

BUY

Bank of Baroda

Target price (INR) 1,066

High upgradation and recovery largely offsets slippages

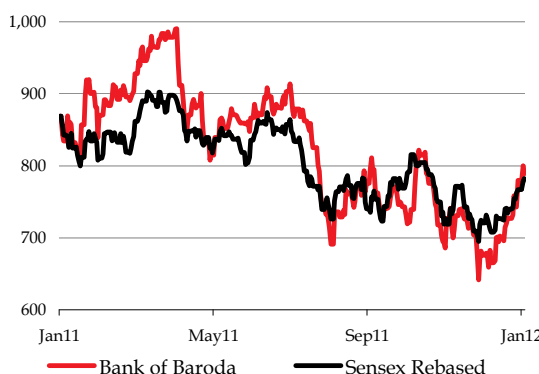
Rating ↔

Last Price (INR) 788.8

Bloomberg code	BOB IN
Reuters code	BOB.BO
Avg. Vol. (3m)	566,591
Avg. Val.(3m)(INRmn)	414
52-wk H/L (INR)	1,007 / 630
Sensex	17,077
MCAP (INRbn/USDbn)	308.85 / 6.16

Shareholding (%)	9/11	12/11
Promoters	57.0	57.0
MFs, FIs, Banks	16.8	17.2
FIIIs	14.3	13.6
Public	5.0	5.0
Others	6.8	7.2

Stock Chart (Relative to Sensex)



Stock Perf. (%)	1m	3m	1yr
Absolute	16.8	9.7	-9.2
Rel. to Sensex	8.3	10.7	0.8

Financials (INRbn)	03/11	03/12f	03/13f
NII	88.0	106.2	129.1
YoY (%)	48.2	20.6	21.6
Operating profit	69.8	87.4	104.7
A.PAT	42.4	48.9	52.9
Sh o/s (diluted)	392.8	392.8	392.8
A.EPS (INR)	111.9	124.4	134.7
YoY (%)	29.1	15.2	8.3
Equity/Assets (%)	5.9	5.8	5.6
P/E (x)	7.3	6.3	5.9
P/B (Adj) (x)	1.5	1.2	1.1
RoA (%)	1.3	1.2	1.1
RoE (%)	23.5	21.3	19.6

Quarterly Trends	03/11	06/11	09/11	12/11
Op. income (INRbn)	34.5	29.4	33.0	38.0
PAT (INRbn)	12.9	10.3	11.7	12.9

While core fee income and NII sustained the growth momentum, a sharp rise in trading gains boosted operating profit growth to 41% y-o-y. Asset quality weakened, with a sharp rise in slippage. The rise in the gross NPL ratio was restricted to 7-bp due to a large increase in upgradation and recovery. We raise our FY12f PAT estimate by 2.6% to factor in higher-than-estimated trading gains in the Dec11 quarter. However, our numbers already build in high slippage; therefore, our forecasts for incremental NPL and NPL provisions for FY12f stay unchanged. We roll over the TP to Dec12 and lower it marginally to INR1,066. The TP values the stock at 1.29x one-year forward adjusted book value. We maintain Buy. Higher-than-estimated NPL provisions and NIM contraction are risk factors.

Trading gains boost profitability; fall in NIM was in line with estimates

The 70% y-o-y rise in trading gains boosted operating profit growth to 41% y-o-y, while core fee income grew 20% y-o-y. The 8-bp sequential fall in global NIM to 2.99% was in line with estimates. A larger contraction in domestic NIM was due to the 13-bp decline in the yield on loans, while the cost of deposits increased by 6-bp. We estimate a 7-bp decline in global NIM in FY12f. The moderation in domestic savings deposits growth continued during the quarter to c17% y-o-y. However, the domestic CASA ratio remained stable, at 34%.

High upgradation and recovery largely offsets a sharp rise in slippage

Slippage during the quarter increased to INR9.5bn (1.63% of loans, annualized), the highest in the past seven quarters. However, the increase in outstanding gross NPL was restricted to INR4.9bn due to strong recovery (INR1.4bn) and upgradation (INR1.7bn). Upgradation was the highest in the past seven quarters. This led to a 7-bp and 4-bp rise in gross and net NPL ratios, respectively. NPL provisions increased by 147% to INR5.08bn, and were 0.87% of average loans (annualized). Restructured loans were 5.52% of domestic loans at end Dec11; the amount restructured was INR21bn compared to INR11bn in 1HFY12.

High restructuring, slippage may weigh on the stock in the near term

While a sharp rise in restructured loans and slippage is likely to weigh on stock performance in the near term, our numbers already build in high slippage in FY12f. Therefore, our estimates for incremental slippage and NPL provisions for FY12f stay unchanged. We forecast an INR6.5bn addition to gross NPL in the Mar12 quarter compared to INR7.4bn in the preceding three quarters. We forecast the provision to be maintained at 0.56% of loans for FY12f. We raise FY12f PAT forecast by 2.6% due to an increase in our estimate for trading gains.

Rollover TP to Dec11, maintain Buy

We roll over the blended target price to Dec12 and lower it by 2.3% to INR1,066. The 12-month average P/E and P/B has fallen by up to 10% in the past three months, leading to the fall in the target price. The target values the stock at 1.29x one-year forward adjusted book value. We maintain Buy. Higher-than-estimated NPL provisions and NIM contraction are risk factors.

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Exhibit 1: Results snapshot for the Dec11 quarter

(INRbn)	Dec10	Sep11	q-o-q (%)	Dec11	y-o-y (%)
Interest income	56.66	72.51	5.81	76.72	35.40
Interest expense	33.74	46.85	7.09	50.16	48.69
Net interest income	22.92	25.67	3.47	26.56	15.85
Other income	6.76	7.34	56.52	11.49	69.99
Operating income	29.68	33.01	15.27	38.05	28.18
Operating expense	11.17	11.74	1.91	11.97	7.11
Operating profit	18.51	21.27	22.65	26.08	40.90
Provisions & contingencies	3.04	4.83	73.13	8.50	175.24
Tax	4.78	4.78	-1.86	4.69	-2.01
Net profit	10.69	11.66	10.64	12.90	20.67
Key ratios (%)					
Loan growth	32.68	23.92	1.87	25.80	-6.88
Deposit growth	30.86	22.07	1.97	24.05	-6.82
SB deposit growth	24.22	15.49	1.25	16.74	-7.48
Global NIM	3.20	3.07	-0.08	2.99	-0.21
GNPL	1.32	1.41	0.07	1.48	0.16
NNPL	0.36	0.47	0.04	0.51	0.15

Source: Company, Avendus Research

We raise PAT estimate by c3% for FY12f, lower it by c2% for FY13f

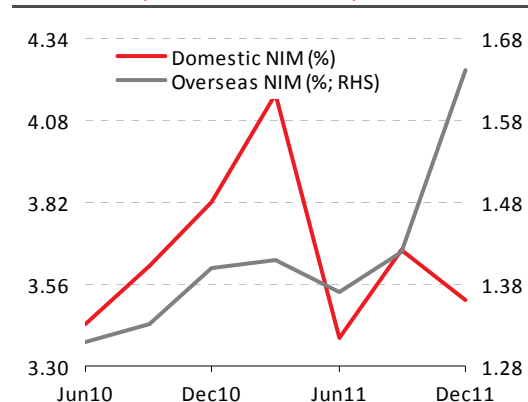
Exhibit 2: Earnings revision summary

(INRbn)	FY12f			FY13f			FY14f		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Net interest income	106.6	106.2	-0.4	129.3	129.1	-0.2	157.9	157.6	-0.2
Operating income	136.8	140.3	2.6	164.2	166.6	1.5	198.3	199.8	0.7
Operating profit	83.6	87.4	4.6	101.9	104.7	2.7	121.9	125.9	3.2
Loan-loss provisions	14.1	14.1	0.0	20.5	23.7	15.4	27.4	29.4	7.1
Net Profit	47.6	48.9	2.6	53.9	52.9	-1.8	63.8	63.7	0.0
EPS (INR)	121.3	124.4	2.6	137.1	134.7	-1.8	162.3	162.2	0.0

Source: Company, Avendus Research

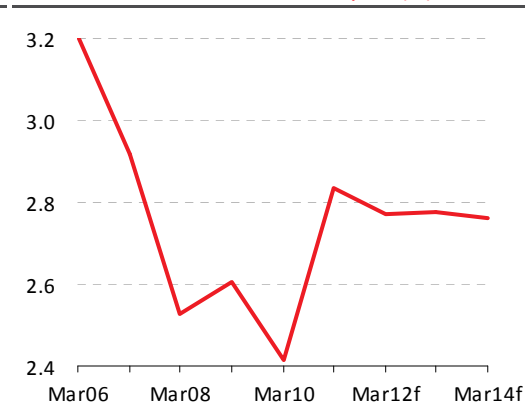
Sequential fall in domestic NIM driven by decline in yield on loans

Exhibit 3: Reported NIM for the quarter



Source: Company, Avendus Research

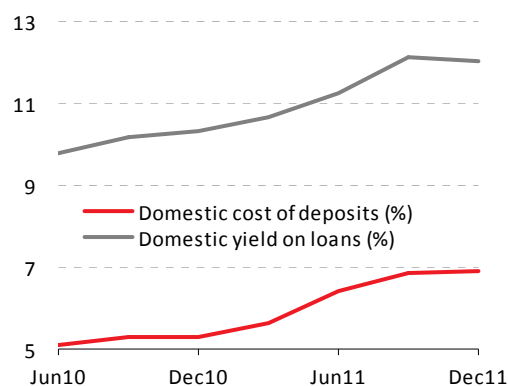
Exhibit 4: Estimated NIM for the year (%)



Source: Company, Avendus Research

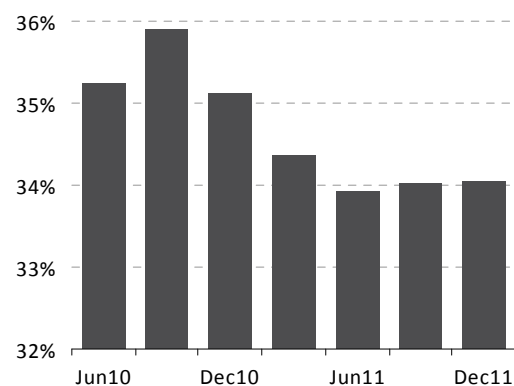
Cost of domestic deposits rose 6-bp, while yield declined by 13-bp sequentially

Exhibit 5: Cost of deposits and yield on loans



Source: Company, Avendus Research

Exhibit 6: Domestic CASA ratio



Source: Company, Avendus Research

High upgradation, recovery largely offsets a sharp rise in slippage

Exhibit 7: Movement in gross NPL

	Jun10	Sep10	Dec10	Mar11	Jun11	Sep11	Dec11
Opening gross NPL	24,007	26,574	27,199	27,703	31,525	34,255	34,021
Addition	6,662	2,881	2,762	6,665	5,848	5,825	9,527
- as % of loans (annualized)	1.63%	0.67%	0.61%	1.32%	1.12%	1.08%	1.63%
Reduction	4,095	2,256	2,258	2,842	3,119	6,059	4,597
Closing gross NPL	26,574	27,199	27,703	31,526	34,075	34,021	38,951

Source: Company, Avendus Research

Exhibit 8: Loan-loss provisions (INRmn)

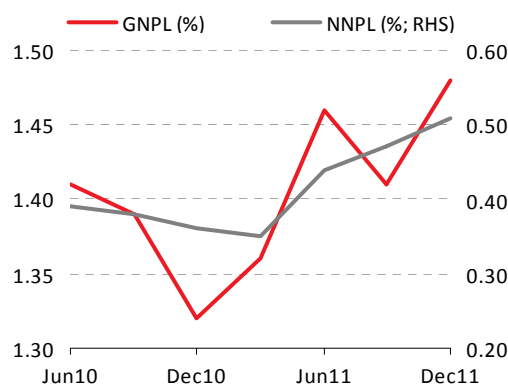
	Jun10	Sep10	Dec10	Mar11	Jun11	Sep11	Dec11
Loan-loss provisions	2,775	1,423	2,064	4,244	1,320	3,011	5,089
-as % of loans (annualized)	0.68%	0.33%	0.45%	0.84%	0.25%	0.56%	0.87%

Source: Company, Avendus Research

Our forecast factors high incremental NPL for FY12f-FY13f

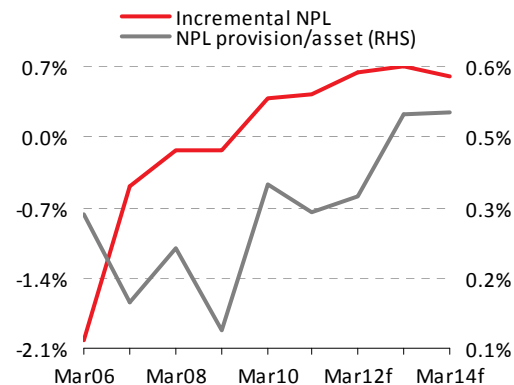
Our assumption for incremental NPL remains unchanged at 0.55% and 0.75% for FY12f and FY13f, respectively. It had averaged at 0.44% during FY09-FY11.

Exhibit 9: NPL ratios (%)



Source: Company, Avendus Research

Exhibit 10: Incremental NPL / starting loans (%)



Source: Company, Avendus Research

Target price values BOB at 1.29x one-year forward book value

We estimate the mean one-year forward P/E and P/B for the 12-month period ended 25 Jan11 at 6.09x and 1.20x, respectively. We apply these to our forecast EPS and book value for Dec12 to arrive at fair values of INR946/share and INR991/share, respectively. The 12-month average P/E and P/B has fallen by up to 10% in the past three months. Therefore, P/E and P/B-based fair values have declined by up to 7%. The DCF-based fair value has increased, largely due to the rollover to Dec12. Our TP of INR1,066 is a weighted average, where we assign a weight of 30% to our DCF-based fair value and 35% each to our P/E and P/B-based fair values. The target price values BOB at 1.29x one-year forward book value. We maintain the Buy rating.

Exhibit 11: Average P/E and P/B

	1-month	3-month	6-month	12-month
P/E	5.13	5.26	5.53	6.09
P/B	1.00	1.03	1.09	1.20

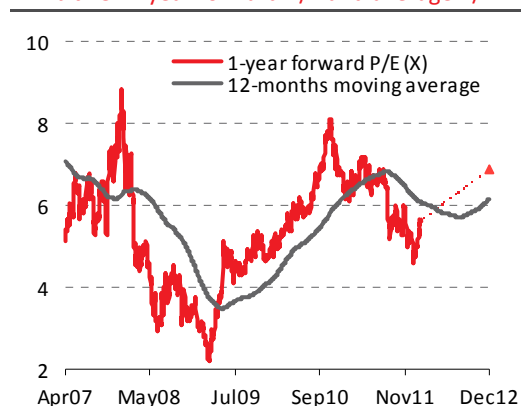
Source: Company, Avendus Research, Bloomberg

Exhibit 12: Price target based on P/E, P/B and DCF methods

Weights	35%	35%	30%	
	P/E	P/B	DCF	Weighted average
Target price	946	991	1,294	1,066

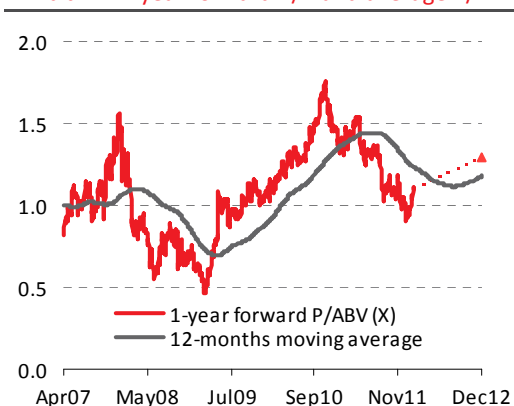
Source: Company, Avendus Research

Exhibit 13: 1-year forward P/E and average P/E



Source: Bloomberg, Avendus Research

Exhibit 14: 1-year forward P/B and average P/ABV



Source: Bloomberg, Avendus Research

Risk factors

- ▶ A higher-than-estimated rise in incremental NPL and loan-loss provisions in FY13f is likely to result in a downward risk to earnings.
- ▶ Higher than estimated NIM contraction may result in a downside earnings risk.

Financials and valuations

Income statement (INRbn)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Net interest income	88.0	106.2	129.1	157.6
Fee income	15.4	19.3	21.6	24.0
Trading profit	4.4	5.2	5.4	6.6
Other income	8.3	9.6	10.6	11.6
Total operating income	116.1	140.3	166.6	199.8
Total operating expense	46.3	52.8	62.0	73.9
Operating profit	69.8	87.4	104.7	125.9
Provision for bad debt	10.5	14.1	23.7	29.4
Other provision	2.8	5.5	5.4	5.5
PBT (reported)	56.5	67.9	75.6	91.0
Total taxes	14.1	19.0	22.7	27.3
PAT (reported)	42.4	48.9	52.9	63.7
(+) Share in assoc. earnings	0.0	0.0	0.0	0.0
Less: Minority interest	0.0	0.0	0.0	0.0
Prior period items	0.0	0.0	0.0	0.0
Net income (reported)	42.4	48.9	52.9	63.7
Aventus net income	42.4	48.9	52.9	63.7
Shares outstanding (mn)	393	393	393	393
Aventus dil. shares (mn)	393	393	393	393
Aventus EPS (INR)	108.0	124.4	134.7	162.2

Growth ratios (%)

Loans	30.6	21.9	23.8	23.9
Net interest income	48.2	20.6	21.6	22.1
Fee income	19.6	25.7	11.7	11.3
Provision for bad debt	10.0	34.3	67.9	24.0
Aventus net income	38.7	15.2	8.3	20.4
Aventus EPS	29.1	15.2	8.3	20.4

Operating ratios (%)

NII/operating income	75.8	75.7	77.5	78.9
Fee income/operating income	13.2	13.8	12.9	12.0
Operating profit margin	60.1	62.3	62.8	63.0
Net profit margin	36.5	34.8	31.8	31.9
Effective Tax rate	24.9	28.0	30.0	30.0

Balance sheet (INRmn)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Equity capital	3.9	3.9	3.9	3.9
Preference capital	0.0	0.0	0.0	0.0
Reserves and surplus	206.0	245.2	287.8	339.0
Net worth	209.9	249.1	291.7	342.9
Deposits	3,054.4	3,756.9	4,658.6	5,747.8
Total borrowings	129.1	47.9	56.6	59.6
Other liabilities and provisions	190.6	214.7	248.5	261.7
Total liabilities	3,584.0	4,268.6	5,255.4	6,412.0
Cash and bank balances	499.3	493.9	611.2	676.3
Investments	712.6	881.2	1,074.1	1,325.6
Loans	2,286.8	2,788.1	3,452.8	4,277.1
Fixed assets	23.0	15.5	11.1	6.3
Other assets	62.3	89.9	106.2	126.8
Total assets	3,584.0	4,268.6	5,255.4	6,412.0
Business Ratios (%)				
Loan / Deposit	74.9	74.2	74.1	74.4
Investment / Deposit	23.3	23.5	23.1	23.1
SLR Investment / Deposit	19.9	20.9	20.8	21.0
SLR Investment / NDTL	19.1	20.7	20.6	20.8
Debenture / Investment	3.3	3.1	2.5	2.0

Decomposition of RoA (%)

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Net interest income	2.76	2.70	2.71	2.70
Fee income	0.48	0.49	0.45	0.41
Other income	0.40	0.38	0.34	0.31
Operating income	3.65	3.57	3.50	3.42
Operating expenses	1.45	1.35	1.30	1.27
Operating profit	2.19	2.23	2.20	2.16
Loan loss provisions	0.33	0.36	0.50	0.50
Provision for investments	0.00	0.08	0.04	0.02
Other provisions	0.09	0.06	0.07	0.07
Tax	0.44	0.48	0.48	0.47
Net profit	1.33	1.24	1.11	1.09
RoA	1.33	1.24	1.11	1.09
Assets / Equity	17.64	17.11	17.61	18.39
RoE	23.50	21.29	19.58	20.09

Key Ratios

Fiscal year ending	03/11	03/12f	03/13f	03/14f
Valuation ratios (x)				
P/E (on Aventus EPS)	7.3	6.3	5.9	4.9
P/BV	1.5	1.2	1.1	0.9
P/Adjusted BV	1.5	1.2	1.1	0.9
Dividend yield (%)	2.4	2.5	2.9	3.5
Per share ratios (INR)				
Basic Reported EPS (INR)	111.9	124.4	134.7	162.2
Diluted Reported EPS (INR)	111.9	124.4	134.7	162.2
Reported Book Value (BV)	534.4	634.2	742.7	873.0
Adjusted Book Value (ABV)	529.9	635.6	729.1	858.6
Dividend per share (INR)	19.2	20.0	23.0	28.0
Return / Profitability Ratios (%)				
Yield on advances	8.0	8.1	8.1	8.1
Yield on investments	7.2	7.2	7.0	6.9
Cost of deposits	4.3	4.5	4.5	4.5
Net interest margin	2.8	2.8	2.8	2.8
Fee income/ Op revenue	13.2	13.8	12.9	12.0
Trading profit/Op revenue	3.8	3.7	3.2	3.3
Op expense/ Op revenue	39.9	37.7	37.2	37.0
Capitalization Ratios (%)				
Equity / Assets	5.9	5.8	5.6	5.3
Loans / Assets	63.8	65.3	65.7	66.7
Investments / Assets	19.9	20.6	20.4	20.7
Dividend payout	17.8	18.5	19.6	19.8
Internal capital growth	23.1	19.0	17.1	17.5
Capital adequacy	14.5	14.0	12.9	12.3
Asset Quality				
Gross NPL ratio	1.4	1.6	1.8	1.9
Net NPL ratio	0.4	0.5	0.6	0.6
Net NPL / networth	3.6	5.7	7.3	7.7
Loan-loss reserve / Gross NPL	76.0	68.3	66.9	68.5
Loan provisions / NII	11.9	13.3	18.3	18.6
Loan provisions / Total loans	0.5	0.5	0.7	0.7
Productivity / Efficiency ratios				
Business per branch (INRmn)	1,562.7	1,809.0	2,124.5	2,605.2
Net profit per employee (INRmn)	1.1	1.1	1.1	1.3

Analyst Certification

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Bank of Baroda	No	No	No

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