

Oriental Bank of Commerce

BLOOMBERG: OBC IN EQUITY | BSE: 500315 | NSE: ORIENTBANK

Asset quality disappoints

OBC's Q2FY12 results came in significantly below our and street estimates due to sharp deterioration in asset quality. Slippages increased sharply to Rs 15bn (6.9% of advances) and were broad-based in nature. NII declined by 8% YoY (3% QoQ) due to interest income reversal of ~Rs 1.4bn. The sharp interest income reversal also led to a 30bps contraction in NIMs to 2.64%. GNPLs/NNPLs increased from 2.1%/1.1% in Q1FY12 to 3.0%/1.9% in Q2FY12. PAT declined 58% YoY to Rs 1.7bn on higher provisions and lower NIMs. While current valuations (0.6x FY13 BV/ 4x FY13 EPS) are inexpensive, asset quality concerns are likely to remain a near-term overhang.

- ❖ **Asset quality under pressure:** Of the total slippages of Rs 15bn, Rs 7bn/Rs 1.5bn were on account of migration to system-based recognition of NPLs in the sub-Rs 1mn/Rs 1mn–5mn categories. The remaining slippages were broad-based in nature. Total provisions moved up sharply on higher NPL provisions and MTM losses. The total outstanding restructured book stood at Rs 41bn (~4% of advances). The total exposure to the power sector was at Rs 135.4bn (13% of advances) and that to the Airlines sector at Rs 15.3bn. While the management has guided for a sharp improvement in slippages/recoveries in H2, this would remain a near-term overhang.
- ❖ **NIMs contract sharply:** The yield on advances grew 27bps QoQ due to base rate/PLR hikes, whereas a 44bps increase in cost of deposits pulled down NIMs by 30bps. NIMs were at 2.79% in H1FY12, which the management expects to stand at 2.8–2.85% for FY12. Advances growth was strong at 21% YoY and 7.3% QoQ. CASA deposits mobilisation was healthy at 5.5% (2.7% for savings deposits), improving the CASA proportion by 43bps to 22.9%.
- ❖ **Asset quality to remain a near-term overhang:** We cut our FY12/FY13 estimates by 19%/2% to factor in higher slippages and lower-than-expected NIMs. We now estimate an earnings CAGR of 32% over FY11–FY13 and average ROEs of 16%. While current valuations are inexpensive, we believe asset quality concerns would weigh on the stock over the near term.

Financial highlights

Year End: 31 Mar	FY10A	FY11A	FY12E	FY13E	FY14E
Net interest income (Rs mn)	29,074	41,786	44,928	53,167	63,673
Net revenues (Rs mn)	41,075	51,386	56,633	66,591	79,271
Pre-provision profits (Rs mn)	24,215	32,461	34,712	41,163	49,153
Adj. PAT (Rs mn)	11,347	15,039	13,875	20,629	24,187
Adj. EPS (Rs)	45.3	51.5	47.6	70.7	82.9
ROE (%)	16.5	17.2	12.8	16.8	17.1
ROA (%)	0.9	1.0	0.8	1.0	1.0
Gross NPA (%)	1.7	2.0	3.0	2.8	2.6
Net NPA (%)	0.9	1.0	2.0	1.5	1.2
Tier I ratio (%)	9.3	11.2	10.6	10.3	10.0
P/BV (x)	1.4	0.8	0.7	0.6	0.6
P/ABV (x)	1.5	0.9	0.9	0.7	0.6
P/E (x)	8.9	5.6	6.1	4.1	3.5

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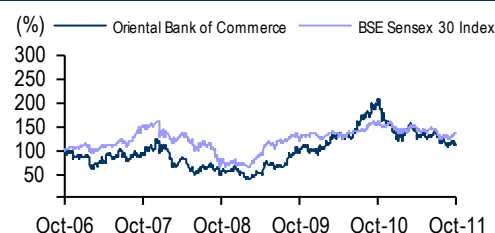
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CMP	Rs 290
Target NEW	Rs 340
Previous	Rs 380
Rating	BUY
Previous	BUY
% Upside / (Downside)	17%
+ Dividend yield	2%
Total return	19%

Company data

Market cap (Rs mn / US\$ mn)	84,567 / 1,734
Outstanding equity shares (mn)	291.8
BVPS (Rs)	390
Free float (%)	42.0
52-week high / low (Rs)	534 / 278
2-month avg. daily vol (mn)/ value (US\$ mn)	1 / 3

Stock performance



Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
NII	9,895	10,709	(7.6)
Net revenues	12,669	13,709	(7.6)
PPP	7,582	8,155	(7.0)
PAT	1,677	4,029	(58.4)

Source: RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q1FY12	Q1FY11	%Chg YoY	Q4FY11	%Chg QoQ
Interest income	38,011	29,919	27.0	35,965	5.7
Interest expenses	28,116	19,148	46.8	25,782	9.1
Net interest income	9,895	10,771	(8.1)	10,183	(2.8)
Other income	2,774	2,141	29.6	3,238	(14.3)
Total Income	12,669	12,912	(1.9)	13,421	(5.6)
Operating expenses	5,087	4,853	4.8	5,408	(5.9)
- Staff expenses	2,783	2,764	0.7	3,196	(12.9)
PPP	7,582	8,060	(5.9)	8,014	(5.4)
Provisions and W/off	4,853	2,263	114.5	3,143	54.4
PBT	2,729	5,796	(52.9)	4,871	(44.0)
Taxes	1,051	1,820	(42.2)	1,324	(20.6)
PAT	1,677	3,977	(57.8)	3,547	(52.7)
Cost to Income ratio (%)	40.2	37.6		40.3	
Tax rate (%)	38.5	31.4		27.2	
NIMs (%)	2.6	3.3		2.9	
CAR (%)	12.6	12.8		13.6	
Gross Advances (Rs bn)	1,055	872	20.9	983	7.3
Deposits (Rs bn)	1,496	1,258	18.9	1,446	3.5
CASA (%)	22.9	25.4		22.4	
Gross NPA (Rs mn)	31,111	14,569	113.5	20,348	52.9
Gross NPA (%)	3.0	1.7		2.1	
Net NPA (Rs mn)	19,783	6,066	226.1	10,592	86.8
Net NPA (%)	1.9	0.7		1.1	
Provision coverage ratio (%)	36.4	58.4		47.9	

Source: Company, RCML Research

Fig 3 - Trend in Asset Quality

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Gross NPA (Rs mn)	14,951	14,569	17,641	19,205	20,348	31,111
Gross NPA (%)	1.7	1.7	1.9	2.0	2.1	3.0
Net NPA (Rs mn)	6,159	6,066	8,161	9,382	10,592	19,783
Net NPA (%)	0.7	0.7	0.9	1.0	1.1	1.9
Provision coverage ratio (%)	58.8	58.4	53.7	51.2	47.9	36.4

Source: Company, RCML Research

Results below expectation across key metrics due to deterioration in asset quality

Higher provisions stemmed from excess provisions made on higher incremental slippages

CASA deposits remain stable QoQ

Incremental slippages high led by system-based recognition of NPLs

Loan growth remains strong both on a
QoQ and YoY basis

Fig 4 - Loan Growth Trend

Growth	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Advances (Rs bn)	861	875	908	959	982	1,045
QoQ Growth (%)	2.3	1.6	3.8	5.6	2.4	6.4
YoY growth (%)	20.3	14.3	16.8	13.9	14.1	19.5

Source: Company, RCML Research

NPAs increase sharply on account of
migration to system-based NPL
recognition

Fig 5 - Movement of NPAs

(Rs mn)	Q4FY11	Q1FY12	Q2FY12
Op. Gross NPA	17,641	19,205	20,347
Addition	6,492	3,780	15,033
Total reduction	4,928	2,638	4,270
Cash recovery	1,750	838	1,498
Up-gradation	150	375	916
Write-off	3,028	1,425	1,857
Cl. Gross NPA	19,205	20,347	31,110
Slippages (Annualised)	3.08	1.76	6.89

Source: RCML Research, Company

Profit and Loss statement

Y/E 31 Mar (Rs mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Interest income	102,571	120,888	145,415	175,323	204,786
Interest expense	(73,497)	(79,103)	(100,487)	(122,155)	(141,113)
Net interest income	29,074	41,786	44,928	53,167	63,673
Non-interest income	12,000	9,601	11,705	13,423	15,598
Non-interest income (ex-treasury)	7,765	8,847	10,455	12,023	13,998
Net revenue	41,075	51,386	56,633	66,591	79,271
Operating expenses	(16,860)	(18,925)	(21,921)	(25,428)	(30,118)
Pre-provisioning profits	24,215	32,461	34,712	41,163	49,153
Provisions & contingencies	(8,160)	(12,083)	(14,749)	(11,693)	(14,100)
PBT	16,055	20,378	19,963	29,470	35,054
Extraordinaries	0	0	0	0	0
Income tax	(4,708)	(5,339)	(6,089)	(8,841)	(10,867)
Reported PAT	11,347	15,039	13,875	20,629	24,187
Adj. Net profit	11,347	15,039	13,875	20,629	24,187

Balance sheet

Y/E 31 Mar (Rs mn)	FY10A	FY11A	FY12E	FY13E	FY14E
Cash in hand & bal with RBI	80,868	95,151	99,909	104,904	110,150
Bal with banks, Money at call	65,131	95,736	100,523	105,549	110,826
Investments	357,853	420,748	481,659	588,361	710,740
Advances	834,893	959,082	1,131,717	1,324,109	1,562,448
Fixed assets (net)	13,940	13,978	14,327	14,686	15,053
Other assets	12,450	19,874	20,593	21,329	22,084
Total Assets	1,365,136	1,604,570	1,848,728	2,158,938	2,531,301
Equity capital	2,505	2,918	2,918	2,918	2,918
Reserves & surplus	70,700	99,190	110,983	128,518	149,077
Net worth (ex-Pref capital)	73,205	102,107	113,901	131,435	151,994
Preference capital	0	0	0	0	0
Deposits	1,202,576	1,390,543	1,606,077	1,879,110	2,207,954
-CASA deposits	300,229	341,480	390,277	473,536	551,988
-Term deposits	902,347	1,049,063	1,215,800	1,405,574	1,655,965
Borrowings (+sub-ord bonds)	48,870	56,392	67,671	81,205	97,446
Other liabilities & provisions	40,484	55,528	61,080	67,188	73,907
Total Equity & Liabilities	1,365,136	1,604,570	1,848,728	2,158,938	2,531,301

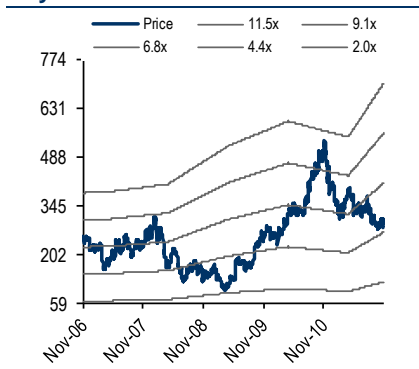
Per share data

Y/E 31 Mar (Rs)	FY10A	FY11A	FY12E	FY13E	FY14E
Reported EPS	45.3	51.5	47.6	70.7	82.9
Adjusted EPS	45.3	51.5	47.6	70.7	82.9
DPS	9.1	10.4	6.1	9.1	10.7
Book value	292.2	350.0	390.4	450.5	521.0
Adjusted book value	271.8	326.2	337.8	402.8	476.6

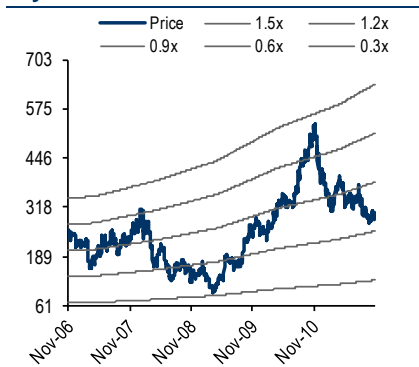
Valuation ratios

Y/E 31 Mar (x)	FY10A	FY11A	FY12E	FY13E	FY14E
P/E	8.9	5.6	6.1	4.1	3.5
P/BV	1.4	0.8	0.7	0.6	0.6
P/ABV	1.5	0.9	0.9	0.7	0.6

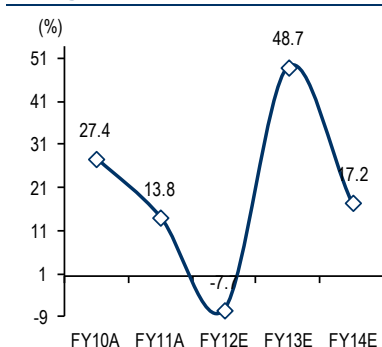
1-yr fwd P/E band



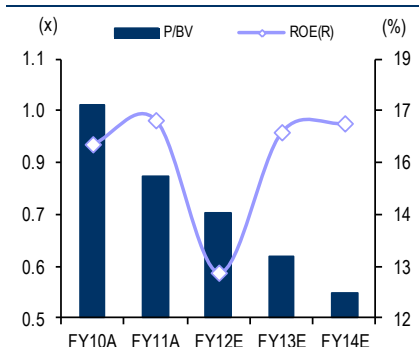
1-yr fwd P/BV band



EPS growth



ROE vs P/BV



Financial ratios

Y/E 31 Mar (%)	FY10A	FY11A	FY12E	FY13E	FY14E
Spread analysis					
Yield on advances	10.0	10.0	10.3	10.7	10.6
Yield on investments	7.7	7.1	7.2	7.2	7.1
Cost of funds	6.5	5.9	6.4	6.7	6.6
NIMs	2.4	2.9	2.7	2.7	2.8
Operating ratios					
Operating cost to income	41.0	36.8	38.7	38.2	38.0
Operating expenses/Avg assets	1.4	1.3	1.3	1.3	1.3
Proportion of CASA deposits	25.0	24.6	24.3	25.2	25.0
Non-int inc/Total income	29.2	18.7	20.7	20.2	19.7
Credit/Deposit ratio	69.4	69.0	70.5	70.5	70.8
Investment/Deposit	29.8	30.3	30.0	31.3	32.2
Asset quality and capital					
Gross NPA	1.7	2.0	3.0	2.8	2.6
Net NPA	0.9	1.0	2.0	1.5	1.2
Coverage ratio	50.7	51.2	36.3	46.8	54.5
CAR	12.5	14.2	13.5	13.2	12.8
Tier I ratio	9.3	11.2	10.6	10.3	10.0
Growth ratios					
Net interest income	45.6	43.7	7.5	18.3	19.8
Non-interest income	12.0	(20.0)	21.9	14.7	16.2
Non-interest income (Ex-treasury)	32.4	13.9	18.2	15.0	16.4
Pre-provisioning profit	45.0	34.1	6.9	18.6	19.4
Net profit	27.4	32.5	(7.7)	48.7	17.2
Assets	22.3	17.5	15.2	16.8	17.2
Advances	21.9	14.9	18.0	17.0	18.0
Deposits	22.3	15.6	15.5	17.0	17.5
Book value	13.5	19.8	11.6	15.4	15.6
EPS	27.4	13.8	(7.7)	48.7	17.2

Quarterly trend

Y/E 31 Mar (Rs mn)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net interest income	10,771	10,299	10,134	10,183	9,895
YoY growth (%)	92.0	18.0	2.4	(3.8)	(8.1)
QoQ growth (%)	1.8	(4.4)	(1.6)	0.5	(2.8)
Non-interest income	2,141	2,314	2,998	3,238	2,774
Total income	12,912	12,613	13,132	13,421	12,669
Total operating expenses	(4,853)	(4,873)	(4,702)	(5,408)	(5,087)
- Employee expenses	(2,764)	(2,771)	(2,418)	(3,196)	(2,783)
Pre-provision profit	8,060	7,739	8,430	8,014	7,582
Provisions	(2,263)	(1,918)	(5,605)	(3,143)	(4,853)
PBT	5,796	5,822	2,825	4,871	2,729
Income taxes	(1,820)	(1,739)	512	(1,324)	(1,051)
PAT	3,977	4,083	3,337	3,547	1,677
YoY growth (%)	46.8	41.1	5.2	(2.7)	(57.8)
QoQ growth (%)	9.1	2.7	(18.3)	6.3	(52.7)

DuPont analysis

Y/E 31 Mar (%)	FY10A	FY11A	FY12E	FY13E	FY14E
Net interest income/Assets	2.3	2.8	2.6	2.7	2.7
Non-interest income/Assets	1.0	0.6	0.7	0.7	0.7
Operating expense/Assets	1.4	1.3	1.3	1.3	1.3
Provisions/Assets	0.7	0.8	0.9	0.6	0.6
Taxes/Assets	0.4	0.4	0.4	0.4	0.5
ROA	0.9	1.0	0.8	1.0	1.0
Equity/Assets	5.6	5.9	6.3	6.1	6.0
ROAE	16.5	17.2	12.8	16.8	17.1

Company profile

With an asset size of US\$ 36bn, OBC is India's tenth largest public sector bank. Established in 1943, OBC was nationalised in 1980 along with six other banks. In July '04, it took over 104 branches of Global Trust Bank (GTB) along with Rs 13bn in accumulated losses. OBC now has around 1,600 branches largely concentrated in North India. The government holds 58% in the bank. OBC recently entered into life insurance via a JV with Canara Bank and HSBC and holds a 23% stake in the venture.

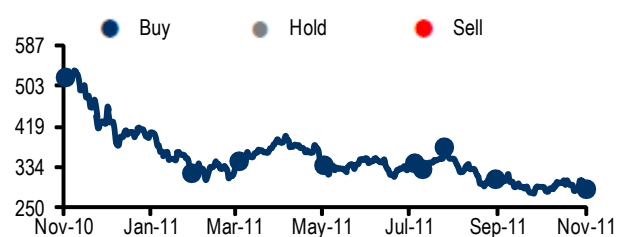
Shareholding pattern

(%)	Mar-2011	Jun-2011	Sep-2011
Promoters	58.0	58.0	58.0
FIs	13.7	11.3	9.8
Banks and FIs	21.7	24.0	25.4
Public	6.6	6.7	6.8

Recommendation history

Date	Event	Reco price	Tgt price	Reco
24-Aug-10	Sector Report	424	490	Buy
3-Nov-10	Results Review	521	580	Buy
30-Jan-11	Results Review	321	445	Buy
3-Mar-11	Company Update	347	445	Buy
2-May-11	Results Review	337	445	Buy
4-Jul-11	Sector Update	343	445	Buy
10-Jul-11	Sector Update	331	435	Buy
25-Jul-11	Results Review	374	435	Buy
30-Aug-11	Sector Report	311	380	Buy
1-Nov-11	Results Review	290	340	Buy

Stock performance



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Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Expected absolute returns are based on the share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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