

Banking

Company update

Target price: Rs25

Shareholding pattern

	Jun '22	Sep '22	Dec '22
Promoters	0.0	0.0	0.0
Institutional investors	23.6	19.4	21.8
MFs and others	0.0	0.0	0.0
FI / Banks.	0.1	0.1	0.1
Insurance	16.0	11.5	6.7
FII	7.5	7.8	15.0
Others	76.4	80.6	78.2

Source: BSE

ESG disclosure score

Year	2020	2021	Chg
ESG score	32.8	33.8	0.9
Environment	1.8	1.8	0.0
Social	25.5	28.3	2.8
Governance	71.1	71.1	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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INDIA



South Indian Bank

BUY

Maintain

Revamped business model yielding positive results;
improving profitability trajectory to continue

Rs18

South Indian Bank (SIB), post the onboarding of new MD (Mr. Murali Ramakrishnan) in Sep'20, reimagined its business model and adopted 6Cs strategy which focuses on – i) CASA, ii) cost ratios, iii) customer focus, iv) capital, v) compliance and vi) competency building. In order to ensure the successful implementation of the above stated strategy, it initiated a series of corrective measures like – i) reducing exposure to BBB and below rated corporates, ii) revamp HR policies to bring in 'ownership' approach, iii) focus on 'profitable growth' rather than 'volume growth' and iv) restructure asset and liability operations. It also realigned organisational structure by setting up a separate operations team for asset and liability, segregating underwriting and business functions, strengthening capabilities in digital, risk management and analytics with focus on mitigating frauds and improving collections.

Successful execution of renewed business strategy reflects in – i) the share of BBB and below rated corporates falling to ~5% in Dec'22 from 34% in Oct'20, ii) PCR improving to 60% by Dec'22 from 48% in Sep'20, iii) GNPL in the new book (stood at 0.06% with SMA-2 of 0.22%, iv) CASA ratio increasing to 34% by Dec'22 from 28% in Sep'20 and v) NIM expanding to 3.5% in Dec'22 from 2.6% in Sep'20. We believe SIB is on the right path to build sustainable, scalable and profitable model under the leadership of Mr. Murali Ramakrishnan. Maintain BUY.

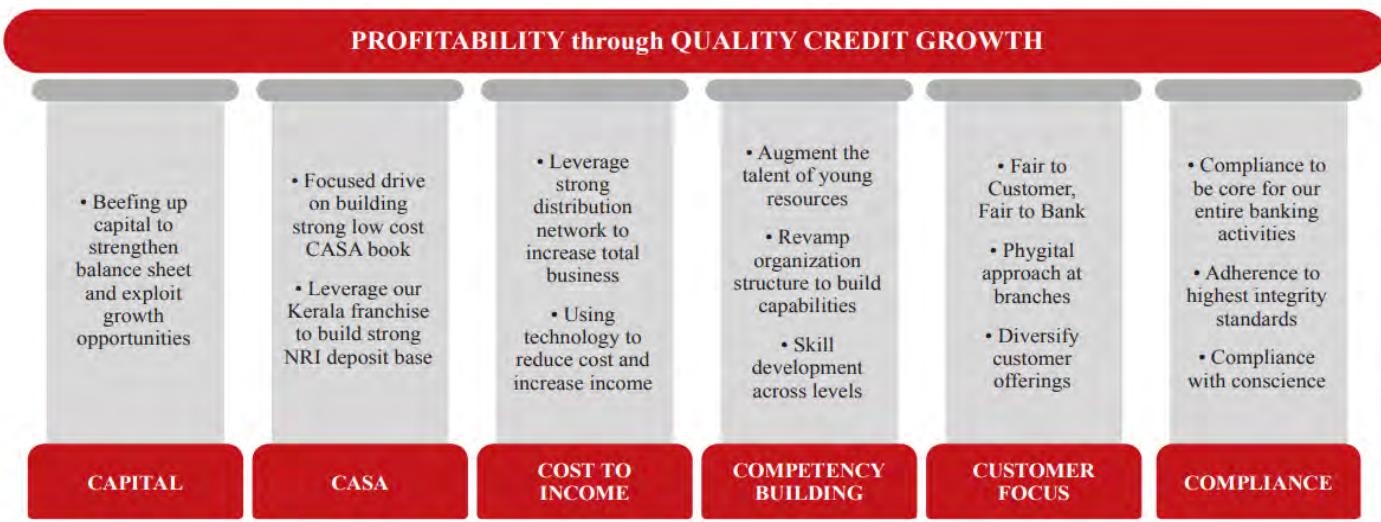
- ▶ **Revamped business architecture to ensure quality growth.** In order to successfully implement the 6Cs strategy, it revamped business architecture. Firstly, to ensure quality growth, it segregated sales function of various businesses as a separate vertical with a business head to carry the P&L responsibility. Secondly, removing book or disbursement target for credit team with deliverables on TAT and credit quality. Further, it set up a separate collections and recovery team to reduce net slippage run-rate. It also diverted operations team from front line function to improve sales productivity. GNPA at 0.06% of new book is testimony of revamped business architecture yielding the desired outcome.
- ▶ **Transformation journey remains on track.** Considering the legacy of higher stress in SIB's corporate and mid-corporate segments, the new management (post taking charge in Sep'20) revisited the business strategy with emphasis on 'quality over quantity'. Further, it completely revamped the sourcing and underwriting process with clear focus on margins and asset quality. Based on renewed business strategy, it has built a new book of Rs377bn (54% of the total loans) with GNPA of 0.06% and SMA2 of 0.22%.
- ▶ **Deposit vertical reimaged; CASA ratio expanded to 34% by Dec'22 from 28% in Sep'20.** While the new management was focused on building granular quality asset book, it remained equally focused on building retail liability base. Hence, to bring in sharper focus on deposit mobilisation, it introduced a concept of Clusters – each region will have 5-6 clusters and each cluster will handle 8-9 branches.

Market Cap	Rs38.7bn/US\$472mn	Year to Mar	FY22	FY23E	FY24E	FY25E
Reuters/Bloomberg	SIBK.BO/SIB IN	NII (Rs bn)	22.3	28.4	33.0	38.7
Shares Outstanding (mn)	2,092.7	Net Profit (Rs bn)	0.5	6.9	9.5	12.1
52-week Range (Rs)	21/7	EPS (Rs)	0.2	3.3	4.6	5.8
Free Float (%)	100.0	% Chg YoY	(32.2)	Nmf	36.5	28.1
FII (%)	15.0	P/E (x)	84.9	5.5	4.0	3.1
Daily Volume (US\$'000)	9,346	P/ABV (x)	0.9	0.7	0.7	0.6
Absolute Return 3m (%)	2.2	Net NPA (%)	2.9	2.1	1.9	1.9
Absolute Return 12m (%)	134.2	ABVPS (Rs)	20.4	24.6	28.5	33.2
Sensex Return 3m (%)	(3.4)	RoA (%)	0.0	0.7	0.8	0.9
Sensex Return 12m (%)	14.4	RoE (%)	0.8	11.8	14.2	15.8

Please refer to important disclosures at the end of this report

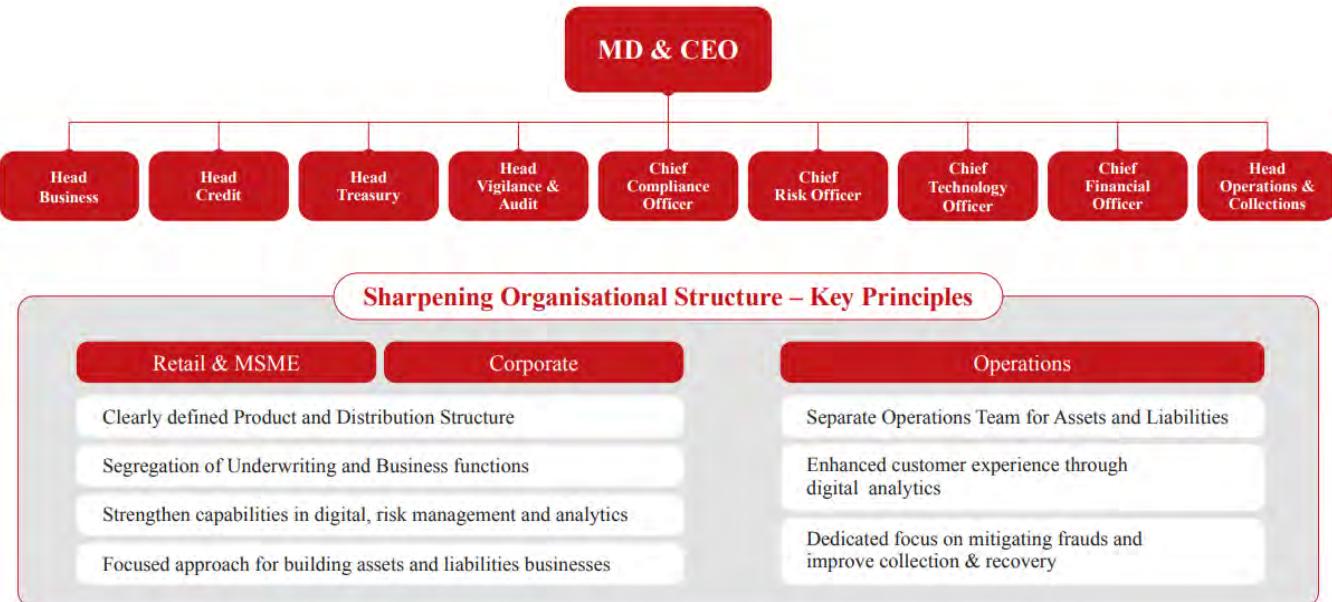
- ▶ **Reduced exposure of BBB and below rated corporates and pristine asset quality in new book...** In line with its long-term vision to build scalable and sustainable granular asset book, the new management initiated corporate book consolidation – specifically to reduce exposure in low-rated corporates. Similarly, during the past eight quarters, it reduced BBB and below rated corporates to only 5% of total corporate book by Dec'22 from 34% in Sep'20. At the same time, new book (Rs377bn - 54% of the total loans), under the leadership of new management, showed pristine asset quality as reflected in SMA2 of 0.22% and GNPA of 0.06%, as on Dec'22.
- ▶ **...coupled with healthy PCR at 60% to ensure sustainability of low credit cost going ahead.** While laying down the foundation to build long term scalable business model, management has also focused on cleaning balance sheet for legacy NPLs, to neutralise P&L from any lumpy provisioning requirement going ahead. In line with this, it started shoring up PCR on NPLs Sep'20 onwards. By Dec'22, PCR improved to 60% from 48% in Sep'22. Further, since the end-of standstill NPL tagging in Q4FY21, gross slippage ratio has been trending downwards steadily on quarterly basis. Considering the subsiding incremental stressed asset formation, PCR @60% as on Dec'22 and pristine asset quality in new book (54% of total loans), we expect credit cost over FY24/25E to remain at 120bps vs average >200bps during FY18-22.
- ▶ **NIM expansion of >50bps over the past 2 years is an outcome of its focused approach on 'profitable growth'.** Since taking charge at SIB in Sep'20, one of the key focus areas of the new management is to grow in a 'profitable' manner by ensuring high quality growth along with better pricing. Further, it focused on scaling high-margin retail products. As a result, the combined share of its two high-margin products, gold loan (15% of total loans) and personal loans (4%) increased to 19% by Dec'22 from ~11% in Sep'20. Increased share of high-margin products coupled with steady decline in cost of deposits led to >50bps improvement in NIM to 3.52% by Dec'22 from 2.94% in Sep'20.
- ▶ **Revamped HR policies would lead to better quality growth in coming years.** As a part of its transformation process, to ensure successful implementation of 6Cs strategy and to instill sense of ownership, the bank revamped its HR policies by adopting new balance scorecard based performance review system. The new review system is prepared in a way that it captures the bank's strategic plans and breaks down to quantifiable parameters. Further, allotment of jobs from top to bottom is done in a scientific way by ensuing common direction across the bank. Further, it introduced a 6-month appraisal system with feedback mechanism to identify gaps and improve the performance. Performance linked incentive scheme, promotions and transfers are linked to balance score card.
- ▶ **Key risks:** a) Higher credit cost than anticipated, and b) NIM contraction if increase in cost of deposit outpaces asset repricing.

Chart 1: New management adopted 6Cs strategy to build long-term sustainable and scalable business model...



Source: Company, I-Sec research

Chart 2: ... it sharpened organisational structure to successfully implement 6Cs strategy



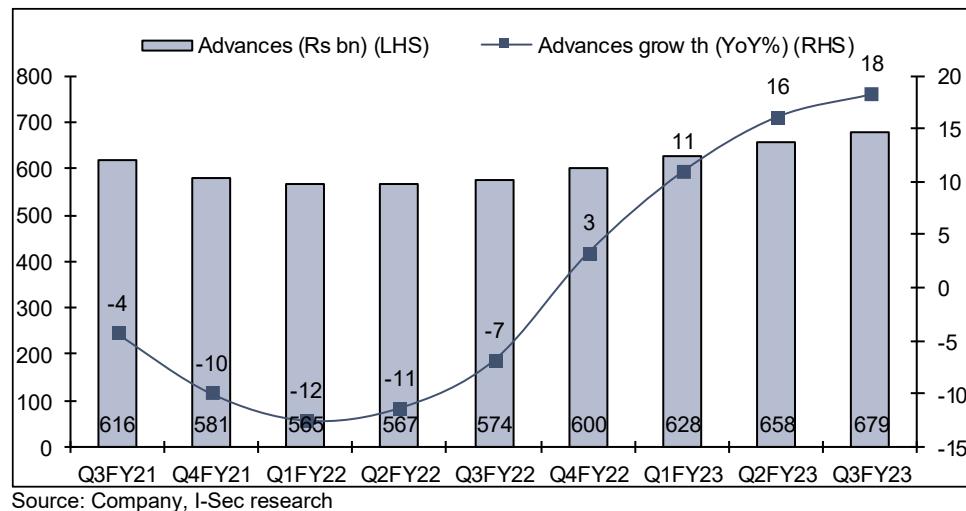
Source: Company, I-Sec research

Table 1: New book built as per renewed business model, showing encouraging performance

Rs bn	New Book	Old Book	Total
Loan book	377	324	701
% of total loans	54%	46%	
Large Corporate A+ rated	84	19	103
% of loans	22%	6%	
SMA 2	0.8	6.1	7.0
% of loans	0.2%	1.9%	1.0%
GNPA (%)	0.1%	11.8%	5.5%
NNPL (%)	0.0%	4.7%	2.2%

Source: Company, I-Sec research

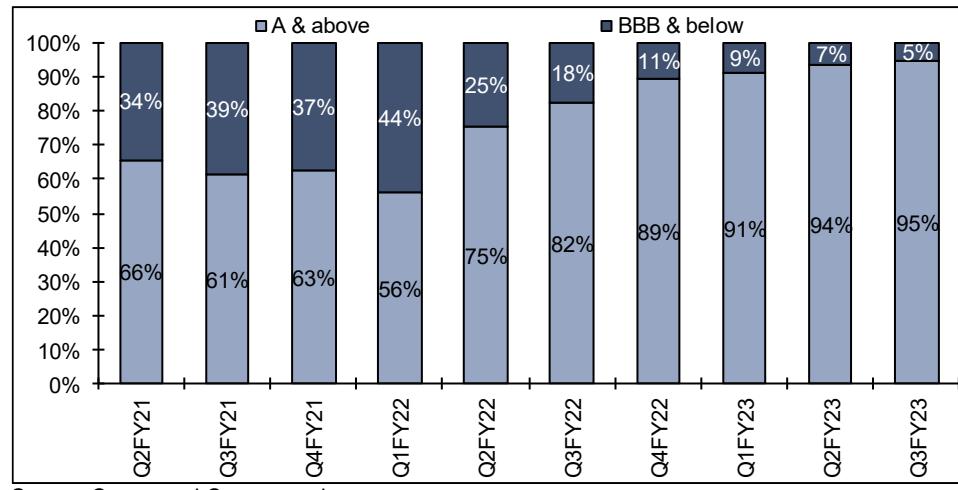
Chart 3: Revamped business architecture yielding positive results as reflected in improved credit growth trajectory since Q3FY22...



Source: Company, I-Sec research

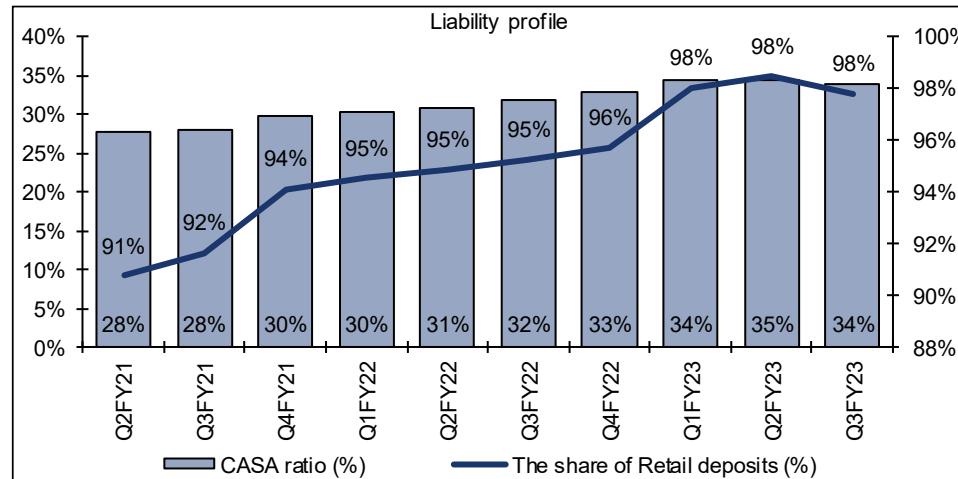
Chart 4: ...with focus on reducing exposure in low-rated corporates

The share of BBB and below rated corporates fell to 5% in Dec'22 from 34% in Sep'20.



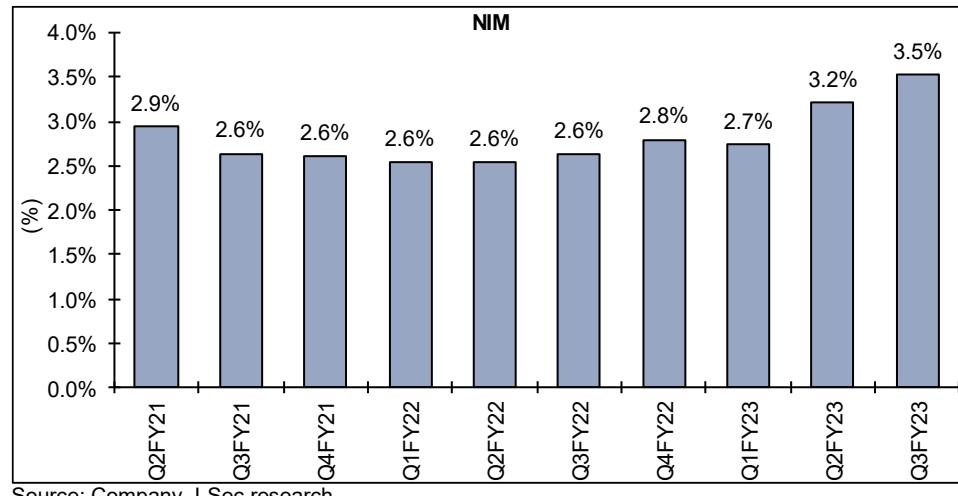
Source: Company, I-Sec research

Chart 5: New management is equally focused on building granular retail liability franchise



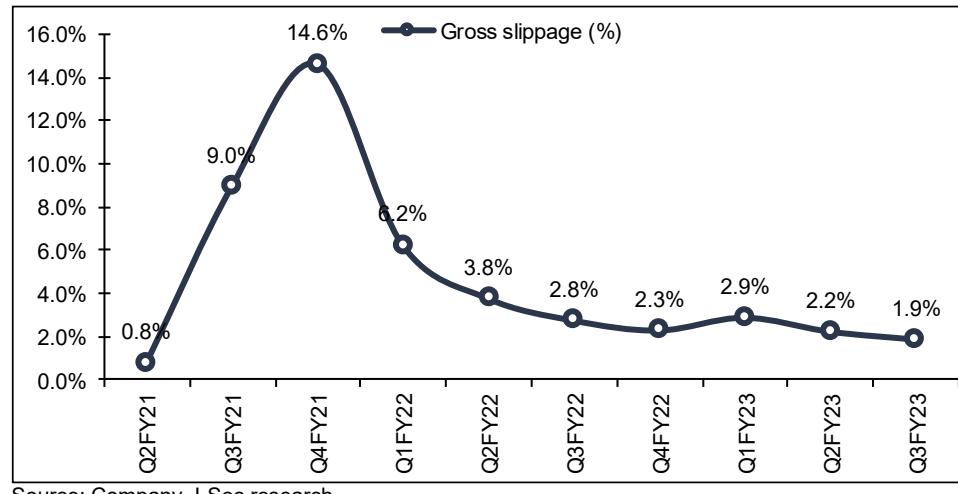
Source: Company, I-Sec research

Chart 6: NIM improvement remained one of the key focus areas while executing new business strategies



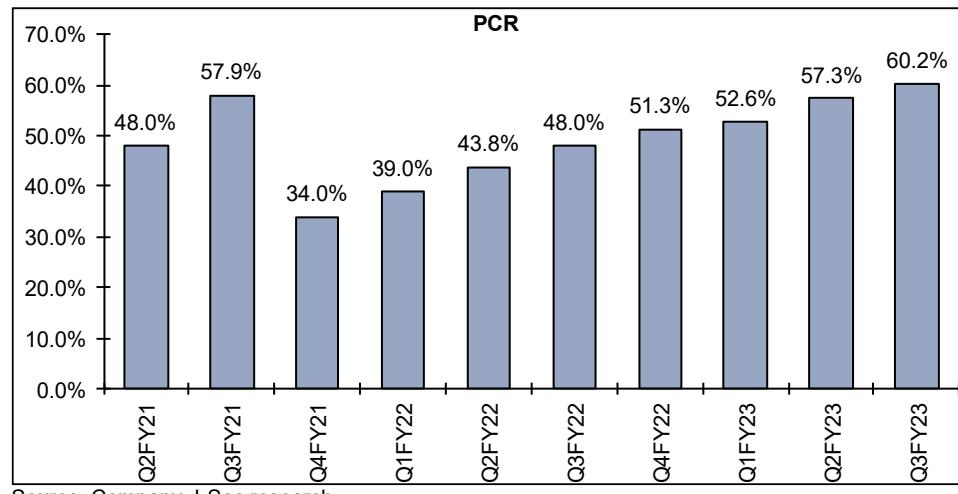
Source: Company, I-Sec research

Chart 7: Incremental stressed asset formation remained well within manageable range

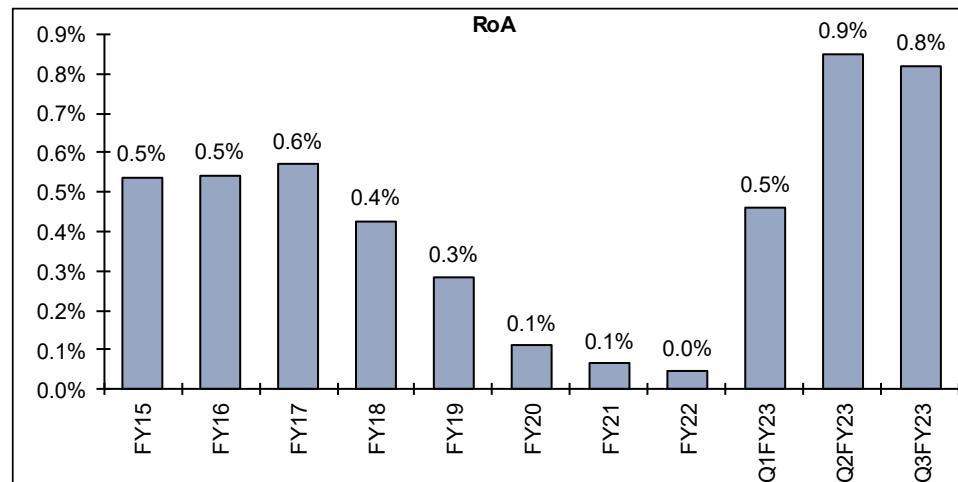


Source: Company, I-Sec research

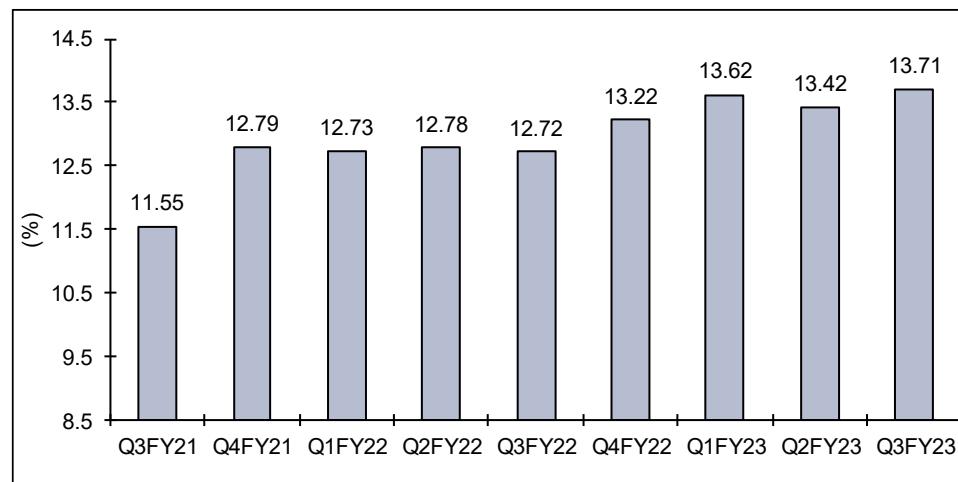
Chart 8: Steady increase in coverage ratio post new management taking charge in Sep'20



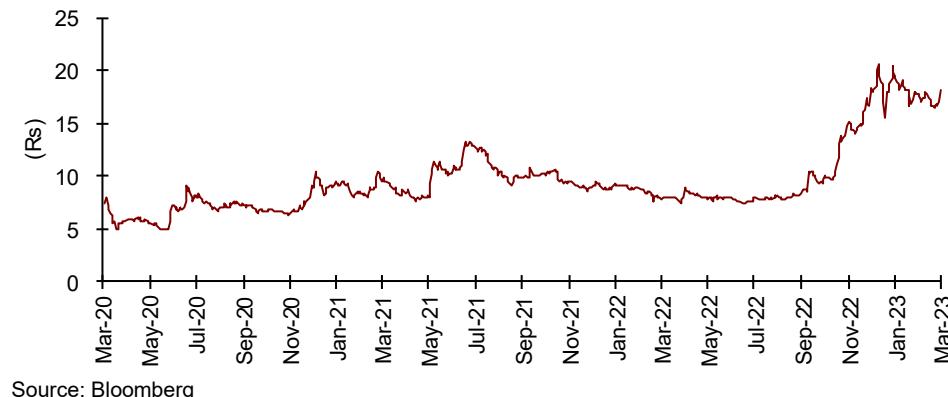
Source: Company, I-Sec research

Chart 9: Profitability improved sharply during 9MFY23

Source: Company, I-Sec research

Chart 10: Tier-1 ratio remained at 13.7% (highest in recent past) reflecting conservative capital consumption over the past two years

Source: Company, I-Sec research

Price chart

Source: Bloomberg

Financial summary

Table 2: Profit and loss statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Interest Income	65,865	70,892	81,710	94,201
Interest Expense	43,468	42,531	48,761	55,497
Net Interest Income	22,398	28,361	32,949	38,704
% NII Growth	(6.9)	26.6	16.2	17.5
Treasury Income				
Non-interest income	10,341	11,168	12,062	13,027
Net Revenue	32,739	39,530	45,010	51,731
Employees Expenses	11,979	12,817	13,715	14,675
Other Op. Expenses	8,284	8,896	9,556	10,270
Operating Profit	12,476	17,816	21,739	26,786
% OP Growth	-22.9	42.8	22.0	23.2
Tax	(1,370)	2,341	3,182	4,077
Total Provisions	13,396	8,513	9,091	10,581
Net Profit	450	6,963	9,466	12,128
% PAT Growth	(27.3)	1,448.0	36.0	28.1

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Capital	2,093	2,093	2,093	2,093
Reserves and Surplus	56,452	62,484	71,485	83,149
Deposits	8,91,421	9,58,278	10,73,271	12,02,064
Borrowings	32,945	28,850	36,844	49,407
Other Liabilities & Provisions	17,614	18,142	18,687	19,247
Total liabilities	10,00,524	10,69,846	12,02,379	13,55,960
Cash & Balances with RBI	36,766	38,488	43,283	48,795
Bal. with banks/ call money	75,268	51,105	46,372	27,247
Investment	2,14,450	2,17,168	2,33,124	2,62,809
Loans and advances	5,99,934	6,83,914	7,94,405	9,25,410
Fixed Assets	8,111	7,896	8,219	8,564
Other Assets	65,995	71,275	76,977	83,135
Total assets	10,00,524	10,69,846	12,02,379	13,55,960

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY22	FY23E	FY24E	FY25E
Per Share Data				
Book value per share (Rs)	26.8	29.7	34.0	39.6
Adj. BVPS (Rs)	20.4	24.6	28.5	33.2
Price/Book value	0.7	0.6	0.5	0.5
Price/ Adj. Book value	0.9	0.7	0.6	0.6
EPS(Rs)	0.2	3.3	4.5	5.8
P/E Ratio	84.9	5.5	4.0	3.1
DPS	0.2	0.2	0.2	0.2
Asset Quality				
Gross NPA (Rs mn)	36,481	34,909	38,955	44,812
Gross NPA (%)	5.90	5.10	4.90	4.84
Net NPA (Rs mn)	17,778	14,086	15,355	17,826
Net NPA (%)	2.97	2.06	1.93	1.93
Capital Adequacy Ratios				
RWA (Rs mn)	4,57,430	4,85,954	5,40,134	6,02,227
Tier I (%)	13.2	13.8	14.1	14.6
Tier II (%)	2.6	2.5	2.2	2.0
Total CAR (%)	15.9	16.3	16.3	16.6
Business Ratios				
Credit / Deposit(%)	67.3	71.4	74.0	77.0
Investment / Deposit (%)	24.1	22.7	21.7	21.9
CASA (%)	31.0	33.0	33.0	33.0
RoA (%)	0.0	0.7	0.8	0.9
Core RoE (%)	0.8	11.8	14.2	15.8
Dividend Yield (%)	1.2	1.2	1.2	1.2
Earnings Ratios				
Interest Inc. / Avg.assets (%)	6.8	6.8	7.2	7.4
Interest Exp./ Avg. assets (%)	4.5	4.1	4.3	4.3
NIM (%)	2.3	2.7	2.9	3.0
Int. exp/ Int earned (%)	66.0	60.0	59.7	58.9
Oth. Inc./ Tot. Inc. (%)	31.6	28.3	26.8	25.2
Staff exp/Total opt. exp (%)	59.1	59.0	58.9	58.8
Cost/ Income Ratio (%)	61.9	54.9	51.7	48.2
Prov./ Operating Profit (%)	107.4	47.8	41.8	39.5
Loan loss prov./Avg. loans (bps)	226.9	132.6	123.0	123.0

Source: Company data, I-Sec research

Table 5: RoA tree

(% , year ending March 31)

	FY22	FY23E	FY24E	FY25E
Interest income/Assets	6.8	6.8	7.2	7.4
Interest expenses/Assets	4.5	4.1	4.3	4.3
Net interest income/Assets	2.3	2.7	2.9	3.0
Other Inc. from operations/Assets	1.1	1.1	1.1	1.0
Total income/Assets	3.4	3.8	4.0	4.0
Employee expenses/Assets	1.2	1.2	1.2	1.1
Other operating expenses/Assets	0.9	0.9	0.8	0.8
Operating profit/Assets	1.3	1.7	1.9	2.1
Tax/Assets	(0.1)	0.2	0.3	0.3
Loan loss provisions/Assets	1.4	0.8	0.8	0.8
Net profit/Assets	0.0	0.7	0.8	0.9

Source: Company data, I-Sec research

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