Company Flash

31 January 2008 | 6 pages

Bank of Baroda (BOB.BO)

Results

Buy: 3Q08 Results – Growing, and Profitably

- **Strong profit growth, 30% ahead of expectations** — BoB's 3Q08 net profit is up 52% yoy, well ahead of expectations and likely driven by strong treasury and asset recovery gains. Qualitatively, the quarter appears fairly robust in terms of both P&L and balance sheet quality and growth.
- **Margins hold, non-interest income lifts –** While margins are down a bit yoy and qoq, this was expected with no meaningful surprises. The profit push comes from other income – we believe this is largely treasury related, but await more details. Controlled operating expenses are a key driver of profit expansion, though a sharp qoq drop suggests more details are needed. Overall, the P&L appears fairly well rounded.
- **Loans grow, and asset quality holds**— BoB continues to grow loans rapidly, up 23% yoy and almost 6% qoq, and impressively continues to maintain asset quality. This is an area management has focused on and appears to be backing with delivery in spite of higher growth levels. Deposits show fair momentum, 4% qoq growth, suggesting balanced balance sheet growth. We await details on international businesses, which is almost 20% of BoB's assets.
- **Maintain Buy/Medium Risk rating –** We also await further details from the analyst meeting scheduled for 1st February.

Buy/Medium Risk	**1M**
Price (30 Jan 08)	Rs391.30
Target price	Rs390.00
Expected share price return	-0.3%
Expected dividend yield	1.5%
Expected total return	**1.2%**
Market Cap	Rs142,537M
	US$3,627M

Price Performance (RIC: BOB.BO, BB: BOB IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	8,270	25.06	9.0	15.6	1.8	12.3	1.3
2007A	10,260	28.07	12.0	13.9	1.7	12.4	1.4
2008E	14,758	40.37	43.8	9.7	1.4	15.9	1.5
2009E	17,697	48.41	19.9	8.1	1.3	16.7	1.5
2010E	20,043	54.83	13.3	7.1	1.1	16.5	1.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. 3Q08 BOB Financial Highlights (Rupees Million, %)

	3Q08	3Q07	YoY %	2Q08	QoQ%	Citi Investment Research Comments
Interest Income	30,022	23,344	28.6	28,798	4.3	
Interest Expense	(20,047)	(14,262)	40.6	(18,983)	5.6	Relatively sharp escalation in cost
Net Interest Income	**9,975**	**9,082**	**9.8**	**9,814**	**1.6**	**Below expectation, Relatively weak performance after a very strong 2Q**
Non Interest Income	6,180	3,337	85.2	4,541	36.1	50% ahead of expectations. Another strong quarter, but likely driven by treasury and asset recoveries
Operating Income	16,155	12,419	30.1	14,355	12.5	
Operating Expenses	(6,831)	(6,375)	7.1	(7,983)	-14.4	Modest increase in expenses. Includes Rs450mn charge on account of AS15 transitional liability; excluding this, operating expenses are flat yoy - strong show, though likely supported by one-offs
Pre-Provision Profit	**9,324**	**6,044**	**54.3**	**6,372**	**46.3**	**Well ahead of expectations, though likely driven by treasury gains**
Charges for Bad Debts	(1,570)	(891)	76.1	(981)	60.1	Limited asset quality pressures, and management provides to maintain coverage levels
Pre-Tax Profit	**7,754**	**5,152**	**50.5**	**5,392**	**43.8**	
Tax	(2,744)	(1,861)	47.5	(2,120)	29.4	Effective tax at 35% this quarter
Net Profit	**5,011**	**3,291**	**52.2**	**3,272**	**53.1**	**30% ahead of expectations boosted by higher non interest income and lower operating expenses**
EPS	13.7	11.2	22.7	9.0	53.1	
Customer Loans	955,180	776,610	23.0	902,120	5.9	Accelerated loan growth continues
Customer Deposits	1,369,000	1,122,980	21.9	1,313,730	4.2	Strong deposit growth quarter in a quarter where most peers have shed high cost deposits/or chose to go slow
AIEA	1,424,211	1,237,388	15.1	1,306,616	9.0	
AIBL	1,284,985	1,091,143	17.8	1,223,795	5.0	
Total Assets	1,395,077	1,213,110	15.0	1,455,392	-4.1	
Avg Assets	1,425,234	1,239,334	15.0	1,448,120	-1.6	
Non-Performing Loans (NPL)	20,403	23,886	-14.6	21,294	-4.2	Stable asset quality, provides comfort - ahead of peers
Loan Loss Reserves (LLR)	(15,231)	(18,683)	-18.5	(16,329)	-6.7	
Shareholders' Funds	95,910	84,005	14.2	90,899	5.5	Total AS 15 pension charge of 9bn, only about 1.38 provided so far
Book Value Per Share	262	231	13.8	249	5.5	
Key Ratios (%)	**3Q08**	**3Q07**	**Bps Δ YoY**	**2Q08**	**Bps Δ QoQ**	
ROAA (annualized)	1.41	1.09	32	0.90	54	
ROAE (annualized)	20.90	15.67	522	14.40	650	
Net Interest Margin (bps)	298	305	-7	300	-2	Some pressure, though largely anticipated
Other Non-Interest Inc/Op Inc	38.3	26.9	1139	31.6	662	
Op. Cost/ Operating Income	42.3	51.3	-905	55.6	-1333	Has come down dramatically, amongst the lowest in the industry - cost control, and strong revenue growth
Loan-to-Deposit Ratio (LDR)	69.8	69.2	62	68.7	110	
NPL/Loan Ratio	2.1	3.1	-94	2.4	-22	Continues to keep a focus on asset quality
LLR/NPL Ratio	75	78	-357	77	-203	Coverage levels have come down this quarter but remain above most peers

Source: Company Reports and Citi Investment Research

Bank of Baroda

Company description

Bank of Baroda (BoB) was incorporated in 1908 as a private institution, and subsequently nationalized in 1969. The bank is headquartered in Baroda, Gujarat. The government holds 66% of the bank's equity. BoB is among the top-five banks in the country, with a nearly 5% share of the deposits and advances of the banking system. BoB has a large nationwide branch network of 2,730 branches, and has 38 branches in 10 countries.

Investment strategy

We rate BoB Buy (1M) with a target price of Rs390. BoB has made visible improvements in key operating parameters. However, it has lagged behind the sector: loan growth, until recently, has been well below the industry levels and its technology plan has been slow to take off. Management's aggressive interest-rate positioning on the bank's bond portfolio led to losses in the portfolio when interest rates reversed. This aspect of its balance sheet has meant that BoB has been viewed largely as an interest-rate cyclical stock, with falling/rising rates increasing/decreasing the value of its bond portfolio. Structurally, we believe BoB will continue to trade at a discount to its larger peers due to lower fee incomes, a higher proportion of international businesses, a modest lending franchise, and a slight geographic concentration. BoB will also likely remain the most interest-rate cyclical bank among its larger peers. However, the focus on bond yields has camouflaged changes in what the market formerly perceived as other weakness. We believe positive changes have come about, and the market appears to have failed to fully appreciate them.

Valuation

Our target price of Rs390 is based on CIR's EVA model, which we believe captures the long-term value of the business and is a standard valuation measure for our India banking coverage. We are factoring in a risk-free rate of 8%. We maintain industry-average margin (230bps) and higher-than-industry capital ratio (6%).

We are also benchmarking our target price on a 1.3x FY09E PBV. Our target price based on this methodology is Rs394 . Our target multiple factors in the healthy asset pricing and operating environment. Our target multiple continues to be at discounts to those for SBI and PNB. We believe a valuation discount to some peer banks is still justified due to the quality and structure of the businesses. BoB generates relatively low fee income, has a higher proportion of international businesses that we believe adds less value to the business, and its business has a modest geographic concentration. Important to note, its ROEs have also tended to lag the sector, and though we do see signs of a catch-up, management still needs to deliver.

Risks

We rate BoB Medium Risk based on our quantitative risk-rating system, which tracks 260-day share price volatility. The following downside risks could impede the stock from reaching our target price: (1) sharp rises in interest rates, which could undermine the performance of the bond portfolio; (2) BoB's inability to sustain loan growth; and (3) further delays in management's technology plans.

Appendix A-1

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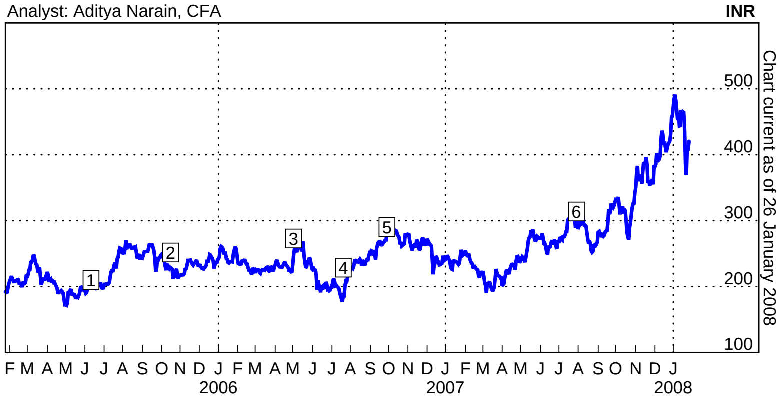
Bank of Baroda (BOB.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Aditya Narain, CFA



#	Date	Rating	Target Price	Closing Price
1:	10 Jun 05	*1M	*253.00	203.65
2:	17 Oct 05	1M	*305.00	228.80
3:	2 May 06	1M	*298.00	246.55
4:	20 Jul 06	1M	*248.00	186.65
5:	28 Sep 06	1M	*326.00	286.60
6:	30 Jul 07	1M	*390.00	293.15

*Indicates change.

Covered
Not covered

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