

## Andhra Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,374	ANDB IN
	REUTERS CODE
S&P CNX: 2,851	ADBK.BO

13 January 2006

**Buy**

*Previous Recommendation: Buy*

**Rs99**

Equity Shares (m)	400.0
52-Week Range	123/69
1,6,12 Rel.Perf.(%)	4/-31/-26
M.Cap. (Rs b)	39.5
M.Cap. (US\$ b)	0.9

YEAR END	NET INCOME (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	CAR (%)	ROE (%)	ROA (%)	P/ABV (X)
3/05A	18,224	5,201	13.0	12.2	7.6	2.1	12.1	31.6	1.7	2.2
3/06E	16,639	5,301	10.9	-15.9	9.0	1.6	14.4	22.0	1.5	1.6
3/07E	19,863	6,212	12.8	17.2	7.7	1.4	14.0	19.3	1.5	1.4

Price Band	Rs82-Rs90
Recommendation	Subscribe

### Background

Andhra Bank is a mid-sized public sector bank having a dominant presence in southern India. It was incorporated in 1923 as a private sector bank and was nationalized in 1980. The bank has 1,177 branches across 21 states and 2 Union territories, serving 14m customers. Consistency in core earnings with greater focus on retail assets, superior asset quality and high RoE are the strong positives of the bank.

Issue Opens on	16 January 2006
Issue Closes on	20 January 2006
Final Pricing Date	22 January 2006
Listing Date	1 February 2006

### Issue details

Andhra Bank proposes to issue 85m equity shares to the public. This offer will be made at a price band of Rs82-90, which will be calculated through a 100% book building process. The issue will constitute 17.53% of total post-issue paid-up equity capital of the bank.

<b>Equity Shares o/s</b>	<b>(M)</b>
Prior to the Issue	400
Post Issue	485

The follow-on public offer (FPO) will reduce the government's holding in the bank from the existing 62.5% to 51.55%. The objective of this issue is to enhance the bank's capital adequacy, which in turn, will help support future credit growth apart from meeting Basel II norms.

#### FPO DETAILS

PARTICULARS	EQUITY SHARES (M)	% OF TOTAL
<b>Issue</b>	<b>85</b>	<b>100</b>
<i>Of which:</i>		
<b>Reservation for Eligible Employees</b>	<b>Up to 8.5</b>	<b>10</b>
<b>Net Issue to the Public</b>	<b>At least 76.5</b>	<b>90</b>
<i>Of which:</i>		
Qualified Institutional Buyers	Up to 38.25	50
<i>Of which:</i>		
Reservation for MFs	Up to 1.912	5
Balance for All QIBs (Incl MFs)	Up to 36.34	95
Non-institutional Portion	At least 11.5	15
Retail Portion	At least 26.78	35

## Key highlights

### Steadily growing bank

Andhra Bank has historically maintained steady growth across most financial parameters. During 1HFY06, loan growth has been strong at 30% YoY while deposits grew at a steady 24% YoY. We expect loan growth to remain robust at 28% during FY06 and at 20% thereafter.

### Key focus on SME and retail

The key focus areas for the bank are small and medium enterprises (SME) and the retail segment. As a result, Andhra Bank has relatively better yields versus the banking industry. As of 30 September 2005, these two segments constituted 37% of the bank's total lending portfolio.

### Interest margins also likely to remain stable

Interest margins have already declined during 1HFY06 to 3.6% as the bank's investment book is getting repriced. While we expect pressure on margins to be visible during FY06, we expect margins to stabilize thereafter, as incremental deposits will be funding the loan book for Andhra Bank. Overall, we expect margins to decline by 30bp during FY06 and improve marginally in the following years.

### Investment book — well cushioned

The bank has already done a Held to Maturity (HTM) transfer during 1HFY06 and taken a hit on its profitability. Currently the bank has 64% of its statutory liquidity ratio (SLR) book in HTM. In the Available-for-Sale (AFS) category, the duration is 1.9 years and the bank has a cushion of up to 7.5% (10-year G-Sec rates).

### Amongst the best in asset quality

Despite strong loan growth, Andhra Bank has been maintaining creditable asset quality — amongst the best in the industry. As of September 2005, gross NPAs (non-performing assets) were 2.27%, while net NPAs were a

mere 0.26%. We believe that incrementally provisions are likely to be lower. Further, the bank is also likely to benefit on account of any write-backs through its bad loans and written-off loans.

### Post issue Capital Adequacy extremely comfortable

High Tier-I capital post issue should result in strong growth. Currently the bank has a capital adequacy of 12% (pre - issue) with a Tier-I of 8.4%, not including Investment Fluctuation Reserve (IFR). Even after adjusting for operational risk and market risk as of March 2006, capital adequacy is likely to decline by less than 100bp. Post the issue, we expect capital adequacy ratio (CAR) to be at 14%, with a Tier-I of 11%, which should take care of the next 2-3 years' growth for the bank.

### Dividend yield of >3%

At the upper end of the issue price (Rs90), the stock is likely to have a dividend yield of >3% for FY06.

### Valuation

Despite the dilution, the bank is likely to deliver RoE of 19% in FY07. At the upper end of the issue band, the stock trades at 1.3x FY07E BV and 7x FY07E EPS. We believe the issue is attractively priced. We recommend **Subscribe**.

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E March	2004	2005	2006E	2007E	2008E	
Interest Income	22,273	22,735	26,036	30,733	36,095	
Interest Expended	13,167	12,044	14,173	16,340	19,365	
<b>Net Interest Income</b>	<b>9,106</b>	<b>10,690</b>	<b>11,862</b>	<b>14,393</b>	<b>16,730</b>	
Change (%)	20.9	17.4	11.0	21.3	16.2	
Other Income	6,780	7,534	4,777	5,470	5,827	
<b>Net Income</b>	<b>15,886</b>	<b>18,224</b>	<b>16,639</b>	<b>19,863</b>	<b>22,557</b>	
Change (%)	17.1	14.7	-8.7	19.4	13.6	
Operating Expenses	6,585	8,295	8,126	9,735	10,679	
<b>Operating Income</b>	<b>9,302</b>	<b>9,930</b>	<b>8,513</b>	<b>10,128</b>	<b>11,878</b>	
Change (%)	23.3	6.7	-14.3	19.0	17.3	
Other Provisions	2,426	2,501	1,150	1,500	1,600	
<b>PBT</b>	<b>6,876</b>	<b>7,429</b>	<b>7,363</b>	<b>8,628</b>	<b>10,278</b>	
Tax	2,241	2,228	2,062	2,416	2,878	
Tax Rate (%)	32.6	30.0	28.0	28.0	28.0	
<b>PAT</b>	<b>4,635</b>	<b>5,201</b>	<b>5,301</b>	<b>6,212</b>	<b>7,400</b>	
Change (%)	15.1	12.2	19	17.2	19.1	
Proposed Dividend	1,264	1,357	1,455	1,698	1,940	

BALANCE SHEET		(Rs Million)				
Y/E March	2004	2005	2006E	2007E	2008E	
Capital	4,000	4,000	4,850	4,850	4,850	
Reserves & Surplus	10,526	14,370	25,016	29,531	34,991	
<b>Net Worth</b>	<b>14,526</b>	<b>18,370</b>	<b>29,866</b>	<b>34,381</b>	<b>39,841</b>	
<b>Deposits</b>	<b>229,405</b>	<b>275,507</b>	<b>325,098</b>	<b>377,114</b>	<b>433,681</b>	
Change (%)	8.9	20.1	18.0	16.0	15.0	
Borrowings	8,430	9,832	10,816	12,114	13,567	
Other Liabilities & Prov.	17,728	23,577	25,935	29,047	32,533	
<b>Total Liabilities</b>	<b>270,089</b>	<b>327,287</b>	<b>391,715</b>	<b>452,656</b>	<b>519,622</b>	
Current Assets	25,732	35,233	38,803	42,031	46,471	
Investments	103,174	106,463	117,109	128,820	139,126	
Change (%)	-19	3.2	10.0	10.0	8.0	
Advances	128,855	175,168	224,216	269,059	320,180	
Change (%)	11.9	35.9	28.0	20.0	19.0	
Net Fixed Assets	1,799	1,873	2,183	2,589	2,877	
Other Assets	10,530	8,550	9,405	10,167	10,970	
<b>Total Assets</b>	<b>270,089</b>	<b>327,287</b>	<b>391,715</b>	<b>452,656</b>	<b>519,622</b>	

ASSUMPTIONS	(%)				
Deposit Growth	8.9	20.1	18.0	16.0	15.0
Advances Growth	11.9	35.9	28.0	20.0	19.0
Investments Growth	-19	3.2	10.0	10.0	8.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	28.0	30.0	30.0	35.0	40.0
CRR	4.5	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS						
Y/E March	2004	2005	2006E	2007E	2008E	
<b>Spreads Analysis (%)</b>						
Avg. Yield - Earning Assets	9.1	8.0	7.5	7.6	7.7	
Avg. Cost-Int. Bear. Liab.	5.7	4.6	4.6	4.5	4.6	
Net Interest Margin	3.7	3.8	3.4	3.5	3.5	
<b>Profitability Ratios (%)</b>						
RoE	36.1	31.6	22.0	19.3	19.9	
RoA	18	17	15	15	15	
Int. Expended/Int. Earned	59.1	53.0	54.4	53.2	53.7	
Other Inc./Net Income	42.7	41.3	28.7	27.5	25.8	
<b>Efficiency Ratios (%)</b>						
Op. Exps./Net Income	41.4	45.5	48.8	49.0	47.3	
Empl. Cost/Op. Exps.	62.2	65.0	59.0	60.6	58.6	
Busi. per Empl. (Rs m)	26.1	30.9	38.5	46.5	55.0	
NP per Empl. (Rs lac)	3.5	4.0	4.1	4.8	5.8	

Asset-Liability Profile (%)						
Adv./Deposit Ratio	56.2	63.6	69.0	71.3	73.8	
Invest./Deposit Ratio	45.0	38.6	36.0	34.2	32.1	
G-Sec/Invest. Ratio	87.5	83.9	83.9	83.9	83.9	
Gross NPAs to Adv.	4.6	2.5	1.8	1.6	1.5	
Net NPAs to Adv.	0.9	0.3	0.3	0.4	0.5	
CAR	13.7	12.1	14.4	14.0	13.8	
Tier 1	8.2	8.0	11.3	11.0	10.9	

VALUATION						
Book Value (Rs)	36.3	45.9	61.6	70.9	82.1	
Price-BV (x)	2.7	2.1	1.6	1.4	1.2	
Adjusted BV (Rs)	34.4	45.1	60.8	69.5	80.0	
Price-ABV (x)	2.9	2.2	1.6	1.4	1.2	
EPS (Rs)	11.6	13.0	10.9	12.8	15.3	
EPS Growth (%)	15.1	12.2	-15.9	17.2	19.1	
Price-Earnings (x)	8.5	7.6	9.0	7.7	6.5	
OPS (Rs)	23.3	24.8	17.6	20.9	24.5	
OPS Growth (%)	23.3	6.7	-29.3	19.0	17.3	
Price-OP (x)	4.2	4.0	5.6	4.7	4.0	

E: MOST Estimates



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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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