THEMATIC | July 03, 2024

The party isn't over yet

Improvement in ROE/growth in the past 4 years led to rerating of public sector banks (PSBs), which narrowed the valuation discount to private banks. There was fundamental improvement in business/practices of some PSBs w.r.t. loan-book diversification, expansion in sourcing channels and lower TAT, and better underwriting and collection infrastructure. Earnings momentum would continue with lower CD ratio (74% vs 87% for private banks) and higher share of MCLR-linked loans supporting NIMs. Higher share of corporate loans (lower risk at present), retail loan exposure to high-end customers, lower share of unsecured loans and high PCR would keep asset quality in check. SBI and BOB score over other PSBs on fundamental franchise strength and have near-term earnings drivers (NIM, credit cost) in place. Maintain BUY on SBI and initiate BOB with BUY, with TPs of Rs960/Rs330 (1.4x/1.2x FY26E BVPS).

Improvement across parameters drive re-rating

From making losses of Rs855bn in FY19, PSBs reported profits of Rs1.4trn in FY24 with ROE of 15%. PSBs witnessed improvement in asset quality, loan growth and operating margin during this period and closed the gap on these aspects with private peers. This resulted in re-rating to 1.5x TTM BV with the valuation gap vs PVBs contracting from 80% in FY20 to 56% now.

Mixed trends on structural drivers

PSBs have lost market share in deposits but the overall quality of their deposit franchise is still formidable. PSBs reduced reliance on corporate loans (share down ~5% in the last 4 years), distribution became multi-channel, sanction time reduced, scorecards were implemented in underwriting, and loan monitoring mechanism improved. Hence, they are better prepared to compete with private banks than in the past.

Better-placed cyclically

From a cyclical perspective, PSBs still have levers to maintain/improve ROE. Higher share of MCLR-linked loans (40-55% vs 20% for private banks) and lower CD ratio of 74% vs 87% for private banks should keep NIMs stable. Higher share of corporate loans (where stress is low), exposure to high-end retail loans, lower share of unsecured loans and high PCR of 78% should keep credit costs low. There is scope for improvement in opex/asset ratio as the bulk of wage settlement burden was up-fronted in FY23/24.

SBI and BOB best-placed in the medium term

We expect earnings momentum to continue for PSBs, leading to further narrowing of the valuation gap vs PVBs over the next year. SBI and BOB score over other PSBs on sustainable earnings framework determined by: (i) stickiness in deposit franchise, (ii) quality of asset diversification, (iii) quality of underwriting templates, (iv) transactional capabilities and (v) ability to generate higher revenues from underlying business. Hence, these banks can be seen as a proxy to the PSB cycle in the medium term.

Performers on our framework

Company	Mcap (Rs bn)	Ambit Reco.
State Bank of India	7,373	BUY
Bank of Baroda	1,370	BUY
Punjab National Bank	1,330	NR
Union Bank of India	1,023	NR
Bank of India	537	NR
Canara Bank	1,055	NR

Source: Ambit Capital research, Company

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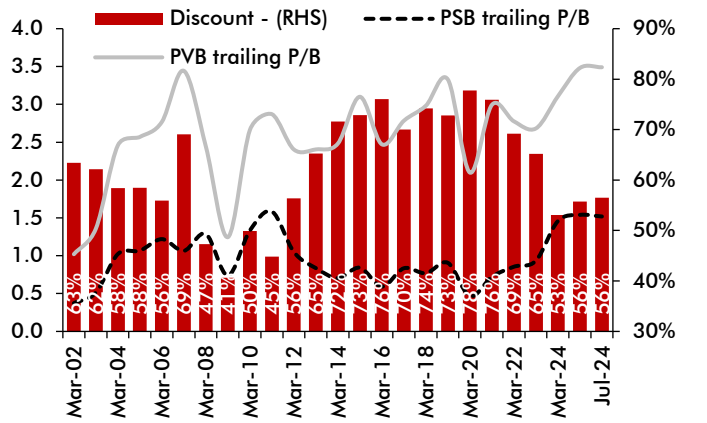
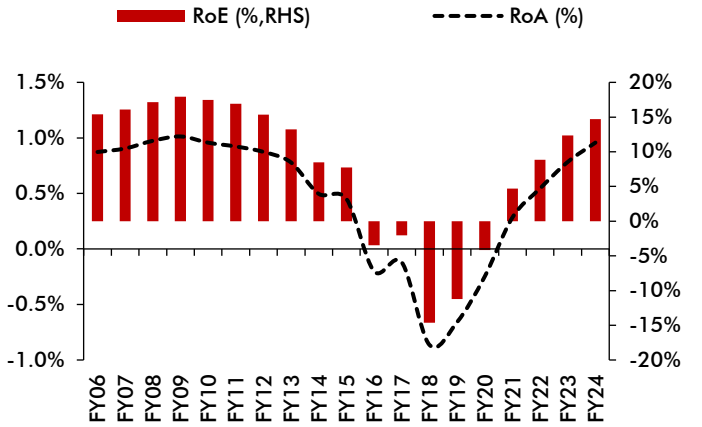
Narrative in charts

Exhibit 1: Valuation gap of PSBs with PVBs has declined from a peak of 80% to 56%...



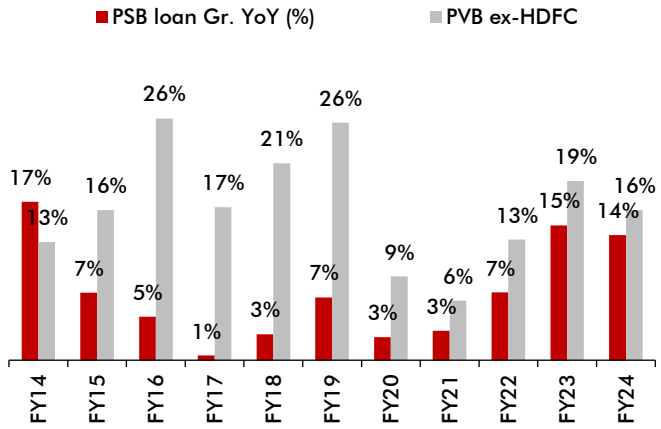
Source: Company, Ambit Capital research. PSB trailing is calculated as sum of market cap of 12 PSBs divided by sum of net worth of 12 PSBs, PVB include data of HDFCB, ICICI, Axis, Kotak, IIB and Federal bank.

Exhibit 2: ...as profitability staged a sharp recovery, closing the gap with PVBs



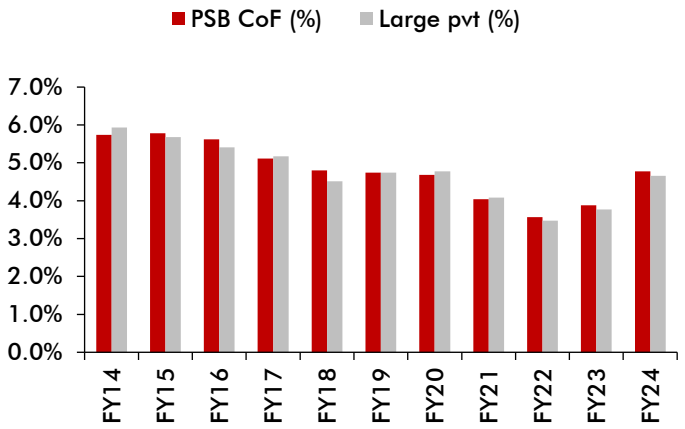
Source: RBI, Company, Ambit Capital research; represent PAT of all PSBs

Exhibit 3: Loan growth gap reduced from 21% at the peak to 200bps in FY24



Source: RBI, company, Ambit Capital research; adjusted PVB loan book by deducting HDFCB to neutralize impact of its reverse merger; PSB and PVB represents data of entire sector

Exhibit 4: PSBs have held on to their CoF advantage vs. large private banks



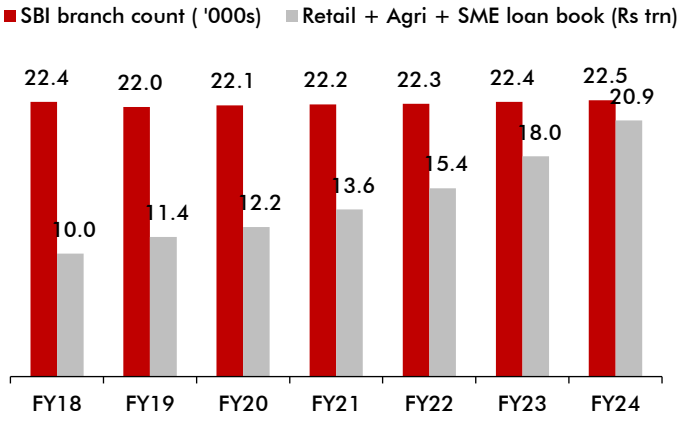
Source: Company, Ambit Capital research, weighted average data of SBI, BOB, CBK, UNBK, PNB and BOI in PSB CoF, Large pvt includes ICICI, Axis, KMB and IIB

Exhibit 5: PSBs modernizing systems to tap demand efficiently...

Measures to improve productivity
Verticalization of asset segments with creation of separate processing centres (PC) has improved TAT; for example, setting up auto loan PC and home loan PC vs. underwriting for both by branch staff earlier.
Automating document submission has lowered clerk requirements/hiring.
Introducing dedicated sales for retail, MSME and agriculture in branches.
Hiring CTO from market to integrate different parts of loan journeys.
Some PSBs have asked operation staff to also do sales to improve branch productivity.

Source: Company, Ambit Capital research

Exhibit 6: ...visible in better productivity; e.g. SBI's branch banking book doubled while branch count was stagnant



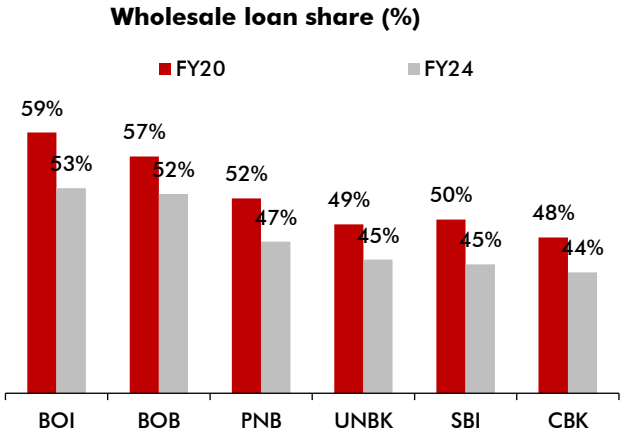
Source: Company, Ambit Capital research

Exhibit 7: Underwriting process has been revamped

Specifics	Earlier	Now
Retail/MSME	Subjective	Automated underwriting after Rs1mn
Consortium	Lead bank responsible for due diligence & monitoring	All banks conduct own analysis
Agriculture	Crop loans preferred	Gold loans; higher ticket size crop loans where collateral possible
Monitoring	Discussion after 90dpd	EWS (30 parameters, mostly given by RBI); mgmt. tracking overdue per region/segment
RBI initiatives		Stress data for >Rs50mn exposure available to all lenders
		Current account can only be opened by lenders having >10% borrower debt exposure

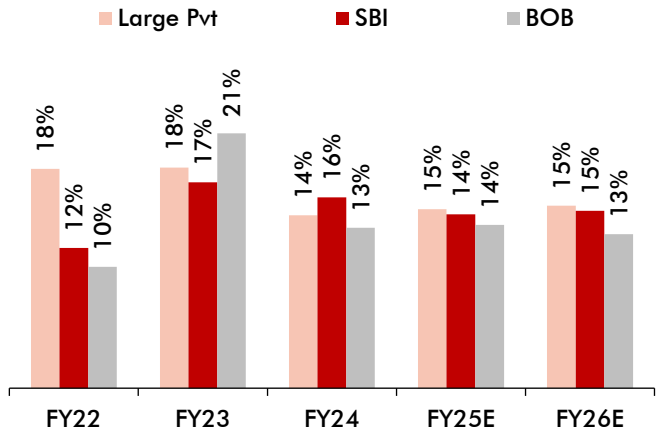
Source: Company, Ambit Capital research

Exhibit 8: PSBs diversified loan book away from Corporate



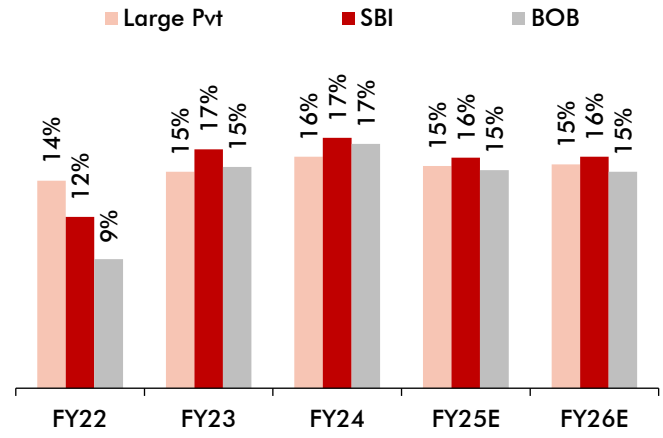
Source: Company, Ambit Capital research

Exhibit 9: Hence, loan growth for PSBs will stay closer to that of large private banks...



Source: Company, Ambit Capital research, Large pvt loan growth is weighted average data of HDFCB, ICICI, Axis, Kotak and IIB

Exhibit 10: ...and RoE differential will be negligible



Source: Company, Ambit Capital research, Large pvt loan growth is weighted average data of HDFCB, ICICI, Axis, Kotak and IIB

Exhibit 11: Whilst cycle is in favour for PSBs, fundamentally SBI and BOB score ahead of others on franchise strength

	Asset quality	Asset mix	Liability	Core revenues (%)	Digital capabilities	Score	P/BV TTM
SBI	●	●	●	●	●	●	1.73x
BOB	◕	◑	◕	◕	◕	◕	1.15x
BOI	●	◑	◕	◑	◕	◕	0.77x
PNB	◑	◑	◕	◑	◑	◑	1.21x
UNBK	◔	◑	◑	◑	◕	◑	1.06x
CBK	◑	◔	◑	◔	◕	◑	1.15x

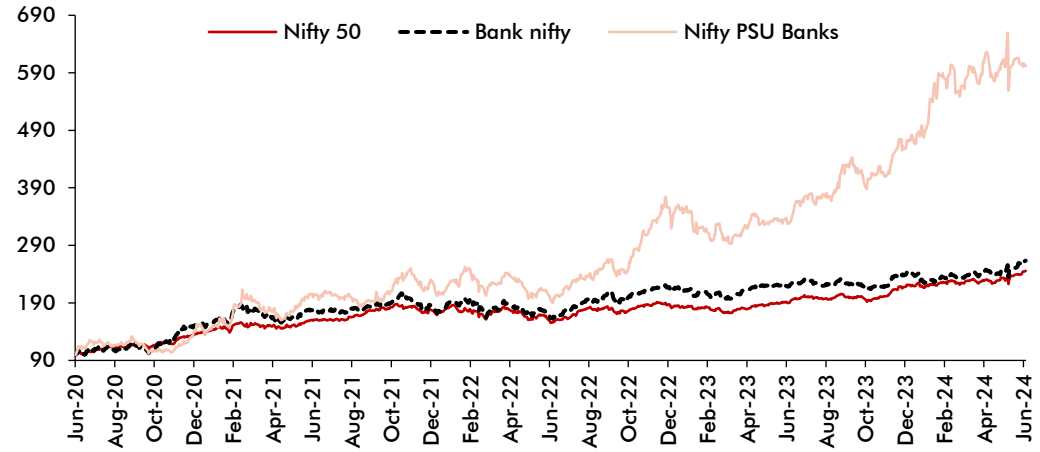
Source: Company, Ambit Capital research, Note: P/BV TTM is on consolidated basis, Note: ● - Strong; ◕ - Relatively Strong; ◑ - Average; ◔ - Relatively weak

Improving fundamentals drive outperformance

PSU banks (PSBs) index rose 6x in 4 years, outperforming Nifty/Bank Nifty which increased 2.6x/2.5x respectively, leading to lowest valuation gap vs private banks in the last decade. From making a loss of Rs850bn in FY18, PSBs delivered profit of Rs1.4trn in FY24 with ROE of 15%. Improvement in asset quality has been a key driver of improvement in ROE of PSBs with average credit cost falling from a peak of 510bps in FY18 to 70bps in FY24. PSBs have also seen improvement in loan growth (from 3% to 14%) and 20bps expansion in PPOP/asset ratio during this period. Overall, PSBs have closed the gap with private banks on loan growth, PPOP margins and ROE with the differential being the lowest in the last decade.

PSU banking index rose ~500% over the last 4 years and outperformed Nifty/Bank Nifty.

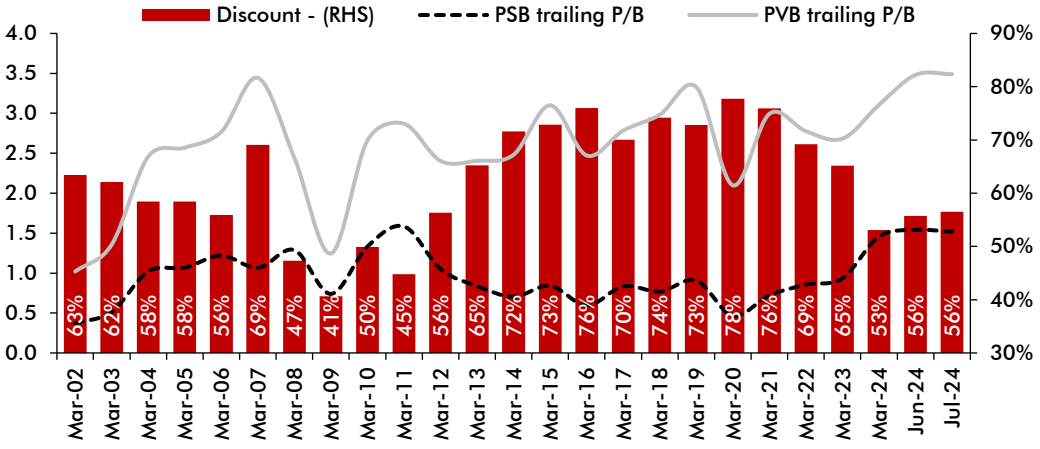
Exhibit 12: PSU banks significantly outperformed private banks as well as the broader markets over the last 4 years



Source: Ace equity, Ambit Capital research

So, the valuation gap vs private banks narrowed to the lowest in the last decade.

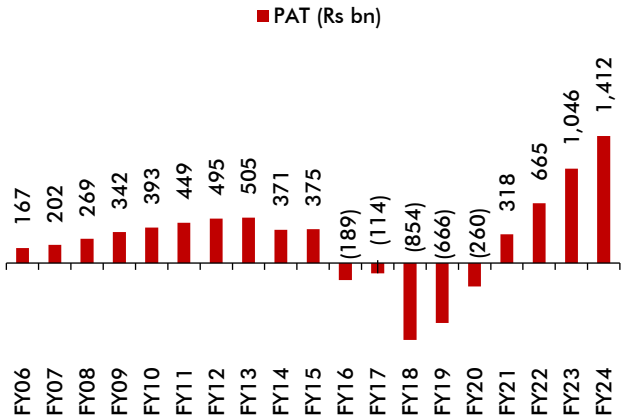
Exhibit 13: PSBs' valuation discount to private banks has come down



Source: Company, Ambit Capital research. PSB trailing is calculated as sum of market cap of 12 PSBs divided by sum of net worth of 12 PSBs, PVB include data of HDFCB, ICICI, Axis, Kotak, IIB and Federal bank.

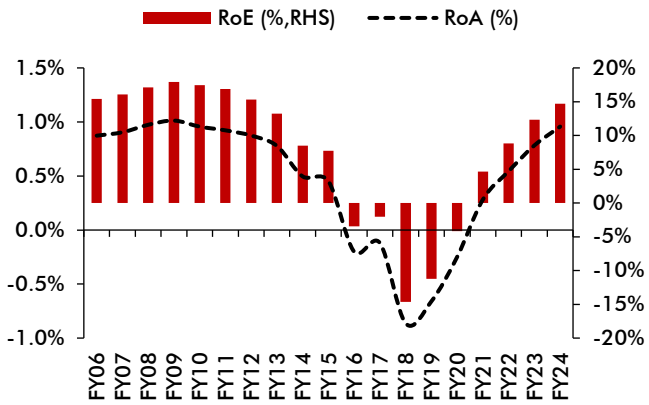
During this period of outperformance, profits of PSBs increased to Rs1.4trn in FY24 vs losses of Rs850bn in FY18. And, ROE of 15% is also the highest in the last decade.

Exhibit 14: PSBs' profitability has turned around sharply



Source: RBI, Company, Ambit Capital research; represent PAT of all PSBs

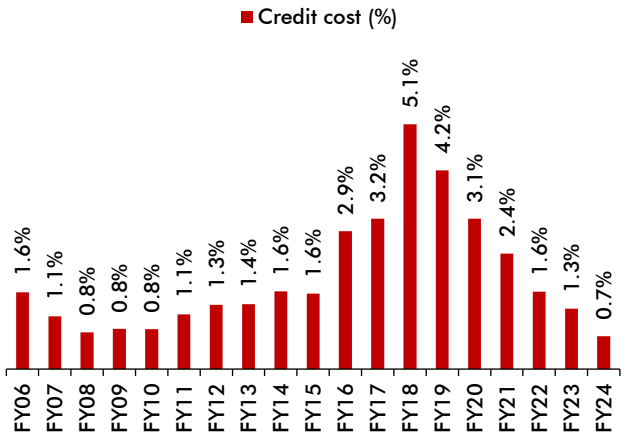
Exhibit 15: PSBs' RoE has improved to 15%



Source: RBI, Company, Ambit Capital research; represent PAT of all PSBs

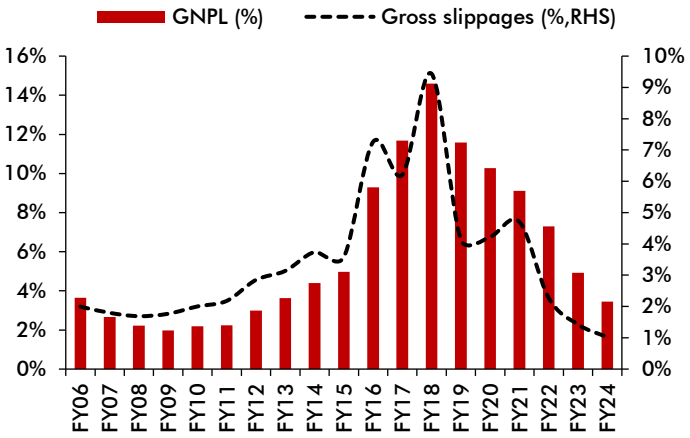
The key driver of improvement in ROE of PSU banks is a decrease in credit cost which fell from a peak of 510bps in FY18 to 70bps in FY24. This was led by a decline in new bad loan formation (slippages) as well as stock of bad loans (GNPLs).

Exhibit 16: Credit cost has fallen sharply...



Source: RBI, Company, Ambit Capital research; represents data of all PSBs

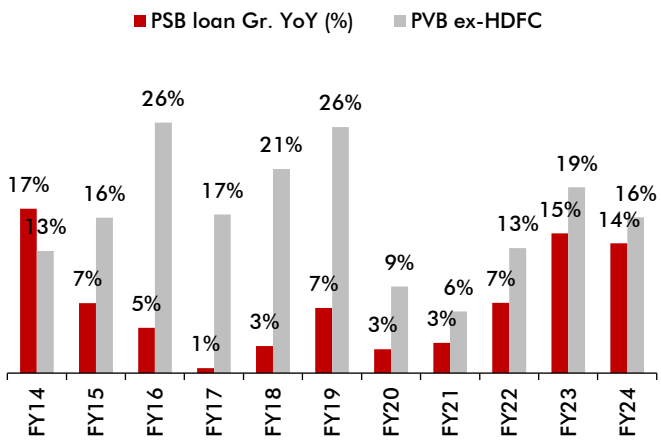
Exhibit 17: ...due to sharp dip in gross slippages and GNPLs



Source: RBI, Company, Ambit Capital research; represents data of all PSBs

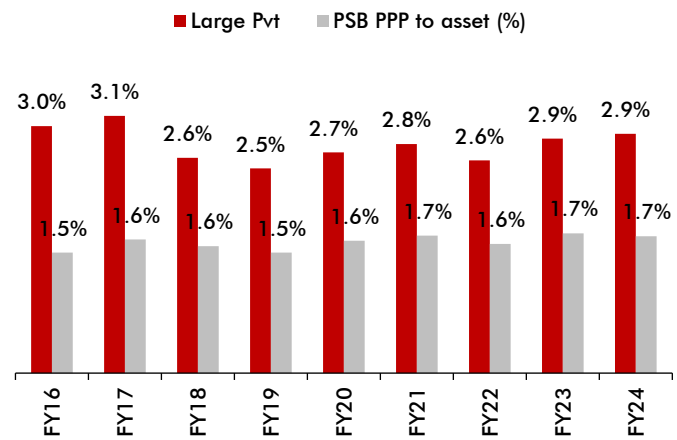
During this period, PSBs also closed the gap with private sector banks on loan growth whilst maintaining operating margins (PPP/asset ratio).

Exhibit 18: PSBs have closed gap on loan growth with PVBs...



Source: RBI, company, Ambit Capital research; adjusted PVB loan book by deducting HDFCB to neutralize impact of its reverse merger; PSB and PVB represents data of entire sector

Exhibit 19: ...whilst holding on w.r.t. PPP to assets ratio



Source: Company, Ambit Capital research, PPP to asset for PSB is weighted average of SBI, BOB, CBK, UNBK, PNB and BOI. Large private includes ICICI, Axis, Kotak and IndusInd

Has there been any fundamental improvement?

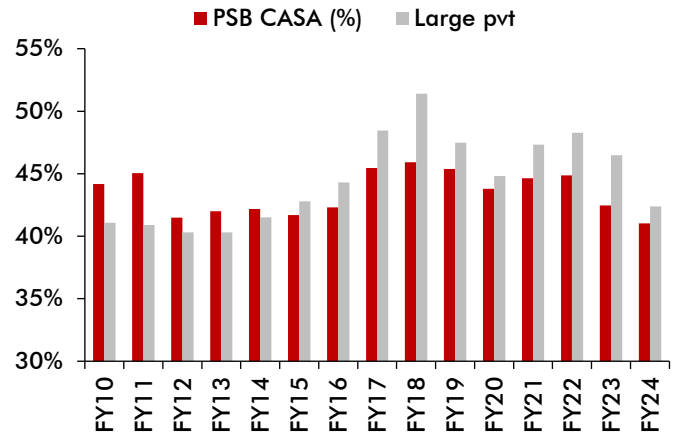
PSBs have had a sticky and granular deposit franchise historically. Whilst they rapidly lost market share of ~10% between FY15-19, the pace decelerated to just ~6% in the last 5 years. PSBs also have a diversified loan book with share of corporate loans reducing in the loan mix, which should lead to reduced growth/credit cost cyclicality. PSBs also reduced dependence on branches with loan sourcing through co-lending, digital channels and dedicated sales in branches. Digital capabilities also improved with the SBI giving even private banks a run for their money. There has been improvement in credit underwriting, monitoring and collection practices too, which improved asset quality.

The key question which arises is, how much of the improvement in PSBs is because of cyclical reasons and how much structural? Answering this question is important from the perspective of how long PSBs can sustain their current growth/ROE.

Deposit franchise weakened but remains formidable

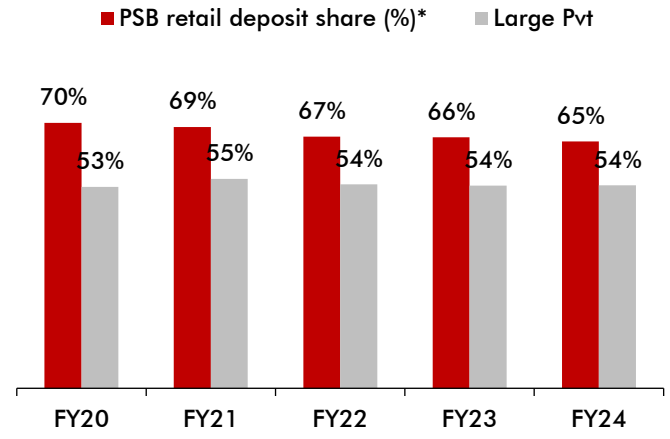
Historically, low cost granular deposits have been a fundamental strength of PSU banks given their long operational history and trust of depositors due to government ownership. Though PSBs have seen a decrease in the share of low cost CASA deposits and sticky retail deposits in their deposit mix, their quality of deposits are still marginally better than that of private banks.

Exhibit 20: Large private banks have overtaken PSBs in CASA ratio but PSBs still have more stable CASA deposits



Source: Company, Ambit Capital research, PSB CASA is weighted average of CASA of SBI, BOB, CBK, UNBK, PNB and BOI. Large private includes ICICI, Axis, Kotak and IndusInd

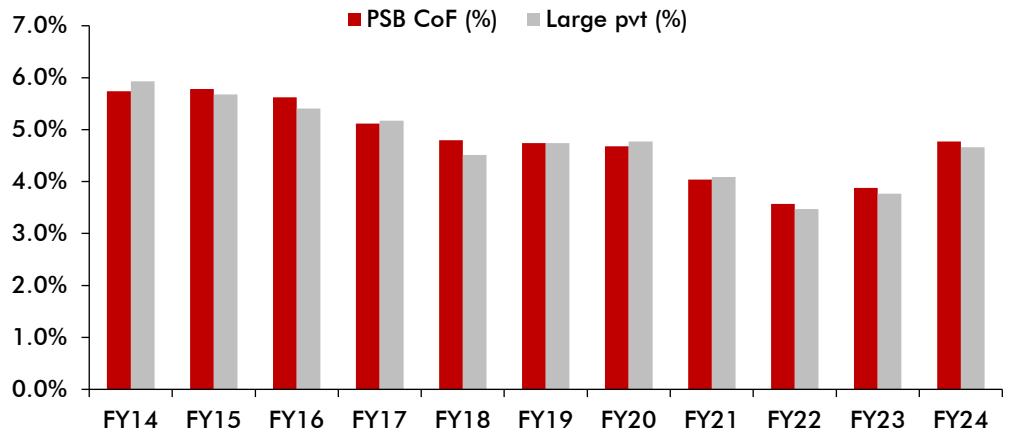
Exhibit 21: Share of retail deposits has come down for PSBs but is still significantly higher than that of private banks



Source: Company, Ambit Capital research, PSB retail deposit share is weighted average of SBI and BOB; large private includes ICICI, Axis, Kotak and IndusInd

Despite losing deposit market share, PSBs have had competitive CoF in line with large private sector banks.

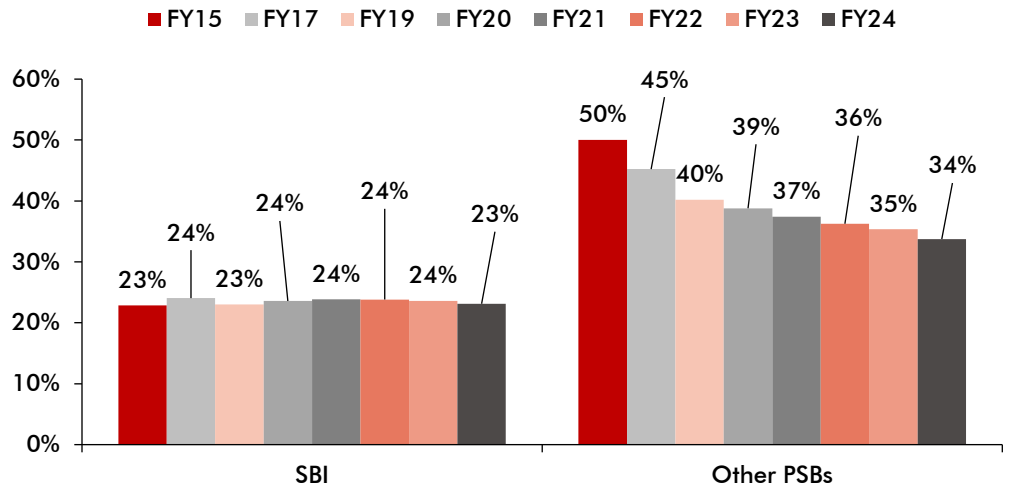
Exhibit 22: PSB CoF similar to large private despite market share loss for many years



Source: Company, Ambit Capital research, weighted average data of SBI, BOB, CBK, UNBK, PNB and BOI in PSB CoF, Large pvt includes ICICI, Axis, KMB and IIB

PSBs lost ~10% market share in deposits between FY15 and FY19 but the pace of market share loss came down considerably with market share loss of ~6% between FY19-24. In the former period, market share loss was due to RBI/banks themselves imposing business restriction owing to asset quality challenges. However, with PSBs starting to lend again after capitalization, the pace of market share loss declined. Though, SBI was able to maintain its market share.

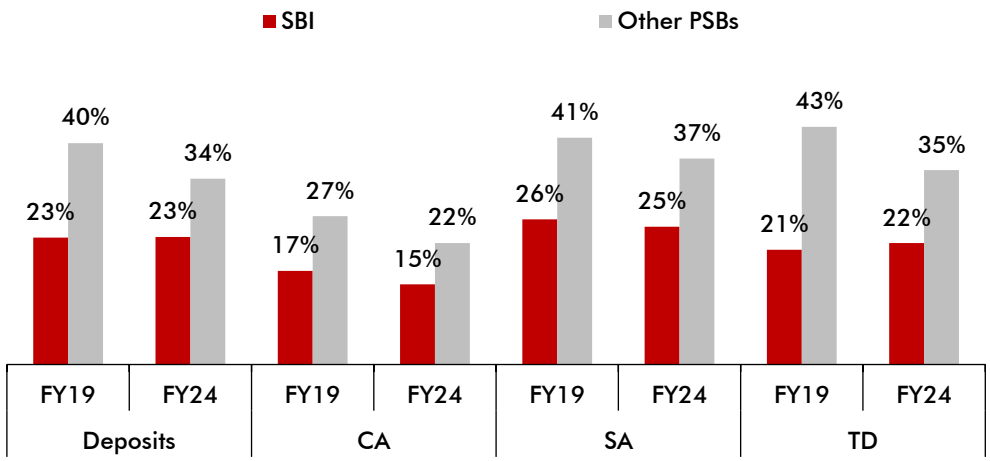
Exhibit 23: The pace of market share loss slowed after FY19



Source: RBI, Company, Ambit Capital research

Market share loss for PSBs was relatively low in saving deposits but high in current deposits and term deposits due to PVBs' aggression on SME/ecosystem banking (CA float) and higher term deposit rates. However, note that SBI was able to defend its market share across all the three deposit categories.

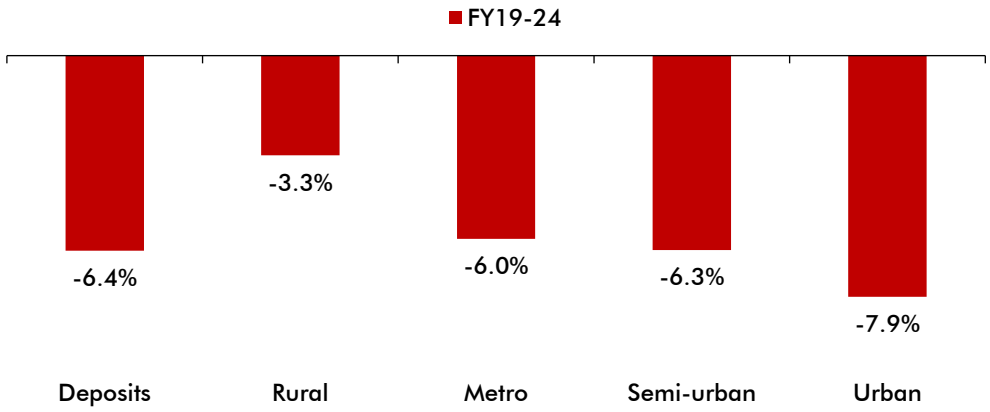
Exhibit 24: SBI defended its turf across all three categories, others lost more on CA/TD



Source: RBI, Company, Ambit Capital research

Better performance of PSBs on saving deposits was a function of better distribution in rural/semi-urban areas along with perception of being government-owned banks; the impact is visible in lower market share loss in rural deposits.

Exhibit 25: Market share loss in rural deposits was least at 330bps vs 640bps overall

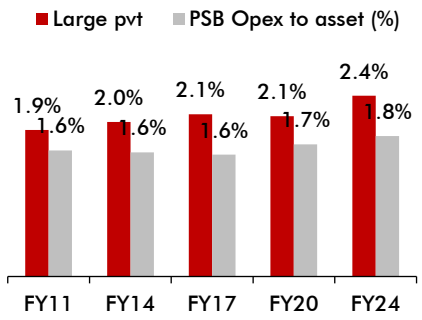


Source: RBI, Ambit Capital research

Better operational efficiency

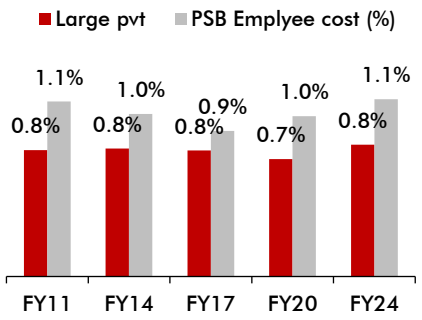
Large balance sheet, depositors' trust, corporate-oriented loan mix and higher presence in the hinterland drive better operational efficiency for PSBs with opex to asset ratio at 1.8%, which is ~60bps lower than that of their private counterparts, in FY24.

Exhibit 26: PSB has lower opex to assets



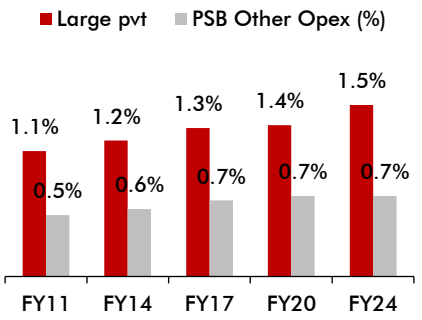
Source: Company, Ambit Capital research; opex to asset for PSB is weighted average of SBI, BOB, Canara, PNB, Union and BOI; Large private includes ICICI, Axis, Kotak and IndusInd

Exhibit 27: Employee cost is a drag



Source: Company, Ambit Capital research; opex to asset for PSB is weighted average of SBI, BOB, Canara, PNB, Union and BOI; Large private includes ICICI, Axis, Kotak and IndusInd

Exhibit 28: Lower other opex support



Source: Company, Ambit Capital research; opex to asset for PSB is weighted average of SBI, BOB, Canara, PNB, Union and BOI; Large private includes ICICI, Axis, Kotak and IndusInd

Employee cost is higher due to pension requirements (25-30% of employee cost) and lower employee productivity. However, PSBs benefit on other expenses due to higher share of corporate loans which have lower operational intensity and higher presence in rural/semi-urban areas where branch cost is lower. PSBs have taken measures to improve productivity by (i) introducing verticalization approach leading to lower TAT, (ii) introducing sales specialists for multiple products in branches and (iii) getting operations people to also perform sales. Moreover, across multiple branches, we observed that young staff do not plan to spend their entire career at one bank and are more sales/customer service/growth oriented than some of their complacent colleagues. This has been pushing up branch productivity.

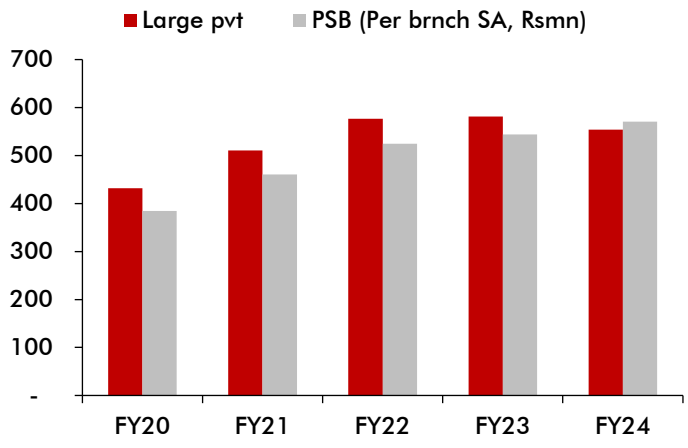
Exhibit 29: Structural approach to enhance productivity

Measures to improve productivity
Verticalization of asset segments with creation of separate processing centres has improved TAT, for example setting up auto loan centre and home loan centre vs. underwriting for both by branch staff earlier
Automating document submission has lowered clerk requirements
Introducing dedicated sales for retail, MSME and agriculture in branches
Hiring CTO from market to integrate different parts of loan journey
Some PSBs have asked operation staff to also do sales to improve branch productivity

Source: Company, Ambit Capital research

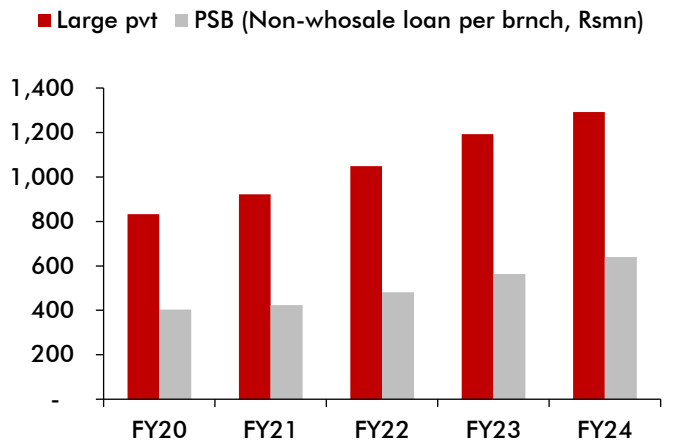
The result of these measures, though lower vs private banks, are visible in branch productivity improvement in both SA balances and non-corporate loans.

Exhibit 30: SA per branch is comparable to PVBs...



Source: Company, Ambit Capital research, Sa per branch is calculated as total savings of SBI, BOB, Canara, PNB, Union and BOI divided by their combined branches; Large private includes ICICI, Axis, Kotak and IndusInd

Exhibit 31: ...but lacks considerably on asset productivity



Source: Company, Ambit Capital research, Non-wholesale loans include retail, agriculture and MSME loans; these loans are typically done via branches across country; whilst corporate loans are typically done via select clusters

Capabilities to manage credit risk higher in this cycle

Diversified loan book has reduced cyclicality

All PSBs have adopted the policy of diversification away from corporate loans. This is reflected in share of wholesale loans declining from 48-59% to 44-53% over the last 4 years. Most of this got moved to retail loans, enhancing granularity of the book. Moreover, most PSBs formulated the internal policy of capping exposure to any corporate group/sub-industry to ensure banks don't face concentration risk similar to the last cycle (2015-2020).

Exhibit 32: PSBs' loan book has become more diversified

Loan mix (%)	SBIN		PNB		BOB		UNBK		BOI		CBK	
	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24
Corporate book	*35%*	*30%*	*49%*	*43%*	*39%*	*35%*	*49%*	*42%*	*45%*	*37%*	*43%*	*38%*
International	*15%*	*14%*	*3%*	*4%*	*17%*	*18%*	*NA*	*3%*	*14%*	*16%*	*5%*	*5%*
Wholesale	**50%**	**45%**	**52%**	**47%**	**57%**	**52%**	**49%**	**45%**	**59%**	**53%**	**48%**	**44%**
Retail	31%	36%	17%	23%	14%	20%	17%	20%	15%	19%	16%	16%
SME + Agri + Others	20%	20%	31%	30%	29%	28%	34%	35%	26%	28%	37%	40%

Source: Company, Ambit Capital research

Besides, they introduced some fundamental changes to underwriting and monitoring of loans, such as:

- Automating underwriting for retail/MSME loans vs. manual underwriting earlier,
- Individual banks undertaking separate due diligence in consortium lending vs. complete reliance on lead lender earlier,
- Identifying stress before it turns into NPA with early warning systems (usually has 30-50 parameters such as change in ratings, change in interest coverage ratio, etc.),
- Management taking stock of overdue loans on a quarterly basis, and
- Tracking usage of loans with stricter norms around current account opening.

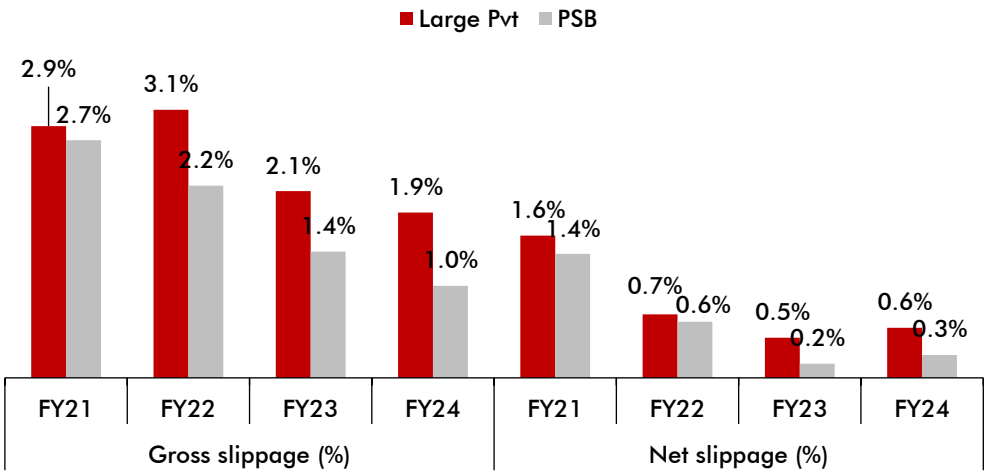
Exhibit 33: Structural changes done on underwriting and loan monitoring

Function	Segment	Strategy
Underwriting	General	Branches are only sourcing channel, underwriting is automated beyond certain threshold (Rs1mn+) for retail/MSME
		Beyond a certain threshold (Rs5cr+), retail/MSME loans are committee approved
		Pre-disbursement audit and forensic audit mandatory for corporate loans
	Corporate	Both internal and external rating given weightage. RM responsible for collections/overdue; present proposal to committee for final approval.
		Board-approved industry/sub-industry/group exposure limits
		In consortium lending, each lender conducts its own due diligence vs earlier practice of lead bank driving decisions
	Agriculture	Focus on big ticket size (especially >Rs0.16mn) because these can be secured by borrower's land
		Prefer production loans over crop loans; NPL in former is historically lower
		Region-based strategy; for instance, tweak loan mix between gold, crop and production depending on region
		Increase share of gold loans
	MSME	Templated underwriting vs. manual earlier. Different clusters have different templates.
	Retail	Branches only sourcing now; underwriting is centralized in processing centres via scorecards
		Collateral valuation above certain threshold (e.g. Rs10mn) is verified by multiple valuers
		Some PSBs restrict unsecured to only those customers having salary/pension account with them.
Monitoring	General	Earnings Warming System (30-50 parameters; most parameters are given by RBI to PSBs) introduced in 2020
		Tracking overdue loans frequently vs. earlier practice of discussion after 90dpd+
		CRILC report (for >Rs50mn loan) monitored and available to all lenders; Introduced in 2014
		For consortium lending of >Rs2.5bn, ASM (agency of specialized monitoring) was implemented which gives quarterly details of credit/debit transactions to each member
		Current account can be opened by only large lenders to borrower, thus enhancing monitoring of loan usage; Introduced in 2021

Source: Company, Ambit Capital research

This is reflected in lower gross/net slippages at PSBs than at large private banks during FY21-24.

Exhibit 34: Gross/net slippages of PSBs stood out positively in the last 3 years



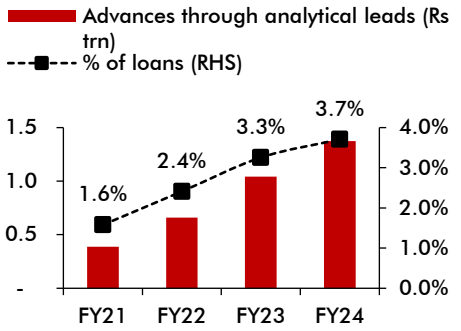
Source: Company, Ambit Capital research, Large private is weighted average data of ICICI, Axis, Kotak and IndusInd; PSB includes SBI, BOB, Canara, Union, PNB and BOI

Although there is no denying that high share of corporate loans drove this performance, insertion of multiple risk layers (as highlighted in exhibit 33) at various levels can continue the benefit for a longer period. Moreover, automated underwriting in retail and that too mostly to liability customers stand to benefit PSBs in case the retail cycle turns bad.

Distribution capabilities have expanded beyond branches

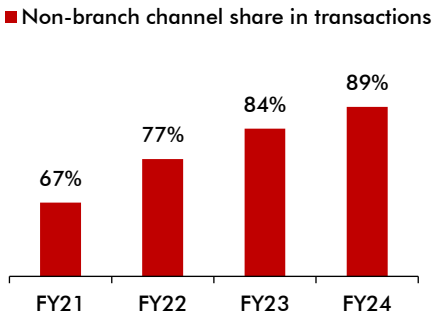
Earlier, PSBs mostly drove business from branch walk-ins but data shows they now have added other channels such as co-lending, dedicated sales and also improved their digital interface for generating business.

Exhibit 35: SBI's 4% advances came from the analytical route in FY24



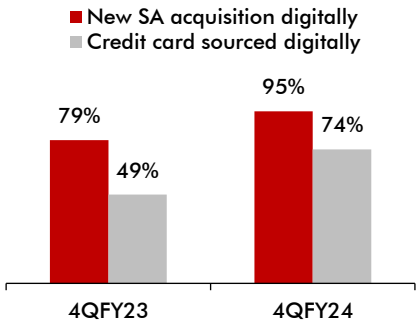
Source: Company, Ambit Capital research

Exhibit 36: SBI's dependence on branch has come down over the years



Source: Company, Ambit Capital research

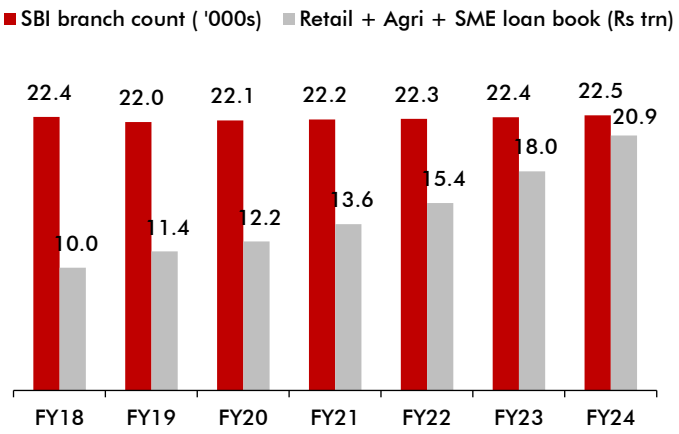
Exhibit 37: BOB's digital sourcing has improved across asset/liability products



Source: Company, Ambit Capital research

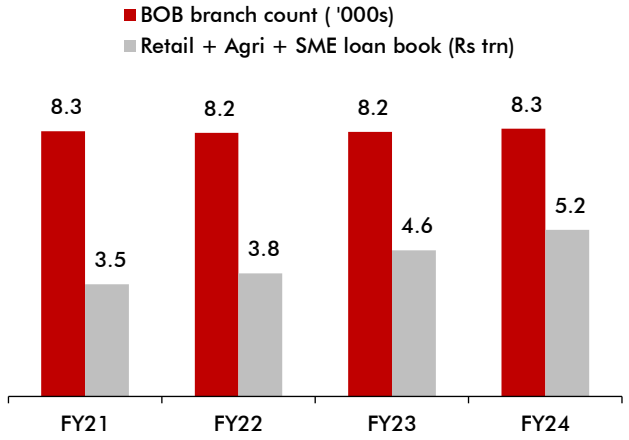
Whilst branch count for both SBI and BOB has remained stagnant over the years, their branch banking business has increased.

Exhibit 38: SBI branch count was stagnant in the last 7 years



Source: Company, Ambit Capital research

Exhibit 39: Still, branch banking book doubled to Rs21trn



Source: Company, Ambit Capital research

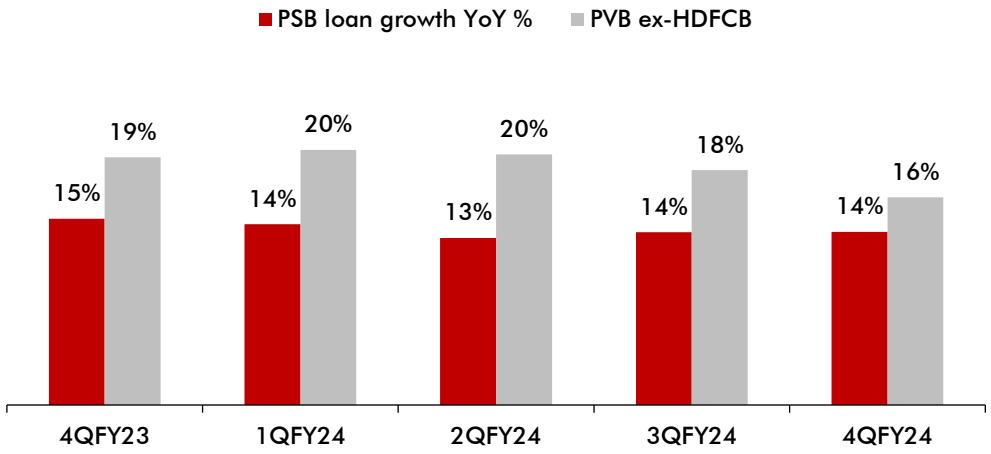
Well-placed on cyclical drivers

We expect the loan growth gap to remain narrow for PSBs vs private banks due to (i) higher balance sheet liquidity, (ii) pick-up in home loans, corporate, agriculture sectors where PSBs are more dominant and (iii) capital levels ~500bps higher than minimum requirement. NIMs should stay stable given 40-55% of loans are linked to MCLR and capacity would further increase the CD ratio. Credit cost normalization will be more gradual than private banks because of (i) loan mix being skewed to corporate, (ii) retail disbursed mostly to internal/housing customer, (iii) PCR being high at 78% and (iv) technical write-off pool of 5-10% of loans. Further, the opex to asset ratio should improve and add to ROE given some PSBs up-fronted wage provisions in FY23/24.

Well-placed to maintain growth momentum

Loan growth picked up for PSBs to 14% and the gap with private banks came down from 600bps in 1QFY24 to 200bps in 4QFY24.

Exhibit 40: Loan growth gap has reduced



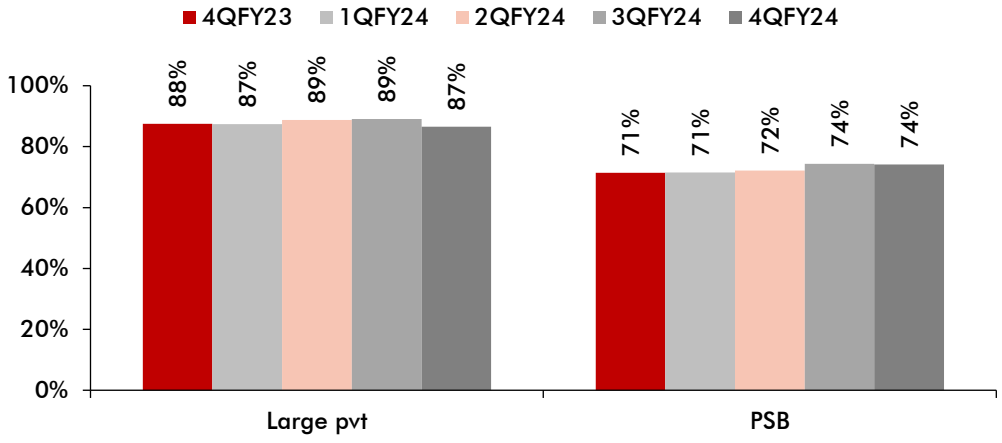
Source: RBI, Ambit Capital research; have excluded HDFCB because of merged data in 2QFY24

We expect growth momentum to sustain for PSBs due to low CD ratio, adequate capital levels and pick-up in PSB-dominant segments such as agriculture, housing and corporate. Moreover, in case corporate demand picks up, PSBs stand to benefit over PVBs.

Low CD ratio

PSBs still have room to improve the CD ratio, which in light of muted deposit growth gives bigger wriggle room to grow the loan book.

Exhibit 41: PSBs still have room to increase the CD ratio unlike PVBs



Source: Company, Ambit Capital research, Large private include ICICI, Axis, Kotak and IIB; PSBs include SBI, BOB, CBK, PNB, UNBK and BOI

Adequate capital levels

Capital levels deteriorated following the asset quality downturn in the corporate/mid-corporate segment after 2015 due to requirement of high provisions. This prompted infusion of capital from the government and that too with book value dilution, severely impairing PSBs' ability to grow their balance sheets. However, with the sharp pick-up in profitability and supportive equity market, capital levels improved and are sufficiently enough (~480bps above minimum requirement) to fund growth. In fact, current levels are better than 2004, the year which marked the beginning of the credit growth cycle. Moreover, current calculation norms are stringent (Basel III) vs 2004 (Basel I), better positioning PSBs to take advantage of an upcycle. We also see a lower likelihood of book dilution in case banks tap equity markets for capital in order to reduce government holding.

Exhibit 42: Capital adequacy is sufficient to fund growth aspirations

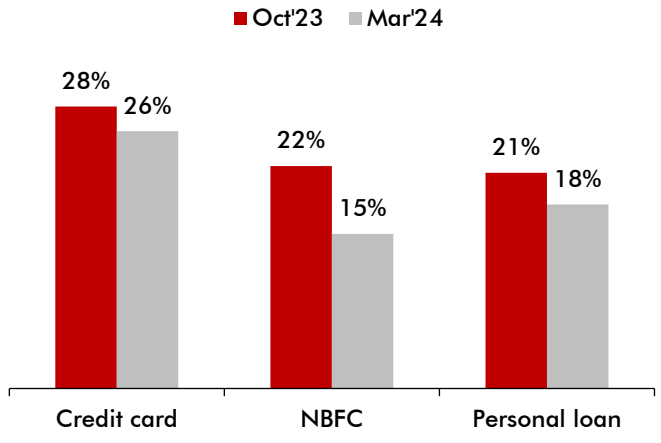
Banks	Tier I	CRAR	Excess CRAR	Tier I	CRAR	Excess CRAR
	FY04	FY04	FY04	FY24	FY24	FY24
SBIN	8.3%	13.5%	4.5%	11.9%	14.3%	2.2%
BOB	8.5%	13.9%	4.9%	14.1%	16.3%	4.8%
BOI	7.5%	13.0%	4.0%	15.6%	16.0%	4.5%
CBK	7.8%	12.7%	3.7%	14.0%	17.0%	5.5%
PNB	7.0%	13.1%	4.1%	13.2%	17.0%	5.5%
UNBK	6.5%	12.3%	3.3%	15.0%	16.3%	4.8%
Median	**7.6%**	**13.1%**	**4.1%**	**14.0%**	**16.3%**	**4.8%**

Source: Company, Ambit Capital research, minimum CRAR for SBI is 12.1% vs. 11.5% for other PSBs in FY24 because of it having Domestic Systematically Important Bank (D-SIB) status.

Pick-up in growth in PSB strongholds

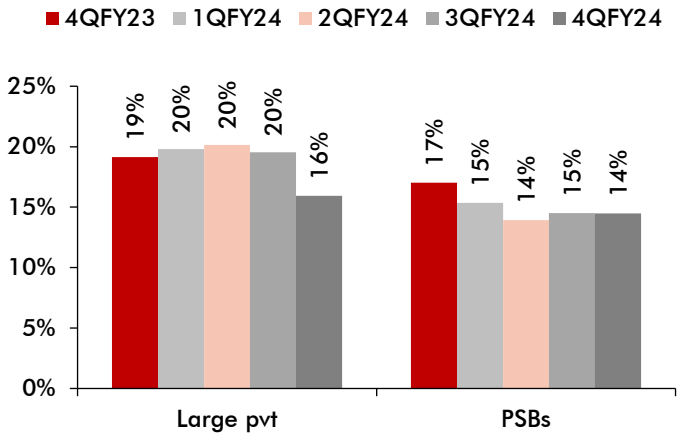
Following the RBI raising risk weight on products like unsecured personal loans, credit cards and NBFCs in Nov 2023, loan growth declined in these segments. This impacted private banks more.

Exhibit 43: Loan growth slowed down in certain segments...



Source: RBI, Ambit Capital research

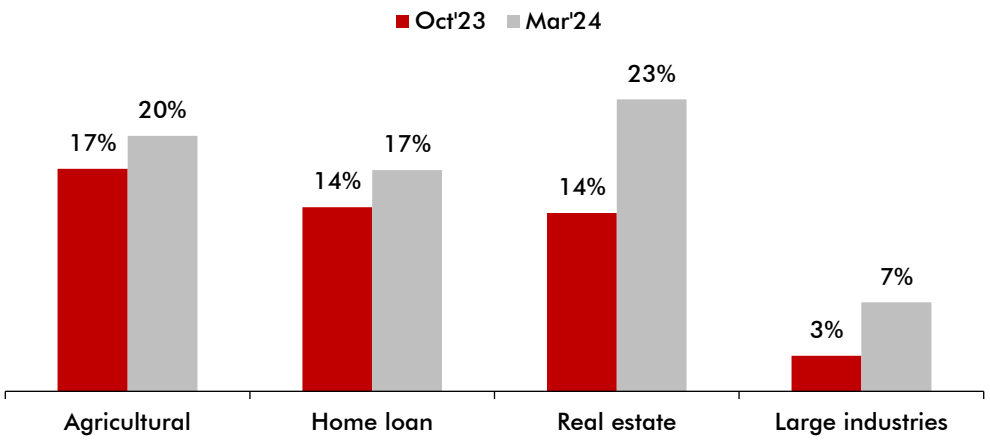
Exhibit 44: ...hitting loan growth of PVBs more than PSBs



Source: Company, Ambit Capital research, Large private include ICICI, Axis, Kotak and IIB; PSBs include SBI, BOB, CBK, PNB, UNBK and BOI

On the other hand, segments such as home loans, agriculture and large corporate loans, typically strongholds of PSBs, have picked up.

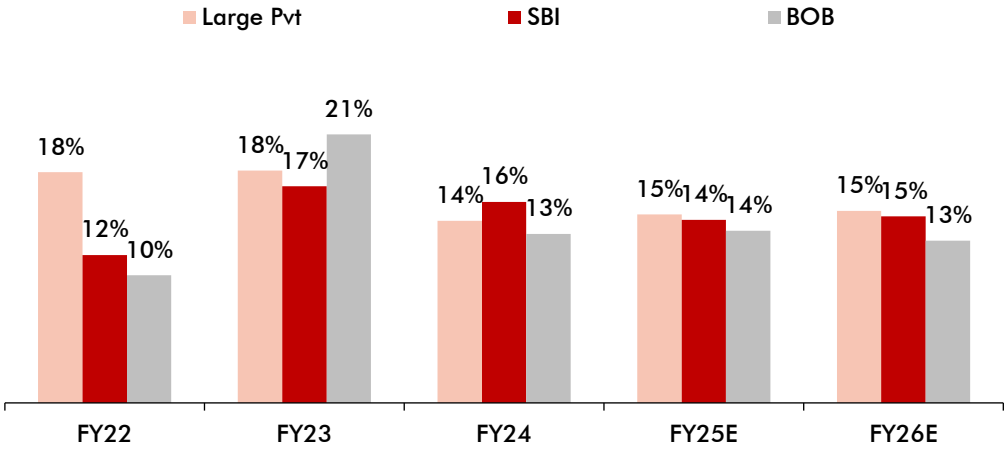
Exhibit 45: Sector data: PSBs' stronghold segments are picking up



Source: RBI, Ambit Capital research; segments represent growth for SCBs

Hence, we expect PSB growth to hold up and stay closer to private bank levels.

Exhibit 46: Loan growth differential to stay low



Source: Company, Ambit Capital research, Large private include HDFCB, ICICI, Axis, Kotak and IIB

Optionality of pick-up in the corporate credit cycle

Credit growth in industry loans picked up following a long period of de-leveraging. Commentary from certain sector indicate capacity utilization reaching peak levels and improving prospects of long-waited capex. Given corporate orientation, PSBs stand to benefit from growth in case that materializes. Note that, in the previous capex cycle of FY04-11, banking credit increased by 24% CAGR and corporate loans (industry + services) grew at 26%, increasing the market share of PSU banks.

Exhibit 47: PSB gained market share in the last capex cycle

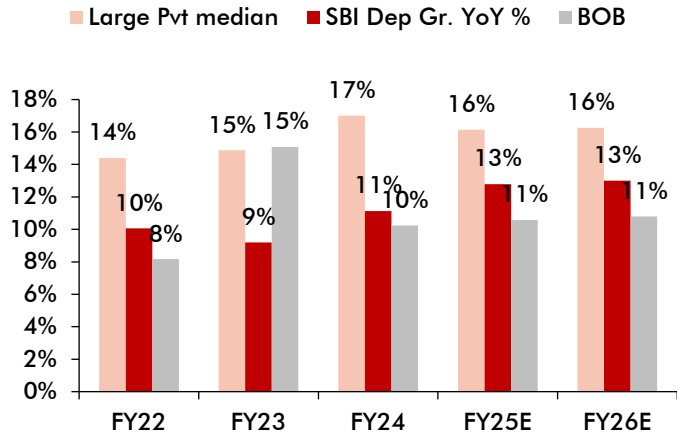
YoY % growth	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11
Overall loans	**37%**	**41%**	**28%**	**23%**	**18%**	**17%**	**21%**
Industry + Services	39%	41%	26%	26%	21%	20%	23%
% of overall loans	63%	63%	62%	64%	65%	67%	68%
Simple avg. of six banks	**27%**	**29%**	**28%**	**23%**	**30%**	**21%**	**26%**

Source: Company, Ambit Capital research, six banks include SBI, BOB, CBK, PNB, UNBK and BOI

Multiple factors to support NIM

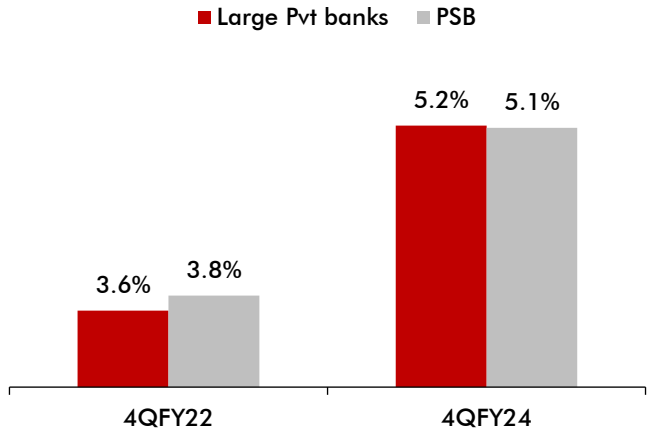
In order to achieve similar loan growth by PSBs and PVBs, the former require lower deposit growth. Given trajectory of incremental cost of deposit being higher than outstanding stock, this will percolate into higher increase in cost of funds for the latter.

Exhibit 48: Modelled deposit growth is lower for PSBs for similar loan growth expectations



Source: Company, Ambit Capital research, large private include ICICI, Axis, Kotak and IIB

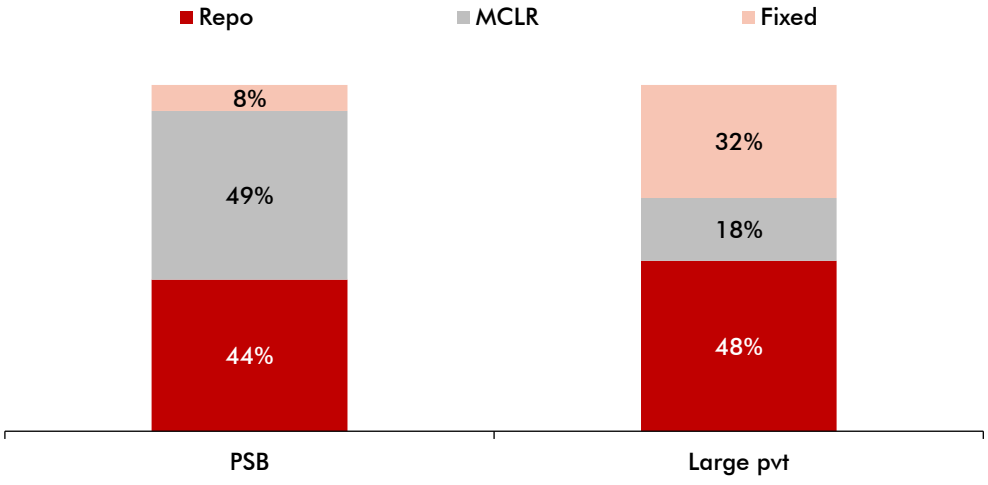
Exhibit 49: CoF increase of 130bps (PSB) has been lower than PVB (160bps) because of excess balance sheet liquidity



Source: Company, Ambit Capital research, Median of large private include ICICI, Axis, Kotak and IIB; Median of PSB include SBI, BOB, CBK, PNB, UNBK and BOI

Lower deposit growth will be led by uptick in CD ratio, leading to lower liquidity drag and hence higher margins. Moreover, high share of MCLR loans (40-50%) renders pricing power to PSBs and should support margins. Typically, MCLR loans reprice with change in cost of funds even if the central bank keeps key rate (repo rate) unchanged. For example, after Mar 2023 the repo rate has been unchanged but median 1-year MCLR rate increased by 35bps till May 2024.

Exhibit 50: MCLR book renders pricing power to PSBs

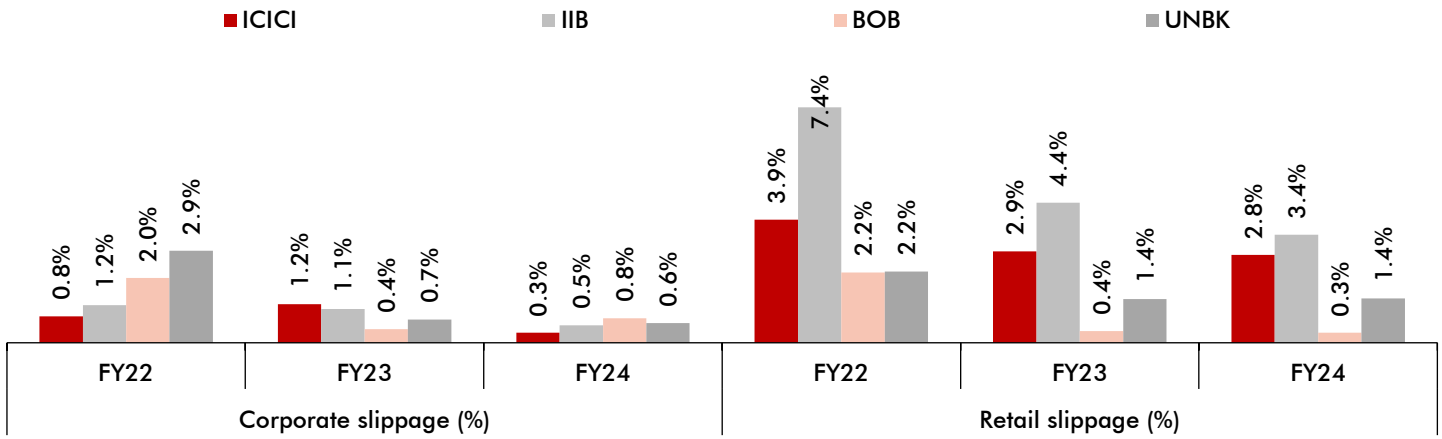


Source: Company, Ambit Capital research, Median of large private include ICICI, Axis, Kotak and IIB; Median of PSB include SBI, BOB, CBK, PNB, UNBK and BOI

Credit cost normalization will be gradual

We expect credit cost to increase for PSBs but expect the increase to be gradual. Higher share of corporate loans should benefit given healthier corporate balance sheets.

Exhibit 51: Corporate slippages have been lower across a variety of banks

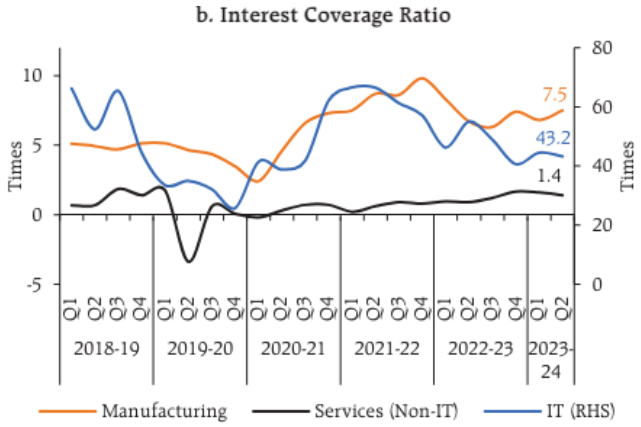


Source: Company, Ambit Capital research; ICICI corporate includes SME as well

Exhibit 52: Corporate leverage has come down considerably from the peak

Source: RBI, Ambit Capital research, NFC Debt is debt of all listed non-financial corporates as percentage of GDP

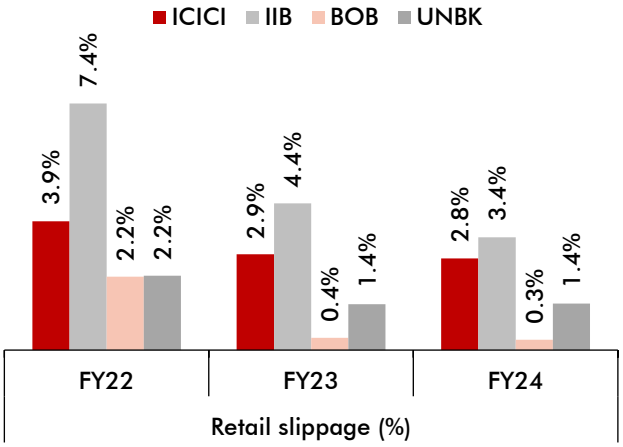
Exhibit 53: Improvement in corporate profitability has led to higher debt serving capabilities



Source: RBI, Ambit Capital research, Interest coverage ratio is operating profit (EBITDA) divided by interest cost; data is for all private listed NFC

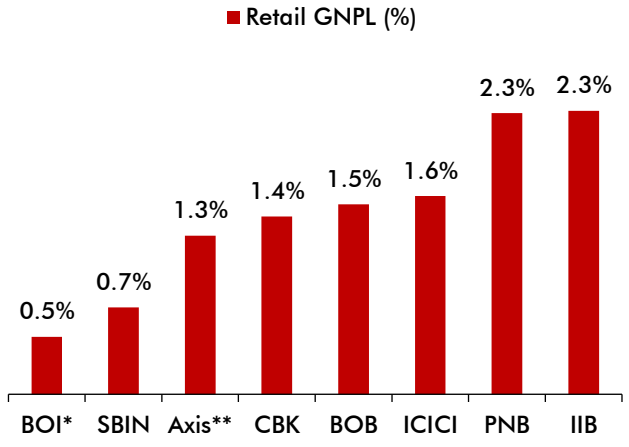
On the retail side, stress formation should be lower for PSBs low due to loan mix being skewed towards housing loans (~50%+ of retail). During Covid, PSBs saw lower slippages than PVBs.

Exhibit 54: PSBs' retail book is more resilient than that of private banks



Source: Company, Ambit Capital research

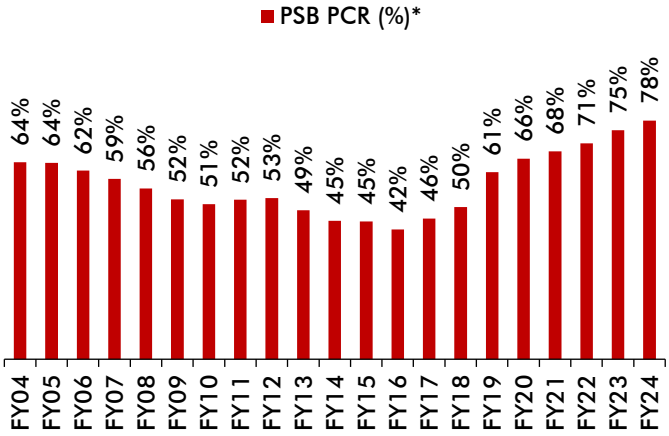
Exhibit 55: Their retail GNPL is comparable/lower than large private banks



*Source: Company, Ambit Capital research, *as of Sept 2023, ** as of Dec 2023, rest data is as of Mar 2024*

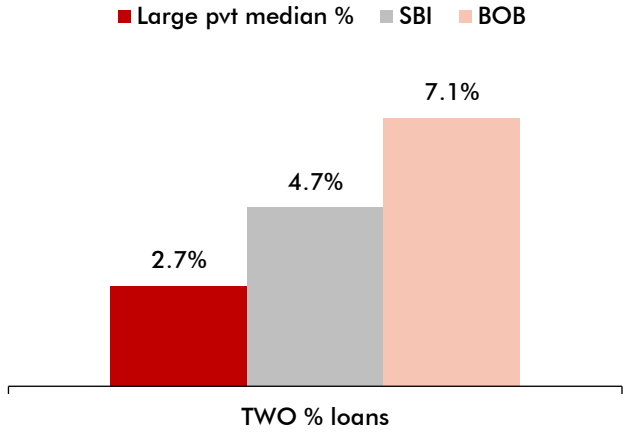
PSBs' PCR of 78% has mostly taken care of legacy provision requirements. In fact, the current level is higher that of the last two decades. Whilst PSBs don't have much floating/contingent provisions, unlike some large private banks, presence of a large technical write-off book can bring in recoveries, driving better-than-expected earnings.

Exhibit 56: PCR is higher than any time in last two decades



Source: Company, Ambit Capital research, large private include ICICI, Axis, Kotak and IIB

Exhibit 57: Recoveries from TWO can surprise positively

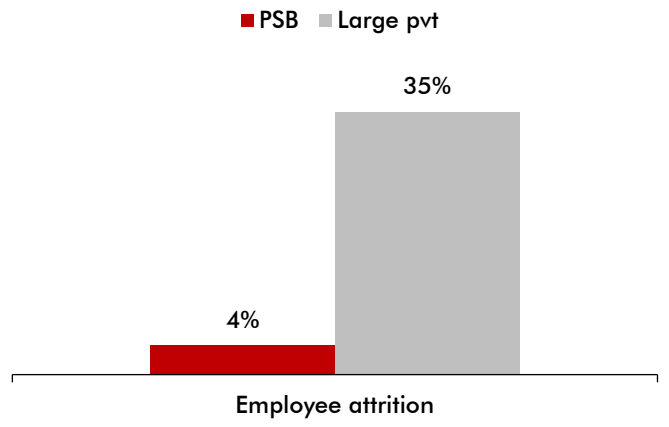


Source: Company, Ambit Capital research, large private include ICICI, Axis, Kotak and IIB; TWO is technical write-off pool

Scope for operating leverage

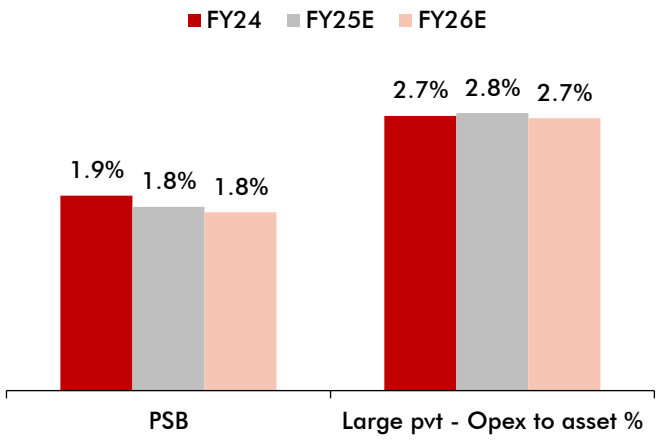
There exist scope of operating leverage since they have up-fronted provisions related to bipartite settlement in FY23/24 which was supposed to be spread over 5 years. In fact, for some PSBs, there could be an absolute decline in employee cost in FY25E. On the other hand, with a further shift towards retail loans, competition for talent (employee attrition 30-50% for private banks vs 1-5% for PSBs) will keep opex growth higher for the former.

Exhibit 58: PVBs dealing with high employee attrition



Source: Company, Ambit Capital research, data as of FY23 as FY24 annual report is yet to be published for banks

Exhibit 59: PSBs' opex ratio will improve whilst being sticky for large private banks



Source: Company, Ambit Capital research

Not all PSBs are same

All PSB stocks have re-rated by riding on cyclical tailwinds. However, we believe not all PSBs are same on fundamental strength. Banks such as SBI and BOB score ahead of other banks, and could be considered a proxy to benefit from the PSB cycle from a medium-term perspective. Although in the near term, trigger on margins and credit cost places Union and PNB higher. Better margins will be a function of lower CD ratio and high MCLR share. Better credit cost will be a function of high PCR (%) and high technical write-off pool.

Exhibit 60: SBI and BOB score ahead of others on fundamental parameters

	Asset quality	Asset mix	Liability	Core revenues (%)	Digital capabilities	Score
SBI	●	●	●	●	●	●
BOB	◕	◑	◕	◕	◕	◕
BOI	●	◑	◕	◑	◕	◕
PNB	◑	◑	◕	◑	◑	◑
UNBK	◔	◑	◑	◑	◕	◑
CBK	◑	◔	◑	◔	◕	◑

Source: Company, Ambit Capital research, Note: ● - Strong; ◕ - Relatively Strong; ◑ - Average; ◔ - Relatively weak

Asset quality - SBI/BOI score well

In the last four years, net stress formation was lowest for SBI and BOI but higher for others. This ratio, in our view, gives insights into whether PSU banks have fundamentally improved on underwriting; it is calculated as a summation of net slippage and incremental restructuring in the last four years. Both banks also score better on credit cost, which indicates P&L impact of new and legacy stress in the books.

Exhibit 61: SBI and BOI scored higher on asset quality in the last 3 years

	SBI	BOI	BOB	PNB	CBK	UNBK
Net stress formation (FY21-24)	1.9%	1.7%	4.3%	6.4%	6.6%	9.6%
FY21- FY24 Credit cost as % of Mar'20 loans	3.9%	6.1%	6.1%	13.8%	12.3%	16.1%
FY21- FY24 Credit cost as % average loans**	3.0%	4.8%	4.8%	9.3%	7.8%	8.5%
Score on underwriting capabilities	●	●	◕	◑	◑	◔

Source: Company, Ambit Capital research, Note: ● - Strong; ◕ - Relatively Strong; ◑ - Average; ◔ - Relatively weak

Liabilities – SBI/BOB score well

Besides having lowest cost of funds, both banks have granular and less-concentrated deposits. In fact, in the last 6 years, SBI was able to defend its deposit market share as well. On the other hand, CBK and UNBK come out as inferior franchises.

Exhibit 62: SBI scores best, UNBK the lowest

	Market share change over FY18-9MFY24*	Current CASA ratio	Top 20 depositors	Current CoF (%)	Score
SBI	-0.25%	40%	4.0%	5.2%	●
BOB	-1.40%	35%	4.7%	5.1%	◕
PNB	-2.12%	40%	4.9%	5.1%	◕
BOI	-1.11%	37%	7.7%	5.1%	◕
CBK	-0.79%	30%	10.2%	5.7%	◑
UNBK	-1.27%	34%	8.0%	5.5%	◑

*Source: Company, Ambit Capital research, *FY18 is proforma merged figures for BOB, PNB, CBK and UNBK, Note: ● - Strong; ◕ - Relatively Strong; ◑ - Average; ◔ - Relatively weak*

Loan mix diversified for all; best for SBI

All PSBs reduced the share of wholesale loans and focused on loan diversification as indicated in the previous section. SBI has been able to build a dominant retail share (36% vs. 16-23% for other banks). CBK scores low because it chose to scale up SME/agriculture book which typically exhibits more volatility in profits.

Exhibit 63: SBI scores highest, CBK the lowest

Loan mix (%)	SBIN		PNB		BOB		UNBK		BOI		CBK	
	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24
Corporate book	*35%*	*30%*	*49%*	*43%*	*39%*	*35%*	*49%*	*42%*	*45%*	*37%*	*43%*	*38%*
International	*15%*	*14%*	*3%*	*4%*	*17%*	*18%*	*NA*	*3%*	*14%*	*16%*	*5%*	*5%*
Wholesale	**50%**	**45%**	**52%**	**47%**	**57%**	**52%**	**49%**	**45%**	**59%**	**53%**	**48%**	**44%**
Retail	31%	36%	17%	23%	14%	20%	17%	20%	15%	19%	16%	16%
SME + Agri + Others	20%	20%	31%	30%	29%	28%	34%	35%	26%	28%	37%	40%
Score												

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Positioning on core revenues – SBI/BOB score well

Given limited differentiation on opex to assets for PSBs, differential in core revenues leads to an RoA differential. SBI and BOB are able to generate better spreads whilst SBI and PNB score ahead of others on fee income. On the other hand, Canara Bank is weakly positioned on both margins and fee income.

Exhibit 64: SBI/BOB score well, CBK lowest on core revenues

	Fee	NIM	Total score
SBI			
BOB			
BOI			
PNB			
UNBK			
CBK			

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 65: BOB/SBI generate higher NIMs

NIM % assets	Avg. FY23 and FY24	Score
BOB	2.98%	
SBI	2.75%	
UNBK	2.71%	
BOI	2.64%	
PNB	2.57%	
CBK	2.51%	

Source: Company, Ambit Capital research, For NIMs, we have taken average of last two fiscal to neutralize lead-lag impact of interest rate. Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 66: SBI and PNB have better fee income capabilities

	% of NII			% loans			Score
	CEB	Forex income	Total	CEB	Forex income	Total	
SBIN	18.1%	2.0%	20.1%	0.8%	0.1%	0.9%	
PNB	16.3%	2.3%	18.6%	0.7%	0.1%	0.8%	
BOI	6.7%	5.0%	11.7%	0.3%	0.2%	0.5%	
CBK	5.1%	7.1%	12.2%	0.2%	0.3%	0.5%	
UNBK	6.6%	2.5%	9.0%	0.3%	0.1%	0.4%	
BOB	7.2%	1.6%	8.8%	0.3%	0.1%	0.4%	
PSB	**10.0%**	**3.4%**	**13.4%**	**0.4%**	**0.1%**	**0.6%**	
Large Private banks	**27.6%**	**5.6%**	**33.1%**	**1.6%**	**0.3%**	**2.0%**	

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Digital capabilities – SBI/BOB score well

Digital capabilities indicates banks' competitiveness in payment infrastructure. A competitive bank will see liability customer use its platform more often than others. Clearly, SBI stands out on the quality of both CA and SA deposits. PNB is a laggard on both metrics.

Exhibit 67: SBI scores ahead of others on digital capabilities

Market share	NEFT+RTGS: Inward+Outward - Value (Market share) (A)	CA market share (B)	C = A / B	Debit cards spends/with drawal market share (D)	SA market share (E)	F= D / E	UPI remitter & beneficiary market share (G)	H= G / E	Score
SBI	12%	14%	86%	33%	27%	122%	18%	68%	
BOB	2%	4%	51%	4%	6%	71%	5%	77%	
BOI	1%	2%	83%	2%	4%	64%	2%	64%	
CBK	2%	3%	58%	6%	5%	107%	3%	66%	
UNBK	2%	4%	46%	5%	5%	90%	5%	84%	
PNB	2%	4%	61%	5%	8%	61%	4%	46%	

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Overall, SBI and BOB stand out as superior franchises on the five major parameters of asset quality, loan book mix, strength of liability franchise, core profitability and digital capabilities.

Exhibit 68: Overall bank-wise scorecard

	Asset quality	Asset mix	Liability	Core revenues (%)	Digital capabilities	Score	P/BV TTM
SBI							1.73x
BOB							1.15x
BOI							0.77x
PNB							1.21x
UNBK							1.06x
CBK							1.15x

Source: Company, Ambit Capital research, Note: P/BV TTM is on consolidated basis Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Near-term earning triggers – Union Bank and PNB are better-placed than others

Whilst fundamentally banks differ on their positioning, in the near term, banks such as Union and PNB are better-placed than SBI/BOB and other banks. Near-term triggers consist of NIM levers and credit cost levers.

Exhibit 69: Union Bank and PNB score ahead of others on near-term triggers

	NIM lever	Asset quality lever	Score
Union			
PNB			
BOB			
CBK			
BOI			
SBIN			

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

On NIMs, banks which have a higher share of MCLR loans and high balance sheet liquidity are better-placed. Canara and Union Bank score ahead of others.

Exhibit 70: SBI/BOB are behind other PSBs on NIM levers in the near term

	MCLR (%)	CD ratio (%)	Score
CBK	50%	71%	
Union	48%	71%	
PNB	38%	68%	
BOI	53%	76%	
BOB	53%	80%	
SBIN	41%	75%	

Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

On asset quality, banks which have high PCR and larger technical write-off books are better-placed. PNB and Union Bank score ahead of others.

Exhibit 71: SBI and Canara Bank lag others on asset quality levers in the near term

	PCR (%)	TWO (% of loan)	Score
PNB	88%	9.8%	
Union	79%	9.2%	
BOI	77%	7.7%	
BOB	77%	7.1%	
CBK	71%	7.3%	
SBIN	75%	4.7%	

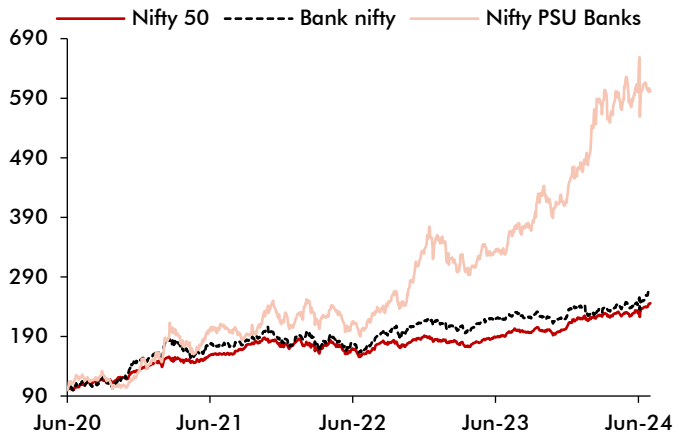
Source: Company, Ambit Capital research, Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Can valuation gap further narrow?

PSBs outperformed Nifty/Bank Nifty in the last four years with a sharp recovery from making loss of Rs855bn in FY18 to profit of Rs1.4trn in FY24 and RoE of 15%. The pack re-rated to 1.5x on TTM BVPS, closing the gap with private banks. We believe the discount can further come down as earnings gap will stay narrow in the next 2 years. However, SBI/BOB have superior franchise strength across parameters and should be seen as proxy for the PSB cycle in the medium term.

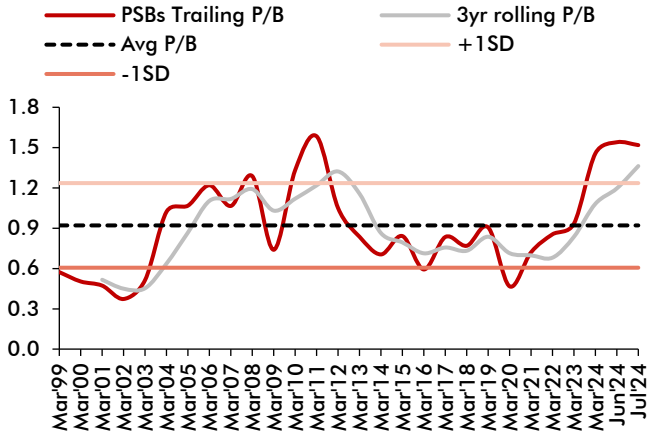
PSBs outperformed the market index and Bank Nifty in the last 4 years driven by sharp pick-up in earnings. This re-rated the pack to 1.5x on TTM BVPS.

Exhibit 72: Nifty PSU banking index outperformed other indices...



Source: Company, Ambit Capital research

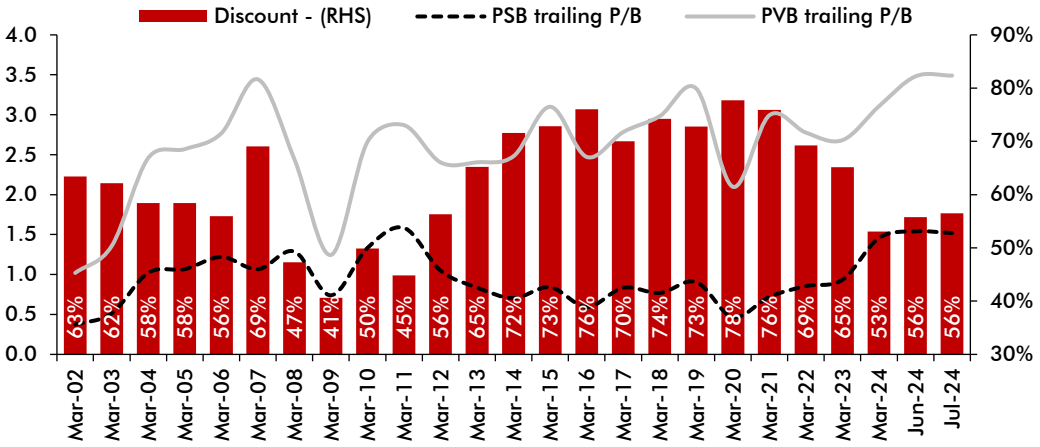
Exhibit 73: ...which led to a rerating, closing on its own past peak of 1.6x of Mar'11



Source: Company, Ambit Capital research, PSB trailing is calculated as sum of market cap of 12 PSBs divided by sum of networth of 12 PSBs

Since earning momentum is likely to continue with narrowing loan growth/ROE gap with private banks, PSB valuations have further room for improvement.

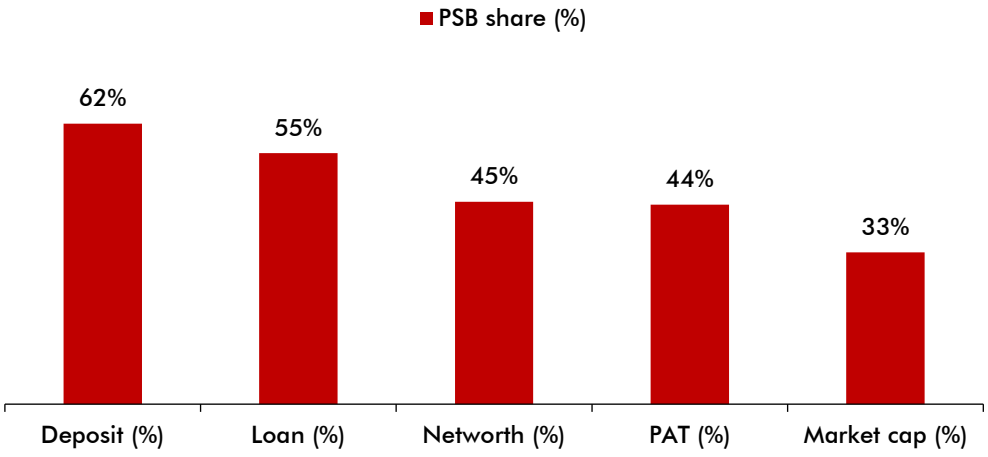
Exhibit 74: PSBs' valuation gap with PVBs has narrowed



Source: Company, Ambit Capital research, Note: PSB trailing is calculated as sum of market cap of 12 PSBs divided by sum of net worth of 12 PSBs, PVB include data of HDFCB, ICICI, Axis, Kotak, IIB and Federal bank.

Moreover, PSBs' share in business/PAT/net-worth is lower than their share in market cap.

Exhibit 75: PSB market cap share amongst listed banks is much below their share in business or profitability



Source: Company, Ambit Capital research, share of PSB with denominator of private banks, PSBs and SFBs. We have excluded RRBs and foreign banks from all parameters since they are not listed in Indian market

In the near term, Union Bank and PNB are better-placed on margins and credit cost but in terms of franchise strength, SBI and BOB are better and can be looked as a proxy to ride the PSB cycle in the medium term.

Exhibit 76: Scorecard on fundamental strength

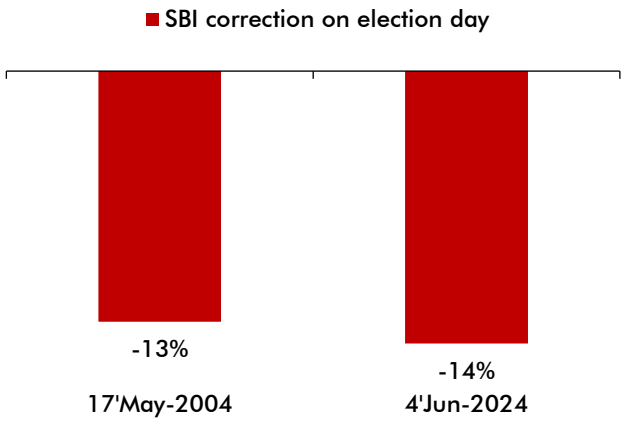
	Asset quality	Asset mix	Liability	Core revenues	Digital capabilities	Score	P/BV TTM
SBI							1.73x
BOB							1.15x
BOI							0.77x
PNB							1.21x
UNBK							1.06x
CBK							1.15x

Source: Company, Ambit Capital research, Note: P/BV TTM is on consolidated basis Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Election outcome and impact

Since the government holds a majority stake in SBI (57%), the election outcome imparts higher volatility in its share price. SBI corrected by 14% on the day of election results because the actual verdict was different from the exit polls. Similarly, in 2004 too, SBI corrected by 13% on the results day due to an unexpected verdict.

Exhibit 77: SBI witnessed similar correction two decades back



Source: Company, Ambit Capital research

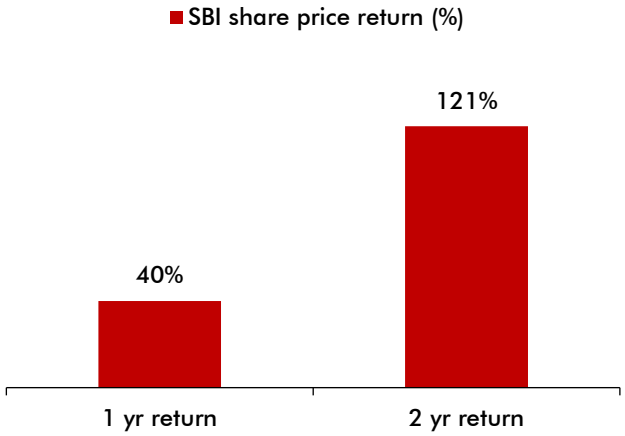
Exhibit 78: Actual verdict differed from exit polls

	2004			2024		
	NPA	UPA/ INDIA	Others	NPA	UPA/ INDIA	Others
Exit poll	250-280	175-190	87-102	342-392	118-169	32-33
Actual result	181	218	143	292	234	17

Source: Company, Ambit Capital research

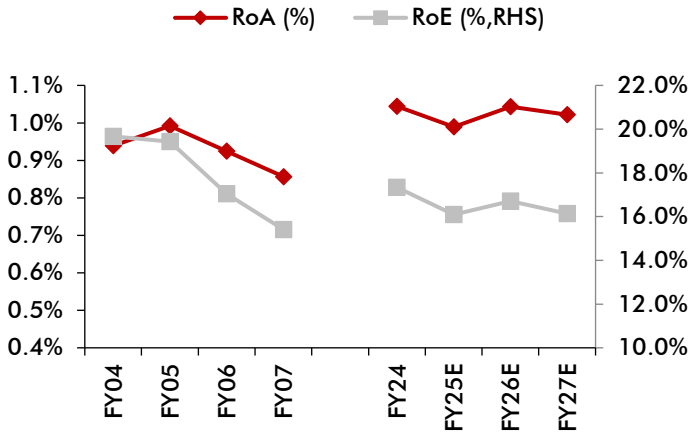
However, in 2004, the stock staged a sharp recovery and delivered 40%/120% returns in 1yr/2yr timeframe. Fundamentals remained intact with RoA/RoE being 0.9% and 17% respectively over the next 3 years. This was driven by benign asset quality. We expect fundamentals to stay strong in the current cycle too driven by similar reasons. Hence, we don't see impact of the poll result on the share price over a 2-year timeframe.

Exhibit 79: SBI moved up sharply over the medium term...



Source: Company, Ambit Capital research

Exhibit 80: ...as its fundamentals were intact; we expect similar resilience this time too



Source: Company, Ambit Capital research

Where do we go from here?

SBI (BUY, 14% upside): It is comfortably positioned to grow its loan book at 15% (over FY24-27E) from a deposit/capital standpoint. Stable NIMs and operating leverage will drive core PPP growth higher to 23%. Asset quality will stay better than private peers' due to high share of corporate book and retail book being exposed to government and corporate employees, driving EPS CAGR of 9% and average RoE of 16% over FY24-27E. We value SBI at Rs960 (1.4x/10x FY26E BVPS/EPS for standalone) and maintain BUY.

BOB (BUY, 25% upside): BOB is comfortably positioned to grow its loan book at 13% (FY24-27E) from a deposit standpoint. Stable NIMs and operating leverage will drive core PPP growth higher to 15%. Given loan mix skewed towards corporate (seeing low stress) and retail mostly to internal customers, credit cost normalization will be gradual. This will lead to EPS CAGR of 7% and average RoE of 15% over FY24-27E. We value BOB at Rs330 (1.2x/9x FY26E BVPS/EPS for standalone) and maintain BUY.

BOI (Not Rated): BOI is a fundamentally better-positioned bank compared to CBK/PNB/UNBK because of its asset quality performance in the last 4 years and the strength of its liability franchise. However, its loan mix is skewed towards bulky segments, leading to concentration risk and volatile RoAs given below-average PPP levels.

CBK (Not Rated): Whilst CBK has near-term NIM levers because of 50% MCLR share, it scores mediocre on most fundamental parameters, especially on core revenues which are lower than peers' and asset mix skewed towards bulky segments.

PNB (Not Rated): PNB has near-term tailwinds on NIM and asset quality but fundamentally it is positioned behind most PSBs with weak underwriting templates, modest core revenues and asset mix skewed towards bulky segments.

UNBK (Not Rated): Like PNB, UNBK has similar near-term tailwinds but fundamentally is positioned at the lower end of PSBs due to its weak liability franchise and worst asset quality performance in the last 4 years.

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AMBIT
Acumen at work

Bank of Baroda

BUY

INITIATING COVERAGE | **BOB IN EQUITY** | **July 03, 2024**

Still some steam left

BOB scores over other PSBs (ex SBI) on lower CoF, better asset quality, a more diversified loan book, and better-managed overseas & agricultural businesses. Moreover, 53% of loans linked to MCLR and room for further increase in CD ratio equip it to manage loan growth/NIM better. Up-fronting of wage-related opex in FY24 should lower opex/asset ratio, driving core PPP growth of 15% over FY24-27E. Given low SMA (15bps of loans, for >₹50mn exposure), 35% corporate share and 78% PCR, credit cost will stay low, averaging 85bps vs 1.4% in the past 4 years. This would drive average RoE of 15% over FY24-27E. Initiate with BUY and TP of ₹330 (1.2x FY26E BVPS). We believe 15% discount to SBI is justified given lower loan growth/RoE and weaker franchise. However, BOB should command a premium to other PSBs.

Competitive position: MEDIUM Changes to this position: POSITIVE

2nd best franchise amongst PSBs

BOB is among better-run PSU banks, as visible in (i) better asset quality performance vs peers during COVID, (ii) lower cost of funds and granular deposits, (iii) Historically, managing overseas business and agriculture loans better than peers as reflected in lower NPAs and higher margins.

Stable NIM to aid Core PPP growth surpass loan growth

BOB has further room to increase CD ratio by 200bps and has 53% of loans linked to MCLR; hence, it is better placed to manage loan growth/NIMs. Up-fronting of wage provisions in FY24 should lead to reduction in opex ratio, taking core PPP growth ahead of loan growth.

Texture of loan exposure will keep credit cost below LTA

35% corporate book (seeing benign asset quality at the system level), retail loan mostly exposed to liability customers and 78% PCR will keep credit cost at average 85bps over FY24-27E vs 1.4% last 4 years. 7% of loans lying in written-off pool will potentially bring recoveries given industry-specific dynamics are improving for these exposures, leading to faster and higher value from liquidation.

15% RoE; maintain valuation discount to SBI

We expect average RoE of 15% over FY25-27. Target price of ₹330 implies 1.2x FY26E P/B. BOB is trading at 15% discount to SBI on FY26E BVPS, which we believe is justified given lower ROE and weaker franchise than SBI. However, it deserves a premium to other PSBs given better franchise strength visible in higher longer-term ROE. Risks: (i) inability to pass on MCLR rate and (ii) net slippage higher than large private banks.

Key Financials

Year to March (₹ bn)	FY23	FY24	FY25E	FY26E	FY27E
Net interest income	414	447	489	554	628
Pre Provisioning Profits	269	310	329	372	425
PAT	141	178	180	201	220
EPS (basic) (₹)	27	34	35	39	42
EPS growth (%)	94.0%	26.1%	1.2%	11.7%	9.4%
P/E - standalone	9.7	7.7	7.6	6.8	6.2
P/B - standalone	1.4	1.2	1.1	0.9	0.8
ROE (%)	15.3%	16.9%	15.1%	15.0%	14.6%
ROA (%)	1.0%	1.2%	1.1%	1.1%	1.0%

Source: Company, Ambit Capital research

Banks

Recommendation

Mcap (bn):	₹1,370/US$16.4
6M ADV (mn):	₹5,544/US$66.6
CMP:	₹265
TP (12 Mths):	₹330
Upside (%):	25

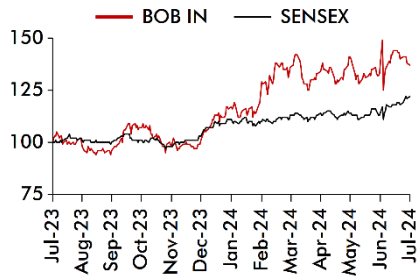
Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	GREEN

Catalysts

- Stable NIM of 3% over the next one year.
- Asset quality holding up compared to large private banks, delivering 15% RoE in FY25E.

Performance



Source: ICE, Ambit Capital Research

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Second-best franchise amongst PSBs

Whilst PSBs as a pack benefitted from cyclical tailwinds, they meaningfully differ on franchise strength. As highlighted in the thematic section, BOB scores ahead of PSBs barring SBI on (i) deposit franchise, (ii) quality of asset diversification, (iii) quality of underwriting templates, (iv) transactional banking capabilities, and (v) ability to generate higher revenues from the underlying business.

Managed asset quality better than peers

BOB's net stress formation and credit cost during Covid were lower compared to PNB/CBK/UNBK, indicating it has better underwriting/collection infrastructure.

Exhibit 1: BOB demonstrated better underwriting/collection infrastructure than PNB, CBK and UNBK

	SBI	BOI	BOB	PNB	CBK	UNBK
Net stress formation (FY21-24)	1.9%	1.7%	4.3%	6.4%	6.6%	9.6%
FY21- FY24 Credit cost as % of Mar'20 loans	3.9%	6.1%	6.1%	13.8%	12.3%	16.1%
FY21- FY24 Credit cost as % average loans**	3.0%	4.8%	4.8%	9.3%	7.8%	8.5%
Score on underwriting capabilities						

Source: Company, Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

More diversified loan mix

BOB, like all PSBs, reduced the share of wholesale loans and diversified its book by growing retail loans. Whilst it ranks below SBI/PNB, BOB is looking to further scale retail with multiple partnerships and lower TAT, which should help it build a granular asset franchise.

Exhibit 2: Retail share has increased for BOB

Loan mix (%)	SBIN		PNB		BOB		UNBK		BOI		CBK	
	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24	FY20	FY24
Corporate book	*35%*	*30%*	*49%*	*43%*	*39%*	*35%*	*49%*	*42%*	*45%*	*37%*	*43%*	*38%*
International	*15%*	*14%*	*3%*	*4%*	*17%*	*18%*	*NA*	*3%*	*14%*	*16%*	*5%*	*5%*
Wholesale	**50%**	**45%**	**52%**	**47%**	**57%**	**52%**	**49%**	**45%**	**59%**	**53%**	**48%**	**44%**
Retail	31%	36%	17%	23%	14%	20%	17%	20%	15%	19%	16%	16%
SME + Agri + Others	20%	20%	31%	30%	29%	28%	34%	35%	26%	28%	37%	40%
Score												

Source: Company, Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Granular and low-cost liabilities

Lower CoF and low concentration risk position BOB ahead of most PSBs on liability franchise, thus giving it the ability to underwrite quality customers without compromising on margins.

Exhibit 3: BOB has a granular deposit franchise with CoF advantage

	Market share change over FY18-9MFY24*	Current CASA ratio	Top 20 depositors	Current CoF (%)	Score
SBI	-0.25%	40%	4.0%	5.2%	
BOB	-1.40%	35%	4.7%	5.1%	
PNB	-2.12%	40%	4.9%	5.1%	
BOI	-1.11%	37%	7.7%	5.1%	
CBK	-0.79%	30%	10.2%	5.7%	
UNBK	-1.27%	34%	8.0%	5.5%	

*Source: Company, Ambit Capital research. * FY18 is proforma merged figures for BOB, PNB, CBK and UNBK Note: - Strong; - Relatively Strong; - Average; - Relatively weak*

Higher core revenues

BOB scores ahead of all PSBs on NIM, leading to higher core revenues as a % of assets. This is driven by better balance sheet efficiency. However, it scores mediocre on fee capabilities, which potentially will improve as the bank increases retail in the mix.

Exhibit 4: BOB scores well...

	Fee	NIM	Total score
SBI			
BOB			
BOI			
PNB			
UNBK			
CBK			

Source: Company, Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 5: ... as it generates higher NIMs than others

NIM % assets	Avg. FY23 and FY24	Score
BOB	2.98%	
SBI	2.75%	
UNBK	2.71%	
BOI	2.64%	
PNB	2.57%	
CBK	2.51%	

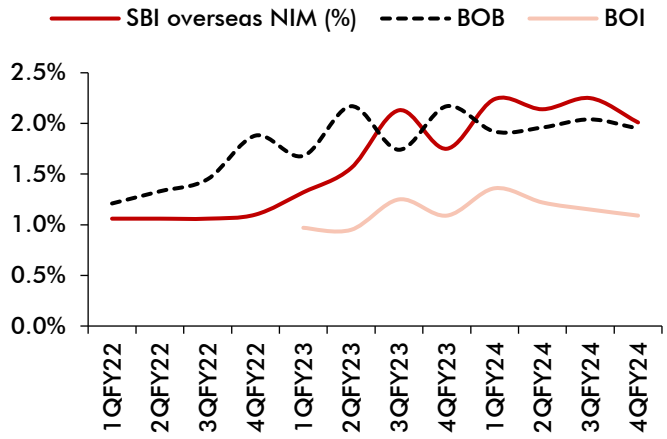
Source: Company, Ambit Capital research. For NIMs, we have taken average of last two fiscal to neutralize lead-lag impact of interest rate Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Unique areas of strength where BOB differs over other PSBs

Strong in overseas operations

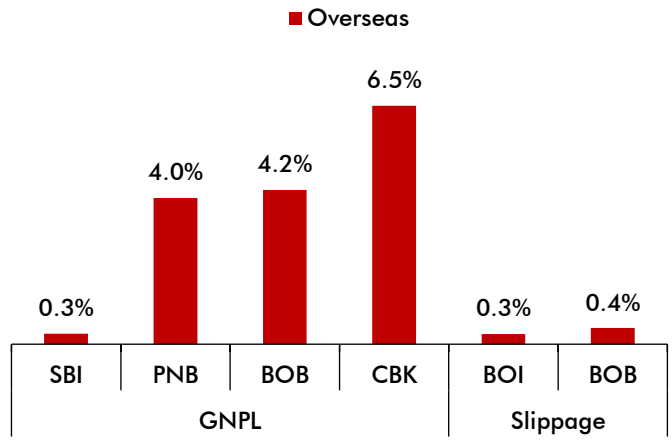
Overseas loan/deposit constituted ~18%/15%. Amongst the three dominant players (BOB, SBI and BOI), BOB's NIM is at the top end primarily because overseas deposits themselves fund asset growth, whilst for SBI domestic deposits fund asset growth. Hence, BOB's ability to sustain stable NIM is better. Asset quality is in line or better than PSBs barring SBI.

Exhibit 6: BOB NIM is at the top end amongst main players



Source: Company, Ambit Capital research

Exhibit 7: Asset quality in line or better than some banks

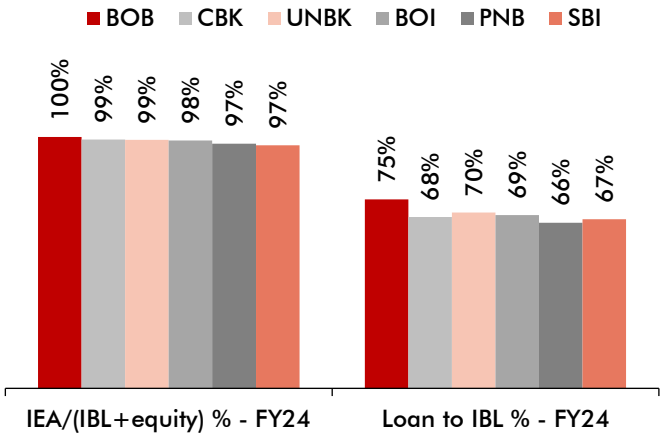


Source: Company, Ambit Capital research

Efficient asset management leading to better top-line

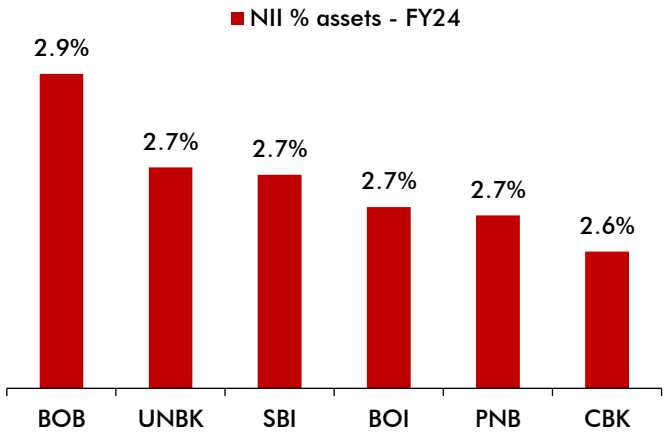
BOB's share of earning assets (IEA) is equivalent to available funding (IBL + Equity), in line with other PSBs. *IBL is the sum of deposits and borrowings*. However, its share of loans in the earning asset is higher at 75% vs <70% for others since other PSBs' funding is stuck in investments or cash, creating a liquidity drag. This gives BOB the best NIM amongst six PSBs. As per our calculations, a 1% better loan share leads to 5bps/50bps uptick in NIM/RoE for BOB.

Exhibit 8: BOB's loan to IBL is highest...



Source: Company, Ambit Capital research

Exhibit 9: ...leading to higher NIM

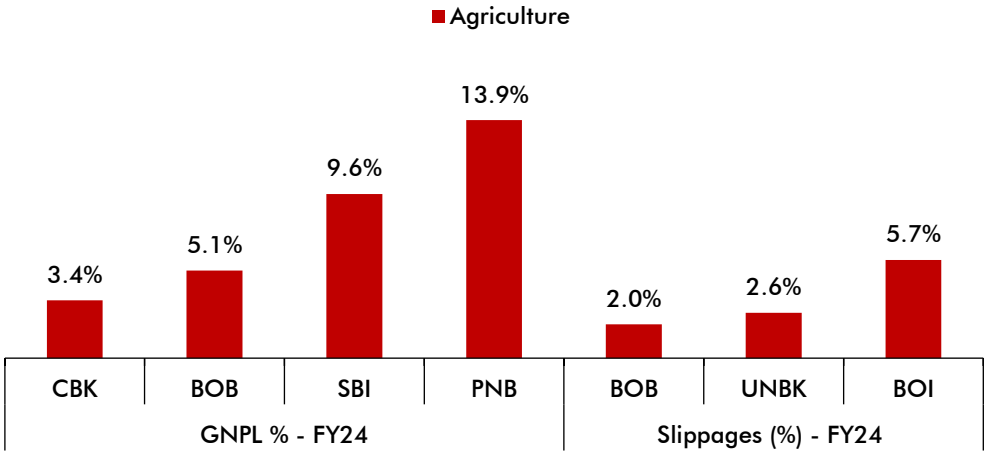


Source: Company, Ambit Capital research

Better-managed asset quality in the agriculture book

Delinquency outcome for BOB has been lower than others including SBI. GNPL in agriculture is 5% vs average 9% for PSBs. On similar lines, the bank's slippage in agriculture was 2% for FY24 vs 2.5-6% for peers. Canara's NPL is lower than BOB, which can be attributed to ~50% loans being gold vs 30% for BOB.

Exhibit 10: BOB has a better-managed asset quality in its agriculture book



Source: Company, Ambit Capital research

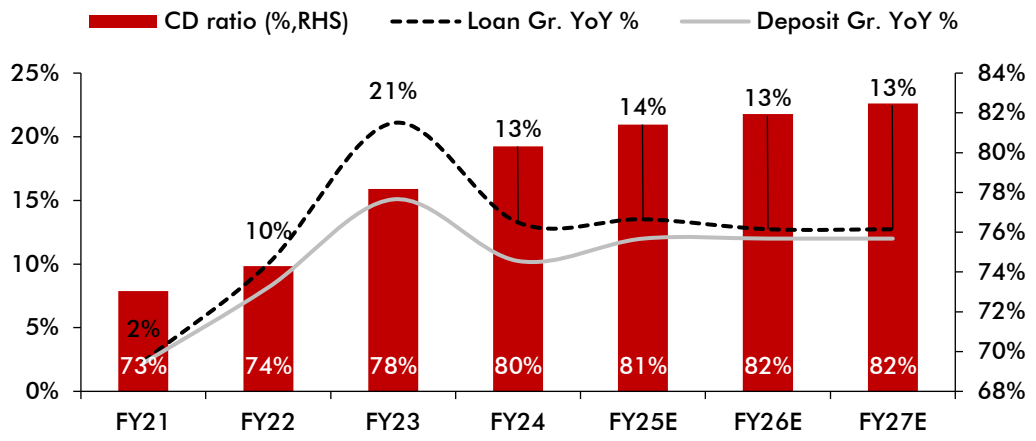
Core PPP growth to be ahead of loan growth

BOB is less constrained by liquidity and is comfortably placed to grow the loan book by 13% CAGR over FY24-27E with retail loans leading growth. 53% MCLR book and retail loans will cushion the impact of increase in CoF and deliver stable NIMs over FY24-27E. Low opex growth because most wage provisions were up-fronted will drive core PPP of 15% over the same period. This is better than that of large private banks, facing NIM contraction and continuous opex intensity.

Loan CAGR of 13% over FY24-27E

BOB expanded its loan book by 15% CAGR over FY21-24 supported by deposit growth of 11% and ~700bps jump in CD ratio.

Exhibit 11: Marginal uptick in deposit growth can easily support 13% loan CAGR



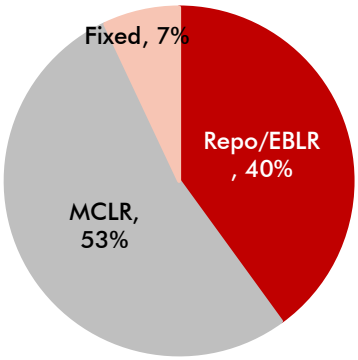
Source: Company, Ambit Capital research

Whilst room to increase CD ratio is limited at 100-200bps from FY24, a marginal pick-up in deposit growth, in line with our assumption for the sector, should support loan growth of 13% over FY24-27E. This is in line with management's guidance of 12-14%, which it said would be driven by its retail book.

Core PPP levels to improve from FY24 levels

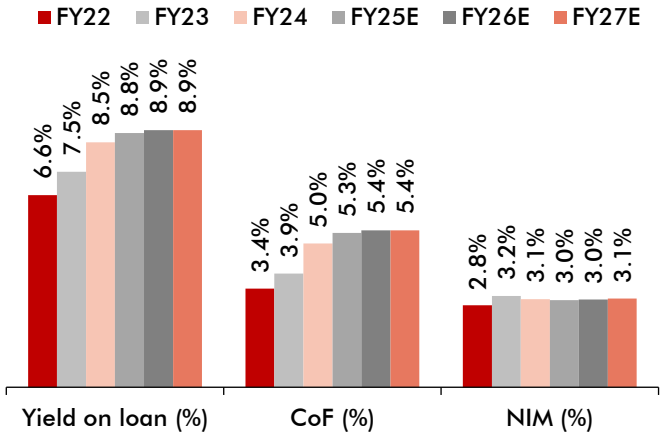
Core PPP improved from 1% to 1.6% between FY21 and FY24 primarily driven by yield repricing of assets. Increase in yield was similar to SBI, which had similar share of repo-linked loans at ~40%. We expect yield to further improve by 30bps over FY24-27E due to 53% MCLR-linked loans and retail loans growing faster than the corporate/overseas book. This will cushion the impact of 30bps CoF increase, leading to stable NIM over FY24-27E.

Exhibit 12: MCLR book will support loan yield, cushioning...



Source: Company, Ambit Capital research

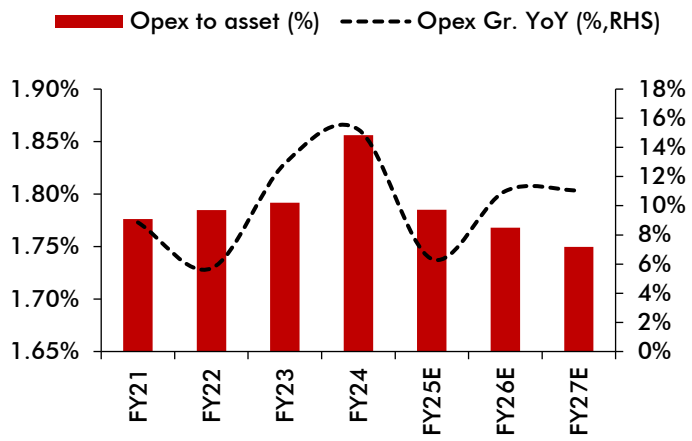
Exhibit 13: ...the impact of CoF increase, driving stable NIM



Source: Company, Ambit Capital research

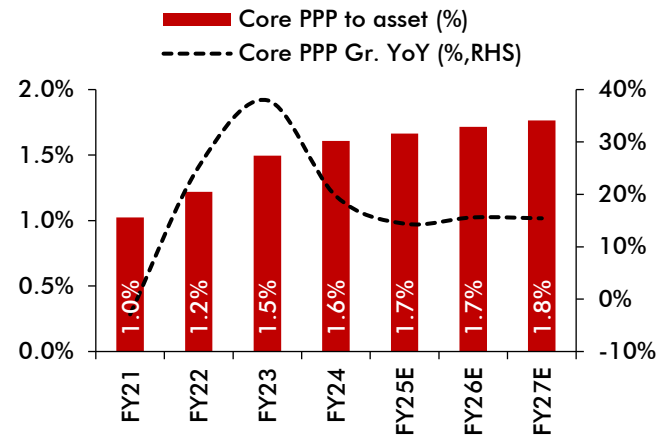
Expense efficiency should improve with opex/asset expanding 10bps over FY24-27 as the bank up-fronted its wage settlement burden in FY23/24. Overall, we expect ~15bps improvement in core PPP to assets over FY24-27E.

Exhibit 14: Opex to grow slower on a high base...



Source: Company, Ambit Capital research

Exhibit 15: ...leading to 15% core PPP CAGR

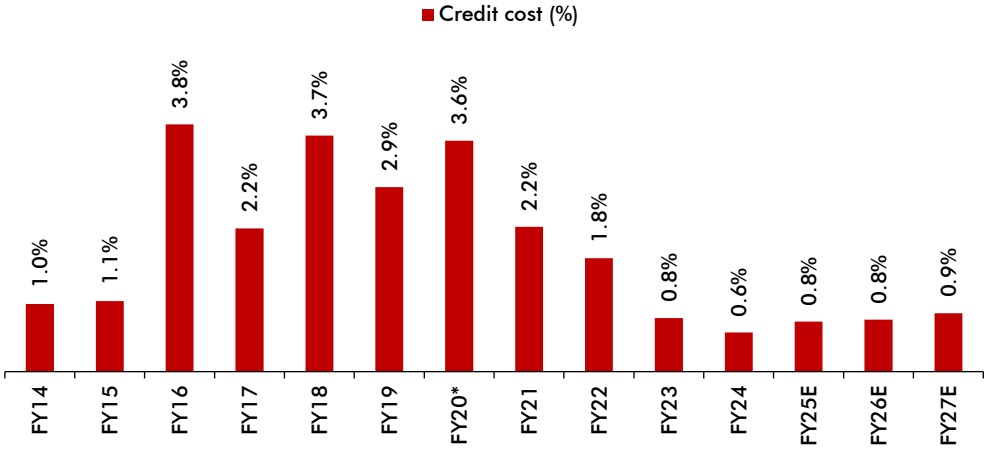


Source: Company, Ambit Capital research

Credit cost to stay benign

Credit will stay benign, averaging 85bps over FY25-27E vs 1.4% in the last four years due to (i) limited net stress formation with the loan book skewed to the corporate segment (currently showing low stress at the system level) and (ii) 78% PCR being sufficient to cover for existing NPL. Moreover, recoveries from technical write-off book (7% of loans) will continue at a run-rate of 5%.

Exhibit 16: Credit cost will be lower than LTA



*Source: Company, Ambit Capital research. *FY20 and prior period is for standalone bank; post-FY21 data is for the merged bank including Vijaya and Dena bank*

New stress formation should be limited

Given loan book is skewed towards corporate (35% of loans), increase in net slippage will be gradual. We expect net slippage of 90/105/110bps, conservatively to be in line with large private banks.

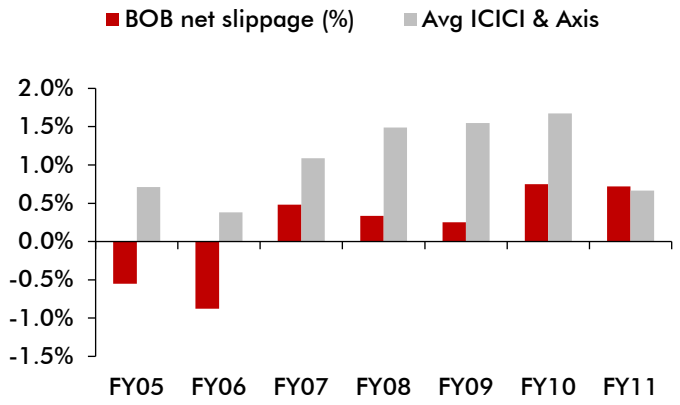
Exhibit 17: We expect gross slippage to stay low vs 2% in the last 4 years

	4QFY24 Loan mix (%)	4QFY24 gross slippage reported (%)	FY25E gross slippage assumed (%)
Corporate	35%	0.2%	0.3%
Overseas	18%	0.2%	0.5%
MSME	11%	4.0%	5.0%
Retail	20%	1.3%	1.5%
Agriculture	13%	3.0%	4.0%
Others	4%	0.1%	0.1%
Total gross slippage	**100%**	**1.2%**	**1.5%**

Source: Company, Ambit Capital research

In the previous cycle between FY05-11, BOB's net slippage was lower than that of private banks. Moreover, BOB undertook multiple initiatives to improve the quality of loan book origination by increasing the share of high-rated customers along with strengthening the loan monitoring/recovery system. Whilst low corporate customer leverage and share of A and above being 90% (vs 73% in FY21) will keep its gross slippage contained, in other segments we are already baking in constructive figures. Gross slippage in the retail segment should hold up since loan is mostly restricted to liability customers.

Exhibit 18: In the previous cycle, BOB's net slippage was lower than private banks



Source: Company, Ambit Capital research

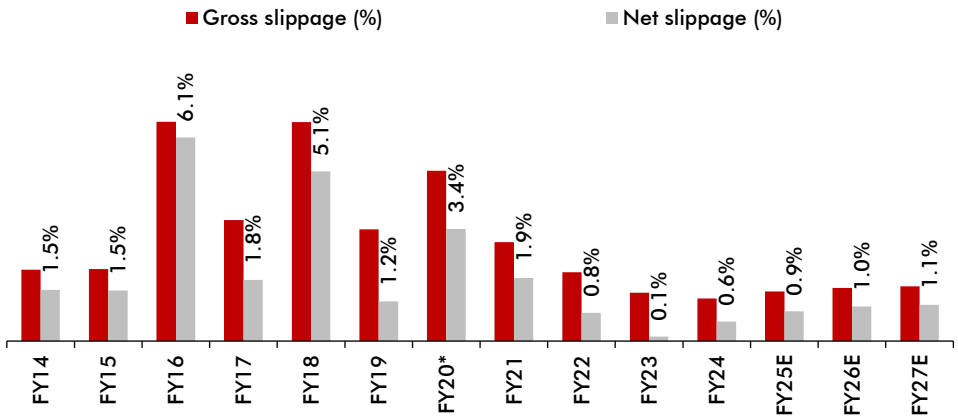
Exhibit 19: Structural initiatives undertaken to improve quality of origination and post-disbursal monitoring

Initiatives
Scorecard-based underwriting in RAM is more uniform and objective vs. the earlier subjective branch-led model
Increased focus on A and above customers in corporate; share improved from 73% in FY21 to 90% in FY24
Setting sub-industry/corporate limit to manage concentration risk
Implementing tech-based EWS from Aug 2020 to track incipient stress. Branches/zones being tracked on overdue outstanding
Sector initiatives - regular account tracking due to weekly submission of ₹50mn+ stress by all banks on CRILC platform
Setting up cluster recovery hubs with officers being segment specialists vs. generic earlier in RAM (Retail, Agriculture, MSME)

Source: Company, Ambit Capital research

Thus, gross/net slippage will be lower than historical trends.

Exhibit 20: Gross/net slippage to stay lower than LTA

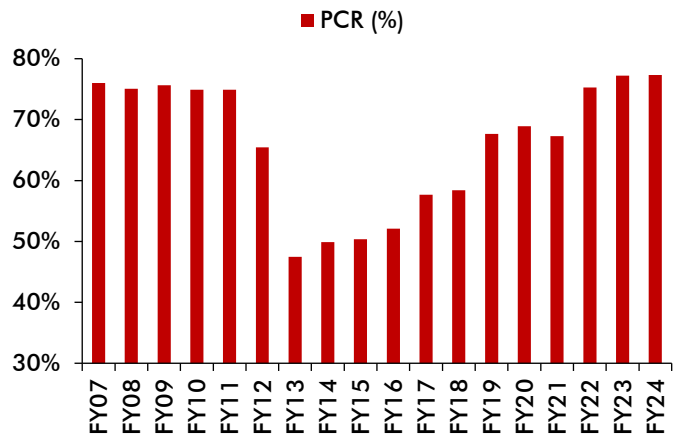


*Source: Company, Ambit Capital research. * FY20 and prior period is for standalone bank; post-FY21 data is for the merged bank including Vijaya and Dena Bank*

PCR sufficient on NPLs

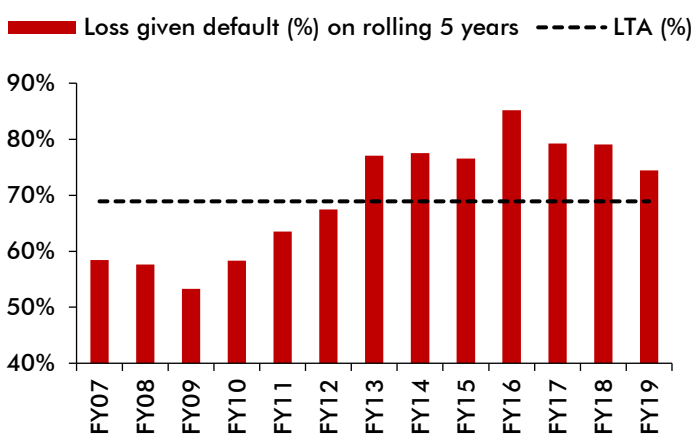
BOB has PCR of 78%, which is at a historical high. Moreover, historically 70% PCR was sufficient for the bank on a cross-cycle basis. In fact, in a benign asset quality period like the current one, even 60% PCR is sufficient.

Exhibit 21: PCR is at high vs the past



Source: Company, Ambit Capital research

Exhibit 22: On cross-cycle basis, 70% PCR was sufficient

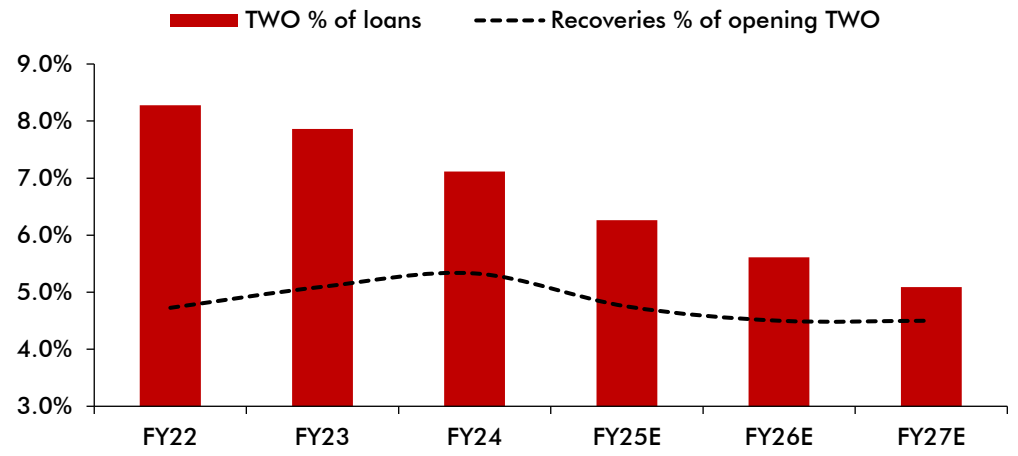


Source: Company, Ambit Capital research

TWO recoveries should add to bottom line

Whilst large banks have contingency buffer which will keep net credit cost low, the same for BOB can come in the form of recoveries from the large pool of technical write-offs (TWO), which stand at 7% of loans. We expect 5% recovery rate to continue with corporate leading the way.

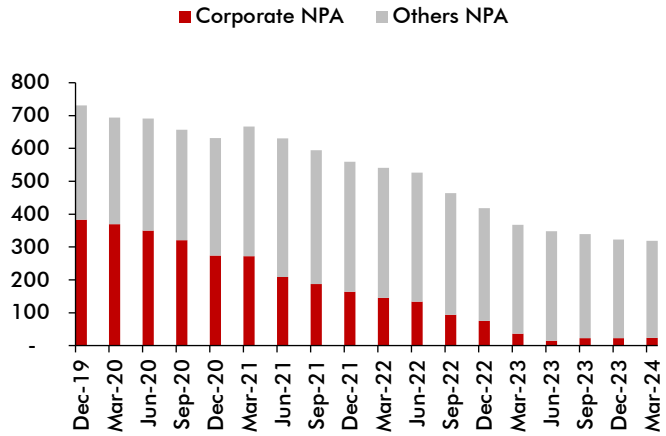
Exhibit 23: Recovery from TWO book (7% of loans) to aid profitability



Source: Company, Ambit Capital research

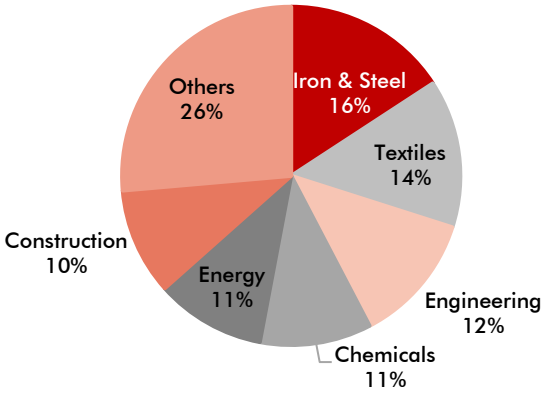
The GNPL amount has come down by 56% from the peak in Dec 2019. The majority (87%) of this reduction came from the corporate book, and the majority came from write-offs instead of recoveries. Within corporate NPA, the top 6 sub-segments of iron & steel, textile, engineering, chemicals, energy and construction constituted 84% and is expected to form a considerable chunk of the existing TWO book. Some of these sub-segments started showing uptick in profitability, implying improvement in industry dynamics. This should help BOB sustain the recovery rate.

Exhibit 24: Corporate NPA drove decline in GNPA



Source: Company, Ambit Capital research

Exhibit 25: Corporate GNPA's Dec 2019 mix had 84% coming from 6 sub-segments



Source: Company, Ambit Capital research

Expect RoE of 15%; valuation discount with SBI to stay narrow

Stable NIM, loan growth (13% CAGR) close to sector levels and sustenance of asset quality will drive 15% RoE, broadly in line with consensus expectations. BOB is the 2nd best franchise amongst PSBs and can be seen as a proxy to the PSB cycle besides SBI. Given 100bps lower RoE expectation than SBI, we expect BOB to maintain its 15% discount to SBI. However, the discount can narrow in case corporate credit picks up given BOB has a higher share of corporate than SBI. Compared to other PSBs, we expect it to trade at a premium given better loan growth/RoE expectations and franchise strength. We arrive at a TP of ₹330 (1.2x/9x FY26E BVPS/EPS) expecting 20-year loan growth/RoE of 13%/14.5%.

Well-placed to deliver 15% RoE

Loan CAGR of 13% and margins about 20bps above FY22 levels will be a function of balance sheet optimization and change in loan mix. This would translate into average RoE of 15% over FY24-27E supported by benign credit cost of 85bps (average).

Exhibit 26: Rationale for assumptions

Assumptions	FY22	FY23	FY24	FY25E	FY26E	FY27E	Comments
YoY loan growth	10.0%	21.1%	13.3%	13.5%	12.7%	12.7%	Loan growth to be led by retail loans whilst we build just 10% growth in corporate/overseas book in line with FY24 trends
Net interest margins (calculated)	2.83%	3.16%	3.05%	3.01%	3.04%	3.07%	Stable margins with increase in CD ratio and loan mix change to cushion impact of rise in CoF
Other income to asset	0.94%	0.73%	0.95%	0.83%	0.81%	0.79%	Expect a decline due to lower treasury gains because of new investment circular
Cost to asset ratio	1.78%	1.79%	1.86%	1.79%	1.77%	1.75%	Up-fronting of wage provisions in FY23/24 will led to decline in opex/asset ratio
Gross NPA ratio	6.61%	3.79%	2.92%	2.70%	2.70%	2.74%	Asset growth of 12% and low net slippages of 1% vs 1.2% LTA will continue to drive decline
Credit cost	1.75%	0.83%	0.61%	0.77%	0.81%	0.90%	Assuming steady PCR to drive average credit cost of 85bps, though it will still be lower than LTA of 1.5%
Outputs (₹ bn)							
NII	326.2	413.6	447.2	489.5	554.3	628.0	FY24-27E CAGR of 12% vs. FY22-24E CAGR of 17%
Operating profit	223.9	268.6	309.7	329.4	373.0	425.7	FY24-27E CAGR of 11% vs. FY22-24E CAGR of 18%
Net Profit	72.7	141.1	177.9	180.5	201.5	220.4	FY24-27E CAGR of 7% vs. FY22-24E CAGR of 56%
EPS (₹)	14.0	27.3	34.4	34.9	38.9	42.6	FY24-27E CAGR of 7% vs. FY22-24E CAGR of 56%
BVPS (₹)	157.5	179.1	206.1	233.2	263.5	296.6	FY24-27E CAGR of 13% vs. FY22-24E CAGR of 14%
RoA (%)	0.6%	1.0%	1.2%	1.1%	1.1%	1.0%	
RoE (%)	8.9%	15.3%	16.9%	15.1%	15.0%	14.6%	

Source: Company, Ambit Capital research

Our EPS estimate for FY25 is marginally lower than street due to lower other income. For FY26/27E, our EPS estimates are in line with consensus.

Exhibit 27: We are ahead of consensus estimates

Bank of Baroda (₹ bn)	Consensus	Ambit	Difference (%)
Net profit (₹ bn)			
FY25E	187	180	-4%
FY26E	202	201	-1%
FY27E	216	220	2%
EPS (₹)			
FY25E	36	35	-3%
FY26E	39	39	-1%
FY27E	42	42	2%
RoA (%)			
FY25E	1.12%	1.07%	(5) bps
FY26E	1.08%	1.07%	(1) bps
FY27E	1.04%	1.04%	(0) bps
RoE (%)			
FY25E	15.6%	15.1%	(55) bps
FY26E	15.0%	15.0%	3 bps
FY27E	14.5%	14.6%	11 bps

Source: Company, Ambit Capital research

Changes undertaken to improve sourcing quality and tracking of borrowers should keep asset quality in check over the next three years, resulting in RoE outpacing cost of equity. With reliance on the corporate segment (35% of loan book) and a still evolving retail/MSME infrastructure, we foresee asset growth of 13% over the longer term. This is lower than the 14% growth assumption for the sector.

Exhibit 28: Expect positive excess returns at lower growth than sector (14% growth)

Long term assumptions	FY05-19	FY20-24	Phase 1 - FY24-27E	Phase 2 – FY27-44E
Median assets growth (YoY)	20.5%	9.7%	12.3%	13.0%
Median RoA	0.8%	0.8%	1.1%	1.0%
Median RoE	12.6%	12.1%	15.0%	14.7%

Source: Company, Ambit Capital research

Our cost of equity is 13.75%, which is 25bps higher than SBI and 50-70bps higher than large private banks due to less efficient capital allocation in the past. Based on our assumptions, our "excess return model" gives a **target price of ₹330, implying 1.2x FY26E BVPS and 9x FY26E EPS**.

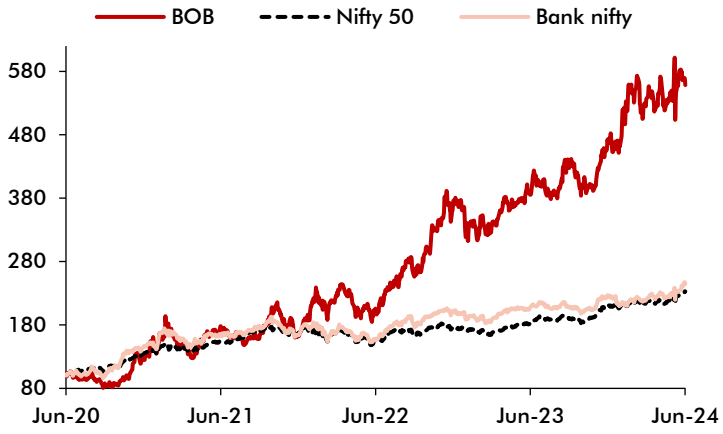
Exhibit 29: Sensitivity of valuations to long-term growth and RoE assumptions

FY27-44E	Bear Case	Base Case	Bull Case	Comments
Assets growth YoY	12.0%	13.0%	14.0%	In the bull case, expect corporate/overseas book to increase traction, supporting growth
Average RoA	0.95%	1.00%	1.05%	In the bull case, RoA will benefit from operating leverage
Average RoE	13.7%	14.6%	15.6%	
Target Price (incl. subs)	**275**	**330**	**400**	
Cost of Equity (%)	13.75%	13.75%	13.75%	
Implied FY26E P/E standalone	1.0	1.2	1.4	
Implied FY26E P/B standalone	7.4	8.9	10.9	

Source: Company, Ambit Capital research

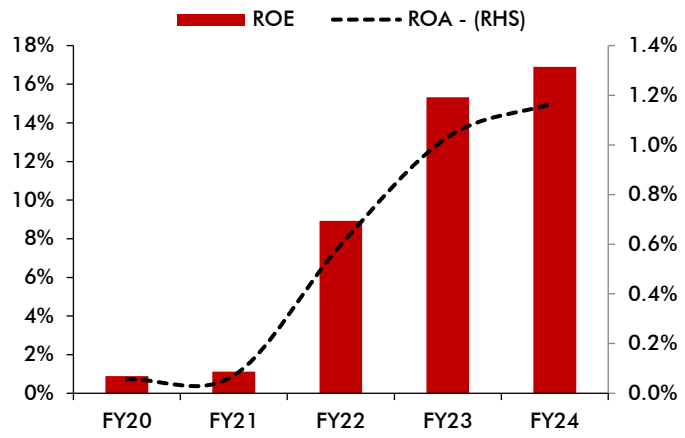
The stock has given 460% returns in the last 4 years vs ~135%/145% for Nifty/Bank Nifty due to sharp improvement in profitability of the bank.

Exhibit 30: BOB outperformed Bank Nifty and Nifty 50...



Source: Company, Ambit Capital research

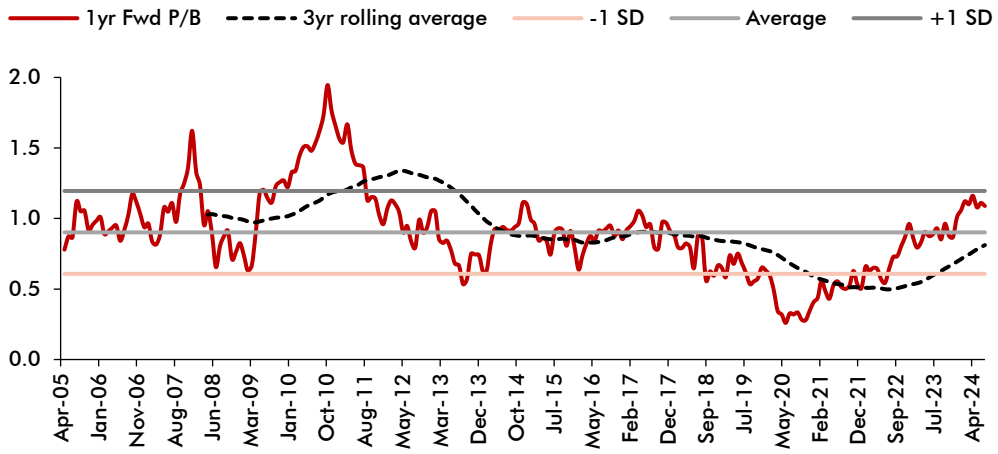
Exhibit 31: ...driven by sharp recovery in RoE (%)



Source: Company, Ambit Capital research

This re-rated BOB to 1.1x 1-yr fwd BVPS and 1x FY26E BVPS and is now trading at 15% discount to SBI.

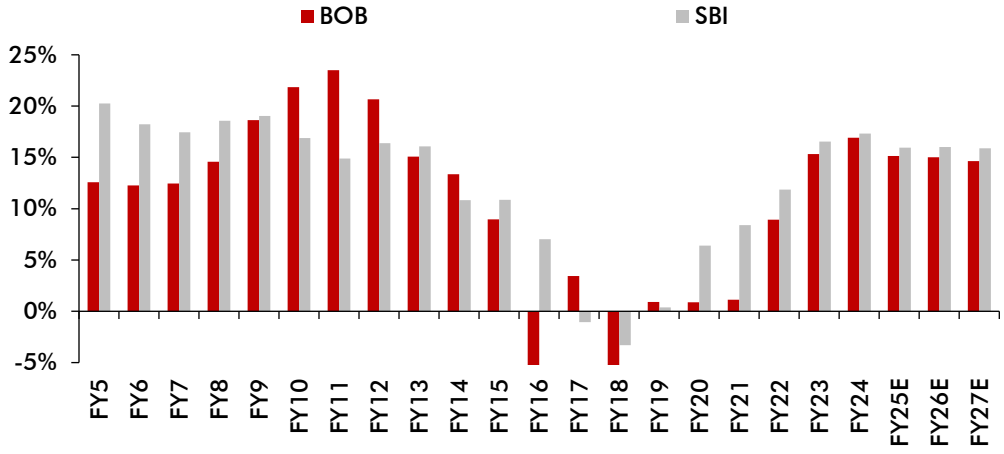
Exhibit 32: BOB's valuation re-rated to 1.1x on 1-yr fwd P/B



Source: Company, Ambit Capital research

We expect BOB to continue re-rating supported by 15% RoE but expect its multiple to be at a discount to SBI due to loan growth/RoE being lower by 200bps/100bps.

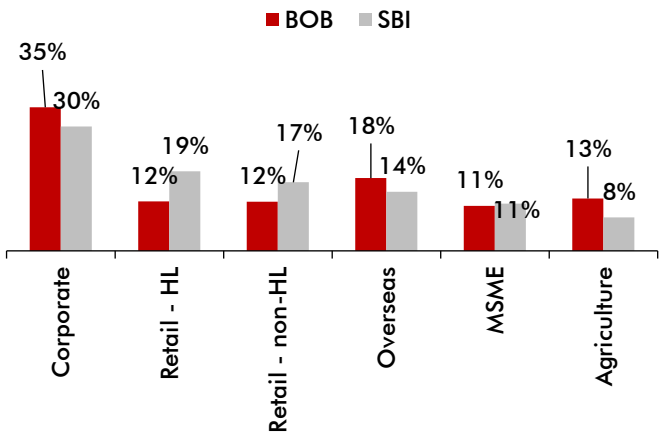
Exhibit 33: RoE will stay closer to SBI



Source: Company, Ambit Capital research

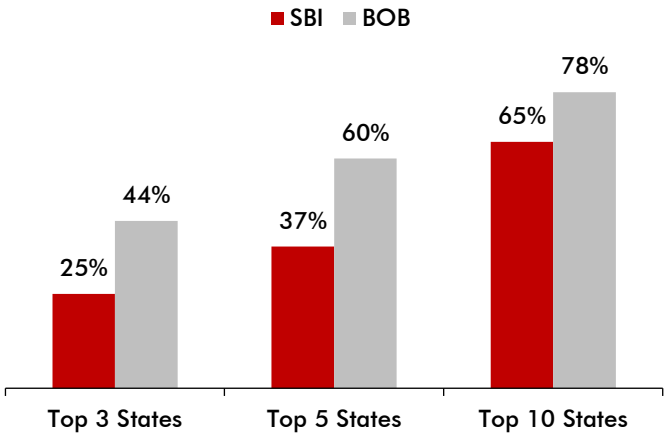
The current discount of 15% is justified because of these reasons: (i) concentrated loan mix in terms of ticket size and geography leading to volatile growth opportunities, (ii) unproven track record in scaling the retail book (which is a focus area of BOB), (iii) weaker positioning on digital payments leading to lesser float and data analytics-led growth opportunity and (iv) history of higher volatility in return ratios leading to higher CoE assumptions.

Exhibit 34: BOB has higher exposure to bulky segments



Source: Company, Ambit Capital research

Exhibit 35: It has more state concentration than SBI



Source: RBI, Ambit Capital research. Data as of Jun 2023

Exhibit 36: Relative valuations

Bank names	Bloomberg Ticker	Mcap (US$ bn)	Ambit Stance	TP (₹)	Upside / (Downside) (%)	P/E (x)			P/B (x)			EPS CAGR (%)	RoA (%)			RoE (%)		
						FY24	FY25E	FY26E	FY24	FY25E	FY26E	FY24-26E	FY24	FY25E	FY26E	FY24	FY25E	FY26E
Large Banks																		
HDFC Bank	HDFCB IN	158.0	BUY	1,718	(1)	18	18	15	2.6	2.4	2.1	8	1.7	1.8	1.8	15	14	14
ICICI Bank	ICICIBC IN	100.7	BUY	1,255	5	17	15	14	3.1	2.6	2.3	13	2.4	2.3	2.2	19	18	17
State Bank of India	SBIN IN	88.4	BUY	960	15	9	8	7	1.5	1.3	1.1	8	1.0	1.0	1.0	17	16	16
Kotak Mahindra Bank	KMB IN	41.5	SELL	1,583	(9)	22	19	17	2.5	2.3	2.0	13	2.5	2.0	1.9	15	12	12
Axis Bank	AXSB IN	46.1	BUY	1,347	8	14	13	11	2.4	2.1	1.8	13	1.8	1.7	1.7	18	16	17
						16	**15**	**13**	**2.4**	**2.1**	**1.8**	**11**	**1.9**	**1.7**	**1.7**	**17**	**15**	**15**
Mid & Small Banks																		
IndusInd Bank	IIB IN	13.3	BUY	1,777	25	12	11	9	1.8	1.5	1.3	16	1.8	1.8	1.9	15	15	16
Federal Bank	FB IN	5.1	BUY	205	17	11	11	9	1.5	1.3	1.2	11	1.3	1.2	1.2	15	13	13
Bandhan Bank	BANDHAN IN	3.9	SELL	157	(22)	15	11	10	1.5	1.3	1.2	22	1.3	1.5	1.4	11	13	13
Karur Vysya Bank	KVB IN	2.0	BUY	227	11	10	9	8	1.6	1.4	1.2	13	1.6	1.6	1.5	17	17	16
RBL Bank	RBK IN	1.9	SELL	150	(42)	13	15	12	1.1	1.0	0.9	6	0.9	0.7	0.8	8	7	8
City Union Bank	CUBK IN	1.5	BUY	170	2	12	11	10	1.5	1.3	1.2	8	1.5	1.5	1.5	13	12	12
Karnataka bank	KBL IN	1.0	BUY	340	53	6	6	5	0.8	0.7	0.6	9	1.2	1.1	1.1	14	12	12
Yes Bank*	YES IN	9.0	NA	NA	NA	62	36	20	1.6	1.6	1.5	75	0.3	0.5	0.7	3	5	7
IDFC First Bank*	IDFCFB IN	7.1	NA	NA	NA	18	15	11	1.7	1.5	1.4	27	1.1	1.2	1.3	10	11	13
AU SFB*	AUBANK IN	6.0	NA	NA	NA	28	23	18	3.6	3.0	2.6	27	1.6	1.6	1.6	13	14	15
Equitas SFB*	EQUITASB IN	1.3	NA	NA	NA	13	11	9	1.8	1.6	1.4	22	2.0	1.9	1.9	15	15	17
Ujjivan SFB*	UJJIVANS IN	1.0	NA	NA	NA	7	6	5	1.6	1.3	1.1	13	3.3	2.9	2.8	27	21	21
South Indian Bank*	SIB IN	0.8	NA	NA	NA	6	6	6	0.8	0.7	0.7	4	0.9	0.9	0.9	15	13	13
DCB bank*	DCBB IN	0.5	NA	NA	NA	9	7	6	0.9	0.8	0.7	21	0.9	1.0	1.0	11	12	13
						16	**13**	**10**	**1.6**	**1.4**	**1.2**	**20**	**1.4**	**1.4**	**1.4**	**13**	**13**	**13**
PSU Banks																		
Bank of Baroda	BOB IN	16.4	BUY	330	24	8	8	7	1.3	1.1	1.0	6	1.2	1.1	1.1	17	15	15
PNB*	PNB IN	15.9	NA	NA	NA	17	10	8	1.3	1.2	1.1	42	0.5	0.8	0.9	8	12	13
Union Bank*	UNBK IN	12.3	NA	NA	NA	7	6	6	1.1	1.0	0.9	12	1.0	1.1	1.1	17	16	15
Canara Bank*	CBK IN	12.6	NA	NA	NA	7	7	6	1.3	1.2	1.0	8	1.0	1.0	1.0	19	18	17
Indian Bank*	INBK IN	8.6	NA	NA	NA	9	7	7	1.3	1.1	1.0	16	1.1	1.2	1.2	16	16	16
Bank of India*	BOI IN	6.4	NA	NA	NA	7	6	5	0.8	0.7	0.6	17	0.8	1.0	1.0	12	13	14
						9	**7**	**7**	**1.2**	**1.1**	**0.9**	**17**	**0.9**	**1.0**	**1.0**	**15**	**15**	**15**

Source: Bloomberg, Ambit Capital research. NA means not applicable/available. Updated as on 2nd Jul'24

Catalysts & risks

Catalysts

Maintaining NIM: 53% loan book linked to MCLR and increase in CD ratio should negate the impact of increase in CoF, resulting in stable NIM vs decline for most banks in the sector over the next one year.

Net slippage in line or lower than large private banks: Higher share of corporate loans in the book (35%) and retail to internal customers should get reflected in lower net slippages. This will keep credit cost low at 80bps in FY25 vs 1.4% in the last 4 years.

Risks

Competition leading to NIM pressure: We expect majority of MCLR loans to be of a bulky nature for BOB. Limited growth in the corporate book could prompt the bank to refrain from repricing these customers in line with increase in CoF, resulting in NIM pressure.

Negative surprises on slippage: BOB saw slippage in its domestic airline account and an international account, cumulatively amounting to 25bps of loans (vs 1.3% overall slippage) last year. This led to discomfort on BOB's ability to manage asset quality on a consistent basis. In case the negative surprise continues, BOB's discount to SBI would widen from 15% currently.

Exhibit 37: Explanation of our flags on the cover page

Segment	Score	Comments
Balance sheet risks	**GREEN**	We do not find anything unusual in the company's accounting policies and believe reported numbers are a true reflection of performance.
Predictability	**GREEN**	Relatively benign corporate asset quality, 78% PCR and higher liquidity on the balance sheet should lead to lower volatility in earnings.
Earnings momentum	**GREEN**	In the past six months, consensus increased FY25 and FY26 EPS by 7% each.

Source: Company, Ambit Capital research

Bank of Baroda (BOB IN, Buy)

Valuation Methodology

We value BOB using "excess return" methodology with cost of equity of 13.75% and terminal asset growth rate of 5%, resulting in TP of ₹330 (implying 1.2x FY26E BVPS). This includes subsidiary valuation of ₹19 arrived relative to peer multiple.

Risks

Risks: (i) inability to reprice MCLR book in accordance with increase in cost of funds and (ii) negative surprise on asset quality in the form of higher-than-expected slippages from corporate/overseas book.

Financials - Standalone

Income statement

Year to March (₹ bn)	FY23	FY24	FY25E	FY26E	FY27E
Interest income	896	1,126	1,294	1,471	1,655
Interest expense	482	679	804	917	1,027
Net interest income	**414**	**447**	**489**	**554**	**628**
Total Non-Interest Income	100	145	140	152	168
Total Income	**514**	**592**	**630**	**707**	**796**
Total Operating Expenses	245	283	301	334	371
Employee expenses	134	158	160	175	190
Other Operating Expenses	112	124	141	160	181
Pre Provisioning Profits	**269**	**310**	**329**	**372**	**425**
Provisions	71	61	88	104	131
Profit before tax	197	249	240	269	294
Tax	56	71	61	68	74
PAT	**141**	**178**	**180**	**201**	**220**

Source: Company, Ambit Capital research

Balance sheet

Year to March (₹ bn)	FY23	FY24	FY25E	FY26E	FY27E
Networth	982	1,122	1,262	1,419	1,590
Deposits	12,037	13,270	14,862	16,645	18,643
Borrowings	1,019	944	1,057	1,184	1,326
Other Liabilities	547	522	620	678	845
Total liabilities	**14,586**	**15,858**	**17,802**	**19,926**	**22,403**
Cash & Balance with RBI & Banks	957	951	955	981	1,098
Investments	3,625	3,698	4,142	4,639	5,196
Advances	9,410	10,658	12,099	13,640	15,376
Other Assets	594	551	606	666	733
Total assets	**14,586**	**15,858**	**17,802**	**19,926**	**22,403**

Source: Company, Ambit Capital research

Du-Pont analysis

Year to March	FY23	FY24	FY25E	FY26E	FY27E
NII/Assets (%)	3.0%	2.9%	2.9%	2.9%	3.0%
Other income/Assets (%)	0.7%	1.0%	0.8%	0.8%	0.8%
Total Income/Assets (%)	3.8%	3.9%	3.7%	3.7%	3.8%
Cost to Assets (%)	1.8%	1.9%	1.8%	1.8%	1.8%
PPP/Assets (%)	2.0%	2.0%	2.0%	2.0%	2.0%
Provisions/Assets (%)	0.5%	0.4%	0.5%	0.5%	0.6%
PBT/Assets (%)	1.4%	1.6%	1.4%	1.4%	1.4%
Tax Rate (%)	28.5%	28.5%	25.2%	25.2%	25.2%
ROA (%)	1.0%	1.2%	1.1%	1.1%	1.0%
ROE (%)	15.3%	16.9%	15.1%	15.0%	14.6%

Source: Company, Ambit Capital research

Ratio analysis

Year to March	FY23	FY24	FY25E	FY26E	FY27E
Credit-Deposit (%)	78.2%	80.3%	81.4%	81.9%	82.5%
CASA ratio (%)	39.5%	37.7%	39.0%	40.1%	41.1%
Cost/Income ratio (%)	47.7%	47.7%	47.8%	47.3%	46.6%
Gross NPA (₹ bn)	368	318	334	376	430
Gross NPA (%)	3.8%	2.9%	2.7%	2.7%	2.7%
Net NPA (₹ bn)	84	72	73	90	108
Net NPA (%)	0.9%	0.7%	0.6%	0.7%	0.7%
Provision coverage (%)	77.2%	77.3%	78.0%	76.0%	75.0%
Credit cost (%)	0.8%	0.6%	0.8%	0.8%	0.9%
NIMs (%)	3.2%	3.1%	3.0%	3.0%	3.1%
Tier-1 capital ratio (%)	14.0%	14.1%	14.1%	14.2%	14.1%

Source: Company, Ambit Capital research

Valuation analysis

Year to March	FY23	FY24	FY25E	FY26E	FY27E
EPS (basic) (₹)	27	34	35	39	42
EPS growth (%)	94.0%	26.1%	1.2%	11.7%	9.4%
BVPS (Consolidated)	205	233	260	290	323
Adj. BVPS (₹)	179	206	233	263	307
P/E Standalone	9.7	7.7	7.6	6.8	6.2
P/B Consolidated	1.3	1.1	1.0	0.9	0.8
P/B Standalone	1.4	1.2	1.1	0.9	0.8

Source: Company, Ambit Capital research

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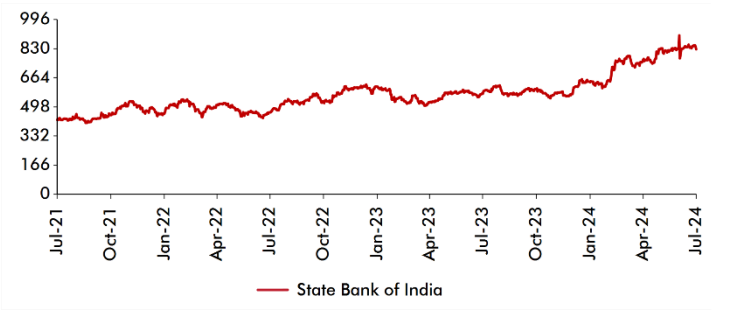
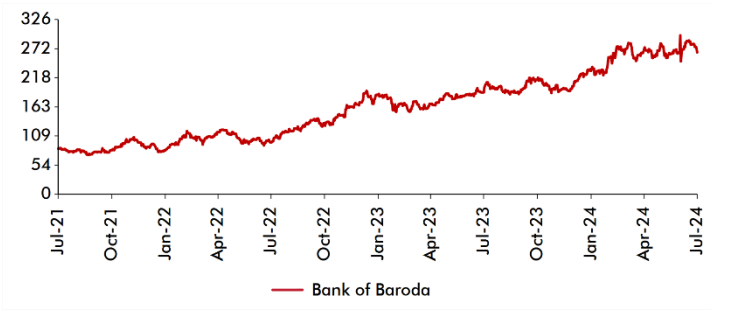
State Bank of India (SBIN IN, BUY, CMP: *Rs 826*)



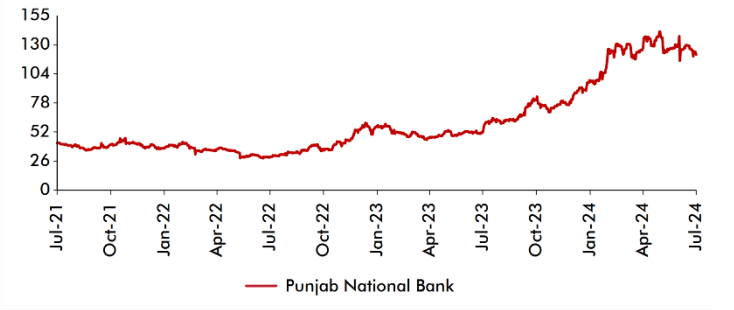
Source: ICE, Ambit Capital research

Bank of Baroda (BOB IN, BUY, CMP: Rs 265)



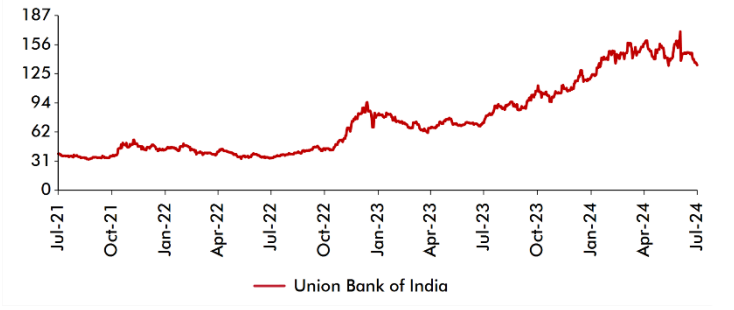
Source: ICE, Ambit Capital research

Punjab National Bank (PNB IN, Not Rated, CMP: Rs 121)



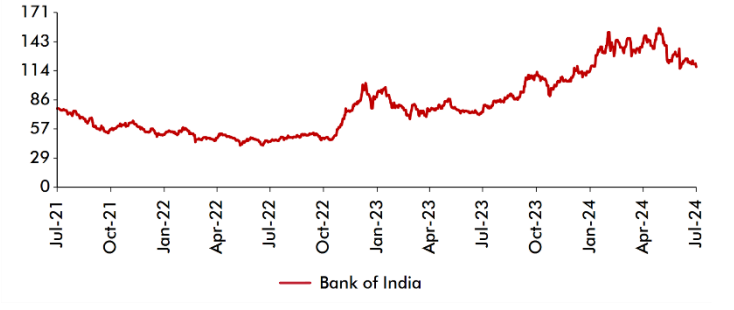
Source: ICE, Ambit Capital research

Union Bank of India (UNBK IN, Not Rated, CMP: Rs 134)



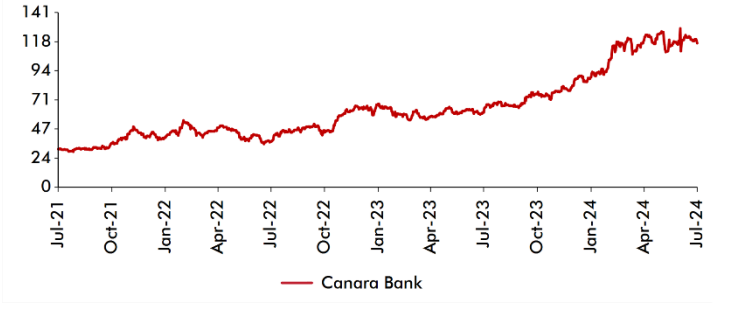
Source: ICE, Ambit Capital research

Bank of India (BOI IN, Not Rated, CMP: Rs 118)



Source: ICE, Ambit Capital research

Canara Bank (CBK IN, Not Rated, CMP: Rs 116)



Source: ICE, Ambit Capital research

Explanation of Investment Rating - Our target prices are with a 12-month perspective. Returns stated are our internal benchmark

Investment Rating	Expected return (over 12-month)
BUY	We expect this stock to deliver more than 10% returns over the next12 month
SELL	We expect this stock to deliver less than or equal to 10 % returns over the next 12 months
UNDER REVIEW	We have coverage on the stock but we have suspended our estimates, TP and recommendation for the time being NOT
NOT RATED	We do not have any forward-looking estimates, valuation, or recommendation for the stock.

Note: At certain times the Rating may not be in sync with the description above as the stock prices can be volatile and analysts can take time to react to development.

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