

# SOUTH INDIAN BANK



Growth momentum continues; margins back on track

## Stable core performance and impressive growth

South Indian Bank (SIB) reported stable core operating performance in Q1FY11, led by 36% advance growth and improved margins at 2.83% (against 2.77% in FY10). Asset quality also remained stable with gross NPAs at 1.3%; restructuring during the quarter was negligible. Fee income, at INR 325 mn (7% Y-o-Y growth), was below our estimates. Net interest income (NII) grew 10% Y-o-Y, to INR 1,674 mn, in line with our estimates. PAT stood at INR 584 mn compared to INR 463 mn after adjusting for extraordinary interest cost and staff expenses in Q1FY10.

## Healthy business growth; margins revert to ~2.8%

Bucking the industry trend, SIB's business growth continued to show strong traction, with advances growth at ~36% Y-o-Y and 4% Q-o-Q, to INR 167 bn. Gold loans (17% of advances) continued to witness strong traction during the quarter. Deposits remained flat at INR 233 bn. SIB's CASA ratio improved 2ppt Q-o-Q, to 25%, while low cost NRI deposits contributed 6.8% to deposits. Total contribution of NRI deposit (including high cost) declined 280bps Y-o-Y, to ~16%, but remained flat Q-o-Q. Reported NIMs reverted to 2.83% in Q1FY11 against 2.77% in FY10, driven by improvement in CD ratio (up 200bps Q-o-Q). We are building in loan book CAGR of 25% over FY11-12E and stable NIM of 2.5% (calculated).

## Asset quality stable; provision coverage ratio maintained

The bank's asset quality remained stable, with gross NPA at INR 2,231 mn (1.33%) and net NPA at INR 648mn (0.37%). Provision coverage remained stable at 71%. LLP (annualized) was contained at 0.36%. Slippages were reined in at INR 236 mn, lower than INR 435 mn (quarterly average in FY10). Restructuring for the quarter was minimal at INR 0.25 mn, with outstanding restructured assets of ~INR 3.5 bn (2.2% of advances).

## Outlook and valuation: back on track; maintain 'BUY'

SIB has reported strong core operating performance in Q1FY11. Business growth remained healthy and above industry, while margins rebounded strongly after deteriorating in Q4FY10. Provision coverage was stable, though restructured assets were below industry average. The stock is currently trading at 1.1x FY12E book, reasonably attractive for a bank delivering ROE of 17-18%. We maintain 'BUY' on SIB and rate it 'Sector Performer' on relative returns.

### Financials

Year to March	Q1FY11	Q1FY10	Growth (%)	Q4FY10	Growth (%)	FY10	FY11E
Net int. inc. (INR mn)	1,674	1,524	9.8	789	112.2	5,683	7,132
Net profit (INR mn)	584	601	(2.8)	386	51.3	2,338	2,676
B/V per share (INR)						129.7	149.2
Diluted EPS (INR)	5.2	5.3	(3.2)	3.4	51.5	20.7	23.7
Price/ Adj. book (x)						1.5	1.3
Price/ PPOP (x)						6.3	4.4
Diluted P/E (x)						8.9	7.8

July 15, 2010

Reuters: SIBK.BO Bloomberg: SIB IN

### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

Note:

Please refer last page of the report for rating explanation

### MARKET DATA

CMP	:	INR 186
52-week range (INR)	:	193 / 88
Share in issue (mn)	:	113.0
M cap (INR bn/USD mn)	:	21 / 450
Avg. Daily Vol. BSE/NSE ('000):	:	517.5

### SHARE HOLDING PATTERN (%)

Promoters*	:	0.0
MFs, FIs & Banks	:	16.0
FIIIs	:	36.8
Others	:	47.2
* Promoters pledged shares (% of share in issue)	:	NIL

### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	17.0	3.6	3.9
3 months	9.6	1.2	8.4
12 months	111.0	31.0	46.4

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Other highlights

- Core fee income grew 7% Y-o-Y, to INR 325 mn, but declined 14% Q-o-Q.
- Treasury income stood at INR 92.1 mn.
- Investment depreciation stood at INR 27.4 mn.
- The management highlighted that during the quarter it has not made any contingent provisions towards an erstwhile FEMA case. The bank has already made provisions of INR 430 mn and needs to take another INR 200 mn.

Chart 1: Business momentum continues

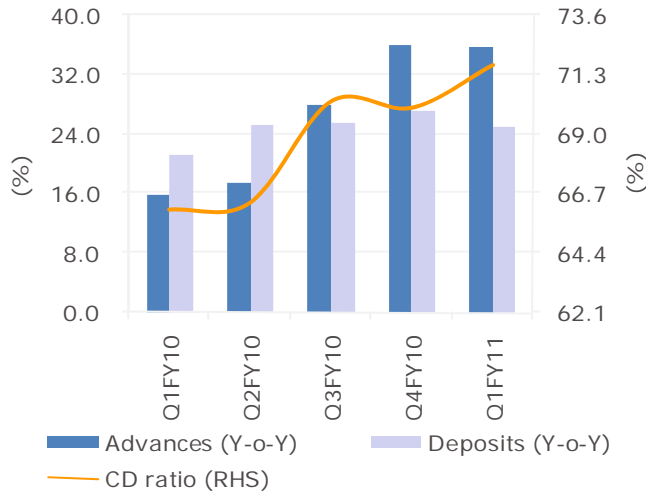
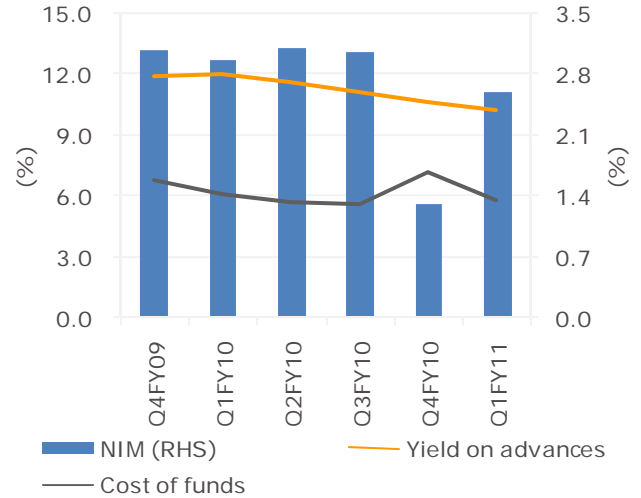
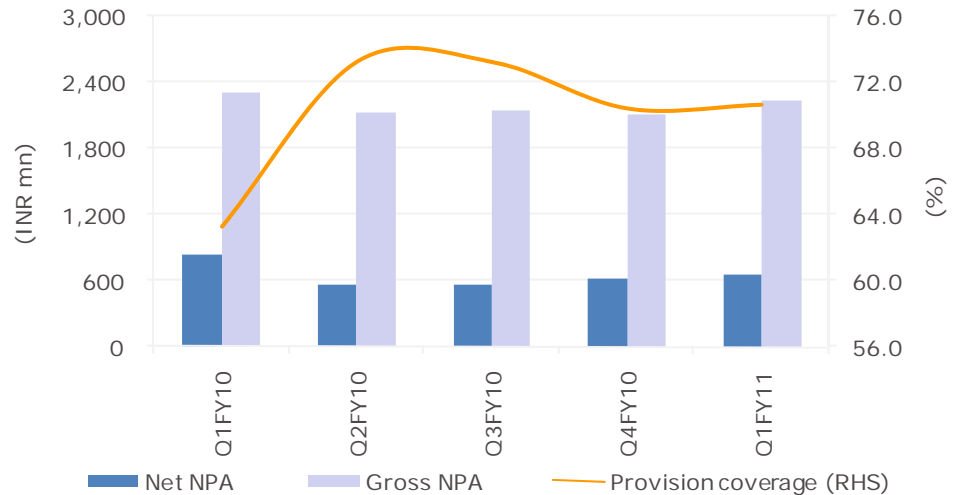


Chart 2: NIMs settling at ~2.8% level



Source: Company, Edelweiss research

Chart 3: Stable asset quality; slippages reined in



Source: Company, Edelweiss research

**Table 1: Modest fee income growth**

	Q1FY11	Q1FY10	Growth (%)	Q4FY10	Growth (%)
Com, exchange and brokerage	81	79	2.8	86	(5.4)
Forex	41	59	(29.9)	43	(3.5)
Others	202	165	22.2	250	(19.1)
Total	325	303	7.0	378	(14.2)
Profit on sale of inv	92	256		61	

Source: Company, Edelweiss research

**Financials snapshot****(INR mn)**

Year to March	Q1FY11	Q1FY10	Growth (%)	Q4FY10	Growth (%)	FY10	FY11E	FY12E
Interest on advances	4,211	3,616	16.5	4,060	3.7	15,186	19,865	25,112
Interest on investments	1,096	931	17.7	1,008	8.7	3,789	4,392	5,471
Interest on other resources	94	106	(11.4)	70	33.8	382	700	786
Interest income	5,401	4,653	16.1	5,138	5.1	19,357	24,957	31,369
Interest expenses	3,728	3,128	19.2	4,349	(14.3)	13,674	17,825	22,544
Net interest income	1,674	1,524	9.8	789	112.2	5,683	7,132	8,825
Other income	417	560	(25.6)	439	(5.0)	2,085	1,931	2,258
Fee income	325	303	7.0	378	(14.2)	1,305	1,581	1,908
Operating expenses	1,046	1,015	3.1	711	47.1	3,662	4,010	4,770
Staff expense	675	683	(1.2)	331	103.8	2,263	2,409	2,966
Other opex	372	332	11.9	380	(2.3)	1,399	1,601	1,804
Pre prov Op profit (PPP)	952	813	17.1	456	108.9	3,326	4,703	5,962
Provisions	167	104	60.1	-31	(642.2)	432	999	1,334
Profit before tax	877	965	(9.1)	547	60.4	3,674	4,054	4,979
Provision for tax	293	364	(19.5)	161	82.2	1,336	1,378	1,692
Profit after tax	584	601	(2.8)	386	51.3	2,338	2,676	3,286

**Ratios**

NII / GII	31.0	32.8		15.4		29.4	28.6	28.1
Cost - income	50.1	48.7		58.0		47.1	44.2	43.0
Provisions / PPOP	17.5	12.8		(6.8)		13.0	21.2	22.4
Tax rate	33.4	37.7		29.4		36.4	34.0	34.0

**Asset quality (INR mn)**

Gross NPA (%)	1.3	1.9		1.3		1.3	1.1	0.9
Gross NPA	2,231	2,309	(3.4)	2,110	5.7	2,110	2,192	2,394
Net NPA (%)	0.4	0.7		0.4		0.4	0.3	0.2
Net NPA	648	833	(22.2)	613	5.6	613	605	403

**Balance sheet data (INR mn)**

Advances	167,277	123,203	35.8	161,150	3.8	161,150	201,438	251,797
Deposits	233,310	186,500	25.1	230,120	1.4	230,120	280,500	350,857
CD ratio (%)	71.7	66.1		70.0		70.0	71.8	71.8

### ▪ Company Description

SIB, a private sector bank, was incorporated at Thrissur in Kerala, south India. The bank has a pan- India presence with a network of over 550 branches and over 300 ATMs across 23 states, and 2 Union Territories. ~56% of the branches are in Kerala.

SIB came out with an IPO in 1998, followed it up with a rights issue of 1:3 at a premium of INR 30 in 2004, and came out with a follow on public issue at INR 66 in 2006. SIB raised equity capital of INR 3.26bn (20m shares at Rs163/share) through a Qualified Institutional Placement in September 2007.

The new management's efforts at improving the bank's operating performance are visible with improvement in return on assets (RoA) to 1% in FY09 from 0.1% in FY05. Over the past four years, the bank has achieved considerable progress in terms of bringing profitability focus among branches, re-energizing employees, improving asset quality, and creating greater brand awareness and technology coverage. The employee compensation has been linked to performance and union clout has diminished. The re-branding exercise of bank has created greater brand re-call and awareness among customers. The bank has implemented core banking solution (CBS) platform covering the entire business. We believe the present management is innovative and dynamic, and so far superior to other regional banks' management.

### ▪ Investment Theme

South Indian Bank is one of the best regional-based private banks in the country. We like the bank for its strong regional presence, good technology network, and possible M&A play. SIB generates decent margins on the back of its structurally strong deposit franchise. Around 32% of its deposits comprise low-cost current account and savings account (CASA) deposits, and non-residential external (NRE) deposits. Of this, 25% is CASA deposits and 7% NRE deposits, (where the bank pays lower interest), which collectively enable the bank to contain its deposit costs. It offers an attractive play on robust loan growth, improving asset quality, and consolidation in the Indian banking space.

### ▪ Key Risks

- System wide economic slowdown will lead to a sharp deterioration in asset quality and lower than anticipated recoveries.
- Slowdown in business growth is a key systematic risk for the bank as 80% of total revenues are derived from net interest income. Being a mid-sized bank, it does not have huge diversification option.
- Disruption by employee union and the management's inability to sustain pace of reforms could cause concern.
- Redemption in NRE deposit base will lead to rise in cost of funds thereby impacting margin.

## Financial Statements

<b>Income statement</b>					<b>(INR mn)</b>
Year to March	FY08	FY09	FY10	FY11E	FY12E
Interest income	13,092	16,869	19,357	24,957	31,369
Interest expended	9,156	11,646	13,674	17,825	22,544
Net interest income	3,936	5,223	5,683	7,132	8,825
Non interest income	1,437	1,676	2,085	1,931	2,258
- Fee & forex income	448	558	505	631	758
- Misc. income	674	755	800	950	1,150
- Investment profits	316	364	780	350	350
Net revenue	5,374	6,899	7,768	9,063	11,082
Operating expense	2,476	3,279	3,662	4,010	4,770
- Employee exp	1,464	2,142	2,263	2,409	2,966
- Other opex	1,012	1,137	1,399	1,601	1,804
Preprovision profit	2,898	3,620	4,106	5,053	6,312
Provisions	581	607	432	999	1,334
Loan loss provisions	129	220	414	649	1,014
Investment depreciation	115	236	(409)	100	200
Other provisions	337	151	427	250	120
Profit before tax	2,317	3,014	3,674	4,054	4,979
Provision for tax	801	1,066	1,336	1,347	1,654
Profit After Tax	1,516	1,948	2,338	2,707	3,325
Reported PAT	1,516	1,948	2,338	2,707	3,325
Diluted EPS (INR)	16.8	17.2	20.7	24.0	29.4
Dividend per share (INR)	3	3	4	4	4
Dividend payout (%)	18.2	17.7	17.7	17.6	17.6

<b>Growth ratios (%)</b>					
Year to March	FY08	FY09	FY10	FY11E	FY12E
NII growth	7.2	32.7	8.8	25.5	23.7
Fees growth	14.8	24.6	(9.4)	25.0	20.0
Opex growth	13.3	32.4	11.7	9.5	19.0
PPOP growth	8.2	26.1	2.1	41.4	26.8
PPP growth	7.2	24.9	13.4	23.1	24.9
Provisions growth	(53.1)	4.5	(28.8)	131.3	33.4
Net profit	45.6	28.4	20.1	15.8	22.8

<b>Operating ratios</b>					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Yield on advances	10.5	11.4	10.9	11.0	11.1
Yield on investments	7.4	6.8	6.1	6.3	6.5
Yield on assets	8.7	9.2	8.5	8.8	9.1
Net interest margins	2.6	2.8	2.5	2.5	2.6
Cost of funds	6.3	6.7	6.2	6.5	6.7
Cost of deposits	6.5	6.8	6.5	6.8	7.0
Cost of borrowings	10.4	9.1	9.0	9.5	9.5
Spread	2.4	2.5	2.3	2.4	2.4
Cost-income	46.1	47.5	47.1	44.2	43.0
Tax rate	34.6	35.4	36.4	33.2	33.2

<b>Balance sheet</b>					<b>(INR mn)</b>
As on 31st March	FY08	FY09	FY10E	FY11E	FY12E
Equity capital	904	1,130	1,130	1,130	1,130
Reserves & surplus	10,518	11,726	13,526	15,757	18,496
Net worth	11,422	12,856	14,657	16,887	19,626
Sub bonds/pref cap	1,550	1,550	1,750	2,250	2,750
Deposits	151,561	180,923	230,120	280,500	350,857
Borrowings	276	2,570	3,309	3,309	3,309
Other liabilities	5,902	5,752	13,335	14,559	10,926
<b>Total liabilities</b>	<b>170,712</b>	<b>203,651</b>	<b>263,170</b>	<b>317,505</b>	<b>387,468</b>
Loans	104,538	118,520	161,150	201,438	251,797
Gilts	36,183	40,674	50,190	59,810	72,814
Others	9,540	20,078	14,550	16,860	19,490
Cash and equivalents	17,027	20,359	29,448	30,562	36,099
Fixed assets	940	1,179	1,311	1,541	1,753
Other Assets	2,486	2,841	6,521	7,296	5,514
<b>Total assets</b>	<b>170,712</b>	<b>203,651</b>	<b>263,170</b>	<b>317,505</b>	<b>387,468</b>
Credit growth	31.0	13.0	35.5	24.9	24.9
Deposit growth	23.8	19.4	27.2	21.9	25.1
EA growth	25.8	19.3	27.9	20.9	23.2
SLR ratio	23.8	22.2	21.5	21.0	20.5
C-D ratio	70.7	67.0	71.3	73.1	73.0
Low-cost deposits	24.1	23.8	23.1	23.5	23.8
Gross NPA ratio	1.8	2.2	1.3	1.1	0.9
Net NPA ratio	0.3	1.1	0.4	0.3	0.2
Provision coverage	82.0	48.5	71.0	72.4	83.2
Incremental slippage	0.4	0.6	1.5	1.2	1.1
Net NPA / Equity	3.0	10.4	4.2	3.6	2.1
Capital adequacy	13.8	14.8	12.7	12.0	11.7
- Tier 1	12.1	13.2	11.4	10.6	10.4
Book value per share (INR)	126.3	113.8	129.7	149.4	173.7

**RoE decomposition (%)**

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Net interest income/assets	2.6	2.8	2.5	2.5	2.6
Fees/Assets	0.7	0.7	0.6	0.6	0.6
Investment profits/Assets	0.2	0.2	0.3	0.1	0.1
Net revenues/assets	3.6	3.8	3.4	3.2	3.2
Operating expense/assets	(1.6)	(1.8)	(1.6)	(1.4)	(1.4)
Provisions/assets	(0.4)	(0.3)	(0.2)	(0.4)	(0.4)
Taxes/assets	(0.5)	(0.6)	(0.6)	(0.5)	(0.5)
Total costs/assets	(2.6)	(2.7)	(2.4)	(2.3)	(2.3)
ROA	1.0	1.1	1.0	1.0	1.0
Equity/assets	6.2	6.6	6.0	5.6	5.3
ROAE %	16.2	16.0	17.0	17.2	18.2

**Valuation parameters**

Year to March	FY08	FY09	FY10E	FY11E	FY12E
Diluted EPS (INR)	16.8	17.2	20.7	24.0	29.4
<i>Y-o-Y growth (%)</i>	<i>13.4</i>	<i>2.8</i>	<i>20.1</i>	<i>15.8</i>	<i>22.8</i>
Book value per share (INR)	126.3	113.8	129.7	149.4	173.7
Adjusted book value per share (INR)	123.7	105.4	125.9	145.7	171.2
Diluted PE (x)	11.1	10.8	9.0	7.8	6.3
Price/BV (x)	1.5	1.6	1.4	1.2	1.1
Price/ Adj. BV (x)	1.5	1.8	1.5	1.3	1.1
Dividend yield (%)	1.6	1.6	2.2	2.2	2.2
Price to income (x)	7.9	8.6	7.8	6.6	5.7
Price to PPOP (x)	6.5	6.5	6.3	4.5	3.5



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Allahabad Bank	BUY	SO	H	Axis Bank	BUY	SO	M
Bank of Baroda	BUY	SO	L	Federal Bank	BUY	SO	M
HDFC	HOLD	SU	L	HDFC Bank	HOLD	SP	L
ICICI Bank	BUY	SO	L	Indian Overseas Bank	HOLD	SU	H
Infrastructure Development Finance Co Ltd	HOLD	SU	M	ING Vysya	BUY	SO	H
Karnataka Bank	BUY	SO	L	Kotak Mahindra Bank	BUY	SP	L
LIC Housing Finance	BUY	SP	M	Manappuram General Finance	BUY	SO	M
Oriental Bank Of Commerce	BUY	SO	H	Power Finance Corp	BUY	SP	L
Punjab National Bank	BUY	SO	L	Reliance Capital	HOLD	SP	M
Rural Electrification Corporation	BUY	SO	L	Shriram City Union Finance	BUY	SP	H
South Indian Bank	BUY	SP	H	State Bank of India	BUY	SP	L
Syndicate Bank	BUY	SP	H	Union Bank Of India	BUY	SO	L
Yes Bank	BUY	SO	M				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return





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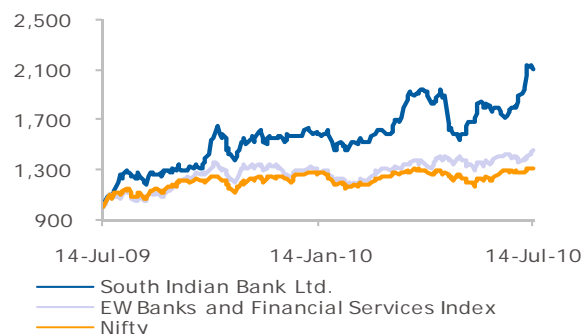
**Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services**

Allahabad Bank, Axis Bank, Bank of Baroda, Federal Bank, HDFC, HDFC Bank, ICICI Bank, Infrastructure Development Finance Co Ltd, Indian Overseas Bank, Karnataka Bank, Kotak Mahindra Bank, LIC Housing Finance, Manappuram General Finance, Oriental Bank Of Commerce, Punjab National Bank, Power Finance Corp, Reliance Capital, Rural Electrification Corporation, State Bank of India, Shriram City Union Finance, South Indian Bank, Syndicate Bank, Union Bank Of India, ING Vysya, Yes Bank

**South Indian Bank**



**EW Indices**



**Distribution of Ratings / Market Cap**

**Edelweiss Research Coverage Universe**

	Buy	Hold	Reduce	Total
Rating Distribution*	109	52	12	177
* 4 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	108	54	15	

**Recent Research**

Date	Company	Title	Price (INR)	Recos
15-Jul-10	<b>LIC Housing Finance</b>	Delivering quarter after quarter; <i>Result Update</i>	1,074	Buy
14-Jul-10	<b>HDFC</b>	Quality performance; <i>Result Update</i>	3,077	Hold
09-Jul-10	<b>Banking</b>	Liquidity blues = deposit rates set to move = Positive for margins; <i>Sector Update</i>		

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