Bank of Baroda (BOB.BO)

Buy: 4Q07 Results - Modest Headline Hides Healthy Fundamentals

- **Lower reported profits but operating performance healthy** — BOB's 4Q07 reported profits at Rs2.46bn, up 17.7% yoy, though 9% below our expectations; operating performance remains healthy, with PBT and adjusted pre-provision profits 27% and 20% higher than expectations, respectively. Operating performance driven by higher-than-expected NIMs, healthy fee incomes and asset recoveries.

- **Led by margins, followed by fees** — Net interest margins for the quarter improved to 342 bps (13bps yoy and about 30bps qoq) on the cumulated effect of 200bps of lending rate increases during the year. This provides comfort and suggests that BOB's higher-than-industry growth levels are being managed profitably. Core fee income growth is also healthy and has increased about 33% yoy.

- **Asset quality continues to improve** — BOB's asset quality has shown continuous improvement and gross NPLs have reduced to 2.5% and though coverage levels have reduced slightly in the quarter, absolute cushion provides comfort.

- **Above-industry loan growth with "international boosters"** — BOB's loan growth at about 40% is significantly higher than industry levels. While growth has been boosted by its profitable international businesses, we do see growth peaking, as BOB has exhausted its surplus liquidity, and its deposit mix has deteriorated supporting growth. Nonetheless, a good mix of growth and margins.

- **Maintain Buy** — While we expect BOB to trade only at industry average multiples, we see value at current valuations, with improving margins and high growth. We maintain our Buy (1M) rating.

Buy/Medium Risk	1M
Price (27 Apr 07)	Rs242.90
Target price	Rs326.00
Expected share price return	34.2%
Expected dividend yield	2.3%
Expected total return	**36.5%**
Market Cap	Rs88,480M
	US$2,169M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	6,768	22.98	-30.1	10.6	1.3	12.6	2.1
2006A	8,270	25.06	9.0	9.7	1.1	12.3	2.1
2007E	10,469	28.64	14.3	8.5	1.0	12.7	2.3
2008E	12,460	34.09	19.0	7.1	0.9	13.6	2.5
2009E	15,606	42.69	25.3	5.7	0.8	15.2	2.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	10.6	9.7	8.5	7.1	5.7
P/E reported (x)	10.6	9.7	8.5	7.1	5.7
P/BV (x)	1.3	1.1	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.3	1.2	1.1	0.9	0.8
Dividend yield (%)	2.1	2.1	2.3	2.5	2.5
Per Share Data (Rs)					
EPS adjusted	22.98	25.06	28.64	34.09	42.69
EPS reported	22.98	25.06	28.64	34.09	42.69
BVPS	191.08	214.61	236.95	264.25	297.41
Tangible BVPS	191.08	214.61	236.95	264.25	297.41
Adjusted BVPS diluted	182.22	207.47	229.81	257.11	290.27
DPS	5.00	5.00	5.50	6.00	6.00
Profit & Loss (RsM)					
Net interest income	29,793	32,249	37,549	42,842	48,905
Fees and commissions	3,426	3,610	4,332	4,938	5,630
Other operating Income	9,622	8,307	8,291	9,222	10,371
Total operating income	**42,841**	**44,166**	**50,171**	**57,002**	**64,906**
Total operating expenses	-19,822	-23,848	-25,303	-27,898	-30,761
Oper. profit bef. provisions	**23,019**	**20,318**	**24,868**	**29,104**	**34,145**
Bad debt provisions	-4,562	-3,400	-3,243	-5,547	-6,851
Non-operating/exceptionals	-9,826	-5,772	-6,000	-5,500	-5,000
Pre-tax profit	**8,631**	**11,146**	**15,625**	**18,057**	**22,294**
Tax	-1,863	-2,876	-5,156	-5,598	-6,688
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Attributable profit	**6,768**	**8,270**	**10,469**	**12,460**	**15,606**
Adjusted earnings	6,768	8,270	10,469	12,460	15,606
Growth Rates (%)					
EPS adjusted	-30.1	9.0	14.3	19.0	25.3
Oper. profit bef. prov.	-7.2	-11.7	22.4	17.0	17.3
Balance Sheet (RsM)					
Total assets	**946,642**	**1,133,925**	**1,361,983**	**1,580,520**	**1,837,520**
Avg interest earning assets	879,725	1,010,934	1,212,050	1,434,200	1,672,047
Customer loans	462,112	620,237	799,837	967,155	1,151,185
Gross NPLs	33,220	23,903	25,925	29,586	39,239
Liab. & shar. funds	**946,642**	**1,133,925**	**1,361,983**	**1,580,520**	**1,837,520**
Total customer deposits	813,335	936,620	1,153,005	1,356,282	1,595,423
Reserve for loan losses	28,108	21,119	23,326	27,576	33,086
Shareholders' equity	**56,278**	**78,444**	**86,613**	**96,589**	**108,712**
Profitability/Solvency Ratios (%)					
ROE adjusted	12.6	12.3	12.7	13.6	15.2
Net interest margin	3.39	3.19	3.10	2.99	2.92
Cost/income ratio	46.3	54.0	50.4	48.9	47.4
Cash cost/average assets	2.2	2.3	2.0	1.9	1.8
NPLs/customer loans	7.2	3.9	3.2	3.1	3.4
Reserve for loan losses/NPLs	84.6	88.4	90.0	93.2	84.3
Bad debt prov./avg. cust. loans	1.1	0.6	0.5	0.6	0.6
Loans/deposit ratio	56.8	66.2	69.4	71.3	72.2
Tier 1 capital ratio	7.5	10.3	9.0	8.4	8.0
Total capital ratio	13.3	13.7	11.7	10.7	10.0

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Powered by: dataCentral

Figure 1. 4Q07 Results: Key Highlights (Rupees Millions)

	4Q07	4Q06	YoY %	3Q07	QoQ%	Citigroup Investment Research Comments
Interest Income	26,721	19,573	36.5	23,870	11.9	
Interest Expense	(15,674)	(10,883)	44.0	(14,262)	9.9	Increase in Deposit cost more than increase in Interest income due to increase in funding costs and reduced low cost deposit ratio
Net Interest Income	11,046	8,690	27.1	9,608	15.0	NII 8% higher than expectations on continued strong growth in lending and increases in lending rate
Non Interest Income	2,403	4,011	-40.1	3,337	-28.0	Reported income depressed due to shifting of Rs2.08bn of investment charges from provisions. About 12% growth in non-interest income adjusted for this charge
Operating Income	13,450	12,701	5.9	12,944	3.9	
Operating Expenses	(7,584)	(6,667)	13.8	(6,375)	19.0	Higher than expected after a strong show in the first half of the year
Pre-Provision Profit	**5,866**	**6,035**	**-2.8**	**6,569**	**-10.7**	**After adjusting for accounting changes20% higher than expectations (+31.7% yoy and 21% qoq) ; underlines strong operating fundamentals**
Charges for Bad Debts	(500)	(1,735)	-71.2	(2)	33233.3	Low provisioning due to high traction on recoveries including those on written off accounts
Other Operating Items	(1,043)	(1,676)	-37.8	(1,415)	-26.3	High mtm charges on bond portfolio, but reported numbers depressed due to shifting of amortization charges to non-interest income
Pre-Tax Profit	4,322	2,624	64.8	5,152	-16.1	27% higher than expectations on account of lower provisioning
Tax	(1,866)	(536)	248.4	(1,861)	0.3	High effective tax rate of 43% during the quarter
Net Profit	**2,457**	**2,088**	**17.7**	**3,291**	**-25.4**	**Profits 9% below expectations**
EPS	6.7	7.1	-5.2	9.0	-25.4	
Customer Loans	836,209	599,306	39.5	776,610	7.7	Domestic loan growth slightly lower at 33%yoy but higher than industry levels. QoQ growth also strong despite a challenging quarter
Customer Deposits	1,249,160	936,620	33.4	1,122,980	11.2	Well above industry averages and supports a strong growth in loan book. Domestic growth at 26% yoy is also above industry
AIEA	1,291,690	1,058,252	22.1	1,237,388	4.4	
AIBL	1,169,976	879,681	33.0	1,091,143	7.2	
Total Assets	1,431,462	1,133,730	26.3	1,213,110	18.0	
Avg Assets	1,322,286	1,016,165	30.1	1,239,334	6.7	
Non-Performing Loans (NPL)	20,921	23,901	-12.5	23,886	-12.4	Reduction in NPLs a reflection of efforts on recovery of assets
Loan Loss Reserves (LLR)	(15,905)	(18,721)	-15.0	(18,683)	-14.9	Though provisioning is reduced; net NPLs are lower on a yoy and qoq basis
Shareholders' Funds	84,361	76,197	10.7	84,005	0.4	
Book Value Per Share	231	208	10.7	231	0.1	
Key Ratios (%)	**4Q07**	**4Q06**	**Bps Δ YoY**	**3Q07**	**Bps Δ QoQ**	**Citigroup Investment Research Comments**
ROAA (annualized)	0.69	0.74	-5	1.09	-40	Lower than expected after a strong and profitable previous quarter
ROAE (annualized)	11.65	10.96	69	15.67	-402	
Net Interest Margin (bps)	342	328	14	311	31	Improvement over the year despite a challenging quarter shows fundamentals remain healthy
Other Non-Interest Inc/Op Inc	17.9	31.6	-1371	25.8	-791	
Op. Cost/ Operating Income	56.4	52.5	390	49.3	714	Increase in costs after a strong show in H1
Loan-to-Deposit Ratio (LDR)	66.9	64.0	296	69.2	-221	
NPL/Loan Ratio	2.5	4.0	-149	3.1	-57	Consistent reductions healthy and meaning de-risking the credit portfolio
LLR/NPL Ratio	76	78	-230	78	-219	Slight dip in coverage but remains healthy

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 a 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 rate BoB Buy (1M) 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 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.

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.

Appendix A-1

Analyst Certification

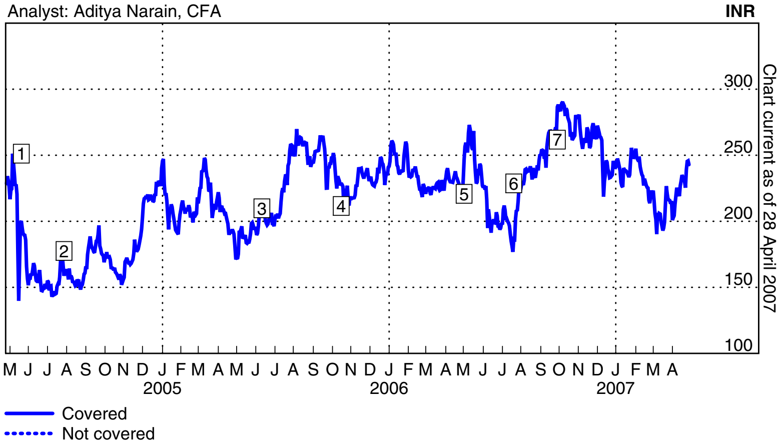
We, Aditya Narain, CFA and Manish Chowdhary, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Bank of Baroda (BOB.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



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

*Indicates change.

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