

SOUTH INDIAN BANK



Beat on core – led by margins

Strong core operating performance

South Indian Bank (SIB) reported strong core operating performance in Q2FY11. Net interest income (NII), after adjusting for extraordinary interest cost in Q2FY10, grew 40% Y-o-Y (much ahead of our expectations), to INR 1.97 bn; this was led by 36% advance growth and better margins at 3% (against 2.83% in Q1FY11), a function of higher average CD ratio during the quarter. Provisioning also surprised positively with credit cost coming lower at 0.12% (against 0.31% in FY10) as gross NPLs came off to 1.27% (from 1.33% in Q1FY11). Core fee income, at INR 386 mn (up 34% Y-o-Y and 19% Q-o-Q), was ahead of our estimates. PAT stood at INR 770 mn against INR 588 mn in Q2FY10, after adjusting for extraordinary interest cost and staff expenses (reported PAT at INR 726mn). During the quarter, the bank made good use of the strong core income to make provisions towards pension and gratuity, reflecting in higher staff costs.

Healthy business growth; margins revert

SIB's business growth continued to show strong traction, with advances growth at ~36% Y-o-Y and 6% Q-o-Q, to INR 177 bn. Gold loans grew 14% Q-o-Q (62% Y-o-Y), to INR 33 bn (equivalent to 19% of loan book), followed by SSI growing at 60% Y-o-Y. Deposits grew 27% Y-o-Y and 7.4% Q-o-Q, to INR 250 bn. However, SIB's CASA ratio declined 124bps Q-o-Q, to 24%, while low cost NRI deposits contributed 6.3% to deposits (against 6.8% in Q1FY11). Total contribution of NRI deposit (including high cost) declined 111bps Q-o-Q, to 14.7%. Reported NIMs improved 17bps Q-o-Q, to 3% in Q2FY11 (against 2.77% in FY10). While CD ratio dropped 100bps Q-o-Q to 70.7%, management indicated that average CD ratio during Q2FY11 remained above 72%, leading to margin uptick. We are building in loan book CAGR of 27% over FY11-12E and stable NIM of 2.8% (calculated).

Outlook and valuation: Back on track; maintain 'BUY'

SIB reported strong core operating performance in Q2FY11. Business growth remained healthy and above industry, while margins rebounded strongly after deteriorating in Q4FY10. Provision coverage was stable, while restructured assets were below industry average. We are revising our estimate by 7%, and the stock is currently trading at 1.6x FY12E book, reasonably attractive for a bank delivering ROE of 19%. We maintain 'BUY' on SIB and rate it 'Sector Performer' on relative returns.

Financials

Year to March	Q2FY11	Q2FY10	Growth (%)	Q1FY11	Growth (%)	FY10	FY11E
Net int. inc. (INR mn)	1,973	1,652	19.4	1,674	17.9	5,683	7,977
Net profit (INR mn)	770	726	6.1	584	31.8	2,338	2,891
B/V per share (INR)						13.0	15.0
Diluted EPS (INR)	0.7	0.6	5.9	0.5	32.0	2.1	2.6
Price/ Adj. book (x)						2.2	1.9
Price/ PPOP (x)						0.8	0.7
Diluted P/E (x)						13.4	10.8

October 21, 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	Equalweight

Note:

Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 28
52-week range (INR)	:	28 / 13
Share in issue (mn)	:	1,130.1
M cap (INR bn/USD mn)	:	31 / 704
Avg. Daily Vol. BSE/NSE ('000):	:	6,423.5

SHARE HOLDING PATTERN (%)

Promoters*	:	0.0
MFs, FIs & Banks	:	13.2
FIIIs	:	37.6
Others	:	49.2
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	25.9	0.0	(1.4)
3 months	45.7	11.4	19.5
12 months	86.2	17.0	31.4

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■ **Asset quality stable; provision coverage ratio maintained**

The bank's asset quality remained stable, with gross NPA at INR 2,277 mn (1.27% of advances) and net NPA at INR 671 mn (0.38% of advances). Provision coverage remained stable at 71%. LLP (annualised) dropped further to 0.12% against 0.32% in Q1FY11 (0.31% in FY10). Slippages were reined in at INR 261 mn (INR 100 mn in Q1FY11) and lower than INR 435 mn (quarterly average in FY10). Restructuring for the quarter was at INR 240 mn, with outstanding restructured assets of ~INR 4.4 bn (2.5% of advances).

■ **Other highlights**

- Treasury income stood at INR 62 mn.
- 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.
- Liability towards pension, second pension option and gratuity are estimated at INR 1.47 bn at end of FY11, to be amortised over three years. INR 170 mn has been provided towards the same this quarter.

Chart 1: Business momentum continues

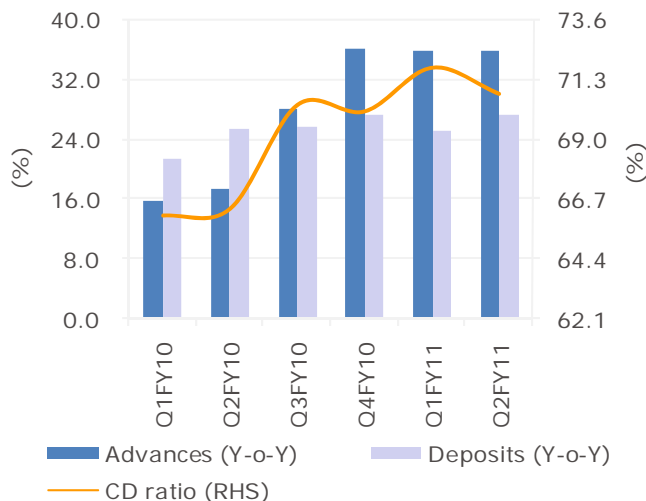
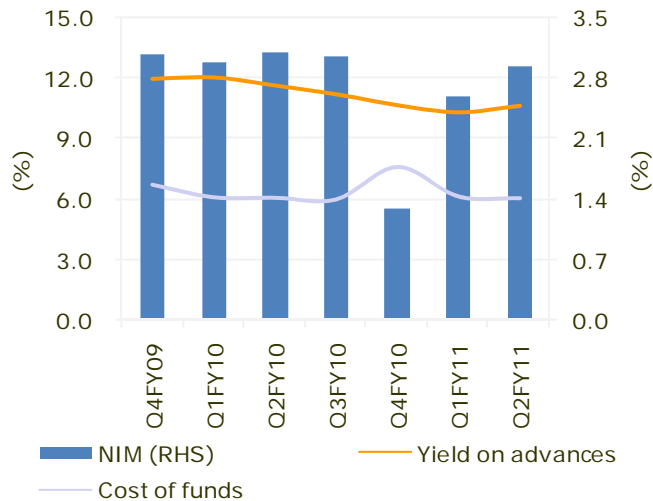
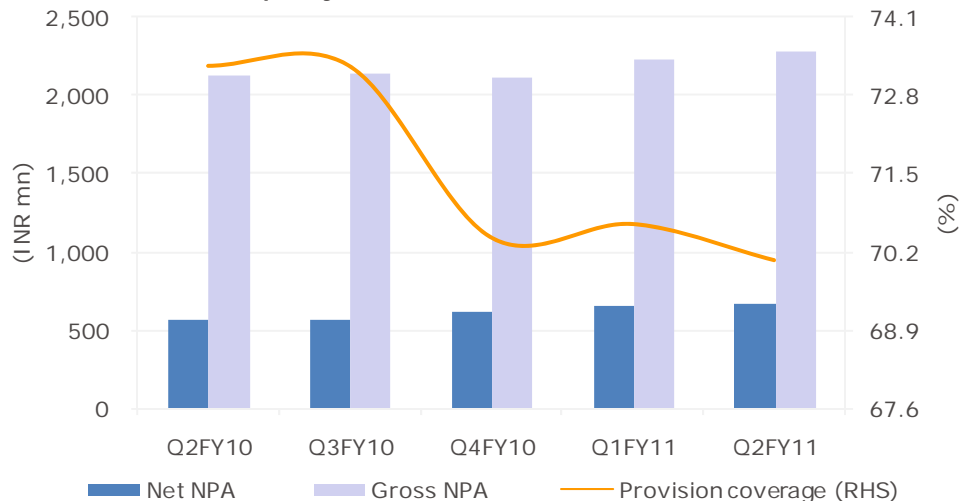


Chart 2: NIMs (cal) touched 2.9%



Source: Company, Edelweiss research

Chart 3: Stable asset quality



Source: Company, Edelweiss research

Financials snapshot

(INR mn)

Year to March	Q2FY11	Q2FY10	Growth (%)	Q1FY11	Growth (%)	FY10	FY11	FY12
Interest on advances	4,556	3,671	24.1	4,211	8.2	15,186	20,234	26,404
Interest on investments	1,164	922	26.3	1,096	6.3	3,781	4,412	5,368
Interest on other resources	75	96	(21.6)	94	(20.3)	390	596	811
Interest income	5,795	4,689	23.6	5,401	7.3	19,357	25,243	32,583
Interest expenses	3,822	3,037	25.9	3,728	2.5	13,674	17,267	22,858
Net interest income	1,973	1,652	19.4	1,674	17.9	5,683	7,977	9,725
Other income	449	655	(31.5)	417	7.7	2,556	1,842	2,077
Fee income	386	289	33.7	325	19.0	1,775	1,543	1,727
Operating expenses	1,174	968	21.2	1,046	12.2	3,662	4,739	5,592
Staff expense	774	634	22.1	675	14.7	2,263	3,115	3,762
Other opex	400	335	19.4	372	7.6	1,399	1,624	1,830
Pre prov Op profit (PPP)	1,186	973	21.9	952	24.6	4,577	5,079	6,210
Investment gains	62	366	(83.0)	92	(32.5)	364	781	299
Provisions	68	165	(58.6)	167	(59.2)	904	706	813
Profit before tax	1,180	1,174	0.5	877	34.5	3,673	4,373	5,397
Provision for tax	410	448	(8.6)	293	40.1	1,335	1,482	1,830
Profit after tax	770	726	6.1	584	31.8	2,338	2,891	3,568
EPS (INR)	0.7	0.6	5.9	0.5	32.0	2.1	2.6	3.2

Ratios

NII / GII	34.0	35.2		31.0		29.4	31.6	29.8
Cost - income	48.5	42.0		50.1		46.8	46.0	47.6
Provisions / PPOP	5.7	16.9		17.5		19.8	13.9	13.1
Tax rate	34.7	38.2		33.4		36.4	33.9	33.9
CD ratio (%)	70.7	66.3		71.7		69.3	71.5	71.5
CASA ratio (%)	23.9	24.3		25.1		23.8	23.5	23.8
Net interest margin (%)	3.0	2.6		2.8		2.5	2.8	2.7

Balance sheet data (INR mn)

Advances	177,179	130,590	35.7	167,277	5.9	158,229	205,698	257,122
Deposits	250,604	196,880	27.3	233,310	7.4	230,115	289,867	362,068
CD ratio (%)	70.7	66.3		71.7		68.8	71.0	71.0

Asset quality (INR mn)

Gross NPA (%)	1.3	1.6		1.3		2.2	1.1	0.9
Gross NPA	2,277	2,129	7.0	2,231	2.1	2,606	2,190	2,397
Net NPA (%)	0.4	0.4		0.4		0.4	0.3	0.3
Net NPA	671	564	18.9	648	3.6	616	659	661
Provision coverage (%)	70.1	73.3		70.7		82.1	69.7	72.3

- **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 30% of its deposits comprise low-cost current account and savings account (CASA) deposits, and non-residential external (NRE) deposits. Of this, 24% is CASA deposits and 6% 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

Income statement		(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E	
Interest income	13,092	16,869	19,357	25,243	32,583	
Interest expenses	9,156	11,646	13,681	17,267	22,858	
Net interest income	3,936	5,223	5,676	7,977	9,725	
Non interest income	1,437	1,676	2,556	1,842	2,077	
- Fee & forex income	448	558	975	1,084	1,188	
- Misc. income	674	755	800	459	539	
- Investment profits	316	364	781	299	350	
Net revenues	5,374	6,899	8,232	9,818	11,802	
Operating expense	2,476	3,279	3,662	4,739	5,592	
- Employee exp	1,464	2,142	2,263	3,115	3,762	
- Other opex	1,012	1,137	1,399	1,624	1,830	
Preprovision profit	2,898	3,620	4,570	5,079	6,210	
Provisions	581	607	904	706	813	
- Loan loss provisions	129	220	371	366	413	
- Investment depreciation	115	236	0	120	200	
- Other provisions	337	151	533	220	200	
PBT	2,317	3,014	3,666	4,373	5,397	
Taxes	801	1,066	1,335	1,482	1,830	
PAT	1,516	1,948	2,331	2,891	3,568	
Reported PAT	1,516	1,948	2,331	2,891	3,568	
Diluted EPS	1.7	1.7	2.1	2.6	3.2	
DPS	3.0	3.0	4.0	4.0	4.0	
Payout ratio (%)	18.2	17.7	19.6	19.6	19.6	

Growth ratios (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
NII growth	7.2	32.7	8.7	40.5	21.9
Fees growth	14.8	24.6	74.9	11.2	9.6
Opex growth	13.3	32.4	11.7	29.4	18.0
PPOP growth	8.2	26.1	16.4	26.2	22.6
PPP growth	7.2	24.9	26.2	11.1	22.3
Provisions growth	(53.1)	4.5	49.1	(21.9)	15.1
PAT growth	45.6	28.4	19.7	24.0	23.4

Operating ratios (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Yield on advances	10.5	11.4	11.0	11.1	11.4
Yield on investments	7.4	6.8	5.8	5.9	6.2
Yield on assets	8.7	9.2	8.6	8.9	9.2
Net interest margins	2.6	2.8	2.53	2.81	2.74
Cost of funds	6.3	6.7	6.3	6.2	6.6
Cost of deposits	6.5	6.8	6.5	6.5	6.9
Cost of borrowings	10.4	9.1	7.5	9.5	9.5
Spread	2.4	2.5	2.3	2.7	2.6
Cost-income	46.1	47.5	44.5	48.3	47.4
Tax rate	34.6	35.4	36.4	33.9	33.9

Balance sheet					
	(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E
Liabilities					
Equity capital	904	1,130	1,130	1,130	1,130
Reserves	10,518	11,726	13,542	15,865	18,732
Net worth	11,422	12,856	14,672	16,995	19,862
Sub bonds/pref cap	1,550	1,550	0	500	1,000
Deposits	151,561	180,923	230,115	289,867	362,068
Borrowings	276	2,570	3,310	3,310	3,310
Other liabilities	5,902	5,752	7,063	19,898	14,852
Total	170,712	203,651	255,160	330,569	401,092
Assets					
Loans	104,538	118,520	158,229	205,698	257,122
Investments					
Gilts	36,183	40,674	56,410	61,731	75,066
Others	9,540	20,078	15,146	17,366	19,907
Cash & equi	17,027	20,359	19,877	33,075	38,649
Fixed assets	940	1,179	1,345	1,560	1,758
Other assets	2,486	2,841	4,153	11,139	8,588
Total	170,712	203,651	255,160	330,570	401,092
Balance sheet ratios (%)					
Credit growth	31.0	13.0	31.7	29.9	25.0
Deposit growth	23.8	19.4	27.2	26.0	24.9
EA growth	25.8	19.3	25.1	27.3	22.9
SLR ratio	23.8	22.2	24.2	21.0	20.5
C-D ratio	70.7	67.0	69.3	71.5	71.5
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	0.3
Provision coverage	82.0	48.5	70.8	69.9	72.4
Incremental slippage	0.4	0.6	0.1	1.2	1.1
Net NPA / Equity	3.0	10.4	4.2	3.9	3.3
Capital adequacy	13.8	14.8	14.7	4.2	4.7
- Tier 1	12.1	13.2	11.9	4.4	4.8
Book value (INR)	13	11	13	15	18
ROA decomposition (%)					
Year to March	FY08	FY09	FY10	FY11E	FY12E
Net interest Income/Assets	2.6	2.8	2.5	2.8	2.7
Fees/Assets	0.7	0.7	0.8	0.5	0.5
Investment profits/Assets	0.2	0.2	0.3	0.1	0.1
Net revenues/Assets	3.6	3.8	3.7	3.5	3.3
Operating expense/Assets	(1.6)	(1.8)	(1.6)	(1.7)	(1.6)
Provisions/Assets	(0.4)	(0.3)	(0.4)	(0.2)	(0.2)
Taxes/Assets	(0.5)	(0.6)	(0.6)	(0.5)	(0.5)
Total costs/Assets	(2.6)	(2.7)	(2.6)	(2.4)	(2.3)
ROA	1.0	1.1	1.0	1.0	1.0
Equity/Assets	6.2	6.6	6.1	5.6	5.2
ROAE	16.2	16.0	16.9	18.3	19.4

Valuation metrics

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	1.7	1.7	2.1	2.6	3.2
<i>EPS growth (%)</i>	<i>13.4</i>	<i>2.8</i>	<i>19.7</i>	<i>24.0</i>	<i>23.4</i>
Book value per share (INR)	12.6	11.4	13.0	15.0	17.6
Adjusted book value/share (x)	12.4	10.5	12.6	14.6	17.2
Diluted P/E (x)	16.5	16.0	13.4	10.8	8.8
Price/ BV (x)	2.2	2.4	2.1	1.8	1.6
Price/ ABV (x)	2.2	2.6	2.2	1.9	1.6
Dividend yield (%)	<i>10.8</i>	<i>10.8</i>	<i>14.5</i>	<i>14.5</i>	<i>14.5</i>
Price to income (x)	1.2	1.3	1.0	1.0	0.9
Price to PPOP (x)	1.0	1.0	0.8	0.7	0.5



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	SP	H
Karnataka Bank	BUY	SO	L	Kotak Mahindra Bank	BUY	SP	L
LIC Housing Finance	BUY	SP	M	Manappuram General Finance	HOLD	SU	M
Oriental Bank Of Commerce	BUY	SU	H	Power Finance Corp	BUY	SO	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	SO	H	SREI Infrastructure Finance	UNDER REVIEW	SO	L
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

Edelweiss
Ideas create, values protect



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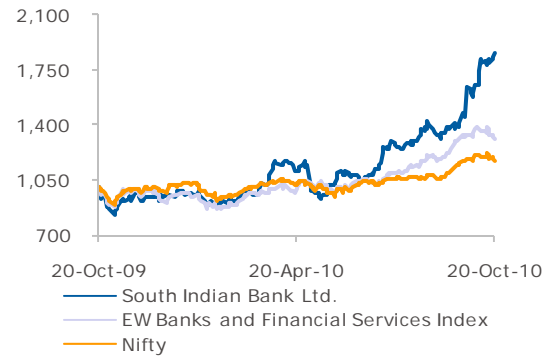
Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

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, SREI Infrastructure Finance, 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*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recos
21-Oct-10	Allahabad Bank	Momentum continues; <i>Result Update</i>	241	Buy
20-Oct-10	Kotak Mahindra Bank	Financing business going strong; few one-offs suppress earnings; <i>Result Update</i>	502	Buy
20-Oct-10	Yes Bank	Growth unlimited; <i>Result Update</i>	352	Buy

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