

## Company In-Depth

23 April 2007 | 7 pages

# Bank of Baroda (BOB.BO)

## Buy: Lower Growth, But Value Intact

 Rating change   
 Target price change   
 Estimate change 

- Tougher environment hurts growth; profits remain on course** — The higher interest rate scenario in the Indian banking sector will likely be a drag on growth, lead to higher provisioning on loans and bonds. However, it should be supportive of margins and profitability, with asset quality declining but not significantly. The stock price has corrected 10% in the last 3 months and our target price offers 44% upside potential. We maintain our Buy (1M) rating.
- Loan growth should ease, margins hold** —BoB's Loan growth has been running high at 35%+ and NIMs, though slightly volatile, have been around 300bps. While growth should moderate to 20-25% levels, margins should remain at around 300bps. BoB's international business (19% of advances) is seeing strong momentum (60%+ growth) and broadens and hedges the bank's business, although it does moderate the leverage to the domestic opportunity.
- Asset quality improving, provisioning moderate** — BoB has made among the most consistent and impressive improvements on the asset quality front; net NPLs are at 0.6%. While asset provisioning could increase, the underlying asset environment should be stable. On the bond portfolio, while rising interest rates would require additional provisioning relative to peer banks, BoB is one of the better protected from an accounting perspective.
- Valuations look attractive** — We continue to see value in BoB and raise FY07-09 estimates 9-5% on account of higher growth and fees. Growth and margins are likely to be in line with industry average, asset quality is fine, and, with the technology rollout on schedule. Valuations look attractive to us at 0.9x FY08E book.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (20 Apr 07)	Rs229.85
Target price	Rs326.00
Expected share price return	41.8%
Expected dividend yield	2.4%
<b>Expected total return</b>	<b>44.2%</b>
Market Cap	Rs83,727M
	US\$2,013M

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



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

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	6,768	22.98	-30.1	10.0	1.2	12.6	2.2
2006A	8,270	25.06	9.0	9.2	1.1	12.3	2.2
2007E	10,469	28.64	14.3	8.0	1.0	12.7	2.4
2008E	12,460	34.09	19.0	6.7	0.9	13.6	2.6
2009E	15,606	42.69	25.3	5.4	0.8	15.2	2.6

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
<b>Valuation Ratios</b>					
P/E adjusted (x)	10.0	9.2	8.0	6.7	5.4
P/E reported (x)	10.0	9.2	8.0	6.7	5.4
P/BV (x)	1.2	1.1	1.0	0.9	0.8
P/Adjusted BV diluted (x)	1.3	1.1	1.0	0.9	0.8
Dividend yield (%)	2.2	2.2	2.4	2.6	2.6
<b>Per Share Data (Rs)</b>					
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
<b>Profit &amp; Loss (RsM)</b>					
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
<b>Total operating income</b>	<b>42,841</b>	<b>44,166</b>	<b>50,171</b>	<b>57,002</b>	<b>64,906</b>
Total operating expenses	-19,822	-23,848	-25,303	-27,898	-30,761
<b>Oper. profit bef. provisions</b>	<b>23,019</b>	<b>20,318</b>	<b>24,868</b>	<b>29,104</b>	<b>34,145</b>
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
<b>Pre-tax profit</b>	<b>8,631</b>	<b>11,146</b>	<b>15,625</b>	<b>18,057</b>	<b>22,294</b>
Tax	-1,863	-2,876	-5,156	-5,598	-6,688
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
<b>Attributable profit</b>	<b>6,768</b>	<b>8,270</b>	<b>10,469</b>	<b>12,460</b>	<b>15,606</b>
Adjusted earnings	6,768	8,270	10,469	12,460	15,606
<b>Growth Rates (%)</b>					
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
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>946,642</b>	<b>1,133,925</b>	<b>1,361,983</b>	<b>1,580,520</b>	<b>1,837,520</b>
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
<b>Liab. &amp; shar. funds</b>	<b>946,642</b>	<b>1,133,925</b>	<b>1,361,983</b>	<b>1,580,520</b>	<b>1,837,520</b>
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	<b>56,278</b>	<b>78,444</b>	<b>86,613</b>	<b>96,589</b>	<b>108,712</b>
<b>Profitability/Solvency Ratios (%)</b>					
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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## Bank of Baroda

Figure 1. Earnings revision table

	Net Profit			EPS			DPS	
	Old	New	% change	Old	New	% change	Old	New
2007E	9,565	10,469	9.45%	26.17	28.64	9.45%	5.5	5.5
2008E	12,281	12,460	1.46%	33.60	34.09	1.46%	6	6
2009E	14,830	15,606	5.23%	40.57	42.69	5.23%	6	6

Source: Citigroup Investment Research estimates

## 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.

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### **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

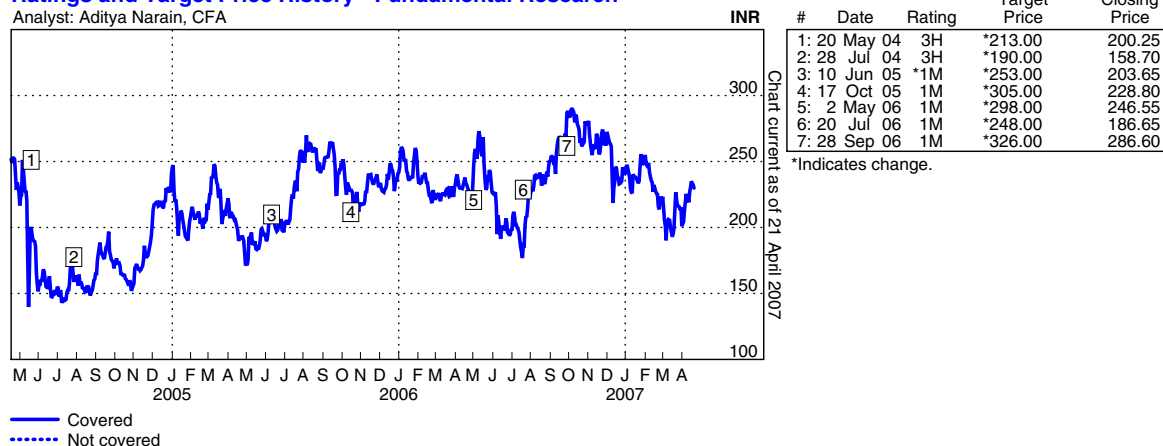
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