7 May 2009

BSE Sensex: 12117

INDIA RESEARCH

Union Bank

Rs160

NEUTRAL

RESULT NOTE

Mkt Cap: Rs80.6bn; US$1.62bn

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Result: Q4FY09

Comment: Speed Breaker Ahead!

Revision: FY10 earnings upgraded by 6.4% and expect PAT growth of 16% yoy in FY11

Key valuation metrics

Year to March 31 (Rs m)	NII	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	P/ Adj.Bk (x)	PER (x)	RoE (%)
FY07	27,902	17.5	8,453	25.2	16.7	1.6	9.5	18.2
FY08	28,530	2.2	13,873	64.1	27.5	1.3	5.8	25.7
FY09	38,136	33.7	17,266	24.5	34.2	1.1	4.7	27.2
FY10E	44,988	18.0	18,970	9.9	37.6	0.9	4.2	24.1
FY11E	53,132	18.1	22,008	16.0	43.6	0.7	3.7	22.9

HIGHLIGHTS OF Q4FY09 RESULTS

Union Bank ('UNBK') reported PAT of Rs4.7bn – 11% yoy decline on a high base, ahead of our estimate of Rs4.0bn. While NII was muted, earnings growth was bolstered by robust treasury gains.

- **Subdued NII growth…:** NII growth was muted at 20% yoy to Rs9.3bn (lower than our estimates), owing to a sharp contraction in margins and ~200bp yoy decline in CD ratio.
- **…as margins disappoint:** NIMs were down by ~90bp qoq and flat yoy to 2.8% due to recent PLR cuts and full impact of high-cost term deposits taken in H1FY09. With ~85% of bank's term deposits being retail, re-pricing benefits are expected to kick in with a lag. (Exhibit 1)
- **Strong treasury gains; fee income in-line:** Treasury gains of Rs2.3bn (25% of operating profits) led to strong ~50% yoy growth in other income. Reflecting the challenging credit environment recoveries remained subdued at Rs350mn, against Rs620mn in Q4FY08. Fee income grew at a healthy pace of 22% yoy buoyed by traction in LCs / guarantees as well as strong credit off-take. (Exhibit 3)
- **Rise in NPAs; 3% of credit restructured:** Gross NPAs increased by 30bp qoq to 1.96%, while increasing by Rs3.6bn in absolute terms. The rise is attributed to rise in slippages to 0.6% of average loans. (Exhibit 5) The bank restructured Rs29.6bn of advances (3% of the book) during FY09, and made corresponding Rs1.05bn provisions (3.5% of restructured loans). Applications worth Rs1.4bn are under consideration. (Exhibit 7 & 8)
- **Strong balance-sheet growth:** Gross credit stood at Rs983bn – a growth of ~30% yoy and 6% qoq, driven by corporate and SME loans. Deposit flow remained strong at 33% yoy and 7% qoq to Rs1384bn, leading to 200bp+ yoy decline in CD ratio. While CASA remained muted at 30.1% (30.4% in Q3FY09), the pace of decline has come-off (~270bp qoq decline in Q3FY09). The bank is targeting CASA of 35% by FY12.(Exhibit 2)
- **Elevated provisions as expected; coverage declines:** The bank made provisions of Rs2.8bn, of which Rs2.7bn are specific loan loss provisions (including provisions on restructured assets of Rs1bn). NPA provisions were lower than

expectations, leading to ~900bp qoq decline in coverage ratio to 83%. The bank booked a MTM depreciation write back of Rs330mn possibly on the corporate bond book. (Exhibit 6)

- **Comfortable capital adequacy:** Tier-1 ratio came in at 8.2%, with overall CAR at 13.3% under Basel-II. The bank's CAR has improved from 12.32% in Q3FY09 owing to capital release under Basel-II.
- **Introducing FY11 numbers:** We are forecasting a profit growth of 16% yoy in FY11 to Rs22.0bn. NII is estimated at Rs53.1bn – a 18% yoy growth, driven by a 20% yoy growth in credit and CASA of 33.5%.

VALUATIONS & VIEW

Union Bank outperformed our earnings estimates in Q4FY09 on the back of robust treasury gains. Asset quality witnessed strain as Gross NPAs increased and the bank restructured ~3% of the credit (at the higher end of industry average). To factor in stress on the loan book, we are building in ~40% rise in credit costs into our estimates over FY09-10. We expect elevated credit costs and lower margins to depress the earnings in the near term. However, margins are likely to revive over the next couple of quarters, as deposits re-price at lower rates and CASA stabilizes. Factoring in traction in fee income and lower operating expenses we are revising our FY10 earnings estimates by 6.4%. We expect the bank to report a 13% CAGR in net profit over FY09-11, with an average RoE of ~23%. Though the stock is currently trading at cheap valuations (0.90x FY10E and 0.74x FY11E adjusted book), we expect the concerns on asset quality and core profitability to limit the upside. Maintain Neutral with a 12 month price target of Rs187.

Quarterly results

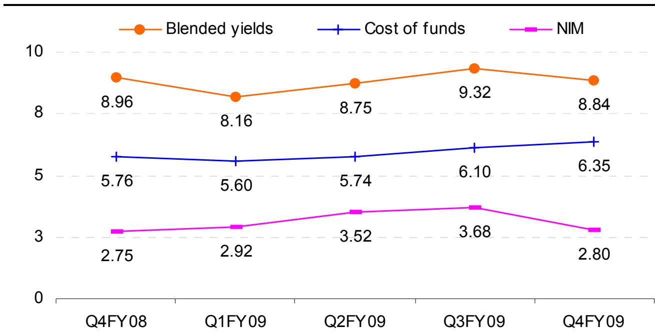
P&L (Rs m)	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	FY09	FY10E	FY11E	Remarks
Total intt income	25,400	25,332	28,313	32,617	32,897	118,894	138,094	159,371	
Interest expense	17,685	17,232	18,560	21,333	23,633	80,758	93,106	106,239	
Net interest income	**7,715**	**8,100**	**9,753**	**11,284**	**9,264**	**38,136**	**44,988**	**53,132**	Muted due to a sharp decline in NIMs
yoy growth	*(1.8)*	*10.3*	*48.6*	*50.0*	*20.1*	*33.7*	*18.0*	*18.1*	
Other income	**3,731**	**2,217**	**2,833**	**3,921**	**5,590**	**14,826**	**15,565**	**15,685**	Bolstered by robust treasury gains & traction in LCs & guarantees
yoy growth	54.3	2.9	(1.4)	2.3	49.8	12.3	5.0	0.8	
Non trading income	3,061	2,137	3,213	2,941	3,320	11,876	13,565	15,185	Subdued recoveries reflect challenging credit environment
Trading	670	80	(380)	980	2,270	2,950	2,000	500	Robust at 25% of operating profit
Net revenue	**11,446**	**10,317**	**12,586**	**15,205**	**14,854**	**52,961**	**60,553**	**68,816**	
Operating expenses	2,539	4,157	5,589	6,656	5,740	22,141	23,813	26,507	Includes Rs360mn for wage hike and Rs140mn for branding
yoy growth	*(22.1)*	*(2.0)*	*34.6*	*33.2*	*126.1*	*39.0*	*7.5*	*11.3*	On a low base
Operating profit	**8,907**	**6,160**	**6,997**	**8,548**	**9,115**	**30,820**	**36,741**	**42,309**	
yoy growth	*27.0*	*17.3*	*32.4*	*34.4*	*2.3*	*19.4*	*19.2*	*15.2*	
Total provisions	3,652	2,957	2,033	(449)	2,834	7,375	9,641	10,869	Includes Rs1.0bn on restructured advances
PBT	**5,255**	**3,203**	**4,965**	**8,997**	**6,281**	**23,446**	**27,099**	**31,441**	
Tax	44	920	1,350	2,280	1,630	6,180	8,130	9,432	
PAT	**5,211**	**2,283**	**3,615**	**6,717**	**4,651**	**17,266**	**18,970**	**22,008**	Ahead of estimates buoyed by robust treasury
yoy growth	*203.7*	*1.5*	*31.1*	*84.0*	*(10.8)*	*24.5*	*9.9*	*16.0*	

Quarterly results (contd)

	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	FY09	FY10E	FY11E	Remarks
Ratios (%)									
NIMs (reported)	2.8	2.9	3.5	3.7	2.8				Decline in yields owing to PLR cuts while deposits reprice with a lag
NIMs (calc*)	2.5	2.6	2.9	3.1	2.4	2.7	2.6	2.7	
Non-fund rev/Avg assets	1.2	0.7	0.9	1.1	1.4	0.9	0.8	0.7	
Op expenses/avg assets	0.8	1.3	1.7	1.8	1.5	1.6	1.4	1.3	
Provisions / Avg assets	1.3	(0.3)	1.2	0.7	1.2	0.5	0.6	0.5	Elevated as expected
PBT/avg assets	1.7	1.0	1.5	2.5	1.6	1.6	1.6	1.6	
RoA	1.7	0.7	1.1	1.9	1.2	1.2	1.1	1.1	
Tax/PBT	0.8	28.7	27.2	25.3	26.0	26.4	30.0	30.0	
Tier I CAR	7.5	7.5	7.6	7.5	8.2				Raised Rs3.4bn perpertual Tier-I in FY09
Overall CRAR	12.5	12.2	12.5	12.3	13.3				Rise aided by adoption of Basel-II
CD ratio	73.1	70.7	74.7	71.7	71.0				Decline of 200bp+ yoy- in line with the industry
Balance Sheet (Rs bn)									
Credit	759	758	865	930	983				Strong growth; driven by corporate and SME loans
yoy growth(%)	*19.2*	*19.0*	*26.2*	*25.2*	*29.5*				
Deposits	1,039	1,072	1,159	1,296	1,384				Remains strong; primarily driven by term deposits
yoy growth(%)	*21.9*	*23.3*	*22.3*	*30.7*	*33.3*				

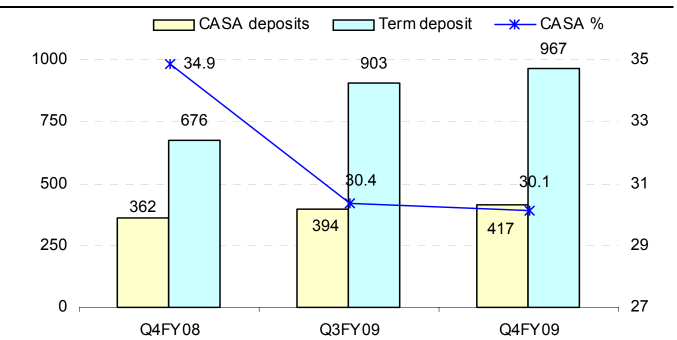
** Calculated on average quarterly balances*

Exhibit 1: Stress on margins



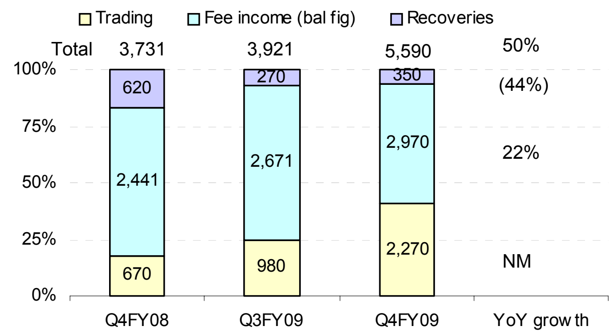
- Steep decline in NIMs due to pressure on yields – a function of recent PLR cuts and decline in pricing power
- High proportion of retail term deposits (re-pricing with a lag) leads to rise in cost of funds

Exhibit 2: CASA remains stable sequentially (Rs bn)



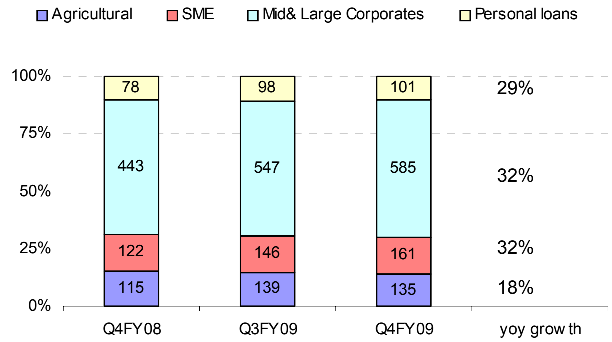
- Deposit growth remains strong at 33% yoy, while the pace of decline in CASA ratio comes-off
- Savings deposits up 18% yoy and Current up 10% yoy

Exhibit 3: Non-interest income break up (Rs m)



- Stellar treasury gains at 25% of operating profits; subdued recoveries reflect stressed operating environment
- Fee income growth led by traction in LCs / guarantees

Exhibit 4: Composition of loan book stable (Rs bn)



- Advances growth remains strong at 25% yoy with stable composition
- Growth driven by agricultural and corporate loans- no incremental disbursement to restructured accounts

Exhibit 5: Gross NPAs rise

Rs m	Q4FY08	Q3FY09	Q4FY09	YoY grth(%)	qoq grth(%)
Gross NPAs	16,566	15,640	19,233	16	23
Net NPAs	1,264	1,275	3,259	158	156
Additions	1,950	1,830	5,630	189	208
Write-off	120	2,230	960	700	(57)
Upgradations/Recoveries	870	710	1,080	24	52
Gross NPA %	2.18	1.66	1.96	(22)	30
Net NPA %	0.17	0.14	0.34	17	20
Additions/average loans (%)	0.26	0.20	0.59	33	38

- Gross NPA rise sequentially, due to increased slippages
- Slippages indicated to emanate from commodities, trading, leather and real estate sectors among others

Exhibit 6: Provisions breakup

Rs m	Q4FY08	Q3FY09	Q4FY09	YoY gth (%)	qoq gth (%)
Provision for NPA	2,350	1,660	2,770	18	67
Investment depreciation	1,100	(2,910)	(330)	(130)	(89)
Others	202	801	394	95	(51)
Total Provisions	3,652	(449)	2,834	(22)	(731)

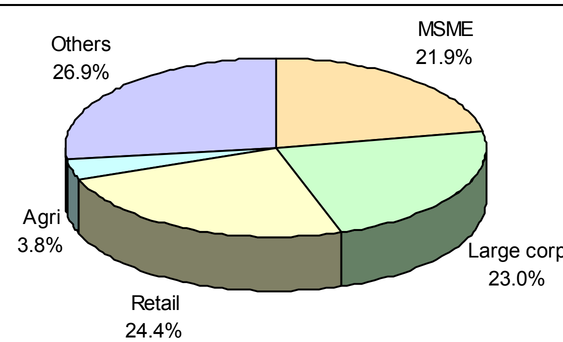
- NPA provisions include Rs 1bn on restructured assets
- Higher slippages and lower than expected NPA provisions drive a ~900bp qoq decline in coverage ratio to 83%

Exhibit 7: ~3% of credit restructured (Rs m)

Restructured loans	Q4FY09
Approved	29,593
% of net loans	3.01
Provisions	1050
% of restructured loans	3.55
Pending applications	1,360
% of net loans	0.14

- Unviable accounts classified as NPA amount to ~Rs6bn; ~Rs4bn of large restructured accounts would have turned NPAs
- Bulk of the loans involve only principal deferment without interest rate modifications

Exhibit 8: Composition of restructured loans



- ~45% of restructured loans emanate from corporates (large as well as SMEs)
- Others includes small borrowers & housing loans

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