



## Andhra Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,212	ANDB IN
	REUTERS CODE
S&P CNX: 4,124	ADBK.BO

29 January 2007

Buy

Previous Recommendation: Buy

Rs86

Equity Shares (m)	485.0
52-Week Range	99/57
1,6,12 Rel.Perf.(%)	-4/-17/-52
M.Cap. (Rs b)	41.5
M.Cap. (US\$ b)	0.9

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	8.5	1.4	14.0	20.5	1.3	1.5
3/07E	18,960	5,576	11.5	14.9	7.4	1.3	11.9	18.1	1.3	1.3
3/08E	21,663	6,749	13.9	21.0	6.1	1.1	11.8	19.4	1.3	1.1

Andhra Bank reported 23% YoY growth in net interest income (NII) to Rs3.6b in 3QFY07, higher than our expectation of 17% NII growth. Even QoQ, NII has grown by 10%. Margins improved by 10bp YoY in 3QFY06. Other income growth was 12% YoY, as treasury income reported a decline. Gross advances increased 24% YoY to Rs255b, while deposits increased 15% to Rs361b. Due to the recognition of a few accounts as NPAs during the quarter, the level of NPAs has increased for the bank.

- ⚡ NII grows by 23% on the back of steady business growth
- ⚡ Margins improve YoY on the back of improvement in yield on advances
- ⚡ Treasury records a decline YoY; fee income increases YoY
- ⚡ NPAs rise during the quarter

Overall, core earnings growth has been higher versus our expectation, and the bank has been able to improve its margins YoY. The stock is trading at P/E of 6.1x and P/BV of 1.1x FY08E with an RoE of 19%. The stock offers a dividend yield of >4%. We expect the bank to continue to grow its loan portfolio at a healthy pace and record stable margins. Despite rising NPAs, the level of NPAs in the industry is the lowest. Reiterate **Buy**.

### QUARTERLY PERFORMANCE

(RS MILLION)

	FY 06				FY 07				FY 06	FY 07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	6,172	6,353	6,986	7,232	7,599	7,721	8,128	8,478	26,744	31,925
Interest Expense	3,429	3,468	4,028	4,130	4,247	4,412	4,493	4,716	15,054	17,868
<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>3,309</b>	<b>3,635</b>	<b>3,761</b>	<b>11,690</b>	<b>14,058</b>
% Change (Y-o-Y)	2.4	5.6	13.0	16.6	22.2	14.7	22.8	21.3	9.3	20.3
Other Income	772	1,179	1,189	1,441	1,018	1,287	1,327	1,271	4,581	4,903
<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>4,596</b>	<b>4,962</b>	<b>5,032</b>	<b>16,270</b>	<b>18,960</b>
% Change (Y-o-Y)	-13.9	-24.0	1.6	8.9	24.3	13.1	19.6	10.8	-10.7	16.5
Operating Expenses	1,914	2,060	2,118	2,488	2,306	2,365	2,356	2,489	8,580	9,515
<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>2,231</b>	<b>2,606</b>	<b>2,543</b>	<b>7,691</b>	<b>9,445</b>
Other Provisions	449	146	296	1,225	466	92	645	498	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>2,140</b>	<b>1,961</b>	<b>2,045</b>	<b>5,574</b>	<b>7,745</b>
Tax Provisions	300	530	445	-556	435	675	600	459	719	2,169
<b>Net Profit</b>	<b>852</b>	<b>1,329</b>	<b>1,289</b>	<b>1,386</b>	<b>1,164</b>	<b>1,465</b>	<b>1,361</b>	<b>1,586</b>	<b>4,855</b>	<b>5,576</b>
% Change (Y-o-Y)	-43.3	21.5	5.8	-0.1	36.7	10.2	5.6	14.5	-6.7	14.9
Cost to Income Ratio (%)	54.5	50.7	51.1	57.1	52.8	51.5	47.5	55.6	52.7	50.2
Interest Expense/Interest Income (%)	55.6	54.6	57.6	31.7	55.9	57.1	55.3	25.2	56.3	56.0
Other Income/Net Income (%)	22.0	29.0	28.7	31.7	23.3	28.0	26.7	25.2	28.2	25.9

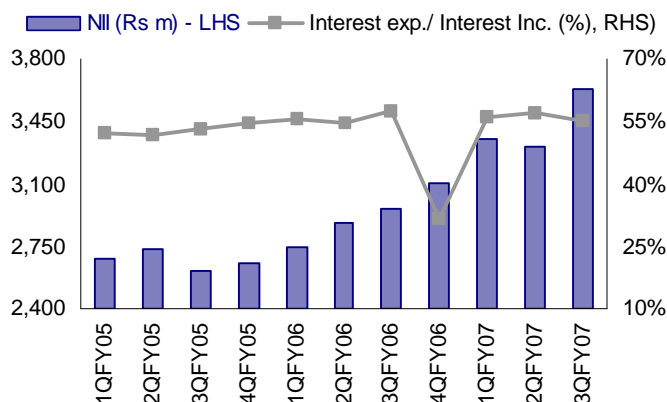
E: M0St Estimates

Andhra Bank reported 23% YoY growth in NII to Rs3.6b in 3QFY07, higher than our expectation of 17% NII growth. Even QoQ, NII has grown by 10%. Margins improved by 10bp YoY in 3QFY06. Other income growth was 12% YoY, as treasury income reported a decline. Gross advances increased 24% YoY to Rs255b, while deposits increased 15% to Rs361b. Due to the recognition of a few accounts as NPAs during the quarter, the level of NPAs has increased for the bank.

**NII grows by 23% on the back of steady business growth**

Andhra Bank’s NII grew by 23% YoY to Rs3.6b in 3QFY07 as margins expanded YoY. NII increased by 10% on a QoQ basis.

TRENDS IN NII



Source: Company/Motilal Oswal Securities

The overall business of the bank grew by 19% to Rs617b from Rs520b in 3QFY06. The advances portfolio expanded by 24% to Rs256b. Within this, retail loans increased by 29% constituting 23% of the bank’s total credit. Credit extended to the housing sector increased to Rs33b from Rs23b, recording a growth rate of 43%. Educational loans have risen by 32% to Rs8.6b.

Priority sector advances stood at Rs94b (constituting 40% of NBC). Advances for agriculture have risen by 15% to Rs44b (constituting 18.7% of NBC). Credit extended to the SME sector increased to Rs28b, recording a growth rate of 18% YoY.

Deposits grew 15% to Rs361b. Low-cost deposits of the bank increased by 17% YoY to Rs134b constituting 37% of total deposits.

**Margins improve YoY on back of improvement in yield on advances**

Andhra Bank’s NIMs improved from 3.46% in 3QFY06 to 3.56% in 3QFY07, as yield on advances expanded by 47bp YoY to 9.7%. Lending to the SME and retail and agriculture sectors resulted in improving margins for the bank. Cost of deposits inched up to 5.13% in 3QFY07 from 4.84% in 3QFY06.

NIM (%)

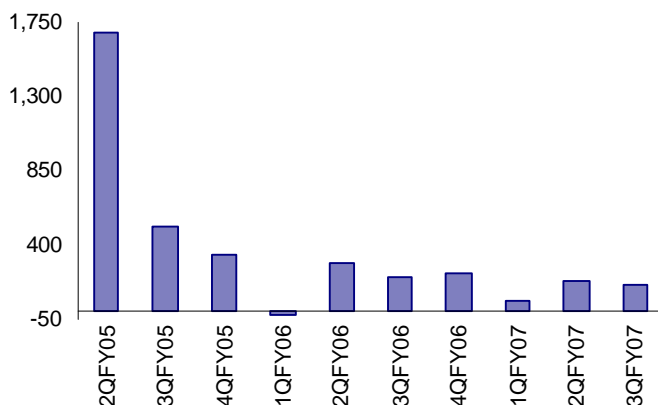
	9MFY06	FY06	9MFY07
Avg Yield on Advances	9.30	9.26	9.77
Avg Yield on Investments	7.34	7.29	7.31
Avg Cost of Deposits	4.84	4.86	5.13
Net Interest Margin	3.46	3.32	3.56

Source: Company/Motilal Oswal Securities

**Treasury records a decline YoY; fee income increases YoY**

Other income growth was 12% YoY, as treasury income reported a YoY decline by 23% YoY to Rs159m. Core other income increased by 19% YoY to Rs1.2b.

TREND IN TREASURY PROFITS



Source: Company/Motilal Oswal Securities

**NPAs increase during the quarter**

Due to the recognition of a few accounts as NPAs during the quarter, the level of NPAs has increased for the bank. Gross NPAs declined 4bp QoQ to 1.72% in 3QFY07, but net NPAs rose from 0.1% to 0.44% QoQ. The management mentioned that on account of delay in repayments, few of accounts have been classified as NPAs and is confident that this is a one-off classification and expects big recoveries and upgradations in 4Q.

**Valuation and view**

Overall, core earnings growth has been above our expectation, and bank has been able to improve its margins YoY. Andhra Bank trades at a P/E of 6.1x and P/BV of 1.1x FY08E with an RoE of 19%. The stock offers a dividend yield of >4%. We expect the bank to continue to grow its loan portfolio at a healthy pace and keep its margins stable. Despite the increase in NPAs, the level of NPAs is the lowest in industry. Reiterate **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 1,010 units, viz., 896 branches, 99 extension counters (EC) and 15 service centers, 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 1.8% 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 3-way insurance company.
- ✍ Mr. Kalyan Mukherjee has taken over as the new ED of the bank. He was earlier GM of UCO Bank.

### Valuation and view

- ✍ The stock is trading at P/E of 6.1x and P/BV of 1.1x FY08E with an RoE of 19%.
- ✍ Reiterate **Buy** with a price target of Rs126.

### Sector view

- ✍ YTD loan growth of 30%+, the 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	SYNDICATE	IOB
P/E (x)	FY07E	7.4	5.3	6.5
	FY08E	6.1	4.6	5.5
P/ABV (x)	FY07E	1.3	1.2	1.6
	FY08E	1.1	1.0	1.3
RoE (%)	FY07E	18.1	23.0	27.0
	FY08E	19.4	22.1	25.8
RoA (%)	FY07E	1.3	1.0	1.5
	FY08E	1.3	0.9	1.5

#### SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	51.6	51.5	62.5
Domestic Inst	10.2	9.5	4.5
Foreign	19.0	18.2	15.8
Others	19.2	20.8	17.2

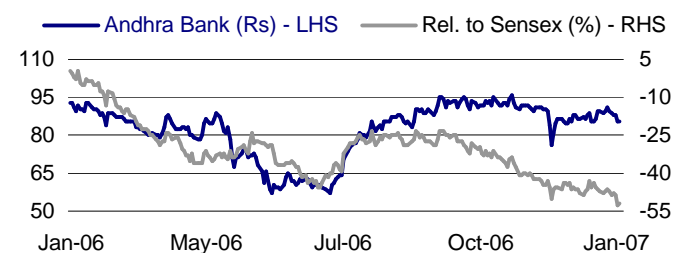
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	11.5	10.8	6.4
FY08	13.9	12.5	10.9

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
86	126	47.3	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Interest Income	22,735	26,744	31,925	37,570	44,321
Interest Expended	12,044	15,054	17,868	21,080	24,598
<b>Net Interest Income</b>	<b>10,690</b>	<b>11,690</b>	<b>14,058</b>	<b>16,490</b>	<b>19,723</b>
Change (%)	17.4	9.4	20.3	17.3	19.6
Other Income	7,534	4,581	4,903	5,173	5,595
<b>Net Income</b>	<b>18,224</b>	<b>16,271</b>	<b>18,960</b>	<b>21,663</b>	<b>25,317</b>
Change (%)	14.7	-10.7	16.5	14.3	16.9
Operating Expenses	8,295	8,580	9,515	10,290	11,311
<b>Operating Income</b>	<b>9,930</b>	<b>7,691</b>	<b>9,445</b>	<b>11,374</b>	<b>14,006</b>
Change (%)	6.7	-22.5	22.8	20.4	23.1
Other Provisions	2,501	2,036	1,700	2,000	2,250
<b>PBT</b>	<b>7,429</b>	<b>5,655</b>	<b>7,745</b>	<b>9,374</b>	<b>11,756</b>
Tax	2,228	800	2,169	2,625	3,527
Tax Rate (%)	30.0	14.1	28.0	28.0	30.0
<b>PAT</b>	<b>5,201</b>	<b>4,855</b>	<b>5,576</b>	<b>6,749</b>	<b>8,229</b>
Change (%)	12.2	-6.7	14.9	21.0	21.9
Proposed Dividend	1,357	1,698	1,940	2,183	2,425

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Capital	4,000	4,850	4,850	4,850	4,850
Reserves & Surplus	14,370	24,089	27,726	32,292	38,096
<b>Net Worth</b>	<b>18,370</b>	<b>28,939</b>	<b>32,576</b>	<b>37,142</b>	<b>42,946</b>
<b>Deposits</b>	<b>275,507</b>	<b>339,224</b>	<b>393,500</b>	<b>452,525</b>	<b>520,404</b>
Change (%)	20.1	23.1	16.0	15.0	15.0
Borrowings	9,832	7,585	8,495	9,515	10,656
Other Liabilities & Prov.	23,577	30,945	34,658	38,817	43,475
<b>Total Liabilities</b>	<b>327,287</b>	<b>406,693</b>	<b>469,229</b>	<b>537,999</b>	<b>617,482</b>
Current Assets	35,233	51,394	60,330	68,006	75,411
Investments	106,463	114,442	123,597	129,777	136,266
Change (%)	3.2	7.5	8.0	5.0	5.0
Advances	175,168	221,004	265,205	318,246	381,895
Change (%)	35.9	26.2	20.0	20.0	20.0
Net Fixed Assets	1,873	1,928	1,992	2,054	2,002
Other Assets	8,550	17,926	18,105	19,916	21,907
<b>Total Assets</b>	<b>327,287</b>	<b>406,693</b>	<b>469,229</b>	<b>537,999</b>	<b>617,482</b>

ASSUMPTIONS					
	(%)				
Deposit Growth	20.1	23.1	16.0	15.0	15.0
Advances Growth	35.9	26.2	20.0	20.0	20.0
Investments Growth	3.2	7.5	8.0	5.0	5.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	30.0	35.0	40.0	45.0	50.0
CRR	5.0	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning Assets	8.0	7.7	7.9	8.2	8.4
Avg. Cost-Int. Bear. Liab.	4.6	4.8	4.8	4.9	5.0
Interest Spread	3.4	2.9	3.1	3.3	3.4
Net Interest Margin	3.8	3.4	3.5	3.6	3.7

Profitability Ratios (%)					
RoE	31.6	20.5	18.1	19.4	20.6
RoA	1.7	1.3	1.3	1.3	1.4
Int. Expended/Int. Earned	53.0	56.3	56.0	56.1	55.5
Other Inc./Net Income	41.3	28.2	25.9	23.9	22.1

Efficiency Ratios (%)					
Op. Exps./Net Income	45.5	52.7	50.2	47.5	44.7
Empl. Cost/Op. Exps.	65.0	57.4	56.5	54.6	52.6
Busi. per Empl. (Rs m)	30.9	38.4	46.2	54.1	63.2
NP per Empl. (Rs lac)	4.0	3.7	4.2	5.1	6.2

Asset-Liability Profile (%)					
Adv./Deposit Ratio	63.6	65.1	67.4	70.3	73.4
Invest./Deposit Ratio	38.6	33.7	31.4	28.7	26.2
G-Sec/Invest. Ratio	83.9	86.5	88.1	90.6	93.2
Gross NPAs to Adv.	2.5	1.9	1.5	1.2	1.0
Net NPAs to Adv.	0.3	0.3	0.2	0.2	0.1
CAR	12.1	14.0	11.9	11.8	12.0
Tier 1	8.0	12.2	11.5	9.9	10.0

VALUATION					
Book Value (Rs)	45.9	59.7	67.2	76.6	88.5
Price-BV (x)	19	14	13	11	10
Adjusted BV (Rs)	45.1	58.9	66.3	75.7	87.8
Price-ABV (x)	19	15	13	11	10
EPS (Rs)	13.0	10.0	11.5	13.9	17.0
EPS Growth (%)	12.2	-23.0	14.9	21.0	21.9
Price-Earnings (x)	6.6	8.5	7.4	6.1	5.0
OPS (Rs)	24.8	15.9	19.5	23.5	28.9
OPS Growth (%)	6.7	-36.1	22.8	20.4	23.1
Price-OP (x)	3.4	5.4	4.4	3.6	3.0

E: MOST Estimates



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**Andhra Bank**

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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 |
| 4. Investment Banking relationship with company covered | No |

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