South Indian Bank

16 October 2018

Reuters: SIBK.BO; Bloomberg: SIB IN

2QFY19 Result Update

Early Signs Of A Lower Slippage Regime

South Indian Bank (SBL) reported 2QFY19 results with the key takeaways being: (1) NPA addition moderated to Rs2.13bn compared with a past 10-quarter average of Rs4.96bn, with management guiding for ~Rs2.5bn slippage per quarter over the remainder of FY19 (2) NIM seems to have bottomed out, displaying a 1 bp rise QoQ to 2.61% with MCLR re-repricing still to play out over 2HFY19 given most of MCLR-linked book has a ~1 year tenure. (3) Loan book is retailising in a meaningful way with core retail book growing 31% YoY (See *comprehensive* conference call takeaways on page 2). Per se, on the results front, SIBL posted NII growth of 1% YoY at Rs5,065mn, PPOP decline of 33% YoY at Rs3,098mn and PAT growth of 1,523% YoY at Rs701mn. We have revised our estimates for FY19/FY20/FY21 and have retained Buy rating on SBL, revising our target price to Rs21 (from Rs18 earlier) and valuing the stock at 0.6x 1HFY21E P/BV.

NPA addition moderated to Rs 2.13bn compared with a past 10-quarter average of Rs4.96bn, with management guiding for ~Rs2.5bn slippage per quarter over the remainder of FY19: Slippages from corporate accounts (ticket size > Rs250mn) were just 9 bps of corporate book, indicating that the source of major stress accretion for SIB may, now, be under relative control. On internal ratings, 20.8% of corporate book is still sub-investment grade (840bps of total loan book), which is a concern but management indicated that the behavior of this pool has not been particularly untoward. Management has guided for Rs2.5bn gross slippage per quarter for the remainder of FY19. Importantly, they have also re-iterated their full year guidance for recoveries amounting to Rs5bn, implying ~Rs3.5bn worth of recoveries for the remainder of the year. SBL made a prudential provision of Rs 200mn on exposure to an infrastructure-sector conglomerate, presumably IL&FS group.

NIM seems to have bottomed out, displaying a 1 bp rise QoQ to 2.61% with MCLR re-repricing still to play out over 2HFY19 given most of MCLR-linked book has a ~1 year tenure: Cost of deposits rose just 2bps QoQ to 6.08% despite significant rise in non-core (wholesale) deposits of 26% YoY, whose share rose ~220bps YoY to 18.7% of total deposits. Some of this rise may be back-ended towards the quarter. However, importantly, NIM seems to have bottomed out as major MCLR-linked re-pricing is prospective given most of the MCLR-linked book has a ~1 year tenure.

Loan book is retailising in a meaningful way with core retail book growing 31% YoY: Core retail book (including Gold loans) grew 31% YoY with its share in total loan rising ~340bps to 28%. This was driven by Manufacturing (up 48% YoY), Service & Traders (up 42% YoY) and, to some extent, by Housing loans (up 30% YoY), which now form 19%, 29% and 25% of core retail book, respectively. Corporate book rose 13% YoY with its share declining ~80bps YoY to 35% of total loans. While unflinching focus on additional collateral security has kept a lid on loan yield, ceteris paribus, traction in non-Housing core retail will act to support margins.

Valuation and outlook: We have revised our NII estimates by 0%/0%/0.5%, PPOP estimates by 0%/0%/0.03% and PAT estimates by 1%/0.7%/0.6% for FY19/FY20/FY21, respectively. We have retained Buy rating on SBL, revising our target price on it to Rs21 (from Rs18 earlier) and valuing the stock at 0.6x 1HFY21E P/BV.

BUY

Sector: Banking

CMP: Rs15

Target Price: Rs21

Upside: 42%

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Key Data

Current Shares O/S (mn)	1,809.7
Mkt Cap (Rsbn/US$mn)	26.5/359.5
52 Wk H / L (Rs)	35/12
Daily Vol. (3M NSE Avg.)	16,280,520

Price Performance (%)

	1 M	6 M	1 Yr
South Indian Bank	(10.8)	(41.8)	(54.7)
Nifty Index	(8.1)	0.5	3.5

Source: Bloomberg

Y/E March (Rsmn)	2QFY19	2QFY18	1QFY19	YoY (%)	QoQ (%)
Interest income	16,965	15,362	16,539	*10.4*	*2.6*
Interest expenses	11,900	10,330	11,597	*15.2*	*2.6*
Net interest income	**5,065**	**5,032**	**4,943**	*0.6*	*2.5*
NIM (%)	**2.6**	**2.9**	**2.6**	*(29bps)*	*1bps*
Non-interest income	1,579	2,805	1,459	*(43.7)*	*8.2*
Operating income	**6,644**	**7,837**	**6,402**	*(15.2)*	*3.8*
Staff costs	1,963	1,681	2,111	*16.8*	*(7.0)*
Other operating expenses	1,583	1,554	1,594	*1.9*	*(0.7)*
Total operating expenses	3,546	3,234	3,705	*9.6*	*(4.3)*
Cost-to-income (%)	*53.4*	*41.3*	*57.9*	*1,210bps*	*(451bps)*
Pre-provision profit	**3,098**	**4,603**	**2,696**	*(32.7)*	*14.9*
Provisions	2,047	4,537	2,315	*(54.9)*	*(11.6)*
PBT	**1,051**	**66**	**381**	*1,494.8*	*175.8*
Tax	350	23	151	*1,440.5*	*132.1*
-Effective tax rate	*33.3*	*34.4*	*39.5*	*(117bps)*	*(627bps)*
PAT	**701**	**43**	**230**	*1,523.4*	*204.4*
EPS (Rs)	0.4	0.02	0.1	*1,518.6*	*204.4*
BV (Rs)	29.0	27.6	29.1	*5.1*	*(0.3)*
Deposits	7,49,112	6,71,421	7,24,880	*11.6*	*3.3*
Advances	5,65,725	4,89,543	5,54,440	*15.6*	*2.0*

Source: Company, Nirmal Bang Institutional Equities Research

Comprehensive Conference Call Takeaways

Asset Quality

- The management stated that SIBL has exposure to an Infra conglomerate (presumably IL&FS group). They have made a prudential provision of Rs200mn in this regard.
- The management stated that they have consciously avoided any exposure to road and power / energy SPV projects since the last 4 years.
- The management stated that the increase in their sub-investment grade proportion in this quarter is mainly due to downgrade of their Infra conglomerate exposure.
- The management stated that there is only one account of an EPC contractor now under their watchlist. This account has seen devolvement and SIBL has made a provision of Rs100mn on this exposure.
- SMA2 book stood at Rs23680mn, 4.12% of total advances.
- Guidance for total recovery of Rs 5bn for full year FY19 remains intact. This implies recoveries worth ~Rs 3.5bn over 2HFY19. This estimate does not factor in recoveries from IBC accounts.
- Credit costs of Rs 1.5bn per quarter are expected over the remainder of the financial year.
- Apart from the downgrade of the infra sector conglomerate, the account that has been newly identified under watchlist is the other contributor to rise in sub-investment grade portfolio. This account was rated A earlier.
- Slippages of Rs 2.5bn per quarter are expected for the remainder of the financial year. No slippages are expected from large corporate book of accounts with ticket size greater than Rs 1bn.
- For the sub-investment grade portion for the large corporate book of ticket size greater than Rs 1bn, which is ~9% of the said book, the only problem account is the infra conglomerate. Management expects the rest of the sub-investment grade book to behave well.
- The sub-investment grade book for accounts of Rs 250mn ticket size and higher, other than the portion of accounts with ticket size Rs 1bn and higher, has not behaved in an untoward manner historically. Apart from cashew sector accounts, few gold loan accounts, slippages from this portion of sub-investment grade book have been in a controlled manner.
- Of the SMA2 book, 8 accounts belong to accounts with ticket size Rs 250mn or higher, amounting to Rs 7.32bn.

More on Asset Quality – Specifically on Kerala Floods

- Total advances in Kerala stood at Rs2,33,680mn as of this quarter end. Of the total exposure, advances in the 12 districts affected by floods stood at Rs1,71,940mn. Of this Rs1,71,940mn exposure, Rs100300mn were in businesses that are not affected by floods.
- Therefore, ~Rs7000mn of the total exposure in Kerala were in some way impacted by floods. Of the Rs7000mn exposure, ~Rs5000mn were agri and rural loans, which have availed RBI dispensation and the entire amount is eligible for restructuring. Hence, the final impacted quantum stood at Rs 2000mn.
- The management stated that following the first approach of granular determination of affected accounts in Kerala led to a Rs1000mn worst case scenario figure of NPAs (of the Rs 2000mn impacted quantum) over the next two quarters.
- The management also stated that based on an analysis of SMA2 that has emerged from Kerala floods, worst case scenario of NPAs will be ~Rs1000mn over 2HFY19, thus, leading to the same slippage estimate due to Kerala floods from two different approaches.

Loan growth

- The management stated that their business in Kerala has grown faster than rest of India. They do not anticipate any serious slowdown due to Kerala floods and are looking forward to register a ~20% YoY growth overall in 2HFY19.
- South ex Kerala has not grown well in 2QFY19. However, there are several proposals in the pipeline and this would lead to better growth from this region in 2HFY19.
- SBL has not permitting drawings from certain NBFCs, which has also impacted growth.
- The average ticket size for SME loans indicated in the presentation is for the overall book (not incremental).
- There is a clear intention to grow the Gold loan book faster from current growth rate.
- On large corporate book, SBL is staying away from stressed sectors and also focusing exclusively on high-rated borrowers with good repayment track records. To that extent, risk appetite in this area is lower.

Fee and Other Income

- Fee income declined 6.25% on a YoY basis. The management stated that the lower demand for PSLC impacted the growth of fee income.
- While Third Party Distribution is currently not contributing significantly to fees, the building blocks are in place for traction in this regard.

Capital

- Board approval has been taken for Tier 2 capital raise of Rs 5bn. The rest of the current financial year can be managed with this capital raise. SBL will also be looking at other (Tier 1) opportunities of capital raise.

Margin

- The management stated that SIBL's orientation towards additional collateral in the form of residential mortgages etc is leading to low pricing. They will like to wait for a while before reducing their security orientation, which is currently leading to flat margins.
- The management stated that most of their MCLR linked book is of 1-year duration, so, repricing upwards will take some time, whereas, liabilities are getting repriced higher with immediate effect. They expect to see some difference in NIM in the upcoming quarters.
- SBL's mortgages and auto loans pricing is on the lower sise. However, the pricing of business loans is on the higher side.

Opex

- The management stated that total 18 branches were impacted by floods. Only 3 branches were physically impacted. Operational expenses for rebuilding branches was almost nil as insurance support is available.
- The management stated that their immediate target is to bring C/I ratio under 50% levels. PSLC and treasury income are the main contributors to Other Income, which have been tracking lower but will improve.
- SBL had started making provisions due to IBA-linked staff expense revision from November last year itself.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net interest income	16,754	19,655	24,078	31,294	40,311
Pre-provision profit	12,146	14,808	15,519	20,501	27,977
PAT	3,925	3,349	3,966	6,483	10,641
EPS (Rs)	2.2	1.9	2.1	3.4	5.1
BV (Rs)	26.9	29.0	30.7	33.6	38.9
P/E (x)	6.7	7.9	7.0	4.3	2.9
P/BV (x)	0.5	0.5	0.5	0.4	0.4
GNPAs (%)	*2.5*	*3.6*	*4.5*	*4.2*	*3.8*
NNPAs (%)	*1.5*	*2.6*	*3.2*	*2.9*	*2.4*
RoA (%)	*0.6*	*0.4*	*0.4*	*0.6*	*0.8*
RoE (%)	*9.0*	*6.6*	*7.2*	*10.6*	*14.7*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates

(Rsmn)	2QFY19	2QFY18	1QFY19	*YoY (%)*	*QoQ (%)*	2QFY19E	*Devi. (%)*
Net interest income	5,065	5,032	4,943	*1*	*2*	5,632	*(10)*
Pre-provision profit	3,098	4,603	2,696	*(33)*	*15*	3,210	*(3)*
PAT	701	43	230	*1,523*	*204*	(36)	*NA*

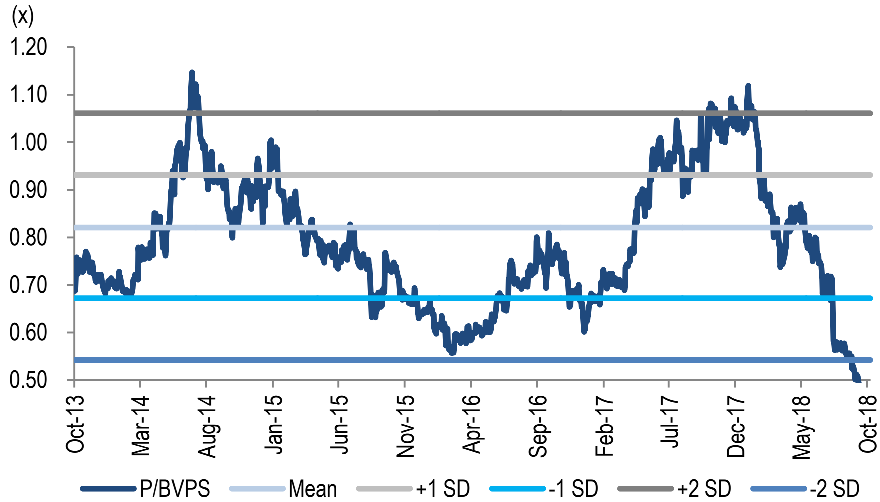
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Change in our estimates

	Revised estimate			Earlier estimate			*% Revision*		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Net interest income (Rsmn)	24,078	31,294	40,311	24,078	31,294	*40,097*	-	-	*0.5*
NIM (%)	*2.9*	*3.2*	*3.3*	*2.9*	*3.2*	*3.3*	**-**	**-**	**2bps**
Operating profit (Rsmn)	15,519	20,501	27,977	15,519	20,501	*27,968*	-	-	*0.0*
Profit after tax (Rsmn)	3,966	6,483	10,641	3,926	6,435	*10,576*	*1.0*	*0.7*	*0.6*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: One-year forward P/BV



Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Interest income	58,471	61,928	74,972	92,369	1,13,567
Interest expenses	41,716	42,273	50,894	61,075	73,255
Net interest income	**16,754**	**19,655**	**24,078**	**31,294**	**40,311**
Fee income	550	557	720	945	1,612
Other Income	6,606	7,816	6,107	7,345	8,768
Net revenues	23,910	28,028	30,906	39,584	50,691
Operating expenses	11,764	13,220	15,387	19,083	22,714
-Employee expenses	6,765	7,132	8,185	9,635	11,073
-Other expenses	4,999	6,088	7,202	9,448	11,641
Pre-provision profit	**12,146**	**14,808**	**15,519**	**20,501**	**27,977**
Provisions	6,144	9,809	9,510	10,678	11,855
-Loan loss provision	6,201	7,008	8,376	9,660	10,630
-Provision for investment	422	3,090	1,134	1,018	1,224
-Other provisions	(478)	(289)	-	-	-
PBT	6,002	4,999	6,009	9,822	16,123
Tax	2,077	1,650	2,043	3,340	5,482
PAT	**3,925**	**3,349**	**3,966**	**6,483**	**10,641**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Key ratios

Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Growth (%)					
NII growth	11.0	17.3	22.5	30.0	28.8
Pre-provision profit growth	38.1	21.9	4.8	32.1	36.5
PAT growth	17.7	(14.7)	18.4	63.5	64.1
Business (%)					
Deposit growth	18.7	8.9	18.2	20.3	22.7
Advance growth	12.9	17.6	20.0	22.0	24.2
Business growth	16.2	12.5	19.0	21.0	23.3
CD	70.2	75.8	76.9	78.0	79.0
CASA	23.8	23.8	24.9	27.3	28.0
Operating efficiency (%)					
Cost-to-income	49.2	47.2	49.8	48.2	44.8
Cost-to-assets	1.7	1.7	1.7	1.7	1.7
Productivity (Rsmn)					
Business per branch	1,323.6	1,482.3	1,703.6	1,994.4	2,381.6
Business per employee	161.3	173.7	198.1	224.1	264.5
Profit per branch	4.6	3.9	4.5	7.1	11.3
Profit per employee	0.6	0.5	0.5	0.8	1.3
Spreads (%)					
Yield on advances	10.2	9.4	9.8	10.0	10.1
Yield on investments	7.2	6.7	7.3	7.3	7.3
Cost of deposits	6.5	5.8	6.1	6.1	6.1
Yield on assets	9.5	8.8	9.2	9.3	9.4
Cost of funds	6.6	5.9	6.1	6.1	6.0
NIM	2.7	2.8	2.9	3.2	3.3
Capital adequacy (%)					
Tier I	10.9	10.4	10.0	9.2	9.4
Tier II	1.5	2.3	2.0	1.8	1.9
Total CAR	12.4	12.7	11.9	11.0	11.3
Asset quality (%)					
Gross NPAs	2.5	3.6	4.5	4.2	3.8
Net NPAs	1.5	2.6	3.2	2.9	2.4
Specific provision coverage	39.3	27.3	30.0	31.7	37.1
Slippage	3.9	3.6	3.0	2.5	2.0
Credit cost	1.4	1.4	1.3	1.2	1.1
Return (%)					
RoE	9.0	6.6	7.2	10.6	14.7
RoA	0.6	0.4	0.4	0.6	0.8
RoRWA	1.0	0.7	0.8	1.1	1.4
Per share (Rs)					
EPS	2.2	1.9	2.1	3.4	5.1
BV	26.9	29.0	30.7	33.6	38.9
ABV	23.0	21.0	19.7	21.4	27.5
Valuation (x)					
P/E	6.7	7.9	7.0	4.3	2.9
P/BV	0.5	0.5	0.5	0.4	0.4
P/ABV	0.6	0.7	0.7	0.7	0.5

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

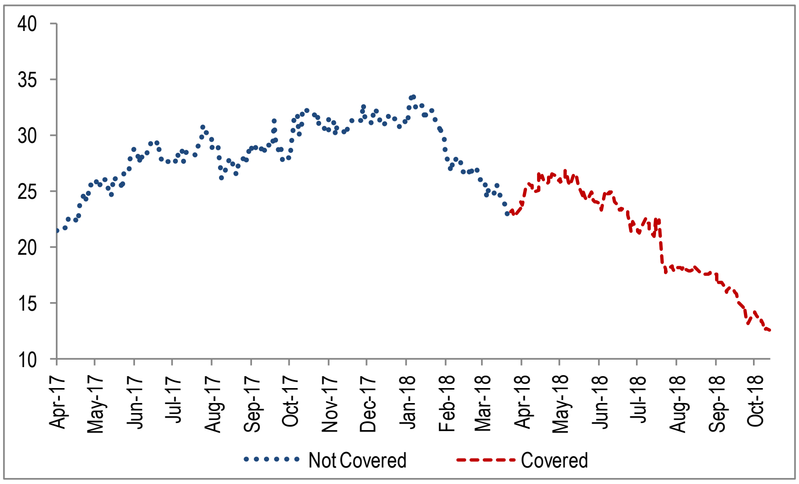
Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity Capital	1,803	1,809	1,899	1,899	2,089
Reserves & Surplus	46,682	50,623	56,392	61,966	79,203
Shareholder's Funds	**48,485**	**52,432**	**58,292**	**63,865**	**81,293**
Deposits	**6,61,175**	**7,20,296**	**8,51,247**	**10,24,102**	**12,56,074**
-Current deposits	27,526	30,576	37,455	49,157	62,804
-Saving deposits	1,29,938	1,40,841	1,74,506	2,30,423	2,88,897
-Term deposit	5,03,712	5,48,879	6,39,286	7,44,522	9,04,373
Borrowings	19,578	40,434	58,567	71,042	75,427
Other liabilities	13,884	13,697	31,623	52,044	75,009
Total liabilities	**7,43,122**	**8,26,859**	**9,99,729**	**12,11,053**	**14,87,802**
Cash/Equivalent	38,877	42,210	55,654	67,898	84,329
Advances	4,63,895	5,45,629	6,54,755	7,98,801	9,92,110
Investments	1,94,297	1,83,631	2,23,535	2,66,160	3,18,354
Fixed Assets	6,561	6,808	7,489	8,237	9,061
Other assets	39,492	48,581	58,297	69,956	83,948
Total assets	**7,43,122**	**8,26,859**	**9,99,729**	**12,11,053**	**14,87,802**

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 March 2018	Buy	23	28
15 May 2018	Buy	26	30
23 July 2018	Buy	18	26
9 October 2018	Buy	13	18
16 October 2018	Buy	15	21

Rating track graph



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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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