

24 March 2009

India Banks

Environment to get tougher, focus on value

Nifty: 2939

Sensex: 9471



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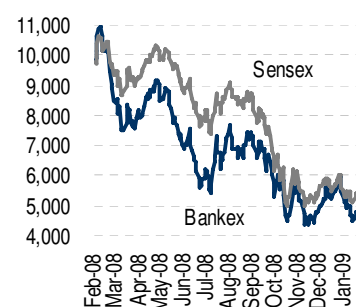
- Caution to the fore.** We expect business conditions for Indian banks to get tougher given decelerating credit demand, falling margins and worsening asset quality (NPAs to rise 3x over FY09-11). Among banks, we prefer ICICI Bank, Axis, PNB, BoB and UBI for their cautious asset growth, ample NPA coverage and sizeable CASA base.
- Credit growth to decelerate.** After deflation through most of FY10, our economist expects price instability, leading to lower private investment and durables consumption. Given this, we expect credit growth to decelerate to 15.1% in FY10, and slip sharply to 7.6% in FY11 – resulting in an 11.5% CAGR in bank credit over FY09-11.
- Margin pressure ahead; CRR cuts to soften impact.** Aggressive monetary easing would make credit cheaper. Banks, however, would not have much flexibility to lower deposit rates as small savers would have other attractive investment avenues open to them. Though margins would come under pressure, we expect CRR cuts to soften the impact.
- Asset quality issues to drive price performance, not rates or growth.** We expect NPAs to increase three-fold over FY09-11, yet they would be at manageable levels of around 4.5% vs around 20% during the previous peak NPAs in the 1990s. Banks today are also better capitalized and credit growth is broad-based. Perceptions of risk, though, would be high and would determine price movements until macro-economic conditions improve.
- Buy value.** We prefer stocks that seem to have already priced in the worst case and are trading at or close to trough valuations. Buy ICICI Bank, Axis Bank, PNB, Bank of Baroda and Union Bank.

Bank large caps – Valuation matrix

	Rating	Price (Rs)	Target (Rs)	MCap (US\$bn)	PE (x)*	PABV (x)*	RoE (%)*
State Bank of India	Sell	1,035	900	12.9	7.8	1.0	14.4
ICICI Bank	Buy	355	430	7.7	8.9	0.9	8.7
HDFC Bank	Sell	941	800	7.8	16.6	2.2	14.5
Axis Bank	Buy	372	455	2.6	6.4	1.2	19.1
Bank of India	Sell	204	175	2.1	3.1	0.8	23.3
Punjab National Bank	Buy	364	450	2.3	3.9	0.7	18.4
Bank of Baroda	Buy	224	270	1.6	4.4	0.6	13.9
Canara Bank	Sell	151	115	1.2	3.7	0.8	13.2
Union Bank of India	Buy	136	170	1.3	3.7	0.7	19.1

Source: Anand Rathi Research (* FY10); Prices as of 24 March 2009

Sensex vs Bankex



Source: Anand Rathi Research

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