

Union Bank of India

 BSE code: 532477
 NSE code: UNIONBANK

CMP: Rs 160
Target: Rs 198
BUY
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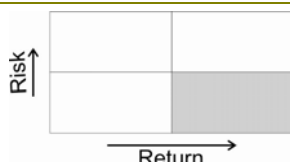
Company data

Particulars	
Market cap (Rs bn / US\$ bn)	80.1/ 2.0
Outstanding equity shares (bn)	505.1
52-week high/low (Rs)	191/84
Quarterly average daily volume	458,884

Financial snapshot

Particulars	FY07	FY08E	FY09E
NII (Rs bn)	27.9	32.1	36.6
Growth (%)	17.5	15.0	14.1
Adj net profit (Rs bn)	8.5	10.4	12.4
Growth (%)	25.2	23.2	19.1
FDEPS (Rs)	16.7	20.6	24.6
Growth (%)	25.2	23.2	19.1
P/ABV (x)	2.0	1.6	1.4
ROE (%)	17.3	18.7	19.2

Risk-return profile



Shareholding pattern

(%)	Sept-07	Jun-07
Promoters	55.4	55.4
FIIIs	19.6	19.7
Banks & FIs	11.5	10.9
Public	13.5	14.0

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Union Bank	160	1.5	3.0	45.5
Sensex	18,771	11.0	19.5	32.0
Bankex	9,924	10.9	19.8	37.1

 Company website: www.unionbankofindia.com

Robust profit growth

Sluggish credit offtake resulted in lower-than-expected NII growth for Union Bank of India (UBI). However, robust non-interest income, an improving cost-to-income ratio and lower provisioning expenses expanded profitability beyond our estimates. Net profit for the quarter increased 42% YoY to Rs 2.8bn as against Rs 2.5bn expected. The management has guided for 24% business growth with an ROE of ~20% for FY08. While the growth in H1FY08 was subdued, we are keeping our estimates unchanged considering the positive management guidance. We continue with our Buy recommendation on the stock with a target price of Rs 198.

Actual vs estimated performance

(Rs bn)	Actual	Estimated	% Variance
Net interest income	6.7	7.6	(11.2)
PPP	5.3	5.3	0.2
PAT	2.8	2.5	11.8
EPS (Rs)	5.5	4.9	11.8

Source: Company, Religare Research

Quarterly results

(Rs bn)	Q2FY08	Q2FY07	% Chg YoY	Q1FY08	% Chg QoQ
Int on advances	16.3	12.3	32.2	15.4	5.9
Inc on invest	5.9	5.3	11.1	5.6	5.3
Int on bal with RBI etc.	0.4	0.1	190.3	0.2	112.3
Interest income	22.5	17.7	27.2	21.1	6.8
Interest expenses	15.8	11.4	38.2	13.4	18.1
Net interest income	6.7	6.3	7.2	7.7	(12.8)
Other income	2.7	1.9	41.2	1.8	51.9
Total Income	9.4	8.2	15.2	9.5	(0.6)
Operating expenses	4.2	3.9	6.2	4.2	(2.1)
Provisions and W/off	1.0	1.2	(20.0)	1.6	(37.2)
PBT	4.3	3.1	40.6	3.7	16.4
Taxes	1.6	1.1	38.2	1.5	6.9
PAT	2.8	1.9	42.0	2.3	22.5
Cost/Income ratio (%)	44.0	47.7	-	44.7	-

Source: Company, Religare Research

Result highlights

Asset yields slowed due to a greater share of liquid investments

Below-par growth in NII...

Net interest income (NII) growth for the quarter was muted at 7% YoY to Rs 6.7bn. The lower growth could be attributed to a higher 98bps increase in the cost of funds to 6.02% as compared to a 78bps rise in yield on assets to 8.58%. Asset yield slowed down because a greater proportion of funds were parked in liquid investments, and hence the returns thereon were classified as other income and not interest income.

...with a NIM of 2.56%

The bank reported a net interest margin (NIM) of 2.56% for the quarter as against 2.76% in Q2FY07. Adjusted for the income classified as non-interest income, the NIM would have increased by 20bps YoY. At the end of September 2007, UBI continues to hold liquid investments worth Rs 15bn as compared with Rs 28bn held at end-H1FY07.

Robust 77% YoY rise in non-interest income

Non-interest income for the quarter rose substantially by 77% YoY to Rs 2.7bn. Adjusted for treasury gains the growth was lower at 47% led by higher recoveries and profit from exchange transactions.

Break up of non-interest income

	Q2FY08	Q2FY07	Var (%)
Comm, exch and brokerage	690.0	620.0	11.3
Trading gains (adj for amortisation exp)	440.0	(10.0)	-
Profit on exchange transactions	610.0	380.0	60.5
Miscellaneous income	970.0	540.0	79.6
Recoveries	530.0	260.0	103.8
Total	2,710	1,530	77.1

Source: Company, Religare Research

Credit to the key segments of SME, agriculture and retail have shown robust growth

Advances growth slows to 11.6% but offtake from key segments picks up

UBI's overall business growth has been lower at 16.7% YoY to Rs 1,634bn as at the end of September 2007. Deposits increased 20.7% to Rs 948bn, but advances registered slackened growth of 11.6% to Rs 686bn. Although the overall credit offtake remained low, key segments like SME, agriculture and retail have shown robust growth. The management believes that with continued credit growth in these segments and expected improvement in loan offtake from corporates, UBI would be able to meet its guidance for FY08.

Decline in CASA deposits to 32.5%

The proportion of CASA deposits has declined to 32.5% at the end of Q2FY08 from 33.2% at the end of Q1FY08 led by a slower growth in saving bank account deposits.

Yield on investments dips 21bps YoY

Maturity of HTM investments and a substantial amount of funds in liquid investments has raised the proportion of AFS holdings. With income on liquid investments not accounted for as interest income, yield on investments dropped 21bps YoY to 7.4%.

Lower operating expenses expand PAT 42% YoY

Operating expenses for the quarter increased at a slower pace of 6.2% YoY to Rs 4.2bn, resulting in an improved cost-to-income ratio of 44% compared to 47.7% at the end of Q2FY07. UBI has provided Rs 500mn towards the new AS-15 norms during the H1FY08 and expects to provide a total of Rs 1bn in the current fiscal. The new norms would require a total provisioning of ~Rs 3.5bn which would be booked gradually. Lower provisioning expenses aided PAT growth of 42% YoY to Rs 2.8bn.

Asset quality continues to show improvement

The bank's gross and net NPAs stood at 2.4% and 0.65% at the end of September 2007 as compared to 2.8% and 0.78% at the end of Q1FY08 respectively. Higher recoveries and a lower incremental slippage ratio aided the improvement.

CAR at 11.6%

The bank's capital adequacy ratio (CAR) at the end of September 2007 improved to 11.6% with tier I capital at 7.4%. UBI has room to raise Rs 18bn through the issue of hybrid instruments, of which Rs 4bn would be towards tier I capital. The bank intends to raise Rs 3bn through the issue of hybrid tier I instruments.

Management maintains guidance for FY08

UBI has guided for deposit growth of 23% YoY to Rs 1,050bn and advances growth of 25% YoY to Rs 850bn. ROE is guided to be close to 20% whereas ROA would be ~1%. The management expects continual improvement in asset quality with gross NPAs targeted to fall below 2% with a slippage ratio of under 1.25%. The bank aims to achieve a NIM of 3% with a cost-to-income ratio of 41%.

Growth to pick up in H2; Maintain Buy

Although UBI has reported lower-than-expected business growth during the first half of the fiscal, we believe that it would still be able to achieve its full year targets. Growth in advances would be higher in H2FY08 due to the lower base in H2FY07 when advances grew by mere 3.6% due to the bank's focus on high-quality loan disbursements over absolute growth. Redemption or liquidation of liquid investments would result in higher yields going forward. Further, UBI has cut interest rates on deposits which could help to increase NIMs. The bank has also introduced new schemes to attract low-cost saving bank account deposits.

Strong growth in non-interest income, an improving cost-to-income ratio and lower incremental slippage would continue to fuel UBI's profitability. The stock is currently trading at a P/ABV of 1.4x on FY09E. We maintain our estimates and reiterate Buy with a DDM-based target price of Rs 198. At our target price, the stock would trade at a P/ABV of 1.7x on FY09E.

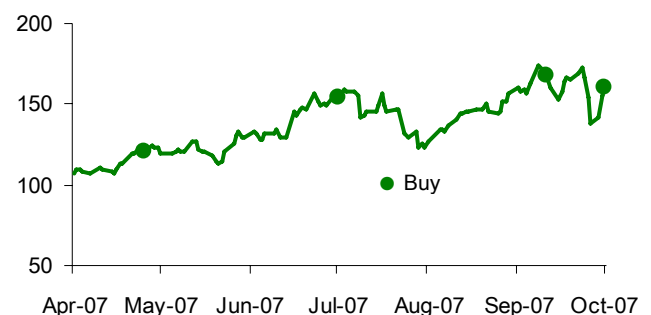
Growth targets to be achieved despite subdued H1FY08; Maintain Buy

Recommendation history

Date	Event	Reco price	Tgt price	Reco
21-May-07	Results Update	121	151	Buy
25-Jul-07	Results Update	154	191	Buy
5-Oct-07	Quarterly Preview	167	198	Buy
26-Oct-07	Results Update	160	198	Buy

Source: Religare Research

Stock performance



Source: Religare Research

Financials

Profit and Loss statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Interest earned	58.6	73.8	87.4	102.7
Interest expended	34.9	45.9	55.3	66.1
Net interest income	23.7	27.9	32.1	36.6
Growth (%)	15.0	17.5	15.0	14.1
Non-interest income	4.9	6.9	7.6	8.4
Comm, Exchange & Brokerage	3.7	4.7	5.4	6.3
Growth (%)	(35.5)	38.8	10.7	11.2
Operating expenses	14.0	14.8	16.7	18.5
Pre-provisioning profits	14.7	20.0	23.0	26.6
Growth (%)	(6.8)	36.4	15.1	15.4
Provisions & contingencies	5.7	6.2	7.5	8.1
PBT	8.9	13.8	15.5	18.5
Income tax, Interest tax	2.2	5.4	5.1	6.1
Net profit	6.8	8.5	10.4	12.4
Growth (%)	(6.1)	25.2	23.2	19.1

Source: Company, Religare Research

Balance sheet

(Rs bn)	FY06	FY07	FY08E	FY09E
Cash in hand & bal with RBI	43.9	59.2	68.6	80.7
Balance with banks, Money at call	20.0	25.1	27.7	29.7
Investments	259.2	279.8	320.4	366.8
Advances	533.8	623.9	739.3	872.3
Fixed assets (net)	8.1	8.2	8.5	8.8
Other assets	26.3	30.6	33.2	37.1
Total assets	891.3	1,026.8	1,197.7	1,395.4
Equity capital	5.1	5.1	5.1	5.1
Reserves & surplus	40.5	46.8	54.7	64.2
Net worth	45.6	51.9	59.7	69.3
Deposits	740.9	851.8	1,008.5	1,186.8
Current deposits (a)	59.8	86.2	101.3	118.5
Savings bank deposits (b)	180.0	207.6	254.3	307.8
Term deposits (c)	501.2	557.9	652.8	760.5
Borrowings (incl sub-ord bonds)	67.4	76.4	89.7	100.9
Other liabilities & provisions	37.3	46.7	39.8	38.4
Total liabilities	891.3	1,026.8	1,197.7	1,395.4

Source: Company, Religare Research

Key ratios

Year-end March	FY06	FY07	FY08E	FY09E
Per share data				
Shares outstanding (mn)	505.1	505.1	505.1	505.1
FDEPS (Rs)	13.4	16.7	20.6	24.6
DPS (Rs)	3.5	3.5	4.5	5.0
Book value (Rs)	90.2	102.7	118.3	137.2
Adjusted book value (Rs)	64.5	81.8	97.6	116.3

Valuation ratios

P/E (x)	12.0	9.6	7.8	6.5
P/BV (x)	1.8	1.6	1.4	1.2
P/ABV (x)	2.5	2.0	1.6	1.4

Earnings quality (%)

Net interest margin	3.1	3.0	3.0	2.9
Yield on advances	8.0	8.8	9.2	9.2
Yield on investments	8.0	8.8	9.2	9.2
Cost of funds	4.6	5.1	5.3	5.3
Cost/Income	48.9	42.5	42.0	41.0
Return on average net worth	16.5	17.3	18.7	19.2
Return on average assets	0.8	0.9	0.9	1.0

Growth ratios (%)

Net interest income	15.0	17.5	15.0	14.1
Other income	(35.5)	38.8	10.7	11.2
Total income	1.3	21.2	14.2	13.5
Pre-provisioning profit	(6.8)	36.4	15.1	15.4
Net profit	(6.1)	25.2	23.2	19.1
Advances	33.1	16.9	18.5	18.0
Deposits	19.8	15.0	18.4	17.7

Asset quality

Proportion of low-cost deposits (%)	32.4	34.5	35.3	35.9
Credit-Deposit ratio (x)	72.0	73.2	73.3	73.5
Investment/Deposit (%)	35.0	32.9	31.8	30.9
Net NPA ratio	1.6	1.0	0.8	0.7
CAR	11.4	12.8	11.6	11.0
Tier-I ratio	7.3	7.8	7.0	6.6

Source: Company, Religare Research

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Recommendation parameters

Large-caps*	> 10%	< - 5%	Returns	Absolute
	BUY	SELL		
Mid-caps**	> 25%	< 10%		

**Market cap over US\$ 1bn **Market cap less than US\$ 1bn*

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