

Upgrade to Neutral; risk-return attractive

UBI U/p since our downgrade and recent sector news

UBI has underperformed the benchmark indices by ~15% since our downgrade post their very weak 2Q earnings. More importantly, the underperformance (relative) over the last 1 week by +10% has to do with recent emerging concerns of banks exposure to MFI's, Telco's and housing loan scam. UBI's exposure to MFI's is <0.5% of loans and its commercial RE exposure is <2.5-3.0% and the bank has not been named in housing loan scam.

Upgrade to Neutral (from U/P) on risk-return; PO at Rs375

We believe that with RoEs at 19%/ 21% for FY11/12, stock may trade at +1.6-1.7x FY12 adj. BV (Gordon model). This implies no premium to Gordon model owing to weak earnings outlook (<4% for FY11), lingering NPL concerns and, capital constraints (GOI holding at 55.4%), implying new PO of Rs375 and Neutral.

Why not a Buy

We believe UBI has yet to emerge from asset quality headwinds post 2Q and we reckon earnings growth of only ~10-11% in 2H (yoy), amongst the weakest in govt. bank space. Hence, a Neutral vs. a Buy. We estimate earnings growth to be muted at ~4% in FY11 after building in 84bps of credit costs (vs. 60bps in FY10) and also crystallized pension costs, but we reckon that earnings growth may rebound +30% in FY12 on a lower credit costs, topline and low base.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	17,266	20,749	21,467	28,161	36,202
EPS	34.18	41.08	42.50	55.75	71.67
EPS Change (YoY)	24.5%	20.2%	3.5%	31.2%	28.6%
Dividend / Share	5.00	5.50	6.50	7.50	8.50
Pre-exceptional EPS	29.59	31.86	34.68	51.98	69.15
Pre-exceptional EPS Change (YoY)	40.8%	7.7%	8.8%	49.9%	33.0%
Book Value / Share	139.66	174.37	209.59	256.94	319.09

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	10.0x	8.3x	8.0x	6.1x	4.8x
Dividend Yield	1.47%	1.61%	1.90%	2.20%	2.49%
Pre-exceptional PE	11.53x	10.71x	9.84x	6.56x	4.93x
Price / Book	1.97x	1.65x	1.41x	1.18x	0.972x
RoE / PB	10.88x	13.09x	13.43x	17.80x	23.04x
Price / Pre-Provision Profit	6.27x	5.58x	4.56x	3.53x	2.76x

Equity | India | Banks-Retail
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Bank of America Merrill Lynch

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Stock Data

Price	Rs341.25
Price Objective	Rs375.00
Date Established	29-Nov-2010
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs236.80-Rs426.95
Mrkt Val / Shares Out (mn)	US\$3,760 / 505.1
Average Daily Volume	1,214,289
BofAML Ticker / Exchange	UBOIF / BSE
Bloomberg / Reuters	UNBK IN / UNBK.BO
ROE (2011E)	19.0%
Total Dbt to Cap (Mar-2006A)	NA
Est. 5-Yr EPS / DPS Growth	22.0% / 9.0%
Free Float	39.2%

Key Changes

(Rs)	Previous	Current
Inv. Opinion	C-3-7	C-2-7
Inv. Rating	UNDERPERFORM	NEUTRAL
Price Obj.	410.00	375.00

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Refer to important disclosures on page 6 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 10997860

iQprofileSM Union Bank Of India

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Net Interest Income	38,136	41,924	55,115	66,213	80,917
Net Fee Income	8,133	10,799	12,783	14,822	17,379
Securities Gains / (Losses)	3,386	3,227	3,711	4,156	4,572
Other Income	0	0	0	0	0
Total Non-Interest Income	11,518	14,026	16,494	18,978	21,951
Total Operating Income	49,654	55,950	71,609	85,191	102,868
Operating Expenses	(22,141)	(25,078)	(33,769)	(36,337)	(40,373)
Pre-Provision Profit	27,513	30,872	37,840	48,854	62,495
Provisions Expense	(6,266)	(7,199)	(12,385)	(10,528)	(10,528)
Operating Profit	20,010	21,434	24,855	37,326	50,667
Non-Operating Income	NA	NA	NA	NA	NA
Pre-Tax Income	23,566	28,329	29,406	40,230	53,239
Net Income to Comm S/Hold.	17,266	20,749	21,467	28,161	36,202
Adjusted Net Income (Operating)	17,266	20,749	21,467	28,161	36,202

Key Balance Sheet Data

Total Assets	1,609,755	1,951,618	2,314,093	2,809,872	3,394,828
Average Interest Earning Assets	1,364,195	1,719,265	2,066,681	2,491,374	3,026,437
Weighted Risk Assets	952,449	1,225,980	1,422,778	1,825,398	2,414,668
Total Gross Customer Loans	981,317	1,210,212	1,503,084	1,862,141	2,287,805
Total Customer Deposits	1,387,028	1,700,397	2,023,141	2,469,549	2,993,551
Tier 1 Capital	77,950	96,970	117,867	130,785	161,179
Tangible Equity	77,950	96,970	117,867	130,785	161,179
Common Shareholders' Equity	87,404	104,238	122,027	145,945	177,339

Key Metrics

Net Interest Margin	2.80%	2.44%	2.67%	2.66%	2.67%
Tier 1 Ratio	8.2%	7.9%	8.3%	7.2%	6.7%
Effective Tax Rate	26.7%	26.8%	27.0%	30.0%	32.0%
Loan / Assets Ratio	61.0%	62.0%	65.0%	66.3%	67.4%
Loan / Deposit Ratio	70.7%	71.2%	74.3%	75.4%	76.4%
Oper Leverage (Inc Growth - Cost Growth)	-8.2%	-0.6%	-6.7%	11.4%	9.6%
Gearing (Assets / Equity)	18.4x	18.7x	19.0x	19.3x	19.1x
Tangible Common Equity / Assets	4.8%	5.0%	5.1%	4.7%	4.7%
Tangible Common Equity / WRAs	8.2%	7.9%	8.3%	7.2%	6.7%
Revenue Growth	30.8%	12.7%	28.0%	19.0%	20.7%
Operating Expense Growth	39.0%	13.3%	34.7%	7.6%	11.1%
Provisions Expense Growth	-5.8%	14.9%	72.1%	-15.0%	0%
Operating Revenue / Average Assets	3.5%	3.1%	3.4%	3.3%	3.3%
Operating Expenses / Average Assets	1.6%	1.4%	1.6%	1.4%	1.3%
Pre-Provision ROA	1.9%	1.7%	1.8%	1.9%	2.0%
ROA	1.2%	1.2%	1.0%	1.1%	1.2%
Pre-Provision ROE	34.2%	32.2%	33.4%	36.5%	38.7%
ROE	21.5%	21.7%	19.0%	21.0%	22.4%
RoTE	22.1%	21.4%	18.2%	21.5%	22.5%
RoWRAs	1.8%	1.7%	1.5%	1.5%	1.5%
Dividend Payout Ratio	0.2%	0.2%	0.2%	0.2%	0.1%
Efficiency Ratio (Cost / Income Ratio)	47.9%	47.6%	49.7%	44.8%	41.1%
Total Non-Interest Inc / Operating Inc	23%	25%	23%	22%	21%
Market-Related Revenue / Total Revenues	6.8%	5.8%	5.2%	4.9%	4.4%
Provisioning Burden as % of PPP	22.8%	23.3%	32.7%	21.5%	16.8%
NPLs plus Foreclosed Real Estate / Loans	2.0%	2.2%	2.6%	2.3%	1.9%
Loan Loss Reserves / NPLs	83.1%	63.9%	60.0%	65.0%	70.5%
Loan Loss Reserves / Total Loans	1.7%	1.4%	1.6%	1.5%	1.4%
Provisions Expense / Average Loans	0.7%	0.7%	0.9%	0.6%	0.5%

Other Metrics

Income / Employee	0.628	0.747	0.777	1.02	1.32
(Operating Expenses) / Employee	0.805	0.903	1.22	1.32	1.48
Pre-Provision Profit / Employee	0.857	1.02	1.06	1.46	1.95
Net Profit / Employee	0.628	0.747	0.777	1.02	1.32

Company Description

Union Bank of India, one of the largest state-owned banks with a balance sheet of Rs800bn, is based out of Western India and has over 2,000 branches. The bank is likely to be a key beneficiary of the pickup in corporate credit cycle. It has one of the lowest interest rate risk with a low duration and de-risked bond portfolio. Union Bank also has a superior technology platform and better asset quality among the government banks.

Investment Thesis

UBI has three key strengths, in our view: large balance sheet and distribution, good technology, ahead of its peer group in implementation, and a clean balance sheet with low gross and net NPLs, in line with the industry's. Union Bank is the seventh largest bank in India and sixth largest government bank, with a large balance sheet and a diversified distribution network.

Stock Data

Price to Book Value 1.4x

Price objective basis & risk

Union Bank India (UBOIF)

We believe that with RoEs at 19%/ 21% for FY11/12, stock may trade at +1.6-1.7x FY12 adj. BV (Gordon model). This implies no premium to Gordon model owing to weak earnings outlook (4% for FY11), lingering NPL concerns and, capital constraints (GOI holding at 55.4%), implying new PO of Rs375 and Neutral. Upside risks are sharply lower NPLs in the ensuing quarters. Downside risks are further sharp rise in NPLs and capital needs restricting growth.

Link to Definitions

Financials

Click [here](#) for definitions of commonly used terms.

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India - Financials Coverage Cluster

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BUY	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDFF	HDFC IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma

India - Financials Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	Max India	XXMIF	MAX IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
NEUTRAL				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma
UNDERPERFORM				
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Reliance Capital	RLCCF	RCAPT IN	Rajeev Varma

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

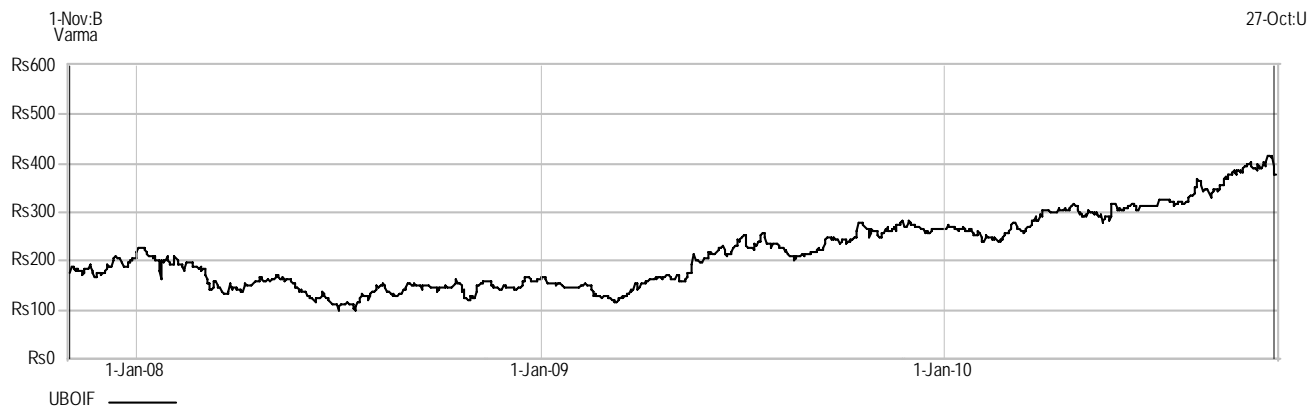
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UBOIF Price Chart



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Investment Rating Distribution: Banks Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	52.56%	Buy	48	47.52%
Neutral	58	24.79%	Neutral	28	56.00%
Sell	53	22.65%	Sell	20	40.82%

Investment Rating Distribution: Global Group (as of 01 Oct 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1948	54.31%	Buy	821	46.73%
Neutral	891	24.84%	Neutral	397	49.07%
Sell	748	20.85%	Sell	259	37.16%

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Underperform	N/A	≥ 20%

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