

Syndicate Bank

Rs80

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs41.6bn; US\$923m

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Result: Q4FY07

Comment: Higher provision spoils otherwise sound operating performance

Revision: Upgrade earnings by 4% each for FY08 & FY09 on back of lower tax rate guidance

Last report: 5 February 2007 (Price Rs75; Recommendation: Outperformer)

Key valuation metrics

Year to 31 March	2005	2006	2007E	2008E	2009E
Net profit (Rs m)	4,029	5,365	7,161	8,479	9,514
yoy growth (%)	(7.2)	33.2	33.5	18.4	12.2
Shares in issue (m)	472	522	522	522	522
EPS (Rs)	8.5	10.3	13.7	16.2	18.2
EPS growth (%)	(7.2)	20.4	33.5	18.4	12.2
PE (x)	9.3	7.7	5.8	4.9	4.4
Book value (Rs/share)	46.6	55.4	69.4	81.6	95.3
Adjusted Book Value(Rs / share)	45.8	58.2	70.9	83.2	97.1
P/ Adjusted Book (x)	1.7	1.4	1.1	1.0	0.8
RONW (%)	19.6	21.1	22.0	21.5	20.6

Syndicate Bank reported net profit of Rs1.04 bn (9x yoy growth) broadly in line with our expectation of Rs1.11bn. Higher provisioning led by standard asset provisions and investment depreciation hit offset the positives on operating performance. Nil growth (excluding exceptional) is robust at 30% (yoy) and margins have remained stable (qoq). Core fee delivered a 20% growth yoy led by increased CEB business. CASA has improved marginally sequentially, although it continues to remain below previous year levels. With Tier 1 at 6.24%, we believe that a dilution would be imminent were the bank to continue its strategy of high loan growth. In the recent past, we have been concerned with the excessive growth strategy followed by the bank, which has led to margin and capital dilution. The management plans to use current financial year for consolidation of loan growth along with focus on reducing bulk deposits and the recent PLR hike (April 2007) by 75bps, all of which if implemented would lead to stable margins going forward. We have increased our earnings estimates by 4% each for FY07 and FY08, mainly incorporating lower tax rates. As the bank is still likely to generate earnings CAGR of 15.3% and 21% average RoE for over FY07-09E and as valuation at 1.0x FY08E and 0.8x FY09E adjusted book are not demanding, we maintain Outperformer with 12-month price target of Rs106 (1.1x FY09E and book).

KEY ISSUES

❑ Excessive growth strategy continues however with some moderation

Syndicate Bank has reported 40% yoy growth in advances (6% qoq) and 46% yoy growth in deposits (4% qoq), which is significantly higher than the system growth. However the pace of growth has moderated from the high of 50% average seen both in the advances and deposit seen in the last 3 quarters. CASA ratio though declined by 560bps to 32.4% has seen some improvement from the low of 30% witnessed in Q3FY07.

Over the last few quarters the bank has been growing the balance sheet aggressively through bulk deposits at the cost of margins. The bank's reliance on bulk deposit is reflected with a high share of 35.6% which is amongst the highest in the system, however in the current quarter, share of bulk deposit has declined from high of 38% seen in the Q3FY07.

Break down of deposits

For the quarter ended	Mar-06	Dec-06	Mar-07
Total deposits (Rs bn)	536.2	752.9	786.3
Bulk deposits (Rs bn) ~	170.0	290.0	280.0
Share of bulk (%) ~	31.7	38.5	35.6

Source: Company

In the recent past, we have been concerned with the excessive growth strategy followed by the Bank which has led to margin dilution. In the current quarter the though the excessive has moderated it still continues to remain above comfort levels.

□ ...Robust NII growth with margins stable qoq

On the bank of strong loan growth, NII increased by 54%. However adjusting for one time CRR interest of ~Rs250m and hit of Rs500m last year on pigmy deposits NII grew by 30.4%.

Correspondingly, NIMs improved 9bps qoq to 2.77 %. Adjusting for the one-offs, the margins have remained stable qoq. While adjusted margins remained stable qoq, loan yields have fallen, as we believe the excessive volume growth would have resulted in dilution of some pricing power. Post Q4FY07, in April 2007, the bank has increased its PLR by 75bps (82% of the portfolio is PLR linked), this coupled with increasing focus on core deposit growth (in Q4FY07, CASA deposits were ~75% of the incremental deposits) we expect margins to remain stable going forward.

Yield and Cost break down

For the quarter ended (%)	Mar-06	Dec-06	Mar-07
Yield on Advances	8.60	9.68	9.46
Yield on Advances (reported)	8.72	9.32	9.28
Yield on Investments	6.25	7.18	7.27
Yield on advances and investments - (a)	7.84	8.82	8.74
Cost of Deposits - (b)	5.06	5.78	5.77
Cost of Deposits (reported)	4.48	5.34	5.44
Deposit spread (a - b)	2.78	3.04	2.97
NIM	2.67	2.68	2.77
NIM (adjusted)	3.00	2.68	2.66
NIM (reported)	3.18	2.69	2.72

Source: SSKI Research, All ratios calculated on quarterly average balances, Reported ratios are on cumulative basis.

□ Other income remained flat due to lower trading gains; Fee income registers 19% growth

Syndicate Bank's other income has shown flat growth yoy. This is largely due to lower trading component of other income remaining flat yoy. On the other hand non –trading income grew by 19% Yoy in Q4FY07, led by higher growth delivered on the CEB business.

Break down of other income

For the quarter ended (Rs m)	Mar-06	Dec-06	Mar-07	Qoq growth (%)	Yoy growth (%)
Forex	162.2	90.0	174.7	94.1	7.7
Trading	500.0	450.0	200.0	(55.6)	(60.0)
CEB	480.8	470	653.1	39.0	35.8
Others	889.3	490	994.8	103.0	11.9
Total	2,032.3	1,500.0	2,022.6	34.8	(0.5)

Source: Company

□ Higher provision spoils the party

The bank provisioning costs has mitigated the positives emanating from operating results. A higher standard asset provision of Rs986m and investment depreciation hit of Rs735m had led to surge in credit cost.

Break down of provision

For the quarter ended (Rs m)	Mar-06	Dec-06	Mar-07
Prov. for NPA	2,173	929	1,352
Prov. for Premium Amortization	75	80	90
Prov. for depreciation	79	290	735
Standard Asset provision	400	150	986
Other Provision	178	29	544
Total Provision	2,905	1,478	3,707

Source: Company

❑ Lower tax rate to continue beyond FY07

The management has indicated that the bank still has HTM depreciation losses of FY06 to the extent of Rs4b resulting in the bank continuing to pay MAT (minimum alternative tax) rate. Management stated that this benefit would continue to run through FY07 and to a large extent in FY08 as well. We are assuming a 11% tax rate for FY08 and 18% tax rate for FY09.

❑ Asset quality improves on back of high NPA provisions

In the Q3FY07, the net NPAs had deteriorated on absolute basis by 10% qoq, as the bank has recognized some assets as NPAs during the quarter. This had raised concern on the asset quality problems in the portfolio. However in the current quarter, bank has done excessive NPA provisions leading to net NPAs declining by 11% qoq. Net NPAs have come down to 0.76% (from 0.90% qoq), while gross NPAs have come down to 2.95% (from 3.33% qoq) in Q4FY07.

❑ Low Tier-I capital

Rapid loan growth has also taken its toll on capital adequacy of the bank. Syndicate Bank has Tier-I CAR of 6.24% as on Mar-07, while overall CAR is at 11.74%. Approximately Rs12-14bn headroom is available to the bank in form of perpetual debt, upper and lower tier 2 capital. We expect the bank to exhaust this headroom before going for dilution. However, was the bank to continue to grow its loan book at this pace we could see the bank coming in for equity dilution well before our belief of end-FY08.

❑ Marginally upgrading FY07 and FY08 earning estimates on lower tax rates

In the recent past, we have been concerned with the excessive growth strategy followed by the bank, which has led to margin and capital dilution. The management plans to use current financial year for consolidation of loan growth along with focus on reducing bulk deposits and the recent PLR hike (April 2007) by 75bps, all of which if implemented would lead to stable margins going forward. We have increased our earnings estimates by 4% each for FY07 and FY08, mainly incorporating lower tax rates. As the bank is still likely to generate earnings CAGR of 15.3% and 21% average RoE for over FY07-09E and as valuation at 1.0x FY08E and 0.8x FY09E adjusted book are not demanding, we maintain Outperformer with 12-month price target of Rs106 (1.1x FY09E and book).

Quarterly results

Amount in Rs. Million	Q4FY06	FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07	FY08E	FY09E
Total intt income	10,592	30,848	12,308	14,373	16,353	17,366	60,401	77,328	92,032
Interest expense	6,655	16,556	7,249	9,527	10,794	11,330	38,900	52,552	63,558
Net interest income	3,937	14,292	5,059	4,846	5,559	6,037	21,501	24,776	28,474
yoy growth (%)	(26.4)	18.1	7.1	1.0	3.9	53.3	14.3	15.2	14.9
Other income	2,035	7,764	1,342	1,656	1,490	2,028	6,516	6,935	7,527
yoy growth (%)	48.2	56.8	1.5	29.8	26.6	(0.4)	10.1	6.4	8.5
Non trading income	1,535	1,618	1,102	1,137	1,040	1,828	2,381	3,190	3,700
yoy growth (%)	64.5	14.6	17.4	18.5	(0.7)	19.0	6.4	34.0	16.0
Net revenue	5,972	22,056	6,401	6,502	7,049	8,064	28,016	31,711	36,001
Operating expenses	3,577	11,514	3,382	3,471	3,768	3,239	13,860	15,026	16,370
Operating profit	2,395	10,542	3,019	3,031	3,281	4,826	14,157	16,685	19,631
yoy growth (%)	(7.2)	70.4	7.7	40.0	12.8	101.5	36.4	17.9	17.7
Total provisions	2,905	3,496	963	730	1,478	3,707	6,878	7,158	8,029
PBT	(510)	7,047	2,056	2,301	1,803	1,119	7,278	9,527	11,602
Tax	(613)	2,705	250	250	(458)	76	118	1,048	2,088
PAT	103	4,341	1,806	2,051	2,261	1,043	7,161	8,479	9,514
yoy growth (%)	(96.3)	26.2	10.7	17.1	20.4	911.5	33.5	18.4	12.2
Ratios (%)									
Int.inc./avg assets	7.2	7.6	7.4	7.5	7.9	8.0	8.2	8.2	8.3
Int. exp/avg assets	4.5	4.1	4.4	5.0	5.2	5.2	5.3	5.6	5.7
Net interest margin/Average assets	2.7	3.5	3.1	2.5	2.7	2.8	2.9	2.6	2.6
Non fund revenues/Avg assets	1.4	1.6	0.8	0.9	0.7	0.9	0.8	0.7	0.6
Core Fee Income / Avg assets	1.0	0.3	0.7	0.6	0.5	0.8	0.3	0.3	0.3
Operating expenses/avg assets	2.4	2.8	2.0	1.8	1.8	1.5	1.9	1.6	1.5
Tot prov/avg assets	2.5	0.9	0.6	0.5	0.8	1.1	0.9	0.8	0.7
PBT/avg assets	2.0	1.7	0.6	0.4	0.7	1.7	1.0	1.0	1.0
Return on Assets	(0.3)	1.1	1.2	1.2	0.9	0.5	1.0	0.9	0.9
Tax/PBT	N.A.	38.4	12.2	10.9	(25.4)	6.8	1.6	11.0	18.0

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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