

Andhra Bank

Bloomberg: ANDB IN Equity

Recommendation: BUY

Reuters: ADBK.BO

No Change

RESULT UPDATE

Going Strong

- PAT growth of 19.4% for 4QFY10 to Rs 2.4bn, 60% for FY10 to Rs 10.5 bn
- Building in 26% loan book growth during FY11E; SMEs and retail to lead
- Margins at 3.44% for Q4 and 3.2% for FY10; likely to dip by 10-15bps
- Gross NPA at 0.6% and net NPA at 0.17%
- Maintain **BUY** with a marginally revised TP of Rs150

Andhra Bank reported a good set of numbers on the operational front for 4QFY10 with NII at Rs6.56bn, far ahead of our expectations and net profit at Rs2.4bn, a little ahead of our expectations. Although the gross and net NPAs moved up marginally during the quarter in absolute terms (in line with our expectations), the ratios have remained stable while provisioning coverage continues to be healthy (above 80%).

Valuation and recommendation: We maintain our **BUY** recommendation on the stock with a marginally revised TP of Rs150. Our FY11E estimates have undergone a marginal upward revision as a result of which our FY11E ABVPS estimate has inched up to Rs110 (up 4% from our earlier estimate of Rs105). At its CMP of Rs133, the stock quotes at 1.3x our FY11E ABVPS of Rs110.

Combined with a ~5% dividend yield, we continue to back Andhra Bank as one of the safest and consistent-performing investments within the mid-cap banking universe.

Exhibit 1: Quarterly performance

(Rs mn)	Q4FY10	Q4FY09	% chg	FY10	FY09	% chg
Interest on advances	13,744	11,988	14.6	51,613	42,151	22.4
Interest on investment	3,273	2,852	14.8	11,883	10,990	8.1
Interest on bal. with RBI	46	58	(21.9)	158	377	(58.0)
Other interest	17	169	(90.0)	75	229	(67.5)
Interest income	17,080	15,067	13.4	63,729	53,746	18.6
Interest expenditure	10,518	11,114	(5.4)	41,781	37,477	11.5
Net interest income	6,562	3,953	66.0	21,948	16,269	34.9
Other income	2,691	3,204	(16.0)	9,646	7,654	26.0
Operating profit	5,272	4,318	22.1	18,098	12,880	40.5
Prov & cont	2,229	1,856	20.1	3,740	3,900	(4.1)
Prov for taxes	640	450	42.2	3,900	2,450	59.2
Net profit	2,403	2,012	19.4	10,459	6,530	60.2
EPS (Rs)	5.0	4.1	19.4	21.6	13.5	60.2

Source: Company, Ambit Capital Research

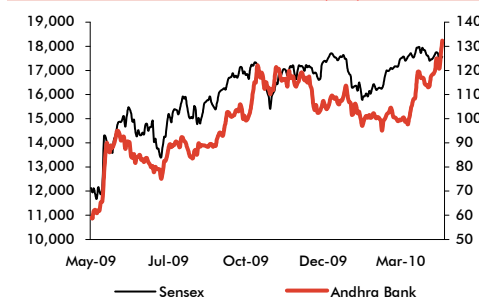
Recommendation

CMP:	Rs133
Target Price (Period): Rs	150
Previous TP: Rs	140
Upside(%)	7%
BVPS (FY11E): Rs	110
% change from previous	5%

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	22.3	24.7	138.3	26.9
Rel. to Sensex	22.1	16.2	54.7	26.2

Performance (%)



Stock Information

Mkt cap:	Rs64,190mn/US\$1,442mn
52-wk H/L:	134 / 54
Avg. daily vol. BSE (mn):	3
Beta:	1.0
BSE Sensex:	17,559
Nifty:	5,278

Source: Company, Ambit Capital research

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The Dolphin Gets Moving

Andhra Bank reported a robust all-round performance, driven by a healthy growth in NII, robust fee income growth and improved efficiency. Although these were partially offset by higher provisioning during the quarter, the overall asset quality still remains strong with provision coverage upwards of 80%.

Balanced business growth continues

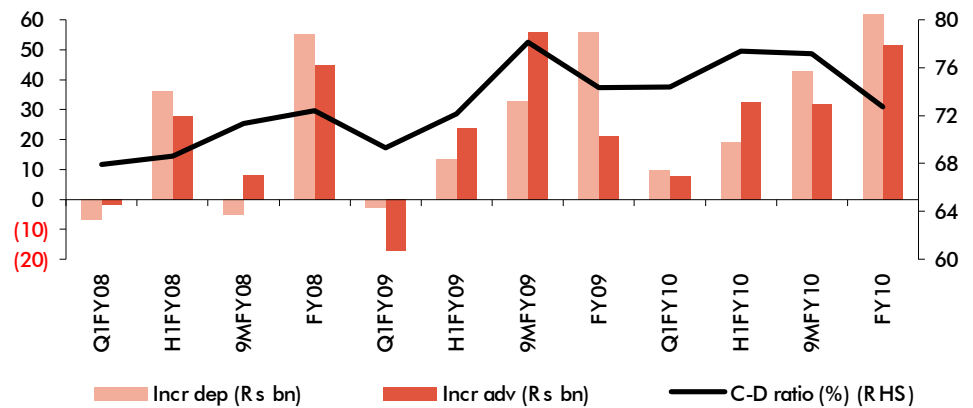
Andhra Bank witnessed a balanced growth in its business, with the loan book at Rs565bn and deposit base at Rs774bn. Loan book growth trailed the growth in deposits as a result of which the C-D ratio cooled off from 77% to ~73%.

Exhibit 2: Balance business performance

Business performance (Rs bn)	FY10	FY09	% chg	9MFY10	% chg
Deposits	776.88	593.90	30.8	665.47	16.7
Advances	565.05	444.28	27.2	513.52	10.0
Business	1,341.93	1,038.18	29.3	1,178.99	13.8
C-D ratio (%)	72.7	74.8		77.2	

Source: Company, Ambit Capital research

Exhibit 3: High incremental deposit growth continues - allows headroom on C-D ratio



Source: Company, Ambit Capital research

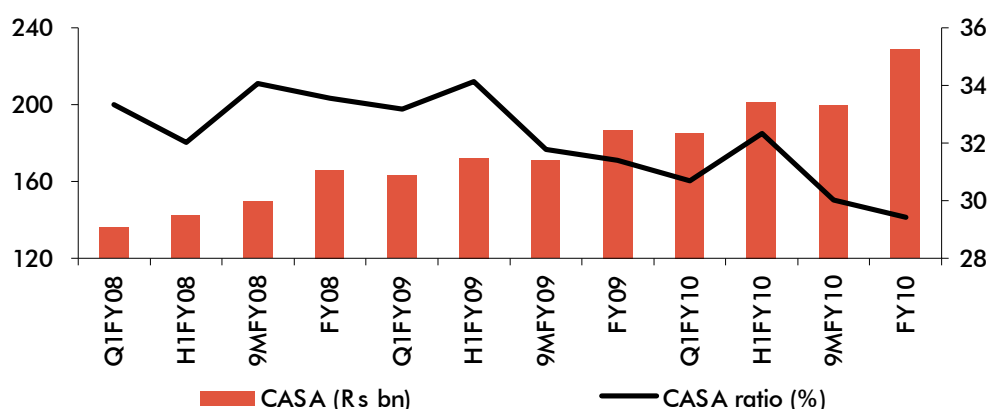
Andhra Bank continues its focus on restructuring both sides of the balance sheet. While the bank has re-aligned its assets side of the balance sheet by shedding low-yielding assets, ANDB has simultaneously shed bulk deposits in a conscious attempt to reduce volatility in funding costs.

Exhibit 4: Liability side restructuring - QoQ movement in deposit mix (Rs bn)

	Q1FY09	H1FY09	9MFY09	FY09	Q1FY10	H1FY10	FY10
Current deposits	36.98	45.99	44.83	52.16	45.14	56.58	67.46
Savings deposits	126.18	126.41	126.33	134.38	140.12	144.82	161.18
CASA deposits	163.16	172.40	171.16	186.54	185.26	201.4	228.64
Retail term deposits (core deposits)	220.71	226.75	275.66	358.74	385.35	405.13	511.56
Bulk deposits	107.88	106.00	91.13	48.62	33.08	16.26	36.68
Term deposits	328.59	332.75	366.79	407.36	418.43	421.39	548.24
Total deposits	491.75	505.15	537.95	593.90	603.69	622.79	776.88

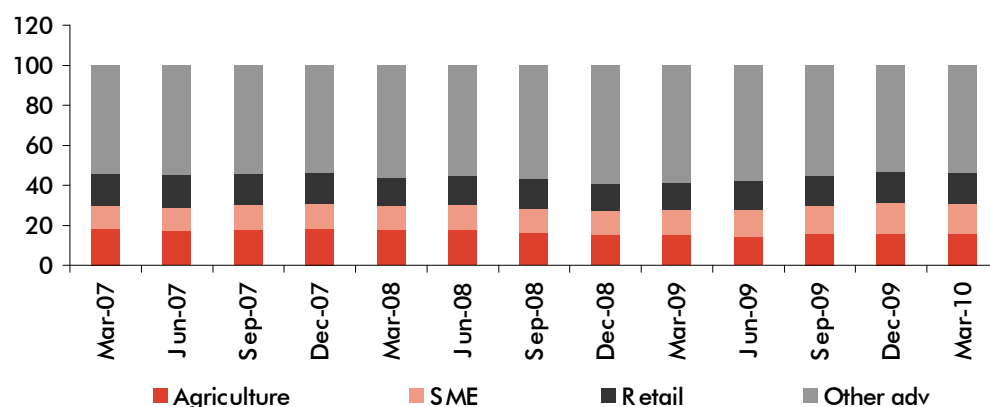
Source: Company, Ambit Capital research

However, CASA mobilization remains an area of relative weakness for the bank, with the CASA ratio below 30% (as against ~34% as of Mar'09).

Exhibit 5: Growth in absolute CASA - however, ratio dips

Source: Company, Ambit Capital research

On the other hand, the credit growth was driven primarily by MSME (55% YoY growth), retail (48% YoY growth) and agriculture (34% YoY growth).

Exhibit 6: Increasing exposure to SMEs and retail advances

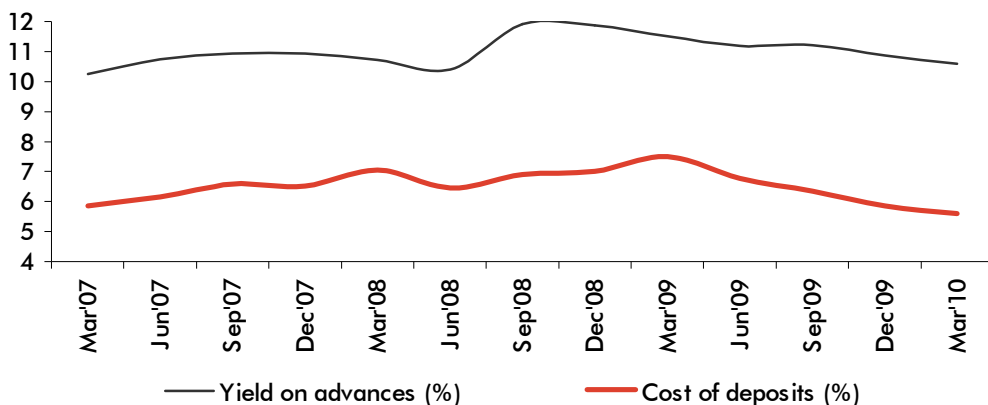
Source: Company, Ambit Capital research

Our FY11E estimates build in a 26.3% growth in advances predominantly on the back of continued focus on SME and retail segments (in line with management guidance). We believe that retail lending will continue to drive incremental loan book growth. Although the share of retail lending within the overall loan book mix has increased by more than 2 percentage points over the last year, we believe that Andhra Bank's retail book exposure remains in relatively safer asset classes such as gold, home and educational loans.

Core operating income exhibits strength

Andhra Bank has done extremely well on the NII front recording highest growth during the quarter at 66% yoy and a record high growth in NII of 35% yoy for the full year. The bank reported NIMs at 3.44% for Q4FY10 as against 2.63% during Q4FY09. On a full year basis, the NIMs stood at 3.21% for FY10 as against 3.03% during FY09, primarily as a result of a steeper decline in the cost of funds vis-à-vis the yield on advances.

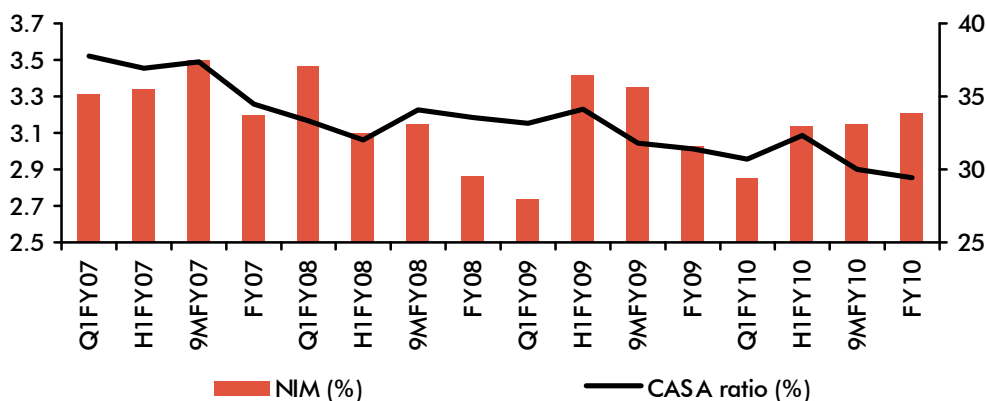
Exhibit 7: Improvement in margins driven from both sides of the balance sheet



Source: Company, Ambit Capital research

Although the management team at Andhra Bank remains confident of maintaining full year margins at 3.2%, we expect the bank to witness a marginal dip in margins as a result of the lag in lending rate movement vis-à-vis the funding costs (which have already begun rising due to the impact of higher cost of savings deposits). Also, with CASA mobilization likely to lag the mobilization of term deposits, we expect cost of deposits to rise a little faster than the yield on advances.

Exhibit 8: CASA accretion key to maintaining or enhancing NIMs from current levels

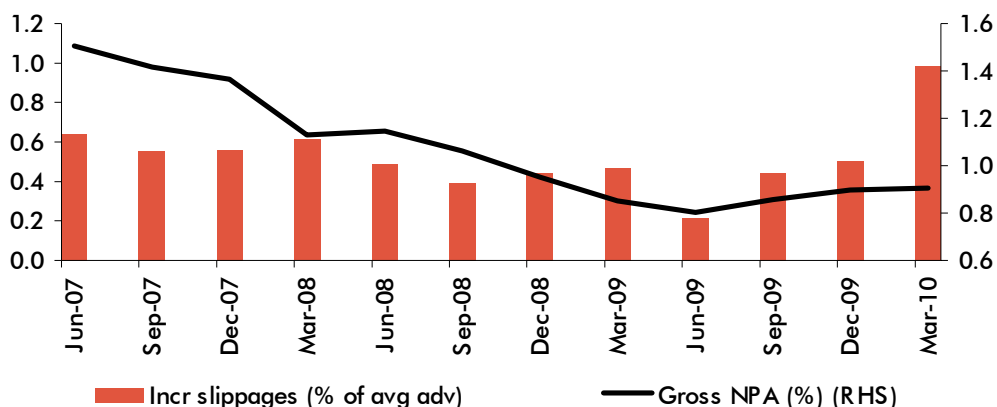


Source: Company, Ambit Capital research

Asset quality - continues to be superior

Despite witnessing a couple of large infrastructure accounts slipping into the NPA category during the quarter (due to non-closure of CDR proceedings), asset quality continues to be healthy. Andhra Bank’s portfolio of restructured advances (at ~Rs30bn), as a proportion of the loan book, is a little higher than the system median. Although the performance of this restructured pool of assets has been encouraging from the evidence of relatively low slippages (compared to the rest of the system), this needs to be closely monitored.

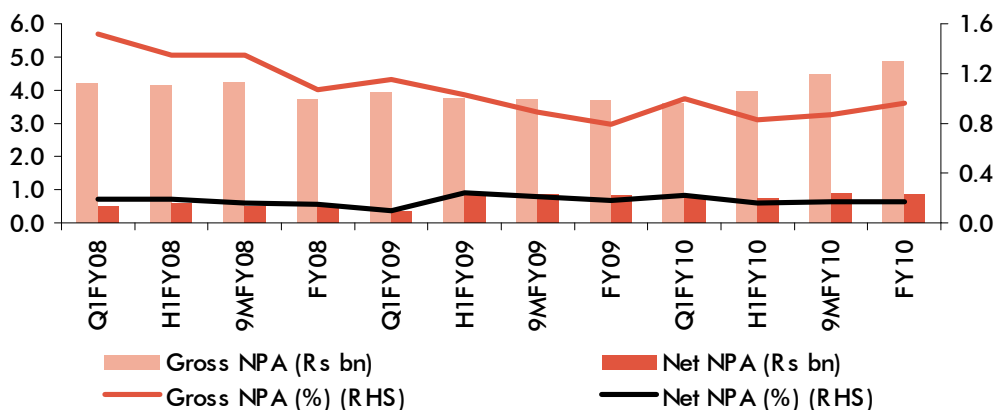
Exhibit 9: Rise in incremental slippages may be a one-off - needs further monitoring



Source: Company, Ambit Capital research

Our FY11E estimates build in a marginal deterioration in asset quality and a higher provisioning burden for Andhra Bank in order to maintain the current provisioning coverage at upwards of 80%.

Exhibit 10: Healthy asset quality - high on coverage



Source: Company, Ambit Capital research

Capital Adequacy - will need Tier-I infusion by Mar'11

The bank’s capital adequacy is currently at 13.93% with the Tier I ratio at 8.18%. Consistent with the Union Government stance, the management at Andhra Bank is intent on keeping a Tier-I ratio at upwards of 8%. The bank has submitted its resource plan (until FY12) and is confident of receiving funds from the government during this fiscal.

However, even without any capital infusion, we expect Andhra Bank to generate a 25% growth in its lending during the current fiscal.

Exhibit 11: Incremental lending mathematics - what the existing capital allows

FY10 profits (Rs mn)	10,459
Dividend per share (Rs)	5.0
No. of shares (mn)	485.0
Dividend payout (Rs mn)	2,425
Retained earnings (Rs mn)	8,034
Tier-I (%)	8%
Risk weighted assets that can be assumed (Rs mn)	100,420
Avg risk weights (%)	90%
Advances (Rs mn)	111,578
Current advances (Rs mn)	561,518
Growth (%)	19.9

Source: Company, Ambit Capital research

In addition, assuming (on a very conservative basis) that Andhra Bank generates profits to the tune of Rs2bn every quarter (adjusted for year-end dividend payout), the bank can generate growth to the tune of ~25% on the existing capital without facing any capital constraints. We assume no capital infusion in our numbers - our FY11E estimates for Andhra Bank are entirely on a business-as-usual basis.

Insurance business

Andhra Bank's foray as a life insurance underwriter took off during Nov'09 with IndiaFirst Life Insurance Company Limited, their 30% joint venture with Bank of Baroda (44% stake) and Legal and General (26% stake). The management has guided for insurance premium origination to the tune of Rs2.5bn annually on the life insurance venture. We are not yet building any material contribution from this venture into our estimates for either Andhra Bank or Bank of Baroda.

The bank is especially handicapped as a result of the recent regulatory uncertainty surrounding ULIPs, given that the insurance venture has only recently begun operations and has very little concurrent business that can be continued during the interim.

Operational re-engineering

During the year, verticals have been created at Head Office for major business segments such as Resources, Large Corporate, Mid Corporate, Retail, MSME, New Branches and Stable State Branches. These verticals are headed by GMs and DGMs who are responsible for achieving specific targets. The bank opened 125 new branches during the year, predominantly in the northern, western and eastern regions.

Exhibit 12: Profit & loss

Rs bn	FY08	FY09	FY10E	FY11E
Interest income	42.10	53.75	63.73	84.45
Interest expense	28.70	37.48	41.78	56.61
Net Interest Income	13.40	16.27	21.95	27.84
% Growth	-5.50	21.45	34.91	26.87
Treasury Income	1.76	2.73	3.07	2.70
Other non-interest income	4.50	4.92	6.56	8.32
Net operating income	19.66	23.92	31.58	38.86
Employee expenses	5.09	6.24	8.24	9.89
Other operational expenses	4.00	4.80	5.25	5.97
Operating profit	10.57	12.88	18.09	23.00
% Growth	13.50	21.86	40.46	27.12
Tax	3.42	2.45	3.87	5.70
Loan Loss Provisions	1.39	3.90	3.75	4.00
Net Profit	5.76	6.53	10.47	13.30
% growth	9.03	13.46	60.27	27.06

Source: Company, Ambit Capital research

Exhibit 13: Balance sheet

Rs bn	FY08	FY09	FY10E	FY11E
Capital	4.85	4.85	4.85	4.85
Reserves and surplus	27.64	31.62	39.42	49.32
Deposits	494.37	593.90	776.88	963.04
Borrowings	5.91	13.11	15.11	15.11
Other liab & prov	33.48	41.21	64.82	75.47
Total liabilities	566.24	684.69	901.08	1,107.79
Cash & balances with RBI	49.02	48.53	66.95	85.97
Balances with banks	7.93	4.34	42.09	35.90
Investments	148.98	169.11	208.81	239.34
Advances	342.38	441.39	561.52	709.28
Fixed assets	2.19	3.35	3.56	4.09
Other assets	15.74	17.96	18.16	33.20
Total assets	566.24	684.69	901.08	1,107.79

Source: Company, Ambit Capital research

Exhibit 14: Business ratio

	FY08	FY09	FY10E	FY11E
Credit-Deposit(%)	68.4	72.0	73.2	73.0
Investment / Deposit (%)	32.1	29.2	27.6	25.8
Cash / Deposit (%)	10.7	10.1	11.8	13.3
RoAA (%)	1.1	1.0	1.3	1.3
RoE (%)	18.0	18.9	25.9	27.0
Dividend Yield (%)	3.0	3.4	3.8	4.5

Source: Company, Ambit Capital research

Exhibit 15: Per share data

	FY08	FY09	FY10E	FY11E
BVPS (Rs)	67.0	75.2	91.3	111.7
Adj BVPS (Rs)	65.9	73.6	89.3	109.8
P/ABV (x)	2.0	1.8	1.5	1.2
EPS (Rs)	11.9	13.5	21.6	27.4
EPS growth (%)	9.0	13.5	60.3	27.1
P/E (x)	11.2	9.9	6.2	4.9

Source: Company, Ambit Capital research

Exhibit 16: Asset quality

	FY08	FY09	FY10E	FY11E
Gross NPA (Rs bn)	3.72	3.68	4.80	5.25
Gross NPA (%)	1.1	0.8	0.8	0.7
Net NPA (Rs bn)	0.54	0.79	0.95	0.93
Net NPA (%)	0.2	0.2	0.2	0.1
Provisioning coverage (%)	86.9	81.5	80.1	82.3

Source: Company, Ambit Capital research

Explanation of Investment Rating

Investment Rating	Expected return (over 12-Month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	< 5%

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