Company Flash

13 July 2007 | 7 pages

UTI Bank (UTBK.BO)

Hold: 1Q08 Results - A Mixed Bag

- UTBK net profit up 45% — UTI Bank's net profit rose 45% yoy, about 6% ahead of expectations, but were lower 17% over the previous quarter. Operationally, the results are mixed with the key positives being healthy expansion in fee income and continued growth momentum with some negatives on margins, operating expenses and slight deterioration in asset quality.

- Positives in fees and growth momentum — UTBK continues to sustain momentum in fees and asset growth – both ahead of expectations. Fee income has grown 47% yoy while loan growth has kept strong momentum with a 60% yoy increase.

- Reduction in margins, higher costs and asset quality – Margins have declined to 272bps from 306bps in 4Q07, though this was expected, the compression is slightly ahead of expectations. Management does suggest this is temporary and should improve as lower yielding priority loans run off. Operating costs are 15% higher than expectations and have increased 76%yoy, driven by 86% yoy and 66% qoq increase in employee costs. Although the quarter has seen relatively higher levels of deterioration, overall asset quality remains comfortable.

- Await clarification on capital raising, maintain Hold — We await further clarification on capital raising; management has called for an EGM on 13 July to discuss the same. Maintain our Hold (2L) recommendation.

Hold/Low Risk	2L
Price (12 Jul 07)	Rs641.10
Target price	Rs560.00
Expected share price return	-12.7%
Expected dividend yield	0.5%
Expected total return	-12.1%
Market Cap	Rs181,207M
	US$4,495M

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	3,346	13.02	8.7	49.2	7.3	18.9	0.4
2006A	4,848	17.20	32.1	37.3	6.2	18.4	0.5
2007E	6,358	22.36	30.0	28.7	5.2	20.2	0.5
2008E	8,125	28.57	27.8	22.4	4.3	21.6	0.5
2009E	10,280	36.15	26.5	17.7	3.5	22.4	0.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. UTI Bank – 1Q08 – Financial Results (Rupees Million)

	1Q08	1Q07	YoY %	4Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	15,370	9,539	61.1	13,668	12.5	Expansion in interest income lower due to acquisition of short term priority assets at the end of previous quarter
Interest Expense	(10,901)	(6,321)	72.5	(9,025)	20.8	Deposit cost increases are relatively high on account of increase in cost of funds by about 50bps and a reduction in low cost deposits of 200bps
Net Interest Income	4,468	3,218	38.8	4,642	-3.7	
Fee-Based Income	2,715	1,846	47.1	2,579	5.3	Strong growth continues - ahead of expectations
Other Non-Interest Income	708	400	77.2	432	64.0	Strong show but remains volatile and difficult to estimate
Non Interest Income	3,423	2,245	52.5	3,011	13.7	
Operating Income	7,892	5,463	44.4	7,653	3.1	9% higher than expectations - driven by non-interest incomes
Operating Expenses	(4,212)	(2,392)	76.1	(3,430)	22.8	14.6% higher than expectations; significant increase is a surprise and well ahead of expectations - expect cost pressures to continue as distribution expansion continues
Pre-Provision Profit	3,679	3,072	19.8	4,223	-12.9	
Charges for Bad Debts	(496)	(138)	260.0	(83)	498.4	Provisioning charges increase significantly after being low in 4Q07 though deterioration seems limited
Other Operating Items	(513)	(1,110)	-53.8	(982)	-47.8	
Operating Profit	2,670	1,824	46.4	3,158	-15.4	
Pre-Tax Profit	2,670	1,824	46.4	3,158	-15.4	
Tax	(921)	(618)	48.9	(1,039)	-11.4	taxed at the marginal level
Net Profit	**1,750**	**1,206**	**45.1**	**2,119**	**-17.4**	**About 5% higher than estimates**
EPS	6.21	4.0	56.7	7.52	-17.4	
Customer Loans	412,850	258,360	59.8	368,760	12.0	Continued expansion in loan growth despite a slowdown in the overall sector growth - reflects a strong pipeline
Customer Deposits	610,910	420,940	45.1	587,860	3.9	Slower growth in the quarter even as low cost deposits reduce by around 200bps
AIEA	658,570	480,277	37.1	602,915	9.2	
Total Assets	791,090	530,020	49.3	732,570	8.0	
Avg Assets	761,830	513,665	48.3	691,135	10.2	
Non-Performing Loans (NPL)	4,831	4,044	19.5	4,187	15.4	Incremental deterioration high qoq; though overall asset quality remains comfortable
Loan Loss Reserves (LLR)	(2,019)	(1,716)	17.7	(1,523)	32.5	
Shareholders' Funds	34,060	29,070	17.2	32,336	5.3	
Book Value Per Share	121	104	16.5	115	5.3	
Key Ratios (%)	**1Q08**	**1Q07**	**Bps Δ YoY**	**4Q07**	**Bps Δ QoQ**	**Citigroup Investment Research Comments**
ROAA (annualized)	0.88	0.91	-3	1.16	-27	Pressure on profitability due to lower NIMs and higher operating expenses
ROAE (annualized)	20.55	16.59	396	26.21	-566	
Net Interest Margin (bps)	272	268	4	306	-34	In line with seasonal trend for the bank - expect improvements over the next 2-3 quarters
Fee Inc/Operating Income	34.4	33.8	63	33.7	70	
Other Non-Interest Inc/Op Inc	43.4	41.1	229	39.3	404	
Op. Cost/ Operating Income	53.4	43.8	960	44.8	856	Significant increase is a surprise and well ahead of expectations - expect cost pressures to continue as distribution expansion continues
Loan-to-Deposit Ratio (LDR)	67.6	61.4	620	62.7	485	
NPL/Loan Ratio	1.2	1.6	-39	1.14	3	
LLR/NPL Ratio	42	42	-64	36	541	Increase in coverage levels in the quarter but remains lower than peers

Source: Citigroup Investment Research

UTI Bank

Company description

UTI Bank is India's third-largest private-sector bank after the significantly larger ICICI Bank and HDFC Bank. It is more than twice the size of the next largest private-sector bank. The top three private-sector banks collectively account for almost 9.6% market share, while private-sector banks as a group are about 18.6% of the system. UTI Bank is a small player in the broader banking sector; its market share is less than 2% in terms of loans and deposits. UTI Bank was started by the erstwhile Unit Trust of India (UTI) in 1994, along with LIC and GIC, two government-owned insurance companies. UTI's stake is now held by UTI-I, a government-owned entity, with a 28% holding. LIC and GIC together own 16.3%, and collectively, these government-owned shareholders own approximately 44% of the bank.

Investment thesis

UTI Bank is one of a few clean (in terms of asset book), rapidly growing, profitable, and competitive private-sector banks in India; thus we think it will be a major beneficiary of the favorable banking environment. The Indian banking sector is in a sweet spot: consumer and corporate lending is strong, asset quality is improving and fee-income opportunities are growing. We expect this favorable environment to continue in the medium term, but recognize that a key challenge for banks will be funding growth. Looking at its profile, we believe UTI Bank stands to gain disproportionately from existing opportunities in the sector. The bank has strong technology and products, an expanding distribution franchise, adequate scale, a strong service culture, and management enterprise – features that should help it stay ahead of the dominant government banks to win market share. We do however believe the current business momentum, and structural opportunity, is now fully valued in by the stock, which we rate Hold / Low Risk (2L). It trades at almost 3.5X FY08E PBV, and well above our EVA-based fair value of Rs560. This is well above its historical trading band, and a near-peak. We believe these valuations – given potential challenges on its asset mix, funding profile, and modest capital cushion – will cap stock performance over the next 12 months, generating only modest returns.

Valuation

We set our Rs560 target price using an EVA-based target of Rs560. EVA is our preferred valuation methodology. Our target price is based on an EVA methodology because it takes into account (1) longer-term earnings and growth of the bank, (2) an improving mix of earnings, and (3) asset quality control. We assume the following: a) a risk-free rate of 8%; 2) a long-term asset loss expectation of 100bp; and 3) higher longer-term margins (+25bps) and fee income growth (+100bps) consistent with the expectation of a reduction in SLR requirements. Our secondary valuation methodology is based on P/BV, which we use to value all banks in our coverage universe. We expect private-sector banks to trade at a premium to the sector on a P/BV basis, reflective of their longer-term prospects, competitiveness and management. We value UTI Bank at 3.4x FY08E PBV or Rs503 based on a discount to HDFC Bank (which we benchmark at 4x one-year forward) of 15%. We prefer the higher of the two target multiples, given the relatively robust business environment, and strong market momentum.

Risks

We rate UTI Bank shares as Low Risk based on our quantitative risk-rating system, which tracks historical share price volatility.Key upside risks to our target price include: (1) stronger-than-expected margins, (2) higher-than-expected fee income levels, and (3) any corporate activity including mergers and acquisitions.Key downside risks that could impede the stock from reaching our target price include: (1) mid-market credit focus; (2) a large share of wholesale funding; (3) aggressive trading orientation; and (4) the role of key shareholders.

Appendix A-1

Analyst Certification

We, Aditya Narain, CFA and Manish Chowdhary, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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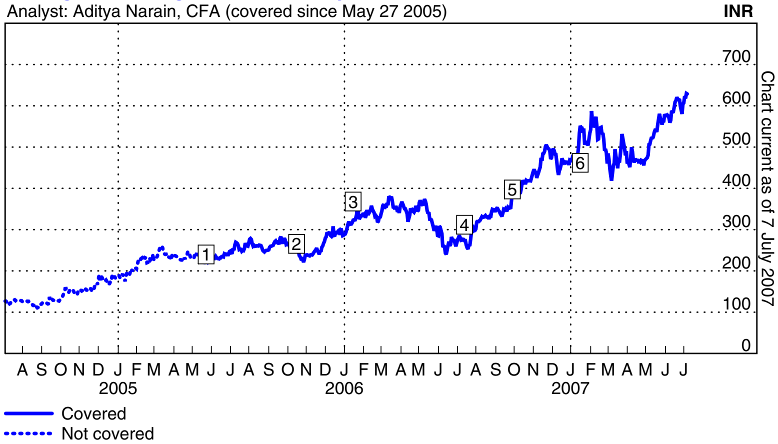
UTI Bank (UTBK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA (covered since May 27 2005)



#	Date	Rating	Target Price	Closing Price
1:	24 May 05	1M	275.00	223.95
2:	17 Oct 05	1M	*315.00	252.05
3:	16 Jan 06	*1L	*365.00	323.10
4:	13 Jul 06	1L	*335.00	273.10
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