

Indian Financials

Q2FY10 Results Review
Credit blues behind...better times ahead!



Pathik Gandotra/ Chinmaya Garg/ Sameer Bhise

(Tel): +91 22 6638 3304/ 325/ 390

pathik@idfcsski.com/ chinmaya@idfcsski.com/ sameer@idfcsski.com

November 2009

Indian Banks: The quarter gone by...

Q2FY10 earnings: Key Themes

PAT ahead of estimates

Our financials universe reported net profit growth of 25% yoy – ahead of our estimate of 14% yoy

NII performance in line

NII growth at 9% yoy and qoq for our coverage universe was per estimates. NII was muted due to

- **Subdued credit growth...** : Muted at ~14% yoy in Q2FY10, in the context of dwindling demand from corporates
- **...however margins expand qoq**: Saw an uptick qoq for almost all banks, as the benefit of deposit re-pricing overplayed the impact of lower loan yields. Private banks saw NIMs expansion yoy also

Improvement in CASA ratio

Recovered from low levels of Q1FY10, aided by sanguine interest rates at a systemic level. Lower deposit growth in line with muted credit off-take also helped

Treasury - remains a mixed bag

While tapering from high levels evidenced in Q1FY10 (16-45% of operating profit), it still remained strong

Sluggish fee income growth

Credit-linked fees remained lukewarm with credit off-take remaining muted during Q2

- Private banks' (excluding ICICI Bank) non-fund income grew by ~15% yoy, with Axis Bank & HDFC Bank able to maintain momentum
- Capital market related fees continued to be sluggish, hurting growth for private banks like ICICI Bank

Asset quality largely stable

Contained rise in Gross NPAs, given the large restructuring of stressed advances by banks till Q1FY10. Incremental restructured advances in Q2FY10 ranged from 0.3-1% across banks

✓ *Positive surprise: Yes Bank, IndusInd Bank, Punjab National Bank, Bank of Baroda, Shriram Transport*

✗ *Key disappointments: Bank of India, HDFC on NII; ING Vysya and SBI on asset quality*

Overview of results

- ❑ PAT ahead of estimates: Financials reported net profit growth of 25% yoy - ahead of our estimate of 14% yoy
- ❑ ...despite NII being in line: NII growth at 9% yoy and qoq for our coverage universe was in-line with estimates
- ❑ Stronger than expected treasury gains on the back of volatile yields and active churning in portfolio

Company	Net Interest Income			Operating profit			PAT		
	Q2FY10	% variance from estimates	yoy growth (%)	Q2FY10	% variance from estimates	yoy growth (%)	Q2FY10	% variance from estimates	yoy growth (%)
Allahabad Bank	6,033	-7.7	22.2	6,498	45.8	106.8	3,336	65.1	700.3
Axis Bank	11,497	-2.4	25.9	13,058	16.2	49.3	5,316	-1.4	32
Bank of Baroda	13,886	5.6	22.5	10,316	4.6	22	6,342	31.6	60.4
Bank of India	14,089	3.7	3.4	12,060	2.7	-0.7	3,233	-47.7	-57.6
Canara Bank	13,137	-3.3	14.3	14,191	35.4	83.5	9,105	62.9	72
Corporation Bank	5,036	3.2	23.8	5,357	14.3	52.4	2,917	36.4	52.3
HDFC	7,844	-13.1	1.8	9,269	1.7	19.4	6,639	7.7	24.3
HDFC Bank	19,558	-8.5	4.8	15,930	6.8	41.9	6,875	-1	30.2
ICICI Bank	20,361	-6.1	-5.2	24,353	-0.5	6.6	10,401	3.4	2.6
IDBI	4,721	34.7	287.1	6,366	88.8	123.8	2,537	60.9	56.2
Indian Bank	7,591	0.7	11.3	5,539	-9	4	3,720	21.2	31.5
IndusInd Bank	2,086	NA	98.2	1,553	NA	131.5	778	NA	131
ING Vysya Bank	1,914	9.3	22.2	1,436	2.7	56.7	535	-8.4	13.8
MMFS	2,325	7.4	18.3	1,630	12	31	692	59.9	96.5
LIC Housing Fin	1,868	-8.8	9.2	1,860	-13.9	3.8	1,712	10.7	26.8
PNB	20,949	7.8	22.4	16,063	2.2	17.4	9,270	9.1	31.1
Shri Ram Transport	5,296	0.6	21.4	4,185	11.6	36.8	2,075	9.9	25.2
Shriram City Union	1,541	-7.0	22.3	1,036	10.6	58.3	502	20	62.8
State Bank of India	56,088	-1.8	2.8	48,350	-3.7	15.3	24,900	-6.8	10.2
Syndicate Bank	6,179	-0.1	-17.3	4,434	3.4	-3.2	1,778	16.2	-32.1
Union Bank of India	8,634	-2.6	-11.5	8,101	4	15.8	5,051	28.2	39.7
Yes Bank	1,600	-6.6	30.5	1,918	12.8	75.2	1,117	21.9	75.6
REC	5,911	9.3	36	6,466	14	45.4	4,944	19.4	60.1
Power Finance	7,200	8.0	32.8	7,769	20.7	43.1	6,387	41.1	93.5
Financial Universe	245,341	(0.7)	10.4	227,736	6.7	26.3	120,163	9.4	25.4

Q2FY10: Outliers at a glance

Key monitorables	Positive outliers	Negative outliers	Comment
Margins (NIMs)	<ul style="list-style-type: none"> ✓ Bank of Baroda - benefits of deposit re-pricing and rise in CASA ✓ Punjab National Bank - contained sub PLR lending and deposit re-pricing ✓ ING Vysya Bank - benefits of deposit re-pricing, rise in CASA and capital raised in Q2 ✓ IndusInd Bank - benefits of lower wholesale costs and rise in CASA 	<ul style="list-style-type: none"> ✗ LIC HF's margins remained flat qoq bogged down by PLR reduction of ~50bps effected in July 2009 ✗ Union Bank margins largely stable qoq as re-pricing benefits yet to kick in ✗ Syndicate Bank margins decline by 100bp yoy and flat qoq 	As expected, NIMs improved qoq across banks owing to significant decline in cost of deposits overplaying the decline in loan yields
CASA ratio	<ul style="list-style-type: none"> ✓ ICICI Bank- up by 650bp qoq due to run down of term deposits and growth in savings deposits ✓ SBI - up ~250bp qoq as 70%+ of incremental deposits emanated from CASA 	<ul style="list-style-type: none"> ✗ Corporation Bank only bank to register a decline in CASA - ~100bp qoq 	CASA ratio increased across banks, aided by benign systemic interest rates
Credit Demand/ Disbursements	<ul style="list-style-type: none"> ✓ Yes Bank - strong ~29% qoq led by large corp loans ✓ HDFC Bank - up 10% qoq led to 20% qoq rise in corp loans ✓ Corporation Bank - rise of 11% yoy- broad based ✓ LICHF- growth in approvals of 82% yoy; disbursements up 74% yoy 		Credit demand remains low on two fronts (i) Lower corporate credit demand owing to delay in corporate capex plans and; (ii) more funds raised in equity markets slower retail demand as a result of uncertainty in the context of economic slowdown
Rise in NPLs/ NPA provisions	<ul style="list-style-type: none"> ✓ ICICI Bank - Gross slippages at ~Rs11bn as against Rs13bn for Q1 ✓ HDFC Bank - 25bp qoq decline ✓ Yes Bank- decline of 17bp qoq as one account restructured and upgraded 	<ul style="list-style-type: none"> ✗ Bank of India - 40% qoq rise in Gross NPAs as slippages surge - ~50% emanate from restructured accounts ✗ ING Vysya Bank ~50bp qoq rise in Gross NPAs, Rs1bn in absolute terms ✗ SBI - 20bp qoq rise in Gross NPAs, up Rs21bn in absolute terms ✗ Axis Bank - 20bp qoq rise in Gross NPAs, slippage to loans up 23bp qoq to 0.69% 	While NPLs are expected to inch-up, they would be significantly lower than in the last economic cycles
Fee income	<ul style="list-style-type: none"> ✓ SBI -core fee income up 73% yoy led by LCs, guarantees, govt business & credit linked fee ✓ Axis Bank -revived to15% yoy led by large and mid corp banking fee ✓ HDFC Bank -CEB up 18% yoy ✓ IndusInd Bank - core fee up 37% qoq led by third party distribution, transaction bking & processing fee 	<ul style="list-style-type: none"> ✗ Bank of India- 6% yoy decline owing to low credit off-take ✗ ICICI Bank - retail fees and capital market related fees remain muted 	Credit-linked fees remained lukewarm with credit remaining muted. Capital market related fees continued to be sluggish, hurting growth for private banks like ICICI Bank
Treasury gains	<ul style="list-style-type: none"> ✓ Canara Bank, Union Bank, Allahabad Bank booked treasury profits at 25-30% of op profit 		Most banks benefitted from volatility in yields and active churn on portfolio

Q2FY10- NII performance in line...

Net Interest Income (Rs m)	Q2FY09	Q1FY10	Q2FY10	yoy growth (%)	qoq growth (%)
Allahabad Bank	4,935	6,291	6,033	22.2	-4.1
Axis Bank	9,135	10,456	11,497	25.9	10
Bank of Baroda	11,338	12,047	13,886	22.5	15.3
Bank of India	13,631	13,006	14,089	3.4	8.3
Canara Bank	11,490	12,915	13,137	14.3	1.7
Corporation Bank	4,067	4,675	5,036	23.8	7.7
HDFC	7,707	7,266	7,844	1.8	8
HDFC Bank Ltd	18,665	18,556	19,558	4.8	5.4
ICICI Bank Ltd	21,476	19,853	20,361	-5.2	2.6
IDBI	1,276	3,164	4,721	269.9	49.2
Indian Bank	6,818	7,377	7,591	11.3	2.9
IndusInd Bank	1,052	1,674	2,086	98.2	24.6
ING Vysya Bank Ltd	1,566	1,719	1,914	22.2	11.3
LIC Housing Finance	1,711	1,742	1,868	9.2	7.3
MMFS	1,964	1,992	2,325	18.3	16.7
PFC	5,420	7,000	7,200	32.8	2.9
PNB	17,122	18,618	20,949	22.4	12.5
REC	4,348	5,750	5,911	36	2.8
Shri Ram Transport	4,427	4,787	5,296	19.6	10.6
Shriram City Union Finance	1,260	1,501	1,541	22.3	2.7
State Bank of India	54,554	50,249	56,088	2.8	11.6
Syndicate Bank	7,475	5,857	6,179	-17.3	5.5
Union Bank of India	9,730	8,016	8,634	-11.3	7.7
Yes Bank	1,226	1,637	1,600	30.5	-2.3
All Banks	195,555	196,110	213,356	9.1	8.8
Private Banks	53,119	53,895	57,014	7.3	5.8
PSU Banks	142,436	142,215	156,342	9.8	9.9
NBFCs	26,836	30,038	31,985	19.2	6.5
Private Banks - ex ICICI	31,643	34,042	36,653	15.8	7.7

NII growth of ~9%yoy and qoq for our coverage universe muted due to:

- ❑ Lackluster credit expansion during the quarter, as demand remained weak despite high liquidity
- ❑ Margins improved for most banks qoq as benefit of deposit re-pricing accrued, offsetting impact of lower loan yields, specifically on the corporate loan book
- ✓ *Positive surprise: PNB, BoB, IDBI and power lenders*
- ✗ *Negative surprise: LICHF, HDFC and Allahabad Bank*

...buoyed by expanding margins

NIMs (%)	Q2FY09	Q1FY10	Q2FY10	yoy change (bps)	qoq change (bps)
Allahabad Bank	2.33	2.48	2.33	(0)	(15)
Axis Bank	3.03	2.90	3.14	11	24
Bank of Baroda	2.42	2.08	2.34	(8)	25
Bank of India	2.82	2.28	2.40	(41)	12
Canara Bank	2.41	2.33	2.31	(11)	(3)
Corporation Bank	2.35	2.14	2.18	(17)	4
HDFC	3.39	3.80	3.80	41	0
HDFC Bank	4.39	4.02	4.12	(27)	10
ICICI Bank Ltd	2.21	2.13	2.22	1	9
IDBI	0.38	0.73	1.04	66	31
Indian Bank	3.66	3.41	3.37	(30)	(5)
IndusInd Bank	1.71	2.42	2.88	117	46
ING Vysya Bank Ltd	2.37	2.24	2.58	20	34
LIC Housing Finance	2.76	2.31	2.31	(45)	(0)
MMFS	10.39	10.63	11.76	136	113
PFC	3.63	4.05	3.99	36	(6)
PNB	3.21	2.95	3.17	(3)	22
REC	3.75	4.17	4.14	39	(2)
Shri Ram Transport	0.00	7.89	7.71	771	(18)
Shriram City Union Finance	12.48	10.67	10.61	(15.0)	(0.5)
State Bank of India	2.78	2.07	2.28	(50)	22
Syndicate Bank	2.82	1.78	1.90	(92)	12
Union Bank of India	2.93	1.95	2.04	(89)	9
Yes Bank	2.67	2.94	2.66	(1)	(27)
All Banks	2.62	2.40	2.53	(9)	12
Private Banks	2.73	2.77	2.93	20	16
PSU Banks	2.56	2.20	2.31	(25)	10
NBFCs	3.99	5.47	5.62	163	14

*NIMs calculated on average quarterly balances

- ❑ Margins expanded qoq for almost all banks (whilst declining over a high base yoy), as high-cost deposits continued to be re-priced downwards
- ❑ Private banks saw NIMs expansion yoy also
- ✓ *Positive surprise: PNB, BoB, IndusInd Bank, ING Vysya*
- ✗ *Negative surprise: LICHF, HDFC and Allahabad Bank*

Credit growth remains muted

Total Advances (Rs bn)	Q2FY09	Q1FY10	Q2FY10	yoy growth (%)	qoq growth (%)
Allahabad Bank	512	601	599	17.0	(0.4)
Axis Bank	689	781	810	17.7	3.8
Bank of Baroda	1,188	1,427	1,489	25.4	4.4
Bank of India	1,293	1,478	1,502	16.2	1.6
Canara Bank	1,193	1,407	1,465	22.7	4.1
Corporation Bank	435	474	526	20.7	11.0
HDFC	812	870	895	10.3	2.8
HDFC Bank	1,022	1,038	1,137	11.2	9.5
ICICI Bank Ltd	2,220	1,981	1,909	(14.0)	(3.7)
IDBI	871	980	1,050	20.5	7.2
Indian Bank	481	520	539	12.1	3.7
IndusInd Bank	140	165	176	25.2	6.9
ING Vysya Bank Ltd	159	161	164	3.3	1.5
LIC Housing Finance	241	293	319	32.1	9.0
MMFS	75	70	77	3.3	10.9
PFC	579	662	687	18.6	3.7
PNB	1,304	1,580	1,636	25.4	3.5
REC	437	548	587	34.3	7.1
Shri Ram Transport	180	193	204	12.8	5.3
State Bank of India	4,993	5,498	5,802	16.2	5.5
Syndicate Bank	695	834	824	18.5	(1.2)
Union Bank of India	865	960	994	14.9	3.5
Yes Bank	115	127	163	41.5	28.6
All Banks	18,176	20,010	20,784	14.3	3.9
Private Banks	4,345	4,253	4,358	0.3	2.5
PSU Banks	13,831	15,758	16,425	18.8	4.2
NBFCs	2,324	2,636	2,768	19.1	5.0

- ❑ In line with expectations, credit growth was muted at ~14% yoy in Q2FY10, as demand from corporates failed to pick-up
- ❑ QoQ credit growth at ~4% for the universe
- ✓ *Positive surprise: Yes Bank, HDFC Bank, Corporation Bank, LIC HF, REC*
- ✗ *Negative surprise: Syndicate Bank, SCUF*

CASA up qoq- aided by sanguine interest rates

CASA (%)	Q2FY09	Q1FY10	Q2FY10	yoy change (bps)	qoq change (bps)
Allahabad Bank	33.3	33.7	35.8	247	211
Axis Bank	40.3	40.1	42.7	243	263
Bank of Baroda	35.9	35.1	36.2	31	107
Bank of India	32.2	30.9	31.1	(112)	14
Canara Bank	32	28.7	29.2	(280)	45
Corporation Bank	25.4	23.3	22.4	(304)	(94)
HDFC Bank	44	45	50.3	630	539
ICICI Bank Ltd	30	30.4	36.9	690	650
IDBI	16.2	11.5	14.8	(143)	329
Indian Bank	33.1	29.6	31	(211)	140
IndusInd Bank	17.9	20.2	21.2	328	102
ING Vysya Bank Ltd	29.1	28.8	32.7	360	390
PNB	38.8	38.3	38.5	(36)	14
State Bank of India	39.7	38.5	41	125	251
Syndicate Bank	31.8	28	30.1	(168)	213
Union Bank of India	33.1	30.5	33	(13)	252
Yes Bank	9	9.5	9.6	56	8
All Banks	33.2	32.4	33.8	60	146
PSU Banks	32.5	31.3	32	(46)	69
Private Banks	36	36.9	41.9	598	505

- ❑ CASA ratio improved across banks qoq, recovering from low levels of Q1FY10 (aided by sanguine interest rates at a systemic level). Lower deposit growth in line with muted credit off-take also helped
- ❑ ICICI Bank reported a strong rise on the back of de-leveraging and thrust on savings deposits
- ✓ *Positive surprise: ICICI Banks, SBI, HDFC Bank*
- ✗ *Negative surprise: Corporation Bank*

Treasury gains provide substantial boost to bottom-lines

- ❑ Treasury gains tapered from high levels (10-30% of operating profit) evidenced in Q2FY10
- ❑ MTM depreciation/ write backs were limited in Q2FY10
- ✓ *Positive surprise: Canara Bank, Union Bank*

Treasury profits	Q2FY09	Q1FY10	Q2FY10	yoy growth (%)	qoq growth (%)
Allahabad Bank	77	2,140	1,683	2,091.10	-21.4
Axis Bank	362	3,260	2,240	519.4	-31.3
Bank of Baroda	923	2,554	1,205	30.6	-52.8
Bank of India	180	2,400	1,511	739.4	-37
Canara Bank	35	282	4,358	12,245.6	1,447.6
Corporation Bank	237	1,854	747	215.3	-59.7
HDFC	226	513	613	171.7	19.5
HDFC Bank Ltd	39	2,560	1,629	4,066.20	-36.4
ICICI Bank Ltd	-1,530	7,140	2,970	NM	-58.4
IDBI	1,060	4,650	1,360	28.3	(70.8)
Indian Bank	30	1,029	299	888.1	-70.9
IndusInd Bank	25	868	91	265.6	-89.5
ING Vysya Bank	45	250	220	388.9	-12
PNB	723	3,585	1,504	108	-58
SBI	1,616	7,088	5,454	237.5	-23.1
Syndicate Bank	-125	2,702	1,018	NM	-62.3
Union Bank	-360	2,090	2,180	NM	4.3

Treasury profits/ PBT	Q2FY09	Q1FY10	Q2FY10
Allahabad Bank	2.40%	36.20%	25.90%
Axis Bank	4.10%	27.70%	17.20%
Bank of Baroda	10.90%	25.30%	11.70%
Bank of India	1.50%	21.90%	12.50%
Canara Bank	0.50%	2.70%	30.70%
Corporation Bank	6.70%	32.50%	13.90%
HDFC	2.90%	6.50%	6.60%
HDFC Bank	0.30%	16.90%	10.20%
ICICI Bank	-6.70%	28.20%	12.20%
IDBI	36.70%	61.50%	21.40%
Indian Bank	0.60%	16.30%	5.40%
IndusInd Bank	3.70%	49.80%	5.90%
ING Vysya Bank	4.90%	17.60%	15.30%
PNB	5.30%	22.80%	9.40%
State Bank of India	3.90%	19.30%	11.30%
Syndicate Bank	-2.70%	46.90%	23.00%
Union Bank of India	-5.10%	26.50%	26.90%

Muted fee income...volatile capital markets still hurt

- ❑ Credit-linked fees remained lukewarm with credit-offtake muted during the quarter
- ❑ Capital market related fees continued to be sluggish for most banks
- ✓ *Positive surprise: Axis Bank, HDFC Bank, SBI, Yes Bank, IndusInd Bank*
- ✗ *Negative surprise: Bank of India, ICICI Bank*

Non trading income	Q2FY09	Q1FY10	Q2FY10	yoy growth (%)	qoq growth (%)
Allahabad Bank	1,236	1,555	2,365	91.4	52.1
Axis Bank	6,268	6,266	7,190	14.7	14.7
Bank of Baroda	3,837	4,476	4,748	23.8	6.1
Bank of India	6,315	4,059	5,249	-16.9	29.3
Canara Bank	3,352	4,454	4,571	36.4	2.6
Corporation Bank	1,507	1,739	2,281	51.4	31.2
HDFC	154	473	701	355.7	48.2
HDFC Bank Ltd	6,392	7,877	8,445	32.1	7.2
ICICI Bank Ltd	20,303	13,759	15,268	-24.8	11
IDBI	3,201	2,906	4,267	33.3	46.8
Indian Bank	2,097	2,472	2,073	-1.2	-16.2
IndusInd Bank	865	860	1,232	42.5	43.3
ING Vysya Bank Ltd	1,191	1,347	1,296	8.8	-3.8
MMFS	33	91	95	186.6	5
PNB	5,905	6,117	5,182	-12.2	-15.3
State Bank of India	21,816	28,599	29,798	36.6	4.2
Syndicate Bank	1,696	1,459	1,781	5	22.1
Union Bank of India	3,216	3,197	3,373	4.9	5.5
All Banks	90,112	92,144	99,118	10	7.6
Private Banks	35,072	30,251	32,199	-8.2	6.4
PSU Banks	55,041	61,893	66,920	21.6	8.1

Incremental restructurings limited up to 1%

- ❑ Gross NPAs continued to rise in a contained manner, given large restructurings under RBI's dispensation in Q1FY10
- ❑ Incremental restructured advances in Q2FY10 ranged from 0.3-1% across banks
- ✓ *Positive surprise: ICICI Bank, HDFC Bank, Yes Bank*
- ✗ *Negative surprise: Bank of India, Axis Bank, SBI, Syndicate Bank, Indian Bank*

	Gross NPAs (%)		Net NPAs (%)		Restructured loans - as % of advances		
	Q1FY10	Q2FY10	Q1FY10	Q2FY10	Q1FY10	Q2FY10	Cumulative
Allahabad Bank	1.79	1.78	0.37	0.35	0.2	0.6	5.1
Axis Bank	1.01	1.21	0.41	0.45	1.3	0.5	2.9
Bank of Baroda	1.44	1.30	0.27	0.27	1.1	0.2	3.1
Bank of India	1.89	2.61	0.84	1.08	1.1	1.3	5.7
Canara Bank	1.74	1.60	1.29	1.36	2.2	0.1	3.7
Corporation Bank	1.29	1.18	0.32	0.29	2.9	0.1	4.6
HDFC Bank	2.05	1.80	0.60	0.50	0.6	*	0.6
ICICI Bank	4.63	4.69	2.33	2.36	0.7	0.4	2.5
IDBI	1.77	1.75	1.23	1.19	6.0	0.3	8.9
Indian Bank	0.91	0.89	0.40	0.18	3.4	1.0	9.5
ING Vysya Bank	2.02	2.57	1.27	1.78	0.0	0.9	1.9
PNB	1.80	1.58	0.19	0.14	3.2	0.5	6.1
State Bank of India	2.79	2.99	1.55	1.73	1.5	0.5	4.3
Syndicate Bank	1.91	2.25	1.02	0.91	1.1	1.0	5.0
Union Bank of India	1.95	1.93	0.72	0.23	2.7	0.1	4.6
Yes Bank	0.48	0.31	0.24	0.08	0.48	0.3	1.0

* Indicated to be negligible

Provisioning costs of Canara Bank and IDBI likely to be impacted more by RBI's new norm of minimum 70% coverage ratio

...better times ahead!

Indian Financials: Evolving industry landscape

Key monitorables

Credit growth

NIMs

CASA

Restructured assets + Gross NPAs

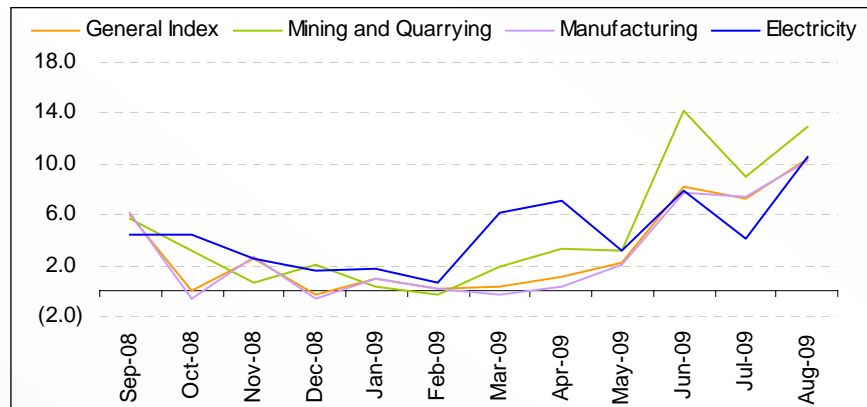
Non-fund income

...our view on likely scenario in H2FY10

- Revival in economic activity and inflation to drive a pick up in credit growth from current levels
- Sequential expansion in margins to continue as benefits of re-pricing accrue in H2FY10
- Lending rates have troughed, and would only inch-up going forward (specifically corporate loans)
- Largely stable lending rates, coupled with traction in credit growth would support margins in H2FY10
- CASA ratio may face pressure from Q4FY10, as deposit growth accelerates and interest rates harden
- Credit costs likely to have peaked, with bulk of stressed cases restructured; slippage in chunky accounts remains a key risk
- Accelerated provisioning in the context of RBI's new floor on total coverage of 70% likely to limit decline in provision costs
- Rise in credit demand and recovering capital markets would buoy core fee income performance in H2FY10

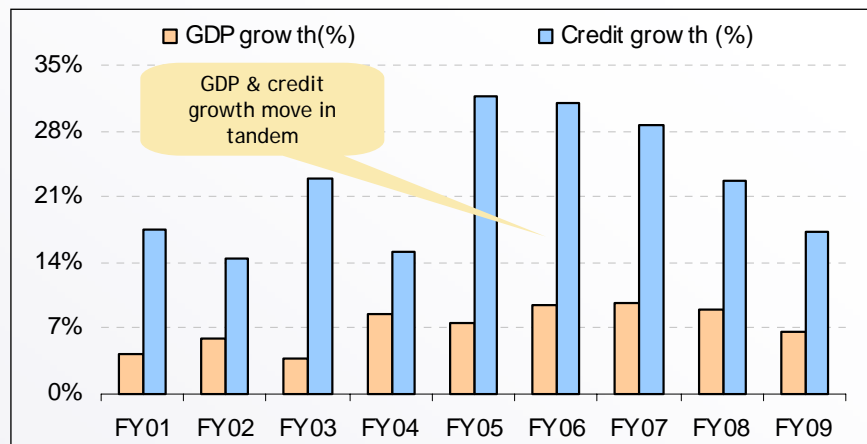
Credit growth expected to revive

Pick up in IIP points towards impending acceleration in growth



Source: CSO

Credit growth expected to accelerate...



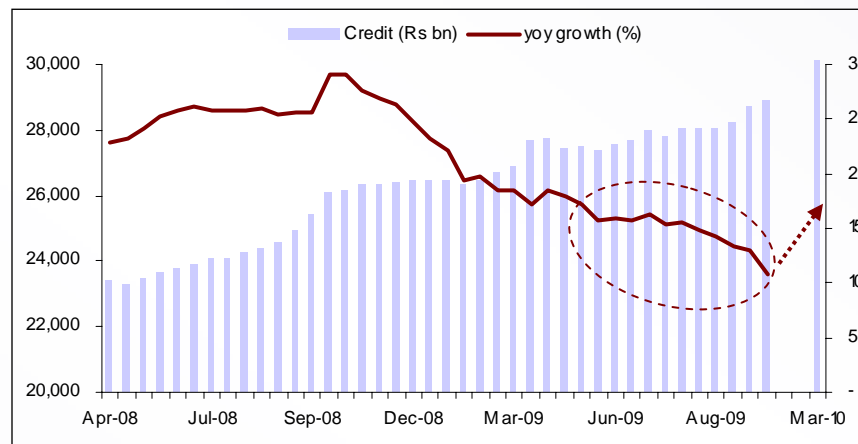
Source: RBI

GDP growth to pick up in H2FY10

% yoy growth	H1FY09	H2FY09	H1FY10E	H2FY10E	FY10E	FY11E
Agri, forestry & fishing	2.5	0.7	(3.0)	(1.3)	(2.0)	2.5
Industry	6.2	1.9	5.0	7.6	6.3	7.3
Services	10	9.4	7.1	9.2	8.2	8.8
GDP at factor cost	7.7	5.8	5.6	6.3	6.0	7.4

Source: CSO, IDFC-SSKI Research

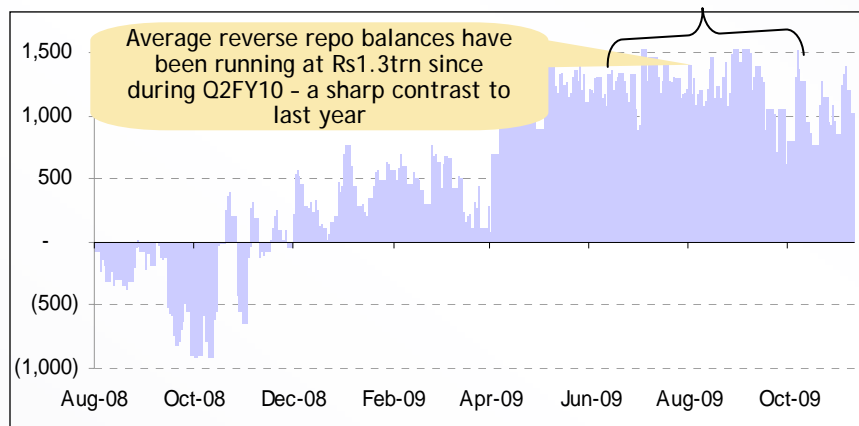
...likely to touch 16-17% by end of FY10



Source: RBI, IDFC-SSKI Research

Higher inflation, driving a rise in working capital needs, will further aid credit growth

System flush with liquidity...



Source: Bloomberg

...but yields remain elevated



Source: Bloomberg

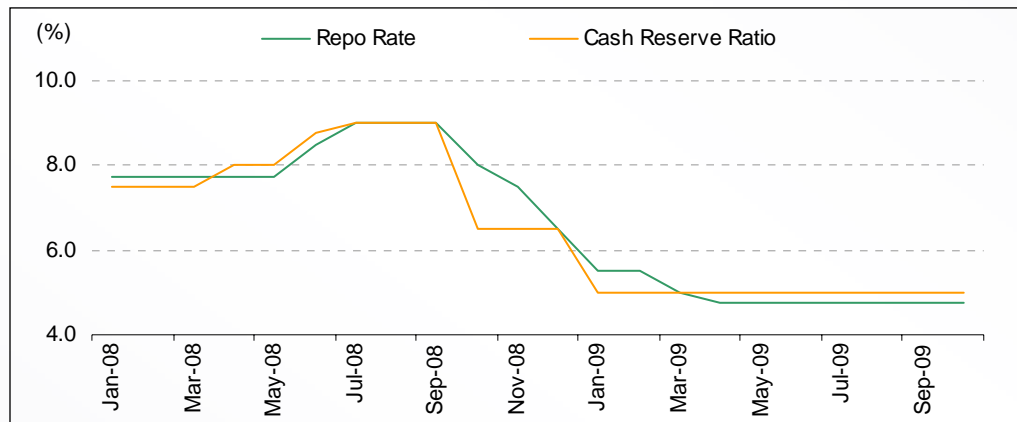
- The Indian financial system continues to be flush with liquidity (average repo balances of ~Rs1.3trn over Q2FY10 as:
 - ✓ Credit growth muted (~10% as of 9th Oct'09) due to lower working capital needs and delayed capex plans
 - ✓ Banks prefer to park funds in RBI's reverse repo window (despite low-yield of 3.25%) against G-Secs to avoid MTM losses on incremental G-Sec purchases in AFS portfolio
- Preferring reverse repo window over G-Secs, banks implicitly building in monetary tightening of ~50bps

A rise in G-sec yields fuelled by concerns around:

- (i) a rise in inflation (aggravated by monsoon deficit) may lead to RBI shifting to tighter monetary policy regime
- (ii) a fallout of Govt's outsized borrowing programme, and
- (iii) pick up in credit growth leading to utilization of excess liquidity, assuming an economic recovery in H2FY10

We see excessive concerns abating and yields moving southwards over Oct '09- Dec '09

In Q2FY10, RBI left key policy rates unchanged...



Source: Bloomberg

...posture may change as Government's borrowing program sails through

(Rs bn)	FY10	H1FY10	H2FY10		
	(Planned)	(Actual)	Planned	Actual	Balance
Gross Market Borrowings	4,180	2,950	1,230	300	930
Less: Repayment	531	331	195	-	195
Net Market Borrowings	3,649	2,619	1,035	300	735
Less: OMO Purchases	575	575	-	-	-
Add: MSS (Net)	-530	-420	-110	-	-110
Net Supply of Fresh Securities	2,543	1,624	925	300	625

Source: RBI

- ❑ In the context of excess systemic liquidity and weak credit demand, RBI left rates unchanged during the Q2 monetary policy review
 - ✓ However, prudential measures were introduced preemptively to contain any systemic risks (i.e. provision coverage ratio prescribed at a minimum of 70% and higher standard asset provisioning on real estate exposure of 1% as against 0.4% earlier)
- ❑ Monetary stance to turn a corner...
 - ✓ To ward-off inflationary pressures in H2FY10, RBI may tighten - albeit we expect such measures to be rear-ended
 - ✓ The excessive monetary easing mechanisms rolled out over last year in a bid to revive the economy...have served their purpose (e.g. SLR leeway of 1% rolled back in Q2FY10)

...Monetary tightening policy to turn a corner - priced in?

Total Provisions	FY09	FY10E	FY11E	CAGR over FY09-11E	CAGR over FY09-11E - (Pre Q2FY10 results)
Allahabad Bank	8,254	8,172	6,738	-10%	-13%
Andhra Bank	3,900	2,621	3,291	-8%	-8%
Axis Bank	9,394	13,279	10,035	3%	16%
Bank of Baroda	9,621	5,208	7,803	-10%	0%
Bank of India	12,924	15,055	14,694	7%	2%
Canara Bank	13,914	13,613	13,191	-3%	9%
Corporation Bank	4,104	5,155	4,748	8%	9%
Dena Bank	1,849	3,087	3,466	37%	37%
HDFC	500	600	600	10%	10%
HDFC Bank	19,071	22,039	20,585	4%	1%
ICICI Bank	38,083	42,491	45,391	9%	12%
IDBI	3,923	13,947	8,190	44%	39%
Indian Bank	4,427	4,582	5,318	10%	20%
IndusInd Bank	1,408	1,781	2,041	20%	
ING Vysya Bank	1,302	2,168	2,622	42%	39%
LIC Housing Finance	54	(164)	307	139%	137%
MMFS	2,824	3,052	3,482	11%	8%
PFC	39	151	277	165%	168%
PNB	9,774	10,997	9,540	-1%	2%
REC	24	200	500	359%	359%
Shri Ram Transport	3,057	3,991	4,209	17%	18%
State Bank of India	37,346	45,868	55,957	22%	11%
Syndicate Bank	7,101	8,353	8,971	12%	12%
Union Bank of India	7,370	6,784	8,035	4%	22%
Yes Bank	617	1,364	1,535	58%	47%

- ❑ Massive restructurings of Q1FY10 mitigated incremental restructurings in Q2FY10 for most banks
- ❑ Improving growth conditions likely to alleviate credit quality concerns in the long term
- ❑ However, impact on provision costs a mixed bag, due to RBI's new provision coverage norm/ negative surprise for some banks/ conscious conservative outlook

Limited restructurings/ rise in Gross NPLs seen as economy recovers in H2FY10

Earnings growth to remain strong

PAT	FY09	FY10E	FY11E	CAGR
Allahabad Bank	7,686	10,196	11,009	19.7
Axis Bank	18,154	24,811	31,041	30.8
Bank of Baroda	22,272	28,156	32,102	20.1
Bank of India	30,074	27,669	34,956	7.8
Canara Bank	20,724	27,993	31,723	23.7
Corporation Bank	8,928	10,616	11,678	14.4
HDFC	22,825	27,286	32,494	19.3
HDFC Bank	22,449	29,186	38,122	30.3
ICICI Bank Ltd	37,581	42,916	60,442	26.8
IDBI	8,595	8,382	9,555	5.4
Indian Bank	12,453	13,705	15,693	12.3
IndusInd Bank	1,483	3,109	4,106	66.4
ING Vysya Bank Ltd	1,888	2,400	3,050	27.1
LIC Housing Finance	5,316	7,336	8,140	23.7
MMFS	2,145	2,505	3,126	20.7
PFC	19,695	21,622	25,007	12.7
PNB	30,909	38,230	44,409	19.9
REC	12,722	20,477	21,183	29.0
Shri Ram Transport	6,125	7,640	9,760	26.2
State Bank of India	91,212	103,155	120,129	14.8
Syndicate Bank	9,128	8,621	9,317	1.0
Union Bank of India	17,270	20,038	22,988	15.4
Yes Bank	3,038	4,520	6,010	40.6
All banks	376,263	445,800	532,521	19.0
PSU banks	259,251	296,760	343,559	15.1
Private Banks	117,011	149,041	188,962	27.1
NBFCs	36,411	44,767	53,520	21.2

- ❑ Margins likely to expand in H2FY10 as high-cost term deposits garnered in Oct-Nov'08 get re-priced and revival in credit demand supports better yields
- ❑ With slippages peaking and bulk of corporate stress behind, provision expenses likely to taper in H2FY10; new provision coverage norms may result in accelerated provisioning by banks
- ❑ Fee income to be driven by improved credit off-take, strong capital markets activity leading to pick-up in third party distribution fee

Current valuations offer significant upside potential

	Price	Mkt Cap	PAT (Rsmln)			Adj EPS (Rs)			Adj Book value (Rs)			RoE (%)			PE (x)			P/Adj. Book Value		
	16 th Nov 2009	(US\$ m)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09	FY10E	FY11E
PSU Banks																				
Allahabad Bank	133.75	1,285	7,686	10,196	11,009	17.2	22.8	24.6	109.3	134.9	159.2	16.4	18.9	17.6	7.8	5.9	5.4	1.2	1.0	0.8
Bank of India	379.8	4,296	30,074	27,669	34,956	57.2	52.6	66.5	214.0	246.4	314.9	30.1	22.5	23.3	6.6	7.2	5.7	1.8	1.5	1.2
Bank of Baroda	541.9	4,246	22,272	28,156	32,102	61.1	77.3	88.1	309.8	356.9	422.4	24.9	25.7	24.4	8.9	7.0	6.1	1.7	1.5	1.3
Canara Bank	373.6	3,295	20,724	27,993	31,723	50.5	68.3	77.4	224.0	297.6	377.4	18.0	20.6	22.9	7.4	5.5	4.8	1.7	1.3	1.0
Corporation Bank	440.7	1,360	8,928	10,616	11,678	62.2	74.0	81.4	343.4	402.8	472.4	19.6	20.0	19.0	7.1	6.0	5.4	1.3	1.1	0.9
IDBI	128.7	2,007	8,585	7,128	8,571	11.8	9.8	11.8	68.2	73.8	75.6	13.4	12.4	13.5	10.9	13.1	10.9	1.9	1.7	1.7
Indian Bank	165.1	1,520	12,453	14,306	15,874	29.1	33.4	37.1	134.6	161.7	192.9	22.9	22.1	20.5	5.7	4.9	4.5	1.2	1.0	0.9
PMB	924.2	6,269	30,909	38,230	44,409	98.0	121.2	140.8	434.7	546.3	663.3	25.8	26.0	24.5	9.4	7.6	6.6	2.1	1.7	1.4
SBI	2,344.7	32,023	91,212	103,155	120,129	144.1	162.5	189.2	1,063.2	1,260.5	1,504.8	17.1	16.6	16.9	16.3	14.4	12.4	2.21	1.86	1.56
Syndicate Bank	89.6	1,006	9,135	8,622	9,321	17.5	16.5	17.9	85.6	97.0	108.3	21.5	17.3	16.3	5.1	5.4	5.0	1.0	0.9	0.8
Union Bank	266.0	2,890	17,270	20,038	22,988	34.2	39.7	45.5	144.8	181.4	223.4	27.2	25.3	23.5	7.8	6.7	5.8	1.8	1.5	1.2
Pvt Banks																				
Axis Bank	999.3	7,718	18,152	24,811	31,042	50.7	65.3	77.4	282.7	439.1	484.2	19.1	18.9	18.0	19.7	15.3	12.9	3.5	2.3	2.1
ING Vysya Bank	309.4	682	1,888	2,400	3,050	18.4	20.1	25.6	137.2	176.0	201.8	13.4	13.3	13.5	16.8	15.4	12.1	2.3	1.8	1.5
Yes Bank	262.5	1,677	3,038	4,520	6,010	10.2	13.2	17.6	54.2	91.5	110.0	20.6	19.1	17.7	25.7	19.8	14.9	4.8	2.9	2.4
HDFC Bank	1,722.1	15,759	22,449	29,186	38,122	52.8	66.6	84.4	353.1	477.1	550.6	16.9	16.3	17.1	32.6	25.9	20.4	4.9	3.6	3.1
ICICI Bank	918.9	22,006	37,581	42,916	52,191	33.8	38.5	46.9	430.2	482.3	543.6	7.8	8.4	9.5	27.2	23.8	19.6	2.1	1.90	1.7
IndusInd Bank	128.5	981	1,483	3,109	4,106	4.4	8.0	10.0	37.2	49.9	57.2	11.7	17.6	18.3	29.2	16.1	12.8	3.5	2.6	2.2
NBFCs																				
HDFC	2,760.0	16,913	22,825	27,286	32,494	80.1	95.8	114.1	480.7	540.0	610.8	17.5	18.8	19.8	34.4	28.8	24.2	5.7	5.1	4.5
Mah & Mah Fin	272.2	568	2,145	2,505	3,126	22.1	25.8	32.2	152.8	187.1	222.8	15.4	16.0	17.4	12.3	10.5	8.4	1.8	1.5	1.2
Shriram City Union	387.0	382	1,170	1,695	2,019	25.5	37.0	44.0	152.0	189.9	231.4	20.6	21.8	21.6	15.2	10.5	8.8	2.5	2.0	1.7
Rural Electrification	239.1	4,417	12,722	20,477	21,183	14.8	23.8	24.7	72.1	97.4	112.2	22.0	28.1	23.5	16.1	10.0	9.7	3.3	2.5	2.1
Power Finance	231.3	5,711	19,695	21,622	25,007	17.2	18.8	21.8	100.3	112.5	126.6	18.9	17.7	18.2	13.5	12.3	10.6	2.3	2.1	1.8
LIC Housing	878.3	1,606	5,316	7,336	8,140	62.5	77.3	85.7	266.6	368.3	440.4	26.2	25.6	21.2	14.0	11.4	10.2	3.3	2.4	2.0
SRTF	439.6	1,926	6,403	7,360	9,306	31.5	35.5	44.0	112.2	142.9	179.8	31.0	27.1	26.6	14.0	12.4	10.0	3.9	3.1	2.4

So, which stocks to buy?

PSU Banks - One and all

- ✓ Historically, PSU Bank stocks have behaved as bond proxies given their higher AFS exposures
- ✓ With G-Sec yields expected to remain soft over Oct'09- Dec '09, we are overweight PSU banks during the period
- ✓ Operating metrics across the board - NIMs, credit growth, CASA, NPAs and fee income have also bottomed and expected to revive in the near term

Private banks remain long-term bets

- ✓ Play the earnings upgrade cycle - likely to be more pronounced for private banks
- ✓ Expectations of pick-up in the loan growth and margins to rise for both private and PSU banks
- ✓ Provisioning expenses to come-off as asset quality stress reduces

Our top picks

- ✓ In the PSU Bank space we prefer State Bank of India, Bank of Baroda and Canara bank
- ✓ Our long-term top picks are ICICI Bank, Axis Bank
- ✓ Amongst mid-caps, we like IndusInd Bank, Yes Bank & Shriram Transport Finance

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