

Oriental Bank of Commerce
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Buy
Rs 134.3

In a follow up to our note for the result update, we are upgrading our 1 year price target for OBC to Rs 203 at 1.2x adj. BV/share 2004F. The key factors for the price target revision are:

Recovery of Assets and Improved Assets Quality

OBC management has talked about recovering assets to the tune of RS 6bn in FY04F. We expect Rs 1bn to go through the P&L account. OBC has been a pioneer in recovery of asset. We believe that OBC's management has shown considerable skill to recover bad loans.

OBC currently has an 80% provisioning for NPA's in FY 03. The management intends to increase the coverage to 100% by FY 04F. We believe that this coverage will be easily attainable. We are projecting coverage of 98.7%. The bank has been very prudent in classification of NPA's and has been one of the first to classify MRPL as a NPA. OBC has emerged as having the best quality assets in its PSU peer group.

Return of capital

OBC intends to return Rs 500mn of capital to the government. OBC currently holds INR 1bn of recapitalisation bonds. The company has already sent a proposal to the government for the return of capital. OBC currently has a capital adequacy ratio (CAR) 14.04%. We expect the CAR to increase to 17.4% in the first half of FY 04F. We believe that even if BASIL II recommendations, which require more capital for risk weighted assets are implemented, 15% CAR according to current norms will be good enough for 12% CAR under BASIL II. Hence OBC has enough leeway to return capital to government. We believe that OBC's management has taken BASIL II recommendations in to consideration while returning capital, unlike some other banks. We believe that this reflects on the prudence of the bank.

We have factored in return of capital in our estimates. We have used the same formula for capital return, which was used in case of Andhra Bank. The formula is capital plus interest minus dividend. The return of capital at a discount to the market rate will have huge benefits for minority shareholders.

Return of Capital

	FY 04F	FY04F*
Equity (Rs mn)	192.5	142.5
BV/Share (Rs)	128.8	170.4
Adj.BV/Share (Rs)	128.0	169.4
EPS (Rs)	30.5	41.2
CMP (x)	134.3	134.3
P/BV (x)	1.04	0.8
P/ adj.BV (x)	1.05	0.8
P/E (x)	4.4	3.3
Price Target @ 1.2x Adj. BV/Share (Rs)	153	203

*post return of capital Rs 500 mn

Cost Efficiencies & Technology Initiatives

The bank has the best cost to income ratios in the industry. The cost to income ratio for FY 03 was 33.1. The reductions in costs have been planned over the last two years. We believe that the

cost efficiencies will continue in the bank. The bank has recently commissioned its core banking solution. The cost of the project is Rs600 mn and will be undertaken for 452 branches. We believe that with this move, our concerns on technology initiatives have been addressed and it will allow better business growth and increase productivity. The bank also has very high productivity, which is reflected in Rs 34.5 mn business being done per employee. This ratio is 100% of some of the peer banks.

Focus on Retail and deposit repricing will drive growth in net interest income

The bank has a retail portfolio of Rs 27.52bn, 17% of advances. Housing portfolio is approximately Rs 21bn. We expect the retail portfolio to grow by 55% to Rs 42.6bn. We believe that retail loans have more sticky spreads and will reduce pressure on yield on advances. OBC's cost of deposit has come down to 7% we expect the cost of deposits to come down to 6.4% in FY04. The repricing of deposits and growth in retail advances will allow good growth in interest income. We are forecasting net interest income (NII) growth of 11.1% to Rs 13.38bn.

Outlook and Valuations

We believe that OBC has emerged as one of the premier banks in the Indian banking space. The business growth, asset quality, productivity, and cost efficiencies are comparable and in some cases better than some private and foreign banks. We believe OBC will continue to grow its business and maintain its asset quality. We feel OBC has a very proactive and prudent management and it should be given a premium to peers. We recognize the fact that the management in OBC is transitional. However, we believe that there is a strong line of second line managers, who could take over the mantle when the time comes. We are factoring in return of capital in our valuations and price target. We rate the stock as a BUY with a 1-year price target Rs 203. The risk to our price target is that the formula for return of capital may be changed or the government may not take capital back.

OBC Earnings Projections

Rs MN/Year ending 31 st March	FY 02	FY 03	YoY%	FY 04F	YoY%
Interest earned	30404.7	32946.9	8%	34021.7	3%
Interest Expended	20684.0	20899.4	1%	20636.0	-1%
Net Interest Income	9720.7	12047.5	24%	13385.7	11%
% of Total Net Income	67%	69%		72%	
Trading Income	3105.8	3408.1	10%	3000	-12%
% of Total Net Income	21%	20%		16%	
Commission & Brokerage	1018.7	1081.9	6%	1103	2%
% of Total Net Income	7%	6%		6%	
Other Income	614.6	919.6	50%	980	7%
% of Total Net Income	4%	5%		5%	
Total Net Income	14459.8	17457.2	21%	18468.7	6%
Staff Cost	2884.5	3475.9	21%	3273.6	-6%
Other Operating cost	2404.4	2350.7	-2%	2374.2	1%
Total Operating Cost	5288.9	5826.6	10%	5647.8	-3%
Pre Provisional Profit	9171.0	11630.6	27%	12820.9	10%
Provision and Contingencies	3476.6	3665.5	16%	2700.0	-26%
Profits before provision of tax	5694.4	7965.1	40%	10120.9	27%
Income Tax	2488.8	3395.6	36%	4250.8	25%
PAT	3205.6	4569.5	43%	5870.2	28%



Stock Ratings Absolute Returns

Buy : > 25%
Out Performer : 16 - 25%
Market Performer : 0 - 15%
Under Performer : < 0%

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