

Union Bank of India

INR: 397

HOLD



Introduction

Union Bank of India is one of the largest PSU bank with business mix of Rs 296,000 cr plus and a branch network of 2,830 branches across India. Around 40% branches are located in Northern India followed by 23% in South. Its market share has been continuously increasing- market share in deposits stood at 3.49% while in advances it stood at 3.42% as on June 30, 2010. The Bank has representative offices in Shanghai and Beijing, PRC, Abu Dhabi, UAE, London, UK and Sydney and also its first full fledged overseas branch in Hong Kong. Recently, it signed a Rs 1,500 cr takeout finance agreement with IIFCL for development of seven power and road projects in the country. Bank is expecting Rs 1500 cr capital infusion from the government through right issues this fiscal.

Key Investment Rationale

Strong volume growth outlook- During June quarter, advances grew by 29.9% y-o-y to Rs 124,743 cr led by strong credit growth in MSME and retail sectors. Retail portfolio saw traction of 36.0% while MSME book grew by 42.9%. Deposits growth remained flat on a sequential basis while grew by 19.2% y-o-y to Rs 171,484 cr. CASA growth continued to be strong at 27.7% y-o-y to Rs 55,845 cr on the back of sturdy savings deposits growth. As a result the CASA ratio increased to 32.6% from 30.4% a year ago. Incrementally ~44% of the deposit growth has come from CASA only. Bank's market share improved in both credit & deposits to 3.42% and 3.49% respectively. We have modeled 25% credit growth in FY11E.

Moderating Net Interest Margins – The cost of funds declined by 107 bps while yield on funds declined only 29 bps. As a result NIM improved by 71 bps on y-o-y basis from 2.32% to 3.03% on the back of strong NII growth of 68% despite higher interest outgo on savings accounts & increase in CRR. However sequentially margin declined from 3.35%. In September quarter, we expect marginal improvement in margins; modest volume growth and stable loan yields to drive interest income. However, going forward we expect the NIM to settle around to 2.7-3.0% by end of FY11.

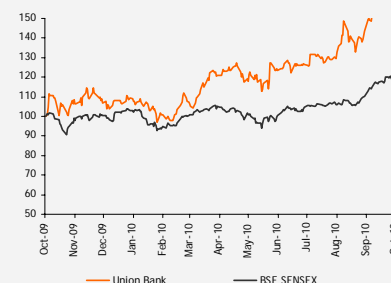
Asset Quality Deterioration in near term – The asset quality continues to be an area of concern for the bank which has deteriorated sharply on account of increased delinquencies. During the June quarter, total slippage amounted to Rs 623 cr against Rs 189 cr a year ago though much lower than Rs 1,785 cr in Q4FY10. However, ~53% reductions were on account of up-gradation & recoveries. Restructured assets amounting to Rs 193.2 cr against Rs 481.4 cr a year ago turned NPA. We expect the farm loan debt waiver to the tune of 400 cr, which is yet to be recognized as NPA, further delinquencies from restructured assets will add pressure on NPA profile in coming quarters. We expect gross NPA to peak at ~2.6% during this fiscal after which it should begin to moderate.

Robust Fee Income growth but lower treasury gains- In June quarter the non-interest income declined by 17.7% y-o-y to Rs 435 cr primarily due to lower treasury income which declined by 26% y-o-y. Fee income however grew by 9% to Rs 200 cr. In Q2FY11, we expect lower non-interest income thanks to modest fee income growth and lower treasury gains. However, we factor in strong growth for this fiscal.

Our View –Stock has given 25% return in the last two months since we recommended it. Notwithstanding solid expected loan growth of ~25%, better margins, 24-25% RoE, strong fee income growth and stabilizing assets quality we believe the stock, which is trading at 1.9x P/ABV of FY12E ABV of Rs 214, is fairly priced. Henceforth we see limited upside potential. We recommend HOLD with a price target of Rs 406.

Price Target (INR): 406

Market Data	Oct13, 2010
Shares outs (Cr)	50.5
Equity Cap (Rs. Cr)	505.1
Mkt Cap (Rs. Cr)	20,049
52 Wk H/L (Rs)	405/237
Avg Vol (1yr avg)	118,470
Face Value (Rs)	10



Market Info:

SENSEX	20,688
NIFTY	6,234

Share Holding pattern (%)

Particulars	Jun10	Mar 10	Chg
Promoters	55.4	55.4	0.0
FII's	12.2	12.7	-3.8
Institutions	18.5	17.4	6.3
Others	13.9	14.5	-4.1
Total	100.0	100.0	0.00

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