

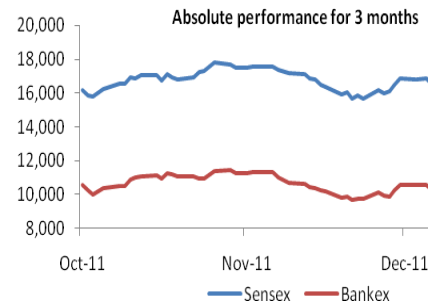
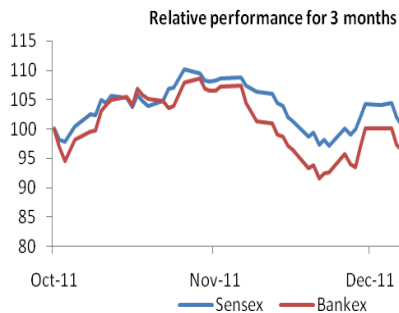
Banking Sector Review

Indian Banks: Key trigger to watch out for Q3FY12

The Past: The overall banking result for Q2FY12 was not good. Asset quality deteriorated and fear of NPAs arised driving down the overall performance of the banking sector which had a lackluster quarter. The primary reasons for this were:

- High interest rates
- Slowdown in the economy
- Depreciating rupee further hurted the bank's asset quality as most of the corporates were exposed to forex losses which could not be sustained by comparatively smaller corporates.

As a result the bankex underperformed the broader markets in the past three months and the banking stocks were beaten over asset quality woes.



| | Price on Q2FY12 results date | CMP | % correction |
|-------------------------|------------------------------|------------|---------------|
| SBI | 1978 | 1630 | -17.6% |
| PNB | 998 | 766 | -23.2% |
| Axis Bank | 1124 | 794 | -29.4% |
| HDFC Bank | 487 | 427 | -12.3% |
| ICICI Bank | 945 | 696 | -26.3% |
| Kotak | 478 | 421 | -11.9% |
| Canara Bank | 460 | 367 | -20.2% |
| Central Bank | 102 | 65 | -36.4% |
| Bank of Baroda | 756 | 669 | -11.5% |
| Union Bank | 231 | 173 | -25.1% |
| Dena Bank | 81 | 49 | -39.5% |
| DCB | 44 | 32 | -27.3% |
| Yes Bank | 285 | 232 | -18.6% |
| Federal Bank | 385 | 336 | -12.6% |
| Karur Vysya Bank | 391 | 348 | -11.1% |
| Indusind Bank | 270 | 226 | -16.3% |
| Allahabad Bank | 148 | 117 | -21.2% |
| Dhanlaxmi Bank | 64 | 45 | -29.4% |
| Uco Bank | 75 | 47 | -37.3% |
| Bank of India | 334 | 267 | -19.9% |
| United Bank of India | 76 | 46 | -39.5% |
| Vijaya Bank | 60 | 45 | -25.5% |
| Indian Overseas Bank | 99 | 73 | -26.3% |
| IDBI Bank | 109 | 79 | -27.5% |

Source: BSE, Nirmal Bang Securities

| | Advances | Gross NPA % | Net NPA % | NIMs | P/E | P/ABV | 52-wk-high | 52-wk-low | ROE | Div. Yield % |
|---------------------|----------------|--------------|--------------|--------------|-------------|-------------|--------------|------------|--------------|--------------|
| SBI | 790,601 | 4.19% | 2.04% | 4.1% | 9.2 | 1.94 | 2,960 | 1576 | 10.4% | 1.2% |
| PNB | 249,020 | 2.05% | 0.84% | 4.0% | 5.0 | 1.20 | 1,237 | 751 | 20.6% | 2.9% |
| BOB | 239,120 | 1.41% | 0.47% | 2.4% | 5.6 | 1.26 | 1,007 | 630 | 20.9% | 2.5% |
| BOI | 214,332 | 3.02% | 1.98% | 2.4% | 7.4 | 1.19 | 498 | 261 | 13.0% | 2.6% |
| HDFC | 188,502 | 1.00% | 0.20% | 4.1% | 20.8 | 3.65 | 520 | 396 | 16.2% | 3.9% |
| IDBI | 155,900 | 2.5% | 1.6% | 2.00% | 3.8 | 0.69 | 168 | 77 | 13.3% | 4.4% |
| Union Bank | 147,300 | 3.49% | 2.04% | 3.20% | 7.8 | 1.22 | 359 | 156 | 16.6% | 4.6% |
| Axis | 140,089 | 1.06% | 0.31% | 3.78% | 8.9 | 1.61 | 1461 | 785 | 18.1% | 1.8% |
| Central Bank | 128,235 | 2.94% | 1.37% | 3.00% | 4.3 | 1.24 | 170 | 63 | 20.7% | 2.3% |
| IOB | 124,550 | 3.07% | 1.21% | 2.9% | 5.5 | 0.64 | 164 | 73 | 12.6% | 6.8% |
| Allahabad Bank | 95,717 | 1.77% | 0.99% | 3.68% | 2.8 | 0.71 | 240 | 114 | 18.6% | 5.1% |
| UCO | 95,549 | 3.64% | 2.11% | 2.8% | 3.2 | 0.79 | 122 | 45 | 18.3% | 6.4% |
| United | 54,842 | 3.48% | 2.21% | 2.80% | 3.2 | 0.67 | 114 | 46 | 15.8% | 4.8% |
| Vijaya | 54,304 | 2.54% | 1.42% | 2.72% | 2.6 | 0.74 | 104 | 44 | 13.4% | 5.6% |
| Yes Bank | 34,194 | 0.20% | 0.04% | 2.9% | 8.7 | 1.92 | 341 | 231 | 19.9% | 1.1% |
| Federal Bank | 33,607 | 3.61% | 0.58% | 3.8% | 7.5 | 1.10 | 477 | 322 | 12.0% | 2.5% |
| IndusInd | 30,266 | 1.09% | 0.31% | 3.4% | 13.7 | 2.52 | 292 | 181 | 16.3% | 0.9% |
| Karur Vysya | 20,216 | 1.48% | 0.29% | 3.1% | 7.7 | 1.53 | 479 | 322 | 19.4% | 3.5% |
| Dhanlaxmi | 10,130 | 0.55% | 0.17% | 2.20% | 22.1 | 0.47 | 136 | 42 | 3.13% | 1.1% |

Source: Company data, Nirmal Bang Securities

Way ahead:

Asset quality pressures are likely to continue for banks with greater exposure to risky sectors like SME, real estate, textiles, aviation, steel, power, infrastructure and higher restructured loan book.

The impact of slowdown has been clearly visible in the performance of the businesses as well as the stock prices of banks. We believe that the **negatives have been broadly priced** in the stock prices and the **downside from here is limited**. The bankex is expected to outperform once RBI starts easing out the monetary policy.

We have tried to analyze and understand bank's **Management's View** with regards to the performance on asset quality front in Q3FY12 and have captured some of the key points. The sources of the interview are Money control, CNBC, ET now etc.

Although most of the banks are apprehensive about the asset quality, they have maintained that better recovery is likely to help them in bringing down the NPAs from the levels of Q2FY12. **We believe that the stock prices have already discounted the expectation of higher slippages in the quarter and thus the stocks are available at an attractive valuation.**

Based on our analysis we have shortlisted some banks which are expected to post better results as compared to Q2FY12 in terms of asset quality. These stocks need to be watched out for in Q3FY12.

➤ **Better performance expected on Asset Quality front:**

Yes Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 69 | 0.20% | 14 | 0.04% |
| Q1FY12 | 56 | 0.17% | 3 | 0.01% |
| Q4FY11 | 81 | 0.23% | 9 | 0.03% |

Management view: Commenting on asset quality front, Rana Kapoor said in an interview “At Yes Bank we have been **fairly proactive in identifying and remedying problems** in some cases and we’ve also been making counter-cyclical buffer provisions.” He further added that the banks net NPA is about 3 bps and gross NPA is 20 bps and provisioning coverage is being maintained at over 80% levels. “So it is very important in markets like these to de-risk and de-bulk certain sectors. At the same time, banks being a very important basket of growth should also look at some less interest sensitive sectors that have a huge opportunity to provide incremental growth opportunities. So, we are looking at rebalancing growth as well.”

Our view: Yes bank has always maintained the **best in class asset quality** and we believe that going forward also with its pro active approach the bank will emerge as a winner in terms of asset quality as compared to most other private sector banks even in the downturn. **The stock has corrected almost 18.6% since Q2FY12 results and is trading at P/ABV of 1.92x.**

Bank of Baroda:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 3,402 | 1.41% | 1,119 | 0.47% |
| Q1FY12 | 3,425 | 1.46% | 1,024 | 0.44% |
| Q4FY11 | 3,153 | 1.36% | 791 | 0.35% |

Management’s View - M D Mallaya, CMD said, “As for the overall asset quality of Bank of Baroda, we are **reasonably placed** because the overall asset quality has been robust right from the beginning. **The overall NPLs after September have been slightly lower than what it was earlier.** Going forward, we would expect the same trend to continue. There could be stresses here and there, but overall, we **have been able to manage them**, and therefore, this trend is likely to continue during the rest of the year.”

Our view: The banks restructured asset book stands at 3.27% of total loan book which is quite lower than its peers group. Also the bank has been able to maintain its asset quality in the previous quarter and we believe that this quarter will be no exception. **The stock has corrected almost 11.5% since Q2FY12 results and is trading at P/ABV of 1.26x.**

Union Bank:

| | Gross NPA | | Net NPA | |
|---------------|--------------|--------------|--------------|--------------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 5,136 | 3.49% | 2,959 | 2.04% |
| Q1FY12 | 3,745 | 2.57% | 1,893 | 1.32% |
| FY11 | 3,623 | 2.37% | 1,803 | 1.19% |

Management's View - SS Mundra, executive director said, "Essentially we expect that in remaining two quarter of the fiscal the **recovery and up gradation would be achieved**. And so far in two months what we have achieved is quite **satisfactory** as per our assumption. So we feel that the further slippage may not exceed what we are able to recover and upgrade in the remaining part of the year."

Talking about NPAs, Chairman and Managing Director of the Union Bank M V Nair said, "**We expect the December quarter bad loan ratio below 3.25% and by March, it should fall to below 3%**".

Our view: The bank has seen a significant increase in its NPA which stood at 3.5% in the last quarter. Looking at this, **Management's outlook is quite encouraging** and if the Management is able to achieve it the stock will perform well in the near term. **The stock has corrected almost 25% since Q2FY12 results and is trading at P/ABV of 1.2x.**

Federal Bank:

| | Gross NPA | | Net NPA | |
|---------------|--------------|--------------|------------|--------------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 1,250 | 3.61% | 196 | 0.58% |
| Q1FY12 | 1,300 | 3.94% | 236 | 0.74% |
| Q4FY11 | 1,148 | 3.49% | 191 | 0.60% |

Management's View - Shyam Srinivasan, MD & CEO, Federal Bank commented on NPA levels, "For FY12 our guidance has been that if we keep the current momentum we should be able to deliver around the second half range. FY13 should see a pick up in the second half. We are quite confident that the overall environment will certainly improve in the second half of FY13. There are some near term headwinds we have to all manage. But we are very sort of actively involved with each and every client to determine the stress that they may be going through because of the environment but broadly FY13 should be on course."

Management added that the bank has undergone a process change in underwriting and the new system is in place which is expected to yield results through improved asset quality.

Our view: Although we expect the asset quality of the bank to remain under pressure given the macro economic scenario and the high restructured book in the near term we believe that the **efforts to improve the bank's asset quality are in full swing and will yield results by the end of FY12E**. The total restructured book stands at 1,430 crs which comprises 4.3% of gross advances as on Q2FY12. **The stock has corrected almost 12.6% since Q2FY12 results and is trading at P/ABV of 1.1x.**

Karur Vysya Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 298 | 1.48% | 58 | 0.29% |
| Q1FY12 | 275 | 1.48% | 39 | 0.21% |
| Q4FY11 | 228 | 1.26% | 14 | 0.07% |

Management's View - K Venkataraman, managing director and chief executive officer, Karur Vysya Bank expects to **maintain asset quality going forward**. He added that "In none of our SME units or short term units there are sector specific issues. Going forward a nominal NPA can come up as in the normal course of business. We do not think economic slowdown in any particular sector is going to be a problem for our NPAs. Also, in relation to the state electricity board, he said, "We do have exposure to SEB in Tamil Nadu Punjab, Rajasthan and Gujarat. They are all okay because they have not faced any problems with us."

Our View: Although the bank has seen some increase in Gross NPAs from FY11 levels it has been able to maintain it in the last quarter. Management expects to maintain the asset quality even though it has exposure to the stressed SEBs, which seems positive. **The stock has corrected almost 11.1% since Q2FY12 results and is trading at P/ABV of 1.5x.**

IndusInd Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 333 | 1.09% | 93 | 0.31% |
| Q1FY12 | 309 | 1.08% | 84 | 0.30% |
| FY11 | 266 | 1.01% | 73 | 0.28% |

Management's View - Romesh Sobti, MD & CEO said, "The gross NPAs at around 2.3% for the industry are still in a **stable** sort of range. The trending is yet to be seen. So if the trend continues for another quarter or so, then you can see definitely that the slowdown is affecting delinquencies. Certainly portfolios are under watch. The credit screens have been tightened but so far **our portfolio is holding up and the retail portfolio where more concerns were expressed is actually holding up much better than we thought.**"

Our View: The bank has been able to maintain a healthy asset quality in the past. Although there may be some near term pressures on the banks asset quality but we believe that the negatives have already been priced as the stock has corrected almost 16.3% and is trading at P/ABV of 2.5x.

➤ **Some concerns over asset quality still persist:**

Allahabad Bank:

| | Gross NPA | | Net NPA | |
|--------|-----------|-------|-----------|-------|
| | Rs in crs | In % | Rs in crs | In % |
| Q2FY12 | 1,715 | 1.77% | 684 | 0.99% |
| Q1FY12 | 1,604 | 1.62% | 589 | 0.60% |
| Q4FY11 | 1,648 | 1.74% | 736 | 0.79% |

Management's View - JP Dua Chairman said, "The four major sectors of the economy are affected aviation, textile, steel and telecommunication. We are not in a space of telecommunication and aviation, we hardly have any exposure. Our exposure is into steel and textile. So far, **we have received only proposal for restructuring in textile**. We have not received any proposal for restructuring in any other sector as far as these four are concerned.

We are one of the major financiers of SMEs and they are affected directly because of rupee depreciation because of increase in freight rates, because of increase in commodity prices mainly coal and steel. **We are worried about the SME sector where there may be little higher delinquency**. The positive side is the monsoon has been good, so agriculture advances will not pose many problems because this year has been a good monsoon and our exposure to agriculture sector directly is around 13.5%, hence, **we do not expect much NPA in agriculture sector this year, maybe some delinquencies in SME sector.**"

Our view: Although the bank had reported lower NPAs in the previous quarter; Management has mentioned that there may be some higher delinquencies in the SME segment. Considering the banks huge concentration in the retail and SME segment we expect the bank's asset quality to remain under pressure in the near term. **The stock has corrected almost 21.2% since Q2FY12 results and is trading at P/ABV of 0.71x.**

Dhanlaxmi Bank:

| | Gross NPA | | Net NPA | |
|--------|-----------|-------|-----------|-------|
| | Rs in crs | In % | Rs in crs | In % |
| Q2FY12 | 56 Cr | 0.55% | 17 Cr | 0.17% |
| Q1FY12 | 61 Cr | 0.63% | 22 Cr | 0.23% |
| Q4FY11 | 67 Cr | 0.74% | 27 Cr | 0.30% |

Management's View - Managing Director and Chief executive Amitabh Chaturvedi said, "We don't have exposure to the power industry, except in Tamil Nadu State Electricity Board. Being a medium-sized bank, our capability to lend to a large project with a high gestation period is limited. Our exposure to the aviation sector is nil. For export-related companies like textiles, there is stress. However, so far, we have **not seen any significant rise** in non-performing assets".

Our view: Given the banks **risky asset profile**, SME and unsecured retail coupled with wholesale funding is likely to pose a problem for the bank in the deteriorating economic conditions. **The stock has corrected almost 29.4% since Q2FY12 results and is trading at P/ABV of 0.47x.**

UCO Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 3,476 | 3.64% | 2,022 | 2.11% |
| Q1FY12 | 3,361 | 3.50% | 2,040 | 2.15% |
| Q4FY11 | 3,150 | 3.13% | 1,825 | 1.84% |

Management's View - The bank had agreed to reschedule cash-strapped Uttar Haryana Bijli Vitran Nigam's (UHBVN) payment of its outstanding term loan of Rs 887 crore from 3 to 10 years.

Arun Kaul, Chairman of UCO Bank said that UHBVN continues to be a standard asset for the lender and UHBVN has not requested for any reduction in rates. Further he said that the bank has not received any requests for restructuring from other state electricity boards. "We have cleaned up our balance sheet significantly and **asset quality will be stable going forward,**" he added. However, Management did point that **steel and textile accounts** remain under some pressure.

Our view: The stock has been punished badly since the news of restructuring has been announced. The banks restructured assets as % of total assets stands very high at around **6.6%** which is higher than most of its peers. We believe some pain on the asset quality still persists for the bank. **The stock has corrected almost 37.3% since Q2FY12 results and is trading at P/ABV of 0.79x.**

Bank of India:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 6,548 | 3.02% | 4,245 | 1.98% |
| Q1FY12 | 5,791 | 2.69% | 2,690 | 1.27% |
| Q4FY11 | 48,12 | 2.23% | 1,945 | 0.91% |

Management's View - N Seshadri, executive director, Bank of India expects to see a significant improvement in the asset quality in second half of FY12 "We are seeing a good amount of recovery and would definitely see a **substantial improvement** in terms of the asset quality and recovery in the future quarters."

Bol has an exposure of Rs 6,500 crore to SEBs and the **Management said that it is looking to restructuring** and will be able to complete the whole restructuring of SEBs in the next couple of quarters. As per the management **less than 20-25% of the portfolio would need restructuring.**

Further, the bank has also lent Rs 500 crore to Kingfisher Airlines and is in talks with the cash strapped airlines for restructuring. Management said "We will definitely provide need based finance to not only Kingfisher but to any airline. We know this sector is in some sort of a problem, we will come to their help as long as the restructuring terms are honoured."

Our view: The banks **restructured assets as % of total assets is high at around 5.2% which is higher than most of its peers.** Although the Management reinforced that the cash recoveries and up gradation have been strong in the past two month, we believe that increase in restructured book is likely to offset the impact. **The stock has corrected almost 19.9% since Q2FY12 results and is trading at P/ABV of 1.19x.**

United Bank of India:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 1,908 | 3.48% | 1,202 | 2.21% |
| Q1FY12 | 1,535 | 2.89% | 8,78 | 1.67% |
| Q4FY11 | 1,356 | 2.5% | 7,57 | 1.42% |

Management's View - Bhaskar Sen, chairman and managing director, UBI said, "It is indeed a major challenge and we are focusing our full attention to **arrest further slippages and at the same time upgrade the existing NPAs by recovering the critical amounts.** We are sure our efforts will yield **positive** results in the near future."

The stock has corrected almost 39.5% since Q2FY12 results and is trading at P/ABV of 0.67x.

Vijaya Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 1,381 | 2.54% | 701 | 1.42% |
| Q1FY12 | 1,450 | 2.83% | 833 | 1.65% |
| Q4FY11 | 1,259 | 2.56% | 741 | 1.52% |

Management's View - HS Upendra Kamath, chairman, Vijaya Bank said, "In Q2FY12 we had brought down the gross as well as net NPAs both in absolute as well as in percentage terms. I did indicate that going forward **there will be some stress** on the quality of assets. Our bank's exposure to the power sector is about Rs 15,100 crore as of September. Within this, the utilities, we have an exposure of about Rs 5,000 crore. **There are one or two requests for restructuring which are under examination by the lenders to each of these utilities together.**"

Our view: The major concern which lies with the bank is its asset quality. Although the bank has managed to keep its NPA in control this quarter and has guided for gross NPAs to be at 2% for FY12E, we believe that due to high power sector exposure, chances of higher slippages still persists. **The stock has corrected almost 25.5% since Q2FY12 results and is trading at P/ABV of 0.74x.**

Indian Overseas Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 3,898 | 3.07% | 1,505 | 1.21% |
| Q1FY12 | 3,292 | 2.76% | 1,258 | 1.08% |
| Q4FY11 | 3,090 | 2.72% | 1,328 | 1.19% |

Management's View - As per M Narendra, chairman of Indian Overseas Bank "As far as asset quality is concerned even though in industry this is slightly a problem and it is primarily connected to the economy, we feel that we should not be unduly worried and we should be able to manage it. For Indian Overseas Bank, **we are on a better position to have a manageable level.**"

On recovery front we are aiming at around Rs 1,200 crore, Rs 500 crore extra. But over and above that, our endeavor is to take it to atleast nearer to another Rs 700 crore. So, if that

recovery comes, we'll be comfortable in as far as the overall NPA is concerned. However around 5.6% is the banks restructured account out of which 95% accounts are standard.

On UHBVN account the Management commented "There is a request for restructure. They are eligible for restructure because we have security of the receivables and all. However, we are examining for restructure."

Our View: IOB had witnessed a significant increase in its NPA levels in the previous quarter. Although Management mentions that asset quality is expected to remain stable, we feel that higher restructured book will pose a problem for the bank. The stock has corrected almost 26.3% since Q2FY12 results and is trading at P/ABV of 0.64x.

IDBI Bank:

| | Gross NPA | | Net NPA | |
|--------|------------|-------|------------|-------|
| | Rs. In Crs | In % | Rs. In Crs | In % |
| Q2FY12 | 3,889 | 2.47% | 2,443 | 1.57% |
| Q1FY12 | 3,288 | 2.10% | 1,933 | 1.25% |
| Q4FY11 | 2,785 | 1.76% | 1,678 | 1.06% |

Management's View - Executive director of IDBI, RK Bansal, said, "We agree this year has been somewhat difficult for the banking sector from the non-performing loan (NPL) perspective and also from the restructuring perspective. We don't envisage a very high increase, but it will be slightly on the higher side. If we look at next two quarters, December end and March, NPLs are still there in the system. So I think the banks have to accept that fact."

Our View: IDBI had witnessed a significant increase in its NPA levels in the previous quarter. Going forward, also the Management has indicated that NPAs will be at the higher side. Looking at this we feel that the asset quality of the bank remains under pressure. The stock has corrected almost 27.5% since Q2FY12 results and is trading at P/ABV of 0.69x.

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NOTE

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