Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bank of Baroda

Strong Outlook

Banks	Sharekhan code: BANKBARODA
Reco/View: Buy ↔	CMP: **Rs. 140**	Price Target: **Rs. 165** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 50.24

Updated Jul 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

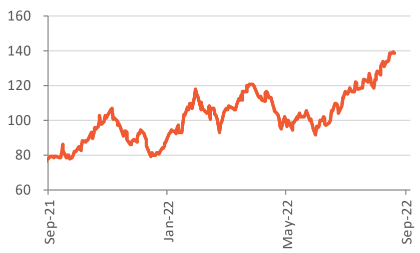
Company details

Market cap:	Rs. 72,632 cr
52-week high/low:	Rs. 142 / 77
NSE volume: (No of shares)	269.5 lakh
BSE code:	532134
NSE code:	BANKBARODA
Free float: (No of shares)	186.2 cr

Shareholding (%)

Promoters	64.0
FII	8.2
DII	16.9
Others	11.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.8	40.0	30.8	79.5
Relative to Sensex	12.3	25.8	24.0	75.8

Sharekhan Research, Bloomberg

Summary

- Bank of Baroda (BOB) has seen steady improvement in its asset quality (net NPAs) at multiyear low of 1.58%, led by lower slippages in corporate book. Lower slippages should clearly sustain over the medium term because of improvement in the corporate credit cycle.
- Credit cost (as a of percentage of avg. loans) was also at a multi-quarter low of 0.9% in Q1FY23, owing to accelerated provisions made in earlier quarters (PCR at ~76%) as well as lower slippages. Benign credit cost is likely to support earnings trajectory in the medium term. Credit cost guidance stands at 1.25-1.50% of advances versus 1.8% in FY22.
- Margins are expected to improve by 10-15 bps from FY22 as the bank is focusing on the higher-margin segment - mid-corporate loans, personal loans, and gold loans within the retail segment. Also, a higher share of floating rate loans ~90% would support the margins and would offset a modest increase in cost of deposits.
- Margin improvement & lower credit cost are key catalysts for improvement in RoA (From 0.6% in FY22 to 0.8% inFY23E/34E) going forward. At the CMP, the stock trades at 0.8x/0.7x its FY23E/24E ABV. We maintain Buy with a revised PT of Rs. 165. Our preferred picks among PSU banks basket remains SBI and BOB.

BOB's balance sheet has improved significantly - capital ratios are healthy with Tier 1 Capital at 12.97%. It has higher retail deposits share, healthy CASA share, higher liquidity (liquidity coverage ratio of 143%) and is well positioned to accelerate market share gains as the macro-outlook improves further. Asset quality has also improved, with lower slippages and lower stressed assets. PPoP growth should improve as the loan growth and margins improve. Overall, the earnings trajectory should also be strong led by benign credit cost. We believe the bank is entering into a sweet spot, where strong core PPoP growth with low credit costs should drive a strong improvement in return ratios over the medium term.

- **Benign credit costs to drive earnings growth:** BOB has emerged stronger from the COVID crisis. It has improved capital ratios, increased coverage, and has higher liquidity ratios. Moreover, trailing loan growth in riskier segments was muted due to the pandemic. Thus, NPA formation should moderate further. A combination of the above factors, along with improving loan growth, implies that credit costs could remain below normalized levels. NNPA at 1.58% multiyear low led by lower slippages in corporate book. Lower slippages should clearly sustain over the medium term because of improvement in corporate credit cycle. Credit cost (percentage of avg. loans) was also at a multi-quarter low of 0.9% in Q1FY23, owing to accelerated provisions made in earlier quarters (PCR at ~76%) as well as lower slippages. Benign credit costs are likely to support earnings trajectory in the medium term. Credit cost guidance stands at 1.25-1.50% of advances vs 1.8% in FY22. SMA 1&2 loans stand at ~0.48% of loans. Key monitorable would-be slippages from restructured book (2.5% of loans).
- **Margins to improve:** The bank has reported strong loan growth (19.6% y-o-y / 3% y-o-y) in Q1FY23 on the back of broad-based growth in retail, corporate & overseas books. Deposit growth has been lagging, but the credit-deposit ratio is comfortable at 77% and management is focused on growing retail deposits. Margins are expected to improve by 10-15 bps from FY22 as the bank is focusing on the higher margin segment - mid-corporate loans, personal loans, and gold loans within the retail segment. Also, a higher share of floating rate loans ~90% would support margins and offset a modest increase in cost of deposits.

Revision in estimates – We have increased our FY2023E/24E earnings estimates, factoring in higher margins & lower credit cost.

Our Call

Valuation – At CMP, BOB trades at 0.8x/0.7x its FY2023E/FY2024E ABV. Improved asset-quality matrix, higher PCR, higher capital levels (CAR at 15.5%) compared to its PSU peers, high-rated loans in the corporate segment along with moderation in slippages and credit cost augur well for the future earnings of the bank. The bank is well positioned on the business front to capture opportunities in the growing Indian economy. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 165. Slippages from restructured book would be a key monitorable.

Key Risks

Economic slowdown due to which slower loan growth and higher-than-anticipated credit cost, especially from corporate and SME book, could affect earnings.

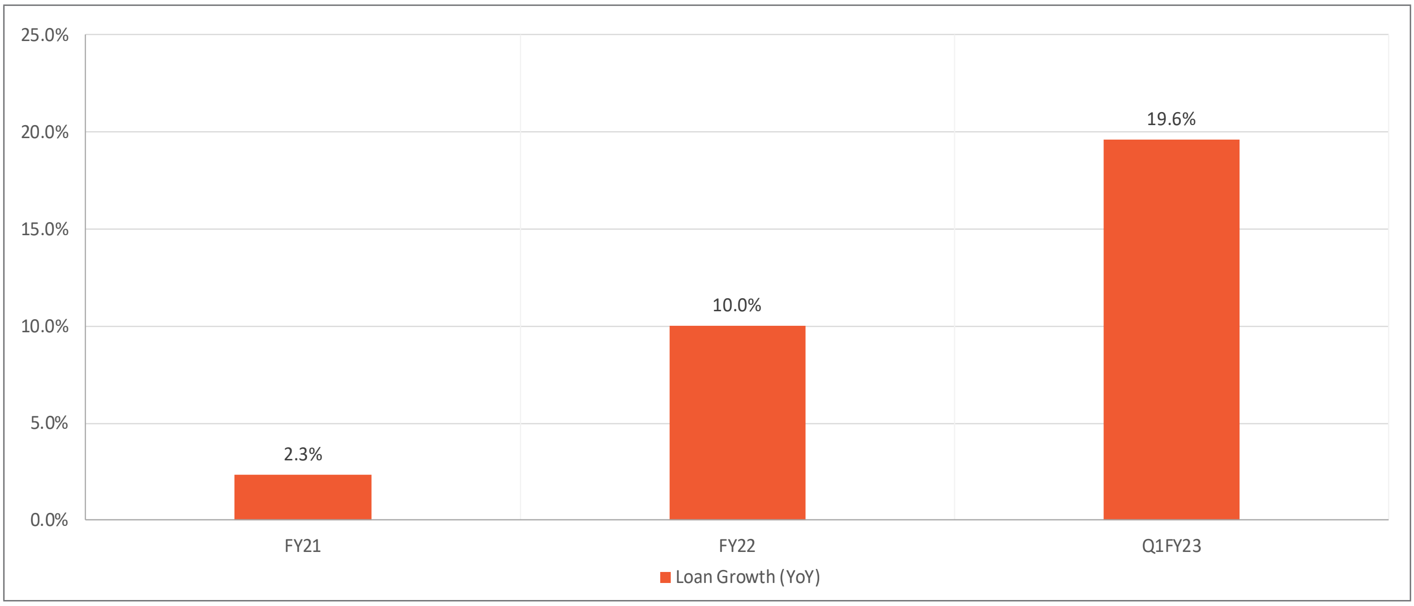
Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Interest Income	28,809	32,621	38,713	43,126
Net profit	829	7,272	10,177	11,710
EPS (Rs.)	1.8	14.1	19.7	22.6
P/E (x)	78.7	10.0	7.1	6.2
P/BV (x)	1.2	0.9	0.8	0.7
RoE	1.1%	8.9%	11.1%	11.4%
RoA	0.1%	0.6%	0.8%	0.8%

Source: Company; Sharekhan estimates

The bank has reported strong loan growth (19.6% y-o-y / 3% y-o-y) in Q1FY23 on the back of broad-based growth in retail (23% y-o-y), corporate (17% y-o-y) & overseas book (31%). In retail segment, the majority of loans are mortgages (68%), which grew by 16% y-o-y. Personal loans, which form only 8% of total retail loans, grew by 147% y-o-y due to smaller book as well as due to higher ticket sizes. Around 70-75% of personal loans are disbursed to the salaried category. The bank also foresees higher growth in gold loans, which forms part of agriculture loans. In the overseas loan book, a large part of growth came from term loan. Further, there was a good credit offtake seen from domestic corporates due to working capital utilization. The bank is focusing on the higher margin segment - mid-corporate loans, personal loans, and gold loans within the retail segment. The bank has guided for overall advances growth of 12-13% in FY23E.

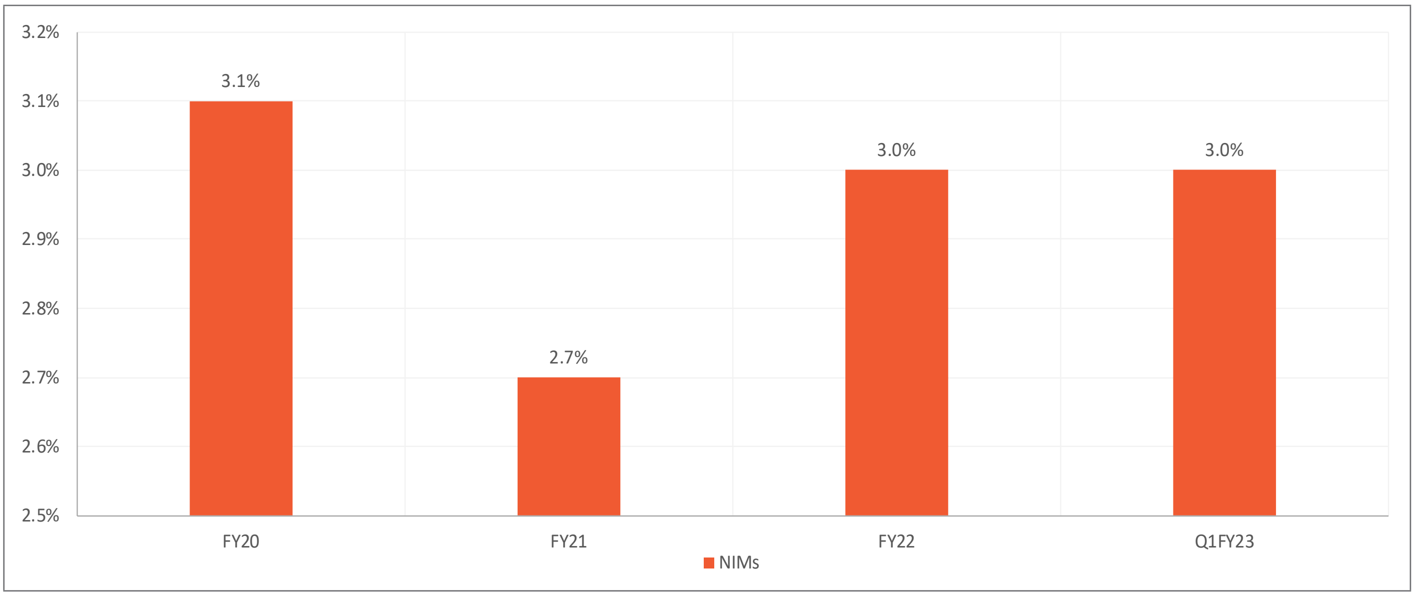
Trend in Loan growth



Source: Company, Sharekhan Research

Margins are expected to improve by 10-15 bps from FY22 as the bank is focusing on the higher margin segment - mid-corporate loans, personal loans, and gold loans within the retail segment. Also, a higher share of floating rate loans ~90% would support margins and would offset modest increase in cost of deposits.

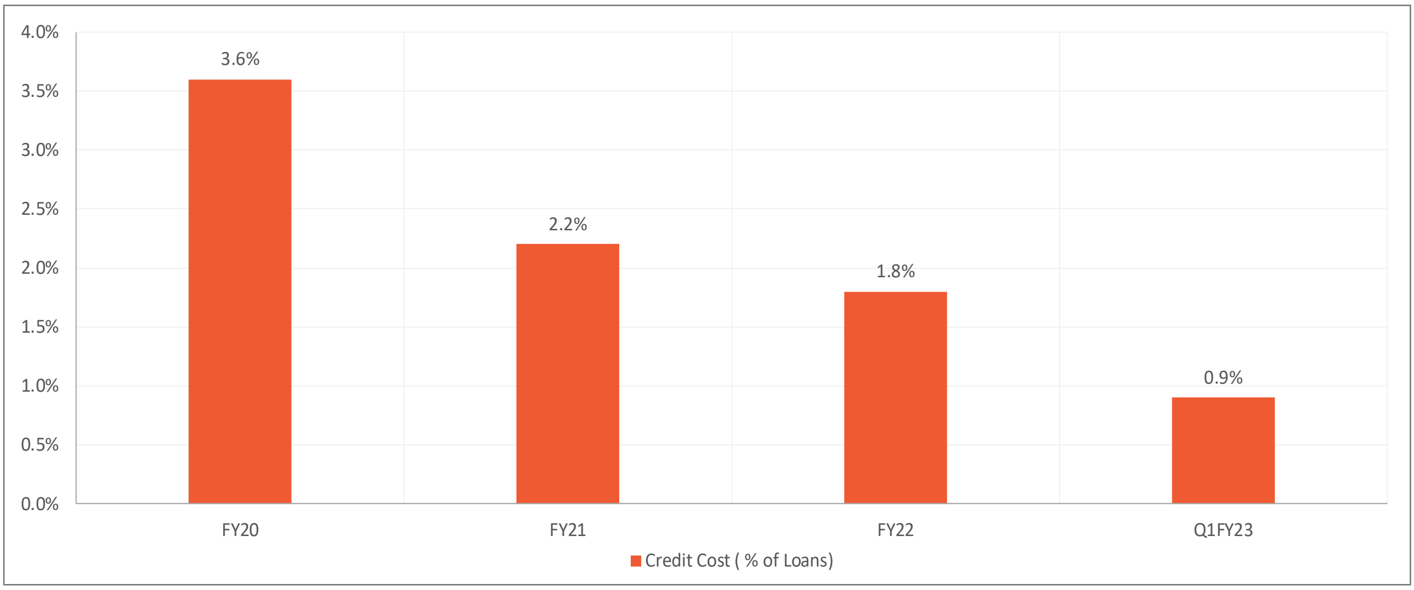
Trend in NIMs



Source: Company, Sharekhan Research

BOB has emerged stronger from the COVID crisis. It has improved capital ratios, increased coverage, and has higher liquidity ratios. Moreover, trailing loan growth in riskier segments has been muted due to the pandemic. NPA formation should moderate further. A combination of the above factors, along with improving loan growth, implies that credit costs could remain below normalized levels. NNPA at 1.58% multiyear low led by lower slippages in corporate book. Lower slippages should clearly be sustained over the medium term as the corporate credit cycle improves. Credit cost (% of Avg. loans) was also at a multi quarter low of 0.9% in Q1FY23, owing to accelerated provisions made in earlier quarters (PCR at ~76%) as well as lower slippages. Benign credit cost is likely to support earnings trajectory in the medium term. Credit cost guidance stands at 1.25-1.50% of advances vs 1.8% in FY22. SMA 1&2 loans stand at ~0.48% of loans. Slippages from restructured book (2.5% of loans) would be a key monitorable.

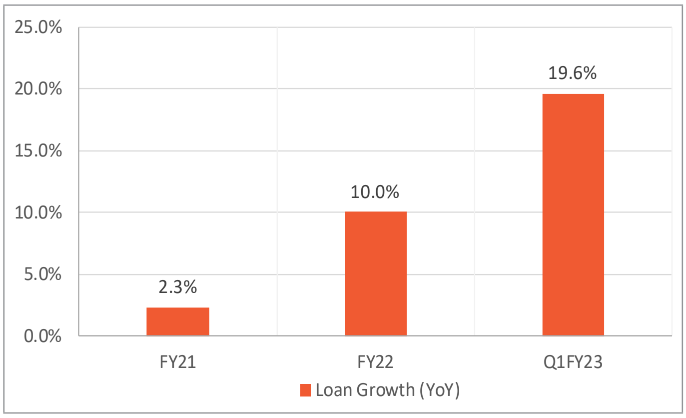
Trend in Credit Cost



Source: Company, Sharekhan Research

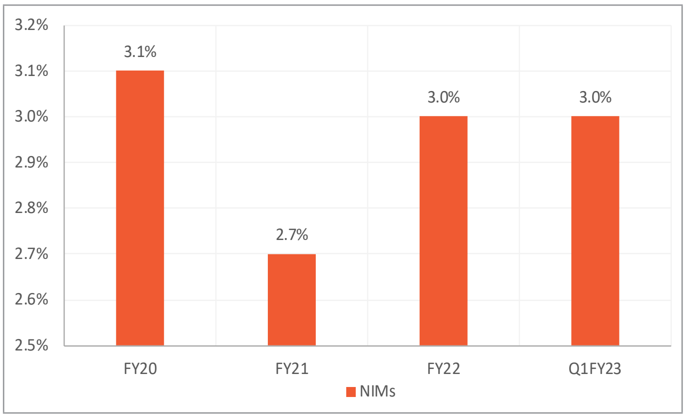
Financials in charts

Trend in Loan growth



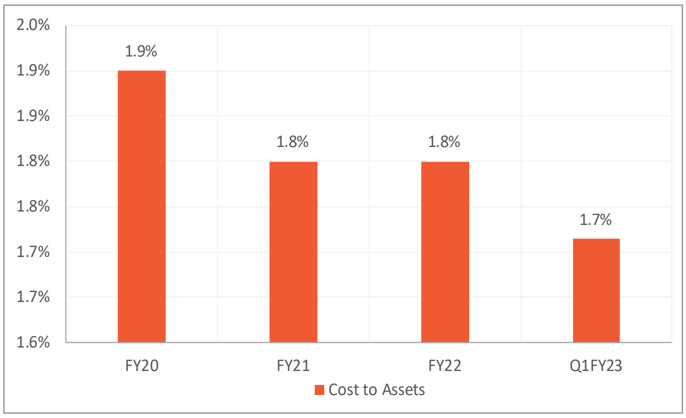
Source: Company, Sharekhan Research

Trend in NIMs



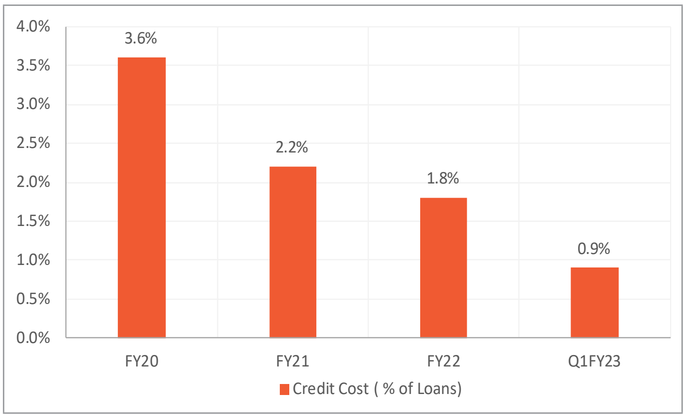
Source: Company, Sharekhan Research

Trend in Cost to Assets Ratio



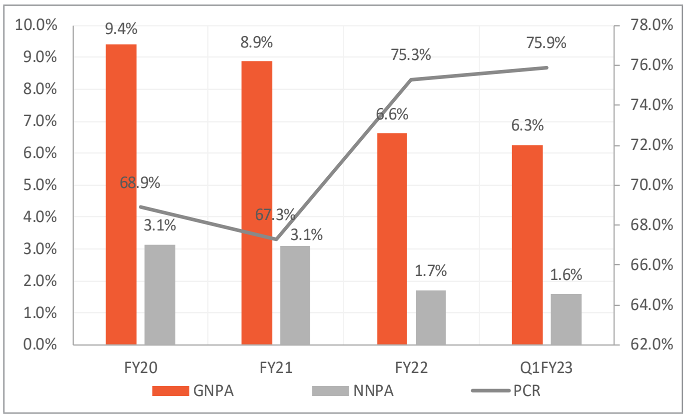
Source: Company, Sharekhan Research

Trend in Credit Cost



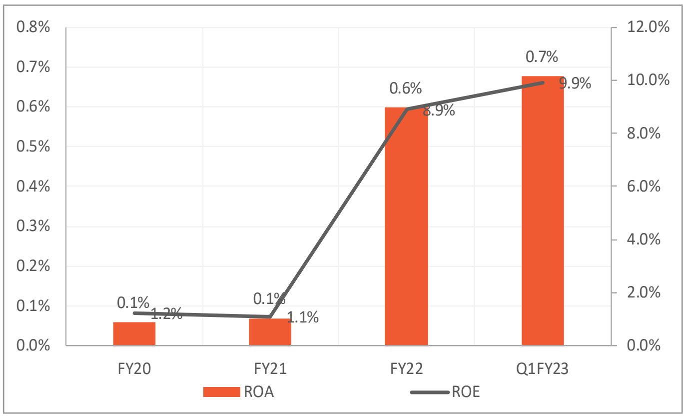
Source: Company, Sharekhan Research

Trend in Asset Quality



Source: Company, Sharekhan Research

Trend in Return Ratios



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – Credit growth accelerating; Top private banks and top PSUs placed better

System-level credit offtake grew by ~15% y-o-y in the fortnight ending August 26, 2022, indicating loan growth has been sustaining, given distinct signs of improving economy and revival of investments and loan demand. On the other hand, deposits rose by ~9.5%, which also reflects a healthier economic scenario but are trailing advanced growth. The bottom-up story is intact, and we should see loan growth accelerate, while margins would continue to expand in a higher interest rate cycle. Asset quality is not a big issue from the end of the corporate loan, as only de-leveraging is being observed. From the retail side, there could be some pressure, but nothing is significant. Asset quality is likely to remain stable except for the MFI segment. Banks are in a sweet spot in terms of fundamentals and reasonable valuations. In the past two years, banks have been cautious on lending to the 'BB and below' category, thus the general risk, which they are carrying on the corporate portfolio, is low. On the retail loans front, due to COVID-19, banks have already seen one downcycle. Most of the exposure has been taken into credit cost. In terms of the MSME book, we need to be watchful. At present, we believe the banking sector is likely to see higher risk-off behaviour, with tactical market share gains for well-placed players. We believe large banks with a strong capital base and asset quality (with high coverage and provision buffers) are well placed to capture growth opportunities.

■ Company outlook – Attractive play on the economy

BOB is an attractive play on the fast-growing Indian economy. The bank has reported healthy credit growth. Improving asset quality, moderation in slippages, and credit cost would augur well for the bank going ahead with higher PCR and higher capital adequacy buffers. We believe credit growth would be driven by both retail and corporate segments as private capex increases. The bank has gradually been reducing stressed assets by fully providing for it upfront. BOB's pole position in terms of liability franchise, an enviable reach, and business strength make it well placed to ride over medium-term challenges.

■ Valuation – We maintain our Buy rating on BOB with a revised PT of Rs. 165.

At CMP, BOB trades at 0.8x/0.7x its FY2023E/FY2024E ABV. Improving asset-quality matrix, higher PCR, higher capital levels (CAR at 15.5%) compared to its PSU peers, high-rated loans in the corporate segment along with moderation in slippages and credit cost augur well for the future earnings of the bank. The bank is well positioned on the business front to capture the opportunities in the growing Indian economy. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 165. Key monitorable would be slippages from restructured book.

Peer Comparison

Particulars	CMP	MCAP	P/E(x)		P/B(x)		RoE (%)		RoA (%)	
	Rs/Share	(Rs. cr)	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
BOB	140	72,632	7.1	6.2	0.8	0.7	11.1	11.4	0.8	0.8
SBI	572	5,10,131	9.1	7.5	1.1	0.9	13.3	15.5	0.7	0.8
PNB	40	44,154	12.9	11.8	0.6	0.6	3.5	3.7	0.3	0.3

Source: Company, Sharekhan research

About company

BOB, established in 1908, is one of the oldest commercial banks in India with a substantial footprint in domestic and international markets. BOB has a wide presence overseas with almost one-third of the total business coming from its international business. The bank has a strong domestic presence through 8,214 branches and 10,033 ATMs and cash recyclers supported by 18,395 self-service channels and BC networks. 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. The bank also has joint ventures for life insurance with India First Life Insurance. BOB has a global presence spanning 100 overseas offices across 20 countries.

Investment theme

BOB has a strong pan-India network along with 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. We believe BOB's higher retail orientation, reasonable capital position, and improving asset-quality position augur well for future.

Key Risks

Economic slowdown owing to slower loan growth and higher-than-anticipated credit costs, especially from corporate and the SME book could affect earnings.

Additional Data

Key management personnel

Mr. Sanjiv Chadha	Managing Director and CEO
Mr. Ajay K Khurana	Executive Director
Mr. Debadatta Chand	Executive Director
Mr. Joydeep Dutta Roy	Executive Director
Mr. Ian De Souza	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	LIC	4.7
2	HDFC Asset Management Co Ltd.	3.1
3	Nippon Life India Asset Management	2.3
4	ICICI Prudential Asset Management	1.6
5	BNP Paribas SA	1.4
6	Kotak Mahindra AMC	1.0
7	The Vanguard Group Inc.	0.7
8	Aditya Birla AMC	0.5
9	Sundaram Asset Management Co.	0.5
10	SBI Pension Funds Pvt. Ltd.	0.4

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

Sharekhan

by BNP PARIBAS

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For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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