# Equity Research

**Industry: Banking**
**Date: August 5, 2011**

# ALLAHABAD BANK LIMITED

**Analyst Recommendation: Buy**

Buy | Accrue | Hold | Ease | Sell

| BSE Code: | 532480 | NSE Code: | ALBK | Reuters Code: | ALBK.NS | Bloomberg Code: |
|---|---|---|---|---|---|---|

| | |
|---|---|
| CMP: | ₹192.9 |
| 6 months target: | ₹230 |
| SL: | ₹183 |

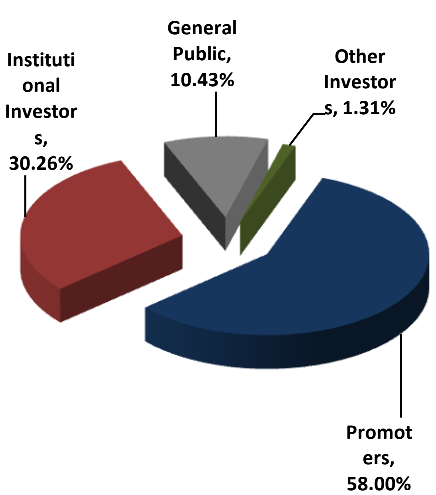
| | |
|---|---|
| EPS (₹) | 30.2 |
| P/E (x) | 6.4 |
| Revenue (₹bn) | 110.8 |
| Operating Profit (₹bn) | 30.5 |
| Operating Margin (%) | 27.5 |
| EV/Operating Income (x) | 12.6 |

| | |
|---|---|
| Market Cap (₹bn) | 91.9 |
| Free Float Mar Cap (₹bn) | 38.6 |
| 52 week high/low | 270.9/183 |
| Total Debt (₹bn) | 1,388 |
| Enterprise Value (₹bn) | 1,400.9 |
| Book Value per Share (₹) | 183.4 |
| P/BV (x) | 1.1 |

## Investors Rationale

- Allahabad Bank (ALBK), one of the oldest lenders of the country, recorded a robust growth of 30.4% y-o-y at ₹987.4 billion in its advances during Q1FY'12, inching up its market share in credit business to 2.39% in Q1FY'12. The bank aims to achieve a 25% growth in its advances basket in FY12, which will give a further boost to its market share in the credit industry.
- In Q1FY'12 Net Interest Income (NII) of the bank recorded an impressive 38.24% growth at ₹11.75 billion on y-o-y basis fuelled by firm advances growth across the sectors. Though consecutive rate hikes has resulted in slight compression in the NIM of the bank in the present quarter, the bank is expected to maintain NIM of over 3% in FY12, backed by expected higher growth in advances.
- ALBK has outlined a network expansion plan of 3,000 branches and 2000 ATMs by 2015. Increased focus on branch expansion will not only accelerate the growth in unsecured retail loans and boost its customer base but will also help the bank to revive growth in sectors, where profit margins are under pressure.
- The fee-based income of the bank has registered an impressive CAGR growth of 61% in the past 3 years. With its consistent focus to improve the profitability in this segment through tie-up and joint ventures with insurance etc., the bank's core fee income is expected to grow by 30% in FY12.
- The bank intends to maintain its CASA deposit at 33-35% of the total deposits in FY12 through increased focus to expand its reach in smaller cities

## Shareholding pattern as on June 30, 2011




| ₹ billion | FY10A | FY11A | FY12E | FY13E |
|---|---|---|---|---|
| Operating Income | 83.8 | 110.8 | 140.0 | 169.4 |
| Operating Profit | 25.5 | 30.5 | 37.8 | 47.4 |
| Net Profit | 12.3 | 14.4 | 18.7 | 24.0 |
| Share Capital | 4.5 | 4.8 | 4.8 | 4.8 |
| EPS (₹) | 27.5 | 30.2 | 39.3 | 50.3 |
| PE (x) | 7.0 | 6.4 | 4.9 | 3.8 |
| P/BV (x) | 1.2 | 1.1 | 0.9 | 0.7 |
| EV/Operating Income(x) | 13.5 | 12.6 | 12.0 | 11.0 |
| ROE (%) | 17.6 | 16.5 | 17.9 | 18.9 |
| ROA % | 1.0 | 0.9 | 1.0 | 1.2 |

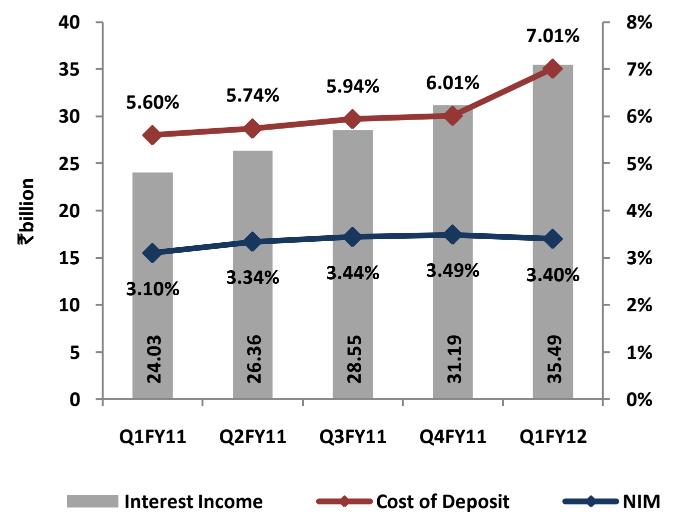
## ALBK aims to achieve turnover of ₹2.8 trillion in FY12

During Q1FY'12, the advances of ALBK recorded a robust growth of 30.4% y-o-y and 5.5% q-o-q at ₹987.4 billion led by strong credit outflow to small and medium enterprise (SME) segment, which reflected a growth of 57.7% y-o-y and 3.7% q-o-q at ₹149.8 billion. As a result, market share of the bank in credit inched up to 2.39% against 2.23% a quarter ago and 2.14% a year ago. Deposits for the period have increased by 23.54% y-o-y and 1.46% q-o-q to ₹1.33 trillion, helping the total business of the bank to register a 26.36% y-o-y growth at ₹2.32 trillion. Market share of the bank in deposits increased to 2.41% against 2.31% a quarter ago. Going further in FY12, the bank intends to grow its advances and deposits by 25% and 22% to ₹1.18 trillion and ₹1.62 trillion, respectively, empowering its total business to grow at a rate of 25% to ₹2.80 trillion. It has also envisaged to achieve a total business of ₹4 trillion by FY15.

## Robust Q1FY'12 earnings led by strong growth in advances

ALBK has recorded an impressive 38.24% growth in its Net Interest Income (NII) at ₹11.75 billion during Q1FY'12 on y-o-y basis. Interest income has increased by 47.7% to ₹35.49 billion on y-o-y basis. The higher interest earnings of the bank were mainly driven by firm 30% y-o-y growth in advances. Other income reported a marginal decline of 4% y-o-y mainly due to a 71% y-o-y decline in treasury income, while core fee income grew at a decent 23% y-o-y. Despite frequent hike in interest rates by RBI, the bank managed to block its operating cost with better cost control strategies at ₹5.71 billion. At the end of the quarter, the bank stood firm with a net profit of ₹418 billion, reflecting an increase of 20.4% over the corresponding quarter ended June 2010. NIM for the period stood at 3.40%. The bank with a pipeline loan sanctions of ₹180 billion, expects to maintain NIM of over 3% in FY12.

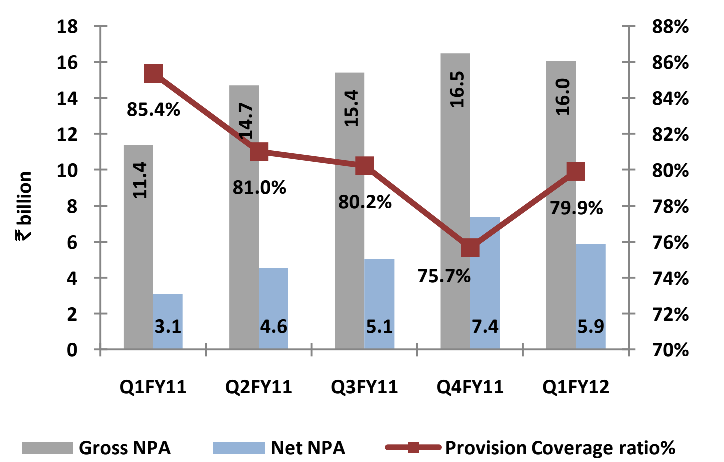
## Q1FY'12 NIM stays at moderate levels despite rate hike




## Q-O-Q asset quality sustained with higher provisioning to offset rate hike concerns

The asset quality of ALBK has shown significant improvement in the Q1FY'12, as net non-performing assets (NPA) slipped 19 basis points to 0.60% of net advances from 0.79% in Q4FY'11. The remarkable growth in the Q1FY'12 has been ascertained by increasing provisions for bad loans at 79.9% of advances, as against the regulatory stipulation of 70%. During the quarter, ALBK's Gross NPAs to Gross Advances ratio also declined to 1.62% from 1.74% on m-o-m basis. Of the outstanding restructured assets worth ₹30.59 billion, only ₹3.12 billion turned to NPA's. However, the bank's Net NPA has increased by 19 bps from 0.41% a year ago due to default from small loans in the agriculture and MSME (micro, small and medium enterprises) segments. However, with the monsoons looking good, the bank is optimistic of restricting further slippages.

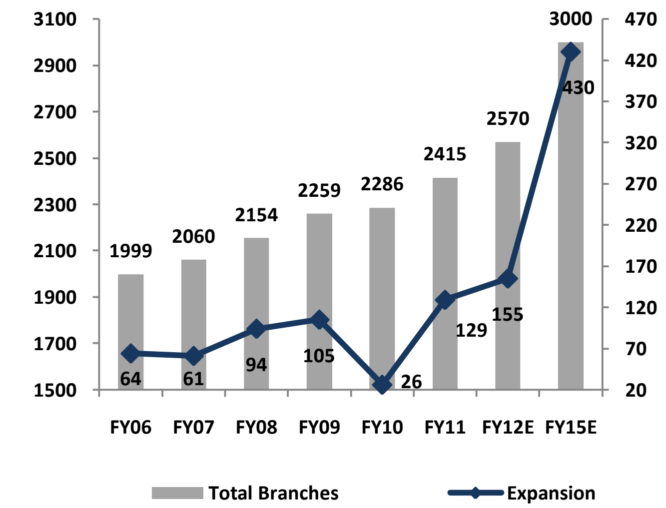
To curb the rising inflation, RBI has raised its policy rates 11 times since March 2010, followed by higher-than-expected rate actions in July 2011. As a result, higher rates could stress the asset quality of the bank by affecting borrower's repayment capacity and thereby deteriorating the health of the bank's balance sheet. However, strong domestic growth environment, improved corporate credit profiles, increasing emphasis on strong retail portfolio, better risk management and less exposure to high risk sectors will help the lender to boost the share of secured loans in the coming quarters, cushioning against probable asset quality risks. Apart from this, better provisioning policies will also help the bank to improve its present asset quality standard.



## Massive Branch expansion plan to enhance business in regions where margin are under pressure

ALBK has wide presence in the eastern and central part of India with 2,415 branches and 212 ATMs, serving 26 million customers across the country. The state-run lender is planning to add another 155 branches and 500 ATMs in FY12 to raise deposits and loans in sectors, where profit margins are under pressure. Going forward, ALBK has outlined a network of 3,000 branches and 2000 ATMs by 2015. This move of the bank aims at leveraging the strength of an extensive network of branches to attract fresh customers. The bank with its constant innovations and new offerings plans to tap business from small shop-keepers, small businesses and others in smaller cities that are growing faster than the metros. Increased focus on branch expansion will accelerate the growth in unsecured retail loans and increase customer acquisition, which in turn is likely to provide another thrust to the loan book of the bank.

## Branch expansion to boost customer base




## Fee Income to reach ₹11.1 billion in FY12

ALBK has been generating healthy fee income at a CAGR of 61% in the past 3 years. During Q1FY'12, the fee based income increased 21.50% to ₹2.07 billion from ₹1.70 billion a year ago. The Bank, in its endeavor to improve the fee based income, apart from tie-up and joint ventures for insurance and sale of third party products, took several new initiatives in the form of ASBA, NPS Subscription, marketing of e-products, sale of gold coin business, loan syndication etc. With the expansion of branch network and consistent focus on credit related activities, the bank's core fee income is expected to grow by 30% in FY12.

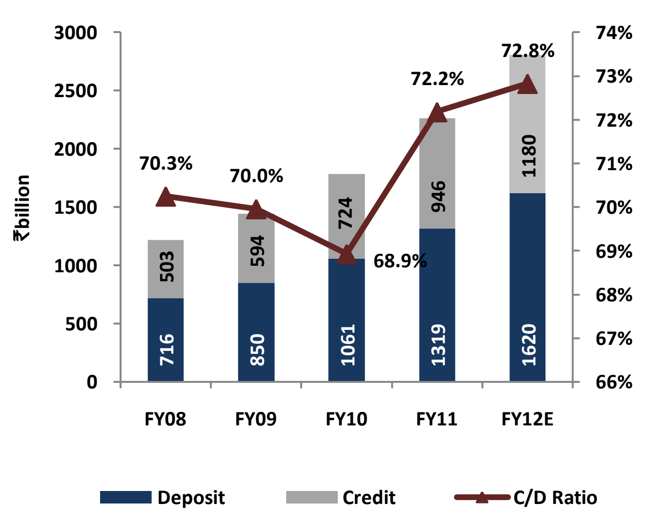
## CASA to be maintained at 33-35% of total deposit in FY12

During Q1FY'12, CASA deposits of the bank grew by 16% y-o-y and slipped 3% q-o-q to ₹428.55 billion. As the result, CASA ratio slipped to 32.17% against 34.42% a year ago and 33.70% a quarter ago. The lower interest rate attached to the CASA accounts in comparison to the term deposit account always creates a cost advantage for the bank, restricting imbalance in the cost structure even in a rate hike scenario. Going further, the bank intends to maintain its CASA deposit at 33-35% of the total deposits in FY12.

## High credit-deposit ratio to support loan book growth

ALBK has registered a strong deposit and advances growth at a CAGR of 23% in the past 3 years. During FY11, the bank's advances grew 30.56% to ₹724.37 billion on y-o-y basis and its deposit registered a growth of 26.36% at ₹1318.87 billion, resulting in a credit-deposit ratio of 72.2%. The credit-deposit ratio helps to find out if the bank has sufficient liquidity to support its loan growth and hence it is always wiser for banks to have higher credit-deposit ratio. Considering banks initiative to strengthen its deposit base and fuel up its credit intake to maintain an above 3% NIM in the coming quarters, the Credit deposit ratio of the bank is expected to sit at a stable position of 72.8% in FY12.

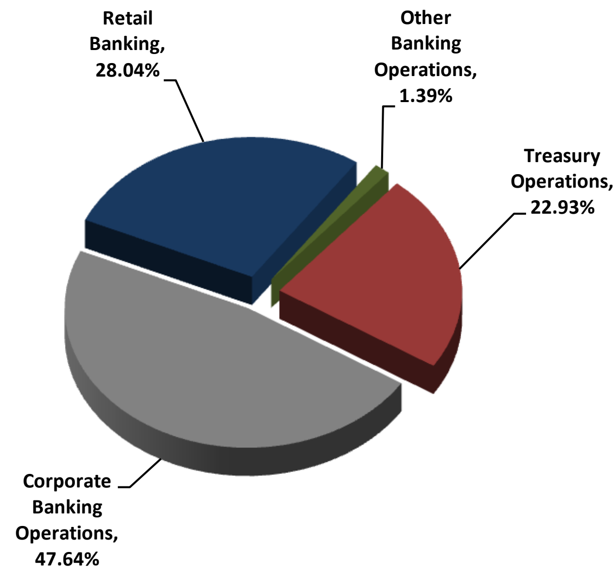
## Robust credit growth to keep C/D ratio elevated in FY12



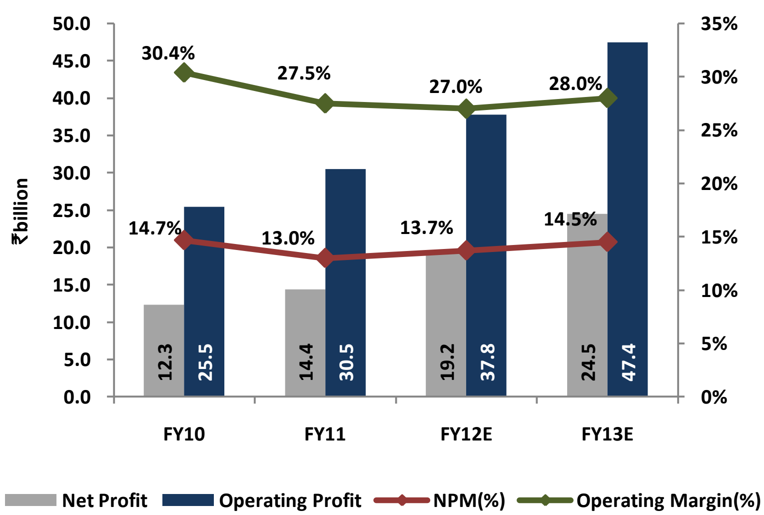
## Risk Factors

- The Banking industry is struggling to maintain its margins weighed by rising borrowing cost and inability to increase the lending rates due to concerns of moderation in loan growth.
- Higher rate hike action by RBI to curb the rising inflation could stress the asset quality of the bank by affecting borrower's repayment capacity and thereby deteriorating the health of its balance sheets.
- Ongoing concerns about the slowing down of the global economy and fears of being hit by another recession could reduce credit off-take of the banking industry
- Opening up of the industry for foreign banks is also increasing the competition for domestic banks.

## Major Chunk of revenue generated from Corporate Banking in Q1FY12




## Operating margins of ~27% in FY12 & FY13 sustainable




- Operating Profits and Net profits of the bank are expected to grow at a CAGR of 25% and 30%, respectively in the coming two years.
- Operating margins likely to stay at a comfortable level of ~27% in FY12 and FY13, despite rate hike concerns.
- By FY13, the net profit margin of the bank is expected to bounce back to FY10 level at ~14.5%, backed by higher credit intake.

## Business Overview

Allahabad Bank (Allbank) is one of the oldest banks in India and was established in the historic town of Allahabad on 24th April 1865 by a group of Europeans. As on June 2011, the bank has a network of 2415 branches and 212 ATMs, serving 26 million customers across the country. Presently, the bank has a pipeline of loan sanctions worth ₹180 billion and aims to grow its total business by 25% to ₹2.8 trillion in FY12 and above ₹4 trillion by FY15.

## ALBK to raise $500 million to strengthen foreign business

The state-run lender is planning to raise US$500 million by issuing medium-term notes for tenure of five and a half years overseas, to fund its growing business in Hong Kong and list it. ALBK overseas branch in Hong Kong has an outstanding loan portfolio of ₹33 billion, catering to some 45,000 ethnic populations. The bank is also planning to open more branches overseas which include one at Singapore, Shanghai, Dhaka and Kowloon in Hong Kong.

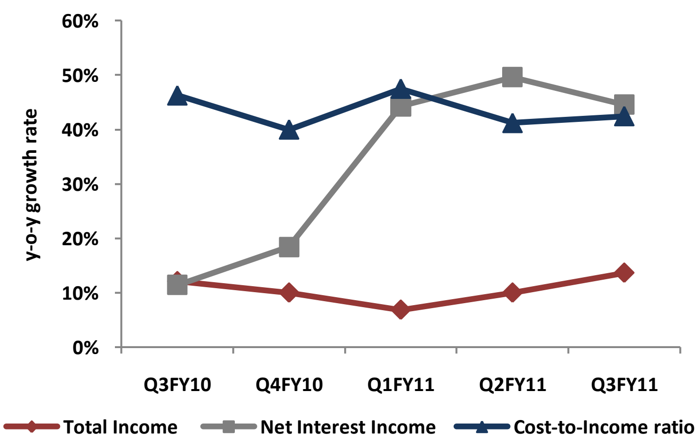
## Indian Banking Industry

The Indian Banking Industry has played a vital role in the sectoral growth as well as overall development of the Indian economy in the past decade. The collective net profit of the industry registered an eight-fold growth to ₹571 billion in 2010 from ₹71 billion in 2001. Meanwhile, bad asset as a percentage of loans retreated to 1% in 2010 from 6.83% a decade ago. With enhanced profitability, efficiency and productivity, return on assets of the industry has increased from 0.57% in 2001 to 1.05% by 2010. Empowered by strong financial fundamentals and notable efforts of the policy makers like RBI, Ministry of Finance etc, the Indian Banking sector has emerged as one of the toughest and sound banking systems worldwide, during the global financial turmoil.

### FY11 profitability improves on higher core interest income

In FY11, the total income and net interest income of the industry has increased by 17.20% and 39.94% on y-o-y basis, respectively, with hefty contribution of core interest income from the PSU banks. Cost-to-Income ratio during the period remained almost unchanged at 45.35% against 45.42% a year ago due to significant improvement in the cost-to-income ratios among state-run lenders owing to improved their top-line and robust growth in NII accompanied by moderate growth in operating costs. Provisioning expenses rose by 37.43% on y-o-y basis in FY11 on back of higher amount set aside by banks to achieve the RBI mandated 70% NPA provision coverage. Though PSU banks rose their provisioning significantly, private lenders eased it off with the reduced stress on its asset quality.

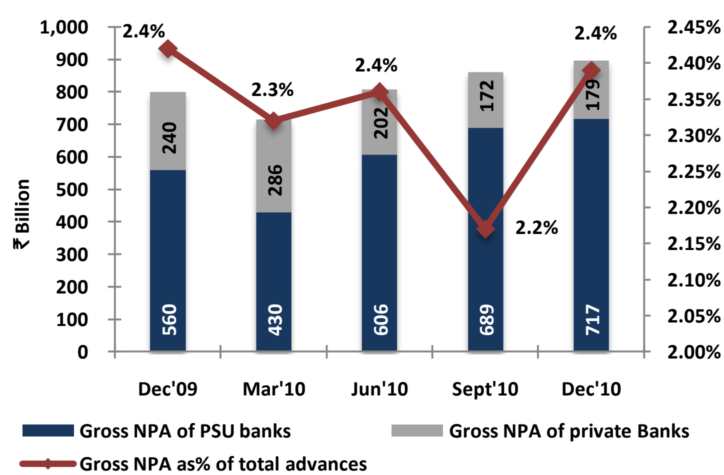
### Moderation in cost helps improve NII growth




### Domestic growth to support shrinking asset quality

In FY11, the gross NPA level of the industry rose by 21.5% y-o-y basis to ₹914 billion with Public Sector banks, accounting for almost 82% of the same. However, during the year, overall Gross NPAs as a % of advances reduced to 2.27% against 2.31% as on Mar'10, owing to the improved recovery levels across banks. RBI has raised its key rates for the 11th times since March 2010, which could stress the asset quality of the bank by affecting borrower's repayment capacity and thereby deteriorating the health of its balance sheets. However, strong domestic growth environment, improved corporate credit profiles, better risk management and less exposure to high risk sectors could go a long way in easing asset quality concerns for a large part of banks' loan portfolios. Apart from this, better provisioning policies will also help the bank to maintain its present asset quality standard.

### Higher Bad loans in PSU banks pressurizes asset quality




### Outlook

In FY11, due to higher growth in credit take off, the growth numbers of the sector improved to around 20% y-o-y. Going further, with the inflation seemingly out of control and monetary policy very clearly coming down hard on inflation, the growth momentum of the industry in the coming months are likely to witness some moderation. However, the profitably of the sector is expected to garner some support from higher credit growth due to gradual broad basing of the industrial growth. Apart from this, with Government's initiative to infuse a sum of ₹60 billion to the under-capitalized public sector banks to ensure strong capital base among PSU banks by FY12 will go a long way in helping to banks to strengthen their financial position and stay firm under tight liquidity conditions.

## Balance Sheet (Consolidated)

| (₹ billion) | FY10A | FY11A | FY12E | FY13E |
|---|---|---|---|---|
| Equity Capital | 4.5 | 4.8 | 4.8 | 4.8 |
| Reserves & Surplus | 65.2 | 82.6 | 99.8 | 121.9 |
| Shareholders' Fund | 69.6 | 87.3 | 104.6 | 126.7 |
| Deposits | 1,060.5 | 1,318.8 | 1,620.0 | 1,806.3 |
| Borrowings | 54.4 | 69.2 | 72.6 | 79.3 |
| Other Liabilities & Provisions | 35.0 | 40.7 | 41.1 | 44.3 |
| **Capital Employed** | **1,219.5** | **1,516.1** | **1,838.3** | **2,056.6** |
| Cash and Balances with RBI | 71.8 | 79.0 | 98.8 | 118.5 |
| Money at call and short notice | 20.0 | 31.4 | 39.6 | 47.5 |
| Investments | 386.4 | 435.0 | 480.1 | 532.5 |
| Advances | 716.1 | 936.3 | 1,180.0 | 1,309.8 |
| Fixed Assets | 11.3 | 11.6 | 13.6 | 16.4 |
| Other Assets | 13.9 | 22.8 | 26.2 | 31.9 |
| **Capital Deployed** | **1,219.5** | **1,516.1** | **1,838.3** | **2,056.6** |

## Profit & Loss Account (Consolidated)

| (₹ billion) | FY10A | FY11A | FY12E | FY13E |
|---|---|---|---|---|
| Interest Income | 83.8 | 110.8 | 140.0 | 169.4 |
| Interest Expended | 57.2 | 69.9 | 93.8 | 115.2 |
| Net Interest Income | 26.6 | 40.9 | 46.2 | 54.2 |
| Growth (%) | | 53.9 | 12.9 | 17.3 |
| Other Income | 15.4 | 13.6 | 15.4 | 18.6 |
| Operating Income | 42.0 | 54.5 | 61.6 | 72.8 |
| Growth (%) | | 29.9 | 12.9 | 18.3 |
| Operating Expenses | 16.5 | 24.1 | 23.8 | 25.4 |
| Operating Profit | 25.5 | 30.5 | 37.8 | 47.4 |
| Growth (%) | | 19.8 | 24.0 | 25.5 |
| Operating Margins (%) | 30.4 | 27.5 | 27.0 | 28.0 |
| Provisions and Contingencies | 13.4 | 16.3 | 19.3 | 23.7 |
| Share of earnings/loss in Associates | 0.3 | 0.3 | 0.3 | 0.3 |
| Net Profit | 12.3 | 14.4 | 18.7 | 24.0 |
| Net Profit Margin (%) | 14.7 | 13.0 | 13.4 | 14.2 |

## Key Ratios & Valuations (Consolidated)

| | FY10A | FY11A | FY12E | FY13E |
|---|---|---|---|---|
| Operating Margin (%) | 30.4 | 27.5 | 27.0 | 28.0 |
| NPM (%) | 14.7 | 13.0 | 13.4 | 14.2 |
| Cost to Income Ratio (%) | 39.4 | 44.1 | 38.6 | 34.9 |
| ROE | 17.6 | 16.5 | 17.9 | 18.9 |
| ROCE | 2.1 | 2.1 | 2.1 | 2.4 |
| ROA | 1.0 | 0.9 | 1.0 | 1.2 |
| EPS | 27.5 | 30.2 | 39.3 | 50.3 |
| P/E ratio (x) | 7.0 | 6.4 | 4.9 | 3.8 |
| Book Value | 155.9 | 183.4 | 219.6 | 266.0 |
| P/BV ratio (x) | 1.2 | 1.1 | 0.9 | 0.7 |
| EV/Interest Income (x) | 13.5 | 12.6 | 12.0 | 11.0 |
| EV/EBITDA (x) | 44.4 | 46.0 | 44.6 | 39.2 |
| EV/CE (x) | 1.0 | 0.9 | 0.9 | 0.9 |

## Valuation

ALBK has a long term strategy to capitalize on the prevailing strong and steady economic growth of India and over the past few years it has demonstrated its ability to grow in a highly competitive business environment. The bank presently has a market share of 2.39% in credit and 2.41% in deposits basket of the industry and with its long term strategy to achieve a total business of ~₹4 trillion by FY15, ALBK will not only strengthen its position among its peers but will also achieve multi-fold growth in its customer base. Beside, ALBK is also expected to maintain its operating margins at adequate levels despite rate hike pressure, backed by its consistent efforts to lift its loan book. Considering the above aspects, we rate the stock as 'BUY' at the current market price of ₹192.9. At the current market price, the stock is trading at a 0.9x FY12E BV and 0.7x FY13E BV.

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