

May 8, 2008

BUY

Price	Target Price
Rs174	Rs230

Sensex	17,339
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Price Performance

(%)	1M	3M	6M	12M
Absolute	17	(15)	(6)	62
Rel. to Sensex	6	(9)	5	28

Source: Capitaline

Stock Details

Sector	Banks
Reuters	UNBK.BO
Bloomberg	UNBK@IN
Equity Capital (Rs mn)	5051
Face Value	10
52 Week H/L	235/84
No of shares o/s (mn)	505
Market Cap	Rs88bn/US\$2.1bn
Daily Avg Volume (No of shares)	965,617
Daily Avg Turnover (US\$)	3.8mn

Shareholding Pattern (%)

	M'08	D'07	S'07
Promoters	55.2	55.2	55.2
FII/NRI	18.6	18.7	18.8
Institutions	9.7	9.7	9.2
Private Corp	2.9	3.2	3.0
Public	13.7	13.3	13.7

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Union Bank of India

Result
Update

Disappointing results

Union Bank of India's (UBI) operating performance for Q4FY08 was disappointing. The NII adjusted for extraordinary income has remained flat at Rs7.4bn. The pressure on margins was severe as they dipped by 47bps yoy and 36bps sequentially driven by sharp increase in cost of funds. The other income at Rs3.1bn (up 28.5% yoy) mainly driven by higher treasury gains and recoveries. The reported net profit at Rs5.2bn, was far ahead of our expectations driven by employee cost write back and lower tax provisions. The CASA mix has improved by 180bps yoy as well as sequentially driven by slower growth of 16% in the total deposits.

The improving asset quality and strong cost/asset ratios remain positives for the bank. The asset quality continues to improve with both, GNPA and NNPA declining in absolute as well as percentage terms. The GNPA as on March 2007 stood at 2.20% and NNPA at 0.17%.

We have lowered our estimates for both FY09E and FY10E by 8% each to take into account near term pressure on the margins. We have also lowered our price target on the stock downward to Rs230 (from Rs240 earlier). The stock is currently trading at 1.1x FY10E ABV and 5.5x FY10E FPER. We maintain our BUY recommendation on the stock.

NII adjusted for one-offs remains flat

UBI has reported a flat NII of Rs7.4bn (adjusted for one-off items) for Q4FY08, which is far below our expectations. The flat NII was attributable to a 47bps drop in NIMs on yoy basis.

	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% yoy chg
Reported NII	8,339	8,424	7,881	-1.0	5.8
Less:					
interest on CRR balances	-	270	-	-	-
interest on IT refunds	930	670	-	-	-
other one time income	-	180	-	-	-
Adjusted NII	7,409	7,304	7,881	1.4	-6.0

Source: Company, Emkay Research

... Driven by sharp rise in cost of funds

The drop in NIMs was attributable to sharp rise of 98bps in the cost of funds over last year. During the quarter, UBI has retired ~ Rs100bn of high cost deposits taken during Q4FY07 (average cost 10.5-11%) and replaced the same with special scheme deposits having cost of ~9%. With effect from May 2008, the bank revised the interest rate on special scheme deposits to 8.75%. The full impact of retirement of high cost deposits and lower rate on special scheme deposits will come up in Q1FY09.

On sequential basis, the NIMs saw a dip as the blended yield fell far more than the fall in cost of funds. The bank has seen a 17bps decline in advances as well as investment yield whereas, the cost of funds has declined by just 9bps.

Yield analysis

%	Q4FY08	Q4FY07	Q3FY08	Change in bps	
				yoy	qoq
Yield on assets #	8.6	8.1	9.1	52	-46
Cost of funds #	6.1	5.1	6.2	98	-9
NIM #	2.5	3.0	2.9	-47	-36
NIM-reported	2.8	3.5	2.8	-77	-8
NIM-reported #	2.4	3.1	2.8	-61	-39

Source: Company, Emkay Research Note: calculated on average quarterly balances

SME segment drives advances growth

During the quarter the CD ratio has improved by 146bps yoy to 73.1% mainly driven by the SME segment which grew by 38.6% yoy. The retails loans have grown by decent 18.8% yoy.

A better asset mix has helped the bank to improve the yield on advances from 8.98% in FY07 to 10.12% in FY08, an expansion of 114bps.

Advances mix

%	Rs bn	% change		% of portfolio	Change in bps	
		yoy	qoq		yoy	qoq
Retail	161	18.8	6.2	21.2	-8	81
SME	122	38.6	10.3	16.1	226	118
Agriculture	115	7.8	-1.9	15.1	-159	-64
Others	361	17.7	-0.6	47.6	-59	-135
Total	759	19.2	2.2			

Source: Company, Emkay Research

Slower loan growth help to improve CASA

A slower loan growth and consequent slower deposit growth has helped the bank to improve its CASA mix as the same expanded by 180bps on sequential as well as yoy basis.

Deposit mix

Rs mn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% yoy chg
Current account	118	86	101	37.3	17.1
Savings account	244	208	227	17.4	7.2
Total deposits	1,039	889	992	16.8	4.7
CASA ratio (%)	34.9	33.1	33.1	181bps	176 bps

Source: Company, Emkay Research

Other income grows strong but fee income disappoints

The other income during the quarter has grown by 28.5% yoy, albeit the same was achieved on the back of higher treasury income and recoveries, which grew by 3x yoy to Rs400mn and 65% yoy to Rs610mn respectively. The bank still has a substantial amount in w/off accounts which will keep the recovery income stable in coming quarters. The fee income disappointed during the quarter with a modest 9.3% yoy growth.

Other income

Rs mn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% yoy chg
CEB	940	860	770	9.3	22.1
Forex	760	670	690	13.4	10.1
Treasury income	400	130	1,560	207.7	-74.4
Recoveries	610	370	420	64.9	45.2
Others	777	768	390	1.2	99.2
Amortisation	-380	-380	-360	0.0	5.6
Total	3,107	2,418	3,470	28.5	-10.5

Source: Company, Emkay Research

CBS roll out to help improve fee income

During FY08, the bank has brought all of its 2361 branches under core banking solution. Also, during the year bank has expanded its international presence with branches and representative offices in Abu Dhabi, Shanghai and Hong Kong.

The CBS roll out and international presence are likely to provide much needed boost to the fee income with higher transaction banking and government banking business.

Core operating profit grows at just 7.0%

While the reported operating profit has grown by 17.5% yoy, the core adjusted operating profit has grown by just 7% to Rs6.3bn.

The employee expenses during the quarter were just at 571mn compared with Rs1.4bn for Q4FY07 and Rs2.8bn for Q3FY08. The drop was for following reasons:

1. The bank had provided Rs2240mn during M9FY08 for AS-15 liabilities for FY08 including an ad-hoc amount of Rs750mn towards transitional liability then estimated to be Rs3.5bn.
2. With the clarity on guidelines, the transitional liability as on FY08 arising due to the adoption of AS-15 amounting to Rs 4.0bn has been adjusted from opening balance of Reserves
3. Consequently Rs 1.28bn charged in earlier quarters has been written back now.

Consequently we have added back Rs1.28bn and Rs450mn to the employee costs for Q4FY08 and Q4FY07 respectively (these are extra provisions which have been written back). We have deducted Rs250 (ad-hoc provision done in Q3FY08) and Rs 500mn [(Rs2240mn-Rs750mn)/3].

Adjusted employee costs

Rs mn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% qoq chg
Reported employee expenses	571	1,488	2,794	-61.6	-79.6
Add:					
Write back of transitional liabilities	1,280	450	-	-	-
Less:					
Provision for FY08 ascertained liability	-	-	500	-	-
Ad hoc provisions for transitional AS-15 liability	-	-	250	-	-
Adjusted employee expenses	1,851	1,938	2,044	-4.5	-9.4

Source: Company, Emkay Research

Adjusted core operating profit growth of 7%

Rs mn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% qoq chg
Reported operating profit	8,907	7,583	6,359	17.5	40.1
Less:					
Write back of provisions	1280	450	-	-	-
interest on CRR balances	-	270	-	-	-
interest on IT refunds	930	670	-	-	-
other one time income	-	180	-	-	-
Add:					
Provision for FY08 ascertained liability	-	-	500	-	-
Ad hoc provisions for transitional AS-15 liability	-	-	250	-	-
Adjusted operating profit	6,697	6,013	7,109	11.4	-5.8
Less: Treasury income	400	130	1560	-	-
Core operating profit	6,297	5,883	5,549	7.0	13.5

Source: Company, Emkay Research

Net profit shoots up for near zero tax

During Q4FY08, the bank has provided just Rs44mn for tax provisions or 0.8% of the profit before tax.

We believe that the lower provision for Q4FY08 is on account of higher treasury income and over provisions for the preceding quarters. For FY08, the tax rate adjusted for treasury income is at healthy 30%.

Aggressive provisioning for NPA

The bank has prudently used better profitability for provisioning for bad loans as the NPA provisioning has grown by 48.7% yoy to Rs2.4bn. The investment depreciation also remained higher at Rs1.1bn.

Break up of provisions

Rs bn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% qoq chg
Investment Depreciation	1,100	780	-640	41.0	NA
NPA	2,350	1,580	1,360	48.7	72.8
<i>As % of advances</i>	<i>0.31</i>	<i>0.25</i>	<i>0.18</i>		
Std assets	210	920	160	-77.2	31.3
Others	-100	-120	230	NA	NA
Total	3,560	3,160	1,110	12.7	220.7

Source: Company, Emkay Research

Asset quality best in the industry

The bank has continued on the asset quality improvement. The gross NPA during the quarter have declined to 2.10% (3.27% last year) and net NPA to 0.35% (1.12% last year). The provisioning cover on bad loans now stands at 92.4% as on Q4FY08 compared with 67.4% last year.

Improving asset quality

Rs bn	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% qoq chg
Gross NPA (Rs mn)	1,657	1,873	1,561	-11.6	6.1
Gross NPA (%)	2.18	2.94	2.10		
Net NPA (Rs mn)	126	611	257	-79.3	-50.7
Net NPA (%)	0.17	0.96	0.35		
Provision Cover (%)	92.4	67.4	83.6		

Source: Company, Emkay Research

Low tier I CAR – equity infusion required soon

UBI's tier I CAR as at the end of Q4FY08 stood at 7.5% with overall CAR at 12.5%. Under Basel II norms, the CAR is likely to fall to 11.7% with tier I CAR likely to see similar dip. While, the bank has some room left for quasi tier I capital as well as tier II capital, it will require equity capital soon to fund the expansion. The management has guided for a rights issue in FY09.

Valuations and view

We have lowered our estimates for both FY09E and FY10E by 8% each to take into account near term pressure on the margins. We have also lowered our price target on the stock downward to Rs230 from Rs240 earlier). The stock is currently trading at 1.1x FY10E ABV and 5.5x FY10E FPER. We maintain our BUY recommendation on the stock.

Estimate change

Rs	Old estimates		New estimates		% change	
	FY09	FY10	FY09	FY10	FY09	FY10
EPS	28.0	34.3	25.8	31.6	-8.0	-7.8
ABV	138.7	169.3	134.6	162.6	-2.9	-4.0

Quarterly results

Rs mn	FY08	FY07	% yoy chg	Q4FY08	Q4FY07	Q3FY08	% yoy chg	% qoq chg
Net interest income	30,861	27,903	10.6	8,339	8,424	7,881	-1.0	5.8
Other Income	10,870	6,868	58.3	3,107	2,418	3,475	28.5	-10.6
<i>Fee income</i>	3,080	2,770	11.2	940	860	770	9.3	22.1
Net income	41,731	34,771	20.0	11,446	10,842	11,356	5.6	0.8
Total operating expenses	15,930	14,759	7.9	2,539	3,259	4,997	-22.1	-49.2
Operating Profit	25,801	20,011	28.9	8,907	7,583	6,359	17.5	40.1
Provisions & Contingencies	7,290	6,198	17.6	3,652	3,153	1,108	15.8	229.5
<i>Prov for NPA</i>	5,850	3,300	77.3	2,350	1,580	1,360	48.7	72.8
Profit before tax	18,511	13,813	34.0	5,255	4,430	5,251	18.6	0.1
Provision for Taxes	4,644	5,350	-13.2	44	2,144	1,600	-98.0	-97.3
Net Profit	13,867	8,463	63.8	5,212	2,286	3,651	128.0	42.8

Valuation table

Y/E March 31	Net income (Rs mn)	Net profit (Rs mn)	EPS (Rs)	ABV (Rs)	RoA (%)	RoE (%)	PE (x)	P/ABV (x)
FY2007	34,761	8,448	16.7	81.4	0.9	17.3	13.0	2.7
FY2008E	41,731	13,867	27.5	111.0	1.0	20.6	6.6	1.6
FY2009E	43,811	13,718	25.8	134.6	1.0	20.1	6.8	1.3
FY2010E	50,988	16,846	31.6	162.6	1.1	20.3	5.5	1.1

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