India Infoline Result Update
Bank of India *(Q2 FY07)*
CMP Rs165, Rating HOLD
October 30, 2006

Controlled loan growth of 25% leading to better margins, helped BOI report strong profit growth of 60%, albeit on a lower base. Improving asset quality and sustained profit growth expectation are the major investment themes for BOI. The last two quarter results have been in line with our expectations. BOI is one of our top picks in the Banking sector. We value the stock at Rs185 on FY08 valuations, implying an upside of 12% from the current levels. The recent stock performance offers limited upside and in line with this, we revise our rating to HOLD from BUY earlier.

Financial highlights

(Rs mn)	Q2 FY07	Q2 FY06	Growth	FY07E	FY06	Growth
	(3)	(3)	(%)	(12)	(12)	(%)
Interest Income	22,582	16,614	35.9	88,884	70,287	26.5
Interest Expenses	(14,088)	(10,828)	30.1	(53,145)	(41,527)	28.0
Net Interest Income	8,494	5,786	46.8	35,739	28,760	24.3
Other Income	3,533	3,031	16.5	12,389	11,844	4.6
Net Total Income	12,026	8,818	36.4	48,127	40,604	18.5
Operating Expenses	(7,236)	(5,517)	31.2	(25,187)	(21,151)	19.1
Pre Provisioning Profit	4,791	3,301	45.1	22,940	19,453	17.9
Total Provisions	(1,587)	(1,521)	4.3	(9,540)	(10,296)	(7.3)
Profit Before Tax	3,204	1,780	80.0	13,400	9,157	46.3
Tax	(1,083)	(459)	136.1	(4,489)	(2,142)	109.6
Profit After Tax	2,121	1,322	60.5	8,911	7,014	27.0

Source: Company data, India Infoline estimates

Core business drove profit growth of 60%, albeit on a lower base

Controlled loan growth of 25% resulting in better margins helped BOI report strong profit growth of 60%. Fee income also came back strongly in Q2 FY07 reporting a growth of 20%, after a 1% drop in Q1 FY07. Asset quality also improved significantly, with net NPAs now down at 1.1% from 1.5% in March 06.

Conscious decision to restrict business growth

BOI has stuck to its strategy of maintaining a lower than industry loan growth. While the Bank has grown its loan book by 25%, the Bank continues its stance that it would moderate its loan growth to 20% by the full year. This put less pressure on funding cost resulting in the Bank retiring wholesale deposits. This coupled with 20% steady growth in CASA deposits kept the ratio at 40.4%, marginally down from 41.7% in Q1 FY07.

Lower pressure on funding cost kept margins stable

As explained earlier stable CASA ratio kept funding cost from escalating significantly. This was offset by 30bps rise in lending yields during the quarter. As a result net interest margin (NIM) remained stable at 2.74%, up 2bps from 2.72% in Q1 FY07. Domestic NIM improved by 7bps to 3.02%, as against 2.95% in Q1 FY07.

Bank would continue to maintain low duration strategy

While most banks benefited from investment depreciation write back, BOI benefited very little as it continued to carry more than 85% of the investments in the held to maturity category. However, this has reduced volatility in revenues and the Bank continues to enjoy better yield on its investment book. The Bank intends to maintain its low duration strategy in the future as well. We feel this is a sound strategy as it would maintain the Bank's focus on core business performance.

Spurt in operating expenses one off

While staff cost grew by 21% yoy, other operating cost grew by a whopping 49%. This was a result of two one off items in the current quarter relating to information technology and bond issue expenses. These together formed Rs900mn during the quarter. Normalizing for this the growth in other operating expenses was mere 5%.

Significant improvement in asset quality

Net NPAs for the Bank came down by Rs1.9bn sequentially to Rs7.9bn during Q2 FY07. We feel this is a result of the Bank's efforts to contain loan growth and maintain asset quality. Net NPAs have dropped to 1.1% by the end of Q2 FY07 as against Rs1.5% in Q4 FY06.

Valuations

Improving asset quality and sustained profit growth expectation are the major investment themes for BOI. The last two quarter results have been in line with our expectations. BOI is one of our top picks in the Banking sector. We value the stock at Rs185 on FY08 valuations, implying an upside of 12% from the current levels. In line with this, we revise our rating to HOLD from BUY earlier.