

# Raise PO on 2Q earnings beat and positive risk return

## Raise PO to Rs260 on positive risk-return

We raise our PO to Rs260 factoring in +6% 2Q earnings beat driven by topline surprise. We have also raised earnings by only +4/3% for FY12/13 (earnings growth at +14/18% in FY12/13), as we normalize credit costs at +70bps (vs. 50bps reported). Risk-return remains positive, with stock trading at +1.1-1.2x FY12E book / 1.0x FY13E book, with RoEs of still +20/21%, resp. We believe Indian Bk can trade up to ~1.2x FY13E book owing to healthy return ratios. Our target multiple is still at a +15% discount to Gordon multiples owing to low stock liquidity (Govt. owns 80% of stock) and higher exposures to riskier sectors (~20% of loans to Infra; +4% to textiles).

## 2Q: +6% beat (adj. earnings) on topline surprise

Indian Bank reported earnings of Rs4.7bn, 13% yoy growth (+15% headline beat) driven by topline surprise and in part, also owing to int. on IT refund of Rs400mn (incl. in other income). Adjusted for this, earnings beat of +6%. Topline grew 16% yoy driven by 24% yoy loan growth and flat margins (up 33bps qoq). Other income (core) was up +6% yoy. CASA down ~250bps yoy and 75bps qoq to 30%. Capital remains very healthy, with Tier 1 at ~11% (total at 13.3%).

## Asset quality manageable, despite higher qoq slippages

Slippages for Indian Bk increased by +125% qoq (to Rs3.8bn). However, almost +40-50% of this rise qoq was driven by ~3 corporate / SME a/c's (Dye unit, Steel unit and a Hotel), which the mgmt believes will be upgraded in the subsequent quarters. Owing to higher slippages, headline gross NPLs are up 30% qoq (at 1.2%) and net up 42% (at 0.7%). But provision cover stands healthy at +79%. We estimate slippages at +Rs11.5bn for FY12 and credit costs at ~75bps.

## Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	15,150	16,741	19,050	22,446	26,397
EPS	35.25	38.95	44.33	52.23	61.42
EPS Change (YoY)	25.4%	10.5%	13.8%	17.8%	17.6%
Dividend / Share	6.50	7.50	8.50	9.50	11.00
Pre-exceptional EPS	35.25	38.95	44.33	52.23	61.42
Pre-exceptional EPS Change (YoY)	25.4%	10.5%	13.8%	17.8%	17.6%
Book Value / Share	154.66	184.44	208.80	240.41	277.64

## Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	6.1x	5.6x	4.9x	4.1x	3.5x
Dividend Yield	NA	NA	NA	NA	NA
Pre-exceptional PE	6.14x	5.56x	4.89x	4.15x	3.53x
Price / Book	1.18x	1.02x	0.926x	0.824x	0.727x
RoE / PB	17.54x	19.31x	21.46x	25.53x	30.13x
Price / Pre-Provision Profit	3.39x	2.83x	2.54x	2.14x	1.85x

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11104474

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## Stock Data

Price	Rs216.55
Price Objective	Rs260.00
Date Established	1-Nov-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs184.55-Rs310.90
Mrkt Val / Shares Out (mn)	US\$1,911 / 429.8
Market Value (mn)	Rs93,067
Average Daily Volume	269,571
BofAML Ticker / Exchange	INBIF / BSE
Bloomberg / Reuters	INBK IN / INBA.BO
ROE (2012E)	19.9%
Total Dbt to Cap (Mar-2011A)	NA
Est. 5-Yr EPS / DPS Growth	25.0% / 20.0%
Free Float	20.0%

## Key Changes

(Rs)	Previous	Current
Price Obj.	240.00	260.00
2012E EPS	42.81	44.33
2013E EPS	50.88	52.23
2014E EPS	60.05	61.42

## iQprofile<sup>SM</sup> Indian Bank

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
<b>(Rs Millions)</b>					
Net Interest Income	31,612	40,361	46,862	54,738	63,493
Net Fee Income	2,235	3,355	3,758	4,284	4,927
Securities Gains / (Losses)	3,603	1,484	1,262	1,577	1,498
Other Income	7,326	6,979	7,464	8,346	9,340
<b>Total Non-Interest Income</b>	<b>13,164</b>	<b>11,819</b>	<b>12,484</b>	<b>14,207</b>	<b>15,765</b>
Total Operating Income	44,776	52,180	59,346	68,944	79,258
Operating Expenses	(17,302)	(19,263)	(22,639)	(25,551)	(28,842)
<b>Pre-Provision Profit</b>	<b>27,473</b>	<b>32,917</b>	<b>36,707</b>	<b>43,393</b>	<b>50,415</b>
Provisions Expense	(4,021)	(7,194)	(6,420)	(8,346)	(9,598)
<b>Operating Profit</b>	<b>23,452</b>	<b>25,723</b>	<b>30,287</b>	<b>35,047</b>	<b>40,817</b>
Non-Operating Income	64.00	621.40	(1,256)	(948.41)	(821.00)
<b>Pre-Tax Income</b>	<b>23,516</b>	<b>26,345</b>	<b>29,031</b>	<b>34,098</b>	<b>39,996</b>
Net Income to Comm S/Hold.	15,150	16,741	19,050	22,446	26,397
<b>Adjusted Net Income (Operating)</b>	<b>15,150</b>	<b>16,741</b>	<b>19,050</b>	<b>22,446</b>	<b>26,397</b>

### Key Balance Sheet Data

Total Assets	1,013,893	1,217,183	1,430,739	1,616,928	1,842,207
Average Interest Earning Assets	893,164	1,079,800	1,285,209	1,482,540	1,685,365
<b>Weighted Risk Assets</b>	<b>628,924</b>	<b>747,951</b>	<b>872,501</b>	<b>1,032,018</b>	<b>1,257,862</b>
Total Gross Customer Loans	621,461	752,499	880,424	1,012,487	1,184,610
Total Customer Deposits	882,277	1,058,042	1,252,110	1,413,901	1,610,286
<b>Tier 1 Capital</b>	<b>70,027</b>	<b>82,424</b>	<b>93,738</b>	<b>107,319</b>	<b>123,320</b>
Tangible Equity	65,021	75,295	82,145	89,675	101,246
<b>Common Shareholders' Equity</b>	<b>78,721</b>	<b>91,211</b>	<b>100,489</b>	<b>112,995</b>	<b>128,029</b>

### Key Metrics

Net Interest Margin	3.54%	3.74%	3.65%	3.69%	3.77%
<b>Tier 1 Ratio</b>	<b>11.1%</b>	<b>11.0%</b>	<b>10.7%</b>	<b>10.4%</b>	<b>9.8%</b>
Effective Tax Rate	33.9%	34.9%	33.0%	33.0%	33.0%
Loan / Assets Ratio	61.3%	61.8%	61.5%	62.6%	64.3%
<b>Loan / Deposit Ratio</b>	<b>70.4%</b>	<b>71.1%</b>	<b>70.3%</b>	<b>71.6%</b>	<b>73.6%</b>
Oper Leverage (Inc Growth - Cost Growth)	13.9%	5.2%	-3.8%	3.3%	2.1%
Gearing (Assets / Equity)	12.9x	13.3x	14.2x	14.3x	14.4x
Tangible Common Equity / Assets	6.4%	6.2%	5.7%	5.5%	5.5%
Tangible Common Equity / WRAs	10.3%	10.1%	9.4%	8.7%	8.0%
Revenue Growth	22.9%	16.5%	13.7%	16.2%	15.0%
Operating Expense Growth	8.9%	11.3%	17.5%	12.9%	12.9%
Provisions Expense Growth	1,310.5%	78.9%	-10.8%	30.0%	15.0%
Operating Revenue / Average Assets	4.8%	4.7%	4.5%	4.5%	4.6%
Operating Expenses / Average Assets	1.9%	1.7%	1.7%	1.7%	1.7%
<b>Pre-Provision ROA</b>	<b>3.0%</b>	<b>3.0%</b>	<b>2.8%</b>	<b>2.8%</b>	<b>2.9%</b>
ROA	1.6%	1.5%	1.4%	1.5%	1.5%
<b>Pre-Provision ROE</b>	<b>47.6%</b>	<b>45.1%</b>	<b>43.2%</b>	<b>45.3%</b>	<b>47.2%</b>
ROE	20.7%	19.7%	19.9%	21.0%	21.9%
RoTE	23.3%	22.2%	23.2%	25.0%	26.1%
RoWRAs	2.4%	2.2%	2.2%	2.2%	2.1%
Dividend Payout Ratio	21.4%	22.1%	21.6%	20.6%	20.3%
<b>Efficiency Ratio (Cost / Income Ratio)</b>	<b>42.0%</b>	<b>38.0%</b>	<b>39.0%</b>	<b>37.9%</b>	<b>37.1%</b>
<b>Total Non-Interest Inc / Operating Inc</b>	<b>29%</b>	<b>23%</b>	<b>21%</b>	<b>21%</b>	<b>20%</b>
Market-Related Revenue / Total Revenues	10.6%	5.7%	5.0%	5.2%	4.9%
Provisioning Burden as % of PPP	14.6%	21.9%	17.5%	19.2%	19.0%
NPLs plus Foreclosed Real Estate / Loans	0.8%	1.0%	1.6%	2.5%	3.2%
<b>Loan Loss Reserves / NPLs</b>	<b>78.8%</b>	<b>97.2%</b>	<b>46.9%</b>	<b>32.9%</b>	<b>25.5%</b>
Loan Loss Reserves / Total Loans	0.7%	1.0%	0.7%	0.8%	0.8%
Provisions Expense / Average Loans	0.7%	1.0%	0.8%	0.9%	0.8%

### Other Metrics

Income / Employee	2.28	2.70	2.93	3.24	3.55
(Operating Expenses) / Employee	0.881	0.998	1.12	1.20	1.29
Pre-Provision Profit / Employee	1.40	1.70	1.81	2.04	2.26
Net Profit / Employee	0.771	0.867	0.940	1.05	1.18

### Company Description

The bank started on 15 Aug 1907. Indian Bank experienced some financial setbacks in the 1990s. Post recapitalization and restructuring of the bank by GOI, Indian Bank has become a +US\$20bn bank with +1750 branches across India and deposit market share of +2.0% and loan market share of 1.7% in the system. The bank offers one of the highest RoAs and RoEs in the Indian Banking space.

### Investment Thesis

We expect Indian Bank's recent restructuring programme to drive healthy earnings growth over the next few years. The bank is focusing on the non-urban market, which has a strong potential and low competition but higher risks as well. The bank has tied up with Corporation Bank and OBC to provide great value to customers and benefit from cost synergies in functions like procurement, IT hardware and ATMs, etc. We see the risk reward as attractive.

### Stock Data

Price to Book Value 0.9x

## 2QFY12 Results Summary

Table 1: 2QFY12 Results Summary

Indian Bank	2QFY11	2QFY12	yoy	Comments
Interest earned	22,756	30,348	33.4%	
- on Advances / Bills	17,259	23,562	36.5%	24% loan growth led by Corporate (30%) and Overseas (46%)
- Income on investments	5,388	6,752	25.3%	
- on bal with RBI	109	34	-68.7%	
Interest Expended	12,924	18,994	47.0%	CASA down ~240bps yoy to 29.8%
<b>Net Interest Income</b>	<b>9,832</b>	<b>11,354</b>	<b>15.5%</b>	11% ahead of estimates. Margins flat yoy and up +30bps qoq
Other income	2,837	3,423	20.7%	Other income include interest on Income tax refund (Rs400mn)
<b>Operating income</b>	<b>12,669</b>	<b>14,777</b>	<b>16.6%</b>	
Total Opex	5,279	5,568	5.5%	
Employee exp	3,692	3,667	-0.7%	
Other op exp	1,587	1,901	19.8%	
<b>Operating profit</b>	<b>7,389</b>	<b>9,209</b>	<b>24.6%</b>	13% ahead of estimates
Provisions	1,330	2,203	65.7%	Gross NPAs (at 1.2%) up 30% qoq and Net (at 0.7%) up 42% qoq. Coverage continues to be healthy at +79%.2Q
PBT	6,060	7,005	15.6%	slippages at Rs3.8bn vs Rs1.7bn in 1Q.
Provision for Tax	1,902	2,318	21.9%	
<b>PAT</b>	<b>4,158</b>	<b>4,687</b>	<b>12.7%</b>	Earnings (adj. for one-offs) 6% ahead of est. on stronger topline. Headline no. 15% ahead of est.
PPP (ex-TP)	7,189	8,999	25.2%	

Source: BofA Merrill Lynch Global Research Estimates

## Price objective basis & risk

### Indian Bank (INDIF)

Our PO of Rs260 is based on average historical PB multiple. Our PO is still at a +15% discount to theoretical multiples owing to Indian Bks higher exposure to possible problem sectors (Power, textiles, Steel, etc) at 20%. PO also captures the discount for low stock liquidity (Govt. owns 80% of stock). Downside risks to our PO are further rise in NPLs and slower asset growth leading to weak earnings outlook.

## Link to Definitions

### Financials

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

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**India - Financials Coverage Cluster**

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Corporation Bank	XCRRF	CRPBK IN	Veekesh Gandhi
	Federal Bank	XFDRF	FB IN	Veekesh Gandhi
	HDFC	HGDF	HDFC IN	Rajeev Varma
	HDFC Bank	XHDF	HDFCB IN	Rajeev Varma
	HDFC Bank	HDB	HDB US	Rajeev Varma
	ICICI Bank	ICIJF	ICICIB IN	Rajeev Varma
	ICICI Bank - A	IBN	IBN US	Rajeev Varma
	IndiaBulls Financial Services	IBLFF	IBULL IN	Veekesh Gandhi
	Indian Bank	INDIF	INBK IN	Rajeev Varma
	LIC Housing Finance, Ltd.	LHFLF	LICHF IN	Veekesh Gandhi
	Manappuram	XMGPF	MGFL IN	Veekesh Gandhi
	Max India	XMJIF	MAX IN	Rajeev Varma
	Power finance corporation Ltd	PWFEE	POWF IN	Veekesh Gandhi
	Punjab	PUJBF	PNB IN	Rajeev Varma
	Reliance Capital	RLCCF	RCAPT IN	Veekesh Gandhi
	Rural Electrification Corporation Ltd	XULEF	RECL IB	Veekesh Gandhi
	SBI	SBINF	SBIN IN	Rajeev Varma
	SBI -G	SBKFF	SBID LI	Rajeev Varma
	Shriram Transport Finance	SHTFF	SHTF IN	Veekesh Gandhi
	Yes Bank Ltd	YESBF	YES IN	Veekesh Gandhi
<b>NEUTRAL</b>				
	Axis Bank	XAXSF	AXSB IN	Rajeev Varma
	Axis Bank - GDR	XBKSF	AXB LI	Rajeev Varma
	Bank of Baroda	BKBAF	BOB IN	Rajeev Varma
<b>UNDERPERFORM</b>				
	Bank of India	XDIIF	BOI IN	Rajeev Varma
	Canara Bank	CNRKF	CBK IN	Rajeev Varma
	IDBI	XDBIF	IDBI IN	Veekesh Gandhi
	Infrastruct Dev	IFDFF	IDFC IN	Rajeev Varma
	Kotak Mahindra Bank	XXRVF	KMB IN	Rajeev Varma
	ORBC	ORBCF	OBC IN	Rajeev Varma
	Union Bank India	UBOIF	UNBK IN	Rajeev Varma

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>	<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

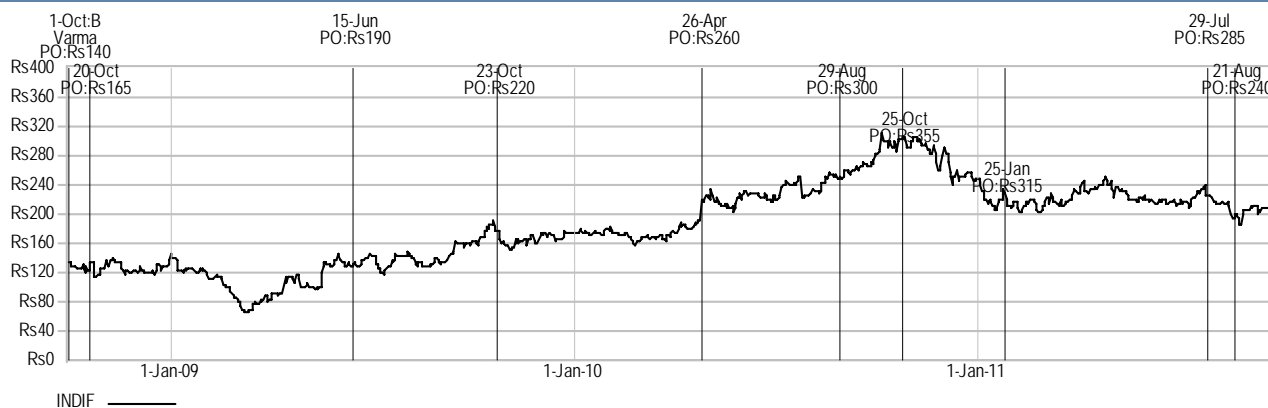
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### INDIF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [September 30, 2011] or such later date as indicated.

### Investment Rating Distribution: Banks Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	123	48.05%	Buy	63	63.00%
Neutral	76	29.69%	Neutral	41	65.08%
Sell	57	22.27%	Sell	27	49.09%

### Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

\* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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