

Bank of Baroda

Capital infusion: concerns on capital constraints recede but infusion EPS and ROE dilutive - ALERT

- **Large capital infusion by the government:** According to CNBC reports, the Indian government has infused ~Rs100bn in PSU banks with stakes of <57-58%. BOB has received Rs35bn and assuming current market prices, the infusion would lead to ~10% dilution and would take the government's stake in BOB from 54% to 58% and lead to ~175bps increase in BOB's Tier 1.
- **Positives - No constraints on capital now:** The capital infusion addresses concerns about capital constraints not only in the near term but also longer term, as the increase in the government's stake to 58% leaves leeway for further capital issuance without government help in the future.
- **Negatives: EPS and ROE dilutive, capital marginally higher than required:** Assuming current prices, EPS dilution would be ~6% over FY11-12E and ROEs would be brought down by ~250bps to ~20-20.5% for FY12-13. Given strong internal capital generation, we estimate that it would take more than three years for BOB to leverage up again, leading to lower ROEs over that period.
- **Prefer PNB now vs. BOB:** Though we currently have no official confirmation of the same, we assume the infusion to be 100% equity. Given very low dilution for PNB, we would prefer PNB vs. BOB as the capital infusion would widen ROE differentials for BOB vs. PNB from 200bps earlier to 500bps now and valuations would be on par on a post diluted book basis.
- **Maintain Overweight:** Though the news is positive for PSU banks in general as it addresses their capital issues, we believe for BOB the large dilution is at best neutral, given the large EPS and ROE dilution. We continue with our Overweight on BOB, given superior asset quality but would prefer PNB for return ratio differentials post the capital infusion.

Overweight

BOB.BO, BOB IN

Price: Rs955.55

01 December 2010

Banks

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Figure 1: BOB: Possible impact on EPS, BPS and Return ratios

	FY11E	FY12E	FY13E
EPS			
Revised	91	112	135
Earlier	97	119	144
Change (%)	-6.9%	-5.9%	-6.5%
BPS			
Revised	505	600	716
Earlier	459	562	688
Change (%)	10.0%	6.8%	4.1%
ROE			
Revised	21.4%	20.3%	20.4%
Earlier	23.3%	23.4%	23.0%
Change (%)	-1.91%	-3.06%	-2.57%

Source: J.P.Morgan estimates.

Figure 2: BOB : Change in estimates in case of 100% Equity infusion

	FY11E	FY12E	FY13E
PPOP			
Revised	64,800	81,787	98,547
Earlier	63,504	79,470	96,232
Change (%)	2.0%	2.9%	2.4%
Net Profit			
Revised	36,455	45,202	54,130
Earlier	35,600	43,673	52,602
Change (%)	2.4%	3.5%	2.9%
EPS			
Revised	91	112	135
Earlier	97	119	144
Change (%)	-6.9%	-5.9%	-6.5%
BPS			
Revised	505	600	716
Earlier	459	562	688
Change (%)	10.0%	6.8%	4.1%
ROA			
Revised	1.20%	1.22%	1.21%
Earlier	1.17%	1.17%	1.17%
Change (%)	0.03%	0.05%	0.04%
ROE			
Revised	21.4%	20.3%	20.4%
Earlier	23.3%	23.4%	23.0%
Change (%)	-1.91%	-3.06%	-2.57%

Source: J.P.Morgan estimates.

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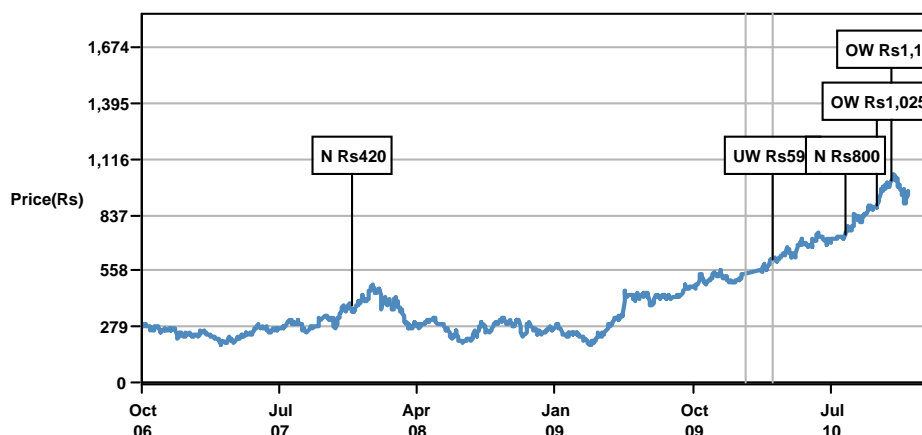
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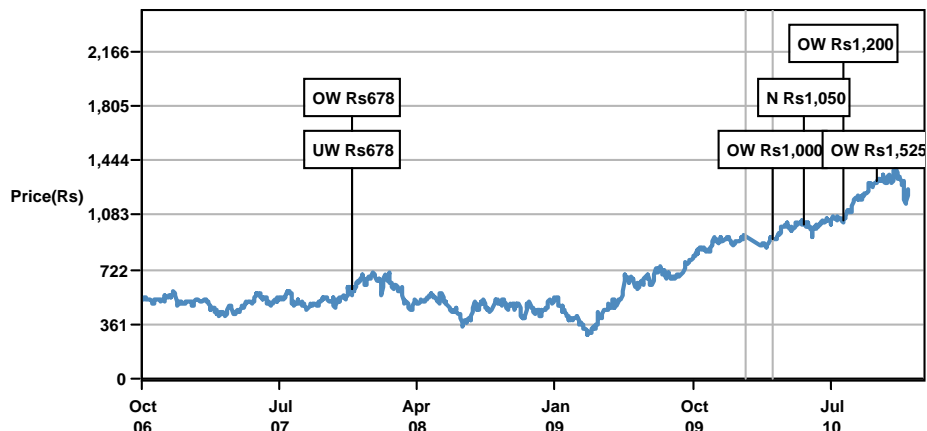
Bank of Baroda (BOB.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
21-Nov-07	N	383.90	420.00
09-Mar-10	UW	610.35	590.00
30-Jul-10	N	734.20	800.00
02-Oct-10	OW	887.20	1025.00
29-Oct-10	OW	1011.00	1125.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

Punjab National Bank (PNBK.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
20-Nov-07	UW	590.00	678.00
21-Nov-07	OW	590.00	678.00
08-Mar-10	OW	927.75	1000.00
10-May-10	N	1016.10	1050.00
27-Jul-10	OW	1051.10	1200.00
02-Oct-10	OW	1307.80	1525.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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