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Financial Analysis & The Best Investment Opportunities in The Indian Banking Industry

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Abstract:
Banking sector is the major source of finance for modern trade and commerce. The economic progress of a country depends upon financial intermediaries such as banks. The performance of Indian banks has remained robust during the past few years despite the challenges due to both domestic and international developments. From the point of investment decisions, fundamental analysis is quite significant. It provides an insight into the economic performance of a business enterprise. This research was undertaken to understand the performance of the Indian Banking system. The present study makes it clear that EPS is the strongest indicator for an investor to look for before investing his money in a company. A company may have high OPM, NPM, ROE, PER, DPS and DPR but there is no significant relationship found between these variables and EPS. Moreover in order to which company will be more profitable, an investor should compare the EPS of all companies taken into consideration because a company may be having profits but it may not always give dividends and can keep the profits as retained earnings. Therefore, EPS becomes the best indicator for investment decision.

Keywords: Operating Profit Margin (OPM), Net Profit Margin (NPM), Return on Equity (ROE), Earnings per Share (EPS), Price Earnings Ratio (PER), Dividend per Share (DPS), Dividend Payout Ratio (DPR), Banking system, Fundamentals.

INTRODUCTION

The last decade has seen many positive developments in the Indian banking sector. The policy makers, which comprise the Reserve Bank of India, Ministry of Finance and related government and financial sector regulatory entities, have made several notable efforts to improve regulation in the sector. The sector now compares favourably with the banking sectors in the region on metrics like growth, profitability and non-performing assets (NPAs). A few banks have established an outstanding track record of innovation, growth and value creation in the sector. This is reflected in their market valuation.

However, improved regulations, innovation, growth and value creation in the sector remain limited to a small part of it. The cost of banking intermediation in India is higher and bank penetration is far lower than in other markets. India's banking industry must strengthen itself significantly if it has to support the modern and vibrant economy which India aspires to be. While the onus of this change lies mainly with bank managements, an enabling policy and regulatory framework will also be critical for their success.

The failure to respond to the changing market realities has stunted the development of financial service industry in many developing countries. A weak banking structure has been unable to fuel continued growth, which has harmed the long-term health of their economies.

GOOD PERFORMANCE, QUESTIONABLE HEALTH

Indian banks have compared favourably on growth, asset quality and profitability with other regional banks over the last few years. The banking index has grown at a compounded annual rate of over 51 per cent since April 2001 as compared to a 27 per cent growth in the market index for the same period. Policy makers have made some notable changes in policy and regulation to help strengthen the sector.

These changes include strengthening prudential norms, enhancing the payments system and integrating regulations between commercial and cooperative banks. However, the cost of intermediation remains high and bank penetration is limited to only a few customers segments and geographies. While bank lending has been a significant driver of GDP growth and employment, periodic instances of the "failure" of some weak banks have often threatened the stability of the system. Structural weaknesses such as a fragmented industry structure, restrictions on capital availability and deployment, lack of institutional support infra structure, restrictive labour laws, weak corporate governance and ineffective regulations beyond Scheduled Commercial Banks (SCBs), unless addressed, could seriously weaken the health of the sector. Further, the inability of bank managements (with some notable exceptions) to improve capital allocation, increase the productivity of their service platforms and improve the performance ethic in their organisations could seriously affect future performance.

Objective of the project are:

To analyze the Banking Industry using internationally accepted norms of investment analysis.

To identify good investment opportunities among the listed companies in the Indian stock market.

There are three broad categories in which factors that affect a firm's profitability can be classified.

1. Economic-wide factors
2. Industry-wide factors
3. Company-specific factors.

Top-Down Approach

The Top-Down approach or the EIC (Economy, Industry and Company) was adopted in an attempt to identify the interrelationships between the three to for the Indian Banking Industry.

METHODOLOGY

Stage 1: Setting up of the project objectives and guidelines.
Stage 2: The data pertaining to the Economic and industry factors sensitive for the Indian banking Industry was studied.
Stage 3: Selection of the companies followed by company analysis:
Stage 4: Proper documentation and submission of the report to the M/s. Anand Rathi Investments.
AnandRathi is a leading full-service securities firm providing the entire gamut of financial services. The firm, founded in 1994 by Mr. AnandRathi, today has a pan India presence as well as an international presence through offices in Dubai and Bangkok. AnandRathi provides a breadth of financial and

advisory services including wealth management, investment banking, corporate advisory, brokerage & distribution of equities, commodities, mutual funds and insurance - all of which are supported by powerful research teams.

The firm's philosophy is entirely client centric, with a clear focus on providing long term value addition to clients, while maintaining the highest standards of excellence, ethics and professionalism. The entire firm activities are divided across distinct client groups: Individuals, Private Clients, Corporates and Institutions.

SERVICES

In line with its client-centric philosophy, the firm offers to its clients the entire spectrum of financial services ranging from brokerage services in equities and commodities, distribution of mutual funds, IPOs and insurance products, real estate,
corporate advisory.
Clients deal with a relationship manager who leverages and brings together the product specialists from across the firm to create an optimum solution to the client needs.

RESEARCH DESIGN

AnandRathi's research expertise is at the core of the value proposition that it offers to its clients. Research teams across the firm continuously track various markets and products. The aim is however common - to go far deeper than others, to deliver incisive insights and ideas and be
accountable for results.

SOME HIGHLIGHTS

India has more billionaires than China. This year there were 15 billionaires in China but last year in India, there were 20 billionaires, according to the Forbes magazine.
India has emerged as the world's fastest growing wealth creator, thanks to a buoyant stock market and higher earnings.
A number of Indian companies surpassed last year's net profit in just six months of the current fiscal, reflecting an accelerated growth in corporate earnings.
Forty-four per cent of Top 100 Fortune 500 companies are present in India.
With its manufacturing and services sector on a searing growth path, India's economy may soon touch the coveted 10 per cent growth figure.

OBJECTIVE OF THE PROJECT

To analyze the Banking Industry using internationally accepted norms of investment analysis. To identify good investment opportunities among the listed companies in the Indian stock market. Investments in shares can be a very risky business. However the risk can be minimized by a proper analysis before taking an investment decision. The project attempts to perform such an analysis for the banking industry adopting the internationally accepted norms of investment analysis. The ultimate function of all economic activities is to produce goods and services to be consumed by the households. The aggregate demand from the household sector is influenced by the level of disposable income and its distribution. There are three broad categories in which factors that affect a firm's profitability can be classified.

FINANCIAL ANALYSIS

India is well positioned to become world's forth largest economy by 2025 following United States of America, Japan and China. GDP growth rates of 7-8% will be sustainable going forward if the key enabling factors are put in place. By 2025 the Indian economy is projected to be about 60 per cent the size of the US economy. The transformation into a tri- polar economy will be complete by 2035, with the Indian economy only a little smaller than the US economy but larger than that of Western Europe. By 2035, India is likely to be a larger growth driver than the six largest countries in the EU, though its impact will be a little over half that of the US. India, which is now the fourth largest economy in terms of purchasing power parity, will overtake Japan and become third major economic power within 10 years.

NEED TO CREATE A MARKET
- DRIVEN BANKING SECTOR WITH ADEQUATE FOCUS ON SOCIAL DEVELOPMENT

The term "policy makers" refers to the Ministry of Finance and the RBI and includes the other relevant government and regulatory entities for the banking sector. We believe a coordinated effort between the various entities is required to enable positive action. This will spur on the performance of the sector. The policy makers need to make coordinated efforts on six fronts: Help shape a superior industry structure in a phased manner through "managed consolidation" and by enabling capital availability. This would create 3-4 global sized banks controlling 35-45 per cent of the market in India; 6-8 national banks controlling 20-25 per cent of the market; 4-6 foreign banks with 15- 20 per cent share in the market, and the rest being specialist players (geographical or product/ segment focused) Focus strongly on "social development" by Amity Business School, Noida moving away from universal directed norms to an explicit incentive-driven framework by introducing credit guarantees and market subsidies to encourage leading public sector, private and foreign players to leverage technology to innovate and profitably provide banking services to lower income and rural markets. Create a unified regulator, distinct from the central bank of the country, in a phased manner to overcome supervisory difficulties and reduce compliance costs. Improve corporate governance primarily by increasing board independence and accountability. Accelerate the creation of world class supporting infrastructure (e.g., payments, asset reconstruction companies (ARCs), credit bureaus, back-office utilities) to help the banking sector focus on core activities. Enable labour reforms, focusing on enriching human capital, to help public sector and old private banks become competitive.

EXPANDING REACH TO NET A WIDER CUSTOMER BASE:

Bank of India has a well diversified presence across India with 2,622 branches and 24 overseas offices.

Global assets

total Rs 1,123 billion. Currently, its international operations account for 19% of the asset base. The bank aims to increase the number of branches by 50 in India in FY08 and expand global operations by opening branches in Antwerp (Belgium) and Tanzania. Representative offices are likely to be opened in China, Qatar, South Africa and in South East Asia.

FOCUSING ON QUALITATIVE GROWTH:
In FY07 till date, while deposits grew by 19%, loans grew by 17%. The slower loan growth was on account of a 5% decline in international assets owing to repayment of IMDs, wherein Bank of India has extended loans to its customers. The bank aims to achieve a steady growth of 20%-25% in its loan book and 15%-16% in deposits. The bank has plans to focus on quality loans, with its spotlight on Small and Medium Enterprise, agriculture and retail, that can realize reasonable margins. Also, the bank does not intend to raise funds at a high cost to fund balance sheet growth.

NEED FOR DECISIVE ACTION BY BANK MANAGEMENTS
Management imperatives will differ by bank. However, there will be common themes across classes of banks: PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management and the overall organisational performance ethic. The last, i.e., strengthening human cap- ital will be the single biggest challenge. Old private sector banks also have the fundamentally strengthen skill levels. However, even more imperative is their need to examine their participation in the Indian banking sector and their ability to remain independent in the light of the discontinuities in the sector. New private banks could reach the next level of their growth in the Indian banking sector by continuing to innovate and develop differentiated business models to profitably serve segments like the rural/low income and affluent/HNI segments; actively adopting acquisitions as a means to grow and reaching the next level of performance in their service plat- forms. Attracting, developing and retaining more leadership capacity would be the key to achieving this and would pose the biggest challenge. Foreign banks committed to making a play in India will need to adopt alternative approaches to win the “race for the customer” and build a value creating customer franchise in advance of regulations potentially opening up post 2009. At the same time, they should stay in the game for potential acquisition opportunities as and when they appear in the near term.

Maintaining a fundamentally long- term value-creation mindset will be their greatest challenge. The extent to which Indian policy makers and bank managements develop and execute such a clear and complementary agenda to tackle emerging discontinuities will lay the foundations for a high-performing sector in 2010.

CONCLUSION
One of the problems faced during the duration of the project was the recent change in the environmental factors like inflation, interest rate hike and the recent slump in the market etc. It was really difficult to incorporate these changes in the project. But the long term views on the scrips remain as projected. Projections are based on the long term out look of the banking industry. In the short term the forecasts may not hold true. It may be due to some economic cycles or the government policies. This report has been made assuming that the prevalent economic conditions remain the same.

This project is subject to approval from the research board of AnandRathi before it can be circulated.

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