

## Bank of India

STOCK INFO. BLOOMBERG  
 BSE Sensex: 9,871 BOI IN  
 REUTERS CODE  
 S&P CNX: 2,983 BOL.BO

27 January 2006

**Buy**

*Previous Recommendation: Buy*

**Rs134**

		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)
Equity Shares (m)	488.1	3/05A	33,927	3,401	7.0	-66.3	19.2	1.5	11.5	8.0	0.4	2.0
52-Week Range	148/73	3/06E	36,764	6,448	13.2	89.6	10.1	1.4	13.0	13.7	0.6	1.6
1,6,12 Rel.Perf.(%)	3/-32/11	3/07E	42,091	8,764	18.0	35.9	7.4	1.2	12.0	16.5	0.7	1.3
M.Cap. (Rs b)	65.2											
M.Cap. (US\$ b)	1.5											

Bank of India (BoI) reported earnings growth of 91% to Rs1.4b on a lower base, as the corresponding quarter last year experienced investment losses. In core business, reported net interest income (NII) increased 6% YoY to Rs6.57b. However after adjusting for amortization expenses, NII grew 17% YoY. Improvement in asset quality continued with significant declines in gross and net NPAs, underpinned by robust cash recoveries and aggressive write-offs.

- ✍ NII grew by 17% (excluding amortization expenses)
- ✍ Treasury profits flat; core fee income grew at 12%
- ✍ Expenses on core banking solutions resulted in higher C/I ratio
- ✍ Asset quality improved with net NPAs at 1.98%

With management's intention to lower net NPAs to 1.5% by FY06 and resultant higher NPA provisions in the last three quarters, we have revised downward our earnings estimates by 14% for FY06 and by 5% for FY07 respectively. We expect BoI's profit to grow by 90% in FY06 and by 36% in FY07 respectively. The stock trades at a P/E of 7.4x FY07E and P/BV of 1.2x FY07E. We maintain **Buy**.

Y/E MARCH	QUARTERLY PERFORMANCE										(RS MILLION)	
	FY05				FY06				FY05	FY06E		
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
Interest Income	14,087	15,220	15,099	15,910	15,645	16,614	18,006	18,808	60,315	69,073		
Interest Expense	8,702	9,263	8,908	11,074	10,056	10,828	11,440	11,960	37,946	44,284		
<b>Net Interest Income</b>	<b>5,384</b>	<b>5,957</b>	<b>6,191</b>	<b>4,837</b>	<b>5,590</b>	<b>5,786</b>	<b>6,566</b>	<b>6,848</b>	<b>22,369</b>	<b>24,789</b>		
% Change (Y-o-Y)	0.8	18.5	3.9	-15.0	3.8	-2.9	6.1	41.6	1.6	10.8		
Other Income	2,750	2,598	2,334	3,876	2,944	3,031	2,625	3,375	11,558	11,975		
<b>Net Income</b>	<b>8,134</b>	<b>8,555</b>	<b>8,525</b>	<b>8,713</b>	<b>8,533</b>	<b>8,818</b>	<b>9,191</b>	<b>10,223</b>	<b>33,927</b>	<b>36,764</b>		
% Change (Y-o-Y)	-6.3	-13.9	-12.5	-24.7	4.9	3.1	7.8	17.3	-15.0	8.4		
Operating Expenses	4,528	4,643	4,717	5,436	4,867	5,517	5,444	5,513	19,323	21,340		
<b>Operating Profit</b>	<b>3,607</b>	<b>3,912</b>	<b>3,808</b>	<b>3,277</b>	<b>3,666</b>	<b>3,301</b>	<b>3,747</b>	<b>4,710</b>	<b>14,604</b>	<b>15,424</b>		
Other Provisions	1,332	3,138	2,684	2,840	1,392	1,521	1,804	2,334	9,993	7,050		
<b>Profit Before tax</b>	<b>2,274</b>	<b>774</b>	<b>1,124</b>	<b>437</b>	<b>2,275</b>	<b>1,780</b>	<b>1,943</b>	<b>2,376</b>	<b>4,610</b>	<b>8,374</b>		
Tax Provisions	648	279	374	-91	557	459	512	398	1,210	1,926		
<b>Net Profit</b>	<b>1,627</b>	<b>495</b>	<b>750</b>	<b>528</b>	<b>1,717</b>	<b>1,322</b>	<b>1,431</b>	<b>1,978</b>	<b>3,401</b>	<b>6,448</b>		
% Change (Y-o-Y)	-20.2	-78.2	-67.2	-84.9	5.6	166.8	90.7	274.7	-66.3	89.6		
Cost to Income Ratio (%)	55.7	54.3	55.3	62.4	57.0	62.6	59.2	53.9	57.0	58.0		
Interest Expense/Interest Income (%)	61.8	60.9	59.0	69.6	64.3	65.2	63.5	63.6	62.9	64.1		
Other Income/Net Income (%)	33.8	30.4	27.4	44.5	34.5	34.4	28.6	33.0	34.1	32.6		

E: MOST Estimates

Bank of India reported earnings growth of 91% to Rs1.4b in 3QFY06, on a lower base, as the corresponding quarter of the previous year experienced investment losses. In the core business reported NII increased 6% YoY to Rs6.57b. However after adjusting for amortization expenses, NII has grown by 17% YoY. Improvement in asset quality continued with significant declines in the gross and net NPAs, backed by robust cash recoveries and aggressive write-offs.

### NII grows by 17% (excluding amortization expenses)

While on a reported basis, NII increased by 6% YoY to Rs6.6b, actual NII grew 17% YoY after adjusting for amortization expenses. Owing to the bank's accounting method of booking amortization expenses as a part of interest expenses, NII growth was impacted. During the quarter, the bank has booked amortization expenses of Rs680m as a part of interest expenses as against NIL booked in 3QFY05 (these are normally treated as provisions). Since the amortization expenses have remained high during FY06 (80% of its investment book is present in the HTM category), reported NII growth has remained subdued over the last three quarters. However, on a reported basis 4QFY06 will result in high NII growth as amortization expenses for the full year FY05 was booked during 4QFY05, resulting in lower NII for 4QFY05.

#### NII BREAKDOWN (RS M)

	3QFY06	3QFY05	GR. (%)
Interest Income	18,006	15,099	19.3
Interest Expenses	11,440	8,908	28.4
Reported NII	6,566	6,191	6.1
Amortization Expenses	680	0	
Adjusted NII	7,246	6,191	17.0

Source: Company/Motilal Oswal Securities

Excluding amortization expenses, the spreads have increased to 2.65% (impact of 27bp added from amortization cost) compared with 2.49% in FY05. The expansion was the result of an increase in the yield on advances to 7.59% from 7.05% in 3QFY05 and a contraction in the cost of deposits to 4.1% from 4.16%.

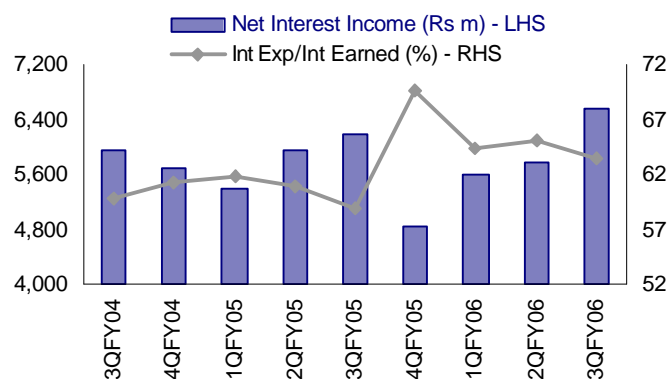
While domestic spread for the bank is closer to 3%, its international operations (20% of the bank's asset book) have spreads of 1.35%.

### Business momentum steady

Business momentum remained steady in 3QFY06. Deposits grew by 14% to Rs878b, while loan book grew by 16% to Rs627b (advances in India grew by 19% YoY)

While 19% loan growth has been below industry standards, management has stated that they have been selective in loan book expansion so as to maintain asset quality. Within loans, retail continued its growth momentum, recording an increase of 34% and currently constitutes over 27% of non-food advances. Amongst retail advances, the home loans and mortgages were the fastest growing segments. Advances to the agricultural sector registered growth of 54% YoY. BoI expects retail, small and medium enterprises (SME), and agriculture to drive loan growth and thereby derive better yields.

#### TREND IN NET INTEREST INCOME



Source: Company/Motilal Oswal Securities

### Flat treasury profits; core fee income grows at 12% YoY

BoI's profits from treasury were flat YoY at Rs235m YoY. On the core fee income front too, the bank posted growth of 12% YoY to Rs2.4b in 3QFY06.

The bank holds a largely de-risked portfolio. Of the domestic SLR portfolio, 80% is in the HTM category. The remaining

investments under the AFS category comprise treasury bills with a maturity profile of less than a year. The bank has also been focusing on gradually lowering the duration for its entire investment book, which is now closer to 3.5 years.

### Expenses on core banking solutions result in higher C/I ratio

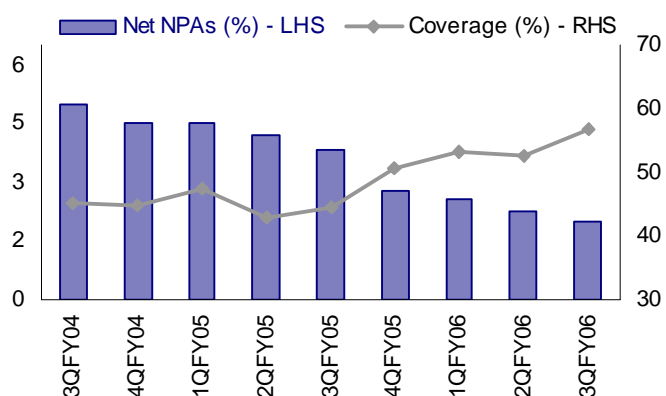
Operating expenses of the bank include approximately Rs200m on account of implementation of its core banking solutions, which resulted in an increase of 390bp YoY in the C/I ratio to 59%. Excluding these, growth in operating expenses was modest. These expenses are likely to continue in future since the bank is gearing up in technology and envisages bringing 750 branches under the CBS (core banking solutions) umbrella. This accomplishment should cover 80% of its business by June 2006 compared with 418 branches at end-December 2005. Management has also stated that Bank of India has been expensing the CBS under the head expenditure rather than capitalizing it, thereby taking a higher charge on profitability during the current financial year.

### Asset quality improves with net NPAs at 1.98%

The bank has witnessed sharp improvement in its asset quality on the back of aggressive provisioning and strong recoveries. Net NPAs have declined sharply by 187bp from 3.85% as on December 2004 to 1.98% as on December 2005 (QoQ decline of 25bp). Even the gross NPAs have declined YoY from 6.73% to 4.47% at 3QFY06 (QoQ decline of 12bp). In absolute terms, they declined by Rs8.4b, to Rs28b from Rs36b. The provision cover of the bank improved to 57% from 44% in 3QFY06. The bank continues to have higher cash recoveries compared with slippages

during 9MFY06. The management continues to expect strong recoveries to continue in future as well, even as provisioning requirement is expected to decline as net NPAs have declined sharply. The bank also has Rs16b in written off accounts, which can kick off strong recoveries.

TREND IN NET NPAS



Source: Company/Motilal Oswal Securities

The management has indicated their objective to achieve a gross NPA level of 3.9% and net NPAs of at least 1.5% by end-FY06.

### Valuation and view

With management's intent to bring down the bank's net NPAs to 1.5% by FY06, and the resultant higher provisions for NPAs in the last three quarters, we have revised downward our earnings estimates by 14% for FY06 and by 5% for FY07 respectively. We expect BoI's profit to grow by 90% for FY06 and by 36% for FY07 respectively. The stock trades at a P/E of 7.4x FY07E and P/BV of 1.2x FY07E. We maintain **Buy**.

## Bank of India: an investment profile

### Company description

Bank of India (BoI) was incorporated in 1906 by a group of eminent businessmen in Bombay. It was under private ownership until 1969. Later it was nationalized along with 13 other major banks. The bank is the sixth largest bank (fifth largest state-owned bank) in India assetswise. The bank has a large branch network of 2,594 chiefly present in the western and the eastern regions of India. Over the last 3-4 years, high NPA levels have impacted the bank. The bank is now focusing on cleaning up its NPAs.

### Key investment arguments

- ✍ Asset quality to improve sharply
- ✍ Bank is gearing up on the technology platform
- ✍ Core business expected to do well

### Key investment risks

- ✍ Huge workforce resulting in a higher wage bill
- ✍ Higher NPAs compared with peers

### Recent developments

- ✍ Bank of India (BoI) has raised US\$250m through multi-currency Medium Term Note (MTN) bond issue, priced at 85bp above the London Inter-Bank Offered Rate (LIBOR)

### Valuation and view

- ✍ We expect loan growth of 20% and earnings growth of 90% in FY06
- ✍ Improvement in core RoE, significant clean-up in balance sheet and superior technology platform will drive re-rating
- ✍ The stock trades at a P/E of 7.4x FY07E and P/BV of 1.2x FY07E. We maintain **Buy**

### Sector view

- ✍ Loan growth of 29%+ at the beginning of the capex cycle
- ✍ Volatility in interest rates would impact treasury
- ✍ Benefits of significant improvement in asset quality not yet factored into earnings, valuations
- ✍ We maintain an overweight stance on the sector

#### COMPARATIVE VALUATIONS

		BOI	PNB	VIJAYA BANK
P/E (x)	FY06E	10.1	8.7	10.0
	FY07E	7.4	7.4	6.3
P/ABV (x)	FY06E	1.6	1.6	1.6
	FY07E	1.3	1.3	1.4
RoE (%)	FY06E	13.7	18.9	16.3
	FY07E	16.5	19.0	22.7
RoA (%)	FY06E	0.6	1.2	0.9
	FY07E	0.7	1.3	1.2

#### SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	69.5	69.5	69.5
Domestic Institutions	5.7	5.7	4.3
FII's/FDIs	14.4	14.2	12.1
Others	10.4	10.6	14.1

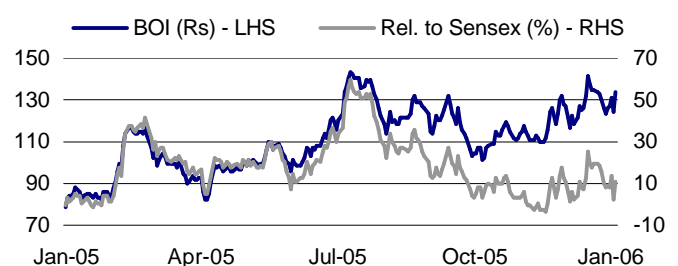
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	13.2	15.20	-13.2
FY07	18.0	18.40	-2.2

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
134	162	20.9	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E March	2004	2005	2006E	2007E	2008E
Interest Income	57,959	60,315	69,073	80,593	93,106
Interest Expended	35,945	37,946	44,284	51,227	58,683
<b>Net Interest Income</b>	<b>22,014</b>	<b>22,369</b>	<b>24,789</b>	<b>29,365</b>	<b>34,424</b>
Change (%)	8.1	16	10.8	18.5	17.2
Other Income	17,920	11,558	11,975	12,726	14,085
<b>Net Income</b>	<b>39,934</b>	<b>33,927</b>	<b>36,764</b>	<b>42,091</b>	<b>48,508</b>
Change (%)	8.6	-5.0	8.4	14.5	15.2
Operating Expenses	17,515	19,323	21,340	23,906	26,897
<b>Operating Income</b>	<b>22,419</b>	<b>14,604</b>	<b>15,424</b>	<b>18,185</b>	<b>21,611</b>
Change (%)	10.4	-34.9	5.6	17.9	18.8
Other Provisions	8,910	9,993	7,050	6,500	6,600
<b>PBT</b>	<b>13,509</b>	<b>4,610</b>	<b>8,374</b>	<b>11,685</b>	<b>15,011</b>
Tax	3,426	1210	1,926	2,921	4,128
Tax Rate (%)	25.4	26.2	23.0	25.0	27.5
<b>PAT</b>	<b>10,083</b>	<b>3,401</b>	<b>6,448</b>	<b>8,764</b>	<b>10,883</b>
Change (%)	18.5	-66.3	89.6	35.9	24.2
Proposed Dividend	1,650	976	1,464	1,708	1,708

BALANCE SHEET					
(Rs Million)					
Y/E March	2004	2005	2006E	2007E	2008E
Capital	4,881	4,881	4,881	4,881	4,881
Reserves & Surplus	35,215	39,767	44,751	51,806	60,981
<b>Net Worth</b>	<b>40,097</b>	<b>44,649</b>	<b>49,632</b>	<b>56,688</b>	<b>65,862</b>
<b>Deposits</b>	<b>710,031</b>	<b>788,214</b>	<b>898,564</b>	<b>1,033,349</b>	<b>1,188,351</b>
Change (%)	10.8	11.0	14.0	15.0	15.0
Borrowings	63,808	79,605	95,525	119,407	133,736
Other Liabilities & Prov	34,664	37,314	41,046	45,150	49,665
<b>Total Liabilities</b>	<b>848,600</b>	<b>949,782</b>	<b>1,084,768</b>	<b>1,254,594</b>	<b>1,437,614</b>
<b>Current Assets</b>	<b>85,579</b>	<b>75,263</b>	<b>73,601</b>	<b>95,091</b>	<b>107,250</b>
Investments	271,629	282,026	304,588	350,277	402,818
Change (%)	11.2	3.8	8.0	15.0	15.0
Advances	458,559	560,126	672,151	772,974	888,920
Change (%)	7.6	22.1	20.0	15.0	15.0
<b>Net Fixed Assets</b>	<b>7,986</b>	<b>8,142</b>	<b>7,779</b>	<b>7,472</b>	<b>6,969</b>
Other Assets	24,847	24,225	26,648	28,780	31,658
<b>Total Assets</b>	<b>848,600</b>	<b>949,782</b>	<b>1,084,768</b>	<b>1,254,594</b>	<b>1,437,614</b>

ASSUMPTIONS					
(%)					
Deposit Growth	10.8	11.0	14.0	15.0	15.0
Advances Growth	7.6	22.1	20.0	15.0	15.0
Investments Growth	11.2	3.8	8.0	15.0	15.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	30.0	20.0	30.0	35.0	35.0
CRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E March	2004	2005	2006E	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning As	7.5	7.0	7.0	7.0	7.1
Avg. Cost-Int. Bear. Lie	4.9	4.6	4.8	4.8	4.7
Interest Spread	2.5	2.4	2.2	2.2	2.3
Net Interest Margin	2.8	2.6	2.5	2.6	2.6

Profitability Ratios (%)					
RoE	26.7	8.0	13.7	16.5	17.8
RoA	13	0.4	0.6	0.7	0.8
Int. Expended/Int. Earne	62.0	62.9	64.1	63.6	63.0
Other Inc./Net Income	44.9	34.1	32.6	30.2	29.0

Efficiency Ratios (%)					
Op. Exps./Net Income	43.9	57.0	58.0	56.8	55.4
Empl. Cost/Op. Exps.	66.9	65.4	63.9	63.0	62.0
Busi. per Empl. (Rs m)	26.0	29.5	34.8	40.8	47.7
NP per Empl. (Rs lac)	2.3	0.8	1.5	2.1	2.7

Asset-Liability Profile (%)					
Adv./Deposit Ratio	64.6	71.1	74.8	74.8	74.8
Invest./Deposit Ratio	38.3	35.8	33.9	33.9	33.9
G-Sec/Invest. Ratio	67.9	70.8	68.9	62.9	57.4
Gross NPAs to Adv.	7.9	5.4	4.5	3.8	3.3
Net NPAs to Adv.	4.5	2.8	1.6	1.2	0.9
CAR	13.0	11.5	13.0	12.0	10.5
Tier 1	7.5	7.1	7.0	6.5	6.5

VALUATION					
Book Value (Rs)	78.6	88.1	98.1	112.6	131.4
Price-BV (x)	1.7	1.5	1.4	1.2	1.0
Adjusted BV (Rs)	51.1	67.4	83.8	100	121
Price-ABV (x)	2.6	2.0	1.6	1.3	1.1
EPS (Rs)	20.7	7.0	13.2	18.0	22.3
EPS Growth (%)	18.5	-66.3	89.6	35.9	24.2
Price-Earnings (x)	6.5	12.2	10.1	7.4	6.0
OPS (Rs)	45.9	29.9	31.6	37.3	44.3
OPS Growth (%)	10.4	-34.9	5.6	17.9	18.8
Price-OP (x)	2.9	4.5	4.2	3.6	3.0

E: MOST Estimates



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**Bank of India**

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|--|----|
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| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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