

Industry

7 July 2010 | 10 pages

India Banks

 Equity

An Indian Bank Analyst In China

- Industry Structure** — We recently attended Citi's China Financial Tour, to compare the banking industry structures. We expect these to be increasingly benchmarked together given strong growth potential, dominating role of financial systems, and converging valuations. While there is a lot in common, key structural differences are: a) Size: China is 8.5x of India in loans; b) Penetration: 121% loan/GDP in China (India 54%); c) Loan growth: China 30% in 2009 vs. 17%; d) Competition: Fewer scale banks in China; e) Regulations: More protection in China vs. India.
- Operating Fundamentals** — Fundamentally, return profiles in both countries are relatively similar (ROAs of 1-1.2%, ROEs – 18-20%); details though are different: a) NIMs: implicitly protected in China (controlled lending and deposit rates); b) Loan composition: China banks are mainly corporate focused and concentrated in fewer sectors/SOEs; c) Funding: deposits dominate for both, higher demand deposits in China; and d) Leverage: slightly higher asset/equity for China.
- Valuations** — There has been a convergence in valuations of Indian PSU banks and Chinese banks recently (China 1.8x, India 1.5x P/BV): a) Historically, Chinese banks trade at premiums to Indian PSUs (Mean: 2.1x vs 1.2x for India); b) Key reasons for premiums: protected NIMs/profitability, greater industry concentration (top 4 banks: 78% of listed market cap vs. 56% for India), implicit government backstop on asset quality; c) Valuations (P/BV) for Indian PSUs have been more stable than Chinese banks (China – Max: 4.0x, Min: 1.2; India PSUs – 1.8x, 0.6x).
- Industry Cycles** — India and China banks are at opposite ends of the cycle: a) Loan growth, ROEs: India at lower end of historical range (trending up) vs. China at the higher end (trending down); b) Valuations: Indian PSU banks trading at 1SD above mean, China banks at 0.6 SD below; and c) Chinese banks at a similar stage to India banks in Mar09. Citi's regional banks analyst Simon Ho is overweight China banks and neutral on India; our India strategist Aditya Narain is overweight banks in his India portfolio.

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Figure 1. Valuations (Market Cap Weighted Average): China and India

	China	India - SOE Banks	India - All
12m Fwd P/BV	1.5	1.5	1.7
12m Fwd P/E	13.6	4.6	10.4
12m Fwd P/PPOP	6.3	6.3	4.4
12m Fwd Market Cap/Total Assets	0.12	0.21	0.15
12m Fwd Market Cap/Deposits	0.16	0.23	0.18

Source: Citi Investment Research and Analysis

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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India and China Banks: A Comparison

1) Banking industry in both countries (India and China) is large and diversified with large number of banks overall (though the tail is much longer in China).

2) Concentration of market share in the SOE banks is relatively higher in India than in China.

1) Big 4 banks have similar loan market share in both India (42%) and China (48%).

2) However, in terms of market cap, the Big 4 banks in China dominate with 78% share of the listed space vs. 56% for India.

3) We believe, this creates greater scarcity value for the larger listed players in China relative to India.

1) NIMs in both countries are relatively similar (especially compared to Indian PSU banks) despite the perceived protected nature of NIMs in China (regulated lending and deposit rates).

2) Higher Non-Interest income for Indian PSU banks are compensated by their higher operating expenses.

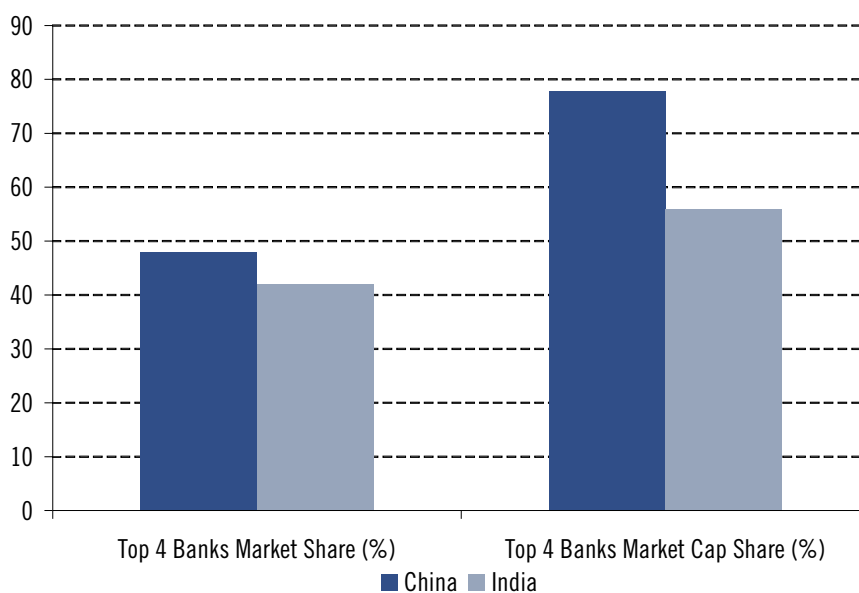
3) Overall profitability levels (ROA, ROE) were again quite similar for Indian PSU Banks relative to China.

Figure 2. Banks - Industry Structure: India and China

	China	India
No. of Scale Banks	18	80
Market Cap of Listed Banks (US\$bn)	787.8	164.1
Market Share (by loans) of SOE Banks (%)	52.2	75.3
Top 4 Banks Loan Market Share (%)	48.0	42.0
Top 4 Banks Market Cap Share (%)	77.9	56.0

Source: Citi Investment Research and Analysis

Figure 3. Comparative Market Shares on Loans and Market Cap for Top 4 Banks in India and China



Source: Citi Investment Research and Analysis

Figure 4. Dupont Analysis: China (CY09) vs. India (FY10) PSU Banks and All Banks

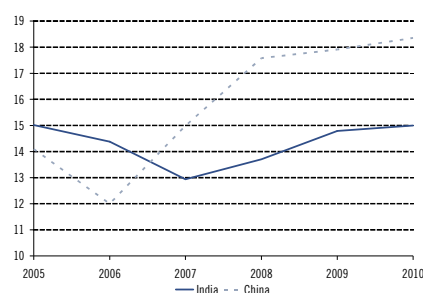
	China	India - SOE Banks	India - All
Net Interest Income	2.3	2.4	2.6
Non-Interest Income	0.7	1.0	1.3
Operating Income	3.0	3.6	4.1
Operating Expenses	1.2	1.6	1.8
Pre-provisioning Profits	1.7	2.0	2.4
Provisions	0.2	0.3	0.5
Profit Before Tax	1.5	1.6	1.9
Taxes	0.4	0.5	0.5
Net Income	1.1	1.1	1.3
Assets/Equity	17.0	17.3	13.3
ROE	19.4	19.6	17.3

Source: Citi Investment Research and Analysis

1) Historically, Indian banks have had significantly lower ROEs than Chinese banks.

2) Indian banks however, have grown loan books faster than Chinese banks for most of the last decade.

Figure 5. Historical Trends in ROEs: India and China (%)



Source: Citi Investment Research and Analysis

Figure 6. Historical Loan Growth Trends: India and China (% YoY)



Source: Citi Investment Research and Analysis

1) Valuations (on aggregate) for Indian PSU banks and Chinese banks are quite similar on P/BV and P/PPOP basis.

2) Indian PSU banks are cheaper on P/E comparison.

3) However, they are more expensive from a P/Assets or P/Deposits perspective.

4) We believe the historical premiums accorded to Chinese banks (over Indian PSU banks) have been due to their higher profitability, greater scale and scarcity value.

5) Recently, valuations for India and China have converged – a combination of better performance by India and a correction in China.

6) Valuations for Chinese banks appear to be more volatile historically than Indian PSU banks (bigger peak-trough gap).

7) Indian PSU banks have historically traded in a much narrower range than China banks.

Figure 7. Valuations (Market Cap Weighted Average): China and India

	China	India - SOE Banks	India - All
12m Fwd P/BV	1.8	1.5	1.7
12m Fwd P/E	13.6	4.6	10.4
12m Fwd P/PPOP	6.3	6.3	4.4
12m Fwd Market Cap/Total Assets	0.12	0.21	0.15
12m Fwd Market Cap/Deposits	0.16	0.23	0.18

Source: Citi Investment Research and Analysis

Figure 8. P/BV Comparison (2m Fwd): Indian PSU Banks and China Banks



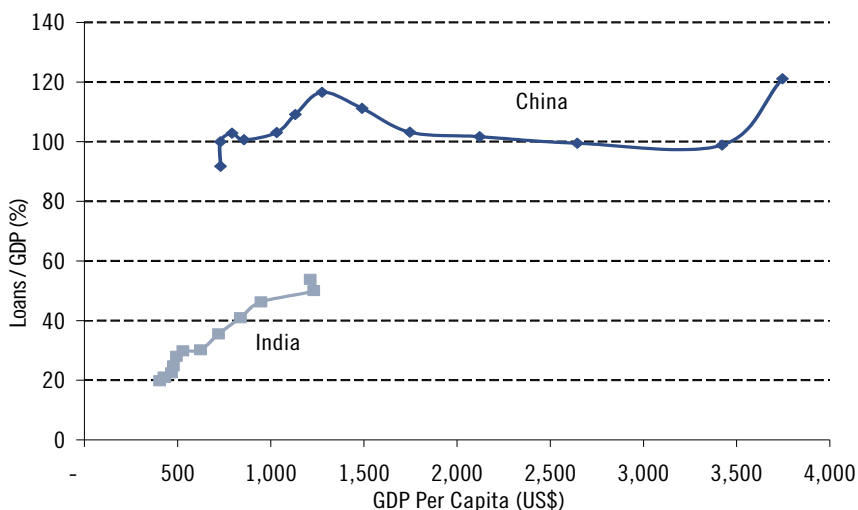
Source: Citi Investment Research and Analysis

1) India's credit penetration has increased meaningfully over the last decade (from ~20% to 54% currently).

2) Increasing credit penetration has largely followed in the rise in income levels in India.

3) China's credit penetration has however, remained stable between 100-120% during this period despite 5x increase in income levels.

Figure 9. India and China: Loan / GDP (%) vs. GDP Per Capita (US\$)



Source: Citi Investment Research and Analysis

1) Loan book size for China Banks is over 8x of Indian banks.

2) China added over US\$1,000bn in CY09 (equivalent to 2x of Indian banks outstanding loans).

3) Banking industry penetration in China is significantly higher than India (Loan / GDP of 121% in China vs. 54% in India).

Figure 10. Select Macroeconomic Indicators: India and China

	China - CY09	India - FY10
Total Loans (US\$bn)	5,845.7	689.5
Real GDP Growth (%)	8.7	7.4
Nominal GDP Growth (%)	10.0	8.5
Loan Growth (%)	30.0	17.0
Loans/GDP (%)	121.0	53.8
Consumer Loan/GDP (%)	16.3	9.4
GDP per Capita (US\$)	3,746.0	1,122.3

Source: Citi Investment Research and Analysis

1) We believe China banks are currently at a similar stage to Indian banks in March 2009.

2) Valuations in both cases had corrected, loan growth was on the way down, and credit costs expected to rise.

3) ROEs were however, expected to decline further from their above cycle levels.

4) A pickup in valuations is the most likely case, but will depend on regaining confidence on the macro environment.

5) For a more detailed note business cycles refer to Simon Ho's 2 July note: Asian Banks Strategist - Banking Cycles: Upside and Downside Risks

Figure 11. Summary Business Cycle Graph: India (March 2009) vs. China (Current)



Source: Citi Investment Research and Analysis

1) Overall, we believe, Indian banks' lending books are significantly more diversified (and well balanced) than China banks.

2) Loan composition in China is much more skewed towards corporate lending (70% of loans) much of which is SOE lending.

3) Overall retail proportion is relatively similar for both countries, but mortgage is higher in China (16%) than India (10%).

4) Large banks in China have much less exposure to the SME segment.

1) Within Corporate loans as well – China banks have greater concentration than Indian banks.

2) Indian banks have a lot of room to expand in infrastructure loans (well below Chinese banks).

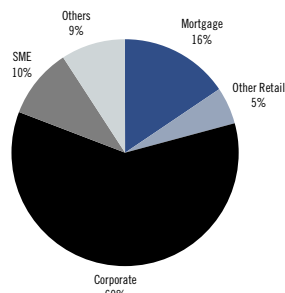
3) Indian banks exposure to manufacturing segment appears to be relatively higher given the lower reliance of the economy on manufacturing.

4) Exposure to property and construction loans for Indian banks are much less than in China (partly due to regulatory restrictions on exposure).

1) On the liability side, both countries are dominated by deposit funding; other borrowings contribute a relatively lower proportion to overall funding needs.

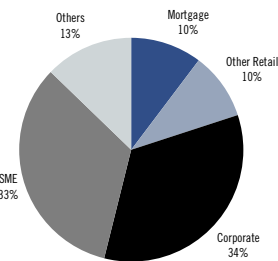
2) Demand deposits for China banks are higher than India at 47% of loans (vs. 31% in India).

Figure 12. China: Loan Book Composition (2009)



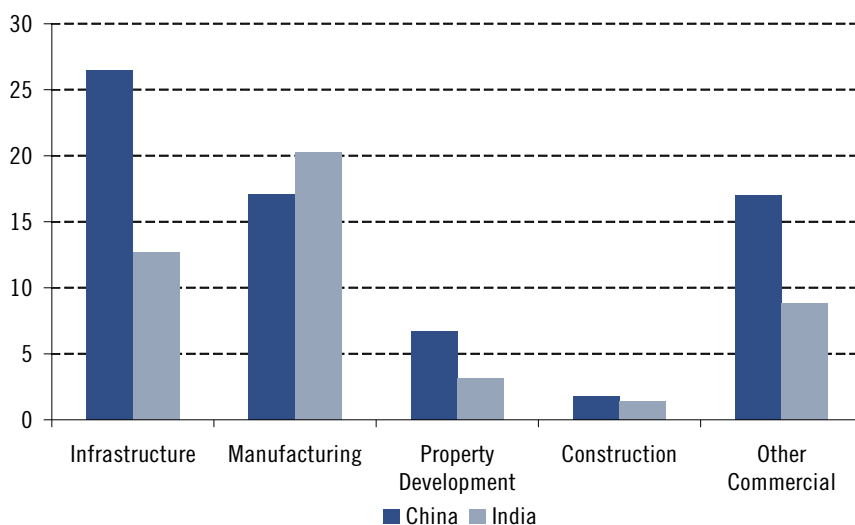
Source: Citi Investment Research and Analysis

Figure 13. India: Loan Book Composition (FY10)



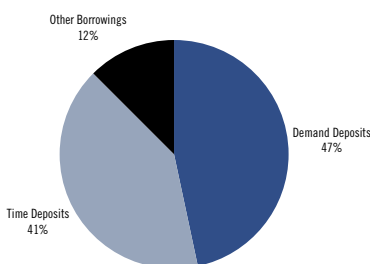
Source: RBI

Figure 14. Major Industry Segments within Loans: India and China (% of Total Loans)



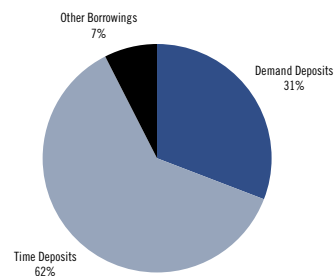
Source: RBI, Citi Investment Research and Analysis

Figure 15. China: Funding Profile (2009)



Source: Citi Investment Research and Analysis

Figure 16. India: Funding Profile (FY10)



Source: RBI

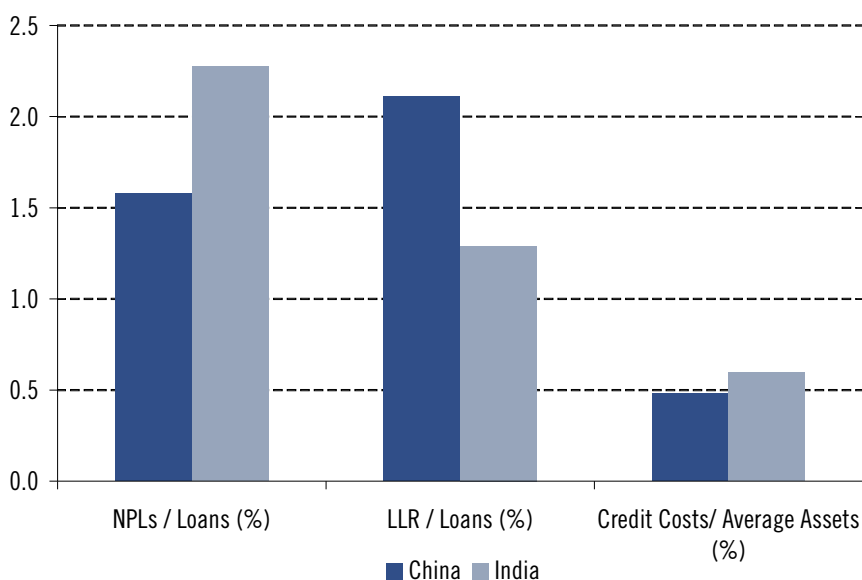
1) Indian banks have relatively higher NPLs (2.3% of loans) compared to their Chinese counterparts (1.6%).

2) Loan loss coverage is also much lower for Indian banks.

3) Credit costs for Indian banks are marginally higher compared to Chinese banks.

4) More importantly Chinese banks have an implicit backstop from the government in terms of asset quality (as most of their lending is to the SOE segment).

Figure 17. Comparative Asset Quality: India (FY10) and China (CY09)



Source: Citi Investment Research and Analysis

Figure 18. Indian Banks – Valuation Summary Table

	RIC Code	Price (Rs) 7-Jul	TP (Rs)	Rating	P/E (x) 2011	P/B (x) 2011	ROE (%) 2011	ROA (%) 2011	Div. Yld 2011	M-Cap USD Mn
Private Sector Banks										
ICICI Bank	ICBK.BO	847.5	1065	2M	19.6	1.7	9.2%	1.3%	1.5%	20,212
HDFC Bank	HDBK.BO	1943.5	2050	2L	23.9	3.6	16.5%	1.6%	0.5%	19,102
AXIS Bank	AXBK.BO	1246.5	1335	2L	17.0	2.7	17.8%	1.5%	1.0%	10,859
Kotak Mahindra Bank	KTKM.BO	760.8	700	3H	21.3	3.0	15.3%	2.4%	0.1%	5,937
Yes Bank	YESB.BO	273.1	330	1M	14.2	2.5	20.7%	1.6%	0.0%	1,991
Infrastructure Development Finance	IDFC.BO	179.7	141	3M	17.4	2.8	17.4%	3.4%	0.8%	5,023
LIC Housing Finance	LICH.BO	996.1	740	3M	12.9	2.3	19.5%	1.8%	1.5%	2,022
Shriram Transport Finance	SRTR.BO	587.0	615	1M	11.9	2.8	25.6%	3.7%	1.2%	2,830
Federal Bank	FED.BO	344.1	336	1M	9.0	1.1	12.9%	1.4%	1.3%	1,258
Govt. Banks										
State Bank of India	SBI.BO	2296.5	2515	1L	13.2	1.9	15.7%	1.0%	1.3%	31,173
SBI - Consolidated		2296.5	2515	1L	10.7	1.6	15.2%	0.9%	1.3%	31,173
Punjab National Bank	PNBK.BO	1067.0	950	3M	7.8	1.7	22.0%	1.4%	2.0%	7,193
Bank of Baroda	BOB.BO	722.4	590	3M	8.9	1.6	17.8%	1.0%	1.4%	5,626
Canara Bank	CNBK.BO	460.0	490	1M	5.7	1.2	20.0%	1.2%	2.0%	4,032
Union Bank Of India	UNBK.BO	312.8	275	3L	6.7	1.5	20.6%	1.2%	1.8%	3,378
Oriental Bank of Commerce	ORBC.BO	328.6	390	1M	5.1	0.8	17.6%	1.1%	2.3%	1,760
Corporation Bank	CRBK.BO	525.8	565	2M	5.5	1.1	21.3%	1.2%	2.7%	1,613
Andhra Bank	ADBK.BO	134.7	140	1M	5.7	1.2	23.5%	1.3%	3.4%	1,396
Central Bank Of India	CBI.BO	141.5	135	3M	4.4	1.0	18.6%	0.7%	1.6%	1,223
Other Financial Services										
Edelweiss Capital	EDEL.BO	480.4	612	1M	10.5	1.4	14.3%	4.5%	0.9%	771
Motilal Oswal Financial Services	MOFS.BO	174.2	176	3M	13.8	2.3	17.9%	8.4%	0.6%	533
Reliance Capital	RLCP.BO	756.2	821	3M	16.7	2.0	12.8%	4.1%	0.9%	3,972

Source: Citi Investment Research and Analysis estimates

Appendix A-1

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