

## Bank of India

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,617	BOIIN
	REUTERS CODE
S&P CNX: 3,110	BOI.BO

26 July 2006

**Buy**
*Previous Recommendation: Buy*
**Rs103**

	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)
Equity Shares (m)	488.1										
52-Week Range	156/80										
1,6,12 Rel.Perf.(%)	-4/-31/-64										
M.Cap. (Rs b)	50.2										
M.Cap. (US\$ b)	1.1										
	3/06A	38,164	7,012	14.4	106.0	7.2	1.0	10.8	14.9	0.7	1.2
	3/07E	42,820	8,644	17.7	23.3	5.8	0.9	9.9	16.4	0.7	1.0
	3/08E	49,489	10,533	21.6	21.8	4.8	0.8	9.4	17.5	0.8	0.8

Bank of India (BoI) reported earnings growth of 22% to Rs2.1b during 1QFY07, as spreads improved and advances growth was steady. Reported net interest income (NII) increased 37% YoY to Rs7.64b. However, after adjusting for amortization expenses of Rs521m, core NII grew 31% YoY. Improvement in asset quality continued with decline in gross and net NPAs.

- NII grew by 31% YoY (excluding amortization expenses)
- Margins improved on back of improving yields
- Treasury profits increased YoY; core fee income grew by 17%
- Business growth continued to be steady
- Asset quality improved with net NPAs at 1.4%

BoI is likely to be a beneficiary of low operating expenses, steady NII growth and very low risk on AFS portfolio, as it has over 75% of investments in HTM. We expect BoI's net profit to grow by 23% in FY07 and by 22% in FY08. The stock trades at 5.8x FY07E EPS and 0.9x FY07E BV. We maintain **Buy**.

Y/E MARCH	QUARTERLY PERFORMANCE										(RS MILLION)	
	FY06				FY07E				FY06	FY07E		
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE				
Interest Income	15,645	16,614	18,006	20,022	20,211	20,767	21,427	23,096	70,287	85,500		
Interest Expense	10,056	10,828	11,440	11,644	12,566	13,101	13,499	15,059	43,967	54,226		
<b>Net Interest Income</b>	<b>5,590</b>	<b>5,786</b>	<b>6,566</b>	<b>8,378</b>	<b>7,644</b>	<b>7,666</b>	<b>7,928</b>	<b>8,037</b>	<b>26,320</b>	<b>31,275</b>		
% Change (Y-o-Y)	3.8	-2.9	6.1	73.2	36.8	32.5	20.7	-4.1	17.7	18.8		
Other Income	2,944	3,031	2,625	3,244	3,107	2,780	2,650	3,009	11,844	11,545		
<b>Net Income</b>	<b>8,533</b>	<b>8,818</b>	<b>9,191</b>	<b>11,622</b>	<b>10,751</b>	<b>10,446</b>	<b>10,578</b>	<b>11,046</b>	<b>38,164</b>	<b>42,820</b>		
% Change (Y-o-Y)	4.9	3.1	7.8	33.4	26.0	18.5	15.1	-5.0	12.5	12.2		
Operating Expenses	4,867	5,517	5,444	5,324	6,075	6,178	6,097	6,144	21,151	24,494		
<b>Operating Profit</b>	<b>3,666</b>	<b>3,301</b>	<b>3,747</b>	<b>6,298</b>	<b>4,676</b>	<b>4,267</b>	<b>4,481</b>	<b>4,902</b>	<b>17,012</b>	<b>18,326</b>		
Other Provisions	1,392	1,521	1,804	3,140	1,685	1,600	1,800	1,715	7,856	6,800		
<b>Profit Before tax</b>	<b>2,275</b>	<b>1,780</b>	<b>1,943</b>	<b>3,159</b>	<b>2,991</b>	<b>2,667</b>	<b>2,681</b>	<b>3,187</b>	<b>9,157</b>	<b>11,526</b>		
Tax Provisions	557	459	512	614	904	667	670	797	2,142	2,881		
<b>Net Profit</b>	<b>1,717</b>	<b>1,322</b>	<b>1,431</b>	<b>2,544</b>	<b>2,087</b>	<b>2,001</b>	<b>2,010</b>	<b>2,390</b>	<b>7,014</b>	<b>8,644</b>		
% Change (Y-o-Y)	5.6	166.8	90.7	381.9	21.5	51.4	40.5	-6.1	106.1	23.2		
Cost to Income Ratio (%)	57.0	62.6	59.2	45.8	56.5	59.1	57.6	55.6	55.4	57.2		
Interest Expense/Interest Income (%)	64.3	65.2	63.5	58.2	62.2	63.1	63.0	65.2	62.6	63.4		
Other Income/Net Income (%)	34.5	34.4	28.6	27.9	28.9	26.6	25.1	27.2	31.0	27.0		

E: MOST Estimates

Note: In the interest of timeliness, this report has not been edited.

Bank of India (BoI) reported earnings growth of 22% to Rs2.1b during 1QFY07, as spreads improved and advances growth was steady. Reported net interest income (NII) increased 37% YoY to Rs7.64b. However, after adjusting for amortization expenses of Rs521m, core NII grew 31% YoY. Improvement in asset quality continued with decline in gross and net NPAs.

### NII grows by 31% YoY (excluding amortization expenses)

While on a reported basis, NII increased by 37% YoY to Rs7.6b, actual NII grew 31% YoY after adjusting for amortization expenses. Owing to the bank's accounting method of booking amortization expenses as a part of interest expenses, NII growth on a YoY basis has been distorted. During the quarter, the bank has booked amortization expenses of Rs521m as a part of interest expenses compared with Rs639m booked in 1QFY06 (these are normally treated as provisions).

#### NII BREAKDOWN (RS M)

	1QFY07	1QFY06	GROWTH (%)
Interest Income	20,211	15,645	29.2
Interest Expenses	12,566	10,056	25.0
Reported NII	7,644	5,590	36.8
Amortization expenses	520.8	639.4	
Adjusted NII	8,165	6,229	31.1

Source: Company/Motilal Oswal Securities

### Margins improve as yields expand

Excluding amortization expenses, the global spreads have increased to 2.9% compared with 2.6% in 1QFY06. The expansion was the result of an increase in the yield on advances to 8.15% from 7.39% in 1QFY06 and increased yield on investments by 27bp YoY to 7.18% in 1QFY07. Cost of deposits increased to 4.32% in 1QFY07 from 4.03% in 1QFY06.

Domestically, spreads have improved to 3.21% in 1QFY07 from 2.99% in 1QFY06, as yield on funds improved to 7.43%

from 7.15% in 1QFY06. Cost of funds (domestic) has increased marginally by 6bp to 4.22% in 1QFY07. We believe that the bank had effected a hike by 50bp on its PLR resulting in improved yields. NIM (Global) also improved to 2.70% from 2.35% whereas domestic NIM improved to 2.95% from 2.65% in 1QFY06.

#### TREND IN SPREADS (%)

	1QFY07	1QFY06
<b>Global Spreads (%)</b>		
Yield on advances	8.15	7.39
Yield on investments	7.18	6.91
Yield on Funds	7.13	6.58
Cost of Deposits	4.32	4.03
Cost of Funds	4.22	3.96
Global Spreads	2.91	2.62
<b>Domestic Spreads (%)</b>		
Yield on Funds	7.43	7.15
Cost of Funds	4.22	4.16
Domestic Spreads	3.21	2.99

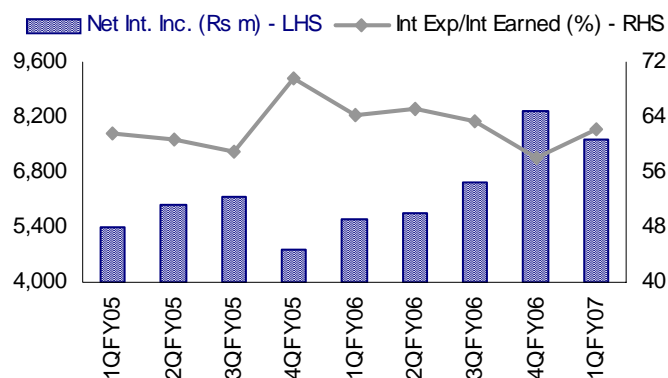
Source: Company/Motilal Oswal Securities

### Business momentum steady

Business momentum remained steady in 1QFY07. Global deposits grew by 19% to Rs958b. Domestic deposits increased by Rs124b or 19% YoY to Rs790b from Rs665b in 1QFY06. Low-cost deposits share in total deposits has expanded by 174bp YoY to 41.7%. Global loan book grew by 22% to Rs682b (loans in India grew by 26% YoY to Rs554b in 1QFY07).

Within loans, retail continued its growth momentum, recording an increase of 42% and currently constitutes over 28% of non-food advances compared to 25% in 1QFY06. Advances to the agricultural sector registered growth of 31% to Rs93b, while SME credit increased by 18% YoY to Rs165b in 1QFY07. On Y-o-Y basis, Priority Sector Advances recorded an impressive growth of 25% and reached Rs229b constituting 48% of net bank credit. Bank of India expects retail, SME and agriculture to drive loan growth and thereby derive better yields.

## TREND IN NET INTEREST INCOME



Source: Company/Motilal Oswal Securities

### Treasury profits increase YoY; core fee income grew by 17%.

BoI's profits from treasury increased YoY to Rs510m in 1QFY07 from Rs305m in 1QFY06. On the core fee income (Commission & brokerage and forex) front, the bank recorded a 17% rise to Rs1.8b from 1.6b in 1QFY06. Recovery from written-off accounts was Rs190 in 1QFY07 from Rs210m in 1QFY06.

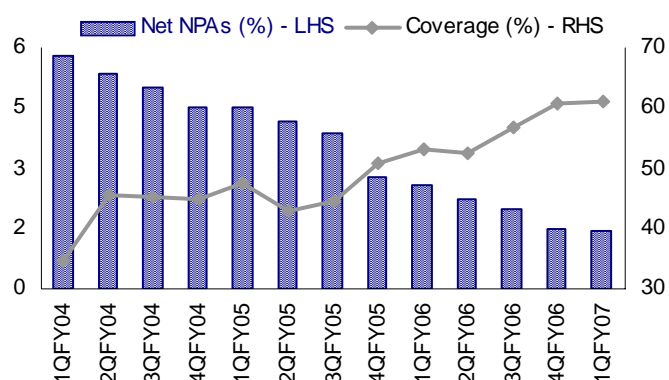
The bank holds a largely de-risked bond portfolio. Of the total domestic SLR investment book of Rs222b, over 75% is in the HTM category. The remaining investments under the AFS category comprise treasury bills with a maturity profile of ~0.6 years. The bank has also been focusing on gradually lowering the duration for its entire investment book, which is now closer to 3.6 years.

### Asset quality improves with net NPAs at 1.43%

The bank has witnessed sharp improvement in its asset quality on the back of aggressive provisioning and strong recoveries. Net NPAs have declined sharply by 116bp from 2.6% as on 1QFY06 to 1.4% as on 1QFY07 (QoQ decline of 6bp). Even the gross NPAs have declined during the same period by 176bp from 5.4% to 3.6% at 1QFY06 (QoQ decline of 11bp). In absolute terms also, gross NPAs declined by Rs5.6b YoY to Rs25.2b in 1QFY07, while net NPAs have declined by Rs4.7b to Rs9.8b in 1QFY07. The provision cover improved to 61% from 53% in 1QFY06.

The management expects strong recoveries in future, which shall reduce the pressure to make higher provisioning. With net NPAs at 1.4% currently, we expect provisioning to slow down once the bank reaches net NPAs of below 1%. This shall give a big boost to profitability as NPA provisioning has been significant for the bank over the last couple of fiscals. The management has indicated their objective to achieve net NPAs of below 1% by end-FY07, which in our view is likely to be very comfortable as large recoveries happen in the second half of the fiscal.

## TREND IN NET NPAs



Source: Company/Motilal Oswal Securities

### Capital adequacy at 10.4%

BoI's CAR is currently at 10.4%, with Tier 1 at 6.65%. With the bank targeting business growth of 20% in FY07, we believe the bank will soon need a round of capital to support regulatory requirements. With recent RBI circular allowing banks to raise perpetual debt in the international market, we believe that BoI will be amongst the first state-owned bank to raise capital in form of hybrid instruments.

### Valuation and view

BoI is likely to be a beneficiary of low operating expenses, steady NII growth and very low risk on AFS portfolio, as it has over 75% of investments are in HTM. We expect BoI's profit to grow by 23% in FY07 and by 22% in FY08. The stock trades at a P/E of 5.8x FY07E EPS and P/BV of 0.9x FY07E BV. We maintain **Buy**.

## Bank of India: an investment profile

### Company description

Bank of India (BoI) was incorporated in 1906 by a group of eminent businessmen in Bombay. It was under private ownership until 1969. Later it was nationalized along with 13 other major banks. The bank is the sixth largest bank (fifth largest state-owned bank) in India assets-wise. The bank has a large branch network of 2,622 chiefly present in the western and the eastern regions of India. Over the last 3-4 years, high NPA levels have impacted the bank. The bank is now focusing on cleaning up its NPAs. Bank has 810 branches under CBS covering 70% of its business.

### Key investment arguments

- Asset quality to continue to improve
- Bank is gearing up on the technology platform
- Core business expected to do well

### Key investment risks

- Huge workforce resulting in a higher wage bill
- Higher NPAs compared with peers

### Recent developments

- Bank of India (BoI) has raised US\$250m through multi-currency Medium Term Note (MTN) bond issue, priced at 85bp above the London Inter-Bank Offered Rate (LIBOR)

### Valuation and view

- We expect loan growth of 18% and earnings growth of 23% in FY07
- Improvement in core RoE, significant clean-up in balance sheet and superior technology platform will drive re-rating
- The stock trades at a P/E of 5.6x FY07E EPS and P/BV of 0.9x FY07E BV. We maintain **Buy**.

### 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 into earnings, valuations
- We maintain an overweight stance on the sector

#### COMPARATIVE VALUATIONS

		BOI	PNB	VIJAYA BANK
P/E (x)	FY07E	5.8	7.0	6.5
	FY08E	4.8	5.7	5.4
P/ABV (x)	FY07E	1.0	1.1	1.0
	FY08E	0.8	0.9	0.9
RoE (%)	FY07E	16.4	15.6	15.2
	FY08E	17.5	16.7	16.5
RoA (%)	FY07E	0.7	1.0	0.8
	FY08E	0.8	1.1	0.8

#### SHAREHOLDING PATTERN (%)

	JUN.06	MAR.05	JUN.05
Promoters	69.5	69.5	69.5
Domestic Institutions	4.6	4.7	4.4
FII's/FDIs	15.6	16.3	15.1
Others	10.4	9.6	11.1

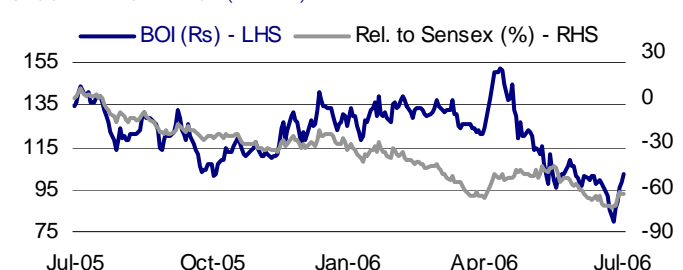
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	17.7	17.3	2.3
FY08	21.6	20.9	3.4

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
103	167	62.1	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E March	2004	2005	2006	2007E	2008E
Interest Income	57,959	60,315	70,287	85,500	101,738
Interest Expended	35,945	37,946	43,967	54,226	64,209
<b>Net Interest Income</b>	<b>22,014</b>	<b>22,369</b>	<b>26,320</b>	<b>31,275</b>	<b>37,528</b>
Change (%)	8.1	16	17.7	18.8	20.0
Other Income	17,920	11,560	11,844	11,545	11,960
<b>Net Income</b>	<b>39,934</b>	<b>33,929</b>	<b>38,164</b>	<b>42,820</b>	<b>49,489</b>
Change (%)	8.6	-15.0	12.5	12.2	15.6
Operating Expenses	17,515	19,323	21,151	24,494	28,161
<b>Operating Income</b>	<b>22,419</b>	<b>14,606</b>	<b>17,012</b>	<b>18,326</b>	<b>21,328</b>
Change (%)	10.4	-34.8	16.5	7.7	16.4
Other Provisions	8,910	9,993	7,859	6,800	6,800
<b>PBT</b>	<b>13,509</b>	<b>4,613</b>	<b>9,154</b>	<b>11,526</b>	<b>14,528</b>
Tax	3,426	1,210	2,142	2,881	3,995
Tax Rate (%)	25.4	26.2	23.4	25.0	27.5
<b>PAT</b>	<b>10,083</b>	<b>3,403</b>	<b>7,012</b>	<b>8,644</b>	<b>10,533</b>
Change (%)	18.5	-66.3	106.0	23.3	218
Proposed Dividend	1,650	976	1,660	1,953	2,441

BALANCE SHEET					
(Rs Million)					
Y/E March	2004	2005	2006	2007E	2008E
Capital	4,881	4,881	4,881	4,881	4,881
Reserves & Surplus	35,215	39,767	44,507	51,199	59,291
<b>Net Worth</b>	<b>40,097</b>	<b>44,649</b>	<b>49,389</b>	<b>56,081</b>	<b>64,173</b>
<b>Deposits</b>	<b>710,031</b>	<b>788,214</b>	<b>939,320</b>	<b>1,089,611</b>	<b>1,253,053</b>
Change (%)	10.8	11.0	19.2	16.0	15.0
Borrowings	63,808	79,605	88,425	110,531	123,795
Other Liabilities & Prov.	34,664	37,314	45,159	49,675	54,643
<b>Total Liabilities</b>	<b>848,600</b>	<b>949,782</b>	<b>1,122,293</b>	<b>1,305,899</b>	<b>1,495,663</b>
Current Assets	85,579	75,263	114,021	127,233	143,258
<b>Investments</b>	<b>271,629</b>	<b>286,863</b>	<b>317,818</b>	<b>368,668</b>	<b>423,969</b>
Change (%)	112	5.6	10.8	16.0	15.0
<b>Advances</b>	<b>458,559</b>	<b>555,289</b>	<b>651,727</b>	<b>769,038</b>	<b>884,394</b>
Change (%)	7.6	21.1	17.4	18.0	15.0
Net Fixed Assets	7,986	8,142	8,100	7,881	7,657
Other Assets	24,847	24,225	30,628	33,079	36,386
<b>Total Assets</b>	<b>848,600</b>	<b>949,782</b>	<b>1,122,293</b>	<b>1,305,899</b>	<b>1,495,664</b>

ASSUMPTIONS					
(%)					
Deposit Growth	10.8	11.0	19.2	16.0	15.0
Advances Growth	7.6	21.1	17.4	18.0	15.0
Investments Growth	112	5.6	10.8	16.0	15.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	33.8	20.0	34.0	40.0	50.0
CRR	4.5	5.0	5.0	5.0	5.0

E: M O S t Estimates

RATIOS					
Y/E March	2004	2005	2006	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning As	7.5	7.0	7.0	7.3	7.5
Avg. Cost-Int. Bear. Li.	4.9	4.6	4.6	4.9	5.0
Interest Spread	2.5	2.4	2.4	2.4	2.5
Net Interest Margin	2.8	2.6	2.6	2.7	2.8

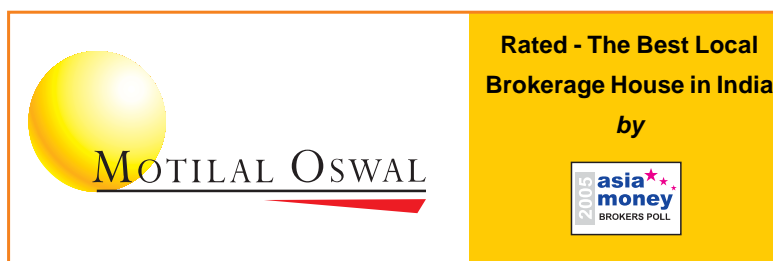
Profitability Ratios (%)					
RoE	26.7	8.0	14.9	16.4	17.5
RoA	1.3	0.4	0.7	0.7	0.8
Int. Expended/Int. Earned	62.0	62.9	62.6	63.4	63.1
Other Inc./Net Income	44.9	34.1	31.0	27.0	24.2

Efficiency Ratios (%)					
Op. Exps./Net Income	43.9	57.0	55.4	57.2	56.9
Empl. Cost/Op. Exps.	66.9	65.4	62.8	61.2	59.5
Busi. per Empl. (Rs m)	26.0	29.5	34.8	41.3	48.5
NP per Empl. (Rs lac)	2.3	0.8	1.7	2.1	2.6

Asset-Liability Profile (%)					
Adv./Deposit Ratio	64.6	70.4	69.4	70.6	70.6
Invest./Deposit Ratio	38.3	36.4	33.8	33.8	33.8
G-Sec/Invest. Ratio	67.9	69.6	71.6	64.8	59.1
Gross NPAs to Adv.	7.9	5.5	3.7	3.1	2.7
Net NPAs to Adv.	4.5	2.8	1.5	0.8	0.5
CAR	13.0	11.5	10.8	9.9	9.4
Tier 1	7.5	7.1	6.8	6.4	6.1

VALUATION					
Book Value (Rs)	78.6	88.1	98.0	111.9	128.6
Price-BV (x)	1.3	1.2	1.0	0.9	0.8
Adjusted BV (Rs)	51.1	67.4	85.0	104	123
Price-ABV (x)	2.0	1.5	1.2	1.0	0.8
EPS (Rs)	20.7	7.0	14.4	17.7	21.6
EPS Growth (%)	18.5	-66.3	106.0	23.3	218
Price-Earnings (x)	5.0	14.7	7.2	5.8	4.8
OPS (Rs)	45.9	29.9	34.9	37.5	43.7
OPS Growth (%)	10.4	-34.8	16.5	7.7	16.4
Price-OP (x)	2.2	3.4	2.9	2.7	2.4

E: M O S t Estimates



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**Bank of India**

- |   |    |
|---|----|
| 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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