Equity Research

Equity Research Report Banks.

Date: January 10, 2019

Bank of Baroda

Analyst Recommendation: BUY

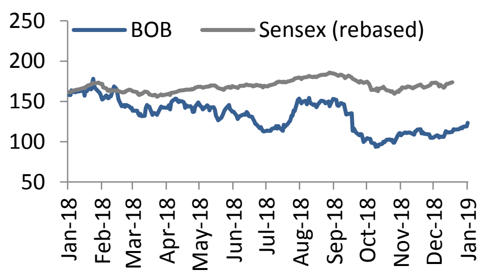
BSE Code:	532134	NSE:	BANKBARODA	Reuters Code:	BOB.NS	Bloomberg Code:	BOB:IN

CMP : Rs 123

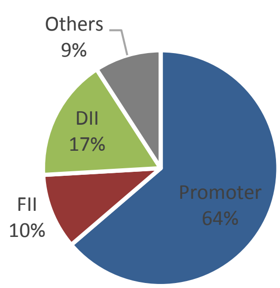
1 Year Target - Rs 135

Face Value	2.0
Market Cap (Rscr)	32,553
52 week high/low	180/91
Avg. Daily Volume (6m)	2.3 cr
Shares O/S (Cr)	264.6
Book Value per Share (Rs)	163.6
Sensex	36,213
Nifty	10,855

1 yr. Price Chart of Stock and BSE



Shareholding pattern as on 30th September 2018



Investor's Rationale

- **Domestic retail segment continues to drive loan growth:** BOB witnessed decent loan book traction of 11.9% YoY in H1FY19 mainly led by domestic loan book (↑20.4% YoY). Within the domestic advances, both corporate loans and retails loans continued to grow at a robust pace of 23.3% YoY and 33.6% YoY, respectively. Growth in retail loan book was contributed by home (↑39.8% YoY) and auto segments (↑38.8% YoY). Overseas loan book continued to witness decline in growth (↓10.2% YoY) due to regulatory issues towards LOU and Buyer's credit. While the international book is shrinking, its composition is changing in a manner that is aiding margin expansion. Going forward, we expect advances to grow at a healthy pace of 13% CAGR over FY18-20E mainly led by domestic loans.

- **Strong operating performance:** Net interest income (NII) continued to grow at a healthy pace of 20.8% YoY in Q2FY19 on the back of 57 bps YoY expansion in net interest margin (NIM) to 3.0%. We expect NIM to sustain at current level over FY18-20E on account of the bank's focus towards high yielding assets. Other income declined by 22.2% YoY largely due to weak treasury income. As a result, pre-provisioning profit grew at a meagre pace of 1.3% YoY. Lower provisions (↑4.3% YoY) helped the net profit to grow by 19.7% YoY. With lower slippages, strong core earnings and better fee trajectory, we expect the bank's return ratios to improve (0.6% - RoA and 10.0% - RoE by FY20E) over FY18-20E.

- **Improving asset quality:** Slippages moderated to 3.9% of loans in Q2FY19 as compared to 5.0% in Q1FY19, of which 84% were from watch list. Consequently, Gross and Net non-performing asset (NPA) ratios improved by 68 and 54 bps sequentially to 11.8% and 4.9%, respectively. Provision coverage ratio (PCR) also improved by 164 bps QoQ to 70.8%. BOB has an exposure of Rs21,980cr to NCLT accounts with PCR of 65%. Going forward, we believe that asset quality will improve as the incremental loan addition is with better rated customers. We project Gross/Net NPA ratios to decline to 8.7%/3.7% by FY20E

Valuation: While the operating metrics have been steadily improving for the last four quarters and BOB is on track to deliver RoE of ~10% by FY20E, the proposed merger with Vijaya & Dena bank will present its own set of challenges and will remain an overhang on the stock. This along with extension of CEO's tenure by only one year does not augur well for the stock. However, the stock price has seen sharp correction recently especially post announcement of merger. As a result, the stock is currently trading at 1.0x P/ABV of FY20E which is quite attractive and renders limited downside. Hence, we continue to maintain BUY rating on the stock with a revised target price (TP) of Rs135 and value the bank at P/ABV of 1.2x for FY20E.

	FY17	FY18	FY19E	FY20E
Net Int. Income	13,513	15,522	18,000	20,304
Pre Pro Profit	10,975	12,006	13,457	15,553
Net Profit	1,383	(2,432)	3,478	4,970
EPS	6.0	(10.5)	13.1	18.7
P/E	20.5	(11.7)	9.4	6.6
P/BV	0.7	0.8	0.7	0.6
P/ABV	1.3	1.6	1.4	1.0
RoE (%)	3.4	-5.8	7.7	10.1
RoA (%)	0.2	-0.3	0.5	0.6

Quarterly Financials (Standalone)

(Rs cr)	Q2FY19	Q2FY18	YoY Growth %	Q1FY19	QoQ Growth %
Interest Income	12,078	10,753	12.3	11,640	3.8
Interest Expense	7,586	7,033	7.9	7,259	4.5
Net Interest Income	**4,493**	**3,721**	**20.8**	**4,381**	**2.5**
Non-Interest Income	1,352	1,737	(22.2)	1,148	17.8
Total Net Income	**5,844**	**5,458**	**7.1**	**5,529**	**5.7**
Operating Expenses	2,762	2,416	14.3	2,523	9.5
Employee Cost	1,222	1,213	0.7	1,101	11.0
Other Operating Exp.	1,541	1,203	28.1	1,422	8.3
Total Income	**13,430**	**12,490**	**7.5**	**12,788**	**5.0**
Total Expenditure	**10,348**	**9,449**	**9.5**	**9,782**	**5.8**
Pre-Provisioning profit	**3,082**	**3,042**	**1.3**	**3,006**	**2.5**
Provisions	2,430	2,329	4.3	2,166	12.2
Profit Before Tax	**652**	**712**	**(8.4)**	**840**	**(22.3)**
Tax	227	357	(36.4)	312	(27.2)
Net Profit	**425**	**355**	**19.7**	**528**	**(19.5)**
EPS - Diluted (Rs)	1.6	1.3	19.7	2.0	(19.5)

Source: Company, In-house research

Business Performance (Rs cr)

(Rs cr)	Q2FY19	Q2FY18	YoY Growth %	Q1FY19	QoQ Growth %
Advances	433,549	387,302	11.9	414,517	4.6
Deposits	606,973	583,212	4.1	581,484	4.4
Business	**1,040,522**	**970,514**	**7.2**	**996,001**	**4.5**
Gross NPA	55,121	46,307	19.0	55,875	(1.3)
Net NPA	21,059	19,573	7.6	22,384	(5.9)

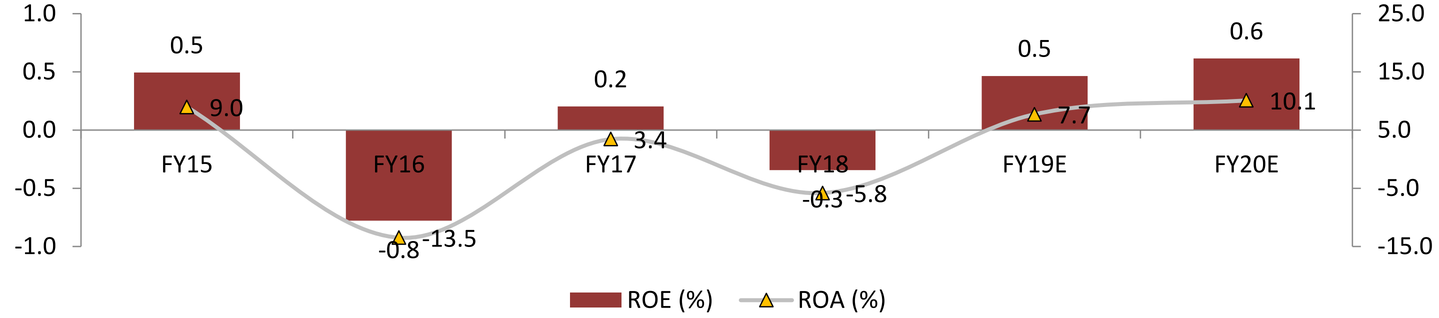
Domestic retail segment continues to drive loan growth

BOB witnessed decent loan book traction of 11.9% YoY in H1FY19 mainly led by domestic loan book (↑20.4% YoY). Within the domestic advances, both corporate loans and retails loans continued to grow at a robust pace of 23.3% YoY and 33.6% YoY, respectively. Growth in retail loan book was contributed by home (↑39.8% YoY) and auto segments (↑38.8% YoY). Notably, the bank has been improving upon its new sourcing strategy and it has sourced ~75% of the customers with a CIBIL score of more than 760 as against 30% prior to April 2016. Overseas loan book continued to witness decline in growth (↓10.2% YoY) due to regulatory issues towards LOU and Buyer's credit. While the international book is shrinking, its composition is changing in a manner that is aiding margin expansion. Going forward, we expect advances to grow at a healthy pace of 13% CAGR over FY18-20E mainly led by domestic loans.

Strong operating performance

Net interest income (NII) continued to grow at a healthy pace of 20.8% YoY in Q2FY19 on the back of 57 bps YoY expansion in net interest margin (NIM) to 3.0%. We expect NIM to sustain at current level over FY18-20E on account of the bank's focus towards high yielding assets. Other income declined by 22.2% YoY largely due to weak treasury income. As a result, pre-provisioning profit grew at a meagre pace of 1.3% YoY. Lower provisions (↑4.3% YoY) helped the net profit to grow by 19.7% YoY. With lower slippages, strong core earnings and better fee trajectory, we expect the bank's return ratios to improve (0.6% - RoA and 10.1% - RoE by FY20E) over FY18-20E.

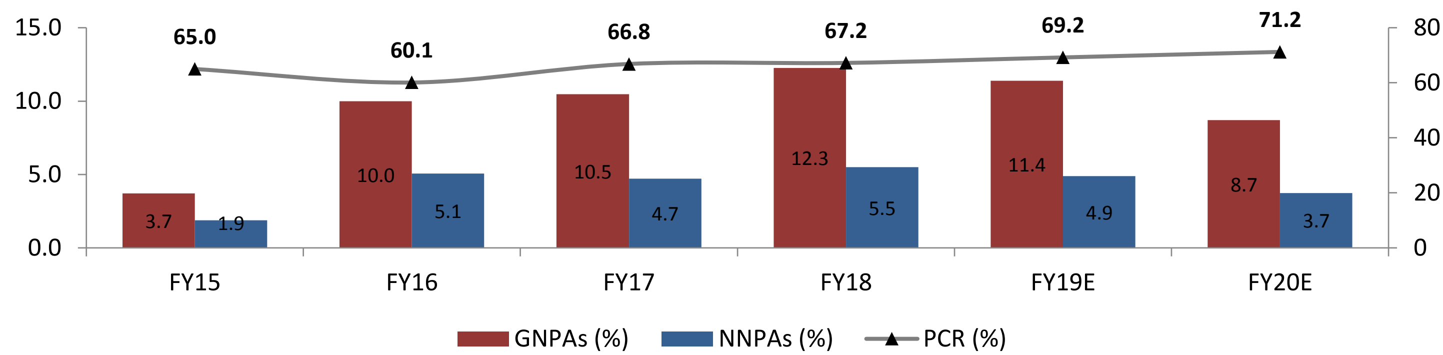
Return ratios to improve gradually from FY20E



Improving asset quality

Slippages moderated to 3.9% in Q2FY19 of loans as compared to 5.0% in Q1FY19, of which 84% were from watch list. Consequently, Gross and Net non-performing asset (NPA) ratios improved by 68 and 54 bps sequentially to 11.8% and 4.9%, respectively. Provision coverage ratio (PCR) also improved by 164 bps QoQ to 70.8%. Though, management did not disclose amount/percentage exposure to IL&FS group, however, the watch list of Rs8,500cr includes IL&FS exposure towards parent company & financial service entity. BOB has an exposure of Rs21,980cr to NCLT accounts with PCR of 65%. Going forward, we believe that asset quality will improve as the incremental loan addition is with better rated customers. We project Gross/Net NPA ratios to decline to 8.7%/3.7% by FY20E.

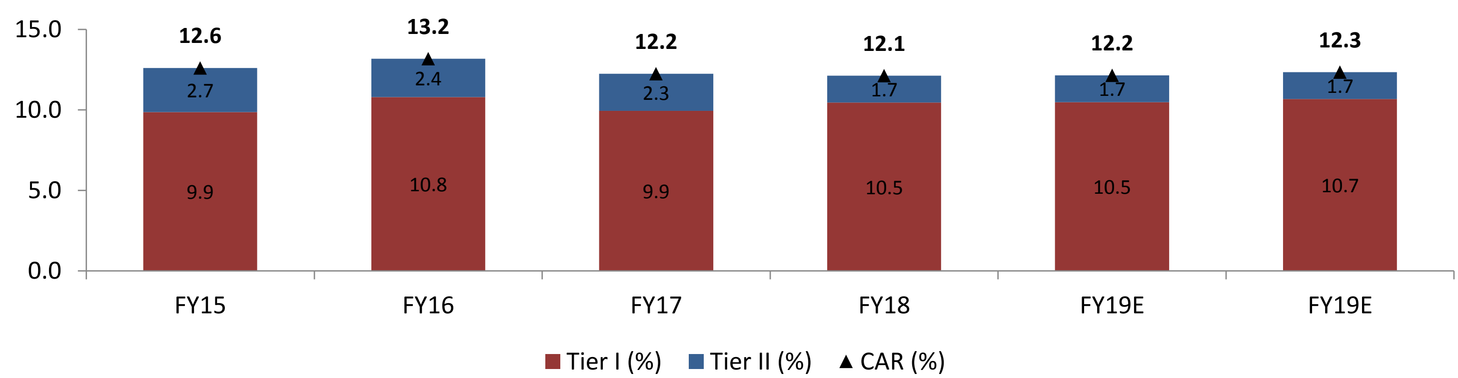
Asset quality to improve from FY19E



Source: Company, In-house research

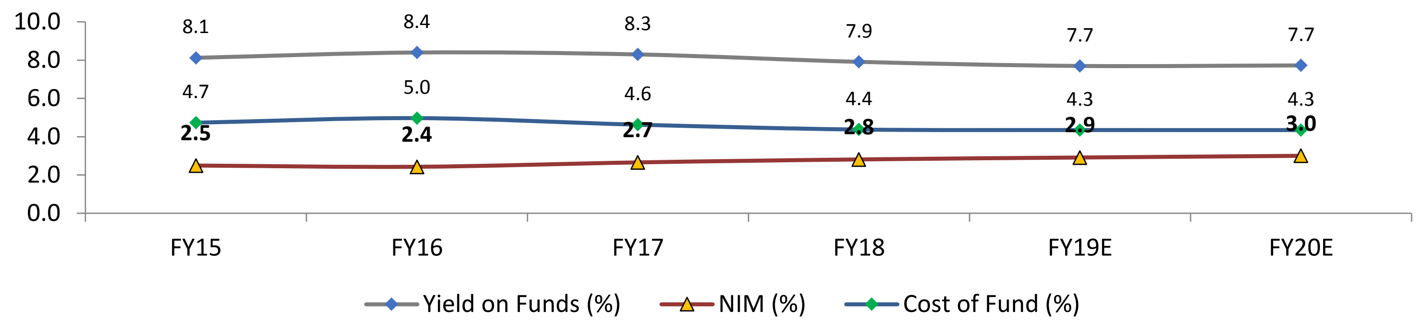
Adequately capitalized

While most of its PSB peers have seen a decline in their tier-1 ratios, BOB has managed to maintain its tier 1 capital ratio at 9%+ for the past six years despite challenging macros. This is important aspect as many PSU banks have witnessed heavy dilution over the last 2-3 years due to the new Basel III requirements. The Bank's capital adequacy ratio (CAR) as per Basel III norms continues to remain strong at 11.9% with Tier-I capital ratio of 10.3% as of Q2FY19.



Source: Company, In-house research

NIM to improve to ~3.0% by FY20E



Source: Company, In-house research

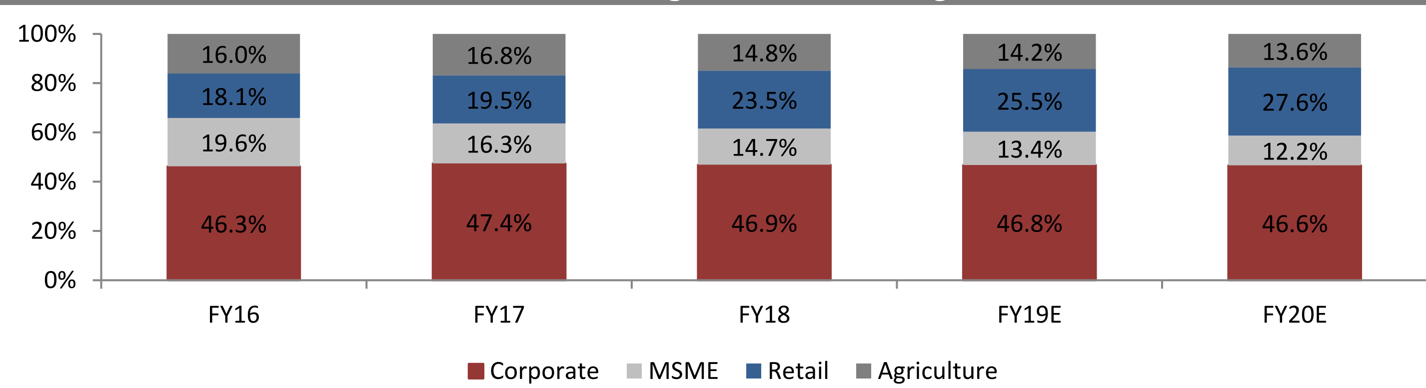
Outlook and Valuation

While the operating metrics have been steadily improving for the last four quarters and BOB is on track to deliver RoE of ~10% by FY20E, the proposed merger with Vijaya & Dena bank will present its own set of challenges and will remain an overhang on the stock. This along with extension of CEO's tenure by only one year does not augur well for the stock. However, the stock price has seen sharp correction recently especially post announcement of merger. As a result, the stock is currently trading at 1.0x P/ABV of FY20E which is quite attractive and renders limited downside. Hence, we continue to maintain BUY rating on the stock with a revised target price (TP) of Rs135 and value the bank at P/ABV of 1.2x for FY20E.

Bank of Baroda: Business overview

BoB is amongst the top 5 Indian banks in terms of balance sheet size and third largest amongst PSU banks in deposit franchise. The bank has strong domestic presence with 5,534 branches and 9,632 ATM's across the country and over 107 offices abroad. It has a well-diversified balance sheet within India, while it has leveraged its international branch network to build a >20% balance sheet from outside India. To consolidate its balance sheet to limit stressed exposures, the bank went through a business transformation, whereby it re-aligned its loan book towards better yielding products with an optimal risk profile over FY16-18. The gradual shift of both the domestic and overseas book towards high yielding advances (retail advances in the domestic book and local credit in the overseas book) is apparent now.

Business mix shifting in favour of retail segment



Key Risks

- **Lower growth than expected:** We expect loan growth of 13% over FY18-20E largely led by higher growth in retail assets. While our assumptions are base case, any major change in our assumption will pose risk to our earnings estimates.
- **Increase in slippages:** We have factored in the slippages of 3.2% and 2.2% for FY19E and FY20E, respectively. Increase in slippages beyond our estimates will deteriorate asset quality and will increase credit cost and hence affect the bottom line.
- **Spike in Interest rates:** We expect the interest rate (repo rate) to remain broadly stable over FY19-20E. However, any further increase in interest rates will affect the margins of the bank and hence the operating matrix.

Balance Sheet (Standalone)

(Rs crore)	FY17	FY18	FY19E	FY20E
Liabilities				
Capital	462	530	530	530
Reserves & Surplus	39,841	42,864	46,279	51,122
Deposits	601,675	591,315	641,098	695,490
Borrowings	30,611	62,572	64,628	69,784
Other Liabilities & Provisions	22,286	22,718	23,960	24,481
Total Liabilities	**694,875**	**720,000**	**776,494**	**841,407**
Assets				
Cash & Balances	150,470	92,897	96,165	97,369
Investments	129,631	163,185	166,685	166,918
Advances	383,259	427,432	478,724	540,958
Fixed Assets	5,758	5,367	5,288	5,288
Other Assets	25,757	31,119	29,633	30,875
Total Assets	**694,875**	**720,000**	**776,494**	**841,407**

Profit and Loss (Standalone)

(Rs crore)	FY17	FY18	FY19E	FY20E
Interest Income	42,200	43,649	47,565	52,269
Interest Expense	28,687	28,127	29,566	31,965
Net Interest Income	**13,513**	**15,522**	**18,000**	**20,304**
Non-Interest Income	6,758	6,657	6,373	6,919
Net Income	20,271	22,179	24,373	27,223
Operating Expenses	9,296	10,173	10,916	11,670
Total Income	**48,958**	**50,306**	**53,939**	**59,188**
Total Expenditure	**37,983**	**38,300**	**40,482**	**43,635**
Pre-Provisioning Profit	**10,975**	**12,006**	**13,457**	**15,553**
Provisions	8,502	14,796	8,138	7,952
Profit Before Tax	2,473	(2,791)	5,319	7,601
Tax	1,090	(359)	1,841	2,631
Net Profit	**1,383**	**(2,432)**	**3,478**	**4,970**

Key Ratios & Valuations (Standalone)

Y.E. March	FY17	FY18	FY19E	FY20E
EPS	6.0	(10.5)	13.1	18.7
DPS	1.2	0.0	0.2	0.4
BV	174.4	163.6	176.5	194.8
ABV	96.2	75.1	88.2	118.4
Valuation (%)				
P/E	20.5	(11.7)	9.4	6.6
P/BV	0.7	0.8	0.7	0.6
P/ABV	1.3	1.6	1.4	1.0
Div. Yield	1.0	0.0	0.2	0.3
Spreads (%)				
Yield on Advances	7.2	7.2	7.2	7.3
Yield on Investments	8.5	7.1	7.2	7.2
Yield on Funds	8.3	7.9	7.7	7.7
Cost of Funds	4.6	4.4	4.3	4.3
Capital (%)				
CAR	12.2	12.1	12.2	12.3
Tier I	9.9	10.5	10.5	10.7
Tier II	2.3	1.7	1.7	1.7
Asset (%)				
GNPA	10.5	12.3	11.4	8.7
NNPA	4.7	5.5	4.9	3.7
PCR	66.8	67.2	69.2	71.2
Management (%)				
Credit/ Deposit	63.7	72.3	74.7	77.8
Cost/ Income	45.9	45.9	44.8	42.9
CASA	32.2	35.8	36.8	37.7
Earnings (%)				
NIM	2.7	2.8	2.9	3.0
ROE	3.4	(5.8)	7.7	10.1
ROA	0.2	(0.3)	0.5	0.6

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Between 10% & -5%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than -5%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.*

** Bank of Baroda is a Large-cap company.*

Member: BSE, NSE, MCX, MCX-SX, CDSL

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