

## Vijaya Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,360	VJYBK IN
	REUTERS CODE
S&P CNX: 3,664	VJBK.BO

5 May 2006

**Neutral**
*Previous Recommendation: Buy*
**Rs54**

	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)	433.5											
52-Week Range	72/49											
1,6,12 Rel.Perf.(%)	-10/-52/-105											
M.Cap. (Rs b)	23.5	3/06A	13,418	1,269	2.9	-66.7	18.5	1.4	12.4	7.8	0.4	1.4
M.Cap. (US\$ b)	0.5	3/07E	14,173	2,477	5.7	95.2	9.5	1.3	11.9	14.1	0.7	1.3
		3/08E	16,009	3,113	7.2	25.7	7.5	1.2	11.9	16.1	0.8	1.2

Vijaya Bank reported disappointing results for 4QFY06. NII declined 5% and provisions relating to NPAs and investment depreciation were significantly higher. The bank reported a loss of Rs345m against a net profit of Rs1.6b in 4QFY05. Asset quality deteriorated QoQ, with gross NPAs moving up from Rs49b to Rs54b (2.98% in 3QFY06 to 3.17% in 4QFY06). Net NPAs, however, declined from 0.97% in 3QFY06 to 0.85% in 4QFY06.

- ✍ Business growth lower than industry
- ✍ NII declines; margins contract
- ✍ Asset quality worsens – gross NPAs increase to 3.2%

Following the disappointing 4QFY06 results, we have downgraded our earnings estimates for FY07 and FY08, significantly. At 1.3x FY07E book value, the stock trades in line with other state-owned banks that offer sustainable earnings growth. We are downgrading our recommendation to **Neutral**. We would be monitoring the bank's performance over the next couple of quarters closely for any signs of a turnaround.

**QUARTERLY PERFORMANCE**

(RS MILLION)

	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Interest Income	4,962	5,094	5,429	5,459	5,550	5,715	5,953	5,900	20,943	23,118
Interest Expense	2,624	2,656	2,923	2,894	3,178	3,386	3,362	3,464	11,098	13,390
<b>Net Interest Income</b>	<b>2,337</b>	<b>2,437</b>	<b>2,506</b>	<b>2,565</b>	<b>2,372</b>	<b>2,329</b>	<b>2,591</b>	<b>2,436</b>	<b>9,845</b>	<b>9,728</b>
% Change (Y-o-Y)	39.0	28.4	6.4	5.0	1.5	-4.5	3.4	-5.0	17.5	-1.2
Other Income	1,144	834	688	870	1,027	941	731	992	3,538	3,690
<b>Net Income</b>	<b>3,481</b>	<b>3,271</b>	<b>3,194</b>	<b>3,435</b>	<b>3,399</b>	<b>3,269</b>	<b>3,322</b>	<b>3,428</b>	<b>13,383</b>	<b>13,418</b>
% Change (Y-o-Y)	7.1	-6.4	-7.9	0.3	-2.3	-0.1	4.0	-0.2	-1.8	0.3
Operating Expenses	1,308	1,389	1,352	1,443	1,376	1,634	1,612	1,613	5,492	6,235
<b>Operating Profit</b>	<b>2,173</b>	<b>1,883</b>	<b>1,842</b>	<b>1,992</b>	<b>2,023</b>	<b>1,635</b>	<b>1,710</b>	<b>1,815</b>	<b>7,891</b>	<b>7,182</b>
Other Provisions	737	1,449	1,076	900	1,944	536	731	2,177	4,162	5,388
Tax Provisions	460	-279	209	-468	-196	348	390	-17	-78	526
<b>Net Profit</b>	<b>976</b>	<b>714</b>	<b>556</b>	<b>1,559</b>	<b>275</b>	<b>751</b>	<b>588</b>	<b>-345</b>	<b>3,807</b>	<b>1,269</b>
% Change (Y-o-Y)	20.6	-25.6	-49.5	25.3	-71.8	5.2	5.7	-122.1	-7.4	-66.7
Cost to Income Ratio (%)	37.6	42.4	42.3	42.0	40.5	50.0	48.5	47.1	41.0	46.5
Interest Expense/Interest Income (%)	52.9	52.1	53.8	53.0	57.3	59.3	56.5	58.7	53.0	57.9
Other Income/Net Income (%)	32.9	25.5	21.5	25.3	30.2	28.8	22.0	28.9	26.4	27.5

E: MOST Estimates

Vijaya Bank reported disappointing results for 4QFY06. NII declined 5% and provisions relating to NPAs and investment depreciation were significantly higher. The bank reported a loss of Rs345m against a net profit of Rs1.6b in 4QFY05. Asset quality deteriorated QoQ, with gross NPAs moving up from Rs49b to Rs54b (2.98% in 3QFY06 to 3.17% in 4QFY06). Net NPAs, however, declined from 0.97% in 3QFY06 to 0.85% in 4QFY06.

### Business growth lower than industry

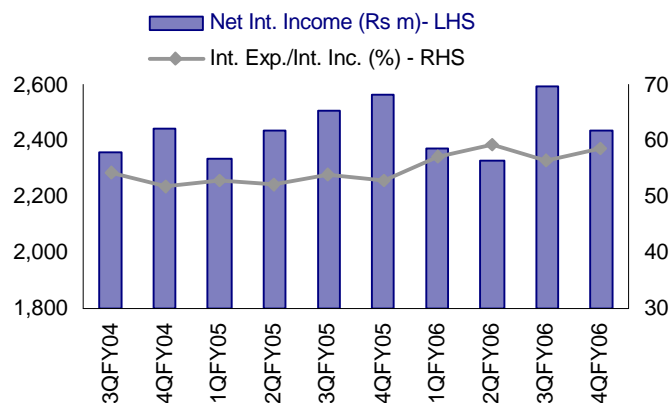
Vijaya Bank's business growth has been much lower than the industry. Gross loans have grown just 16% in FY06 to Rs171b. Growth in retail loans has also been in line with the overall loan book growth; the proportion of retail loans has been maintained at 34%. However, priority sector credit and agriculture credit have grown faster at 24% and 34%, respectively.

Deposits have grown at 8% during FY06 to Rs277b. Low cost deposits have grown faster and form 35.3% of total deposits in FY06 as against 32.6% in FY05. Loan-deposit ratio has expanded from 57% in FY05 to 62% in FY06. With a stronger thrust on growing the loan book, we expect this ratio to improve further, going forward.

### NII declines; margins contract

NII declined by 5% YoY to Rs2.4b in 4QFY06. For FY06, NII declined by 1% to Rs9.7b. Net interest margins declined sharply in FY06 to 3.22% from 3.56% in FY05. We believe that the management has recognized few accounts as non-performing during 4QFY06, which has resulted in no earnings from these accounts and in interest reversals during 4QFY06. Lower yield on loans (8.85% against 9.3% in FY05) coupled with lower investment yields (8bp) and rising cost of deposits (16bp) has resulted in margin compression in FY06. To improve margins from here, we believe that the management will have to build a strong loan book pipeline and shed its excess treasury book.

TREND IN NII



Source: Company/Motilal Oswal Securities

### Higher provisions result in a loss for the quarter

The bank has made very high NPA provisions of Rs1b during 4QFY06, as asset quality worsened. It also took a hit of Rs690m during the quarter towards depreciation of the investment book. Higher provisions resulted in the bank posting a Rs345m loss during 4QFY06.

For FY06, the bank has made provisions of Rs1.3b towards NPAs and Rs2.6b towards the investment book. We believe that provisions are likely to decline during FY07, as a large part of treasury losses have already been taken care of in FY06. However, the bank is likely to transfer securities to HTM during 1QFY07 and accordingly take a hit in 1QFY07.

### Treasury income is still significant

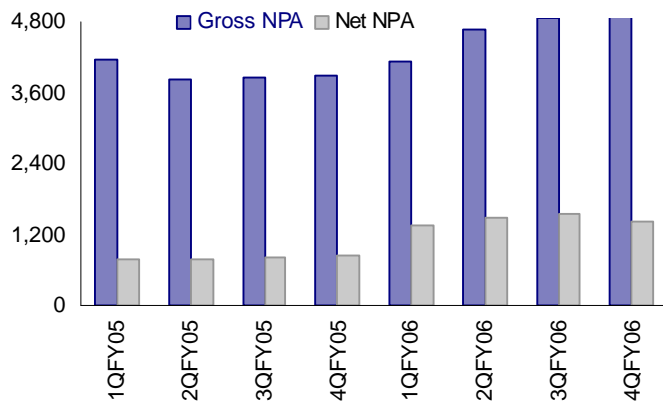
Vijaya Bank's treasury profits for FY06 have remained flat at Rs1.48b and constitute 82% of its pre-tax profit. We expect income from treasury to decline significantly in FY07. Growth in non-interest income other than treasury was also modest at 7% in FY06 at Rs2.2b.

### Asset quality worsens; gross NPAs increase to 3.2%

While net NPAs have declined by 12bp on QoQ basis to 0.85%, gross NPAs have increased from 2.98% in 3QFY06 to 3.17% in 4QFY06. We believe that the management has recognized few accounts as non-performing during 4QFY06,

which has resulted in no earnings from these accounts during the quarter, worsened asset quality and higher provisions.

DETERIORATING ASSET QUALITY



Source: Company/Motilal Oswal Securities

**Downgrade to Neutral**

Following the disappointing 4QFY06 results, we have downgraded our earnings estimates for FY07 and FY08, significantly. At 1.3x FY07E book value, the stock trades in line with other state-owned banks that offer sustainable earnings growth. We are downgrading our recommendation to **Neutral**. We would be monitoring the bank’s performance over the next couple of quarters closely for any signs of a turnaround.

## Vijaya Bank: an investment profile

### Company description

Vijaya Bank, established in 1932, is a mid-sized Bangalore-based state-owned bank having a balance sheet size of Rs240b+. The bank has made public offerings in 2001 and 2003, after which the government's stake has reduced to 54%. It has a network of 923 branches, with approximately 309 branches under CBS covering almost 65% 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 0.85%
- ✍ Sufficient capital adequacy ratio of 12.2%

### Key investment risks

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

### Recent developments

- ✍ Mr PP Mallya, formerly Executive Director, Syndicate Bank has taken over as Chairman & Managing Director effective 1 April 2006
- ✍ Mr T Valliappan was recently appointed Executive Director of Vijaya Bank

### Valuation and view

- ✍ Healthy loan growth, clean asset portfolio makes Vijaya Bank an efficient bank
- ✍ The stock trades at 9.5x FY07E EPS and 1.3x FY07E BV.

### Sector view

- ✍ Loan growth of 30% in FY06; likely to remain strong in FY07
- ✍ Volatility in interest rates would impact treasury income
- ✍ Benefits of significant improvement in asset quality not yet factored in earnings, valuations
- ✍ We maintain an overweight stance on the sector

#### COMPARATIVE VALUATIONS

		VIJAYA BANK	PNB	CANARA
P/E (x)	FY07E	9.5	7.6	7.1
	FY08E	7.5	6.4	6.2
P/ABV (x)	FY07E	1.3	1.3	1.3
	FY08E	1.2	1.1	1.2
RoE (%)	FY07E	14.1	18.5	19.3
	FY08E	16.1	18.6	18.8
RoA (%)	FY07E	0.7	1.3	1.1
	FY08E	0.8	1.3	1.1

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	53.9	53.9	53.9
Domestic Institutions	6.5	7.2	7.9
FII's/FDIs	16.6	16.9	14.7
Others	23.0	22.0	23.5

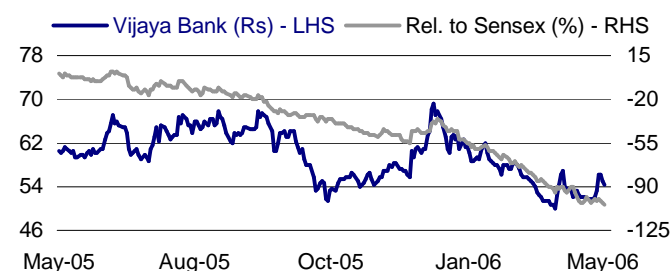
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	5.7	8.5	-32.8
FY08	7.2	11.2	-35.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
54	55	-	Neutral

#### STOCK PERFORMANCE (1 YEAR)



**INCOME STATEMENT** (Rs Million)

Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	19,401	20,943	23,118	26,761	31,945
Interest Expended	11,023	11,098	13,390	15,688	19,137
<b>Net Interest Income</b>	<b>8,378</b>	<b>9,845</b>	<b>9,728</b>	<b>11,073</b>	<b>12,809</b>
Change (%)	30.2	17.5	-12	13.8	15.7
Other Income	5,257	3,538	3,690	3,100	3,200
<b>Net Income</b>	<b>13,635</b>	<b>13,383</b>	<b>13,418</b>	<b>14,173</b>	<b>16,009</b>
Change (%)	37.8	-18	0.3	5.6	13.0
Operating Expenses	4,978	5,492	6,235	6,933	7,685
<b>Operating Income</b>	<b>8,656</b>	<b>7,891</b>	<b>7,182</b>	<b>7,240</b>	<b>8,324</b>
Change (%)	100.2	-8.8	-9.0	0.8	15.0
Other Provisions	3,128	4,162	5,388	3,800	4,000
<b>PBT</b>	<b>5,529</b>	<b>3,729</b>	<b>1,795</b>	<b>3,440</b>	<b>4,324</b>
Tax	1,415	-78	526	963	1,211
Tax Rate (%)	25.6	-2.1	29.3	28.0	28.0
<b>PAT</b>	<b>4,113</b>	<b>3,807</b>	<b>1,269</b>	<b>2,477</b>	<b>3,113</b>
Change (%)	109.3	-7.4	-66.7	95.2	25.7
Proposed Dividend	1,223	1,225	434	867	1,084

**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	12,392	14,002	16,031
<b>Net Worth</b>	<b>13,355</b>	<b>15,892</b>	<b>16,727</b>	<b>18,337</b>	<b>20,366</b>
<b>Deposits</b>	<b>210,151</b>	<b>256,180</b>	<b>277,093</b>	<b>324,199</b>	<b>379,312</b>
Change (%)	23.5	21.9	8.2	17.0	17.0
Borrowings	3,366	6,408	7,690	8,459	9,305
Other Liabilities & Prov.	13,838	14,875	17,106	19,672	22,623
<b>Total Liabilities</b>	<b>240,710</b>	<b>293,355</b>	<b>318,616</b>	<b>370,667</b>	<b>431,607</b>
Current Assets	11,186	16,146	13,938	16,233	18,133
Investments	108,370	120,687	124,308	136,739	150,413
Change (%)	22.3	11.4	3.0	10.0	10.0
Advances	110,453	143,358	166,582	203,230	247,940
Change (%)	40.1	29.8	16.2	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
<b>Total Assets</b>	<b>240,710</b>	<b>293,355</b>	<b>318,616</b>	<b>370,667</b>	<b>431,607</b>

**ASSUMPTIONS** (%)

Deposit Growth	23.5	21.9	8.2	17.0	17.0
Advances Growth	40.1	29.8	16.2	22.0	22.0
Investments Growth	22.3	11.4	3.0	10.0	10.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	28.2	28.3	10.0	20.0	25.0
CRR	4.5	5.0	5.0	5.0	5.0

E: M O S t Estimates

**RATIOS**

Y/E MARCH	2004	2005	2006E	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning Asset	9.4	8.2	7.9	8.0	8.2
Avg. Cost-Int. Bear. Liab.	5.7	4.7	4.9	5.1	5.3
Interest Spread	3.7	3.6	3.0	2.9	2.9
Net Interest Margin	4.1	3.9	3.3	3.3	3.3

**Profitability Ratios (%)**

RoE	38.3	26.0	7.8	14.1	16.1
RoA	19	14	0.4	0.7	0.8
Int. Expended/Int. Earned	56.8	53.0	57.9	58.6	59.9
Other Inc./Net Income	38.6	26.4	27.5	21.9	20.0

**Efficiency Ratios (%)**

Op. Exps./Net Income	36.5	41.0	46.5	48.9	48.0
Empl. Cost/Op. Exps.	66.6	58.1	60.8	60.7	61.4
Busi. per Empl. (Rs m)	24.5	31.3	36.4	41.5	49.0
NP per Empl. (Rs lac)	0.4	0.3	0.1	0.2	0.3

**Asset-Liability Profile (%)**

Adv./Deposit Ratio	52.6	56.0	60.1	62.7	65.4
Invest./Deposit Ratio	51.6	47.1	44.9	42.2	39.7
G-Sec/Invest. Ratio	83.9	87.5	93.4	93.4	93.4
Gross NPAs to Adv.	3.4	2.9	2.7	2.5	2.3
Net NPAs to Adv.	0.9	0.6	0.4	0.4	0.4
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	38.6	42.3	47.0
Price-BV (x)	1.8	1.5	1.4	1.3	1.2
Adjusted BV (Rs)	29.3	35.4	37.6	41.2	45.5
Price-ABV (x)	1.8	1.5	1.4	1.3	1.2
EPS (Rs)	9.5	8.8	2.9	5.7	7.2
EPS Growth (%)	61.0	-7.4	-66.7	95.2	25.7
Price-Earnings (x)	5.7	6.2	18.5	9.5	7.5
OPS (Rs)	20.0	18.2	16.6	16.7	19.2
OPS Growth (%)	54.0	-8.8	-9.0	0.8	15.0
Price-OP (x)	2.7	3.0	3.3	3.2	2.8

E: M O S t Estimates



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**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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