

**MARCH 31, 2010**
**UPDATE**

Coverage view: **Attractive**

Price (Rs): **639**

Target price (Rs): **750**

BSE-30: **17,528**

**Traction getting stronger.** Our recent management meeting has reaffirmed our positive view on BoB. We expect medium-term earnings to remain strong with robust loan growth (over 20%) and better-than-expected asset quality performance; MTM hit will likely be negligible in 4QFY10E. Despite a strong outperformance, valuations remain attractive—1.4X PBR FY2011E for RoE of about 20%. We upgrade our earnings (mainly to factor in lower provisions in FY2011E) and raise our target price to Rs750.

**Company data and valuation summary**

Bank of Baroda

**Stock data**

52-week range (Rs) (high,low) 655-216

Market Cap. (Rs bn) 233.6

**Shareholding pattern (%)**

Promoters 53.8

FIs 14.2

MFs 10.2

**Price performance (%)**

Absolute 1M 3M 12M 9.5 24.3 172.7

Rel. to BSE-30 2.6 23.9 51.0

**Forecasts/Valuations**

	2010	2011E	2012E
EPS (Rs)	79.1	84.6	101.2
EPS growth (%)	29.8	7.0	19.6
P/E (X)	8.1	7.6	6.3
NII (Rs bn)	58.3	70.4	81.9
Net profits (Rs bn)	28.9	30.9	37.0
BVPS	375.0	445.0	528.7
P/B (X)	1.7	1.4	1.2
ROE (%)	23.1	20.6	20.8
Div. Yield (%)	1.8	2.0	2.3

**QUICK NUMBERS**

- Loan growth, fee income growth and liability franchise trends extremely healthy
- Asset quality remains stable at 1.4% gross NPL ratio with provision coverage of 78%
- Revising target price to Rs750

**Valuations remain inexpensive at 1.4X PBR FY2011E despite recent outperformance**

Bank of Baroda has given a 24% absolute returns and has outperformed the Sensex by 24% over the last three months. Despite the outperformance, we believe that the valuations at 1.4XFY2011E PBR is not expensive and given a sustainable 20%+ RoE, valuations could tract higher.

**Controlling costs and better leverage—key variable**

One of the key reasons for lower historic RoEs for the bank has been its relatively higher cost to assets, lower leverage and productivity as compared to peers. This has changed over the last 3-4 years due to improving productivity (employee base has been flat since FY2002 despite 20% CAGR in balance sheet); BoB's operating costs to assets ratio has declined to 1.6% in FY2010E from 2% in FY2006, thereby pulling up sustainable RoAs over 1% and RoEs to 20%. A strong retail banking franchisee, lower provisioning costs due to lower NPLs and stable management will further drive valuation rerating, in our view.

**Strong growth coupled with steady margins**

We expect a 20% loan growth in FY2010E, followed by a 22% loan growth in FY2011E. NIMs are likely to remain stable at 3% levels, as the likely pricing power in the environment takes care of higher cost of saving balances. Domestic margins are now at 3.4% while international margins have been coming off with increased focus on low-risk trade finance business. The bank has reduced their exposure to low-yielding bulk advances (reduced from 9% to 6% of loan book over last 12 months) on its asset side and high-cost bulk deposits (reduced from 22% to 15% of total deposits over last 12 months), thereby resulting in better NIMs. We are factoring overall margin improvement of ~10 bps in FY2011.

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### Core earnings likely to remain strong; treasury earnings to be lower

BoB's overall loans have grown by 23% yoy to Rs1.56 tn in 3QFY10, of which domestic loans grew by 19% y-o-y and international loans by 38% y-o-y. Our recent meeting has reaffirmed our confidence on higher loan growth at BoB over the next few quarters. We are factoring the overall loan book to growth at 20% CAGR for FY09-11E. Deposit mobilisation continues to remain healthy (up 22% y-o-y on domestic deposits as of December 2009). Importantly, the thrust on improving its low-cost deposits (CASA) was even stronger—CASA ratio increased to 37% from 35% as of 3QFY09. Absolute CASA deposits grew >25% yoy which lead to improvement of its market share. Post implementation of CBS, the growth traction has improved on low-cost liabilities as well as fee income. Core fee income, on the other hand, continues to see strong traction, with 9MFY2010 showing an impressive 27% yoy growth. Given the current movement on interest rates, we see lower treasury income, a trend similar to the overall industry.

#### CASA ratio for BoB on a rise

CASA ratio across banks, quarterly data, 2QFY09-3QFY10E (%)

	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	2QFY10
<b>Public banks</b>						
Andhra Bank	34	32	31	31	32	30
<b>Bank of Baroda</b>	<b>36</b>	<b>36</b>	<b>35</b>	<b>35</b>	<b>36</b>	<b>37</b>
Bank of India	27	27	26	26	27	28
Canara Bank	32	30	30	28	29	30
Corporation Bank	25	25	31	23	22	23
Indian Bank	33	31	31	30	31	31
IOB	29	29	30	29	31	30
OBC	25	26	23	24	24	24
PNB	39	37	39	38	39	39
State Bank of India	40	37	39	38	41	43
Union Bank	33	30	30	30	33	32
<b>New private banks</b>						
Axis Bank	40	38	43	40	43	46
HDFC Bank	44	40	44	45	50	52
ICICI Bank	30	28	29	30	37	40

Source: Company

#### BoB has been improving its market share in CASA

YoY market share of CASA deposits growth, quarterly data, 2QFY09-3QFY10E (%)

	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	Mkt Share gain (bps)
<b>Public banks</b>						
Andhra Bank	2.1	2.1	2.1	2.1	1.9	(20.6)
<b>Bank of Baroda</b>	<b>7.6</b>	<b>7.5</b>	<b>7.7</b>	<b>7.6</b>	<b>7.7</b>	<b>53.4</b>
Bank of India	5.8	5.4	5.7	5.4	5.6	1.6
Canara Bank	6.5	6.2	6.0	6.0	6.1	(74.0)
Corporation Bank	1.9	2.6	1.9	1.8	1.9	(0.0)
Indian Bank	2.7	2.5	2.5	2.5	2.6	(9.8)
IOB	3.3	3.4	3.3	3.4	3.1	(22.1)
OBC	2.9	2.5	2.7	2.6	2.6	(11.0)
PNB	9.1	9.1	9.3	9.1	8.8	(24.9)
State Bank of India	31.5	32.2	32.6	32.2	32.2	153.3
Union Bank	4.9	4.6	4.9	5.0	4.8	(3.0)
<b>Old private banks</b>						
Federal Bank	0.9	0.9	0.9	0.9	0.9	4.7
J&K Bank	1.4	1.4	1.3	1.2	1.3	(7.4)
<b>New private banks</b>						
Axis Bank	5.0	5.6	4.9	5.0	5.1	(11.5)
HDFC Bank	7.2	7.0	7.3	7.7	7.8	43.6
ICICI Bank	7.2	7.0	7.1	7.4	7.6	(72.5)
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	

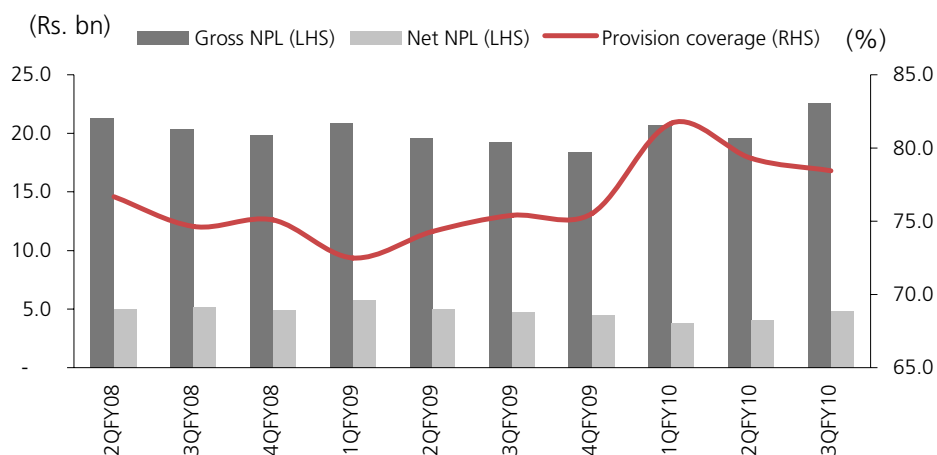
Source: Kotak Institutional Equities

### Asset quality—cushion available with recent dispensation from RBI

One of the key positives has been the bank's ability to manage asset quality in the current environment. Reported gross and net NPL ratios as of December 2009 were at 1.4% and 0.3%, respectively, with an overall provision coverage ratio of 78% (excluding technical write-off). Gross NPLs increased by 16% qoq in December 2009 but only by 4% qoq excluding debt waiver. Slippages have been below 1% in 9MFY10 (excluding the agri NPA in 3QFY10) and management expects slippages to remain below their target ratio of 1-1.25%. The recent RBI dispensation on the waiver that allows banks to extend the moratorium payment period to June 2010 from December 2009 will have a positive impact on its NPL position—in 3QFY10 agri NPLs (pertaining to the debt waiver) stood at Rs2.1 bn, i.e. about 10% of BoB's total gross NPLs. Given the current trend, we have revised our slippage assumption downwards to ~1.5% levels for FY2010 and FY2011.

#### Asset quality continues to remain healthy for the bank

Gross NPL, Net NPL and provision coverage ratio, quarter ending, 2QFY08-3QFY10



Source: Kotak Institutional Equities, Company

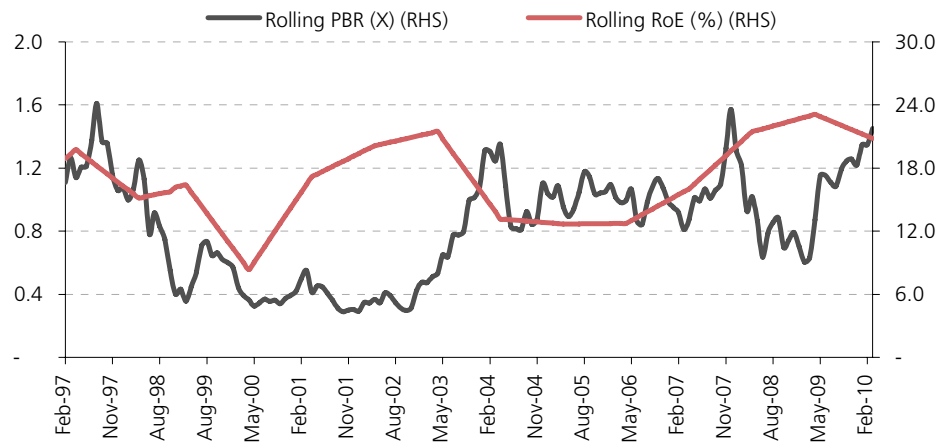
#### We marginally increase our near-term estimates by around 10%

Old and new estimates, March fiscal year-ends, 2010-2012E (Rs mn)

	Old Estimates			New Estimates			% change		
	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
NII	58,217	70,239	81,589	58,259	70,400	81,924	0.1	0.2	0.4
Loan growth	21.0	20.0	19.9	21.0	20.0	19.9			
NIM	2.46	2.55	2.56	2.46	2.56	2.57			
Non-treasury other inc	20,524	23,556	26,863	21,025	24,324	27,974	2.4	3.3	4.1
Operating expenses	39,248	43,676	48,013	39,248	43,676	48,013	0.0	0.0	0.0
Employee expenses	25,125	27,638	29,849	25,125	27,638	29,849	0.0	0.0	0.0
Provisions and contingencies									
Loan loss prov	8,750	11,495	13,789	8,750	9,580	11,491	0.0	-16.7	-16.7
<b>PBT</b>	<b>39,743</b>	<b>42,124</b>	<b>50,150</b>	<b>41,286</b>	<b>45,470</b>	<b>54,394</b>	<b>3.9</b>	<b>7.9</b>	<b>8.5</b>
<b>PAT</b>	<b>27,423</b>	<b>28,223</b>	<b>33,601</b>	<b>28,900</b>	<b>30,919</b>	<b>36,988</b>	<b>5.4</b>	<b>9.6</b>	<b>10.1</b>
<b>PBT- invt gains + provisions</b>	<b>39,493</b>	<b>50,120</b>	<b>60,439</b>	<b>40,036</b>	<b>51,049</b>	<b>61,885</b>	<b>1.4</b>	<b>1.9</b>	<b>2.4</b>

Source: Company, Kotak Institutional Equities estimates

**BoB has been trading at the higher end of valuation**  
 P/B chart and RoE of Bank of Baroda, March fiscal year-ends, 1997-2010E



Source: Kotak Institutional Equities

Bank of Baroda, Key ratios and growth rates  
March fiscal year-ends, 2008-2012E (%)

	2008	2009	2010E	2011E	2012E
<b>Growth rates (%)</b>					
Net loan	22.6	31.6	18.0	18.0	18.0
Total Asset	25.5	26.6	15.8	15.6	14.9
Deposits	21.7	26.5	18.9	16.9	15.9
Current	18.4	23.6	18.9	16.9	15.9
Savings	13.3	18.8	13.1	16.9	15.9
Fixed	25.3	29.5	20.8	16.9	15.9
Net interest income	3.3	31.0	13.7	20.8	16.4
Loan loss provisions	57.4	(34.9)	111.8	9.5	19.9
Total other income	49.8	29.8	3.4	2.9	12.9
Net fee income	14.2	38.0	22.0	20.0	20.0
Net capital gains	290.9	69.1	(27.8)	(38.5)	0.0
Net exchange gains	16.5	33.6	20.0	16.0	12.0
Operating expenses	17.1	20.0	9.8	11.3	9.9
Employee expenses	12.5	27.0	7.0	10.0	8.0
<b>Key ratios (%)</b>					
Yield on average earning assets	7.7	7.7	7.0	7.1	7.2
Yield on average loans	8.8	8.9	7.9	7.9	7.9
Yield on average investments	7.2	7.1	7.1	7.1	7.1
Average cost of funds	5.4	5.4	4.9	4.9	4.9
Interest on deposits	5.3	5.3	4.9	4.9	4.9
<b>Difference</b>	<b>2.3</b>	<b>2.3</b>	<b>2.1</b>	<b>2.2</b>	<b>2.2</b>
Net interest income/earning assets	2.6	2.6	2.5	2.6	2.6
New provisions/average net loans	0.7	0.3	0.6	0.5	0.5
Interest income/total income	72.2	73.7	73.8	74.7	74.9
Fee income to total income	9.1	9.6	10.6	11.1	11.5
Operating expenses/total income	55.0	51.5	49.7	46.3	43.9
Tax rate	35.0	34.4	30.0	32.0	32.0
Dividend payout ratio	20.4	14.8	14.8	14.8	14.8
Share of deposits					
Current	7.7	7.5	7.5	7.5	7.5
Fixed	68.8	70.4	71.5	71.5	71.5
Savings	23.5	22.1	21.0	21.0	21.0
Loans-to-deposit ratio	70.2	74.8	76.1	78.1	80.9
Equity/assets (EoY)	6.1	5.6	5.7	5.7	5.8
<b>Dupont analysis (%)</b>					
Net interest income	2.4	2.5	2.4	2.5	2.5
Loan loss provisions	0.4	0.2	0.4	0.3	0.4
Net other income	1.3	1.3	1.1	1.0	1.0
Operating expenses	1.9	1.8	1.6	1.5	1.5
Invt. depreciation	0.0	0.3	(0.1)	0.0	0.0
(1- tax rate)	65.0	66.6	70.0	68.0	68.0
ROA	0.9	1.1	1.2	1.1	1.1
Average assets/average equity	18.0	19.6	19.6	18.9	18.4
ROE	16.0	21.4	23.1	20.6	20.8

Source: Company, Kotak Institutional Equities estimates

Bank of Baroda, P&L and balance sheet  
March fiscal year-ends, 2008-2012E (Rs mn)

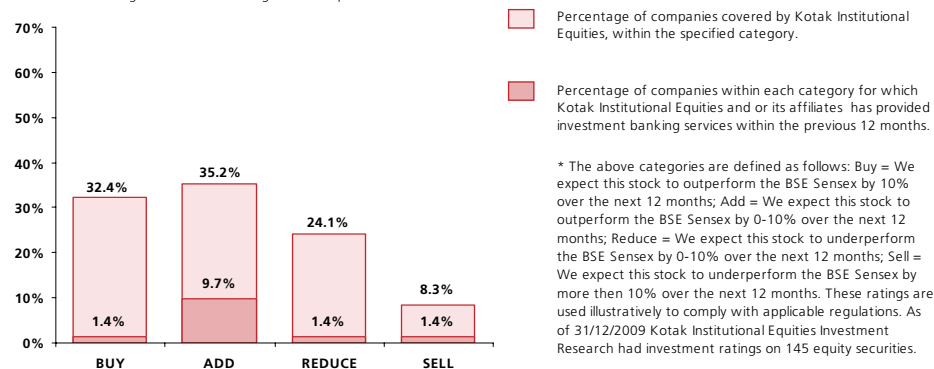
	2008	2009	2010E	2011E	2012E
<b>Income statement</b>					
<b>Total interest income</b>	118,135	150,916	167,613	197,902	229,389
Loans	84,130	111,974	125,138	152,176	182,493
Investments	27,373	33,107	37,473	40,347	42,557
Cash and deposits	6,632	5,836	5,002	5,380	4,339
<b>Total interest expense</b>	79,017	99,682	109,354	127,502	147,465
Deposits from customers	74,044	91,875	103,294	122,088	142,051
<b>Net interest income</b>	39,118	51,234	58,259	70,400	81,924
Loan loss provisions	6,347	4,131	8,750	9,580	11,491
<b>Net interest income (after prov.)</b>	32,771	47,104	49,509	60,821	70,433
Other income	20,507	26,626	27,525	28,324	31,974
Net fee income	5,402	7,455	9,095	10,914	13,097
Net capital gains	5,322	9,001	6,500	4,000	4,000
Net exchange gains	2,788	3,724	4,469	5,184	5,806
<b>Operating expenses</b>	29,793	35,761	39,248	43,676	48,013
Employee expenses	18,488	23,481	25,125	27,638	29,849
Depreciation on investments	418	5,368	(3,500)	0	0
Other Provisions	1,000	123	—	—	—
Pretax income	22,068	32,479	41,286	45,470	54,394
Tax provisions	7,716	11,157	12,386	14,550	17,406
<b>Net Profit</b>	<b>14,355</b>	<b>22,272</b>	<b>28,900</b>	<b>30,919</b>	<b>36,988</b>
% growth	40	55	30	7	20
<b>PBT - treasury gains + provisions</b>	24,510	33,098	40,036	51,049	61,885
% growth	8	35	21	28	21
<b>Balance sheet</b>					
<b>Cash and bank balance</b>	222,993	240,871	259,310	278,665	299,892
Cash	8,810	9,990	9,990	9,990	9,990
Balance with RBI	84,887	95,974	114,412	133,767	154,994
Balance with banks	13,945	14,034	14,034	14,034	14,034
Net value of investments	438,701	524,459	561,718	607,755	625,796
Govt. and other securities	335,480	401,347	448,272	494,309	512,350
Shares	7,758	6,061	6,061	6,061	6,061
Debentures and bonds	26,033	30,140	30,140	30,140	30,140
Net loans and advances	1,067,013	1,439,859	1,742,003	2,089,823	2,506,417
<b>Fixed assets</b>	24,270	23,468	25,000	23,093	21,143
Net leased assets	—	—	—	—	—
Net Owned assets	24,270	23,468	25,000	23,093	21,143
Other assets	43,018	45,781	45,781	45,781	45,781
<b>Total assets</b>	<b>1,795,995</b>	<b>2,274,067</b>	<b>2,633,811</b>	<b>3,045,116</b>	<b>3,499,029</b>
Deposits	1,520,341	1,923,970	2,288,248	2,675,343	3,099,890
Borrowings and bills payable	110,635	139,713	112,791	112,791	112,791
Other liabilities	54,580	82,029	82,029	82,029	82,029
<b>Total liabilities</b>	<b>1,685,556</b>	<b>2,145,712</b>	<b>2,483,069</b>	<b>2,870,164</b>	<b>3,294,710</b>
Paid-up capital	3,655	3,655	3,655	3,655	3,655
Reserves & surplus	106,784	124,700	147,087	171,297	200,663
<b>Total shareholders' equity</b>	<b>110,439</b>	<b>128,355</b>	<b>150,743</b>	<b>174,952</b>	<b>204,319</b>

Source: Company, Kotak Institutional Equities estimates

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Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of December 31, 2009

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**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.

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

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