Sharekhan
by BNP PARIBAS

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Stock Update

Bank of Baroda

A steady quarter

Banks & Finance	Sharekhan code: BANKBARODA	Result Update

Summary

- Q3FY21 results were positive, with operational numbers largely matching expectations; reported asset quality improved q-o-q as domestic margins rose.
- Proforma asset quality with GNPA / NNPA at 9.63% / 3.36% saw a increase of 30BPS and 69BPS on sequential basis; overall collection efficiency is at 92% and 95-96% for corporate book.
- BoB has proactively created provisions and has a manageable restructuring book; but asset quality outlook challenges persist; we expect higher slippages/credit cost in Q4 and H1FY22
- Reasonable valuations of 0.41x / 0.39x FY22E / FY23E BVPS, but outlook still uncertain; we maintain a Hold rating with an unchanged PT of Rs 75.

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↔
CMP: **Rs. 67**	
Price Target: **Rs. 75**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

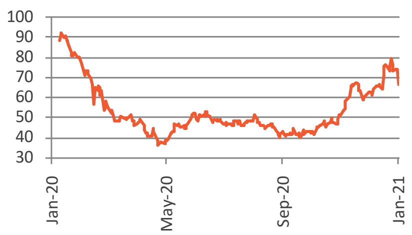
Company details

Market cap:	Rs. 30,842 cr
52-week high/low:	Rs. 94/36
NSE volume: (No of shares)	383.0 lakh
BSE code:	532134
NSE code:	BANKBARODA
Free float: (No of shares)	131.2 cr

Shareholding (%)

Promoters	71.6
FII	4.8
DII	11.3
Others	12.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.1	55.6	41.1	-28.7
Relative to Sensex	-55.6	-80.9	-73.4	-37.0

Sharekhan Research, Bloomberg

Q3FY2021 results were positive, with operational numbers largely matching expectations. However, reported asset quality improved q-o-q with a rise in domestic margins. Net interest income (NII) increased to Rs 7,748 crore, up 8.6% y-o-y and 3.2% q-o-q, in line with expectations. However, higher than expected provisions kept PAT below expectations. Business traction was encouraging, with healthy advances growth of 8.31% y-o-y, led by Retail segment (13.7% y-o-y), Agriculture (14% y-o-y) and within segments, strong growth in Gold, Auto and Home loans. Deposits growth also in sync, growing by 6.7% y-o-y, with Domestic CASA ratio improving to 41.2% (from 39.8% in Q2FY2021). Asset quality, even on a proforma basis (normalised, not considering a standstill as per court orders) stood at GNPA / NNPA at 9.63% / 3.36% from 9.33% / 2.67% in Q2FY21, which we believe is reasonable. Overall collection efficiency stood at 92% for overall book and 95-96% in the corporate book which is reasonably positive. Total restructuring advances stands at 1.39% of standard advances. Of the total restructuring, Rs 1,079 crore (0.16% of standard advances) has been implemented till December 2020 and corporate loans accounted for 82%. The management has warned of rising stress in the coming months, possibly emanating from the retail and small business segments as a fallout of covid-19 stress. Also, the SMA 1 & 2 accounts have risen to 4.41% from 2.88% of standard advances in Q2FY2021, which is a niggle. While the bank has been proactive in provisions and restructuring book is also manageable, we believe that the asset quality wise the outlook continues to be faced with challenges therein persists. We expect higher slippages/credit cost in Q4 and the H1 FY22 and believe that the performance of restructured and MSME book would be critical. The benefits of the merger (with Vijaya Bank and Dena Bank) will most likely accrue over the long term, but may entail higher operating costs and provisions for the merged entity in the interim. The bank has board approval to raise capital, which when it occurs, will help strengthen the balance sheet. We have fine-tuned our estimates and the target multiple. We maintain a Hold rating with an unchanged PT of Rs. 75.

Key positives

- Domestic low cost deposit share at 41.2% versus 38.84% y-o-y & vs 39.78% q-o-q
- Dom NIM improved to 3.07% as against 2.96% for Q2 FY2021 and 2.8% for Q3 FY2020

Key negatives

- SMA-1 & 2 accounts have risen to 4.41% from 2.88% of standard advances in Q2FY2021, which is a niggle.
- Bank recognised slippages of Rs 4000 crores predominantly contributed by two large overseas accounts (a chemical company in middle-east and another company).

Our Call

Valuation: BoB currently trades at valuations of 0.41x / 0.39x FY2022E/ FY2023E BVPS, which is reasonable. We expect the bank to post a RoA/RoE of 0.4%/6.5% by FY23E, led by a stable balance sheet growth along with higher PCR and stable asset quality. However, we believe asset quality performance would still be a key monitorable during the medium term. Also, the bank's expectation of rationalisation benefits post-merger will be difficult to achieve given the complexity of the task at hand. CET-I at 9.3% (including 9M PAT) leaves little headroom, and bank's plans to raise capital will help shore up the CRAR. We have fine-tuned our estimates and the target multiple considering still uncertain outlook. We maintain our Hold rating with a revised PT of Rs. 75.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/or retail books due to overall macroeconomic slowdown and prolonged pandemic recovery would impact growth and profitability.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net interest income	18,480.3	27,451.3	30,705.5	33,092.6	38,736.3
Net profit	433.5	546.2	2,540.3	4,171.1	5,170.2
EPS (Rs)	1.6	1.2	5.5	9.0	11.2
PE (x)	40.6	55.9	12.0	7.3	5.9
Book value (Rs/share)	179.5	148.7	155.0	162.1	170.9
P/BV (x)	0.37	0.44	0.43	0.41	0.39
RoE (%)	0.9	0.9	3.5	5.5	6.5
RoA (%)	0.1	0.1	0.2	0.3	0.4

Source: Company; Sharekhan estimates

Key Conference Call Highlights

Asset quality: The restructured book is at came in at 1.38% of total loans, and excluding NPA accounts it stood at 0.8%. The bank holds COVID-19 provisions of Rs. 1,700 crore. There are six accounts with amount outstanding over Rs. 500 crore.

Restructuring: BoB has not seen any substantial restructuring during the current quarter.

Collection Efficiency: CE is at 93% (was 91% in Q2 FY2021) and 95% in corporate loan book. Collection efficiency as of September end was at 91% compared to 94% during pre-COVID periods. In the moratorium book, collection efficiency is 87% and for non-moratorium book it is at 94%.

Large slippage in international book: International slippages were at Rs. 4,000 crore, of which Rs. 2,700 crore was from a single account which had already slipped earlier and upgraded. This account is a chemical company from the Middle East.

Asset quality guidance: The bank expects normalised slippages to be at 1.5-2%. The management expects more stress in MSME and retail segments as compared to the corporate book.

Slippage in Domestic book: Pro-forma slippages for the quarter was Rs. 8630 crore; around Rs. 680 crore from Agri, Rs. 5,670 crore from Corporate and Rs 2280 crores from Retail.

DHFL exposure: Direct exposure to DHFL is at Rs. 2,000 crore and of this, the bank expects recovery of Rs 800 crores.

SMA-1 & 2: SMA book is at 4.4% of overall loan book; ex of pro-forma slippages it came at 3.6%.

On business segments: Growth will be from secured retail loans and higher rated corporate lending. Gold loans are 20-21% of overall agri loans, and form more than 40% in incremental agri loans.

Good Quality assets: Bank has around 75% of incremental lending is to A-rated/Govt entities/PSUs and around 73% of retail accounts have a credit score of Rs. 725 score or above. Unsecured retail is less than 1%.

ECLGS sanctions of above Rs. 8,000 crore; more than 50% of incremental MSME loans is towards ECLGS

Fund-raising plans: The bank is planning a QIP during soon of Rs 2000-4000 crores

On merger: The merger with Dena and Vijaya Bank has been completed; all branches are being migrated to the core platform of Bank of Baroda. Due to synergy benefits, the bank aims to achieve significant savings in the next 5 years. The bank has shut ~1300 branches and 1000 ATMs of the combined entity. The amalgamation process is complete with respect to Vijaya Bank's branches, while for Dena Bank, the process should conclude by the end of 2021.

Guidance on cost reduction: On account of an aggressive plan for cost reduction it is expected to make cost savings about Rs 1,300 crore on account of the merger and over the next five years of total aggregate saving of about Rs. 10,000 crore.

Rationalising infrastructure: By virtue of the expansion of the savings bank franchise across the entire network the CASA ratio has increased by 400 bps.

Asset quality: The bank has made provisions for accounts benefitting from the SC's injunction while also interest reversal has been done totalling to around Rs 1,500 crore. Accounts worth Rs 14000 crore have got asset classification benefits due to the moratorium; the bank holds 12% provisions on this. The AA and above NBFC book constitutes 90% and A rated and above constitutes 95%.

Recoveries stood at Rs. 1640 crore, NCLT recoveries were at Rs. 200 crore, and asset sale stood at Rs 300 crore.

Business update: Cost of deposits fell 53 bps q-o-q as there is surplus liquidity in the system. BoB expects to achieve the guidance of 7% growth on deposits as well as advances. The advances book declined 9% QoQ due to drawdown in corporate book as yields are not attractive.

Capital Raise: Have an enabling resolution for raising Rs. 13,500 crore taken at the start of the year, which included AT-1 bonds.

Results

Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Interest income	17,768.7	19,071.1	-6.8	17,917.6	-0.8
Interest Expense	10,020.0	11,938.9	-16.1	10,410.1	-3.7
Net Interest income	**7,748.7**	**7,132.3**	**8.6**	**7,507.5**	**3.2**
Non-interest income	422.5	546.5	-22.7	2,802.3	-84.9
Net total Income	8,171.2	7,678.7	6.4	10,309.8	-20.7
Operating Expenses	5,053.6	4,911.8	2.9	4,758.0	6.2
- Employee cost	2,800.2	2,594.2	7.9	2,550.3	9.8
- Other Costs	2,253.4	2,317.6	-2.8	2,207.7	2.1
Pre-provisioning profit	**5,590.6**	**4,958.5**	**12.7**	**5,551.8**	**0.7**
Provisions	3,956.7	7,155.4	-44.7	3,001.6	31.8
Profit before tax	1,634.0	-2,197.0	NA	2,550.2	-35.9
Tax	572.9	-790.0	NA	871.6	-34.3
Profit after tax	**1,061.1**	**-1,407.0**	**NA**	**1,678.6**	**-36.8**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Headwinds continue for PSU Banks

The economy is showing signs of a gradual recovery, which augurs well for long-term demand. However, potential risks due to stress in the economy and uncertainty on COVID-19 related developments continue to pose a challenge, especially for PSU banks. While supportive regulatory measures have cushioned on the earnings front (at least, especially on asset quality recognition part) and the gradual return to normalised business traction will be positive for the BFSI sector, we believe the capital constrained PSU banks which and still are burdened with legacy NPLs may take longer to recover and hence, near-term return ratios may remain weak.

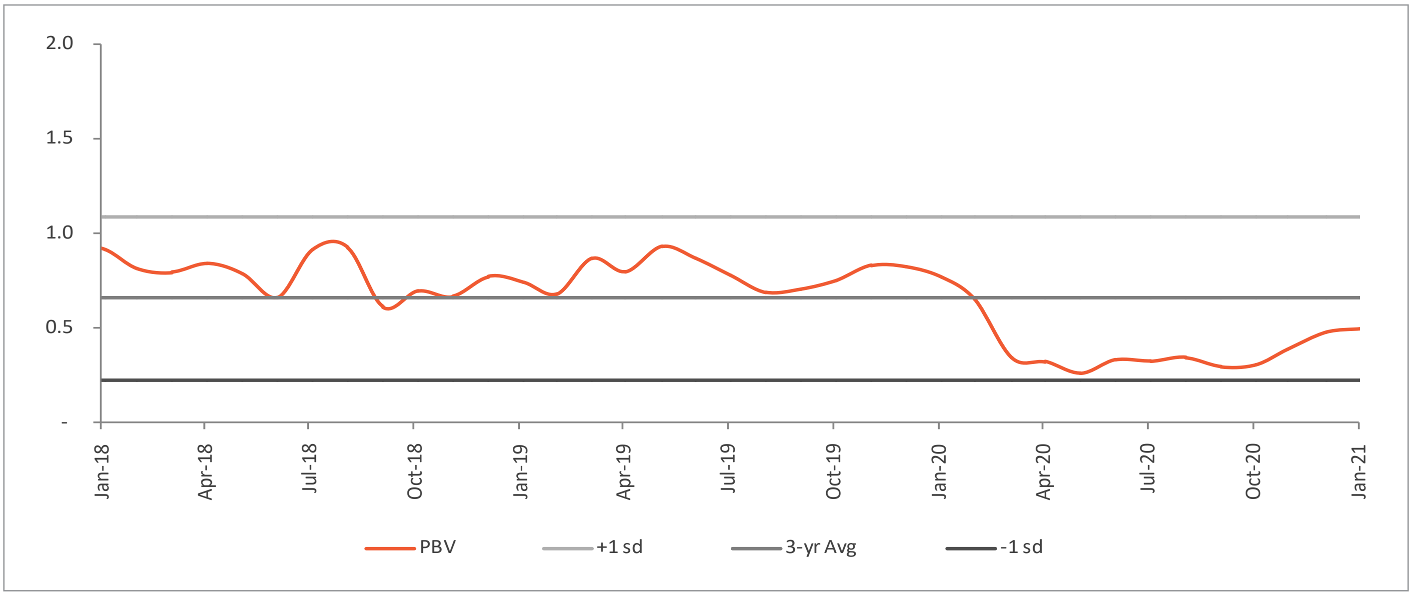
■ Company outlook - Encouraging performance, but longer road to normalcy

Q3FY21 numbers were encouraging, albeit helped by the standstill on NPA recognition. We believe that while economic performance is encouraging, asset quality will continue to be a key monitorable. The increased SMA-1 & 2 remains a concern but we believe the restructuring pipeline and fresh slippages were manageable in FY2021E. Driven by the merged entity's exposure to various stressed groups and uncertainty on the outcome of resolutions and recoveries. Integration issues will continue to be a challenge and opex, may continue to pose a challenge. The bank has reduced its liability pricing, but softening yields and slow credit growth may keep NIMs muted. We expect a revert to normalcy in return ratios is likely to be prolonged.

■ Valuation - Maintain Hold rating with PT of Rs 75

BoB currently trades at valuations of 0.41x / 0.39x FY2022E/ FY2023E BVPS, which is reasonable. We expect the bank to post a RoA/RoE of 0.4%/6.5% by FY23E, led by a stable balance sheet growth along with higher PCR and stable asset quality. However, we believe asset quality performance would still be a key monitorable during the medium term. Also, the bank's expectation of rationalisation benefits post-merger will be difficult to achieve given the complexity of the task at hand. CET-I at 9.3% (including 9M PAT) leaves little headroom, and bank's plans to raise capital will help shore up the CRAR. We have fine-tuned our estimates and the target multiple considering still uncertain outlook. We maintain our Hold rating with a revised PT of Rs. 75.

One-year forward P/BV (x) band



Source: Bloomberg, Sharekhan Research

Peer valuation

Particulars	CMP Rs/Share	P/BV(x)		P/E(x)		RoA (%)		RoE (%)	
		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Bank of Baroda	67	0.43	0.41	12.1	7.4	0.2	0.3	3.5	5.5
State Bank of India	283	1.10	1.00	16.1	10.7	0.4	0.5	7.9	10.4
Punjab National Bank	33	0.39	0.39	34.4	8.4	0.1	0.3	2.0	4.7

Source: Bloomberg, Company, Sharekhan research

About company

Bank of Baroda (BoB), established in 1908, is one of the oldest commercial banks in India with a substantial footprint in the domestic and international markets. BoB has a wide presence overseas with almost one-third of the total business, coming from its international business. Strong domestic presence through 9,224 branches & 12,619 ATMs and Cash Recyclers supported by self-service channels and BC network of 18,395. The Bank has a significant international presence with a network of 100+ overseas offices spanning 21 countries. BoB's subsidiaries include business in Capital Markets and for asset management. It also has joint ventures for life insurance with India First Life Insurance. Bank of Baroda has a global Presence spanning 100 overseas offices across 20 countries.

Investment theme

Bank of Baroda has a strong pan-India network along with a diversified products and services portfolio and strong client relationships. Performance in terms of business growth as well as profitability and asset-quality improvement is gradual but in the desired direction. The recent Covid 19 pandemic is likely to result in slower growth and higher credit costs for banking sector, and will also impact in the medium term the outlook of Bank of Baroda as well. Adding to that, the bank has been under integration process with two other PSU Banks, which would entail synergy benefits,. Notwithstanding the synergies that will accrue over a longer period, we believe near-term challenges in terms of asset quality and integration issues of merged entity may mute medium-term performance. While the business fundamentals are improving, we believe that the sector and bank is yet to emerge to normalized business runrate.

Key Risks

Risk of further NPAs, especially in the corporate, agri and/or retail books due to overall macroeconomic slowdown and prolonged pandemic recovery would impact growth and profitability.

Additional Data

Key management personnel

Shri Sanjiv Chadda	Managing Director & CEO
Shri Ian De Souza	CFO
Shri S. L. Jain	Executive Director
Shri Vikramaditya Singh Khichi	Executive Director

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	3.1
2	ICICI Prudential Asset Management	2.2
3	ICICI PRUDENTIAL BANK ETF	2.0
4	Reliance Capital Trustee Co Ltd	1.3
5	Vanguard Group Inc/The	0.7
6	Nippon Life India Asset Management	0.6
7	SBI Pension Funds Pvt Ltd	0.4
8	Dimensional Fund Advisors LP	0.3
9	Jupiter Fund Management Pvt Ltd	0.2
10	SBI Funds Management Pvt Ltd	0.2

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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