

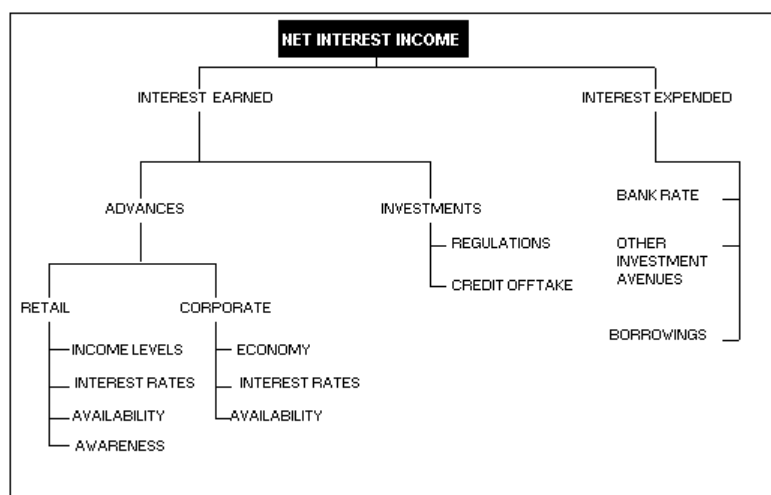
An Analytical Study on Equity Research of Stocks in Banking Sector

* *R. Thamaraiselvi*

** *Anupama*

I. INTRODUCTION

With the economic growth picking up pace and the investment cycle on the way to recovery, the banking sector has witnessed a transformation in its vital role of intermediating between the demand and supply of funds. Public sector banks have been very proactive in their restructuring initiatives both in technology implementation or pruning their loss assets. Windfall treasury gains made in the falling interest rate regime were used for writing off the doubtful and loss assets. Retail lending, especially mortgage financing formed a significant portion of the portfolio for most banks and the entities customized their products to cater to the diverse demands. With better penetration in the semi urban and rural areas, the banks garnered a higher proportion of low cost deposits thereby economizing on the cost of funds. Apart from streamlining their processes through technology initiatives such as ATMs, telephone banking, online banking and web based products; banks also resorted to cross selling of financial product. Unlike any other manufacturing or service company, a bank's accounts are presented in a different manner (as per banking regulations). The analysis of a bank account differs significantly from any other company.



These are the various ways in which bank earns its revenues

- Of the cash reserve, a bank is mandated to maintain a certain percentage of deposits with the Reserve Bank of India as CRR (cash reserve ratio), on which it earns lower interest. Whenever there is a reduction in CRR announced in the monetary policy, the amount available with a bank, to advance as loans, increases.
- The second part of regulatory requirement is to invest in G-Secs that are a part of its statutory liquidity ratio (SLR). The bank's revenues are basically derived from the interest it earns from the loans it gives out as well as from the fixed income investments it makes. If credit demand is lower, the bank increases the quantum of investments in G-Sec.
- Apart from this, a bank also derives revenues in the form of fees that it charges for the various services it provides (like processing fees for loans and forex transactions). In developed economies, banks derive nearly 50% of revenues from this stream. This stream of revenues contributes a relatively lower 15% in the Indian context.
- One of the key parameters used to analyze a bank is the "NET INTEREST INCOME" (NII). "NII is essentially the difference between the bank's interest revenues and its interest expenses". This parameter indicates how effectively the bank conducts its lending and borrowing operations.

* *Lecturer, PSG Institute of Management, Peelamedu, Coimbatore-641004, Tamil Nadu. E-mail : thamaraiselvi2007@gmail.com*

** *Management Graduate, PSG Institute of Management, Peelamedu, Coimbatore-641004, Tamil Nadu.*

Interest revenues = Interest earned on loans + Interest earned on investments + Interest on deposits with RBI.

- Interest on loans - While banks earn more on loans, it has to pay higher on deposits also. If interest rates are high, both corporate and retail classes will hesitate to borrow. But when interest rates are low, banks find it difficult to generate revenues from advances. A bank cannot reduce interest rates on deposits significantly, so as to maintain its customer base, because there are other avenues of investments available for them.
- Interest on investments & deposits with RBI - The bank's interest income from investments depends upon some key factors like government policies (CRR and SLR limits) and credit demand. If a bank had invested in G-Secs in a high interest rate scenario, the book value of the investment would have appreciated significantly when interest rates fall from those high levels or vice versa.
- Interest expenses: The main expense for the bank is in the form of "Interest on deposits and borrowings". This in turn is dependent on the factors that drive cost of deposits. If a bank has high savings and current deposits, cost of deposits will be lower. The propensity of the public to save also plays a crucial role in this process. If the spending power for the populace increases, the need to save reduces and this in turn reduces the quantum of savings.

II. ANALYSIS

The three main banks considered for this study are:

Oriental Bank of Commerce

Oriental Bank of Commerce (OBC) was established in 1943 at Lahore. After the partition, the registered office was shifted to Amritsar from Lahore. When the bank was nationalized in 1980, it had 307 branches. The bank's paid-up capital is Rs.192.54 crore and reserves stand at Rs. 3134.57 crore. The Government of India holds 66.50 per cent of the shares of the bank. OBC is a Delhi based PSU bank (GOI holding 66%), with nearly 1,000 branches. It is the ninth largest public sector bank in India. The Bank is particularly strong in the North and the West of India. It has a strong presence in North Indian states of Punjab, Haryana and Uttar Pradesh. OBC is one of the most efficient public sector banks in the country. The bank has over 1,000 branches that are mainly concentrated in northern India. Post its merger with Global Trust Bank, OBC, will have an enhanced presence in the western and southern regions of the country.

Punjab National Bank

Established in 1895 at Lahore, undivided India, Punjab National Bank (PNB) has the distinction of being the first bank to have been started solely with Indian capital. During its existence of over one-hundred years, PNB has faced many a trials of strength including the trauma of partition of India in 1947 at the time of independence. The bank was nationalized in July 1969 along with 13 other banks.

PNB is one of the largest public sector banks (by size) in the country with a pan Indian presence. A large branch size of 4,037 branches provides it with strong reach in rural, semi urban, urban and metropolitan markets. Post its merger with Kerala based Nedungadi Bank; PNB now has a strong presence in the southern state of Kerala. With its presence in all the important centers of the country, PNB offers a wide variety of banking services which include corporate and personal banking, Industrial finance, Agricultural finance, Financing of trade and International banking.

State Bank of India

The State Bank of India (SBI) is the largest commercial bank in India in terms of profits, assets, deposits, branches and employees. It is also the oldest bank of India. The East India Company and the British Government set up the Bank of Bengal in 1806. It was later merged with the Bank of Bombay and the Bank of Madras to form the Imperial Bank in 1921 which functioned as the central bank for some time till the formation of the RBI in 1935. In 1955 the assets and liabilities of the Imperial Bank were taken over and the State Bank of India was created by an Act of Parliament to succeed the Imperial Bank of India.

Incorporated through the enactment of SBI Act 1955, State Bank of India is the country's largest banking entity both in terms of market share (20%) and asset size (23% of total banking sector assets). Catering to a lion's share of the country's population, the bank also acts as a proxy to the government and the RBI wherever the respective entities do not have their reach.

FINANCIAL OVERVIEW OF BANKING SECTOR

TABLE 1: SALES GROWTH

| Sales | 2003 | | 2004 | | 2005 | |
|-------|----------|-------|----------|-------|---------|------|
| | | % | | % | | % |
| OBC | 3304.28 | 8.68 | 3300.54 | -0.11 | 3571.9 | 8.22 |
| PNB | 7485.01 | 12.59 | 7778.95 | 3.93 | 8459.85 | 8.75 |
| SBI | 31087.02 | 4.28 | 30460.49 | -2.02 | 32428 | 6.46 |

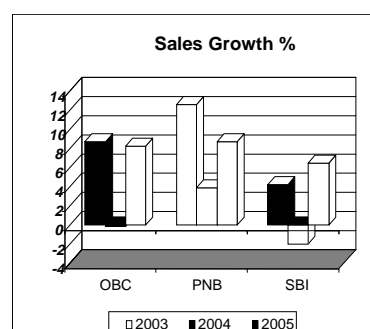


CHART 1: SALES GROWTH

- From the above table, we do see that SBI plays a major role in the banking sector as it has a huge chunk of market share in the banking space.
- PNB has consistent sales growth than other two banks. In 2004 when the other two banks failed to perform better than 2003, PNB increased its sales growth by 3.93%.

TABLE 2: PROFIT GROWTH

| Profit after tax (PAT) | 2003 | | 2004 | | 2005 | |
|------------------------|--------|-------|---------|-------|---------|-------|
| | | % | | % | | % |
| OBC | 456.95 | 42.55 | 686.07 | 50.14 | 760.81 | 10.89 |
| PNB | 842.2 | 27.19 | 1108.69 | 31.64 | 1410.12 | 27.19 |
| SBI | 3105 | 27.69 | 3681 | 18.55 | 4304.52 | 16.94 |

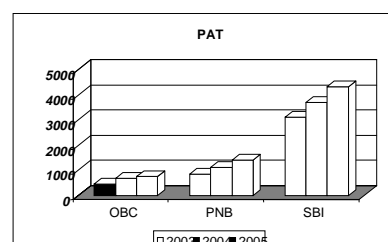


CHART 2: PROFIT GROWTH

- SBI earns higher profit compared to the other two bank and has outperformed the others.
- In 2003 and 2004, OBC had high growth rate of around 50% but PNB and SBI had consistent growth rate in their profits of up to 20%- 30% for the past 3 years.

TABLE 3: CAPITAL ADEQUACY RATIO

| Cap. Adequacy % | 2003 | 2004 | 2005 |
|-----------------|-------|-------|-------|
| OBC | 14.04 | 14.47 | 9.21 |
| PNB | 12.02 | 13.10 | 14.78 |
| SBI | 13.50 | 13.53 | 12.45 |

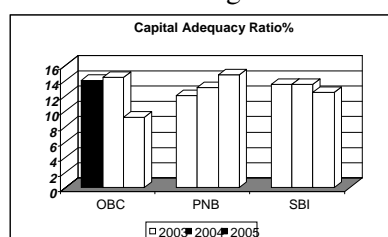


CHART 3: CAPITAL ADEQUACY RATIO

- The CAR prescribed by RBI is 12%.
- SBI has an ideal capital adequacy ratio of 12.45%, while OBC's capital adequacy ratio is below the ideal level.

TABLE 4: RETURN ON EQUITY (ROE)

| ROE % | 2003 | 2004 | 2005 |
|-------|-------|-------|-------|
| OBC | 24.51 | 28.67 | 25.34 |
| PNB | 25.59 | 26.42 | 22.49 |
| SBI | 19.15 | 19.67 | 19.43 |

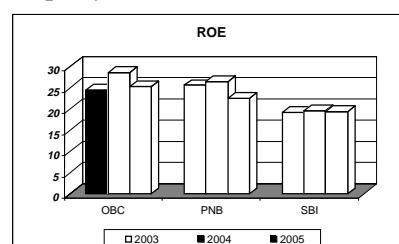
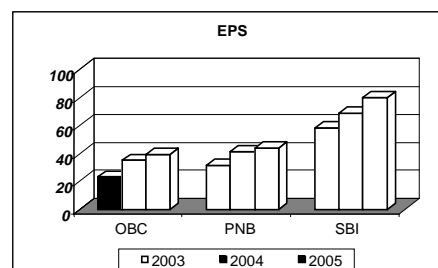


CHART 4: RETURN ON EQUITY (ROE)

- ROE indicates how well the firm has used the resources of the owners. It is calculated to see the profitability of the owner's investment.
- From the above table it is evident that, all the banks seem to give substantial amount of earning. OBC earns a higher return of 25.34% among the three banks but its earnings have reduced in the year 2005.

TABLE 5 : EARNINGS PER SHARE (EPS)

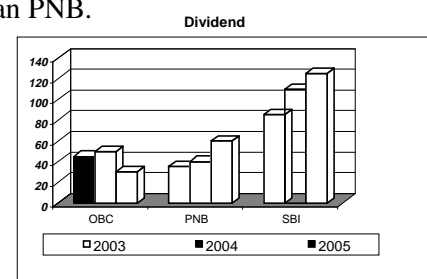
| EPS | 2003 | 2004 | 2005 |
|-----|-------|-------|-------|
| OBC | 23.16 | 34.99 | 39.09 |
| PNB | 31.3 | 41.28 | 43.98 |
| SBI | 57.91 | 68.53 | 80.01 |

**CHART 5: EARNINGS PER SHARE (EPS)**

- EPS is the amount of reported income, on a per share basis, that a firm has available to pay dividends to common stock holders or to reinvest. SBI has a better EPS than any the other two banks.
- SBI's EPS is nearly three times higher than OBC and twice greater than PNB.

TABLE 6: DIVIDEND ANNUALISED

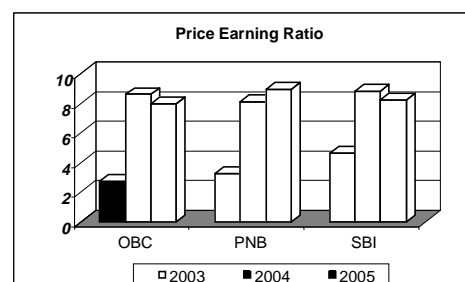
| Dividend | 2003 | 2004 | 2005 |
|----------|------|------|------|
| OBC | 45 | 50 | 30 |
| PNB | 35 | 40 | 60 |
| SBI | 85 | 110 | 125 |

**CHART 6: DIVIDEND ANNUALISED (%)**

- The above table & graph shows the dividend paid to share holders as a percentage on the face value of the share.
- PNB and SBI have increased their dividend over the years. Among the three SBI stands out by paying much higher dividend of around 125% on its face value. There has been decline in the dividend of OBC in the year 2005 when compared to the past two years.

TABLE 7: PRICE EARNING RATIO

| P/E | 2003 | 2004 | 2005 |
|-----|------|------|------|
| OBC | 2.77 | 8.6 | 7.95 |
| PNB | 3.25 | 8.09 | 8.94 |
| SBI | 4.66 | 8.84 | 8.21 |

**CHART 7: PRICE EARNING RATIO**

- The market price of a share divided by earnings per share is the PE ratio.
- All the three banks seem to be attractive at the current level with good growth percentage.

MOVING AVERAGE INDICATOR:

A moving average is an indicator that shows the average value of a security's price over a period of time. The most popular method of interpreting a moving average is to compare the relationship between a moving average of the security's price with its price itself. A buy signal is generated when the security's price rises above the moving average, and a sell signal is generated when the security's price falls below its moving average.

MOVING AVERAGE CONVERGENCE/ DIVERGENCE (MACD):

The MACD shows the relationship between two moving average of price. The MACD is the difference between a 26-day and 12-day exponential moving average. When the MACD is above zero, it indicates a bullish trend in the market and when it is below zero it indicates bearishness.

TECHNICAL ANALYSIS ON BANKING SECTOR

Price Volume Indicator of OBC

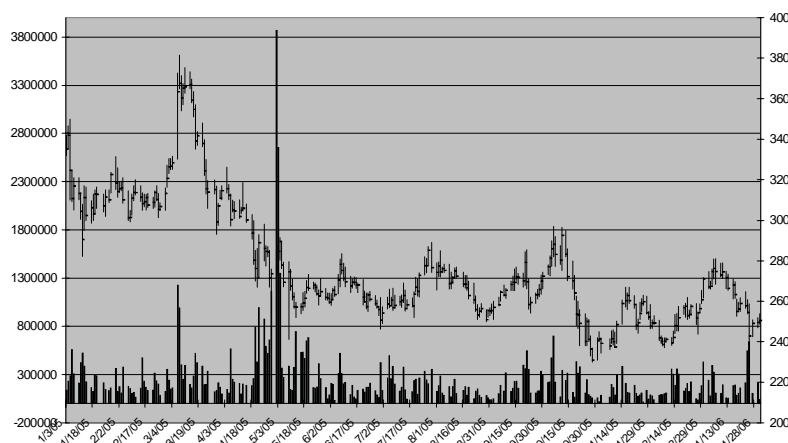


CHART 8 : PRICE & VOLUME INDICATOR OF OBC

TREND - After a sudden spike up in the month of March 2005, the script seem to be on the correction mode for a long period of time. But for the past 6 months it started to move sideways with the band of 240 to 280.

SUPPORT & RESISTANCE LEVEL - It has a strong support at 225 to 230 levels. And it has a strong resistance at 280 & at 300 levels. **BREAKOUT** - It didn't have any major breakout for almost a year. There was a major breakout during 7th march 2005, where it broke the resistance level of 330 with huge volume and zoomed to 380 levels in that month. After that it seemed to be on a corrective phase.

Moving Average Indicator of OBC

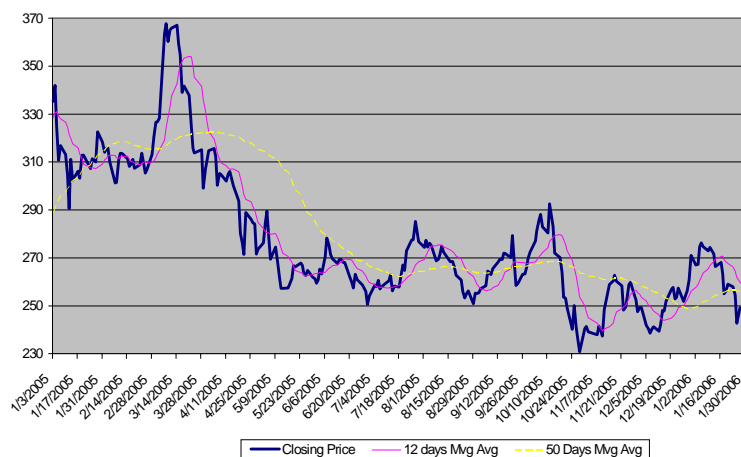
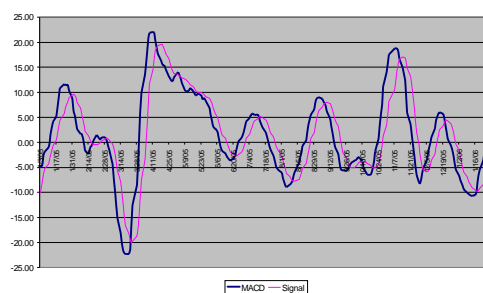


CHART 9 : MOVING AVERAGE INDICATOR OF OBC

Whenever the closing price moves above the moving average it means that the Bull Run is on and it gives a clear indication for the buyers to get in at this point of time. Following table gives the Buy & sell Signal:

| Buy | Sell |
|-------------------|-------------------|
| 24/1/05 - 308.75 | 4/2/05 - 312. |
| 25/2/05 - 309.95 | 16/3/05- 350.49 |
| 18/7/05 - 258.48 | 5/8/05- 274.79 |
| 27/9/ 05 - 267.82 | 13/10/05 - 278.58 |
| 12/12/05 - 246.20 | 13/01/06 - 269.50 |

Buy & Sell Signals



After a sharp rise in the script, it started to move on the sideways and technically the script doesn't look good. During the past six months the stock seemed to move within a band of about 230 to 280. Hence a short term trader can enter this script at 230 levels with the target of 275. A long term trader can look into this stock if it breaks the resistance level of 280. But on a long term basis it is better go in for some other banking scripts.

TECHNICAL ANALYSIS OF PNB

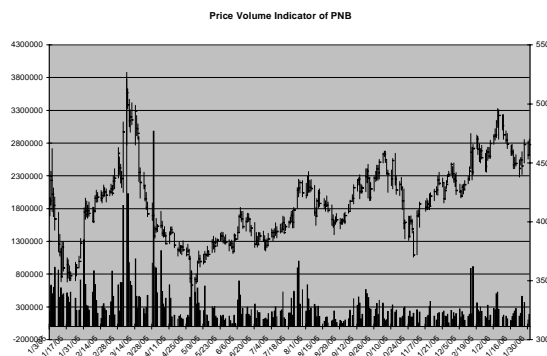


CHART 10 : PRICE & VOLUME INDICATOR OF PNB

TREND: After sharp rising trend during 7th March 2005, the script seems to be corrected sharply, and now its consolidating at 450 levels.

SUPPORT & RESISTANCE LEVEL: It has a strong support level at 380 to 390 and a strong resistance level at 480 and 490. **BREAKOUT:** For the past 8 - 9 month there is no breakout except for the breakout in the month of March where there is a spurt up in the volume of which it broke the resistance level and the stock rallied till 521. Recently the script seems to be consolidating at current levels. Once if it breaks 500 levels, we can see an up trend in this counter again.

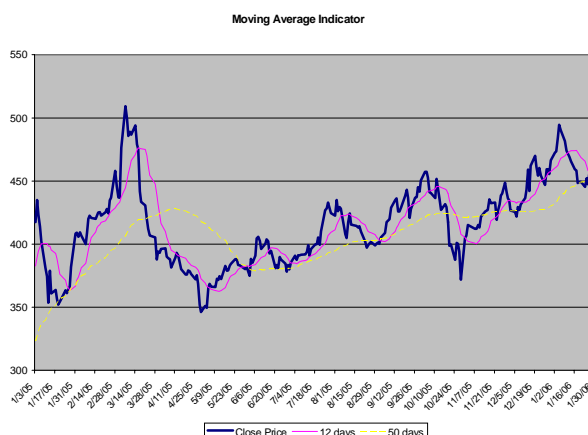


CHART 11 : MOVING AVERAGE INDICATOR OF PN

Whenever the closing price moves above the moving average it means that the Bull Run is on and it gives a clear indication for the buyers to get in at this point of time and vice-versa. Following table gives the Buy & sells Signal:

| Buy | Sell |
|-------------------|-------------------|
| 25/1/05 - 310.14 | 4/2/05 - 312.84 |
| 8/2/05 - 313.2 | 10/03/05 - 350.49 |
| 3/6/05 - 265.35 | 17/06/05 - 268.05 |
| 29/9/05 - 269.9 | 14/10/05 - 279.32 |
| 12/12/05 - 246.20 | 12/1/06 - 268.30 |

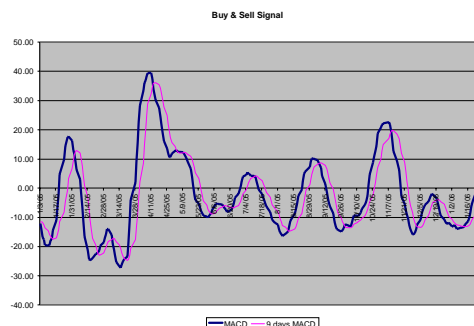


CHART 12 : MACD OF PNB

Technically the stock is consolidating at current levels. In short run, the investor should have a close watch in the market and take every fall as a buying chance. Long term investors can enter this script at 450 levels. Since it has consolidated for more than six to eight months, any positive trigger in this counter can decisively move this script above 500 levels. On a one year horizon one can expect a price target of around 600 levels.

TECHNICAL ANALYSIS OF SBI

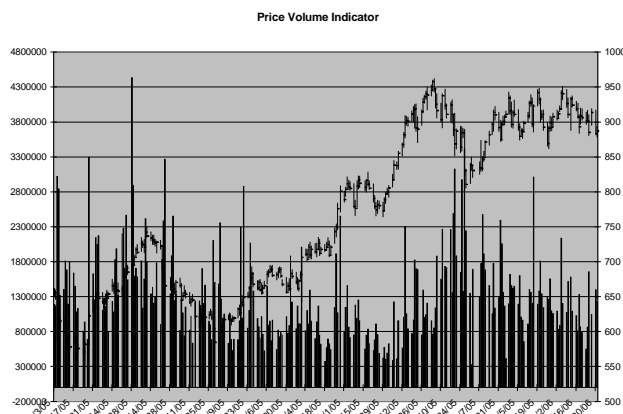


CHART 13 : PRICE & VOLUME INDICATOR OF SBI

TREND: There has been a terrific bull run in this counter so far. The trend seems to be upward. For the past three months the script seems to move in the narrow band. Once the resistance level of 950 is broken, one can see a sharp up move in this counter.

SUPPORT AND RESISTANCE LEVEL: It has good support level between 860 to 870 level and has a stiff resistance level at 950. **BREAKOUT:** There has been a volume break out 28th February and 16th of December, after the second breakout in December the prices rose up to 948.

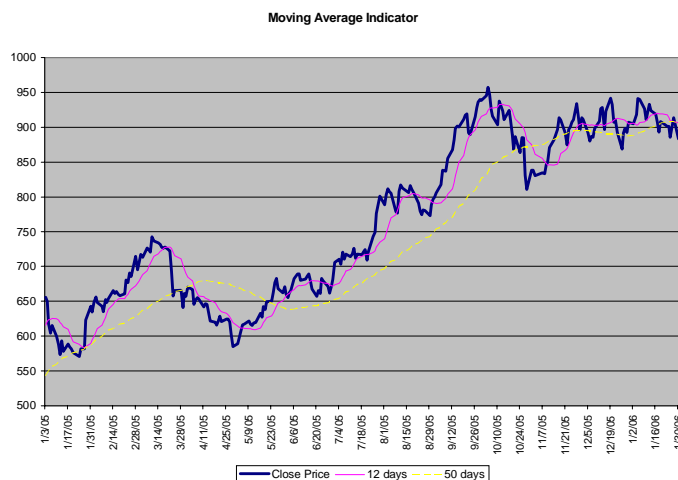


CHART 14 : MOVING AVERAGE INDICATOR OF SBI

Whenever the closing price moves above the moving average it means that the Bull Run is on and it gives a clear indication for the buyers to get in at this point of time. Following table gives the Buy & sell Signal:

| Buy | Sell |
|-------------------|------------------|
| 28/01/05 - 583.81 | 21/3/05 - 727.85 |
| 5/5/05 - 616.2 | 16/6/05 - 678.85 |
| 30/6/05 - 681.55 | 22/8/05 - 790.6 |
| 30/6/05 - 681.55 | 7/10/05 - 927.53 |
| 3/1/06 - 911.6 | 18/1/06 - 919.12 |

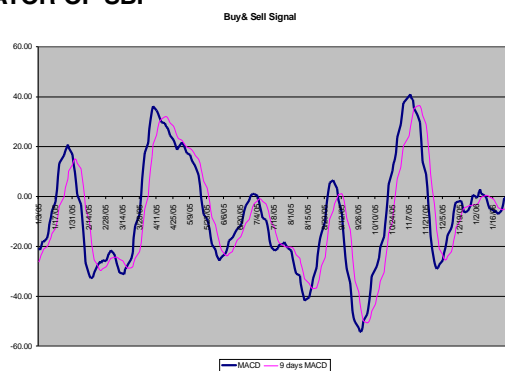


CHART 15 : MACD OF SBI

The stock seemed to be at the resistance level. If it breaks out at this point, definitely one can see a 10% appreciation from the current level. In the short - term, one can wait for a certain dip in the stock and then we can pick up. Else if the volume picks up or if there is any good news in the script one can pick this script at the current level. In the long-term perspective, one can certainly pick this script at any level. It is a fundamentally strong script. P/E also stands at only 8.21 which mean that the stock is undervalued.

I. FINDINGS

- SBI plays a major role in banking sector with huge chunk of market share and earns higher profit compared to other two banks.
- SBI has a good EPS growth rate of 17 % which is best in the group, while PNB has a growth rate of only 6% and moreover SBI also pays a dividend of 125 % to its share holders.
- The ROE of OBC and PNB has declined compared to the previous year, but SBI ROE is consistent over the years.
- The P/E ratio of SBI is 8.21. Considering its profit and growth, it can be said that the script is currently undervalued and therefore one can expect a further rise in this script.
- SBI chart is on rising trend with good volumes.
- PNB is at the resistance level, once the resistance level is broken with good volumes then one can see an upward movement.
- After a deep correction, OBC is consolidating at current level.

II. RECOMMENDATIONS:

Short term:

- OBC bank can be purchased at 235 levels with the target of 265 with a stop-loss of 225. Current market price is around Rs.250.45
- PNB bank can be purchased at 440 to 450 levels with the target of 475 with the stop-loss of 425. Current market price is around Rs.465.55.
- SBI can be purchased at 865 to 870 levels with target of 980 with a stop-loss of 855. Current market price is 886.76.

Long term:

- As the fundamental of OBC is not that attractive, the investors can look in for other script in this sector. A long term trader can look into this stock if it breaks the resistance level of 280.
- PNB be purchased at 450 levels with a long term target of 590 with a stop-loss of 410. Current market price is around Rs.465.55.
- SBI can be purchased at current level with target of 1200 within the next year. Current market price is 886.76.

III. CONCLUSION:

SBI is expected to maintain its Earnings momentum and improve its productivity levels with the use of technology and improved staff efficiency. As everything remains positive, the investor could expect the scripts with a long term target price of 1200. PNB is carrying forward its aggressive expansion in balance sheet with a thrust on its retail business. Future earnings would be driven by strong volume growth. Therefore the investor could expect the scripts to reach a target price of 590 within the year end. OBC as the fundamental are not that attractive long term investor can go in for others scripts in the banking sector.

BIBLIOGRAPHY

- Pandey I.M., Financial Management, (8th ed, New Delhi: Vikas Publishing House Pvt Ltd, 2004)
- Kothari.C.R., Research Methodology: Methods & techniques, (2 nd ed, New Delhi: Viswa Prakasham, 1996)
- Achelis Steven B., Technical Analysis: From A- to- Z (2nd Ed, New Delhi: Vision Books)
- Bhalla V.K., Investment Management: Security Analysis and Portfolio Management ,(12th ed, New Delhi: S.Chand, 2005)
- www.equitymaster.com
- www.icicidirect.com
- www.indiainfoline.com
- www.moneycontrol.com
- www.myiris.com
- www.nseindia.com