

## Company In-Depth

23 April 2007 | 6 pages

# Union Bank Of India (UNBK.BO)

## Upgrade to Buy: High ROE; Low Multiple

 Rating change 

 Target price change 

 Estimate change 

- Upgrade to Buy post stock price correction** — Upgrading Union Bank to Buy/Low Risk (1L) from Sell (3L) as current valuation is at 0.9x FY08E book value, following a 21% correction from its peak. Maintain target price and estimates.
- Tougher environment hurts growth; profits remain on course** — The higher interest rate scenario in the Indian banking sector will be a drag on growth, lead to higher provisioning on loans and bonds. However, it should be supportive of margins and profitability, with asset quality declining but not damaging.
- Managing growth and profitability, better** — Union Bank bounced back in 3Q07 – with a strong profit performance, and a healthy growth and margin mix. We see management more focused and committed to manage this equation than in the past, where profitability was sacrificed for growth. Limited funding flexibility, and slightly higher share of wholesale funding is a constraint
- Amongst most profitable, but finely balanced on capita** — Union generates one of the highest ROE's amongst Government banks, has significant fee income momentum, and is ahead of peers on technology. Its relatively finely balanced capital position is an offset, though prudent management – which we see evidence of - could well support higher valuations.
- Maintain target price, valuations in-line with peers** — We maintain our target price of Rs125 based on our EVA model and value the bank in-line with the Government banks.

<b>Buy/Low Risk</b>	<b>1L</b>
<i>from Sell/Low Risk</i>	
Price (20 Apr 07)	Rs103.75
Target price	Rs125.00
Expected share price return	20.5%
Expected dividend yield	3.9%
<b>Expected total return</b>	<b>24.3%</b>
Market Cap	Rs52,406M US\$1,260M

### Price Performance (RIC: UNBK.BO, BB: UNBK IN)



See Appendix A-1 for Analyst Certification and important disclosures.

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	7,191	15.63	1.0	6.6	1.3	21.5	2.4
2006A	6,750	13.99	-10.5	7.4	1.1	16.5	3.4
2007E	8,260	16.35	16.9	6.3	1.0	17.0	3.9
2008E	9,861	19.52	19.4	5.3	0.9	17.9	4.3
2009E	11,321	22.41	14.8	4.6	0.8	17.9	4.3

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
<b>Valuation Ratios</b>					
P/E adjusted (x)	6.6	7.4	6.3	5.3	4.6
P/E reported (x)	6.6	7.4	6.3	5.3	4.6
P/BV (x)	1.3	1.1	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.5	1.3	1.1	1.0	0.8
Dividend yield (%)	2.4	3.4	3.9	4.3	4.3
<b>Per Share Data (Rs)</b>					
EPS adjusted	15.63	13.99	16.35	19.52	22.41
EPS reported	15.63	13.99	16.35	19.52	22.41
BVPS	78.55	90.24	102.02	116.46	133.80
Tangible BVPS	78.55	90.24	102.02	116.46	133.80
Adjusted BVPS diluted	68.23	81.02	92.80	107.25	124.58
DPS	2.50	3.50	4.00	4.50	4.50
<b>Profit &amp; Loss (RsM)</b>					
Net interest income	20,646	23,743	27,524	30,532	34,941
Fees and commissions	1,769	2,178	2,505	2,880	3,226
Other operating Income	5,892	4,073	2,512	4,135	4,551
<b>Total operating income</b>	<b>28,307</b>	<b>29,994</b>	<b>32,541</b>	<b>37,547</b>	<b>42,717</b>
Total operating expenses	-12,575	-14,024	-15,694	-17,572	-19,683
<b>Oper. profit bef. provisions</b>	<b>15,732</b>	<b>15,970</b>	<b>16,847</b>	<b>19,975</b>	<b>23,034</b>
Bad debt provisions	-2,165	-1,560	-3,447	-4,289	-5,261
Non-operating/exceptionals	-7,451	-5,470	-1,600	-1,600	-1,600
<b>Pre-tax profit</b>	<b>6,116</b>	<b>8,940</b>	<b>11,800</b>	<b>14,087</b>	<b>16,173</b>
Tax	1,075	-2,190	-3,540	-4,226	-4,852
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>7,191</b>	<b>6,750</b>	<b>8,260</b>	<b>9,861</b>	<b>11,321</b>
Adjusted earnings	7,191	6,750	8,260	9,861	11,321
<b>Growth Rates (%)</b>					
EPS adjusted	1.0	-10.5	16.9	19.4	14.8
Oper. profit bef. prov.	6.1	1.5	5.5	18.6	15.3
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>724,131</b>	<b>891,260</b>	<b>1,039,694</b>	<b>1,222,751</b>	<b>1,422,749</b>
Avg interest earning assets	639,081	788,392	944,034	1,106,755	1,295,465
Customer loans	412,008	548,430	667,229	792,851	927,565
Gross NPLs	20,581	20,981	22,992	26,240	32,787
<b>Liab. &amp; shar. funds</b>	<b>724,131</b>	<b>891,260</b>	<b>1,039,694</b>	<b>1,222,751</b>	<b>1,422,749</b>
Total customer deposits	618,306	740,943	878,243	1,048,154	1,232,787
Reserve for loan losses	10,957	14,631	15,993	17,881	20,850
Shareholders' equity	<b>36,144</b>	<b>45,582</b>	<b>51,531</b>	<b>58,828</b>	<b>67,587</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	21.5	16.5	17.0	17.9	17.9
Net interest margin	3.23	3.01	2.92	2.76	2.70
Cost/income ratio	44.4	46.8	48.2	46.8	46.1
Cash cost/average assets	1.9	1.7	1.6	1.6	1.5
NPLs/customer loans	5.0	3.8	3.4	3.3	3.5
Reserve for loan losses/NPLs	53.2	69.7	69.6	68.1	63.6
Bad debt prov./avg. cust. loans	0.6	0.3	0.6	0.6	0.6
Loans/deposit ratio	66.6	74.0	76.0	75.6	75.2
Tier 1 capital ratio	6.2	7.3	6.8	6.7	6.7
Total capital ratio	12.4	11.4	10.2	9.5	9.1

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## Union Bank Of India

### Company description

Union Bank is the seventh largest bank in India and sixth largest government bank, with a large balance sheet size and diversified distribution network. It currently has 2082 branches and 473 ATMs spread across the country. Its business is distributed across the country with a slight concentration in Western India. Union Bank listed in 2002. A follow-on offer was transacted in February 2006, with the government holding a 55% stake in the bank.

### Investment thesis

We rate Union Bank Buy/Low Risk (1L) with a target price of Rs125. Union has four key strengths, in our view: large balance sheet and distribution; low operating costs (as a proportion of assets), below industry averages; good technology, ahead of its peer group in implementation; and a clean balance sheet with low gross and net NPLs, in line with the industry's. However, the risks to Union lie in its low balance sheet liquidity, and the need to grow term deposits rapidly to fund loan growth. The stock price has corrected over 20% from its peak and offers reasonable upside potential to our target price.

### Valuation

Our target price of Rs125 is based on our EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for our India banking coverage. We are factoring in a risk-free rate of 8% while maintaining an industry average margin (230bps) and a slightly lower than industry average cost income ratio (42% vs average 45%).

We are also benchmarking our target price on a 1.25x one-year forward PBV multiple. This translates to a fair value of Rs125. We maintain a discount to our target multiples for the larger, quality government banks. We believe this discount is warranted, due to the risk to margins and earnings or to loan growth from the lack of surplus liquidity and the need to grow deposits rapidly. This is despite Union's above-sector average RoE, lower bond risk relative to peers and large and scaled balance sheet.

We use EVA as a primary methodology as we believe it better adjusts for the relatively dynamic cost of capital, and as it is usually the more conservative target price in a difficult interest rate environment.

### Risks

We rate Union Bank Low Risk, based on our quantitative risk rating system, which tracks 260-day historical share price volatility. Key downside risks that could impede the stock from reaching our target price are: low surplus balance sheet liquidity; modest deposit mix; reversal in loans growth and asset quality; large bond portfolio could erode economic value; and some geographic concentration in Western India.

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## Appendix A-1

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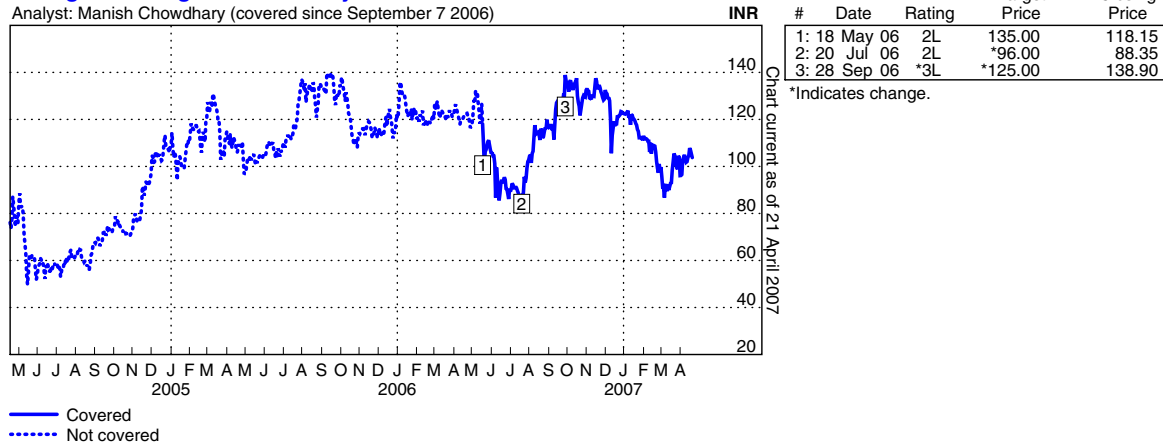
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Analyst: Manish Chowdhary (covered since September 7 2006)



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