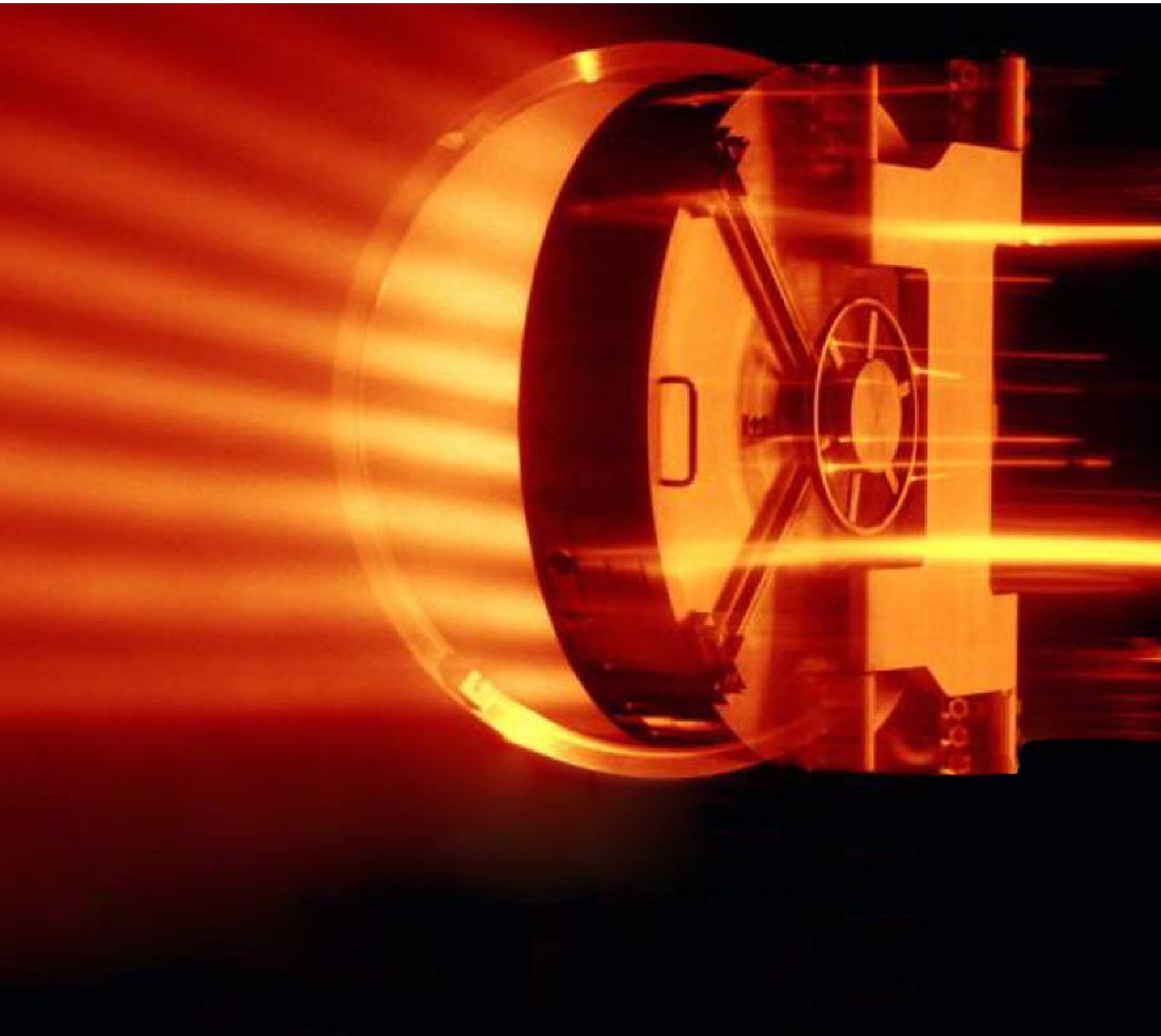
April 2007

Banking



Strong Vault

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Contents

Banking

BSE Sensex:12,455 S&P CNX: 3,634 2 April 2007

Bank stocks have taken a hit following concerns that rising interest rates would lead to a slowdown in growth, pressure on margins and higher asset quality risks. Though we expect some moderation in credit growth, it would still be a robust 20% (our estimate for FY08). With deposit growth also picking up, funding this credit growth should not be a problem. The challenge, however, lies in keeping the cost of deposits under control. Banks with strong liability franchise would be at an advantage in this regard.

We believe that banks continue to have enough pricing power to maintain their margins at current levels. Yet, a few players that are weak on the liability management front could witness lower margins. While risks relating to asset quality have increased, we do not see any issues on the ground so far. We believe that as long as the macro economic scenario remains robust, asset quality will remain good. In light of the sharp decline in valuations, we believe that the opportunities outweigh the near-term concerns.

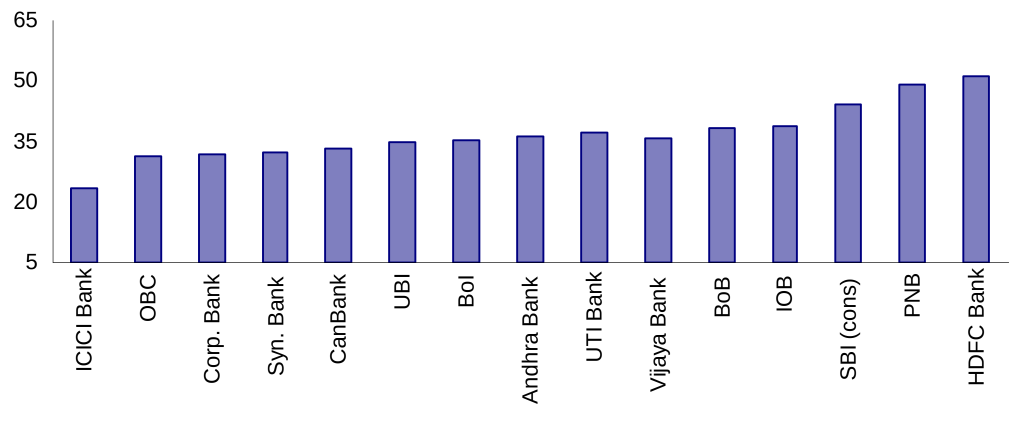
Monetary tightening leads to sector underperformance

Taming inflation has been the central regulatory theme over the last few months, leading to multiple hikes in CRR and repo rates, and other anti-inflation monetary measures. The result – fears of a consequent slowdown in credit growth have led to a beating down of banking stocks. However, as the regulatory measures begin having the desired impact, we expect the near-term concerns on banking stocks to alleviate.

Effective liability management – the key differentiator

Liability cost is becoming an important determinant of profitability. While deposit growth is picking up, and would help keep up the strong credit growth, raising deposits at the right price would be the key driver of profits. We believe that banks that have a strong liability franchise (and consequently, high CASA ratio) would be at an advantage.

BANKS WITH HIGHER CASA RATIO (%) AT AN ADVANTAGE (FY07)



Source: Company/Motilal Oswal Securities

Growth – would moderate, but will remain healthy at 20%

We expect loan growth to moderate to 20% due to rising interest rates and monetary tightening in FY08 after a CAGR of 30% over the last three years. However, a steep fall in the growth rate is unlikely, as the macro economic scenario remains robust, corporate balance sheets are de-leveraged at a time of capacity expansions and consumers are under-leveraged. Structurally too, India remains under-penetrated in terms of credit.

Margins – pricing power to sustain margins

Though deposit costs are going up, banks have aggressively raised lending rates in order to maintain margins. While private banks have been most aggressive in raising lending rates, even state-owned banks have increased their prime lending rates (PLR) by 175-200bp over the last 12 months. Further, banks have also curtailed sub-PLR lending and withdrawn all other forms of discount. We believe that banks would be able to sustain their margins at current levels over the near to medium term. However, banks that have low CASA deposit ratio could witness margin pressure.

LENDING RATE HIKES BY ICICI BANK AND SBI OVER THE LAST 12 MONTHS

PLR HIKE BY ICICI BANK	TO (%)	BY (bp)	PLR HIKE BY SBI	TO (%)	BY (bp)
January 2006	11.50	50	April 2006	10.75	50
February 2006	11.75	25	August 2006	11.00	25
March 2006	12.75	100	December 2006	11.50	50
June 2006	13.25	50	February 2007	12.25	75
December 2006	13.75	50			
February 2007	14.75	100			
April 2007	15.75	100			

Source: Company/ Motilal Oswal Securities

Asset quality – risks increased, but still manageable

Most banks have been showing quarter on quarter improvement in asset quality. The gross NPAs of almost all banks have fallen to 3-4% while net NPAs have declined to 0.5-1.5%. We believe that the asset quality has peaked and any further improvement would be marginal. However, we do not expect a reversal of the improving asset quality cycle despite the strong credit growth in the last three years and the recent spike in interest rates. As long as the overall economic growth remains strong, we do not anticipate a material deterioration in asset quality.

Valuations are attractive, factors near-term concerns

Notwithstanding the near term concerns, we believe that the current valuations for bank stocks are extremely attractive and factor lower growth and probably lower margins, as well. We believe that the structural story for Indian banking continues, and the current decline in stock prices is excessive.

We do not expect sharp declines from current levels. Banking stocks tend to move in phases, and rises and declines have become sharp and large. If the concerns on inflation and shorter-end interest rates assuage (likely in 1QFY08), gains could be large (as witnessed last year during May-August 2006). Our top bets are HDFC Bank and ICICI amongst the private sector banks. Within state-owned banks, we like PNB, BOI, Syndicate.

COMPARATIVE VALUATIONS (FY09E)

	CMP (RS)	MKT. CAP (US $ B)	EPS (RS)	BV RS	P/E (X)	P/BV (X)	ROE (%)	TARGET (RS)	UPSIDE (%)	TARGET P/B MULTIPLE
Private Banks										
HDFC Bank	902	282	62.1	291	14.5	3.1	23.5	1162	29	4x
ICICI Bank	805	716	53.9	349	14.9	2.3	16.4	1123	40	2.5x + 250
Federal bank	203	17	43.0	236	4.7	0.9	19.7	307	51	1.3x
UTI Bank	460	128	34.9	173	13.2	2.7	22.0	554	21	3.2x
Karnataka Bank	166	20	21.6	137	7.7	1.2	16.8	178	7	1.3x
State-Owned Banks										
Bank of India	154	75	29.3	153	5.3	1.0	20.3	229	49	1.5x
Union Bank of India	96	49	22.3	121	4.3	0.8	18.3	157	63	1.3x
Punjab National Bank	428	135	85.8	454	5.0	0.9	20.0	681	59	1.5x
Syndicate Bank	59	31	17.1	86	3.4	0.7	20.5	95	62	1.1x
Andhra Bank	72	35	14.5	83	4.9	0.9	18.5	107	50	1.3x
Bank of Baroda	201	73	41.5	288	4.8	0.7	14.9	288	43	1x
Indian Overseas Bank	96	52	23.8	105	4.0	0.9	24.3	148	53	1.4x
State Bank of India (cons)	930	489	141.7	1,022	6.6	0.9	14.8	1226	32	1.2x
Oriental Bank of Commerce	169	42	41.0	268	4.1	0.6	16.0	268	59	1.0x
J&K Bank	628	30	90.1	550	7.0	1.1	17.5	770	23	1.4x
Canara Bank	183	0	40.9	249	4.5	0.7	17.3	249	36	1x
Vijaya Bank	39	17	9.6	56	4.0	0.7	18.2	56	44	1x
Corporation Bank	259	37	46.8	335	5.5	0.8	14.8	335	29	1x
IDBI	72	52	10.7	111	6.7	0.6	10.1	108	50	0.7x + 30
Bank of Maharashtra	37	16	6.7	44	5.5	0.8	15.8	44	20	1x
Dena Bank	33	9	11.3	61	2.9	0.5	17.3	49	49	0.8x

**For ICICI Bank, target price is based on 2.5x FY09E BV plus Rs250/share value of subsidiaries* *Source: Motilal Oswal Securities*

Monetary tightening leads to sector underperformance

Taming inflation has been the central regulatory theme over the last few months, leading to multiple hikes in CRR and repo rates, and other anti-inflation monetary measures. The result – fears of a consequent slowdown in credit growth have led to a beating down of banking stocks. However, as the regulatory measures begin having the desired impact, we expect the near-term concerns on banking stocks to alleviate.

Inflation control has taken center stage…

Inflation control assumes center stage

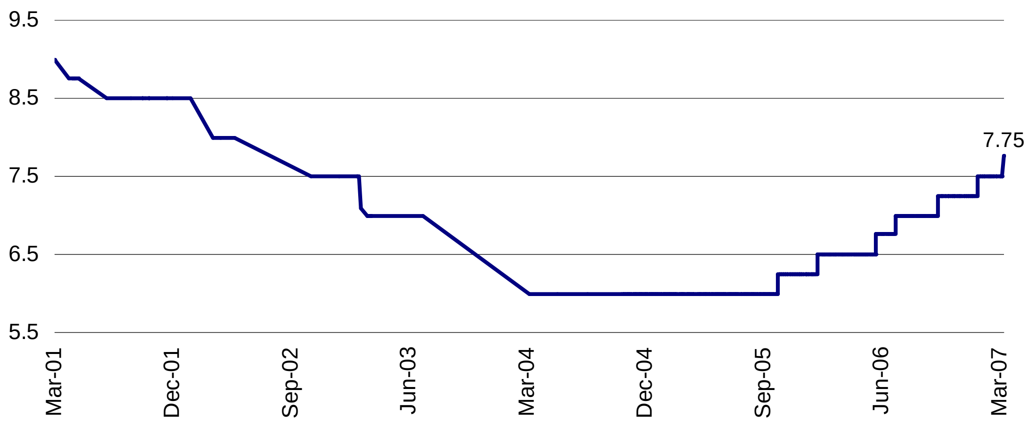
Inflation management has become the central regulatory theme over the last few months. RBI has taken monetary measures like raising CRR and repo rate, and has also increased provisioning and capital requirements for certain asset classes. Yet inflation (6.5%) and money supply (22%) have continued to remain higher than RBI's comfort level of 5-5.5% and 16%, respectively. RBI and the Government have highlighted their intentions to control inflation at any cost.

…leading to further monetary tightening…

The RBI has resorted to monetary tightening …

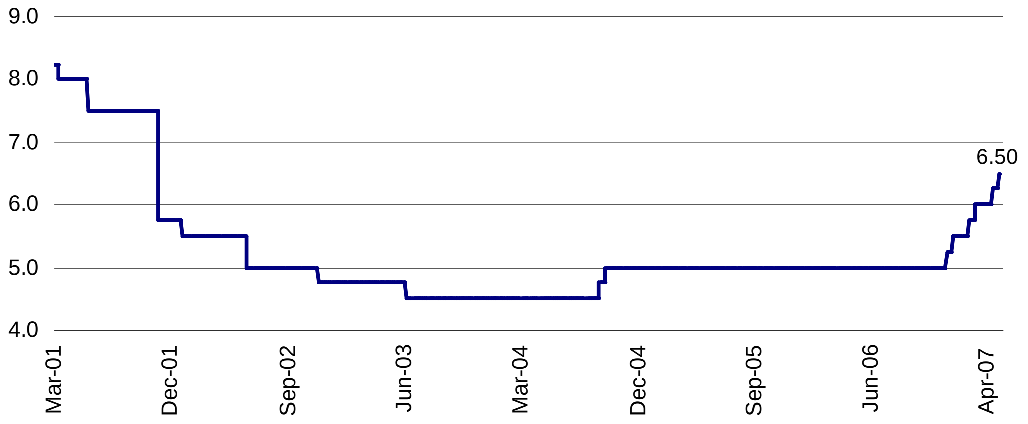
Over the last four months, RBI has raised CRR by 150bp, taking away about Rs450b of liquidity from the markets. It has even raised repo rates by 50bp, signaling higher borrowing and lending rates. This has resulted in banks aggressively raising deposit and lending rates over the last 4-5 months. As most banks have been aggressive in raising their lending rates, we do not expect a large impact on margins. However, growth is likely to slow down for the system, going forward. We have reduced our growth estimates and now expect credit to grow at 20% for FY08 (against a 30% CAGR growth over FY05-07 and our earlier estimate of 23%).

MOVEMENT IN REVERSE REPO RATE (%)



Source: RBI/ Motilal Oswal Securities

MOVEMENT IN CRR (%)



Source: RBI/ Motilal Oswal Securities

…and consequent beating down of banking stocks

… consequently banking stocks declined

On account of the increasing concerns of monetary tightening leading to a slowdown in growth, banking stocks have been declined sharply. The Bankex has declined by 19% from its highs in February.

STOCK PERFORMANCE OF TOP BANKS

				RELATIVE TO SENSEX		
	3M	6M	12M	3M	6M	12M
SBI	-26	-10	-5	-15	-11	-13
PNB	-16	-19	-8	-6	-19	-16
BOI	-26	-5	16	-15	-5	9
ICICI Bank	-10	16	33	0	15	25
HDFC Bank	-16	-2	17	-5	-3	9

Source: Motilal Oswal Securities

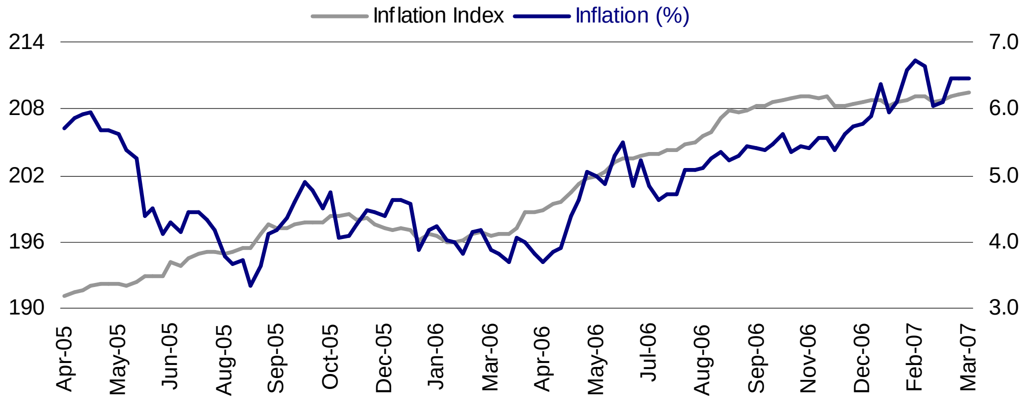
However, inflation should start coming off…

Expect inflation to come off in 1QFY08

We expect inflation to peak off in 1QFY08 (probably in April itself) on the back of base effects such as the oil price hike in April 2006 and 10-12% increase in metal prices in 1QFY07. Despite the rise in oil prices over the last three months, oil prices are still lower than last year. Further, the government is making all efforts to control metal and primary goods prices (through export restrictions, reducing import duties, and additional imports).

Over the last five months, while the inflation index has remained constant, headline inflation numbers have continued to remain high, due to a sharp rise in the index from March - November 2006. The base effect of this should start catching up and we expect YoY inflation to decline from April 2007.

RISING INFLATION HAS BEEN CONCERNING



Source: RBI/ Motilal Oswal Securities

…alleviating the near-term concerns

Risk of further monetary control will reduce significantly

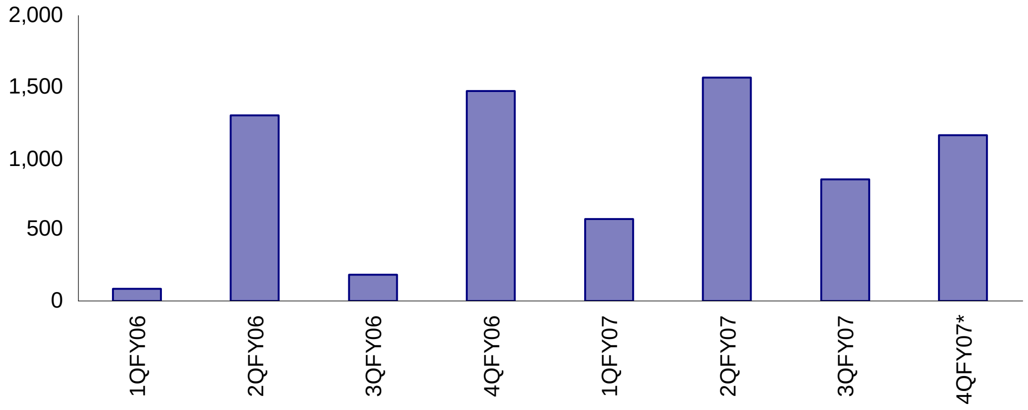
We believe that there has been too much focus on inflation by the regulators, which has resulted in strong measures. In line with our expectations, if the YoY inflation starts declining, we believe that the risk of further monetary tightening would reduce significantly, resulting in higher multiples for the banking sector.

Effective liability management – the key differentiator

Liability cost is becoming an important determinant of profitability. While deposit growth is picking up, and would help keep up the strong credit growth, raising deposits at the right price would be the key driver of profits. We believe that banks that have a strong liability franchise would be at an advantage.

While credit growth has been strong for Indian banks in the last three years, deposit mobilization has been a challenge. Indian households have been parking their surplus across multiple avenues – capital markets, national savings certificates (NSCs), public provident fund (PPF), mutual funds, etc. Consequently, the growth in bank deposits has been impacted. Against a CAGR of over 30% in bank credit during the last three years, bank deposits have grown at a CAGR of 19% (FY04-07).

INCREMENTAL DEPOSIT MOBILIZATION BY BANKS (RS B)



* Upto 15 March 2007 Source: RBI/ Motilal Oswal Securities

Banks have been raising rates to garner retail deposits…

Banks have been raising deposit rates …

To garner deposits, banks have been raising deposit rates. Earlier, it was only the private banks that were borrowing at 8-9% for ~1 year deposits. Now, banks have started borrowing at 9.5-10% at the longer end as well, indicating a scarcity of long-term resources. ICICI Bank is offering 9.5% for 5-year deposits (less than Rs0.1m). Even SBI, which earlier resisted offering higher deposit rates, has started offering rates as high as 9.5% for 4-5 year retail deposits.

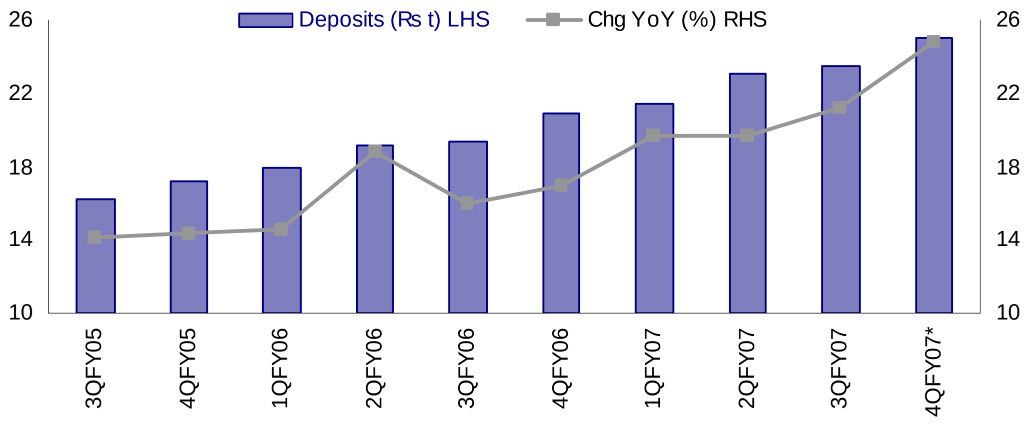
SBI is offering 9.5% interest on deposits with maturity between 4-5 years

DEPOSIT RATE HIKES BY SBI (%)

	29 NOV.04	9 JAN.06	1 MAY06	19 AUG.06	11 DEC.06	22 JAN.07
SBI Rates Across Maturities (%)						
7 days - 14 days	3.00	3.00	3.00	3.50	3.75	3.75
15 days - 45 days	4.00	4.50	4.50	4.75	5.00	5.00
46 days - 179 days	4.50	4.75	5.00	5.25	5.50	5.50
180 days - less than 1 year	5.00	5.50	6.00	6.25	6.50	6.50
1 year to less than 3 years	5.50	6.00	6.25	6.75	7.50	8.25
3 years to less than 5 years	5.75	6.25	6.50	7.00	7.75	8.25
4 years to less than 5 years (spec. dep.)	-	-	-	-	-	9.50
5 years and above	6.25	6.50	7.00	7.25	8.00	8.25

Source: Company/ Motilal Oswal Securities

QOQ TREND IN DEPOSITS – GROWTH PICKING UP



** Upto 15 March 2007* *Source: RBI/ Motilal Oswal Securities*

While the share of demand deposits has been increasing and time deposits declining, the composition of time deposits has also been undergoing a significant change. The share of short-term deposits in total time deposits increased sharply from 43.8% at FY00 to 58.2% at FY06. New private sector banks and foreign banks have been the largest mobilizers of short-term time deposits.

The preference for short-term deposits could be attributed to low returns on long-term deposits. This is evident from the spread between long-term and short-term deposit rates, which had declined to as low as 50-100bp during FY06. Of late, in order to match the ALM profile, banks have started offering higher rates on longer tenure deposits, as well. For SBI, the spread between long-term and short-term deposit rates has increased to 175-225bp (in January 2007).

…and have also been raising funds via the bulk route

… and also tapping corporate liquidity to meet credit growth

In order to meet the rising credit growth, banks have also been tapping corporate liquidity to shore up their deposit base. However, rates for bulk borrowings have increased sharply over the last year (up 200-225bp over March 2006), which might result in higher deposits for few banks, but at a higher cost.

Higher rates have resulted in term deposit growth picking up

With banks offering higher rates, deposit growth in the banking system has picked up to 25%, currently. Also, as bank deposit rates are becoming more favorable versus the small savings rate, there has been a shift towards bank deposits.

RATES OFFERED BY VARIOUS INSTRUMENTS

SMALL SAVINGS INSTRUMENTS	RATE OF INTEREST (P.A.%)	MATURITY PERIOD	I. TAX BENEFITS
Public Provident Fund	8% compounded yearly	15 yrs	Available
National Savings Certificate	8.16% compounded half-yearly	6 yrs	Available
Monthly Income Scheme	8.0	6 yrs	No
Kisan Vikas Patra	~8.3	8 yrs, 7 mths	No
SBI Tax Savings Deposit	7.5	5 yrs	Available
ICICI Bank Tax Saver Deposit	9.5	5 yrs	Available
SBI Super Saver Term Deposit	9.5	4 to 5 yrs	No
ICICI Bank Term Deposit	9.5	4 to 5 yrs	No

Source: Company/ Motilal Oswal Securities

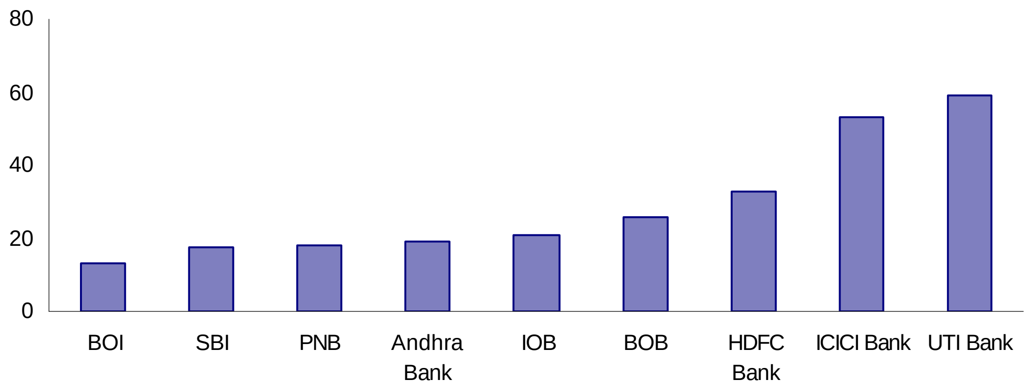
Ability to source core deposits is the key differentiator

Key is ability to source core deposits

While raising short-term deposits would enable banks to hold market shares, it would not help enhance/maintain profitability. We believe that the banks' ability to source core deposits (CASA) would be the key differentiator. Banks that are strong on CASA and retail deposits would have an edge over other banks, as these deposits are low-cost and result in better margin management.

Players such as SBI, PNB, BoB and BoI amongst the large state-owned banks and Andhra Bank and IOB amongst the medium-sized state-owned banks would be at an advantage. Not only do they already have a high CASA base, they also have large branch networks across India, which would allow them to further source low-cost deposits faster. Amongst private banks, HDFC Bank, which has a 55% CASA deposit ratio, would witness the lowest re-pricing of deposits and could witness an improvement in margins.

GROWTH IN CASA DEPOSITS AS OF DECEMBER 2006 (%)



Source: Company/ Motilal Oswal Securities

Value of franchise is increasing; branch network is the key asset

Banks with strong current and savings account franchises stand to gain as G-sec yields and interest rates in the economy have risen – the funding cost advantage widens as rates on term deposits rise. Banks with lower cost of funding would be at an advantage.

MCAP/DEPOSITS & MCAP/CASA DEPOSITS

FY07	DEPOSITS (RS)	CASA (RS)	CASA %	BRANCHES EX ECS FY06- NOS	MCAP/ DEP. (%)	MCAP/ CASA DEP. (%)
State-Owned Banks						
Andhra Bank	393	142	36.0	1,213	8.8	24.5
Bank of Baroda	1,190	454	38.2	2,704	6.2	16.2
Bank of India	1,137	400	35.0	2,622	6.6	18.8
Canara Bank	1,402	470	33.5	2,532	5.4	16.0
Corp. Bank	418	134	32.0	835	8.9	27.8
IOB	622	239	38.5	1,513	8.4	21.9
OBC	592	185	31.2	1,148	7.1	22.9
PNB	1,412	692	49.0	4,500	9.5	19.5
SBI (cons)	6,256	2,753	44.0	13,852	7.8	17.8
Syndicate Bank	778	253	32.5	2,006	3.9	12.1
UBI	852	298	35.0	2,082	5.7	16.3
Vijaya Bank	333	118	35.5	923	5.1	14.2
Total	**15,383**	**6,137**	**39.9**	**35,930**	**7.2**	**18.1**
Private Sector Banks						
HDFC Bank	737	376	51.0	535	38.3	75.1
ICICI Bank	2,361	548	23.2	625	30.3	130.7
UTI Bank	554	205	37.0	450	23.2	62.6
Total	**3,651**	**1,128**	**30.9**	**1,610**	**30.8**	**99.8**

Source: Company/ Motilal Oswal Securities

Growth – would moderate, but will remain healthy at 20%

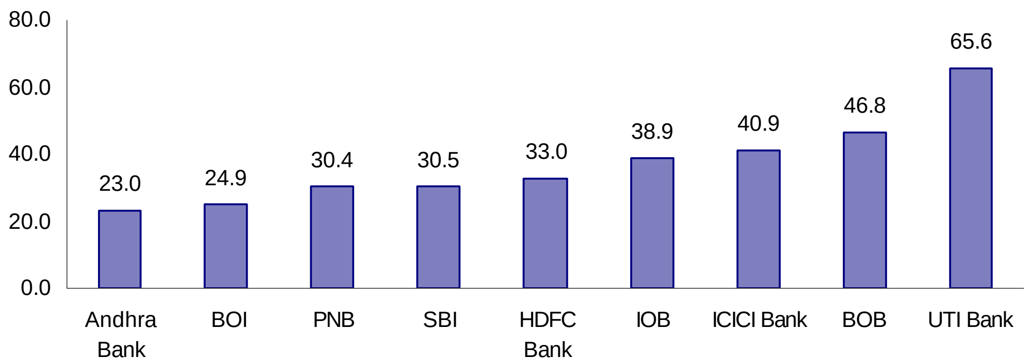
Credit potential remains strong, with credit/GDP ratio at just 48% in FY06. While we expect growth in the retail segment to slow down, growth in the corporate, international and rural segments would continue to be strong. Post a 30% CAGR in overall bank credit over the last couple of years, we expect credit growth to be 20% in FY08.

Robust credit growth over last 2-3 years

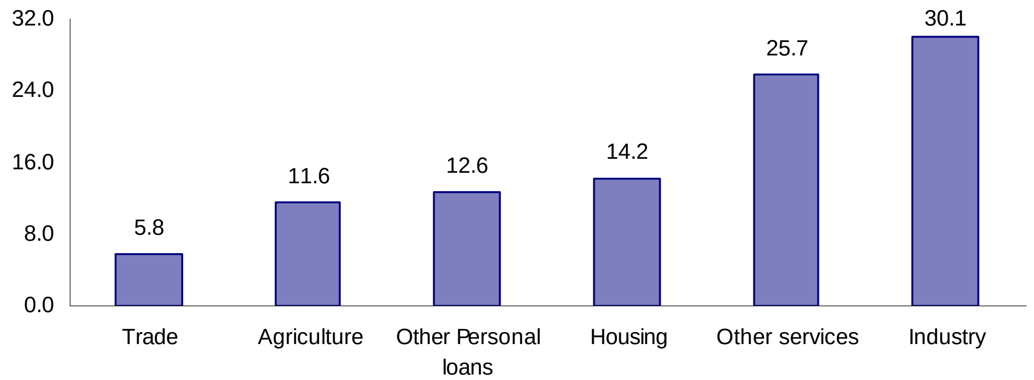
Indian banks have been witnessing robust credit growth over the last 24-36 months. Loan growth has accelerated to average ~30% in FY05-07 from average 18% in FY00-04. Key drivers for India's credit growth story are:

- Favorable macro environment – strong GDP / industrial growth averaging 8%+
- De-leveraged corporate balance sheets, with a lot of headroom to borrow at a time of capacity expansions
- Under-leveraged consumers with rising disposable incomes and who are now more willing to borrow to fund consumption expenditure

LOAN GROWTH STILL RUNNING STRONG ACROSS BANKS (DECEMBER 2006, YOY - %)



INCREMENTAL BANK CREDIT FLOW IN FY06 (%)



Source: RBI/Motilal Oswal Securities

The momentum in loan growth is being led by multiple segments. While continued growth in mortgages, auto and personal loans are driving the robust growth in retail credit, corporate credit has started to pick up owing to increased working capital requirements and significant capacity expansions. Moreover, agriculture and infrastructure lending is also witnessing strong growth.

Besides large corporates, retail and agriculture, banks are also focusing on tapping the growth opportunity in the SME segment, where average yields are 150-200bp higher than the average yields in the corporate segment. We believe that focus on the SME segment is proving to be a major growth driver for banks looking to enhance their lending profile.

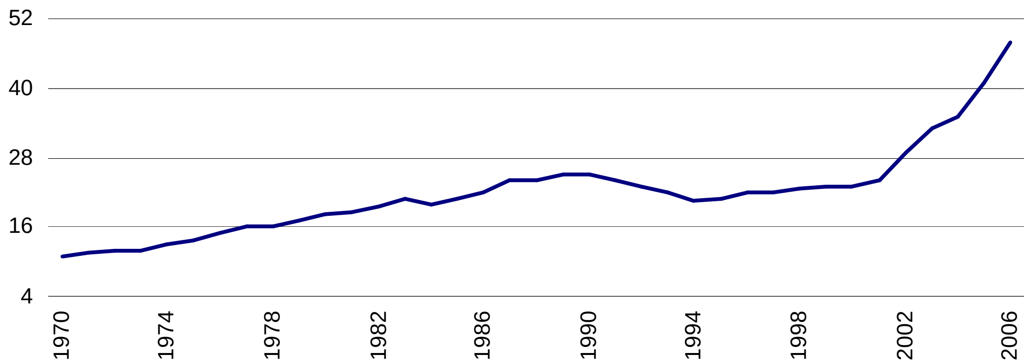
The runaway credit growth and rising inflation have been key concerns for the central bank, which has taken corrective steps. While we expect some moderation in growth, it is unlikely that credit growth will come off significantly, we expect a credit growth of 20% for FY08.

Growth potential continues to be huge…

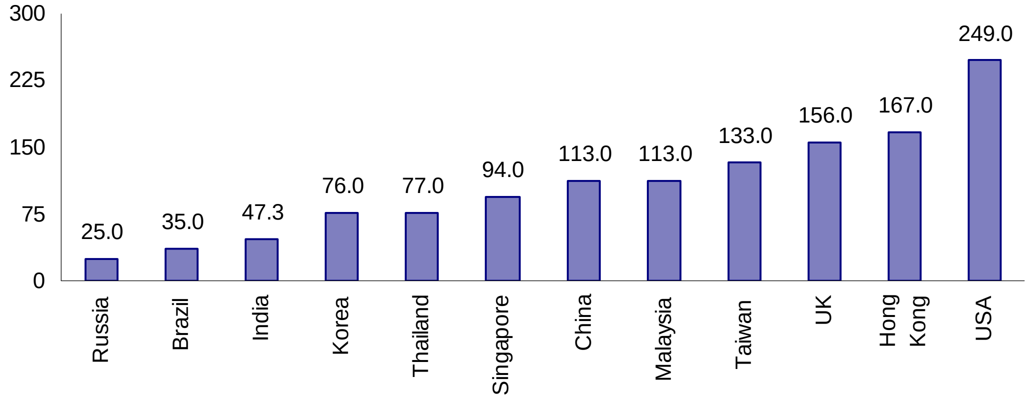
Sector offers substantial growth potential

While the credit/GDP ratio has been moving upward since FY91, India still lags behind all other developed countries as well as several developing countries. For FY06, India's credit/GDP ratio was 48%.

CREDIT AS A % OF GDP



CREDIT/GDP RATIO OF SELECT COUNTRIES (X)



Source: Company/ Motilal Oswal Securities

… with strong demand for both corporate credit …

Corporate credit has broadly followed the trend of industrial production. Credit flow to industry increased by around 27% in FY06 compared with 17% in FY05 and 5% in FY04. The industry's share in gross bank credit, however, remains low due to higher dependence on internal resources and funds from the capital market – both overseas and domestic. Nonetheless, the industry absorbed 30% of incremental bank credit in FY06.

Corporate credit will witness strong demand

With the economy on the growth path and increasing working capital requirements and investments for expanding existing capacities, corporate credit is expected to continue to witness strong growth. Investments by the corporate and infrastructure sectors have risen sharply over the past 2-3 years, driven by:

1. Low capex in the preceding 6-7 years (1997-2004);
2. Strong growth and higher capacity utilization across sectors; and
3. Significant infrastructure bottlenecks – power, roads, ports, airports, etc.

Infrastructure spend in India is likely to increase from 3.6% of GDP (US$28b) in FY06 to ~4.8% of GDP (US$50b) by FY09.

… and retail credit

Retail credit is underpenetrated ...

Despite the robust growth in retail credit over the past few years, we believe that retail credit continues to be relatively under-penetrated, thereby offering strong growth potential. We expect growth to moderate to ~20% in FY08 from the 40%+ witnessed over the last few years. We expect retail credit to grow at a CAGR of 20-25% over the next three years, due to a sharp rise in affordability led by favorable demographics.

... but we expect growth to moderate

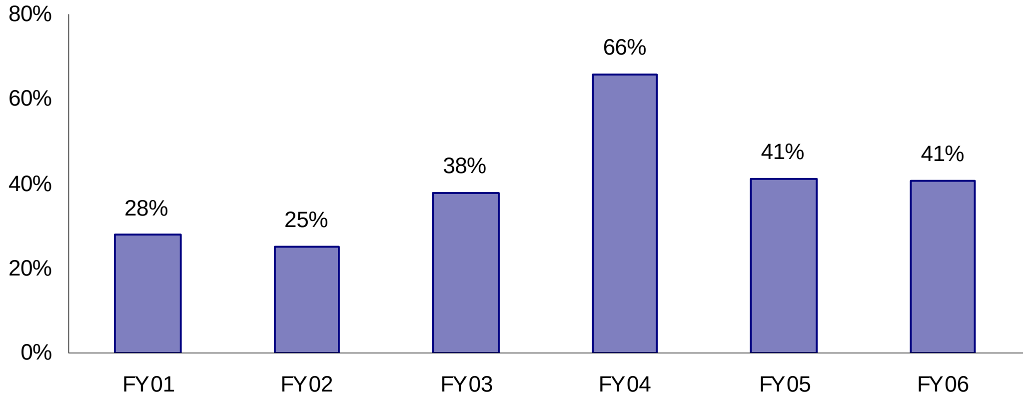
According to a recent NCAER report, the total number of households with average annual income of >Rs350,000 (the target segment for retail credit) is likely to increase from 18.8m in FY06 to over 32m in FY10. Additionally, the increasing penetration levels would also drive up effective demand for retail credit. (Penetration of retail credit in India is around 11% of GDP – amongst the lowest globally).

RETAIL CREDIT: GROWTH STRONG, BUT CONSTITUTES ONLY 25% OF TOTAL CREDIT

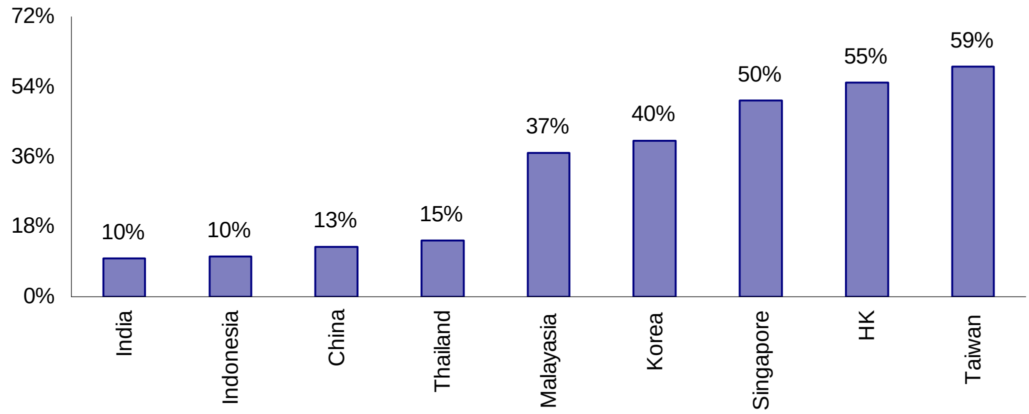
	AMOUNT OUTSTANDING (RS B)			% CHANGE	% CHANGE
	FY04	FY05	FY06	YOY-FY05	YOY-FY06
Retail Portfolios of Banks (as of 30 March 2006)					
Housing Loans	894	1,343	1,791	50.2	33.4
Consumer Durables	63	38	45	-39.5	17.3
Credit Card Receivables	62	84	124	35.6	47.9
Other Personal Loans	872	1,201	1,797	37.8	49.6
Total Retail Credit	1,891	2,666	3,757	41.0	40.9
Share of Retail in Total Credit	21.0	23.2	24.8		

Source: Company/ Motilal Oswal Securities

STRONG RETAIL SECTOR GROWTH OVER THE YEARS

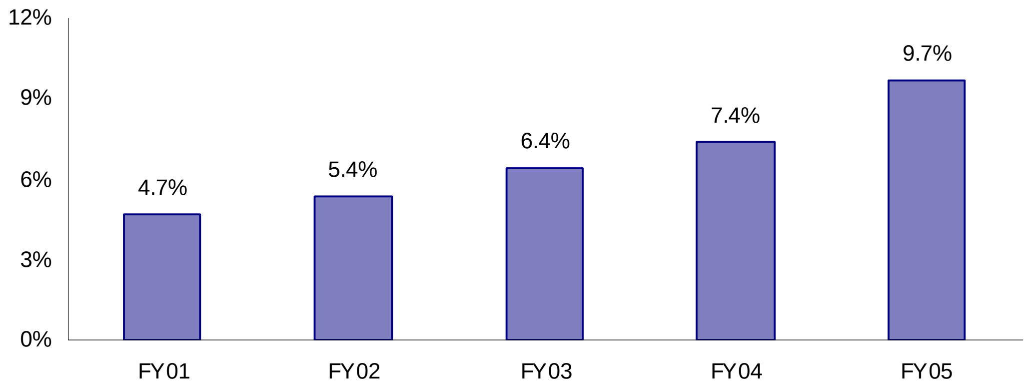


PENETRATION OF RETAIL CREDIT LOW COMPARED TO OTHER COUNTRIES



Source: Company/ Motilal Oswal Securities

LOW LEVEL OF HOUSEHOLD LEVERAGE



Source: GoI/RBI

Priority sector lending too is picking up

Lending to priority sector picking up

The government's continued thrust on priority sector lending – particularly the agriculture sector – has opened up major business propositions for the banking sector. The government has announced various measures to double credit flow to the agriculture sector over the next three years.

The emergence of micro finance, tie-ups with non-government organizations (NGOs), and big corporate groups foraying into agriculture through contract farming etc., has provided a new dimension to agriculture lending. Citing the opportunity and commercial viability of the agriculture lending business, leading private banks have taken up agriculture lending as one of their focus areas. However, we believe that state-owned banks would benefit the most in the agriculture lending business due to their widespread reach in rural areas.

PRIORITY SECTOR CREDIT GROWTH REMAINS STRONG (RS B)

	OUTSTANDINGS AS ON				
	22-MAR-02	21-MAR-03	19-MAR-04	18-MAR-05	31-MAR-06
Agriculture	607.6	735.2	905.4	1,252.5	1,722.9
Growth (YoY- %)		*21.0*	*23.2*	*38.3*	*37.6*
Small Scale Industries	572.0	603.9	658.6	745.9	902.4
Growth (YoY- %)		*5.6*	*9.0*	*13.3*	*21.0*
Other Priority Sectors	573.0	777.0	1,074.4	1,816.4	2,473.8
Growth (YoY- %)		*35.6*	*38.3*	*69.1*	*36.2*

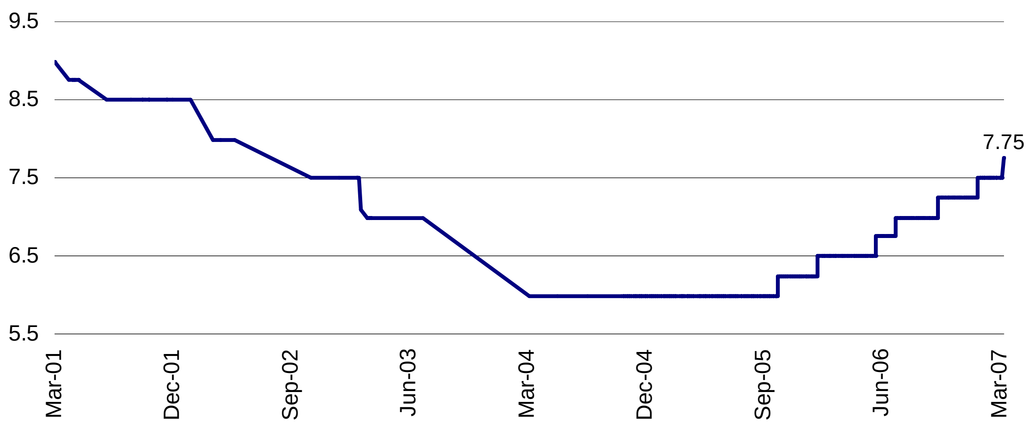
Source: RBI/Motilal Oswal Securities

High growth – a concern for the regulator

Run-away credit growth a concern

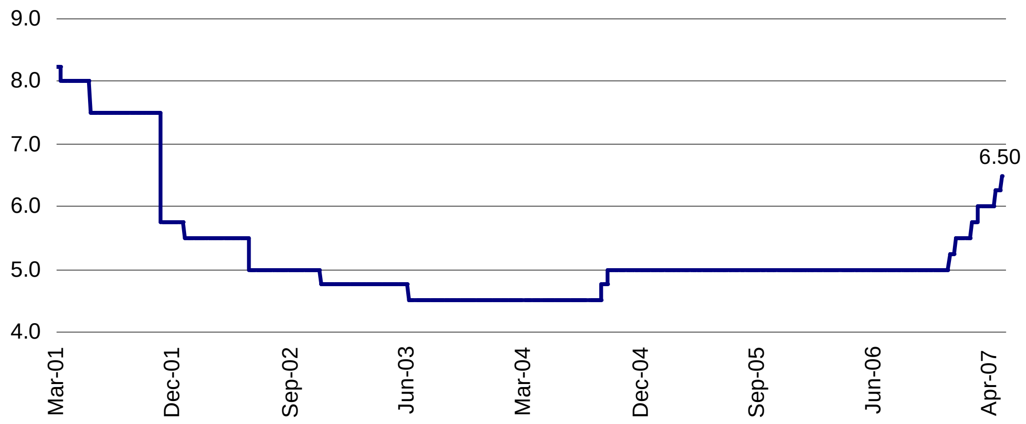
The runaway credit growth (~30%) has been one of the key concerns for the central bank, which has taken measures to increase the cost of bank borrowings as well as controlling liquidity in the system (the recent CRR hike).

MOVEMENT IN REVERSE REPO RATE (%)



Source: RBI/Motilal Oswal Securities

MOVEMENT IN CRR (%)



Source: RBI/ Motilal Oswal Securities

While growth could moderate, it is unlikely to come off sharply

Though interest rates have been rising recently, India's structural growth story is intact. While interest rates have increased by >300bp over the last few months, there is little impact on credit growth so far. Rising interest rates could lead to a moderation in credit growth, but we believe that even a lower growth of 20% will be very healthy. We expect loan growth in the system to be 29% in FY07 and about 20% in FY08.

Expect credit growth to moderate to~29% in FY07 and 20% in FY08

We expect some moderation in credit growth on account of:

- Administrative measures by the RBI to tighten liquidity, and its closer scrutiny of the end use of funds
- Higher interest rates could impact retail lending, especially mortgages and autos
- The relatively higher base would impact YoY growth
- Increased offshore borrowing limits (external commercial borrowings, ECBs) and a strengthening rupee (capped global rates should make such borrowings more favorable)
- Banks are deploying additional deposits raised for SLR, as there is not much excess SLR holding in the system currently (SLR / NDTL currently is 27% against requirement of 25%)

We expect credit growth to moderate to ~29% in FY07 and 20% in FY08. We also believe that moderate loan growth would be the best-case scenario for banks, as margin pressures would subside and the risk on asset quality would decline.

Margins – pricing power to sustain margins

In the current environment, we believe that banks have enough pricing power to sustain margins. While state-owned banks have raised lending rates by ~200bp over the last 12 months, private banks have raised rates faster. With cost of deposits rising, we are building in a 5-15bp margin contraction for most banks under our coverage.

We believe that banks have adequate pricing power, with loan growth opportunities higher than balance sheet funding availability. More importantly, banks have also demonstrated the willingness to raise lending rates to manage margins. Loan yields have already risen over the past 3-4 quarters. Further, the risk of investment book re-pricing is now low. Hence, we expect margins to sustain.

Lending rates are rising

Lending rates northward bound

While interest rates have been rising over the last two years, the real signs of actual increase in asset yields are visible only from FY07. There was excess liquidity in the system until 4QFY06, which prevented lending rates to rise fast. With this additional liquidity being mopped up / tightened, banks have been aggressive in raising their lending rates. While private banks have raised lending rates (ICICI Bank has raised lending rates by 425bp, HDFC Bank has raised rates by 400bp), the state-owned banks have curtailed their sub-PLR lending, while officially have increased rates by 150bp-200bp. We are expecting a further rate hike by state-owned banks in April 2007.

LENDING RATE HIKES BY ICICI BANK AND SBI OVER THE LAST 12 MONTHS

PLR HIKE BY ICICI BANK	TO (%)	BY (bp)	PLR HIKE BY SBI	TO (%)	BY (bp)
January 2006	11.50	50	April 2006	10.75	50
February 2006	11.75	25	August 2006	11.00	25
March 2006	12.75	100	December 2006	11.50	50
June 2006	13.25	50	February 2007	12.25	75
December 2006	13.75	50			
February 2007	14.75	100			
April 2007	15.75	100			

LOAN RATE INCREASES IN VARIOUS CATEGORIES OVER THE LAST 15 MONTHS

	KEY PLAYERS IN THE SEGMENT	PRICING CHARGES
Mortgages	HDFC, ICICI and SBI account for more than 70% of the market	The leader ICICI Bank has raised prices by almost 400bp over the last 15 months
Other Retail Loans	Private banks and few state owned banks	Auto loans have increased by 300bp, banks have become aggressive in other retail loans such as personal loans, credit cards, etc as there is enough demand and available yields range from 18-40%
Corporate Loans	State-owned banks	Benchmark PLRs have gone up by 150-200bp. Banks have reduced discount to PLRs. Rates are up by 200-250bp
Agri Loans, Other Priority Sec Loans	State-owned banks, few private banks	Banks have reduced discount on PLRs. However directed agri loans are still given at 9%.

Source: Company/ Motilal Oswal Securities

Sub-PLR lending rate has been raised: While PLRs for most banks were in the range of 10-11% for the last few years, more than 75% of the lending was done at sub-PLR, wherein the banks offered discounts of 250-300bp. While PLR was revised only thrice over the last 12 months, the revision in sub-PLR lending rates has been higher (200-350bp). However, as the new rates are applied only when the loans come up for re-pricing, the increase in lending yields would be gradual.

Retail lending yields have risen

Retail yields have also gone up: In retail lending as well, where private banks are the key players, yields have been rising. Mortgages have already witnessed an increase of 250bp-300bp over the last twelve months (350-400bp from their lows). Even fixed-rate loans such as auto, 2-wheeler, personal and CV loans have witnessed an increase of 200-400bp. As mortgages are usually floating rate loans, re-pricing occurs when the banks raise their lending rates. Other fixed-price loans, however, have an average tenor of 18 months and the effect of re-pricing is felt only over a length of time.

ICICI BANK: MORTGAGE RATE (%)

MONTH/YEAR	HIKE	(BP)
November 2004	8.25	50
June 2005	8.75	50
February 2006	9.25	50
May 2006	9.75	50
June 2006	10.25	50
December 2006	10.75	50
February 2007	11.75	100
April 2007	12.75	100

INDICATIVE YIELDS AND INCREASE IN LOAN RATES OVER LAST ONE YEAR

RETAIL LOANS	% RISE IN (YOY) LENDING RATE	CURRENT LENDING RATE%
Auto	3-4	13-13.5
CVs	3-4	12-14
2Ws	3-5	18-20
Personal Loans	3-5	15-18
Loans against Securities	3-4	14-18
Credit Cards	2-3	18-36

Source: Company/ Motilal Oswal Securities

Cost of deposits is also rising…

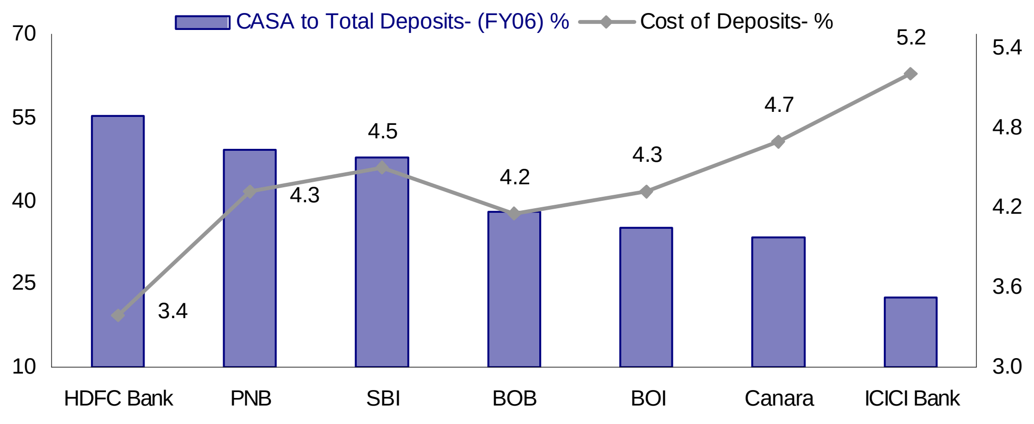
Deposit cost rising too

In line with the general rise in interest rates, cost of deposits has also moved up sharply. The sharp increase has largely been in the bulk deposit segment. With liquidity likely to be tight, banks – primarily those with low CASA base – mopped up bulk deposits at a hectic pace in 9MFY07. Private banks like ICICI Bank, and a few state-owned banks like Syndicate Bank, Canara Bank and Oriental Bank of Commerce have aggressively raised deposits. Banks have raised term deposit rates by 150-250bp over the last 12 months.

…but only 60% of deposits will get re-priced

As the current and savings account rates are fixed, 40% of the banking industry's deposits costs are fixed. Owing to their vast network of branches, the state-owned banks have a high proportion of CASA deposits. Amongst the private banks, HDFC Bank has a high proportion of CASA deposits.

CASA RATIO – HIGHER THE BETTER



Source: Company/ Motilal Oswal Securities

Risk of investment book re-pricing is low

However, investment book repricing risk is low …

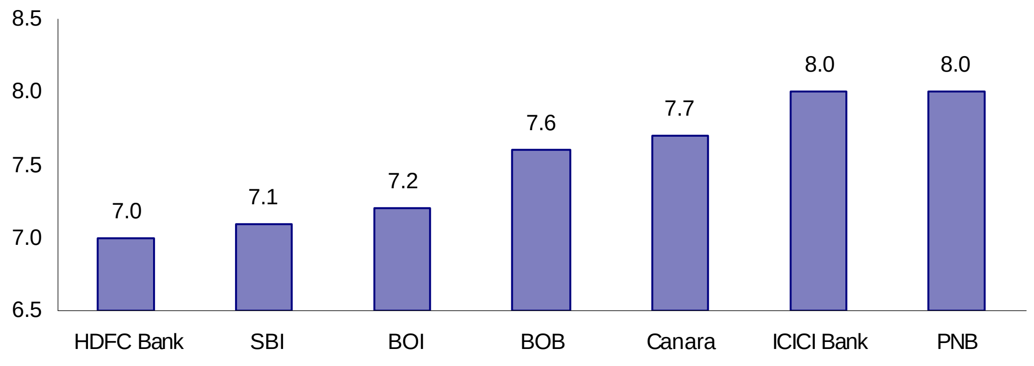
Investment yields for most banks have been declining over the last couple of years mainly on account of:

- High yielding securities acquired during 1996-2001 being sold / maturing
- Banks lowering the duration of their portfolios
- Incremental securities bought being of a lower duration and yield

We believe that a decline in investment yields from here onward is unlikely to be sharp for most banks. The reasons:

- Newer securities being bought offer similar or higher yields compared with average yields.
- Duration of the overall portfolio has already been brought down to 3-5 years from 5-7 years over the last couple of fiscals.
- For most banks, the duration of the available for sale (AFS) portfolio is in the range of 0.5-2 years. Re-pricing will be faster and at higher yields.
- Banks have taken marked-to-market (MTM) hits and are also amortizing the premium on HTM portfolios, resulting in a decline in the cost of securities held. As a result, banks' investment yields should improve.

INVESTMENT YIELDS FOR VARIOUS BANKS (%)



Source: Company/ Motilal Oswal Securities

No big fall in margins likely

… and big margin falls are unlikely

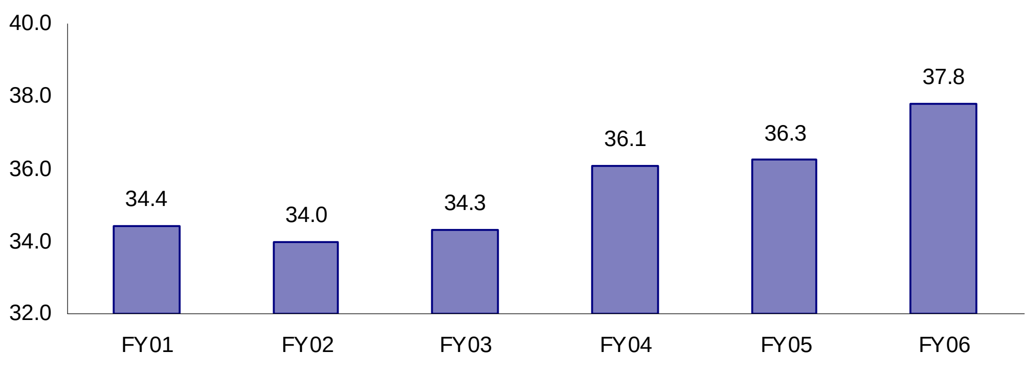
The concern of possible margin pressure in a rising interest rate scenario was belied during 9MFY07, as banks benefited from rising asset yields. In fact, most banks witnessed much better margins than in FY06. Banks with low proportion of CASA deposits, however, witnessed margin pressure.

We believe that the larger state-owned banks are much better placed to sustain their margins in a rising rate scenario, given their high CASA ratio and relatively higher tenor term deposits. The private banks have shown their ability to raise lending rates to protect margins.

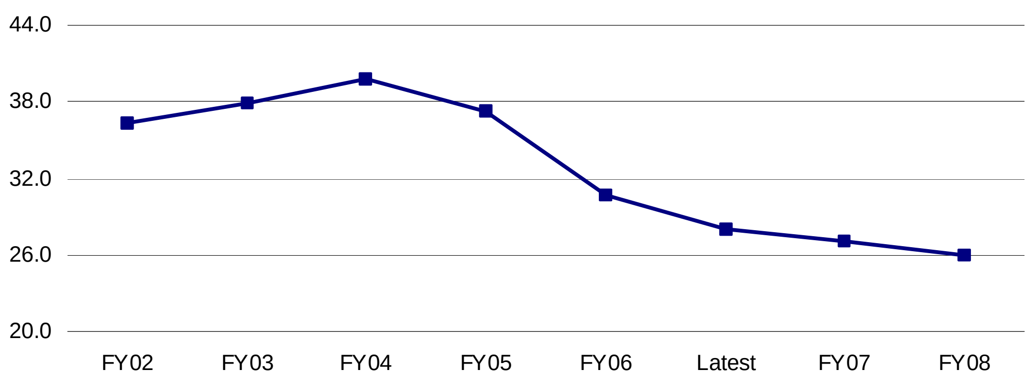
Banks currently have pricing power, and we believe that they would pass on cost increases rather than take a hit on their margins. The combination of improving yields on loans and low risk of investment book re-pricing bodes well for net interest margins (NIMs).

In addition, for the first time in the last six years, low-cost demand deposits (current account and savings account balances i.e. CASA) are higher than investments in government securities (G-secs). The average cost of CASA balances is 2.5-3%, while the average yield on G-secs is 7.5-8%.

CASA DEPOSITS AS A PERCENTAGE OF TOTAL DEPOSITS FOR THE SECTOR OVER THE LAST 5 YEARS



SLR (G-SEC INVESTMENTS) TO TOTAL LIABILITIES FOR THE SECTOR OVER THE LAST 5 YEARS (%)



Source: Company/ Motilal Oswal Securities

Following are margin supporters:

Support for margins is likely to arise from the following:

- Surplus loan demand suggests pricing power will be held with the banks
- Meaningful push-up in asset pricing for the past six months, with some product prices being hiked 200-300bp, in contrast to a 125-150bp hike in PLR
- We believe that further pressure on bond yields is unlikely, as bond portfolios are reduced and incremental yields have risen substantially from the lows touched 18-24 months ago
- Increases in deposit rates have been relatively measured – only about 60% of deposits get re-priced (the remainder are fixed rate), which limits average deposit cost increases.

However, again we stress that banks having a higher proportion of CASA deposits would tend to benefit more than banks with low CASA deposits.

Incremental spreads still at 2.9%

INCREMENTAL SPREAD AT 2.9% FOR AN AVERAGE STATE-OWNED BANKS

	PROPORTION (%)	INCREMENTAL COST/YIELD (%)	INCREMENTAL IMPACT (%)
Deposits			
Current	12	0.0	0.0
Savings	26	3.0	0.8
Term Bulk	20	11.5	2.3
Term Retail	42	9.0	3.8
Borrowings	10	11.0	1.1
Incremental cost of funds %	**110**		**7.2**
CRR	7	0.3	0.0
Advances	77	10.5	8.0
Investments	27	7.5	2.0
Incrementaltal yield on assets %	**110**		**10.1**
Incremental Spread %			**2.9**

Source: Company/ Motilal Oswal Securities

Concerns on investment book to subside

While near-term concerns on MTM hit for banks remain, we expect further rise in bond yields to be moderate, as banks turn net buyers of G-Secs.

A spurt in interest rates over the past year raised concerns over banks' balance sheets. Indian banks took a substantial hit on their investment portfolios on account of the marked-to-market (MTM) provisioning of investments in the available-for-sale (AFS) category. Most banks transferred long-dated G-secs to the held-to-maturity (HTM) category by taking one-time big hits on the profit and loss (P&L) account over the last two years. This helped to insulate their income statements from further big hits.

Banks have also been gradually reducing the tenor of their investments to de-risk their investment portfolios against interest rate volatility. Banks that still hold a large proportion of their investments in the AFS category would take hits in 4QFY07, though it would be lower than in 4QFY06. In 4QFY07, the rise in shorter-end paper (2-year) has been steep compared with longer-tenor paper (10-year). Banks that have a relatively high proportion of their books in AFS are SBI, PNB, Canara Bank and OBC.

MTM IMPACT OF G-SEC YIELDS HARDENING

	SBI	PNB	CANARA	BOB	UBI	OBC
Investment book- outstanding SLR (Rs b)	1,250	350	353	270	271	164
- HTM	875	263	141	210	209	58
- AFS	375	88	212	60	61	107
AFS duration (yrs)	2	3	2	2	1	3
If yields stable at current levels - % loss	1.5	1.8	1.7	1.5	0.9	1.7
Absolute losses on SLR portfolio (Rs. b)	5.5	1.6	3.6	0.9	0.5	1.8
Losses on Non-SLR portfolio (Rs.b)	0.0	0.7	0.0	0.6	0.0	0.0
Total MTM Losses (Rs.b)	**5.5**	**2.3**	**3.6**	**1.5**	**0.5**	**1.8**
Impact on 4QFY07 PBT (%)	19.1	14.9	33.3	5.0	10.0	24.4
Impact on FY07 PBT (%)	4.5	3.3	10.7	1.3	2.2	5.8
Impact on FY07 BV (%)	1.0	0.8	2.2	0.3	0.5	1.3

Source: Company/ Motilal Oswal Securities

Bond yields are likely to moderate…

Bond yields should moderate FY08 onward

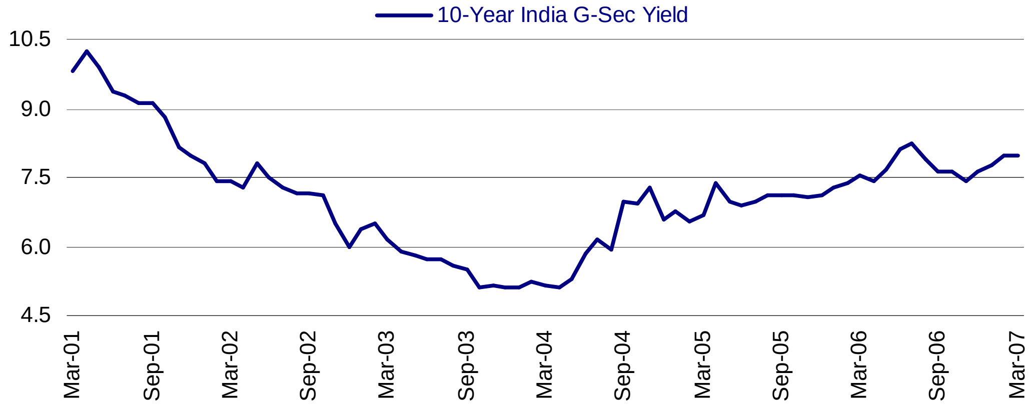
While we believe that yields have remained high until March 2007 (demand for funds remains strong in March every year), we expect the rates to moderate from FY08. For FY08, the government has budgeted net market borrowings of Rs1,096b, a marginal jump of 2% YoY. This reflects the comfortable deficit management by the government without resorting to borrowings. Thus, the overall supply of G-Secs during the next year could be contained. However, with banks also turning net buyers of G-Secs (the SLR/NDTL ratio is 27%, currently) during FY08, coupled with growing demand from other segments such as insurance, pension funds, provident funds (PFs) etc., there is likely to be demand-supply gap for G-Secs. This should result in higher G-Sec prices and softer yields, going forward.

FALLING INVESTMENT DEPOSIT RATIO

	SBI	PNB	BOB	CANARA
FY04	58.3	47.9	52.1	41.5
FY07E	38.3	32.0	33.1	30.3
Decline YoY (Actual-%)	**20.0**	**15.9**	**19.0**	**11.2**

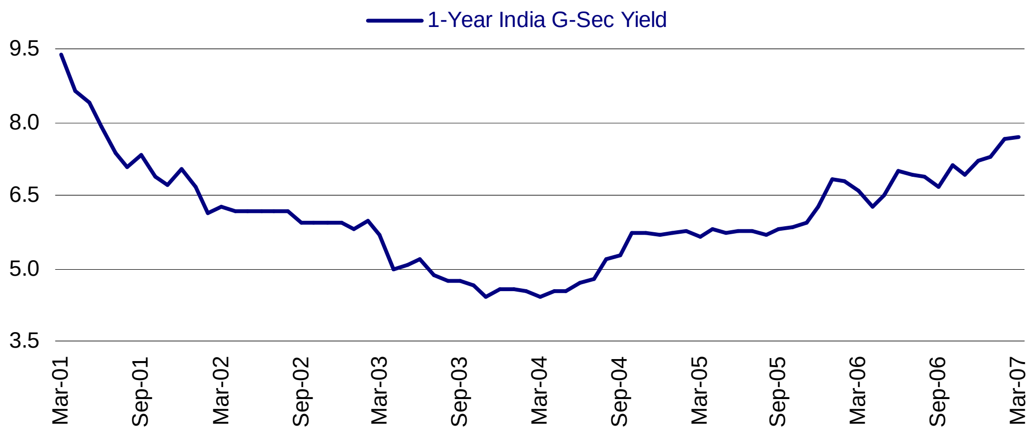
Source: Company/ Motilal Oswal Securities

MOVEMENT OF 10-YEAR YIELD (%)



Source: Motilal Oswal Securities

MOVEMENT OF 1-YEAR YIELD (%)



Source: Motilal Oswal Securities

…with banks turning into net buyers of bonds

Banks could turn net buyers of G-secs from FY08

Due to surplus investments in SLR securities and strong credit growth, Indian banks have not been buying bonds over the last two years. Instead, they have been using the incremental deposits and excess SLR investments to fund their credit growth. We believe that from FY08, banks will turn net buyers of G-Secs, as the current strong credit demand will exhaust their surplus holdings of government securities for the first time in recent economic history. Also, it would limit RBI's ability to inject liquidity through open market operations by purchasing bonds from banks having surplus SLR. We believe that the requirement of minimum SLR will result in banks having to buy bonds, resulting in softer yields in FY08.

SLR REQUIREMENTS (RS B)

	FY02	FY03	FY04	FY05	FY06	LATEST	FY07	FY08
Deposits	11,280	13,237	15,428	17,666	20,877	25,047	25,470	30,309
Borrowings	1,422	1,580	1,755	2,525	2,808	3,273	3,369	4,043
Total NDTL	**12,702**	**14,816**	**17,183**	**20,191**	**23,684**	**28,320**	**28,839**	**34,352**
SLR	4,540	5,616	6,834	7,512	7,276	7,861	7,931	8,931
SLR (%)	*35.7*	*37.9*	*39.8*	*37.2*	*30.7*	*27.8*	*27.5*	*26.0*
Requirement	25	25	25	25	25	25	25	25
Excess SLR	1,365	1,912	2,539	2,464	1,355	781	721	344
Excess SLR (%)	*10.7*	*12.9*	*14.8*	*12.2*	*5.7*	*2.8*	*2.5*	*1.0*

Source: Company/ Motilal Oswal Securities

BANK INVESTMENTS IN SLR SECURITIES (RS B)

	FY02	FY03	FY04	FY05	FY06	FY07	FY08E
Net Market Borrowings	915	1,000	830	710	1,004	1,075	1,096
Incremental SLR Inv by Banks	699	1,076	1,218	678	-236	655	1,001
Bank Inv as a % of Net Mkt Borrowings	76.4	107.6	146.8	95.4	-23.5	60.9	91.3
SLR / NDTL (%)	35.7	37.9	39.8	37.2	30.7	27.5	26.0

Source: Company/ Motilal Oswal Securities

There is a case for reducing SLR requirement…

The buoyant economy offers a case for reduction of banks' SLR requirement

The improving fiscal situation reflected in reducing deficits coupled with higher allocation from insurance/MFs towards government securities implies sufficient funds for the available government securities. We believe that there is a case for the government to lower the SLR requirement (currently 25%) for banks. This would be extremely positive for banks, as any reduction in SLR requirement would translate into higher margins – the yield on loans is nearly 300bp higher than the yield on G-Secs.

IF SLR IS REDUCED FROM 25% TO 20% - HOW MARGINS CAN IMPROVE FOR BANKS	DP
Incremental Yield on Loans	11
Incremental Yield on G-Sec Inv	8
Difference	3
Impact on Overall Margins (bp)	
3% Reduction in SLR	9
5% Reduction in SLR	15

…and the Cabinet has approved an ordinance to amend SLR ratio

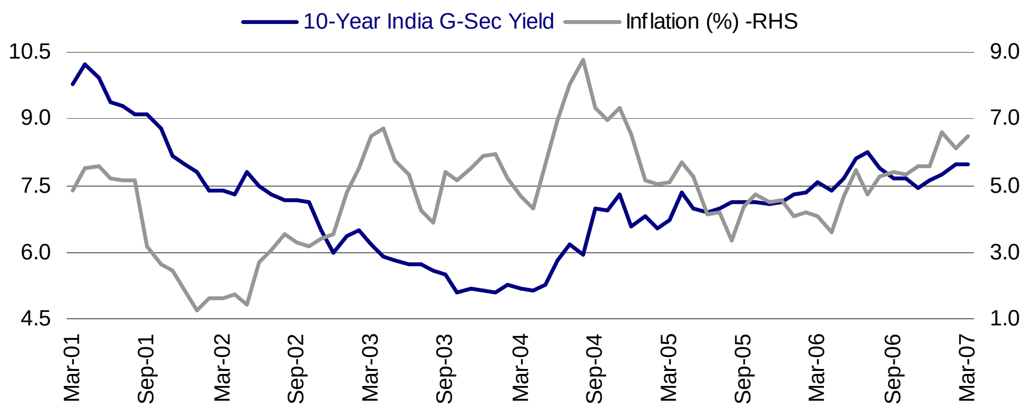
Cabinet approves ordinance to allow RBI decide SLR ratio

Recently, the Union Cabinet has approved an ordinance to amend the SLR ratio, which shall ensure greater credit availability. The ordinance shall empower the RBI to decide the quantum of SLR to be maintained by banks. There is a case for lower SLR, as incremental government deficit can easily be taken care of by the insurance, pension and provident funds and banks need not fund this deficit. Also, in the current scenario, it is difficult to raise resources at reasonable cost to match the credit growth in the system, resulting in deposit costs going up sharply. The SLR ratio has already reduced to ~27% for the banking sector. The minimum requirement currently is 25%.

RBI unlikely to act in the near-term, as inflation is the prime concern…

We do not expect the RBI to take any step in the direction of reducing banks' SLR in the near-term, as it battles inflation. Immediate lowering of the SLR ratio would mean fuelling strong credit growth as well as inflation.

TREND IN INFLATION AND BOND YIELDS (%)



Source: Company/ Motilal Oswal Securities

…but the Cabinet approval is a medium-to-long-term positive

Cabinet approval is medium-long term +ve

When the SLR requirement for banks is reduced, it would have a favorable impact on their margins – banks' lending yields are higher than SLR yields by 300bp. A reduction in SLR ratio by 5% over the next 12-24 months could result in a 10-15bp increase in margins. This would, in turn, have a positive effect on RoA, RoE and bank valuations. Additionally, lower SLR would also imply that sensitivity of banks' financials to interest rate moves would reduce. On the same note, earnings volatility could reduce, which would be positive for bank valuations.

Asset quality – risks increased, but still manageable

While risks relating to asset quality have increased with interest rates going up, we do not expect a significant rise in NPAs. Systemic NPAs are at an all-time low and are still declining. Further, banks are making high standard asset provisioning (40-200bp) on various loans – these are higher than actual delinquencies in several cases.

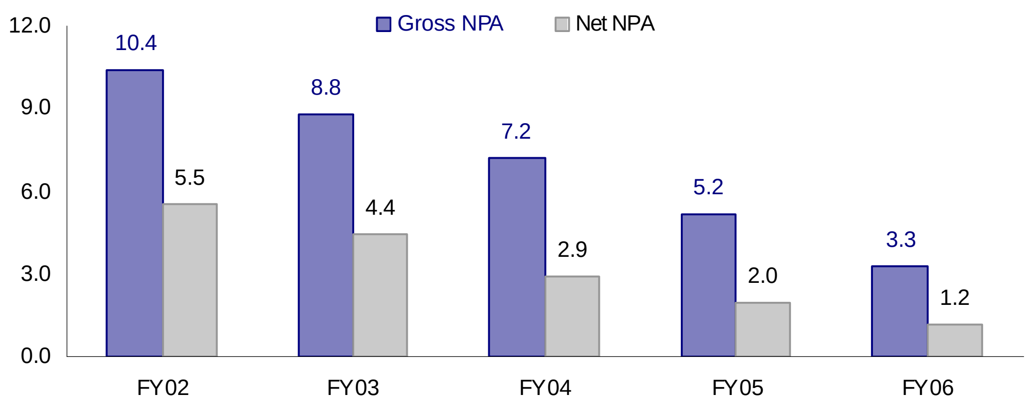
On the back of windfall treasury profits over the last few years, banks have been proactively cleaning their balance sheet. Of late, the secondary market for stressed assets has further enabled banks to offload bad assets, resulting in improved asset quality, particularly for state-owned banks. There is growing concern now that the robust credit growth witnessed over last 2-3 years and the rising interest rates would once again lead to a scenario of increasing NPAs. However, our interaction with bankers reveals that deterioration in asset quality is more a function of economic growth than lending rates. No economic indicators project a slowdown in the Indian economy; fears of a large-scale increase in NPAs in the next 2-3 years are exaggerated, in our opinion.

Asset quality at its best

Banks' asset quality at its best currently

Gross NPA levels in the system fell from a peak of 23% in 1994 to 3.3% in FY06 even as NPA recognition norms have gradually strengthened. Declining trend in NPAs has continued even in FY07, albeit some banks witnessing higher delinquencies.

GROSS & NET NPAS OVER THE LAST 5-6 YEARS



Source: Company/ Motilal Oswal Securities

Banks are increasing provisioning levels for bad loans

In line with RBI directives, banks are already making higher provisions for standard assets. Standard asset provisioning has been increased to 100bp (from 40bp earlier) during FY07, except for agri and rural loans. Further, in the recent credit policy, provisioning requirement for riskier asset classes (credit cards, personal loans, capital market exposure and real estate) has been increased to 200bp. While this would increase the provisioning requirement for banks in FY07 (for ICICI Bank, the standard asset provisioning itself would be 90bp), incremental provisioning for bad loans might be lower. Higher provisioning also increases the balance sheet strength of banks in India.

Banks have been increasing provisioning for bad loans

ASSET QUALITY TRENDS- NET NPAS (%)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
SBI	2.44	2.27	1.67	1.87	1.69	1.67	1.45
PNB	0.09	0.31	0.25	0.29	0.35	0.18	0.45
Canara	1.67	1.46	1.20	1.12	0.91	0.96	0.96
BOB	1.47	1.13	1.10	0.87	0.92	0.77	0.67
BOI	2.59	2.23	1.98	1.49	1.43	1.07	0.95
ICICI Bank	1.96	0.97	0.80	0.71	0.80	0.90	1.00
HDFC Bank	0.40	0.45	0.40	0.40	0.40	0.40	0.40
UTI Bank	1.16	1.03	0.95	0.75	0.73	0.74	0.68

Source: Company/ Motilal Oswal Securities

While there have been few instances of NPAs increasing during the 2-3 quarter, these have been primarily on account of recognition of few old accounts as NPAs or due to loan mix tilting in favor of higher yielding loans as was the case with ICICI Bank.

NET NPAS AS A % OF NET WORTH

	FY05	FY06
SBI	22.2	17.7
PNB	1.5	2.2
Canara	18.4	12.3
BoB	11.0	6.4
BoI	34.8	19.6
ICICI Bank	11.9	4.8
HDFC Bank	1.3	2.9
UTI Bank	9.4	7.6

Source: Company/ Motilal Oswal Securities

RECOVERIES CONTINUE TO REMAIN STRONG FOR THE SYSTEM (RS M)

	FY03-04 AMOUNT		FY04-05 AMOUNT		FY05-06 AMOUNT	
	ANVOLVED	RECOVERED	ANVOLVED	RECOVERED	ANVOLVED	RECOVERED
Industry-recovery of bad loans under various laws						
OTS/Compromise	15,100	6,170	13,320	8,800	7,720	6,080
Lok Adalats	10,630	1,490	8,010	1,130	11,010	2,230
Debt recovery tribunals	123,050	21,170	143,170	26,880	61,230	47,100
SARFAESI Act	78,470	11,560	132,240	23,910	98,310	34,230
Total Recoveries		**40,390**		**60,720**		**89,640**
Total reduction in NPLs		280,340		250,070		287,170
Recoveries as a % of reduction		*14.4*		*24.3*		*31.2*
Gross NPLs at year beginning		686,980		630,960		591,240
Recoveries- % of Op GNPLs		5.9		9.6		15.2
Sales to ARCs		Nil		145,060		211,260

Source: Company/ Motilal Oswal Securities

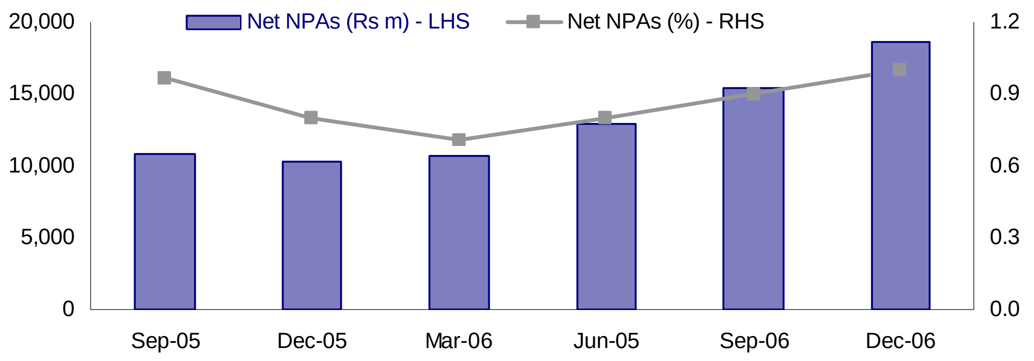
With rising rates, risk of bad assets is increasing

Indian banks have been witnessing unprecedented credit growth (more than 65% of the retail loan book has been created in a few recent years). We believe that with strong credit growth in the last couple of years and rising rates, banks would need constant monitoring of their assets to avoid higher incremental delinquencies.

While we agree that asset quality is peaking…

In our view, asset quality is peaking and provision costs will start rising, especially for banks with large retail books and/or low coverage ratios. We also believe that recoveries have peaked and will be more modest in the future. There are loan segments that need to be watched more carefully – agriculture lending, where growth has been very rapid, and lending and recovery mechanisms in many cases are still evolving; the auto segment, where collateral loan management remains a challenge; and large infrastructure projects, where implementation could also be a challenge.

NET NPAS FOR ICICI BANK – RISING OVER THE LAST FEW QUARTERS



Source: Company/ Motilal Oswal Securities

…fears of a drastic rise in NPAs are unfounded

Fears of NPAs rising unfounded

While we believe that banks need to constantly monitor their assets, fears of a large-scale increase in NPAs are exaggerated, in our opinion. Favorable demographic changes and structural shifts in agri-economy, coupled with improved corporate performance will limit incremental bad loans (as seen from table below - lower slippages) for banks.

SLIPPAGES AS A % OF OPENING ADVANCES

	FY05	FY06
SBI	2.7	2.2
PNB	1.5	1.5
Canara	2.8	2.3
BOB	1.9	1.3
BOI	1.6	1.3
ICICI Bank	1.8	1.1
HDFC Bank	1.5	2.2
UTI Bank	1.4	1.1

Source: Company/ Motilal Oswal Securities

NPAs - factor of slowing economy rather than higher interest rates

We believe that large scale NPAs are more of a factor of a slowing economy rather than higher interest rates. Nevertheless, owing to higher interest rates, risks on asset quality has increased. There is little to suggest that the broader asset quality environment is weakening or that asset prices have come off, lowering collateral cover.

However, we expect some slowdown in demand due to a sharp rise in interest rates over the last 4 months. Furthermore, there is no visibility of any slowdown in demand, or surplus capacity creation and any systemic issues with the lending process over the last few years of strong growth. Incremental delinquencies in the banking system have also continued to fall in FY06.

Opex growth – leverage play for some state-owned banks

We believe that there exists strong leverage for the larger state-owned banks, as opex costs would largely be contained. This could result in strong growth in net earnings.

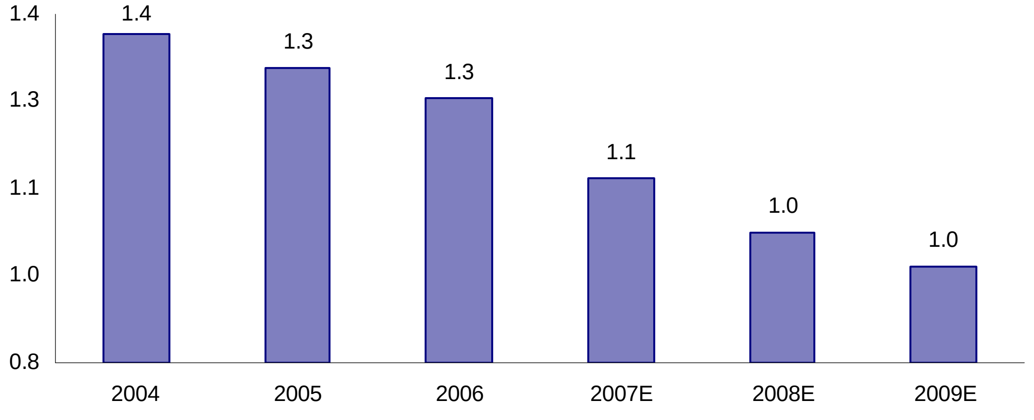
Operating costs for entities across the sector have escalated, with expansion in franchise network and employee additions. Even the relatively leaner private sector banks have not been spared. With the average cost to income ratio at ~45%, net profit margins continue to remain depressed despite higher net interest income. With higher pressure on net interest margins for low CASA banks being envisaged, inability to lower operating costs may lead to even the most efficient players compromising on their profitability in the medium term. Technological transformation remains a challenge for the state-owned banks, together with an inflexible and inefficient labor force.

Opex growth slower than asset growth

Banks' opex growth slower v/s asset growth

Employee expenses for state-owned banks have been the single largest cost, accounting for 66% of their total operating expenses (FY06). For private banks, the ratios are 28% (employee expense to total operating expense).

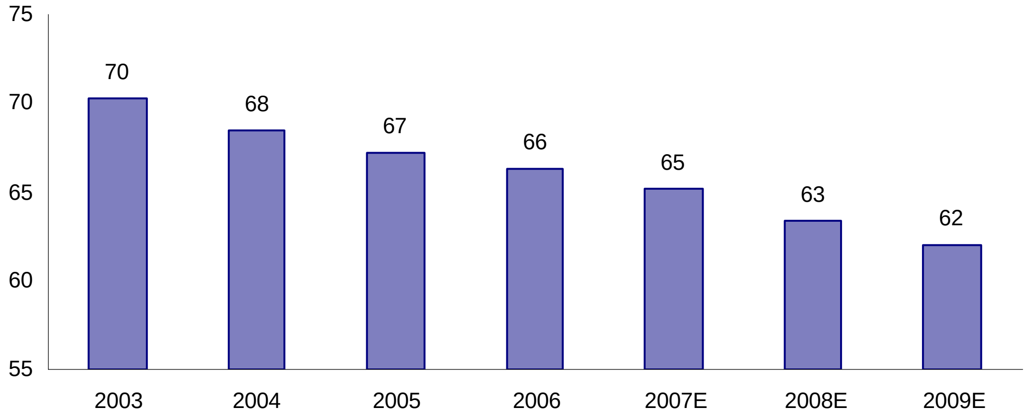
EMPLOYEE EXPENSES V/S AVERAGE ASSETS (%)



Source: Company/ Motilal Oswal Securities

Natural attrition along with technology rollout for state-owned banks would lead to improvement in operating efficiency. We expect employee expenses to account for 54% of total operating expenses by FY08. Employee expenses should fall from 1.4% of total average assets in FY04 to 1% by FY08. Thus, a reduction in employee expenses offers excellent leverage for banks to increase their operating profits.

EMPLOYEE EXPENSES V/S TOTAL OPERATING EXPENSES



Source: Company/ Motilal Oswal Securities

Strong earnings leverage, going forward

While most state-owned banks have been actively implementing technology since the last few years, none of them (except for the SBI associates) are fully under the CBS net. With Basel-2 approaching, banks will need to be fully or almost fully technologically capable. We expect state-owned banks to ramp up their CBS implementation in FY07, resulting in a slight spurt in operating expenses to total average assets ratio.

Opex costs to reduce when all PSU banks are under CBS …

We believe that once the state-owned banks fully implement CBS and other banking technologies, operating costs would decline drastically. Not only would they be able to leverage technology to increase their income, costs too would decline, as better technology would mean lesser manpower requirement. With the proliferation of internet and telecom facilities, cheaper delivery points like internet and tele-banking would reduce expenses. Cost of ATM banking is ~80% of the cost of branch banking, while the cost of internet and tele-banking is only ~15% of the cost of branch banking.

We expect banks to leverage their technological skills to augment their bottomline. However, we believe that pension provisions would continue to take a toll on the state-owned banks, as many of them are under-provisioned. This could result in higher than normalized employee provisions.

However, some issues prevail

... but some gray areas will remain

FY08 – new wage agreement needs to be drawn: While overall employee related expenses are likely to grow at a slow rate, the new wage agreement due in FY08 would result in a one-time increase in salary costs. Going by the previous wage agreement, which was settled three years after which it was due, even this agreement could take its own time before it is acceptable to both management and the unions. However, the banks would be required to make provisions in lieu of higher salary costs in FY08.

Pensions – a gray area: Pension provisions for state-owned banks are likely to increase, based on revised guidelines of AS-15 issued by the Institute of Chartered Accountants of India (ICAI).

- While banks currently make their own assumptions regarding pensions and gratuity, AS-15 calls for pension provisions to be certified by professional actuaries.
- Based on the revised guidelines, there is likely to be shortfall in the pension corpus, which will need to be provided for either through the income statement or through the balance sheet (reserves & surplus).
- While SBI would take the largest hit (~Rs40b or 12% FY07E BV), banks like PNB, BoB, Canara Bank, BoI and others are likely to see 2-6% erosion of their FY07E BV.

Fee income – great promise

Fee income offers great potential for private banks as well as state-owned banks. While the private banks have taken the lead, state-owned banks target to improve their fee income base significantly over the next few years. Currently, fee income is growing faster than net interest income for most banks.

Fee-based income is today a thrust area for Indian banks. Not only is it a non-fund based source from which income can be earned, it also helps banks to retain customers – who are able to get value-added services besides their basic banking needs.

While private banks have taken the lead…

Fee income is a key thrust area

Income from non-fund sources for both bank groups (private and state-owned) is startlingly in contrast. While private banks have been able to witness robust growth in core fee income (62% CAGR over FY04-06), state-owned banks have not been able to earn notable fee income. This is largely because of lack of computerization and branch networking, and the non-retail focus in lending portfolio.

BREAK-UP OF NON-INTEREST INCOME (RS B) OF PRIVATE AND STATE-OWNED BANKS

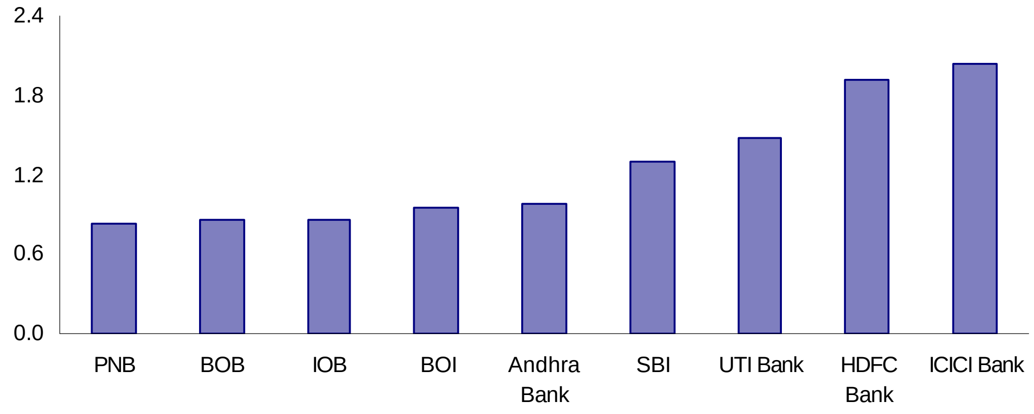
	FY04	FY05	FY06	CAGR %	YOY-FY05	YOY-FY06
Public Sector Banks						
Comm & Exch	68	78	89	14.7	15.3	14.1
Sale of Invst.	138	75	40	-46.4	-46.0	-46.8
Other Income	53	69	83	25.0	30.6	19.6
Total Non interest income	**259**	**222**	**211**	**-9.6**	**-14.3**	**-4.7**
Private Sector Banks						
Comm & Exch	21	35	55	62.2	66.3	58.2
Sale of Invst.	31	9	12	-38.3	-70.2	27.8
Other Income	15	21	24	26.8	36.0	18.1
Total Non interest income	**67**	**65**	**91**	**16.6**	**-3.6**	**41.1**

Source: Cline

… computerization would help plug leakages for state-owned banks

With state-owned banks on a computerization / branch-networking spree, we believe that they too would begin to witness strong growth in core non-interest income. Besides the traditional fee-based income business, banks are also targeting the under-penetrated Indian markets through various financial products like Equity Advisory, Wealth Management, Mutual Funds, Insurance, Credit Cards, Debit Cards, etc. They have also initiated services like Cash Management Services, Depository Services, Money Transfer, etc. to drive their fee-based income.

FEE INCOME AS A % OF ASSETS (FY07)



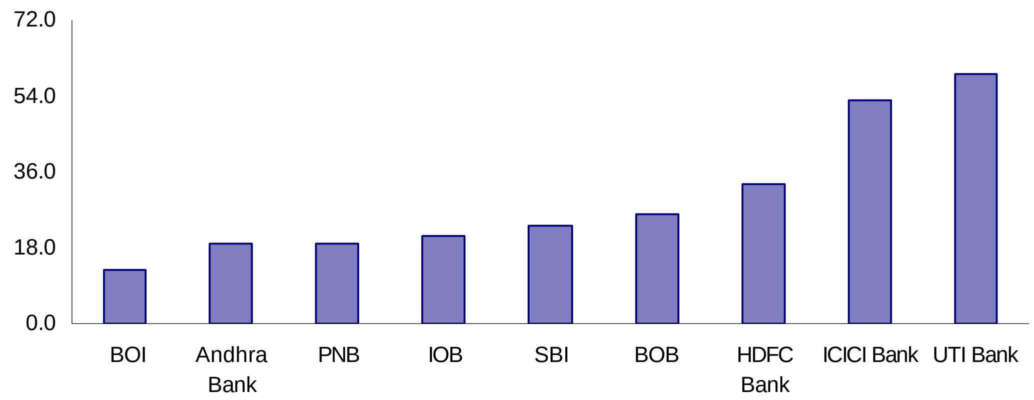
Source: Company/ Motilal Oswal Securities

Banks using distribution network/technology to enhance fee income

Technology usage will enhance fee income

With the state-owned banks having enabled core banking solutions (CBS) platforms to a great extent, they have started charging customers for minimum balance accounts/ debit cards, etc. Since the whole process is technology enabled, the leakages have also reduced. At the same time, these banks are leveraging their client relationships by offering a whole bouquet of services including third-party products.

FEE INCOME GROWTH OF BANKS IN 3QFY07



Source: Company/ Motilal Oswal Securities

Hybrid capital – will defer dilution; improve RoE

Owing to hybrid capital, the leverage potential for Indian banks has increased. This would allow them to defer dilution and report better RoEs. Here again, the larger banks might be bigger beneficiaries, as they can raise hybrid capital at a reasonable price.

The government's stake in most state-owned banks is at or near the required minimum of 51%. Barring BoI, Canara Bank, IOB and Syndicate Bank, none of the state-owned banks have substantial room for further equity dilution. As the date for compliance with Basel-2 norms closes in, Indian banks have to strengthen their capital bases to maintain the required minimum CAR. State-owned banks could utilize the avenue of hybrid capital, which would help banks to not only defer dilution but also increase RoE.

LITTLE ROOM FOR EQUITY DILUTION

	PROMOTERS STAKE (%)	TIER 1 RATIO -% (1QFY07)
Andhra Bank	51.55	12.10
Bank of Baroda	53.81	10.10
Bank of India	69.47	6.80
Canara Bank	73.17	7.70
Corporation Bank	57.17	12.00
Indian Overseas	61.23	8.60
Oriental Bank	51.09	10.44
Pun. Natl. Bank	57.80	9.60
State Bank of India	59.73	8.00
Syndicate Bank	66.47	6.40
Union Bank (I)	55.43	8.50
Vijaya Bank	53.87	9.09

Source: Company/ Motilal Oswal Securities

Hybrids – cheaper than raising equity

Raising hybrid capital is innovative and beneficial to banks

The RBI had earlier agreed to allow Indian banks to raise "Innovative Capital" via the following:

1. Perpetual debt instruments (IPDI) eligible for inclusion as Tier-I capital;
2. Debt capital instruments eligible for inclusion as upper Tier-II capital;
3. Perpetual non-cumulative preference shares eligible for inclusion as Tier-I capital; and
4. Redeemable cumulative preference shares eligible for inclusion as Tier-II capital.

Some of the key features of perpetual bonds are:

- Perpetual bonds (IPDI) have no maturity date, i.e. these are redeemable but will pay interest forever.
- The interest payable to the investors may be either at a fixed rate or at a floating rate referenced to a market-determined rupee interest benchmark rate.

However, in its guidelines, the RBI has put a caveat that such hybrid securities will cease to provide returns if the issuing bank's CAR falls below regulatory requirements (9%). This makes perpetual debt instruments a risky option for investors, particularly in those banks where the CAR is low.

Significantly, FII and NRI investment limits in these securities have been fixed at 49%, versus the 20% foreign equity holding allowed in state-owned banks. Subsequently, the RBI has also allowed banks to raise a part of this innovative capital from foreign markets.

Positive for banks – to improve leverage; RoE

Hybrid capital to improve RoE

We believe that raising capital through hybrids will not only help the banks meet Basel-2 norms, but also help improve their RoEs, as leveraging will tend to increase. Currently, most banks leverage their capital in the range of 11x-16x, which could increase to 14x-18x. This could lead to RoEs improving by 100-200bp even considering the impact on account of Basel-2 norms.

Overall, we believe that hybrids will be a positive for the larger banks, which can access perpetual debt at a reasonable rate. Also, as banks would like to raise these funds in the overseas markets, banks with an international presence would be at an advantage (as they can use these funds overseas).

HYBRID CAPITAL WOULD IMPROVE ROE

	ASSUMPTIONS	REMARKS
Current Risk Weighted Assets	100	
Current Leverage (x)	14	
Current Tier I (%)	7.1	
Current RoA (%)	1.0	
Current Profts (Rs)	1.0	
Current RoE (%)	14.0	
Hybrid at 15% of Tier I	1.1	Banks can raise maximum 15% as Hybrid Tier I capital
New Tier I (%)	8.2	Tier I would increase post raising Hybrid Capital
Leverage	14	
Risk Weighted Assets	115	Banks can do more business by raising hybrid capital
New Business Generated		
Hybrid Tier I capital	1.1	Banks would lend the hybrid capital
New business assuming simlar leverage	13.9	
Total	15.0	
Returns on New Business		
RoA on Hybrid Capital	-0.02	Assuming negative returns on hybrid capital
RoA on incremental RWA	0.14	Assuming 1% RoA on incremental assets
Additional Profits	0.12	
New Profits	1.12	Total profits made post hybrid capital
New RoE	15.65	ROE post hybrid capital
Increase in RoE	**1.7**	**Assuming the bank utilises the full 15% Tier 1**

Source: Company/ Motilal Oswal Securities

Consolidation – a necessity, going forward

To create stronger and bigger banks, consolidation is necessary in the Indian banking system. To take on global competition, Indian state-owned banks will have to create scale, cut down costs and improve efficiencies. They would require size and stronger balance sheets to expand their international presence. In the past, mergers and acquisitions (M&As) amongst the state-owned banks took place with the intention of bailing out weak banks. We expect this to change, going forward. M&As would now occur in accordance with the needs and objectives of the banks.

Political will is a must

Political will essential for consolidation

Whilst consolidation appears to be inevitable, there has hardly been any forward movement in this direction, apart from consolidating banks that have not been performing well. We believe stronger political will is required and the government might have to play a bigger role to facilitate larger mergers amongst state-owned banks.

Recent mergers highlight the value of branch network

Over the last 12 months, there have been four takeovers (two forced by the regulator and two voluntary). The valuations that these banks commanded highlight the value of their franchise.

VALUATION FOR BANKS SOLD/CONSOLIDATED

	BRANCHES	DEPOSITS (RS B)	APPROX PRICE PAID (RS B)	PRICE/ BRANCH (RS M)	PRICE / DEPOSITS (%)
Sangli Bank	186	20	3	16	15
United Western Bank	230	50	4	15	7
Lord Krishna Bank	249	14	3	13	24
GTB	104	52	13	123	25

Source: Company/ Motilal Oswal Securities

2009 – the year to watch out for

Watch out for year 2009!

The regulator is likely to allow foreign banks to acquire Indian banks in its next policy review on M&As within the industry in 2009. This throws opens a huge opportunity for foreign banks to expand their presence in India through acquisitions and we believe that banks like Yes Bank, Centurion Bank of Punjab, Karnataka Bank, Karur Vysya, Federal Bank would be the key targets – these are relatively larger banks with healthy branch networks. With several foreign banks wanting to set up a larger presence in India, acquiring an Indian bank would be an ideal way to start the process.

PRIVATE BANKS (RS M)

COMPANY NAME	MKT CAP	NETWORTH FY06	BRANCHES	DEPOSITS FY06	MCAP/ DEPOSITS (%)	MCAP/ BRANCH
Centurion Bank of Punjab	55,460	9,178	270	93,996	59	205
City Union Bank	3,887	2,862	160	35,177	11	24
Federal Bank	17,373	12,429	520	178,787	10	33
Karnataka Bank	20,151	111,111	410	132,432	15	49
Karur Vysya Bank	12,894	8,716	275	75,768	17	47
UTI Bank	129,550	28,722	481	401,135	32	269
Yes Bank	38,612	5,727	29	29,104	133	1,331

Source: Company/ Motilal Oswal Securities

Valuations are attractive, factors near-term concerns

We believe that current valuations factor in most negatives. State-owned banks are available at 0.8-1.2x FY08E BV, even as RoEs are likely to be in the range of 16-25%. Private banks, which trade at relatively higher valuations, are growth plays.

Notwithstanding the near term concerns, we believe that the current valuations for bank stocks are extremely attractive and factor lower growth and probably lower margins, as well. We believe that the structural story for Indian banking continues, and the current decline in stock prices is excessive.

Most negatives are already in the price

We do not expect sharp declines from current levels. We also believe that banking stocks tend to move in phases, and rises and declines have become sharp and large. If the concerns on inflation and shorter-end interest rates assuage (likely on April 2007, gains could be large (as witnessed last year during May-August 2006).

STOCK PERFORMANCE OF TOP BANKS

				RELATIVE TO SENSEX		
	3M	6M	12M	3M	6M	12M
SBI	-26	-10	-5	-15	-11	-13
PNB	-16	-19	-8	-6	-19	-16
BOI	-26	-5	16	-15	-5	9
ICICI Bank	-10	16	33	0	15	25
HDFC Bank	-16	-2	17	-5	-3	9

Source: Motilal Oswal Securities

We are modeling lower credit growth and margins

Credit growth has remained strong at a CAGR of 30% over FY05-07. While credit potential continues to be huge, we believe that higher interest rates would lead to some moderation in credit growth. We are now factoring in 20% growth for the whole sector, with private banks growing at 27% and state-owned banks growing at 18%.

In line with the sharp rise in deposit costs, we are factoring in some margin contraction, especially for banks having low CASA deposits and lacking the ability to increase interest rates. Though banks have been aggressive in increasing their lending rates, we have factored in a margin decline of 5-15bp for most banks. However, banks having high CASA ratios and growing at a steady pace might witness some margin improvement.

Valuations factor in the near-term concerns

In our discussions with investors, we note that their primary concerns center around growth, margins and asset quality risks. Though we expect some moderation in credit growth, it would still be a robust 20% (our estimate for FY08). We believe that banks continue to have enough pricing power to maintain their margins at current levels.

Yet, a few players that are weak on the liability management front could witness lower margins. While risks relating to asset quality have increased, we do not see any issues on the ground so far. We believe that as long as the macro economic scenario remains robust, bank assets would continue to perform. In light of the sharp decline in valuations, we believe that the opportunities outweigh the near-term concerns.

Key investor concerns

Key investor concerns:

- **Growth:** With rising rates, credit growth is bound to slow down. However, we do not expect growth to come off sharply. Given the strong economic growth and under-penetration of credit across sectors, credit growth (though down from ~30% witnessed in the last three years) would still be over 20% in FY08.
- **Margins:** On the back of rising deposit costs, we expect some squeeze on margins in FY08. We have assumed a decline of 10-15bp for most banks. However, for banks with high CASA ratios, margins could actually improve, given that only 55-60% of the deposits are likely to get re-priced. Also, we believe that banks have enough pricing power to pass on the additional cost to the borrowers.
- **NPAs:** On back of strong credit growth over the last three years (CAGR of 30%), coupled with rising rates, the risk of assets turning bad has increased. However, there are no big issues on the ground yet. We believe that NPAs would rise significantly only if the economy slows down considerably, which is not the case currently.

State-owned banks are value picks; private banks offer strong growth

While valuations appear to be attractive for state-owned banks and rather expensive for private banks, we believe that these categories reflect value and growth, respectively. While private banks would continue to grow faster than the sector, state-owned banks have been growing at a steady pace and protecting margins, as well.

Better liability management should command premium

Premium stock pricing will come from better liability management

We like banks that are growing their balance sheets at a reasonable pace, driven by core retail deposits/CASA. Credit risks would be lower for such banks and their margins would remain intact. Our top picks are HDFC Bank, PNB, Bank of India and Bank of Baroda.

We also like ICICI Bank on account of its relatively attractive valuations and improving RoEs. Despite lower CASA compared with the sector, ICICI Bank has demonstrated its ability to raise lending rates in order to maintain its margins. Strong traction in fee income and increasing value of subsidiaries offer further upsides.

Amongst the stocks in distress, we like Syndicate Bank at current valuations, as a contra-play, as earnings visibility continues to remain very strong. The bank is comfortably placed in terms of liquidity and would see a margin improvement over the next few quarters.

COMPARATIVE VALUATIONS (FY09E)

	CMP (RS)	MKT. CAP (US $ B)	EPS (RS)	BV RS	P/E (X)	P/BV (X)	ROE (%)	TARGET (RS)	UPSIDE (%)	TARGET P/B MULTIPLE
Private Banks										
HDFC Bank	902	282	62.1	291	14.5	3.1	23.5	1162	29	4x
ICICI Bank	805	716	53.9	349	14.9	2.3	16.4	1123	40	2.5x + 250
Federal bank	203	17	43.0	236	4.7	0.9	19.7	307	51	1.3x
UTI Bank	460	128	34.9	173	13.2	2.7	22.0	554	21	3.2x
Karnataka Bank	166	20	21.6	137	7.7	1.2	16.8	178	7	1.3x
State-Owned Banks										
Bank of India	154	75	29.3	153	5.3	1.0	20.3	229	49	1.5x
Union Bank of India	96	49	22.3	121	4.3	0.8	18.3	157	63	1.3x
Punjab National Bank	428	135	85.8	454	5.0	0.9	20.0	681	59	1.5x
Syndicate Bank	59	31	17.1	86	3.4	0.7	20.5	95	62	1.1x
Andhra Bank	72	35	14.5	83	4.9	0.9	18.5	107	50	1.3x
Bank of Baroda	201	73	41.5	288	4.8	0.7	14.9	288	43	1x
Indian Overseas Bank	96	52	23.8	105	4.0	0.9	24.3	148	53	1.4x
State Bank of India (cons)	930	489	141.7	1,022	6.6	0.9	14.8	1226	32	1.2x
Oriental Bank of Commerce	169	42	41.0	268	4.1	0.6	16.0	268	59	1.0x
J&K Bank	628	30	90.1	550	7.0	1.1	17.5	770	23	1.4x
Canara Bank	183	0	40.9	249	4.5	0.7	17.3	249	36	1x
Vijaya Bank	39	17	9.6	56	4.0	0.7	18.2	56	44	1x
Corporation Bank	259	37	46.8	335	5.5	0.8	14.8	335	29	1x
IDBI	72	52	10.7	111	6.7	0.6	10.1	108	50	0.7x + 30
Bank of Maharashtra	37	16	6.7	44	5.5	0.8	15.8	44	20	1x
Dena Bank	33	9	11.3	61	2.9	0.5	17.3	49	49	0.8x

**For ICICI Bank, target price is based on 2.5x FY09E BV plus Rs250/share value of subsidiaries* *Source: Motilal Oswal Securities*

Companies

BSE Sensex:12,455 S&P CNX: 3,634 2 April 2007

ICICI Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	ICICIBC IN
S&P CNX: 3,634	REUTERS CODE ICBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs805

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	47.1	65.6	86.0	109.0
OP (Rs b)	46.9	70.8	90.4	112.6
NP (Rs b)	25.4	32.4	39.9	48.0
EPS (Rs)	28.5	36.4	44.8	53.9
EPS Growth (%)	4.9	27.6	23.1	20.2
BV/Share (Rs)	249.6	274.8	308.0	349.0
P/E (x)	28.2	22.1	17.9	14.9
P/BV (x)	3.2	2.9	2.6	2.3
ABV (Rs)	241.7	259.1	285.8	319.9
P/ABV (x)	3.3	3.1	2.8	2.5
RoE (%)	14.6	13.9	15.4	16.4
RoA (%)	1.3	1.1	1.0	1.0

KEY FINANCIALS	
Shares Outstanding (m)	889.8
Market Cap. (Rs b)	715.9
Market Cap. (US$ b)	16.5
Past 3 yrs. NII Growth (%)	49.0
Past 3 yrs. NP Growth (%)	28.2
Dividend Payout (%)	29.9
Dividend Yield (%)	1.1
P/E to Growth (x)	0.9

STOCK DATA	
52-Week Range	1,007/440
Major Shareholders (%) (December 2006)	
Promoters	0.0
Domestic Institutions	17.3
FIIs	71.4
Others	11.3
Average Daily Turnover	
Volume ('000 shares)	1,570.1
Value (Rs million)	1,142.9
1/6/12 Month Rel. Performance (%)	-2/15/25
1/6/12 Month Abs. Performance (%)	-5/16/33

Steady balance sheet growth, with stable margins: ICICI Bank has raised lending rates aggressively over the last 3 months, in line with its rise in deposits. We expect the bank to maintain its margins, even as we believe that incremental growth would slow down from current levels.

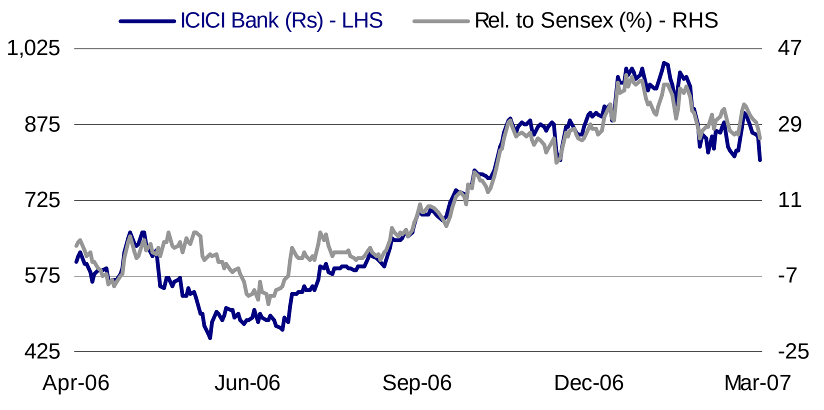
Fee income growth continues to be robust: Traction in core fees continues for the bank. Fees to total assets was 2.3% in 3QFY07, almost as much as its NII. Of the current fees, 56% is from retail; 13% comes from international operations and the balance from corporates.

NPAs – the key aspect to watch out for: The biggest concern for ICICI Bank in the past had been its asset quality. While the NPA problems have subsided, over the last couple of quarters, NPAs have resurfaced again. Increasing NPA provisions could impact profitability in the interim.

ICICI Holdings would unlock subsidiary values: ICICI Bank's has formed a 100% holding company for life insurance, general insurance and asset management, ICICI Holdings Ltd. The listing of the holding company (expected by end of CY07) would also unlcok the true value of its successful insurance and asset management ventures.

We maintain Buy: Steady balance sheet growth with stable margins and traction in fee revenues will drive earnings. However, higher NPAs are concerning and would result in higher provisions in future. We value subsidiaries at Rs250 per share (at 20% holding discount). Adjusting for subs value, it trades at 1.6x FY09E BV and 10.3x FY09E EPS.

STOCK PERFORMANCE (1 YEAR)



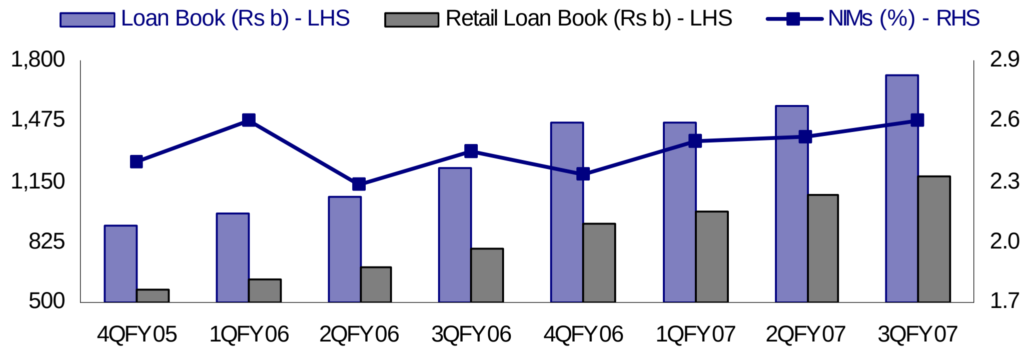
Balance sheet continues to grow fast

ICICI Bank's balance sheet continues to witness robust growth – in 3QFY07, it grew 39% YoY to Rs2.9t, led by aggressive deposit raising and strong loan growth.

Though there is some slowdown in retail loan disbursements…

In 9MFY07, the bank's total retail disbursements were about Rs541b including home loan disbursements of about Rs213b. However, in 3QFY07, growth in retail disbursements slowed down to 20%. The bank's rural portfolio grew by about 43% YoY, while its international loan book grew 73% YoY to Rs208b.

QUARTERLY TREND OF LOAN BOOK AND RETAIL LOANS

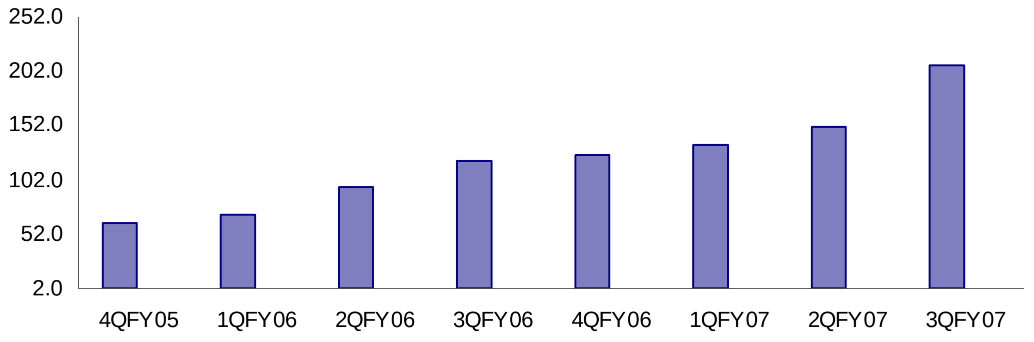


Source: Company/ Motilal Oswal Securities

…international operations are witnessing robust growth

International operations are likely to be the next growth engine for ICICI Bank. ICICI Bank is fast building up its international operations across continents. In just three years, it has built up presence in 12 locations and currently the international operations contribute 15% of total assets. The bank has already built up a market share of 25% in the remittances business. Strong flows of remittances to India (about US$20b in FY05) and increasing cross-border acquisitions by Indian companies offer big business opportunities to grow fee income. The bank targets to increase international assets from 15% presently to 25% in the coming two years.

INTERNATIONAL ASSET BOOK (RS B)



Source: Company/ Motilal Oswal Securities

CASA deposits growing at a healthy rate

In order to support its strong loan growth, the bank has been aggressively growing its deposit base. Overall deposits have grew by 47% YoY in 3QFY07 to Rs1.97t; CASA deposit growth of 32% YoY continues to be robust. As a percentage of deposits, the share of CASA declined YoY to 23.9%; however, this has increased QoQ (2Q CASA ratio was 22.5%). Incremental CASA contribution to incremental deposit mobilization has increased to 60% in 3QFY07 from 40% in 2QFY07, 14% in 1QFY07 and 10% in FY06.

Margins likely to sustain; bank aggressive in hiking rates

We believe that the management's endeavor is to maintain margins at current levels of 2.5-2.6% in the medium term and gradually grow, as we expect balance sheet growth to slow down due to slowdown in retail loans. In line with the rising deposit cost, ICICI Bank has been raising its lending rates in order to maintain its margins.

HIKE IN MORTGATE RATE

	MORTGAGE RATE (%)	HIKE (BP)	PLR HIKE BY ICICI BANK		
November 2004	8.25	50	January 2006	11.50	50
June 2005	8.75	50	February 2006	11.75	25
February 2006	9.25	50	March 2006	12.75	100
May 2006	9.75	50	June 2006	13.25	50
June 2006	10.25	50	December 2006	13.75	50
December 2006	10.75	50	February 2007	14.75	100
February 2007	11.75	100			

Source: Company/ Motilal Oswal Securities

TREND OF YIELD ON LOANS, COST AND MARGINS

	FY06				FY07		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Yield on Advances	8.7	8.7	8.7	8.7	9.4	9.8	10.0
Cost of Deposits	5.0	5.0	4.8	5.2	5.8	6.1	6.3
Cost of Funds	5.9	5.8	5.7	6.0	6.2	6.5	6.5
NIMs	**2.6**	**2.3**	**2.5**	**2.3**	**2.5**	**2.5**	**2.6**

Source: Company/ Motilal Oswal Securities

Fee income growth continues to be robust

A key highlight is the continued traction in its core fee revenue. Fees (non-treasury) to total assets was 2.3% in 3QFY07 (up from 2% in 3QFY06), almost as much as its NII. Of the current fees, 56% arises from retail; ~13% comes from international operations and the balance from corporates. We expect growth in fee income to remain robust on the back of growing fees from distribution products and international operations.

FEE INCOME - STRONG GROWTH OVER THE LAST FEW QUARTERS

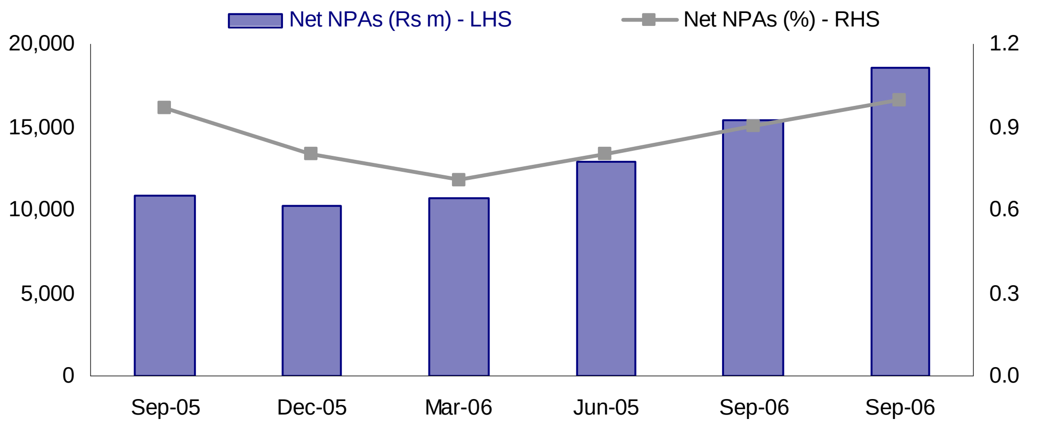
	FY03	FY04	FY05	FY06	FY07E	FY08E	FY09E
% Contribution to Total Income							
Net Interest Income	42	42	48	49	49	50	50
Fee Income	45	35	43	44	44	46	47
Treasury Income	13	23	8	7	7	4	3
Total Income	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: Company/ Motilal Oswal Securities

NPAs – the key aspect to watch out for

The biggest concern for ICICI Bank in the past had been its asset quality. While the NPA problems have subsided, over the last couple of quarters, NPAs have resurfaced again. Incremental NPAs have come in on account of a sharp increase in non-collateral loans like credit cards, personal loans, etc, wherein the yields are also higher. However, NPAs on its key products like mortgages and auto loans continue to be low.

NET NPAS TREND



Source: Company/ Motilal Oswal Securities

Increasing provisions could impact profitability in the interim

In line with RBI guidelines, over FY06, ICICI Bank has built in a 40bp provision on its standard assets. It is moving towards a 100bp provisioning for mortgages over Rs2m. Further, as per the recent RBI guidelines, provisioning requirement would increase to 200bp for credit cards, personal loans, real estate and capital market exposure, which would result in higher provisioning in 4QFY07 and FY08.

Subsidiaries – value unlocking by end of CY07

Over the years, ICICI Bank has built subsidiaries, which have been leaders in their respective fields. Most of these subsidiaries have attained respectable scale and are still exhibiting strong growth rates. We believe that these subsidiaries could create significant value for ICICI Bank over a period of time. <u>We value the subsidiaries at Rs200 per share on FY08 basis and Rs250 per share on FY09 basis post a 20% holding company discount.</u>

The bank's board has recently approved a proposal to set up a new 100% subsidiary – ICICI holdings. ICICI Bank would transfer its investments in ICICI Prudential Life (74% stake), ICICI Lombard (74% stake), Prudential ICICI AMC (51% stake) and Prudential ICICI Trust at its current book value of Rs19.5b. As per RBI norms, a bank can invest in subsidiaries only up to 20% of its networth into equities. Current investment of ICICI Bank are 15% of its networth and would probably had restricted its further investment in the insurance venture. However, now ICICI holdings would raise capital through an IPO (most likely before end-07). This will enable the group to fund the growth of subsidiaries without impairing the capital adequacy of ICICI Bank (as per current RBI guidelines, any investment in subsidiaries gets reduced from networth while calculating CAR for bank).

ICICI Prudential Life – big value generation: ICICI Prudential Life Insurance is one of the fastest growing private insurance companies, with a 30 % market share among the private players. During FY06, the company's New Business Achieved Profit (NBAP) increased by 69% to Rs5.3b and we estimate an NBAP of Rs8.7b in FY07. ICICI Bank holds 74% of the life insurance venture. The management has reiterated that whenever norms for FDI are revised, it will have to sell an additional 23% to the foreign partner. However, the sale is likely to be at a value prevailing at that point of time and not at any pre-determined price, which many other insurance ventures have.

We have valued ICICI Prudential Life on a DCF basis. We estimate that its new business (non-single premium) will grow at 75% in FY07 and 40% in FY08. Beyond that, we have assumed a slower growth rate because of high base. We have assumed a 20% margin on regular premium payment policies and 5% margin on single premium policies. We have built up a gradual decline in margins and a terminal growth of 5%. We value the life insurance venture at Rs225b (20x FY08E NBAP). For its 74% holding, the value per share for ICICI Bank is Rs185.

ICICI Lombard: ICICI Lombard is a market leader, with 31% share among private players in the non-life insurance business. It achieved a profit after tax of Rs500m in FY06 compared to Rs480m in FY05 despite claims from floods in major cities and investments in the retail franchise. About 58% of its gross written premiums comprised non-corporate business. In our view, its general insurance venture is worth Rs9.4b, which translates into Rs11/share for ICICI Bank.

Asset management: Prudential ICICI Asset Management Company is among the top two private sector mutual funds in India currently with assets under management of over Rs347b (US$5.3b) and about 10% market share. Its venture capital fund management company manages nine funds, with a corpus of over US$1.5b. This business is also gaining scale and significance. We estimate the value of its asset management business at Rs27b, which translates into Rs16/share of ICICI Bank (for 51% holding).

Brokerage and investment banking: ICICI Securities Limited is India's leading full service investment bank, with a dominant position in all segments of its operations - Corporate Finance, Fixed Income and Equities. The company has handled 31 equity transactions, raising more than Rs137b in FY06. In FY06, I-Sec registered a 146% increase in profit after tax from Rs640m in FY05 to Rs1.57b in FY06; it had a RoE of 34% in FY06. We estimate value of its brokerage and investment banking business (ICICI Securities) at Rs22.6b, which translates into Rs25/share of ICICI Bank.

VALUE OF SUBSIDIARIES (FY08)

	(RS M)	% HOLDING	VALUE (RS)	
ICICI Pru Life	213,382	74	187	for 74% stake in ICICI Pru
I-Sec	23,833	100	27	valued at 12xFY08 earnings
I-Ventures	11,789	100	13	valued at 15xFY08 earnings
I-Lombard	11,318	74	9	valued at 15xFY08 earnings
I-AMC	27,376	51	16	valued at 6% of AUMs (FY08E)
Total	**287,697**		**252**	
Discount (20%)			*50*	
Value per share of ICICI Bank			**202**	

Source: Company/ Motilal Oswal Securities

Other investments: The bank owns 7% in NSE, 8% in NCDEX, 60% stake in its BPO arm – ICICI One-Source (pre-IPO) and a 54% stake in its software venture, 3-I Infotech. While we are not considering the value of these ventures in our valuation exercise, we believe that the unrealized gains on these ventures could result as a decent source for treasury gains, as and when ICICI Bank divests these holdings.

We maintain Buy

While margin expansion is expected to be nominal, strong volume growth and robust traction in fee revenues will drive earnings growth. However, higher NPAs are concerning and would result in higher provisions going forward. Improving performance of its subsidiaries will serve as a key valuation driver. We value subsidiaries at Rs250 per share (at 20% holding discount). Adjusting for subs value, it trades at 1.6x FY09E BV and 10.3x FY09E EPS. We maintain **Buy**.

Concerns

Deterioration in asset quality: Though the possibility is low, any slowdown in the economy could result in higher NPAs. Also, growth has been very fast for ICICI Bank over the last three years, which could result in asset quality issues in case of a downturn. ICICI Bank is known to have asset quality issues in previous economic slowdowns.

Capital requirement: Strong growth and the present low RoE could result in the bank again requiring capital by FY08. Current capital adequacy is 13.4%, with a tier-I of 9.2%. The bank, however, could raise capital through hybrid instruments and resort to securitization (which has slowed down over the last six months). The management at this stage does not intend to raise any equity capital till FY08.

Low RoE: As the bank has recently raised capital, its RoE is suppressed at 13-14%, which might result in lower discounting for the stock. However, as the bank leverages its capital, we expect RoE to increase. We estimate sustainable RoE at 17-18%.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	97,849	143,075	227,766	340,834	439,807
Interest Expended	65,709	95,974	162,118	254,844	330,834
Net Interest Income	**32,140**	**47,100**	**65,647**	**85,989**	**108,973**
Change (%)	*44.3*	*46.5*	*39.4*	*31.0*	*26.7*
Other Income	34,161	49,831	71,052	86,875	107,518
Profit on sale of investment	5,461	6,963	10,800	6,500	6,000
Other non-interest income	28,700	42,869	60,252	80,375	101,518
Net Income	66,301	96,932	136,699	172,865	216,491
Change (%)	*25.2*	*46.2*	*41.0*	*26.5*	*25.2*
Operating Expenses	36,741	50,025	65,929	82,468	103,903
Employee expense	7,374	10,823	16,800	20,520	26,100
Operating Income	29,560	46,907	70,770	90,397	112,589
Change (%)	*19.2*	*58.7*	*50.9*	*27.7*	*24.5*
Provisions & contingencies	4,288	15,941	31,259	38,580	47,764
Provision for NPAs	-1,214	7,947	16,809	23,780	30,464
PBT	**25,272**	**30,966**	**39,512**	**51,817**	**64,825**
Tax	5,220	5,565	7,112	11,918	16,854
PAT	**20,052**	**25,401**	**32,399**	**39,899**	**47,970**
Change (%)	*22.5*	*26.7*	*27.6*	*23.1*	*20.2*
Proposed Dividend	7,231	7,593	8,453	8,898	9,788

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	7,368	8,898	8,898	8,898	8,898
Preference Capital	3,500	3,500	3,500	3,500	3,500
Reserves & Surplus	118,132	213,162	235,671	265,158	301,677
Net Worth	**129,000**	**225,560**	**248,069**	**277,557**	**314,075**
Deposits	**998,188**	**1,650,830**	**2,360,687**	**3,068,893**	**3,866,805**
Change (%)	*46.6*	*65.4*	*43.0*	*30.0*	*26.0*
Borrowings	335,445	385,221	604,104	755,130	959,015
Other Liabilities & Prov.	213,963	252,281	313,294	377,189	456,265
Total Liabilities	**1,676,594**	**2,513,890**	**3,526,153**	**4,478,768**	**5,596,160**
Current Assets	129,300	170,402	224,969	276,922	354,793
Investments	504,874	715,474	1,015,973	1,300,445	1,651,566
Change (%)	*18.1*	*41.7*	*42.0*	*28.0*	*27.0*
Advances	914,052	1,461,631	2,067,798	2,649,046	3,296,918
Change (%)	*45.9*	*59.9*	*41.5*	*28.1*	*24.5*
Net Fixed Assets	**40,380**	**39,807**	**40,207**	**39,707**	**37,707**
Other Assets	87,989	126,575	177,205	212,646	255,176
Total Assets	**1,676,594**	**2,513,890**	**3,526,153**	**4,478,768**	**5,596,160**

ASSUMPTIONS (%)

Deposit Growth	46.6	65.4	43.0	30.0	26.0
Advances Growth	45.9	59.9	41.5	28.1	24.5
Investments Growth	18.1	41.7	42.0	28.0	27.0
Dividend	85.0	85.0	95.0	100.0	110.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.3	7.4	8.1	9.0	9.2
Avg. Cost-Int. Bear. Liab.	5.4	5.7	6.5	7.5	7.6
Interest Spread	1.9	1.7	1.6	1.5	1.5
Net Interest Margin	2.4	2.4	2.3	2.3	2.3
Profitability Ratios (%)					
RoE	19.5	14.6	13.9	15.4	16.4
RoA	1.4	1.3	1.1	1.0	1.0
Int. Expended/Int.Earned	67.2	67.1	71.2	74.8	75.2
Other Inc./Net Income	51.5	51.4	52.0	50.3	49.7
Efficiency Ratios (%)					
Op. Exps./Net Income	55.4	51.6	48.2	47.7	48.0
Empl. Cost/Op. Exps.	20.1	21.6	25.5	24.9	25.1
Busi. per Empl. (Rs m)	89.4	98.9	117.8	133.5	143.1
NP per Empl. (Rs lac)	11.1	10.0	10.1	10.5	10.7
Asset-Liability Profile (%)					
Adv./Deposit Ratio	91.6	88.5	87.6	86.3	85.3
Invest./Deposit Ratio	50.6	43.3	43.0	42.4	42.7
G-Sec/Invest. Ratio	68.3	71.4	67.9	71.6	76.1
Gross NPAs to Adv.	3.0	1.5	1.7	1.9	1.9
Net NPAs to Adv.	1.7	0.7	1.0	1.1	1.2
CAR	11.8	13.4	12.6	10.6	10.0
Tier 1	*7.6*	*9.2*	*8.7*	*7.0*	*6.8*

VALUATION

Book Value (Rs)	170.3	249.6	274.8	308.0	349.0
Price-BV (x)	4.7	3.2	2.9	2.6	2.3
Adjusted BV (Rs)	156.8	241.7	259.1	285.8	319.9
Price-ABV (x)	5.1	3.3	3.1	2.8	2.5
EPS (Rs)	27.2	28.5	36.4	44.8	53.9
EPS Growth (%)	2.5	4.9	27.6	23.1	20.2
Price-Earnings (x)	29.6	28.2	22.1	17.9	14.9
OPS (Rs)	40.1	52.7	79.5	101.6	126.5
OPS Growth (%)	-0.3	31.4	50.9	27.7	24.5
Price-OP (x)	20.1	15.3	10.1	7.9	6.4

E: MOSt Estimates

HDFC Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	HDFCB IN
	REUTERS CODE
S&P CNX: 3,637	HDBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs902

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	25.5	36.1	47.7	61.0
OP (Rs b)	19.8	28.3	36.0	44.1
NP (Rs b)	8.7	11.5	15.0	19.5
EPS (Rs)	27.8	36.6	47.8	62.1
EPS Growth (%)	29.5	31.7	30.4	30.0
BV/Share (Rs)	169.2	198.3	237.3	290.6
P/E (x)	32.4	24.6	18.9	14.5
P/BV (x)	5.3	4.5	3.8	3.1
ABV (Rs)	166.0	194.8	234.0	286.0
P/ABV (x)	5.4	4.6	3.9	3.2
RoE (%)	17.7	19.9	21.9	23.5
RoA (%)	1.4	1.4	1.4	1.4

KEY FINANCIALS	
Shares Outstanding (m)	313.1
Market Cap. (Rs b)	282.3
Market Cap. (US$ b)	6.5
Past 3 yrs. NII Growth (%)	45.8
Past 3 yrs. NP Growth (%)	31.0
Dividend Payout (%)	19.8
Dividend Yield (%)	0.6
P/E to Growth (x)	1.1

STOCK DATA	
52-Week Range	1,150/620
Major Shareholders (%) (December 2006)	
Promoters	22.3
Domestic Institutions	6.6
FIIs	52.1
Others	19.1
Average Daily Turnover	
Volume ('000 shares)	657.8
Value (Rs million)	573.0
1/6/12 Month Rel. Performance (%)	-2/-3/9
1/6/12 Month Abs. Performance (%)	-5/-2/17

Best placed bank in a rising rate scenario: With deposit cost on a rise, we believe that banks with strong retail franchise, higher proportion of CASA deposits and thus lower cost of funds would be best placed. HDFC Bank emerges as our most preferred bank.

Margins set to improve: HDFC Bank has the highest CASA ratio in the industry (55% in 3QFY07). With yields likely to rise faster than cost of funds for HDFC Bank, margins could improve going forward.

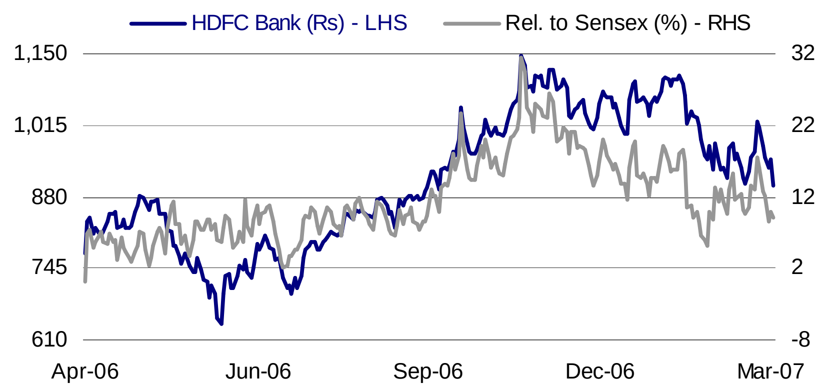
New branch additions - would ensure growth: After a long gap of one year due to regulatory issues, HDFC Bank has added 48 new branches during 3QFY07. Rapid branch expansion in future on removal of regulatory block, would ensure robust business growth.

Asset quality - already carrying adequate provisions: HDFC Bank's net NPAs of 0.4% are amongst the lowest and the bank already carries enough provisions to withstand likely increases in default rates.

Equity dilution in FY08 - likely to be book accretive: We expect capital raising in FY08/FY09, which will again happen at a significant premium to book. Based on the past experiences, such dilution can improve the book value by almost 20%.

Valuations reasonable on FY09 basis, 'Buy': The stock now trades at PE of 14.5x and P/B of 3.1x on FY09, making it attractive for the aforesaid reasons. We recommend **Buy** with a price target of Rs1,162.

STOCK PERFORMANCE (1 YEAR)

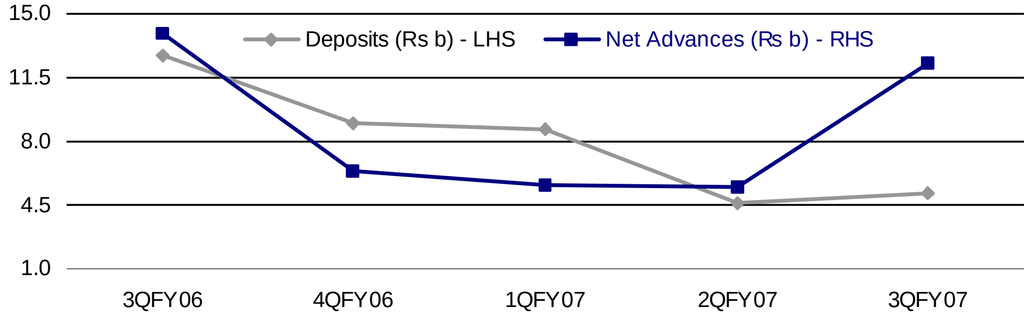


HDFC Bank continues to maintain its high quality growth, on the back of its strong business model. In 3QFY07, the bank's earnings grew by 31.6% YoY. Margins were sustained at over 4%, while NII growth was 39% YoY. The bank added 48 new branches during the quarter, after four quarters of no new branch addition. Asset quality remains high, with net NPAs at 0.4%.

Conscious strategy to slow down growth

Over the last few quarters, HDFC Bank has slowed down its business (deposits and core customer assets) growth. Growth slowed down to 29% YoY in 3QFY07 from 37% in 2QFY07 and 50% in 1QFY07. Deposits growth (30% YoY in 3QFY07) has been slowing down each quarter, as the management has taken a conscious decision of not taking in incremental deposits at higher cost.

INCREMENTAL GROWTH (%) SLOWING DOWN

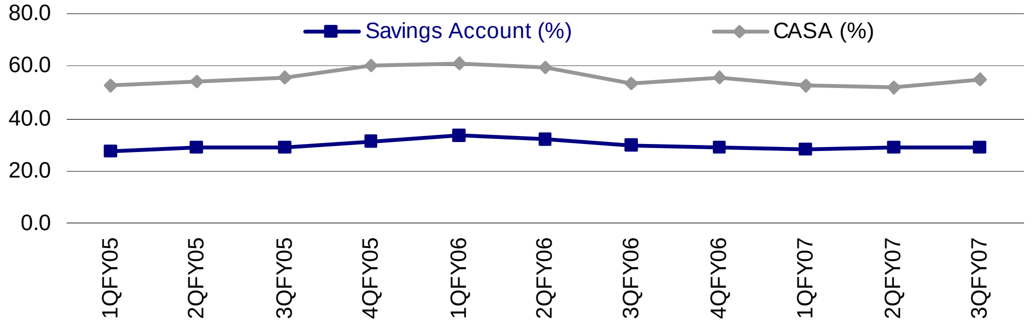


Source: Company/ Motilal Oswal Securities

Higher CASA component to result in better margins

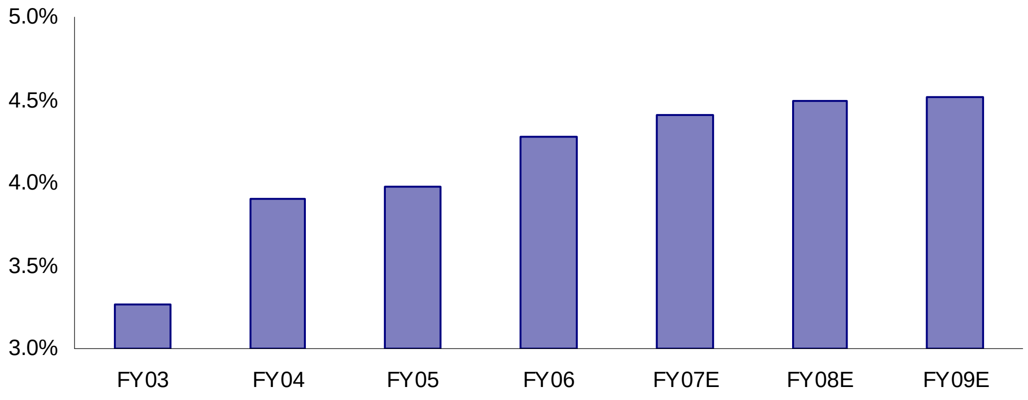
Despite no new branches over the last four quarters, HDFC Bank has been able to maintain its CASA deposits at over 50% of total deposits. In fact, in 3QFY07, it has even improved its CASA proportion to 55% (the highest in the banking sector). With loan yields across products going up, HDFC Bank is likely to witness an improvement in NIMs, as cost of deposits is likely to be largely contained as more than half of its deposits are contracted at fixed rates (CASA deposits) of ~2.5%- 2.8%

TREND OF CASA DEPOSITS (%)



Source: Company/ Motilal Oswal Securities

TREND IN NIM (%)

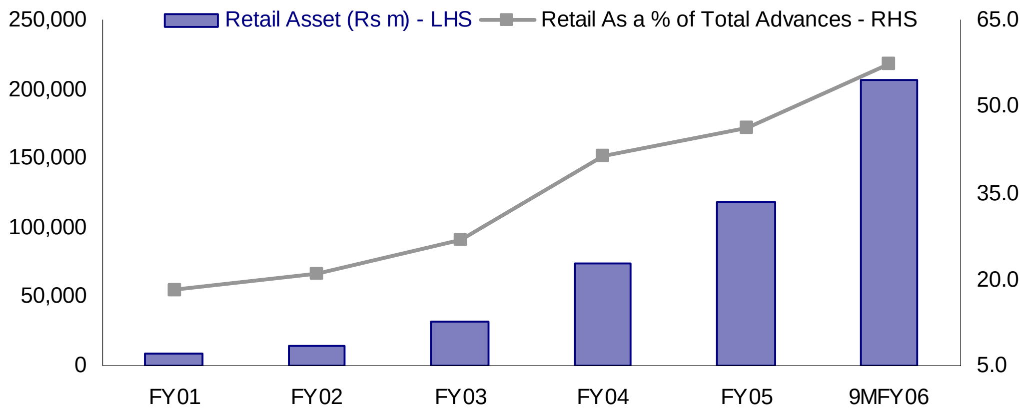


Source: Company/ Motilal Oswal Securities

Retail loans driving asset growth; corporate loan book also picking up

Retail has been the key growth driver for the bank, although the pace of growth is slowing down. Retail loans grew 36% YoY (down from 44% YoY growth in 2QFY07 and 57% YoY growth in 1QFY07), and now constitute 58.4% of net advances. In retail, the main growth drivers have been personal loans, two-wheeler loans and credit cards.

GROWTH IN RETAIL ASSET



Source: Company/ Motilal Oswal Securities

HDFC Bank entered the corporate loan and loan syndication business in 2QFY07. Till then, the bank was concentrating more on disbursing loans for working capital. Sequential growth in corporate loans in 3QFY07 was 14% versus <2% growth reported in the last couple of quarters.

New branch licenses – additions to gather pace

In 3QFY07, the first quarter post new branch approval for HDFC Bank by RBI, the bank opened 48 new branches. The branches were opened within 45 days after receiving RBI approval. It now has 583 branches spread across 263 cities and 1,471 ATMs. We expect another 45-50 branches getting added during 4QFY07. HDFC Bank continues to have aggressive plans to increase its distribution network subject to RBI approval.

Asset quality consistent, with net NPAs at 0.4%

HDFC Bank's asset quality remains the best in the Indian banking sector notwithstanding the bank's aggressive growth over the past several quarters. Its net NPAs stand at 0.4%. This asset quality has been maintained despite the change in loan mix towards high yielding and riskier assets (personal loans, credit cards, etc), as the bank has stepped up its provisioning over the last 2-3 fiscals. HDFC bank's risk assessment and management systems are time tested and conservative.

Equity dilution in FY08 – likely to be book accretive

The management has intended that it might look at raising capital over the next 12-18 months. HDFC Bank has always raised capital at a substantial premium to its book value in the past. Assuming bank makes a further 7% equity dilution in January 2008 and at a price of Rs 1,152 (5x Dec 07E BV); the issue would be significantly book value additive for the bank. The book value post issue would rise to Rs297 and Rs347 against pre-diltuion book value of Rs237 and Rs291 in FY08E and FY09E BV respectively. The ROE would be around 18% for FY08 and FY09 with this dilution.

Valuations attractive, recommend 'Buy'

We expect HDFC Bank to report EPS of Rs48 in FY08 and Rs62 in FY09. The book value would be Rs237 (FY08) and Rs291 (FY09). The stock has always enjoyed a valuation premium for the dynamic and proactive management and we believe the same should continue in future as well. The stock now trades at PE of 14.5x and P/B of 3.1x on FY09, making it attractive for the aforesaid reasons. We recommend **Buy** with a price target of Rs1,162.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	30,935	44,753	67,917	94,141	124,364
Interest Expended	13,156	19,295	31,815	46,397	63,381
Net Interest Income	**17,779**	**25,458**	**36,103**	**47,744**	**60,983**
Change (%)	*32.9*	*43.2*	*41.8*	*32.2*	*27.7*
Other Income	**6,513**	**11,240**	**15,900**	**20,624**	**26,434**
Net Income	**24,293**	**36,698**	**52,003**	**68,368**	**87,417**
Operating Expenses	10,854	16,911	23,691	32,399	43,331
Operating Income	13,439	19,787	28,313	35,969	44,086
Change (%)	*33.3*	*47.2*	*43.1*	*27.0*	*22.6*
Other Provisions	3,643	7,249	12,000	14,600	16,300
PBT	**9,796**	**12,538**	**16,313**	**21,369**	**27,786**
Tax	3,140	3,830	4,845	6,411	8,336
PAT	6,656	8,708	11,468	14,958	19,450
Change (%)	*30.6*	*30.8*	*31.7*	*30.4*	*30.0*
Proposed Dividend	1,401	1,722	2,035	2,349	2,349

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	3,099	3,131	3,131	3,131	3,131
Reserves & Surplus	42,104	49,865	58,951	71,162	87,864
Net Worth	45,203	52,996	62,083	74,293	90,996
Deposits	363,482	557,968	736,518	957,473	1,196,842
Borrowings	52,900	45,605	62,145	83,152	110,563
Other Liab & Provisions	52,645	78,495	102,043	132,656	172,453
Total Liabilities	**514,229**	**735,064**	**962,789**	**1,247,575**	**1,570,853**
Current Assets	44,740	69,190	80,461	103,924	124,295
Investments	193,438	283,888	374,732	487,152	608,940
Advances	**255,663**	**350,613**	**483,845**	**628,999**	**805,119**
Net Fixed Assets	7,083	8,551	9,750	11,500	12,500
Other Assets	13,306	22,823	14,000	16,000	20,000
Total Assets	**514,229**	**735,064**	**962,789**	**1,247,575**	**1,570,853**

KEY ASSUMPTIONS (%)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Deposit Growth	19.5	53.5	32.0	30.0	25.0
Advances Growth	44.1	37.1	38.0	30.0	28.0
Investments Growth	0.5	46.8	32.0	30.0	25.0
Provision Coverage	86.2	69.1	77.0	84.6	83.9
Dividend per share	4.5	5.5	6.5	7.5	7.5

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield-Earn Assets	6.9	7.5	8.3	8.8	9.1
Avg. Cost-Int. Bear. Liab.	3.6	3.9	4.7	5.2	5.5
Interest Spread	3.4	3.7	3.7	3.6	3.6
Net Interest Margin	4.0	4.3	4.4	4.5	4.5
Profitability Ratios (%)					
RoE	18.5	17.7	19.9	21.9	23.5
RoA	1.4	1.4	1.4	1.4	1.4
Int. Exp./Int. Earned	42.5	43.1	46.8	49.3	51.0
Other Income/Net Inc.	26.8	30.6	30.6	30.2	30.2
Efficiency Ratios (%)					
Op Exp/Net Income	44.7	46.1	45.6	47.4	49.6
Employee Cost/Op.Exps	25.5	28.8	33.2	33.5	34.6
Business per Emp. (Rs m)	60.9	51.3	53.0	53.7	52.9
Net Profit per Empl. (Rs m)	0.7	0.6	0.6	0.6	0.6
Asset Liability Profile (%)					
Advances/Deposit Ratio	70.3	62.8	65.7	65.7	67.3
Invest./Deposit Ratio	53.2	50.9	50.9	50.9	50.9
G-Sec/Investment Ratio	58.0	69.2	52.4	40.3	32.2
Gross NPAs to Advances	1.7	1.4	1.5	1.6	1.7
Net NPAs to Advances	0.2	0.4	0.3	0.2	0.3
CAR	12.7	11.4	11.0	10.5	10.5
Tier 1	*8.9*	*8.6*	*8.0*	*7.4*	*7.0*

VALUATION

Book Value (Rs)	145.9	169.2	198.3	237.3	290.6
Price-BV (x)	6.2	5.3	4.5	3.8	3.1
Adjusted BV (Rs)	144.6	166.0	194.8	234.0	286.0
Price-ABV (x)	6.2	5.4	4.6	3.9	3.2
EPS (Rs)	21.5	27.8	36.6	47.8	62.1
EPS Growth	20.1	29.5	31.7	30.4	30.0
Price Earnings (x)	42.0	32.4	24.6	18.9	14.5
OPS (Rs)	43.4	63.2	90.4	114.9	140.8
Price-OP (x)	20.8	14.3	10.0	7.8	6.4

E: MOSt Estimates

Punjab National Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	PNB IN
	REUTERS CODE
S&P CNX: 3,634	PNBK.BO

2 April 2007

Buy

Previous Recommendation: Buy

Rs428

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	46.7	55.6	64.4	74.6
OP (Rs b)	28.7	33.2	40.8	49.8
NP (Rs b)	14.4	17.0	22.0	27.0
EPS (Rs)	45.6	53.9	69.8	85.8
EPS Growth (%)	2.1	18.1	29.4	23.0
BV/Share (Rs)	287.8	330.0	385.7	453.9
P/E (x)	9.4	7.9	6.1	5.0
P/BV (x)	1.5	1.3	1.1	0.9
ABV (Rs)	283.5	325.3	379.9	448.6
P/ ABV (x)	1.5	1.3	1.1	1.0
RoE (%)	16.4	16.9	19.0	20.0
RoA (%)	1.1	1.1	1.2	1.3

KEY FINANCIALS	
Shares Outstanding (m)	315.3
Market Cap. (Rs b)	134.8
Market Cap. (US$ b)	3.1
Past 3 yrs. NII Growth (%)	14.3
Past 3 yrs. NP Growth (%)	19.6
Dividend Payout (%)	19.7
Dividend Yield (%)	2.1
P/E to Growth (x)	0.4

STOCK DATA	
52-Week Range	585/300
Major Shareholders (%) (December 2006)	
Promoters	57.8
Domestic Institutions	14.0
FIIs	20.1
Others	8.1
Average Daily Turnover	
Volume ('000 shares)	767.7
Value (Rs million)	354.5
1/6/12 Month Rel. Performance (%)	3/-19/-16
1/6/12 Month Abs. Performance (%)	0/-19/-8

Better positioned bank in the current scenario: Punjab National Bank (PNB) is ideally placed to protect its NIMs of >4%. The bank's NIMs have been expanding with rising interest rates.

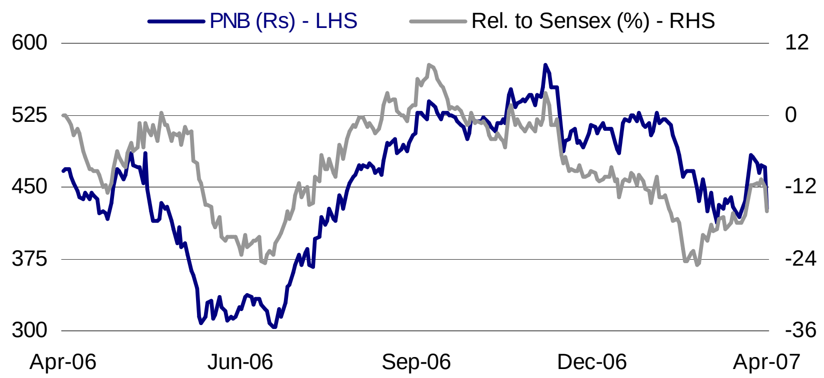
Investment in technology is paying off: PNB has made substantial investments in technology, which have begun reflecting in higher fee income. Further, the management claims that its risk assessment capabilities have improved, resulting in lower slippages.

Leverage to enhance RoA, RoE: With operating costs likely to grow at a slower pace, and absence of / lower investment related provisions, there is huge leverage to grow profitability. PNB is likely to generate a 1.2%+ RoA in FY08. With higher recoveries and lower provisions, RoA could increase further, resulting in a higher sustainable RoE.

Asset quality amongst the best: PNB's net NPAs at 0.4% are amongst the lowest. With slippages likely to remain low, NPA recoveries could provide upside to our estimates.

Preferred bet among large cap banks: Current valuations at 0.9x FY09E BV and 5x FY09E EPS are attractive, given its high sustainable margins, strong deposit franchise and 18-19% RoE over the next two years. Earnings could surprise on the upside due to higher recoveries and lower provisions. Given PNB's high RoE and strong earnings visibility, we value the stock at 1.5x FY09E BV. PNB is our top pick amongst the large cap banks. We reiterate **Buy**, with a target price of Rs681.

STOCK PERFORMANCE (1 YEAR)

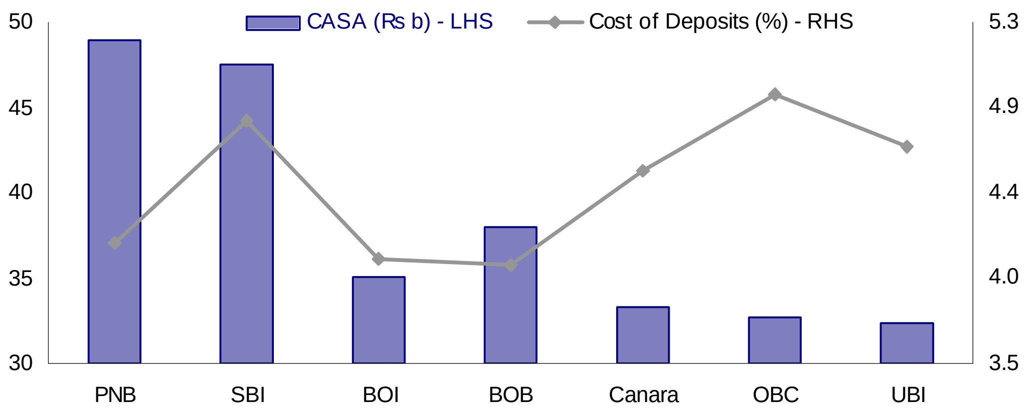


Best positioned bank in the current scenario

We believe that banks that can manage their liabilities well would be able to grow their balance sheet, with reasonable margins. PNB clearly stands out in this respect; it has a strong liability base arising out of its historical presence in the cash-rich northern belt of India. A strong network of 4,500 branches allows PNB to steadily grow retail deposits.

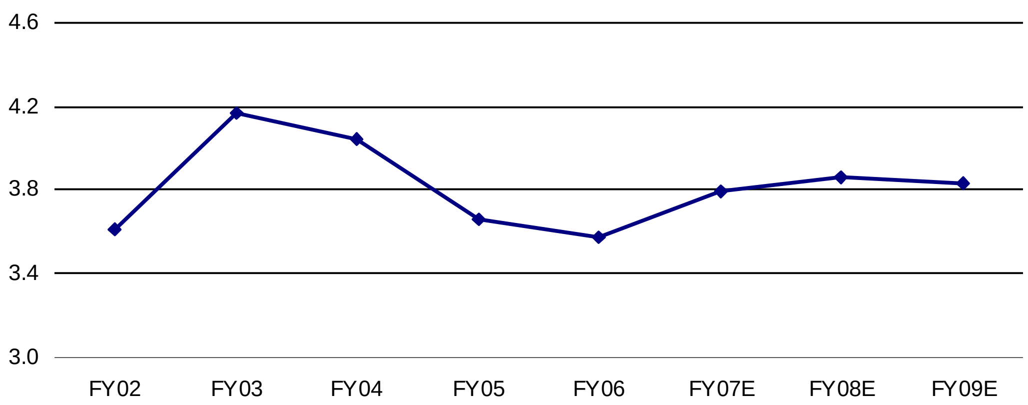
Currently, the bank's margins are ~4%, one of the highest amongst Indian banks, supported by its strong low cost deposit franchise. In an environment where raising resources at a reasonable cost is crucial, we believe PNB is best positioned amongst the state-owned banks. Despite rising interest rates over the last few quarters, PNB has been able to maintain its deposit costs, thereby enhancing its NIMs.

HIGHER PROPORTION OF CASA - LOWER COST OF DEPOSITS (%)



Source: Company/ Motilal Oswal Securities

TREND IN MARGINS (%)



Source: Company/ Motilal Oswal Securities

Not only does the bank have high a CASA composition (49% of total deposits), it also has the highest share of savings deposits (35% of total deposits). We believe that savings deposits are stickier than current account deposits. The management targets a CASA ratio of 51%, which we believe the bank would be able to attain especially given that it is adding branches in agri-rich rural communities in the northern region (68% of branches opened in FY06 were in rural and semi-urban areas).

Valuable franchise

PNB is the second largest bank in India after State Bank of India (SBI). It has over 4,500 branches spread across the country but it is particularly strong in the northern region. In terms of deposit growth, PNB has been consistent in growing its deposit base at a steady pace, with improving CASA ratio. While its total deposits have grown at a CAGR of 17% over FY02-06, its CASA deposits have grown at a CAGR of 20% during the period. PNB has the highest CASA ratio (CASA deposits as a percentage of total deposits) amongst the state-owned banks in India. PNB's incremental CASA deposits as a percentage of incremental total deposits during FY03-06 have been as high as 60%.

DEPOSIT GROWTH OVER FY02-06 (RS B)

	FY02	FY03	FY04	FY05	FY06	CAGR (%)
Current Deposits	67.6	98.9	99.0	124.7	167.2	25.4
Savings Deposits	216.6	256.5	304.2	353.4	419.1	17.9
CASA Deposits	284.2	355.4	403.2	478.1	586.3	19.8
Term Deposits	357.0	402.8	475.9	553.6	610.5	14.4
Total Deposits	**641.2**	**758.1**	**879.2**	**1031.7**	**1196.9**	**16.9**

Source: Company/ Motilal Oswal Securities

Core value of CASA franchisee could increase further

The current franchise value of the bank is 11% of its deposits (FY06). However, the core CASA franchisee value is at 23%. We expect this franchise to get more valuable, as deposits become costlier for the whole system. Further, a high CASA component supports strong loan growth with higher margins.

PNB: A VALUE BUY

	MCAP/TOTAL DEPOSITS (%)	MCAP/ CASA (%)	MCAP/ SAVINGS (%)
PNB	11.3	23.0	32.2
SBI(cons)	9.0	20.8	32.5
BOB	7.8	20.7	27.0
Bank of India	5.2	14.8	19.0
OBC	8.4	25.8	37.2
IOB	10.4	26.0	36.3
Canara Bank	6.4	19.3	26.2
HDFC Bank	50.6	91.3	174.4
UTI Bank	32.0	79.9	158.9
ICICI Bank	43.4	190.8	341.9

Source: Company/ Motilal Oswal Securities

Diversified, high-yielding loan book

PNB has a diversified loan book, with the retail segment constituting 24% and priority sector constituting 44% (including agri-loans, which constitute 19%) of the total loan book. Given the underlying demand for credit, we expect PNB's loan book to grow at a CAGR of 23% over FY06-09. Retail and SME credit are likely to remain the key drivers of credit growth in the coming years. With high proportion of low cost deposits and a high-yielding loan book, we expect margins to remain strong.

The bank's yield on advances has increased from 8.3% in FY06 to 9% in 2QFY07, on the back of PLR hikes and also due to focus on retail and agri-loan generation. The management reiterated that agriculture is the most profitable segment for PNB, as it still enjoys a blended yield of over 9%. With current recovery rates being in excess of 9%, agriculture loans have the highest RoA.

Special focus on agri loans: PNB has a strong branch network in the traditionally rich agricultural belt of Punjab and Haryana. This has helped the bank to build a large agri-loan portfolio (19% of total loans). PNB does not face risks of inadequate rains, as the northern belt is very well irrigated. The recovery rate in agricultural loans for PNB has been ~ 95%.

Technology initiatives – will pay off over the next few years

PNB is one of the few large state-owned banks in India to have rolled out CBS in almost 50% of its branches. CBS has been implemented in 2,171 service outlets at 571 centers, covering 76.2% of bank's total business. CBS implementation has lowered revenue leakages, resulting in higher revenues.

PNB has been an early entrant in the technology space. We believe that the experience gained by its staff in the technology domain puts the bank much ahead of its peers. This would be a key differentiator in the years to come, enabling better service standards, improved better credit monitoring, enhanced fee revenues, etc.

Fee-based income to grow on the back of technology rollout

While the CBS rollout has been favorably impacting its fee income, PNB has also taken various initiatives to augment its fee-based income. Some of these include:

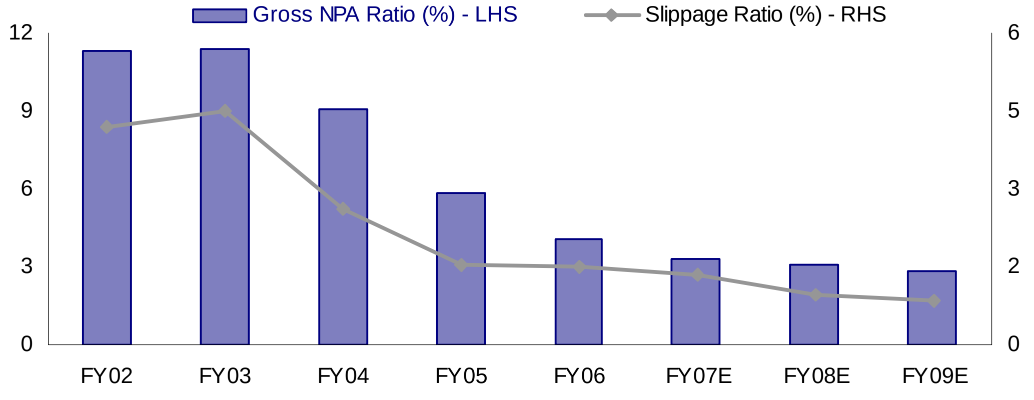
- Cash Management Services (CMS is operational at 500 centers).
- Marketing and distribution of financial and bancassurance products
- Depository services: The bank has installed new software to provide centralized online depository services at 85 CBS branches. Going forward, it plans to offer end-to-end solutions such as online trading, speed –e facility and broking services).
- Implementation of online tax accounting system for the collection of taxes.
- PNB also handles the payments of dividend / interest warrants / refund orders. The bank has obtained SEBI registration for category -1 merchant banker.

In 1HFY07, fee income for PNB grew 54% YoY. We believe this to be a result of CBS implementation, resulting in lower revenue leakages. Going forward, we expect fee income to remain strong on the back of CBS rollout and added focus on management's part to grow non-fund based income.

Asset quality amongst the best in the system

PNB has one of the cleanest loan books amongst the state-owned banks, with net NPAs close to zero (0.2% as of 2QFY07). PNB has enough floating provisions on its books (Rs9.8b as of FY06) as against its actual net NPAs, resulting in lower provisioning and possible write-back in future. Its higher provision coverage at 95%, and expected low incremental defaults would protect earnings in coming years. Higher recoveries of written-off accounts could be a possible upside to our estimates.

IMPROVING ASSET QUALITY (%)



Source: Company/ Motilal Oswal Securities

Stable op-ex to provide strong leverage

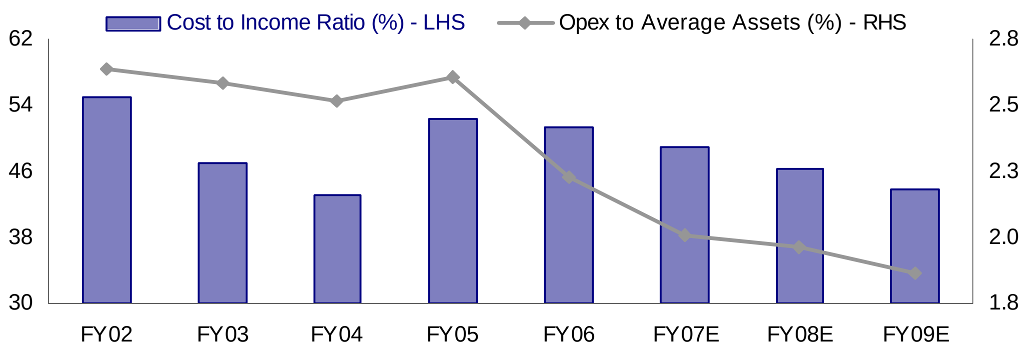
About 70% of PNB's operating costs are wages, which are largely fixed in nature, apart from the normal inflation-related hike in salaries. Over the last three quarters, PNB's wage costs have largely remained flat. With most incremental costs owing to higher pensions and higher wages being taken care of, we expect wage costs to remain at similar levels. The new wage revision would be effective from November 2007 and the impact of higher wages would only come in FY09. Further, there are several retirements coming up over the next few years. The management has stated that over the next five years, ~15% of the current workforce is likely to retire.

In terms of other operating costs, PNB has already made a larger investment in technology. We do not expect technology costs to increase substantially from here on. Thus, from the current base, we do not expect a sharp growth in op-ex. In our projections, we are assuming overall op-ex to grow at 9% CAGR during FY06-09.

Net reduction in PNB's workforce over the next few years would lead to a significant improvement in operating ratios. For instance, a mere 3% reduction in PNB's workforce could result in a 50bp improvement in RoE. However, the big benefit for state-owned banks from this exercise would be a sustainable growth in earnings. While the business income over the next few years will continue to grow at 15%, cost growth will be lower at 10%, resulting in earnings growth of 20-22%. This is possible, as a decline in C/I ratio could result in strong earnings growth for PNB.

On the AS-15 impact, PNB has already started making higher provisions as per actuarial valuations (~Rs1.5b in 1HFY07). On the past arrears, the management indicated that the gap is likely to be in the range of Rs4-5b (~4% of FY07 book value).

DECLINING COST/INCOME RATIO

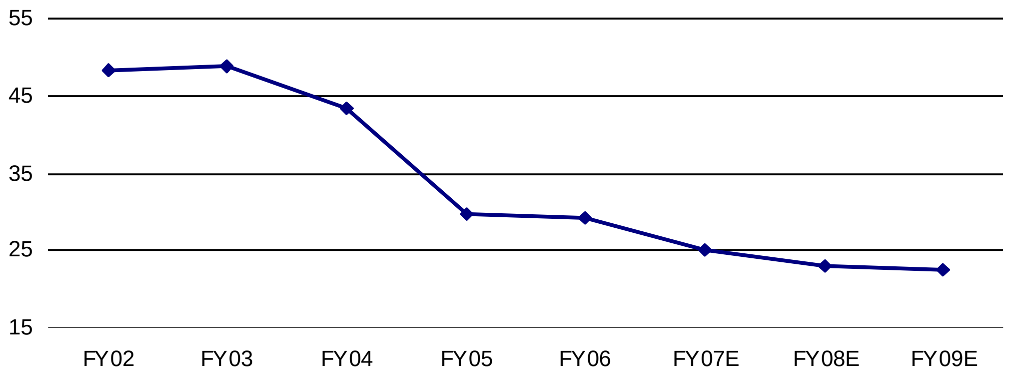


Source: Company/ Motilal Oswal Securities

Provisioning requirement to decline substantially

Over the last three years, PNB has been resorting to very high provisioning, either on the back of its pension expenses or investment provisions. PNB had a high duration investment book exposed to mark-to-market risks. As a result, in a rising rate environment, it had to make heavy provisioning.

PROVISIONS AS A % OF OPERATING PROFITS



Source: Company/ Motilal Oswal Securities

However, with interest rates coming off, PNB need not make any more provisions for its investment book. Further, with net NPAs being at 0.2%, it does not have any requirement of NPA-related provisions. We expect provisioning requirement for PNB to also come off, going forward.

Investment book – lower risks going forward

PNB has been selling securities to fund its loan growth. Post transfers and sell downs, the proportion of SLR securities in HTM category has been increased to 62%. The AFS duration is still >3 years and the AFS book has been marked-to-market up to 8.1%. PNB was one of the most vulnerable banks in a rising rate scenario. However, with a view that rate hikes from current levels would be moderate, we believe that incremental losses for PNB would come down sharply.

Well placed on capital front

Capital adequacy is 12.7% (Tier-I is 9.6%). Basel-2 operational risk impact on PNB is likely to be ~90bp in FY07. Post Basel-2 impact, the management has stated that by FY07, PNB would like to maintain a capital adequacy ratio (CAR) of over 12%. Further, the option to raise capital by way of hybrids exists for PNB and the bank also has room to augment its tier-II capital.

Strong RoA – leverage to enhance RoE

PNB has consistently delivered strong RoA since FY03 (1.0-1.2%), driven by high margins, improving cost ratios, and declining provisions. We believe that its high RoA could generate higher than presently reported RoE (~18%). According to our calculations, RoE could improve 200bp on the back of higher-than-expected fee income and containment of costs, coupled with already strong margins.

Reiterate Buy, with a price target of Rs681

Current valuations at 0.9x FY09E BV and 5x FY09E EPS are attractive, given its high sustainable margins, strong deposit franchise and 18-19% RoE over the next two years. Earnings could surprise on the upside due to higher recoveries and lower provisions. Given PNB's high RoE, strong earnings visibility, we value the stock at 1.5x FY09E BV. PNB is our top pick amongst the large cap banks. Maintain **Buy** with a target price of Rs681.

Concerns

Investment yield at 8%: PNB continues to enjoy high yields on its investment book. However, we expect the yields to decline as the bank churns its portfolio. We are building in a decline in investment yields in our projections.

Pension – AS-15: On the AS-15 impact, PNB has already started making higher provisions as per actuarial valuations (~Rs1.5b in 1HFY07). With regard to past arrears, management indicated that the gap is likely to be in the range of Rs4b-5b (~4% of FY07 book value). We have not built in pension related costs in our projections.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	84,599	95,842	114,001	136,682	160,997
Interest Expended	44,531	49,174	58,408	72,308	86,419
Net Interest Income	**40,067**	**46,668**	**55,593**	**64,374**	**74,578**
Change (%)	*10.5*	*16.5*	*19.1*	*15.8*	*15.9*
Other Income	16,757	12,312	8,744	11,461	13,895
Bond Gains	3,528	2,109	-4,170	-2,000	-500
Net Income	**56,824**	**58,979**	**64,337**	**75,835**	**88,473**
Change (%)	*3.5*	*3.8*	*9.1*	*17.9*	*16.7*
Operating Expenses	29,752	30,232	31,156	35,012	38,634
Operating Income	**27,072**	**28,748**	**33,181**	**40,823**	**49,838**
Change (%)	*-13.3*	*6.2*	*15.4*	*23.0*	*22.1*
Other Provisions	8,016	8,399	8,900	9,400	11,200
PBT	**19,056**	**20,348**	**24,281**	**31,423**	**38,638**
Tax	4,955	5,955	7,284	9,427	11,591
Tax Rate (%)	*26.0*	*29.3*	*30.0*	*30.0*	*30.0*
PAT	**14,101**	**14,393**	**16,997**	**21,996**	**27,047**
Change (%)	*27.2*	*2.1*	*18.1*	*29.4*	*23.0*
Proposed Dividend	1,977	2,838	3,153	3,784	4,730

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	3,153	3,153	3,153	3,153	3,153
Reserves & Surplus	78,460	90,611	103,918	121,488	143,001
Net Worth	**81,613**	**93,764**	**107,071**	**124,641**	**146,154**
Deposits	**1,031,669**	**1,196,850**	**1,412,283**	**1,652,371**	**1,916,750**
Change (%)	*17.3*	*16.0*	*18.0*	*17.0*	*16.0*
Borrowings	27,183	66,872	18,000	18,000	18,000
Other Liabilities & Prov.	121,948	95,188	110,188	125,188	140,188
Total Liabilities	**1,262,413**	**1,452,674**	**1,647,543**	**1,920,200**	**2,221,093**
Current Assets	110,890	247,917	168,376	190,340	200,778
Investments	506,728	410,553	451,608	496,769	546,446
Change (%)	*20.3*	*-19.0*	*10.0*	*10.0*	*10.0*
Advances	604,128	746,274	970,156	1,173,889	1,408,666
Change (%)	*27.9*	*23.5*	*30.0*	*21.0*	*20.0*
Net Fixed Assets	9,652	10,302	12,402	14,202	18,202
Other Assets	31,015	37,628	45,000	45,000	47,000
Total Assets	**1,262,414**	**1,452,674**	**1,647,543**	**1,920,200**	**2,221,093**

ASSUMPTIONS (%)

Deposit Growth	17.3	16.0	18.0	17.0	16.0
Advances Growth	27.9	23.5	30.0	21.0	20.0
Investments Growth	20.3	-19.0	10.0	10.0	10.0
Dividend	60.0	90.0	100.0	120.0	150.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.7	7.3	7.8	8.2	8.3
Avg. Cost-Int. Bear. Liab.	4.6	4.2	4.3	4.7	4.8
Interest Spread	3.2	3.1	3.4	3.5	3.5
Net Interest Margin	3.7	3.6	3.8	3.9	3.8
Profitability Ratios (%)					
RoE	21.4	16.4	16.9	19.0	20.0
RoA	1.2	1.1	1.1	1.2	1.3
Int. Expended/Int.Earned	52.6	51.3	51.2	52.9	53.7
Other Inc./Net Income	29.5	20.9	13.6	15.1	15.7
Efficiency Ratios (%)					
Op. Exps./Net Income	52.4	51.3	48.4	46.2	43.7
Empl. Cost/Op. Exps.	71.3	70.0	70.1	69.4	69.0
Busi. per Empl. (Rs m)	25.6	30.9	37.9	46.5	55.9
NP per Empl. (Rs lac)	2.4	2.5	3.0	3.9	4.9
Asset-Liability Profile (%)					
Adv./Deposit Ratio	58.6	62.4	68.7	71.0	73.5
Invest./Deposit Ratio	49.1	34.3	32.0	30.1	28.5
G-Sec/Invest. Ratio	85.7	84.4	85.9	87.5	89.1
Gross NPAs to Adv.	5.8	4.0	3.3	3.1	2.9
Net NPAs to Adv.	0.2	0.3	0.2	0.2	0.2
CAR	14.8	12.0	10.2	10.1	10.1
Tier 1	8.9	10.1	8.5	8.4	8.5

VALUATION

Book Value (Rs)	249	288	330	386	454
Price-BV (x)	1.7	1.5	1.3	1.1	0.9
Adjusted BV (Rs)	246	283	325	380	449
Price-ABV (x)	1.7	1.5	1.3	1.1	1.0
EPS (Rs)	44.7	45.6	53.9	69.8	85.8
EPS Growth (%)	7.0	2.1	18.1	29.4	23.0
Price-Earnings (x)	9.6	9.4	7.9	6.1	5.0
OPS (Rs)	85.9	91.2	105.2	129.5	158.1
OPS Growth (%)	-27.0	6.2	15.4	23.0	22.1
Price-OP (x)	5.0	4.7	4.1	3.3	2.7

E: MOSt Estimates

Bank of Baroda

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	BOB IN
S&P CNX: 3,634	REUTERS CODE BOB.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs201

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	32.2	37.3	42.5	48.2
OP (Rs b)	20.3	24.9	27.3	30.8
NP (Rs b)	8.3	10.6	12.7	15.2
EPS (Rs)	22.6	28.9	34.7	41.5
EPS Growth (%)	-1.6	27.9	19.9	19.7
BV/Share (Rs)	207.4	229.3	255.8	288.0
P/E (x)	8.9	6.9	5.8	4.8
P/ BV (x)	1.0	0.9	0.8	0.7
ABV (Rs)	198.2	221.6	247.7	278.9
P/ ABV (x)	1.0	0.9	0.8	0.7
RoE (%)	12.3	12.8	13.9	14.9
RoA (%)	0.8	0.8	0.8	0.9

KEY FINANCIALS	
Shares Outstanding (m)	365.5
Market Cap. (Rs b)	73.5
Market Cap. (US$ b)	1.7
Past 3 yrs. NII Growth (%)	15.3
Past 3 yrs. NP Growth (%)	2.3
Dividend Payout (%)	25.1
Dividend Yield (%)	2.5
P/E to Growth (x)	0.3

STOCK DATA	
52-Week Range	296/176
Major Shareholders (%) (December 2006)	
Promoters	53.8
Domestic Institutions	15.1
FIIs/FDIs	20.8
Others	10.3
Average Daily Turnover	
Volume ('000 shares)	898.1
Value (Rs million)	217.2
1/6/12 Month Rel. Performance (%)	-3/-30/-21
1/6/12 Month Abs. Performance (%)	-7/-29/-14

Bank of Baroda (BoB), is the fourth largest state-owned bank in India. It has a balance sheet size of over Rs1.4t, a large network of 2,700+ domestic branches and 39 foreign offices. It is one of the fastest growing state-owned banks, with steady fee income growth and stable margins.

The fastest growing amongst the large state-owned banks: BoB's global loans grew 47% YoY in 3QFY07, a significant acceleration from 45% growth in 2QFY07 and 38% growth in FY06.

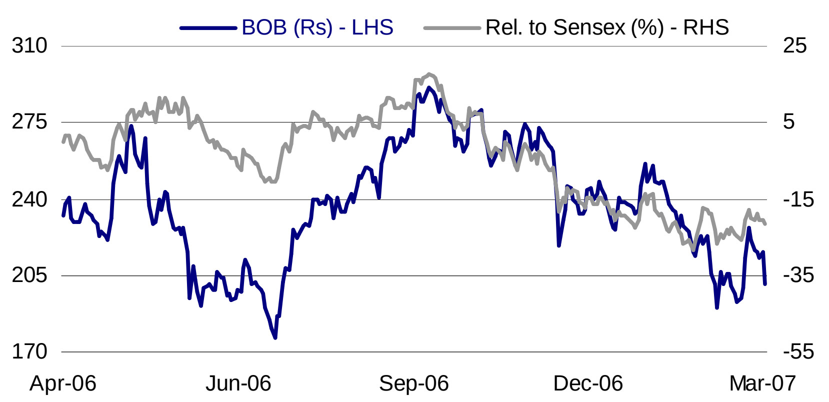
Margins stable despite strong growth: BoB has been the most aggressive amongst the state-owned banks in raising PLR. Its NIMs are down just 2bp YoY in 9MFY07, despite strong balance sheet growth.

Fee income growing at a steady pace: One of the key highlights of BoB has been its growing fee income base. Over the last three quarters, its fee income has grown by over 20% YoY.

Improving asset quality; lower provisioning going forward: BoB's net NPAs have declined from 3.4% in FY02 to 0.7% as of Dec-06. We expect lower incremental provisioning requirement.

With strong loan growth, coupled with lower provisioning requirement going forward (as NPAs are merely 0.7%), we believe earnings progression is likely to be strong in FY08 and FY09, even as we expect margins and growth to moderate. The stock trades at 4.8x FY09E EPS and 0.7x FY09E BV. We maintain **Buy** with a target price of Rs288.

STOCK PERFORMANCE (1 YEAR)

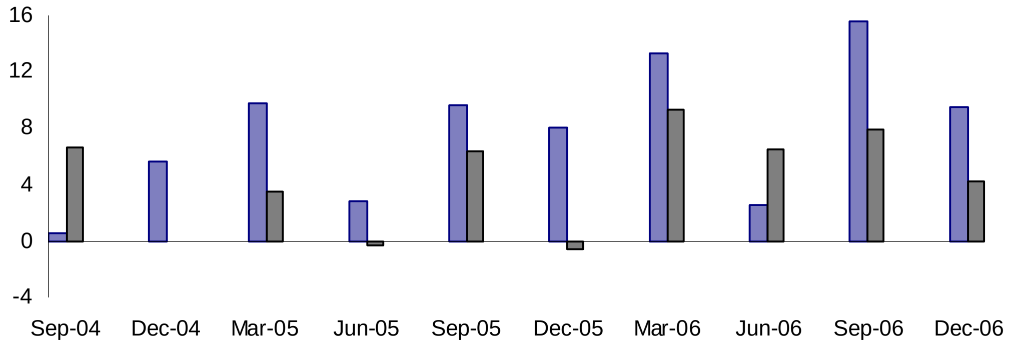


Bank of Baroda (BoB), incorporated in 1908, is the fourth largest state-owned bank in India. It has a balance sheet size of over Rs1.4t, a large network of 2,700+ domestic branches, 39 overseas offices and 650+ ATMs. About 60% of its branches are located in rural and semi-urban regions of India. The government owns 53.8% of the bank's equity. Its overseas book contributes 20% to the total business.

The fastest growing amongst the large state-owned banks

BoB did not witness any increase in balance sheet size during the period FY02-04 and the management is planning to catch up now by growing its loan book aggressively. A large part of this growth is likely to come from retail (17% of total loans and 20% of domestic loans, YoY growth of 49% in 9MFY07). BoB would also focus on growing its SME loan book faster, as this segment is better yielding than the corporate sector, even on a risk adjusted basis.

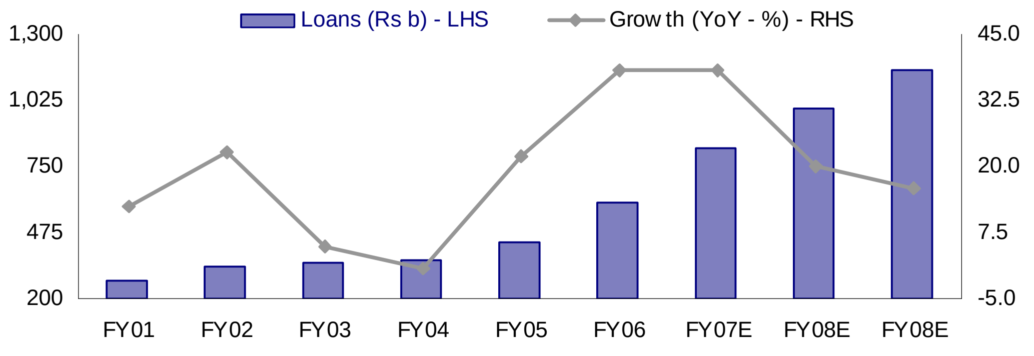
QOQ GROWTH IN LOANS AND DEPOSITS



Source: Company/Motilal Oswal Securities

BoB's global loans grew 47% YoY in 3QFY07, a significant acceleration from 45% growth in 2QFY07 and 38% growth in FY06. Retail loans (up 49%) continue to grow even faster and constituted 19% of total domestic loans. BoB is the fastest growing amongst the large state-owned banks; its growth is comparable to the leading new private banks. However, it has a much lower proportion of retail loans than its peers.

LOANS GROWTH YOY



Source: Company/Motilal Oswal Securities

Margins stable despite strong growth

BoB has been the most aggressive amongst the state-owned banks in raising PLR (50bp hike each in May, August and December 2006). NIMs are down just 2bp YoY in 9MFY07, despite strong balance sheet growth. In future as well, the management has guided stable margins. The management has stated that BoB is not chasing high cost deposits and would maintain margins at any cost. We are, however, assuming a margin decline, going forward.

NIMS OVERALL BREAKDOWN (%)

	9MFY06	FY06	9MFY07
Yield on Advances	7.64	7.65	8.33
Yield on Investments	7.98	8.23	8.16
Cost of Deposits	4.11	4.28	4.94
NIMs - Overall	**3.23**	**3.29**	**3.21**

Source: Company/Motilal Oswal Securities

CASA deposits constitute over 40% of total deposits

Despite the strong balance sheet growth, BoB has been maintaining a strong CASA deposit base of 40%. The bank has been aggressively marketing these deposits and has been offering innovative schemes like 8-8 banking and free credit / debit cards, which were not offered earlier. As of December 2006, growth in CASA deposits was running strong – 18% growth in savings deposits and 22% growth in current accounts.

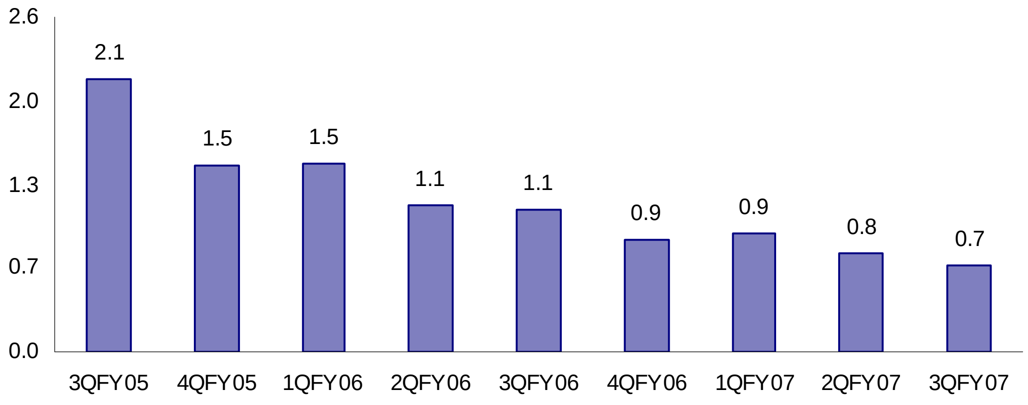
Fee income growing at a steady pace

One of the key highlights of BoB has been its growing fee income base. Over the last three quarters, its fee income has grown by over 20% YoY. The management is focusing on third-party distribution and selling life / non-life insurance, on the retail side. On the corporate side, increasing loan book is having a direct impact on fee generation. The bank is negotiating higher fee income from corporates while giving out loans. We expect steady growth in BoB's fee income, going forward.

Improving asset quality; lower provisioning going forward

BoB's asset quality is continuously improving, with tight control over incremental defaults. Net NPAs have declined from 3.4% in FY02 to 0.7% as of December 2006. In 9MFY07, the bank recovered Rs2.5b (as against Rs4b in FY06) from bad loans. We expect asset quality to remain healthy, with gross NPAs at 2.8% and net NPAs at 0.4% in FY09. Given the low net NPA levels, incremental provisioning requirement is likely to be low. Further, we expect significant recoveries – BoB has huge written-off accounts of about Rs18b.

TREND IN NET NPAS (%)

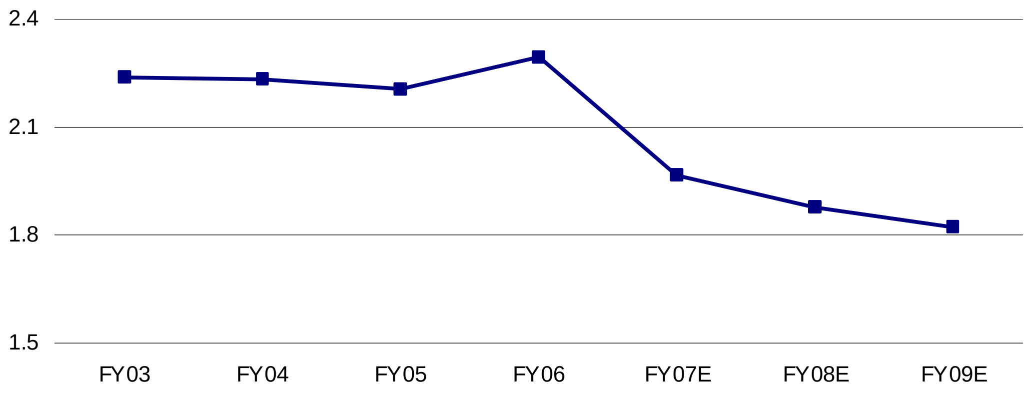


Source: Company/Motilal Oswal Securities

Enough levers to grow profitability

BoB's operating expenses are likely to grow at a slower rate, due to retirements coupled with larger part of IT expenditure already taken care off. Further, as the bank is growing its asset book at a rapid pace, opex as a percentage of assets is likely to trend downwards.

OPEX AS A % OF ASSETS



Source: Company/Motilal Oswal Securities

At <1x FY08E BV, valuations are extremely attractive

With strong loan growth, coupled with lower provisioning requirement going forward (as NPAs are merely 0.7%), we believe earnings progression is likely to be strong in FY07 and FY08. We expect earnings CAGR of 20% over FY07-09. The stock trades at 4.8x FY09E EPS and 0.7x FY09E BV. One reason for the low valuations is the bank's low RoE. However, given the strong earnings growth expected over the next couple of fiscals, we expect RoE to increase to 15% by FY09. We maintain **Buy** with a target price of Rs288.

Concerns

Low RoE: One of the key reasons for BoB's low valuations has been its lower RoE. With a tier-I of ~11%, the leverage for BoB is still lower. With strong growth anticipated in profitability, coupled with lower growth in opex and lower provisioning requirement going forward, RoE is likely to tend upwards.

Lagging in technology implementation: BoB was a late starter on technology and is yet to implement technology on a large scale. However, it has ramped up its operations on the technology front, with an aggressive rollout of CBS at 126 branches in a record 90 days. The bank had 513 branches running on the CBS platform as of September 2006 and targets to cover 1,000 branches (~70% of business) by March 2007.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	64,314	71,000	95,783	118,792	139,165
Interest Expended	34,521	38,751	58,505	76,318	90,940
Net Int. Income	**29,793**	**32,249**	**37,278**	**42,475**	**48,225**
Change (%)	*15.9*	*8.2*	*15.6*	*13.9*	*13.5*
Other Income	13,048	11,916	12,766	13,530	14,549
Net Income	**42,841**	**44,165**	**50,044**	**56,005**	**62,774**
Change (%)	*-0.2*	*3.1*	*13.3*	*11.9*	*12.1*
Operating Expenses	**19,822**	**23,848**	**25,130**	**28,715**	**31,963**
Operating Income	**23,019**	**20,318**	**24,914**	**27,290**	**30,810**
Change (%)	*-7.4*	*-11.7*	*22.6*	*9.5*	*12.9*
Other Provisions	14,388	9,173	8,650	8,650	8,500
PBT	**8,631**	**11,145**	**16,264**	**18,640**	**22,310**
Tax	1,863	2,876	5,692	5,965	7,139
Tax Rate (%)	*21.6*	*25.8*	*35.0*	*32.0*	*32.0*
PAT	**6,768**	**8,269**	**10,572**	**12,676**	**15,171**
Change (%)	*-30.0*	*22.2*	*27.9*	*19.9*	*19.7*
Proposed Dividend	1,670	2,077	2,193	2,559	2,924

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	2,945	3,655	3,655	3,655	3,655
Reserves & Surplus	53,332	74,789	82,795	92,477	104,226
Net Worth	**56,278**	**78,444**	**86,450**	**96,132**	**107,882**
Deposits	**813,335**	**936,620**	**1,189,507**	**1,367,933**	**1,573,123**
Change (%)	*11.5*	*15.2*	*27.0*	*15.0*	*15.0*
Borrowings	31,408	70,722	91,939	110,326	132,392
Other Liab. & Prov.	45,622	48,139	52,953	58,248	64,073
Total Liabilities	**946,642**	**1,133,925**	**1,420,849**	**1,632,640**	**1,877,470**
Current Assets	92,542	134,546	147,032	129,395	142,379
Investments	370,744	351,142	393,279	452,271	520,112
Change (%)	*-2.5*	*-5.3*	*12.0*	*15.0*	*15.0*
Advances	434,004	599,118	826,783	992,139	1,150,881
Change (%)	*21.9*	*38.0*	*38.0*	*20.0*	*16.0*
Net Fixed Assets	8,608	9,207	9,852	10,541	10,975
Other Assets	40,744	39,912	43,903	48,293	53,122
Total Assets	**946,642**	**1,133,925**	**1,420,849**	**1,632,640**	**1,877,470**

ASSUMPTIONS (%)

Deposit Growth	11.5	15.2	27.0	15.0	15.0
Advances Growth	21.9	38.0	38.0	20.0	16.0
Investments Growth	-2.5	-5.3	12.0	15.0	15.0
Dividend	50.0	50.0	60.0	70.0	80.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg.Yield-Earn.Assets	7.6	7.2	7.7	7.8	7.9
Avg. Cost-Int. Bear. Liab.	4.4	4.2	5.1	5.5	5.7
Interest Spread	3.2	3.0	2.6	2.3	2.2
Net Interest Margin	3.5	3.3	3.0	2.8	2.7
Profitability Ratios (%)					
RoE	12.6	12.3	12.8	13.9	14.9
RoA	0.8	0.8	0.8	0.8	0.9
Int. Expended/Int.Earned	53.7	54.6	61.1	64.2	65.3
Other Inc./Net Income	30.5	27.0	25.5	24.2	23.2
Efficiency Ratios (%)					
Op. Exps./Net Income	46.3	54.0	50.2	51.3	50.9
Empl. Cost/Op. Exps.	69.7	63.9	63.7	61.6	59.0
Busi. per Empl.(Rs m)	31.6	35.9	47.7	61.2	74.1
NP per Empl. (Rs mln)	0.2	0.2	0.3	0.4	0.4
Asset-Liability Profile (%)					
Adv./Deposit Ratio	53.4	64.0	69.5	72.5	73.2
Invest./Deposit Ratio	45.6	37.5	33.1	33.1	33.1
G-Sec/Invest. Ratio	79.2	74.8	74.8	74.8	74.8
Gross NPAs to Adv.	7.2	3.9	3.1	2.8	2.8
Net NPAs to Adv.	1.4	0.9	0.5	0.5	0.4
CAR	12.6	13.3	11.4	10.8	12.8
Tier 1 (inc. IFR)	8.2	10.3	8.5	8.0	7.9

VALUATION

Book Value (Rs)	182.2	207.4	229.3	255.8	288.0
Price-BV (x)	1.1	1.0	0.9	0.8	0.7
Adjusted BV (Rs)	168.5	198.2	221.6	247.7	278.9
Price-ABV (x)	1.2	1.0	0.9	0.8	0.7
EPS (Rs)	23.0	22.6	28.9	34.7	41.5
EPS Growth (%)	-30.0	-1.6	27.9	19.9	19.7
Price-Earnings (x)	8.7	8.9	6.9	5.8	4.8
OPS (Rs)	78.2	55.6	68.2	74.7	84.3
OPS Growth (%)	-7.4	-28.9	22.6	9.5	12.9
Price-OP (x)	2.6	3.6	2.9	2.7	2.4

E: MOSt Estimates

Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	BOI IN
	REUTERS CODE
S&P CNX: 3,634	BOI.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs154

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	26.3	33.5	39.6	47.2
OP (Rs b)	17.0	21.2	23.6	28.0
NP (Rs b)	7.0	9.3	11.4	14.3
EPS (Rs)	14.4	19.0	23.4	29.3
EPS Growth (%)	106.0	33.1	22.4	25.4
BV/Share (Rs)	98.0	112.6	130.3	152.9
P/E (x)	10.7	8.1	6.6	5.3
P/ BV (x)	1.6	1.4	1.2	1.0
ABV (Rs)	85.0	106.2	125.8	149.0
P/ ABV (x)	1.8	1.5	1.2	1.0
RoE (%)	14.9	17.6	18.8	20.3
RoA (%)	0.7	0.8	0.8	0.9

KEY FINANCIALS	
Shares Outstanding (m)	488.1
Market Cap. (Rs b)	75.2
Market Cap. (US$ b)	1.7
Past 3 yrs. NII Growth (%)	8.9
Past 3 yrs. NP Growth (%)	-6.3
Dividend Payout (%)	23.7
Dividend Yield (%)	2.2
P/E to Growth (x)	0.3

STOCK DATA	
52-Week Range	214/80
Major Shareholders (%) (December 2006)	
Promoters	69.5
Domestic Institutions	7.1
FIIs/FDIs	14.8
Others	8.6
Average Daily Turnover	
Volume ('000 shares)	2,204.5
Value (Rs million)	343.3
1/6/12 Month Rel. Performance (%)	-2/-5/9
1/6/12 Month Abs. Performance (%)	-5/-5/16

Focusing on qualitative growth: BoI aims to achieve a steady 20-25% growth in its loan book and 18-20% growth in deposits. The management has stated that it is being selective in loan book expansion so as to maintain asset quality.

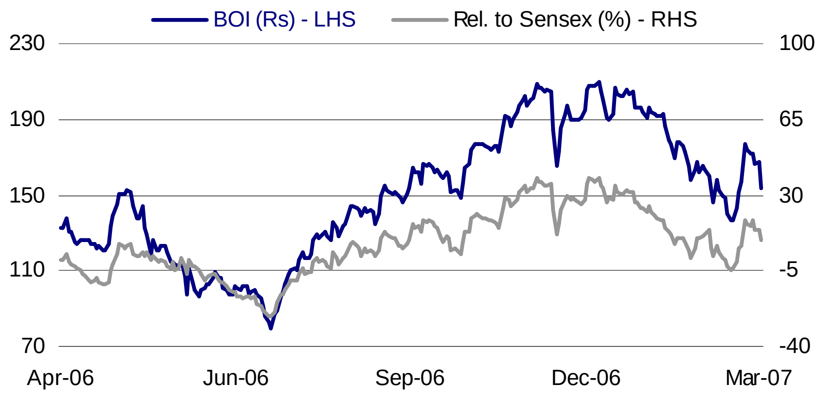
Cost to income ratio to decline post FY08: BoI is expensing the costs related to its CBS, resulting in higher C-I ratio. The management does not expect its technology related costs to increase post FY08, resulting in a decline in cost to income ratio.

Margins stable as cost of funds is contained: Apart from lending rate hikes, BoI has been growing its retail and SME loan portfolio (which is high yielding). On the liabilities front, the key focus has been on raising CASA deposits, which has curtailed any sharp rise in its deposit costs.

Provisions to decline, resulting in higher profitability growth: BoI has been aggressively providing for NPAs in the last few years, impacting its profitability growth. With net NPAs <1%, we expect provisioning requirements to reduce.

Valuations reasonable; reiterate Buy: While we expect PAT to grow 22% in FY08 and 25% in FY09, we believe that the bank has enough levers for a positive surprise on earnings. BoI is only one of the larger state-owned banks wherein FIIs can participate. The stock trades at 5.3x FY09E EPS and 1.0x FY08E BV. We maintain **Buy**.

STOCK PERFORMANCE (1 YEAR)



Bank of India (BoI) has been witnessing consistent improvement across all business parameters – be it margins, asset quality, RoA or RoE. At the same time, it has aggressively taken up CBS implementation, costs for which are front-ended, and which would result lower expenses, going forward. We believe that the bank would be a beneficiary of low operating expenses, steady NII and margin growth, with very low risk on its AFS portfolio (85% of SLR securities are in HTM). Further, BoI is one of the larger state-owned banks wherein FIIs can participate.

Focusing on qualitative growth

BoI aims to achieve a steady 20-25% growth in its loan book and 18-20% growth in deposits. It is concentrating on quality loans, with a focus on SME, agriculture and retail, which would help realize reasonable margins. Also, the bank does not intend to raise resources at a high cost to fund balance sheet growth. During 3QFY07, BoI's loan and deposit growth was below industry average (deposits grew by 21%, loans grew by 28%), as the bank focused on margins as against volumes.

GROWTH YOY (%)

	DEC-05	FY06	DEC-06
Indian Deposits	11.8	18.3	22.3
Foreign Deposits	24.1	23.3	17.7
Global Deposits	14.0	19.2	21.4
Indian Advances	17.9	23.3	29.6
Foreign Advances	5.0	-5.0	22.7
Global Advances	14.9	16.7	28.1

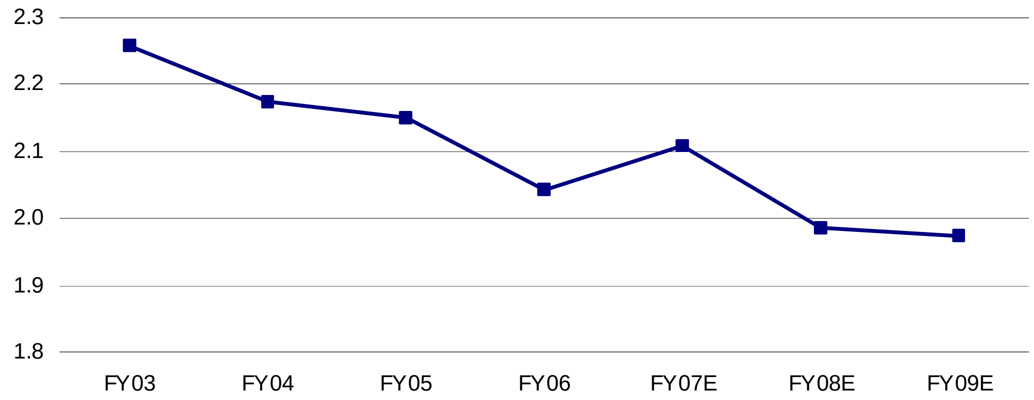
Source: Company/ Motilal Oswal Securities

While 28% loan growth has been below industry standards, the management has stated that it has been selective in loan book expansion so as to maintain asset quality and improve yields by shedding low yielding loans. Within loans, retail is growing fast, recording an increase of 56% and currently constitutes over 32% of non-food advances compared to 26.5% in 3QFY06. Advances to the agricultural sector registered 18% growth to Rs101b, while SME credit increased by 18% YoY to Rs173b in 3QFY07.

Cost to income ratio to decline post FY08

BoI is probably the only bank, which is expensing the costs related to its CBS, resulting in higher C-I ratio. The management does not expect its technology related costs to increase post FY08. By end-FY07, the bank is likely to have at least 1,200 branches under CBS (900 branches currently under CBS track 66% of the business), which would account for 80% of the business. Further, as employee retirements are likely to be considerable, these expenses are also likely to grow only marginally (5-7%).

OPERATING COSTS / AVERAGE ASSETS (%)



Source: Company/ Motilal Oswal Securities

Margins improving, as yields expand while cost of funds is contained

Excluding amortization expenses, global spreads increased to 3.2% in 3QFY07 from 3% in 3QFY06. The expansion was the result of a 47bp increase in the yield on funds to 8%. Cost of funds increased by just 32bp to 4.8% in 3QFY07 from 4.5% in 3QFY06. Domestically, spreads improved to 3.8% in 3QFY07 from 3.6% in 3QFY06.

Apart from lending rate hikes, the bank has been growing its retail and SME portfolio (which is high yielding) on the assets side. On the liabilities front, the key focus has been on raising CASA deposits, which has curtailed any sharp rise in its cost of funds.

GLOBAL SPREADS (%) (EXCLUDING AMORTIZATION EXPENSE)

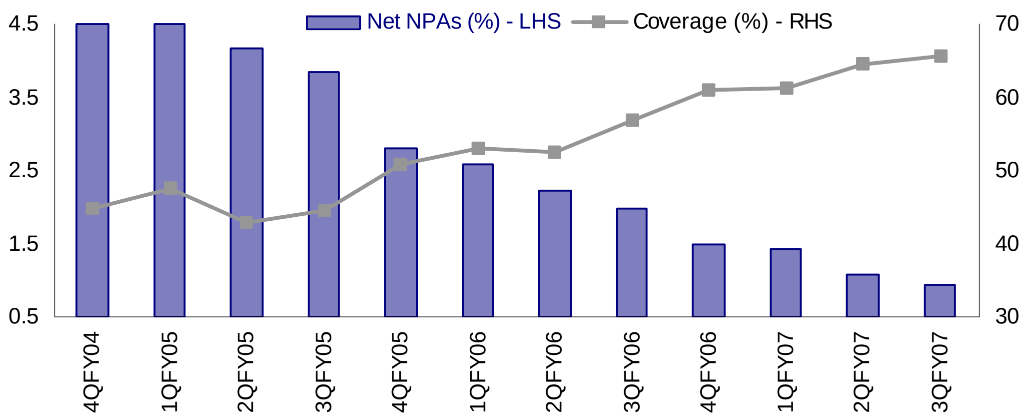
	9MFY06	FY06	9MFY07
Yield on Advances	7.65	7.58	8.43
Yield on Investments	7.04	7.15	7.28
Yield on Funds	7.25	7.40	7.89
Cost of Deposits	4.10	4.05	4.4
Cost of Funds	4.36	4.37	4.68
Global Spreads	2.89	3.03	3.21
Domestic Spread (%)			
Yield on Funds	7.89	7.95	8.36
Cost of Funds	4.47	4.40	4.66
Domestic Spreads	3.42	3.55	3.70

Source: Company/ Motilal Oswal Securities

Provisions to decline, resulting in higher profitability growth

BoI has been aggressively providing for NPAs in the last few years, which has also affected its profitability growth. BoI's asset quality has been improving steadily on back of higher provisions (net NPAs <1% in 3QFY07). With net NPAs <1%, we expect provisioning requirements to reduce considerably and earnings growth to remain strong.

TREND IN NET NPAS



Source: Company/ Motilal Oswal Securities

NPA MOVEMENT (RS M)

	9MFY05	FY06	9MFY06
Opening Gross NPA	**31,560**	**31,560**	**24,790**
Total Reduction	**7,840**	**13,860**	**8,940**
Recovery	4,310	7,210	4,520
Upgradation	560	1,420	930
Write-off	2,970	5,230	3,490
Slippages	**4,320**	**7,090**	**6,010**
Net Reduction	3,520	6,770	2,930
Closing Gross NPA	**28,040**	**24,790**	**21,860**
Total Nettable Credits	15,910	15,100	14,370
NPA Provision	13,980	13,320	12,770
Other Credit	1,930	1,780	1,600
Net NPA	**12,140**	**9,690**	**7,480**
Gross NPA Ratio (%)	4.5	3.7	2.7
Net NPA Ratio (%)	2.0	1.5	1.0
Provision Cover Ratio (%)	56.7	60.9	65.8

Source: Company/ Motilal Oswal Securities

Capital adequacy at 11.8%; to raise capital in FY08

BoI's CAR is currently at 11.8%, with tier-I at 6.2%. During the quarter ended September 2006, the bank raised upper tier-II capital of Rs7.3b in the domestic market and Rs11.1b in the foreign market. The management mentioned that BoI could still raise Rs8b through perpetual debt (~90bp of tier-I). While the management has stated that it does not intend to dilute equity in FY08, we believe that it might have to raise capital during 2HFY08.

Valuation and view

BoI has been witnessing consistent improvement across all business parameters. We believe that the bank would be a beneficiary of low operating expenses, steady NII and margin growth, with very low risk on its AFS portfolio. While we expect PAT to grow 22% in FY08 and 25% in FY09, we believe that the bank has enough levers for a positive surprise on earnings. The stock trades at 5.3x FY09E EPS and 1.0x FY08E BV. We maintain our **Buy** recommendation.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	60,315	70,287	89,863	106,994	126,275
Interest Expended	37,946	43,967	56,327	67,358	79,057
Net Interest Income	**22,369**	**26,320**	**33,536**	**39,636**	**47,218**
Change (%)	*1.6*	*17.7*	*27.4*	*18.2*	*19.1*
Other Income	11,560	11,844	13,714	12,760	13,621
Net Income	**33,929**	**38,164**	**47,249**	**52,395**	**60,839**
Change (%)	*-15.0*	*12.5*	*23.8*	*10.9*	*16.1*
Operating Expenses	19,323	21,151	26,090	28,837	32,855
Operating Income	**14,606**	**17,012**	**21,159**	**23,558**	**27,984**
Change (%)	*-34.8*	*16.5*	*24.4*	*11.3*	*18.8*
Other Provisions	9,993	7,859	8,200	7,700	8,100
PBT	**4,613**	**9,154**	**12,959**	**15,858**	**19,884**
Tax	1,210	2,142	3,629	4,440	5,567
Tax Rate (%)	*26.2*	*23.4*	*28.0*	*28.0*	*28.0*
PAT	**3,403**	**7,012**	**9,331**	**11,418**	**14,316**
Change (%)	*-66.3*	*106.0*	*33.1*	*22.4*	*25.4*
Proposed Dividend	976	1,660	1,953	2,441	2,929

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,881	4,881	4,881	4,881	4,881
Reserves & Surplus	39,767	44,507	51,554	60,116	71,005
Net Worth	**44,649**	**49,389**	**56,435**	**64,997**	**75,886**
Deposits	788,214	939,320	1,136,577	1,307,064	1,503,123
Change (%)	*11.0*	*19.2*	*21.0*	*15.0*	*15.0*
Borrowings	79,605	88,425	110,531	123,795	138,650
Other Liabilities & Prov.	37,314	45,159	49,675	54,643	60,107
Total Liabilities	**949,782**	**1,122,293**	**1,353,219**	**1,550,499**	**1,777,767**
Current Assets	75,263	114,021	129,161	146,015	166,109
Investments	**286,863**	**317,818**	**375,025**	**431,278**	**495,970**
Change (%)	*5.6*	*10.8*	*18.0*	*15.0*	*15.0*
Advances	**555,289**	**651,727**	**808,142**	**929,363**	**1,068,768**
Change (%)	*21.1*	*17.4*	*24.0*	*15.0*	*15.0*
Net Fixed Assets	8,142	8,100	7,813	7,456	6,895
Other Assets	24,225	30,628	33,079	36,386	40,025
Total Assets	**949,782**	**1,122,293**	**1,353,219**	**1,550,499**	**1,777,767**

ASSUMPTIONS (%)

Deposit Growth	11.0	19.2	21.0	15.0	15.0
Advances Growth	21.1	17.4	24.0	15.0	15.0
Investments Growth	5.6	10.8	18.0	15.0	15.0
Dividend	20.0	34.0	40.0	50.0	60.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg.Yield-Earn. Assets	7.0	7.0	7.5	7.5	7.7
Avg. Cost-Int. Bear. Liab.	4.6	4.6	5.0	5.0	5.1
Interest Spread	2.4	2.4	2.5	2.5	2.6
Net Interest Margin	2.6	2.6	2.8	2.8	2.9
Profitability Ratios (%)					
RoE	8.0	14.9	17.6	18.8	20.3
RoA	0.4	0.7	0.8	0.8	0.9
Int. Expended/Int.Earned	62.9	62.6	62.7	63.0	62.6
Other Inc./Net Income	34.1	31.0	29.0	24.4	22.4
Efficiency Ratios (%)					
Op. Exps./Net Income	57.0	55.4	55.2	55.0	54.0
Empl. Cost/Op. Exps.	65.4	62.8	61.2	59.1	57.7
Busi. per Empl. (Rs m)	29.5	34.8	42.3	50.8	59.3
NP per Empl. (Rs lac)	0.8	1.7	2.2	2.8	3.5
Asset-Liability Profile (%)					
Adv./Deposit Ratio	70.4	69.4	71.1	71.1	71.1
Invest./Deposit Ratio	36.4	33.8	33.0	33.0	33.0
Gross NPAs to Adv.	5.5	3.7	3.0	2.6	2.4
Net NPAs to Adv.	2.8	1.5	0.6	0.4	0.3
CAR	11.5	10.8	10.2	10.2	10.5
Tier 1	7.1	6.8	6.2	6.3	6.5

VALUATION

Book Value (Rs)	88.1	98.0	112.6	130.3	152.9
Price-BV (x)	1.7	1.6	1.4	1.2	1.0
Adjusted BV (Rs)	67.4	85.0	106.2	125.8	149.0
Price-ABV (x)	2.3	1.8	1.5	1.2	1.0
EPS (Rs)	7.0	14.4	19.1	23.4	29.3
EPS Growth (%)	-66.3	106.0	33.1	22.4	25.4
Price-Earnings (x)	22.1	10.7	8.1	6.6	5.3
OPS (Rs)	29.9	34.9	43.3	48.3	57.3
OPS Growth (%)	-34.8	16.5	24.4	11.3	18.8
Price-OP (x)	5.2	4.4	3.6	3.2	2.7

E: MOSt Estimates

Union Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	UNBK IN
	REUTERS CODE
S&P CNX: 3,634	UNBK.BO

2 April 2007

Buy

Previous Recommendation: Buy

Rs96

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	23.7	26.6	30.8	35.4
OP (Rs b)	16.0	18.5	20.4	23.5
NP (Rs b)	6.8	8.1	9.5	11.3
EPS (Rs)	13.4	16.1	18.9	22.3
EPS Growth (%)	-14.5	20.1	17.8	18.1
BV/Share (Rs)	81.0	91.8	104.9	120.8
P/E (x)	7.2	6.0	5.1	4.3
P/ BV (x)	1.2	1.0	0.9	0.8
ABV (Rs)	70.3	82.4	96.8	112.7
P/ ABV (x)	1.4	1.2	1.0	0.9
RoE (%)	16.5	16.8	17.6	18.3
RoA (%)	0.8	0.8	0.9	0.9

KEY FINANCIALS	
Shares Outstanding (m)	505.1
Market Cap. (Rs b)	48.5
Market Cap. (US$ b)	1.1
Past 3 yrs. NII Growth (%)	16.6
Past 3 yrs. NP Growth (%)	6.9
Dividend Payout (%)	29.9
Dividend Yield (%)	4.2
P/E to Growth (x)	0.3

STOCK DATA	
52-Week Range	142/81
Major Shareholders (%) (December 2006)	
Promoters	55.4
Domestic Institutions	9.1
FIIs/FDIs	19.7
Others	15.8
Average Daily Turnover	
Volume ('000 shares)	2,204.5
Value (Rs million)	343.3
1/6/12 Month Rel. Performance (%)	4/-29/-29
1/6/12 Month Abs. Performance (%)	0/-29/-21

Strong, well-spread branch network: Union Bank of India (UBI) has about 2,200 branches, spread across the country. 100% branch computerization, fast transition to the CBS platform (currently 77% of the business) is helping the bank to improve customer service.

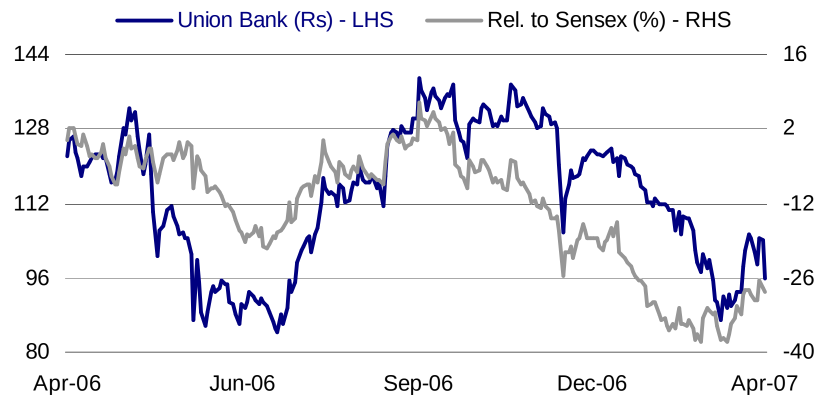
CASA ratio, margins likely to improve improving: A conscious sequential slowdown in growth in 3QFY07 helped the bank to improve its CASA ratio and increase the proportion of retail deposits Margins have begun improving We believe that UBI would further improve its NIMs, following its selective growth strategy.

Fee income growth is strong: It has witnessed strong fee income growth in the last couple of quarters (47% YoY in 2QFY07 and 43% YoY in 3QFY07). Focus on third-party product distribution business coupled with overall business growth is helping the bank to ramp up its fee income base.

Asset quality on an improving trend: With gross NPAs at 3.27% and net NPAs at 1.12%, the bank's asset quality is not only healthy but is also improving quarter on quarter.

Valuations attractive; Buy: We expect UBI to post RoE of 17.3% in FY07 and 18.1% in FY08. We estimate EPS at Rs16.7 for FY07 and Rs19.9 for FY08, and book value at Rs93/share for FY07 and Rs108/share for FY08. The stock trades at 1x FY08E BV and 5.6x FY08E EPS. We maintain our **Buy** recommendation.

STOCK PERFORMANCE (1 YEAR)

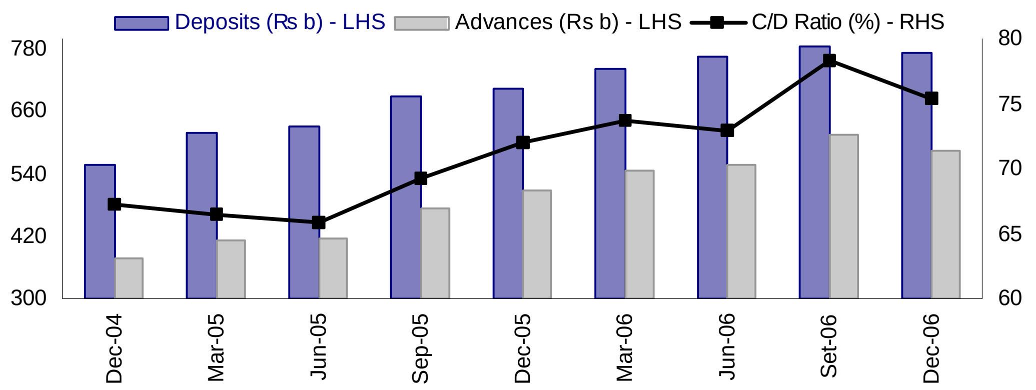


Union Bank of India (UBI) has about 2,200 branches, spread across the country. It has already completed 100% branch computerization, and has ~80% of its business under CBS platform. It is evenly distributed throughout India and has a balance sheet strength of Rs1t.

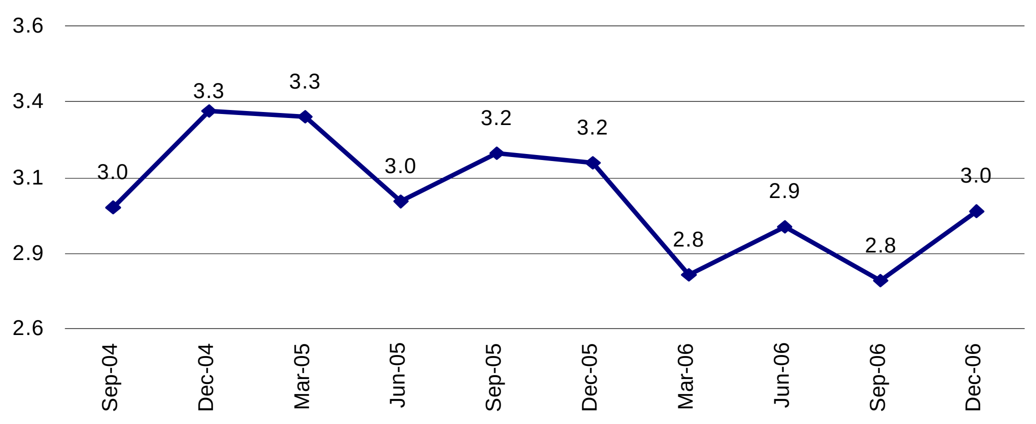
Slowing down growth; resulting in better margins

Union Bank has been one of the fastest growing PSU bank and had been relying on bulk deposits while funding this loan growth, which had resulted in margins declining for the bank. However, a conscious sequential slowdown in growth in 3QFY07 helped the bank to improve its CASA ratio (35% as at December 2006) and increase the proportion of retail deposits (81% of total deposits as at December 2006). After a declining trend in NIMs for the bank, 3Q, witnessed an expansion in margins. With the current strategy of growing selectively and not chasing continuing, we expect margins to improve further for Union Bank of India.

DEPOSITS AND ADVANCES GROWTH



TREND IN NIMS (%)

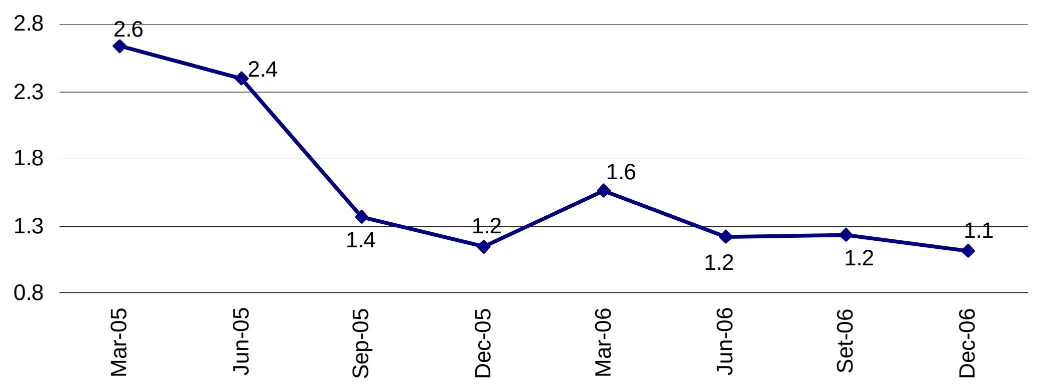


Source: Company/ Motilal Oswal Securities

Fee income growing at a steady pace: The bank's thrust on growing fee income is yielding results. It has witnessed strong fee income growth in the last couple of quarters (47% YoY in 2QFY07 and 43% YoY in 3QFY07). Focus on third-party product distribution business coupled with overall business growth is helping the bank to ramp up its fee income base.

Asset quality on an improving trend: With gross NPAs at 3.27% and net NPAs at 1.12%, the bank's asset quality is not only healthy but is also improving quarter on quarter. Here again, the bank has become extremely selective over the last few quarters in terms of its lending. Currently the management does not perceive any big risks to its asset quality.

TREND IN NET NPAS



Source: Company/ Motilal Oswal Securities

CAR has increased and is at comfortable levels

Its public issue in FY06, followed by perpetual bonds of Rs3b has helped the bank to increase tier-I capital to 8.1% and overall CAR to 13.2% (up from 10.9% in 3QFY06). Further, as the bank has slowed down its balance sheet growth, CAR is comfortable, currently. In our view, it gives the bank enough room to grow its assets without any pressure for capital funds in the near future. Further as the bank intends to grow selectively, we do not anticipate any dilution over the next 12-18 months.

Valuations attractive; Maintain Buy

We expect UBI to post RoE of 17.3% in FY07 and 18.1% in FY08. We estimate EPS at Rs16.7 for FY07 and Rs19.9 for FY08, and book value at Rs93/share for FY07 and Rs108/share for FY08. The stock trades at 0.8x FY09E BV and 4.5x FY09E EPS. The dividend yield would be ~5%. We maintain our **Buy** recommendation.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	49,698	58,638	72,048	85,735	100,636
Interest Expended	29,052	34,894	45,480	54,951	65,249
Net Interest Income	**20,646**	**23,743**	**26,567**	**30,783**	**35,387**
Change (%)	*18.9*	*15.0*	*11.9*	*15.9*	*15.0*
Other Income	7,661	6,251	7,530	7,156	7,852
Net Income	**28,307**	**29,994**	**34,098**	**37,939**	**43,239**
Change (%)	*10.2*	*6.0*	*13.7*	*11.3*	*14.0*
Operating Expenses	12,575	14,024	15,596	17,578	19,774
Operating Income	15,732	15,970	18,501	20,361	23,465
Change (%)	*6.1*	*1.5*	*15.9*	*10.1*	*15.2*
Other Provisions	9,616	7,024	6,400	7,100	7,800
PBT	**6,116**	**8,946**	**12,101**	**13,261**	**15,665**
Tax	-1,075	2,195	3,993	3,713	4,386
Tax Rate (%)	*-17.6*	*24.5*	*33.0*	*28.0*	*28.0*
PAT	**7,191**	**6,752**	**8,108**	**9,548**	**11,279**
Change (%)	*1.0*	*-6.1*	*20.1*	*17.8*	*18.1*
Proposed Dividend	1,821	2,020	2,273	2,526	2,778

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,601	5,051	5,051	5,051	5,051
Reserves & Surplus	31,543	40,530	45,979	52,572	60,600
Net Worth	**36,144**	**45,581**	**51,030**	**57,623**	**65,651**
Deposits	618,306	740,940	852,081	990,544	1,149,031
Change (%)	*22.3*	*19.8*	*15.0*	*16.3*	*16.0*
Borrowings	20,210	39,745	48,488	58,186	69,823
Other Liabilities & Prov.	49,473	64,992	82,540	104,825	133,128
Total Liabilities	**724,131**	**891,258**	**1,034,139**	**1,211,179**	**1,417,634**
Current Assets	65,721	63,905	69,304	88,616	126,011
Investments	227,927	259,175	298,051	342,758	394,172
Change (%)	*1.6*	*13.7*	*15.0*	*15.0*	*15.0*
Advances	401,051	533,800	629,883	740,113	854,831
Change (%)	*36.3*	*33.1*	*18.0*	*17.5*	*15.5*
Net Fixed Assets	**8,238**	**8,104**	**7,998**	**7,898**	**7,648**
Other Assets	21,196	26,275	28,902	31,793	34,972
Total Assets	**724,132**	**891,258**	**1,034,139**	**1,211,179**	**1,417,634**

ASSUMPTIONS (%)

Deposit Growth	22.3	19.8	15.0	16.3	16.0
Advances Growth	36.3	33.1	18.0	17.5	15.5
Investments Growth	1.6	13.7	15.0	15.0	15.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	35.0	40.0	45.0	50.0	55.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.0	7.6	7.8	8.0	8.1
Avg. Cost-Int. Bear. Liab.	5.0	4.9	5.4	5.6	5.8
Interest Spread	2.9	2.7	2.4	2.3	2.3
Net Interest Margin	3.3	3.1	2.9	2.9	2.8
Profitability Ratios (%)					
RoE	21.5	16.5	16.8	17.6	18.3
RoA	1.1	0.8	0.8	0.9	0.9
Int. Expended/Int.Earned	58.5	59.5	63.1	64.1	64.8
Other Inc./Net Income	27.1	20.8	22.1	18.9	18.2
Efficiency Ratios (%)					
Op. Exps./Net Income	44.4	46.8	45.7	46.3	45.7
Empl. Cost/Op. Exps.	64.1	61.8	60.7	59.3	58.5
Busi. per Empl. (Rs m)	34.6	45.1	55.4	65.8	78.1
NP per Empl. (Rs lac)	2.8	2.7	3.3	3.9	4.7
Efficiency Ratios (%)					
Adv./Deposit Ratio	64.9	72.0	73.9	74.7	74.4
Invest./Deposit Ratio	36.9	35.0	35.0	34.6	34.3
G-Sec/Invest. Ratio	72.0	78.3	78.3	78.3	78.3
Gross NPAs to Adv.	5.0	3.8	3.4	3.1	3.0
Net NPAs to Adv.	2.6	1.6	1.2	0.8	0.7
CAR	12.1	11.4	9.5	9.3	10.5
Tier 1	*6.1*	*7.3*	*6.3*	*6.1*	*5.8*

VALUATION

Book Value (Rs)	68.2	81.0	91.8	104.9	120.8
Price-BV (x)	1.4	1.2	1.0	0.9	0.8
Adjusted BV (Rs)	53.3	70.3	82.4	96.8	112.7
Price-ABV (x)	1.8	1.4	1.2	1.0	0.9
EPS (Rs)	15.6	13.4	16.1	18.9	22.3
EPS Growth (%)	1.0	-14.5	20.1	17.8	18.1
Price-Earnings (x)	6.1	7.2	6.0	5.1	4.3
OPS (Rs)	34.2	31.6	36.6	40.3	46.5
OPS Growth (%)	6.1	-7.5	15.9	10.1	15.2
Price-OP (x)	2.8	3.0	2.6	2.4	2.1

E: MOSt Estimates

Syndicate Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	SNDB IN
	REUTERS CODE
S&P CNX: 3,634	SBNK.BO

2 April 2007

Buy

Previous Recommendation: Buy

Rs59

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	18.8	21.2	25.0	28.2
OP (Rs b)	10.4	12.5	15.3	17.7
NP (Rs b)	5.4	7.3	8.1	8.9
EPS (Rs)	10.3	13.9	15.5	17.1
EPS Growth (%)	20.4	35.3	11.7	10.3
BV/Share (Rs)	50.5	61.2	73.2	86.3
P/E (x)	5.7	4.2	3.8	3.4
P/BV (x)	1.2	1.0	0.8	0.7
ABV (Rs)	46.6	56.8	67.1	77.5
P/ABV (x)	1.3	1.0	0.9	0.8
RoE (%)	21.3	23.3	21.9	20.5
RoA (%)	0.9	1.0	0.9	0.8

KEY FINANCIALS	
Shares Outstanding (m)	522.0
Market Cap. (Rs b)	30.8
Market Cap. (US$ b)	0.7
Past 3 yrs. NII Growth (%)	15.8
Past 3 yrs. NP Growth (%)	16.0
Dividend Payout (%)	24.3
Dividend Yield (%)	4.2
P/E to Growth (x)	0.2

STOCK DATA	
52-Week Range	103/47
Major Shareholders (%) (December 2006)	
Promoters	66.5
Domestic Institutions	6.4
FIIs/FDIs	11.5
Others	15.6
Average Daily Turnover	
Volume ('000 shares)	2,086.7
Value (Rs million)	153.9
1/6/12 Month Rel. Performance (%)	-11/-36/-44
1/6/12 Month Abs. Performance (%)	-14/-35/-36

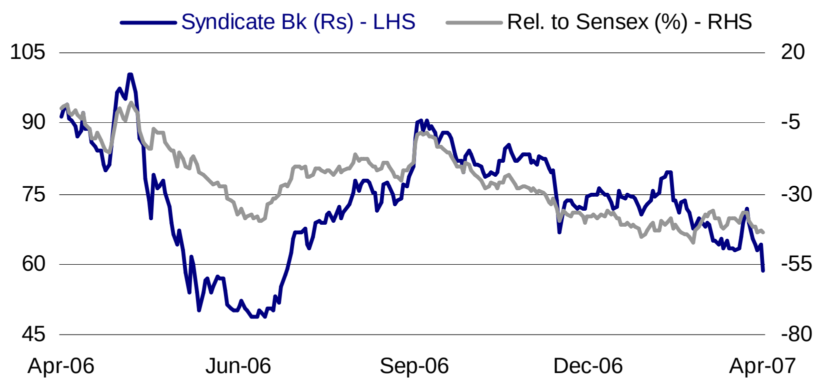
Huge intake of bulk deposits had led to margin decline: Syndicate Bank had resorted to huge bulk borrowings in order to grow its balance sheet. This had resulted in margins declining in 1QFY07 and 2QFY07.

Margins to improve, as bulk deposit intake slows down: In 3QFY07, the bank went slow on bulk deposits. There was a QoQ improvement in margins. We expect a further improvement in margins and strong earnings growth over the next couple of quarters.

Net NPAs comfortable at 0.9%: Asset quality continues to be comfortable, with net NPAs at 0.9%. The management expects strong asset quality to continue, as recoveries are likely to remain strong.

Valuations are very attractive; Buy: The stock has underperformed the sector over the last few quarters. Valuations at 0.7x FY09E BV and 3.4x FY08E EPS are attractive, and there is plenty of room for FIIs to invest. FII holding in the bank is just 11% as at December 2006. We upgrade our recommendation to **Buy**, with a target price of Rs95.

STOCK PERFORMANCE (1 YEAR)



Margins set to improve going forward

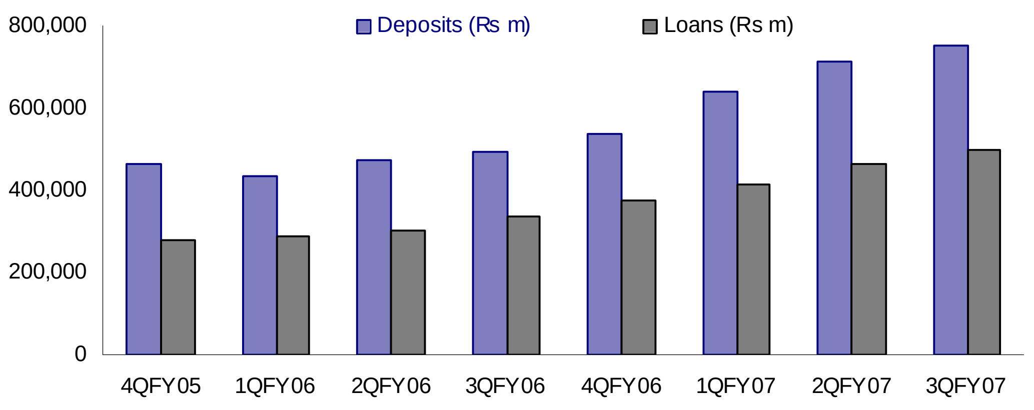
Syndicate Bank had resorted to huge bulk borrowings in 1QFY07 and 2QFY07. It deployed these resources in short-term loans and as loan disbursal takes time, the bank's margins had suffered in the interim. However, as the incremental term deposit growth has slowed down (31% QoQ in 1QFY07; 15% QoQ in 2QFY07 and 7% QoQ in 3QFY07), margins have begun improving. Also, the bank is shying away from short-term loans. In 3QFY07, margins improved by 12bp over 2QFY07 to 2.7%, and we expect further improvement in 4QFY07.

The bank had contracted its bulk deposits at a competitive rate and at the right time – interest rates in 1QFY07 and 2QFY07 were lower. It is ideally placed as far as liquidity is concerned and is not quoting aggressive rates to garner deposits, currently. As most of the bulk deposits mature post March 2007, it is unlikely to have further issues on deposit cost. At the same time, as the bank takes lending rate hikes and deploys short-term deposits in long-term loans, margins should improve.

Balance sheet continues to see robust growth

On the back of huge accumulation of bulk deposits, balance sheet growth continues to remain strong for Syndicate Bank. Deposits were up 52% YoY as at December 2006 and advances grew 48% YoY. CASA ratio declined to 29% in 3QFY07 from 38% in 3QFY06, as bulk / term deposits grew faster.

DEPOSITS AND ADVANCES FOR LAST 8 QUARTERS

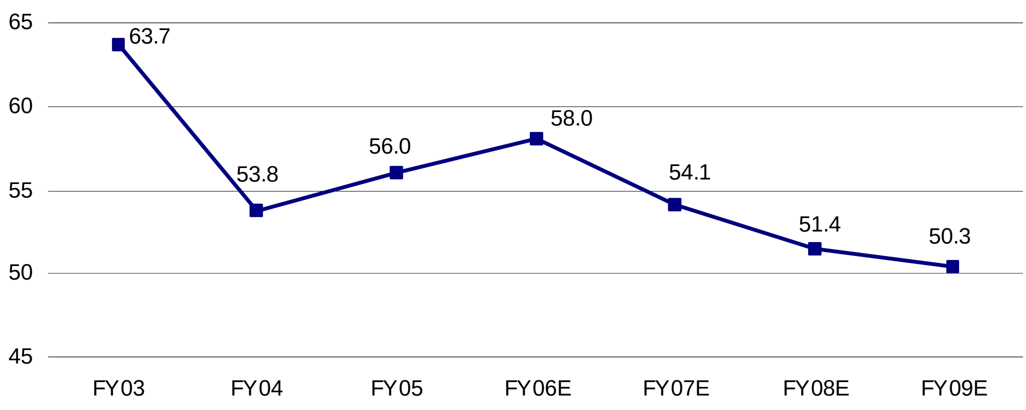


Source: Company/ Motilal Oswal Securities

Cost / Income ratio improving

One of the key arguments put up by the management while putting in place its strategy of growing its balance sheet, was that it had a higher C/I ratio and low labor productivity. Over the last few quarters, as it has been growing its balance sheet through various sources, it has improved its labor productivity and at the same time its C/I ratio has been declining.

COST / INCOME RATIO (%)



Source: Company/ Motilal Oswal Securities

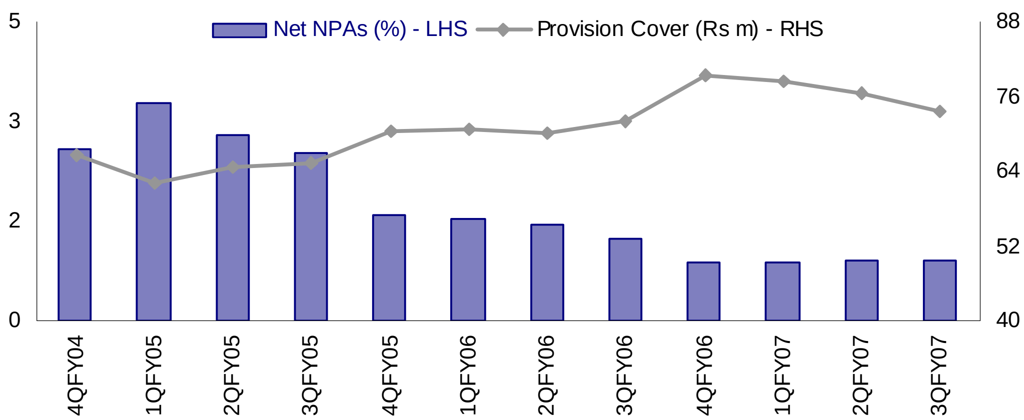
Over the last three quarters, Syndicate Bank has also aggressively implemented the CBS platform. The number of CBS branches increased from 351 as on 31 December 2005 to 1,227 currently, covering 84% of business. While the number of branches has risen to 2,113 from 1,914 branches a year ago, the number of ATMs increased to 558 from 326.

We expect operating expenses growth to be moderate going forward. Syndicate Bank's C/I ratio has further room to improve and could positively impact profitability.

Net NPAs at 0.9%

Asset quality continues to be comfortable, with net NPAs at 0.9%. The management expects strong asset quality to continue, as recoveries are likely to remain strong. While net NPAs had increased 10% QoQ in 3QFY07, as the bank recognized some accounts as NPAs, the management has guided very strong recoveries in 4QFY07 and FY08. NPAs are likely to trend downwards as we move forward.

TREND IN NET NPA

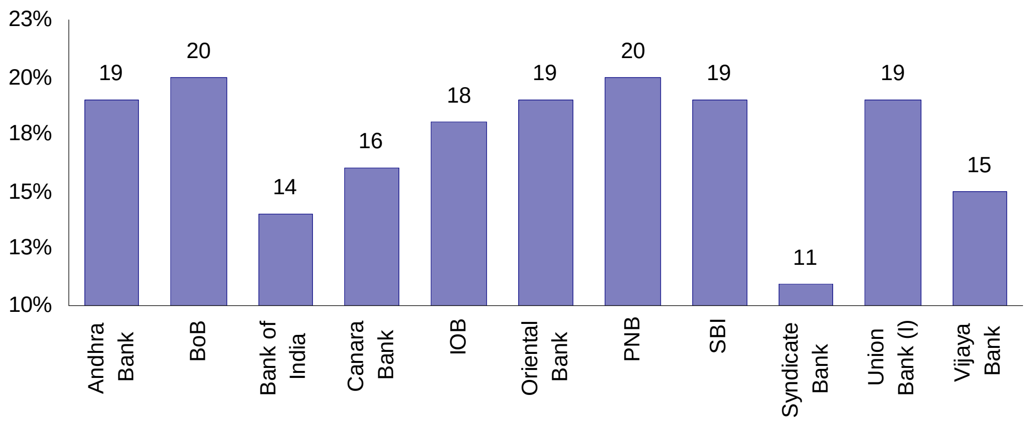


Source: Company/ Motilal Oswal Securities

Plenty of room for FIIs to buy

With FII holding only at 11%, Syndicate Bank is one of the two (the other being Bank of India) ~US$1b state-owned banks, which FIIs can buy.

FII HOLDING IN VARIOUS BANKS (%)



Source: Company/ Motilal Oswal Securities

Valuations are very attractive; Buy

The stock has underperformed the sector over the last few quarters. Valuations at 0.7x FY09E BV and 3.4x FY08E EPS are attractive, and there is plenty of room for FIIs to invest. We upgrade our recommendation to **Buy**, with a target price of Rs95.

Concerns

Would require capital, if current growth rates persist: The bank's capital adequacy stood at 11.2% as at 3QFY07. Tier-I ratio was 6.4%. While the bank has enough room to raise capital through innovative instruments, given the strong balance sheet growth, we anticipate that the bank would require capital in the next 12 months.

Strategy is relatively riskier: We perceive the current strategy of growing its balance sheet aggressively a bit risky and could lead to asset quality problems if the economy slows down.

INCOME STATEMENT					(RS MILLION)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	37,576	40,504	59,736	77,539	93,140
Interest Expended	20,638	21,696	38,546	52,552	64,971
Net Interest Income	16,938	18,809	21,190	24,987	28,169
Change (%)	*18.5*	*11.0*	*12.7*	*17.9*	*12.7*
Other Income	5,646	5,916	5,927	6,292	7,189
Net Income	**22,584**	**24,725**	**27,117**	**31,279**	**35,358**
Change (%)	*2.4*	*9.5*	*9.7*	*15.4*	*13.0*
Operating Expenses	12,642	14,348	14,625	15,983	17,706
Operating Income	**9,942**	**10,376**	**12,492**	**15,296**	**17,653**
Change (%)	*-2.5*	*4.4*	*20.4*	*22.5*	*15.4*
Other Provisions	5,608	4,861	4,428	4,900	5,400
PBT	**4,334**	**5,515**	**8,064**	**10,396**	**12,253**
Tax	305	150	806	2,287	3,308
Tax Rate (%)	*7.0*	*2.7*	*10.0*	*22.0*	*27.0*
PAT	**4,029**	**5,365**	**7,257**	**8,109**	**8,944**
Change (%)	*-7.2*	*33.2*	*35.3*	*11.7*	*10.3*
Proposed Dividend	1,067	1,305	1,435	1,566	1,827

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,720	5,220	5,220	5,220	5,220
Reserves & Surplus	17,265	23,116	28,694	34,972	41,779
Net Worth	**21,985**	**28,336**	**33,914**	**40,191**	**46,998**
Deposits	462,946	536,240	777,548	894,180	1,019,365
Change (%)	*8.7*	*15.8*	*45.0*	*15.0*	*14.0*
Borrowings	10,458	20,673	25,841	32,301	40,376
Other Liabilities & Prov.	25,706	25,519	30,623	36,747	44,097
Total Liabilities	521,094	610,768	867,926	1,003,420	1,150,837
Current Assets	30,696	52,135	63,150	70,492	75,540
Investments	203,707	172,691	241,768	275,615	314,201
Change (%)	*13.7*	*-15.2*	*40.0*	*14.0*	*14.0*
Advances	267,292	364,662	539,700	631,449	732,481
Change (%)	*29.5*	*36.4*	*48.0*	*17.0*	*16.0*
Net Fixed Assets	3,813	4,193	4,513	4,813	5,038
Other Assets	15,586	17,086	18,795	21,050	23,576
Total Assets	**521,094**	**610,768**	**867,926**	**1,003,420**	**1,150,837**

ASSUMPTIONS					(%)
Deposit Growth	8.7	15.8	45.0	15.0	14.0
Advances Growth	29.5	36.4	48.0	17.0	16.0
Investments Growth	13.7	-15.2	40.0	14.0	14.0
Dividend	22.6	25.0	27.5	30.0	35.0

E: MOSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.9	7.5	8.3	8.4	8.8
Avg. Cost-Int. Bear. Liab.	4.6	4.2	5.7	6.1	6.5
Interest Spread	3.4	3.2	2.6	2.4	2.2
Net Interest Margin	3.6	3.5	2.9	2.7	2.6
Profitability Ratios (%)					
RoE	19.6	21.3	23.3	21.9	20.5
RoA	0.8	0.9	1.0	0.9	0.8
Int. Expended/Int.Earned	54.9	53.6	64.5	67.8	69.8
Other Inc./Net Income	25.0	23.9	21.9	20.1	20.3
Efficiency Ratios (%)					
Op. Exps./Net Income	56.0	58.0	53.9	51.1	50.1
Empl. Cost/Op. Exps.	76.0	72.3	68.1	66.1	64.8
Busi. per Empl. (Rs m)	27.4	33.1	46.0	62.0	75.2
NP per Empl. (Rs lac)	1.6	2.2	3.0	3.5	4.1
Asset-Liability Profile (%)					
Adv./Deposit Ratio	57.7	68.0	69.4	70.6	71.9
Invest./Deposit Ratio	44.0	32.2	31.1	30.8	30.8
G-Sec/Invest. Ratio	92.4	90.1	90.1	90.1	90.1
Gross NPAs to Adv.	5.2	4.0	3.1	3.2	3.4
Net NPAs to Adv.	1.6	0.9	0.7	0.8	1.0
CAR	10.7	11.7	10.4	10.0	9.5
Tier 1	*6.1*	*7.4*	*6.4*	*6.0*	*5.5*

VALUATION					
Book Value (Rs)	42.4	50.5	61.2	73.2	86.3
Price-BV (x)	1.4	1.2	1.0	0.8	0.7
Adjusted BV (Rs)	35.9	46.6	56.8	67.1	77.5
Price-ABV (x)	1.6	1.3	1.0	0.9	0.8
EPS (Rs)	8.5	10.3	13.9	15.5	17.1
EPS Growth (%)	-7.2	20.4	35.3	11.7	10.3
Price-Earnings (x)	6.9	5.7	4.2	3.8	3.4
OPS (Rs)	21.1	19.9	23.9	29.3	33.8
OPS Growth (%)	-2.5	-5.6	20.4	22.5	15.4
Price-OP (x)	2.8	3.0	2.5	2.0	1.7

E: MOSt Estimates

State Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	SBIN IN
	REUTERS CODE
S&P CNX: 3,634	SBI.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs930

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	156.4	158.1	181.9	206.3
OP (Rs b)	113.0	113.7	130.3	149.1
NP (Rs b)	44.1	40.6	46.3	53.7
EPS (Rs)	83.7	77.1	88.0	102.1
EPS Growth (%)	2.4	-8.0	14.2	16.1
BV/Share (Rs)	525.3	584.8	652.8	735.0
P/E (x)	11.1	12.1	10.6	9.1
P/BV (x)	1.8	1.6	1.4	1.3
ABV (Rs)	464.7	525.4	593.9	678.4
P/ABV (x)	2.0	1.8	1.6	1.4
RoE (%)	17.0	13.9	14.2	14.7
RoA (%)	0.9	0.8	0.8	0.8

KEY FINANCIALS	
Shares Outstanding (m)	526.3
Market Cap. (Rs b)	489.6
Market Cap. (US$ b)	11.3
Past 3 yrs. NII Growth (%)	16.2
Past 3 yrs. NP Growth (%)	12.4
Dividend Payout (%)	19.1
Dividend Yield (%)	1.5
P/E to Growth (x)	1.8

STOCK DATA	
52-Week Range	1,379/684
Major Shareholders (%) (December 2006)	
Promoters	60.6
Domestic Institutions	11.9
FIIs/FDIs	19.8
Others	7.7
Average Daily Turnover	
Volume ('000 shares)	1,985.4
Value (Rs million)	1,929.1
1/6/12 Month Rel. Performance (%)	-4/-11/-13
1/6/12 Month Abs. Performance (%)	-8/-10/-5

State Bank of India (SBI) is the largest Indian bank having a network of over 14,000 branches and an asset base of over Rs7.5t (March 2008, consolidated). Apart from banking, SBI has floated subsidiaries for mutual funds, life insurance, merchant banking and credit cards.

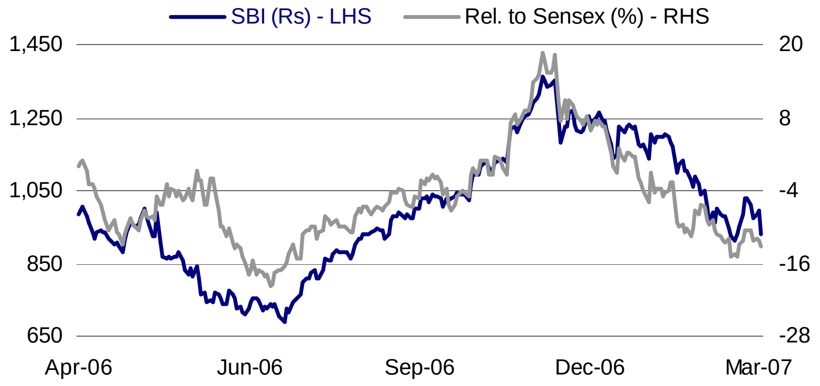
Strong loan growth, but slow deposit growth: In 9MFY06, SBI's loan book expanded by a robust 28% YoY to Rs3t, fuelled by strong growth in retail, SME and agriculture loans.

Margins to decline, as cost of funds increase: While margins are currently sustaining ~3.25% for the bank, we believe that cost of funds is likely to increase over the next few quarters, resulting in lower margins over the next few quarters.

Operating leverage exists: Operating expenses growth is likely to be moderate on account of large retirements over the next few years. We believe that this could be a key earnings driver for the bank.

We maintain Buy: We expect margins to decline, as cost of funds will rise. Higher fee income and stable opex would result in steady operational performance for the bank, going forward. However, the AS-15 shortfall and the way it would be treated would be a key issue to watch for. We expect SBI to report consolidated EPS of Rs142 and book value of Rs1,022 in FY09. The stock trades at 6.6x FY09E consolidated EPS and 0.9x FY09E consolidated BV. We maintain **Buy**.

STOCK PERFORMANCE (1 YEAR)



State Bank of India (SBI) is the largest Indian bank having a network of over 14,000 branches and an asset base of over Rs7.5t (March 2008, consolidated). It has nearly ¼ th market share in terms of advances and deposits. SBI has also promoted seven associate banks, which cumulatively have an asset base of close to Rs1.7t. Apart from core banking, SBI has floated subsidiaries that are present in mutual funds, life insurance, merchant banking and credit cards.

Slow balance sheet growth

Over the last few quarters, balance sheet growth has been slow for SBI, as it has not been resorting to bulk borrowings and has been funding its loan book through its excess SLR. Overall deposits grew by 11% to Rs4t in 3QFY07. CASA ratio, however, improved from 42.6% to 43.3% YoY (has been stable QoQ).

Advances increased 28% YoY to Rs3t; retail advances grew by 33% YoY. There continues to be a compositional shift in advances, with retail, agriculture and mid-corporates (SMEs) witnessing strong growth rates, while top-tier corporates have witnessed a decline. Owing to the shift in the profile coupled with lending rate hikes over the last couple of quarters, yield on loans has increased by 77bp YoY. On a QoQ basis, yields on loans have just increased by 6bp.

Deposit costs to increase; margins to decline marginally

Over the last few quarters, SBI's margins have been in the range of 3.25-3.35% (increase over FY06), as it has largely stayed away from bulk borrowings and was funding its loans through excess SLR. However, with this cushion now declining, SBI has been getting aggressive on raising deposits. With the deposit rate hikes over the last quarter, we expect deposit costs to rise much faster now. SBI has raised its PLR by 50bp from January 2007. Overall, we expect NIMs to decline marginally in 4QFY07, as SBI starts building up its balance sheet. However, overall adjusted margins would be much better in FY07.

SBI		
Feb-07	12.25	75
Dec-06	11.50	50
Aug-06	11.00	25
Apr-06	10.25	50

SBI is offering 9.5% interest on deposits with maturity between 4-5 years

DEPOSIT RATES HIKES BY SBI (%)

	29 NOV.04	9 JAN.06	1 MAY06	19 AUG.06	11 DEC.06	22 JAN.07
SBI Rates Across Maturities (%)						
7 days - 14 days	3.00	3.00	3.00	3.50	3.75	3.75
15 days - 45 days	4.00	4.50	4.50	4.75	5.00	5.00
46 days - 179 days	4.50	4.75	5.00	5.25	5.50	5.50
180 days - less than 1 year	5.00	5.50	6.00	6.25	6.50	6.50
1 year to less than 3 years	5.50	6.00	6.25	6.75	7.50	8.25
3 years to less than 5 years	5.75	6.25	6.50	7.00	7.75	8.25
5 years and above	6.25	6.50	7.00	7.25	8.00	8.25

Source: Company/ Motilal Oswal Securities

Significant operating leverage exists

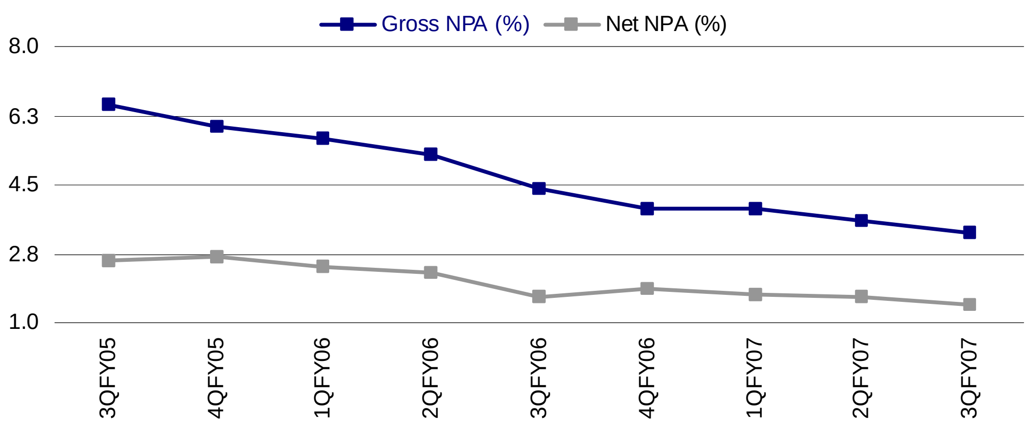
With a lot of hits already taken on account of higher pension provisioning, HTM transfer, marked-to-market provisions, exit scheme in FY06, we believe that operating expenses are likely to grow slowly for SBI. Further provisioning requirement would decline going forward, as investment-related losses would decline sharply for SBI.

Opex declined by 15% YoY in 3QFY07 and grew by just 2% QoQ. Even in 1HFY07, opex was largely flat for SBI. We believe that this is the sustainable level of operating expenses and could actually provide the biggest leverage to profitability going forward, as retirements are also likely to pick up from FY07. Also, the bank has already incurred a large part towards implementing its technology platform.

Asset quality on an improving trend

As compared to other state-owned banks, SBI has had high NPAs. We believe that this is primarily on account of lower NPA provisions by the bank over the last few quarters, as it had to make other provisions. However, in 3QFY07 it stepped up its NPA provisions, resulting in a 22bp decline in net NPAs to 1.45%. Gross NPAs also declined 27bp QoQ. We believe that the bank would continue to resort to higher provisions going forward, as it intends to bring down its net NPAs to below 1% by FY08.

TREND IN NPAS (%)



Source: Company / Motilal Oswal Securities

Tier-I capital of 8%; has been raising resources to strengthen capital

SBI has a total capital adequacy of 11.9% as at December 2006. The bank added Rs69b to its capital during 9MFY07 by way of upper tier-II subordinated debt, which helped it to maintain its capital adequacy. Total tier-II bond mobilization in the last 13 months has been to the tune of Rs102b. The bank also has a cushion to raise another Rs40b in the form of hybrid tier-I. While we believe that SBI is comfortable on capital adequacy currently, there have been reports stating that it is likely to raise capital during FY08.

Government to acquire RBI's stake in SBI

The government is proposing to acquire the RBI's stake (59.8%) in a cash-neutral transaction at Rs1,300/share. SBI is the only state-owned bank, which is owned by the regulator and not directly by the government. Once the government acquires the stake, the SBI Act is also likely to be amended and government holding can be reduced to 51% (presently, the RBI holding cannot fall below 55%).

Plans to raise capital in FY08

Recent comments by the management indicate plans to raise capital in FY08. While SBI is comfortable with its capital adequacy (12.3%, Tier-I - 8.3%), we believe that SBI would initially explore the innovative instruments (upper tier-II and perpetual debt) before going in for any fresh equity issuance. Even if SBI were to raise capital in FY08, we believe that it will happen at a discount to the prevailing market price (as both the government and public would need to subscribe at least 80%) and accretion to the book value on account of the capital issue would be limited.

We maintain Buy

We expect margins to decline, as cost of funds will rise. Higher fee income and stable opex would result in steady operational performance for the bank, going forward. However, the AS-15 shortfall and the way it would be treated would be a key issue to watch for. We expect SBI to report consolidated EPS of Rs142 and book value of Rs1,022 in FY09. The stock trades at 6.6x FY09E consolidated EPS and 0.9x FY09E consolidated BV. We maintain **Buy**.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	324,280	357,949	386,769	462,248	543,491
Interest Expended	184,834	201,593	228,654	280,378	337,226
Net Interest Income	139,446	156,356	158,115	181,869	206,264
Change (%)	*24.7*	*12.1*	*1.1*	*15.0*	*13.4*
Other Income	**71,199**	**73,887**	**73,089**	**77,036**	**83,665**
Profit on sale of investment	17,753	5,872	6,500	4,000	3,000
Other non-interest income	53,446	68,015	66,589	73,036	80,665
Net Income	**210,645**	**230,243**	**231,204**	**258,905**	**289,929**
Change (%)	*12.1*	*9.3*	*0.4*	*12.0*	*12.0*
Operating Expenses	100,742	117,251	117,520	128,600	140,806
Employee expense	69,073	81,230	81,143	85,892	92,387
Operating Income	**109,904**	**112,992**	**113,684**	**130,305**	**149,123**
Change (%)	*15.0*	*2.8*	*0.6*	*14.6*	*14.4*
Provisions & contingencies	44,688	43,931	48,274	49,988	60,786
Provision for NPAs	12,040	1,478	11,774	17,988	26,786
PBT	**65,216**	**69,062**	**65,410**	**80,317**	**88,337**
Tax	22,171	24,995	24,856	34,021	34,601
PAT	**43,045**	**44,067**	**40,554**	**46,296**	**53,736**
Change (%)	*16.9*	*2.4*	*-8.0*	*14.2*	*16.1*
Proposed Dividend	7,516	8,402	7,894	8,947	8,947

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	5,263	5,263	5,263	5,263	5,263
Reserves & Surplus	235,458	271,178	302,495	338,323	381,591
Net Worth	**240,721**	**276,441**	**307,758**	**343,586**	**386,854**
Deposits	3,670,475	3,800,461	4,370,530	5,026,109	5,780,025
Change (%)	*15.2*	*3.5*	*15.0*	*15.0*	*15.0*
Borrowings	191,843	306,412	373,823	429,897	494,381
Other Liabilities & Prov.	495,790	555,384	638,690	798,362	997,952
Total Liabilities	**4,598,829**	**4,938,696**	**5,690,801**	**6,597,953**	**7,659,212**
Current Assets	393,221	445,600	471,615	595,307	752,421
Investments	1,970,979	1,625,342	1,674,103	1,874,995	2,099,994
Change (%)	*6.2*	*-17.5*	*3.0*	*12.0*	*12.0*
Advances	2,023,745	2,616,415	3,270,519	3,826,507	4,477,014
Change (%)	*28.1*	*29.3*	*25.0*	*17.0*	*17.0*
Net Fixed Assets	26,977	27,529	28,373	30,335	31,894
Other Assets	183,907	223,808	246,189	270,808	297,889
Total Assets	**4,598,829**	**4,938,696**	**5,690,801**	**6,597,953**	**7,659,212**

ASSUMPTIONS (%)

Deposit Growth	15.2	3.5	15.0	15.0	15.0
Advances Growth	28.1	29.3	25.0	17.0	17.0
Investments Growth	6.2	-17.5	3.0	12.0	12.0
Dividend	125.0	140.0	150.0	170.0	170.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.9	7.9	7.7	8.0	8.1
Avg. Cost-Int. Bear. Liab.	5.1	5.1	5.2	5.5	5.7
Interest Spread	2.7	2.9	2.5	2.5	2.4
Net Interest Margin	3.4	3.5	3.1	3.1	3.1
Profitability Ratios (%)					
RoE	19.4	17.0	13.9	14.2	14.7
RoA	1.0	0.9	0.8	0.8	0.8
Int. Expended/Int.Earned	57.0	56.3	59.1	60.7	62.0
Other Inc./Net Income	33.8	32.1	31.6	29.8	28.9
Efficiency Ratios (%)					
Op. Exps./Net Income	47.8	50.9	50.8	49.7	48.6
Empl. Cost/Op. Exps.	68.6	69.3	69.0	66.8	65.6
Busi. per Empl. (Rs m)	25.4	30.5	36.5	43.7	51.7
NP per Empl. (Rs lac)	2.1	2.2	2.1	2.5	2.9
Asset-Liability Profile (%)					
Adv./Deposit Ratio	55.1	68.8	74.8	76.1	77.5
Invest./Deposit Ratio	53.7	42.8	38.3	37.3	36.3
G-Sec/Invest. Ratio	88.9	85.0	90.8	87.6	84.4
Gross NPAs to Adv.	6.0	3.9	2.7	2.2	1.8
Net NPAs to Adv.	2.6	1.9	1.4	1.2	1.0
CAR	12.5	11.9	10.1	9.9	10.2
Tier 1	8.0	9.4	7.5	7.1	7.4

VALUATION

Book Value (Rs)	457.4	525.3	584.8	652.8	735.0
Price-BV (x)	2.0	1.8	1.6	1.4	1.3
Adjusted BV (Rs)	391.3	464.7	525.4	593.9	678.4
Price-ABV (x)	2.4	2.0	1.8	1.6	1.4
EPS (Rs)	81.8	83.7	77.1	88.0	102.1
EPS Growth (%)	16.9	2.4	-8.0	14.2	16.1
Price-Earnings (x)	11.4	11.1	12.1	10.6	9.1
OPS (Rs)	208.8	214.7	216.0	247.6	283.3
OPS Growth (%)	15.0	2.8	0.6	14.6	14.4
Price-OP (x)	4.5	4.3	4.3	3.8	3.3

E: MOSt Estimates

Andhra Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	ANDB IN
	REUTERS CODE
S&P CNX: 3,637	ADBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs72

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	11.7	14.1	16.1	18.0
OP (Rs b)	7.7	9.6	10.9	12.4
NP (Rs b)	4.9	5.5	6.3	7.0
EPS (Rs)	10.0	11.2	12.9	14.5
EPS Growth (%)	-23.0	12.3	15.2	12.0
BV/Share(Rs)	59.7	66.2	73.9	82.6
P/E (x)	7.2	6.4	5.5	4.9
P/BV (x)	1.2	1.1	1.0	0.9
ABV (Rs)	58.9	65.4	73.1	82.2
P/ABV (x)	1.2	1.1	1.0	0.9
RoE (%)	20.5	17.9	18.5	18.5
RoA (%)	1.3	1.2	1.2	1.2

KEY FINANCIALS	
Shares Outstanding (m)	485.0
Market Cap. (Rs b)	34.8
Market Cap. (US$ b)	0.8
Past 3 yrs. NII Growth (%)	15.8
Past 3 yrs. NP Growth (%)	6.4
Dividend Payout (%)	35.0
Dividend Yield (%)	4.9
P/E to Growth (x)	0.5

STOCK DATA	
52-Week Range	99/57
Major Shareholders (%) (December 2006)	
Promoters	51.6
Domestic Institutions	10.2
FIIs/FDIs	19.0
Others	19.2
Average Daily Turnover	
Volume ('000 shares)	1,015.1
Value (Rs million)	84.5
1/6/12 Month Rel. Performance (%)	-4/-25/-22
1/6/12 Month Abs. Performance (%)	-7/-24/-14

Andhra Bank is a relatively small player, with a deposit share of just about 1.6%. Over 70% of Andhra Bank's branches are located in the state of Andhra Pradesh in southern India. Its business is also concentrated – about 58% of its loans and 64% of deposits are in the state.

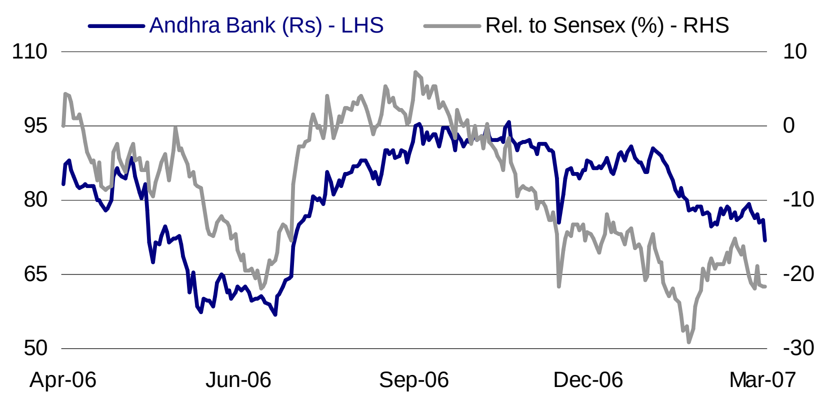
Moderate business growth; NIMs to be stable: It has grown its credit portfolio by 23% over the past two quarters, with strong focus on NIMs. Its NII for 9MFY07 rose 18% YoY, with an improving margins.

Asset quality amongst the best in the sector: The bank's gross NPAs were 1.7% while its net NPAs were 0.4% in 3QFY07. Incremental defaults to average credit declined to 0.8% in FY06, one of the lowest amongst its peers.

Sustaining strong RoA; RoE set to improve: Andhra Bank has consistently delivered high RoA (1.2-1.8%) and has been delivering strong RoE as well (18-30%).

Andhra Bank is amongst the more profitable Indian banks, with a strong balance sheet and low NPAs. It also has innovative human resource practices and technology. The stock trades at 4.9x FY09E EPS and 0.9x FY09E BV, with an RoE of 19%. It offers a dividend yield of >4%. We expect the bank to continue growing its loan portfolio at a healthy pace, with stable margins. Andhra Bank's asset quality is amongst the best in the industry. We reiterate our **Buy** recommendation.

STOCK PERFORMANCE (1 YEAR)

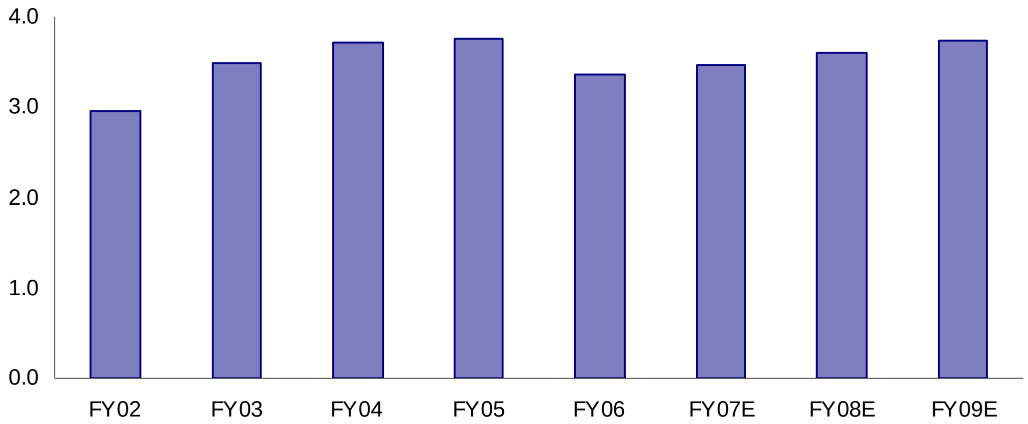


Andhra Bank is a relatively small player, with a deposit share of just about 1.6%. It is the 18th largest bank in India and the 15th largest among state-owned banks. Over 70% of Andhra Bank's branches are located in the state of Andhra Pradesh in southern India. Its business is also concentrated – about 58% of its loans and 64% of deposits are in the state, with the rest spread across the country.

Moderate business growth; NIMs to remain stable

Andhra Bank has grown its credit portfolio by 22-23% over the past couple of quarters, with a strong focus on NIMs. Its 9MFY07 NII rose 18% YoY, and margins rose 45bp to 3.8%, on higher loan yields and new capital raised at the end of 4QFY06. We believe that such growth is healthier than the 30%+ levels seen recently, from a funding, pricing and credit perspective.

TREND IN NIMs (%)



Source: Company/ Motilal Oswal Securities

Margins improve YoY in 3QFY07: Andhra Bank's NIMs improved from 3.46% in 3QFY06 to 3.56% in 3QFY07, as yield on advances expanded by 47bp YoY to 9.7%. Lending to SME, retail and agriculture resulted in improving margins for the bank. Cost of deposits inched up to 5.13% in 3QFY07 from 4.84% in 3QFY06.

TREND IN NIM

	9MFY06	FY06	9MFY07
Avg Yield on Advances	9.30	9.26	9.77
Avg Yield on Investments	7.34	7.29	7.31
Avg Cost of Deposits	4.84	4.86	5.13
Net Interest Margin	**3.46**	**3.32**	**3.56**

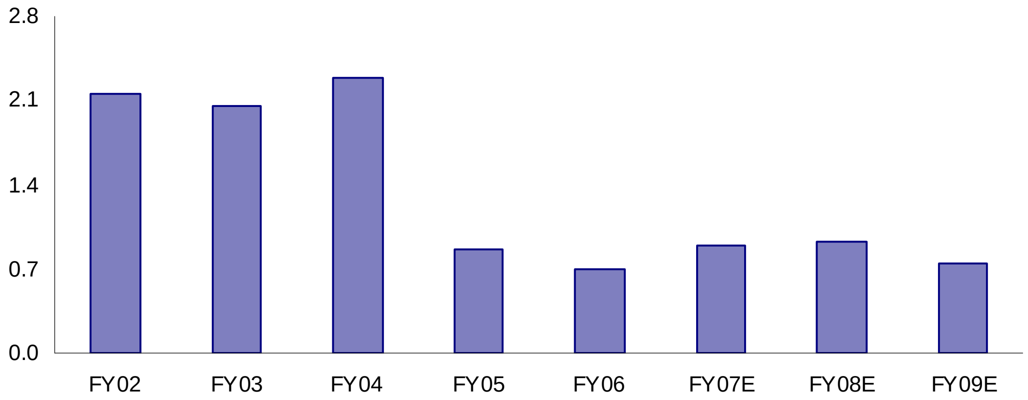
Source: Company/ Motilal Oswal Securities

Asset quality amongst the best in the sector

While gross NPAs were 1.7%, net NPAs were 0.4% in 3QFY07. Incremental defaults to average credit declined to 0.8% in FY06, one of the lowest rates amongst its peers. Even provisioning requirement has been low for Andhra Bank. While in 3QFY07, net NPAs increased on account of recognition of couple of accounts as NPAs, the management is confident of higher recoveries going forward through these accounts. We expect gross NPAs to decline to 1% in FY09 on strong risk management practices.

The bank proposes to be aggressive with recoveries, even in written-off accounts. As against Rs627m of recoveries from written-off accounts in FY05 and Rs452m in FY06, the bank aims to recover Rs1.2b from this head during FY07.

INCREMENTAL SLIPPAGES (%)



Source: Company/ Motilal Oswal Securities

Sustaining strong RoA; RoE set to improve

Andhra Bank has consistently delivered high RoA and has been delivering strong RoE as well. With margins likely to sustain and lower operating costs, we expect higher RoA and RoE, going forward.

DU PONT ANALYSIS OF ROA

	FY03	FY04	FY05	FY06	FY07E	FY08E	FY09E
Net interest income/avg assets (%)	3.30	3.52	3.58	3.19	3.22	3.21	3.13
Fee income/avg assets (%)	0.91	1.07	1.23	1.06	1.01	0.91	0.91
Treasury Income/ avg assets (%)	1.73	1.55	1.29	0.19	0.14	0.10	0.09
Total revenue/avg assets (%)	**5.95**	**6.15**	**6.10**	**4.43**	**4.36**	**4.22**	**4.13**
Operating costs/income (%)	44.36	41.45	45.51	52.73	49.85	48.51	47.61
Operating costs/avg assets (%)	**2.64**	**2.55**	**2.78**	**2.34**	**2.17**	**2.05**	**1.97**
Emp Costs/avg assets (%)	1.74	1.58	1.81	1.34	1.23	1.12	1.03
Other Exp / avg Assets (%)	0.90	0.96	0.97	0.99	0.95	0.93	0.93
Pre-provision profits/avg assets (%)	**3.31**	**3.60**	**3.32**	**2.10**	**2.19**	**2.17**	**2.16**
Loan-loss-provisions/avg assets (%)	0.74	0.94	0.04	0.11	0.14	0.16	0.17
Other provisions/avg assets (%)	0.11	0.00	0.80	0.45	0.32	0.28	0.24
Tax/avg assets (%)	0.69	0.87	0.75	0.22	0.48	0.49	0.52
RoAA (%)	**1.77**	**1.79**	**1.74**	**1.32**	**1.25**	**1.25**	**1.22**
Leverage (x)	22.82	20.13	18.16	15.51	14.34	14.79	15.17
RoAE (%)	**40.30**	**36.10**	**31.62**	**20.52**	**17.86**	**18.48**	**18.54**

Source: Company/ Motilal Oswal Securities

Maintain Buy

Andhra Bank is amongst the more profitable Indian banks, with a strong balance sheet and low NPAs. It also has innovative human resource practices and technology. The stock trades at 4.9x FY09E EPS and 0.9x FY09E BV, with an RoE of 19%. It offers a dividend yield of >4%. We expect the bank to continue growing its loan portfolio at a healthy pace, with stable margins. Andhra Bank's asset quality is amongst the best in the industry. We reiterate our **Buy** recommendation.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	22,735	26,744	33,235	39,107	45,416
Interest Expended	12,044	15,054	19,148	22,968	27,396
Net Interest Income	**10,690**	**11,690**	**14,087**	**16,139**	**18,020**
Change (%)	*17.4*	*9.4*	*20.5*	*14.6*	*11.6*
Other Income	7,534	4,581	5,003	5,073	5,741
Net Income	**18,224**	**16,271**	**19,089**	**21,212**	**23,761**
Change (%)	*14.7*	*-10.7*	*17.3*	*11.1*	*12.0*
Operating Expenses	8,295	8,580	9,515	10,290	11,311
Operating Income	**9,930**	**7,691**	**9,574**	**10,923**	**12,449**
Change (%)	*6.7*	*-22.5*	*24.5*	*14.1*	*14.0*
Other Provisions	2,501	2,036	2,000	2,200	2,400
PBT	**7,429**	**5,655**	**7,574**	**8,723**	**10,049**
Tax	2,228	800	2,121	2,442	3,015
Tax Rate (%)	*30.0*	*14.1*	*28.0*	*28.0*	*30.0*
PAT	**5,201**	**4,855**	**5,453**	**6,280**	**7,034**
Change (%)	*12.2*	*-6.7*	*12.3*	*15.2*	*12.0*
Proposed Dividend	1,357	1,698	1,940	2,183	2,425

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,000	4,850	4,850	4,850	4,850
Reserves & Surplus	14,370	24,089	27,273	30,999	35,197
Net Worth	**18,370**	**28,939**	**32,123**	**35,849**	**40,047**
Deposits	275,507	339,224	393,500	452,525	520,404
Change (%)	*20.1*	*23.1*	*16.0*	*15.0*	*15.0*
Borrowings	9,832	7,585	8,495	9,515	10,656
Other Liabilities & Prov.	23,577	30,945	34,658	38,817	43,475
Total Liabilities	**327,287**	**406,693**	**468,776**	**536,706**	**614,582**
Current Assets	35,233	51,394	59,877	72,018	85,135
Investments	106,463	114,442	123,597	129,777	136,266
Change (%)	*3.2*	*7.5*	*8.0*	*5.0*	*5.0*
Advances	175,168	221,004	265,205	312,942	369,272
Change (%)	*35.9*	*26.2*	*20.0*	*18.0*	*18.0*
Net Fixed Assets	1,873	1,928	1,992	2,054	2,002
Other Assets	8,550	17,926	18,105	19,916	21,907
Total Assets	**327,287**	**406,693**	**468,776**	**536,706**	**614,582**

ASSUMPTIONS (%)

Deposit Growth	20.1	23.1	16.0	15.0	15.0
Advances Growth	35.9	26.2	20.0	18.0	18.0
Investments Growth	3.2	7.5	8.0	5.0	5.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	30.0	35.0	40.0	45.0	50.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.0	7.7	8.2	8.6	8.7
Avg. Cost-Int. Bear. Liab.	4.6	4.8	5.1	5.3	5.5
Interest Spread	3.4	2.9	3.1	3.2	3.2
Net Interest Margin	3.8	3.4	3.5	3.5	3.5
Profitability Ratios (%)					
RoE	31.6	20.5	17.9	18.5	18.5
RoA	1.7	1.3	1.2	1.2	1.2
Int. Expended/Int.Earned	53.0	56.3	57.6	58.7	60.3
Other Inc./Net Income	41.3	28.2	26.2	23.9	24.2
Efficiency Ratios (%)					
Op. Exps./Net Income	45.5	52.7	49.8	48.5	47.6
Empl. Cost/Op. Exps.	65.0	57.4	56.5	54.6	52.6
Busi. per Empl. (Rs m)	30.9	38.4	46.2	53.9	62.5
NP per Empl. (Rs lac)	4.0	3.7	4.1	4.8	5.3
Asset-Liability Profile (%)					
Adv./Deposit Ratio	63.6	65.1	67.4	69.2	71.0
Invest./Deposit Ratio	38.6	33.7	31.4	28.7	26.2
G-Sec/Invest. Ratio	83.9	86.5	88.1	90.6	93.2
Gross NPAs to Adv.	2.5	1.9	1.5	1.2	1.0
Net NPAs to Adv.	0.3	0.3	0.2	0.2	0.1
CAR	12.1	14.0	11.8	11.6	12.0
Tier 1	*8.0*	*12.2*	*11.5*	*9.7*	*10.0*

VALUATION

Book Value (Rs)	45.9	59.7	66.2	73.9	82.6
Price-BV (x)	1.6	1.2	1.1	1.0	0.9
Adjusted BV (Rs)	45.1	58.9	65.4	73.1	82.2
Price-ABV (x)	1.6	1.2	1.1	1.0	0.9
EPS (Rs)	13.0	10.0	11.2	12.9	14.5
EPS Growth (%)	12.2	-23.0	12.3	15.2	12.0
Price-Earnings (x)	5.5	7.2	6.4	5.5	4.9
OPS (Rs)	24.8	15.9	19.7	22.5	25.7
OPS Growth (%)	6.7	-36.1	24.5	14.1	14.0
Price-OP (x)	2.9	4.5	3.6	3.2	2.8

E: MOSt Estimates

Federal Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	FB IN
	REUTERS CODE
S&P CNX: 3,634	FED.BO

2 April 2007

Buy

Previous Recommendation: Buy

Rs203

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	6.0	6.9	7.9	9.3
OP (Rs b)	4.5	5.3	6.2	7.4
NP (Rs b)	2.3	2.6	3.1	3.7
EPS (Rs)	26.3	30.5	36.2	43.0
EPS Growth (%)	91.6	16.1	18.6	18.8
BV/Share (Rs)	145.6	170.9	200.7	236.1
P/E (x)	7.7	6.6	5.6	4.7
P/BV (x)	1.4	1.2	1.0	0.9
ABV (Rs)	137.2	166.8	200.3	236.5
P/ABV (x)	1.5	1.2	1.0	0.9
RoE (%)	22.9	19.3	19.5	19.7
RoA (%)	1.2	1.2	1.2	1.2

KEY FINANCIALS	
Shares Outstanding (m)	85.8
Market Cap. (Rs b)	17.4
Market Cap. (US$ b)	0.4
Past 3 yrs. NII Growth (%)	8.8
Past 3 yrs. NP Growth (%)	29.1
Dividend Payout (%)	13.3
Dividend Yield (%)	20.2
P/E to Growth (x)	2.6

STOCK DATA	
52-Week Range	274/137
Major Shareholders (%) (December 2006)	
Promoters	0.0
Domestic Institutions	8.8
FIIs/FDIs	62.9
Others	28.3
Average Daily Turnover	
Volume ('000 shares)	317.4
Value (Rs million)	66.7
1/6/12 Month Rel. Performance (%)	-4/-4/-8
1/6/12 Month Abs. Performance (%)	-8/-3/0

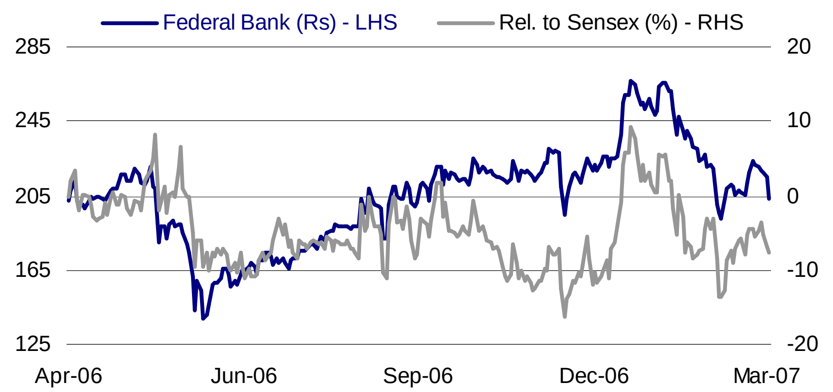
Federal Bank is one of the largest old generation private sector banks, with dominance in the southern and western parts of India. It is a mid-sized bank, with a network of 532 branches and a balance sheet size of Rs240b (FY07E). Federal Bank offers a strong play on loan growth, steady margins, low NPAs and huge recovery prospects.

Steady balance sheet growth: Federal Bank has been focusing on raising deposits and using excess SLR to fund its loan growth. The management expects advances to increase by 30% in FY07, while deposits are likely to increase by 20%.

Clean book; recoveries could provide significant upsides: Over the last three years, the bank has resorted to heavy provisioning. Its net NPAs have declined to Rs1b (0.7%) as at September 2006. It has ~Rs5b of written-off accounts and the management expects to recover at least 20% of these plus the accrued interest.

Valuations attractive; Buy: We believe that steady growth in balance sheet, coupled with steady margins and NPA recoveries will drive the bank's earnings going forward. We expect earnings growth of 18.6% in FY08, followed by 18.8% growth in FY09. The stock trades at 4.7x FY09E EPS and 0.9x FY09E BV. Based on the bank's sustainable RoE of >20%, we believe that the stock could trade at 1.3x FY09E book value. We recommend **Buy** with a 12-month target price of Rs307.

STOCK PERFORMANCE (1 YEAR)



Expect steady loan growth to continue

Federal Bank has been focusing on raising deposits and using excess SLR to fund its loan growth. The management expects advances to increase by 30% in FY07, while deposits are likely to increase by 20%. We expect an incremental C/D ratio of 110% for the bank in FY07, with the overall C/D ratio increasing to 71%.

The bank also has a clear focus of growing its agriculture loans. To this end, it has been targeting plantation companies, self-help groups, and reputed NGOs. The management has also mentioned that the risk of NPAs is lower in Kerala (its principal market) – the value of land is high, holding greater value as a security.

NRI deposits – the key differentiator

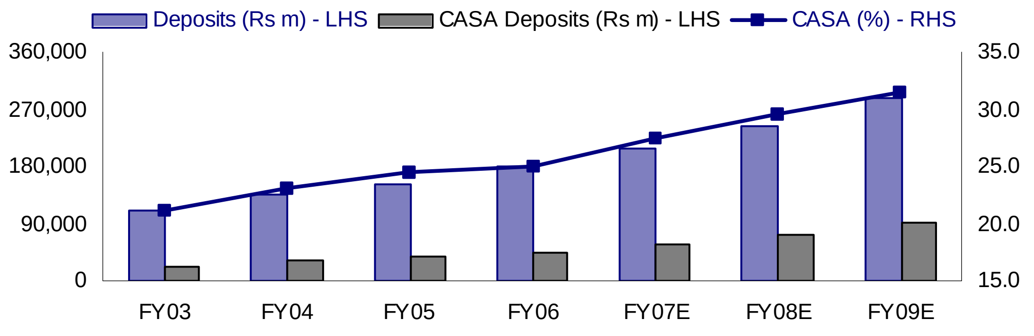
The key differentiator for Federal Bank is NRI deposits, which constitute nearly 31% of its total deposits. The bank enjoys the trust of Gulf-based NRIs originally from Kerala, whom it has been serving for over 70 years. NRI deposits have not only been a very stable source of funds for Federal Bank, but have been very profitable as well. The average blended cost for NRI funds is about 5% and the bank earns a gross spread of 3-4% on these deposits.

Though the NRI deposit cost has been increasing following the increase in LIBOR rates, the bank still maintains a good spread on its NRI deposits. Further, we are not very concerned about the upward re-pricing of NRI deposits. This is because in FY05, when the rates on NRI deposits were the lowest, there was a negligible growth in Federal Bank's NRI deposits. On the contrary, a lot of deposits were withdrawn due to the lower deposit rates offered and also due to the fear of tax concessions being taken away.

CASA deposits rising faster

On the back of the management's increased efforts to grow CASA deposits through aggressive marketing and putting the required technology in place, CASA deposits have been growing at a robust xx% over FY02-06. CASA deposits have increased from 21% of total deposits in FY03 to 25% in FY05 and to 26% as at end-September 2006. The management has a target of growing its CASA deposit base to 35% by FY09.

DEPOSITS GROWTH AND COMPOSITIONS

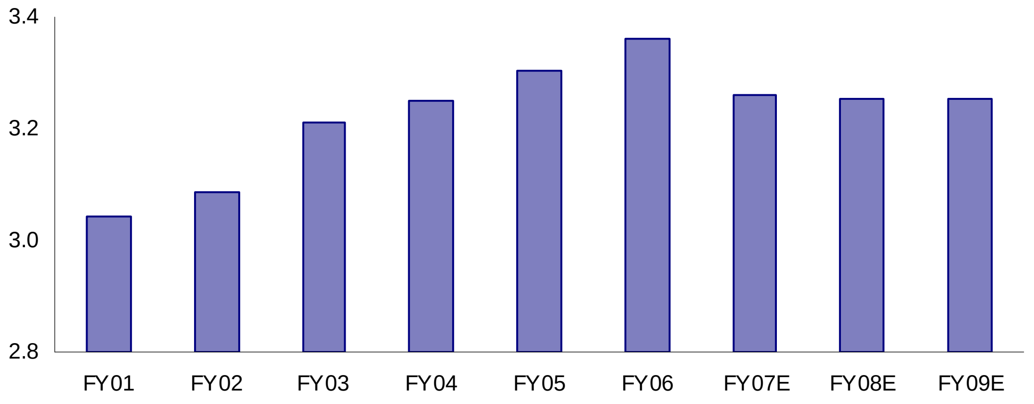


Source: Company/Motilal Oswal Securities

Margins likely to be maintained at current levels

Federal Bank has witnessed margin improvement in FY05 and FY06 mainly due to deposit re-pricing and a higher incremental C/D ratio. With deposit costs now starting to rise, we expect margins to be maintained in a range of 3-3.2% (margins in QFY07 were 3.19%). The bank has raised its PLR to counter the rising deposit costs. Nevertheless, we are assuming that margins would decline marginally, as deposit costs could rise faster and given the bank's CASA ratio of just 27%. However, the bank has Rs6b of additional SLR securities, which it could use for funding its loans.

TREND IN NIMS (%)

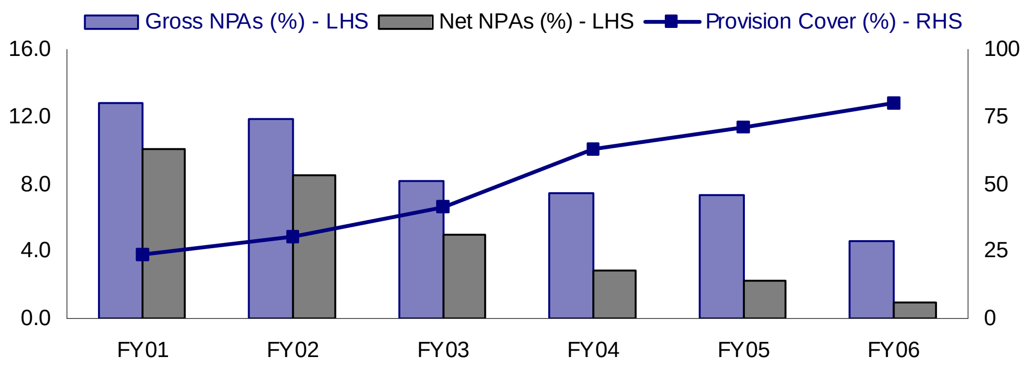


Source: Company/Motilal Oswal Securities

Asset quality has improved considerably

The key highlight for Federal Bank has been its success in containing NPAs and improving its asset quality. The bank had a history of high NPAs, which were mainly in the steel and NBFC sectors. Its gross NPAs amounted to Rs6.4b (12.8%) and its net NPAs were Rs4.9b (10.1%) as at end-FY01. Over the last three years, the bank has resorted to heavy provisioning, on the back of strong treasury gains booked. Thus, net NPAs declined to RsXb (0.67%) as at March 2006. As at September 2006, net NPAs stood at Rs1b (0.7%). The provision cover has also shot up to 85% as at December 2006.

TREND IN NPAS



Source: Company/Motilal Oswal Securities

Recoveries could be huge – a key earnings driver

We expect strong recoveries to continue for Federal Bank, even as provisioning might be lower going forward. As of September 2006, it had Rs5.4b of gross NPAs, on which it has collateral securities apart from primary security. The value of these securities is nearly 80% of the loans outstanding. In most cases, the security is real estate, which has appreciated significantly over the last 2-3 years. Thus, the probability of recovery is very high. Further, Federal Bank has over the years prudentially written off bad loans. It has ~Rs5b of written-off accounts (mainly in NBFCs and SMEs). The management expects to recover at least 20% of the written-off accounts plus the accrued interest.

RECOVERY OF NPAS(RS B)

	EXP RECOVERY (%)	RECOVERY (%)	
Gross NPAs (as of Sept 06)	5.4	80	4.3
Written off accounts	5.0	20	1.0
			5.3
Additional Recovery from Int (assumed)	1.5		
Total expected Recovery (over next 3 years)	6.8		
Expect aggregate profits (FY07-09)	9.7		

Source: Company/Motilal Oswal Securities

Fee income – a core focus area

Federal Bank has started utilizing its network for distributing insurance policies, mutual funds, credit cards, etc. It has tied up with a host of players for bill collection, which has helped the bank in increasing its fee income as well as its float income. Since the bank has its strength in its NRI client base, it is one of the prominent players in foreign exchange operations and has been witnessing strong growth over the last few years. It also offers various merchant banking services, such as depository and other capital market-related services.

Federal Bank's fee income has been constant at 0.9% of its average assets over the last 2-3 years. Over the last four years, fee-based income has been increasing at 15% CAGR. However, we expect faster growth over the next three years, on the back of its increased thrust on generating fee-based income. With fee income growing at a faster pace than asset accretion, Federal Bank's RoE would increase.

Expanding branch network to aid growth

Federal Bank is consistently growing its branch network. Post the acquisition of Ganesh Bank, it has 519 branches, which is likely to increase to 532 branches by March 2007. The management intends to open 35-40 branches each year, thereafter. It intends to grow in the western, central and northern part of India.

Acquisition of Ganesh Bank of Kuruwad

Federal Bank has acquired Ganesh Bank of Kurundwad in FY07. The main attraction was the 32 branches of Ganesh Bank, concentrated in Sangli and the Konkan belt (Federal Bank had 20 branches in Maharashtra, earlier). The branches of Ganesh Bank are a good fit, in line with the growth strategy. The acquisition would result in higher thrust to agricultural and SME advances. The merger will help Federal Bank step up its agriculture and retail portfolio.

Could emerge as a key takeover target

We also believe that Federal Bank could emerge as a key takeover target by the MNC banks whenever allowed. In our opinion, it offers scale (relative to other 'traditional' private sector banks), stable asset quality and leading technology. While we agree that most of the government banks and traditional private sector banks have their share of efficiency and staffing issues, they have a strong deposit franchise in India by virtue of their wide distribution network.

Valuations attractive; Buy

We believe that steady growth in balance sheet, coupled with steady margins and NPA recoveries will drive the bank's earnings going forward. We expect earnings growth of 18.6% in FY08, followed by 18.8% growth in FY09. The stock trades at 4.7x FY09E EPS and 0.9x FY09E BV. Based on the bank's sustainable RoE of >20%, we believe that the stock could trade at 1.3x FY09E book value. We recommend **Buy** with a 12-month target price of Rs307 (upside of 51%).

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	11,910	14,371	17,449	20,860	25,380
Interest Expended	6,888	8,367	10,557	12,944	16,119
Net Interest Income	**5,023**	**6,004**	**6,893**	**7,915**	**9,261**
Change (%)	*19.1*	*19.5*	*14.8*	*14.8*	*17.0*
Other Income	2,120	2,169	2,389	2,765	3,034
-Fee income	1,571	2,000	2,189	2,565	2,784
-Treasury Income	548	169	200	200	250
Net Income	**7,143**	**8,173**	**9,282**	**10,680**	**12,295**
Change (%)	*-0.7*	*14.4*	*13.6*	*15.1*	*15.1*
Operating Expenses	3,139	3,646	4,003	4,464	4,917
Operating Income	4,004	4,528	5,278	6,216	7,378
Change (%)	*-8.3*	*13.1*	*16.6*	*17.8*	*18.7*
-Employee Expenses	1,858	2,284	2,460	2,690	2,856
-Other Exp	1,281	1,362	1,543	1,774	2,062
Other Provisions	2,843	1,672	1,875	1,900	2,250
-NPA provisions	1,359	956	800	800	900
-Other provisions	1,485	716	1,075	1,100	1,350
PBT	**1,161**	**2,856**	**3,403**	**4,316**	**5,128**
Tax	260	598	783	1,209	1,436
Tax Rate (%)	*22.4*	*20.9*	*23.0*	*28.0*	*28.0*
PAT	**901**	**2,258**	**2,621**	**3,108**	**3,692**
Change (%)	*-33.9*	*150.7*	*16.1*	*18.6*	*18.8*
Proposed Dividend	**164**	**300**	**386**	**472**	**558**

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	656	858	858	858	858
Reserves & Surplus	6,577	11,642	13,811	16,367	19,406
Net Worth	**7,233**	**12,501**	**14,670**	**17,225**	**20,264**
Deposits	151,929	178,787	207,393	244,724	286,327
Change (%)	*12.7*	*17.7*	*16.0*	*18.0*	*17.0*
-Savings Deposits	28,647	35,342	43,553	55,063	68,718
-Current Deposits	8,611	9,383	13,481	17,131	21,474
-Term Deposits	114,671	134,063	150,360	172,530	196,134
Borrowings	4,559	8,804	10,564	12,149	15,186
Other Liabilities & Prov.	4,488	6,337	7,604	8,364	9,201
Total Liabilities	**168,209**	**206,428**	**240,231**	**282,462**	**330,978**
Current Assets	15,559	18,725	19,452	25,003	28,049
Investments	57,992	62,724	65,860	72,446	85,486
Change (%)	*5.3*	*8.2*	*5.0*	*10.0*	*18.0*
Advances	88,226	117,365	146,706	176,047	207,735
Change (%)	*14.6*	*33.0*	*25.0*	*20.0*	*18.0*
Net Fixed Assets	1,855	1,739	2,043	2,302	2,511
Other Assets	4,578	5,877	6,171	6,664	7,197
Total Assets	168,209	206,428	240,231	282,462	330,978

ASSUMPTIONS (%)

Deposit Growth	12.7	17.7	16.0	18.0	17.0
Advances Growth	14.6	33.0	25.0	20.0	18.0
Investments Growth	5.3	8.2	5.0	10.0	18.0
Dividend	25.1	34.9	45.0	55.0	65.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.8	8.0	8.1	8.3	8.6
Avg. Cost-Int. Bear. Liab.	4.6	4.9	5.2	5.5	5.8
Interest Spread	3.2	3.2	2.9	2.9	2.8
Net Interest Margin	3.3	3.4	3.2	3.2	3.1
Profitability Ratios (%)					
RoE	13.1	22.9	19.3	19.5	19.7
RoA	0.6	1.2	1.2	1.2	1.2
Int. Expended/Int.Earned	57.8	58.2	60.5	62.1	63.5
Other Inc./Net Income	29.7	26.5	25.7	25.9	24.7
Efficiency Ratios (%)					
Op. Exps./Net Income	43.9	44.6	43.1	41.8	40.0
Empl. Cost/Op. Exps.	59.2	62.6	61.5	60.3	58.1
Busi. per Empl. (Rs m)	34.9	40.8	48.9	57.6	67.3
NP per Empl. (Rs lac)	1.4	3.4	3.9	4.6	5.4
Asset-Liability Profile (%)					
Adv./Deposit Ratio	58.1	65.6	70.7	71.9	72.6
Invest./Deposit Ratio	38.2	35.1	31.8	29.6	29.9
G-Sec/Invest. Ratio	87.7	90.7	91.1	85.6	81.9
Gross NPAs to Adv.	7.3	4.6	3.3	2.9	2.8
Net NPAs to Adv.	2.2	1.0	0.4	0.0	0.0
CAR	11.3	13.8	12.0	12.0	11.0
Tier 1	*6.4*	*9.7*	*9.5*	*9.0*	*8.5*

VALUATION

Book Value (Rs)	110.3	145.6	170.9	200.7	236.1
Price-BV (x)	1.8	1.4	1.2	1.0	0.9
Adjusted BV (Rs)	91.0	137.2	166.8	200.3	236.5
Price-ABV (x)	2.2	1.5	1.2	1.0	0.9
EPS (Rs)	13.7	26.3	30.5	36.2	43.0
EPS Growth (%)	-34.3	91.6	16.1	18.6	18.8
Price-Earnings (x)	14.8	7.7	6.6	5.6	4.7
OPS (Rs)	61.0	52.7	61.5	72.4	86.0
OPS Growth (%)	-8.8	-13.6	16.6	17.8	18.7
Price-OP (x)	3.3	3.8	3.3	2.8	2.4

E: MOSt Estimates

Jammu & Kashmir Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	JKBK IN
	REUTERS CODE
S&P CNX: 3,634	JKBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs628

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	6.6	7.7	9.1	10.8
OP (Rs b)	4.5	5.8	7.0	8.4
NP (Rs b)	1.8	3.0	3.6	4.4
EPS (Rs)	36.5	62.7	74.3	90.1
EPS Growth (%)	53.7	72.0	18.4	21.4
BV/Share (Rs)	371.1	420.4	478.5	549.7
P/E (x)	17.2	10.0	8.5	7.0
P/ BV (x)	1.7	1.5	1.3	1.1
ABV (Rs)	353.1	407.5	467.8	538.9
P/ ABV (x)	1.8	1.5	1.3	1.2
RoE (%)	10.3	15.9	16.5	17.5
RoA (%)	0.7	1.1	1.2	1.3

KEY FINANCIALS	
Shares Outstanding (m)	48.5
Market Cap. (Rs b)	30.4
Market Cap. (US$ b)	0.7
Past 3 yrs. NII Growth (%)	8.0
Past 3 yrs. NP Growth (%)	-19.2
Dividend Payout (%)	24.8
Dividend Yield (%)	1.3
P/E to Growth (x)	0.3

STOCK DATA	
52-Week Range	703/306
Major Shareholders (%) (December 2006)	
Promoters	53.2
MFs/FIs	1.4
FIIs	33.9
Others	11.5
Average Daily Turnover	
Volume ('000 shares)	91.6
Value (Rs million)	44.6
1/6/12 Month Rel. Performance (%)	2/34/31
1/6/12 Month Abs. Performance (%)	-1/34/39

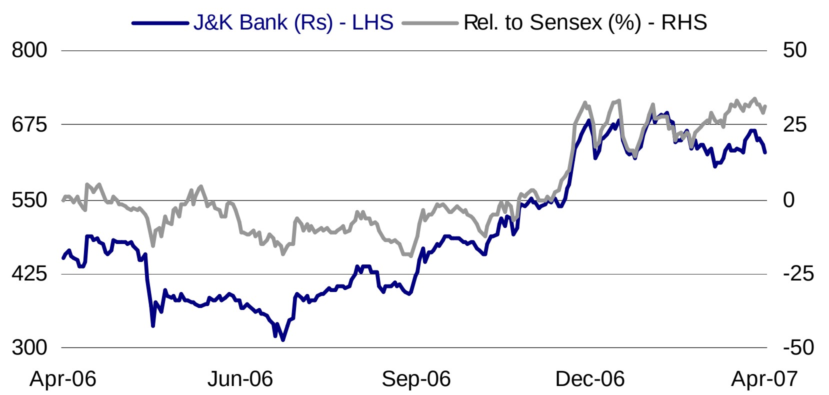
Restructuring over; profitable growth will follow: J&K Bank has shifted focus in favor of growth within the state of Jammu and Kashmir (J&K). With increased investments, the state's economy is likely to provide significant growth opportunities. Further, margins are much higher in the state for J&K Bank as compared to its business outside the state. The bank is re-aligning its strategy to shift the ratio of business within J&K state to business outside J&K from 40:60 to 50:50.

Margins on an improving trend: The increased focus on in-state operations and redemption of high cost deposits has resulted in margins improving to 3.6% (3% in 3QFY07) and are likely to sustain. In 3QFY07, NII grew in line with our estimate at 21% while profit growth at 66% was better than estimated. Loans grew by 18%.

Fee income initiatives paying off: By virtue of its near monopoly status, the bank is targeting big fee-based revenues from the J&K state. It is the sole banker to the J&K government. The bank aims to achieve 35-40% fee income growth in FY07. Further, the bank is a sizeable distributor of third-party products (mutual funds and insurance).

Valuations attractive: J&K Bank is set to scale up rapidly from hereon – it has good asset quality and is also adequately capitalized. We expect return ratios to improve over the next couple of fiscals. We reiterate **Buy** with a target price of Rs770 (upside of 22.6%).

STOCK PERFORMANCE (1 YEAR)



Restructuring over; profitable growth will follow

J&K Bank has shifted focus in favor of growth within the state of Jammu and Kashmir (J&K). It has been pursuing this strategy over the last few quarters. With increased investments, the state's economy is likely to provide significant growth opportunities. Further, margins are much higher in the state for J&K Bank as compared to its business outside the state. The bank is re-aligning its strategy to shift the ratio of business within J&K to business outside J&K from 40:60 to 50:50.

There were two key issues plaguing growth for J&K Bank – investment book losses and high-cost deposits, resulting in lower margins. During the course of the last couple of years, the bank has taken corrective steps to remedy this and has been successful – its investment book is now largely de-risked and the high-cost deposits are being increasingly replaced with CASA deposits. We believe that the stage is now set for the bank to deliver strong earnings growth on the back of steady volume growth and improving margins, leading to higher return ratios.

Focus shifting back to the state of J&K

Of the total loans, ~30% of the bank's lending is within the state of J&K. The bank has a market share of 67% in the lending business in J&K. With increased investments in the state coupled with economic stability and strong GDP growth, the overall growth momentum in the J&K economy is likely to remain strong over the next few years. The bank has renewed its focus to grab a significant share of the new emerging opportunities within the state. The bank also generates yields of 11.5-12% within the state as compared to 8-9% outside the state and current yields of 8.5% for J&K Bank.

J&K Bank's current strategy is to target the higher end of the yield spectrum within the state – SME, retail (mostly commercial vehicles) and horticulture. We believe that the bank can pull this off considering its extensive presence in the state as well as due to a resurgent economy.

On deposits too, focus within the state

The bank's earlier strategy of meeting business targets with high-cost bulk deposits led to margin squeeze. To address this anomaly, the bank has adopted two corrective measures:

1. Wholesale (corporate) deposits (~45% of total versus 68% in FY05 and FY06) will be collected only at the corporate office level so that branches do not compete for them. This will allow branches to focus on retail deposits to meet their business targets.
2. Sourcing higher deposits from within the state. Currently, about 58% of deposits are raised from the state, which has shown about 18% growth; almost 80% of the bank's incremental deposits are sourced from the state. The bank's CASA ratio within the state stands at 55% compared with 37% overall. Higher CASA and retail deposits will lower costs.

Out of state "specialist" focus

The management admits that although within the state of J&K, the bank's presence is dominant; it lacks a presence outside the state. So in addition to the usual large chunk of corporate business, which is low-margin high-volume and invariably occurring in a consortium, J&K Bank has decided to experiment with knowledge banking. J&K Bank intends to convert one branch each in Chennai, Kochi and Mumbai to specialized branches handling the leather, spices and castor oil businesses, respectively. Depending on how this strategy would evolve, outside of its home state, J&K Bank could become a niche banker.

Sustaining steady loan growth; redeeming high cost deposits

Business momentum continued across all segments with advances growing 22% YoY to Rs148b during 3QFY07. The bank's business portfolio currently has a mix of 35:65, with 35% of business in the state of J&K. The bank continues to focus on the high-yielding small and medium enterprises (SME) segment and retail loans, which together constitute almost 55% of bank's loan book. Management has indicated that it would like to increase its loan portfolio in J&K state, as the returns are much higher. The compositional shift in the deposits and advances portfolios of the bank in the J&K state has led to improvement in C/D ratio from 62% in 3QFY06 to 73% in 3QFY07.

Despite deposits growing at 4% YoY, J&K Bank's demand deposits are growing at a much faster pace. Low-cost deposits have grown at the rate of 23% YoY and now constitute 40.4% of total deposits. The management has indicated that low-cost deposits outside the state of J&K are only ~20%, while within the state, the proportion of low-cost deposits to total deposit is 55%.

Deposit growth within J&K much higher than overall deposit growth

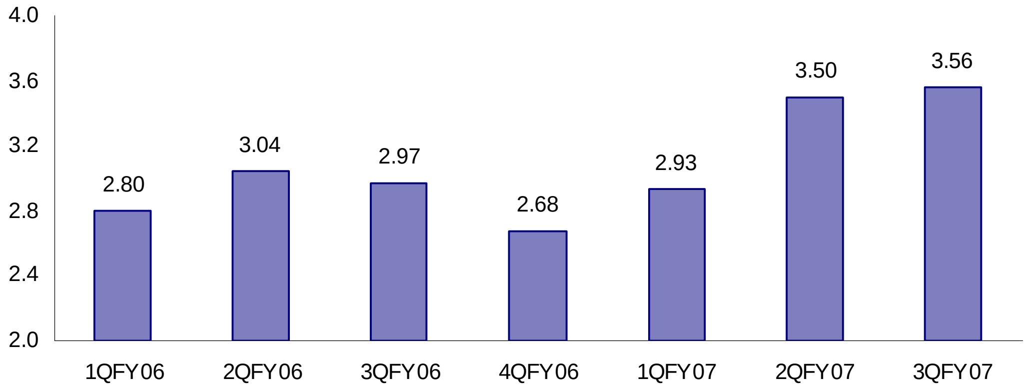
While deposits from within the state of J&K were up 23% YoY in 3QFY07, overall deposits were up by just 4% YoY due to the redemption of high cost deposits in favor of low cost deposits and also due to changing strategy of sourcing more retail/low-cost deposits from within the state. This has resulted in subdued growth in total deposits.

Margins on a rising trend

Despite pressure on yields on investments due to a conscious decision by the management to move to a low-yielding portfolio to reduce dependence on income from investments, net interest margins (NIM) have increased to 3.56% in 3QFY07 from 2.97% in 3QFY06, largely due to improvement in advance yields and lowering the cost of deposits. Management is focused on protecting its current margins, by sourcing greater high-margin business. This coupled with the growing advances portfolio, higher accretion of low-cost deposits and sell-down of the low-yielding investment portfolio should result in sustaining higher margins going forward.

While yield on advances has improved by 38bp YoY to 9.4% in 3QFY07, cost of deposits has come down by 9bp YoY to 5%, as the bank shed high-cost deposits outside J&K for low-cost retail deposits in the J&K state.

TREND IN NIMS OVER THE LAST 7 QUARTERS (%)

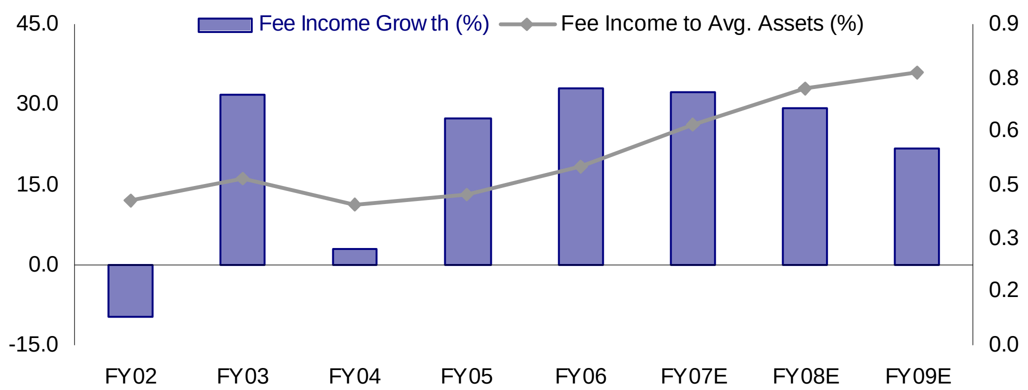


Source: Company/ Motilal Oswal Securities

Fee income initiatives appear to be paying off well

Fee income is a function of the technology employed, the depth of franchise, product range and government business. While J&K Bank had franchise and technology, it lagged product range. However, it is currently making rapid strides in this area. The bank has been proactive in opening branches at suitable locations, a necessity to generate income from non-fund sources. Currently, the bank is a big distributor of third-party products (mutual funds and insurance); it also offers bill payment services and cash management services. Also, the bank is an advisor to the government for their infrastructure investments. It aims to achieve growth of 35-40% in fee income in FY07.

FEE INCOME TO AVG. ASSETS RISING

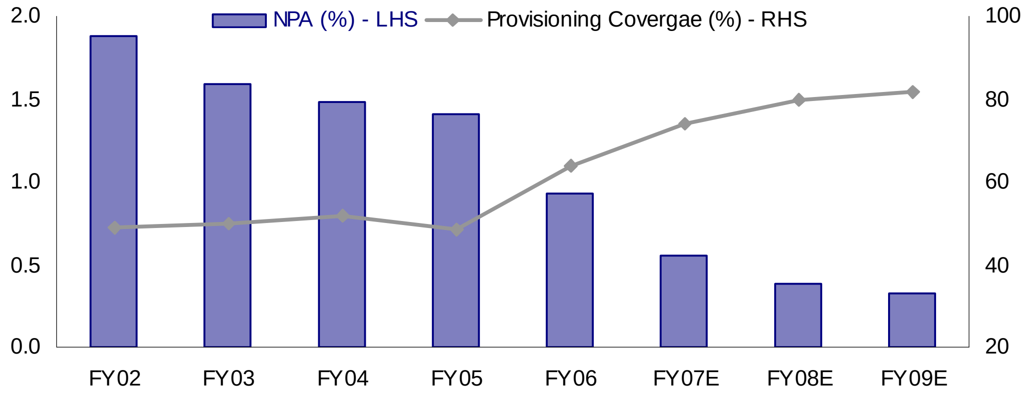


Source: Company/ Motilal Oswal Securities

Net NPAs at 0.7%

Asset quality remains strong, with net NPAs having declined to 0.7%. The bank has improved its coverage ratio to 73% in 3QFY07 from 57% in 3QFY06. The bank is aiming at international standards of 80% provision coverage ratio.

NET NPA ON A DECLINING TREND (%)



Source: Company/ Motilal Oswal Securities

Valuations attractive, despite recent run-up

With strong latent demand in the state of J&K, we expect healthy loan growth for J&K Bank to continue. Current margins are likely to sustain, as the bank reduces its cost of deposits by improving CASA and shedding high-cost deposits. Yields on advances are likely to sustain or improve by a slight margin. Fee income is also likely to increase further, as the bank is focused on selling third-party products and undertakes more J&K state related businesses. Post 3QFY07 results, we have upgraded our earnings estimates by 12% for FY07 and 7% for FY08. The stock trades at 7x FY09E EPS and 1.1x FY09E BV. We reiterate **Buy** with a target price of Rs770 (upside of 22.6%).

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	15,492	17,063	19,148	22,435	26,293
Interest Expended	9,530	10,425	11,402	13,344	15,495
Net Interest Income	**5,962**	**6,637**	**7,746**	**9,090**	**10,799**
Change (%)	*-3.8*	*11.3*	*16.7*	*17.4*	*18.8*
Other Income	961	1,332	1,735	2,280	2,754
Net Income	**6,924**	**7,969**	**9,481**	**11,370**	**13,553**
Change (%)	*-24.9*	*15.1*	*19.0*	*19.9*	*19.2*
Operating Expenses	3,228	3,453	3,657	4,327	5,110
Operating Income	3,696	4,517	5,824	7,044	8,443
Change (%)	*-41.2*	*22.2*	*29.0*	*20.9*	*19.9*
Other Provisions	2,336	1,905	1,600	1,900	2,200
PBT	**1,359**	**2,611**	**4,224**	**5,144**	**6,243**
Tax	209	843	1,183	1,543	1,873
Tax Rate (%)	*15.3*	*32.3*	*28.0*	*30.0*	*30.0*
PAT	**1,151**	**1,769**	**3,042**	**3,601**	**4,370**
Change (%)	*-71.7*	*53.7*	*72.0*	*18.4*	*21.4*
Proposed Dividend	439	442	558	669	781

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	485	485	485	485	485
Reserves & Surplus	16,169	17,510	19,899	22,717	26,173
Net Worth	16,654	17,995	20,384	23,201	26,658
Deposits	**216,450**	**234,846**	**248,937**	**286,278**	**329,219**
Change (%)	*16.0*	*8.5*	*6.0*	*15.0*	*15.0*
Borrowings	4,065	3,509	3,860	4,246	4,671
Other Liabilities & Prov.	7,633	8,135	8,542	8,969	9,418
Total Liabilities	**244,802**	**264,486**	**281,724**	**322,695**	**369,966**
Current Assets	31,783	22,874	23,870	25,426	26,146
Investments	90,892	90,020	76,517	80,343	84,360
Change (%)	*7.6*	*-1.0*	*-15.0*	*5.0*	*5.0*
Advances	115,171	144,831	173,797	208,557	250,268
Change (%)	*24.0*	*25.8*	*20.0*	*20.0*	*20.0*
Net Fixed Assets	2,024	1,946	2,244	2,544	2,784
Other Assets	4,931	4,814	5,296	5,825	6,408
Total Assets	**244,802**	**264,486**	**281,723**	**322,695**	**369,966**

ASSUMPTIONS (%)

Deposit Growth	16.0	8.5	6.0	15.0	15.0
Advances Growth	24.0	25.8	20.0	20.0	20.0
Investments Growth	7.6	-1.0	-15.0	5.0	5.0
Dividend	80.0	80.0	100.0	120.0	140.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%					
Avg. Yield - Earning Assets	7.0	6.9	7.1	7.5	7.6
Avg. Cost-Int. Bear. Liab.	4.6	4.5	4.6	4.9	5.0
Interest Spread	2.4	2.4	2.5	2.6	2.6
Net Interest Margin	2.7	2.7	2.9	3.0	3.1
Profitability Ratios (%)					
RoE	7.1	10.3	15.9	16.5	17.5
RoA	0.5	0.7	1.1	1.2	1.3
Int. Expended/Int.Earned	61.5	61.1	59.5	59.5	58.9
Other Inc./Net Income	13.9	16.7	18.3	20.1	20.3
Efficiency Ratios (%)					
Op. Exps./Net Income	46.6	43.3	38.6	38.1	37.7
Empl. Cost/Op. Exps.	55.4	55.7	57.6	58.0	57.1
Busi. per Empl. (Rs m)	48.3	52.0	55.7	60.8	68.9
NP per Empl. (Rs lac)	1.7	2.6	4.2	4.8	5.6
Asset-Liability Profile (%)					
Adv./Deposit Ratio	53.2	61.7	69.8	72.9	76.0
Invest./Deposit Ratio	42.0	38.3	30.7	28.1	25.6
G-Sec/Invest. Ratio	64.4	71.0	71.0	71.0	71.0
Gross NPAs to Adv.	2.7	2.5	2.1	1.9	1.7
Net NPAs to Adv.	1.4	0.9	0.6	0.4	0.3
CAR	15.2	12.1	12.8	10.6	10.8
Tier 1	*12.5*	*11.8*	*12.0*	*9.8*	*9.5*

VALUATION

Book Value (Rs)	343.4	371.1	420.4	478.5	549.7
Price-BV (x)	1.8	1.7	1.5	1.3	1.1
Adjusted BV (Rs)	321.6	353.1	407.5	467.8	538.9
Price-ABV (x)	2.0	1.8	1.5	1.3	1.2
EPS (Rs)	23.7	36.5	62.7	74.3	90.1
EPS Growth (%)	-71.7	53.7	72.0	18.4	21.4
Price-Earnings (x)	26.5	17.2	10.0	8.5	7.0
OPS (Rs)	76.2	93.1	120.1	145.3	174.1
OPS Growth (%)	-41.2	22.2	29.0	20.9	19.9
Price-OP (x)	8.2	6.7	5.2	4.3	3.6

E: MOSt Estimates

Indian Overseas Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	IOB IN
	REUTERS CODE
S&P CNX: 3,634	IOBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs96

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	20.7	24.2	27.7	32.0
OP (Rs b)	15.3	18.8	20.1	23.7
NP (Rs b)	7.8	9.6	11.1	13.0
EPS (Rs)	14.4	17.5	20.3	23.8
EPS Growth (%)	20.3	22.0	15.8	17.2
BV/Share (Rs)	56.1	70.1	86.3	105.5
P/E (x)	6.7	5.5	4.7	4.0
P/BV (x)	1.7	1.4	1.1	0.9
ABV (Rs)	53.4	68.3	84.2	102.8
P/ABV (x)	1.8	1.4	1.1	0.9
RoE (%)	27.2	26.8	25.3	24.3
RoA (%)	1.4	1.4	1.4	1.4

KEY FINANCIALS	
Shares Outstanding (m)	544.8
Market Cap. (Rs b)	52.5
Market Cap. (US$ b)	1.2
Past 3 yrs. NII Growth (%)	19.2
Past 3 yrs. NP Growth (%)	23.5
Dividend Payout (%)	18.1
Dividend Yield (%)	2.7
P/E to Growth (x)	0.3

STOCK DATA	
52-Week Range	129/66
Major Shareholders (%) (December 2006)	
Promoters	61.2
Domestic Institutions	5.1
FIIs/FDIs	18.2
Others	15.5
Average Daily Turnover	
Volume ('000 shares)	483.6
Value (Rs million)	49.4
1/6/12 Month Rel. Performance (%)	-3/-12/-9
1/6/12 Month Abs. Performance (%)	-6/-11/-1

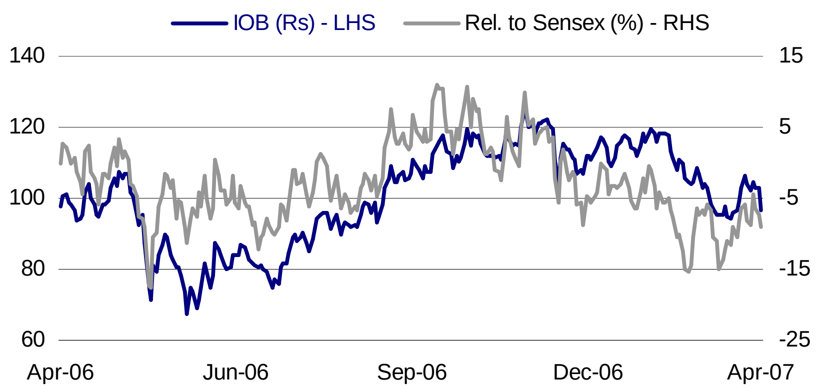
Hallmark is consistency: Indian Overseas Bank (IOB) has been the most consistent performer amongst PSU banks in the last five years. Net profit has grown at 36% CAGR over FY02-06, margins have improved, RoE has been >25% and assets have grown at 23% CAGR.

One of the highest margins: The bank enjoys NIMs of ~4%, and has been able to sustain margins at these levels. The high yields are on account of greater exposure to traders and SMEs, which constitute around 42% of the credit portfolio. Even as we expect margins to decline, IOB would still be amongst the high margin earning banks.

Well managed asset quality: NPA levels have been prudently reduced by progressive write-offs, lower slippages and better recoveries. At the end of 2QFY07, gross NPAs were 2.9% (3.4% in FY06) and net NPAs were 0.6% (0.7% in FY06) – lower than most large state-owned banks. In 9MFY07, recoveries amounted to Rs2.5b, a 36% growth.

Sustained RoE and RoA; deserves better valuations: We are impressed by IOB's ability to maintain profit growth despite cleaning up its balance sheet. Besides, it has been sustaining its high RoA and RoE. Given the growth prospects and high margins, we believe IOB will continue delivering historical RoA and RoE for the net couple of years. The stock trades at 4x FY09E EPS and 0.9x FY09E BV and offers a yield of ~4%. We expect the bank to deliver RoE of >24% for FY07-09. We reiterate **Buy,** with a target price of Rs148.

STOCK PERFORMANCE (1 YEAR)



Hallmark is consistency

IOB has been the most consistent performer amongst state-owned banks in the last five years. Net profit has grown 36% CAGR over FY02-06, margins have improved YoY, RoE has been >25%, and assets have grown at 23% CAGR.

On the back of high margins and efficient capital management, the bank has, for the fifth consecutive year, delivered 25%+ RoE. Moreover, expectation of RoA of around 1.5% indicates improved asset utilization levels and profitability. The RoE-RoA combination in IOB is amongst the best in industry. We expect the bank to maintain RoA at 1.5% and RoE at 25%+ over next couple of years on the back of strong margins, lower operating expenses and lower provisions.

Maintaining ~4% margins

IOB is amongst the few banks, maintaining high margins (~4%) on account of higher advances and investment yields, and relatively lower costs due to the higher proportion of its low-cost deposit base. Yields on the credit portfolio were 9.5% in 2QFY07 (60bp improvement from FY06; 9.1% in 1QFY07). High yields are on account of greater exposure to traders and the SME and agriculture sectors, which constitute around 42% of the bank's credit portfolio. We expect this relatively higher yield to sustain, leading to higher margins ahead.

BREAK-UP ON MOVEMENT OF NIMS (%)

	1HFY06	9MFY07	FY06	1QFY07	1HFY07	9MFY07
Avg Yield on Adv.	8.9	8.9	8.9	9.1	9.5	9.5
Avg Yield on Inv.	8.6	8.6	8.5	8.4	8.3	8.2
Avg Cost of Dep.	4.6	4.6	4.7	4.8	5.0	5.2
NIMs	**4.1**	**4.1**	**4.1**	**4.0**	**4.0**	**3.9**

Source: Company / Motilal Oswal Securities

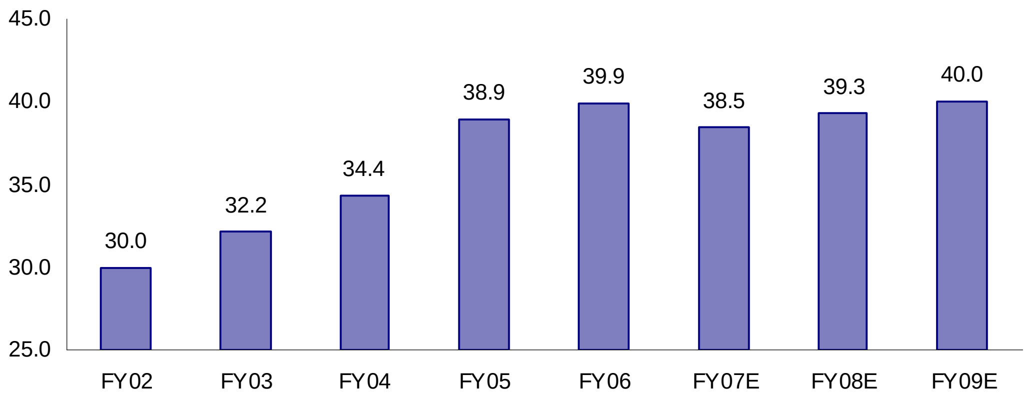
The management has stated its intent to continue focusing on retail trade, agriculture, and credit to the SSI/SME sectors, where average yields are 11%, 9-10%, and 10-13%, respectively. Corporate lending, on the other hand, yields ~10%.

IOB ADVANCES PROFILE (RS B)

	FY04	FY05	FY06	% OF DOM. FY06	GR. (%) (%)
Global Advances	203	252	348	NA	37.9
Domestic Advances	188	235	327	NA	39.4
Priority Sector Advances	79	99	137	41.9	39.0
Agriculture Advances	34	43	60	18.2	39.7
SSI Advances	22	25	32	9.7	28.6
SME Advances	NA	37	47	14.3	28.1

Source: Company / Motilal Oswal Securities

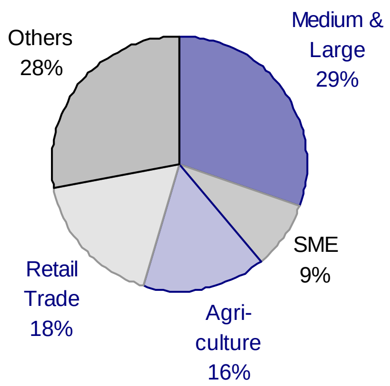
TREND IN CASA DEPOSITS (%)



Source: Company / Motilal Oswal Securities

While the bank has been able to contain increase in cost of deposits, leading to higher margins, its investment yields continue to be on the higher side. We expect investment yield to taper off gradually to ~7.5%, which could lead to some margin pressure. Nonetheless, we have built lower future margins due to declining investment yields.

BREAK-UP OF LOAN BOOK (%)



Source: Company / Motilal Oswal Securities

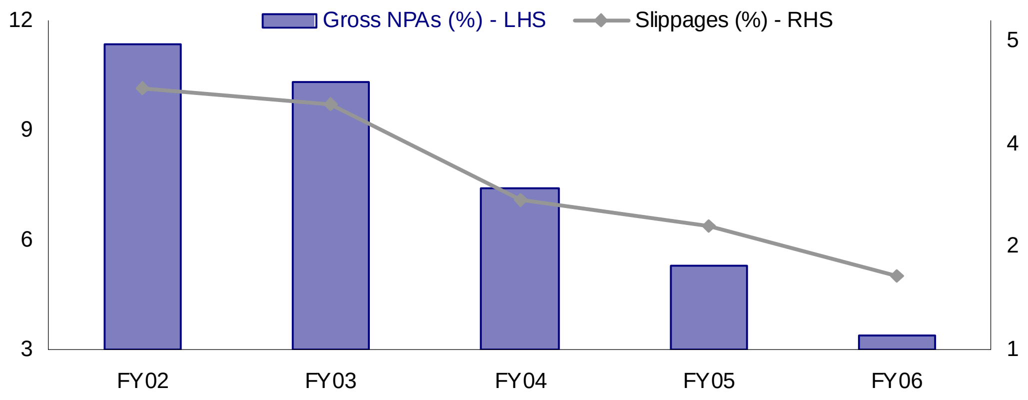
The bank earns one of the best NIMs in the sector; additionally, IOB has been able to manage these 4%+ margins over the last eight quarters. However, going forward, we believe that while asset yields would tend to improve (we believe the recent PLR hike is not fully captured in 3QFY07 results), investment yields would tend to decline and could result in slight margin pressure. Overall, we are factoring in declining margins for the next few fiscals, in our expectations.

Asset quality well managed; recoveries could provide upside

IOB has progressively reduced its NPA levels by its prudent strategy of write-offs, lower slippages and better recoveries. At the end of 2QFY07, gross NPAs stood at 2.9% (3.4%

in FY06) and net NPAs were 0.6% (0.7% in FY06), lower than most large state-owned banks. Also, the bank recovered Rs3.5b in FY06 versus Rs2.5b in FY05. In 1HFY07, recoveries amounted to Rs1.8b, 36% higher than Rs1.4b in 1HFY06.

ASSET QUALITY WELL MANAGED (%)

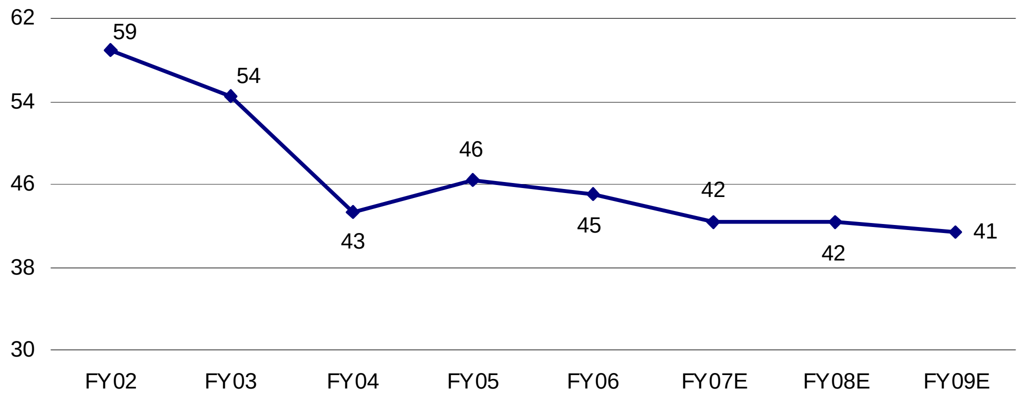


Source: Company / Motilal Oswal Securities

Low op-ex growth

IOB's operating expenses including employee expenses have grown by just 7.5% CAGR over FY01-06, one of the lowest growth rates in the system. With income growth and slower growth in operating expenses over the stated period, cost-income ratio has also trended downward from as high as 74% in FY01 to 45% in FY06. We expect C-I ratio to move further downward to 42% by FY09 on the back of controlled expenses.

COST TO INCOME RATIO (%)



Source: Company / Motilal Oswal Securities

Fee income initiatives paying off well

IOB has been diversifying its fee income stream by focusing on the retail segment apart from traditional fee income streams (LCs, guarantees, etc.) from the corporate sector.

The bank has alliances with third party financial companies to distribute their mutual fund and insurance products (8 AMCs, LIC & United India). It has also started to sell gold through select retail branches, which also earns good returns. Additionally, the bank recently signed an MoU for a five-way tie-up (Allahabad Bank, Karnataka Bank, Dabur Investments and Sampo Japan) for a non-life insurance venture. IOB will have 19% stake in this venture. The results are already visible in the bank's fee income growth – 27% YoY in 1HFY07.

Investment book well cushioned

IOB's investment book size is Rs198b, of which 77% is in HTM (85% in HTM-SLR). The balance in the AFS book is largely floating notes. IOB's modified duration on the AFS book has been brought down to two years.

Adequate capital to fund growth

Currently, IOB's total capital adequacy is 14.7%; an improvement of 129bp QoQ, coming in largely from tier-II, with tier-I at 8.9%. IOB has been raising capital in the form of upper tier-II capital (raised Rs10b in 1HFY07), allowing the bank to improve its tier-II ratio by 126bp YTD. Until date, besides raising Rs10b as upper tier-II capital, it has also raised Rs2.8b as perpetual debt and Rs8b as syndicated debt. The management also indicated that post implementation of Basel 2 norms, the bank could see erosion of ~125bp in its capital (based on risk-weighted assets as of September 2006). Moreover, with government holding at 61%, IOB has further headroom ahead to increase its capital requirements by way of equity dilution. We believe the bank will have minimal problems as far as regulatory capital requirements are concerned.

Pension adequately funded; AS-15 impact ~Rs2b

Close to 40% of the bank's employees have opted for the pension scheme. The management indicated that IOB's corpus is adequately funded and there are no material issues. As far as AS-15 is concerned, management stated that discussions are ongoing with the RBI to apportion this shortfall. Nonetheless, the management has indicated likely pension shortfall on account of AS-15 at about Rs2b (5% of FY07E BV).

Bharat Overseas Bank acquisition at reasonable price

IOB has recently taken control of Bharat Overseas Bank (BhoB, an unlisted private sector bank. It has bought out the stakes of the six other banks in BhoB, in which IOB held the highest stake – 30%. The consideration was Rs155/share, resulting in IOB paying out Rs1.7b for the acquisition.

While as of now it is a 100% subsidiary of IOB, post regulatory approvals from the Thailand regulators, the bank plans to fold BhoB into itself. Clearly, IOB has got a better bank with net NPAs of less than 2% and adequate capital strength. BhoB also strengthens IOB's branch network with addition of ~100 additional branches and would add about Rs20b of advances to its portfolio apart from its famous Thai operations.

The acquisition would also allow IOB to expand the balance sheet to around 6%. The acquisition would not strain IOB's capital levels, given capital adequacy 11% for BhoB. Moreover, BhoB is neither sick nor weak and we do not expect it to be a drag on IOB's existing credit quality levels.

AS OF MARCH 2006 (RS M)

	BHOB	IOB	BHOB AS A % OF IOB
Deposits	32,441	505,293	6.4
Advances	20,535	347,562	5.9
Investments	9,606	189,523	5.1
SLR	7,867	155,181	5.1
Assets	37,304	593,578	6.3
Net Worth	2,038	31,774	6.4
NII	1,066	20,672	5.2
Net Profit	56	7,833	0.7
CAR (%)	11.24	13.04	NA
Net NPA (%)	1.87	0.65	NA
No of branches	102	1,513	6.7
No of employees	1,049	24,178	4.3

Source: Company / Motilal Oswal Securities

Deserves better valuations; Buy

IOB has maintained consistency in core earnings growth, supported by steady growth in its advances portfolio and high and stable NIMs. It has continued to impress by maintaining profit growth, despite cleaning up of its balance sheet and sustaining high RoEs. We expect earnings to grow by 22% in FY07 and by 17% in FY08. The stock trades at 4x FY09E EPS and 0.9x FY09E BV and offers a yield of ~4%. We expect the bank to deliver RoE of >24% for FY07 and FY08. We reiterate **Buy,** with a target price of Rs148.

Concerns

- In the medium-to-long term, the key risk for the bank is economic slowdown, which could impact asset growth as well as lead to increase in NPA levels given the bank' relatively high exposure to the SME/retail sectors, which would be more susceptible to a slowdown.
- Investment yields continue to be above 8%, which are likely to decline in future, resulting in margin pressure.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	39,510	44,063	56,434	69,747	84,010
Interest Expended	20,955	23,391	32,272	41,999	52,010
Net Interest Income	**18,555**	**20,672**	**24,162**	**27,748**	**32,000**
Change (%)	*16.0*	*11.4*	*16.9*	*14.8*	*15.3*
Other Income	6,398	7,282	7,924	7,116	8,127
Net Income	**24,953**	**27,954**	**32,087**	**34,864**	**40,127**
Change (%)	*6.6*	*12.0*	*14.8*	*8.7*	*15.1*
Operating Expenses	11,585	12,616	13,316	14,791	16,449
Operating Income	**13,368**	**15,338**	**18,771**	**20,073**	**23,678**
Change (%)	*0.9*	*14.7*	*22.4*	*6.9*	*18.0*
Other Provisions	3,498	5,482	5,500	4,700	5,400
PBT	**9,870**	**9,856**	**13,271**	**15,373**	**18,278**
Tax	3,356	2,023	3,716	4,304	5,301
Tax Rate (%)	*34.0*	*20.5*	*28.0*	*28.0*	*29.0*
PAT	**6,514**	**7,833**	**9,555**	**11,069**	**12,977**
Change (%)	*27.0*	*20.3*	*22.0*	*15.8*	*17.2*
Proposed Dividend	1,484	1,416	1,634	1,907	2,179

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	5,448	5,448	5,448	5,448	5,448
Reserves & Surplus	20,304	26,326	33,969	42,807	53,235
Net Worth	**25,752**	**31,774**	**39,417**	**48,255**	**58,683**
Deposits	**442,412**	**505,293**	**621,510**	**739,597**	**880,121**
Change (%)	*6.7*	*14.2*	*23.0*	*19.0*	*19.0*
Borrowings	5,907	7,366	9,004	11,255	14,068
Other Liabilities & Prov.	34,079	49,144	59,956	65,952	69,249
Total Liabilities	**508,150**	**593,578**	**729,887**	**865,059**	**1,022,121**
Current Assets	49,540	37,072	44,290	55,467	64,310
Investments	190,147	189,523	198,999	218,899	251,734
Change (%)	*-5.7*	*-0.3*	*5.0*	*10.0*	*15.0*
Advances	252,052	347,562	465,733	568,194	681,833
Change (%)	*24.2*	*37.9*	*34.0*	*22.0*	*20.0*
Net Fixed Assets	4,523	4,577	4,537	4,537	4,487
Other Assets	11,888	14,843	16,328	17,961	19,757
Total Assets	**508,150**	**593,578**	**729,887**	**865,059**	**1,022,121**

ASSUMPTIONS (%)

Deposit Growth	6.7	14.2	23.0	19.0	19.0
Advances Growth	24.2	37.9	34.0	22.0	20.0
Investments Growth	-5.7	-0.3	5.0	10.0	15.0
Dividend	24.0	26.0	30.0	35.0	40.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.4	8.3	8.8	9.0	9.2
Avg. Cost-Int. Bear. Liab.	4.8	4.9	5.6	6.1	6.3
Interest Spread	3.6	3.4	3.2	2.9	2.8
Net Interest Margin	3.9	3.9	3.8	3.6	3.5
Profitability Ratios (%)					
RoE	28.0	27.2	26.8	25.3	24.3
RoA	1.3	1.4	1.4	1.4	1.4
Int. Expended/Int.Earned	53.0	53.1	57.2	60.2	61.9
Other Inc./Net Income	25.6	26.1	24.7	20.4	20.3
Efficiency Ratios (%)					
Op. Exps./Net Income	46.4	45.1	41.5	42.4	41.0
Empl. Cost/Op. Exps.	72.8	70.8	70.1	69.3	67.9
Busi. per Empl. (Rs m)	26.9	32.0	40.5	50.2	60.4
NP per Empl. (Rs lac)	2.7	3.2	4.0	4.6	5.5
Asset-Liability Profile (%)					
Adv./Deposit Ratio	57.0	68.8	74.9	76.8	77.5
Invest./Deposit Ratio	43.0	37.5	32.0	29.6	28.6
G-Sec/Invest. Ratio	82.7	81.9	87.3	86.5	86.5
Gross NPAs to Adv.	5.3	3.4	2.7	2.5	2.3
Net NPAs to Adv.	1.3	0.7	0.3	0.3	0.3
CAR	14.2	13.0	13.5	12.0	11.7
Tier 1	7.1	8.5	8.5	7.5	7.2

VALUATION

Book Value (Rs)	44.7	56.1	70.1	86.3	105.5
Price-BV (x)	2.2	1.7	1.4	1.1	0.9
Adjusted BV (Rs)	40.9	53.4	68.3	84.2	102.8
Price-ABV (x)	2.4	1.8	1.4	1.1	0.9
EPS (Rs)	12.0	14.4	17.5	20.3	23.8
EPS Growth (%)	27.0	20.3	22.0	15.8	17.2
Price-Earnings (x)	8.1	6.7	5.5	4.7	4.0
OPS (Rs)	24.5	28.2	34.5	36.8	43.5
OPS Growth (%)	0.9	14.7	22.4	6.9	18.0
Price-OP (x)	3.9	3.4	2.8	2.6	2.2

E: MOSt Estimates

UTI Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	UTIB IN
	REUTERS CODE
S&P CNX: 3,634	UTBK.BO

2 April 2007 **Buy**

Previous Recommendation: Buy Rs460

Y/E MARCH	2006	2007E	2008E	2009E
NII (Rs b)	10.8	15.5	20.2	24.9
OP (Rs b)	9.9	13.4	16.5	19.8
NP (Rs b)	4.9	6.3	7.8	9.7
EPS (Rs)	17.4	22.6	28.1	34.9
EPS Growth (%)	42.4	30.0	24.0	24.5
BV/Share (Rs)	103.1	121.0	143.7	173.3
P/E (x)	26.4	20.3	16.4	13.2
P/BV (x)	4.5	3.8	3.2	2.7
ABV (Rs)	98.0	115.7	136.7	163.6
P/ABV (x)	4.7	4.0	3.4	2.8
RoE (%)	18.4	20.2	21.2	22.0
RoA (%)	1.1	1.1	1.0	1.0

KEY FINANCIALS	
Shares Outstanding (m)	278.7
Market Cap. (Rs b)	128.2
Market Cap. (US$ b)	2.9
Past 3 yrs. NII Growth (%)	49.5
Past 3 yrs. NP Growth (%)	36.2
Dividend Payout (%)	23.2
Dividend Yield (%)	0.8
P/E to Growth (x)	0.8

STOCK DATA	
52-Week Range	615/222
Major Shareholders (%) (December 2006)	
Promoters	43.2
Domestic Institutions	8.4
FIIs/FDIs	40.8
Others	7.6
Average Daily Turnover	
Volume ('000 shares)	711.0
Value (Rs million)	299.3
1/6/12 Month Rel. Performance (%)	1/20/20
1/6/12 Month Abs. Performance (%)	-2/21/27

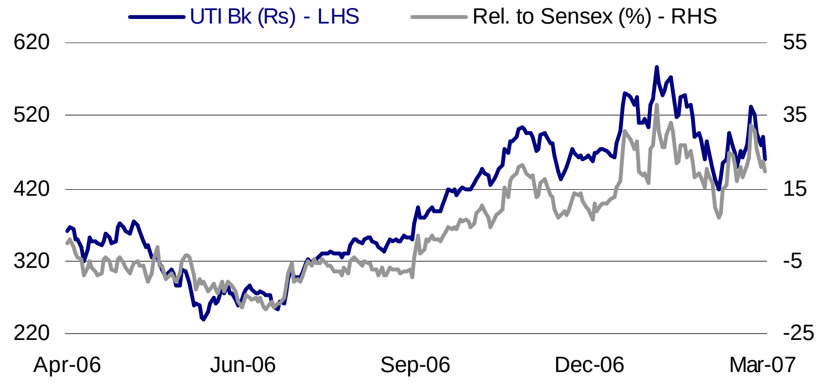
UTI Bank has been one of the fastest growing banks. Over the last couple of fiscals, it has aggressively invested in branch additions, resulting in its CASA ratio moving up from 30-32% to 37-39%. It is also building up its fee income stream, which has been growing very fast. Given its net NPAs at 0.7% and strong earnings visibility, we continue to be positive on the prospects of UTI Bank.

Will maintain strong growth across parameters: UTI Bank is likely to sustain strong balance sheet growth of 40% CAGR over the next two years, driven both by the corporate and retail segment. Increasing proportion of retail loans would have positive impact on yield on advances and NIMs. The bank has brought down its NPAs to below 1% and is likely to maintain this. We also believe that the bank will continue to maintain strong growth in fee income, going forward.

Investment in new branches will result in faster growth: Over the last couple of quarters, UTI Bank has been aggressively growing its distribution network. In FY06, it added 111 branches and is likely to add ~85 branches in FY07.

Strong earnings visibility; Buy: We expect earnings to grow by 24% in FY08 and by 25% in FY09. The bank will be considering raising equity in 2HFY08, which we believe could be significantly book accretive. The stock trades at 13.2x FY09E EPS and 2.7x FY09E BV. Considering its RoE of >21%, we believe that the stock could trade at 3.2x FY09E BV. We maintain **Buy** with a price target of Rs554.

STOCK PERFORMANCE (1 YEAR)



Will sustain strong balance sheet growth

UTI Bank is likely to sustain its strong balance sheet growth of 40% CAGR over the next two years, driven both by the corporate and retail segment. The bank expects to maintain a ratio of 70:30 in terms of corporate and retail loan book. While retail has been growing fast traditionally, the management believes that corporate loan portfolio has become more profitable in the current environment.

New branches will aid growth

UTI Bank has over the last few quarters aggressively opened new branches, which should aid strong growth for the bank. These new branch additions are already resulting in strong growth in its core deposit base, which is growing at 50%+.

NO OF INCREMENTAL BRANCH ADDITIONS (QOQ)

	FY06				FY07			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE
UTI Bank	11	23	40	37	13	6	12	40-50

Source: Company / Motilal Oswal Securities

CASA to grow with network expansion

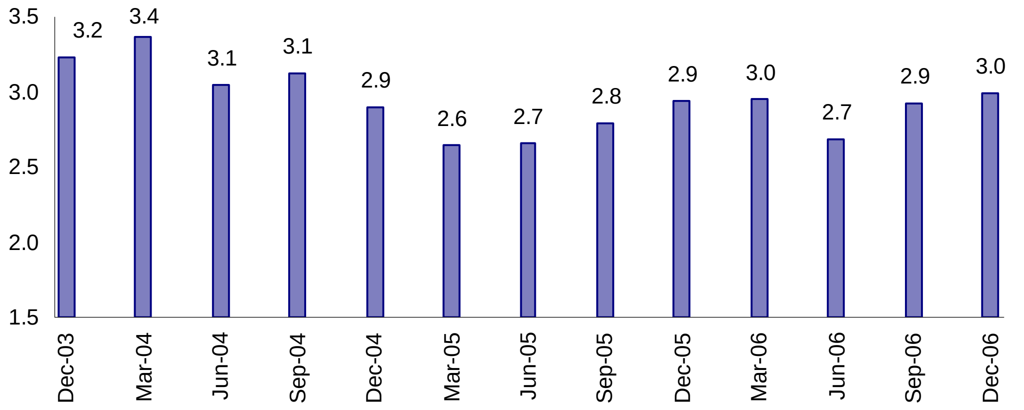
With the growing branch network, UTI Bank's savings accounts have been increasing rapidly. The bank's saving accounts base has grown to 3.8m in 1QFY07. It has the third largest debit card base in India. The daily average savings bank balances during FY06 grew by 68% YoY. Salary savings accounts, which are relatively stable, constitute 25% of saving deposits. Apart from several corporates, the bank handles salary accounts of the armed forces, too. The bank also had 0.24m current account relationships as at end-FY06 and the daily average current account balances grew by 55% YoY to Rs44.3b in FY06.

Low cost deposit ratio of UTI bank has been improving over the past few quarters. With the rapid expansion of branch and ATM network and steady widening of the bank's reach to smaller cities and towns, we believe UTI bank is well positioned to further improve its low-cost deposits ratio by another 3-4% over the next 12 months. This would help it to reduce the upward pressure on cost of funds and protect its NIMs.

Margins have been on an increasing trend

NIMs increased by 8bp QoQ in 3QFY07, the second straight quarter of sequential increase in margins for the bank. NIMs increased to 3% in 3QFY07 from 2.92% in 2QFY07. The bank believes that it now has a credible and encouraging pipeline of corporate advances, indicating a visible upswing in the credit cycle. As this translates into loan assets, UTI Bank's NIMs should rise further. Average cost of funds decreased marginally to 5.53% in 3QFY07 as compared to 5.42% in 2QFY07, but increased 67bp from 4.86% in 3QFY06.

TREND IN NIMs (%)



Source: Company / Motilal Oswal Securities

Fee income growth to continue

UTI Bank currently generates fee income from activities like credit transactions, cash management, ATM sharing, collection for governments, retail banking (including distribution of third party products), capital markets, debt syndication and placements, and debit cards. It has also put in place a wealth management team, which will begin contributing to fee income growth.

The bank has also launched its own credit cards in 2QFY07. Besides, its international branches (initially Singapore, later China, Hong Kong and Dubai) will start contributing to fee income. Even in the corporate segment, the bank foresees increased opportunities to earn fees in the areas of project appraisal, loan syndication, etc.

Fee income growth has continued to be steady for UTI Bank - it grew 61% YoY in 3QFY07. The bank has diversified its sources of fee income in the last 12 months and built in a sustainable source of income. We expect steady growth in fee income in future years, as well with higher contribution coming from retail fees on the back of its credit cards and wealth management operations.

Tier-I ratio at 7%

UTI Bank raised hybrid capital of US$150m and Rs2b by way of upper tier-II bonds and US$46m and Rs2.1b by way of tier-I perpetual debt during the nine months ended December 2006. This is part of the US$700m capital raising announced by the bank some time ago in the form of hybrid tier-I, upper tier-II and subordinated bonds during FY07. The management has clearly indicated that equity capital issuance would not occur until 2HFY08. Post the current capital raising, the tier-I ratio has increased over 7%.

Strong earnings visibility; Buy

We expect earnings to grow by 24% in FY08 and by 25% in FY09. The bank will be considering raising equity in 2HFY08, which we believe could be significantly book accretive. The stock trades at 13.2x FY09E EPS and 2.7x FY09E BV. Considering its RoE of >21%, we believe that the stock could trade at 3.2x FY09E BV. We maintain **Buy** with a price target of Rs554.

Key concern

UTI-1 holds 27%: The erstwhile UTI still holds a 27% stake in the bank. While it is likely to sell off this holding over the next 12-15 months, the mechanics of the sale are still not clear. While the probability is low, it could even look at selling it to LIC / some other public sector entity which might hamper the valuations of the bank.

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	19,242	28,888	44,677	61,027	76,587
Interest Expended	11,930	18,106	29,223	40,821	51,718
Net Interest Income	7,312	10,782	15,455	20,207	24,869
Change (%)	*26.7*	*47.5*	*43.3*	*30.7*	*23.1*
Other Income	4,158	7,296	10,153	12,681	15,957
Net Income	**11,470**	**18,079**	**25,608**	**32,888**	**40,826**
Operating Expenses	5,814	8,141	12,244	16,426	21,006
Operating Income	5,656	9,938	13,364	16,462	19,821
Change (%)	*-19.0*	*75.7*	*34.5*	*23.2*	*20.4*
Other Provisions	619	2,625	3,950	4,700	5,500
PBT	**5,037**	**7,313**	**9,414**	**11,762**	**14,321**
Tax	1,691	2,462	3,107	3,940	4,583
PAT	**3,346**	**4,851**	**6,307**	**7,822**	**9,738**
Change (%)	*20.2*	*45.0*	*30.0*	*24.0*	*24.5*
Proposed Dividend	878	1,126	1,115	1,282	1,282

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	2,738	2,787	2,787	2,787	2,787
Reserves & Surplus	21,344	25,935	30,938	37,260	45,498
Net Worth	**24,082**	**28,722**	**33,725**	**40,046**	**48,285**
Deposits	317,120	401,135	553,567	691,958	864,948
Borrowings	17,948	26,943	37,721	41,493	45,642
Other Liab & Provisions	18,287	40,510	52,663	68,462	89,001
Total Liabilities	**377,437**	**497,311**	**677,676**	**841,960**	**1,047,876**
Current Assets	45,029	36,418	43,300	51,341	62,527
Investments	150,480	215,274	290,619	363,274	454,093
Advances	**156,029**	**223,142**	**323,556**	**404,445**	**505,557**
Net Fixed Assets	5,184	5,677	6,200	6,900	7,700
Other Assets	20,714	16,800	14,000	16,000	18,000
Total Assets	**377,437**	**497,311**	**677,676**	**841,960**	**1,047,876**

KEY ASSUMPTIONS (%)

Deposit Growth	51.3	26.5	38.0	25.0	25.0
Advances Growth	66.6	43.0	45.0	25.0	25.0
Investments Growth	93.1	43.1	35.0	25.0	25.0
Provision Coverage	46.3	41.9	55.4	60.2	62.3
Dividend per share	2.8	3.5	4.0	4.6	4.6

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield-Earning Assets	6.7	7.1	7.9	8.3	8.4
Avg. Cost - Int. Bear. Liab.	4.3	4.7	5.7	6.2	6.3
Interest Spread	2.3	2.3	2.2	2.1	2.1
Net Interest Margin	2.5	2.6	2.7	2.7	2.7
Profitability Ratios (%)					
RoE	18.9	18.4	20.2	21.2	22.0
RoA	1.1	1.1	1.1	1.0	1.0
Int. Expended/Int. Earned	62.0	62.7	65.4	66.9	67.5
Other Income/Net Income	36.3	40.4	39.6	38.6	39.1
Efficiency Ratios (%)					
Op Exp/Net Income	50.7	45.0	47.8	49.9	51.5
Employee Cost/Op.Exps	30.4	29.5	31.1	31.5	30.3
Business per Empl. (Rs m)	81.5	83.7	75.1	82.2	88.1
Net Profit per Empl. (Rs m)	0.7	0.7	0.6	0.7	0.7
Asset Liability Profile (%)					
Advances/Deposit Ratio	49.2	55.6	58.4	58.4	58.4
Invest./Deposit Ratio	47.5	53.7	52.5	52.5	52.5
G-Sec/Investment Ratio	50.1	54.8	40.6	32.5	26.0
Gross NPAs to Advances	2.0	1.7	1.6	1.9	2.2
Net NPAs to Advances	1.1	1.0	0.7	0.7	0.8
CAR	12.7	11.1	11.0	10.5	10.3
Tier 1	*8.9*	*7.3*	*6.4*	*6.3*	*6.2*

VALUATION

Book Value (Rs)	88.0	103.1	121.0	143.7	173.3
Price-BV (x)	5.2	4.5	3.8	3.2	2.7
Adjusted BV (Rs)	82.6	98.0	115.7	136.7	163.6
Price-ABV (x)	5.6	4.7	4.0	3.4	2.8
EPS (Rs)	12.2	17.4	22.6	28.1	34.9
EPS Growth	1.7	42.4	30.0	24.0	24.5
Price Earnings (x)	37.6	26.4	20.3	16.4	13.2
OPS (Rs)	20.7	35.7	48.0	59.1	71.1
Price-OP (x)	22.3	12.9	9.6	7.8	6.5

E: MOSt Estimates

Others

BSE Sensex:12,455 S&P CNX: 3,634 2 April 2007

Canara Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	CBK IN
	REUTERS CODE
S&P CNX: 3,634	CNBK.BO

Equity Shares (m)	410.0
52-Week Range	320/165
1,6, 12 Rel.Perf.(%)	-8/-36/-40
M.Cap. (Rs b)	75.1
M.Cap. (US$ b)	1.7

2 April 2007

Buy

Previous Recommendation: Buy

Rs183

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	52,704	12,798	31.2	-4.7	5.9	0.9	10.7	16.8	0.9	1.0
3/08E	58,397	14,157	34.5	10.6	5.3	0.8	10.3	16.5	0.9	0.9
3/09E	66,868	16,784	40.9	18.6	4.5	0.7	10.6	17.3	0.9	0.8

Canara Bank, the third-largest state-owned bank in India, was established in 1906. It has a balance sheet size of Rs1.8t and a network of 2,513 branches. About 57% of its branches are located in the southern part of India. The government owns 73.2% of the bank's equity.

Growing at a steady pace, but margins declining: While Canara Bank is growing at a steady pace in terms of loans (up 29% YoY in December 2006) and deposits (up 26% YoY), margins have been declining. CASA ratio has declined from 35% to 33% YoY as at December 2006. In terms of loans, retail, SME and agriculture are the fastest growing segments for Canara Bank.

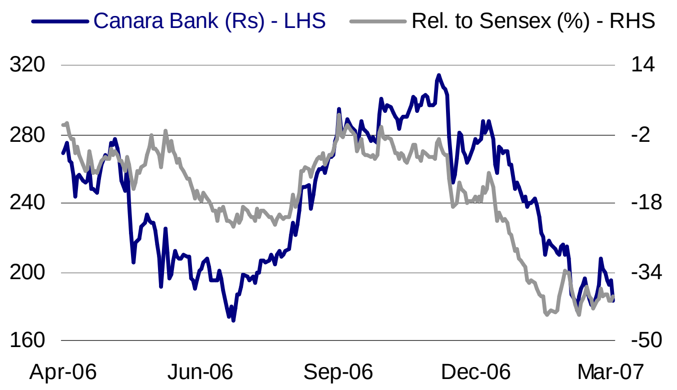
Asset quality on an improving trend: Canara Bank has been witnessing an improvement in its asset quality, with both gross and net NPAs gradually declining. Net NPAs have declined from 3.96% as of March 2003 to 0.96% as of December 2006. Gross NPAs at 2.06% are one of the lowest in the industry and the bank is very aggressive in writing-off its bad assets. Lower NPAs and declining slippages would result in lower NPA provisions, going forward.

Investment book – 60% in AFS: In terms of its investment book, Canara Bank still has 60% of its investment in AFS. This has resulted in significant investment-related losses during last few quarters. Given the volatile interest rate regime, in case of a sharp rise in interest rates, the bank might have to take further hits on its bottomline.

Tier-I at 7.7%; expect capital raising by end of FY08: With tier-I at 7.7% and room to raise further perpetual debt and tier-II debt, we do not see any capital raising in the near term, though there have been some media reports to the contrary. The bank could, however, raise capital by the end of FY08, as it might not be comfortable with a tier-I ratio of less than 7%.

Valuations attractive; maintain Buy: The stock has been an underperformer over the last couple of quarters. It has declined 35% in the last six months. However, valuations at 0.7x FY09E BV, with an expected RoE of 17.3% are attractive. We maintain **Buy**.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	75,720	87,115	113,046	135,713	159,968
Interest Expended	44,215	51,300	72,660	90,697	107,027
Net Interest Incom.	**31,505**	**35,815**	**40,386**	**45,015**	**52,941**
Change (%)	*17.5*	*13.7*	*12.8*	*11.5*	*17.6*
Other Income	15,438	13,775	12,318	13,381	13,926
Net Income	**46,943**	**49,590**	**52,704**	**58,397**	**66,868**
Change (%)	*-1.3*	*5.6*	*6.3*	*10.8*	*14.5*
Operating Expenses	21,090	23,471	26,018	28,363	31,409
Operating Income	**25,853**	**26,119**	**26,686**	**30,034**	**35,459**
Change (%)	*-9.6*	*1.0*	*2.2*	*12.5*	*18.1*
Other Provisions	13,058	10,687	11,400	11,200	12,250
PBT	**12,795**	**15,432**	**15,286**	**18,834**	**23,209**
Tax	1,700	2,000	2,488	4,677	6,424
PAT	**11,095**	**13,432**	**12,798**	**14,157**	**16,784**
Change (%)	*-17.1*	*21.1*	*-4.7*	*10.6*	*18.6*
Proposed Dividend	2,255	2,706	2,870	3,280	4,100

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,100	4,100	4,100	4,100	4,100
Reserves & Surplus	56,990	67,222	76,662	86,982	98,969
Net Worth	**61,090**	**71,322**	**80,762**	**91,082**	**103,069**
Deposits	969,084	1,168,030	1,401,636	1,611,881	1,853,664
Change (%)	*12.2*	*20.5*	*20.0*	*15.0*	*15.0*
Borrowings	26,938	35,304	40,310	48,000	57,600
Other Liabilities & Prov.	45,940	53,557	58,511	66,511	76,111
Total Liabilities	**1,103,052**	**1,328,213**	**1,581,219**	**1,817,474**	**2,090,444**
Current Assets	86,687	128,236	125,714	118,902	116,909
Investments	380,539	369,742	425,203	488,984	562,331
Change (%)	*6.3*	*-2.8*	*15.0*	*15.0*	*15.0*
Advances	604,214	794,257	992,821	1,169,543	1,368,366
Change (%)	*26.8*	*31.5*	*25.0*	*17.8*	*17.0*
Net Fixed Assets	6,728	6,885	5,477	4,841	4,113
Other Assets	24,883	29,094	32,004	35,204	38,725
Total Assets	**1,103,052**	**1,328,213**	**1,581,219**	**1,817,474**	**2,090,444**

ASSUMPTIONS (%)

	2005	2006	2007E	2008E	2009E
Deposit Growth	12.2	20.5	20.0	15.0	15.0
Advances Growth	26.8	31.5	25.0	17.8	17.0
Investments Growth	6.3	-2.8	15.0	15.0	15.0
Dividend	55.0	66.0	70.0	80.0	100.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.5	7.4	8.0	8.1	8.2
Avg. Cost-Int. Bear. Liab.	4.7	4.7	5.5	5.8	6.0
Interest Spread	2.8	2.7	2.5	2.2	2.2
Net Interest Margin	3.1	3.0	2.8	2.7	2.7
Profitability Ratios (%)					
RoE	19.5	20.3	16.8	16.5	17.3
RoA	1.1	1.1	0.9	0.9	0.9
Int. Expended/Int.Earned	58.4	58.9	64.3	66.8	66.9
Other Inc./Net Income	32.9	27.8	23.4	22.9	20.8
Efficiency Ratios (%)					
Op. Exps./Net Income	44.9	47.3	49.4	48.6	47.0
Empl. Cost/Op. Exps.	65.4	64.6	63.1	60.9	59.3
Busi. per Empl. (Rs m)	35.1	37.7	46.6	53.3	62.0
NP per Empl. (Rs lac)	2.5	2.9	2.7	3.0	3.6
Asset-Liability Profile (%)					
Adv./Deposit Ratio	62.3	68.0	70.8	72.6	73.8
Invest./Deposit Ratio	39.3	31.7	30.3	30.3	30.3
G-Sec/Invest. Ratio	78.3	84.6	84.6	84.6	84.6
Gross NPAs to Adv.	3.8	2.2	2.0	2.1	2.2
Net NPAs to Adv.	1.9	1.1	0.6	0.5	0.6
CAR	12.8	11.2	10.7	10.3	10.6
Tier 1	7.3	7.8	7.1	6.7	6.8

VALUATION

	2005	2006	2007E	2008E	2009E
Book Value (Rs)	146.1	171.2	194.2	219.4	248.6
Price-BV (x)	1.3	1.1	0.9	0.8	0.7
Adjusted BV (Rs)	128.3	157.3	184.4	209.8	236.0
Price-ABV (x)	1.4	1.2	1.0	0.9	0.8
EPS (Rs)	27.1	32.8	31.2	34.5	40.9
EPS Growth (%)	-17.1	21.1	-4.7	10.6	18.6
Price-Earnings (x)	6.8	5.6	5.9	5.3	4.5
OPS (Rs)	63.1	63.7	65.1	73.3	86.5
OPS Growth (%)	-9.6	1.0	2.2	12.5	18.1
Price-OP (x)	2.9	2.9	2.8	2.5	2.1

E: MOSt Estimates

Karnataka Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	KBL IN
	REUTERS CODE
S&P CNX: 3,634	KNBK.BO

Equity Shares (m)	121.3
52-Week Range	193/74
1,6,12 Rel.Perf.(%)	-1/38/55
M.Cap. (Rs b)	20.1
M.Cap. (US$ b)	0.5

2 April 2007

Buy

Previous Recommendation: Buy — Rs166

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	5,747	2,020	16.7	14.7	10.0	1.6	11.5	17.0	1.3	1.7
3/08E	6,629	2,343	19.3	16.0	8.6	1.4	10.0	17.2	1.3	1.4
3/09E	7,582	2,615	21.6	11.6	7.7	1.2	10.0	16.8	1.3	1.2

Karnataka Bank is one of the largest old generation private sector banks, with dominance in the southern and western parts of India. It is a mid-sized bank, with a network of 405 branches and a balance sheet size of Rs170b (FY07E).

Growing at a steady pace: One of the hallmarks of Karnataka Bank has been its consistent performance across all parameters. Its deposit base has been growing at a CAGR of 17% for the last five years, while loans have increased at a CAGR of 22%. We expect a similar consistent trend, going forward.

Asset quality to continue improving: On the back of controlled slippages and increased recoveries, Karnataka Bank's asset quality has been consistently improving. As at December 2006, its net NPAs were 1.36% (down from a high of 7.4% in March 2003) and gross NPAs were 4.56%. We expect stronger recoveries coupled with lower slippages to result in further improvement in its asset quality.

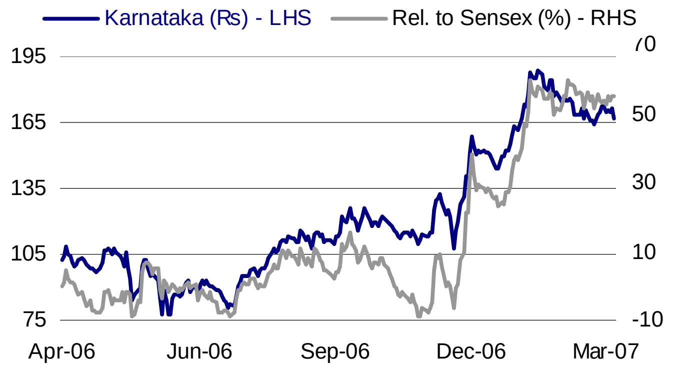
CASA ratio at 22%, pressure on margins: While we like the bank's overall profile, we believe that CASA deposits at just 22% of total deposits might result in lower margins in the current scenario, as deposit costs are likely to increase faster.

Tier-I at 11%, comfortable on capital front: With tier-I at 11%, the bank is comfortable on the capital front and has a room to raise tier-II, before looking at any dilution.

M&A – a very big trigger: Karnataka Bank has over 405 branches, spread over 17 states and two union territories. In terms of technology, it is almost at par with the best, with about 95% of the business under CBS. Further, it has a very lean manpower structure, with just 11 employees per branch and its C/I ratio has been less than 40%. The bank does not have a promoter and is professionally managed. We believe that Karnataka Bank offers a judicious mix of branches, technology, manpower and a deposit base, which could be of great value for any acquirer.

Despite the run-up, valuations are reasonable: The stock has moved up by 10% over the last three months, outperforming the banking index by 25%. Even after the run-up, the stock trades at 7.7x FY09E EPS and 1.2x FY09E BV.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	8,399	10,180	12,496	14,986	17,789
Interest Expended	5,230	6,521	8,492	10,396	12,489
Net Interest Income	**3,169**	**3,660**	**4,003**	**4,590**	**5,300**
Change (%)	*48.3*	*15.5*	*9.4*	*14.7*	*15.5*
Other Income	2,211	1,668	1,743	2,039	2,282
Net Income	**5,380**	**5,328**	**5,747**	**6,629**	**7,582**
Change (%)	*11.2*	*-1.0*	*7.9*	*15.4*	*14.4*
Operating Expenses	1,973	2,045	2,242	2,534	2,885
Operating Income	**3,407**	**3,283**	**3,505**	**4,095**	**4,696**
Change (%)	*3.3*	*-3.6*	*6.8*	*16.9*	*14.7*
Other Provisions	1,005	592	490	650	850
PBT	**2,402**	**2,691**	**3,015**	**3,445**	**3,846**
Tax	931	931	995	1,102	1,231
Tax Rate (%)	*38.8*	*34.6*	*33.0*	*32.0*	*32.0*
PAT	**1,471**	**1,760**	**2,020**	**2,343**	**2,615**
Change (%)	*10.5*	*19.6*	*14.7*	*16.0*	*11.6*
Proposed Dividend	277	364	424	485	546

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	1,213	1,213	1,213	1,213	1,213
Reserves & Surplus	8,568	9,899	11,494	13,351	15,421
Net Worth	**9,780**	**11,111**	**12,707**	**14,564**	**16,634**
Deposits	108,370	132,432	149,648	172,095	198,770
Change (%)	*15.2*	*22.2*	*13.0*	*15.0*	*15.5*
Borrowings	2,437	1,827	2,101	2,521	3,025
Other Liabilities & Prov.	4,680	4,163	4,579	5,037	5,541
Total Liabilities	**125,267**	**149,533**	**169,034**	**194,217**	**223,970**
Current Assets	13,725	12,146	12,692	13,906	15,995
Investments	45,557	55,486	58,260	62,921	69,213
Change (%)	*-6.6*	*21.8*	*5.0*	*8.0*	*10.0*
Advances	62,874	77,916	93,499	112,199	132,955
Change (%)	*34.7*	*23.9*	*20.0*	*20.0*	*18.5*
Net Fixed Assets	966	1,043	1,347	1,632	1,891
Other Assets	2,145	2,942	3,236	3,560	3,916
Total Assets	**125,267**	**149,533**	**169,034**	**194,217**	**223,970**

ASSUMPTIONS (%)

Deposit Growth	15.2	22.2	13.0	15.0	15.5
Advances Growth	34.7	23.9	20.0	20.0	18.5
Investments Growth	-6.6	21.8	5.0	8.0	10.0
Dividend Yeild (%)	1.2	1.8	2.1	2.4	2.7
Dividend	20.0	30.0	35.0	40.0	45.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.5	7.6	8.0	8.3	8.5
Avg. Cost-Int. Bear. Liab.	5.1	5.3	5.9	6.4	6.6
Interest Spread	2.4	2.3	2.1	1.9	1.9
Net Interest Margin	2.8	2.7	2.6	2.5	2.5
Profitability Ratios (%)					
RoE	17.6	16.9	17.0	17.2	16.8
RoA	1.3	1.3	1.3	1.3	1.3
Int. Expended/Int.Earned	62.3	64.1	68.0	69.4	70.2
Other Inc./Net Income	41.1	31.3	30.3	30.8	30.1
Efficiency Ratios (%)					
Op. Exps./Net Income	36.7	38.4	39.0	38.2	38.1
Empl. Cost/Op. Exps.	63.4	56.8	56.7	57.6	58.7
Busi. per Empl. (Rs m)	35.5	43.9	49.3	54.9	61.6
NP per Empl. (Rs lac)	3.3	4.1	4.4	4.9	5.2
Asset-Liability Profile (%)					
Adv./Deposit Ratio	58.0	58.8	62.5	65.2	66.9
Invest./Deposit Ratio	42.0	41.9	38.9	36.6	34.8
G-Sec/Invest. Ratio	74.7	73.7	73.7	73.7	73.7
Gross NPAs to Adv.	7.6	5.1	4.1	3.4	3.0
Net NPAs to Adv.	2.3	1.2	0.9	0.6	0.5
CAR	14.2	11.8	11.5	10.0	10.0
Tier 1	*12.2*	*11.3*	*10.5*	*9.0*	*9.0*

VALUATION

Book Value (Rs)	80.7	91.6	104.8	120.1	137.2
Price-BV (x)	2.1	1.8	1.6	1.4	1.2
Adjusted BV (Rs)	73.0	86.7	100.2	116.6	133.4
Price-ABV (x)	2.3	1.9	1.7	1.4	1.2
EPS (Rs)	12.1	14.5	16.7	19.3	21.6
EPS Growth (%)	-63.2	19.6	14.7	16.0	11.6
Price-Earnings (x)	13.7	11.4	10.0	8.6	7.7
OPS (Rs)	28.1	27.1	28.9	33.8	38.7
OPS Growth (%)	-65.5	-3.7	6.8	16.9	14.7
Price-OP (x)	5.9	6.1	5.7	4.9	4.3

E: MOSt Estimates

Oriental Bank of Commerce

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	OBC IN
	REUTERS CODE
S&P CNX: 3,634	ORBC.BO

Equity Shares (m)	250.5
52-Week Range	280/139
1,6,12 Rel. Perf.(%)	0/-38/-36
M.Cap. (Rs b)	42.3
M.Cap. (US$ b)	1.0

2 April 2007

Neutral

Previous Recommendation: Neutral

Rs169

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	22,926	8,772	35.0	9.2	4.8	0.8	12.0	16.2	1.4	0.8
3/08E	25,389	9,094	36.3	3.7	4.6	0.7	11.3	15.5	1.2	0.7
3/09E	29,470	10,265	41.0	12.9	4.1	0.6	10.5	16.0	1.2	0.7

Expect some margin improvement: One of the key concerns plaguing OBC has been its low NIM. Relatively low CASA ratio (~30%, hence higher cost of deposits), low yielding assets acquired from e-GTB continue to adversely impact its margins (NIMs at 2.54% in 2QFY07, 2.75% in 3QFY07) and NII growth. Though the management has guided improving margins going forward, we believe that in a rising interest rate scenario, OBC's margin expansion would be restricted.

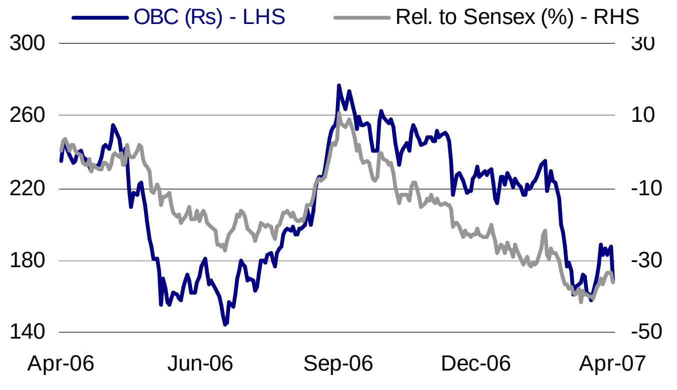
Operating profit growth to improve: Lower growth in NII and decreasing treasury profit have stunted the bank's operating profit growth for several quarters. Though there has been robust growth in fee income (on a lower base) and significant NPA recoveries, these have not been able to compensate. Going forward, higher NII growth, sustained increase in fee income and operational leverage would help shore up operating profit growth.

Slowdown in recoveries could impact PAT growth: OBC has done a commendable job in NPA recoveries – both its own and e-GTB's. At the same time, fresh slippages have been well contained. Improving asset quality is reflected in the uninterrupted decrease in gross NPAs for the last four quarters (gross NPAs at 4.2% and net NPAs at 0.5% as on 31 December 2006). Reversal of excess NPA provisions made in past is helping the bank to show robust PAT growth despite poor operating performance. Slowdown in recoveries could result in lower PAT growth.

Still the most efficient state-owned bank: With C/I ratio at 43%, OBC is the most efficient state-owned bank, delivering relatively higher RoA than several other banks. However, concerns on margins continue to prevail and current profits are largely on account of recoveries. Improvement in margins could lead to better valuations for the bank.

We maintain Neutral: We expect OBC to post RoE of 15.5% in FY08 and 16% in FY09. We estimate EPS at Rs36.3 for FY08 and Rs41 for FY09, and BV at Rs235/share for FY08 and Rs268/share for FY09. The stock trades at 0.6x FY09E BV and 4.1x FY09E EPS. We maintain our **Neutral** recommendation.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	35,719	41,189	50,749	59,337	69,131
Interest Expended	20,482	25,139	33,936	40,173	46,761
Net Interest Income	**15,237**	**16,051**	**16,814**	**19,164**	**22,370**
Change (%)	*4.7*	*5.3*	*4.8*	*14.0*	*16.7*
Other Income	5,052	5,528	6,113	6,225	7,100
Net Income	**20,289**	**21,578**	**22,926**	**25,389**	**29,470**
Change (%)	*-6.8*	*6.4*	*6.2*	*10.7*	*16.1*
Operating Expenses	7,957	9,659	10,023	11,101	12,413
Operating Income	12,332	11,919	12,904	14,289	17,057
Change (%)	*-19.6*	*-3.3*	*8.3*	*10.7*	*19.4*
Other Provisions	4,002	2,271	1,800	2,000	2,800
PBT	**8,330**	**9,649**	**11,104**	**12,289**	**14,257**
Tax	722	1,617	2,332	3,195	3,992
PAT	**7,608**	**8,031**	**8,772**	**9,094**	**10,265**
Change (%)	*10.9*	*5.6*	*9.2*	*3.7*	*12.9*
Proposed Dividend	659	1,286	1,403	1,528	1,754

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	1,925	2,505	2,505	2,505	2,505
Reserves & Surplus	31,345	49,202	53,873	58,718	64,471
Net Worth	**33,270**	**51,708**	**56,378**	**61,224**	**66,977**
Deposits	478,503	501,975	592,330	681,180	783,356
Change (%)	*34.1*	*4.9*	*18.0*	*15.0*	*15.0*
Borrowings	7,281	8,764	10,000	12,000	12,000
Other Liabilities & Prov.	21,640	26,927	29,620	32,582	35,840
Total Liabilities	**540,695**	**589,374**	**688,328**	**786,985**	**898,173**
Current Assets	75,433	55,257	50,629	55,497	67,876
Investments	183,422	168,176	181,630	196,160	211,853
Change (%)	*9.2*	*-8.3*	*8.0*	*8.0*	*8.0*
Advances	252,992	335,772	423,073	499,226	579,103
Change (%)	*28.5*	*32.7*	*26.0*	*18.0*	*16.0*
Net Fixed Assets	**3,805**	**3,842**	**4,036**	**4,246**	**4,300**
Other Assets	25,043	26,327	28,960	31,856	35,041
Total Assets	**540,695**	**589,374**	**688,328**	**786,985**	**898,173**

ASSUMPTIONS (%)

Deposit Growth	34.1	4.9	18.0	15.0	15.0
Advances Growth	28.5	32.7	26.0	18.0	16.0
Investments Growth	9.2	-8.3	8.0	8.0	8.0
Dividend	34.2	51.3	56.0	61.0	70.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.9	7.7	8.4	8.5	8.7
Avg. Cost-Int. Bear. Liab.	4.8	5.0	6.1	6.2	6.3
Interest Spread	3.0	2.7	2.3	2.3	2.4
Net Interest Margin	3.4	3.0	2.8	2.7	2.8
Profitability Ratios (%)					
RoE	25.3	18.9	16.2	15.5	16.0
RoA	1.6	1.4	1.4	1.2	1.2
Int. Expended/Int.Earned	57.3	61.0	66.9	67.7	67.6
Other Inc./Net Income	24.9	25.6	26.7	24.5	24.1
Efficiency Ratios (%)					
Op. Exps./Net Income	39.2	44.8	43.7	43.7	42.1
Empl. Cost/Op. Exps.	49.9	51.8	46.5	45.7	44.5
Busi. per Empl. (Rs m)	44.1	52.4	61.3	72.2	83.0
NP per Empl. (Rs m)	0.5	0.5	0.6	0.6	0.7
Asset-Liability Profile (%)					
Adv./Deposit Ratio	52.9	66.9	71.4	73.3	73.9
Invest./Deposit Ratio	38.3	33.5	30.7	28.8	27.0
G-Sec/Invest. Ratio	81.7	83.0	83.0	83.0	83.0
Gross NPAs to Adv.	9.1	5.9	5.2	4.7	4.4
Net NPAs to Adv.	1.3	0.5	0.4	0.6	0.7
CAR	9.2	12.5	12.0	11.3	10.5
Tier 1	5.4	11.7	11.0	10.0	9.0

VALUATION

Book Value (Rs)*	121.9	177.1	205.6	234.7	267.5
Price-BV (x)	1.4	1.0	0.8	0.7	0.6
Adjusted BV (Rs)	110.9	172.9	200.9	227.3	256.7
Price-ABV (x)	1.5	1.0	0.8	0.7	0.7
EPS (Rs)	39.5	32.1	35.0	36.3	41.0
EPS Growth (%)	10.9	-18.9	9.2	3.7	12.9
Price-Earnings (x)	4.3	5.3	4.8	4.6	4.1
OPS (Rs)	64.0	47.6	51.5	57.0	68.1
OPS Growth (%)	-19.6	-25.7	8.3	10.7	19.4
Price-OP (x)	2.6	3.5	3.3	3.0	2.5

*E: MOSt Estimates, * BV adjusted for goodwill*

Vijaya Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	VJYBK IN
	REUTERS CODE
S&P CNX: 3,634	VJBK.BO

Equity Shares (m)	433.5
52-Week Range	59/33
1,6,12 Rel.Perf.(%)	-4/-32/-36
M.Cap. (Rs b)	16.8
M.Cap. (US$ b)	0.4

2 April 2007

Neutral

Previous Recommendation: Neutral

Rs39

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	13,791	3,363	7.8	165.1	5.0	0.9	11.1	18.8	1.0	0.9
3/08E	15,472	3,770	8.7	12.1	4.5	0.8	10.3	18.6	0.9	0.8
3/09E	17,073	4,170	9.6	10.6	4.0	0.7	10.5	18.2	0.9	0.7

Margins under pressure: Vijaya Bank has grown its advances in line with the industry (25-30%) but its deposit growth is much faster than industry (27% YoY in 3QFY07). However, its CASA ratio has reduced from 34% as at December 2005 to 31% as at December 2006, implying a rise in cost of funds. NII growth is stunted despite robust credit and interest income growth for the past couple of quarters. The bank's balance sheet growth is, thus, at the cost of NIMs (down from 3.36% in 3QFY06 to 3.09% in 3QFY07). Given the lower CASA ratio compared to other banks, we expect margins to be under pressure in the current scenario.

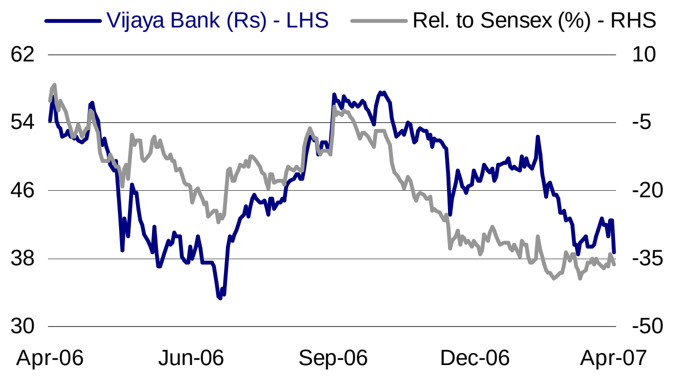
Operating profit stagnant: Lower growth in NII and fee income, coupled with reducing trading gains, is impacting the bank's operating profit growth despite stable operating costs. However, with faster core income growth in FY08, we expect operating income to grow faster.

One of the best in terms of asset quality: Vijaya Bank has maintained one of the lowest NPAs in the system, with gross NPAs at just 2.5% and net NPAs at 0.5% as at December 2006. The management has mentioned that it does not see any stress on asset quality and NPAs could decline further. On account of its low NPAs, we believe provisioning requirement would reduce for Vijaya Bank in FY08, which would be positive for its net earnings.

Smaller size relative to peers: The bank has a relatively smaller network of about 1,000 branches, predominantly spread in South India (focus on Karnataka). The small scale, in our view, acts as a natural impediment to increasing low cost deposits, sustaining margins in the face of intense competition, and to fee income and overall business growth.

We maintain Neutral: We expect the bank to post RoE of 18.6% in FY08 and 18.2% in FY09. We estimate EPS at Rs8.7 for FY08 and Rs9.6 for FY09, and book value at Rs50/share for FY08 and Rs56/share for FY09. While valuations at 0.7x FY09E BV are attractive, margin pressure might hamper the bank's core earnings growth. We maintain our **Neutral** recommendation.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	20,943	23,118	27,737	32,896	38,657
Interest Expended	11,098	13,390	17,170	20,798	25,183
Net Interest Income	**9,845**	**9,728**	**10,566**	**12,097**	**13,473**
Change (%)	*17.5*	*-1.2*	*8.6*	*14.5*	*11.4*
Other Income	3,513	3,690	3,225	3,375	3,600
Net Income	**13,359**	**13,418**	**13,791**	**15,472**	**17,073**
Change (%)	*-2.0*	*0.4*	*2.8*	*12.2*	*10.3*
Operating Expenses	5,492	6,235	6,457	7,060	7,681
Operating Income	7,867	7,182	7,335	8,412	9,392
Change (%)	*-9.1*	*-8.7*	*2.1*	*14.7*	*11.7*
Other Provisions	4,142	5,388	2,850	3,175	3,600
PBT	**3,725**	**1,795**	**4,485**	**5,237**	**5,792**
Tax	-78	526	1,121	1,466	1,622
Tax Rate (%)	*-2.1*	*29.3*	*25.0*	*28.0*	*28.0*
PAT	**3,802**	**1,269**	**3,363**	**3,770**	**4,170**
Change (%)	*-7.6*	*-66.6*	*165.1*	*12.1*	*10.6*
Proposed Dividend	1,225	434	867	1,084	1,301

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,335	4,335	4,335	4,335	4,335
Reserves & Surplus	11,557	12,356	14,705	17,208	19,856
Net Worth	**15,892**	**16,692**	**19,041**	**21,543**	**24,192**
Deposits	256,180	277,093	332,511	382,388	439,746
Change (%)	*21.9*	*8.2*	*20.0*	*15.0*	*15.0*
Borrowings	6,408	5,164	5,680	6,248	6,873
Other Liabilities & Prov.	14,875	16,398	18,858	21,687	24,940
Total Liabilities	**293,355**	**315,346**	**376,090**	**431,866**	**495,751**
Current Assets	16,146	28,351	41,369	45,007	49,028
Investments	120,687	111,797	117,387	123,256	131,884
Change (%)	*11.4*	*-7.4*	*5.0*	*5.0*	*7.0*
Advances	143,358	166,640	208,300	254,126	304,951
Change (%)	*29.8*	*16.2*	*25.0*	*22.0*	*20.0*
Net Fixed Assets	**2,176**	**2,030**	**2,180**	**2,280**	**2,330**
Other Assets	10,988	6,528	6,854	7,197	7,556
Total Assets	**293,355**	**315,346**	**376,090**	**431,866**	**495,751**

ASSUMPTIONS (%)

Deposit Growth	21.9	8.2	20.0	15.0	15.0
Advances Growth	29.8	16.2	25.0	22.0	20.0
Investments Growth	11.4	-7.4	5.0	5.0	7.0
Dividend	28.3	10.0	20.0	25.0	30.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.2	7.9	8.4	8.6	8.7
Avg. Cost-Int. Bear. Liab.	4.7	4.9	5.5	5.7	6.0
Interest Spread	3.6	3.0	2.9	2.9	2.7
Net Interest Margin	3.9	3.3	3.2	3.2	3.0
Profitability Ratios (%)					
RoE	26.0	7.8	18.8	18.6	18.2
RoA	1.4	0.4	1.0	0.9	0.9
Int. Expended/Int.Earned	53.0	57.9	61.9	63.2	65.1
Other Inc./Net Income	26.3	27.5	23.4	21.8	21.1
Efficiency Ratios (%)					
Op. Exps./Net Income	41.1	46.5	46.8	45.6	45.0
Empl. Cost/Op. Exps.	58.1	60.8	59.3	58.0	56.9
Busi. per Empl. (Rs m)	31.3	36.7	42.4	50.3	58.5
NP per Empl. (Rs lac)	0.3	0.1	0.3	0.3	0.4
Asset-Liability Profile (%)					
Adv./Deposit Ratio	56.0	60.1	62.6	66.5	69.3
Invest./Deposit Ratio	47.1	40.3	35.3	32.2	30.0
G-Sec/Invest. Ratio	87.5	85.2	89.2	89.2	87.6
Gross NPAs to Adv.	2.9	3.2	2.8	2.6	2.4
Net NPAs to Adv.	0.6	0.9	0.8	0.7	0.7
CAR	12.9	11.9	11.1	10.3	10.5
Tier 1	*7.6*	*9.3*	*8.0*	*7.3*	*7.1*

VALUATION

Book Value (Rs)	36.7	38.5	43.9	49.7	55.8
Price-BV (x)	1.1	1.0	0.9	0.8	0.7
Adjusted BV (Rs)	35.4	36.4	41.5	46.9	52.6
Price-ABV (x)	1.1	1.1	0.9	0.8	0.7
EPS (Rs)	8.8	2.9	7.8	8.7	9.6
EPS Growth (%)	-7.6	-66.6	165.1	12.1	10.6
Price-Earnings (x)	4.4	13.3	5.0	4.5	4.0
OPS (Rs)	18.1	16.6	16.9	19.4	21.7
OPS Growth (%)	-9.1	-8.7	2.1	14.7	11.7
Price-OP (x)	2.1	2.3	2.3	2.0	1.8

E: MOSt Estimates

IDBI Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	IDBI IN
	REUTERS CODE
S&P CNX: 3,634	IDBI.BO

Equity Shares (m)	723.8
52-Week Range	110/49
1,6,12 Rel.Perf.(%)	-7/-16/-18
M.Cap. (Rs b)	51.9
M.Cap. (US$ b)	1.2

2 April 2007

Buy

Previous Recommendation: Not Rated

Rs72

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	18,455	6,098	8.4	8.7	8.5	0.8	13.8	9.2	0.6	0.8
3/08E	22,423	6,999	9.7	14.8	7.4	0.7	12.5	9.8	0.6	0.7
3/09E	26,452	7,771	10.7	11.0	6.7	0.6	12.0	10.1	0.6	0.7

UWB acquisition has doubled branch network: The basic problem with IDBI Bank was that its network of 196 branches was inadequate to support a balance sheet size of Rs900b. The acquisition of United Western Bank has added about 230 branches, resulting in a network of 426 branches for IDBI Bank. At the same time, it gets a ready employee base, with relevant experience in banking.

Margins likely to improve, as assets begin performing: IDBI Bank has assets of about Rs14.5b under SASF (transfer value of Rs9b), which it has been recovering over the last two years. Against these, it has zero-coupon securities, which are not yielding any returns. However, these securities would be redeemed, as IDBI Bank makes recoveries from SASF. Further, the bank has Rs40-45b of written-off accounts, from which it expects to recover significant amounts along with interest. It also has Rs40-45b of restructured assets (like Dabhol), which earn very little interest for IDBI Bank. As these accounts begin performing, they would start contributing to earnings, resulting in margin improvement.

Value of strategic stake likely to be monetized over time: Over the years, IDBI has also invested in / promoted various entitles, which now have considerable value. IDBI owns 8% in NSE, 20% in SIDBI, 19% in SHCIL, 30% in NSDL, 20% in Arcil, and 26% in CARE. Amongst the listed entities, it owns 3% in IDFC (market value at Rs3b). We value all of IDBI's investments (along with treasury equity investments) at ~Rs35 per share of IDBI. The management intends to sell these holdings and monetize them. This apart, the management has mentioned having Rs10b of surplus real estate, which it might sell over the next 2-3 years.

Expect improvement in operating profits only post March 2007: IDBI Bank's reported profits are entirely derived from equity gains (the management considers these as core earnings, as this equity was acquired due to restructuring of loans) and recovery from written-off assets. We believe that over the next 2-3 quarters, the reported profits will only consist of equity gains (still has plenty of unrealized gains) and recovery of bad loans. This will mean an addition to book value on a regular basis. However, with a doubling of branch network, we expect margins to start improving post March 2007. Any marked improvement will only be visible in FY08.

Core margin improvement to gather pace from FY08: We believe that IDBI earns spreads of ~1.5% on its incremental business. As its non-earning assets begin performing, we believe that the spread on its current book would improve over the next 18 months. As we believe that the bank is likely to build its core deposit base only post March 2007, core margin improvement will be visible from FY08.

Valuations attractive: Currently, the stock trades at 0.6x FY09E BV. However, adjusted for the gains it could have through these ventures, it trades at 0.4x FY09E BV. The key aspect to watch for would be improvement in the bank's core business fundamentals, which in turn should drive up valuations. We initiate coverage with a **Buy.**

INCOME STATEMENT (RS MILLION)

Y/E MARCH	2005*	2006	2007E	2008E	2009E
Interest Income	26,559	53,807	64,377	77,617	93,555
Interest Expended	24,679	50,008	57,612	67,767	79,923
Net Interest Income	**1,880**	**3,799**	**6,765**	**9,850**	**13,633**
Change (%)		*102.1*	*78.1*	*45.6*	*38.4*
Other Income	6,271	12,804	11,690	12,573	12,819
Net Income	**8,151**	**16,603**	**18,455**	**22,423**	**26,452**
Change (%)		*103.7*	*11.2*	*21.5*	*18.0*
Operating Expenses	4,540	8,595	9,079	11,047	13,309
Operating Income	**3,612**	**8,009**	**9,376**	**11,376**	**13,142**
Change (%)		*121.7*	*17.1*	*21.3*	*15.5*
Other Provisions	725	2,125	2,600	3,600	4,000
PBT	2,886	5,884	6,776	7,776	9,142
Tax	-188	275	678	778	1,371
Tax Rate (%)	*-6.5*	*4.7*	*10.0*	*10.0*	*15.0*
PAT	**3,074**	**5,609**	**6,098**	**6,999**	**7,771**
Change (%)		*82.5*	*8.7*	*14.8*	*11.0*
Proposed Dividend	541	1,087	1,267	1,448	1,448

*** 6 months year as IDBI merged with IDBI Bank**

BALANCE SHEET (RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	7,218	7,238	7,238	7,238	7,238
Reserves & Surplus	52,045	56,474	61,306	66,857	73,180
Net Worth	**59,263**	**63,712**	**68,544**	**74,095**	**80,418**
Deposits	151,026	260,009	434,215	607,901	851,062
Change (%)		*72.2*	*67.0*	*40.0*	*40.0*
Borrowings	538,834	513,346	487,678	463,294	440,130
Other Liabilities & Prov.	64,481	48,581	53,439	58,783	64,662
Total Liabilities	**813,602**	**885,648**	**1,043,876**	**1,204,074**	**1,436,271**
Current Assets	56,533	53,628	53,706	51,835	93,040
Investments	250,547	253,439	291,455	320,600	352,660
Change (%)		*1.2*	*15.0*	*10.0*	*10.0*
Advances	454,140	527,391	643,417	772,100	926,520
Change (%)		*16.1*	*22.0*	*20.0*	*20.0*
Net Fixed Assets	0	8,109	7,910	7,410	6,710
Other Assets	43,494	43,081	47,389	52,128	57,341
Total Assets	**804,714**	**885,648**	**1,043,876**	**1,204,074**	**1,436,271**

ASSUMPTIONS (%)

Deposit Growth	0.0	72.2	67.0	40.0	40.0
Advances Growth	0.0	16.1	22.0	20.0	20.0
Investments Growth	0.0	1.2	15.0	10.0	10.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	7.5	15.0	17.5	20.0	20.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	4.1	7.0	7.2	7.2	7.5
Avg. Cost-Int. Bear. Liab.	4.1	6.8	6.8	6.8	6.8
Interest Spread	0.0	0.1	0.4	0.4	0.8
Net Interest Margin	0.3	0.5	0.8	0.9	1.1
Profitability Ratios (%))					
RoE	6.8	9.1	9.2	9.8	10.1
RoA	0.4	0.7	0.6	0.6	0.6
Int. Expended/Int.Earned	92.9	92.9	89.5	87.3	85.4
Other Inc./Net Income	76.9	77.1	63.3	56.1	48.5
Efficiency Ratios (%)					
Op. Exps./Net Income	55.7	51.8	49.2	49.3	50.3
Empl. Cost/Op. Exps.	34.7	37.1	38.6	36.9	35.9
Busi. per Empl. (Rs m)	34.6	153.1	216.9	270.1	322.2
NP per Empl. (Rs lac)	2.8	12.3	14.2	15.4	15.9
Asset-Liability Profile (%)					
Adv./Deposit Ratio	300.7	202.8	148.2	127.0	108.9
Invest./Deposit Ratio	165.9	97.5	67.1	52.7	41.4
G-Sec/Invest. Ratio	59.5	63.8	63.8	63.8	63.8
Gross NPAs to Adv.	2.5	2.0	1.6	1.4	1.3
Net NPAs to Adv.	1.7	1.0	0.6	0.3	0.1
CAR	15.5	14.8	13.8	12.5	12.0
Tier 1	*11.9*	*11.7*	*11.0*	*9.5*	*9.0*

VALUATION

Book Value (Rs)	82.1	88.0	94.7	102.4	111.1
Price-BV (x)	0.9	0.8	0.8	0.7	0.6
Adjusted BV (Rs)	74.5	83.0	91.2	100.4	110.1
Price-ABV (x)	1.0	0.9	0.8	0.7	0.7
EPS (Rs)	4.3	7.7	8.4	9.7	10.7
EPS Growth (%)	-72.5	81.9	8.7	14.8	11.0
Price-Earnings (x)	16.8	9.2	8.5	7.4	6.7
OPS (Rs)	5.0	11.1	13.0	15.7	18.2
OPS Growth (%)	-84.5	121.1	17.1	21.3	15.5
Price-OP (x)	14.3	6.5	5.5	4.6	3.9

E: MOSt Estimates

Corporation Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,124	CRPBK IN
	REUTERS CODE
S&P CNX: 3,820	CRBK.BO

Equity Shares (m)	143.4
52-Week Range	445/205
1,6,12 Rel.Perf.(%)	7/-38/-44
M.Cap. (Rs b)	37.1
M.Cap. (US$ b)	0.9

2 April 2007

Sell

Previous Recommendation: Sell Rs259

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/07E	19,215	5,316	37.1	19.6	7.0	1.0	11.9	14.8	1.2	1.0
3/08E	21,621	6,022	42.0	13.3	6.2	0.9	10.6	15.0	1.1	0.9
3/09E	24,144	6,716	46.8	11.5	5.5	0.8	11.0	14.8	1.0	0.8

Margins continue to be under pressure: Owing to Corporation Bank's strategy of growing through bulk deposits, its margins remain under pressure at ~3%. NII growth has also been subdued over the last 6-8 quarters.

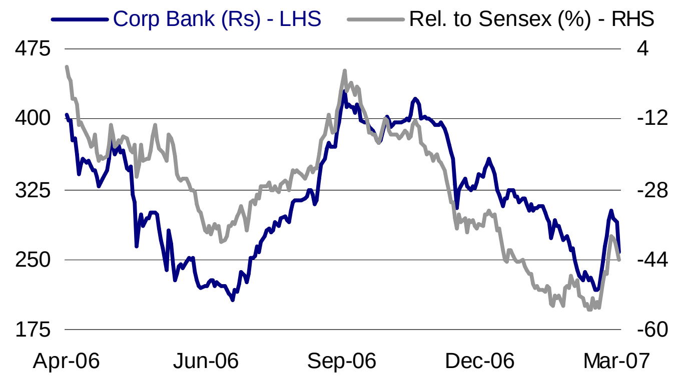
CASA deposits at 30%: With the bank having a CASA ratio of just about 30%, the bank's cost of funds has been increasing fast, leading to margin pressure. Further, the bank has been very aggressive in mopping up bulk deposits.

Net NPAs comfortable at 0.5%: The bank had faced some issues on retail lending over the last 15 months. However, the management has put in place adequate systems and slowed down retail lending (mainly mortgages). As a result, NPAs have been declining over the last couple of quarters. Currently, gross NPAs are 2.1%, while net NPAs are 0.5%.

Low leverage, resulting in lower RoE: With tier-I capital ~11%, Corporation Bank continues to have a lower leverage as compared to other banks, resulting in lower RoE. In FY07, we expect Corporation Bank's RoE to be 14.5%.

Maintain Sell: We believe that improvement in margins would be challenging for Corporation Bank as it does not have any excess SLR to fund its loan growth. Further, with deposits coming in at a higher price and slow absolute CASA deposit growth (15% YoY), incremental margins could decline. Investment yields, currently at 7.7%, would continue to decline. The stock trades at 5.5x FY09E EPS and 0.8x FY09E BV. With RoE likely to be 15%, on a relative basis, we prefer other banking stocks. We maintain our **Sell** recommendation.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					(RS MILLION)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	22,498	26,265	33,770	42,082	51,174
Interest Expended	11,204	13,997	20,609	26,740	33,673
Net Interest Income	**11,294**	**12,268**	**13,161**	**15,342**	**17,501**
Change (%)	*16.8*	*8.6*	*7.3*	*16.6*	*14.1*
Other Income	5,646	5,715	6,054	6,279	6,643
Net Income	**16,940**	**17,983**	**19,215**	**21,621**	**24,144**
Change (%)	*13.9*	*6.2*	*6.9*	*12.5*	*11.7*
Operating Expenses	6,813	7,468	7,770	8,715	9,945
Operating Income	**10,127**	**10,515**	**11,444**	**12,906**	**14,199**
Change (%)	*13.5*	*3.8*	*8.8*	*12.8*	*10.0*
Other Provisions	4,081	3,770	3,450	3,850	4,100
PBT	**6,046**	**6,745**	**7,994**	**9,056**	**10,099**
Tax	2,024	2,300	2,678	3,034	3,383
PAT	4,022	4,445	5,316	6,022	6,716
Change (%)	*-20.7*	*10.5*	*19.6*	*13.3*	*11.5*
Proposed Dividend	1,059	932	1,004	1,076	1,148

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	1,434	1,434	1,434	1,434	1,434
Reserves & Surplus	29,115	32,315	36,456	41,219	46,593
Net Worth	**30,549**	**33,749**	**37,890**	**42,654**	**48,027**
Deposits	272,332	328,765	417,532	488,512	569,117
Change (%)	*17.4*	*20.7*	*27.0*	*17.0*	*16.5*
Borrowings	12,979	19,601	23,913	26,304	28,935
Other Liabilities & Prov.	23,379	22,949	29,146	37,015	47,009
Total Liabilities	**339,238**	**405,064**	**508,481**	**594,485**	**693,087**
Current Assets	35,806	40,887	55,848	65,375	81,546
Investments	102,611	106,518	117,170	137,088	159,023
Change (%)	*-4.0*	*3.8*	*10.0*	*17.0*	*16.0*
Advances	185464	239624	316304	370076	429288
Change (%)	*33.5*	*29.2*	*32.0*	*17.0*	*16.0*
Net Fixed Assets	2,562	2,559	2,909	3,259	3,609
Other Assets	12,795	15,477	16,250	18,688	19,622
Total Assets	**339,239**	**405,064**	**508,481**	**594,485**	**693,087**

ASSUMPTIONS					(%)
Deposit Growth	17.4	20.7	27.0	17.0	16.5
Advances Growth	33.5	29.2	32.0	17.0	16.0
Investments Growth	-4.0	3.8	10.0	17.0	16.0
Dividend	70.0	65.0	70.0	75.0	80.0

E: MOSt Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	7.6	7.4	7.8	8.0	8.3
Avg. Cost-Int. Bear. Liab.	4.3	4.4	5.2	5.6	6.1
Interest Spread	3.3	3.0	2.5	2.4	2.3
Net Interest Margin	3.8	3.5	3.0	2.9	2.8
Profitability Ratios (%))					
RoE	13.8	13.8	14.8	15.0	14.8
RoA	1.3	1.2	1.2	1.1	1.0
Int. Expended/Int.Earned	49.8	53.3	61.0	63.5	65.8
Other Inc./Net Income	33.3	31.8	31.5	29.0	27.5
Efficiency Ratios (%)					
Op. Exps./Net Income	40.2	41.5	40.4	40.3	41.2
Empl. Cost/Op. Exps.	41.5	48.7	47.1	45.8	47.3
Busi. per Empl. (Rs m)	38.5	45.3	56.0	66.8	76.0
NP per Empl. (Rs lac)	3.7	3.9	4.6	5.1	5.5
Asset-Liability Profile (%)					
Adv./Deposit Ratio	68.1	72.9	75.8	75.8	75.4
Invest./Deposit Ratio	37.7	32.4	28.1	28.1	27.9
G-Sec/Invest. Ratio	81.1	84.7	84.7	81.0	78.3
Gross NPAs to Adv.	3.5	2.6	1.9	1.5	1.2
Net NPAs to Adv.	1.1	0.6	0.4	0.3	0.3
CAR	16.2	13.9	11.9	10.6	11.0
Tier 1	*13.6*	*12.4*	*10.9*	*9.5*	*9.0*

VALUATION					
Book Value (Rs)	213.0	235.3	264.2	297.4	334.8
Price-BV (x)	1.2	1.1	1.0	0.9	0.8
Adjusted BV (Rs)	203.6	228.3	257.8	291.9	329.4
Price-ABV (x)	1.3	1.1	1.0	0.9	0.8
EPS (Rs)	28.0	31.0	37.1	42.0	46.8
EPS Growth (%)	-20.7	10.5	19.6	13.3	11.5
Price-Earnings (x)	9.2	8.3	7.0	6.2	5.5
OPS (Rs)	70.6	73.3	79.8	90.0	99.0
OPS Growth (%)	13.5	3.8	8.8	12.8	10.0
Price-OP (x)	3.7	3.5	3.2	2.9	2.6

E: MOSt Estimates

Bank of Maharashtra

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	BOMH IN
	REUTERS CODE
S&P CNX: 3,634	BMBK.BO

Equity Shares (m)	430.5
52-Week Range	51/18
1,6,12 Rel.Perf.(%)	-2/20/15
M.Cap. (Rs b)	16.1
M.Cap. (US$ b)	0.4

2 April 2007

Neutral

Initiating Coverage

Rs37

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/06A	10,238	508	1.2	-71.3	31.7	1.0	11.3	3.3	0.2	1.2
3/07E	12,537	2,378	5.5	367.8	6.8	0.9	11.2	14.4	0.7	1.0
3/08E	14,191	2,880	6.7	21.1	5.6	0.8	11.0	15.8	0.7	0.9

Well penetrated in investment/income rich Maharashtra: Bank of Maharashtra (BoM) has a strong presence in the investment/income rich Maharashtra and Madhya Pradesh, which would support growth. The bank's 45% reach in the rural region would enable robust agriculture lending, which yields higher margins. BoM targets business of Rs1t in FY09 against the Rs530b estimated for FY07. Retail, agriculture and infrastructure lending would drive growth.

Margins to improve: One of BoM's key strengths is its high CASA ratio of 43% (as at September 2006). This has enabled the bank to lower its cost of deposits. We expect NIM improvement going forward, as the bank focuses more on retail and on maintaining its healthy CASA levels. It intends to focus on the housing sector growth in the city of Pune to drive up the contribution of retail loans.

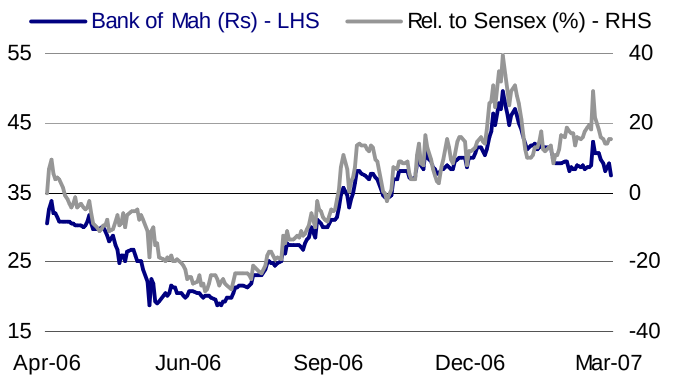
Also focusing on enhancing fee income: BoM has realized the significance of fee income for stability in a bank's earnings and has tied up with the leading majors for distribution of life and non-life insurance, and mutual fund products. It has also entered into MoUs to tap the opportunity in the two-wheeler, tractor and housing sector. We expect fee income/average assets to increase from 0.65% in FY06 to 0.71% in FY07.

Lower incremental slippage to better asset quality: As at September 2006, gross NPAs were at 4.74% and net NPAs at 1.66%. The management intends to bring down its gross NPAs to 3.5% and net NPAs to 1% in FY07. Slowdown in incremental delinquency rate and rise in cash recoveries would help the bank to improve its asset quality.

Has adequate capital: BoM has a capital adequacy of 11.2% (as at September 2006). The bank intends to issue Rs2.3b worth of subordinated debt and upper tier-II of Rs3.5b during the rest FY07 in order to meet its growth estimates, besides the option of issuing perpetual debt. Additionally, it is one of the few banks left with high government stake (77%).

Valuations attractive: We expect BoM to post RoE of 14.4% in FY07 and 15.8% in FY08. We estimate an EPS of Rs5.5 for FY07 and Rs6.7 for FY08, and a book value of Rs40/share for FY07 and Rs44/share for FY08. The stock trades at 0.8x FY08E BV and 5.6x FY08E EPS.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Interest Income	21,988	23,677	23,495	25,853	32,226
Interest Expended	14,317	14,860	15,029	16,457	21,522
Net Interest Income	**7,671**	**8,817**	**8,466**	**9,396**	**10,704**
Change (%)	*13.4*	*14.9*	*-4.0*	*11.0*	*13.9*
Other Income	5,206	3,852	1,772	3,141	3,488
Net Income	**12,878**	**12,669**	**10,238**	**12,537**	**14,191**
Change (%)	*19.6*	*-1.6*	*-19.2*	*22.4*	*13.2*
Operating Expenses	5,962	7,204	6,587	7,055	7,855
Operating Income	**6,916**	**5,465**	**3,651**	**5,482**	**6,337**
Change (%)	*39.5*	*-21.0*	*-33.2*	*50.1*	*15.6*
Other Provisions	2,339	2,682	2,774	1,900	2,000
PBT	**4,577**	**2,783**	**878**	**3,582**	**4,337**
Tax	1,531	1,011	369	1,203	1,457
Tax Rate (%)	*33.5*	*36.3*	*42.1*	*33.6*	*33.6*
PAT	**3,046**	**1,771**	**508**	**2,378**	**2,880**
Change (%)	*37.2*	*-41.8*	*-71.3*	*367.8*	*21.1*
Proposed Dividend	777	687	196	775	990

BALANCE SHEET (RS MILLION)

Y/E MARCH	2004	2005	2006	2007E	2008E
Capital	4,305	4,305	4,305	4,305	4,305
Reserves & Surplus	10,050	11,119	11,416	13,019	14,909
Net Worth	**14,356**	**15,424**	**15,721**	**17,325**	**19,214**
Deposits	264,459	288,442	269,062	317,493	371,467
Change (%)	*19.3*	*9.1*	*-6.7*	*18.0*	*17.0*
Borrowings	4,699	7,211	4,884	5,861	6,740
Other Liabilities & Prov.	38,726	17,904	22,478	23,602	24,782
Total Liabilities	**322,240**	**328,981**	**312,145**	**364,280**	**422,202**
Current Assets	54,663	38,733	23,887	31,260	27,858
Investments	140,920	144,796	113,543	111,272	116,835
Change (%)	*19.4*	*2.8*	*-21.6*	*-2.0*	*5.0*
Advances	117,315	130,616	164,697	210,813	265,624
Change (%)	*23.4*	*11.3*	*26.1*	*28.0*	*26.0*
Net Fixed Assets	1,705	1,829	1,842	1,942	1,992
Other Assets	7,637	13,007	8,176	8,993	9,893
Total Assets	**322,240**	**328,981**	**312,145**	**364,280**	**422,202**

ASSUMPTIONS (%)

Deposit Growth	19.3	9.1	-6.7	18.0	17.0
Advances Growth	23.4	11.3	26.1	28.0	26.0
Investments Growth	19.4	2.8	-21.6	-2.0	5.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	16.0	14.0	4.0	18.0	23.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2004	2005	2006	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.0	7.6	7.7	8.0	8.6
Avg. Cost-Int. Bear. Liab.	5.8	5.3	5.3	5.5	6.1
Interest Spread	2.2	2.3	2.4	2.5	2.4
Net Interest Margin	2.8	2.8	2.8	2.9	2.8
Profitability Ratios (%)					
RoE	25.2	11.9	3.3	14.4	15.8
RoA	1.1	0.5	0.2	0.7	0.7
Int. Expended/Int.Earned	65.1	62.8	64.0	63.7	66.8
Other Inc./Net Income	40.4	30.4	17.3	25.1	24.6
Efficiency Ratios (%)					
Op. Exps./Net Income	46.3	56.9	64.3	56.3	55.3
Empl. Cost/Op. Exps.	62.3	71.3	64.4	64.4	62.4
Busi. per Empl. (Rs m)	23.3	28.3	30.3	33.9	40.4
NP per Empl. (Rs lac)	NA	1.3	0.4	1.7	2.0
Asset-Liability Profile (%)					
Adv./Deposit Ratio	44.4	45.3	61.2	66.4	71.5
Invest./Deposit Ratio	53.3	50.2	42.2	35.0	31.5
G-Sec/Invest. Ratio	86.3	88.4	85.2	91.2	91.2
Gross NPAs to Adv.	7.7	7.0	5.5	3.9	3.1
Net NPAs to Adv.	2.5	2.1	2.0	1.1	0.8
CAR	11.9	12.7	11.3	11.2	11.0
Tier 1	*5.8*	*7.1*	*7.5*	*7.2*	*7.0*

VALUATION

Book Value (Rs)	32.6	35.2	35.9	39.8	44.3
Price-BV (x)	1.1	1.1	1.0	0.9	0.8
Adjusted BV (Rs)	28.3	30.9	30.8	36.3	41.2
Price-ABV (x)	1.3	1.2	1.2	1.0	0.9
EPS (Rs)	7.1	4.1	1.2	5.5	6.7
EPS Growth (%)	5.3	-41.8	-71.3	367.8	21.1
Price-Earnings (x)	5.3	9.1	31.7	6.8	5.6
OPS (Rs)	16.1	12.7	8.5	12.7	14.7
OPS Growth (%)	7.1	-21.0	-33.2	50.1	15.6
Price-OP (x)	2.3	2.9	4.4	2.9	2.5

E: MOSt Estimates

Dena Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,455	DBNK IN
	REUTERS CODE
S&P CNX: 3,634	DENA.BO

Equity Shares (m)	286.8
52-Week Range	42/20
1,6,12 Rel.Perf.(%)	1/-1/-18
M.Cap. (Rs b)	9.4
M.Cap. (US$ b)	0.2

2 April 2007

Buy

Initiating Coverage

Rs33

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV RATIO
3/07E	11,906	1,841	6.6	152.2	4.9	0.7	9.5	13.3	0.7	0.9
3/08E	13,209	2,454	9.2	33.3	3.5	0.6	10.3	16.3	0.8	0.7
3/09E	15,168	3,249	11.3	32.4	2.9	0.5	10.0	17.3	0.9	0.6

Lower provisioning / recoveries would be a huge kicker for profitability: Dena Bank has made provisions and write-offs of over Rs14b over the past five years. As coverage on existing NPAs improves and fresh slippages remain under control, incremental provisioning expense should decline. Besides, the bank's profitability was also depressed in the last two fiscal years due to heavy depreciation provisioning on its investment portfolio. However, it has substantially de-risked its investment portfolio by shifting securities to HTM (AFS less than 35% of total investment book) and reducing modified duration of AFS portfolio to less than two years.

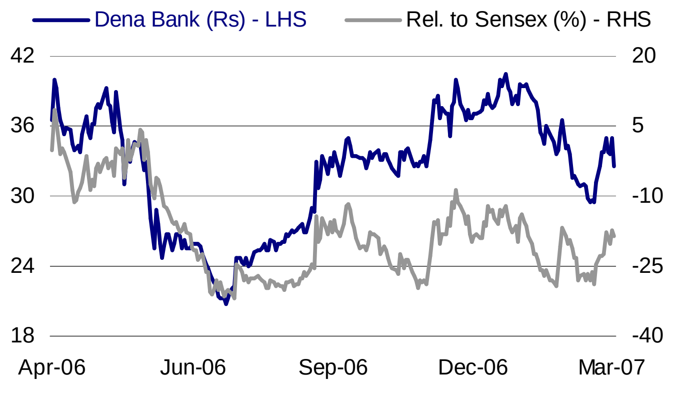
Has a strong liability profile: Unlike the problems on the asset side, the liability side of Dena Bank is quite healthy. Its low cost deposits (CASA) ratio of over 43% is one of the highest amongst the state-owned banks. Due to modest overall growth in deposits in FY06 (13% YoY), the bank was able to reduce its cost of deposits. Though deposit costs have started moving up in the current fiscal, the bank's ability to maintain high CASA ratio should help it restrict the increase in cost of deposits. We expect NIMs to be stable at ~3%.

Asset quality to continue improving: Dena Bank expects gross NPAs to be Rs8-8.5b in FY07 (Rs9.5b in FY06). We, however, estimate gross NPAs for FY07 at Rs9b (5.4% of gross loans), as some corporate legacy accounts could be classified as NPAs. The bank also expects healthy recoveries from certain accounts and is trying to control slippages in fresh accounts by centralizing retail loan processing, collaborating with SMERA – an SME-rating agency initiative by SIDBI, and is monitoring existing accounts.

Branch network concentrated in cash rich states: Dena Bank has about 1,122 branches (as at end-FY06). Almost 60% of these branches are situated in rural and semi-urban areas, helping the bank to mobilize low cost deposits. In terms of geographical presence, more than 60% of Dena Bank's branches are located in the cash-rich states of Gujarat and Maharashtra.

Valuations attractive: We expect Dena Bank to report EPS of Rs9.2 for FY08 and Rs11.3 for FY09. We estimate book value at Rs52/share for FY08 Rs62/share for FY09. The stock trades at attractive valuations of 2.9x FY09E EPS and 0.5x FY09E BV. We initiate coverage with a **Buy.**

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT

(RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	17,252	17,601	20,528	24,210	28,227
Interest Expended	10,386	10,375	12,229	14,348	16,794
Net Interest Income	**6,866**	**7,227**	**8,299**	**9,861**	**11,432**
Change (%)	*15.9*	*5.3*	*14.8*	*18.8*	*15.9*
Other Income	3,112	4,590	3,607	3,348	3,736
Net Income	**9,978**	**11,817**	**11,906**	**13,209**	**15,168**
Change (%)	*-17.5*	*18.4*	*0.8*	*10.9*	*14.8*
Operating Expenses	6,156	5,613	6,163	6,492	7,144
Operating Income	**3,822**	**6,203**	**5,743**	**6,717**	**8,024**
Change (%)	*-46.2*	*62.3*	*-7.4*	*17.0*	*19.5*
Other Provisions	3,825	5,749	3,675	3,600	3,500
PBT	**-3**	**455**	**2,068**	**3,117**	**4,524**
Tax	-613	-275	227	663	1,276
Tax Rate (%)	*22,435*	*-60.5*	*11.0*	*21.3*	*28.2*
PAT	**610**	**730**	**1,841**	**2,454**	**3,249**
Change (%)	*-73.5*	*19.7*	*152.2*	*33.3*	*32.4*
Proposed Dividend	0	0	0	330	495

BALANCE SHEET

(RS MILLION)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	2,868	2,868	2,868	2,868	2,868
Reserves & Surplus	8,169	10,524	12,324	14,544	17,198
Net Worth	**11,037**	**13,392**	**15,192**	**17,413**	**20,066**
Deposits	208,966	236,231	269,303	309,698	356,153
Change (%)	*13.9*	*13.0*	*14.0*	*15.0*	*15.0*
Borrowings	3,350	10	200	500	1,000
Other Liabilities & Prov.	16,933	15,820	16,611	17,442	18,314
Total Liabilities	**240,286**	**265,453**	**301,307**	**345,053**	**395,534**
Current Assets	17,820	25,036	28,419	27,712	24,871
Investments	96,969	85,707	81,421	85,492	89,767
Change (%)	*-0.4*	*-11.6*	*-5.0*	*5.0*	*5.0*
Advances	113,086	142,312	177,890	217,026	264,772
Change (%)	*20.2*	*25.8*	*25.0*	*22.0*	*22.0*
Net Fixed Assets	2,933	4,605	5,004	5,392	5,751
Other Assets	9,478	7,793	8,572	9,430	10,373
Total Assets	**240,286**	**265,453**	**301,307**	**345,053**	**395,534**

ASSUMPTIONS

(%)

Deposit Growth	13.9	13.0	14.0	15.0	15.0
Advances Growth	20.2	25.8	25.0	22.0	22.0
Investments Growth	-0.4	-11.6	-5.0	5.0	5.0
Dividend	0.0	0.0	0.0	10.0	15.0

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	8.0	7.4	7.7	7.9	7.9
Avg. Cost-Int. Bear. Liab.	5.2	4.6	4.8	5.0	5.0
Interest Spread	2.8	2.7	2.9	3.0	2.9
Net Interest Margin	3.2	3.0	3.1	3.2	3.2
Profitability Ratios (%)					
RoE	5.7	6.0	13.3	16.3	17.3
RoA	0.3	0.3	0.7	0.8	0.9
Int. Expended/Int.Earned	60.2	58.9	59.6	59.3	59.5
Other Inc./Net Income	31.2	38.8	30.3	25.3	24.6
Efficiency Ratios (%)					
Op. Exps./Net Income	61.7	47.5	51.8	49.1	47.1
Empl. Cost/Op. Exps.	68.3	63.1	64.5	67.1	66.9
Busi. per Empl. (Rs m)	48.3	34.5	40.8	48.0	56.4
NP per Empl. (Rs lac)	0.6	0.7	1.9	2.6	3.2
Asset-Liability Profile (%)					
Adv./Deposit Ratio	54.1	60.2	66.1	70.1	74.3
Invest./Deposit Ratio	46.4	36.3	30.2	27.6	25.2
G-Sec/Invest. Ratio	84.5	84.4	84.4	84.4	84.4
Gross NPAs to Adv.	9.7	6.4	5.3	4.5	4.0
Net NPAs to Adv.	5.2	3.0	2.1	1.5	1.2
CAR	11.9	10.6	9.5	10.3	10.0
Tier 1	*6.6*	*6.0*	*8.7*	*7.8*	*7.0*

VALUATION

Book Value (Rs)	34.6	37.2	43.8	51.9	61.5
Price-BV (x)	1.0	0.9	0.8	0.7	0.6
Adjusted BV (Rs)	21.2	27.3	35.3	44.3	54.4
Price-ABV (x)	1.6	1.3	1.0	0.8	0.6
EPS (Rs)	2.1	2.5	6.6	9.2	11.3
EPS Growth (%)	-73.5	19.7	152.2	33.3	32.4
Price-Earnings (x)	16.5	13.8	5.3	3.8	3.1
OPS (Rs)	13.3	21.6	20.0	23.4	28.0
OPS Growth (%)	-46.2	62.3	-7.4	17.0	19.5
Price-OP (x)	2.6	1.6	1.7	1.5	1.3

E: MOSt Estimates

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Disclosure of Interest Statement

The MOSt group and its Directors own shares in the following companies covered in this report: Dena Bank, Indian Overseas Bank and State Bank of India.

MOSt does not have a broking relationship with any of the companies covered in this report.

MOSt is engaged in providing investment-banking services in the following companies covered in this report: Nil