

Vijaya Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,215	VJYBK IN
	REUTERS CODE
S&P CNX: 2,986	VJBK.BO

24 July 2006

Neutral
Previous Recommendation: Neutral
Rs39

Equity Shares (m)	433.5
52-Week Range	72/33
1,6,12 Rel.Perf.(%)	-1/-45/-79
M.Cap. (Rs b)	17.1
M.Cap. (US\$ b)	0.4

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
3/06A	13,418	1,269	2.9	-66.6	13.5	1.0	11.9	7.8	0.4	1.1
3/07E	13,824	2,667	6.2	110.2	6.4	0.9	11.1	15.2	0.8	1.0
3/08E	15,692	3,238	7.5	21.4	5.3	0.8	10.3	16.5	0.8	0.9

After disappointing results for the last six quarters, Vijaya Bank has reported steady earnings in 1QFY07 with core net interest income (NII) growth of 9%, marginally above our expectations. This was largely due to improved margins QoQ and overall growth in business. Earnings were Rs726m, resulting from improved NII, core other income and lower tax provisions. The bank had transferred Rs14b securities to HTM in 1QFY07, post which 95% of bank's SLR book is in HTM and AFS duration too has been reduced to less than a year, thereby largely insulating the bank from any further mark-to-market (MTM) hits. Asset quality was maintained with net NPAs at 0.85%.

- ✍ Strong business growth; NII grows 9% YoY
- ✍ Margins improve from FY06 levels
- ✍ Core other income posts growth; treasury income declines
- ✍ Asset quality stable

Post 1QFY07 results, we are upgrading our earnings estimates, as we expect lower provisions going forward. While, we believe that 1QFY07 is probably the first quarter of improved performance, sustaining the uptrend in core earnings is likely to be a key parameter for Vijaya Bank. We expect the bank to report EPS of Rs6.2x in FY07E and Rs7.5x in FY08E. At CMP, the stock is trading at a P/E of 6.4x FY07E EPS and P/BV of 0.9x FY07E BV. We maintain **Neutral**.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Interest Income	5,550	5,715	5,953	5,900	6,134	6,458	6,727	6,930	23,118	26,249
Interest Expense	3,178	3,386	3,362	3,464	3,551	3,827	3,933	4,039	13,390	15,350
Net Interest Income	2,372	2,329	2,591	2,436	2,583	2,631	2,794	2,891	9,728	10,899
% Change (Y-o-Y)	1.5	-4.5	3.4	-5.0	8.9	13.0	7.8	18.7	-1.2	12.0
Other Income	1,027	941	731	992	866	700	600	759	3,690	2,925
Net Income	3,399	3,269	3,322	3,428	3,450	3,331	3,394	3,649	13,418	13,824
% Change (Y-o-Y)	-2.3	-0.1	4.0	-0.2	1.5	1.9	2.2	6.5	0.4	3.0
Operating Expenses	1,376	1,634	1,612	1,613	1,498	1,600	1,779	1,942	6,235	6,819
Operating Profit	2,023	1,635	1,710	1,815	1,951	1,731	1,614	1,708	7,182	7,005
Other Provisions	1,944	536	731	2,177	1,105	700	700	795	5,388	3,300
Tax Provisions	-196	348	390	-17	120	277	258	382	526	1,037
Net Profit	275	751	588	-345	726	754	656	531	1,269	2,667
% Change (Y-o-Y)	-71.8	5.2	5.7	-122.1	163.7	0.5	11.6	NA	-66.6	110.2
Cost to Income Ratio (%)	40.5	50.0	48.5	47.1	43.4	48.0	52.4	53.2	46.5	49.3
Interest Expense/Interest Income (%)	57.3	59.3	56.5	58.7	57.9	59.3	58.5	58.3	57.9	58.5
Other Income/Net Income (%)	30.2	28.8	22.0	28.9	25.1	21.0	17.7	20.8	27.5	21.2

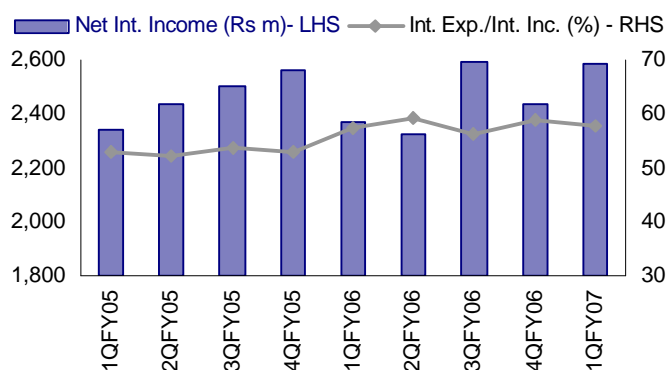
E: MOST Estimates

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Strong business growth; NII grows 9% YoY

Vijaya Bank reported YoY growth in business of 20% to Rs468b, with net advances growth by 28% YoY to Rs179b and deposits growth by 15.5% to Rs289b during the quarter. Consequently, NII grew by 9% YoY to Rs2.58b during 1QFY07, after six quarters of negligible or negative growth. The bank's C-D ratio improved from 56%-62% in 1QFY07.

TREND IN NII (YOY)



Source: Company / Motilal Oswal Securities

Net advances grew 28% YoY to Rs179b. The growth in advances came from all quarters; with retail advances growth of 19% YoY to Rs62.5b versus Rs52.6b. Priority sector advances grew by 25% YoY to Rs76.7b compared with Rs61.4b in 1QFY07. Priority sector advances as a percentage to net bank advances stood at 45.54% v/s 43.76% in 1QFY07. Agricultural advances increased from Rs16.8b in 1QFY06 to Rs24.7b in 1QFY07, recording 47.3% YoY growth. Agricultural advances now constitute

14.65% of net bank advances. Advances to SMEs stood at Rs14.7b constituting 8.7% of net advances, while advances to SSIs stood at Rs10.3b, constituting 6.1% of net advances made by the bank.

Deposits also grew by 15.5% to Rs289b, with CASA growing by 18% YoY to Rs94b. Savings deposits increased from Rs54b to Rs66.6b YoY, recording 23% growth in 1QFY07. Demand deposits increased from Rs25.4b to Rs33.1b, recording growth of 30%. The percentage of low cost deposits to total deposits has gone up from 31.8% to 34.53% in the quarter.

Margins improve from FY06 levels

Net interest margins have improved QoQ as well as compared with FY06 to 3.34%, as the bank effected a 25bp hike in lending rates (PLR) during May 2006. However, compared with 1QFY06, margins have declined, as cost of deposits has increased. Whilst yield on advances has been increasing, yield on investments is expected to decline going forward. We expect margins to remain stable in FY07.

NIMS BREAK-DOWN (%)

	1QFY07	1QFY06	FY06
Yield on Advances	9.02	8.88	8.83
Yield on Investments	7.99	7.88	8.10
Cost of Funds	4.56	4.60	4.43
Cost of Deposits	5.02	4.88	4.97
Net Interest Margins	3.34	3.52	3.20

Source: Company/ Motilal Oswal Securities

Core other income up; treasury income declines

Vijaya Bank's core other income grew YoY by 48% to Rs646m in 1QFY07, as higher recoveries from written-off accounts and higher forex income resulted in the same. Fee income was largely muted with core fee income of Rs158m in 1QFY07 compared with Rs156m in 1QFY06.

Treasury income declined YoY to Rs220m in 1QFY07 from Rs590m in 1QFY06. The bank has shifted Rs14b worth of securities to HTM in 1QFY07 and absorbed an impact of Rs830m on this account. Post transfer, 95% of the bank's SLR investment book is in HTM (72% of total investment book) and on the AFS front, the duration has been reduced to less than a year.

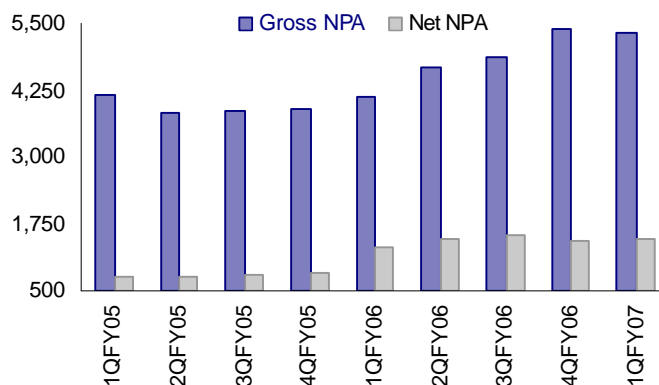
Provisions lower than expectations

Vijaya Bank made provisions of Rs1.1b in 1QFY07, compared with our expectation of Rs1.31b. Shifting of securities to HTM resulted in an impact of Rs830m. MTM losses amounted to Rs180m in 1QFY07, while Rs44m was due to amortization of premium of investments in 1QFY07. The bank has changed the method of amortization of premium on investment under HTM category from the Straight Line Method to the Constant Yield Method, resulting in lower amortization to the extent of Rs185m in the quarter. Provision for NPA was only Rs60m in 1QFY07. The bank has provided entirely for standard assets (1%) for certain asset classes, with recent change in RBI norms pertaining to standard asset provisions.

Asset quality stable

Vijaya Bank's asset quality on net levels is constant at FY06 levels at 0.85%. However, on an absolute basis, net NPAs have increased QoQ by 4% to Rs1.49b, while gross NPAs have reduced by 2% QoQ to Rs5.3b. Provision cover stands at 72% in 1QFY06. The bank has effected a recovery of Rs620m in 1QFY07 compared with Rs2b in FY06.

TREND IN NPA (RS M)



Source: Company/ Motilal Oswal Securities

Valuation and recommendation

Post 1QFY07 results, we are upgrading our earnings estimates, as we expect lower provisions going forward. While, we believe that 1QFY07 is probably the first quarter of improved performance, sustaining the uptrend in core earnings is likely to be a key parameter for Vijaya Bank. We expect the bank to report EPS of Rs6.2x in FY07E and Rs7.5x in FY08E. The stock is trading at a P/E of 6.4x FY07E EPS and P/BV of 0.9x FY07E BV. We maintain **Neutral**.

Vijaya Bank: an investment profile

Company description

Vijaya Bank, established in 1932, is a mid-sized Bangalore based state-owned bank having a balance sheet size of Rs325b+. The bank has made public offerings in 2001 and 2003, after which the government's stake has reduced to 54%. It has a network of 924 branches, with approximately 325 branches under CBS covering almost 68% of bank's business.

Key investment arguments

- ✂ Consistently grown its loan book with greater thrust on retail advances
- ✂ Asset quality is one of the best in the sector with net NPAs at 0.85%
- ✂ Sufficient capital adequacy ratio of 11.6%, of which Tier 1 is 9.1%.

Key investment risks

- ✂ Since the government's stake is 54%, there is not much room for further dilution

Recent developments

- ✂ Mr PP Mallya, formerly Executive Director, Syndicate Bank has taken over as Chairman & Managing Director effective 1 April 2006
- ✂ Mr T Valliappan was recently appointed Executive Director of Vijaya Bank
- ✂ Vijaya Bank is raising Rs2.5b through a 10-year bond issue. These bonds, rated AA+ are priced at 9.25% and would comprise part of the banks Tier-II capital.

Valuation and view

- ✂ Healthy loan growth, clean asset portfolio makes Vijaya Bank an efficient bank
- ✂ The stock trades at 6.4x FY07E EPS and 0.9x FY07E BV.

Sector view

- ✂ YTD loan growth of 30%+, highest in last 12 years
- ✂ Volatility in interest rates would impact treasury income
- ✂ Benefits of significant improvement in asset quality not yet factored in earnings, valuations
- ✂ We maintain an overweight stance on the sector

COMPARATIVE VALUATIONS

		VIJAYA BANK	PNB	CANARA
P/E (x)	FY07E	6.4	6.7	5.4
	FY08E	5.3	5.4	4.5
P/ABV (x)	FY07E	1.0	1.0	0.9
	FY08E	0.9	0.9	0.8
RoE (%)	FY07E	15.2	15.6	17.8
	FY08E	16.5	16.7	18.3
RoA (%)	FY07E	0.8	1.0	1.0
	FY08E	0.8	1.1	1.1

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	53.9	53.9	53.9
Domestic Institutions	6.5	7.2	7.9
FII's/FDIs	16.6	16.9	14.7
Others	23.0	22.0	23.5

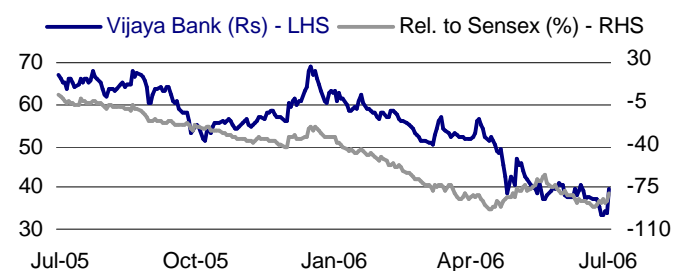
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	6.2	7.1	-12.1
FY08	7.5	7.2	4.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
39	50	26.7	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Interest Income	19,401	20,943	23,118	26,249	31,528	
Interest Expended	11,023	11,098	13,390	15,350	18,911	
Net Interest Income	8,378	9,845	9,728	10,899	12,617	
Change (%)	30.2	17.5	-12	12.0	15.8	
Other Income	5,257	3,513	3,690	2,925	3,075	
Net Income	13,635	13,359	13,418	13,824	15,692	
Change (%)	37.8	-2.0	0.4	3.0	13.5	
Operating Expenses	4,978	5,492	6,235	6,819	7,545	
Operating Income	8,656	7,867	7,182	7,005	8,148	
Change (%)	100.2	-9.1	-8.7	-2.5	16.3	
Other Provisions	3,128	4,142	5,388	3,300	3,650	
PBT	5,529	3,725	1,795	3,705	4,498	
Tax	1,415	-78	526	1,037	1,259	
Tax Rate (%)	25.6	-2.1	29.3	28.0	28.0	
PAT	4,113	3,802	1,269	2,667	3,238	
Change (%)	109.3	-7.6	-66.6	110.2	21.4	
Proposed Dividend	1,223	1,225	434	867	1,084	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2004	2005	2006	2007E	2008E	
Capital	4,335	4,335	4,335	4,335	4,335	
Reserves & Surplus	9,020	11,557	12,356	14,157	16,311	
Net Worth	13,355	15,892	16,692	18,492	20,646	
Deposits	210,151	256,180	277,093	324,199	379,312	
Change (%)	23.5	21.9	8.2	17.0	17.0	
Borrowings	3,366	6,408	5,164	5,680	6,248	
Other Liabilities & Prov.	13,838	14,875	16,398	18,858	21,687	
Total Liabilities	240,710	293,355	315,346	367,229	427,894	
Current Assets	11,186	16,146	28,351	32,607	35,035	
Investments	108,370	120,687	111,797	117,387	123,256	
Change (%)	22.3	11.4	-7.4	5.0	5.0	
Advances	110,453	143,358	166,640	208,300	260,375	
Change (%)	40.1	29.8	16.2	25.0	25.0	
Net Fixed Assets	1,913	2,176	2,030	2,080	2,030	
Other Assets	8,789	10,988	6,528	6,854	7,197	
Total Assets	240,710	293,355	315,346	367,229	427,894	

ASSUMPTIONS	(%)				
Deposit Growth	23.5	21.9	8.2	17.0	17.0
Advances Growth	40.1	29.8	16.2	25.0	25.0
Investments Growth	22.3	11.4	-7.4	5.0	5.0
Dividend	28.2	28.3	10.0	20.0	25.0
CRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS						
Y/E MARCH	2004	2005	2006	2007E	2008E	
Spreads Analysis (%)						
Avg. Yield - Earning Asset:	9.4	8.2	7.9	8.0	8.3	
Avg. Cost-Int. Bear. Liab.	5.7	4.7	4.9	5.0	5.3	
Interest Spread	3.7	3.6	3.0	3.0	3.0	
Net Interest Margin	4.1	3.9	3.3	3.3	3.3	

Profitability Ratios (%)						
RoE	38.3	26.0	7.8	15.2	16.5	
RoA	19	14	0.4	0.8	0.8	
Int. Expended/Int. Earned	56.8	53.0	57.9	58.5	60.0	
Other Inc./Net Income	38.6	26.3	27.5	21.2	19.6	

Efficiency Ratios (%)						
Op. Exps./Net Income	36.5	41.1	46.5	49.3	48.1	
Empl. Cost/Op. Exps.	66.6	58.1	60.8	58.5	57.4	
Busi. per Empl. (Rs m)	24.5	31.3	36.7	42.1	50.1	
NP per Empl. (Rs lac)	0.4	0.3	0.1	0.2	0.3	

Asset-Liability Profile (%)						
Adv./Deposit Ratio	52.6	56.0	60.1	64.3	68.6	
Invest./Deposit Ratio	51.6	47.1	40.3	36.2	32.5	
G-Sec/Invest. Ratio	83.9	87.5	85.2	89.2	89.2	
Gross NPAs to Adv.	3.4	2.9	3.2	2.8	2.5	
Net NPAs to Adv.	0.9	0.6	0.9	0.7	0.7	
CAR	14.1	12.9	11.9	11.1	10.3	
Tier 1	8.4	7.6	9.3	8.0	7.3	

VALUATION						
Book Value (Rs)	30.8	36.7	38.5	42.7	47.6	
Price-BV (x)	1.3	1.1	1.0	0.9	0.8	
Adjusted BV (Rs)	29.3	35.4	36.4	40.4	45.0	
Price-ABV (x)	1.3	1.1	1.1	1.0	0.9	
EPS (Rs)	9.5	8.8	2.9	6.2	7.5	
EPS Growth (%)	61.0	-7.6	-66.6	110.2	21.4	
Price-Earnings (x)	4.2	4.5	13.5	6.4	5.3	
OPS (Rs)	20.0	18.1	16.6	16.2	18.8	
OPS Growth (%)	54.0	-9.1	-8.7	-2.5	16.3	
Price-OP (x)	2.0	2.2	2.4	2.4	2.1	

E: MOST Estimates



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Disclosure of Interest Statement

Vijaya Bank

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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