Lakshmi Vilas Bank

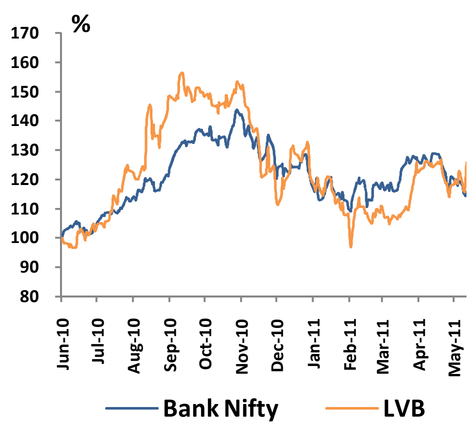
Cultural And Structural Change To Make The Difference

CMP:	**Rs.119**
Target Price:	**NA**
Recommendation:	**ACCUMULATE**

Stock Info	
BSE Group	B
BSE Code	590069
NSE Symbol	LAKSHVILAS
Bloomberg	LVB IN
Reuters	-
BSE Sensex	18269
NSE Nifty	5486

Market Info	
Market Capital	₹ 1250 cr
Equity Capital	₹ 97.9 cr
Avg. Trading Vol. (NSE Qtly)	200010
52 Wk High/ Low	143/85
Face Value	10

Shareholding Pattern (%)	(31st Mar. 2011)
Promoters	10.9
Domestic Institutions	8.9
Foreign Institutions	7.0
Non Promoters Corp.	13.3
Public & Others	59.8
Govt. Holdings	0



June 10, 2011

Lakshmi Vilas Bank (LVB) is a small old generation private bank from south India with largely regional operations. It has had a passive presence and operations till a couple of years back. However since FY10 it has become more active and is seeking to make it to the main stream. This process seemed to have initiated with first the promoters increasing their stake in bank from 1% to 10% and then inducting a experienced management team from some of the top banks in India. This new management has managed to put the right foot forward and this has been visible in its financial performance and ratios. The effort of the management is to convert the image and operations of the bank from a "old generation private bank' to a 'new generation private bank'.

Following are the investment positive –

Consistent Growth Over Past few years -
LVB is a late entrant in the growth cycle which began in the economic boom post 2000. However it has done some catching up in the past few years. Advances of LVB have grown @ 22.3% (CAGR) from Rs 2953 cr in FY06 to Rs 8094 cr in FY11. However this growth has been more prominent in the past four years. From FY05-FY09 the CAGR growth in advances was at 18.5% while from FY08 to FY11 it increased to 28%. We expect the initiatives of the new management to improve the momentum from here on.

Healthy Margins
Past six years average of reported NIM of LVB has been healthy at ~2.8% and in FY11 it has shot up to 3.75%. This has been despite the fact that the CASA ratio for the bank has been dipping over the years. The main reason for the same is a consistent CD ratio and a high component of MSME loan book (~36%).

Improving Credit Health Despite Ups and Downs-
After a rise in advances growth (+36% YoY) in FY09, the bank faced heavy asset default in FY10. The GNPA which controlled to 2.7% in FY09 from the highs of >7% before FY06, rose back to 5.2% in FY10. The first target of the new management was to clear its books and it could achieve the same through aggressive recovery and selling down of bad loans in FY11. As at end of FY11 the GNPA has reduced to 1.93% and the coverage as per RBI stood comfortable at ~73% (core 54%). The management has initiated steps to instill suitable risk management practices which will help in controlling such defaults in future.

Management Focus ahead –
Apart from the basic aim to *shed the image of an* old private sector bank, the new management has initiated a number of structural and cultural changes in the bank which will help and make it more in tune with current environment as well as push forward its growth. Bank targets to improve its RoA to 1.2% by FY12 while RoE will be near 15%. Its NIM target is at 3.5%, Net NPA of < 1% and CTI at 50%.

Conclusion
We feel that though the bank may need some more quarters of consistent performance and improvement to give a strong portrayal, the work has begun. At CMP of Rs 119, the bank trades a price to book of 1.3 times and a PE of 11.5 times. This is at a considerable discount to its peers and hence we feel that given the scenario of improving fundamentals of the bank, it should be accumulated on dips. It can make a good long term bet.

About Bank –

Lakshmi Vilas is a small old generation private sector bank set in Tamil Nadu. It has been established for more than 84 years and enjoys its own set of loyal customers and a network of ~270 branches. The bank has had a good focus on technology and over the past few years has invested heavily in strengthening its IT infrastructure and service delivery. It was 100% CBS in year 2008. LVB was one of those seven private sector banks in which promoters' holding was less than 1% till the December 2009. However the same has been increased to 10.9% now to fend off any possible hostile bid for the control of the bank. The promoters list as per Capitaline includes 36 'persons', of which 6 of them (5 private limited Cos and one individual) hold 10.1%. The investor list also includes Federal Bank, Indian Bank and LIC. These institutions except LIC have brought down their share over the years which now stand at 2.36%, 3.06% and 2.32% resp.

Bank branches are spread across 15 states and 1 Union Territory, with deep penetration in Tamil Nadu. Over 50% of its branches are located in rural/ semi urban areas.

The Change from past..

A late entrant in the growth cycle which began in the economic boom post 2000, the bank took some major decisions in FY09-FY10. From Dec 2009 the promoters increased their stake in the bank from less than 1% to more than 10%, to ward off hostile attempts of take over. In Aug 2010 bank inducted a new management, getting people from the top banks in India.

Despite being in existence for more than 80 years and listed in 1988, LVB is a late entrant in the growth cycle which began in the economic boom post 2000. The bank had infact during 1961-65 LVB took over nine Banks and raised its branch network considerably. But due to lack of focus and initiatives it lagged behind its peers who have overtaken the bank and grown stronger. Despite this the bank was well focused on technology though it did not cash on it. Though it has maintained reasonable margins its asset quality has been a cause of concern for it. The low business per branch indicates the slackness.

Bank has diluted four times since past FY05 to improve its capital base. This included three right issues in FY05, FY06 and FY09 and a bonus in FY06. In 2009 the bank successfully managed a rights issue of Rs ~50 cr but it could not benefit from the liquidity provided as it was almost wiped out by a single bulky default of Rs 42 cr in the same year.

Later the bank took some major decisions. From Dec 2009 the promoters increased their stake in the bank to ward off hostile attempts of take over. In Aug 2010 bank inducted a new management, getting people from the top banks in India. This included its present MD Mr. PR Somasundaram from Standard Chartered Bank, ED Mr Rajat Baldhi from Citibank India and ED Mr V Prakash from ICICI Bank.

The new management of the bank has initiated with some basic and positive steps like focusing on employee orientation through cultural changes, focus on growth, structural changes in management, risk management initiatives etc. Like some new generation private banks the bank has also set its center on checking its progress on following parameters - ROA, ROE, NIM, Net NPAs and Employee cost/Income.

The new management has initiated structural changes right from top. The top management is now more structured with its two ED's assigned for execution while MD concentrates on strategic work.

In FY11 the bank focused on NPA in the books and in FY12 its plans to concentrate on employee orientation.

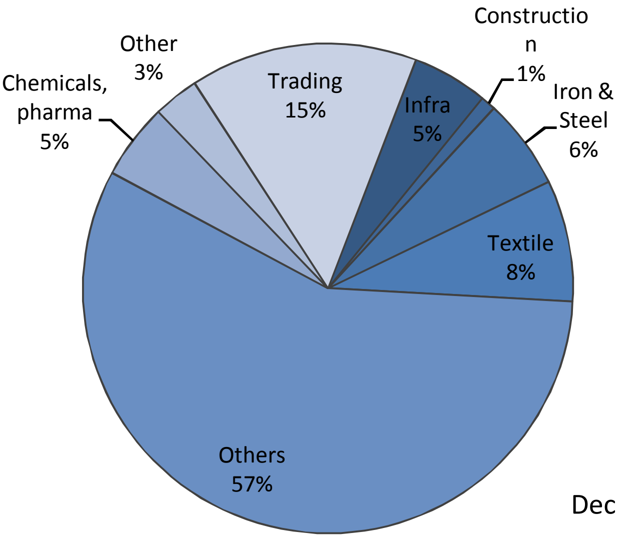
Investment Positive

LVB's growth has been more prominent in the past four years. From FY05-FY09 the CAGR growth in advances was at 18.5% while from FY08 to FY11 it increased to 28%. We expect the initiatives of the new management to improve the momentum from here on

Consistent Growth Over Past few years -

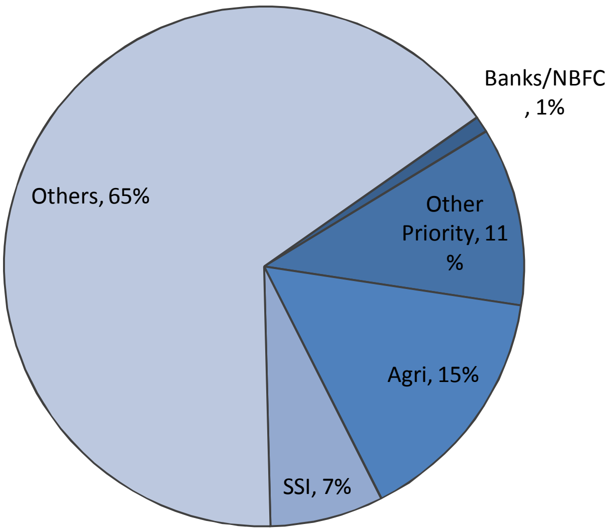
Advances of LVB have grown @ 22.3% (CAGR) from Rs 2953 cr in FY06 to Rs 8094 cr in FY11. However this growth has been more prominent in the past four years. From FY05-FY09 the CAGR growth in advances was at 18.5% while from FY08 to FY11 it increased to 28%. On an average the CD ratio for the bank has been reasonable at around 70%.

Bank has a well diversified portfolio with Infra exposure being ~ 5% of total loan and low exposure to sensitive sectors like commercial real estate, MFI and capital market. The MSME forms ~ 36% of the total loan book would continue to remain a focus area for the bank going ahead. This sector is also on the focus of most of the other banks in the sector as it provides better yield and are generally secured by mortgages and guarantees. Bank plans to pursue working capital loans to SME and mid Corp instead of committing funds for long term assets.

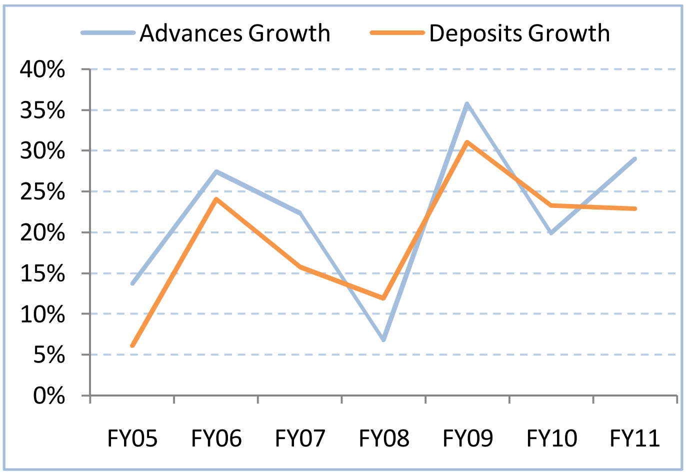


Dec 2010

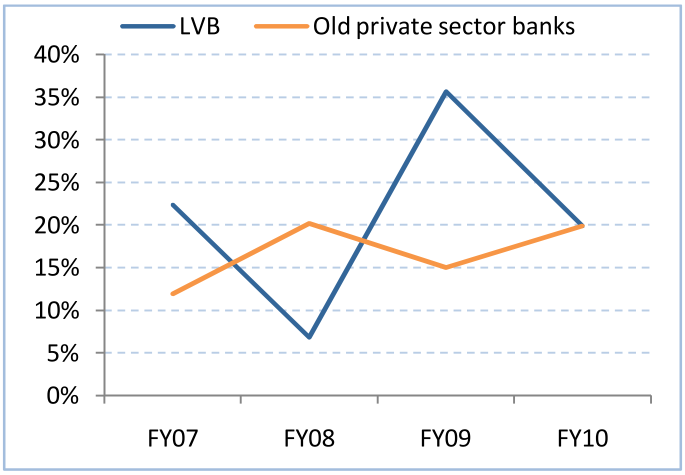
Industry wise break up of Loan Book



Sector break up of loan book

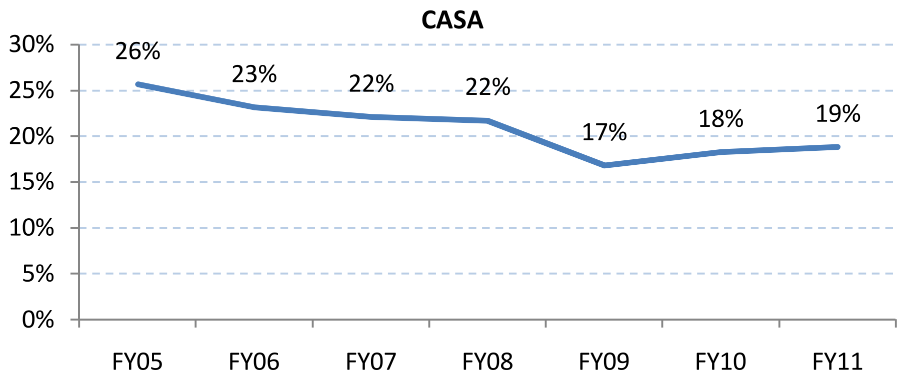


Growing faster since past three years



Has seen erratic growth as compared to average of peers

Deposits have grown @ 21% (CAGR) from Rs 4336 cr in FY06 to Rs 11150 cr in FY11. However the CASA could not keep pace and fell from 26% in FY05 to 17% in FY09 before again bettering to 19% in FY11.



Past six years average of reported NIM of LVB has been healthy at ~2.8% and in FY11 it has shot up to 3.75%.

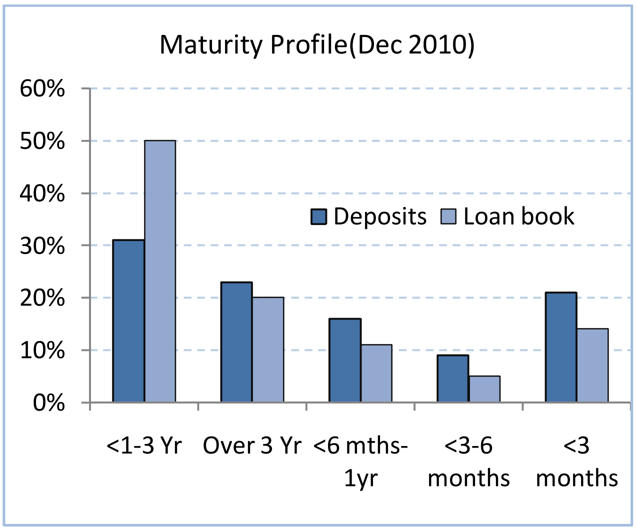
This has been despite the fact that the CASA ratio for the bank has been dipping over the years. The main reason for the same is a consistent CD ratio and a high component of MSME loan book (~36%).

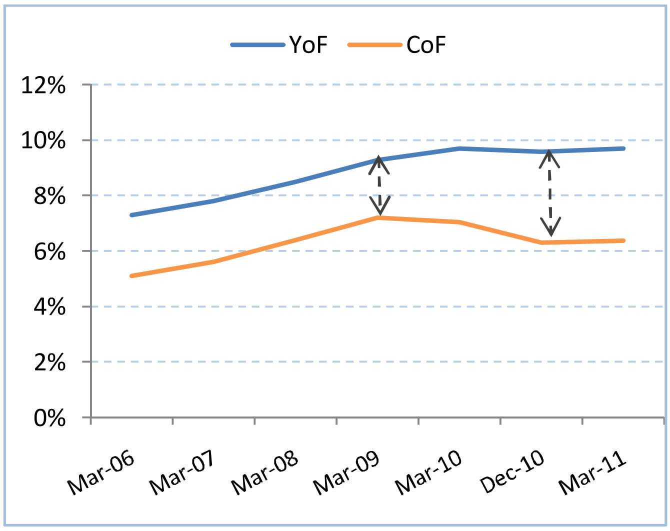
Improving Margins

With good portion of the loan book being tied up in high margin assets like MSME, the bank has been able to maintain healthy yield of above 12.5% on its advances. Despite the fact that the CASA levels of the bank has fallen from the levels of 22% in FY08 to 19% its spreads have improved in the last couple of years. This has been possible by a balanced ALM and good liability management. Past six years the average of reported NIM has been healthy at 2.8% and in FY11 it has shot up to 3.75%.

Retail deposit forms 60% of total term deposit and a majority of it has got re-priced in January this year. The average term of these deposits is about one year. This will go increase its cost of deposits going forward and the bank expects the cost to increase from 7.1% at present to 7.2-7.3% in near term. Hence NIM will be under some pressure going forward even though the bank has raised it lending rates substantially.

After recent hike in rates the base rate for LVB stands at 10.5% which is one of the highest in the industry and the BPLR stands at 16.75%. On the deposit front it recently raised rate on 1-2 years deposit to 10.5% (+40bps).





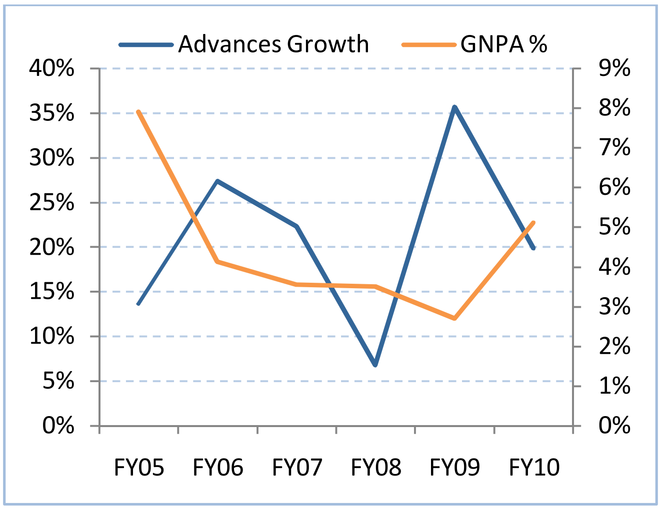
Improving Credit Health Despite Ups and Downs-

A rise in advances growth (+36% YoY) in FY09, resulted in heavy asset default in FY10 with GNPA at 5.2%.

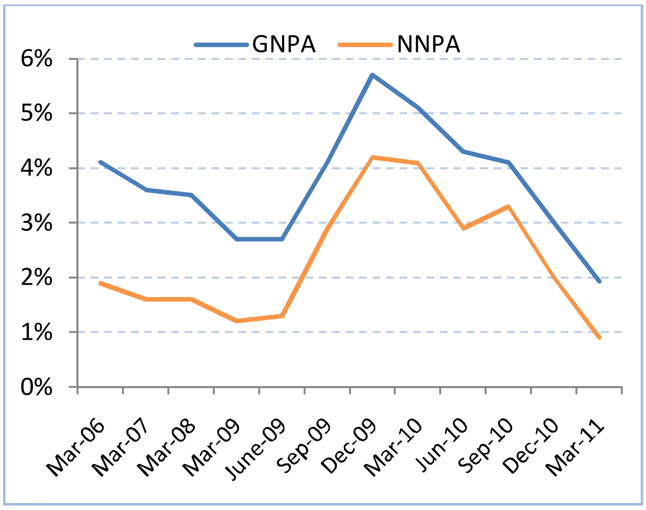
NPA management was the first target of the new management and through aggressive recovery and selling down of bad loans in FY11 the GNPA has reduced to 1.93% and the coverage improved to ~73%.

Bank had a history of bad asset quality and in FY05 the GNPA was ~7.9%. The same was however controlled and brought down t0 2.71% in FY09 before the same increased again to upwards of 5% (5.12) in FY10. The cause for the same can be traced to its weak credit appraisal techniques apart from the aggressive growth in FY09. Bank had increased its concentration towards certain sectors resulting in amplified default. Top five NPLs accounted for around 50% of the total gross NPLs in FY10 and were mainly from corporate sector.

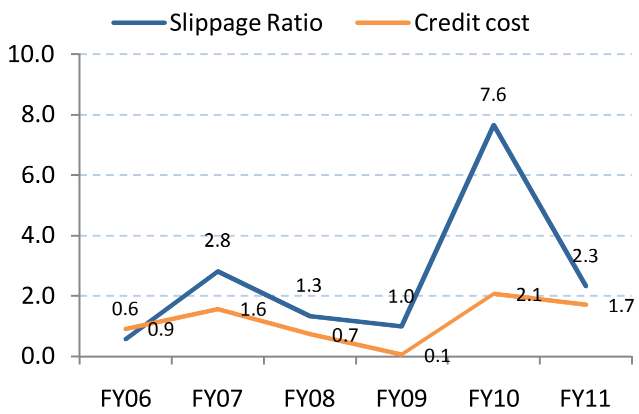
Since last one year LVB has been quite aggressive on the recovery front and has in fact even outsourced recovery function and sold a few non-performing assets. This has amounted to clearing of its books and the GNPA has reduced from 5.69% in Q310 to 1.93% as at end of FY11. The net NPA has fallen to less than one per cent from 4.17% in same period. This has also improved the proportion of bad loans in the sub-standard category. The core coverage is 53.8% while as per RBI same is comfortable at 72.9%. This asset quality concern was one of the reasons the bank has been assigned a BBB rating from credit rating agencies. Now bank targets to upgrade to A rating as it plans to bring down the net NPA to 0.5% and improve coverage to 80%.



Rise in NPA in FY10 is in direct relation to Advances growth in FY09

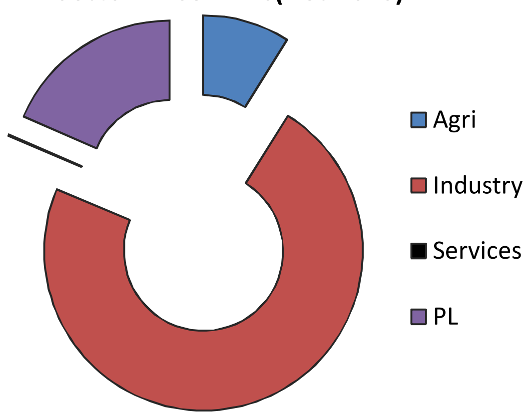


NPA reduction in FY11 aided by aggressive recovery and sell down



Big spike in FY10 stands corrected in FY11

Sector -wise NPAs(Dec 2010)



Higher Default in MSME and Large Industries

Tech Savvy Bank

Like most banks in South, LVB also has been tech savvy. In fact the bank got itself 100% under CBS in 2008 itself. Up-to-date technology and continuous focus on the same will allow the bank to pursue its growth more smoothly through better customer service. Its continuous focus on the same is clear from its recent initiative where LVB has been the first private sector bank in South India to offer Interbank Mobile Payment Service facility. There are other firsts also which the Microsoft's Unified Communication Services at all branches enabling usage of Data, Voice & Video.

Focus ahead - *shed the image of an old private sector bank*

Bank is in the process of drawing up a three-year strategic business plan concentrating on organic growth rather than M&A initiatives. It plans to grow in a phased manner. The focus is to increase the size of the bank. In line with some other new private generation banks, LVB plans to check its progress on following parameters - ROA, ROE, NIM, Net NPAs and Employee cost/Income.

FY12 target –	
RoA –	1.20%
ROE	15%
NIM	3.50%
Net NPA	< 1%
CTI	50%

Bank plans to focus on strengthening the liability side of the balance sheet by focusing on deposit by offering value added services. It will also focus on overseas deposits and remittances in a big way. The bank also plans to centralize the credit process and for this has plans to open six signature branches across its network by the second quarter of FY12. This will help the bank take care of the corporate side while it also plans process improvement in the retail side of the business. The corporate office will be shifted to Chennai by September while the headquarters will still be in Karur.

With main focus to shed the image of an old private sector bank, LVB aims to bring in structural and cultural changes in the bank. With its hand on NPA in FY11, it plans to focus on employees in FY12. Manpower is the key resource of any bank and the efforts of LVB in this direction can take them a long mile.

Bank also plans to focus on new Business areas which includes wealth management, third party product distribution etc. As per bank its insurance distribution activity is doing very well as it concentrates more on single premium products. For wealth management the bank has tied up with a private bank.

In future, the bank plans to focus more on non-funded business which will allow it a better fee income. However its treasury is not yet mature therefore cost to income (CTI) is expected to remain ~ 50%.

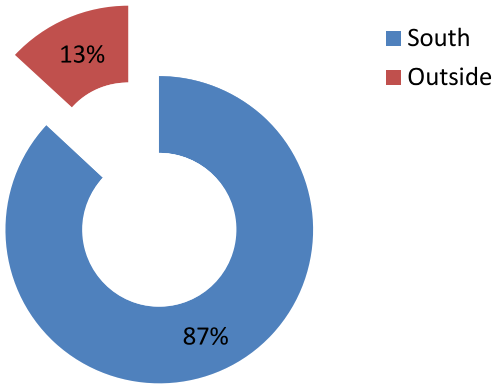
Immediately with the induction of new management, the bank aggressively had went ahead to announce its plans to set up a housing finance subsidiary for special focus on mortgage business as well as issue capital by way of QIP/GDR/ADR/Follow-on (upto 40% of capital). Though none of this has been consummated till date, the first plan has been shelved while the Bank plans to raise capital in next one to two quarters which can be either through, QIP, subordinated capital or tier II capital.

The existing management believes in perseverance and execution. It aims for consistent growth in lieu of aggressive growth – 15% balance sheet growth is sufficient.

Though regional the bank still has a low business per branch which indicates scope for further improvement.

Branch Network

In FY11 the bank got 17 branch licenses and it plans to apply for 100 more branches in FY12. Of this 6 will be signature branches (in all has license for 10) which will clear all loans above 5 crs. Apart from improving efficiency and better risk management, this will also help the bank to concentrate more on corporate lending and wealth mgmt. It has in fact employed trained staff for the job. Most of the other new branches are expected to open in North and West. At present nearly 36 branches are outside south India and bank plans to increase it to 100 though the focus will not shift from south.



Focus on Employee Orientation

FY12 focus of the bank as per its MD will be on employees. The bank needs to concentrate and induce sales orientation in its employees and also change their cultural mindset. This requires getting them field-oriented, understand products and market aggressively. Despite some resistance the first ice breaking has been done towards changing cultural mindset. The bank management has been able to steer through union opposition, allowing the bank to employ new staff on CTC basis as against scale based wages. Bank intends to bring in sizeable number of people at the middle management level. For motivating employees compensation by offering performance-linked incentives and even ESOP is under consideration.

Manpower is the key resource of any bank and the efforts of LVB in this direction can take them a long mile.

The bank has approval to dilute another 40% capital which may be done in first half of FY12.

LVB promoters have pledged shares to the tune of 4.2% of which 4.1% belongs to the top 5 promoters. This is the highest amongst the private banks in India.

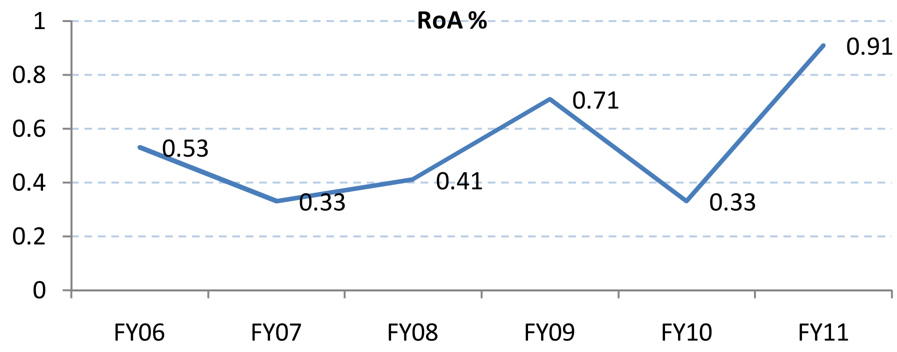
Capital Raising on Cards

The capital adequacy ratio of the bank stood at 13.19% with Tier I at 10.78% as at end of FY11. In September 2009 its CAR had dipped to 9.7% after which the bank diluted 40% through a rights issue @ 54/share and increased the capital to Rs 97.5 cr. This helped the CAR to improve to 16%. Since then the advances has grown by 31% and NPA has risen. Thus the CAR has slipped down to ~13.2%. The bank has approval to dilute another 40% capital which may be done in first half of FY12. However bank is open to explore various modes available to it the like QIP, subordinated capital etc and even raising tier II capital.

LVB promoters have pledged shares to the tune of 4.2% of which 4.1% belongs to the top 5 promoters. This is the highest amongst the private banks in India.

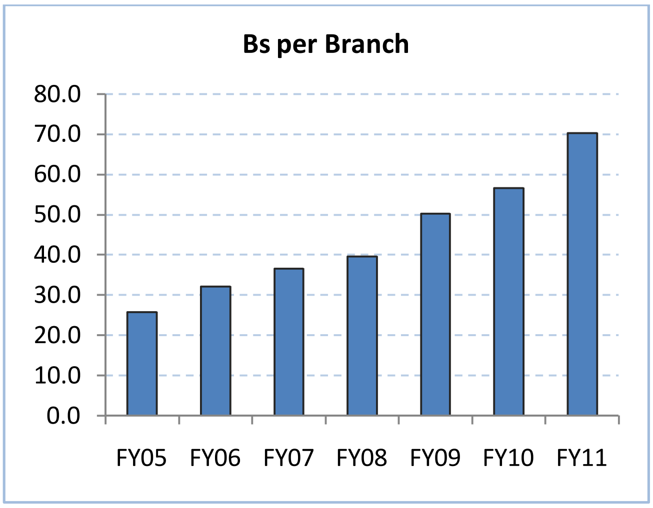
Low Return Ratios

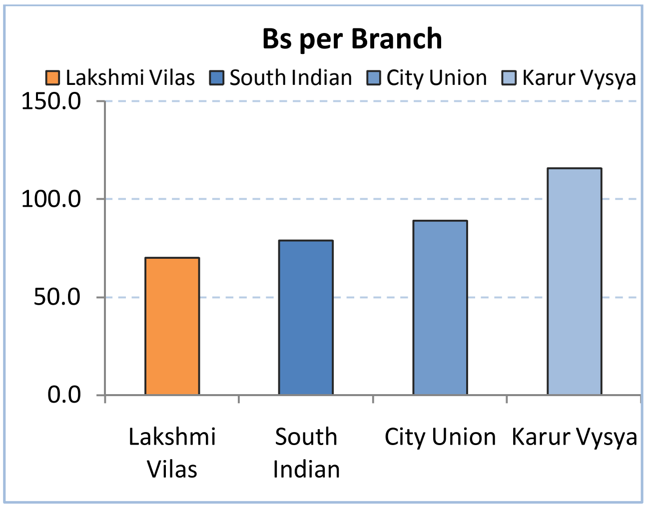
Lower leverage and lower other income support translates into a lower return on assets for LVB. However bank posted a decent improvement in FY11 and as the management strategies materialize, the same will improve further. FY12 target of management is about 1.2%.



Low business per branch –

Though improving steadily LVB still has one of the lowest business per branch amongst its peers.





Quarterly Numbers

Q4 has been the most important quarter in FY11 where the bank grew its business aggressively with advances growing at 17% sequentially and deposits growing 12%. There was marked improvement in efficiency, NPA and coverage. However as the interest expense grew faster than interest income which restricted the NII growth. The third quarter was a bit dull for the bank due to weak Income growth. In the second quarter the bank utilized its other income to make higher provisions. The core coverage of the bank has improved considerably all through the year except for December quarter when the profits were not sufficient to provide more.

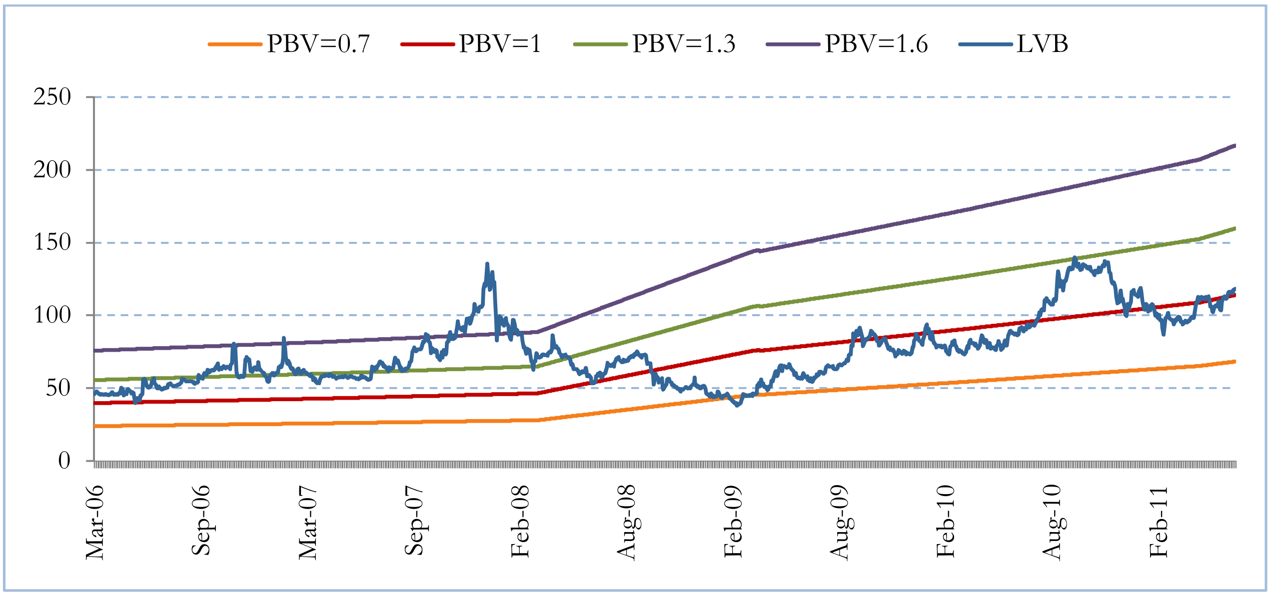
The CD ratio has been consistently maintained at ~70%.

Rs in Cr	Mar-11	Mar-10	YoY	Dec-10	Sep-10	Jun-10
Interest Earned	294.8	240.2	22.7	266.2	255.8	248.1
Interest Expended	195.3	162.5	20.1	174.8	166.0	163.8
NII	**99.5**	**77.7**	28.1	**91.5**	**89.8**	**84.2**
Other Income	48.6	28.8	68.7	21.4	40.2	26.9
Operating income	**148.1**	**106.5**	39.1	**112.8**	**129.9**	**111.2**
Operating Expenses	59.0	51.8	13.9	54.4	57.4	57.4
Payment To Provisions For Employees	26.9	24.4	10.0	26.1	29.3	34.1
Other Operating Expenses	32.1	27.4	17.4	28.3	28.1	23.4
PBPT	**89.1**	**54.7**	62.8	**58.5**	**72.6**	**53.7**
Provisions and Contingencies	56.7	101.2	(43.9)	32.8	41.5	18.7
PBT	**32.4**	**-46.4**	169.8	**25.7**	**31.1**	**35.0**
Tax	5	-25.7	119.5	-	6.4	11.6
Profit After Tax	**27.4**	**-20.8**	231.8	**25.7**	**24.7**	**23.4**
CTI	39.8	48.6		48.2	44.2	51.7
Provision coverage	53.8	20.7		32.3	31.2	23.2
Tax Rate	15.4	55.3		0.0	20.6	33.2
Burden Ratio	17.6	44.4		60.7	30.0	53.1
Capital Adequacy Ratio	13.19	14.82		12.5	13.5	14.0
Gross / Net NPA						
Amount of Gross NPA	157.79	325.18		206.3	263.6	273.6
Amount of Net NPA	72.87	257.78		139.7	181.3	210.2
Percentage of Gross/Net NPA						
% of Net NPAs	1.93	5.12		3.0	4.1	4.3
% of Gross NPAs	0.9	4.11		2.0	2.9	3.3
Return on Assets	0.91	-0.82		0.92	0.93	0.90
Coverage	72.87			70.1		
Deposits	11150	9075.4		9,954	9,350	8,956
Advances	8094	6277.5		6,905	6,454	6,413
CD Ratio	72.6	69.2		69.4	69.0	71.6

Peer Comparison

As at end of FY11	Lakshmi Vilas	City Union	Karur Vysya	South Indian
4 yr CAGR advances growth	22.4	28.8	26.1	26.8
4 yr CAGR deposits growth	22.1	29.1	27.6	24.8
Advances (in Rs Cr)	8,094	9,225	17,814	20,488
Branches	274	250	369	641
Bs per Branch	70.2	88.9	115.9	78.8
NIM %	3.75	3.64	3.39	3.06
GNPA %	1.93	1.28	1.26	1.11
Peak GNPA since FY07	5.7(FY10)	2.6 (FY07)	2.82(FY07)	3.9(FY07)
NNPA %	0.9	0.52	0.07	0.29
Coverage %	72.9 #	76.7 #	93.9	73.9
CASA %	18.8	19.6	23.2	21.6 ^
RoA %	0.91	1.67	1.71	1.05
RoE %	12.8	23.5	19.5	15.9
MSME % of loan book	36.0	30.0	13.4*	10.5*
Book Value	91.5	24.8	200.3	15
P/BV (FY11)	1.3	1.81	2.1	1.7
PE (FY11)	11.5	8.4	9.2	9.8

^with low cost NRI deposits – 26.5% ; # including technical write off ; * SME



Income Statement				
Year to 31st March (Rs.Cr)	**FY08**	**FY09**	**FY10**	**FY11**
Interest Income	506	658	909	1065
Interest Expenses	382	504	660	700
Net Interest Income	**124**	**154**	**249**	**365**
- growth %	*4*	*24*	*101*	*138*
Fee-based Income	44	65	81	106
Treasury Income	27	39	21	19
Other Non-interest Income	11	3	1	12
Operating Income	**207**	**261**	**353**	**502**
- growth %	*18*	*26*	*71*	*93*
Operating Expenses	116	152	186	228
- Staff Cost	63	78	92	116
- Other Operating Exp.	53	73	94	112
Gross Profits	**90**	**109**	**166**	**274**
- growth %	*23*	*21*	*84*	*152*
Provisions	42	27	135	150
Profit Before Taxes	**48**	**81**	**31**	**124**
Taxes	23	31	1	23
Profit After Taxes	**25**	**50**	**31**	**101**
- growth %	*44*	*99*	*-39*	*230*

Balance sheet				
As on 31st March (Rs. Cr)	**FY08**	**FY09**	**FY10**	**FY11P**
Capital	49	49	98	98
Reserves & Surplus	369	405	641	795
Deposits	5618	7,361	9,075	11,150
- growth %	*11.9*	*31.0*	*23.3*	*22.9*
Borrowings	163	143	334	725
Other liabilities & provisions	322	350	338	534
TOTAL LIABILITIES	**6,521**	**8,308**	**10,486**	**13,301**
Cash on hand & with RBI	385	592	751	944
Money at call and short notice	230	289	83	83
Advances	3859	5,236	6,277	8,094
- growth %	*6.8*	*35.7*	*19.9*	*28.9*
Investments	1694	1,863	2,983	3,519
Fixed assets	40	54	66	179
Other assets	313	273	326	482
TOTAL ASSETS	**6,521**	**8,308**	**10,486**	**13,301**

Ratio Analysis				
	FY08	**FY09**	**FY10**	**FY11P**
Basic Ratio (Rs.)				
EPS	5.2	10.3	4.2	10.4
Book Value per share	86	93	101	92
70% Adjusted Book Value	83	89	79	89
Dividend per share	1.5	2.5	0.6	2.5
Asset Quality (%)				
Gross NPAs	3.5	2.7	5.1	1.9
Net NPAs	1.5	1.2	4.1	0.9
NPA Coverage	56.9	55.0	20.7	53.8
Profitability ratios (%)				
RoAE	6.20	11.53	5.14	12.40
RoAA	0.41	0.68	0.33	0.85
NIM	2.27	2.36	3.00	3.48
Operating Profit Margin	15.3	14.2	16.4	22.8
Net Profit Margin	4.3	6.6	3.0	8.4
Cost to Income	56.4	58.2	52.9	45.4
Fee-based income to Operating Income	21.3	24.9	23.0	21.1

	FY08	**FY09**	**FY10**	**FY11P**
Spread analysis (%)				
Yield on advances	10.1	11.4	12.5	11.6
Yield on investments	6.9	7.1	7.5	7.1
Yield on interest-earning assets	8.9	9.0	9.8	9.1
Cost of deposits	6.8	7.4	7.8	6.6
Cost of borrowings	10.0	14.8	6.9	6.8
Cost of funds	6.6	6.6	6.9	5.8
Spread	2.3	2.4	2.9	3.3
Net Interest Income to AWF	2.1	2.2	2.8	3.2
Non Interest Income to AWF	1.4	1.5	1.1	1.2
Operating Profit to AWF	1.5	1.5	1.8	2.4
Net Profit to AWF	0.4	0.7	0.3	0.9

Valuation ratios (x)				
P/E	23.0	11.6	28.4	11.5
P/BV	1.38	1.28	1.18	1.30
P/ABV	1.44	1.34	1.50	1.34

Arihant Research Desk

E. research@arihantcapital.com
T. 022-42254834/32

Head Office

3rd Floor, Krishna Bhavan,
67 Nehru Road, Vile Parle (East),
Mumbai - 400057
Tel: (91-22) 42254800
Fax: (91-22) 42254880

Registered Office

E-5 Ratlam Kothi
Indore - 452003, (M.P.)
Tel: (91-731) 3016100
Fax: (91-731) 3016199

Stock Rating Scale

	Absolute Return
BUY	>20
ACCUMULATE	12-20
HOLD	5-12
REDUCE	<5