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Rating **BUY** Target **179**

## Allahabad Bank

Risk **MEDIUM** CMP **92**

1<sup>st</sup> August, 2007

Sector **Bank** Market Capitalization **Rs. 4174 Cr** Free Float **15.11%** 52 week H/L **108/53**

### Company Research



### Star of East to Explode

The bank has pan-India presence with the sixth largest network of over 2,080 branches across India, and a strong presence in the eastern region. Despite 20% plus RoE and 5% plus dividend yield, the bank trades at significant discount (40-50%) to its peers, mainly due to technological backwardness and poor perception of its asset quality. With the change in management, technology initiatives (through CBS rollout), economic development in eastern states and inroads into other locations, the present discount is likely to narrow down in the future and will provide superior return.

#### Projections

(Rs Crores)

	2005	2006	2007	2008 (E)
Sales	3185	3767	4883	5372.25
PAT	541	696	750	889
EPS (Rs)	15.16	15.25	16.28	19.90

#### Our Views

- Allahabad bank is among the selected public sector bank whose book value of equity is higher than the market cap.
- Allahabad Bank dominates the banking sector in central and eastern India. Its network, comprising 2,082 branches, is sixth largest in the country and accounts for 3% of the branch network all over the country.
- In term of asset class, the bank is more focused towards priority sector which contributes 40% of total advances.
- The bank is expected to open 50 more branches in the next nine months most of its branches are located towards northern and eastern region.
- The bank has recently rolled out its core banking solution (CBS) programme (technology from TCS) and has already covered two branches under this programme.
- We expect that bank will cover 900 by December 2007 (85% business). The technology platform should enable the bank to gather higher fee income and low-cost deposit accounts December 2007 and 900 by December 2008 (85% business).

#### Valuation

Our investment rationale is based on attractive valuation, improvement in the performance of the bank, more towards priority sector and decent dividend yield.

At Rs.95, the stock is trading at 5.50 trailing P/E. The company's EPS in FY07 stood at 16.28. Allahabad bank is expected to earn a net profit of Rs.889 crore, backed by new expansion plan in northern region. This results in P/E of 8 x of FY 08 earnings.

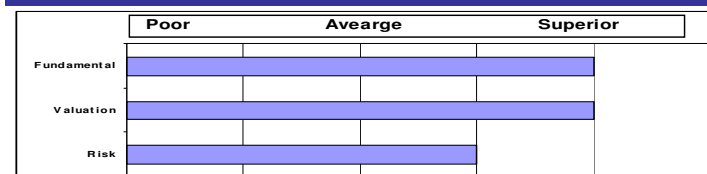
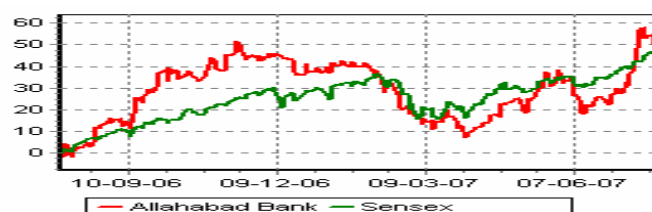
**Overview**

Allahabad Bank dominates the banking sector in central and eastern India. Its network, comprising 2,082 branches, is sixth largest in the country and accounts for 3% of the branch network all over the country. However, it commands 7-10% share of the network in Uttar Pradesh and West Bengal. Even though UP and Bihar account for ~40% of its branch network, the contribution from these regions to the bank's loan portfolio is less than 25%.

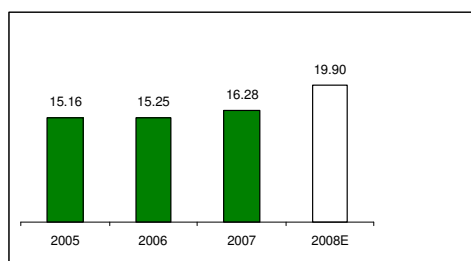
The new management is increasingly focusing on expanding its reach in southern India, western Maharashtra and Gujarat, thereby lowering the concerns regarding its dominant presence in high risk, low returns states. Moreover, loan portfolio mix is likely to shift in favor of retail advances in eastern and central regions from public sector advances in western and northern regions. Improving economic fundamentals of West Bengal and other eastern regions where Allahabad Bank has a strong foothold will aid shift in loan mix and benefit the bank's profitability in the coming years. West Bengal is second only to Karnataka (6.2%) and well above the national average of 4.2%.

**Key Indicators**

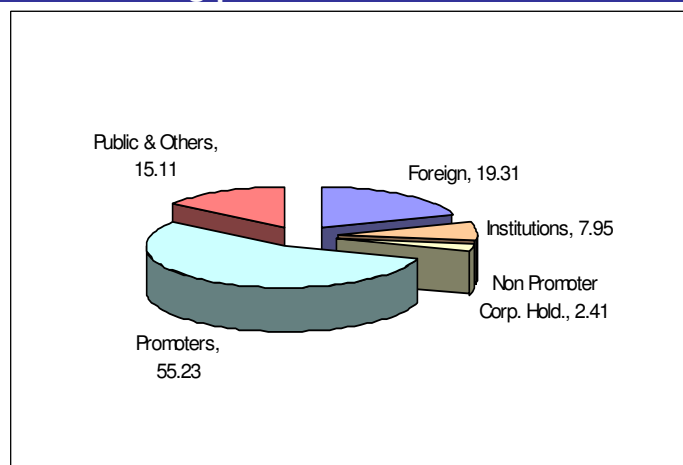
CAGR %	22	NPM %	10.1%
PE	5.72	Key Inputs	Economy credit demand
Industry PE	7.52	Critical Factors	Interest rate

**Scorecard****Price Chart****Peer Group Comparison**

	Market Capitalization (Cr)	Sales (Cr)	PAT (Cr)	CAGR-%	Credit/deposit (%)	Investment/deposit (%)	ROE-%	Price/BV	PE
IOB	7115.09	9212	1026	19.2	65	32	12	1.84	7.60
BOI	13111.06	9180	1123.17	23	70	31	21	2.28	12.10
Dena bank	1495.77	2118	201.56	74	63	34	17	1.20	7.60
Bank of Baroda	10393.44	9212	1026	22	65	32	12	1.20	10.60
OBC	6288.55	5983.19	729	15	68	32	13	1.12	8.80
Canara bank	11502.55	11364	1420	22	68	31	18	8.42	1.42
Allahabad Bank	4714	4883	750	22	65	34	22	0.90	5.72

**Valuations****Annual EPS Trend****P/E Multiples**

	2005	2006	2007
Company	6.36	5.18	5.72
Market	12.5	15	13

**Shareholding pattern**

## Company Background

### *Origin*

Allahabad Bank (ABL), the oldest joint stock bank, was set up in 1865 by a Group of Europeans. In 1920, the bank was taken over by P&O Banking Corporation at a bid price of Rs 436 per share. The head office and the Registered Office of the bank were then shifted to Kolkata in 1923 for business considerations and operational convenience. In 1927 the bank went into the fold of Chartered Bank that acquired the controlling interest in the P&O Banking Corporation. However in 1969 along with 13 other major commercial banks, ABL too was nationalised. At the time of nationalisation the bank had a network of 151 branches.

### *Promoters*

**Shri Avinash Chander Mahajan, Chairman & Managing Director** Shri Mahajan has assumed the office of Chairman & Managing Director of the Bank on 1.8.2006. Prior to his present appointment Shri Mahajan was the Executive Director of Bank of Baroda. Shri Mahajan has started his Banking career by joining Bank of India as Probationary Officer in October 1972. During his long career in Bank of India he held various positions i.e. Head of Credit Department, Forex Department, In-charge of the Bank's Integrated Treasury, Risk Management Deptt besides overseeing the revision of Bank's Manuals of Instructions covering Advances and Foreign Exchange. He headed Bank's oversea offices at Japan and long stint in Kenya as Chief Manager of their Nairobi Branch.

**Shri Ashok Jain, Government Nominee Chartered Accountant Director** Shri Jain is associated with the Bank as Director w.e.f. 11.10.2006. Shri Jain is a practicing chartered accountant. He qualified his chartered accountant course in the year 1978. Since then he has been actively participating and leading the various social as well as professional organizations. He has the professional experience in the field of Banking, Finance and Insurance.

**Shri Mohammad Tahir, RBI Nominee Director** Shri Tahir is associated with the Bank as Director W.e.f. 27.02.07. Shri Tahir has retired as Executive Director of the Reserve Bank of India. Mr. Tahir served Reserve Bank of India for 37 ½ years. He specialized in Banking regulation and supervision including inspection of banks, Mutual funds including investment analysis/credit appraisal/ planning, organization and Methods/ Management Services, Industrial and Export Credit, Personnel Administration, Human Resource Development and General administration and Internal Debt.

### *Businesses/Products*

Allahabad Bank has a pan-India presence with the sixth largest network of over 2,080 branches across India, and a strong presence in the eastern region. Nearly 70% of the bank's branches are in Uttar Pradesh and eastern India. Its market share in advances and deposits was at 2.02% and 2.29%, respectively, as on March 2006.

## Industry Outlook

### A. Current Scenario

The Reserve Bank of India continued to ensure appropriate liquidity in the system conducive for credit requirements, consistent with the objective of price and financial stability. Towards this end, RBI continued demand management of liquidity using all the policy instruments at its disposal with a overall stance; to ensure a monetary and interest rate environment that enables continuation of the growth momentum consistent with price stability, to focus on credit quality and financial market conditions to support export and investment demand in the economy for maintaining macroeconomic, in particular, financial stability, to respond swiftly to evolving global developments.

### B. Demand Supply Situation

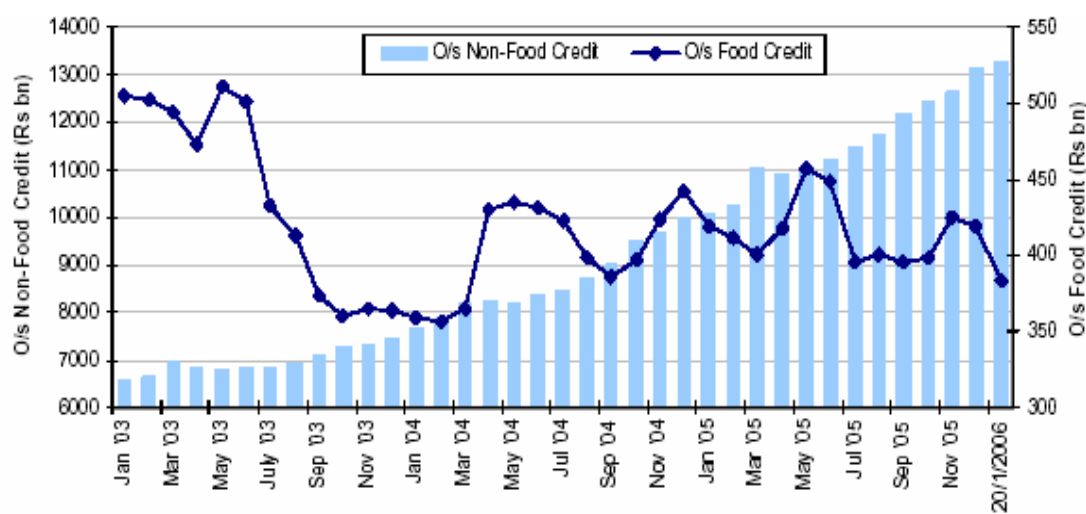
Interest rates on both deposits and advances spike on rising inflation and tight money policies; sector is resilient with rising fee income and ability to protect interest spread.

The sustained acceleration in the pace of growth in industrial sector, buoyancy in services sector and sharp spurt in real estate sector together facilitated healthy rise in the advances of the banking sector. In the process, the banking sector witnessed another quarter of hefty growth in their revenues and profits. Surge in operational income despite rising interest rates was the main characteristics of this quarter's growth. The benign economic growth, resilient industrial activity and thrust on infrastructure development led to a sustained growth in credit offtake.

### C. Growth Potential

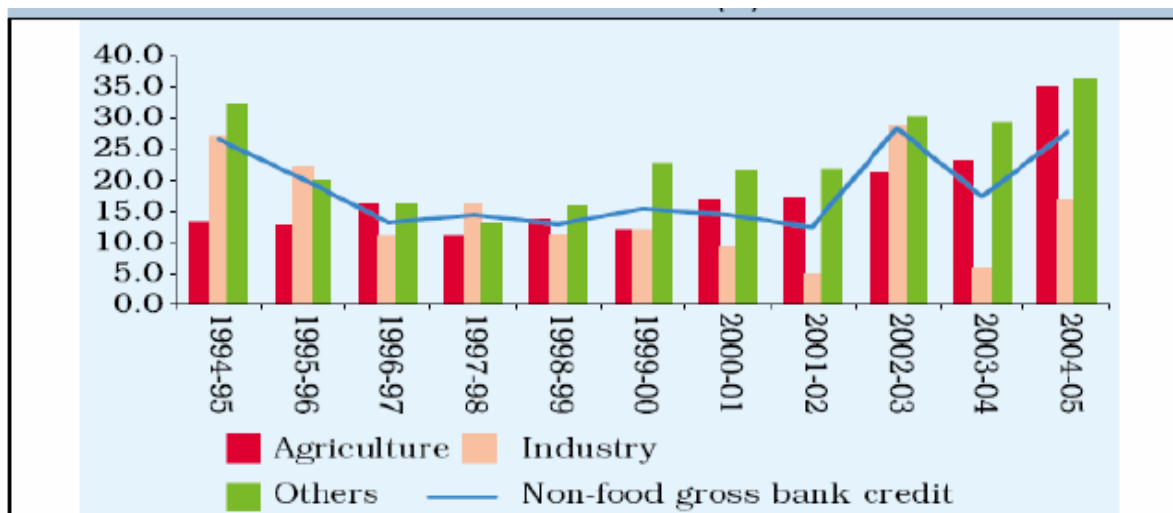
A robust macroeconomic environment and higher capex by India Inc in addition to an uptrend in the retail segment fuelled the credit growth of the Banking sector over the last two years. Non-food credit which registered a strong growth of 25-30% in the past two years played a significant role in driving the banks' core earnings. In FY2006 till date, the credit portfolio of scheduled commercial banks (SCBs) has grown by over 30% YoY, one of the highest for the Banking Industry. Going forward, overall credit growth of banks is expected to remain buoyant on the back of robust demand from corporate, infrastructure segment, retail, agriculture and the emerging SME segment. Optimism regards the uptrend in credit growth in the Banking space was reaffirmed by the RBI too in the *Review of the Monetary & Credit Policy*

**Credit Growth**



Demand and growth in credit is spread across sectors, which is in turn raising the confidence levels in the economy and indicates that the growth momentum in the banking sector is broader based. This is reaffirmed by new avenues of lending emerging in agriculture and the SME segment in addition to corporate and retail. Hence, there exists clear visibility about the expansion of business volumes for banks in the ensuing years.

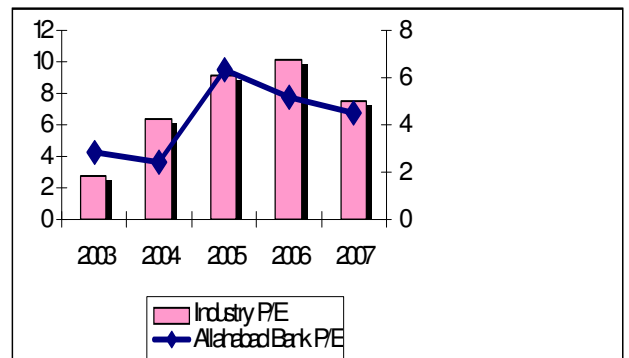
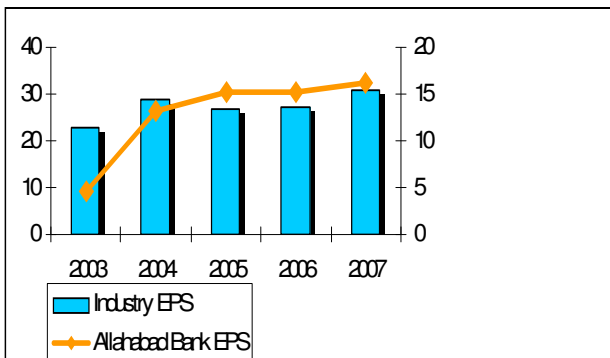
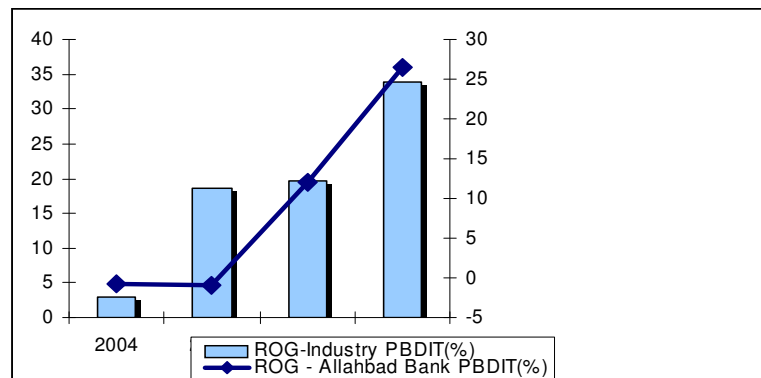
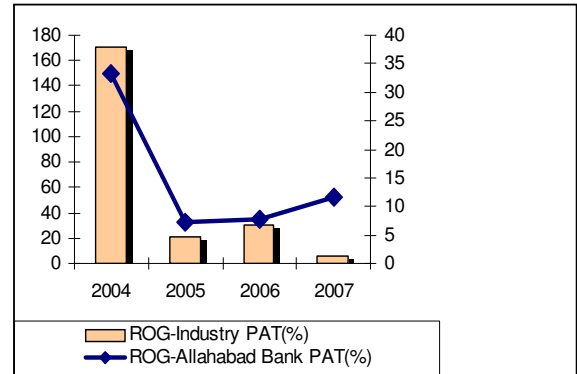
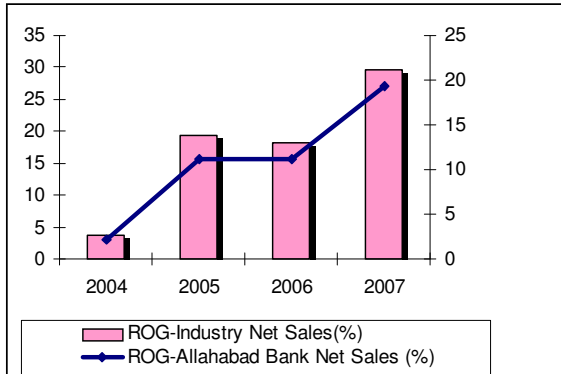
#### Growth in Non food Credit



# Fundamental Analysis

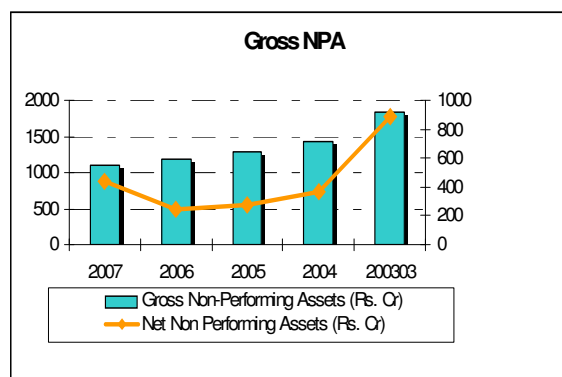
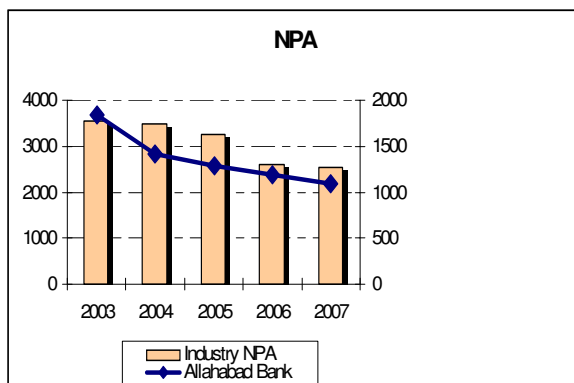
## A. Financial Analysis (3-5 years)

### Past Growth



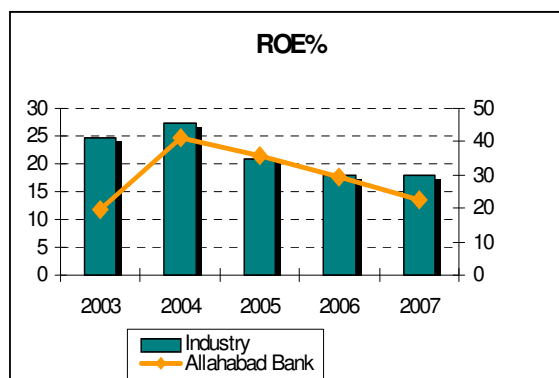
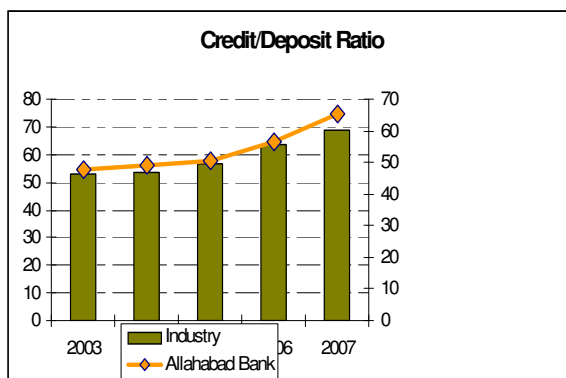
### B. Credit Analysis

If we undertake comparison in Industry and company it can be interpreted that over a period of time NPA of Allahabad bank has seen a downward trend. This shows bank is capable of maintaining healthy rate in reducing their NPA. The bank's asset quality has improved due to high provisions and lower incremental slippages. Consequently, net NPAs, which were 2.4% of advances in FY04, reduced to 1.3% in FY05 and 0.8% in FY06. Incremental slippages have declined from INR 3.5 bn in FY05 to INR 3.3 bn in FY06. Going forward, we expect this secular trend to continue and net NPA ratio to come down to about 0.7% in FY07E.

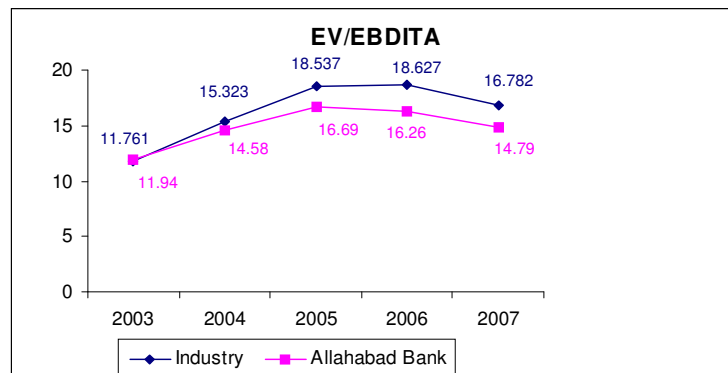
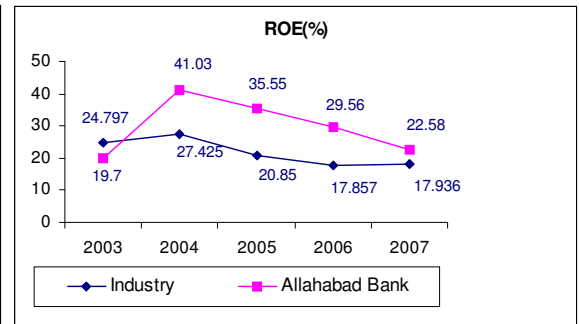
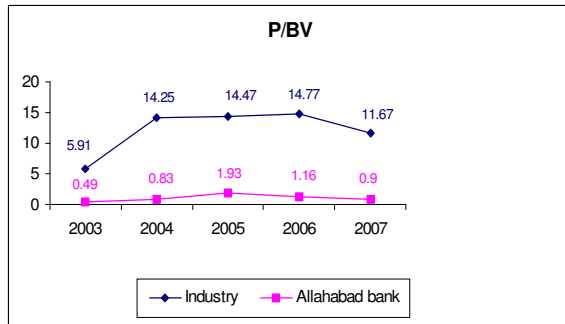
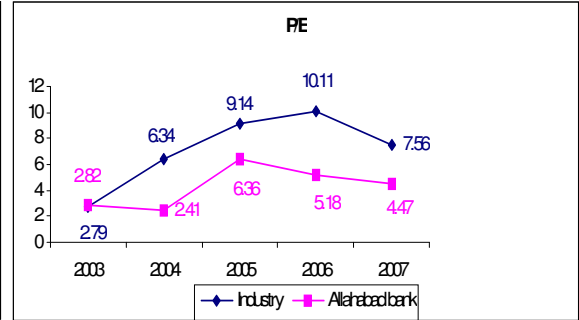
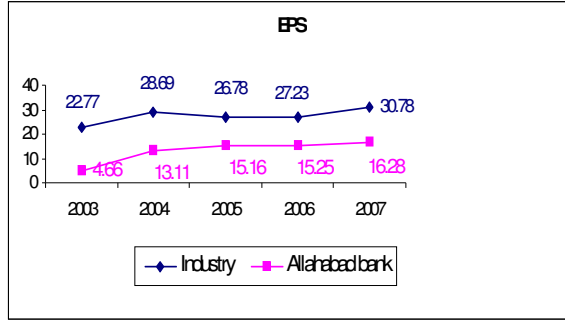


It is the proportion of loan-assets created by banks from the deposits received. The higher the ratio, the higher the loan-assets created from deposits. It can be determined from the that Allahabad bank has upward trend and it has lot more to tap in industry as its penetration is almost a half in the industry. Increase in Credit/ Deposit ratio has an impact on ROE%.

The next ratio which is ROE is in tandem with Industry. It can be observed from the chart that the ROE of Industry and Allahabad bank is declining since FY06. the declining trend of ROE can be attributed to rising interest rate and increasing impact on Net profit margin. This ratio has seen an upward trend form FY07 and it will start recovering as interest rate in India has on downside.



### Key Ratio Analysis



## ***B. Future Plans***

Allahabad Bank is targeting a business growth at a compounded rate of Upto 25 per cent so that by the end of 2010 the bank reaches a business figure of Rs 2 lakh crore. Allahabad bank has entered into a Reliance Mutual marketing alliance for selling its products. Through this alliance, the fund house would be selling its entire range of 28 schemes through Allahabad Banks 2,098 branches spread across the country. This tie-up will also strengthen Reliance Mutual Fund's existing distribution network of over 20,000 distributors selling products across 150 cities. Allahabad Bank can leverage this Tie up as the new tie-up arrangement; the bank's basket will have more variety to woo the customers. Reliance Mutual Fund, having an investor base of over 3.2 million, manages assets more than Rs 59,000 crore.

## ***C. SWOT***

### **Strength**

The bank's capital adequacy currently stands at 13% with tier-1 capital of 8.5%. We believe that the bank is adequately capitalised for next two years of growth and Basel II implementation.

### **Weakness**

Hardening of interest rate scenario and occasional tight liquidity continued to be concern in short term for bank.

### **Opportunity**

The sustained acceleration in the pace of growth in industrial sector, buoyancy in services sector and sharp spurt in real estate sector together facilitated healthy rise in the advances of the banking sector.

### **Threat**

In event of an economic slowdown, there is a greater risk of NPA accretion for Allahabad Bank than its peers, given its geographical spread and relatively weaker risk management systems.

## ***D. Cautions***

**Increase in the interest rate will lead to higher MTM provisioning and fall in the treasury income:** If the interest rate further rises, due to which bank might have to increase the cost of deposits and increase in BPLR would not be able to keep the pace with it due to two successive hike taken places in first two quarters. At the same time bank might have to make higher provision on its AFS category portfolio which is about 30% of the total investment portfolio.

**Delayed implementation of CBS** may lead to the slower business growth in comparison to our expectation.

**Slow down in the economy can lead to the higher NPL**

If the economy is slowing down from current 8% plus GDP growth rate and having an exposure to all sector of the economy we feel it may lead to higher Non Performing Assets with the bank.

## Investment Rationale

### Sound Investment portfolio

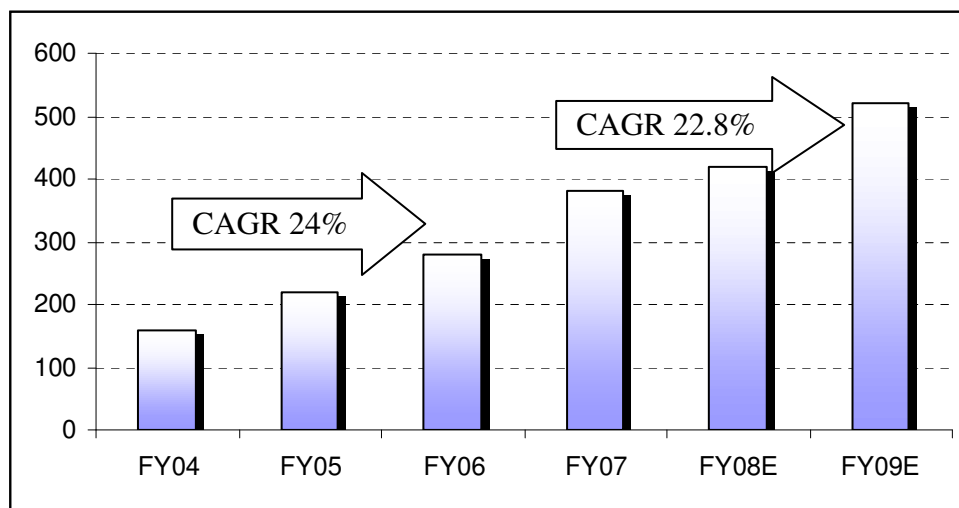
Treasury income accounted for 39.5% of total income in FY2006, which has come down from 45.9% in FY2005. During Q1FY2007 the bank has transferred investments worth Rs. 2000cr from Available for Sale (AFS) category to Held to Maturity (HTM), increasing the proportion of HTM to ~61% and ~39% in AFS portfolio with average duration of 2.7 years. Bank's yield on investments stood at 8.05% in FY2006, which the bank is expected to maintain at 8.05% over FY2007, and is likely to depress further to 7.9% in FY2008. Resultantly, the proportion of treasury income is likely to come down as the bank increases its thrust on Core interest income resulting into stable Net Revenues. Bank is maintaining around 29-30% as Statutory Liquidity Ratio (SLR). We expect it to be at the same level mainly due to the conservative approach on the Advances Portfolio. Higher SLR ratio protects the bank in time of liquidity crunch in the System; therefore this conservative approach of the bank further boosts our confidence in the bank.

### NIM's likely to remain stable

Due to softening of interest rate, Bank's Net Interest Margin slipped during FY2004-06, however, despite a hike in the reverse repo rate by RBI, we expect that the bank would be able to maintain sustained NIM's of 3.3% in FY2007-08E. Since the bank maintains a higher SLR, which means the bank has ample liquidity and probability of increase in cost of funds is comparatively lower. Secondly, following hike in Benchmark PLR carried out twice in the year to touch 11.50% from 11.00% FY2006 and the bank continues to be in talks with corporate clients for re-pricing of Loans, as 80% of the Advances portfolio is linked to Sub PLR rates. We expect the Bank's average yield on advances to increase from 8.7% to 9.1% by FY2008E.

### Strong 47% credit growth in H1

Allahabad Bank has posted strong growth of 47% Y-o-Y in advances to INR 356 bn during Q2FY07. The bank has renewed its focus on retail finance, which grew by 44% in H1 over last year. The bank has 236 retail boutiques dedicated to retail business. SME lending, which includes SSI, forms 17% of the total loan book. Its credit book is well-diversified with corporate advances forming 45%, retail 20.2%, agricultural loans 17.2%, and other priority loans 21.2%. The bank has grown its loan book by 38% CAGR over the past two years; we expect the loan book to further grow by 23% over in FY06-09E.



## Valuation

**Lagging on technology:** Aims to cover 85% business under CBS by December 2008 Allahabad Bank lags its peer PSU banks on the technology penetration front. Hence, it has been unable to offer high-tech banking products such as cash management solutions, internet banking, and fee generating products so far. However, the bank has recently rolled out its core banking solution (CBS) programme (technology from TCS) and has already covered two branches under this programme. We expect the bank to cover 40 branches under CBS by March 2007, extending it to 400 by December 2007 and 900 by December 2008 (85% business). The technology platform should enable the bank to gather higher fee income and low-cost deposit accounts. We expect the bank to cover 40 under CBS by March 2007, extending it to 400 by December 2007 and 900 by December 2008 (85% business).

**Growth in Total business remains healthy:** Total business of the bank grew at a robust 30% yoy to Rs1,00,834cr (Rs77,648cr) helped by a 42% yoy growth in Advances to Rs41,290cr (Rs29,148cr) and 23% yoy growth in Deposits to Rs59,544cr (Rs48,500cr). Credit to deposit ratio of the bank improved to 69% (60%). In Q4FY2007, the bank accepted bulk deposits to take care of Advances. Share of low-cost deposit declined 131bp to 38% (39.3%).

## Valuation

Over the year the operating parameters has improved substantially. In last four year, the total business of the bank grew with CAGR of 27% and total business of the bank crossed Rs. One lakh crores. We expect this counter may hit target price of Rs.179 buoyed by the growth in top line by 10-15% in FY 08 and bottomline by 15-20%.

(Rs. in Crores)	2003	2004	2005	2006	2007	2008E
<b>Revenues</b>						
Interest earned	2570.33	2668.67	3185.60	3767.24	4883.86	5372.25
Other Income	538.77	820.97	655.87	620.83	525.24	530.49
<b>Total Income</b>	3109.1	3489.64	3841.47	4388.07	5409.5	5902.74
<b>Expenditures</b>						
Interest Expended	1660.56	1582.92	1821.6	2189.8	3133.12	3415.10
Payment to Provision for Employees	513.5	559.06	680.54	681.1	620.72	651.76
Operating Expenses & Administrative	106.23	118.87	150.04	216.53	255.53	275.80
Depreciation	38.77	34.9	32.41	38.47	47.55	50.00
Other expenses, Provision & contingencies	482.38	743.88	559.87	557.12	603.99	622.11
Provision for Tax	120.02	-5	54	0	0	0.00
Fringe Benefit tax	0.00	0.00	0.00	10.24	4.57	6.00
Deferred tax	21.62	-8.42	1.26	-11.52	-6.36	-7.03
<b>Total Expenditure</b>	2943.11	3026.24	3299.47	3681.74	4658.96	5013.74
<b>Net Profit</b>	165.99	463.38	541.79	706.13	750.14	889.00
Extraordinary item	-0.02	0.05	0.03	9.6	0.03	0.02
<b>Adjusted Net Profit</b>	166.01	463.33	541.76	696.53	750.11	889.02
Equity Dividend%	10	20	30	40	30	30
<b>EPS</b>	4.66	13.11	15.16	15.25	16.28	19.90

Valuation

# Disclaimer

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