

Changing FII Holdings in Banking Stocks

October 31, 2008

Highlights

Banking has been one of the favorite sectors of institutional investors. Banking stocks are liquid and highly volatile. Over the past few years, Indian banking stocks have been attracting attention of FIIs due to major reforms in the sector (particularly the enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests - SARFAESI - Act in 2002).

We analysed the stock price performance of banking stocks vis-à-vis FII outflows during the recent bear phase (period from January 10, 2008 to October 29, 2008). We also considered changes in banks' shareholding patterns between December 31, 2007 and September 30, 2008. The results of our analysis are presented below.

Summary Conclusions

1. Performance of the Sector vis-à-vis the Sensex

Banking stocks have marginally outperformed the Sensex during the period under consideration. The aggregate market cap of PSU banks and private banks declined by 55.3% vis-à-vis the decline of 56.1% in the Sensex between January 10, 2008 and October 29, 2008.

2. Underperformance led by private sector banks

Private sector banks led the drop with a decline of 60.5% in market cap, while PSU banks saw a decline of 49.2%. We believe the erosion in the market cap of private sector banks is attributable mainly to FII-led selling.

3. Changes in value of FII holdings

Total market value of FII holdings has eroded by 64.6% in case of private sector banks and by 61.1% overall.

4. Underperforming private sector banks

In the private banks space, stocks which saw a major sell off from FIIs are Axis Bank, ICICI Bank, IndusInd Bank, etc.

5. Underperforming public sector banks

In the public sector banks space, IDBI Bank, Syndicate Bank and Central Bank saw a major sell off from FIIs.

Impending liberalization, a trigger

In the second phase of reforms beginning April 2009, the RBI will consider allowing acquisitions of private sector banks in India, by foreign banks.

Stocks which saw major sell off from FIIs

We present below the data for top 5 stocks among private sector banks and public sector banks each.

	FII holdings			Value of FII holdings (RsCr)			Market Cap (RsCr)		
	31.12.07	30.09.08	Change	10.01.08	29.10.08	Change	10.01.08	29.10.08	Change
Private Sector Banks									
Axis Bank	31.7%	27.5%	-4.2%	12,296	5,208	-58%	38,838	18,945	-51%
ICICI Bank	40.0%	36.4%	-3.5%	60,331	14,026	-77%	1,50,940	38,491	-74%
IndusInd Bank	20.4%	17.9%	-2.5%	751	246	-67%	3,691	1,374	-63%
J & K Bank	34.1%	32.1%	-2.0%	1,353	598	-56%	3,973	1,866	-53%
Karur Vysya Bank	21.4%	20.4%	-1.0%	582	253	-57%	2,726	1,241	-54%
Public Sector Banks									
IDBI Bank	9.4%	3.3%	-6.1%	1,116	134	-87%	11,823	4,044	-66%
Syndicate Bank	13.5%	8.0%	-5.5%	824	209	-75%	6,097	2,618	-57%
Central Bank	8.0%	3.4%	-4.6%	434	48	-88%	5,409	1,408	-74%
Allahabad Bank	18.6%	14.6%	-4.0%	1,034	314	-70%	5,566	2,151	-61%
Canara Bank	17.1%	13.3%	-3.8%	2,561	860	-67%	14,986	6,447	-57%

Note: We assume there were no major changes in FII holdings in these stocks between December 31, 2007 and January 10, 2008.

Private sector banks

Conclusions

1. The outperformer - HDFC Bank

FIIIs have maintained their holdings in HDFC Bank. The stock was the major outperformer in the banking sector. It witnessed a fall of 34% in the market value, way below the decline in market cap of private sector banks.

2. The laggards

Private sector banks, particularly Axis Bank and ICICI Bank have apparently been hit badly by FII selling. ICICI Bank lost 74% of its market capitalisation (and 77% of the value of FII holdings). FII holdings reduced by 3.6% during the period. It can be attributable to the bank's exposure to the US and European markets.

3. Axis Bank is another stock which saw a big sell off from FIIIs, which reduced their holdings by 4.2%. However, domestic institutions have raised their holdings in both these banks during the period under consideration.

4. Low p/e stocks attract FII interest

A few low p/e stocks, viz., Federal Bank and Karnataka Bank saw strong buying from FIIIs. While Federal Bank trades at around 5.4x its TTM earnings, Karnataka Bank trades at 4.5x. Federal Bank attracted investments from domestic institutions as well, which increased their holding by 4.4%.

5. Change in aggregate value of FII holdings

The total value of FII holdings fell from Rs1,106bn on 10 January 2008 to Rs391bn on 29 November 2008, a decline of 64.6%.

FII sell-off vis-à-vis valuation

	P/e (x)	P/b (x)	Change in FII holdings	Change in DII holdings	Market Cap change
Federal Bank	5.4	0.5	3.2	4.4	-74%
Karnataka Bank	4.5	0.7	3.1	0.0	-61%
Yes Bank	7.8	1.4	1.3	-1.1	-34%
HDFC Bank	21.2	3.5	0.5	3.3	-76%
ING Vysya Bank	8.7	1.0	0.5	-0.4	-67%
Kotak Mah. Bank *	11.1	1.3	0.4	0.8	-64%

	P/e (x)	P/b (x)	Change in FII holdings	Change in DII holdings	Market Cap change
Axis Bank	13.5	2.2	-4.2	2.6	-51%
ICICI Bank	9.3	0.8	-3.5	2.7	-74%
IndusInd Bank	14.9	1.2	-2.5	-0.2	-63%
J & K Bank	5.0	0.8	-2.0	0.7	-53%
Karur Vysya Bank	5.9	1.0	-1.0	-0.6	-54%

Public sector banks (PSU banks)

1. Limited FII interest

The Government of India holds a majority stake in PSU banks. Most of these banks have banking operations in India only. Due to stringent regulatory controls in respect of shareholdings, these banks have attracted limited interests from FIIs and historically, have been fetching lower valuations vis-à-vis private sector banks.

2. Low FII holdings

FIIs hold only around 13% of the market cap of PSU banks, aggregate value of which is over Rs200bn. This is in sharp contrast to private sector banks, in which FIIs hold around 32%. Regulations such as maximum foreign investment limit of 20% in PSU banks, limits the interest of FIIs in these stocks.

3. Reducing FII exposure

Over the last 12 months, FIIs have reduced their exposure to PSU banks substantially, particularly in mid-cap PSU banks. Only Vijaya Bank and Corporation Bank have seen increase in stakes held by FIIs. Aggregate FII holding in these stocks increased by 1.4% and 0.3% respectively. Interestingly, domestic institutions have sold off their 7.9% stake in Vijaya Bank.

4. Some divestments

FIIs divested substantial stakes in IDBI Bank, Syndicate Bank, Central Bank and Allahabad Bank.

5. Low valuations

PSU banks currently trade in the 2x - 9x TTM earnings range.

FII sell-off vis-à-vis valuation

	P/e (x)	P/b (x)	Change in FII holdings	Change in DII holdings	Market Cap change
IDBI Bank	5.4	0.6	-6.1%	4.0%	-66%
Syndicate Bank	3.7	0.7	-5.5%	1.7%	-57%
Central Bank	2.9	0.5	-4.6%	1.8%	-74%
Allahabad Bank	3.2	0.5	-4.0%	0.7%	-61%
Canara Bank	4.1	0.8	-3.8%	2.7%	-57%
Dena Bank	2.0	0.5	-3.1%	-4.3%	-68%
Andhra Bank	3.9	0.6	-1.6%	0.5%	-64%
Pun. Natl. Bank	5.9	1.2	-1.5%	1.1%	-38%
Oriental Bank	5.1	0.6	-1.1%	1.0%	-56%
Bank of Mah.	3.9	0.6	-1.1%	-1.3%	-70%
Bank of India	4.5	1.3	-1.0%	6.4%	-40%
Bank of Baroda	5.7	0.8	-0.9%	0.8%	-46%
Indian Bank	5.1	1.2	-0.6%	0.2%	-40%
Indian Overseas	3.2	0.8	-0.3%	0.1%	-63%
Union Bank (I)	4.4	1.2	-0.3%	-0.2%	-41%
St Bk of India	9.2	1.4	-0.3%	0.7%	-45%
UCO Bank	4.9	0.8	-0.3%	0.0%	-65%
St Bk of Travanc	2.9	0.7	-0.1%	-1.1%	-70%
St Bk of Bikaner	3.7	0.8	0.0%	0.0%	-65%
St Bk of Mysore	7.9	1.3	0.0%	0.0%	-62%
Corporation Bank	3.8	0.7	0.3%	-0.5%	-53%
Vijaya Bank	7.6	0.5	1.4%	-7.9%	-70%

Impending liberalization, a trigger

The Reserve Bank of India (RBI) had announced a set of reforms in FY06. In the second phase of reforms beginning April 2009, the RBI will consider allowing acquisitions of private sector banks in India, by foreign banks.

We believe these can be a major trigger for Indian private banking space.

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