

Syndicate Bank

CMP: ₹ 76

TP: ₹ 122

Buy

The stock of Syndicate Bank corrected sharply by almost 20% in recent sessions primarily led by concerns over deterioration in asset quality. In line with these concerns, we have also reduced our earnings estimates by 6.5% and 16% for FY12 and FY13 respectively. Accordingly we have also reduced our target price by 18% to Rs 122 at 0.9x ABV FY13.

However, we also believe that the current valuations (stock price) is reflecting a collapse of profitability and return ratios, which we find too pessimistic. Our reverse calculations suggest that the market is building in RoAA and RoAE of 0.3-0.35% and 8.5-9.5% respectively. This appears extremely unlikely to us even in the most pessimistic scenarios. Even in the worst of the times over the last decade, the bank always reported RoAA of more than 0.6%. We reiterate our BUY rating on the stock based on following rationale :

- Credit book expansion much slower than industry in last couple of years, hence we see lower risk verse peers on deterioration of book
- Build-up in gross slippages least among peers in recent quarterly results
- Continuous maintenance or step up in NPL coverage even in most strained times; PCR (including technical write-offs) is relatively higher at 79% among peers
- Deposit rebalancing aiding margin
- Management willing to sacrifice balance-sheet size for quality; foresees bottom-line growth at 25% in FY12. There would be a top management change in February'12, considering the track record of incoming CMD (Mr. M. G. Sanghvi, current ED at Bank of Maharashtra), we believe that the bank's policy of conservatism would continue
- Expectation of capital infusion in FY13 considering lower Tier I
- The stock quotes at historically cheap valuation at 0.6x FY13 ABV with 5.5% dividend yield (on FY12's dividend)

Credit book expansion much slower than industry in last couple of years: Syndicate bank prudently reduced its credit expansion pace from FY10 onwards. The bank also moderated its leveraging of balance-sheet on the back of lesser credit book expansion and equity infusion. In the current fiscal year, the bank's management expects credit growth in proximity of 18% YoY.

Financials

Year	NII	PPP	NP	NIM (%)	BV (Rs)	ABV (₹)	RoAA (%)	RoAE (%)	P/B (x)	P/ABV (x)	P/E (x)
FY10	27,398	18,737	8,133	2.1	100	87	0.6	16.6	0.8	0.9	4.9
FY11	43,828	27,738	10,720	3.0	116	101	0.7	18.0	0.7	0.7	3.8
FY12E	52,381	34,719	12,971	3.1	134	115	0.8	18.1	0.6	0.7	3.4
FY13E	59,571	40,311	15,636	2.9	156	131	0.8	18.8	0.5	0.6	2.8

Figure in ₹ mn

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BSE Sensex	15,874
NSE Nifty	4,750

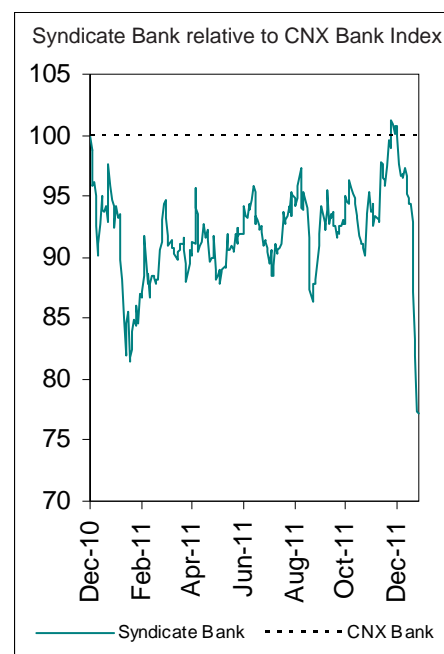
Scrip Details

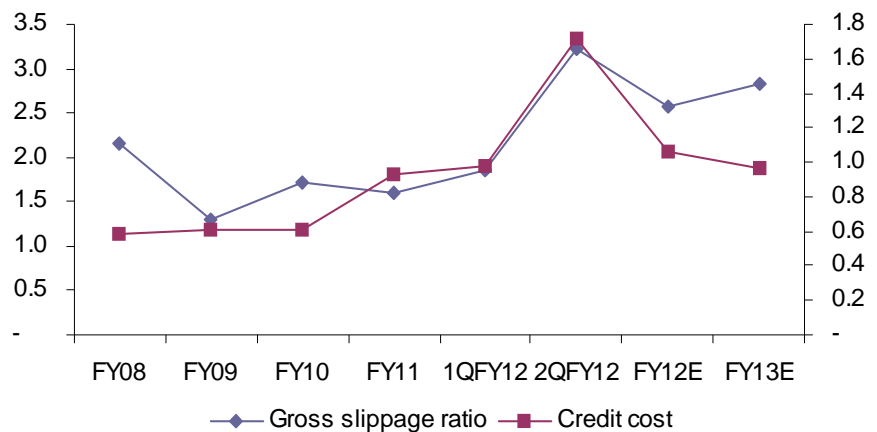
Equity	₹ 5733mn
Face Value	₹10/-
Market Cap	₹ 43.6bn
	USD 0.8bn
52 week High/Low	₹ 133 / 73
Avg. Volume (no)	1,608,352
BSE Code	532276
NSE Symbol	SYNDIBANK
Bloomberg Code	SNDB IN
Reuters Code	SBNK.BO

Shareholding Pattern (%)

Promoter	69.5
MF/Banks/FIs	12.3
FIIIs	4.4
Public / Others	13.8

as on Sept'11



Syndicate Bank's credit growth vis-à-vis Industry credit growth:


We expect credit book to grow at 18.3% CAGR in FY11-13. Major credit growth drivers would be SME, retail and industrial sectors; in retail sector housing and education loans would expand at faster pace. With respect to industrial loans, the bank's management intends to lend only to established corporates and to viable projects. In absence of satisfactory proposals, the bank is in no hurry to expand its loan book.

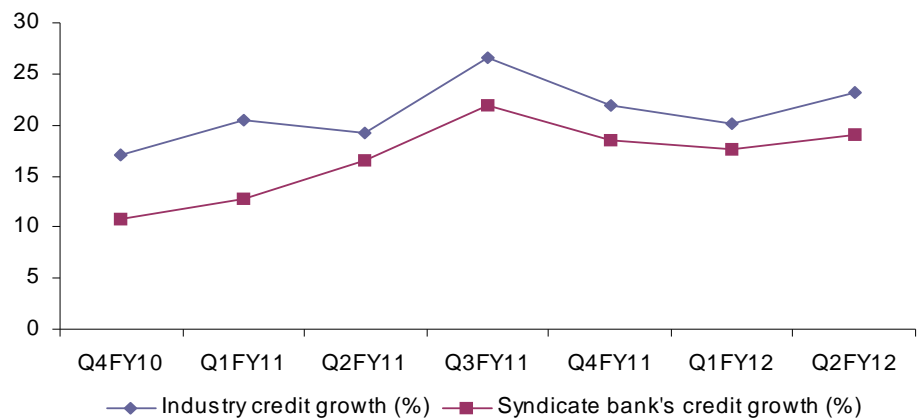
Build-up in gross slippages least among peers in recent quarterly results: Syndicate Bank reported much lesser slippages in Q2 FY12 compared to its peers. Upon the completion of migration of CBS migration in Q2 FY12, deterioration in Syndicate Bank's asset quality was much lesser, which reflects the bank's cautious approach on credit book expansion. Unlike its peers, in Q2 FY12, Syndicate Bank's GNPA ratio decreased slightly to 2.38% from 2.39% in Q1 FY12. Higher provisioning led NNPA ratio to stagnate at 0.93%. As on end-Q2 FY12, Syndicate Bank's provision coverage ratio stood at 79% (including technical write-offs) compared to its peers of 61-64%.

Gross slippage ratio of Syndicate Bank and its peers:

Particulars	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Andhra Bank	1.1	1.9	1.4	1.2	1.5	6.5
IOB	1.8	3.6	1.9	2.2	1.9	3.7
OBC	0.6	0.8	2.2	1.7	1.6	6.2
Syndicate Bank	1.4	1.6	1.7	1.6	1.8	3.2

Going forward, we foresee increase in its NPLs due to slippages in normal course of business and from restructured loan book. However, we foresee lesser slippages in its loan book than its peers. We expect the bank's slippages ratio to increase to 2.6% and 2.83% in FY12 and FY13 from 1.6% in FY11. We estimate GNPA of 2.5% and 2.8% in FY12 and FY13 respectively.

Syndicate Bank's gross slippage ratio and credit cost (%)



Source: Company & Dolat Capital

The bank has exposure to Tamil Nadu and Rajasthan state electricity boards (SEBs). Bank's loans to SEBs would go for restructuring in the 2HFY12. In power sector, the bank has exposure to generation companies and distribution to the tune of Rs 50bn and Rs 40bn respectively. In Infrastructure sector, the bank exposure to Lanco group to the tune of Rs 6bn. In aviation sector, the bank's exposure to Air India is to the tune of Rs 12bn. The bank does not have any exposure to Kingfisher airline.

Bank's credit exposure to vulnerable sectors:

Particulars	Credit Exposure (Rs mn)	% to total Fund & Non Fund Exposure
Infrastructure	158,690	12.7
Power	112,500	9.0
SEBs	20,000	1.6
Iron and Steel	42,810	3.4
Construction	27,630	2.2
Textiles	16,300	1.3
Gems and Jewellery	7,340	0.6
Aviation	12,000	1.0

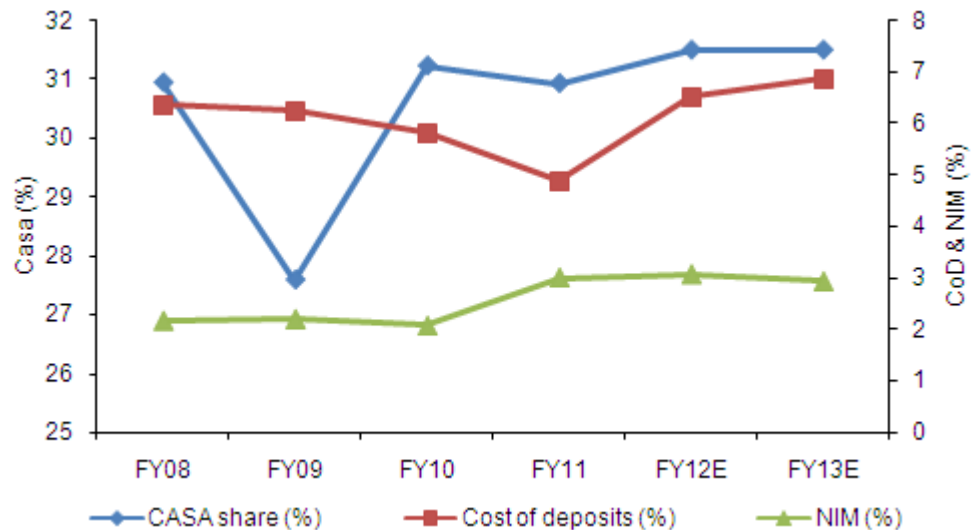
Source: Company & Dolat Capital

Continuous step up in NPL coverage even in most strained times: In Q2 FY12, the bank's asset quality remained under control with GNPA and NNPA at 2.38% and 0.93% respectively. The bank's much higher provision coverage ratio at 79% provides comfort to future NPL provisioning in prevailing turbulent scenario.

On the back of an expected increase in its restructured book and slippages therein, we expect gross NPAs to rise to 2.8% in FY13 from 2.4% as of end-March'11. We estimate provision coverage to further improve to 63% (excluding write-offs) from 60% as of end-FY11.

Deposit rebalancing aiding margin: During FY11 and 1HFY12, due to moderate balance-sheet growth and widespread branch network, the bank could maintain a high composition of low-cost deposits at 31% level. On liability-side, the bank management's lesser business growth expectations would continue to aid margin.

Syndicate Bank's CASA, CoD & NIM (%)



Source: Banks, Dolat Research

In recent preceding quarters, the bank's margin improved on the back of hikes in lending rates. In coming quarter, the bank's margin could stabilise at Q2 FY12 level. Going forward, in FY13, we factor in 14 bps decline in margin to 2.95% (on yearly average basis) mainly due to expected decline in interest rates.

Management willing to sacrifice balance-sheet size for quality; foresees bottom-line growth at 25% in FY12: The bank's management prefers to rather take a hit on margin and balance-sheet expansion pace and aim to protect asset quality.

On credit book front, the bank focus areas are priority sector and retail (mostly housing loans). On large-ticket industrial loans, the bank has a clear roadmap to sanction loans only to established corporate houses and viable projects. The bank puts more emphasis on quality and soundness of corporate houses.

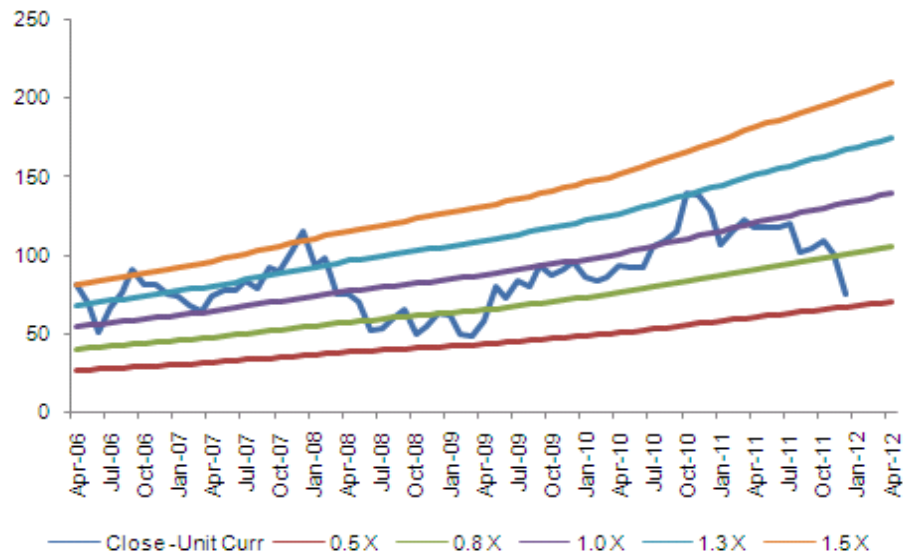
Expectation of capital infusion in FY13: As on end-Sept'11, the bank had capital adequacy ratio of 11.8% with tier I capital at 8.6%. In FY13, the bank is expected to receive capital infusion from the government.

Change in guard in February'12: The bank's current CMD (Mr. Basant Seth) would come for retirement in end-January'12. Thereafter, Bank of Maharashtra's current ED (Mr. M. G. Sanghvi) would take over. Considering the track record of the latter, we believe that the bank's policy of conservatism would continue, which would result in sustainable growth in profitability with comfortable asset quality.

Valuation

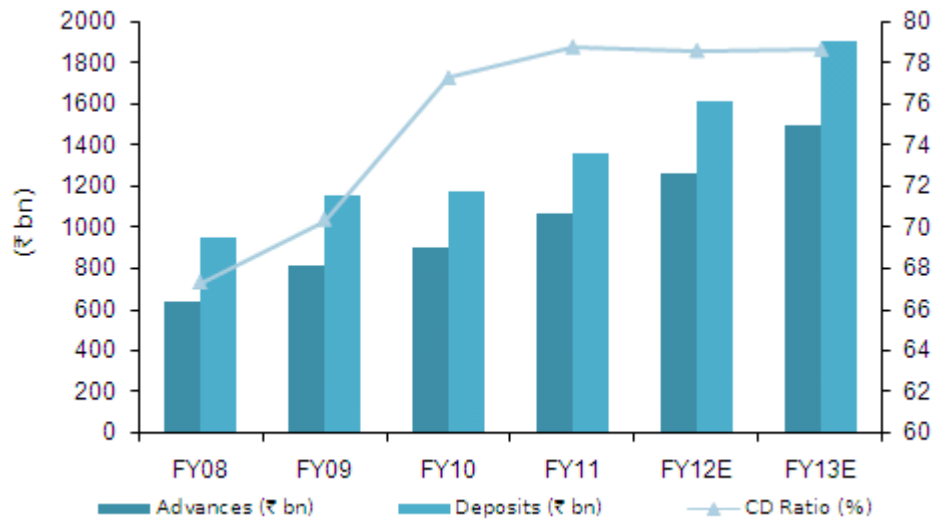
We estimate that the bank would report RoAA of ~0.75% and RoAE of 18-18.5%. Considering the concern over asset quality, we reduce our earnings estimates for FY12 & FY13 by 6.5% and 16% respectively. We reduce our target price by 18% to Rs 122. We reiterate our Buy rating on the stock with a price target of Rs 122 at 0.9x adjusted book value FY13. At current price, the stock quotes at 0.6x ABV FY13. The stock is available at an attractive dividend yield of 5.5% (on FY12's dividend). At current price, the stock quotes at historically lower valuation.

Syndicate Bank's P/ABV Chart:



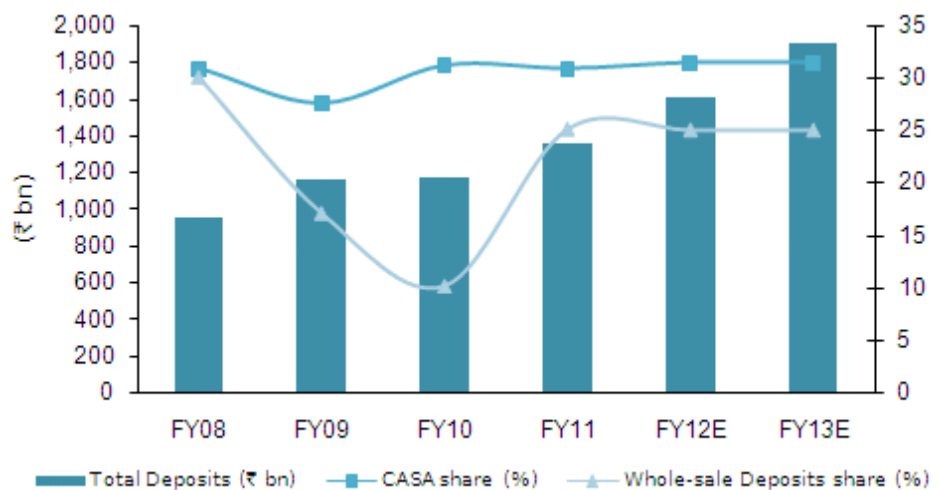
source: Capital Line, Dolat Research

Syndicate Bank's Business Mix



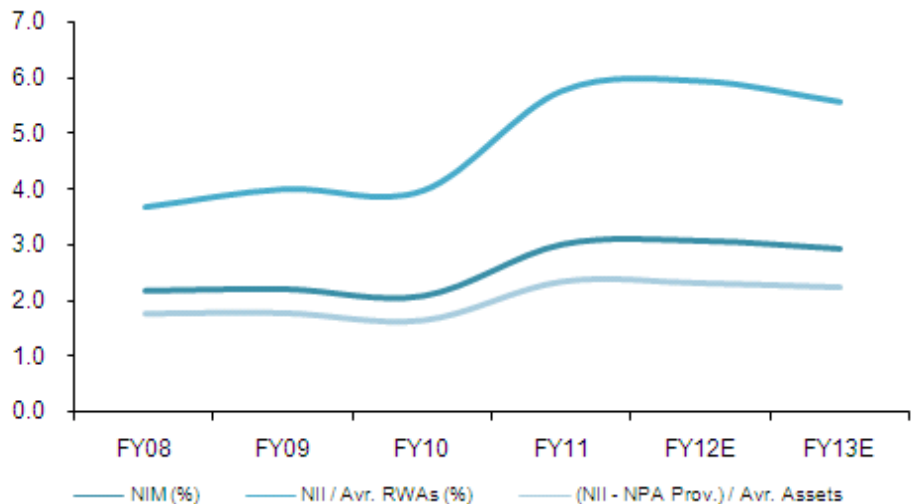
Source: Banks, Dolat Research

Syndicate Bank's CASA & Whole-sale Deposit share (%)



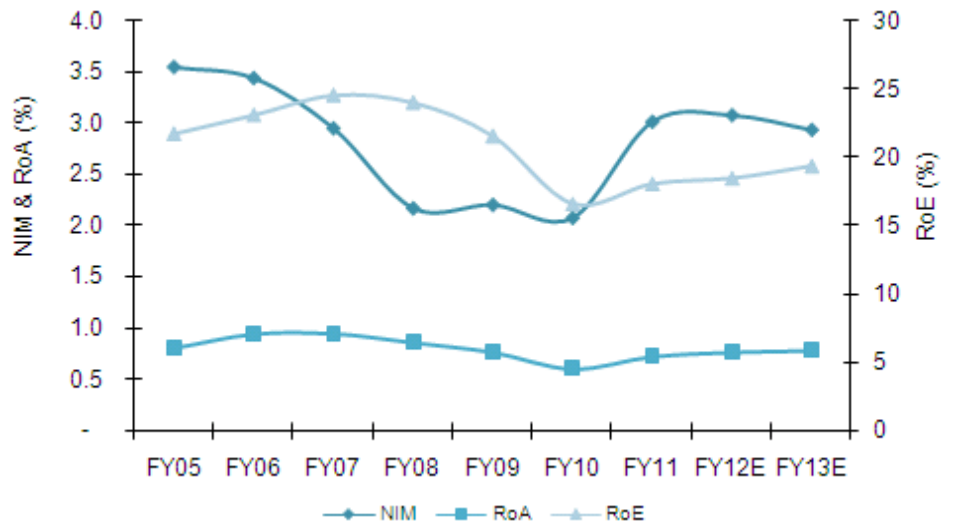
Source: Banks, Dolat Research

Syndicate Bank's margin, Risk-adjusted margins (%)



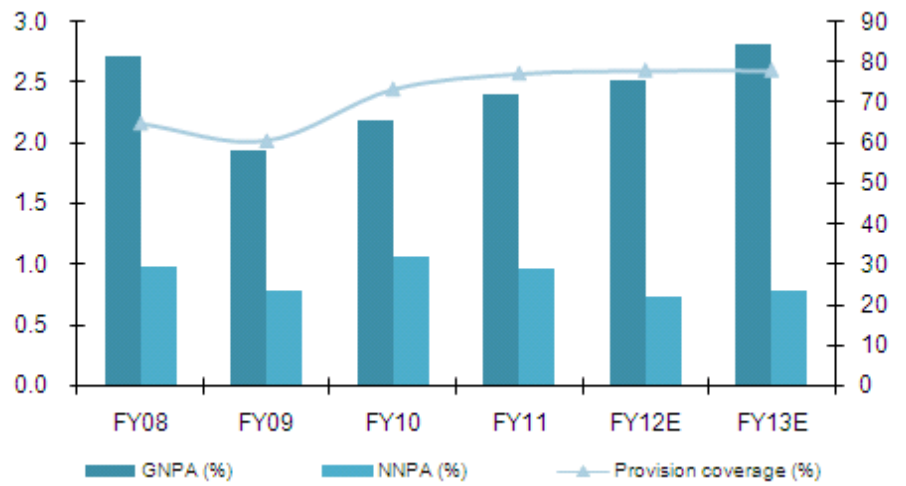
Source: Banks, Dolat Research

Syndicate Bank's Return Ratios (%)



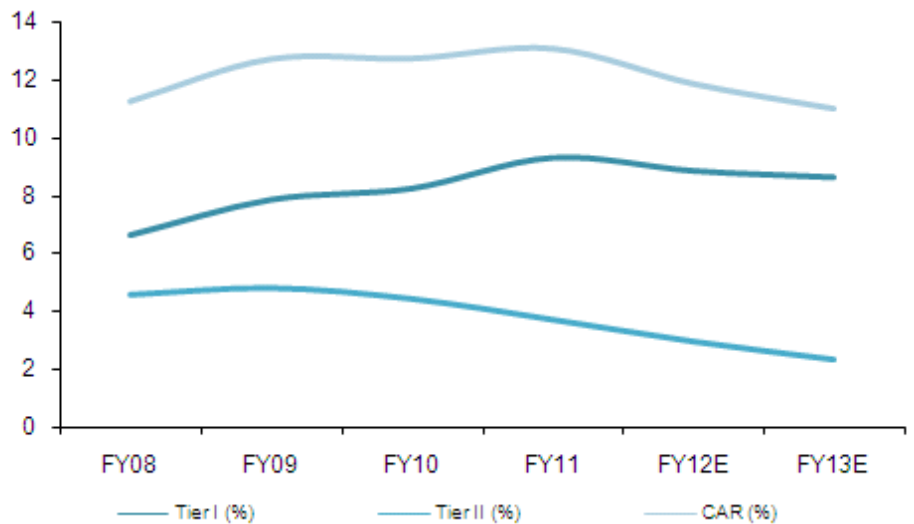
Source: Banks, Dolat Research

Syndicate Bank's Asset Quality



Source: Banks, Dolat Research

Syndicate Bank's Capital Adequacy



Source: Banks, Dolat Research

INCOME STATEMENT					IMPORTANT RATIOS				
Particulars	₹ m n				Particulars	Mar10	Mar11	Mar12E	Mar13E
	Mar10	Mar11	Mar12E	Mar13E					
Net Interest Income	27,398	43,828	52,381	59,571	DPS (₹)	3.0	3.7	4.2	5.0
CXB	3,630	4,422	4,950	5,655	Book Value (₹)	100	116	134	156
Profits on sale of investments	3,889	352	580	400	Adjusted Book Value (₹)	87	101	115	131
Profits on foreign exchange	682	979	1,130	1,310	EPS (₹)	16	20	23	27
Other operating income	3,474	3,398	3,784	4,185	EPS Growth (%)	-11	29	13	21
Total other income	11,675	9,151	10,444	11,550	Payout (%)	19	18	19	18
Total Income	39,073	52,979	62,825	71,121	Net interest margin (%)	2.1	3.0	3.1	2.9
Salaries	13,378	17,733	19,310	20,600	Spread (%)	1.7	2.7	2.6	2.5
Other operating costs	6,958	7,508	8,796	10,210	Cost-to-income (%)	52.0	47.6	44.7	43.3
Total Overheads	20,336	25,241	28,106	30,810	ROAA				
Profit before provisions	18,737	27,738	34,719	40,311	Net Interest Income	2.0	3.0	3.0	2.9
Bad Debt Provisions	5,306	9,290	12,930	14,655	Other Income	0.9	0.6	0.6	0.6
Std. Asset Provision	0	246	928	995	Less Overheads	-1.5	-1.7	-1.6	-1.5
Investment Provisions	-446	387	1,520	1,550	Less Provisions	-0.5	-1.0	-1.1	-1.0
Other provision	2,137	4,720	3,860	3,655	Less Tax	-0.3	-0.2	-0.1	-0.2
Total provisions	6,997	14,644	19,238	20,855	ROAA	0.6	0.7	0.8	0.8
Profit before tax	11,740	13,095	15,481	19,456	ROAE	16.6	18.0	18.1	18.8
Tax	3,607	2,375	2,510	3,820	Valuation				
Reported Net profit	8,133	10,720	12,971	15,636	Price Earnings (x)	4.88	3.79	3.36	2.79
					Price to Book Value (x)	0.76	0.65	0.57	0.49
					Price to Adjusted BV (x)	0.87	0.75	0.66	0.58
					Dividend Yield (%)	3.95	4.87	5.53	6.58
					Asset Quality				
					Gross NPLs	20,068	25,990	33,418	46,391
					Restructured standard Loans	40,022	45,285	71,200	97,500
					Gross Impaired Loans	60,091	71,275	104,618	143,891
					Net NPLs	9,632	10,308	12,947	17,845
					Provision coverage ratio (%)	52.0	60.3	61.3	61.5
					Gross NPLs (%)	2.2	2.4	2.6	3.0
					Net NPLs (%)	1.1	1.0	1.0	1.2
					Assumptions				
					Yield on Advances (%)	8.95	9.33	10.90	11.00
					Yield on Investment (%)	7.14	6.49	6.75	6.80
					Cost of Deposits (%)	5.82	4.90	6.55	6.88
					Interest Inc. on Cash (%)	0.38	0.09	0.08	0.10
					CRAR (%)	12.70	13.04	11.82	10.98
					Growth in credit book (%)	10.9	18.1	18.6	18.1
					Growth in Deposits (%)	1.0	15.9	18.8	18.1
					Growth in Investments (%)	8.1	6.2	32.2	16.1
					Gross slippages ratio (%)	1.71	1.59	2.66	2.84
					Credit Cost (%)	0.61	0.93	1.09	1.04
					E-estimates				

BALANCE SHEET				
Particulars	₹ m n			
	Mar10	Mar11	Mar12E	Mar13E
Cash with RBI	71,891	104,431	107,996	127,212
Cash at call	55,447	15,225	18,820	23,296
Total Cash	127,339	119,657	126,816	150,508
Govt. securities	282,863	303,025	398,576	462,585
Other investments	47,246	47,651	64,884	75,305
Total Investments	330,109	350,676	463,460	537,890
Bills discounted	11,643	15,093	25,319	29,911
Cash credit	472,756	547,976	645,624	329,021
Term loans	419,665	504,751	594,987	1,136,618
Total Credit	904,064	1,067,819	1,265,930	1,495,550
Gross Fixed Assets	12,792	13,478	15,700	16,597
Accumulated Depreciation	5,967	6,707	7,655	7,855
Net Fixed Assets	6,825	6,770	8,045	8,742
Capital work in progress	190	157	0	0
Other Assets	21,984	20,309	26,935	28,090
Total Assets	1,390,509	1,565,388	1,891,186	2,220,780
Demand Deposits	101,861	107,388	128,873	152,154
Savings Deposits	263,647	312,066	378,564	446,951
Term Deposits	804,750	936,507	1,103,473	1,302,815
Total Deposits	1,170,258	1,355,961	1,610,909	1,901,920
Perpetual Debts (IPDI)	7,730	7,730	9,030	11,730
Upper Tier II Capital	8,197	8,197	9,197	10,197
Subordinate Debt	20,250	19,250	20,250	21,750
Other Borrowings	85,550	60,099	87,580	101,520
Total Borrowings	121,727	95,276	126,057	145,197
Other liabilities	42,254	43,642	73,561	80,724
Equity	5,220	5,733	5,733	5,733
Reserves	51,051	64,776	74,927	87,206
Total Equity	56,270	70,508	80,660	92,939
Total Liab & Equity	1,390,509	1,565,388	1,891,186	2,220,780



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BUY	Upside above 20%
ACCUMULATE	Upside above 5% and up to 20%
REDUCE	Upside up to 5%
SELL	Negative Returns

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