IndusInd Bank

DOLAT CAPITAL

CMP: ₹ 344 Target Price: ₹ 434 Buy

We initiate coverage on IndusInd Bank with a Buy rating. Post smooth transition brought by incumbent senior management, the bank has been strengthening itself gradually in each of the key areas. Well-diversified retail loan book, more focus on relatively newer retail product lines and improvement in SA deposits hereon would aid margin. Core fee income would continue robust performance with investment banking, trade finance and forex income. High T ier I capital warrants the bank's strong business growth without raising additional equity capital in near future. We rate the stock as a Buy with a target price of ₹ 434 at 3.1x ABV FY14. At current market price, the stock trades at 3.0x and 2.5x ABV FY13 and FY14 respectively.

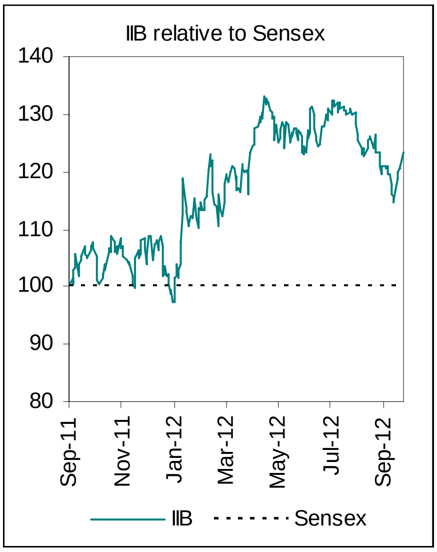
BSE Sensex	18,632
NSE Nifty	5,663

Scrip Details

Equity	₹ 4689mn
Face Value	₹ 10/-
Market Cap	₹ 161bn
	USD 3.0 bn
52 week High/Low	₹ 352 / 222
Avg. Volume (no)	603118
BSE Code	532187
NSE Symbol	INDUSINDBK
Bloomberg Code	IIB IN
Reuters Code	INBK.BO

Shareholding Pattern as on June'12(%)

Promoter	19.41
MF/Banks/FIs	8.70
FIIs	34.22
Public / Others	37.67



Margin expansion with increase in high-yielding credit composition and expected improvement in SA deposits: We believe that IndusInd Bank (hereinafter IIB) would witness improvement in margin in FY13 mainly on the back of increase in overall CASA deposit share and increase in high-yielding credit composition in the loan portfolio.

On deposit front, it is expected that SA deposit share would improve to 14.5% in FY13 and further to 17.5% in FY14. On credit book front, the bank is expecting to increase its loan book composition of credit card business and LAP (Loans against properties) business. We expect RIDF investments to further come down due to expected increase in CV, business banking and loans to small business leading to overall increase in PSL lending, which would further aid margin.

Branch expansion plan: IIB plans to add around 110 and 115 branches in FY13 and FY14 respectively. On ATMs, the bank would take total count to 940 by the end-March'13. We believe that basic reason for continued branch expansion is to mobilize SA deposit and to expand retail term deposit base.

SA deposit per branch has been on continuous uptrend over years with ₹ 117mn per branch as on end-FY12. For IIB, there exists a lot of scope of improvement on this front. Bigger private sector banks' average level of SA deposit per branch is close to Rs 300mn.

Robustness in core fee income to remain in investment banking, trade & remittance and foreign exchange income: IIB's core fee income line is expected to continue robust performance. Key reason for much higher growth would be better prospects in 'Trade & Finance', 'Foreign exchange income' and 'Investment banking income'.

On retail side, the bank's been generating fee income by cross-selling third-party products to existing customers & pushing it to potential retail customers. In FY12, IIB recorded 47% YoY jump to ₹ 1.0bn in life insurance product commission. On corporate side, each of the four corporate SBUs has been doing exceedingly well. 'Corporate & investment banking unit' earned fee income close to ₹ 1.0bn with sharp increase in addition of new clients. Investment banking division also posted strong performance with 31% YoY rise to ₹ 790mn.

Financials

Year	NII	PPP	NP	NIM (%)	BV (₹)	ABV (₹)	RoAA (%)	RoAE (%)	P/B (x)	P/ABV (x)	P/E (x)
FY11	13,765	10,817	5,773	3.6	82	81	1.4	19.3	4.2	4.3	27.8
FY12	17,042	13,730	8,026	3.4	96	95	1.6	19.3	3.6	3.6	20.1
FY13E	23,466	18,818	10,538	3.8	116	115	1.6	21.2	3.0	3.0	15.3
FY14E	28,742	23,372	13,014	3.9	139	139	1.7	21.8	2.5	2.5	12.4

Figures in ₹ mn

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September 26, 2012

Asset quality firm with improvement in NPLs in CV and two-wheelers segments; the bank's management sounded confident on asset quality: Over the year during FY12, the bank witnessed improvement in asset quality in each of the retail segment barring utility vehicle loans and three-wheelers loans. In utility loans and three-wheelers loans, GNPA almost doubled to ₹ 160mn and ₹ 180mn respectively. Overall, in FY12, the bank contained its net slippages at 0.43% (as against 0.46% in FY11) and asset quality remained stable with GNPA below 1.0% mark. Provision coverage level remained strong at 73%. IIB does not have any floating provisions outstanding.

Capital adequacy and promoters' stake dilution: In FY12, IIB's credit risk capital requirements increased in-line with credit book & credit substitute. Capital requirements for credit risk grew by 36% & 27% and credit book & credit substitute book expanded by 32% and 27% in FY11 and FY12 respectively. After factoring in 25% (cagr FY12-14) credit book, tier I capital would be close to 11% by the end-FY13. The bank is not in an urgency to raise equity capital, though the bank might raise equity capital by the end of FY14.

Marginal increase in credit book average maturity and reduction in deposit maturity; introduction of 400 days and 999 days retail deposit products to balance out ALM: Over the last two years, we witness gradual increase in average maturity of credit book; IIB's credit portfolio average maturity was close to 1.0 year as on end-FY10, it increased to around 1.4 years by end-FY12. With introduction of two retail deposit products of 400 days and 999 days at highest interest rate of 9.5%, the bank would be able to bridge the gap in ALM.

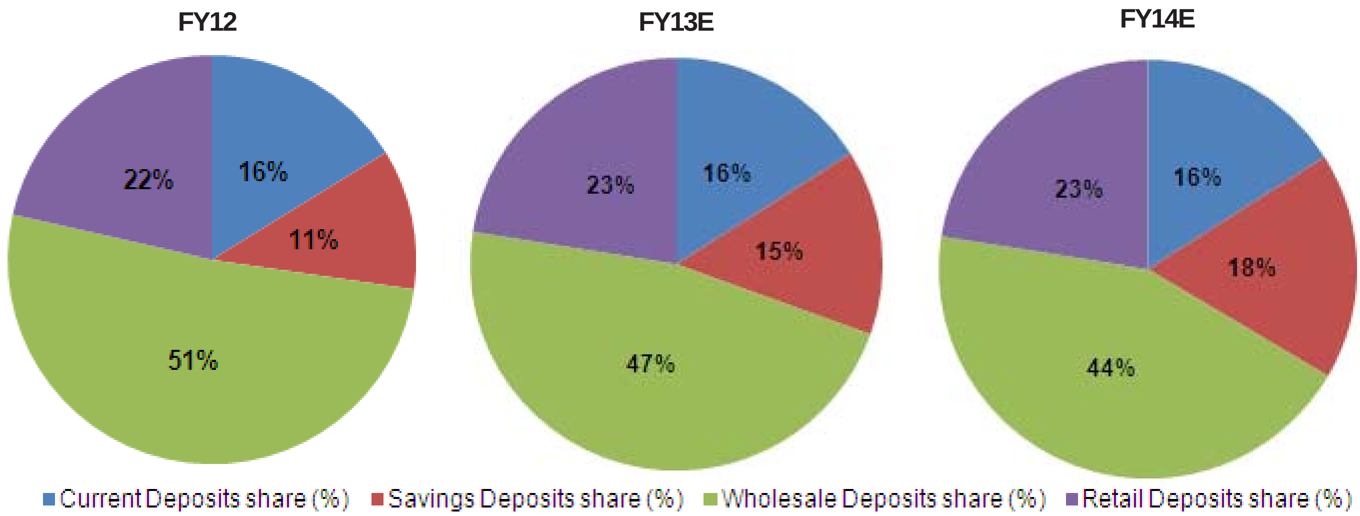
Valuation

We assume that the bank's business would expand at 24.3% cagr (during FY12-14) with improvement in margin in FY13 and being flat in FY14. Core fee income would remain robust. The bank does not face any significant asset quality issues so far in any of the credit segments; going forward, the bank's management does not foresee any pipeline of loan restructuring. We do not factor in return ratio dilution due to equity raising plan since the bank is sitting on high tier I capital (11% as on end-June'12). With RoAA of 1.6% and RoAE at 21%, we determine the bank's intrinsic worth at ₹ 434 at 3.1x adjusted book value FY14. We rate the stock as a **Buy** with a target price of ₹ 434.

Margin expansion with increase in high-yielding credit composition and expected improvement in SA deposits: We believe that IIB would witness improvement in margin in FY13 mainly on the back of increase in overall CASA deposit share and increase in high-yielding credit composition in the loan portfolio.

On deposit front, we expect that SA deposit share would improve to 14.5% in FY13 and further to 17.5% in FY14. Share of CA deposits is expected to remain flat going forward. Also, on whole-sale deposit side, IIB's with close to half of the total deposits from whole-sale markets; with recent decrease in whole-sale rates, the bank's liabilities costs would come down aiding margin. In secondary money market, CD rates have already fallen by almost 25-50bps from the top of 10.5% (12-months CPs).

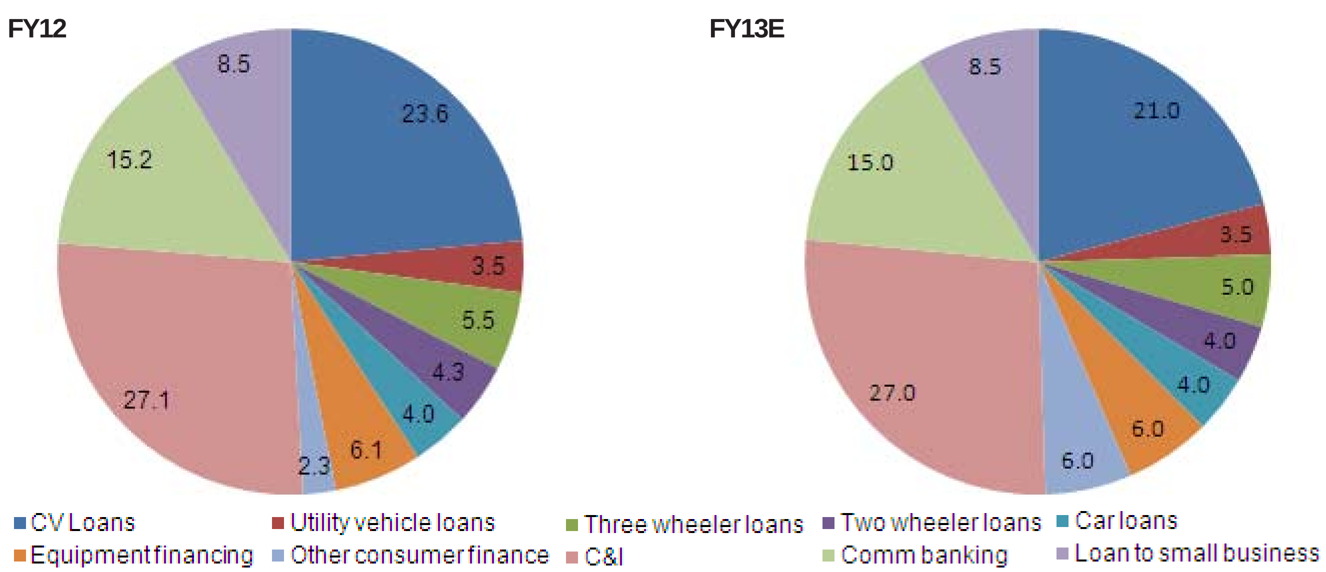
Chart 1: IIB's Deposit Profile



Source: Banks, Dolat Research

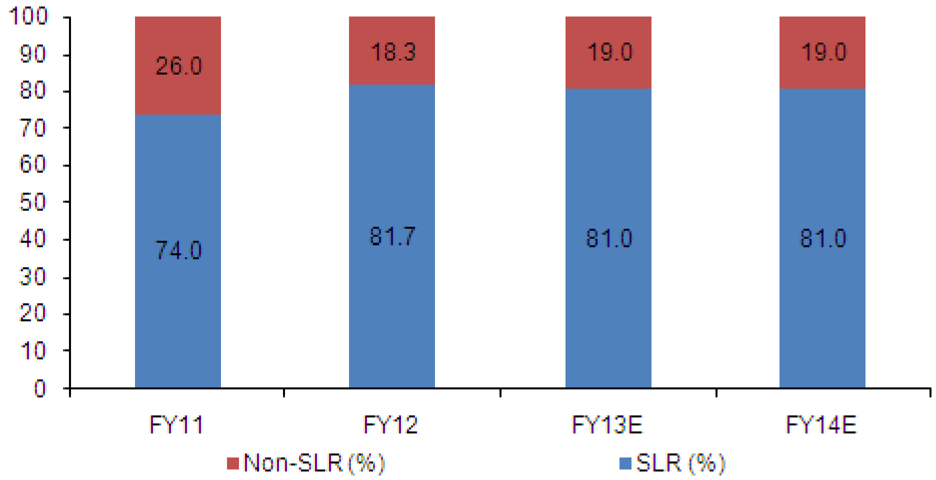
On credit book front, we expect increase in its loan book composition of credit card business and LAP (Loans against properties) business. Both retail loan products are high-yielding and particularly the LAP product brings better customer relationship with a bank. As on end-March'12, both these loan products are at nascent stage with respective contributions of merely 0.7% and 1.2% respectively to total loan book. Also, in retail credit portfolio, the bank would add one more product line of 'Gold Loan', which is high-yielding, much safer credit and consumes relatively lesser capital.

Chart 2: IIB's Credit book break-up (%)



On investment portfolio front, in FY12, the bank altered composition by increasing exposure to long-dated G-Sec bonds and reducing holding in bonds/debentures; G-Sec book composition increased to 82% from 74% as on end-FY11. In FY12, increase in investment yield mainly came from increase in duration of SLR investments and decrease in RIDF investments over the year. In FY12, RIDF investments came down by ~15% YoY to ₹ 14.3bn, which is a low-yielding investment. We expect RIDF investments to further come down due to expected increase in CV, business banking and loans to small business leading to overall increase in PSL lending. In our view, IIB would reduce its exposure to long-dated SLR portfolio with some decline in yields in the secondary markets and shift to short-term corporate debt papers. With the expected decrease in overall duration, yield might reduce. Though, on positive side, with increase in credit risk due to shift from G-Sec papers to corporate papers, yield gap may not be significant.

Chart 3: IIB's Investment book break-up



Source: Banks, Dolat Research

On credit-deposit ratio front, IIB does not have more headroom left; therefore margin expansion could mainly come from either change in credit composition in favor of high-yielding advances or by increasing CASA deposit share.Declining interest rate scenario actually impacts margin adversely but due to the bank's preemptive measures in terms of increasing exposures to high-yielding retail loan book would dilute deposit re-pricing lag effect.

Chart 4: IIB's C-D & Incremental C-D ratio (%)

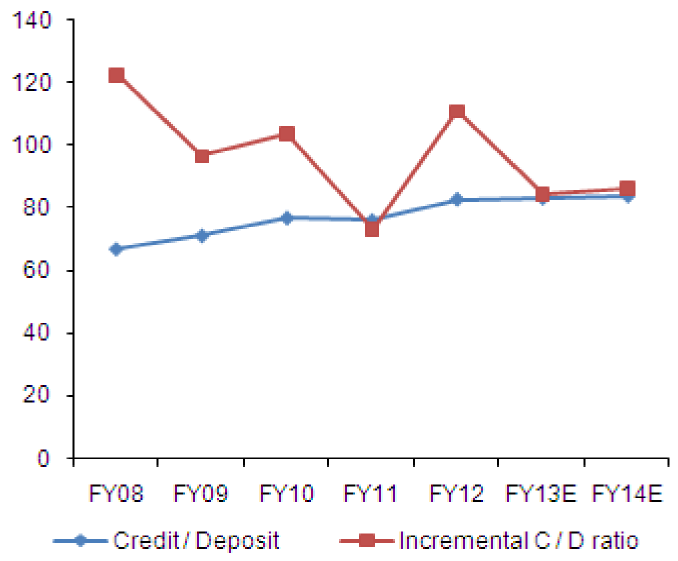
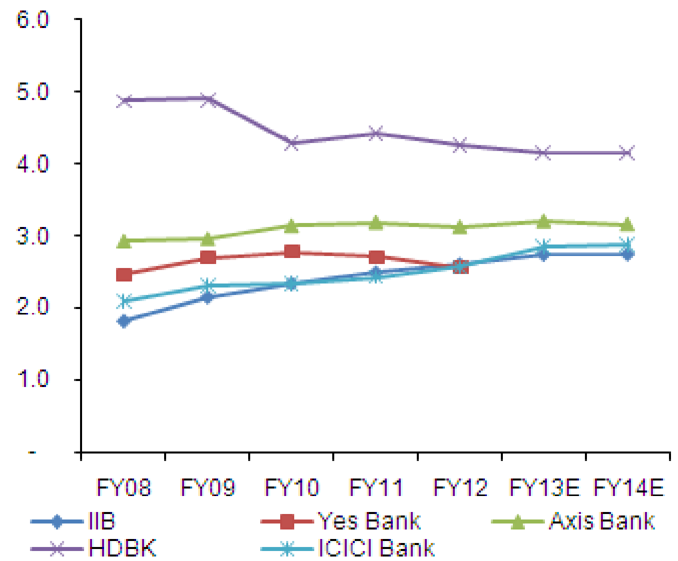


Chart 5: Private Banks' margin (%)



Source: Banks, Dolat Research

Sensitivity of IIB's margin with change in credit, investment and deposit yield

Table 1: For a change in CASA share

	SA Share (%)	NIM (%)	CA Share (%)	NIM (%)
	16.5	3.87	18.0	3.92
	15.5	3.85	17.0	3.88
Base Case	14.5	3.84	16.0	3.84
	13.5	3.83	15.0	3.80
	12.5	3.81	14.0	3.76

On a sensitivity analysis of IIB's margin on a change in SA deposit share, we estimate that for a 100bps change in SA share, the bank's margin changes by almost 1bps. For a 100bps change in CA deposit share, the bank's margin changes by around 4bps on either side.

For a change in Deposit Cost

	Deposit Cost (%)	NIM (%)
	8.76	3.07
	8.26	3.45
Base Case	7.76	3.84
	7.26	4.23
	6.76	4.62

IIB's margin sensitivity is high with total deposit cost; for each 50bps change in deposit cost, margin changes by 38-39bps.

For a change in lending Yield (%)

	Lending rate (%)	NIM (%)
	14.30	4.48
	13.80	4.16
Base Case	13.30	3.84
	12.80	3.52
	12.30	3.20

Impact of change in lending rate is relatively lesser due to its lesser composition to total assets; the bank's margin would change either way to an extent of 32bps for a 50bps change in lending rate.

For a change in investment yield

	Investment Yield (%)	NIM (%)
	8.35	4.10
	7.85	3.97
Base Case	7.35	3.84
	6.85	3.71
	6.35	3.58

We estimate that for a 50bps change in investment yield, IIB's margin would vary in either direction by almost 13bps.

Impact of change in NIM on PBT

	NIM (%)	Chng. in PBT (%)
	4.09	9.4% increase in PBT
Base Case	3.84	16,200 mn
	3.59	9.4% decrease in PBT

In a base case scenario, we estimate that IIB's PBT would be ₹ 16.2bn in FY13 at 3.84% margin. Leverage on earnings (PBT) is quite high with a variation in margin.

For each 25bps change in margin, the bank's PBT would vary by 9.4% in either direction.

Branch expansion plan: IIB plans to add around 110 and 115 branches in FY13 and FY14 respectively. On ATMs, the bank would take total count to 940 by the end-March'13.

Chart 6: IIB's Branches & ATMs

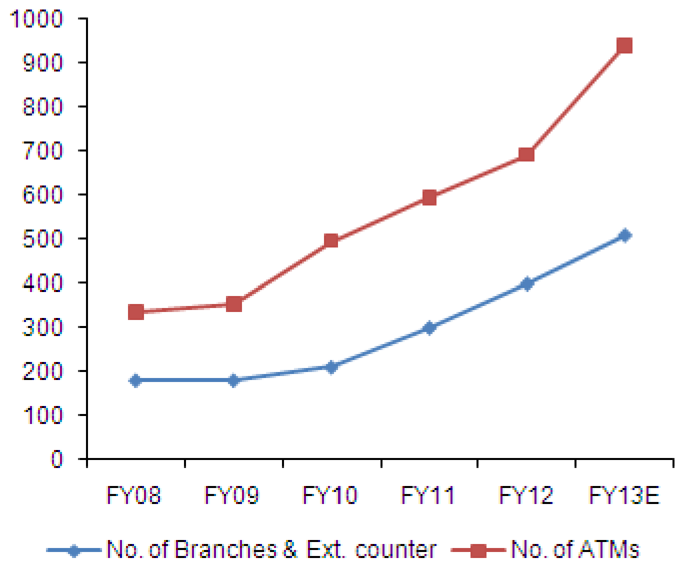
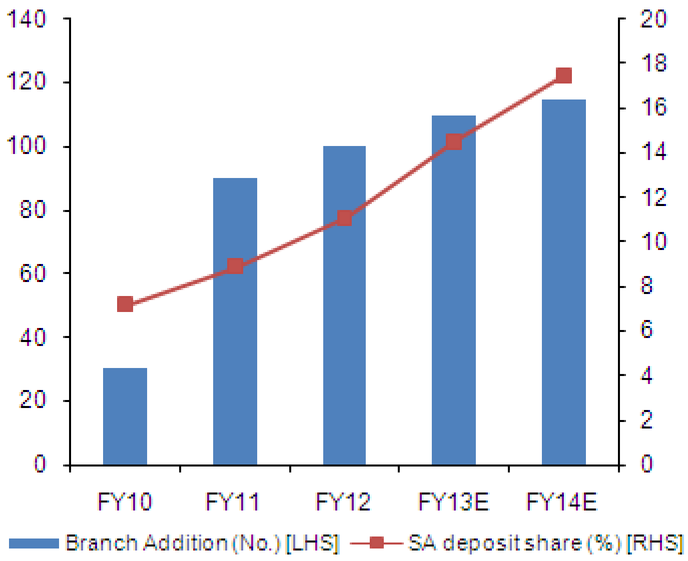


Chart 7: IIB's Branch addition and SA deposit share



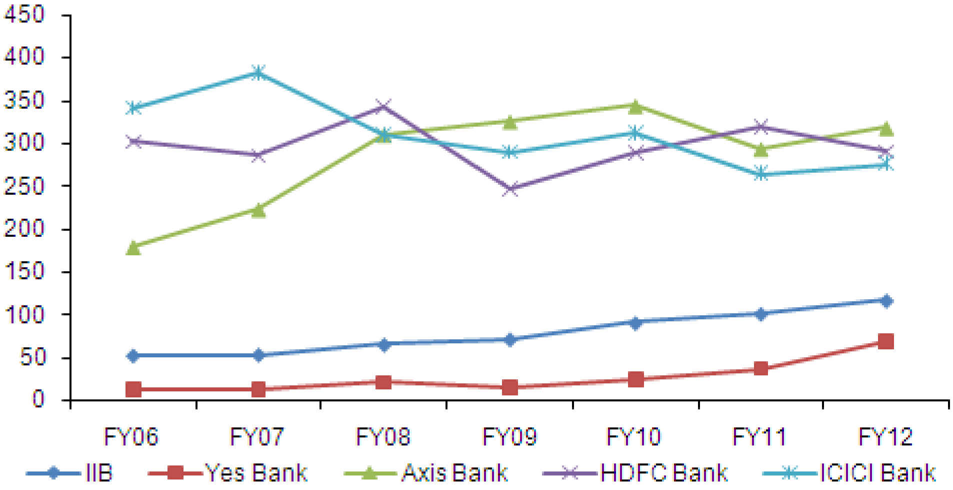
Source: Banks, Dolat Research

In a slowing credit demand scenario, the bank is planning to add incremental branches at a same pace as it had done in FY12. Here, it is to be noted that the bank is increasing its fixed asset leverage even though topline (NII) growth would be under pressure due to lesser asset expansion rate.

We believe that basic reason for continued branch addition would be to expand SA deposit and retail term deposit base. Since, CA deposit has been under pressure for the entire banking system due to issues regarding corporates' subdued topline and strain on cash flow. Also, with SA deposit share at 11%, the bank has to take measures to improve it going forward.

After mapping-in potential customer zone wise, the bank would devise a right mix of liability products loaded with features to pull potential depositors. The bank needs to establish more contact points and increase visibility in order to gain SA deposit share gradually. SA deposit per branch has been on continuous uptrend over years with ₹ 117mn as on end-FY12. For IIB, there exists a lot of scope of improvement on this front. Bigger private sector banks' average level of SA deposit per branch is close to ₹ 300mn. With expected additions in branches in FY13 and FY14, we expect that the bank's SA deposit per branch would inch up to ₹ 150mn in FY13 and thereafter to ₹ 182mn in FY14. IIB's management expects to increase SA deposit share to 14.5% by end-FY13 and further to 17.5% by end-FY14.

Chart 8: IIB's SA Deposits per branch



Source: Banks, Dolat Research

Robustness in core fee income to remain in investment banking, trade & remittance and foreign exchange income: IIB's core fee income line is expected to continue robust performance. Key reason for much higher growth would be better prospects in 'Trade & Finance', 'Foreign exchange income' and 'Investment banking income'.

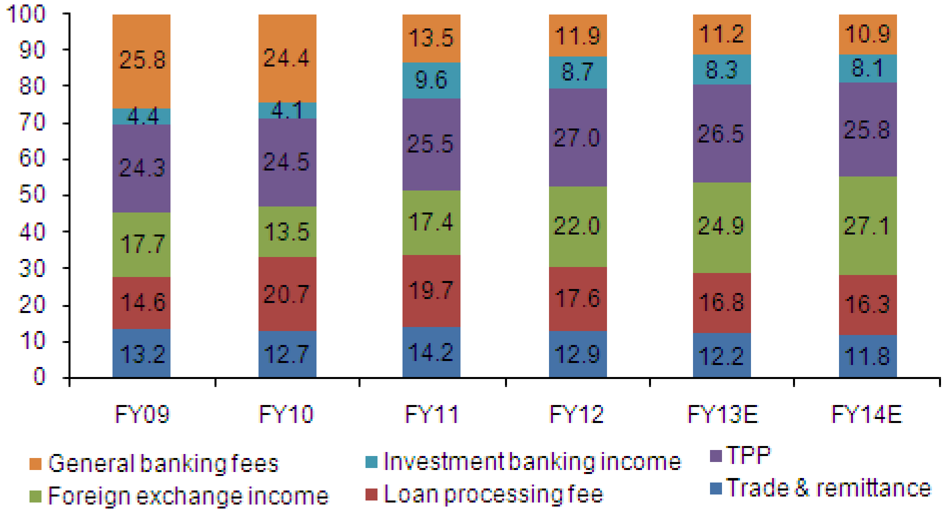
On retail side, the bank's been generating fee income by cross-selling third-party products to existing customers & pushing it to potential retail customers. On life Insurance front, the bank sells Aviva's insurance products; in FY12, IIB recorded 47% YoY jump to ₹ 1.0bn in life insurance product commission. On health & general insurance front, IIB is in alliance with Cholamandalam MS to sell its products. In FY12, the bank earned insurance commission of ₹ 563mn (-16% YoY); during the FY, general insurance income was subdued due to change in IRDA norms on third-party commission on vehicle insurance schemes. In the fiscal year, the bank did not earn any income on third-party products of vehicle insurance for almost 7-8 months. Loan processing charges and general banking charges are expected to expand in-line with credit book expansion. If the bank revises loan processing & other banking charges upward, growth in fee income would be even higher.

Table2: IIB's Bancassurance Fee break-up

₹ mn	FY10	FY11	FY12	YoY%
TPP				
For selling life insurance policies	553	714	1,050	47
For selling non life insurance policies	449	669	563	(16)
For selling mutual fund products	140	227	265	17
Total	**1,141**	**1,611**	**1,878**	**17**

On corporate side, each of the four corporate SBUs has been doing exceedingly well. 'Corporate & investment banking unit' earned fee income close to Rs 1.0bn in FY12 with sharp increase in addition of new clients. Trade finance and foreign exchange commission recorded robust growth. Investment banking division also posted strong performance with 31% YoY rise to Rs 790mn on the back of debt syndications proposals, structured finance and advisory to corporates. 'Commercial banking unit' mainly catering to mid-sized corporates and SMEs providing with tailored & customized products in trade finance and foreign exchange transactions. 'Business banking group division' mainly catering to small businesses has been showing very encouraging performance on foreign exchange income front, the division's forex income almost doubled on YoY basis. 'Financial institutions & PSU group', which caters to public sector entities, reported 90% YoY jump in fee income. Overall, with trade finance, forex income and investment banking deals, IIB has been yielding good results on corporate segments front by providing well structured and customized products.

Chart 9: IIB's Core fee income break up



Source: Banks, Dolat Research

Asset quality firm with improvement in NPLs in CV and two-wheelers segments; the bank's management sounded confident on asset quality: Over the year during FY12, the bank witnessed improvement in asset quality in each of the retail segment barring utility vehicle loans and three-wheelers loans. In utility loans and three-wheelers loans, GNPA almost doubled to ₹ 160mn and Rs 180mn in FY12 respectively. Due to slump in business activities, multi-utility vehicle segment witnessed asset quality stress in Q1FY12 and Q2FY12 and thereafter it slightly improved. In three-wheeler segment, discontinuance of fresh permits from state-level authorities put pressure on continuity of business. Overall, in FY12, the bank contained its net slippages at 0.43% (as against 0.46% in FY11) and asset quality remained stable with GNPA below 1.0% mark. Provision coverage level remained flat 73%. IIB does not have any floating provisions outstanding.

Table 3: IIB's NPA movement:

₹ mn	1QFY13			4QFY12			3QFY12		
	CCB	CFD	Total	CCB	CFD	Total	CCB	CFD	Total
Opening Balance	1,100	2,370	3,470	920	2,420	3,340	1,040	2,280	3,320
Additions	510	580	1,090	210	630	840	50	630	680
Deduction	80	830	910	30	680	710	170	500	670
Gross NPA	1,530	2,120	3,650	1,100	2,370	3,470	920	2,410	3,330
Provisions	1,170	1,480	2,650	980	1,540	2,520	900	1,490	2,390
Net NPA	360	640	1,000	120	830	950	20	920	940
% of Gross NPA			0.97			0.98			1.02
% of Net NPA			0.27			0.27			0.29
Restructured Advances (%)			0.24			0.26			0.22

In retail credit book, gross addition went up by 19% YoY to ₹ 2.4bn and in corporate book, gross slippages reported faster addition at 22% YoY to ₹ 1.1bn. Credit losses in retail credit book came down to 1.7% from 1.97% in FY11 and in corporate credit book it remained flat.

In major sectors (agriculture, industry and services), GNPA levels have been drifting down since end-March'10. IIB's credit book concentration to top twenty borrowers went up to 22.6% as on end-FY12 from 20.6% in end-FY11 and total NPA from top four NPA loan accounts (as a % of total GNPA) was slightly lesser at 13% as compared to 14% a year back.

Table 4: IIB's % of NPAs to Advances

% of NPAs to Advances in that sector as on	FY10	FY11	FY12
Agriculture & allied activities	1.17	0.94	0.93
Industry (Micro & Small, Medium and Large)	0.52	0.56	0.45
Services	0.71	0.69	0.48
Personal Loans	54.69	72.41	75.95

Table 5:

%	FY10	FY11	FY12
Total Exposure to top four NPA accounts	59.0	13.8	13.1
Credit book concentration to top twenty borrowers	18.2	20.6	22.6

On restructured loan book front, the bank is quite comfortable with negligible amount restructured loans outstanding and the management does not expect much loan restructuring going forward. Total restructured loan book outstanding was just 0.3% of the net credit book as on end-FY12.

IIB's key fund-based risky exposure is with construction related infrastructure, power generation, Gems & Jewellery and NBFC (other than HFCs); total fund-based risky exposure contribute close to 7.2% (₹ 39bn) of funded exposure. On non-fund based side, the bank's key risky exposure is to construction related infrastructure, power transmission, Steel sector, capital market brokers and edible oil. IIB's non-fund-based risky exposures contribute close to 15% (₹ 27bn) of funded exposure.

Table 6: IIB's Fund based exposure

FY12	Fund Based Exposure (₹ mn)	%
Construction related to infrastructure	8,580	1.6
Power generation	6,660	1.2
Gems & Jewellery	4,770	0.9
NBFCs (other than HFCs)	18,940	3.5

Table 7: IIB's Non-Fund based exposure

FY12	Non Fund Based Exposure (₹ mn)	%
Construction related to infrastructure	10,460	5.9
Power Transmission	2,070	1.2
Steel sector	7,620	4.3
Capital market brokers	3,190	1.8
Edible Oils	5,570	3.1

Going ahead, if the economic activity remains tepid, second-hand CV loans in retail segment and loans to small business (Business Banking) segment might see some increase in slippages.

Capital adequacy and promoters' stake dilution: In FY12, IIB's credit risk capital requirements increased in-line with credit book & credit substitute. Capital requirements for credit risk grew by 36% & 27% and credit book & substitute expanded by 32% and 27% in FY11 and FY12 respectively. Total market risk capital requirements remained flat in FY12.

Table 8: IIB's Capital Requirements

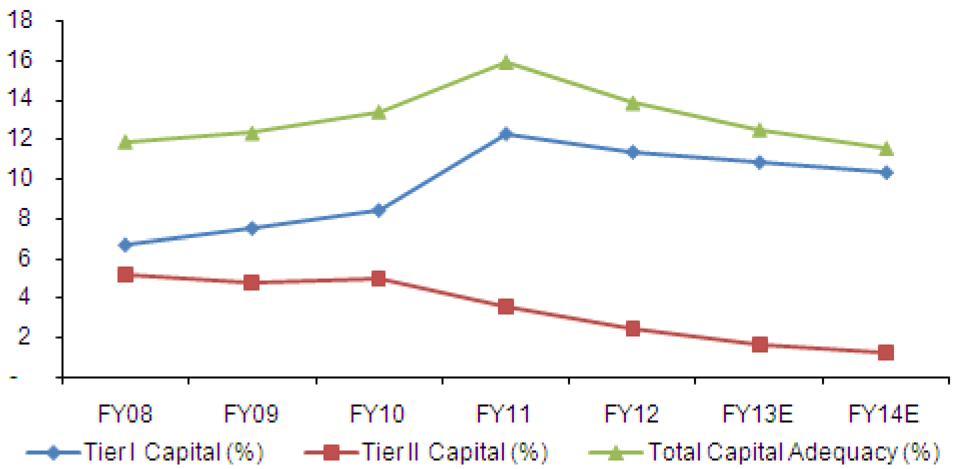
₹ mn	FY09	FY10	FY11	FY12	FY13E	FY14E	Growth Rate (%) FY10-11	FY11-12
Capital requirement for credit risk	15,484	18,195	24,763	31,467	38,839	47,573	36	27
Capital requirement for Market risk	310	347	714	718	942	1,154	106	0
Capital requirement for operational risk	985	1,421	2,167	3,099	4,264	5,554	53	43
Total Capital requirement at 9.0%	16,780	19,962	27,644	35,283	44,045	54,281	38	28
Net Credit	157,706	205,506	261,656	350,640	437,285	545,604	27	34
Net Investment	80,834	104,018	135,508	145,719	174,355	203,580	30	8

Under the total risk-weighted gross credit exposure, composition of credit book (with more 100% risk-weight) increased to 9.8% in FY12 from 8.1% in FY11. With tier I at 11.2% (with Q1FY13 net profit), the bank is in quite comfortable situation on capital adequacy front. Also, with tier II capital at 2.2%, there exist lot of headroom. After factoring in 25% (cagr FY12-14) credit book, tier I capital would be close to 11% by the end-FY13. The bank is not in an urgency to raise equity capital, though the bank could raise equity capital by the end of FY14.

Table 9: IIB's Risk weight-wise distribution of gross credit exposure

Category (₹ mn)	FY09	FY10	FY11	FY12
Below 100% Risk Weights	172,180	273,860	368,400	518,810
100% Risk Weights	131,860	131,700	192,610	164,120
More than 100% Risk Weights	15,160	17,690	21,360	34,710
Investments in subsidiaries	(11)	(11)	(11)	(5)
Gross Advances	158,465	207,042	263,587	353,164
Credit book with more 100% risk-weight to gross credit (%)	9.6	8.5	8.1	9.8

Chart 10: IIB's Capital Adequacy (%)



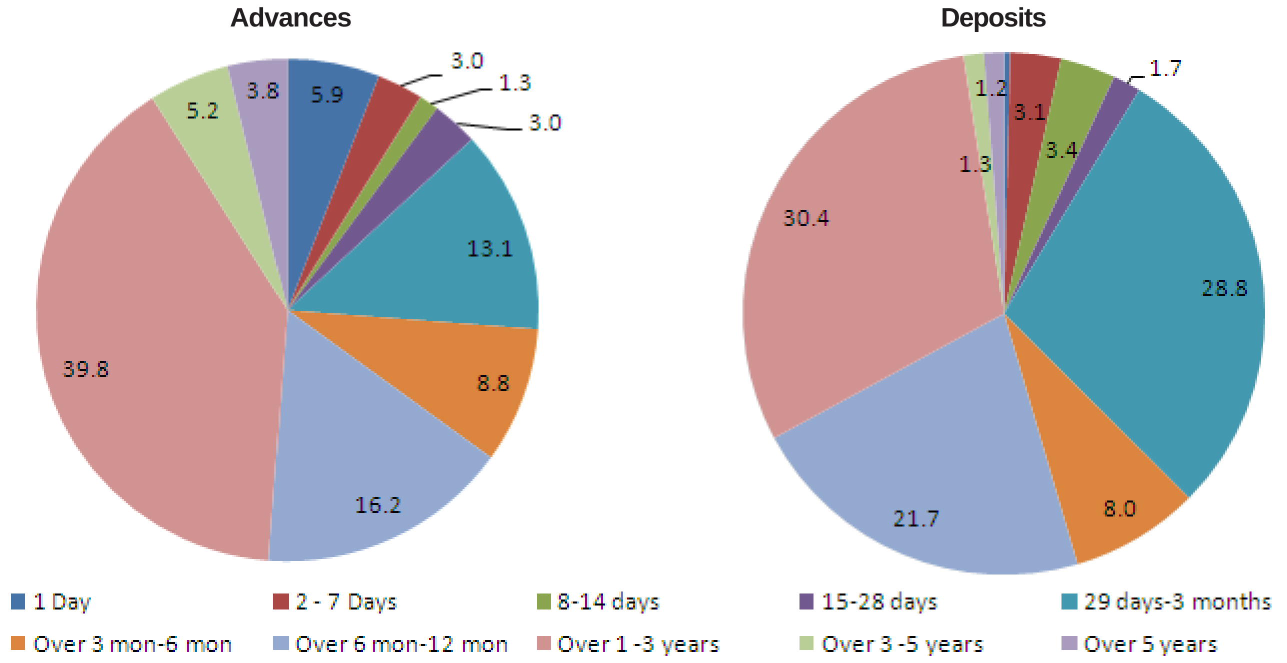
Source: Banks, Dolat Research

Marginal increase in credit book average maturity and reduction in deposit maturity; introduction of 400 days and 999 days retail deposit products to balance out ALM: Over the last two years, we witness gradual increase in average maturity of credit book; IIB's credit portfolio average maturity was close to 1.0 year as on end-FY10, it increased to around 1.4 years by end-FY12. Proportion of total credit book with maturity more than a year maturity increased to 49% in end-FY12 from 32% in end-FY10. Though, on the other hand, deposits average maturity has been on gradual decline; as on end-FY10, IIB's deposits average maturity was close to 1.1 year which decreased to around 0.9 years by end-FY12. Proportion of deposits with maturity more than a year maturity decreased to 33% in end-FY12 from 35% in end-FY10. Therefore, on volume basis, change in distribution of credit book and deposits aided margin slightly.

Table 10: IIB's Average maturity

Average Maturity (Yrs)	FY09	FY10	FY11	FY12
Average Maturity of Advances	1.0	1.0	1.3	1.4
Average Maturity of Investments	4.5	4.6	4.4	4.4
Average Maturity of Deposits	2.1	1.1	1.0	0.9
Average Maturity of Borrowings	1.8	2.4	1.7	1.1

Chart 11: IIB's Credit & Deposit maturity break-up



Source: Banks, Dolat Research

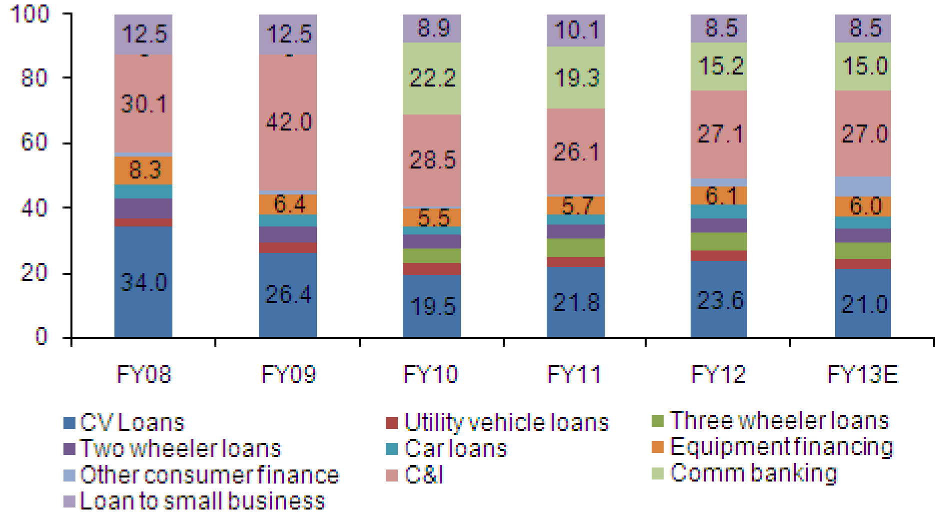
With introduction of two retail deposit products of 400 days and 999 days at highest interest rate of 9.5%, the bank would be able to bridge the gap in ALM. The bank expects to garner good amount of resources from these retail deposit products. Also with the expected increase in SA deposit share, the bank's average maturity would increase due to stickiness characteristic of SA deposits.

With expected increase in retail term deposits mobilization (relatively higher maturities like 400 days & 999 days), SA deposits and refinancing (with re-pricing lag of 1-7 years), the bank's liabilities maturity would increase over the period. And against this, the bank would increase its exposure to fixed rate credit portfolio with almost similar maturity.

Change in top management; IIB as on end-FY08 and thereafter: While peeping into past performance and the present stand, we get insights into key changes brought in by the incumbent management. Ever since the change in top management in February'08, we witness lot of re-balancing act on asset and liability fronts.

In FY05, merger with erstwhile Ashok Leyland Finance Ltd. (ALFL), an NBFC mainly brought in loan portfolios of CV and equipment financing. On credit book front, over dependence on CV financing and equipment financing was trimmed over the period; in end-FY08, CV financing and equipment segments composition stood at 34% and 8.3% of IIB's total loan book. Disbursement to CV segment was reduced to ₹ 25.2bn in FY08 from ₹ 32.4bn in FY07 in order to trim over-dependence and re-align for serving the dual purpose of PSL requirements and maintaining higher yields as well. These segments composition were cut to 26% and 6.4% respectively as on end-March'09.

Chart 12: IIB's Advances Mix



Source: Banks, Dolat Research

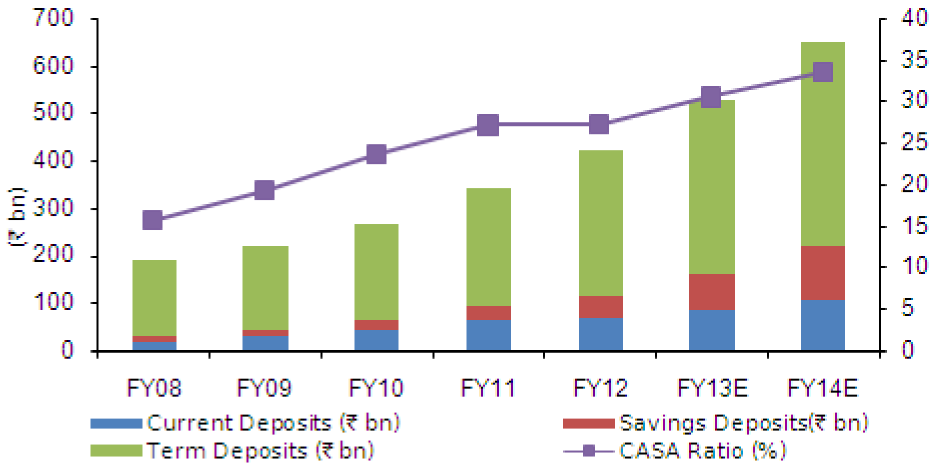
With curtailment of exposure to these two segments in consumer finance division in FY09, the bank hiked business in 'Corporate & Investment Banking' group mainly catering to large corporate clients in whole-sale banking front. Enhanced activity in C&I banking group also expanded fee income base on investment banking front.

Table 11: IIB's Loan Portfolio

₹ mn	FY08	FY09	FY10	FY11	FY12	FY13E
Consumer finance	73,490	71,800	83,010	116,190	172,370	252,313
% to loans	57.4	45.5	40.4	44.4	49.2	49.5
Corp & comm banking	56,710	86,710	122,490	145,470	178,270	220,829
% to loans	44.3	55.0	59.6	55.6	50.8	50.5
Less: BRDS	2,250	800	-	-	-	-
Total	**127,950**	**157,710**	**205,500**	**261,660**	**350,640**	**473,142**

On liability front, the bank hiked its CASA share by 350bps entirely on the back of expansion in current deposit base.

Chart 13: IIB's Deposit Profile

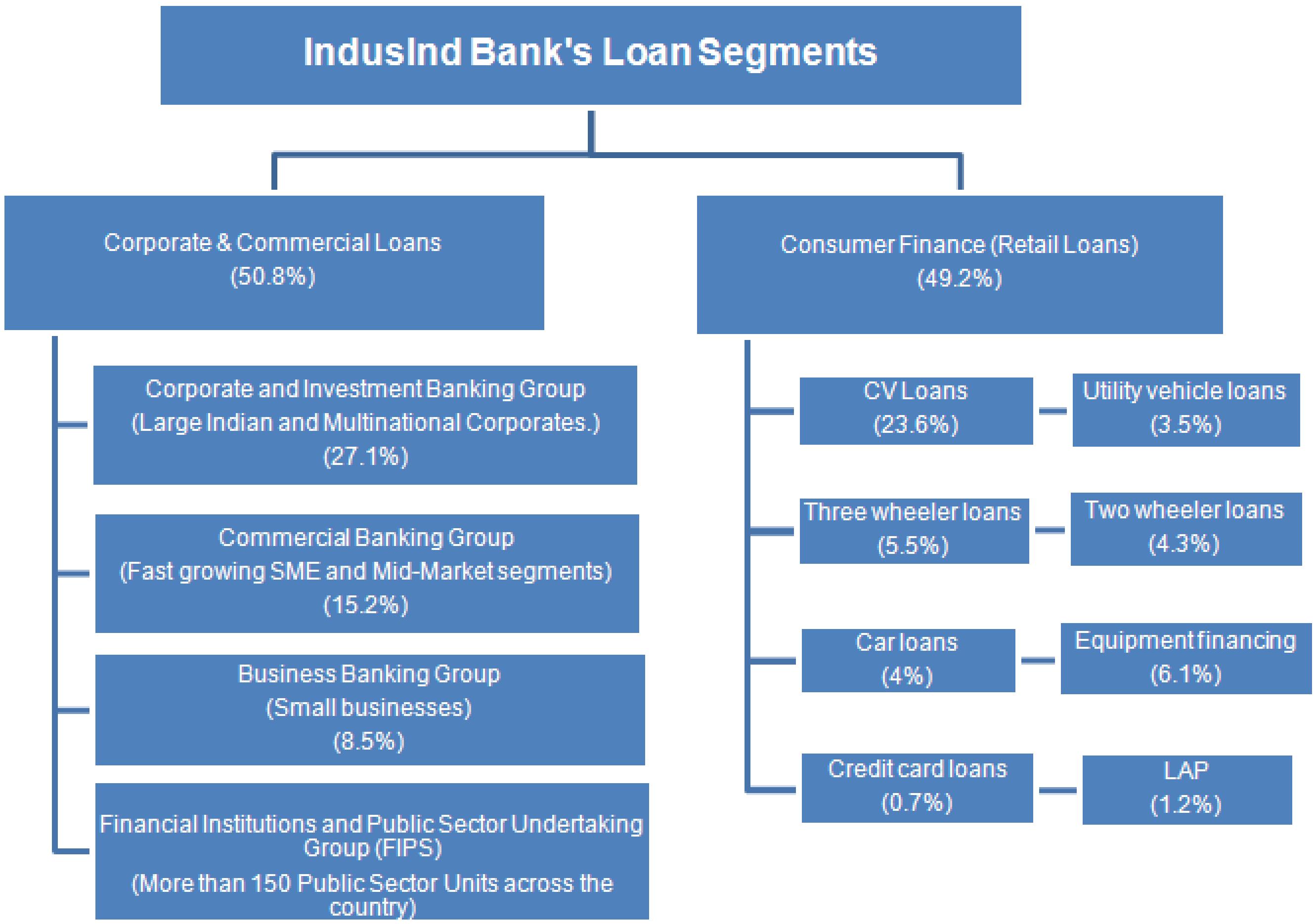


Source: Banks, Dolat Research

On consumer banking side, more penetration through various channels (like central acquisition team) resulted into mobilization of ₹ 2.5bn retail CASA from an entirely new set of clients.

The new management brought in lots of relationships with corporates across value chain, which reflected into corporate book expansion and swift improvement in current deposits. On corporate banking front, a key change was to transform it from branch-banking model to a business unit based model.

Four business units were formed. Among these business units, 'corporate & Investment Banking Group' established new connections and brought in 50 new large clients. Other business units like 'Commercial Banking Group' mainly catering to SME and mid-sized corporates and 'Business Banking Group' catering to small businesses also moved aggressively to further new relationships. The latter business unit expanded its book by 67% YoY. Another business unit 'Financial Institution & Public Sector Group' providing services to PSU entities, government bodies and financial institutions; the business group has been a major source of deposits. The bank gets huge quantum of floats especially from government bodies at centre & state levels and PSU entities enhancing current deposits share. This business unit came into existence only after induction of top management.



Source: Banks, Dolat Research

Overall, induction of top management sparked off some rationalization of older & lesser yielding assets particularly on CV and equipment financing side and hiked exposure to corporate banking segments. On liability front, new channels aided in saving deposit mobilization and impetus on corporate banking fronts enhanced current deposits substantially.

Comparison of IIB with HDBK in earlier years: Post transformation in IIB over the period, we find some similarities in IIB and HDBK. On asset front, as on end-March'12, IIB's credit profile appears quite similar to that of HDBK's in FY06. HDBK had 55% of gross credit book from retail credit and the rest from corporate sector as on end-FY06. Though, on investment book front, HDBK had quite high SLR and N-SLR portfolios as compared to deposits and C-D ratio was relatively lesser. It had an impact on asset yield to that extent. Overall, IIB's credit portfolio resembles that of HDBK; in some of the retail loans sub-segment like credit card and loan against properties, IIB's product offerings are relatively new. IIB plans to ramp up these product lines significantly with added features. Comparision of IIB's retail book with HDBK gets us an understanding that in which sector & segments, IIB would like to focus and where could it stand 2-3 years down the line.

Chart 14: HDFC Bank - Retail Loans (FY06)

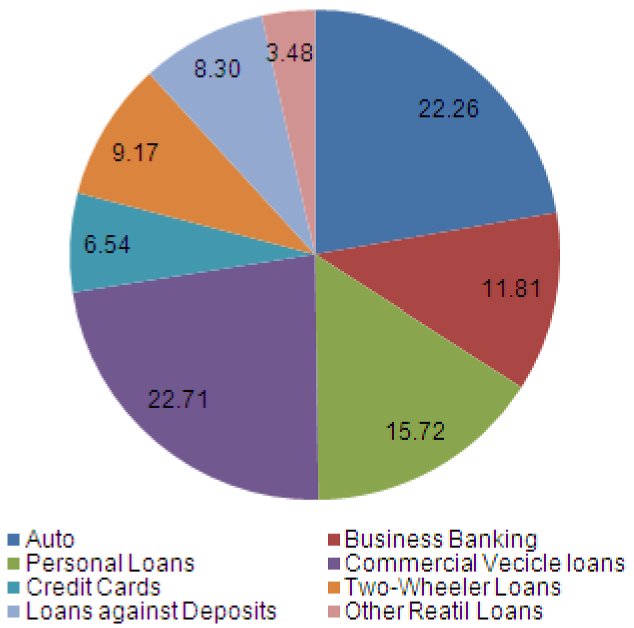
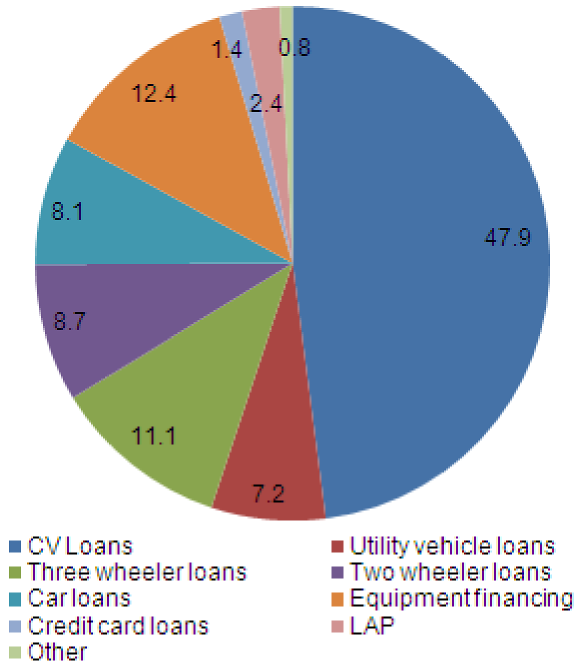


Chart 15: IIB- Retail Loans (FY12)



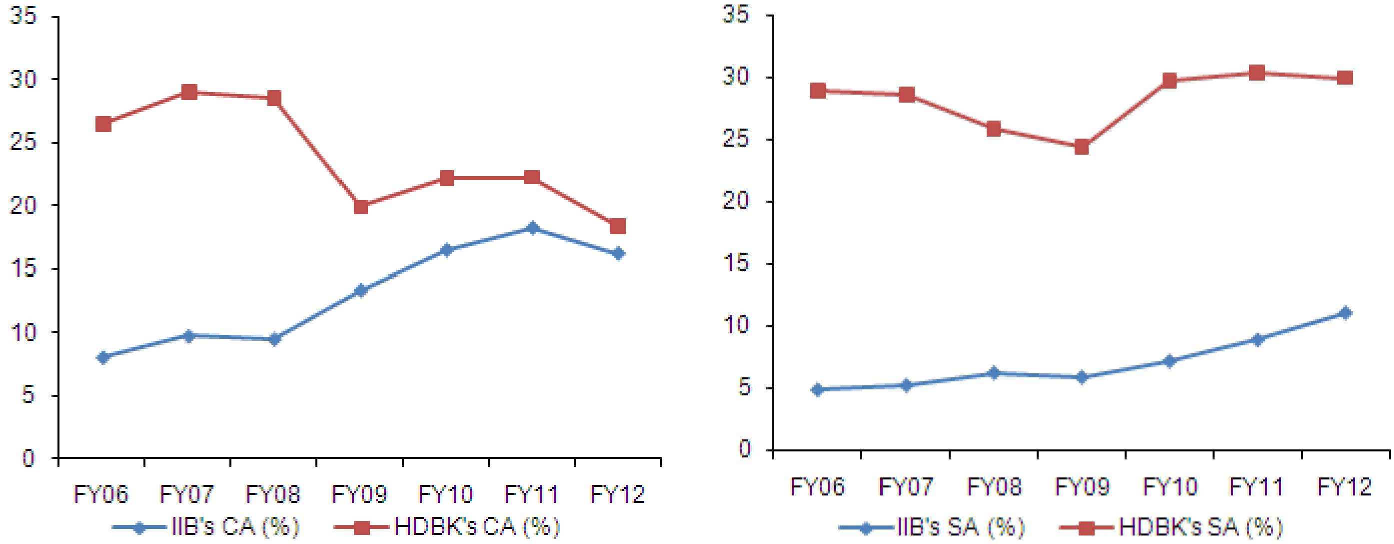
Source: Banks, Dolat Research

Table 12:

Particulars	HDFC Bank FY06	IIB FY12
Retail Credit as % to gross credit	55.3	49.2
SLR as % total investments	69.2	81.7
Non-SLR as % total investments	30.9	18.3
Investment / deposit ratio	50.9	34.4
Credit / Deposit ratio	62.8	82.8
CASA share (%)	55.4	27.3
Whole-sale deposit share	38.0	51.2

On liability side, IIB stands quite behind as compared to HDBK (as on end-FY06). This is the space, where IIB would have to do lot of improvements. As on end-March'06, HDBK had CASA share and whole-sale deposit share of 55.4% and 38% compared to IIB's 27.3% and 50%. On saving deposit front, post increase in saving deposit rates, fresh product offerings with added features and acquisition of saving accounts through new channels & employees' salary account have been aiding saving deposit share. The bank has been recording significant traction on SA deposit share front.

Chart 16: HDBK & IIB CA & SA ratio movement



Source: Banks, Dolat Research

Overall, from asset side, IIB appears to have squeezed lots of upside from margin perspective, but there is lot of upside left in liability front. Though, further re-composition on asset side especially on retail credit book front, would certainly add to the margin going forward.

Comparison with peer group (YES Bank's) current performance: On a peer group comparison basis, IIB stands quite taller as against YES Bank. On deposit profile front, IIB has got much more qualitative franchise as compared to YES Bank. As on end-FY12, on retail deposit, IIB with SA and retail term deposit shares at 11% and 21.5% respectively is much better than that of YES Bank's 5% and 18%. On whole-sale side, IIB's again ranks higher with CA and bulk deposit share of 16% and 51% as against YES Bank's 10% and 67%. Overall, IIB's deposit base much more diversified and visibility in deposit mobilization is much higher at lesser cost. In turbulent times, YES Bank might face difficulty in raising resources with costs contained.

Deposit profile (FY12)	IIB	Yes Bank
Current deposit share	16.2	9.9
Saving deposit share	11.1	5.1
Retail deposit share	21.5	18.0
Bulk (whole-sale) deposit share	51.2	67.0

On credit book front, IIB's loan book is more diversified among sectors; retail and corporate both contributing almost equally. Retail loan book has been further segregated into eight sub-segments with concentration in CV financing business; this has been IIB's legacy business with robust domain knowledge. IIB has been one of the top players in the loan segment. IIB's institutional loan book is fragmented among corporates with different balance-sheet sizes and various loan ticket sizes. On the other hand, YES Bank's loan book size has been quite concentrated in certain sectors and lumpy. Also, its retail loan book's composition is quite small relatively. Corporate and Institutional Banking (large cap companies) segment makes for almost 60% of YES Bank's loan book.

Advances profile (FY12)	IIB	Yes Bank
Corporate & Commercial Banking	50.8	81.8
Retail & Others	49.2	18.2

On investment book front, YES Bank's investment book has been tilted more towards N-SLR portfolios. In FY12, in absence of credit book expansion, investment book grew at much faster pace. Over the period, SLR investment has been close to mandatory requirements and N-SLR has been quite high. In case of IIB, N-SLR investment has been relatively lesser and SLR investment has been in the proximity of regulatory level.

Investment profile (FY12)	IIB	Yes Bank
SLR (%)	81.7	58.3
Non-SLR (%)	18.3	41.7

From the profitability perspective at gross level, IIB's margin was better (at 3.45% as against YES Bank's 2.56%) mainly due to better credit yield in FY12. Much higher exposure to retail sector contributed to higher yield. On liability cost front, deposit cost was almost similar in both the banks; even though IIB's higher CASA share. This was mainly due to much lesser duration of YES Bank's deposits at 0.8 years in FY12 (compared to 0.6 years in FY11). IIB's deposit maturity was higher at 0.95 years in FY12 as against one year in FY11; IIB's higher CASA also reflects in higher average maturity of deposits. In FY12, YES Bank went for high amount of borrowings at opportunistically lesser rates containing erosion in margin.

Cost & Yield ratios	IIB		Yes Bank	
	FY11	FY12	FY11	FY12
CoF	6.2	8.0	6.9	8.5
YoF	9.3	10.8	8.8	10.0
Risk adjusted margin (adjusted for credit cost)	3.1	2.9	2.6	2.5
NIM	3.6	3.4	2.7	2.6

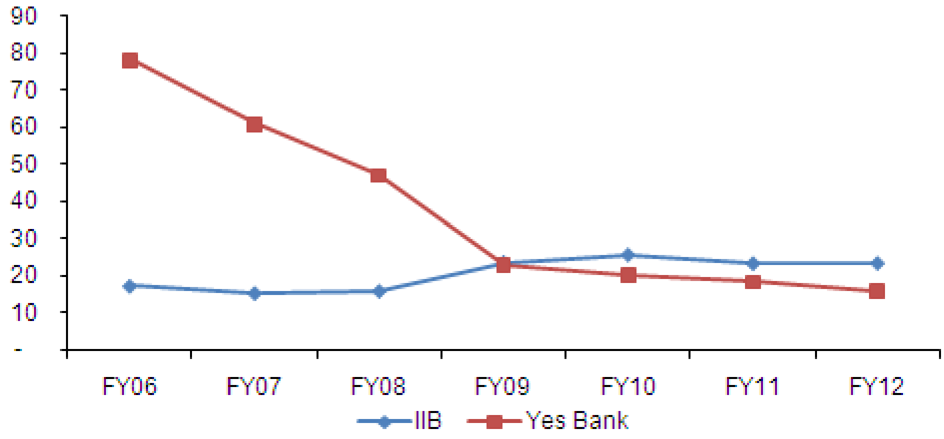
Average Maturity of Deposits	FY11	FY12
IIB	1.0	0.9
Yes Bank	0.6	0.8

On core fee income front, IIB's fee income from Bancassurance business has been more robust as compared to YES Bank mainly due to IIB's wide retail clientele base. On total core fee income (Other income-capital gains-cash recoveries) front, IIB has been better than YES Bank; for FY12, IIB's core fee income as a proportion of average assets was 1.8% as against YES Bank's 1.2%. On comparative basis, IIB has got robust franchisee and visibility in retail segment and also building up corporate side. YES Bank's concentrated exposure in large corporate segment makes its fee income stronger in corporate segment but in retail segment, the bank has to go a long way.

Fees/ Remuneration received from bancassurance	FY11	FY12
IIB (Rs mn)	1,611	1,878
% to total other income	22.6	18.6
Yes Bank (Rs mn)	128	148
% to total other income	2.1	1.7

On operating efficiency front, YES Bank stands higher compared to IIB mainly due to former whole-sale banking characteristics and lesser operating overheads oriented to retail banking. On employee expenses front, IIB's total headcount per branch is higher at 23 as against 17 (on normalized basis). IIB's normalized cost per employee has been in proximity of 0.5mn as against 0.85mn in case of YES Bank. IIB's total employees' cost has been higher for the quantum of business created as compared to YES Bank.

Chart 17: IIB's Headcount per branch

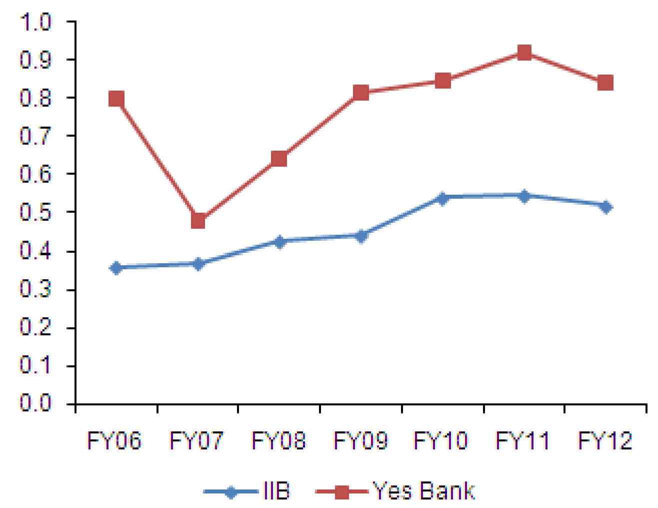


Source: Banks, Dolat Research

On operating overheads front, total operating cost (including employees cost) has been higher in case of IIB at ₹ 34-35mn as compared to YES Bank's ₹ 31-32 mn. Incremental operating overheads for incremental branch addition have been much higher in case of IIB as compared to YES Bank. In recent interactions, we got an indication that IIB have been setting up branches in rural areas with almost all the relevant services as they believe that in rural centers also, there is a lot of business potential. On the other hand, YES Bank's management has been adding footprints in rural areas with a minimum possible cost and to merely abide by the regulatory requirements.

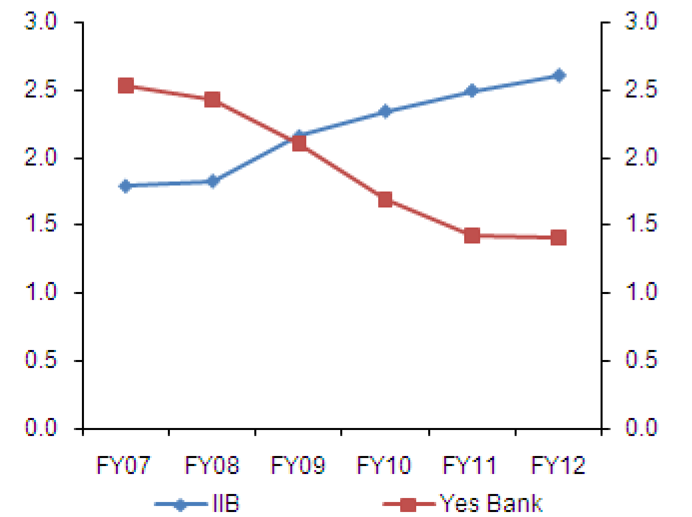
Incremental OH for Incremental Branches (₹mn)	FY10	FY11	FY12
IIB	28.5	20.1	23.2
Yes Bank	13.0	11.6	9.9

Chart 18: IIB's total cost per employee (₹mn)



Source: Banks, Dolat Research

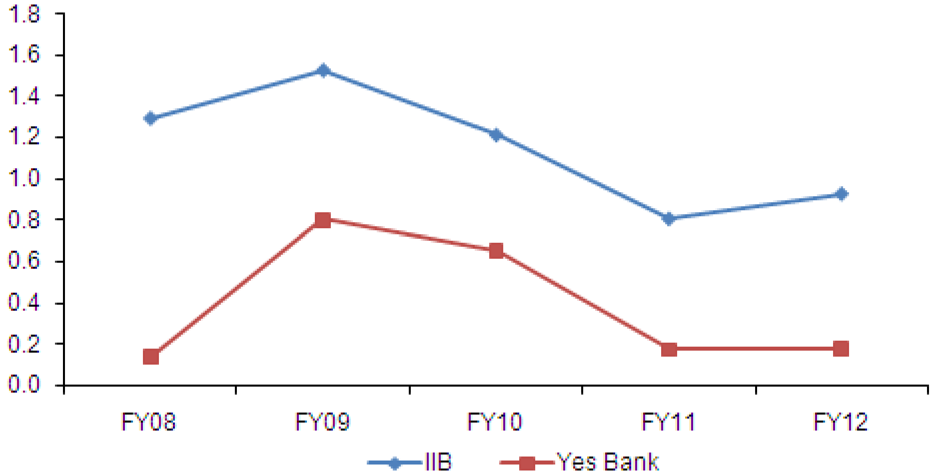
Chart 19: IIB's Opex/Avr. Assets (%)



On asset quality front, YES Bank's performance has been superior compared to IIB's. One major reason being IIB's half of the loan book being exposed to retail segment. Also, in corporate & commercial Banking segment, IIB's gross slippage has been higher than that of YES Bank (which is predominantly present in wholesale banking only). Though, overall risk-adjusted margin has been higher in case in IIB as compared to YES Bank. YES Bank reported total gross slippages of 18bps in FY11 & FY12 each year and IIB's CCB segment posted 66bps and 70bps in respective years. YES Bank's risk-adjusted margins were 261bps and 246bps as compared to IIB's 307bps and 287bps in FY11 and FY12 respectively.

We expect that in the prevailing economic condition, drawing an analogy from Axis Bank & HDBK asset quality position, we believe that banks like YES Bank (with higher composition of whole-sale assets) should be the first to face asset quality troubles. YES Bank's selective asset picking strategy has been able to protect the bank's asset quality so far. Though, we expect that sustained weakness in economic activity would lead a negative surprise in YES Bank's asset quality going forward. In case of IIB, we've been witnessing relatively high slippages due to its higher retail exposure.

Chart 20: IIB's Slippages / Avr. Gross Advances



Source: Banks, Dolat Research

Overall, on the peer set comparision, we believe that on income front, IIB is ahead of YES Bank and on cost side, YES Bank is better. On margin and core fee income fronts, IIB has been doing better than YES Bank and on operating expenses and credit cost fronts, YES Bank is ahead of IIB. On bottomline level, IIB's core RoAA (adjusted for non-recurring interest income and treasury income) in FY12 is marginally higher than that of YES Bank.

IIB's recent quarter performance: Strong business growth continues in Q1 FY13 with 31% YoY growth in advances and 28% YoY in deposits. The bank's credit book growth was primarily led by Consumer Finance loan segment (growing 48% YoY) to ₹ 188bn; of which highest contribution was from Car loans, Utility vehicle loans, Equipment financing loans and CV loans, growing 70%, 57%, 46, and 44% YoY respectively. On the deposits side, the CASA share rose to 27.9% from 27.3% in Q4 FY12 and slightly came down from 28.2% in Q1 FY12.

During the quarter, NII grew by 24% YoY and 4% QoQ to ₹ 4.8bn. NIM declined to 3.22% in Q1 FY13 as against 3.29% in Q4 FY12 and 3.41% in Q1 FY12. Other income grew by 48% YoY to ₹ 3.2bn. Better growth in bottom-line was due to higher core and non-fund income. Bottom-line increased by 31.1% YoY to ₹ 2.4bn slightly higher than market consensus.

During the quarter, the bank's GNPAs rose merely by 5% QoQ to ₹ 3.6bn. The asset quality in the CCB book has deteriorated with 39% QoQ jump in GNPAs, whereas it has showed improvement in CFD book (10.5% QoQ decline). Overall, the asset quality improved with decrease in GNPA ratio to 0.97% from 1.08% in Q1FY12 and NNPA ratio to 0.27% from 0.30% in Q1FY12. However, ratios remain stable on sequential basis. PCR stabilized at 73% in Q1 FY13. The gross slippage ratio increased to 1.32% in Q1 FY13 from 1.09% in Q4 FY12 and 1.16% in Q1 FY12. Restructured advances stood at ₹ 0.9bn (0.24% of Gross Advances) as on end-June, 2012. Overall, the result was strong and management sounds quite confident of maintaining business growth and asset quality going forward.

Particulars (₹ mn)	Q1FY13	Q4FY12	Q1FY12	QoQ (%)	YoY (%)	FY12	FY11	YoY (%)
Total Interest Earned	16,320	14,810	11,646	10.2	40.1	53,592	35,894	49.3
Interest Expenditure	11,479	10,166	7,746	12.9	48.2	36,550	22,129	65.2
NII	4,841	4,644	3,900	4.2	24.1	17,043	13,765	23.8
Non-interest Income	3,188	2,921	2,154	9.2	48.0	10,118	7,137	41.8
Total Net Income	8,029	7,565	6,054	6.1	32.6	27,160	20,902	29.9
Operating Expenses	3,989	3,774	2,937	5.7	35.8	13,430	10,085	33.2
Payments to employees	1,526	1,334	1,107	14.3	37.8	4,855	3,827	26.9
Other operating expenses	2,463	2,439	1,830	1.0	34.6	8,575	6,258	37.0
Operating Profit	4,040	3,791	3,117	6.6	29.6	13,730	10,817	26.9
Tax	1,143	1,097	870	4.1	31.4	3,900	3,025	29.0
Provisions	535	460	446	16.3	20.0	1,804	2,019	-10.6
PAT	2,363	2,234	1,802	5.8	31.1	8,026	5,773	39.0
Equity	4,689	4,677	4,662	0.3	0.6	4,677	4,660	0.4
EPS	5.0	4.8	3.9	5.5	30.4	17.2	12.4	38.5
GNPA	3,651	3,471	3,093	5.2	18.1			
NNPA	999	947	838	5.5	19.2			
GNPA (in %)	1.0	1.0	1.1					
NNPA (in %)	0.3	0.3	0.3					
RoA (Annulised)	1.57	1.60	1.59			1.57	1.46	

Key risks to our call:

- **Sudden drop in business growth:** Drop in business expansion pace would be a key risk. Though, since the end-June'12, the bank's management has been sounding confident of expanding its business at 25%-30% rate. At present, there is no meaningful change in banking industry's credit and deposit growth since end-June'12 and the central bank also expects credit growth at 17% rate. Therefore, there is no justification to assume a significant moderation in business expansion at current juncture.

- **Drop in saving deposit mobilization:** A major contribution in margin improvement would come from higher SA deposit mobilization. Deviation in SA deposit share from our expectations would lead to lesser margin than estimated.

- **Increase in gross slippages:** Sharp increase in slippages in CV and Utility vehicle segments is not foreseen at this point of time. The bank does not operate in fleet segment (under CV segment), which is undergoing pain. Also, in corporate loan front, the bank's management does not have any pipeline for loan restructuring.

- **Change in top management:** We witness that almost all the positive changes brought in the bank was done by the incumbent senior management; any change in the management (particularly top management) would be negative for stock's price performance. Though, the top management has already got renewal of its tenure in office, therefore we do not visualize this as a risk at the moment.

- **Promoters' group a new NBFC startup:** The new NBFC could create a conflict of interest between the bank and the NBFC. Since in accordance with RBI's current stipulations, the promoter has to bring down its stake to 10% by the end-December'12 and after losing controlling stake in IIB, for maintaining its presence in domestic financial markets, the promoter would like to have some entity (NBFC) with a controlling stake. We do not expect any kind of favoritism offered by IIB to the NBFC. But, in a very later stage, merger of this NBFC with the bank might be a possibility providing the promoters with a sizeable stake in the bank again. At current juncture, the probability of the event appears to be quite remote and very far on the horizon.

Valuation

We assume that the bank's business would expand at 24.3% cagr (during FY12-14) with improvement in margin in FY13 and would be flat in FY14. Core fee income would remain robust. The bank does not face any significant asset quality issues so far in any of the credit segments; going forward, the bank's management does not foresee any pipeline of loan restructuring. We do not factor return ratio dilution due to equity raising plan since the bank is sitting on high tier I capital (10.6% as on end-June'12). With RoAA of 1.6% and RoAE at 21%, we determine the bank's intrinsic worth at ₹ 434 at 3.1x adjusted book value FY14. We rate the stock as a **Buy** with a target price of ₹ 434.

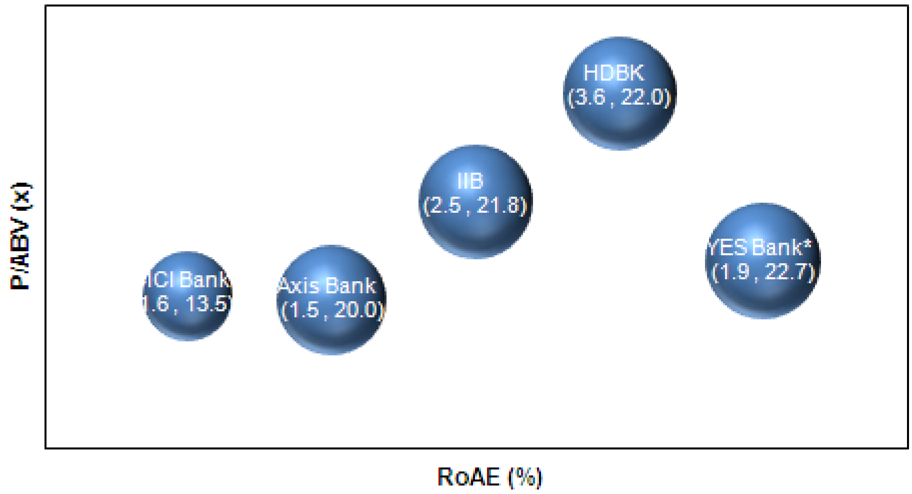
IIB's three stage Gordon Growth Valuation Model Assumptions:

Sustainable RoAE	20.9
Avr. Payout ratio	13.9
Sustainable growth rate	18.0
Beta	1.3
Cost of equity (Post high-growth phase)	14.5
Expected growth rate	7.0
Terminal growth rate	4.0

IIB's Dupont Analysis

Particulars	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Total interest income earned	8.51	9.08	8.60	8.86	10.38	10.1	9.81
Other income	1.35	1.79	1.76	1.76	1.96	2.01	2.06
Commission, Exchange & Brokerage	0.46	0.55	0.61	0.63	0.55	0.56	0.56
Profit on sale of investment	0.09	0.48	0.35	0.10	0.11	0.07	0.05
Other fee income	0.80	0.77	0.79	1.03	1.30	1.38	1.46
Total interest expenses	-7.15	-7.27	-5.78	-5.46	-7.08	-6.45	-6.17
NII	1.36	1.80	2.81	3.40	3.30	3.66	3.65
Pay to / Prov for Employees	-0.55	-0.74	-0.92	-0.94	-0.94	-1.02	-1.02
Op Exps & Admin Exps	-1.27	-1.41	-1.41	-1.55	-1.66	-1.72	-1.72
Total Oper. Exps.	-1.82	-2.15	-2.34	-2.49	-2.60	-2.74	-2.74
Provisions & Cont and Taxes	-0.55	-0.86	-1.12	-1.25	-1.11	-1.29	-1.31
Prov for NPAs	-0.28	-0.52	-0.42	-0.40	-0.28	-0.34	-0.36
Prov for income tax	-0.18	-0.31	-0.58	-0.75	-0.76	-0.88	-0.89
Other Provisions	-0.10	-0.03	-0.13	-0.10	-0.07	-0.07	-0.06
Net Profit (RoAA)	0.34	0.58	1.11	1.43	1.55	1.64	1.65
RoAE	6.93	11.7	19.51	19.31	19.27	21.20	21.78
Core RoAA	0.19	0.23	0.83	1.34	1.43	1.55	1.59

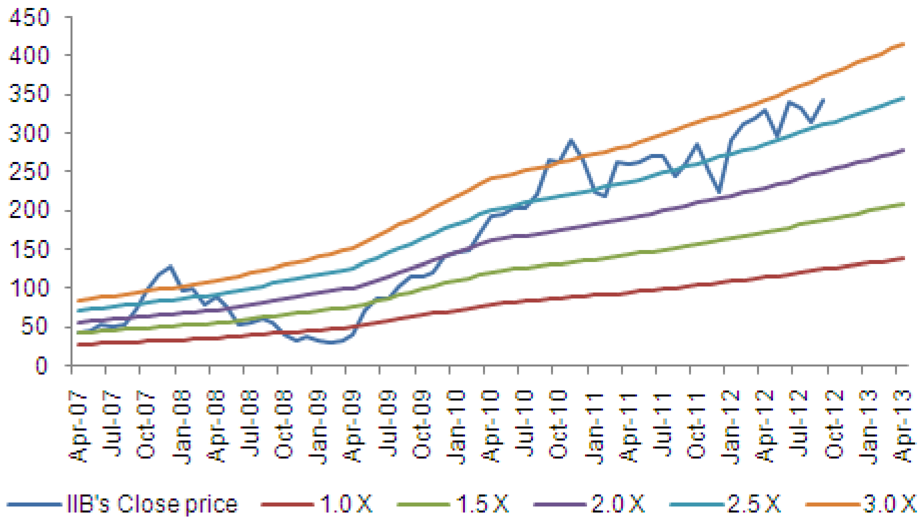
Comparision of peer banks' valuations:



*Note: * Bloomberg concensus*

Source: Dolat Research

IIB's P/ABV chart:



Source: Capitaline, Dolat Research

Financials

DOLAT CAPITAL

INCOME STATEMENT ₹ mn

Particulars	Mar11	Mar12	Mar13E	Mar14E
Net Interest Income	13,765	17,042	23,466	28,742
CXB	2,570	2,837	3,588	4,386
Profits on sale of investments	404	577	455	355
Profits on foreign exchange	1,542	2,378	3,142	4,111
Other operating income	2,621	4,326	5,741	7,395
Total other income	7,137	10,118	12,926	16,247
Total Income	20,902	27,160	36,392	44,989
Salaries	3,826	4,855	6,553	8,058
Other operating costs	6,258	8,575	11,021	13,559
Total Overheads	10,085	13,430	17,574	21,617
Profit before provisions	10,817	13,730	18,818	23,372
Bad Debt Provisions	1,612	1,426	2,200	2,850
Stnd. Asset Provision	229	358	369	445
Other provision	178	21	50	55
Total provisions	2,019	1,804	2,619	3,350
Profit before tax	8,798	11,927	16,200	20,022
Tax	3,025	3,900	5,662	7,008
Reported Net profit	5,773	8,026	10,538	13,014

BALANCE SHEET

Particulars	Mar11	Mar12	Mar13E	Mar14E
Cash with RBI	24,560	29,036	35,080	42,556
Cash at call	15,686	26,360	23,688	20,202
Total Cash	40,246	55,396	58,768	62,758
Govt. securities	100,219	119,019	141,228	164,900
Other investments	35,290	26,700	33,127	38,680
Total Investments	135,508	145,719	174,355	203,580
Bills discounted	22,958	8,197	13,119	16,359
Cash credit	75,543	85,166	122,440	152,685
Term loans	163,155	257,277	301,727	376,260
Total Credit	261,656	350,640	437,285	545,304
Gross Fixed Assets	9,713	10,828	10,976	11,167
Accumulated Depreciation	3,992	4,687	4,500	4,578
Net Fixed Assets	5,721	6,141	6,476	6,588
Capital work in progress	244	427	0	0
Other Assets	12,983	17,638	31,192	49,697
Total Assets	**456,358**	**575,961**	**708,076**	**867,927**
Demand Deposits	62,721	68,689	84,158	104,133
Savings Deposits	30,588	46,941	76,268	113,896
Term Deposits	250,345	307,985	365,562	432,804
Total Deposits	343,654	423,615	525,988	650,833
Upper Tier II Capital	3,089	3,089	4,339	5,589
Subordinate Debt	8,601	8,601	8,101	8,101
Other Borrowings	43,564	75,130	91,553	109,868
Total Borrowings	55,254	86,820	103,993	123,558
Other liabilities	17,028	18,217	21,730	26,076
Equity	4,660	4,677	4,677	4,677
Reserves	35,763	42,631	51,688	62,784
Total Equity	40,422	47,308	56,365	67,461
Total Liab & Equity	**456,358**	**575,961**	**708,076**	**867,927**

E-estimates

IMPORTANT RATIOS

Particulars	Mar11	Mar12	Mar13E	Mar14E
DPS (₹)	2.0	2.0	2.7	3.5
Book Value (₹)	81.9	96.5	116.1	139.4
Adjusted Book Value (₹)	80.9	95.1	115.0	138.9
EPS (₹)	12.4	17.2	22.5	27.8
EPS Growth (%)	45.2	38.5	31.3	23.5
Payout (%)	16.1	11.7	12.0	12.6
Net interest margin (%)	3.6	3.4	3.8	3.9
Spread (%)	3.1	2.8	3.4	3.5
Cost-to-income (%)	48.2	49.4	48.3	48.0
ROAA				
Net Interest Income	3.4	3.3	3.7	3.6
Other Income	1.8	2.0	2.0	2.1
Less Overheads	(2.5)	(2.6)	(2.7)	(2.7)
Less Provisions	(0.5)	(0.3)	(0.4)	(0.4)
Less Tax	(0.7)	(0.8)	(0.9)	(0.9)
ROAA	1.4	1.6	1.6	1.7
ROAE	19.3	19.3	21.2	21.8
Valuation				
Price Earnings (x)	27.8	20.1	15.3	12.4
Price to Book Value (x)	4.2	3.6	3.0	2.5
Price to Adjusted BV (x)	4.3	3.6	3.0	2.5
Dividend Yield (%)	0.6	0.6	0.8	1.0
Asset Quality				
Gross NPLs	2,659	3,471	4,668	5,862
Net NPLs	728	947	839	345
Provision coverage ratio (%)	72.6	72.7	82.0	94.1
Gross NPLs (%)	1.0	1.0	1.1	1.1
Net NPLs (%)	0.3	0.3	0.2	0.1
Assumptions				
Yield on Advances (%)	12.1	13.8	13.3	12.9
Yield on Investment (%)	6.1	7.7	7.4	7.0
Cost of Deposits (%)	6.0	8.0	7.8	7.4
Interest Inc. on Cash (%)	0.3	0.5	0.5	0.5
CRAR (%)	15.9	13.8	12.5	11.6
Growth in credit book (%)	27.3	34.0	24.7	24.7
Growth in Deposits (%)	28.7	23.3	24.2	23.7
Growth in Investments (%)	30.3	7.5	19.7	16.8
Gross slippages ratio (%)	0.8	0.9	0.9	0.9
Credit Cost (%)	0.7	0.5	0.6	0.6

E-estimates

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BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside of upto 5% or downside of upto 15%
SELL	Downside of more than 15%

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