

## Union Bank of India

|                   |              |
|-------------------|--------------|
| STOCK INFO.       | BLOOMBERG    |
| BSE SENSEX: 9,849 | UNBK IN      |
|                   | REUTERS CODE |
| S&P CNX: 2,975    | UNBK.BO      |

30 January 2006

Buy

Previous Recommendation: Buy

Rs123

|                     |            | YEAR  | NET INCOME | PAT    | EPS  | EPS        | P/E | P/BV | CAR  | ROE  | ROA | P/ABV |
|---------------------|------------|-------|------------|--------|------|------------|-----|------|------|------|-----|-------|
|                     |            | END   | (RS M)     | (RS M) | (RS) | GROWTH (%) | (X) | (X)  | (%)  | (%)  | (%) | (X)   |
| Equity Shares (m)   | 460.1      | 3/05A | 28,307     | 7,191  | 15.6 | 1.0        | 7.9 | 1.8  | 12.1 | 21.5 | 1.1 | 2.3   |
| 52-Week Range       | 149/93     | 3/06E | 30,072     | 8,279  | 16.4 | 4.9        | 7.5 | 1.4  | 11.3 | 19.6 | 1.0 | 1.6   |
| 1,6,12 Rel.Perf.(%) | -4/-37/-40 | 3/07E | 34,537     | 10,707 | 21.2 | 29.3       | 5.8 | 1.2  | 11.2 | 20.4 | 1.1 | 1.2   |
| M.Cap. (Rs b)       | 56.6       |       |            |        |      |            |     |      |      |      |     |       |
| M.Cap. (US\$ b)     | 1.3        |       |            |        |      |            |     |      |      |      |     |       |

Union Bank reported 10% YoY net interest income (NII) growth to Rs6.39b in 3QFY06. This has come on the back of strong 35% loan growth. Non-interest income declined by 27% YoY to Rs1.39b for the quarter. However on account of the low-base effect of 3QFY05 arising out of HTM transfer hits, PAT increased 288% to Rs2.29b in 3QFY06.

- ✍ Strong loan growth and stable margins QoQ
- ✍ Loan growth of 35%; deposits up 26%
- ✍ Net NPAs decline sharply to 1.15%

Union Bank is among the fastest growing state-owned banks in our banking universe. It has already created a strong technology platform and now has 75% of its business under core banking solutions (CBS), which should help the bank maintain strong growth going forward.

The stock is trading at 1.2x FY07E BV and 5.8x FY07E EPS. Even after incorporating the additional capital, we expect the bank to deliver RoE of 20% in FY07. The stock still offers a dividend yield of 3.3% on our expectation of Rs4 dividend for FY06. We maintain **Buy**.

### QUARTERLY PERFORMANCE

|                                      |              |              |              |              |              |              |              |              | (RS MILLION)  |               |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
|                                      | FY05         |              |              |              | FY06         |              |              |              | FY05          | FY06E         |
|                                      | 1Q           | 2Q           | 3Q           | 4Q           | 1Q           | 2Q           | 3Q           | 4QE          |               |               |
| Interest Income                      | 11,658       | 11,931       | 12,888       | 13,221       | 13,578       | 14,202       | 15,135       | 16,180       | 49,698        | 59,094        |
| Interest Expense                     | 6,992        | 7,363        | 7,092        | 7,606        | 8,230        | 8,179        | 8,741        | 9,684        | 29,052        | 34,834        |
| <b>Net Interest Income</b>           | <b>4,667</b> | <b>4,568</b> | <b>5,796</b> | <b>5,615</b> | <b>5,347</b> | <b>6,023</b> | <b>6,394</b> | <b>6,496</b> | <b>20,646</b> | <b>24,260</b> |
| % Change (Y-o-Y)                     | 6.4          | 8.2          | 28.0         | 32.9         | 14.6         | 31.9         | 10.3         | 15.7         | 18.9          | 17.5          |
| Other Income                         | 2,348        | 1,611        | 1,914        | 1,788        | 1,337        | 1,403        | 1,390        | 1,683        | 7,661         | 5,812         |
| <b>Net Income</b>                    | <b>7,015</b> | <b>6,179</b> | <b>7,709</b> | <b>7,403</b> | <b>6,684</b> | <b>7,426</b> | <b>7,784</b> | <b>8,179</b> | <b>28,307</b> | <b>30,072</b> |
| % Change (Y-o-Y)                     | 27.1         | -1.1         | 22.1         | -2.5         | -4.7         | 20.2         | 1.0          | 10.5         | 10.2          | 6.2           |
| Operating Expenses                   | 3,085        | 3,094        | 3,774        | 2,622        | 3,153        | 3,855        | 3,501        | 3,615        | 12,575        | 14,124        |
| <b>Operating Profit</b>              | <b>3,930</b> | <b>3,085</b> | <b>3,936</b> | <b>4,781</b> | <b>3,531</b> | <b>3,571</b> | <b>4,283</b> | <b>4,564</b> | <b>15,732</b> | <b>15,948</b> |
| Other Provisions                     | 1,006        | 658          | 4,145        | 3,806        | 647          | 2,690        | 1,302        | 961          | 9,616         | 5,600         |
| Tax Provisions                       | 820          | 320          | -800         | -1,415       | 480          | 270          | 690          | 630          | -1,075        | 2,070         |
| <b>Net Profit</b>                    | <b>2,104</b> | <b>2,107</b> | <b>591</b>   | <b>2,389</b> | <b>2,404</b> | <b>611</b>   | <b>2,291</b> | <b>2,973</b> | <b>7,191</b>  | <b>8,279</b>  |
| % Change (Y-o-Y)                     | 35.0         | 24.0         | -60.6        | 1.1          | 14.3         | -71.0        | 287.8        | 24.4         | 1.0           | 15.1          |
| Cost to Income Ratio (%)             | 44.0         | 50.1         | 49.0         | 35.4         | 47.2         | 51.9         | 45.0         | 44.2         | 44.4          | 47.0          |
| Interest Expense/Interest Income (%) | 60.0         | 61.7         | 55.0         | 57.5         | 60.6         | 57.6         | 57.8         | 59.9         | 58.5          | 58.9          |
| Other Income/Net Income (%)          | 33.5         | 26.1         | 24.8         | 24.2         | 20.0         | 18.9         | 17.9         | 20.6         | 27.1          | 19.3          |

E: MOST Estimates

**Union Bank of India will come out with follow-on-public-offer (FPO) shortly. Owing to this, management has not provided all details of the results for the third quarter ended December 2005.**

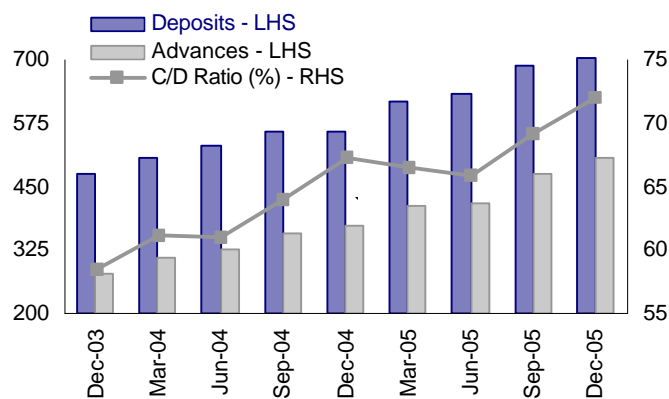
Union Bank reported 10% YoY net interest income (NII) growth to Rs6.39b in 3QFY06. This has come on the back of strong 35% loan growth. Non-interest income declined by 27% YoY to Rs1.39b for the quarter. However on account of the low-base effect of 3QFY05 arising out of HTM transfer hits, PAT increased 288% to Rs2.29b in 3QFY06.

**Loan growth strong; deposit growth also robust**

Net interest income grew 10% YoY to Rs6.39b in 3QFY06. This growth is a result of sustained management effort to grow the loan book and focus on higher yielding assets. This strong loan growth has been supported by margins as well, with the bank able to maintain its yields on advances at the 1HFY06 level of 8.28% for the 9MFY06.

Loan book has grown by 35% to Rs507b. Deposits grew by 26% to Rs705b. Union Bank is probably one of the few state-owned banks that has been able to raise deposits even in a scenario where raising deposits has now become challenging. We believe this ability would result in strong forward loan growth as the bank will be able to fund loans through deposits.

TRENDS IN BUSINESS VOLUME (RS B)



Source: Company/Motilal Oswal Securities

**Margins stable QoQ**

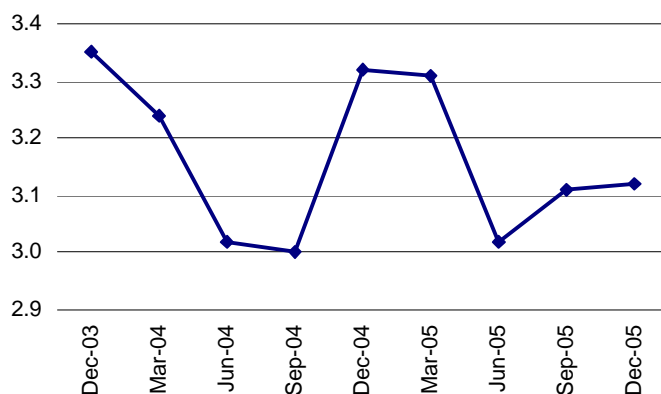
UBI has maintained its NIMs in 3QFY06 at nearly the same level as at 1HFY06. However, on a YoY basis for 9MFY06, margins have declined by 10bp, as the yields on investments have declined.

BREAKDOWN OF MARGINS (%)

|                      | 9MFY06      | 9MFY05      | 1HFY06      |
|----------------------|-------------|-------------|-------------|
| Yield on Advances    | 8.28        | 8.40        | 8.28        |
| Yield on Investments | 7.86        | 8.15        | 7.89        |
| Cost of Deposits     | 4.73        | 4.99        | 4.78        |
| <b>NIMs</b>          | <b>3.12</b> | <b>3.21</b> | <b>3.11</b> |

Source: Company/Motilal Oswal Securities

TREND IN NIMs (%)



Source: Company/Motilal Oswal Securities

**Non-interest income declines as treasury profits falls sharply**

Non-interest income of the bank has fallen 27% YoY to Rs1.39b in 3QFY06. However, the bank has not provided details of non-interest income owing to the forthcoming FPO issue.

**Net NPAs decline to 1.15%**

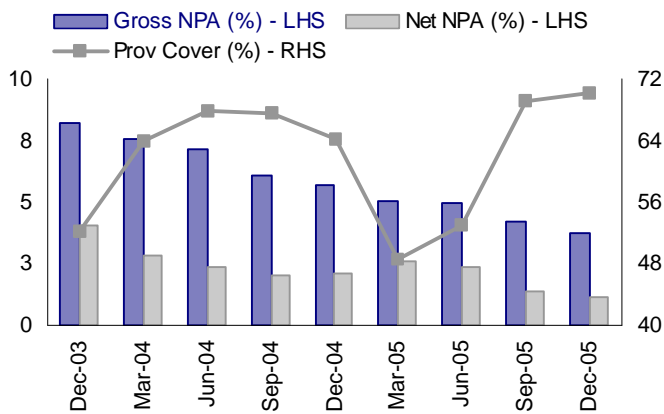
Until a few quarters ago, the bank was using its floating provisions for capital adequacy but has now reverted to using this for NPAs. Consequently, the bank's reported net NPAs have fallen sharply YoY to 1.15%, compared with 4.07% in 3QFY05.

Gross NPAs for the bank have witnessed a decline to 3.75% in 3QFY06 from 8.18% in 3QFY05. Over the last quarter, gross NPAs for the bank has declined by 47bp. Provision cover of the bank has been continuously improving and currently stands at 70%.

**Strong business momentum, maintain Buy**

Union Bank is among the fastest growing state-owned banks in our banking universe. It has already created a strong technology platform and now has 75% of its business under core banking solutions (CBS), which should help the bank maintain strong growth going forward.

MOVEMENT IN NPA (%)



Source: Company/Motilal Oswal Securities

The stock is trading at 1.2x FY07E BV and 5.8x FY07E EPS. Even after incorporating the additional capital, we expect the bank to deliver RoE of 20% in FY07. The stock still offers a dividend yield of 3.3% on our expectation of Rs4 dividend for FY06. We maintain **Buy**.

## Union Bank of India: an investment profile

### Company description

Union Bank is amongst the large state-owned banks in India with a balance sheet size of over Rs795+bn. The bank completed its initial public offering (IPO) in FY2003 at a price of Rs16 and has lowered the government's stake in the bank to 61%. While the bank is based in western India, its network of over 2,000 branches is well spread across the country. Over the last five years, the bank's earnings have grown at a CAGR of 41%.

### Key investment arguments

- Strong focus on loan growth, with an incremental loan/deposit ratio of over 90%.
- Has networked 677 branches under core banking solution category (CBS, 2<sup>nd</sup> highest after PNB).
- Strong and expanding technology platform to ensure robust fee income going forward.

### Key investments risks

- Tier-I capital adequacy of 5.8% (September 2005) constrains significant asset expansion.

#### COMPARATIVE VALUATIONS

|           |       | UBI  | BOI  | VIJAYA BANK |
|-----------|-------|------|------|-------------|
| P/E (x)   | FY06E | 7.5  | 9.8  | 9.8         |
|           | FY07E | 5.8  | 7.2  | 6.2         |
| P/ABV (x) | FY06E | 1.6  | 1.5  | 1.6         |
|           | FY07E | 1.2  | 1.3  | 1.3         |
| RoE (%)   | FY06E | 19.6 | 13.7 | 16.3        |
|           | FY07E | 20.4 | 16.5 | 22.7        |
| RoA (%)   | FY06E | 1.0  | 0.6  | 0.9         |
|           | FY07E | 1.1  | 0.7  | 1.2         |

#### SHAREHOLDING PATTERN (%)

|                       | DEC.05 | SEP.05 | DEC.04 |
|-----------------------|--------|--------|--------|
| Promoters             | 60.9   | 60.9   | 60.9   |
| Domestic Institutions | 5.1    | 4.9    | 6.2    |
| FII's/FDIs            | 18.4   | 19.2   | 15.2   |
| Others                | 15.6   | 15.0   | 17.7   |

### Recent developments

- UBI will soon issue to the public 45m shares through 100% book-building route. This will bring down government's stake in the bank to 55.43% from current 60.8%.
- Dena Bank's chairman and managing director, Mr. M.V. Nair will take over as CMD of Union Bank of India as of 1 April 2006.
- UBI recently introduced a Rs4b Tier-II capital bond issue, with a greenshoe option of Rs4b, which was oversubscribed by the participants.

### Valuation and view

- We expect earnings to grow by 15% in FY06. Stronger momentum in core earnings will result in better valuations for the stock.
- The stock is trading at 1.2x and FY07E BV of 5.8x FY07E earnings.

### Sector view

- Loan growth of 30% at the beginning of capex cycle.
- Volatility in interest rates would impact treasury.
- Benefits of significant improvement in asset quality not yet factored into earnings, valuations.
- We maintain an overweight stance on the sector.

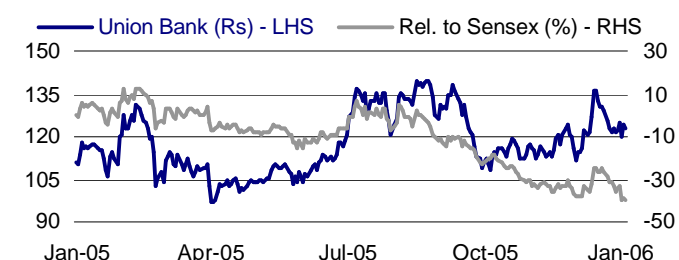
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

|      | INQUIRE FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|------------------|--------------------|---------------|
| FY06 | 16.4             | 19.3               | -15.2         |
| FY07 | 21.2             | 25.3               | -16.3         |

#### TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 123                | 168               | 36.6       | Buy   |

#### STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT           |               |               |               |               |               |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million)               |               |               |               |               |               |
| Y/E March                  | 2004          | 2005          | 2006E         | 2007E         | 2008E         |
| Interest Income            | 45,163        | 49,698        | 59,094        | 69,768        | 80,246        |
| Interest Expended          | 27,801        | 29,052        | 34,834        | 41,343        | 47,095        |
| <b>Net Interest Income</b> | <b>17,362</b> | <b>20,646</b> | <b>24,260</b> | <b>28,425</b> | <b>33,152</b> |
| Change (%)                 | 15.9          | 18.9          | 17.5          | 17.2          | 16.6          |
| Other Income               | 8,315         | 7,661         | 5,812         | 6,112         | 6,757         |
| <b>Net Income</b>          | <b>25,677</b> | <b>28,307</b> | <b>30,072</b> | <b>34,537</b> | <b>39,909</b> |
| Change (%)                 | 10.6          | 10.2          | 6.2           | 14.8          | 15.6          |
| Operating Expenses         | 10,846        | 12,575        | 14,124        | 15,882        | 17,447        |
| <b>Operating Income</b>    | <b>14,831</b> | <b>15,732</b> | <b>15,948</b> | <b>18,656</b> | <b>22,462</b> |
| Change (%)                 | 13.7          | 6.1           | 14            | 17.0          | 20.4          |
| Other Provisions           | 6,630         | 9,616         | 5,600         | 4,750         | 4,950         |
| <b>PBT</b>                 | <b>8,200</b>  | <b>6,116</b>  | <b>10,348</b> | <b>13,906</b> | <b>17,512</b> |
| Tax                        | 1,080         | -1,075        | 2,070         | 3,198         | 4,378         |
| Tax Rate (%)               | 13.2          | -17.6         | 20.0          | 23.0          | 25.0          |
| <b>PAT</b>                 | <b>7,120</b>  | <b>7,191</b>  | <b>8,279</b>  | <b>10,707</b> | <b>13,134</b> |
| Change (%)                 | 28.8          | 10            | 15.1          | 29.3          | 22.7          |
| Proposed Dividend          | 1,817         | 1,821         | 2,020         | 2,273         | 2,526         |

| BALANCE SHEET             |                |                |                |                  |                  |
|---------------------------|----------------|----------------|----------------|------------------|------------------|
| (Rs Million)              |                |                |                |                  |                  |
| Y/E March                 | 2004           | 2005           | 2006E          | 2007E            | 2008E            |
| Capital                   | 4,601          | 4,601          | 5,051          | 5,051            | 5,051            |
| Reserves & Surplus        | 26,270         | 31,543         | 43,201         | 51,635           | 62,244           |
| <b>Net Worth</b>          | <b>30,871</b>  | <b>36,144</b>  | <b>48,252</b>  | <b>56,687</b>    | <b>67,295</b>    |
| <b>Deposits</b>           | <b>505,589</b> | <b>618,306</b> | <b>748,150</b> | <b>867,854</b>   | <b>1,006,711</b> |
| Change (%)                | 13.0           | 22.3           | 21.0           | 16.0             | 16.0             |
| Borrowings                | 9,342          | 20,210         | 26,272         | 32,052           | 38,463           |
| Other Liabilities & Prov. | 37,364         | 49,473         | 62,830         | 79,794           | 101,339          |
| <b>Total Liabilities</b>  | <b>583,167</b> | <b>724,131</b> | <b>885,503</b> | <b>1,036,387</b> | <b>1,213,807</b> |
| Current Assets            | 38,479         | 65,720         | 85,314         | 100,563          | 118,006          |
| Investments               | 224,420        | 227,927        | 255,278        | 285,911          | 320,221          |
| Change (%)                | 15.9           | 16             | 12.0           | 12.0             | 12.0             |
| Advances                  | 294,259        | 401,051        | 513,345        | 616,014          | 739,217          |
| Change (%)                | 15.3           | 36.3           | 28.0           | 20.0             | 20.0             |
| Net Fixed Assets          | 7,668          | 8,238          | 8,251          | 8,251            | 8,151            |
| Other Assets              | 18,340         | 21,196         | 23,316         | 25,647           | 28,212           |
| <b>Total Assets</b>       | <b>583,167</b> | <b>724,131</b> | <b>885,504</b> | <b>1,036,387</b> | <b>1,213,807</b> |

| ASSUMPTIONS        |      |      |      |      |      |
|--------------------|------|------|------|------|------|
| (%)                |      |      |      |      |      |
| Deposit Growth     | 13.0 | 22.3 | 21.0 | 16.0 | 16.0 |
| Advances Growth    | 15.3 | 36.3 | 28.0 | 20.0 | 20.0 |
| Investments Growth | 15.9 | 16   | 12.0 | 12.0 | 12.0 |
| Average PLR        | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 |
| Dividend           | 35.0 | 35.0 | 40.0 | 45.0 | 50.0 |
| CRR                | 4.5  | 5.0  | 5.0  | 5.0  | 5.0  |

E: Most Estimates

| RATIOS                      |      |      |       |       |       |
|-----------------------------|------|------|-------|-------|-------|
| Y/E March                   | 2004 | 2005 | 2006E | 2007E | 2008E |
| <b>Spreads Analysis (%)</b> |      |      |       |       |       |
| Avg. Yield - Earning Asset  | 8.7  | 8.0  | 7.7   | 7.7   | 7.5   |
| Avg. Cost-Int. Bear. Liab   | 5.8  | 5.0  | 4.9   | 4.9   | 4.8   |
| Interest Spread             | 2.9  | 2.9  | 2.8   | 2.7   | 2.7   |
| Net Interest Margin         | 3.3  | 3.3  | 3.2   | 3.1   | 3.1   |

| Profitability Ratios (%)  |      |      |      |      |      |
|---------------------------|------|------|------|------|------|
| RoE                       | 25.2 | 21.5 | 19.6 | 20.4 | 21.2 |
| RoA                       | 13   | 11   | 10   | 11   | 12   |
| Int. Expended/Int. Earned | 61.6 | 58.5 | 58.9 | 59.3 | 58.7 |
| Other Inc./Net Income     | 32.4 | 27.1 | 19.3 | 17.7 | 16.9 |

| Efficiency Ratios (%)  |      |      |      |      |      |
|------------------------|------|------|------|------|------|
| Op. Exps./Net Income   | 42.2 | 44.4 | 47.0 | 46.0 | 43.7 |
| Empl. Cost/Op. Exps.   | 66.5 | 64.1 | 60.9 | 60.9 | 59.8 |
| Busi. per Empl. (Rs m) | 28.6 | 34.6 | 45.3 | 55.1 | 66.2 |
| NP per Empl. (Rs lac)  | 2.8  | 2.8  | 3.3  | 4.3  | 5.4  |

| Asset-Liability Profile (%) |      |      |      |      |      |
|-----------------------------|------|------|------|------|------|
| Adv./Deposit Ratio          | 58.2 | 64.9 | 68.6 | 71.0 | 73.4 |
| Invest./Deposit Ratio       | 44.4 | 36.9 | 34.1 | 32.9 | 31.8 |
| G-Sec/Invest. Ratio         | 74.1 | 72.0 | 72.0 | 72.0 | 72.0 |
| Gross NPAs to Adv.          | 7.6  | 5.0  | 3.4  | 2.8  | 2.4  |
| Net NPAs to Adv.            | 2.9  | 2.6  | 1.2  | 0.5  | 0.2  |
| CAR                         | 12.3 | 12.1 | 11.3 | 11.2 | 11.2 |
| Tier 1                      | 6.5  | 6.1  | 7.3  | 7.3  | 7.4  |

| VALUATION          |      |      |      |       |       |
|--------------------|------|------|------|-------|-------|
| Book Value (Rs)    | 56.6 | 68.2 | 86.1 | 102.8 | 123.8 |
| Price-BV (x)       | 2.2  | 18   | 14   | 12    | 10    |
| Adjusted BV (Rs)   | 44.6 | 53.3 | 78.0 | 98.6  | 122.1 |
| Price-ABV (x)      | 2.8  | 2.3  | 16   | 12    | 10    |
| EPS (Rs)           | 15.5 | 15.6 | 16.4 | 21.2  | 26.0  |
| EPS Growth (%)     | 28.8 | 10   | 4.9  | 29.3  | 22.7  |
| Price-Earnings (x) | 7.9  | 7.9  | 7.5  | 5.8   | 4.7   |
| OPS (Rs)           | 32.2 | 34.2 | 316  | 36.9  | 44.5  |
| OPS Growth (%)     | 13.7 | 6.1  | -7.7 | 17.0  | 20.4  |
| Price-OP (x)       | 3.8  | 3.6  | 3.9  | 3.3   | 2.8   |

E: Most Estimates



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**Union Bank of India**

- |  |    |
|--|----|
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| 3. Broking relationship with company covered | No |

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