Volume No. III Issue No. 153

Bank of Baroda (BOB)

Dec. 8, 2017

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

Green shoots visible...

Bank of Baroda (BOB) is the third largest public sector bank (PSB) in India in terms of asset size and the fourth largest bank in terms of branches as of FY17. The bank has strong domestic presence with 5,451 branches and 10,136 ATM's across the country. BOB is also known as the international bank of India as it has one of the largest branch networks in foreign countries. BOB has presence in over 27 countries with 139 overseas branches/offices, which generates close to 25% of its total business.

Investment Rationale

- **Retail and agri loans to drive future credit growth:** BOB's loan book declined by 10% in FY16 and remained almost flat in FY17 as the bank decided 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. However, with the end of consolidation phase, we expect advances to grow at a healthy pace of 11% CAGR over FY17-19E mainly led by retail and agri loan books.

- **Healthy retail liability franchise:** BOB reported only 1% CAGR in deposits over FY15-17 as the bank has decided to move away from high cost bulk term deposits to low cost retail term deposits to reduce cost of funds. As a result, while total deposits increased at a muted pace of 3% YoY but CASA ratio improved by 580 bps YoY to 33.4% in Q2FY18. We expect the strong traction in retail deposits to continue while bulk deposits are expected to decline going forward. Hence, we expect modest CAGR of 5% in deposits over FY17-19E.

- **Declining trend in slippages to improve asset quality:** Although BOB's asset quality deteriorated significantly over the last 5 years due to slowdown in economy, fresh NPA generation for the bank has already peaked out and on a declining trend. We expect slippages to decline gradually and witnessed remarkable improvement in FY19E. Hence, we project Gross/Net NPA ratios to decline to 8.5%/3.2% by FY19E.

- **Return ratios to improve steadily:** BOB's return ratios declined mainly on account of higher credit cost as a result of significant deterioration in asset quality. However, the bank has taken several measures to address the concern. Therefore, we expect credit costs to decline from hereon given the declining trend in delinquencies. With the growth in core income as well as non-core income coupled with improving operating metrics, the bank's ROE will improve steadily from 3.4% in FY17 to 8.5% in FY19E.

Valuation: The Bank's new management is gradually reinstating confidence through major changes in operating structure which will start yielding desired outcome. Further, we also like management's focus on cleaning up the balance sheet and laying the foundation for sustainable growth. We continue to prefer BOB among public sector banks owing to its better capital position, able management and higher provision coverage ratio. Moreover, gradual improvement in asset quality will lead to better profitability. As a result, we expect RoA and RoE to improve to 0.5% and 9%, respectively by FY19E. Hence, we continue to maintain BUY rating on the stock with a revised upwards TP of Rs200 and value the bank at P/ABV of 1.6x for FY19E.

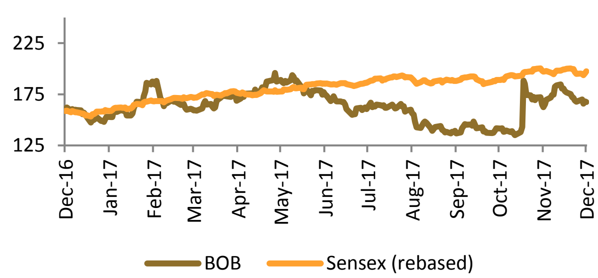
Market Data

Rating	**BUY**
CMP (Rs.)	168
Target (Rs.)	200
Potential Upside	19%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	207/134
Adj. all time High (Rs.)	226
Decline from 52WH (%)	18.9
Rise from 52WL (%)	25.4
Beta	2.75
Mkt. Cap (Rs.Cr)	38,595

Fiscal Year Ended

Y/E	FY16	FY17	FY18E	FY19E
Net Interest Income (Rs. Cr)	12,740	13,513	14,858	16,690
Pre-Pro Profit (Rs. Cr)	8,816	10,975	11,747	13,409
Net Profit (Rs. Cr)	(5,396)	1,383	2,021	3,716
EPS	(23.4)	6.0	8.7	16.1
P/E (x)	--	27.9	19.1	10.4
P/BV (x)	1.0	1.0	0.9	0.9
P/ABV (x)	1.9	1.7	1.8	1.3
ROE (%)	--	3.4	4.9	8.5
ROA (%)	--	0.2	0.3	0.5

One-year Price Chart



Shareholding Pattern	Dec-17	Sep-17	Chg.
Promoters (%)	59.2	59.2	-
Public (%)	40.8	40.8	-

FUNDSINDIA

Bank of Baroda (BOB) is the third largest public sector bank in India. (*in terms of asset size as of FY16)*

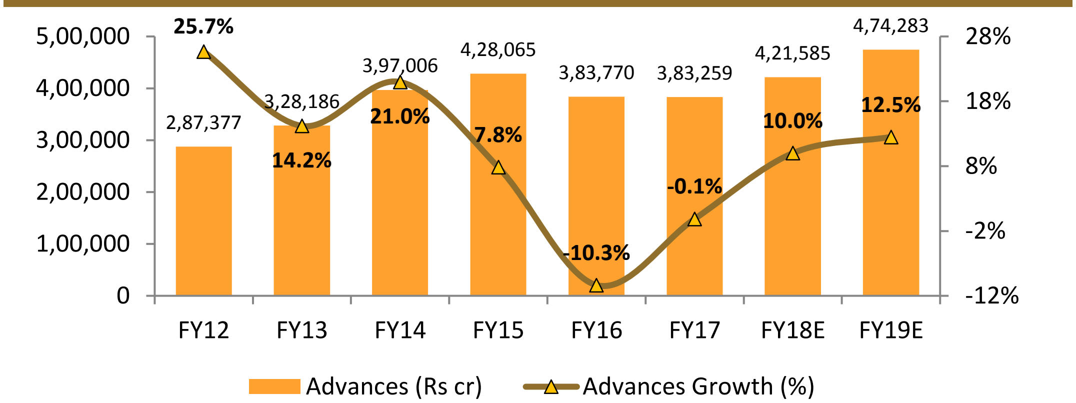
Bank of Baroda (BOB) - Company Overview

Bank of Baroda (BOB) is the third largest public sector bank (PSB) in India in terms of asset size and the fourth largest bank in terms of branches as of FY17. The bank has strong domestic presence with 5,451 branches and 10,136 ATM's across the country. BOB is also known as the international bank of India as it has one of the largest branch networks in foreign countries. BOB has presence in over 27 countries with 139 overseas branches/offices, which generates close to 27% of its total business.

Retail and agri loans to drive future credit growth

BOB consistently showed impressive advances growth by registering 20% CAGR over FY10-15. The growth was largely led by the overseas loan book, which increased at a strong pace of 26% CAGR (32% of total advances) whereas domestic advances registered a healthy CAGR of 17%. However, BOB's loan book declined by 10% in FY16 and remained almost flat in FY17 as the bank decided 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.

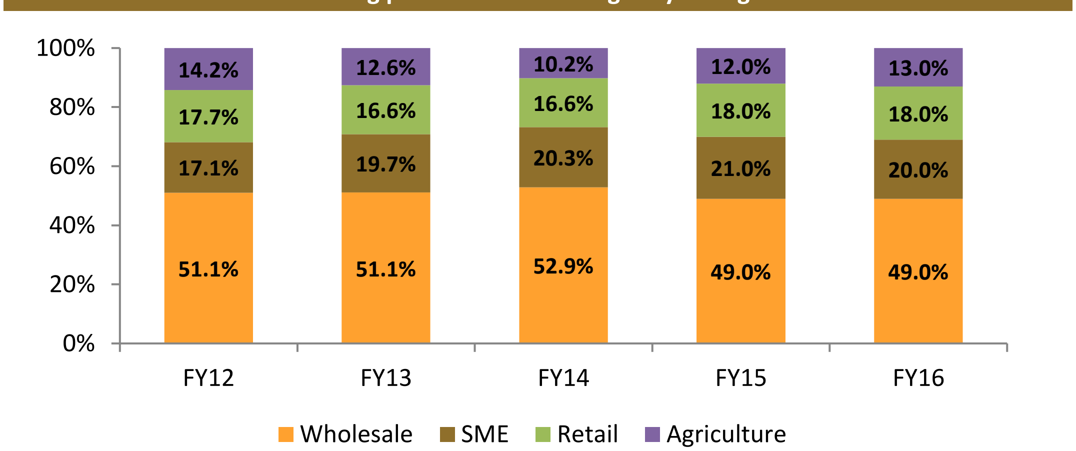
Advances to grow at a CAGR of 11% over FY17-19E



Source: Company, In-house research

In Q2FY18, BOB's loan book grew at a modest pace of 9% YoY mainly led by domestic advances. Domestic loan book witnessed healthy trends (↑14% YoY) aided by strong growth in retail advances (↑26% YoY) and stable growth in wholesale credit (↑15% YoY). Within retail, home loans outperformed (↑34% YoY) aided by portfolio buyouts. However, the bank continues to curtail its low yielding international loan book (↓1% YoY). Going forward, we expect advances to grow at a healthy pace of 11% CAGR over FY17-19E mainly led by retail and agri loan books.

Reshuffling portfolio towards higher yielding assets

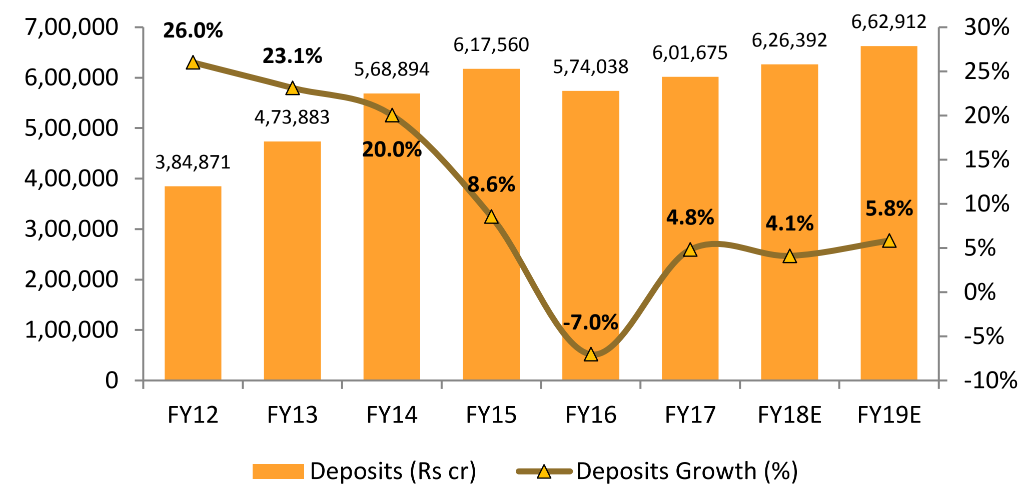


Source: Company, In-house research

Healthy retail liability franchise

BOB has registered a healthy CAGR of 21% in deposits over FY10-15 mainly led by 30% CAGR in overseas deposits (33% of total deposits) while domestic advances registered a CAGR of 17%. However, the bank reported only 1% CAGR in deposits over FY15-17 as the bank has decided to move away from high cost bulk term deposits to low cost retail term deposits to reduce cost of funds. As a result, while total deposits increased at a muted pace of 3% YoY but CASA ratio improved by 580 bps YoY to 33.4% in Q2FY18. We expect the strong traction in retail deposits to continue while bulk deposits are expected to decline going forward. Hence, we forecast 5% CAGR in deposits over FY17-19E.

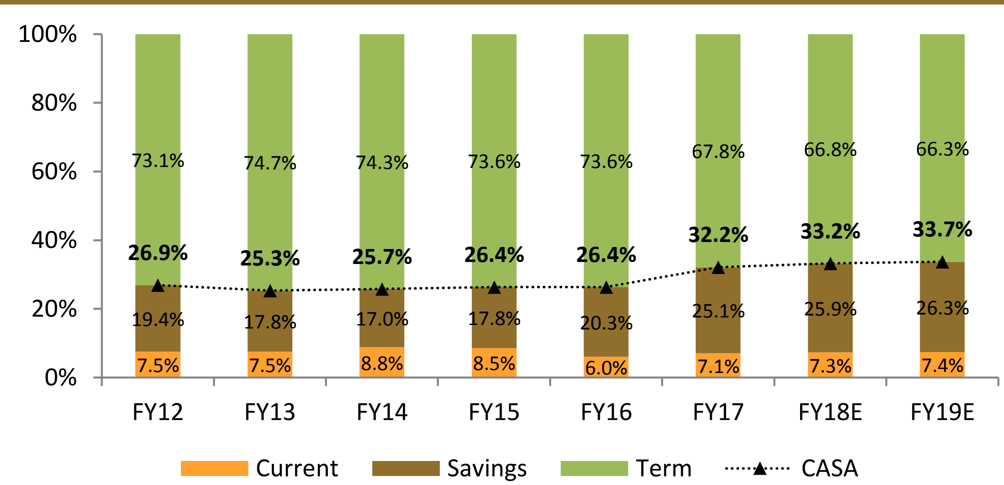
Deposits to grow at a CAGR of 5% over FY17-19E



Source: Company, In-house research

BoB has a well-diversified network of 5,451 branches, which is the fifth largest among public sector banks. In our view, this enables the bank to build a strong retail liability franchise to fund its advances growth. As 34% of its branch network is located in the rural areas, it helps BoB to maintain high CASA balance. Going forward, we expect this trend to continue over FY17-19E driven by high accretion of CASA deposit post demonetization coupled with decline in bulk deposits.

CASA ratio to improve further to 34% by FY19E

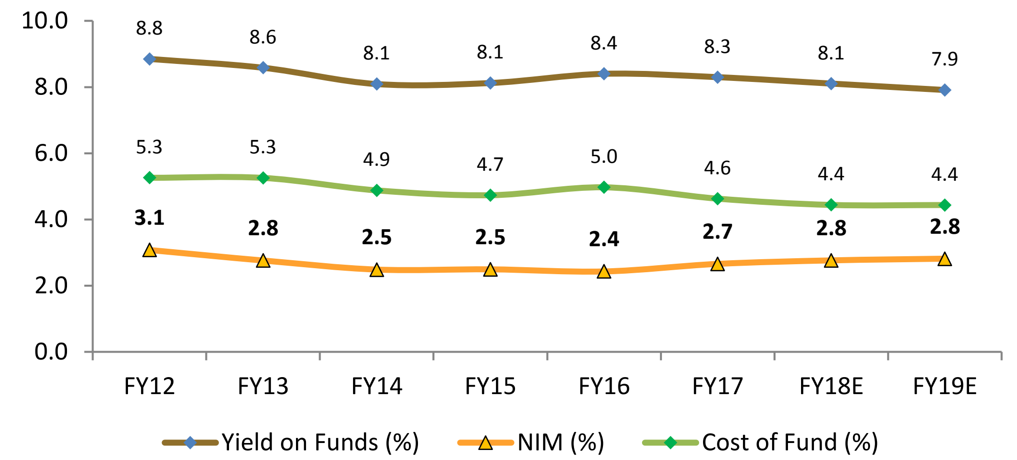


Source: Company, In-house research

Net Interest Margin (NIM) to improve marginally

Domestic margins have improved by 20 bps QoQ to 2.7% in Q2FY18 on account of benefit of lower re-pricing of deposits and increase in the CD ratio. Going forward, we believe NIM to remain in the range of 2.7%-2.8% over FY17-19E on the back of (1) replacement of low yielding overseas loans with a better yielding local credit (2) run-down of high cost bulk deposits with low cost retail deposits and (3) strategic pricing (preferably in the retail portfolio) to improve loan yields. With stable margins and a pick-up in credit growth, Net Interest Income is expected to post a CAGR of 11% during FY17-19E.

NIM to improve to 2.8% by FY18E

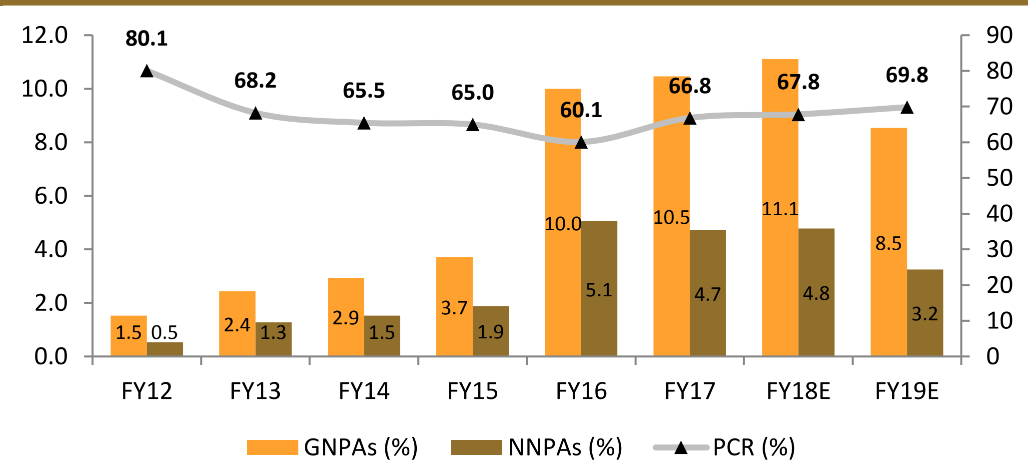


Source: Company, In-house research

Declining trend in slippages to improve asset quality

BOB's asset quality deteriorated significantly over the last 5 years on account of slowdown in economy along with implementation of asset quality review (AQR) by the RBI. Hence, BOB's Gross/Net NPA increased to 11.2%/5.1% in Q2FY18 from 1.5%/0.5% in FY12. However, fresh slippages declined by 41% QoQ in Q2FY18 Provision coverage ratio also (PCR) improved by 90 bps QoQ to 67.2% as the bank continues to make provisions judiciously. The Bank has total exposure to the tune of Rs77bn towards first list of loan accounts referred to IBC/NCLT. Notably, all these loans have already been classified as NPAs and currently the Bank holds PCR of ~54% for these accounts. We believe that some green shoots are visible and expect asset quality to improve gradually from hereon. We project Gross/Net NPA ratios to decline to 8.5%/3.2% by FY19E.

Asset quality to improve remarkably in FY19E

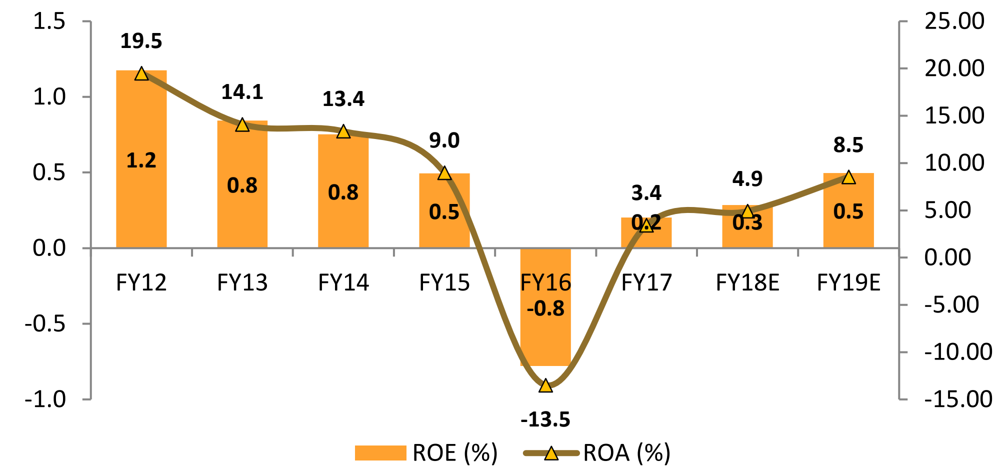


Source: Company, In-house research

Return ratios to improve steadily

BOB's return ratios declined mainly on account of higher credit cost as a result of significant deterioration in asset quality. Hence, BOB reported net loss of Rs5,396cr in FY16. However, the bank has taken several measures to address the concern. Therefore, we expect credit costs to decline from hereon given the declining trend in delinquencies. With the growth in core income as well as non-core income coupled with improving operating metrics, the bank's ROE will improve steadily from 3.4% in FY17 to 8.5% in FY19E.

Return ratios to improve consistently over FY17-19E

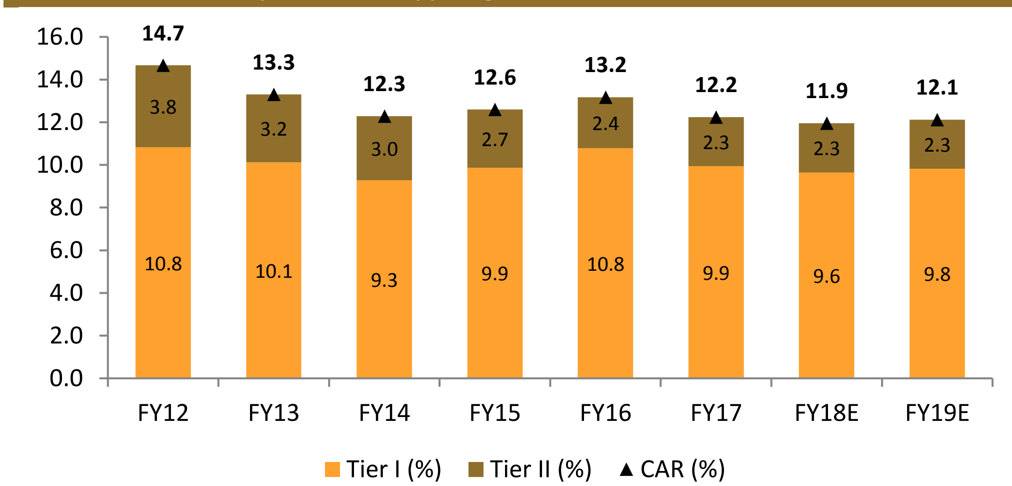


Source: Company, In-house research

Comfortable capital adequacy ratio

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 11.6% with Tier-I capital ratio of 9.6% as of Q2FY18. We believe that the bank is in a comfortable position to maintain its current growth momentum without issuing any fresh equity capital in the next one year.

Well capitalized to support growth momentum over FY17-19E



Source: Company, In-house research

Outlook and Valuation

The Bank's new management is gradually reinstating confidence through major changes in operating structure which will start yielding desired outcome. Further, we also like management's focus on cleaning up the balance sheet and laying the foundation for sustainable growth. We continue to prefer BOB among public sector banks owing to its better capital position, able management and higher provision coverage ratio. Moreover, gradual improvement in asset quality will lead to better profitability. As a result, we expect RoA and RoE to improve to 0.5% and 9%, respectively by FY19E. Hence, we continue to maintain BUY rating on the stock with a revised upwards TP of Rs200 and value the bank at P/ABV of 1.6x for FY19E.

Key Risks:

- **Lower growth than expected:** We expect loan growth of 11% over FY17-19E 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 credit cost of 2.1% and 1.6% for FY18E and FY19E, respectively. Increase in slippages beyond our estimates can result into increase in credit cost and hence it may affect the profitability of the bank.
- **Spike in Interest rates:** We expect the interest rate (repo rate) to remain broadly stable over FY17-19E. However, any further increase in interest rates may affect the margins of the bank and hence the operating matrix. Additionally, it will have a negative impact on investments and in capex, which may also impact asset quality of the bank adversely.

Profit & Loss Account (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Interest Income	44,061	42,200	43,577	46,909
Interest Expense	31,321	28,687	28,718	30,219
Net Interest Income	**12,740**	**13,513**	**14,858**	**16,690**
Non Interest Income	4,999	6,758	6,603	7,417
Net Income	**17,739**	**20,271**	**21,461**	**24,107**
Operating Expenses	8,923	9,296	9,714	10,699
Total Income	**49,060**	**48,958**	**50,180**	**54,326**
Total Expenditure	**40,245**	**37,983**	**38,432**	**40,917**
Pre Provisioning Profit	**8,816**	**10,975**	**11,747**	**13,409**
Provisions	15,514	8,502	8,685	7,778
Profit Before Tax	**(6,698)**	**2,473**	**3,063**	**5,631**
Tax	(1,303)	1,090	1,041	1,914
Net Profit	**(5,396)**	**1,383**	**2,021**	**3,716**

Balance Sheet (Standalone)

Y/E (Rs. Cr)	FY16	FY17	FY18E	FY19E
Liabilities				
Capital	462	462	462	462
Reserves and Surplus	39,737	39,841	41,474	44,747
Deposits	574,038	601,675	626,392	662,912
Borrowings	33,472	30,611	35,413	37,943
Other Liabilities and Provisions	23,668	22,286	22,486	22,877
Total Liabilities	**671,376**	**694,875**	**726,228**	**768,940**
Assets				
Cash and Balances	133,900	150,470	131,542	112,695
Investments	120,451	129,631	140,938	149,155
Advances	383,770	383,259	421,585	474,283
Fixed Assets	6,254	5,758	5,467	5,248
Other Assets	27,002	25,757	26,695	27,559
Total Assets	**671,376**	**694,875**	**726,228**	**768,940**

Key Ratios (Standalone)

Y/E	FY16	FY17	FY18E	FY19E
Per share data (Rs.)				
EPS	(23.9)	6.0	8.7	16.1
DPS	0.0	1.2	1.4	1.6
BV	174.0	174.4	181.5	195.7
ABV	90.0	96.2	94.3	129.1
Valuation (%)				
P/E	-	27.9	19.1	10.4
P/BV	1.0	1.0	0.9	0.9
P/ABV	1.9	1.7	1.8	1.3
Div. Yield	0.0	0.7	0.8	1.0
Capital (%)				
CAR	13.2	12.2	12.1	12.3
Tier I	10.8	9.9	9.8	10.0
Tier II	2.4	2.3	2.3	2.3
Asset (%)				
GNPA	10.0	10.5	11.1	8.5
NNPA	5.1	4.7	4.8	3.2
PCR	60.1	66.8	67.8	69.8
Management (%)				
Credit/ Deposit	66.9	63.7	67.3	71.5
Cost/ Income	50.3	45.9	45.3	44.4
CASA	26.4	32.2	33.2	33.7
Earnings (%)				
NIM	2.4	2.7	2.8	2.8
ROE	-	3.4	4.9	8.5
ROA	-	0.2	0.3	0.5

Rating Criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**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 bank.

Disclaimer:

The SEBI registration number is INH200000394.

The analyst for this report certifies that all the views expressed in this report accurately reflect his / her personal views about the subject company or companies, and its / their securities. No part of his / her compensation was / is / will be, directly / indirectly related to specific recommendations or views expressed in this report.

This material is for the personal information of the authorized recipient, and no action is solicited on the basis of this. It is not to be construed as an offer to sell, or the solicitation of an offer to buy any security, in any jurisdiction, where such an offer or solicitation would be illegal.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable, though its accuracy or completeness cannot be guaranteed. Neither Wealth India Financial Services Pvt. Ltd., nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance.

We and our affiliates, officers, directors, and employees worldwide:

1. Do not have any financial interest in the subject company / companies in this report;
2. Do not have any actual / beneficial ownership of one per cent or more in the company / companies mentioned in this document, or in its securities at the end of the month immediately preceding the date of publication of the research report, or the date of public appearance;
3. Do not have any other material conflict of interest at the time of publication of the research report, or at the time of public appearance;
4. Have not received any compensation from the subject company / companies in the past 12 months;
5. Have not managed or co-managed the public offering of securities for the subject company / companies in the past 12 months;
6. Have not received any compensation for investment banking, or merchant banking, or brokerage services from the subject company / companies in the past 12 months;
7. Have not served as an officer, director, or employee of the subject company;
8. Have not been engaged in market making activity for the subject company;

This document is not for public distribution. It has been furnished to you solely for your information, and must not be reproduced or redistributed to any other person.

Contact Us:

Funds India
Uttam Building, Third Floor|
No. 38 & 39| Whites Road|
Royapettah|Chennai – 600014|
T: +91 7667 166 166
Email: contact@fundsindia.com

Dion's Disclosure and Disclaimer

I, Kaushal Patel, employee of Dion Global Solutions Limited (Dion) is engaged in preparation of this report and hereby certify that all the views expressed in this research report (report) reflect my personal views about any or all of the subject issuer or securities.

Disclaimer

This report has been prepared by Dion and the report & its contents are the exclusive property of the Dion and the client cannot tamper with the report or its contents in any manner and the said report, shall in no case, be further distributed to any third party for commercial use, with or without consideration.
Recipient shall not further distribute the report to a third party for a commercial consideration as this report is being furnished to the recipient solely for the purpose of information.

Dion has taken steps to ensure that facts in this report are based on reliable information but cannot testify, nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this report. It is hereby confirmed that wherever Dion has employed a rating system in this report, the rating system has been clearly defined including the time horizon and benchmarks on which the rating is based.

Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this report is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. Dion has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. This report is not to be relied upon in substitution for the exercise of independent judgment. Opinions or estimates expressed are current opinions as of the original publication date appearing on this report and the information, including the opinions and estimates contained herein, are subject to change without notice. Dion is under no duty to update this report from time to time.

Dion or its associates including employees engaged in preparation of this report and its directors do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of securities, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

The investments or services contained or referred to in this report may not be suitable for all equally and it is recommended that an independent investment advisor be consulted. In addition, nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to individual circumstances or otherwise constitutes a personal recommendation of Dion.

REGULATORY DISCLOSURES:
Dion is engaged in the business of developing software solutions for the global financial services industry across the entire transaction lifecycle and inter-alia provides research and information services essential for business intelligence to global companies and financial institutions. Dion is listed on BSE Limited (BSE) and is also registered under the SEBI (Research Analyst) Regulations, 2014 (SEBI Regulations) as a Research Analyst vide Registration No. INH100002771. Dion's activities were neither suspended nor has it defaulted with requirements under the Listing Agreement and / or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 with the BSE in the last five years. Dion has not been debarred from doing business by BSE / SEBI or any other authority.

In the context of the SEBI Regulations, we affirm that we are a SEBI registered Research Analyst and in the course of our business, we issue research reports /research analysis etc that are prepared by our Research Analysts. We also affirm and undertake that no disciplinary action has been taken against us or our Analysts in connection with our business activities.

In compliance with the above mentioned SEBI Regulations, the following additional disclosures are also provided which may be considered by the reader before making an investment decision:

1. Disclosures regarding Ownership

Dion *confirms that:*

(i) Dion/its associates have no financial interest or any other material conflict in relation to the subject company (ies) covered herein at the time of publication of this report.

(ii) It/its associates have no actual / beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

Further, the Research Analyst confirms that:

(i) He, his associates and his relatives have no financial interest in the subject company (ies) covered herein, and they have no other material conflict in the subject company at the time of publication of this report.

(ii) He, his associates and his relatives have no actual/beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

2. Disclosures regarding Compensation:

During the past 12 months, Dion or its Associates:

(a) Have not managed or co-managed public offering of securities for the subject company (b) Have not received any compensation for investment banking or merchant banking or brokerage services from the subject company (c) Have not received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject. (d) Have not received any compensation or other benefits from the subject company or third party in connection with this report

3. Disclosure regarding the Research Analyst's connection with the subject company:

It is affirmed that I, Kaushal Patel employed as Research Analyst by Dion and engaged in the preparation of this report have not served as an officer, director or employee of the subject company

4. Disclosure regarding Market Making activity:

Neither Dion /its Research Analysts have engaged in market making activities for the subject company.