

Lakshmi Vilas Bank

Initiating Coverage

Lakshmi Vilas Bank (LVB) is a south based private sector bank with major business (50.2%) concentrated in the state of Tamil Nadu. As of FY16, LVB has a network of 460 branches and 910 ATMs, with business size of ₹45,250cr. LVB has beefed up teams with lateral hiring from banks & NBFCs and implemented innovative large scale technology for long term sustainability.

Focused & experience management to drive growth: At the end of CY2015, Axis Bank group executive, Mr. Parthasarathi Mukherjee, joined LVB as MD & CEO, which was a sign of relief especially after the frequent exits in top management from 2011-2015. Since then, LVB has successfully hired the top executives from other banks.

Increasing mix of Retail/SME to drive credit: Over the next few years, the management aim to scale up retail/SME portfolio from 43% (FY16) to 60% (FY20); this should drive 18% loan CAGR over FY16-18. Within retail segment, the bank intends to grow in mortgage and gradually get into two & four wheeler; while on SME, it will continue to focus on working capital financing. Considering the accelerated growth, management plans to raise capital (Tier-1) of ~₹500cr.

Laying a sustainable foundation of CASA to boost NIM: LVB's CASA ratio was at 14.9% (FY12) and has grown to 17.36% (FY16). Nevertheless, this is one of the lowest CASA amongst regional banks. The new management targets to improve CASA ratio by 2% every year for the next two-three years. LVB has taken a few steps: a) Offering higher interest rates (5-6%) vs. industry average (4%), b) Employing RM to garner salary A/C, c) On an average, addition of 70-80 branches over the next three years, and d) Sales force incentivizes to mobilize liability products.

RoA booster - Focus fees income & non-funded business: LVB's fees based income remained very low (0.5% of average assets over FY11-16), lower than close peer City Union bank (~0.75%). With extensive experience in corporate banking, new MD has taken several steps to extend non-funded services to SME such as treasury products, letter of credit, bank guarantees among others, etc. In addition to this, the third-party distribution will also contribute to the fees income.

Asset quality: From the peak 3.4% (FY14), NPA declined to 1.3% (FY16) owing to strengthening the credit underwriting and monitoring process. In 2QFY17, NPA has increased to 1.87%.

Outlook & Valuation: We believe that scaling up of the liability franchise led by CASA, higher contribution from other incomes and prudence approach to alleviate bad loans will drive profitability and propel return ratio (FY18E - ROE - 12.7% & RoA - 0.72). This can drive further re-rating. At the current market price, the stock is trading at 1.25x its FY2018E BV of ₹116. **We recommend a BUY rating on the stock, with a target price of ₹174 (1.50x FY2018E BV).**

Key financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017E	FY2018E
Nil	486	527	645	777	914
% chg	24.0	8.4	22.5	20.4	17.6
Net Profit	60	132	181	205	254
% chg	(34)	120	36	13	24
NIM%	2.8	2.6	2.6	2.7	2.8
EPS	6	7	10	11	14
P/E	24	20	14	13	10
P/ABV	1.8	1.9	1.6	1.6	1.4
RoA (%)	0.31	0.58	0.68	0.66	0.72
RoE (%)	5.8	10.1	10.9	11.2	12.7

Source: Company, Angel Research; Note: CMP as of November 28, 2016

BUY

CMP	₹148
Target Price	₹174

Investment Period	12 Months
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Stock Info

Sector	Banking
Market Cap (₹ cr)	2,650
Beta	0.7
52 Week High / Low	169/78
Avg. Daily Volume	79,946
Face Value (₹)	10
BSE Sensex	26,316
Nifty	8,114
Reuters Code	LVLS.BO
Bloomberg Code	LVB@IN

Shareholding Pattern (%)

Promoters	9.7
MF / Banks / Indian Fls	33.0
FII / NRIs / OCBs	8.7
Indian Public / Others	48.7

Abs. (%)	3m	1yr	3yr
Sensex	(5.5)	2.1	27.7
Lakshmi Vilas Bank	4.2	65.9	181.9

3-Year Daily Price Chart



Source: Company, Angel Research

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Focused & experience management to drive growth

After the exits of MDs - Mr. PM Somasundaram (FY11-12), Mr. KSR Anjaneyulu (FY13-14), and Mr. Rakesh Sharma (FY14-15), Mr. Parthasarathi Mukherjee, Axis Bank group executive, joined LVB as MD & CEO at the end of CY2015. Since the induction of new MD & CEO, LVB has been able to attract well-diversified talent baked by rich financial services experience from lenders including HDFC, SBI, Axis Bank, Royal Bank of Scotland and RBL to achieve transformational journey – LVB 2.0. We believe LVB is now equipped with experienced and strong credential team to run next phase of growth.

Mr.Parthasarathi Mukherjee - MD and CEO

Mukherjee was earlier with Axis Bank as group executive (corporate relationships and international business). He was with the bank for nearly 21 years. Before that, he worked for the State Bank of India (SBI) for nearly 12 years. His expertise lies in corporate relationships and international business.

Mr. NS Venkatesh – Executive Director

Former Executive Director and CFO of IDBI bank, with 33 years of experience.

RVS Sridhar – Chief risk Officer

His past experience was with SBI and AXIS bank. At Axis bank, he served for 21 years in Treasury, operation and Audit.

Mr. Govind Ravindran - Head Consumer Lending

Madhusudhana Rao - Chief Customer Service

Peeush Jain - Head of Business

B Nedumaran - Human Resources

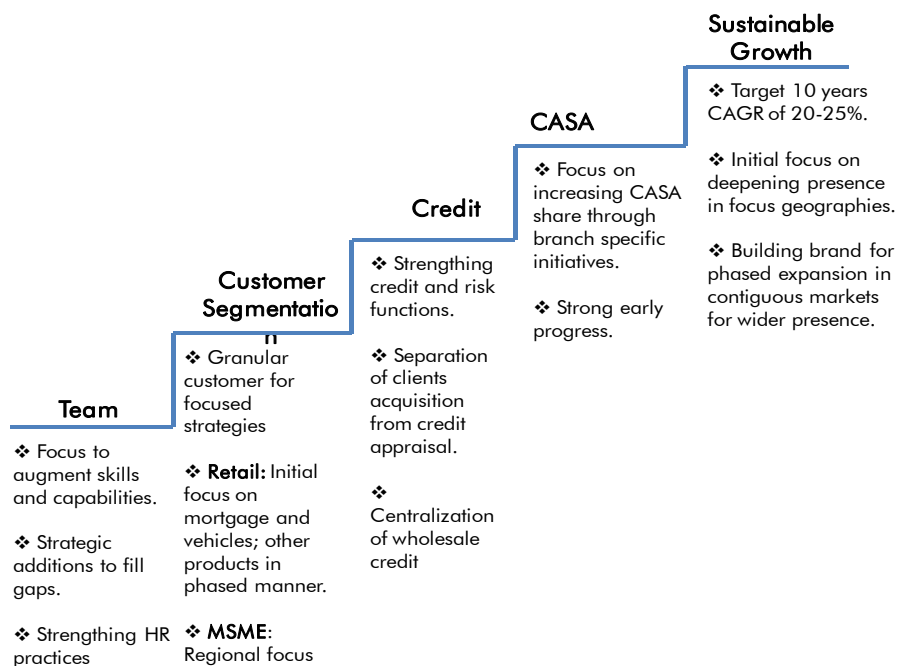
The management has drafted Vision documents for 2020 and 2026, labelled **LVB 2.0**, with targets on asset size, market share and shareholder returns.

Exhibit 1: LVB 2.0

	FY 16	FY 20E
Number of Branches	460	1000
Total Assets (INR Bn)	287	650
Net Interest Margins (%)	2.8%	3.3%
Cost/Income Ratio	57.1%	48.7%
Gross NPA	2.0%	1.6%
Return on Assets	0.7%	1.2%
Return on Equity	11.7%	18.3%

Source: Company, Angel Research

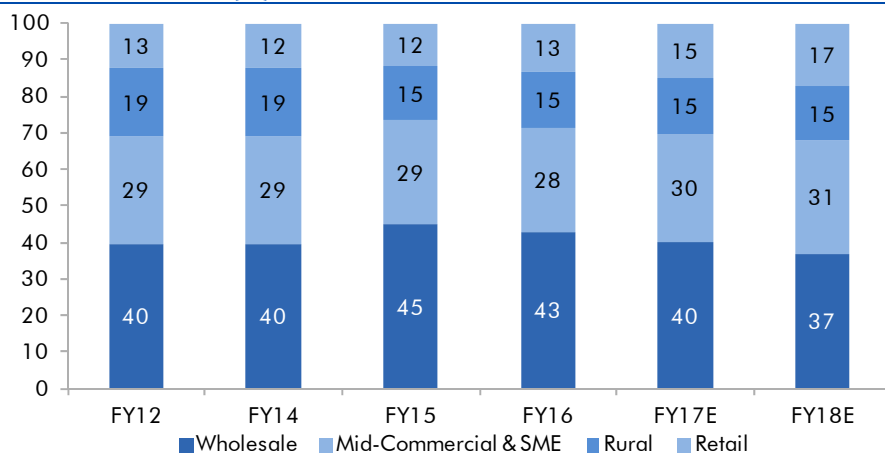
Exhibit 2: Strategic plan to accomplish LVB – 2.0



Source: Company, Angel Research

Increasing mix of Retail/SME to drive credit: Over the next few years, the management intends to ramp up retail/SME portfolio from 41.5% (FY16) to 60% (FY20). This should drive 18% loan CAGR over the period of FY16-18. We believe higher yielding retail portion would go up from current 13% (FY16) to 17.2% (FY18), resulting retail book to grow at 30%+ CAGR over FY16-18. To attain this high growth and gain retail proportion, bank has hired Mr. Govind Ravindran as head of consumer and retail lending. Mr. Govind was working with HDFC for the past 12 years and was handling Home/LAP business in Karnataka and Goa region.

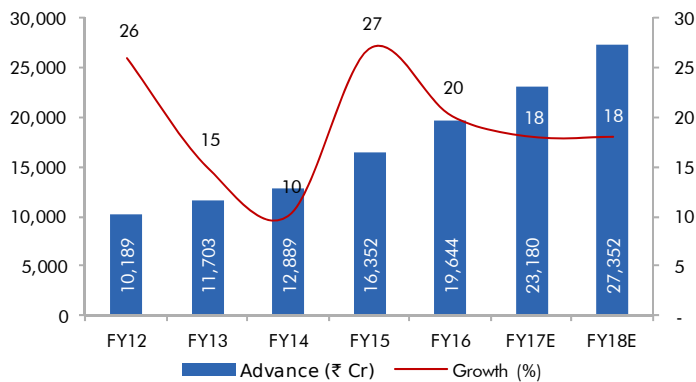
Exhibit 3: Loan Mix (%)



Source: Company, Angel Research

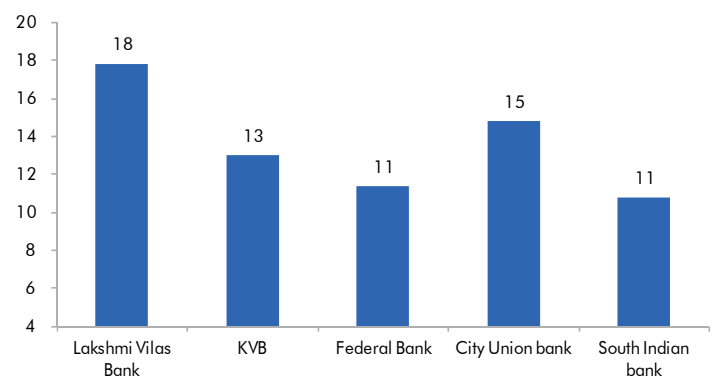
The corporate loans (Wholesale) constitute around 43% (FY16) of the bank's total loan portfolio and continue to grow moderately by concentrating only top rated corporate. The bank aims to increase retail/SME segment share as this offer better yields as well as lower delinquencies. To accomplish target, bank is expanding their services in calibrated manner beginning with Home loans, mortgages, and then moving towards two-wheeler and four-wheeler financing. After an appropriate level of experience, the bank is planning to get into unsecured financing, including personal loans. To grow retail base at steady rate, bank is putting together the collection and appraisal mechanism.

Exhibit 4: Loan Book Growth



Source: Company, Angel Research

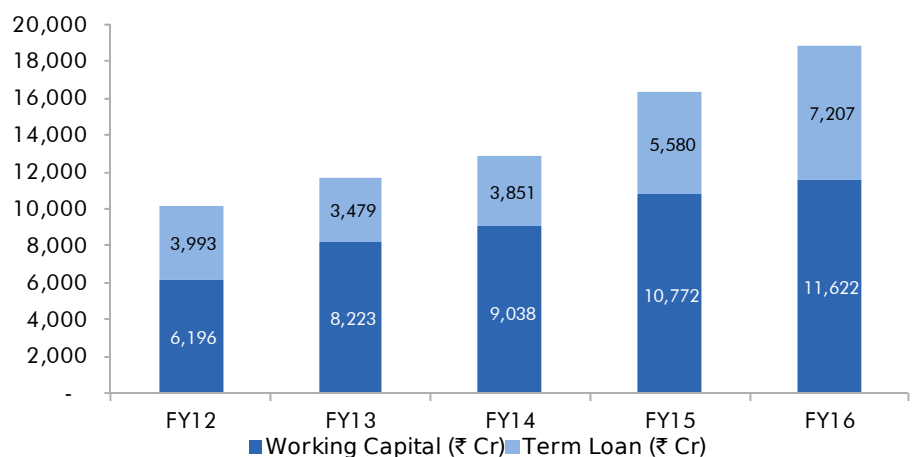
Exhibit 5: Comparative – 4 Year CAGR Loan Book Growth



Source: Company, Angel Research

On SME front, it continues to focus on working capital. As working capital loans are of shorter duration in nature and backed by cash flows from the business, asset quality issues are relatively lower. Being a regional bank, it helps to understand SME risk profile well. This can be leveraged to build SME lending business with lower delinquency.

Exhibit 6: Working Capital Loan



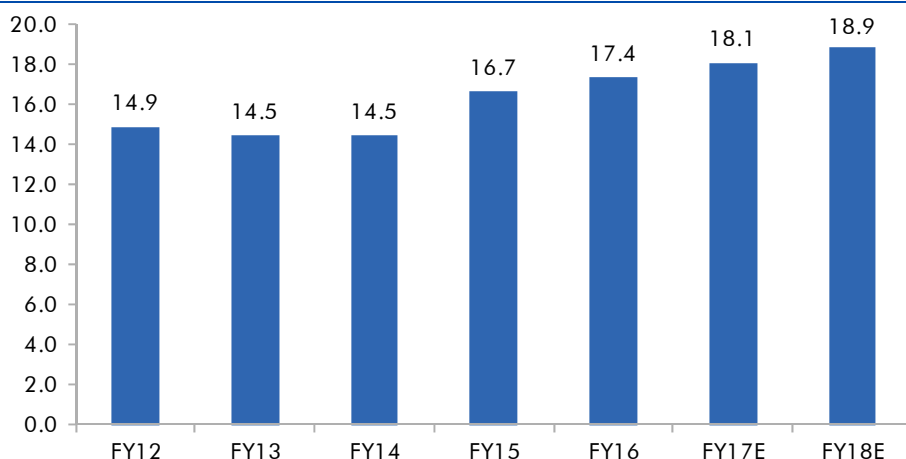
Source: Company, Angel Research

Capital raising likely in 2HFY17

LVB's tier-1 ratio stands at 8.2% as on Q2FY17. Taking into account the rate at which the bank is growing and expected to grow, the management indicated that it will raise ~₹500cr of equity capital in 2HFY17. This should support the bank's target to grow at 18% for the next two years.

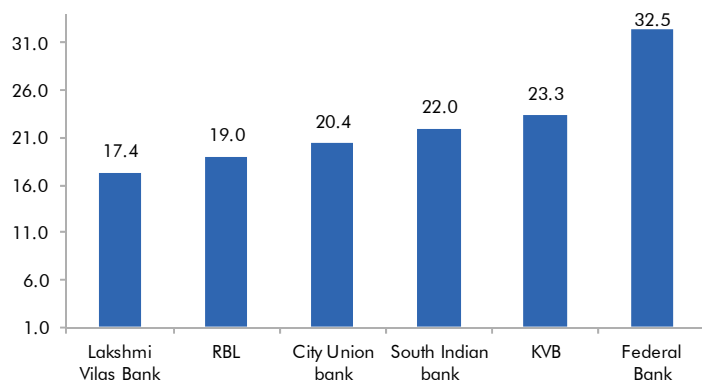
Laying a sustainable foundation of CASA to boost NIM: LVB's CASA ratio was at 14.9% (FY12) and has grown to 17.36% (FY16). Nevertheless, this is one of the lowest CASA ratio amongst regional banks. The new management has a slew of steps to improve CASA ratio by 2% every year for the next two-three years. Steps taken to improve CASA are: a)Offering competitive interest rate of 5-6 %, which is higher than industry average on saving accounts, b)Launched new services such as - Crown, NRI Banking Product, Flexi Current Account – SME, and Debit Card for Entities, c)Formation of a new position - large business RM to tap salary account and dedicated team for liability business d)On an average, addition of 70–80 branches over the next three years, and e)Freeing bandwidth at the branch level by moving the credit appraisal function to the RO/CO level and sales force incentivises to mobilise liability products.

Exhibit 7: LVB – CASA (%)

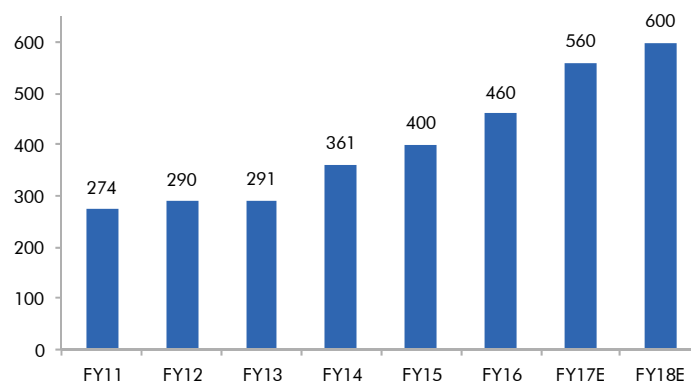


Source: Company, Angel Research

Exhibit-8 clearly depicts LVB's Casa (17.4%) ratio which is still lower compared to regional peers such as Federal Bank Ltd (32.5%), KVB (23.3%), South Indian bank (22%), and City Union bank (20.4%). Therefore, incumbent management has set priorities to expand CASA by 2% every year for the next 2-3 years, led by branch expansion, new customer acquisition, roll-out of new products and superior technology. Improving share of low-cost CASA is likely to taper LVB's overall cost of deposits (which is again higher among peers) resulting stable/improving NIM.

Exhibit 8: Comparative CASA (%) FY16


Source: Company, Angel Research

Exhibit 9: Branch Expansion


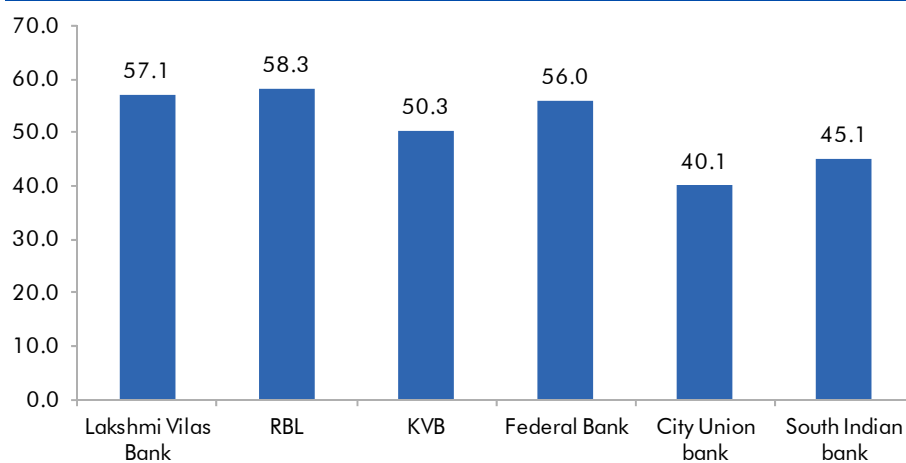
Source: Company, Angel Research

Exhibit-10 shows there is enough scope to improve branch performance; LVB is at lower end in almost all parameters. New team has been changing the hiring culture to move towards a professionally run new-age bank. Additionally, higher focus towards other income would also greatly benefit LVB to reduce cost/income ratio.

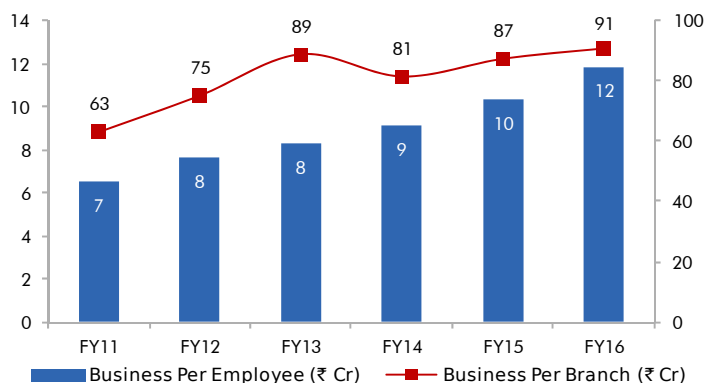
Exhibit 10: Branch Efficiency Comparative (FY16)

(₹ Cr)	Per Branch Business	Per branch CASA	Per branch Advance	Per Branch Deposit
Lakshmi Vilas Bank	98	10	43	55
RBL	231	23	108	124
KVB	133	17	58	74
Federal Bank	110	21	46	63
City Union bank	92	11	40	52
South Indian bank	115	15	49	66

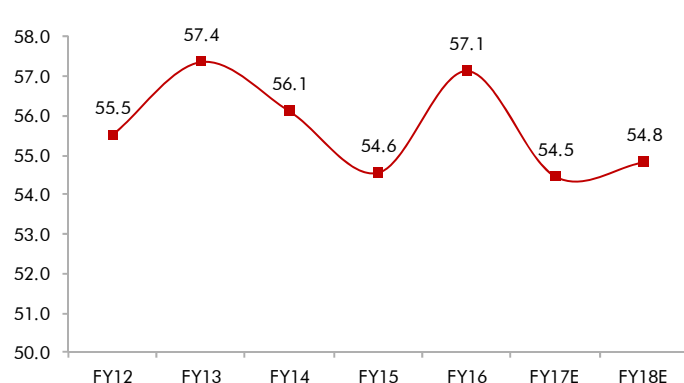
Source: Company, Angel Research

Exhibit 11: Comparative (FY16) - Cost/Income (%)


Source: Company, Angel Research

Exhibit 12: Business efficiency


Source: Company, Angel Research

Exhibit 13: Cost/Income (%)


Source: Company, Angel Research

ROA booster- Focus fees income & non funded business: Fees based income remained very low over a period of time (0.5% of average assets over FY11-16), which is lower than close peers - City Union bank (~0.75%). With wide experience in corporate banking, the new MD has taken several steps to extend non-funded services to SME such as treasury products, letter of credit, and bank guarantees among others. In addition to this, third-party distribution fees will also contribute to fees income. The new management's target is to reach at 25% of total income in FY26 from 11% in FY16.

Exhibit 14: Comparative of Non-fund based exposures, FY16

As % Of Total Asset	LVB	CUB	KVB	Federal	RBL	Yes bank
Acceptances, Endorsement	4.4	1.1	4.1	1.4	3.3	15.6
Guarantees given	3.5	6.2	5.3	4.8	12.7	10.8
Forward Exchange Contracts	4.0	15.3	8.4	15.6	23.4	106.9
Total contingent liability	12.8	20.8	18.0	22.2	75.9	200.4

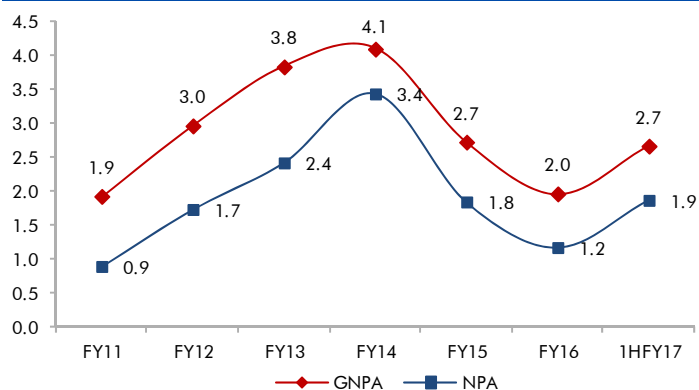
Source: Company, Angel Research

Better placed ALM, supported by retail deposit

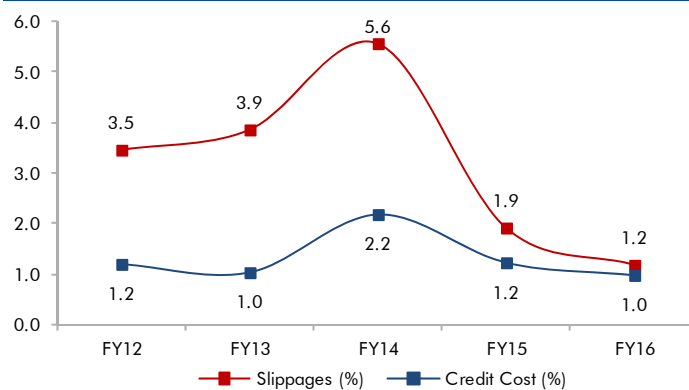
LVB's ALM is better placed as majority of its deposits (84.23%) and advances (84.65%) are maturing up to 3 years. Similarly, maturity bucket in ALM helps bank to maintain stable margin (NIM) as it is able to pass on deposit rate hike/decline to borrowers.

Asset Quality

The bank has lent aggressively to corporate and registered high growth during 2009 to 2012. This led to spike in stress advance over FY13-14 as large part of loans were lent to mid-corporate, which were badly hit by economic downturn. GNPA peaked at 4.1% (FY14) from 1.9% (FY11). The bank has taken majority of accounted stress assets, either NPA or sold to ARC. After 2014, GNPA/NPA has constantly reduced. However, in Q2FY17, GNPA/ NPA increased moderately to 2.7%/1.9%, owing to one bill discounting fraud. We believe, going forward, the asset quality to gradually improve considering alteration in lending decision.

Exhibit 15: GNPA & NPA (%)


Source: Company, Angel Research

Exhibit 16: Slippages & Credit Cost (%)


Source: Company, Angel Research

Exhibit 17: Comparative – Asset Quality

FY16 (%)	NPA	Total Stressed Asset	PCR	Slippages
Lakshmi Vilas Bank	1.2	5.0	69	1.2
RBL	0.6	0.4	56	1.4
KVB	0.6	3.5	82	3.1
Federal Bank	1.7	2.6	72	3.7
City Union bank	1.5	1.4	60	2.4
South Indian bank	2.9	3.2	40	4.3

Source: Company, Angel Research

Outlook & Valuation

We believe that scaling up of the liability franchise led by CASA, higher contribution from other incomes and prudence approach to alleviate bad loans will drive profitability and propel return ratio (FY18E-ROE – 12.7% & RoA - 0.72). This can drive further re-rating. At the current market price, the stock is trading at 1.25x its FY2018E BV of ₹116. **We recommend a Buy rating on the stock, with a target price of ₹174 (1.50x FY2018E BV).**

Exhibit 18: Comparative table

	P/BV*		ROE*		ROA*		4 CAGR		
	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	Loan growth (%)	NPA (%)
Lakshmi Vilas Bank	1.2	10.9	11.2	12.7	0.68	0.66	0.72	18	1.2
RBL	2.6	11.2	12.3	13.9	0.83	0.96	1.04	51	0.6
KVB	0.9	12.9	12.1	14.2	1.02	0.93	1.04	13	0.6
Federal Bank	1.2	6.0	9.5	11.6	0.55	0.82	0.92	11	1.7
City Union bank	2.0	15.5	15.7	16.6	1.50	1.54	1.60	15	1.5
South Indian bank	0.6	9.0	10.7	12.2	0.55	0.63	0.70	11	2.9

Source: Company, Angel Research, Note: CMP as of November 23, 2016, * other bank Consensus taken from Bloomberg,

Exhibit 19: Comparative DuPont Analysis

FY2016	KVB	Federal Bank	City Union bank	South Indian bank	RBL	LVB
NII	3.2	2.9	3.3	2.5	2.5	2.4
Non Interest Income	1.3	0.9	1.4	0.8	1.5	1.1
Total Revenues	4.5	3.8	4.7	3.3	4.0	3.6
Operating Cost	2.3	2.1	1.9	1.9	2.3	2.0
PPP	0.6	0.8	0.8	0.6	0.3	0.7
Total provisions	0.6	0.8	0.8	0.6	0.3	0.7
Pre-Tax Profit	1.7	0.8	2.0	0.8	1.3	0.9
Tax	0.6	0.3	0.5	0.3	0.4	0.2
ROA	1.0	0.5	1.5	0.5	0.9	0.7
Leverage	12.6	11.0	10.3	16.4	12.7	16.1
RoE (%)	12.9	6.0	15.5	9.0	11.2	10.9

Source: Company, Angel Research

Key Risk

High concentration to a single state: LVB derives half of its business from 60% branch network based in Tamil Nadu alone. Any change in socio political situation/occurrence of a natural calamity can impact the economic condition of the borrowers and in turn impact the credit quality of the company.

Standard Restructured: Higher delinquency from standard restructured can escalate provisioning requirement and hence can impact the return ratio.

Demonetisation: For FY16, LVB loan book consist 26% of Mid Commercial & SME. Post demonetization, higher slippages from SME loan Book may dent profitability.

Company background

Lakshmi Vilas Bank is a south based private sector bank with major business (50.2%) concentrated in the state of Tamil Nadu. Currently, LVB has a network of 463 branches (plus 7 extension counters) pan India and 926 ATMs. The extensive branch network (60%) in Tamil Nadu, which is one of the more progressive and industrialized states in the country, provides a solid market base of business and customers.

Key Management Personnel

The top management team comprises of Mr. Parthasarathi Mukherjee, supported by Mr. M. Palaniappan - Chief Financial officer, Mr. AJ Vidyasagar - CGM & COO, and Mr. RM Meenakshi Sundaram - Chief General Manager of Whole Sale Banking and General Managers.

Income Statement

Y/E March (₹ cr)	FY14	FY15	FY16	FY17E	FY18E
Nil	486	527	645	777	914
- YoY Growth (%)	24.0	8.4	22.5	20.4	17.6
Other Income	218	284	305	414	462
- YoY Growth (%)	10.6	30.3	7.2	35.9	11.6
Operating Income	704	811	950	1,191	1,376
- YoY Growth (%)	19.5	15.2	17.2	25.4	15.5
Operating Expenses	395	442	543	648	754
- YoY Growth (%)	16.9	12.0	22.7	19.5	16.3
Pre - Provision Profit	309	368	407	542	621
- YoY Growth (%)	23.0	19.2	10.5	33.2	14.6
Prov. & Cont.	269	180	177	269	269
- YoY Growth (%)	136.9	(32.9)	(2.0)	52.5	0.0
Profit Before Tax	40	188	231	273	352
- YoY Growth (%)	(70.7)	366.0	22.5	18.4	29.0
Prov. for Taxation	(20)	56	50	68	99
- YoY Growth (%)	-	-	(10.6)	36.5	44.5
PAT	60	132	181	205	254
- YoY Growth (%)	(34.4)	120.2	36.5	13.4	23.8

Balance Sheet

Y/E March (₹ cr)	FY14	FY15	FY16	FY17E	FY18E
Share Capital	98	179	179	179	179
Reserve & Surplus	956	1,377	1,584	1,727	1,905
Net Worth	1,054	1,556	1,764	1,907	2,084
Deposits	18,573	21,964	25,431	29,246	33,632
- YoY Growth (%)	18.9	18.3	15.8	15.0	15.0
Borrowing	458	458	723	847	975
Other Lia & Prov	568	727	815	930	1,100
Total Liabilities	20,653	24,705	28,732	32,930	37,792
Cash and Bal with RBI	1,192	1,143	1,287	1,367	1,493
Bal With BANK	120	175	82	137	157
Investment	5,689	6,051	6,545	7,108	7,860
Advance	12,889	16,352	19,644	23,180	27,352
- YoY Growth (%)	10.1	26.9	20.1	18.0	18.0
Fixed Asset	201	243	367	410	456
Other Asset	563	740	807	728	474
Total Asset	20,653	24,705	28,732	32,930	37,792
Growth (%)	16.9	19.6	16.3	14.6	14.8

Ratio Analysis

Y/E March	FY14	FY15	FY16	FY17E	FY18E
Data Per Share					
EPS	6.2	7.4	10.1	11.4	14.1
BV	108	87	98	106	116
Adj BV	80.5	76.8	88.4	91.3	101.1
Profitability ratio					
NIM	2.8	2.6	2.6	2.7	2.8
Cost to Income	56.1	54.7	57.1	54.5	54.8
RoA	0.31	0.58	0.68	0.66	0.72
RoE	5.8	10.1	10.9	11.2	12.7
B/S ratios (%)					
CASA Ratio	14.2	16.7	17.4	18.1	18.9
Credit/Deposit	71.9	72.1	75.9	78.3	80.4
Asset Quality					
GNPA	4.1	2.7	2.0	2.0	1.7
NPA	3.4	1.8	1.2	1.1	0.9
Slippages	5.6	1.9	1.2	2.1	1.7
Credit Cost	2.2	1.2	1.0	1.3	1.1
Valuation					
PER	23.5	19.6	14.4	12.7	10.3
P/ABVPS	1.8	1.9	1.6	1.6	1.4
Div Yield	0.7	1.4	2.1	2.4	2.9

Du Pont Analysis

	FY14	FY15	FY16	FY17E	FY18E
NII	2.5	2.3	2.4	2.5	2.6
Non Interest Income	1.1	1.3	1.1	1.3	1.3
Total Revenues	3.7	3.6	3.6	3.9	3.9
Operating Cost	2.1	2.0	2.0	2.1	2.1
PPP	1.6	1.6	1.5	1.8	1.8
Total provisions	1.4	0.8	0.7	0.9	0.8
TreTax Profit	0.2	0.8	0.9	0.9	1.0
Tax	(0.1)	0.2	0.2	0.2	0.3
ROA	0.3	0.6	0.7	0.7	0.7
Leverage	18.5	17.4	16.1	16.8	17.7
RoE (%)	5.8	10.1	10.9	11.2	12.7

Source: Company, Angel Research

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Disclosure of Interest Statement

Lakshmi Vilas Bank

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)