

Industry Focus

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India Banks

3Q09 Results Review: Looked Good, but Doesn't Feel So

- **Well ahead qualitatively and quantitatively, but rising concerns** — Banks reported strong 3Q09 results with profits up 31% yoy (22% expectations), core profits up a healthy 26% yoy, loan growth remained robust at 26% yoy, and only limited 'reported' asset deterioration. While the strong headlines should suggest cheer, we believe a rising sense (and some indications) of brewing and broad-based (and still unrecognized) asset quality pressures suggest a cautionary outlook.
- **Strong and qualitative sector P&L** — The bank sector P&L is considerably above expectations. 3Q09 profits were up 31% yoy (22% expectations), pre-provision profits (ex-trading gains) were up 26% backed by rising margins (+35bps), 10% fee income growth was healthy, and there were bond write-backs. While loan loss provisioning charges were up 28% yoy and cost pressures evident (notably pension charges), the strong fixed income trading environment and portfolio write-backs more than offset these pressures. Overall, we view 3Q09 as a strong P&L performance.
- **Asset quality appears OK, but may not be the case** — Asset quality has been a key concern but while deterioration was evident in 3Q09 (+27% qoq, 0.4% of loans), the numbers (and most management comments) suggest only limited pain. We view the reasons to be more cautious as: a) aggressive restructurings appear underway (RBI sanctioned, not reported yet), b) meaningfully slower and slightly cash strapped economy, and c) feed-back from a few bank managements (smaller banks). We believe underlying asset quality pressure is building and while deterioration is unlikely to show in March 2009, it will likely catch up sometime and until then we view there will be stock overhang. Loan growth remained robust at 26% yoy in 3Q09, although the pace is moderating.
- **Government banks lead the performance and risk charge** — 3Q09 has been a decisive quarter for the Government banks with depositor flight to safety, counter-cyclical lending effort (prompted by the Government/RBI), and clearly a more dominant role ahead. They have also backed this up with performance by reporting 52% yoy profit growth in 3Q09 (5% for private banks), 26% balance sheet expansion (20% for privates), strong margin and fee increases, and reported asset deterioration lower than the private banks (10% vs. 47%). We view that Government banks are now relatively more important than a quarter ago but, along with growth, the risks are rising faster than for private banks.
- **Still prefer to be safe than brave** — We prefer larger banks vs. smaller/regional ones, diversified loan books vs. concentrated ones, strong deposit franchises, and well capitalized banks. Our top picks are HDBK, SBI, BOB and AXIS.

See Appendix A-1 for Analyst Certification and important disclosures.

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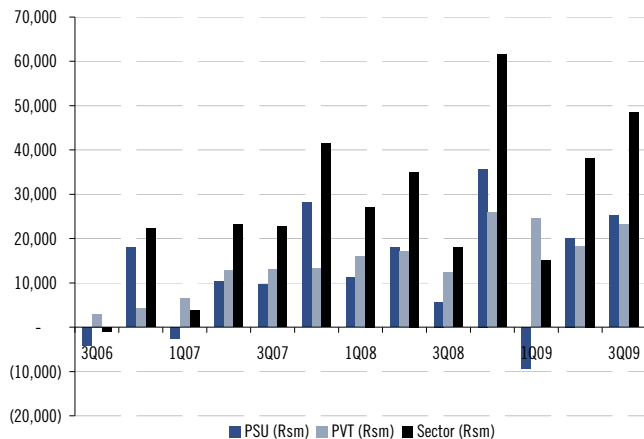
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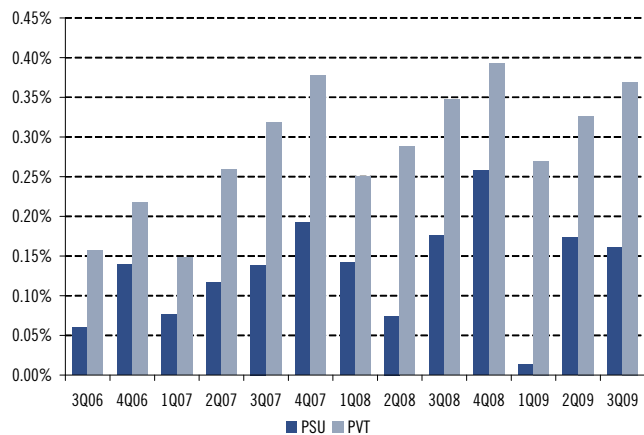
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Figure 1. Asset Deterioration of PSU Banks, PVT Banks and Sector (Rsm)



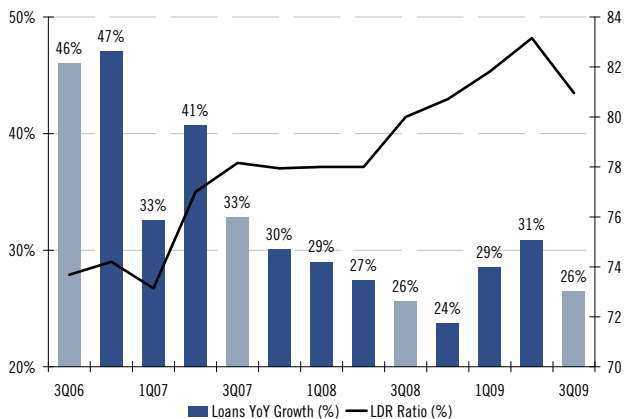
Source: Citi Investment Research

Figure 3. Ratio of Bad Debt Charges to Opening Loans (%)



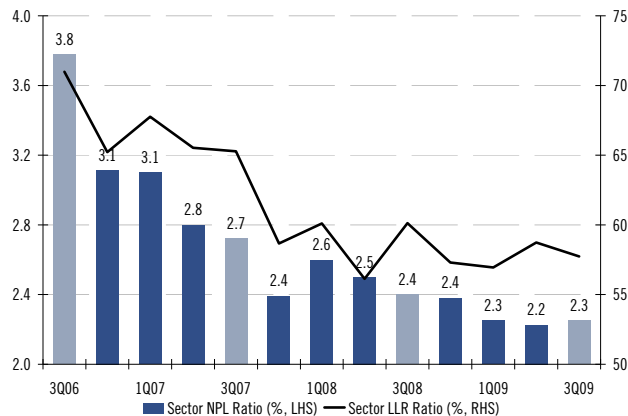
Source: Citi Investment Research

Figure 5. Indian Banks – Loan Growth and LDR Ratios (%)



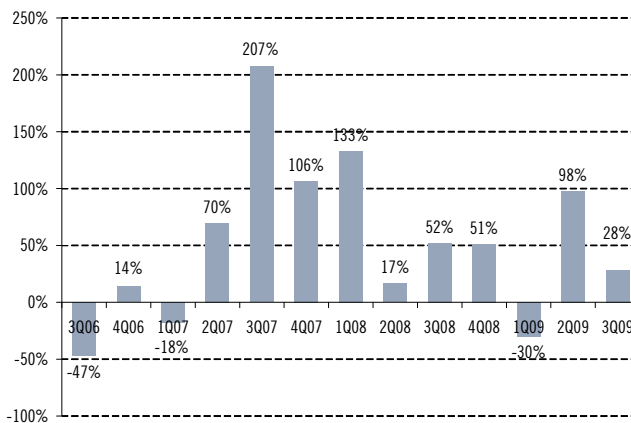
Source: Citi Investment Research

Figure 2. Indian Banks – Gross NPLs and Loan Loss Ratio (Percent)



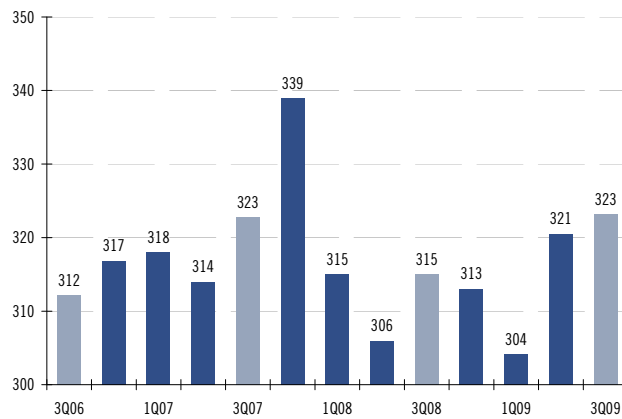
Source: Citi Investment Research

Figure 4. Indian Banks: Bad Debt Charges – YoY Growth (%)



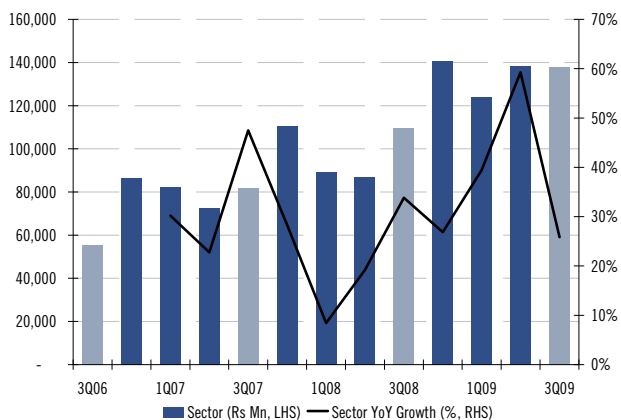
Source: Citi Investment Research

Figure 6. Indian Banks – Net Interest Margins (bps)



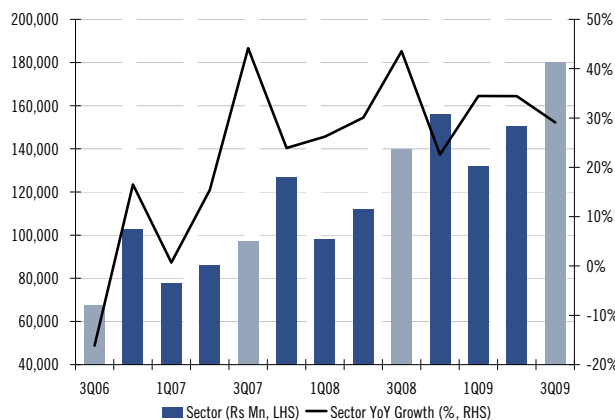
Source: Citi Investment Research

Figure 7. Indian Banks – Pre Provision Profits Ex Trading Gains (Rsm) and YoY Growth (%)



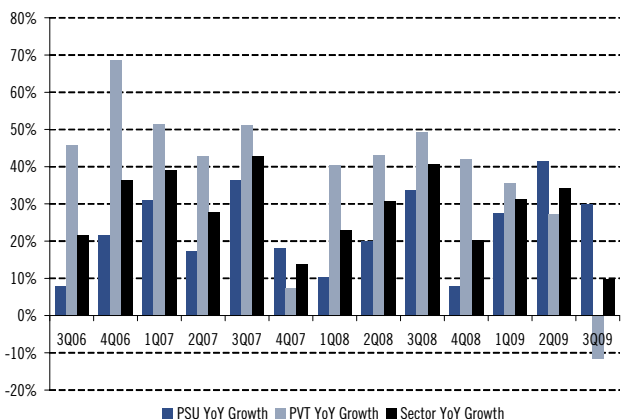
Source: Citi Investment Research

Figure 8. Indian Banks – Pre Provision Profits (Rsm) and YoY Growth (%)



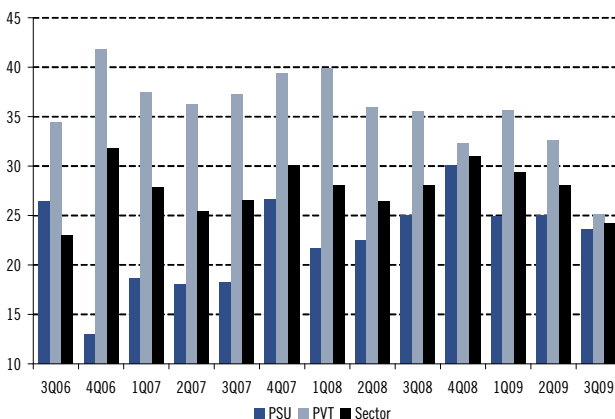
Source: Citi Investment Research

Figure 9. PSU / PVT / Banking Sector – Fee Income YoY Growth (%)



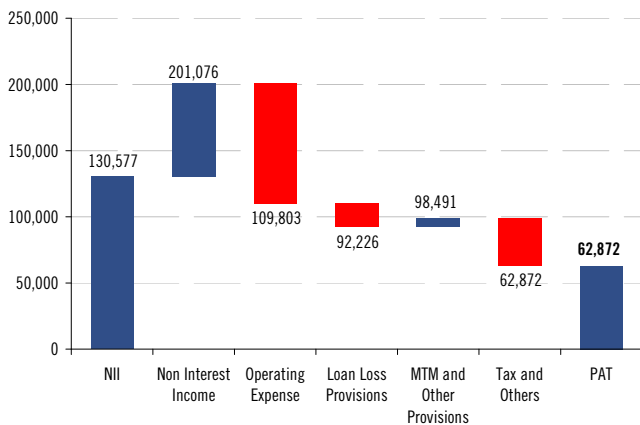
Source: Citi Investment Research

Figure 10. PSU / PVT / Banking Sector – Fee Income as % of Op. Income



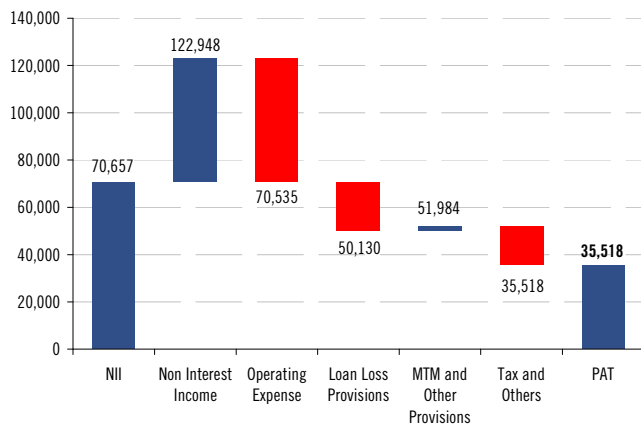
Source: Citi Investment Research

Figure 11. PSU Banks – PnL Bridge Chart (Rsm)



Source: Citi Investment Research

Figure 12. PVT Banks – PnL Bridge Chart (Rsm)



Source: Citi Investment Research

Figure 13. Individual PSU Banks – 3Q09 Financial Highlights (Rsm, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	3Q09	YoY	QoQ	3Q09	YoY	QoQ	3Q09	YoY	QoQ
	Rsm	%	%	Rsm	%	%	Rsm	%	%
State Bank of India	57,582	35%	6%	44,826	22%	7%	24,784	37%	10%
Punjab National Bank	19,674	38%	15%	18,059	82%	32%	10,058	86%	42%
Bank of Baroda	14,618	47%	29%	14,147	52%	67%	7,084	41%	79%
Union Bank	11,284	50%	16%	8,548	34%	22%	6,717	84%	86%
Canara Bank	12,443	33%	8%	12,141	60%	57%	7,015	53%	33%
Corporation bank	4,780	43%	18%	4,494	62%	28%	2,565	34%	34%
Oriental Bank of commerce	5,678	41%	9%	3,862	30%	-5%	2,522	82%	6%
Andhra Bank	4,519	22%	4%	3,725	29%	34%	2,127	34%	32%
Central Bank of India	6,719	23%	4%	4,665	66%	59%	3,533	76%	267%
PSU Banks	137,297	37%	10%	114,468	41%	24%	66,405	52%	34%

Source: Company Information and Citi Investment Research

Figure 14. Individual Private Banks – 3Q09 Financial Highlights (Rsm, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	3Q09	YoY	QoQ	3Q09	YoY	QoQ	3Q09	YoY	QoQ
	Rsm	%	%	Rsm	%	%	Rsm	%	%
ICICI Bank	19,904	2%	-7%	27,708	23%	21%	12,722	3%	25%
HDFC bank	19,793	38%	6%	14,581	37%	30%	6,217	45%	18%
Axis Bank	9,297	24%	2%	9,096	35%	4%	5,009	63%	24%
Kotak	5,883	21%	1%	2,914	-56%	-6%	1,215	-68%	-22%
IDFC	2,570	44%	30%	2,684	-12%	-19%	1,846	-15%	-21%
Yes Bank	1,204	29%	-2%	1,844	83%	68%	1,058	95%	66%
Federal Bank	3,846	89%	16%	3,844	129%	27%	2,039	98%	78%
Private Banks	70,657	22%	2%	70,535	15%	15%	35,518	5%	17%

Source: Company Information and Citi Investment Research

Figure 15. Individual PSU Banks – Divergence Between Citi Estimated and Actual 3Q09 Results (Rsm, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	3Q09E (Citi)	3Q09A	Divergence	3Q09E (Citi)	3Q09A	Divergence	3Q09E (Citi)	3Q09A	Divergence
	Rsm	Rsm	%	Rsm	Rsm	%	Rsm	Rsm	%
State Bank of India	56,230	57,582	2%	44,236	44,826	1%	26,743	24,784	-7%
Punjab National Bank	18,002	19,674	9%	13,717	18,059	32%	7,439	10,058	35%
Bank of Baroda	11,787	14,618	24%	9,294	14,147	52%	5,941	7,084	19%
Union Bank	10,757	11,284	5%	8,136	8,548	5%	4,621	6,717	45%
Canara Bank	12,044	12,443	3%	7,939	12,141	53%	6,684	7,015	5%
Corporation bank	4,055	4,780	18%	3,840	4,494	17%	2,196	2,565	17%
Oriental Bank of commerce	5,172	5,678	10%	3,670	3,862	5%	3,124	2,522	-19%
Andhra Bank	4,528	4,519	0%	3,004	3,725	24%	2,012	2,127	6%
Central Bank of India	6,880	6,719	-2%	3,423	4,665	36%	2,080	3,533	70%
PSU Banks	129,456	137,297	6%	97,258	114,468	18%	60,838	66,405	9%

Source: Company Information and Citi Investment Research estimates

Figure 16. Individual Private Banks – Divergence Between Citi Estimated and Actual 3Q09 Results (Rsm, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	3Q09E (Citi)	3Q09A	Divergence	3Q09E (Citi)	3Q09A	Divergence	3Q09E (Citi)	3Q09A	Divergence
	Rsm	Rsm	%	Rsm	Rsm	%	Rsm	Rsm	%
ICICI Bank	21,985	19,904	-9%	26,481	27,708	5%	11,168	12,722	14%
HDFC bank	20,169	19,793	-2%	13,084	14,581	11%	6,167	6,217	1%
Axis Bank	9,739	9,297	-5%	8,518	9,096	7%	4,231	5,009	18%
Kotak	6,185	5,883	-5%	3,157	2,914	-8%	1,640	1,215	-26%
IDFC	2,039	2,570	26%	3,343	2,684	-20%	2,336	1,846	-21%
Yes Bank	1,304	1,204	-8%	1,223	1,844	51%	730	1,058	45%
Federal Bank	3,441	3,846	12%	2,972	3,844	29%	1,434	2,039	42%
Private Banks	72,933	70,657	-3%	66,996	70,535	5%	33,328	35,518	7%

Source: Citi Investment Research

Figure 17. Indian Banks – 3Q09 Financial Highlights (Rsm, %)

	Private Banks			Government Banks			Sector		
	3Q09A	YoY Change	QoQ Change	3Q09A	YoY Change	QoQ Change	3Q09A	YoY Change	QoQ Change
	Rsm	%	%	Rsm	%	%	Rsm	%	%
Interest Income	214,721	26.4%	7.3%	407,289	39.4%	14.3%	622,010	34.7%	11.8%
Interest Expense	-144,064	28.5%	10.0%	-276,711	40.2%	16.0%	-420,776	35.9%	13.9%
Net Interest Income	70,657	22.4%	2.3%	130,577	37.9%	10.8%	201,234	32.0%	7.6%
Fee-Based Income	30,863	-11.6%	-17.0%	47,509	30.1%	15.9%	78,373	9.8%	0.3%
Other Non-Interest Income	19,493	34.3%	179.9%	22,989	47.4%	339.3%	42,482	41.1%	248.3%
Non Interest Income	52,291	3.8%	16.1%	70,498	35.3%	52.5%	122,789	19.8%	34.5%
Operating Income	122,948	13.7%	7.7%	201,076	37.0%	22.5%	324,024	27.1%	16.5%
Operating Expenses	(52,413)	11.9%	-1.1%	(91,272)	33.4%	21.8%	(143,685)	24.7%	12.3%
Pre-Provision Profit	70,535	15.1%	15.4%	109,803	40.1%	23.1%	180,339	29.1%	20.0%
Pre-Provision ex trading	51,042	9.2%	-5.8%	86,814	38.2%	3.4%	137,856	25.8%	-0.2%
Charges for Bad Debts	(20,405)	35.2%	17.0%	(17,577)	21.1%	2.6%	(37,982)	28.3%	9.9%
Other Operating Items	1,854	-353.9%	-495.5%	6,265	-1647.2%	-694.5%	8,119	-815.2%	-633.2%
Pre-Tax Profit	51,984	14.4%	20.3%	98,491	55.2%	38.7%	150,475	38.1%	31.8%
Tax	(16,420)	38.9%	28.7%	(35,619)	67.8%	57.9%	(52,039)	57.4%	47.4%
Minorities	2	-97.0%	-107.4%	0	NA	NA	2	-97.0%	-107.4%
Extraordinary Items	(48)	3129.4%	-460.4%	0	-100.0%	NA	(48)	-92.1%	-460.4%
Net Profit	35,518	5.4%	16.6%	62,872	51.0%	29.8%	98,390	30.6%	24.7%
Customer Loans	5,481,983	16.8%	-0.8%	11,534,616	31.6%	5.2%	17,016,599	26.5%	3.2%
Customer Deposits	5,317,917	16.6%	0.3%	15,701,556	29.7%	8.1%	21,019,473	26.1%	6.0%
AIEA	8,457,295	18.7%	4.6%	16,447,097	22.6%	7.9%	24,904,392	21.2%	6.7%
AIBL	5,956,824	13.4%	-4.8%	13,919,798	31.3%	9.7%	19,876,621	25.4%	4.9%
Total Assets	9,414,844	19.6%	3.8%	19,023,801	25.7%	4.1%	28,438,645	23.6%	4.0%
Avg Assets	9,241,827	20.6%	3.8%	18,650,999	26.8%	6.8%	27,892,826	24.6%	5.8%
Non-Performing Loans (NPL)	136,966	46.9%	0.3%	246,025	9.6%	6.8%	382,991	20.6%	4.4%
Loan Loss Reserves (LLR)	(79,124)	37.4%	-3.0%	(141,990)	6.5%	6.0%	(221,114)	15.8%	2.6%
Shareholders' Funds	1,054,371	14.5%	3.5%	1,110,030	30.3%	6.0%	2,164,400	22.1%	4.8%
Book Value Per Share	2,061	11.6%	4.2%	2,633	17.4%	6.2%	4,694	14.8%	5.3%
Key Ratios (%)	3Q09A	Bps Δ YoY	Bps Δ QoQ	3Q09A	Bps Δ YoY	Bps Δ QoQ	3Q09A	Bps Δ YoY	Bps Δ QoQ
ROAA (annualized)	1.54	-22	17	1.35	22	24	1.41	6	21
ROAE (annualized)	13.47	-116	152	22.66	311	416	18.18	119	291
Net Interest Margin (bps)	334	10	-8	318	35	8	323	26	3
Fee Inc/Operating Income	25.1	-718	-746	23.6	-124	-135	24.2	-382	-390
Other Non-Interest Inc/Op Inc	42.5	-408	306	35.1	-43	689	37.9	-231	509
Op. Cost/ Operating Income	42.6	-69	-380	45.4	-121	-27	44.3	-86	-163
Loan-to-Deposit Ratio (LDR)	103.1	22	-116	73.5	109	-200	81.0	24	-220
NPL/Loan Ratio	2.5	51	3	2.1	-43	3	2.3	-11	3
LLR/NPL Ratio	58	-401	-196	58	-172	-44	58	-239	-100

Source: Company Information and Citi Investment Research

Figure 18. Indian Banks – Summary Valuation

	Price	TP	Rating	P/E	P/B	ROE	ROA	Div. Yld	M-Cap	EPS				BVPS				
	Rs	Rs		(x)	(x)	(%)	(%)	2009E		2009E	USD Mn	Abs.	Grth.	Abs.	Grth.	Abs.	Grth.	Abs.
	5-Feb			2009E	2009E	2009E	2009E	2009E		2009E	2009E	2010E	2009E	2010E	2009E	2010E	2009E	2010E
Private Sector Banks																		
ICICI Bank	387.2	489	1H	12.4	0.9	7.4%	0.9%	2.8%	8,848	31.3	-15%	30.3	-3%	435.5	4%	452.4	4%	
HDFC Bank	892.3	1350	1L	15.4	2.5	17.5%	1.4%	1.0%	7,790	57.9	27%	74.8	29%	361.0	11%	494.3	37%	
AXIS Bank	388.6	710	1L	8.6	1.4	17.3%	1.3%	1.6%	2,864	45.1	28%	47.3	5%	284.7	16%	326.3	15%	
Kotak Mahindra Bank	262.0	282	3H	16.2	1.4	9.2%	1.3%	0.3%	1,858	16.2	-45%	17.5	8%	184.4	9%	201.0	9%	
Infrastructure Development Finance	52.7	58	3M	8.1	1.1	14.1%	2.7%	2.3%	1,401	6.5	5%	7.9	22%	48.3	12%	54.7	13%	
Yes Bank	58.5	75	3H	7.1	1.1	16.8%	1.2%	0.0%	357	8.2	18%	10.5	28%	52.8	18%	63.3	20%	
Federal Bank	136.5	215	1M	4.5	0.5	12.5%	1.5%	3.3%	479	30.3	6%	25.6	-16%	254.6	11%	275.0	8%	
Public Sector Banks																		
State Bank of India	1089.3	1453	1L	7.6	1.2	17.2%	1.2%	2.0%	14,196	143.6	24%	150.4	5%	894.3	15%	1018.3	14%	
SBI – Consolidated	1089.3	1453	1L	8.4	1.0	12.7%	0.7%	1.4%	14,196	129.5	-9%	170.6	32%	1042.4	11%	1185.3	14%	
Punjab National Bank	393.0	420	3M	4.6	0.9	20.0%	1.2%	3.6%	2,544	85.0	31%	83.6	-2%	459.4	18%	525.6	14%	
Bank of Baroda	243.3	315	1M	5.0	0.7	15.3%	0.9%	3.5%	1,819	49.1	25%	50.1	2%	341.7	13%	381.7	12%	
Canara Bank	177.6	165	3M	4.2	0.6	15.7%	0.9%	4.8%	1,495	42.8	12%	44.3	4%	289.0	13%	322.9	12%	
Union Bank Of India	144.5	165	1L	4.5	0.8	20.0%	1.2%	2.8%	1,498	31.8	16%	29.9	-6%	172.7	19%	197.6	14%	
Oriental Bank of Commerce	130.4	175	3H	3.8	0.5	14.2%	0.9%	3.8%	670	34.7	146%	43.9	27%	259.6	13%	298.0	15%	
Corporation Bank	175.7	175	3H	3.0	0.5	18.5%	1.2%	6.5%	517	59.0	15%	59.6	1%	342.3	16%	389.4	14%	
Andhra Bank	53.4	76	1M	4.6	0.7	16.4%	0.9%	7.9%	532	11.5	-3%	14.4	25%	73.6	10%	82.8	13%	
Central Bank Of India	37.2	34	3M	2.5	0.3	11.1%	0.5%	2.7%	308	14.9	13%	11.5	-22%	141.0	11%	151.3	7%	

Source: Citi Investment Research estimates

Appendix A-1

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India Banks5 February 2009

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