

13 February 2016

SELL

TP: INR 115.00

▲ 1.1%

Bank of Baroda

BOB IN

Leaving legacy issues behind

BOB reported a PBT loss of Rs 45bn for Q3FY16 as provisions spiked QoQ. However, tax write-backs of Rs 11bn helped the bank narrow the loss to Rs 33bn. Asset quality worsened as stressed asset formation rose to Rs 240bn with Rs 156bn of fresh slippages, Rs 3bn of fresh restructuring, Rs 54bn of 5:25 and Rs 24bn of SDR. On a positive note, management is confident of having cleaned up its books, leaving no uncertainty for future quarters. We cut earnings and reiterate SELL with a new Mar'17 TP of Rs 115 (from Rs 145).

➔ **AQR dealt with in one bold move:** GNPA ratio rose to 9.7% vs. 5.6% in Q2 as BOB reported fresh slippages worth Rs 156bn (Rs 68bn in Q2). The positive was that the bank has recognised all assets arising out of the RBI's asset quality review (AQR) in the current quarter itself, unlike most PSBs who have spread it over Q3 and Q4. BOB has created 30% provisions on Rs 74bn worth of AQR slippages. It refinanced 9 accounts worth Rs 54bn under 5:25 and evoked SDR on 14 cases worth Rs 24bn.

Fresh restructuring was minimal at Rs 2.5bn as infrastructure loans worth Rs 2bn and other small agri loans were restructured due to a change in DCCO. Restructured assets fell to Rs 171bn (Rs 229bn:Q2) as Rs 58bn worth of loans slipped into NPA.

➔ **Margins decline on interest reversals:** BOB's global NIMs declined to 1.7% from 2.1% in Q2 on account of interest reversal. According to management, large slippages have dented global NIMs by 44bps (domestic NIM: 66bps), excluding which margins would have improved on a sequential basis.

➔ **Maintain SELL:** We cut our FY16-FY18 earnings estimates to factor in the sharp rise in provisions and to account for the loss reported in Q3. Despite the cleanup exercise, we maintain SELL and move to a lower Mar'17 TP of Rs 115 (from a Sep'16 TP of Rs 145), as valuations are rich at 1.5x FY17E ABV despite assuming lower NNPA by FY17-end and a 30% hit to the restructured portfolio.

Financial Highlights

Y/E 31 Mar	FY14A	FY15A	FY16E	FY17E	FY18E
Net interest income (INR mln)	119,653	131,872	123,847	145,850	166,646
Net revenues (INR mln)	164,281	175,892	167,731	195,560	222,856
Pre-provision profits (INR mln)	92,910	99,151	83,586	108,356	126,619
Adj. PAT (INR mln)	45,411	33,984	(14,288)	33,290	46,784
Adj. EPS (INR)	21.3	15.5	(6.3)	14.1	19.1
ROE (%)	13.4	9.0	(3.6)	8.1	10.2
ROA (%)	0.8	0.5	(0.2)	0.4	0.5
Gross NPA (%)	2.9	3.7	8.6	8.0	6.2
Tier I ratio (%)	9.3	10.4	8.3	8.0	7.9
P/BV (x)	0.7	0.6	0.7	0.6	0.6
P/E (x)	5.3	7.3	(18.0)	8.0	6.0

Source: Company, Bloomberg, RCML Research



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PRICE CLOSE (12 Feb 16)

INR 113.70

MARKET CAP

INR 262.0 bln

USD 3.8 bln

SHARES O/S

429.4 mln

FREE FLOAT

43.7%

3M AVG DAILY VOLUME/VALUE

6.6 mln / USD 13.9 mln

52 WK HIGH

INR 216.30

52 WK LOW

INR 109.35

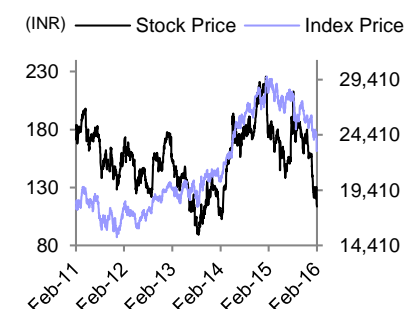
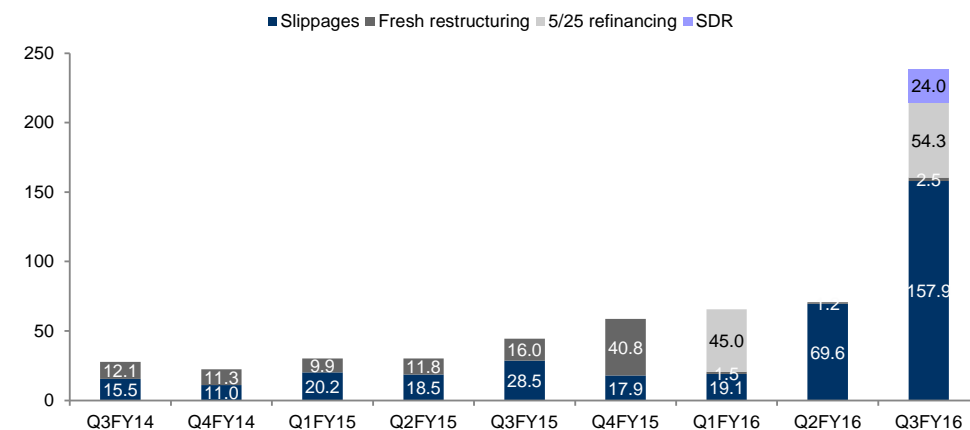




Fig 1 - Quarterly performance

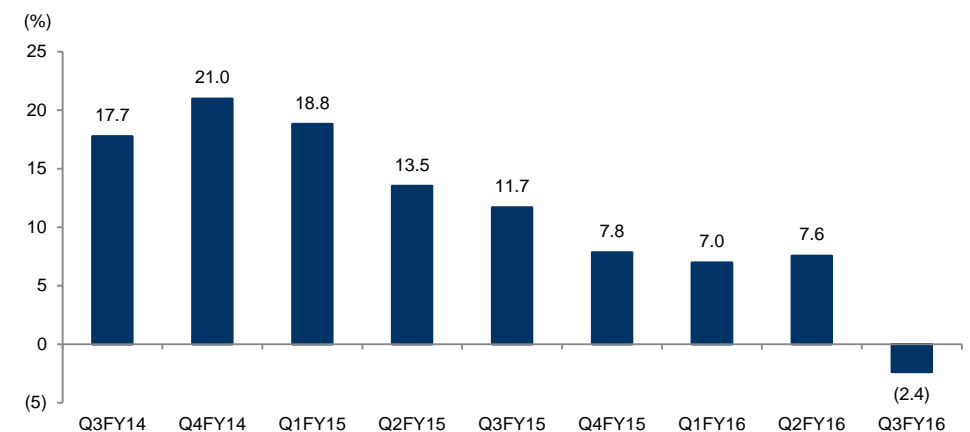
(Rs mn)	Q3FY15	Q2FY16	Q3FY16	YoY (%)	QoQ (%)
Net interest income	32,861	32,445	27,053	(17.7)	(16.6)
Non-interest income	10,904	11,440	11,129	2.1	(2.7)
Net total income	43,765	43,885	38,183	(12.8)	(13.0)
Staff cost	11,198	10,440	11,548	3.1	10.6
Other operating expenses	9,177	10,075	9,593	4.5	(4.8)
Operating expenses	20,375	20,515	21,141	3.8	3.1
Pre-provisioning profit	23,390	23,370	17,041	(27.1)	(27.1)
Provision - NPL	11,498	18,438	64,740	463.0	251.1
Prov for investment dep	(502)	1,120	300	(159.8)	(73.2)
Other provisions	1,626	(641)	(3,395)	(308.8)	429.5
Total provisions	12,623	18,917	61,646	388.4	225.9
Profit before tax	10,768	4,453	(44,604)	(514.2)	(1101.6)
Tax	7,428	3,208	(11,184)	(250.6)	(448.6)
Profit after tax	3,340	1,245	(33,420)	(1100.7)	(2784.8)
Balance Sheet					
Loans	39,36,305	41,48,998	38,42,721	(2.4)	(7.4)
Retail Loans	4,87,360	5,21,880	5,17,280	6.1	(0.9)
Retail as a % of total advances	12.4	12.6	13.5	108 bps	88 bps
Deposits	56,45,997	61,24,578	58,96,872	4.4	(3.7)
CASA ratio (%)	32.4	32.0	30.0	(246 bps)	(198 bps)
Margins (%)					
NIM	2.2	2.1	1.7	(48 bps)	(36 bps)
Key ratios (%)					
Cost/Income	46.6	46.7	55.4	881 bps	862 bps
Core Cost/Income ratio	46.9	49.3	59.9	1296 bps	1064 bps
Tax rate	69.0	72.0	25.1	(4391 bps)	(4697 bps)
Core Fee Income/Operating Income	24.1	21.0	21.6	(251 bps)	62 bps
Loan to Deposit ratio	69.7	67.7	65.2	(455 bps)	(258 bps)
Capital adequacy ratios (%)					
Tier-1	9.1	9.9	9.6	48 bps	(35 bps)
Total CAR Ratio	12.4	12.5	12.2	(24 bps)	(33 bps)
Asset quality					
Gross NPLs	1,54,530	2,37,103	3,89,341	152.0	64.2
Net NPLs	82,913	1,27,978	2,18,062	163.0	70.4
Reserve coverage ratio (%)	46.3	46.0	44.0	(235 bps)	(203 bps)
Gross NPL ratio (%)	3.9	5.6	9.7	583 bps	412 bps
Net NPL ratio (%)	2.1	3.1	5.7	356 bps	259 bps
LLP/Advances	1.2	1.8	6.3	515 bps	454 bps

Source: Company, RCML Research


Fig 2 - Stressed asset formation high at Rs 240bn...


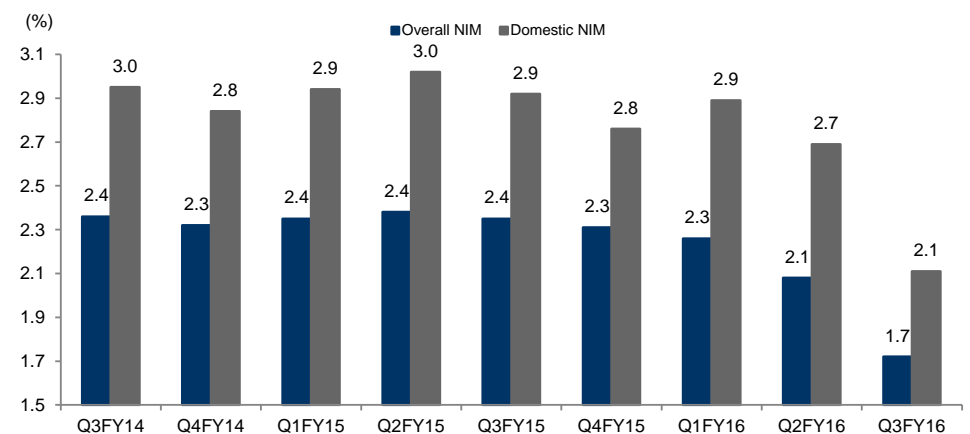
Source: Company, RCML Research

...given the high slippages from RBI's AQR

Fig 3 - Loan book declined by 2% YoY...


Source: Company, RCML Research

...and 7% QoQ

Fig 4 - Global NIM declined to 1.7% QoQ...


Source: Company, RCML Research

...as interest reversals impacted NIMs by 44bps

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**Results Review****INDIA
BANKING****Valuation**

We cut our FY16-FY18 earnings estimates to factor in the sharp rise in provisions and to account for the loss reported in Q3. Despite the cleanup exercise, we maintain SELL and move to a lower Mar'17 TP of Rs 115 (from a Sep'16 TP of Rs 145), as valuations are rich at 1.5x FY17E ABV despite assuming lower NNPA by FY17-end and a 30% hit to the restructured portfolio.

Fig 5 - Revision in estimates

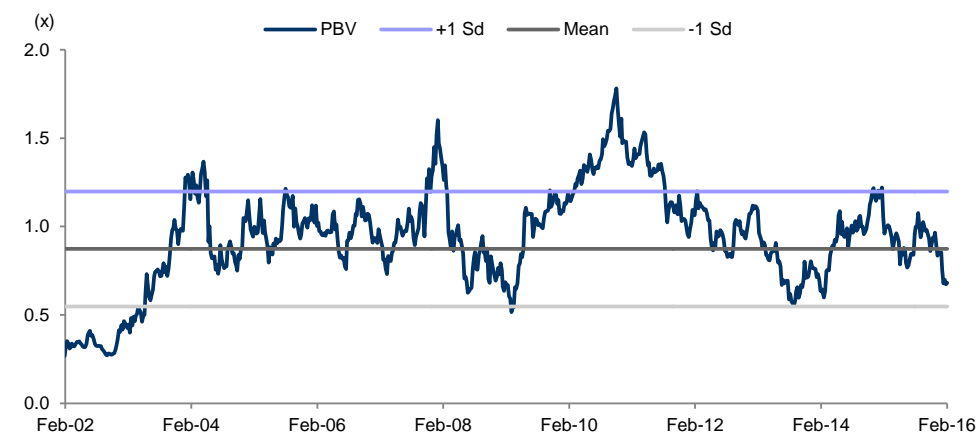
Particulars	Earlier estimates			New estimates			Change (%)		
	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E	FY16E	FY17E	FY18E
Net interest income (Rs mn)	1,36,848	1,56,275	1,80,876	1,23,847	1,45,850	1,66,646	(9.5)	(6.7)	(7.9)
Pre-provisioning profit (Rs mn)	1,00,795	1,22,879	1,45,302	83,586	1,08,356	1,26,619	(17.1)	(11.8)	(12.9)
Profit after tax (Rs mn)	33,617	47,716	57,260	(14,288)	33,290	46,784	(142.5)	(30.2)	(18.3)
EPS (Rs)	15	20	23	(6)	14	19	(142.5)	(30.2)	(18.3)

Source: RCML Research

Fig 6 - Valuation snapshot

Components of two-stage GGM	Assumptions
g (perpetual growth rate)	5.0%
Risk free rate	7.50%
Market risk premium	4.5%
Current beta for stock	1.0x
r (cost of equity)	12.3%
Blended RoE estimate	12.7%
Discounted P/BV	1.5x
Mar'17 adj book value (Rs)	96
Restructuring hit assumption	18
BV taken for price target (Rs)	78
Target Price based on adj BV (Rs)	115

Source: RCML Research

Fig 7 - One-year forward P/BV – BOB is trading below its mean

Source: Company, Bloomberg, RCML Research



Per Share Data

Y/E 31 Mar (INR)	FY14A	FY15A	FY16E	FY17E	FY18E
Reported EPS	21.3	15.5	(6.3)	14.1	19.1
Adjusted EPS	21.3	15.5	(6.3)	14.1	19.1
DPS	4.3	3.2	4.4	4.4	4.4
Book value	167.1	179.6	168.9	178.5	193.9
Adjusted book value	144.0	156.8	nm	126.1	136.0

Valuation Ratios

Y/E 31 Mar (x)	FY14A	FY15A	FY16E	FY17E	FY18E
P/E	5.3	7.3	(18.0)	8.0	6.0
P/BV	0.7	0.6	0.7	0.6	0.6
P/ABV	0.8	0.7	nm	0.9	0.8

Financial Ratios

Y/E 31 Mar (%)	FY14A	FY15A	FY16E	FY17E	FY18E
Spread Analysis					
Yield on advances	7.7	7.5	7.2	7.2	7.1
Yield on investments	7.3	8.1	7.7	7.5	7.5
Cost of funds	4.9	4.7	4.7	4.6	4.6
NIMs	2.0	2.0	1.7	1.8	1.8
Operating Ratios					
Operating cost to income	43.4	43.6	50.2	44.6	43.2
Operating expenses / Avg assets	1.2	1.1	1.1	1.0	1.0
Proportion of CASA deposits	25.7	26.4	26.2	26.0	25.7
Non-int inc / Total income	27.2	25.0	26.2	25.4	25.2
Credit / Deposit ratio	69.8	69.3	67.8	68.1	68.8
Investment / Deposit	20.4	19.8	19.7	19.7	19.8
Asset Quality and Capital					
Gross NPA	2.9	3.7	8.6	8.0	6.2
Net NPA	1.5	1.9	3.2	3.3	3.3
Coverage ratio	49.2	50.4	64.7	60.3	48.4
CAR	12.3	13.1	11.1	10.8	10.6
Tier I ratio	9.3	10.4	8.3	8.0	7.9
Growth Ratios					
Net interest income	5.7	10.2	(6.1)	17.8	14.3
Non-interest income	14.3	3.1	10.0	18.0	18.0
Non-interest income (ex-treasury)	123.4	91.3	108.5	113.5	113.7
Pre-provisioning profit	3.2	6.7	(15.7)	29.6	16.9
Net profit	1.3	(25.2)	(142.0)	(333.0)	40.5
Assets	20.5	8.4	12.5	14.1	14.4
Advances	21.3	8.3	16.4	14.9	14.3
Deposits	20.0	8.6	14.4	15.4	15.4
Book value per share	10.4	7.5	(6.0)	5.7	8.7
EPS	(0.8)	(27.0)	(140.6)	(323.8)	35.1

DuPont Analysis

Y/E 31 Mar (%)	FY14A	FY15A	FY16E	FY17E	FY18E
Net interest income / Assets	2.0	1.9	1.6	1.7	1.7
Non-interest income / Assets	0.7	0.6	0.6	0.6	0.6
Operating expenses / Assets	1.2	1.1	1.1	1.0	1.0
Provisions / Assets	0.6	0.7	1.4	0.7	0.6
Taxes / Assets	0.2	0.3	(0.1)	0.2	0.2
ROA	0.8	0.5	(0.2)	0.4	0.5
Equity / Assets	17.8	18.1	19.3	21.0	21.5
ROAE	13.4	9.0	(3.6)	8.1	10.2


Profit and Loss Statement

Y/E 31 Mar (INR mln)	FY14A	FY15A	FY16E	FY17E	FY18E
Interest income	389,397	429,636	454,445	514,452	589,447
Interest expense	(269,744)	(297,763)	(330,597)	(368,602)	(422,801)
Net interest income	119,653	131,872	123,847	145,850	166,646
Non-interest income	44,627	44,020	43,884	49,710	56,211
Non-interest income (ex-treasury)	37,189	33,950	36,835	41,815	47,526
Net revenue	164,281	175,892	167,731	195,560	222,856
Operating expenses	(71,371)	(76,741)	(84,145)	(87,204)	(96,237)
Pre-provision profits	92,910	99,151	83,586	108,356	126,619
Provisions & contingencies	(37,937)	(44,945)	(103,998)	(59,400)	(57,819)
PBT	54,973	54,206	(20,411)	48,956	68,801
Extraordinaries	0	0	0	0	0
Income tax	(9,562)	(20,222)	6,123	(15,666)	(22,016)
Reported PAT	45,411	33,984	(14,288)	33,290	46,784
Adj. net profit	45,411	33,984	(14,288)	33,290	46,784

Balance Sheet

Y/E 31 Mar (INR mln)	FY14A	FY15A	FY16E	FY17E	FY18E
Cash in hand & bal with RBI	186,291	224,886	213,642	202,960	192,812
Bal with banks, money at call	1,122,488	1,258,646	1,286,789	1,315,585	1,345,049
Investments	1,161,127	1,223,197	1,394,041	1,605,979	1,866,531
Advances	3,970,058	4,280,651	4,794,330	5,554,976	6,473,424
Fixed assets (net)	27,341	28,748	30,773	32,558	34,093
Other assets	127,740	133,757	322,600	463,985	583,726
Total Assets	6,595,045	7,149,885	8,042,174	9,176,044	10,495,635
Equity capital	4,307	4,436	4,621	4,806	4,998
Reserves & surplus	355,550	393,918	385,596	424,075	479,621
Net worth (ex-pref capital)	359,857	398,353	390,217	428,881	484,619
Preference capital	0	0	0	0	0
Deposits	5,688,944	6,175,595	7,066,988	8,152,772	9,406,795
- CASA deposits	1,464,878	1,629,689	1,851,450	2,116,053	2,418,726
- Term deposits	4,224,066	4,545,907	5,215,539	6,036,719	6,988,069
Borrowings (+sub-ord bonds)	392,144	382,280	383,024	383,769	384,518
Other liabilities & provisions	154,101	193,657	201,946	210,622	219,704
Total Equity & Liabilities	6,595,045	7,149,885	8,042,174	9,176,044	10,495,635

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