UNITED BANK OF INDIA

Moving in the right direction

We recently interacted with the management of United Bank of India (UBI). Mr. Sen, after taking over as CMD in March 2009, has initiated steps to improve the bank's operating and financial metrics. In Q4FY10 itself positive trends were visible in a few of the operating metrics, viz., improved NIMs, higher fee income, better operating efficiency, though asset quality disappointed due to higher restructuring and slippages. Following are the key takeaways of our interaction:

Balance sheet restructuring to lead to better profitability

Advances: Run down low yield bulk advances; increase proportion of retail advances

- Management is focused on reducing the share of low yielding bulk advances (which stood at INR 72 bn; 20% of FY09 advances). The portfolio has been allowed to run down to a larger extent—brought down to INR 27 bn by FY10, less than 5% of advances—and UBI will keep it at bare minimum level by September 2010.
- UBI had resorted to short term corporate loans in H1FY10 (in a bid to step up balance sheet growth—41% growth), which led to subdued yield on advances at 9.5% and lower margins of ~2.2% in H2FY10. However, the bank is consciously not adding exposure to yields less than 10%.
- Moreover, the bank will focus on increasing the proportion of relatively higher yielding retail (13% of advances) and SME portfolios (15%) to ~20% each. It disbursed INR 5 bn to telecom companies for 3G auction (sanction was of INR 8 bn) by way of short term loans.
- Management will try to balance growth with capital and does not target credit growth beyond 23% over the next 12 months.

Deposits: Shed wholesale CDs and reprice high cost deposits

- While some high cost deposits were repriced in the past six months, UBI still carries deposits worth INR 24 bn, out of a total deposit base of INR 680 bn, raised at 9% plus. These are expected to re-price over the next six months.
- The bank has aggressively resorted to wholesale CDs to fund asset growth in H1FY10, which a couple of quarters ago constituted ~20% of deposits. Management targets reducing it to less than 10% of the deposit base.
- CASA deposits once again recovered to 38% of total deposits in FY10 led by 27% growth in savings deposits. Management expects to maintain it at the current level with an upward bias over the next 12-18 months.
- Initiatives on liabilities will ensure that cost of funds currently at 5.9% will come off to 5.75% over the next couple of quarters.
- It is amongst the few banks to have hiked deposit rates in the past one month. But it was more to do with realignment of rates with other banks.

June 30, 2010

Reuters : UBOI.BO *Bloomberg : UNTDB IN*

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA

CMP	:	INR 81
52-week range (INR)	:	90 / 66
Share in issue (mn)	:	316.4
M cap (INR bn/USD mn)	:	25.6 / 552.3
Avg. Daily Vol. BSE/NSE ('000)	:	3,042.7

SHARE HOLDING PATTERN (%)

Promoters*	:	84.2
MFs, FIs & Banks	:	2.4
FIIs	:	1.2
Others	:	12.2
* *Promoters pledged shares (% of share in issue)*	:	*Nil*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	3.5	3.4	(0.1)
3 months	(0.3)	18.6	18.9
12 months	21.0	18.2	(2.7)

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Room for improvement on CD ratio

UBI's CD ratio is expected to increase from the current 63% as the bank sheds excess wholesale CDs and steps up asset growth. It expects the ratio to improve to 65-70**%** in the near term.

With restructuring of assets and liabilities, management expects to sustain margins at over 2.5% in FY11E from 2% in FY10.

Non-interest income: Significant room for improvement

Currently, the share of fee income is less than 10% of total income against industry average of more than 16%. Management believes there is significant room to put to use its underleveraged platform:

- Under the new management, the fee structure has been revised from May 1, 2010. In the past four years, UBI's fee structure had not undergone any change.
- Having already migrated to CBS, UBI believes new avenues for fee-based income via introduction of a cash management services product is set to open.
- Focus is to build Letter of Credit/Bank Guarantee commission and fund-based fee income like loan processing fees and forex income.
  Given the underleveraged platform and management's focus on non-fund based income, management expects fee income to grow faster than the loan book and increase its share in the net revenue income to around **13%** by FY12E.

Operating efficiency: Moving in the right direction

Currently, UBI is running at a high cost-to-income ratio of **55%**. Management believes the ratio could come off closer to **50%** given the following:

- Currently, depreciation on technology is at INR 0.9 bn annually, which will run down over the next two years.
- Benefit from retirement of high-cost employees will steadily increase by replacing them with low cost and relatively aggressive young work force.

Gross NPLs to be contained below 3%; better and timely monitoring

- UBI's gross NPLs increased to 3.2% from 2.5% in Q3FY10 due to higher slippages (2.7% in FY10). To some extent, the change in management has led to higher slippages as a preemptive measure. Restructuring was higher in H2FY10 and the restructured pool in FY10 stood at INR 24.8 bn **(5.8% of loans**). Of this, ~11% has slipped into NPLs; a large part came in Q4FY10. There have been a few more slippages post FY10 primarily accruing from three-four accounts.
- Coverage ratio has come off marginally to 43% in Q4FY10 (48% in Q3FY10) which including technical write-off is at 67%.
- UBI has agri debt of INR 320 mn (eligible under debt waiver scheme) of which till date it has realised INR 30 mn.
- Management expects to contain gross NPLs below 3% going forward. It has set up a specialised NPL recovery cell under a dedicated GM along with two DGMs which will ensure pick up in recoveries. Monitoring systems have been strengthened and it now follows monthly generation of reports to identify chronic region/variance.

Higher AFS a misnomer

- UBI's share of AFS at **35%** appears risky as it will expose the bank's P&L to mark-to-market hits. However, a closer look at the composition of the AFS portfolio reveals that it includes liquid schemes and CDs that are not subject to mark-to-market hits. Excluding these investments, the share of AFS in the statutory liquidity ratio (SLR) portfolio is limited to 18%, which we believe is manageable.

- However, the risk the bank carries is in the form of a longer duration of 3.2 years for the AFS portfolio.

Capital adequacy: Received another tranche from government

The bank's capital adequacy currently stands at 12.8% (with tier 1 at 8.16%). It has recently received a capital infusion of INR 2.5 bn in the form of preference share capital from the Government of India. In total, it has received INR 8 bn, with INR 5.5 bn till March 2010.

Outlook and valuations: Moving towards profitability

Management expects the bank's RoA to improve closer to 0.8% by FY12E driven by better margins, lower opex/assets, and lower credit cost. Management stated that it will try to balance growth with capital and is not targeting credit growth beyond 23%. The stock is currently trading at 0.9x FY10 book.

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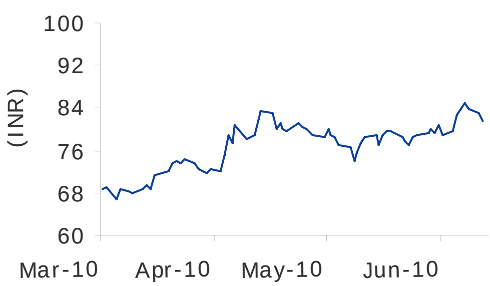
Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Manappuram General Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Syndicate Bank, Union Bank Of India, ING Vysya, Yes Bank

United Bank of India



Recent Research

Date	Company	Title	Price (INR)	Recos
29-Jun-10	**Banking**	Base rate set to roll; *Sector Update*		
28-Jun-10	**Life Insurance**	IRDA's final guidelines: Near-term pain, long-term gain; *Sector Update*		
24-Jun-10	**Life Insurance**	Private insurers' WNRP-individual growth at 14% in May; *Monthly Update*		
27-May-10	**Life Insurance**	IRDA plans to cap surrender charges; negative for margins, volumes; *Sector Update*		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	101	56	9	169

*3 stocks under review

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	53	13

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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