

Company Flash

12 March 2008 | 7 pages

Bank of Baroda (BOB.BO)

Citi India Conference 2008: Day 2 Takeaways

- Conference takeaways** — BoB spoke with investors at the Citi India Investor Conference 2008. Here are some of the highlights of that presentation.
- Overall business** — Management is confident of growing at 23-25% over the next year. It sees growth strong in the tier 1 and 2 cities, and expects continued momentum in global operations, maintaining margins at 2.8% levels.
- Derivative positions, well under control** — BoB had \$300m in offshore CLN (corporate-linked note) and MTM charges of about \$5m as of Feb 08 with no investment in CDS. Management suggests that it has no complex FX derivative structures in place and has no MTM exposure risk with corporates.
- Farm credit, no problem** — BoB has a total farm credit overdue exposure of Rs9-10bn with the small and marginal farmers, and a total outstanding farm credit of Rs120bn as of Dec 07. BoB suggests this would be reimbursed by the government and there could be some write-backs for provisions made.
- Gains on investment portfolio** — BoB has realised equity gains of Rs2.9m in P&L for 9M08 on an equity book of Rs8bn (book value). There are also potential unrealized gains on some unlisted investments (SIDBI, NSE, etc.).
- Insurance, MF** — The insurance venture has got shareholder nod. It could take 6-8 months to be operational (BoB has 49% stake; Andhra Bank and Legal and General are other partners). BoB has sold a 49% stake in the AMC business (AUM of sub-Rs10bn) to Pioneer; it would be running at full pace in 3 months.

Buy/Medium Risk	1M
Price (12 Mar 08)	Rs289.20
Target price	Rs475.00
Expected share price return	64.2%
Expected dividend yield	2.1%
Expected total return	66.3%
Market Cap	Rs105,346M
	US\$2,610M

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



Statistical Abstract

Year to	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
31 Mar							
2006A	8,270	25.06	9.0	11.5	1.3	12.3	1.7
2007A	10,260	28.07	12.0	10.3	1.2	12.4	1.9
2008E	15,970	43.69	55.7	6.6	1.1	17.1	2.1
2009E	18,009	49.27	12.8	5.9	0.9	16.8	2.1
2010E	21,558	58.98	19.7	4.9	0.8	17.4	2.1

Source: Powered by dataCentral

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

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Bank of Baroda

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 strategy

We rate BoB Buy (1M) with a target price of Rs475. 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 Rs475 (previously Rs390) 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 revising our EVA-based target on the back of a) revised earnings estimates, b) lower risk-free rate of 7.5% (previously 8%) and c) slightly lower long-term loan growth estimates. We maintain industry-average margin (230bps) and higher-than-industry capital ratio (6%).

We are also benchmarking our target price on a 1.4x FY09E PBV (previously 1.3X PBV FY09E). Our target price based on this methodology is now Rs430 (previously Rs394). 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. Important to note, its ROEs have also tended to lag the sector, and though we do see signs of a catch-up, management still needs to deliver.

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

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Bank of Baroda (BOB.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



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Bank of Baroda (BOB.BO)

12 March 2008

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