Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Bank of Baroda Ltd.

EQUITY REPORT

March 07, 2014

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Bank of Baroda (BoB) is the second-largest public sector bank in India, with a balance sheet size of ₹5,471 bn as on March 2013. The bank has a network of 4,575 domestic branches and more than 5,000 ATMs, mainly in western India (~42% of the total branch network). The bank has a strong presence overseas, with more than 32% of its advances coming from overseas branches. The Bank has a wide geographic reach as it has presence in 24 countries through 101 offices. During the last quarter of the current financial year, the Bank proposes to set up two new offices, notably in Abu Dhabi and Kenya.

Investor's Rationale

Growth in balance sheet size with advances grew by 18% in Q3FY'14, whereas, deposits grew by 21%. Growth in credit was mainly driven by higher growth in the SME book. Going ahead it would try to rebalance its portfolio in favor of retail segment on account of relatively better delinquency prospects.

With improved operating performance during Q3FY14, BoB reported lower slippages and restructured loans on a sequential basis. Given the overall weak macro environment, asset quality pressures are likely to persist in the near term. However, with the lower slippages and higher recoveries coupled with upgrades, the bank plans to bring down the non-performing asset (NPAs). Therefore, we believe that BoB has a relatively better visibility on the asset quality front as compared to peer banks as it can capitalize on its healthy financial position along with recoveries to manage the NPAs better.

Historically, BoB has been maintaining a strong growth trend: Global deposits grew 21.5% YoY, with 15.4% YoY and 36.4% YoY growth in domestic book and overseas book, respectively. Global loan book grew at 18% YoY on the back of strong growth in SME and retail segments. Thus, with its well-managed liability franchisee & capital position, the Bank is poised to respond to the growth signals by keeping loan and deposit growth higher than the industry average to protect its market share & position as the largest nationalized bank of India.

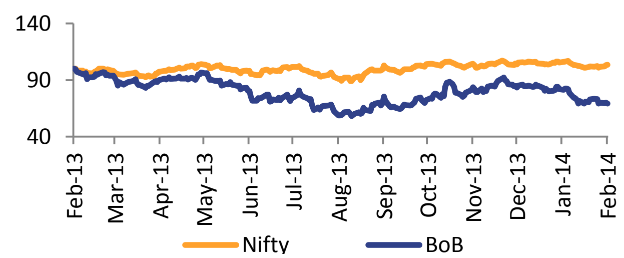
Leveraging overseas operations: Overseas operations continued to do well; during 9M FY14, it contributed 32.4% in total business, 25.2% in total gross profit and 33.3% in total fee-based income. Lower NIM in overseas business (1.18% vs. 2.95% in domestic segments during Q3FY14) is more than compensated by lower operating expenses (overseas Cost/Income ratio at 17.25% as compared to 49.33% in domestic operations during 9MFY14) and lower credit costs (overseas gross NPA: 1.75% while domestic gross NPA: 4.09%).

Market Data	
Rating	**BUY**
CMP (₹)	649.5
Target (₹)	**740**
Potential Upside	~14%
Duration	Long Term
Face Value (₹)	10.0
52 week H/L (₹)	760.0/430.0
Adj. all time High (₹)	1050.0
Decline from 52WH (%)	17.0
Rise from 52WL (%)	51.0
Beta	1.9
Mkt. Cap (₹bn)	279.7
Book Value(₹)	756.6

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
NII(₹bn)	103.2	113.2	123.2	136.6
Net Profit (₹bn)	50.1	44.8	46.7	52.9
Share Capital (₹bn)	4	4	4	4
Adj.EPS (₹)	121.4	106	110.6	125.2
P/E (x)	5.4	6.1	5.9	5.2
P/AdjBV (x)	1.0	0.9	0.7	0.7
Cost-Income Ratio (%)	37.5	39.8	41.8	41.6
RoA(%)	1.2	0.9	0.8	0.8
RoE (%)	20.6	15.1	13.6	13.6

One year Price Chart



Shareholding Pattern	Dec'13	Sep'13	Diff.
Promoters	55.41	55.41	0.00
FII	15.54	15.51	0.03
DII	19.58	19.61	(0.03)
Others	9.47	9.47	0.00

BOB has a network of 4,575 domestic branches and more than 5,000 ATMs, mainly in western India (~42% of the total branch network).

BOB has a strong presence overseas, with more than 32% of its advances coming from overseas branches.

Bank of Baroda - 2nd Largest PSU bank in India

Bank of Baroda (BoB) is the second-largest public sector bank in India, with modern & contemporary personality, offering banking products and services to large industrial, SME, retail & agricultural customers across the country. The Company operates in four segments: Treasury, Corporate / Wholesale Banking, Retail Banking and Other Banking Operations. Its Wholesale Banking Division offers a range of loan products and services, such as term loans, short-term loans, demand loans, working capital facilities, trade finance products, treasury products, bridge loans, syndicated loans, infrastructure loans, cross currency/interest rate swaps, foreign currency loans and loan against future rent receivables. Its retail loan book consisted of five products, such as home loan, auto loan, education loan, traders loan and mortgage loan. It provides third products in life insurance, non life insurance, including health insurance, mutual funds and equity trading under tie-up arrangements with different partners.

The Bank has a wide geographic reach as it has a presence in 24 countries through 101 offices. During the financial year so far, the Bank has opened two new branches in its Overseas Subsidiaries – Tanzania and Uganda in June-July, 2013 and closed one OBU (Offshore Banking Unit) in Mumbai. During the last quarter of the current financial year, the Bank proposes to set up two new offices in Abu Dhabi and Kenya. During 9MFY14, the Bank's Overseas Operations contributed 32.4% to its total Business, 25.2% to its operating Profits and 33.3% to its core fee-based income.

Despite adverse macro-economic backdrop, the Bank added further strength to its business during FY13 and emerged as the largest nationalized bank in terms of global business in the Indian banking space by outpacing the sector in terms of credit growth, by growing at a CAGR of ~25.0% vs 18.0% for the sector.

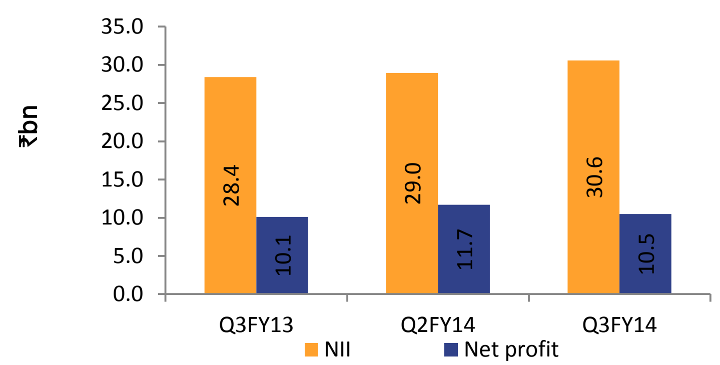
During Q3FY14 Non- Interest Income grew by 14.8% YoY. Healthy non-interest income growth was aided by improved performance on the fee income front, higher recoveries on written off accounts

During Q3FY14 total business growth outpaced the industry growth

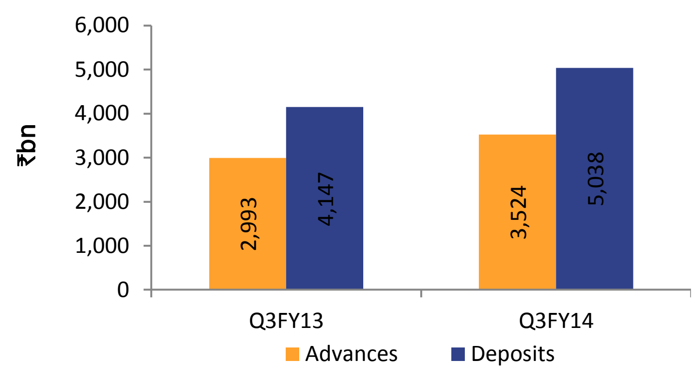
During Q3FY14, BOB reported a relatively better performance with signs of improvement in asset quality. BoB's NII grew by 7.6% YoY to ₹30.6 bn in Q3 FY14, aided by 17.7% YoY growth in advances and 5bps expansion in global NIM's to 2.4%. While non-interest income registered a decent growth of 10.9% YoY at ₹9.3bn on the back of moderate growth of 9.1% YoY in core-fee income and 44.4% YoY growth in its forex fee income. In addition, the operating expenses (opex) increased by 25.7% YoY as the bank continued to make provisions for wage revisions (₹0.75 bn per quarter) and AS-15. Provisions & Contingencies (excluding tax provisions) have also gone down 26% YoY and 11.5% QoQ to ₹7.69 bn. There were write-back of mark to market (MTM) investment provisions to the tune of ₹1.2 bn, which led to decline in provisions. BOB created ₹2.7bn of deferred tax liabilities (DTL) on special reserves in line with RBI guidelines, restricting bottom-line growth at 3.6% YoY at `10.5 bn vs. 17% growth in operating profit.

The total business of BoB grew at a decent pace as it rose sharply above the industry growth, at 20% YoY to ₹8,562.2 bn at end December 2013, driven by 17% YoY and 28% YoY increase in domestic business and the overseas business, respectively. Global advances increased at an accelerated pace of 17.8% to ₹3,524 bn at end December 2013 compared to 16% growth at end September 2013.

NII and Net profit quarterly trend



Business growth during Q3FY14



Loan portfolio expanded 18% YoY in Q3FY'14

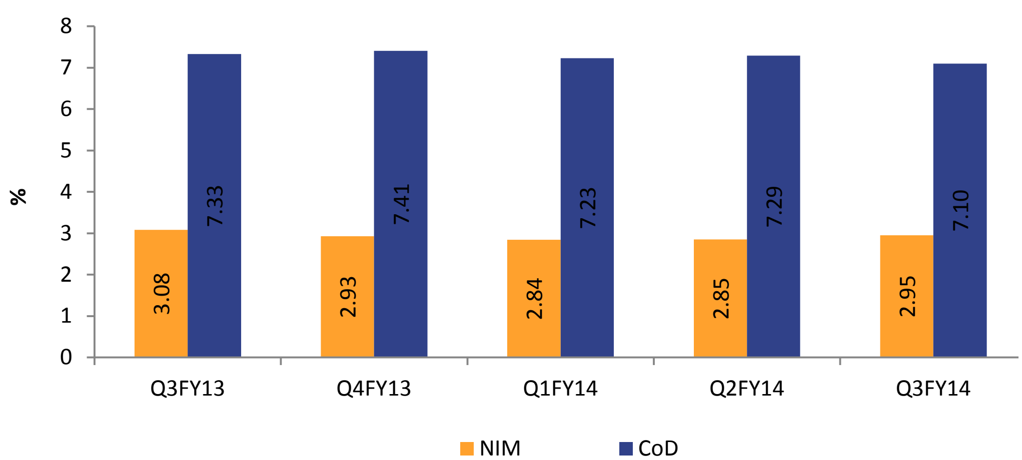
BOB's domestic loan growth accelerated in Q3 FY14 to 18% YoY from 16% YoY in the previous quarter. Retail and SME segments continued to drive credit growth of the bank and their share further improved to 18% and 23% respectively. Under its domestic business, SME segment has grown the fastest at 39.2% YoY followed by retail, which grew 20.9% YoY. Under retail, home loans have gone up 21.0% YoY. Farm credit has declined by 4.8% YoY to ₹263.1 bn. Growth in SME loans was partially led by the change in classification of loans (certain agro based industries) to SME from agriculture, which led to 5% YoY decline in agriculture loans. On a sequential basis, international advances grew by 5% QoQ. The bank intends to grow marginally faster than the system in FY14 without taking undue risks.

Global NIM came in at 2.37% increasing 5 bps sequentially. Domestic NIM improved QoQ to 2.95% from 2.85% in Q2 while overseas NIM remained constant at 1.18%

Domestic NIM to improve to 2.95% in FY14E

Despite a subdued credit sentiment, BoB has managed to exhibit improved performance on the margin front. During Q3FY14, the bank's NIMs rose to 2.37% as against 2.32% in Q2FY14. The main push to the NIMs came from the domestic business where the NIMs expanded by 10 bps QoQ to 2.95% in Q3FY14, driven by a 19 bps QoQ decline in the cost of deposits, which in turn also helped global NIM to inch up 05 bps QoQ to 2.4% in Q3FY14. The bank has taken several initiatives to reduce the cost of deposits (5.24% in Q3FY14 vs 5.41% in Q2FY14), such as a reduction in the bulk deposits, an increase in the current account and savings account (CASA) moblisation and an increase in the retail term deposits (55% in Q3FY14 vs 43% in Q4FY13) and all these measures has had a positive impact on the NIMs. Going ahead, the Management has guided for domestic margin to be at ~3.0% for FY14.

Lower cost of deposit (CoD) enables domestic NIM to improve 10bp QoQ



Strong CAR and sustained ROA bodes well for BoB

BoB is adequately capitalized to meet its growth aspiration with a healthy capital adequacy ratio (CAR) and healthy Tier-1 capital of 12.26% and 8.83% respectively at the end of December 31, 2013. Under Basel III, the Bank's Capital Adequacy Ratio stood at 12.01% with the Tier 1 capital at 8.72% & Core Tier 1 at 8.35% as on 31st December, 2013. These numbers do not include profits for 9MFY14. Thus, with the addition of profit of 9M FY14, all capital ratios would improve by 98 bps.

During the first nine months of FY14, the Bank raised ₹20 bn by way of Tier II capital from India in two tranches of ₹10 bn each thereby, boosting its core capital. Thus, we believe that with the help of its sustained profitability, BoB will continue to maintain the comfortable level of CAR and Tier 1 ratio in the coming years also. Moreover, the bank is on the right track as far as incremental ROAs are concerned, as the return on average assets (ROAA) remained stable at 0.8% in 9MFY14 and expects to take the ROAA close to 1.0% by further improving the CASA share, despite sluggish market condition. However, we expect ROAA to remain stable at 0.80% in FY14E.

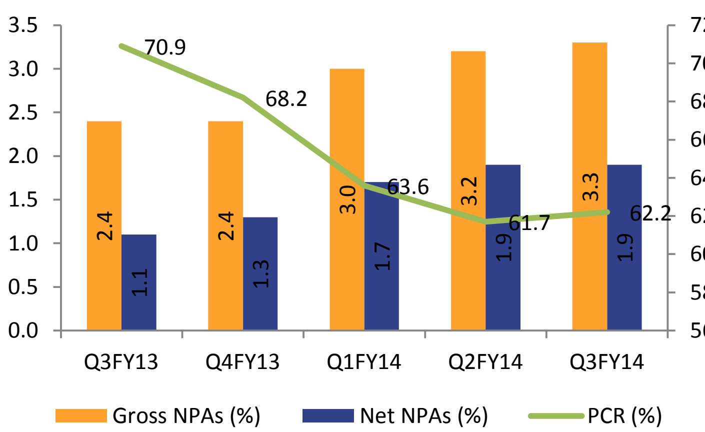
On the back of lower slippages and higher recoveries and upgrades in Q3FY14, the bank anticipates its asset quality woes to be stable to improving in the next quarter.

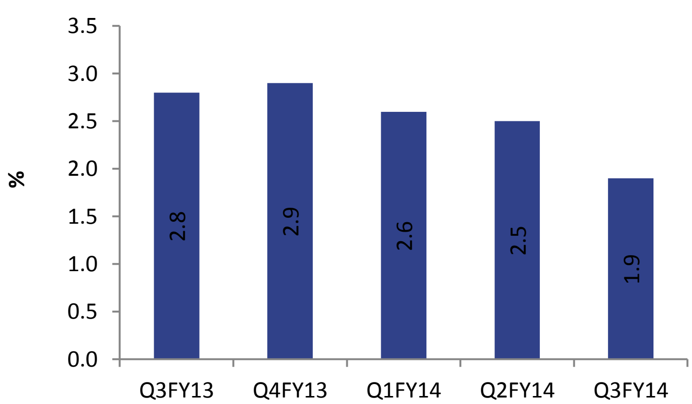
Lower run rate of slippages is expected to moderate asset quality woes

The Bank has performed relatively better than its PSU counterparts on the asset quality front with slippages at ₹15.3 bn in Q3FY14, slightly lower as against ₹20.2 bn in Q2FY14. The Gross NPA ratio increased by 17bps QoQ to 3.3%, while the Net NPA ratio increased by 2bps QoQ to 1.9%. PCR for the bank increased 54bp QoQ to 62.2%. Recoveries and upgrades came at ₹5.0 bn as against a quarterly average of ₹3.0 bn over the last four quarters. Incremental slippages declined steadily from ₹18.6 bn in Q2FY14 to ₹15.5 bn (annualized slippage rate of 1.7%) in Q3FY14 in the Bank's global operations. Similarly, the Bank's "Incremental Restructuring" globally has been easing sequentially from ₹16.4 bn in Q2FY14 to ₹12.1 bn in Q3FY14.

Till Q2 FY13, the bank had been outperforming PSUs with gross and net NPA ratios at 2.0% and 0.8% respectively, much lower than gross and net NPA ratio of 4.0% and 2.1% for all large PSUs altogether. During the last five quarters, the bank has witnessed higher asset quality pressures, as its NPA ratios have increased 134bps over the same period. But again on the back of lower slippages and higher recoveries and upgrades in Q3FY14, the bank anticipates its asset quality woes to be stable to improving in the next quarter.
BOB's largest account being restructured was about the size of ₹1.32 bn. Going ahead, as per the Management, the restructuring pipeline for the bank stands at ₹15.0 bn. As per the management guidance, the bank's asset quality woes are expected to moderate, aided by the lower run rate of slippages and better recoveries and upgrades.

Lower slippages led to stabilizing in asset quality





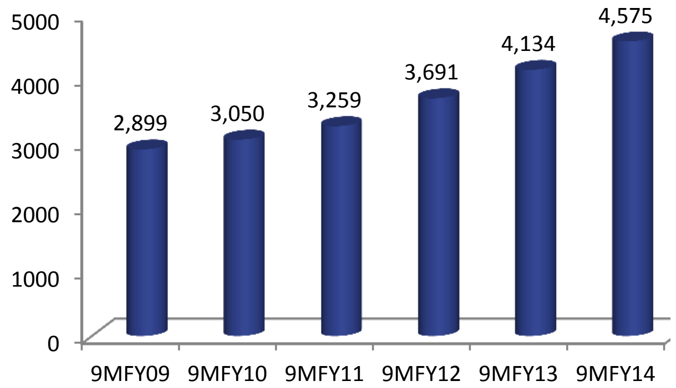
Deposits grew by 21.5%, aided by $1.9 billion of foreign currency non-resident deposits raised under the RBI's concessional window. The CASA ratio was largely stable at 32.27%.

Strong CASA growth

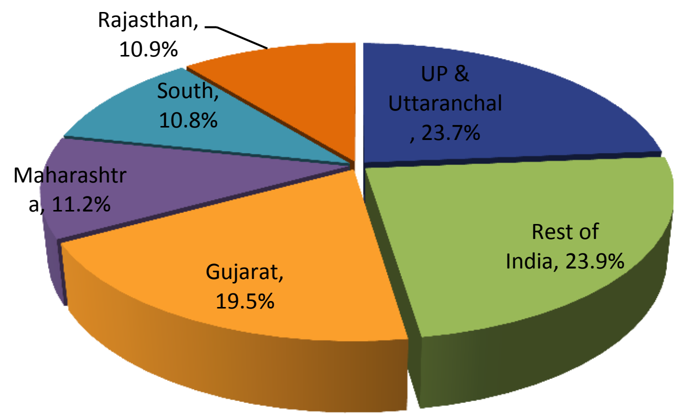
Growth in domestic saving deposits remained moderate at 12.4% YoY, while growth in domestic current deposits came in strong at 29.8% YoY. Domestic CASA deposits witnessed a growth of 15.6% YoY. Overall, the domestic CASA ratio increased by 5bps to 32.3% YoY during Q3FY14.

On a global basis, current deposits witnessed a strong growth of 49.0% YoY, which coupled with a moderate growth of 13.0% YoY in saving deposits, led to a 22.4% YoY growth in CASA deposits. Global CASA ratio increased by 19bps YoY (12bps decrease sequentially) to 32.3%.

Domestic Branch Network (as on Dec. 2013)



Concentration (%): Domestic Branch Network



During Dec-FY09 to Dec-FY14, the Bank added 1,676 branches to its domestic network. The newly opened 301 branches in 9MFY14 mainly belonged to UP & Uttaranchal; Bihar, Jharkhand & Orissa.

RBI Guidance: Aggregate Deposits to grow by 14.0% & Non – food credit by 15.0% in FY14 for the Indian banking industry.

Strong network expansion

During the quarter ended December 2013, BoB added 92 new domestic branches. The bank also installed 1751 new ATMs during the quarter ended December 2013. The network of branches was 4638 branches (including 63 overseas branches) at the end of December 2013. ATM count has improved to 5121 at end December 2013.

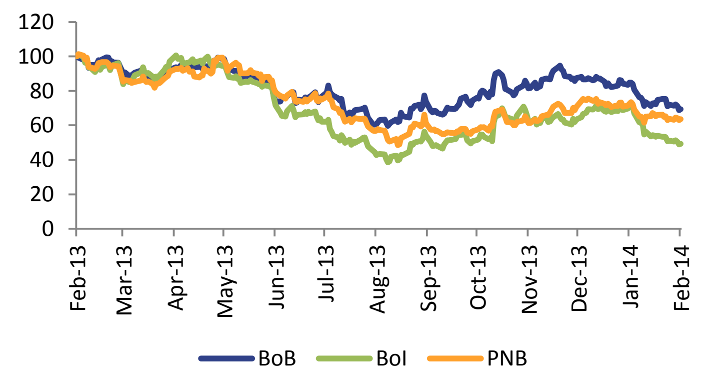
The Bank has opened 301 new branches & merged 2 branches in its domestic operations and set up 2,491 new ATMs and 3,425 new POS machines (Point of Sale Machines) in 9MFY14. Out of 301 newly opened branches, 80 belonged to 'metro & urban' areas; 45 to semi-urban areas & 176 in the rural areas. Further, in order to offer 24*7 basic banking operations, the Bank has opened 30 e-Lobbies during 9MFY14. The bank converted 57 more metro and urban branches into Baroda Next branches in 9MFY14.

Company Guidance: By the end- March, 2014 the Bank would like to improve its domestic NIM to 3.0% through further rebalancing of loan-book; take the return on average assets (ROAA) close to 1.0 % by further improving the CASA share and the yield on advances by taking advantage of the busy season and reducing credit costs.

Relative Valuation

	P/E	P/BVPS	Dividend Yield (%)
BoB	6.1	1.0	3.3
BoI	4.2	0.5	5.2
PNB	4.4	0.6	4.4

Relative Price Chart



Balance Sheet (Consolidated)

Y/E (₹bn)	FY12A	FY13A	FY14E	FY15E
Paid up capital	4	4	4	4
Total reserve & surplus	271	315	363	406
Deposit	3,849	4,739	5,260	5,839
Borrowings	236	266	290	300
Other liabilities & provisions	114	147	160	177
Total Equity & Liabilities	**4,473**	**5,471**	**6,076**	**6,727**
Cash & bank Balance with RBI	642	854	804	918
Advances	2,874	3,282	3,741	4,340
Investments	832	1,214	1,396	1,326
Fixed assets	23	25	26	28
Other assets	102	97	109	114
Total Assets	**4,473**	**5,471**	**6,076**	**6,727**

Profit & Loss Account (Consolidated)

Y/E (₹bn)	FY12A	FY13A	FY14E	FY15E
Interest income	**297**	**352**	**391**	**442**
Interest expense	194	239	268	305
Net Interest Income	**103**	**113**	**123**	**134**
Growth (%)	17	10	9	11
Non-interest income	**34**	**36**	**42**	**46**
Operating income	137	150	165	183
Operating expenses	**52**	**60**	**69**	**76**
Profit before provisions	86	90	96	107
Provisions	36	45	49	54
Net Profit	**50**	**45**	**47**	**53**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
Avg. Cost of deposits (%)	1.5	1.4	1.4	1.4
ROA	1.2	0.9	0.8	0.8
ROE	20.6	15.1	13.6	13.6
Interest Expense/ Interest Income	65.2	67.9	68.5	69.1
Investment/Deposit	21.6	25.6	26.5	22.7
Cost-Income Ratio (%)	37.5	39.8	41.8	41.6
C-D Ratio (%)	74.7	69.3	71.1	74.3
Adj.BVPS (₹)	666.3	756.6	868.6	971.7
P/Adj.BV (x)	1.0	0.9	0.7	0.7
Adj.EPS (₹)	121.4	106.0	110.6	125.2
P/E (x)	5.4	6.1	5.9	5.2

Valuation and view

BoB has delivered sustained performance during Q3FY14 to prove the resilience of its brand. Further, the bank's focused strategies have ensured continuance of strong growth momentum in SME and retail segment. We expect the bank to maintain one of the lowest stressed asset pool amongst the PSBs. The management has well utilized the opportunity offered by MTM write-backs to improve provisions for employee benefits. We believe that the bank would continue to attract better valuations than its peers in terms of lower earnings volatility, better return ratios, higher provision coverage ratios, lower slippages and better capitalization.

At a current CMP of ₹649.5, the stock trades at a P/BV of 0.73x FY14E and of 0.66x FY15E, book value. We recommend 'BUY' with a target price of ₹740, arrived at FY15E book value, which implies potential upside of ~14% to the CMP from a long term perspective.

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