PhillipCapital

Oriental Bank of Commerce (OBC IN)

High provision will continue to suppress earnings

INDIA | BANKING | Quarterly Update

10 November 2016

Top takeaways from Q2FY17

- Performance continued to remain weak with net profit of Rs 1.5bn (-49% yoy) below expectation, due to lower non-interest income, higher expenses, and higher provisions.
- NII remains weak (-5% yoy) due to decline in credit growth (-2.5% yoy) and tepid NIM of 2.66% (-10bps qoq).
- Asset-quality deteriorated as fresh slippages remained high at Rs 21.4bn (Rs 34.6bn in Q1FY17). Consequently, GNPA/NNPA increased by 182bps/82bps qoq to 12.36%/8.93%.

Key highlights

- Loan book growth remained weak (3% yoy) due to weak growth in corporate (+2%) and SME (-7%). Retail loan book grew 18% due to strong growth in home loans, while agri was up 19%. The muted growth in corporate credit is due to conversion of Rs 40bn SEB loan into UDAY bonds.
- Non-interest income growth buoyed 37% yoy, driven by strong treasury gains, however fee income growth remained weak due to poor credit off-take in corporate and SME loan book.
- Of the totals slippages of Rs 21.4bn (Rs 6.6bn including slippages from restructured loan book), significant contribution came from iron & steel and power.

Management comments / concall takeaways

- ✓ Significant exposure of Iron & steel has been recognized as stress (60% is recognized as NPA and 7% as restructured). Therefore incremental stress from this sector would be minimal compared to the stress seen in FY16.
- Provision includes Rs750 mn for Punjab Food Credit.
- Outstanding loans under SDR and 5/25 refinancing amounts to Rs 51.3bn and Rs 20.2bn respectively, Of which Rs 21.7bn and Rs 12.6bn are NPAs respectively. SMA2 Rs114bn out of which restructured is Rs32bn.
- Employee expenses increased due to reduction in discount rate for calculation of pension liabilities. Employee cost also includes sick leave provision of Rs 750mn.

Outlook and valuation: High provision requirement will weaken earnings growth, translating into weak returns ratio for the next couple of years, thus overshadowing cheap valuation. Given subdued valuation, equity dilution will be book-value decretive. At CMP of Rs 126, the stock trades at 1x FY18 ABVPS of Rs 121. We downgrade to SELL (earlier Neutral) as it trades at par to its adjusted book value, which is not warranted given week earnings profile. We maintain our PT to Rs 90 (implying 0.75x FY18 adjusted book value).

Sell (Downgrade)

CMP RS 126/ TARGET RS 90 (-29%)

COMPANY DATA

O/S SHARES (MN) :	346
MARKET CAP (RSBN) :	40
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	158 / 75
LIQUIDITY 3M (USDMN) :	8.8
PAR VALUE (RS) :	10

SHARE HOLDING PATTERN, %

	Sep 16	Jun 16	Mar 16
FII / NRI :	58.4	58.4	55.2
FI / MF :	8.1	7.6	8.8
NON PRO :	20.9	21.9	24.1
PUBLIC :	3.7	2.4	4.4
GOVT :	9.0	9.7	7.5

Key Financials

Rs mn	FY16	FY17E	FY18E
Pre-prov ROE (%)	27.4	26.3	25.4
Pre-prov ROA (%)	1.6	1.6	1.6
Net Profit	1561	5491	7243
% growth	-68.6	251.8	31.9
Adj BVPS (Rs)	205	130	122
ROE (%)	1.2	3.9	4.8
P/E (x)	25.9	7.9	6.6
Adj P/BV (x)	0.61	0.97	1.04
EPS (Rs)	4.9	15.9	19.1

CHANGE IN ESTIMATES

	Revised Est.		% Revision	
Rs bn	FY17E	FY18E	FY7E	FY18E
NII	51.6	56.0	-7.6	-10.0
PPP	37.1	38.1	6.6	-1.0
Core PAT	5.5	7.2	103.4	18.7
EPS (Rs)	15.9	19.1	133.3	31.6

Manish Agarwalla, Pradeep Agrawal, Paresh Jain

(Rs bn)	Q2FY17	Q2FY16	yoy %	Q1FY17	qoq %	vs. expect. %	Comments
Net interest income	13.2	13.8	-4.9	12.0	9.2	4.5	NII was impacted due to weak credit growth
NIM (%)	2.7	2.8	(10bps)	2.4	30bps	26bps	Qoq improvement in NIM was due to decline in cost of funds
Advances	1430.4	1467.8	-2.5	1503.0	-4.8	-7.2	Growth remain muted due to weakness in corporate and SME loan book
Corporate advances	625.7	671.2	-6.8	699.5	-10.5		
Retail advances	191.2	174.9	9.3	183.3	4.3		
Deposit	2015.4	1992.0	1.2	2045.1	-1.5		Term deposit declined -1% yoy, CASA deposit grew 7.3% yoy
CASA	533.4	497.3	7.3	529.9	0.7		Savings deposit grew 10%, while demand deposit declined 1% yoy
CASA %	26.5	25.0	151bps	25.9	56bps		CASA ratio improved due to weak growth in term deposits
Core fee	2.2	2.4	-7.8	2.7	-19.9	-13.6	Fee income remains muted due to lack of pick up in corporate loan book
Trading gain	3.3	1.3	160.3	1.6	105.3	33.6	
Operating expenses	**9.4**	**8.2**	15.7	**9.0**	4.7	3.6	Employee expenses increased 25% yoy, other expenses increased 5% yoy.
Cost to income ratio (%)	**60.3**	**48.5**	1172bps	**54.4**	583bps		
Provision	7.7	5.7	36.0	7.5	3.2	3.3	NPA (Rs 6.9bn), Investment dep (Rs 55.6 bn), Std. adv. (Rs -520mn)
PAT	1.5	3.0	-49.1	1.0	52.2	-16.1	PAT was below expectation due to lower non interest income
Slippage	21.4	7.7	178.3	34.6	-38.2		Slippages from restructured loans were Rs 6.6bn
GNPA	**12.4**	**5.7**	666bps	**11.5**	91bps		
NNPA	8.9	3.6	538bps	8.1	82bps		PCR declined 86 bps qoq to 48.47%.
Tier 1 Capital %	**10.3**	**8.4**	184bps	**9.2**	109bps		Core equity capital at 8.75%

Result update

(Rs mn)	Q2FY17	Q2FY16	yoy Growth	Q1FY16	qoq Growth
Interest earned	46,953	50,296	-6.6	47,789	-1.8
Interest expended	33,797	36,465	-7.3	35,743	-5.4
Net interest income	**13,156**	**13,831**	**-4.9**	**12,046**	**9.2**
Net interest margins	**2.66**	**2.76**	**-0.10**	**2.36**	0.3
Non interest income	5,834	4,246	37.4	6,138	-4.9
Total Income	**18,991**	**18,076**	**5.1**	**18,184**	**4.4**
Total operating expenses	**9,432**	**8,151**	**15.7**	**9,013**	**4.7**
Payroll costs	5,617	4,508	24.6	5,383	4.3
Others	3,815	3,643	4.7	3,630	5.1
Pre-provision Profit	**9,558**	**9,925**	**-3.7**	**9,171**	**4.2**
Provisions & Contingencies	7745	5694	36.0	7504	3.2
% Operating income	81.0	57.4	23.7	81.8	-0.8
PBT	**1,813**	**4,231**	**-57.1**	**1,667**	**8.8**
Provision for Taxes	280	1,218	-77.0	660	-57.5
% of PBT	15.5	28.8	-13.3	39.6	-24.1
Net Profit	**1,533**	**3,013**	**-49.1**	**1,007**	**52.2**
Equity	3,462	2,999	15.4	3,462	0.0
EPS, Rs	**4.4**	**10.0**	**-55.9**	**2.9**	**52.2**
Advances	14,30,427	14,67,768	-2.5	15,03,010	-4.8
Deposits	20,15,378	19,92,007	1.2	20,45,080	-1.5
Advances / Deposits (%)	71.0	73.7	-2.7	73.5	-2.5
Gross NPAs	183825	85580	114.8	172089	6.8
Gross NPAs (%)	12.4	5.7	6.66	11.5	0.9
Net NPAs	127482	51891	145.7	117343	8.6
Net NPAs (%)	8.930	3.6	5.38	8.1	0.8
CAR – Tier I	10.3	8.4	1.8	9.2	1.1
CAR – Total	13.4	10.8	2.5	12.4	1.0

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY15	FY16	FY17e	FY18e
Interest on Loans	151,450	147,941	136,105	140,188
Interest on Investments	46,699	47,750	49,469	51,448
Others	1,464	4,897	5,141	5,656
Total Interest Earned	199,614	200,587	190,716	197,292
Total Interest Expended	148,772	146,841	139,151	141,300
Net Interest Income	**50,842**	**53,746**	**51,564**	**55,992**
Total non-interest income	**21,214**	**17,663**	**23,973**	**24,894**
Total Income	**72,056**	**71,408**	**75,537**	**80,886**
Personnel Expenses	16,375	20,317	22,755	25,485
Other Expenses	13,411	14,271	15,698	17,268
Total Op expenses	**29,785**	**34,588**	**38,453**	**42,753**
Net Inc (Loss) before prov	**42,271**	**36,821**	**37,084**	**38,132**
Provision and contingencies	35,923	33,562	29,240	27,158
Net Inc (Loss) before tax	**6,348**	**3,258**	**7,844**	**10,974**
Provision for Income Tax	1,377	1,698	2,353	3,731
Net Profit	**4,971**	**1,561**	**5,491**	**7,243**

Balance Sheet

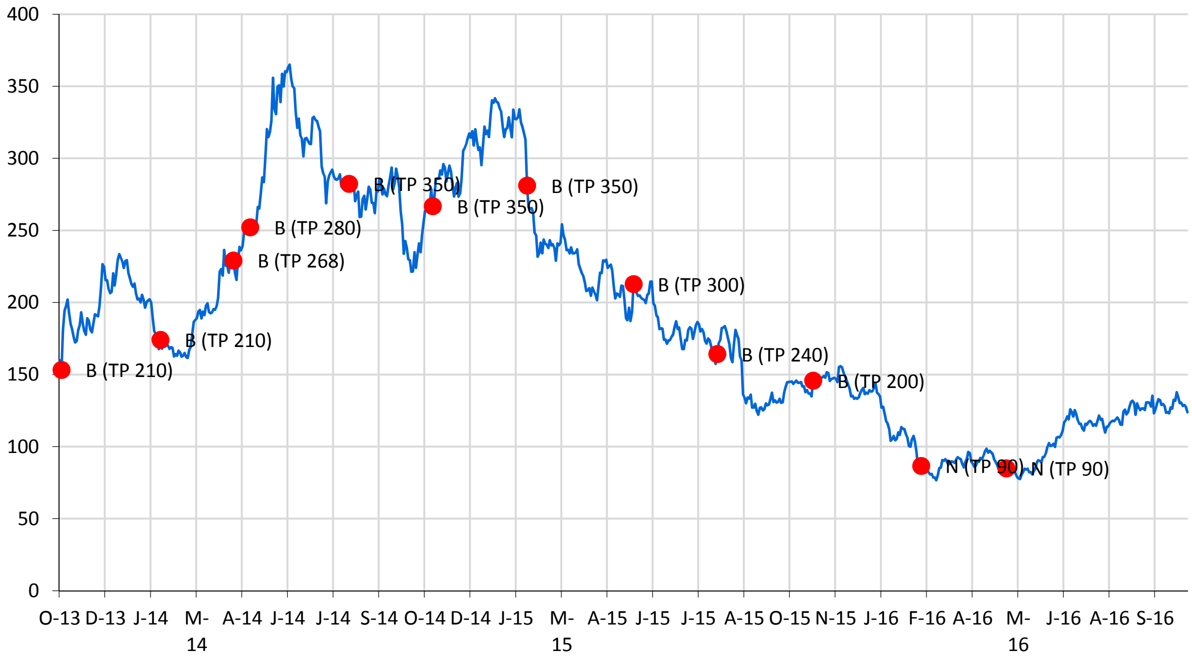
Y/E Mar, Rs bn	FY15	FY16	FY17e	FY18e
Assets				
Cash & Bal with RBI	107,758	99,624	103,090	106,716
Loans, Adv & Int accrued	1,452,613	1,488,800	1,503,688	1,578,872
Investments	698,902	670,800	686,602	712,169
Fixed Assets (Net)	13,525	22,719	25,672	29,010
Other assets	32,338	93,472	102,820	113,102
Total Assets	**2,305,136**	**2,375,415**	**2,421,872**	**2,539,869**
Liabilities				
Share capital	2,998	3,214	3,462	3,795
Reserves and Surplus	128,576	134,125	141,355	151,933
Hybrid Capital	8,500	13,500	28,500	33,500
Debt	42,250	52,250	57,250	67,250
Borrowing	14,700	13,224	14,547	16,001
Total Deposits	2,042,838	2,092,630	2,115,314	2,205,583
Other liab incld prov	59,054	51,399	46,372	46,735
Total Liabilities	**2,305,136**	**2,375,415**	**2,421,872**	**2,539,869**

Source: Company, PhillipCapital India Research Estimates

Valuation Ratios

	FY15	FY16	FY17e	FY18e
Earnings and Valuation Ratios				
Pre-provision Operating RoAE (%)	32.6	27.4	26.3	25.4
RoAE (%)	3.8	1.2	3.9	4.8
Pre-provision Operating ROA (%)	1.9	1.6	1.5	1.5
RoAB (%)	0.2	0.1	0.2	0.3
EPS (Rs.)	16.6	4.9	15.9	19.1
Dividend per share (Rs.)	3.3	0.7	2.5	3.0
Book Value (Rs.)	438.8	427.3	418.3	410.3
Adj BV (Rs.)	320.5	205.5	130.0	121.5
Revenue Analysis				
Interest income on IBA (%)	9.0	8.9	8.4	8.4
Interest cost on IBL (%)	7.2	6.9	6.3	6.2
NIM on IBA / AWF (%)	2.30	2.38	2.27	2.39
Core fee Inc / AWF (%)	0.5	0.4	0.5	0.5
Portfolio gains / Total Inc (%)	9.4	7.3	11.8	8.0
Op.Exp / TI (%)	45.2	52.0	56.9	57.1
Op.Exp / AWF (%)	1.3	1.5	1.7	1.8
Employee exps / Op exps (%)	55.0	58.7	59.2	59.6
Tax / Pre-tax earnings (%)	21.7	52.1	30.0	34.0
Asset Quality				
GNPAs / Gr Adv (%)	5.3	9.9	13.2	13.7
NNPAs / Net Adv (%)	3.4	6.9	9.7	10.2
Growth Ratio				
Loans (%)	4.4	2.5	1.0	5.0
Investments (%)	11.4	(4.0)	2.4	3.7
Deposits (%)	5.5	2.4	1.1	4.3
Networth (%)	2.6	10.6	4.9	6.8
Net Int Income (%)	(0.8)	5.7	(4.1)	8.6
Non-fund based income (%)	5.3	(1.1)	10.0	12.0
Non-Int Exp (%)	2.1	16.1	11.2	11.2
Profit Before Tax (%)	(59.8)	(48.7)	140.7	39.9
Net profit (%)	(56.4)	(68.6)	251.8	31.9
Asset / Liability Profile				
Avg Adv / Avg Dep (%)	24.2	24.7	26.0	27.2
Avg Invst / Avg Dep (%)	68.1	65.7	62.9	61.8
Incr Adv / Deposits (%)	33.3	33.1	32.3	32.4
Avg Cash / Avg Dep (%)	58.1	72.7	65.6	83.3
	6.3	5.0	4.8	4.9
Capital Adequacy Ratio:				
Tier I (%)	11.4	11.8	13.1	13.8
Internal Capital Generation rate (%)	8.7	9.1	10.3	10.7
NNPAs to Equity (%)	3.1	1.0	3.4	4.2

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) 2483 1919
Kinshuk Bharti Tiwari (Head – Institutional Equity)	(91 22) 6667 9946
Jignesh Shah (Head – Equity Derivatives)	(91 22) 6667 9735

Research

Automobiles		**IT Services**		**Pharma & Speciality Chem**	
Dhawal Doshi	(9122) 6667 9769	Vibhor Singhal	(9122) 6667 9949	Surya Patra	(9122) 6667 9768
Nitesh Sharma, CFA	(9122) 6667 9965	Shyamal Dhruve	(9122) 6667 9992	Mehul Sheth	(9122) 6667 9996
Banking, NBFCs		**Infrastructure**		**Strategy**	
Manish Agarwalla	(9122) 6667 9962	Vibhor Singhal	(9122) 6667 9949	Naveen Kulkarni, CFA, FRM	(9122) 6667 9947
Pradeep Agrawal	(9122) 6667 9953	Deepak Agarwal	(9122) 6667 9944	Aashima Mutneja	(9122) 6667 9764
Paresh Jain	(9122) 6667 9948	**Logistics, Transportation & Midcap**		**Telecom**	
Consumer & Retail		Vikram Suryavanshi	(9122) 6667 9951	Naveen Kulkarni, CFA, FRM	(9122) 6667 9947
Naveen Kulkarni, CFA, FRM	(9122) 6667 9947	**Media**		Manoj Behera	(9122) 6667 9973
Jubil Jain	(9122) 6667 9766	Manoj Behera	(9122) 6667 9973	**Technicals**	
Preeyam Tolia	(9122) 6667 9950	**Metals**		Subodh Gupta, CMT	(9122) 6667 9762
Cement		Dhawal Doshi	(9122) 6667 9769	**Production Manager**	
Vaibhav Agarwal	(9122) 6667 9967	Yash Doshi	(9122) 6667 9987	Ganesh Deorukhkar	(9122) 6667 9966
Economics		**Mid-Caps & Database Manager**		**Editor**	
Anjali Verma	(9122) 6667 9969	Deepak Agarwal	(9122) 6667 9944	Roshan Sony	98199 72726
Engineering, Capital Goods		**Oil & Gas**		**Sr. Manager – Equities Support**	
Jonas Bhutta	(9122) 6667 9759	Sabri Hazarika	(9122) 6667 9756	Rosie Ferns	(9122) 6667 9971
Vikram Rawat	(9122) 6667 9986				

Sales & Distribution

Ashvin Patil	(9122) 6667 9991	**Sales Trader**			
Shubhangi Agrawal	(9122) 6667 9964	Dilesh Doshi	(9122) 6667 9747		
Kishor Binwal	(9122) 6667 9989	Suniil Pandit	(9122) 6667 9745		
Bhavin Shah	(9122) 6667 9974				
Ashka Mehta Gulati	(9122) 6667 9934	**Execution**			
Archan Vyas	(9122) 6667 9785	Mayur Shah	(9122) 6667 9945		

Corporate Communications

Zarine Damania	(9122) 6667 9976
Bharati Ponda	(9122) 6667 9943

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 10, 330 Collins Street
Melbourne, VIC 3000, Australia
Tel: (61) 3 8633 9800 Fax: (61) 3 8633 9899
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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Registered office: No. 1, 18th Floor, Urmi Estate, 95 Ganpatrao Kadam Marg, Lower Parel West, Mumbai 400013