Company In-Depth

17 April 2007 | 8 pages

UTI Bank (UTBK.BO)

Hold: 4Q07 - Maintains Momentum in a Challenging Environment

- **4QFY07 profits up 40% yoy, well ahead of expectations** — UTBK continues to expand aggressively and profitably in the face of a challenging environment. Pre-provisioning profits are up 42% (10% ahead of our expectations), with 40% net profits boosted by a surprisingly large provisioning write-back. Overall, an impressive, and ahead of our (9%) and consensus expectation (33%), quarter.
- **Strong asset expansion, robust asset quality** – UTBK has expanded its loan book 65% yoy (14% qoq), with offshore loans boosting growth, even as retail assets record a relative slowdown. Asset quality remains strong; no strains on numbers at the retail or corporate levels. Management, however, suggests a meaningful watch; given the higher rate environment, particularly in the retail asset space.
- **Margins expand, fee growth sustains, and costs remain in check** – All the trappings of a strong P&L, which is reflected in a 63% pre-provision (ex-trading gains) profit expansion. This is likely to be well ahead of best-of-breed peers, has been achieved in a challenging environment, and caps what has been a strong year. The quarter's P&L is clearly a quantitative and qualitative standout.
- **Non-business uncertainties abound** – Strong quarterly performance is, however, clouded by strategic uncertainties. There is little clarity on the incumbent Chairman continuing in his role (press reports suggest he is retiring shortly), on UTI Bank continuing to use its brand, and management has now proposed capital raising in the current year. Maintain our Hold (2L) recommendation, given relatively high valuations and strategic uncertainties.

Hold/Low Risk	2L
Price (17 Apr 07)	Rs472.50
Target price	Rs560.00
Expected share price return	18.5%
Expected dividend yield	0.7%
Expected total return	**19.3%**
Market Cap	Rs133,071M
	US$3,185M

Price Performance (RIC: UTBK.BO, BB: UTIB IN)

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	3,346	13.02	8.7	36.3	5.4	18.9	0.6
2006A	4,848	17.20	32.1	27.5	4.6	18.4	0.7
2007E	6,358	22.36	30.0	21.1	3.9	20.2	0.7
2008E	8,125	28.57	27.8	16.5	3.2	21.6	0.7
2009E	10,280	36.15	26.5	13.1	2.6	22.4	0.7

Source: Powered by dataCentral

Aditya Narain, CFA[1]
+91-22-6631-9879
aditya.narain@citigroup.com

Manish Chowdhary, CFA[1]
+91-22-6631-9853
manish.chowdhary@citigroup.com

Himani Shah[1]
himani.shah@citigroup.com

[1]Citigroup Global Market India Private Limited

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	36.3	27.5	21.1	16.5	13.1
P/E reported (x)	36.3	27.5	21.1	16.5	13.1
P/BV (x)	5.4	4.6	3.9	3.2	2.6
P/Adjusted BV diluted (x)	5.5	4.7	3.9	3.3	2.7
Dividend yield (%)	0.6	0.7	0.7	0.7	0.7
Per Share Data (Rs)					
EPS adjusted	13.02	17.20	22.36	28.57	36.15
EPS reported	13.02	17.20	22.36	28.57	36.15
BVPS	87.96	103.06	122.37	148.03	181.41
Tangible BVPS	87.96	103.06	122.37	148.03	181.41
Adjusted BVPS diluted	86.16	101.00	119.92	145.06	177.78
DPS	2.80	3.50	3.50	3.50	3.50
Profit & Loss (RsM)					
Net interest income	7,312	10,782	15,459	20,271	25,850
Fees and commissions	3,305	4,889	6,600	8,118	9,985
Other operating Income	853	2,407	3,266	3,105	3,529
Total operating income	**11,470**	**18,079**	**25,326**	**31,494**	**39,365**
Total operating expenses	-5,814	-8,141	-12,119	-15,625	-19,641
Oper. profit bef. provisions	**5,656**	**9,938**	**13,207**	**15,869**	**19,723**
Bad debt provisions	-162	-1,718	-1,608	-2,242	-2,880
Non-operating/exceptionals	-458	-910	-2,250	-1,500	-1,500
Pre-tax profit	**5,037**	**7,310**	**9,349**	**12,127**	**15,344**
Tax	-1,691	-2,462	-2,992	-4,002	-5,063
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**3,346**	**4,848**	**6,358**	**8,125**	**10,280**
Adjusted earnings	3,346	4,848	6,358	8,125	10,280
Growth Rates (%)					
EPS adjusted	8.7	32.1	30.0	27.8	26.5
Oper. profit bef. prov.	-17.8	75.7	32.9	20.1	24.3
Balance Sheet (RsM)					
Total assets	**377,437**	**497,311**	**646,273**	**825,437**	**1,033,892**
Avg interest earning assets	262,551	396,589	538,098	698,879	888,591
Customer loans	156,972	224,709	333,659	457,784	605,519
Gross NPLs	3,111	3,743	5,110	7,157	9,730
Liab. & shar. funds	**377,437**	**497,311**	**646,273**	**825,437**	**1,033,892**
Total customer deposits	317,120	401,135	535,982	698,086	885,938
Reserve for loan losses	943	1,567	2,261	3,441	4,992
Shareholders' equity	**24,082**	**28,722**	**34,104**	**41,254**	**50,559**
Profitability/Solvency Ratios (%)					
ROE adjusted	18.9	18.4	20.2	21.6	22.4
Net interest margin	2.78	2.72	2.87	2.90	2.91
Cost/income ratio	50.7	45.0	47.9	49.6	49.9
Cash cost/average assets	1.9	1.9	2.1	2.1	2.1
NPLs/customer loans	2.0	1.7	1.5	1.6	1.6
Reserve for loan losses/NPLs	30.3	41.9	44.2	48.1	51.3
Bad debt prov./avg. cust. loans	0.1	0.9	0.6	0.6	0.5
Loans/deposit ratio	49.5	56.0	62.3	65.6	68.3
Tier 1 capital ratio	8.9	7.3	6.8	6.3	6.0
Total capital ratio	12.7	11.1	9.6	8.6	7.9

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Figure 1. 4Q07 Results: Another Good quarter

Rs M	4Q07	4Q06	YoY %	3Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	13,668	8,327	64.1	11,896	14.9	
Interest Expense	(9,025)	(5,198)	73.6	(7,738)	16.6	Deposit cost increases are relatively high - over 30bp in quarter, but have been offset by a push through on yields
Net Interest Income	**4,642**	**3,129**	**48.4**	**4,158**	**11.6**	Strong and ahead of expectation performance, driven by rising margins in a challenging market
Fee-Based Income	2,579	1,624	58.8	2,005	28.7	Continues to maintain robust and broad-based momentum. Continues to better peers
Other Non-Interest Income	432	657	-34.3	793	-45.6	Drop, but is ahead of our expectations. UTBK's treasury operations continue to well ahead of best of breed peers, consistently performing across favorable and challenging markets
Non Interest Income	3,011	2,281	32.0	2,797	7.6	
Operating Income	7,653	5,409	41.5	6,956	10.0	
Operating Expenses	(3,430)	(2,429)	41.2	(3,370)	1.8	Increases remain relatively high, but in line with expectations
Pre-Provision Profit	**4,223**	**2,981**	**41.7**	**3,586**	**17.8**	
Charges for Bad Debts	(83)	(214)	-61.2	(303)	-72.6	Very modest increase, inspite of a relatively large charge on account of new provisioning norms - appears to have been supported by a large write-back
Other Operating Items	(982)	(468)	109.9	(460)	113.5	Mark down on the bond book - a little ahead of expectations
Operating Profit	3,158	2,299	37.4	2,824	11.8	
Pre-Tax Profit	3,158	2,299	37.4	2,824	11.8	
Tax	(1,039)	(782)	32.9	(977)	6.3	
Net Profit	**2,119**	**1,517**	**39.6**	**1,846**	**14.8**	**Well ahead of our 9% growth expectations - combination of stronger operating performance, and lower than expected loan provisioning**
EPS	7.52	5.0	50.8	6.59	14.2	
Customer Loans	368,760	223,140	65.3	323,370	14.0	Aggressive expansion - corporate heavy, and boosted by lending from its offshore platform
Customer Deposits	587,860	401,140	46.5	509,200	15.4	Sustains well above industry growth, while maintaining its already healthy deposit mix
AIEA	602,915	523,627	15.1	554,432	8.7	
AIBL	548,530	385,000	42.5	473,616	15.8	
Total Assets	732,570	497,310	47.3	649,700	12.8	
Avg Assets	691,135	462,690	49.4	623,680	10.8	
Non-Performing Loans (NPL)	4,187	3,780	10.8	4,723	-11.3	Very strong show - almost no incremental deterioration, in an environment with some risk. The actual reduction in NPA's likely a reflection of aggressive write-offs. Management suggests little pressure on asset quality, but remains watchful, particularly on the retail portfolio
Loan Loss Reserves (LLR)	(1,523)	(1,581)	-3.7	(2,053)	-25.8	Coverage remains low - and falls
Shareholders' Funds	32,336	27,842	16.1	31,969	1.1	Capital is under pressure - management announces capital raising plans in the current year, though without a defined timeframe
Book Value Per Share	115	103	11.4	114	1.0	

Key Ratios (%)	4Q07	4Q06	Bps Δ YoY	3Q07	Bps Δ QoQ	Citigroup Investment Research Comments
ROAA (annualized)	1.16	1.22	-6	1.14	2	
ROAE (annualized)	26.21	21.80	441	23.10	311	
Net Interest Margin (bps)	306	296	10	300	6	Impressive show - expands margins, in a challenging quarter
Fee Inc/Operating Income	33.7	30.0	368	28.8	488	Maintains its high growth momentum, which remains well above best of breed players
Other Non-Interest Inc/Op Inc	39.3	42.2	-282	40.2	-87	
Op. Cost/ Operating Income	44.8	44.9	-8	48.4	-362	Costs remain in line with averages, and expectedly record a marked improvement over previous quarter
Loan-to-Deposit Ratio (LDR)	62.7	55.6	710	63.5	-78	
NPL/Loan Ratio	1.1	1.7	-56	1.46	-33	
LLR/NPL Ratio	36	42	-545	43	-709	

Source: Citigroup Investment Research & Company Reports

Figure 2. Breakup of Deposit and loans

Rs M	4Q07	4Q06	YOY %	3Q07	QOQ %
Savings	121,260	80,660	50.3	97,260	24.7
Current	113,040	79,700	41.8	98,530	14.7
Low Cost Deposits	**234,300**	**160,360**	**46.1**	**195,790**	**19.7**
Term	353,560	240,780	46.8	313,410	12.8
Total Deposits	**587,860**	**401,140**	**46.5**	**509,200**	**15.4**
% CASA	39.9	40.0		38.5	
Corporate Loans	279480	158240	76.6	231590	20.7
Retail Loans	89280	64900	37.6	91780	-2.7
Advances	**368760**	**223140**	**65.3**	**323370**	**14.0**

Source: Citigroup Investment Research & Company Reports

UTI Bank

Company description

UTI Bank is India's third-largest private-sector bank after the significantly larger ICICI Bank and HDFC Bank. It is more than twice the size of the next largest private-sector bank. The top three private-sector banks collectively account for almost 9.6% market share, while private-sector banks as a group are about 18.6% of the system. UTI Bank is a small player in the broader banking sector; its market share is less than 2% in terms of loans and deposits. UTI Bank was started by the erstwhile Unit Trust of India (UTI) in 1994, along with LIC and GIC, two government-owned insurance companies. UTI's stake is now held by UTI-I, a government-owned entity, with a 28% holding. LIC and GIC together own 16.3%, and collectively, these government-owned shareholders own approximately 44% of the bank.

Investment thesis

UTI Bank is one of few clean (in terms of asset book), rapidly growing, profitable, and competitive private-sector banks in India; thus we think it will be a major beneficiary of the favorable banking environment. The Indian banking sector is in a sweet spot: consumer and corporate lending is strong, asset quality is improving and fee-income opportunities are growing. We expect this favorable environment to continue in the medium term, but recognize that a key challenge for banks will be funding growth. Looking at its profile, we believe UTI Bank stands to gain disproportionately from existing opportunities in the sector. The bank has strong technology and products, an expanding distribution franchise, adequate scale, a strong service culture, and management enterprise – features that should help it stay ahead of the dominant government banks to win market share. We do however believe the current business momentum, and structural opportunity, is now fully valued in by the stock, which we rate Hold / Low Risk (2L). It trades at almost 3.5X FY08E PBV, and well above our EVA-based fair value of Rs560. This is well above its historical trading band, and a near-peak. We believe these valuations – given potential challenges on its asset mix, funding profile, and modest capital cushion – will cap stock performance over the next 12 months, generating only modest returns.

Valuation

We set our Rs560 target price using an EVA-based target of Rs560. EVA is our preferred valuation methodology. Our target price is based on an EVA methodology because it takes into account (1) longer-term earnings and growth of the bank, (2) an improving mix of earnings, and (3) asset quality control. We assume the following: a) a risk-free rate of 8%; 2) a long-term asset loss expectation of 100bp; and 3) higher longer-term margins (+25bps) and fee income growth (+100bps) consistent with the expectation of a reduction in SLR requirements. Our secondary valuation methodology is based on P/BV, which we use to value all banks in our coverage universe. We expect private-sector banks to trade at a premium to the sector on a P/BV basis, reflective of their longer-term prospects, competitiveness and management. We value UTI Bank at 3.4x FY08E PBV or Rs503 based on a discount to HDFC Bank (which we benchmark at 4x one-year forward) of 15%. We prefer the higher of the two target multiples, given the relatively robust business environment, and strong market momentum.

Risks

We rate UTI Bank shares as Low Risk based on our quantitative risk-rating system, which tracks historical share price volatility. Key upside risks to our target price include: (1) stronger-than-expected margins, (2) higher-than-expected fee income levels, and (3) any corporate activity including mergers and acquisitions. Key downside risks that could impede the stock from reaching our target price include: (1) mid-market credit focus; (2) a large share of wholesale funding; (3) aggressive trading orientation; and (4) the role of key shareholders.

Appendix A-1

Analyst Certification

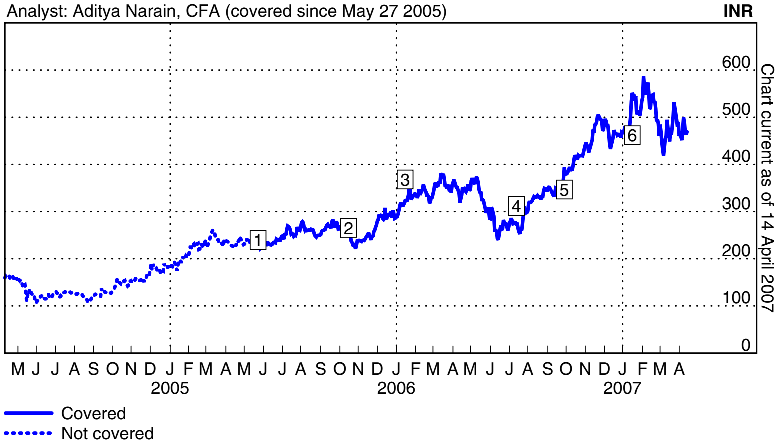
We, Aditya Narain, CFA and Manish Chowdhary, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

UTI Bank (UTBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA (covered since May 27 2005)



#	Date	Rating	Target Price	Closing Price
1:	24 May 05	1M	275.00	223.95
2:	17 Oct 05	1M	*315.00	252.05
3:	16 Jan 06	*1L	*365.00	323.10
4:	13 Jul 06	1L	*335.00	273.10
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% of companies in each rating category that are investment banking clients	42%	50%	42%

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