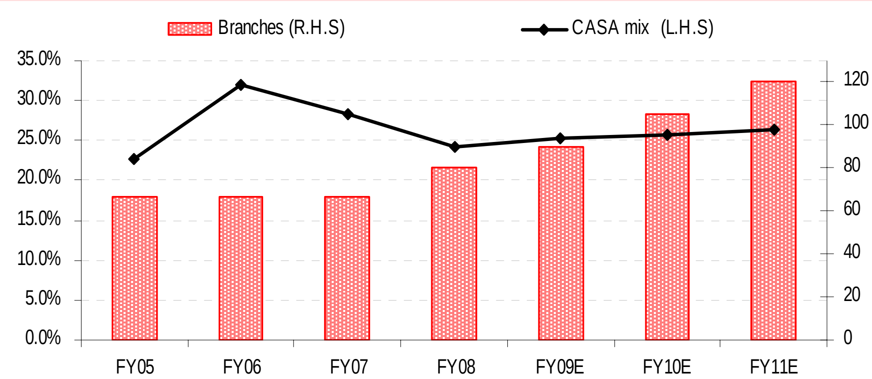


Source: Company, JM Financial

Resumption of branch expansion to help low-cost mix

The liability profile at DCB should get a boost due to resumption of branch expansion. The bank added 8 branches and converted 5 extension counters into branches during FY08, as compared to adding just 12 branches over FY01-07 (impacted due to legacy problems). Expansion of branch network to 120 by FY11E should improve the low-cost mix by ~200 bps over FY08-11E to 26.3%. We expect 10 bps improvement in margins to ~2.9% by FY11E led by branch expansion.

Exhibit 12: Branches and CASA mix



Source: Company, JM Financial

Fee income: Focus on Third party distribution

DCB has started distributing life and non-life insurance policies of Birla Sun Life and Reliance General Insurance, respectively. This along with distribution of various mutual fund products should boost third party distribution of fee income. It has also tied up with HDFC to market their loan products for commission, launched cash management services and tied up with Indiainfoline for on-line broking and all this should help boost its fee income. We expect 25% CAGR in core non-interest income over FY08-11E.

Cost ratios – Potential for Improvement

Possibility of Improvement in cost ratios

The cost ratios at DCB are one of the highest in the industry at 3.73% for FY08, which is a major drag on ROA.

DCB fares poorly in terms of productivity parameters like asset per employee, where it lags its peers, generating lowest asset per employee. DCB generates one of the lowest assets per employee at Rs 34 mn in FY08. In our opinion, there is potential for improvement in employee productivity and consequently business generated per employee at DCB.

Exhibit 13: Peer comparison: Cost ratios

Cost/Assets	FY07	FY08
Development Credit Bank	3.8%	3.7%
HDFC Bank (merged)	3.2%	3.4%
ING Vysya Bank	2.8%	2.7%
Yes Bank	2.5%	2.4%
Axis Bank	2.0%	2.4%
ICICI Bank	2.2%	2.2%
Karnataka Bank	1.5%	1.7%
Indusind Bank	1.8%	1.7%
Federal Bank	1.8%	1.6%

Exhibit14: Peer Comparison: Assets/Employee (Rs mn)

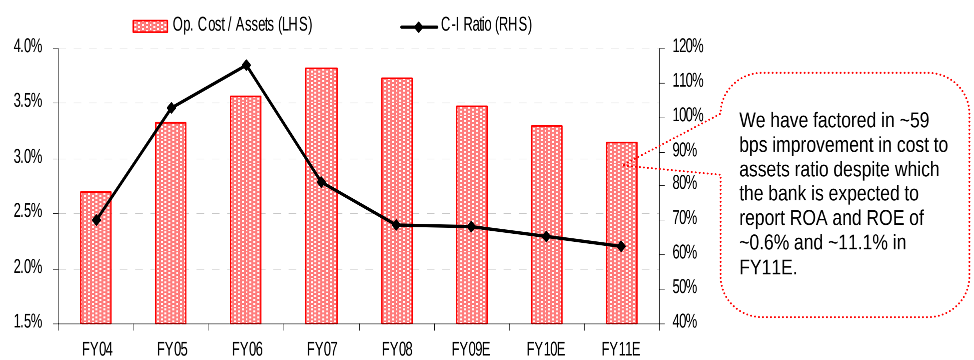
Assets/Employee(Rs mn)	FY07	FY08
Development Credit Bank	29.0	33.9
HDFC Bank (merged)	40.2	35.4
Karnataka Bank	36.4	41.3
ING Vysya Bank	36.1	43.6
Federal Bank	38.0	46.7
Yes Bank	45.5	53.9
Axis Bank	73.4	74.3
Indusind Bank	80.1	82.2
ICICI Bank	103.4	108.6

Source: Company, JM Financial.

Have factored in significant improvement in cost ratios

We expect cost to assets ratio to improve substantially by ~59 bps to 3.14% during FY08-11E. Cost improvement would primarily be driven by a 60% increase in assets per employee from Rs 34 mn in FY08 to Rs 54 mn in FY11E. Despite such a massive improvement in cost ratios, ROA and ROE is expected to be at 0.6% and 11.1% in FY11E.

Exhibit 15: Trend in cost ratios



Source: Company, JM Financial

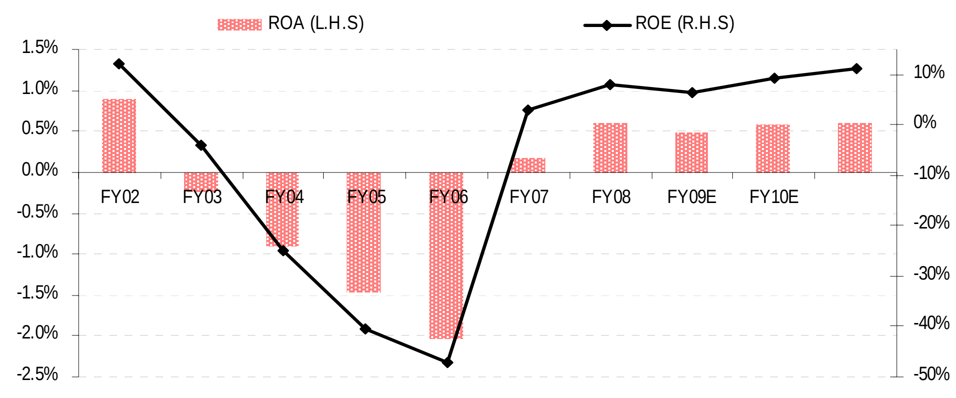
Valuations

We expect ~29% CAGR in balance sheet growth over FY08-11E with ROA of ~0.6% in FY11E, which should lead to 31% CAGR in profits for DCB.

Unexciting return ratios

We expect DCB to report unexciting ROA and ROE of 0.6% and 11.1% in FY11E, lower than its peers. Increase in effective tax rate post FY11E is further expected to keep the return ratios depressed.

Exhibit 16: ROA and ROE trends



Source: Company, JM Financial

Compared to the return ratios of peers, DCB will report the lowest return ratios in FY10E and FY11E.

Exhibit 17: Peer comparison of return ratios

	ROE		ROA	
	FY10E	FY11E	FY10E	FY11E
Yes Bank	18.5%	18.7%	1.32%	1.33%
Axis Bank	17.4%	18.9%	1.15%	1.17%
HDFC Bank (merged)	16.2%	16.6%	1.25%	1.28%
Karnataka Bank	15.4%	17.0%	1.16%	1.22%
ING Vysya Bank	12.7%	n.a.	1.00%	n.a
ICICI Bank	11.3%	12.3%	1.21%	1.24%
Development Credit Bank	9.2%	11.1%	0.57%	0.60%

Source: Company, JM Financial

Currently, DCB is trading at 23x FY09E and 15x FY10E earnings.

Exhibit 18: Peer comparison of price to earnings multiple

	PE (x)	
	FY09E	FY10E
HDFC Bank	24.7	20.0
Development Credit Bank	23.3	15.2
Axis Bank	19.0	14.3
ICICIB	18.9	14.0
Yes Bank	16.9	12.6
Karnataka Bank	11.9	7.2

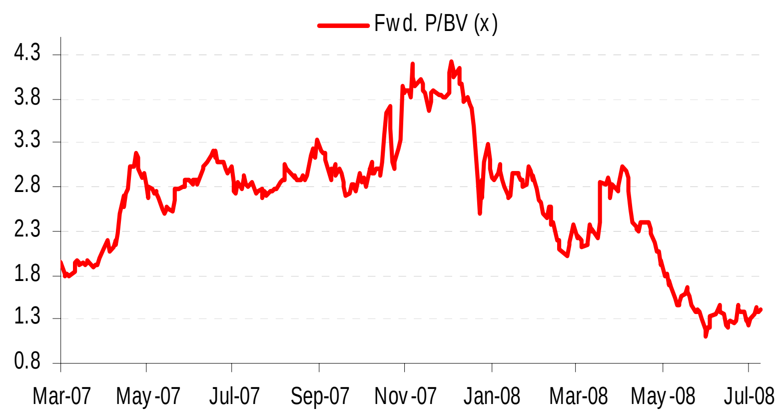
Source: Company, JM Financial

Stock down 62% YTD, Pain to continue

Despite sharp YTD 63% correction in the stock, we believe, given the resurfacing of credit quality risk, pain will continue for DCB. Higher provisioning requirements and increase in effective tax rate would keep ROA and ROE depressed going forward.

Based on a normalised ROE of 12.9%, we value the stock at 0.9x book (on two-stage Gordon growth model), implying August 2009 **target price of Rs.38 – downside of ~32%** from the current levels. We initiate coverage of DCB with a sell rating.

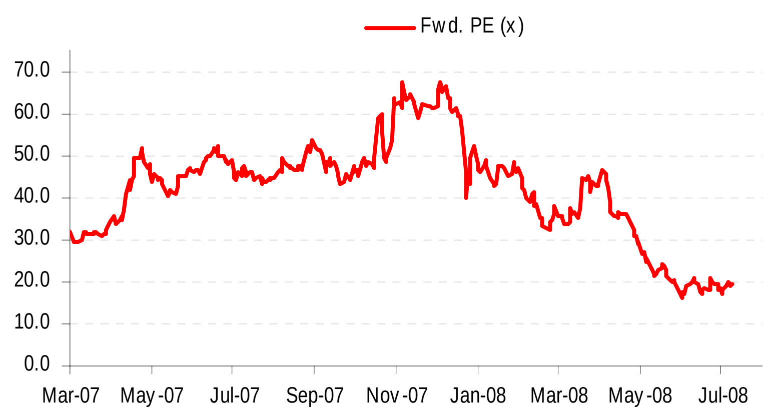
Exhibit 19: One-year Fwd P/BV (x)



Source: Bloomberg, JM Financial.

On PE basis, the target price would imply P/E of 10.3x FY10 EPS.

Exhibit 20: One-year Fwd PE (x)



Source: Bloomberg, JM Financial.

DCB: Normalised ROE

Based on a normalised ROE of 12.9%, we value the stock at 0.9x book (on 2-stage Gordon growth model), implying August 2009 target price of Rs.38 – downside of ~32% from the current levels.

Exhibit 21: Normalised Earnings (%)

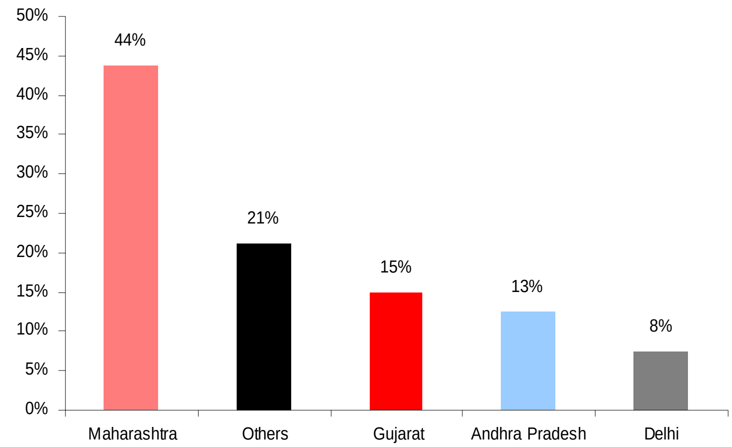
Development Credit Bank	NORMALISED	FY06	FY07	FY08	FY09E	FY10E	FY11E
Net Margin (as % of avg. IEA)	2.90%	1.28%	2.32%	2.77%	2.82%	2.85%	2.87%
NIM (as % of avg. Assets)	2.78%	1.19%	2.18%	2.64%	2.71%	2.74%	2.78%
Core Non-IR/Asset	2.23%	1.58%	2.40%	2.51%	2.26%	2.21%	2.17%
Core Non-IR/Revenues	44.5%	57.0%	52.4%	48.8%	45.5%	44.7%	43.9%
Core Revenue / Assets	5.02%	2.77%	4.58%	5.15%	4.97%	4.96%	4.95%
Cost/ Core Income	53.8%	128.8%	83.5%	72.4%	69.9%	66.6%	63.5%
Cost/Assets	2.70%	3.57%	3.82%	3.73%	3.47%	3.30%	3.14%
Core operating Profits	2.32%	-0.80%	0.76%	1.42%	1.50%	1.66%	1.81%
LLP/Loans	2.00%	3.02%	1.56%	2.08%	1.97%	2.12%	2.12%
Loans/Assets	55.0%	47.9%	50.3%	52.5%	54.3%	55.2%	56.1%
Profits/Provisions on Sect.	-0.06%	-0.29%	-0.05%	-0.23%	-0.06%	-0.09%	-0.09%
Pre-Tax	1.28%	-1.96%	0.02%	0.56%	0.48%	0.57%	0.70%
Effective Tax Rate	33.0%	-3.7%	-565.5%	-6.1%	0.0%	0.0%	15.0%
ROAA	0.86%	-2.03%	0.16%	0.60%	0.48%	0.57%	0.60%
Equity / Assets	6.61%	4.32%	5.35%	7.34%	7.45%	6.26%	5.38%
RoE	12.9%	-47.0%	3.1%	8.1%	6.5%	9.2%	11.1%
Adjusted BV	43.7						
PV of Adj BV	34.5						
g (high growth phase, FY11-16E)	20%						
g (perpetual)	5%						
COE	15.5%						
Current Price	56						
Fair P/BV	0.9x	(2 stage Gordon Growth Model)					
Current Fair Value	33	12 months Price Target (August 2009) = Rs. 38					

Source: Company, JM Financial.

Key Risks

M&A activity key upside risk to our target price: Fundamentally, DCB will report unexciting return ratios over the next several years. However, any potential M&A activity would be a significant positive catalyst for the stock. DCB could be a potential target for private and foreign banks primarily because of its branches. DCB currently has 80 branches, of which ~44% is in Maharashtra (most of them in Mumbai) and can be a source of attraction for potential buyers.

Exhibit 22: Distribution of Branch network (FY08)



Source: Company, JM Financial

Higher than expected delinquencies: Given the uncertain and difficult macro-economic environment and bank's significant exposure towards unsecured loan segment, higher than expected delinquencies remains the key downside risk to our estimates.

Company background

DCB has been in existence for over 77 years. In the 1990s there were about 1400 co-operative banks in India and a few of these co-operative banks were given permission by RBI to convert into scheduled commercial banks. DCB was one of 11 such banks that converted themselves into scheduled commercial banks. It ran into capital and NPL related problems and consequently a new management team, led by Mr. Nasser Munjee was inducted in FY06. The Bank has a strong and committed promoter, the Aga Khan Fund for Economic Development S.A. (AKFED), which currently has ~26.5 % stake in DCB. DCB came out with an IPO in FY07 at Rs 26 per share which was oversubscribed ~ 35 times. Currently, it has a balance sheet size of ~Rs 72 bn (USD 1.7 bn) and a network of 80 branches with customer base of ~0.65 mn.

DCB intends to become as strong regional player with focus on Western India which is one of the fastest growing regions in the country. It wants to focus in the states of Maharashtra, Gujarat and Goa, Rajasthan, Punjab, Andhra Pradesh, Haryana and the National Capital Region. The bank finds immense opportunities in these states on account of high per capita income.

Exhibit 23: Management Team

Name	Designation	Profile
Mr. Nasser Munjee	Chairman	Between 1997-2004, Mr Munjee worked with IDFC and played a key role in its initial development, and later served as its MD and CEO.
Mr. Gautam Vir	MD & CEO	He has > 29 yrs of banking experience across India, Asia Pacific, Middle East & Eastern Europe. Prior Assignment: CEO of Hebros Bank (Sofia, Bulgaria) from 2000-2005. He has also held very senior positions in Citibank N.A., Singapore, and Standard Chartered Bank, Dubai.
Mr. H. Krishnamoorthy	Exec. VP & & Head Treasury and Financial Institutions Group	He has > 22 yrs of experience in banks such as the Standard Chartered Bank & Commerzbank.
Mr. Susheel Kak	Exec. VP & Chief Credit and Risk Officer	He has 30 yrs of corporate & commercial banking experience. Prior Assignment: Head of Corporate Banking, at IDBI Bank Ltd.
Mr. Parag Patankar	Exec. VP & Chief Operations and Technology Officer	He has > 14 yrs of experience in the areas of project finance, banking and technology in organisations including ICICI Bank and 3i Infotech. Prior Assignment: Co-founder & Director, CIO & Business Head of Apnaloan.com
Mr. Praveen Kutty	Exec. VP & Head Consumer Banking	He has 16 yrs of banking experience and worked with Citibank's Indian and international operations where he successfully managed multiple consumer banking businesses. Prior Assignment: Area Director for Citibank's NRI Business in North America.
Mr. Pravin Batra	Exec. VP & Head Corporate and Business Banking Group	He has 20 yrs of banking experience, the majority of which has been with Citibank NA in India & overseas in various capacities. Prior Assignment: Senior VP & Head of Corporate Banking – IndusInd Bank.
Mr. R. Venkattesh	Exec. VP & Head Human Capital	He has > 15 yrs of experience in the field Human Resource Mgmt and M&A. Prior Assignment: Standard Chartered Bank as Head, Human Resources – Countries.

Source: Company, JM Financial

Exhibit 24: Key Events

Month, Year	Key Events
1981	Amalgamation of Masalawala Co-operative Bank Limited and Ismailia Co-operative Bank Limited into Development Co-operative Bank Limited
1995	Conversion of Development Co-operative Bank Limited into Development Credit Bank Ltd.
2003 - 2004	Classified as a “new private sector bank” by the RBI
2004 - 2005	Crisil Rating of P1+ for the Certificate of Deposits Programme for an aggregate value of Rs. 30 bn which was raised to Rs. 70 bn subsequently.
2005 - 2006	Private Equity Investment to the extent of ~Rs.5.2 bn
2006 - 2007	IPO whereby the bank raised Rs1.86 bn at Rs26 per share
2007 - 2008	Private placement whereby the bank raised Rs 2.8 bn at Rs 105 per share

Source: Company, JM Financial

About Promoter group

DCB has a strong and committed promoter Aga Khan Fund for Economic Development (AKFED), which currently holds 26.5% stake in the bank. AKFED is an international development agency which promotes entrepreneurship in the private sector in the developing world. AKFED operates as a network of affiliates with more than 90 separate project companies employing over 30,000 people, with annual revenues in excess of US$1.5 billion. AKFED operates in five broad sectors: financial services, industry and infrastructure, tourism development, media and aviation. AKFED has in the past supported the bank by infusing capital when required.

Financial Tables

Profit & loss statement (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Interest Income	3,254	5,572	7,959	10,539	13,715
Interest Expenses	2,274	3,880	5,616	7,481	9,729
Net Interest Income (NII)	980	1,692	2,343	3,058	3,986
Profit on Investments	63	184	100	100	125
Exchange Income	149	229	320	416	562
Fee & Other Income	928	1,382	1,639	2,053	2,555
Non-Interest Income	1,140	1,795	2,059	2,569	3,242
Total Income	2,120	3,487	4,403	5,628	7,227
Operating Expenses	1,718	2,391	3,007	3,680	4,511
Pre-provisioning Profits	403	1,096	1,395	1,948	2,716
Loan Loss Provisions	353	701	928	1,307	1,706
Provisions on Investments	29	31	50	0	0
Other Provisions	10	3	0	0	0
Total Provisions	392	735	978	1,307	1,706
PBT	11	361	417	641	1,010
Tax	-63	-22	0	0	152
PAT (Pre-Extra ordinaries)	74	383	417	641	859
Extra ordinaries (Net of Tax)	0	0	0	0	0
Reported Profits	74	383	417	641	859
Dividend	0	0	0	0	0
Retained Profits	74	383	417	641	859

Source: Company, JM Financial.

Balance sheet (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	1,476	1,743	1,743	1,743	1,743
Reserves & Surplus	1,694	4,497	4,914	5,555	6,413
Deposits	44,152	60,750	78,975	102,668	133,468
Borrowings (Incld. Sub Debt)	3,204	5,928	8,449	11,424	14,956
Other Liabilities	1,970	2,754	3,429	4,105	4,915
Total Liabilities	52,496	75,671	97,510	125,494	161,495
Investments	18,466	21,346	29,265	37,760	47,893
Net Advances	26,585	40,688	53,347	69,849	91,016
Cash & Equivalents	4,677	10,616	10,902	13,794	17,146
Fixed Assets	687	894	1,178	1,454	1,790
Other Assets	2,081	2,128	2,817	2,637	3,650
Total Assets	52,496	75,671	97,510	125,494	161,495

Source: Company, JM Financial.

Key ratios (%) (Rs mn)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Growth (YoY) (%)					
Deposits	41.3%	37.6%	30.0%	30.0%	30.0%
Advances	42.4%	53.0%	31.1%	30.9%	30.3%
Total Assets	40.3%	44.1%	28.9%	28.7%	28.7%
NII	95.5%	72.7%	38.5%	30.5%	30.3%
Non-Interest Income	42.0%	57.4%	14.7%	24.8%	26.2%
Operating Expenses	14.5%	39.2%	25.8%	22.4%	22.6%
Operating Profits	-304.7%	172.3%	27.3%	39.6%	39.4%
Core Operating Profits	-201.2%	168.6%	42.0%	42.7%	40.2%
Provisions	-37.4%	87.7%	33.1%	33.7%	30.5%
PAT	-108.7%	419.5%	8.9%	53.5%	34.0%
Yields / Margins (%)					
Interest Yield (%)	7.71%	9.11%	9.58%	9.81%	9.89%
Cost of Funds (%)	5.57%	6.80%	7.29%	7.42%	7.41%
Interest Spread (%)	2.13%	2.30%	2.29%	2.38%	2.47%
NIM (%)	2.32%	2.77%	2.82%	2.85%	2.87%
Profitability (%)					
ROA (%)	0.16%	0.60%	0.48%	0.57%	0.60%
ROE (%)	3.1%	8.1%	6.5%	9.2%	11.1%
Assets Quality (%)					
Gross NPAs (%)	5.29%	1.55%	3.39%	3.36%	3.37%
Net NPAs (%)	1.64%	0.66%	1.72%	1.71%	1.71%
Provision Coverage (%)	70.2%	57.5%	50.0%	50.0%	50.0%
Capital Adequacy (%)					
Tier I (%)	8.44%	11.80%	9.73%	8.42%	7.45%
CAR (%)	11.34%	13.38%	11.98%	10.85%	9.85%

Source: Company, JM Financial.

DuPont Analysis (%)

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
NII / Assets (%)	2.18%	2.64%	2.71%	2.74%	2.78%
Other income / Assets (%)	2.54%	2.80%	2.38%	2.30%	2.26%
Total Income / Assets (%)	4.72%	5.44%	5.08%	5.05%	5.04%
Cost to Assets (%)	3.82%	3.73%	3.47%	3.30%	3.14%
PPP / Assets (%)	0.90%	1.71%	1.61%	1.75%	1.89%
Provisions / Assets (%)	0.87%	1.15%	1.13%	1.17%	1.19%
ROA (%)	0.16%	0.60%	0.48%	0.57%	0.60%

Source: Company, JM Financial.

Valuations

Y/E March	FY07	FY08	FY09E	FY10E	FY11E
Shares in issue (mn)	147.6	174.3	174.3	174.3	174.3
EPS (Rs.)	0.5	2.2	2.4	3.7	4.9
EPS (YoY) (%)	-104.5%	340.0%	8.9%	53.5%	34.0%
PE (x)	111.2	25.3	23.2	15.1	11.3
BV (Rs.)	21.5	35.8	38.2	41.9	46.8
P/BV (x)	2.59	1.55	1.46	1.33	1.19
DPS (Rs.)	0.0	0.0	0.0	0.0	0.0
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, JM Financial.

Notes

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