

**Bank Of Baroda****Initiating Coverage****Banking****24th March 2009**

Recommendation : BUY
CMP(Rs.): 220
Target (Rs.): 284
Upside Potential: 29%

BSE code : 532134
 NSE Symbol: BANKBARODA
 Bloomberg : BOB IN
 Reuters : BOB BO

Key Data :

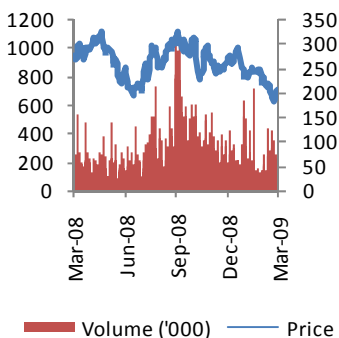
Sensex : 8912
 52 week H/L 434 / 180
 Outstanding Shares (mn) : 365.5
 Avg. 2Wk Volumes (shrs) : 261,797
 Market Cap (Rs Mn.) 75,293
 Face Value (Rs.) : 10

(Source :Prowess)

Share Holding Pattern (%):

Govt : 53.81
 Institutions : 19.96
 FIIs/NRI's : 17.41
 Non Promoter Corp. Hold. : 1.78
 Public & Others : 7.04

(Source : BSE)

Price Volume Analysis:

(Source : Prowess)

Research Analyst:

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Bank of Baroda has posted a positive improvement in its return ratios driven by robust growth in the top line particularly non interest income. Asset quality of the bank also improved and the Gross NPA level now stands at 1.5%. Improvement in ROA will lead to an improvement in ROE, which we believe result in re rating for the stock. Looking at its sustainable growth prospect and attractive valuation, We recommend "BUY" on the stock with a target price of Rs.284 for a medium to long term horizon.

Investment Rationale:

Continued focus on the asset growth. We expect the bank's advances to grow at a CAGR of approx 22% during FY08A-FY10E against management guidance of 25% growth. Priority sector status to the housing loan may result in a decent growth in the mortgage loan portfolio of the bank. In the FY10E, we expect much of the growth coming from the SME segment. The growth in the advances will lead to a decent growth in the NII of the bank resulting in stable net profit growth.

Non interest income continues to improve: We expect non interest income of the bank to grow at a CAGR of 18% during the period FY08A-FY10E. We believe the growth would be coming from the fee income mostly trade related finance and business activities.

Return Ratios continues to improve: The strong growth in the non interest income will result in improvement of return ratios of the bank. We expect the ROA of the bank to show an improvement of 9bps during the period resulting in ROE of 17% during the period FY08A-FY10E.

Valuation: At CMP of Rs.220, BOB is presently trading at P/ABV 0.7x of our FY09E ABV of Rs.279 and at P/E 4x of our FY09E EPS of Rs.53.9. We recommend a "BUY" on the stock with a fair value target price of **Rs.284** Discounting the FY09E ABV by 1x and FY10E ABV by 0.95x

Financials : (Rs. Mn)

Particulars	FY08	FY09E	FY10E
Net interest Income	39118.1	48503.2	55156.8
Non interest Income	20510.5	24328.4	28631.3
Total Expenses	29342.9	34646.2	40275.4
Net Profit	14355.3	19289.3	21766.7
EPS	39.3	52.8	59.5
Book Value	253.2	293.8	339.7
P/BV	0.9	0.7	0.6

(Source: Company, ULJK Research)

Background:

Bank of Baroda is the 6th largest public sector bank in India in which Government holds approx 53% stake. Established in 1908, the bank has pan India presence and has operation in 25 countries apart from India. The bank has increasingly pursued a strategy to increase foot hold in the international markets. Presently international business mix stands at approx Rs.517 bn, registering a 3 yr CAGR of approx 28.9%. In the domestic market, the bank has a well diversified loan book portfolio. Recently the bank has changed its corporate logo replicating a rising sun with a focus to increase its brand acceptance. The bank has wide range of products in offering starting catering to all segments i.e. SME, Retail, Corporates and Agriculture. At present the bank has approx 2899 operational branches out of which 1923 branches are under the CBS platform.

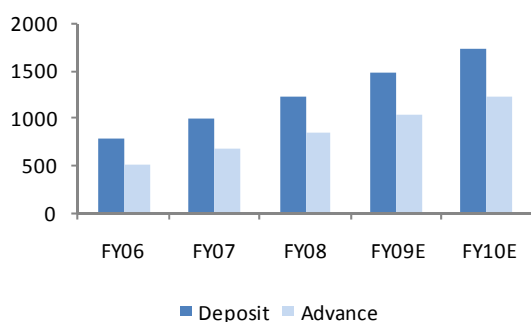
Domestic Business:

Approx 80% of the total business of the bank is from the domestic markets. Its advance mix is fairly distributed with concentrated efforts to raise the quality of earnings from each of the sectors. Most of the branches of the bank are positioned in the industrial active states i.e. Gujarat & Maharashtra. BOB also provides credit card through its subsidiary BOB cards. In the recent times the bank has increased its focus on growing the non interest income portfolio to improve its return ratios. The bank enjoys a CASA ratio at 36% in the domestic market and maintains a NIM of approx 2.94% as on 31st December 2008.

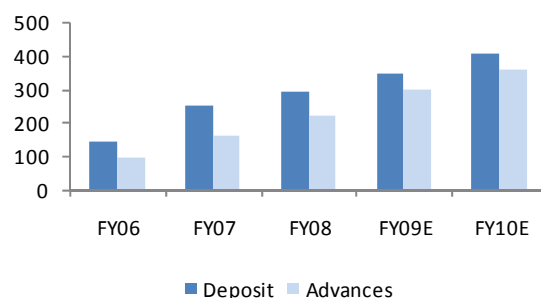
International business:

The bank has 71 branches in 25 countries operating through joint venture as well as subsidiaries. Most of the bank's international business is related to the trade financing. Presently the segment is facing some slowdown due to the prevailing dip in the international business, but bank do expect the momentum to pick up in the segment once the trade activities start functioning normally. It has grown its international business by 18% during the 9MFY09. The CD ratio in the international business is maintained at 90% during 9MFY09 and 75% in FY08.

Domestic Business (Rs. bn)



International Business (Rs. bn)



Investment Rational:

Continued focus on the asset growth.

The bank has grown its asset base with a CAGR of approx 24.7% in the last five year against a system growth of approx 23%. During the nine months of the current financial year, the advances of the bank have posted a YoY growth of approx 33% supported by 31.4% growth in the domestic markets and 39.4% in the international business. The Indian banking system has recently seen a downtrend in the advances growth in the system, but during the third quarter monetary policy review, RBI has raised its credit growth target to 24% from the previous level of 20%. We feel the low CRR and the favourable interest rate regime will result an increase in the credit off take in retail segment in general and system in the particular. We feel most of the growth will to come from the public sector banks as private sector banks are shying away due to the fear of bad loans. During the Q3FY09, system credit seen a growth of 7.6% on QoQ basis where as BOB registered a 7.4% growth in the advances. The bank is increasingly focusing on the SME business as its part of growth driver and seeing the present crisis in the market as an opportunity to increase its share in the SME segment. At present the SME sector accounts for approx 14% of the total advances of the bank. and the bank want to increase the share to 17%.

System Credit Vs Bank of Baroda

Year	System Credit Growth YoY	Bank Baroda Credit Growth YoY	System credit Market share (Rs. bn)
FY06	15.49%	0.72%	8748.51
FY05	31.50%	21.91%	11522.09
FY06	30.80%	38.04%	1496474
FY07	28.14%	39.57%	1931189
FY08	21.61%	27.60%	2348493

(Source: Company, RBI)

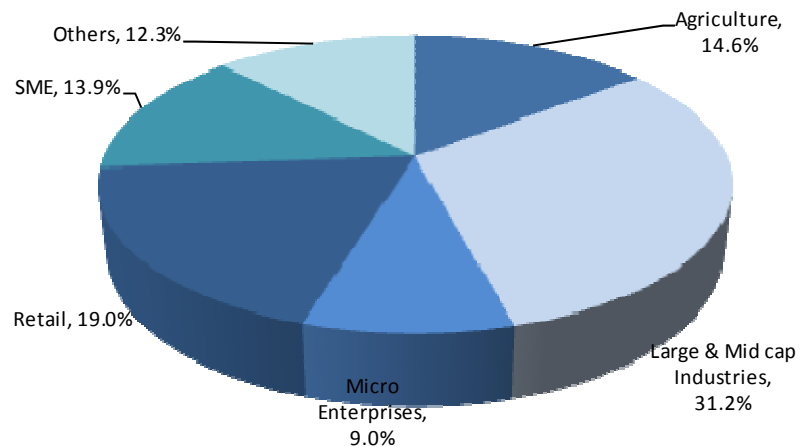
Overall we expect the bank's advances to grow at a CAGR of approx 22% during FY08A-FY10E against management guidance of 25% growth. We expect much of the advance growth in the Q4FY09 to be driven by priority sector lending. As the advances to housing sector has come into the priority sector norm, we expect the home loan portfolio of the bank to show a decent growth. In the FY10E, we expect much of the growth from the SME segment as we do believe that the trade activities will start functioning normally raising demand for working capital finance. The sustainable growth in the advances will lead to a decent growth in the NII of the bank resulting in strong profit growth.

Advances mix to support the asset growth:

BOB's advance mix is fairly distributed with perfect blend of SME, retail and corporate segment. This segregation of the advances will result in consistent asset growth in the coming few quarters. During the period April –Dec 2008, retail credit seen a growth of 22.1% YoY, Home loan portfolio grown at 18.3% on YoY basis.

We expect the growth from this segment to continue in the same fashion. On the SME front, the bank is bit aggressive. SME advances during 9MFY09 have grown up by 27.8% on YoY basis. The bank has dedicated branches to cater to the SME segment which reduces the sanctioning period and also to keep a control on the quality of the book.

Advance Breakup

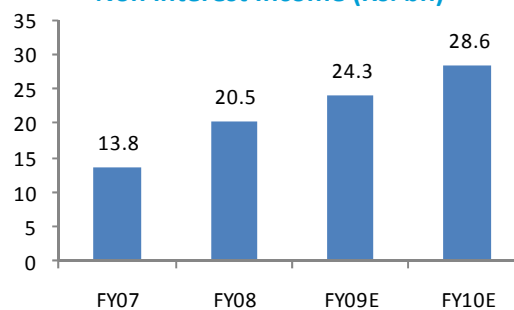


(Source: Company, ULJK Research)

Non interest income continues to improve:

Non interest income share in the total income stands at approx 34.4% in FY08 and 33.1% during the first nine month of FY09. During the nine month period ended December 2008, the bank has posted a 38% growth in the core fee income. In the third party product portfolio the bank sales products of HDFC life and other mutual funds. Increasing technology adoption will also support building up the non interest income. We expect non interest income of the bank to grow at a CAGR of 18% during the period FY08A-FY10E. We believe the growth would be coming from the fee income mostly trade related finance and business activities. As we expect international trade to pick up in Q4FY09 and the government stimulation package will help the trade activities to pick up. Investment income is expected to be remain sluggish on back of stable Gsec yield and smaller equity portfolio.

Non interest Income (Rs. bn)

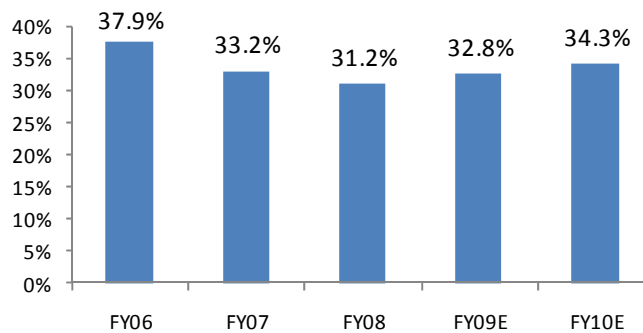


(Source: Company, ULJK Research)

CASA ratio to stabilize at present level:

The bank has been able to maintain a strong CASA ratio on back of the strong network of branches with a pan Indian presence. Out of 2899 domestic branches approx 60% in rural area and 22% are in the metro areas. This strong presence helps the bank to maintain its CASA ratio at this level resulting in a competitive funding cost. During the 9MFY09 the bank has reported a domestic CASA ratio of 36.1% on terminal numbers and approx 34% on the average basis. With the increasing number of ATM, the bank is increasing its servicing capacity which may bring more customers under its kitty. We expect the bank to maintain a overall CASA ratio of approx 32.8% in FY09E and 34.2% in FY10E.

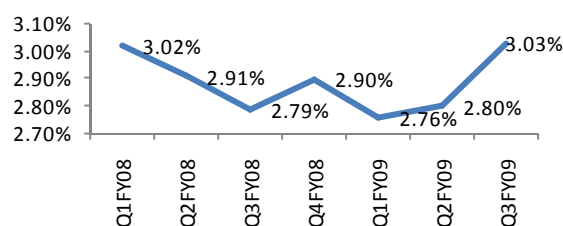
Movement in Global CASA Ratio



(Source: Company, ULJK Research)

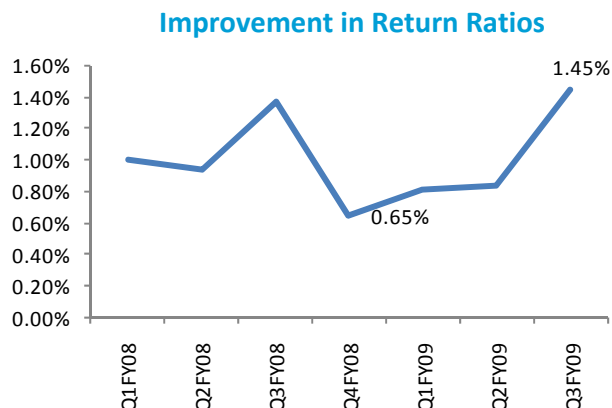
NIM is expected to maintain at 2.8% level:

During the 9MFY09, the bank is been able to maintain a NIM of 2.94% compared to 2.9% in the FY08. On the QoQ basis the NIM of the bank shown an improvement on the back of the improvement in the yield of advances. The bank has increased its PLR by 125bps during mid of 2008 on the back of RBI decision to increase the repo rate. But after that the bank has reduced its PLR to 12.5% effective from 1st January 2009 and then to 12% from April 2009. The bank has also reduced the deposit rates effective from the Q4FY09. This will help the bank to maintain its interest spread resulting in maintaining the NIM margin. Lower deposit rates and stable CASA will result in stable funding cost for the bank. We expect the yield on advances of the bank to remain in a range of 9.2% during FY09E – FY10E and funding cost to remain at 6% during the period. Thus we expect the NIM to remain at 2.8% level against the management expectations of 3.03%.



Return Ratios continues to improve:

In the recent past, lower ROA was the major concern for the bank hurting its overall valuation. During the period FY05-FY08, the ROA of the bank remained at sub 0.80% level, compared to other PSU banks whose ROA were at 1% level. The bank management is keen on increasing the ROA at 1% level. To improve the return ratios the bank is putting more stress on growing the fee income. We expect the ROA of the bank to show an improvement of 9bps till FY10E. This will result in 17.5% ROE during the period FY08A-FY10E.



(Source: Company, ULJK Research)

Monetization of gains from HTM portfolio may provide cushion against Delinquencies:

Due to the current slump in the economy we do expect the delinquencies of the bank to rise. But we think loss arising out of delinquencies can be offsetted by gains from HTM Investment. RBI allows bank to shift its Investment from HTM category once in a year. We expect bank to take the benefit which will reduce the investment provisioning in the first quarter of FY10E. As on December 2008, the bank had Rs.298.7bn in SLR – HTM portfolio with a duration of approx 4 years. We expect the 10 year Gsec bond yield to be stable at the around 6.85% , resulting in huge MTM profit under HTM category for the bank. We feel the bank will book profit on its investment portfolio to shore up its operating profit which will reduce the impact of the possible higher provision to be made on loan loss assets. This will help the bank to maintain a healthy growth in the bottom line during FY10E.

Sustainable performance in Q3FY09:

Bank of Baroda has posted a strong performance during the Q3FY09 with a sustainable growth in the Advances. Net profit of the bank has grown by 41.3% on YOY basis and 79.20% on QoQ basis on account of 37% growth in the non interest income. Net interest income of the bank has posted a 46.55% growth on YoY basis. The bank has seen in the yield of advances decreasing by 3bps and the cost of deposit has increased by 13bps. The bank has seen a positive growth in the

advances on QoQ basis which will result in a consistent growth in the net interest income of the bank. The non interest income of the bank shown a growth of 36.9% on YoY basis and 773.8% on the QoQ basis mostly on account of the treasury gains which is seen a jump of 350%. During the quarter the bank has wound up its Hongkong subsidiary and recorded profit of Rs.690.7mn. even after the extraordinary income the net profit of the bank has grown by 21% on YoY basis. The bank managed to show a lower gross NPA ratio on back of the higher recovery and upgradation during the period. The fresh slippages during the 9MFY09 stand at Rs.7.2bn.

Performance review for the Third Quarter FY09 (Rs. mn)

Particulars	Q3FY09	Growth (%)		Q3FY08	Q2FY09	9M FY09	9M FY08	Change %
		YoY	QoQ					
Interest Earned	41,080	36.83%	15.69%	30,022	35,510	109,528	84,824	29.12%
Interest Exp	26,462	32.00%	9.47%	20,047	24,172	73,002	55,991	30.38%
NII	14,618	46.55%	28.94%	9,975	11,338	36,526	28,833	26.68%
Non Interest Income	8,465	36.97%	77.86%	6,180	4,759	18,090	14,964	20.89%
Total Income	23,083	42.89%	43.40%	16,155	16,097	54,616	43,797	24.70%
Employee Cost	6,673	68.55%	43.98%	3,959	4,635	17,135	13,826	23.93%
Other Operating Exp	2,954	2.87%	-1.72%	2,872	3,006	8,427	7,830	7.62%
Total Exp	9,627	40.94%	26.00%	6,831	7,641	25,561	21,656	21.05%
Operating Profit	13,456	44.32%	59.13%	9,324	8,456	29,055	22,141	28.10%
Provision & Contingencies	3,501	123.02%	44.72%	1,570	2,419	7,523	3,965	89.76%
Exceptional Income	691					950		
Profit Before Tax	10,646	37.29%	76.34%	7,754	6,037	22,482	18,177	20.12%
Tax	3,562	29.83%	70.92%	2,744	2,084	7,737	6,586	17.48%
Profit After Tax	7,084	41.38%	79.20%	5,010	3,953	14,745	11,591	21.55%
EPS	19.38			13.71	10.81	40.34	33.19	

(Source: Company, ULJK Research)

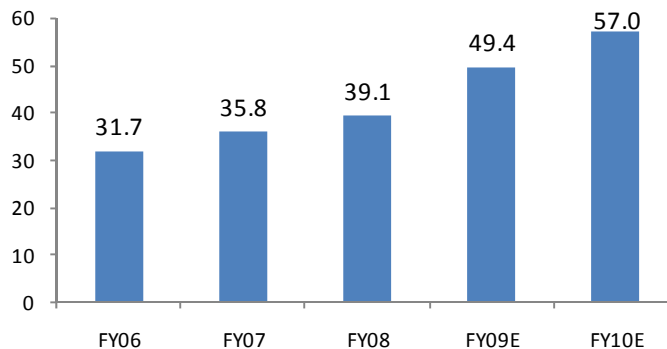
We believe the bank will be able to deliver a sustainable profit growth in the coming quarters. The positive QoQ advance growth will reflect in consistent growth in the net interest income of the bank in the coming quarters. The non interest income may see some pressure due to the lower income from the investment portfolio. but we do expect a strong growth in the fee income business. The NIM of the bank is expected to be maintained at 2.8% level as both PLR and deposit rate have been realigned from the starting of the quarter. Overall we expect bank to post a Rs.4.96bn as net profit during the Q4FY09..

Financial outlook:

NII to grow at 20.7%:

The bank has reported a 26.7% growth in the net interest in come during the first nine month of the current financial year. We expect the NII of the bank to grow at a CAGR of 20.7% during FY08A-FY10E on back of consistent growth in the advances and maintenance of NIM at 2.8%.

Growth in Net Interest Income (Rs.bn)



(Source: Company, ULJK Research)

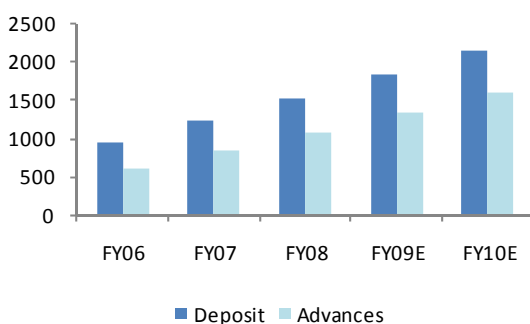
Business mix to grow at 20%:

The business mix of the bank has grown by 27.3% during 9MFY09. We business mix of the bank to grow at a CAGR of 20% during FY08A-FY10E. We expect domestic deposits to grow at 19% and International deposit to grow at 18% during FY08A -FY10E. Advances of the bank is expected to grow at a CAGR of 22% out of which international advances are expected to grow at CAGR 27% during the period FY08A-FY10E.

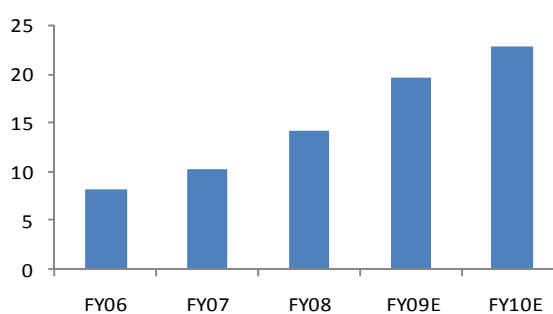
Net profit is expected to grow at 26.3%

We expect the net profit of the bank to grow at CAGR of 26.3% during the period FY08A-FY10E on back of the 20% growth in NII and 18% in the non interest income. We expect the bank to report NIM of 2.8% and expect consistent growth in the fee based income. Profit prior to provision is expected to grow at CAGR of 22% during FY08A-FY09. The higher profit will reflect in the improvement in the return ratios.

Growth in Business Mix (Rs. bn)



Growth Net Profit (Rs. bn)

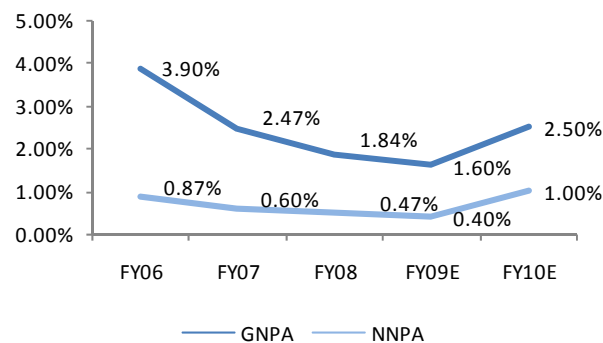


(Source: Company, ULJK Research)

Asset quality may come under pressure, but expected to remain under check:

The bank continuously improves its asset quality with better quality control and strong recoveries. The bank has reduced its gross NPA level from 11.42% in 2003 to 1.50% at the end of 31st December 2008. The bank's advance to sensitive sector is very less. Real estate exposure is at Rs.30bn (2.5% of the total loan book). We expect the Gross NPA of the bank to remain at 1.6% in FY09E and 2.5% in FY10E. The estimation of the higher NPA ratio is on the back of bleak outlook on the economy resulting in a spurt of bad assets in the SME and retail sector. The bank is expected to maintain provision coverage ratio at ...% which will result in Net NPA ratio to be maintained at 1% in FY10E.

Improvement in Asset Quality



(Source: Company, ULJK Research)

Concerns:

Slower growth in the Business Mix:

We have factored a slower growth in the business mix based on the lower growth in GDP. But any significant slowdown in the GDP will result in lower advances growth of advances which will have a negative impact on the NII growth of the bank resulting in lower net profit. A sudden change in the deposit mix with hurting CASA ratio may increase the funding cost of the bank hurting the NIM of the bank.

Sudden spurt in Delinquencies:

A significant rise in NPA from our expected level of 3% will result in lower book value which will hurt the overall valuation of the bank. The SME sector is expected to hurt most by the current slump and if the trade activities don't pick up their debt servicing capacity may come under pressure.

Slower growth in the Fee based income:

Slower growth in the fee based income of the bank will deter the income growth of the bank and the return ratios. We have factored in lower income from the investment portfolio and expect...% growth in the core fee income.

Valuation:

At CMP of Rs.220 BOB is presently trading at P/ABV 0.7x of our FY09E ABV of Rs.279 and at P/E 4x of our FY09E EPS of Rs.53.9. With a strong presence of Branches and consistent asset growth, we believe BOB will be able to show a strong performance in its topline. Well aversered risk management practice and management's point to help the borrowers in troubled time will help in keeping the NPA at lower level. We expect, improvement in ROA and ROE of the bank will result in re rating for the stock. Thus we maintain a "BUY" on the stock with a fair value target price of Rs.284 Discounting the FY09E ABV by 1.01x and FY10E ABV by 0.95x

Particulars	Value / Share	
Core banking Business	0.85 P/ABV	263.60
UTI AMC (AUM in Rs. mn)		
AUM- Nov - 08	347838.9	
Dec-08	351644.3	
Jan-09	446537.3	
Feb- 09	492249.3	
Weighted Average	426484.4	
Valuation @ 7%	29853.9	
BOB's 25% stake valuation (Rs. mn)	7463.5	
So value per share (Rs.)	20.42	
Total Per share Value (Rs.)	284.01	

(Source: Company, ULJK Research)

Financials :

Earnings Statement				Balance Sheet				
			Rs bn				Rs bn	
Particulars	FY08	FY09E	FY10E	Sources of Funds		FY08	FY09E	FY10E
Interest Income	118.1	152.3	175.6	Equity Capital		3.7	3.7	3.7
Interest Expenses	79.0	103.8	120.4	Reserves		106.8	121.6	138.4
Net Interest Income	39.1	48.5	55.2	Networth		110.4	125.3	142.1
Non Interest Income	20.5	24.3	28.6	Deposits		1520.3	1836.9	2159.0
Total Income	59.6	72.8	83.8	<i>Of this CASA ratio</i>		<i>31.22%</i>	<i>32.83%</i>	<i>34.28%</i>
Operating Cost	29.3	34.6	40.3	Borrowings		39.3	61.0	71.7
Profit before Provision	30.3	38.2	43.5	Other Liabilities		125.9	169.0	172.7
Provisions	8.2	10.3	11.0	Total Liabilities		1,796.0	2,192.2	2,545.5
Exceptional Income		0.95	-	Cash & Balance with RBI		93.7	102.5	120.5
Profit Before Tax	22.1	28.8	32.5	Balance with banks & Call money		129.3	137.8	161.9
Tax	7.7	9.5	10.7	Investments		438.7	550.9	609.9
Net Profit	14.36	19.29	21.77	Advances		1,067.0	1,330.6	1,579.1
				<i>CD ratio</i>		<i>70.18%</i>	<i>72.44%</i>	<i>73.14%</i>
				Fixed assets		24.3	27.9	30.7
				Other Assets		43.0	42.5	43.4
				Total Assets		1,796.0	2,192.2	2,545.5
Margins (%)	FY08	FY09E	FY10E	Profitability Ratios (%)		FY08	FY09E	FY10E
Yield on advances	8.8%	9.3%	9.2%	ROA		0.89%	0.97%	0.92%
Yield on Investment	6.9%	7.0%	7.2%	ROE			16.4%	16.3%
Cost of Fund	5.7%	6.2%	6.0%	Other income/ Total income		34.4%	33.4%	34.2%
NIM	2.9%	2.9%	2.7%	Cost / Income		49.2%	47.6%	48.1%
Per share data (Rs)	FY08	FY09E	FY10E	Asset Quality Ratio		FY08	FY09E	FY10E
EPS - Basic	39.3	52.8	59.5	Gross NPA		1.9%	1.6%	2.5%
Book Value	253.2	293.8	339.7	Net NPAs		0.5%	0.4%	1.0%
Adjusted Book Value	239.7	279.2	296.5	CAR		12.9%	12.8%	12.8%
				Tier 1		7.6%	7.3%	7.2%
Growth metrix	FY08	FY09E	FY10E	Key Valuation Ratios (x)		FY08	FY09E	FY10E
Deposits	21.7%	20.8%	17.5%	P/E		5.60	4.17	3.69
Advances	27.6%	24.7%	18.7%	P/BV		0.87	0.75	0.65
Net Interest Income	9.3%	24.0%	13.7%	P/ABV		0.92	0.79	0.74
Operating Expenses	15.3%	18.1%	16.2%					
Provisions	8.0%	25.9%	6.6%					
Net Profit	39.9%	34.4%	12.8%					

(Source: Company, ULJK Research)

Research Desk**Tel: 022- 3028 4719****Institutional Sales Desk****Tel: 022- 2272 1687****Disclaimer Appendix****ULJK Group investment rankings: (Time range- 12 months)**

BUY (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks and 30% or more for High-Risk stocks); **ACCUMULATE** (expected total return of 5%-15% for Low- Risk stocks, 10%-20% for Medium-Risk stocks and 15%-30% for High-Risk stocks,); **REDUCE** (expected total return of less than 5% for Low Risk stocks, less than 10% for Medium Risk stocks and less than 15% for High Risk stocks) and **SELL** (expected total return of -5% or less for Low-Risk stocks, -10% or less for Medium-Risk stocks, -15% or less for High-Risk stocks, and -20% or less for Speculative stocks).

Analyst(s) holding in the Stock : Nil**Analyst Certification**

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