

## Bank of Baroda

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,374	BOB IN
	REUTERS CODE
S&P CNX: 2,851	BOB.BO

13 January 2006

**Buy**

*Previous Recommendation: Buy*

**Rs243**

Equity Shares (m)	294.5
52-Week Range	274/171
1,6,12 Rel.Perf.(%)	-6/-17/-41
M.Cap. (Rs b)	71.1
M.Cap. (US\$ b)	1.6

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)
3/05A	42,841	6,768	23.0	-30.0	10.5	1.3	12.6	12.6	0.8	1.4
3/06E	41,258	8,300	22.7	-1.2	10.6	1.2	14.1	12.3	0.8	1.2
3/07E	46,084	10,352	28.3	24.7	8.5	1.1	13.5	12.6	0.9	1.1

Price Band	Rs210-230
Recommendation	Subscribe

### Background

Bank of Baroda (BoB) is amongst the top five state-owned banks. BoB proposes to issue 71m equity shares to the public. This offer will be made at a price band of Rs210-230, which will be calculated through a 100% book building process. The issue will be open from 16-20 January 2006. A 10% reservation for existing eligible employees will be available. The issue will constitute 19.5% of the total post-issue paid-up equity capital of the bank. It is expected that the price band will be announced shortly.

Issue opens	16th January 2006
Closes dates	20th January 2006
Final pricing date	N/A
Listing date	N/A

### Issue details

The proposed issue will reduce the government holding in the bank from 66.83% to 53.81%. The objective of the issue is to enhance the bank's capital adequacy, which will, in turn, help the bank support future credit growth and whilst meeting Basel II norms.

Equity Shares o/s	(M)
Prior to the Issue	294.5
Post Issue	365.5

### FPO DETAILS

PARTICULARS	EQUITY SHARES (M)	% OF TOTAL
<b>Issue</b>	<b>71</b>	<b>100</b>
<i>Of which:</i>		
<b>Reservation for Eligible Employees</b>	<b>7.1</b>	<b>10</b>
<b>Net issue to the public</b>	<b>At least 63.9</b>	<b>90</b>
<i>Of which:</i>		
Qualified Institutional Buyers	Up to 31.95	50
<i>Of which:</i>		
Reservation for MFs	Up to 1.597	5
Balance for all QIBs (Incl MFs)	Up to 30.353	95
Non-Institutional portion	At least 9.585	15
Retail Portion	At least 22.365	35
Equity shares o/s prior to the issue	293	
Equity shares o/s post issue	364	

Bank of Baroda is among the top five public sector banks in India with an extensive countrywide network of around 2,700 branches. While a majority of its business is sourced from western and northern India, its 59 overseas-based offices contribute 15% to the bank's business and 9% to its total income.

### **Loan growth picking up**

Following up on slow credit growth over FY02-FY05, loan growth has been strong for the last three quarters. During 1HFY06, credit growth has remained strong at 31% YoY. Given the strong credit momentum, we expect loan book growth to remain strong going forward as well at 26% during FY06 and at 20% in FY07.

### **Interest margins decline; should stabilize in FY07**

Interest margins for Bank of Baroda have already declined to 3.35% during 1HFY06. On account of the investment book getting repriced downward, the interest margins might decline further during FY06. We however believe incremental margins could improve, as loan growth for the bank is likely to remain strong and the bank can use all its incremental deposits for loans (BoB has excessive SLR on its books), wherein the margins are better.

### **Investment book — cushioned upto a yield of 7.25%**

Currently 60% of its SLR book is in the Held to Maturity (HTM) category, which substantially de-risks the investment portfolio. The Available-for-Sale (AFS) portfolio has an average duration of around 2.8 years and a cushion up to 7.25%.

Though lower credit growth and surplus SLR investments had served as a drag for BoB previously, these very parameters could turn advantageous, as the surplus SLR investments can now be liquidated to fund future credit growth.

### **Asset quality**

Improvement in asset quality has been the key positive for BoB over the last few quarters. Its net non-performing assets (NPAs) are currently at 1.13% and expected to decline to below 1% by March 2006. We expect lower incremental provisioning and strong recoveries, which could directly flow through the profit and loss (P&L) account to have a positive impact on financials going forward.

### **Technology — a major focus area**

BoB's technology transformation is already underway. The total cost of the technology plan and its re-branding exercise is estimated at Rs6bn (includes core banking solutions, CBS) in 1,979 branches by FY09. During the first phase we expect BoB to have 125 key branches under CBS by FY06 and a total of 600 branches, incorporating CBS, by FY07.

With a view to transform itself into a customer-centric banking organization enabled by modern technology, the bank has commissioned a Business Transformation Program. Under this program, the bank has engaged Hewlett Packard in April 2005 as a Strategic Technology Partner, to build, operate and transfer (BOT model) the entire IT systems of the bank across the entire gamut of the bank's operations over a 5-year period. The program aims at transforming the way the bank executes the business and the manner in which it delivers services to its customers. The bank will embrace global best practices and delivery standards to provide state-of-the-art banking to its customers.

### **Improving its brand image**

BoB has taken the initiative to establish its own brand by creating a new logo 'Baroda Sun' and selecting cricket icon, Rahul Dravid, to be the brand ambassador. In a bid to improve customer service and ensure convenience, the working hours of its 355 branches have been extended to 12 hours from 8 am to 8 pm and that of seven branches to 24 hours a day. The bank also plans to utilize its surplus manpower to market its products and services. These

initiatives appear to be paying off. During a recent drive to mobilize savings deposits, the bank garnered some Rs6.5b by adding over a million customers in a month.

## Concerns

### Low RoE and low return on assets

Bank of Baroda is likely to have low RoEs in the range of 12%-14% post the issue, which could restrict improvement in valuations. But as earnings momentum improves, RoE too is expected to improve post-FY07. Further the bank is also likely to use the incremental capital for life insurance, which might not result in immediate benefits and hence suppress RoE.

### FII limit at 18%

The current Foreign Institutional Investor (FII) holding in the bank is at 18%. Thus, nearly 80% of the entire Rs16b (assuming the issue price per share at Rs225) will be for domestic investors. We expect the FII limit to be fully exhausted (at 20%) post the issue, which might restrict improvement in valuations in the near term.

## Valuation

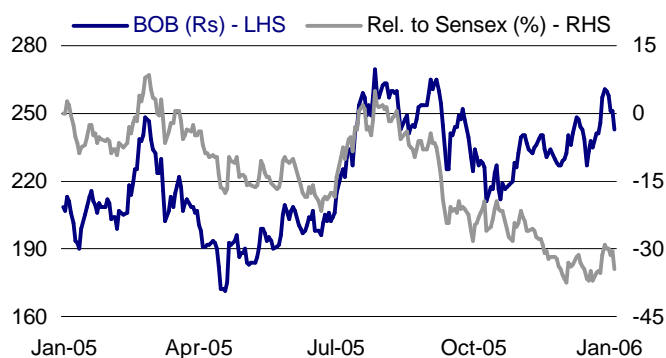
The follow-on offer will not only meet the Basel II requirements, but will also allow the bank to grow its core business, without creating concerns about the capital.

Significant drivers for improvement in RoA are lower investment depreciation, lower bad debt provisions and also lower overheads.

Transferring a considerable amount of securities to HTM and the shift to credit will pose a lower interest rate risk than previously. Absence of employees' Voluntary Retirement Charges (VRS) will also benefit the bank's cost structure.

While low RoEs remain a concern, we believe that the current valuations at 1.1x FY07 BV and 8.5x FY07 earnings appear attractive. At the upper end of the issue band, the stock is available at 1x FY07E BV. We recommend **Subscribe**.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	61,471	64,314	70,551	82,063	94,450
Interest Expended	35,755	34,521	38,831	45,964	53,068
<b>Net Interest Income</b>	<b>25,716</b>	<b>29,793</b>	<b>31,721</b>	<b>36,098</b>	<b>41,383</b>
Change (%)	22.3	15.9	6.5	13.8	14.6
Other Income	17,190	13,048	9,537	9,986	10,724
<b>Net Income</b>	<b>42,906</b>	<b>42,841</b>	<b>41,258</b>	<b>46,084</b>	<b>52,107</b>
Change (%)	27.5	-0.2	-3.7	11.7	13.1
Operating Expenses	18,053	19,822	22,010	24,805	27,687
<b>Operating Income</b>	<b>24,853</b>	<b>23,019</b>	<b>19,248</b>	<b>21,279</b>	<b>24,420</b>
Change (%)	44.8	-7.4	-16.4	10.6	14.8
Other Provisions	9,524	14,388	7,800	7,000	7,000
<b>PBT</b>	<b>15,329</b>	<b>8,631</b>	<b>11,448</b>	<b>14,279</b>	<b>17,420</b>
Tax	5,659	1,863	3,148	3,927	4,790
Tax Rate (%)	36.9	21.6	27.5	27.5	27.5
<b>PAT</b>	<b>9,670</b>	<b>6,768</b>	<b>8,300</b>	<b>10,352</b>	<b>12,629</b>
Change (%)	25.1	-30.0	22.6	24.7	22.0
Proposed Dividend	1,906	1,670	2,193	2,559	2,559

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Capital	2,945	2,945	3,655	3,655	3,655
Reserves & Surplus	48,364	53,332	74,704	82,498	92,569
<b>Net Worth</b>	<b>51,309</b>	<b>56,278</b>	<b>78,359</b>	<b>86,153</b>	<b>96,224</b>
<b>Deposits</b>	<b>729,673</b>	<b>813,335</b>	<b>927,201</b>	<b>1,057,010</b>	<b>1,204,991</b>
Change (%)	9.8	11.5	14.0	14.0	14.0
Borrowings	8,751	16,408	20,000	23,000	26,000
Other Liabilities & Provisions	61,353	60,622	66,684	73,352	80,688
<b>Total Liabilities</b>	<b>851,087</b>	<b>946,642</b>	<b>1,092,245</b>	<b>1,239,515</b>	<b>1,407,903</b>
Current Assets	72,668	92,542	95,420	96,827	107,713
Investments	380,188	370,744	396,697	428,432	462,707
Change (%)	26.0	-2.5	7.0	8.0	8.0
Advances	356,009	434,004	546,845	656,214	774,332
Change (%)	0.7	21.9	26.0	20.0	18.0
Net Fixed Assets	8,153	8,608	8,466	8,742	8,921
Other Assets	34,069	40,744	44,818	49,300	54,230
<b>Total Assets</b>	<b>851,087</b>	<b>946,642</b>	<b>1,092,245</b>	<b>1,239,515</b>	<b>1,407,903</b>

ASSUMPTIONS	(%)	(%)
Deposit Growth	9.8	14.0
Advances Growth	0.7	18.0
Investments Growth	26.0	8.0
Average PLR	10.0	10.0
Dividend	65.0	70.0
CRR	4.5	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning A	8.1	7.6	7.2	7.3	7.3
Avg. Cost-Int. Bear. L	5.1	4.4	4.4	4.5	4.6
Interest Spread	3.0	3.2	2.9	2.7	2.8
Net Interest Margin	3.4	3.5	3.3	3.2	3.2

Profitability Ratios (%)					
RoE	20.3	12.6	12.3	12.6	13.8
RoA	12	0.8	0.8	0.9	10
Int. Expended/Int. Earr	58.2	53.7	55.0	56.0	56.2
Other Inc./Net Income	40.1	30.5	23.1	21.7	20.6

Efficiency Ratios (%)					
Op. Exps./Net Income	42.1	46.3	53.3	53.8	53.1
Empl. Cost/Op. Exps.	69.4	69.7	65.2	64.5	63.8
Busi. per Empl. (Rs m)	27.3	31.6	35.1	42.9	51.7
NP per Empl. (Rs mln)	0.2	0.2	0.2	0.3	0.4

Asset-Liability Profile (%)					
Adv./Deposit Ratio	48.8	53.4	59.0	62.1	64.3
Invest./Deposit Ratio	52.1	45.6	42.8	40.5	38.4
G-Sec/Invest. Ratio	75.7	79.2	79.2	79.2	79.2
Gross NPAs to Adv.	10.3	7.2	5.8	4.9	4.1
Net NPAs to Adv.	2.9	1.4	1.0	0.8	0.5
CAR	13.9	12.6	14.1	13.5	13.1
Tier 1 (inc. IFR)	8.5	8.2	10.8	10.0	9.6

VALUATION					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Book Value (Rs)	165.3	182.2	207.2	228.5	256.1
Price-BV (x)	15	13	12	1.1	0.9
Adjusted BV (Rs)	142.3	168.5	197.3	219.7	249.0
Price-ABV (x)	1.7	1.4	1.2	1.1	1.0
EPS (Rs)	32.8	23.0	22.7	28.3	34.6
EPS Growth (%)	25.1	-30.0	-12	24.7	22.0
Price-Earnings (x)	7.3	10.5	10.6	8.5	7.0
OPS (Rs)	84.4	78.2	52.7	58.2	66.8
OPS Growth (%)	44.7	-7.4	-32.6	10.6	14.8
Price-OP (x)	2.9	3.1	4.6	4.1	3.6

E: MOST Estimates

**N O T E S**



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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 |

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