

Oriental Bank of Commerce

STOCK INFO. BLOOMBERG
 BSE Sensex: 9,465 OBC IN
 REUTERS CODE
 S&P CNX: 2,884 ORBC.BO

23 January 2006

Buy

Rs258

Previous Recommendation: Buy

Equity Shares (m) 250.5
 52-Week Range 382/230
 1,6,12 Rel. Perf.(%) -2/-33/-71
 M.Cap. (Rs b) 64.6
 M.Cap. (US\$ b) 1.4

| YEAR | NET INCOME | PAT | EPS | EPS | P/E | P/BV | CAR | ROE | ROA | P/ABV |
|-------|------------|--------|------|------------|-----|------|------|------|-----|-------|
| END | (RS M) | (RS M) | (RS) | GROWTH (%) | (X) | (X) | (%) | (%) | (%) | (X) |
| 3/05A | 20,289 | 7,608 | 39.5 | 10.9 | 6.5 | 2.1 | 9.2 | 25.3 | 1.6 | 2.3 |
| 3/06E | 21,107 | 7,189 | 28.7 | -27.4 | 9.0 | 1.5 | 13.0 | 17.1 | 1.2 | 1.5 |
| 3/07E | 23,821 | 8,901 | 35.5 | 23.8 | 7.3 | 1.3 | 12.0 | 16.7 | 1.3 | 1.3 |

Oriental Bank of Commerce reported 60% growth in earnings to Rs2.05b (excluding amalgamation losses) largely due to a low base of 3QFY05 (impacted on account of the OBC-GTB merger). Net interest income (NII) grew by 5.4% YoY to Rs3.95b, as deposit costs increased by 20bp YoY (10bp QoQ). Other income witnessed a sharp decline of 24% YoY to Rs1.26b, largely due to a sharp drop in trading profits. On the back of continued recoveries, net NPAs reduced further to 0.6% from 1.7% in 3QFY05 (first quarter of amalgamation).

- ✍ NII grows by 5.4% as pressure on NIMs continue
- ✍ Business growth steady; deposits up by 16%, loans grow by 35%
- ✍ Trading income declines; modest decline in non-interest other income
- ✍ Investment book de-risked
- ✍ Asset quality on an improving trend
- ✍ Restructured assets could provide the upside

OBC trades at a P/E of 7.3x and P/BV (adjusted for goodwill) of 1.3x FY07E earnings. While concern on margins remain, we believe that 4QFY06 will be a key quarter to watch for, as a few of the restructured assets (~Rs4b) are likely to be upgraded, which coupled with strong recoveries should result in better asset quality and margins going forward. We maintain **Buy**.

QUARTERLY PERFORMANCE

| | (Rs Million) | | | | | | | | | |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|
| | FY05 | | | | FY06 | | | | FY05 | FY06E |
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4QE | | |
| Interest Income | 8,652 | 8,526 | 9,102 | 9,439 | 9,876 | 10,069 | 10,499 | 10,598 | 35,719 | 41,042 |
| Interest Expense | 4,880 | 4,664 | 5,356 | 5,583 | 5,846 | 6,027 | 6,549 | 6,496 | 20,482 | 24,918 |
| Net Interest Income | 3,772 | 3,862 | 3,746 | 3,857 | 4,030 | 4,042 | 3,950 | 4,102 | 15,237 | 16,124 |
| % Change (YoY) | 17.1 | 7.2 | -1.3 | -2.3 | 6.8 | 4.7 | 5.4 | 6.4 | 4.7 | 5.8 |
| Other Income | 998 | 660 | 1,525 | 1,869 | 955 | 1,720 | 1,263 | 1,044 | 5,052 | 4,983 |
| Net Income | 4,770 | 4,522 | 5,271 | 5,726 | 4,986 | 5,762 | 5,213 | 5,146 | 20,289 | 21,107 |
| % Change (YoY) | -3.9 | -22.8 | -1.6 | 2.3 | 4.5 | 27.4 | -1.1 | -10.1 | -6.8 | 4.0 |
| Operating Expenses | 1,631 | 1,657 | 2,370 | 2,300 | 2,136 | 2,503 | 2,225 | 2,196 | 7,957 | 9,059 |
| Operating Profit | 3,139 | 2,865 | 2,902 | 3,426 | 2,850 | 3,259 | 2,988 | 2,951 | 12,332 | 12,048 |
| Provision & Contingencies | 222 | 226 | 2,072 | 1,482 | 1,028 | 324 | 309 | 540 | 4,002 | 2,200 |
| PBT | 2,917 | 2,639 | 830 | 1,944 | 1,822 | 2,935 | 2,679 | 2,411 | 8,330 | 9,848 |
| Tax Provisions | 1,111 | 490 | -452 | -428 | 775 | 670 | 633 | 582 | 722 | 2,659 |
| Net Profit | 1,806 | 2,149 | 1,282 | 2,372 | 1,048 | 2,265 | 2,047 | 1,829 | 7,608 | 7,189 |
| % Change (YoY) | 26.8 | 32.0 | -15.9 | 3.7 | -42.0 | 5.4 | 59.7 | -22.9 | 10.9 | -5.5 |
| Cost to Income Ratio (%) | 34.2 | 36.6 | 45.0 | 40.2 | 42.8 | 43.4 | 42.7 | 42.7 | 39.2 | 42.9 |
| Int Exp/ Int Earned (%) | 56.4 | 54.7 | 58.8 | 59.1 | 59.2 | 59.9 | 62.4 | 61.3 | 57.3 | 60.7 |
| Other Income / Net Income (%) | 20.9 | 14.6 | 28.9 | 32.6 | 19.2 | 29.9 | 24.2 | 20.3 | 24.9 | 23.6 |

E: MOSt Estimates

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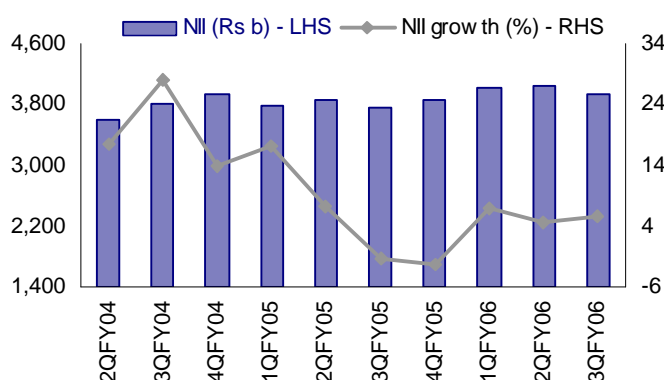
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NII grows 5.4% as the pressure on cost of deposits continue

OBC reported 3QFY06 NII below our expectations with growth of 5.4% YoY to Rs3.95b. Pressures on margins continued on the back of lower yielding GTB assets. Overall NIMs were maintained at 2.9% QoQ (declined YoY from 3.2% in 3QFY05). Cost of deposits has increased YoY (20bp) as well as QoQ (10bp), while yields on advances and investment yields have remained stable QoQ at 7.9% and 8.4%, respectively. The GTB operations are still earning negligible margins, which in turn are having its effect on the overall margins for OBC. With the focus shifting towards advances, we expect margins to remain steady at current levels, as losses on investment yields are likely to be offset by higher yields from advances.

TREND IN NII



Source: Company/ Motilal Oswal Securities

Strong business growth; deposits up by 16%, loans grow by 35%

On the business front, the bank has done well to grow its loan book by 35% YoY to Rs310b and deposit base by 16%

YoY to Rs494b. However, on a QoQ basis, deposit growth has been stagnant. Focus on retail loans is likely to shore up volumes and keep margins intact going forward.

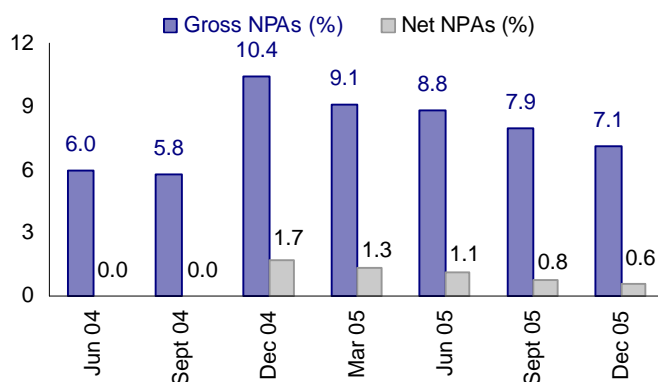
Trading income declines; modest decline in non-interest other income

The bank has booked treasury income of Rs500m in the quarter driven by debt as well as equities; however, this is 41% lower v/s 3QFY05. Even fee income has witnessed marginal 3% YoY decline to Rs763m.

Asset quality on an improving trend

OBC has been consistently witnessing an improvement in its asset quality over the last four quarters. During first nine months the bank has recovered Rs5b, with GTB recoveries to the tune of Rs1.5b. Gross NPAs reduced by Rs23.4b during the quarter. Net NPAs have declined further from Rs3.83b (3QFY05) to Rs19.7b (1.7% to 0.6% during the quarter). On the back of controlled slippages and strong recoveries emanating from the eGTB accounts, we expect net NPAs to decline further during FY06.

TRENDS IN NPAS



Source: Company/Motilal Oswal Securities

Investment portfolio cushioned up to 10-year G-sec yield at 7.6%

OBC's SLR investment book stood at Rs189b. At 3QFY06, 74% of the bank's SLR investment book is in AFS; and in the AFS book, the bank has created a cushion upto 10 year G-sec yield of 7.6% with a modified duration of 4.2.

Restructured assets could provide the upside

Post the takeover of GTB, OBC had restructured assets worth Rs4.1b. We believe that with OBC's strong history of recovering bad debt, a lot more could be upgraded over the next couple of quarters. On upgradation, OBC could write back its excess provisioning, which could flow into earnings. Also, since the assets will turn performing, it could start accruing interest income as well, which could improve margins for OBC. In our calculations, we have not factored in any gains from the same.

Valuations and view

OBC trades at a P/E of 7.3x and P/BV (adjusted for goodwill) of 1.3x FY07E earnings. While concern on margins remain, we believe that 4QFY06 will be a key quarter to watch for, as a few of the restructured assets (~Rs4b) are likely to be upgraded, which coupled with strong recoveries should result in better asset quality and margins going forward. We maintain **Buy**.

Oriental Bank of Commerce: an investment profile

Company description

Oriental Bank of Commerce (OBC), established in 1943, is a northern India-based state-owned bank, with a balance sheet size of Rs410b. The government owns 66.5% equity. After the merger with Global Trust Bank (GTB) in August 2004, OBC acquired a pan-India presence and has a network of 1,121 branches. Though most of OBC's ratios post-merger have deteriorated, we believe the bank has strong recovery procedures in place to tackle the bad loans and turn around GTB's loss-making operations.

Key investment arguments

- ⚡ Aggressive loan growth to continue with higher retail focus, branch expansion in industrial belts and credit disbursements from GTB branches.
- ⚡ Cost to income ratio would reduce, as GTB's high cost borrowings are repaid and salary levels are brought in line with OBC.
- ⚡ Sustained cash recoveries from GTB's NPAs would result in higher NIMs and superior asset quality.

Key investment risks

- ⚡ Cash recoveries, NPA reduction could be less than expected.

Recent developments

- ⚡ OBC along with four other banks viz., Central Bank of India, J&K Bank, Union Bank of India and Standard Chartered Bank, in a proposed asset reconstruction company.
- ⚡ Oriental Bank of Commerce expects to raise Rs5.0b crore Tier-II capital by end-February.

Valuation and view

- ⚡ Robust loan growth, stable NIMs and superior asset quality on the back of strong cash recoveries from GTB's NPAs to drive the earnings growth in FY06-FY07.
- ⚡ The stock trades at 7.3x FY07E earnings and 1.3x FY07E book value. We maintain our **Buy** recommendation with a price target of Rs329 (an upside of 27.5%).

Sector view

- ⚡ Loan growth of 29%+ at the beginning of the capex cycle.
- ⚡ Volatility in interest rates would impact treasury.
- ⚡ Benefits of significant improvement in asset quality not yet factored into earnings, valuations.
- ⚡ We maintain an overweight stance on the sector.

COMPARATIVE VALUATIONS

| | | OBC | CANARA BANK | PNB |
|-----------|-------|------|-------------|------|
| P/E (x) | FY06E | 9.0 | 7.8 | 8.4 |
| | FY07E | 7.3 | 6.5 | 7.0 |
| P/ABV (x) | FY06E | 1.5 | 1.5 | 1.5 |
| | FY07E | 1.3 | 1.2 | 1.3 |
| RoE (%) | FY06E | 17.1 | 18.5 | 18.9 |
| | FY07E | 16.7 | 19.1 | 19.0 |
| RoA (%) | FY06E | 1.2 | 1.0 | 1.2 |
| | FY07E | 1.3 | 1.1 | 1.3 |

SHAREHOLDING PATTERN (%)

| | DEC.05 | SEP.05 | DEC.04 |
|-----------------------|--------|--------|--------|
| Promoters | 51.1 | 51.1 | 66.5 |
| Domestic Institutions | 19.9 | 18.7 | 11.8 |
| FII's/FDIs | 19.9 | 20.0 | 13.6 |
| Others | 9.1 | 10.2 | 8.1 |

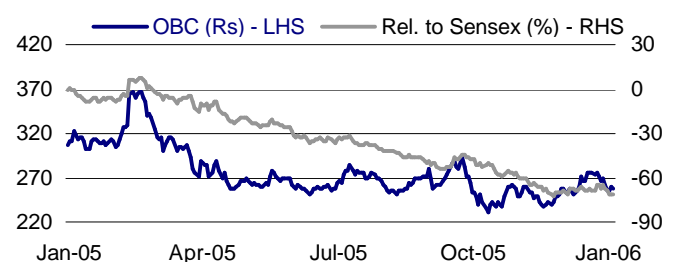
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

| | INQUIRE FORECAST | CONSENSUS FORECAST | VARIATION (%) |
|------|------------------|--------------------|---------------|
| FY06 | 28.7 | 31.0 | -7.5 |
| FY07 | 33.5 | 36.3 | -7.6 |

TARGET PRICE AND RECOMMENDATION

| CURRENT PRICE (RS) | TARGET PRICE (RS) | UPSIDE (%) | RECO. |
|--------------------|-------------------|------------|-------|
| 258 | 329 | 27.5 | Buy |

STOCK PERFORMANCE (1 YEAR)



| INCOME STATEMENT | | | | | |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| (Rs Million) | | | | | |
| Y/E MARCH | 2004 | 2005 | 2006E | 2007E | 2008E |
| Interest Income | 33,005 | 35,719 | 41,042 | 47,618 | 54,520 |
| Interest Expended | 18,447 | 20,482 | 24,918 | 28,506 | 32,527 |
| Net Interest Income | 14,558 | 15,237 | 16,124 | 19,112 | 21,993 |
| Change (%) | 20.8 | 4.7 | 5.8 | 15.5 | 15.1 |
| Other Income | 7,217 | 5,052 | 4,983 | 4,708 | 5,480 |
| Net Income | 21,776 | 20,289 | 21,107 | 23,821 | 27,473 |
| Change (%) | 24.7 | -6.8 | 4.0 | 12.9 | 15.3 |
| Operating Expenses | 6,445 | 7,957 | 9,059 | 9,659 | 10,892 |
| Operating Income | 15,331 | 12,332 | 12,048 | 14,162 | 16,581 |
| Change (%) | 31.8 | -19.6 | -2.3 | 17.5 | 17.1 |
| Other Provisions | 3,874 | 4,002 | 2,200 | 1,800 | 2,300 |
| P B T | 11,456 | 8,330 | 9,848 | 12,362 | 14,281 |
| Tax | 4,595 | 722 | 2,659 | 3,461 | 3,999 |
| P A T | 6,861 | 7,608 | 7,189 | 8,901 | 10,282 |
| Change (%) | 50.1 | 10.9 | -5.5 | 23.8 | 15.5 |
| Proposed Dividend | 963 | 659 | 1,629 | 1,754 | 2,004 |

| BALANCE SHEET | | | | | |
|---------------------------|----------------|----------------|----------------|----------------|----------------|
| (Rs Million) | | | | | |
| Y/E MARCH | 2004 | 2005 | 2006E | 2007E | 2008E |
| Capital | 1,925 | 1,925 | 2,505 | 2,505 | 2,505 |
| Reserves & Surplus | 24,843 | 31,345 | 48,365 | 53,052 | 58,870 |
| Net Worth | 26,768 | 33,270 | 50,870 | 55,557 | 61,375 |
| Deposits | 356,735 | 478,503 | 555,064 | 638,323 | 734,072 |
| Change (%) | 19.7 | 34.1 | 16.0 | 15.0 | 15.0 |
| Borrowings | 7,005 | 7,281 | 8,500 | 10,000 | 10,000 |
| Other Liabilities & Prov. | 19,558 | 21,640 | 23,804 | 26,185 | 28,803 |
| Total Liabilities | 410,066 | 540,695 | 638,238 | 730,065 | 834,250 |
| Current Assets | 36,004 | 75,433 | 65,397 | 66,147 | 69,851 |
| Investments | 167,941 | 183,422 | 205,432 | 221,867 | 239,616 |
| Change (%) | 13.6 | 9.2 | 12.0 | 8.0 | 8.0 |
| Advances | 196,808 | 252,992 | 341,539 | 416,678 | 500,013 |
| Change (%) | 25.5 | 28.5 | 35.0 | 22.0 | 20.0 |
| Net Fixed Assets | 1,618 | 3,805 | 3,037 | 2,717 | 2,308 |
| Other Assets | 7,695 | 25,043 | 22,833 | 22,657 | 22,462 |
| Total Assets | 410,066 | 540,695 | 638,239 | 730,065 | 834,250 |

| ASSUMPTIONS | % | | | | |
|-----------------------|------|------|------|------|------|
| Deposit Growth | 19.7 | 34.1 | 16.0 | 15.0 | 15.0 |
| Advances Growth | 25.5 | 28.5 | 35.0 | 22.0 | 20.0 |
| Investments Growth | 13.6 | 9.2 | 12.0 | 8.0 | 8.0 |
| Average PLR | 10.0 | 10.0 | 10.0 | 10.5 | 10.5 |
| Chg. in Avg Dep. Rate | -0.5 | 0.0 | 0.5 | 0.5 | 0.5 |
| Dividend | 50.0 | 34.2 | 65.0 | 70.0 | 80.0 |
| CRR | 4.5 | 5.0 | 5.0 | 5.0 | 5.0 |

E: M O S t Estimates

| RATIOS | | | | | |
|-----------------------------|------|------|-------|-------|-------|
| Y/E MARCH | 2004 | 2005 | 2006E | 2007E | 2008E |
| Spreads Analysis (%) | | | | | |
| Avg. Yield - Earning Asset: | 9.1 | 7.9 | 7.5 | 7.5 | 7.4 |
| Avg. Cost-Int. Bear. Liab. | 5.5 | 4.8 | 4.7 | 4.7 | 4.7 |
| Interest Spread | 3.6 | 3.0 | 2.7 | 2.8 | 2.7 |
| Net Interest Margin | 4.0 | 3.4 | 2.9 | 3.0 | 3.0 |

| Profitability Ratios (%) | | | | | |
|---------------------------|------|------|------|------|------|
| RoE | 28.7 | 25.3 | 17.1 | 16.7 | 17.6 |
| RoA | 18 | 16 | 12 | 13 | 13 |
| Int. Expended/Int. Earned | 55.9 | 57.3 | 60.7 | 59.9 | 59.7 |
| Other Inc./Net Income | 33.1 | 24.9 | 23.6 | 19.8 | 19.9 |

| Efficiency Ratios (%) | | | | | |
|------------------------|------|------|------|------|------|
| Op. Exps./Net Income | 29.6 | 39.2 | 42.9 | 40.5 | 39.6 |
| Empl. Cost/Op. Exps. | 56.9 | 49.9 | 51.6 | 48.3 | 47.9 |
| Busi. per Empl. (Rs m) | 37.1 | 44.1 | 55.8 | 66.4 | 77.9 |
| NP per Empl. (Rs m) | 0.5 | 0.5 | 0.5 | 0.6 | 0.7 |

| Asset-Liability Profile (%) | | | | | |
|-----------------------------|------|------|------|------|------|
| Adv./Deposit Ratio | 55.2 | 52.9 | 61.5 | 65.3 | 68.1 |
| Invest./Deposit Ratio | 47.1 | 38.3 | 37.0 | 34.8 | 32.6 |
| G-Sec/Invest. Ratio | 76.9 | 81.7 | 73.0 | 67.6 | 62.5 |
| Gross NPAs to Adv. | 5.8 | 9.1 | 6.5 | 5.4 | 4.8 |
| Net NPAs to Adv. | 0.0 | 1.3 | 0.5 | 0.3 | 0.3 |
| CAR | 14.5 | 9.2 | 13.0 | 12.0 | 12.0 |
| Tier 1 | 9.9 | 5.4 | 9.0 | 8.0 | 8.0 |

| VALUATION | | | | | |
|--------------------|-------|-------|-------|-------|-------|
| Book Value (Rs)* | 139.0 | 121.9 | 173.8 | 202.3 | 235.3 |
| Price-BV (x) | 1.9 | 2.1 | 1.5 | 1.3 | 1.1 |
| Adjusted BV (Rs) | 139.0 | 110.9 | 169.6 | 198.7 | 230.9 |
| Price-ABV (x) | 1.9 | 2.3 | 1.5 | 1.3 | 1.1 |
| EPS (Rs) | 35.6 | 39.5 | 28.7 | 35.5 | 41.0 |
| EPS Growth (%) | 50.1 | 10.9 | -27.4 | 23.8 | 15.5 |
| Price-Earnings (x) | 7.2 | 6.5 | 9.0 | 7.3 | 6.3 |
| OPS (Rs) | 79.6 | 64.0 | 48.1 | 56.5 | 66.2 |
| OPS Growth (%) | 31.8 | -19.6 | -24.9 | 17.5 | 17.1 |
| Price-OP (x) | 3.2 | 4.0 | 5.4 | 4.6 | 3.9 |

E: M O S t Estimates, * BV adjusted for goodwill



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Oriental Bank of Commerce

- | | |
|--|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |

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