Indian Bank

Initiating Coverage

Preferred high beta play in Banking

Indian Bank differentiates itself from other public banks

Indian Bank having a major presence in southern India witnessed a loan CAGR of 22.7% over FY08-12. In the aforementioned period, the bank delivered superior RoAs (average 1.55% over FY08-12) underpinned by robust NIM (average 3.5%), lean operating structure and sanguine asset quality. Operating efficiency was driven by reduction in headcount, improving employee age pyramid and calibrated branch expansion. Asset quality though has deteriorated in recent quarters; however, displayed stress has been lower than peers.

After having shed majority of the short term corporate loans, Indian Bank's loan growth is expected to accelerate H2 FY13 onwards. NIM would likely stabilize near 3.2% with the impact of lending rate cuts being offset by improvement in deposit franchise, more productive deployment of excess liquidity and re-pricing of term deposits. With the bank having no or low exposure to some publicly known stressed companies, slippages are less likely to surprise negatively in coming quarters. Even if PCR is sustained at the extant prudential level of 70%+, credit cost is estimated to be manageable. Therefore, RoA of the bank would likely settle at 1.2% over FY13-14; much better than projected sub-1% delivery for a host of PSU Banks. Another important differentiator for Indian Bank is its robust capitalization (Tier-1 capital at 11.8%) and higher government stake (80%).

Valuation attractive both on relative and absolute basis

On YTD basis, Indian Bank has substantially underperformed peers and the Bankex. Consequently, it is one of the cheapest stocks amongst PSBs with valuation at 0.68x FY14 P/adj.BV. On absolute basis too, valuation is alluring in the light of impressive RoA/RoE delivery (average 1.2%/18% respectively). Based on 1-yr rolling fwd P/adj.BV, valuation is at 30% discount to 5-year mean. Amid improving appetite for mid-sized PSU banks, Indian Bank is our preferred bet. In our view, choosing a bank with relatively resilient earnings profile and robust capitalization is important. Indian Bank with stronger NIMs, higher PCR and sturdy capitalization provides much better comfort. Initiate coverage with a BUY recommendation and 9-month target price of Rs223.

Financial summary

Y/e 31 Mar (Rs m)	FY11	FY12	FY13E	FY14E
Total operating income	52,180	56,502	59,275	68,240
Yoy growth (%)	16.5	8.3	4.9	15.1
Operating profit (pre-provisions)	32,917	34,632	34,999	40,081
Net profit	17,141	17,470	18,487	21,639
yoy growth (%)	10.2	1.9	5.8	17.0
EPS (Rs)	39.9	40.6	43.0	50.3
Adj. BVPS (Rs)	175.2	187.1	225.0	262.0
P/E (x)	4.5	4.4	4.1	3.5
P/Adj.BV (x)	1.0	1.0	0.8	0.7
ROE (%)	22.3	19.4	17.9	18.1
ROA (%)	1.6	1.3	1.2	1.2

Source: Company, India Infoline Research

November 26, 2012

IIFL INDIA PRIVATE CLIENTS

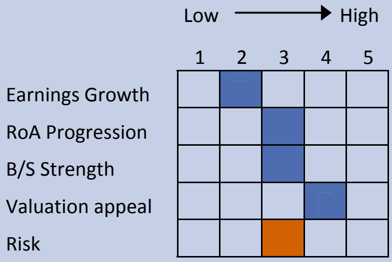
Rating: BUY

Target:	Rs223
CMP:	Rs178
Upside:	25.2%

Sector:	**Financials**
Sector view:	**Neutral**
Sensex:	18,507
52 Week h/l (Rs):	265 / 151
Market cap (Rscr) :	7,633
6m Avg vol ('000Nos):	319
Bloomberg code:	INBK IS
BSE code:	532814
NSE code:	INDIANB
FV (Rs):	10

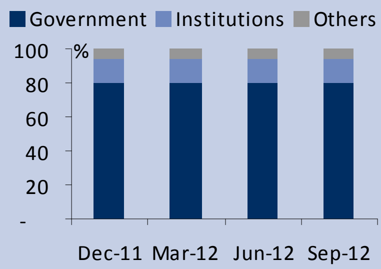
Price as on Nov 23, 2012

Company rating grid



Share price trend

Share holding pattern



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Company Report

Shift in focus towards Retail & MSME segments

Indian Bank's lending portfolio is spread across Corporate and Commercial (52% of total advances), Agriculture (16%), MSME (14%), Retail (12%) and Overseas (6%). It operates through a wide distribution network of 2,002 branches (including 3 overseas branches), 32 extension counters, 1,425 Ultra-small branches and 1,295 ATMs. Rural and Semi-urban areas accounts for ~54% of total branch network.

Wide distribution network of 2,002 branches

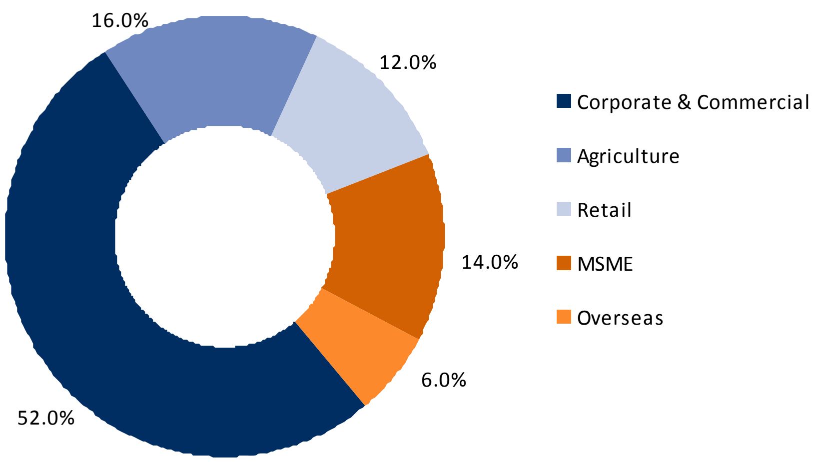
Advances reported a healthy 20.7% CAGR over FY09-12. Over the past few quarters, there has been shift in the focus from Large Corporate term loans towards Retail and MSME segments. Corporate and Commercial book was almost flat in H1 FY13 vis-à-vis 10%+ growth in all other segments. Bank is consistently shedding short-term unsecured corporate loans (with duration of less than 6months). During Q2 FY13, bank ran down short-term loans worth Rs9.5bn resulting in weak 11% yoy credit growth. With some residual short term unsecured loans to be shed by Dec'2012, credit growth is expected to pick-up in H2 FY13. We expect advances to grow by 15% in FY13, largely driven by Retail and MSME segments and disbursements on the sanctioned infrastructure loans. Retail book is diversified across home loans, vehicle loans, personal loans, salary loans, gold loans etc. Focus on Retail segment not only supports margin (being relatively higher yielding) but also boosts non-interest income (due to processing and other fees charged on retail products). We build in 16.5% CAGR in advances over FY12-14E.

Advances reported a healthy 20.7% CAGR over FY09-12

Shift in focus towards Retail and MSME segments

We build in 16.5% CAGR in advances over FY12-14E

Break-up of loan book as on Sept'2012



Source: Company, India Infoline Research

Asset quality to stabilize in H2 FY13; current NPL risk is relatively lower

Reflecting systemic stress, Indian Bank's asset quality has deteriorated over the past few quarters. However, in comparison to many of its peers, jump in Gross NPLs has been much lower for the bank over the past two years. Indian Bank's current GNPL and NPL ratios of 2.1% and 1.3% respectively are one of the lowest amongst the public banks. Delinquency ratio of 2% for the bank in the H1 FY13 stands lower than most peers. This despite the bank recognizing a chunky (~Rs3.5bn) Mumbai-based export account as NPA that has been referred for CDR. Further, Bank's PCR at 71% as at the end of Q2 FY13 is higher than most PSU Banks representing a relatively conservative approach towards specific provisioning. Consequently, Indian Bank has one of the lowest Net NPL/Networth ratio at 11.7%.

Better NPL ratios that most peers; relatively lesser stress witnessed by Indian Bank

Higher PCR and lower NNPL/Networth ratio implies lower risk

Bank expects slippages to moderate in ensuing quarters from a higher base of Rs7.3bn in Q2 FY13. We build in delinquencies at Rs4-4.5bn/quarter through H2 FY13 and FY14 manifesting our expectation of continued stress. An expected improvement in credit growth from H2 FY13 and better recoveries in FY14 should contain a material increase in the GNPL ratio. We estimate GNPL ratio to move in the range of 2.1-2.3%.

Slippages to moderate in ensuing quarters; GNPL ratio to remain near 2.2%

Bank has an infrastructure exposure of Rs183bn, accounting for 19.1% of total advances. Within infrastructure, power accounts for 11.4% of total advances. Out of the total SEB exposure of Rs75bn, Rs23bn pertaining to Rajasthan and Haryana SEBs has been already restructured. Bank also has an exposure to Tamil Nadu, Andhra Pradesh and Maharashtra SEBs. But so far none of these entities has requested for restructuring and are serving loan obligations on time. Ex-power exposure in the infrastructure segment comprises significantly of roads, ports and educational institutions, where the credit quality is behaving well. As per the bank, its infrastructure portfolio (excluding SEBs) is granular in comparison to most other PSU Banks with relatively lower ticket size of loans. Therefore, even if couple of accounts turn NPL in future, a major impact on the bank's asset quality is unlikely. Indian Bank does not have any exposure to stressed companies such as Kingfisher Airlines, Deccan Chronicle, Suzlon, etc and also its exposure to some strained infrastructure companies (Lanco, GVK and GMR) is not significant.

Power exposure stands at 11.4% of total advances

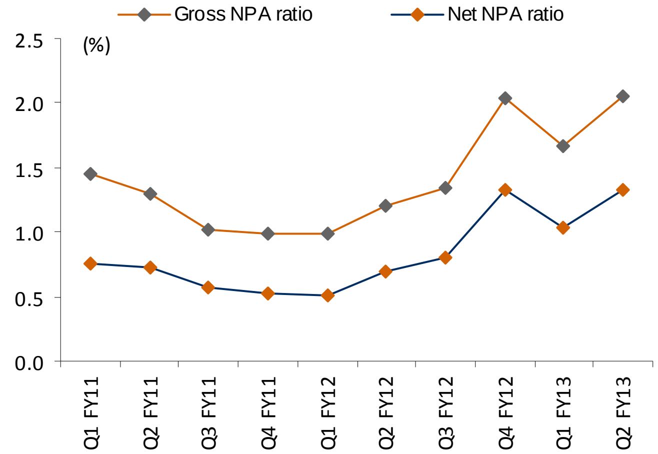
No or low exposure to some of the publicly known stressed companies

Outstanding restructured advances stood at 10.8% of total advances; addition during H1 FY13 was Rs22.6bn. Indian Bank does not expect substantial restructuring to take place in H2 FY13. Lower net addition to GNPL stock in ensuing quarters would likely drive a moderation is specific provisioning even if PCR is sustained at prudential level of 70%. The 75bps increase in provisioning on restructures assets (announced by RBI in October monetary policy) is expected to depress Q3 FY13 earnings by Rs750-800mn.

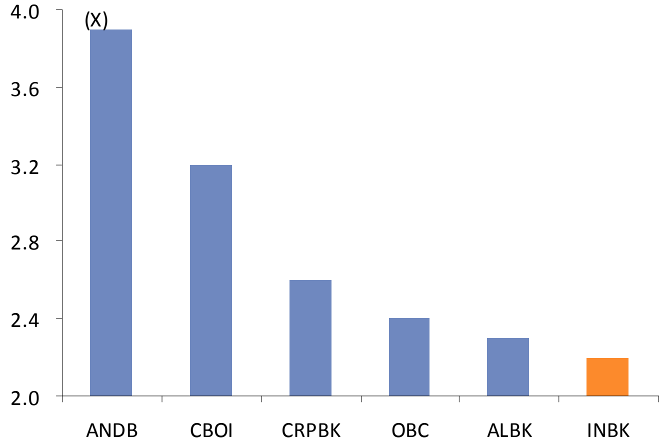
Substantial restructuring unlikely in H2 FY13

Specific provisioning could be significantly lower than Q2 FY13 levels

Asset quality has shown some stress in recent quarters

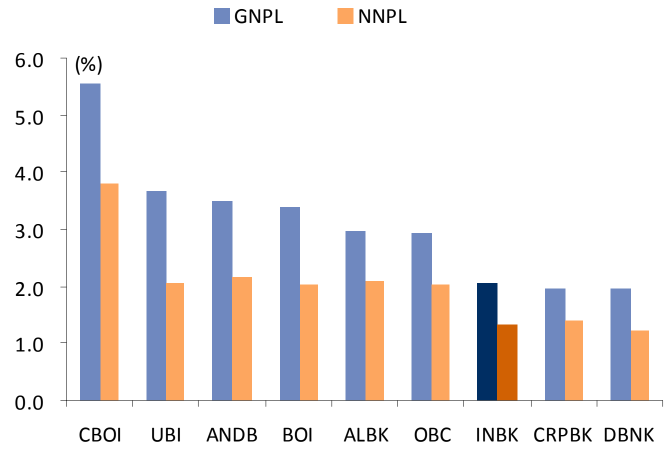


… however, jump in GNPLs over Q2 FY11-Q2 FY13 has been one of the lowest for Indian bank

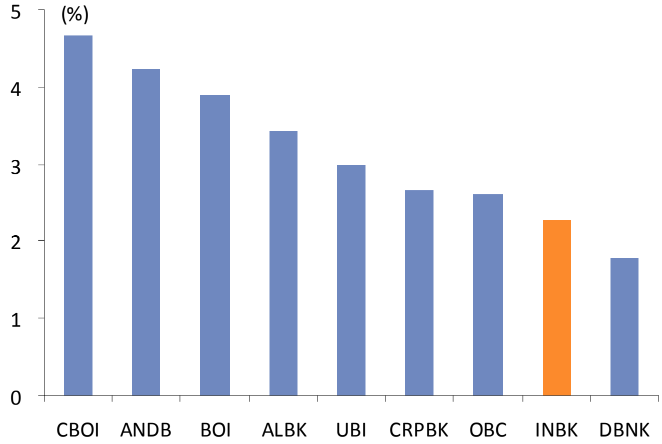


Source: Company, India Infoline Research

Current NPL ratios better than most peers

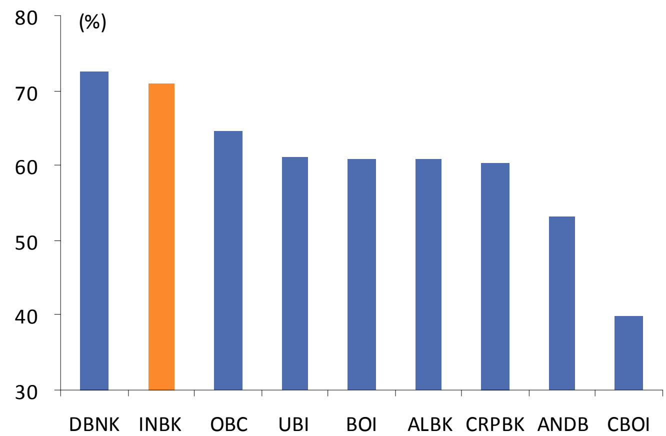


Indian Bank had relatively lower delinquencies in H1 FY13

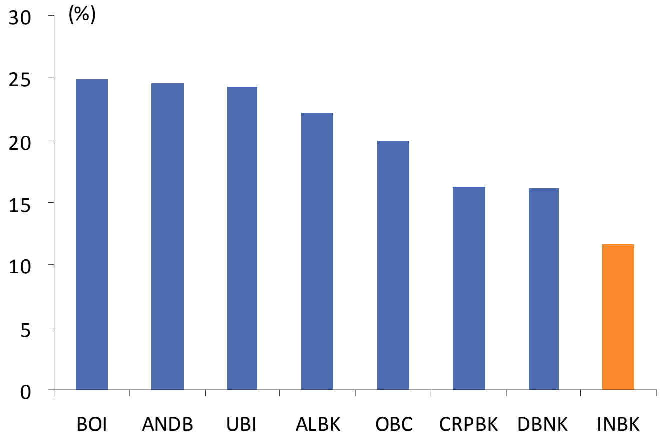


Source: Company, India Infoline Research

Higher PCR of the bank indicates relatively conservative provisioning approach

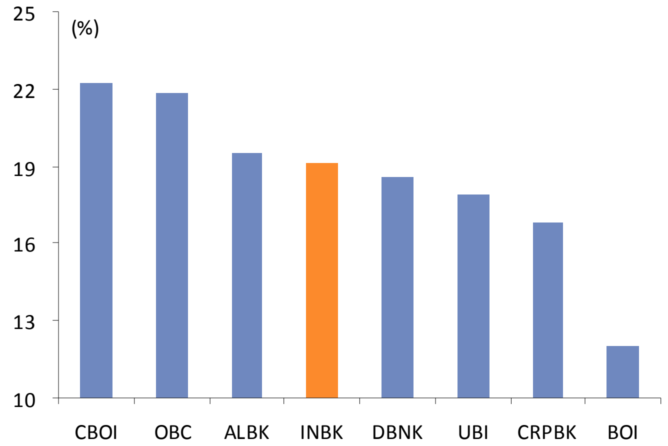


Net NPL/Networth ratio is the lowest for the bank implying lower risk

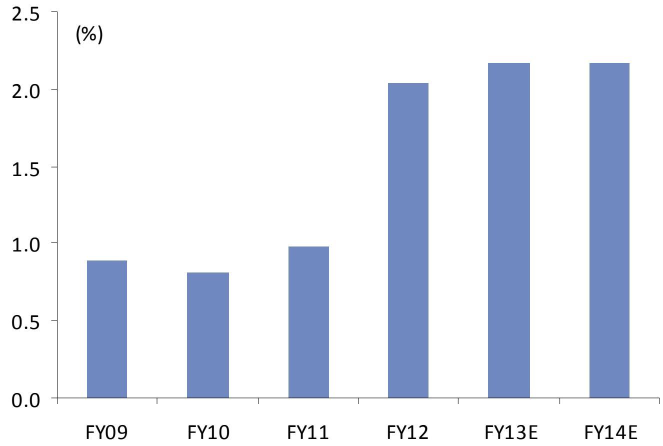


Source: Company, India Infoline Research

Indian Bank has significant infra exposure; but, ex-SEB exposure is more granular than peers



Gross NPL ratio to stabilize at 2.1-2.3%



Source: Company, India Infoline Research

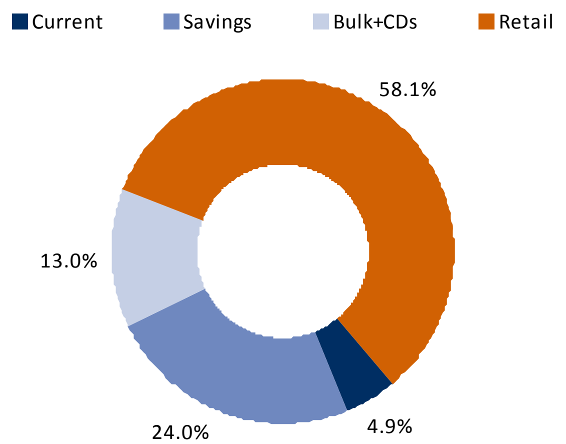
Deposit profile to improve; NIM to remain superior to comparable banks

Indian bank has a healthy deposit profile with CASA ratio of 29% and high-cost deposits (Bulk Deposits above card rate + CDs) at ~13% of total deposits. Over the past few years there has been a marginal decline in CASA ratio (from 31.8% in FY10 to 29% in H2 FY13) owing to increase in interest rate offered on Term Deposits and higher savings rate offered by few private banks post its deregulation. Softening of term deposits rates and accelerated branch addition (target to add 150 branches in FY13 compared to 95 branches added in FY12) is likely to improve CASA ratio in the longer term. Bank has been consistently shedding short-term high-cost deposits (from 17% to 13%) in order to meet the RBI norms and shed excess liquidity created from non-renewal of short-term corporate loans.

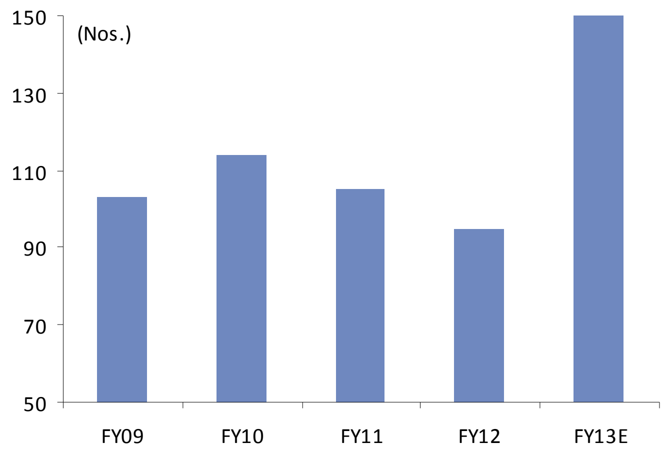
High-cost deposits share low at 13%

CASA improvement to be driven by cyclical and structural factors

Healthy deposit profile

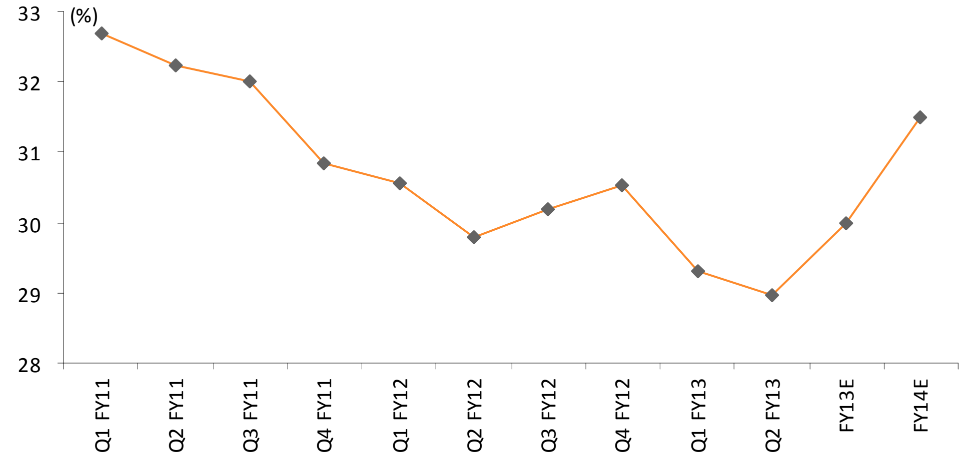


Branch addition to accelerate in FY13



Source: Company, India Infoline Research

CASA ratio to improve in the longer term



Source: Company, India Infoline Research

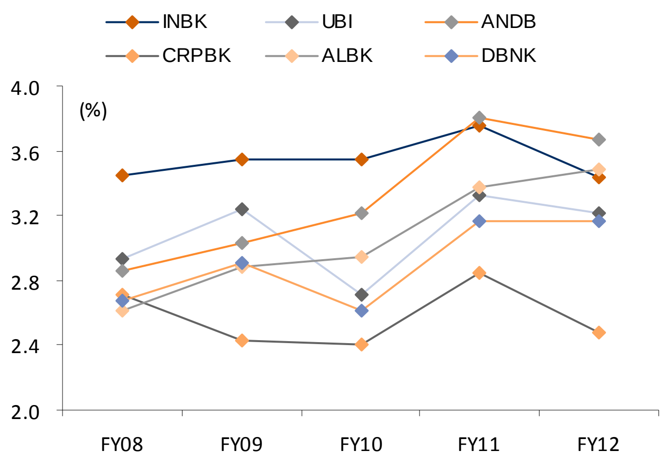
NIM has been resilient for Indian Bank, trending in a narrow range of 3.4-3.8% over FY08-12. Bank's NIM has consistently been higher than most PSBs. In the recent quarters, margin has witnessed a decline owing to a fall in yield on advances (interest reversal due to high slippages and restructuring and impact of 25bps Base Rate cut in May 2012), increase in cost of deposits (due to re-pricing of term deposits at higher rate and marginal decline in CASA ratio) and decline in credit/deposit ratio. In the past few months, Indian Bank has cut interest rates on key retail products of home loans and vehicle loans (by 50bps in early September) but has retained the Base Rate at 10.5%. On the deposit side, bank has reduced rates across tenors. Notwithstanding rate reduction on retail products, NIM is expected to remain stable in Q3 FY13 supported by lower slippages and benign deposit cost. In the medium term, lagged impact of deposit rate cut, more productive deployment of the current surplus liquidity (~Rs65bn; C/D ratio to improve in H2 FY13), lower share of high-cost deposits and improvement in CASA ratio would protect the margin from the headwinds of further Base Rate reductions. We estimate NIM near 3.2% in FY13/14; continue being superior to most of the comparable banks.

NIM has trended in a narrow range over FY08-12

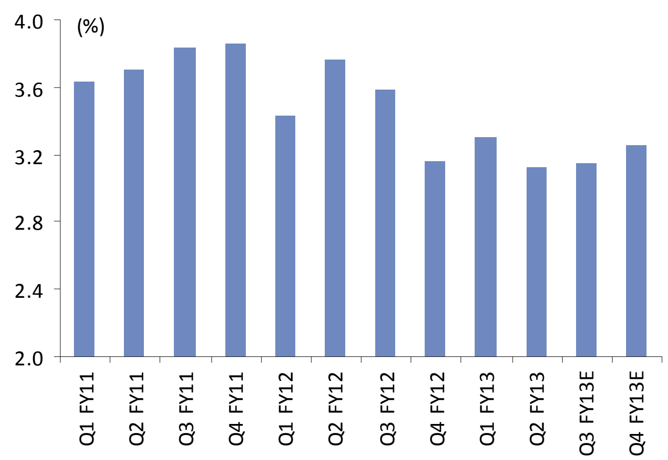
Bank has cut rates on home loans and auto loans recently

NIM to remain near 3.2% in the medium term; higher than most other public banks

Indian bank's NIM has been higher and stronger than peers



NIM to stabilize near 3.2% in the medium term



Source: Company, India Infoline Research

Non-interest income to remain weak; C/I ratio to increase marginally

Total non-interest income witnessed 6% CAGR over FY09-12 vis-à-vis robust 19% CAGR in NII. As a result, non-interest income as a proportion of total income declined from 28.4% in FY09 to 21.8% in FY12. Fee growth would continue to remain muted in FY13/14 with the bank recently waiving processing fee on home loans.

Non-interest income share has declined in the total income

Indian Bank is one of the operationally efficient banks having cost/income ratio below 40%. There has been consistent decline in the employee count from 20,548 in FY08 to 18,782 in FY12. The replacement of the aged workforce (retirees) by young employees resulted in productivity improvement as well as cost savings. Resultantly, opex/average assets declined from 2.1% in FY08 to 1.7% in FY12 and pre-provision profit/average employees more than doubled from Rs0.7mn in FY08 to Rs1.8mn in FY12. The branch expansion was also calibrated with the bank adding nearly 100 branches each year. In FY13, branch addition is guided at 150 and net employee addition is likely to be marginal. Bank expects opex to grow at brisk pace in the medium term with the onset of salary hike from November and requirement of higher pension provisioning due to decline in G-Sec yield. Consequently, further moderation in fee growth and material increase in opex would increase the cost/income ratio to 41-42% from the current level of 39%. Even at the increased level, Indian Bank would have one of the best C/I ratio in the industry.

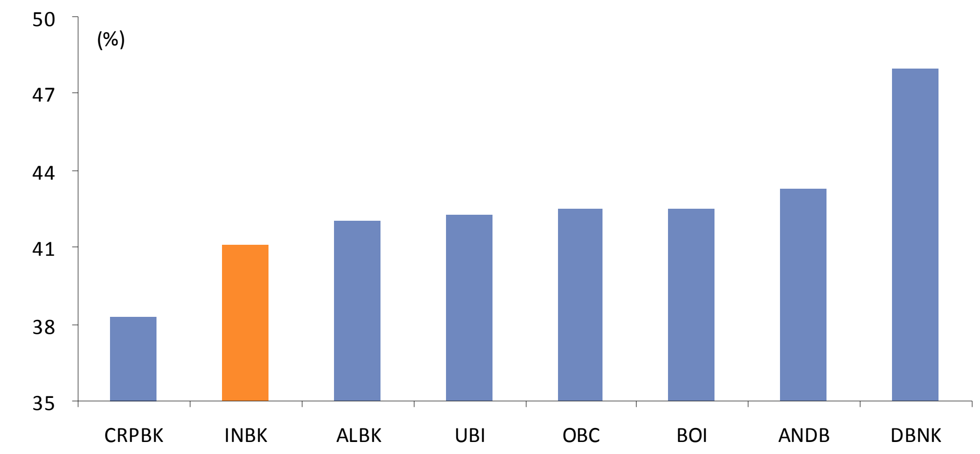
One of the most efficient PSU banks

Opex/average assets declined from 2.1% in FY08 to 1.7% in FY12

PPOP/average employees more than doubled over FY08-12

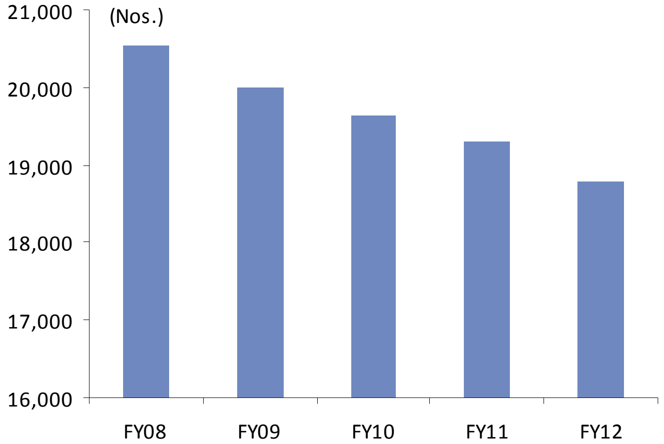
Faster opex growth to drive an increase in C/I ratio

Average cost/income ratio over FY08-12 – Indian Bank one of the best

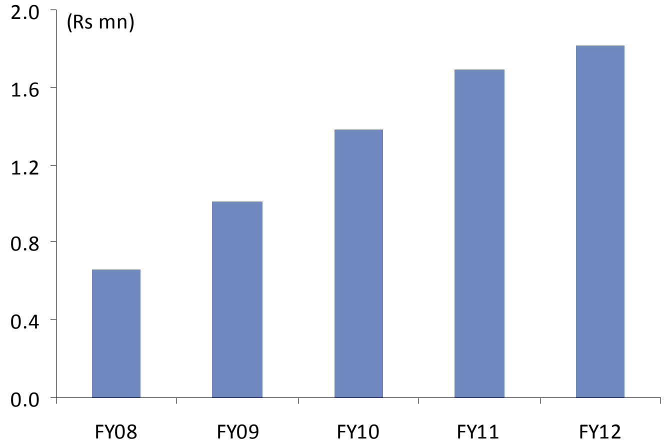


Source: Company, India Infoline Research

Employee headcount has come down in each of the past four years

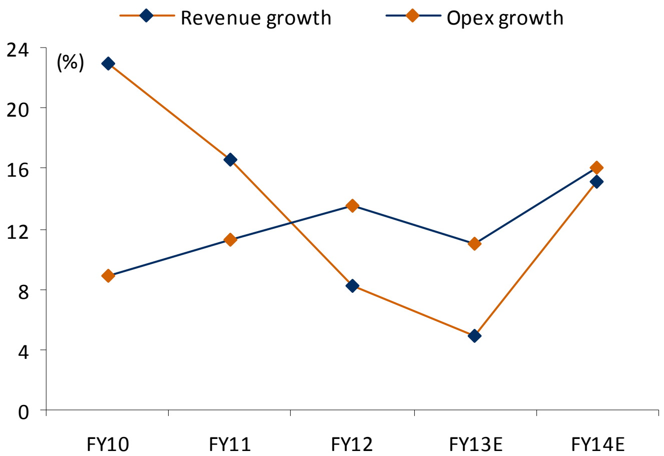


Resultantly, there has been consistent improvement in PPOP/Employee

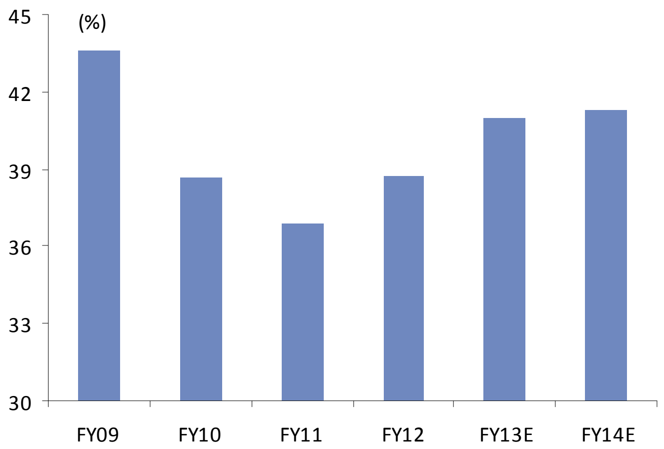


Source: Company, India Infoline Research

Opex growing faster than revenue



Cost/income ratio to inch up in FY13 and FY14



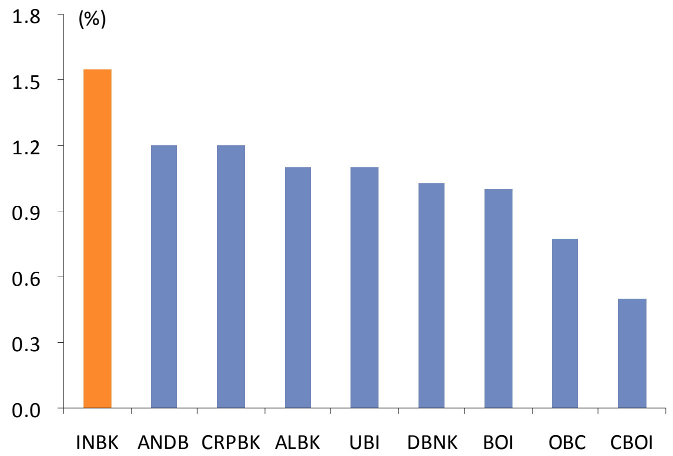
Source: Company, India Infoline Research

Strong profitability to sustain; RoA/RoE to average 1.2%/18% over FY13/14

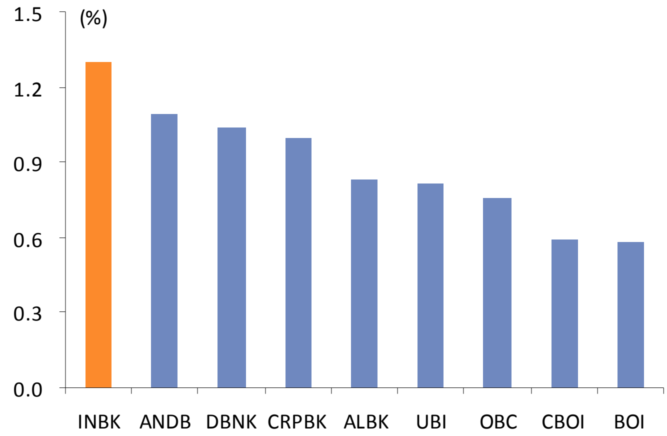
Structural factors supporting higher RoAs of the bank

Indian Bank has reported an average RoA of 1.55% over FY08-12, probably the best amongst public sector banks. Superior profitability was driven by robust NIM (average 3.5%), lean operating structure and sanguine asset quality. Bank's RoA has come-off to 1.3% during H1 FY13 impacted by high delinquencies and muted non-interest income. Such RoA delivery in the current stressed environment is commendable, also much better than sub-1% delivery by most PSBs. While we expect slight further reduction in RoA due to higher opex growth, Indian Bank would still deliver a superior profitability metric over FY13-14. Average RoA and RoE is estimated at 1.2% and 18% respectively during FY13-14.

Average RoA of Indian Bank over FY08-12 has been significantly superior to peers

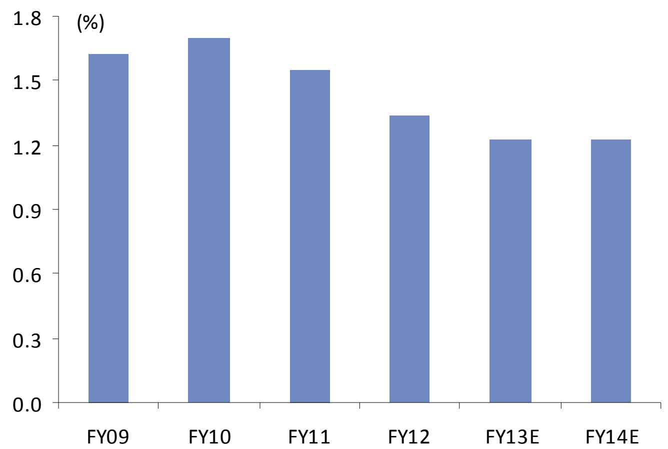


Indian Bank sustained RoA superiority even in H1 FY13

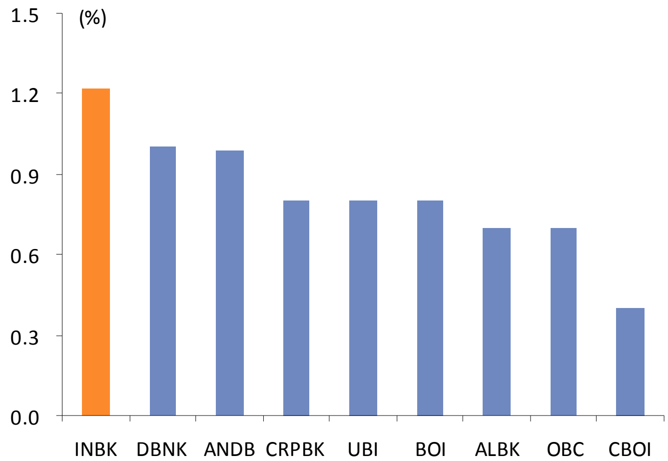


Source: Company, India Infoline Research

Bank's RoA to settle at 1.2%



RoA delivery (FY13-14E average) to continue to be much better than peers



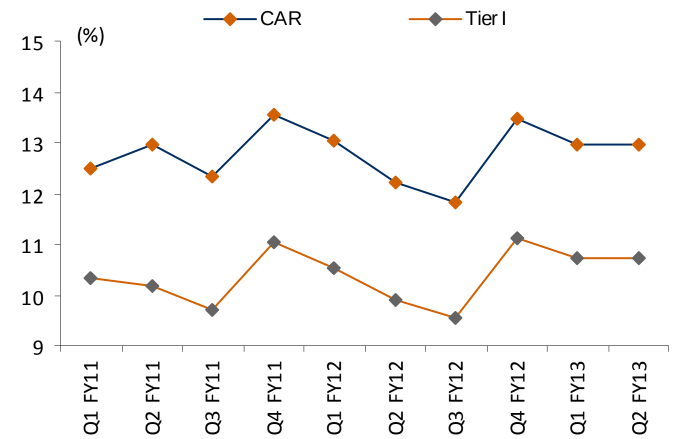
Source: Company, India Infoline Research

One of the well-capitalized public banks

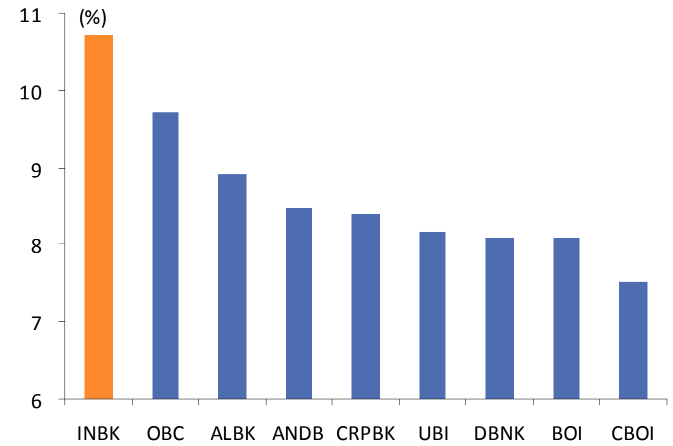
Another key feature that differentiates Indian Bank from most PSBs is its robust capitalization. Including H1 profit, the Tier-1 ratio of the bank stands at 11.8%, much higher than peers. Low Tier-2 capital at 2.25% implies capital raising headroom of Rs76bn. Robust core capital and impressive RoE should suffice a brisk balance sheet growth over the next three years. Further, Indian Bank has a relatively high government stake of 80% and permission in place to dilute it by 10% ie to issue 61.4mn shares in the market. Therefore, the bank's business expansion is not linked to the health of government finances.

Robust capitalization and high government stake provide comfort

The bank has been adequately capitalized

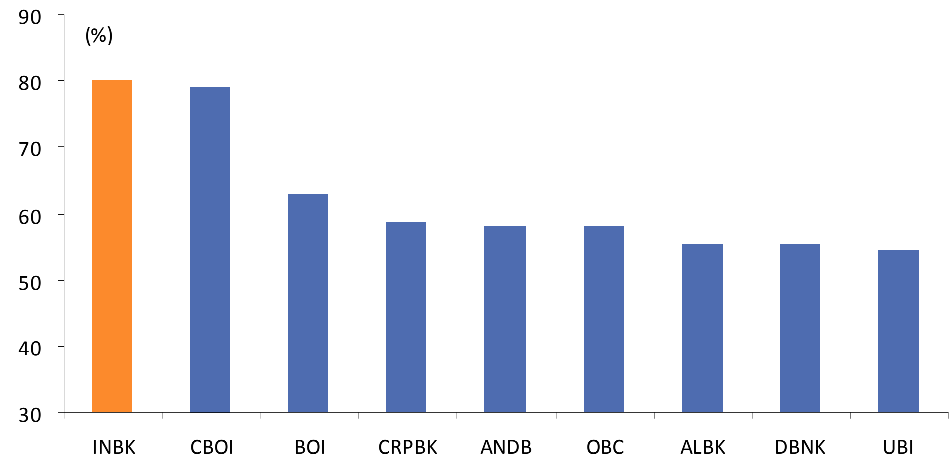


Tier-1 ratio (without H1 profits) is much higher than peers



Source: Company, India Infoline Research

Government stake is significantly higher than most PSBs



Source: Company, India Infoline Research

Attractive valuation both on relative and absolute basis; preferred high beta bet in the sector

On YTD basis, Indian Bank has substantially underperformed peers and the Bankex. This contrasts bank's relatively stable earnings performance over the past six quarters. The significant price underperformance has made Indian Bank one of the cheapest stocks amongst PSBs with valuation at 0.68x FY14 P/adj.BV. On absolute basis also, valuation is extremely attractive given that bank would likely deliver respectable RoA/RoE of 1.2%/18%. Current valuation is at nearly 30% discount to the 5-year mean on 1-year rolling fwd P/adj.BV basis.

One of the cheapest public banks on valuation

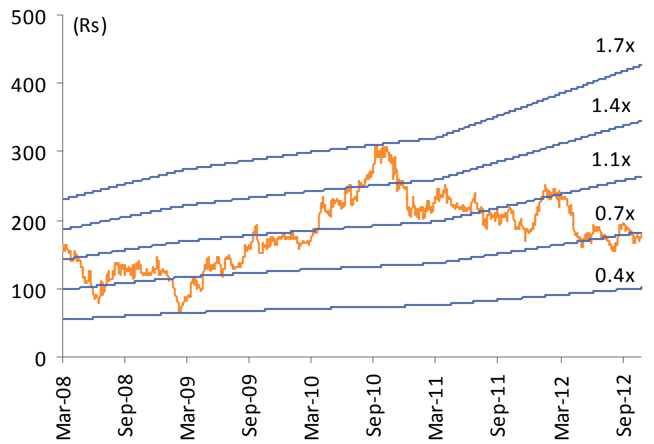
Currently trading at 30% discount to 5-year mean

With market risk appetite improving, demand for mid-sized PSU banks trading at deep discount to book value has increased. While their cheap valuation seems to largely factor near-to-medium term operating challenges, it does not price-in negative shocks in our view. So it is important to choose a bank that has a relatively resilient earnings profile to absorb unpleasant surprises and robust capitalization. Indian Bank with stronger NIMs, higher PCR and sturdy capitalization provides better comfort. We initiate coverage on the bank with a BUY recommendation and 9-month target price of Rs223 implying 25% upside. Indian Bank is our preferred high-beta bet within the banking sector.

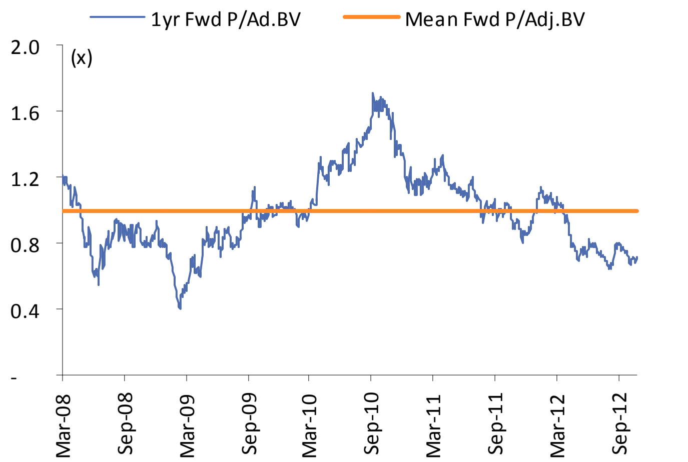
Bank has a relatively resilient earnings profile and robust capitalization

Initiate coverage with a Buy rating and 9m target of Rs223

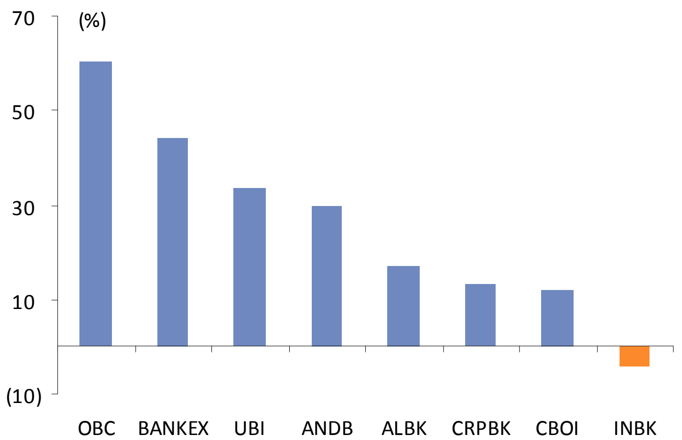
Valuation on 1-year rolling fwd P/adj.BV is extremely attractive



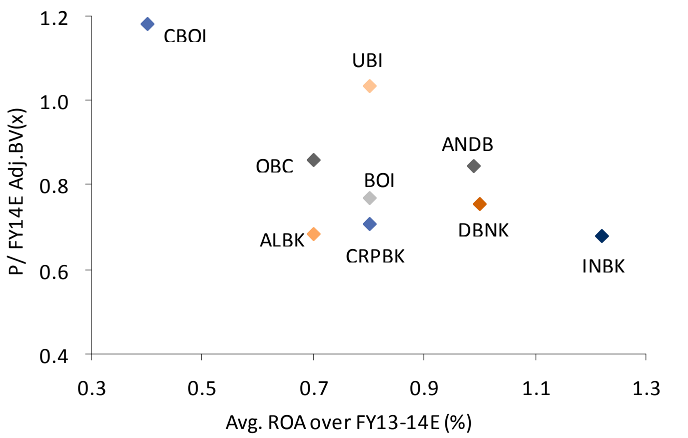
Trading at ~30% discount to five year mean valuation



Indian Bank has substantially underperformed the Bankex and peers since January



The most attractive bank on the valuation v/s fundamental matrix



Source: Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs mn)	FY11	FY12	FY13E	FY14E
Interest income	93,610	122,313	139,038	155,299
Interest expense	(53,249)	(78,133)	(92,084)	(100,859)
Net interest income	**40,361**	**44,180**	**46,953**	**54,440**
Non-interest income	11,819	12,322	12,322	13,800
Total op income	**52,180**	**56,502**	**59,275**	**68,240**
Total op expenses	(19,263)	(21,870)	(24,276)	(28,160)
Op profit (pre-prov)	**32,917**	**34,632**	**34,999**	**40,081**
Total provisions	(6,572)	(11,953)	(8,011)	(8,492)
Profit before tax	**26,345**	**22,679**	**26,989**	**31,589**
Taxes	(9,204)	(5,209)	(8,501)	(9,951)
Net profit	**17,141**	**17,470**	**18,487**	**21,639**

Balance sheet

Y/e 31 Mar (Rs mn)	FY11	FY12	FY13E	FY14E
Total cash & equivalents	85,623	88,134	91,485	99,802
Investments	347,838	379,760	455,712	542,298
Advances	752,499	903,236	1,038,721	1,225,691
Total int-earning assets	**1,185,960**	**1,371,130**	**1,585,919**	**1,867,790**
Fixed assets	16,060	16,307	17,122	17,978
Other assets	15,163	26,755	30,768	35,384
Total assets	**1,217,183**	**1,414,192**	**1,633,810**	**1,921,153**
Net worth	**95,211**	**108,014**	**122,042**	**138,970**
Deposits	1,058,042	1,208,038	1,398,908	1,650,711
Borrowings	21,004	48,729	56,038	66,125
Total int-bearing liabs	**1,079,046**	**1,256,767**	**1,454,946**	**1,716,836**
Non-int-bearing liabs	42,926	49,411	56,823	65,346
Total liabilities	**1,121,972**	**1,306,178**	**1,511,769**	**1,782,182**
Equity + Total liabilities	**1,217,183**	**1,414,192**	**1,633,810**	**1,921,153**

Key ratios

Y/e 31 Mar	FY11	FY12	FY13E	FY14E
Growth matrix (%)				
Net interest income	22.2	9.5	6.3	15.9
Total op income	16.5	8.3	4.9	15.1
Op profit (pre-provision)	19.8	5.2	1.1	14.5
Net profit	10.2	1.9	5.8	17.0
Advances	21.1	20.0	15.0	18.0
Deposits	19.9	14.2	15.8	18.0
Total assets	20.1	16.2	15.5	17.6
Profitability Ratios (%)				
NIM	3.7	3.5	3.2	3.2
Non-int inc/Total inc	22.7	21.8	20.8	20.2
Return on Avg Equity	22.3	19.4	17.9	18.1
Return on Avg Assets	1.6	1.3	1.2	1.2
Per share ratios (Rs)				
EPS	39.9	40.6	43.0	50.3
Adj.BVPS	175.2	187.1	225.0	262.0
DPS	7.5	7.5	8.0	8.5
Valuation ratios (x)				
P/E	4.4	4.3	4.1	3.5
P/Adj.BVPS	1.0	0.9	0.8	0.7
Other key ratios (%)				
Credit/Deposits	71.1	74.8	74.3	74.3
Cost/Income	36.9	38.7	41.0	41.3
CASA	30.9	30.6	30.0	31.5
CAR	13.6	13.5	13.1	12.6
Tier-I capital	11.0	11.1	11.0	10.6
Gross NPLs/Loans	1.0	2.0	2.2	2.2
Credit Cost	1.0	1.4	0.8	0.8
Net NPLs/Net loans	0.5	1.3	1.4	1.3
Tax rate	34.9	23.0	31.5	31.5
Dividend yield	4.2	4.2	4.5	4.8

IIFL
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After receiving two reputed awards for being the 'Best Broker' in 2011, IIFL has now bagged the Best Broking House with Global Presence in 2012.

'Best Equity Broker of the Year' – Bloomberg UTV, 2011

IIFL was awarded the 'Best Equity Broker of the Year' at the recently held Bloomberg UTV Financial Leadership Award, 2011. The award presented by the Hon'ble Finance Minister of India, Shri Pranab Mukherjee. The Bloomberg UTV Financial Leadership Awards acknowledge the extraordinary contribution of India's financial leaders and visionaries from January 2010 to January 2011.

'Best Broker in India' – Finance Asia, 2011

IIFL has been awarded the 'Best Broker in India' by Finance Asia. The award is the result of Finance Asia's annual quest for the best financial services firms across Asia, which culminated in the Country Awards 2011

Other awards

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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