INSTITUTIONAL EQUITY RESEARCH

PhillipCapital

Bank of Baroda (BOB IN)

Clean up exercise

INDIA | BANKING | Quarterly Update

7 November 2015

Top takeaways from Q2FY16

- ✗ Earnings lower than expected due to higher slippage. Seems to be a cleanup exercise of visible stress in the portfolio.
- ✗ Consequential impact: interest reversal; high provision and hence lower PAT
- ✓ The new management articulated strategy – contain asset quality & focus on recovery; improvement in spread by reducing low margin buyer's credit; introduce risk based pricing model; reduce dependency on syndicate loans.
- ✓ Management expects to grow the business with focus on profitability. Expects to reach 15%-18% RoE in next three years time frame.

Key highlights

- NII declined 4.6% yoy Rs 32.4bn due to weak loan growth (+7.6% yoy) and NIM decline of 32bps yoy to 2.08%. Sequential compression in NIM is due to interest reversal owing high slippage.
- Non-interest income growth was 15.4% yoy to Rs 11.4bn due to trading gains of Rs 2.9bn (+25% yoy) and recovery from written-off assets of Rs 0.8bn (+157%). Core-fee increased to Rs 8.4bn (+7.5% yoy).
- Opex growth at 3% yoy to Rs 20.5bn. Decline in NII led to decline in PPP by 2.7% to Rs 23.4bn
- Slippage was high at Rs 68.2bn, (Q1 was Rs 19bn). Weak upgrades of Rs 5bn added to GNPA. It restructured Rs 1.1bn, taking the outstanding restructured book to Rs 229bn.

Management comments / concall takeaways

- ✗ Slippage mainly from corporate segment. Iron & steel 26%; Mining 15%; infra 11%; textile 6%; electronics 5%. Top 20 a/c contributed 75% of slippage. Slippage from restructured category Rs14bn. International GNPA increased to 3.17% (142bps qoq) mostly Indian corporate with international operations.
- ✗ Tax rate high due to increased provision in international operation. The loan loss provision in UAE territory is not tax deductible hence tax rate seemed to be high.
- ✓ Initiated SDR in two accounts amounting to Rs 2.5bn. Not done re-finance under 5/25.

Outlook and valuation: Profitability to remain key focus this may result some change in loan portfolio. The loan book may remain subdued as the bank trims down non profitability business like buyer's credit. We expect earnings decline of 30% in FY16 followed by 72% earnings growth in FY17. At CMP of Rs 167, the stock trades at 1.1x our FY16 ABVPS of Rs 146 and 1x our FY17 ABVPS of Rs 166. We cut our PT by Rs20 due to adjustment in ABVPS owing to high slippage. Maintain Buy with a revised PT of Rs 210 (Rs 235 earlier).

Buy (Maintain)

CMP RS 167 / TARGET RS 210 (+26%)

COMPANY DATA

O/S SHARES (MN) :	2304
MARKET CAP (RSBN) :	376
MARKET CAP (USDBN) :	5.7
52 - WK HI/LO (RS) :	229 / 139
LIQUIDITY 3M (USDMN) :	28.4
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Jun 15	Mar 15	Dec 14
FII / NRI :	57.5	57.5	56.3
FI / MF :	14.4	17.3	18.6
NON PRO :	20.7	17.8	18.0
PUBLIC :	1.0	0.9	0.9
GOVT :	7.2	7.3	7.0

Key Financials

Rs mn	FY15	FY16E	FY17E
Pre-prov ROE (%)	26.9	22.4	25.1
Pre-prov ROA (%)	1.5	1.2	1.3
Net Profit	34	24	41
% growth	-24.1	-29.9	72.4
Adj BVPS (Rs)	148.9	145.9	166.4
ROE (%)	9.2	5.9	9.1
P/E (x)	10.9	16.3	9.9
Adj P/BV (x)	1.1	1.14	1.00
EPS (Rs)	15.3	10.2	16.9
BLM Cons EPS	15.3	20.0	25.3

CHANGE IN ESTIMATES

	Revised Est.		% Revision	
Rs bn	FY16E	FY17E	FY16E	FY17E
NII	130.5	158.6	-9.4	-3.3
PPP	91.1	113.3	-13.3	-7.1
Core PAT	23.8	41.1	-44.6	-27.9
EPS (Rs)	10.2	16.9	-44.4	-27.6

Manish Agarwalla, Pradeep Agrawal, Paresh Jain

(Rs bn)	Q2FY16	Q2FY15	yoy %	Q1FY16	qoq %	vs. expect. %	Comments
Net interest income	32.4	34.0	-4.6	34.6	-6.2	-7.8	NII declined due to interest reversal on higher slippage
NIM (%)	2.1	2.4	(32bps)	2.3	(18bps)	(19bps)	Base rate cut and interest reversal resulted in lower yields impacting NIM
Advances	4149.0	3857.7	7.6	4083.9	1.6	-0.4	Growth was driven by retail loans and farm credit
Corporate advances	1319.8	1220.8	8.1	1230.4	7.3		
Retail advances	521.9	473.8	10.2	517.4	0.9		Retail advances were driven by healthy growth in home loans
Deposit	6124.6	5669.3	8.0	5930.9	3.3	1.9	Term deposit grew 9.4% yoy and CASA deposit grew 4% yoy
CASA	1541.1	1480.3	4.1	1535.4	0.4		Current account declined 10%, while savings account grew 11% yoy
CASA %	32.0	31.9	6bps	31.9	6bps		
Core fee	8.4	7.8	7.5	8.0	5.5		Fee income was driven by commission, exchange and miscellaneous fee
Trading gain	2.2	1.8	25.3	1.6	42.7		
Operating expenses	20.5	19.9	3.1	22.2	-7.8	1.6	Staff expenses declined 5% yoy, other opex increased 14% yoy
Cost to income ratio (%)	49.3	47.2	204bps	52.1	(284bps)		
Provision	18.9	8.9	113.0	6.0	215.4	110.2	NPA (Rs 18bn)/ Inv. depreciation (Rs 1.1bn)/ Standard provision (Rs -800mn)
PAT	1.2	11.0	-88.7	10.5	-88.2	-89.1	Higher NPA and lower NII impacted net profit
Slippage	69.3	18.5	273.9	18.5	273.9		Significant slippages came from iron & steel, infra and mining
GNPA	5.6	3.3	224bps	4.1	143bps		
NNPA	3.1	1.7	134bps	2.1	101bps		Provision Coverage ratio declined 671bps to 58.23%
Tier 1 Capital %	9.9	9.5	45bps	9.4	51bps		Government infused capital of Rs 17.9bn

Result update

(Rs mn)	Q2FY16	Q2FY15	yoy growth	Q1FY16	QoQ growth
Interest earned	111,564	108,257	3.1	112,765	-1.1
Interest expended	79,119	74,246	6.6	78,169	1.2
Net interest income	**32,445**	**34,011**	**-4.6**	**34,596**	**-6.2**
Net interest margin	2.08	2.40	-0.32	2.26	-7.96
Non-interest income	11,440	9,917	15.4	9,672	18.3
Total Income	43,885	43,928	-0.1	44,269	-0.9
Total operating expenses	20,515	19,898	3.1	22,249	-7.8
Payroll costs	10,440	11,078	-5.8	13,451	-22.4
Others	10,075	8,820	14.2	8,798	14.5
Pre-provision Profit	**23,370**	**24,029**	**-2.7**	**22,020**	**6.1**
Provisions & Contingencies	18,917	8,880	113.0	5,997	215.4
% Operating income	80.9	37.0	44.0	27.2	53.7
PBT	4,453	15,149	-70.6	16,022	-72.2
Provision for Taxes	3,208	4,107	-21.9	5,501	-41.7
% of PBT	72.0	27.1	44.9	34.3	37.7
Net Profit	**1,245**	**11,042**	**-88.7**	**10,522**	**-88.2**
Equity	4,621	4,307	7.3	4,436	4.2
EPS, Rs	2.7	25.6	-89.5	23.7	-88.6
Advances	4,148,998	3,857,663	7.6	4,083,881	1.6
Deposits	6,124,578	5,669,259	8.0	5,930,872	3.3
Advances / Deposits (%)	67.7	68.0	-0.3	68.9	-1.6
Gross NPAs	237,103	130,576	81.6	172,740	37.3
Gross NPAs (%)	5.6	3.3	2.2	4.1	1.4
Net NPAs	127,978	67,045	90.9	84,700	51.1
Net NPAs (%)	3.1	1.7	1.3	2.1	1.0
CAR – Total	12.5	12.2	0.3	12.0	0.5

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rsbn	FY14	FY15	FY16e	FY17e
Interest on Loans	279	308	323	372
Interest on Investments	87	97	101	109
Others	24	25	27	30
Total Interest Earned	389	430	451	511
Total Interest Expended	270	298	321	352
Net Interest Income	**120**	**132**	**130**	**159**
Total non-interest income	45	44	45	47
Total Income	164	176	175	206
Personnel Expenses	41	43	47	52
Other Expenses	30	34	37	41
Total Op expenses	71	77	84	93
Net Inc (Loss) before prov	**93**	**99**	**91**	**113**
Provision and contingencies	38	45	54	50
Net Inc (Loss) before tax	55	54	37	63
Provision for Income Tax	10	20	13	22
Net Profit	**45**	**34**	**24**	**41**

Balance Sheet

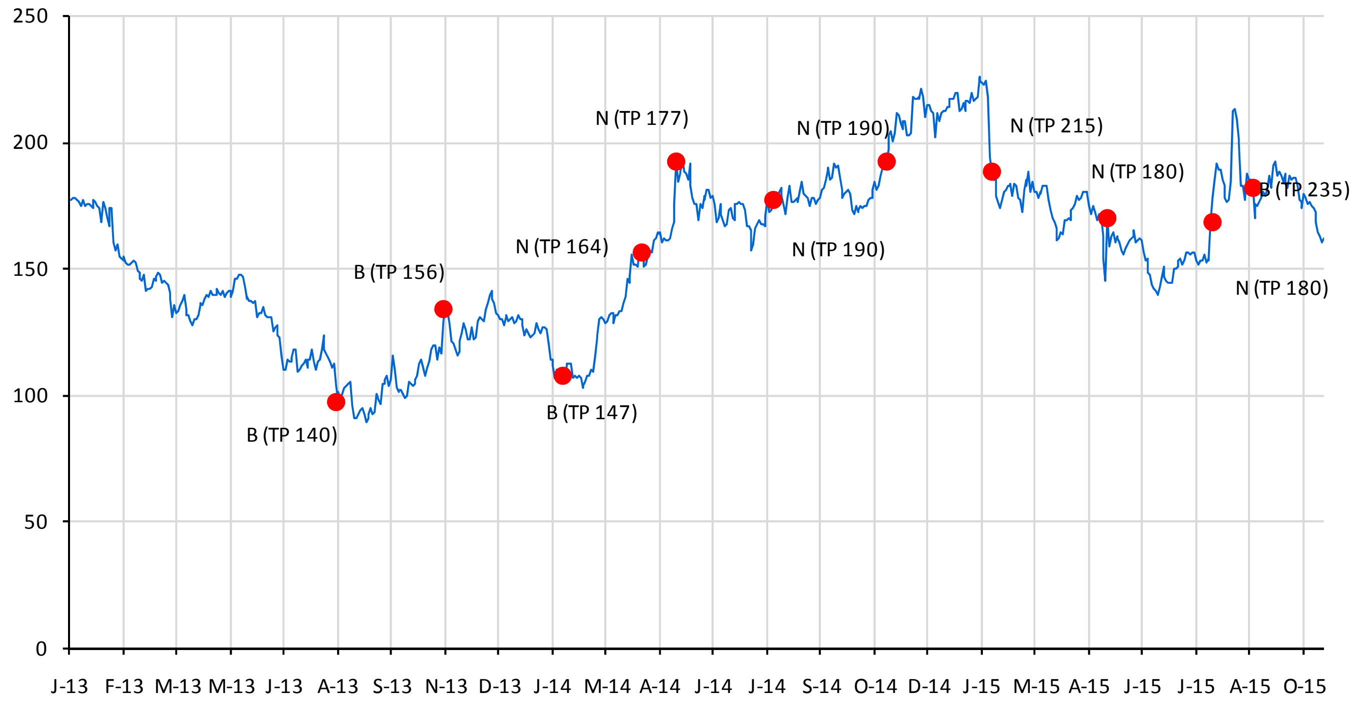
Y/E Mar, Rsbn	FY14	FY15	FY16e	FY17e
Assets				
Cash & Bal with RBI	1,309	1,484	1,649	1,824
Loans, Adv & Int accrued	3,970	4,281	4,836	5,562
Investments	1,207	1,266	1,380	1,560
Fixed Assets (Net)	27	29	31	34
Other assets	81	91	95	100
Total Assets	**6,595**	**7,150**	**7,992**	**9,079**
Liabilities				
Share capital	4	4	5	5
Reserves and Surplus	345	384	421	473
Hybrid Capital	19	19	21	23
Debt	105	102	107	112
Borrowing	244	232	255	280
Total Deposits	5,726	6,222	6,974	7,952
Other liab incld prov	141	177	200	226
Total Liabilities	**6,595**	**7,150**	**7,992**	**9,079**

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY14	FY15	FY16e	FY17e
Earnings and Valuation Ratios				
Pre-provision Operating RoAE (%)	28.2	26.9	22.4	25.1
RoAE (%)	13.8	9.2	5.9	9.1
Pre-provision Operating ROA (%)	1.5	1.4	1.2	1.3
RoAB (%)	0.8	0.5	0.32	0.49
EPS (Rs.)	20.8	15.3	10.2	16.9
Dividend per share (Rs.)	4.8	3.2	3.5	4.0
Book Value (Rs.)	167.1	179.6	186.7	200.4
Adj BV (Rs.)	141.8	148.9	145.9	166.4
Revenue Analysis				
Interest income on IBA (%)	6.6	6.4	6.1	6.1
Interest cost on IBL (%)	4.8	4.7	4.6	4.5
NIM on IBA / AWF (%)	2.0	2.0	1.8	1.9
Core fee Inc / AWF (%)	0.4	0.4	0.4	0.4
Portfolio gains / Total Inc (%)	4.7	6.1	4.5	2.7
Op.Exp / TI (%)	45.5	46.3	50.2	46.2
Op.Exp / AWF (%)	1.2	1.1	1.1	1.1
Employee exps / Op exps (%)	58.0	55.5	55.6	55.6
Tax / Pre-tax earnings (%)	17.4	37.3	35.0	35.0
Asset Quality				
GNPAs / Gr Adv (%)	3.0	3.8	4.8	4.4
NNPAs / Net Adv (%)	1.5	1.9	2.5	1.9
Growth Ratio				
Loans (%)	21.0	7.8	13.0	15.0
Investments (%)	(3.4)	4.9	9.0	13.0
Deposits (%)	20.0	8.7	12.1	14.0
Networth (%)	12.6	10.7	9.1	11.8
Net Int Income (%)	5.7	10.2	(1.1)	21.6
Non-fund based income (%)	23.4	(8.7)	10.1	11.9
Non-Int Exp (%)	21.5	7.5	9.8	10.0
Profit Before Tax (%)	12.1	(1.4)	(32.4)	72.4
Net profit (%)	(0.0)	(24.1)	(29.9)	72.4
Asset / Liability Profile				
Avg CASA/ Deposits (%)	25.4	25.9	26.2	26.3
AvgAdv / AvgDep (%)	67.2	66.7	66.1	66.5
AvgInvst / AvgDep (%)	23.4	20.7	20.1	19.7
IncrAdv / Deposits (%)	72.1	62.6	73.8	74.2
Avg Cash / AvgDep (%)	20.6	23.4	23.7	23.3
Capital Adequacy Ratio:	12.3	12.6	12.1	11.8
Tier I (%)	9.3	9.9	9.7	9.6
Internal Capital Generation rate (%)	11.2	7.7	4.0	7.4
NNPAs to Equity (%)	16.8	20.3	27.7	21.3

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

Management

Vineet Bhatnagar (Managing Director)	(91 22) 2300 2999
Kinshuk Bharti Tiwari (Head – Institutional Equity)	(91 22) 6667 9946
Jignesh Shah (Head – Equity Derivatives)	(91 22) 6667 9735

Research

Automobiles
Dhawal Doshi (9122) 6667 9769
Nitesh Sharma, CFA (9122) 6667 9965

Agri Inputs
Gauri Anand (9122) 6667 9943

Banking, NBFCs
Manish Agarwalla (9122) 6667 9962
Pradeep Agrawal (9122) 6667 9953
Paresh Jain (9122) 6667 9948

Consumer, Media, Telecom
Naveen Kulkarni, CFA, FRM (9122) 6667 9947
Jubil Jain (9122) 6667 9766
Manoj Behera (9122) 6667 9973

Cement
Vaibhav Agarwal (9122) 6667 9967

Economics
Anjali Verma (9122) 6667 9969

Engineering, Capital Goods
Jonas Bhutta (9122) 6667 9759
Hrishikesh Bhagat (9122) 6667 9986

Infrastructure & IT Services
Vibhor Singhal (9122) 6667 9949
Deepan Kapadia (9122) 6667 9992

Logistics, Transportation & Midcap
Vikram Suryavanshi (9122) 6667 9951

Metals
Dhawal Doshi (9122) 6667 9769
Yash Doshi (9122) 6667 9987

Oil & Gas
Sabri Hazarika (9122) 6667 9756

Pharma
Surya Patra (9122) 6667 9768
Mehul Sheth (9122) 6667 9996

Midcap
Amol Rao (9122) 6667 9952

Portfolio Strategy
Anindya Bhowmik (9122) 6667 9764

Technicals
Subodh Gupta, CMT (9122) 6667 9762

Production Manager
Ganesh Deorukhkar (9122) 6667 9966

Database Manager
Deepak Agarwal (9122) 6667 9944

Editor
Roshan Sony 98199 72726

Sr. Manager – Equities Support
Rosie Ferns (9122) 6667 9971

Sales & Distribution

Ashvin Patil (9122) 6667 9991
Shubhangi Agrawal (9122) 6667 9964
Kishor Binwal (9122) 6667 9989
Sidharth Agrawal (9122) 6667 9934
Bhavin Shah (9122) 6667 9974

Sales Trader
Dilesh Doshi (9122) 6667 9747
Suniil Pandit (9122) 6667 9745

Execution
Mayur Shah (9122) 6667 9945

Corporate Communications

Zarine Damania (9122) 6667 9976

Contact Information (Regional Member Companies)

SINGAPORE
Phillip Securities Pte Ltd
250 North Bridge Road, #06-00 RafflesCityTower,
Singapore 179101
Tel : (65) 6533 6001 Fax: (65) 6535 3834
www.phillip.com.sg

MALAYSIA
Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3, Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450 Kuala Lumpur
Tel (60) 3 2162 8841 Fax (60) 3 2166 5099
www.poems.com.my

HONG KONG
Phillip Securities (HK) Ltd
11/F United Centre 95 Queensway Hong Kong
Tel (852) 2277 6600 Fax: (852) 2868 5307
www.phillip.com.hk

JAPAN
Phillip Securities Japan, Ltd
4-2 Nihonbashi Kabutocho, Chuo-ku
Tokyo 103-0026
Tel: (81) 3 3666 2101 Fax: (81) 3 3664 0141
www.phillip.co.jp

INDONESIA
PT Phillip Securities Indonesia
ANZTower Level 23B, Jl Jend Sudirman Kav 33A,
Jakarta 10220, Indonesia
Tel (62) 21 5790 0800 Fax: (62) 21 5790 0809
www.phillip.co.id

CHINA
Phillip Financial Advisory (Shanghai) Co. Ltd.
No 550 Yan An East Road, OceanTower Unit 2318
Shanghai 200 001
Tel (86) 21 5169 9200 Fax: (86) 21 6351 2940
www.phillip.com.cn

THAILAND
Phillip Securities (Thailand) Public Co. Ltd.
15th Floor, VorawatBuilding, 849 Silom Road,
Silom, Bangrak, Bangkok 10500 Thailand
Tel (66) 2 2268 0999 Fax: (66) 2 2268 0921
www.phillip.co.th

FRANCE
King & Shaxson Capital Ltd.
3rd Floor, 35 Rue de la Bienfaisance
75008 Paris France
Tel (33) 1 4563 3100 Fax : (33) 1 4563 6017
www.kingandshaxson.com

UNITED KINGDOM
King & Shaxson Ltd.
6th Floor, Candlewick House, 120 Cannon Street
London, EC4N 6AS
Tel (44) 20 7929 5300 Fax: (44) 20 7283 6835
www.kingandshaxson.com

UNITED STATES
Phillip Futures Inc.
141 W Jackson Blvd Ste 3050
The Chicago Board of TradeBuilding
Chicago, IL 60604 USA
Tel (1) 312 356 9000 Fax: (1) 312 356 9005

AUSTRALIA
PhillipCapital Australia
Level 37, 530 Collins Street
Melbourne, Victoria 3000, Australia
Tel: (61) 3 9629 8380 Fax: (61) 3 9614 8309
www.phillipcapital.com.au

SRI LANKA
Asha Phillip Securities Limited
Level 4, Millennium House, 46/58 Navam Mawatha,
Colombo 2, Sri Lanka
Tel: (94) 11 2429 100 Fax: (94) 11 2429 199
www.ashaphillip.net/home.htm

INDIA
PhillipCapital (India) Private Limited
No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg, Lower Parel West, Mumbai 400013
Tel: (9122) 2300 2999 Fax: (9122) 6667 9955 www.phillipcapital.in

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