

Andhra Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,219	ANDB IN
	REUTERS CODE
S&P CNX: 3,605	ADBK.BO

2 May 2006

Buy
Rs85
Previous Recommendation: Buy

Equity Shares (m)	485.0
52-Week Range	115/74
1,6,12 Rel.Perf.(%)	-3/-55/-106
M.Cap. (Rs b)	41.2
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	4,856	10.0	-23.0	8.5	1.4	14.4	20.4	1.3	1.4
3/07E	18,611	5,616	11.6	15.6	7.3	1.2	13.8	18.1	1.3	1.3
3/08E	21,420	6,596	13.6	17.5	6.2	1.1	13.4	18.6	1.3	1.1

Andhra Bank reported flat YoY growth in earnings to Rs1.38b in 4QFY06 on the back of 17% net interest income (NII) growth but lower other income due to fall in treasury profits. Business growth momentum has remained strong with 26% loan growth and 23% deposit growth. Asset quality has remained strong, with net NPAs one of the lowest in the industry at 0.24% in 4QFY05.

- ✍ NII grows by 17%; margins decline
- ✍ Treasury gains decline, fee income increase negligible
- ✍ Asset quality remains one of the best amongst public sector banks (PSB)

FY06 has been a year when the bank's treasury gains have been modest after constituting a substantial chunk in FY05. Going forward, we expect Andhra Bank's strong business growth coupled with the lower provisioning requirement to grow its core income. At CMP, the stock offers a dividend yield in excess of 4%. The share currently trades at 6.2x FY08E earnings and 1.1x FY08E book value. We maintain **Buy** with our price target of Rs102.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY05				FY06				FY05	FY06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Interest Income	5,605	5,676	5,597	5,856	6,172	6,353	6,986	7,232	22,735	26,744
Interest Expense	2,926	2,943	2,979	3,196	3,429	3,468	4,028	4,130	12,044	15,054
Net Interest Income	2,679	2,733	2,618	2,660	2,743	2,886	2,959	3,102	10,690	11,690
% Change (Y-o-Y)	43.2	14.5	10.7	14.5	2.4	5.6	13.0	16.6	17.4	9.3
Other Income	1,948	2,612	1,463	1,511	772	1,179	1,189	1,441	7,534	4,581
Net Income	4,627	5,345	4,081	4,171	3,515	4,065	4,148	4,543	18,224	16,270
% Change (Y-o-Y)	20.1	19.7	17.2	5.8	-13.9	-24.0	1.6	8.9	14.7	-10.7
Operating Expenses	1,982	1,943	2,064	2,306	1,914	2,060	2,118	2,488	8,295	8,580
Operating Profit	2,645	3,402	2,017	1,865	1,601	2,005	2,030	2,055	9,930	7,691
Other Provisions	368	1,949	274	-91	449	146	296	1,225	2,501	2,117
Profit before Tax	2,277	1,453	1,744	1,955	1,152	1,859	1,734	830	7,429	5,574
Tax Provisions	775	360	525	568	300	530	445	-556	2,228	719
Net Profit	1,502	1,093	1,219	1,388	852	1,329	1,289	1,386	5,201	4,855
% Change (Y-o-Y)	29.3	-20.2	30.3	21.4	-43.3	21.5	5.8	-0.1	12.2	-6.7
Cost to Income Ratio (%)	42.8	36.3	50.6	55.3	54.5	50.7	51.1	57.1	45.5	52.7
Interest Expense/Interest Income (%)	52.2	51.8	53.2	54.6	55.6	54.6	57.6	31.7	53.0	56.3
Other Income/Net Income (%)	42.1	48.9	35.9	36.2	22.0	29.0	28.7	31.7	41.3	28.2

E: MOST Estimates

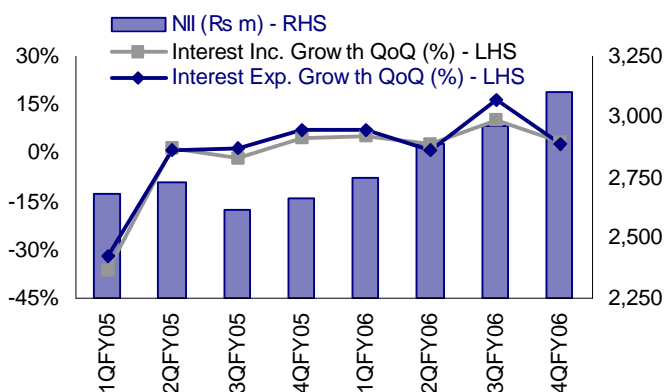
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NII grows 17% as loan growth remains strong

Net interest income has grown by 17% to Rs3.1b, as strong loan growth of 26% in FY06 has enabled the bank to increase its income from advances by 28% YoY.

TRENDS IN NII



Source: Company/Motilal Oswal Securities

Overall business of the bank grew by 25% to Rs564b from Rs454b in FY05. The advances portfolio expanded by 26% to Rs225b. Within this, retail loans increased by 36% constituting 22.5% of the bank’s total credit. Credit extended to the housing sector increased to Rs24b from Rs18.8b, recording a growth rate of 30%. Educational Loans have risen by 32% to Rs6.8b from Rs5.1b in FY05.

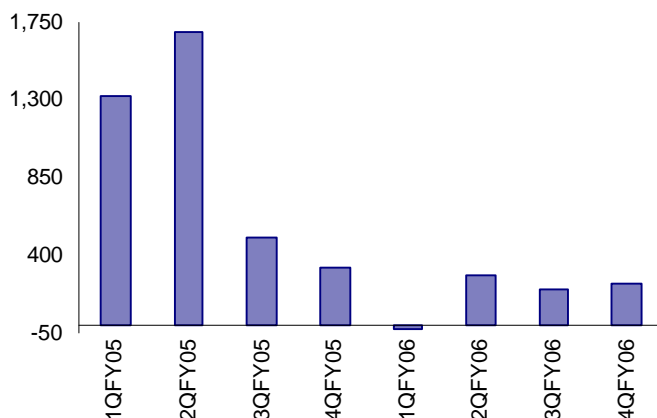
Priority Sector Advances stood at Rs89b (constituting 40.27% of NBC) registering a growth rate of 26.22 % from Rs71b in FY05. Advances for agriculture have risen by 32% to Rs41b (constituting 18.34% of NBC) from Rs31b. Credit extended to the SME sector increased to Rs24b recording a growth rate of 27% YoY.

Deposits grew 23% to Rs339b. This has led to expansion in the credit/deposit ratio on a YoY basis to 67% in FY06 from 65% in FY05. Low-cost deposits of the bank increased to Rs123b from Rs100b recording a growth rate of 23.68%.

Treasury profits decline sharply; fee income growth details

Treasury gains have declined sharply YoY to Rs233m in 4QFY06 from Rs336m. This also affected the bank’s overall non-interest income, which declined by 5% to Rs1.4b in 4QFY06 from Rs1.5b in 4QFY05. However, excluding trading gains, fee/other income has remained flat YoY at Rs1.2b, compared with Rs1.18b during 4QFY05. For FY06, treasury profits have declined to Rs708m from Rs3.85b in FY05.

TREND IN TREASURY PROFITS (RS M)



Source: Company/Motilal Oswal Securities

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 1.9% of gross bank credit at FY06. Net NPAs have been relatively stable at 0.24% YoY. As net NPAs stand at very low levels, the bank will have to make minimal provisions in the future. Also, recoveries would add directly to the bottom line. We expect the bank to maintain net NPAs at current levels in FY07 too.

Valuation and view

FY06 has been a year when the bank's treasury gains have been modest after constituting a substantial chunk in FY05. Going forward, we expect Andhra Bank's strong business growth coupled with the lower provisioning requirement to

grow its core income. At CMP, the stock offers a dividend yield in excess of 4%. The share currently trades at 6.2x FY08E earnings and 1.1x FY08E book value. We maintain **Buy** with our price target of Rs102.

Andhra Bank: an investment profile

Company description

Andhra Bank is a mid-sized public sector bank with dominant presence in southern India. It was incorporated in 1923 as a private sector bank but was nationalized in 1980. The bank has a widespread network of 1,764 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.

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 0.2% respectively.

Key investment risks

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

Recent developments

- ✎ The bank's second public issue (closed on 20 January 2006) of 85m equity shares of Rs10 each in a price band of Rs82-Rs90 was well received, with the issue being oversubscribed 11x. The pricing has been fixed at Rs90.
- ✎ Mr. Kalyan Mukherjee, earlier GM of UCO Bank, has taken over as the new ED of the bank.

Valuation and view

- ✎ The stock trades at 6.2x FY08E earnings and 1.1x FY08E book value.
- ✎ We maintain a **Buy** with a price target of Rs102.

Sector view

- ✎ Loan growth of 30% in FY06. Likely to remain strong in FY07
- ✎ 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
PE (x)	FY07E	7.3	6.4	6.4
	FY08E	6.2	5.4	5.0
P/ABV (x)	FY07E	1.3	1.6	1.3
	FY08E	1.1	1.3	1.1
RoE (%)	FY07E	18.1	25.1	20.9
	FY08E	18.6	24.1	23.2
RoA (%)	FY07E	1.3	1.4	1.0
	FY08E	1.3	1.5	1.1

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/FDIs	17.5	15.8	16.2
Others	24.4	17.2	18.5

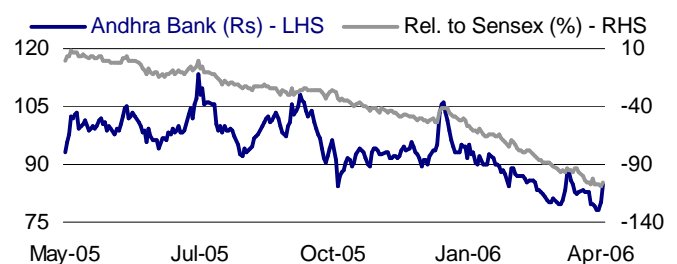
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	11.6	10.8	7.4
FY08	13.6	12.7	7.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
85	102	20.0	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	31,118	36,620
Interest Expended	13,167	12,044	15,054	17,627	20,776
Net Interest Income	9,106	10,690	11,690	13,491	15,843
Change (%)	20.9	17.4	9.4	15.4	17.4
Other Income	6,780	7,534	4,581	5,120	5,577
Net Income	15,886	18,224	16,271	18,611	21,420
Change (%)	17.1	14.7	-10.7	14.4	15.1
Operating Expenses	6,585	8,295	8,580	9,421	10,358
Operating Income	9,302	9,930	7,691	9,189	11,061
Change (%)	23.3	6.7	-22.5	19.5	20.4
Other Provisions	2,426	2,501	2,116	1,800	1,900
PBT	6,876	7,429	5,575	7,389	9,161
Tax	2,241	2,228	719	1,773	2,565
Tax Rate (%)	32.6	30.0	12.9	24.0	28.0
PAT	4,635	5,201	4,856	5,616	6,596
Change (%)	15.1	12.2	-6.6	15.6	17.5
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	24,329	28,150	32,952
Net Worth	14,526	18,370	29,179	33,000	37,802
Deposits	229,405	275,507	339,220	393,495	452,519
Change (%)	8.9	20.1	23.1	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
Total Liabilities	270,089	327,287	405,149	467,656	536,421
Current Assets	25,732	35,233	60,330	68,636	73,704
Investments	103,174	106,463	112,851	121,879	131,629
Change (%)	-19	3.2	6.0	8.0	8.0
Advances	128,855	175,168	220,471	264,565	317,478
Change (%)	119	35.9	25.9	20.0	20.0
Net Fixed Assets	1,799	1,873	2,093	2,419	2,640
Other Assets	10,530	8,550	9,405	10,157	10,970
Total Assets	270,089	327,287	405,149	467,656	536,421

ASSUMPTIONS					
(%)					
Deposit Growth	8.9	20.1	23.1	16.0	15.0
Advances Growth	119	35.9	25.9	20.0	20.0
Investments Growth	-19	3.2	6.0	8.0	8.0
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 O S t Estimates

RATIOS					
Y/E MARCH	2004	2005	2006	2007E	2008E
Spreads Analysis (%)					
Avg. Yield - Earning Assets	9.1	8.0	7.8	7.8	7.9
Avg. Cost-Int. Bear. Liab.	5.7	4.6	4.7	4.7	4.8
Interest Spread	3.4	3.4	3.1	3.2	3.2
Net Interest Margin	3.7	3.8	3.4	3.4	3.4

Profitability Ratios (%)					
RoE	36.1	31.6	20.4	18.1	18.6
RoA	18	17	13	13	13
Int. Expended/Int. Earned	59.1	53.0	56.3	56.6	56.7
Other Inc./Net Income	42.7	41.3	28.2	27.5	26.0

Efficiency Ratios (%)					
Op. Exps./Net Income	41.4	45.5	52.7	50.6	48.4
Empl. Cost/Op. Exps.	62.2	65.0	57.4	55.7	54.2
Busi. per Empl. (Rs m)	26.1	30.9	38.9	46.9	55.0
NP per Empl. (Rs lac)	3.5	4.0	3.7	4.3	5.1

Asset-Liability Profile (%)					
Adv./Deposit Ratio	56.2	63.6	65.0	67.2	70.2
Invest./Deposit Ratio	45.0	38.6	33.3	31.0	29.1
G-Sec/Invest. Ratio	87.5	83.9	87.0	88.7	88.7
Gross NPAs to Adv.	4.6	2.5	1.8	1.6	1.5
Net NPAs to Adv.	0.9	0.3	0.2	0.3	0.4
CAR	13.7	12.1	14.4	13.8	13.4
Tier 1	8.2	8.0	11.2	10.7	10.4

VALUATION					
Book Value (Rs)	36.3	45.9	60.2	68.0	77.9
Price-BV (x)	2.3	19	14	12	11
Adjusted BV (Rs)	34.4	45.1	59.6	67.0	76.1
Price-ABV (x)	2.5	19	14	13	11
EPS (Rs)	11.6	13.0	10.0	11.6	13.6
EPS Growth (%)	15.1	12.2	-23.0	15.6	17.5
Price-Earnings (x)	7.3	6.5	8.5	7.3	6.2
OPS (Rs)	23.3	24.8	15.9	18.9	22.8
OPS Growth (%)	23.3	6.7	-36.1	19.5	20.4
Price-OP (x)	3.7	3.4	5.4	4.5	3.7

E: M O S t 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 |

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