

Bank of Baroda

Rs493
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs179.7bn; US\$3.8bn

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Result: Q2FY10

Comment: Strong operating performance!

Revision: Upgrading earning estimates by 5% for FY10E and 5.7% for FY11

Key valuation metrics

Year to March 31 (Rs m)	NII	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	Adj. Book Value per share (Rs)	P/ Adj.Bk (x)	PER (x)	RoE (%)
FY07	35,772	12.7	10,251	24.0	28	228	2.16	17.5	12.8
FY08	39,118	9.4	14,355	40.0	39	258	1.91	12.5	16.0
FY09	51,234	31.0	22,272	55.1	61	310	1.59	8.1	21.3
FY10E	59,507	16.1	28,156	26.4	77	357	1.38	6.4	22.7
FY11E	71,194	19.6	32,102	14.0	88	422	1.17	5.6	21.9

HIGHLIGHTS OF Q2FY10 RESULTS

Bank of Baroda ('BoB') delivered strong net profit growth of ~60% yoy to Rs6.34bn in Q2FY10, well ahead of our estimate of Rs4.82bn. The outperformance was driven by lower provisioning expenses and traction in NII.

- **NII ahead of estimates...:** NII came in at Rs13.9bn, a 22% yoy growth, (ahead of our estimate of Rs13.2bn), owing to (i) expansion in global margins by ~25bp qoq; and (ii) steady credit off-take of 25.4% yoy (up 4.4% qoq). Domestic CD ratio has increased by ~270bp yoy and qoq to ~72%.
- **...as margins expand:** NIMs were reported at 2.89% on domestic portfolio, a 32bps qoq rise as loan spreads increased owing to re-pricing of high cost deposits garnered in FY09. At the same time, costs in the overseas business declined by 16bps qoq, more than offsetting the decline in yields, leading to 11bp qoq rise in NIMs to 1.59%. (Exhibit 1)
- **Other income in line; healthy momentum in CEB:** Non-interest income grew by ~25% yoy to Rs6.0bn (in line with estimates). Treasury profits came in at Rs1.2bn (12% of operating profit). Non-trading income has grown at a robust 24% yoy to Rs4.7bn aided by strong growth in recoveries. CEB income has increased at a healthy 18% yoy, though lower than BoB's high growth trajectory owing to (i) increase in competitive intensity in context of ample liquidity during the quarter, and (ii) lower domestic credit-off take. Incidental charges remained flat yoy reflecting the slower credit demand. (Exhibit 3)
- **Lower provisions bolster bottom-line:** During the quarter, BoB's provisions at Rs1.16bn (decline of 52% yoy), were lower than expectations on the back of Rs611m of MTM write-back on investments (of which 90%+ is indicated to flow from overseas investments). Of this specific loan loss provisions came in at Rs1.7bn. NPA provisions to avg loans decreased to 0.47% from 0.85% in Q1FY10. (Exhibit 6)
- **Domestic credit off-take muted; growth in the overseas book:** During Q2FY10, BOB reported loan growth of ~25% yoy to Rs1489bn. The bank's foreign loan book has grown by a strong ~39% yoy and 9% qoq. At the same time, domestic advances increased by a lower ~21% yoy (up 3% qoq) due to weak credit demand. Retail credit is up by ~6% qoq to Rs214bn, while large corporate loans came off marginally on a qoq basis – a function of strategy of letting bulk advances run-off. (Exhibit 4)

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- **CASA inches up:** CASA ratio (as a proportion of domestic deposits) came in at 36.2% as of September '09, a ~110bp qoq improvement likely buoyed by momentum in saving deposits. CASA deposits have grown by 24% yoy, while domestic term deposits are up ~22% yoy. Consequently, on a yoy basis also CASA is up by 30bp. During the quarter, BoB's deposits grew by 29% yoy to Rs2074bn driven by ~56% yoy growth in foreign deposits and 23% yoy growth in local deposits. (Exhibit 2)
- **Gross NPAs decline; negligible incremental restructurings:** Gross NPAs decreased by ~14bp qoq to 1.30% (a decline of Rs1.1bn in absolute terms), owing to higher write-offs. Net NPAs remained stable sequentially at 0.27%. Consequently, provision coverage has come-off marginally by 240bps to 79.3%, while still remaining at elevated levels. The bank restructured ~Rs3bn of advances during Q2FY10, amounting to 0.2% of net advances, taking the cumulative restructured assets to 3.1% of net advances. (Exhibit 5)
- **Comfortably capitalized:** BoB's CRAR stands at 14.57% as of September '09, with a Tier-I ratio of 8.86%. Tier-II CRAR was bolstered by a bond issue of Rs5bn during the quarter.

VALUATIONS & VIEW

Bank of Baroda (BoB) reported net profit of Rs6.3bn in Q2FY10 (well ahead of our estimates) buoyed by lower provisions and traction in NII. Notably, margins expanded by ~25bps qoq bolstered by re-pricing of high cost deposits garnered in FY09. Fee income increased at a healthy pace while CASA also inched up. Asset quality remained strong with Gross NPAs declining sequentially, negligible incremental restructurings and elevated provisioning coverage. We believe yields have bottomed-out, and expect a steep deposit re-pricing over the next few quarters to augment margins. We are upgrading our FY10 and FY11 earning estimates by 5% and 5.7% after building in the impact of (i) higher margins and (ii) lower provisioning expenses – a function of better visibility on asset quality front. We expect a 20% CAGR in profits over FY09-11E, with an average ROE of ~22% over the next couple of years. Stock currently trades at 1.4x FY10E and 1.2x FY11E adjusted book value. Reiterate Outperformer, with a 12-month price target of Rs635 (1.5x FY11E ABV).

Quarterly results

P&L (Rs mn)	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	FY09	FY10E	FY11E	Comments
Interest income	35,510	41,080	41,388	40,321	41,354	150,916	171,321	207,163	
Interest expenses	24,172	26,462	26,680	28,274	27,468	99,682	111,814	135,969	
Net interest income	11,338	14,618	14,708	12,047	13,886	51,234	59,507	71,194	NII surpasses than estimates as margins expand
<i>yoy growth (%)</i>	<i>15.52</i>	<i>46.55</i>	<i>43.00</i>	<i>13.97</i>	<i>22.48</i>	<i>16.1</i>	<i>19.6</i>	<i>14.9</i>	
Net revenue	16,097	23,083	23,244	19,077	19,839	78,811	86,828	98,799	
Non fund income	4,759	8,465	8,536	7,030	5,953	27,577	27,321	27,606	
Trading profits	923	4,159	3,010	2,554	1,205	9,001	5,400	3,000	Steady at ~12% of operating profit
Fee Income	3,837	4,306	5,526	4,476	4,748	18,576	21,921	24,606	18% yoy growth in CEB as excess liquidity drives escalation in competition and low credit growth
Operating expenses	7,641	9,627	10,199	8,978	9,523	35,761	37,968	41,226	Rs450mn of AS-15 provisions made
Operating profit	8,456	13,456	13,045	10,099	10,316	43,050	48,861	57,574	
<i>yoy growth (%)</i>	<i>33</i>	<i>44</i>	<i>83</i>	<i>17</i>	<i>22.0</i>				
Provisions	2,419	3,501	2,097	(390)	1,163	9,621	5,208	7,803	NPA provisions of Rs1.7bn made; MTM write-back of Rs661m - bulk on the overseas investment book
PBT	6,037	10,646	10,947	10,489	9,153	33,429	43,653	49,771	
Tax	2,084	3,562	3,421	3,635	2,811	11,157	15,497	17,669	
PAT	3,953	7,084	7,527	6,854	6,342	22,272	28,156	32,102	Strong quarter, with evident signs of improvement in core performance
<i>yoy growth (%)</i>	<i>20.8</i>	<i>41.4</i>	<i>326.6</i>	<i>84.8</i>	<i>60.4</i>	<i>55.1</i>	<i>26.4</i>	<i>14.0</i>	

Quarterly results

Ratios (%)	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	FY09	FY10E	FY11E	Comments
NIMs - Reported	2.8	3.61	2.91						Margins surprise positively as high cost deposits re-price, incremental credit flow to SMEs might have aided yields
NIMs - calculated	2.42	3.00	2.75	2.08	2.34	2.52	2.38	2.39	
Non-fund income/Avg assets	1.0	1.7	1.6	1.2	1.0	1.4	1.1	0.9	
Core fee incom/avg assets	0.8	0.9	1.0	0.8	0.8	0.7	0.9	0.8	
Trading income / pre provision profit	10.9	30.9	23.1	25.3	11.7	20.9	11.1	5.2	
Operating exp/avg assets	1.6	2.0	1.9	1.6	1.6	1.8	1.5	1.4	
Cost/Net rev.	47.5	41.7	43.9	47.1	48.0	45.4	43.7	41.7	
Prov/avg assets	0.5	0.7	0.4	(0.1)	0.2	0.47	0.21	0.26	
PBT/Avg assets	1.3	2.2	2.0	1.8	1.5	1.64	1.74	1.67	
RoA	0.8	1.5	1.4	1.2	1.1	1.09	1.12	1.08	
Tax/PBT	34.5	33.5	31.2	34.7	30.7	33.4	35.5	35.5	
CRAR	12.86	12.75	14.05	14.56	14.57				Raised Rs5bn of Tier-II bonds
Tier-I CRAR	7.75	8.5	8.49	8.81	8.86				Well capitalized for growth
Overall CD ratio	73.7	75.4	74.8	71.8	71.8				Domestic CD ratio up ~270bp yoy and qoq to ~72%
Balance Sheet (Rs bn)									
Credit	1,188	1,272	1,440	1,427	1,489				Domestic book up 21% yoy (4% qoq)
yoy change (%)	31.6	33.2	34.9	28.3	25.4				
Deposits	1,611	1,686	1,924	1,986	2,074				
yoy change (%)	22.6	23.2	26.5	28.2	28.7				

Calculated ratios are on average quarterly balance

Exhibit 1: Margins expand...

Reported	Q2FY09	Q1FY10	Q2FY10	yoy chg (bps)	qoq chg (bps)
Domestic					
Yield on advances	11.13	10.10	10.23	(90)	13
Cost of Deposits	6.20	6.16	5.87	(33)	(29)
Loan Spreads	4.93	3.94	4.36	(57)	42
NIMs	2.92	2.57	2.89	(3)	32
Foreign					
Yield on advances	5.08	4.69	4.48	(60)	(21)
Cost of Deposits	3.34	2.65	2.49	(85)	(16)
Loan Spreads	1.74	2.04	1.99	25	(5)
NIMs	2.06	1.48	1.59	(47)	11

- Domestic NIMs up ~32bps qoq as high cost deposits re-price
- Yields hold up as the bank focuses on trimming bulk advances and bulk of the incremental credit flows to SME segment

Exhibit 2: ...aided up uptick in CASA

Rs m	Sep-08	Jun-09	Sep-09	yoy gwth (%)	qoq gwth (%)
Global Deposits	1,611	1,986	2,074	28.7	4.4
Foreign Deposits	301	442	467	55.6	5.8
Local Deposits	1,310	1,544	1,606	22.6	4.0
Domestic Term deposits	840	1,002	1,025	22.0	2.3
CASA deposits (Rs m)	470	542	581	23.6	7.2
CASA as % of dom dep	35.9	35.1	36.2	30	107.0

- CASA moves up on a yoy as well as qoq basis likely buoyed by momentum in saving deposits
- Bank continues to shed bulk deposits - down to 15% from 25% in Q1FY10

Exhibit 3: Non-interest income break up

Rs mn	Q2FY09	Q1FY10	Q2FY10	yoy gwth (%)	qoq gwth (%)
Other Income	4,759	7,030	5,953	25.1	(15.3)
Trading profits	923	2,554	1,205	30.6	(52.8)
Non-trading income	3,837	4,476	4,748	23.8	6.1
CEB	1,632	2,010	1,921	17.7	(4.5)
Forex income	551	963	842	52.9	(12.6)
Recoveries	437	499	666	52.5	33.4
Incidental charges	783	1,000	780	(0.3)	(22.0)
Misc. others	393	3	535	36.1	NM

- Traction in non-interest income on the back of strong recoveries and yoy growth in forex
- CEB healthy, though impacted by escalated competitive intensity and lower credit off-take

Exhibit 4: Composition of loan book

Rs bn	Q2FY09	Q1FY10	Q2FY10	yoy growth (%)	% of total advances
Total advances	1,188	1,427	1,489	25.4	
Foreign advances	282	361	393	39.5	26.4
Domestic advances	906	1,066	1,096	21.0	73.6
Of which:					
Retail	177	202	214	20.6	14.4
Agriculture	146	180	186	27.0	12.5
SME	127	151	167	31.4	11.2
Others (Corporate)	455	532	530	16.4	35.6
Total	906	1,066	1,096	21.0	73.6

- Domestic credit grew by ~21% yoy; overall growth at ~25% yoy
- Bulk of the incremental credit in Q2 towards SME and retail, bulk advances decline by Rs68bn yoy

Exhibit 5: Asset quality steady

	Q2FY09	Q1FY10	Q2FY10	yoy gwth / chg	qoq gwth / chg
Gross NPAs (Rsm)	19,544	20,682	19,566	0	(5)
Gross NPAs (%)	1.62	1.44	1.3	(32)	(14)
Net NPAs (Rs m)	5,092	3,786	4,053	(20)	7
Net NPAs (%)	0.43	0.27	0.27	(16)	-
Loan loss coverage	73.9	81.7	79.3	534	(241)

- Gross NPAs down 14bp qoq (Rs1.1bn), due to aggressive write-offs
- Negligible incremental restructuring; cumulative at 3.1% of net advances

Exhibit 6: Provisioning expenses breakup

Rs mn	Q2FY09	Q1FY10	Q2FY10
NPA provision	227	3,044	1,722
Investment depreciation	1,189	(3,600)	(611)
Other provisions	1,002	167	52
Total Provisions	2,419	(390)	1,163

- 90%+ of MTM write-back on investments is indicated to flow from overseas investments
- NPA prov to avg loans down to 0.47% from 0.85% in Q1FY10

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