Morgan Stanley

MORGAN STANLEY RESEARCH
ASIA/PACIFIC

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Stock Rating
Underweight

Industry View
In-Line

Oriental Bank of Commerce

F3Q13: Weak Overall Trends

OBC reported F3Q13 PAT of Rs3.3 bn (- 8% YoY, +8% QoQ): Our estimate was Rs3.5bn. PAT declined despite significant tax write-backs. PBT was down 28% YoY (-30% QoQ) and 35% lower than our estimates. This was mainly driven by lower core revenues and higher provisions. Impaired loan formation moved up to Rs16 bn (1.1% of trailing 12M loans, non-annualized) vs. 1% in F2Q13.

Core trends were lackluster: NII was up 6% YoY (+4% QoQ). Reported NIMs were higher (+5 bps QoQ), driven by higher recoveries and lower funding costs. However, we expect NIMs to come under pressure in FY14 as loan yields compress. Loan growth (+12% YoY) and deposit growth (8% YoY as the bank continued to shed bulk deposits) remained muted. Core fees rose +10% YoY. Employee expenses were up 15% QoQ (+16% QoQ) as the bank took wage hike provisions this quarter. Further, contribution of net capital gains + recoveries was high at 44% of PBT.

Asset-quality stress continues: New NPL formation increased to Rs8.1bn (0.7% of trailing 12M loans non-annualized (vs 0.6% in F2Q13). MSME/textiles formed ~40% of gross slippages. Even restructuring of Rs7.4bn (0.7%) during the quarter was driven by MSMEs. Overall credit cost (annualized) moved up QoQ to 184 bps vs. 160 bps. Management guided for potential restructuring of Rs22bn (1.9%) in F4Q13, which could be offset by conversion of 50% restructured SEB loans into bonds, if the restructuring package is approved by state governments *(more details on pages 3-4)*

Maintain UW: We expect core earnings to remain weak in F2014 (F14e core RoA of 0.7%). This coupled with weak balance sheet (impaired loans ratio at 11.9% (7.6% excluding SEB's/Air India), coverage ratio (ex tech write-offs) of 29% and infra exposure at 22% of loans keep us UW despite cheap multiple at 0.7x F14e P/BV.

Key Ratios and Statistics

Reuters: ORBC.NS Bloomberg: OBC IN
India Financial Services

Price target	Rs255.00
Shr price, close (Jan 25, 2013)	Rs329.85
52-Week Range	Rs364.75-190.10
Sh out, dil, curr (mn)	292
Mkt cap, curr (mn)	US$1,789

Fiscal Year ending	03/12	03/13e	03/14e	03/15e
ModelWare EPS (Rs)	39.13	50.79	58.80	71.94
ModelWare net inc (Rs mn)	11,416	14,817	17,156	20,988
P/E	6.5	6.5	5.6	4.6
P/BV	0.6	0.7	0.7	0.6
Return on avg eqty (%)	9.9	11.8	12.5	13.8

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
e = Morgan Stanley Research estimates

F3Q13 Results Highlights

Exhibit 1

F3Q13 Results Summary

Rs Mn	F3Q12	F2Q13	F3Q13	YoY	QoQ
Interest Income	41965	44146	44687	6%	1%
Interest Expense	30566	32575	32643	7%	0%
Net interest Income	**11399**	**11571**	**12044**	**6%**	**4%**
Fee income	1675	1825	1849	10%	1%
Forex	481	246	380	-21%	55%
Core Revenues	**13555**	**13642**	**14273**	**5%**	**5%**
Expenditure	6081	6427	6859	13%	7%
---Employee	3632	3665	4206	16%	15%
---Other	2449	2762	2652	8%	-4%
Core PPOP	**7474**	**7215**	**7415**	**-1%**	**3%**
Cost to Core Income Ratio	*44.9%*	*47.1%*	*48.1%*		
Other Non-Interest income	797	1997	1549	94%	-22%
---Capital Gains	365	519	618	69%	19%
---Bad Debt Recovery	299	1412	955	220%	-32%
---Others	133	66	-23	NA	NA
Total Income	14352	15639	15822	10%	1%
Operating Profit	**8271**	**9212**	**8964**	**8%**	**-3%**
Cost to Income Ratio	42.4%	41.1%	43.3%		
Provisions – Loan Loss	1011	3010	3512	247%	17%
Provisions on Investments	903	-62	153	-83%	NA
Others	1895	1650	2073	9%	26%
Total Provisions	3809	4599	5738	51%	25%
Reported PBT	**4462**	**4614**	**3226**	**-28%**	**-30%**
Tax	920	1592	-39	NA	NA
Effective Tax Rate	*21%*	*35%*	*-1%*		
Net Profit	**3542**	**3022**	**3264**	**-8%**	**8%**
PBT ex net cap gains	**5000**	**4033**	**2761**	**-45%**	**-32%**
Loans	1106983	1188440	1236260	12%	4%
Deposits	1561942	1641740	1684920	8%	3%
Loan to Deposit Ratio	71%	72%	73%		
Credit Cost / Avg. Loans	1.1%	1.6%	1.8%		
LLP/Avg Loans	0.4%	1.0%	1.2%		
Gross NPL	32322	34656	36900	14%	6%
Net NPL	20616	23934	26106	27%	9%
Coverage	11707	10722	10794		
Gross NPL Ratio	2.9%	2.9%	3.0%		
Net NPL Ratio	1.9%	2.0%	2.1%		
Coverage Ratio	36.2%	30.9%	29.3%		
--Including Technical Write-Offs	63.3%	64.5%	63.6%		
Tier I Ratio*	10.3%	10.3%	9.9%		
Reported NIM	2.90%	2.79%	2.84%		

Source: Company Data, Morgan Stanley Research; Note: 1) * Tier I ratio has been adjusted to include YTD profits.

Exhibit 2

F3Q13 Actuals vs. Estimates

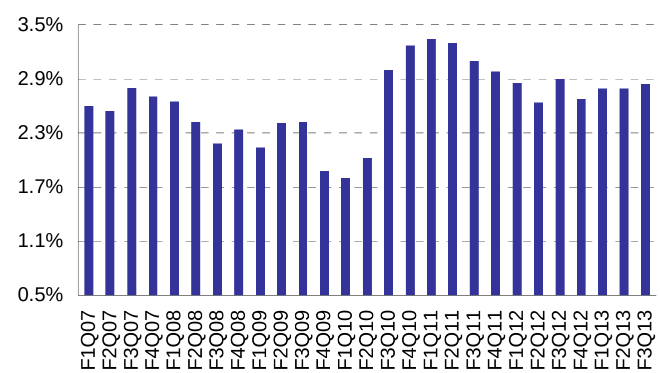
Rs Mn	F3Q12	F2Q13	F3Q13e	F3Q13a	Act. vs Est.	%YoY	%QoQ
Net Int Inc	**11399**	**11571**	**12569**	**12044**	**-4%**	**6%**	**4%**
Fee Income	1675	1825	1842	1849	0%	10%	1%
FX Income	481	246	578	380	-34%	-21%	55%
Core Revenues	**13555**	**13642**	**14988**	**14273**	**-5%**	**5%**	**5%**
Total Expenses	**6081**	**6427**	**6448**	**6859**	**6%**	**13%**	**7%**
Core PPOP	**7474**	**7215**	**8540**	**7415**	**-13%**	**-1%**	**3%**
Cap Gains	365	519	750	618	-18%	69%	NA
Recoveries	299	1412	1344	955	-29%	220%	-32%
Others	133	66	92	-23	NA	NA	NA
Total Non Int Inc	2953	4068	3855	3778	-2%	28%	-7%
Total Income	**14352**	**15639**	**16424**	**15822**	**-4%**	**10%**	**1%**
Operating Profit	**8271**	**9212**	**9976**	**8964**	**-10%**	**8%**	**-3%**
Total Provisions	3809	4599	4991	5738	15%	51%	25%
--Prov for NPA	1011	3010	3198	3512	10%	247%	17%
--Prov for Inv	903	-62	250	153	NA	NA	NA
--Other Prov	1895	1650	1543	2073	34%	9%	26%
PBT	**4462**	**4614**	**4985**	**3226**	**-35%**	**-28%**	**-30%**
Tax	920	1592	1495	-39	NA	NA	NA
PAT	**3542**	**3022**	**3490**	**3264**	**-6%**	**-8%**	**8%**
PBT ex Net Cap Gains	**5000**	**4033**	**4485**	**2761**	**-38%**	**-45%**	**-32%**

Source: Company Data, Morgan Stanley Research

Margins

Exhibit 3

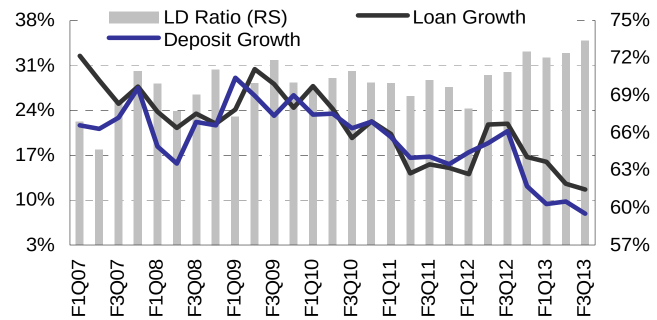
NIM expanded by 5bps QoQ to 2.84% as both share and cost of bulk deposits have come down. We compute that implied cost of term deposits has decreased by 24bps over the past two quarters.



Source: Company data, Morgan Stanley Research;

Volumes

Exhibit 4
Loan growth was 12% YoY; Deposit growth slowed to 8% YoY as the bank continued to shed bulk deposits



Source: Company data, Morgan Stanley Research

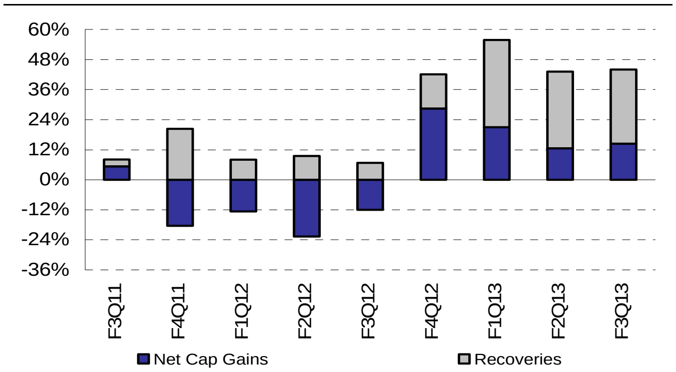
Non-Interest Income

Exhibit 5
Core non-interest income growth was muted; Recoveries remain strong

Rs mn	F3Q12	F2Q13	F3Q13	%YoY	%QoQ
Core Fee Income	1675	1825	1849	10%	1%
FX Income	481	246	380	-21%	55%
Recoveries	299	1412	955	220%	-32%
Capital Gains	365	519	618	69%	19%
Other Income	133	66	-23	NA	NA
Total Non-Interest Income	2953	4068	3778	28%	-7%

Source: Company Data, Morgan Stanley Research

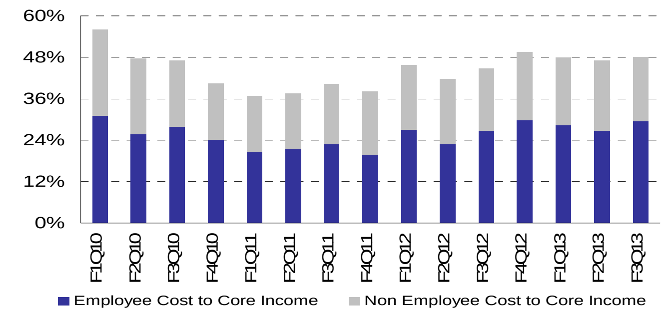
Exhibit 6
Contribution of net capital gains + recoveries was 44% of PBT vs. 43% last quarter; recoveries remain strong, but cap gains for the bank have been limited in F13, as the bank holds ~90% of SLR securities in the HTM bucket.



Source: Company Data, Morgan Stanley Research

Costs

Exhibit 7
Cost to core income ratio moved up QoQ, as the bank took Rs.300mn of provisions towards wage hike effective November 1, 2012



Source: Company data, Morgan Stanley Research

Asset Quality

Impaired loan formation moved up QoQ to 1.1% of trailing 12M loans, non-annualized vs. 1% last quarter. New NPL formation moved up to 8.1bn (0.7%) vs. Rs6.5 bn (0.6%) in F2Q13. Loans to MSMEs/textiles formed ~40% of gross slippages. Recoveries and upgrades were at Rs2.5bn (0.2%) vs. Rs2.7 bn (0.3%) last quarter. The bank wrote off loans worth Rs3.4 bn (0.3%) vs. Rs3.0 bn (0.3%). Consequently, GNPLs were up 6% QoQ (+14% YoY), despite the high new NPL formation. GNPL ratio moved higher QoQ to 2.98% from 2.92%.

Provisions for NPA for the quarter were Rs5.6bn (184 bps of loans, annualized) vs. Rs4.6bn (160 bps) in F2Q13 – ~25bps was due to catch-up provisioning of 0.75% on stock of restructured loans. Coverage ratio (excluding tech write-offs) moved lower QoQ to 29% from 31% in F2Q13. Coverage ratio including technical write-offs was at 63.6% vs. 64.5% in F2Q13.

The bank restructured Rs7.4 bn (0.7% of trailing 12M loans, non-annualized) in this quarter vs. Rs5.3bn in F2Q13. This was mainly driven by small accounts in the MSME segment.

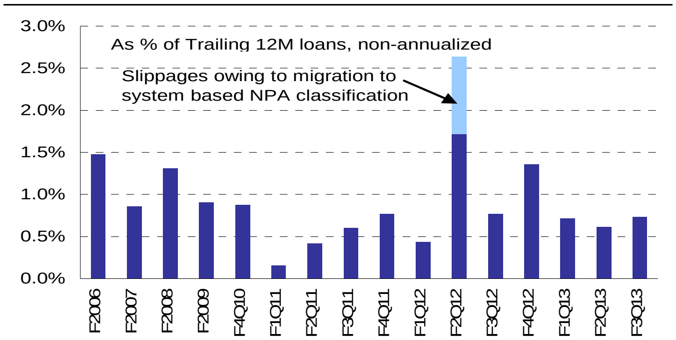
The bank's stock of impaired loans excluding SEB and Air India moved up to 7.6% vs. 7.2% last quarter. Overall stock of impaired loans (including SEB's/Air India) moved lower to 11.9% from 12.1% of loans last quarter, driven by the Rs5bn repayment from Air India. Further, management has indicated additional restructuring of Rs22 bn in the fourth quarter ~Rs12 bn (1% of loans, non-annualized) because of Punjab SEB and ~Rs10bn (0.8%) on account of some corporate loans. Management expects this to be offset by the conversion of

50% restructured SEB loans into bonds. However, this is subject to approval of SEB restructuring package by the respective state governments.

Update on the SEB restructuring package: The SEB restructuring package will likely be implemented by March 31, 2013 (deadline extended from December 31, 2012 earlier). If approved, 50% of the restructured SEB loan book will be converted into bonds (outstanding resttructured SEB loans for OBC as of December 31, 2012 are Rs.42bn). These bonds in due course will be converted into special state government securities. While special securities will likely not have SLR status, they will have preferred claim to the state government's share in the central pool of taxes, unlike normal bonds. Management highlighted that the interest rate on these bonds will likely be ~11.1-11.4%, lower than the current interest rate of 12.4% on these loans (base rate + 2%). However, this difference will be likely be offset by the release of existing restructured provisions (@2.75%) on these loans.

Exhibit 8

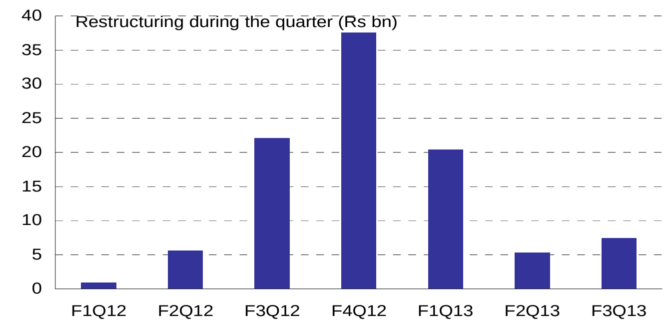
New NPL formation ratio was 0.7% of trailing 12M loans (non-annualized) vs. 0.6% in F2Q13



Source: Company data, Morgan Stanley Research

Exhibit 9

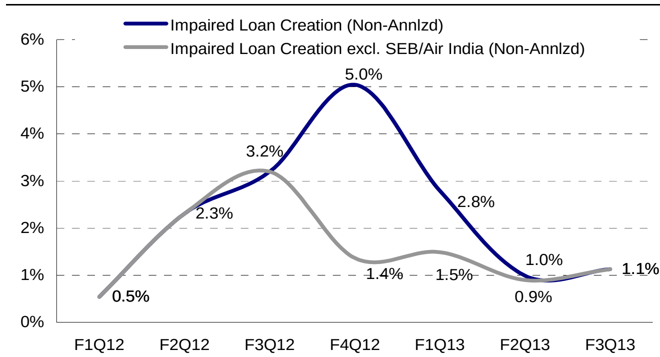
OBC restructured Rs7.4 bn (0.7% of trailing 12M loans, non-annualized) this quarter – Majority of which were granular MSME loans



Source: Company Data, Morgan Stanley Research

Exhibit 10

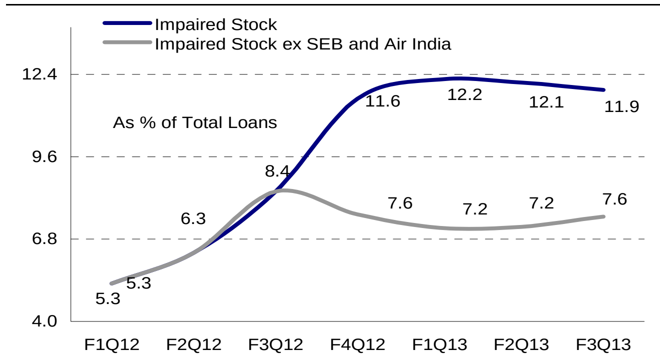
Impaired loan formation was 1.1% of loans (non-annualized) vs. 1% last quarter



Source: Company Data, Morgan Stanley Research

Exhibit 11

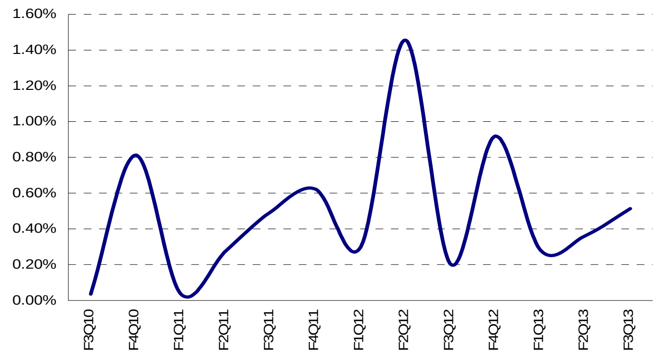
Impaired loans ratio excluding SEB/Air India increased to 7.6% vs. 7.2% last quarter



Source: Company Data, Morgan Stanley Research

Exhibit 12

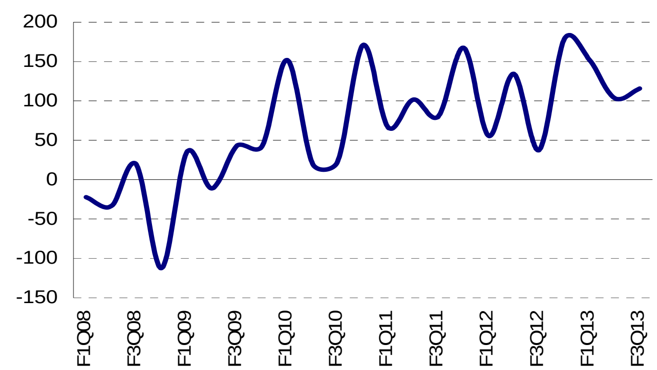
Net new NPL formation was higher QoQ at 0.5% of trailing 12M loans, non-annualized vs. 0.4% in F2Q13



Source: Company Data, Morgan Stanley Research

Exhibit 13

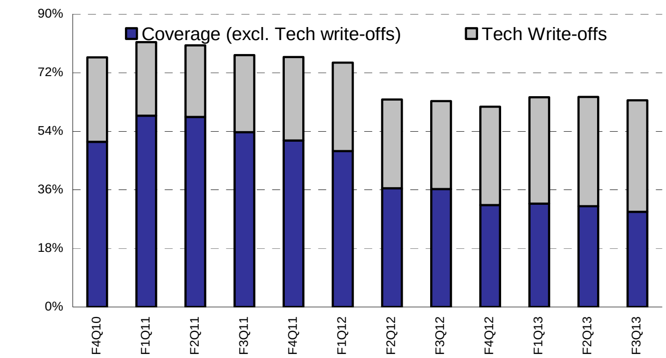
LLP/average loans (annualized) increased QoQ to 116 bps vs. 103 bps in F2Q13; Overall credit costs increased to 184bps vs. 160bps last quarter. ~25bps was driven by the increase in provisions on restructured assets to 2.75%



Source: Company data, Morgan Stanley Research

Exhibit 14

Coverage ratio (ex tech write-offs) declined QoQ to 29% vs. 31% last quarter

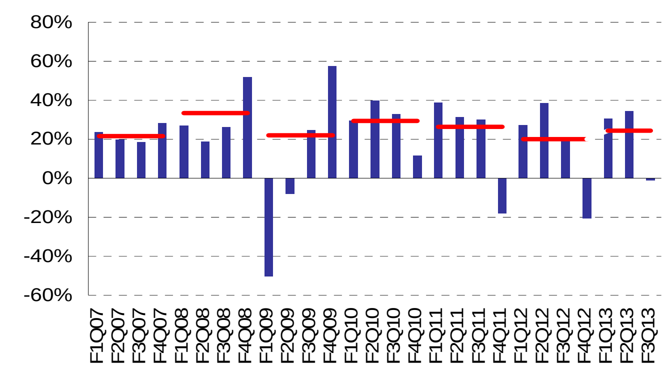


Source: Company data, Morgan Stanley Research

Tax Rate

Exhibit 15

Effective Tax rate was -1% this quarter (YTD 24%), because of tax benefits on write-offs and release of tax provisions on few disputes cases.



Source: Company data, Morgan Stanley Research

Target Price Discussion

We arrive at our price target of Rs255 using a probability weighted three-phase residual income model – a five-year high growth period, a 10-year maturity period, followed by a declining period. We assign a 65% weight to our base case, 30% to our bear case (reflecting the general conditions of balance sheets at the SOE banks as well as the depth and duration of the economic slowdown), and 5% to our bull case (reflecting the low likelihood of a V-shaped recovery).

We use cost of equity of 13.9% derived using a risk-free rate of 8.25% (Indian 10-year g-sec yield), market risk premium of 5.5% and beta of 1.0.

Risks to Our Price Target

Key upside risks to our price target include:
Better-than-expected margin progressions & fee income growth and lower-than-expected credit costs driven by:

a) better-than-expected economic environment,
b) improvement in capital flows into the country, and
c) improvement in execution of infrastructure projects.

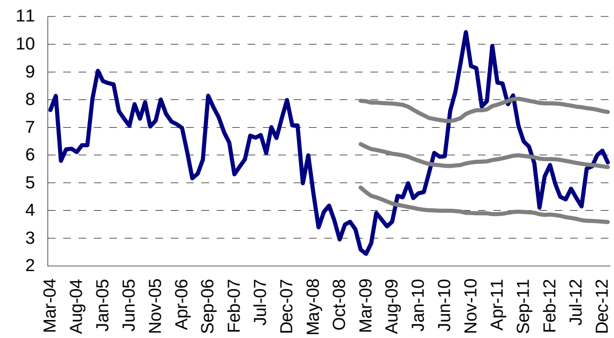
Key downside catalysts to our price target include:
slower-than-expected loan growth, sharp compression in NIMs, and significant deterioration in asset quality (increase in restructuring + new NPL formation). Also, the Reserve Bank of India's final guidelines (when issued) on dynamic provisioning could potentially bring down long-term returns.

Exhibit 16
OBC: Residual Income Model Valuation

	Base	Bear	Bull
Probability weights	65%	30%	5%
Ke	13.9%	13.9%	13.9%
RI Based Value	**290**	**155**	**365**
BVPS (F2015e)	550	550	550
Implied Target P/BV	0.5	0.3	0.7
Target Price	**255**		

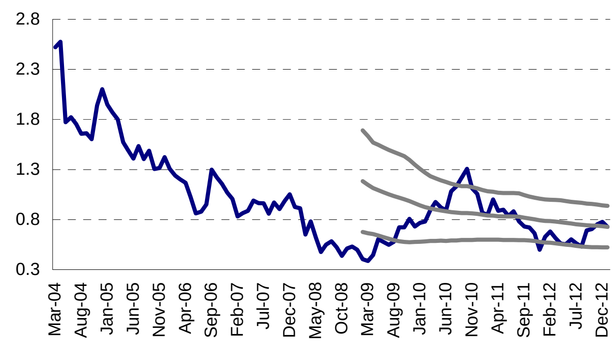
Source: Company data, Morgan Stanley Research

Exhibit 17
Forward P/E



Source: Company data, Morgan Stanley Research

Exhibit 18
Forward P/B



Source: Company data, Morgan Stanley Research

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of December 31, 2012)

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Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**1103**	**37%**	**436**	**41%**	**40%**
Equal-weight/Hold	**1301**	**44%**	**497**	**46%**	**38%**
Not-Rated/Hold	**108**	**4%**	**27**	**3%**	**25%**
Underweight/Sell	**478**	**16%**	**111**	**10%**	**23%**
Total	**2,990**		**1071**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.
Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.
Not-Rated (NR) - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index on a risk-adjusted basis, over the next 12-18 months.
Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.
Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.
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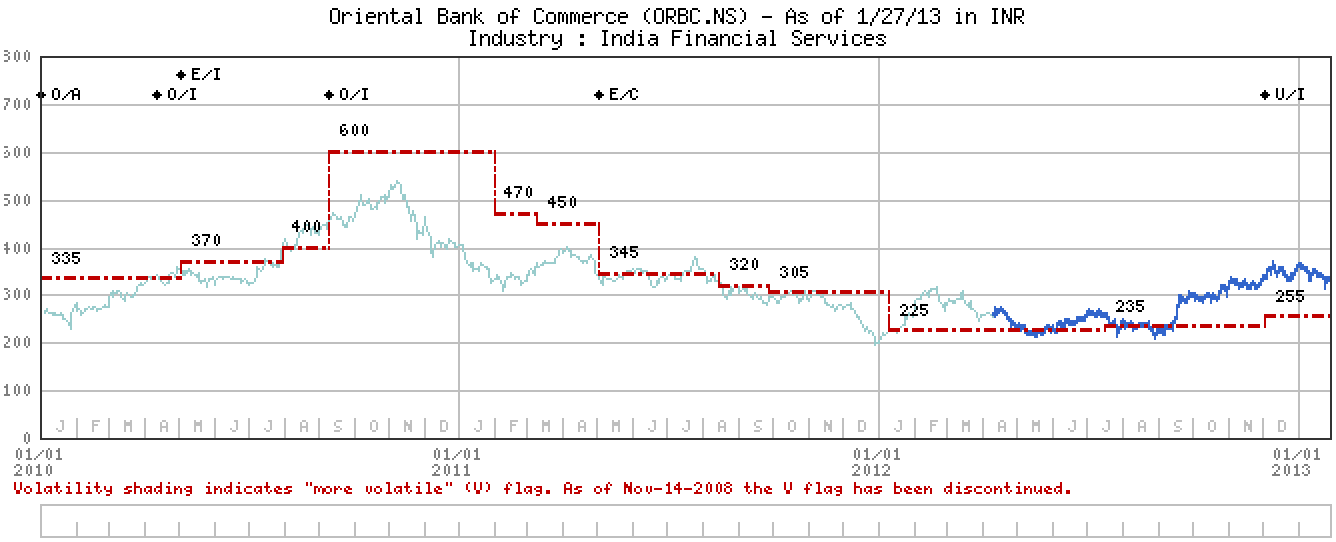
Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 1/1/10 : O/A; 4/12/10 : O/I; 5/3/10 : E/I; 9/9/10 : O/I; 5/2/11 : E/C; 12/3/12 : U/I

Price Target History: 11/30/09 : 335; 5/3/10 : 370; 7/30/10 : 400; 9/9/10 : 600; 1/31/11 : 470; 3/9/11 : 450; 5/2/11 : 345; 8/15/11 : 320; 9/27/11 : 305; 1/10/12 : 225; 7/16/12 : 235; 12/3/12 : 255

Source: Morgan Stanley Research   Date Format : MM/DD/YY   Price Target   No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst)   Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage:India Financial Services

Company (Ticker)	Rating (as of)	Price* (01/25/2013)
Anil Agarwal		
AXIS Bank (AXBK.NS)	U (09/05/2012)	Rs1,386.25
Bank of Baroda (BOB.NS)	E (07/16/2012)	Rs882
Bank of India (BOI.NS)	U (05/02/2011)	Rs363.75
Canara Bank (CNBK.NS)	U (05/02/2011)	Rs489.1
Corporation Bank (CRBK.NS)	U (12/03/2012)	Rs453.85
HDFC (HDFC.NS)	O (05/08/2012)	Rs805.85
HDFC Bank (HDBK.NS)	O (01/18/2010)	Rs665.05
ICICI Bank (ICBK.NS)	E (09/27/2011)	Rs1,172.95
IDBI (IDBI.NS)	U (10/21/2005)	Rs108.05
IDFC (IDFC.NS)	E (10/28/2012)	Rs169.65
ING Vysya Bank Ltd. (VYSA.NS)	E (12/22/2010)	Rs562.85
IndusInd Bank (INBK.NS)	O (12/03/2012)	Rs431.5
Kotak Mahindra Bank (KTKM.NS)	U (07/16/2012)	Rs665.2
LIC Housing Finance Ltd. (LICH.NS)	O (12/03/2012)	Rs283.05
Oriental Bank of Commerce (ORBC.NS)	U (12/03/2012)	Rs329.85
Punjab National Bank (PNBK.NS)	U (05/02/2011)	Rs873.35
Shriram Transport Finance Co. Ltd. (SRTR.NS)	O (07/25/2012)	Rs758.75
State Bank of India (SBI.NS)	U (05/02/2011)	Rs2,513.7
Union Bank of India (UNBK.NS)	U (12/03/2012)	Rs253.2
Yes Bank (YESB.NS)	O (10/20/2009)	Rs504.25
Subramanian Iyer		
Multi Commodity Exchange of India Ltd (MCEI.NS)	E (04/10/2012)	Rs1,364.55

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