



Banking earnings preview

Indian banking sector finally set to see a joyful quarter

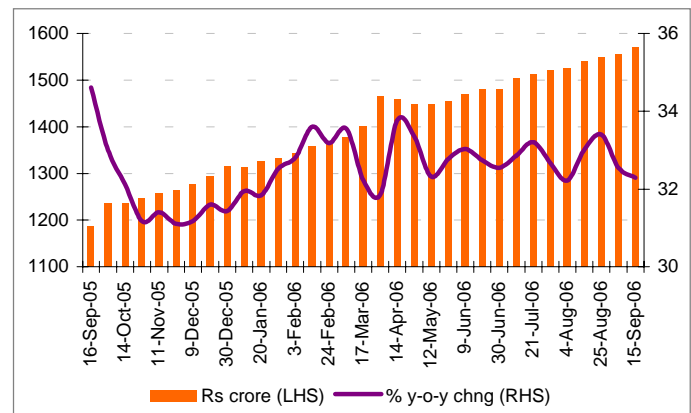
- ◆ We expect Indian public sector banks (PSBs) excluding State Bank of India (SBI), to report a healthy year-on-year (y-o-y) growth of 20% in their net interest income (NII) and a strong growth of 32.5% in their earnings for Q2FY2007. SBI, an exception, is likely to report a decline in its earnings due to high loan recoveries in the same quarter last year.
- ◆ The private sector banks are likely to continue their strong performance, as their earnings are likely to grow at 27.4% year on year (yoy) for the same period.
- ◆ We expect the loan book of the PSBs to grow at a healthy rate of 18-20% and that of the private sector banks at 40-50%.
- ◆ The net interest margins (NIMs) are expected to remain stable as most of the banks have raised their prime lending rates over the last two quarters. The same should help them to mitigate the loss of income on account of non-payment of interest on cash reserve ratio (CRR) balances with the Reserve Bank of India.
- ◆ The strong performance at the operating level is likely to be aided by the declining 10-year government bond

yield, which should help the PSBs to reduce their mark-to-market losses to nil or a negligible level.

Loan book continues to grow strongly...

Despite an increase in the prime lending rates effected by most of the banks during the quarter, the loan book of the scheduled commercial banks continued the robust growth during Q2FY2007, growing by 32.3% yoy.

Stupendous loan growth continues unabated



Source: RBI, Sharekhan research

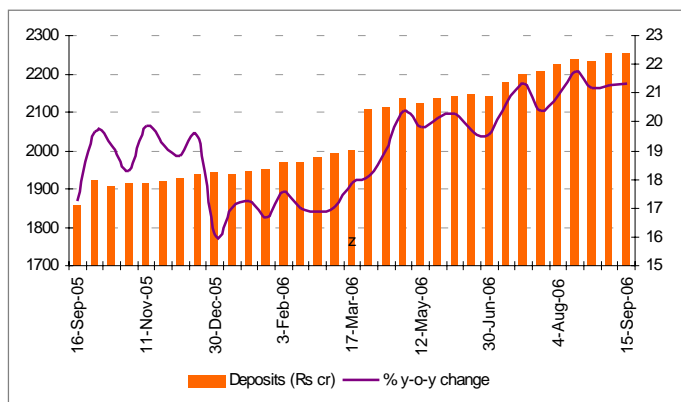
Quarterly estimates

	NII				Core operating profit				Net profit			
	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq	Q2FY07E	Q2FY06	% yoy	% qoq
Allahabad Bank	429.8	367.6	16.9	9.9	235.5	193.8	21.5	6.5	190.5	168.3	13.2	48.6
Andhra Bank	357.2	288.6	23.8	6.5	224.4	171.5	30.8	13.0	153.5	132.9	15.5	31.9
BOB	1,015.2	781.8	29.9	15.1	574.1	380.7	50.8	4.6	290.5	259.1	12.1	77.9
BOI	734.8	578.6	27.0	-3.9	382.8	330.1	16.0	-18.1	201.6	132.2	52.5	-3.4
Canara Bank	940.2	806.7	16.6	-0.8	652.3	573.1	13.8	10.7	368.3	306.5	20.2	92.9
Corporation Bank	338.8	306.5	10.5	4.3	270.6	232.2	16.6	10.4	154.5	105.6	46.3	7.1
PNB	1,434.9	1,190.7	20.5	11.0	894.6	609.1	46.9	-0.5	532.0	422.0	26.1	44.7
UBI	662.4	602.3	10.0	4.4	375.6	324.8	15.7	-5.7	212.5	61.1	247.8	27.4
Total-PSBs excl SBI	5,913.3	4,922.8	20.1	6.1	3,609.9	2,815.3	28.2	1.2	2,103.4	1,587.7	32.5	41.5
State Bank of India	3,855.3	3,608.0	6.9	-0.7	2,135.0	1,736.2	23.0	-18.7	1,077.2	1,215.4	-11.4	34.7
HDFC Bank	837.5	612.1	36.8	2.4	569.1	458.7	24.1	-7.9	264.4	199.6	32.4	10.5
ICICI Bank	1,443.3	953.5	51.4	-2.2	1,240.0	804.1	54.2	8.5	723.6	580.1	24.7	16.8
UTI Bank	381.4	255.5	49.3	18.5	269.6	159.0	69.6	0.9	142.2	109.0	30.4	18.0
Total-private banks	2,662.2	1,821.1	46.2	1.8	2,078.7	1,421.8	46.2	2.5	1,130.2	888.7	27.2	15.4

...and so do the deposits

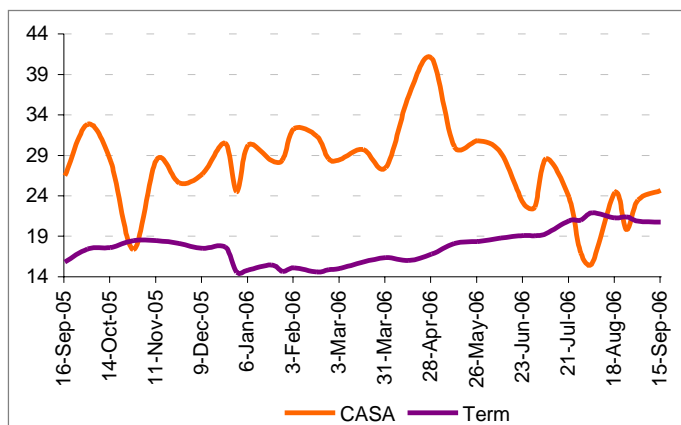
The deposits of the scheduled commercial banks also grew by a strong 21.3% yoy during Q2FY2007 with the demand deposits growing at 24.7% yoy and the term deposits growing at 20.8% yoy.

Strong growth in deposit mobilisation



Source: RBI, Sharekhan research

CASA deposits growing faster (% y-o-y change)



Source: RBI, Sharekhan research

NIM to remain stable

Over Q4FY2006 and Q1FY2007, the banks have substantially upped their deposit rates with the hike ranging between 25 basis points and 50 basis points across various maturities. Although the banks had commensurately raised the lending rates too, yet the same had not been able to mitigate the rising borrowing costs. Consequently, the pressure on the NIMs was clearly visible in these quarters.

With no significant increase in the interest rate visible going forward, we expect the pressure on the NIMs to ease a little going forward. With the full impact of the increase in the prime lending rates (of 25-50 basis points, that too despite a strong opposition from the finance ministry) to be felt in Q2FY2007, we expect the NIMs to improve in Q2FY2007 over Q1FY2007.

The strong growth in loan book and stable NIMs will also help the banks to mitigate loss of income on account of non-payment of interest on the CRR balances with the RBI.

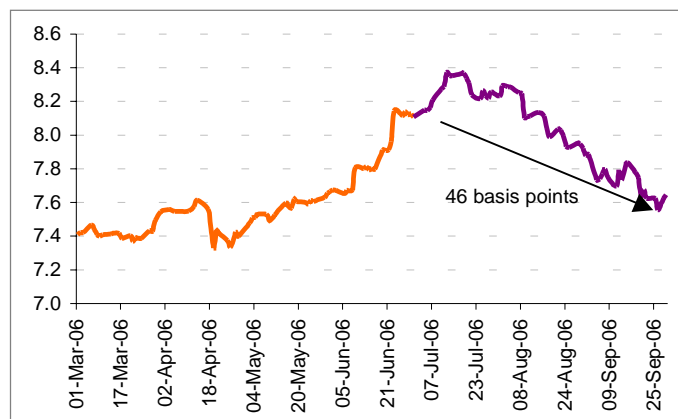
Strong NII growth backed by stable NIM and growing loan book

We expect the NII of the PSBs excluding SBI to grow by 20.1% and that of the private sector banks by 46.2% backed by the stable NIMs and the strong loan growth.

Mark-to-market losses to be lower or absent

With the 10-year government bond settling at approximately 46 basis points lower than its June 2006 level, we believe that the mark-to-market losses will be much lower for banks or may not be there at all.

10-year G-Sec yield declining (%)



Source: Bloomberg, Sharekhan research

Earnings to grow by 32.5% for PSBs and 27.2% for private banks

We expect the PSBs excluding SBI to report a healthy y-o-y growth of 20.1% in their NII and a strong growth of 32.5% in their earnings for Q2FY2007.

The growth is likely to be the highest for Bank of India at 52.4%, followed by Corporation Bank, in the range of 46%. Union Bank of India is likely to report a 247.8% growth in its earnings but primarily due to the low base effect. During the same quarter last year the bank had provided Rs235 crore for amortisation of its bond portfolio and the same was a one-time expense.

The only exception amongst the whole banking sector is the State Bank of India, which is likely to report a decline in its earnings due to a higher income from loan recoveries in Q2FY2006.

Amongst the private sector banks, HDFC Bank is likely to lead the pack with a 32% yoy earnings growth followed by UTI Bank, whose earnings are expected to grow by 30.4% yoy.

Valuation table

	Price	PER (x)			P/BV (x)			P/PPP		
	(Rs)	FY06	FY07E	FY08E	FY06	FY07E	FY08E	FY06	FY07E	FY08E
Allahabad Bank	89.9	5.7	6.1	4.1	1.1	1.0	0.8	4.6	5.0	3.3
Andhra Bank	93.7	9.4	8.8	7.1	1.6	1.4	1.3	5.4	4.6	3.8
BOB	289.4	12.8	10.8	7.6	1.3	1.2	1.1	4.1	3.6	3.0
BOI	166.7	11.6	10.8	9.3	1.6	1.5	1.3	3.9	3.3	2.9
Canara Bank	289.5	10.7	9.5	7.4	1.7	1.5	1.3	3.2	2.8	2.5
Corporation Bank	413.4	13.3	11.8	9.6	1.8	1.6	1.4	4.1	3.8	3.2
Punjab National Bank	539.1	11.8	10.4	8.3	1.9	1.6	1.4	5.2	5.1	4.3
State Bank of India#	1,039.1	12.4	11.6	9.1	2.0	1.7	1.5	4.3	4.1	3.8
Union Bank of India	136.0	10.2	7.5	6.1	1.5	1.3	1.1	3.6	3.1	2.7
HDFC Bank	930.6	33.2	25.8	19.8	5.5	4.7	3.9	12.9	9.9	7.7
ICIC Bank#	705.5	24.7	20.1	15.2	2.8	2.6	2.2	15.9	11.9	9.7
UTI Bank	388.0	22.2	18.4	14.5	3.8	3.2	2.7	9.6	8.1	6.3

The author doesn't hold any investment in any of the companies mentioned in the article.

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