

PSU Banks

Thy time has come



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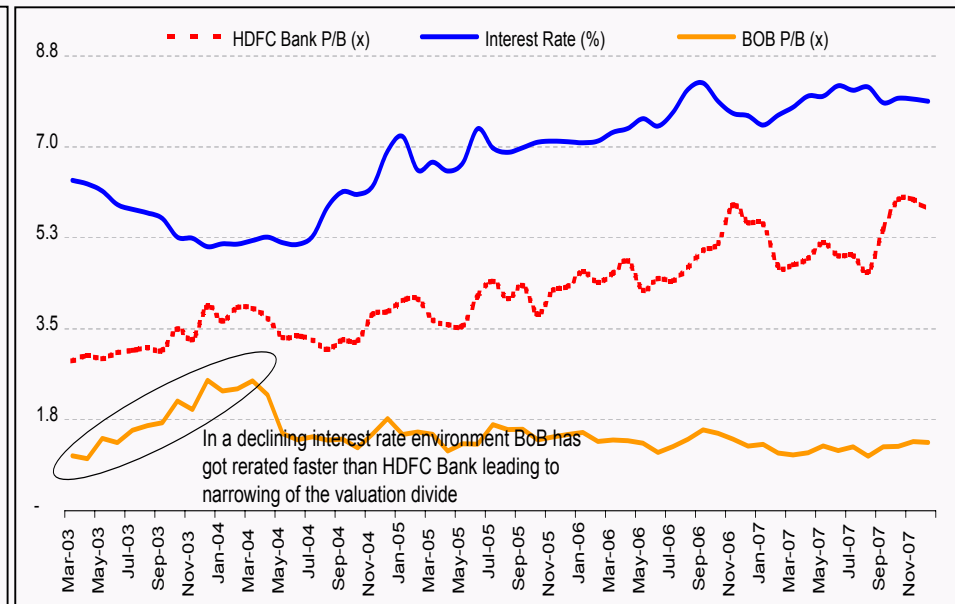
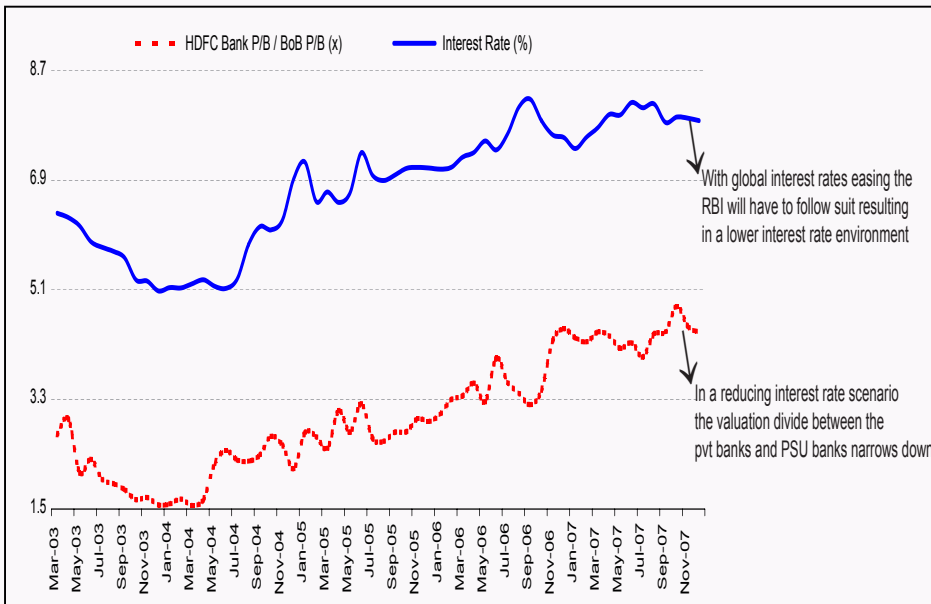
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December 2007

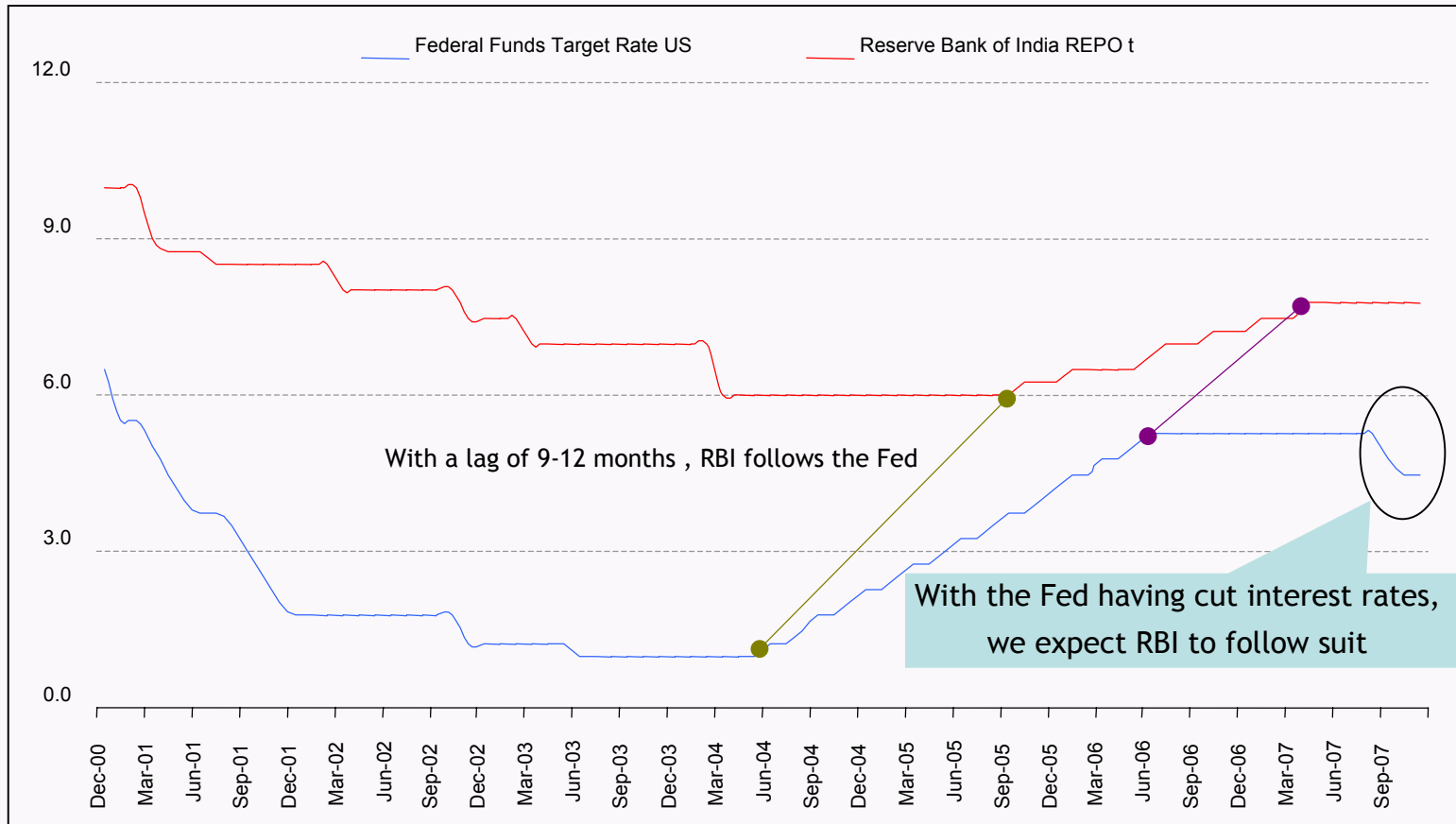
Valuation Gap (Pvt Banks vs PSU Banks) at 5 year high

- ✓ Valuation gap between PSU and private banks (on a trailing P/BV basis) at 4.4x. An illustrative example is the chart which shows the comparison between HDFC bank and BoB P/BVs.
- ✓ The valuation gap is very highly correlated with interest rate movements... the gap had fallen to lows of 1.5x when the 10 year bond was in the region of 5.1-5.25% in Nov' 03- Mar'04.

Relative valuation comparison v/s interest rates (10 yr bond)

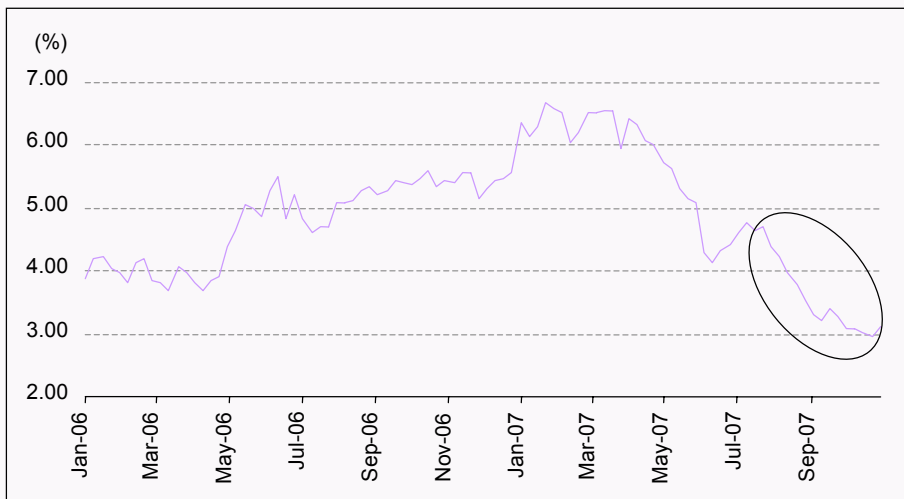


RBI walks the Fed way albeit with a lag



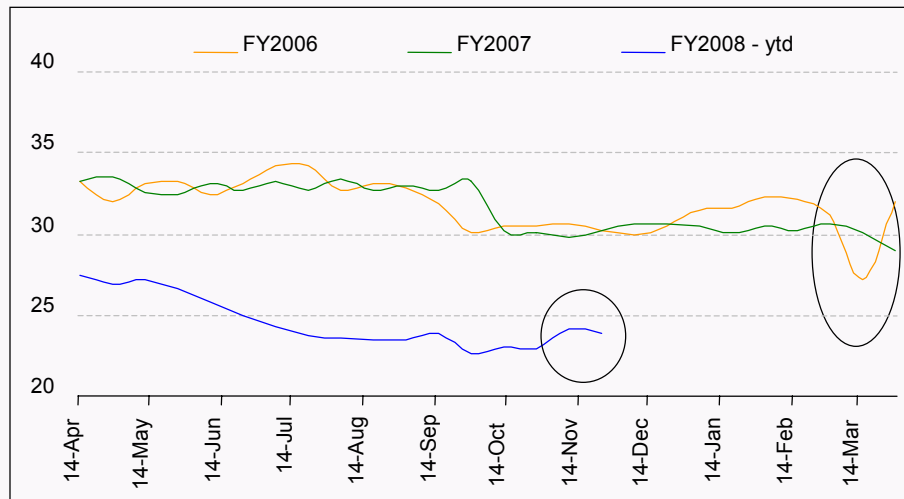
RBI's key monitorables show encouraging trends

Inflation heads South



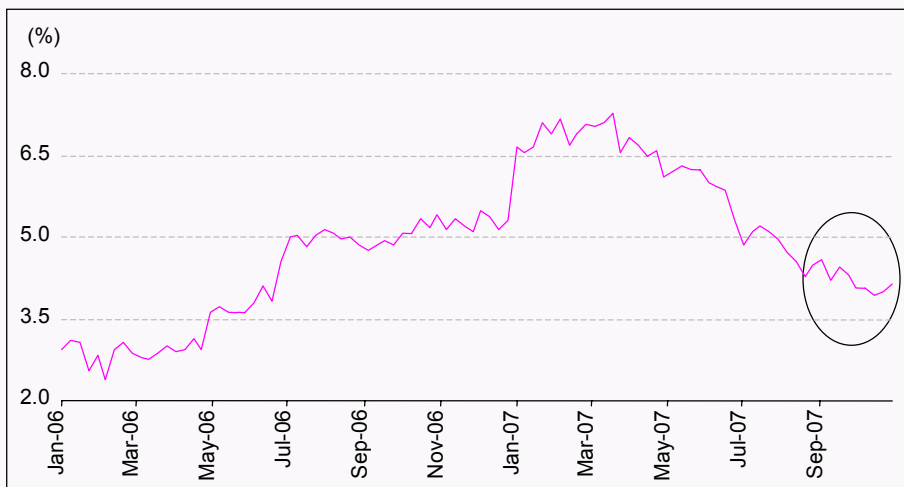
Source: eaindustry.nic.in

Credit growth, especially retail, reined in - put circle



Source: RBI

Core WPI also under control



Source: eaindustry.nic.in

With RBI's key monitorables falling in line, we expect it to reduce interest rates in the next 3-6 months

Operating performance likely to improve

- ✓ Reasons for the subdued operating performance of PSU banks was due to
 - Declining CD ratio: Incremental CD ratio for H1FY08 at 38%
 - Increase in deposit costs
- ✓ Change now
 - CD ratio on an improving trend :Incremental CD ratio from Oct to Nov at 82%
 - Banks cutting deposit rates

| Banks | Range of rate cuts (bps) | Current peak deposit rate (%) | Tenure of peak deposit |
|---------------------|--------------------------|-------------------------------|------------------------|
| Bank of India | 25-50 | 9.00 | 5 years and above |
| IDBI | 25-75 | 9.00 | 5 years |
| State Bank of India | 25-75 | 8.75 | 550 days |
| Union Bank of India | 25-100 | 8.75 | Over 94 months |
| Centurion Bank | 25-50 | 9.00 | 13 months 15 days |
| ICICI Bank | 25-50 | 8.75 | 590 days |

- ✓ After the fall in H12008, margins to remain stable in at lower levels and marginally improve for banks who focus on accumulation of low cost deposits
- ✓ Treasury income in a stable to declining environment will contribute materially to the bottom-line growth

Margins likely to stabilize

| | NIM (%) | | | | | | FY09E |
|--------------------------|---------|------|------|------|-------|-------|-------|
| | FY03 | FY04 | FY05 | FY06 | FY07E | FY08E | |
| Private Banks | | | | | | | |
| Axis Bank | 1.9 | 2.6 | 2.4 | 2.5 | 2.5 | 2.6 | 2.8 |
| Centurion Bank of Punjab | 2.8 | 3.9 | 4.9 | 3.9 | 3.5 | 3.5 | 3.5 |
| HDFC Bank | 3.1 | 3.7 | 3.8 | 4.1 | 4.5 | 4.6 | 4.6 |
| ICICI Bank | 1.8 | 2.0 | 2.1 | 2.5 | 2.5 | 2.5 | 2.5 |
| Public Banks | | | | | | | |
| Allahabad Bank | 3.4 | 3.5 | 3.4 | 3.1 | 2.8 | 2.8 | 2.8 |
| Andhra Bank | 3.3 | 3.5 | 3.6 | 3.2 | 3.1 | 3.0 | 3.0 |
| Bank of Baroda | 2.9 | 3.2 | 3.3 | 3.1 | 3.0 | 2.7 | 2.6 |
| Canara Bank | 2.9 | 3.0 | 3.0 | 2.9 | 2.7 | 2.4 | 2.4 |
| Corporation Bank | 3.2 | 3.5 | 3.6 | 3.3 | 3.0 | 2.7 | 2.7 |
| IDBI | 0.2 | 1.7 | 0.3 | 0.5 | 0.7 | 0.9 | 1.2 |
| Punjab National Bank | 3.9 | 3.8 | 3.5 | 3.4 | 3.6 | 3.5 | 3.5 |
| State Bank of India | 2.8 | 2.9 | 3.2 | 3.3 | 3.0 | 3.0 | 2.9 |
| Syndicate Bank | 3.7 | 3.5 | 3.4 | 3.3 | 2.9 | 2.7 | 2.6 |
| Union Bank of India | 3.1 | 3.2 | 3.2 | 2.9 | 2.9 | 2.9 | 2.9 |

Overall, margins to remain stable in FY08 and marginally improve for banks who focus on accumulation of low cost deposits.

Cost to Income ratio to improve

| | Cost to income ratio (%) | | | | | | |
|--------------------------|--------------------------|------|------|------|-------|-------|-------|
| | FY03 | FY04 | FY05 | FY06 | FY07E | FY08E | FY09E |
| Private Banks | | | | | | | |
| Axis Bank | 44.1 | 37.9 | 50.7 | 45.0 | 47.1 | 49.2 | 50.5 |
| Centurion Bank of Punjab | 88.1 | 93.8 | 90.3 | 71.9 | 70.4 | 66.1 | 64.1 |
| HDFC Bank | 45.4 | 44.6 | 44.9 | 45.0 | 48.6 | 49.2 | 49.9 |
| ICICI Bank | 38.5 | 47.0 | 50.4 | 50.2 | 48.6 | 49.0 | 49.0 |
| Public Banks | | | | | | | |
| Allahabad Bank | 64.0 | 52.3 | 53.4 | 53.1 | 50.7 | 48.7 | 47.5 |
| Andhra Bank | 44.4 | 41.4 | 45.5 | 52.7 | 48.2 | 47.2 | 46.8 |
| Bank of Baroda | 49.0 | 42.1 | 46.3 | 55.4 | 51.3 | 50.9 | 50.2 |
| Canara Bank | 46.7 | 39.4 | 44.9 | 47.3 | 46.8 | 50.5 | 50.0 |
| Corporation Bank | 35.6 | 38.7 | 37.6 | 41.5 | 39.8 | 39.4 | 38.5 |
| IDBI | 39.5 | 24.0 | 55.7 | 51.8 | 46.2 | 48.7 | 43.7 |
| Punjab National Bank | 47.0 | 43.2 | 50.8 | 49.2 | 48.0 | 51.7 | 50.0 |
| State Bank of India | 50.5 | 49.2 | 47.8 | 58.7 | 54.2 | 51.2 | 49.0 |
| Syndicate Bank | 63.7 | 52.2 | 55.3 | 58.0 | 49.6 | 47.1 | 44.9 |
| Union Bank of India | 43.9 | 42.2 | 44.4 | 46.8 | 44.9 | 46.1 | 46.9 |

- ✓ Cost to income ratio to continue to improve on back of absence of any wage arrears and as technology spends come off
- ✓ For some private banks the trend will be opposite, given their aggressive expansion plans

Bottom-line growth to be robust

| | PAT(Rs m) | | | | CAGR (%) | |
|--------------------------|-----------|--------|--------|--------|------------|------------|
| | FY06 | FY07 | FY08E | FY09E | FY05-FY07 | FY07-FY09 |
| Allahabad Bank | 7,061 | 7,501 | 8,877 | 9,972 | 18% | 15% |
| Andhra Bank | 4,855 | 6,108 | 6,997 | 8,398 | 8% | 17% |
| Bank of Baroda | 8,269 | 9,740 | 13,295 | 15,671 | 20% | 27% |
| Canara Bank | 13,432 | 14,208 | 14,492 | 16,844 | 13% | 9% |
| Centurion Bank of Punjab | 915 | 1,213 | 1,880 | 2,759 | NM | 51% |
| Corporation Bank | 4,445 | 5,355 | 6,176 | 7,372 | 15% | 17% |
| HDFC Bank | 8,708 | 11,414 | 14,985 | 19,785 | 31% | 32% |
| ICICI Bank | 25,401 | 31,106 | 45,257 | 61,256 | 15% | 40% |
| IDBI | 5,609 | 6,303 | 7,024 | 8,187 | 43% | 14% |
| Punjab National Bank | 14,393 | 15,400 | 18,416 | 22,346 | -2% | 20% |
| State Bank of India | 44,067 | 45,413 | 56,571 | 68,210 | 3% | 23% |
| Syndicate Bank | 5,365 | 7,141 | 8,674 | 9,870 | 33% | 18% |
| Union Bank of India | 6,752 | 8,453 | 10,502 | 12,389 | 8% | 21% |
| Axis Bank | 4,851 | 6,590 | 9,367 | 12,289 | 40% | 37% |
| All Banks | | | | | 13% | 25% |
| Private Banks | | | | | 23% | 38% |
| Public Banks | | | | | 9% | 19% |

A lot of PSU banks will show an improving trendline of profit growth over FY07-09

Valuation Summary

| | Recco | Price | MCAP | Adj Book value (Rs) | | | RoE(%) | | | P/B (x) | | | FII's |
|----------------------|---------|----------|-------|---------------------|---------|---------|--------|--------|--------|---------|-------|-------|---------|
| | | 11-12-07 | (bn) | FY07E | FY08E | FY09E | FY07E | FY08E | FY09E | FY07E | FY08E | FY09E | Holding |
| PSU Banks | | | | | | | | | | | | | |
| Allahabad Bank | OP | 120.1 | 53 | 88.0 | 103.6 | 121.3 | 18.5 | 18.4 | 17.9 | 1.4 | 1.2 | 0.99 | 19% |
| Andhra Bank | OP | 106.0 | 52 | 68.8 | 79.1 | 91.3 | 20.2 | 20.6 | 21.5 | 1.5 | 1.3 | 1.16 | 19% |
| Bank of India | OP | 362.0 | 175 | 120.7 | 145.5 | 175.9 | 20.6 | 24.0 | 24.5 | 3.0 | 2.5 | 2.06 | 17% |
| Bank of Baroda | OP | 398.6 | 144 | 240.1 | 270.1 | 302.7 | 11.8 | 14.5 | 15.3 | 1.7 | 1.5 | 1.32 | 20% |
| Canara Bank | OP | 316.9 | 125 | 186.1 | 216.4 | 251.9 | 16.3 | 13.3 | 13.8 | 1.7 | 1.5 | 1.26 | 17% |
| Corporation Bank | OP | 446.1 | 63 | 265.7 | 304.4 | 348.2 | 15.0 | 15.4 | 16.1 | 1.7 | 1.5 | 1.28 | 9% |
| Dena Bank | OP | 88.9 | 25 | 38.3 | 54.7 | 69.3 | 14.2 | 14.9 | 15.1 | 2.3 | 1.6 | 1.28 | 13% |
| IDBI | UP | 170.6 | 123 | 83.3 | 94.6 | 106.0 | 10.1 | 10.8 | 11.5 | 2.0 | 1.8 | 1.61 | 9% |
| Indian Bank | Unrated | 218.7 | 94 | 90.7* | 92.1* | 109.4* | 24.34* | 24.83* | 24.82* | 1.0* | 2.4* | 2.0* | 14% |
| Punjab National Bank | OP | 668.2 | 203 | 339.9 | 395.1 | 463.6 | 15.5 | 16.4 | 17.1 | 2.0 | 1.7 | 1.44 | 20% |
| State Bank of India | OP | 2,445.9 | 1,272 | 762.7 | 1,073.4 | 1,206.9 | 15.4 | 16.5 | 16.7 | 3.21 | 2.28 | 2.03 | 20% |
| Syndicate Bank | OP | 117.3 | 60 | 70.9 | 85.1 | 97.6 | 21.9 | 20.1 | 18.4 | 1.7 | 1.4 | 1.20 | 13% |
| Union Bank of India | OP | 207.3 | 101 | 102.2 | 120.9 | 142.8 | 17.3 | 18.7 | 19.0 | 2.0 | 1.7 | 1.45 | 20% |
| Pvt Banks | | | | | | | | | | | | | |
| Centurion Bank | OP | 58.5 | 108 | 9.0 | 11.7 | 12.8 | 10.0 | 10.4 | 11.9 | 6.5 | 5.0 | 4.6 | 33% |
| HDFC Bank | OP | 1,774.7 | 598 | 200.7 | 330.3 | 370.8 | 19.5 | 16.6 | 16.0 | 8.8 | 5.4 | 4.8 | 46% |
| ICICI Bank | OP | 1,316.1 | 1,394 | 272.0 | 431.5 | 479.4 | 13.4 | 12.5 | 12.1 | 4.8 | 3.0 | 2.7 | 71% |
| Axis Bank | OP | 939.7 | 335 | 115.5 | 238.7 | 266.4 | 21.0 | 15.5 | 13.4 | 8.1 | 3.9 | 3.5 | 40% |

*Bloomberg estimates

Considering the above average RoE of the PSU Banks and improving operating performance in a falling interest rate scenario, the valuation divide is expected to narrow down

PSU BANKS: THY TIME HAS COME

- ✓ With global interest easing , RBI sooner or later will have to align with the global easing cycle and will likely do so over the next 3-6 months
- ✓ Operating performance of the PSU banks on an uptick after having bottomed out in the Q2FY08
- ✓ Valuation divide has started to contract as the interest rates have flattened out and the absence of bond losses which hurt their earnings growth

BoB, Bol, SBI, PNB amongst the large caps

Indian Bank, Allahabad bank, Dena bank amongst the mid caps

Derivatives view

Multi year breakouts witness trimming of open positions pointing to exit of sceptics

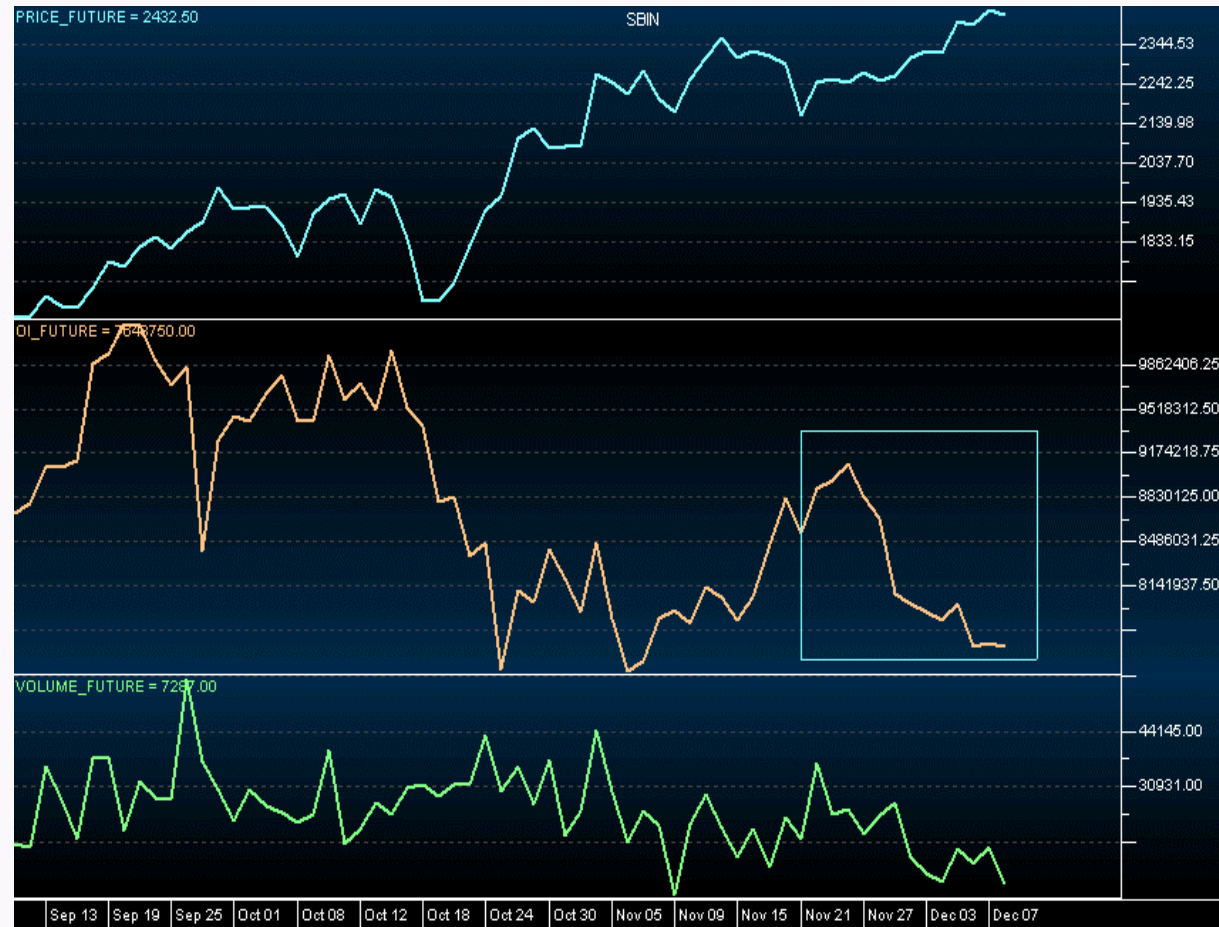
Stocks covered

- ✓ SBI
- ✓ BOB
- ✓ Canara Bank
- ✓ BOI
- ✓ Union Bank
- ✓ Syndicate Bank
- ✓ Corporation Banks

SBI (Rs 2445): Buy for a target of 2700

- ✓ The SBI stock along with the rest of the banking pack is set for a sharp move as seen by statistical volatility indicators which has contracted sharply indicating a large move in offing.
- ✓ Further the open interest in SBI futures has fallen sharply; this low leverage too is a bullish sign .
- ✓ Buy SBI for a 10% move to 2700.

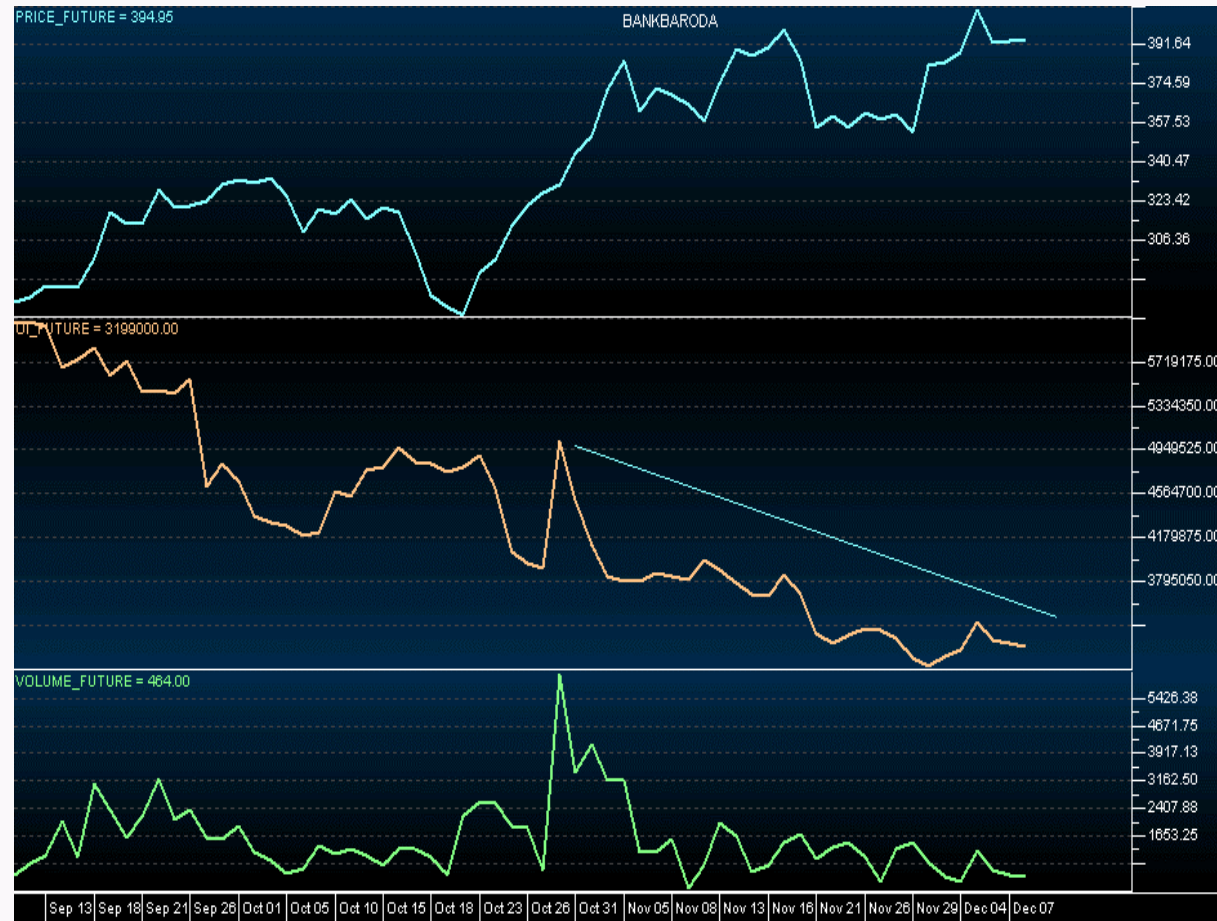
SBI Price and OI Chart



BOB (Rs 393): Buy for a target of 550

- ✓ The stock just like SBI has seen substantial fall in futures open interest positions as the stock crossed its multi year resistance levels at 300.
- ✓ This fall in open interest is clear sign weak players have exited the stock and its getting under owned now.
- ✓ The falling open int and the multi year break out ensures that the breakout will sustain and we recommend to buy for a target of Rs 500 or a 40% move.

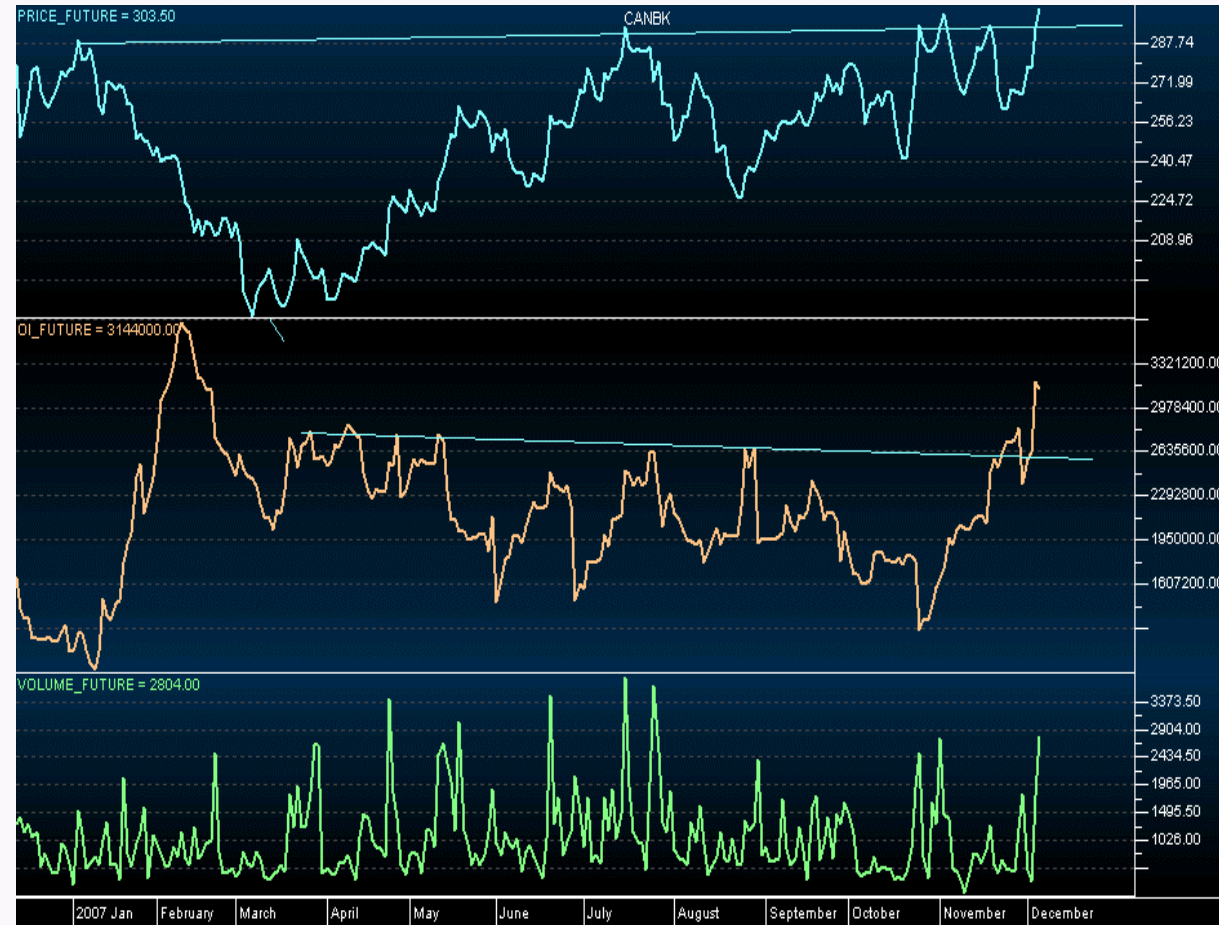
BOB Price and OI Chart



Canara Bank (Rs 315) : Buy for a target of 400

- ✓ The stock has broken the stiff resistance its been facing at the 300 level for the last 2 years.
- ✓ Stock future open interest has scaled to one year highs having doubled from 1.5 mn over 3 mn shares indicating huge accumulation in the stock.
- ✓ While BOB has already given a break out, Canara bank is just about doing that.
- ✓ Buy Canara bank for a 25% move near 300.

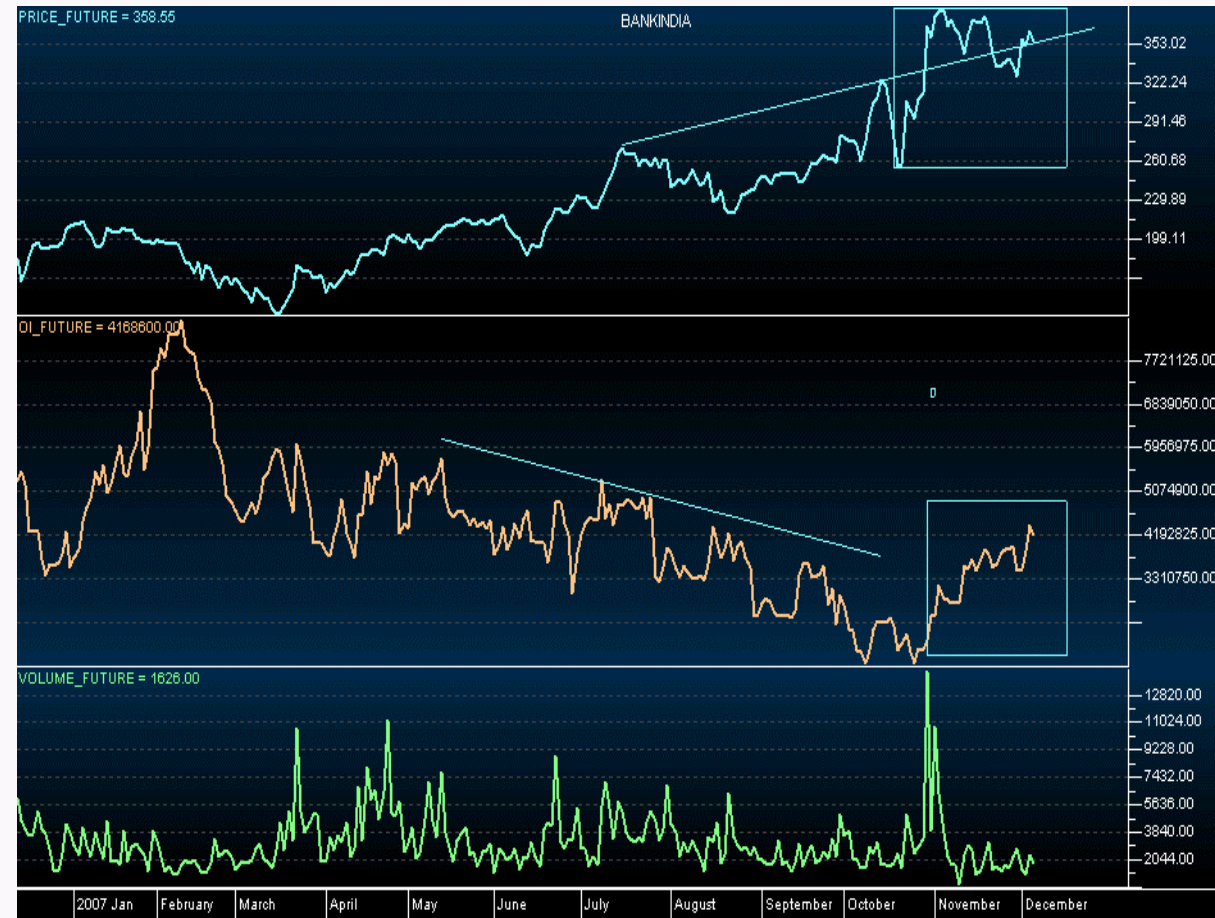
Canara Bank Price and OI Chart



BOI (Rs 362): Buy for a tgt of 450

- ✓ The stock has been one of the better performers in the last few months having moved from 250 levels to almost to a high of 425. The stock has since corrected and is seen consolidating its gains.
- ✓ Huge accumulation in this period has been in its stock future from a low of 1.5 mn shares to almost 4 mn shares now.
- ✓ We expect the stock to cross its previous high of 415 and target around 450.

BOI Price and OI Chart



Other PSU Banks exhibiting similar pattern

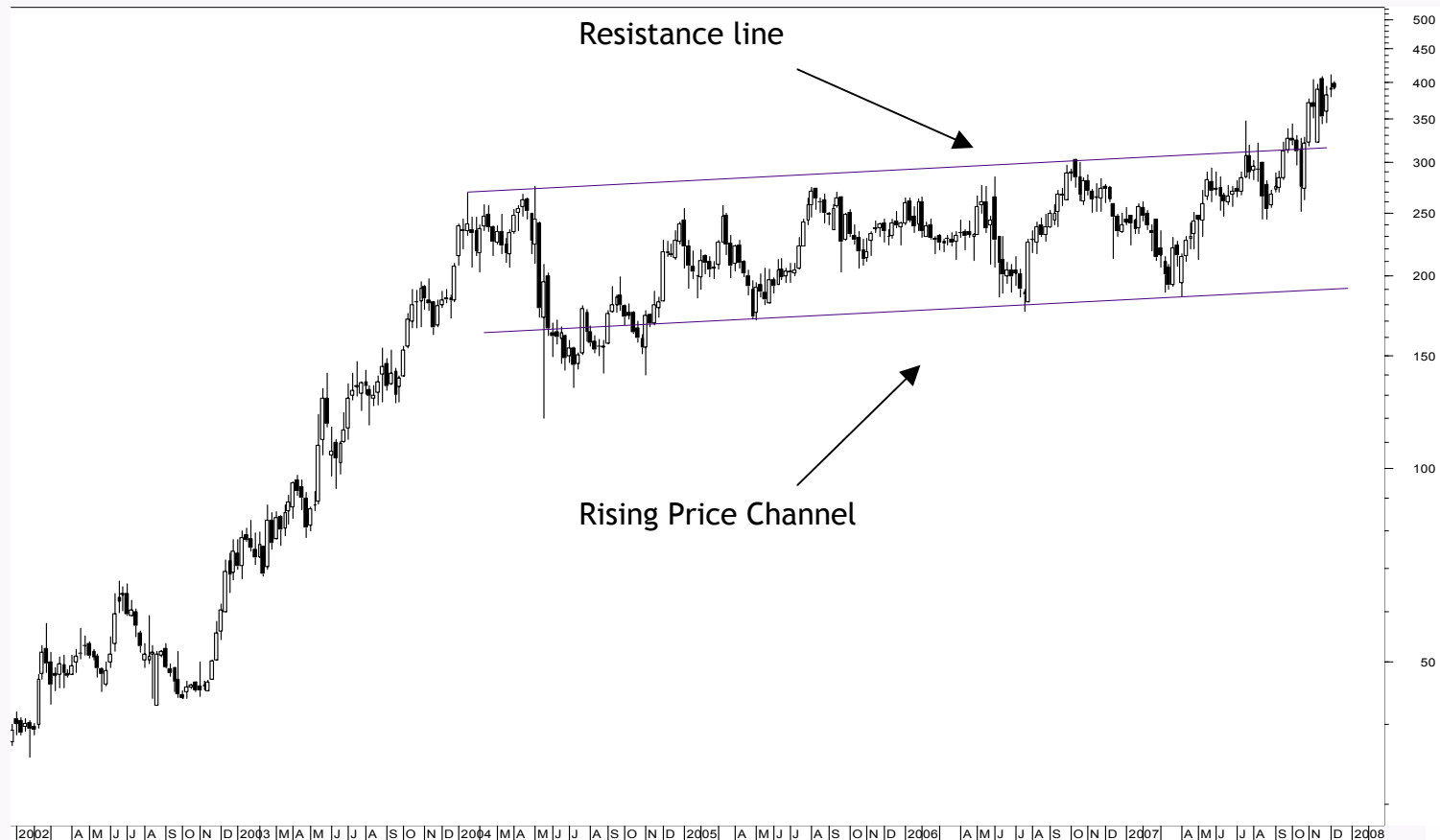
- ✓ Banks such as Union Bank, Syndicate Bank and Corporation Bank have all similar open interest chart patterns.
- ✓ All of these banks can move by 20% at least from here.

Technical view

PSU Banks on a verge of breakout , offering a 40% plus upside

Bank of Baroda

- ✓ Bank of Baroda (Last: 391) surged seven times from its 2001 low's in January-2004. After this sharp surge the stock moved into the consolidation in form of rising price channel. The slope of the channel is ascending on higher peaks and troughs. A bullish breakout of the resistance line of the rising channel at 310 on late October-2007 opens the doors to 520-650. Broken resistance line of the channel works as a support at 310.



Bank of India

- ✓ Bank of India (Last: 357) is moving in the rising channel from the year 2000, now facing the resistance of the upper trendline of the channel. The stock has given a bullish breakout of rising wedge pattern at 275 on October-2007. The rising wedge considered as a consolidation pattern and would signal a continuation higher. A break and stabilize above the resistance line of the channel at 400 would open the way to 660. Broken resistance line of the wedge channel works as a support at 275.



Canara Bank

- ✓ Canara Bank (Last: 305) successfully break the downward trendline of the 1-year symmetrical triangle. The symmetrical triangle is a consolidation pattern; a bullish breakout (upside) indicates a new price high. The Breakout with a strong white candlestick would validate the bullish breakout. As long as the stock remains above the resistance line of the pattern, the price target would be 500.



Corporation Bank

- ✓ Corporation Bank (Last: 442) consolidating above the peak between two troughs confirming the double bottom-trend reversal formation. In addition breaking the descending trendline from mid-2005 high reconfirm the double bottom. A broken resistance at 410 turns into the support. The possible price target is 650.



Thank you

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