

Q4FY07 result

Union Bank of India

BUY

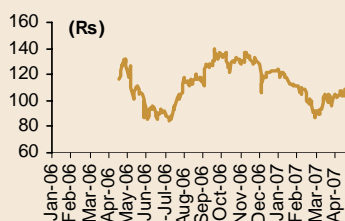
Bloomberg: UNBK IN
Reuters: UNBK.NS
Mkt cap: Rs65.7bn/US\$1.4bn

Current price: INR 109*
Target price: INR 125

Sharp increase in margins

**As on 7 May 2007*
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Stock performance


(%)	Absolute	Relative
3 months	(2.6)	1.1
6 months	(17.8)	(22.8)
12 months	(15.2)	(24.5)

Key financials

Yr ended 31 Mar	FY07E	FY08E	FY09E
Adj net profit (INR bn)	8.7	9.0	9.4
EPS (INR)	16.7	16.3	17.5
Adj. EPS (INR)	17.3	17.8	18.6
BVPS (INR)	93.9	106.5	120.0
Adj. RoE (%)	19.8	17.7	16.4
Adj. RoA (%)	0.9	0.8	0.7
PER (x)	6.5	6.7	6.2
Adj. PER (x)	6.3	6.1	5.9
Price/Book (x)	1.2	1.0	0.9
Dividend yield (%)	3.1	3.0	3.2
Consensus EPS (INR) *		16.8	20.4

** Bloomberg*
Sharp increase in margins...

Union Bank of India's (UNBK) net interest margins (NIM) for Q4FY07 came in at 3.52%, which is a steep 53bp increase over 2.99% in Q3FY07. This was the second consecutive quarter of margins increase after a disappointing Q2FY07.

...on the back of steep increase in yield on advances

Increase in margins was primarily due to 105bp sequential increase in yield on advances. This was unlike the last quarter when margins improvement was due to cost of deposits remaining stable.

Loan growth continues to materially moderate

Loan growth came in at 17% YoY, which was significantly lower than 27% overall sector growth. UNBK has a relatively weak liability profile, characterised by a high dependence on wholesale deposits. Hence, there is a trade-off between margins and asset growth. Trends in the last two quarters indicate that the management is now giving priority to maintaining margins. For a bank with a low Tier 1, we view this to be positive.

Non-interest non-trading income surprises on the positive again

Non-interest non-trading income grew by 38% YoY. While recoveries have indeed contributed to this growth, core fee income revenue streams have also shown an impressive growth. This result has lent credibility to the claim that the CBS implementation measures are driving fee income.

Tier 1 capital at 7.8% — No plans for dilution in FY08

Tier 1 ratio at end-FY07 stood at 7.8%. More importantly, the management has indicated that there are plans to go in for an equity dilution for at least the next one year. This is after factoring the higher capital requirements for Basel 2 compliance.

Maintain BUY

We believe that UNBK is structurally weak on the liabilities side due to its low casa ratio and high dependence on bulk deposits. Consequently, its margins will continue to be weak vis-à-vis the rest of the PSU pack, in our view. However, the management now seems to be clearly focused on maintaining margins, even at the expense of a lower loan growth, which we believe is positive. Strong growth in fee income is another positive, in our view. We continue to maintain BUY with an end-FY08 price target of INR 125.

Table 1: Quarterly result

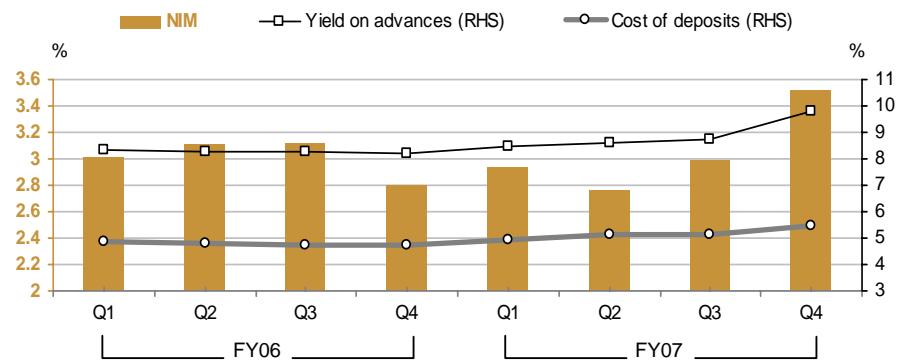
	Q4FY06	Q3FY07	Q4FY07	Q4FY07E	YoY growth (%)	QoQ growth (%)
Net interest income	5,979	6,859	8,424	6,622	41	23
NIM (%)	2.80	2.99	3.52	0.00		
Non-interest income	2,122	2,052	2,418	1,800	14	18
Operating income	8,100	8,911	10,841	8,422	34	22
Operating expenses	(3,515)	(3,860)	(3,259)	(4,194)	-7	-16
Operating profit	4,585	5,051	7,583	4,228	65	50
Provision charges	(2,384)	(1,426)	(3,153)	(2,268)	32	121
Profit before tax	2,201	3,625	4,430	1,960	101	22
Tax provided	(755)	(1,067)	(2,144)	(376)	184	101
Tax rate (%)	34	29	48	19		
Net profit	1,446	2,558	2,286	1,583	58	-11
Net advances	533,800	583,030	623,860	661,911	17	7

Source: Company, Brics Research

Q4FY07 – Key takeaways

Figure 1: NIM (YoY)

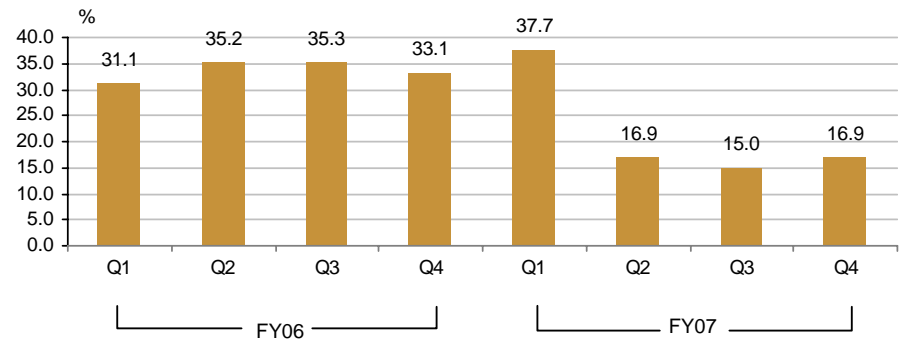
Sharp increase in margins, primarily due to 105bp increase in yield on advances



Source: Company, Brics Research

Figure 2: Loan growth (YoY)

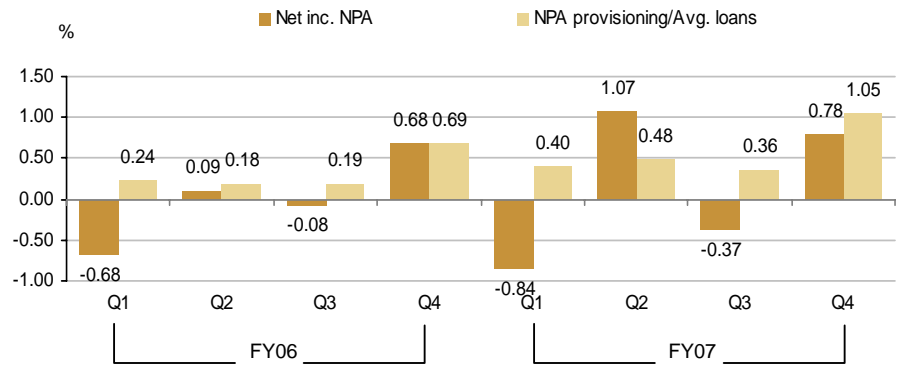
The management is now demonstrating a clear preference for maintaining margins, even at the expense of loan growth. For a capital-scarce bank, we would positively view such a strategy



Source: Company, Brics Research

Net inc. NPA increased this quarter, which was in line with our expectations

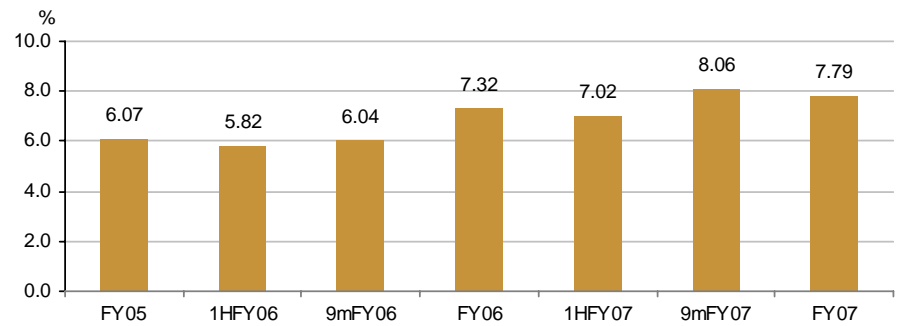
Figure 3: Asset quality (%)



Source: Company, Brics Research

The management has said that the bank will not dilute for at least the next one year, even after factoring in the higher capital requirements for Basel 2 compliance

Figure 4: Tier 1 ratio (%)



Source: Company, Brics Research

Income statement						Key ratios					
<i>(INR bn)</i>											
Year ending 31 March	FY05	FY06E	FY07E	FY08E	FY09E	Year ending 31 March	FY05	FY06E	FY07E	FY08E	FY09E
Net interest income	20.6	23.7	27.9	28.8	33.0	Per-share data (INR)					
Growth (%)	18.9	15.0	17.5	3.3	14.6	EPS	15.6	10.8	16.7	16.3	17.5
Non-interest income	7.7	4.9	6.9	7.5	9.0	Adj. EPS	9.0	11.3	17.3	17.8	18.6
Fee/Commission income	1.8	2.2	2.7	3.2	3.7	DPS	3.0	2.2	3.3	3.3	3.5
Operating income	28.3	28.7	34.8	36.4	42.0	BVPS	68.2	81.0	93.9	106.5	120.0
Core operating income	25.7	29.0	35.2	37.4	42.8	Profitability (%)					
Operating expenses	(12.6)	(14.0)	(14.8)	(17.7)	(19.6)	RoE	25.0	15.0	19.1	16.2	15.5
Employee expenses	(8.1)	(8.7)	(8.7)	(10.5)	(11.3)	Adj. RoE	14.4	15.8	19.8	17.7	16.4
Operating profit	15.7	14.7	20.0	18.6	22.4	RoA	1.1	0.7	0.9	0.7	0.7
Provision Charges	(9.6)	(7.0)	(6.2)	(6.9)	(9.7)	Adj. RoA	0.6	0.7	0.9	0.8	0.7
Bad and doubtful debts charge	(2.2)	(1.6)	(3.3)	(5.8)	(8.6)	Growth ratios (%)					
Profit before tax	6.1	7.6	13.8	11.7	12.6	Core operating income growth	20.5	13.0	21.3	6.3	14.3
Tax Provided	1.1	(2.2)	(5.4)	(3.5)	(3.8)	Operating profit growth	6.1	-6.9	36.5	-6.9	20.1
Profit after tax	7.2	5.4	8.5	8.2	8.9	Net profit growth	1.0	-24.3	55.3	-2.9	7.8
Adj Net Profit	4.1	5.7	8.7	9.0	9.4	EPS growth	1.0	-31.1	55.3	-2.9	7.8
No. of shares outstanding(INR m)	460.1	505.1	505.1	505.1	505.1	Adj. EPS growth	23.6	25.7	53.3	2.7	4.6
Adj Net Pat Growth (%)	23.6	38.0	53.3	2.7	4.6	BVPS growth	20.6	18.7	15.9	13.4	12.7
						Advances Growth	38.7	33.1	16.9	20.0	18.0
						Yields (%)					
Balance sheet	<i>(INR bn)</i>					Yield on advances	8.3	8.2	8.8	9.4	9.4
Year ending 31 March	FY05	FY06E	FY07E	FY08E	FY09E	Yield on investments	8.2	7.8	7.8	7.7	7.5
Cash and equivalents	2	2	17	3	3	Cost of liabilities	4.9	4.8	5.3	5.8	5.9
Net advances	401	534	624	749	883	NIM	3.3	3.1	3.0	2.7	2.7
Investments	228	259	282	306	356	Interest spread	3.1	2.8	2.7	2.4	2.3
Investments in government securities	164	203	221	254	301	Efficiency ratios (%)					
Other interest earning assets						Cost-income ratio	44.4	48.9	42.4	48.7	46.7
Interest earning assets	695	857	989	1,146	1,341	Core cost-income ratio	48.9	48.3	41.9	47.3	45.9
Other assets	25	29	32	36	39	Operating costs to assets	1.9	1.7	1.5	1.6	1.5
Total assets	719	886	1,022	1,182	1,381	Asset quality					
Deposits from banks	14	17	-	21	23	Gross NPLs (%)	5.1	3.9	2.9	3.2	3.8
Deposits from customers	605	724	852	977	1,157	Net NPLs (%)	2.6	1.6	1.0	0.8	0.7
Demand deposits	48	55	86	102	117	PL provisions/avg. loans	0.6	0.3	0.6	0.9	1.1
Savings deposits	152	180	208	239	275	Capitalisation ratios (%)					
Time deposits	405	488	558	636	766	Tier 1 ratio	6.1	7.3	7.8	8.3	7.9
Borrowings	20	40	40	40	40	Tier 2 ratio	6.0	0.0	0.0	0.0	0.0
Other interest bearing liabilities	20	28	42	46	50	CAR	12.1	11.9	12.8	10.6	9.7
Interest bearing liabilities	658	808	933	1,083	1,270	Liquidity Ratio					
Total liabilities	688	846	974	1,128	1,320	Loans/Deposits	64.2	69.9	70.0	73.7	73.8
Shareholders funds	31	41	47	54	61	Investment/Deposits	36.5	33.9	31.6	30.1	29.7
Capital	5	5	5	5	5	Inc. loans/deposits ratio	93.7	95.9	70.3	100.0	74.5
Reserves and surpluses	27	36	42	49	56	Valuations					
Total liabilities and equity	719	887	1,022	1,182	1,381	PER (x)	7.0	10.1	6.5	6.7	6.2
						Adj. PER(x)	12.1	9.7	6.3	6.1	5.9
						Price/Book (x)	1.6	1.3	1.2	1.0	0.9
						Dividend yield (%)	2.8	2.0	3.1	3.0	3.2

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