

## Banking

### BOI.BO, Rs235

Rating	ADD
Sector coverage view	Attractive
Target Price (Rs)	310
52W High -Low (Rs)	369 - 179
Market Cap (Rs bn)	123.6

### Financials

June y/e	2009	2010E	2011E
Sales (Rs bn)	85.8	88.2	100.5
Net Profit (Rs bn)	31.1	27.0	31.3
EPS (Rs)	59.2	51.3	59.5
EPS gth	45.7	(13.4)	16.0
P/E (x)	4.0	4.6	3.9
P/B (x)	1.2	1.1	0.9
Div yield (%)	1.3	2.3	2.6

### Pricing performance

Perf-1m	Perf-3m	Perf-6m	Perf-1y
1.1	(2.4)	5.7	(29.5)

### Shareholding, March 2009

	Pattern	% of Portfolio	Over/(under) weight
Promoters	64.5	-	-
FIs	14.3	0.4	(0.0)
MFs	1.4	0.2	(0.3)
UTI	-	-	(0.4)
LIC	6.4	0.6	0.2

## Bank of India: Earnings growth tapers off; retain ADD on valuations

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- **PAT growth tapers off to 7% yoy after 10 consecutive quarters of +50% yoy growth**
- **NIM comes off sharply in 4QFY09 and is a cause of concern**
- **Proposals worth Rs62 bn (4.3% of FY2009 loan book) have been restructured or are being considered for restructuring**
- **Increase our slippage ratio assumptions in FY2010E and FY2011E to account for likely stress on asset quality. Retain ADD rating with price target of Rs310**

Bank of India (BoI) has reported a PAT of Rs8.1 bn - a moderate 7% yoy growth and 8% below our estimates. The company's core operational income (PBT-treasury + profits) grew by a marginal 5% yoy, which was the first time in 13 quarters that the growth was lower than 25% yoy. BoI's NIM declined by a steep 42 bps on a sequential basis in 4QFY09 and this is a cause for concern particularly when credit losses are expected to rise. The company is considering or has already restructured proposals worth Rs62 bn (4.3% of loan book as of FY2009). We have increased the slippage ratio to 4% in FY2010E and 3% in FY2011E to account for likely stress in credit portfolio apart from assuming a margin compression of 33bps in FY2010E compared to FY2009. Consequently, our target price is reduced to Rs310 (Rs330 earlier). Retain ADD rating recommendation on the stock at the current valuation of 0.9X PBR and 5.2X PER FY2010E.

**Net interest income growth remains healthy.** Bank of India (BoI) had net interest income (NII) of Rs14.3 bn in 4QFY09—a healthy growth of 18% yoy and in line with our estimates. The company's NII benefited from an equity infusion of Rs13.6 bn in 4QFY08. The lower growth in advances along with a sharper fall in yield on assets compared to the cost on its liabilities resulted in the company's NIM declining by 42 bps on a sequential basis. The management has indicated that the company has shed Rs120 bn worth of high-cost deposits (6.3% of overall deposits) in last week of March 2009, which could be positive for its margin apart from reducing the rates offered on retail deposits. We model a 33 bps decline in FY2010E compared to FY2009 given the expected moderation in loan growth and possibility of further compression on its spread.

**Loan growth has come off in 4QFY09.** BoI had an outstanding loan book of Rs1.45 tn as of March 2009—loan growth of 26% yoy. The incremental growth in domestic advances was Rs68 bn in 4QFY09, which was lower than the incremental advances growth in 3QFY09. We note that typically incremental loan growth in the 4<sup>th</sup> quarter of a fiscal is better than the first three quarters. The management indicated that the slower loan growth was on account of a conscious strategy given the macro environment.

**Loan restructuring has been higher than expected.** BoI has restructured and implemented a new package for Rs50.5 bn of assets (3.5% of loan book) as of March 2009. The company is reviewing proposals for restructuring worth Rs12 bn (0.8% of March 2009 loan book), which are likely to be implemented before June 2009. The quantum of restructuring was higher than some of its peers that have reported thus far. We have increased our slippage ratio assumptions to 4% in FY2010E and 3% in FY2011E compared to 3.2% and 2% earlier to account for likely higher stress on asset quality.

### **Non-interest revenues driven by higher fee income and treasury income**

Bol had non-interest revenues of Rs7.8 bn—supported by (1) higher core fee income of Rs3.1 bn (up 23% yoy), (2) higher foreign exchange income of Rs1.2 bn (up 34 % yoy) and (3) treasury gains of Rs2.2 bn (up 2.7X yoy) on account of the lower Gsec yields. We believe that the growth in fee income at such high levels might not be sustainable as the loan growth will come off over the next year and pricing power might also reduce. We model 15% growth in fee income in FY2010E compared to 40% yoy observed in FY2009.

### **Other key highlights for the current quarter/fiscal**

- Bol has made ad hoc provisions of Rs1.9 bn in FY2009 for the likely wage liabilities following the negotiations that are currently underway between the IBA and employee unions.
- The other operational expenses were higher on account of the one-off items such as expenses for implementing core banking solution and higher insurance expenses. These items resulted in an additional operational expense burden of around Rs420 mn in 4QFY09 compared to 4QFY08.
- Bol also made NPL provisions of Rs1.9 bn in 4QFY09 compared to Rs1.8 bn in 4QFY08.
- Gross NPL ratio and net NPL ratio of the company stood at 1.7% and 0.4% as of 4QFY09. Bol has decided to utilize the floating provisions to net off the gross NPLs rather than use it to augment its Tier II capital. The provision coverage ratio was 75% as of March 2009 and the quantum of floating provisions held by the company as of March 2009 was Rs3.3 bn.
- Bol has provision of Rs2 bn on its CLN exposures (all have Indian entities as underlying). These provisions are likely to be written back in future periods when the international markets stabilize or when these assets mature. The company had made full provisions for its exposure to Lehman group by 3QFY09.

### **Valuations are inexpensive; Reiterate ADD**

We have adjusted our financial model to factor in the likely risks to earnings (as highlighted above) and expect earnings to decline by 20% yoy in FY2010E. Our FY2010E and FY2011E earnings estimates have been reduced by 11% and 8%. The key risks to our earnings are higher-than-expected delinquencies, on the back of very strong credit growth over the last couple of fiscals. We reiterate ADD rating on the stock with a target price of Rs310.

## Bank of India, quarterly results (Rs mn)

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09	% chg	4QFY09KS	Actual Vs KS
Interest Income	35,016	35,483	39,628	43,810	44,931	28.3	44,154	2
- Loans	26,221	26,874	30,524	34,402	33,593	28.1	35,827	(6)
- Investments	7,311	7,859	8,046	8,652	9,146	25.1	8,196	12
- others	1,485	750	1,058	378	2,192	47.6	509	330
Interest expense	22,850	23,676	25,996	28,215	30,598	33.9	29,718	3
<b>NII</b>	<b>12,166</b>	<b>11,808</b>	<b>13,631</b>	<b>15,594</b>	<b>14,334</b>	<b>17.8</b>	<b>14,436</b>	<b>(1)</b>
Other income	6,520	5,664	6,495	10,506	7,854	20.5	7,630	3
- treasury	600	683	180	4,350	2,240	273.3	1,287	74
- core fees	2,520	2,309	2,641	2,870	3,110	23.4		
- forex income	880	1,125	1,020	2,370	1,180	34.1		
- recoveries	1,290	861	867	250	550	(57.4)		
- other income	1,230	686	1,787	670	770	(37.4)		
Total income	18,686	17,472	20,126	26,100	22,187	18.7	22,067	1
Operating expenses	6,580	6,748	7,979	8,107	8,107	23.2	8,315	(3)
- staff	4,140	4,598	4,817	5,180	4,779	15.4	5,388	(11)
- others	2,440	2,149	3,162	2,927	3,328	36.4	2,927	14
<b>Operating profit</b>	<b>12,106</b>	<b>10,724</b>	<b>12,147</b>	<b>17,994</b>	<b>14,081</b>	<b>16.3</b>	<b>13,752</b>	<b>2</b>
Provisions	2,860	3,490	2,868	2,720	3,846	34.5	2,292	68
NPLs	1,800	1,440	800	2,070	1,920	6.7	2,060	(7)
Invst depreciation	580	1,273	1,920	630	900	55.2	177	407
Other provisions	480	778	150	20	1,020	112.5	52	1,844
PBT	9,246	7,234	9,280	15,274	10,234	10.7	11,459	(11)
Tax	1,690	1,615	1,651	6,174	2,131	26.1	2,669	(20)
<b>Net profit</b>	<b>7,557</b>	<b>5,620</b>	<b>7,629</b>	<b>9,100</b>	<b>8,104</b>	<b>7.2</b>	<b>8,790</b>	<b>(8)</b>
<b>Core operating profit</b>	<b>12,086</b>	<b>11,314</b>	<b>13,887</b>	<b>14,274</b>	<b>12,741</b>	<b>5.4</b>	<b>12,642</b>	<b>1</b>
Tax rate	18.3	22.3	17.8	40.4	20.8		23.3	

Source: Company, Kotak Institutional Equities estimates.

## Bank of India, quarterly results -- key balance sheet items

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09	% chg
<b>Advances (Rs bn)</b>						
Global	1,148	1,229	1,293	1,361	1,447	26.1
India	914	960	1,012	1,085	1,154	26.2
Foreign	234	269	281	276	294	25.5
Agriculture	132	129	140	151	163	23.8
SME	204	211	224	239	254	24.7
Retail	194	195	199	190	174	(10.2)
Residential mortgage	55	61	58	65	73	32.1
Business mortgage	32	30	29	28	23	(27.1)
Auto finance	6	6	7	8	9	49.7
Educational loan	10	11	12	13	13	30.5
Others	91	86	92	77	56	(38.3)
<b>Deposits (Rs bn)</b>						
Global	1,500	1,592	1,642	1,717	1,897	26.5
India	1,254	1,327	1,382	1,472	1,595	27.2
Foreign	246	266	261	245	302	22.9
Saving deposits	332	348	355	359	379	14.3
Current deposits	110	102	90	104	107	(2.5)
CASA ratio on global deposits(%)	29.4	28.2	27.1	27.0	25.6	
CASA ratio on Indian deposits(%)	35.2	33.9	32.2	31.4	30.5	
<b>Investments (Rs bn)</b>						
Global	421	449	424	466	533	26.6
India	377	401	375	416	480	27.5
Foreign	44	48	49	50	53	19.3
SLR investments	338	359	340	376	433	27.9
Gsec	331	352	333	369	426	28.8
Other approved securities	7	7	7	7	7	(11.6)

Source: Company, Kotak Institutional Equities estimates.

**Bank of India quarterly results-- key analytical ratios**

	4QFY08	1QFY09	2QFY09	3QFY09	4QFY09
<b>Asset quality</b>					
Gross NPLs (Rs bn)	19.3	20.2	19.8	22.1	24.7
Gross NPLs (%)	1.7	1.6	1.5	1.6	1.7
Net NPLs (Rs bn)	5.9	6.3	6.1	7.0	6.3
Net NPLs (%)	0.5	0.5	0.5	0.5	0.4
<b>Yield management measures (%)</b>					
Cost of deposits	5.6	5.5	5.8	6.1	6.1
India	6.0	6.0	6.3	6.6	6.7
Foreign	3.4	3.0	3.1	3.4	2.4
Cost of funds	5.4	5.1	5.4	5.6	5.7
India	5.6	5.5	5.8	6.0	6.3
Foreign	4.3	3.4	3.4	3.8	2.8
Yield on advances	9.7	9.2	9.8	10.5	9.7
India	10.8	10.3	11.2	11.8	11.0
Foreign	5.6	4.9	4.8	5.5	4.6
Yield on investments	7.3	7.3	7.5	7.9	7.4
India	7.5	7.5	7.7	8.0	7.6
Foreign	5.2	5.7	5.6	6.7	6.1
Yield on funds	8.2	7.7	8.2	8.6	8.3
India	8.8	8.3	9.0	9.3	9.2
Foreign	5.8	4.9	4.8	5.5	4.3
Spread	2.9	2.6	2.8	3.0	2.7
Domestic	3.2	2.8	3.1	3.3	2.9
Foreign	1.5	1.5	1.5	1.8	1.5
<b>Capital adequacy (%)</b>					
CAR	12.0	12.2	12.3	13.4	13.0
- Tier I	7.7	7.8	8.2	8.9	8.9
- Tier II	4.34	4.41	4.1	4.47	4.1
RWA (Rs bn)	1,222	1,288	1,322	1,315	1,399
Tier I	94	101	108	117	125
Tier II	53	57	54	59	57

Source: Company, Kotak Institutional Equities estimates.

**Bank of India (Old and new estimates Rsmn)**

	New estimates			New estimates			% change		
	2009E	2010E	2011E	2009E	2010E	2011E	2009E	2010E	2011E
Net interest income	55,470	59,696	71,884	54,989	57,522	70,151	(0.9)	(3.6)	(2.4)
Loan growth (%)	24.5	15.6	15.7	26.7	15.5	15.7			
NIM (%)	2.90	2.56	2.60	2.84	2.51	2.68			
Loan loss provisions	6,370	16,754	21,139	6,230	17,038	21,489	(2.2)	1.7	1.7
Other income	30,295	28,472	28,600	30,519	27,530	29,415	0.7	(3.3)	2.9
Fee income	11,352	12,487	13,735	10,930	12,570	14,455	(3.7)	0.7	5.2
Treasury income	6,500	4,000	2,500	7,453	3,000	2,500			
Operating expenses	31,148	33,459	35,463	30,940	33,181	36,434	(0.7)	(0.8)	2.7
Employee expenses	19,983	20,725	21,402	19,370	20,512	22,490	(3.1)	(1.0)	5.1
Depreciation on investments	4,000	-	-	4,723	-	-			
PBT	31,138	26,978	31,303	30,074	23,990	28,961	(3.4)	(11.1)	(7.5)
<b>Net profit</b>	<b>31,138</b>	<b>26,978</b>	<b>31,303</b>	<b>30,074</b>	<b>23,990</b>	<b>28,961</b>	<b>(3.4)</b>	<b>(11.1)</b>	<b>(7.5)</b>
<b>PBT-treasury</b>	<b>24,638</b>	<b>22,978</b>	<b>28,803</b>	<b>22,620</b>	<b>20,990</b>	<b>26,461</b>	<b>(8.2)</b>	<b>(8.7)</b>	<b>(8.1)</b>
<b>PBT-treasury + loan loss provi:</b>	<b>31,008</b>	<b>39,732</b>	<b>49,943</b>	<b>28,850</b>	<b>38,028</b>	<b>47,950</b>	<b>(7.0)</b>	<b>(4.3)</b>	<b>(4.0)</b>

Source: Company, Kotak Institutional Equities estimates.

**Bank of India growth rates and key ratios, March year-ends 2007-2011E**

	2007	2008	2009E	2010E	2011E
<b>Growth rates (%)</b>					
Net loan	30.3	33.6	26.7	15.5	15.7
Total Asset	26.2	26.3	23.6	13.5	13.9
Deposits	27.6	25.1	26.5	14.6	14.9
Current	26.5	33.2	(14.3)	2.5	14.9
Savings	14.8	14.3	13.5	20.4	14.9
Fixed	33.1	28.1	35.5	14.0	14.9
Net interest income	28.1	14.8	30.0	4.6	22.0
Loan loss provisions	24.0	11.5	(27.8)	173.5	26.1
Total other income	30.6	36.8	44.2	(9.8)	6.8
Net fee income	15.0	31.2	39.6	15.0	15.0
Net capital gains	79.6	78.7	103.5	(59.7)	(16.7)
Net exchange gains	22.9	36.8	85.8	8.0	8.0
Operating expenses	23.3	1.4	17.0	7.2	9.8
Employee expenses	21.5	2.7	16.9	5.9	9.6
<b>Key ratios (%)</b>					
Yield on average earning assets	7.5	8.0	8.4	7.8	7.9
Yield on average loans	8.5	9.3	9.7	8.9	8.9
Yield on average investments	7.4	6.9	7.2	6.7	6.7
Average cost of funds	4.6	5.5	5.9	5.6	5.5
Interest on deposits	4.3	5.2	5.8	5.4	5.4
<b>Difference</b>	<b>2.8</b>	<b>2.5</b>	<b>2.5</b>	<b>2.2</b>	<b>2.4</b>
Net interest income/earning assets	3.0	2.7	2.8	2.5	2.7
New provisions/average net loans	1.0	0.9	0.5	1.1	1.2
Interest income/total income	70.4	66.6	64.3	67.6	70.5
Fee income to total income	11.4	12.3	12.8	14.8	14.5
Operating expenses/total income	49.9	41.7	36.2	39.0	36.6
Tax rate	26.7	25.2	27.8	27.0	27.0
Dividend payout ratio	17.5	10.5	10.5	10.5	10.5
Share of deposits					
Current	9.9	9.9	6.7	6.0	6.0
Fixed	59.2	63.4	69.5	69.0	69.0
Savings	30.9	26.7	23.8	25.0	25.0
Loans-to-deposit ratio	70.8	75.6	75.8	76.3	76.9
Equity/assets (EoY)	4.2	5.9	5.9	6.0	6.2
<b>Dupont analysis (%)</b>					
Net interest income	2.9	2.7	2.8	2.5	2.6
Loan loss provisions	0.6	0.5	0.3	0.7	0.8
Net other income	1.2	1.3	1.5	1.2	1.1
Operating expenses	2.1	1.7	1.7	1.5	1.4
Inv. depreciation	0.0	0.1	0.2	0.0	0.0
(1- tax rate)	73.3	74.8	72.2	73.0	73.0
ROA	0.9	1.3	1.5	1.0	1.1
Average assets/average equity	24.0	21.9	19.5	18.7	18.0
ROE	21.2	27.6	29.6	19.2	19.5

Source: Company, Kotak Institutional Equities estimates.

**Bank of India income statement and balance sheet, March year-ends 2007-2011E (Rs mn)**

	2007	2008	2009E	2010E	2011E
<b>Income statement</b>					
<b>Total interest income</b>	91,803	123,552	163,474	178,113	207,054
Loans	63,975	92,751	125,393	137,152	160,104
Investments	24,601	26,390	33,703	38,442	44,649
Cash and deposits	3,227	4,411	4,378	2,518	2,300
<b>Total interest expense</b>	54,958	81,260	108,485	120,591	136,902
Deposits from customers	46,084	70,585	97,767	110,541	126,852
<b>Net interest income</b>	36,845	42,293	54,989	57,522	70,151
Loan loss provisions	7,741	8,628	6,230	17,038	21,489
<b>Net interest income (after prov.)</b>	29,104	33,665	48,759	40,485	48,662
Other income	15,470	21,169	30,519	27,530	29,415
Net fee income	5,967	7,829	10,930	12,570	14,455
Net capital gains	2,049	3,662	7,453	3,000	2,500
Net exchange gains	2,241	3,066	5,695	6,150	6,642
<b>Operating expenses</b>	26,084	26,450	30,940	33,181	36,434
Employee expenses	16,140	16,570	19,370	20,512	22,490
Depreciation on investments	2,574	834	4,723	0	0
Other Provisions	747	703	1,971	1,971	1,971
Pretax income	15,328	26,846	41,644	32,863	39,672
Tax provisions	4,097	6,753	11,571	8,873	10,712
<b>Net Profit</b>	<b>11,232</b>	<b>20,094</b>	<b>30,074</b>	<b>23,990</b>	<b>28,961</b>
% growth	60.1	78.9	49.7	(20.2)	20.7
<b>PBT - treasury gains + provisions</b>	24,341	33,349	47,115	48,872	60,633
% growth	36.0	54.5	41.3	3.7	24.1
<b>Balance sheet</b>					
<b>Cash and bank balance</b>	174,055	177,174	184,016	151,766	154,887
Cash	3,246	4,563	4,563	4,563	4,563
Balance with RBI	68,723	112,855	123,602	91,352	94,473
Balance with banks	15,106	19,524	15,620	15,620	15,620
Net value of investments	354,928	418,029	530,077	634,841	718,173
Govt. and other securities	252,937	330,318	425,930	543,884	628,461
Shares	3,365	3,145	3,910	4,675	5,440
Debentures and bonds	30,831	24,820	22,338	20,104	18,094
Net loans and advances	849,359	1,134,763	1,437,596	1,660,145	1,921,368
<b>Fixed assets</b>	7,893	24,261	25,021	27,683	29,122
Net leased assets	—	—	—	—	—
Net Owned assets	7,893	24,261	25,021	27,683	29,122
Other assets	30,135	34,073	34,073	34,073	34,073
<b>Total assets</b>	<b>1,416,370</b>	<b>1,788,300</b>	<b>2,210,784</b>	<b>2,508,508</b>	<b>2,857,623</b>
Deposits	1,198,817	1,500,120	1,897,090	2,174,596	2,499,088
Borrowings and bills payable	125,162	133,562	133,562	133,562	133,562
Other liabilities	33,437	48,724	48,724	48,724	48,724
<b>Total liabilities</b>	<b>1,357,416</b>	<b>1,682,406</b>	<b>2,079,376</b>	<b>2,356,882</b>	<b>2,681,374</b>
Paid-up capital	4,881	5,259	5,259	5,259	5,259
Reserves & surplus	54,072	100,635	126,148	146,367	170,990
Revaluation reserve	1,495	17,631	16,749	15,912	15,116
<b>Total shareholders' equity</b>	<b>58,954</b>	<b>105,894</b>	<b>131,408</b>	<b>151,626</b>	<b>176,249</b>

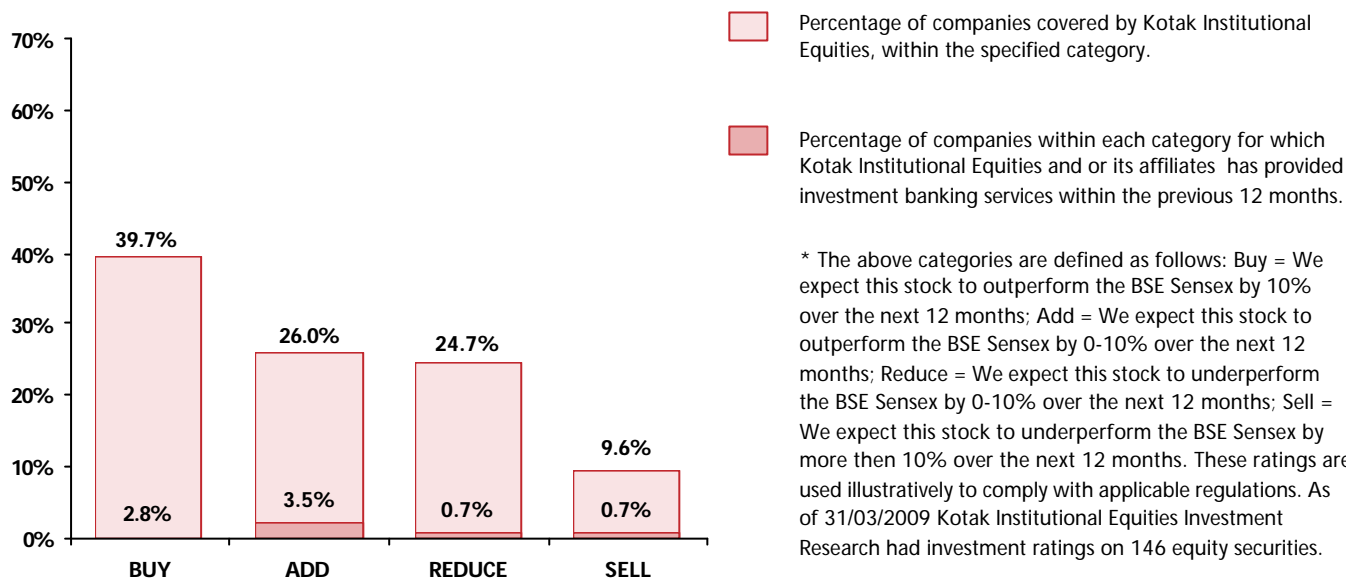
Source: Company, Kotak Institutional Equities estimates.



"I, Manish Karwa, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

### Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2009

## Ratings and other definitions/identifiers

### Rating system

Definitions of ratings

**BUY.** We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

**ADD.** We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

**REDUCE:** We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

**SELL:** We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

### Other definitions

**Coverage view.** The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

### Other ratings/identifiers

**NR = Not Rated.** The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

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