

June 25, 2013

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Rating	BUY
Price	Rs22
Target Price	Rs28
Implied Upside	27.3%
Sensex	18,541
Nifty	5,590

(Prices as on June 25, 2013)

Trading data

Market Cap. (Rs bn)	2.4
Shares o/s (m)	113.4
3M Avg. Daily value (Rs m)	46.8

Major shareholders

Promoters	0.00%
Foreign	43.97%
Domestic Inst.	12.28%
Public & Other	43.75%

Stock Performance

(%)	1M	6M	12M
Absolute	(13.8)	(15.7)	(7.3)
Relative	(7.9)	(11.9)	(16.6)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2014	3.7	4.4	-15.7
2015	4.5	5.3	-14.6

Price Performance (RIC: SIBK.BO, BB: SIB IN)



Source: Bloomberg

We upgrade South Indian Bank (SIB) to 'BUY' after remaining cautious for the last nine months as (1) Some of the structural issues we have been highlighting have played out with the impact running through the P&L now (2) We do not see NBFCs-like risk to SIB's gold book and Infra book risks also seem limited (3) Moderation of return ratios and possible asset quality risks have been more than factored in with ~30% drop in P/B multiples. Upgrade to 'BUY' with a PT of Rs28/share implying 1.1x Sep-14 book (~30% upside).

- Large part of structural challenges recognized:** Structural issues like low CASA, NRI deposit de-reg, low PSL compliance and high dependence on low credit costs to deliver ROAs were the key reasons for our UW rating for the last nine months. Though low CASA remains, issues like NRI de-reg deposit is fully recognised and ~60bps of credit costs in FY13 has led to consensus increasing their credit costs expectations. Also, PSL compliance has improved from FY12 (31% from <25%) levels and mgt. expects a steady recovery from here on.
- Asset quality manageable; Gold book risk not as high as NBFCs:** (1) SIB's Infra book is <20% private power and disclosures on road exposure shows limited risk (2) Ex-NAFED, corporate book asset quality remained robust, given high share of secured funding (3) Gold portfolio at ~20% of loans remains a risk with falling gold prices. However, management discussions indicate that >90% LTV portfolio is "nil" currently and hence, risk in that book is lower than that for NBFCs.
- Return ratios come-off but valuations down further; Upgrade to 'BUY':** In line with our earlier expectations, ROAs for SIBs have come down to <1% from 1.15% in FY11-13. However, ~30% fall in valuations in the last nine months does reflect the ROA deterioration and asset quality risks. Admittedly, leverage levels for SIB remain unsustainable (no risk weight on gold loans currently) but even adjusting for that, we believe ROEs of ~15-16% is reasonable considering valuations at 0.75x Mar-15 book. **Upgrade to 'BUY', with PT of Rs28/share (~30% upside).**

Key financials (Y/e March)

	2012	2013	2014E	2015E
Net interest income (Rs m)	10,217	12,808	14,470	16,961
Growth (%)	29.2	25.4	13.0	17.2
Operating profit (Rs m)	6,515	8,486	9,158	10,884
PAT (Rs m)	4,017	5,023	5,011	6,063
EPS (Rs)	3.5	3.8	3.7	4.5
Growth (%)	36.9	5.9	(0.2)	21.0
Net DPS (Rs)	0.6	0.6	0.7	0.8

Profitability & Valuation

	2012	2013	2014E	2015E
NIM (%)	2.80	2.85	2.70	2.71
RoAE (%)	21.6	20.5	16.4	17.3
RoAA (%)	1.10	1.12	0.94	0.97
P / BV (x)	1.2	1.0	0.9	0.8
P / ABV (x)	1.2	1.1	0.9	0.8
PE (x)	6.1	5.7	5.8	4.8
Net dividend yield (%)	2.8	2.8	3.2	3.7

Source: Company Data; PL Research

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Some of the structural issues now recognized

Structural issues like low CASA, NRI deposit de-reg, low PSL compliance and high dependence on low credit costs to deliver ROAs were the key reasons for our UW rating for the last nine months. Though low CASA remains, issues like NRI de-reg deposit is fully recognized and ~60bps of credit costs in FY13 has led to consensus, increasing credit costs expectations as well. Also, PSL compliance has improved from FY12 levels (31% from 20%). SIB expects a slow and steady recovery from here on.

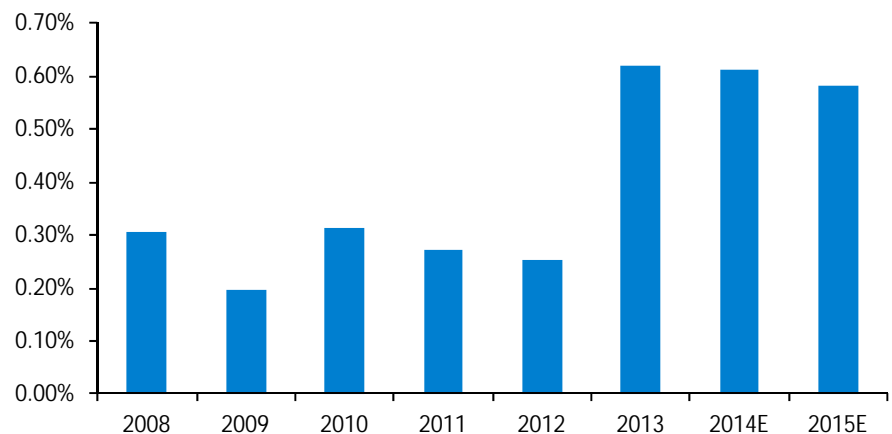
Exhibit 1: NRI deposit de-reg almost done -- Negative impact on NIMs recognized

	FY11	FY13
NRE SB	12,540	14,273
FCNR	5,000	3,471
NRO SB	1,570	2,254
NRO TD	9,850	5,542
NRE TD	10,120	39,675
Total NRI deposits	39,100	65,224
Low Cost Deposits	29,250	20,008
(% of NRI deposits)	74.8%	30.7%
(% of total deposits)	9.8%	4.5%

NRI deposit de-regulation done – Negative impact would reflect in margins

Source: Company Data, PL Research

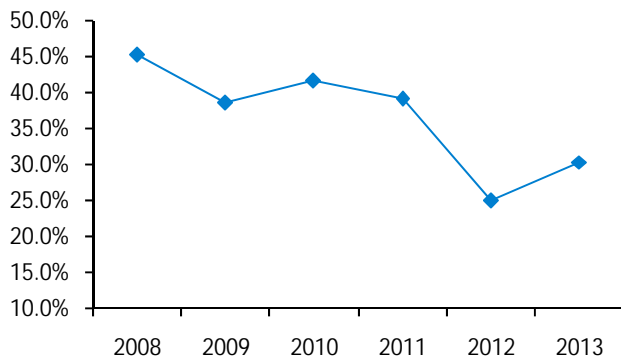
Exhibit 2: Credit costs inched up in FY13 after 5 yrs of <30bps of credit costs



We have been highlighting that credit costs at ~30bps for last five years were low, given dominance of SME/corporate book

Source: Company Data, PL Research

Exhibit 3: Some rebound in PSL compliance to 31% from <25% in FY12



Source: Company Data, PL Research

Exhibit 4: PSL compliance up largely driven by MSME reclassification – Agri and other PSL segments growth inline with B/S

	FY11	FY12	FY13	YoY
Agri and related	36,867	19,932	22,594	13.4%
MSME	12,658	17,655	45,515	157.8%
Other priority sector	13,393	14,628	17,809	21.7%
Total Priority Sector	62,918	52,215	85,918	64.5%

Source: Company Data, PL Research

Overall PSL compliance has improved due to higher MSME compliance but Agri and weaker section PSL compliance remain weak

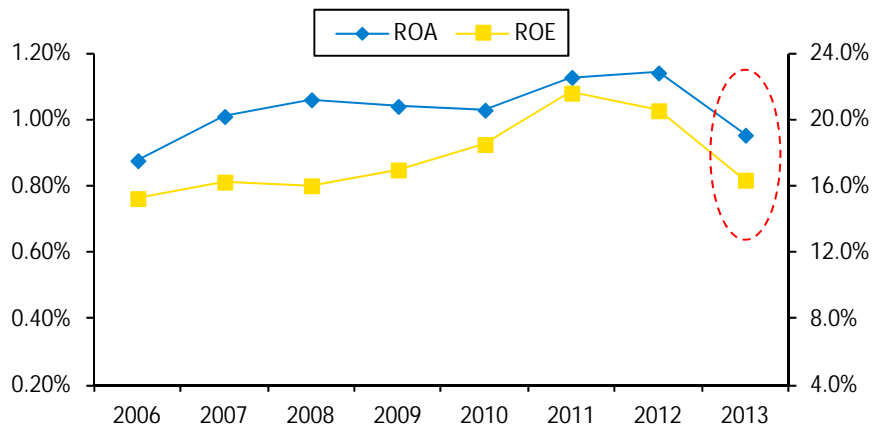
Exhibit 5: Agri and Weaker sections compliance remains weak

	Target	Achievement	Shortfall
Overall PSL	40.0%	31.2%	8.8%
Direct Agri	13.5%	5.3%	8.2%
Indirect Agri	4.5%	3.0%	1.5%
Total Agri	18.0%	8.2%	9.8%
Weaker Section	10.0%	5.4%	4.6%

Source: Company Data, PL Research

Return ratios have moderated due to the above recognitions – We expect stability or improvement in most issues from here on

Exhibit 6: Return ratios have come off in response to recognitions

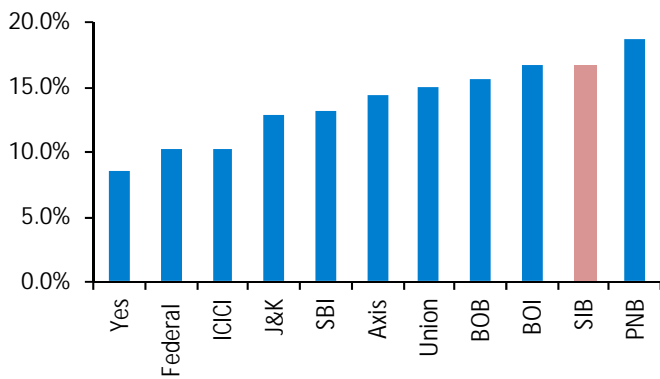


Source: Company Data, PL Research

Asset quality manageable; Gold book risk not as high as NBFCs

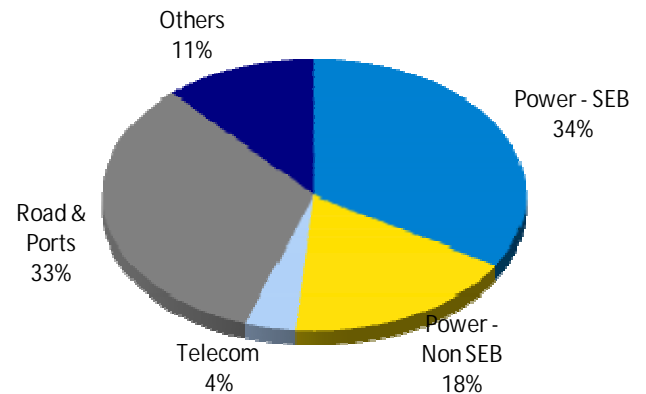
(1) SIB's Infra book is <20% private power and disclosures on road exposure shows limited risk (2) Ex-NAFED, corporate book asset quality remained robust, given high share of secured funding (3) Gold portfolio at -19% of loans remains a risk with falling gold prices. However, management discussion indicated that >90% LTV portfolio is "nil" currently and hence, risk in that book is lower than that for NBFCs.

Exhibit 7: Infra book large v/s peers...



Source: Company Data, PL Research

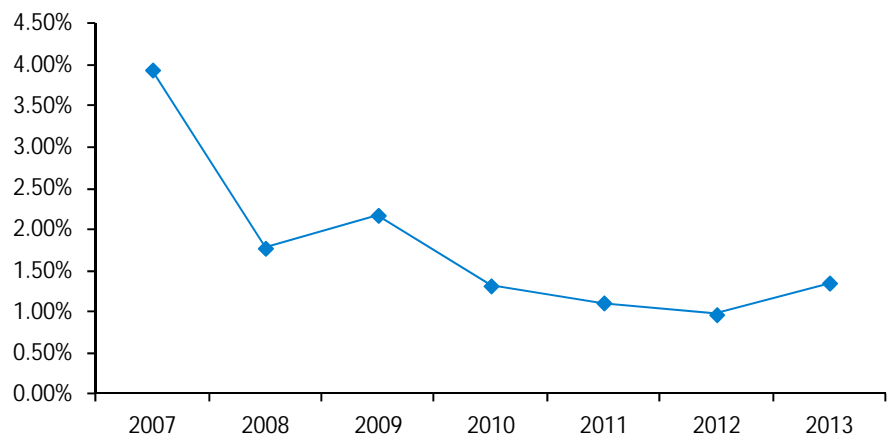
Exhibit 8: ...but not as risky – Private power <20% of Infra book



Source: Company Data, PL Research

Exhibit 9: Some inch-up in Gross NPAs but largely manageable (Gross NPA %)

Gross NPAs have inched up but still low relative to peers, especially PSUs, which have similar valuations



Source: Company Data, PL Research

Exhibit 10: Gold loan portfolio less risky than NBFCs

No gold loans with >90% LTVs even after
~15% fall in gold prices

	2010	2011	2012	2013
Gold Loan portfolio	28,680	46,330	54,090	69,720
Total Loans	158,228	204,887	272,807	318,155
% of Loans	18.1%	22.6%	19.8%	21.9%
% of incremental Loans	37.8%	37.8%	11.4%	34.5%
>100% LTV				0.00%
>90% LTV				0.00%
Portfolio with 87% LTV				2.87%

Source: Company Data, PL Research

Return ratios come off but valuations down further; Upgrade to BUY

In line with our earlier expectations, ROAs for SIB have come down to <1% from 1.15% in FY11-13. However, ~30% fall in valuations in the last nine months does reflect ROA deterioration and asset quality risks. Admittedly, leverage levels for SIB remain unsustainable (no risk weight on gold loans), even adjusting for that, we believe ROEs of ~15% is reasonable considering valuations at 0.75x Mar-15 book. Upgrade to 'BUY' with PT of Rs28/share (30% upside).

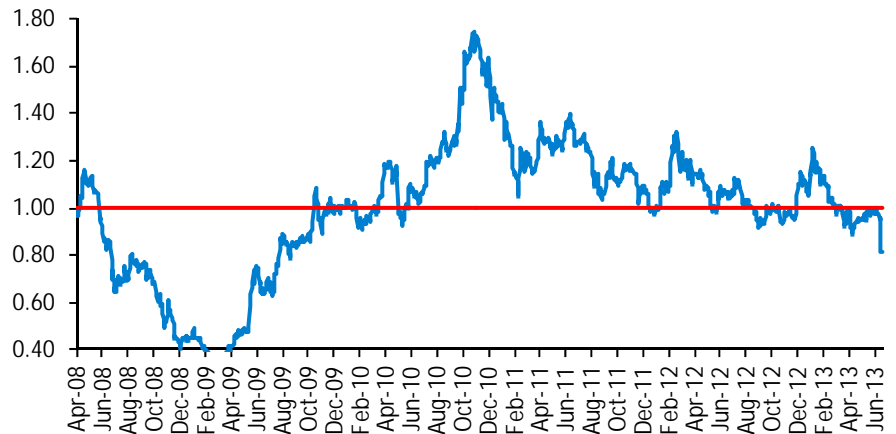
Exhibit 11: Return ratios have come off in FY13 – But some of the structural issues remain

	2009	2010	2011	2012	2013	2014E	2015E	2016E
NIM/Assets	2.85%	2.53%	2.78%	2.87%	2.91%	2.75%	2.76%	2.75%
Fees/Assets	0.70%	0.58%	0.56%	0.58%	0.63%	0.58%	0.59%	0.59%
Inv. Gains/Assets	0.20%	0.35%	0.14%	0.12%	0.13%	0.14%	0.12%	0.10%
Net Revenues/Assets	3.75%	3.46%	3.48%	3.56%	3.67%	3.48%	3.47%	3.44%
Opex/Assets	-1.79%	-1.63%	-1.63%	-1.73%	-1.74%	-1.74%	-1.70%	-1.67%
Provisions/Assets	-0.31%	-0.19%	-0.28%	-0.22%	-0.44%	-0.40%	-0.38%	-0.36%
Taxes/Assets	-0.58%	-0.59%	-0.54%	-0.48%	-0.35%	-0.39%	-0.40%	-0.41%
Total Costs/Assets	-2.68%	-2.42%	-2.45%	-2.44%	-2.53%	-2.53%	-2.49%	-2.44%
ROA	1.06%	1.04%	1.03%	1.13%	1.14%	0.95%	0.99%	1.00%
Equity/Assets	6.62%	6.13%	5.56%	5.22%	5.56%	5.83%	5.69%	5.55%
ROE	16.03%	16.99%	18.52%	21.62%	20.55%	16.37%	17.33%	18.03%
RORWA	2.05%	2.24%	2.25%	2.54%	2.50%	1.99%	2.06%	2.08%

Source: Company Data, PL Research

Exhibit 12: Valuations have corrected significantly over the last 12 months

Recent fall in valuations more than reflects the change in return ratios that we were worried about nine months back



Source: Company Data, PL Research

Exhibit 13: South Indian bank - PT of Rs28/share

Risk free rate	7.8%
Equity Risk Premium	6.0%
Beta	1.35
Cost of Equity	15.9%
Terminal growth	5.0%
Normalised ROE	14.6%
Stage 2 growth	13.0%
Mar-14 PT	28
Implied Sep-14 P/B	1.07
Implied Sep-14 P/E	6.8

Our PT of Rs28/share implies ~30% upside from current level

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2012	2013	2014E	2015E
Int. Earned from Adv.	28,681	35,759	40,896	46,672
Int. Earned from Inv.	6,211	7,464	9,260	10,899
Others	942	1,120	1,120	1,120
Total Interest Income	35,834	44,343	51,276	58,691
Interest expense	25,617	31,535	36,806	41,730
NII	10,217	12,808	14,470	16,961
<i>Growth (%)</i>	29.2	25.4	13.0	17.2
Treasury Income	416	582	750	750
NTNII	2,055	2,767	3,072	3,625
Non Interest Income	2,471	3,349	3,822	4,375
Total Income	38,305	47,692	55,098	63,066
<i>Growth (%)</i>	44.9	24.5	15.5	14.5
Operating Expense	6,173	7,672	9,133	10,451
Operating Profit	6,515	8,486	9,158	10,884
<i>Growth (%)</i>	24.0	30.2	7.9	18.8
NPA Provisions	601	1,830	2,101	2,345
Investment Provisions	151	112	—	—
Total Provisions	792	1,927	2,101	2,345
PBT	5,723	6,559	7,058	8,539
Tax Provisions	1,707	1,536	2,047	2,476
<i>Effective Tax Rate (%)</i>	29.8	23.4	29.0	29.0
PAT	4,017	5,023	5,011	6,063
<i>Growth (%)</i>	37.3	25.1	(0.2)	21.0

Balance Sheet (Rs m)

Y/e March	2012	2013	2014E	2015E
Par Value	10	10	10	10
No. of equity shares	113	134	134	134
Equity	1,134	1,339	1,339	1,339
Networth	20,229	28,656	32,571	37,381
Adj. Networth	19,325	26,161	29,839	34,774
Deposits	365,005	442,623	515,413	611,482
<i>Growth (%)</i>	22.8	21.3	16.4	18.6
Low Cost deposits	71,793	82,328	96,640	110,067
<i>% of total deposits</i>	19.7	18.6	18.8	18.0
Total Liabilities	402,226	496,545	574,491	676,737
Net Advances	272,807	318,155	369,060	435,491
<i>Growth (%)</i>	33.2	16.6	16.0	18.0
Investments	93,999	125,235	151,642	178,536
Total Assets	402,226	496,571	574,491	676,737

Source: Company Data, PL Research.

Quarterly Financials (Rs m)

Y/e March	Q1FY13	Q2FY13	Q3FY13	Q4FY13
Interest Income	10,694	10,717	11,278	11,654
Interest Expense	7,727	7,740	7,751	8,317
Net Interest Income	2,968	2,977	3,526	3,337
Non Interest Income	750	728	662	1,210
CEB	—	—	—	—
Treasury	—	—	—	—
Net Total Income	3,718	3,706	4,188	4,547
Operating Expenses	1,643	1,709	1,834	2,486
Employee Expenses	1,002	1,015	1,082	1,627
Other Expenses	641	695	752	859
Operating Profit	2,075	1,996	2,354	2,061
Core Operating Profit	2,075	1,996	2,354	2,061
Provisions	254	560	455	659
Loan loss provisions	—	—	—	—
Investment Depreciation	—	—	—	—
Profit before tax	1,821	1,437	1,899	1,402
Tax	591	465	616	(136)
PAT before EO	1,230	972	1,283	1,538
Extraordinary item	—	—	—	—
PAT	1,230	972	1,283	1,538

Key Ratios

Y/e March	2012	2013	2014E	2015E
CMP (Rs)	22	22	22	22
Equity Shrs. Os. (m)	113	134	134	134
Market Cap (Rs m)	2,443	2,885	2,885	2,885
<i>M/Cap to AUM (%)</i>	0.6	0.6	0.5	0.4
EPS (Rs)	3.5	3.8	3.7	4.5
Book Value (Rs)	18	21	24	28
Adj. BV (75%) (Rs)	18	21	24	28
P/E (x)	6.1	5.7	5.8	4.8
P/BV (x)	1.2	1.0	0.9	0.8
P/ABV (x)	1.2	1.1	0.9	0.8
DPS (Rs)	0.6	0.6	0.7	0.8
<i>Dividend Yield (%)</i>	2.8	2.8	3.2	3.7

Profitability (%)

Y/e March	2012	2013	2014E	2015E
NIM	2.8	2.9	2.7	2.7
RoAA	1.1	1.1	0.9	1.0
RoAE	21.6	20.5	16.4	17.3

Efficiency

Y/e March	2012	2013	2014E	2015E
<i>Cost-Income Ratio (%)</i>	48.7	47.5	49.9	49.0
<i>C-D Ratio (%)</i>	74.7	71.9	71.6	71.2
Business per Emp. (Rs m)	—	—	—	—
Profit per Emp. (Rs m)	—	—	—	—
Business per Branch (Rs m)	865	897	907	934
Profit per Branch (Rs m)	5	6	5	5

Asset Quality

Y/e March	2012	2013	2014E	2015E
Gross NPAs (Rs m)	2,672	4,339	5,939	7,242
Net NPAs (Rs m)	903	2,495	2,732	2,607
<i>Gr. NPAs to Gross Adv. (%)</i>	1.0	1.4	1.6	1.7
<i>Net NPAs to Net Adv. (%)</i>	0.3	0.8	0.7	0.6
<i>NPA Coverage (%)</i>	66.2	42.5	54.0	64.0

Source: Company Data, PL Research.

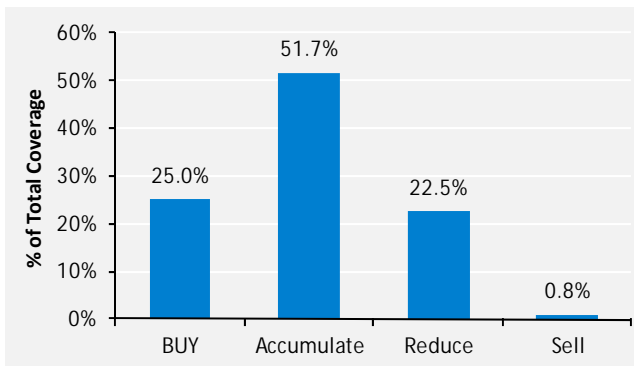


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Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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