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Industry View  
In-Line

## India Financial Services Government Announces Capital Infusion in Five SOE Banks

**What's new?** Over the weekend, the government announced the first large capital infusion of Rs62.1 bn (US\$1.3 bn) in five state-owned banks (IDBI Bank, Union Bank, Bank of Maharashtra, UCO Bank and Central Bank of India). In our view, this announcement is positive for the state-owned banks because the government is executing on its commitment to infuse capital. However, the government has infused part of the capital in the form of preference shares. Given the increased focus worldwide on core equity capital, the benefit from preference share infusion is relatively lower.

In the Union Budget (released in February 2010), the government had announced plans to infuse equity capital to the tune of Rs165 bn (US\$3.5bn) in SOE banks so as to ensure they are able to attain a minimum 8% Tier I ratio by March 2011. The government would fund Rs150bn out of the total Rs160bn using the loan secured from the World Bank for the purpose of capitalizing SOE banks. This weekend's announcement is part of the same plan and follows a smaller infusion of Rs15 bn announced in May 2010. We expect the government to continue this process through the rest of the year and gradually also provide capital to the relatively stronger banks as well to fund their growth plans.

**Which banks have received the infusion?** The table alongside gives the details regarding the allocation of money among various banks and the mode of infusion. So far the money has been allocated to the banks with relatively weaker capitalization (i.e. Tier 1 less than 8%).

Among our coverage universe, the two banks that have received capital infusion are IDBI Bank and Union Bank.

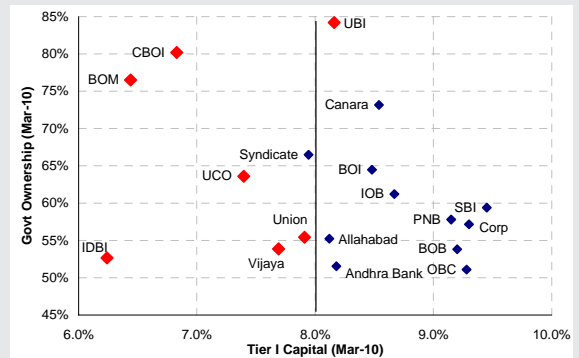
### Details of Capital Infusion

	When announced	Amount (Rs mn)	Mode of Infusion
IDBI Bank	June'10	31190	Preferential equity allot.
Union Bank of India	June'10	1110	PNCPs
Bank of Maharashtra	June'10	5900	PNCPs
Central Bank of India	May'10	2500	PNCPs
UCO Bank	June'10	20160	Rights
	May'10	3000	PNCPs
Vijaya Bank	June'10	3750	PNCPs
United Bank of India	May'10	7000	PNCPs
	May'10	2500	PNCPs

PNCPs : Perpetual Non-Cumulative Preference shares

Source: GOI, Morgan Stanley Research

### Indian SOE Banks: Tier 1 Capital vs. Government Ownership Levels



1. Red dots refer to banks that have received the capital infusion
2. Tier 1 ratios for Syndicate & UCO Bank are MS estimates

Source : Company data, Morgan Stanley Research

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The government is infusing Rs31 bn in IDBI Bank via a preferential placement (the deal terms – pricing, etc. –haven't yet been announced). This would improve IDBI Bank's Tier I ratio to ~8% from 6.2% as of March 2010. At the current price (Rs112.3/share), this would imply an increase in share count to the tune of 38%. Government ownership in IDBI Bank would increase to 65.8% from 52.7% -- hence the bank now has adequate room to go for a follow-on issue to other shareholders.

For Union Bank, a relatively small capital infusion has been announced (Rs. 11.1 bn) in the form of perpetual non-cumulative preference shares – this would take its Tier I ratio to 8% from 7.9% as of March 2010. In our recent meeting with Union Bank management, they had mentioned this as a possibility. In their view, this small infusion is a symbol that the government is willing to infuse capital in relatively stronger banks as well.

Among non-covered banks – Central Bank of India has received a sizeable capital infusion of Rs20.2 bn. The issuance will be by way of the government (which currently has an 80.2%

stake) participating in its rights issue. This implies that rights will be offered to the balance of the shareholder base as well. Our approximate calculations – after factoring in only the government infusion – indicate that Central Bank of India's Tier I ratio will improve to 9.3% from around 7%.

**Not all the capital infused is core equity...** One disappointment from the announcement is that part of the money that has been disbursed is in the form of perpetual non-cumulative preference shares. This has two implications:

- Given the increasing focus on core Tier I equity worldwide – this infusion in the form of preference shares will have limited utility.
- The preference share infusion won't increase the headroom available (given ownership limits at 51%) for these banks to raise money from the market. We note, however, that this only applies to Union, where the government ownership is at 55%; the other banks have greater ownership headroom.

Exhibit 1

## Details of Capital Infusion and Impact on Bank Capital Ratios and Ownership Levels

	When announced	Amount (Rs mn)	Mode of Infusion	Tier I Ratio		Govt. O/ship	
				Pre	Post	Pre	Post
IDBI Bank	June'10	31190	Preferential equity allot.	6.2%	8.0%	52.7%	65.8%
Union Bank of India	June'10	1110	PNCPs	7.9%	8.0%	55.4%	55.4%
Bank of Maharashtra	June'10	5900	PNCPs	6.4%	8.0%	76.5%	76.5%
Central Bank of India	May'10	2500	PNCPs	6.8%	7.1%	80.2%	80.2%
	June'10	20160	Rights	7.1%	9.3%	80.2%	80.2%
UCO Bank	May'10	3000	PNCPs	7.4%	7.8%	63.6%	63.6%
	June'10	3750	PNCPs	7.8%	8.4%	63.6%	63.6%
Vijaya Bank	May'10	7000	PNCPs	7.7%	9.5%	53.9%	53.9%
United Bank of India	May'10	2500	PNCPs	8.2%	8.8%	84.2%	84.2%

Source: GOI, Company Data, Morgan Stanley Research; PNCPs : Perpetual Non-Cumulative Preference Shares

Note: We highlight that the above Tier I computations are rough estimates given that the annual reports (which contain the necessary information) haven't yet been released.

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
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<b>Not-Rated/Hold</b>	<b>13</b>	<b>1%</b>	<b>3</b>	<b>0%</b>	<b>23%</b>
<b>Underweight/Sell</b>	<b>349</b>	<b>14%</b>	<b>95</b>	<b>11%</b>	<b>27%</b>
<b>Total</b>	<b>2,552</b>		<b>853</b>		

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## Industry Coverage: India Financial Services

Company (Ticker)	Rating (as of)	Price* (06/11/2010)
<b>Anil Agarwal</b>		
HDFC (HDFC.BO)	O (10/13/2009)	Rs2,798.1
HDFC Bank (HDBK.BO)	O (01/18/2010)	Rs1,943.6
ICICI Bank (ICBK.BO)	E (04/12/2010)	Rs845.35
IDFC (IDFC.BO)	O (09/16/2005)	Rs163.25
State Bank of India (SBI.BO)	O (08/14/2009)	Rs2,338
<b>Mansi Shah</b>		
IDBI (IDBI.BO)	U (10/21/2005)	Rs112.35
<b>Mihir Sheth</b>		
AXIS Bank (AXBK.BO)	E (11/30/2009)	Rs1,241.95
Bank of Baroda (BOB.BO)	O (08/28/2009)	Rs729.3
Bank of India (BOI.BO)	O (11/30/2006)	Rs329.15
Canara Bank (CNBK.BO)	E (03/03/2008)	Rs430.95
Corporation Bank (CRBK.BO)	O (11/30/2009)	Rs535.45
IndusInd Bank (INBK.BO)	E (04/12/2010)	Rs191
Kotak Mahindra Bank (KTKM.BO)	U (08/21/2006)	Rs755.45
Oriental Bank of Commerce (ORBC.BO)	E (05/03/2010)	Rs336.6
Punjab National Bank (PNBK.BO)	O (08/28/2009)	Rs1,034.85
Reliance Capital (RLCP.BO)	E (08/20/2008)	Rs681.6
Union Bank of India (UNBK.BO)	O (08/28/2009)	Rs305.9
Yes Bank (YESB.BO)	O (10/20/2009)	Rs287.2

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