

Equities

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India Banks

2Q12 Review: Better Margins, But Testing the Quality

■ Industry Overview

- 2Q12 profits up 12%yoy (vs. 9% exp) on better NIMs** — Indian banks' 2Q12 earnings were better than expected (+12% yoy). Qualitatively, they were more mixed – higher pre-provisioning profits ex-trading gains (+21% yoy vs. +15% exp), but higher credit costs as well. Key operational drivers were: a) Better than expected NIMs (+15bps QoQ) and b) Healthy loan growth (+20%). Private banks were better than estimates (profits up 27% yoy), outperformed PSU banks (+3% yoy, ex-SBI: -3% yoy). Asset quality was the key focus this quarter – slippages were high (mostly on migration to automated NPL recognition), though there were signs of increased underlying stress.
- Healthy loan growth, but no balm for asset quality concerns** — Asset quality stress (apart from migration related slippages) has started to show up; PSU banks (especially SBI) performed markedly worse and are likely to be impacted more going ahead as we expect pressures to spread across peers – NPLs (for PSU banks) increased to 3% (vs. 2.5% in 1Q12, +22% qoq) and specific loan loss coverage dropped to 50% (-430bps qoq). Loan growth remained healthy (+20% yoy), more corporate driven (SME, working capital) than retail – should moderate. Funding mix (CASA ratio) is under pressure higher rates for most banks (on higher rates) and costs likely to remain elevated.
- Margins ahead, partly offset by higher credit costs** — Operationally, the P&L was better than balance sheet –a) NIMs surprised on the upside (+15bps qoq, 343 bps now) - close to historical peaks now, would expect gradual moderation hereon; b) Fee incomes continued to lag asset growth (+10% yoy); c) Operating expenses were up 9% yoy (cost-income ratio down 50bps qoq to 43%). These were however, partly offset by higher credit costs (100bps overall), especially from PSU banks (120bps), while private banks' credit costs declined further to 60bps. We expect PSU banks' credit costs to remain elevated, should rise for private banks too (best historically), though with a lag.
- Sector view: Defensive near term** — We remain cautious near term (high interest rates, moderating growth, likely asset quality stress) – HDBK, Kotak most defensive. Our top picks (Axis, SBI, ICICI) remain more leveraged to the economy – easier rates, better growth and quality – should outperform when the outlook turns more benign.

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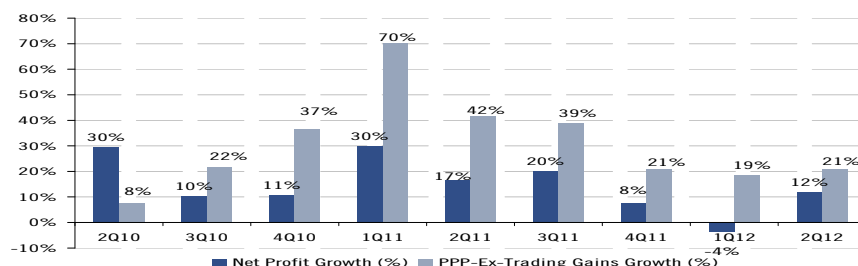
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Figure 1. India Banks: Growth in Net Profits, Pre-Provision Profits Ex-Trading (%)



Source: Citi Investment Research and Analysis

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 2. Indian Banking Sector: 2Q12 Results – Key Financial Highlights (Rupees Million, Percent)

	Private Banks			PSU Banks			Sector		
	2Q12 Rsm	YoY Change %	QoQ Change %	2Q12 Rsm	YoY Change %	QoQ Change %	2Q12 Rsm	YoY Change %	QoQ Change %
Interest Income	301,652	38.3%	8.7%	694,794	34.4%	6.9%	996,446	35.6%	7.4%
Interest Expense	-192,263	54.2%	9.6%	-453,347	45.8%	6.6%	-645,609	48.2%	7.4%
Net Interest Income	109,389	17.2%	7.3%	241,448	17.3%	7.5%	350,837	17.2%	7.4%
Fee-Based Income	51,476	12.9%	11.1%	68,662	7.2%	5.7%	120,139	9.5%	7.9%
Other Non-Interest Income	7,881	-38.8%	-7.3%	6,917	-21.7%	-21.7%	14,798	-31.8%	-14.7%
Non Interest Income	59,358	1.5%	8.2%	75,580	3.7%	2.4%	134,937	2.7%	4.9%
Operating Income	168,746	11.1%	7.6%	317,027	13.7%	6.2%	485,774	12.8%	6.7%
Operating Expenses	(71,157)	5.2%	3.7%	(138,084)	10.5%	6.3%	(209,241)	8.6%	5.4%
Pre-Provision Profit	97,589	16.0%	10.7%	178,944	16.3%	6.2%	276,533	16.2%	7.7%
Pre-Provision ex trading	89,708	25.9%	12.6%	172,026	18.6%	7.7%	261,734	21.0%	9.4%
Charges for Bad Debts	(12,124)	-27.8%	-1.8%	(61,248)	46.4%	12.7%	(73,372)	25.1%	10.0%
Other Operating Items	(952)	-1.4%	67.4%	(10,119)	74.5%	-45.1%	(11,071)	63.7%	-41.7%
Operating Profit	84,513	27.3%	12.3%	107,577	1.3%	12.4%	192,090	11.3%	12.3%
Pre-Tax Profit	84,513	27.3%	12.3%	107,577	1.3%	12.4%	192,090	11.3%	12.3%
Tax	(24,834)	28.6%	11.6%	(32,290)	-1.6%	-1.9%	(57,124)	9.6%	3.6%
Minorities	(136)	370.3%	12.6%	0	NM	NM	(136)	370.3%	12.6%
Extraordinary Items	102	110.4%	9.5%	0	NM	NM	102	110.4%	9.5%
Net Profit	59,645	26.6%	12.6%	75,287	2.6%	19.8%	134,932	12.0%	16.5%
Customer Loans	8,486,491	21.6%	6.1%	20,561,792	19.1%	2.7%	29,048,283	19.8%	3.7%
Customer Deposits	8,673,388	17.2%	7.0%	27,051,755	17.9%	3.0%	35,725,143	17.7%	4.0%
AIEA	12,604,297	18.2%	3.8%	28,307,486	18.2%	2.3%	40,911,783	18.2%	2.8%
AIBL	10,406,159	9.7%	5.7%	30,918,876	34.9%	68.4%	41,325,035	27.5%	46.5%
Total Assets	14,067,785	21.2%	7.0%	32,653,235	17.3%	0.0%	46,721,019	18.4%	2.0%
Avg Assets	13,605,219	21.1%	5.0%	32,623,225	20.8%	3.5%	46,228,444	20.9%	3.9%
Non-Performing Loans (NPL)	165,689	2.5%	1.4%	614,459	47.3%	22.0%	780,148	34.8%	16.9%
Loan Loss Reserves (LLR)	(141,639)	17.6%	4.7%	(304,773)	34.0%	12.1%	(446,412)	28.4%	9.7%
Shareholders' Funds	1,598,380	12.4%	4.2%	1,867,735	20.7%	9.1%	3,466,115	16.7%	6.8%
Book Value Per Share	1,951	13.0%	4.3%	4,347	21.8%	7.9%	6,298	18.9%	6.7%
Key Ratios (%)	2Q12	Bps Δ YoY	Bps Δ QOQ	2Q12	Bps Δ YoY	Bps Δ QOQ	2Q12	Bps Δ YoY	Bps Δ QOQ
ROAA (annualized)	1.75	8	12	0.92	-16	13	1.17	-9	13
ROAE (annualized)	14.93	168	112	16.12	-284	144	15.57	-66	130
Net Interest Margin (bps)	347	-3	11	341	-3	16	343	-3	15
Fee Inc/Operating Income	30.5	47	96	21.7	-132	-11	24.7	-74	28
Other Non-Interest Inc/Op Inc	35.2	-334	21	23.8	-231	-89	27.8	-273	-48
Op. Cost/ Operating Income	42.2	-240	-161	43.6	-128	2	43.1	-167	-54
Loan-to-Deposit Ratio (LDR)	97.8	351	-81	76.0	75	-27	81.3	140	-25
NPL/Loan Ratio	2.0	-36	-9	3.0	57	47	2.7	30	30
LLR/NPL Ratio	85	1098	269	50	-492	-434	57	-288	-379

Source: Citi Investment Research and Analysis and Company Data

Figure 3. Indian Banking Sector (Ex-SBI): 2Q12 Results – Key Financial Highlights (Rupees Million, Percent)

	PSU Banks ex SBI			Sector ex SBI		
	2Q12 Rsm	YoY Change %	QoQ Change %	2Q12 Rsm	YoY Change %	QoQ Change %
Interest Income	435,123	36.5%	6.6%	736,775	37.2%	7.5%
Interest Expense	-297,895	53.5%	6.2%	(490,158)	53.8%	7.5%
Net Interest Income	137,228	10.0%	7.5%	246,617	13.1%	7.4%
Fee-Based Income	35,511	23.2%	5.7%	86,987	16.9%	8.8%
Other Non-Interest Income	5,796	43.9%	18.9%	13,678	-19.1%	2.3%
Non Interest Income	41,307	25.7%	7.4%	100,665	10.2%	7.9%
Operating Income	178,536	13.3%	7.5%	347,282	12.2%	7.5%
Operating Expenses	(74,335)	10.3%	6.2%	(145,492)	7.7%	4.9%
Pre-Provision Profit	104,201	15.5%	8.4%	201,790	15.7%	9.5%
Pre-Provision ex trading	98,404	14.1%	7.9%	188,112	19.4%	10.1%
Charges for Bad Debts	(30,826)	53.6%	30.3%	(42,950)	16.5%	19.3%
Other Operating Items	(6,685)	393.4%	-11.5%	(7,638)	229.2%	-6.0%
Operating Profit	66,689	-3.1%	2.8%	151,202	11.8%	7.9%
Pre-Tax Profit	66,689	-3.1%	2.8%	151,202	11.8%	7.9%
Tax	(19,506)	-4.7%	9.1%	(44,340)	11.5%	10.5%
Minorities	0	NM	NM	(136)	370.3%	12.6%
Extraordinary Items	0	NM	NM	102	110.4%	9.5%
Net Profit	47,183	-2.5%	0.4%	106,827	11.9%	6.9%
Customer Loans	12,455,672	20.5%	2.5%	20,942,163	20.9%	4.0%
Customer Deposits	17,320,044	20.4%	3.4%	25,993,432	19.3%	4.6%
AIEA	17,315,976	19.5%	2.2%	29,920,273	18.9%	2.9%
AIBL	19,240,823	31.8%	4.8%	29,646,982	23.1%	5.1%
Total Assets	20,228,066	20.4%	0.2%	34,295,851	20.7%	2.9%
Avg Assets	20,169,586	24.1%	5.3%	33,774,805	22.9%	5.2%
Non-Performing Loans (NPL)	274,996	48.6%	21.6%	440,685	27.1%	13.1%
Loan Loss Reserves (LLR)	(126,515)	13.6%	6.8%	(268,154)	15.7%	5.7%
Shareholders' Funds	1,172,464	42.1%	12.0%	2,770,844	23.3%	7.4%
Book Value Per Share	3,252	33.8%	9.1%	5,203	25.2%	7.2%
Key Ratios (%)	2Q12	Bps Δ YoY	Bps Δ QOQ	2Q12	Bps Δ YoY	Bps Δ QOQ
ROAA (annualized)	0.94	-25	-5	1.27	-12	2
ROAE (annualized)	16.10	-735	-187	15.42	-157	-7
Net Interest Margin (bps)	317	-27	16	330	-17	14
Fee Inc/Operating Income	19.9	160	-34	25.0	99	29
Other Non-Interest Inc/Op Inc	23.1	229	-3	29.0	-53	9
Op. Cost/ Operating Income	41.6	-111	-51	41.9	-174	-104
Loan-to-Deposit Ratio (LDR)	71.9	10	-58	80.6	111	-46
NPL/Loan Ratio	2.2	42	35	2.1	10	17
LLR/NPL Ratio	46	-1417	-637	61	-600	-429

Source: Citi Investment Research and Analysis

Figure 4. Individual PSU Banks – 2Q12 Financial Highlights (Rs mn, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	2Q12 Rsm	YoY %	QoQ %	2Q12 Rsm	YoY %	QoQ %	2Q12 Rsm	YoY %	QoQ %
State Bank of India	104,219	28%	7%	74,743	18%	3%	28,104	12%	77%
Punjab National Bank	34,526	16%	11%	25,278	20%	2%	12,050	12%	9%
Bank of Baroda	25,669	26%	12%	21,400	29%	17%	11,791	16%	14%
Union Bank	16,612	8%	4%	12,051	7%	3%	3,525	16%	-24%
Canara Bank	19,617	-2%	9%	16,053	13%	26%	8,522	-15%	17%
Government Banks	241,448	17%	7%	178,944	16%	6%	75,287	3%	20%

Source: Citi Investment Research and Analysis and Company data

Figure 5. Individual Private Banks – 2Q12 Financial Highlights (Rs mn, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	2Q12 Rsm	YoY %	QoQ %	2Q12 Rsm	YoY %	QoQ %	2Q12 Rsm	YoY %	QoQ %
ICICI Bank	25,064	14%	4%	23,538	6%	5%	15,032	22%	13%
HDFC bank	29,445	17%	3%	21,258	18%	5%	11,994	31%	11%
Axis Bank	20,073	24%	16%	17,756	19%	14%	9,203	25%	-2%
Kotak	9,591	14%	4%	6,553	15%	5%	4,326	19%	4%
IDFC	4,980	33%	3%	7,587	44%	55%	5,243	55%	67%
Yes Bank	3,856	23%	9%	3,859	37%	19%	2,350	33%	9%
Federal Bank	4,744	8%	3%	3,613	-6%	2%	1,912	36%	31%
Private Banks	109,389	17%	7%	97,589	16%	11%	59,644	27%	13%
LIC Housing Finance	3,341	10%	-7%	3,354	5%	-11%	984	-58%	-62%
Shriram Transport Finance	8,347	11%	7%	6,818	19%	3%	2,994	0%	-14%
SKS Microfinance	614	-75%	-29%	-294	-121%	-4474%	-3,845	-577%	76%
Mahindra & Mahindra Finance	4,146	25%	17%	2,585	18%	21%	1,363	11%	29%

Source: Citi Investment Research and Analysis and Company Data

Figure 6. Individual PSU Banks – Divergence Between CIRA Estimates and Actuals – 2Q12 Results (Rs mn, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	2Q12E Rsm	2Q12A Rsm	Divergence %	2Q12E Rsm	2Q12A Rsm	Divergence %	2Q12E Rsm	2Q12A Rsm	Divergence %
State Bank of India	99,649	104,219	5%	76,433	74,743	-2%	24,629	28,104	14%
Punjab National Bank	32,433	34,526	6%	23,959	25,278	6%	11,370	12,050	6%
Bank of Baroda	23,913	25,669	7%	19,736	21,400	8%	11,722	11,791	1%
Union Bank	15,926	16,612	4%	10,552	12,051	14%	3,691	3,525	-4%
Canara Bank	18,353	19,617	7%	12,297	16,053	31%	7,181	8,522	19%
PSU Banks	229,660	241,448	5%	170,969	178,944	5%	72,609	75,287	4%

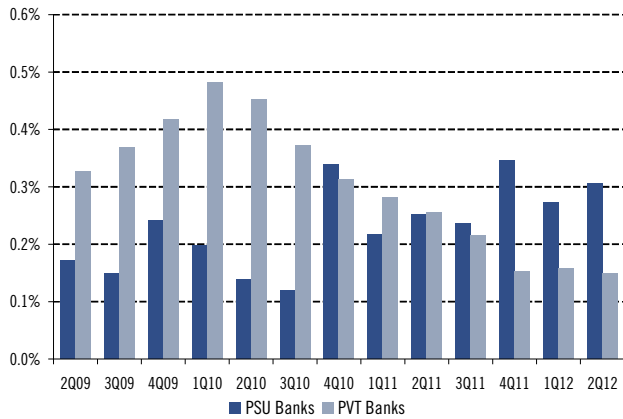
Source: Citi Investment Research and Analysis and Company Data

Figure 7. Individual Private Banks – Divergence Between CIRA Estimates and Actuals – 2Q12 Results (Rs mn, %)

	Net interest Income			Pre-Provision Profit			Net Profit		
	2Q12E Rsm	2Q12A Rsm	Divergence %	2Q12E Rsm	2Q12A Rsm	Divergence %	2Q12E Rsm	2Q12A Rsm	Divergence %
ICICI Bank	24,919	25,064	1%	23,074	23,538	2%	14,454	15,032	4%
HDFC bank	28,951	29,445	2%	21,240	21,258	0%	12,169	11,994	-1%
Axis Bank	18,484	20,073	9%	16,556	17,756	7%	9,525	9,203	-3%
Kotak	9,437	9,591	2%	6,719	6,553	-2%	4,286	4,326	1%
IDFC	4,909	4,980	1%	4,898	7,587	55%	3,128	5,243	68%
Yes Bank	3,724	3,856	4%	3,414	3,859	13%	2,191	2,350	7%
Federal Bank	4,720	4,744	1%	3,750	3,613	-4%	1,689	1,912	13%
Private Banks	106,750	109,389	2%	93,140	97,589	5%	56,839	59,644	5%
LIC Housing Finance	3,551	3,341	-6%	3,638	3,354	-8%	2,596	984	-62%
Shriram Transport Finance	8,334	8,347	0%	6,738	6,818	1%	3,352	2,994	-11%
SKS Microfinance	614	614	0%	-294	-294	0%	-3,845	-3,845	0%
MMFSL	4,088	4,146	1%	2,659	2,585	-3%	1,470	1,363	-7%

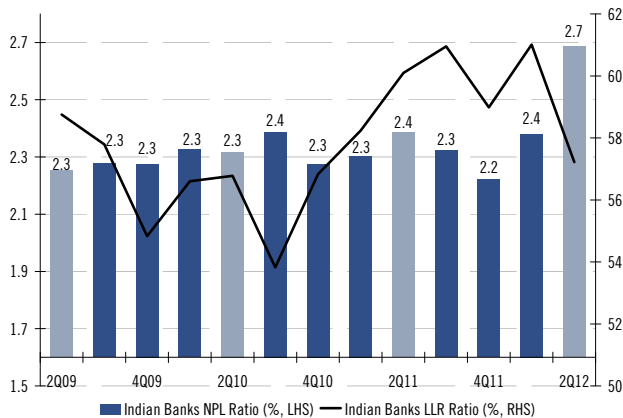
Source: Citi Investment Research and Analysis and Company Data

Figure 8. India Banks – Bad Debt Charges (as % of Opening Loans)



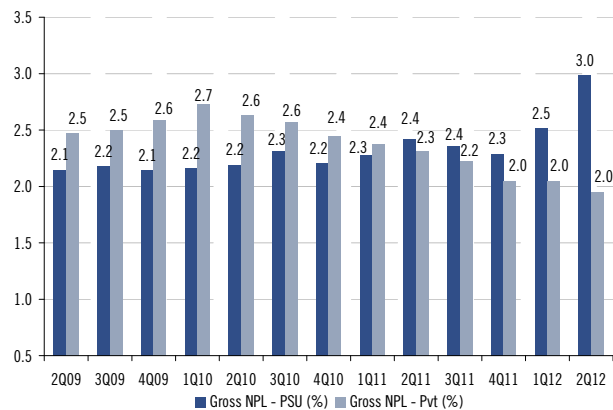
Source: Citi Investment Research and Analysis and Company Data

Figure 10. India Banks – Gross NPLs and Loan Loss Ratio (% YoY)



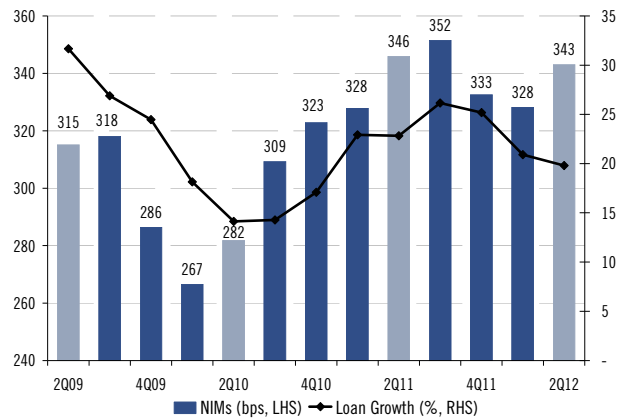
Source: Citi Investment Research and Analysis and Company Data

Figure 12. Gross NPLs – PSU and Private Banks



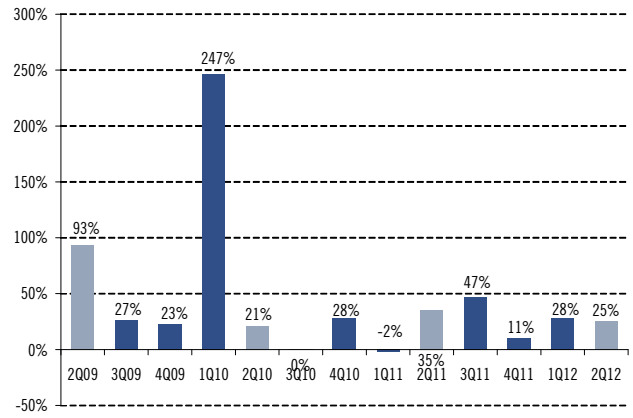
Source: Citi Investment Research and Analysis and Company Data

Figure 9. India Banks – Net Interest Margin (bps) & Loan Growth (%YoY)



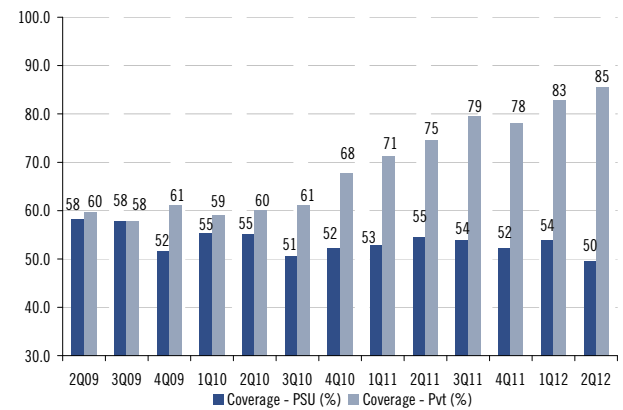
Source: Citi Investment Research and Analysis and Company Data

Figure 11. India Banks – Bad Debt Charges Growth (% YoY)



Source: Citi Investment Research and Analysis and Company Data

Figure 13. Coverage – PSU and Private Banks



Source: Citi Investment Research and Analysis and Company Data

Figure 14. Restructured Assets (as Percentage of Loans) as on 2Q12

Individual Banks	2Q11	3Q11	4Q11	1Q12	2Q12
ICICI Bank	1.3	1.2	0.9	0.9	1.1
HDFC Bank	0.3	0.3	0.4	0.4	0.4
AXIS Bank	1.9	1.7	1.4	1.6	1.7
Federal Bank	0.4	0.5	0.9	1.0	0.1
Private Sector Banks	1.0	0.9	0.8	0.8	0.9
State Bank of India	4.4	4.4	4.5	4.4	4.4
Punjab National Bank	6.4	6.5	6.3	6.4	8.0
Bank of Baroda		2.9	2.9	3.1	3.3
Canara Bank	4.8	4.6	3.8	4.0	3.9
Union Bank Of India		3.9	3.7	4.0	4.5
Oriental Bank of Commerce	6.1	5.7	5.4	4.9	3.9
Andhra Bank	3.6	3.7	3.5	3.2	3.8
Central Bank Of India	4.4	4.1	4.0	4.4	5.0
Government Banks	4.5	4.5	4.3	4.4	4.8
Indian Banks	3.7	3.6	3.5	3.5	3.8

Source: Citi Investment Research and Analysis and Company Data

Figure 15. India Banks – CIRA Coverage Universe Valuation Summary

	RIC Code	Price (Rs) 15-Nov	TP (Rs)	Rating	P/E (x) 2012	P/E (x) 2013	P/B (x) 2012	P/B (x) 2013	ROE (%) 2012	ROA (%) 2012	Div. Yld 2012	M-Cap USD Mn
Private Sector Banks												
ICICI Bank	ICBK.BO	790.8	1000	1	14.4	11.9	1.5	1.4	11.1%	1.4%	2.0%	18,080
HDFC Bank	HDBK.BO	471.8	500	2	22.0	17.1	3.6	3.0	18.1%	1.7%	0.7%	21,895
AXIS Bank	AXBK.BO	1008.2	1400	1	11.0	9.0	1.9	1.6	19.3%	1.5%	1.6%	8,249
Kotak Mahindra Bank	KTKM.BO	486.9	490	2	19.0	15.8	2.8	2.4	15.9%	2.4%	0.2%	7,131
Yes Bank	YESB.BO	284.9	345	1	10.3	8.2	2.1	1.7	22.7%	1.4%	1.1%	1,985
Federal Bank	FED.BO	378.1	460	1	9.4	7.8	1.1	1.0	12.7%	1.2%	1.6%	1,283
Government Banks												
State Bank of India	SBI.BO	1729.9	2250	1	9.9	7.6	1.5	1.3	16.0%	0.8%	1.7%	21,793
SBI - Consolidated	SBI.BO	1729.9	2250	1	8.2	6.4	1.2	1.1	15.1%	0.8%	1.7%	21,793
Punjab National Bank	PNBK.BO	931.0	930	3	5.8	4.9	1.2	1.0	19.6%	1.2%	2.5%	5,852
Bank of Baroda	BOB.BO	765.0	820	2	5.8	5.0	1.2	1.0	22.2%	1.3%	2.3%	5,943
Canara Bank	CNBK.BO	446.1	375	3	4.9	3.9	0.9	0.8	18.6%	1.1%	2.5%	3,921
Union Bank Of India	UNBK.BO	216.4	200	3	5.7	5.0	0.9	0.8	14.7%	0.8%	3.7%	2,251
Diversified Financial Services												
Infrastructure Development Finance	IDFC.BO	114.3	135	1	12.5	10.3	1.4	1.3	11.7%	2.6%	1.7%	3,318
LIC Housing Finance	LICH.BO	215.9	188	3	9.8	7.9	2.0	1.7	22.7%	1.8%	1.7%	2,033
L&T Finance Holdings	LTFH.BO	47.5	54	2	15.1	11.0	1.6	1.4	13.4%	2.3%	0.0%	1,614
Shriram Transport Finance	SRTR.BO	552.7	660	2	8.8	7.5	2.1	1.7	25.8%	4.0%	1.3%	2,480
SKS Microfinance	SKSM.BO	142.7	155	3H	NM	NM	0.9	1.0	-48.4%	-18.6%	0.0%	207
Mahindra And Mahindra Financial Services	MMFS.BO	656.1	610	3	11.1	9.4	2.2	1.9	21.7%	3.7%	1.7%	1,354
Edelweiss Capital	EDEL.BO	24.8	24	3	12.1	9.7	0.8	0.7	6.6%	1.0%	2.0%	372
Motilal Oswal Financial Services	MOFS.BO	81.5	77	3	11.6	9.7	1.0	0.9	9.2%	5.2%	1.6%	235
Reliance Capital	RLCP.BO	322.3	455	1	15.5	13.1	1.0	0.9	6.4%	1.5%	2.0%	1,570

Source: Citi Investment Research and Analysis estimates

Appendix A-1

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