



## Oriental Bank of Commerce

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,024	OBC IN
	REUTERS CODE
S&P CNX: 3,769	ORBC.BO

30 October 2006

Neutral

Previous Recommendation: Neutral

Rs260

Equity Shares (m)	250.5
52-Week Range	281/139
1,6,12 Rel. Perf.(%)	-9/3/-57
M.Cap. (Rs b)	65.1
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)
3/06A	21,578	8,031	32.1	-18.9	8.1	1.5	12.5	18.9	1.4	1.5
3/07E	23,184	8,446	33.7	5.2	7.7	1.3	12.0	15.6	1.3	1.3
3/08E	26,593	9,347	37.3	10.7	7.0	1.1	11.3	15.9	1.3	1.1

Oriental Bank of Commerce (OBC) has reported the second consecutive quarter of marginal core NII growth of 2% YoY to Rs4.1b, as margins were squeezed further on account of rising deposit costs. Other income, resulting from increased treasury profits, was higher than our estimate. On the back of continued recoveries, net NPAs reduced to 0.5% from 0.8% in 2QFY06, although they were stable from 1QFY07 levels.

- ⚡ NII grows by 2%; margin pressure continues
- ⚡ Deposits up by 21%, loans grew by 29%
- ⚡ Core fee income up; trading income declines
- ⚡ Operating expenses, ex-staff costs up
- ⚡ Asset quality maintained QoQ

Further improvement in asset quality and continued recoveries are key things to watch out for. However, we believe that lower margins will continue to drag core operating earnings for OBC. On the back of continued strong recoveries and lower provisions, we have upgraded our earnings estimates by 10% for FY07 and by 6% for FY08E, although concerns remain on the margin front. OBC trades at P/E of 7x and P/BV (adjusted for goodwill) of 1.1x FY08 earnings. Maintain **Neutral**.

### QUARTERLY PERFORMANCE

	(Rs Million)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Interest Income	9,876	10,069	10,499	10,747	11,353	12,822	13,018	13,372	41,189	50,566
Interest Expense	5,846	6,027	6,549	6,717	7,244	8,695	8,775	8,781	25,139	33,494
<b>Net Interest Income</b>	<b>4,030</b>	<b>4,042</b>	<b>3,950</b>	<b>4,030</b>	<b>4,110</b>	<b>4,128</b>	<b>4,243</b>	<b>4,591</b>	<b>16,051</b>	<b>17,072</b>
%Change (YoY)	6.8	4.7	5.4	3.9	2.0	2.1	7.4	13.9	5.3	6.4
Other Income	955	1,720	1,263	1,590	1,687	1,579	1,427	1,420	5,528	6,113
<b>Net Income</b>	<b>4,986</b>	<b>5,762</b>	<b>5,213</b>	<b>5,619</b>	<b>5,797</b>	<b>5,707</b>	<b>5,670</b>	<b>6,011</b>	<b>21,578</b>	<b>23,184</b>
%Change (YoY)	4.5	27.4	-1.1	-0.1	6.3	-1.0	8.8	7.0	6.4	7.4
Operating Expenses	2,136	2,503	2,225	2,795	2,287	2,566	2,581	2,590	9,659	10,023
<b>Operating Profit</b>	<b>2,850</b>	<b>3,259</b>	<b>2,988</b>	<b>2,824</b>	<b>3,510</b>	<b>3,141</b>	<b>3,089</b>	<b>3,421</b>	<b>11,919</b>	<b>13,162</b>
Provision & Contingencies	1,028	324	309	610	1,477	-737	464	697	2,271	1,900
<b>PBT</b>	<b>1,822</b>	<b>2,935</b>	<b>2,679</b>	<b>2,214</b>	<b>2,033</b>	<b>3,878</b>	<b>2,626</b>	<b>2,724</b>	<b>9,649</b>	<b>11,262</b>
Tax Provisions	775	670	633	-460	481	771	696	868	1,617	2,815
<b>Net Profit</b>	<b>1,048</b>	<b>2,265</b>	<b>2,047</b>	<b>2,673</b>	<b>1,553</b>	<b>3,108</b>	<b>1,930</b>	<b>1,856</b>	<b>8,031</b>	<b>8,446</b>
%Change (YoY)	-42.0	5.4	59.7	12.5	48.2	37.2	-5.7	-30.6	5.6	5.2
Cost to Income Ratio (%)	42.8	43.4	42.7	49.7	39.4	43.4	45.5	43.1	44.8	43.2
Int Exp/Int Earned (%)	59.2	59.9	62.4	62.5	63.8	59.9	67.4	65.7	61.0	66.2
Other Income / Net Income (%)	19.2	29.9	24.2	28.3	29.1	29.9	25.2	23.6	25.6	26.4

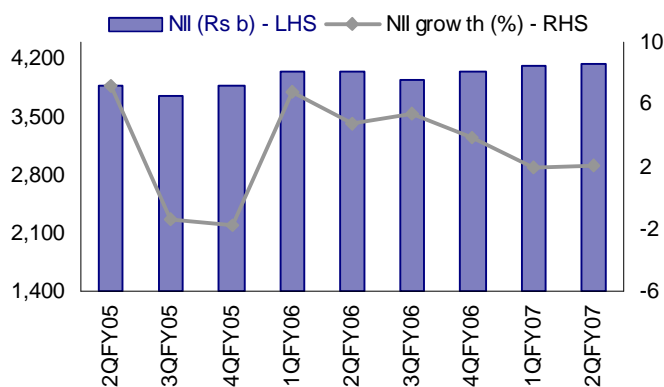
E: MOST Estimates

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### NII grows by 2%; margin pressure continues

Oriental Bank of Commerce has recorded the second consecutive quarter of marginal core NII growth of 2% YoY to Rs4.1b. Pressure on margins continued on the back of lower yielding Global Trust Bank (GTB) assets and rising deposit costs. Overall net interest margins (NIMs) declined 36bp YoY and 6bp QoQ, as investment yields declined and cost of deposits increased.

TREND IN NII



Source: Company / Motilal Oswal Securities

Cost of deposits have increased (60bp YoY) to 5.6% in 2QFY07, while yields on investments have declined by 35bp YoY to 8.1%. Yield on advances have moved up post-PLR hike and now are up by 60bp YoY to 8.5%. We believe that GTB's operations continue to earn negligible margins, which in turn is impacting OBC's overall margins. Given the rise in cost of funds and falling investment yields, we expect margins to remain at current levels, which shall result in below par performance over the next couple of quarters.

BREAKDOWN OF MARGINS (%)

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Avg Yield on Advances	7.9	7.9	7.9	8.1	8.5
Avg Yield on Investments	8.4	8.4	8.4	8.2	8.1
Avg Cost of Deposits	5.0	5.1	5.1	5.3	5.6
<b>NIMs</b>	<b>2.9</b>	<b>2.9</b>	<b>2.8</b>	<b>2.6</b>	<b>2.5</b>

Source: Company / Motilal Oswal Securities

### Deposits up 21%, loans higher by 29%

On the business front, the bank has grown its loan book by 29% to Rs387b. Deposits have grown at 21% to Rs598b. CASA ratio has been maintained at ~30%. Total retail credit portfolio increased from Rs56.6b in 2QFY06 to Rs71.5b, as on 2QFY07, reflecting growth of 26% and constituting 20% of net credit. Home Loans increased from Rs44b as at 2QFY07 to Rs54b as at 2QFY07, reflecting growth of 24% and constituting 15% of net credit.

Other Retail Loans increased from Rs13b as on 2QFY06 to Rs17.4b as on 2QFY07, reflecting growth of 35% and constituting 5% of net credit. We believe that going forward, focus on retail loans is likely to shore up volumes and keep margins intact going forward.

### Core fee income up; trading income declines

The bank has booked treasury income of Rs194m during the quarter driven by debt as well as equities compared with Rs974m in 2QFY06; Core non-interest other income has witnessed a 32% YoY increase to Rs985m. The bank also booked a one-time gain of ~Rs400m on account of property sale in 2Q, which has resulted in higher-than-expected other income and profitability.

### Operating expenses, ex staff costs up by 18% YoY

Operating expenses, ex staff costs are up by 18% YoY on the back of increased expenses resulting from accelerating CBS implementation (188 new branches added under CBS in 1HFY07).

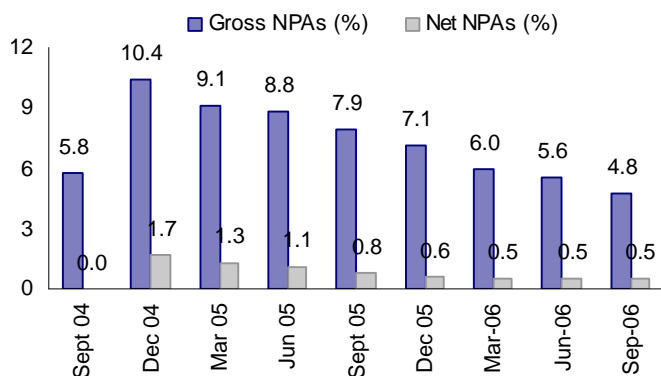
### Provision writeback due to cooling off of interest rates

Provisions in 1QFY07 were high on account of investment depreciation. However with interest rates cooling off, the bank has written back provisions in 2QFY07.

### Asset quality maintained QoQ

While gross NPAs have declined 82bp QoQ to 4.8% in 2QFY07, net NPAs are largely unchanged at 0.5%. In absolute terms, gross NPAs reduced by 11% QoQ to Rs18b, while net NPAs have increased by 6% during the same period to Rs1.7b. Management has set a target to achieve 0% net NPAs by FY07. OBC effected total recovery of Rs5.1b during 1HFY07, while total cash recoveries in 1HFY07 were Rs3.2b.

#### TREND IN NPA



Source: Company / Motilal Oswal Securities

### Restructured assets / Recoveries could provide the upside

Post takeover of GTB, OBC had restructured assets worth ~Rs4b. This notwithstanding, the bank has Rs20b as gross NPAs, wherein management expects strong recoveries. We believe that OBC's successful history of recovering bad debt shall result in high recoveries / upgradations over the next couple of quarters. On upgradation, OBC could write back its excess provisioning, which could flow into earnings.

### Valuation and view

Further improvement in asset quality and continued recoveries are key aspects to watch for. However, we believe that lower margins will continue to drag core operating earnings for OBC. On the back of continued strong recoveries and lower provisions, we have upgraded our earnings estimates by 10% for FY07 and by 6% for FY08E, although concerns on margins remain. OBC trades at P/E of 7x and P/BV (adjusted for goodwill) of 1.1x on FY08 earnings. Maintain **Neutral**.

## 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 Rs550b+. The government owns 51% of the bank's equity. After the merger with Global Trust Bank (GTB) in August 2004, OBC has acquired a pan-India presence and has a network of over 1,200 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's.
- ✍ 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

- ✍ The Oriental Bank of Commerce, Indian Bank and Corporation Bank business alliance is considering sharing payment modes and launching a joint credit card.
- ✍ OBC intends to raise Tier I capital by issuing Perpetual Bonds on private placement basis, not exceeding Rs2.5b.

### Valuation and view

- ✍ The stock trades at 7x FY08E EPS and 1.1x FY08E BV. We maintain **Neutral**.

### Sector view

- ✍ YTD loan growth of 30%+, highest in the last 12 years
- ✍ Volatility in interest rates would impact treasury.
- ✍ Benefits of significant improvement in asset quality not yet factored in earnings, valuations.
- ✍ We maintain an overweight stance on the sector

#### COMPARATIVE VALUATIONS

		OBC	KARNATAKA	ICICI BK
P/E (x)	FY07E	7.7	7.3	22.2
	FY08E	7.0	6.3	17.6
P/ABV (x)	FY07E	1.3	1.2	3.0
	FY08E	1.1	1.0	2.6
RoE (%)	FY07E	15.6	16.9	13.5
	FY08E	15.9	17.0	15.3
RoA (%)	FY07E	1.3	1.2	1.1
	FY08E	1.3	1.3	1.0

#### SHAREHOLDING PATTERN (%)

	SEP-06	JUN-05	SEP-05
Promoter	51.1	51.1	51.1
Domestic Inst	20.8	20.4	18.7
Foreign	19.7	19.7	20.0
Others	8.4	8.8	10.3

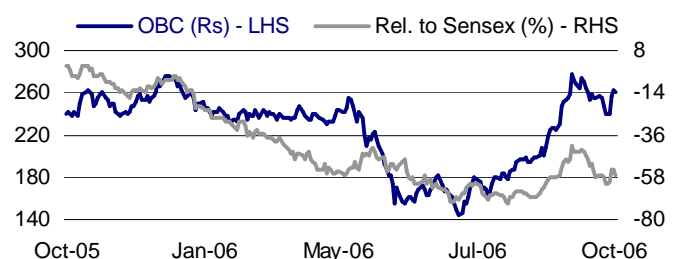
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	33.7	30.8	9.4
FY08	37.3	35.3	5.7

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
260	254	-2.2	Neutral

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Interest Income	35,719	41,189	50,566	59,266	69,074	
Interest Expended	20,482	25,139	33,494	39,148	45,011	
<b>Net Interest Income</b>	<b>15,237</b>	<b>16,051</b>	<b>17,072</b>	<b>20,118</b>	<b>24,063</b>	
Change (%)	4.7	5.3	6.4	17.8	19.6	
Other Income	5,052	5,528	6,113	6,475	7,100	
<b>Net Income</b>	<b>20,289</b>	<b>21,578</b>	<b>23,184</b>	<b>26,593</b>	<b>31,162</b>	
Change (%)	-6.8	6.4	7.4	14.7	17.2	
Operating Expenses	7,957	9,659	10,023	11,101	12,413	
<b>Operating Income</b>	<b>12,332</b>	<b>11,919</b>	<b>13,162</b>	<b>15,493</b>	<b>18,749</b>	
Change (%)	-19.6	-3.3	10.4	17.7	21.0	
Other Provisions	4,002	2,271	1,900	2,600	2,800	
<b>P B T</b>	<b>8,330</b>	<b>9,649</b>	<b>11,262</b>	<b>12,893</b>	<b>15,949</b>	
Tax	722	1,617	2,815	3,546	4,944	
<b>P A T</b>	<b>7,608</b>	<b>8,031</b>	<b>8,446</b>	<b>9,347</b>	<b>11,005</b>	
Change (%)	10.9	5.6	5.2	10.7	17.7	
Proposed Dividend	659	1,286	1,403	1,528	1,629	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Capital	1,925	2,505	2,505	2,505	2,505	
Reserves & Surplus	31,345	49,202	53,786	59,145	66,061	
<b>Net Worth</b>	<b>33,270</b>	<b>51,708</b>	<b>56,291</b>	<b>61,650</b>	<b>68,567</b>	
<b>Deposits</b>	<b>478,503</b>	<b>501,975</b>	<b>587,310</b>	<b>675,407</b>	<b>776,718</b>	
Change (%)	34.1	4.9	17.0	15.0	15.0	
Borrowings	7,281	8,764	10,000	12,000	12,000	
Other Liabilities & Prov.	21,640	34,264	36,957	39,919	43,177	
<b>Total Liabilities</b>	<b>540,695</b>	<b>596,711</b>	<b>690,558</b>	<b>788,976</b>	<b>900,462</b>	
Current Assets	75,433	55,257	47,249	53,776	68,542	
Investments	183,422	168,176	181,630	196,160	211,853	
Change (%)	9.2	-8.3	8.0	8.0	8.0	
Advances	252,992	335,772	423,073	499,226	579,103	
Change (%)	28.5	32.7	26.0	18.0	16.0	
Net Fixed Assets	3,805	3,842	4,036	4,246	4,300	
Other Assets	25,043	33,664	34,571	35,568	36,664	
<b>Total Assets</b>	<b>540,695</b>	<b>596,711</b>	<b>690,558</b>	<b>788,976</b>	<b>900,462</b>	

ASSUMPTIONS	(% )				
Deposit Growth	34.1	4.9	17.0	15.0	15.0
Advances Growth	28.5	32.7	26.0	18.0	16.0
Investments Growth	9.2	-8.3	8.0	8.0	8.0
Dividend	34.2	51.3	56.0	61.0	65.0
GRR	5.0	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS		2005	2006	2007E	2008E	2009E
<b>Spreads Analysis (%)</b>						
Avg. Yield - Earning Asset		7.9	7.7	8.4	8.5	8.7
Avg. Cost-Int. Bear. Liab.		4.8	5.0	6.0	6.1	6.1
Interest Spread		3.0	2.7	2.3	2.4	2.6
Net Interest Margin		3.4	3.0	2.8	2.9	3.0

Profitability Ratios (%)		2005	2006	2007E	2008E	2009E
RoE		25.3	18.9	15.6	15.9	16.9
RoA		16	14	13	13	13
Int. Expended/Int. Earned		57.3	61.0	66.2	66.1	65.2
Other Inc./Net Income		24.9	25.6	26.4	24.3	22.8

Efficiency Ratios (%)		2005	2006	2007E	2008E	2009E
Op. Exps./Net Income		39.2	44.8	43.2	41.7	39.8
Empl. Cost/Op. Exps.		49.9	51.8	46.5	45.7	44.5
Busi. per Empl. (Rs m)		44.1	52.4	61.1	71.8	82.6
NP per Empl. (Rs m)		0.5	0.5	0.6	0.6	0.7

Asset-Liability Profile (%)		2005	2006	2007E	2008E	2009E
Adv./Deposit Ratio		52.9	66.9	72.0	73.9	74.6
Invest./Deposit Ratio		38.3	33.5	30.9	29.0	27.3
G-Sec/Invest. Ratio		81.7	83.0	83.0	83.0	83.0
Gross NPAs to Adv.		9.1	5.9	5.2	4.6	4.1
Net NPAs to Adv.		1.3	0.5	0.3	0.3	0.3
CAR		9.2	12.5	12.0	11.3	10.5
Tier 1		5.4	11.7	11.0	10.0	9.0

VALUATION		2005	2006	2007E	2008E	2009E
Book Value (Rs)*		121.9	177.1	205.2	236.4	273.8
Price-BV (x)		2.1	1.5	1.3	1.1	0.9
Adjusted BV (Rs)		110.9	172.9	201.8	232.6	269.9
Price-ABV (x)		2.3	1.5	1.3	1.1	1.0
EPS (Rs)		39.5	32.1	33.7	37.3	43.9
EPS Growth (%)		10.9	-18.9	5.2	10.7	17.7
Price-Earnings (x)		6.6	8.1	7.7	7.0	5.9
OPS (Rs)		64.0	47.6	52.5	61.8	74.8
OPS Growth (%)		-19.6	-25.7	10.4	17.7	21.0
Price-OP (x)		4.1	5.5	4.9	4.2	3.5

E: MOST 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 |
| 4. Investment Banking relationship with company covered | No |

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