Bank of Baroda

Investment Report

AMBALAL SHARES & STOCKS PRIVATE LIMITED

Snapshot

CMP	159
Target price	200
1 year High/Low	229/102
Market Cap: (in cr)	35,477
Face Value	2
Rating	Buy
Risk rating	Medium
Weightage	Overweight
NSE SYMBOL	BANKBARODA

Shareholding Pattern (%)

	Current	Q3FY15	Q2FY15
Promoters	57.5	56.3	56.3
MF's & FI's	17.7	18	17.6
FII's	16.5	18	18
Others	8.2	7.8	8.1

Price Performance

	Stock	Nifty
1 Month	1.1	-3
3 Month	-7.7	-5.4
12 Month	6.5	24.4

Valuation

At the CMP of INR 159, Bank of Baroda is trading at 0.8x FY17E ABV for RoE of 14-15% and earnings CAGR of > 30% over FY15-17E. Despite volatility of asset quality and current management vaccum, valuations are attractive. We initiate BUY.

Bank of Baroda's (BoB) Q4FY15 PAT at ~INR6bn was lower than our (INR9bn) estimate following higher provisions. However, the quarter was marked by improved asset quality with slippages restricted to 1.8% (~3% in Q3FY15 and expectation of similar slippages). Although restructuring was higher at INR40bn (INR16bn in Q3FY15), this was on expected lines given Q4FY15 was last quarter of RBI dispensation. Core operating performance was muted (down YoY), a derivative of tepid revenue momentum (domestic NIMs declined >10bps QoQ). The positive structural changes (viz., governance structure, etc) initiated by the government and curtailed opex (lower-than-expected basic pay rise, green shoots visible during this quarter) will aid large PSU banks. This, when juxtaposed with BoB's consistent track record of superior asset quality (vis-à-vis peers), adequate capital adequacy (Tier 1 >9.9%), tailwind of gradual improvement in macros and attractive valuations of 0.8x FY17E P/ABV lends comfort. Maintain 'BUY' with target price of INR270.

Asset quality: A positive surprise

Post hiccup in Q3FY15, BoB impressed with much improved asset quality (defying expectations of incremental stress). Slippages were restricted to ~INR18bn (>50% from restructured book). The bank has been consistently reporting superior asset quality vis- à-vis other PSU banks benefitting from restricted exposure to stressed segments. Restructuring surged to INR40bn (driven by iron & steel and infra segments); this was largely a preponement of anticipated stress (as RBI dispensation on restructuring ends in Q4FY15). BoB does not foresee any major restructuring pipeline.

Core profitability supported by controlled opex

BoB's core operating performance was muted (down 6% YoY) following slower revenue momentum (domestic NIMs declined >10bps QoQ) and below average loan growth. However, lower staff expenses (down 11% YoY, as the bank already adequately provided for staff expenses) aided core operating performance.

Financials INR mn

Year to March	Q4FY15	Q4FY14	Growth %	FY15	FY16E	FY17E
Net int income	31717	31243	1.5	131872	153409	183606
Net profit	5983	11573	-48.3	33984	58905	75149
B/V per share				179.6	200.4	227.9
EPS (INR)	15.8	27.1	-41.5	15.3	26.6	33.9
Price/Book				1.1	1	0.8
P/E				11.1	6.4	5

Domestic NIMs decline feeding into pressure on global NIMs

BoB's global NIMs were marginally down at 2.17% (down 3bps QoQ) following 16bps decline in domestic NIM (to 2.76%) which was partially offset by better NIMs from overseas book (up 3bps at 0.96%). The drop in domestic NIMs flowed from lower yield on advances (down 45bps QoQ to ~10.56%, partially a reflection of higher interest income reversal) and 6bps QoQ dip in investment yields; this was, however, marginally counteracted by lower deposit costs (down 2bps QoQ to 7.10%). After 2 quarters of reeling under pressure, overseas NIMs showed an upward trajectory and came in at 0.96% (versus 0.93% in Q3FY15) primarily due to 15bps QoQ inch up in yield on investment (to 4.37%) and dip of 5bps in cost of deposit (against 1.02% in Q3FY15). However, given the focus on lower-yielding trade finance, management remained cautious on this and expects some pressure in ensuing quarters. BoB is targeting domestic NIMs of 3% through further rebalancing of the loan book.

Loan growth lower than trend, back ended in nature

During the quarter, BoB posted loan growth of ~7.8% YoY, this was mostly back ended in nature with 8.7% surge QoQ (implying that during 9mFY15 loan book actually came off). The growth was on account of 7.2% YoY rise in domestic and 9.1% growth in international book. Management attributed slower growth to dearth of investment opportunities, which is a reflection of slower-than-anticipated macro recovery. Domestic loan book posted broad-based improvement with retail segment maintaining healthy traction, up 14% YoY, SME up 9.5% YoY and agri up 32% (this was after accounting for RIDF classification into agri permitted by RBI). The bank highlighted that going forward focus will be on the retail segment to drive growth and it will be on profitability rather than growth

Higher treasury gains support profitability

BoB's profitability during the quarter was aided by higher treasury gains (INR3.6bn versus run-rate of INR1.64bn over past few quarters). On the other hand, core fee income was at 5% YoY (albeit on sequential basis it was up 13% QoQ largely a function of back-ended growth). However, the key miss was on recovery from written-off accounts at INR606mn versus INR3.7bn (same quarter last year). Management has identified this as potential area of improvement and expects some traction going forward.

Other highlights

- There are 98 SMA 2 accounts amounting to INR182.4bn of which INR47.43bn is already restructured. Of the balance SMA 2 accounts, large part have tradition of being into SMA 2, thus chances of them slipping is less.
- Provisions were higher as bank made provisions on account of : migration in NPL categories of INR3bn , Diminution in fair value of iNR5.5bn, INR3.54bn on account to follow RBI inspection, provision towards Non-fund based – INR1.2bn. In addition to this the bank utilised floating provisions of INR4.25bn (as per RBI dispensation) during the quarter,

Company Description

Established in 1908 by Maharaja Sayajirao Gaekwad of Baroda, BoB was one of the 14 banks that were nationalised in 1969. With nearly 5,190 branches within India and over 100 offices abroad, and a balance sheet size of over ~INR7.1tn, BoB is amongst the top 5 Indian banks in terms of balance sheet size and third largest amongst PSU banks in deposit franchise. It has a well-diversified balance sheet within India, while it has leveraged its international branch network to build a 25% balance sheet from outside India. It has been one of the early players to have identified the potential and importance of international presence and is currently operating through its eight banking subsidiaries apart from the parent.

Since FY06, the bank has charted a new growth strategy under project “Parivartan”, rebranding itself, energising its century old brand

Investment Theme

Given its relatively better underwriting and monitoring standards, BOB’s stressed asset pool (NNPL and restructured assets) compares well with peers. Banks has been consistently delivering on asset quality front and management indicated trend should stabilise or further improve. This will cap credit cost near 1% and aid in generating 0.9% RoA and 15% RoE. It is also better capitalized than peers with Tier-I of over 9.9%.

Key Risks

- Sharper-than-expected decline in net interest margins
- Sharper-than-expected slippage in asset quality
- International book can throw lumpy slippages

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