



Syndicate Bank

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,212	SNDB IN
	REUTERS CODE
S&P CNX: 4,124	SBNK.BO

29 January 2007

Buy

Previous Recommendation: Neutral

Rs73

Equity Shares (m)	522.0
52-Week Range	103/47
1,6,12 Rel.Perf.(%)	-6/-21/-71
M.Cap. (Rs b)	38.0
M.Cap. (US\$ b)	0.9

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)
3/06A	24,725	5,365	10.3	20.4	7.1	1.4	11.7	21.3	0.9	1.6
3/07E	27,019	7,170	13.7	33.6	5.3	1.2	10.4	23.0	1.0	1.2
3/08E	31,070	8,277	15.9	15.4	4.6	1.0	10.0	22.1	0.9	1.0

Syndicate Bank's results for 3QFY07 were better than our expectations, even though profit growth was driven by tax write-backs. NII increased by 4% YoY (v/s our estimate of a 5% YoY decline), as the bank reduced the proportion of bulk deposits. There was a one-off interest item in 3QFY06, adjusted for which NII growth has been 9% YoY. NII grew by almost 15% QoQ.

- ✍ Strong balance sheet growth continues
- ✍ Margins decline YoY; improve QoQ
- ✍ Tax write-backs buoy profits
- ✍ Would require capital, if growth at current rates persists

We do not like the bank's strategy to grow through bulk deposits. However, we notice that incrementally, the proportion of bulk deposits has been falling lately, which has resulted in a QoQ margin expansion for the bank. Tax write-back during 3QFY07 resulted in earnings being much higher than expected. We have increased our earnings estimates by 6% for FY07 and FY08, incorporating lower taxes and higher margins. The stock has underperformed the sector over the last few quarters. However, valuations at 1x FY08E BV and 4.6x FY08E EPS are attractive and there is still a lot of room for FIIs to invest. We upgrade our recommendation to **Buy**, with a target price of Rs95.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Interest Income	9,534	9,903	10,475	10,592	12,308	14,373	16,353	16,405	40,504	59,439
Interest Expense	4,810	5,103	5,127	6,655	7,249	9,527	10,794	10,776	21,696	38,346
Net Interest Income	4,724	4,799	5,349	3,937	5,059	4,846	5,559	5,629	18,809	21,093
% Change (Y-o-Y)	37.8	13.9	35.6	-26.4	7.1	1.0	3.9	43.0	11.0	12.1
Other Income	1,322	1,276	1,177	2,035	1,342	1,656	1,490	1,438	5,916	5,927
Net Income	6,046	6,076	6,526	5,972	6,401	6,502	7,049	7,067	24,725	27,019
% Change (Y-o-Y)	12.4	13.2	27.6	-11.2	5.9	7.0	8.0	18.3	9.5	9.3
Operating Expenses	3,242	3,911	3,618	3,577	3,382	3,471	3,768	4,004	14,348	14,625
Operating Profit	2,803	2,165	2,908	2,395	3,019	3,031	3,281	3,064	10,376	12,394
Other Provisions	729	243	879	2,905	963	730	1,478	1,257	4,861	4,428
Tax Provisions	444	170	150	-613	250	250	-458	755	150	797
Net Profit	1,631	1,752	1,879	103	1,806	2,051	2,261	1,052	5,365	7,170
% Change (Y-o-Y)	30.2	131.8	n.a.	-96.3	10.7	17.1	20.4	920.4	33.2	33.6
Cost to Income Ratio (%)	53.6	64.4	55.4	59.9	52.8	53.4	53.5	56.7	58.0	54.1
Interest Expense/Interest Income (%)	50.5	51.5	48.9	62.8	58.9	66.3	66.0	65.7	53.6	64.5
Other Income/Net Income (%)	21.9	21.0	18.0	34.1	21.0	25.5	21.1	20.4	23.9	21.9

E: MOST Estimates

Syndicate Bank's results for 3QFY07 were better than our expectations, even though profit growth was driven by tax write-backs. NII increased by 4% YoY (v/s our estimate of a 5% YoY decline), as the bank reduced the proportion of bulk deposits. There was a one-off interest item in 3QFY06, adjusted for which NII growth has been 9% YoY. NII grew by almost 15% QoQ.

Strong balance sheet growth continues

On the back of huge accumulation of bulk deposits, balance sheet growth remains strong for Syndicate Bank. Deposits were up 52% YoY and advances grew 48% YoY. CASA ratio declined to 29% in 3QFY07 from 38% in 3QFY06.

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NET INTEREST INCOME

	3QFY06	3QFY07	% GR.
Interest Income	10,475	16,353	56.1
Interest Expense	5,127	10,794	110.5
Reported NII	5,349	5,559	3.9
Write-back of interest expense	270	0	
NII (adjusting for one - off)	5,079	5,559	9.5

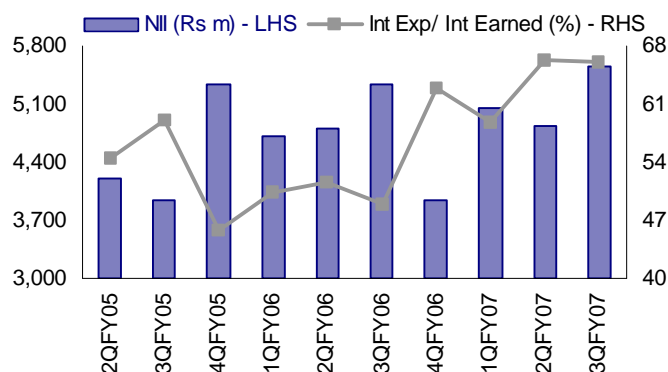
Source: Company/ Motilal Oswal Securities

While we do not like the strategy of growing the balance sheet aggressively through bulk deposits at the cost of margins, we believe that the bank is well placed in terms of liquidity. It has already tied up all its bulk borrowings at competitive rates during 1HFY07 and is not aggressively looking at bulk deposits. Also, as most of the bulk deposits mature post March 2007, it is unlikely to have further issues on deposit costs. At the same time, as the bank takes lending rate hikes and shifts short term deposits towards long term loans, margins could further improve in 4QFY07.

The management is targeting 40% growth in advances and 42% growth in deposits in FY07. Given the growth in business to date, we believe that the bank is well on its way

of exceeding its targets for FY07. The management also intends to focus more on low cost deposits and increase the share of low cost deposits over the next few quarters.

TRENDS IN NII



Source: Company/ Motilal Oswal Securities

Margins decline YoY; improve QoQ

NIMs improved 12bp QoQ to 2.7%, although YoY margins are lower. The YoY margin decline is on account of high cost deposit accumulation by the bank from 3QFY06 onwards. Cost of deposits increased 76bp YoY and 16bp QoQ. The yield on advances increased by 68bp YoY and 25bp QoQ. Yield on investments remained flat QoQ at 7.03%.

However, as the incremental term deposit growth has slowed down (7% QoQ in 3Q, 15% in 2Q and 31% in 1Q), margins have improved QoQ for Syndicate Bank. As the bank has been taking lending rate hikes and shifting its shorter term loans towards long dated loans, margins could improve further for Syndicate Bank.

NIMS BREAKDOWN- BY MGMT

	9MFY06	FY07	1HFY07	9MFY07
Avg. yield on adv	8.64	8.72	9.07	9.32
Avg. yield on inv	7.61	7.04	7.02	7.03
Avg. cost of depo	4.58	4.48	5.18	5.34

Source: Company/ Motilal Oswal Secur

The management also mentioned that NIMs were ~2.85% in 3QFY07 and the bank is targeting NIM of ~3 for 4QFY07. The bank has hiked its PLR by 25bp in January 2007.

Treasury income gains; fee income growth muted

Other income, excluding treasury, was flat in 3QFY07, as recoveries from written off accounts were lower. Treasury gains were higher at Rs450m as against Rs160m in 3QFY07. Core fee income growth continued at ~15% for Syndicate Bank

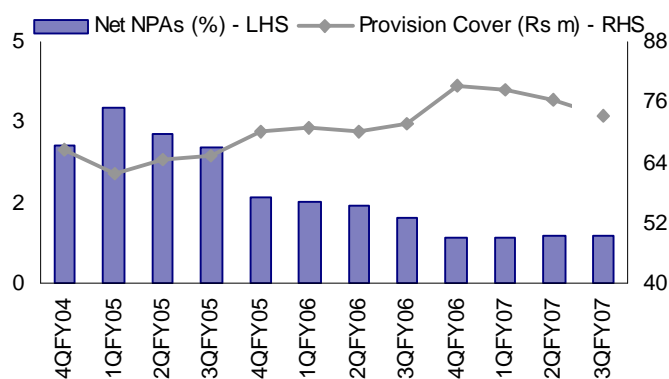
Tax rate to be lower in FY07

The management has indicated that the bank still has carry forward losses to the extent of Rs7b, due to which they continue to pay MAT (minimum alternative tax) rate. Management stated that this benefit would continue to run through FY07 and to some extent in FY08 as well. We are assuming a 10% tax rate for FY07 and 22% tax rate for FY08.

Asset quality worsens on an absolute basis

While net and gross NPAs have both declined YoY on absolute basis, net NPAs have actually increased by 10% QoQ, as the bank has recognized some assets as NPAs during the quarter. The management has guided very strong recoveries in 4QFY07 and FY08 as well, and expects NPAs to trend downwards as we move forward.

TREND IN NET NPA



Source: Company/ Motilal Oswal Securities

Would require capital, if growth at current rates persists

Capital adequacy stood at 11.2% as at 3QFY07. Tier-I ratio was 6.4%. While the bank has enough room to raise capital through innovative instruments, given the strong balance sheet growth, we anticipate that the bank would require capital in the next 12 months.

Branch and network expansion continues

The number of CBS branches increased from 351 as on 31 December 2005 to 1,227 currently, covering 84% of business. While the number of branches has risen to 2,113 from 1,914 a year ago, the number of ATMs increased to 558 from 326 as at end-FY06.

Valuation extremely attractive; upgrade recommendation

We do not like the bank’s strategy to grow through bulk deposits. However, we notice that incrementally, the proportion of bulk deposits has been falling lately, which has resulted in a QoQ margin expansion for the bank.

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The stock has underperformed the sector over the last few quarters. However, valuations at 1x FY08E BV and 4.6x FY08E EPS are attractive and there is still has lot of room for FIIs to invest. We upgrade our recommendation to **Buy**, with a target price of Rs95.

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 2,110 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

- ✍ Improving core income going forward
- ✍ Declining cost / income ratio
- ✍ Improving asset quality

Key investment risks

- ✍ Slowdown in the economy could hurt asset quality of the bank
- ✍ Pressure on margins on account of accumulation of bulk deposits

COMPARATIVE VALUATIONS

		SYNDICATE	IOB	ANDHRA BK
P/E (x)	FY07E	5.3	6.5	7.4
	FY08E	4.6	5.5	6.1
P/ABV (x)	FY07E	1.2	1.6	1.3
	FY08E	1.0	1.3	1.1
RoE (%)	FY07E	23.0	27.0	18.1
	FY08E	22.1	25.8	19.4
RoA (%)	FY07E	1.0	1.5	1.3
	FY08E	0.9	1.5	1.3

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	66.5	66.5	66.5
Domestic Inst	6.4	7.3	8.5
Foreign	11.5	11.1	9.6
Others	15.6	15.1	15.4

Recent developments

- ✍ Syndicate Bank has hiked deposit rates for maturities between three and five years to 8%. This rate would apply to both bulk and retail deposits during the festive season, between October and December 2006. Currently, rates for retail deposits in this maturity category are 7.25% and for bulk deposits are 7.5%.
- ✍ Syndicate Bank has revised its benchmark prime lending rate (PLR) from 11.5% to 11.75% with effect from January 2007.

Valuation and view

- ✍ The stock trades at 4.6x FY08E EPS and 1x FY08E BV. We upgrade the stock to **Buy**.

Sector view

- ✍ YTD loan growth of 30%+; highest in the last 12 years
- ✍ Volatility in interest rates will impact the bond gains
- ✍ Benefits of significant improvement in asset quality, not yet factored into earnings, valuations
- ✍ We maintain an Overweight stance on the sector

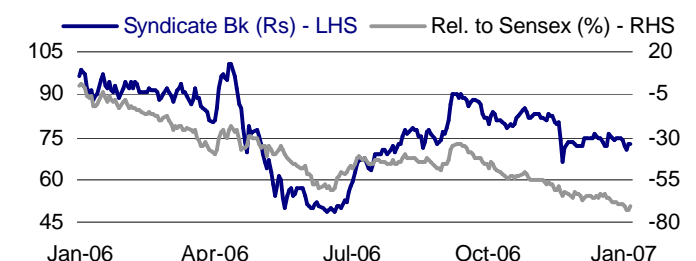
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	13.7	13.3	3.0
FY08	15.9	15.9	-

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
73	95	30.1	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Interest Income	37,576	40,504	59,439	77,330	92,948
Interest Expended	20,638	21,696	38,346	52,552	64,971
Net Interest Income	16,938	18,809	21,093	24,778	27,977
Change (%)	18.5	11.0	2.1	17.5	12.9
Other Income	5,646	5,916	5,927	6,292	7,189
Net Income	22,584	24,725	27,019	31,070	35,167
Change (%)	2.4	9.5	9.3	15.0	13.2
Operating Expenses	12,642	14,348	14,625	15,983	17,706
Operating Income	9,942	10,376	12,394	15,087	17,461
Change (%)	-2.5	4.4	19.4	21.7	15.7
Other Provisions	5,608	4,861	4,428	4,476	4,800
PBT	4,334	5,515	7,966	10,611	12,661
Tax	305	150	797	2,335	3,419
Tax Rate (%)	7.0	2.7	10.0	22.0	27.0
PAT	4,029	5,365	7,170	8,277	9,243
Change (%)	-7.2	33.2	33.6	15.4	11.7
Proposed Dividend	1,067	1,305	1,435	1,566	1,827

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Capital	4,720	5,220	5,220	5,220	5,220
Reserves & Surplus	17,265	23,116	28,851	35,562	42,978
Net Worth	21,985	28,336	34,071	40,782	48,197
Deposits	462,946	536,240	777,548	894,180	1,019,365
Change (%)	8.7	15.8	45.0	15.0	14.0
Borrowings	10,458	20,673	25,841	32,301	40,376
Other Liabilities & Prov.	25,706	25,519	30,623	36,747	44,097
Total Liabilities	521,094	610,768	868,082	1,004,010	1,152,036
Current Assets	30,696	52,135	63,306	71,083	76,739
Investments	203,707	172,691	241,768	275,615	314,201
Change (%)	13.7	-15.2	40.0	14.0	14.0
Advances	267,292	364,662	539,700	631,449	732,481
Change (%)	29.5	36.4	48.0	17.0	16.0
Net Fixed Assets	3,813	4,193	4,513	4,813	5,038
Other Assets	15,586	17,086	18,795	21,050	23,576
Total Assets	521,094	610,768	868,082	1,004,010	1,152,035

ASSUMPTIONS	(%)				
Deposit Growth	8.7	15.8	45.0	15.0	14.0
Advances Growth	29.5	36.4	48.0	17.0	16.0
Investments Growth	13.7	-15.2	40.0	14.0	14.0
Dividend	22.6	25.0	27.5	30.0	35.0
CRR	5.0	5.0	5.0	5.0	5.0

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Spreads Analysis (%)					
Avg. Yield - Earning Ass	7.9	7.5	8.3	8.5	8.8
Avg. Cost-Int. Bear. Liat	4.6	4.2	5.6	6.1	6.5
Interest Spread	3.4	3.2	2.7	2.4	2.3
Net Interest Margin	3.6	3.5	2.9	2.7	2.7

Profitability Ratios (%)					
RoE	19.6	21.3	23.0	22.1	20.8
RoA	0.8	0.9	1.0	0.9	0.9
Int. Expended/Int. Earned	54.9	53.6	64.5	68.0	69.9
Other Inc./Net Income	25.0	23.9	21.9	20.3	20.4

Efficiency Ratios (%)					
Op. Exps./Net Income	56.0	58.0	54.1	51.4	50.3
Empl. Cost/Op. Exps.	76.0	72.3	68.1	66.1	64.8
Busi. per Empl. (Rs m)	27.4	33.1	46.0	62.0	75.2
NP per Empl. (Rs lac)	1.6	2.2	3.0	3.6	4.2

Asset-Liability Profile (%)					
Adv./Deposit Ratio	57.7	68.0	69.4	70.6	71.9
Invest./Deposit Ratio	44.0	32.2	31.1	30.8	30.8
G-Sec/Invest. Ratio	92.4	90.1	90.1	90.1	90.1
Gross NPAs to Adv.	5.2	4.0	2.9	2.6	2.4
Net NPAs to Adv.	1.6	0.9	0.4	0.2	0.1
CAR	10.7	11.7	10.4	10.0	9.5
Tier 1	6.1	7.4	6.4	6.0	5.5

VALUATION					
Book Value (Rs)	42.4	50.5	61.5	74.4	88.6
Price-BV (x)	1.7	1.4	1.2	1.0	0.8
Adjusted BV (Rs)	35.9	46.6	58.7	72.7	88.0
Price-ABV (x)	2.0	1.6	1.2	1.0	0.8
EPS (Rs)	8.5	10.3	13.7	15.9	17.7
EPS Growth (%)	-7.2	20.4	33.6	15.4	11.7
Price-Earnings (x)	8.5	7.1	5.3	4.6	4.1
OPS (Rs)	211	19.9	23.7	28.9	33.5
OPS Growth (%)	-2.5	-5.6	19.4	21.7	15.7
Price-OP (x)	3.5	3.7	3.1	2.5	2.2

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 |
| 4. Investment Banking relationship with company covered | No |

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