Company Results

30 October 2006 | 7 pages

Bank of Baroda (BOB.BO)

2Q07 Results: Growth, at a Price

- **Up 11%: ahead of consensus but 3% below our estimates** — BOB's net profits are marginally ahead of consensus. Pre-provisioning profits up 24%, a little ahead of our estimates. Qualitatively, the performance appears a little mixed and not very directional. We also need more data from management for a more confident judgment.
- **Balance sheet: Growth and quality** — High growth quarter – 15%+ qoq loan growth, with the international businesses leading the way. Asset quality though remains robust and well covered; though at near 50% loan growth, there is a fundamental need for closer watching. Deposit growth, 20%+ while maintaining the deposit mix, is impressive
- **Margins shrink: Appears to be the bond book, but likely the price of growth** — Margins have contracted almost 40bp over the quarter; management suggests it's the bond book re-pricing, but we suspect it is the price of accelerated asset growth (not enough clarity from disclosures). A bit disappointing, given management's recent confidence in sustaining margins.
- **Overall, a little disappointing** — The relatively aggressive erosion in margins is a disappointment; while peaking growth should be a support, management now probably needs to pull back margins over the next quarter or two to suggest this is an aberration, rather than a structural issue.

Buy/Medium Risk	1M
Price (30 Oct 06)	Rs277.85
Target price	Rs326.00
Expected share price return	17.3%
Expected dividend yield	2.0%
Expected total return	19.3%
Market Cap	Rs101,211M
	US$2,247M

Price Performance (RIC: BOB.BO, BB: BOB IN)

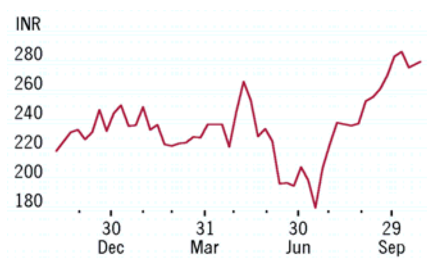

Figure 1. Statistical Abstract

Year to March	Net Profit (Rs Mils.)	FD EPS (Rs)	EPS Growth (%)	P/E (X)	P/BV (X)	RoAE (%)	ROAA (%)	Div Yld (%)
FY05	6,768	23.0	-30.1	12.1	1.5	12.6	0.8	1.8
FY06	8,270	25.1	9.0	11.1	1.3	12.3	0.8	1.8
FY07E	9,565	26.2	4.4	10.6	1.2	11.7	0.8	2.0
FY08E	12,281	33.6	28.4	8.3	1.1	13.6	0.9	2.2
FY09E	14,830	40.6	20.8	6.8	1.0	14.7	0.9	2.2

Source: Company Reports and Citigroup Investment Research

Aditya Narain, CFA[1]
+91-22-6631-9879
aditya.narain@citigroup.com

Manish Chowdhary[1]
+91-22-6631-9853
manish.chowdhary@citigroup.com

Himani Shah[1**]
himani.shah@citigroup.com

See page 5 for Analyst Certification and important disclosures.

[**] US investors please do not contact this analyst [1] Citigroup Global Market India Private Limited

Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E (x)	12.2	11.2	10.7	8.3	6.9
P/E - reported (x)	12.2	11.2	10.7	8.3	6.9
P/BV (x)	1.5	1.3	1.2	1.1	1.0
P/Adjusted BV (x)	1.5	1.3	1.2	1.1	1.0
Dividend yield (%)	1.8	1.8	2.0	2.1	2.1
Per Share Data (Rs)					
EPS (adjusted)	22.98	25.06	26.17	33.60	40.57
EPS (reported)	22.98	25.06	26.17	33.60	40.57
BVPS	191.08	214.61	234.48	261.28	292.33
Tangible BVPS	191.08	214.61	234.48	261.28	292.33
Adjusted BVPS	182.22	207.47	227.34	254.14	285.19
DPS	5.00	5.00	5.50	6.00	6.00
Profit & Loss (RsM)					
Net interest income	29,793	32,249	37,111	41,587	46,875
Fees and commissions	3,426	3,610	4,115	4,692	5,348
Other operating Income	9,622	8,307	7,851	9,008	10,128
Total operating income	**42,841**	**44,166**	**49,077**	**55,287**	**62,351**
Total operating expenses	-19,822	-23,848	-26,288	-28,981	-31,768
Oper. profit bef. provisions	**23,019**	**20,318**	**22,789**	**26,306**	**30,583**
Bad debt provisions	-4,562	-3,400	-3,626	-5,262	-5,896
Non-operating/exceptionals	-9,826	-5,772	-5,500	-3,500	-3,500
Pre-tax profit	**8,631**	**11,146**	**13,664**	**17,544**	**21,186**
Tax	-1,863	-2,876	-4,099	-5,263	-6,356
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**6,768**	**8,270**	**9,565**	**12,281**	**14,830**
Reported net income	**6,768**	**8,270**	**9,565**	**12,281**	**14,830**
Adjusted earnings	6,768	8,270	9,565	12,281	14,830
Growth Rates (%)					
EPS (adjusted)	-30.1	9.0	4.4	28.4	20.8
Oper. profit bef. prov.	-7.2	-11.7	12.2	15.4	16.3
Balance Sheet (RsM)					
Total assets	**946,642**	**1,133,925**	**1,280,605**	**1,464,655**	**1,669,700**
Avg Interest earning assets	879,725	1,010,934	1,171,552	1,335,950	1,530,279
Customer loans	462,112	620,237	760,623	897,497	1,041,563
Gross NPLs	33,220	23,903	25,925	29,260	37,996
Liab. & shar. funds	**946,642**	**1,133,925**	**1,280,605**	**1,464,655**	**1,669,700**
Total customer deposits	813,335	936,620	1,072,531	1,241,500	1,429,461
Reserve for loan losses	28,108	21,119	23,708	27,938	32,874
Shareholders' equity	56,278	78,444	85,709	95,506	106,854
Profitability/Solvency Ratios (%)					
ROE adjusted	12.6	12.3	11.7	13.6	14.7
Net interest margin	3.4	3.2	3.2	3.1	3.1
Cost/income ratio	46.3	54.0	53.6	52.4	51.0
Cash cost/average assets	2.2	2.3	2.2	2.1	2.0
NPLs/customer loans	7.2	3.9	3.4	3.3	3.6
Reserve for loan losses/NPLs	84.6	88.4	91.4	95.5	86.5
Bad debt prov./avg. cust. loans	1.1	0.6	0.5	0.6	0.6
Loans/deposit ratio	56.8	66.2	70.9	72.3	72.9
Tier 1 capital ratio	7.5	10.3	9.3	8.9	8.6
Total capital ratio	13.3	13.7	12.2	11.3	10.7

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Figure 2. 2QFY07 Results: Highlights

	2Q07	2Q06	YoY %	1Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	21,859	16,940	29.0	20,201	8.2	Aggressive asset expansion
Interest Expense	(12,952)	(9,123)	42.0	(11,378)	13.8	
Net Interest Income	**8,908**	**7,818**	**13.9**	**8,823**	**1.0**	Largely in-line with expectations - but driven by loan growth, at the expense of margins
Non Interest Income	3,217	3,096	3.9	2,775	15.9	
Operating Income	12,125	10,913	11.1	11,599	4.5	
Operating Expenses	(5,968)	(5,960)	0.1	(6,040)	-1.2	Ahead of expectations, given relatively high base effect
Pre-Provision Profit	**6,157**	**4,953**	**24.3**	**5,559**	**10.8**	
Charges for Bad Debts	(632)	(1,049)	-39.8	(1,230)	-48.7	Relatively strong underlying asset quality supporting lower P&L provisioning
Other Operating Items	(962)	(208)	362.0	(1,824)	-47.3	
Operating Profit	4,564	3,696	23.5	2,504	82.2	
Pre-Tax Profit	4,564	3,696	23.5	2,504	82.2	
Tax	(1,680)	(1,106)	52.0	(871)	92.9	
Net Profit	**2,884**	**2,591**	**11.3**	**1,633**	**76.6**	In-line with consensus, but about 4% lower than our expectations
EPS	7.9	8.8	-10.3	4.5	76.6	
DPS			NM		NM	
Customer Loans	709,567	489,523	45.0	613,797	15.6	Aggressive quarterly expansion -well ahead of industry; off-shore businesses grows even faster than the international business
Customer Deposits	1,076,815	861,717	25.0	997,784	7.9	Among the highest growth in the sector, and very rapid in itself; while the deposit mix has remained stable across the quarter, there is a meaningful impact on margins reflecting possibly higher cost funding
AIEA	1,213,937	919,649	32.0	1,099,752	10.4	
AIBL	1,050,018	833,347	26.0	971,266	8.1	
Total Assets	1,265,558	997,827	26.8	1,165,579	8.6	Very aggressive growth - not sustainable with the same levels of profitability
Avg Assets	1,215,569	983,062	23.7	1,128,048	7.8	
Non-Performing Loans (NPL)	24,880	32,350	-23.1	25,547	-2.6	Strongest trend in the result; continued improvement, with stable coverage levels
Loan Loss Reserves (LLR)	(19,478)	(26,877)	-27.5	(19,937)	-2.3	
Shareholders' Funds	80,714	60,959	32.4	77,830	3.7	
Book Value Per Share	222	207	7.0	264	-16.2	
Key Ratios (%)	**2Q07**	**2Q06**	**Bps Δ YoY**	**1Q07**	**Bps Δ QoQ**	**Citigroup Investment Research Comments**
ROAA (annualized)	0.91	1.04	-13	0.56	35	
ROAE (annualized)	14.29	17.00	-271	8.39	590	
Net Interest Margin (bps)	294	340	-47	321	-27	Growth driving down margins well beyond expectations; weakest part of the results
Other Non-Interest Inc/Op Inc	26.5	28.4	-183	23.9	261	
Op. Cost/ Operating Income	49.2	54.6	-539	52.1	-285	
Loan-to-Deposit Ratio (LDR)	65.9	56.8	909	61.5	438	
NPL/Loan Ratio	3.4	6.3	-285	4.0	-52	
LLR/NPL Ratio	78	83	-480	78	25	

Source: Company Reports and Citigroup Investment Research

Bank of Baroda

Company Description

Bank of Baroda (BoB) was incorporated in 1908 as a private institution, and subsequently nationalized in 1969. The bank is headquartered in Baroda, Gujarat. The government holds 66% of the bank's equity. BoB is among the top five banks in the country, with nearly 5% share of the deposits and advances of the banking system. BoB has a large, nationwide branch network of 2,730 branches, and has 38 branches in 10 countries.

Investment Thesis

We maintain our Buy (1M) rating on BoB with a target price of Rs326. BoB has made visible improvements in key operating parameters. However, it has lagged behind the sector: loan growth, until recently, has been well below the industry levels and its technology plan has been slow to take off. Management's aggressive interest-rate positioning on the bank's bond portfolio led to losses in the portfolio when interest rates reversed. This aspect of its balance sheet has meant that BoB has been viewed largely as an interest-rate cyclical stock, with falling/rising rates increasing/decreasing the value of its bond portfolio.

Structurally, we believe BoB will continue to trade at a discount to its larger peers due to lower fee incomes, a higher proportion of international businesses, a modest lending franchise, and a slight geographic concentration. BoB will also likely remain the most interest-rate cyclical bank among its larger peers. However, the focus on bond yields has camouflaged changes in what the market formerly perceived as other weakness. We believe positive changes have come about, and the market appears to have failed to fully appreciate them.

Valuation

Our revised target price of Rs326 is based on CIR's EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for our India banking coverage. We are factoring in a risk-free rate of 8%. We maintain industry-average margin (230bps) and higher-than-industry capital ratio (6%).

We are also benchmarking our target price on a 1.3x one-year forward P/BV. Our target multiple factors in the healthy asset pricing and operating environment. Our target multiple continues to be at discounts to those for SBI and PNB. We believe a valuation discount to some peer banks is still justified due to the quality and structure of the businesses. BoB generates relatively low fee income, has a higher proportion of international businesses that we believe adds less value to the business, and its business has a modest geographic concentration. This translates to a target price of Rs313. We prefer to use the EVA measure as our primary methodology as we believe it adjusts well for the relatively dynamic cost of capital and captures well the long-term value of the business.

Risks

We rate BoB Medium Risk based on our quantitative risk-rating system, which tracks 260-day share price volatility. The following downside risks could impede the stock from reaching our target price: (1) sharp rises in interest rates, which could undermine the performance of the bond portfolio; (2) BoB's inability to sustain loan growth; and (3) further delays in management's technology plans.

Analyst Certification Appendix A-1

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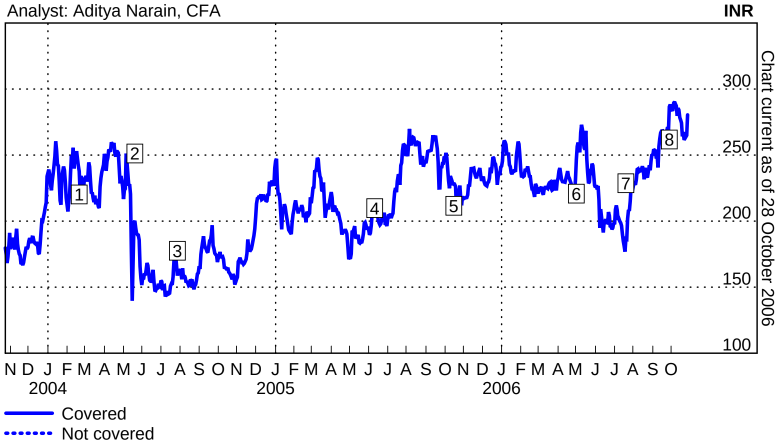
Bank of Baroda (BOB.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Aditya Narain, CFA



#	Date	Rating	Target Price	Closing Price
1:	20 Feb 04	3H	*218.00	237.85
2:	20 May 04	3H	*213.00	200.25
3:	28 Jul 04	3H	*190.00	158.70
4:	10 Jun 05	*1M	*253.00	203.65
5:	17 Oct 05	1M	*305.00	228.80
6:	2 May 06	1M	*298.00	246.55
7:	20 Jul 06	1M	*248.00	186.65
8:	28 Sep 06	1M	*326.00	286.60

*Indicates change.

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