



Bank of Baroda

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,110	BOB IN
	REUTERS CODE
S&P CNX: 4,090	BOB.BO

24 January 2007

Buy

Previous Recommendation: Buy

Rs246

Equity Shares (m)	365.5
52-Week Range	296/176
1,6,12 Rel.Perf.(%)	2/-16/-44
M.Cap. (Rs b)	89.9
M.Cap. (US\$ b)	2.0

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)
3/06A	44,165	8,269	22.6	-1.6	10.9	1.2	13.3	12.3	0.8	1.2
3/07E	50,037	10,794	29.5	30.5	8.3	1.1	11.4	13.0	0.8	1.1
3/08E	56,377	12,929	35.4	19.8	7.0	0.9	11.0	14.0	0.8	1.0

Net interest income (NII) grew 18% YoY (higher than our estimate of 12% growth) as margins were largely flat at 3.2%, against our expectation of a decline in margins. Core fee income growth was strong at 29% YoY due to higher exchange gains and recoveries. Deposits increased 31% YoY to Rs1.12t while loan book expanded by 47% to Rs777b. Asset quality continues to improve YoY as well as QoQ.

- ✍ Loan growth at 47%; NII up 18% YoY
- ✍ Margins largely maintained at 3.21%
- ✍ Other income (ex-treasury) drives non-interest income
- ✍ Asset quality continues to improve

The strong loan growth coupled with lower provisioning requirement going forward (as NPAs are a mere 0.7%), we believe that earnings progression is likely to be strong in FY07 and FY08. We have raised our earnings estimates by 9% for FY07 and 10% for FY08, in order to factor in higher margins and stronger balance sheet growth (we are still expecting margins to decline in FY08). The stock is trading at a P/E of 7x and P/BV of 0.9x FY08E. Maintain **Buy**.

QUARTERLY PERFORMANCE

	(RS MILLION)								FY06	FY07E
	FY06				FY07					
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	16,732	16,940	17,754	19,573	20,201	21,859	23,870	32,344	71,000	98,274
Interest Expense	9,145	9,123	9,599	10,883	11,378	12,952	14,262	22,412	38,751	61,003
Net Interest Income	7,587	7,818	8,155	8,690	8,823	8,908	9,608	9,932	32,249	37,271
% Change (YoY)	11.1	13.6	12.0	-1.2	16.3	13.9	17.8	14.3	8.2	15.6
Other Income	2,087	3,096	2,723	4,011	2,775	3,217	3,337	3,437	11,917	12,766
Net Income	9,674	10,913	10,877	12,701	11,599	12,125	12,945	13,369	44,166	50,037
% Change (YoY)	-10.2	4.2	7.4	10.8	19.9	11.1	19.0	5.3	3.1	13.3
Operating Expenses	5,118	5,960	6,102	6,667	6,040	5,968	6,375	6,747	23,847	25,130
Operating Profit	4,556	4,953	4,775	6,035	5,559	6,157	6,569	6,622	20,319	24,907
Provision & Contingencies	2,571	1,257	1,933	3,411	3,054	1,593	1,417	2,236	9,173	8,300
PBT	1,985	3,696	2,842	2,624	2,504	4,564	5,153	4,386	11,146	16,607
Tax Provisions	415	1,106	820	536	871	1,680	1,861	1,400	2,876	5,812
Net Profit	1,570	2,591	2,022	2,088	1,633	2,884	3,292	2,986	8,270	10,794
% Change (YoY)	-46.4	21.5	190.7	106.7	4.0	11.3	62.8	43.0	22.2	30.5
Cost to Income Ratio (%)	52.9	54.6	56.1	52.5	52.1	49.2	49.3	50.5	54.0	50.2
Int Exp/ Int Earned (%)	54.7	53.9	54.1	55.6	56.3	59.2	59.7	69.3	54.6	62.1
Other Income / Net Income (%)	21.6	28.4	25.0	31.6	23.9	26.5	25.8	25.7	27.0	25.5

E: MOST Estimates

Net interest income (NII) grew 18% YoY (higher than our estimate of 12% growth) as margins were largely flat at 3.2% against our expectation of a decline in margins. Core fee income growth was strong at 29% YoY due to higher exchange gains and recoveries. Deposits have increased by 31% YoY to Rs1.12t while loan book has expanded by 47% to Rs777b. Asset quality continues to improve YoY as well as QoQ.

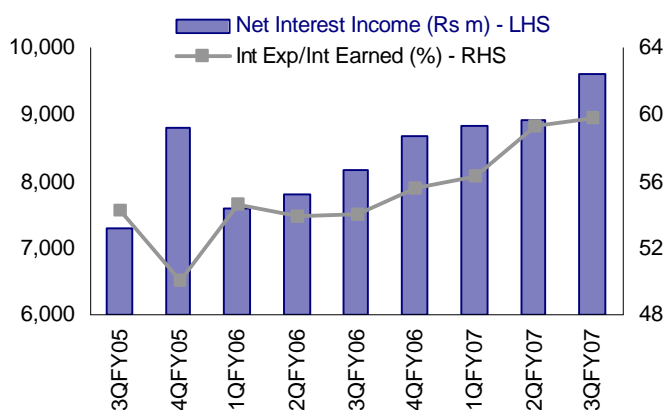
Loan growth at 47%; reported NII up 18% YoY

The bank has clearly been focusing on growing its loan book; however it has been able to maintain its margins (better versus our expectation).

Loans grew by 45% to Rs777b YoY with growth arising mainly from retail, SMEs and agricultural credit. Retail advances have grown by 49% YoY to Rs122b and are 19% of the domestic loan book, which in turn is ~82% of bank’s total loan book. The growth in loans has resulted in a 51% upsurge in interest earned on advances.

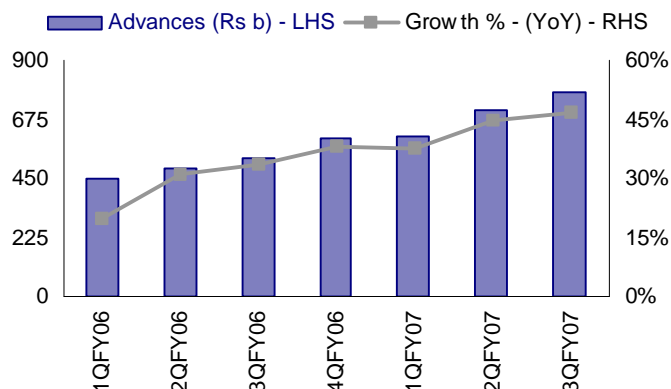
The bank’s global deposits grew by 31% YoY to Rs1.13t in 3QFY07. Domestic deposit growth was 23% and currently constitutes 80% of total deposits. Overseas deposits are up 75% YoY to Rs219b. BoB continued to maintain higher CASA at 40% of domestic deposits, even as it has declined QoQ from 41.8%.

TREND IN NET INTEREST INCOME



Source: Company/ Motilal Oswal Securities

TREND OF GROWTH IN ADVANCES



Source: Company/ Motilal Oswal Securities

Margins decline YoY

BoB reported NIMs of 3.21%, despite strong loan growth and rising deposit costs. Overall yields on loans have expanded by 69bp YoY, while investment yields are up 18bp (as yields on international investments have increased significantly). The global cost of deposits has increased by 83bp YoY. Management reiterated its intention to maintain margins, despite growing its balance sheet aggressively. BoB has raised its PLR by 50bp from January 2007 to counter the rise in deposit costs. However, we are assuming margins to decline, as the cost of funds is likely to grow faster for the bank.

NIMS OVERALL BREAKDOWN (%)

	9MFY06	FY06	9MFY07
Yield on Advances	7.64	7.65	8.33
Yield on Investments	7.98	8.23	8.16
Cost of Deposits	4.11	4.28	4.94
NIMs - Overall	3.23	3.29	3.21

Source: Company/ Motilal Oswal Securities

Other income (ex-treasury) drives non-interest income

Treasury gains increased from losses of Rs82m in 3QFY06 to a positive Rs312m in 3QFY07. Core fee income increased 29% YoY during 9mFY06. During 2Q, the bank earned core fee income of Rs1.26b. Recovery from written-off accounts and foreign exchange income was also higher.

Investment book - trimming down

BoB also reduced its investment book YoY by 7% to Rs391b to fund the strong loan growth. In fact, the domestic investment book declined 9% and SLR investments also declined by 9% YoY. As of December 2006, BoB still had Rs30b (~3%) of excess SLR on the books. BoB has been reducing the modified duration on its books; currently duration stands at 2.1 years for its AFS book.

Operating expenses remained flat YoY

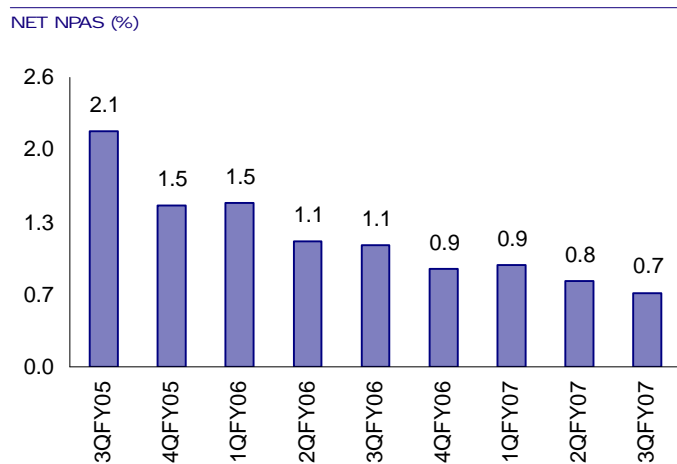
Employees' expenses increased 8% YoY, likely reflecting the pension expenses incurred during the quarter. Other operating costs, however, declined by 2% YoY. Overall, opex have grown by just 4% YoY.

Asset quality continues to improve

Asset quality continued to improve. Gross NPAs declined by 4% QoQ, while net NPAs declined 5% QoQ in absolute terms. In percentage terms, gross NPAs have come down to 3% in 3QFY07 (down by 42bp QoQ and 270bp YoY), while net NPAs have reduced to 0.67% (down 10bp QoQ and 43bp YoY).

During 3QFY07, total cash recovery was Rs1.2b, recovery in written-off accounts was Rs0.6b, while asset upgradation was to the extent of Rs100m. Loan loss coverage is at a

comfortable 78%. Management has guided that, going forward; it does expect NPA levels to reduce, as it expects strong recoveries and upgradation ahead.



Source: Company/ Motilal Oswal Securities

Valuation and view

With strong loan growth, coupled with lower provisioning requirement going forward (as NPAs are merely 0.7%), we believe earnings progression is likely to be strong in FY07 and FY08. We have raised our earnings estimate by 9% for FY07 and by 10% for FY08 to factor in higher margins and stronger balance sheet growth (we are still expecting margins to decline in FY08). Stock trades at a P/E of 7x and P/BV of 0.9x FY08E. Maintain **Buy**.

Bank of Baroda: an investment profile

Company description

Bank of Baroda, incorporated in 1908, is the fourth largest state-owned bank in India. It has a balance sheet size of over Rs1,100b, a large network of 2,700+ domestic branches, 39 overseas offices and 650+ ATMs. 60% of its branches are located in the rural and semi-urban regions of India. The government owns 53.8% of the bank's equity.

Key investment arguments

- After remaining flat for a year, loan growth has picked up momentum.
- Net NPAs have been brought down to below 1%.
- Post recent equity issuance, the bank is well capitalized at 12.9%.

Key investment risks

- Delay in upgradation of the technology platform could hurt the bank's competitive position (up to now only 513 branches are under CBS. This number is set to reach 900 by FY07).

Recent developments

- BoB is negotiating with Japanese insurance companies to establish a life insurance joint venture company.

Valuation and view

- We expect the bank to grow its earnings by 27% in FY07 on the back of strong loan growth and increased efficiency resulting from implementation of CBS.
- The stock trades at 7x FY08E EPS and 0.9x FY08E 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 in earnings, valuations.
- We maintain an Overweight stance on the sector.

COMPARATIVE VALUATIONS

		BOB	OBC	KARNATAKA
P/E (x)	FY07E	8.3	1.1	7.0
	FY08E	7.0	0.9	6.1
P/ABV (x)	FY07E	1.1	1.1	1.2
	FY08E	1.0	1.0	1.0
RoE (%)	FY07E	13.0	16.8	16.9
	FY08E	14.0	15.6	17.0
RoA (%)	FY07E	0.8	1.4	1.2
	FY08E	0.8	1.3	1.3

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	53.8	53.8	66.8
Domestic Inst	15.1	14.4	7.2
Foreign	20.8	20.9	17.7
Others	10.3	10.9	8.3

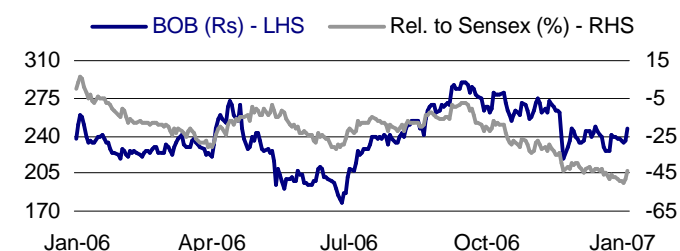
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	29.5	28.0	5.3
FY08	35.4	35.3	0.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
246	311	26.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	64,314	71,000	98,274	122,155	143,126
Interest Expended	34,521	38,751	61,003	79,108	93,918
Net Int. Income	29,793	32,249	37,271	43,047	49,208
Change (%)	15.9	8.2	15.6	15.5	14.3
Other Income	13,048	11,916	12,766	13,330	14,202
Net Income	42,841	44,165	50,037	56,377	63,410
Change (%)	-0.2	3.1	13.3	12.7	12.5
Operating Expenses	19,822	23,848	25,130	28,715	31,963
Operating Income	23,019	20,318	24,907	27,663	31,447
Change (%)	-7.4	-11.7	22.6	11.1	13.7
Other Provisions	14,388	9,173	8,300	8,650	8,500
PBT	8,631	11,145	16,607	19,013	22,947
Tax	1,863	2,876	5,812	6,084	7,343
Tax Rate (%)	21.6	25.8	35.0	32.0	32.0
PAT	6,768	8,269	10,794	12,929	15,604
Change (%)	-30.0	22.2	30.5	19.8	20.7
Proposed Dividend	1,670	2,077	2,193	2,559	2,924

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	2,945	3,655	3,655	3,655	3,655
Reserves & Surplus	53,332	74,789	83,390	93,760	106,440
Net Worth	56,278	78,444	87,046	97,416	110,095
Deposits	813,335	936,620	1,189,507	1,367,933	1,573,123
Change (%)	11.5	15.2	27.0	15.0	15.0
Borrowings	31,408	70,722	91,939	110,326	132,392
Other Liab. & Prov.	45,622	48,139	52,953	58,248	64,073
Total Liabilities	946,642	1,133,925	1,421,444	1,633,924	1,879,683
Current Assets	92,542	134,546	147,628	130,679	144,593
Investments	370,744	351,142	393,279	452,271	520,112
Change (%)	-2.5	-5.3	12.0	15.0	16.0
Advances	434,004	599,118	826,783	992,139	1,150,881
Change (%)	21.9	38.0	38.0	20.0	16.0
Net Fixed Assets	8,608	9,207	9,852	10,541	10,975
Other Assets	40,744	39,912	43,903	48,293	53,122
Total Assets	946,642	1,133,925	1,421,444	1,633,924	1,879,683

ASSUMPTIONS	(%)				
Deposit Growth	11.5	15.2	27.0	15.0	15.0
Advances Growth	21.9	38.0	38.0	20.0	16.0
Investments Growth	-2.5	-5.3	12.0	15.0	15.0
Dividend	50.0	50.0	60.0	70.0	80.0
CRR	5.0	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield-Earn. Asset	7.6	7.2	8.0	8.2	8.2
Avg. Cost-Int. Bear. L	4.4	4.2	5.3	5.7	5.9
Interest Spread	3.2	3.0	2.7	2.4	2.3
Net Interest Margin	3.5	3.3	3.0	2.9	2.8

Profitability Ratios (%)					
RoE	12.6	12.3	13.0	14.0	15.0
RoA	0.8	0.8	0.8	0.8	0.9
Int. Expended/Int. Earr	53.7	54.6	62.1	64.8	65.6
Other Inc./Net Income	30.5	27.0	25.5	23.6	22.4

Efficiency Ratios (%)					
Op. Exps./Net Income	46.3	54.0	50.2	50.9	50.4
Empl. Cost/Op. Exps.	69.7	63.9	63.7	61.6	59.0
Busi. per Empl. (Rs m)	31.6	35.9	47.7	61.2	74.1
NP per Empl. (Rs mln)	0.2	0.2	0.3	0.4	0.5

Asset-Liability Profile (%)					
Adv./Deposit Ratio	53.4	64.0	69.5	72.5	73.2
Invest./Deposit Ratio	45.6	37.5	33.1	33.1	33.1
G-Sec/Invest. Ratio	79.2	74.8	74.8	74.8	74.8
Gross NPAs to Adv.	7.2	3.9	3.1	2.7	2.5
Net NPAs to Adv.	1.4	0.9	0.5	0.4	0.2
CAR	12.6	13.3	11.4	11.0	12.8
Tier 1 (inc. IFR)	8.2	10.3	8.6	8.1	7.9

VALUATION					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Book Value (Rs)	182.2	207.4	231.0	259.3	294.0
Price-BV (x)	1.4	1.2	1.1	0.9	0.8
Adjusted BV (Rs)	168.5	198.2	222.9	252.7	289.2
Price-ABV (x)	1.5	1.2	1.1	1.0	0.9
EPS (Rs)	23.0	22.6	29.5	35.4	42.7
EPS Growth (%)	-30.0	-1.6	30.5	19.8	20.7
Price-Earnings (x)	10.7	10.9	8.3	7.0	5.8
OPS (Rs)	78.2	55.6	68.1	75.7	86.0
OPS Growth (%)	-7.4	-28.9	22.6	11.1	13.7
Price-OP (x)	3.1	4.4	3.6	3.3	2.9

E: MOST Estimates



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Bank of Baroda

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|---|----|
| 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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