

Vijaya Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,521	VJYBK IN
	REUTERS CODE
S&P CNX: 2,901	VJBK.BO

21 January 2006

Buy

Previous Recommendation: Buy

Rs63

Equity Shares (m)	433.5
52-Week Range	76/51
1,6,12 Rel.Perf.(%)	10/-35/-51
M.Cap. (Rs b)	27.4
M.Cap. (US\$ b)	0.6

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)
3/05A	13,383	3,807	8.8	-7.4	7.2	1.7	12.9	26.0	1.4	1.8
3/06E	13,483	2,722	6.3	-28.5	10.1	1.6	12.4	16.3	0.9	1.6
3/07E	14,801	4,327	10.0	59.0	6.3	1.3	11.9	22.7	1.2	1.4

Vijaya Bank reported 3.4% growth in NII, in line with our expectations. However, earnings growth was muted at 5.7% YoY to Rs588m, much below our expectations. This was largely due to increased staff costs (due to pension expenses) and higher provisions. Business momentum continued to be steady with loan portfolio up 25% YoY and deposits up 10% YoY. Asset quality remained constant, with net NPAs at 0.97%.

- ✍ NII growth in line with expectations; margins stable QoQ
- ✍ Loan book up by 25%; deposits up 10% YoY
- ✍ Operating expenses jump 19% YoY
- ✍ Provisions increase QoQ; net NPAs constant at 0.97%

Incorporating the higher wage costs and higher provisions during 3QFY06, we have revised our earnings estimates for FY06 and FY07. Although, we have revised our earnings for FY06 and FY07 downward by 22% and 14%, we maintain our price target of Rs75, and value the bank at 1.6x FY07E BV, given high RoE. Despite the lower earnings, we still estimate the bank would record 16% RoE for FY06 and 23% RoE for FY07. The stock trades at P/E of 6.3x FY07E EPS and 1.3x FY07E BV. We maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	4,962	5,094	5,429	5,459	5,550	5,715	5,953	6,287	20,943	23,504
Interest Expense	2,624	2,656	2,923	2,894	3,178	3,386	3,362	3,546	11,098	13,472
Net Interest Income	2,337	2,437	2,506	2,565	2,372	2,329	2,591	2,740	9,845	10,032
% Change (Y-o-Y)	39.0	28.4	6.4	5.0	1.5	-4.5	3.4	6.9	17.5	1.9
Other Income	1,144	834	688	870	1,027	941	731	753	3,538	3,451
Net Income	3,481	3,271	3,194	3,435	3,399	3,269	3,322	3,493	13,383	13,483
% Change (Y-o-Y)	7.1	-6.4	-7.9	0.3	-2.3	-0.1	4.0	1.7	-1.8	0.7
Operating Expenses	1,308	1,389	1,352	1,443	1,376	1,634	1,612	1,525	5,492	6,148
Operating Profit	2,173	1,883	1,842	1,992	2,023	1,635	1,710	1,968	7,891	7,335
Other Provisions	737	1,449	1,076	900	1,944	536	731	589	4,162	3,800
Tax Provisions	460	-279	209	-468	-196	348	390	271	-78	813
Net Profit	976	714	556	1,559	275	751	588	1,108	3,807	2,722
% Change (Y-o-Y)	20.6	-25.6	-49.5	25.3	-71.8	5.2	5.7	-28.9	-7.4	-28.5
Cost to Income Ratio (%)	37.6	42.4	42.3	42.0	40.5	50.0	48.5	43.7	41.0	45.6
Interest Expense/Interest Income (%)	52.9	52.1	53.8	53.0	57.3	59.3	56.5	56.4	53.0	57.3
Other Income/Net Income (%)	32.9	25.5	21.5	25.3	30.2	28.8	22.0	21.5	26.4	25.6

E: MOST Estimates

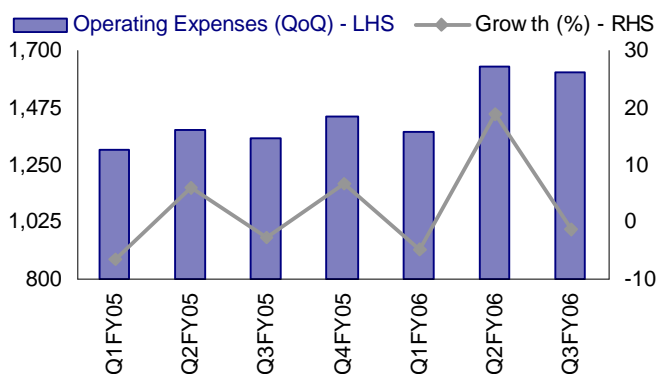
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Loan book up by 25%; deposits up 10% YoY

Loan growth remained steady with gross advances growing 25% YoY to Rs163b. The bank continues to focus on retail loans, which now constitute 36.5% of the bank’s gross credit. The increase in loan book has enabled the bank to increase its interest earned on advances by 20% YoY.

Deposits have grown by 10% YoY to Rs263b. Low cost deposits have grown faster and now form 34% of the total deposits. Loan deposit ratio at 62.1% has expanded by 730bp YoY from 54.7% at 3QFY05. With a strong thrust on growing the loan book, we expect this ratio to improve further going forward.

OPERATING EXPENSES TREND (RS M)



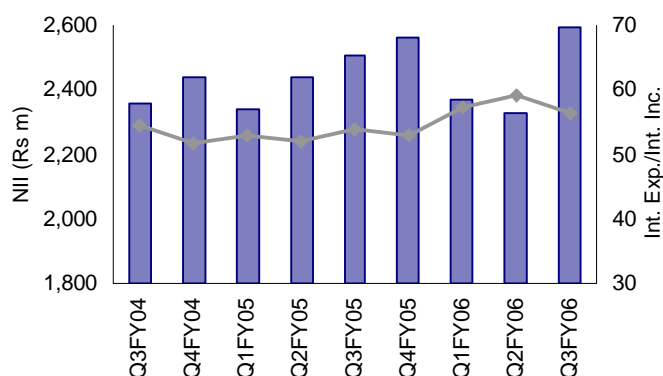
Source: Company/Motilal Oswal Securities

NII growth in line with expectations; margins stable QoQ

Net interest margins increased by 2bp QoQ to 3.36%, mainly on account of increased yields on advances and cost of deposits remaining flat. Management has stated that the

bank is taking prudent measures while lending to corporates. Costs of deposits have remained flat QoQ at 4.96% in 3QFY06. With NIMs increasing QoQ, NII growth also picked up at 11% QoQ. Going forward, we expect NII to improve as the bank shifts its excess investment book towards loans.

TREND IN NII YOY



Source: Company/Motilal Oswal Securities

Operating expenses jump by 19% YoY

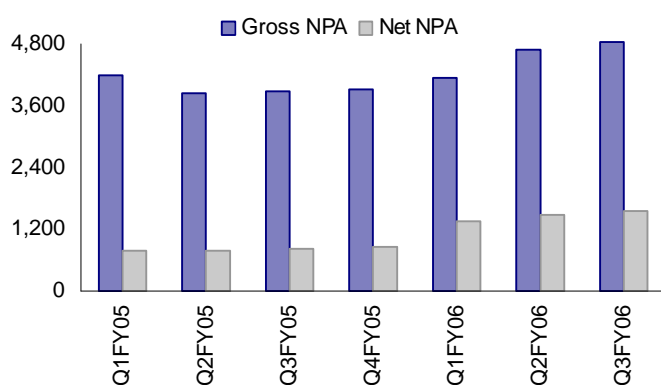
Operating expenses increased by 19% YoY to Rs1.61b in 3QFY06. The increase was largely due to the bank’s pension fund liabilities being revised due to wage-revisions at the bank in July. Nearly Rs150m of staff cost increase was a result of this pension fund revision arising out of recently concluded wage-revisions. The bank has taken a conservative view of these expenses and charged off the whole amount during 3QFY06. However, going forward, wage costs are likely to remain stable.

Provisions increase QoQ; net NPAs constant at 0.97%

Provisions for the bank have increased QoQ to Rs731m in 3QFY06, of which Rs416m pertains to diminution of non-SLR investments and amortization of investments arising out of transfer. The balance is NPA provisions. The bank has, in this quarter, made ad hoc provisions of Rs50m for increased weightage on standard assets. Additionally, the bank had to provide Rs100m relating to its historic coffee advances, in accordance with government directives.

Overall, net NPAs have remained flat on QoQ basis at 0.97%, while on an absolute basis, both gross and net NPAs increased marginally on a YoY and QoQ basis. Management has indicated that absolute increase in NPAs is largely due to the increasing asset base. Cash recoveries in 3QFY06 were Rs220m and in 1HFY06, recoveries were another Rs220m.

ASSET QUALITY TREND (RS M)



Source: Company/Motilal Oswal Securities

Capital not a constraint for growth

The capital adequacy ratio in 3QFY06 was 12.9%, with Tier-1 almost 8.8%. Bank has transferred only Rs900m of IFR to Tier-1 in 3QFY06. The bank still has Rs2.34b of

IFR classified as Tier-II. This would add almost another 200bp to Tier-1. Thus, even after adjusting for market risks, we believe that capital will not be a constraint for the bank to grow its loan book ahead.

Investment book cushioned up to 10-year G-Sec yield of 7.6%

One significant concern that Vijaya Bank had been facing was its investment book, which was exposed to interest rate fluctuations. In 1QFY06 the bank transferred a sizable sum of securities to HTM and took a substantial hit on earnings. In 3QFY06, 41% of the bank's investment book is in HTM and in the AFS books. This offers a cushion of almost 45bp with a modified duration of 3.52.

Maintain Buy with a target price of Rs75

Incorporating the higher wage costs and higher provisions during 3QFY06, we have revised our earnings estimates for FY06 and FY07. Although, we have revised our earnings for FY06 and FY07 downward by 22% and 14%, we maintain our price target of Rs75, and value the bank at 1.6x FY07E BV, given high RoE. Despite the lower earnings, we still estimate the bank would record 16% RoE for FY06 and 23% RoE for FY07. The stock trades at P/E of 6.3x FY07E EPS and 1.3x FY07E BV. We maintain **Buy**.

Vijaya Bank: an investment profile

Company description

Established in 1932, Vijaya Bank is a mid-sized Bangalore-based public sector bank with a balance sheet size of Rs241b. The bank has made public offerings in 2001 and 2003, after which the government's stake reduced to 54%. It has a network of 931 branches, with approximately 285 branches under CBS, covering almost 62% of bank's business

Key investment arguments

- ✍ Consistently grown its loan book with greater thrust on retail advances
- ✍ Asset quality is one of the best in the sector with net NPAs at 0.97%
- ✍ Adequate capital adequacy ratio of 13%

Key investment risks

- ✍ Since the government's stake is 54%, there is not much room for further dilution

Recent developments

- ✍ The bank has transferred bonds worth Rs40b from AFS category to HTM category in 1QFY06
- ✍ Mr. Prakash Mallaya is expected to be the new CMD for Vijaya Bank

Valuation and view

- ✍ Healthy loan growth, clean asset portfolio places Vijaya Bank amongst the efficient banks
- ✍ The stock trades at a P/E of 6.3x FY07E and a P/BV of 1.3x FY07E. We maintain our **Buy** recommendation

Sector view

- ✍ Loan growth of 29%+ at the beginning of the capex cycle
- ✍ Interest rate volatility could impact treasury
- ✍ Benefits of significant improvement in asset quality not yet factored into earnings, valuations
- ✍ We maintain an overweight stance on the sector

COMPARATIVE VALUATIONS

		VIJAYA BANK	PNB	CANARA
P/E (x)	FY06E	10.1	8.4	7.1
	FY07E	6.3	7.1	5.8
P/ABV (x)	FY06E	1.6	1.5	1.4
	FY07E	1.4	1.3	1.2
RoE (%)	FY06E	16.3	18.9	19.7
	FY07E	22.7	19.0	20.3
RoA (%)	FY06E	0.9	1.2	1.1
	FY07E	1.2	1.3	1.2

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	53.9	53.9	53.9
Domestic Institutions	7.2	6.6	9.4
FII's/FDIs	16.9	17.9	12.9
Others	22.0	21.6	23.8

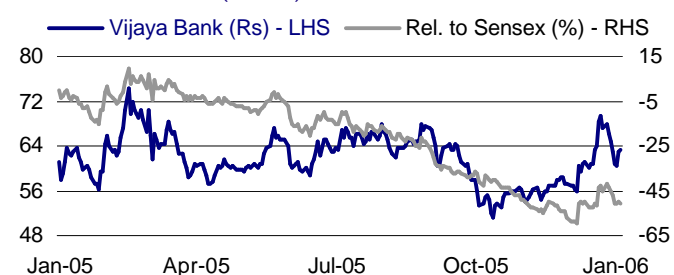
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	6.3	8.5	-25.5
FY07	10.0	10.8	-7.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
63	75	19.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	19,401	20,943	23,504	27,720	32,514
Interest Expended	11,023	11,098	13,472	16,019	18,927
Net Interest Income	8,378	9,845	10,032	11,701	13,587
Change (%)	30.2	17.5	1.9	16.6	16.1
Other Income	5,257	3,538	3,451	3,100	3,200
Net Income	13,635	13,383	13,483	14,801	16,787
Change (%)	37.8	-18	0.7	9.8	13.4
Operating Expenses	4,978	5,492	6,148	6,606	7,118
Operating Income	8,656	7,891	7,335	8,195	9,669
Change (%)	100.2	-8.8	-7.0	11.7	18.0
Other Provisions	3,128	4,162	3,800	2,425	2,450
PBT	5,529	3,729	3,535	5,770	7,219
Tax	1,415	-78	813	1,442	1,949
Tax Rate (%)	25.6	-2.1	23.0	25.0	27.0
PAT	4,113	3,807	2,722	4,327	5,270
Change (%)	109.3	-7.4	-28.5	59.0	21.8
Proposed Dividend	1,223	1,225	1,084	1,301	1,517

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Capital	4,335	4,335	4,335	4,335	4,335
Reserves & Surplus	9,020	11,557	13,195	16,222	19,975
Net Worth	13,355	15,892	17,530	20,557	24,310
Deposits	210,151	256,180	302,292	350,659	406,764
Change (%)	23.5	21.9	18.0	16.0	16.0
Borrowings	3,366	6,408	7,049	7,754	8,529
Other Liabilities & Prov.	13,838	14,875	17,106	19,672	22,623
Total Liabilities	240,710	293,355	343,978	398,642	462,227
Current Assets	11,186	16,146	15,369	13,372	9,592
Investments	108,370	120,687	132,756	148,687	166,529
Change (%)	22.3	11.4	10.0	12.0	12.0
Advances	110,453	143,358	182,064	222,119	270,985
Change (%)	40.1	29.8	27.0	22.0	22.0
Net Fixed Assets	1,913	2,176	2,251	2,351	2,401
Other Assets	8,789	10,988	11,537	12,114	12,720
Total Assets	240,710	293,355	343,978	398,642	462,227

ASSUMPTIONS	%				
Deposit Growth	23.5	21.9	18.0	16.0	16.0
Advances Growth	40.1	29.8	27.0	22.0	22.0
Investments Growth	22.3	11.4	10.0	12.0	12.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	25.0	25.0	25.0	30.0	35.0
GRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Asset:	9.4	8.2	7.7	7.6	7.6
Avg. Cost-Int. Bear. Liab.	5.7	4.7	4.7	4.8	4.9
Interest Spread	3.7	3.6	3.0	2.8	2.7
Net Interest Margin	4.1	3.9	3.3	3.2	3.2

Profitability Ratios (%)					
RoE	38.3	26.0	16.3	22.7	23.5
RoA	19	14	0.9	12	12
Int. Expended/Int. Earned	56.8	53.0	57.3	57.8	58.2
Other Inc./Net Income	38.6	26.4	25.6	20.9	19.1

Efficiency Ratios (%)					
Op. Exps./Net Income	36.5	41.0	45.6	44.6	42.4
Empl. Cost/Op. Exps.	66.6	58.1	59.0	58.8	58.3
Busi. per Empl. (Rs m)	24.5	31.3	38.8	46.1	54.0
NP per Empl. (Rs lac)	0.4	0.3	0.2	0.4	0.5

Asset-Liability Profile (%)					
Adv./Deposit Ratio	52.6	56.0	60.2	63.3	66.6
Invest./Deposit Ratio	51.6	47.1	43.9	42.4	40.9
G-Sec/Invest. Ratio	83.9	87.5	87.5	85.9	84.4
Gross NPAs to Adv.	3.4	2.9	2.5	2.3	2.1
Net NPAs to Adv.	0.9	0.6	0.4	0.3	0.3
CAR	14.1	12.9	12.4	11.9	11.9
Tier 1	8.4	7.6	7.2	6.8	6.8

VALUATION					
Book Value (Rs)	30.8	36.7	40.4	47.4	56.1
Price-BV (x)	2.1	1.7	1.6	1.3	1.1
Adjusted BV (Rs)	29.3	35.4	39.4	46.5	54.8
Price-ABV (x)	2.2	1.8	1.6	1.4	1.2
EPS (Rs)	9.5	8.8	6.3	10.0	12.2
EPS Growth (%)	61.0	-7.4	-28.5	59.0	21.8
Price-Earnings (x)	6.7	7.2	10.1	6.3	5.2
OPS (Rs)	20.0	18.2	16.9	18.9	22.3
OPS Growth (%)	54.0	-8.8	-7.0	11.7	18.0
Price-OP (x)	3.2	3.5	3.7	3.3	2.8

E: MOST Estimates



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Disclosure of Interest Statement

Vijaya Bank

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| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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