

Bank of Baroda

STOCK INFO. BLOOMBERG
 BSE Sensex: 9,849 BOB IN
 REUTERS CODE
 S&P CNX: 2.975 BOB.BO

30 January 2006

Buy

Rs258

Previous Recommendation: Buy

		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)	365.5	3/05A	42,841	6,768	23.0	-30.0	11.2	1.4	12.6	12.6	0.8	1.5
52-Week Range	274/171	3/06E	41,838	8,273	22.6	-1.5	11.4	1.2	14.2	12.2	0.8	1.3
1,6,12 Rel.Perf.(%)	2/-29/-24	3/07E	45,917	10,519	28.8	27.1	9.0	1.1	13.6	12.7	0.9	1.2
M.Cap. (Rs b)	94.4											
M.Cap. (US\$ b)	2.1											

Bank of Baroda has reported a 191% (low-base effect) increase in PAT to Rs2.02b, in line with our Rs2.04b estimate. While NII has grown 12% YoY to Rs8.16b, other income has declined by 4%. The substantially improved asset quality (net NPAs at 1.1%) resulted in the bank's provisions declining by 61% to Rs1.93b in 3QFY06 thereby enabling the bank to report 191% growth in earnings for 3QFY06.

- ✍ Loan growth at 34%, NII grows by 12%
- ✍ Non-interest income declines 4% YoY; however, this is higher than our expectations
- ✍ Asset quality improves considerably, net NPAs at 1.1%

With Bank of Baroda focusing on growing its loan book and maintaining stable margins along with improved asset quality, we forecast earnings to grow by 22% in FY06 and 27% in FY07. While the low RoE of 14% is a concern, the stock trades at an attractive valuation of 1.1x FY07E BV and 9x FY07E earnings. We maintain **Buy**.

QUARTERLY PERFORMANCE	(RS MILLION)									
	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	15,284	15,481	15,924	17,625	16,732	16,940	17,754	19,154	64,314	70,581
Interest Expense	8,454	8,598	8,641	8,829	9,145	9,123	9,599	10,814	34,521	38,681
Net Interest Income	6,830	6,883	7,283	8,796	7,587	7,818	8,155	8,341	29,793	31,900
% Change (YoY)	2.8	9.5	12.0	40.0	11.1	13.6	12.0	-5.2	15.9	7.1
Other Income	3,946	3,594	2,843	2,665	2,087	3,096	2,723	2,032	13,048	9,937
Net Income	10,776	10,477	10,126	11,462	9,674	10,913	10,877	10,373	42,841	41,838
% Change (YoY)	23.2	-8.9	-7.9	-1.7	-10.2	4.2	7.4	-9.5	-0.2	-2.3
Operating Expenses	4,811	4,978	4,920	5,112	5,118	5,960	6,102	5,746	19,822	22,926
Operating Profit	5,965	5,499	5,206	6,349	4,556	4,953	4,775	4,628	23,019	18,912
Provision & Contingencies	1,622	2,457	5,008	5,302	2,571	1,257	1,933	1,739	14,388	7,500
PBT	4,343	3,042	198	1,048	1,985	3,696	2,842	2,889	8,631	11,412
Tax Provisions	1,414	909	-498	38	415	1,106	820	797	1,863	3,138
Net Profit	2,930	2,133	695	1,010	1,570	2,591	2,022	2,091	6,768	8,273
% Change (YoY)	19.9	-17.8	-77.3	-35.2	-46.4	21.5	190.7	107.0	-30.0	22.2
Cost to Income Ratio (%)	44.6	47.5	48.6	44.6	52.9	54.6	56.1	55.4	46.3	54.8
Int Exp/ Int Earned (%)	55.3	55.5	54.3	50.1	54.7	53.9	54.1	56.5	53.7	54.8
Other Income / Net Income (%)	36.6	34.3	28.1	23.3	21.6	28.4	25.0	19.6	30.5	23.8

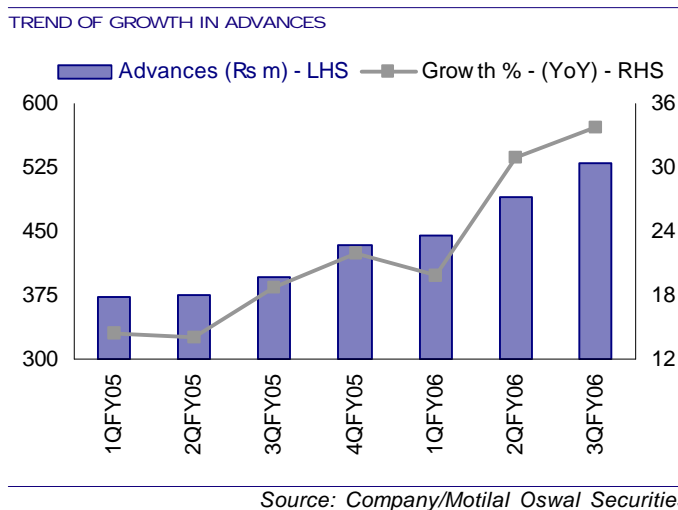
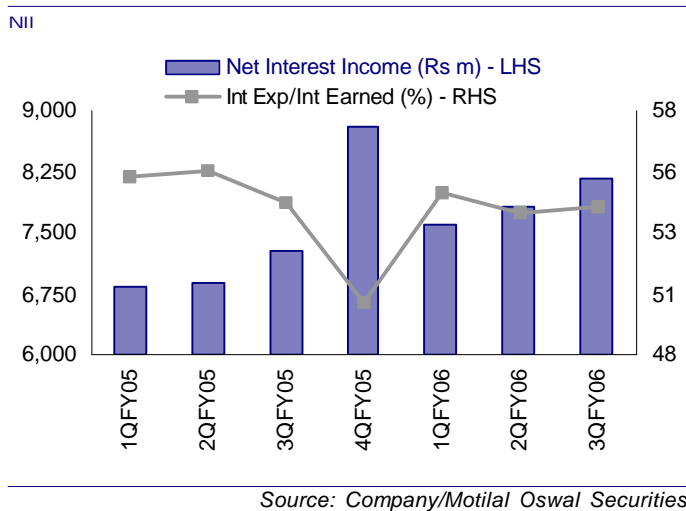
E: M0St Estimates

Bank of Baroda (BoB) has introduced a follow-on-public-offer (FPO) that ended on 20 January 2006. Owing to this, management has not provided all the details of results for the quarter ended December 2005.

Bank of Baroda has reported a 191% (low-base effect) increase in PAT to Rs2.02b, in line with our Rs2.04b estimate. While NII has grown 12% YoY to Rs8.16b, other income has declined by 4%. The substantially improved asset quality (net NPAs at 1.1%) resulted in the bank's provisions declining by 61% to Rs1.93b in 3QFY06 thereby enabling the bank to report 191% growth in earnings for 3QFY06.

Loan growth at 34%; NII up by 12%

Over the last three quarters, the bank has clearly been focusing on growing its loan book, which in turn, has been positive for its NII. Loans grew by 34% to Rs529b. Expansion of the loan book resulted in BoB witnessing a 30% upsurge in interest earned on advances. Global deposits grew by 9% to Rs857b during the quarter. However, growth in interest expense was only 11% YoY to Rs9.6b, signaling an increase in low-cost deposits.

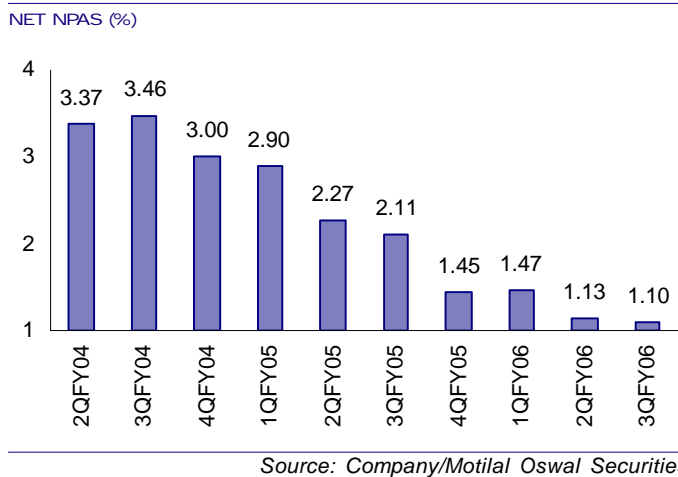


Non-interest other income declines 4% YoY; although higher than expectations

Non-interest other income declined 4% YoY to Rs2.72b, although this number was higher than our expectations of Rs2.2b for 3QFY06.

Asset quality improves considerably, net NPA at 1.1%

Since 3QFY04 asset quality has witnessed significant improvement — net NPAs were down to 1.1% in 3QFY06 from 3.5% in 3QFY04 — commendable performance in just seven quarters. Gross NPAs too have improved by 570bp during the afore-mentioned period to 5.7% at 3QFY06. This was largely possible owing to strengthening of the risk-management systems during the stated period, resulting in reduced slippages. During the period the bank also witnessed strong recoveries of its bad loans.



FPO update

Bank of Baroda has successfully raised Rs16.33b by issuing 71m shares at Rs230 a share. The issue was oversubscribed 14.52 times. Following this, the government's holding in the bank has decreased from 66% to 53%. The new shares are likely to be listed on 6 February 2006.

Valuation and view

With Bank of Baroda focusing on growing its loan book and maintaining stable margins along with improved asset quality, we forecast earnings to grow by 22% in FY06 and 27% in FY07. While the low RoE of 14% is a concern, the stock trades at an attractive valuation of 1.1x FY07E BV and 9x FY07E earnings. We 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 Rs947b and a large network of 2,700+ domestic branches, 57+ overseas offices and 500+ ATMs. 60% of its branches are located in the rural and semi-urban regions of India. Prior to the recent issue that closed on 20 January 2006, the government's holding was 66.8%.

Key investment arguments

- ✍ After remaining flat for a year, loan growth has picked up momentum.
- ✍ Net NPAs have come down to 1.1%.
- ✍ We expect earnings to be boosted, as FY05 was the last year of VRS write-off.

Key investment risks

- ✍ Delay in the upgradation of its technology platform, which is scheduled to be rolled-out from December 2005.

COMPARATIVE VALUATIONS

		BOB	SBI	PNB
P/E (x)	FY06E	11.4	10.0	8.9
	FY07E	9.0	8.6	7.5
P/ABV (x)	FY06E	1.3	1.8	1.6
	FY07E	1.2	1.5	1.3
RoE (%)	FY06E	12.2	17.8	18.2
	FY07E	12.7	17.9	18.5
RoA (%)	FY06E	0.8	1.0	1.2
	FY07E	0.9	1.0	1.3

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	66.8	66.8	66.8
Domestic Institutions	7.2	7.0	4.1
FII's/FDI's	17.7	17.9	20.5
Others	8.2	8.3	8.6

Recent developments

- ✍ Bank of Baroda has fixed the price for their public offer at Rs230/share. At this price, BoB would be able to raise Rs16.33b for its issue of 71m shares.
- ✍ The bank has recently raised Rs7.7b through Tier-11 bonds to shore up its capital adequacy ratio (CAR). The bonds are fixed option bonds, where the 9-year and 7-month bonds have been priced at 7.45%.

Valuation and view

- ✍ We expect the bank to grow its earnings by 22% in FY06 compared with negative growth of 30% reported in FY05 due to a significant decline in other income and increased provisions and contingencies.
- ✍ The stock trades at 9x FY07E earnings and P/BV of 1.1x FY07E BV.
- ✍ 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.

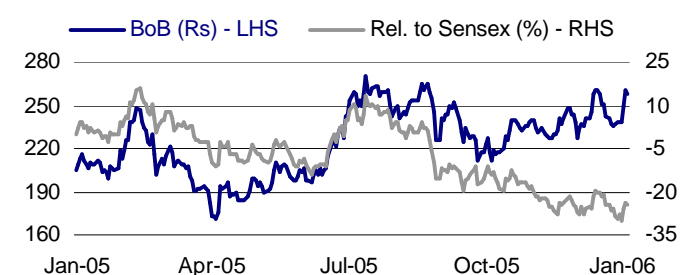
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	22.6	30.8	-26.6
FY07	28.8	37.3	-22.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
258	278	7.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Interest Income	61,471	64,314	70,581	81,745	93,887
Interest Expended	35,755	34,521	38,681	46,014	53,166
Net Interest Income	25,716	29,793	31,900	35,731	40,721
Change (%)	22.3	15.9	7.1	12.0	14.0
Other Income	17,190	13,048	9,937	10,186	10,724
Net Income	42,906	42,841	41,838	45,917	51,446
Change (%)	27.5	-0.2	-2.3	9.8	12.0
Operating Expenses	18,053	19,822	22,926	24,908	27,340
Operating Income	24,853	23,019	18,912	21,009	24,105
Change (%)	44.8	-7.4	-17.8	11.1	14.7
Other Provisions	9,524	14,388	7,500	6,500	6,500
PBT	15,329	8,631	11,412	14,509	17,605
Tax	5,659	1,863	3,138	3,990	4,841
Tax Rate (%)	36.9	21.6	27.5	27.5	27.5
PAT	9,670	6,768	8,273	10,519	12,764
Change (%)	25.1	-30.0	22.2	27.1	21.3
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	75,388	83,348	93,553
Net Worth	51,309	56,278	79,043	87,003	97,208
Deposits	729,673	813,335	927,201	1,057,010	1,200,763
Change (%)	9.8	11.5	14.0	14.0	13.6
Borrowings	8,751	16,408	20,000	23,000	26,000
Other Liabilities & Provisions	61,353	60,622	66,684	73,352	80,688
Total Liabilities	851,087	946,642	1,092,928	1,240,365	1,404,659
Current Assets	72,668	92,542	99,810	105,611	121,957
Investments	380,188	370,744	392,989	420,498	458,343
Change (%)	26.0	-2.5	6.0	7.0	9.0
Advances	356,009	434,004	546,845	656,214	761,208
Change (%)	0.7	21.9	26.0	20.0	16.0
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
Total Assets	851,087	946,642	1,092,928	1,240,365	1,404,659

ASSUMPTIONS					
(%)					
Deposit Growth	9.8	11.5	14.0	14.0	13.6
Advances Growth	0.7	21.9	26.0	20.0	16.0
Investments Growth	26.0	-2.5	6.0	7.0	9.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	65.0	50.0	60.0	70.0	70.0
CRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning A	8.1	7.6	7.3	7.3	7.4
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	12.2	12.7	13.9
RoA	12	0.8	0.8	0.9	10
Int. Expended/Int. Earr	58.2	53.7	54.8	56.3	56.6
Other Inc./Net Income	40.1	30.5	23.8	22.2	20.8
Efficiency Ratios (%)					
Op. Exps./Net Income	42.1	46.3	54.8	54.2	53.1
Empl. Cost/Op. Exps.	69.4	69.7	67.0	65.4	64.6
Busi. per Empl. (Rs m)	27.3	316	35.1	42.9	515
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	63.4
Invest./Deposit Ratio	52.1	45.6	42.4	39.8	38.2
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	4.2
Net NPAs to Adv.	2.9	1.4	1.0	0.8	0.5
CAR	13.9	12.6	14.2	13.6	13.4
Tier 1 (inc. IFR)	8.5	8.2	10.9	10.1	9.8

VALUATION					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Book Value (Rs)	165.3	182.2	209.1	230.9	258.8
Price-BV (x)	16	14	12	11	10
Adjusted BV (Rs)	142.3	168.5	199.1	222.0	251.7
Price-ABV (x)	18	15	13	12	10
EPS (Rs)	32.8	23.0	22.6	28.8	34.9
EPS Growth (%)	25.1	-30.0	-15	27.1	21.3
Price-Earnings (x)	7.9	11.2	11.4	9.0	7.4
OPS (Rs)	84.4	78.2	51.7	57.5	65.9
OPS Growth (%)	44.7	-7.4	-33.8	11.1	14.7
Price-OP (x)	3.1	3.3	5.0	4.5	3.9

E: MOST Estimates



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Bank of Baroda

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

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