

## Syndicate Bank

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,238	SNDB IN
	REUTERS CODE
S&P CNX: 2,809	SBNK.BO

18 January 2006

**Buy**
*Previous Recommendation: Buy*
**Rs95**

		YEAR	NET INCOME	PAT	EPS	EPS	P/E	P/BV	CAR	ROE	ROA	P/ABV
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	(%)	(X)
Equity Shares (m)	522.0	3/05A	22,584	4,029	8.5	-7.2	11.2	2.2	10.7	19.6	0.8	2.7
52-Week Range	102/46	3/06E	24,858	6,770	13.0	51.9	7.3	1.8	12.4	26.0	1.2	1.9
1,6,12 Rel.Perf.(%)	10/15/24	3/07E	27,691	7,856	15.1	16.0	6.3	1.4	11.0	23.6	1.2	1.5
M.Cap. (Rs b)	49.7											
M.Cap. (US\$ b)	1.1											

Syndicate Bank reported earnings of Rs1.88b in 3QFY06, compared with a loss Rs781m during 3QFY05. In the core business, net interest income (NII) grew by 29% YoY (adjusting for one-off gains) to Rs5.08b. NII growth arose from margin expansion on the back of lower deposit costs and stable loan yields. Asset quality has improved QoQ with net NPAs declining to 1.22% from 1.44% as of 2QFY06.

- Net interest income has grown by 36%; margins have expanded
- Steady balance sheet growth: loans up 34%; deposits up 11%
- Operating expenses higher by 27% YoY
- Investment book: well cushioned
- Net NPAs decline further to 1.44%

The bank's strategy of not chasing high-cost deposits, de-risking its balance sheet by reducing investments to fund loan growth, whereby it can derive superior margins is commendable. Coupled with steady fee income growth and likely cost savings benefits expected on account of nil VRS charges from FY07 and natural attrition would enable the bank to deliver high earnings. Post 3QFY06, we have upgraded our PAT estimates by 6% for FY06 to Rs6.77b and by 4% to Rs7.86b in FY07. The stock trades at P/E of 6.3x and P/BV of 1.4x on FY07 earnings and offers a yield of >2.4%. We expect the bank to deliver an RoE of 23%+ in FY07. We reiterate **Buy**.

**QUARTERLY PERFORMANCE**

(RS MILLION)

	FY 05				FY 06				FY 05	FY 06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	8,804	9,273	9,647	9,853	9,534	9,903	10,475	10,981	37,576	40,893
Interest Expense	5,375	5,058	5,702	4,503	4,810	5,103	5,127	5,841	20,638	20,881
<b>Net Interest Income</b>	<b>3,429</b>	<b>4,215</b>	<b>3,945</b>	<b>5,349</b>	<b>4,724</b>	<b>4,799</b>	<b>5,349</b>	<b>5,141</b>	<b>16,938</b>	<b>20,012</b>
% Change (Y-o-Y)	23.4	11.6	20.8	19.6	37.8	13.9	35.6	-3.9	18.5	18.1
Other Income	1,952	1,151	1,169	1,374	1,322	1,276	1,177	1,071	5,646	4,846
<b>Net Income</b>	<b>5,381</b>	<b>5,366</b>	<b>5,114</b>	<b>6,723</b>	<b>6,046</b>	<b>6,076</b>	<b>6,526</b>	<b>6,212</b>	<b>22,584</b>	<b>24,858</b>
% Change (Y-o-Y)	23.7	-6.3	0.9	-2.7	12.4	13.2	27.6	-7.6	2.4	10.1
Operating Expenses	2,851	2,808	2,842	4,141	3,242	3,911	3,618	3,081	12,642	13,852
<b>Operating Profit</b>	<b>2,530</b>	<b>2,558</b>	<b>2,272</b>	<b>2,582</b>	<b>2,803</b>	<b>2,165</b>	<b>2,908</b>	<b>3,130</b>	<b>9,942</b>	<b>11,006</b>
Other Provisions	553	1,352	3,626	76	729	243	879	900	5,608	2,750
Tax Provisions	725	450	-574	-297	444	170	150	723	305	1,486
<b>Net Profit</b>	<b>1,252</b>	<b>756</b>	<b>-781</b>	<b>2,802</b>	<b>1,631</b>	<b>1,752</b>	<b>1,879</b>	<b>1,508</b>	<b>4,029</b>	<b>6,770</b>
% Change (Y-o-Y)	23.0	-34.0	-187.8	117.7	30.2	131.8		-46.2	-7.2	68.0
Cost to Income Ratio (%)	53.0	52.3	55.6	61.6	53.6	64.4	55.4	49.6	56.0	55.7
Interest Expense/Interest Income (%)	61.1	54.5	59.1	45.7	50.5	51.5	48.9	53.2	54.9	51.1
Other Income/Net Income (%)	36.3	21.5	22.9	20.4	21.9	21.0	18.0	17.2	25.0	19.5

E: MOSt Estimates

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Syndicate Bank recorded earnings of Rs1.88b in 3QFY06, compared with a loss Rs781m during 3QFY05. In its core business, net interest margins grew by 29% YoY (adjusting for one-off gains) to Rs5.08b. NII growth resulted from margin expansion on the back of lower deposit costs and stable loan yields. Asset quality has improved QoQ with net NPAs declining to 1.22% from 1.44% as of 2QFY06.

### Reported net interest income grows by 36%; margins expand

Syndicate Bank has grown its reported NII by 36% in 3QFY06 to Rs5.35b. The bank achieved this on the back of its strategy to grow its loan book by selling down its excess statutory liquidity ratio (SLR) securities. While the deposit base grew by a mere 11%, the bank could grow its loan book aggressively by shifting its excess SLR securities to loans.

Margins improved on both YoY and QoQ basis. They increased to 3.39% in 3Q v/s 2.95% in 3QFY05 and 3.21% in 2QFY06. Yields remained stable, while cost of deposits declined as the bank shed high cost deposits over the last 3-4 quarters.

#### MARGIN BREAKDOWN

	3QFY06	3QFY05	2QFY06
Yield on Advances	8.61	9.47	8.64
Cost of Deposit	4.48	4.87	4.58
NIMs	3.39	2.95	3.21

Source: Company/ Motilal Oswal Securities

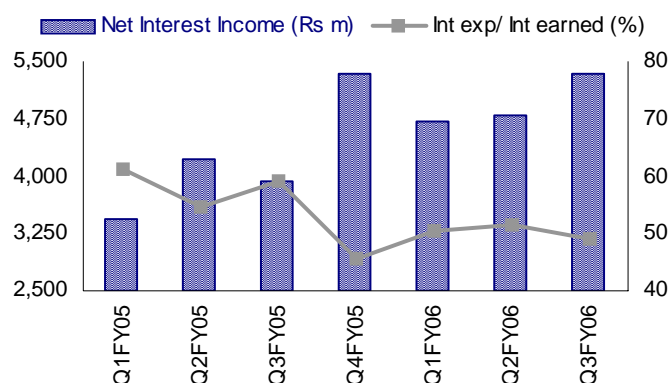
The bank has made a one-off reversal (on account of interest paid towards pigmy deposits) of Rs270m of interest expenses. Adjusting for this one-off, NII growth has been robust at 29% YoY to Rs5.08b in 3QFY06.

#### NET INTEREST INCOME - BREAKDOWN

	3QFY06	3QFY05	% GROWTH
Interest Income	10475	9647	8.6
Interest Expense	5127	5702	-10.1
Reported NII	5349	3945	35.6
Write-back of interest expense	270	0	
NII (adjusting for one - off)	5079	3945	28.7

Source: Company/ Motilal Oswal Securities

#### TRENDS IN NII



Source: Company/ Motilal Oswal Securities

### Steady balance sheet growth; loans up by 34%, deposits higher by 11%

Deposits grew by 11% (CASA deposits grew by 19% YoY). Currently, CASA constitutes 38% (compared with 37% in March '05 and 35% as of December '04) of total deposits. Advances grew by 34% YoY (of the total advances, 34% were to the corporate sector while the retail and agriculture sectors accounted for 32% and 18%). The investment book, however has declined by 20% YoY respectively, as the bank shed its excessive SLR investments.

### Lower treasury income

Treasury income has fallen YoY from Rs430m to Rs130m at 3QFY06. Other non-fund income (apart from treasury) for the bank has increased by 42% YoY to Rs1.05b in 3QFY06 largely due to increased non-fund based sources of income i.e. forex income and distribution of mutual fund and insurance products. Overall, other income has increased by 1% YoY to Rs1.18b in 3QFY06.

### Operating expenses up 27% YoY

Operating expenses increased by 27% YoY to Rs2.66b in 3QFY06, largely due to absorption of the pending 4Q VRS expenses (Rs200m) during the current quarter. The bank also charged off the remaining public issue expenses of Rs140m during the quarter. Thus, going forward, 4Q operating expenses are likely to be lower QoQ.

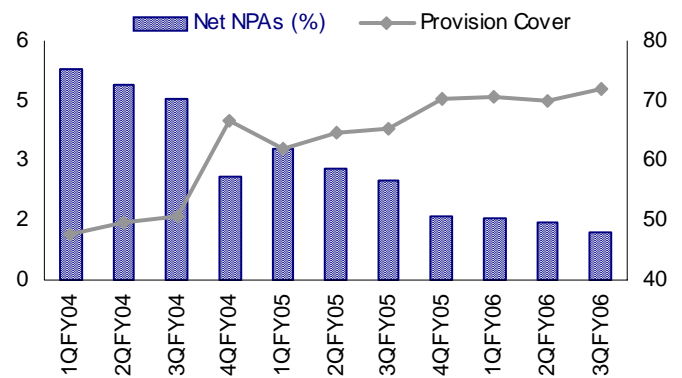
### Investment book — well cushioned

The bank has transferred securities worth Rs84b in the third quarter of FY05 and in 1QFY06. Simultaneously, it has been trimming its investment book to fund its loan growth, rather than raise deposits. The investment book is down to Rs166b in 3QFY06 from Rs207b in 3QFY05. In 3QFY06, SLR investments were 78% of total investments. Of this, 69% of SLR securities were in the Held-to-Maturity (HTM) and in the Available-for-Sale (AFS) book. The bank has now created a cushion of almost 90bp, with a modified duration of 1.45.

### Net NPAs decline further to 1.22%

The bank has been consistently improving its asset quality. Net NPAs have dropped QoQ by 22bp to 1.22%. The gross NPAs have also declined QoQ by 46bp to 4.22% at 3QFY06. Management expects to effect a cash recovery of Rs4b in FY06 and has, up to the first nine-months, made a cash recovery of Rs2.8b. With increase in loan portfolio and aggressive cash recoveries, we expect net NPAs to decline considerably from current levels. Currently, incremental slippages have come down to 1.5% from as high as 3% some time ago.

TREND IN NET NPA



Source: Company/ Motilal Oswal Securities

### Valuation and view

Syndicate Bank's strategy of not chasing high-cost deposits, de-risking its balance sheet by reducing investments to fund loan growth, whereby it can derive superior margins is commendable. This coupled with steady fee income growth and likely cost savings benefits to be derived on account of nil VRS charges from FY07 and natural attrition would enable the bank to deliver high earnings.

Post 3QFY06, we have upgraded our PAT estimates by 6% for FY06 to Rs6.77b and by 4% to Rs7.86b in FY07. The stock trades at P/E of 6.3x and P/BV of 1.4x on FY07 earnings and offers yield of >2.4%. We expect the bank to deliver an RoE of 23%+ in FY07. We reiterate **Buy**.

## Syndicate Bank: an investment profile

### Company description

Syndicate Bank, which has a balance sheet size of Rs521b, is the tenth largest state-owned bank in India in terms of the asset-size. The bank operates through a network of 1,914 domestic branches, one international branch. It has a dominant presence in the southern region, which houses 58% of its branches. The bank made its first public offer in 1999, when it offered 125m equity shares at par and raised Rs1.25b. The bank raised further capital of Rs2.5b in July 2005, by offering 50m shares at a premium of Rs40 per share. As a result, the government's stake has reduced to 66.5%

### Key investment arguments

- Consistent growth in core earnings for last several quarters
- Net NPAs falling despite low provisioning
- Transfer of bonds to HTM will serve as a cushion against interest rate risk

### Key investment risks

- Slowdown of the economy could hurt asset quality of the bank

### Recent developments

- The bank raised further capital of Rs2.5b in July 2005 by offering 50m shares at a premium of Rs40 per share. As a result, the government's stake has reduced to 66.5%.
- Mr. N. Kantha Kumar is likely to retire as Chairman and Managing Director w.e.f. 31 March 2006

### Valuation and view

- Aggressive loan growth and margin expansion will drive core earnings growth
- The bank could be an active participant in the consolidation process
- The stock trades at P/E of 6.3x and P/BV of 1.4x on FY07 earnings and offers yield of >2.4%
- We maintain our **Buy** recommendation

### Sector view

- YTD loan growth of 29%, highest in the last 12 years
- Volatility in interest rates will impact the bond gains
- Benefits of significant improvement in asset quality, yet not factored into earnings, valuations
- We maintain an overweight stance on the sector

#### COMPARATIVE VALUATIONS

		SYNDICATE	IOB	ANDHRA
P/E (x)	FY06E	7.3	8.1	8.5
	FY07E	6.3	6.8	7.3
P/ABV (x)	FY06E	1.9	2.2	1.5
	FY07E	1.5	1.7	1.4
RoE (%)	FY06E	26.0	26.7	22.1
	FY07E	23.6	25.5	19.5
RoA (%)	FY06E	1.2	1.4	1.5
	FY07E	1.2	1.5	1.5

#### SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	66.5	66.5	73.5
Domestic Institutions	8.5	8.5	5.2
FIs/FDIs	9.6	8.9	2.5
Others	15.4	16.1	18.9

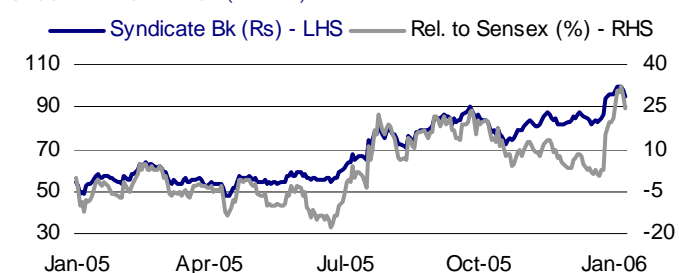
#### EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	13.0	12.4	4.8
FY07	15.1	14	7.9

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
95	130	36.8	Buy

#### STOCK PERFORMANCE (1 YEAR)



**INCOME STATEMENT (Rs Million)**

Y/E March	2004	2005	2006E	2007E	2008E
Interest Income	30,848	37,576	40,893	47,330	55,609
Interest Expended	16,556	20,638	20,881	24,834	29,551
<b>Net Interest Income</b>	<b>14,292</b>	<b>16,938</b>	<b>20,012</b>	<b>22,497</b>	<b>26,058</b>
Change (%)	18.1	18.5	18.1	12.4	15.8
Other Income	7,764	5,646	4,846	5,194	5,533
<b>Net Income</b>	<b>22,056</b>	<b>22,584</b>	<b>24,858</b>	<b>27,691</b>	<b>31,592</b>
Change (%)	29.4	2.4	10.1	11.4	14.1
Operating Expenses	11,864	12,642	13,852	13,955	15,578
<b>Operating Income</b>	<b>10,192</b>	<b>9,942</b>	<b>11,006</b>	<b>13,736</b>	<b>16,013</b>
Change (%)	64.7	-2.5	10.7	24.8	16.6
Other Provisions	3,146	5,608	2,750	2,825	3,250
<b>PBT</b>	<b>7,047</b>	<b>4,334</b>	<b>8,256</b>	<b>10,911</b>	<b>12,763</b>
Tax	2,705	305	1,486	3,055	3,574
Tax Rate (%)	38.4	7.0	18.0	28.0	28.0
<b>PAT</b>	<b>4,341</b>	<b>4,029</b>	<b>6,770</b>	<b>7,856</b>	<b>9,189</b>
Change (%)	26.2	-7.2	68.0	16.0	17.0
Proposed Dividend	1,065	1,067	1,174	1,305	1,435

**BALANCE SHEET (Rs Million)**

Y/E March	2004	2005	2006E	2007E	2008E
Capital	4,720	4,720	5,220	5,220	5,220
Reserves & Surplus	14,333	17,265	24,861	31,412	39,166
<b>Net Worth</b>	<b>19,053</b>	<b>21,985</b>	<b>30,081</b>	<b>36,631</b>	<b>44,385</b>
<b>Deposits</b>	<b>425,848</b>	<b>462,946</b>	<b>518,499</b>	<b>601,459</b>	<b>697,692</b>
Change (%)	38.9	8.7	12.0	16.0	16.0
Borrowings	7,062	10,458	15,687	19,609	24,511
Other Liabilities & Prov.	20,269	25,706	32,646	39,175	47,010
<b>Total Liabilities</b>	<b>472,232</b>	<b>521,094</b>	<b>596,913</b>	<b>696,874</b>	<b>813,599</b>
Current Assets	65,775	30,696	53,057	55,712	66,986
Investments	179,166	203,707	183,337	210,837	242,463
Change (%)	29.6	13.7	-10.0	15.0	15.0
Advances	206,469	267,292	339,461	407,353	478,640
Change (%)	26.6	29.5	27.0	20.0	17.5
Net Fixed Assets	3,637	3,813	3,913	4,113	4,388
Other Assets	17,185	15,586	17,145	18,860	21,123
<b>Total Assets</b>	<b>472,232</b>	<b>521,094</b>	<b>596,913</b>	<b>696,874</b>	<b>813,599</b>

**ASSUMPTIONS (%)**

Deposit Growth	38.9	8.7	12.0	16.0	16.0
Advances Growth	26.6	29.5	27.0	20.0	17.5
Investments Growth	29.6	13.7	-10.0	15.0	15.0
Average PLR	10.0	10.0	10.0	10.0	10.0
Dividend	20.0	20.0	22.5	25.0	27.5
CRR	4.5	5.0	5.0	5.0	5.0

E: Most Estimates

**RATIOS**

Y/E March	2004	2005	2006E	2007E	2008E
<b>Spreads Analysis (%)</b>					
Avg. Yield - Earning Assets	8.0	7.9	7.8	7.8	7.9
Avg. Cost-Int. Bear. Liab.	4.5	4.6	4.1	4.3	4.4
Interest Spread	3.5	3.4	3.6	3.5	3.5
Net Interest Margin	3.7	3.6	3.8	3.7	3.7

**Profitability Ratios (%)**

RoE	24.9	19.6	26.0	23.6	22.7
RoA	11	0.8	12	12	12
Int. Expended/Int. Earned	53.7	54.9	51.1	52.5	53.1
Other Inc./Net Income	35.2	25.0	19.5	18.8	17.5

**Efficiency Ratios (%)**

Op. Exps./Net Income	53.8	56.0	55.7	50.4	49.3
Empl. Cost/Op. Exps.	76.4	76.0	73.3	71.0	71.2
Busi. per Empl. (Rs m)	219	27.4	33.3	40.8	50.3
NP per Empl. (Rs lac)	17	16	2.8	3.4	4.2

**Asset-Liability Profile (%)**

Adv./Deposit Ratio	48.5	57.7	65.5	67.7	68.6
Invest./Deposit Ratio	42.1	44.0	35.4	35.1	34.8
G-Sec/Invest. Ratio	90.8	92.4	92.4	92.4	92.4
Gross NPAs to Adv.	7.3	5.2	3.9	3.7	3.4
Net NPAs to Adv.	2.6	1.6	0.9	0.8	0.8
CAR	11.5	10.7	12.4	11.0	10.4
Tier 1	6.8	6.1	8.0	7.0	6.4

**VALUATION**

Book Value (Rs)	36.1	42.4	53.8	66.4	81.2
Price-BV (x)	2.6	2.2	1.8	1.4	1.2
Adjusted BV (Rs)	28.1	35.9	50.0	62.1	76.8
Price-ABV (x)	3.4	2.7	1.9	1.5	1.2
EPS (Rs)	9.2	8.5	13.0	15.1	17.6
EPS Growth (%)	26.2	-7.2	51.9	16.0	17.0
Price-Earnings (x)	10.3	11.2	7.3	6.3	5.4
OPS (Rs)	21.6	21.1	21.1	26.3	30.7
OPS Growth (%)	64.7	-2.5	0.1	24.8	16.6
Price-OP (x)	4.4	4.5	4.5	3.6	3.1

E: Most Estimates



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#### Syndicate Bank

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|--|----|
| 1. Analyst ownership of the stock            | No |
| 2. Group/Directors ownership of the stock    | No |
| 3. Broking relationship with company covered | No |

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