INDIAN BANK

Quality at Compelling Valuations

Sunidhi
"In your prosperity lies our success"
Institutional Research

March 16, 2011

Rating	BUY
CMP (₹)	213
Price Target (₹)	310
Upside (%)	46

Key Data	
BSE Code	532814
NSE Code	INDIANB
Reuters Code	INBA.BO
Bloomberg Code	INBK IN
Sensex	18168
No.of Shares, mn	429.8
Face Value ₹	10
Mcap, ₹ mn	91547
Mcap,USD mn @ ₹46	1990
52 week H/L ₹	317/162
2Wk Avg. Daily Vol. BSE	0.3 Lac

Share holding, Dec'10	% Holding
Promoters	80.0
FIIS	10.7
DIIs	4.3
Others & Public	4.9
Total	100.0

Share Holding >1%	%
LIC	1.9
Emerging Mkts Mgmt	1.0
SBI Life	1.0

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Best in class NIMs coupled with sound asset quality led to superior ROAs

Indian Bank's loan book is skewed towards high yielding segments such as SME, retail and agriculture, which form about 43% of the banks advances. As a result, despite having a moderate CASA ratio of 32%, the bank's NIMs are the highest amongst its peer set at around 3.7% as compared to ~3.1% for its peers. Best in class NIMs coupled with sound asset quality and cost efficiencies has led to superior ROAs for the bank. Indian Bank's ROA at 1.7% for FY10 is one of the highest in the industry.

Loan book to grow at CAGR of 20% for FY11-13

Indian Bank has displayed a robust loan book growth in the past, with advances expanding by a CAGR of 27.6% from FY05 to FY10 as compared to a systemic CAGR of 24.6% for the same period. Going ahead we expect loan growth to moderate from current levels based on a slowdown in general bank lending to infrastructure, telecom, and microfinance sectors. Despite moderation, the advance book expansion is expected to remain strong, at around 20% CAGR for FY11-13.

Adequately capitalized to fund growth

The bank is adequately capitalized with a CRAR of 12.4% and a Tier 1 CAR of 9.7%. The bank has further headroom to raise ₹ 50720 mn of Tier II capital to fund future growth.

Asset quality concerns overdone

Despite its focus on riskier, high yielding assets, the bank's asset quality is sound. This can be attributed to its strong relationships with its clients as well as its prudent attitude towards asset quality. With the shift towards system based recognition of NPAs, the asset quality of Indian Bank witnessed a setback with slippages spiking to 5.1% in Q1FY11. In the last two quarters, however slippages have moderated and stood at 1.4% for Q3FY11. Going ahead we expect asset quality to improve on the back of system recognition of NPAs which would lead to better monitoring and control.

Outlook &Valuation

Given Indian Banks superior ROAs, best in class NIMs, sound asset quality and strong loan book growth, we believe it should trade at a premium to its peer group. At a CMP of ₹ 213, the bank is available at compelling valuations, marginally below its long term average one year forward P/ABV multiple (rolling basis) of 1.1x and at a 55% discount to its historical high valuation. We initiate coverage on Indian Bank with a BUY rating and a price target of ₹ 310 (1.4x FY12E ABV).

Brief Financials (₹mn)	NII	PAT	EPS	ABV	ROA	ROE	P/E	P/ABV
FY10	33039	15550	36.2	160.4	1.7%	24.1%	5.9	1.3
FY11E	40983	16968	39.5	185.9	1.5%	22.0%	5.4	1.1
FY12E	43987	18995	44.2	221.9	1.4%	20.8%	4.8	1.0
FY13E	53334	23392	54.4	263.5	1.5%	21.7%	3.9	0.8

Source: Company & Sunidhi Research

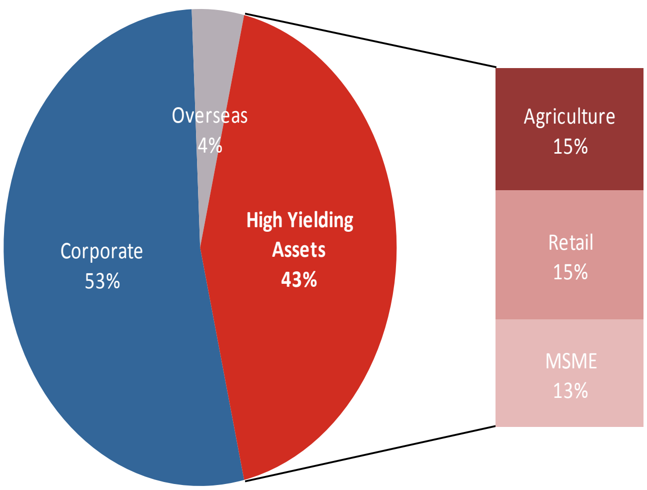
Investment Rationale

NIMs at 3.7% highest among peer group

Best in class NIMs…

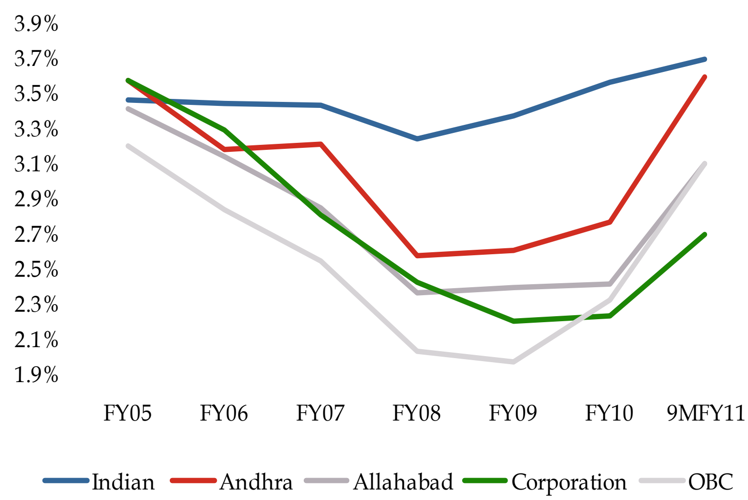
Indian Bank's loan book is skewed towards high yielding segments such as SME, retail and agriculture, which form about 43% of the banks advances. As a result, despite having a moderate CASA ratio of 32%, the bank's NIMs are the highest amongst its peer set at around 3.7%(9MFY11) as compared to ~3.1% for its peers.

Exhibit-1: Advance book composition as on 31st Dec 2010



Source: Company, Sunidhi Research

Exhibit-2: Trend in NIMs: A peer comparison



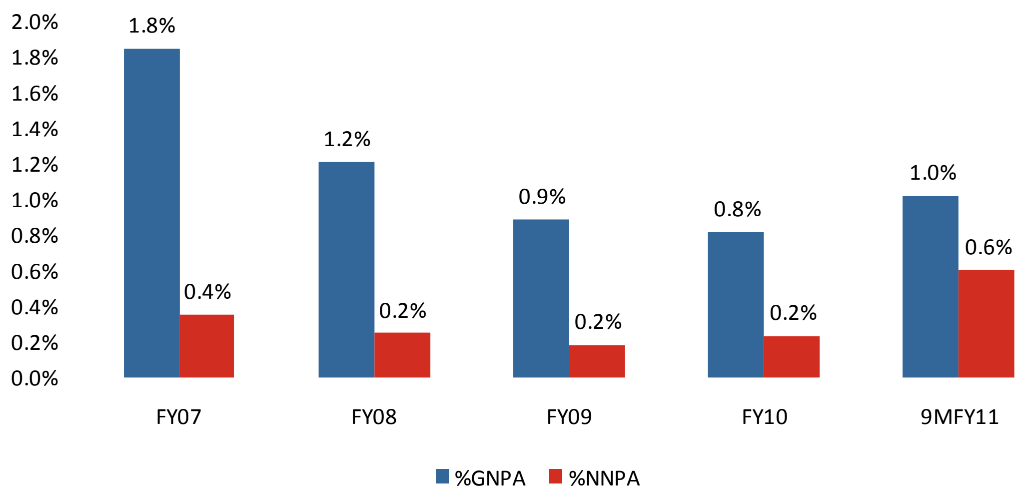
Source: Company, Sunidhi Research

Q3FY11 GNPAs at 1%, amongst lowest in the industry

…coupled with sound asset quality…

Despite its focus on riskier, high yielding assets, the bank's asset quality is sound. This can be attributed to its strong relationships with its clients as well as its prudent attitude towards asset quality. At the end of Q3FY11, the banks %GNPAs stood at 1%, amongst the lowest in the industry and %NNPAs stood at 0.6%.

Exhibit-3: Trend in asset quality

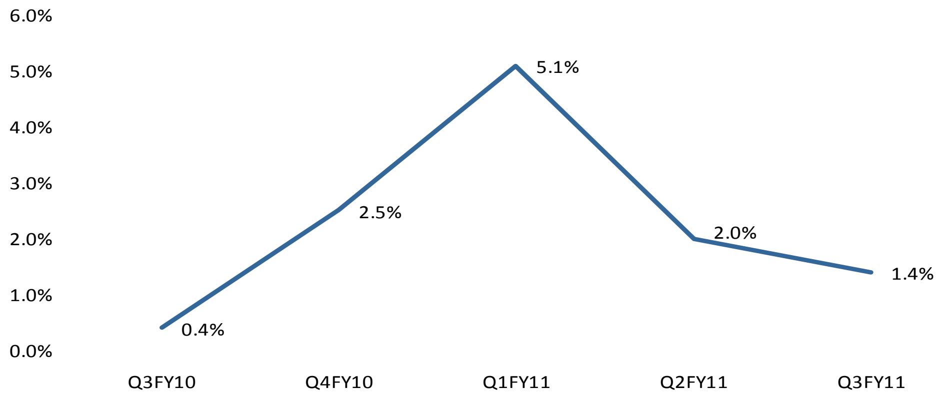


Source: Company, Sunidhi Research

The bank adopted system based recognition of NPA's from June 2010, well above the RBI's deadline of March 2011 in order to allow the bank to initiate recovery procedures and give it substantial time to clean up its books before the end of the fiscal year. As a result of this move, the bank's slippages witnessed a spike in Q1FY11. The same has however come down since then and we do not forsee any major asset quality concerns going ahead.

Move to system based NPA recognition caused a spike in slippages in Q1FY11

Exhibit-4: Trend in slippages



Source: Company, Sunidhi Research

The bank has in the past exercised prudence as far as NPA provisioning is concerned, consistently providing more than the RBI mandate. The table below compares Indian Bank's internal provisioning norms to the RBI mandate.

Prudent NPA provisioning policies

Exhibit-5: Provisioning Norms

	RBI Mandate	Indian Bank
Unsecured NPA	100%	100%
Substandard	10%	20%
Doubtful Assets 1	20%	100%
Doubtful Assets 2	30%	100%

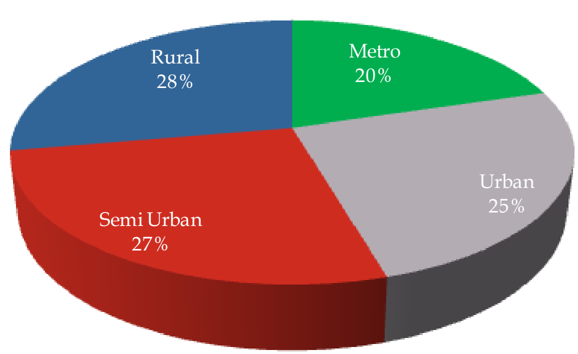
Source: Company, Sunidhi Research

...and cost efficiencies...

As a result of the bank's thrust on financial inclusion and its focus on advances to MSME and agricultural segments, around 55% of its branches are located in semi-urban and rural areas.

Focus on financial inclusion has led to cost efficiencies

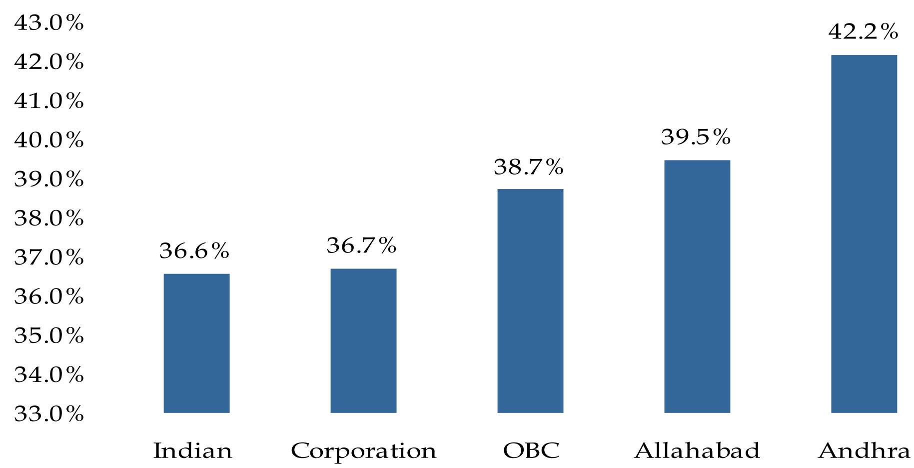
Exhibit-6: Branch Location as on 31st Dec 2010



Source: Company, Sunidhi Research

Operating expenses for branches located in semi-urban and rural areas are lower than those for urban and metro branches. Thus the bank enjoys one of the lowest cost to income ratio's amongst its peer group.

Exhibit-7: Cost to income ratio (average of trailing 5 qtrs): A peer comparison



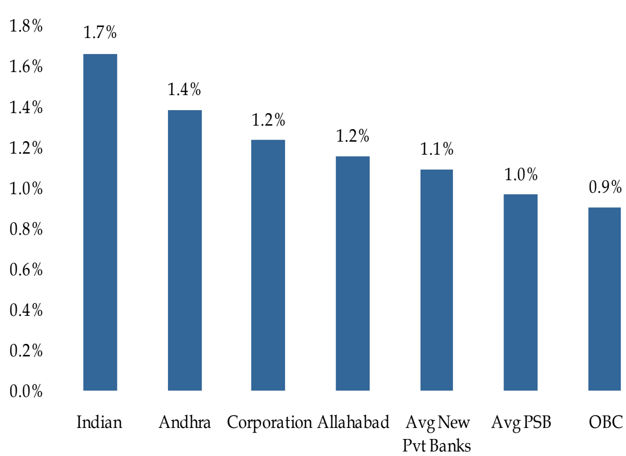
Source: Company, Sunidhi Research

…led to superior ROAs…

ROAs at 1.7% for FY10, amongst highest in the industry

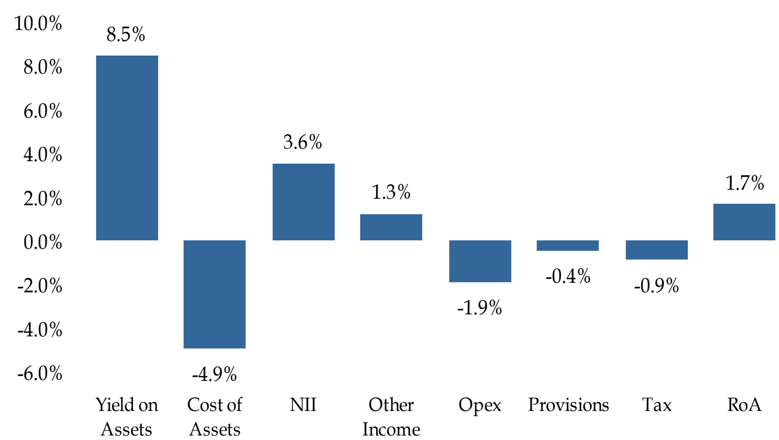
Indian Bank's ROA at 1.7% for FY10 is one of the highest in the industry. It stands well above the average ROA for all new private sector banks as well as that for public sector banks.

Exhibit-8: FY10 ROA: A comparative analysis



Source: RBI, Sunidhi Research

Exhibit-9: Dupont Analysis (FY10)



Source: Sunidhi Research

Adequately capitalized to fund growth

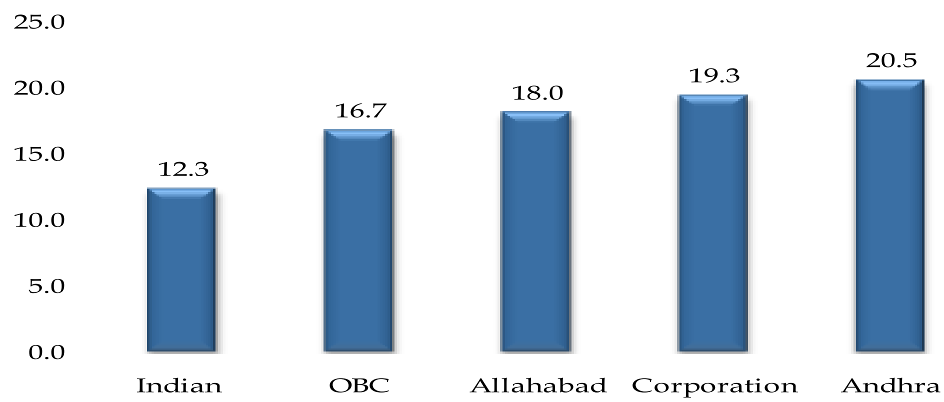
The bank has further headroom to raise ₹ 50720 mn of Tier II capital.

The bank is adequately capitalized with a CRAR of 12.4% and a Tier 1 CAR of 9.7%. The bank has further headroom to raise ₹ 50720 mn of Tier II capital. Additionally the government stake in the bank is high at 80%, thus the bank has adequate room to raise fresh capital to fund its expansion plans. The bank is planning an FPO in FY12, although the plans are yet to be finalized, it is expected that the bank would raise around ₹ 15000 mn from the issue.

Leeway to leverage balance sheet further

Indian bank's leverage ratio of 12.3x (FY10) is significantly lower than its peers that have an average leverage ratio of 18.6x. Thus, the bank has leeway to leverage its balance sheet further, which would lead to an improvement in ROE going forward.

Exhibit-10: FY10 Leverage: A peer comparison

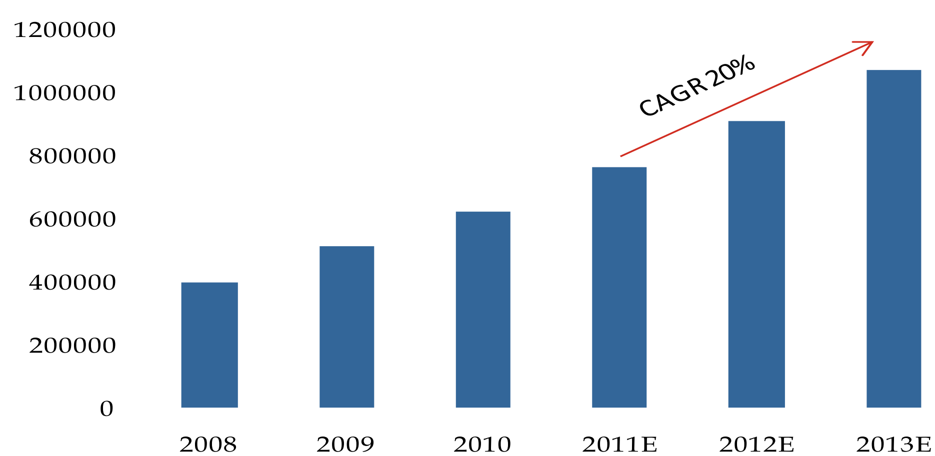


Source: Company & Sunidhi Research

Loan book to grow at a CAGR of 20% for FY11-13

Indian Bank has displayed a robust loan book growth in the past, with advances expanding by a CAGR of 27.6% from FY05 to FY10 as compared to a systemic CAGR of 24.6% for the same period. Going ahead we expect loan growth to moderate from current levels based on a slowdown in general bank lending to infrastructure, telecom, and microfinance sectors. Despite moderation, the advance book expansion is expected to remain strong, at around 20% CAGR between FY11-13.

Exhibit-11: Trend in advances growth



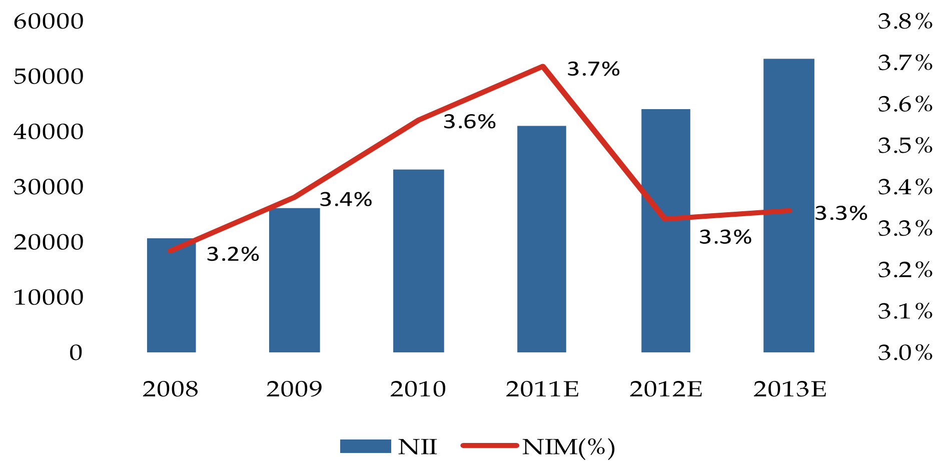
Source: Sunidhi Research

Healthy NII growth of 17% CAGR despite NIM compression

We have factored in a NIM compression of 37 bps in FY12, keeping in mind the tight liquidity scenario, coupled with the rise in interest rates. Despite NIM pressure in FY12, the NIM of Indian bank is expected to remain healthy at ~3.3%. Healthy NIMs coupled with strong growth in advances is expected to lead to a 17% CAGR in NII for FY11-13.

Exhibit-12: Trend in NII and NIM

Strong NII growth expected despite conservative NIM compression estimate of 37 bps



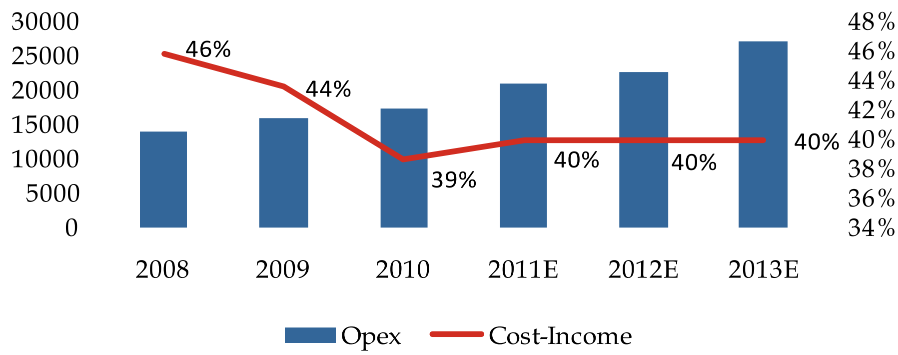
Source: Company, Sunidhi Research

Factored in a 100 bps increase in the banks cost to income ratio to 40%.

Operating expenses to rise on branch expansion and higher employee costs

Operating expenses are likely to rise on the back of higher employee costs on account of provisions towards second pension option coupled with the bank's branch expansion plans. We have factored in a 100 bps increase in the banks cost to income ratio to 40%.

Exhibit-13: Trend in operating expenses



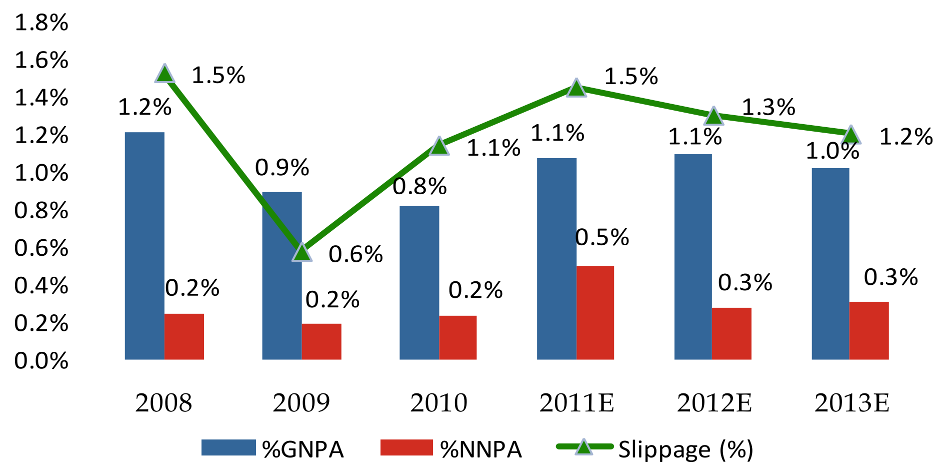
Source: Company, Sunidhi Research

Going ahead we expect asset quality to improve on the back of system recognition of NPAs which would lead to better monitoring and control.

Asset quality concerns overdone

With the shift towards system based recognition of NPAs, the asset quality of Indian Bank witnessed a setback with slippages spiking to 5.1% in Q1FY11. In the last two quarters, however slippages have moderated and stood at 1.4% for Q3FY11. The banks restructured asset book at 7% of total advances stands largely in line with that of its peers and slippages from the restructured assets stand at around 8%. Going ahead we expect asset quality to improve on the back of system recognition of NPAs which would lead to better monitoring and control.

Exhibit-14: Trend in asset quality



Source: Company, Sunidhi Research

Estimates based on conservative assumptions

Exhibit-15: Key Assumptions

Assumption	FY11E	FY12E	FY13E
Loan growth	23%	19%	18%
NIM	3.7%	3.3%	3.3%
CEB (% of avg adv)	0.3%	0.3%	0.3%
Cost-Income Ratio	40.0%	40.0%	40.0%
GNPA	1.07%	1.09%	1.02%
NNPA	0.5%	0.3%	0.3%
Slippage Rate	1.5%	1.3%	1.2%

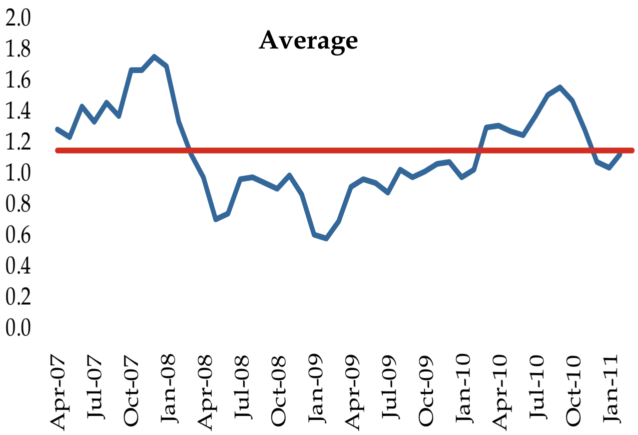
Source, Sunidhi Research

Outlook and Valuation

Available at compelling valuations

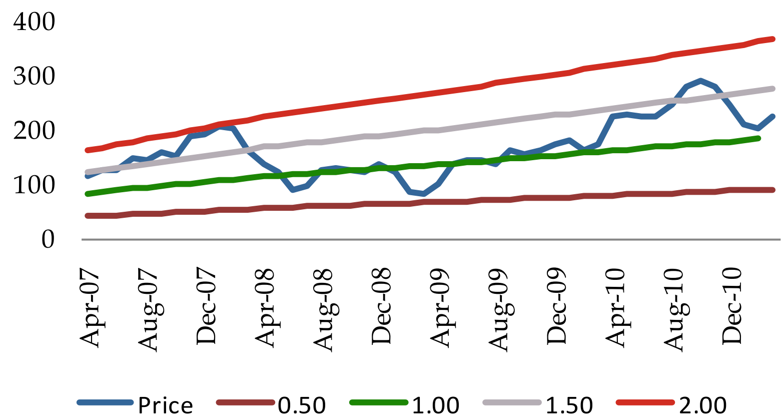
Given Indian Banks superior ROAs, best in class NIMs, sound asset quality and strong loan book growth, we believe it should trade at a premium to its peer group. At a CMP of ₹ 213, the bank is available at compelling valuations, marginally below its long term average one year forward P/ABV multiple (rolling basis) of 1.1x and at a 55% discount to its historical high valuation. We initiate coverage on Indian Bank with a BUY rating and a price target of ₹310 (1.4x FY12E ABV).

Exhibit-16: One year forward P/ABV



Source: Sunidhi Research

Exhibit-17: One year forward P/ABV Band



Source: Sunidhi Research

Exhibit-18: Peer valuation

	CMP	ROE (%)		ROA (%)		P/E (x)		P/ABV (x)	
	₹	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Indian	213	22%	21%	1.5%	1.4%	5.4	4.8	1.1	1.0
Andhra	133	25%	24%	1.2%	1.2%	5.3	4.6	1.3	1.1
Allahabad	202	26%	23%	1.3%	1.1%	5.3	4.9	1.4	1.1
Corporation	553	22%	21%	1.2%	1.2%	5.7	4.9	1.2	1.0
OBC	367	20%	18%	1.1%	1.0%	5.7	5.5	1.2	1.1

Source: Sunidhi Research, Bloomberg

Company Background

Indian Bank, established on 15th August 1907, is a south based mid-sized public sector bank with a global branch network of 1822 branches and 1085 ATMs. The bank is a frontrunner in specialized banking with over 90 branches for handling forex transactions and over 60 special SME branches. Indian bank occupies a leadership position in rural development and is a pioneer in introducing self help groups and financial inclusion projects in the country. The banks focus on financial inclusion is reflected through its loan book 43% of which is focused on the agricultural, retail and MSME segments. Despite its focus on rural, MSME lending, the bank has managed to maintain sound asset quality, with %GNPAs at 1.02% as on Dec 2010. The bank has been awarded as no.1 in Asset Quality & Efficiency for 2010 as per Business world and Price water house Cooper's Study.

Management Team

Chairman & Managing Director

Mr T M Bhasin
Mr T.M. Bhasin has assumed charge as Chairman & Managing Director of Indian Bank on 1st April 2010. Prior to assuming charge as Chairman & Managing Director, he was Executive Director of United Bank of India since 7th November 2007

Executive Director

Mr V. Rama Gopal
Shri V. Rama Gopal has assumed charge as Executive Director of Indian Bank on 7th December 2009. He joined as Probationary Officer in Indian Bank in the year 1973, before moving to Andhra Bank in 1976 where he rose to the position of General Manager.

Executive Director

Mr Rajeev Rishi
Shri. Rajeev Rishi has assumed charge as Executive Director of Indian Bank on 1st October 2010. Before joining Indian Bank, he was the General Manager of Oriental Bank of Commerce

Investment Concerns

Asset quality

Due to the banks strong focus on financial inclusion and education loans, a significant proportion of the banks advance book is unsecured. Unsecured loans stood at 14% of the loan book in FY10. High weightage of unsecured loans on the book, coupled with significant exposure to risky segments such as retail, agri, MSME poses a risk to asset quality.

Increased competition

Financial inclusion is likely to play a strong role in the government's decision on awarding new banking licenses. The government's thrust towards financial inclusion could lead to higher competition for Indian Bank.

Financials

Standalone (₹ mn)

Profit & Loss Account	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Interest Earned	68,303	78,571	96,263	117,800	139,828
Interest expended	42,218	45,532	55,279	73,813	86,494
Net interest income	26,085	33,039	40,983	43,987	53,334
Non-interest income	10,354	11,737	11,624	13,071	14,794
Net total income	**36,440**	**44,776**	**52,609**	**57,058**	**68,128**
Operating expenses	15,881	17,302	21,043	22,823	27,251
Pre- provisioning profit (PPP)	**20,558**	**27,473**	**31,564**	**34,235**	**40,877**
Provision & Contingency	2,697	3,958	5,904	5,509	5,501
PBT	17,861	23,516	25,660	28,726	35,376
Tax	5,408	7,966	8,692	9,731	11,983
PAT	**12,453**	**15,550**	**16,968**	**18,995**	**23,392**

Source: Company & Sunidhi Research

Standalone (₹ mn)

Balance Sheet	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Liabilities					
Equity Capital	4,298	4,298	4,298	4,298	4,298
Reserves	63,061	74,423	87,654	102,464	120,704
Networth	71,359	82,721	95,951	110,762	129,001
Deposits	725,818	882,277	1,047,120	1,246,073	1,533,381
Borrowings	8,308	9,574	13,759	27,289	16,101
Other Liabilities & Provisions	35,053	39,322	49,913	56,148	72,403
Total Liabilities	840,538	1,013,893	1,206,744	1,440,271	1,750,886
Assets					
Cash & Balances with RBI	62,116	70,607	80,272	99,056	118,297
Balances with Banks & money at Call	4,722	10,525	8,769	9,576	12,659
Investments	228,006	282,683	315,430	395,460	466,171
Government Securities	194,553	238,810	266,474	334,083	393,819
Advances	513,965	621,461	764,397	909,633	1,073,367
Fixed Assets	15,942	15,796	18,101	21,604	26,263
Other Assets	15,787	12,821	19,775	4,942	54,129
Total Assets	840,538	1,013,893	1,206,744	1,440,271	1,750,886

Source: Company & Sunidhi Research

Ratios	FY2009	FY2010	FY2011E	FY2012E	FY2013E
RoNW	23.0%	24.1%	22.0%	20.8%	21.7%
RoA	1.6%	1.7%	1.5%	1.4%	1.5%
Cost to income	43.6%	38.6%	40.0%	40.0%	40.0%
NIM	3.4%	3.6%	3.7%	3.3%	3.3%
CASA	31.6%	32.2%	33.2%	34.2%	34.2%
GNPA	0.9%	0.8%	1.1%	1.1%	1.0%
NNPA	0.2%	0.2%	0.5%	0.3%	0.3%

Source: Company & Sunidhi Research

Valuation Table	FY2009	FY2010	FY2011E	FY2012E	FY2013E
Net profit (₹ mn)	12,453	15,550	16,968	18,995	23,392
Shares in issue (mn)	429.8	429.8	429.8	429.8	429.8
EPS (₹)	29.0	36.2	39.5	44.2	54.4
EPS growth	23.5%	24.9%	9.1%	11.9%	23.1%
PE (x)	7.4	5.9	5.4	4.8	3.9
P/PPP (x)	4.5	3.3	2.9	2.7	2.2
Book value (₹/share)	166.0	192.5	223.3	257.7	300.2
P/BV (x)	1.3	1.1	1.0	0.8	0.7
Adj book value (₹/share)	134.4	160.4	185.9	221.9	263.5
P/ABV (x)	1.6	1.3	1.1	1.0	0.8
ROA	1.6%	1.7%	1.5%	1.4%	1.5%
RONW	23.0%	24.1%	22.0%	20.8%	21.7%

Source: Company & Sunidhi Research

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