October 4, 2010

Syndicate Bank (SYNBN)

₹ 120

Rating Matrix

Rating	:	Strong Buy
Target	:	₹ 144
Target Period	:	12 months
Potential Upside	:	20%

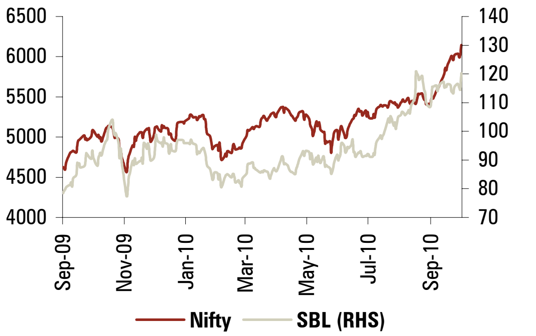
Performance highlights

Amt in crore	FY09	FY10	FY11E	FY12E
NII	2548	2740	3431	4049
PPP	1671	1874	2390	2829
PAT	913	813	1095	1381

Stock Metrics

Bloomberg Code	SNDB:IN
Reuters Code	SBNK.BO
Face Value (Rs)	10
Market Cap (Rs cr)	6,264
52 week H/L	123 / 76
Sensex	20,445
Average volumes (BSE)	125,000

Price movement



Comparable return matrix (%)

Company	1m	3m	6m	12m
SBL	3.9	25.6	32.7	26.1
Corporation Bank	18.2	34.4	44.7	64.1
Andhra Bank	3.1	23.4	47.3	52.5
Indian Bank	12.1	26.7	59.4	71.0
Vijaya Bank	1.4	32.6	70.0	63.2

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In consolidation and transition phase...

Syndicate Bank (SBL) is a mid-sized public sector bank with over 80 years of expertise and spread across India through 2,364 branches. The bank is in a consolidation phase where we see the business mix growing at 16% CAGR to ₹ 278,580 crore over FY10-12E (vs. 20% CAGR expected for industry) supported by 16% CAGR in both advances (vs. 32% CAGR in FY05-09) and deposits (vs. 26% in FY05-09). We anticipate that incremental slippages will ebb from H2FY12E supporting bottomline growth. We expect 30% CAGR in PAT over FY10-12E to ₹ 1381 crore.

Better liability management to help maintain NIM ~3%

The bank is improving its core banking parameters by reducing the dependence on high-cost bulk deposits (share down to less than 10% in Q1FY11 vs. ~30% in FY08). The bank is also focusing on higher accumulation of low cost deposits, which now stand at ~39% (CASA at 36% plus 3% NRI deposits) in total deposits for Q1FY11 against avg. 34% in FY06-09. This helped the bank to control cost of deposit from 6.6% in Q1FY10 to 5.3% in Q1FY11E and pushed up the NIM to over 3% (reported). The improved liability profile will, help maintain NIM above at current level of ~3% in our investment horizon.

Asset quality concern to recede from FY12E

The management expects slippages in the bank's restructured assets, which now stand at ₹ 4,500 crore in Q1FY11, to peak at ~18-20% by H1FY12E (only 3.3% slipped till date). As a result, we expect asset quality concerns to remain high in the coming three or four quarters. However, SBL's improved focus on loan quality (internal and external rating system now adopted for loan appraisal) and high provision cover (74% in FY10) reduces our balance sheet concern, going forward. We see GNPA at 2.1% and NNPA at 1.04% for FY12E.

Valuations

At the CMP of ₹ 120, the stock is trading at an attractive 1.2x FY12E P/ABV. We expect the bank's asset quality concern to recede in FY12E on the back of high provision cover and the management's focus on high quality loan portfolio. We expect SBL's NIM to stay at peak levels of above 3% (reported) till FY12E leading to improved bottomline and deliver RoE of 20% and RoA of 0.8% in FY12E. We value SBL at 1.4x FY12E ABV and arrive at a TP of ₹ 144 and initiate coverage with a **STRONG BUY** rating.

Exhibit 1: Key Financials*

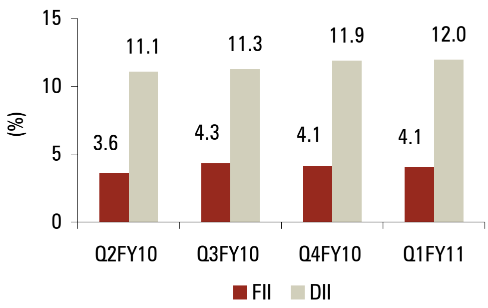
	FY08	FY09	FY10	FY11E	FY12E
Net Profit (₹crore)	848.1	912.8	813.3	1094.6	1380.6
EPS (₹)	16.2	17.5	15.6	21.0	26.4
Growth (%)	18.4	7.6	-10.9	34.6	26.1
P/E (x)	7.4	6.9	7.7	5.7	4.5
ABV (Rs)	62.1	75.9	81.6	93.6	102.7
Price / Book (x)	1.6	1.4	1.2	1.0	0.9
Price / Adj Book (x)	1.9	1.6	1.5	1.3	1.2
GNPA (%)	2.8	2.0	2.2	2.2	2.1
NNPA (%)	1.0	0.8	1.1	1.1	1.0
RoNA (%)	0.9	0.8	0.6	0.7	0.8
RoE (%)	21.4	19.6	15.3	18.2	20.5

*Source: Company, ICICIdirect.com Research, *Standalone financials*

Shareholding pattern (Q1FY11)

Shareholders	Holding (%)
Promoter (GOI)	66.5
Institutional Investors	16.1
Others	17.5

Promoter & Institutional holding trend (%)

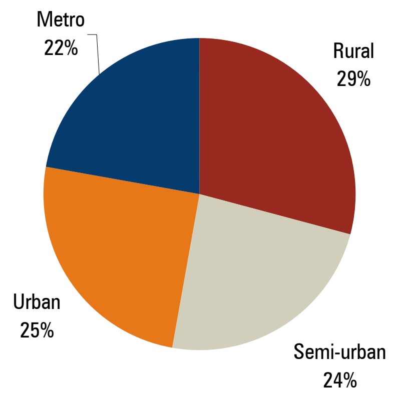


Company Background

Incorporated in 1925, Syndicate Bank (SBL) is one of the oldest banks in India. After its nationalisation in 1969, the government of India owns a majority share in the bank (66.5%). As on Q1FY11, the bank reported a business mix (advances and deposits) of ₹ 2,02,622 crore and had a pan-India presence with a total of 2,364 branches. SBL has a dominant presence in South India with ~45% branches located in Karnataka and Andhra Pradesh.

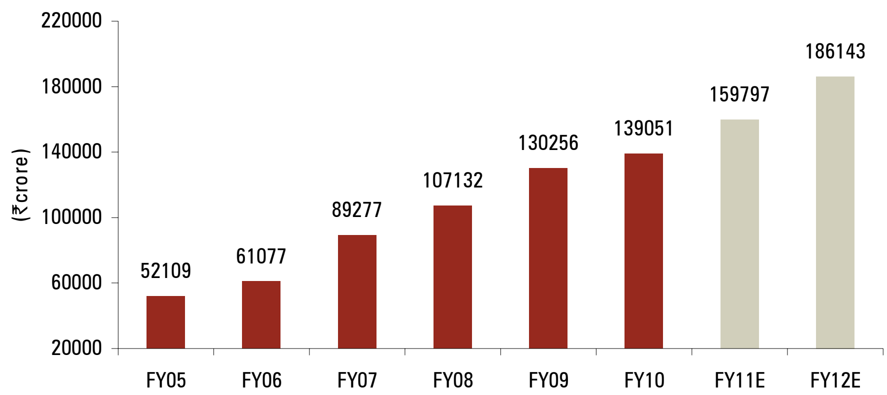
With the eighth-largest branch network and tenth-largest asset book among Indian banks, SBL has emerged as a strong player in the domestic market. Headquartered in Manipal, Karnataka, the bank is headed by Basant Seth and has employee strength of 27,713 (March 2010).

Exhibit 2: Domestic advances by sector (FY10)



Source: Company, ICICIdirect.com Research

Exhibit 3: Balance sheet growth



Source: Company, ICICIdirect.com Research

SBL is in a transition and consolidation phase

Investment Rationale

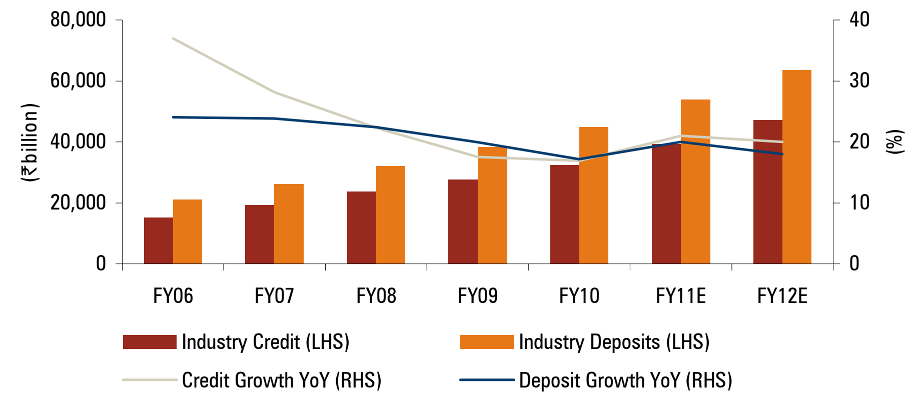
We see a moderate 16% CAGR in the business mix to ₹ 2,78,580 crore over FY10-12E, lower than the expected industry growth of 20%. SBL is currently in a consolidation phase as the bank has strategically reduced its dependence on high-cost bulk deposits (share down to less than 10% of total deposits in Q1FY11 vs. ~30% in FY08) and improved its CASA franchise (33.3% in FY10 vs. 29.4% in FY09). As a result, SBL's cost of funds has reduced by 135 bps YoY to 5.3% in Q1FY11, leading to improved NIMs (3.1% in Q1FY11 vs. 2.1% in Q1FY10). However, the asset quality of the bank will be under pressure in the interim. We expect pressure on NPA addition to ease from H2FY12E. The bank maintains a high provision cover (74% in Q1FY11). Overall, we expect the transition phase (till H1FY12) to lay a foundation for a swift take-off post H2FY12E.

A pick-up in the domestic credit environment and strong deposit mobilisation will support growth of 16% CAGR in SBL's business mix in FY10-12E

Business mix consolidating now for smooth transition

After a high growth period in FY05-09 where the bank registered a balance sheet growth of 26% CAGR, the bank has now entered a consolidation phase to make a base for a swift pick-up from FY12E. We expect SBL's business mix (deposits and advances) to grow at 16% CAGR (lower than expected industry growth) to ₹ 278,580 crore in FY10-12E (vs. 5%YoY growth in FY10). The C/D ratio is expected to stay at the higher end and is seen at 76% levels for FY12E.

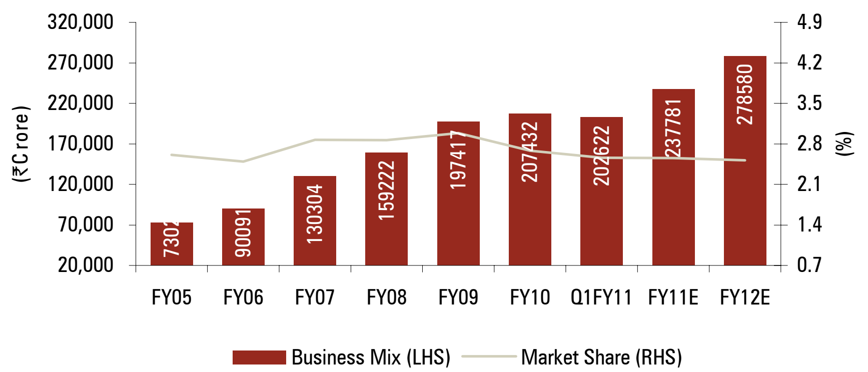
Exhibit 4: Industry business mix expected to grow at 20% CAGR over FY10-12E



Source: RBI monthly bulletin, ICICIdirect.com Research

SBL's market share for total business done by SCB is expected to marginally decline to 2.5% in FY12E vs. 2.7% in FY10

Exhibit 5: Business mix to grow lower than industry in near term



Source: RBI, Company, ICICIdirect.com Research

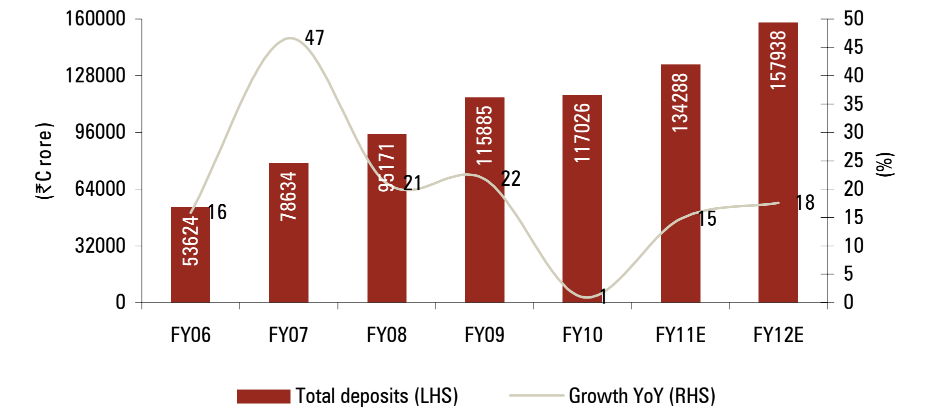
Strong branch network, rising deposit rates and focus on CASA deposits will drive SBL's deposit franchise

Improved quality of deposits to help improve NIM

After witnessing a robust growth of 26% CAGR in FY05-09, SBL's total deposits grew by merely 1% YoY in FY10 to ₹ 1,17,026 crore primarily due to de-growth witnessed in term deposits (-4% YoY vs. 28% YoY in FY09). The decline in term deposits was strategically driven to reduce the bank's dependence on high-cost bulk deposits (share reduced to less than 10% vs. ~30% in FY08), resulting in decreased interest costs (cost of funds reduced to 5.3% in Q1FY11 vs. 6.6% in Q1FY10). Also, SBL has strongly benefited from the high CASA deposit (share of 33% in total deposits in FY10 vs. 29% in FY09 and against 32% for the industry). This has helped the bank to keep a check on cost of deposits (CoD).

We expect SBL's total deposits to witness a rebound with higher growth from retail deposits in FY10-12E (16% CAGR to ₹ 157938 crore) proving beneficial on the back of the current rising interest rate environment. The bank has already increased deposit rates by ~50-75 bps across various maturities, recently. Further, SBL's strong pan-India presence of 2,364 branches (eighth largest in India) and the management's focus on high CASA mobilisation will boost the deposit franchise and control the CoD for the bank, going forward.

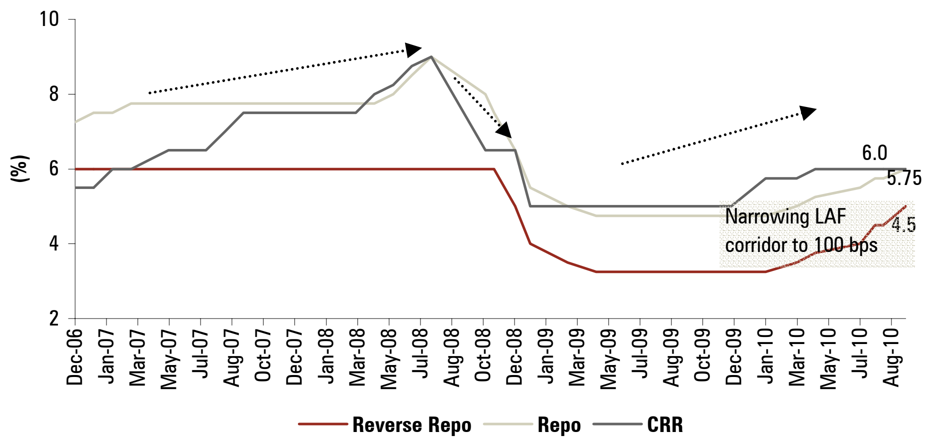
Exhibit 6: Deposits to grow at 16% CAGR in FY10-12E



Source: Company, ICICIdirect.com Research

The bank is better placed in a rising rate environment since the share of retail deposits is inching up

Exhibit 7: Rising rate environment



Source: RBI policy announcements, ICICIdirect.com Research

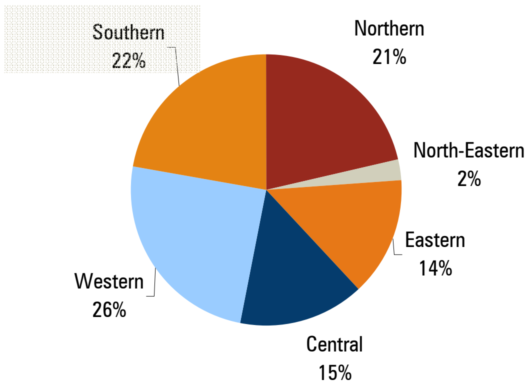
CASA mobilisation is supported by a large branch network in southern states for SBL

For Q1FY11, CASA for SBL stood at 36%

…and well supported by high CASA mobilisation…

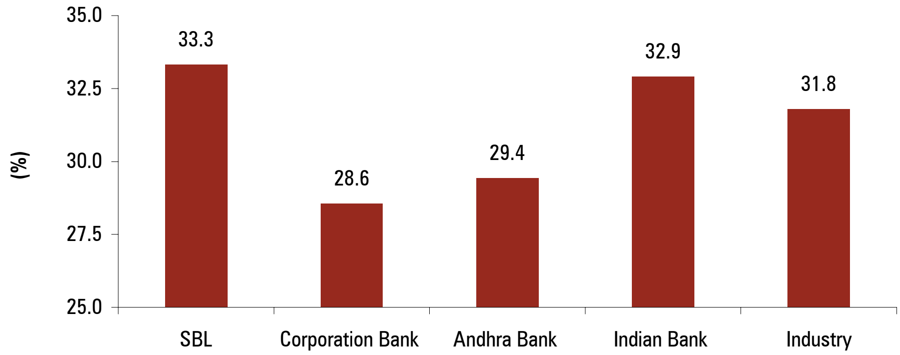
With ~60% of total branches in the southern states, SBL has historically benefited from high CASA deposits (accounting for an average of 34% of total deposits in FY06-10) as southern states accounted for second-highest CASA mobilisation among all regions in India. During FY10, SBL's CASA ratio improved to 33% (vs. 29% in FY09) benefiting from lower term deposit growth, which resulted in lower funding costs for the bank.

Exhibit 8: Region wise CASA mobilisation in FY09 (Industry)



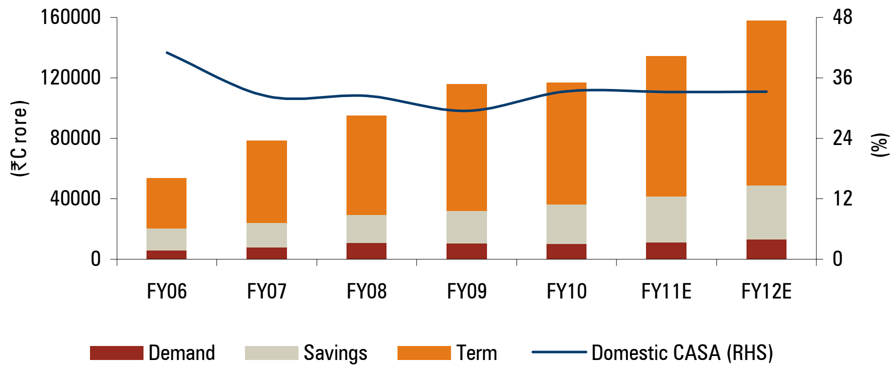
Source: RBI Trend and Progress 2009, ICICIdirect.com Research

Exhibit 9: SBL had highest CASA levels compared to its peers in FY10



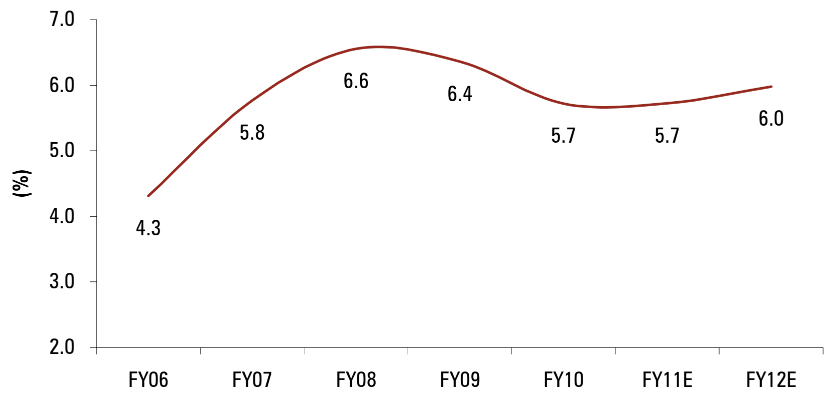
Source: Company specific press release, ICICIdirect.com Research

Exhibit 10: Domestic CASA to remain high at 33% in FY10-12E…



Source: Company, ICICIdirect.com Research

Exhibit 11: …resulting in stable cost of funds for SBL



Source: Company, ICICIdirect.com Research

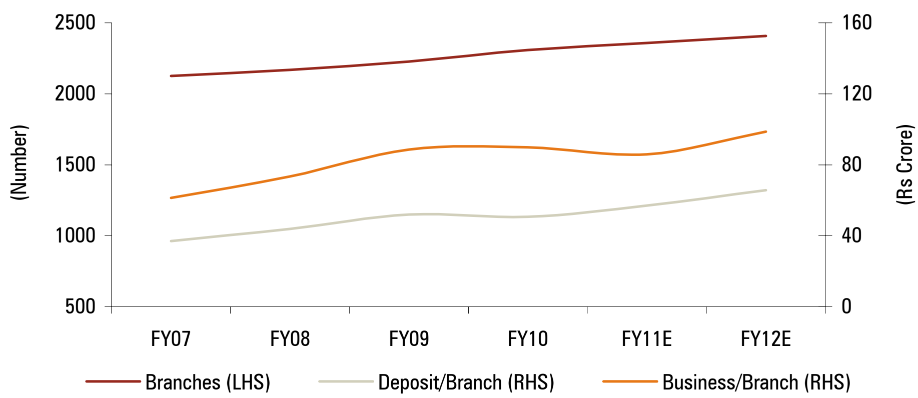
SBL is focusing on Tier II and Tier III cities for branch expansion

…and strong branch network

We expect SBL's CASA level to remain stable in our forecast period (average of 33% in FY11E-12E) supported by the bank's branch addition plans (~200 new branches) in the next two or three years and increased focus on retail deposits.

Further, the introduction of the new rule of calculating interest on savings accounts on a daily basis (from April 1, 2010) will increase the yield for customers, leading to improved saving deposit mobilisation in the near term for the industry. This is also likely to benefit SBL. In our view, the management's focus on improving the branch network in Tier II and Tier III cities and high saving rate of customers in these cities will augur well for the low-cost saving deposits base of the bank.

Exhibit 12: Robust branch expansion plan to boost deposit growth in FY10-12E



Source: Company, ICICIdirect.com Research

Expanding the branch network and increased focus on retail deposits will help SBL to maintain CASA at 33% for FY121E.

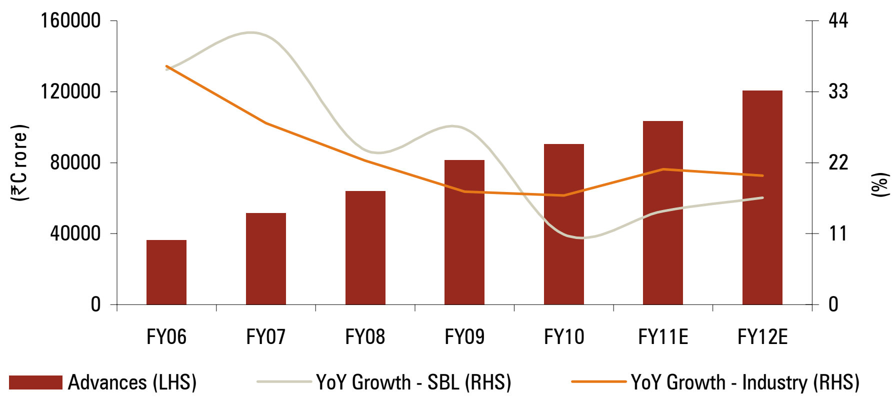
SBL's loan book growth will moderate at 16% CAGR in FY10-12E after witnessing robust growth in the past few years

Moderate loan book growth in FY10-12E…

During FY06-09, SBL's loan book witnessed robust growth of 32% CAGR to ₹ 81532 crore (higher than the 26% CAGR for the industry). However, the bank's credit expansion moderated to 11% in FY10 (vs. 17% for the industry) primarily due to rising slippages (GNPA rose by 26% YoY to ₹ 2007 crore in FY10 vs. decline of 10% YoY in FY09) and the slowdown witnessed in the domestic market.

We believe the strong credit expansion in the domestic market will be fuelled by rising industrial capex (primarily from infrastructure sector and corporate working capital requirements) and expectation of strong economic growth (GDP expected to grow by 8.5% and 9% in FY11E and FY12E, respectively). We are still cautious on SBL's loan book growth prospects as the management is expecting further slippages in restructured assets (cumulative ₹ 4500 crore in Q1FY11). As a result, we forecast that SBL's loan portfolio will grow at 16% CAGR to ₹ 120642 crore in FY10-12E (slower than 20% CAGR expected for the industry).

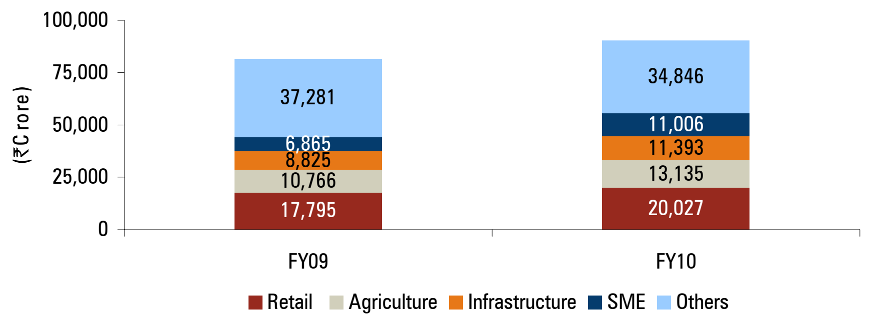
Exhibit 13: Moderate loan growth expected in FY10-12E



Source: RBI, Company, ICICIdirect.com Research

SBL has strong credit exposure in the retail sector (accounting for 22% share in total advances in FY10) with housing and mortgage loans constituting ~50% of the total retail advances and the other major segment being infrastructure with ~11% share. The bank has started disbursing gold loans to its retail customers in FY10 as these loans generate higher yields (~12-13%) compared to the traditional retail loan portfolio. On the other hand, the share of personal loans in total retail portfolio decreased to 25% in FY10 (vs. 27% in FY09) indicating the management's strong intention to reduce higher slippages from these loans, going forward.

Exhibit 14: Retail advances account for more than one-fifth of total advances in FY10



Source: Company, ICICIdirect.com Research

…NIM to stay ~3% in near term

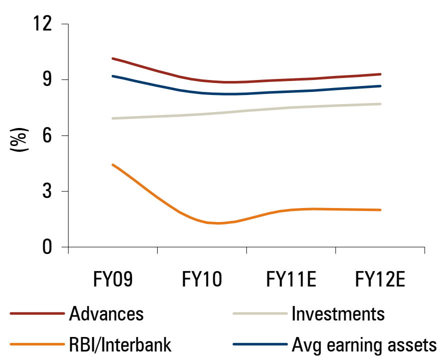
With the significant reduction in high-cost bulk deposits and high C/D ratio (76% in FY12E vs. 67% average for FY06-08), we therefore expect SBL's NIM to stay ~3% in FY10-12E. In our view, SBL will enjoy a favourable interest spread, primarily driven by the expectation of rising interest rates in the economy and robust credit expansion (rising industrial capex to lead to strong working capital requirement and term loans in the industry). As a result, the yields on advances are expected to improve to 9.3% in FY12E (vs. 9% in FY10). Further, we expect that SBL's cost of deposits will rise by ~32 bps to 6.1% in FY10-12E (slower than the ~35 bps increase in yields on advances) aided by high level of CASA deposits.

The bank has changed its tag in call money market from lender to borrower. This comes on back of bank's strategy to bring in new business only where spreads are positive. This will also help maintain NIM

During Q1FY11, SBL's NIM improved impressively to 3.1% accentuated by disposal of high-cost bulk deposits. The re-pricing benefits on the bulk-deposits and increased focus on CASA deposits (share of 33% in domestic market in FY10 from 29% in FY09) significantly aided the improvement in NIMs for the bank.

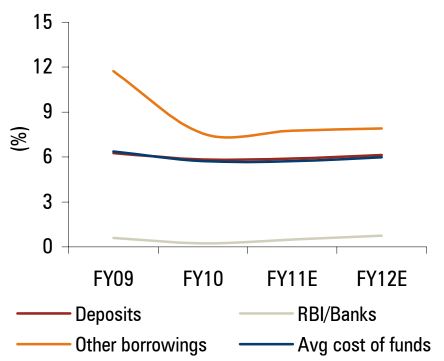
NIMs are supported by favourable interest spread

Exhibit 15: Interest yields set to improve



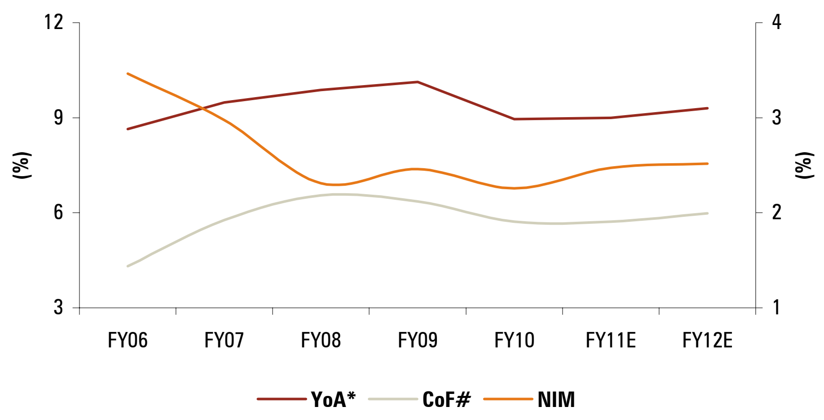
Source: Company, ICICIdirect.com Research

Exhibit 16: while cost of funds to remain stable



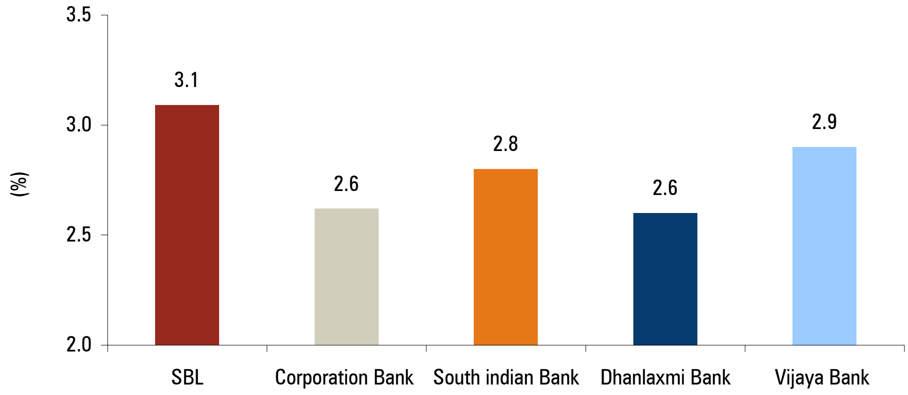
Source: Company, ICICIdirect.com Research

Exhibit 17: NIMs on an uptrend during FY11E-12E after witnessing decline in FY10



*Source: Company, ICICIdirect.com Research, *Yield on Advances, # Cost of Funds*

Exhibit 18: NIM of SBL on the higher side vs. other south-based banks (Q1FY11)



Source: Company, ICICIdirect.com Research

We believe NIMs will stay at current levels of ~3% for SBL, well supported by stable growth in low cost deposits and falling share of high cost bulk deposits. In a rising interest rate scenario where we have already seen the deposits rate inching up and ~125-150 bps in bulk deposits, the strategy seems to be well planned to protect the NIM. On other hand we expect CD ratio to remain at higher end for the bank at 76% which will aid to NIM.

With high restructured assets of ~5% of the loan book, the asset quality will remain a concern for SBL in the next two or three quarters

Of ₹ 4500 crore of restructured assets, ~33% is from big real estate players. The management indicated that these dues are now paid in time and no defaults expected from this segment

Incremental slippages are expected to moderate from H2FY12E

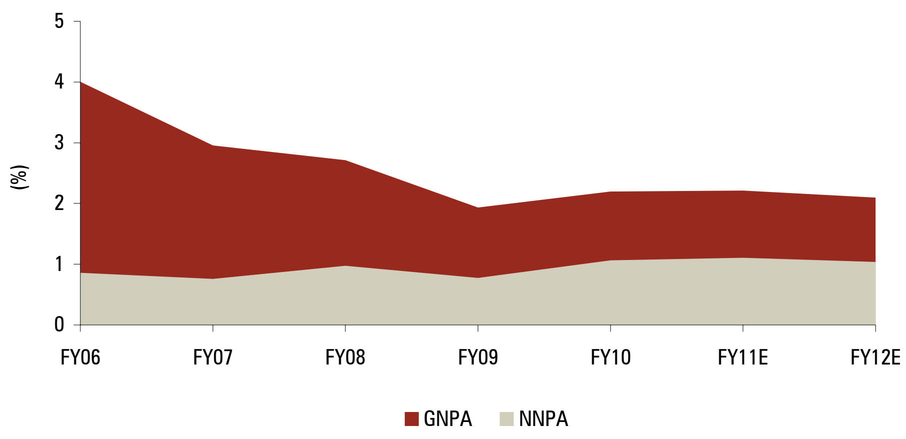
Asset quality fragile but under control

During FY10, SBL's GNPA rose to 2.2% of gross advances (vs. 1.9% in FY09) primarily contributed by the service sector followed by corporate and personal loans. The trend of slippages continued with the GNPA ratio increasing to 2.3% in Q1FY11. SBL's deteriorating asset quality is primarily due to the aggressive loan growth policy adopted by the management during the period FY06-FY09 (loan growth at 31% CAGR vs. 23% for the industry).

In Q1FY11, SBL's cumulative restructured assets stood at ₹ 4,500 crore, accounting for 4.8% of the loan book, which was on the higher side as compared to its peers (3.8% for the industry and 4.3% for the public sector banks). According to the management, slippages in restructured assets are expected to peak at ~18-20% in the next few quarters (from the current 3.3% at ₹ 150 crore in Q1FY11), raising concerns that more pains are in the offing. As a result, we expect the GNPA ratio to remain high at 2.4% in FY11E.

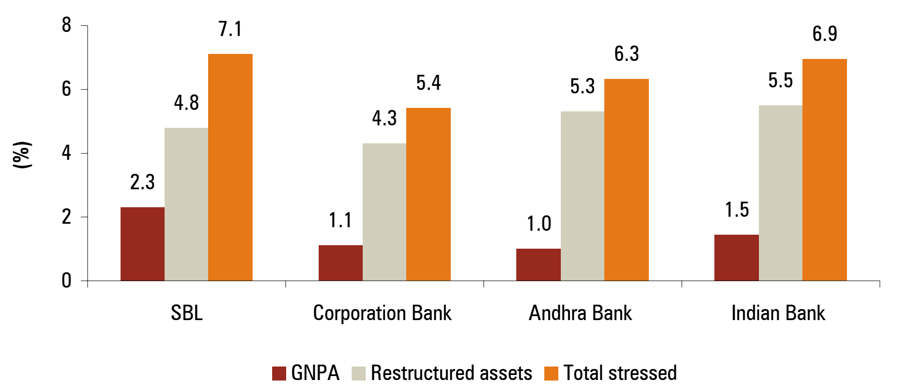
However, the high provision cover (74% in Q1FY11) and adequate capital adequacy ratio (CAR of 12.4%) provide a significant cushion to the bank for any near-term contingency. Also, the management is increasingly focusing on the quality of loan assets rather than high growth. Hence, we see incremental slippages moderating from H2FY12E.

Exhibit 19: Asset quality: Under focus



Source: Company, ICICIdirect.com Research

Exhibit 20: SBL had high share of stressed assets in Q1FY11 as compared to its peers



Source: Company, ICICIdirect.com Research

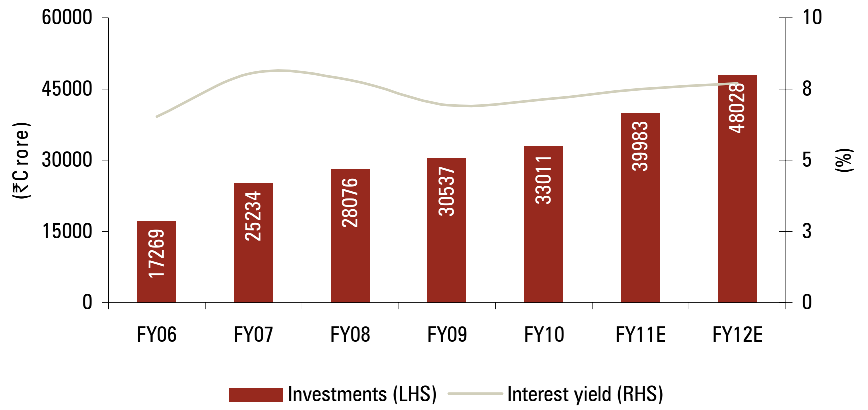
The large HTM portfolio will provide a cushion against significant MTM loss for the bank

MTM loss limited due to high share of HTM investments

During FY10, SBL reported a total investment book of ₹ 33,011 crore out of which ~85% of the investments were in the HTM category. As a result, the bank is well placed against the current rising interest rate environment (yields on 10-year government bonds are hovering in the range of 7.8% at present). Further, the AFS portfolio of SBL is hedged up to 8.1%, leaving little scope for an MTM hit on the portfolio.

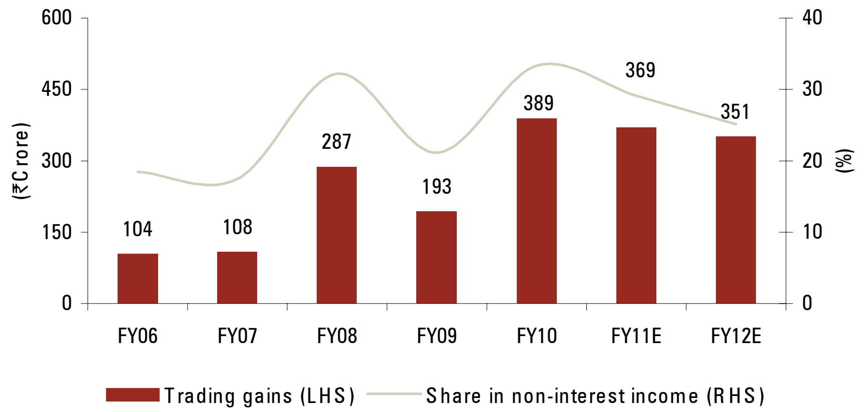
However, the rise in interest rates is expected to negatively impact the growth in trading gains for the bank. As a result, we see trading gains declining by 5% CAGR to ₹ 351 crore in FY10-12E (vs. growth of 39% CAGR in FY06-10).

Exhibit 21: Interest yield on investment asset to trend up



Source: Company, ICICIdirect.com Research

Exhibit 22: Expectation of rising interest rate to negatively impact trading gains in FY11E-12E



Source: Company, ICICIdirect.com Research

Financials

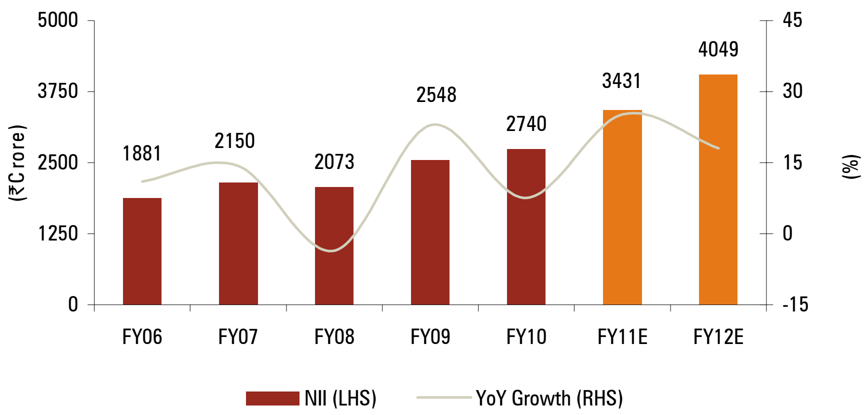
Net interest income to grow at 22% CAGR in FY10-12E

Favourable interest spread to fuel NIMs at 2.5% in FY12E

We estimate that SBL's net interest income (NII) will grow at 22% CAGR to ₹ 4,049 crore in FY10-12E (vs. 15% CAGR in FY08-10). NII growth will be fuelled by robust interest income (18% CAGR in FY10-12E) and lower interest expenses (16% CAGR) due to favourable interest spread (3.3% in FY12E vs. 3.2% in FY10). Also, we believe that SBL is adequately capitalised to fuel near term loan growth with the CAR at 12.4% in Q1FY11, leading to NII growth projected for the coming period.

During FY10, NII grew by merely 7.5% YoY to ₹ 27,398 crore due to muted growth in interest income (5.5% in FY10 vs. 20.5% in FY09). Interest income was negatively impacted by the slow movement in the loan portfolio (11% YoY vs. 17% for the industry).

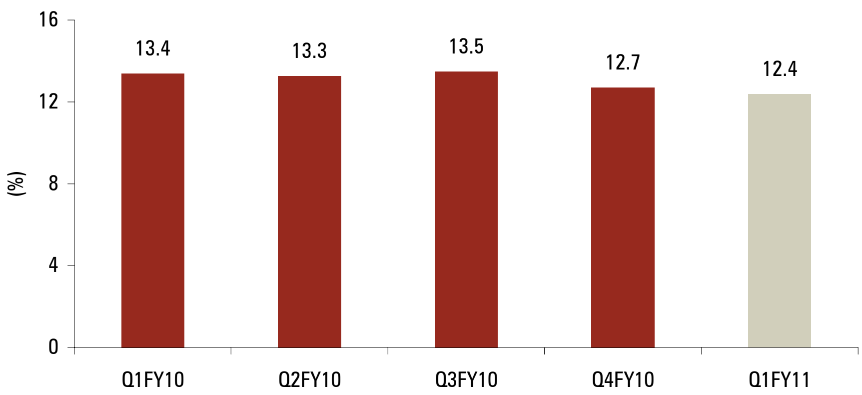
Exhibit 23: Trend in NII



Source: Company, ICICIdirect.com Research

As per RBI guidelines, Q1FY11 profits are not considered in calculating CAR of 12.4%

Exhibit 24: Comfortable CAR (Tier I +II) to support loan growth in FY10-12E



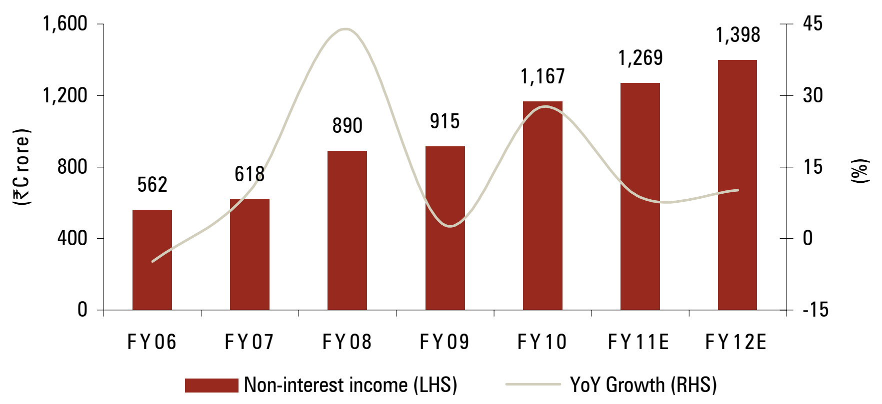
Source: Company, ICICIdirect.com Research

Core fee-based income to drive non-interest income in FY10-12E

Fee-based income to drive non-interest income

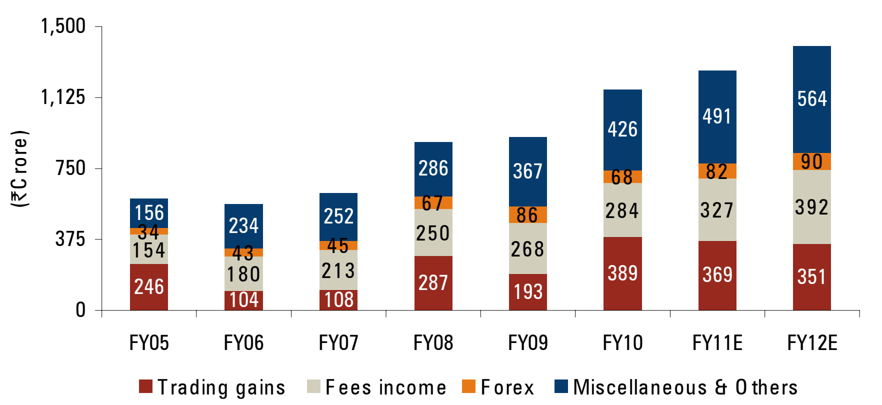
We forecast that SBL's non-interest income will grow moderately at 9% CAGR in FY10-12E (vs. 15% CAGR in FY08-10) to ₹ 1,398 crore primarily due to de-growth expected in trading income (decline of 5% CAGR in FY10-12E vs. growth of 16.5% in FY08-10). We believe the bank's core fee-based income growth will be moderate at 17% CAGR at ₹ 392 crore in FY10-12E owing to slower growth in the loan portfolio. However, the expectation of positive growth in fee-based income (vis-à-vis decline in trading gains) will drive the bank's non-interest income in our forecast period.

Exhibit 25: Non-interest income to grow moderately



Source: Company, ICICIdirect.com Research

Exhibit 26: Core fee-based income to drive non-interest income in FY10-12E



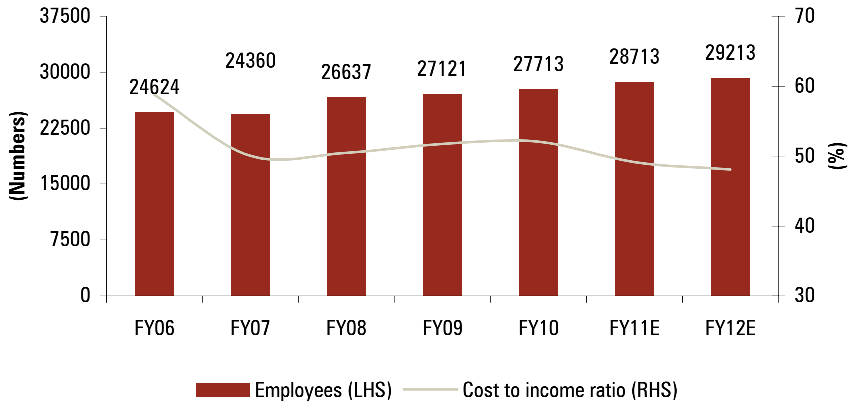
Source: Company, ICICIdirect.com Research

Improvement in costs and efficiency expected in FY11E-12E

Although SBL's cost to income ratio improved to 52% in FY10 (vs. 59% in FY06), it still lags behind its peers in terms of cost efficiency. The bank has absorbed ₹ 180 crore towards pension provision on one hand and witnessed lower treasury profit on other hand in Q1FY11,which is non repetitive in nature. We therefore forecast that the bank's cost to income ratio improving to 48% by FY12E despite rising employee headcounts (~1,500 new employees expected in FY11E-12E).

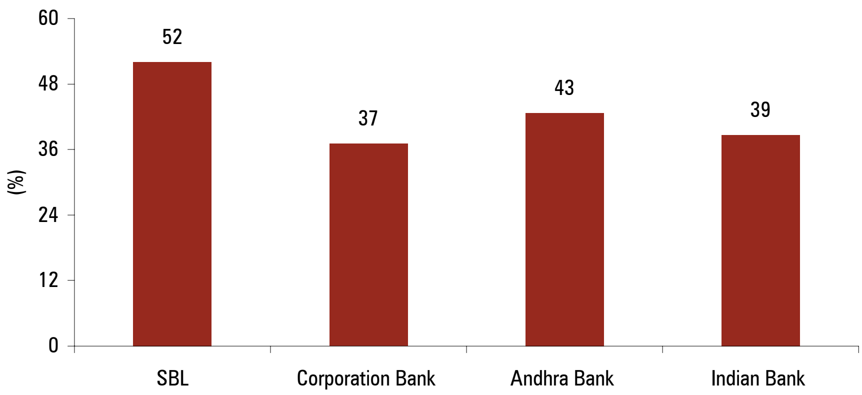
SBL has already absorbed ₹ 180 crore towards pension provision in Q1FY11

Exhibit 27: Cost to income ratio to improve to 48% in FY12E vs. 52% in FY10



Source: Company, ICICIdirect.com Research

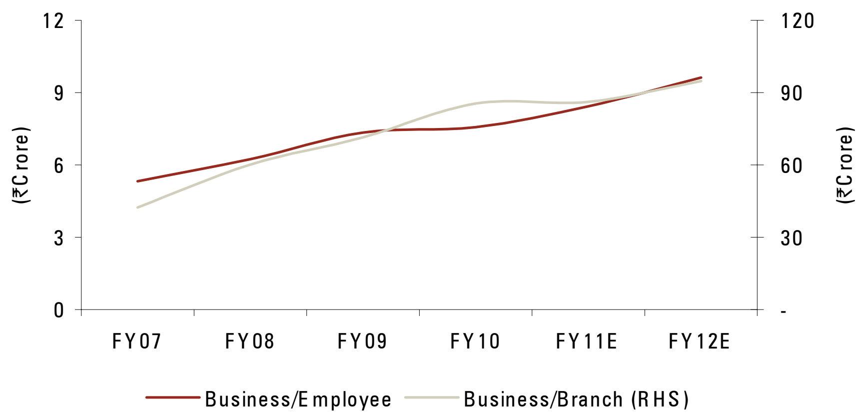
Exhibit 28: Cost to income ratio for SBL higher as compared to its peers in FY10



Source: Company, ICICIdirect.com Research

With the entire branch network connected to core-banking services (CBS), SBL has invested strongly in technology to enhance branch performance. As a result, business per branch improved ~2x to ₹ 86 crore in FY10 (vs. ₹ 42 crore in FY07). We expect the bank's business per branch to improve further to ₹ 99 crore in FY12E, thereby also reducing pressure on the cost ratio as well.

Exhibit 29: Business per employee to improve from current levels



Source: Company, ICICIdirect.com Research

Return ratio to improve in FY11E-12E

We expect SBL's PAT to grow at 30% CAGR to ₹ 1381 crore in FY10-12E vs. de-growth of 11% YoY in FY10. Our view is supported by a pick-up in SBL's business mix, which is expected at 16% CAGR over FY10-12E against just 5% YoY growth in FY10 and improving NIM. The strong bottomline is expected to drive the bank's RoE, which is expected to improve to 19% by FY12E.

During FY10, SBL's PAT declined by 11% to ₹ 813 crore due to higher wage expenses (19% YoY primarily due to higher provision of ₹ 220 crore towards wage arrears vs. ₹ 75 crore in FY09) and taxes (~2x to ₹ 361 crore). As a result, the bank's return ratios declined significantly in FY10. The RoE came down to 15% vs. 20% in FY09 while the RoA declined to 0.6% vs. 0.8% in FY09. The bank is expected to restore to MAT provision from current year supporting 30% CAGR in PAT which we have forecasted.

RoA to improve from current level

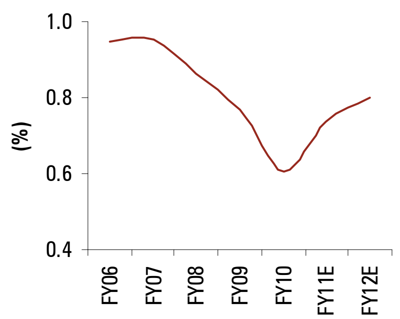
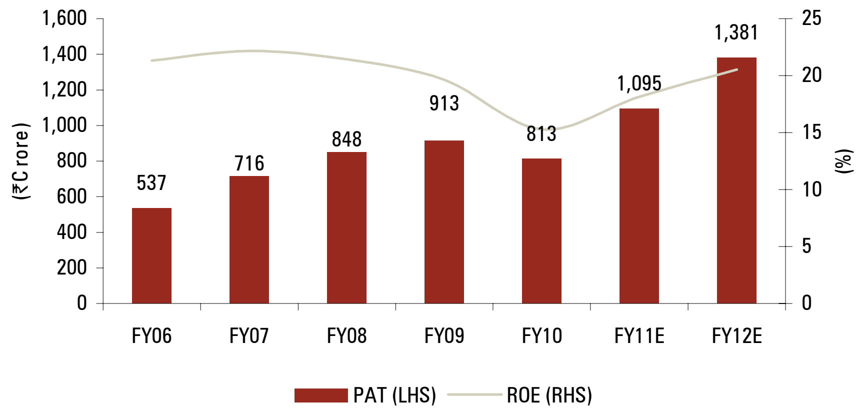


Exhibit 30: Improvement in RoE expected in FY12E



Source: Company, ICICIdirect.com Research

Risks and Concerns

Significant rise in slippages to negatively impact profitability

In Q1FY11, SBL's restructured assets accounted for ~4.8% (₹ 4,500 crore) of the total advances. Out of this, the bank has witnessed slippages of ₹ 150 crore (3.3% of restructured assets). The management expects the slippages (from restructured assets) to peak at ~18-20% in a phased manner. In case of a higher-than-expected increase in slippages, the profitability of the bank will be negatively impacted, going forward. Further, rising concerns on asset quality (GNPA of 2.3% in Q1FY11 vs. 1.9% in Q1FY10) provide a significant challenge for the management to grow its loan book.

Slower than expected pick-up in industry loan growth

We expect a strong revival in industry capex in FY11E. This is expected to boost credit expansion in the industry (loan growth of 21% YoY in FY11E vs. 17% YoY in FY10). Slower than expected industry revival will negatively impact our credit growth forecast for the industry as well as SBL.

Delay in branch expansion plan

SBL is planning to improve its branch network (~100 branches in FY11E-12E), primarily in Tier II and Tier III cities, in order to mobilise low-cost CASA deposits. Any delay in the branch expansion plan will negatively impact our forecast for SBL's CASA deposits and, consequently, the cost of funds.

Concentration risk

Nearly 45% of the bank's branches are concentrated in Karnataka and Andhra Pradesh, which leaves the bank vulnerable to region specific risks.

Savings interest rate deregulation to impact NIM

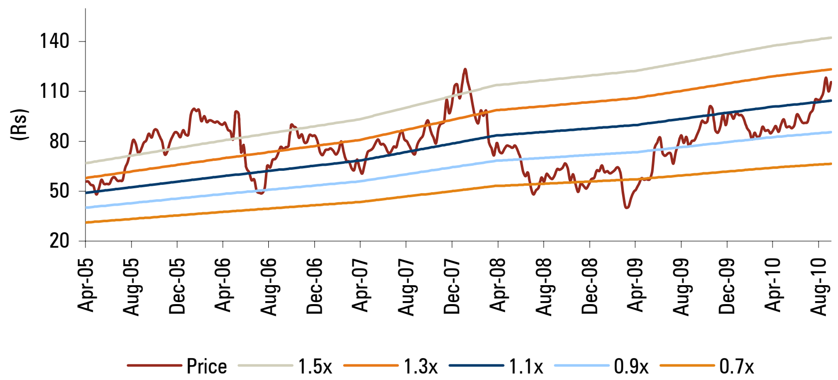
We believe the changes expected in savings rate deregulation may hamper bank's cost of funding under current scenario of rising rates and thereby pressuring NIM.

We have valued SBL at 1.3x FY12E P/ABV and arrived at a target price of ₹ 129/share

Valuation

At the CMP of ₹ 120, the stock is trading at an attractive 1.2x FY12E P/ABV. We expect the bank's asset quality concern to recede in FY12E on the back of high provision cover and the management's focus on high quality loan portfolio. We expect SBL NIM to stay at peak levels of above 3% (reported) till FY12E leading to improvement bottom-line and deliver RoE of 20% and RoA of 0.8% in FY12E. We value SBL at 1.4x FY12E ABV and arrive at a TP of ₹ 144 and initiate coverage with a **STRONG BUY** rating.

Exhibit 31: P/ABV band



Source: Company, ICICIdirect.com Research

We see the return matrix (RoA, RoE) improving from FY12E for SBL after a brief consolidation in the coming three or four quarters

SBL has emerged as India's tenth largest bank in terms of asset size with a market share of 2.7% in the business mix (FY10). We expect SBL NIM to stay above 3% till FY12E (vs. 2.3% in FY10). Also, we expect the bank's loan portfolio to grow at 16% CAGR to ₹ 120,642 crore in FY10-12E (11% CAGR in FY10) driven by the upturn witnessed in the domestic credit market (IIP index grew at an average rate of 11% in Q1FY11 vs. 4% in Q1FY10). Further, SBL's deposit base is expected to grow at 16% CAGR to ₹ 157,938 crore in FY10-12E on the back of a strong branch network and the management's focus on CASA mobilisation. We have modelled PAT growth of 30% CAGR to ₹ 1,381 crore. This will result in higher RoE of 20% in FY12E (vs. 15% in FY10) and RoA of 0.8%.

Key risks include SBL's higher stressed assets (4.8% of total loans in Q1FY11) as compared to its peers (that has led us to forecast higher GNPA of 2.2% in FY11E vs. 2.1% in FY10). We feel that the bank faces high concentration risk as ~45% of the branches are located in the southern states of Karnataka and Andhra Pradesh.

Financial scorecard

Exhibit 32: Profit and loss account

Amount in Crore	FY08	FY09	FY10	FY11E	FY12E
Interest Earned	7906	9525	10047	11600	13939
Interest Expended	5834	6978	7307	8169	9890
Net Interest Income	2073	2548	2740	3431	4049
growth (%)	-4	23	8	25	18
Non Interest Income	890	915	1167	1269	1398
Fees and advisory	250	268	284	327	392
Treasury Income and sale of Invt.	287	193	389	369	351
Other income	353	454	494	572	654
Net Income	2963	3462	3907	4699	5447
Employee cost	929	1120	1338	1511	1675
Other operating Exp.	566	671	696	799	943
Operating Income	1468	1671	1874	2390	2829
Provisions	463	635	700	1013	1103
PBT	1006	1036	1174	1377	1726
Taxes	157	124	361	282	345
Net Profit	848	913	813	1095	1381
growth (%)	18	8	-11	35	26

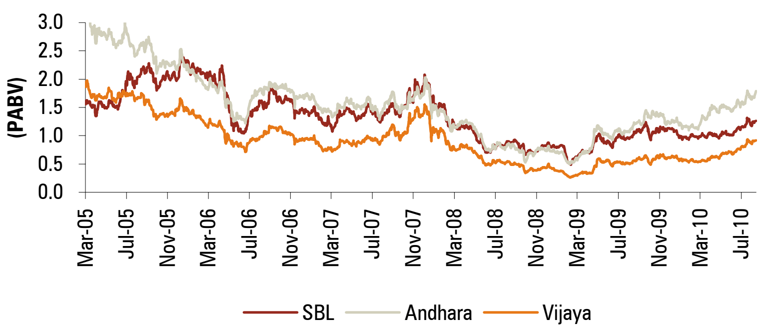
Source: Company, ICICIdirect.com Research

Exhibit 33: Balance sheet

Amount in Crore	FY08	FY09	FY10	FY11E	FY12E
Sources of Funds					
Capital	522	522	522	522	522
Reserves and Surplus	3769	4488	5105	5912	6490
Networth	4291	5010	5627	6434	7012
Deposits	95171	115885	117026	134288	157938
Borrowings	1306	5414	12173	14350	16007
Subordinated Debt	0	2645	2845	3345	3845
Other Liabilities & Provisions	6364	1302	1381	1380	1342
Total	107132	130256	139051	159797	186143
Uses of Funds					
Fixed Assets	770	742	701	794	818
Investments	28076	30537	33011	39983	48028
Advances	64051	81532	90406	103493	120642
Other Assets	2579	3040	2198	2398	2750
Cash with RBI & call money	11657	14404	12734	13128	13906
Total	107132	130256	139051	159797	186143

Source: Company, ICICIdirect.com Research

Exhibit 34: Comparative matrix



Source: Company, ICICIdirect.com Research

Exhibit 35: Ratios

	FY08	FY09	FY10	FY11E	FY12E
Valuation					
No. of Equity Shares	52.2	52.2	52.2	52.2	52.2
EPS (Rs.)	16.2	17.5	15.6	21.0	26.4
BV (Rs.)	74.0	88.0	100.1	115.5	126.6
BV-ADJ (Rs.)	62.1	75.9	81.6	93.6	102.7
P/E	7.4	6.9	7.7	5.7	4.5
P/BV	1.6	1.4	1.2	1.0	0.9
P/ABV	1.9	1.6	1.5	1.3	1.2
Div. Yield (%)	2.7	2.9	2.9	2.6	3.1
DPS (Rs.)	3.3	3.5	3.5	3.1	3.7
Yields & Margins (%)					
Yield on avg int earning assets	8.8	9.2	8.3	8.4	8.7
Avg. cost on funds	6.6	6.4	5.7	5.7	6.0
Net Interest Margins	2.3	2.5	2.3	2.5	2.5
Avg. Cost of Deposits	6.4	6.3	5.8	5.9	6.1
Yield on average advances	9.9	10.1	9.0	9.0	9.3
Profitabilty (%)					
Interest expense / total avg. assets	5.9	5.9	5.4	5.5	5.7
Interest income/ total avg. assets	8.1	8.0	7.5	7.8	8.1
Non-interest income/ avg. assets	0.9	0.8	0.9	0.8	0.8
Non-interest income/ Net income	30.0	26.4	29.9	27.0	25.7
Net-interest income/ Net income	70.0	73.6	70.1	73.0	74.3
Cost / Total net income	50.4	51.7	52.0	49.1	48.1
Quality and Efficiency (%)					
Credit/Deposit ratio	67.3	70.4	77.3	77.1	76.4
GNPA	2.8	2.0	2.2	2.2	2.1
NNPA	1.0	0.8	1.1	1.1	1.0
RONW	21.4	19.6	15.3	18.2	20.5
ROA	0.9	0.8	0.6	0.7	0.8

Source: Company, ICICIdirect.com Research

Exhibit 36: RoE decomposition

(%)	FY08	FY09	FY10	FY11E	FY12E
Net interest income/ Avg. assets	2.1	2.1	2.0	2.3	2.3
Non-interest income/ Avg. assets	0.9	0.8	0.9	0.8	0.8
Net total income/ Avg. assets	3.0	2.9	2.9	3.1	3.1
Operating expenses/ Avg. assets	1.5	1.5	1.5	1.5	1.5
Operating profit/ Avg. assets	1.5	1.4	1.4	1.6	1.6
Provisions/ Avg. assets	0.5	0.5	0.5	0.7	0.6
Return on Avg. assets	0.9	0.8	0.6	0.7	0.8
Leverage (Avg assets/ Avg equity) (x)	24.8	25.5	25.3	24.8	25.7
Return on equity	21.4	19.6	15.3	18.2	20.5

Source: Company, ICICIdirect.com Research

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