QUANTUM

QUANTUM SECURITIES PVT. LTD.

Oriental Bank of Commerce

BUY

Industry	Public Sector Bank
Close Price(Rs)	272
FY11 Target(Rs)	333
52 Week H/L (Rs)	296/94.6
Volumes (BSE+NSE)*	708018
Shares O/S (mn)	250.54
Market Cap (Rs mn)	68,009.0
Free Float	49.99
Bloomberg	OBC IN
Reuters	ORBC.BO
*Three month avg	

Share Holding Pattern*		
Particulars	No. of Shares	% Holding
GOI	128000000	51.09
DII	67355497	26.88
FII	33913281	13.54
Corporate	5424446	2.17
Public and Others	15846476	6.32
Total	**250539700**	**100.00**

*As on December 31, 2009

Date: 25th February, 2010
Analyst: Rati Pandit
Tel: 91-22-66321300
rati@qsmail.com

Financial Highlights

(Rsmn)

Y/E March 31st	Net Operating Income	NIM (%)	PAT	Growth (%)	ABV (Rs)	P/ABV (x)	P/E (x)
FY08	22986.7	2.1	8409.4*	44.8	209.0	1.3	19.3
FY09	30678.2	2.0	9054.2	7.7	277.8	1.0	7.5
FY10E	38261.4	2.3	10496.9	15.9	305.8	0.9	6.5
FY11E	45845.2	2.4	11822.2	12.6	343.2	0.8	5.8
FY12E	56599.1	2.5	14543.1	23.0	386.5	0.7	4.7

*PAT for FY08 excludes extraordinary items. Adjusted PAT after deducting extraordinary items on account of e-GTB losses stood at Rs 3.5bn in FY08.

Company Profile

Oriental Bank of Commerce (OBC) is a mid-size PSU bank with a network of 1461 branches, 58 extension counters and 934 ATMs, servicing over 12 mn customers most of which are concentrated in North India. The bank provides a broad range of financial services which includes wholesale and retail banking products, merchant banking, credit assistance, lead banking and management and foreign exchange.

Investment Rationale

Strong Growth Plans

OBC plans to add over 100 branches every year in order to have a network of 2000 branches by FY12. Most of these new branches are being opened in key strategic locations in metro/urban areas in South and West India, a small part in the East and tier II and tier III locations in North India which will enable the bank to have a Pan India presence and a robust business growth ahead. As per our conservative estimates, the bank's business is expected to grow at a CAGR of 21.5% over FY09-FY12E with advances and deposits estimated to grow at a CAGR of 21.3% and 21.7% respectively during the same period.

NIM to Improve with better Asset Liability Management

OBC at present has a modest business and franchise profile with relatively low NIMs and CASA ratio. In order to improve upon these parameters, the management has already initiated steps to revamp its business. As a strategy, bank intends to focus on qualitative asset growth with increased focus on higher yielding retail and SME advances on one hand and boosting its CASA ratio, and reducing dependency on high cost bulk deposits on the other, in order to improve margins. We have estimated the CASA ratio and Net Interest Margin (NIM) to improve to 26.6% and 2.5% respectively in FY12E from 23.7% and 2% in FY09.

Comfortable Capital Position to Aid Growth

OBC's capital adequacy ratio remains comfortable at 13.2% after it raised Rs 3bn by way of perpetual tier I bonds in Dec 09. The tier I capital ratio of 9.5% is sufficient to fund near-medium term asset growth. The management is also expecting Rs 10bn capital infusion from the Government in FY11 which will enable sustainable and quality asset growth in the long term.

Life Insurance Business to Add Value

Canara HSBC Oriental Bank of Commerce Life Insurance Company the bank's joint venture life insurance company in association with Canara Bank and HSBC, in which OBC holds a 23% stake, commenced operations in June 08 and within 18 months of its inception managed to garner a market share of ~2% amongst the private players. At present, as OBC is not disclosing the financial details of this JV, we haven't included it in the valuations of our target price. However, going forward if this JV company keeps gaining market share at a rapid pace then we will start ascribing value to this business, which could be around 7-8% of the current market price of OBC.

Investment Concerns

- Competition from private and larger PSU banks in key metro/urban locations could make it difficult for the bank to attract new customers without increasing the deposit rates.
- Higher than estimated slippages in asset quality is a key risk to our investment call.
- The banks provision coverage ratio is expected to increase to 70% in FY11E, as a result of which provisions are expected to increase by 40.5% to Rs 8.8bn in FY11E and net profit growth is expected to slow down to 12.6% in FY11E.

Outlook and Valuations

We have projected the net income and net profit of OBC to grow at a CAGR of 22.6% and 17.1% over FY09-FY12E to Rs 56.6bn and Rs 14.5bn in FY12E respectively. Its earnings are expected to grow at a CAGR of 17.1% during FY09-FY12E which will translate into an ROE of 15% in FY12E.

While we believe that OBC's business and net profit will grow at a gradual pace, its undervaluation relative to its peers makes it an attractive investment opportunity. Also an improving operational performance and the fact that overhang on the stock from past legacy issues (*negative impact of GTB merger, declining NIMs, high sensitivity to bond yields and asset quality concerns on stock price of OBC, in past 5 yrs*) is behind us, gives us an indication that the stock is a strong re-rating candidate.

At a CMP of Rs 271.5 the stock is trading at 0.8x its FY11E adjusted book value of Rs 343.2 and 5.8x its FY11E earnings of Rs 47.2.

Our one year target price of Rs 333 for OBC is derived by assigning 25% weightage to its past 6 months average one year forward historical P/ABV multiple and 75% weightage to fair multiple based on a two-stage Gordon Growth Model respectively. At this price the stock will trade at 0.97x its FY11E ABV, which will provide 22.4% upside over current levels. We recommend investors to **'BUY'** the stock.

Company Background

Oriental Bank of Commerce (OBC) is a midsized PSU bank with a primary focus on Northern India and an asset size of over Rs 1200bn at the end of December 31, 2009. At present it operates 1461 branches, 58 extension counters and 934 ATMs, servicing over 12 mn customers. The bank provides a broad range of financial services which includes wholesale and retail banking products, merchant banking, credit assistance, lead banking and management and foreign exchange.

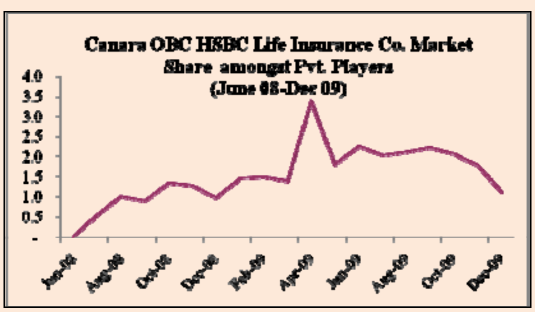
Key Events

Year	Event
1943	Founded in Lahore, Pakistan by Late Lala Rai Bahadur Sohan Lal.
1945	Acquired by Thapar Group
1947	Head Office shifted to Amritsar
1951	Head Office shifted to Delhi
1980	Nationalized with a network of 307 branches and business of Rs 4.4 bn
1994	Initial Public Offer at Rs 60 per share
1997	Bari Doab Bank and Punjab Co-operative Bank amalgamated with OBC
2004	GTB merged with OBC on August 14, 2004
2005	Follow on Public Issue at Rs 250 per share

Key Management Personnel

Name	Position	Profile
Mr. T. Y. Prabhu	CMD	With over 39 years of experience in the banking industry, he started his career with Canara Bank in 1970. He has worked under various departments including international banking division, corporate credit, commercial credit, foreign exchange, treasury and investments and general administration. Prior to joining OBC as CMD in Aug 09, he was ED of Union Bank of India since June 2007.
Mr. H. Ratnakara Hegde	ED	Before appointment as ED in OBC in May 2008, he was heading the personnel, treasury, credit corporate and industrial finance in Vijaya bank. During his 38 year stint in Vijaya Bank he served as the manager and head of several branches and regions of the bank
Mr. S. C. Sinha	ED	Has over 34 yrs of industry experience in retail banking, resource management and NID products. Prior to joining OBC he was GM at Union Bank of India.

Joint Venture and Other Initiatives



Source: IRDA, QS Research

Established presence in Dubai in March 09 and exploring opportunities in Hong Kong, S. Africa, Singapore, UK and Middle East

- **Life Insurance Business –** Canara HSBC Oriental Bank of Commerce Life Insurance Company is the bank's joint venture life insurance company in association with Canara Bank and HSBC, in which OBC holds a 23% stake. OBC has infused Rs 1.15bn as its share of capital till date in this JV. The JV company started selling life insurance products from June 16, 2008 and within 18 months of its operations it has managed to sell over 30,000 policies and has garnered ~2% market share amongst the private players. In the long term as this business turns around within 7-10 yrs of its commencement of operations, it is expected to provide upside to the valuation of the bank.

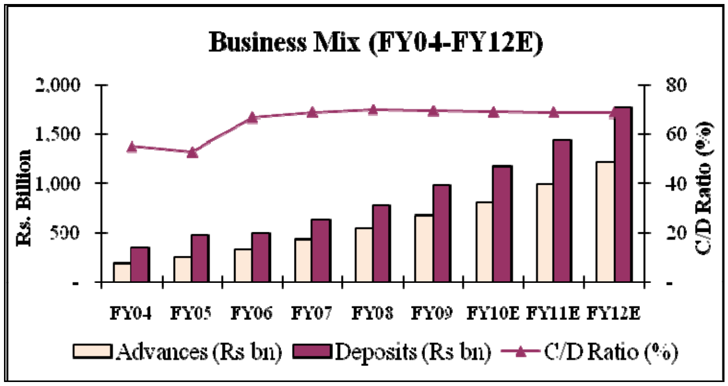
- **Global Presence** – The bank's expansion plans on the international front are still at a nascent stage. In March 2009 it opened a representative office at Dubai to tap the NRI business from the Middle East. Currently it is in the process of seeking permission from RBI to open a branch / representative office in Hong Kong, where it sees an opportunity in trade financing to Indian corporates. It is also exploring opportunities in South Africa, Singapore, UK and Middle East.

OBC's business undergoing a major revamping exercise with management's increased focus towards improving NIM through better asset liability management.

Business Overview

OBC at present has a modest business and franchise profile with relatively low NIMs and CASA ratio. Consequently, OBCs return ratios are weaker than its peers. The management has already initiated steps to improve upon these parameters. The bank is currently undergoing a significant business revamping exercise signifying a change, within and its approach towards business. As a strategy, the bank intends to focus on qualitative asset growth with increased focus on higher yielding assets on one hand and boosting its CASA ratio, and reducing dependency on high cost bulk deposits on the other, in order to improve margins.

The business of the bank has grown at a CAGR of 24.7% over FY04-FY09 to Rs 1.7bn at the end of FY09. Credit-deposit ratio improved to 69.6% in FY09 from 52.9% in FY05.



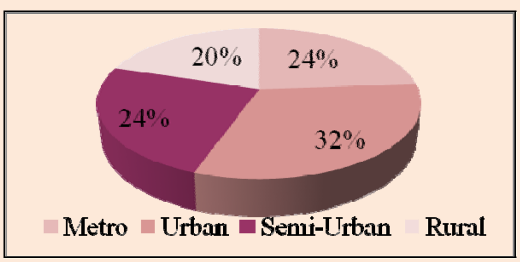
Source: Company, QS Research

Business to grow at a CAGR of 21.5% over FY09-FY12E.

Going forward, we expect OBC's business to grow at a CAGR of 21.5% over FY09-FY12E to Rs 3bn in FY12, driven by an increasing reach by way of an additional branch rollout and improved credit growth outlook with revival in the economy. We have estimated the advances and deposits to grow at a CAGR of 21.3% and 21.7% respectively over FY09-FY12E.

Branch Expansion: An initiative to improve the low cost deposit mix

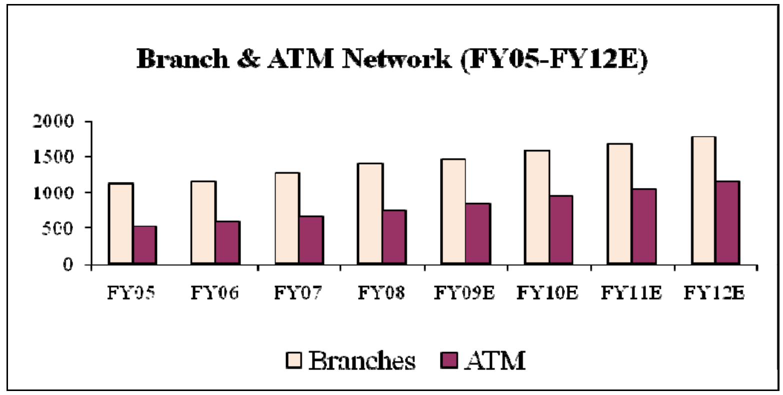
At the end of December 31, 2009 the bank had 1450 branches (excluding 58 extension counters) and 922 ATMs, servicing over 12 mn customers. Out of the 1450 branches, around 900+ branches are located in northern states of Punjab, Haryana, UP and Delhi. At present 44% of the bank's branches and 16% of its business comes from rural and semi-urban locations. In the next 2 yrs it is targeting 25% of its business from rural and semi-urban locations.



Source: Company, QS Research

For FY10 the bank holds 117 new branch licenses and it plans to have over 1500 branches (excluding 58 extension counters) and 945 ATMs by March 2010 end and targets to acquire 2 mn new customers in FY10. Thereafter it will be adding 100 branches every year over next 3 yrs in order to reach a target of 2000 branches. Most of these new branches are being opened in metro/urban locations in South and West India, a small part in East India and tier II and tier III locations in North India having a huge growth potential, which in turn will enable the bank to have a Pan India presence.

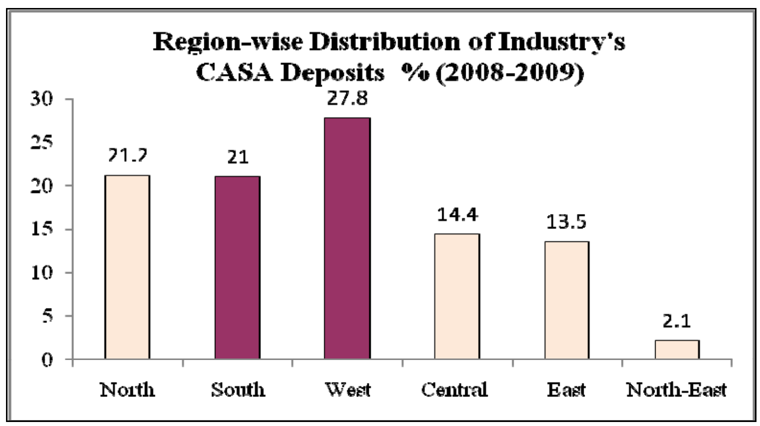
Plans to add 100 branches and ATMs every year over next 2-3 yrs in metro/urban locations in West and South and tier II and tier II locations in North India having good growth potential.



Source: Company, QS Research

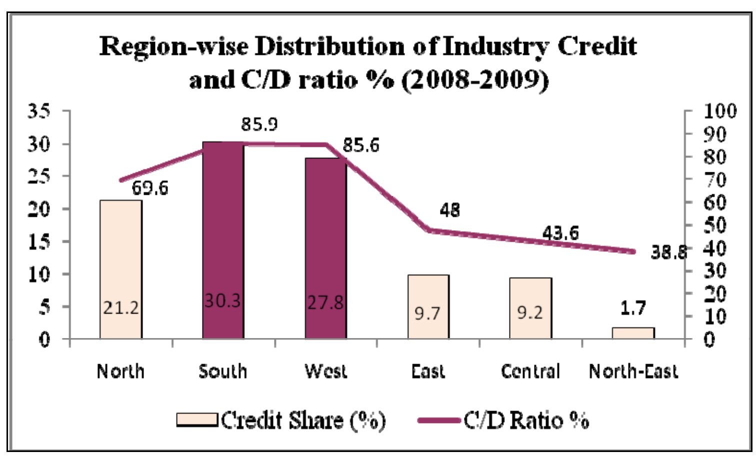
In our view OBC's expanding distribution network and retail liability franchise in CASA rich locations in metro and urban locations in the West and in the South, will help the bank to increase its low cost deposit base and improve its Net Interest Margins (NIM). A good low cost deposit mix will also offer the bank a certain amount of flexibility to lend at competitive rates to customers with good risk profile.

North, South and West India account for around 70% of industry's CASA deposits



Source: RBI, QS Research

North, South and West India account for 79.3% of the banking system's credit.

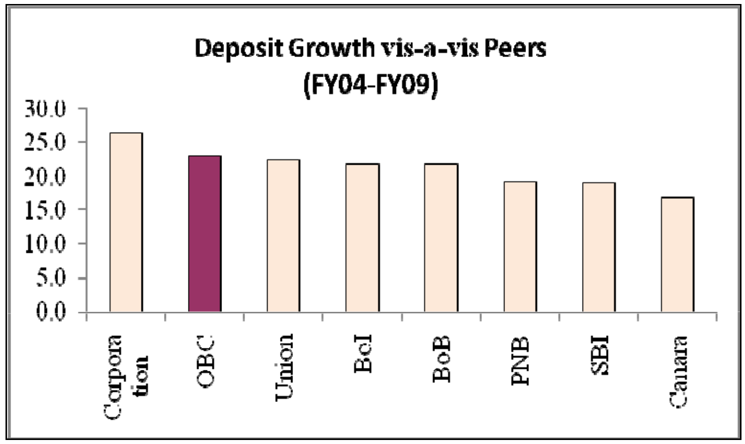


Source: RBI, QS Research

Deposits to Grow at a CAGR of 21.7% over FY09-FY12E

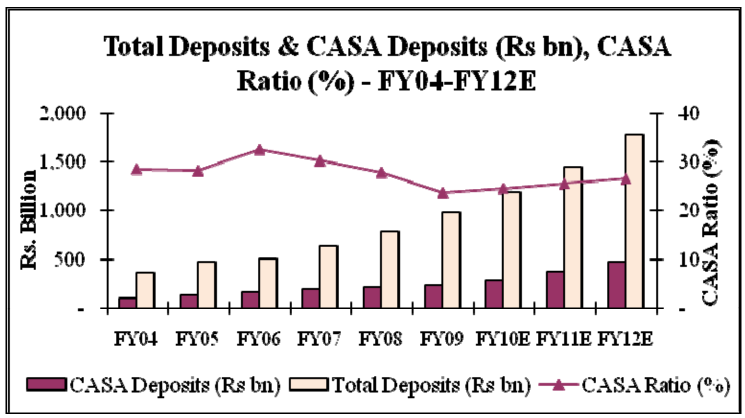
Total deposits of OBC grew at a CAGR of 22.5% over FY04-FY09 to Rs 983.7bn in FY09, constituting of 2.6% of the Indian banking system's total deposits as on March 31, 09. Going forward we expect the bank's total deposits to grow by 20%, 21.9% and 23.2% to Rs 1180.6bn, Rs 1439.6bn and Rs 1773.4bn in FY10E, FY11E and FY12E respectively.

Total deposits of OBC have grown at a CAGR of 22.5% over FY04-FY09



Source: Company Annual reports, QS Research

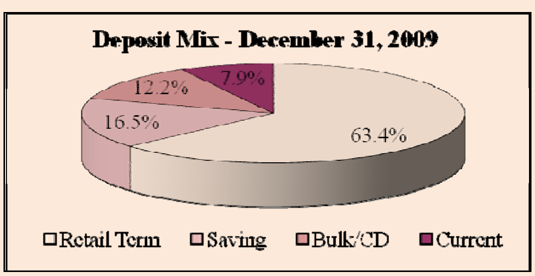
We expect OBC's deposits to grow by 20%, 21.9% and 23.2% in FY10E, FY11E and FY12E respectively.



Source: Company, QS Research

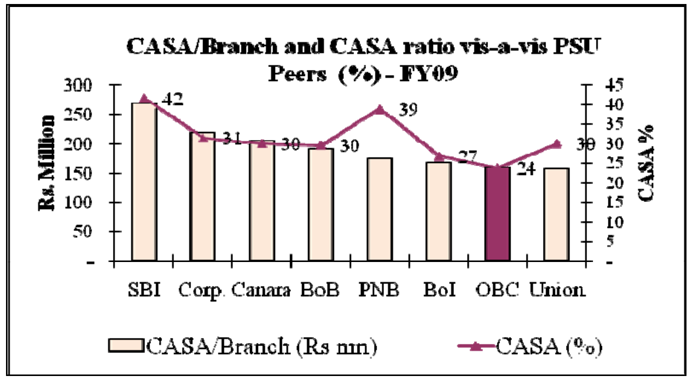
Deposits Mix: Segment Wise Analysis of Deposits

CASA ratio of OBC deteriorated from 32.6% in FY06 to 23.7% in FY09 due to increased competition from private banks and larger PSU banks' presence in metro and urban locations in North India (*where 56% of its branches are located and 84% of its business is derived*). During the same period it also increased dependence on high cost retail and bulk deposits in order to fund its asset growth.



Source: Company, QS Research

Going forward the bank plans to scale up its CASA ratio to 30% by the end of FY12E by way of expanding its branch network and acquiring new customers in tier II and tier III locations in North and CASA rich metro and urban locations in South and West India (*as discussed earlier*). However, as per our conservative estimates we have assumed a CASA growth of 26.5% over FY09-FY12E and CASA ratio to increase to 26.6% in FY12E.



Source: Company, QS Research

We expect the demand deposits to grow at a CAGR of 19.5% during FY09-FY12E to Rs 131.6bn in FY12E.

Current Deposits

The current account balances grew at a CAGR of 19.9% during FY04-FY09 to Rs 77.1bn in FY09 which was a result of the bank's efforts at offering customized products for different corporate and SME clients. Under the special current account scheme 'Pragati' launched by the bank w.e.f August 2007, it had mobilized deposits over Rs. 11bn till the end of December 31, 2009.

Going forward, with an expected improvement in the overall macro and business environment, we expect the demand deposits to grow at a CAGR of 19.5% during FY09-FY12E to Rs 131.6bn in FY12E.

We have estimated the savings deposits to grow at a CAGR of 29.7% over FY09-FY12E to Rs 341bn in FY12E.

Savings Deposits

OBC's savings deposits grew at a CAGR of 17.2% over FY04-FY09 to Rs 156.5bn in FY09 due to the bank's increased thrust on customer segmentation and offering innovative savings bank products which were in turn complemented with improved technology. Under the special savings deposit scheme launched w.e.f May 2007, the bank mobilized deposits over Rs 35bn till the end of Dec 09. Under 'UNNATI' scheme launched w.e.f Aug 09 (inorder to garner more no of salary accounts from PSU companies and the financial sector), the bank mobilized deposits of over Rs 4bn till the end of Dec 09. We have estimated the savings deposits to grow at a CAGR of 29.7% over FY09-FY12 to Rs 341bn in FY12E.

We expect the growth in term deposits to slow down to 20.1% over FY09-FY12E. As a result the proportion of term deposits to total deposits is expected to decline to 73.4% in FY12E.

Term Deposits

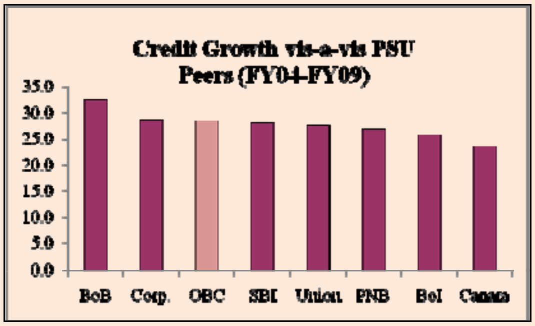
Term deposits of OBC grew at a CAGR of 24.1% over FY04-FY09 to Rs 750.1bn in FY09. Term deposits as a percentage of total deposits increased from 67.4% in FY06 to 76.3% in FY09. Going forward with the bank's focus towards increasing low cost deposits and reducing dependence on high cost deposits, we expect the growth in term deposits to slow down to 20.1% over FY09-FY12E. As a result the proportion of term deposits to total deposits is expected to decline to 73.4% in FY12E.

With low term-deposit rates at present, we expect a slowdown in the CAGR of domestic retail term deposits to 26.8% over FY09-FY12E as against a robust 53.4% YoY growth registered in FY09E. The bulk deposits which constituted 21.8% of the total deposits in FY09 have been reduced to 12.2% of deposits in Q3FY10. So going forward we have assumed bulk deposits to decline by 30% in FY10E and then grow by 17% and 19% in FY11E and FY12E respectively, as the bank plans to maintain the same proportion of bulk deposits at 12-13%.

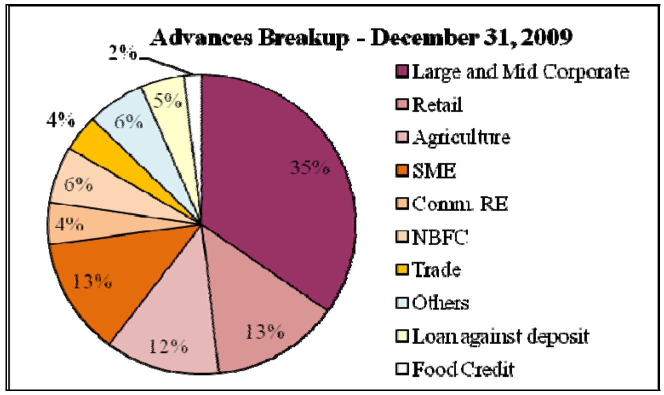
Asset Profile: Focus to Increase towards High Yielding Retail and SME Advances

We expect the bank's advances to grow at a CAGR of 21.3% over FY09-FY12E to Rs 1221.6bn in FY12E.

The advances (net of provisions held) of OBC have grown at a CAGR of 28.3% over FY04-FY09 from Rs 196.8bn in FY04 to Rs 685bn in FY09 (*constituting 2.5% of the banking system's credit as on March 31, 09*). We expect the bank's advances to grow at a CAGR of 21.3% over FY09-FY12E to Rs 1221.6bn in FY12E.



Source: Company Annual Reports, QS Research

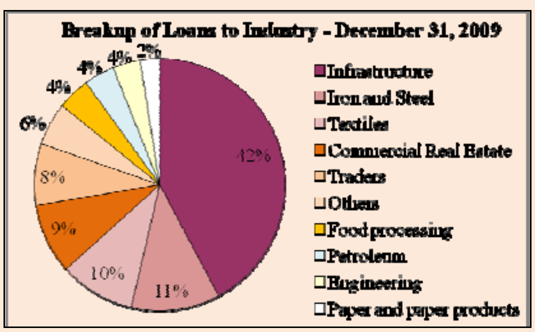


Source: Company, QS Research

The advances mix of OBC is tilted towards lower yielding corporate advances, housing loans and agriculture loans which formed over 60% of the bank's loan book at the end of December 31, 2009. Besides this, with the bank facing stiff competition in its key market in the north on the lending side with respect to the corporate segment, its NIMs stood below the industry average at 2% in FY09 and 2.3% in 9MFY10. However, the bank has now taken a conscious decision to increase its lending to the high yielding retail and SME segments with continued focus on large/mid corporates as well, thus enabling it to maintain a judicious asset mix and improve its NIMs to 2.5% by the end of FY12E.

Advances to Industry – Large and Mid Corporate and SME

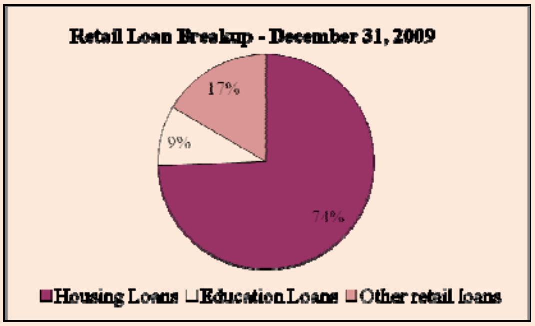
The bank's advances to industry constituted 47.4% at the end of December 31, 2009 which comprised of large and mid corporate and SME credit. Top sectoral exposures included loans to infrastructure (42.2% of industry loans), commercial real estate (9%), iron and steel (11.4%), textiles (9.7%) and traders (7.9%).



Source: Company, QS Research

Advances to large and mid corporate segment stood at Rs 308.1bn constituting 35% of the total loan book of the bank at the end of December 31, 2009. We expect the corporate advances to grow at a CAGR of 20.3% over FY09-FY12E from Rs 259.6bn in FY09 to Rs 452.1bn in FY12E, with key drivers of growth being the infrastructure sector and the mid corporate segment. At the end of December 09, the bank had sanctions of Rs 120bn from the infrastructure sector a major part of which is expected to get disbursed from Q4FY10 onwards.

SME advances stood at Rs 98.8bn at the end of December 31, 2009 constituting 12.6% of the total advances. As against a growth of 11.4% in FY09, we have estimated the SME advances to grow at a CAGR of 27% over FY09-FY12E from Rs 69.4bn in FY09 to Rs 142.1bn in FY12E, as with an overall improvement in the economy, the bank plans to increase focus on higher yielding SME loans.



Source: Company, QS Research

Retail Advances

Retail advances stood at Rs 105.8bn comprising 13.5% of the total loan book as on December 31, 2009. For quick disposal of retail loan applications OBC has established retail hubs. To accomplish the desired growth in the retail loan book, the bank has made tie-ups with various reputed builders and auto manufacturers to boost lending in the retail segment. Besides this, it has introduced various retail credit schemes which are designed to suit all sections of the society.

Housing loans at Rs 78.7bn constituted 74.4% of the total retail loans. Education loans (*fastest growing segment in retail*) and other retail loans (*including auto loans and other personal loans*) constituted 9% and 17% of the total retail credit respectively.

As against a growth of 21.7% in FY09, we expect the retail loan book of OBC to grow at a CAGR of 25.4% over FY09-FY12 from Rs 93.1bn in FY09 to Rs 183.8bn in FY12E. The key growth drivers of this growth in retail loans will be home, education and auto loans and certain higher yielding personal loans.

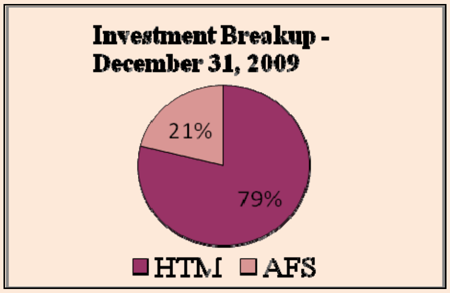
Agriculture Advances

Agriculture advances stood at Rs 94.5bn forming around 12% of the total loan book as on December 31, 2009. Loans to direct and indirect agriculture stood at Rs 52.1bn and Rs 42.5bn respectively.

In order to ensure that loans to agriculture segment are disbursed by people who understand the agriculture business well, the bank recruited 191 agriculture officers in FY09 and plans to recruit another 83 officers in FY10. As against a growth of 24.3% in FY09, we expect the agriculture advances to grow at a CAGR of 20.5% over FY09-FY12 from Rs 86.1bn in FY09 to Rs 150.7bn in FY12E.

Food Credit and Other Segments

The balance 27.1% of loans (*loans excluding retail, industry and agriculture loans*) include loans given to NBFCs (*6.1% of advances as on December 31, 09*), trade (4%), loan against deposit (4.6%), commercial real estate (4.5%), food credit (1.9%), and other segments (6.1%). We expect food credit and other segments to grow at a CAGR of 18.3% over FY09-FY12 from Rs 176.8bn in FY09 to Rs 293bn in FY12E.



Source: Company, QS Research

We expect the investments to grow at a CAGR of 20.4% over FY09-FY12E to Rs 497.7bn in FY12E.

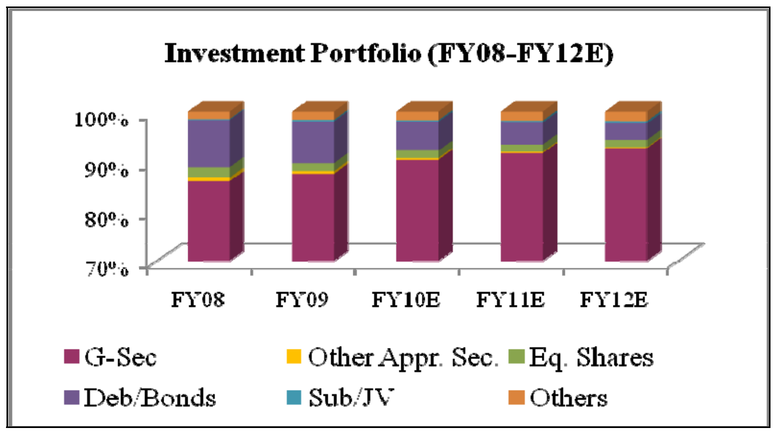
The tier I capital ratio of 9.8% is sufficient to fund near-medium term growth. The low tier II capital ratio at 3.4% gives enough head room to raise tier II capital whenever required.

Investment Portfolio

OBC's investments grew at a CAGR of 11.1% over FY04-FY09 to Rs 284.9bn in FY09. The investment-deposit ratio which was at 47.1% in FY04 came down to 29% in FY09.

In the past OBC's earnings have been highly sensitive to bond yield movements. In March 2007, OBC was having 70% of its bonds in the AFS book with a duration of 4 yrs. However, over a period of time it has consciously lowered its AFS book to 21% (*25% in Mar 09*) with a modified duration of 2.8 yrs at the end of December 31, 2009. Going forward OBC's bond portfolio is hedged against MTM losses upto a yield of 8%.

Assuming the investment-deposit ratio to remain constant at 28-29% and SLR ratio to remain in the region of 26-27%, we expect the investments to grow at a CAGR of 20.4% over FY09-FY12E to Rs 497.7bn in FY12E.



Source: Company, QS Research

Comfortable Capital Adequacy to Enable Quality Asset Growth

OBC's capital adequacy ratio remains comfortable at 13.2% after it raised Rs 3bn by way of perpetual tier I bonds in Dec 09. The tier I capital ratio of 9.8% is sufficient to fund near-medium term asset growth. Besides this, the low tier II capital ratio at 3.4% gives enough head room to the bank to raise tier II bonds/debentures whenever required.

The fact that government shareholding for OBC is only 51% has been a cause of concern recently. However, the management remains confident of receiving Rs 10bn of capital infusion from the government in early FY11 which will enable sustainable and quality asset growth in the long term.

Financial Analysis

Strong Growth in Core Business to drive Revenues and Earnings Growth

Net Interest Income (NII) is expected to grow at a CAGR of 28.6% over FY09-FY12E to Rs 42.5bn in FY12E.

With the outlook for treasury income turning weak due to rising bond yields, we expect the bank's core business to remain a key contributor to its revenues. Net Interest Income (NII) is expected to grow at a CAGR of 28.6% over FY09-FY12E from Rs 20bn in FY09 to Rs 42.5bn in FY12E, mainly on account of 22.3% CAGR in advances and 26.5% growth in low cost deposits.

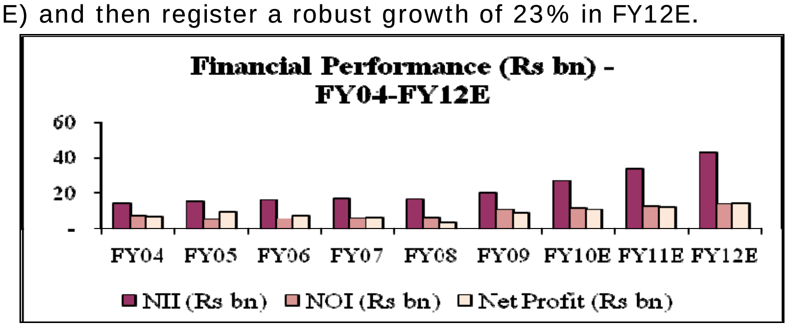
We expect the bank's NOI CAGR to slow down to 9.6% over FY09-FY12E, as against 24.7% CAGR registered in between FY06-FY09.

The Non Interest Income (NOI) also remains a critical component to the overall earnings growth of the bank. The importance of NOI can be ascertained from the fact that it constitutes just 10.8% of the total income of OBC, but covers 77.5% of the bank's total operating expenses. We expect the bank's NOI CAGR to slow down to 9.6% over FY09-FY12E, as against 24.7% CAGR registered in between FY06-FY09. This is expected to be mainly on account of a lower treasury income from H2FY10 onwards due to rise in bond yields and slowdown in recoveries from written-off accounts.

Fee income is expected to grow at a CAGR of 23.9% over FY09-FY12E to Rs 7.6bn in FY12E as a result of an improved commission income from life insurance business and continued buoyancy in income from sale of third party products and credit linked fee income. Besides this the various ongoing IT initiatives of the bank have already started yielding results which in turn will complement the growth in fee income.

Over FY09-FY12E we expect the bank's net profit to grow at a CAGR of 17.1% to Rs. 14.5bn in FY12E.

OBC's net profit grew at a low CAGR of 5.7% over FY04-FY09 mainly on account of a cumulative hit of Rs 9.2 bn over FY04-FY08 arising out of the GTB merger during FY04. However, this legacy issue is behind us as the company hasn't taken any additional charges since March 2008. Over FY09-FY12E, we expect the bank's net profit to grow at a CAGR of 17.1% to Rs 14.5bn in FY12E on the back of improvement in NIMs, stable operating costs and robust fee income. With the bank's provision coverage ratio expected to increase to 70% in FY11E, we expect its bottomline growth to slow down to 12.6% in FY11E (from 15.9% in FY10E) and then register a robust growth of 23% in FY12E.



Source: Company, QS Research

Net Interest Margin (NIM) set to improve

We expect OBC's NIM to improve by 25bps, 15bps and 10bps to 2.25%, 2.4% and 2.5% in FY10E, FY11E and FY12E respectively.

OBC had the second lowest Net Interest Margin (NIM) in the industry in FY09 at 2% (*IDBI bank had the lowest NIM of 1.1% in FY09*). With the bank's initiative towards improving margins by boosting the CASA ratio, reducing its dependence on high cost deposits and increasing focus on higher yielding retail and SME advances on the asset side, we expect its NIM to improve by 25bps, 15bps and 10bps to 2.25%, 2.4% and 2.5% in FY10E, FY11E and FY12E respectively.

Deposits of Rs 70-80bn expected to get redeemed/repriced at lower rates within next 4-5 months.

At the end of 31st December 2009, the bank had outstanding bulk deposits of Rs 135bn and out of this Rs. 20-30bn is expected to get repriced at lower rates by March 2010. Besides this Rs 50bn of retail term deposits are expected to come up for redemption or repricing in the next 4-5 months time. As a result, the cost of deposits is expected to decline to 6.81% in FY10E from 7.52% in FY09, but increase by 12bps to 6.94% and 7.05% in FY11E and FY12E respectively.

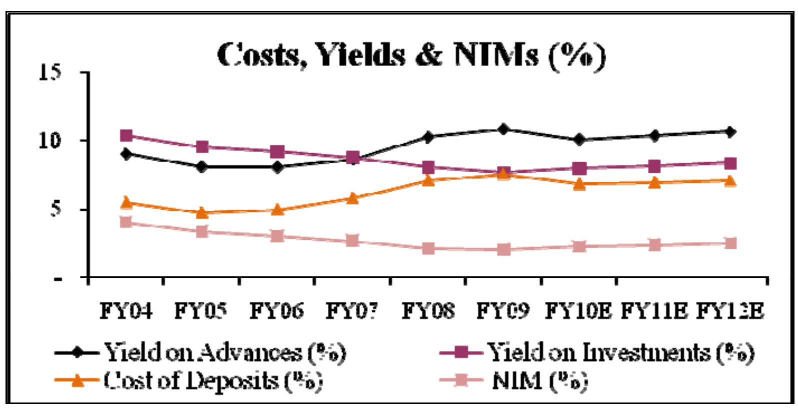
We expect the yield on advances to decline to 10.08% in FY10E and then inch up to 10.34% and 10.64% in FY11E and FY12E respectively.

The yield on advances is estimated to decline by 74bps to 10.08% in FY10E. Thereafter, with the bank's higher yielding advances portfolio expected to see good growth and anticipated increase in key policy rates by RBI, we expect the yield on advances to inch up by 26bps and 29bps to 10.34% and 10.64% respectively in FY11E and FY12E respectively.

PLR / Non-PLR Lending	March 31, 2009	December 31, 2009
Below PLR	75.0%	73.2%
Above PLR	12.0%	12.9%
At PLR	13.0%	13.9%

Source: Company, QS Research

In order to improve its yields the bank has also managed to reduce the proportion of its lending below PLR to 73.2% in Q3FY10 as against 75% in March 09. Proportion of loans above PLR improved to 12.9% from 12% in March 09 and proportion of loans at PLR improved to 13.9% from 13% in March 09.



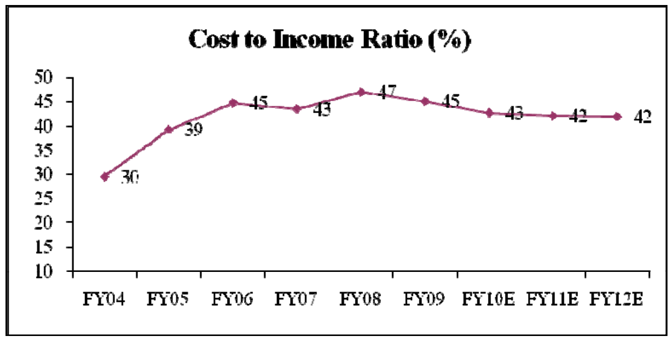
Source: Company, QS Research

Cost to Income Iatio to remain stable in a range of 42-43% over FY09-FY12E

In order to support its branch expansion plans over FY09-FY12E, OBC plans to recruit 1550 new employees in FY10E and over 1500 new employees each, in FY11E and FY12E respectively. It will also be incurring other additional operating expenses during the same period. As a result the operating costs of the bank are expected to grow at a CAGR of 19.8% over FY09-FY12E to Rs 23.8bn in FY12E, as against a CAGR of 12.7% over FY06-FY09. However, as compared to industry standards the growth in the operating expenses will still be well under control.

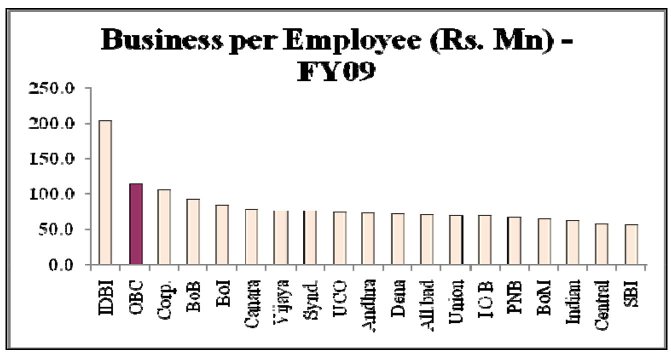
We expect the cost to income ratio to remain stable in a range of 42-43% over FY09-FY12E, after considering the improving employee productivity, enrichment in fee income, and control over operating costs.

We expect the cost to income ratio to remain stable in a range of 42-43% over FY09-FY12E.



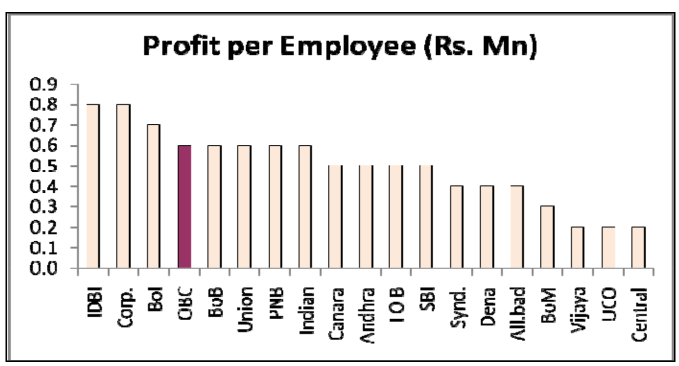
Source: Company, QS Research

OBC has the 2nd highest business per employee ratio amongst 19 PSU banks.



Source: Company Annual Reports, QS Research

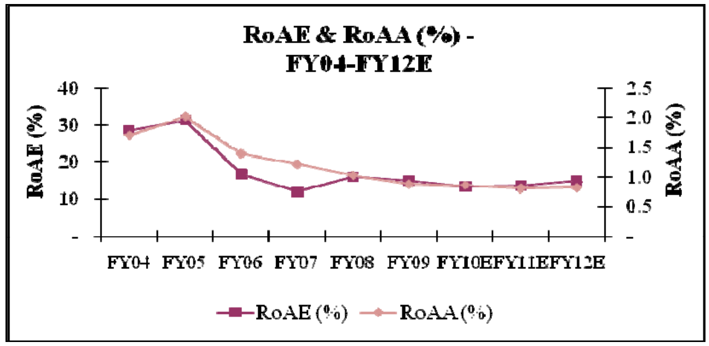
OBC has the 4th highest profit per employee amongst 19 PSU banks.



Source: Company Annual Reports, QS Research

RoAE to decline to 13.4% in FY10E and increase to 15% in FY12E; RoAA to remain stable at 0.8% over FY09-FY12E

Return on Average Equity (RoAE) is expected to decline to 13.4% in FY10E mainly on lower growth in interest income from advances due to 74bps decline in yield on advances and lower net profit growth of 15.9% due to higher provisions and tax outgo. RoAE is expected to increase to 15% in FY12E on the back of 21.3% growth in advances over FY09-FY12E and improvement in NIMs to 2.5% in FY12E from 2% in FY09. Return on Average Assets (RoAA) is expected to remain stable at 0.8% over FY09-FY12E.



Source: Company, QS Research

Slippages in Asset Quality expected, Provision coverage to move up to 70% in FY11E

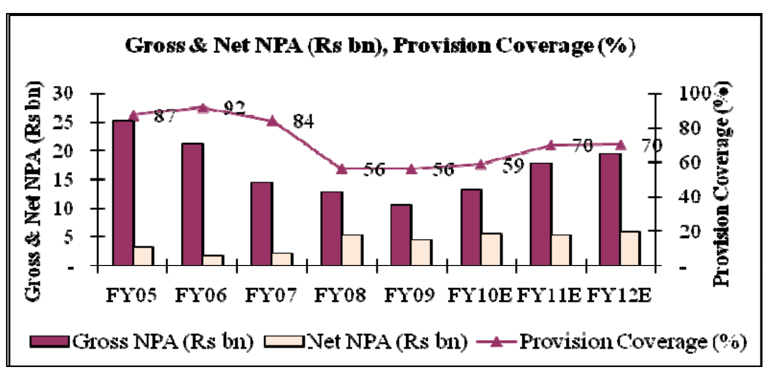
OBC has been successfully able to reduce its Gross NPA levels from a peak of 9.14% in FY05 (post GTB merger) to a low of 1.5% in FY09.

However, asset quality still remains a cause of concern for OBC as the proportion of its restructured assets stands at 6.8% of its total loans which is amongst the highest in the industry. Especially, some part of Rs 8bn of loans restructured in case of textile sector, are expected to turn bad in the coming quarters.

While it may be difficult to gauge the extent of slippages, we have factored the same in our estimates. We have estimated the Gross NPA levels to increase to 1.6% and 1.8% in FY10E and FY11E respectively and then decline to 1.6% in FY12E. The Net NPA levels are expected to increase to 0.7% in FY10E and then decline to 0.5% in FY11E mainly on account of an estimated increase in provision coverage ratio to 70% from FY11E onwards from its present 55% levels.

Breakup of Restructured Loans – December 31, 2009	Amount (Rs mn)
Textile	8890
Infrastructure	8070
Iron and Steel	7280
Cement	3980
Real Estate	3790
Paper	2940
Engineering	1860
Construction	1810
Auto	1590
Other	12925
Total	53135

Source: Company, QS Research



Source: Company, QS Research

Investment Concerns

Competition from Private and Larger PSU Banks

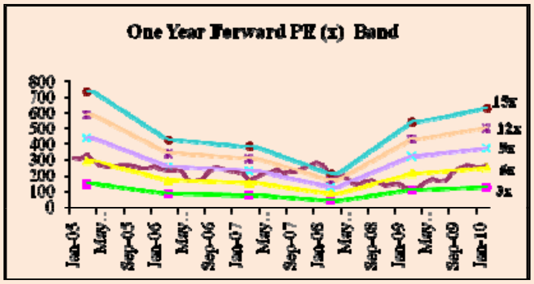
Competition from private and larger PSU banks in key metro/urban locations could act as a hindrance in deposit mobilization which will make it difficult for the bank to attract new customers without increasing the deposit rates. CASA may come under pressure due to competition.

Higher than Estimated Slippages in Asset Quality

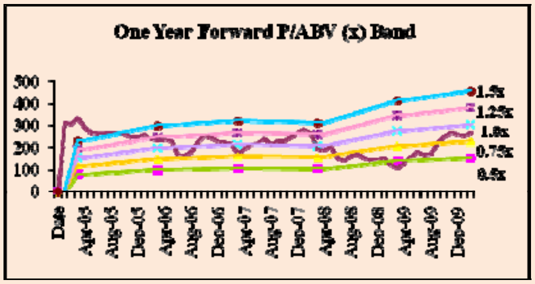
Higher than estimated slippages in asset quality of OBC in light of a delayed revival in the economy or higher than estimated loans from the bank's restructured asset portfolio turning bad, is a key risk to our investment call.

Higher Credit Costs to Depress Bottomline over Medium Term

The banks provision coverage ratio is expected to increase to 70% in FY11E, as a result of which provisions are expected to increase by 40.5% to Rs 8.8bn in FY11E and the net profit growth is expected to slow down to 12.6% in FY11E.



Source: QS Research



Source: QS Research

Valuations

While we believe that OBC's business and net profit will grow at a gradual pace, its undervaluation relative to its peers makes it an attractive investment opportunity. Also an improving operational performance and the fact that overhang on the stock from past legacy issues (*negative impact of GTB merger, declining NIMs, high sensitivity to bond yields and asset quality concerns on stock price of OBC, in past 5 yrs*) is behind us, gives us an indication that the stock is a strong re-rating candidate.

At a CMP of Rs 271.5 the stock is trading at 0.9x, 0.8x and 0.7x its FY10E, FY11E and FY12E adjusted book value of Rs 305.8, Rs 343.2 and Rs 386.5 respectively. On a P/E basis the stock is trading at 6.5x, 5.8x and 4.7x its FY10E, FY11E and FY12E earnings of Rs 41.9, Rs 47.2 and Rs 58 respectively.

Our one year target price of Rs 333 for OBC is derived by assigning 25% weightage to its past 6 months average one year forward historical P/ABV multiple and 75% weightage to fair multiple based on a two-stage Gordon Growth Model respectively. At this price the stock will trade at 0.97x its FY11E ABV, which will provide 22.4% upside over current levels. We recommend investors to **'BUY'** the stock.

Price Target Calculation	**Weights (%)**	
Historical Multiple (x) (past 6 months average)	25	0.82
RoE-P/ABV based Multiple (x)	75	1.02
Weighted Average Multiple (x)		0.97
ABV (FY11E) Rs.		343
Price Target (Rs.)		**333**

Source: QS Research

Life Insurance Business to Add Value over Long Term

As per our quick estimate, we arrive at Canara OBC HSBC Life Insurance Company's value/share attributable to OBC at Rs 18.9 after assuming a conservative CAGR of 9% for private insurers over FY09-FY11E and 2.5% market share for Canara OBC HSBC Life at the end of FY11E. However, **as OBC currently is not disclosing the full fledged financial details of its life insurance JV, we havent included it in the valuations of OBC's target price.** Going forward if this life insurance company keeps gaining market share at a rapid pace, we will start including it in our valuations of OBC.

Quick Estimate of Life Insurance Business	
APE Pvt Players - FY09 (Rs. Mn)	309239.2
FY09-FY11E CAGR (%)	9
Industry APE - FY11E (Rs. Mn)	367407.0
Canara OBC HSBC Life Estimated Market Share amongst Pvt. Players for FY11E (%)	**2.5**
Canara OBC HSBC APE FY11E (Rs. Mn)	9185.2
NBAP Margin (%)	14
NBAP (Rs. Mn)	1285.9
New Business Multiple (x)	16
PV of new business (Rs. Mn)	20574.8
Value of OBC's 23% Stake (Rs. Mn)	4732.2
Value per share attributable to OBC (Rs.)	**18.9**

Source: IRDA, Company, QS Research

Quarterly Income Statement

Particulars (Rs mn)	Q3FY10	Q3FY09	% Var (YoY)	Q2FY10	% Var (QoQ)
Interest / Discount on advances / Bills	19,516.9	18,098.5	7.8	18,697.9	4.4
Income from Investment	6,579.4	5,464.5	20.4	5,810.2	13.2
Interest on Balances with RBI & Others	619.2	464.5	33.3	448.1	38.2
Others Interest	0.4	0.6	-33.3	2.1	-81.0
Interest Earned	**26,715.9**	**24,028.1**	**11.2**	**24,958.3**	**7.0**
Interest Expended	17,987.2	18,349.7	-2.0	19,347.9	-7.0
Net Interest Income (NII)	**8,728.7**	**5,678.4**	**53.7**	**5,610.4**	**55.6**
Other Income	2,376.8	3,153.9	-24.6	3,050.7	-22.1
Net Income Earned	**11,105.5**	**8,832.3**	**25.7**	**8,661.1**	**28.2**
Payments to & Provisions for employees	2,891.3	3,614.0	-20.0	1,967.3	47.0
Other Operating Expenses	1,986.3	1,356.0	46.5	1,645.0	20.7
Operating Expenditure	4,877.6	4,970.0	-1.9	3,612.3	35.0
Pre Provisioning Profits	**6,227.9**	**3,862.3**	**61.2**	**5,048.8**	**23.4**
Other Expenses, Provisions and Contengencies	1,920.6	519.4	269.8	551.4	248.3
Profit Before Tax	**4,307.3**	**3,342.9**	**28.8**	**4,497.4**	**-4.2**
Provison for Tax	1,413.0	821.0	72.1	1,789.4	-21.0
Net Profit	**2,894.3**	**2,521.9**	**14.8**	**2,708.0**	**6.9**

Income Statement

Income Statement (Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Interest / Discount on Advances / Bills	48,386.4	65,197.0	75,660.7	93,531.8	117,758.7
Income from Investment	18,445.0	21,410.3	25,161.7	31,114.5	37,934.5
Interest on Balances with RBI & Others	1,191.5	1,689.3	2,190.3	2,525.7	3,459.7
Others Interest	249.0	268.2	301.7	542.5	588.3
Interest Earned	**68,271.9**	**88,564.7**	**103,314.4**	**127,714.5**	**159,741.3**
% Change YoY	*32.2*	*29.7*	*16.7*	*23.6*	*25.1*
Interest Expended	**51,561.7**	**68,599.7**	**76,545.9**	**94,130.5**	**117,233.7**
% Change YoY	*48.4*	*33.0*	*11.6*	*23.0*	*24.5*
Net Interest Income (NII)	**16,710.2**	**19,965.0**	**26,768.5**	**33,584.0**	**42,507.5**
% Change YoY	*(1.2)*	*19.5*	*34.1*	*25.5*	*26.6*
Other Income	6,276.5	10,713.2	11,492.9	12,261.2	14,091.5
Net Income Earned	**22,986.7**	**30,678.2**	**38,261.4**	**45,845.2**	**56,599.1**
% Change YoY	*0.2*	*33.5*	*24.7*	*19.8*	*23.5*
Payments to & Provisions for employees	5,493.7	7,561.6	8,827.1	10,692.6	12,982.6
Depreciation on Bank Property	750.5	803.0	920.7	1,042.8	1,153.0
Other Operating Expenses and Adminsitrative Expenses	4,552.2	5,463.9	6,591.2	7,567.9	9,633.1
Operating Expenditure	10,796.3	13,828.4	16,339.1	19,303.4	23,768.7
Pre Provisioning Profits	**12,190.4**	**16,849.8**	**21,922.3**	**26,541.8**	**32,830.4**
% Change YoY	*(6.0)*	*38.2*	*30.1*	*21.1*	*23.7*
Other Expenses, Provisions and Contengencies	(425.8)	5,255.2	6,239.1	8,764.1	10,627.2
Profit Before Tax	**12,616.2**	**11,594.6**	**15,683.2**	**17,777.7**	**22,203.2**
Provison for Tax	4,206.8	2,540.3	5,186.3	5,955.5	7,660.1
Reported Net Profit	**8,409.4**	**9,054.3**	**10,496.9**	**11,822.2**	**14,543.1**
Extraordinary Items	4,877.2	-	-	-	-
Adjusted Net Profit	**3,532.2**	**9,054.2**	**10,496.9**	**11,822.2**	**14,543.1**
% Change YoY	*(45.2)*	*156.3*	*15.9*	*12.6*	*23.0*

Balance Sheet

Particulars (Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
SOURCES OF FUNDS					
Equity Capital	2,505.4	2,505.4	2,505.4	2,505.4	2,505.4
Reserve incl Revaluation Reserve	55,253.6	71,529.1	79,624.4	88,812.8	100,153.8
Net Worth	**57,759.0**	**74,034.5**	**82,129.7**	**91,318.2**	**102,659.2**
Demand Deposits	77,623.9	77,105.7	90,599.2	108,719.1	131,550.1
Savings Deposit	139,610.9	156,456.0	200,263.6	260,342.7	341,048.9
Term Deposits	561,332.2	750,126.8	889,687.4	1,070,531.1	1,300,791.2
Deposits	**778,567.0**	**983,688.5**	**1,180,550.3**	**1,439,592.9**	**1,773,390.2**
Borrowings	18,398.4	7,219.6	6,815.0	7,711.0	9,038.0
Other Liabilities	52,328.9	60,883.4	61,885.2	65,193.3	69,221.6
Total Liabilities	**907,053.2**	**1,125,825.9**	**1,331,380.2**	**1,603,815.4**	**1,954,309.0**
APPLICATION OF FUNDS					
Cash and Balances with RBI	73,222.5	68,798.9	67,881.6	89,974.6	119,703.8
Balances with Banks & Money at Call	28,924.9	53,452.4	58,312.7	62,238.1	68,499.3
Investments	239,506.8	284,889.5	351,824.3	416,434.3	497,651.2
Net Advances	**545,658.3**	**685,003.7**	**816,064.1**	**992,955.5**	**1,221,566.4**
Fixed Assets	3,874.6	13,838.6	14,986.6	15,822.0	16,365.1
Other Assets	15,866.1	19,842.8	22,310.9	26,390.9	30,523.1
Total Assets	**907,053.2**	**1,125,825.9**	**1,331,380.2**	**1,603,815.4**	**1,954,309.0**
Contingent Liabilities	195,168.6	300,646.1	396,587.2	524,731.5	696,389.0
Bills for Collection	28,004.7	28,389.6	34,067.5	40,881.0	49,057.2
Total Business	**1,324,225.3**	**1,668,692.1**	**1,996,614.4**	**2,432,548.5**	**2,994,956.7**
% Change YoY	*22.5*	*26.0*	*19.7*	*21.8*	*23.1*

Cash Flow Statement

Particulars (Rs mn)	FY08	FY09	FY10E	FY11E	FY12E
Net Profit Before Tax & Extraordinary Items/Provisions	12,616.2	11,594.6	15,683.2	17,777.7	22,203.2
Net Cash From Operating Activities	27,888.7	21,696.1	17,237.1	42,280.8	55,077.8
Net Cash Used in Investing Activities	(771.7)	(1,257.5)	(13,349.9)	(12,509.7)	(14,017.3)
Net Cash Used in Financing Activities	(61.7)	(334.7)	55.7	(3,752.7)	(5,070.0)
Cash and Cash Equivalents at Beginning of the Year	**75,092.1**	**102,147.4**	**122,251.4**	**126,194.3**	**152,212.7**
Net Inc/(Dec) in Cash and Cash Equivalent	27,055.3	20,103.9	3,943.0	26,018.3	35,990.5
Cash and Cash Equivalents at End of the Year	**102,147.4**	**122,251.4**	**126,194.3**	**152,212.7**	**188,203.1**

Key Ratios	FY08	FY09	FY10E	FY11E	FY12E
Valuations					
EPS (Rs.)	14.1	36.1	41.9	47.2	58.0
BVPS (Rs)	226.2	254.1	327.8	364.5	409.8
Adj BVPS (Rs.)	209.0	277.8	305.8	343.2	386.5
PER (x)	19.3	7.5	6.5	5.8	4.7
PEG (x)	(0.4)	0.0	0.4	0.5	0.2
P/BV (x)	1.2	1.1	0.8	0.7	0.7
P/Adj BV (x)	1.3	1.0	0.9	0.8	0.7
Dividend Yield (%)	1.7	2.7	3.1	3.5	4.2
Payout (%)	39.0	23.6	23.7	23.6	23.2
Growth (%)					
NII	(1.2)	19.5	34.1	25.5	26.6
Advances	23.6	25.5	19.1	21.7	23.0
Deposits	21.7	26.3	20.0	21.9	23.2
Investments	20.9	18.9	23.5	18.4	19.5
Net Profit	(45.2)	156.3	15.9	12.6	23.0
EPS	(45.2)	156.3	15.9	12.6	23.0
Total Funds (Business Growth)	22.5	26.0	19.7	21.8	23.1
Balance Sheet Size	22.4	24.1	18.3	20.5	21.9
Profitability (%)					
Yield on Advances	10.3	10.8	10.1	10.3	10.6
Yield on Investments	8.0	7.6	7.9	8.1	8.3
Yield on Interest Earning Assets	10.4	10.1	9.7	9.9	10.2
Cost of Deposits	7.1	7.5	6.8	6.9	7.1
Cost of Funds	6.7	7.2	6.7	6.8	7.0
Interest Spread (On Advances/Deposit)	3.2	3.3	3.3	3.4	3.6
Interest Spread (overall)	3.6	2.9	3.0	3.1	3.2
Net Interest Margin	2.1	2.0	2.3	2.4	2.5
Cost/Income	47.0	45.1	42.7	42.1	42.0
CASA	27.9	23.7	24.6	25.6	26.6
Tax/PBT	33.3	21.9	33.1	33.5	34.5
RoAE	16.0	14.9	13.4	13.6	15.0
RoAA	1.0	0.9	0.9	0.8	0.8
Balance Sheet Ratios (%)					
Credit/Deposit	70.1	69.6	69.1	69.0	68.9
Investment/Deposit	30.8	29.0	29.8	28.9	28.1
Cash/Deposit	13.1	12.4	10.7	10.6	10.6
Productivity Ratios (Rs mn)					
Business Per Employee	89.7	113.3	131.5	150.8	175.9
Profit Per Employee	0.2	0.6	0.7	0.7	0.9
Business Per Branch	944.5	1,137.5	1,260.5	1,444.5	1,678.8
Net Profit Per Branch	2.5	6.2	6.6	7.0	8.2
Other Parameters Per Branch (Rs mn)					
CASA/Branch	154.9	159.2	183.6	219.2	264.9
Deposits/Branch	555.3	670.5	745.3	854.9	994.1
Advances/Branch	389.2	466.9	515.2	589.6	684.7
Gross Block / Branch & ATM	4.5	8.9	9.1	8.9	8.6
Employees/Branch	10.5	10.0	9.6	9.6	9.5
Capital Adequacy (%)					
Capital to Risk Weighted Assets Ratio	12.1	13.0	12.9	11.8	11.0
Tier I Capital Ratio	9.3	9.1	9.1	8.5	8.1
Tier II Capital Ratio	2.8	3.9	3.8	3.3	2.9
Asset Quality (%)					
Gross NPA	2.3	1.5	1.6	1.8	1.6
Net NPA	1.0	0.6	0.7	0.5	0.5
Provision Coverage	56.3	56.2	58.5	70.0	70.2
Net NPA/Networth	9.3	6.0	6.7	5.8	5.7
Basic Data					
Sh. Price (Rs.)	271.5	271.5	271.5	271.5	271.5
Market Capitalisation (Rs mn)	68,009.0	68,009.0	68,009.0	68,009.0	68,009.0

Peer Comparison

Particulars (FY11E)	CMP (Rs.)	MCap (Rs. Mn)	P/E (x)	P/BV (x)	RoAE (%)*	RoAA (%)*	Net Operating Income (Rs. mn)*	Net Profit (Rs. mn)*	EPS (Rs.)*	Book Value (Rs.)*
OBC	**271.5**	**68,009.1**	**5.8**	**0.7**	**13.6**	**0.8**	**45,845.2**	**11,822.2**	**47.2**	**364.5**
BoB	564.7	206,396.5	7.0	1.3	19.5	1.0	103,847.0	29,582.4	81.2	438.0
Canara Bank	380.7	156,066.5	5.6	1.1	19.7	1.0	92,444.5	29,170.9	68.1	358.6
Corporation Bank	424.0	60,810.5	4.9	0.9	19.6	1.1	37,391.9	12,496.6	87.0	461.0
PNB	874.0	275,556.4	6.3	1.4	23.1	1.3	138,755.6	45,067.2	137.7	612.0
Allahabad Bank	128.0	57,177.6	4.6	0.8	17.5	1.0	43,476.0	12,481.4	27.8	155.6
BoI	323.9	170,316.0	8.6	1.2	13.8	0.7	91,956.3	19,712.3	37.5	271.5

Source: QS Research, Bloomberg

**The comparison is based on FY11E consensus estimates*