



- ✓ Credit off-take slows; banks prefer to invest more than lend to maintain quality of the credit book
- ✓ NIMs unlikely to see a significant dent
- ✓ Increase in G-Sec yields likely to lead to lower treasury gains
- ✓ Higher NPL provisions expected
- ✓ Bottom-line growth to moderate
- ✓ Loans restructuring expected to take centre stage
- ✓ Valuations look attractive as many banks still trade below 1x trailing book

Credit Off-take slows down

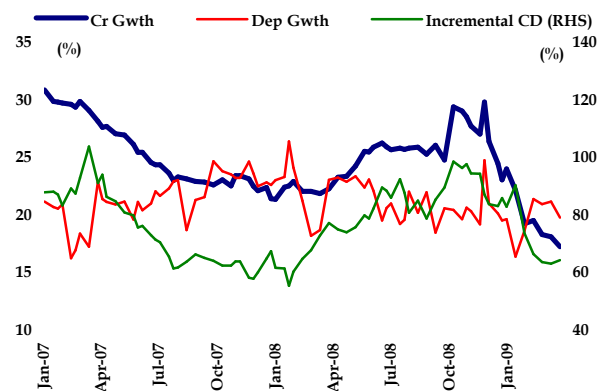
Credit growth has slowed down in line with our expectations, although more deeper to 17.3% after staying in the range of 28-30% during most part of the last quarter. Sudden dip in credit growth is on account of repayment of oil marketing companies, slowdown in industrial production, lower working capital requirement and delay in execution of capex plans. All the mentioned factors led to a magnified impact resulting in sharp slowdown in credit off-take. Credit growth somehow remained healthy during early part of the year on account of desperate need for funds as other source of capital for corporate India such as ECB, FCCB has totally dried up.

In our reckon credit off-take has slowed down mainly on two counts. Firstly banks seem to have shifted their focus on investments from credit in a bid to become more risk-averse. In a relatively more challenging macro and external environment, decreasing corporate profits coupled with decreasing interest rates banks would quite obviously prefer to give selective credit to safeguard their balance sheet. Banks preference to investments is reflected in increasing Investment-Deposit ratio to 30.4% from 28.7% last September and with increase in Gsec yield, it is bound to increase further.

Secondly Deposits are not growing at the required pace. Deposit growth is continuously hovering between 19-21% for the quarter as against 23-25% in corresponding quarter last year. Credit-Deposit ratio remains healthy at 72.3%. Major growth in deposits during the year has come through time deposits. Going forward with decreasing interest

rate scenario, transition from time to demand deposit should take place.

Credit growth slows



Source: RBI, Khandwala Research

Margins unlikely to be significantly impacted

There will be some strain on the margin front. Most of the banks, mainly PSU banks have cut their lending rates quite aggressively during the quarter. Also considering sluggish demand deposit growth spreads between lending yield and cost of deposits is bound to be under pressure. Cut in retail deposit rates as well as significant dip in wholesale deposit rates will support the margins. Even 50 bps cut in CRR during the quarter will cushion the NIMs. Indian Banks have over the year depicted a trend of stable behavior in terms of net interest margins. Interest rates have remained volatile and have moved over 300-400 bps over past few years, still the net interest margins for the industry are somewhat stable. We view Indian banking industry has become lot more mature and can protect margins, even at the cost of lower credit growth.

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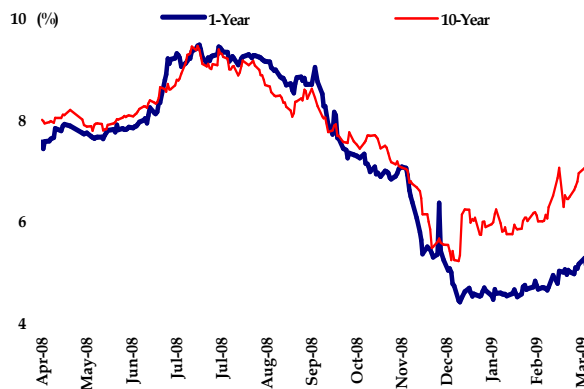
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Increase in G-Sec yield will lead to lower treasury gains

We expect banks will report lower treasury gains for the quarter, after the spurt in Gsec yields especially in the long end. However some of the banks seem to have cashed in during the earlier part of the quarter, when the yields were significantly lower. There could be investment provisioning for selective banks, however it will be limited as current quoted yield are below the cushion yield for most of the banks.

1-Year G-Sec Yield & 10-Year G-Sec Yield



Source: RBI, Khandwala Research

Higher NPL Provision

We expect banks to provide heavily on account of Non Performing Loans (NPL). We expect some amount of increase in non-performing loans in retail segment. Even SME segment has to be monitored as interest rates continue to remain high coupled with higher credit growth for past few years. Few stress points to be watched out is commercial real estate lending, credit card receivables and other unsecured lending. We have conservatively built in higher delinquencies going forward for companies across our coverage.

Net NPA to be computed without deducting floating provision

As per the recent announcement made by the RBI, Floating provision will not be allowed to be deducted from Gross NPA while arriving at Net NPA. As a result Net NPA for various banks will show a jump during the quarter without similar jump in Gross NPA. However RBI has allowed such banks to consider the floating provision as a part of its Tier II capital which will thereby help

banks in improving its capital adequacy. Banks which will be mainly affected are PNB & UBI.

As a result banks are likely to provide higher for its loss assets to partially offset the change in norm of floating provision on Net NPA.

Easing of Restructuring Norms will provide temporary relief

RBI has allowed banks to restructure real estate loans (until June 30, 2009) & still classify them under standard asset. Also banks can restructure other loans second time until June 30, 2009. Infrastructure loans can be classified non-performing if overdue for more than two years post date of project completion (as originally envisaged) as opposed to one year earlier. These measures are likely to push back recognition of NPLs. These measures are aimed to provide temporary relaxation to real estate and infrastructure projects

Banks will still have to provide for loss in present value on account of restructuring. But it is expected that such provisioning will be less than provisioning required if those loans slip into NPA. Restructuring will mainly include modification in repayment schedule and in some cases change in interest rates also. Restructuring is expected to be ~2-4% of existing loan book. Restructuring will postpone recognition of NPA for at least next 2-3 quarters.

Also RBI has decreased risk weights on exposure to real estate and NBFC. General provisioning on commercial real estate, personal/credit card loans, capital markets exposure and to systemically important NBFCs reduced to 0.4% from 2%. We believe these moves increase the underlying risks for Indian banks. Nothing much would be visible on NPL front due to restructuring during the quarter, but it will increasing uncertainty about NPLs been masked by the banks.

Net profit likely to moderate

We expect net profit to be moderate for most of the banks on account of lower credit growth, pressurized margins, moderating fee income, lower treasury gains and higher provisions. Rise in Gsec yields will lower treasury income. Banks have cut their lending rates more sharply than their deposit rates, which will impact their spreads. Fee income growth might slow down with decreasing expectation about economic growth. Banks have



continuously focused on containing operating cost. Most of the banks have completed major part of the CBS implementation; hence operating expenses will further be controlled. Restructuring process will take the centre stage during the quarter; banks will have to provide for loss in present value on account of restructuring.

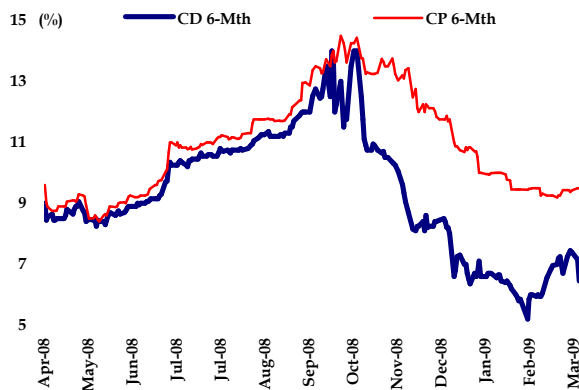
Economic Outlook

Interest rates have remained high for over a year and the ill effects have already been seen in the form of slowing IIP & GDP. There has been a sharp deterioration in the global financial environment, which has impacted domestic money, and forex markets with a marked increase in volatility and a sharp imbalance on market liquidity as reflected in the movements in overnight interest rates and the high recourse to the Liquidity Management Facility.

Wholesale funding cost has decreased significantly

CD & CP rates have come down significantly. Private Banks like ICICI Bank and Axis Bank mainly, which are highly dependent upon wholesale funding will benefit the most. Further decrease in wholesale deposit cost will further push the retail deposit downwards.

CD and CP Rates



Source: RBI, Khandwala Research

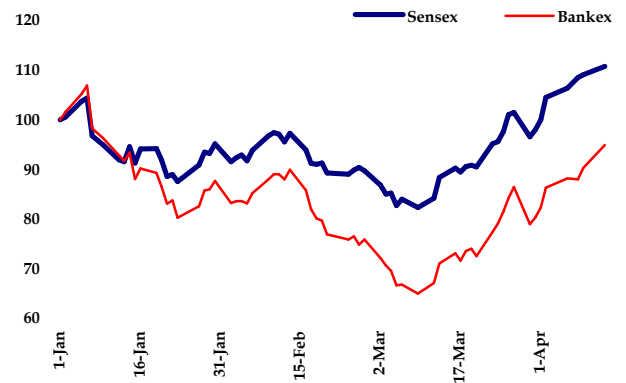
Fee Income to moderate

We expect fee income to moderate on account of slowing credit growth. Large part of the fee income depends on credit off take. Even slowing growth of third party distribution products like life insurance and mutual funds and slowing economic activity along with corporate financing will lead to moderation in Fee income.

Valuations are Attractive

Although all the banking stocks have performed well over last month, still the bankex has underperformed broader indices over last quarter, thereby leaving scope for further upside. Even current valuations appear to be quite cheap and attractive. Market for the time being is also not giving enough value for the subsidiaries. However as the market stabilize; we do believe that there is lot of unlocked embedded value in such companies.

Bankex underperformed in 4Q against benchmark Indices



Source: Comline, Khandwala Research



4QFY09 Results Estimates

Descriptions (INR Mn)	Recom	Mar-09 4QFY09E	Mar-08 4QFY08	YoY' % Growth	Dec-08 3QFY09	QoQ' % Growth	FY 2009E	FY 2008	YoY' % Growth
Axis Bank	OUTPER								
Net Interest Income		10,075	8,284	21.6%	9,297	8.4%	36,610	25,853	41.6%
PAT		4,435	3,614	22.7%	5,009	-11.5%	16,775	10,710	56.6%
Equity		3,590	3,577	0.4%	3,590	0.0%	3,590	3,577	0.4%
FDEPS (Ann.) (Rs)		49.42	40.41	22.3%	55.81	-11.5%	46.73	29.94	56.1%
Bank of Baroda	OUTPER								
Net Interest Income		14,225	10,285	38.3%	14,618	-2.7%	50,750	39,118	29.7%
PAT		4,290	2,764	55.2%	7,084	-39.4%	19,130	14,355	33.3%
Equity		3,655	3,655	0.0%	3,655	0.0%	3,655	3,655	0.0%
FDEPS (Ann.) (Rs)		46.95	30.25	55.2%	77.53	-39.4%	52.34	39.27	33.3%
Bank of India	OUTPER								
Net Interest Income		15,220	12,170	25.1%	15,217	0.0%	55,875	42,292	32.1%
PAT		8,280	7,570	9.4%	8,722	-5.1%	30,250	20,094	50.5%
Equity		5,259	5,259	0.0%	5,259	0.0%	5,259	5,259	0.0%
FDEPS (Ann.) (Rs)		62.98	57.58	9.4%	66.34	-5.1%	57.52	38.21	50.5%
ICICI Bank	OUTPER								
Net Interest Income		20,980	20,795	0.9%	19,905	5.4%	83,260	73,042	14.0%
PAT		9,025	11,502	-21.5%	12,722	-29.1%	39,165	41,578	-5.8%
Equity		11,133	11,127	0.1%	11,133	0.0%	11,133	11,127	0.1%
FDEPS (Ann.) (Rs)		32.43	41.35	-21.6%	45.71	-29.1%	35.18	37.37	-5.9%
Punjab National Bank	OUTPER								
Net Interest Income		18,965	15,173	25.0%	19,673	-3.6%	70,205	55,342	26.9%
PAT		6,935	5,438	27.5%	10,058	-31.0%	29,190	20,488	42.5%
Equity		3,153	3,153	0.0%	3,153	0.0%	3,153	3,153	0.0%
FDEPS (Ann.) (Rs)		87.98	68.99	27.5%	127.60	-31.0%	92.58	64.98	42.5%
SBI	OUTPER								
Net Interest Income		57,460	48,006	19.7%	57,582	-0.2%	217,775	170,212	27.9%
PAT		24,360	18,832	29.4%	24,784	-1.7%	88,150	67,291	31.0%
Equity		6,349	6,315	0.5%	6,349	0.0%	6,349	6,315	0.5%
FDEPS (Ann.) (Rs)		153.47	119.28	28.7%	156.14	-1.7%	138.84	106.56	30.3%



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