# UTI Bank

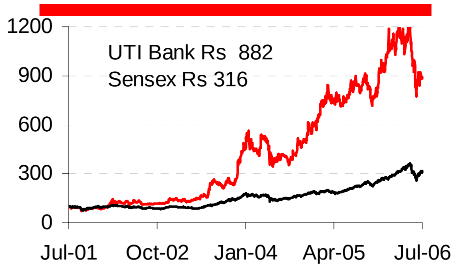
**Buy** **Target price: Rs 360**

## Market data

| | |
|---|---|
| Current price | Rs 274 (BSE) |
| Market cap | Rs 76,364 m |
| Face value (Rs) | 10.0 |
| FY06 Div/share | 3.5 |
| NSE symbol | UTIIBANK |
| No of shares | 278.7 m |
| Free float | 56.3% |
| 52 week H/L | Rs 425 / 220 |

## Share price chart


## Rs 100 invested is worth




## Shareholding

| Category | (%) |
|---|---|
| Promoters | 43.7 |
| Mutual Funds | 6.8 |
| Banks/Fis | 0.2 |
| FIIs | 35.3 |
| GDR holders | 6.8 |
| Public | 7.2 |
| Total | 100.0 |

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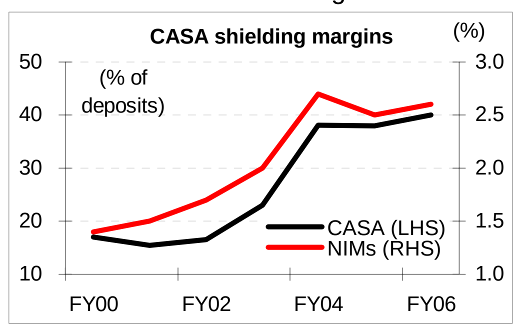
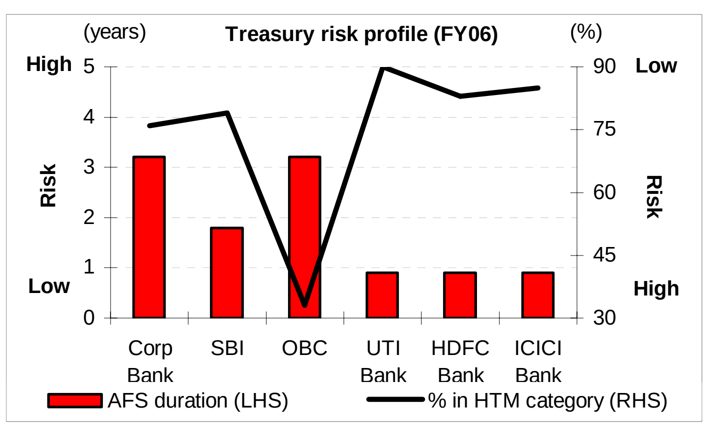
## Investment Rationale

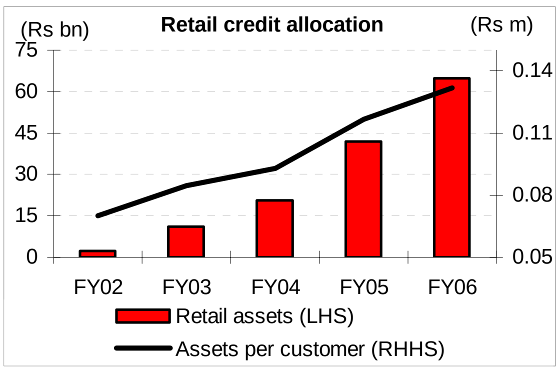
- **CASA to shield margins:** At a time when most banks are scurrying to raise high cost term deposits to fund their incremental offtakes, having a high proportion of low cost deposits in its books puts UTI Bank on a firm footing. CASA (current and savings accounts) comprised 40% of the bank's total deposits in FY06, of which the zero cost current accounts alone comprised nearly 45%. In 1QFY07 too, the demand deposits have grown by 52% YoY, indicating no liquidity pressure. More importantly, the historical trend of the bank's CASA and net interest margins clearly shows a positive correlation. This gives us the confidence that a higher growth in low cost deposits will continue to shield the bank's net interest margins. It also needs to be noted that ahead of capital raising (due later in FY07), the bank's liabilities are of a shorter average duration than assets, thus getting re-priced faster than assets in a rising interest rate environment. As the growth rate of the bank gets moderated and interest rates plateau, the net interest margins (NIMs) can be expected to rise again. We have, nevertheless, retained our conservative outlook with respect to the bank's NIMs.




- **Treasury de-risked:** With 90% of its investments in the held-to-maturity (HTM) basket at the end of FY06 and a duration of less than a year in the available-for-sale (AFS) category, UTI Bank stands to be one of the best hedged banks in terms of interest rate risk on the treasury portfolio. This means relatively lower provisioning for the investments book going forward. Also, a 61% YoY growth in fee income took the contribution of fee-based income to the bank's total income to 34% in 1QFY07 from 31% in the corresponding quarter of FY06. The higher fee income contribution insulates the bank's bottomline against any negative surprises on the treasury side.



- **Judicious asset allocation:** UTI Bank has successfully capitalised on the RAC (retail asset centre) model to capture growth opportunities in retail credit segment and at the same time not compromised on asset quality. It may be recalled that the bank had set up RACs for dedicated disbursement of retail credit (distinct from branch distribution) so as to avoid any undue favours to the branch deposit customers and compromises on loans appraisals. The same seems to have paid off well now. With 15 RACs at the end of 1QFY07, the bank has achieved a CAGR of 243% in retail loans (30% of total advances) over the last 5 years. At the same time, with the judicious allocation through the RACs, there has not been any asset concentration and the asset per customer has also grown proportionately (from Rs 0.07 m in FY02 to Rs 0.13 m in FY06).




- **Costs curtailed:** UTI Bank's initiative of setting up RACs for processing of retail loans and shifting of institutional back office jobs to the CMS hubs has considerably helped the bank control its operating expenses. In fact, the bank's cost to income ratio of 45% in FY06 was actually lower than that of HDFC Bank (46% in FY06), which has historically had one of the best cost efficiency ratios.

- **Attractive valuations:** On the valuation metrics, UTI Bank compares reasonably favourably vis-à-vis its peers in the private sector banking space. More so, because of the bank's consistency in performance and management quality, it has historically been accorded a premium in terms of valuations. Also, post FY09, once the sector opens up to foreign investments, UTI Bank could possibly prove to be one of the most lucrative targets, especially for HSBC, which earlier had a strategic stake (14%) in the bank. This could, again, call for an upgrade in valuations.

## Investment Concerns

- **Efficiency compromised:** While UTI Bank's employee efficiency compares favourably against its peers in private sector and PSU banking space, the rapid expansion in franchise has led to the bank compromising in terms of branch efficiency. However, going forward, as the bank's growth rate gets moderated, we expect efficiency ratios to improve.

**On the efficiency scale…**

| FY06 (Rs m) | Buss/ branch | Buss/ employee | Profit/ branch | Profit/ empl. |
|---|---|---|---|---|
| UTI Bank | 1,387 | 95 | 11 | 0.7 |
| HDFC Bank | 1,698 | 61 | 16 | 0.6 |
| Corp.Bank | 681 | 50 | 5 | 0.4 |
| OBC | 794 | 62 | 4 | 0.3 |

- **Capital crunch:** Given the bank's low capital base (CAR 10.3%) in 1QFY07 and the compulsion to comply with Basel-II norms by 4QFY07, capital raising by way of equity or long-term debt is inevitable in FY07. While on one hand this will be benign, as it will provide relatively low-cost long term funding to the bank, on the other hand, it will lead to equity dilution. However, under the current RBI guidelines, the bank may also opt for hybrid capital (to be classified as Tier I), which can avoid equity dilution. We have not factored in the possible dilution in our assumptions.

- **Slippages likely:** The bank's net NPAs as a percentage of advances dropped to 0.7% in 1QFY07 against 1.2% in 1QFY06. The fall in gross NPA levels also suggests lower slippages. The bank, in recent years, has written off impaired assets aggressively. The provisions held together with accumulated write-offs amount to 77% of gross NPAs in 1QFY07. If the accumulated write-offs are excluded, then the provisions held as a proportion of gross NPAs amounts to 42%. Notwithstanding this, given the frequent interest rate hikes, the possibility of higher delinquencies in retail loans cannot be ignored. We have accordingly assumed higher slippage ratios for the bank in the coming fiscals, which will necessitate higher NPA provisioning.

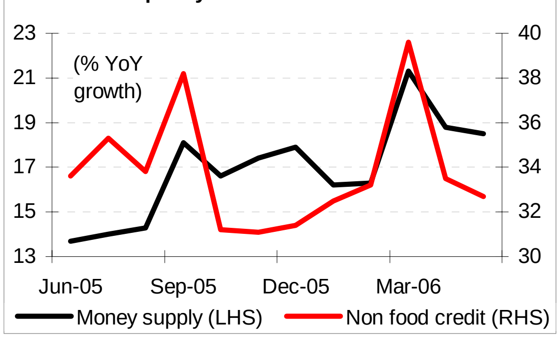
## Background

UTI Bank is one of the most aggressive players in the private sector banking industry, having nearly doubled its share in non-food credit over the last 6 years from 0.9% in FY00 to 1.7% in FY06. The bank in the last few years has changed its focus from the corporate segment and is currently focusing on the retail segment to fuel growth. Its exposure to the retail segment stands at 30% of total advances in 1QFY07. The bank's strategy is to aggressively tap the retail domain via the use of ATMs. Following this strategy, the bank has set up a network of 1,891 ATMs, the third largest in the country. Despite the GDR issue in FY05, the bank's CAR stood at a low 10.3% in 1QFY07.

## Industry Prospects

As opposed to the anticipations of severe liquidity pressure during 1QFY07, the money supply continued to remain buoyant during the quarter, expanding by 18.5% YoY. Although the monetary tightening led to a fall in the month on month supply over the last couple of months, the same is comfortably higher as compared to the corresponding period of FY05. More importantly, it outpaced RBI's projections of 15% YoY growth. Non-food credit growth (97% of total credit), in line with the seasonal downturn, was only 1% YoY. However, one must note that in percentage terms the growth is almost at par with the figure registered last year. At the end of FY06, private sector banks accounted for 21% of aggregate deposits and 29% of gross bank credit. Their network of approximately 6,500 branches accounted for 13% of the total branch network of scheduled commercial banks in India. While the high base effect will certainly tame the growth figures for the banking sector in FY07 and FY08, a check on the interest rates is warranted to keep the incremental offtakes strong.

**Liquidity concerns unwarranted**




## Risk Analysis

**Sector:** The growth in non-food credit is closely linked to the GDP growth of the country. With the contribution of non-food credit to GDP having grown from 36% in FY00 to in 80% in FY06, we see a higher proportion of the same being inevitable to keep the GDP growth of the country at a sustainable 7.5% per annum. Also, the rising income levels and ongoing capex drive of the corporates make the case strong for retail and corporate lending respectively. Nevertheless, the high base assumed in FY06 and hardening interest rates may limit growth on certain counters. Based on these factors, we have assigned a medium risk rating of 4 to the stock.

**Sales:** UTI Bank has witnessed a CAGR of 34% in its topline over the last 5 years, which is higher than the industry average of 25%. Foray into high-yielding SME segment and raising of long term funding may help the bank propel its asset growth further. This shall be backed by rise in non-fund based income with a higher market share in cash management services and government related business. The possible margin pressure, however, poses a downside to the company's bottomline. Also, since the company has breached our parameter of sales above US$ 500 m, we assign a medium risk rating of 5 to the stock.

**Long-term EPS growth:** We expect the bank's net profit to grow at a CAGR of 24% between FY06 to FY09 (CAGR of 59% during FY03-FY06). In a normal scenario, we consider a compounded growth of over 20% in net profits over a period of 3 to 5 years as healthy for a company. As such, the rating assigned to the stock on this factor is 8.

**Dividend payout:** UTI Bank has maintained an average dividend payout ratio of 23% over the last 5 years. The rating assigned is on this parameter is, thus, 5.

**Promoter holding:** A larger share of promoter holding indicates the confidence of the people who run it. We believe that a greater than 40% promoter holding indicates safety for retail investors. At the end of March 2006, the promoter holding in UTI Bank stood at 43.7%. We have assigned a low risk rating of 8 to the stock.

**FII holding:** We believe that FII holding of greater than 25% can lead to high volatility in the stock price. FII holding in the bank stood at 35% at the end of March 2006, which is a risky factor. Therefore, the rating assigned is 2.

**Liquidity:** The past one-year average daily volume of the stock is in the range of 200,661 shares, which is reasonable. The rating assigned is 7.

**NIMs:** The bank has historically had NIMs between 2% to 3% over the last 4 years. We therefore assign a medium risk rating of 5 to the stock.

**NPAs:** The bank has historically had net NPA levels below 2% over the last 4 years. We therefore assign a medium risk rating of 6 to the stock.

**Considering the above parameters, the total ranking assigned to the company is 50. This makes the stock a medium-risk investment from a long-term perspective.**

### Risk Matrix

| | High Risk | Medium Risk | Low Risk |
|---|---|---|---|
| Rating | (1 to 3) | (4 to 6) | (7 to 10) |
| Sector | High | Medium | Low |
| Sales (US$ m) | < 500 | 501 - 1000 | > 1001 |
| Long term EPS growth (%) | < 10 | 10 – 20 | > 20 |
| Dividend Payout (%) | < 15 | 15 - 25 | > 25 |
| Promoter holding (%) | < 25 | 25 – 40 | > 40 |
| FII Holding (%) | > 25 | 10 - 25 | < 10 |
| Liquidity (Nos. '000) | < 100 | 100 - 200 | > 200 |
| NIMs (%) | < 2 | 2 - 3 | > 3 |
| NPAs (%) | > 2 | 1 - 2 | < 1 |
| Final Rating | < 27 | 27 - 54 | > 54 |

### Valuations

UTI Bank has emerged as one of the most aggressive private sector banking entity in the country after ICICI Bank, with a forte in retail banking. However, unlike the latter, the bank has also been able to maintain a good asset quality and supplemented it with a strong growth on non-fund based income. Not to mention, the profits in its investment book have enabled it to write off all its delinquencies over the last couple of years. Going forward, given the latent growth opportunities in SME credit and fee income, the growth prospects of the bank appear enthusing. At the same time, improvements are due on the net interest margin and operating efficiency fronts.

While we acknowledge the fact that UTI Bank certainly has the steam to cater to the country's incremental credit demand, the current valuations of the bank are also at a discount to most of its peers in the private sector banking space. Based on the risk-return matrix, we believe that the stock is attractive from a two-year perspective and we recommend a BUY with a FY08 target price of Rs 360 (compounded annual returns of 16.5%).

### Valuation table

| (Rs m) | FY06 | FY07E | FY08E | FY09E |
|---|---|---|---|---|
| Total Revenues | 18,079 | 19,618 | 23,486 | 27,701 |
| Net Profit | 4,851 | 5,893 | 6,628 | 7,407 |
| EPS (Rs) | 17.4 | 21.1 | 23.8 | 26.6 |
| Adjusted BV (Rs) | 95.7 | 112.9 | 130.6 | 153.1 |
| P/E (x) | 15.7 | 13.0 | 11.5 | 10.3 |
| P/Adj BV (x) | 2.9 | 2.4 | 2.1 | 1.8 |

### Performance over the years…

| FY06, (Rs m) | UTI Bank | HDFC Bank | Corp Bank** |
|---|---|---|---|
| Return on assets | 1.1% | 1.4% | 1.2% |
| Return on equity | 16.8% | 17.7% | 13.2% |
| Net interest margin | 2.6% | 4.0% | 3.5% |
| Net NPA/Advances | 0.7% | 0.4% | 0.6% |
| Cost/income | 45.0% | 46.0% | 41.5% |
| Business per employee | 95 | 61 | 50 |
| Business per branch | 1,387 | 1,698 | 681 |
| Profits per employee | 0.7 | 0.6 | 0.4 |
| Valuations | | | |
| Price to earnings | 15.7 | 26.2 | 7.0 |
| Price to adjusted BV | 2.9 | 4.4 | 1.0 |
| Dividend yield | 1.3% | 1.0% | 3.2% |

** Unaudited numbers

## Financials at a glance

| (Rs m) | FY06 | FY07E | FY08E | FY09E |
|---|---|---|---|---|
| Interest income | 28,888 | 37,965 | 44,902 | 53,303 |
| Interest expense | 18,106 | 26,363 | 32,409 | 39,343 |
| Net interest income | 10,782 | 11,602 | 12,494 | 13,960 |
| Other income | 7,296 | 8,016 | 10,993 | 13,741 |
| Other expenses | 8,141 | 9,931 | 12,116 | 14,782 |
| Provisions and contingencies | 2,625 | 798 | 1,373 | 1,747 |
| Profit before tax | 7,313 | 8,888 | 9,997 | 11,172 |
| Tax | 2,462 | 2,995 | 3,369 | 3,765 |
| Profit after tax/(Loss) | 4,851 | 5,893 | 6,628 | 7,407 |
| *Net profit margin (%)* | *16.8%* | *15.5%* | *14.8%* | *13.9%* |
| No of shares (m) | 278.7 | 278.7 | 278.7 | 278.7 |
| Diluted earnings per share (Rs) | 17.4 | 21.1 | 23.8 | 26.6 |

| **Balance Sheet** | | | | |
|---|---|---|---|---|
| Advances | 223,142 | 272,233 | 326,680 | 392,016 |
| Investments | 215,273 | 231,398 | 267,877 | 305,772 |
| Fixed assets | 5,677 | 6,245 | 6,869 | 7,556 |
| Cash and balance with RBI | 24,294 | 23,065 | 26,525 | 30,504 |
| Balance with other banks | 12,124 | 12,731 | 13,367 | 14,036 |
| Other assets | 16,800 | 27,720 | 38,808 | 46,569 |
| **Total assets** | **497,311** | **573,392** | **680,126** | **796,453** |
| | | | | |
| Net worth | 28,856 | 33,634 | 39,008 | 45,022 |
| Deposits | 401,135 | 461,306 | 530,501 | 610,077 |
| Subordinated (Tier II) debt | 17,886 | 17,886 | 17,886 | 17,886 |
| Borrowings | 26,809 | 57,663 | 75,786 | 101,679 |
| Other liabilities | 22,624 | 2,903 | 16,945 | 21,789 |
| **Total liabilities** | **497,311** | **573,392** | **680,126** | **796,453** |

## Sector Statistics

| Total Revenue (Rs m) | | Market cap. (Rs m) | | Net interest margin (%) | | Net profit margin (%) | | Return on NW (%) | |
|---|---|---|---|---|---|---|---|---|---|
| HDFC Bank | 55,993 | HDFC Bank | 227,937 | HDFC Bank | 4.0% | HDFC Bank | 19.5% | HDFC Bank | 17.7% |
| **UTI Bank** | **18,079** | **UTI Bank** | **76,364** | Corp. Bank | 3.5% | Corp. Bank | 16.9% | **UTI Bank** | **16.8%** |
| Corp. Bank | 17,983 | Corp. Bank | 31,118 | **UTI Bank** | **2.6%** | **UTI Bank** | **16.8%** | Corp. Bank | 13.2% |

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**Disclosure:** The author of this article does not hold shares in the recommended company. QIS does not hold shares in the recommended company.