

## Andhra Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,680	ANDB IN
S&P CNX: 3,131	REUTERS CODE
	ADBK.BO

28 July 2006

Buy

Previous Recommendation: Buy

Rs71

Equity Shares (m)	485.0
52-Week Range	115/57
1,6,12 Rel.Perf.(%)	11/-32/-76
M.Cap. (Rs b)	34.2
M.Cap. (US\$ b)	0.7

YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
3/06A	16,271	4,855	10.0	-23.0	7.0	1.2	14.0	20.5	1.3	1.2
3/07E	18,614	5,739	11.8	18.2	6.0	1.0	13.2	18.6	1.3	1.1
3/08E	21,365	6,606	13.6	15.1	5.2	0.9	12.9	18.7	1.3	0.9

Andhra Bank reported net profit growth of 37% YoY, higher than our estimates of 11% growth, due to higher than expected NII resulting from improved margins. Other income grew by 32% to Rs1.0b on the back of improved fee income and treasury profits. Business growth momentum has remained strong with 21% loan growth and 29% deposit growth. Asset quality has remained strong, with net NPAs one of the lowest in the industry at 0.07% in 1QFY07.

- NII grows by 22% on back of steady business growth
- Margins improve on the back of improvement in yield on advances
- Treasury records profit, fee income increases YoY
- Asset quality remains one of the best amongst public sector banks (PSB)

Going forward, we expect Andhra Bank's strong business growth with focus on high-yielding segments coupled with the lower provisioning requirement to grow its core income. The stock currently trades at 6.0x FY07E EPS and 1.0x FY07E BV. We maintain **Buy**.

QUARTERLY PERFORMANCE										(RS MILLION)
	FY 06				FY 07				FY 06	FY 07
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Interest Income	6,172	6,353	6,986	7,232	7,599	7,751	8,034	8,193	26,744	31,578
Interest Expense	3,429	3,468	4,028	4,130	4,247	4,300	4,511	4,625	15,054	17,682
<b>Net Interest Income</b>	<b>2,743</b>	<b>2,886</b>	<b>2,959</b>	<b>3,102</b>	<b>3,352</b>	<b>3,451</b>	<b>3,524</b>	<b>3,569</b>	<b>11,690</b>	<b>13,895</b>
% Change (Y-o-Y)	2.4	5.6	13.0	16.6	22.2	19.6	19.1	15.0	9.3	18.9
Other Income	772	1,179	1,189	1,441	1,018	1,100	1,275	1,325	4,581	4,719
<b>Net Income</b>	<b>3,515</b>	<b>4,065</b>	<b>4,148</b>	<b>4,543</b>	<b>4,371</b>	<b>4,551</b>	<b>4,799</b>	<b>4,894</b>	<b>16,270</b>	<b>18,614</b>
% Change (Y-o-Y)	-13.9	-24.0	1.6	8.9	24.3	12.0	15.7	7.7	-10.7	14.4
Operating Expenses	1,914	2,060	2,118	2,488	2,306	2,300	2,400	2,357	8,580	9,362
<b>Operating Profit</b>	<b>1,601</b>	<b>2,005</b>	<b>2,030</b>	<b>2,055</b>	<b>2,065</b>	<b>2,251</b>	<b>2,399</b>	<b>2,537</b>	<b>7,691</b>	<b>9,252</b>
Other Provisions	449	146	296	1,225	466	300	400	534	2,117	1,700
<b>Profit before Tax</b>	<b>1,152</b>	<b>1,859</b>	<b>1,734</b>	<b>830</b>	<b>1,599</b>	<b>1,951</b>	<b>1,999</b>	<b>2,003</b>	<b>5,574</b>	<b>7,552</b>
Tax Provisions	300	530	445	-556	435	500	500	377	719	1,812
<b>Net Profit</b>	<b>852</b>	<b>1,329</b>	<b>1,289</b>	<b>1,386</b>	<b>1,164</b>	<b>1,451</b>	<b>1,499</b>	<b>1,626</b>	<b>4,855</b>	<b>5,739</b>
% Change (Y-o-Y)	-43.3	21.5	5.8	-0.1	36.7	9.2	16.3	17.3	-6.7	18.2
Cost to Income Ratio (%)	54.5	50.7	51.1	57.1	52.8	50.5	50.0	56.4	52.7	50.3
Interest Expense/Interest Income (%)	55.6	54.6	57.6	31.7	55.9	55.5	56.1	27.1	56.3	56.0
Other Income/Net Income (%)	22.0	29.0	28.7	31.7	23.3	24.2	26.6	27.1	28.2	25.3

E: MOSI Estimates

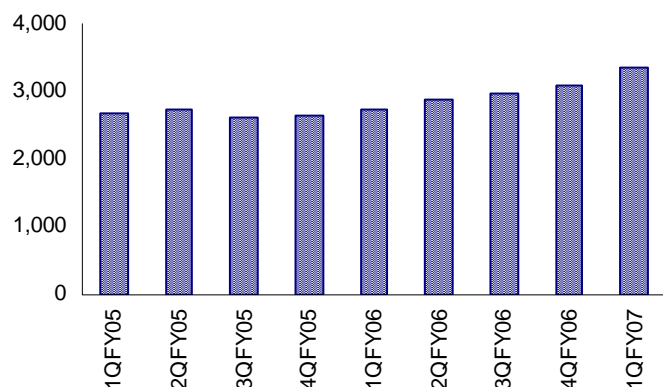
Note: In the interest of timeliness, this report has not been edited.

Andhra Bank reported net profit growth of 37% YoY, higher than our estimates of 11% growth, due to higher than expected NII resulting from improved margins. Other income grew by 32% to Rs1.0b on the back of improved fee income and treasury profits. Business growth momentum has remained strong with 21% loan growth and 29% deposit growth. Asset quality has remained strong, with net NPAs one of the lowest in the industry at 0.07% in 1QFY07.

### NII grows by 22% on back of steady business growth

Net interest income has grown by 22% to Rs3.4b, on the back of steady loan growth of 21% in 1QFY07 coupled with improving margins.

TRENDS IN NII (RS M)



Source: Company/Motilal Oswal Securities

Overall business of the bank grew by 25% to Rs549b from Rs438b in 1QFY06. The advances portfolio expanded by 21% to Rs218b. Within this, retail loans increased by 27% constituting 22.5% of the bank's total credit. Credit extended to the housing sector increased to Rs24b from Rs20b, recording a growth rate of 22%. Educational loans have risen by 31% to Rs7b from Rs5.4b in 1QFY06.

Priority sector advances stood at Rs86b (constituting 41% of NBC) registering a growth rate of 15% from Rs75b in 1QFY06. Advances for agriculture have risen by 29% to Rs36.7b (constituting 18.2% of NBC) from Rs28.5b. Credit extended to the SME sector increased to Rs27b recording a growth rate of 35% YoY.

Deposits grew 29% to Rs331b. Low-cost deposits of the bank increased to Rs125b from Rs99b recording a growth rate of 26%.

### Margins improve on back of improvement in yield on advances

Andhra Bank's NIMs improved from 3.5% in 1QFY06 to 3.7% in 1QFY07, as yield on advances expanded by 36bp YoY to 9.6% and also due to IPO funds (Rs7.7b) which came in 4QFY06. Further higher lending to SME, retail and agriculture aided margin improvement for the bank. Cost of deposits inched up to 5.1% in 1QFY07 from 4.9% in 1QFY06.

MARGINS IMPROVEMENT

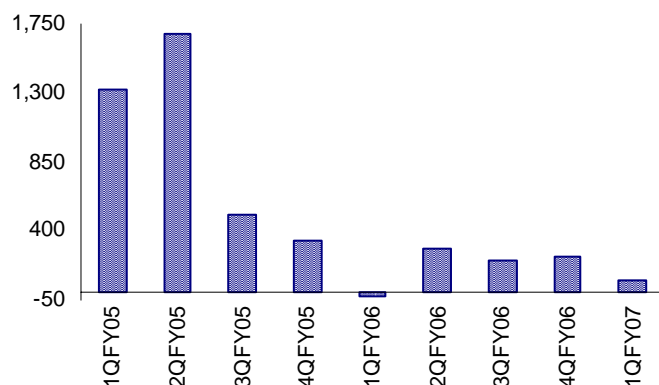
	1QFY06	FY06	1QFY07
Avg Yield on Advances	9.3	9.3	9.6
Avg Yield on Investments	7.5	7.3	7.2
Avg Cost of Deposits	4.9	4.9	5.1
<b>Net interest margin</b>	<b>3.5</b>	<b>3.3</b>	<b>3.7</b>

Source: Company/Motilal Oswal Securities

### Treasury records profit, fee income increases YoY

Treasury reported net profit of Rs80m in 1QFY07 compared with loss of Rs20m in 1QFY06. Non-treasury other income increased by 18% YoY to Rs938m in 1QFY07.

TREND IN TREASURY PROFITS



Source: Company/ Motilal Oswal Securities

**Investment book - HTM is 75%**

Andhra Bank's investment book totaled Rs113b at 1QFY07. Of this, ~Rs91b was in SLR. Of the SLR book, ~ 80% of the book is in HTM (of the total book ~75% is in HTM). The bank has only 1.0%-1.5% excess SLR as of 1QFY07. SLR-HTM is 23% of NDTL. The bank has transferred Rs8.5b of securities to HTM in 1QFY07 and taken a hit of Rs200m as a result. Total portfolio duration is 4.8 years, while AFS duration is 1.2 years. Every 10bp rise in 10-year G-sec yield will result in a hit of ~Rs200m to the bank post this transfer.

**Asset quality remains one of the best amongst PSBs**

Andhra Bank has one of the best asset qualities in the sector with gross NPAs constituting only 0.07% of bank's credit at 1QFY07. As net NPAs stand at very low levels, the

bank will have to make minimal provisions in the future. We expect the bank to maintain net NPAs at low levels in FY07 too. Management has indicated that their top priority areas would be reduction in NPAs and prevention of slippage in asset quality.

The bank proposes to be aggressive in recoveries, even in written off accounts. As against Rs627m of recoveries from written-off accounts in FY05 and Rs452m in FY06, the bank aims to recover Rs1.2b from this head during FY07.

**Valuation and view**

Going forward, we expect Andhra Bank's strong business growth with focus on high-yielding segments coupled with the lower provisioning requirement to grow its core income. The stock currently trades at 6.0x FY07E EPS and 1.0x FY07E BV. We maintain **Buy**.

## Andhra Bank: an investment profile

### Company description

Andhra Bank is a mid-sized public sector bank with a dominant presence in southern India. It was incorporated in 1923 as a private sector bank but was nationalized in 1980. The bank has a large network of 1,784 business delivery channels. Consistency in core earnings with greater focus on retail assets, superior asset quality and high RoE are the strong positives of the bank. The Bank has implemented CBS across 1010 units, viz., 896 Branches, 99 Extension Counters and 15 Service Centres, covering 91.5 % of its business.

### Key investment arguments

- Strong business growth with increased focus on the retail segment will support core earnings growth.
- Since a major portion of the securities are held in the HTM category, volatile interest rate fluctuations will not warrant higher mark-to-market provisioning.
- The asset quality remains one of the best amongst public sector banks (PSB) as the gross and net NPAs stand at low levels of 1.9% and 0.1% respectively.

### Key investment risks

- Increase in incremental NPAs could be a risk.
- Rise in interest rates could hurt bank's earnings

### Recent developments

- Andhra Bank is planning to tie-up with Dai-ichi Mutual Life Insurance, Japan and Bank of India for a three-way insurance company.
- Mr. Kalyan Mukherjee has taken over as the new ED of the bank, who was earlier GM of UCO bank.

### Valuation and view

- The stock trades at 7.7x FY07E earnings and 1.3x FY07E book value.
- We maintain a **Buy** with a price target of Rs95.

### Sector view

- YTD loan growth of 30%+, highest in the last 12 years.
- Volatility in interest rates would impact treasury.
- Benefits of significant improvement in asset quality not yet factored into earnings, valuations.
- We maintain an overweight stance on the sector.

#### COMPARATIVE VALUATIONS

		ANDHRA BK	IOB	VIJAYA BK
P/E (x)	FY07E	6.0	5.3	6.7
	FY08E	5.2	4.5	5.5
P/ABV (x)	FY07E	1.1	1.3	1.0
	FY08E	0.9	1.0	0.9
RoE (%)	FY07E	18.6	25.6	15.2
	FY08E	18.7	24.5	16.5
RoA (%)	FY07E	1.3	1.4	0.8
	FY08E	1.3	1.5	0.8

#### SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	51.6	62.5	62.5
Domestic Institutions	6.7	4.5	2.8
FII's/FDI's	17.5	15.8	16.2
Others	24.4	17.2	18.5

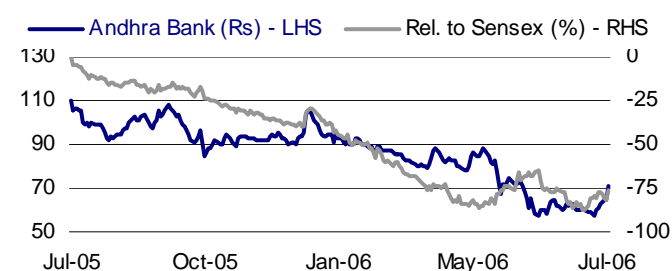
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	11.8	10.3	14.9
FY08	13.6	12.3	10.6

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
71	95	33.4	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Interest Income	22,273	22,735	26,744	31,578	37,136
Interest Expended	13,167	12,044	15,054	17,682	20,904
<b>Net Interest Income</b>	<b>9,106</b>	<b>10,690</b>	<b>11,690</b>	<b>13,895</b>	<b>16,232</b>
Change (%)	20.9	17.4	9.4	18.9	16.8
Other Income	6,780	7,534	4,581	4,719	5,134
<b>Net Income</b>	<b>15,886</b>	<b>18,224</b>	<b>16,271</b>	<b>18,614</b>	<b>21,365</b>
Change (%)	17.1	14.7	-10.7	14.4	14.8
Operating Expenses	6,585	8,295	8,580	9,362	10,290
<b>Operating Income</b>	<b>9,302</b>	<b>9,930</b>	<b>7,691</b>	<b>9,252</b>	<b>11,076</b>
Change (%)	23.3	6.7	-22.5	20.3	19.7
Other Provisions	2,426	2,501	2,036	1,700	1,900
<b>PBT</b>	<b>6,876</b>	<b>7,429</b>	<b>5,655</b>	<b>7,552</b>	<b>9,176</b>
Tax	2,241	2,228	800	1,812	2,569
Tax Rate (%)	32.6	30.0	14.1	24.0	28.0
<b>PAT</b>	<b>4,635</b>	<b>5,201</b>	<b>4,855</b>	<b>5,739</b>	<b>6,606</b>
Change (%)	15.1	12.2	-6.7	18.2	15.1
Proposed Dividend	1,264	1,357	1,698	1,795	1,795

BALANCE SHEET (Rs Million)					
Y/E MARCH	2004	2005	2006	2007E	2008E
Capital	4,000	4,000	4,850	4,850	4,850
Reserves & Surplus	10,526	14,370	24,089	28,034	32,846
<b>Net Worth</b>	<b>14,526</b>	<b>18,370</b>	<b>28,939</b>	<b>32,884</b>	<b>37,696</b>
<b>Deposits</b>	<b>229,405</b>	<b>275,507</b>	<b>339,224</b>	<b>393,500</b>	<b>452,525</b>
Change (%)	8.9	20.1	23.1	16.0	15.0
Borrowings	8,430	9,832	7,585	8,495	9,515
Other Liabilities & Prov.	17,728	23,577	30,945	34,658	38,817
<b>Total Liabilities</b>	<b>270,089</b>	<b>327,287</b>	<b>406,693</b>	<b>469,538</b>	<b>538,553</b>
Current Assets	25,732	35,233	51,394	60,638	68,560
Investments	103,174	106,463	114,442	123,597	129,777
Change (%)	-1.9	3.2	7.5	8.0	5.0
Advances	128,855	175,168	221,004	265,205	318,246
Change (%)	11.9	35.9	26.2	20.0	20.0
Net Fixed Assets	1,799	1,873	1,928	1,992	2,054
Other Assets	10,530	8,550	17,926	18,105	19,916
<b>Total Assets</b>	<b>270,089</b>	<b>327,287</b>	<b>406,693</b>	<b>469,538</b>	<b>538,553</b>

ASSUMPTIONS (%)					
Deposit Growth	8.9	20.1	23.1	16.0	15.0
Advances Growth	11.9	35.9	26.2	20.0	20.0
Investments Growth	-1.9	3.2	7.5	8.0	5.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	28.0	30.0	35.0	37.0	37.0
CRR	4.5	5.0	5.0	5.0	5.0

E: M OSt Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning Asset:	9.1	8.0	7.7	7.8	8.1
Avg. Cost-Int. Bear. Liab.	5.7	4.6	4.8	4.7	4.8
Interest Spread	3.4	3.4	2.9	3.1	3.3
Net Interest Margin	3.7	3.8	3.4	3.4	3.5

Profitability Ratios (%)					
RoE	36.1	31.6	20.5	18.6	18.7
RoA	18	17	13	13	13
Int. Expended/Int. Earned	59.1	53.0	56.3	56.0	56.3
Other Inc./Net Income	42.7	41.3	28.2	25.3	24.0

Efficiency Ratios (%)					
Op. Exps./Net Income	41.4	45.5	52.7	50.3	48.2
Empl. Cost/Op. Exps.	62.2	65.0	57.4	55.8	54.6
Busi. per Empl. (Rs m)	26.1	30.9	38.4	46.2	54.1
NP per Empl. (Rs lac)	3.5	4.0	3.7	4.3	5.0

Asset-Liability Profile (%)					
Adv./Deposit Ratio	56.2	63.6	65.1	67.4	70.3
Invest./Deposit Ratio	45.0	38.6	33.7	31.4	28.7
G-Sec/Invest. Ratio	87.5	83.9	86.5	88.1	90.6
Gross NPAs to Adv.	4.6	2.5	1.9	1.5	1.2
Net NPAs to Adv.	0.9	0.3	0.3	0.2	0.2
CAR	13.7	12.1	14.0	13.2	12.9
Tier 1	8.2	8.0	12.2	10.2	10.0

VALUATION					
Book Value (Rs)	36.3	45.9	59.7	67.8	77.7
Price-BV (x)	19	15	12	10	0.9
Adjusted BV (Rs)	34.4	45.1	58.9	67.1	77.0
Price-ABV (x)	2.1	16	12	11	0.9
EPS (Rs)	11.6	13.0	10.0	11.8	13.6
EPS Growth (%)	15.1	12.2	-23.0	18.2	15.1
Price-Earnings (x)	6.1	5.4	7.0	6.0	5.2
OPS (Rs)	23.3	24.8	15.9	19.1	22.8
OPS Growth (%)	23.3	6.7	-36.1	20.3	19.7
Price-OP (x)	3.0	2.8	4.4	3.7	3.1

E: M OSt Estimates



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#### Andhra Bank

- |   |     |
|---|-----|
| 1. Analyst ownership of the stock                       | No  |
| 2. Group/Directors ownership of the stock               | Yes |
| 3. Broking relationship with company covered            | No  |
| 4. Investment Banking relationship with company covered | No  |

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