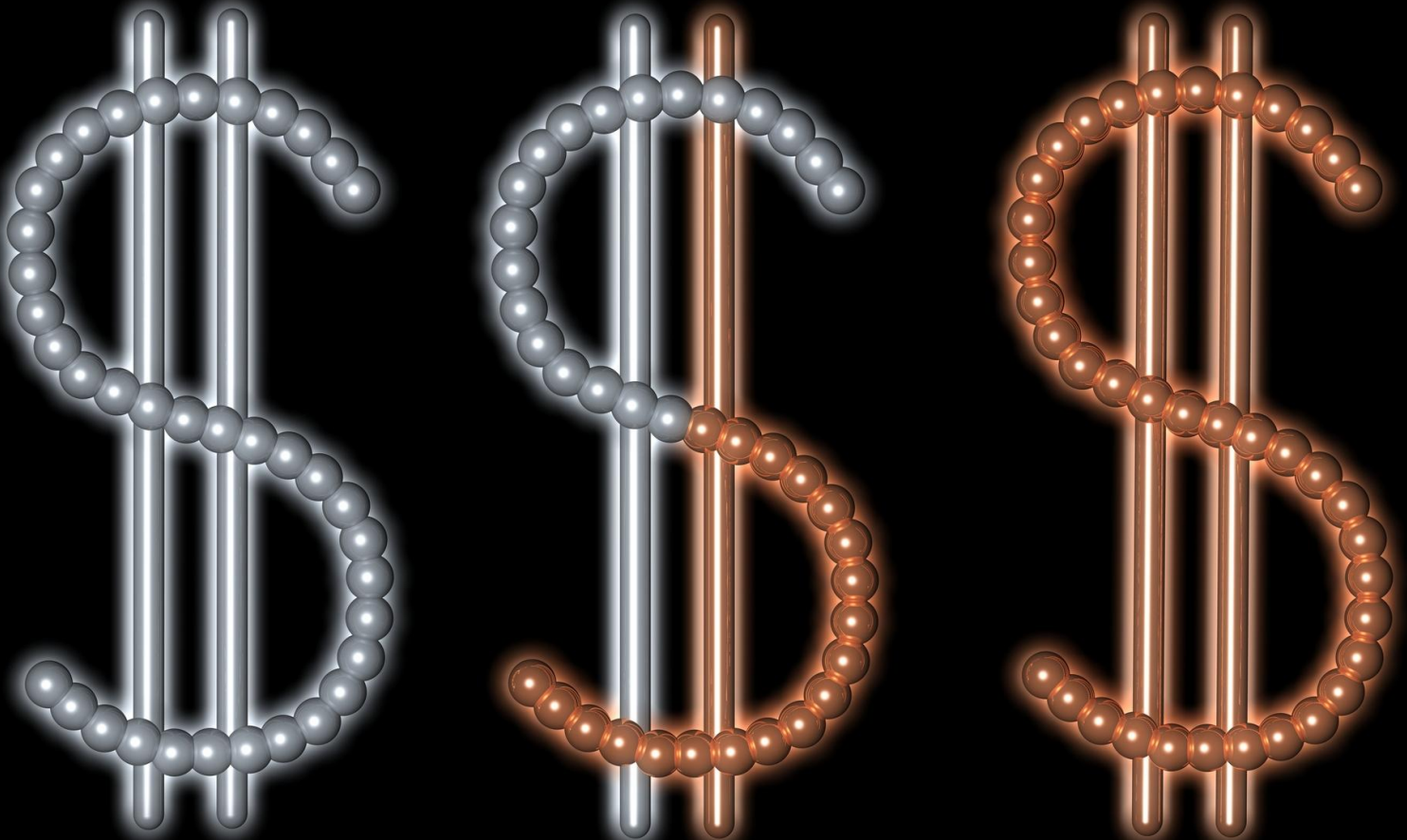


Allahabad Bank

In a transformation mode...





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Allahabad Bank

| | |
|----------------|--------|
| Rating | BUY |
| Price | Rs138 |
| Target Price | Rs211 |
| Implied Upside | 52.5% |
| Sensex | 17,000 |

(Prices as on March 3, 2010)

Trading Data

| | |
|----------------------------|---------|
| Market Cap. (Rs bn) | 61.8 |
| Shares o/s (m) | 446.7 |
| Free Float | 44.77% |
| 3M Avg. Daily Vol ('000) | 1,144.1 |
| 3M Avg. Daily Value (Rs m) | 152.5 |

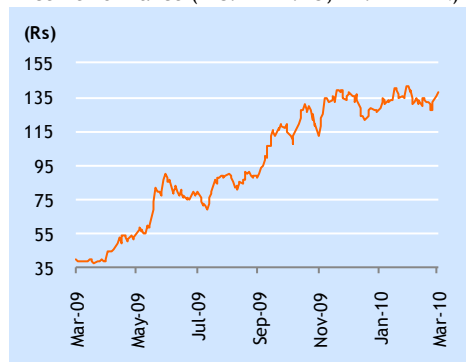
Major Shareholders

| | |
|-----------------|--------|
| Government | 55.23% |
| Foreign | 13.22% |
| Domestic Inst. | 15.08% |
| Public & Others | 16.47% |

Stock Performance

| (%) | 1M | 6M | 12M |
|----------|-------|------|-------|
| Absolute | (0.3) | 54.6 | 258.0 |
| Relative | (3.3) | 44.2 | 156.2 |

Price Performance (RIC: ALBK.BO, BB: ALBK IN)



Source: Bloomberg

- Sustainable turnaround in core operating performance should lead to re-rating:** Allahabad Bank has witnessed a significant turnaround in its core operating performance on the back of various structural changes incorporated by its former CMD (Mr. Kamath - currently CMD of PNB). This improvement is sustainable, with the bank clocking an average core RoAA (excl. treasury) of ~0.7% for the past five quarters which clearly reflects consistency in earnings that was missing earlier. **We believe that the current CMD Mr. Dua, who was a part of this structural change, is committed to take the bank to the next level of growth.** The current focus of the top management is on 1) high-yielding retail and SME advances to maintain margins with a positive bias 2) expansion in the Western and Southern regions, offering healthy advances growth potential and 3) rapid technology implementation, targeting 100% CBS rollout by December 2010 to aid in boosting its fee-based income along with improvement in cost efficiency and productivity of employees.
- Asset quality stable, negative surprises unlikely:** Allahabad Bank's asset quality remains stable with %GNPAs at 1.8% (lowest in past 12 quarters). We draw comfort from the fact that bank maintains provision cover of ~80%, among the highest in industry. Restructured assets constitute 5.6% of the overall loan portfolio, slightly higher than its peers.
- Capital adequacy comfortable with Tier-I at 8.9%, budget announcement - a Positive:** The bank has sought Rs10bn of capital from the Government. We believe that the recent announcement in the budget regarding bank recapitalization is a *positive* for the bank.
- Valuations attractive, re-rating on the cards:** Allahabad Bank is well poised for the next phase of growth, with continuation of the current top management, which has a focus on delivering consistent and qualitative growth. Moreover, legacy issues such as higher reliance on high-cost deposits, lower technology adoption and volatility in earnings have been addressed. Allahabad Bank is currently trading at 48% discount (1-yr fwd P/BV (x)) to its larger peers, which is higher than the current valuation discount given to mid-cap banks (36%) and long-term average discount of ~30%. We believe that such high valuation gap is unwarranted, given the 20% plus RoE's and change in legacy issues, which definitely call for re-rating of the stock. The stock is currently trading at 4.0x and 3.0x its FY11E and FY12E EPS respectively and 0.8x and 0.7x its FY11E and FY12E ABV respectively. We initiate coverage with a 'BUY' recommendation and a price target of Rs211 (1 x FY12E ABV).
- Key risks:** Sharp spike in bond yields and re-emergence of risk aversion in global equities.

| Key financials (Y/e March) | FY09 | FY10E | FY11E | FY12E |
|----------------------------|--------|--------|--------|--------|
| Net interest income (Rs m) | 21,587 | 26,285 | 34,373 | 43,119 |
| Growth (%) | 29.1 | 21.8 | 30.8 | 25.4 |
| Operating profit (Rs m) | 19,012 | 25,277 | 29,871 | 38,753 |
| PAT (Rs m) | 7,686 | 12,871 | 15,585 | 20,760 |
| EPS (Rs) | 17.2 | 28.8 | 34.9 | 46.5 |
| Growth (%) | (21.1) | 67.5 | 21.1 | 33.2 |
| Net DPS (Rs) | 2.5 | 3.0 | 3.5 | 4.0 |

Source: Company Data; PL Research

| Profitability & valuation | FY09 | FY10E | FY11E | FY12E |
|---------------------------|------|-------|-------|-------|
| NIM (%) | 2.5 | 2.5 | 2.7 | 2.8 |
| RoAE (%) | 13.9 | 20.1 | 20.3 | 22.3 |
| RoAA (%) | 0.9 | 1.2 | 1.2 | 1.3 |
| P / BV (x) | 1.2 | 1.0 | 0.8 | 0.7 |
| P / ABV (x) | 1.3 | 1.0 | 0.8 | 0.7 |
| PE (x) | 8.0 | 4.8 | 4.0 | 3.0 |
| Net dividend yield (%) | 1.8 | 2.2 | 2.5 | 2.9 |

Source: Company Data; PL Research

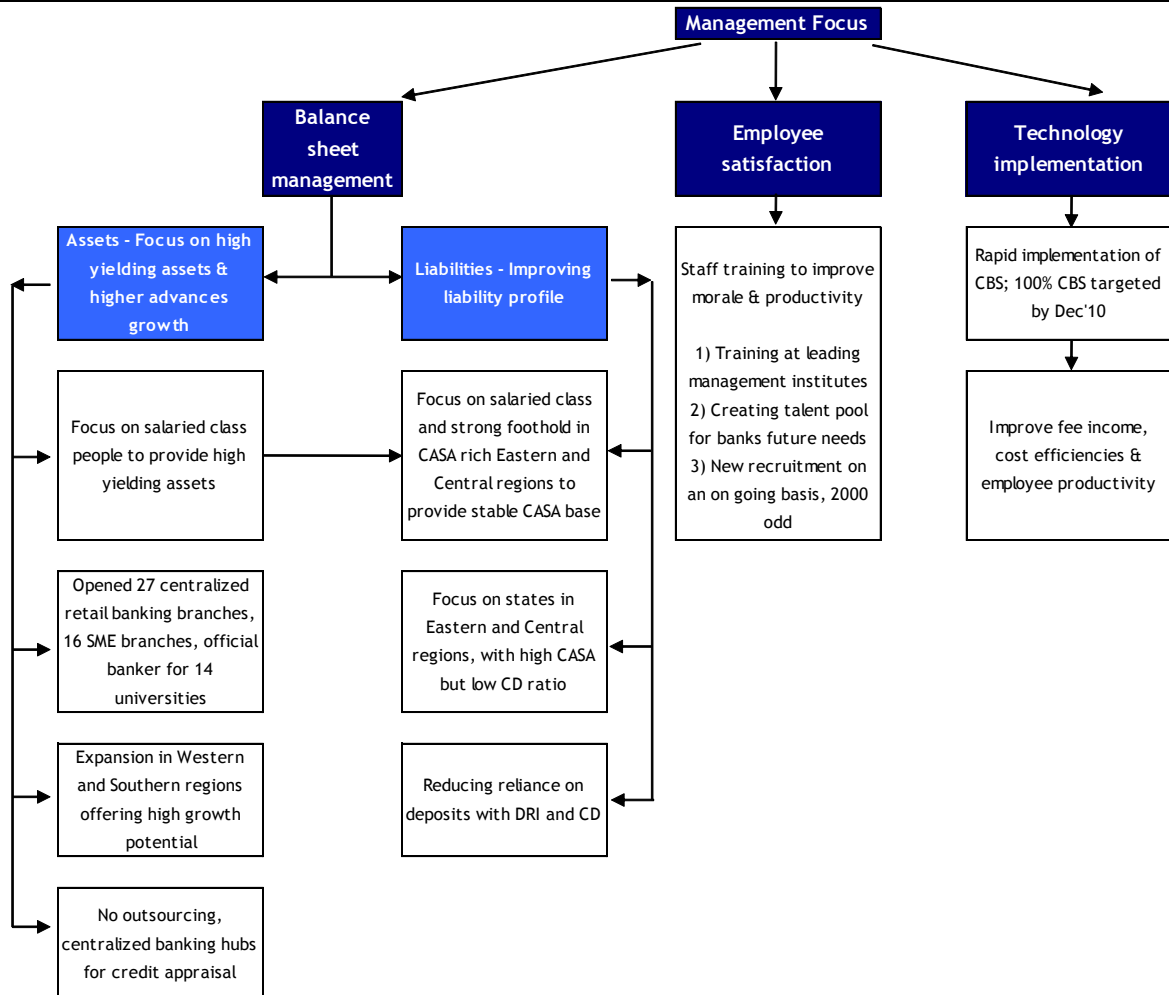
Investment Argument

Management striking the right chord - sustainable improvement in core earnings

We believe that the current CMD Mr. Dua, who was a part of this structural change, is committed to take the bank to the next level of growth.

Allahabad Bank has witnessed a significant turnaround in its core operating performance on the back of various structural changes incorporated by former CMD (Mr. Kamath - currently CMD of PNB). This improvement is sustainable, with the bank clocking an average core RoAA (excl. treasury) of -0.7% for the past five quarters which clearly reflects consistency in earnings that was missing earlier. We believe that the current CMD Mr. Dua, who was a part of this structural change, is committed to take the bank to the next level of growth. The renewed focus of the top management is currently on technology implementation, improving operating efficiency, asset quality and fee-based income and balance sheet management. These measures have reduced the volatility in bank's earnings which acted as an overhang on its valuations earlier.

New Management Focus



Source: Company Data, PL Research

Volatility in earnings - a key concern earlier, now addressed

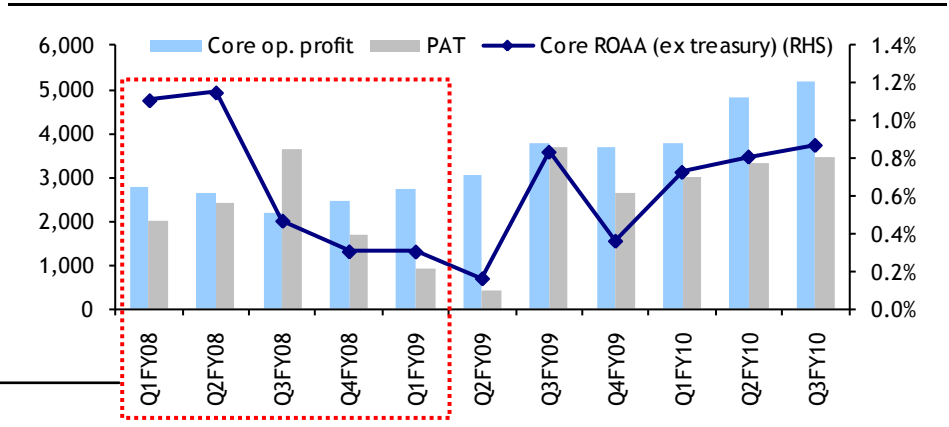
As a result of various initiatives taken by the management, Allahabad Bank has witnessed stability in its earnings and significant improvement in its core operating performance. As evident in the chart below, the bank has consistently delivered an average core RoAA (excl. treasury) of ~0.7% for the past five quarters. We expect this to improve, going forward, on the back of higher core fee income, lower operating expenses and higher asset growth.

Lower topline growth, lower fee-based income and higher operating costs affected the core operating profit of the bank earlier.

The bank has clocked an average core RoAA (excl. treasury) of ~0.7% for past five quarters.

Volatility in earnings before Mr. Kamath took helm at the bank

Change in the profitability profile of the bank



Source: Company Data, PL Research

Notions of higher NPL risk from major concentration in UP, data suggests otherwise

Despite having a major presence in Uttar Pradesh, the NPL risk remains limited as the credit deposit (CD) ratio in this state (42.1%) is much lower than industry average (72.6%), implying lack of opportunities. On the contrary, this state provides very stable CASA balances (discussed later in the report)

2009 - CD Ratio (Region-wise)

| | |
|--------------|--------------|
| Northern | 68.5% |
| Eastern | 48.9% |
| Central | 44.8% |
| Western | 85.2% |
| Southern | 88.4% |
| Total | 72.6% |

Source: RBI, PL Research

State-wise branches, industry CD ratio and industry CASA ratio (FY09)

| | Br Spread (Allahabad Bank) | CD Ratio (Industry) | CASA ratio (Industry) |
|----------------|----------------------------|---------------------|-----------------------|
| Uttar Pradesh | 33.60% | 42.10% | 53.00% |
| West Bengal | 22.80% | 60.80% | 40.30% |
| Bihar | 8.10% | 27.30% | 65.40% |
| Madhya Pradesh | 7.50% | 57.40% | 47.10% |
| Jharkhand | 4.90% | 32.00% | 53.40% |

Source: RBI, Company Data, PL Research

Drivers of sustainable improvement in core earnings

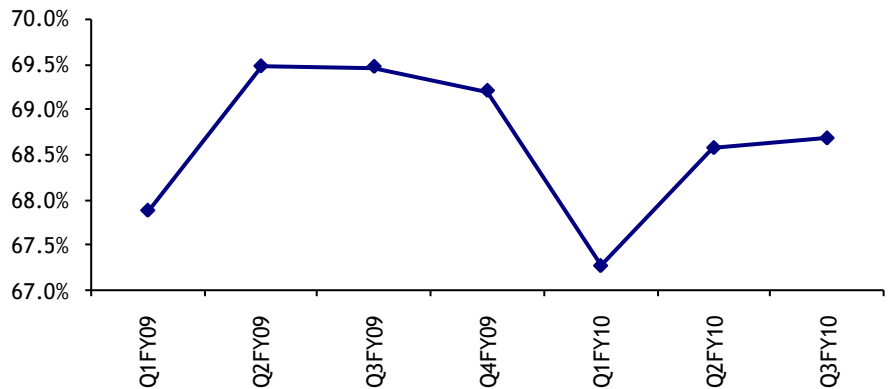
Branch expansion to fuel growth

The bank has 68 new licenses and plans to open another 100 branches in FY11-12.

Allahabad Bank has always been perceived as a ‘regional’ bank, with a very strong presence in the Eastern and Central parts of the country. The bank has ~2% industry market share in the overall business. Almost three-fourth of the bank’s branch network is concentrated in the Eastern and Central region put together. The bank has 68 new licenses and plans to open another 100 branches in FY11-12. A major portion of these new branches is planned to diversify and expand its presence in the Western and Southern regions to improve growth potential and gain market share.

CD ratio currently is at 68.5%; opportunities exist to improve it further by deploying liquid mutual fund investments (~Rs20-30bn) into advances once credit demand picks up.

Trend in CD ratio - opportunities remain to improve CD ratio further

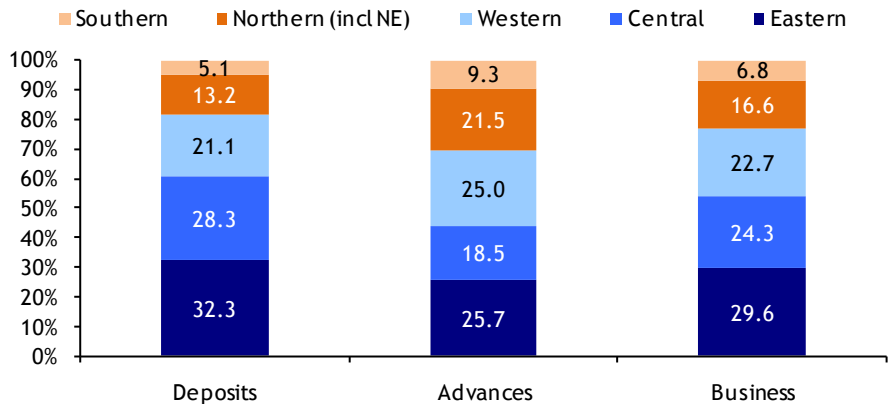


Source: Company Data, PL Research

Bank’s deposit profile is more concentrated, with over 60% coming from the Eastern and Central regions put together.

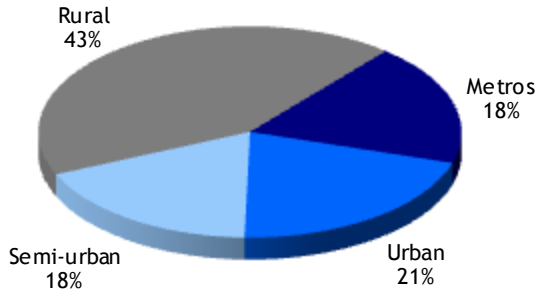
Region-wise business spread

Meanwhile, the advances are more diversified with Eastern and Western regions, contributing around 25% each.

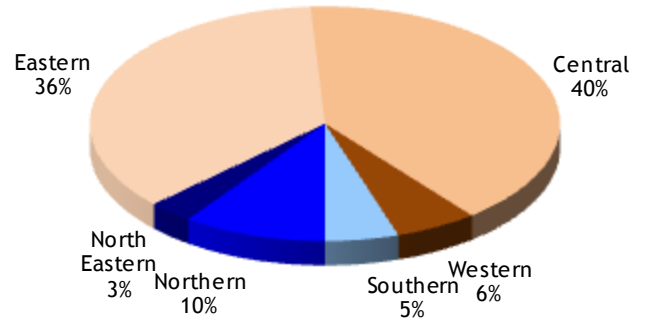


Source: Company Data, PL Research

Branch spread (FY09)



Regionwise branch spread (FY09)

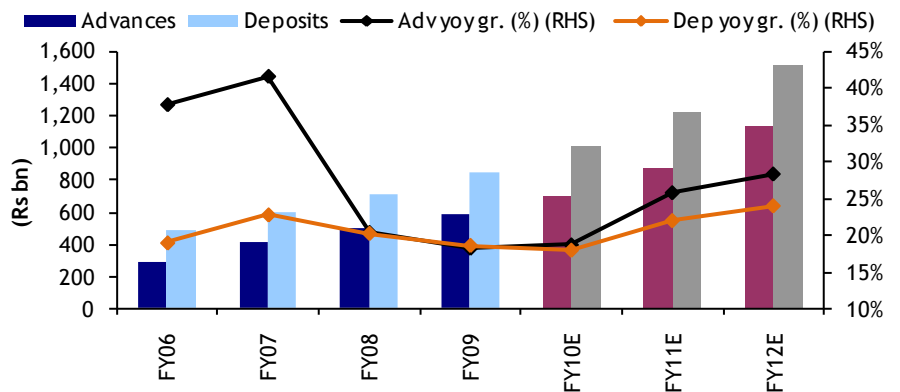


Source: RBI, Company data, PL Research

After falling sharply in FY08 and remaining subdued in FY09, we expect the advances growth to gradually pick up, going forward.

Meanwhile, deposit growth has remained much stable over the years as the bank refrained from growing rapidly by accumulating bulk deposits.

Trend in business growth

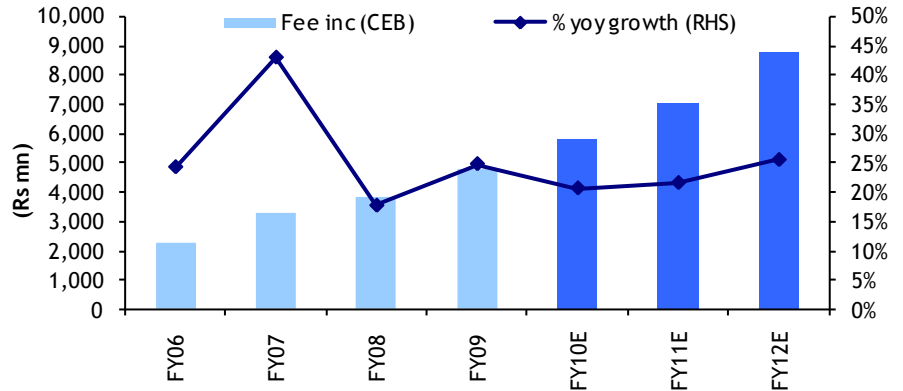


Source: Company Data, PL Research

Thrust on fee-based income

The new management has placed significant thrust on increasing fee-based income and it is one of their key focus areas. Though being one of the oldest banks in the country, Allahabad Bank’s performance in terms of technology implementation has remained lacklustre. As on December 31, 2009, the bank has 40% of its branches (912 branches out of total 2285 branches) under CBS, covering 82% of bank’s business. The bank aims at completing 100% CBS rollout by December 2010. Rapid technology implementation would only aid in improving the core fee-based income of the bank.

Trend in core fee income



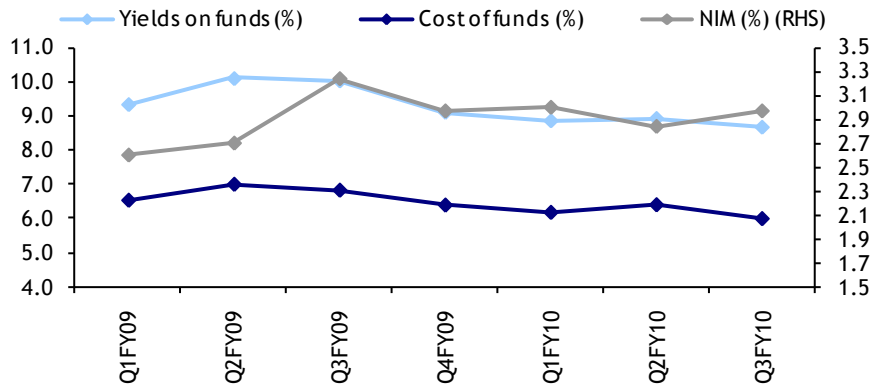
Source: Company Data, PL Research

Margins stable with positive bias

Allahabad Bank has been able to maintain an average net interest margin (NIM) of ~3% over the past five quarters. We expect margins to remain stable at around these levels with a positive bias. The bank is benefitted by a lot of factors that have a positive bearing on its margins.

Stable CASA share, declining proportion of DRI deposits / CDs and focus on high-yielding assets has helped the bank in consistently maintaining its margins at around 3% levels.

Trend in yields, costs and margins



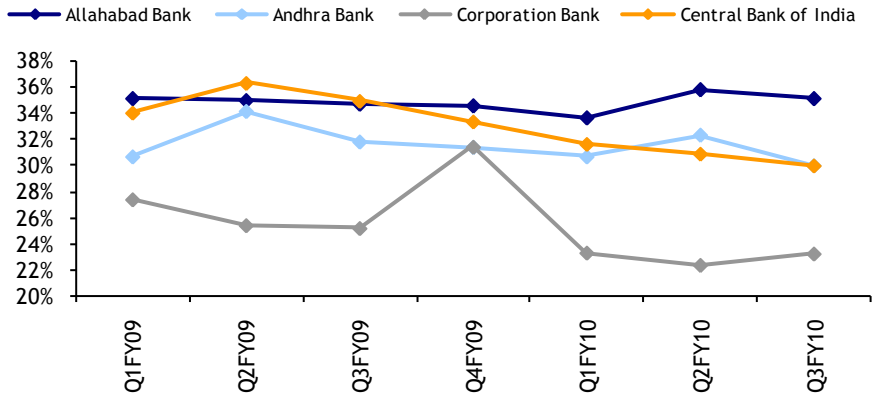
Source: Company Data, PL Research

i) Strong foothold in CASA rich region: Allahabad Bank has a very strong presence in the Eastern and the Central parts of the country, with almost three-fourth of bank’s branch network concentrated in these two regions put together. Based on the industry data, Eastern and the Central region enjoy CASA ratio close to 47% and 50%, respectively. By virtue of having a strong presence in these regions, the bank has around 60% deposits coming from these two regions. Assuming the proportion of CASA deposits for Allahabad Bank being as high as its regional average, the bank garners ~70% of its CASA deposits from these two regions. This gives Allahabad Bank an edge over its

peers in terms of stable CASA share. For over past six quarters, the bank has been able to maintain an average CASA ratio of ~35%.

Trend in CASA ratio of peer banks

Compared to its peers, Allahabad Bank's CASA ratio has remained stable at ~35% on account of its dominant presence in CASA rich Eastern and Central regions



Source: Company Data, PL Research

Region-wise CASA ratio

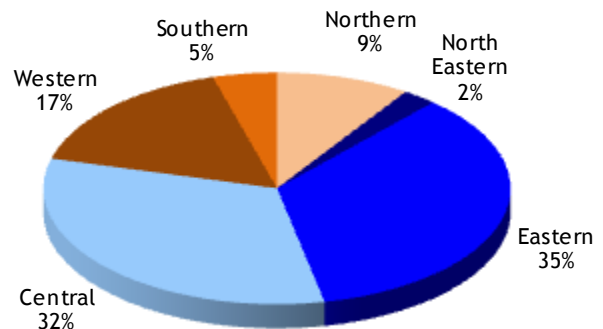
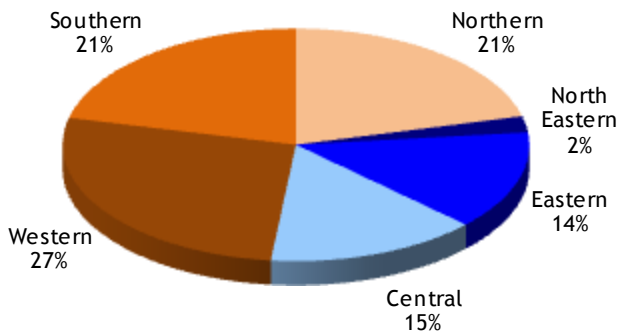
| | |
|------------------|--------------|
| Northern | 35.8% |
| North Eastern | 54.3% |
| Eastern | 47.2% |
| Central | 49.8% |
| Western | 33.9% |
| Southern | 37.7% |
| All India | 38.7% |

Source: RBI, PL Research

#Based on 2008 figures

Region-wise CASA share for the industry (FY09)

Region-wise CASA share for Allahabad Bank (FY09)



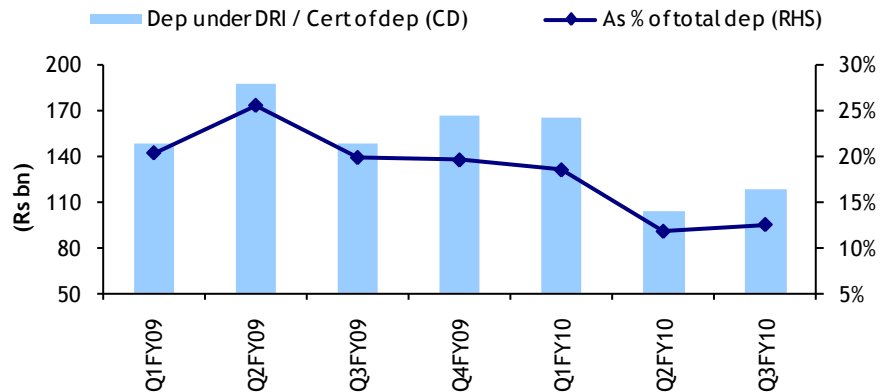
Source: RBI, Company Data, PL Research

ii) Declining proportion of DRI deposits / CDs: As a part of its balance sheet restructuring exercise, Allahabad Bank consciously made attempts to reduce the proportion of deposits with differential rate of interest (DRI) and CDs. Not only has the share of such deposits reduced from 28% in FY08 to 12.6% in Q3FY10, also the quantum of the same stands reduced from Rs193.4bn in FY08 to Rs118.4bn in Q3FY10. The management expects the remaining such deposits/CDs to run off the balance sheet in the next two-three quarters. We expect this to aid margin improvement for the bank.

Trend in share of deposits with differential rate of interest

The proportion of deposits with DRI and CDs has declined considerably from 28% in FY08 to just 12.6% in Q3FY10

Management expects these deposits to run off the balance sheet in the next couple of quarters

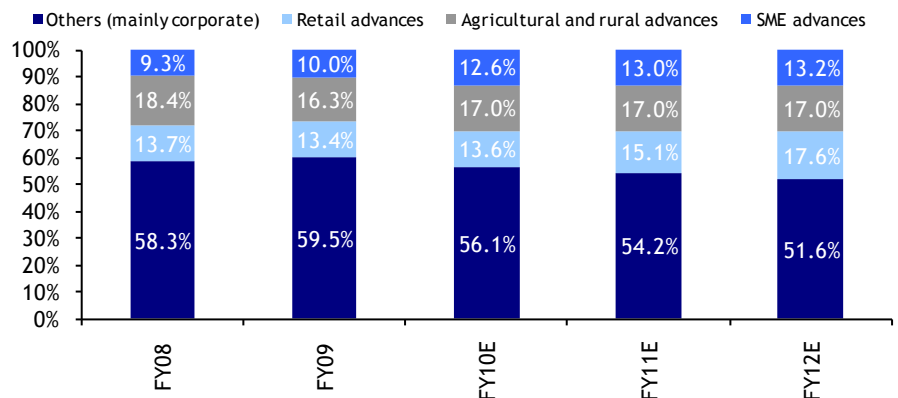


Source: Company Data, PL Research

iii) Focus on high-yielding assets: Lastly, the management is focusing on improving its yields by increasing the proportion of high-yielding assets. This is clearly evident from the fact that the proportion of the SME loans increased to 13% in Q3FY10 from slightly below 10% during the corresponding period last year. The bank targets to increase proportion of retail loans from 12-14% currently to 21-22%, going forward. Moreover, centralized processing will help in standardizing lending procedures, resulting in higher growth and improved quality of credit.

Loan book break-up

Proportion of retail advances to increase from 13.4% in FY09 to 17.0% in FY12E and SME advances from 10.0% in FY09 to 13.2% in FY12E



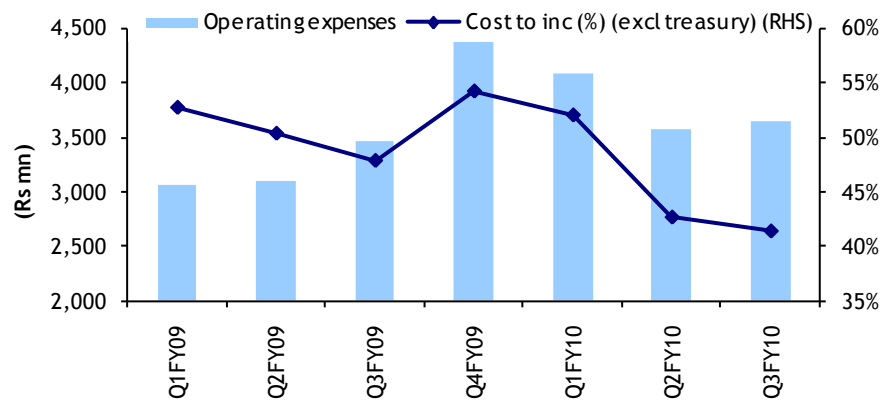
Source: Company Data, PL Research

Cost efficiency - among the best in the industry

One of the other areas where the management has taken certain conscious steps is improving its cost efficiency. The core cost-to-income ratio (excl. treasury gains) has steadily improved for the bank during the YTD period. Allahabad Bank can now compare with its larger peers in terms of cost efficiencies, with its core cost to income ratio being as low as 41% in Q3FY10.

The bank has also provided Rs470m towards second round of pension shortfall during Q3FY10 (first PSU bank to undertake such provisioning).

Trend in cost to income ratio (excl. treasury gains)



Source: Company Data, PL Research

The bank is most forthcoming in making all necessary provisions and hence, superior core cost-to-income ratio is not on account of lower provisioning.

Peer comparison for core cost-to-income (excl. treasury gains) ratio

| | FY09 | Q1FY10 | Q2FY10 | Q3FY10 |
|-----------------------|--------------|--------------|--------------|--------------|
| State Bank of India | 50.5% | 62.4% | 50.1% | 54.8% |
| Punjab National Bank | 45.3% | 51.1% | 44.3% | 42.8% |
| Union Bank of India | 44.5% | 48.4% | 50.7% | 47.7% |
| Bank of Baroda | 51.2% | 54.3% | 51.1% | 46.9% |
| Bank of India | 39.6% | 50.0% | 45.4% | 48.6% |
| Allahabad Bank | 51.3% | 52.0% | 42.7% | 41.4% |
| Andhra Bank | 51.2% | 60.2% | 45.2% | 42.8% |
| Corporation Bank | 42.5% | 39.9% | 37.0% | 36.8% |
| Central Bank of India | 64.4% | 87.1% | 56.9% | 54.9% |

Source: Company Data, PL Research

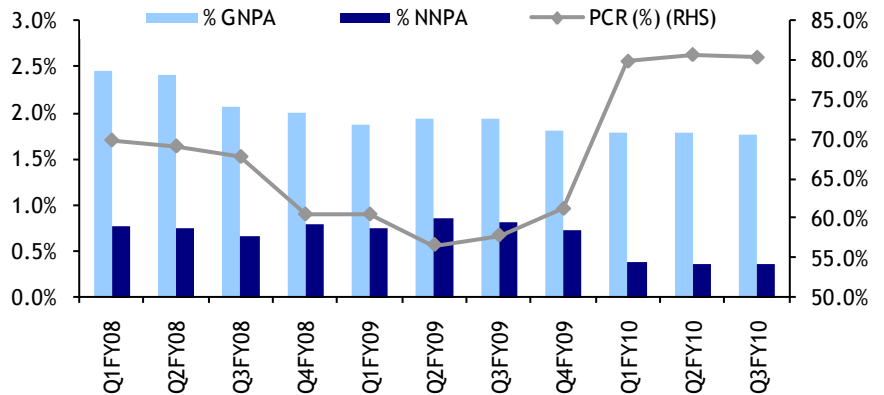
Asset quality stable, high provision coverage - a positive

Moreover, provision coverage high at ~80% provides significant cushion to the asset quality (including technical write-offs as per RBI guidelines coverage improves to 88%).

Allahabad Bank's asset quality has remained fairly stable. The %GNPAs have reduced from ~2.5% levels at the start of the previous fiscal to ~1.8% as on Q3FY10. Moreover, high provision coverage at ~80% provides cushion to the asset quality (including technical write-offs as per RBI guidelines coverage improves to 88%). The recent announcement in the budget regarding extension in repayment deadline for farmers under the debt relief scheme augurs well for the bank.

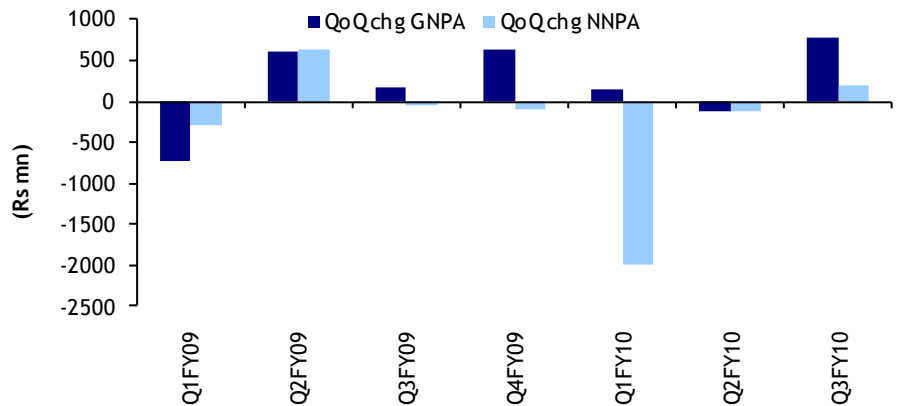
Trend in asset quality

Treasury profits and MTM reversals used up to increase provision coverage ratio



Source: Company Data, PL Research

Trend in QoQ change in NPAs



Source: Company Data, PL Research

Restructured assets on the higher side...

The bank has restructured assets worth Rs36.3bn as on Q3FY10, which constitutes 5.6% of the total outstanding loans of the bank. This is slightly higher compared to its peers.

Real estate exposure comprises ~19% of total restructured assets, of which one major account based out of Delhi is in the range of Rs2-2.5bn.

The account has been performing and debt-servicing capacity has improved considerably as the company had raised equity from the capital markets and also property sales had picked up improving its cash flows. Exposure to commercial real estate stands at 3.4% of total outstanding loans.

Sector-wise restructured assets

(Rs bn)

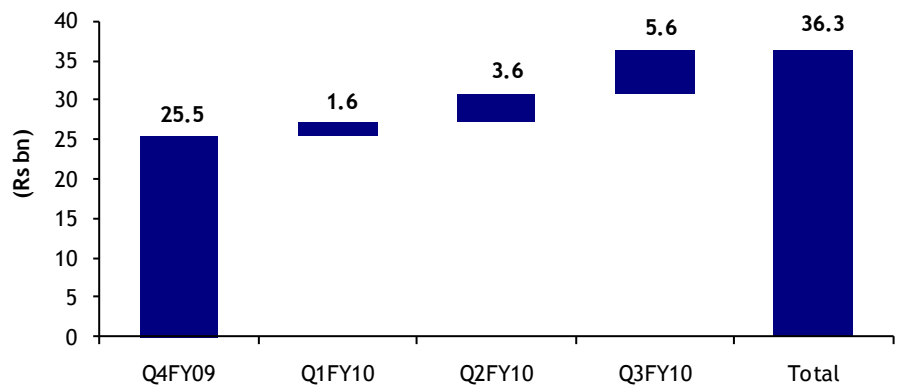
| | Rs bn | % of restructured assets |
|----------------|-------------|--------------------------|
| Real Estate | 7.0 | 19.2% |
| Infrastructure | 3.9 | 10.8% |
| Pharma | 3.2 | 8.8% |
| Agriculture | 2.9 | 8.0% |
| Iron & steel | 2.4 | 6.5% |
| Housing | 2.1 | 5.8% |
| Textile | 2.1 | 5.8% |
| Sugar | 1.8 | 5.0% |
| Engineering | 1.5 | 4.2% |
| Others | 9.4 | 25.9% |
| Total | 36.3 | 100.0% |

Source: Company Data, PL Research

...no major NPL surprises expected, going forward

Major incremental large ticket slippages are unlikely for Allahabad Bank. However, the bank has exposure to one of the large Southern-based infrastructure and real estate player which is to the tune of Rs1.5-2.0bn (fund and non-fund based exposure put together). The asset has been restructured and is currently performing and classified as standard on the books, but needs to be monitored. It's unlikely that the entire exposure will be treated as NPA. Even in the worst case scenario, a 70% provisioning would result in ~Rs1-1.2bn which we believe would impact PBT by 5%. However, the bank can absorb the same and move forward.

Trend in restructured assets



Source: Company Data, PL Research

No significant threat of MTM losses, interest rate sensitive AFS investments are lower than reported

Negative sentiment on PSU banks in case of rising bond yields could be used as an entry point for the stock.

Our assumptions for MTM losses are 10yr yield at 8.25% for year end March 2011, AFS portfolio to the tune of 28.7% and duration of 2.75 years. This results in a MTM loss of Rs619m as we factor in a 50bps increase in the yields by assuming 10yr yield at 7.75% for year end March 2010.

Interest risks remain, but much lower than past trends

As on Q3FY10, the bank has ~85% of its SLR investments in the HTM category. Out of Rs103bn worth of AFS investments, Rs50-60bn will be interest rate sensitive. Hence, we do not expect the bank to get impacted significantly if bond yields suddenly spike up. Despite modified duration of MTM portfolio at 2.46 years, we do not foresee any significant MTM hit for the bank, going forward.

Sensitivity analysis for MTM

| | Change in yields | | | | |
|-----------|------------------|-------|-------|-------|-------|
| | 0.30% | 0.50% | 0.70% | 0.90% | 1.10% |
| HTM Prop. | | | | | |
| 75.0% | 1.5% | 2.5% | 3.6% | 4.6% | 5.7% |
| 70.0% | 2.1% | 3.5% | 5.0% | 6.6% | 8.1% |
| 65.0% | 2.7% | 4.6% | 6.5% | 8.6% | 10.7% |
| 60.0% | 3.3% | 5.6% | 8.1% | 10.6% | 13.3% |

Trend in AFS portfolio

| Y/e March | Q3FY09 | Q4FY09 | Q1FY10 | Q2FY10 | Q3FY10 |
|---------------------------|--------|--------|--------|--------|--------|
| Gross Investment | 279.9 | 300.8 | 352.9 | 304.8 | 344.7 |
| SLR | 193.5 | 218.0 | 236.7 | 253.0 | 279.0 |
| Held to maturity (HTM) | 166.2 | 165.5 | 181.7 | 212.3 | 236.4 |
| HTM to SLR (%) | 85.9 | 75.9 | 76.8 | 83.9 | 84.7 |
| Available for sale (AFS)* | 113.8 | 135.4 | 170.8 | 92.0 | 103.1 |
| AFS to gr investments (%) | 40.6 | 45.0 | 48.4 | 30.2 | 29.9 |
| Modified Duration | | | | | |
| Total investments (yrs) | 3.99 | 3.99 | 4.68 | 4.96 | 4.67 |
| AFS (yrs) | 1.87 | 3.36 | 3.28 | 2.97 | 2.46 |

Source: Company Data, PL Research

* Includes investments into liquid schemes

Capital adequacy comfortable, Tier-I at 8.98%, budget announcement a positive

The bank remains well capitalized, with CAR of 15% as on Q3FY10. During the quarter gone by, the bank raised Rs1.5bn through Tier-I bonds and Rs5.0bn through Tier-II bonds, taking the Tier-I capital adequacy to 8.98% and the overall CAR at 15%. This provides bank with enough headroom to raise Tier-II capital, which would support the bank's growth for the coming fiscal. However, the Gov holding is 55%, which remains a concern on the bank's ability to raise fresh capital for growth. The bank has sought Rs10bn capital from Government of India, the decision on which is pending. The recent announcement of Rs16.5bn capital infusion in PSBs in FY11 by the government is a positive development for Allahabad Bank.

YTD FY10 performance analysis

- The bank recorded 12% YoY as well as QoQ growth in its net interest income (NII) driven by healthy advances growth (24% YoY and 8% QoQ) and sequential improvement in NIMs during the quarter.
- Though the operating profit declined marginally on a YoY basis and remained flat sequentially, the core operating profit (excl. treasury) grew by a healthy 36.8% YoY and 7.3% QoQ.
- The net profit declined by 6.5% YoY for Q3FY10, but has almost doubled to Rs9.8bn for the YTD period.
- GNPA's grew by 7.2% QoQ to Rs11.6bn, but the coverage stood healthy at 80%, among the highest in the industry.

Q3FY10 Result Overview

(Rs m)

| Y/e March | Q3FY10 | Q3FY09 | YoY gr. (%) | Q2FY10 | 9MFY10 | 9MFY09 | YoY gr. (%) |
|---------------------------------|---------------|---------------|-------------------|---------------|---------------|---------------|----------------|
| Interest Income | 21,078 | 18,980 | 11.0 | 20,467 | 61,626 | 54,496 | 13.1 |
| Interest Expense | 14,322 | 12,939 | 10.7 | 14,434 | 42,548 | 38,835 | 9.6 |
| Net Interest Income | 6,756 | 6,041 | 11.8 | 6,033 | 19,079 | 15,662 | 21.8 |
| Non-Interest Income | 3,395 | 4,084 | (16.9) | 4,048 | 11,139 | 6,837 | 62.9 |
| Treasury | 1,333 | 2,883 | (53.8) | 1,683 | 5,156 | 3,281 | 57.1 |
| CEB | 1,555 | 1,178 | 32.0 | 1,820 | 4,840 | 3,163 | 53.0 |
| Net total Income | 10,151 | 10,125 | 0.3 | 10,081 | 30,217 | 22,498 | 34.3 |
| Operating Expenses | 3,650 | 3,465 | 5.3 | 3,582 | 11,311 | 9,628 | 17.5 |
| Operating profit | 6,501 | 6,661 | (2.4) | 6,498 | 18,906 | 12,870 | 46.9 |
| Core operating profits | 5,169 | 3,778 | 36.8 | 4,816 | 13,750 | 9,589 | 43.4 |
| Provisions | 2,463 | 1,030 | 139.2 | 1,939 | 4,798 | 5,717 | (16.1) |
| Profit before tax | 4,038 | 5,631 | (28.3) | 4,560 | 14,108 | 7,153 | 97.2 |
| Tax | 585 | 1,936 | (69.8) | 1,224 | 4,290 | 2,108 | 103.6 |
| Net Profit after tax | 3,454 | 3,695 | (6.5) | 3,336 | 9,818 | 5,045 | 94.6 |
| Asset Quality | | | | | | | |
| Gross NPA's | 11,605 | 10,160 | 14.2 | 10,821 | 11,605 | 10,160 | 14.2 |
| <i>% Gross NPA's</i> | <i>1.77</i> | <i>1.93</i> | | <i>1.78</i> | <i>1.77</i> | <i>1.93</i> | |
| Net NPA's | 2,275 | 4,292 | (47.0) | 2,084 | 2,275 | 4,292 | (47.0) |
| <i>% Net NPA's</i> | <i>0.35</i> | <i>0.82</i> | | <i>0.35</i> | <i>0.35</i> | <i>0.82</i> | |
| Provision Coverage | 80.4 | 57.8 | | 80.7 | 80.4 | 57.8 | |
| Yield Measurement ratios | | | | | | | |
| <i>RoA (%)</i> | <i>1.31</i> | <i>1.78</i> | | <i>1.33</i> | <i>1.29</i> | <i>0.81</i> | |
| <i>NIM - reported (%)</i> | <i>2.97</i> | <i>3.24</i> | <i>(27.0) bps</i> | <i>2.84</i> | <i>2.93</i> | <i>2.85</i> | <i>8.0 bps</i> |
| <i>Cost to Income (%)</i> | <i>36.0</i> | <i>34.2</i> | | <i>35.5</i> | <i>37.4</i> | <i>42.8</i> | |
| Balance Sheet Items | | | | | | | |
| Deposits | 941,640 | 750,950 | 25.4 | 873,090 | 941,640 | 750,950 | 25.4 |
| CASA | 330,880 | 260,760 | 26.9 | 312,620 | 330,880 | 260,760 | 26.9 |
| <i>CASA (%)</i> | <i>35.1</i> | <i>34.7</i> | | <i>35.8</i> | <i>35.1</i> | <i>34.7</i> | |
| Advances | 646,693 | 521,666 | 24.0 | 598,682 | 646,693 | 521,666 | 24.0 |
| Investments | 346,689 | 279,936 | 23.8 | 304,796 | 346,689 | 279,936 | 23.8 |
| Total Assets | 1,054,558 | 830,268 | 27.0 | 1,003,281 | 1,054,558 | 830,268 | 27.0 |

Source: Company Data, PL Research



Valuations attractive, re-rating on the cards

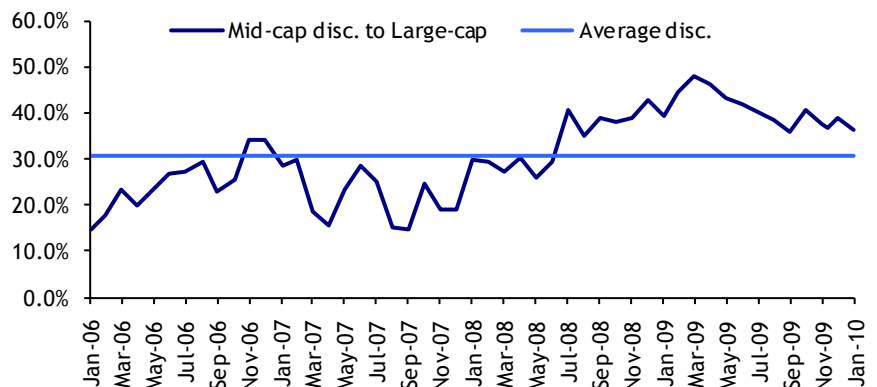
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Allahabad Bank is well poised for the next phase of growth, with continuation of the current top management, which has a focus on delivering consistent and qualitative growth. Moreover, legacy issues such as higher reliance on high-cost deposits, lower technology adoption and volatility in earnings have been addressed. Allahabad Bank is currently trading at 48% discount (1-yr fwd P/BV (x)) to its larger peers, which is higher than the current valuation discount given to mid-cap banks (36%) and long-term average discount of ~30%. We believe that such high valuation gap is unwarranted, given the 20% plus RoE's and change in legacy issues, which definitely call for re-rating of the stock. The stock is currently trading at 4.0x and 3.0x its FY11E and FY12E EPS respectively and 0.8x and 0.7x its FY11E and FY12E ABV respectively. We initiate coverage with a 'BUY' recommendation and a price target of Rs211 (1 x FY12E ABV).

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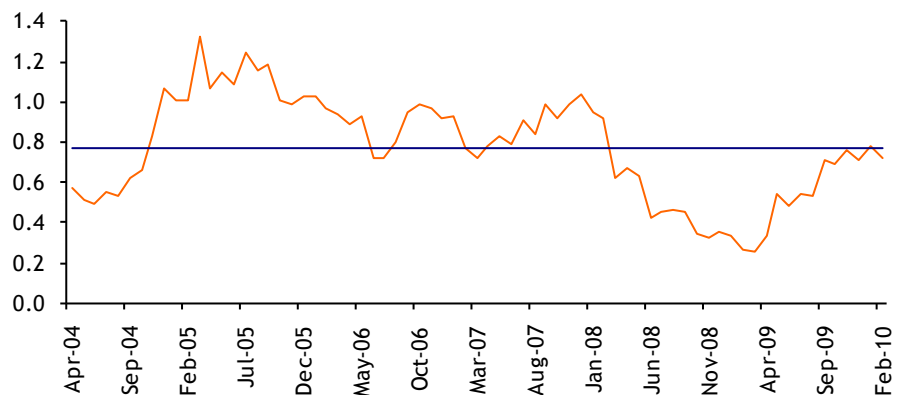
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Trend in valuation discount between PSU mid-cap banks v/s large PSU banks



Source: Bloomberg, PL Research

Trend in one-year forward price to adjusted book value (x)



Source: Bloomberg, PL Research

Peer comparison - Valuations

| Banks | CMP (Rs) | PER (x) | | P/BV (x) | | P/ABV (x) | |
|-----------------------|------------|------------|------------|------------|------------|------------|------------|
| | | FY10E | FY11E | FY10E | FY11E | FY10E | FY11E |
| Allahabad Bank | 138 | 4.8 | 4.0 | 1.0 | 0.8 | 1.0 | 0.8 |
| Andhra Bank | 102 | 5.1 | 4.4 | 1.1 | 1.0 | 1.1 | 0.9 |
| Corporation Bank | 450 | 6.4 | 5.5 | 1.1 | 0.9 | 1.1 | 0.9 |
| Indian Bank | 168 | 5.8 | 4.0 | 1.1 | 0.9 | 1.1 | 0.9 |
| Central Bank | 158 | 5.6 | 4.1 | 1.4 | 1.1 | 1.5 | 1.1 |
| UCO Bank | 60 | 4.1 | 4.2 | 0.9 | 0.8 | 1.0 | 0.8 |
| Vijaya Bank | 49 | 5.3 | 4.9 | 0.8 | 0.7 | 0.8 | 0.7 |

Source: PL Research

Shareholding Pattern (%) (as on Dec'09)

| | Allahabad Bank | Andhra Bank | Corporation Bank | Central Bank | UCO bank | Vijaya Bank |
|------------|----------------|-------------|------------------|--------------|----------|-------------|
| Government | 55.2 | 51.6 | 57.2 | 80.2 | 63.6 | 53.9 |
| FII | 13.2 | 15.1 | 4.0 | 4.6 | 2.5 | 4.0 |
| DII | 15.1 | 17.6 | 34.0 | 9.1 | 10.1 | 14.6 |
| Others | 16.5 | 15.8 | 4.9 | 6.2 | 23.8 | 27.5 |

Source: BSE India

Peer Comparison - Operating metrics

| | Allahabad Bank | Andhra Bank | Corporation Bank | Central Bank | UCO bank | Vijaya Bank |
|--------------------------|----------------|-------------|------------------|--------------|----------|-------------|
| NIM (%)* | 3.0% | 3.4% | 2.5% | 2.0% | 2.3% | 2.8% |
| CASA (%)* | 35.1% | 30.0% | 23.3% | 29.9% | 23.3% | NA |
| RoAE (%)^ | 20.1% | 24.3% | 18.6% | 18.9% | 21.9% | 14.3% |
| RoAA (%)^ | 1.2% | 1.3% | 1.0% | 0.7% | 0.6% | 0.6% |
| GNPA (Rs bn)* | 11.6 | 4.5 | 7.5 | 24.8 | 14.9 | 10.0 |
| GNPA (%)* | 1.77% | 0.87% | 1.32% | 2.72% | 2.01% | 2.53% |
| NNPA (Rs bn)* | 2.3 | 0.9 | 2.6 | 6.6 | 6.6 | 5.1 |
| NNPA (%)* | 0.35% | 0.17% | 0.45% | 0.74% | 0.89% | 1.30% |
| Provision Coverage (%)* | 80.39% | 80.33% | 65.71% | 73.31% | 55.98% | 48.54% |
| Restructured assets (%)* | 5.60% | 5.15% | 4.33% | 4.46% | 7.60% | NA |
| Advances market share# | 1.96% | 1.47% | 1.62% | 2.85% | 2.29% | 1.18% |
| Deposits market share# | 2.09% | 1.46% | 1.82% | 3.23% | 2.47% | 1.34% |
| Branches# | 2217 | 1425 | 1028 | 3527 | 2058 | 1101 |

Source: Company data, PL Research

as on FY09

* as on Q3FY10

^ PL Estimates

Company Background

Allahabad Bank is one of the oldest (145 years) public sector banks in the country. It is a mid sized public sector bank with a deposits and advances market share of ~2%. The bank has pan India presence with 2285 branches with very strong presence in the rural and semi-urban regions. Of which, the bank has 912 branches under CBS, which covers 82% of bank's business. The bank also has 3 regional rural banks (2 in UP and 1 in MP).

Brief history of the bank

| Year | Key Milestones |
|------|--|
| 1865 | Foundation year |
| 1927 | Allahabad Bank became a subsidiary of Chartered Bank |
| 1991 | Formed 100% subsidiary AllBank Finance Ltd. |
| 2002 | Listing with an initial public offering of Rs1 bn |
| 2005 | Follow on public offering of Rs1 bn |
| 2006 | Opened representative office in Shenzhen, China |
| 2006 | Formed JV with Universal Sampo General Insurance Company |
| 2007 | Opened branch in Hong Kong |

Source: Company Data, PL Research

Other Interests

AllBank Finance: AllBank Finance Ltd (ABFL) is a wholly-owned subsidiary of Allahabad Bank. ABFL is engaged into merchant banking activities and offers various financial services such as IPO management, debt syndication, structured finance, QIPs, investment advisory, distribution of financial products among others.

Universal Sampo General Insurance Co Ltd: Universal Sampo is a joint venture between Allahabad Bank (30%), Indian Overseas Bank (19%), Karnataka Bank (15%), Dabur Investments (10%) and Sampo Japan Insurance Inc (26%). The JV was formed in 2006 and the company received license from IRDA in November 2007. The company is present across almost all product lines, mainly classified into property, marine, general accident, workmen compensation and motor insurance.

On the life insurance front, the bank does not have any joint venture but has a bancassurance tie up with LIC of India.

Financials

Income Statement

| | (Rs m) | | | | | |
|----------------------------------|---------------|---------------|---------------|---------------|----------------|----------------|
| Y/e March | FY07 | FY08 | FY09 | FY10E | FY11E | FY12E |
| Interest Earned from Advances | 32,483 | 44,598 | 54,944 | 60,372 | 81,710 | 108,008 |
| Interest Earned from Investments | 15,365 | 16,695 | 18,494 | 22,429 | 26,257 | 30,752 |
| Others | 991 | 419 | 210 | 1,298 | 2,061 | 2,932 |
| Total Interest Income | 48,839 | 61,712 | 73,647 | 84,099 | 110,028 | 141,692 |
| Interest expense | 31,331 | 44,989 | 52,061 | 57,814 | 75,655 | 98,573 |
| Net Interest Income | 17,507 | 16,723 | 21,587 | 26,285 | 34,373 | 43,119 |
| <i>Growth (%)</i> | <i>11.0</i> | <i>(4.5)</i> | <i>29.1</i> | <i>21.8</i> | <i>30.8</i> | <i>25.4</i> |
| Treasury Income | (312) | 4,710 | 5,727 | 5,750 | 2,500 | 3,000 |
| Non Treasury Non Interest Income | 4,076 | 4,937 | 5,692 | 8,271 | 10,397 | 12,721 |
| Non Interest Income | 3,764 | 9,648 | 11,419 | 14,021 | 12,897 | 15,721 |
| Total Income | 52,603 | 71,360 | 85,067 | 98,120 | 122,925 | 157,413 |
| <i>Growth (%)</i> | <i>23.8</i> | <i>35.7</i> | <i>19.2</i> | <i>15.3</i> | <i>25.3</i> | <i>28.1</i> |
| Operating Expense | 10,272 | 11,576 | 13,995 | 15,029 | 17,398 | 20,087 |
| Operating Profit | 10,999 | 14,795 | 19,012 | 25,277 | 29,871 | 38,753 |
| <i>Growth (%)</i> | <i>10.0</i> | <i>34.5</i> | <i>28.5</i> | <i>33.0</i> | <i>18.2</i> | <i>29.7</i> |
| NPA Provisions | 900 | 2,686 | 3,132 | 6,371 | 5,586 | 7,030 |
| Investment Provisions | (1,690) | (22) | (2,492) | - | - | - |
| Total Provisions | 2,645 | 3,574 | 8,254 | 7,149 | 7,607 | 9,097 |
| PBT | 8,354 | 11,221 | 10,758 | 18,128 | 22,264 | 29,657 |
| Tax Provisions | 852 | 1,474 | 3,072 | 5,257 | 6,679 | 8,897 |
| <i>Effective Tax Rate (%)</i> | <i>10.2</i> | <i>13.1</i> | <i>28.6</i> | <i>29.0</i> | <i>30.0</i> | <i>30.0</i> |
| PAT | 7,501 | 9,747 | 7,686 | 12,871 | 15,585 | 20,760 |
| <i>Growth (%)</i> | <i>6.2</i> | <i>29.9</i> | <i>(21.1)</i> | <i>67.5</i> | <i>21.1</i> | <i>33.2</i> |

Source: Company Data, PL Research

Balance Sheet

| | (Rs m) | | | | | |
|----------------------------|----------------|----------------|----------------|------------------|------------------|------------------|
| Y/e March | FY07 | FY08 | FY09 | FY10E | FY11E | FY12E |
| Par Value | 10 | 10 | 10 | 10 | 10 | 10 |
| No. of equity shares | 447 | 447 | 447 | 447 | 447 | 447 |
| Equity | 4,467 | 4,467 | 4,467 | 4,467 | 4,467 | 4,467 |
| Networth | 36,385 | 44,768 | 52,211 | 58,520 | 69,822 | 83,578 |
| Adj. Networth | 31,983 | 40,770 | 47,989 | 55,681 | 66,250 | 79,573 |
| Deposits | 595,437 | 716,164 | 849,718 | 1,002,667 | 1,223,254 | 1,516,835 |
| <i>Growth (%)</i> | <i>22.8</i> | <i>20.3</i> | <i>18.6</i> | <i>18.0</i> | <i>22.0</i> | <i>24.0</i> |
| Low Cost deposits | 226,115 | 258,087 | 293,976 | 350,933 | 428,139 | 530,892 |
| <i>% of total deposits</i> | <i>38.0</i> | <i>36.0</i> | <i>34.6</i> | <i>35.0</i> | <i>35.0</i> | <i>35.0</i> |
| Total Liabilities | 676,759 | 829,435 | 976,578 | 1,154,801 | 1,405,806 | 1,738,365 |
| Net Advances | 412,900 | 497,205 | 588,018 | 698,302 | 878,768 | 1,128,047 |
| <i>Growth (%)</i> | <i>41.7</i> | <i>20.4</i> | <i>18.3</i> | <i>18.8</i> | <i>25.8</i> | <i>28.4</i> |
| Investments | 187,461 | 234,003 | 296,511 | 330,880 | 366,976 | 424,714 |
| Total Assets | 676,759 | 829,435 | 976,578 | 1,154,801 | 1,405,806 | 1,738,365 |

Source: Company Data, PL Research

**Key Ratios**

| Y/e March | FY07 | FY08 | FY09 | FY10E | FY11E | FY12E |
|----------------------------------|--------|--------|--------|--------|--------|--------|
| Valuation | | | | | | |
| CMP (Rs) | 138 | 138 | 138 | 138 | 138 | 138 |
| Equity (m) | 447 | 447 | 447 | 447 | 447 | 447 |
| Market Cap (Rs m) | 61,801 | 61,801 | 61,801 | 61,801 | 61,801 | 61,801 |
| Market Cap to AUM (%) | 9.1 | 7.5 | 6.3 | 5.4 | 4.4 | 3.6 |
| EPS (Rs) | 16.8 | 21.8 | 17.2 | 28.8 | 34.9 | 46.5 |
| Book Value (Rs) | 80.4 | 97.2 | 111.5 | 136.8 | 167.5 | 209.3 |
| Adjusted Book Value (Rs) | 76.7 | 93.9 | 108.0 | 138.3 | 169.5 | 211.6 |
| P/E (x) | 8.2 | 6.3 | 8.0 | 4.8 | 4.0 | 3.0 |
| P/BV (x) | 1.7 | 1.4 | 1.2 | 1.0 | 0.8 | 0.7 |
| P/ABV (x) | 1.8 | 1.5 | 1.3 | 1.0 | 0.8 | 0.7 |
| DPS (Rs) | 3.0 | 3.5 | 2.5 | 3.0 | 3.5 | 4.0 |
| Payout ratio (incl. Div Tax) (%) | 20.9 | 18.8 | 17.0 | 12.2 | 11.7 | 10.1 |
| Dividend Yield (%) | 2.2 | 2.5 | 1.8 | 2.2 | 2.5 | 2.9 |
| Profitability (%) | | | | | | |
| Cost of Deposit | 5.6 | 6.6 | 6.2 | 5.7 | 6.2 | 6.6 |
| Yield on advances | 9.2 | 9.8 | 10.1 | 9.4 | 10.4 | 10.8 |
| Yield on Investments | 8.4 | 7.9 | 7.0 | 7.2 | 7.5 | 7.8 |
| NIM | 3.0 | 2.3 | 2.5 | 2.5 | 2.7 | 2.8 |
| RoAA | 1.2 | 1.3 | 0.9 | 1.2 | 1.2 | 1.3 |
| RoAE | 18.5 | 20.1 | 13.9 | 20.1 | 20.3 | 22.3 |
| Efficiency (%) | | | | | | |
| Cost-Income ratio | 48.3 | 43.9 | 42.4 | 37.3 | 36.8 | 34.1 |
| C-D ratio | 69.3 | 69.4 | 69.2 | 69.6 | 71.8 | 74.4 |
| Business per Employee (Rs m) | 49.5 | 60.4 | 70.3 | 85.8 | 105.6 | 125.4 |
| Net Profit per Employee (Rs m) | 0.4 | 0.5 | 0.4 | 0.6 | 0.8 | 1.0 |
| Business per Branch (Rs m) | 489.5 | 563.0 | 636.2 | 736.4 | 890.7 | 1086.2 |
| Net Profit per Branch (Rs m) | 3.6 | 4.5 | 3.4 | 5.6 | 6.6 | 8.5 |
| Asset Quality | | | | | | |
| Gross NPAs (Rs m) | 10,936 | 10,105 | 10,683 | 14,193 | 17,861 | 20,021 |
| Net NPAs (Rs m) | 4,402 | 3,998 | 4,221 | 2,839 | 3,572 | 4,004 |
| Gross NPAs to Gross Advances (%) | 2.6 | 2.0 | 1.8 | 2.0 | 2.0 | 1.8 |
| Net NPAs to Net Advances (%) | 1.1 | 0.8 | 0.7 | 0.4 | 0.4 | 0.4 |
| NPA Coverage (%) | 59.7 | 60.4 | 60.5 | 80.0 | 80.0 | 80.0 |

Source: Company Data, PL Research

Appendix

Current and likely CMDs of various public sector banks

| Name | Current CMDs | Expected retirement date | Most Likely candidates | Current responsibilities |
|------------------|-----------------------|--------------------------|---------------------------|---|
| Allahabad Bank* | Mr. J P Dua | Aug-12 | | |
| Andhra Bank | Mr. R S Reddy | Aug-10 | Mr. R Ramachandran | ED - Syndicate Bank |
| Bank of Maha | Mr. Allen C A Pereira | Sep-10 | Mr. A S Bhattacharya | ED - Indian Bank |
| Canara Bank | Mr. A C Mahajan | Jul-10 | Mr. Basant Seth / S Raman | CMD - Syndicate Bank / ED - Union Bank of India |
| Corporation Bank | Mr. Jag Mohan Garg | Jul-10 | Mr. P Ramnath | ED - Central Bank |
| IDBI Bank | Mr. Yogesh Agarwal | Jun-10 | Mr. R M Malla | CMD - SIDBI |
| Indian Bank | Mr. Sundarrajan | Mar-10 | Mr. Bhasin | ED - Untd Bank of India |
| Indian Overseas | Mr. S A Bhat | 2010 | Due for announcement | |
| Oriental Bank | Mr. T Y Prabhu | Dec-10 | Mr. N Pydah | ED - Punjab National Bank |
| Syndicate Bank | Mr. Basant Sheth | Feb-12 | Mr. Basant Seth / S Raman | CMD - Syndicate Bank / ED - Union Bank of India |
| UCO Bank | Mr. S K Goel | Sep-10 | Mr. A Kaul | ED - Central Bank |
| United Bank | Mr. S C Gupta | Feb-10 | Mr. Bhaskar Sen | ED - Dena Bank |

Source: BSE, Media Reports

* We believe the likelihood of Mr. Dua moving out of Allahabad Bank is minimal because generally a PSB chairman needs to serve as a CMD of any bank for at least a year for him to be promoted, which currently reduces the chance of him being shifted to another bank. Recent media reports suggest that for all mid sized PSU banks (except IOB), prospective CMDs have been identified to fill up the vacancies.

Key inputs / assumptions (YoY change unless mentioned)

| | FY08 | FY09 | FY10E | FY11E | FY12E |
|--------------------------------|---------|---------|---------|---------|---------|
| Balance Sheet items | | | | | |
| Advances | 20.4% | 18.3% | 18.8% | 25.8% | 28.4% |
| CD ratio | 69.4% | 69.2% | 69.6% | 71.8% | 74.4% |
| Deposits | 20.3% | 18.6% | 18.0% | 22.0% | 24.0% |
| CASA | 14.1% | 13.9% | 19.4% | 22.0% | 24.0% |
| CASA ratio | 36.0% | 34.6% | 35.0% | 35.0% | 35.0% |
| Business | 20.3% | 18.5% | 18.3% | 23.6% | 25.8% |
| Investments | 24.8% | 26.7% | 11.6% | 10.9% | 15.7% |
| ID ratio | 32.7% | 34.9% | 33.0% | 30.0% | 28.0% |
| Assets | 22.6% | 17.7% | 18.3% | 21.7% | 23.7% |
| Profit & Loss items | | | | | |
| Net Interest Income | -4.5% | 29.1% | 21.7% | 30.9% | 25.4% |
| Non-interest income | 156.3% | 18.4% | 22.8% | -8.0% | 21.9% |
| Treasury (Rs m) | 4,710.3 | 5,727.0 | 5,750.0 | 2,500.0 | 3,000.0 |
| CEB | 17.7% | 24.8% | 20.7% | 22.6% | 23.7% |
| Core operating profits | -12.0% | 34.7% | 39.7% | 41.0% | 31.8% |

Source: PL Research



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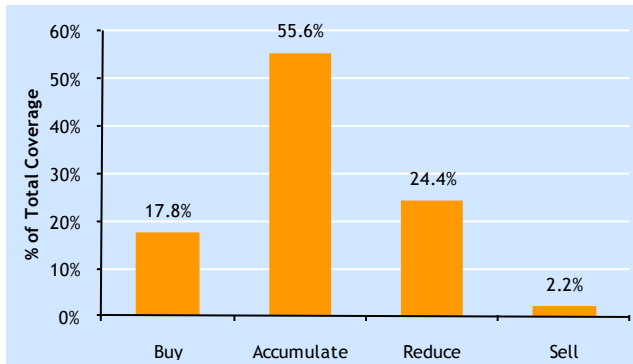
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Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India

Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

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